CITIBANK 2010 OUTLOOK: INVESTOR CAUTION WARRANTED AMID SUSTAINED BUT UNEVEN GLOBAL RECOVERY

A discerning and selective approach towards investments needed as the benefits of global fiscal and monetary stimulus in driving economies and markets fade

The second half of last year was marked by an exit from recession by almost all major economies, riding on the benefits of fiscal and monetary stimulus. This year, Citi analysts remain optimistic on the trajectory of the global economic recovery but signal greater investor caution as these benefits may wane and the catalysts which drove global markets through much of 2009 may lose their tailwind of government stimulus. As a result, the strategy for the first half of 2010 is one of moderating risk exposure ahead of an expectation of increased volatility in global capital markets.

Global GDP growth for 2010 is forecasted to come in at 3.2 per cent, on the back of a contraction of 2.1 per cent in 2009. But recovery is expected to be divergent across regions through 2010, with Asia ex-Japan – at a forecast of 7.8 per cent - expected to show the strongest recovery, following a strong V-shaped rebound last year. Recovery in the US is expected to be moderate, while a more gradual medium-term recovery is expected in Europe and Japan.

Said Mr Shrikant Bhat, Head of Wealth Management, Citibank Singapore Ltd: “The view towards 2010 should be one of cautious optimism. While we do see continued growth in global economies, this is likely to be more uneven compared to last year. And unlike the investment environment of the later part of 2009 when there was almost universal upside experienced across assets, sectors and geographies, a more discerning and selective approach is now needed.

“Against this backdrop, investors should continue to stick with time-honoured principles of asset allocation and diversification; and investing according to their risk profiles within the framework of a holistic portfolio as they seek capital growth and preservation.”
Citi analysts continue to favour equities over bonds and expect 2010 to be likely characterised by earnings recovery and rising earnings expectations. They note that there may be increased volatility but view such market setbacks as potential opportunities in the recovery phase of the market. The preference for emerging market versus developed market equities remains though greater selectivity is warranted. Modest returns are expected in the US, with the year-end forecast for the S&P 500 and Dow Jones Industrial Average at 1,175 and 11,150 respectively. Citi analysts also forecast a modest 9 to 14 per cent rise in the MSCI Asia-Pacific ex-Japan index as the region, which led the global recovery last year, is expected to lead the removal of crisis-related stimulus through much of 2010. Within the fixed income space, Citi analysts prefer corporate credit to government bonds, favouring high yield and emerging market credit debt.

The US dollar (USD) remains in an overall bear market – its reducing appeal as a reserve currency given the sharp deterioration of public finances and the country’s trade deficit, among other factors underpinning the greenback’s weakness. The euro, the key beneficiary of reserve managers switching out of the USD, could see further gains, peaking in six to 12 months against the USD. The Japanese yen for its part, is likely to stay elevated with the preference for USD to fund carry trades given expected lower USD rates. The Chinese yuan is also likely to come under appreciation pressures arising from overall USD depreciation, further improvement in China’s trade balance or capital inflows; and continuing attempts to “internationalise” the currency.

Citi analysts are positive on the outlook for commodities given upward revisions in global economic growth, an expected subdued inflationary environment and therefore low interest rates. Citi forecasts the West Texas Intermediate (WTI) crude oil price to average at US$80.50 per barrel for 2010 and US$85/bbl for 2011 and 2012. Gold, supported by central bank buying such as the increase of gold reserves by China, is expected to average US$1,162/oz for 2010, US$1,133/oz for 2011 and US$1,033/oz in 2012.

Tactically, opportunities may be found in global healthcare, in particular global pharmaceuticals whose sales of branded drugs have held up despite competition from generics. Relatively cheap valuations of healthcare stocks, an improved outlook arising from expected rises in healthcare spending; and the traditionally defensive properties of the sector bode well for its investment prospects. Investors with a strategic view could look to the long-term theme of emerging market consumerism in areas such as food, retail and travel, given the strong growth in the middle-income population globally, accompanied by higher purchasing power and changing lifestyles.
Outlook for Singapore

Citi’s Singapore economist forecasts Q1 GDP growth to peak near 10 per cent year on year, moderating from Q2, with full-year 2010 growth likely to come in at 6.5 per cent. The growth drivers include:

- The rising tide of global demand and re-stocking in the developed markets which will lift the export boat, boosting manufacturing and trade-related services, at least, in the first half of the year
- Opening of the two Integrated Resorts in the first half, which could lift tourist arrivals, retail and hospitality; and
- Modest investment recovery on land transport infrastructure, capacity additions in manufacturing and residential construction investments, which should support bank lending and jobs growth.

The global recovery, while uneven, is expected to be sustained and Singapore, which is highly leveraged to global growth and trade, will benefit from this. Growth momentum will likely moderate from Q2 or the second half on the back of fading base effects and withdrawal of policy stimulus but barring shocks in global demand, a double dip recession is unlikely.

The benchmark STI, likewise, is expected to edge higher in early 2010, driven by the global recovery, inventory restocking and continued accommodative fiscal and monetary policies. But the STI rally may stall as monetary tightening begins, fiscal stimulus fades and inventory restocking ends in the later part of the year. Citi’s STI target for 2010 is 3,250, revised upwards from 3,000.

Citi analysts are overweight banks, offshore marine and healthcare; underweight property developers and land transport; and neutral on telcos, media and REITs.

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