CAPITAL WATCH

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Message from IPP

Since the low in March, global stock markets have had a good run with minor correction at times. On the economic picture, we see improvement and confidence has clearly returned to the market on the back of a reasonable set of corporate earnings in the first two quarters. We have averted a meltdown in the financial and credit system. However, we remain watchful and concerned with the risks that are still out there. Household debt in the US is still above 130% of income and foreclosures are still rising with no end in sight.

Financial write-downs globally are still less than half of what the IMF has projected, which means there are still lots of skeletons in the closet. Delinquencies in the US commercial real estate market are rising in an unabated manner.

Valuations of global stock markets are no longer cheap with the massive rally in the market. Most of the markets are trading at fair value. On the technical front, we are expecting a correction globally, possibly in the range of 20%.

In conclusion, we have gone from a testing period where our financial system almost broke down into a period where we are still in severe global slowdown. Investors should continue to remain cautious amidst this Great Recession, as the bear is likely still lurking around, waiting for the next opportunity to pounce at the bull.

Albert Lam
Investment Director
IPP Financial Advisers Pte Ltd

IPP House View

Inside This Issue

Fundamentals

Positive

- Price-to-earnings of equities have reached historical averages, while price-to-book remains attractive. Current ratios may not have discounted prolonged economic slump. Expect long-term recovery to be anaemic.
- Major central banks are likely to maintain loose policies, for now. Fiscal liquidity and government guarantees have triggered equities rally; full positive impact takes time but could risk inflation.

Negative

- European banks have not revealed full exposure to peripheral economies.
- Deutsche Bank analysts warn US “underwater loans” to rise to 48% or 25 million homes.
- New home sales in the US rose 11% year-on-year, but on declining value (-18% year-on-year); US homes remain overvalued.
- IMF raised forecast of global loan and securities losses at US$4 trillion by end-2010.
- Watch for further downgrade in credit rating, asset value, dividend payout, earnings forecast and GDP growth. Capital hoarding chokes both leveraged and cash-starved companies and emerging countries. Other threats of protectionism (trade, jobs) get more prevalent and negative.

World In Perspective

Economic and Market Overview

Globally, equity markets performance were mixed in August with Chinese equity market seeing a correction of over 10%.

The Chinese stock market took a breather in August as Premier Wen Jiabao cautioned against being 'blindly optimistic' despite improvements in the economy. Amid news that the Chinese banks would curb lending, Mr Wen promised to stick to policies meant to boost domestic demand and maintain credit availability.

Chinese banks are expected to slow down in lending in 2H 2009. Data agency, EPFR Global reported that investors pulled $810 million from Asia ex Japan funds in the third week of Aug.

Investors have grown increasingly worried that an asset bubble may be forming in China, fueled by its 4 trillion yuan stimulus package and an aggressive state-directed lending programme which has led banks to loan out 7.4 trillion yuan in the first six months of the year. The onslaught of easy cash has helped propelled a meteoric rise in the Shanghai stock market as an estimated 20% of loans were channelled into stock investments. In some ways, the sell-off on the Shanghai stock exchange is a natural, even healthy correction after a spectacular run. The Chinese banks are expected to loan out 10 trillion yuan this year, and having met nearly three-quarters of the quota, China banks are anticipated to slow down in lending in the second half of the year. Investors likely took the opportunity to cash in on gains.

In the third week of August, funds that invest in emerging-market stocks worldwide lost $946 million, while China funds had their worst week since the first quarter of 2008, according to data agency EPFR Global. Investors pulled $810 million from Asia ex Japan funds, the most in 24 weeks[1].

Over in the developed economies, improving (less negative) economic data have boosted asset prices throughout August. Data ranging from improving PMI in eurozone to increase in US housing starts were perceived positively by investors.

Technical readings suggest the current rally to likely take a breather before year-end.

No doubt investors' sentiment has improved, however, we prefer a more cautious approach. Technical readings suggest the current rally to likely take a breather before year-end. But the rally may still continue for a while.

We maintain our view that while some regions may have seen their financial markets bottomed out, others are likely to see corrections in the coming months. We hence propose clients not to take an all or nothing approach. Instead, continue with RSP so as to dollar cost average and avoid timing the market, and keeping some cash handy for deployment when opportunities arise as market corrects.

The present market conditions present an excellent opportunity for aggressive clients with a 3-5 year investment time frame to accumulate at attractive valuation and reap potentially good returns when the market recovers.

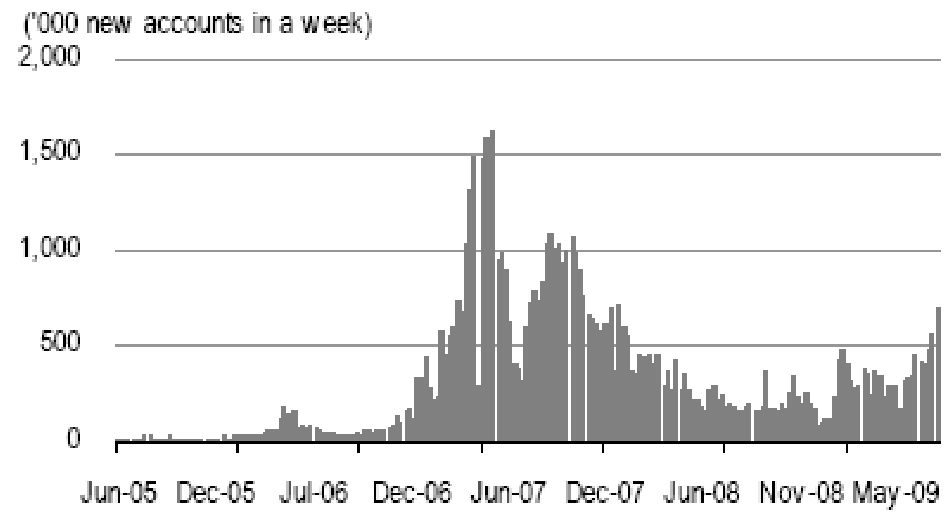
Our view remains that the present market conditions present an excellent opportunity for aggressive clients with a 3-5 year investment time frame to accumulate at attractive valuation and reap potentially good returns when the market recovers. Those who prefer to go slow and steady can consider participating in the market through regular savings plan.

[1] *Bloomberg, "Emerging-Market Funds Post Biggest Outflows of 2009", 21/08/2009*

World In Perspective

Speculative fever is back in China… Number of new broking accounts being opened has seen an increase since the start of this year.

Figure 5: Retail investors are back

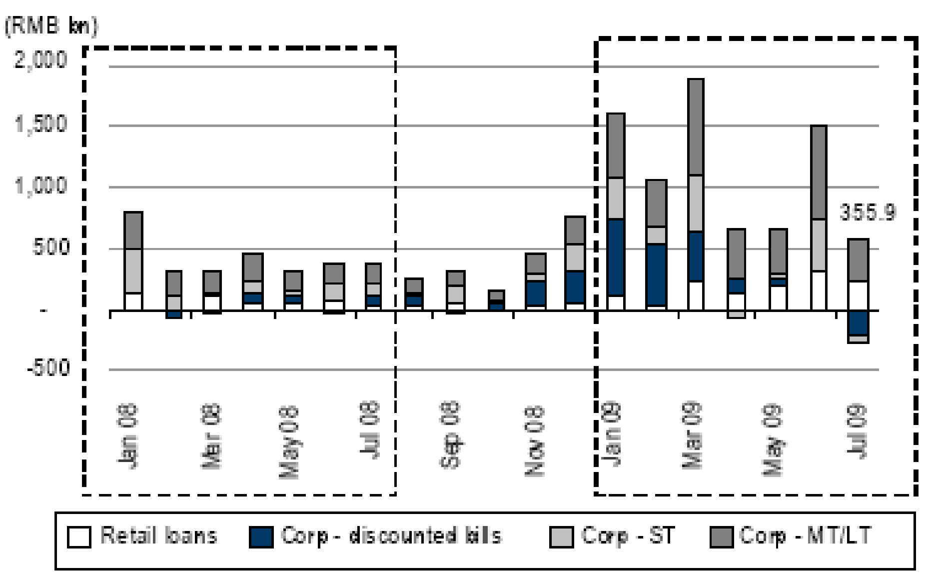


Source: WIND Database

Source: Credit Suisse

China reins in lending momentum as a first measure to control risks of overheating…

Figure 1: Monthly new loans (Rmb bn)



Source: PBC, Credit Suisse

US Update

The US equity markets continued its uptrend in August. Housing activity data seems to indicate stabilization after a 3-year slump.

The US equity markets continued its upward trend in August. The Dow Jones Industrial Average (DJIA), S&P 500 and Nasdaq Composite gained between 2% to 4%, a smaller increase versus July's appreciation. Improving economic data has been streaming from the US government reports, boosting investors' confidence that the US may be out of recession by the end of the year. Housing activity data seems to indicate stabilisation after a 3-year slump. Federal Reserve Chairman Ben Bernanke has been confirmed his re-appointment as Chairman for a second term. The continuity in leadership was positively received by investors.

New single-family housing starts in July were estimated to have increased by 1.7%. S&P Case-Shiller home price index showed that home prices gained 2.9% in 2Q, though year-on-year, it declined 14.7%.

New single-family housing starts in July were estimated at 490,000 which is an increase of 1.7% above the revised figure for June. The figure for housing starts in June has been revised from 582,000 to 587,000[2]. Sales of new single-family houses in July were at a seasonally adjusted annual rate of 433,000 according to estimates released by the US authorities. Though 9.6% above the revised June figure of 395,000, this is still 13.4% lower on a year-on-year (July 2008's estimate was 500,000) basis. The gain was the biggest since February 2005. The median price of a new house sold in July was US$210,000 while the average was US$269,200. The seasonally adjusted estimate of new houses for sale at the end of July was 271,000 and presents a supply of 7.5 months at the current sales rate[3]. S&P Case-Shiller home price index showed that home prices gained 2.9% in 2Q while year-on-year change put it in a decline of 14.7%. The 20-city composite index showed house prices gaining 1.4% in June[4]. Overall housing economic data buoyed the market in August.

Though home sales and prices seem to have improved, the housing sector is unlikely to see a sharp rebound. We continue to monitor the housing situation in the US closely as housing starts data is a sign of the commitment of builders to new construction activity. This in turn can indicate whether growth in the housing sector is returning.

Although the housing situations seems to be improving, foreclosures are still rising. According to MBA, over 13% of American homeowners are either late on their mortgage payments or in foreclosures as more people become unemployed.

Although the housing situation seems to be improving, the number of foreclosures is rising. According to the Mortgage Bankers Association (MBA), over 13% of American homeowners are either late on their mortgage payments or in foreclosure as more people lose their jobs. As of June, more than 4% of all borrowers were in foreclosure while about 9% had missed at least one installment. Loan delinquencies among borrowers with prime, fixed-rate mortgages increased from 1Q to the 2Q in all 50 states in the US[5]. Meanwhile, experts opined that delinquencies on commercial real estate loans remain a potential trouble spot.

[2] US Department of Housing and Urban Development, Press Release, 18/08/2009
[3] US Department of Housing and Urban Development, Press Release, 26/08/2009
[4] S&P Residential Real Estate Indicators, August 2009
[5] The Associated Press, "Mortgage delinquencies hit record high in Q2", 20/08/2009

US Update

The number of banks seized by US regulators is 77 year-to-date. The average cost to FDIC to wind up failing banks over the past 19 months has increased.

Last month we reported that 69 US banks had failed year-to-date. More have followed suit, and as of third week of August, 77 banks have been seized by US regulators – the most since 1992 at the height of the savings-and-loans crisis. The Federal Deposit of Insurance (FDIC) expects bank failures will cost the fund around US$70 billion through 2013. The average cost to FDIC to wind up failing banks over the past 19 months has gone above the cost incurred during the savings-and-loans crisis. Many of the banks that have been shut recently were brought down not by complex mortgage products, which buttress that loan delinquencies remain a cause of concern.

We maintain that the US financial sector seems to have stabilised, with the collapse of the US banking system being less of a threat. Banks' books also remain saddled with other types of loans that could spell trouble – consumer credit cards and loans, commercial loans.

Initial unemployment benefit claims data for the week ending 15 August was 576,000, an increase of 15,000 from the previous week.

On the employment situation, the US Department of Labour reported that the advance figure for seasonally adjusted initial claims was 570,000 for the week ending August 22. This is a decrease of 10,000 from the week ending August 15, which saw revised figure of initial jobless claims at 580,000. The 4-week moving average for initial claims was 566,250, down from the previous week's revised figure of 571,000[6].

Crude oil crossed the US$74 per barrel peak rate on 21 August, on news of inventory dip, rising equity prices and positive economic data coming from Europe; thus raising expectations of demand recovery as the economic situation seemingly improves.

After consecutive dips in June and July, the Conference Board Consumer Confidence Index ® rebounded in August.

The Conference Board Consumer Confidence Index® rebounded after retreating in June and July. The Index gained 6.7 points and now stands at 54.1 in August[7]. After two consecutive months of decline, consumer confidence appears to be recovering as the short-term outlook on the economy appears positive. On a separate note, orders for durable goods such as appliances, planes, automobiles and computers increased nearly 5% in July. The sales figure confirmed a subtle but evident shift in consumer confidence about the economy.

Auto production, a component of the industrial production report, surged 20.1% on a monthly basis in July, as the Cash-for-Clunkers program spurred demand. If we strip out car production, industrial production would have declined by 0.1% on a monthly basis in July[8]. Therefore the sustainability of manufacturing rebound remains uncertain and is expected to be sluggish.

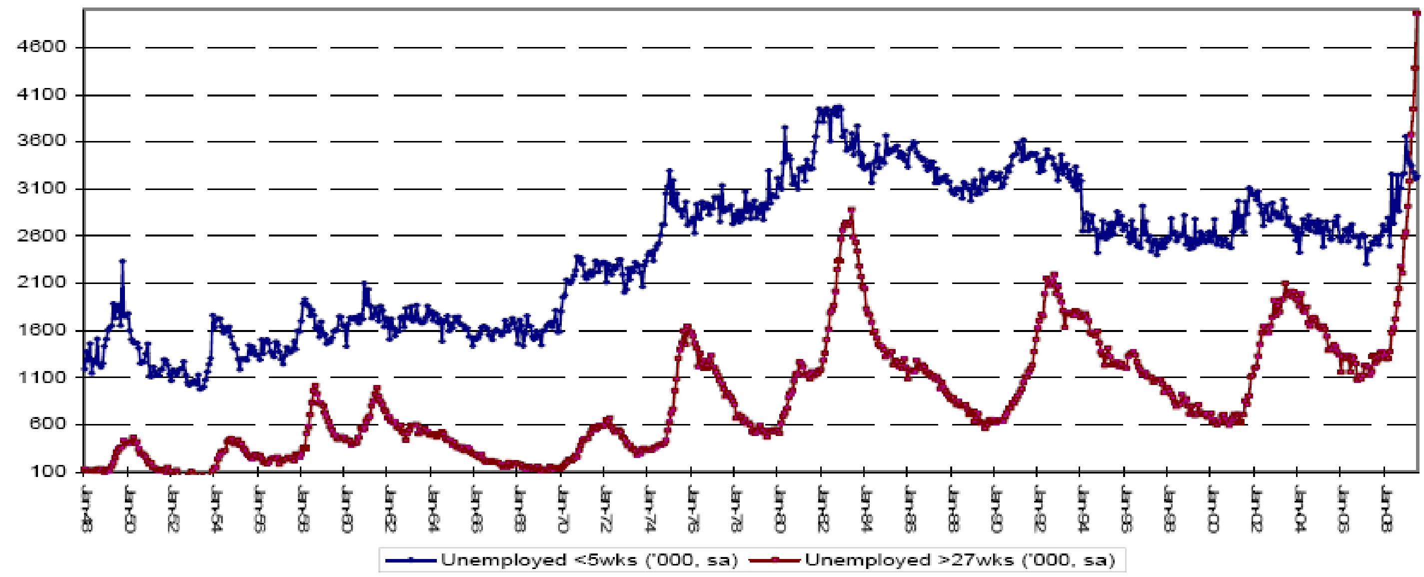
In the short-term, our outlook for the US is negative.

[6] *US Department of Labour, Unemployment Insurance Weekly Claims Report, 27/08/2009*
[7] *The Conference Board, Press Release 25/08/2009*
[8] *FFTW Weekly Commentary, week ending 21/08/2009*

US Update

Disturbing trend – US jobs that could be lost for an indefinite period of time.

Numbers Unemployed in terms of Duration



Source: Bureau of Labor Statistics

UK & Europe Update

European bourses also rose in August.

European bourses also continued to climb higher in August. The major markets of the UK, Germany and France gained between 2% and 7%. Positive economic data coming from the eurozone not only boosted local markets, but also spread the positive spirit to the US markets.

Germany and France's economic output both rebounded in the 2Q. Their GDP expanded 0.3%. However, overall Eurozone's economic growth fell 0.1%, showing the region as a whole is still in recession.

Germany and France both reported rebound in their 2Q GDP growth, surprising observers and investors alike. Germany reported growth of 0.3% in 2Q, ending a four-quarter recession. The rebound followed a sharp drop of 3.5% in 1Q GDP. France's 2Q GDP also expanded 0.3%[9]. In comparison, the UK looks to be in poor shape as its economy shrank 0.8% in 2Q. Meanwhile, the Netherlands, Italy and Austria also reported contraction in their 2Q economy. 2Q GDP shrank by 0.9%, 0.5% and 0.4% respectively for the Netherlands, Italy and Austria. Overall, Eurozone's economic activity fell 0.1%, showing the region as a whole is still in recession.

Eurozone services and manufacturing PMI both in August. Despite improvement in the PMI reading, we remain cautious of the economic recovery prospects in Europe as the PMI are still below the expansion level of 50.

Eurozone services Purchasing Manager Index (PMI) rose to 49.5 in August from 45.7 in July while manufacturing PMI is 47.9 in August, up from 46.3 in July[10]. Despite recording improvement in the PMI reading, we remain cautious of the economic recovery prospects in Europe as the PMI are still below the expansion/contraction threshold of 50. This indicates possibility of continued recession conditions in both manufacturing and service sectors. The stimulus packages rolled out by the governments will also exert their toll on budgets, while unemployment is likely to continue ascending.

In terms of business confidence, Germany, one of the largest economies in Europe has seen a second month of improvement in its business confidence survey. The Ifo Business Climate for industry and trade in Germany improved again in August[11]. The firms have assessed their current business situation clearly less negatively. However, when compared to conditions a year ago, the situation of the firms is still considerably worse at the moment.

UK home prices rose for the fourth consecutive month in August. BOE would be further enhancing its asset purchase programme by £50 billion, to be completed within the next three months.

Turning to the housing situation in the UK, home prices rose for the fourth consecutive month in August. On a seasonally adjusted basis, the increase was 1.6%. Compared to a year ago, house prices remain 2.7% lower, which is also an improvement. The seasonally adjusted index of house prices has risen by 3.2% year-to-date. The average price of a house is £160,224, versus a year ago average price of £158,871[12].

Last month we wrote that the Bank of England (BOE) had approved an asset purchase programme totaling £125 billion. BOE in its August's meeting proposed and approved a further financing of £50 billion of asset purchases by the creation of central bank reserves. This implies a total of £175 billion of asset purchases run by the BOE, and it seeks to complete the additional purchases within the next three months. This initiative would provide additional liquidity in the market.

[9] *CnnMoney.com, "Germany, France pull out of recession", 13/08/2009*
[10] *The Wall Street Journal, "Europe's stocks rally on PMI data", 21/08/2009*
[11] *Ifo Business Climate Germany, August 2009*
[12] *Nationwide, House Prices, 27/08/2009*

UK & Europe Update

UK unemployment was 7.8% for the three months to June, up 0.2 percentage point from the previous three months.

UK unemployment rate was 7.8% for the three months to June 2009. Unemployment rate was 7.6% for the three months to May 2009. The number of unemployed people increased by 220,000 over the quarter and by 750,000 over the year, to reach 2.43 million. The claimant count, which measures the number of people claiming Jobseeker's Allowance, reached 1.58 million in July 2009. This is 24,900 higher than the previous month and up 709,000 over the year. The claimant count rate was 4.9%, up 0.1 percentage point from June and up 2.2 percentage points from a year earlier[13].

CLIs for France, Italy, UK and Germany all rose in June.

The Composite Leading Indicators (CLIs) show stronger signs of improving economic outlook. The Euro area^ CLI rose by 1.5 point in June but was 1.6 points lower than in June 2008. France and Italy's CLIs increased by 1.4 and 2.2 points respectively in June, and are now above the level reached a year ago. UK's CLI rose by 1.1 point in June 2009 but was 0.9 point lower than in June 2008. Germany's CLI rose by 1.7 point in June but was 6.6 points lower than in June 2008[14].

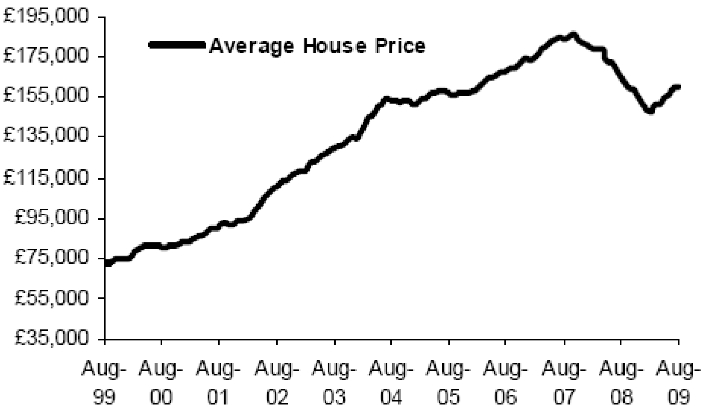
Our outlook for Europe is negative.

[13] Office for National Statistics, Labour Market Statistics, 12/08/2009
[14] OECD Composite Leading Indicators, News Release, 07/08/2009

^ *The* ***Euro area*** *(only Euro area countries that are members of OECD) covers the following 12 countries: Austria, Belgium, Finland, France, Germany, Greece, Italy, Ireland, Luxembourg, the Netherlands, Portugal, Slovak Republic and Spain.*

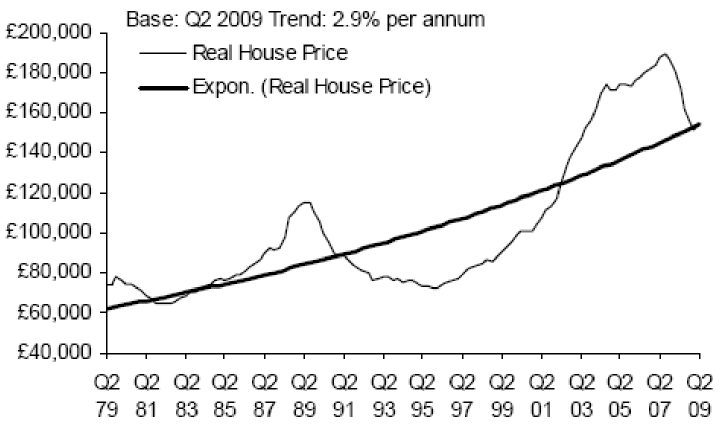
UK & Europe Update

Average UK House Price

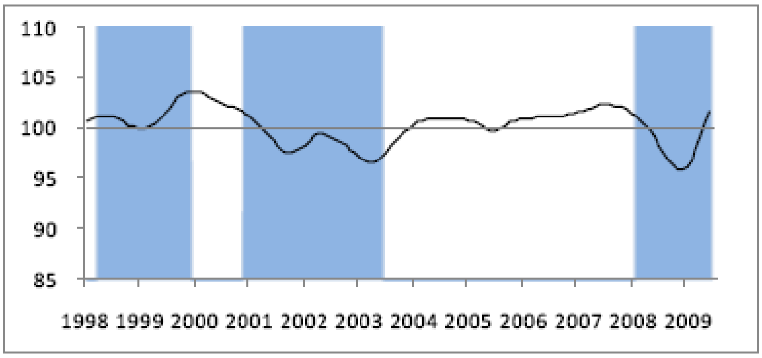


Source: Nationwide

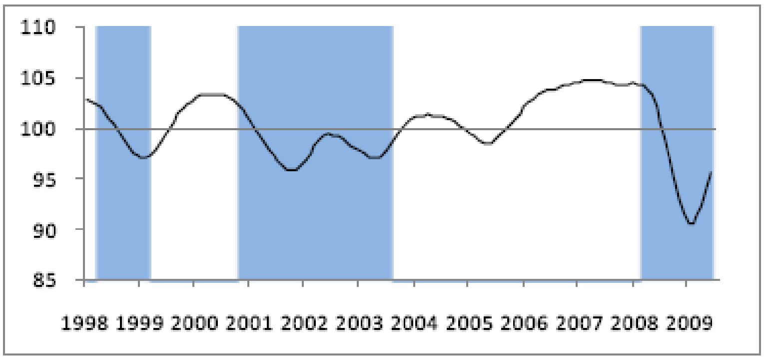
Long Term Real House Price Trend



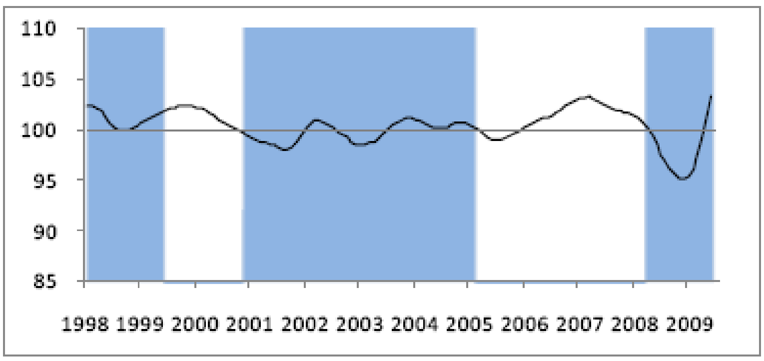
Recovery in France



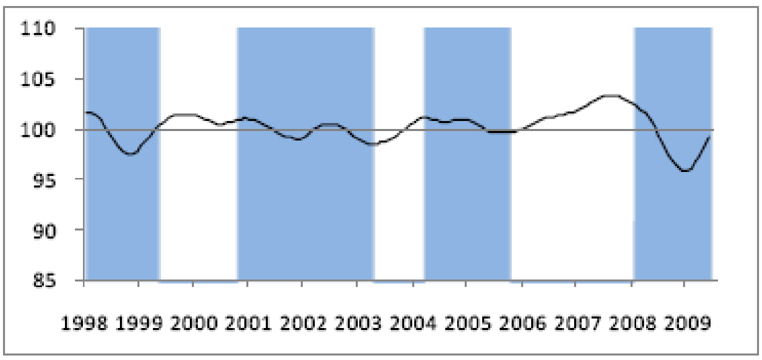
Trough in Germany



Recovery in Italy



Trough in the United Kingdom



Source: OECD

Asia / Emerging Markets Update

China was on a correction streak in August. Other emerging markets such as Brazil, India, Mexico and Russia posted gains.

Performance of Asia and Emerging Markets stock markets were mixed in August. The Chinese market corrected in August, bringing down the related economies of Taiwan, Hong Kong and Singapore. The Shanghai market is in a technical bear after falling 21.8% in August. Taiwan, Hong Kong and Singapore fell 2.66%, 3.95% and 1.68% respectively. After a strong run in the Chinese market, it is not surprising to see some profit taking, and a correction could be viewed as healthy. Other emerging markets such as Brazil (+3.15%), Mexico (+4.03%) and Russia (+4.84%) were positive in August.

In the August issue, we wrote about the improvements in the real economy of China, Indonesia and Singapore. Malaysia and Thailand are the latest Asian countries that have news regarding improving signs (though the data is still negative) in their economies.

Malaysia's economy contracted at a slower rate of 3.9% in 2Q on higher public spending and positive growth in private consumption. CPI was lower in 2Q at 1.3%. Credit conditions have been relatively healthy.

The Malaysian economy contracted at a slower rate of 3.9% in 2Q 2009 (the economy contracted 6.2% in 1Q 2009). Higher public spending and positive growth in private consumption drove the improvement in the reading. However, growth continued to be affected by weak external demand as real net exports of goods and services fell by 0.7%. All key sectors of the economy saw improvement in 2Q with the services sector registering growth of 1.6% (versus negative growth of 0.2% in 1Q) as the financial sector picked up. Manufacturing is still underperforming albeit at a slower pace, with a fall of 14.5% (versus decline of 17.9% in 1Q). Inventory re-stocking that took place widely in 2Q likely contributed to the slower pace of manufacturing decline.

The Consumer Price Index (CPI) was 1.3% in 2Q (versus 3.7% in 1Q). Lower food and transport prices resulted in the lower CPI reading. Bank Negara has kept the overnight policy rate unchanged at 2% in 2Q. Credit conditions in Malaysia is relatively healthy, with the total gross financing raised by the private sector through the banking system and capital markets higher at RM183.4 billion in 2Q (RM157.4 billion was raised in 1Q)[15]. Monetary conditions have been relatively accommodative since end-2008. Overall loan applications, approvals and disbursements were also higher compared to the previous quarter.

Bank of Thailand maintained its policy rate at 1.25%. Manufacturing resumed growth on a quarterly basis, expanding 6.2%.

Thailand emerged from recession in the second quarter as manufacturing grew and the government boosted spending. Thailand, Southeast Asia's second largest economy fell into recession in 1Q following contractions in the last two quarters of 2008. Manufacturing resumed growth on a quarterly basis, recording an expansion of 6.2%. Thailand exports a myriad of goods including cars and electronics. GDP fell 4.9% but was an improvement over 1Q's contraction of 7.1%. The National Economic & Social Development Board expects the Thai economy to contract between 3% and 3.5% in 2009[16]. The Bank of Thailand maintained its policy rate at 1.25%, it has been at this level since May.

[15] Bank Negara Malaysia, Economic and Financial Developments in Malaysia in the Second Quarter of 2009, 26/08/2009
[16] The Associated Press, "Thai economy emerges from recession in 2Q", 24/08/2009

Asia / Emerging Markets Update

Singapore's July manufacturing output increased 23% (including the volatile biomedical sector).

Visitor arrivals declined at a lower rate in July, while the key markets of Hong Kong, Malaysia and Vietnam saw double-digit growth.

Jobless rate in Japan hit 5.7% in July. Core consumer prices fell 2.2%, following falls in May and June. Exports also fell as lesser cars were shipped out.

Singapore celebrated its forty-fourth year of independence in August and in a speech, Prime Minister Lee Hsien Loong expressed cautious optimism that the worst is likely over for our local economy and that the labour market has stabilised. Manufacturing in July saw output increasing 23% on a seasonally adjusted month-on-month basis. Excluding the volatile biomedical sector, output rose 7.7% in July which is encouraging. On an annual basis, manufacturing output rose 12.4% in July and output actually contracted by 7.4% if biomedical sector was stripped out. Manufacturing remains fragile as cumulative output in the first seven months of this year contracted by 10.3% versus the same period a year ago.

On tourism, although visitor arrivals to Singapore showed a 4.5% decline year-on-year in July. The fall is the smallest year-on-year recorded this year. 881,000 visitors came to Singapore in July and key markets Hong Kong, Malaysia and Vietnam all registered double-digit growth in July. Visitor arrivals from these countries were up 18.2%, 14.9% and 11.2% respectively, mainly due to attractive promotions put up by the Singapore Tourism Board.

Japan, the second largest economy in the world, saw its jobless rate rose to 5.7% in July. Jobless rate was 5.4% in June. Following falls in May and June, Japanese core consumer prices fell again in July, hitting a record 2.2%, worsening the deflation situation. The drop in the core consumer price index, which excludes volatile fresh fruit, vegetable and seafood prices but includes those of oil products, matched market's forecast and was larger than June's 1.7% fall in consumer price. July also marked the fifth straight month of annual falls. In what seemed to be an indicator that the impact of stimulus measures in major economies seems to be waning, Japan saw exports falling 1.3% in July. Compared with the same period a year ago, Japanese exports declined 36.5% in July, and worse than the 35.7% annual decline in June. Slower shipments of cars to the Middle East, Russia and the US contributed to the faster annual rate of decline in exports.

We maintain our view that Asian equities have gained substantially as risk appetite increased over the previous months. As such, Asian equity markets are no longer as cheap as early this year. Overcrowding risks exist, expect volatility in the coming months.

Despite the challenges that lie ahead of Asian and emerging economies, we remain positive on these regions over the mid- to long-term. Asia and the emerging markets continue to see positive GDP growth forecasts, domestic consumption demand, well-buffered foreign exchange reserves and high productivity.

We continue to suggest including funds invested in Asia and Emerging Markets for long-term investment purpose. In the short term, these markets will be volatile as financial markets work their way out of previous years' of excess leverage and global growth crawls.

We are positive on Asia and Emerging Markets.

Asia / Emerging Markets Update

Table 1 shows the ten largest developing countries' populations and their respective share of the world population, GDP and market capitalisation. Although an increasing labour force does not necessarily translate into higher prosperity, labour participation rate is one of the factors driving GDP growth. If these emerging economies can boost their income per capita, the large populations will help in boosting their share of the global economy and eventually upping the market capitalisation.

TABLE 1
Demographics, GDP And Market Capitalization: Relative Shares In World

	As Of 2010			Current
	Total Population* (Mn)	Share Of World Population	Share Of World GDP At PPP**	Share Of World Equity Market Cap***
China	1354.1	19.6%	13.6%	2.31%
India	1214.5	17.6%	5.5%	0.85%
Indonesia	232.5	3.4%	1.4%	0.22%
Brazil	195.4	2.8%	2.9%	1.84%
Pakistan	184.8	2.7%	0.6%	0.01%
Russia	140.4	2.0%	3.2%	0.70%
Mexico	110.6	1.6%	2.2%	0.55%
Philippines	93.6	1.4%	0.5%	0.06%
Vietnam	89.0	1.3%	0.4%	0.01%
Turkey	75.7	1.1%	1.3%	0.18%

* Source: United Nations Population Division
** Purchasing power parity
*** Source: MSCI Inc. (see last page)

Source: BCA

Potential Risks

- S&P may slash credit ratings of US$235 billion debt backed by US commercial property.
- The US and UK residential housing risk further downside on lofty value, inventory level, massive household debt and rising unemployment.
- US unemployment inched higher to 9.4% (July statistics), bringing total unemployed to >6 million. Unemployment in the US and Europe is still a serious impediment to economic recovery.
- IMF expects credit card default rate in the US to hit 14% (of total US$1.9 billion); in Europe, the rate is a lower 7% (but on a higher total of US$2.5 billion).
- Deflation affects many economies. But after deflation, inflation represents a serious problem, which requires protection via commodities.
- Weakening economic condition in emerging Europe, where credit ratings have been slashed to junk, could trigger regional contagion.
- RBS expects 1,000 US financial institutions to go bust.
- Beware of further cash calls and asset impairment charges.
- Gyration in currencies (especially those of emerging markets) and currency war (bouts of devaluation) wreaks havoc in equities. Recent meeting of BRIC economies hints further diversification away from US$, placing the greenback structurally at risk. Gold remains safe haven.