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DBS Treasures clients

July – September 2011



Managing Asia's New Wealth

Dear Clients,

The scenario that we expected in the second quarter of 2011 has played out. Investors turned jittery when US economic figures, particularly employment data, disappointed. In our outlook report for the second quarter, we wrote then that "the US economic surprise index suggests significant risk of disappointment". This scenario has come to life in May and June. While worries over Japan's natural disaster and the political uncertainty in the Middle East and North Africa (MENA) are now far behind (on the minds of investors), new concerns have emerged.

Worries over Greece's debt issues plagued the minds of investors in the second quarter. But by the time this newsletter reaches you, you would probably have gotten a clearer idea on the action plan taken by the International Monetary Fund and the European Union to keep Greece from defaulting and whether any debt restructuring would take place. Whichever the action plan, heaps of confidence in the PIGS (Portugal, Italy, Ireland, Greece and Spain) economies has been lost and it will probably take some time before investors regain confidence in the Eurozone.

In contrast to the poor sentiment over in the West, there has been an increasing number of reports in Asia that are pretty positive on the burgeoning growth in the number of wealthy in Asia – in particular, Singapore. According to the Boston Consulting Group (BCG) Wealth Report 2011, the proportion of millionaire households by market in Singapore rose further to 15.5% in 2010 from 11.4% in 2009. That means that out of every ten households, about 1.5 households amassed Assets Under Management (AUM) of more than a million dollars. In fact, the startling speed of wealth creation gave us inspiration for the overriding themes in this quarter's issue.

To start off, our Chief Investment Officer (CIO), Mr. Lim Say Boon, provided his view on why insufficient attention has been given to

Asia within a globally diversified portfolio, given the strong growth in the number of wealthy in Asia. In another section of the newsletter, we also shared the type of asset classes the wealthy are actually investing in, including real estate – a type of alternative investment.

And on the topic of managing wealth for the growing affluent in Asia, what better way than to round it up with special features on alternative investments – an asset class that has been gaining attention among the affluent. In this issue, we included a primer on this asset class and interviews with experts on the recent developments on Funds of Hedge Funds (a type of alternative investment).

It is good to know that Asians are growing wealthier and this is definitely a positive for the region. A healthy growth in the number of wealthy individuals usually translates to stronger spending power, and that tends to trickle down to benefit the economy at large. But managing wealth remains a key issue in the minds of the growing affluent in Asia. With markets seeing some consolidation at this juncture, this could be the time to explore ways to gain better risk-adjusted returns by seeking alternative investments that could possibly further diversify your investment portfolio.



Mah Ching Cheng
Wealthline Editor

Contributors Acknowledgement

Chief Investment Officer
Lim Say Boon

Editorial Team
Mah Ching Cheng
Michele Lee Huixian
Ansel Tan Tsu Minh

The Importance of Asia in the World

Asia ex-Japan still does not get the "respect" it deserves in global wealth management strategies.

The region is still massively "under-represented" in global portfolios, although it has become over recent years the most important driver of global growth.

However, international attitudes toward Asia in wealth management strategies are changing – albeit gradually. Over coming years, we are likely to see a more pronounced shift, with the wealthy of the world increasing the weighting to Asia ex-Japan in their asset portfolios.

400,000 newly-minted millionaires emerged in Asia between 2006 and 2009, notwithstanding the global financial crisis, according to data from Capgemini and Merrill Lynch. That is, the population of Asia's high net worth individuals (HNWIs) grew by an average of 366 a day over that period. China led the field with 123 HNWIs created every day. Singapore didn't do too badly either with 13 people joining the HNWI league every day. Indeed, another study by Boston Consulting Group found that Singapore is the top millionaire household capital of the world, with the highest percentage of millionaire households. In contrast, the HNWI population in the US and Europe was stagnant over that period.

These Asian HNWIs have invested overwhelmingly in the region itself. According to Capgemini and Merrill Lynch's Asia Pacific Wealth Report 2010, the rich in Singapore had an average of 80 per cent of their portfolios allocated to the region. In Hong Kong, the figure was 68 per cent and in Taiwan, it was 72 per cent. This should not be surprising. The rich in Asia make their money doing business in Asia. They understand the region's profit-generating potential. In fact, Asia ex-Japan grew its collective GDP by more than US\$7.6 trillion since year 2000. This is equivalent to the combined GDP of Germany and Japan.

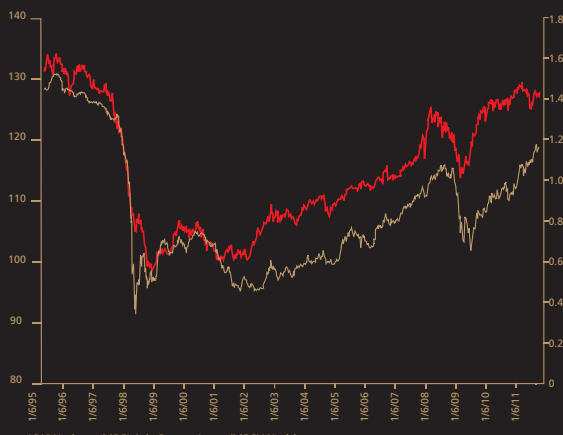
However, many international wealth management outfits continue to recommend a relatively small percentage allocation to Asia ex-Japan for their clients' portfolios. While liquidity and depth of the asset markets in Asia had in the past been a legitimate concern, the degree to which international portfolios are structurally underweight Asia ex-Japan goes way beyond the comparative sizes of the Asian capital markets.

The International Monetary Fund (IMF) found that emerging markets accounted for a little more than 2 per cent of total portfolios in the US although emerging market equities' share of global market capitalisation totalled around 16 per cent. The picture for Asia ex-Japan specifically is likely to be similar.

Attitudes among the rich in the developed markets have lagged the enormous economic changes in Asia over the course of the past 10 to 11 years. Asia ex-Japan is still seen as high risk and hence assigned a relatively small portion of portfolios by wealth managers in the developed world. It does not help of course that historical data which captures the Asian Financial Crisis will paint a high-risk picture for emerging market and Asia ex-Japan assets.

But the world has changed dramatically from the late 1990s. Asia ex-Japan experienced a long cycle of prosperity from 2003 to 2007, with its stock market outperformance relative to the rest of the world being accompanied by currency appreciation against the USD. After a brief interruption during the global financial crisis, the trend has resumed and is likely to continue. (Figure 1)

Figure 1: Asia ex-Japan equities outperformed alongside appreciating currencies



Source: Bloomberg, data as of 3 June 2011

Asian economies recovered earlier than developed economies from the global financial crisis, and have enjoyed far more robust growth rates than the US, Euro area and Japan.

US households continue to struggle with weak balance sheets and high unemployment. The Euro area is fighting a desperate battle against potential sovereign debt defaults in Portugal, Ireland and Greece. Japan never really recovered from the deflation of the 1990s.

But Asian household balance sheets are generally sound. Corporate balance sheets have been rebuilt since the time of the Asian Financial Crisis. With the notable exception of India, governments generally run either budget surpluses or manageable and non-structural deficits. Current account balances are similarly either in surplus or suffer only small deficits. The banking systems are much stronger than those in the West, and domestic consumption is growing rapidly.

There may be shocks from time to time which could affect fund flows into Asia. But over the longer term, Asia ex-Japan is likely to become more important in global portfolios. The rich in Asia already "get it". The rich in the developed economies are starting to "get it" as well.

A Primer on Alternative Investments

The impression that investors have of alternative investments is that they are too complicated to grasp or understand. In fact, these types of investments are not difficult to grasp if one concentrates on their key features and principles and focuses on the major groups of alternative investment products available.

What are alternative investments?

Alternative investments are simply investments which are not constrained by the limitations of traditional long-only listed investments. They include real estate, private equity, hedge funds, managed futures and distressed securities. We have highlighted some key characteristics of these types of investments in Figure 1.

In private equity, the investor is investing in unlisted private businesses whose pricing is not subject to the vagaries of the listed securities markets. Often, professional investors can exercise elements of control over the companies helping them to grow and achieve their objectives. The value created is realised when such companies are listed or bought by other companies or investors.

In real estate, the investor is investing in physical property and sometimes through direct equity or as a provider of debt financing. Real Estate Investment Trusts (REITs) are an example of real estate investments which are more familiar to most investors. In contrast to physical property, REITs require a lower initial investment capital and are more liquid.

Hedge funds are a varied class of investments that are highly unconstrained and can therefore take advantage of a huge variety of instruments and strategies to make money. When we mean unconstrained, it is likely that hedge fund managers can take on not only long strategies when they are bullish on the market, but can also look to short-selling. Hedge funds may short in a rising market if they believe that assets that they short (sell) will underperform those that they have long positions on. In addition, hedge funds can use derivatives and leverage to improve their risk-adjusted returns.

Generally, hedge funds seek to be compensated for taking specific risks and thus isolate and remove or hedge away unintended risks.

What are the common features?

To start with, most of the investors in alternative investments are institutional investors or accredited individuals rather than retail clients. That is because alternative investments are deemed to be more complicated, thus requiring financial sophistication (i.e. the client needs to declare that he or she is an accredited or high net worth individual). Although this is a limitation, retail clients can still invest in alternatives through selected products such as REITs, commodity exchange traded funds (ETFs) and funds of hedge funds.

The second feature is that some alternative investments, including hedge funds and direct property, can sometimes have low levels of liquidity. This is a feature that may not be easily accepted by investors. For this very reason, investors usually demand a liquidity premium on the returns of these investments.

Other less attractive features include high due diligence costs, difficulty in valuation, and lack of access to information. Due diligence costs of less common alternative assets tend to be high as the associated research and monitoring costs reflect limited information levels due to poor manager transparency and pricing difficulties. An example is the challenge in pricing "distressed securities" or securities of companies that are in or near bankruptcy.

Since alternative investments seem to be much more complicated than the traditional asset classes, what is the key attraction for investing in them?

Alternative investments help in diversification

The key advantage of alternative investments lies in their ability to provide better risk-adjusted returns with lower volatility and better loss mitigation. This makes them an excellent diversifier in a portfolio of traditional investments.

Figure 1: Key characteristics of common alternative investments

Alternative Investment	Ways to get access	Risk/return features
Real estate	<ul style="list-style-type: none"> - Physical property: residential, commercial, office (Direct) - Publicly-traded shares in a portfolio of real estate, also known as real estate investment trusts or REITs (Indirect) 	<ul style="list-style-type: none"> - Large idiosyncratic risk component - Provides good diversification - Physical real estate have lower liquidity; REITs have higher liquidity
Commodities	<ul style="list-style-type: none"> - Physical commodity such as crude oil, metals (Direct) - Commodities futures based on the future price of specific commodities (Direct) - Companies whose primary business is associated with commodities, e.g. owning shares of a mining company (Indirect) 	<ul style="list-style-type: none"> - Low correlation with stocks and bonds - Positive correlation with inflation - Fairly liquid
Private equity	<ul style="list-style-type: none"> - Preferred shares of stock (Direct) - Venture capital (Indirect) - Buyout funds (Indirect) 	<ul style="list-style-type: none"> - Start-up and middle-market private companies have greater risk and lower returns than investments in established companies
Hedge funds	<ul style="list-style-type: none"> - Single-manager hedge funds - Fund of hedge funds / multi-manager hedge funds 	<ul style="list-style-type: none"> - Dependent on the specific hedge fund strategy, e.g. those that trade on spreads have a low correlation with the market
Managed futures	<ul style="list-style-type: none"> - Private commodity pools - Publicly-traded commodity futures funds 	<ul style="list-style-type: none"> - Risk levels between equities and bonds - Negative and low correlation with equities - Low-to-moderate correlation with bonds - Lower liquidity for private than publicly-traded commodity futures funds
Distressed securities	<ul style="list-style-type: none"> - Through hedge funds or private equities (investments can be in debt and/or equity) 	<ul style="list-style-type: none"> - Depends on skill-based strategies. - Low access and legal complications means that it is not easy to invest in them – thus providing "protection" to the returns

In the crisis of 2008, hedge funds were more resilient as they lost only 19% in the year, while equities lost 43% and commodities lost 36%. On the other hand, bonds (being a popular safe haven asset class) outperformed that year with a gain of 6.8% during the year. Over a 10 year period, however, hedge funds gained an annualised 6.9% with a volatility of 6.9%, while equities made a paltry 2.7% with a volatility of 17.1%. Global bonds returned an annualised 6.6% with a volatility of 4%, and commodities made 6.7% but also recorded a volatility of over 20%.

In fact, to leverage on the opportunity in getting better risk-adjusted returns, many large institutional and government pension and endowments plans have started to allocate a small portion of their portfolios to alternative investments such as hedge funds. For instance, Government of Singapore Investment Corporation (GIC), which is managing Singapore's foreign reserves, announced that they increased its allocations to alternative investments (including private equity, real estate and hedge funds) to 30% in the year ended March 2009 from 23% in the previous year, according to a Bloomberg report dated 11 November.

Hedge funds vs. Mutual funds

In contrast to mutual funds, managers of hedge funds have a greater freedom to implement their market views, which can be beneficial in improving their fund's risk-adjusted returns. Hedge Funds, in addition to conventional long only investing, may employ derivatives, leverage and short selling to improve risk-adjusted returns. This additional flexibility improves their ability to make money.

Hedge funds	Mutual funds
<ul style="list-style-type: none"> • Aim for attractive rates of return over a market cycle with reduced volatility • May use leverage • Flexibility in investment strategies (may take either long or short positions or both) • Performance-based compensation • Fund manager typically invests his/her own capital and has a stake in the fund management firm • Large minimum investment • Monthly/quarterly/annual liquidity 	<ul style="list-style-type: none"> • Aim to outperform benchmark relative to return • Limited use of leverage, if any • Relatively inflexible (long only) • Asset-based compensation • Fund manager is typically an employee • Small minimum investment • Daily liquidity

Source: Permal, DBS Compilation

The article was written by **Mah Ching Cheng**, Wealthline Editor and **Bryan Goh**, Head of Alternative Investments for DBS Wealth Management.

Did You Know?

More millionaires have been created every day in Asia than anywhere else in the world since 2006. Unsurprisingly, Asian wealth has also grown at an annual pace of more than double the global average after the Asian Financial Crisis.

According to the Boston Consulting Group's Eleventh Annual Global Wealth Report, an absolute growth of 59% in global wealth (from 2009 to 2010) was due to strong financial market performance, while the rest came from savings. The growth in Asian wealth was boosted by local currencies appreciating against the US dollar, which turned a 17.1% growth in local currency terms to 22.8% in US dollar terms.

High net worth individuals around the world recognise Asia's growth potential, and are adjusting their allocations to include more of Asia. Capgemini and Merrill Lynch data shows that those residing in the developed markets have transferred nearly 8% from their home countries to emerging and frontier markets; Asia has received half of these flows.

The 2010 Capgemini/Merrill Lynch Global and Asia Wealth Reports found that within the Asia ex-Japan region, high net worth individuals have shown a preference for equities (27% of financial assets) and real estate (26% of financial assets). Residential property accounts for 60% of all real estate investment, mainly because of the tight supply-demand dynamics that has pushed both mass and luxury residential property prices up.

In comparison, luxury home sales in the developed markets have begun to recover, but are mostly taking place at the lower end of the luxury market as investors look for value and bargains.

Developed world investors also have a wider range of property investments that include REITs.

Another reason for property investment is that it is something tangible. Asia investors have always had an affinity for tangible goods, and like having physical assets in their financial investment strategies. It makes sense. These are familiar instruments after all.

The question is, what do high net worth investors plan to do with all the wealth they have amassed? We think that it is important to have a wealth succession plan. Why spend years painstakingly building up wealth, only to allow familial disputes or inflation to mar the joy of enjoying the benefits? To ensure that the next generation benefits from this wealth, it is necessary to create a blueprint.

The key hurdle to wealth preservation is inflation. This means that keeping a large portion of assets in low-yielding cash deposits or fixed income instruments is a sure-fire way to erode the actual value of your wealth in an inflationary environment. The solution is to invest. Put the monies into instruments that will preserve the value of your hard-earned money for the future generations.

Right now, the world is waking up to Asia's true growth potential. Won't you be part of the Asia-centric allocation strategy?

Fund of Funds – On a Steadier Footing

Industry rocked by financial crisis and Madoff scandal

The fund of hedge funds (FoHF) industry has been through much turbulence in the wake of the global financial crisis and high profile hedge fund scandals of 2008. The global financial crisis hit the entire investment landscape hard in 2008. In December that year, the widely publicised Madoff scandal further dented confidence in the hedge fund industry.

Hedge funds, already perceived to be secretive and complex, were then viewed with even more mistrust and suspicion. Investors felt that investing in hedge funds could possibly mean a loss of control, and were generally uncertain of how it added value to a portfolio of traditional asset classes. Aversion to risky assets touched record highs, and we saw widespread flight-to-safety bids and withdrawal of funds. FoHF industry performance, as measured by the Hedge Funds Research Inc. Fund of Funds Index (HFRI FoF), declined 21% from the peak of the bull run in November 2007 to end December 2008. However, this figure should be put in context, as other risky assets fared much worse at that time. Global equities, measured by the MSCI AC World Index lost around 44%, while commodities, measured by the Thomson Reuters/Jefferies CRB Commodity Index, shed 32%.

The size of the FoHF industry also shrank from 2008 on this widespread loss of confidence. According to a report dated April 2011 by Preqin, an alternative asset research provider, the FoHF industry shrank from 2008 to 2011 for the third year in a row in terms of the number of operating firms. Since 2008, the industry's total assets under management (AUM) also decreased from US\$1.25 trillion to around US\$910 billion by end 2010.

We had the opportunity to interview Permal Group (Permal) and Nikko Asset Management (Nikko AM). They shared with us their insights on the benefits and risks of FoHFs, the state of affairs within the FoHFs landscape and how the industry has evolved post-Madoff.

Is there still a case for FoHFs?

A FoHF invests across various hedge fund strategies and investment styles, thus providing extra diversification and improving risk-adjusted returns. In this way, they offer consistent returns that are generally independent of stock market or individual hedge fund performances. A FoHF does not seek extraordinary outperformance, but seeks to manage downside risk.

What is a fund of hedge funds?

A fund of hedge funds (FoHFs) is a collective investment vehicle which invests in a portfolio of hedge funds. Although there are many different FoHFs that have different characteristics, in general, a well-diversified FoHF aims to deliver stable returns at lower volatility levels while benefiting from the underlying hedge fund strategies that can outperform markets over time. Key to its value as an alternative investment is its lower correlation to assets like equities and bonds, basically the tendency to respond differently and sometimes independently of economic and market movements as a result of the underlying hedge fund strategies.

In addition, having additional managers also reduces the impact of any single manager underperforming.

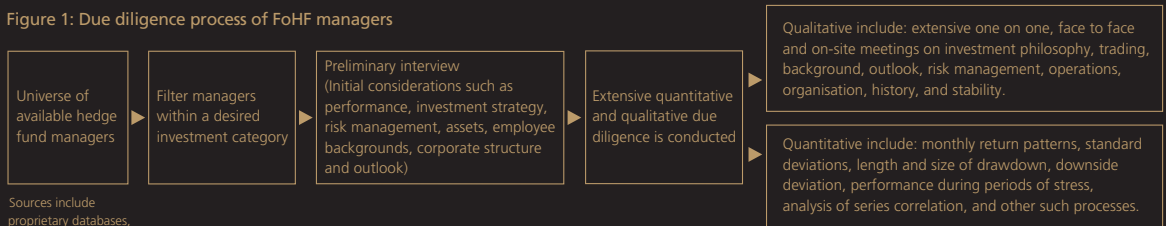
FoHFs also offer professional management services – experience, expertise, due diligence and risk management capabilities. This professional management, according to Nikko AM, improves risk-adjusted performance and reduces drawdown through appropriate manager diversification and effective strategy allocations.

In addition, FoHF managers actively monitor the risk of each of the constituent hedge funds and the overall portfolio. According to Nikko AM, this helps to safeguard investors from fraud, fund blow-ups, headline risk and excessive investment losses. Permal believes that FoHF managers' process is critical as they conduct extensive quantitative and qualitative due diligence, as well as understand the drivers behind the underlying managers. They also believe the key value-add comes from the management expertise and portfolio construction FoHFs can offer.

FoHF managers' due diligence framework process sets in place a comprehensive filtering process that helps to ensure, as far as possible, a correct fit for the FoHF portfolio's stated objectives. The process diagram below depicts very broadly the typical procedures a FoHF manager/analyst might go through when choosing a fund for the portfolio (Figure 1).

The rigorous process is highly selective. Permal stated that only around 20 to 30 managers are chosen each year out of 500 managers at the preliminary interviews. They use around 180 managers equating to roughly only 2% of the hedge funds investment universe.

Figure 1: Due diligence process of FoHF managers



Sources include proprietary databases, professional or personal networks, capital introduction and references

Source: Permal and Nikko AM

Main gripe: Added layer of costs

An obvious gripe for investors reluctant to look at FoHFs in a portfolio has been the additional layer of fees they have to pay. The perception is that investing in FoHFs is more costly than single-manager hedge funds, because they do not produce extraordinary returns to justify the additional layer of fees.

However, Nikko AM was of the opinion that many FoHF managers add value over time, net of all fees. The fees can be justified by a FoHF manager's expertise in appropriately sourcing, selecting, and monitoring hedge fund investments. The manager then combines those hedge funds so that they complement each other within the context of the overall portfolio, managing risk and lowering volatility. This 'outsourcing' of expertise as well as provision of a structure balances out prohibitive costs faced by investors who construct a comparative portfolio of hedge funds on their own.

Choosing a FoHF and HF manager

Both FoHF managers identified key aspects that would make the difference when it comes to selecting a particular hedge fund in a portfolio.

Permal stated that long-term risk-adjusted returns are a key factor. Investors should ensure that the fund managers they choose have good track records in establishing long-term positive returns within their stated risk parameters.

Permal also found that many of the best investment ideas came from existing managers, leading on to new managers and third generation managers. As a result, they tend to prefer the second and third generation managers – those that have learnt their trade at established hedge fund houses and are often backed by their former employees.

Nikko AM said that investors should consider the degree to which a manager's interests are aligned with theirs. They saw it as necessary that investors should consider the likelihood of all possible scenarios where their interests and the fund managers' could come into conflict.

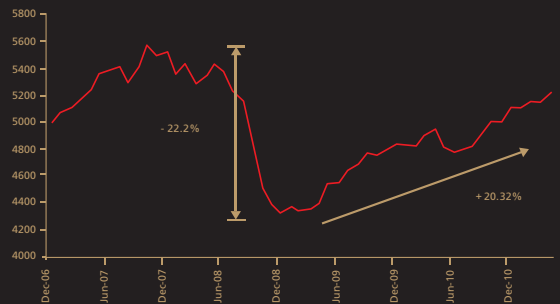
Nikko AM stated that another key consideration for them was if a manager's process was conducive to identifying and exploiting specific, persistent, market inefficiencies. They felt that examining a manager's performance through their stated process allows for additional corroboration, and helps to identify potential 'red flags', such as those that should have been raised over Madoff.

Confidence returns to the FoHF industry post-Madoff

In recent years, as FoHFs have responded to increasing calls for an evolution in the industry's practices, funds have started flowing back into the industry. Anecdotal and statistical evidence shows interest gradually ticking back up this year, as the industry evolved to meet investors' demands for greater information, transparency and liquidity.

Nikko AM is of the opinion that larger and more established FoHF firms are regaining investor confidence and successfully raising assets. This is because these large organisations are able to offer more customised solutions to investors in addition to organisational stability.

Figure 2: HFRI Fund of Funds Index (2007-2011)



Source: Bloomberg, data as of 31 May 2011

In Permal's case, their asset base has grown to \$23 billion as of 31 March 2011 from \$19.4 billion in end of March 2009. They too see growth in the industry driven by the larger managers. According to statistics published by Hedge Fund Intelligence in March 2011, there are 109 large fund of hedge funds (those with more than \$1 billion under management) managing \$625 billion in aggregate, compared with 134 at the end of 2005 managing a similar sum. This validates Permal's point that larger managers are getting the market share of investment.

Indeed, the HFRI FOF Index also shows that performance in the FoHF industry has picked up since the global financial crisis, steadily gaining about 20% from December 2008 to April 2011. The index is now close to pre-crisis levels (Figure 2).

Investors have also raised their expectations for proper management, such as having recognised independent third party administrators and custodians to price investments and report performance. Nikko AM believes that focus has been increased on issues such as the underlying managers' cash controls, approach to counterparty risk, relationship with service providers, transparency and reporting.

Interest in separately managed accounts (SMAs) that provide greater transparency and liquidity have also become more popular. SMAs are single accounts that FoHF managers have with the underlying hedge fund manager, which allows greater customisation according to the specifications of the FoHF manager, such as liquidity requirements. Permal's SMAs for example now stand at US\$7 billion, about 30% of the US\$23 billion on their books. They believe that the key advantages of using SMAs are in having the control and ability to tailor portfolios, add and remove risk at will, and not be restricted by other investors in a co-mingled account.

With Asia's burgeoning wealth, the hedge fund industry (and by extension the FoHF industry) has started to regain its relevance in the investment landscape. Investors have also become increasingly savvy and comfortable with wealth accumulation and portfolio management theories, and should respond well to the increased transparency and liquidity in FoHFs.

As such, hedge funds look set to become increasingly prominent in well-diversified portfolios, given their versatility in terms of investment objectives amidst today's ever-changing, volatile investment climate.

DBS Treasures makes waves at Boat Asia 2011



With luxury yachting fast becoming a lifestyle of the affluent, DBS Treasures rode on the rising tide and invited valued clients to the exclusive Boat Asia 2011. As the Official Wealth Management partner of South Asia's largest premier boat show, DBS Treasures presented our invited guests with the privilege to view an extensive fleet of the most luxurious sailing yachts, powerboats and super yachts at the beautiful Marina at Keppel Bay. A showcase of waterfront properties, exclusive resorts, marinas, clubs, and fine wines, also elevated the exhilarating boating lifestyle.

Our VIP guests were also treated to a specially arranged private dockside cocktail party with Simpson Marine. Guests were given the unique opportunity to preview the Azimut 38, the most prestigious entry-level model for flybridge yachts from Asia's top luxury yacht broker.

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Reward for every successful referral (DBS Treasures established)	1st Tier* at end of First Month	S\$350,000 and above	
		S\$200	
	2nd Tier* at end of Third Month	> S\$500,000 - S\$1.5 million	> S\$1.5 million
		S\$500	S\$800

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¹ While stocks last. Terms and conditions apply. Rewards are valid till 30 April 2012. We make no warranty or representation as to the quality, merchantability or fitness for purpose of the merchant's goods and services. Any dispute about the same must be resolved directly with the merchant. We shall not be liable for any loss, injury, claim or damage suffered or incurred as a result of the use of the merchant's goods and services. We are not an agent of the merchant and vice versa. We reserve the right at our sole and absolute discretion to replace the rewards with any item(s) of similar value without notice.

* For example, if the First Account is established on 1 July 2011, the Introducer will qualify for the first tier reward on 31 July 2011 and the second tier reward on 31 September 2011.

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