

GYC Investment Update

From the GYC Investment Desk

Outlook for 2012

Investors will head into 2012 with a great deal of caution as policy makers and economists grapple with the high level of uncertainty that the world economy is currently facing. Investment professionals are likewise treading with caution, with expectations of a turbulent first half as a decisive resolution on the European sovereign crisis remains elusive. Given the high level of negativity, perhaps it is time to consider the contrarian view. After all, 2012 could turn out to be better than what the consensus expects.

There are three questions investors should ask when assessing the investment outlook for 2012:

1. Will the US economy rebound from the soft patch which started in the second half of last year?
2. Can Europe be stabilised or will another panic ensue?
3. Will we see the start of monetary easing in emerging economies?

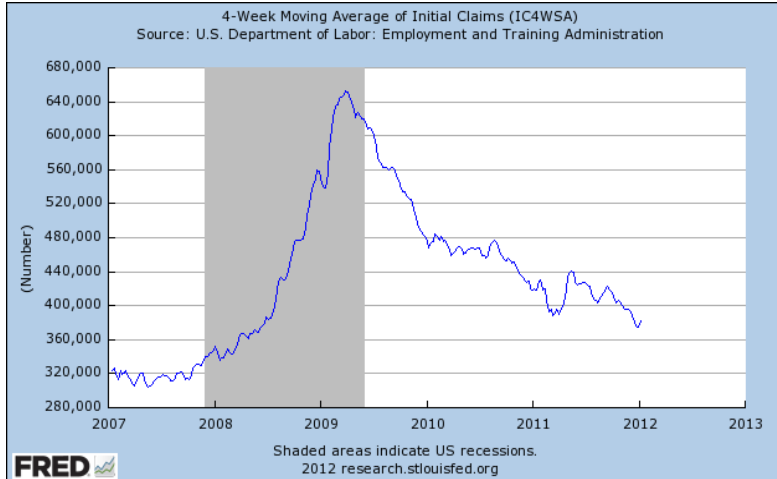


Figure 1: Initial claims for unemployment insurance has fallen below the previous low.

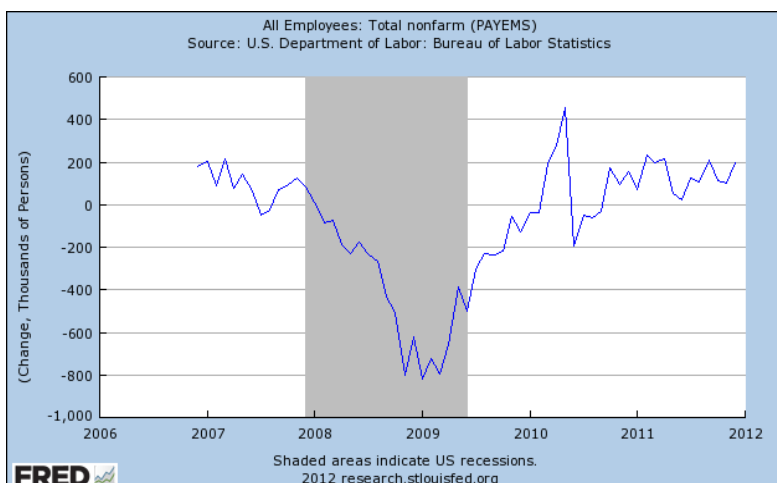


Figure 2: Jobs created hit 200,000 last month.

Macro Strategy Update

Produced by:
GYC Financial Advisory Pte Ltd

1 Raffles Place
#15-01 One Raffles Place
Singapore 048616
Tel: 65-6349 1441

After a weak second half last year, the economic data in the US is beginning to improve. Employment has begun to make significant headway as seen from the declines in unemployment insurance claims (Figure 1) and a rise in jobs created (Figure 2).

More importantly, the leading indicators of employment are showing signs of strength. "Temporary Help Services" has been gaining jobs (see Figure 3). In previous business cycles, a decline in Temporary Help Services tends to signal a downturn in the economy. As we have yet to see this happen, it means that the US economy could continue growing. Hours worked in the goods producing sector is rising, signalling more work for employees and better business conditions (see Figure 4).

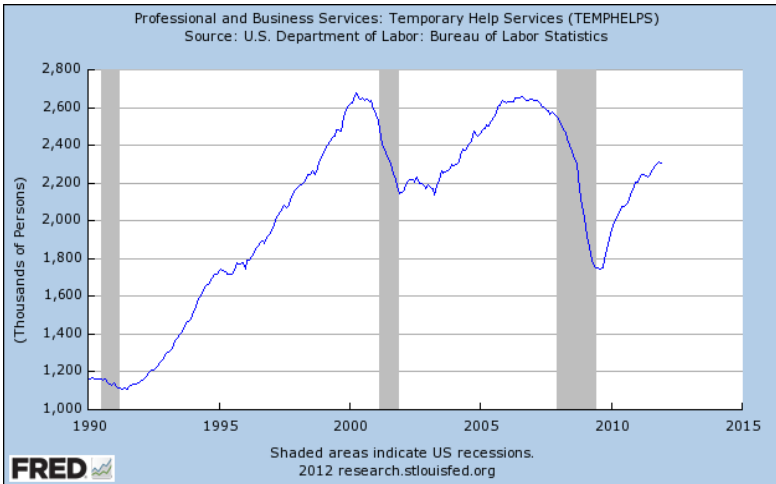


Figure 3: Rising temporary help jobs signals better employment growth.

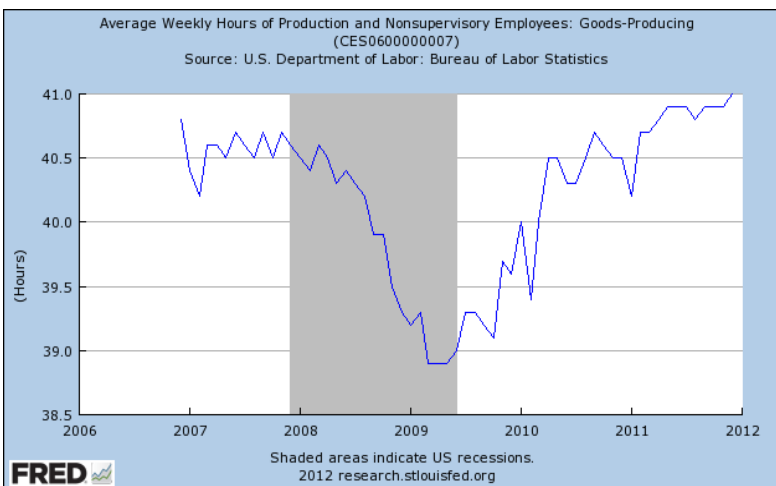


Figure 4: Average weekly hours in goods producing sector is rising.

All this positive data has contributed to a second consecutive month of improvement in the PMI. The manufacturing sector (see Figure 5) rebounded after a bout of weakness while the non-manufacturing sector (Figure 6) held steady in its expansion.

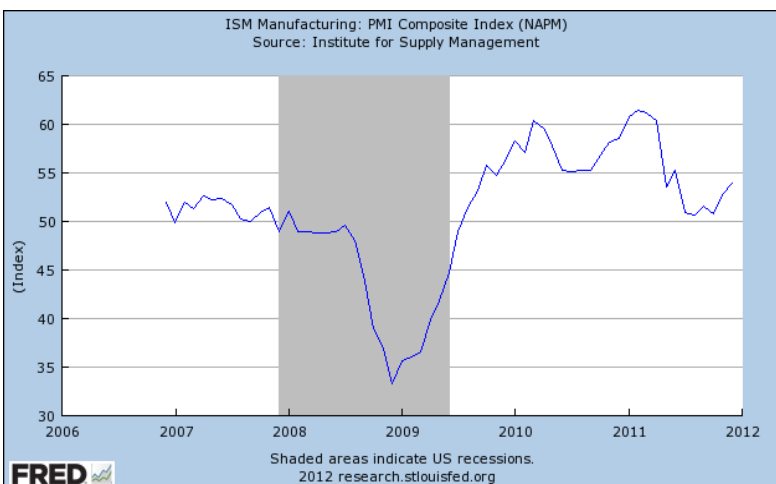


Figure 5: Manufacturing PMI rebounding.

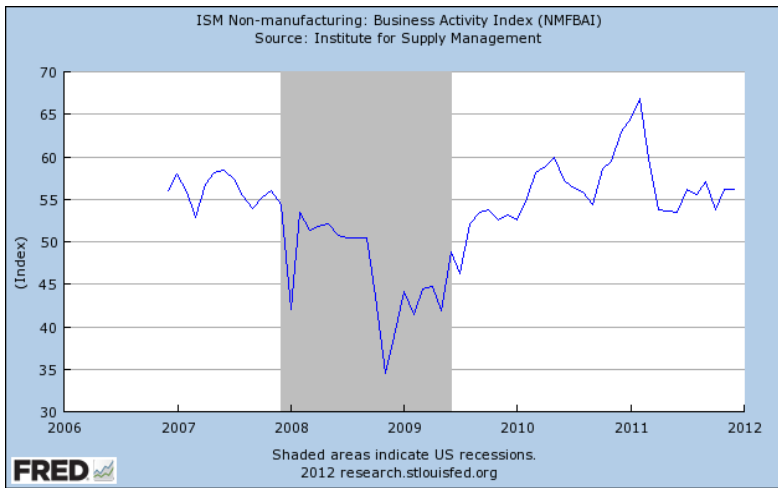


Figure 6: Services PMI continues to expand.

The stock market seems to be signalling that things may not be as bad as the consensus makes it out to be. The consumer discretionary sector has been rising steadily, making a series of higher highs and higher lows since bottoming out in October last year (Figure 7). The cyclical industrial (Figure 8) and material (Figure 9) sector are also tracing out a nice recovery.

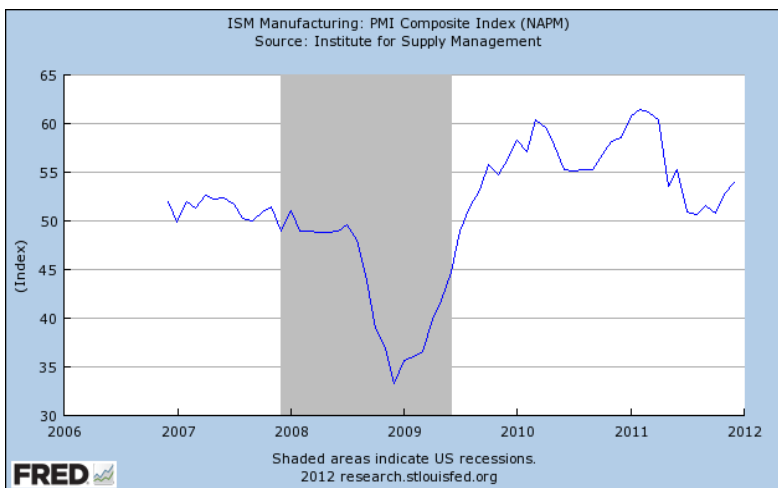


Figure 7: Consumer discretionary stocks making a good recovery.



Figure 8: Industrial stocks rising.



Figure 9: Material stocks rising.

However there are still signs that suggest that one should remain cautious. Only the industrial sector is showing relative out performance (rising against the market) while the materials and consumer discretionary sectors are underperforming (falling against the market) (see Figure 10).



Figure 10: Relative sector performance. Only the industrial sector is outperforming, while consumer discretionary and materials are underperforming.

However, things could still improve if the housing sector begins to turn around. Although housing starts have yet to improve (see Figure 11), the market seems to be signalling an improvement to the US housing sector as seen by the strong performance of housing sector equities, which is up 45% since late September (see Figure 12).

Given the mixed signals on the US economy, one should assume that economic expansion could go on for a few more quarters but that the risk of a material slowdown cannot be ruled out this year. Corporate profits seem to have peaked (see Figure 13) and a slowdown in profitability could lead to cutbacks in spending and investment.

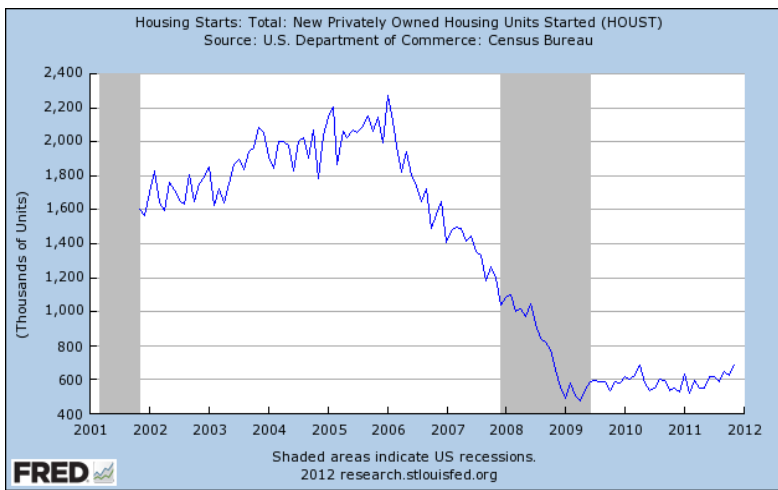


Figure 11: US housing starts still languishing.



Figure 12: Housing related equities are outperforming.

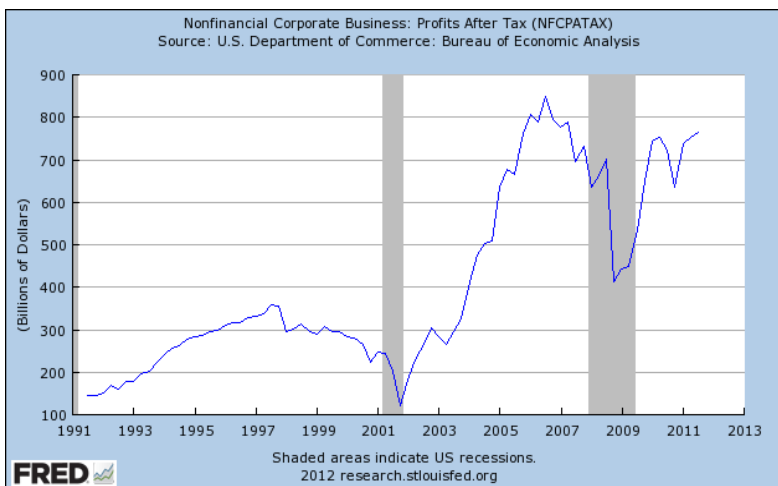


Figure 13: Non-financial corporate profits peaking.

Thus the answer to the first question is that growth is set to continue although the market is signalling that sustainability could be an issue and given how high profits are, the risk of a contraction in economic activity is very real.

The second question for investors concerns Europe. We have viewed the ECB's decision to extend unlimited credit for three years as a critical stabilisation factor for the European sovereign debt crisis. While this will not solve the problem, the ECB has provided EU members with extra time to enhance the details of the proposed fiscal union and for countries to improve their debt profile.

Thus, as long as things stabilise in Europe, the risk of a banking crisis in Europe has fallen. We have been monitoring interest rates, bank shares and the euro to assess the odds of continued stability in Europe. So far, the 1-month euro LIBOR rate has fallen from 1.31% to 0.83% while the overnight rate has dropped from 0.87% to 0.29%. Italian and Spanish bond yields have fallen and stabilised since the ECB's decision (see Tables 1 and 2). Clearly, risk premiums has fallen overall.

Country	11 Jan 2012	1 year high	1 year low
Italy	4.94	7.67	2.32
Spain	3.29	6.09	2.85

Table 1: 2-yr bold yields of Italian and Spanish bonds.

Country	11 Jan 2012	1 year high	1 year low
Italy	7.02	7.26	4.58
Spain	5.36	6.70	4.99

Table 2: 10-yr bold yields of Italian and Spanish bonds.

European financial shares appear to have stabilised (Figure 14) but there is still a dislike for them. On a relative basis, European financials are still underperforming the market as investors continue to switch out of financials into more defensive sectors in Europe (see Figure 15).



Figure 14: European financials bottoming.

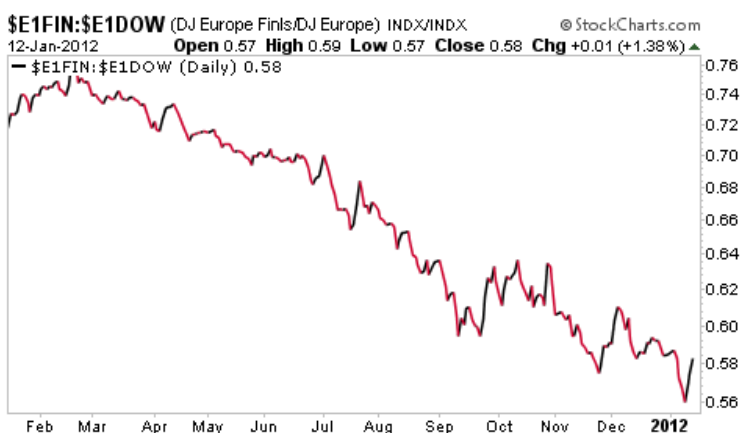


Figure 15: European financials poor relative performance

We also note that the euro has turned weaker since the ECB's decision. We view this as positive as it confirms that the ECB is likely to be aggressive in quantitative easing. A side benefit of a weaker euro is that it helps improve the competitiveness of European economies by making their exports cheaper, thereby spurring economic growth and increasing tax revenues in the future.



Figure 16: The euro is falling again.

So despite some stabilisation in sovereign bond yields and relief from currency depreciation, the fact that European financials could not rally is confirmation that the ECB alone cannot solve Europe's problems. Policy makers need to be more forceful in resolving the over-indebtedness of certain countries and provide necessary bailout when needed. For now, the threat of Europe imploding and dragging world financial markets along with it has been minimised.

Finally, investors need to ask if 2012 marks the year of monetary easing after aggressive tightening in 2011. Emerging economies have been struggling with high inflation, especially rising food prices. But food prices have been on a decline for a while (see Figure 17) and it is translating to lower inflation for countries like China (see Figure 18). This gives policy makers more room to stimulate their economies via monetary policy.

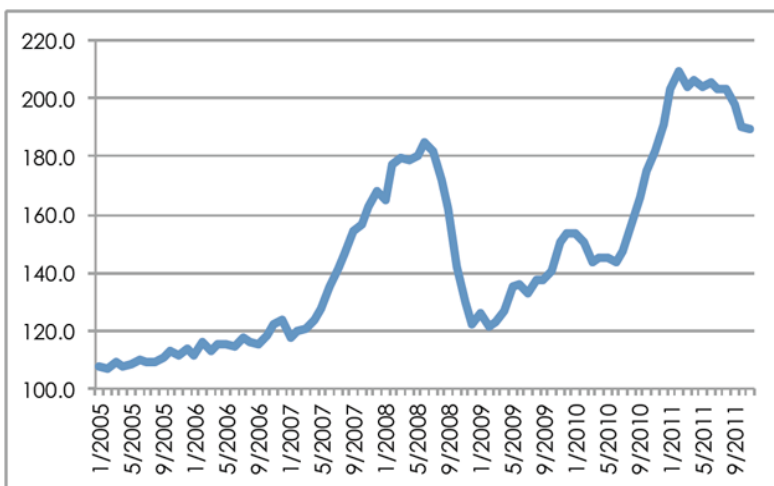


Figure 17: FAO Food Price Index on the decline.

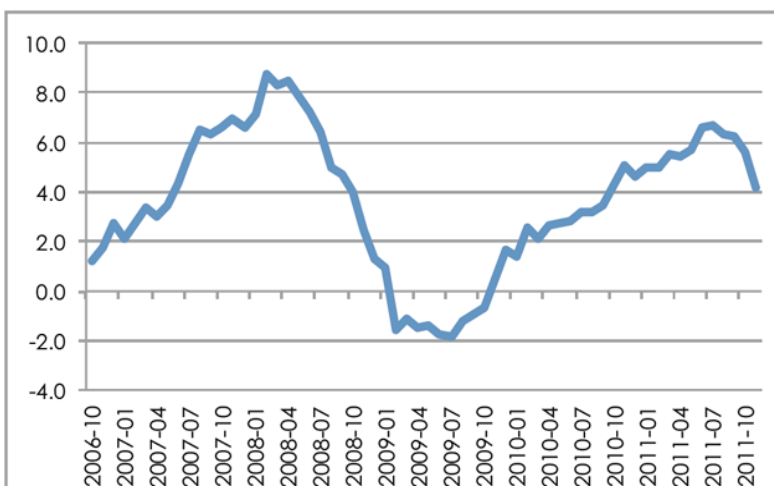


Figure 18: China CPI falling.

Many emerging economies are already stimulating their economies via monetary policy by cutting rates in response to the economic uncertainty in the developed world. Most investors would view lower interest rates as a tailwind for risk assets but we see it as one less headwind since the lowering of interest rates was done to counter the effects of an external slowdown. Hence, we are cognizant of the risk when investing in emerging markets, preferring to call it an extension of a bear market rally than the start of a new bull market.

Conclusion

Many investors are still carrying the emotional baggage of 2011, expecting more pain before any gain. Doubts on Europe remain, curtailing investors' expectation of any gains for 2012. This sets up a good contrarian play to be long in risk assets provided the conditions are right for positive surprises. From our point of view, the conditions are starting to show up. Thus, 2012 may just turn out better than most expect.

Portfolio Positions

There are no changes to our portfolio positions. We continue to remain underweight in equities as we expect more volatility ahead. However we are not severely underweight and think we are in a sweet spot to take advantage of any positive surprise in equity markets.

Page 8



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

Tel: (65) 6349 1441
Email: enquiries@gyc.com.sg

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



Change of address? Update your particulars here:

Name _____
NRIC _____
Address _____

Contact No. _____
Email _____

Send your updated particulars to:
GYC Financial Advisory Pte Ltd
1 Raffles Place
#15-01 One Raffles Place
Singapore 048616

Alternatively, email us at:
customercare@gyc.com.sg

IMPORTANT NOTES: This report is provided for the information of the intended recipient only and should not be reproduced, published, circulated or disclosed to any other person without the prior written consent of GYC. The information and opinions expressed herein reflect a judgment of the markets at its original date of publication and are subject to change without notice. GYC does not warrant the accuracy, adequacy or completeness of the information herein and expressly disclaims liability for any errors or omissions. The information is given on a general basis without obligation and on the understanding that any person acting upon or in reliance on it, does so entirely at his or her own risk. Any projections or other forward-looking statements regarding future events or performance of countries, markets or companies are not necessarily indicative of, and may differ from, actual events or results. Neither is past performance necessarily indicative of future performance. You should make your own assessment of the relevance, accuracy and adequacy of the information contained in the information provided and make such independent investigations as you may consider necessary or appropriate. Accordingly, neither GYC nor any of our directors, employees or Representatives can accept any liability whatsoever for any loss, whether direct or indirect, or consequential loss, that may arise from the use of information or opinions provided.

GYC
Grow Your Capital