



MARKET REVIEW 2010 & GLOBAL OUTLOOK 2011



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2010 was again a fascinating year. The global economy survived another year coming out of the crisis of 2008. It behooves us to remember that the crisis was the biggest to hit since the Great Depression and on certain days in 2008/9, financial Armageddon was a distinct possibility.

At the beginning of 2010, we wrote that there were broadly four possible scenarios for the coming year.

The first is Super Bullish. In this scenario, stimulus money continues to flow and there is low inflation. Liquidity shifts from low-risk assets to high-risk assets. Equities outperform fixed-income by a margin.

In the second scenario, the stimulus is gradually withdrawn. Momentum is carried into the first half of 2010. Equities outperform but are muted by rising fixed-income yields.

The third scenario sees bond yields spiking, stimulus being withdrawn and demand failing to materialise. Equities and fixed-income perform poorly.

The final scenario may be classified as an Absolute Nightmare. Here we see the withdrawal of monetary stimulus leading to deflation and the infamous double-dip. It is back to 2008 once again.

We felt that on balance, the second scenario would look the most likely.

Thankfully, the year has come and gone and there was no double-dip. In the end, things turned out pretty close to scenario two and were better than most expectations. Most investors made money in equities as well as commodities. Gold also rose on the back of weakness in the USD.

WE ALSO WROTE ABOUT THE POTENTIAL MINEFIELDS IN 2010.

Sovereign debt continued to make headlines. Workers took to the streets in France to protest against the extension of the official retirement age by a mere two years. In the UK, students took to the streets to demonstrate against the increase in university fees by threefold. All over Europe, governments were met with outrage as they turned in the screws of austerity, reminiscent of Iceland not so long ago. The tiny country first came to prominence as the first country casualty of the global financial crisis. Drastic measures were implemented, and last year, the Icelandic Krona appreciated 9.16%, just a small fraction behind the Singapore Dollar's appreciation of 9.6%.

Unemployment globally continued to be a drag on household incomes, though signs emerged in the US that the rate of unemployment was actually falling. Firms were actually hiring again. Similarly, housing markets were lethargic. But here too, things were not getting worse and perhaps a bottom had been reached. Given that stimulus money takes a bit of time to find its way into the real economy, these are encouraging signs.

Another potential headwind in 2010 was the trade wars. There was some fear that after the initial co-operation and joint efforts by the leading global economies to fight the crisis, complacency and self-interest might creep in. In this regard, the G7 or G8 has now expanded to become the G20, which includes the emerging economies. China in particular has also been given more say in global affairs via the International Monetary Fund. Hence, while some trade barriers were erected, these were not significant and hopefully rational decision-making by politicians will continue to prevail.



Instead, wars of a different kind threatened to de-rail global recovery. Central banks and finance ministers traded accusations. Most notable were voices from Brazil. Certain sections in the US administration were keen to label China a currency manipulator and pushed for the Renminbi to appreciate more against the USD. If they had pushed through the agenda, it would have dealt a significant blow to global trade. Tensions continue to run high. It would not have been lost on the Chinese that the US had pursued a similar policy with the Japanese currency in the 80s. The Yen appreciated a phenomenal 300% from 1980 to the 1990s. The Japanese economy has been anaemic since.

As a matter of interest, there was a tie for the best performing currency against the US Dollar. The Yen, not unexpectedly, appreciated 14.78% against the greenback. The second place finisher might surprise many. The Mongolian Tugrik rose 14.77%. Following close behind were the Australian Dollar at 13.98% and the South African Rand at 11.31%. One would not have failed to notice that these are resource-rich economies.

Speaking of tensions, the Korean Peninsula became the centre of attention as North Korea attacked and killed four South Koreans, including two military personnel, on an island in the demilitarised zone. While the two Koreas are technically still at war, human casualties from direct assault represented a new line in the sand in the game of brinkmanship between the two neighbours.

Elsewhere, terrorism continued to rear its ugly head in extracting human toll. For a while, heightened security measures at US airports became a talking point. Most air travellers now accept that these increased checks bordering on invasion of privacy, is the price we pay for living and travelling in the modern world.

Nature played a big role last year in the form of volcano eruptions and snow. Many passengers were stranded as airports in Europe and the US ground to a standstill and billions of dollars were lost. Snow also froze transportation in many US cities during the post-Christmas period that traditionally contributes a significant portion to consumer sales. In the end, the numbers indicated that the US consumer was buying more despite the setback. US equity markets rose close to 10% in USD terms.

GOING INTO 2011, MORE OPTIMISM HAS RETURNED.

The economic recovery that has started slowly in the US may be gaining traction. It is easy to take pot shots at the US when it is down. Many are its woes and failings. But it is necessary to remember that its people are some of the most resilient, not to mention creative. Who knows what new avenues or products and services may emerge to become world players? Think iPod, iPhone, iPad, Facebook and Google. US stocks may be the most under-valued stocks and could make a comeback in 2011.

Europe continues to be mired in debt and faces tremendous challenges. But even here, the breakup of Euroland is far from certain. It is easy to forget that Emerging European equities have grown more than 20% in Euro terms.

Turning our attention to Asia as a whole, the inflow of hot money chasing returns may become an issue in 2011. This has led to many calls for currency controls. China itself has implemented various measures to try and cool its stock and property markets, including raising interest rates. The global investment community seems to maintain their faith in the Chinese economy. The Renminbi is a much sought-after currency.

Inflation poses the biggest challenge to Asian economies in the coming year. Weather will be a major factor in 2011, in determining food prices.

Gold will see some pullback after its astonishing rise. Gold bulls will do well to continue to accumulate on dips in prices.

Infrastructure and technology are other sectors to look out for.

And for good measure, investors with appetite for risk will be looking at frontier markets. Apart from BRIC, another concept that has been picked up is "The Next 11" – referring to the next economies that should do well in the coming years.

As for fixed-income, Asian bonds will offer more options for diversification. Asian high-yield is fast becoming an asset class with breadth and depth. In this regard, our Asian balanced portfolio, introduced at the beginning of last year, has garnered double-digit returns. The portfolio also consists of sufficient bond components to protect on the downside.

In a new development for retail investors, Man Investments launched a Managed Futures fund. This type of investment is capable of making returns in both up and down markets. In this regard, the Man fund has a tremendous record of double-digit returns accompanied by low volatility. It also improves diversification benefits in a portfolio of stocks and bonds.



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