Quarterly Investment Strategy
First Quarter 2015

MID-CYCLE EXPANSION

ASSET ALLOCATION

Remain Overweight Equities, Raise Fixed Income to Neutral, Downgrade Commodities to Underweight

EQUITY

Continue to favour Developed over Emerging Markets with bias towards the US and Asia

FIXED INCOME

Prefer Emerging to Developed Markets with bias towards Asia, remain short duration

COMMODITIES

Downgrade Bulk Commodities further to Underweight, Remain Overweight Gold and Base Metals, Maintain Neutral Agriculture and Energy

UOB Asset Management
大華資產管理

As one of the thought leaders in asset management, UOBAM regularly produces topical investment research articles and publications to help our clients stay on top of financial market developments.

Webcast – Asset Allocation Strategy for Q1 2015

In our quarterly webcast, Mr Tony Raza, Head of Multi Asset Strategy Unit, will share our asset allocation strategy, as well as discuss key issues driving developments in global markets.

View the webcast on the homepage of our website at uobam.com.sg.

INVESTMENT STRATEGY SUMMARY

Low inflation coupled with moderate global economic growth will set the stage for another year of stable investment returns from bonds and equities in 2015.

While there is the risk of deflation in the current environment, this risk is reduced by improvements in the US labour market and greater central bank policy commitments in Japan and Europe.

Investors should watch out for the strengthening of the US dollar (USD) and declining oil prices which will be big trends for the coming quarters.

A strong USD and oil price instability will add to volatility in the equity and fixed income markets. Other risks that may destabilise the investment markets are the upcoming European elections, a hard landing in China and knee-jerk reactions to increases in interest rates.

Notwithstanding these risks, we remain positive on the outlook of the global economies and investment markets outlook. In a world of gradual growth, steady rise in prices, low interest rates and supportive fiscal policies, we expect equities to outperform the market.

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GLOBAL ASSET ALLOCATION SUMMARY

Our asset allocation for the quarter reflects our constructive view on global economic growth and preference for risk assets due to their relative valuation attractiveness. We continue to be overweight on risk assets, namely equities, and have upgraded fixed income to neutral and downgraded commodities to an underweight position.

Global Asset Allocation*	--	-	N	+	++
Equities	○	○	○	●	◄
Fixed Income	○	►	●	○	○
Commodities	○	●	◄	○	○
Cash	●	○	○	○	○

Note:
*3-6 months horizon
The weights are relative to the appropriate benchmark(s).
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

Equities – Overweight

Consistent with our view of the global economic cycle being at a mid-cycle stage, we recommend being overweight on equities. Typical mid-cycles see market returns driven by earnings growth and low correlation of returns with individual corporate shares, which implies good stock picking opportunities. Valuation re-ratings play less of a role compared with earnings delivery. Across most markets, global consensus forecasts are for seven to 10 per cent earnings growth in all major markets and we expect equity returns to be in a seven to 10 per cent range. Our overweight recommendation is slightly moderated from the strong overweight position we held in previous quarters. This is due primarily to the change in our fixed income outlook that is now more neutral.

Fixed Income – Neutral

While we had been concerned about a greater rotation of global investments to equities, the reality is that fixed income markets are enjoying one of their longest cycles. With inflation around the world increasingly benign and as oil prices decline, headwinds to the fixed income market have been delayed further. Also, although the US is the only market that faces the risk of rising inflation, the global trends of a strong USD and weaker oil prices are mitigating this risk. We upgrade fixed income to neutral from an underweight position.

Commodities – Underweight

As we have mentioned in previous quarters, we traditionally like commodities at this stage of the growth cycle, but the combination of a strong USD environment and changes in Chinese property construction demand has led to the commodity outlook being more complicated than usual. For this reason, we have stayed neutral on commodities in previous quarters but we find that even this is not conservative enough. While commodities are likely to be oversold at this stage, we think it will take at least another quarter for the cycle to improve. We therefore cut the outlook to negative and underweight.

Cash – Strong Underweight

Cash returns remain near zero per cent while the outlook for both equities and fixed income remains attractive. Despite the risks in Europe and China as well as the risks pertaining to the first US rate increase, we do not advise holding cash currently.

GLOBAL INVESTMENT STRATEGY
MID CYCLE EXPANSION

We have described in previous quarters that we saw the world as finely-balanced between a global slow growth/deflationary environment and a moderate growth/reflationary environment. While there have been concerns during the fourth quarter of 2014 that deflation could be taking hold, the trends are becoming clearer as we look towards 2015 that growth is resilient and key markets such as the US are looking increasingly reflationary.

Our base case for 2015 is for a year of modest but solid global growth that will lead to a moderate interest rate normalisation pace in the US but still loose monetary policies in other parts of the world. We expect such an environment will enable equities to provide attractive returns driven by corporate earnings growth, while fixed income will provide stable returns in the face of slow and moderate interest rate normalisation.

Greater Global Focus on Staving Off Deflation

It has been a key part of our investment framework that if the world falls into deflation, we would reduce our exposure to growth assets. This is because the history of deflation in Japan has shown that growth assets have had negligible (if not negative) returns and fixed income markets have had very low returns.

In the early part of Q4 2014, inflation trends in Europe, Japan and the US were disappointing with Europe facing risks of outright deflation. By the end of the quarter, these concerns were reversed, due largely to policy commitment to reflation in Japan and Europe, as well as the improving labour market in the US.

Over the past year, Japan has made significant progress in turning around its deflation problems. Its inflation trends were averaging -1.5 per cent in mid-2012. By mid-2014, Japan's core inflation was averaging 1.5 per cent but the positive momentum was fading by the end of the third quarter. In light of its target to achieve two per cent inflation by the second quarter of 2015, when the inflation momentum slowed, the Bank of Japan (BOJ) responded with a significant increase in its quantitative easing (QE) policies at the end of October. This "Halloween surprise" resulted in further weakness in the Japanese yen and a renewed rally in the equity market. As we enter 2015, Japan's economic trends remain mixed, but the equity market and inflation outlook have retained some confidence from the BOJ's commitment.

European growth trends, as indicated by both industrial production and manufacturing indices, were slowly weakening throughout 2014 and several European countries were starting to report deflation by the third quarter of 2014. The policy response of the European Central Bank (ECB) was to cut interest rates to negative levels and to roll out a targeted programme to provide low interest rate loans to the banking sector which could be used as funding for further loan growth in the economy. When this programme's rollout was slower than expected, the ECB announced more asset purchases in asset-backed securities and covered bonds and hinted at the potential of sovereign bond QE if needed. We expect the ECB to remain committed to fighting deflation and to expand its QE programme to include sovereign securities in the first half of 2015.

The US appears to have enough natural growth and inflation trends that it no longer needs policy support. Employment and manufacturing capacity utilisation have picked up and the economy is expected to continue at "normalised growth" of about three per cent. Business sentiment surveys point to an increase in hiring and a significant improvement in wages. The November 2014 employment data indicated the first significant growth in average hourly wages for the year. As there are enough real trends of inflation returning, we should expect the start of normalisation in interest rates. However, the strong USD and weaker oil prices are likely to keep inflation trends modest so that interest rate normalisation could happen at a moderate pace.

Lower Oil and Stronger Dollar Should Be Net Positives

One of our most confident views is that the USD appreciation trend should continue in 2015. The USD is benefiting from both economic factors and interest rate differentials. The US has seen a stronger improvement in economic growth trends than most other markets. It had greater improvements in its debt levels and better trends in its trade deficit levels. On top of these fundamentals, our key models for currency trends are driven by interest rate differentials which are clearly positive for the USD. Due to healthy labour growth and modest signs of improving inflation, the US Federal Reserve (Fed) ended its QE programme and is prepared to increase interest rates in 2015. While the US is starting to tighten its policy, other developed markets are increasing monetary stimulus. Several emerging markets which are experiencing lower than expected inflation are also set to lower interest rates in 2015. These add up to a strong case for continued USD strength.

The USD has already increased by about 10 per cent over the past year on an exchange-weighted basis and we expect the strength to continue in 2015. We note that previous periods of strong USD lasted for three to five years (such as in the mid-1990s and early 1980s) with appreciation averaging about five per cent per year. Markets remained healthy in these previous periods of a strong trending dollar with the US economy and equity market performing well. Global markets also performed well during the early stages of the strong dollar trend but the key exception was during the Asian Financial Crisis in 1998. The Asian Financial Crisis was a result of the region's fundamental economic problems which do not appear to be present now. As such we do not think that a strong dollar now implies a crisis in other parts of the world.

The other obvious trend that emerged in the fourth quarter of 2014 was weaker oil prices. In November 2014, crude oil prices broke below the psychological support level of US$80 per barrel and then fell further to below US$70 in December. Weaker oil prices are frequently a sign of global economic weakness, but in our view the current weakness in the oil price is primarily a result of an increase in the global supply of oil instead of a weakness in demand. US shale fracking has had a significant impact on oil supply and key oil groups such as the Organisation of the Petroleum Exporting Countries (OPEC) have not been able to agree to production reductions to stabilise prices. We note that the marginal cost of producing the excess oil is expensive and we expect the oil market to stabilise at US$80 per barrel fundamentally, as this is the fundamental value of the marginal cost (our estimate) of production. However, we think it will take six months before supply is reduced by shale runoff declines by non-OPEC US producers and this will subsequently result in price stability.

From an economic viewpoint, the net impact of weaker oil prices is positive for most economies as the benefits to consumers and potential employment trends will have a greater effect than the lower profitability of oil-related companies.

Global economic trends will remain attractive as a result of the strong USD and weak oil prices. The US economy is able to support the stronger dollar and other markets could benefit from their weaker currencies creating a stimulative effect on their economies. The decline in oil prices can be compared to a tax cut to consumers globally and it will have a large impact on the emerging markets. Our investment focus is to be overweight on consumer-related sectors and countries that are net users of oil and to be underweight on exporters and oil producers. We also expect that USD strength and oil price instability will translate into equity and fixed income market volatility over the first half of 2015.

Key Risks

While we have a positive outlook on global growth and market performance, we see several key risks in 2015.

We continue to think that Europe poses many risks to global growth and in particular, we think political risks are rising in 2015. Anti-European Union policy parties are polling strongly in Greece and Spain – countries that will be holding elections in 2015. The United Kingdom (UK) will also be holding its elections and although it is not part of the euro monetary union, the anti-European Union party in the country has been gaining strength and may play a role in the eventual final coalition formed. In addition, the political divides within the ECB appear to be growing as the central bank moves closer towards sovereign QE and there is risk of greater internal conflict that could paralyse the ECB.

US' "taper tantrums" resulted in volatility in equity and fixed income markets in 2013 when the Fed announced plans to wind down its asset purchase programme. While we expect the Fed to start increasing interest rates by mid-2015 and to increase rates at a slow pace thereafter, the risk of an initial "rate tantrum" or market sell-down and volatility remains. We note that while there has been historical market declines around the first rate increase, positive market performance returns after three to six months.

China continues to manage its growth from 10 per cent in recent years down to slightly above seven per cent in 2014 and we expect even lower growth of 6.5 per cent or below in 2015. Our view is that while these growth levels are still double that of markets such as the US, it remains a difficult challenge to manage slower growth smoothly and the risk of policy mistakes remains high. So far, we see that more companies are managing capital expenditure investments and costs better than they have done in the past, but we will continue to monitor this key risk.

Assessment and Outlook

In summary, global macroeconomic growth in 2015 should be in line or better than 2014. Developed markets such as the US and Europe as well as key emerging markets such as India and Indonesia are expected to achieve better GDP growth in 2015. China however is managing down its growth rate and oil producing countries such as Russia and those in the Middle East are also likely to post declining growth.

With stable or positive economic growth, we expect that equity markets will deliver returns in line with earnings growth in these countries with improved economic growth as we do not see a significant case for a re-rating of valuation metrics. Consensus estimates across most of the major geographies is for earnings growth of seven to 10 per cent in 2015 and we think that that is a reasonable outlook for equity returns. We continue to be overweight on equities and prefer more consumer-focused markets such as the US and those in Asia that will benefit from the decline in oil prices and the stronger USD.

We think the fixed income market has already seen greater persistence of performance than in previous cycles and the macro environment continues to look benign for fixed income investments. While the US is set to start raising interest rates, most other countries are expanding their QE policies or cutting interest rates. The stronger USD and weaker oil prices are likely to keep inflation muted in the US and global rate trends will be positive for the fixed income markets. We upgrade our weighting in fixed income from underweight to neutral and maintain a focus on Asian credits with moderate duration.

While we traditionally expect commodities to perform well at this stage of the cycle and we are seeing many commodity-related companies that are priced attractively, we are taking a more cautious stance due to volatile price trends. Supply conditions and changing Chinese demand as it rebalances its economy away from being overly reliant on fixed assets investments, have made the commodity cycle harder to predict. Therefore, we downgrade the asset class to underweight.

EQUITY STRATEGY
GLOBAL EQUITY

SECTOR ALLOCATION	--	-	N	+	++
Consumer Discretionary	○	○	●	○	○
Consumer Staples	○	○	●	○	○
Energy	○	●	○	○	○
Financials	○	○	●	○	○
Healthcare	○	○	○	●	○
Industrials	○	○	○	●	○
Materials	▶	●	○	○	○
Information Technology	○	○	○	○	●
Telecommunications Services	○	●	○	○	○
Utilities	○	●	○	○	○

Note: The weights are relative to the benchmark - MSCI AC World Index.
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

We have a positive outlook on global equities, underpinned by improving growth in the advanced economies, modest earnings growth outlook and strong corporate profitability. Given the cyclical pick-up in demand, we are overweight on the technology sector, which continues to benefit from rising corporate expenditure and an IT upgrade cycle that has been suppressed so far, due to prior uncertainties.

With the global recovery on track and the eventual tightening in capacity utilisation, we remain overweight on the industrial sector which should benefit from a pick-up in corporate expenditure. We continue to remain overweight on the healthcare sector given its strong cash generation and dividend yield. The recent merger and acquisition activities and strong earnings growth momentum from the biotech sub-sector has boosted the sector.

Our strategy continues to be underweight on the deep cyclical sectors, such as energy and materials, given the sub-par growth of the global economy. We have also adopted a more cautious stance on interest rate-sensitive sectors such as utilities and telecommunication that could be impacted adversely by the impending US Fed rate increases.

REGIONAL ALLOCATION	--	-	N	+	++
DEVELOPED				●	
US					●
EUROPE		●			
JAPAN		●			
CANADA			●		
AUSTRALIA			●		
EMERGING		●			
Asia Ex-Japan			●		
LATAM		●			
EMEA		●			

Note: The weights are relative to the benchmark - MSCI AC World Index.
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

We have a preference for developed markets (DM) over emerging markets (EM) given the divergence in broader growth trajectories, the effects of capital flows (due to the US Fed's taper) and perceived risks to earnings expectations from shifting revenue and cost trends. Our largest overweight is on the US. We remain underweight on Japan and on Europe in the coming quarter given deteriorating economic conditions and rising geopolitical risks.

The economic data in Europe remains weak while the Eurozone continues to face challenges from high unemployment, balance sheet deleveraging and internal imbalances. The inflation picture remains precarious.

Concerns continue to linger over the long-term efficacy of Japanese Prime Minister Abe's 'third arrow' economic policy. However, there are opportunities arising from the beneficiaries of Japan's quantitative easing. Economic data over the next few months would be crucial for us to ascertain the country's economic path.

We continue to be underweight on EM. Cyclical challenges and structural reforms are reducing growth in the near term and are affecting the corporate earnings prospects negatively. We remain cognizant that some of these reforms will need time and we could see lower growth rates in the near term.

ASIA PACIFIC EQUITY

SECTOR ALLOCATION	--	-	N	+	++
Consumer Discretionary				●	
Consumer Staples				●	
Energy		●			
Financials			●		
Healthcare					●
Industrials			●		
Materials	▶	●			
Information Technology				●	◀
Telecommunications Services		●			
Utilities		●			

Note: The weights are relative to the benchmark - MSCI Asia Pacific Index. '- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

Our representative Asia Pacific strategy is currently overweight on the healthcare and technology sectors. We are slightly overweight on the consumer discretionary and staples sectors as we see some selective value plays within the broad consumer sector. We remain positive on the longer-term trend for the consumer sector as it provides exposure to the continued strong growth of domestic demand in the emerging economies.

The strategy is underweight on the deep cyclical sectors such as energy and materials due to concerns over incremental demand from China, which is experiencing slower growth and implementing reforms.

REGIONAL ALLOCATION	--	-	N	+	++
Asia Ex Japan		▶	●		
Japan	●	◀			
Australia & NZ				▶	●

Note: The weights are relative to the benchmark - MSCI Asia Pacific Index. '- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

The current positioning of the Asia Pacific strategy is to be overweight on Australia and underweight on Japan. The positioning is a result of bottom-up securities selection and does not necessarily reflect a view on the broader index.

For example the overweight position in Australia is due mainly to the relative attractiveness of Australian materials and financials against the rest of the region. Similarly, the underweight position in Japan reflects our concern on the prospects for Japanese financials and materials, due to the relatively less attractive operating prospects and valuations.

ASIA EX-JAPAN EQUITY

SECTOR ALLOCATION	--	-	N	+	++
Consumer Discretionary	○	○	○	○	●
Consumer Staples	○	○	○	●	○
Energy	○	●	○	○	○
Financials (Ex Re)	○	▶	●	○	○
Real Estate	○	●	◀	○	○
Healthcare	○	○	▶	●	○
Industrials	○	○	●	◀	○
Information Technology	○	○	●	◀	◀
Materials	○	●	○	○	○
Telecommunications Services	○	●	○	○	○
Utilities	▶	●	○	○	○

Note: The weights are relative to the benchmark - MSCI Asia ex-Japan Index. '- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

Asia markets are trading at reasonable valuations with growth in 2015 expected to improve across most of the region except in China and Malaysia. The tailwinds from lower energy prices have yet to be factored in by the market and this could present an upside surprise to earnings.

We expect most of the Asian economies to benefit from a drop in global oil prices, with the exception of Malaysia, which is an oil exporter. The lower oil prices are expected to lift growth, ease inflation pressures and alleviate fiscal and current account concerns across Asia.

An expected increase in US rates in 2015 may create some uncertainty, but Asian economies' external positions are now less vulnerable. Historically, Asian markets have rallied in past US rate hike cycles when the starting yield was below five per cent, which is currently the case.

COUNTRY ALLOCATION	--	-	N	+	++
China	○	○	●	◀	◀
Hong Kong	○	●	◀	◀	○
India	○	○	▶	●	○
Indonesia	○	○	○	○	●
Korea	○	▶	●	○	○
Malaysia	●	○	○	○	○
Philippines	○	○	○	▶	●
Singapore	●	○	○	○	○
Taiwan	●	○	○	○	○
Thailand	○	○	▶	▶	●

Note: The weights are relative to the benchmark - MSCI Asia ex-Japan Index. '- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

The structural challenges that China faces persist with credit and economic growth continuing to slow, though the surprise cut in interest rates by the central bank could potentially alleviate some of these concerns. The first quarter of the year is typically a weak period for China equities and we reduce tactically our overweight position.

We continue to be overweight on and raise our positions in the Thai, Indonesian and Philippine markets, which are expected to be the major beneficiaries of low oil prices. Similarly, we favour India, which is riding on macro tailwinds with lower energy and gold prices.

We reduce our exposure in Hong Kong to an underweight as we expect the market to be more vulnerable to a US rate rise and China's slowdown. The overhang from the Occupy Central movement also heightens political risk.

ASEAN EQUITY

SECTOR ALLOCATION	--	-	N	+	++
Consumer Discretionary	▶	▶	●	○	○
Consumer Staples	○	▶	●	○	○
Energy	○	○	●	◀	◀
Financials (Ex-Re)	○	▶	▶	●	○
Real Estate	○	○	○	●	◀
Healthcare	○	○	○	●	○
Industrials	○	●	◀	○	○
Materials	●	○	○	○	○
Telecommunications Services	○	●	○	○	○
Utilities	○	○	●	○	○

Note: The weights are relative to the benchmark - MSCI South East Asia Index. '- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

Our representative ASEAN strategy is currently overweight on the healthcare, real estate and financial sectors and is underweight on the industrials and materials sectors.

We have reduced the energy sector to a neutral weight on concerns over the impact of lower oil prices on vessel charter day rates as well as the possibility of contracts being delayed or cancelled.

In the short term we turn more bullish on the consumer staples sector as we view that weak prices of commodities such as flour, palm oil and sugar will boost the margins of companies involved in the production of food staples such as noodles and snacks.

COUNTRY ALLOCATION					
Singapore	●	○	○	○	○
Malaysia	●	○	○	○	○
Indonesia	○	○	○	○	●
Thailand	○	○	○	▶	●
Philippines	○	○	○	●	◀

Note: The weights are relative to the benchmark - MSCI South East Asia Index. '- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

We maintain our positive stance on Indonesia, Thailand and the Philippines. Singapore and Malaysia are maintained as underweight markets. The new government in Indonesia has undertaken bold measures such as cutting the fuel subsidy and is committed to implementing much-needed further economic reforms. The Philippines continues to post the highest GDP growth in Southeast Asia while corporates in Thailand are expected to perform better this year on increased government spending that should benefit the economy.

SINGAPORE EQUITY

SECTOR ALLOCATION	--	-	N	+	++
Consumer Discretionary	▶	●	○	○	○
Consumer Staples	○	○	○	●	○
Energy	○	○	●	◀	◀
Financials (Ex-Re)	▶	●	○	○	○
Real Estate	○	○	●	○	○
Industrials	○	●	◀	○	○
Telecommunication Services	○	○	●	○	○

Note: The weights are relative to the benchmark - MSCI Singapore Index.
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

The Singapore market is expected to trade range-bound in the quarter ahead, driven by a mixture of unexciting corporate earnings and modestly supportive valuations.

The strategy is overweight on the consumer staples sector. Weak prices of commodities such as flour, palm oil and sugar will boost the margins of companies involved in the production of food staples such as noodles and snacks. In real estate we prefer the landlords to the developers.

FIXED INCOME STRATEGY
GLOBAL FIXED INCOME

FIXED INCOME	--	-	N	+	++
DEVELOPED	○	●	○	○	○
DM Govt	●	○	○	○	○
DM Credit	○	●	○	○	○
EMERGING	○	○	►	●	○
EM Govt	○	►	●	○	○
EM Corporate	○	○	►	●	○
EM Local Currency	○	●	○	○	○
Duration	○	●	○	○	○
Yield Curve*	○	○	○	●	○
Asia	○	○	○	●	○
Latin America	○	○	●	○	○
CIS/EE	○	●	○	○	○
Middle East/Africa	○	○	●	○	○

Note: The weights are relative to the appropriate benchmark(s).'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight '++' maximum overweight; arrows show change from last quarter.
*'+' denotes Steepener and '-' denotes Flattener.

In the DM, we remain overall slightly underweight. Within the DM debt market, we remain underweight on government bonds and investment grade corporate credits due to the potential gradual rising of the US Treasury (UST) yield, while keeping duration slightly short to the benchmark. We are underweight on high yield credits and are defensive and selective in our credit selection as we believe that valuations have become stretched.

In the EM, we are slightly overweight, with a neutral position in EM sovereign credits and a slight overweight on corporate credits. We are slightly overweight on Asia while maintaining a neutral position in Latin America (Latam) and Middle East/ Africa, as well as slight underweight on Central and Eastern Europe (CIS/EE).

We continue to favour the USD and selectively some Local Currency EM credits. We also favour oil importing countries that will benefit from plunging oil prices.

DEVELOPED MARKETS

Review

US bond yields declined substantially since the beginning of the year despite strength in the underlying recovery in the US. The reasons include muted inflation, strong USD, relative yield pick-up, weaker global growth and plummeting oil prices.

Outlook and Strategy

We expect US yields to finally break the trend in 2015 as the US Fed's policy diverges from its counterparts. The Fed ended asset purchases in October 2014 and we expect wage inflation to pick up with continuing growth, which will move the Fed closer to raising interest rates. We expect the first rate increase by mid-2015, though lower than expected inflation poses a risk of delay. Along with lower commodity prices, a stronger USD helps keep inflation in check and UST yields capped. A preference for UST over other developed world sovereign credits due to the relative yield pick-up would also maintain inflows into the US. We expect the 10-year UST to be range-bound at 2.40 to 2.50 per cent in the coming quarter and three per cent at end-2015. We maintain short duration and overweight on the USD.

In Europe, we expect the ECB to consider a broad-based asset-purchase plan, including purchases of sovereign debt, at its January 2015 meeting. Given that Eurozone's sluggish recovery is having spillover effects on Germany, we revise our 10-year Bund yield forecast to 0.70 to 1.0 per cent with range-bound trading. We are neutral on Bunds with neutral duration and short on euro. We expect USD/EUR to head lower to 1.20 over the next three months. We have revised our underweight on France to neutral and we continue to be tactically overweight on Spain while neutral on Italy. We expect growth in the UK to remain robust in 2015 and domestic wage pressures to build, pushing the central bank to tighten. We think the 10-year yield will grind higher to 2.10 to 2.40 per cent with the curve steepening. We continue to be positive on sterling pounds with a price target of 1.56. Japan's expansion of quantitative easing puts the Japanese yen on a weakening trend. As reforms on fiscal consolidation and economic growth stall, we are underweight on Japanese government bonds and the Japanese yen.

EMERGING MARKETS

Review

EM bonds performed well in 2014, driven mainly by lower interest rates and tighter credit spreads. It has been a difficult and challenging year for EM on many fronts. After last year's sell-off, the asset class has again exhibited resilience and recovered from its losses. This year, EM faced new challenges – the Argentinian default, geopolitical tensions in the Middle East with the emergence of ISIS, the Russian-Ukraine conflict and most recently, the slump in oil prices. Despite these strong headwinds, EM bonds fared well. In the past quarter, EM bonds continued to register positive returns mainly due to higher carry in terms of yield.

Outlook and Strategy

From a fundamental standpoint, EM economies continue to face slower economic growth. However, most economies are in a strong position with little problems in terms of financial capacity. There are nonetheless a few economies that have been more affected by the recent fall in oil prices, but we are confident that isolated problems in some countries will not create contagion risks. We expect continued headline risks from Russia and Ukraine as there is yet to be a long-term political solution. The troubles in the Middle East continue while there is still no resolution to the Argentinian default. We do not see a high probability for oil prices to recover in the near term. Most EM economies, with high oil dependence, will face challenges from reduced fiscal capacity and increased external strain, resulting in lower economic growth and weaker currencies. For economies with low dependence on foreign currency financing, such challenges should be manageable.

However there is much hope for the medium term. A few economies are already sowing the seeds of future potential growth. Mexico for example has enacted powerful economic reforms. For 2015, we expect to stay overweight on the USD and view credit selection to be crucial for performance. The positive change in EM instils optimism on its medium-term prospects. We expect positive returns in the mid- to high-single digits for the year.

ASIA

Review

Asian credits continued to deliver decent returns in the fourth quarter of 2014 (Q4 2014) as 10-year UST yield fell further. Interest rates declined globally as slowing economic growth and falling energy prices led to expectations that inflation will stay moderate. While Asian USD credit spreads widened by 3.16 basis points (bps), the 17.13 bps fall in 10-year UST (to 2.1640 per cent as at end November 2014) ensured that this asset class returned 1.80 per cent in USD terms in the first two months of Q4 2014. This takes the total return for Asian USD credits to 8.7 per cent in the first 11 months of 2014.

Outlook and Strategy

Our in-house Asia leading indicators suggest that economic growth has slowed in Q4 2014 after recovering slightly in the third quarter of 2014 (Q3 2014). Our in-house China activity index also suggests that growth in China continued to slow going into Q4 2014. On a positive note, the Chinese government has eased monetary conditions significantly and this has resulted in onshore interest rates falling by 80 to 120 bps since the beginning of the year.

Despite the moderate economic growth, we believe that Chinese property credits have priced in a lot of bad news on the slowdown in the Chinese property market. We are of the view that easier onshore funding conditions should ensure that Chinese property credits will perform well in 2015. We maintain our overweight position in BB-rated Chinese high yield credits. Likewise we continue to recommend overweighting Chinese state-owned enterprises and Indonesia high yield property credits as well as Sri Lanka quasi-sovereigns, Mongolia sovereigns and quasi-sovereigns. These are relatively resilient to higher US rates and also offer decent yields.

With yield-to-maturity for high yield credits at 7.03 per cent versus 3.11 per cent for high grade credits, the yield difference of 310 bps is 1.33 standard deviations above the mean of 214 bps. We think that the yield premium of Asian high yield over high grade is excessive. Hence, we believe that high yield credits will outperform high grade credits over the next twelve months.

SINGAPORE

Review

The Singapore dollar (SGD) bond market rallied further in the fourth quarter of 2014 on the back of falling global interest rates with both Singapore government bonds and local currency corporate bonds rising and with the latter outperforming year-to-date (YTD) as at November in SGD terms. On the economy, Singapore's GDP growth has been moderating with the slower growth broad-based across manufacturing, construction and services. The government narrowed its 2014 GDP growth forecast to between 2.5 and 3.5 per cent and lowered its 2014 Consumer Price Index (CPI) forecast to between 1 and 1.5 per cent from 1.5 to 2 per cent previously. For 2015, they expect headline inflation to trend lower at between 0.5 and 1.5 per cent.

Outlook and Strategy

Given the weak global economic growth as well as sharply lower energy prices, we think that the government's inflation estimates for 2015 could be too optimistic. The SGD weakened 1.35 per cent in November 2014 to 1.3044 taking YTD depreciation against USD to 3.18 per cent. We have been negative on the SGD for several months. We think that the SGD should end 2014 at around the 1.31 to 1.32 range. A key caveat is that if the Japanese yen weakens significantly beyond 120, then the SGD could end 2014 at 1.35.

There was a slowdown of new SGD bond issuances in Q4 2014 with investors becoming more selective as shipping and offshore marine credits were impacted by falling oil prices. In 2015, we expect foreign issuers to continue tapping on low-cost funding in the SGD market. The secondary market was supported by a limited supply of investment grade issues. Shorter-dated, good quality papers were well-bid and corporate perpetual yields remained unchanged largely. Buying interest from private banking clients continued to be concentrated in high yield credits where attractive leveraged yields were the main drivers of demand.

With global inflation now moderating due to weak growth and falling energy prices, we think that a rise in UST yield is now a remote possibility over the next three to six months. Hence, we are now calling for a slight overweight on the long-end Singapore Government Securities (SGS).

COMMODITIES STRATEGY

COMMODITIES	--	-	N	+	++
Agriculture	○	○	●	○	○
Base Metals	○	○	○	●	○
Bulk Commodities	●	◄	○	○	○
Energy	○	○	●	○	○
Gold	○	○	○	●	○

Notes: The weights are relative to the appropriate benchmark(s). '- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

Overview

We move to an overall slight underweight position in commodities, given the deteriorating outlook for bulk commodity prices and the expectation that crude oil price is unlikely to stage a sudden rebound. Base metal demand should remain positive with aggregate global purchasing managers' index manufacturing data remaining in expansionary territory and industrial production showing growth. However, the outlook for commodity demand is weakened slightly by lacklustre growth in China and Europe. The related strength in the USD, combined with volatility in other cross currency rates, may also have an unsettling effect on global economic growth.

Agriculture

We remain at a neutral weight for agriculture commodities with good harvests continuing to exert downward pressure on grain prices. The strong US harvest in 2014 means total planted acreage is likely to be lower in 2015. This is expected to have an additional dampening effect on fertilizer prices. Weather-related events continue to have the potential to cause rapid changes in pricing outlook.

Base Metals

We remain in an overweight position in base metals, where falling London Metal Exchange (LME) inventory levels are generally supportive of an improving trend in demand-supply fundamentals. Copper continues to trade at a premium to its cost curve, with industry forecast suggesting a shortage of copper from 2016. Aluminium production cuts have maintained a sizeable premium on physical delivery. Nickel is the only base metal to see growth in LME inventories, but inventories are expected to peak in 2015 as China consumes its current stockpile of nickel pig iron from Indonesia and the Philippines.

Bulk Commodities

We have moved to a maximum underweight position in bulk commodities. Having made substantial infrastructure investments in prior years, leading iron ore companies can now bring new production to the market at low marginal costs. This is likely to depress iron ore prices for the foreseeable future, with prices unlikely to rise above US$90/tonne. Coking coal will also remain over-supplied, even though existing producers have started to announce production cut-backs. Although thermal coal prices normally get a seasonal boost during the northern hemisphere winter, increased production and new Chinese import taxes are expected to dampen seaborne prices.

Energy

We remain neutral on energy. Saudi Arabia's recent decision to boost production has resulted in increased supply and a sharp drop in global benchmark crude oil prices. Its action has overshadowed possible geopolitical supply shocks and has reinforced its role as the global swing producer. Although global crude oil demand growth has been positive in 2014, it has underperformed earlier projections. By lowering crude oil prices, Saudi Arabia is hoping to deter higher cost non-OPEC supply, such as US shale oil, from entering the market. Although the short-term outlook for oil price is negative, we believe the possibility of unexpected supply shocks and structural cost pressures to non-OPEC supply means that crude oil price is likely to recover by mid-2015.

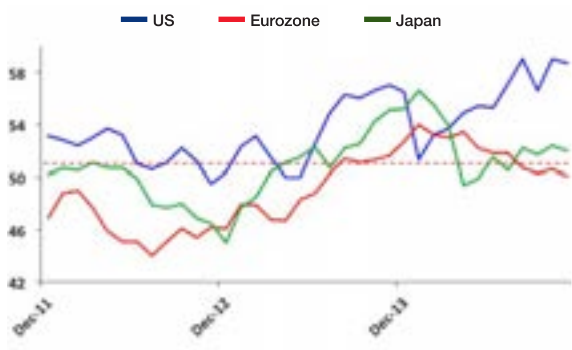
Gold

We remain overweight on gold, given strong physical demand from China and India, where demand remains strong typically in the first quarter due to seasonal factors such as the Lunar New Year. Although the price of gold recently moved below its long-standing trading range of US$1,200 to US$1,400/ounce, it has strengthened in other currencies, such as the Japanese yen and euro.

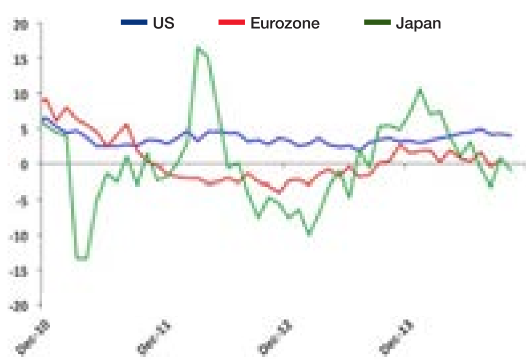
APPENDIX ECONOMIC INDICATORS

DEVELOPED ECONOMIES

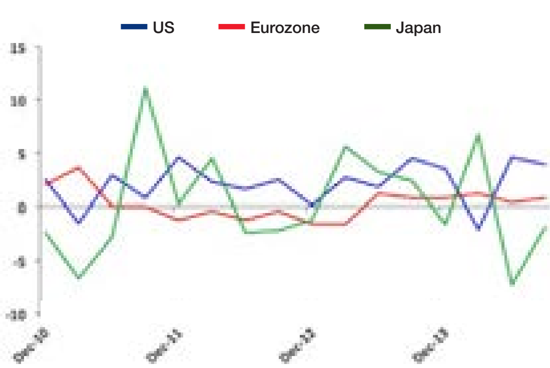
Purchasing Managers' Index



Industrial Production Growth (YoY%)

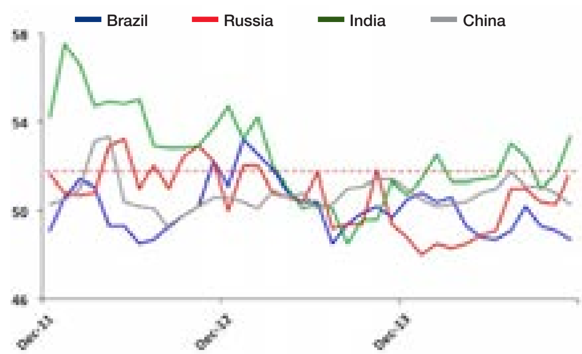


Real GDP growth (QoQ%, saar)*

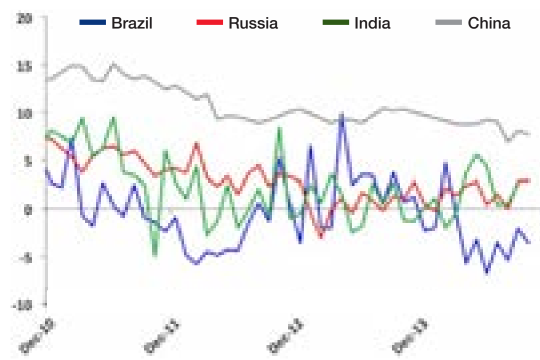


EMERGING ECONOMIES

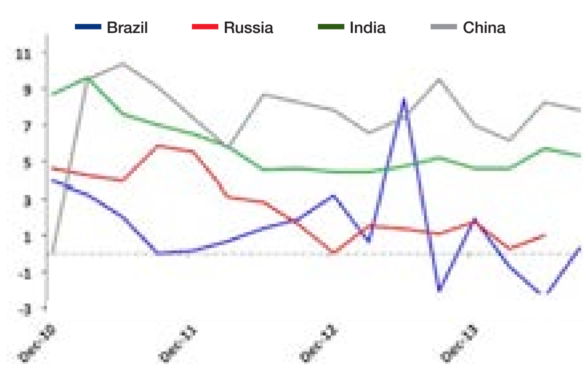
Purchasing Managers' Index



Industrial Production Growth (YoY%)

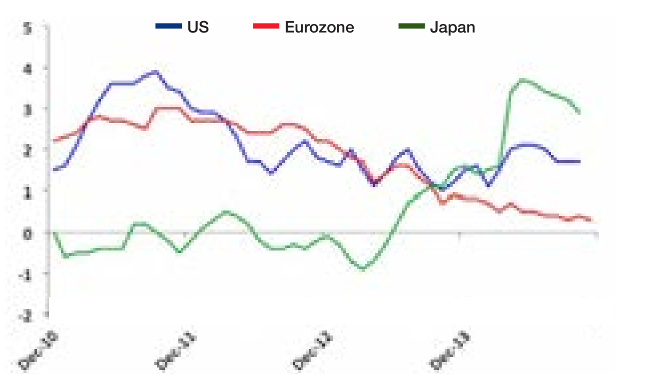


Real GDP growth (QoQ%, saar)*

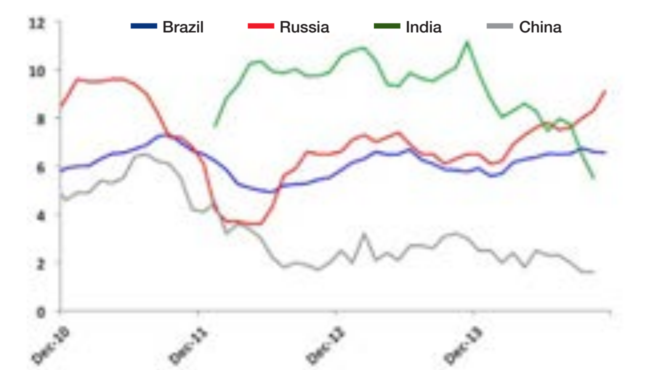


*For some economies, annualised GDP data were estimated by UOBAM. For India, data are in year-on-year percentages (YoY%).
Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 4 December 2014.

Inflation - CPI (YoY%)



Inflation - CPI (YoY%)



Note: All data are sourced from Bloomberg, Datastream and UOB Asset Management Ltd (UOBAM) unless otherwise stated, as at 4 December 2014.

Central Banks Interest Rates

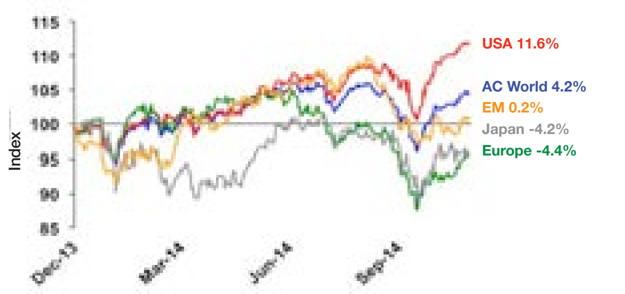
Country	Interest Rate	Current Rate (%pa)	Latest Meeting	Change at Latest Mtg (bp)	Last Change	Next Meeting
		3-Dec-2014				
United States	Fed Funds Target Rate US	0.250	-	-	16 Dec 2008 (-75bp)	18 Dec 2014
Eurozone	Refinance Rate	0.050	-	-	4 Sep 2014 (-10bp)	4 Dec 2014
Japan	BOJ Overnight Call Rate	0.100	-	-	19 Dec 2008 (-20bp)	-
United Kingdom	UK Offical Bank Rate	0.500	2 Dec 2014	-	5 Mar 2009 (-50bp)	4 Dec 2014
Brazil	Brazil Selic Target Rate	11.250	-	-	29 Oct 2014 (+25bp)	16 Jul 2014
Russia	Russia Refinacing Rate Announcement	8.250	-	-	13 Sep 2012 (+25bp)	-
India	Reverse Repo Rate	7.000	2 Dec 2014	-	28 Jan 2014 (+25bp)	3 Feb 2015
China	Interbank Repo 1D	2.610	-	-	-	-
South Africa	South Africa Repo Avg Rate	5.750	2 Dec 2014	-	17 Jul 2014 (+25bp)	29 Jan 2015

Source: Bloomberg, as at 3 December 2014

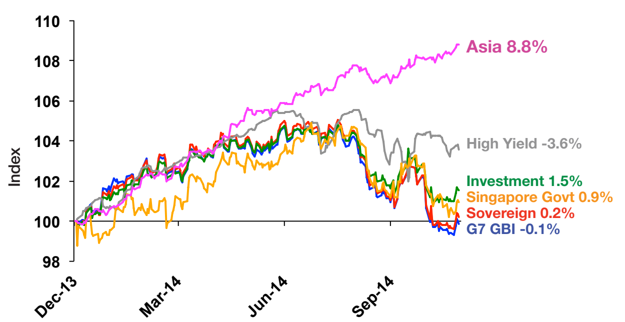
MARKET PERFORMANCE

DEVELOPED MARKETS

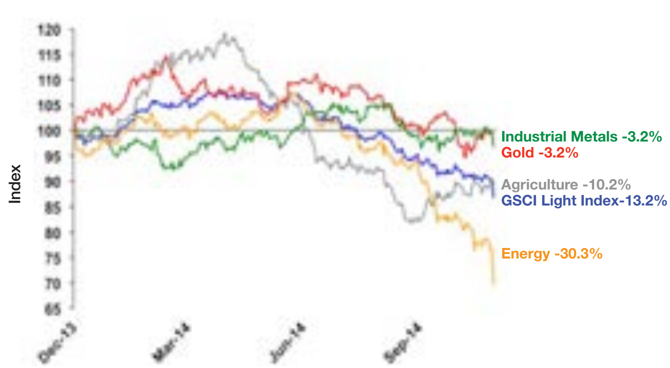
Equity Indices
(Rebased 100 on 31 December 2013)



Fixed Income Indices
(Rebased 100 on 31 December 2013)

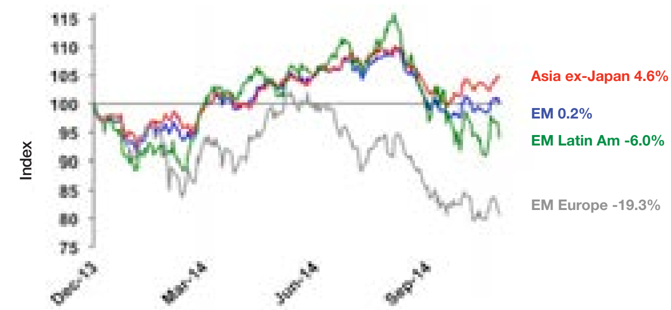


Commodity Indices
(Rebased 100 on 31 December 2013)



EMERGING MARKETS

Equity Indices
(Rebased 100 on 31 December 2013)



Fixed Income Indices
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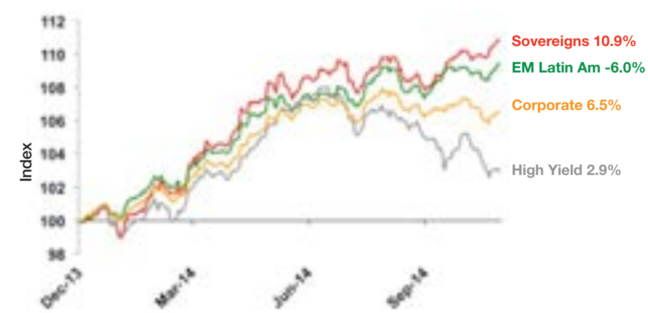
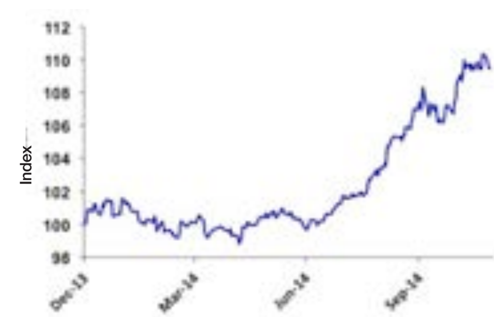


Dollar Index Spot
(Rebased 100 on 31 December 2013)

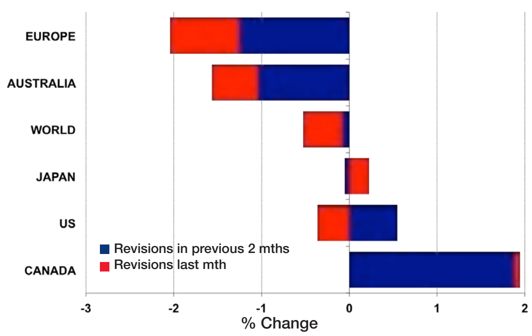


Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 4 December 2014.

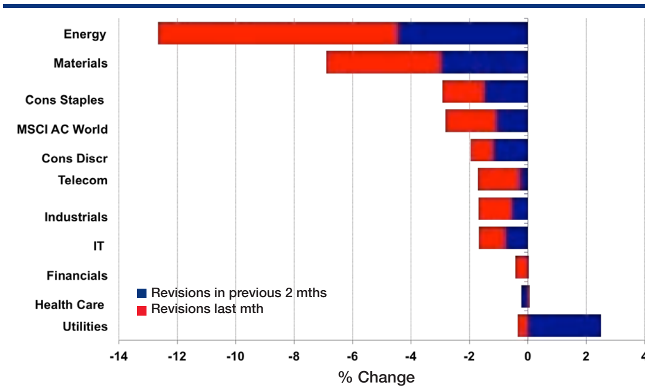
EQUITY MARKET INDICATORS

DEVELOPED MARKETS

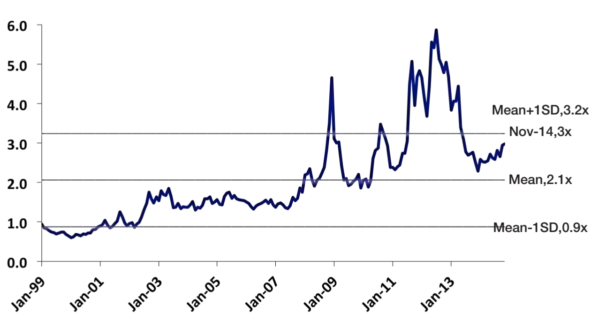
Earnings Revision by Regions for FY2



Earnings Revision by Sectors for FY2

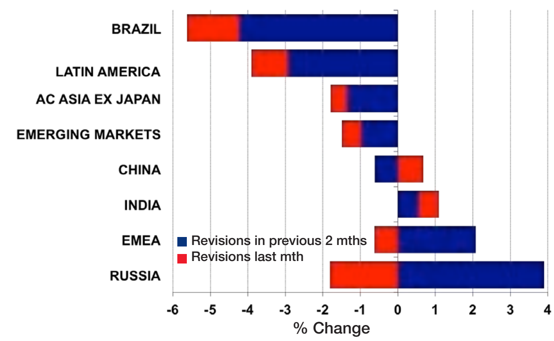


Earnings Yield Ratio*

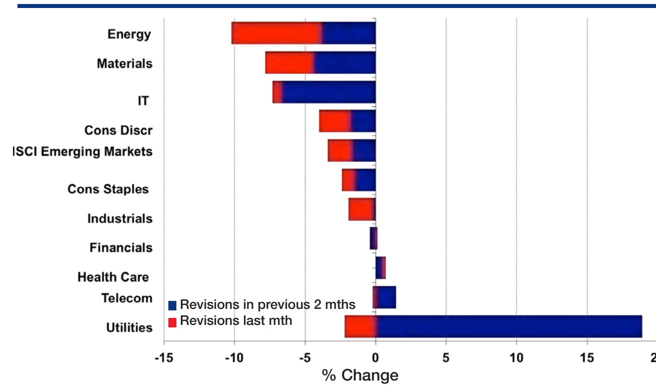


EMERGING MARKETS

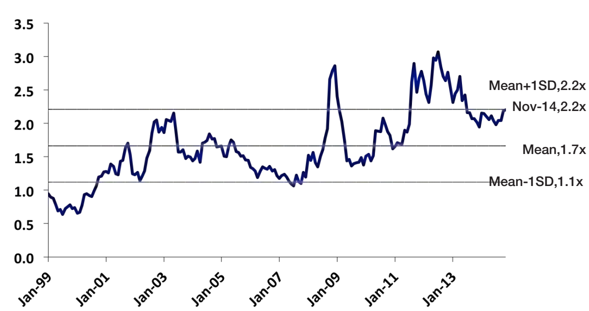
Earnings Revision by Regions for FY2



Earnings Revision by Sectors for FY2

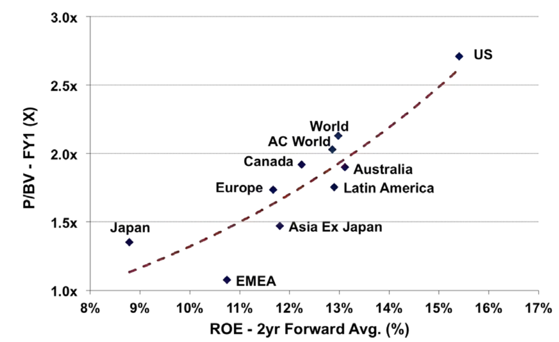


Earnings Yield Ratio*

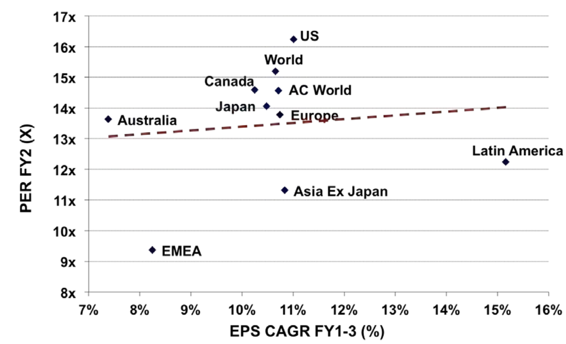


*Mean and SD are based on data from 1999.
Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 4 December 2014.

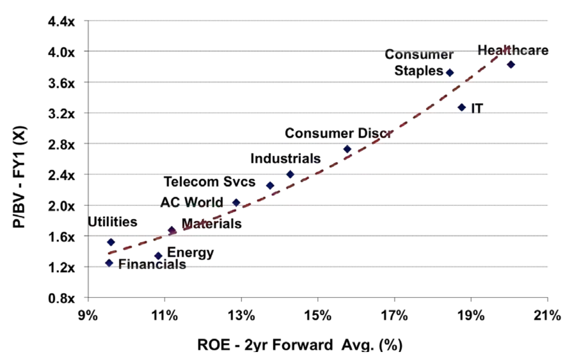
P/BV vs ROE by Region



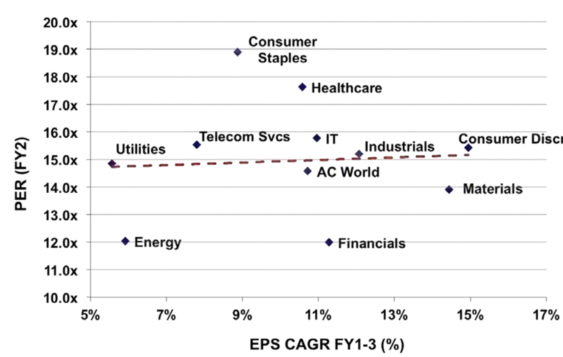
P/E vs Growth by Region



P/BV vs ROE by Sector



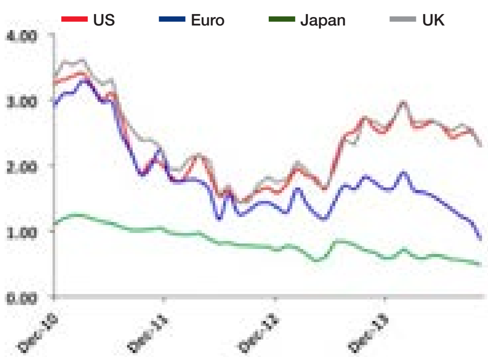
P/BV vs Growth by Sector



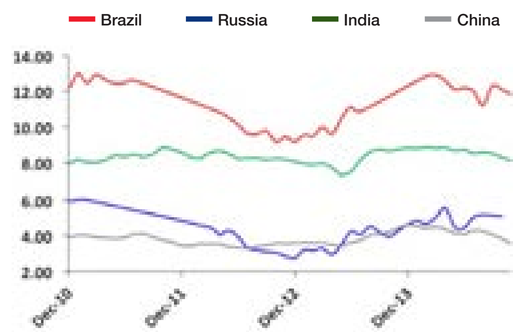
Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 4 December 2014.

FIXED INCOME MARKET INDICATORS

Developed Markets 10-Year Govt Yield (%)

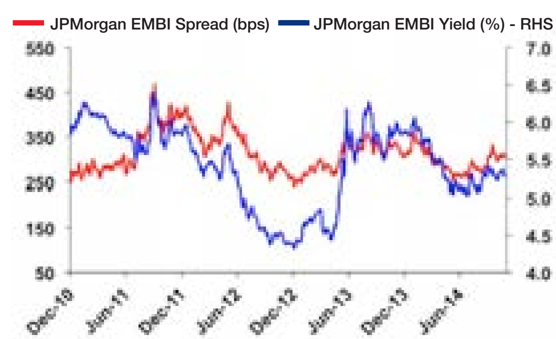


Emerging Markets 10-Year Govt Yield (%)



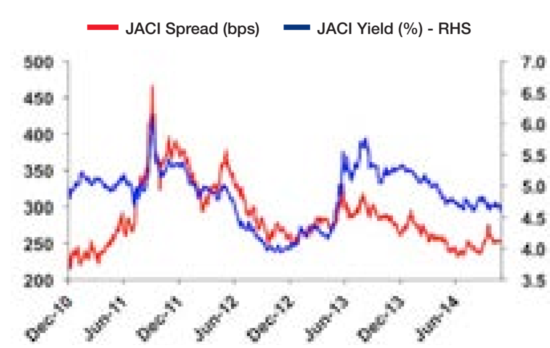
Emerging Markets (USD) Total Return Index

Emerging Markets Yield and Credit Spread



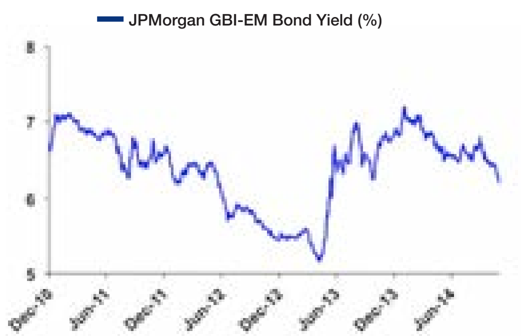
Asia (USD) Total Return Index

Asia Yield and Credit Spread

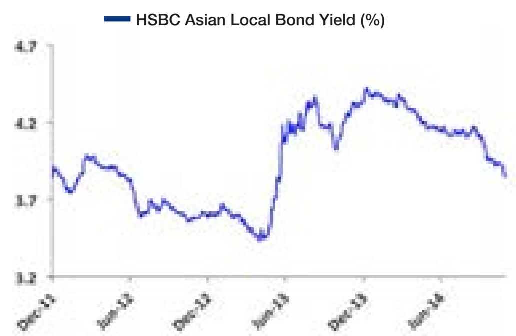


Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 4 December 2014.

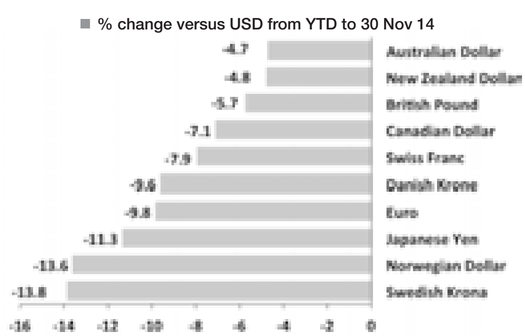
Emerging Markets (Local Currency) Bond Yield



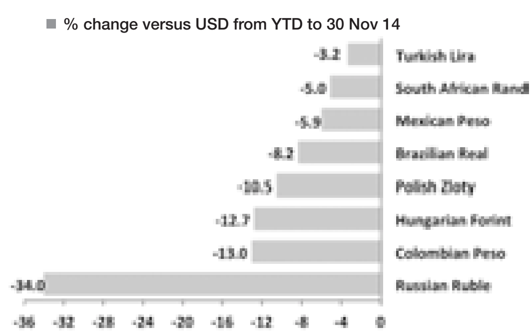
Asia (Local Currency) Bond Yield



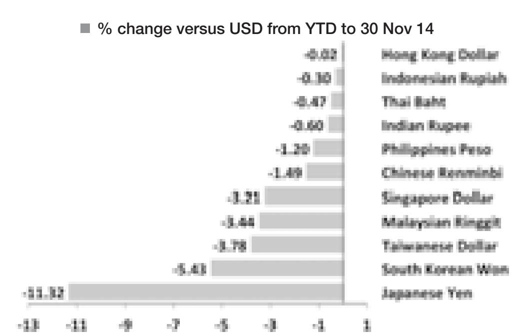
G-10 FX against US Dollar



Emerging Markets FX against US Dollar



Asia FX against US Dollar

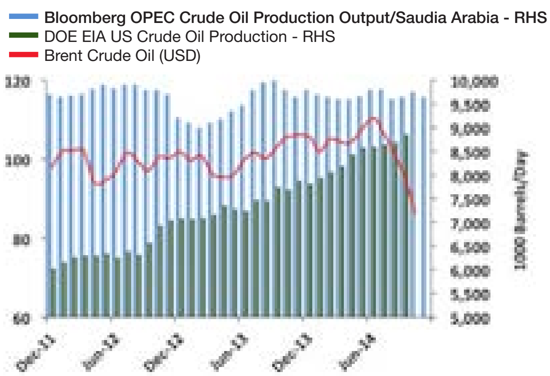


Singapore Bond Index

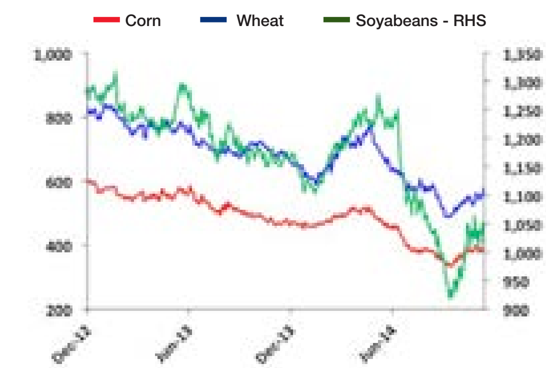
Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 4 December 2014.

COMMODITY MARKET INDICATORS

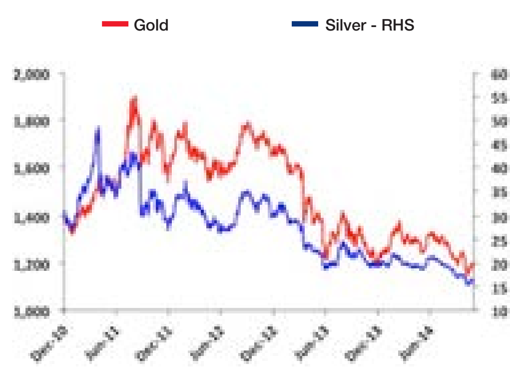
Brent Crude Oil Price and Production



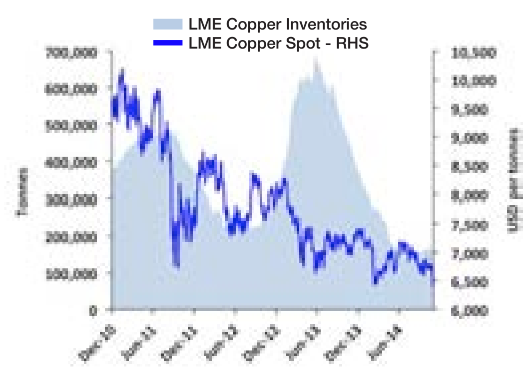
Agriculture Price (USD)



Precious Metal Price (USD)



Base Metal Price



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Important Notice & Disclaimer

The contents in this report were updated as at December 2014.

UOB Asset Management Ltd Co. Reg. No. 198600120Z