



Investment Alerts Archive

2011 Investment Strategies

Key Takeaways: 2011

- **Growing confidence about economic outlook:** Recent economic data out of the U.S. and elsewhere has been better than expected, leading to greater optimism that the global economy could finally be on a sustained recovery path.
- **Positive on equities:** The growing optimism about economic recovery augurs well for equity markets which should also benefit from improving corporate profits, still reasonable valuations and an abundance of liquidity.
- **Sanguine on Asia and Emerging Markets:** In the equities space, we are most positive on the outlook for Asia and Emerging markets which is enjoying superior growth compared to its peers in developed markets. We also see greater capital inflows into these markets as global risk appetite grows and investors seek higher yields.

Look back at 2010

Uncertainties continued to dominate the news headlines in 2010, starting with concerns about Greece's ability to service its sovereign debts, which snowballed into a bailout by the European Union (EU) and the International Monetary Fund (IMF) of the troubled European nation. The concerns eventually spread to other peripheral European nations like Ireland, which also had to be rescued by the EU and IMF.

Europe aside, other uncertainties that caused markets to be choppy last year included fears of a double-dip recession in United States, as stimulus measures from 2009 started to wear off. This led the Federal Reserve (Fed) to launch a second round of quantitative easing, to the tune of US\$600 billion, to boost economic recovery.

China was also in the limelight in 2010 as it attempted to rein in its red-hot economy and property market and cool rising inflationary pressures. The country's central bank tightened monetary policy by raising the reserve requirement for banks several times, leading to fears that its economy may slow down sharply, which could weigh on the global economic recovery.

The uncertainties mentioned above, resulted in significant inflows into bond funds and boosted the price of gold which is seen as a safe haven. Nevertheless, investors with a medium-term horizon used sharp dips in stock markets to bargain hunt for equities, and by year-end, global stock markets were generally higher compared to where they were at the start of the year.

2011: Macroeconomic outlook

Confidence about the U.S. and global economic outlook grew towards the end of last year, following significant fiscal and monetary stimulus measures from the Obama administration and the Fed.

While the U.S. economy has been gaining traction, the high unemployment and weak housing market continues to present strong headwinds. Consequently, the Fed is likely to maintain its loose monetary policy for the rest of this year, to help the U.S. economy recover.

On the global front, the International Monetary Fund (IMF) has projected that the world economy is likely to see a "two-speed" recovery this year, with emerging markets witnessing stronger growth than advanced economies.

However, emerging economies will have to deal with the challenge of capital inflows and preventing excessive speculation in areas like the property sector and the domestic debt market. Inflation is also a concern in Asia and the region's central banks are likely to tightening monetary policy further to manage inflation expectations. However we do not see them doing anything too drastic as inflation is still not rampant in Asia. Also, as the higher inflation is due to rising food prices, raising rates significantly may not be very effective in tackling the problem as higher commodity prices are a global phenomenon and not something within the control of central banks.

In Europe, the debt crisis is unlikely to go away anytime soon. In fact, it could even escalate as peripheral nations in the region will need significant structural banking reforms and tighter fiscal policies. These changes could take several years to execute, casting a pall on European economies.

Corporates are in a good shape

There is a silver lining to the global financial crisis in 2007 and 2008. It led to aggressive cost-cutting measures, which helped to boost corporate profits. In addition, companies exercised greater prudence, building up their cash reserves in the process. This has put them in a good stead to utilize their cash hoard for expansion, greater capital spending, merger & acquisitions, stock buy-backs and to make greater dividend payouts – all of which should provide further fuel to stock markets to head higher.

More upside for stock markets

Although equity markets defied gravity and posted gains last year, valuations are still not demanding. The growth prospects for companies also look promising. While profit growth over the past two years was aided by cost cutting measures, going forward, earnings growth should emanate to a greater extent from rising revenues helped by recovering economies. Unlike cost cuts, earnings growth coming from revenue improvements is more sustainable and this should help to boost investor sentiment towards stock markets. Also, liquidity remains abundant and this should serve to fuel buying interest in equities. Overall, we expect equities to outperform bonds this year and see stock markets benefiting from a shift in asset allocation away from bonds towards equities.

Key risk factors

The European debt crisis and austerity measures to rein in fiscal deficits in the region will cause intermittent uncertainties and volatility in stock markets.

Inflation, especially in Asia, is another risk that investors ought to be wary about. While we are positive on Asia, we are also aware that the fight against inflation by the region's central banks may cause markets in the region to be even more volatile this year. Nevertheless, we are confident that Asian markets should end the year on a higher note compared to where they were at the start of the year.

Implications for Investors

We are positive on the outlook for equities this year and think that investors with the risk appetite should not shy away from stock markets. This is not to say that we see markets going up in a straight line. Uncertainties and volatility will continue to cause markets to be choppy. However, we see sharp pullbacks as an opportunity to buy. Also, while we are sanguine on equities, we are not suggesting that investors throw all their funds into equity markets. Prudent asset allocation calls for some representation of bonds in investors portfolios; and in the bond universe, we see selective opportunities among short duration, emerging market and high yield bonds.

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