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What to buy in 2011

BY KELVIN TAN

This year has been topsy-turvy, and divided into diverse halves. For most of 1H2010, global financial markets — spooked by China's surprise credit-tightening measures, Greece's sovereign-debt turmoil and the fear of a double-dip recession in the US — were in a slump.

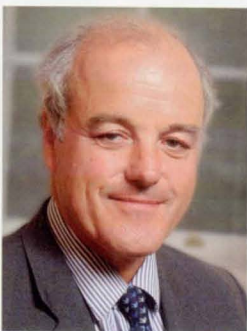
After hitting a low in July, global equities and other risky assets started to make a comeback in late August after a slew of better-than-expected US economic data confirmed the world's biggest economy was still growing, but at a dreary pace. News of more quantitative easing, dubbed QE2, by the US Federal Reserve to aid the economic recovery in the US further boosted sentiment, triggering a big rally in the prices of risky assets over the past four months.

Bob Doll, vice-chairman and chief equity strategist for fundamental equities at global fund management house BlackRock, says: "Equity markets have come a long way over the past couple of months. For the year as a whole, they have been able to grind higher despite high volatility and some significant setbacks along the way."

Overall, 2010 turned out to be a decent year for most asset classes, particularly equities, gold and commodities. For equities, key stock market indices such as the Standard & Poor's 500, the MSCI World and the MSCI Emerging Market were up 11.5%, 7.8% and 12.4% respectively as at Dec 16. Equally

impressive were commodities, whose prices, measured by the Thomson Reuters/Jefferies CRB Index of 19 raw materials, rose 12% on average this year (as at Dec 16). Among the biggest winners in the commodity space were gold and silver, whose prices surged 25% and 73% respectively.

To get some perspective on the investment landscape next year, *Personal Wealth* recently spoke to a panel of investment experts comprising Doll; emerging-markets guru Mark Mobius, chairman of Templeton Asset Management; veteran fund manager Angus Tulloch, joint managing partner of the Asia Pacific/global emerging markets equity team at First State Investments; Malay-



Tulloch: We consider Africa the most interesting emerging area for investment at present

sia- and Singapore-based Tan Teng Boo, founder of boutique fund management firm Capital Dynamics; bond specialist Xavier Baraton, global chief investment officer (CIO) of fixed income at HSBC Global Asset Management; Frederic Lamotte, CIO of Credit Agricole Private Banking; and Lim Say Boon, CIO of DBS Private Banking.

Looking ahead to 2011, the consensus among the experts is that risky assets such as equities and commodities are going to see another year of good returns, fuelled by easy monetary policies in a benign interest rate environment. Although volatility will remain high, equities, bonds and currencies from the emerging markets are expected to outperform those of the developed world next year, say the experts, who also like gold and industrial metals. Government bonds remain clearly out-of-favour with many investment pros, who continue to like corporate bonds. Read on to find out what you should be doing with your money in the coming year.

It was another volatile year for global financial markets. Which market event was the most remarkable?

Angus Tulloch: I would look back at 2010 as a year of inordinate confusion. Markets were, and are still, uncertain as to whether quantitative easing is working. On the macro front, the Greek and more recent Irish bailouts showed how fragile the global financial system is. My view is that we will see more episodes like these over the next year. Until invest-

ment-banking activities are conducted by genuinely standalone entities, independent of the retail banking sector, we are unlikely to see a more sustained return of global financial stability. On the micro front, the BP oil spill highlighted the importance of corporate governance and, specifically, the need for companies to look after the interests of all stakeholders — customers, employees, the community at large as well as shareholders. Companies that cut corners in search of short-term profit growth invariably hit a brick wall, and thereby fail to deliver long-term shareholder returns.

Tan Teng Boo: It was a year when many market events — such as the rolling European debt crisis, the unnecessary US-China currency war and the inexplicable tension in the Korean Peninsula — could have tipped the global economy into another year of contraction. But, despite persistent fears of a double-dip recession, the global economy continued with its merry expansion. For equity markets, 2010 was like 'much ado about nothing'. Many equity markets had a sideways trend. There was a dip of sorts in the middle of the year but confidence re-emerged after that. Unlike the collapse of Lehman Brothers in 2008, there was no single event that shook the market hard in 2010. To me, what is clearly very distinct about 2010 was the relentless bashing of China from every angle, especially by the developed nations.

Share prices on display at a securities company in Jakarta, Indonesia, whose stock market surged 41.3% this year (as at Dec 17). For 2011, many fund managers and strategists are still bullish on emerging-market stocks.

Microsoft



Both BlackRock's Doll and International Value Advisers' de Vaulx like US tech companies such as Microsoft

Top investors' best picks

BY ALINA SELYUK |

Top global money managers recently spoke at the Reuters 2011 Investment Outlook Summit and addressed concerns over the European debt debacle, the euro currency, the future of global markets and the world recovery. Here are some of the investment ideas they shared, offering a peek into their expectations and possible trends in 2011.

Equities

The message from top investors on equities remained similar: They will be an attractive trade in 2011. Percival Stanton, head of Baring Asset Management's global multi-asset team, likes British equities with overseas exposure and, in general, international companies exposed to emerging markets such as **Unilever** and **SABMiller**.

Bob Doll, chief equity strategist for fundamental equities at BlackRock, said the growth of the equities market is resting on emerging markets and global cyclical firms, many of which are "cheap, good, free-cash-flow kinds of companies".

Doll likes technology companies **IBM**, **Microsoft**, **Western Digital** and **Seagate Technology**; energy companies **Marathon** and **ConocoPhillips**; and media firms **News Corp** and **Comcast**. As sectors to underweight, he listed consumer staples, which have been hurt by spikes in the cost of raw materials, and financials. Doll is looking at a target of 1,350 for the Standard & Poor's 500 at end-2011. That's more than 8% from the index's current level.

International Value Advisers portfolio manager Charles de Vaulx zoomed in on Japan, sounding optimistic notes on growth prospects of Japanese stocks. He also said he liked technology stocks as well as large-cap US stocks — such as **Microsoft** and **Dell** — relative to small and mid-sized stocks.

Foreign exchange

The euro, damaged by the eurozone debt troubles, drew sceptical comments from money managers. Baring's Stanton said his firm only owns the US dollar and Chinese renminbi, entirely avoiding euro exposure.

"We think it's very likely [the euro] will fall apart," he said. "The chances to keep pushing things down the road in the hope of being bailed out by global growth is pretty low."

Sovereign debt

BNP Paribas Investment Partners is underweight in US Treasuries, although William de Vijlder, the firm's chief investment officer, said the US Federal Reserve's quantitative easing programme was capable of massaging away any large spike in yields if a market sell-off gets under way. "We think Treasuries are unattractive because they are unstable," he said, referring to the current potential for low yields to quickly bounce higher.

Stanton was also negative on sovereign debt. "We don't like government bonds," he said. "We don't like Western bonds. The few bits of safe-haven status we have, we are gradually trading out of."

De Vaulx especially discouraged investors from betting on long-dated bonds with euro-debt worries lingering and concerns over the possibility of the US inflating away some of its outstanding debt.

Emerging markets

BNP Paribas Investment Partners expects emerging-market equities to gain 20% over 2011, De Vijlder said. He also said BNP liked emerging-market bonds and corporate credit for 2011 and plans on keeping its overweight positions in them. Overall, De Vijlder said he expected 2011 to be similar to 2010. "It will be a bit of the same. We don't expect anything interesting from nominal government bonds. We want to stay overweight in emerging debt, equities and corporate debt," he said.

Baring's Stanton also said emerging markets had better growth prospects than developed countries and, so, offer better opportunities for 2011.

Commodities

Gold remains a bright spot on investors' radar screens, used heavily as a hedge against inflation and expectations of quantitative easing. "I'd never bought gold for institutional clients until 2007," Stanton said. "We bought it because the tensions in financial markets were some sort of money-printing exercise."

Gold, whose price has been lingering at historically high levels, is neither cheap nor "outrageously expensive," said IVA's de Vaulx, a long-time gold investor. While he stopped short of predicting further large price jumps in gold, he underscored the value gold carries not per se but in comparison with other asset classes. — Reuters

'Volatility will be around for a while'

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Xavier Baraton: As a bond manager, if I were to stress one critical event in 2010, it would be the spike in volatility in 2Q caused by the Greek turmoil, which caused the eurozone to be under fire. The European Union was so slow to react and disorganised in the handling of the Greek crisis. The pressure on Greek bonds was already felt in January, and only in May did the EU start to fix the problem with an appropriate response. That was disappointing. Another interesting development in the fixed-income market this year was the increase in appetite for emerging-market bonds, which have been spectacular in 2010 in terms of investment inflows. The rally in US Treasuries, which we have seen for most of this year until very recently, was also unique in the history of the bond market.

Frederic Lamotte: 2010 was the year of risk reassessment. We discovered that bonds, normally thought of as a safe asset class, aren't [safe] any more. Compared with equities, some bonds have been slightly more volatile. Emerging stock markets were considered to be more risky in the past. Now, it is the opposite. If you look at volatility, high-growth markets of the emerging world, in general, are less volatile than developed markets. The same could be said of commodities. Gold has always been considered a safe asset. But, the volatility of gold, this year, has been going up quite significantly because a lot of investors have been buying gold through many kinds of instruments, causing an increase in the volatility of this asset class.

Lim Say Boon: This has been a year of sideways trading for the equities markets of the developed world, with the global index, the MSCI World, yet to clear its year high. But, 2010 has been the year of the emerging market investment theme, as manifested by [the outperformance of] emerging-market equities, local currency emerging market bonds, Asia ex-Japan properties and commodities, all of which are driven by emerging-market growth.

Mark Mobius: 2010 was a year of economic recovery. Many emerging markets recorded strong GDP growth as economies recovered from the financial crisis in 2008. A critical aspect of the year was the way the two most populous countries in the world, China and India, forged ahead with incredible GDP growth.

Bob Doll: I think the European debt crisis, which began during the second quarter of this year, combined with the markets' ability to overcome the issues, was remarkable. While the short-term response was negative in the markets, the markets were able to get past the crisis and eventually move higher.

Will 2011 be a good year for equities and risky assets in general?

Lim: The best part of the bull market that started in early 2009 is over. Typically, the biggest gains are seen in the early part of the bull cycle, when markets are most fearful. That's what you get paid for taking risks. Nevertheless, the bull market is not over yet. Markets are not euphoric enough for that final blow-off in optimism. Equities and commodities will continue to struggle upwards, but in fits and starts. They will be pushed and pulled by the opposing forces of aggressive monetary expansion in the US and growing concerns over government deficits and debt in both the US and the euro area. China's monetary tightening is an added concern. On balance, you will

see more gains in both equities and commodities, generally. Liquidity should win out in the end. Stock valuations are still trading at the low end of their cyclical ranges despite ultra-low interest rates.

With bonds — particularly government bonds — looking somewhat overvalued relative to equities, equities should outperform bonds over 2011. But, all diversified portfolios should continue to have some weighting in fixed income, depending on the investor's risk appetite. Even in the most bullish of scenarios, bonds are an important diversifier and insurance against volatility. Next year, in particular, insurance will be important. Commodities should outperform. Cash, with near-zero interest rates in many parts of the world, won't give you much performance.

Mobius: Yes, 2011 will be a good year for equities as investors continue to look for higher returns in a low-interest-rate environment while valuations remain attractive. As such, we expect the strong fund inflows seen in 2010 to continue into 2011, which could further support prices. Although we are optimistic about the markets' upside potential, it is important to realise that volatility is still with us and will be with us for a while. This means there will be down markets as well as up markets. We therefore must pay attention to valuations and long-term earnings growth prospects to avoid buying or holding expensive stocks as a result of dramatic price rises that we have seen.

Doll: Yes, stocks will outperform. The middle-through economy, which we have experienced in 2010, will likely continue into 2011, allowing earnings to grind higher. While we do not anticipate strong economic growth, we do see enough growth in the US to allow corporate earnings to improve, paving the way for higher positive equity market returns in 2011.

Tulloch: We believe stock selection rather than market forecasting to be our core competence. However, barring some cataclysmic disaster, it is difficult to see real returns on bonds or cash being higher than equities so long as interest rates continue at such low levels. Careful stock selection, as always, is key to outperformance. Risky assets are generally priced for near-perfection at present, and investors will be better off focusing on well-managed companies with solid "price-giving" franchises and sound balance sheets and which also generate strong sustainable cash flows.

Lamotte: Risky assets will do well in 2011. At the top [in terms of asset allocation], I would stick with equities and, just below that, I would pick commodities. We also see alternative investments making a comeback next year because volatility will be a bit more under control in 2011 compared with this year. Fixed income is clearly at the bottom in terms of our preference. I think everybody agrees with that.

Tan: Select equity markets will do well, while some recent top performers such as Sri Lanka and Turkey will not. So far, the global economic recovery has been uneven. 2011 may see synchronised economic growth in the major economies such as China, the US and Germany. But inflationary pressures may worsen.

For equities, are emerging-market stocks still the best bet?

Mobius: Emerging-market equities could fare well next year and even better than 2010 because of the following reasons. First, there is



Tan: China's secular economic transformation is far from over

relatively higher GDP growth in emerging markets. Second, the accumulation of foreign exchange reserves and the relatively lower debt levels put emerging economies in a much stronger position to weather external shocks. Third, there is growing investor confidence in emerging markets, and strong fund flows into emerging markets should continue as investors search for higher returns in the face of low bank interest rates. Finally, and most importantly, emerging-market stocks are still trading at attractive valuations.

Lamotte: We will maintain our high exposure to equities in the high-growth markets. In our balance portfolio, equity exposure to emerging markets is 61% to 62%. But we may go even further. In our selection of US stocks, we have chosen only those with at least 20% of revenues coming from emerging markets. So, even in our choice of US stocks, the ones we like are those geared towards high-growth markets. Similarly, our choices of European stocks for our portfolios are those with at least 50% of revenue coming from high-growth markets.

Doll: Long term, the emerging markets are likely to outperform the developing countries, owing to the strong growth rates when compared with developed countries and a lack of the structural imbalances we see with debt levels and deficits. The fundamental advantage also remains with growing populations, increases in productivity and the emergence of the middle class, to name a few.

Tulloch: There is a case for arguing that developed-market equities will outperform. We are currently finding the most attractive investment



Lamotte: We will maintain our high exposure to equities in the high-growth markets

opportunities often to be listed in developed markets, but with much of their economic exposure being in the developing world.

Which regions and markets within the emerging world look the most attractive?

Mobius: It would be difficult to pick any one region since we are finding opportunities in almost all emerging markets. Currently, our largest exposure is to Asia, simply because the largest emerging market region will naturally have a larger number of investment bargains.

Commodity stocks continue to look good because we expect the global demand for commodities to continue its long-term growth. Consumer stocks are also favoured. With rising per capita income and strong demand for consumer and other goods, the earnings growth outlook for these stocks is positive.

We remain excited about the prospects of frontier markets because we expect many of them to become quite important and eventually become full-fledged emerging markets. We are currently finding opportunities in a number of frontier markets. Vietnam, Kazakhstan, Qatar, Ukraine and Nigeria are very interesting to us. In the Middle East and Africa, Egypt and Kenya are looking attractive. In Eastern Europe and central Asia, the frontier markets of Slovenia, Romania, Croatia and Mongolia are interesting.

If liquidity and valuations permit, our exposure to frontier markets could increase in 2011. It all boils down to where we can find the best bargains for our investors. After all, frontier markets are a subset of emerging markets.

Tulloch: Insofar as one can generalise, we consider Africa the most interesting emerging area for investment at present. North Asia also

Best bets for 2011

Angus Tulloch of First Investments	Preferred regions/markets for stock exposure: Africa, Taiwan and South Korea Stock picks: DBS Bank, Yuhua (South Korea) and select developed-market companies that are benefiting from the growth of emerging markets
Bob Doll of BlackRock	Preferred regions/markets for stock exposure: Emerging markets and the US
Frederic Lamotte of Credit Agricole Private Banking	Preferred asset classes: Equities and commodities Preferred regions/markets for stock exposure: Emerging-markets such as Greater China nations, Brazil and India Stock picks: Rhodia and Air France-KLM of France as well as US counters Apple and Coca-Cola Fixed-income bet: Discounted LBO assets sold by banks on the secondary markets Commodity bets: Copper, zinc, gold and silver Currency bets: Asian and emerging-market currencies, and Swiss franc
Lim Say Boon of DBS Private Banking	Preferred asset classes: Equities and commodities Preferred regions/markets for stock exposure: Emerging markets, Australia and the US Commodity bet: Oil (to hit US\$100 per barrel)
Mark Mobius of Templeton Asset Management	Preferred regions/markets for stock exposure: Emerging markets, including frontier ones such as Vietnam, Kazakhstan, Qatar, Ukraine, Nigeria, Egypt, Kenya, Slovenia, Romania, Croatia and Mongolia Stock picks: Commodity equities
Tan Teng Boon of Capital Dynamics	Preferred markets for stock exposure: Russia, China/Hong Kong, and the Philippines Stock picks: Skilled Group (Australia), REXLot (Hong Kong) and Porsche (Germany)
Xavier Baraton of HSBC Global Asset Management	Fixed income bets: Short duration emerging market debts and corporate bonds such as the BBB- and BB-rated credits Currency bets: Asian currencies

presents some attractive opportunities. South Korea and Taiwan may well outperform, especially if the technology outlook continues to improve. Korean companies have identified certain branded niches (cosmetics as well as consumer electronics) and valuations are still reasonable. Taiwan should continue to benefit from a rapid improvement in its relationship with China, while it boasts some of the best managements in the region.

We are a little wary of China as we believe that interest rates will have to rise much more than the market now expects. We do not believe that recent food-price increases can be entirely attributed to seasonal shortages and suspect that the real rate of inflation is somewhat higher than the official statistics indicate. We hold no Chinese bank shares in our regional portfolios as we believe deposit rates will rise more than lending rates, squeezing margins and possibly also causing some loan servicing problems. Finally, many Chinese companies have yet to experience an extended recession. However well managed the Chinese

economy is — and its government's record so far has been exemplary — we do not believe they can eradicate economic cycles. As Warren Buffett once said, 'You only find out who is swimming naked when the tide goes out,' and very few Chinese companies have lived through difficult times since listing. Nevertheless, it would be very wrong to ignore the exceptional medium-term prospects for China, as well as the extent and speed of the country's industrial infrastructure upgrading.

Tan: Over the next one to two years, we like Russia and China/Hong Kong. As we see it, China's secular economic transformation is far from over. Valuations of stocks in China look attractive and there are just too many China bashers. We see a recovery in the Chinese stock market next year. Over the medium- to longer-term horizon, we are also bullish on the Philippines, which is at the early stages of economic reforms under President Benigno Aquino.

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Of caution, bearishness and bright spots

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Lamotte: We like Asia and, within Asia, we like the Greater China markets such as China, Hong Kong and Taiwan. China is a difficult market; nevertheless, in terms of valuations and growth, stocks there still look compelling at this point. We strongly believe that the Chinese authorities are managing the economy well. For India, we are always positive on that market. India is investing in infrastructure, which is domestic-driven and long term. Looking ahead, we will probably continue to see very good profit figures for companies in India.

Brazil, the largest economy in Latin America, then comes after. We are also very positive on that market. Brazil has managed to control inflation, which is just below 10% at this point. They have lived with hyperinflation before, so they know what harm high inflation could bring. It is a country with increasing reserves and resources plus a young population. It is a good place to be. For Russia, it is a call on oil. I would say I don't have the same enthusiasm for Russia that I have for the other BRIC markets. Clearly, there is massive potential in Russia, which is a large country. There will be quite a lot of IPOs coming up but the question is more about governance. For Russia, we feel that there is more opportunity on the energy front.

Which markets are you cautious on?

Mobius: While it is generally possible to find selective investment bargains in most markets, in terms of valuations, markets such as Colombia, Sri Lanka and Ukraine look increasingly expensive with [price-to-earnings ratios] exceeding 25 times. However, we would not avoid these



Baraton: Emerging-market debts still look very attractive in terms of valuations

markets per se because it is usually possible to find selective bargains in most.

Tulloch: Argentina, Brazil, Indonesia, the Philippines, Sri Lanka, Thailand and Turkey are traditionally volatile and politically sensitive. Stock-market valuations currently seem to assume that recent economic, political and stock-market improvements will continue ad infinitum. Maybe they will, but the downside, if they do not, is substantial.

Tan: We are bearish on Japan, Sri Lanka and India. After 20 years of economic stagnation, Japan is still in an entrenched self-denial mood. For Sri Lanka, we believe that its 2009/10 stock-



Lim: Within the developed region, Australia is probably the most attractive for equities

market rally was overdone. Indian stocks are also looking too richly priced, despite many major negative factors such as its current account and budget deficits, high inflation and a rapidly worsening rural-urban gap.

For developed-market equities, where are the brightest spots?

Doll: Among the developed countries, we continue to favour the US over Europe and Japan. On a cyclical basis and secular basis, the growth of the US economy is likely to be much stronger in comparison to many of the European countries and Japan in the short and longer term. The growth differential should be enough to have the effect on corporate profits, which are



Mobius: Markets such as Colombia, Sri Lanka and Ukraine look increasingly expensive

likely to be better in the US.

On a valuation basis compared with bonds, US stocks look extremely undervalued. In fact, the spread between earnings yields on US stocks compared with BAA-rated corporate bonds are at nearly record levels. While we have seen gaps like this occur in the past, they have always closed. Mathematically, the only way for the gap to close is for earnings to collapse, stock prices to go up or bond prices to go down. We believe that the possibilities for the last two events to occur are higher.

Lim: Within the developed region, Australia is probably the most attractive for equities. Its economy is arguably the strongest within the developed world. Its terms of trade have been rising, thanks to China's demand for its commodities. Its currency has also been rising against both the majors as well as Asian currencies. Its stock market has been resilient in the face of a rate-hiking cycle. My next selection would be the US because this is where the greatest amount of monetary stimulus has been seen.

Which stocks are you bullish on over the next 12 months?

Tulloch: DBS Bank. With both a relatively new and highly regarded chairman and CEO, it looks like a very solid proposition on a reasonable valuation. Singapore has perhaps the best regulated banking sector in the world, and is assuming a private wealth management role in Asia very similar to the one that Switzerland plays in Europe. As a financial and commercial hub as opposed to a major manufacturer, the Singaporean authorities seem much less concerned than China regarding currency appreciation too.

We also like **Yuhan**, a South Korean pharmaceutical company with a Kimberly Clark joint venture in manufacturing personal care products, diaper and paper tissues. The Korean drug industry has been beset with problems of dubious sales commission arrangements for the last couple of years, but these now seem to have been sorted out. As the most ethical participant in the sector, we expect the new environment to favour Yuhan, which has a strong pipeline of new products to be launched shortly. The outlook for **Kimberly Clark** in Korea and China also looks very promising.

Tan: We like **Skilled Group**, a leading provider of staffing/labour services in Australia and New Zealand. The group provides skilled and semi-skilled people in various industries. It was affected by the US-led global financial crisis and, under a new CEO, is repositioning itself for a speedy and sustained recovery, which we think is already underway.

We continue to be bullish on [the Hong

JPMorgan recommends 'new Singapore stocks'

Singapore stocks are expected to turn in dreary gains of just 8% on average in 2011, according to JPMorgan Securities Singapore, which is forecasting the Straits Times Index to reach 3,500 by end-2011. Local stock investors who are gunning for more exciting gains, however, could consider investing in "new Singapore" companies such as those that are experiencing sustained earnings growth momentum, says Christopher Gee, head of Singapore equity research at the brokerage, which is bullish on stocks such as **First Resources**, **China Minzhong Food Corp** and **Keppel Corp**.

"What we are observing in the market today is the emergence of new Singapore companies.

These are companies that are not depending on the domestic economy and they do very little business in Singapore. Even if they are Singapore-based, they are deriving a lot of money from tourists coming in to Singapore, like the casinos," explains Gee in a recent media conference. New Singapore companies are those in the wealth management, tourism and leisure, and resources sectors. On the other hand, he adds, big STI component stocks such as telcos, banks, property and media companies are considered as "old Singapore companies".

"New Singapore stocks will show a lot more growth over the course of the next three to five years," says Gee, who predicts that earnings

growth for these companies will range from the "high teens to 20%" for next year. These fast-growing companies are priced at valuations above the market average while the old Singapore stocks are trading below market average. Old Singapore stocks offer significantly lower growth prospects, with expected 2011 earnings per share (EPS) growth of 9%, Gee points out. "If you are looking for growth, you would want to go with the new Singapore stocks," he says.

Two plantation-related stock names in the new Singapore category that JPMorgan Securities is bullish on are palm oil producer **First Resources** and vegetable seller **China Minzhong Food Corp**. For First Resources, production growth over the next one to two years will average 10% to 12%, predicts JPMorgan analyst Chan Ying-Jian. "That's one of the highest production growth [levels] among plantation companies in Singapore," says Chan. In addition, valuations of First Resources stock, which is trading at a forward PER of 12 times, look cheap, he adds.

Similarly, **China Minzhong Food Corp**, which Chan regards as "a consumer staple play", is a fast-growing company whose shares are trading at compelling levels. "They are going into organic vegetable farming and EPS growth over the next two to three years is about 30%." Yet, the stock is trading at a forward price-to-earnings ratio of just seven times, he points out.

Gee says conglomerate **Keppel Corp** is making a successful transition from an old to new Singapore company. Old Singapore sectors such as rig-building have established a global competitive advantage and deserve to be considered as growth champions, he adds.

"Keppel Corp is gaining market share globally in terms of rig-building. It is beginning to see a pickup in rig orders and that should be positive for Keppel next year," he says. — *By Kelvin Tan*



An offshore platforms belonging to Keppel FELS, a wholly owned subsidiary of Keppel Corp, the world's top offshore rig builder

Kong-listed] **REXLot**, which provides a lottery-related system, machines and services to the Chinese lottery market and the distribution and marketing of lottery tickets in China. REXLot is a major participant in the industry and the welfare and sports lotteries in China will continue to enjoy significant growth in the longer term.

[Germany-listed] **Porsche**, a branded and iconic sports car maker, is another stock we like. It got too ambitious. However, Porsche now offers a cheap entry into the shares of **Volkswagen**, which is easily one of the strongest car makers in the world today.

Lamotte: Some European stocks that we like are [French chemical firm] **Rhodia** and [French airline company] **Air France-KLM**, both of which have good revenue exposure to emerging markets. If you look at the French airline company, more than 50% of revenue comes from high-growth markets. We also like US stocks such as **Coca-Cola** and **Apple**.

What is the outlook for the global fixed-income market next year?

Baraton: It is going to be like this year. I don't want to be boring but I don't see why the big picture would change. The US is still in a deleveraging phase and property prices are likely to go down again in America, owing to high inventory levels. That means negative equity for households, and there is too much capacity in the industries. In Europe, economic growth isn't going to pick up massively because of the current mess in the peripheral countries, where every one of them have to cut their deficits. So again and again, the world will have to rely on emerging markets to make global growth look decent. Unless countries such as China and India continue to grow very fast, global growth could be a little slower compared with 2010. The bottom line is that the interest rates [of developed markets] are not going to go up. That means risky assets such as emerging-market debts are attractive and will continue to be attractive.

What are the drivers that would spur prices of emerging-market debts higher?

Baraton: This year, emerging-market debts have done well. But their good absolute performance was mainly fuelled by the fall in US Treasury yields and not so much from the spread compression. So, emerging-market debts still look very attractive in terms of valuations. Spreads are still wide compared with the low levels of 2006. [The yield-spreads differential of emerging-market bonds and US Treasuries, currently around 300 basis points,] could narrow by another 50 basis points. The lows were just below 200 basis points, so it is not too optimistic to predict another 50-basis-point narrowing of spreads. At the same time, fundamentals continue to improve. We have seen the upgrade of the bonds of China and Hong Kong, and an improved outlook for those of the Philippines, Thailand, India and others. It shows that the rating trend for emerging markets is still on the way up. It is a structural shift. We like Asia bonds relative to those of Latin America.

Inflationary pressure in the developing world could lead to more interest rate hikes next year. Wouldn't that have a negative impact on the prices of emerging-market bonds?

Baraton: Yes, but the way you execute your strategies with emerging-market bonds can make a real difference in terms of returns. Take India, for example. The recent GDP figures were stronger than expected and that has attracted a lot of inflows into India. But, with inflation picking up pretty strongly now, there is a risk that the longer end of the curve could move up and you could book capital losses in bonds with a long duration.

For sure, emerging-market debts look like an interesting to play for the next 12 to 18 months but you need to stick to the short end of the curve. Make sure you make your gains

on the currencies and don't make losses when rates start to go up.

What are your other fixed-income bets?

Lamotte: We are most bullish on secondary-market LBO [leveraged buyout] products [which banks are disposing of]. In the past, banks had been financing big LBOs. They normally would participate in such buyouts with a small stake, such as 5%, to have an alignment of interest. Today, we know that the banks have difficulties with these assets, which yield little. With Basel III, there will be a lot of constraints on the banks' balance sheets and reserve ratios. So, these types of assets are not optimal for

the banks. That means banks will have to sell these LBO assets on the secondary market at massive discounts. Investors can get these assets that are yielding Libor plus 400 to 600 basis points. For our private-banking clients, money could be pooled through a fund, which will go and buy these assets.

Baraton: In terms of corporate bonds, we still like the sweet spot between BBB- and BB-rated credits. The risk premium there is still looking too high, compared with the true default risk. We are a bit cautious on the lower end of the high-yield spectrum, where we are extremely selective.

Are you staying away from government bonds of the developed world?

Baraton: We are staying away from government bonds in general and especially those of the European peripheral countries. The crisis has yet to come to an end. The market is telling us that there must be a more comprehensive answer by the EU to the debt problems of the peripheral countries. The EU is now dealing with their problems one by one, like what they did with Greece and Ireland. But there will be another one. There will be Portugal and then Spain because we know that the situation is going to deteriorate for another three years.

CONTINUES NEXT PAGE

Risks of inflation, deflation and uncertainty

REVIEW PAGE

So, why would you want to lend to Portugal and Spain if you know that, in two years' time, they will have more debts?

Lamotte: We will not touch PIIGS [Portugal, Ireland, Italy, Greece and Spain] bonds. There are other things that look brighter.

What is your outlook for commodities and the best plays for 2011?

Lim: Commodity prices are likely to head higher next year. USD weakness, ongoing tightening of demand-and-supply dynamics in a number of commodity markets, demand growth of China, as well as growing investor interest are key factors that would support higher commodity prices through the year.

Within commodity, we particularly like oil. The demand-and-supply outlook for oil has improved gradually while inventories are being drawn down gradually. Indeed, OPEC spare capacity is still running around 7% of global demand, which is growing. This number could decline to 4% in three to four years' time. While oil could correct in the near term if the USD strengthens further, renewed USD weakness and growing demand over the coming 12 months is likely to push oil towards the US\$100 per barrel level.

Lamotte: We like industrial commodities such as copper and zinc. These are metals you need to build infrastructure. When you have millions of people in China migrating from the rural areas to cities, it takes a lot of copper to wire up everything and a lot of zinc to put up the roofs of new buildings. The demand for these metals remains extremely high. We are seeing that trend in Brazil and India. When the prices of these metals go down, [governments of] emerging markets will start to buy in a big way and dispose of their USD reserves. They will put the commodities in the warehouses, as they will use them anyway in the coming years. So, for investors, as soon as prices of industrial metals go down, start to buy them.

We are also bullish on silver, which everybody thinks is more of a precious metal. But, actually, a lot of silver is used in industrial products such as the welding of electronics. So, if industry demand and the economy go up, silver prices will go up. That's why silver prices have been moving up of late. It is more an industrial metal than a precious metal that you store and put in a safe.

Any view on gold, which is one of 2010's best-performing asset classes?

Lamotte: [CLSA strategist] Christopher Wood has predicted that gold will hit US\$3,000 at the end of this year, owing to the lack of confidence in the greenback. He recognised that his call has been short on the timing but he has seen the uptrend and has been moving in the right direction [CLSA is owned by Credit Agricole]. In the medium term, I do believe that gold will go up. It could correct to US\$1,350. Still, the trend is positive for gold. As long as there is printing of money by the Fed, be it QE2 or QE3, gold will go up.

What are your best currency picks?

Baraton: Stick with Asia and emerging-market currencies.

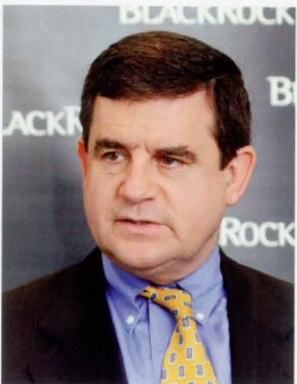
Lamotte: We have told clients to stop looking at euro/USD trade. They should look at high-growth economies' currencies vis-à-vis the rest of the world. We strongly believe that Asian currencies will continue to appreciate. They should also buy Swiss franc [against developed-market currencies] because the largest pool of gold is in Switzerland.

What are the key risks to look out for over the next 12 months?

Baraton: We need to keep an eye on China and whether the authorities there will help its economy land softly. For now, they are doing a good job, raising the banks' reserve requirements and trying to control the lending activities to avoid a property bubble. But it is important that they succeed without resorting to a hard landing because global growth will depend on China. If China's economy experiences a hard landing, it is going to be dark for everyone. Risky assets will suffer.

Doll: The biggest risk we see for investors in the coming year would be deflation. Deflation is a very rare occurrence. We experienced some deflation in the US during the great depression and have seen some of it in Japan in the 1990s. However, the risk of deflation is perhaps higher than normal and we are watching that more so than the concerns around inflation in the markets.

Lamotte: There will always be event risk. The current uncertainty in the Korean peninsula is something that months ago we didn't ever hear of. But you manage your risk after the event happened, not before it, because you don't know what risks will pop out. Will there be more event risks in 2011? Yes, very probably. What will they be? I have no clue.



Doll: The biggest risk we see for investors in the coming year would be deflation

Mobius: The biggest risk is to get caught up in the euphoria of the market if valuations are no longer attractive from a rational point of view. A slowdown in money supply growth as well as an increase in real interest rates and inflation are also key risks.

Tulloch: Inflation in China. Remember the Tiananmen Square incident happened at a time of high inflation. Further financial problems in Europe would be our other main concern. But, problems usually come from totally unexpected sources.

Lim: A euro sovereign debt default, trade and geopolitical tensions between the US and China and the escalation of the conflict on the Korean peninsula are the main risks.

Finally, name one event or scenario that could unfold in the financial markets in 2011.

Baraton: Portugal and Spain [will receive monetary aid from EU in a bid to stop its national debt crisis from spiralling out of control]. It is not even a question of probability. It will happen. The market is just pushing till the ECB, EU and the IMF do a big, big package. I am not talking about a €700 billion but a €2 trillion type of

Ways to play the 'most precious commodity'

BY MIRIAM GOTTFRIED

It takes 2,800 gallons (10,600 litres) of water to make one bed sheet and 634 gallons of water to make one hamburger, according to National Geographic. Americans use about 100 gallons of water at home each day, while millions of poor people around the world subsist on fewer than five gallons.

It follows that as some of these poor nations undergo economic development, their populations will need more water to produce the goods they consume. In short, water is a limited commodity, and demand for it is rising exponentially.



Limited but in demand

That is why Joseph P. Quinlan, chief market strategist for US Trust, has made investing in water a key focus of his long-term commodity strategy. "I've spent enough time travelling in emerging markets, whether it is the Middle East, Asia or Africa. They have come to recognise that, without clean water for agriculture, industry or the urbanised populations, these economies aren't going to grow. So, there is no substitute for water when it comes to economies. You need clean water for sanitation purposes, for agriculture and so forth. It is the world's most precious commodity, but it is grossly

underappreciated all over the place," says Quinlan, who is using US-listed exchange-traded funds (ETFs) such as **PowerShares Water Resources** and **PowerShares Global Water Portfolio** to play the water-shortage theme.

Another way to play water or the water theme is vis-à-vis agricultural commodities, adds the strategist, who is predicting prices of agricultural commodities to rise further. "I think we are in a secular bull market for commodity prices. A lot of the agricultural supply side of the equation is being constrained by water scarcity," adds Quinlan, who is also bullish on an agricultural ETF called the **Market Vectors Agribusiness**.

"If an investor wanted to do an exchange-traded fund related to agriculture and another related to water, that would be a way to invest as well." Global food demand is rising because of the surging world population, which is expected to hit seven billion next year. At the same time, people in emerging markets, where wages and per-capita incomes are rising, are eating better, says Quinlan. "As they eat better, they put more stress on the agricultural

infrastructure, which in turn puts more stress on the water infrastructure," he adds.

The third way for investors to bet on the water theme is through large-cap industrial companies in the US and Europe that are in the business of sewage treatment, including the manufacturers of pumps, valves and filter systems, says Quinlan, who gave no stock names.

"What investors haven't quite squared in their heads is that water and agriculture are so importantly linked. The agricultural play is pretty well known, but the water play isn't," he adds.

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funding facility. They need to see the problems at their gates before they react. That's when Spain will come under fire. If the country can't make a bond issue because the market is 'closed', then many other countries will be next. Then, the next ones will be Italy and France.

Tulloch: Iran is perhaps more of a threat to global stability than North Korea. A strike on that country's nuclear plants would have significant impact on oil prices and thus the level of global economic activity.

Mobius: In the midst of a secular bull market, emerging markets, like most other global equity markets, may experience corrections along the way, since they are likely to be subjected to high volatility, given the prevalence of short selling, the increasing use of derivatives and the expansion of markets globally. However, short-term corrections may provide investors with appealing entry points as valuations drop to attractive levels.

Doll: We believe the significant fiscal and monetary stimulus in the US would begin to take hold and economic growth in the US could come in better than what is expected.

Lim: It will be a year of tensions between monetary expansion and limits of government intervention. On the one hand, governments are intervening to support economies and defend its sovereign [debts]. But, the markets will fear that governments will eventually run out of ammunition. On balance, the massive expansion of money supply in the US and elsewhere will likely win out in keeping the global economy afloat. In the process, this will drive continuation of the asset reflation that started in early 2009.

Tin: Despite all the worries about China overheating, the US economy growing too slowly, the European debt crisis widening to include even countries such as Spain and Italy, the global stock markets will continue with the rally that started in early 2009.

Lamotte: In Europe, people will pay more taxes and have less benefit. That is going to slow their economies. That's for sure. Portugal and Spain will try to avoid any funding from the EU. For financial markets, I think we are going back to normalisation. I don't think we are heading for a big crisis and I don't see massive inflation next year.