

QUARTERLY INVESTMENT STRATEGY

Sweet Spot for Equities

Fourth Quarter 2009



Best Fund Group 2008
(Overall)
UOB Asset Management Ltd
Singapore
The Edge-Lipper Singapore Fund Awards

Best Fund Group 2009
(Overall)
UOB Asset Management Ltd
Singapore
The Edge-Lipper Singapore Fund Awards

Best Equity Fund Group 2009
OSK-UOB Unit Trust
Management Berhad Malaysia
The Edge-Lipper Malaysia Fund Awards

Best Mixed Assets Fund Group 2009
OSK-UOB Unit Trust
Management Berhad Malaysia
The Edge-Lipper Malaysia Fund Awards



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CIO MESSAGE

One year has passed since the bankruptcy filing of Lehman Brothers. Just as the collapse of equity markets and the global economy in the months following the crisis on Wall Street stunned investors, so too has the sharp rebound in equity markets and the recovery in the global economy.

Many equity markets are now back to where they were before the Lehman crisis. Many markets in Asia have outperformed the Developed Markets dramatically and have risen to levels higher than that of pre-Lehman. The reasons for this are well known: Asia's banking system is not broken and growth can return to its trend level relatively quickly, especially if domestic demand stays firm. By contrast, economic growth in the US and Europe is expected to be subdued as the de-leveraging of their banking systems will be ongoing for some time.

Many investors continued to stay on the sidelines in the third quarter. Two severe bear markets in less than 10 years, first from the internet bubble and then the credit crisis, have been very painful experiences and investors have been reluctant to return quickly to the equity market. The global economy, while it is clearly mending, is also still fragile and the cautious pick-up in economic activity does not provide a sufficient level of comfort to some investors.

We turned positive on equity markets in May this year when we saw signs that important turning points had been reached. Economic indicators were moving upwards which meant that the risk of a prolonged economic slump – which was what the equity markets were pricing – had significantly receded. The frozen credit market, the most distressed segment of the financial markets, had also thawed and credit had begun to flow again. The US banking sector has also stabilised with troubled banks being given time to rebuild their capital bases.

Now, into the fourth quarter, we continue to remain positive on equities. The period when the global economy is recovering and the central banks have not yet begun tightening is typically a sweet spot for equities. This is precisely where we are now. In our view, the economic recovery we are seeing is likely to be a sustainable one and the major central banks have indicated that they are likely to keep interest rates low for some time. Corporates have also been extremely aggressive in slashing costs, and if sales pick up, earnings will enjoy a strong boost.

Our investment strategy is presented in detail inside the report. Although we are sanguine about the longer-term outlook for Asia, we make a tactical shift this quarter in our equity allocation from the Emerging Markets to the Developed Markets. Developed Markets have lagged significantly in performance and we believe the gap is due to be narrowed.

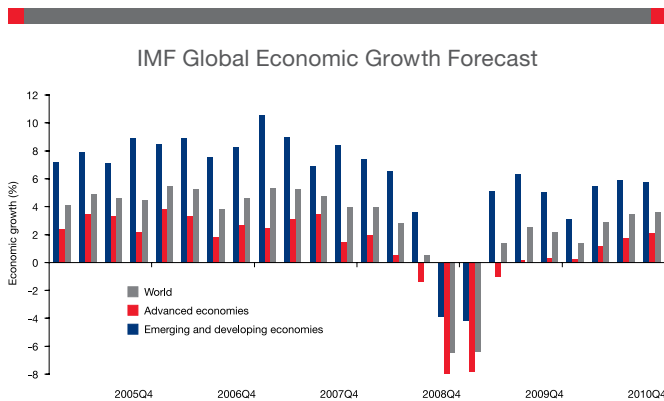
A key risk in our view is an early tightening of policy. In the past, the raising of interest rates by the US Federal Reserve has often triggered a correction in equity markets. But given the increased importance of China as a driver of global economic growth, the financial markets could be taking their cue instead from the Chinese policymakers. Here, the key development to watch is the return of inflation. One consequence of lower interest rates in China, as with the rest of Asia, is that liquidity has surged and with it, the risk of inflation has come back. For the moment though, China is still experiencing negative inflation.

We have included in this report an additional section on our asset allocation unit, describing how we analyse the investment environment and what are some of the drivers of our macro strategy. We hope this will provide investors with a better understanding of our investment thinking and approach.

Thio Boon Kiat, *Chief Investment Officer*



SUMMARY



Source: International Monetary Fund website, 8 July 2009

The recovery in the global economy appears sustainable.

The upturn in economic activity has been faster than expected and it is likely that the US economy returned to positive growth in the third quarter of this year. We believe there is a good chance that a “double-dip” recession can be avoided. The retrenchment in US consumer spending was much larger than the drop in income and we believe the US household saving rate has stabilised. Outlays from the government’s infrastructure spending will also start to come through.

While the recovery is sustainable, it is also likely to be subdued.

For 2009, it is probable that the global economy suffered an overall contraction and for 2010, it is likely to expand only modestly. We are still in the early stage of the de-leveraging cycle and banks will continue to lend only cautiously. Over-leveraged households are also likely to be seeking to repair their balance sheets.

The major central banks are likely to keep interest rates low for some time.

The key message that central banks have sent out in recent weeks is that they are in no hurry to raise interest rates. They see the recovery of the global economy as still reliant on aggressive policy support and a self-sustaining recovery is not yet assured. And despite the huge amount of liquidity that had been pumped into the system, downside risks to inflation also remain.

We continue to have an overweight position in Equities and Commodities and are underweight in Bonds.

The period when the economy is recovering but central banks remain on hold is typically a sweet spot for equities. We, however, make an important shift in allocation from Emerging Markets to the Developed Markets. Emerging Markets have outperformed significantly and we believe that Developed Markets are due to close the gap. We have an overweight position in the US and Europe and reduce our underweight in Japan. We are underweight Asia ex-Japan and slightly overweight Latin America. In Bonds, we continue to prefer Investment Grade bonds. In Commodities, our only overweight is in Gold.



INVESTMENT OUTLOOK AND ASSET ALLOCATION



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Equity and credit markets continued to rally in the third quarter and many indices are now back to the levels they were before the September 2008 Lehman crisis. In some instances, notably in Emerging Markets, equity indices have in fact risen above their pre-Lehman levels. One reason for the continuing increase in risk appetite are the growing signs that the global recession is ending much earlier than expected and that policymakers are prepared to retain their accommodative stance for some time yet.

The key questions for investors are the shape of the economic recovery that lies ahead and the stance of policymakers. How strong will the recovery be? How quickly will policymakers withdraw monetary and fiscal stimulus? We discuss these issues below:

Key Developments

1. Global economy recovering faster than expected

Global economic leading indicators bottomed in the early months of 2009 and they have continued to improve all through the second and third quarters. In the initial stages, the upturn in the indicators only showed the global economy was stabilising and not plunging into a freefall. The economy was actually still contracting. The picture has now changed. In recent weeks, the data releases have been signalling that the global economy is returning to positive growth.

The highly watched US Institute of Supply Management (ISM) purchasing managers' index crossed the boom-bust line of 50¹ in August, the first time since January 2008. A reading over 50 indicates an expansion of activity in the US manufacturing sector. The bellwether New Orders component of the ISM, has also continued to rise, hitting 64.9 in August.

ISM Manufacturing Index and ISM New Orders Index



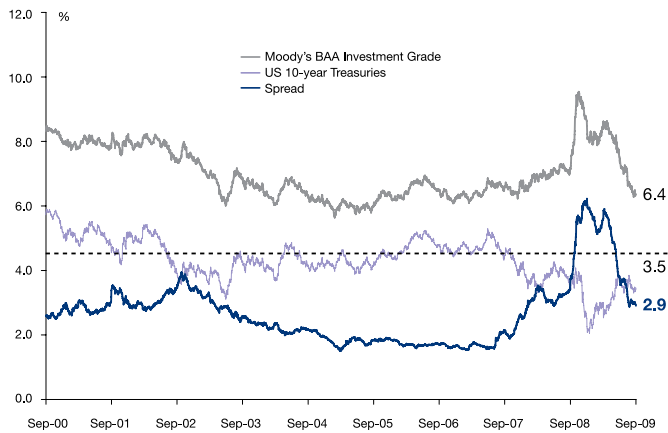
Source: Bloomberg, 16 September 2009

¹ Source: All data sources from Bloomberg, 16 September 2009 unless otherwise indicated.

INVESTMENT OUTLOOK AND ASSET ALLOCATION

Apart from the clear improvement in business confidence, another sign that the credit crunch is easing is the continued tightening of credit spreads. Tighter credit spreads mean that the cost of borrowing for corporates is lower, which helps the healing of the global economy. Since our last report three months ago, US Investment Grade spreads have tightened from 390 basis points (bps) to 290 bps².

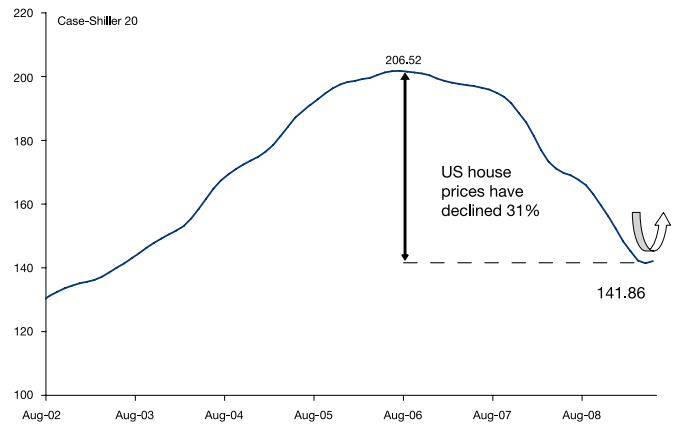
Investment Grade Credit Spreads



Source: Bloomberg, 16 September 2009

Another significant development is the encouraging sign that US house prices may have bottomed. The Case-Shiller 20-City Composite index for June showed that US house prices have risen month-over-month for two consecutive months. The improvement was also relatively broad-based with house prices having risen in 16 of the 20 cities. The inventory of new homes has also been rapidly falling and is currently at 7.5 months. The large amount of excess supply has not only put downward pressure on home prices but also kept residential investment depressed.

Case-Shiller 20 City Composite Index



Source: Bloomberg, 16 September 2009

² Source: Bloomberg, 16 September 2009

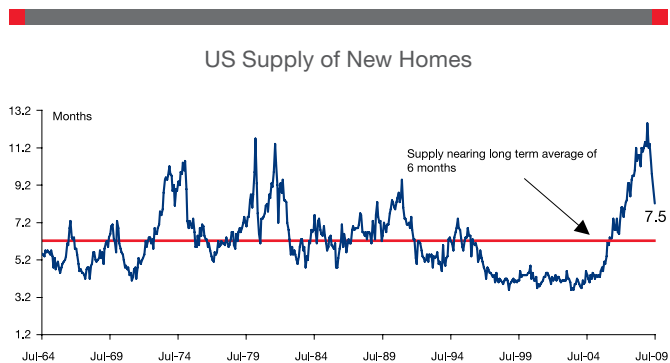


INVESTMENT OUTLOOK AND ASSET ALLOCATION

2. Economic recovery sustainable but subdued

Although the emergence of the global economy out of its deep recession has been much quicker and much sharper than expected, the overall recovery is likely to be a subdued one. The recent rebound in economic activity has been driven by the rebuilding of inventories and the highly successful “cash for clunkers” car scrapping incentives in the US. The initial US\$1 billion was used up in a matter of days and the programme was tripled to US\$3 billion. The revival in auto production is expected to add 3-4%³ to US GDP growth in the third quarter. In France and Germany, where car scrapping incentives have also been successful, the rise in vehicle sales lifted the growth of the two largest economies in the Eurozone into positive territory in the second quarter of 2009.

Although the auto industry’s contribution to growth will fade, there are signs that demand in the US is starting to improve outside of auto sales. First, there are signs that residential construction is finally starting to recover. Housing starts and new home sales have all turned up in recent months and as mentioned, the inventory of new homes has begun falling.



Source: Bloomberg, 16 September 2009

Data is also hinting that income growth is beginning to turn positive, with the work-week and average hourly earnings both beginning to rise. The increase in the work-week is a classic cyclical sign that labour markets are starting to improve as employers first extend hours before hiring new workers.

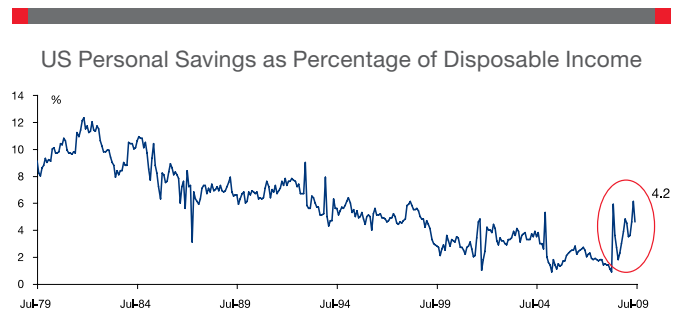
³ Source: Morgan Stanley US Economics, 10 August 2009

⁴ Source: Goldman Sachs Global Economics Weekly, 9 September 2009

⁵ Source: International Monetary Fund website, 8 July 2009

Outside the household sector, infrastructure outlays under the government’s fiscal programmes are also beginning to come through. Infrastructure projects require some time to get off the ground – to obtain permits and hire contractors and conduct studies on the impact on the environment. However, state and local outlays appear to be rising and the pace should quicken in the final quarter and in 2010.

However, there are also strong headwinds for the global economy. For growth to return to the kind of vigorous levels we saw before the financial crisis, the US consumer needs to participate fully. While the stabilisation in US house prices and the recovery in equity markets have restored a measure of the US household sector’s net worth, US households are still likely to go through a period of rebuilding their balance sheets. It has been estimated that weaker US consumer spending could shave 1-2%⁴ off US growth over the next two to three years.



Source: Bloomberg, 16 September 2009

This process is being compounded by the process of de-leveraging taking place within the US and European banking system. Although banks have been successful in raising more capital and the risks of systemic failure have diminished, lending conditions are still tight compared to the period before the crisis and this is likely to remain the case for some time.

In its July update⁵ on the global economic outlook, the IMF said that the global economy is expected to contract by 1.4% for the whole of 2009 while growth in 2010 is likely to be a weak 2.5%.



INVESTMENT OUTLOOK AND ASSET ALLOCATION

3. Central banks likely to keep interest rates low

The view that global economic growth is likely to be anaemic appears to be shared by the major policymakers. The key message that central banks sent out at the Jackson Hole meeting in August, and one repeated at the G20 summit in September, is that they are in no hurry to raise interest rates. The recovery of the global economy is seen as still reliant on aggressive policy support and a self-sustaining recovery is not yet assured. And despite the huge amount of liquidity that had been pumped into the system, downside risks to inflation remains.

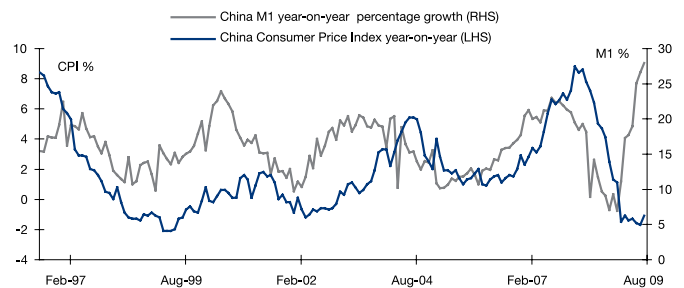
Inflation risks remain low because as mentioned, banks are still in de-leveraging mode and the “money multiplier” continues to be depressed. The money multiplier is a measure of the extent to which the accommodative monetary stance of central banks is being transmitted to the wider economy. As banks have not been extending new loans to any significant extent, the demand for real goods and services, and hence price pressures, are muted.

In the developed economies, core inflation is furthermore driven primarily by wage pressures. Given the deep recession and the rise in unemployment, considerable spare capacity has developed in the global economy and this large ‘output gap’ makes it unlikely that wage inflation will develop any time soon. Based on IMF projections, the global output gap is likely to decline to a large -4.5% in 2010 and remain negative over the next five years.

The response of policymakers in China is also being closely watched by the markets. In contrast to most of the developed economies, the banking system in China is not broken and the fiscal and monetary stimulus programmes by the Chinese authorities have boosted swiftly both the real economy and asset prices. Comments by the Chinese officials that they will scrutinise asset prices and monitor bank lending have led to a degree of nervousness among investors.

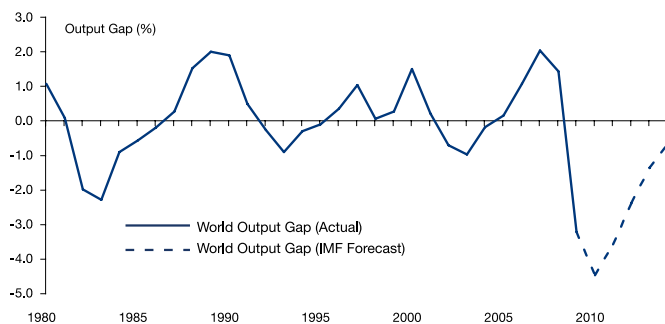
The Chinese premier Wen Jiabao said at the World Economic Forum in September that “China would not withdraw stimulus policies at an inappropriate time” but also said that “we need to be aware of and guard against the inflation risk.” This is the first time since the crisis that there has been public mention by the Chinese authorities of inflation risk in China. It is likely therefore that China is not withdrawing stimulus for the near term but will be ready to do so if economic growth is strong and inflation is rising.

China Money Supply Growth and Consumer Price Index



Source: Bloomberg, 16 September 2009

Global Output Gap



Source: International Monetary Fund website, 4 September 2009



INVESTMENT OUTLOOK AND ASSET ALLOCATION

ASSESSMENT

We believe that the recovery in the global economy is sustainable and that there is a reasonable chance that we are not facing a “double-dip” recession. The sharp plunge in US consumer spending in the aftermath of the Lehman shock was disproportionate to the fall in household income and we believe that the US consumer savings rate is stabilising. The possibility that US housing prices may have finally bottomed will also help support household spending.

We are, however, still in the early stage of the de-leveraging cycle and we expect modest growth in the global economy over the next year or so. The US consumer still continues to represent a significant part of the global economy, notwithstanding the growing weight of Emerging Market economies.

We expect the major central banks to keep monetary policy accommodative for an extended period as inflation is not likely to rise to any worrying extent given the large amount of slack that is building up in the global economic system. Low interest rates will furthermore help banks to rebuild their capital base.

We would be concerned if inflation or inflationary expectations spikes up. As we have mentioned, the immediate risk of inflation in the developed economies is currently low because spare capacity is building up. Inflation expectations are however mercurial and remain a key driver of central bank policy stance. If investors believe that long-term inflation will rise because monetary policy is too loose and push up long-term bond yields, this would represent a loss in central bank credibility and be a signal to policymakers that they should step up the pace of tightening.

Inflationary expectations aside, a rise in government bond yields would also be a problem for the global economy. Government bond markets face long-term headwinds given the massive fiscal stimulus programmes being undertaken by the G7 governments. While the longer-term trend for government bond yields is upwards, our expectations for the near-term are for the yields on 10-year US Treasuries to be capped at around 4% and we would be concerned if yields moved beyond 5% at this stage of the recovery.

For China, in our view it is unlikely that the authorities will tighten policy in the near-term given that the external demand is still weak and inflation is not yet a threat. The sharp rise in China’s money supply has however raised the risk that China’s inflation will also start to rise and this could prompt some tightening in 2010.

ASSET ALLOCATION

	Conservative	Change from 3Q	Moderate	Change from 3Q	Growth	Change from 3Q
Equities <i>Overweight</i>	40%	0%	60%	0%	80%	0%
Bonds <i>Underweight</i>	50%	0%	30%	0%	10%	0%
Commodities <i>Overweight</i>	2.5%	0%	7.5%	0%	7.5%	0%
Cash instruments	7.5%	0%	2.5%	0%	2.5%	0%

Note: The neutral Moderate benchmark weights are Equities (55%), Bonds (35%), Commodities (5%) and Cash (5%).



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Retain Overweight position in Equities

We moved to an overweight position in Equities in May and we retain this overweight. Equities typically enjoy their strongest rally when economic growth has begun to turn up and before the central banks begin to tighten. This is precisely the sweet spot we are in.

We believe equity markets will continue to be supported because we view the economic recovery as a sustainable one and we also do not expect the Fed to tighten in the near term. Some of the indicators we expect to see before we believe the Fed would embark on a tightening cycle include US unemployment on a clear downtrend, consumer confidence close to its historical average and the ISM index holding above 50.

In terms of earnings, profits in this cycle have evolved differently compared to previous cycles. Non-financial earnings fell because of a collapse in revenue rather than because of excessive investment or runaway costs. Firms have, however, been aggressively slashing costs to counteract the weakness in revenues and even a modest recovery of economic activity and sales volume is likely to boost earnings.

Valuations are also not a constraint on equity markets. Equity markets had fallen to such distressed levels at the beginning of the year that now, even with a rise of over 60%⁶ in the MSCI World index, the global Price/Book (P/B) ratio at 1.82x is still below its five-year average of 2.31x. Of course, valuations are no longer compelling but neither are they stretched.

Equity Markets Price/Book Ratios

14 Sep-09	Trailing P/B (x)		Price Index		Difference (Current - 5-yr avg)
	Current	5-yr avg	Current	5-yr avg P/B	
MSCI AC World	1.82	2.31	284	360	-21.15%
S&P 500	2.16	2.60	1,049	1,261	-16.78%
DJ Euro Stoxx 50	1.41	1.85	2,829	3,708	-23.70%
Topix	1.15	1.57	934	1,277	-26.88%
MSCI Asia ex Japan	1.96	1.91	443	431	2.61%
MSCI Singapore/FSSTI Index*	1.70	1.84	2,640	2,863	-7.81%
Hang Seng	2.01	2.00	284	283	0.25%
Shanghai Composite	3.30	3.04	3,027	2,787	8.61%
Taiwan TaieX	1.84	1.62	7,257	6,388	13.60%
Kospi	1.30	1.31	1,635	1,649	-0.85%
S&P/ASX 200	1.93	2.44	4,531	5,736	-21.01%
S&P CNX Nifty	3.41	3.74	4,809	5,269	-8.73%
FTSE Kuala Lumpur Composite	2.11	1.81	1,203	1,032	16.64%
Stock Exchange of Thailand	1.53	1.71	694	776	-10.49%
Jakarta Composite	2.70	2.44	2,383	2,153	10.69%
Philippine Stock Exchange Index	1.93	1.97	2,822	2,878	-1.95%

* P/B Ratios - MSCI Singapore, Price Index - FSSTI (as STI was reconstituted on 10 January 2008)
Source: Bloomberg, 14 September 2009

⁶ Source: Bloomberg, 9 March - 9 September 2009



Please refer to the last page for important notice & disclaimer.

QUARTERLY
INVESTMENT STRATEGY
Fourth Quarter 2009

11

UOB Asset
Management
大華資產管理

INVESTMENT OUTLOOK AND ASSET ALLOCATION

Some investors are concerned about the speed and magnitude of the rally in equity markets. MSCI World has risen 25% while MSCI Asia ex-Japan has risen 55%⁷ since the start of the year. Have we gone too far too fast? Historically, the rise in equity markets has tended to mirror the magnitude of its decline - the faster and deeper the fall, the sharper the rebound. In this regard, this cycle has been no different. This latest equity bear market was not as steep as in the Great Depression but was more severe compared to bursting of the Internet Bubble. The trajectory of equity markets in the current recovery has likewise been a path somewhere in between.

Overall, we remain sanguine on the prospects for equities but for the coming period we are making an important shift in our weights from the Emerging Markets to the Developed Markets. While growth in Emerging Markets is supported by structurally superior fundamentals, Emerging Markets have outperformed the Developed Markets significantly and most Emerging Markets have risen above the pre-Lehman levels. In contrast, Developed Markets are about 10-20% below the pre-Lehman levels and we believe this gap will narrow in the coming months. Developed Markets equities are also not entirely reflective of their economies and many global companies continue to grow their earnings through their exposure to the Emerging Markets.

Equity Indices One Year after Lehman

(Local Currency Terms)	14/9/09 Current	12/9/08 Pre-Lehman	Difference (Current Pre-Lehman)
MSCI AC World	284	320	-11.2%
S&P 500	1,049	1,252	-16.2%
DJ Euro Stoxx 50	2,829	3,278	-13.7%
Topix	934	1,177	-20.7%
MSCI Asia ex Japan	443	403	9.8%
Straits Times	2,640	2,571	2.7%
Hang Seng	20,932	19,353	8.2%
Shanghai Composite	3,027	2,080	45.5%
Taiwan TaieX	7,257	6,311	15.0%
Kospi	1,635	1,478	10.6%
S&P/ASX 200	4,531	4,904	-7.6%
S&P CNX Nifty	4,809	4,228	13.7%
FTSE Kuala Lumpur Composite	1,203	1,044	15.3%
Bangkok Stock Exchange of Thailand	694	654	6.1%
Jakarta Composite	2,383	1,804	32.1%
Philippine Stock Exchange Index	2,822	2,646	6.6%
Vietnam Stock Index	557	476	16.9%

Source: Bloomberg, 14 September 2009

⁷ Source: Bloomberg, 16 September 2009



INVESTMENT OUTLOOK AND ASSET ALLOCATION

We are lowering our weights in Asia ex-Japan and Latin America and we are moving to overweight positions in the US and in Europe. We have increased our exposure to Japan but still remain underweight.

For the **US**, the recovery in the broader economy is starting to be factored into analyst expectations. However, the market has yet to fully reflect this improvement, suggesting significant re-rating potential. Despite not being the cheapest region, we believe the US represents the most compelling re-rating case.

We have also lifted our exposure to **Europe** to a small overweight. The European corporate sector should be a clear beneficiary of the recovery in global growth, as it offers strong operating leverage. However, the more limited corporate restructuring initiatives in Europe may cap the upside potential in a recovery. In addition, the need for significant financial sector reform, the lack of a coordinated regulatory and crisis response framework, and poor visibility on credit risks, funding and capital positions among many of the large European financial institutions are significant risks to the recovery process. While the Eurozone appears to be attractively valued on a relative basis, structural challenges and financial risks prevent us from being more aggressive.

We have reduced our **Japan** to underweight. The export orientation of the Japanese market is a leveraged play on global recovery. The key challenge is the thin level of profitability and poor return on capital generated by the corporate sector. The transition to a new Democratic Party of Japan (DPJ) government is potentially good news for Japan in the long-term, although it is unlikely to be without pain in the near term. We are hopeful that reforms will help foster a more conducive investment environment over the next three to five years, and will monitor developments closely.

We have reduced our exposure to **Asia ex-Japan** to an underweight. While Asia ex-Japan remains a key beneficiary of a global recovery, there is limited re-rating potential following the sharp price appreciation. Much of the upturn in profits has been discounted by the markets, and further price gains will have to be driven by further earnings revisions. As many of the economies around the region step back from the stimulus initiatives targeted at boosting domestic demand, we are increasingly looking for opportunities among the export sectors that should benefit from global recovery, and where valuations are more reasonable. We continue to like Asia from a longer-term growth standpoint.

We have reduced the overweight in **Latin America**. We continue to view the region as offering the best risk-adjusted prospects of any major region. However, share prices are already reflecting likely improvements in profitability into the recovery. The region remains underpinned by strong domestic demand and yields an abundance of good investment opportunities. However, we have tempered our overweight position.

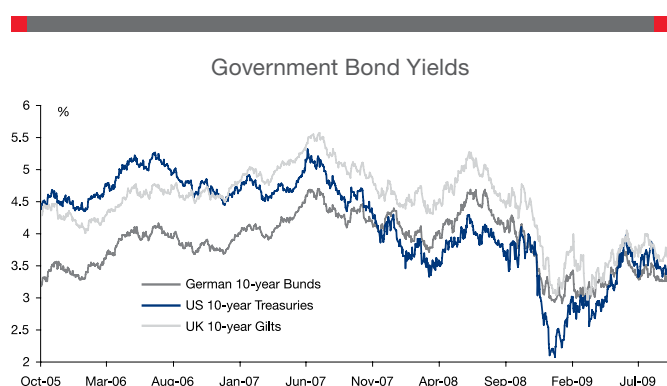
Asset Allocation	4Q 2009 Recommendation	Benchmark
Equities	60%	55%
US	43.7%	42.2%
Europe	28.0%	27.3%
Asia ex-Japan	8.2%	8.8%
Japan	8.6%	9.6%
Australia	2.9%	3.1%
Canada	4.0%	4.3%
Latin America	4.6%	2.6%
Others	0.0%	2.2%



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Stay with the Underweight position in Bonds

We keep our allocations in Fixed Income unchanged. We continue to have an underweight position in **Government** bonds, a position we have held since the start of 2009. Although government bonds yields enjoyed a rally in the third quarter, we believe this was largely driven by the scaling back of inflationary expectations. We do not believe the rally in bond yields can be sustained, especially as the overall macro economic outlook improves. Longer term, the large increase in supply presents a strong headwind.



Source: Bloomberg, 16 September 2009

We continued to have our largest position in **Investment Grade** bonds where valuations continue to remain attractive. Investment Grade bonds typically perform well when growth is anaemic, a scenario we are expecting in the coming quarters. A subdued economy tends to keep corporate behaviour in check while in stronger growth periods, investors tend to chase equities.

Investment Grade corporates have also taken advantage of lower yields in recent months to lock in funding and this has reduced their vulnerability on the financing front. With the aggressive cost cutting that has occurred, their cost structure also appears fully adjusted to a lower revenue environment and this positions them well for any increase in revenue. It is likely that earnings and credit metrics keep improving in the coming quarters and this would justify lower spreads.

We maintain an underweight position in **High Yield** bonds. Historically, the High Yield and the Investment Grade credit

markets rarely go in opposite directions for sustained periods. If Investment Grade continues to heal, High Yield will also continue to compress. However, large refinancing needs loom in the High Yield space and valuations are also less attractive on a risk-adjusted basis compared to Investment Grade.

In the **Asia Fixed Income** market, the main theme for the next two quarters is spread compression. However, we expect the overall tightening to be moderate compared to the sharp compression we saw in the first nine months of 2009. We prefer subordinated bank debt to senior bank debt, particularly in the Tier One notes with high single or double-digit yields; High Yield corporates to High Grade corporates and Korean papers to High Grade corporates.

We continue to be cautious on **Singapore Government Securities (SGS)**. We believe that SGS is likely to sell off going forward. We see a sell-off materialising if oil prices continue to rise and inflationary expectations surge. We expect the 10-year SGS yield to exceed 3.0%. We are reducing our exposure to mid and long duration SGS bonds, that is, from five years to 20 years.

On the **Singapore Corporate** front, we like the short-dated bonds, ranging from two to five years, due to the increasing swap spreads in a rising yield environment. We are biased towards the two-year end as it has the widest swap spreads and hence gives us a higher all-in yield. Some of the bonds we like are the National Agriculture Cooperative Federation (listed in Singapore) which offers a 3.3% yield for one year and City Development Sukuk Bond at 3.25% for one year.

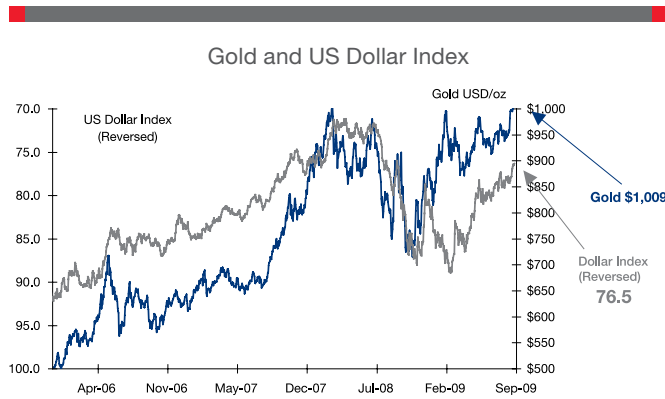
Asset Allocation	4Q 2009 Recommendation	Benchmark
Fixed Income	30%	35%
Government	35%	60%
Investment grade	62.5%	35%
High yield	2.5%	5%
US	40%	40%
Europe	25%	25%
Asia/EM	30%	30%
Japan	5%	5%



INVESTMENT OUTLOOK AND ASSET ALLOCATION

Maintain Overweight position in Commodities

We maintain a small overweight position in **Gold**. Gold has again crossed the US\$1,000 level. The key driver for gold is likely to continue to be the US dollar, whose underlying trend is one of weakness. Changes in the regulatory landscape are also adding to the appeal of gold. As regulatory action tends to be focused on the agricultural and energy markets, the physical market for gold is becoming seen as a potential refuge if, as is likely, position limits on the futures markets are enforced. Inflows into physically backed gold Exchange Traded Funds have also resumed.



Source: Bloomberg, 16 September 2009

We continue to increase our exposure to **Base Metals**, although still maintaining an overall underweight. Chinese demand in the early part of the year was driven by inventory stocking and as stockpiling slows, prices are more likely to reflect “real” demand. This fundamental outlook is not strong and copper inventories on the London Metal Exchange have risen 20% since the middle of July.

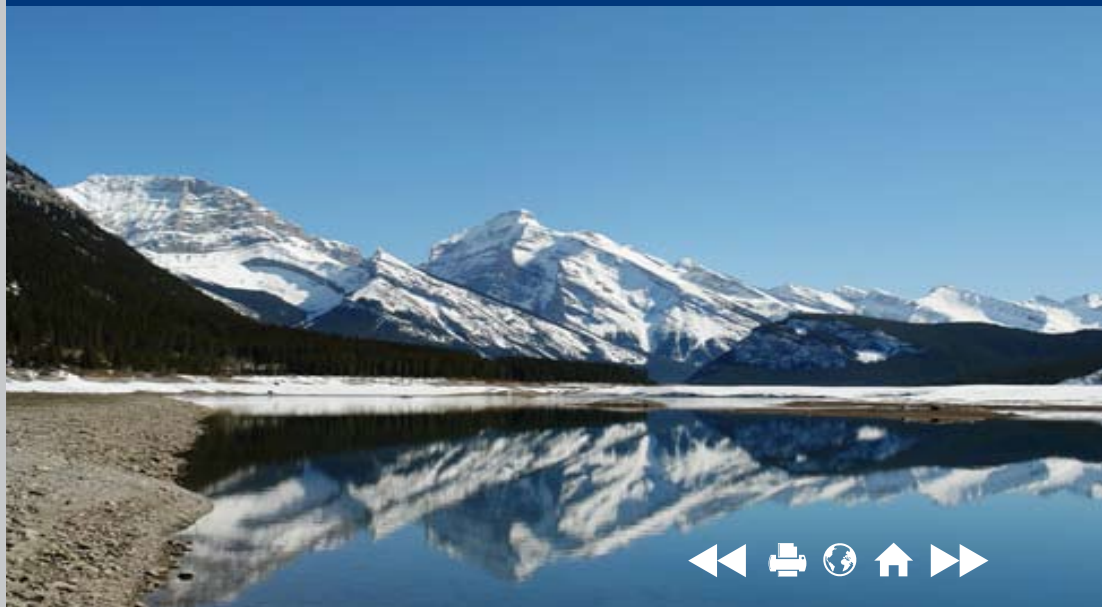
We have a neutral position in **Agriculture**. The agricultural complex has remained under pressure as the weather in the US Midwest has been favourable and there have been upgrades to global corn and wheat production. Australia is also likely to be upgrading its wheat production forecasts. Sugar prices, however, have continued to be supported. Indian demand has remained strong ahead of the festival season while supply has been tight on weak output and depletion in stocks. Demand from other Asian countries has also held up.

Asset Allocation	4Q 2009 Recommendation	Benchmark
Commodities	7.5%	5%
Gold	27%	25%
Base Metals	18%	20%
Agriculture	20%	20%
Energy	35%	35%

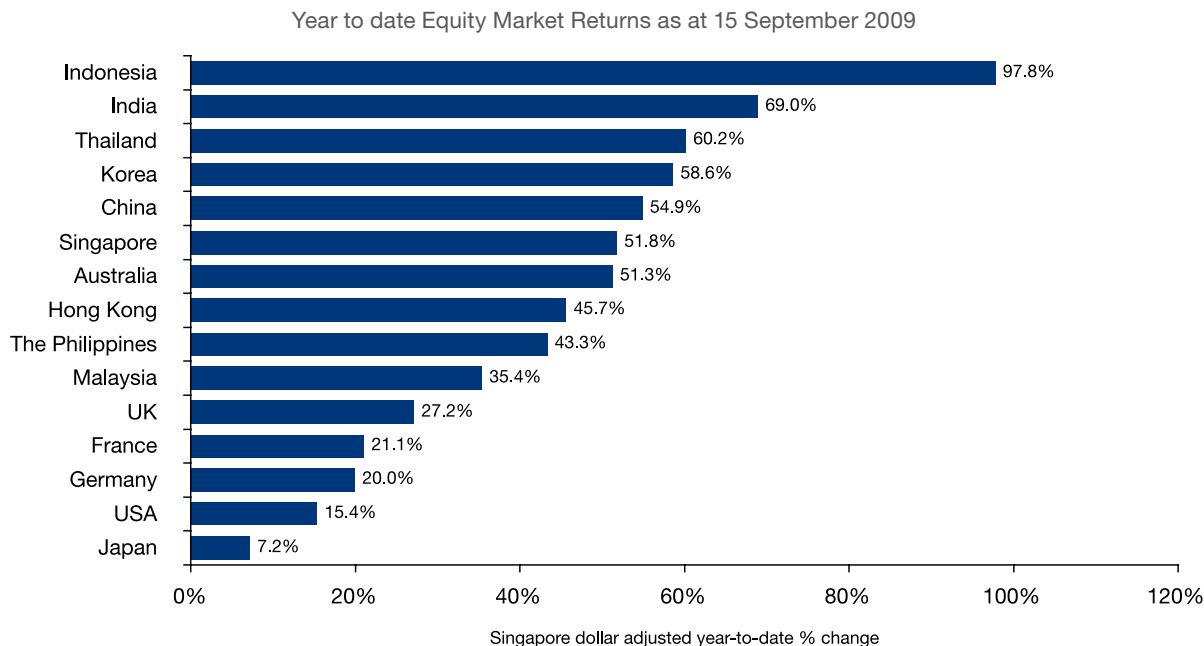
We reduce our position in **Energy** to neutral. Oil prices are trading in the US\$65-75 band and likely to be undergoing a phase of consolidation. Prices are being supported from the improvement in the global economy and members of the Organisation of Petroleum Exporting Countries also appear to be maintaining their quotas, keeping supply side pressure intact.



GLOBAL EQUITY STRATEGY



Market Returns



Source: Bloomberg, 15 September 2009

US

US Equity Strategy

Seven months into the US equity market rally, we are still positive on the cyclical sectors of the S&P. Since the March low, the best performing sectors have been the interest rate-sensitive Financial sector, and the cyclical sectors of Industrials, Materials and Consumer Discretionary. We now expect to see a transition away from interest rate-sensitive sectors and those with purely mean reversion and second derivative growth drivers, in favour of those with organic growth, either from domestic or international sources. As such we have positioned our overweights in **Technology**, **Consumer Discretionary** and **Industrials**.

In **Technology**, the dual drivers for the medium term are improved IT spending and new product cycles like Microsoft Windows 7 and new chips from Intel and AMD. We are

seeing consumer spending faring better than expected; the corporate PC upgrade cycle is also expected to pick up steam in 2010 and last through the year. In addition, better profits are a key catalyst for better capex and tech spending. Statistically, capex and technology spending in consumer IT companies generally improve two quarters after the companies experience improving profits from a pick-up in consumer spending. Business IT spending comes through a year later after a recession is over.

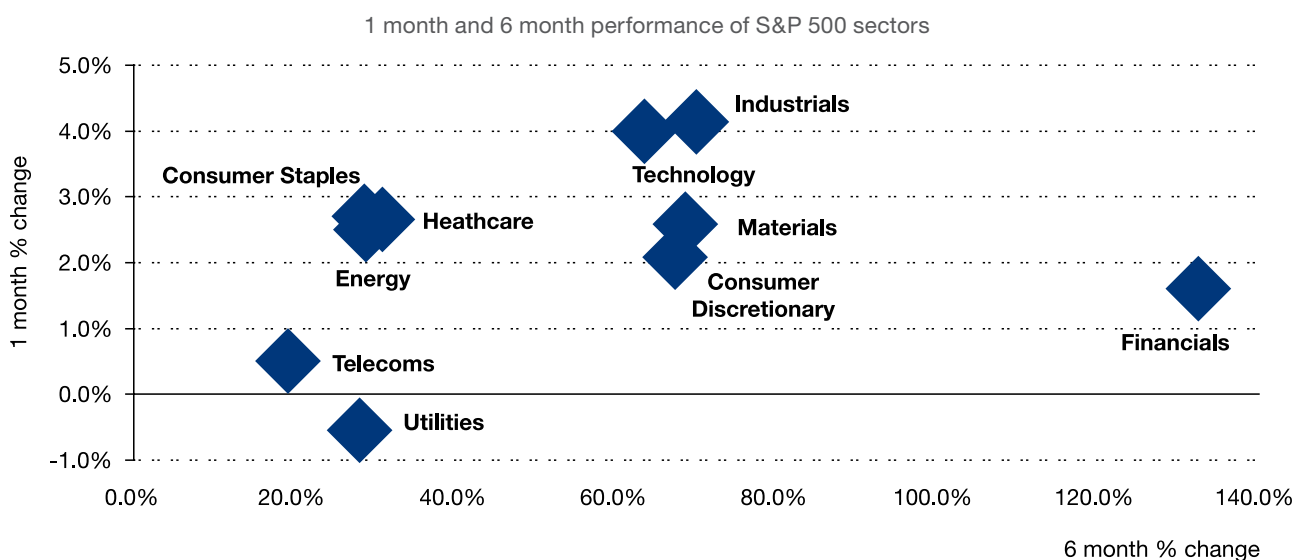
In **Consumer Discretionary**, we are gradually looking to shift away from the early cyclical stocks (for example multi-line retailers) towards the later-stage plays (for example media, broadcasting, consumerservices) which have more sustainable growth drivers. We note that inflationary expectations have a strong influence on the relative outperformance trends of the early cyclicals within this sector. While inflation is not of immediate concern in the US, we are mindful of this factor/driver because of its particularly high correlation.



GLOBAL EQUITY STRATEGY

We are still overweight in **Industrials**. This has been a sector we have liked since the middle of the year. Early on, we had an increased exposure to companies which are expected to benefit from the US stimulus programme, a large part of which will be infrastructure spending. The spending is expected to be broadly distributed, across many participants and various service segments. We are now focusing on broader multi-industry companies like General Electric and companies like railways that are expected to benefit as general industrial activity starts to improve.

In addition, for these sectors overall, easier year-over-year comparisons for top and bottom lines, and the impact of a weaker dollar are added boosts. While this is not a high quality catalyst and is not sustainable, this will have a material impact starting in the third quarter. For example, in the IT Hardware sector, with units and revenue down over 27% in the last four quarters, comparisons will get easier.



Source: Bloomberg, 9 March - 9 September 2009



GLOBAL EQUITY STRATEGY

Key additions to the Model Portfolio

In the Technology sector, we have added two new companies **Dell** and **Micron**, both beneficiaries of the pick-up in IT spending. These two companies have had their earnings expectations brought down significantly. Cost-cutting measures for these two companies have been among the most aggressive within the tech universe. Utilisation has hit trough levels and both have exercised good capex controls. As a result, margin leverage will be substantial for any revenue uplift.

In the Consumer space, we have added **Walt Disney**. Disney has broad exposure to media (cable networks and studios) and leisure and consumer services (parks and hotels). 63% of Disney's Earnings Before Interest and Tax (EBIT) is derived from cable networks. This provides a relatively defensive earnings stream. The company also has strong brands and positions in kids entertainment and live sports. The lull in movie content is also reversing with *Up*, *TS3*, *Cars 2* and *Pirates 4*.

Strategically, Disney has announced its intention to acquire Marvel Entertainment. Marvel has a plethora of evergreen brands and characters that Disney will be able to leverage aggressively across all of its divisions, dramatically expanding its content targeted at boys, such as Spider-Man, X-Men and Fantastic Four. A combination of Marvel's success in film expansion and Disney's ability to merge Marvel into its fold could eventually generate revenue synergies. The impact could be positive enough to offset the near term burden of the dilution created by the deal.

In Industrials, we added **Union Pacific**, an operator of a network of railways in North America. Union Pacific has the highest proportion of legacy contracts, around twice that of its peers, and that should continue to lend the company pricing power. A recovery in industrial production and automobile volumes is also positive for Union Pacific given its relatively large exposures to these areas. Although there is some headline risk given the pending change in US legislation on railroads, the market expects only small changes to railroad economics and there is not likely to be a material risk to earnings.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Overweight	Walt Disney
Consumer Staples	Underweight	CVS Caremark
Energy	Neutral	Schlumberger
Financials	Neutral	JP Morgan Chase
Healthcare	Underweight	Johnson & Johnson, Teva Pharmaceuticals
Industrials	Neutral	General Electric, Union Pacific
Information Technology	Overweight	Intel, Dell, Micron
Materials	Neutral	Freeport-Mcmoran, Newmont Mining
Telecom Services	Neutral	AT&T
Utilities	Underweight	Exelon



EUROPE

Europe Equity Strategy

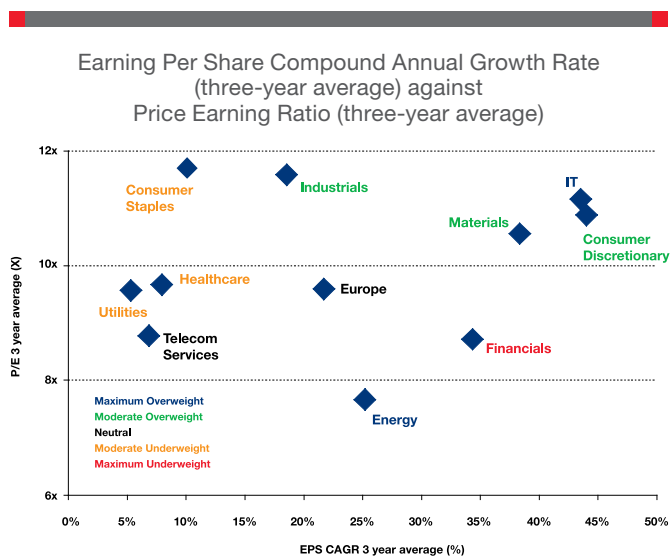
Our positive stance on Europe remains intact amid continuing signs of improving economic and corporate data such as forward-looking indicators like the Purchasing Managers Index (PMI) as well as Economic Sentiment indicators. Earnings momentum also turned positive in the second quarter results reporting season and we saw the highest number of earnings upgrade since the third quarter of 2007. Notably, we are also beginning to see early positive earnings momentum in early cyclical sectors such as retailers.

Since the start of the rally in March this year, Cyclical sectors have massively outperformed the Defensives. Historically, Cyclical sectors outperform at this stage of the business cycle, when key leading indicators such as the OECD Leading Index, are negative but rising. We are likely to remain in this phase till the end of the year. So far, the multiple expansion of the equity market has been driven primarily by a re-pricing of risk. Going forward, any further multiple expansion from the current prospective P/E ratio multiple of 11.3x to the 38-year average of 15x must come from earnings beating expectations. As such we remain Overweight on Cyclical sectors, namely Basic Materials, Industrial, Energy, Consumer Discretionary and Technology. In particular, our bias is towards the early Cyclical sectors within each sector.

One of the sectors that should start to re-rate towards the end of the year is the **Industrial** sector which is entering a period of demand recovery and importantly, intensified cost reduction. Historically, this has been an important source of earnings upgrade. With companies reporting falling industrial production and orders at rates not seen for the past 30 years, earnings expectations are low for the sector. Within the sector, our positioning is based on several structural themes that should underpin earnings. The electrical equipment and machinery companies will benefit from stimulus-led investment in areas including Transmission and Distribution, Infrastructure including power related and rail transport as well as renewable energy. Our top picks include **Gamesa** (leading supplier of turbines for wind energy production) and **ABB** (a leading Transmission & Distribution electrical equipment player). We have also recently added the **Weir Group** to gain exposure to the buoyant energy sector.

Another cyclical sector that stands out in terms of both earnings growth capability that is not fully appreciated by the market is the **Energy** sector. Current fundamentals remain weak but the sector is anticipating an economic and demand recovery. Gasoline demand has stabilised in recent months while diesel demand continues to be weak but with growing evidence of a pick up in economic activity ahead, we believe energy demand will start rise again in coming months. We remain of the view that the worst is over for the sector and believe the commodities prices will continue to trend higher although we do not rule out occasional pullbacks. Our top pick in the sector is **BG Group**.

We are underweight the Defensives namely Utilities, Healthcare and Consumer Staples. We have also stayed below benchmark weight for Financials as we believe the market continues to under-estimate the extent of provision charges, bad debt charges and capital-raising ahead. We have also upgraded Telecom Services to neutral from underweight on valuation grounds.



Source: Datastream, 11 September 2009



GLOBAL EQUITY STRATEGY

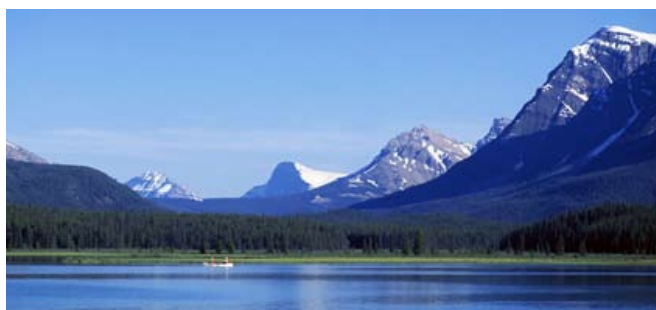
Key additions to the Model Portfolio

We have added **Xstrata** to the Model Portfolio. It is a diversified mining company that is currently inexpensive relative to its peers. The world's fifth largest mining company by market capitalisation, Xstrata provides exposure to the base metals and bulk commodities that we generally favour - coal, copper, nickel, zinc and ferrochrome. It also has a stake in Lonmin, which gives it leverage to platinum. We believe that an Xstrata – Anglo American merger is now unlikely for political reasons and that Xstrata will concentrate on organic growth. Xstrata's rights issue in March this year means that net gearing has dropped to 40% as of June 2009 from 72% as of December 2008.

We have also initiated a position in **Tullow Oil** in line with our positive stance in the Exploration & Production (E&P) sector in the European Energy space. Tullow is the largest E&P company in Europe and is currently on an extensive exploration programme in Africa. They have a credible management which has been extremely successful in Ghana and Congo. Tullow Oil has been widely touted as an M&A target given the uniqueness of their portfolio in Congo and Ghana, countries in which no oil majors currently have any stakes, and which they would be interested in getting into. The development of Tullow's recent find, the world-class Jubilee field in Ghana will transform the company into a more production based company which will provide strong free cashflows to the company for a very long time given the huge reserve base.

We also added the **Weir Group** to replace **Capita** which has come to trade at premium valuation to its peers, which to us is unjustified. Weir is an engineering group whose positives are 1) Strong management as shown in a consistently good earnings track record, 2) Good operating assets with exposure to structurally positive sectors namely minerals and oil/gas and 3) High after market sales. Valuations are reasonable at 14.8x (Financial Year 2010) but the stock deserves to trade at a premium to peers owing to its exposures to relatively resilient and growth sectors such as oil and gas.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Staples	Underweight	British American Tobacco
Consumer Discretionary	Overweight	Pearson
Energy	Overweight	BG Group
Financials	Underweight	HSBC
Healthcare	Underweight	Roche Holdings
Industrials	Overweight	Gamesa
Information Technology	Overweight	Autonomy
Materials	Overweight	Xstrata
Telecom Services	Neutral	KPN
Utilities	Underweight	E.ON



GLOBAL EQUITY STRATEGY

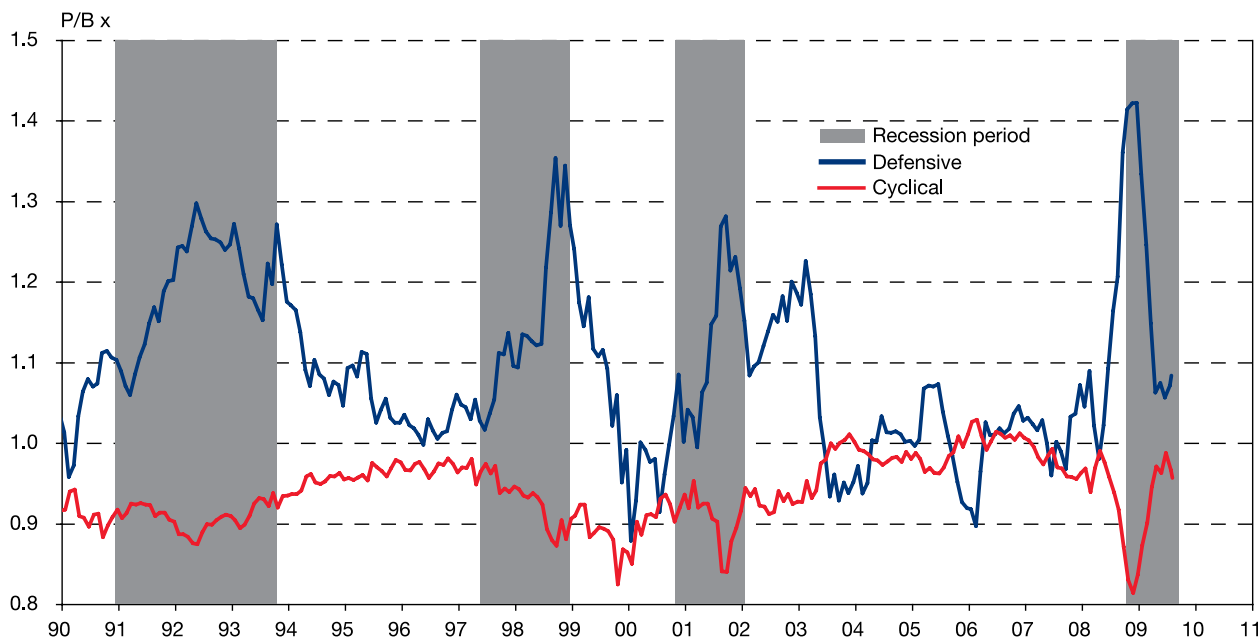
JAPAN

Japan Equity Strategy

The overwhelming victory of the DPJ has led to greater political stability. The shift in government policies to boost household income, away from the traditional emphasis on public works projects, represents a step in the right direction, in our view. However, uncertainties persist on the implementation of these policies. Furthermore, any major change by the new government is likely to have an impact on the economy only in the mid-to-longer term.

The near-term outlook of Japanese equities will be driven largely by global factors. We are optimistic that Japan is on the road to gradual recovery, as evidenced by improvements in industrial production and exports. This should be supportive of Japanese corporate profits. Given high operational gearing of Japanese companies, better-than-expected global growth could lead to stronger top-line growth and positive earnings surprise. Key risks to our optimistic scenario include premature policy tightening, a strong yen, and the DPJ's labour policies.

Cyclicals and Defensives (Relative Price/Book vs TOPIX)



Source: Goldman Sachs, 19 September 2009

We maintain our preference for Cyclicals over Defensives. We are overweight in Industrials, Energy, Real Estate, and Consumer Discretionary. We are neutral on Consumer Staples, Info-Communications, Pharmaceuticals, Materials, Banks, Technology, and Autos, and underweight Utilities, and Non-Banks.



GLOBAL EQUITY STRATEGY

Key additions to the Model Portfolio

We made minor changes to our model portfolio during the quarter. We added **Honda** to the model portfolio, partially funded by weights in Toyota and Exedy. Our preference for Honda within the Japan automotive sector is primarily because of its concentrated line-up (its lower dependence on light trucks) that faces less risk of global mix deterioration, high exposure to the BRIC (Brazil, Russia, India and China) markets, and high capacity utilisation level.

We also added **Fujitsu** to our list. Fujitsu is the fourth-largest IT services firm, and one of the world's leading IT hardware firms. Core profits are expected to surge as it accelerates its disposal of non-core businesses, shifts towards greater foundry outsourcing, and improves its sales mix. Longer-term revenue stands to benefit from increased demand for Intel-architecture servers, as well as software and hardware services for cloud computing.

We have removed **Seven & I** from the model portfolio. The company faces earnings stagnation due to maturity in the convenience store, general merchandise store and department store businesses. Within the retail sector, we favour specialist retailers with stronger medium-term revenue growth prospects. Our holdings include **Sundrug** and **Yamada Denki**. Sundrug is one of the most cost-efficient drugstore chains in Japan, and stands to increase its domination of an industry that is currently undergoing consolidation. Similarly, Yamada Denki is expanding its share of Japan's consumer electronics retail market. In the near-term, the benefits of the government's economic stimulus measures, as well as its initiatives to cut costs, and its foray into growth fields such as home solar power systems, will drive the company's earnings growth.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Autos	Neutral	Honda, Daihatsu
Real Estate	Overweight	Mitsubishi Estate
Financials	Neutral	MUFG, SMFG
Materials	Neutral	Nippon Electric Glass, Kao
Technology	Neutral	Nissha Printing, Fujitsu
Industrials	Overweight	Mitsui & Co
Healthcare	Neutral	Tsumura
Consumer Staples	Neutral	Toyo Suisan
Retail	Overweight	Yamada Denki, Sundrug
InfoComm	Neutral	NTT
Utilities	Underweight	Tokyo Gas



ASIA EX-JAPAN

Asia ex-Japan Equity Strategy

We expect the market recovery to continue on improving economic data in Asia. Low interest rates and further fund inflows should also keep equity markets supported. We think the bulk of the valuation re-rating from distressed stock pricing levels is almost complete for now and earnings growth and surprises will be the main driver going forward. Further upside potential will arise from Asian markets possibly re-rating up to trade back to their peak P/B over the next few years.

Our key strategy going forward will be stock picking. We will focus on sectors and stocks with the greatest upside in terms of earnings growth and the potential to surprise positively. Our main sector tilts are to overweight the Consumer Discretionary sector and underweight Utilities and Telecoms. We also favour the Technology, Financials and Real Estate sectors on the recovery trade. We are also focusing tactically on export recovery plays and nuclear power-related companies.

Consumer Sector – We are overweight in the Consumer sector, maintaining exposure to the consumer discretionary space. We view that underlying growth for stocks in the sector remains strong and this will be more evident in the final quarter of 2009. There is much room for upside earnings surprises from a bottom-up perspective. We look to focus on mispriced stocks that will likely see a re-rating in the coming quarters.

Industrial – The Industrial sector is one of the beneficiaries of China's increased infrastructure spending as well as robust domestic demand. Opportunities in the sector also arise from the alternative energy space, where demand for alternative sources of energy such as nuclear power, will benefit companies such as Dongfang Electric. We also favour the Korean construction players that are likely to receive a boost from the Middle East economies re-starting mega construction projects as well as a recovering Korean housing market.

Conglomerates – We favour offshore and marine companies in the sector that can secure more contracts given rising oil prices and the easing of credit conditions. We also see opportunities in the gas distribution business as the Chinese government's policy to encourage transition to low-cost clean

energy, coupled with increased gas supply from the West-to-East Pipeline No.2 will drive downstream gas distribution growth in China.

Financials – Banks are likely to see a recovery in earnings in the second half of 2009 with margin expansion and a rebound in fee income arising from the recovery in trade activities and transactional banking, credit card fees and capital market-related fees such as wealth management, fund distribution and investment banking. Among the non-bank financial institutions, exchanges and brokerages should benefit from higher market turnover and active capital raising, while the insurers should benefit from asset reflation and higher interest rates, given their leveraged balance sheets.

Real Estate – In the real estate sector, opportunities have arisen in the China property space after the pullback from recent July high levels. We believe concerns over slowing volumes in July and August were overdone given that the period is an expected lull season, while most developers have locked in about 70% of their 2009 sales targets. We acknowledge that policy risk is higher now, but do not expect the government to impose harsh tightening measures in the near term given the importance of the sector to the economy and the fact that the government is still very concerned about growth.

Technology – We raise our weight in the Technology sector given the stronger than expected results in the second quarter, better guidance and expect further positive earnings revisions. We hold the view that end-demand could surprise on the upside with 1) China's incentive package to boost consumption on IT goods gaining traction; and 2) better than expected retail sales in the US and Europe. We see signs of corporate IT spending returning, led by the small-and-medium enterprises.

Telecom Services – We maintain our underweight position in the Telecom sector given its defensive nature and lower prospect for earnings growth surprises. We base our stock selection on: 1) sustainable, attractive dividend yield with potential for capital restructuring; 2) earnings growth, especially in countries where mobile penetration rates are still relatively low such as China and Indonesia; 3) strong balance sheet; and 4) benign regulatory risk with potential positive changes such as the issuance of 3G licences.



GLOBAL EQUITY STRATEGY

Materials – This sector is another beneficiary of government infrastructure spending. A further pick-up in demand also likely as the economy recovers. We expect the Chinese government to introduce tough measures to control capacity growth in the cement industry, which we view to be positive for the cement supply in the long run. Price hikes due to seasonality and demand recovery, evidence of which we are already starting to see across the different regions in China, also bode well for earnings.

Energy – We expect oil prices to be range-bound after the strong rally of almost 100% from the bottom in January 2009, but think prices are unlikely to drop significantly due to oil supply discipline and the stabilisation of economic activity. The postponement of new exploration and production projects will pose a serious supply problem for the oil industry in the longer term, and this support for oil prices will be positive for existing players.

Utilities – The contraction in power demand appears to have bottomed in the second quarter of 2009 in line with the recover of the economy. Electricity consumption in countries such as China and Malaysia has recovered strongly, which should lead to strong earnings recovery for companies in the sector. We remain positive on gas utilities in the region given the government's policy to encourage the transition to low-cost clean energy.

Key additions to the Model Portfolio

We initiated a position in **Genting Singapore**, which owns Resorts World Sentosa, one of the two Integrated Resorts (IR) in Singapore. Based on our assumptions that gaming and theme park revenues will generate Earnings Before Interest Tax Depreciation and Amortisation (EBITDA) margins of 30% each and that the casino operations will open with 500 tables, gradually scaling up to 700 tables, our earnings model suggests that the stock offers an attractive upside. From now until the official opening of the Resorts World, the stock will also benefit from increasing research coverage and positive newsflow. Over the longer term, we believe that Resorts World will be successful and will likely generate more than S\$1 billion in cashflow a year from 2011 onwards. Given that the company has only put in S\$2.2 billion in equity and has S\$4 billion in debt, the Return on Equity can be substantial in the long run.

Dongfang Electric is one of the three major power generation equipment makers in China and is engaged in the manufacturing of various types of power equipment including coal, gas, hydro, nuclear, and wind power generation. In the Nuclear space the company is a market leader, accounting for nearly 50% of all orders secured by domestic manufacturers. Furthermore the Chinese government wants nuclear energy to make up 5% of China power market by 2010, up from the current 1%, and this should further enhance Dongfang's earnings.

We have initiated a position in **Sino-Ocean Land**, a China real estate developer that has a strong brand name, good growth potential and strong management execution ability. In our view, this mid-sized developer, with a landbank of 11.4 million square metres, is well-positioned for rapid expansion in the coming years, given its state-owned enterprise ties and strong financial position, which will enable the company to continue to acquire more prime sites and grow into a top-tier developer that can capture the strong structural demand growth for residential housing in China.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer	Overweight	Geely Auto, Anta Sports
Industrials	Neutral	Dongfang Electric, Cosco Pacific
Conglomerates	Underweight	Beijing Enterprises
Financials	Overweight	China Construction Bank, Bank of China Hong Kong
Property	Overweight	China Overseas Land, Sino Ocean Land
Technology	Neutral	TSMC, Hon Hai
Telecoms	Underweight	PT Telkom, Chunghwa Telecom
Materials	Underweight	Shandong Chenming Paper, China Bluechem
Energy	Overweight	Sinopec, PTT
Utilities	Underweight	Tenaga



SINGAPORE

Singapore Equity Strategy

The current cyclical bull market is close to its 30th week and appears to be in a relative early stage compared to the average 101 weeks seen in past bull markets when Singapore emerged from recessions. However, in terms of the returns from trough, the 81% gain in six months from the March 2009 trough almost matches the average 88% 12-month returns from the trough seen in past bull markets.

Given this backdrop, the market can be vulnerable to a correction although ample liquidity conditions and the still improving economic indicators provide downside support. An FSSTI target of around 2,920 can be reached if the market reverts to mid-cycle valuation or P/B mean of 1.75x.

We retain our neutral stance and continue to position our portfolios in financially sound names which can emerge stronger from this crisis. Similar to past recession episodes, the Financials and Property sectors have led the market from the recent bottom. We believe less value can be found in the property developers at this stage and now prefer the more undervalued Real Estate Investment Trusts (REITs). We continue to have an overweight position in the banks.

We maintain our underweight position in the Industrial sector due to our cautious view on the transport sector but we still favour the Capital Goods sector. The Telecommunications sector stays as a slight underweight position.

Singapore Historical Bull Markets

Period	Duration (wks)	% chg from trough to peak	12m returns from trough
Dec-74 to Jul-81	340	400%	44%
Aug-82 to Feb-84	77	92%	67%
Apr-86 to Aug-87 (Recession)	69	178%	110%
Dec-87 to Mar-90	120	112%	36%
Oct-90 to Feb-97	332	149%	30%
Sep-98 to Jan-00 (Recession)	69	221%	167%
Sep-01 to Mar-02 (Recession)	26	49%	16%
Mar-03 to Oct-07 (Recession)	239	227%	58%
Average	159	179%	66%
Average (Out of Recession)	101	169%	88%
Mar-09 to Current (Recession)	26	81%	...

Source: Datastream, Bloomberg, Citi Investment Research and Analysis, September 8, 2009



GLOBAL EQUITY STRATEGY

Key stocks in the model portfolio

Singapore Press Holdings typically outperforms the broader market as the index reaches mid-cycle during a recovery phase. The Group's revenues are highly correlated to the economy and should be a prime beneficiary of the sharp economic recovery in 2010. From a valuation perspective, the stock's core media business is now trading at a discount to the broader market's P/E ratio whereas historically it has traded at a premium. Downside should be well-supported with dividend yield of at least 6%; underpinned by the strong cashflows which will come with the Temporary Occupation Permit of Sky@Eleven in 2010.

We continue to like the hotel play, **CDL Hospitality Trust**, as we believe the stock is at the bottom of its earnings cycle. As the largest hotel owner (by rooms) in Singapore, CDL Hospitality Trust should benefit from the strong recovery in

tourism arrivals in 2010 with the openings of the two integrated resorts. Amongst the Singapore REITs with beta above 1.0x, CDL Hospitality Trust has the highest growth potential. The Group's gearing is also one of the lowest among the Singapore REITs, giving it headroom to make accretive acquisitions with the easing of credit costs.

We continue to favour **DBS Group** as a good proxy to the local and regional economic recovery, coupled with it being the cheapest local bank on a P/B basis – albeit with a lower Return on Equity than its peers due to the enlarged capital base following the rights issue late last year. Credit costs have been more benign during this downturn and the non-performing loan ratio could peak at lower-than-expected levels next year. The bank's low loan-to-deposit ratio allows it to take advantage of loan growth opportunities. The recent appointment of its Chief Executive Officer removes an overhang on the stock.

MODEL PORTFOLIO		
SECTOR	WEIGHT	TOP PICKS
Consumer Discretionary	Underweight	Singapore Press Holdings
Consumer Staples	Underweight	Wilmar
Energy	Neutral	-
Financials (Banks)	Overweight	DBS, OCBC, UOB
Financials (Real Estate)	Overweight	AREIT, CDL Hospitality Trust
Healthcare	Neutral	-
Industrials (Capital Goods)	Overweight	Keppel Corporation, SembCorp Industries
Industrials (Transportation)	Underweight	SMRT
Information Technology	Neutral	-
Telecommunications	Underweight	Singapore Telecom



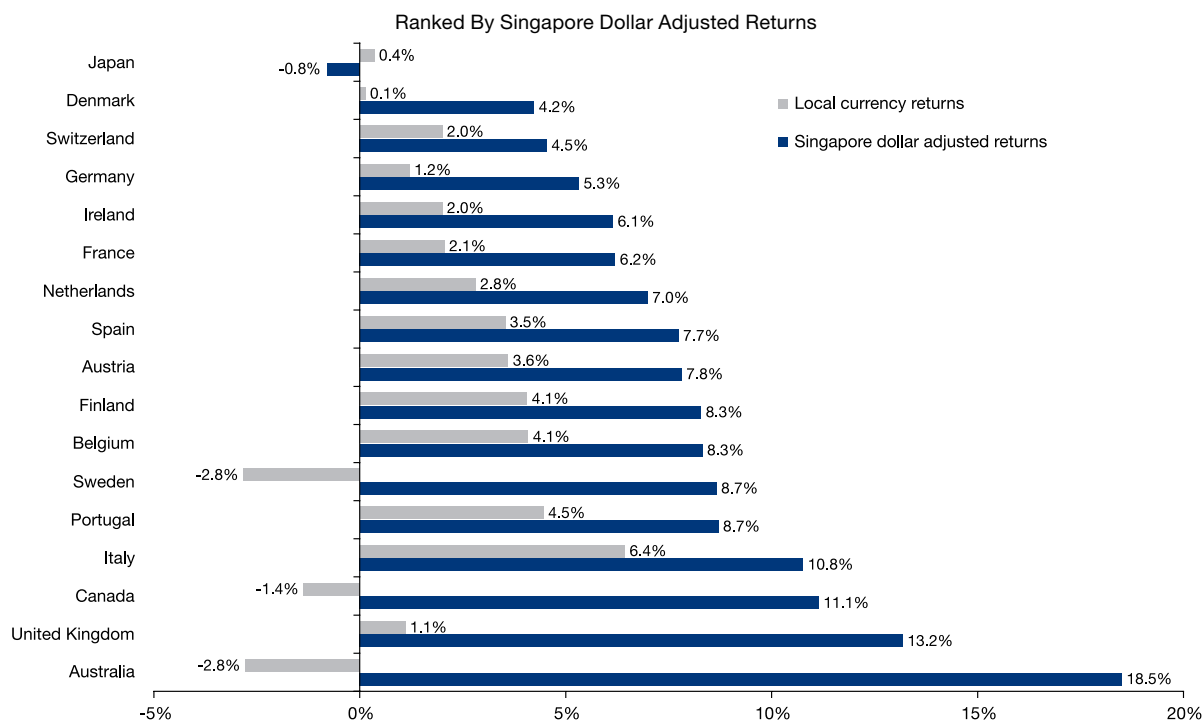
GLOBAL FIXED INCOME STRATEGY



GLOBAL FIXED INCOME STRATEGY

Bond Market Returns

Year to date Bond Market Returns as at 15 September 2009



Source: Bloomberg, 15 September 2009

G-10 FIXED INCOME

Outlook and Strategy

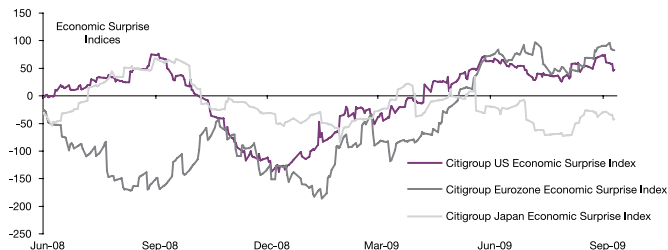
Economic data continued to improve in the third quarter. While the rebound of economic data has to be considered against the severe collapse in demand in the previous quarters, the sharp improvement nevertheless confirms that the risk of a depression has greatly diminished and the aggressive economic stimulus actions by the various governments, whether monetary or fiscal, have been effective and timely. Although the risk of a relapse in economic performance is possible, the various governments have committed

themselves to supporting their respective economies, and also the Emerging Economies via the International Monetary Fund. At the September G20 meeting they reaffirmed their commitment to take necessary actions to prevent another economic collapse and to further strengthen the financial and economic infrastructure. Although the most recent economic indicators have not greatly surprised on the upside the tone of economic data continues to improve compared to the past months. Forward-looking economic indicators also continue to point to more improvement. While there are still risks for the global economy, so far, the recovery appears to be sustainable



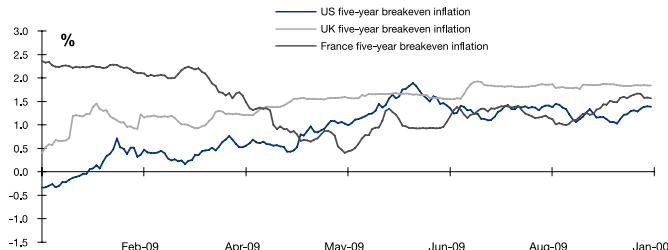
GLOBAL FIXED INCOME STRATEGY

Economic Surprise Indices



Source: Bloomberg, 16 September 2009

Five-year Inflation Breakevens



Source: Bloomberg, 16 September 2009

The sharp economic recovery is due to the aggressive and prompt actions by the various governments in terms of both monetary and fiscal actions. The actions were clearly needed in light of a sharply contracting private sector economy. However, the consequence is the swapping of private for public debt. To prevent an economic depression, the rise in public debt is a massive one. Although policy actions like quantitative easing measures have provided some support to the increase in government debt supply, and central banks are likely to act cautiously before reversing their stimulus, recent auctions have shown reduced participation. The return of risk appetite could be one factor resulting in a lower participation in government debt auctions but the debt auction statistics are revealing that higher yields are required to entice participation. Unless there is a sharp return to strong economic performance, which would allow for a reversal of the stimulus measures, the higher supply of debt is likely to be around for a long time.

The inflation outlook will likely remain subdued for the coming year but there are a few risks ahead to reckon with. Inflationary expectations continue to be sanguine and lower than where they historically were before the recent financial crisis. This has much to do with the global central banks' periodic reaffirmation of their commitment to keep inflation risk under control. Inflation in the major economies on a headline basis have reached negative territory due to the deep and pronounced economic crisis which affected both job and wage growth. If the economic recovery is sustained and the employment outlook improves, the risk to inflation will likely be on the upside. Commodity prices, though lower compared to last year, have also risen year to date despite the nascent economy recovery. Overall, short of another sharp collapse in economic performance, the risk to inflation over the medium term is to the upside.

Surveys of large investors' portfolios have continued to show pronounced holdings in fixed income even as the economy and equity market performance improved. Although recent surveys have shown a reduction in cash levels, overall equities holdings remain at multi-year lows, almost half of historical equities holdings. As more signs of economic stability and even growth manifest themselves, the asset allocation shifts into risk assets at the expense of fixed income will likely accelerate in speed and quantum. Fixed income managers' portfolio surveys indicate close to benchmark duration weight and low levels of cash; showing little impetus to add to risk positions (position at higher interest rates levels) on a duration or cash basis. Unless there is a sharp sell-off in yields, fixed income managers are unlikely to change this stance and significantly increase duration risks.

Given the prospective improvement in economic performance, the risk of higher future inflation, the increase in supply and investors' high allocation to fixed income, we have an underweight position in fixed income markets, focusing on investment grade corporate exposures with short duration. This positioning will allow portfolios to benefit from the expected further tightening in corporate spreads and reduce the impact of higher interest rates. Another strategy for this quarter is to buy floating rate notes whose interest rates are highly correlated to market rates. We are increasing allocations to Australian dollar floating rate notes to benefit both from the likely strengthening in the currency as well as higher Australian interest rates.



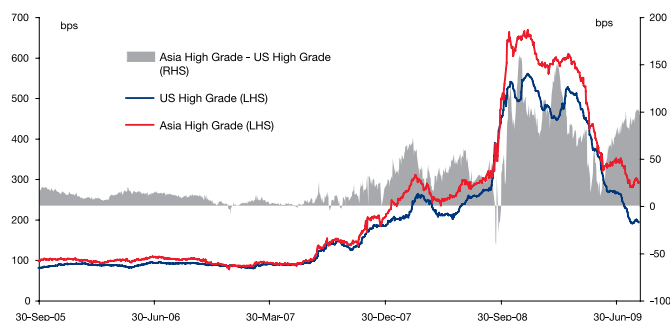
ASIA FIXED INCOME

Third Quarter Review

The rapid compression in Asian credit spreads and the continued surge in new issuance make it appear as though we are back to the pre-crisis bull run. To date, new issuance amounts to US\$40 billion and the supply pipeline is still strong as we enter the last quarter. We forecast this year will be a record-breaking issuance for Asian credits with more marginal credits coming to raise funds as investors grow more convinced of the macro recovery story. While spreads have returned to pre-Lehman levels, we continue to see further spread compression, particularly in high grade credits.

Asia's High Grade corporates continue to trade at an attractive discount to similarly rated corporates in the US. Across the ratings spectrum in the High Grade space, the single A to BBB rated corporates have the largest basis spreads compared to Triple A credits. The good spread difference in these spectrum against its historical trend suggest that spreads have further scope to tighten as risk expectations continue to moderate on improving macro economic data.

Asia High Grade Corporates against US High Grade Corporates



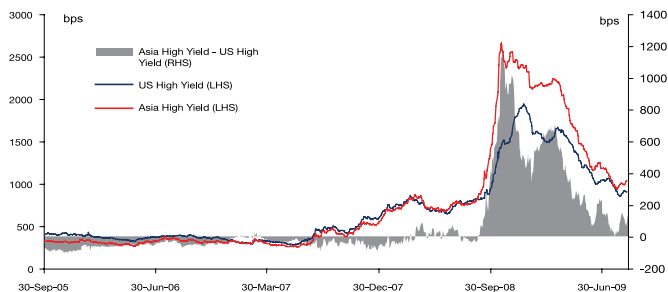
Source: Bloomberg, 11 September 2009

Similarly, in the Asian High Yield space, the spread has compressed from the peak of 1076 bps to 379 bps, below the 10-year historical average of 452 bps. Asia High Yield credit spreads were pulled lower by buybacks from companies that have access to cheaper domestic funding. Looking ahead, we expect to see more supply from some non-investment grade companies, which may lead to some re-pricing in certain High Yield sectors. The pipeline for High Yield corporates was turned on with a new issuance from a BB-rated Chinese property developer, Country Garden Holding Company, which raised US\$300 million at 11.75% for five years in early September. While Asia High Grade has more compelling valuations than Asia High Yield versus the US credit spreads, we still see pockets of value in High Yield corporates given that this sector offers better spread value than US High Yield corporates.



GLOBAL FIXED INCOME STRATEGY

Asia High Yield Corporates against US High Yield Corporates



Source: Bloomberg, 11 September 2009

More value can be found by moving down the credit curve particularly in Korean names with single A ratings such as Korea National Housing, Korea National Oil and Korea Gas Utility. Opportunities are also apparent in the BBB spectrum, but mostly in cyclical sectors like LG Caltex, Gome Electrical Appliance and Cosco Pacific.

Going forward, movements in the US Treasury curve are likely to play a dominant role in total return outcomes. US Treasury yields are expected to rise over the next 12 months. Rising yields will offset to varying degrees the benefit from lower credits spreads for investors who do not hedge their interest rate risks.

Strategy

The credit market should continue to normalise and trend tighter as economic indicators point to a continued macro recovery. The main theme for Asian US dollar bonds in the next two quarters is spread compression. However, we expect the overall tightening to be moderate compared to the sharp compression we saw in the first nine months of 2009. By spread compression, we prefer subordinated bank debt to senior bank debt, particularly in the Tier One notes with high single or double-digit yields; High Yield corporates to High Grade corporates and Korean papers to High Grade corporates.



GLOBAL FIXED INCOME STRATEGY

SECTOR	CREDIT OUTLOOK
Banks	<ul style="list-style-type: none"> Asian bank offshore debt issuance has rebounded significantly at US\$11 billion for first eight month of 2009 – double that of full-year 2008. So far, Korea issuances dominate with senior debt. Asian banks will be faced with higher refinancing requirements as the cohorts of offshore Senior and Lower Tier Two debt issued during the bull market years (2004-2007) reach respective maturity and call dates. With the improved in sentiment given the rally in equity markets, we are now approaching an inflection point where a revival of offshore Asian bank capital supply is expected in the months ahead. Asian banks are expected to refinance about US\$17-20 billion debt annually over 2010-12 (versus about US\$15 billion per year in 2008-09). In aggregate, about 50% of the Asian bank offshore debt universe will come due for call/maturity from 4Q09-2012. While spreads have returned to pre-Lehman levels, we continue to see further upside as risk expectations moderate. Furthermore, Asian banks look cheap compared to counterparts in the United States and Europe as well as Asian corporate issuances. Nevertheless, heavy supply from Korea and/or India could limit performance in 4Q09. Banks that have stronger capitalisation and reserves are expected to outperform as tighter credit conditions deepen the differentiation in credit risk. We thus continue to overweight Investment Grade bank bonds.
Industrials	<ul style="list-style-type: none"> Cyclicals such as shipping and semiconductors are still showing negative credit fundamentals as the outlook is uncertain. We are cautious on High Yield as we do not see relative value after the recent rally brought about by the strong technicals. Supply risks looming in the High Yield space with some Indonesian corporates being rumoured to be in the pipeline such as Adaro (US\$500 million), Bumi Resources (US\$750 million-US\$1 billion) and Indika (US\$500-700 million). We prefer names which still show relative value with stable fundamentals – Hutchison Whampoa, ST Engineering, Posco, Genting International and Stats Chippac.
Property	<ul style="list-style-type: none"> Concerns over more tightening measure are returning after the strong transaction volume and surge in property prices in 2009. Liquidity pressure has somewhat eased as developers achieved strong contracted sales in the first half of 2009 and obtained new funding from equity/rights, trust financing, asset sales. Land bank acquisitions becoming more active with record land prices reached, but the Chinese property issuers seems less aggressive and more cautious on spending. Seeing new bond supply returning to the market after having no issuances in the past year – Country Garden being the “first” to issue. Seeing lesser downgrades and negative outlooks from rating agencies on the issuers as credit profiles have started to stabilise with the improved operating environment. Prefer Chinese property issuers with better balance sheet strength such as China Overseas Land and Investment and Agile, as HK property issuers have become more expensive.
Oil & Gas	<ul style="list-style-type: none"> Having held a fairly negative view for refining margins for the past few quarters, we now expect refining margins to recover in 4Q, underpinned by improvements in diesel and jet fuel margins as economic and industrial activity recovers. Valuations wise – we continue to expect Korean BBB names to continue to tighten, following the rally in Korean A-rated names. We continue to look favourably on Thai refineries, especially IRPC and PTT Aromatics. We expect the merger of both companies to lead to a ratings upgrade for IRPC.
Utilities	<ul style="list-style-type: none"> We expect oil and commodity prices to remain low and for electricity demand to rebound. We expect the implementation of fuel pass-through mechanism (in Korea) to benefit Korea Electric Power Corporation. On their valuations - Korean utilities have performed well in the third quarter. We expect spread tightening to continue on consistent interest in these Korean names.
Consumer	<ul style="list-style-type: none"> With the expectation of economic recovery comes the expectation that consumer spending will remain well supported. We prefer retail companies which 1) operate in Emerging Markets with under-penetrated retailing space which provides room for volume growth; 2) companies with good control over financials and capex plans.
Telecommunication	<ul style="list-style-type: none"> Contrary to expectations, subscriber growth in general has picked up. More significantly, data usage is also picking up across the region. Most telcos have reported stringent cost control, leading to better operating profits. Margins have been somewhat affected, less so by operating expenses, more so due to higher marketing expenses and handset subsidies. The key risks are regulatory risks, bidding for English Premier League rights, and the introduction of nationwide high speed network. Overall, we see broadly stable revenue with margins expected to be maintained. Increases in capital spending are not expected to push gearing beyond the median.



GLOBAL FIXED INCOME STRATEGY

SINGAPORE FIXED INCOME

Third Quarter Review

The second quarter 2009 real GDP growth was revised to -3.5% year-on-year from the advance estimate of -3.7% year-on-year. In the first quarter of 2009, real GDP was -9.5% year-on-year. On a quarter-on-quarter seasonally-adjusted annualised basis, second quarter real GDP rose 20.7%, which is slightly better than the +20.4% reported in the advanced estimate and much better than the -14.6% performance in the first quarter of 2009.

The upward revision in GDP was driven largely by services and construction. Services was driven by a 22.8% quarter-on-quarter seasonally adjusted annualised jump in financial services. Altogether, services GDP rose 8.7% quarter-on-quarter seasonally adjusted annualised in the second quarter of 2009 which is a sharp improvement from the -9.8% in the first quarter of 2009.

The government in the second week of July revised its 2009 GDP forecast to -4% to -6% from -6% to -9% previously. The government's statement was cautious, noting uncertainty about the stock market, the biomedical sector and the sustainability of restocking in the electronics sector, as there are few signs of a decisive turnaround in final demand in key export markets. The Ministry of Trade and Industry also mentioned there is probably little need for more policy stimulus, while the Monetary Authority of Singapore said it will keep liquidity in the banking system higher than normal, with "normalisation" only to come later.

Given the recent upside economic data surprises in the developed economies, the potential for restocking to persist in the second half of 2009, we think that Singapore's full year GDP is likely to be better than the government's forecast. We think that a full year GDP contraction of around 2.1% is a reasonable projection, with real GDP likely to post a small positive growth rate in the third quarter, which will be the first positive growth after three consecutive quarters of year-on-year contraction.

Meanwhile, consumer prices continued to deflate in July. The Consumer Price Index (CPI) fell 0.5% year-on-year in July, unchanged from June. However, on a month-on-month seasonally adjusted basis, inflation rose 0.3%. This is the

third successive month of month-on-month rise and likely portends positive year-on-year CPI inflation by the fourth quarter of 2009. Clothing, housing and transportation were the key drivers of month-on-month inflationary pressures. With stronger economic growth and surging asset prices, deflation is likely to end in the third quarter and inflation is likely to surprise on the upside beginning in the fourth quarter of 2009.

With the economy likely to have resumed growing in the third quarter of 2009 and inflationary pressures likely to rise going forward, the Singapore dollar is likely to resume strengthening going forward. We expect the Singapore dollar against the US dollar to appreciate towards the 1.40 level by end-2009 from 1.4220 currently.

Outlook and Strategy

US Treasuries (USTs) rallied in the third quarter of 2009 on the back of assurance from the US Federal Reserve that it would keep monetary policy easy. Yields fell 12 to 26 bps in the 1-30 year tenors. With 10-year USTs falling 19 bps and two-year USTs falling 19.7 bps, the 2-10 year spread was stable at 2.46%.

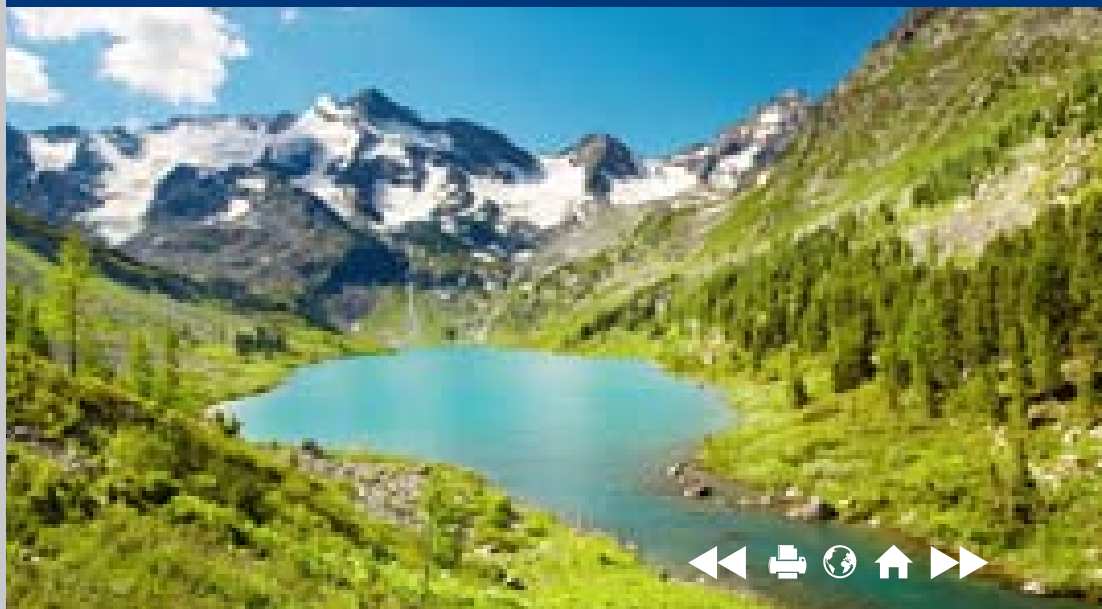
The Singapore Government Securities (SGS) yield curve also rallied in third quarter in line with the rally in USTs. The two-year SGS yield fell 12 bps to 0.479% while the 10-year SGS yield fell 19 bps to 2.395%. Consequently, the 2-10 year spread flattened by 7 bps, to 1.92%.

We are now cautious on SGS bonds. We believe that SGS is likely to sell off going forward. We see a sell off materialising if oil prices continue to rise and inflation expectations surge. We expect the 10-year SGS yield to exceed 3.0%. We are reducing our exposure to mid- and long-duration SGS bonds, that is, from five years to 20 years.

On the corporate front, we like the short-dated bonds, ranging from two to five years, due to the increasing swap spreads in a rising yield environment. We are biased towards the two-year end as it has the widest swap spreads and hence gives us a higher all-in yield. Some of the bonds we like are the National Agriculture Cooperative Federation (listed in Singapore) which offers a 3.3% yield for one year and City Development Sukuk Bond at 3.25% for one year.



CURRENCIES



Third Quarter Review

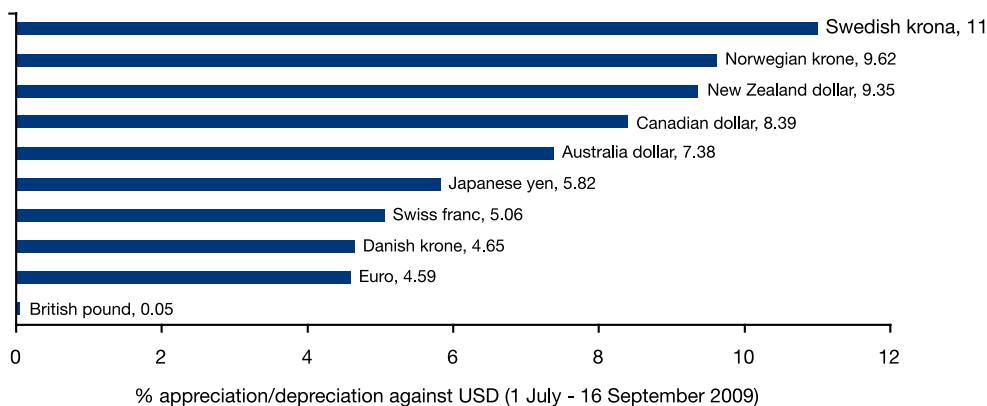
Cyclical currencies outperformed in the third quarter as economic data turned out better than expected and risk appetite stayed strong. The best performing currency was the Swedish krona, as Sweden's European export markets recovered and concerns about Swedish banks' exposure to the Baltic states receded. The improved macro outlook also drove commodity currencies like the New Zealand dollar and the Canadian dollar higher. The currencies whose central banks are expected to lead in the hiking cycle, in particular the Norwegian krone and the Australian dollar, also appreciated during the quarter.

The US dollar, a counter-cyclical currency, continued to depreciate in the third quarter. Its depreciation against the Euro during the quarter was relatively modest compared to

the peripheral currencies. The Japanese yen was surprisingly strong during the quarter. Strength in the yen used to be driven by volatility but the relationship appears broken as the yen strengthened even though volatility fell. The yen's recent strength appears to have been driven by the decline in US bond yields, where three-month risk free yields fell below that of Japanese yields.

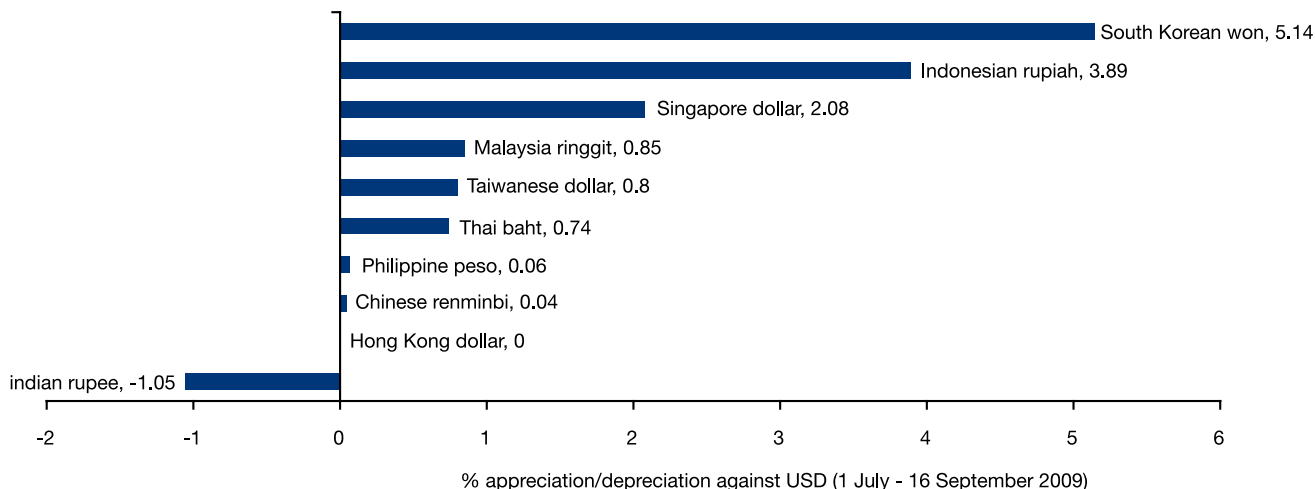
In Asia, there was only a modest strengthening of Asian currencies, with the Asian Dollar Index moving over the quarter. The only currencies to appreciate were the Korean won, the Indonesian rupiah and the Singapore dollar. It is likely that Asian central banks have been accumulating foreign currency reserves and the appreciation of their currencies has been slowed.

G-10 currencies performance against US Dollar



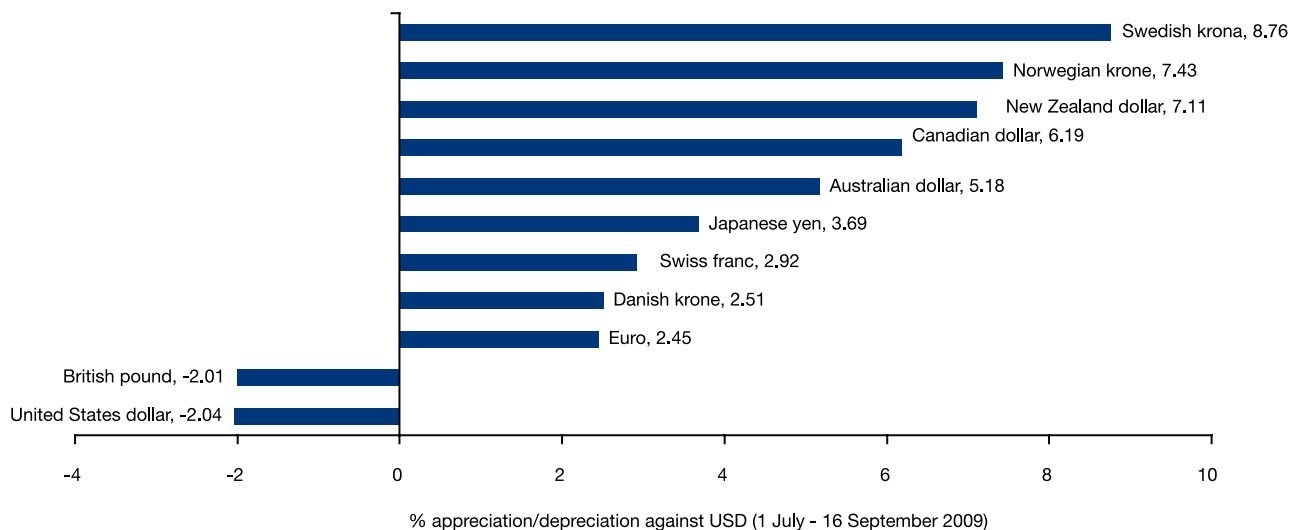
Source: Bloomberg, 16 September 2009

Asian currencies performance against US dollar



Source: Bloomberg, 16 September 2009

Singapore dollar performance against G10 currencies



Source: Bloomberg, 16 September 2009



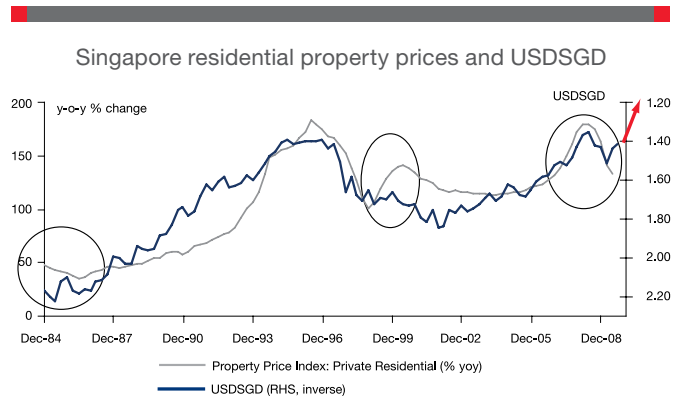
Outlook and Strategy

The global financial crisis and the policymakers' responses created structural problems for some currencies, in particular the US dollar. While the deterioration of the US fiscal position is bearish for the US dollar in the long term, we expect the decline to be orderly. In the coming months, the currency markets are likely to be focussed on cyclical considerations, primarily interest rate differentials.

The futures markets, have by and large, been expecting the US Federal Reserve to hike interest rates before the European Central Bank (ECB) but we believe that there is a good chance the ECB could raise interest rates before the Fed. This would be unusual as the ECB (and before that the Bundesbank) typically raises interest rates after the Fed does so. However, the current levels of interest rates are at emergency levels and we believe the ECB is likely to take the earliest opportunity to normalise them. If so, this would accelerate the depreciation of the US dollar.

Currencies whose central banks have indicated that they are ready to raise interest rates, in particular, the Australian dollar, are likely to continue appreciating. As mentioned, we are positive on Australian floating rate notes in our fixed income portfolios.

Asian currencies are by and large still below their pre-Lehman levels and we expect Asian currencies to strengthen in the coming months. In our observation, Asian currencies typically tend to appreciate when economic growth in Asia is more than 5% higher than the US. For the fourth quarter, we are particularly positive on the Singapore dollar and the Korean won. The recovering property market in Singapore is likely to boost the Singapore dollar. Inflation in Singapore is also likely to rise in the coming months and this would put upward pressure on the currency. We also expect the Korean won to appreciate as it looks highly undervalued on a historical basis, with the nominal effective exchange rate trading two standard deviations below its mean.



Source: Bloomberg, 11 September 2009

CURRENCY FORECAST		
Currency	Against USD 16 September 2009	Forecast End 4Q 2009
Japanese yen (JYP)	91	98
Euro (EUR)	1.47	1.42
Singapore dollar (SGD)	1.42	1.44

Source: Forecast figures are consensus numbers from Bloomberg, 16 September 2009



ASSET ALLOCATION IN UOBAM



ASSET ALLOCATION IN UOBAM

Most of our investors are probably familiar with our investment philosophy but they may not know what it means in practical terms. What is it we look for when we make our investment decisions? What are the factors which drive our investment calls? What are we focused on in the current environment?

To help investors understand how we think about financial markets, we publish a short feature on UOBAM's Asset Allocation unit. The Asset Allocation team looks at the global economy and financial markets from a top down perspective. Its role is to provide a macro anchor for the other UOBAM teams in the positioning of portfolios.

Why Asset Allocation matters

Asset Allocation is a fundamental investment decision. Deciding how much to invest in the different asset classes – equities, fixed income, commodities – can significantly affect the return of a portfolio, in fact more so than the selection of individual securities.

An important first point to make is the difference between an individual's risk allocation and strategic allocation. Every investor has a specific risk profile and an optimal asset allocation. An institution that has a short investment horizon will be more conservative compared to an institution with a longer investment horizon. An individual who has just entered the work force is likely to have a higher risk appetite than someone reaching retirement. Asset allocation decisions based on risk profiles are "mean-variance optimisation" decisions, which is the basis of modern portfolio theory. For any given level of expected risk, there is an optimal mix of equities, bond and commodities that an investor could hold. As risk profiles usually only change gradually, asset allocation revisions of individual portfolios are usually small.

The type of asset allocation we are describing here is different. It is commonly known as *Dynamic or Strategic Asset Allocation*. It refers to strategies that adjust the allocations in portfolios in response to changing market conditions.

Going back to the question of why Asset Allocation matters, empirical studies have shown that the Asset Allocation decision accounts for about 90%⁸ of the variation in returns between different portfolios. A simple way to understand this is to consider an equity bear market. The definition of a bear market is a sustained broad decline across the market. It is very difficult to find a meaningful number of stocks whose prices can rise during a bear market. Similarly, in a bull market, it is common to find the prices of the majority of stocks rising.

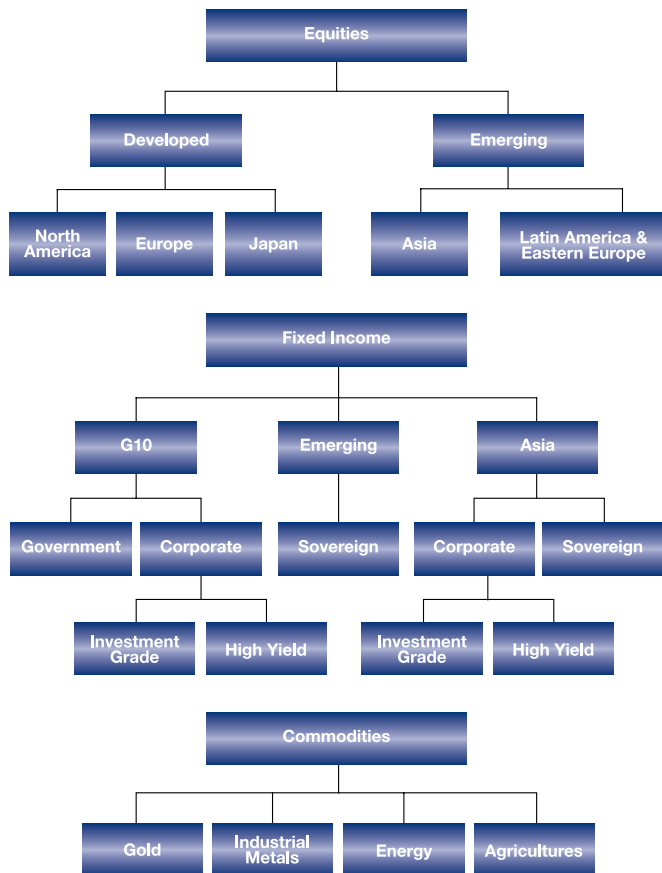
From an asset allocation point of view, you could say that, within each asset class, the similarities are greater than the differences. It is because of this inherent feature of asset classes that the first decision we make in the management of portfolio is the asset allocation one. How much equities? How much bonds? How much commodities? How much cash?

⁸ Source: Ibbotson Associates, *The Role of Asset Allocation in Portfolio Management*, 1 June 1994

ASSET ALLOCATION IN UOBAM

What Asset Classes do we look at

The UOBAM Asset Allocation team focuses on three main asset classes - equities, fixed income and commodities. We break down these broad classes into more specific markets.



What drives our Asset Allocation decisions

We believe that the different asset classes have a high likelihood of outperforming at the different stages of the economic cycle. As the global economy moves through its phases of expansion and contraction, we expect the different asset classes to respond in characteristic ways to the shifts in outlook for economic growth, earnings, inflation and interest rates. 2008 was a classic instance where we saw the growing risk of a deep global recession leading to a massive underperformance for equities and the strong outperformance of government bonds. So far in 2009, equities have strongly outperformed government bonds, in line with indications that the global economy is on the road to recovery.

Financial markets are forward-looking and move in anticipation of what lies ahead. Of course markets can frequently get things wrong and as a result, there is often volatility in markets. Investors who aim for quick, short-term profits also add to day-to-day swings in markets. The Asset Allocation team does not attempt to trade these bounces and dips but concentrates on identifying the critical turning points in markets. Given that the global economy is our starting point, the Asset Allocation team monitors a wide range of economic and financial indicators. The main ones are described below:

Real Economy

In the developed economies, a comprehensive range of economic indicators is available for investors to monitor. They include house prices, unemployment claims, retail sales, lending standards, copper prices, durable goods orders, industrial production, capacity utilisation, producer prices, and so on. The accuracy of the data is reliable and the releases can often trigger large moves in markets. In the emerging economies, the data that is available is not as comprehensive and perhaps also not nearly as reliable.

We monitor a large number of economic indicators every day. They form the basis of our assessments of the global economic outlook. No two economic cycles are alike and depending on the circumstances, we pay more attention to some indicators than others.

We are currently monitoring US retail sales, the US personal savings rate and the US housing market to provide confirmation that we will be able to avoid a “double dip” recession. The recent pick-up in industrial production was largely driven by a rebuilding of inventories and car scrapping incentives. For

ASSET ALLOCATION IN UOBAM

the recovery of the economy to be sustained, final demand must also improve. So far, the signs are that US consumer spending has stabilised although it is unlikely to return to vigorous growth in the next few years given the ongoing deleveraging of the US and European banking system.

We are also tracking demand in the Emerging Markets, given their growing importance in the global economy. When thinking about any economic recovery, one useful milestone is the return of an economy to its trend growth level. We believe that China could be the first major economy to return to its trend growth level given the strong increase in credit growth and fixed investment. China retail sales also appear to have good momentum behind them.

Inflation

Inflation is a key concern of central banks and therefore of financial markets. Too much of inflation is a bad thing while having none of it, which is deflation, is also a bad thing. When prices are rising rapidly, inflationary expectations tend to be stoked and this can lead to a wage-price spiral. When prices are falling, households and corporates tend to delay their purchases in the expectations that prices will fall further, and this leads to a weak economy.

With the plunge in commodity prices in the second half of 2008 and the global economic recession, a number of countries are currently experiencing close to zero or even negative inflation. However there is a degree of unease in the market about the aggressive manner in which central banks have flooded the system with liquidity in response to the credit crisis and the potential longer-term consequences for inflation.

For now, we do not expect inflation to pick up to any worrying extent in the developed economies because there is a lot of spare capacity. Wage pressures tend to be subdued when unemployment is rising. We are more concerned about the potential for inflation to pick up in Asia. Asia is closely tied to the US dollar and effectively “imports” US monetary policy, where official interest rates are likely to remain close to zero for some time. Asia’s banking system is not broken and the increase in liquidity has fed through the system more swiftly than in the developed economies. Also, commodity prices increases, in particular food and energy, have a greater impact on Asian inflation trends.

Policy Response

The market pays intense attention to what policymakers say and do. During the most turbulent months of the credit crisis, policy response was the major driver of financial markets. By and large, it appears that central banks and governments have succeeded in preventing the global economy from sliding into a depression.

However, in their efforts to stabilise the system, policymakers undertook a host of unconventional measures including the purchase of financial assets, such as government debt and mortgage securities. This huge expansion of central banks’ balance sheets, in particular, that of the US Federal Reserve, is of concern to the market and the way in which the central banks execute their “exit strategy” will affect financial markets.

The market is also focussed on how quickly policymakers will ‘normalise’ policy interest rates, that is, raise them from the current very low levels. We expect the US Federal Reserve to start raising interest rates when the US economy is on a surer footing and risks of inflation returns. Among the indicators we are watching to monitor growth and inflation risks are the US labour market, the US housing market, capacity utilisation and the ease of obtaining credit.

But it is in China where the first major tightening of policy is, in our view, likely to come. China’s economic growth has recovered sharply and inflation risk is rising, and the first steps of tightening could be as early as the first half of 2010.

Currencies

Many factors affect the currency markets. Interest rates usually play a large role in influencing currency moves. As the global economy recovers, the currencies whose central banks are likely to raise interest rates first, in particular the Australian dollar and the Norwegian Krone, have been steadily appreciating. Currency moves like these are driven by cyclical factors.

Currencies are also driven by structural considerations. The global financial crisis and the aggressive response of the US policymakers have created a medium-term problem for the US dollar. During the crisis months, the US dollar was supported because investors sought liquidity and safety. With the return of a more stable environment, investors will be more focused on the deteriorating US fundamentals, in particular the expanding US fiscal deficit.



ASSET ALLOCATION IN UOBAM

Most G10 governments have announced large fiscal spending programmes to support their economies and in the coming few years, most of their fiscal positions will deteriorate as a result. The reason why the US dollar is more vulnerable is because of the greater dependence⁹ of the US on foreign investors to finance the government debt.

We believe that the reserve status of the US dollar will protect it from collapse but the possibility of high volatility in currency markets cannot be ruled out. Confidence in a currency can be undermined if policymakers, intentionally or unintentionally, display neglect for the value of their currency. We believe that one way to hedge against currency uncertainty is to have some exposure to gold and gold equities.

Valuation of Markets

Financial markets move extremely rapidly and as a result, what investors expect in the future quickly become reflected in prices. Markets, however, also have a tendency to 'overshoot' and because of this, we often see markets either pricing too optimistic or too bleak a scenario. This is how we get both bubbles and distressed markets.

Equity valuations at the beginning of March 2009 were at extremely depressed levels and reflected expectations of a deep, prolonged economic slump similar to the 1930s Great Depression. After the rebound of equity markets in the second and third quarters, valuations have become consistent with a more 'normal' recession. Equities are now no longer

'cheap' but valuations are reasonable on a historical price-to-book measure and also on mid-cycle price-to-earnings considerations and in our view, valuations as we enter the final quarter of 2009 are not a constraint to equity markets continuing their advance.

Financial Market Indicators

We also look within the financial markets themselves when forming our asset allocation decisions. Matters such as the shape of the yield curve, credit spreads, volatility indices are all indicative of underlying investor risk appetite and expectations. The VIX¹⁰ volatility index for example, reached as high as 80¹¹ after the Lehman episode and remained elevated all through the crisis months. The VIX finally fell below 30 in the middle of May and this, for us, was a positive signal. The sharp improvement in corporate bond markets in recent months has been another signal to us to continue to maintain our higher exposure to the riskier asset classes.

Quantitative Model

Our asset allocation decisions are primarily driven by qualitative evaluations. In addition, we employ a quantitative model which provides an independent set of asset allocation signals. Quantitative techniques use mathematical models to determine relationships between key indicators and the movement in financial markets. Quantitative models can have powerful predictive abilities although historical relationships break down from time to time because the underlying structure of the global economy and financial markets is evolving continuously.



The Asset Allocation Unit is headed by **Mr. Anthony Raza, Director.**

Tony started out as a Financial Analyst in Chase Manhattan Bank (New York) and came to Singapore in 1996 as Regional Bank Analyst at Daiwa Securities. In 2001, he moved to DBS as Vice President (Corporate Planning) and was involved in capital management, financial projects and investor relations. In 2004, he joined Merrill Lynch Singapore as Head of Research, covering the Singapore market. Tony joined UOBAM in 2008. Apart from formulating macro strategies for UOBAM, Tony also manages equity and fixed income portfolios.

⁹ Source: Morgan Stanley FX Pulse, 7 May 2009

¹⁰ Note: VIX refers to the Chicago Board of Exchange Volatility index, and measures the implied volatility of equity markets

¹¹ Source: Bloomberg 16 September, June 2009



ASSET ALLOCATION IN UOBAM

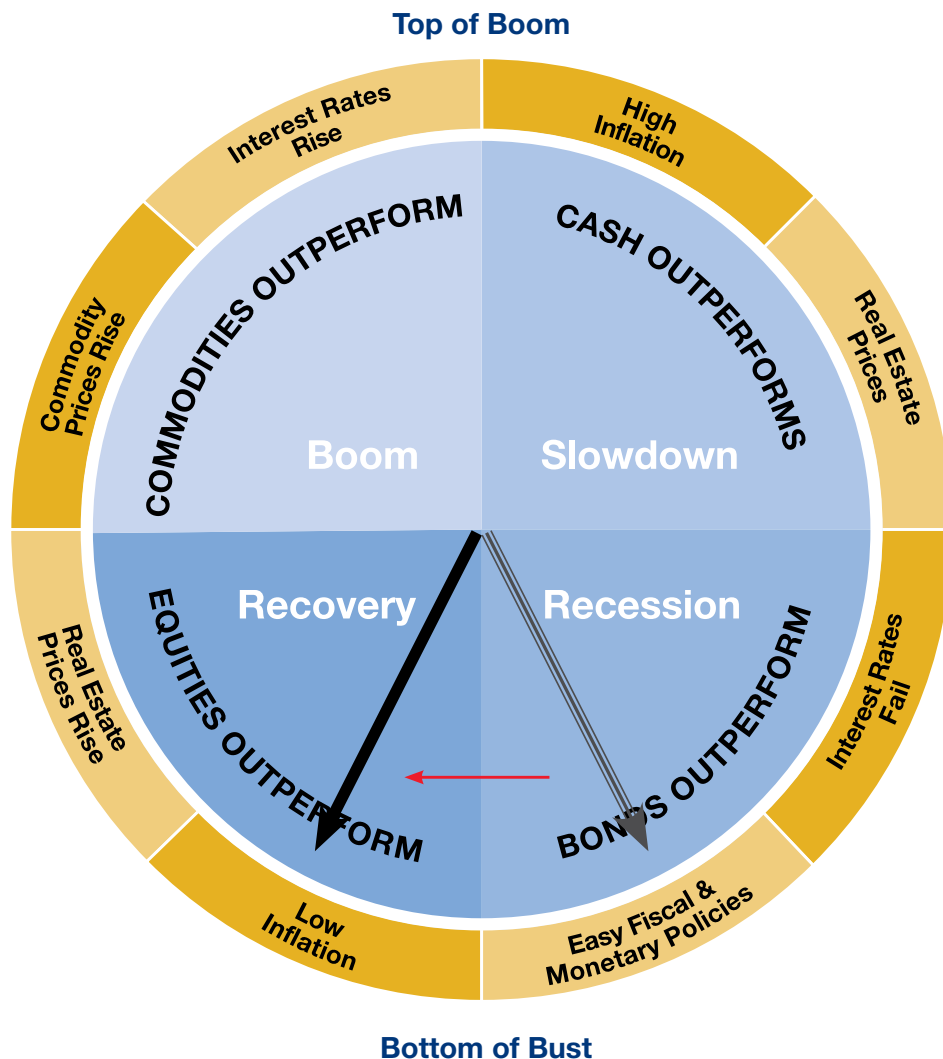
What Time Is It?

The UOBAM Investment Clock encapsulates the way we view the asset allocation cycle. We believe the investment hand has moved past six and we are in the recovery phase. In this phase, we expect equities to outperform government bonds. Although commodities historically outperform only in

the latter stages of the cycle, the increased importance of China in this cycle appears to be pulling forward the timeline of commodities.

We have an overweight position in equities and commodities, and an underweight position in bonds.

UOBAM Investment Clock



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