



Regime Change Reflation Is Here

Quarterly Investment Strategy
First Quarter 2017

ASSET ALLOCATION

Equities raised to Overweight,
Fixed Income reduced to Underweight,
Remain Neutral on Commodities,
Cash raised to Neutral

EQUITY

Developed Markets raised to Overweight,
Emerging Markets reduced to Underweight

FIXED INCOME

Remain Underweight Developed Markets,
Emerging Markets reduced to Underweight

COMMODITIES

Overweight on Gold and Base Metals,
Underweight on Bulk Commodities and Agriculture,
Remain Neutral on Energy

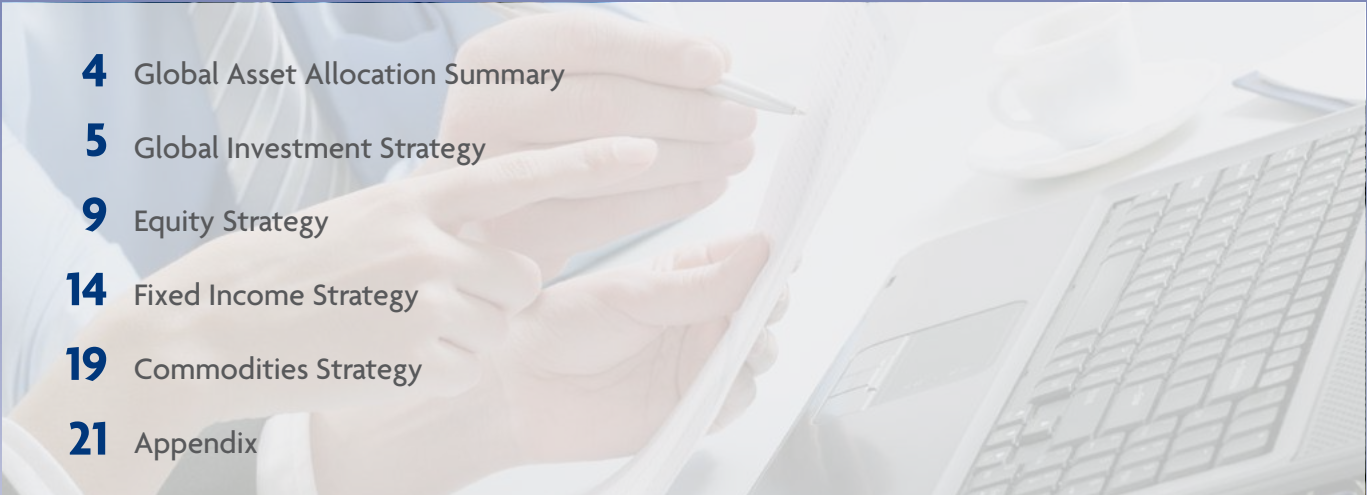
As one of the thought leaders in asset management, UOBAM regularly produces topical investment research articles and publications to help our clients stay on top of financial market developments.

Webcast – Asset Allocation Strategy for Q1 2017

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.

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INVESTMENT STRATEGY SUMMARY

A REFLATION THEME TAKES HOLD

Reflation is the normalisation of inflation and growth rates from low inflation and deflationary levels. High inflation significantly above central bank targets is considered bad inflation. However rising inflation that gets a country out of deflation and back to normal target levels is considered healthy, carrying implied better macro-economic conditions. In the current environment, reflation likely means central banks will no longer have to resort to extraordinary efforts to meet inflation targets. This also demonstrates that slack in the economy has been largely taken up, while growth rates and wages may start to improve. At the same time, normalising inflation also implies that costs are rising in tandem with wages and revenues, and that real wages and profits are not necessarily increasing as fast as much as nominal profits. The broad picture is that overall investment levels tend to improve with nominal growth and the world is desperately in need of some confidence and investment.

In most countries suffering deflationary periods, most asset allocators recommend saving money in either cash or government bonds. However in periods of normalising inflation, most asset allocators would recommend investing in stocks and other growth investments. In a deflationary world, savings in even low yielding cash accounts have positive real returns and government bonds hold positive yields plus real returns. Conversely, investments in new businesses look weaker in a deflationary world. Every loan to start a new business increases in real terms in the amount that has to be paid back. For example in a country with a 2% deflation a \$100 loan turns into a \$102 loan in real terms after a year. The business that the loan was used to invest in, is seeing lower revenues and costs each year due to deflation and thus makes the loan harder to service. Thus investment levels weaken in deflationary environments. And the opposite is true in reflationary environments. Businesses “feel” that the loan taken out to start a new business becomes smaller in real terms each year and they see their profits growing in nominal terms. Thus saving looks less attractive and investment looks more attractive in reflation and thus growth can improve.

It comes as a surprise to many that this reflation trend is taking off at this stage, or 7 years into this expansion. The combination of improving global economic trends and expected fiscal policy support accounts for the sudden change of global sentiment. While growth has appeared lacklustre through most of the year, positive trends had been quietly building. In particular, the US economy had been consistently growing and taking up excess capacity in labour over the past 7 years, and wages appear to be finally climbing. Inflation had been slowly creeping closer to more normal levels and a little stimulus should give market confidence that it will finally happen.

The surprise election of Donald Trump as US president may seem

an unlikely trigger to tip the US into reflation, but we would argue that the key policies that are needed are likely to be implemented. Even more important than the Trump victory is the fact that the US congress is likely to shift from obstructionism to developing policies which supports growth. This fiscal boost on top of the already improving economy becomes a strong basis to expect the reflation theme to dominate market narrative over 2017.

In the last quarter we highlighted that we were neutrally positioned between equities and fixed income as we saw equal dangers of global economies slipping into deflation which would favour fixed income or reflation which would favour equities. This quarter we think the scale has tipped toward reflation and thus we are taking on a more pro-growth positioning.

We recommend an overweight on equities and an underweight position in fixed income. Within equities we are overweight on the developed markets (DM) over the emerging markets (EM) with a focus on the US. In fixed income we are positioning to short duration and an overweight position in credits over government bonds. We are neutral on commodities and cash.



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GLOBAL ASSET ALLOCATION SUMMARY

For the first quarter of 2017 we have raised our equity allocation to overweight from neutral and lowered fixed income from overweight to underweight. We remain neutral on commodities for the first quarter and are also neutral on cash.

We expect the reflation theme to persist as a key theme in investment markets in 2017. Reflation implies normalising levels of inflation and growth which will in turn lead to central bank policy normalisation. In such an environment, better growth and better nominal returns tend to support equity market performance but rising inflation expectations put upward pressure on rates which will act as a headwind to fixed income performance. While these factors are led by the US, we expect these trends to affect global markets due to the influence that US rates have across fixed income markets.



Source: UOBAM, 1 December 2016

Equities – Overweight

Reflation can benefit equities in several ways. Higher nominal growth should improve the corporate earnings outlook. Rising rates should encourage a rotation from fixed income to equities which should in turn support equity prices. Also, better wages and headline growth numbers could further embolden the “animal spirits” or emotion fuelled consumer confidence which supports investment. For the year we would expect high single digit levels of returns.

Fixed Income – Underweight

The global outlook for the past couple of years has been one of low growth and low inflation which is very supportive of fixed income performance. But inflation and interest rate normalisation will likely prove to be a headwind to performance. We expect Fed rate hikes will be modest (3 in 2017) and that long term rates will continue to trend higher. But we think the rate increases will be slow enough that the full year performance for fixed income markets will remain positive at low single digit levels.

Commodities – Neutral

Reflation would tend to be positive for commodities as well but seasonally we find the first quarter to be weak. Additionally the strong moves in the USD tend to be headwinds for commodities. We intend to monitor the commodities outlook for signs of greater strength and may be in position to raise the outlook in the second quarter.

Cash – Neutral

The growth outlook has improved but risks remain high and there are increased uncertainties with the new US Presidency. A neutral call on cash is warranted.

GLOBAL INVESTMENT STRATEGY

REGIME CHANGE – REFLATION IS HERE

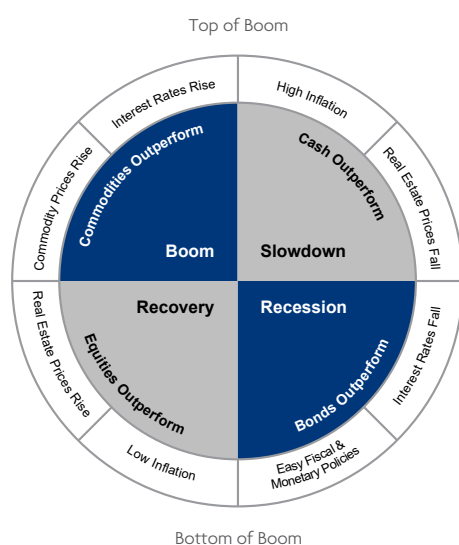
Starting in 2008, one of our main tools used to describe our investment views through the cycle was the investment cycle clock. This is based on traditional academic investment cycle analysis and provides an investment process to determine which asset classes to invest in given the stage of the economic cycle the world is facing. At the peak of the bull market when economies start to slow down, the clock advises investors to focus on cash. When an economy sinks to outright recession it advises a bias toward government bonds which benefit from rising prices as central banks cut rates. Once the economy has survived the worst point of the recession, it advises to focus on equities which will rebound in the recovery. And finally in an overheated economy, commodity prices tend to rise sharply.

The invest clock was a very useful tool from 2007 through the downturn in 2008 and the rebound through 2010. We were cautious and underweight on equities throughout 2008 and then shifted back to equities in May 2009. The period between 2011 to 2016 was confusing in that growth was positive, but none of the usual signs of expansion that the clock monitored were showing. Specifically, the clock points to rising inflation and rising rates as a signal that an expansion is getting mature and could be reaching the peak of the cycle. However the period between 2011 to 2016 was defined by slow but positive growth that did not trigger a rise in inflation or a rise in interest rates.

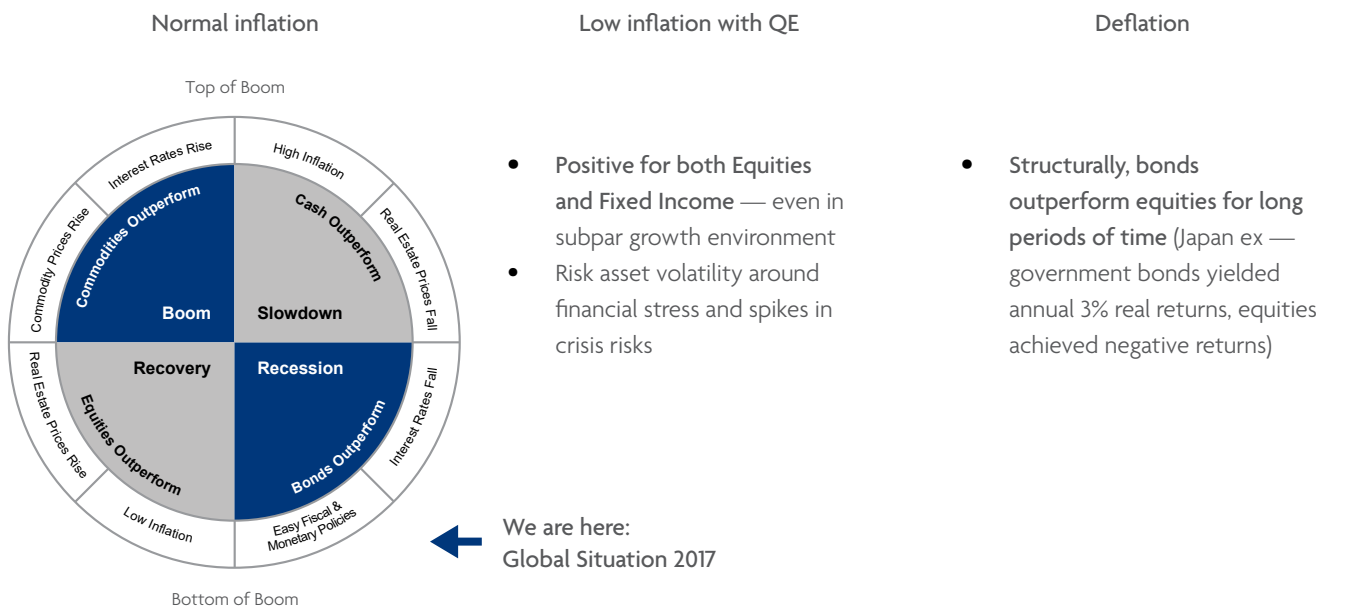
In such an environment the investment clock was no longer a useful tool. We were forced to tell our investors that the clock was “broken” and would be decommissioned until further notice. Economically, our main rationale on why this was happening was that inflation was a key trigger for determining the speed with which markets rotated through the investment cycles. Global inflation had effectively stalled and was even threatening to turn into deflation. Hence we needed a broader methodology on how we would invest when inflation was not progressing as normal.

In 2014 we first published our Inflation Regime Methodology. We explained that there were three main inflation regimes in which asset classes behaved differently. A different asset allocation process would be assigned upon assessment of the kind of inflation regime within the global economy.

UOBAM Investment Clock



INFLATION REGIME INVESTMENT CYCLES



The first regime to take note of is the secular stagnation regime which is frequently associated with outright deflation. From the early 1990's to present, Japan surfaces as the prototypical case of secular stagnation. The experience of Japan is that equities achieved close to flat returns over the past 20 years (this even excludes the initial market collapse and returns would be worse if we included the initial declines). Fixed income returns were positive and low but could generate an average annual return of 3% over the past 20 years. Thus one of the stronger conclusions of secular stagnation is to overweight bonds over equities. Rates remain low for a very long time and growth stayed muted – a perfect environment for fixed income.

The second inflation regime is one of low inflation with monetary policy support. This regime is defined by inflation and growth levels that are below the central bank target levels and central banks are actively trying to reach inflation targets. The prototypical case happened during the post-recession period of 2011 to 2016. Central banks around the world implemented aggressive monetary policy tools in order to generate inflation. The tools included lowering interest rates and purchasing large amounts of assets to increase the liquidity within the economy. During these periods, rates remained low and asset prices rose with liquidity support. The performance of equities and fixed income over this period is consistent with what we would expect – both performed reasonably well although with significant volatility.

Finally the third inflation regime is one of normal inflation. For this regime we go back to the investment clock. Thus in periods of expansion with rising inflation and rising rates the clock would advise equities over fixed income and when the expansion gets very heated, it then focuses on commodities. We would argue that the global expansion is mature at 8 years but that excess slack has only recently been taken up and inflation trends are just starting. We think it points to roughly 10.30pm on the clock – not yet at the peak but at least half way through the expansion. When inflation and growth are overheated at some stage in the next couple of years the clock would advise shifting toward raising cash levels.

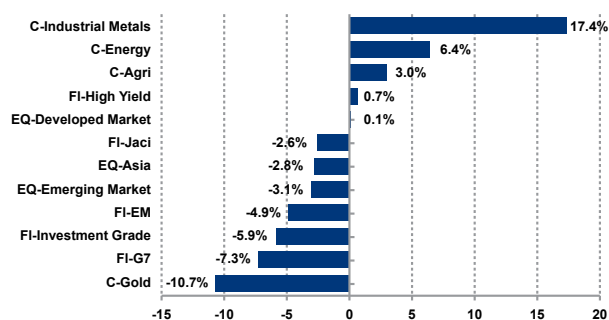
We think this methodology explains a large part of what we have seen in markets over recent years. Global markets were largely in a regime of low inflation with lots of quantitative easing (QE) enabling both equities and fixed income to perform. Markets started to increasingly price a regime shift to secular stagnation in the second half of 2015 and first half of 2016 and thus fixed income outperformed equities over this period. And finally, in the past month markets have concluded that we are back to a reflation regime which implies overweighting equities again.

Global market indicators

After assessing the broad strategic asset class framework, we use our global scorecard to assess the momentum, economic trends, valuations and fund flows around the world. Our view is that global growth signals are improving across the world but that equities the developed markets look stronger compared to the emerging markets. Recent momentum points toward commodities and developed market equities over fixed income and emerging market equities.

Global markets performance trends (3mth return USD)

3 mths performance in USD as of 30 Nov 2016

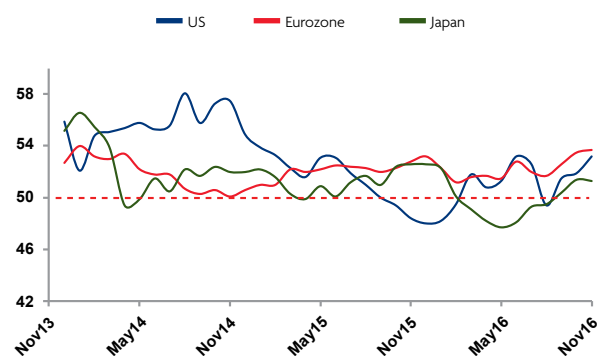


Source: UOBAM, Bloomberg, 30 November 2016

Economic indicators are broadly supportive of global growth and support the consensus outlook for sustained growth at a moderate rate. The Purchasing Managers' Index (PMI) numbers across the world have been above the 50 level, indicating expansion and on improving trends. Economic surprise indices have generally been trending up across the world as global macro-economic data have been showing signs of improving strength.

Global PMI trends

Purchasing Managers' Index

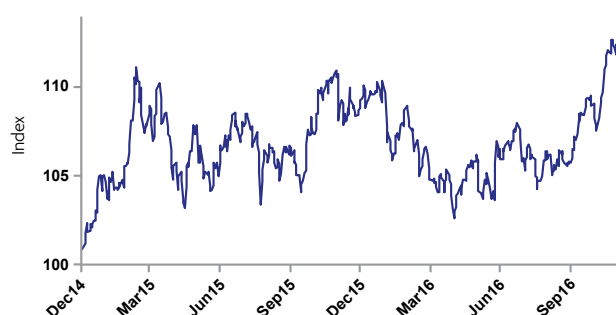


Source: UOBAM, Bloomberg, 30 November 2016

The stronger trends in the US economy and the expectations of further fiscal support have combined for a stronger outlook in the US economy for 2017. Furthermore signs of rising inflation imply that the Fed is likely to raise rates a few times over the course of the next year. In addition, rising rates and a strong macroeconomic backdrop combine to form a strong outlook for the USD.

Dollar Index Spot

(Rebased 100 on 31 December 2014)



Source: UOBAM, Bloomberg, 30 November 2016

We expect that the improving growth environment, reflationary trend and strong USD backdrop imply outperformance for US and DM equities. We expect emerging market (EM) and Asian equities to provide positive returns over the coming year but will lag DM equities as they have done in other periods amid rising US rates and a strong USD.

Assessment and outlook

We expect 2017 to be more reflationary with better growth and normalising levels of inflation and interest rates. Our view is that this trend will help the world break out of its flirtation with secular stagnation and thus implies an environment where equities should perform better than fixed income. Better nominal growth should boost earnings for corporates and could help stimulate “animal spirits” that support investment and further growth. At the same time, reflation implies the US Federal Reserve (Fed) will have to continue with its rate hike plans (we expect 3 more in 2017). We expect this rate hike path will be gradual enough that fixed income markets will be able to continue to provide positive returns, and concurrently create enough of a headwind that expected returns should fall to low single digit levels over the coming year.

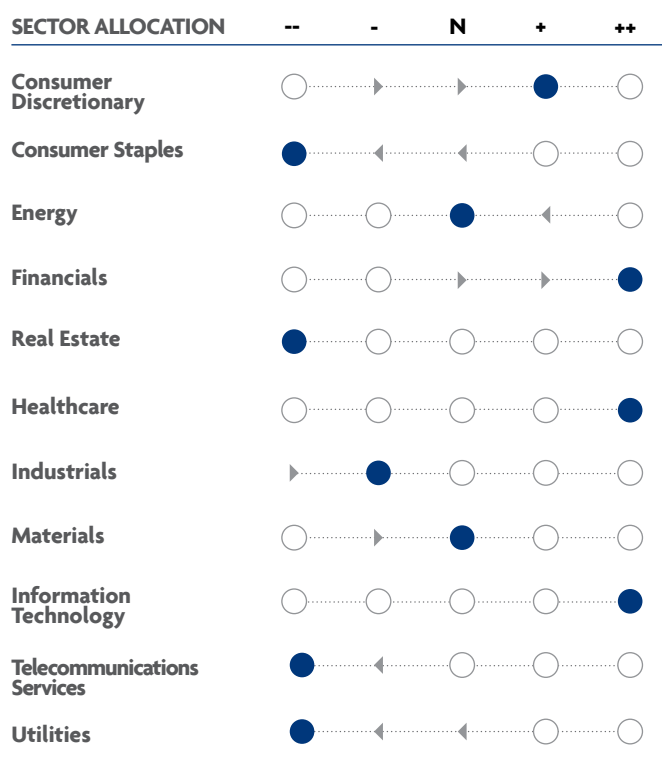
Furthermore, we expect the reflationary trend and interest rate hikes to be supportive of the greenback as we anticipate it to appreciate between the 3 % to 5 % range. Historically, during period of USD strength, developed market equities outperform emerging market equities. And while commodities would usually do well during periods of higher inflation, they also tend to underperform during periods of dollar strength.

We think the risks to look out for in 2017 would include US policy makers failing to deliver on fiscal support promised. Additionally, it will take time for fiscal support to be rolled out either in terms of infrastructure spending or tax cuts. If the economy starts to slow and wage increases don’t materialise, the market would easily return to the momentum from early in 2016 where yields remained low and fixed income performed better than equities. Additionally, there are several Trump policies that are more negative on growth including protectionism and immigration reduction that could start to weigh on growth in 2018. European politics could be another source of risk as both Brexit and the Italian referendum imply growth risks in the European project. Over in China, the economy is currently tracking well, but we expect property construction to begin slowing in 2017 and when China’s economy starts hitting the brakes, global markets would likely turn volatile on fears of a potential hard landing.

There are not many historical periods where major economies have shifted from low inflation and secular stagnation to a reflationary environment. Our asset class investment models indicate that this regime shift should be supportive of growth and assets such as equities. It is fair to note that in this environment, we are forced to make theoretical assumptions rather than decisions that are based on historical precedents. Thus the start of 2017 appears promising for growth but will require careful monitoring for objective evidence for these growth theories to be confirmed.

EQUITY STRATEGY

GLOBAL EQUITY

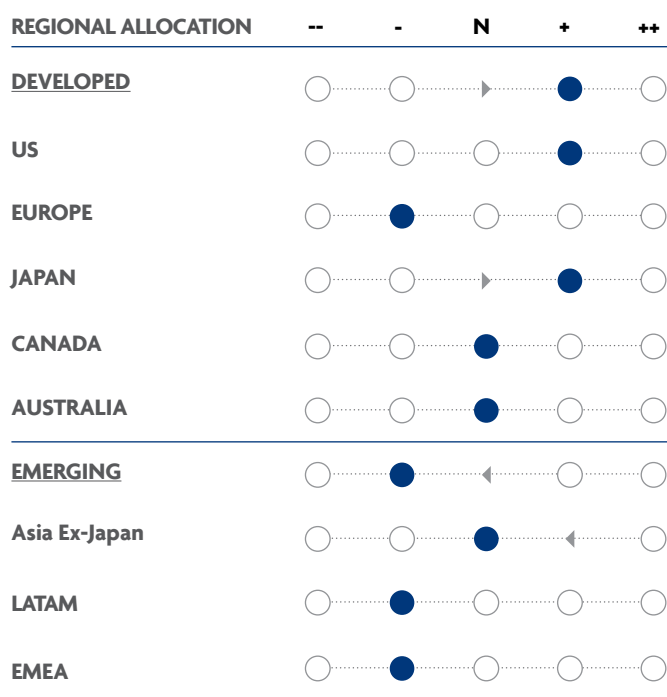


Notes:
The weights are relative to the benchmark – MSCI AC World Index.
‘-’ denotes maximum underweight, ‘-’ slight underweight, ‘N’ neutral, ‘+’ slight overweight, ‘+’ maximum overweight; arrows show change from last quarter.

We have a positive outlook on global equities in the longer term, underpinned by continued growth in the advanced economies, modest earnings growth outlook and strong corporate profitability.

Given the years of underinvestment following the Global Financial Crisis, we believe that technology companies should benefit from rising corporate expenditure on technology hardware, software and business solutions. Hence, we are overweight on the information technology sector. We are also overweight on the healthcare sector given its strong cash generation and dividend yield. The sector continues to benefit from recent merger and acquisition activities and strong earnings growth momentum. We also have an overweight position in financials as we believe that the rising rate environment should be positive for the banks’ margin amid attractive valuations.

Our strategy is to be underweight on yield and interest rate sensitive sectors such as staples, telecommunications and utilities while we are neutral on resources given improving demand and supply balance.



Notes:
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.

Across regions, we have increased our regional exposure in Developed Markets (DM) and decreased for Emerging Markets (EM). This is largely due to our expectations of a stronger USD which should see capital outflows from EM. Trump’s rhetoric on global trade protectionism will also be an overhang on the EM region.

Within DM, we remain overweight on the US which we expect earnings growth to pick up again with improving economic conditions. Meanwhile, the tightening labour force will result in higher wage inflation. A higher disposable income from consumers along with lower gasoline prices will support the

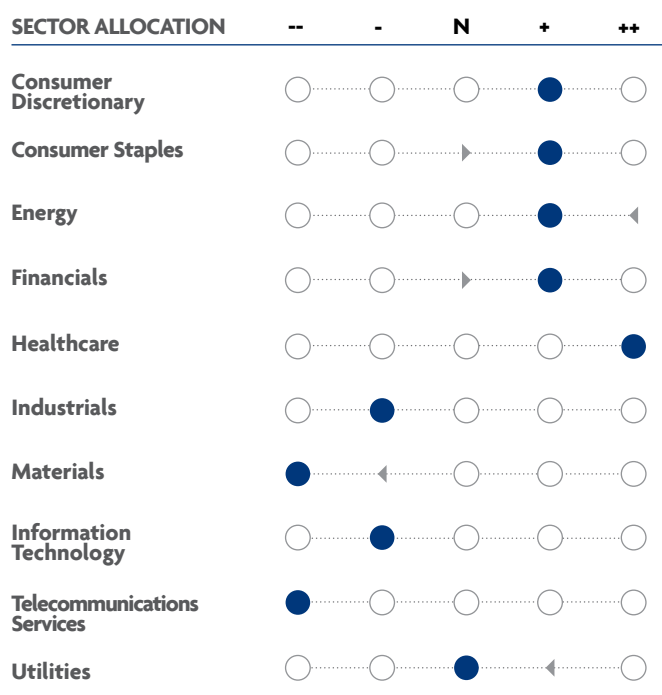
retail sector, which remains a larger part of the economy. We retain the view that the economy remains on a strong recovery trajectory, and the US remains attractive for selective value plays.

We hold an underweight position in Europe despite the potential for further economic recovery. A weaker euro has helped to lift confidence and boost economic activity. The region also has significant operating leverage to an upturn in economic activity with profit margins currently at trough levels. However, we are cautious against the backdrop of increasing geopolitical risks in the region.

Concerns in Japan continue to linger. Economic data remains mixed but we believe that the Bank of Japan (BoJ) will remain accommodative, which would help to support the market. Despite disappointments on policy and the anaemic economic backdrop, there are some positive developments in corporate governance and corporate performance. A weaker Yen also should be beneficial to the exporters and corporate earnings and hence we have upgraded our position in Japan.

We downgraded EM to an underweight position but there remains selective value plays within the region. Challenges are expected to persist due to domestic imbalances and the build-up of excess credit in the period following the Global Financial Crisis. Meanwhile the slowdown in China continues to weigh heavily on the demand and prices of resources. The abrupt shift in the resources sector has dampened investments and growth in much of the developing world. We believe that the EM still present good multi-year opportunities from a structural and macro standpoint but face challenges from a cyclical standpoint. Growth is falling short of expectations and corporate earnings could face further downward pressures unless productivity levels can continue to rise. There are interesting bottom-up opportunities and stock selection is increasingly critical.

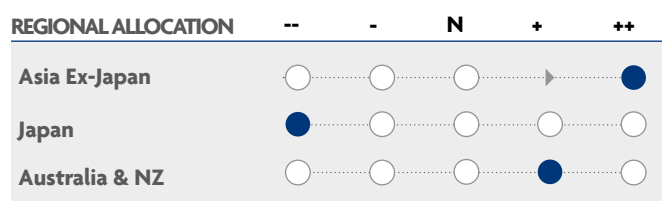
ASIA PACIFIC EQUITY



Notes:
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 strategy is currently an overweight on the energy, healthcare and consumer discretionary sectors. We are retaining our overweight position in the energy sector given the strong demand response resulting from low oil prices and improving demand-supply balance globally. We are also overweight on the healthcare sector given its strong cash generation and dividend yield. We remain positive on the longer-term trend for the consumer sector as it provides exposure to the continued strong growth of domestic demand. We have retained an underweight position in the technology sector on the back of rich valuations and slowing growth outlook. However, we remain positive on the sector on the longer term.

The strategy is underweight on the materials sector due to concerns on China, which is experiencing slower growth. The country is also currently in the midst of implementing reforms.

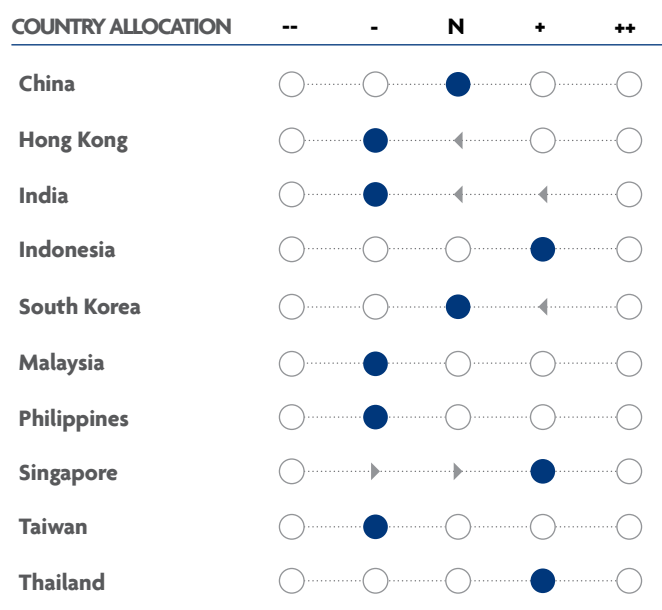


Notes:
The weights are relative to the benchmark – MSCI Asia Pacific Index.
‘--’ denotes maximum underweight, ‘-’ slight underweight, ‘N’ neutral, ‘+’ slight overweight, ‘++’ maximum overweight; arrows show change from last quarter.

Across regions, the current positioning of the Asia Pacific strategy is to be overweight on Asia ex-Japan, Australia and New Zealand. The position is funded from an underweight position in Japan. This is a result of bottom-up securities selection and does not necessarily reflect a view on the respective regions.

For example, the overweight position in Asia ex-Japan is due mainly to the relative attractiveness of Indonesia and India financials against the rest of the region. Similarly, the underweight position in Japan reflects our concern on the operating prospects of Japanese financial and material companies.

ASIA EX-JAPAN EQUITY



Notes:
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.

Against expectations for global reflation and a strengthening USD, inflation in Asia is also expected to rise. Economic growth forecasts have been trimmed to more sustainable levels along stronger growth in Indonesia and Thailand. Most Asian economies have reached the tail end of the monetary easing cycle.

Current expectations of the impact of US President Trump’s trade policies on Asian exports appear to be overly negative. US growth recovery is usually positive for global cyclical, USD earners, selected banks and financials in Asia. However, uncertainty is likely to cap short term market performance.

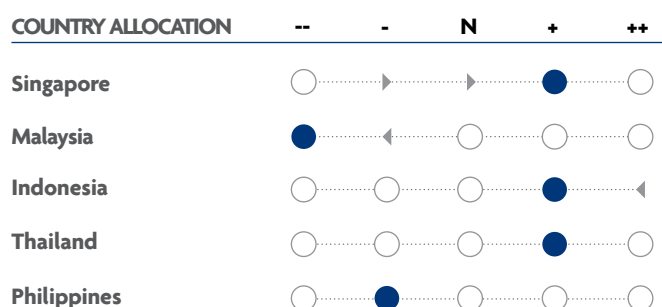
Asian markets and currencies have pulled back since Trump was elected. Valuations are attractive below the mean level on a price-to-book basis. Asian economies are also on better footing today compared to ‘taper tantrum’ in 2013. Current account positions have improved, except in China, Malaysia and Philippines.

In China, the focus on reform and economic restructuring has led to a manageable slowdown in GDP growth. We are neutral on China and favour technology and telecoms sectors which are witnessing stronger growth.

We turn cautious on Hong Kong due to our negative outlook for the property sector, as well as Taiwan due to seasonally weak period for tech earnings. Korea has been trimmed to neutral due to political uncertainty. We are underweight on India owing from a cash liquidity crunch as demonetisation is expected to dent GDP in the coming quarters.

In ASEAN, we turn positive on Singapore as valuations are attractive and corporate earnings should post a mild recovery in 2017. We remain optimistic on Indonesia and Thailand as lower interest rates and improvements in confidence should flow through to spending and investment. The key risks are a disorderly capital outflow, currency volatility and worse-than-expected slowdown in China.

ASEAN EQUITY



Notes:
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.

Macro events are likely to dominate ASEAN market performance in 2017, as USD strength is usually a headwind for emerging markets.

Valuations have pulled back to close to lows on price to book basis and now less than 1 standard deviation above the mean on a price to earnings basis, indicating lower volatility.

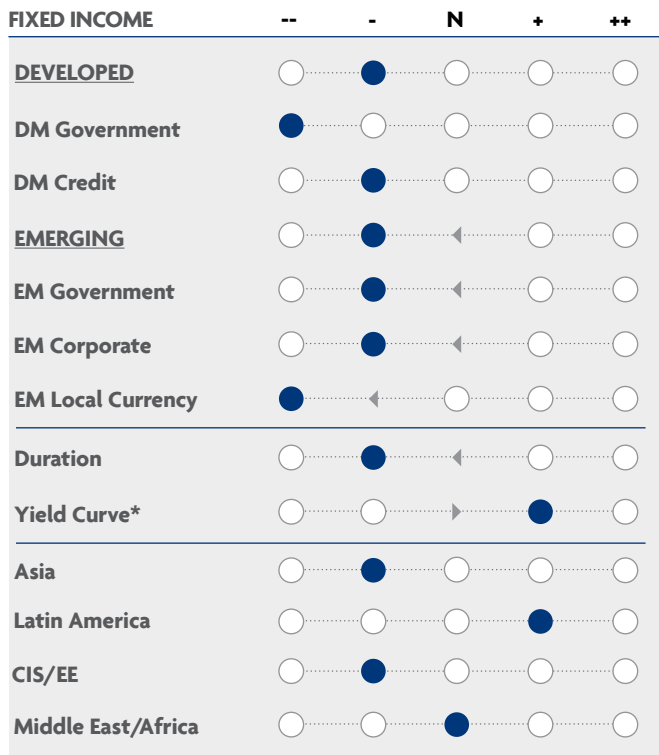
The strategy raises our Singapore position to overweight as we expect GDP and earnings to witness a mild recovery in 2017. The challenging conditions in the oil and gas sector seem to have stabilised and this should improve the outlook for the financial sector.

We believe that the Indonesian economy should recover in 2017 as lower interest rates and the success of the tax amnesty program should accelerate investment spending and improve confidence. A smooth royal succession in Thailand paves the way for improved confidence and continuation of plans to increase public spending.

Within ASEAN, current account positions in Thailand and Indonesia have improved since a ‘taper tantrum’ in 2013. However current account positions in Malaysia and Philippines have deteriorated. Hence we are underweight on these markets as we view that Malaysia and Philippines markets will face challenges amid rising US interest rates. On a positive note, the ASEAN region has been a recipient of rising foreign direct investment from Japan and China.

FIXED INCOME STRATEGY

GLOBAL FIXED INCOME



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.
*'+ ' denotes Steepener and '- ' denotes Flattener.

The capital markets are still digesting news from US President-elect Donald Trump, with yields and the dollar moving higher on sentiments of implied growth from fiscal policies. While inflation and growth expectations have been adjusted upward, we believe the markets have reacted too rapidly in pricing forward rates. We now anticipate that the Fed will enact three hikes for 2017, and the US 10 year yields should range from 2.3 to 2.5% for the first quarter. The USD should remain strong and continue to be supported by repatriation of corporate profits that could take advantage of tax rebates and relative yield trades.

Market volatility is expected to be elevated until we see clarity in Trump's trade policies. Any moderation in Trump's stance towards trade protectionism will be positive for both Asia (China) and emerging markets (EM) which have taken the brunt of the broad USD strength as local currencies and bonds sell-off. Under these circumstances, we will position our funds opportunistically to take advantage of any risk pullback, as we expect market sell-off to fade and yields to stabilize. Nevertheless, there are a few binary events in Europe to watch out for in the political area.

In the Developed Regions, we remain underweight on government debt. We are relatively positive on corporate credits for carry and have reduced duration to short versus the benchmark against steepening yield curves. We remain defensive on high yield credits and are selective in the credit selection. In the EM, we have moved it to a slight underweight position. We are slightly underweight on USD denominated EM sovereign and corporate credits. We remain neutral in Latam, Middle East and Africa regions while maintaining a slight underweight position in Asia and Commonwealth of Independent States and Central and Eastern Europe (CIS/EE). We are underweight on local currency credit in EM.

DEVELOPED MARKETS

Review

Developed market government bond yields moved higher, after the unexpected turn of political events from Brexit and the US Presidential election. An upward bias remains, and moves are likely to follow a more orderly fashion. With inflationary expectations making a comeback and interest rate uncertainties brewing, terms premia is likely to scale higher. While major central banks remain very accommodative, most investors expect some of the developed markets to stay on a gradual normalisation path ahead.

Outlook and Strategy

The US presidential election results came as a shock to the financial market. However, the initial flight to safety trades lasted barely a few hours before US Treasury yields spiked sharply, taking the USD stronger. While still short on specifics, US President-elect Donald Trump's policies are expected to drive higher domestic growth, higher inflation and anti-globalization. This increases the probability of future Fed fund rate hikes alongside energy prices that are also likely to trend higher.

Canada is reliant on the United States through supply chain dependencies and exposed as part of NAFTA. The future of NAFTA is uncertain at this point and is too early to tell if potential higher growth in United States will benefit Canada. Nonetheless, in recent months, the Canadian economy is recovering with support from low interest rates, a drag from energy-related investment demand wearing off, an expanding services sector and fiscal policy. The Bank of Canada is likely to hold its policy rate and allow the interest rate differential with the US to widen.

The spillover of the US Presidential election to Europe was effected through tighter financing conditions and worries over rising populism. Euroscepticism has been rising for some and investors will be watchful of events unfolding after two major surprises. German bunds sold off but to a lesser extent compared to its US counterpart. Investors have priced in higher expectations of inflation in the Eurozone, however at a smaller magnitude compared to the US. Both will effect energy price changes but the pace of economic growth and wage pressures will differ. German bunds are viewed as safe haven assets at least amongst the other European government bond markets. The busy political calendar in Europe in the coming months will potentially stem the increase of German bund yields and the European Central Bank (ECB) may be incentivised to enact a soft tapering of its monetary policy later rather than sooner.

Even as the Italian Referendum culminated in Prime Minister Matteo Renzi resigning, more uncertainties are expected to continue leading up to the next election, evidenced by Italian government bond yield spreads widening against their German counterparts. The short term worries will be on the borrowing costs and health of the banking sector. Over in France, the political landscape is still evolving as candidates for the Presidential election are still unconfirmed. France, the third largest economy in Europe, will impact the euro with its political stand toward the Eurozone.

The monetary policy divergence in at least in the near term and heightened political risks in the Eurozone is putting stress on the euro and weakness is expected to persist for some time. The United Kingdom is expected to trigger Article 50 of the Lisbon Treaty early next year, amid uncertainties surrounding the terms of exit as the negotiations progress.

The Bank of Japan's Quantitative and Qualitative Easing with Yield Curve Control (QQE-YCC) is a regime shift to yield targeting away from asset purchases. This puts Japanese government bond yields within a tighter range and widens the interest rate differential against its peers, thereby weakening the yen. With this new tool, BOJ is not expected to launch other drastic moves without compelling case.

Australia's terms of trade has improved on the back of higher commodity prices. Inflation is still benign with limited wage pressure. The Reserve Bank of Australia is likely to hold a neutral stance and allow for a widening interest rate differential against US to work to increase its currency competitiveness.

We recommend a short duration stance for most developed market bond markets. The movements in developed bond markets are highly correlated to each other especially with longer dated bonds. Japan is an exception with its QQE-YCC where we maintain a neutral duration.

EMERGING MARKETS

Review

In the local currencies market, Brazil was the top performer whilst Mexico was the worst. By region, Latin America and Middle East (South Africa) outperformed, while Asia and Europe underperformed.

EM bonds erased some of their returns achieved year to date in the aftermath of the US elections result, which was largely reflective of the repricing of US Treasuries. The benchmark EMBIGD spread widened by 51 basis points (bps) following the election. Latin America saw the largest impact, while the Middle East and Asia remained more resilient. High yielding commodity exporters fared better than manufacturing exporters to the US.

Outlook and Strategy

Bonds in the EM are facing headwinds from a pullback of monetary support coming from the DM and steepening yield curves globally. This trend is reinforced by expectations of an increased US fiscal support and higher commodity prices. Inflation is likely to increase from base effects and higher input prices, while capital flows are rotating into equities from bonds, and to DM from EM, will drag on local market performance going forward.

The sell-offs in the EM displayed a higher level of resilience as fundamentals in the EM strengthened (reserve adequacy, valuations, real rates, external accounts, inflation). Hence we do not expect EM assets to suffer the losses experienced during the tapering tantrum in 2013.

Overall, the recovery in higher yielding markets such as Russia and Brazil, as well as the rebound of commodity prices alongside recovering global growth should support valuations. We position our short duration in lower yielding markets (Asia, Central and Eastern Europe) and we hold a neutral to long duration on high yielders (Russia, Brazil, South Africa, Colombia). With currencies, we are neutral on high yielders, taking tactical positions according to risk sentiment, while we are negative on Asia currencies.

Trump's election victory has exposed EM fixed income to the threat of higher yields, a stronger USD and lingering uncertainty around trade protectionism. Most vulnerable are Mexico, South Korea and Taiwan with significant manufacturing exports to the US. Other suspects at risk are Honduras and El Salvador with high current account deficits, limited foreign currency reserves or high dependence on remittances growth. Unless we see more clarity with the new US administration agenda and its ability to implement Trump's policies, we expect further EM implications arising from the uncertainty to persist into 1Q17.

The historical low interest rates in DM, including negative rates in Europe and Japan have driven investors out of US Treasuries and into other asset classes in search of higher yield. Higher UST yields led to a modest narrowing between emerging and developed market interest rates. The differential between these two is still relatively high compared to recent history, offering support for EM fixed income.

We are close to benchmark neutral with a 6.1% portfolio yield as we await Trump's policy details. Portfolio risk has been reduced from earlier in the year following the EMBIG benchmark rallying 200 bps. Within a broadly defensive positioning, we continue to prefer higher beta commodity names over manufacturing exporters as we expect stable EM fundamentals and higher yields to mitigate potential adverse US policies.

Stronger EM fundamentals should now provide a buffer preventing significant sell-offs similar to the taper tantrum in 2013. We believe that once the initial adjustment to higher core yields and a stronger USD is complete, a more structural view on market beta will be supported by the resumption of the structural bid for EM. We find a number of positive idiosyncratic stories such as Argentina, Brazil and Russia. Overall, we continue to like EM bonds, primarily for their carry and for the asset class' favourable risk-adjusted returns over the long run.

ASIA

Review

Asian hard currency bonds registered positive year-to-date returns in 2016 of 6.0 % in USD terms, with the first two months of 4Q16 detracting by 2.8 %. Asian credit spreads had continued tightening but the sharp spike in underlying US Treasury yields brought the overall total returns lower. During this quarter, risk sentiment for emerging market assets had turned negative while Asian bonds stood firm showing its resilience.

Within a short span of time, we witnessed another unexpected result from the US presidential election – a Trump Presidency. The outcome seemed to indicate a change to the current status quo and rising support for protectionism led international investors to wonder if America is turning away from globalisation. Countries globally will feel the shocks should the US as the world's biggest economy and consumer engine fulfil Trump's rhetoric of protectionism. As most Asian economies remain export-oriented, the region will be amongst some of the worst affected. Asia was among some of the negatively affected as most remain export-oriented. Talks of huge fiscal expenditures stoked expectations of increased inflationary pressures and thus, more aggressive engaging in US rate hikes. These in turn drove massive weekly fund outflows out of emerging markets. For the first two months of 4Q16, the ten-year US Treasury yield rose by 78 bps from 1.60 % to 2.38 % while the JP Morgan Asia credit composite spread tightened from 250 bps to 239 bps.

Outlook and Strategy

A game changer may really be on the cards now for Asian fixed income. A booster from increased US fiscal spending alongside stabilised global macroeconomic data may help to set the stage for the next quarter to price in a slightly faster than expected US-led global recovery. In addition, the bottoming of oil and commodity prices may also mean lesser headwinds in the near term. However, scepticism likely to remain for Asia as China continues its growth normalisation and reforms in industries facing excess capacity. In addition, increased political instability across the globe and trade protectionism may also add more woes and uncertainties to investor confidence.

On the valuation front, Asian credit spreads further tightened in this quarter. The average Asian credit spread continued to be much tighter than the selloff levels in August 2015. As of end November 2016, the average Asian credit spread stood at about 239 bps which is about 28 bps narrower than its three-year historical average of 267 bps. On a longer historical basis, current spread is just 23 bps wide from the lows in 2010. A sharp massive sell-off in underlying US Treasuries had also brought the overall low average Asian credit yield from 3.80% back up to 4.58% as at end November. At current levels, the room for a further rally looks limited as Asian credit spread valuation looks very stretched while expectations for the underlying US rates remains on the rise.

Moving ahead, we are inclined to stay slightly negative in our positioning due to the stretched valuations. Nonetheless, we remain convicted in gathering a defensive carry by staying invested. We prefer to turn towards a neutral weighting in the non-investment grade segment as the risk premium for the high yield exposure has eroded substantially. Any aggressive chase for yield may likely be largely undermined as global interest rates move higher. In such an environment, the consistent focus on credit differentiation remains paramount for us. Tactical positioning in cash levels (to high single digit) and duration will be employed to gather more returns for the portfolio.

SINGAPORE

Review

Singapore economy grew 1.1% year-over-year (yoy) in the third quarter of 2016, slower than the previous quarter of 2.0% but better than the advance estimate of 0.6%. On a quarter-over-quarter (qoq) basis, the economy contracted 2.0%, a reversal from 0.1% growth in the previous quarter, but better than advance estimate of 4.1% contraction. Sectoral performance wise, the manufacturing sector expanded 1.3% yoy, similar to 1.4% growth in 3Q. The construction sector grew by 1.6% yoy, easing from the 2.0% growth in 3Q. Service sector registered a flat growth; lower than the 1.2% growth in 3Q. Headline inflation fell for the 24th consecutive month and came in at -0.1% yoy in October, compared to -0.2% in September, as a smaller drag from the cost of oil-related items more than offset lower food and services inflation. Core inflation rose to 1.1% yoy in October from 0.9% in September, largely on account of the smaller decline in utilities prices. The Singapore Dollar (SGD) ended the month of November at 1.4334, weaker by 3.0% compared to end-October of 1.3911. This was 0.29% below the mid-point of the Singapore Dollar Nominal Effective Exchange Rate (NEER) policy band. The depreciation was led by weak domestic growth and sharp rally in USD.

While the market was still digesting the implosion of Swiber, more negative headlines shadowed the SGD credit market. Two issuers (Perisai and Rickmers Maritime) defaulted on their bonds after failing to achieve an agreement on restructuring. One issuer (Swissco) applied for judicial management and two issuers (Kris Energy and ASL Marine) announced consent solicitation in restructuring their bonds. This will continue to dampen appetite for higher yielding bonds, especially those in the oil & gas sector. It also contributes to overall subdued issuance volume in the SGD space, with total issuance reduced by 15% year to date.

Outlook and Strategy

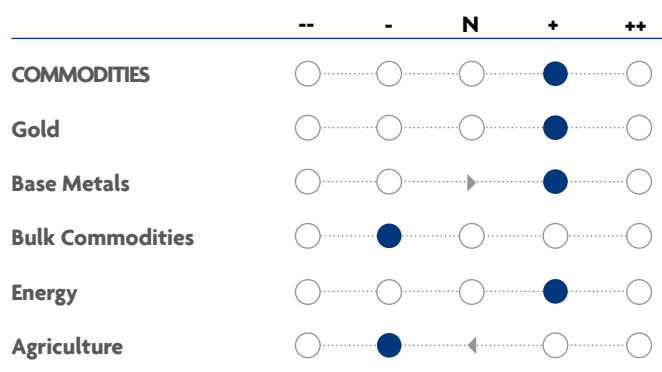
The Ministry of Trade and Industry (MTI) narrowed the 2016 growth forecast for Singapore economy to 1.0% to 1.5% from 1.0% to 2.0% previously. For 2017, MTI expected GDP to grow at a modest pace of 1.0% to 3.0%, bearing the full materialization of downside risks, including uncertainties post Brexit, Chinese economy restructuring and a slowdown in services and wholesale trade sectors. The Monetary Authority of Singapore (MAS) expects headline inflation to pick up to 0.5% to 1.5% in 2017, from around -0.5% in 2016, largely reflecting the rise in private road transport cost. Core inflation is expected to average around 1% in 2016 before rising to 1% to 2% in 2017, as energy related components begin to contribute positively to inflation and temporary disinflationary effects from budgetary measures fade. However, the increase in core inflation will be gradual, given the absence of more generalised demand-induced price pressures.

On the currency front, we expect SGD to remain weak against USD and trade within the lower half of the NEER policy band, on the back of sluggish domestic growth and continued USD strength. As SGD is widely used as a proxy to Asian currencies, it will be affected by investment sentiment towards Asia under the a Trump administration.

Despite the sharp correction in interest rates in November, the seismic shift triggered by Trump that altered an interest rate outlook may still have some room to run into 2017. We expect Singapore Government Securities (SGS) yields to rise further, with the expectations of rate hike and higher inflation. We are short on duration and are underweight on SGS against the benchmark.

Given generally rich valuations and expectations for an increase in market volatility with several potential risk events on the horizon, we maintain our defensive positioning with a preference for quality credits with leading market share, of systemic importance, in defensive sectors and which are professionally managed.

COMMODITIES STRATEGY



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 remain at a neutral weight for the overall commodities sector. Although base metals and bulk commodities have performed strongly in recent months, this has largely been driven by speculative anticipation of deficit spending by the incoming Trump administration, which may fail to live up to expectations. There have also been policy missteps by the Chinese government in the areas of domestic steel and coal production that have driven up prices, but are now in the process of reversing. We are cautious of the current strong rally in the USD due to its negative correlation between commodity prices in recent years. Finally, the first quarter is typically the weakest quarter of the year seasonally, as cold weather and the Chinese Lunar holiday suppresses demand.

Agriculture

We move to a slight underweight position in agriculture commodities. Grain prices remain depressed given the strong US harvest, high crop-to-use levels and anticipated planted area for the coming year. Fertilizer prices also remain depressed, with plenty of available spare capacity. Although the US is a net importer of fertilizers, protectionist rhetoric from incoming President Trump is aimed at bringing manufacturing jobs back to the United States, with no policies towards reducing agricultural imports. Latest data from the Australian Bureau of Meteorology shows a neutral La Nina reading, making it unlikely that drier weather will impact South and North American crop production in 2017. The only positive factor is that prices appear to be bottoming, with a potential to rally on unexpected weather-related events.

Base Metals

We move to a slight overweight on base metals. The evidence of supply-side shortages continues to mount, with zinc, lead, nickel and tin production appearing constrained given new mine capex which peaked in 2011. Environmental and social factors require new mines a timeframe of at least three years from first investment to first production. This makes it probable that global economic growth in the 3% range will produce a continuing reduction in inventory levels, and elevated prices. While copper and aluminium remain well-supplied at this current time, capital expenditure reductions and positive industrial production data point to tightness in these markets in the medium term. Fiscal stimulus programs that target improved infrastructure may also be positive for base metals.

Bulk Commodities

We remain with a slight underweight position in bulk commodities. The recent severe price spike in coking coal, and to a lesser extent in thermal coal and iron ore, stems from Chinese government enforcing lower domestic production targets that reduced the operating days of domestic mines from 330 days to 276 days, and enforcement of mine closures. The resulting price spikes were unintended, as has been shown by the complete reversal of Chinese government policy in recent weeks. In fact, the government is now encouraging all mines to produce at a maximum level. This will inevitably lead to lower bulk commodity prices as previously restricted capacity comes back onto the market.

Energy

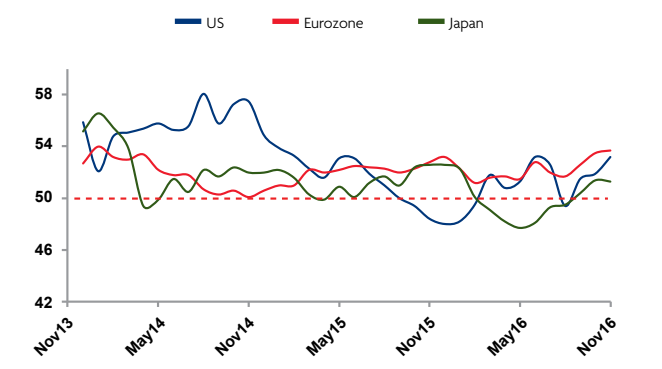
We move to a neutral position in energy. Crude oil prices have rebounded after recent agreement by the Organization of the Petroleum Exporting Countries (OPEC) to cut production by 1.2 million barrels a day (mmbopd), with a further agreed reduction of 0.6 mmbopd by Russia. Yet it is unlikely that crude oil prices can rally above US\$60/barrel in the coming year given potential for US onshore share production to ramp up quickly and profitably at that price point. Supply disruptions could always lead to a price spike but we note that geopolitical tensions in the Middle East are actually reducing. Production from Nigeria and Libya is already running at low levels, and is more likely to increase rather than scale down from current levels.

Gold

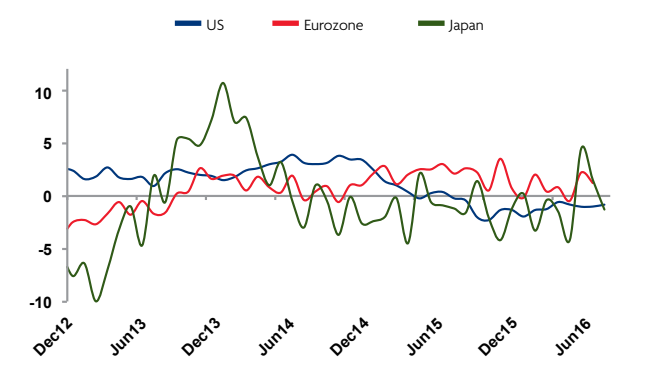
We remain overweight on gold due to the potential for negative interest rates in developed economies, and concerns over further anti-EU catalysts in the coming quarter. The high level of indebtedness in the US economy, together with continued variability in US economic data, means that further hikes could curtail growth. For example, higher market borrowing rates since Trump's election victory have already led to softer mortgage application demand. We believe further US Fed rate increases will actually lag inflation. The resulting negative real rates have historically been positive for gold prices. The recent resignation of Italian Prime Minister Renzi and the upcoming French Presidential election means the stability of the European Union will remain a concern over the coming quarter.

APPENDIX ECONOMIC INDICATORS DEVELOPED ECONOMIES

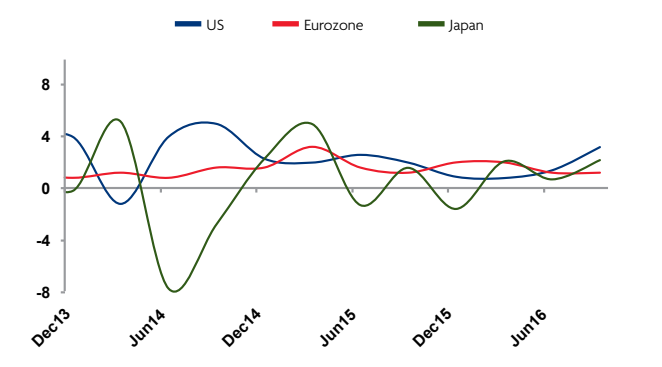
Purchasing Managers' Index



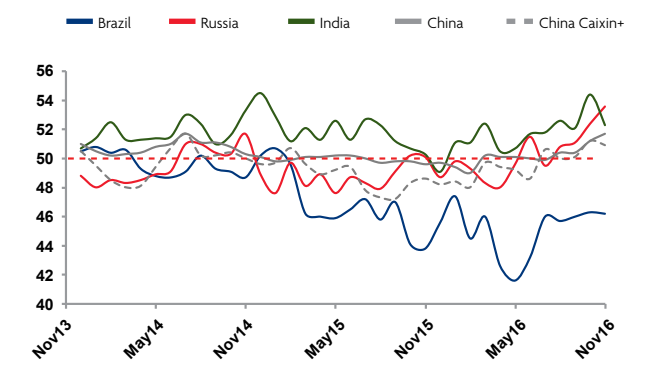
Industrial Production Growth (YoY%)



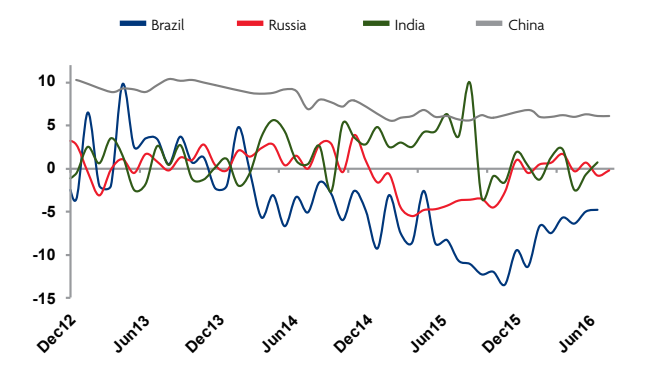
Real GDP growth (QoQ%, saar)*



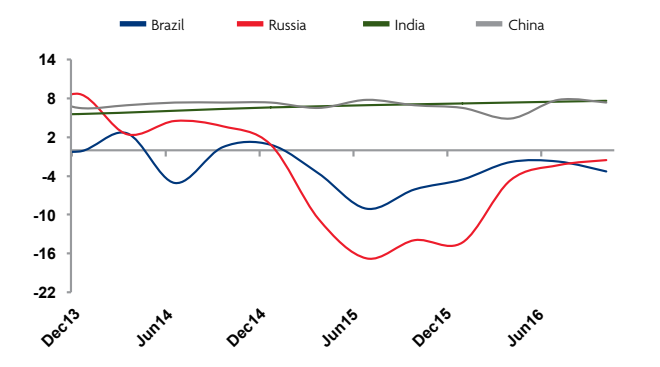
Purchasing Managers' Index



Industrial Production Growth (YoY%)



Real GDP growth (QoQ%, saar)*



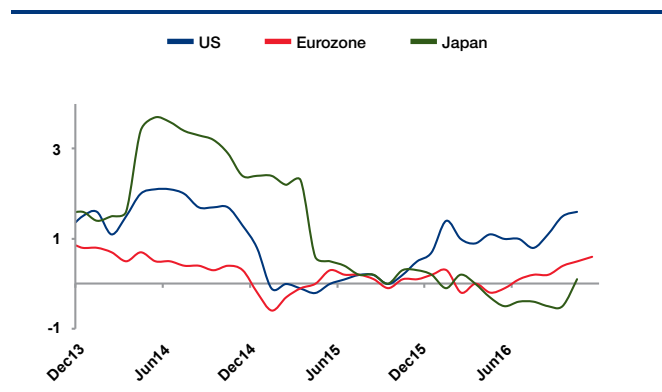
* For some economies, annualised GDP data are estimates by UOBAM. For India, data are in year-on-year percentages (YoY%).

+ China Caixin PMI was previously known as HSBC PMI (effective July 2015).

Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2016.

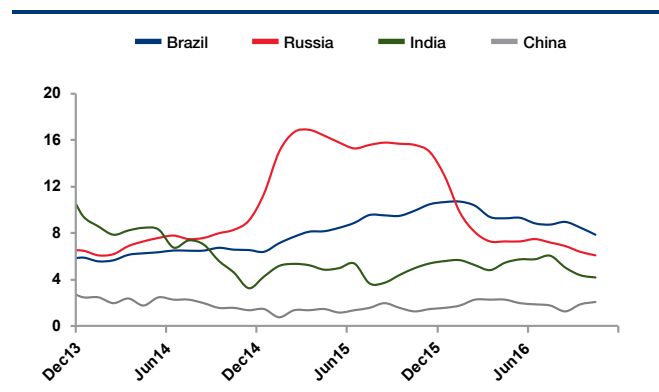
DEVELOPED ECONOMIES

Inflation - CPI (YoY%)



EMERGING ECONOMIES

Inflation - CPI (YoY%)



Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2016.

Central Banks Interest Rates

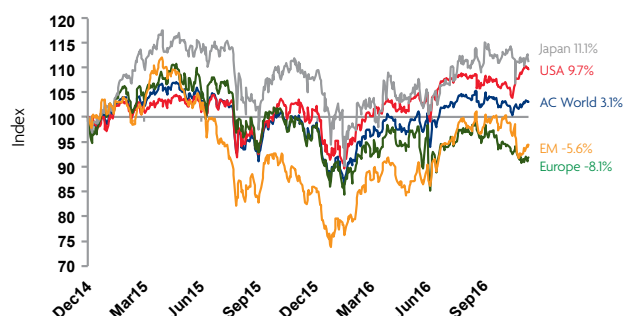
Country	Interest Rate	Current Rate (%pa)	Latest Meeting	Change at Latest Mtg (bp)	Last Change	Next Meeting
		1-Dec-16				
United States	Fed Funds Target Rate US	0.500	2 Nov 2016	-	16 Dec 15 (+25bp)	15 Dec 2016
Eurozone	Refinance Rate	0.000	21 Nov 2016	-	10 Mar 16 (-5bp)	8 Dec 2016
Japan	BOJ Overnight Call Rate	-0.054	-	-	30 Nov 16 (-0.2bp)	-
United Kingdom	UK Official Bank Rate	0.250	30 Nov 2016	-	4 Aug 16 (-25bp)	15 Dec 2016
Brazil	Brazil Selic Target Rate	13.750	30 Nov 2016	(25)	30 Nov 16 (-25bp)	11 Jan 2017
Russia	Bank of Russia Key Rate	10.000	30 Nov 2016	-	19 Sep 16 (-50bp)	-
India	Repurchase Rate	6.250	25 Nov 2016	-	5 Oct 16 (-25bp)	-
China	China Reverse Repurchase Notes 7D Rate	2.250	22 Nov 2016	-	27 Oct 15 (-10bp)	-
South Africa	South Africa Repo Avg Rate	7.000	30 Nov 2016	-	17 Mar 16 (+25bp)	24 Jan 2017

Source: Bloomberg, updated as of 1 December 2016

MARKET PERFORMANCE DEVELOPED MARKETS

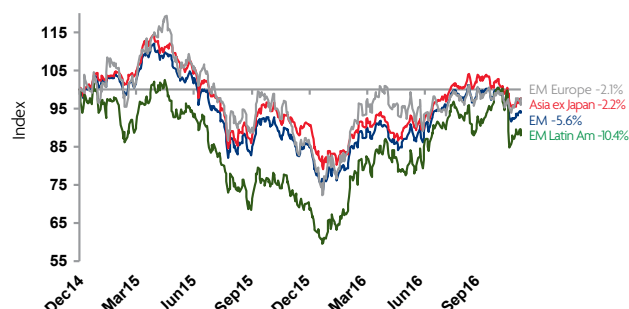
Equity Indices

(Rebased 100 on 31 December 2014)



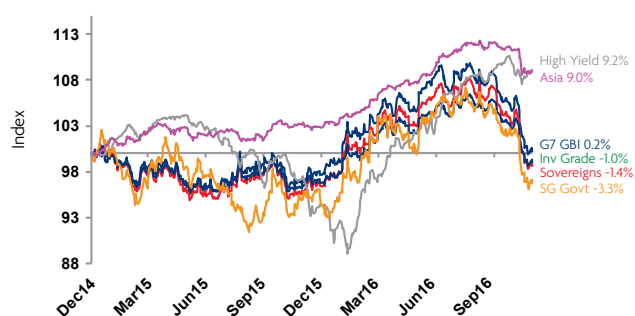
Equity Indices

(Rebased 100 on 31 December 2014)



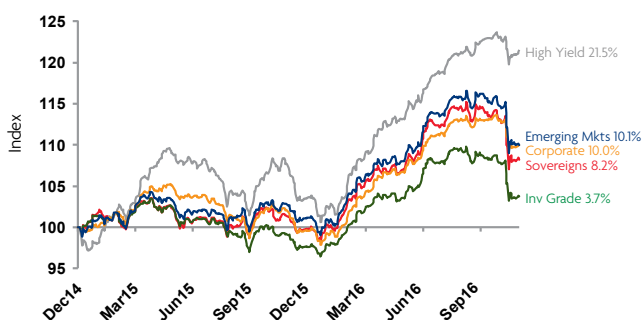
Fixed Income Indices

(Rebased 100 on 31 December 2014)



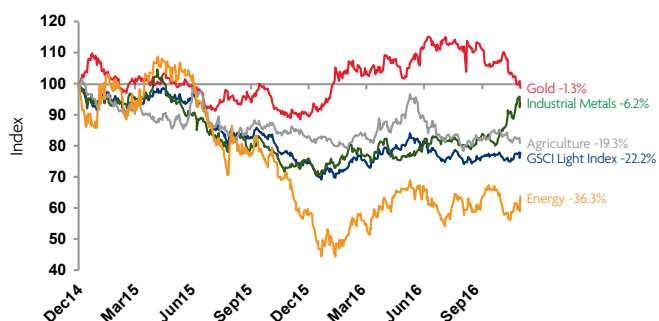
Fixed Income Indices

(Rebased 100 on 31 December 2014)



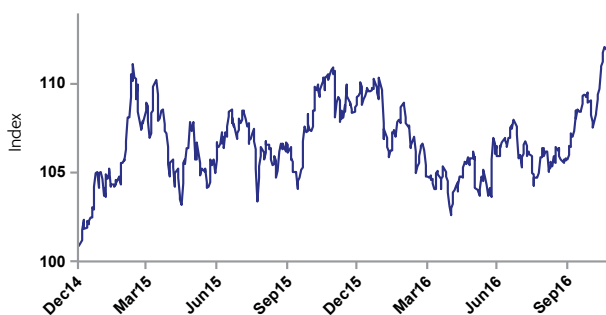
Commodity Indices

(Rebased 100 on 31 December 2014)



Dollar Index Spot

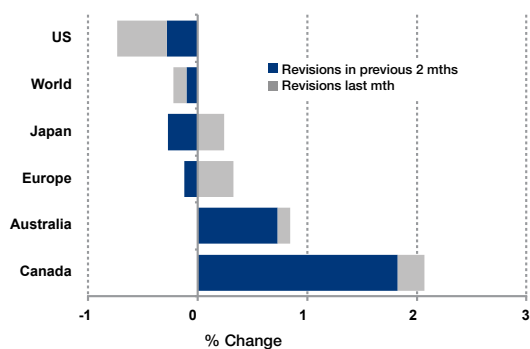
(Rebased 100 on 31 December 2014)



Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2016.

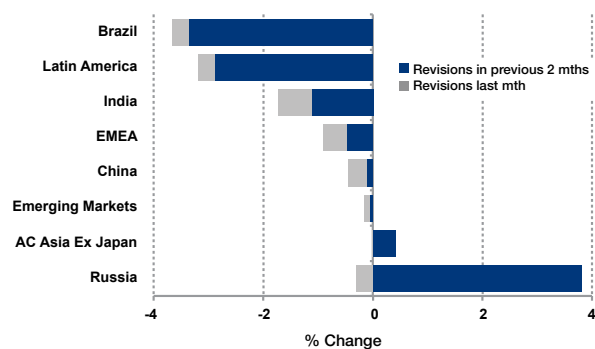
EQUITY MARKET INDICATORS DEVELOPED MARKETS

Earnings Revision by Regions for FY2

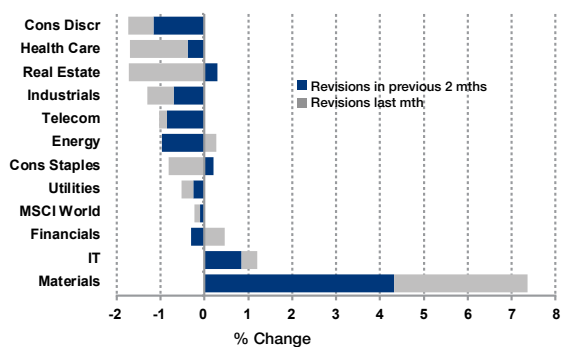


EMERGING MARKETS

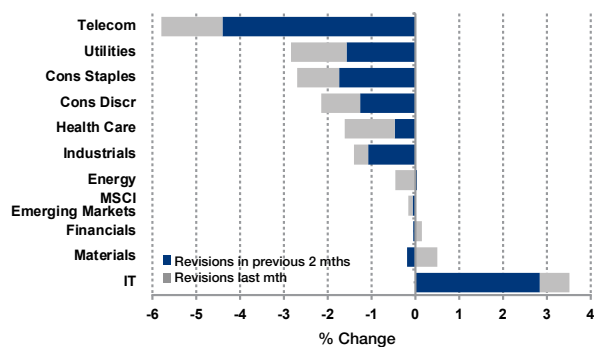
Earnings Revision by Regions for FY2



Earnings Revision by Sectors for FY2



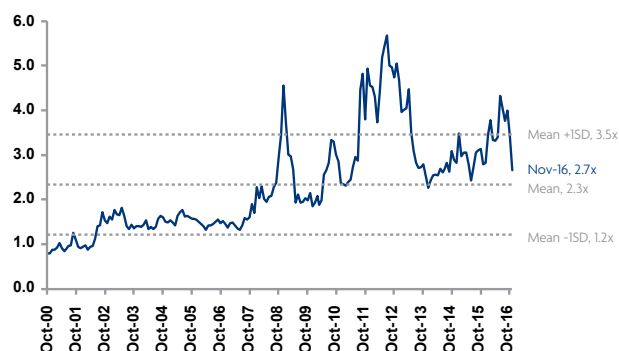
Earnings Revision by Sectors for FY2



Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2016.

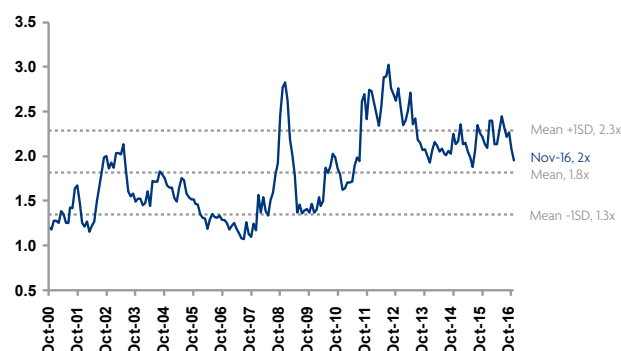
VALUATION

Developed Markets Earnings Yield Ratio*

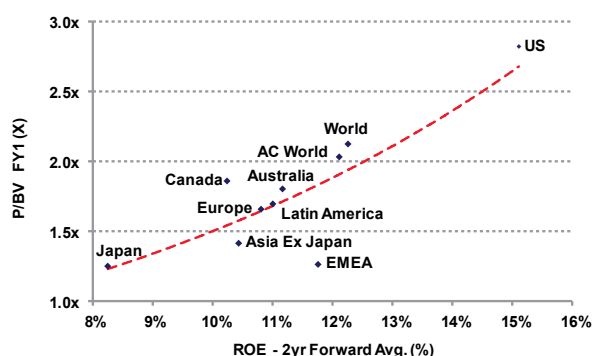


*Mean and SD are based on data from 1999.

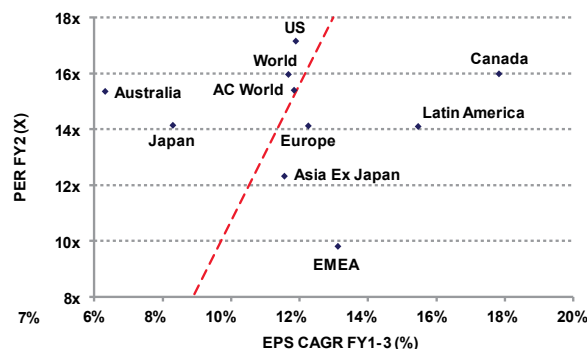
Emerging Markets Earnings Yield Ratio*



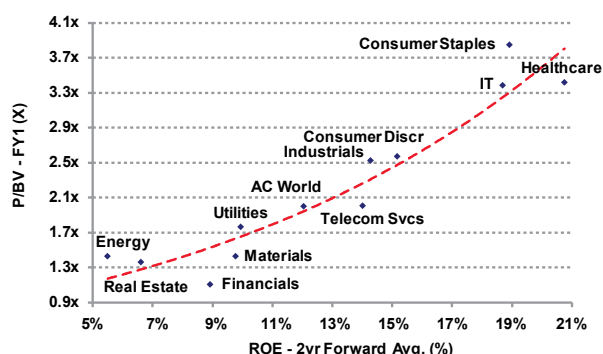
P/BV vs ROE by Region



P/E vs Growth by Region

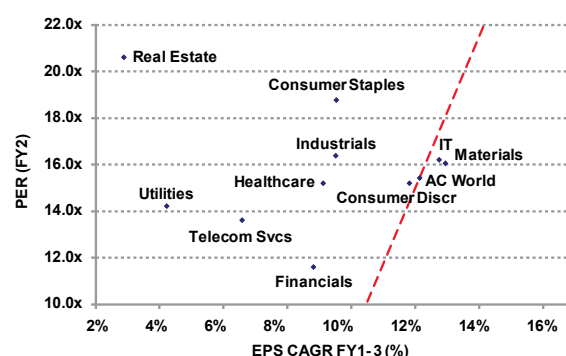


P/BV vs ROE by Sector^



^Energy sector is not shown in the chart.

P/E vs Growth by Sector^

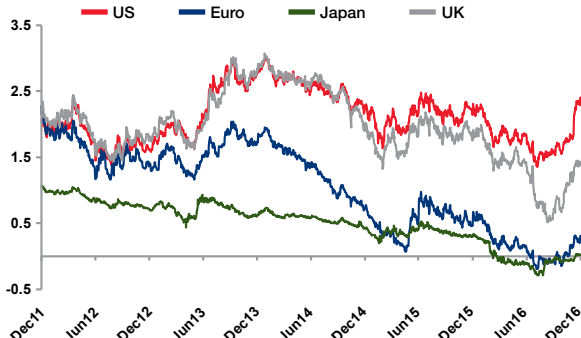


^Energy sector is not shown in the chart.

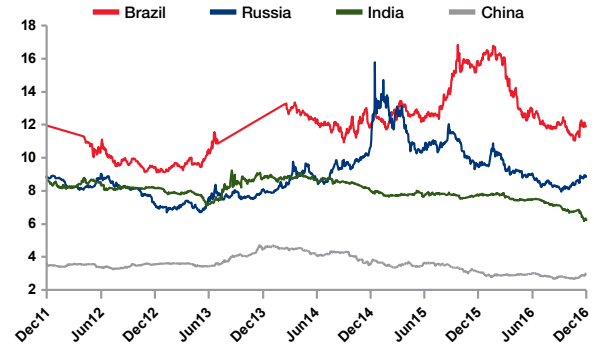
Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2016.

FIXED INCOME MARKET INDICATORS SOVEREIGN

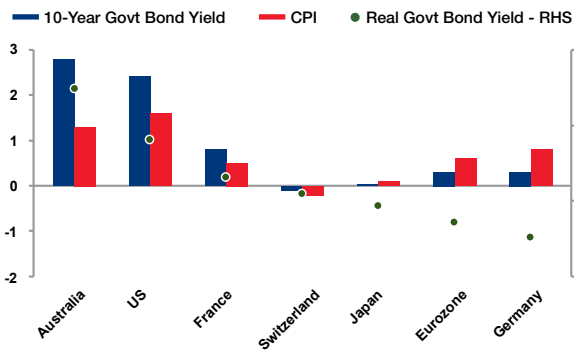
Developed Markets 10-Year Government Yield (%)



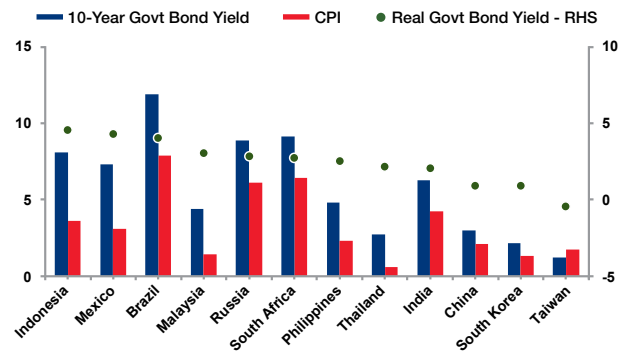
Emerging Markets 10-Year Government Yield (%)



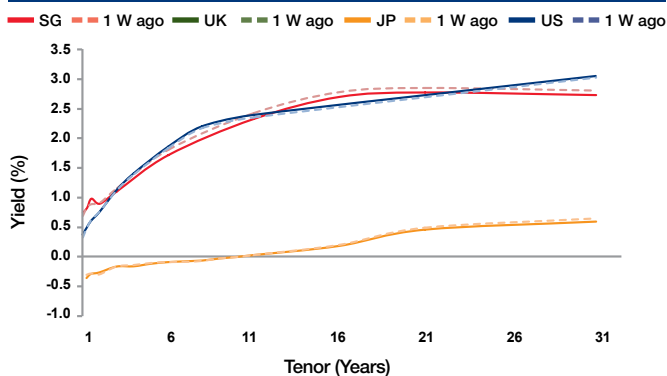
Developed Markets Real Government Yield (%)



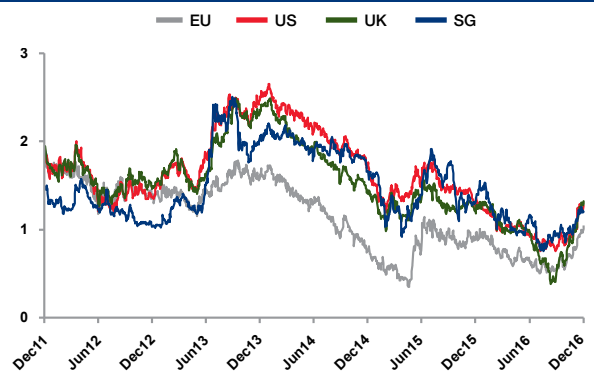
Emerging Markets Real Government Yield (%)



Nominal Yield Curve (%)



Yield Curve Steepness (10Y - 2Y) (%)

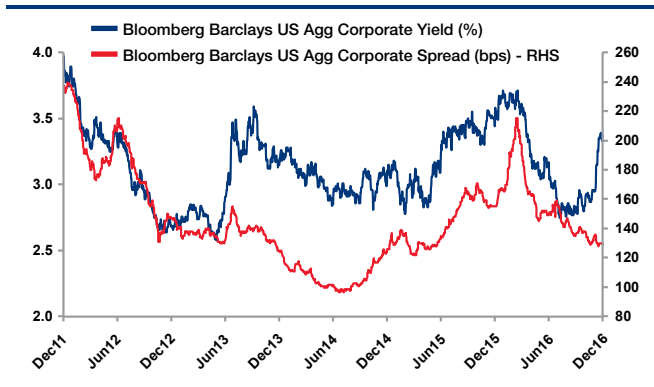


Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2016.

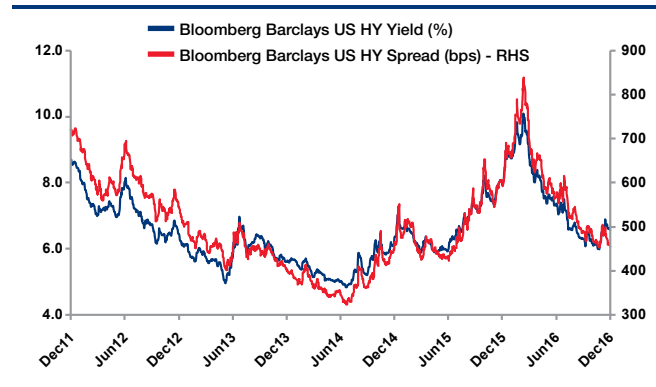
FIXED INCOME MARKET INDICATORS

CREDITS

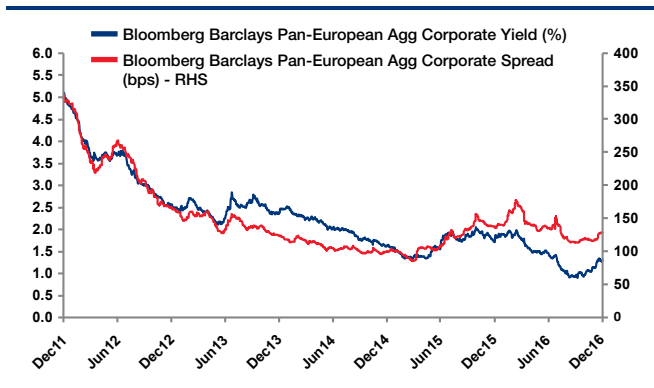
US Markets (USD) Yield and Credit Spread



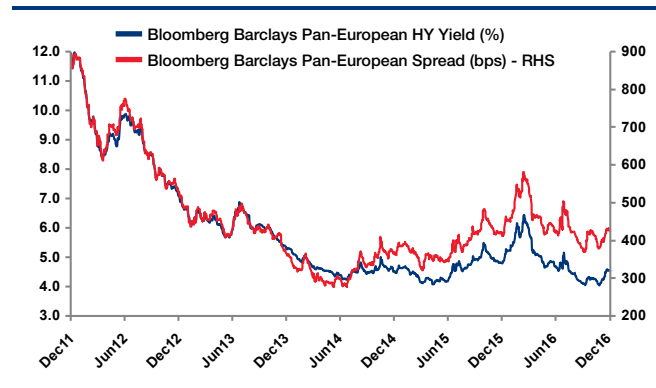
US Markets (USD) HY Yield and Credit Spread



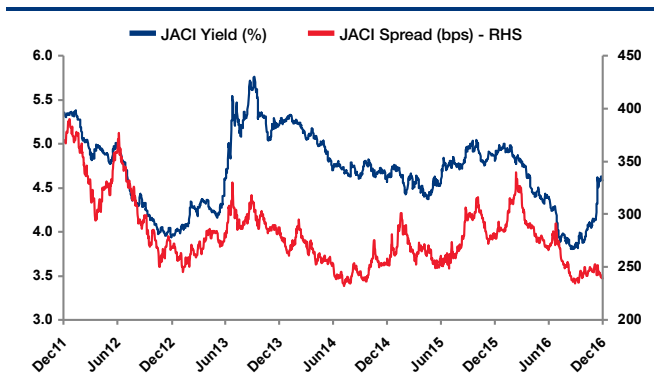
Pan-European Markets (USD) Yield and Credit Spread



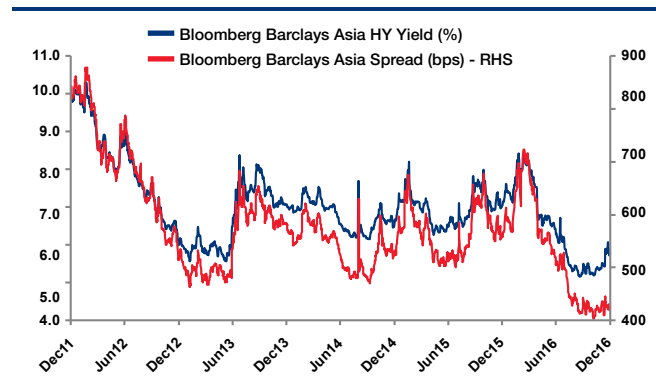
Pan-European Markets (EUR) HY Corporate Yield and Credit Spread



Asia Markets (USD) Yield and Credit Spread



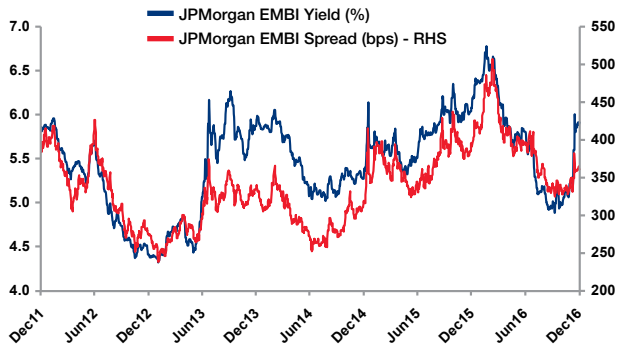
Asia Markets (USD) HY Yield and Credit Spread



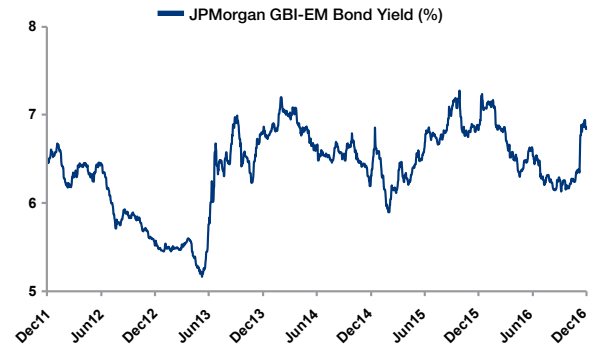
Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2016.

CREDITS

Emerging Markets (USD) Yield and Credit Spread

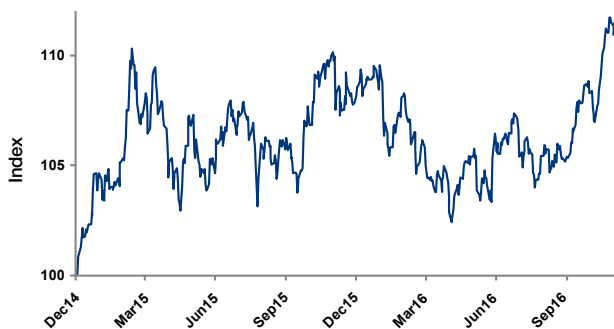


Emerging Markets (Local Currency) Bond Yield

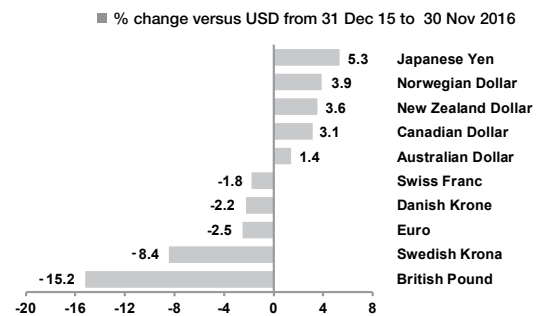


CURRENCIES

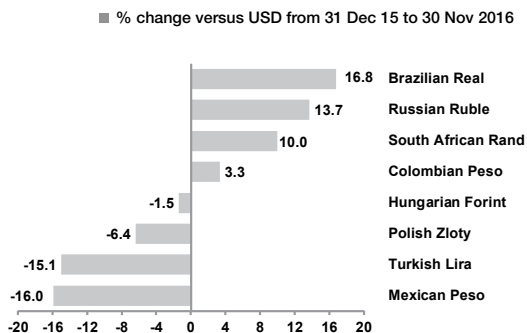
Dollar Index Spot (Rebased 100 on 31 December 2014)



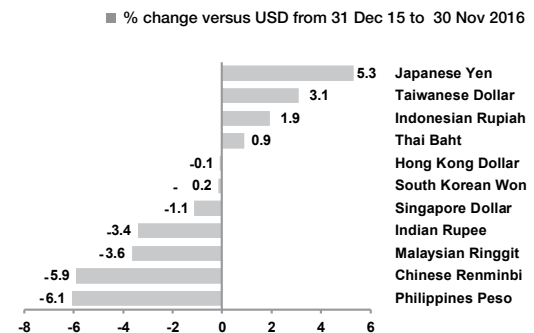
G-10 FX against US Dollar



Emerging Markets FX against US Dollar



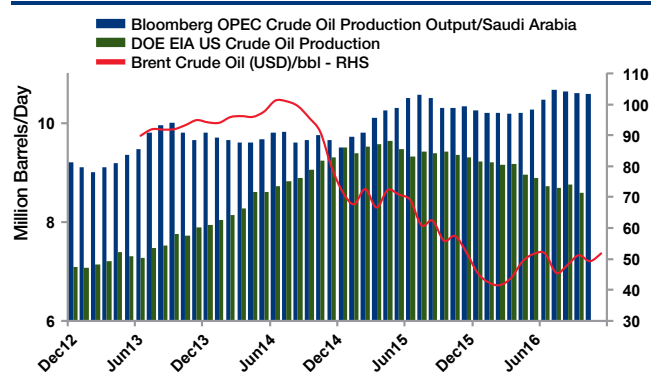
Asia FX against US Dollar



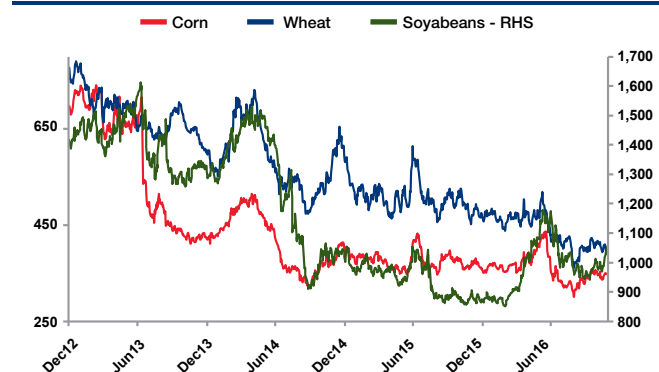
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COMMODITY MARKET INDICATORS

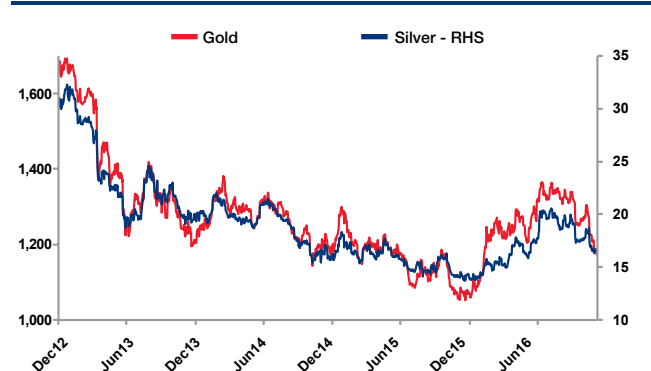
Brent Crude Oil Price and Production



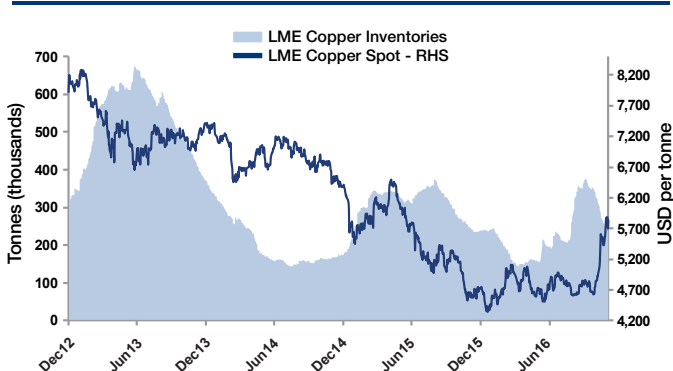
Agriculture Price (USD)



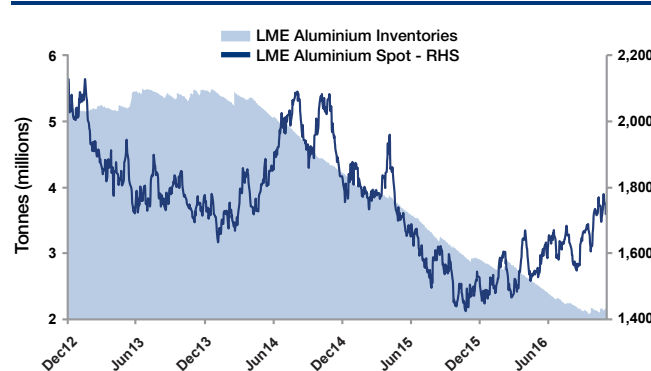
Precious Metal Price (USD)



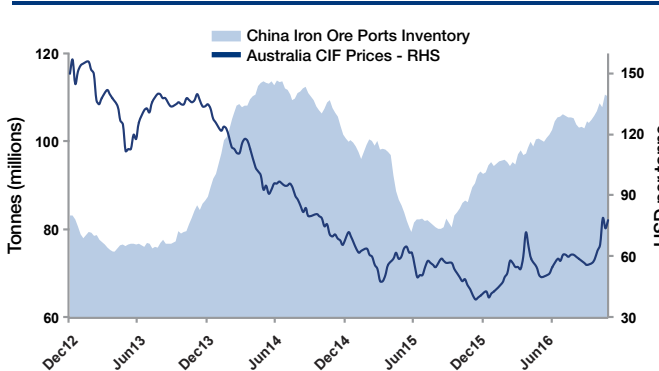
Copper Price (USD)



Aluminum Price (USD)



Iron Ore Price (USD)



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In the event of any discrepancy between the English and Mandarin versions of this publication, the English version shall prevail. The contents in this report were updated as at August 2016.

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