

Royal Preferred Banking



December 2009

MarketWatch

Insights into investment opportunities



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Market Review

US Equities

The risk rally continued through November, although momentum appeared to wane after the Dubai turmoil. Economic data over the month were generally supportive. This partly led the 3 major indices reached the year high for the year. Dow Jones rallied 6.5%, S&P500 posted 5.7% gain, and NASDAQ was up 4.9% for the month. In the November FOMC meeting, the US Federal Reserve reiterated its intention to keep interest rates “exceptionally low for an extended period” which successfully eased investors’ concerns about a near-term withdrawal of liquidity by central banks. Equity market momentum started to pick after the meeting. The US ISM positively surprised the market at 55.7. Its sub-component, employment, jumped from 46.2 to 53.1, the highest level since May 2006.

Europe Equities

The positive economic data in the region and the rise in US equities led to the rally in Euro zone equity markets. The UK’s FTSE 100 index gained 2.9% while Germany’s DAX index advanced 3.9%. The Euro zone officially exited recession as its GDP expanded 0.4% in the 3Q2009 after five consecutive quarters of contraction. Germany reaffirmed its leading status in the region, posting a 0.7% expansion. Furthermore,

the German IFO came in higher than the market expected in November. The business climate index rose to 93.9 up from an upwardly revised 92 in October. In the UK, the manufacturing Purchasing Managers’ Index (PMI) significantly beat the consensus estimate of 50, jumping from 49.9 to 53.7. Such a level is consistent with manufacturing growth in excess of 3% and the highest level since November 2007.

Japan Equities

Japan equity market was the worst performer globally in November, where Nikkei 225 declined by 6.9%. The Bank of Japan maintained its view that the economy is picking up, but it emphasized that it remains in a difficult situation and that “the momentum of a self-sustaining recovery in domestic private demand remains weak”. Deflation continued to deteriorate with prices down a record of 2.5% yoy. Consequently, corporate profits were lower, which could prompt companies to continue downsizing operations. Apart from that, the strong yen also adversely affected its equity market. Yen appreciated by 4.3% against US dollar, and reached to as low as 86.41 in late November. The rapid appreciation of yen hurts the profitability and decreases the competitiveness of exporters in the medium term.

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Performance of Major Asset Classes

Equity Index	End of November 2009 Level	Monthly Performance (November 2009)
Developed Markets		
Dow Jones	10,345	6.5%
Nikkei 225	9,346	-6.9%
FTSE 100	5,191	2.9%
DAX Xetra	5,626	3.9%
Asian Markets		
Hang Seng	21,822	0.3%
KOSPI	1,556	-1.6%
Straits Times	2,732	3.1%
Taiwan Weighted	7,582	3.3%
Emerging Markets		
Brazil Bovespa	67,044	8.9%
Russia RTSI	1,375	2.0%
India Sensex	16,926	6.5%
China SH Composite Index	3,195	6.7%

Far East ex Japan Equities

Equities in Far East Asia (ex Japan) posted positive gain except South Korea in November. China's Shanghai A shares soared 6.7%, the largest gain amongst Asia region. Hong Kong's Hang Seng Index rose marginally by 0.3%, Singapore's Straits Times was up 3.1%, and Taiwan's Taiex advanced 3.3%. South Korea, the only exception, was down 1.6%. Economic data from China continued to dominate the headlines. Production in October rose a slightly-stronger-than expected 16.1% YoY, while retail sales in the same period also beat forecasts with a 16.2% YoY increase. The delay debt payments in Dubai World had limited impact to the most Asia equities, except for Hong Kong and Korea. The significant drop in Hang Seng Index in the last 3 days of November almost erased the gain made earlier, causing by the heavy market-weighting of HSBC in Hang Seng index. According to the market estimation, amongst all the banks, HSBC has the largest exposure to the United Arab Emirates (UAE). HSBC fell by 5.4% in the last 3 trading days of November. Dubai turmoil also caused KOSPI to fall by 3.5% at the same period as the newspapers reported that the financial companies in South Korea may be owed \$32million from Dubai World and Nakheel.

Emerging Market Equities

Emerging market equities enjoyed strong rallies in November. Russia RTSI was up 2%, Brazil Bovespa soared 8.9% and India's Sensex rose 6.5%. Emerging equity markets were cheered as US Fed promised to

keep interest rates exceptionally low for an extended period, and risk appetites returned in the first half of November. Even though the Dubai turmoil interrupted the market rallies for the last week of November, emerging equity markets were still the least affected with their limited exposures to UAE.

Bonds

Government bond yields were lower globally in November. The U.S. 10-year treasury yield was down 18.5BP and Japan 10-year yield was down 14.9BP. The bond yields world wide in general were almost back to the level of April 2009 as market investors were less willing to take on risks when the year end is approaching. Investors are looking for to lock their profits made in the equity markets, and parking the money in the US treasuries. In addition, the Dubai turmoil also magnified the demand of safe assets, further pushed the yields lower.

Hedge Funds

Performance of hedge fund rose only marginally in October with CS Tremont Hedge Fund Index up 0.13%.The performance was more muted as market volatility spiked in the last week of the October and tempered hedge fund returns. The highest return for the month came from Convertible Arbitrage which posted 2.16%, even though the convertible bond markets were down for the month first time since January.

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Bond

	End of November 2009 Yield Level	Monthly Performance (November 2009) (Basis Points)
US Treasury 10-Yr	3.198	-18.5
Japan Govt Bond 10-Yr	1.266	-14.9
UK Govt Bond 10-Yr	3.523	-9.6
Germany Govt Bond 10-Yr	3.159	-7.2

Source: ABN AMRO Bloomberg, EcoWin & AWSJ

Commodities

Gold was the most outstanding commodity in November, climbing on both US dollar weakness and rising risk aversion from the delay debt payments by Dubai World. Gold surged 12.8% to \$1179.6 per oz. In contrast, the oil price in the same period of time closed at \$77.28 per barrel, up 0.4% mom. According to the US energy department, the usage of daily fuel in November was 4% lower in yoy, and the current oil inventories were at a four-week high. Current demand and supply are both negative to the oil market.



Currencies

The dollar weakened against most major currencies in November, except the British Pound. Japanese yen advanced the most against the USD, appreciated 4.3% for the month. AUD appreciated by 1.8% as Reserve Bank of Australia conducted the second time 25BP rise in its interest rate. Market consensus in general is expecting another rate hike in early December. The worse performer in currency market in the month was British Pound, as Bank of England extended the quantitative easing by £25Bn to £200Bn, pumping more liquidities into the market.

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Commodity

	End of November 2009 Level	Monthly Performance (November 2009)
Crude Oil	77.28	0.4%
Gold (Comex)	1179.6	12.8%

Source ABN AMRO Bloomberg. EcoWin & AWSJ

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Currency

	End of November 2009 Level	Monthly Performance (November 2009)
Yen (vs USD)	86.41	-4.1%
Euro (vs USD)	1.501	1.9%

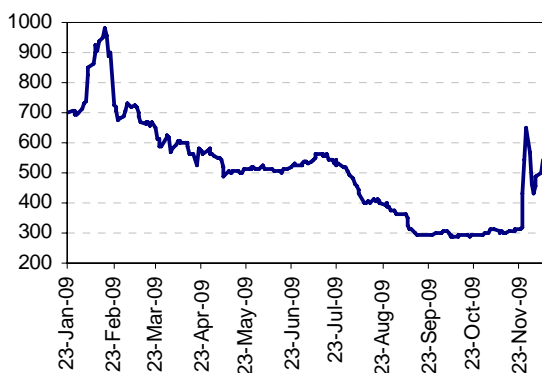
Source ABN AMRO Bloomberg. EcoWin & AWSJ

Monthly Feature

The aftermath of Dubai Turmoil

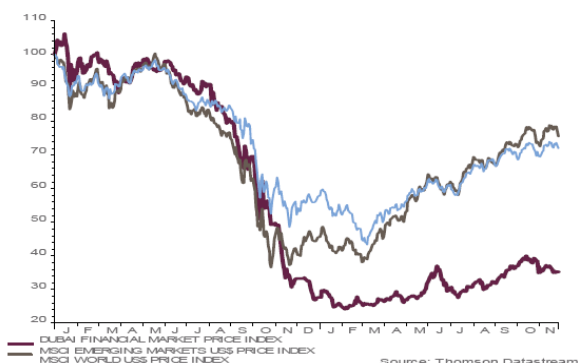
A statement released by the Government of Dubai on the 25th of November 2009, indicated that Dubai World, a state-owned company, would seek a delay in the redemption of debt for 6 months. Particularly the delay affected the redemption of Nakheel's, one of its subsidiaries, US\$3.5bn bond due on 14th of December 2009.

Global equity markets suffered the immediate negative impact as investors were surprised that the Dubai government and the United Arab Emirates (UAE) did not stand behind these debts. Consequently, Moody's downgraded the credit rating of 6 Dubai government-controlled companies, citing a lack of government support over the emirate's debt obligations. As a result, there are growing concerns that more borrowers in Dubai might fall behind on debt payments.



Dubai 5-year senior CDS spread, the cost of insuring against default, widened by 329BP to 647BP after the announcement. Even though it narrowed back temporarily after Dubai World announced that there was only US\$26bn of debt to be restructured, less than half of amount that market expected, it widened quickly again. The growing concerns on the debt-paying ability in the other state-owned Dubai entities will continue to push up the country's CDS spread.

Dubai has lagged global equity markets



Other emerging markets with perceived problems also came under pressure. Hungary, which has had problems refinancing debt, and Greece, which has one of the highest debt burdens in Europe, also saw the cost of insuring their debt soar. Furthermore, in early December, Fitch downgraded Greece's long-term rating from A- to BBB+, with a negative outlook. Greece's budget deficit is forecasted to reach 12.7% of GDP this year, more than four times of the 3% limit for Euro-zone members.

Although we do not think the news of Dubai World appears to be a systemic event, the increasing risk aversion in the near term will likely lead to more profit taking, especially when the year end is approaching. We would expect price corrections from riskier assets, commodities and the currencies.

Dubai turmoil came as a nasty reminder that the aftermath of the credit-fuelled property bubble bursting, financial crisis and global recession, will last for a considerable period. The fall in equities has triggered a good buying opportunities in the medium term.

FX & Interest Rate Monthly

<p>The dollar will continue to depreciate...</p>	<p>Despite talk of 'exit' strategies, the Federal Reserve continues to supply the market with dollar liquidity at close to zero rates in a bid to support the economic and financial market recovery. The consequences for the exchange rate are obvious, with investors and even central banks fleeing the falling US currency.</p>
<p>...as part of the structural change in exchange rates that is needed to accommodate the development of the global economy.</p>	<p>We believe that the long-term trend is for the US's share of the global economy to continue to decline as that of China and other emerging markets rise. The US accounts for around a quarter of the global economy, on a par with the eurozone. Yet the dollar accounts for some 60% of listed foreign currency reserves, compared to a quarter for the euro and insignificant amounts for the currencies of emerging countries, especially the renminbi which is not fully convertible.</p>
<p>Yet we expect a dollar rally at some point next year as short-term factors reverse and structural change proves slower than expected.</p>	<p>Given the pre-eminence of the US currency, the slump in global trade has left the world with a surplus of dollars. Yet this should reverse as trade recovers. Meanwhile, the supply of new dollars is being reduced by the narrower US trade deficit. Together, these factors point to a reversal of sentiment towards an oversold dollar next year. We also believe that the central banks of China and India, as well as other major holders of dollars, are not about to sell their existing dollar reserves when there are no viable alternatives outside the euro or yen, which have problems of their own. The solution to the issue of these countries accumulating dollars is for their authorities to accept fundamental change in the real exchange rates of their own currencies, but this involves economic and political risks which they are reluctant to countenance.</p>
<p>Rising interest rates will support emerging market currencies...</p>	<p>The majority of Asian and emerging economies will need to tighten monetary policy and/or allow their currencies to appreciate if they do not wish to 'import' loose monetary policy from the developed world and risk goods or asset price bubbles.</p>
<p>...but in the developed world interest rates will stay low.</p>	<p>The fragile nature of the recovery and the large amount of excess capacity in the economy suggests that the earliest the central banks of the major developed economies will start to raise rates is in the second half of 2010. The possibility that rapid tightening would weaken the recovery or trigger another recession suggests that the risk to our forecasts is for rate increases to be postponed to 2011.</p>

Currencies	Spot 11/16/2009	RBS Forecast (as of 12 November)				Past Performance (in %)					
		Dec-09	Mar-10	Jun-10	Sep-10	-1W	-1M	-3M	-6M	-12M	YTD
Euro vs Dollar	1.50	1.51	1.55	1.46	1.38	-0.2	0.7	5.2	10.2	18.1	7.8
Yen vs Dollar	89	88	88	90	93	0.6	1.7	5.5	6.3	7.7	1.5
Sterling vs Dollar	1.68	1.61	1.62	1.55	1.45	0.1	2.6	1.5	9.9	13.1	16.7
Swiss Franc vs Dollar	1.01	1.00	0.97	1.01	1.05	0.0	1.2	6.0	8.8	15.5	5.4
Swiss Franc vs Euro	1.51	1.51	1.51	1.47	1.45	0.2	0.6	1.1	-0.5	0.2	-2.0
Australian Dollar vs Dollar	0.94	0.97	1.00	0.93	0.90	0.8	2.4	12.2	23.9	42.3	34.4
Euro vs Sterling	0.89	0.94	0.96	0.94	0.95	-0.3	-1.9	3.6	0.2	4.2	-8.3
Renminbi vs Dollar	6.83	6.80	6.80	6.70	6.60	0.0	0.0	0.1	0.0	0.0	0.0

	Growth (GDP)			Inflation (CPI)			Interest Rates					Decision
	2008	2009(C)	2010(C)	2008	2009(C)	2010(C)	Current	Dec'09 (F)	Mar'10 (F)	Jun'10 (F)	Sep'10 (F)	Next Date
US	0.4	-2.4	2.7	3.8	-0.4	2.0	0.25	0.25	0.25	1.00	2.00	16-Dec-09
UK	0.7	-4.5	1.2	3.6	2.1	2.0	0.50	0.50	0.50	0.50	1.00	3-Dec-09
Eurozone	0.6	-3.8	1.2	3.3	0.3	1.1	1.00	1.00	1.00	1.00	1.00	3-Dec-09
Japan	-0.7	-5.7	1.4	1.4	-1.2	-0.9	0.10	0.10	0.10	0.10	0.10	20-Nov-09

(C) Consensus Forecast

(F) RBS Forecast

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