

GYC Investment Update

From the GYC Investment Desk

Liquidity is preferred

Risk is clearly rising even as we get regular policy-makers meeting over the weekends to strengthen global growth and to resolve the European crisis. Various asset classes are breaking down as rising risk aversion leads to liquidity commanding a premium. Even gold, a market darling for months, has skidded (Fig 1). When investors demand liquidity, it is the return of capital, not on capital that matters. The odds of panic in the financial markets is increasing.



Figure 1: Gold prices fell, losing its status as a safe haven

Fundamental data continue to be poor. Advance estimates from PMI surveys suggest a contraction in China's factories and in the European manufacturing and services sector. China's September PMI shows continued deterioration, falling from 49.9 in August to 49.4.

Over in Europe, the growth in output from stronger economies like Germany and France is close to stagnation levels. The rest of the Eurozone contracted for the fourth successive month. This weakness is also confirmed by the latest IFO survey, which shows continued decline in business expectations¹. The current reading is the lowest since July 2009.

In the US, continued economic weakness is acknowledged by the Federal Reserve. In their recent policy meeting, they noted significant downside risk to the economic outlook amid signs of strains in global financial markets. Employment continues to stagnate (Fig 2) in the US as economic momentum is lost. Both industrial production (Fig 3) and retail sales (Fig 4) slowed.

¹ Eurozone debt crisis hits German business confidence. 26 September 2011, AFP

Macro Strategy Update

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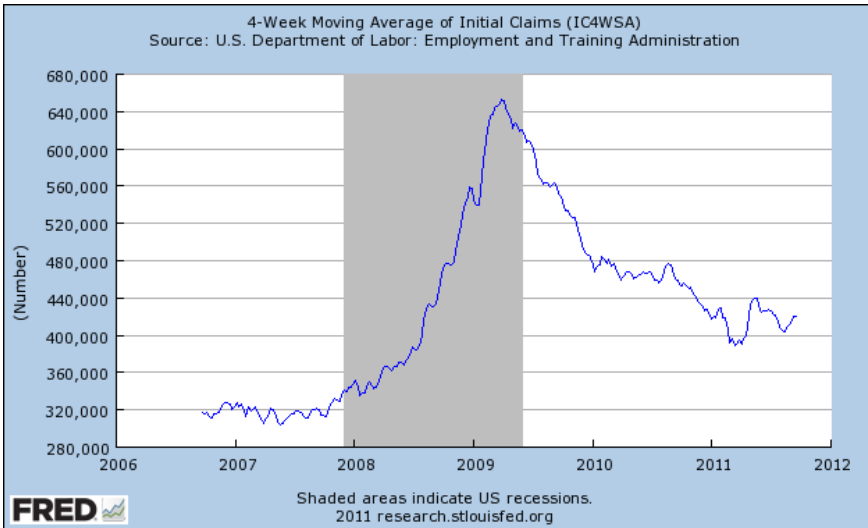


Figure 2: Weekly unemployment claims are beginning to rise

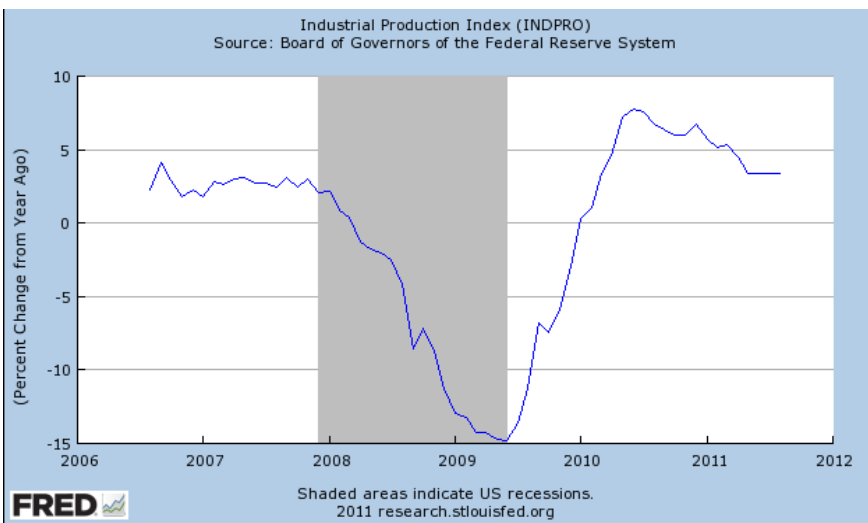


Figure 3: Industrial production growth is slowing

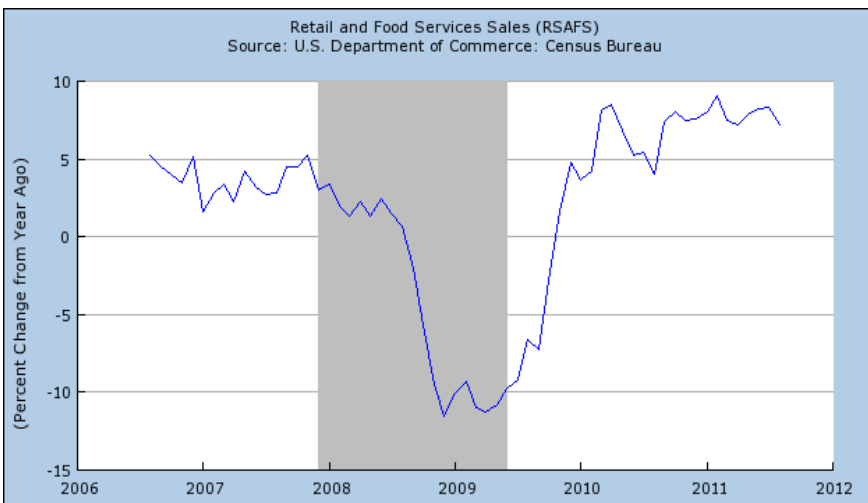


Figure 4: Growth in retail sales is turning down

Recession risk is higher, especially when the banking system is under attack. Coordinated action by the G-7 central banks to provide unlimited US dollars to European banks is a clear sign of distress for Europe. It is likely that Europe is in a recession now and this is another negative for the European debt crisis. Without economic growth, tax revenue would fall even if tax rates were to increase and collection efforts boosted. Countries would struggle to keep the balance deficit in line while the risk rises for countries like Spain and Italy where market access may be threatened.

Those counting on Germany to bail out Europe may be disappointed if Berlin continues to drag her feet in resolving the European crisis. When the German economy is growing, it is easier to sell a bailout plan to voters. However, Germany's dependence on a frail Europe looks set to weaken her own economy. With exports accounting for 40% of GDP, and with five of the top ten trading partners located in the Eurozone (Table 1), a marked slowdown or a recession looks increasingly likely for Germany. If that is the case, Angela Merkel may find it tougher to support an enlarged European Financial Stability Facility.

Table 1: Germany's Top Ten Export Destinations (% of total exports)	
France	10.1
USA	6.7
UK	6.6
The Netherlands	6.6
Italy	6.3
Austria	5.7
Belgium	5.2
China	4.7
Switzerland	4.5

Source: CIA World Factbook

Table 1: Germany's Top 10 Export Destinations within the Eurozone

It does not help that European leaders do not see the gravity of the situation. Bank runs are beginning to occur in Europe with US money market funds withdrawing dollars from European institutions. The 10 biggest funds reduced European bank assets to 42 percent of holdings, the lowest level since at least 2006, according to Fitch Ratings². Siemens, the German industrial conglomerate, moved half a billion euros in cash deposits from an unnamed French bank to the ECB³. Although it was partly due to the higher rates paid by the ECB, there were also concerns regarding the future health of the bank. Neither the Siemens Group nor the ECB commented on the report, leading one to suspect that it is true.

Bank runs occur when confidence in banks is dwindling. The authorities need to act decisively to stem a run on deposits which would undermine the banking system and paralyse the real economy. Recapitalisation is required but policy makers in Europe prefer to stick to their original plan to shore up capital in weak but small banks as identified in the last banking stress test. Despite the need for the central banks to supply a lifeline to struggling banks, the European Banking Authority continues to stick to the April 2012 deadline for recapitalisation. Unfortunately, markets and depositors may not be that patient.

Our fear is that the continued foot dragging by European policy makers will induce a panic in financial markets. Only then would Berlin and the EU be forced to take decisive action to avert a full fledged crisis in Europe, which could potentially engulf the world. In the meantime, liquidity deserves its premium and investors are advised to stay liquid.

² U.S. Money Funds Cut European Bank Debt to Five-Year Low. 23 September 2011, Bloomberg News

³ Siemens shelters up to 6 billion euros at ECB. 20 September 2011, Financial Times.

Portfolio Positions

We have just issued a recommendation to rebalance all our gManaged portfolios to be aligned with our market views. As risks are increasing, we are recommending a further reduction of our equity exposure for both cash and CPF/SRS portfolios.

For our cash portfolios, an important key strategy adopted is the inclusion of the United G Strategic Fund in almost all our portfolios. As the fund manager can move from 100% equities to 100% cash very quickly, this makes the fund ideally suited for such volatile and unpredictable markets as we are facing now. As of 26 Sep 2011, the fund is holding 35% equities with the balance mostly in cash and bonds. This means that the overall equity exposure of the portfolios (after rebalancing) would range from 14% to 34.5% depending on the portfolio type

Equity Exposure of gManaged Portfolio (after rebalancing)								
gManaged	United G Strategic - Equity Holdings							
Portfolio (cash)	100%	80%	60%	50%	40%	35%	20%	0%
A	80.0%	66.0%	52.0%	45.0%	38.0%	34.5%	24.0%	10.0%
B	65.0%	53.0%	41.0%	35.0%	29.0%	26.0%	17.0%	5.0%
C	50.0%	40.0%	30.0%	25.0%	20.0%	17.5%	10.0%	0.0%
D	40.0%	32.0%	24.0%	20.0%	16.0%	14.0%	8.0%	0.0%
A1	80.0%	64.0%	48.0%	40.0%	32.0%	28.0%	16.0%	0.0%
B1	65.0%	52.0%	39.0%	32.5%	26.0%	22.8%	13.0%	0.0%
C1	50.0%	40.0%	30.0%	25.0%	20.0%	17.5%	10.0%	0.0%
D1	40.0%	32.0%	24.0%	20.0%	16.0%	14.0%	8.0%	0.0%

Table 2: Equity Exposure of gManaged Portfolios (after rebalancing)

(see table below).

As the portfolio manager can quickly dial down to 100% cash, it can quickly reduce the overall risk of the overall portfolio - from 0% equities to 10% equities for portfolio A. Conversely, the fund can quickly dial up to 100% equities for the portfolio to take advantage of a sudden positive trend change in equities. This unique feature offers our portfolios key strategic and tactical advantages and are available to GYC clients only. We thus urge you to quickly approve the rebalancing recommendation when you receive the email notification.

To find out how you can get started on your own investment portfolio, call or email us at:

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If you would like to receive market updates, be kept updated on new product launches and investment opportunities, why not sign up to be on our mailing list?

Just send us an email with your name, NRIC, and contact number to: customercare@gyc.com.sg



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