

Global Investment Perspective

October 2011

Highlights

On the whole, data has remained soft, reinforcing the view that the global economy is experiencing a weak patch. That said, after sharp drops in the previous month, US data releases were marginally better, though still mixed, in September. Manufacturing activity for the month and industrial production for August beat expectations, while annualised quarter-on-quarter Gross Domestic Product (GDP) for the April to June period was revised upwards. Conversely, key forecasts for GDP in 2011 and 2012 were downgraded again, while inflation, as measured by the US all items Consumer Price Index (CPI), was up by more than had been anticipated, hitting a 2-year high. Nonetheless, the month saw some cheer as the US Federal Reserve (Fed) launched 'Operation Twist', a policy designed to lower yields on long-term bonds.

The picture was more downbeat in the Eurozone, where economic figures were once again discouraging. Manufacturing and services activity in the region moved into contractionary territory. Unemployment remains high, while July retail sales for the Eurozone were down and consumer confidence fell. In spite of the better than expected industrial production data from Germany and France, the mood remained sombre. Although Germany and France have continued to back Greece publicly, the debt situation in the country continues to cause concern. While the European Central Bank (ECB) kept interest rates at 1.5%, a rate cut is now looking more likely against a backdrop of weak growth, even though inflation across the region remains high. Meanwhile, in the UK, though economic data was once again disappointing, there were some signs of a recovery.

Elsewhere, after promising signs of a pick-up in activity in August, economic data from Japan has started to suffer from the deteriorating global outlook. In contrast, emerging markets have continued to register healthy economic performance, albeit with some moderation as well as variation across the bloc. For example, though year-on-year industrial production numbers in China (August figures) and India (July) have fallen, industrial data beat expectations in August in Russia.

Market Recap

September proved to be another poor month for equities. Although stocks began promisingly amid speculation that President Barack Obama was planning significant economic stimuli next year, they subsequently resumed their downward trajectory, most of all in Europe, after ECB President Jean-Claude Trichet said downside risks to the Eurozone economy had intensified. This engendered increased efforts by policy makers to contain the Eurozone's sovereign debt crisis; Germany's parliament voted to back a Euro rescue package and the ECB announced a further extension of its policy of providing unlimited liquidity to Eurozone banks, saying it would include 12-month loans this month and 13-month loans from December that will bridge two crucial year-end periods. It also unveiled a EUR 40 billion programme to buy 'covered bonds' (ultra safe investments issued by banks). In the UK, the BOE announced that they would provide further monetary stimulus on a greater scale than had been expected increasing its stock purchase of gilts by £ 75 billion over the next 4 months. Meanwhile, in the US, the Fed also launched Operation Twist. However, it was the Fed's pessimistic assessment of the economy that became a catalyst for 'risk-off' behaviour in the markets this month. The Fed noted "significant downside risks to the economic outlook, including strains in the global financial markets". Overall, equities were down in September to end one of the most dismal third quarters in ten years. The S&P 500 fell by 7.0%, one of the worst performing developed equity markets. European equities dropped by 5.8%, amid ongoing fiscal concerns and lacklustre economic data. Concerns over growth and Eurozone debt weighed on Asia ex-Japan equities, which dropped by 9.2%. Emerging markets were also down, underperforming developed equities over the month. Although economic numbers remain robust, signs of a slowdown are clearly emerging. However, Japanese equities were relatively resilient in September; the MSCI Japan index fell by only 0.8%.

Against this backdrop, US Treasuries performed strongly, rising by 1.76% over the month, contributing to their largest quarterly gain since the fourth quarter of 2008. As in the previous month, Eurozone government bonds, except Greece, were up in September.

Outlook and Strategy

Although macroeconomic data remains weak, we continue to hold a constructive view with respect to risky assets. Nonetheless, we are aware that increasing signals of a slowdown in the global economy make the outlook an uncertain one. The ongoing Eurozone debt crisis is of particular concern. On a positive note, equities remain attractively valued and markets have already priced in high levels of risk. As such, we are confident with our moderate exposure to risky assets, although we continue to stress the need to diversify portfolios, given the considerable volatility that has plagued risk markets in recent months.

Against this backdrop, our central scenario is largely unchanged. We still expect lacklustre growth figures across the key developed markets, but anticipate growth from the emerging market bloc to be more robust, in spite of some moderation. This view now seems to be shared by the market. Although economic data releases have continued to disappoint in some regions, we remain optimistic that any global downturn will be soft rather than a full-blown and lasting recession. Interest rates remain low and monetary easing steps to stimulate growth are now in place. However, we recognise that the downside risks are perhaps greater than they were earlier in the year.

The extreme volatility we have seen in markets stems from a plethora of fundamental and long-term concerns. In the short run, volatility is likely to remain. Nonetheless, despite greater risks, valuations have adjusted accordingly. Government bond yields in developed countries remain very low and reflect both the weak economic environment and low interest rates. Given these levels, it is hard to envisage further value. However, the same is not true for corporate issues, most of all at the higher-yielding end of the spectrum, and we favour these over government bonds. Conversely, equities are, on the whole, trading at Forward Price to Earnings (P/E) ratios of 15 or under, with some continents and countries, such as Europe, Russia, China, seeing ratios below 10. As the outlook for earnings growth remains robust for 2012, these valuations, in particular when compared to bonds and cash, are undoubtedly attractive in the long term.

Among developed market equities, we continue to prefer Japanese stocks on a currency-hedged basis. Short-term volatility aside, the current P/E ratio is below its historic average, and we feel the Japanese equity market still provides a number of attractive opportunities. In the emerging markets, Russia's compelling equity valuations, both on a relative and absolute basis, as well as signs of resilient economic conditions make it our favoured market. Nevertheless, we remain aware that a further fall in oil prices amid declining global demand poses a significant risk to Russian equities, although this is not our central view. We have also maintained a tactically overweight exposure to Chinese equities, which appear particularly attractive and are trading at a discount both relative to other emerging markets and historically. Furthermore, tighter monetary policy seems to be having a dampening impact on rampant inflation in China. As such, an end to the inflationary cycle may prove the impetus for supportive inflows.

Equity

Short-term Investment Outlook (6 - 12 months)

Asset Class	Current View	Reasoning
Global Developed Market Equity	Neutral	Equity valuations relative to cash and especially government debt remain attractive, plus liquidity remains supportive. There continue to be risks to the economic recovery, but our core scenario is for positive, although sub-trend growth.
US Equity	Neutral	Corporate earnings have been encouraging. Unemployment remains elevated at over 9%, although recent payroll figures have shown improvements.
Europe Equity (including the UK)	Neutral	Although valuations look cheap, economic conditions remain fragile. UK growth has slowed, while the economic health of peripheral Eurozone countries remains uncertain. That said, policy action has been favourable with major central banks agreeing to measures to help deal with the ongoing Eurozone debt problems.
Japan Equity	Neutral	We maintain our overweight exposure to Japanese equities, which we believe offer attractive opportunities in spite of signs that the economy is beginning to suffer from the deteriorating global outlook. In addition, the current PIE ratio is still trading far below the historic average.
Asia ex-Japan Equity	Positive	In spite of a slowdown in global demand, Asia ex-Japan countries still carry more favourable economic prospects than other developed nations. At a country level, we prefer Chinese equities relative to other Asian emerging markets. Valuations are favourable and inflation is exhibiting early signs of peaking amid further central bank tightening.
Global Emerging Markets	Neutral	Emerging countries are likely to continue to lead the economic recovery, due to robust domestic consumption and strong intra-regional trade. That said, like developed markets, emerging market equities are exposed to volatility stemming from the question marks around the sustainability of the global economic recovery, exacerbated by the monetary tightening cycle that has already begun in a number of key emerging economies.
Latin America Equity	Neutral	The economic performance of Latin American countries remains strong, and earnings growth estimates for 2011 look reasonable. Nonetheless, the good news seems to be well reflected in market prices, and relative valuation measures show no strong signals. We, therefore, retain our neutral stance.
Middle East Equity	Neutral	Given the political unrest within the region, for the short term we expect volatility to persist affecting the overall performance. The investment potential will be largely dependent on oil prices and supply uncertainties.
Eastern Europe Equity	Neutral	Manufacturing data has varied within the different countries. At a country level, we favour Russian equities. Russia's economic activity has been encouraging, while valuations for Russian equities are attractive in both absolute and relative terms.
Euro, British Pound Sterling, Japanese Yen and the US Dollar	Neutral	Valuation indicators are not sending any clear signals at present. We see both event-driven and sentiment-driven risks contributing to ongoing volatility. We thus continue to have a neutral view on currency exposures.

**within the broad asset class*

Summary

We have maintained a moderately overweight allocation to global equities overall relative to both government bonds and cash. In developed market equities, we continue to be moderately positive on Japan, where we continue to see valuations and policy support providing a favourable backdrop for the country's equities. Within emerging market equities, we continue to prefer China and Russia as their valuations are more attractive.

Regarding the four major developed market currencies, we believe that heightened levels of volatility are likely to persist. Valuation measures are not sending strong signals at present and, as a result, we maintain our neutral stance on currency positions.

Given the backdrop of heightened uncertainty with respect to global growth and assuming the continuation of volatility in the markets, our key recommendation is to be well diversified.

Currency

Data remains soft, reinforcing the view that the global economy is experiencing a weak patch. The sovereign debt crisis in the Eurozone and fiscal concerns in other developed markets are among some of the major worries for investors. Coordinated central bank action to try and ease the gloom did little to lift sentiment.

US

Economic data releases were mixed but remained at low levels following sharp drops last month.

- In manufacturing, the US Institute for Supply Management (ISM) Manufacturing Index rose to 51.6 in September (versus 50.6 last

month), higher than the expected level of 50.5. Industrial production also beat expectations, rising 0.2% month-on-month in August, while the University of Michigan Consumer Confidence Index rose to 59.4 in September

- In addition, the US ISM Non-Manufacturing Index beat expectations in September, coming in at 53.0 against expectations of 52.8
- Second-quarter GDP growth was revised up to an annualised 1.3% quarter-on-quarter from 1.0% quarter-on-quarter, and personal consumption was revised up to 0.7% from 0.4% in the second quarter of the year. However personal spending rose only 0.2%

Macro Assessment

month-on-month in August from a revised 0.7% month-on-month in July

- Labour market data was encouraging, US payrolls climbed by 103k in September following a revised 57k increase the prior month, beating expectations. The median forecast had been for a rise of 60k. However, overall the unemployment rate remains elevated at 9.1%. In a separate release, the Bureau of Labor statistics announced an annual revision to the March 2011 total payroll figure, adding 192,000
- President Obama announced a US \$ 447 billion jobs plan (approximately 3% of GDP), combining tax cuts and infrastructure spending in order to spur economic growth and improve the poor employment situation
- In addition, the Fed launched 'Operation Twist' in an attempt to drive down long-term interest rates by purchasing US \$ 400 billion of long-dated securities financed by the sale of an equal amount of bonds with a maturity of less than three years
- The US all items CPI increased to a new 2-year high of 3.8% year-on-year in August, higher than expected. The core Consumer Price Index, excluding food and energy related goods, came in at 2.0% year-on-year in August from 1.8% year-on-year in the previous month
- Consensus Economics forecasts for GDP growth in 2011 and 2012 were downgraded again to 1.6% (-0.2%) and 2.1% (-0.3%) respectively
- International Monetary Fund (IMF) forecasts were also downgraded significantly from previous forecasts in June. The 2011 forecast has fallen by 1.0% to 1.5%, while the 2011 has fallen by 0.9% to 1.8%

Europe ex-UK

Economic data in the Eurozone continued to disappoint.

- Manufacturing and services activity moved into contractionary territory in the region. The Eurozone Purchasing Managers Index (PMI) for manufacturing dropped to 48.5 in September from 49.0 in August, while the PMI services number fell to 49.1 from 51.5
- In addition, the unemployment rate remains high, remaining at 10.0% in August
- On the consumption front, Eurozone retail sales dropped to 0.2% month-on-month in July from a revised 0.7% month-on-month earlier
- With disappointing news across several sectors, Eurozone Consumer Confidence fell again to -18.9 in August from -11.2 in July
- However, in more encouraging news, industrial production numbers beat expectations in July. In Germany, it increased by 4.0% month-on-month, while in France, it rose by 1.5% month-on-month
- Regarding the deteriorating debt situation in Greece, Merkel and Sarkozy continue publicly to back Greece and remain adamant over the country's future in the Eurozone. The statement provided a boost to sentiment although the Greek situation continues to be concerning
- As expected, the ECB maintained interest rates at 1.50% and announced a further extension of its policy of providing unlimited liquidity to Eurozone banks, saying it would include 12-month loans this month and 13-month loans for December that will bridge two crucial year-end periods. It also unveiled a EUR 40 billion programme to buy 'covered bonds' (ultra safe investments issued by banks)
- The Eurozone CPI rate remained at 2.5% year-on-year in August although the initial estimate for September suggests inflation has risen to 3.0%, which would be the highest level in three years. Core CPI year-on-year also remained unchanged at 1.2% in August.
- The Consensus Economics inflation forecast for 2011 remains unchanged at 2.6%, while the 2012 forecast has fallen slightly to 1.8% (down 0.1%) in September
- The Consensus forecasts for 2011 and 2012 Eurozone GDP growth were both revised down to 1.7% (-0.2%) and 1.0% (-0.5%) respectively in September

UK

Data within the UK was generally disappointing although there were some signs of recovery.

- In manufacturing activity, the ISM Manufacturing Index unexpectedly moved into expansionary territory, coming in at 51.1 in September from a revised 49.4 in August
- Industrial production was less encouraging, coming in at -0.2% month-on-month in August. Furthermore, the PMI Services Index fell to 51.1 in August from 55.4 in July, the biggest drop in the measure in a decade
- Elsewhere, retail sales fell by 0.2% year-on-year in July, showing stagnant consumer spending over the last year
- In the labour market, the unemployment rate remained at 7.9% in July, but monthly jobless claims came in lower than expected
- In the housing market, house prices fell by 1.2% month-on-month in August, having risen 0.3% month-on-month in July
- UK inflation increased in August to 4.5% year-on-year from 4.4% year-on-year in July. The core CPI was unchanged at 3.1% year-on-year in August
- The Monetary Policy Committee (MPC) was unanimous in maintaining rates at all-time lows of 0.5% in September and announced that they would provide further monetary stimulus on a

greater scale than had been expected. The Bank's MPC voted to increase its stock purchase of gilts by £ 75 billion over the next 4 months

- Consensus Economics September inflation forecasts for 2011 and 2012 were unchanged at 4.4% and 2.7% respectively
- The Consensus Economics 2011 GDP growth forecast was revised downwards to 1.2% (-0.1%) while the 2012 forecast was revised down to 1.8% (-0.2%) in September

Japan

Economic data from Japan is starting to suffer from the deteriorating global outlook.

- Second-quarter GDP growth was revised down to -0.5% quarter-on-quarter from the initial estimate of -0.3% quarter-on-quarter
- During the second quarter, private consumption was flat, business investment fell by 0.9% and exports declined by 4.9%. A separate report showed second-quarter capital spending fell by 7.8% year-on-year, its first drop in a year
- Japanese industrial production for August came in lower than expected at 0.8% month-on-month (against an expected figure of 1.5% month-on-month), but still illustrates a continued recovery
- However, September's PMI Manufacturing Index fell into contractionary territory, coming in at 49.3 from 51.9 in August
- Machine orders were disappointing, falling by 8.2% month-on-month in July following a 7.7% rise last month. Exports were more encouraging, expanding by 2.8% year-on-year in August, having fallen by a revised 3.4% year-on-year in July. Global uncertainty and the strong Japanese Yen remain a threat to the external outlook
- In consumer activity, real household spending fell by 2.1% year-on-year in July, while nationwide department sales fell 1.7% year-on-year in August
- In the labour market, the jobless rate fell to 4.3% in August from 4.7% in July
- Japan's CPI rose by 0.2% year-on-year in August following a 0.2% rise in July while the core CPI (excluding fresh food and energy) fell by 0.5% year-on-year, slightly less than expectations
- In September, the Consensus Economics forecasts for inflation in 2011 and 2012 have both fallen to -0.2%. The September Consensus GDP growth forecast for 2011 has increased to 0.5% but the 2012 forecast has fallen significantly to 2.4% (-0.8%)

Emerging Markets

Emerging markets continue to display robust economic performance, despite signs of moderation and variation across regions.

- Taking year-on-year industrial production as an example, China (13.5% in August versus 14.0% in July) and India (3.3% in July against 8.8% in June) reported a slowdown below expectations, while Russia reported a higher year-on-year number above expectations (6.2% in August versus 5.2% in July)
- Despite the slowdown in China's manufacturing activity, consumer spending and external trade remain buoyant. Chinese retail sales increased by 17.0% year-on-year in August compared to 17.2% year-on-year in July, in line with expectations, while exports (24.5% year-on-year in August compared to 20.4% year-on-year in July) and imports (30.2% year-on-year in August versus 22.9% year-on-year in July) both increased, beating expectations
- In addition, Indian year-on-year exports remained at impressive levels, coming in at 44.3% in August following an all-time high of 81.8% in July.
- China's PMI Manufacturing Index rose to 51.2 in September from 50.9 in August and remains in expansionary territory. However, the HSBC Manufacturing PMI for September remains in contractionary territory at 49.9
- In Brazil, in an unexpected move the Brazilian Central Bank (BCB) reduced its policy rate by 50 basis points to 12.0%, citing the effects of the global slowdown on the domestic economy
- Brazil's PMI Manufacturing fell for a third straight month to 46.0 in August, whilst retail sales (7.1% year-on-year in July) and unemployment (6.0% in August) remain flat
- In Eastern Europe, Russian economic activity stood out in comparison to the rest of the emerging markets, with increasing real wages (3.9% year-on-year in August versus 2.4% year-on-year in July), retail sales (7.8% year-on-year in August against 5.7% year-on-year in July) and falling unemployment (6.1% in August compared with 6.5% in July)
- In emerging markets inflation has started to come off from its peak. In China, the CPI dropped to 6.2% year-on-year in August down from its 3-year peak of 6.5% year-on-year, in line with consensus forecasts. India's August Wholesale Price Index headline inflation rose to 9.8% year-on-year (versus 9.2% in July), above consensus, and core inflation continued to rise
- Despite global economic weakness, the primary concern of the Reserve Bank of India (RBI) remains inflation, and they continue to tighten their policy rate with the most recent round coming from the tightening of reverse repo rate by 25bps to 7.25%
- In line with other positive Russian economic data, Russia's year-on-year CPI dropped to 8.2% in August from 9.0% in July. In Brazil, year-on-year CPI increased slightly to 7.2% (+0.4%) year-on-year in August
- Overall, the consensus economic forecasts for GDP growth for emerging markets remained solid but moderated slightly in Asia

Equity Markets

Global Developed Markets:

US:

- S&P 500 declined by 7.0% in September, one of the worst performing developed equity markets, with the decline led by financial and material stocks
- This was against a backdrop of mixed economic data. Second-quarter GDP figures were revised upward, while manufacturing and industrial production numbers beat expectations. However, labour market data disappointed, prompting President Obama to announce a significant jobs plan
- Furthermore, the Fed launched 'Operation Twist' in an attempt to drive down long-term interest rates
- Earnings growth estimates at 16.2% for 2011 and 13.6% for 2012 for US companies remain attractive, and earnings results for the second quarter of 2011 were stronger compared to the first quarter
- US equity valuation measures, such as the 12-month Forward P/E ratio of approximately 11.1x, continue to look undemanding
- Most of the economic data in the US points to a stagnant economy. After the August declines, manufacturing surveys and consumer sentiments have stabilised at low levels
- However, it was the Fed's pessimistic assessment of the economy that became a catalyst for 'risk-off' behaviour in the markets this month. The Fed noted "significant downside risks to the economic outlook, including strains in the global financial markets"
- Investors are reluctant to look at P/E valuations, given concerns on earnings revisions. However, about 39% of the S&P 500 stocks with positive earnings, and for which data is available on Bloomberg (around 99%), are trading below the 12x level versus 23% at the end of September last year
- Given the nature of the current economic environment, leading indicators that capture shifts in confidence are particularly useful. Though consumer surveys indicate a drop in confidence, the business surveys are yet to indicate a similar fall, reflecting a more positive outlook among the business community
- Overall, we maintain a modest overweight allocation to the US and other equity markets relative to government bonds and cash (based on the attractive valuation measures), while we remain neutral on the US versus other equity markets

Europe:

- European equities suffered alongside other risky assets in September. Eurozone equities fell by 5.8%, due to fiscal concerns and weak economic data. Meanwhile, UK equities were down 4.7%
- Within the Eurozone, concerns over member countries' debt and growth potential continue to mount and drive equity performance. Ratings agency S&P downgraded Italy's long-term and short-term sovereign ratings by one notch to A/A-1
- On the political front, the agency thinks that Italy's fragile governing coalition will continue to limit the government's ability to respond decisively to the challenging domestic and external macroeconomic headwinds
- In more encouraging news, policy action was favourable. Major central banks across the developed world announced that they will provide additional US Dollar funding to their respective banking systems in coordination with the Fed
- The ECB has scheduled three separate US Dollar liquidity operations, starting from 12 October, with maturities of approximately three months, in full allotments (i.e. unlimited), which are designed to cover banks' funding needs
- In addition, the German parliament showed overwhelming support in extending the German guarantee to an expanded European Financial Stability Facility (EFSF). The decision was greeted in Brussels as a removal of a big potential road block for taking further action on the debt turmoil of the Eurozone
- Although peripheral fiscal Eurozone issues remain a concern and recent economic data releases have been weaker, overall, economic activity remains mildly positive. Whilst the possibility of a technical recession in Europe has increased, we do not expect it to be deep
- The growth figures do not indicate a significant enough slowdown to warrant the major earnings downgrades implied by global equity market prices at the moment. Valuations for riskier asset classes, especially equities are unusually compelling, yet they are not driving market performance. For example, a dividend yield of 5.05% (MSCI Eurozone) is attractive relative to 10-year Eurozone bond yields, which have dipped below 2%
- In addition, our central view is still for rates to remain accommodative in 2011 and 2012 due to the potential impact on fragile growth in the region
- Therefore, with earnings growth still looking positive next year, these valuations, particularly relative to bonds and cash, are compelling, and we still favour equities as a long-term investment.

Japan:

- Japan's equity market remained stagnant in September, as lingering Eurozone debt problems and weakening global growth continued to keep investors away from risky assets. Japanese equities actually stayed resilient and decreased by only 0.8% during the month, outperforming other developed countries (the MSCI World declined by 6.0% in September)
- Recent data suggests that the pace of recovery in Japan may slow as a result of the gloomy global economic outlook

- Industrial production continued to improve on a month-on-month basis, rising 0.8% in August. However, the improvement was below expectations of 1.5%, raising concerns of a less robust recovery
- Export growth was negatively impacted by a higher Yen and lower external demand. Merchandise trade exports grew 2.8% year-on-year in August, missing expectations of 8% Yen 775.3 billion in August due to large growth in imports
- Retail trade came out softer in August at -2.6% year-on-year (versus 0.7% in July) as consumer sentiment was weakened by a worse global economic outlook
- The risk of deflation remained with core CPI unchanged at -0.5% year-on-year in August
- The Bank of Japan (BoJ) kept its target rate at 0.1%, as expected, after the September meeting
- Risk aversion has continued to drive equities lower while the developments in the Eurozone have done little to reverse weak sentiment
- We expect equity markets to continue to be volatile, and our strategy remains concentrated on the investment value over a longer-time horizon
- While we acknowledge the short-term volatility in the stock market, we are confident that Japan will perform relatively better given support from the government's recovery plan
- Economic data, such as export growth and industrial production, will inevitably be impacted by slower external demand. However, local demand and retail consumption could help the economy resist falling into a deep recession
- We expect that the BoJ will maintain its accommodative monetary policy
- The 12-month Forward P/E ratio is trading at around 11.4x as at the end of September for Japanese equities; this attractive valuation supports our overweight position in Japanese equities, as we seek long-term investment value
- Overall, we continue to prefer equities to government bonds and cash because the returns of the latter in real terms are heading towards zero or even negative territory. We also favour Japan within equities due to the support provided by the government's recovery plan and attractive valuations
- The continuous strength of the Yen could lead to further central bank intervention. Thus, it is reasonable to keep the position on a hedged basis

Global Emerging Markets:

- Emerging markets closed the month with negative performance of -7.4% on a total return basis, underperforming developed equities by 1.4%
- Latin America was the relative outperformer, returning -5.3%, with negative performance from Brazil (-4.6%) and Mexico (-5.3%). Asia and Eastern Europe were the relative laggards, returning -8.4% and -10.0% respectively. Within Asia, negative performance from China, Thailand and Indonesia were the main detractors, while Russia and Hungary provided the main drag on returns in Europe
- Economic data over the past month has been mixed. For example, year-on-year industrial production slowed down in China (from 14.0% to 13.5% in August), although this was offset by a marginal increase in the PMI (from 50.9 in August to 51.2 in September). Consumer spending also increased by 17% year-on-year in August (from 17.2% in July), as did external trade, with imports and exports (30.2% year-on-year and 24.5% year-on-year in August respectively) both beating expectations
- India fared less well with a decline in both industrial production (3.3% in July versus 8.8% in June) and export growth. Year-on-year exports fell significantly after a record increase last month (81.8% year-on-year in July versus 44.3% year-on-year in August)
- In Brazil, a marginal increase in year-on-year retail sales (from 7.07% in June to 7.11% in July) was offset by a declining PMI (which fell to 46.0 in August from 47.8 the previous month), prompting an unexpected 50 basis-point cut in policy rates by Brazil's central bank
- In Russia, a 2% decline in year-on-year exports (44.7% in June against 42.6% in July) was offset by a greater than expected increase in industrial production (6.2% in August versus 5.2% in July). Domestic consumption also remains buoyant, with year-on-year retail sales increasing to 7.8% in August (compared to 5.7% in July)
- Overall, the consensus economic forecasts for GDP growth for emerging markets remain solid, albeit at slightly moderated levels.
- The decline in emerging market equities has led to a decline in both trailing and Forward P/E ratios (excluding Brazil, India and Russia). The 12-month Forward P/E ratio currently stands at 9x, which represents a 20% discount to the 5-year average (broadly similar to last month). Relative to the 10-year average valuations, current levels represent a 15% discount
- Inflation has started to decline across most major emerging economies, reflecting the impact of recent tightening in monetary conditions and a continuing slowdown in global growth. A breakdown of the data suggests that non-food inflation remains stable, while food inflation is beginning to ease on the back of softening commodity prices

Other Investments

- While fundamentals remain strong, valuations are still attractive and interest rates in the developed world are at multi-year lows, emerging market equities continue to look favourable on a longer-term view. As with other equity markets, we maintain our modestly overweight position and remain neutral between developed and emerging markets
- At a country level, we keep our preference for Chinese and Russian equities relative to other emerging markets on valuation grounds. Relative to their 5-year average, Russia and China equities' 12-month Forward P/E ratios are trading at -36% and -38% respectively, the largest discounts in the emerging market universe

Asia ex-Japan:

- Asia ex-Japan equities took another hit in September as investors' concerns over growth and Eurozone debt intensified. The MSCI Asia ex-Japan Index slid 9.2% over the month
- Industrial production growth moderated in China, falling from 14.0% year-on-year in July to 13.5% in August. Retail sales were largely unchanged at 17.0% year-on-year in August (17.2% in July). However, China's exports in August expanded and exceeded expectations, rising by 24.5% year-on-year (against an expected figure of 21.9%)
- Export growth in South Korea remained upbeat in August, up 27.1% year-on-year (27.3% in July). However, export growth in Taiwan slowed to 7.2% year-on-year in August, below the 15.5% estimate
- China's Consumer Price Index started to fall in August, down to 6.2% year-on-year from 6.5% last month. This is an integral element for the People's Bank of China to slow its pace of tightening in the months ahead
- In India, monthly wholesale prices bounced back to 9.78% year-on-year in August after a revised measure of 9.22% last month (compared to 9.44% in June). The RBI subsequently stepped in to raise interest rates by 0.25% to 8.25%
- We expect equity markets to continue to be affected by higher volatility while investment sentiment will also be driven considerably by various uncertainties. However, it is not our base case to expect the world to enter into a deep recession, and hence, the lower equity prices we are seeing do offer exceptional investment value over a longer-time horizon
- Since a deep recession is not expected, we therefore do not anticipate significant adverse earnings revisions. Besides, earnings expectations have already discounted the current slower growth scenario
- We reiterate that Asia ex-Japan equities remain very attractive in terms of their valuation. The 12-month Forward P/E ratio is trading at 10.1x as at the end of September, which is well below the historical average
- Given that equity valuations are close to all-time low levels, we suggest equities will offer a better risk-reward trade-off against low-yield government bonds and cash. Within equities, we continue to favour Chinese equities because of the supportive economic fundamentals

Oil:

- Oil prices declined over the month by about 10.8%, making September the second consecutive month with an oil price decline, amid concerns of significant downside risk to economic growth
- WTI Crude closed at US \$ 79.2 per barrel at the end of September, below our target range of US \$ 90-110
- Crude oil price weakness was triggered by the global economic slowdown and bleak prospects for financial markets over the course of September. Oil prices plunged to their lowest levels over the year in tandem with the large sell-off in financial and commodities markets
- Driven by both supply disruption to Brent oil and a glut of WTI oil, the price spread between WTI and Brent, the two most important oil benchmarks in the world, continued to widen, hitting record levels of over US \$ 26 per barrel
- If the current positive reports of preserved Libyan oil infrastructure are correct, domestic Libyan production rates could reach 1.3 million barrels per day by the end of the year, lifting supply and further easing price pressures
- An outlook of lower global gross domestic product growth has prompted the International Energy Agency to reduce again its forecast for 2011 global oil demand by 200 thousand barrels per day to 89.3 million barrels per day.
- Global oil supply rose by 1.0 million barrels per day to 89.1 million barrels per day in August, with non-OPEC providing 80% of the total increase
- OECD industry stocks rose back again by 10.7 million barrels to 2,687 million barrels or 58.4 days of forward demand cover. However, the International Energy Agency notes that this is the first time total oil industry stocks have slipped below the 5-year average since the economic recession of 2008
- The global growth outlook remains relatively subdued although our central forecast is for positive growth. Hence we maintain our expectation for oil to trade in a range of US \$ 90-110 per barrel on a 6 to 12-month view. The risks to this range lie on the downside

Latin America:

- Among the emerging markets, Latin American bourses were the best performing, although they still fell by 5.3% overall in September. Brazil slightly bettered the regional average (-4.6%), while Mexico matched the region's return, falling by 5.3%
- Equity market performance was set against a backdrop of mixed data. In Brazil, a slight improvement in year-on-year retail sales (up from 7.07% in June to 7.11% in July) was offset by a dip in the Purchasing Managers Index (which fell to 46 in August from 47.8), prompting an unanticipated cut of 0.5% in policy rates by the Brazilian Central Bank
- On the whole, however, the economic performance of Latin American countries remains robust amid encouraging earnings growth estimates for 2011
- Moreover, there has already been some progress in the fight against inflation, although this is not likely to be fully under control until the final quarter of this year.
- As such, the economic news seems to be reflected in market prices, and relative valuation measures show no strong signals

Middle East:

- The situation in the Middle East and North Africa remains unsettled, amid ongoing civil unrest in many countries across the region
- In the post-revolution states, there is still no clarity on the economic outlook. For example, in Egypt, the economy continues to struggle despite the country agreeing its 2011/12 budget and terms for an International Monetary Fund financing deal
- However, where political pressures have been negligible, such as in the United Arab Emirates, Kuwait and Qatar, the economic ramifications of unrest have been positive. This is due to the partial shift in economic activity from the troubled nations to the neighboring Middle Eastern countries less affected or not affected at all by the turmoil. We continue to monitor events in the region closely
- Against this backdrop, valuations remain undemanding and 12-month Forward P/E ratios are compelling on an historical basis

Eastern Europe:

- Eastern European bourses suffered a weak month with Russia and Hungary proving to be the worst performing markets
- Economic data offered a mixed bag. In Russia, a small fall in year-on-year exports for July was countered by a larger than anticipated rise in industrial production for August. Meanwhile, domestic consumption continued to rise, with August year-on-year retail sales registering small but not insignificant improvement
- From a regional perspective, though economic activity has clearly moderated, encouraging data continues to emanate from the broader Eastern European region
- At a country level, we maintain our preference for Russian equities relative to other emerging markets. Russia's economic activity remains robust, while valuations for Russian equities are attractive in both absolute and relative terms

Gold:

- Actions by the Fed are likely to continue to provide liquidity and potentially weaken the US Dollar further, both of which are likely to drive commodity prices, including gold, higher
- Increased inflationary risks are adding to the attractiveness of holding the metal as well
- That said, although recent data releases have been disappointing, the economic recovery remains in place
- Balancing these factors, we expect gold will trade in a narrower range of US \$ 1,500 to US \$ 1,600 per troy ounce in the medium-term and maintain our neutral stance

Commercial Real Estate (unlisted):

- A delay in the UK economic recovery is likely due to deterioration in global economic conditions and persistent Eurozone sovereign debt concerns. Accommodative monetary policy is likely to be prolonged, sustaining a substantial property yield margin relative to bond rates
- We believe Asia Pacific has the best long-term economic fundamentals among the regions. However, the heady pace of rental growth is likely to moderate in the event of a global economic slow-down. This is expected to prompt a correction in current aggressive pricing, particularly for prime retail property
- In the US, the sharp deceleration in GDP is expected to persist, and unemployment will likely stay at elevated levels. Occupier markets are predicted to remain subdued and positive rental growth is unlikely to manifest until there is a substantial improvement in the economy
- With a worsening economic outlook in Continental Europe, we believe occupier markets would be challenged to continue the rental growth that started in the fourth quarter of 2010. However, limited new supply provides support for current rental levels, particularly for core markets where tenant demand should be relatively resilient
- Our outlook for property remains neutral. The risks from the impact of the economic slowdown are counteracted by the reduction in supply (given slowing bank funding) and property's attractive yield relative to government bonds

Currency

- The US Dollar found favour from investors in September. Against the Yen, it rose by just 0.5%, but gains were larger against the Sterling (+4.3%) and the crisis ridden Euro (+7.7%). The driving force was the US Dollar's perceived 'safe haven' status in a world with few other such options
- Many emerging market currencies suffered substantial falls against major currencies. The Brazilian Real fell over 18% against the US Dollar and the Russian Rouble by 11.6%. Concern in these economies is switching from inflation to slowing growth, suggesting the interest rate support that previously helped fuel currency appreciation will be reversed. Indeed, Brazil surprised the market with a 0.5% cut in interest rates
- The notable exception to this was the Chinese Renminbi where the onshore currency was virtually unchanged against the US Dollar. Further small steps have been taken by the Chinese authorities to increase the convertibility of the Renminbi, and officials have been talking about their aim of future full convertibility
- Safe haven currencies are becoming scarce. The Swiss National Bank has, so far at least, successfully capped the appreciation of the Swiss Franc. The previously high-flying Australian Dollar is

now less attractive because of softening commodity prices, and Norwegian Krone liquidity was never sufficient for the major players. This leaves the US Dollar to find support, despite the rating downgrade of US sovereign debt by Standard & Poor's last month, in spite of the faltering economy and low interest rates and despite probably unsustainable levels of government debt

- The Euro will continue to be buffeted by the uneven process of finding a resolution to the debt crisis of the peripheral Eurozone countries. Our central forecast is that this will occur but will be protracted, and politics will play a large part making the task of analysing the Euro that much harder. Furthermore, the ECB is likely to ease monetary policy, a move that is not supportive for the currency
- The Japanese Yen continues to be capped by the threat of intervention and the Sterling has little to recommend it, as interest rates will remain low, further quantitative easing is possible, if not probable, and growth remains anaemic. For now, the US Dollar looks like the winner of this 'ugly' contest, but, with many risk factors and political dependencies, we maintain our recommendation for neutral currency positions

Sovereign

Bahrain

The Central Bank of Bahrain (CBB) announced that the monthly issue of the Sukuk Al-Salam Islamic securities for the BD 18 million issue, which carries a maturity of 91 days, has been oversubscribed by 272%. The expected return on the issue, which begins on 28 September 2011 and matures on 28 December 2011, is 0.70%. The securities are issued by the CBB on behalf of the Government of the Kingdom of Bahrain.

Malaysia

Khazanah Nasional Berhad, Malaysia's state investment company, hired banks for a sale of the world's first Yuan-denominated Sukuk. BOC International, CIMB Group Holdings Berhad and Royal Bank of Scotland Group Plc are managing the sale of Sukuk in Hong Kong. Khazanah is seeking to raise Yuan 500 million (DH 288 million) from the 5-year Sukuk that pay returns derived from assets to comply with the religion's ban on interest, one person said. The Yuan-denominated Sukuk comes after Khazanah sold \$ 1.5 billion of 5-year Singapore Dollar Sukuk in August 2010.

UAE

Tamweel, the Dubai Islamic mortgage lender, has revealed plans to issue a US \$ 300 million –US \$ 500 million Sukuk in the fourth quarter of 2011. Tamweel has appointed three banks for the Sukuk, but declined to give further details.

Saudi Arabia

Saudi Aramco Total Refining and Petrochemical (SATORPSATORP) announced the launch of its public offering of Sukuk certificates by Arabian Aramco Total Services Company (AATSC), a company especially established for the purpose of issuing the Sukuk on behalf of SATORPSATORP. The proceeds of the issue of the Sukuk will be contributed by AATSC to the Musharaka and will be used to provide finance for, and procure the construction and delivery of two petrochemical tank farms as part of the development of the SATORPSATORP refinery project. The Sukuk was 3.5 times

Bahrain

The Central Bank of Bahrain has said the Kingdom has selected three international banks to advise on the sale of around US \$ 1 billion in Sukuk next month as the country seeks to bridge its budget deficit. The funds will be used to finance a budget deficit of around 5% of the gross domestic product. Citigroup, BNP Paribas and Standard Chartered will advise on the Sukuk sale, which follows Bahrain's government raising the public debt ceiling by BD 1 billion (US \$ 2.65 billion) to BD 3.5 billion.

Qatar

Qatar International Islamic Bank (QIIB) has revealed plans to issue a benchmark-sized Sukuk and has hired banks to arrange the sale. The Islamic lender appointed QNB Capital, the investment-banking arm of Qatar National Bank, Standard Chartered and HSBC to issue a benchmark Sukuk. The Sukuk is believed to be US Dollar-denominated and could be issued by the end of this year or in early 2012.

oversubscribed, making the final offering size of US \$ 1 billion. The floating rate Sukuk will have a tenor of about 14 years. It was offered at 6-month Saudi interbank offered rate, or SAIBOR, plus 95 basis points. The refinery was projected to cost about US \$ 14 billion to be constructed? and is? capable of carrying 400,000 barrels per day exports. This is expected to be completed and active by the end of 2013.

Turkey

Albaraka Banking Group announced that Albaraka Turk Katilim Bankasi (ALBRK), the Shariah-compliant Turkish unit of the bank, may sell about US \$ 200 million in Sukuk by November, while the Bahrain-based parent may raise about US \$ 300 million from a similar sale by the end of the year. Albaraka has added that the bank is seeking an acquisition in Indonesia, where it plans to buy a "small" conventional bank and turn it into a Shariah-compliant lender. He expects Al Baraka unit in Egypt to post a 15% growth in profit in 2011.

Corporate

Long-term Investment Outlook (3 - 5 years)

Asset Class	Current View	Reasoning
Developed Market Equities	Positive	Average rate of growth somewhat subdued in the developed world. Yet exposure to higher growth areas like emerging markets will benefit earnings growth and dividend growth and are likely to keep average nominal returns at high single digit levels.
Emerging Market Equities	Positive	Expected to outperform developed market equities thanks to a favourable structural backdrop including improved fiscal management and trade balances, labour force expansion and rapid urbanisation.
Commodities	Positive	Growth in emerging markets likely to remain an element of support for this asset class.
Developed Cash Rates	Negative	Subdued economic growth and stimulus measures are likely to keep rates at low levels for the foreseeable future.

For further information, please visit www.premier.sabb.com where you will find contact details for our Premier Relationship Managers.

This report is prepared for information only. Where the information contained in this report is obtained from outside sources, SABB believes the information to be reliable. However, SABB does not guarantee its completeness or accuracy. The opinions expressed are subject to change without notice, and SABB expressly disclaims any and all liability for the information contained in this report.

The report only contains general information. It should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe to any investment. The specific investment objectives, personal situation and particular needs of any person have not been taken into consideration. Accordingly, you should not rely on the report as investment advice.

Neither SABB nor any of its affiliates nor their directors, officers or employees will be liable or have any responsibility of any kind for any loss or damage that may be incurred resulting from the information contained in this report.

T 800 116 0099
W www.premier.sabb.com

SABB  PREMIER