

Investment Insights

From the CIO desk

21 May 2012

Greece and growth concerns still likely to weigh on markets

Figure 1

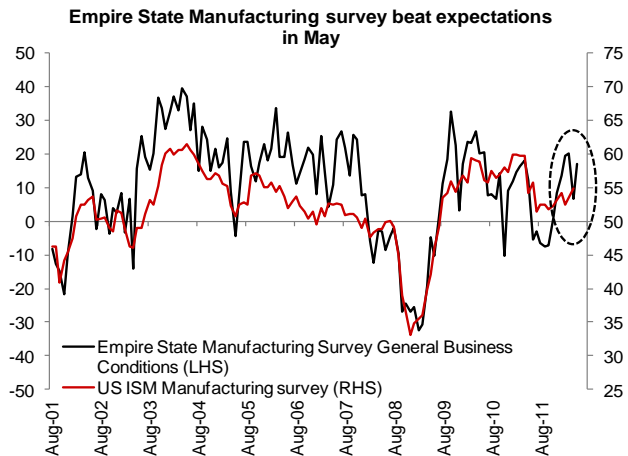


Figure 2

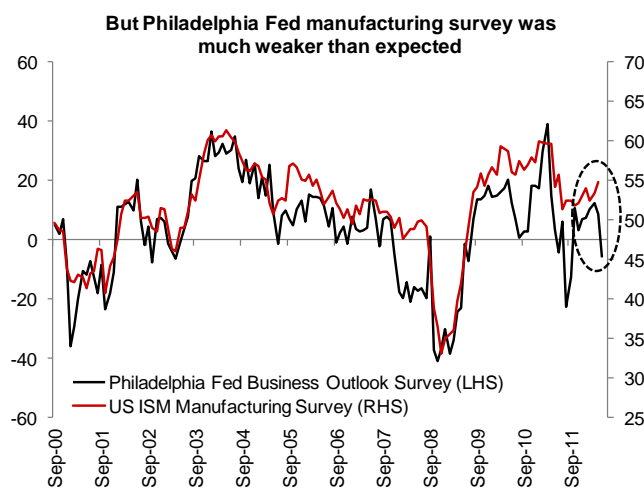
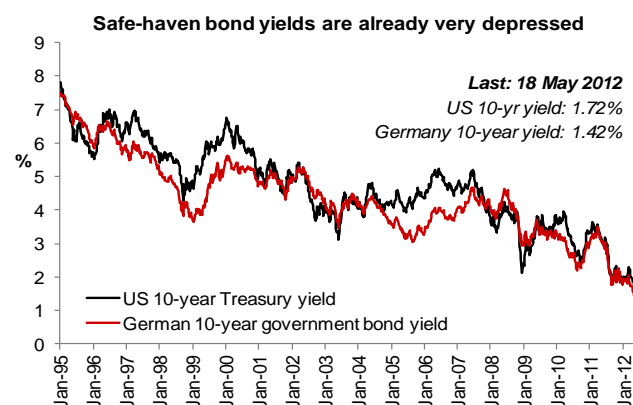


Figure 3



Source: Bloomberg, updated as of 18 May 2012

KEY SUMMARY POINTS

- Risky asset markets likely to stay volatile with a downside bias over coming weeks
- Greece political uncertainty is set to linger to mid-June and possibly July
- Global macro economic data has yet to show a turnaround
- Policy responses may soon materialise
- But current options are unlikely to eliminate market concerns

Risky asset markets are likely to trade jittery-to-weak over coming weeks as concerns over Greece continue to dominate financial markets. The market will likely become increasingly worried about the possibility of a Greece exit from the Euro area and the negative fall-out from such an event. Greece is headed for re-elections on 17 June, with a technocrat government installed in the interim. With Greek political uncertainties set to linger until mid-June and possibly July, investment sentiment will remain vulnerable to European newsflow, keeping downward pressures on equities and upward pressures on the US dollar, as what happened last week. Beyond the resurgence of Europe's problems, global macro economic data continues to be soft on balance, eliminating any support from this front as well.

Concerns over Greece drive European risk perceptions higher. Greece is headed for re-elections on 17 June, with a technocrat government installed in the interim. This means that the political uncertainty of whether an anti-austerity coalition takes power in Greece will linger over the next four weeks. And with that, fears of the Troika (the European Union, International Monetary Fund and the European Central Bank) suspending bailout funding to Greece will simmer. A suspension of bailout funding could lead to a Greek debt default, a hasty exit from the Euro area and spread of contagion to Spain and Italy. Markets could thus stay volatile. Policy makers may try to use rhetoric to ease concerns on a Greece exit over coming days and weeks. But on balance, equities and other risky assets are likely to be weighed down further by contagion fears going well into June and possibly July, depending on how negotiations between the Troika and the new government in Greece shape up.

Global macro economic data has yet to show a turnaround in strength. On balance, global macro economic data continues to be soft. There were some bright spots last week as preliminary numbers showed that the Euro zone managed to avoid a technical recession, i.e. two consecutive quarters of negative quarter-on-quarter (QoQ) GDP growth, on the back of stronger-than-expected 1Q-2012 growth achieved by Germany. In the US, the May reading of the New York Federal Reserve manufacturing survey was stronger than expected (Figure 1). However, these positive indications were offset by the confirmation of notable 1Q-2012 growth contractions in peripheral European countries (-0.3% QoQ for Spain, -0.8% QoQ for Italy), and a much weaker-than-expected Philadelphia Fed manufacturing survey (Figure 2).

Policy responses could help calm markets, but it is questionable whether much can be done at this stage. As sentiment over Europe and data deteriorates further, the possibility of policy makers coming out with responses is rising. But European leaders may not be able to do much about the political uncertainty in Greece, which is now the key source of uncertainty confronting markets. Ring-fencing Spain and Italy, to ensure that their access to sovereign funding is not threatened even in the event of a Greece default and exit from the Euro zone, requires further commitment of resources that is difficult to commandeer on short notice. Thus, policy actions possible at this stage are likely to have a low chance of eliminating the concerns. The Federal Reserve could announce more monetary easing measures at its Federal Open Market Committee (FOMC) meeting during 20-21 June, if US macro data continues to deteriorate. This may help calm broader market sentiment. But even then, the policy decision meeting is still a month away.

Thus, risky asset markets look to stay volatile with a downside bias over coming weeks. With risk perceptions on Europe likely to

rise as Greek concerns linger, and no clear indication that global economic data is regaining momentum, the likelihood is for further volatility and declines in risky asset markets. For equities, we prefer a defensive strategy in the near term with a focus on dividends and low beta names. We favour Chinese and US equities on a 12-month basis, on our belief that China is at or near the bottom of its current economic cycle, and that US equities will outperform given strong corporate balance sheets and the ability of US corporate titans to tap into strong emerging market growth.

In fixed income, the government bonds of US, UK, Japan and Germany could see further upside near term on flight-to-safety moves. But US Treasuries and German bund yields are already very depressed (Figure 3). We remain wary of duration risks and would prefer short-dated credits. On currencies, US dollar strength is likely to continue over coming weeks as risk aversion becomes a dominant driver. But the correction may present an opportunity for investors to take positions in Asian currencies and credits, on which we remain positive over a 12-month time frame.

Focus: Asian Insights

Vietnam: En route to economic stability

Vietnam – Policy efforts to tame inflation have taken a huge toll on growth and inflicted pain on consumers and enterprises. But these efforts are gradually returning some stability to the economy. Vietnam struggled with two bouts of exceptionally high inflation in 2008 and 2011 which were eventually reined in by authorities through policy rate hikes and the introduction of Resolution 11, a package of measures introduced to help cool the overheating economy. To the government's credit, inflation has since eased to 10.5% in April. But gross domestic product (GDP) contracted 9.9% quarter-on-quarter (QoQ) in 1Q-2012.

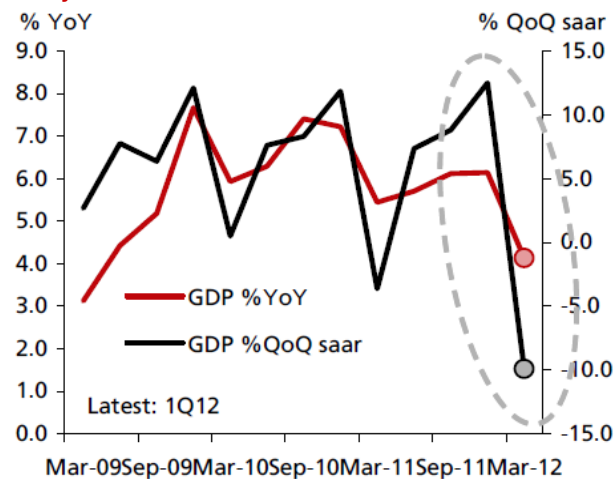
We believe the effect is likely to be transient as the outlook on the external front has remained sanguine. Export performance is recovering from the decline in the second half of last year, and industrial production is rebounding after a temporary blip in January. Tight liquidity conditions have also narrowed the overall trade deficit and helped the Vietnam dong hold firm after multi-year devaluations.

Our GDP growth forecast is now 5.5% for 2012 and 6% for 2013. We expect inflation to moderate to below 5% by 4Q-2012 and average 8.7% for the year. We have also lowered our inflation forecast for 2013 to 5.6%.

Indeed, the State Bank of Vietnam (SBV) lowered its three policy rates by 200 basis points (bps) over the last two months on the basis of slower growth and easing inflation. Judging from the current economic conditions, further cuts of 300-400 bps can be expected further in 2012. Taming inflation remains the key to ensuring economic stability in the longer term. A sudden switch to a pro-growth strategy now will surely sow the seeds for another bout of high inflation and instability. As long as Vietnam exercises prudence in easing monetary policy, i.e. by keeping real policy rates positive, it should remain on track to achieve not only sustainable growth, but also progress towards restoring macroeconomic stability.

Source: *Economics: Vietnam: En route to economic stability*, DBS Group Research, 9 May 2012

Policy-induced GDP contraction in 1Q-2012



Source: DBS Group Research

Coal miner earnings still strong despite weaker coal prices

Indonesia – Coal prices have fallen 10% year-to-date due to weaker demand from China and India as exports from these countries slow. However, coal miners will not see the full impact in this year's financials because most have contracted up to 80% of fiscal year (FY) 2012 production, and have prices locked in for over 50%. In addition, production is expected to increase by 8-22% p.a. over FY2011-2013 (forecast), driven by production ramp-up at existing mines, expansion of transportation capacity, and contribution from new mines or Mergers & Acquisitions (M&A).

Earnings growth in fiscal year 2012 is forecast at a 17% average. The sector is trading at 8.8X price-to-earnings (PE) against its four-year historical average of 12X. We estimate output will grow by 8-34% this year. There is also strong acquisition interest by both large and small miners, driven by large net cash positions and aggressive production growth targets.

The government also recently clarified that coal would not be subject to a 20% export tax in Indonesia. We expect authorities to tread carefully with regulatory change proposals because coal accounted for a substantial 13% of Indonesia's export revenue in 2011. Companies under the long-term Coal Contract of Work (CCoW) will be protected to an extent from any changes, at least until their contracts expire 15 years or more from now. (The major risk to our thesis is the government deciding to renegotiate the contracts before they expire.) Coal production under this agreement accounts for more than 65% of Indonesia's total production.

Source: *Regional Industry Focus, Indonesia Coal Sector*, DBS Group Research. Equity, 16 May 2012

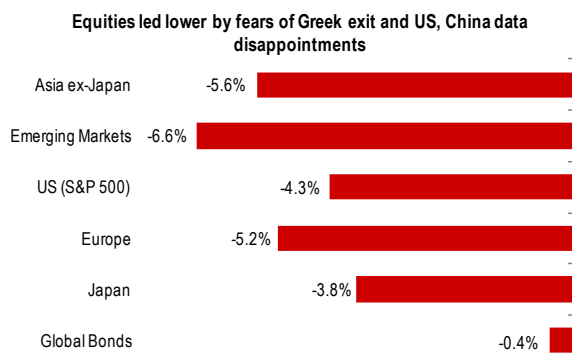
Coal sector trading below 4-year average PE



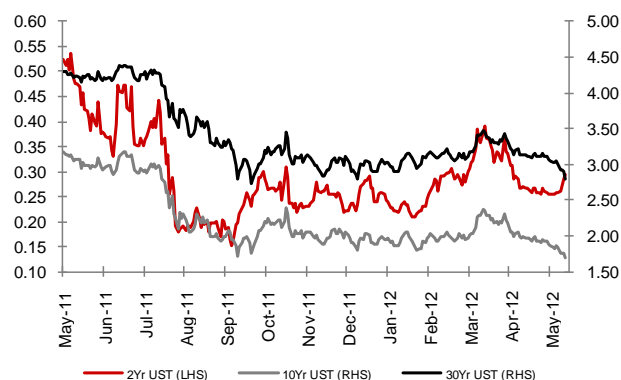
Source: DBS Vickers

Economic & Market Data Monitor

KEY GLOBAL INDICES

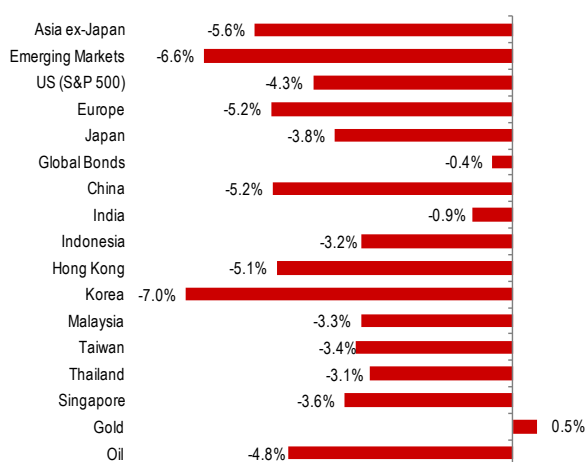


US TREASURY YIELDS (%)

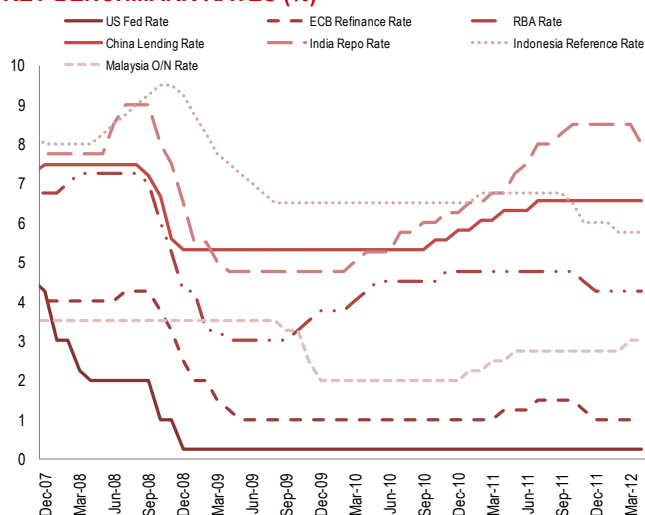


KEY ASIA & EMERGING MARKET INDICES

Gold was the only market that rose



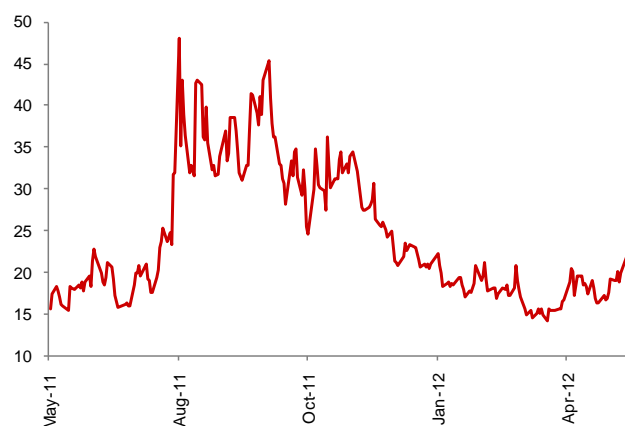
KEY BENCHMARK RATES (%)



KEY FORWARD PE & EARNINGS GROWTH

	Year-to-date	Forward PE 2012	Earnings growth 2012	10-year average PE
Asia ex-Japan	1.7%	10.3	15.1%	12.0
US (S&P 500)*	3.0%	12.3	25.0%	14.9
Europe*	-2.3%	10.0	15.9%	12.4
Japan*	1.8%	13.0	20.4%	NM
Global Bonds	1.1%			
China	0.6%	8.7	10.0%	12.2
India	4.5%	12.8	16.8%	14.5
Indonesia	4.1%	13.1	10.4%	14.0
Hong Kong	2.8%	9.5	2.4%	13.5
Korea	-2.4%	8.5	36.5%	9.4
Malaysia	0.1%	14.4	11.8%	14.0
Taiwan	1.1%	13.8	19.1%	14.0
Thailand	12.6%	10.9	20.4%	10.3
Singapore	5.0%	12.8	5.1%	14.2

VOLATILITY (VIX INDEX)



Source: Bloomberg, IBES, DBS.

*PE and earnings data from Bloomberg. Year-to-date returns in local currency. Earning figures are as of 19 March 2012.

Source: Bloomberg. Data as of 18 May 2012

KEY ECONOMIC EVENTS CALENDAR

21 May-12	Event	Period	Survey	Actual	Prior
TA	Export Orders (YoY)	APR	0.51%	--	-1.58%
TA	Current Account Balance (USD)	1Q	--	--	12095M
US	Chicago Fed Nat Activity Index	APR	--	--	-0.29
22 May-12	Event	Period	Survey	Actual	Prior
TA	Unemployment Rate - sa	APR	4.13%	--	4.14%
CH	Conference Board China April Leading Economic Index				
SK	External Short-Term Debt	1Q	--	--	\$136.1B
HK	CPI - Composite Index (YoY)	APR	4.70%	--	4.90%
US	Richmond Fed Manufacturing Index	MAY	11	--	14
US	Existing Home Sales	APR	4.62M	--	4.48M
US	Existing Home Sales MoM	APR	3.10%	--	-2.60%
MA	Foreign Reserves	15-May	--	--	\$135.90B
23 May-12	Event	Period	Survey	Actual	Prior
SI	CPI (YoY)	APR	5.20%	--	5.20%
TA	Commercial Sales (YoY)	APR	-1.00%	--	-1.06%
TA	Industrial Production (YoY)	APR	-1.20%	--	-3.42%
MA	CPI YoY	APR	2.10%	--	2.10%
MA	Current Account Balance	1Q	--	--	22.0B
US	MBA Mortgage Applications	18-May	--	--	9.20%
US	House Price Index MoM	MAR	0.30%	--	0.30%
US	House Price Purchase Index QoQ	1Q	0.10%	--	-0.10%
US	New Home Sales	APR	335K	--	328K
US	New Home Sales MoM	APR	2.10%	--	-7.10%
MA	GDP YoY%	1Q	4.60%	--	5.20%
24 May-12	Event	Period	Survey	Actual	Prior
CH	HSBC Flash China Manufacturing PMI	MAY	--	--	49.3
HK	Exports YoY%	APR	6.60%	--	-6.80%
HK	Imports YoY%	APR	4.50%	--	-4.70%
HK	Trade Balance	APR	-41.2B	--	-43.9B
US	Durable Goods Orders	APR	0.30%	--	-4.20%
US	Cap Goods Orders Non-defence Ex Air	APR	0.60%	--	-0.80%
US	Cap Goods Ship Non-defence Ex Air	APR	-1.00%	--	2.60%
US	Initial Jobless Claims	19-May	370K	--	370K
US	Continuing Claims	12-May	3250K	--	3265K
US	Kansas City Fed Manufacturing Activity	MAY	5	--	3
25 May-12	Event	Period	Survey	Actual	Prior
SK	SK Consumer Confidence	MAY	--	--	104
CH	MNI May Business Condition Survey				
SI	Industrial Production YoY	APR	5.30%	--	-3.40%
TA	GDP - Constant Prices (YoY)	1Q F	0.36%	--	0.36%
TA	Money Supply M2 Daily Average YoY	APR	--	--	5.05%
US	U. of Michigan Confidence	MAY F	77.8	--	77.8

IN THE COMING WEEK

It is another heavy week on US data, with housing and capital expenditure (capex) orders at the centre of attention. Sales of new and existing homes are expected to grow 2-3% month-on-month (MoM) in April. But as sales levels are effectively still at historical lows, **DBS** believes the data still lacks clarity on whether home sales are truly rising.

The market is expecting a 0.3% MoM rise in US durable goods orders (proxy for capex), and a 0.6% rise in core capex (capex excluding defence and air) in April. But these are not large enough to offset the drops of last month. With core capital goods orders showing zero growth since August 2011, **DBS** believes a jump in investment would be most unexpected.

Singapore consumer price inflation (CPI) is expected to stay flat at 5.2% year-on-year (YoY) in April. **DBS** expects CPI to be 4.1% for the full year of 2012. Industrial production is expected to post a 5.3% YoY rebound, after falling 3.4% in March.

Source: Bloomberg. Data as of 18 May 2012. Note: DBS Group Research (DBS)

ECONOMIC DATA REVIEW

China foreign direct investment (FDI) declined 0.7% YoY in April to US\$8.4 billion, the sixth straight month of falls. A Commerce Ministry spokesman said authorities are “prudently optimistic” about the outlook for foreign investment. FDI from the European Union slumped 27.9% YoY in the first four months of 2012. Chinese banks issued only RMB681.8 billion of new yuan loans in April, missing the RMB750 billion consensus forecast. Loans had grown RMB1.01 trillion in March. **DBS** believes that slower loan growth this year has been due to some banks having loan-to-deposit ratios that are close to the maximum of 75%, limiting their ability to expand their loan books unless there is a rebound in deposit growth. Property prices fell in 46 cities on a YoY basis in April.

India wholesale prices (WPI) grew 7.23% YoY in April, up from the 6.89% YoY growth recorded in March, and surpassing expectations for 6.7%. Higher vegetable and fruit prices were behind the rise in WPI in April. Core WPI (excluding food prices) however remained moderate in April at 4.9%. **DBS** believes headline WPI could be kept hovering at 7% by structural food price inflation and efforts to reduce the gap between international and retail fuel prices. Given the weight of food and fuel in the WPI basket (40%) and CPI basket (75%), little respite is expected from monetary policy. **DBS** thinks deterioration in growth could leave room for another 50 bps cut this year, but the combined 100 bps for the year may not do much to stimulate growth in the context of a generally deteriorating business environment.

Singapore GDP rebounded 10% QoQ annualized in 1Q-2012 after a momentary slump in the previous quarter, as **DBS** expected. Singapore non-oil domestic exports (NODX) rose 8.3% YoY in April, rebounding from a 4.3% contraction in March. Exports were driven by strong showings from pharmaceuticals and petrochemicals exports. The key electronics sector rose a decent 1% YoY, but was still weaker than March's 2.8% rise. The manufacturing sector remains the main driver of growth, and **DBS** thinks Singapore is well on track to achieve the full-year forecast of 3.5% forecast. But downside risks remain, with the Greek political gridlock alongside a sluggish US economic recovery. As such, **DBS** feels that a pullback in Singapore's GDP growth in the second quarter led by manufacturing should not come as a surprise on the backdrop of external weakness.

Indonesia motorcycle sales have been clearly underperforming car sales over the last six months and **DBS** believes the fuel price overhang may be a key reason behind this phenomenon. Motorcycle sales were down 5% in the first four months of the year, while car sales still registered positive growth of 18% (albeit distorted by the Japan disaster in the early part of 2011). Over the last six months, elevated oil prices have prompted the government to consider raising the price of subsidized fuel in order to ease budgetary pressure. **DBS** estimates a 33% fuel price hike will lead to an additional spending of 4% a month for motorcyclists. Comparatively, the impact on car owners will be relatively smaller at 2%. Higher deposit levels for vehicle loans, which take effect in June, should further dampen demand for both motorcycle and cars.

Source: Bloomberg. Data as of 18 May 2012. Note: DBS Group Research (DBS)

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