Quarterly Investment Strategy
First Quarter 2016

THE START OF NORMALISATION

ASSET ALLOCATION

Overweight Equities,
Underweight Fixed Income,
Neutral Commodities,
Underweight Cash

EQUITY

Overweight Developed Markets versus Emerging Markets

FIXED INCOME

Neutral Emerging Markets, Underweight Developed Markets

COMMODITIES

Overweight precious metals and Underweight bulk commodities

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 2016

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

After being "neutral" on equities and fixed income since April, we began adding "risk" back to our strategies as at November 2015. We upgraded equities to an overweight position and downgraded fixed income to an underweight position.

De-risking investment strategies in April helped moderate volatility during the sharp August correction, but we are now more comfortable that most of the key risks we have been monitoring have moderated. We think that economic data trends point to further economic expansion in 2016. Thus, without signs of an imminent recession, we recommend being overweight on equities.

We expect continued global growth in 2016 but the key concerns shift to how well the US economy and global liquidity respond to the expected US rate increase in the coming months. Also, we expect global consumer trends to remain attractive. However, we believe that energy and commodity companies and investments will struggle. This will weigh on global markets and have the potential to offset the consumer-driven growth.

A modest improvement in growth warrants an overweight position in equities and a small underweight position in fixed income investments, but we are quick to point out that we would not become too bearish on fixed income. A gradual path of US rate increases would not put excessive pressure on fixed income investments.

For the quarter, we are overweight on equities, underweight on fixed income, neutral on commodities and underweight on cash.

John Doyle
Chief Investment Officer
Equities & Multi-Assets

Chong Jiun Yeh
Chief Investment Officer
Fixed Income & Structured Investments

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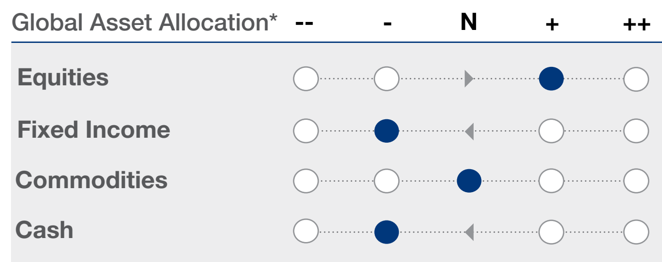
GLOBAL ASSET ALLOCATION SUMMARY

We are overweight on equities and underweight on fixed income for the start of 2016. We expect global growth to continue and the US Federal Reserve (US Fed) to start increasing interest rates which will be a key symbolic start to the normalisation of monetary policies.

Normalisation will likely bring both volatility and some degree of reassurance to markets. Historically, US rate increases have triggered various levels of market volatility in the months right before and after the first increase. However, this volatility is usually followed by calmness in the markets and asset classes then maintain their trajectories. While we expect some volatility in this cycle as well, we also believe the rate increases will offer a signal of reassurance. This rate increase has been anticipated for over a year and comes after a prolonged period of substantial policy support. Evidence that the economy can normalise may prove to be reassuring to markets.



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

Equities – Overweight

Global equities corrected sharply in the second half of 2015. We had reduced equity weights to neutral in April 2015 due to significant macro risks from weak US data, Greece exiting the Euro, a Chinese hard landing and market volatility around a US Fed rate increase. Currently, we find that most of the risks which we have been monitoring have abated and valuations are more reasonable after the correction. As at November 2015, we have upgraded equities to an overweight position.

Fixed Income – Underweight

The long awaited start of interest rate normalisation appears set to be a key issue in 2016 as we expect the US Fed to start raising rates and set a gradual path of increases through the year. It has been our long-term belief that a gradual path of rate increases in a non-inflationary world would not be very negative for fixed income. We would expect minor headwinds in performance but that the fixed income asset class should continue to post positive returns with low volatility. We have downgraded fixed income to an underweight position.

Commodities – Neutral

Most commodities continue to struggle in a strong US dollar world where China is consuming fewer resources than at the peak of its developmental years. However, most of the weakness has largely been felt in commodity prices and producers have cut back production which should stabilise commodity assets – maintain neutral.

Cash – Underweight

We see that key macro risks such as Greece and China are becoming less of an immediate issue and the need for cash buffers is lower. We downgraded Cash to an underweight position.

GLOBAL INVESTMENT STRATEGY
THE START OF NORMALISATION

We expect that a leading issue throughout 2016 will be the start of interest rate normalisation in the US. This interest rate cycle has been the most anticipated first rate increase in the history of rate increases. This is because this cycle has had the longest period of low rates in history and the US Fed has offered more guidance than in the past. In previous cycles such as in 1994, US Fed communication was negligible and the markets largely determined the US Fed path by monitoring market trends. While the start of this interest rate increase cycle has been well anticipated, we note that there are still uncertainties regarding how markets will behave through the cycle.

Rise of volatility

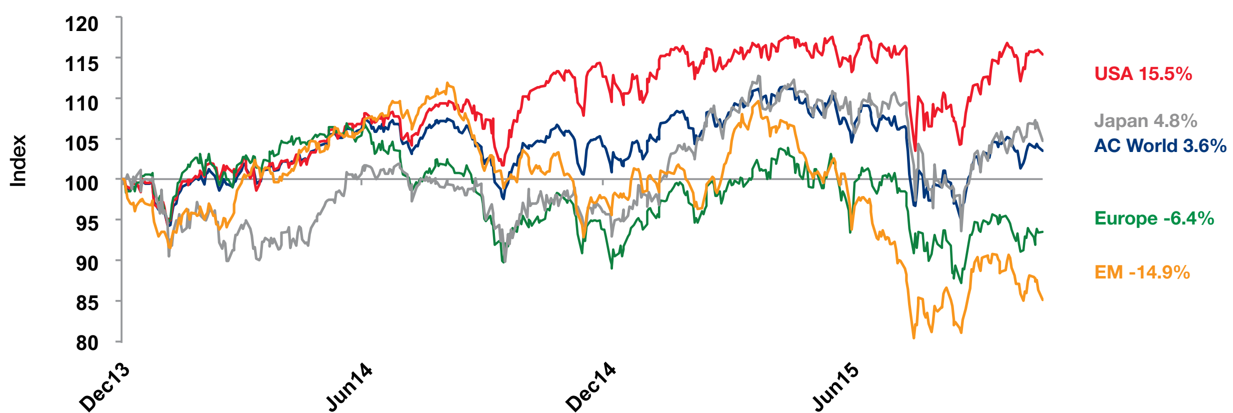
After the first increase in historical US interest rate cycles, we find that there is consistent evidence of volatility in the months around the rate increase. However, there is no evidence of a sustained negative trend for risk assets. Equities experience one to three months of volatility and then generally perform well. Fixed income credits usually outperform government bonds. After the first few rate increases, markets tend to partially ignore the subsequent rate increases.

As rate increases were becoming more imminent in the second half of 2015, risk assets started to become more volatile. Most notably, equity prices around the world fell by ten to 15 per cent in the month of August. Since then, markets have recovered by various degrees of those declines. However, overall market volatility remains elevated compared with volatility levels from the first half of the year.

The year-to-date (YTD) performance of most asset classes is now negative. Asset allocation decisions in 2015 have been about trying to be in asset classes that have been relatively more stable.

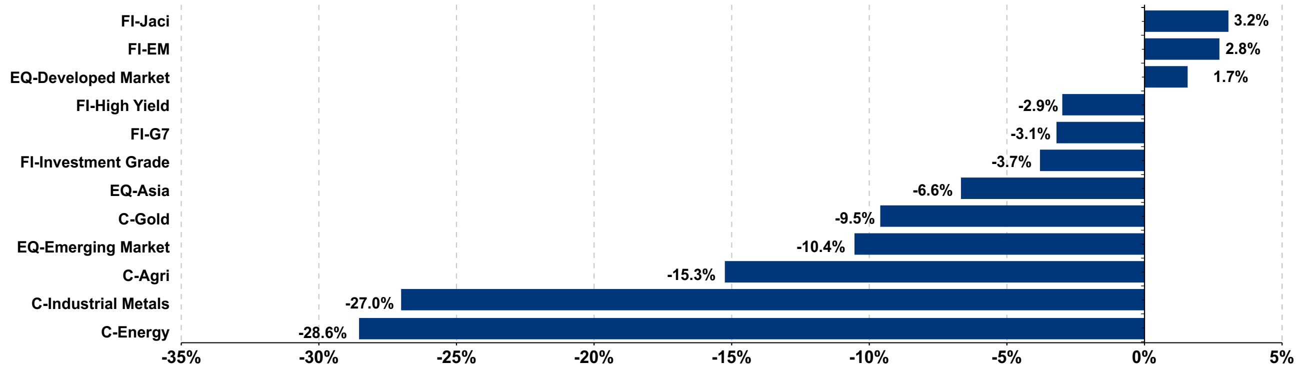
The sharp correction in August left most asset classes with negative YTD returns, with the exceptions of Asian fixed income, emerging market fixed income and developed market equities.

Global equities performance



Source: Bloomberg, Datastream, UOBAM, 1 December 2015

YTD asset class performance (USD)



Source: UOBAM, Bloomberg, November 2015

We seek to avoid volatility. However, if markets correct while we maintain a strong conviction that macroeconomic growth will be sustained, we are also inclined to invest after corrections. While we had neutral weightings on risk assets at the start of the sharp correction, we were more interested to increase our weights on risk assets once valuations were more attractive.

Fundamental macro outlook

We maintain a positive view on the macroeconomic outlook. However, we concede that there are mixed signals in the key global macroeconomic indicators. Employment, income, and consumption trends in the developed markets are trending well but manufacturing indices that are historically good leading indicators have been weak. Consumption and services make up the bigger part of the economies in the developed markets. For example, in the US, the service sector accounts for 85 per cent of GDP. While there are mixed signals from different sectors, we remain confident that the core of the economy remains on track.

As we head into 2016, most global economists forecast better global economic growth compared to 2015. The expectation among consensus from economists according to Bloomberg surveys is that global growth should increase to 3.4 per cent in 2016 from three per cent in 2015. Most notably, developed markets like Europe and Japan were in recession a few years ago, but in 2016 they appear to be able to deliver positive though modest growth of 1.7 per cent and 1.1 per cent respectively – both improved from 2015. Commodity-focused countries like Brazil and India were hit particularly hard in 2015 due to the sharp decline in energy and other commodity prices. These countries are on track for growth of negative three per cent or below. While the outlook for commodities is not strong, prices should nevertheless stabilise and thus the forecasts are for these countries to improve in 2016 as well.

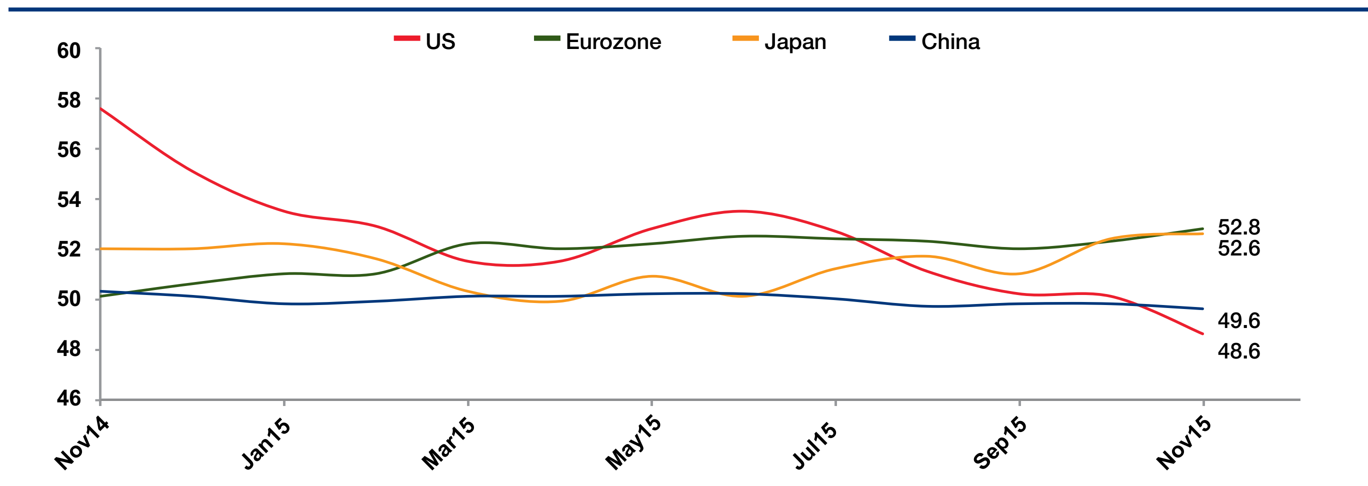
Major country consensus GDP growth forecasts

REAL GDP	ACTUAL		FORECASTS	
	2013	2014	2015	2016
World	3.3	3.4	3.0 (3.0)	3.4 (3.5)
United States	1.5	2.4	2.4 (2.5)	2.5 (2.7)
Eurozone	-0.3	0.9	1.5 (1.5)	1.7 (1.6)
Japan	1.6	-0.1	0.6 (0.7)	1.1 (1.2)
UK	2.2	2.9	2.4 (2.6)	2.3 (2.4)
China	7.7	7.3	6.9 (6.8)	6.5 (6.5)
India*	4.7	6.9	7.4 (7.4)	7.4 (7.5)
Brazil	2.8	0.2	-3.0 (-2.5)	-1.2 (-0.6)
Russia	1.3	0.6	-3.9 (-3.8)	0.2 (0.3)

Figures in brackets are as at 30 September 2015.
*India GDP from 2013 is based on the Fiscal Year ended March.
Source: UOBAM, Bloomberg, November 2015

Weaker growth signals can be found in the manufacturing survey (Purchasing Managers' Index (PMI)) trends. These PMI indicators have historically been good indicators of overall economic direction. The concern is that PMI surveys around the world have been weaker in recent months. The PMI trends for the US have fallen from solid levels of 54, down to levels of 48.8. China's PMI series has been below 50 for the past several months.

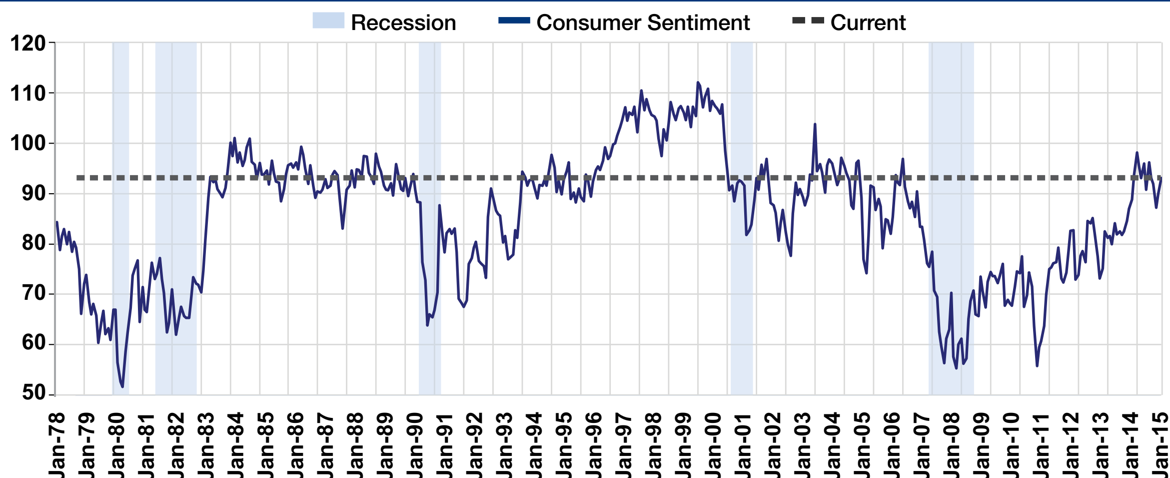
Developed market manufacturing survey indices



Source: UOBAM, Bloomberg, November 2015

Despite the weaker PMI trends, we remain confident about global economic prospects as long as the current positive data continues. The strength in the global economy is driven by income trends. As consumers around the world are better employed with rising annual wages, these new earnings boost consumer confidence and result in increased spending in the global economies. We note that the US has new jobs growth of around two per cent each year. In addition, average earnings are growing by 2.5 per cent. Consumer confidence in the US, Europe and Japan are at the highest levels achieved in the past seven years.

University of Michigan Consumer Sentiment



Source: Bloomberg, December 2015

Imminent interest rate increase cycle

Over the coming year, a key focus of global investors will be how asset classes perform in the face of an interest rate increase cycle. Interest rate increases are usually conducted because the economy is doing well and there are signs that inflation may pick up. While there are clear signs that the US economy and labour markets have normalised, it is also clear that deflationary forces persist and this will keep the pressure on rates modest.

We expect the focus of global investors to shift from guessing the timing of the first rate increase to what the pace of increases will be. Our expectation is that the first rate increase will be in December and then there will be three more increases through the course of 2016. Such a path would be the slowest rate increase path compared with the previous cycles. We think that a gradual path would put very little pressure on the performance of asset classes. In particular, many investors are concerned about the outlook of fixed income funds in the face of interest rate increases. However, we think it is quite clear that even with well-telegraphed plans for rate increases, long-term rates around the world have not shifted significantly. The ten-year government bond rate in the US appears set to end 2015 at similar levels to the start of 2014. Bond funds are much more influenced by longer-term rates like the ten-year benchmark rate than the short-term fed funds rate. If the ten-year rate is not rising significantly, there will not be significant pressure on fixed income funds. We expect the ten-year benchmark rates to see only modest changes because these rates are less affected by short-term rates and are driven much more by long-term growth and inflation assumptions. While global growth is positive and modestly improving into 2016, very few would argue that global growth is overheated and inflationary.

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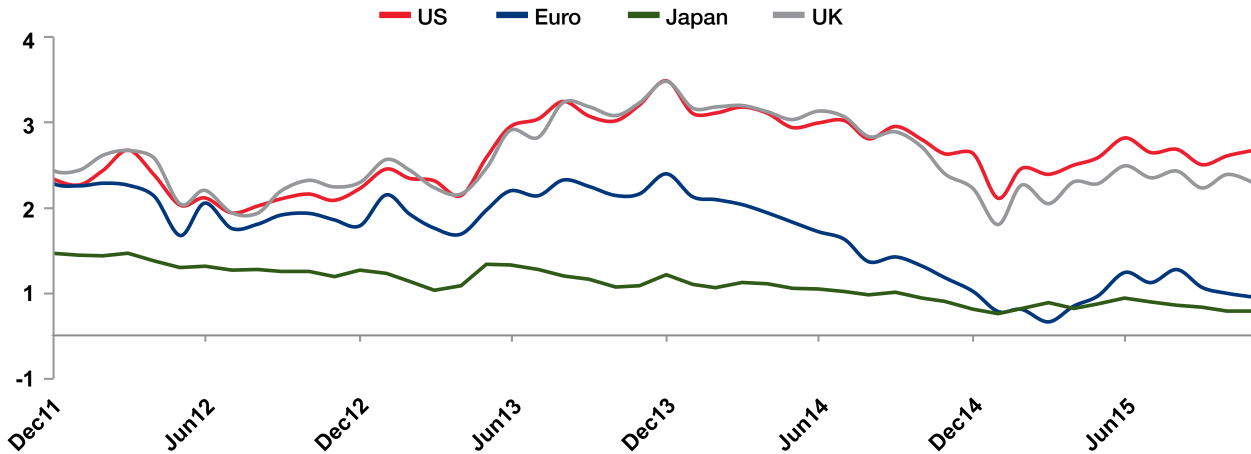
Developed market 10-year government bond yields



Source: Bloomberg, Datastream, UOBAM, 1 December 2015

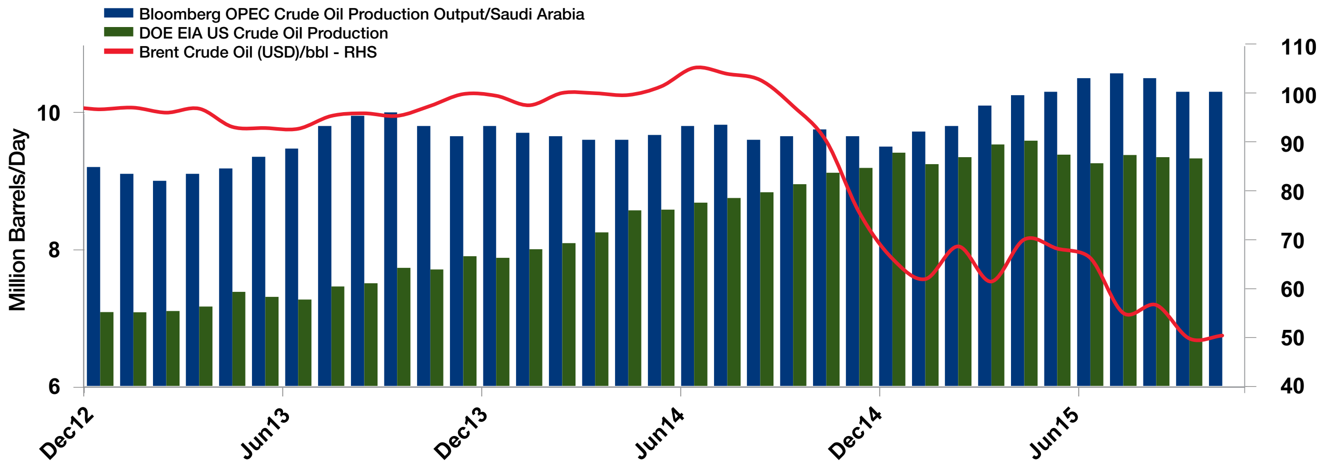
While our base case view is that asset classes will perform as expected through the rate increase with only modest increases in volatility, we also think there is a reasonable chance for a more bullish outcome. This cycle of monetary policy easing has been longer with more extreme policies than we have seen in previous cycles. Some market observers have bearish views which question whether the US would be able to end its 'addiction' to quantitative easing (QE) and whether rates can be raised successfully. Unlike previous cycles, it is possible that there will be greater confidence from the normalisation process in this cycle that could result in a more bullish outlook for risk assets.

Energy and commodity trends

One of the key explanations for the mixed data trends is the fact that energy and other commodity prices have fallen significantly over the past year. The decline in energy and commodity prices has resulted in weaker investment and profits in the related infrastructure businesses. However, for consumers around the world who use energy, the decline in prices instils confidence and benefits spending options as consumers save money on their oil and other commodity item expenditure. It is therefore consistent that manufacturing indices are weak but consumption trends are healthy.

The fall in oil prices has been particularly severe. In the middle of 2014, oil prices ranged from USD90-100 per barrel of oil. Oil prices had fallen to USD60-70 per barrel by the beginning of 2015 and further to USD40-50 per barrel near the end of 2015. We believe that the key explanation of this price trend is the increase in global production with key supply being added by the US via its shale oil production. While the lower oil prices have slowed the production of US shale oil, we have not yet seen clear decreases in supply.

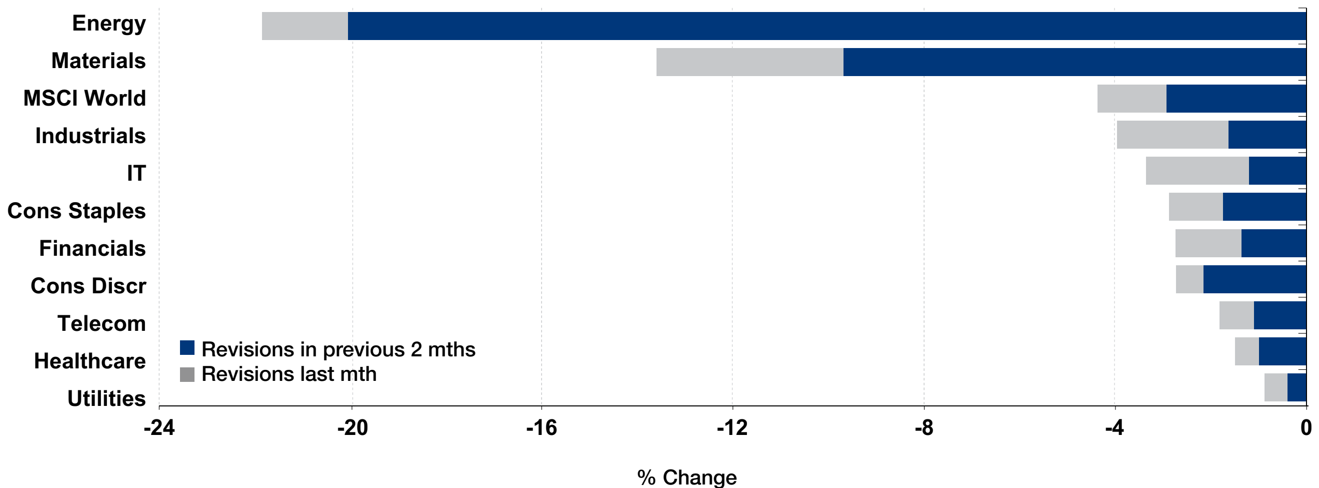
Oil production and price trends



Source: Bloomberg, Datastream, UOBAM, 1 December 2015

There is clearly pressure on the corporate performance of the energy and resource sectors. While it is common to see a modest downward revision of earnings during the course of the year as the high expectations of analysts are met with reality, the downgrades to energy and material companies have been particularly severe. Other sectors may be seeing downward revisions of two to three per cent but energy companies have seen downward revisions of more than 20 per cent.

Developed markets earnings revision by sectors for FY2



Source: Bloomberg, Datastream, UOBAM, 1 December 2015

Assessment and outlook

Our view starts with the macroeconomic assessment that growth appears to be sustained and would improve in 2016 compared with in 2015, both by consensus estimates and our own assessment. If the economic cycle will continue for another year, then the historical relationship for asset class returns is that risk assets will continue to outperform. Additionally, we had neutralised our overweight risk asset positions in April and were inclined to invest again at the better valuations after the sharp August correction should any opportunities arise. Our macro reviews indicated that several of the key risks that we have been monitoring have moderated and that we remain confident about global growth. Thus, in November 2015, we reverted to an overweight recommendation for risk assets.

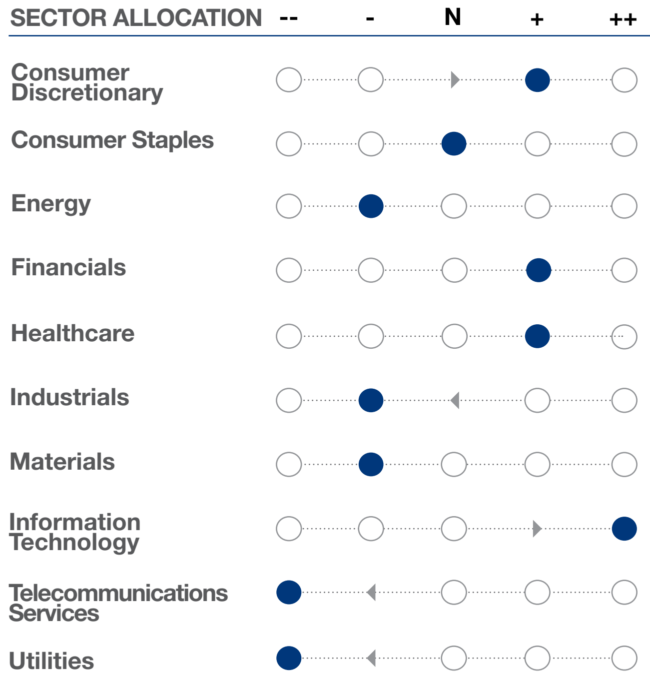
We think there are two key macro issues to decipher for the start of 2016. First, we need to assess how markets and economies will react to the start of interest rate normalisation and second, we need to decipher the mixed signals in the fundamental data.

Our view is that the start of interest rate normalisation will not slow the economy meaningfully and will only create near-term volatility in asset classes. Over the medium term (three months and more), we expect volatility to normalise and for asset classes to continue to perform as expected. Equities will benefit from global growth and fixed income will maintain positive returns with low volatility.

Our view of mixed macro signals is that the strength of income and consumption trends will outweigh the signals from manufacturing trends which are of concern.

Hence, for the start of the first quarter of 2016, we upgrade our equities position to overweight. We think that fixed income markets continue to offer reasonable returns at low volatility levels and that investors do not need to be overly anxious about the impact of US Fed rate increases. Nevertheless, the outlook for equities in the face of global growth and rate increases is more attractive than fixed income and thus we are underweight on fixed income investments. However, we do maintain an inclination toward credits over government bonds. Commodities have performed poorly and the structural demand outlook is not very strong. However, we think oversupply situations across most commodities are becoming less of a problem and we would expect commodity prices and companies to stabilise over the coming quarters. We are underweight on cash in an environment of sustained global economic growth as we believe we would only start to focus on cash holdings again when there is increasing risk that we are at the end of a cycle.

EQUITY STRATEGY
GLOBAL EQUITY

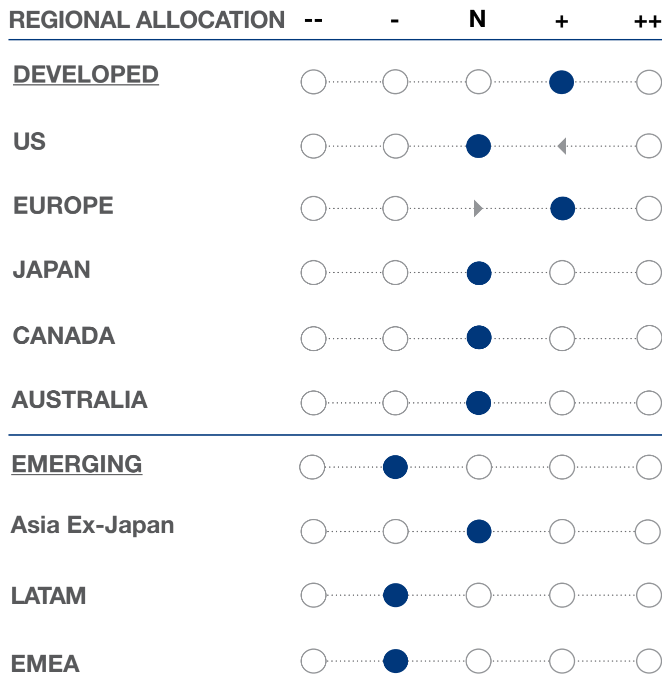


Notes:
The weights are relative to the benchmark – MSCI AC World Index.
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

We have a positive outlook on global equities, 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 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 from the biotech sub-sector. We are also overweight on the financials and consumer discretionary sectors due to attractive valuations. In addition, we have moved to an overweight position in the consumer discretionary sector due to improving wage growth and lower oil prices.

Our strategy continues to be underweight on the deep cyclical sectors such as materials and energy given the sub-par growth of the global economy. However, we hold the view that the energy sector is currently oversold and we look to move to a neutral position once the outlook on the oil price stabilises. We have also adopted a more cautious stance on interest rate-sensitive sectors such as utilities and telecommunication, which could be impacted adversely by the US Fed tightening policies in the coming quarters.



Notes:
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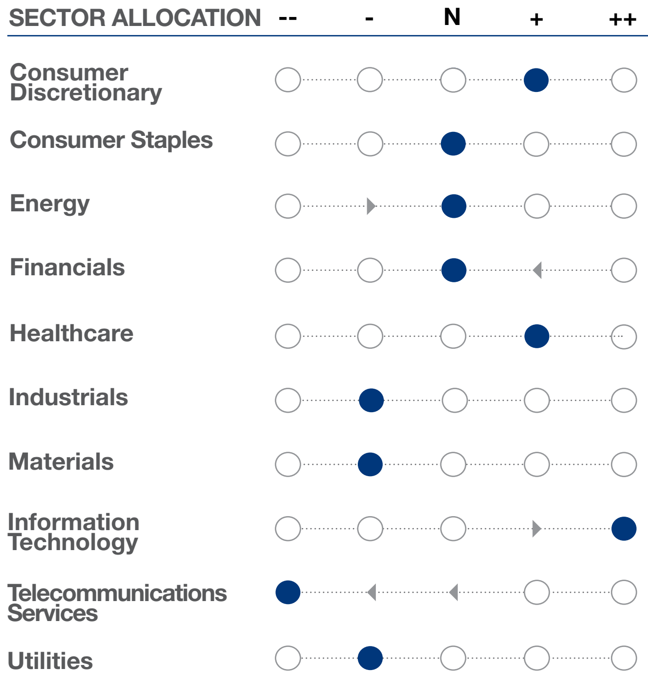
We have a preference for Developed Markets (DM) over Emerging Markets (EM). This is because of the divergence in growth trajectories, the effects of capital flows (due to the impending US Fed rate increase) and perceived risks to earnings expectations from shifting revenue and cost trends. Within DM, we have downgraded our overweight position in US to neutral. Our view is that the continued dollar strength will be a headwind to overseas corporate profit while the tightening labour force will result in a higher wage inflation that will curtail corporate profits. Meanwhile, we retain the view that the region's economies remain on a strong recovery trajectory and the region is still attractive for selective value plays.

We have upgraded Europe to an overweight position as the potential for further corporate earnings upgrades are in place. A weaker euro has helped to lift confidence, boost economic activities and propel the markets higher. The region has significant operating leverage to an upturn in economic activities with the profit margins currently at trough levels. However, we are mindful of possible headwinds with regard to recent election results in the peripheral countries where socialist parties are gaining ground, and increasing geopolitical risks spreading from Middle East conflicts.

Concerns continue to linger over the long-term efficacy of Japan Prime Minister Abe's 'third arrow' economic policy. However, we see opportunities arising from beneficiaries of Japan's QE. Economic data remains mixed, but we believe that the Bank of Japan (BoJ) will remain accommodative, which would in turn support the market. Despite disappointments in policy and the anaemic economic backdrop, there are some positive developments in corporate governance and corporate performance. Hence we retain our neutral position in Japan.

We retain our underweight position in the EM. Challenges are expected to persist due to domestic imbalances and the build-up of excess credit in the period post the Global Financial Crisis. 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. The EM still represent 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 but stock selection is increasingly critical.

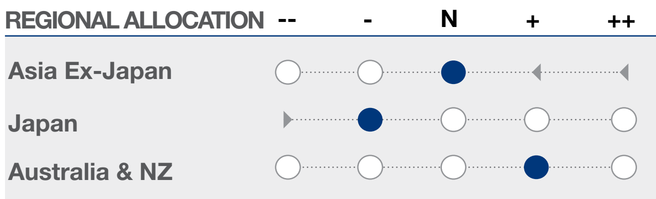
ASIA PACIFIC EQUITY



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 representative Asia Pacific strategy is currently overweight on the consumer discretionary, healthcare and technology sectors. We have increased our weights in technology recently as some selective value plays emerged with the recent correction in the last quarter. We remain optimistic about the longer-term trend for the consumer and technology sectors as they provide exposure to the continued strong growth of domestic demand and e-commerce in the emerging economies.

The strategy is underweight on the materials sector due to concerns on incremental demand from China which is experiencing slower growth and in the midst of implementing reforms. On the other hand, we have moved to a neutral position in energy given strong demand response as a result of low oil prices and improving demand-supply balance globally.



Notes:
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The current positioning of the Asia Pacific strategy is to be overweight on Australia. The position is funded from an underweight position in Japan. We retain a neutral position in Asia ex-Japan. This 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 appeal of Australian materials and financials against the rest of the region. Similarly, the underweight position in Japan reflects our concern on the operating prospects of Japanese financials and materials companies.

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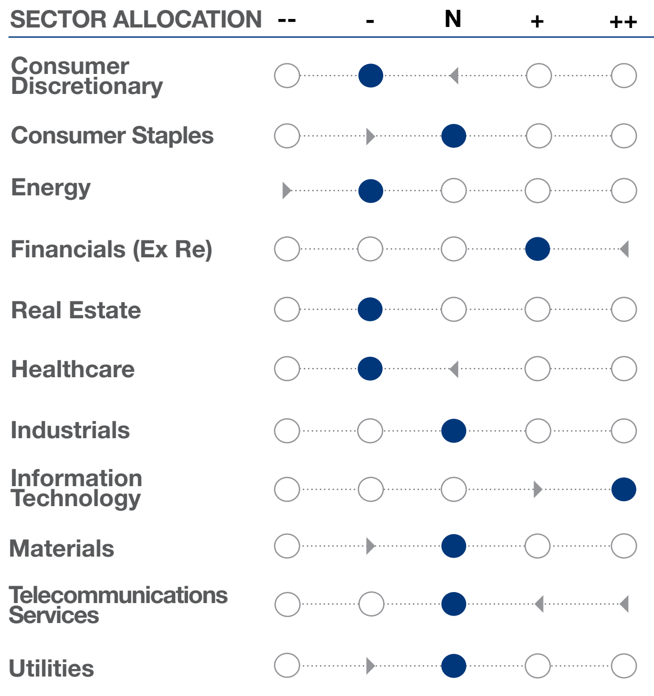
ASIA EX-JAPAN EQUITY



Notes:
The weights are relative to the benchmark – MSCI Asia ex-Japan Index.
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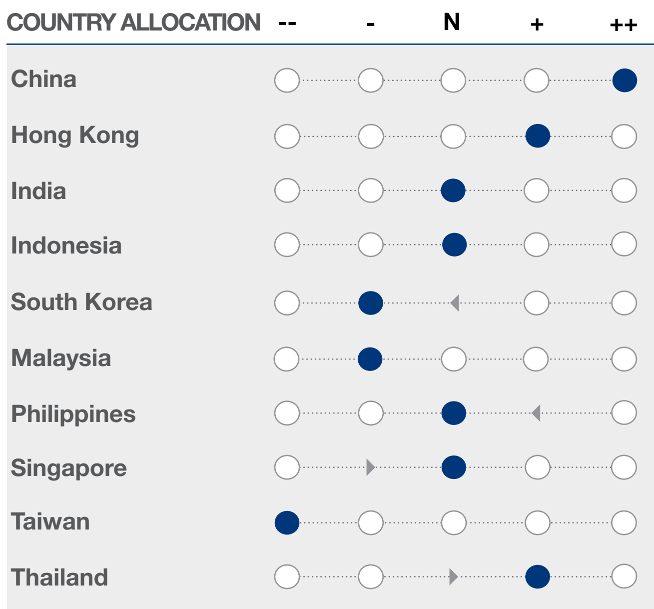

Notes:
The weights are relative to the benchmark – MSCI Asia ex-Japan Index.
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Growth in Asia continues to face headwinds led by China's economic slowdown and weak export growth. While the first US interest rate increase looks imminent, expectations on the path of rate increase will set the tone for investor sentiment.

In China, growth should stabilise with the impact of earlier monetary loosening, mini-stimulus programmes and a property market pick-up. Economic rebalancing is accelerating with the growth in the services sector outpacing that of the industrial production sector. Within the services sector, household services have the strongest prospects for steady growth led by household income growth and supportive economic policy.

We believe that as the US raises interest rates, the North Asian markets are relatively better able to withstand any potential fund outflows. However, the ASEAN markets have corrected, pricing in a slowdown in growth. Meanwhile, progress on policy reform and infrastructure has also been disappointing, but the potential for acceleration in India, Indonesia and Thailand remains.

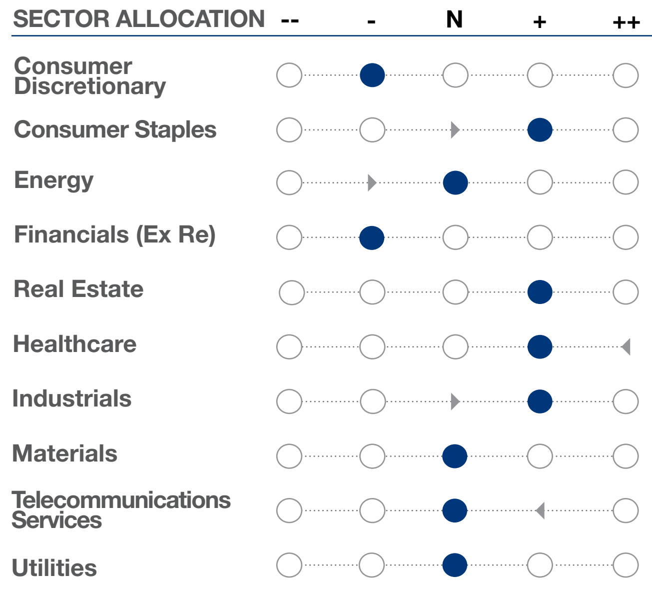
Political uncertainty will be heightened in the first half of 2016 (1H2016) as elections are planned for Taiwan, Korea and the Philippines. Policies are expected to be consumer-friendly in the period leading up to elections. The Taiwan elections in January will be most closely watched due to implications from the cross-straits relations with China.

Asia markets have corrected in the lead up to the US interest rate lift-off. Asian equity valuations are now attractive at more than one standard deviation below the mean level on a price-to-book basis – a level that was last seen during the 2008 Global Financial Crisis.

Even as overall growth remains modest, new economy sectors including internet, healthcare, education and tourism enjoy stronger growth prospects. Rising internet and smartphone penetration will accelerate technological disruption across sectors including retail, financial services, travel and transportation sectors. This trend presents bottom-up investment opportunities in e-commerce, information technology services and financial technology sectors.

The key risks are a disorderly capital outflow, currency volatility and worse-than-expected slowdown in China.

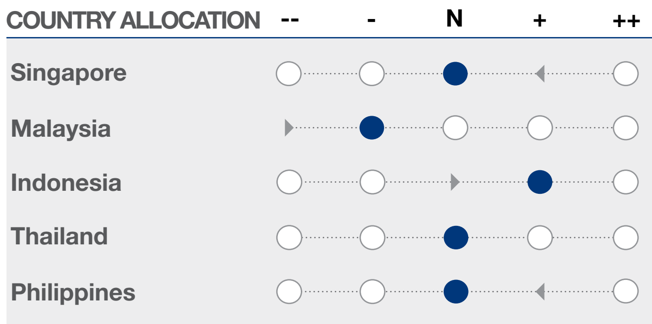
ASEAN EQUITY



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.

ASEAN continues to face macro headwinds from slowing economic growth amid a weaker growth environment in Asia. However, we maintain our view that the economic situation in ASEAN does not foreshadow a repeat of the Asian Financial Crisis in 1997 as foreign reserves, external debt and banking sector health are all stronger now.

Our representative ASEAN strategy is currently overweight on the consumer staples, healthcare, real estate and industrials sectors. On the other hand, the strategy is underweight on the financials and consumer discretionary sectors.

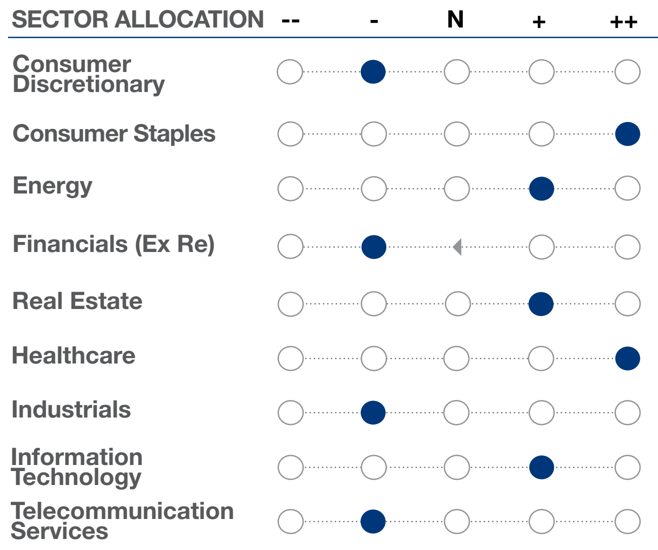


Notes:
The weights are relative to the benchmark – MSCI South East Asia Index.
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

In the first half of 2016, we view that the economic stimulus measures introduced by Indonesia and Thailand will begin to have a more pronounced economic impact. We believe that they are a step in the right direction to improve business confidence and consumer demand, and ultimately boost economic growth. Going forward, the rate of government spending is of crucial importance in markets such as Indonesia, Thailand and the Philippines to drive economic growth.

The ASEAN strategy is overweight on Indonesia while the underweight position in Malaysia has been reduced. We are neutral on Singapore, Thailand and the Philippines.

SINGAPORE EQUITY

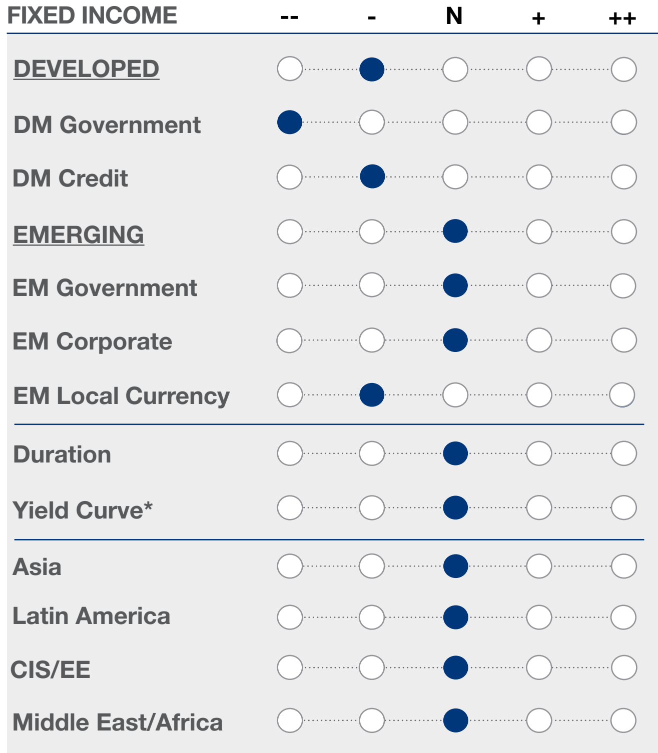


Notes:
The weights are relative to the benchmark – MSCI Singapore Index.
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral,
'+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

The Singapore market is expected to continue to trade in a range in the quarter ahead, driven by unexciting corporate earnings offset by relatively supportive valuations. Economic growth remains muted with market expectations of 2016 GDP growth at around a modest level of two per cent.

The strategy is overweight on the consumer staples, energy, real estate, healthcare and information technology sectors. We are underweight on the consumer discretionary, financials, industrials and telecommunication services sectors.

FIXED INCOME STRATEGY
GLOBAL FIXED INCOME



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

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.

Our global fixed income strategy remains overall underweight on the DM and neutral on the EM and Asia.

In the DM, we remain underweight on government debt, and less underweight on corporates. We are generally positive on investment grade corporate credits for carry against the gradual rising of the US Treasury (UST) yields while keeping duration neutral versus the benchmark. We remain cautious on high yield credits. We also remain defensive and selective in our credit selection.

In the EM, we maintain a neutral weight. Similarly, we remain neutral on EM sovereigns and on corporates. We continue to favour USD-denominated EM credits and remain underweight on local currency credits, particularly in commodity-based EM economies.

Please refer to the last page for the important notice & disclaimer.

DEVELOPED MARKETS

Review

In the last quarter of 2015, the ten-year US Treasury (UST) yield fell to a low of just below two per cent due to the markets having doubts on the US Fed lifting the Fed Fund rate, and with declining oil prices. The yields subsequently rebounded after US Fed officials were seen preparing the markets for a tighter monetary policy with a mid-December meeting and investors were also encouraged by the strong US non-farm payroll data. On the other hand, the ten-year German bond yield moved downwards as expectations built up for another round of QE from the European Central Bank (ECB). In November, the ECB reiterated its willingness to consider additional QE measures. The interest rate differential between the US and German bond yield gapped wider and the euro weakened further against the USD.

Outlook and Strategy

Investors are bracing for the US Fed's first rate increase in years and the market has shifted its thinking from the timing of the rate increase to its pace. This may happen as early as 17 to 18 December 2015 at the last Federal Open Market Committee (FOMC) meeting for the year. We are mindful of the correlation of the rates with long-end DM bond yields. However, the move will be differentiated by the path divergence to be undertaken by the respective central banks.

The Fed Fund futures market is pricing in approximately 2.4 increases in 2016, which we believe will run the risk of underpricing the number of increases for the following year. Previous cycles also underpriced the increase at the onset of the upturn in policy rates. Meanwhile, headline inflation has been low and has upside risk. Oil prices at the current level are unlikely to be sustainable for the long term and the wearing off of base effects will push inflation higher.

In Europe, the ECB delivered further QE in early December including taking deposit rates further into negative territory as well as extending the asset purchase programme.

For the UK, the resilient economy and strong labour market puts it as one of the first to tighten monetary policies following the US Fed's move. However, the recent unexpected dovish tone from the Bank of England faces headwinds to growth from fiscal consolidation which are expected for the following year. UK's referendum on EU membership, date still unconfirmed, will curtail the pound stirling's performance.

The Bank of Japan (BOJ) seems less concerned about the specific timeframe for reaching the two per cent inflation target and has pushed its timing back by six months. We note that while headline inflation is still low, core inflation (headline inflation less food and energy) has been gradually increasing. Coupled with market expectation for a supplementary budget for the following year to boost the economy, the BOJ is likely to put policy changes on hold for another quarter.

In Canada, its economic momentum seems to have troughed. While it is less synchronised with the US than before, it will still benefit from the US economy. We expect the central bank to put the policy rate on hold.

In Australia, the Reserve Bank of Australia still views the overall monetary conditions as accommodative though it believed that the inflation outlook provides room for further easing. The recent improvement in the labour market suggests that the policy rate will be put on hold.

We have a short duration slant for US and UK government bonds while keeping a neutral duration on Japanese, core European, Canadian, and Australian government bonds.

EMERGING MARKETS

Review

Over the second half of 2015, EM has been volatile with yields trading between 6.4 to 5.8 per cent. Despite the tide of negative news, EM did manage to stage a recovery. We believe that too much bad news was priced in and the markets were oversold. As the tide subsided, bond prices and their corresponding foreign exchange (FX) rates recovered some of the losses.

Outlook and Strategy

EM bond spreads above 400 basis points (bps) and yields above six per cent offer an attractive entry point for medium-term investors. While the bullish outlook for EM has passed, we believe that investing in EM bonds offers an attractive yield for any diversified portfolio. The pricing of the bonds often allows investors to be compensated for the risk taken. We remain positive on EM USD sovereign bonds, but negative on EM FX. We have reduced our USD long positions versus EM FX, though we maintain a small position.

In an environment with only modest global growth and low levels of global inflation, it is likely that interest rates stay relatively low for a period of time. Despite the fact that the US Fed is likely to increase interest rates before the year ends, bond yields have remained stable. Interest rate expectations into 2016 and beyond have been pared back. However, we believe that in many cases, a medium-term bond investor may be compensated adequately for interest rate risk and that EM bonds are attractive at yields greater than six per cent.

The second important consideration is adequate compensation for credit risk. The bullish case for EM may be over, but the weight of the asset class in global portfolios has increased. While there are real risks of credit rating downgrades, the inclusion of EM bonds may create a well-diversified portfolio for investors in the immediate horizon. In addition, EM countries still need to maintain a commitment to the bond markets because access to global financial markets is a critical part of a nation's growth plans. For example, Russia was one of the main underperforming markets in 2014 but turned into an outperformer this year. In the face of a recession, the external position of the country was well managed. Russia allowed the depreciation of the ruble, the contraction of imports, and the aggressive increase in interest rates to stem rising inflation. Despite losing its investment grade rating, Russian financial assets staged a remarkable recovery in 2015.

Despite the challenges in EM for 2015, we believe investors should look for good entry points where one may be adequately compensated for risk.

ASIA

Review

Asian hard currency bonds registered a positive return of 1.63 per cent in USD terms for the first two months of the fourth quarter of 2015 (4Q15) after falling 0.53 per cent in the third quarter of 2015 (3Q15). After a substantial spread widening of 49 bps in Asian credit spreads in August and September 2015, we saw a sharp rally in October 2015 as investors were keen to put cash to work alongside a stabilised market. The Asian bond credit spread narrowed by about 30 bps in October 2015.

The absence of weaker-than-expected economic data and positive market technicals was believed to be the main driver for this rally. In addition, money waiting to be invested before the year's end and a quiet new issuance market prompted the market to rally throughout October. The non-investment grade (non-IG) segment had thus done better than IG as investors were more willing to take on risk. With the expectation of a US rate increase in December, the ten-year UST yield rose from 2.04 to 2.14 per cent.

Outlook and Strategy

Moving ahead, although we are neutral with a cautious outlook, we are inclined to stay fully invested in the Asian bond market for the carry. While global growth will remain modest, we believe that the negative shocks that we experienced in August and September are unlikely to be repeated. Deflationary pressures from lower oil prices will continue to keep overall inflation low although this base effect will start to diminish as we approach 2016. On the valuation front, the recent October rally had clawed back almost two-thirds of the credit spread widening suffered during August and September. As at end October, the average spread stood at about 35 bps wide from June's low of 248 bps. The IG credit spread was at 32 bps wide from its low of 185 bps while non-IG credit spread was at 62 bps wide from its low of 498 bps. This may present an attractive proposal for investors to invest so as to gather the carry over cash.

In view of the impending US rate increase cycle towards the end of the year and the uncertainties of the divergent monetary policies that central banks have created, we believe that market volatility will likely rise. As such, highly stringent credit selection and more nimble positioning will be of vital importance for our portfolio management.

SINGAPORE

Review

Singapore's GDP expanded 1.9 per cent year-on-year (yoy) in 3Q15. The upward revision from the advance estimate of 1.4 per cent yoy was led by resilient services growth. Headline inflation came in at -0.8 per cent yoy in October, marking the 12th consecutive month of contraction, on the back of lower private transport and accommodation costs. Core inflation eased to 0.3 per cent yoy from 0.6 per cent yoy in the previous month, reflecting lower electricity tariffs and retail prices. The SGD ended November at 1.4109 and weakened 0.7 per cent from 1.4012 as at end October on renewed SGD depreciation expectations.

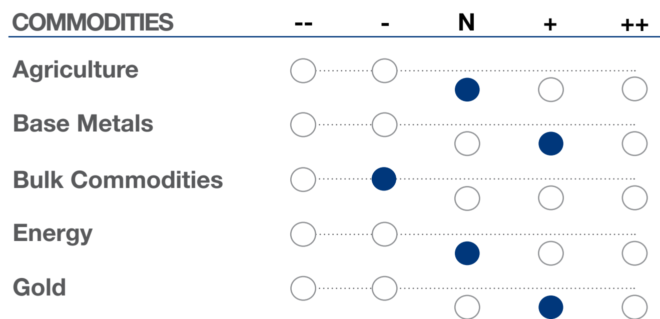
The SGD primary corporate bond markets have been relatively quiet in recent months on the back of the weakening SGD. Scarcity of high yield (HY) new issues in the second half of 2015 (2H2015) has been supportive of secondary prices. The new issuance pipeline looked more skewed towards IG issuers. Interest in perpetual bonds was boosted by issuance from Real Estate Investment Trusts (REITs). Technical factors continue to drive the market.

Outlook and Strategy

The Ministry of Trade and Industry (MTI) expects the Singapore economy to grow by close to two per cent for 2015 and at a modest pace of one to three per cent for 2016 amid a challenging external environment. The Monetary Authority of Singapore (MAS) expects headline inflation to continue to be dampened by lower car prices and imputed rentals and come in at around -0.5 per cent in 2015 and between –0.5 to 0.5 per cent in 2016. Core inflation is expected to pick up gradually over the course of 2016 as the disinflationary effects of lower oil prices as well as budgetary and other one-off measures dissipate. It is expected to come in at around 0.5 per cent in 2015 and between 0.5 to 1.5 per cent in 2016. On the currency front, we expect SGD to remain in the lower band of the SGD nominal effective exchange rate (S$NEER). In view of the renewed SGD depreciation expectations, short-end rates are likely to rise as investors demand higher interest rates in compensation for a weakening SGD. We continue to be underweight on the short-end of the SGS (Singapore Government Securities) curve.

Heading into the end of the year, we expect secondary trading to be lacklustre. Some idiosyncratic credit events brought further uncertainty to Indonesian names (Trikomsel and Lippo Group REITs). However, it should have limited impact on broader investor sentiment. We also expect the SGD primary markets to slow further. The new issue activities will likely pick up in the new year.

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 remain at a neutral weight for the overall commodities sector. We believe 2016 will be a transitional year in the commodity cycle, with the supply-demand balance reaching equilibrium for many commodities and providing a platform for a sustainable recovery across the commodity spectrum. Recent price volatility has stemmed from disappointing industrial production ("IP") and manufacturing PMI data from leading commodity-consuming countries such as China, and the subsequent failure of commodity prices to respond to policy action to counteract weak demand. Price weakness is also due to the strong performance of the USD against nearly all other currencies, as investors wait for the expected increase in US interest rates in December 2015. Our neutral call is based on historical evidence that the USD actually weakened in the past four cycles of US interest rate increases. Similar behaviour in the coming months would see a recovery in commodity prices given their current negative correlation to the USD.

Agriculture

We remain at a neutral weight on agriculture commodities, with data continuing to show little disruption from the weather. While moderate conditions have resulted in slightly lower corn, soybean and wheat prices, it is noticeable that agricultural prices are relatively stable compared to other commodities and may now be close to bottoming. Certainly, grain prices are more likely to see upside price risk through weather factors rather than further selling pressure. We note that fertilizer prices may also be bottoming with the main potash producers starting to show greater production discipline. The Australian Bureau of Meteorology continues to expect an El Nino weather event. Previous El Nino events have produced an upward movement in crude palm oil (CPO) prices as dry weather causes tree stress.

Base Metals

We maintain our overweight position on base metals since prices remain deep in the cost curve and are encouraging closure of existing capacity. This is combined with sharply lower investment in new production across most metals that will limit future supply growth. Despite the negative press reports, China's metal demand has been flat to positive this year, and should strengthen from the stimulative monetary policy. Base metals should also benefit from US expansion and a more stable and modestly expanding Europe as ongoing QE measures lift demand. We note the falling London Metal Exchange (LME) inventory levels for metals such as nickel and lead.

Bulk Commodities

We continue to hold an underweight position in bulk commodities. Although the markets for iron ore, thermal coal and coking coal are clearly over-supplied, new low-cost supply continues to enter the market, only to be faced with weak demand in the steel and power sectors. Downward pricing pressure is likely to persist until the cost curve has flattened and only the lowest cost producers remain in the market. However, we note that it will still be possible for these low-cost producers to make healthy operating margins at current price levels. There are still attractive opportunities for low-cost thermal coal producers who have a strong competitive advantage in their domestic market.

Energy

We maintain our neutral position in energy. Global demand continues to be positive, with strong Chinese gasoline demand and with the US setting a record high for total miles driven. Supply data is also showing positive trends, with US onshore domestic oil production continuing to fall. Offsetting these positive factors are the high levels of US crude oil inventories and concerns over Iranian oil supply returning to the global market. We expect crude oil prices will remain in a trading range as the Organisation of the Petroleum Exporting Countries (OPEC) agrees on coordinated production cuts in order to support crude oil prices. Geopolitical events remain a risk, with any supply disruption in the Middle East likely to produce a sharp upward movement in crude oil prices.

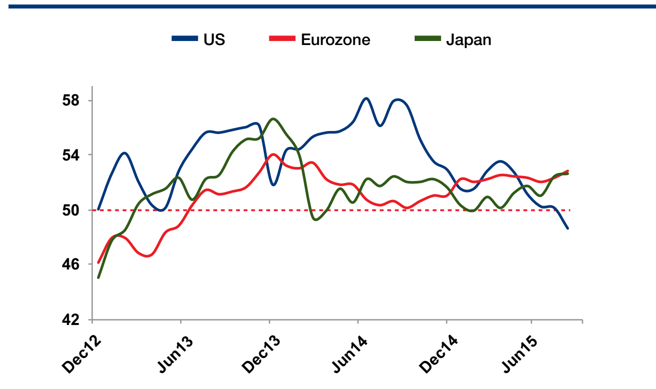
Gold

We remain in an overweight position in gold given mixed global economic data and the probability of continued low real interest rates. Central banks remain as the aggregate net buyers, with the People's Bank of China (PBoC) following its sizeable June 2015 gold acquisition with continuing monthly purchases, and with Russia's Central Bank also making aggressive gold purchases. Retail demand from China and India is at record levels, with the Shanghai Gold Exchange setting the record of transaction levels in physical gold. Although the strong USD remains a potential headwind, a strong dollar also has the positive effect of lowering production costs and strengthening gold revenues for non-USD producers.

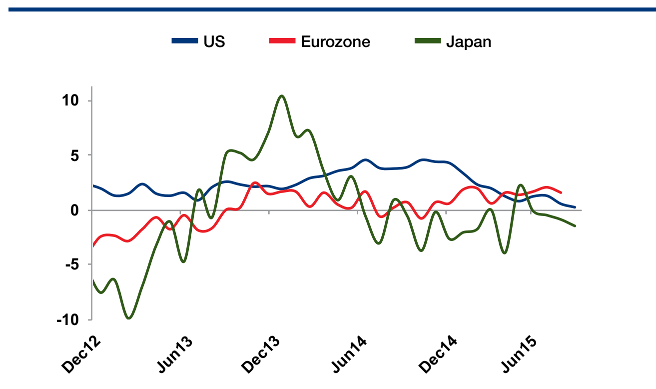
APPENDIX
ECONOMIC INDICATORS

DEVELOPED ECONOMIES

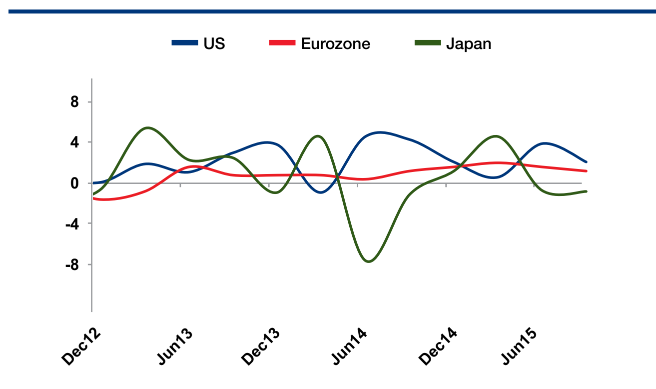
Purchasing Managers' Index



Industrial Production Growth (YoY%)

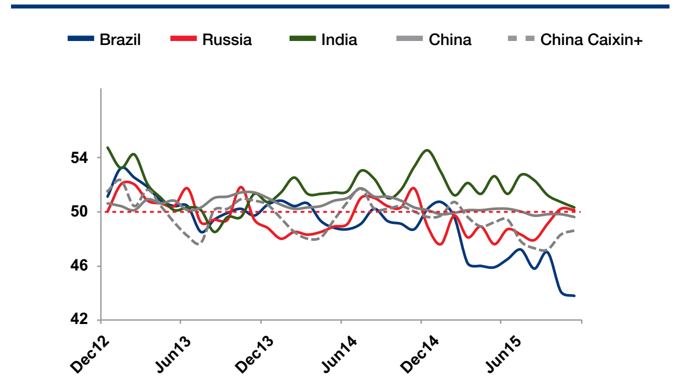


Real GDP growth (QoQ%, saar)*

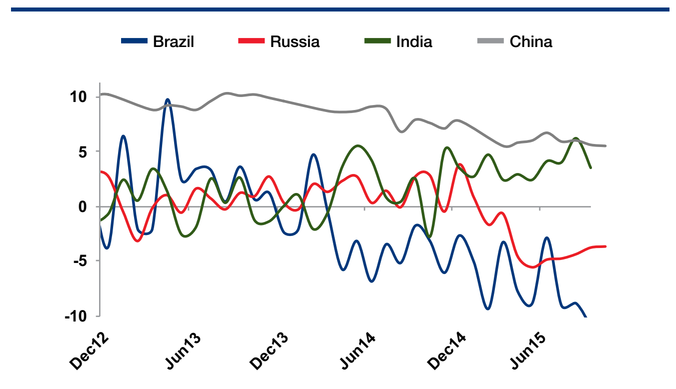


EMERGING ECONOMIES

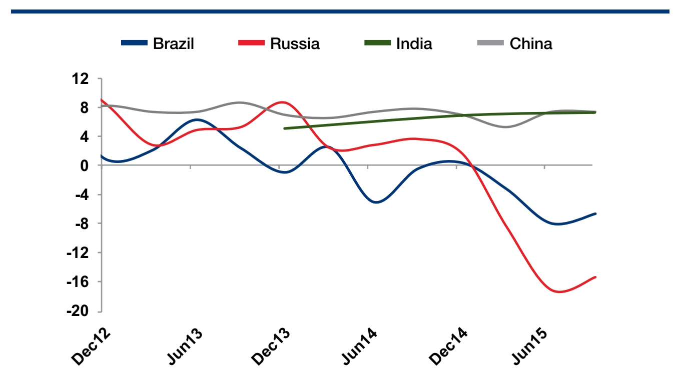
Purchasing Managers' Index



Industrial Production Growth (YoY%)



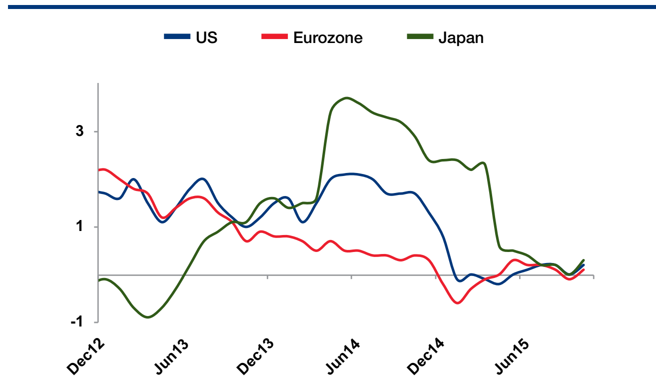
Real GDP growth (QoQ%, saar)*



*For some economies, annualised GDP data 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 2015.

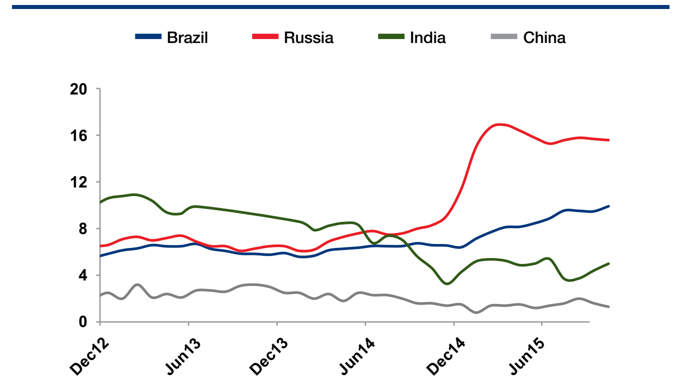
DEVELOPED ECONOMIES

Inflation - CPI (YoY%)



EMERGING ECONOMIES

Inflation - CPI (YoY%)



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Central Banks Interest Rates

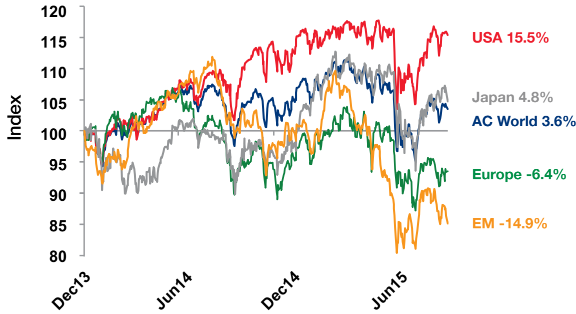
Country	Interest Rate	Current Rate (%pa)	Latest Meeting	Change at Latest Mtg (bp)	Last Change	Next Meeting
		1-Dec-15				
United States	Fed Funds Target Rate US	0.250	28 Oct 2015	—	16 Dec 08 (-75bp)	17 Dec 2015
Eurozone	Refinance Rate	0.050	22 Oct 2015	—	4 Sep 14 (-10bp)	3 Dec 2015
Japan	BOJ Overnight Call Rate	0.077	—	—	27 Nov 15 (+0.1bp)	—
United Kingdom	UK Official Bank Rate	0.500	30 Nov 2015	—	5 Mar 09 (-50bp)	10 Dec 2015
Brazil	Brazil Selic Target Rate	14.250	25 Nov 2015	—	29 Jul 15 (+50bp)	20 Jan 2016
Russia	Russia Refinancing Rate Announcement	8.250	13 Sep 2013	—	13 Sep 12 (+25bp)	—
India	Repurchase Rate	6.750	21 Nov 2015	—	30 Sep 15 (-50bp)	—
China	1 Year Benchmark Lending	4.350	30 Nov 2015	—	26 Oct 15 (-25bp)	—
South Africa	South Africa Repo Avg Rate	6.250	27 Nov 2015	—	19 Nov 15 (+25bp)	28 Jan 2016

Source: Bloomberg, as at 1 December 2015.

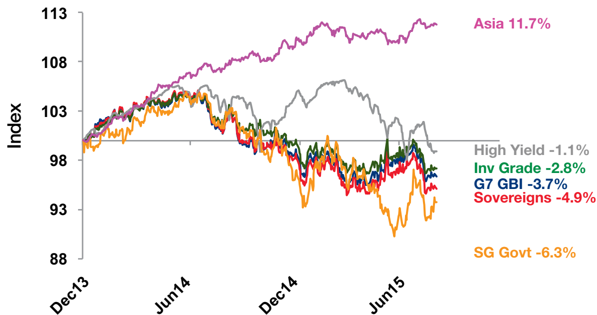
MARKET PERFORMANCE

DEVELOPED MARKETS

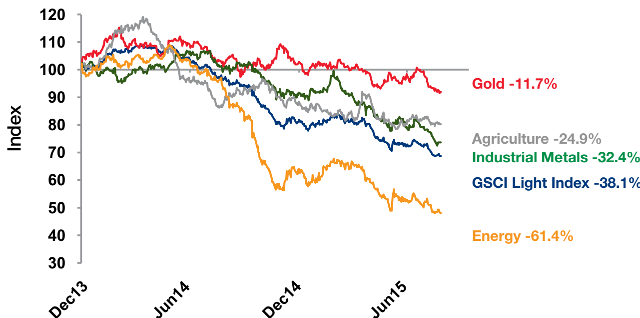
Equity Indices
(Rebased 100 on 31 December 2013)



Fixed Income Indices
(Rebased 100 on 31 December 2013)

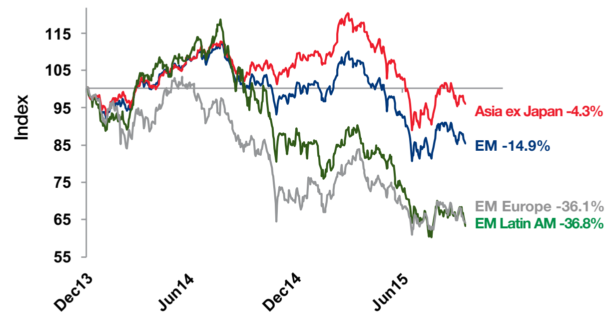


Commodity Indices
(Rebased 100 on 31 December 2013)

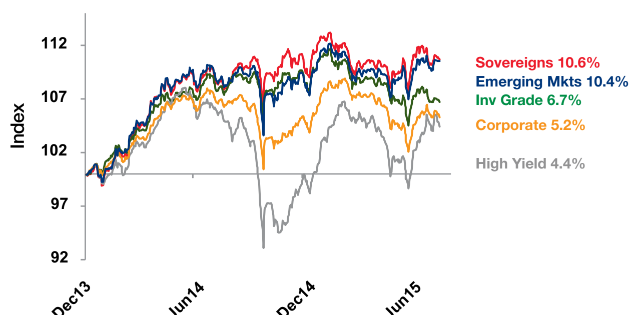


EMERGING MARKETS

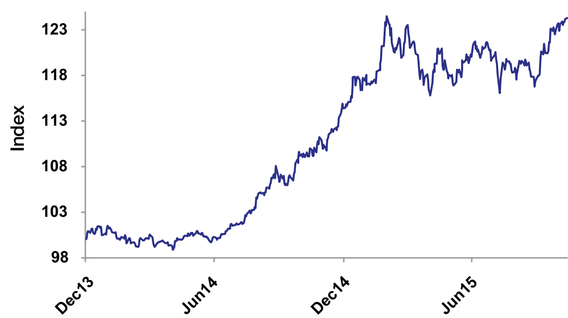
Equity Indices
(Rebased 100 on 31 December 2013)



Fixed Income Indices
(Rebased 100 on 31 December 2013)



Dollar Index Spot
(Rebased 100 on 31 December 2013)



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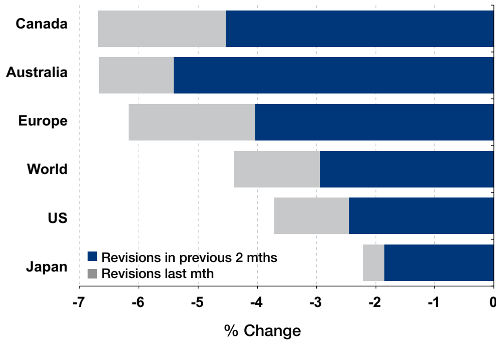
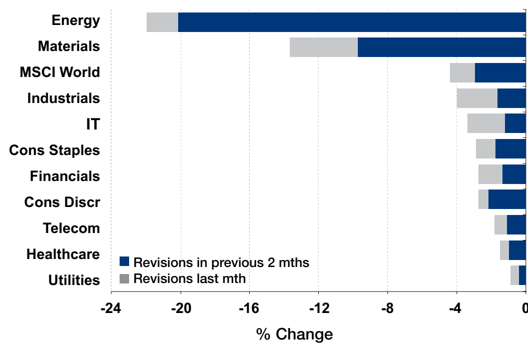
EQUITY MARKET INDICATORS

DEVELOPED MARKETS

Earnings Revision by Regions for FY2

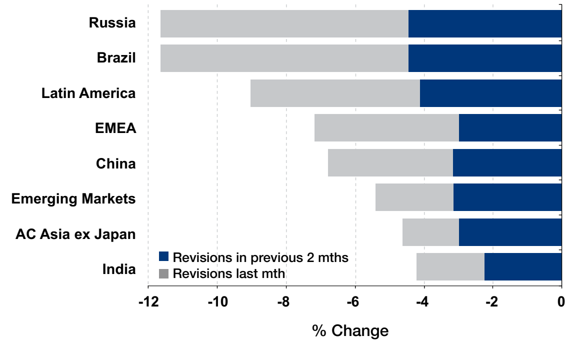


Earnings Revision by Sectors for FY2

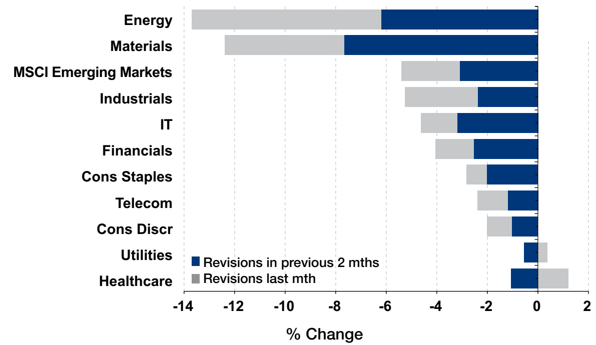


EMERGING MARKETS

Earnings Revision by Regions for FY2



Earnings Revision by Sectors for FY2



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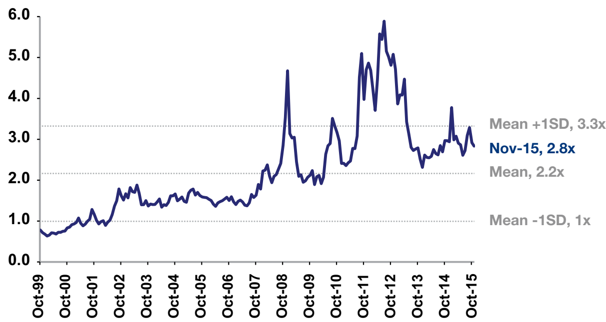
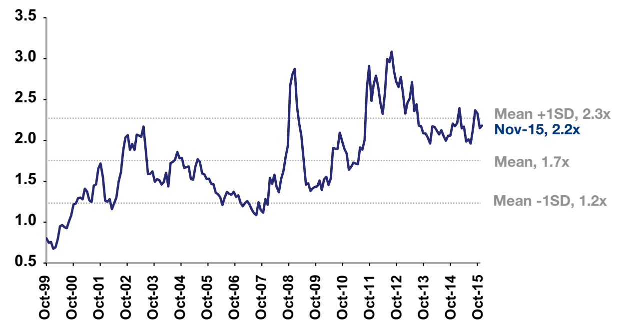
VALUATION

Developed Markets Earnings Yield Ratio*

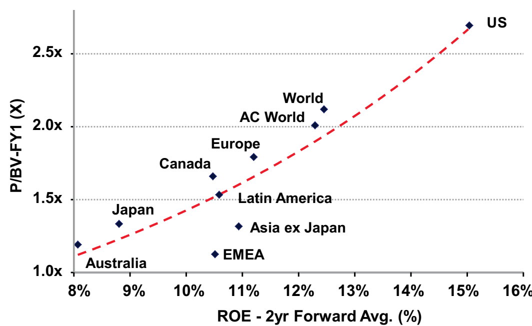


Emerging Markets Earnings Yield Ratio*

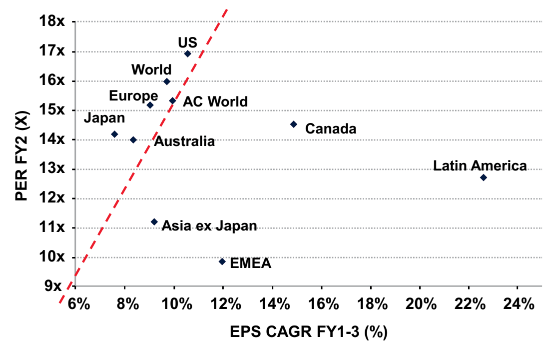


*Mean and SD are based on data from 1999.

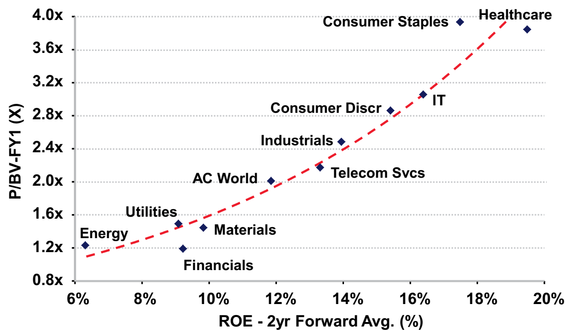
P/BV vs ROE by Region



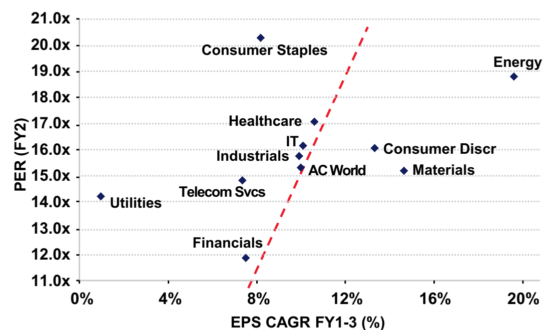
P/E vs Growth by Region



P/BV vs ROE by Sector



P/E vs Growth by Sector



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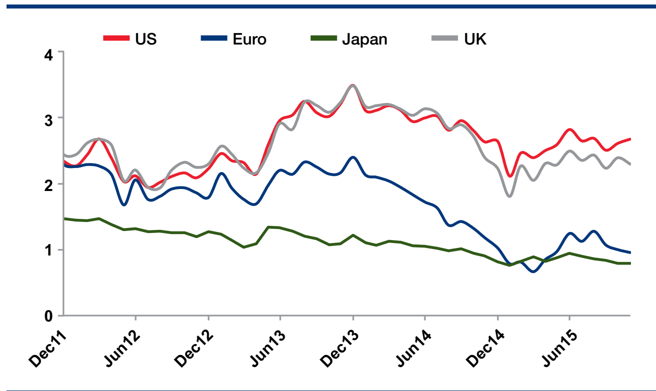
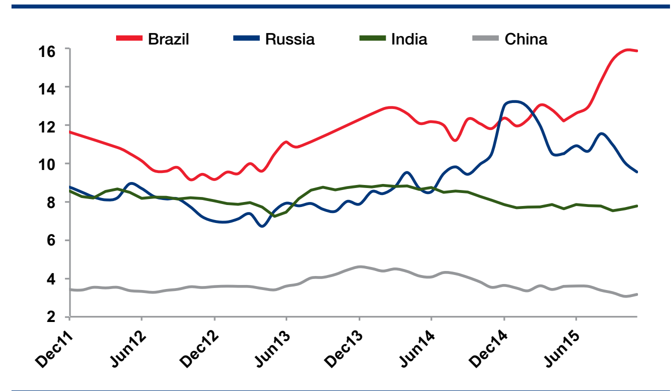
FIXED INCOME MARKET INDICATORS

SOVEREIGN

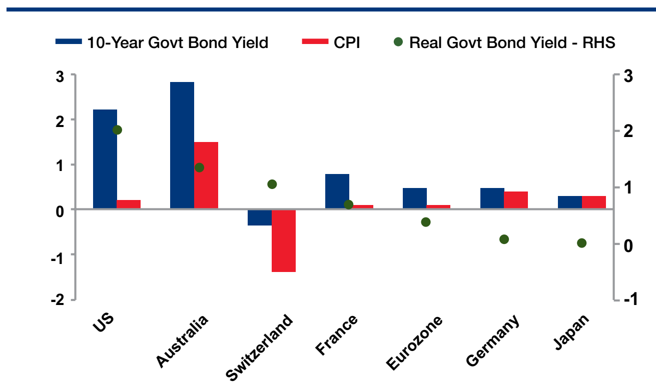
Developed Markets 10-Year Government Yield (%)



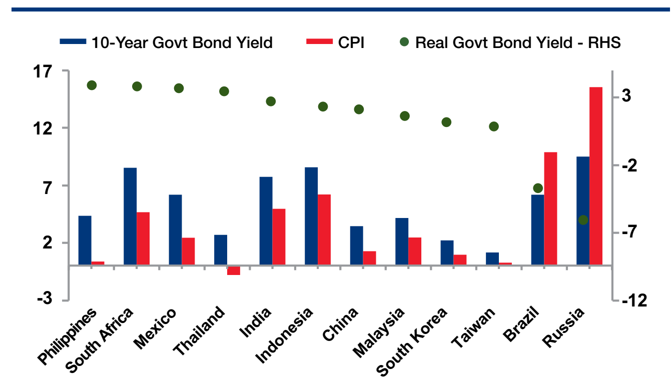
Emerging Markets 10-Year Govenment Yield (%)



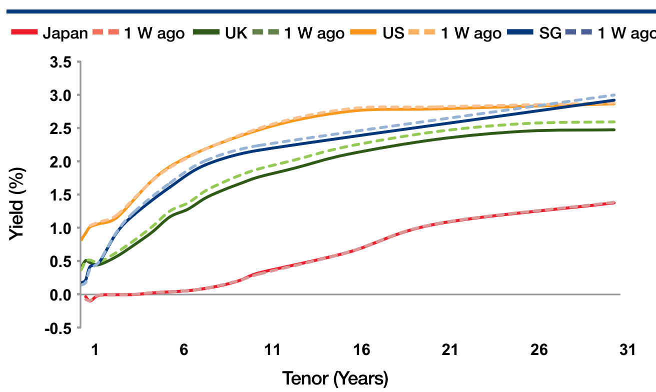
Developed Markets Real Government Yield (%)



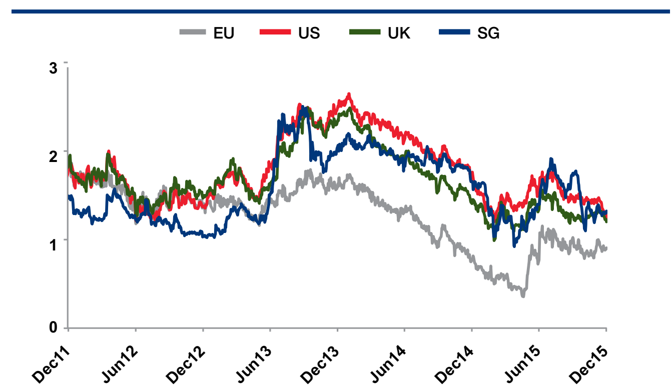
Emerging Markets Real Government Yield (%)



Nominal Yield Curve (%)



Yield Curve Steepness (10Y – 2Y) (%)

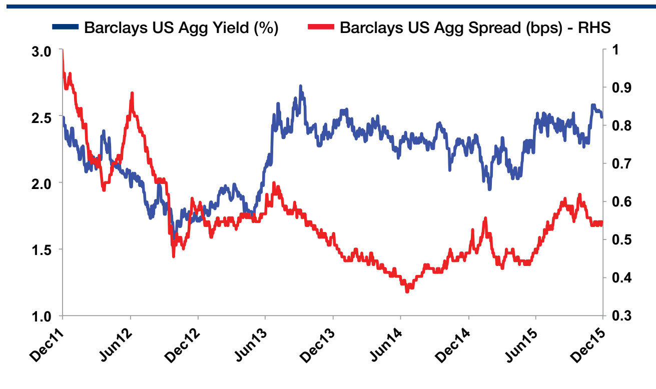


Note: All data are sourced from Bloomberg, Datastream and UOBAM unless otherwise stated, as at 1 December 2015.

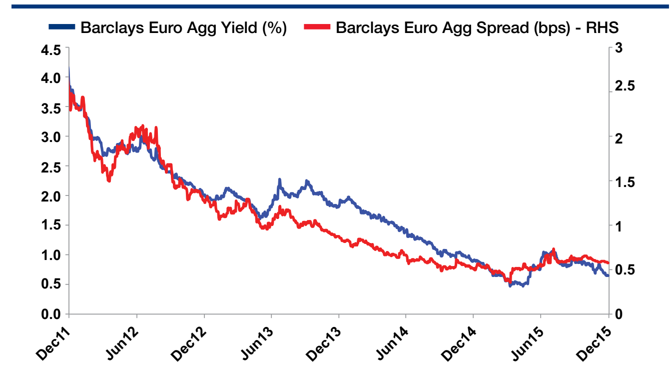
FIXED INCOME MARKET INDICATORS

CREDITS

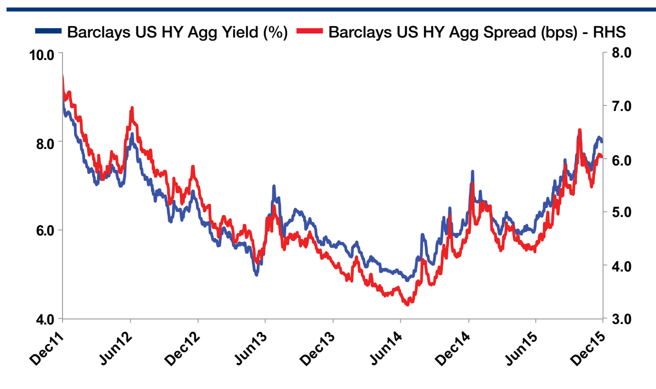
US Markets (USD) Yield and Credit Spread



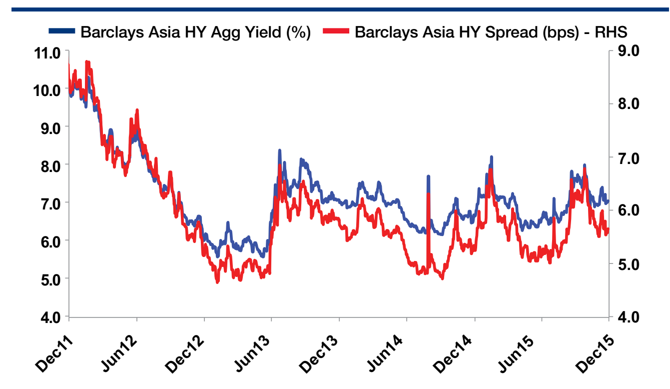
Euro Markets (USD) Yield and Credit Spread



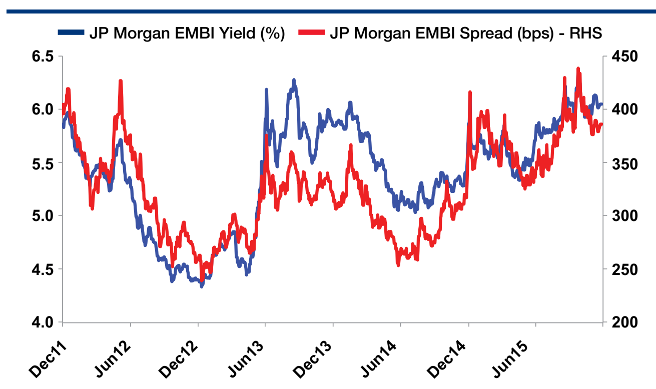
US Markets (USD) HY Yield and Credit Spread



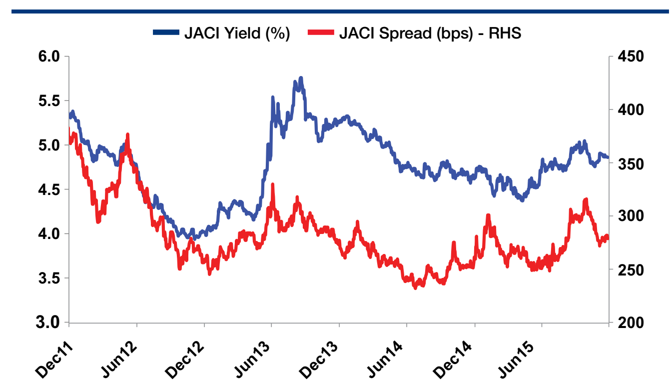
Asia Markets (USD) HY Yield and Credit Spread



Emerging Markets (USD) Yield and Credit Spread



Asia (USD) Yield and Credit Spread



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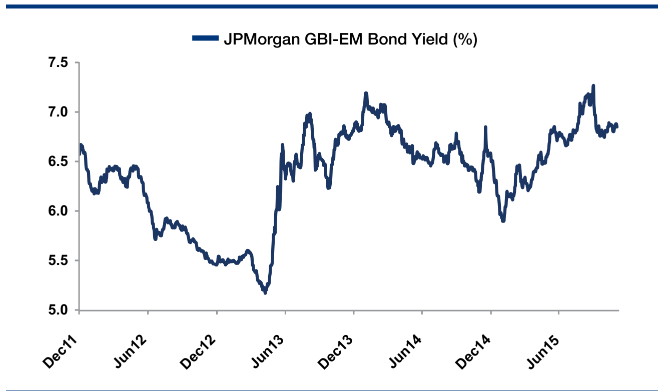
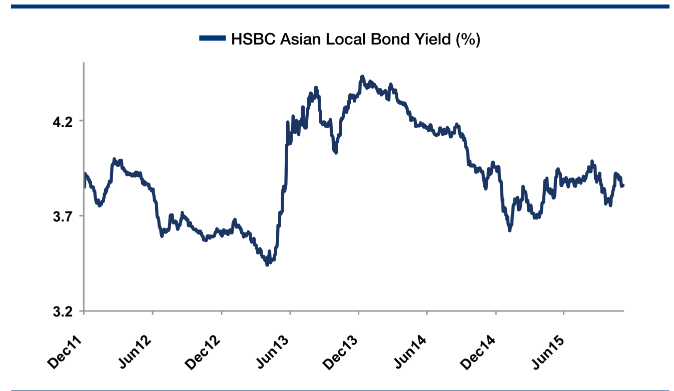
CREDITS

Emerging Markets (Local Currency) Bond Yield

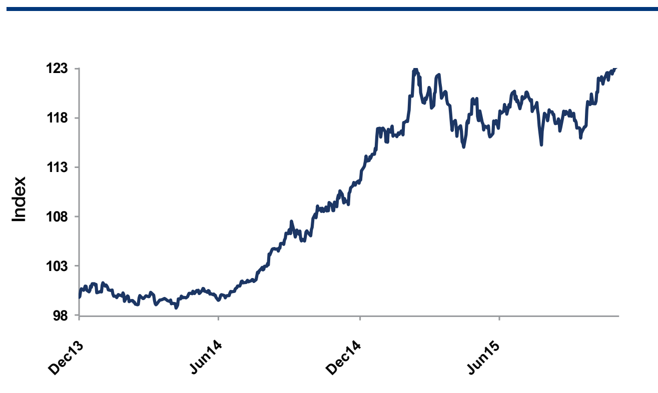


Asia (Local Currency) Bond Yield

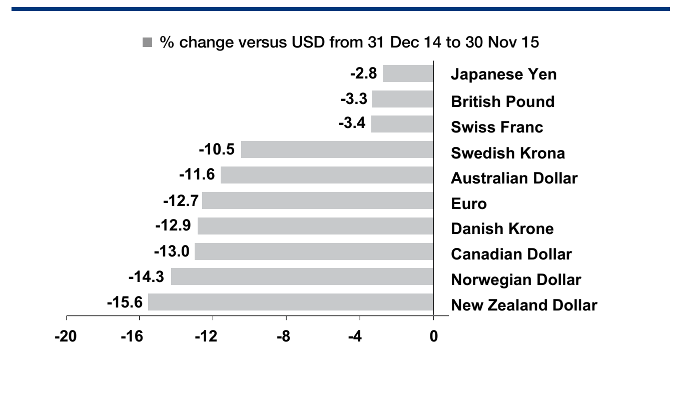


CURRENCIES

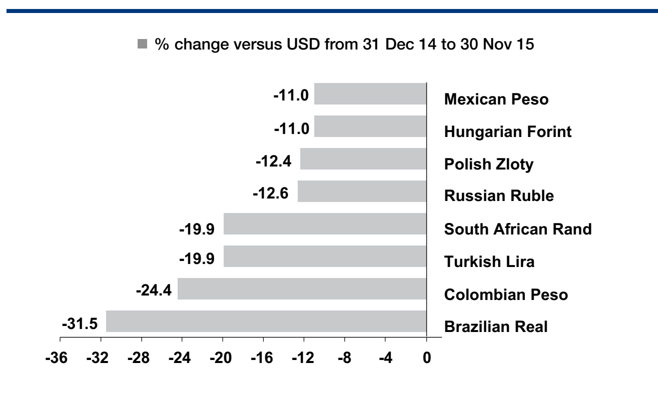
Dollar Index Spot (Rebased 100 on 31 December 2013)



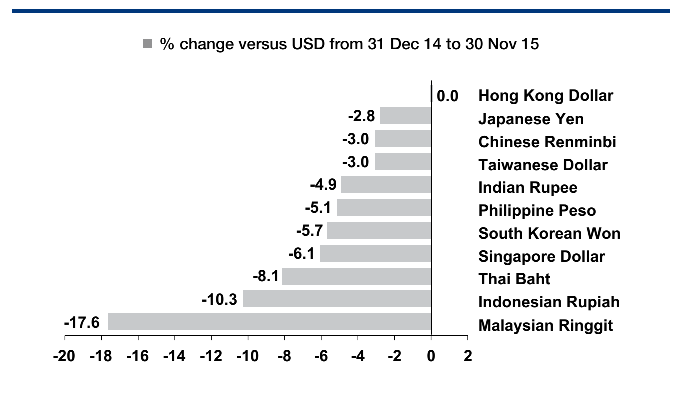
G-10 FX against US Dollar



Emerging Markets FX against US Dollar



Asia FX against US Dollar



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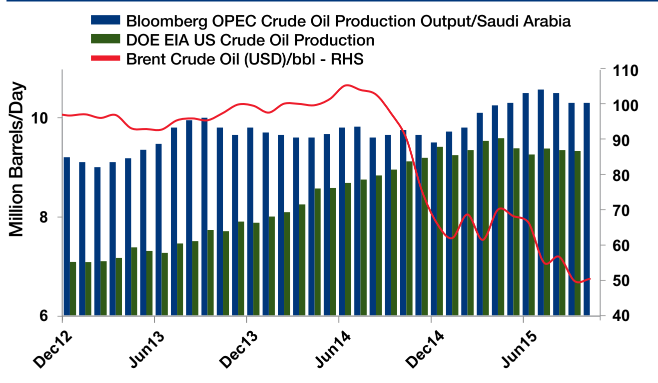
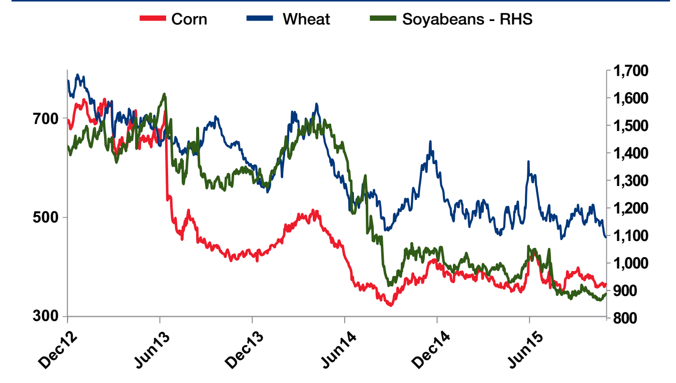
COMMODITY MARKET INDICATORS

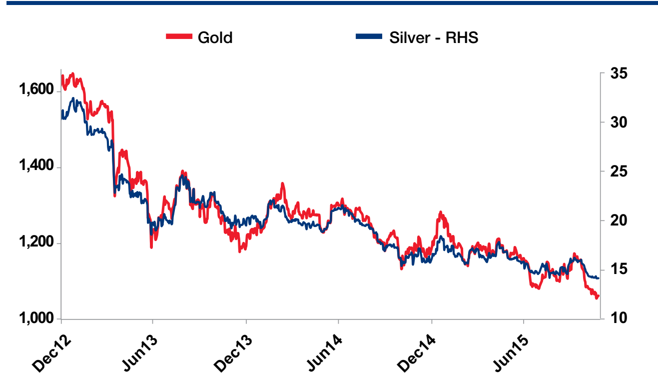
Brent Crude Oil Price and Production



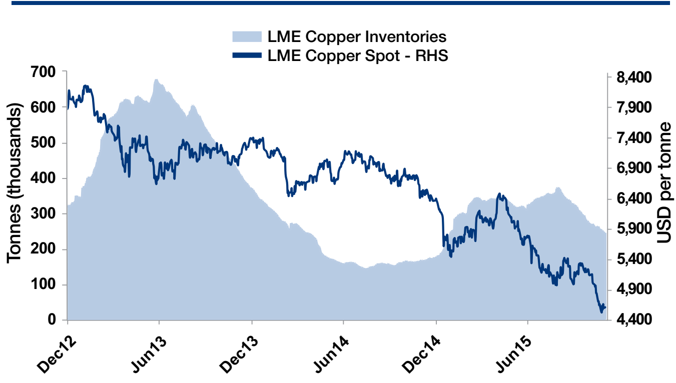
Agriculture Price (USD)



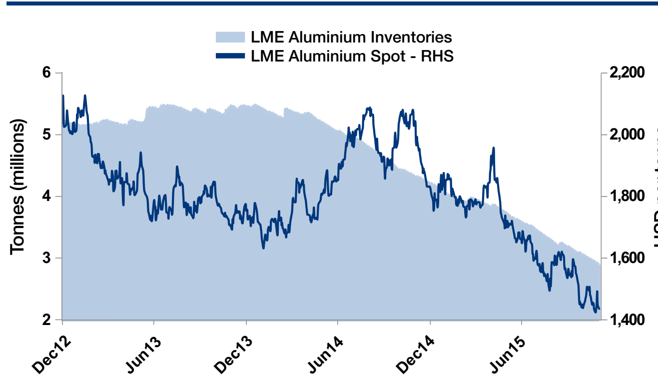
Precious Metal Price (USD)



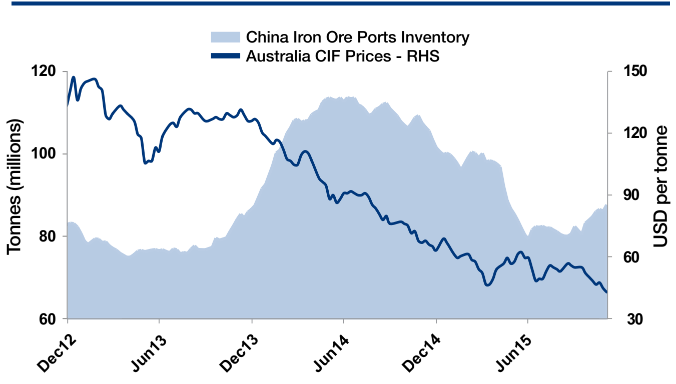
Copper Price (USD)



Aluminum Price (USD)



Iron Ore Price (USD)



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Contact Details

SINGAPORE
UOB Asset Management Ltd

Address 80 Raffles Place UOB Plaza 2 Level 3 Singapore 048624
Tel 1800 222 2228 (Local) • (65) 6222 2228 (International)
Fax (65) 6532 3868
Email uobam@uobgroup.com
Website uobam.com.sg

MALAYSIA
UOB Asset Management (Malaysia) Berhad

Address Level 22, Vista Tower, The Intermark
No. 348 Jalan Tun Razak, 50400 Kuala Lumpur
Tel (60) (03) 2732 1181
Fax (60) (03) 2732 1100
Website uobam.com.my

THAILAND
UOB Asset Management (Thailand) Co., Ltd

Address 23A, 25 Floor, Asia Centre Building, 173/27-30, 32-33
South Sathon Road, Thungmahamek, Sathon, Bangkok 10120, Thailand
Tel (66) 2786 2000
Fax (66) 2786 2377
Website uobam.co.th

BRUNEI
UOB Asset Management (B) Sdn Bhd

Address FF03 to FF05, The Centrepoint Hotel, Gadong,
Bandar Seri Begawan BE 3519, Brunei Darussalam
Tel (673) 2424806
Fax (673) 2424805

TAIWAN
UOB Investment Advisor (Taiwan) Ltd

Address Union Enterprise Plaza, 16th Floor, 109 Minsheng East Road, Section 3,
Taipei 10544
Tel (886)(2) 2719 7005
Fax (886)(2) 2545 6591

JAPAN
UOB Asset Management (Japan) Ltd

Address 13F Sanno Park Tower, 2-11-1 Nagatacho, Chiyoda-ku,
Tokyo 100-6113 Japan
Tel (813) 3500-5981
Fax (813) 3500-5985

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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 December 2015.

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