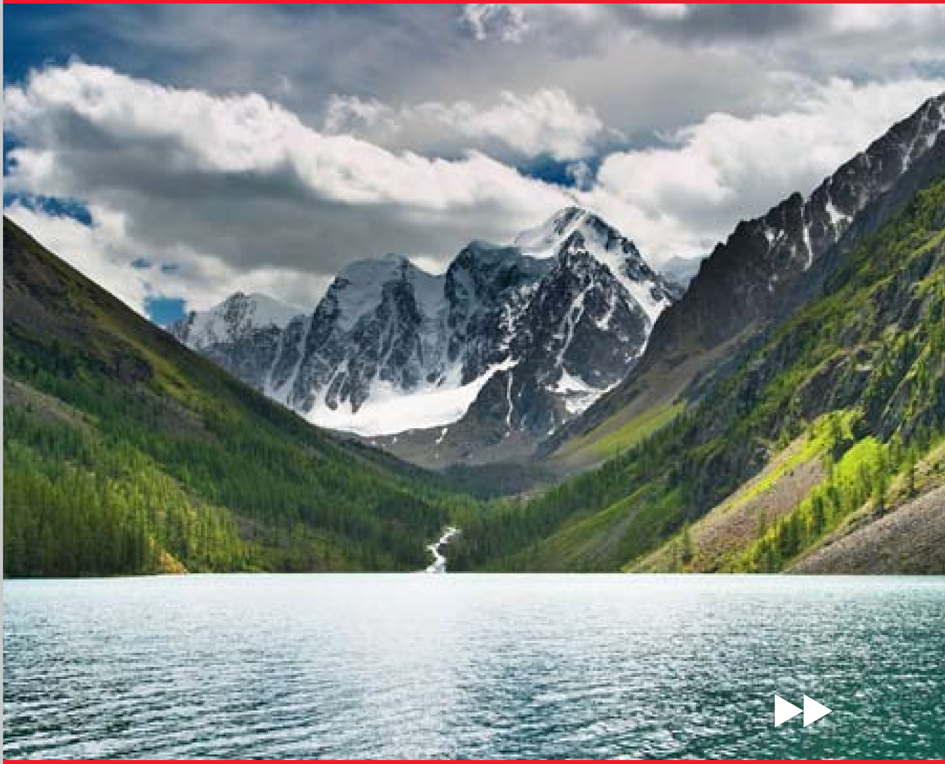
QUARTERLY INVESTMENT STRATEGY

Third 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

CONTENT

CIO MESSAGE

The rally in equity markets in the second quarter took many investors by surprise. The steep decline in equity prices following the Lehman bankruptcy filing had more or less wiped out the entire gains of the previous bull market and investor sentiment was almost universally bearish.

The rebound of equity markets from their lows in March was initially the covering of short positions by traders but the rally steadily broadened, and went on to gain overall strength. Although more investors participated in the rally over the weeks of April and May, a large amount of funds remained on the sidelines.

There are several reasons why many investors have hesitated to return to the market. Apart from the normal pessimism a bear market engenders, it is the second time this decade that we have had equity prices declining by more than 50%, the previous instance being the Internet bubble crash. Experiencing wealth destruction back-to-back not surprisingly left investors feeling more than usually cautious about re-entering the equity markets. In the US, one key class of investors is the baby boomers. This particular group of investors is now entering retirement and they are likely to have adjusted their levels of risk tolerance to a more conservative one.

The nature of the crisis has also left many investors in doubt about the recovery of the US and European economies and the outlook for corporate profits. As investors in Asia remember only too well, the years after a banking crisis are long and painful ones. While there are few doubts that growth in the US and European economies will be muted for some time, the nature of global growth has been evolving and this new cycle is likely to be different from the previous one.

In 2001, the GDP of Emerging Markets was 62%, the size of US GDP. Over the decade, Emerging Markets have overtaken the US and their combined GDP is now 115% of the US and this figure should continue to rise. Although Emerging Markets depend significantly on exporting to the US, their own domestic economy is also growing. An increasing proportion of the Emerging Markets population is crossing the income threshold where discretionary spending develops and mass consumption takes off. Emerging Markets therefore have reasonable potential to take over as the driver of the next economic cycle.

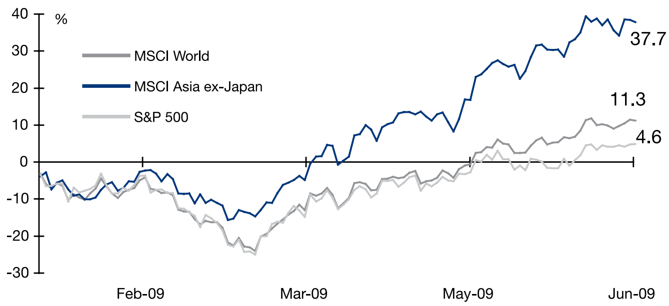
Among Emerging Markets, there is one added consideration for asset markets in Asia. Unlike Latin America and Eastern Europe, Asia is largely a US dollar bloc. Roughly, this means that if interest rates in the US are low, they are also likely to be low in Asia. This, when combined with the fact that Asia has a very high savings rate and its banking system is healthy, translates into the creation of a very large amount of liquidity in Asia. And a high likelihood of a reflation in asset prices. Property markets in Asia have already been stirring and Asian equity markets have clearly outperformed the developed markets so far this year.

Equity markets have had an uninterrupted rally for most of the second quarter and appears to be consolidating the gains as we enter the third quarter. However, we believe that the recovery in the equity markets is a genuine, sustainable one and in this issue of Quarterly Investment Strategy we explain why we think this is so. We also describe our investment strategy for the period ahead. We expect Asia to outperform, for both cyclical and structural reasons. There are risks too, of course, and we highlight them. The tremendous amount of monetary and fiscal stimulus that has been injected into the system will create a new set of issues for markets to grapple with and the path ahead will have rocky moments. But we believe that the worst of the credit crisis is behind us and we expect risk appetite to continue to build.

Thio Boon Kiat, *Chief Investment Officer*

SUMMARY

MSCI World. MSCI Asia ex-Japan and S&P 500



Source: Bloomberg, 16 June 2009

Risk appetite continues to improve and the equity market rally appears sustainable.
The upturn in global leading indicators, the improvement in credit markets and the reduction in uncertainty in the US banking sector have all contributed to a notable recovery in risk appetite. The meaningful fall in volatility to pre-Lehman levels is also likely to encourage more participation in the equity market. A mountain of cash, earning very low interest in money markets and deposits, stands waiting to be deployed.

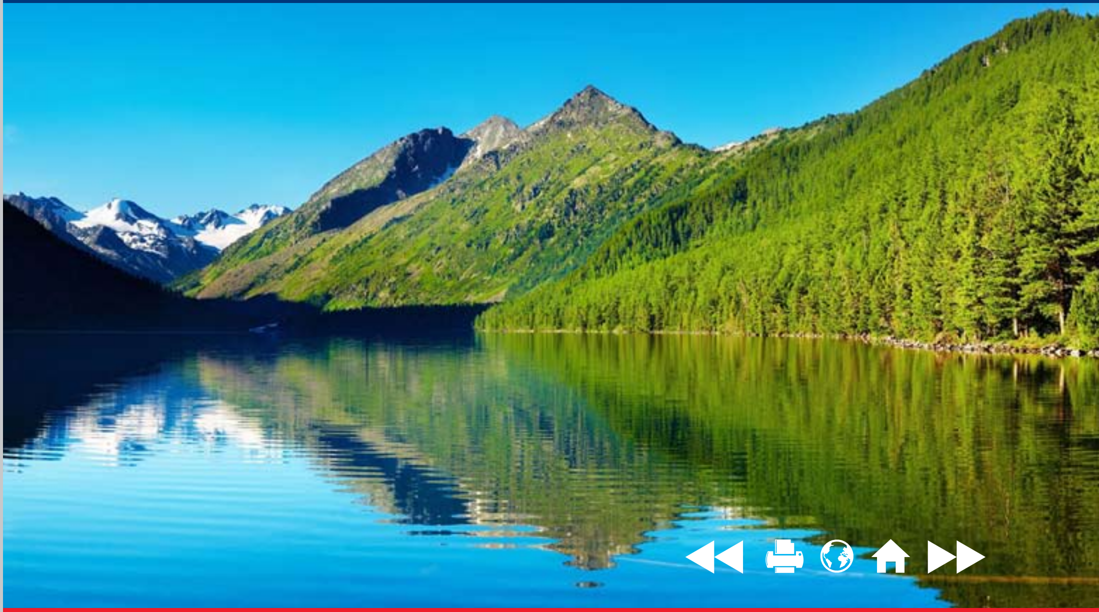
Lack of confirmation of an improvement in final demand and a further back up in bond yields are near-term risks.
The rebound in economic activity has been led by the rebuilding of inventories and the market still needs confirmation that final demand is also picking up. Although bond yields have risen, they are probably still not at levels which would jeopardise the economic recovery or derail the equity rally. A rise of 10-year US Treasuries yields above 5% would be worrying.

Volatility in the US dollar is another risk.
One consequence of the return of risk appetite is the renewed weakness in the US dollar. The US fiscal deficit is the largest among G10 economies and the US is also more dependent on foreign financing for its government debt compared to other major developed economies. The US dollar's reserve status should help protect it from collapse but high volatility in currency markets is nonetheless a risk.

We have moved to an overweight position in Equities and Commodities and are underweight in Bonds.
In Equities, we continue to favour Emerging Markets as they are showing clear signs of decoupling from the Developed Markets. Within the Developed Markets, we have an overweight position in the US and an underweight one in Europe and Japan. In Bonds, we continue to prefer Investment Grade bonds. In Commodities, we stay overweight in Gold and also Energy.

UOB Asset Management 大華資產管理

INVESTMENT OUTLOOK AND ASSET ALLOCATION



Global equity markets are finally showing signs of a sustainable recovery. Following the extraordinary events triggered by the Lehman bankruptcy filing, financial markets had moved to price in an economic scenario similar to the 1930s Great Depression. In the past few months, however, there has been a firm upturn of leading economic indicators, a concomitant sharp improvement in credit markets and also a reduction of uncertainty over the US banking sector. The result has been a marked return of risk appetite and a strong rally in equity, credit and commodity markets.

During the long crisis months, the market was focussed on the response of the policymakers – the speed at which monetary policy was eased, the size of fiscal programmes and the efforts to stabilise the banking sector. In the months ahead, the market is likely to pay increased attention to economic data, seeking confirmation that the global economy is healing and will return to positive growth in 2010. The unprecedented degree of policy action that has been undertaken is, however, also likely to create another set of problems down the road and markets, being forward-looking, are already beginning to grapple with them.

Key Developments

1. Upturn in global leading economic indicators

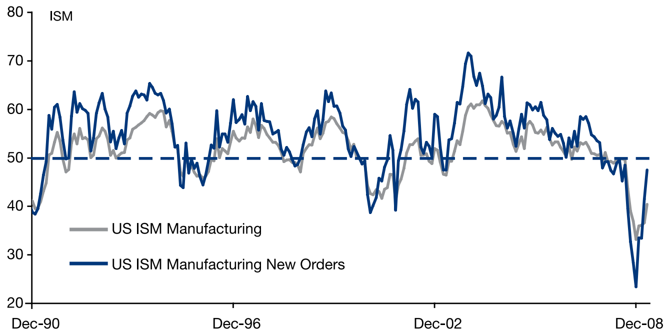
The bankruptcy filing of Lehman Brothers in September 2008 and the ensuing crisis on Wall Street precipitated a severe collapse in global business and consumer confidence. The shock and the unusual degree of uncertainty led to an abrupt reining in of corporate and household spending with the result that the global economy, which was already weak at that point, plunged into a deep recession. Financial markets went into a tailspin and equities suffered one of their worst bear markets ever, with many key equity indices, including the S&P 500, TOPIX and DJ Euro Stoxx 50, breaking their 2002/3[1] lows. Although Emerging Markets also corrected steeply, MSCI Asia ex-Japan and the broader MSCI Emerging Markets however managed to hold above their 2003 lows.

The aggressive response of policymakers in slashing interest rates, embarking on “quantitative easing” and announcing huge fiscal spending programmes has stabilised the system, and one by one, global leading economic indicators have turned. The main indicator of business confidence are the purchasing managers’ surveys, with the barometer of the global economy being the US Institute of Supply Management (ISM) purchasing managers’ index, in particular its New Orders component.

The ISM New Orders index reached a historical low of 28 in December 2008 but since then has steadily risen. The ISM survey is based on a diffusion index and readings below 50 indicate contraction. The New Orders index leads the overall ISM index and the New Orders hit 51.1 in May.

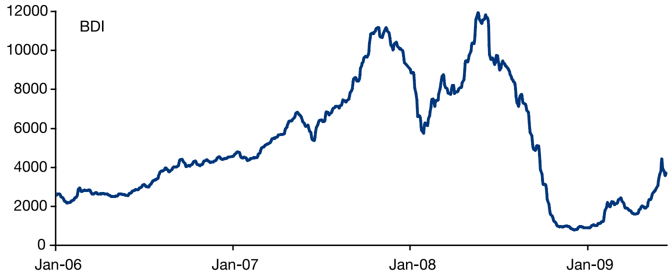
[1] Source: Source: Bloomberg, 10 June 2009. All data cited from Bloomberg, unless otherwise stated.

ISM Manufacturing Index and ISM New Orders Index



Source: Bloomberg, 16 June 2009

Baltic Dry Index



Source: Bloomberg, 16 June 2009

Another signal that the global economy is stabilising is the rise in commodity prices, in particular, those of industrial metals and oil prices whose demand and supply fundamentals are fairly closely tied to real economic activity. Year-to-date, copper spot prices have risen 77%[2] while the price of oil, as measured by West Texas Intermediate, a standard grade of crude, has crossed US$70/barrel.

As many commodities, including oil and copper, are actively traded by financial markets, and are, in addition, also acquired for the purpose of stock-piling inventories, their prices are not wholly reflective of real immediate economic demand. An indicator that more accurately reflects the current real demand for raw materials is the Baltic Dry Index (BDI). The BDI collapsed to 663 points in December 2008, when letters of credit became difficult to obtain in the wake of the Lehman episode and trade collapsed. Letters of credit are typically required to load ships at ports. The BDI has also been recovering.

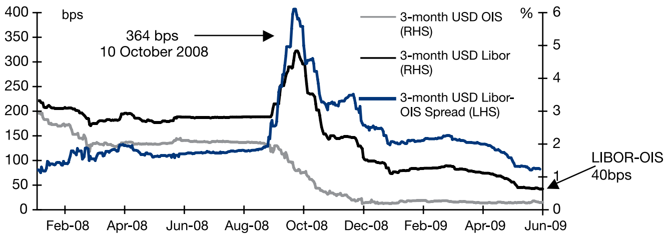
With the improvement in these and other indicators, forecasts of the US economy have also been revised up in recent weeks. Three months ago, consensus expectations[3] were for US real GDP growth to be flat, 0%, in the third quarter and to turn positive, +1.6%, only in the fourth quarter. The latest expectations are for the US economy to return to positive growth, of +0.5%, by the third quarter and to reach +2% in the fourth quarter. The figures mentioned refer to quarter-on-quarter real GDP growth on an annualised basis.

[2] Source: Bloomberg, as at 16 June 2009
[3] Source: Bloomberg, 20 March 2009, 16 June 2009

2. Improvement in credit markets

The root of the crisis is the credit market. Credit markets displayed their first signs of trouble in July 2007. As problems in the sub-prime housing market and the securitisation markets developed, banks began to hoard cash. The reluctance of banks to lend to other banks resulted in the spread between the London Interbank Offered Rates (Libor) and the Overnight Index Swaps (OIS) widening significantly. Three-month US dollar Libor is a key benchmark lending rate for the global economy as a whole range of global interest rates is priced off Libor. This distressed state of the interbank lending market continued all through 2008, and in the days following the Lehman bankruptcy filing, the three-month US dollar Libor-OIS spread surged to a high of 364bps as banks anxiously hoarded cash. The decline in Libor-OIS spreads has come in fits and starts but has now declined to a level lower than the pre-Lehman days, to 40 bps[4].

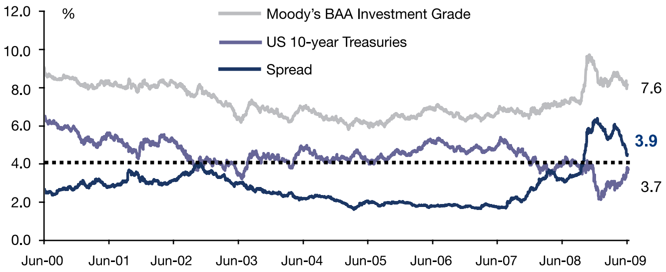
Three-month US dollar Libor-OIS spread



Source: Bloomberg, 16 June 2009

Another key credit indicator which signals that the credit crunch is abating is the difference between Moody's BAA Investment Grade Corporate Bonds and US 10-year Treasuries yields. In a normal recession, the difference will typically be no higher than 400bps but the spread climbed to over 600bps in December last year, a level which meant that businesses could only have access to funding at rates which were punitive. This spread has however also been tightening and has finally dropped below 400bps.

Investment Grade Credit Spreads



Source: Bloomberg, 16 June 2009

Another indication that credit markets are improving is the receptiveness of the market to new corporate bond issues. Anecdotally, investment managers are understood to be receiving record fund inflows. The flow of funds is likely to be coming from deposits and money markets which are earning near-zero interest rates. Despite record issuance volumes, the market for non-financials has been heavily oversubscribed, that is, demand is outstripping supply. Furthermore, despite lower new issue concessions and falling credit quality, the performance of new issues after their launch has been improving over the recent weeks[5].

[4] Source: Bloomberg, as at 15 June 2009
[5] Source: Citi European Credit Outlook, 9 June 2009

3. Reduced uncertainty over US banking sector

A key overhang for the equity market has been the uncertainty over the US banking sector. The continued losses reported by the banks and expectations of future losses had led to concerns that the US banking sector did not have enough capital and there were widespread fears of nationalisation.

The results[6] of the "stress test" for 19 of the largest US banks were released in the early part of May and were well received by the market. The loss scenarios, with an aggregate charge-off (loan loss) rate of 9% for 2009-2010, are fairly stringent. The statement from the US Federal Reserve highlighted the point that the loss assumptions are more severe than what occurred during the Great Depression. The loss rates would translate into an estimated US$2.6 trillion of total losses on US credit assets over the cycle, which is in line with the International Monetary Fund's estimate of US$2.7 trillion in its April 2009 *Global Financial Stability Report*.

The additional capital needed by the banks is also not overly onerous as the regulators appear to be exercising a degree of forbearance and are also sanguine about bank earnings in the coming 18 months. A total amount of US$75 billion new capital needs to be raised by 10 of the 19 banks by the end of 2010. Much of this has actually come relatively quickly with US banks raising US$52.7 billion[7] in new capital in the second quarter of 2009.

In June, the US Treasury also announced[8] that 10 US financial institutions would be allowed to repay a combined US$68 billion of funds that they had received under the Troubled Asset Relief Program (TARP). The US$68 billion is far higher than an earlier estimate by the US Treasury that US$25 billion[9] would be repaid this year.

In summary, the developments in the second quarter indicated to the markets that the US banking sector is stabilising and that financial repair is underway.

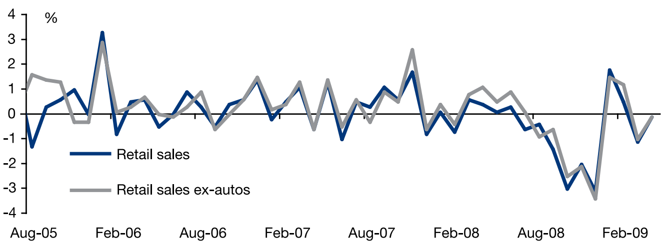
Key Issues Ahead

1. Confirmation of final demand

The plunge in economic activity after the Lehman episode was likely an extraordinary "overshoot". Overshoots by definition do not last and some rebound was to be expected. The current pick-up in industrial production is likely to be driven by a rebuilding of inventories and it is not yet clear that final demand is actually improving.

The key is US retail sales. The picture so far has been mixed. US retail sales improved in January and February this year but declined in March and April. Retail sales in May were boosted by better auto sales while non-auto sales were lifted by higher gasoline prices in the US. The underlying level of sales in May was flat, which is consistent with stabilisation. The developments in US retail sales are likely to be closely followed by the market in the coming months because this is the period when the US stimulus package is having its largest effect on household disposable incomes.

US Retail Sales



Source: Bloomberg, 12 June 2009

Closely connected to US consumer spending is the US labour market. Unemployment is a lagging indicator for the equity market but signs that businesses are not shedding jobs as sharply as before would help consumer confidence and therefore actual spending. Here, the most recent data has been fairly encouraging. "Initial jobless claims" have come off their peak of 674,000 and May non-farm payrolls surprised the market considerably, with only 345,000 job losses when the market was expecting more than 500,000 job cuts.

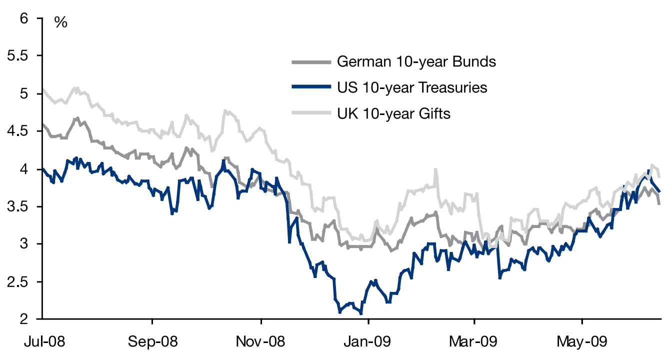
[6] Source: US Federal Reserve, The Supervisory Capital Assessment Program Results, 7 May 2009
[7] Source: Bloomberg, as at 11 June 2009
[8] Source: US Department of Treasury, 9 June 2009
[9] Source: Financial Times, 10 June 2009

2. Rise in bond yields

The improvement in equity markets has been accompanied by a sharp rise in bond yields. The backup in yields has been driven both by technical factors, as bonds were heavily overbought, and also the ongoing bounce in economic activity. Government bonds markets face medium-term headwinds from the massive supply that is forthcoming from the large G10 spending programmes and bond yields are likely to continue heading higher for the coming few years.

Bonds of longer maturities have been adjusting since the beginning of the year but pressure is now also seen at the front end of the curve, that is, in bonds of short maturity. In line with this, futures markets also expect central banks to start raising interest rates within 12 months.

Government Bond Yields



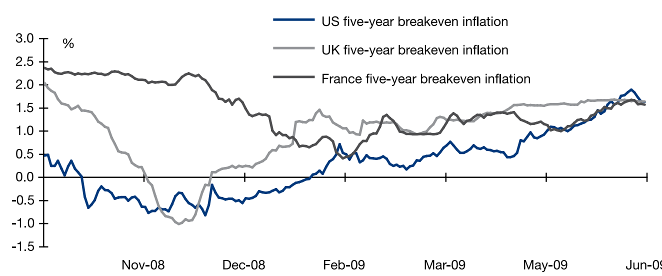
Source: Bloomberg, 16 June 2009

The near-term concern is that the backup in yields will come too quickly and jeopardise the recovery of the global economy, which is still extremely fragile. The latest rise in US government bond yields have pushed up US mortgage rates and this will slow the recovery in the housing market. Mortgage refinancing activity is also likely to be affected. Mortgage refinancing boosts household disposable incomes and supports consumer spending.

3. Return of inflation fears

Bond markets have furthermore begun to worry about inflation. In recent weeks, inflation-linked bonds have also moved higher and appear to be approaching levels that are the typical targets of the major central banks.

Five-year Inflation Breakevens



Source: Bloomberg, 16 June 2009

There are two reasons why inflation fears have returned. The first reason is the colossal amount of liquidity that central banks have pumped into the system. To the extent that banks are still shrinking their balance sheets and the "money multiplier" is still not working, inflation is not a problem today. The concern is that, when de-leveraging pressures abate, central banks will not be able to withdraw liquidity fast enough when they need to.

The second reason why the market is again worried about inflation is the unexpected rise in commodity prices, especially that of oil. As we saw in 2007 and 2008, rising food and energy prices tend to distort perceptions of inflation because these are frequently purchased goods, and a shift up in inflationary expectations could ignite a broad-based surge in inflation. The economic environment today is, however, very different from 2007 and 2008. There is a large amount of spare capacity and rising unemployment. Wage demands and pricing power today are very weak and it is unlikely that underlying inflation will rise significantly. Rising commodity prices are a greater inflation risk in emerging economies because food and energy make up a large portion of the consumer price index.

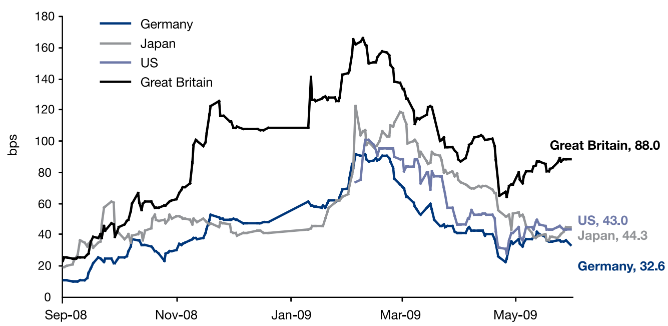
4. Volatility in the US dollar

One consequence of the general return of risk appetite has been renewed weakness of the US dollar. As the global reserve currency, the US dollar was supported during the crisis months because investors sought safety and liquidity. With a more stable environment, investors are now focussing on the deteriorating US fundamentals, in particular the large US fiscal deficit.

Although the fiscal positions of most G10 government are projected to increase significantly in the next few years, the US fiscal deficit is expected to be the largest. What makes the US dollar vulnerable is that the US is far more dependent on foreign investors funding its deficit than other countries. 56% of US government debt is held by foreign investors compared to 32% for the UK and 8%[10] for Japan. But precisely because such a large amount of US government debt is held by foreign central banks, it makes it unlikely that the latter will "refuse" to fund the US deficit because any collapse in the US dollar would reduce the value of their existing holdings of US debt.

Nevertheless, a disorderly decline in the US dollar cannot be ruled out. A currency crisis typically occurs when there is a loss of confidence by investors – they fear either that they will not be repaid or will be repaid in a currency whose value has fallen. When confidence in a currency is lost, investors dump assets of that currency and the move becomes self-fulfilling. A loss of confidence in the US dollar could potentially be triggered by a policy error or a communication gaffe. Any nervousness in the market is likely to be signalled by rising sovereign credit default swaps.

Sovereign Credit Default Swaps



Source: Bloomberg, 16 June 2009

[10] *Source: Morgan Stanley FX Pulse, 7 May 2009*

INVESTMENT OUTLOOK AND ASSET ALLOCATION

ASSESSMENT

We believe that the global economy is stabilising and that we are probably past the worst. Near term, there is still some risk that final demand may not have really recovered and economic activity dips back down again. Government spending programmes should, however, begin to kick in during the second half of 2009 and this should help support economic activity.

For now, the recent rise in bond yields appears to be consistent with the unwinding of the earlier massive flight to safety and also improving economic data. In our view, the equity market rally is not likely to be derailed until yields in US 10-year Treasuries cross 5%. At 5%, the recovery of the global economy would, in our opinion, be jeopardised. Although the futures markets have begun to price a rise in the Fed Funds target rate within 12 months, we believe the Federal Reserve will keep interest rates unchanged until jobs are actually being created again in the US labour market.

We believe core inflation is likely to be contained in the Developed Markets as the output gap is huge and labour markets today do not typically succeed in obtaining large wage increases when unemployment in rising. Oil prices heading towards US$100 would, in our view, make inflation a serious problem again in Asia. Asian central banks would have to tighten monetary policy or face currency pressures.

Looking further out, the recovery of the global economy is not likely to be "V-shaped". Credit crises tend to take longer than normal business cycles to mend and de-leveraging is a process that will stretch over several years. Growth prospects are clearly better in Emerging Markets than in the Developed Markets. This is particularly so for Asia and Latin America because their banking systems are intact. Equity markets have begun to make this differentiation and Emerging Markets have outperformed meaningfully in this latest rally. We believe this outperformance is set to continue.

ASSET ALLOCATION

	Conservative	Change from 2Q	Moderate	Change from 2Q	Growth	Change from 2Q
Equities	40%	+5%	60%	+5%	80%	+5%
Bonds	50%	-5%	30%	-5%	10%	-5%
Commodities	2.5%	+2.5%	7.5%	+2.5%	7.5%	+2.5%
Cash instruments	7.5%	-2.5%	2.5%	-2.5%	2.5%	-2.5%

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

INVESTMENT OUTLOOK AND ASSET ALLOCATION

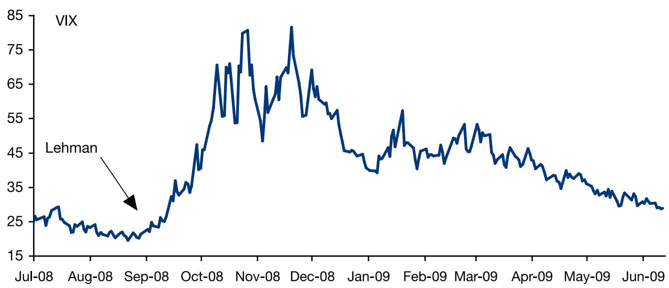
Move to Overweight position in Equities

We have shifted our position in Equities to overweight. We believe this latest equity rally is different from the previous rallies that we have seen since the bear market started, as this rally is backed by a turning up of economic indicators, improvements in the credit markets and a stabilisation of the US banking sector. There are also some modest signs of stabilisation in the US housing market.

Equity market volatility has furthermore fallen to levels which will allow for a sustainable advance in equities. The Chicago Board Options Exchange volatility index, as known as VIX, has fallen below the pre-Lehman level of 30. The very high volatility in the months following the Lehman episode had kept many investors on the sidelines; and there is a mountain of cash in money markets or bank deposits, earning extremely low interest rates and is waiting to be deployed to higher risk asset classes.

In sum, we believe this equity rally can be extended.

VIX Volatility Index



Source: Bloomberg, 16 June 2009

We continue to hold an overweight position in Emerging Markets, still preferring Asia ex-Japan and Latin America to Eastern Europe. Fundamentally, in our view, Asia's growth prospects continue to be among the best in the world and we believe that Asian equity markets will be kept buoyant by the liquidity conditions as much of Asia's money supply is closely connected to US monetary conditions. Latin America's trade exposure to the world is limited and the region continues to benefit from strong domestic demand.

Within the Developed Markets, we keep our overweight position in the US. The US Federal Reserve is likely to keep monetary policy accommodative for some time and fiscal policy under the Obama administration is also likely to be aggressive, which should stabilise demand. We stay underweight in Europe. Also European markets appear attractively valued; for us this is not enough to mitigate the growing risk to earnings. We see significant need for de-leveraging across many of the largest financial institutions in Europe, which will exert a drag on growth. We are also still cautious on Japan. Japanese corporate sector profits are under pressure particularly among the sectors that are more exposed to discretionary consumer spending.

Asset Allocation	3Q 2009 Recommendation	Benchmark
Equities	**60%**	**55%**
US	45.9%	43.9%
Europe	25.2%	27.2%
Asia ex-Japan	8.9%	7.9%
Japan	7.7%	9.7%
Australia	1.8%	2.8%
Canada	3.9%	3.9%
Latin America	6.5%	2.5%
Others	0.1%	2.2%

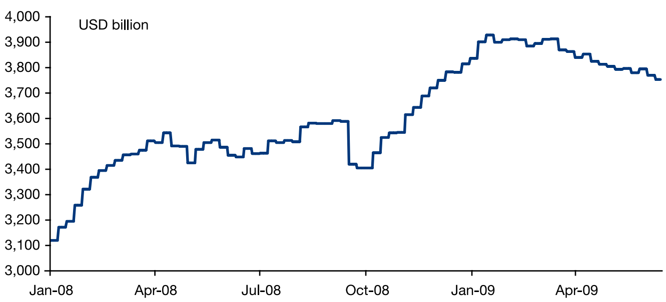
INVESTMENT OUTLOOK AND ASSET ALLOCATION

Move to Underweight position in Bonds

We further reduce our position in **Government** bonds. We have been scaling back our position in Government bonds since the start of 2009 as we felt that Government bonds were expensive and also faced headwinds because of the forthcoming increase in supply. The recovery in risk appetite in recent weeks and the improvement in economic data have only continued to put further pressure on government bond markets.

Our largest position continues to be in **Investment Grade** bonds. Although spreads have tightened, we believe that they can continue to tighten further as Investment Grade bonds were the most distressed asset class of the crisis. Demand for Investment Grade bonds is also likely to match or even exceed supply in the next few months as funds are reallocated out of money markets and Government bonds. We had held nothing in **High Yield** bonds in the earlier part of the year but we now hold benchmark weight. High Yield bonds are likely to continue to be more volatile than Investment Grade bonds.

US Money Market Funds



Source: Bloomberg, 16 June 2009

In the **Asia Fixed Income** market, we continue to maintain our focus on new issues and Investment Grade corporates. We believe Asia's Investment Grade BBB-rated names offer better value compared to US BBB-rated Industrials. We continue to see the opportunity for Asia's Investment Grade corporates to benefit from the rally in Developed Markets and BBB-rated names give the best concessions in credit spreads. We also see opportunities in the laggards in the "callable" bank space. We are more constructive on Korean banks as the easing in external liquidity condition in the banking system has removed a fundamental concern.

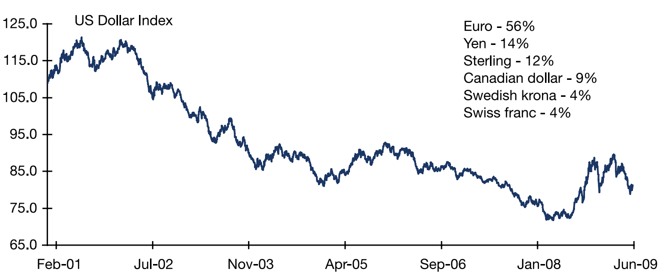
We have turned cautious on **Singapore Government Securities** (SGS). We are likely to be in the first leg of the SGS sell-off and there is risk of more pressure if oil prices continue to rise and inflationary expectations surge. We expect the 10-year SGS yield to exceed 3.0% and prefer shorter maturity bonds. On the Singapore corporate front, we like the short-dated bonds, ranging from two to five years, due to the increasing swap spreads in an environment of rising yields. We are biased towards the two-year space, as it has the widest swap spreads and hence gives us a higher all-in yield.

Asset Allocation	3Q 2009 Recommendation	Benchmark
Fixed Income	**30%**	**35%**
Government	40%	60%
Investment Grade	55%	35%
High Yield	5%	5%
US	30%	40%
Europe	30%	25%
Asia/EM	35%	30%
Japan	5%	5%

Move to Overweight position in Commodities

We shift from a neutral to an overweight position in Commodities. We reduce our overweight position in **Gold** slightly. We believe that gold will continue to be sought for its safe haven status and the main driver of the gold price in the coming months is likely to be the renewed weakness of the US dollar. The total amount of gold held in Exchange Traded Funds has meanwhile hit a new record high[11].

US Dollar Index



Source: Bloomberg, 16 June 2009

We move to a slight overweight position on **Energy**. Although the global economy is still in a recession, a weak US dollar, improving sentiment on the outlook for the global economy and asset allocation flows are likely to keep upward pressure on oil prices. The longer term supply picture for oil also continues to be one of tightness. The replacement cost of crude is estimated to be between US$60 and US$80[12] and this is likely to keep prices supported.

We lift our exposure to **Base Metals**, although still maintaining an overall underweight position. The sector has benefited from a more upbeat assessment of the global economy and from Chinese buying. But for recent gains to be sustained, we would likely need to see Chinese buying continuing. Some seasonal slowdown factors are also beginning to appear and there has been a deceleration in the decline in inventories at the London Metal Exchange.

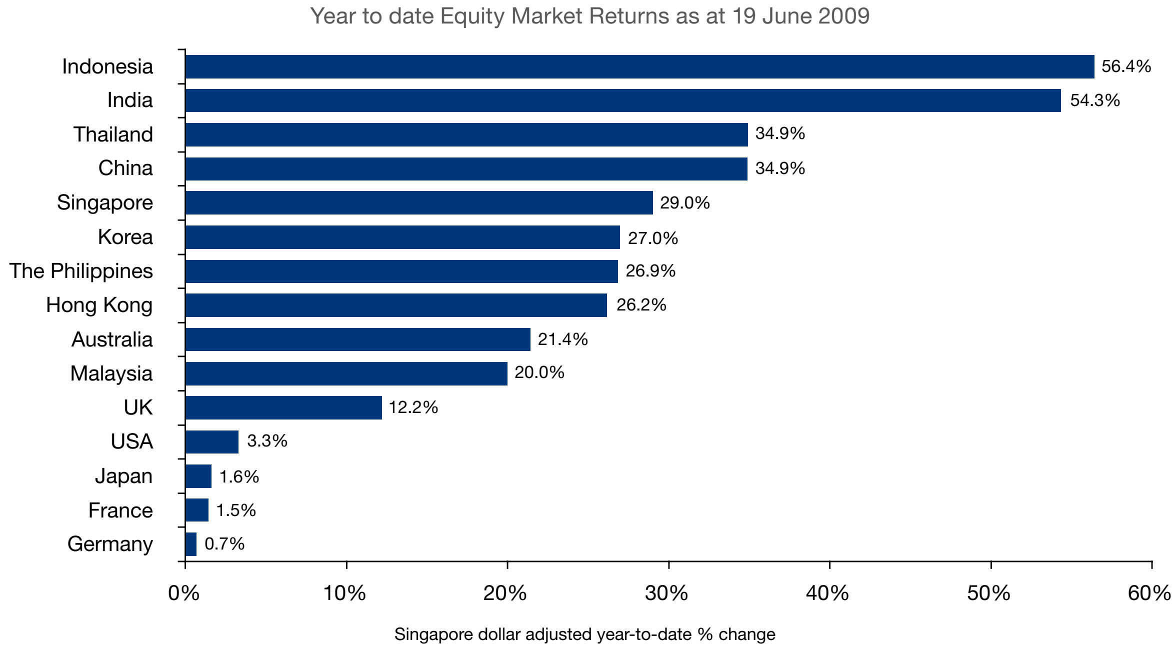
We have a slight overweight position in **Agriculture**. We see upside risk for grain prices, especially corn prices. The summer months are typically weak for corn prices but we believe that corn prices could rally this summer as the acreage report in the US is likely to show that US corn plantings have been revised lower. Inventories for soy beans are also tight given the drought in Argentina and strong Chinese import demand.

Asset Allocation	3Q 2009 Recommendation	Benchmark
Commodities	**7.5%**	**5%**
Gold	30%	25%
Base Metals	15%	20%
Agriculture	22.5%	20%
Energy	37.5%	35%

[11] Source: Deutsche Bank, Commodities Weekly, 5 June 2009
[12] Source: Deutsche Bank, Commodities Weekly, 29 May 2009

GLOBAL EQUITY STRATEGY

Market Returns



Source: Bloomberg, 22 June 2009

US

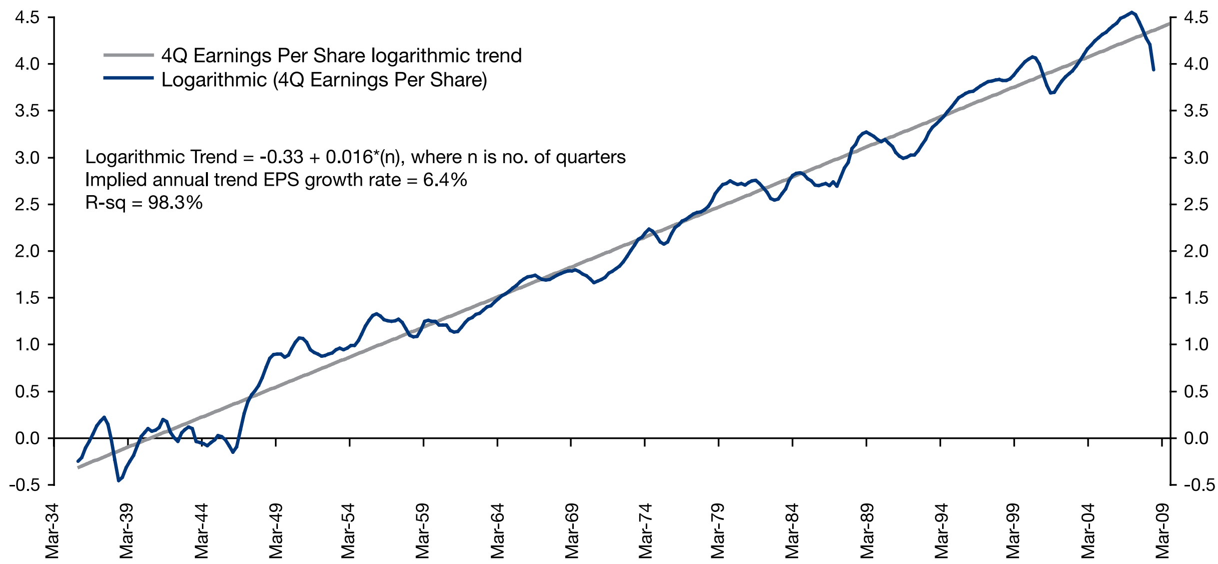
Earnings Outlook

In the recently concluded first quarter reporting season, aggregate earnings fell 36% on a year-on-year basis. The consensus estimates for S&P 500 earnings growth for the full year of 2009 is running at -9.6% but the market is looking beyond 2009 and focussing on the earnings growth in 2010. Our expectations are for S&P 500 earnings to rise 25% in 2010 with the increases coming from lower credit costs, higher oil prices and the rebuilding of inventories.

Although US GDP growth is expected to be fairly modest in 2010, some of the highest earnings growth years have come from the periods when GDP growth was actually relatively weak. The collapse of profits in the current recession has set a low base for next year's earnings. Going back to 1948, a GDP growth rate of 2-3% can come with earnings growth anywhere between -15% and +35%.

Looking back, the trend of long run earnings growth is a stable one, at 6.4% a year, since the mid 1930s, much more stable than GDP growth. One reason why earnings are more stable than GDP growth in recent years has been the rising proportion of S&P 500 earnings coming from faster-growing Emerging Markets.

US Earnings Trend since the 1930s



Source: Deutsche Bank, 5 June 2009

Valuation

One consideration for investors is whether equity multiples will be lower after the financial crisis, that is, whether the risk premia will be higher. Historically, financial crises have tended to be associated with trough multiples rather than with a de-rating in the aftermath of the crisis. In this episode, the multiple has been behaving as it has in the past. The historical Price-Earnings (P/E) multiple has fallen from 21.0x in 2004 to 9.9x during the March low and has now recovered and appears to be anticipating a recovery.

GLOBAL EQUITY STRATEGY

Strategy

We have positioned our portfolios for recovery. We favour cyclicals over defensive names. In the Consumer space, we are increasing our weights in Consumer Discretionary over Consumer Staples and we favour the early cycle discretionary stocks such as retailers (**Amazon.com, TJX**) and media (**Comcast**).

In Basic Materials, we have moved from a defensive position to an overweight one. We are adding the copper and gold producer **Freeport-McMoRan** and also a diversified agricultural company **Monsanto**. We are also overweight in Industrials. We have increased exposure to companies which are expected to benefit from the US stimulus programme, a large part of which will be in infrastructure spending.

We have a small overweight position in Financials. Our newest addition is **NYSE Exchange**. The company is attractively valued in relation to the medium-term revenue and profit prospects and is also a dominant global exchange. In Energy, we have a neutral position. We favour the oil services space which was deeply oversold in the first quarter. Our preferred companies here include **Schlumberger**. We have a neutral position in Technology and an underweight one in Healthcare and Utilities.

MODEL PORTFOLIO

SECTOR	WEIGHT	TOP PICKS
Consumer Staples	Underweight	Colgate-Palmolive
Consumer Discretionary	Overweight	McDonald's, TJX Cos., Amazon
Energy	Neutral	Occidental Petroleum
Financials	Overweight	US Bancorp, State Street
Healthcare	Underweight	Johnson & Johnson, Teva Pharmaceuticals
Industrials	Overweight	Flowserve, Emerson
Information Technology	Neutral	Microsoft
Materials	Overweight	Potash Corp, Goldcorp, Freeport-McMoRan
Telecom Services	Neutral	AT&T
Utilities	Underweight	Exelon

EUROPE

Earnings Outlook

Earnings momentum improved again in May, representing the third consecutive month of improvement. Although downgrades have continued, they have been at a slower pace. Consensus earnings growth expectation for 2009 is at -16.4% (as at May 2009) bringing the peak-to-trough earnings fall close to 40% compared with our own estimate of -50%. On the other hand, the 2010 earnings have been revised upwards from +11.9% in February 2009 to +18.9% in May 2009. Traditionally, earnings tend to bottom two months after the market bottoms. Therefore, assuming that March 2009 represented the trough, this would imply that the second quarter of 2009 is likely to be the bottom for earnings. We have estimated that 2009 earnings will fall by 20% and expected 2010 earnings to rise by 10%, which brings a cumulative peak-to-trough earnings fall of 50%.

Valuation

According to our proprietary Dividend Discount Model, the European market fair value for the MSCI Europe Index is 1368.1, thus offering an 11% upside. We have lowered our market-implied equity risk premium to 6% given falling risk aversion globally. Our risk-free rate remains at 4% and the five-year prospective earnings compounded annual growth rate also stays at 3%. Using the mid-cycle P/E approach, which is typically used as a fair value measure at trough-of-earnings cycle, the market has a 17% upside potential. Additionally, bond yields are still lower than the European market dividend yield which continues to favour equities over bonds. In the final analysis, the European market continues to offer value despite the recent rally.

Europe: Relative Valuations By Sector

	Price Earnings Multiple (x)			% Premium/(Discount) to MSCI Europe		
					Historical Mean	
	2008	2009	2010	2009	5-year	10-year
Consumer Discretionary	11.15	19.67	13.13	59.9	7.0	0.0
Consumer Staples	13.25	13.23	12.00	7.6	33.0	16.0
Energy	6.32	11.78	9.24	(4.2)	(13.0)	(10.0)
Healthcare	10.98	10.40	9.66	(15.5)	(16.0)	(17.0)
Materials	6.77	16.50	12.44	34.1	38.0	31.0
Utilities	9.81	10.46	9.85	(15.0)	15.0	4.0
Financials	15.87	12.14	9.73	(1.3)	48.0	54.0
Information Technology	11.83	21.55	13.63	75.2	(2.0)	(7.0)
Telecom Services	8.32	8.93	8.43	(27.4)	(1.0)	17.0
Industrials	10.88	13.60	12.55	10.6	10.6	(6.0)
MSCI EUROPE	9.92	12.30	10.34	0.0	0.0	0.0

Source: Bloomberg and UBS, 9 June 2009

GLOBAL EQUITY STRATEGY

Strategy

Despite continued macro-economic headwinds, as financial crisis related recessions tend to be deep and long, Europe should see increasing evidence that both economic and earnings risks have lessened somewhat. However, the MSCI Europe Index is likely to remain range-bound until there are more concrete signs of a turnaround. Accordingly, there must be continued recovery in the leading indicators like the Purchasing Managers Index and Economic Sentiment indicators for the market to continue to rally.

Against this backdrop of recovering fundamentals and increasing risk appetite, we have increased our cyclical exposure (Basic Materials and Industrials) but have not completely reversed our positions in Defensives (Consumer Staples) as valuations there have become increasingly compelling in some cases. Financial conditions in Europe remain fragile and balance sheet retrenchment is still sizeable, all of which warrant some caution in our optimism. For example, sovereign risk is high especially in Eastern Europe with Latvia now showing signs of deep financial stress. In particular, this is reflected in our unchanged underweight stance for Financials. Meanwhile, we have upgraded our underweight rating for Consumer Discretionary to neutral. Although it is a cyclical sector, valuations in the sector are no longer cheap, while longer term headwinds of consumer balance sheet de-leveraging and rising unemployment will take time to play out fully. We also have an underweight position in Utilities, Healthcare and Telecom Services.

MODEL PORTFOLIO

SECTOR	WEIGHT	TOP PICKS
Basic Materials	Overweight	K&S
Industrials	Overweight	ABB
Financials	Underweight	HSBC
Energy	Neutral	Royal Dutch Shell
Telecom Services	Underweight	KPN
Consumer*	Neutral	Compass Group
Utilities	Underweight	EDF
Healthcare	Underweight	Roche
Technology	Overweight	Nokia

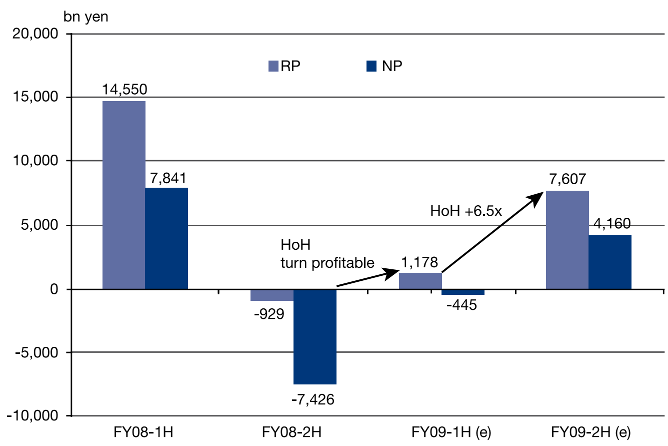
* Overweight Consumer Staples and Underweight Consumer Discretionary

JAPAN

Earnings Outlook

4QFY08 (January–March 2009) results for all sectors showed that sales fell 23.9% year-on-year, and losses were incurred at the operating, recurring and net levels. The main factors behind the sharp earnings deterioration were the strong yen, higher material costs, valuation losses and the sharp plunge in end-demand. The management of listed companies guided for a smaller aggregate net loss in 1HFY09, followed by an earnings turnaround in 2H09. This suggests that the worst may be over for Japan's corporate profits.

Japan company forecasts



Source: Company data, Credit Suisse, 18 May 2009

Valuation

The market is expensive on a price-earnings ratio (P/E) basis, but inexpensive on a price-to-book (P/B) basis. The P/E multiple for FY09 is 39.8x. On the market book-value-per-share of ¥778 as at end-FY08, Japan's P/B ratio of 1.2x is at a sharp discount to the historical average of 1.8x.

Strategy

Several major economic leading indicators show that the recession in Japan may have bottomed. The earnings revision momentum index has also turned positive. In light of the improved economic and profit outlook, we have increased our weighting of the cyclical sectors at the expense of defensives. Our preferred sectors include Industrials, Energy, Real Estate, and Consumer Discretionary. We have reduced Consumer Staples, and Info-Communications to a neutral position. We also have a neutral position on Pharmaceuticals, Materials, Banks and Technology, and an underweight position in Utilities.

GLOBAL EQUITY STRATEGY

MODEL PORTFOLIO		
SECTOR	**WEIGHT**	**TOP PICKS**
Autos	Underweight	Toyota, Daihatsu
Real Estate	Overweight	Mitsubishi Estate
Financials	Neutral	MUFG, SMFG
Materials	Neutral	Shin-Etsu Chemical, Kao
Technology	Neutral	Nissha Printing
Industrials	Overweight	Mitsui & Co, Kubota
Healthcare	Neutral	Tsumura
Consumer Staples	Neutral	Toyo Suisan, Unicharm
Retail	Overweight	Sundrug, Yamada Denki
InfoComm	Neutral	NTT
Utilities	Underweight	Tokyo Gas

ASIA EX-JAPAN

Outlook & Strategy

Globally synchronised rate cuts and liquidity injections, the positive market response to G-20 meetings and the much touted US stress tests appear to have improved risk appetite and overall credit conditions. The recent GDP data releases affirm that the economies in China, Indonesia, Korea and Taiwan bottomed in the last quarter of 2008. The economies of Singapore, Malaysia and Thailand are also likely to have bottomed since then.

We view that liquidity conditions could continue to keep equity markets buoyant for the near term. However, the risk is that corporate earnings for the second quarter could disappoint. Over the medium to longer term, the concern is that inflation returns before growth has yet to normalise. The authorities may then have to restrain fiscal and monetary expansion.

While valuations for Asia ex-Japan stocks are now off their trough levels, there is still some upside as Asia ex-Japan markets are trading at 1.7x P/B compared to a 15-year historical average of 1.8x. Valuations on mid-cycle P/E ratio still look attractive, and Asian markets could trade back to historical average or above despite the slow global growth given evidence of incremental decoupling by the region.

We favour the asset reflation trades that will benefit from increased liquidity. Hence we raise our position in Financials and Real Estate to overweight. We also maintain our overweight position in the Consumer sector as demand remains resilient, for instance in China. We have also raised our weighting in Energy, Industrials and Materials to neutral as these sectors would benefit from a recovery in the economy and also from the various fiscal stimulus programmes. We have trimmed our positions in the defensive sectors like Telecom and Utilities. We keep our underweight position in Technology as we are unconvinced that the final sell-through will materialise.

Consumer Sector – We are overweight in the Consumer sector, maintaining exposure to the Chinese consumer discretionary space. Recent data especially in China has shown a pick up in activities (for example in auto sales and property transactions) indicating that consumer sentiment is improving. There could be a recovery in consumer spending in the second half of 2009 as the effects of the government stimulus package finally trickles down to consumers.

Industrial – We raise our position in the Industrial sector to neutral as this sector will be a beneficiary of the recovery in the economy and the various fiscal stimulus programmes. We favour companies that are positioned to benefit from China's infrastructure spending and resilient domestic demand such as transport companies and toll roads.

Conglomerate – We have an overweight position in the Conglomerates and favour companies which would benefit from the recovery of the global economy such as port operators and the offshore and marine companies.

Financials – We raise our weight in Financials to overweight as asset reflation and the high liquidity environment should benefit banks, exchanges and insurers. We believe that most of the capital raising among Asian banks is now over, and the focus has moved to growth. Asset quality deterioration and muted loan growth have already been priced in and earnings may surprise on the upside if asset quality deterioration is not as bad as feared.

Real Estate – We are positive on the Property sector as being the clearest beneficiary of lower interest rates. Transaction volumes in Asia including China have improved and anecdotal evidence suggests that prices in China are firming. Higher liquidity and historical low interest rates should be supportive of the property market.

GLOBAL EQUITY STRATEGY

Technology – We maintain our underweight stance in the Technology sector given that weakness in demand from the US and Europe will weigh on the sector. While there are signs of inventory restocking giving support to demand currently, there is no firm evidence that this is translating to final end-user demand. Moreover, current utilisation rates are still at very low levels. Hence, the current rally in technology stocks could prove to be temporary if final demand does not come through.

Telecom Services – We reduce the Telecom sector to an underweight position as we view the sector to be relatively defensive with little near-term catalysts. We continue to adopt a barbell strategy with stock selection based on: 1) sustainable attractive dividend yield and the potential for capital restructuring, 2) earnings growth, especially in countries where the mobile penetration rate is still low and rural expansion is ongoing, 3) strong balance sheets, particularly those in net cash position and 4) benign regulatory regimes.

Materials – We raise the Materials sector to neutral weight as the underlying demand and supply fundamentals seem supportive of the price run-ups we have seen. We view that prices of certain materials such as copper have been supported by buying from the Chinese government but that this could soon cease. We favour the fertiliser stocks as government policy towards developing the agricultural sector will boost farmers' income and this supports the increasing use of fertilisers over the longer term.

Energy – Our exposure to the Energy sector is a neutral one as the valuations of many energy companies have overshot and do not offer attractive risk-adjusted returns. We prefer the exploration and production oil plays to the integrated plays on the view that oil prices are likely to be supported given production cuts by the Organisation of Petroleum Exporting Countries and the overall tight supply in the industry.

Utilities – We have a neutral weight in the Utilities sector as we view the earnings profile of utilities stocks as relatively resilient and we view that contraction in electricity demand has bottomed on the back of recovery in global economy. The earnings of independent power producers in China and Malaysia are expected to improve significantly off a low base with the decline in domestic coal prices and interest rate cuts.

MODEL PORTFOLIO

SECTOR	WEIGHT	TOP PICKS
Consumer	Overweight	Geely Auto, Anta Sports
Industrials	Neutral	Zhejiang Expressway
Conglomerates	Overweight	Beijing Enterprises
Financials	Overweight	China Construction Bank, DBS
Property	Overweight	China Overseas Land, Sun Hung Kai
Technology	Underweight	TSMC, Hon Hai
Telecoms	Underweight	PT Telkom, Chunghwa Telecom
Materials	Neutral	Shandong Chenming Paper, China Bluechem
Energy	Neutral	Sinopec, Straits Asia Resources
Utilities	Neutral	Tenaga

SINGAPORE

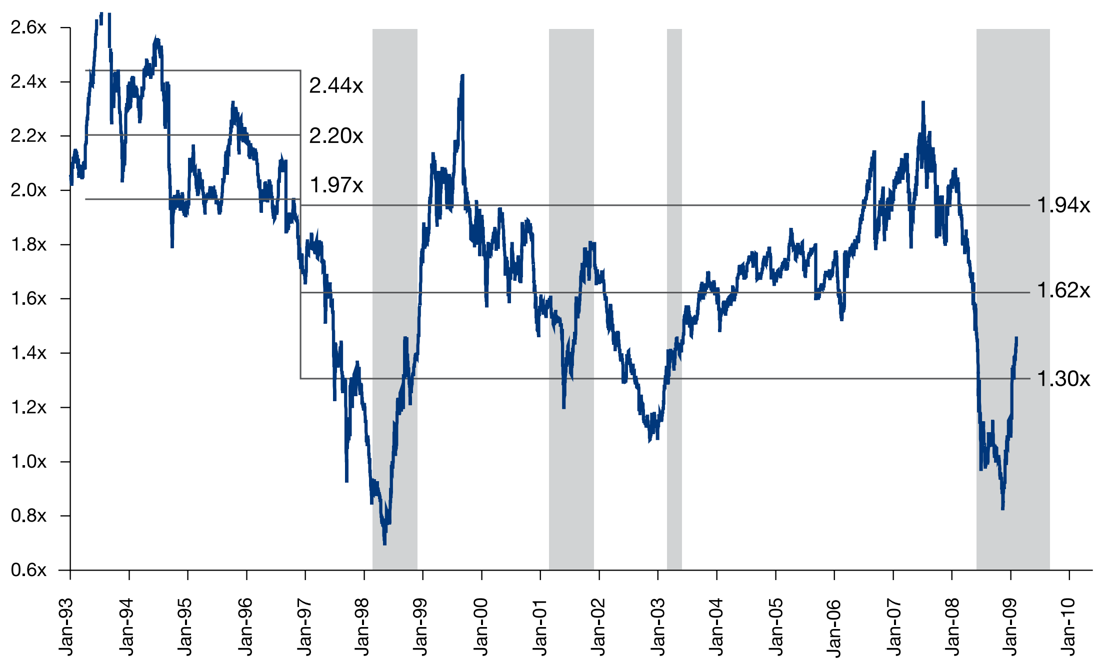
Earnings Outlook

The 12-month forward market earnings growth forecast is at minus 25% year-on-year. While certainly weak, at least it has stopped getting worse, and we have seen a mild reduction in the rate of contraction. There was a small uptick in earnings estimates following the first quarter reporting season. It is uncertain at this stage whether the earnings trend has indeed turned up convincingly given the still weak global economy.

Valuation

Following the sharp rebound from the March lows, the market is now trading at 16.5x 12-month forward P/E and 1.46x 12-month trailing P/B. By these measures the market is no longer considered very cheap as the market has already exceeded the long-term P/E mean although it is still below the long-term P/B mean of 1.76x. At this stage of the economic cycle, we believe a more appropriate measure is the P/B.

FSSTI 12-month Trailing Price-Book Value



Source: Citigroup, 1 June 2009

GLOBAL EQUITY STRATEGY

Strategy

It is possible that an FSSTI target of around 2,870 can be reached if the market reverts to the long-term P/B. The average increase 12 months from a market bottom in the past four recessions has been about 88%. However, because of the steep 60% increase since the market bottom, we believe the risk of a correction has increased. The market appears to have gone way ahead of economic fundamentals in the short-term although strong liquidity conditions could still push it higher. We reduce our overweight position to a neutral one for the coming three months. We continue to position our portfolios in financially sound names which can emerge stronger from this crisis.

Similar to past recessions, the Financials and Property sectors have again 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 property REITs. We continue to have an overweight position in the banks although less so given the sharp rebound in the past three months.

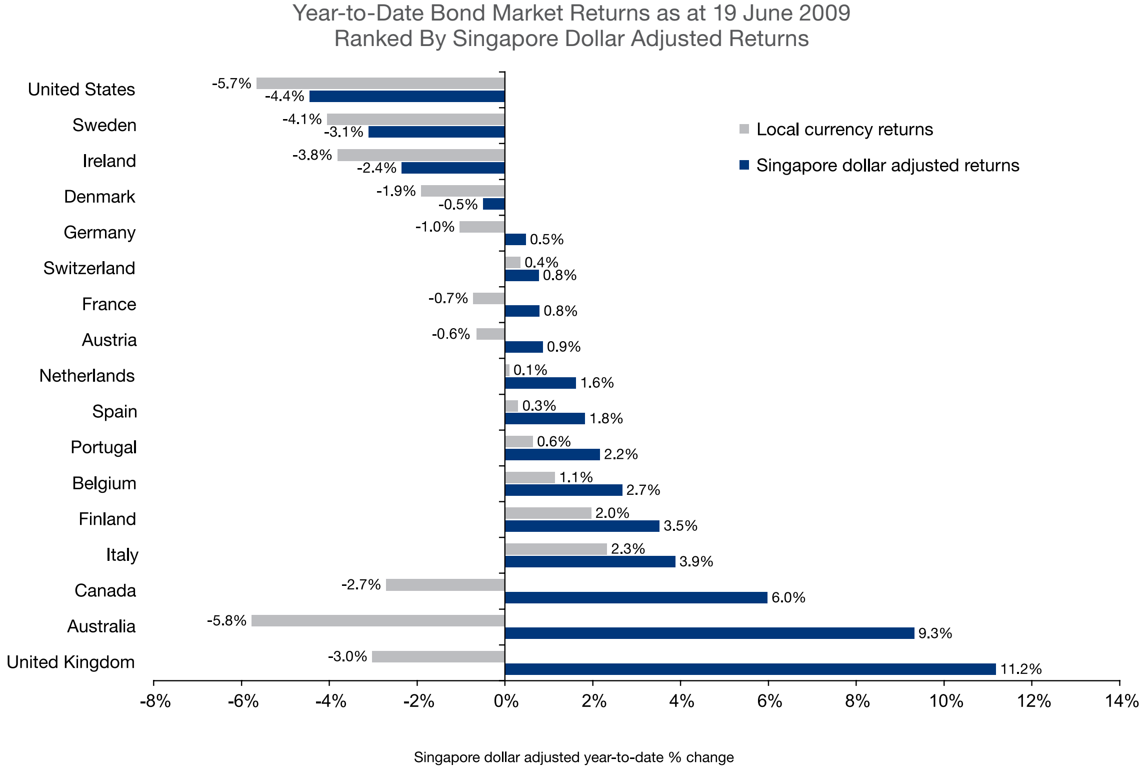
We maintain our underweight position in the Industrial sector due to our cautious view on the transport sector but we still favour the capital goods sector. The Telecommunications sector stays as a slight underweight position.

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

Bond Market Returns



Source: Bloomberg, 22 June 2009

G-10 FIXED INCOME

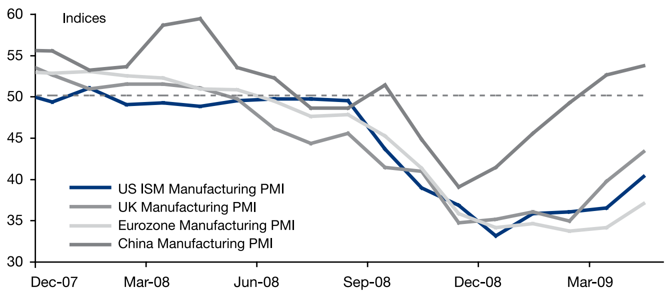
Outlook and Strategy

Recent incoming economic data has improved sharply compared to the extreme weakness seen in the last quarter of 2008. The worst possible outcome of an economic depression has probably been avoided with the aggressive monetary and fiscal measures undertaken by policymakers around the world. With the improvement in economic indicators, equity markets have also rebounded sharply since March. A number of commodity prices, including copper and oil, have also experienced sharp price gains.

The current consensus outlook is that the unusually sharp contraction in global economic growth last year and the ongoing process of de-leveraging will likely mean that it will be some time before global economic growth returns to its trend levels. Coupled with the destruction of wealth and demise of many iconic companies, the appetite to take risk and consume will be muted. The likely feeble economic recovery will mean a moderate rise in future inflation and central banks will likely be able to effect the reversal of the current extreme low interest rates in their stride.

GLOBAL FIXED INCOME STRATEGY

Purchasing Managers' Indices



Source: Bloomberg, 16 June 2009

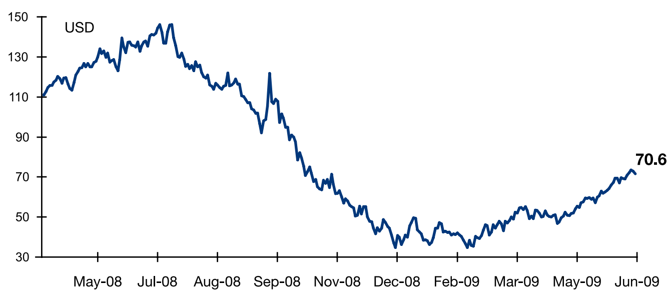
However, there are a few risks to this inflation outlook.

If the pace of economic recovery quickens, the risk to inflation will then clearly be biased upwards. Central banks will therefore have to move to reverse the extremely low interest rate and plentiful liquidity environment. This can be accomplished by removing the various liquidity programmes or simply by raising official interest rates. A change in the stance of the central banks, in their speeches and monetary policy deliberations, away from easy monetary policy, would signal to the debt market that higher interest rates are coming. However, the debt market could interpret the change in stance as being reactive rather than proactive, especially when coupled with the likelihood that central banks are likely to err on the side of caution in tightening monetary policy in order to secure a sustainable economic recovery.

Another concern of the government debt market relates to the large holdings of financial assets held by the various central banks as part of increasing market liquidity during the economic and financial crisis. Buyers need to be found for these assets but whether there is sufficient demand to absorb the official holdings is unclear. Recent government bond auctions have revealed that buyers desire lower duration assets, as short as below a year in duration. Both scenarios could result in a rise in market interest rates, hurting overall debt market performance.

The recent sharp rebound in the oil price, despite the nascent improvement in the economic backdrop, will be an inflation concern if global growth should pick up in a more robust manner. Energy-driven inflation will feed through intermediate input prices and manifest itself in final product prices. As energy and food prices are significant components in the computation of consumer price baskets, this will likely mean that such price rises would flow through fairly quickly into headline inflation calculations, regardless of the current growth environment. Whether the rise in oil price is speculative or otherwise, the upward trend in energy prices is a threat to both the growth outlook and also the future inflation outlook.

West Texas Intermediate Oil Price



Source: Bloomberg, 16 June 2009

There is additional upside risk to the inflation outlook if the US dollar weakens. A continued recovery of risk appetite is likely to result in a weaker US dollar and this would increase US import costs and also commodity prices in general. A sudden depreciation in the US dollar would only quicken the pace of inflation.

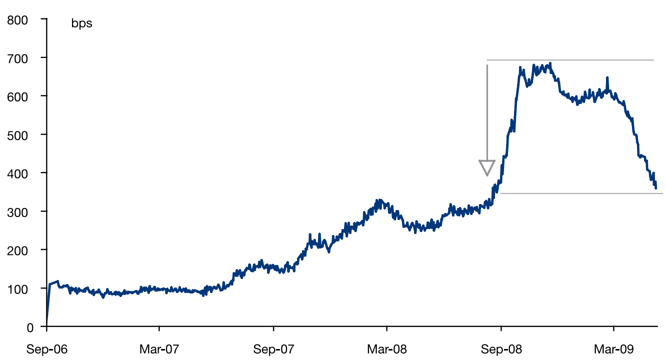
We are cautious on Government bonds. With the worst of the economic and financial crisis likely to be over, debt markets will increasingly focus on the future growth and inflation outlook. Short-dated fixed income investments will be preferred over long duration assets. We are increasing our investments in short-dated debt, especially in currencies which will benefit from an environment of higher commodity prices, such as Australia. We are also tilting towards more floating rate securities, which are likely to benefit in a rising interest rate environment.

ASIA FIXED INCOME

Second Quarter Review

The uninterrupted rally in the Asia credit spreads for the first five months of this year was stunning. The rate of recovery has surpassed most investors' expectations and it would almost seem as though the severe sell-off after the bankruptcy filing of Lehman Brothers never occurred. The near 100% retracement in Investment Grade credit spreads back to the pre-Lehman crisis level leads to the question of how much more tightening in Investment Grade spreads can we see from here.

JACI Investment Grade Spreads

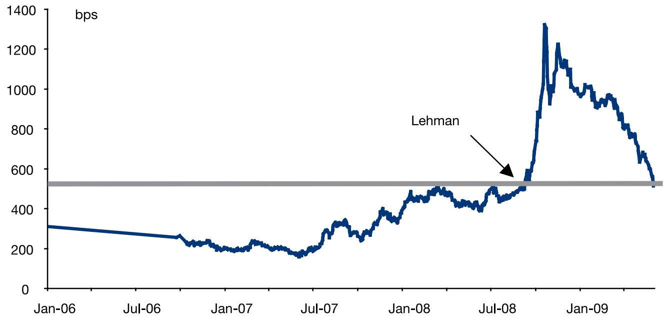


Source: Bloomberg, 5 June 2009

First and foremost, what has changed over this period of rally versus the financial meltdown in the last quarter of 2008? We note, from a credit perspective, the ability of companies to refinance and borrow has improved tremendously with the stronger equity and debt markets. Year-to-date, about US$20.4 billion of Asia bonds have been issued, which is remarkable given that in 2008, the total issuance was US$10.55 billion. The market looks to be on target to revert to the normalised annual issuance of US$35-40 billion per year. But have the economic fundamentals improved so much that we are "out of the woods" and are back to pre-crisis levels? The market seems ready to brush off any bad news, with General Motors's bankruptcy filing hardly making the headlines, leaving us to wonder if market expectations have not surged too high.

In the High Yield space, Asia credit spreads have also snapped back sharply, primarily driven by debt buybacks as borrowers have been successful in raising funds from alternative sources including local markets, existing banking relationships, equity placements and smaller club-sized bond transactions outside of the public arena. The list includes Berlian Laju Tankers, Chartered Semiconductors, Noble Group, China Greentown, Hynix Semiconductor, Shimao Property and Sino-Forest. The sharp rally has led to some higher quality High Yield names being bid up from a price of 40 to around 90. We are now back to the second half 2008 levels when the corporate default rates were not expected to rise above 10%. We therefore feel that bonds in this space are fairly valued and even expensive. Standard and Poor's is forecasting a default rate of 14.3% by April 2010 for speculative grade credits. The market has largely ignored the weak economic fundamentals depicting a difficult business environment and we fear that prices may have overshot.

JACI HIGH Yield Credit Spreads



Source: Bloomberg, 5 June 2009

Strategy

Against this backdrop, we continue to maintain our focus in new issues, Investment Grade corporate and laggards in the callable bank space.

In the bank space, there are a number of callable bonds that have not been re-priced to their call dates after the scare on extension risks triggered by Deutsche Bank's decision not to call their subordinated debt in December 2008. This decision was replicated in Asia, by Woori Bank, in March 2009. Woori Bank has since announced an exchange for its US$400 million subordinated debt maturing in 2014 in an effort to make amends to investors for not calling back their debt, and overall there is pressure on Korean banks to call back their bonds. This has resulted in a recovery in the prices for Korea hybrid bonds as well. Essentially, we are more constructive on Korean banks as the easing in external liquidity conditions in the banking system has removed a fundamental concern. We like Korea Exchange Bank in particular. The bank is an acquisition target and could potentially benefit from a merger with a stronger sponsor.

We believe that, in the Investment Grade curve, BBB-rated names offer better value compared to US BBB-rated Industrials. We continue to see the opportunity for Asia's Investment Grade corporate to benefit from the rally in developed markets and BBB-rated names given the best concessions in credit spreads.

GLOBAL FIXED INCOME STRATEGY

SECTOR	CREDIT OUTLOOK
Banks	• While Asian banks are unlikely to face any systemic problems, we still have to cope with a global recession in 2009. • Investors remain cautious as asset recovery will take some time and contraction in economic activity will mean weakening asset quality. • 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 in Investment Grade bank bonds.
Industrials	• Fundamentals and credit profile deteriorating and more downside stress to credit profile in view of macro uncertainties can be expected. • We are negative on export-oriented and cyclical industries such as semiconductors and shipping, which face margins pressures, weak cash flows, forex losses, tight liquidity and thus refinancing pressures. • Corporate governance and credit specific issues have created headline risks, causing the underperformance of the sector. • Also cautious on companies with huge capital expenditure and aggressive expansion plans that may add pressure to their credit profile, especially so with high yield companies. • Stay defensive in high grade names (BBB and above) with strong balance sheets and cash flows generation capabilities.
Property	• The Chinese government has relaxed some measures to help boost the property market but the economic outlook remains uncertain. • Buyers are adopting a “wait and see” approach, waiting for prices to fall further or for the economy to stabilise and recover. • Tight funding conditions and the global credit crunch have led to banks being cautious in lending to the sector as a whole, to the developers as well as to buyers. • Weak liquidity buffers, shrinking cash balance, corporate governance and scandals have led to underperformance and downgrade risks. • Cautious on Hong Kong companies expanding in China aggressively, prices, volumes and rentals are declining in Hong Kong as well. • Prefer Hong Kong companies with strong credit profile, that is, those with strong balance sheets and recurring cash flows to weather the economic downturn.
Oil & Gas	• With oil prices possibly having bottomed out in the fourth quarter of 2008, we think the worst is over for the oil and gas sector and we expect the upstream exploration and production companies to benefit more than the downstream refineries from any uptick in oil prices due to the latter’s exposure to still weak refining margins. • We continue to remain negative on downstream refining & marketing companies on compression in margins as a result of supply headwinds and declining demand. • However, we note that: 1) supply risks are abating, as more projects are delayed, 2) inventory losses peaked in the fourth quarter after oil prices bottomed out, 3) working capital requirements and short-term debt should decline going forward, leading to improvements in cash flows and gearing levels and 4) ratings of refineries have already been put on negative outlook. • Hence, while we continue to retain a negative outlook on weaker refining margins, we think much of the headwind for the sector has been removed. • We prefer companies with: 1) high complexity ratio 2) government ownership for ratings protection and better access to capital and 3) low leverage/capital expenditure.
Utilities	• We continue to expect a slowdown in electricity consumption to be a key trend for the sector in the coming quarter. • With oil prices hitting a bottom, much of the operational pressures for utilities without a pass-through pricing mechanism have been alleviated. • However, we continue to favour utilities that: 1) possess sound balance sheet strength, 2) government ownership – less refinancing risks, particularly as debt funding costs remain at relatively escalated levels and 3) stable regulation with automatic pass-through pricing mechanism.
Consumer	• Slowing macro economic backdrop puts pressure on consumer discretionary spending. • We still prefer companies with a higher proportion of necessities (such as food and household goods) in their product mix due to the low price elasticity of food and essentials.
Telecommunication	• We note an easing of competitive pressures across wireless sectors in Indonesia and Korea as the uncertain demand outlook deter telecom operators from engaging in expensive price wars. • We think the key overhang for the sector rests on the award of licences to operate nationwide high speed networks in Singapore, Australia and Malaysia. This would result primarily in: 1) an increase in capital spending as the companies will use debt to fund the construction of such networks and 2) the operating profiles of these telecom operators being affected and may also change the competitive landscape as the regulators determine the range of products these operators can offer. That said, this remains a medium- term issue and is one of which we remain vigilant. • We prefer telecom operators with good franchises, sound cash flow and low debt.

SINGAPORE FIXED INCOME

Second Quarter Review

Singapore economy contracted 10.1% year-on-year in the first quarter of 2009, down from -4.2% year-on-year in the fourth quarter of 2008. This is the worst quarterly GDP performance since quarterly GDP statistics began to be compiled in 1975. Weak manufacturing and services performances were the key reasons for the dismal GDP performance. The manufacturing industry shrank 26% year-on-year and services contracted 5.2% year-on-year while construction grew 24.4% year-on-year. We expect Singapore's GDP contraction to moderate to around -3% to -5% year-on-year in the second half of 2009 versus around -8% year-on-year in the first half of 2009. For 2009, we continue to expect GDP to fall 6.5% while the government's official GDP growth forecast, which was announced in the second week of January 2009, is -2% to -5%.

However, there are tantalising signs that the economy is bottoming and the year-on-year GDP contraction could moderate in the second half of 2009. The US ISM New Orders index, which is a good indicator of global demand and a six-month leading indicator of Singapore's exports, improved to 51.1 in May from 47.2 in April. This suggests that Singapore's exports could return to flat-to-slightly positive growth in the fourth quarter of 2009 from -26% year-on-year in the first quarter this year. Singapore's Purchasing Managers Index (PMI) New Orders index also improved in May, rising to 51.2 in May from 49.2 in April. The Electronics PMI rose above 50 for the second consecutive month, rising to 52.9 in May from 51.6 in April.

The Monetary Authority of Singapore (MAS) released its latest Monetary Policy Statement on 14 April 2009. The MAS announced that they were centering the Singapore dollar's Nominal Effective Exchange Rate downwards, with the mid-band being shifted down to the prevailing policy band. This represents a 1.3% devaluation of the Singapore dollar. Despite this devaluation, the Singapore dollar has stayed resilient and has actually appreciated 3.5% against the US dollar since then. At 1.45, the Singapore dollar's Nominal Effective Exchange Rate is currently trading at 0.9% above the policy mid-band. With global risk aversion receding and economic contraction likely to moderate going forward, we no longer expect the Singapore dollar to weaken beyond 1.50. In our view, the Singapore dollar is likely to trade within the 1.44-1.48 range, against the US dollar, in the third quarter of 2009.

Outlook and Strategy

US Treasuries (UST) continued to sell off in the second quarter of 2009 on the back of rising supply concerns and the improving macro outlook, with yields rising 50bps to 126bps in the 1-30 year tenors. With 10-year USTs rising a massive 122bps and two-year USTs rising 50bps, the 2-10 spread widened by 72bps to 2.57%.

The Singapore Government Securities (SGS) yield curve steepened in the second quarter in sympathy with local rates in Asia. The two-year SGS yield fell 9bps while the 10-year SGS yield surged 93bps on the back of rising inflation concerns. Consequently, the 2-10 spread has widened by 102bps, to 2.40%.

We are now cautious on SGS bonds. We believe we are probably in the first leg of the SGS sell-off. We see another leg developing 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 give us a higher all-in yield. Some of the bonds we like are Acendas Reits which offers a 4.75% yield for two years and a potential new issue secured with Great World City with a yield of about 3.75% for two years.

CURRENCIES

Second Quarter Review

There were again large moves in the currency markets in the second quarter. The underlying renewal of risk appetite in equity, corporate bonds and commodity markets has meant renewed weakness in the US dollar. The US dollar had strengthened during the long crisis period as investors sought safety and liquidity. Although credit conditions have not completely returned to the pre-crisis state, systemic risk has faded, and with it a key support for the US dollar has been removed. The Dollar Index has now fallen below its pre-Lehman level.

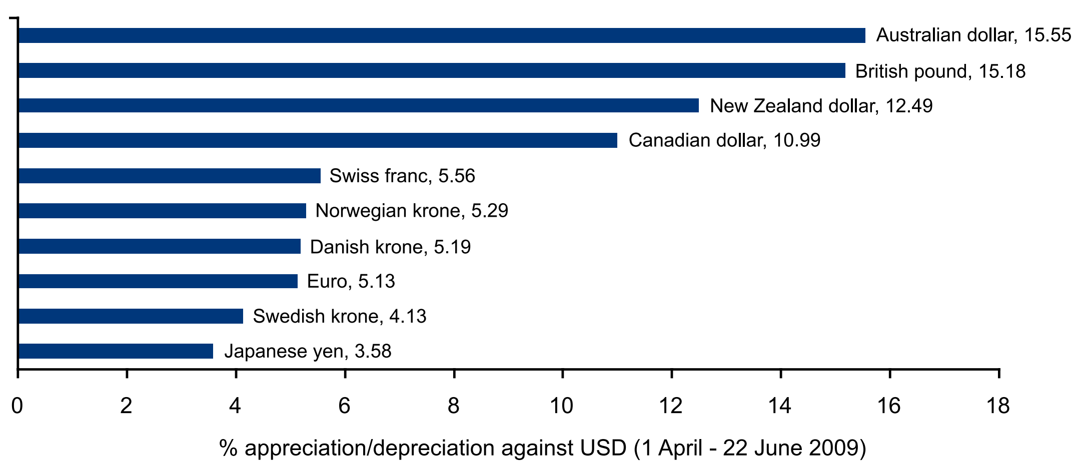
With the overall improvement in sentiment and with volatility receding, investors are also taking risk again in the currency markets. "Carry trades" have been put back on. A 'carry trade' basically entails borrowing in a lower interest rate currency to invest in a currency with higher interest rates.

There is, however, a new twist to the carry trade with the main funding currency likely shifting from the Japanese yen to the US dollar. All other things being equal, there is less risk in borrowing from a low yielding currency with a current account deficit (the US dollar) than there is in borrowing in a low yielding currency with a current account surplus (the Japanese yen or Swiss franc). The main beneficiaries of the carry trade have been Emerging Market currencies such as the Brazilian *real* and South Africa rand where interest rates are still high.

The commodities currencies – the Australian, Canadian and New Zealand dollars – also appreciated strongly in the second quarter as commodity prices continued their sharp recovery. The commodity currencies are now more or less back to their pre-Lehman levels, against the US dollar.

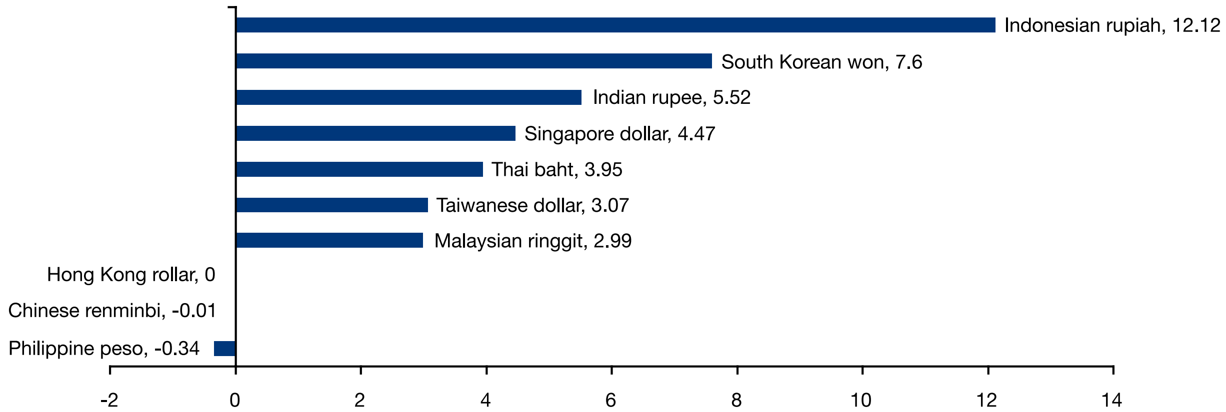
Asian currencies in general also rose against the US dollar in the second quarter, but the Asian Dollar Index has not regained its pre-Lehman levels. The currencies which declined the most during the crisis, the Indonesian rupiah, the Korean won and the Indian rupee, had the strongest performance in the second quarter.

G-10 currencies performance against US Dollar



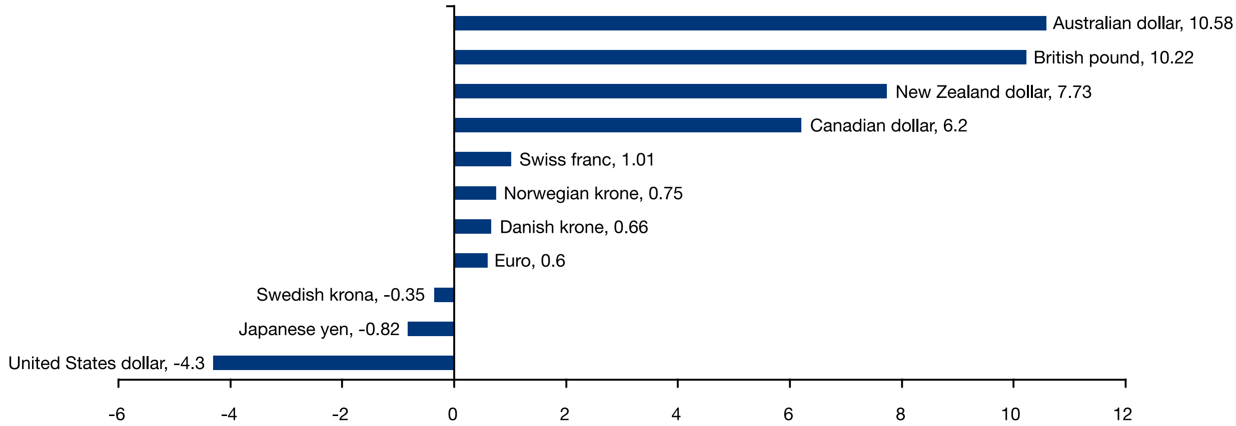
Source: Bloomberg, 22 June 2009

Asian currencies performance against US dollar



Source: Bloomberg, 22 June 2009

Singapore dollar performance against G10 currencies



Source: Bloomberg, 22 June 2009

Outlook and Strategy

The US dollar will likely continue to be a key focus of the currency markets if, as is likely, the recovery in risk assets continues. The other major currencies, except the Japanese currency, are likely to perform better as the financial markets seek higher returns. Despite the various concerns in Eastern Europe, most of the European currencies have been performing better against the US dollar. If the debt issues in Eastern Europe do not worsen further, the European currencies could continue to strengthen. The Japanese currency also managed to perform marginally better than the US dollar despite Japan's own dire economic performance and its even lower interest rate environment.

Asian currencies are expected to perform better on capital inflows as the economic backdrop improves. As export growth improves over the course of the recovery, the Asian governments will likely allow their domestic currencies to strengthen to offset the impact of higher input costs. However, we do not expect Asian currencies to strengthen sharply in an environment where the global trade environment remains challenged and there is no major engine of growth in the developed economies. With regard to the Singapore dollar, we no longer expect the Singapore dollar to weaken and expect the currency to trade within a range of 1.44-1.48.

Overall, we reduce our exposure to the US dollar against most currencies in our fixed income portfolios.

CURRENCY FORECAST

Currency	Against USD 22 June 2009	Forecast End 3Q 2009
Japanese yen (JYP)	96	98
Euro (EUR)	1.39	1.37
Singapore dollar (SGD)	1.46	1.48

Source: Forecast figures are consensus numbers from Bloomberg, 22 June 2009

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