



Market Commentary

May 2010

GLOBAL EQUITY

EQUITIES	1 Mth	3 Mth	YTD	12 Mth
MSCI AC World	-2.0	4.7	0.1	26.5
MSCI World	-2.2	4.4	0.1	24.4
MSCI USA	-0.6	7.8	3.9	26.1
MSCI Europe	-5.1	-1.8	-7.7	20.0
MSCI Japan	-2.2	2.3	3.7	15.0
MSCI AC Asia ex-Japan	-0.2	6.9	0.4	37.5
MSCI Emerging Markets	-1.1	6.6	0.6	42.7

Returns in Singapore dollars. Source: Bloomberg, 30 April 2010

World equity markets were flat in April, with the MSCI AC World Index unchanged in US dollar terms. Asian and Emerging Markets registered further gains, building on their early recovery. Part of the gain was also due to the appreciation of Emerging Market currencies. The US continued to charge along and has overtaken Japan as the best performing region on a year to date basis. European markets declined sharply in late April as concerns about Greece's ability to re-finance its debt weighed on equity markets. The Euro Stoxx 50 Index fell by nearly 4% in Euro terms, and by almost 6% in US dollar terms, with the weakening Euro exacerbating the performance in dollar terms. The Euro declined from the 1.35 to the dollar level to end the month at 1.33. It has dipped below the 1.28 level as we write.

While economic indicators continue to point to a broadening recovery, the Greek situation and concerns about China have added to risk perception and triggered a pull-back in equity markets. We believe the Greek situation is containable, and should not result in further contagion. However, markets will likely react to developments in Greece with the focus shifting to the country's progress in reigning in its deficit.

A backdrop of more rapid fiscal adjustments could represent a strong headwind to the cyclical recovery. This is of particular concern in the UK and the Euro-zone.





Elections in the UK and Germany are further adding market concerns. As we write it appears that the UK will likely transition to a Conservative Government in coalition with the Liberal Democrats. In Germany, the Merkel's centre right alliance has lost its majority in the Upper House following the North Rhine Westphalia elections. We are hopeful that neither has the makings of a Greek tragedy.

Also adding to uncertainty is the lack of clarity around financial reform legislation in the US. Draft legislation is working its way through the House and Senate in the US, and while reform is clearly needed, concerns stem from the fact that existing bills have been pasted together in a somewhat piecemeal manner and do not adequately address the issue of how to best contain systemic risk. Adding to the uncertainty is the highly public drama of the CEO of Goldman Sachs and the former senior executives of Bear Stearns and Lehman Brothers being pulled in front of Congress to testify on issues of conflict of interest and governance breakdown. Unfortunately the questions and testimony have fallen well short of helping to shed light on how to best address the regulatory challenges still in front of policy makers.

The good news is that economic indicators in the US and Europe continue to improve. The recovery will hopefully enable Governments to more decisively address their fiscal challenges. Clearly this is the single greatest concerns of investors and taxpayers.

We had earlier written of overheating challenges in the Emerging world. And although part of the inflation numbers were being driven by food & energy (non-core prices), India and Brazil have already started to raise policy rates to address this challenge. In China, policy has also tightened dramatically in response to a pick up in exports, a seemingly out of control property market and excessive fixed asset investment.

OUTLOOK AND STRATEGY

	Policy	Change	Comment
US	Overweight	–	The US economy has bottomed and there are strong signs that the industrial recovery is broadening out. The housing market appears to be stable as does the job market. Having moved aggressively to manage costs during the downturn, the US corporate sector is poised to benefit from the gradual recovery in final demand. The US appears to be the first-in/first-out (FIFO) of the Developed Markets. Relative valuations vs. growth prompt us to stay Overweight.
Europe	Underweight	–	Leading indicators in Europe have rebounded sharply, but fiscal headwinds may constrain growth. Consensus estimates for Euro-zone growth continue to be reduced. Despite the fact that European valuations are amongst the cheapest in the world, structural concerns prompt us to stay Underweight.



Asia (ex-Japan)	Overweight	–	Growth in Asia has rebounded. However, China’s decision to tighten monetary conditions in the face of a weaker than normal global recovery added confusion to the equation, and highlighted the inflation risk that may surface across a number of economies. This has prompted us to adopt a more defensive stance, focused more on stable growth sectors.
Japan	Underweight	–	Although the Japanese yen had a bout of strength in April as volatility spiked, the medium term pressure on the yen is likely to be downward as the yen appears once again to become the funding currency of carry trades. A weaker yen should help the export sectors, the key driver of Japanese growth. The bad news is that corporate profitability has to recover a long way to warrant meaningful capital allocation. We are slightly Underweight.
Latin America	Overweight	–	Latin America has recovered strongly due to buoyant domestic demand. There are some near term risk due to higher inflation. However, this should not derail the region’s rebound. The region continues to offer strong long term investment opportunities for equity investors. We retain our Overweight position.

In the developed world, although growth is steadily gathering pace financial risks are building, leaving the recovery more susceptible to a confidence shock. We will need to monitor fiscal developments across a large number of countries closely in the ensuing months. Extended debt levels are expected to constrain both consumer and public sector spending. We are hopeful that the private sector will take the baton from Governments. The UK and the Euro-zone face potentially the sharpest near term adjustment due to a combination of political pressures and market imposed discipline. This will leave the developed world close to the cusp of asset price deflation, the key risk of 2010.

In contrast the emerging world faces overheating pressures. Having put into place highly stimulative monetary and fiscal conditions in 2009, many countries are implementing exit strategies now. China is probably the most at risk of policy missteps given the extensive period of unchecked credit growth and fixed asset investment. Recent policies have been designed to remedy this risk, although the outcome will only become clear in time. While the longer term prospects for Emerging Markets remain favorable, expectations of further tightening measures will likely constrain near term performance. We continue to focus our investment strategies on structural growth opportunities in Emerging Markets.

While 2010 continues to look to be a favorable environment for corporate profits, macro factors have the potential to de-rail what should be a strong footing for markets. We are less concerned about inflation risk and the need to raise rates than about a potential growth shock due to fiscal imbalances, public disorder and a second collapse in consumer demand. While valuations still suggest further upside for equities, the fiscal consolidation process poses new challenges.



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