

PhillipCapital U Talk

Issue: December 2006

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Dear Investors,

In December, financial markets continued to rally to new record highs as oil prices remained stable and better-than-expected economic data. This will be discussed in detail as we provide the outlook of the global equity and bond markets.

In this issue, we recommend European funds as we expect them to perform strongly in 2007.

We provide our model portfolios for the short and long terms.

Happy reading and investing!

Regards,
Unit Trust Team

Fund News

- ❖ Outlook of the global equity and bond markets
- ❖ Recommendation on European funds
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Market Outlook

In December, global financial markets rose to new record highs due to better-than-expected economic data, mergers and acquisitions as well as stable oil prices.

The economic releases showed that the economy was relatively strong. Retail sales rose 23 percent on the weekend before Christmas, according to research firm ShopperTrak RCT. Moreover, the National Retail Federation expected retail sales to rise 5 percent in November and December combined. Furthermore, reports showed an upturn in the housing market. The National Association of Realtors reported that purchases increased 0.6 percent in November to an annual rate of 6.28 million as the median price of an existing home dropped 3.1 percent in November to US\$218,000. The Conference Board's index of consumer sentiment also rose to 109 in December, which was the highest level since April. Business activity was expanding as the National Association of Purchasing Management-Chicago business barometer rose to 52.4 in December from 49.9 in November.

Inflation also remained under control as consumer prices and core consumer prices remained flat in November due to the drop in energy and transportation costs. The U.S. jobs market remained strong as the Labour Department reported that U.S. employers added a bigger-than-expected 132,000 jobs in November. The jobs figure exceeded economists' forecast for growth of 110,000 jobs and increased investors' optimism about the outlook for corporate profits. But the U.S. unemployment rate edged up to 4.5 percent in November from the 5-1/2-year low of 4.4 percent reached in October. This was because more people entered the improving job market to look for jobs. Average hourly earnings also rose by 0.2 percent from the previous month to USD 16.94. Therefore, this would lead to strong consumer spending and support the economy.

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However, the third quarter GDP growth was revised to 2 percent from 2.2 percent. This was also weaker than the 2.6 percent growth in the second quarter. Moreover, the U.S. current account deficit grew to a record US\$225.6 billion in the third quarter as it paid more interest to overseas investors and the increase in the trade gap.

The Federal Open Market Committee (FOMC) meeting in December was a non-event as the Fed left interest rates unchanged. The Fed also noted the slowdown in the housing sector and mentioned that some inflation risks remained.

The various mergers and acquisitions boosted the performance of the markets. For example, shares of miners Freeport McMoRan Copper & Gold Inc. and Phelps Dodge Corp. climbed after U.S. antitrust authorities said they approved Freeport's bid to buy Phelps Dodge. Moreover, shares of Internet networking company Savvis Inc. rose after telecommunications services provider Level 3 Communications Inc. said it planned to acquire Savvis' content delivery network assets. AT&T Inc. offered concessions to win approval of its \$86 billion acquisition of BellSouth Corp, which was also approved by the Federal Communications Commission. Alltel Corp., the fifth-largest U.S. wireless operator, advanced on reports the company was a potential takeover target.

Harrah's jumped after news that the company received a buyout offer of as much as \$16.7 billion from Apollo Management LP and Texas Pacific Group. Apollo also agreed to buy Realogy Corp., which owns the Century 21 and Coldwell Banker real-estate brokers, for \$6.6 billion in a sign that the U.S. housing slump may have touched bottom. Caremark Rx, the second-biggest U.S. drug-benefits manager, surged after rival Express Scripts Inc. topped a bid from CVS Corp. Express, the third-biggest U.S. manager of drug benefits, offered about \$26 billion for Caremark, or \$58.50 per share in cash and Express Scripts shares. Bank of New York Co. Inc. announced plans to buy Mellon Financial Corp. for about \$16.5 billion to create the world's largest securities servicing and asset management firm.

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The European Central Bank and Bank of England are expected to continue to raise interest rates on concerns of inflation. Furthermore, the European economy is strong and consumer confidence is high.

Oil prices remained around the USD 60 level in December as fuel supplies remained sufficient to meet demand. But gains were limited due to milder U.S. weather that reduced consumption of heating fuel. On 14 December, the Organisation of Petroleum Exporting Countries (OPEC) agreed to cut production by 500,000 barrels per day from 1 Feb 2007 when the winter in the Northern hemisphere is ending. This was after OPEC had cut production by 1.2 million barrels per day at the meeting in October.

Political concerns over Iran's nuclear plans remained as Iran said that it would continue with its nuclear technology project. The United Nations (UN) had imposed sanctions on Iran. First, all countries will be banned from supplying specified materials and technology that could contribute to the nuclear program. Second, an asset freeze will be imposed on 10 key companies and 12 individuals in Iran's nuclear and missile programs named on a UN list. Third, all states are to notify a Security Council sanctions committee if any of the 12 individuals are in their countries. Iran had responded by resuming efforts to enriching uranium by putting in place 3,000 centrifuges at a key nuclear plant. All these concerns are likely to keep oil prices high.

Equity Markets

We provide our updates and recommendations on the Asian and European equity markets.

China: The Chinese economy was doing well with GDP growth of more than 10 percent in 2006. The performance of the economy and the strong debut of IPOs including Industrial and Commercial Bank of China (ICBC) resulted in funds flowing into the equity markets. There would also be more IPOs as Chinese companies raised funds for expansion of their operations.

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Although the Chinese government raised interest rates, introduced measures to cool the property sector and increased the bank reserves requirements to curb increases in bank loans, the economy is expected to continue to post excellent growth. We had recommended China funds in the July issue and expected them to continue to post gains.

Singapore: In a risky environment, large and developed equity markets including Singapore continued to provide a safe haven for investors and trade at premiums to other regional markets. The economy is performing well with the government forecasting GDP growth of 6.5 to 7.5% for 2006 and 3 to 5 % in 2007. Blue chips and properties performed strongly in December as companies reported better-than-expected earnings and foreigner investors snapped up high-end residential units.

Hong Kong: The Hong Kong market is also another developed market that is expected to perform as it benefits from the booming Chinese economy and influx of tourists. The listing of Chinese companies on the stock exchange is likely to result in fresh funds for the market.

Taiwan: Analysts are more optimistic on the technology sector and the performance of the Taiwan market, which had a number of technology companies. However, the political climate remained unstable with political pressure on the President and opposition leader.

India: The Indian stock markets regained all the losses from the corrections in May 2006 and rose to new record levels. However, risks remained high as valuations were demanding at price-earnings (PE) ratios of 25 times.

Thailand: Thai stocks are currently cheap at undemanding PE ratios of about 10 times. In December, the Thai government imposed capital controls to curb the rise of the Thai Baht, but reversed the measures a day later after the slump in the stock market. Moreover, on 31 December, bombs hit Bangkok and caused serious damages. This would significantly increase the risk premiums for investing in Thailand.

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Malaysia: The market rose to record highs in December. Valuations were attractive as companies continue to return their high cash flows to investors. As palm oil prices remained high, the recent merger among plantation companies was expected to boost the performance of the market.

Indonesia: Most funds were overweight on Indonesian equities as they expected further interest rate cuts by Bank Indonesia. There was also an increase in consumer and government spending.

Korea: Most funds were overweight on Korea funds. The domestic economy was doing well and should benefit the banks and consumables while the technological sector had been upgraded.

Japan: Most funds were slight overweight on Japan, especially the financial sector. The Bank of Japan was expected to raise interest rates as the economy continued to grow strongly and unemployment remained low.

Europe: European equities were expected to perform as most funds found the valuations attractive and the economies continued to perform well.

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Sectors

Sector	Short Term	Medium Term	Long Term
Property	Overweight	Overweight	Overweight
Healthcare	Neutral	Overweight	Overweight
Technology	Overweight	Overweight	Overweight
Banking & Finance	Overweight	Overweight	Overweight
Resources	Overweight	Overweight	Neutral

Property: Currently, most funds were overweight on the property sector. This was because of high demand for office and retail space for businesses that were growing globally. This was especially so for Europe and the developed cities in Asia including Singapore, Hong Kong, Shanghai and Macau.

Healthcare: We had rated the sector as neutral for the short term. The Democrats' win in the U.S. mid-term elections resulted in the drop in shares of big drug makers and health-care companies dropped as investors were concerned that a Democrat-controlled Congress might move to curb prices. However, the healthcare sector was also expected to continue to grow. As people became more affluent and life spans became longer, better healthcare was required.

Technology: Analysts are currently overweight on the technology sector after Microsoft announced that the next version of its Windows operating system, Vista, would be available to retail customers on January 30. This boosted technology shares and Nasdaq rose sharply. For instance, International Business Machines Corp. was up as ThinkEquity Partners raised its recommendation on IBM to "buy" from "sell," citing the company's strong software sales as well as better performance and profitability in IBM's global services segment.

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Banking and Finance: The banking sector had often been beneficiaries of growing economies. This was due to the increase in credit spending, bank loans, demands for wealth management services. We expected the sector to continue its strong performance from the short to long term.

Resources: Oil prices had fallen to the USD 60 level as more supplies of entered the markets due to more exploration and refining. On the other hand, the demand from US, China and India remained strong. There were also political uncertainties in the Middle East. Therefore, we were overweight in the sector.

Bond Markets

US interest rates had peaked as the economy was slowing down and inflation remained under control. In fact, most analysts expected the Fed to start cutting interest rates next year. However, the U.S. dollar dropped in value recently against the Euro and Asian currencies. This was because of expectations that central banks would reduce the holdings of U.S. dollars as reserves.

Moreover, with the European Central Bank and Bank of Japan continuing to hike interest rates, Euro and Japanese yen bonds could drop in values. However, the Euro had recently sharply against most currencies, including the U.S, dollar. Thus, investors would have to select high yield bonds for investment.

Conclusion

Due to the slowing U.S. economy, the Fed was unlikely to further raise interest rates this year and rate cuts could be expected next year. Global equities had a good run in 2006 and most analysts expect equities to gain in 2007, but the returns are likely to be lower than 2006 as growth in corporate earnings moderate.

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U.S. interest rates had peaked, but the U.S. dollar had fallen in value against other currencies. Investors would have to take into account the depreciation of the dollar when investing in U.S. dollar bonds. However, European Central Bank and Bank of Japan were expected to continue their rates hikes. This would result in a drop in the value of bonds.

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Fund Recommendation (31 December 2006)

For investors who would like to diversify their risks, they could look at the European funds. Asian funds had an excellent run this year and valuations are becoming demanding. Hence, we recommend that investors reduce part of their holdings in Asian funds and switch into European funds.

The European economies are growing strongly again after several years of weakness. Currently, consumer confidence is robust and businesses are expanding. There are also mergers and acquisitions taking place among European companies, which could lead to a rise in the valuations of companies. For example, there was a merger between Reebok and Adidas in 2005.

In addition, exports to Asia and U.S. are still growing with many companies setting up their operations and offices in Asia. There are familiar European companies that have global presences such as Commerzbank, BNP Paribas, British Petroleum (BP), Nestle, Nokia, Philips and Puma.

In terms of valuations, most European companies are also trading at low price earnings ratios of about 14 times and dividend yields of more than 3 percent (source: Bloomberg). Given the low valuations, it is likely that there will be a revaluation of European equities in 2007. Thus, investments in European equities are likely to reap good returns for investors.

Furthermore, most European funds have been delivering returns of more than 10 percent over the past three years. Listed are the historical returns (as at 31 December 2006) of the funds:

Fund Name	Annualised Return (%) as at 31/12/06				
	YTD	1 yr	2 yrs	3 yrs	5 yrs
Aberdeen European Opportunities Fund	24.58	23.90	15.17	16.40	10.70
Schroder ISF-Emerging Europe (EUR)	20.84	21.74			
Schroder ISF-EURO Active Value(EUR)	25.50	25.28			
Henderson European Fund	19.19	19.19	16.46	16.31	10.08
Schroder Emerging Europe Fund	23.33	23.58			

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Schroder ISF-European Smaller Co (EUR)	27.25	27.51			
UOB United European Small Caps Fund	30.01	30.75	19.41	16.60	18.01
Schroder European Equity Alpha Fund	22.90	22.20			
DIT- Industria Fund	21.14	20.35	16.27		
HSBC Pan-European Growth Fund	22.45	21.68	16.36	14.33	10.12
Fidelity European Smaller Co Fund (EUR)	24.50	25.30			
PRU Pan European Fund	26.05	26.29	18.33	19.15	9.85
UOB United European Equity Fund	15.51	14.93	12.73	12.69	7.06
OCBC Infinity European Stock Index Fund	23.95	22.89	17.70	17.34	10.74
Fidelity European Growth Fd A(EUR)	14.82	14.82	23.59		
Schroder European Large Cap Equity Fd	20.42	19.65	14.27	14.76	7.88
Legg Mason Pan-Europe Equity Fund	16.67	15.79	11.44	12.90	7.35
DBS Shenton Greater Europe Fund	16.26	15.17	14.51	14.51	6.85
ABN AMRO Star Europe Equity Fd	21.29	21.01	14.85	12.72	4.95
Henderson European Property Securities Fund	49.26	49.81	33.83	36.92	32.68
Fidelity European Aggressive Fund (EUR)	14.44	14.18			
Templeton FTF European Equity Fund	18.64	18.38	13.00	15.34	10.15

In our evaluation of the performances, we noted that most of the funds, which had existed for at least five years, had produced annualised returns of more than 10 percent. To narrow down to the better performing funds, we are highlighting the top three funds that reap year-to-date (YTD) and one-year returns of more than 20 percent and annualised returns of more than 15 percent for the two-year and three-year periods:

- **Aberdeen European Opportunities Fund:** This fund invests mainly in the financial and consumer sectors in Europe, which are expected to benefit from the growth in the European economies. They are also focusing on companies that could be re-rated due to mergers and acquisition. It is currently overweight on Europe and recommends the fund to investors.
- **UOB United European Small Caps Fund:** This fund focused on smaller, growing companies in the industrial, financial and consumer sectors that could reap high returns for investors. It is also overweight on Europe.

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- Henderson European Property Securities Fund: This fund delivered the highest annualized returns of more than 30 percent for the 3-year period. It has a strong focus on properties, which are expected to benefit from the growth of the European economies. It also constantly updates investors and is optimistic on the outlook of the fund.

For risk diversification, we would recommend investments in a few funds rather than focusing on one or two funds as their performances could vary over time as a result of different stock holdings in the funds.

The details and descriptions of the funds are as follows:

	Aberdeen European Opportunities Fund	Schroder ISF- Emerging Europe (EUR)	Schroder ISF- EURO Active Value(EUR)
Launch Date	14 Aug 1998	28 Jan 2000	9 Aug 2002
Latest Fund Size	S\$80.9 million	EUR563.4 million	EUR1,597.8 million
Investment objective	Invests in equities and equity-related securities of corporations registered in Europe	Invests in equity securities of Central and Eastern European companies	Invests in equity securities of companies in Europe
Minimum investment	S\$1000 (initial); S\$100 (subsequent)	EUR1000 (initial); EUR1000 (subsequent)	EUR1000 (initial); EUR1000 (subsequent)
Fees & charges			
Normal sales charge	5%	5%	5%
Annual management fee	1.5%	1.5%	1.5%

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	Henderson European Fund	Schroder Emerging Europe Fund	Schroder ISF-European Smaller Co (EUR)
Launch Date	17 Apr 2000	14 Oct 2005	7 Oct 1994
Latest Fund Size	S\$32.3 million	S\$191.2 million	EUR 613.6 million
Investment objective	Invests in equity securities of companies having their registered office in Europe	Invests in equity securities of Central and Eastern European companies	Invests in equity securities of smaller European companies
Minimum investment	S\$1000 (initial); S\$100 (subsequent)	S\$1000 (initial); S\$500 (subsequent)	EUR1000 (initial); EUR1000(subsequent)
Fees & charges			
Normal sales charge	5%	5%	5%
Annual management fee	1.2%	1.5%	1.5%

	UOB United European Small Caps Fund	Schroder European Equity Alpha Fund	DIT- Industria Fund
Launch Date	Feb 2000	25 Apr 2005	19 Jan 1959
Latest Fund Size	S\$41.33 million	S\$ 102.2 million	EUR 2,319.42 million
Investment objective	Invests in European-listed companies with market capitalization of less than US\$2 billion	Invests in equity securities of European companies	Invests in equities of leading European companies
Minimum investment	S\$1000 (initial); S\$500 (subsequent)	S\$1000 (initial); S\$500(subsequent)	S\$1000 (initial); S\$500(subsequent)
Fees & charges			
Normal sales charge	5%	5%	5%
Annual management fee	1.75%	1.5%	1.35%

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	HSBC Pan-European Growth Fund	Fidelity European Smaller Co Fund (EUR\$)	PRU Pan European Fund
Launch Date	9 Nov 1999	1 Dec 1995	16 Apr 2001
Latest Fund Size	S\$8.3 million	EUR 1,651 million	S\$38.4 million
Investment objective	Invests in company shares quoted on markets in the United Kingdom and in other continental European countries	Invests in equity securities of small and medium-sized European companies	Invests in securities of companies in Europe
Minimum investment	S\$2500 (initial); S\$1000 (subsequent)	EUR2500 (initial); EUR1000(subsequent)	S\$1000 (initial); S\$100 (subsequent)
Fees & charges Normal sales charge Annual management fee	5.5% 1%	5.25% 1.5%	5% 1.5%

	UOB United European Equity Fund	OCBC Infinity European Stock Index Fund	Fidelity European Growth Fd A(EUR\$)
Launch Date	Jul 1997	30 May 2000	1 Oct 1990
Latest Fund Size	S\$19.42 million	S\$8.9 million	EUR20,948 million
Investment objective	Invests in securities listed on the stock exchanges in the European region	Invests in securities in the MSCI Europe Index in roughly the same proportions as presented in the index	Invests in equity securities quoted on European stock exchanges
Minimum investment	S\$1000 (initial); S\$500 (subsequent)	US\$1000 (initial); US\$100(subsequent)	EUR2500 (initial); EUR1000 (subsequent)
Fees & charges Normal sales charge Annual management fee	5% 1.75%	2% 0.475%	5.25% 1.5%

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	Schroder European Large Cap Equity Fd	Legg Mason Pan-Europe Equity Fund	DBS Shenton Greater Europe Fund
Launch Date	24 Jun 1998	9 Feb 1998	31 Jul 1998
Latest Fund Size	S\$ 32.4 million	S\$5 million	S\$10.19 million
Investment objective	Invests in the larger market capitalisation stocks in the major European markets	Invests in securities of companies listed on a Regulated Market in a broad range of OECD European Countries	Invests in securities of corporations in Europe
Minimum investment	S\$1000 (initial); S\$500 (subsequent)	S\$1000 (initial); S\$100 (subsequent)	S\$1000 (initial); S\$500 (subsequent)
Fees & charges			
Normal sales charge	5%	5%	4%
Annual management fee	1.25%	1.5%	1.5%

	ABN AMRO Star Europe Equity Fd	Henderson European Property Securities Fund	Fidelity European Aggressive Fund (EUR)
Launch Date	27 May 1998	1 Jun 1999	1 Feb 1998
Latest Fund Size	EUR172.1 million	EUR 1.5 billion	EUR 3,625 million
Investment objective	Invests in equity securities of European companies.	Invests in quoted equity securities of companies which derive revenue from the ownership, management and/or development of real estate in Europe.	Invests in equity securities of European companies by following an aggressive approach
Minimum investment	S\$1000 (initial); S\$500 (subsequent)	S\$1000 (initial); S\$100 (subsequent)	EUR2500 (initial); EUR1000 (subsequent)
Fees & charges			
Normal sales charge	5.25%	5%	5.25%
Annual management fee	1.35%	1.2%	1.5%

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	Templeton FTF European Equity Fund
Launch Date	16 Jul 2001
Latest Fund Size	EUR 332.7 million
Investment objective	Invests in equity and debt obligations issued by European corporations and governments
Minimum investment	S\$1000 (initial); S\$500(subsequent)
Fees & charges	
Normal sales charge	5%
Annual management fee	1.9%

Source: Factsheets from the various funds

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Model Portfolio (Short Term Period of Less Than One Year)

For the period Oct – Dec 2006 (4Q 06), we had focused on the China and Asian equities funds as we expected them to post better returns. These funds performed well in the fourth quarter and posted good returns for investors.

However, we recommend a reduction in Asian funds and an increase in European funds as Asian equities had run up rapidly in the year end rally and valuations are becoming demanding. European equities are more attractive in terms of valuations and likely to outperform next year.

Moreover, China funds are expected to continue their strong performances in the short term, which is until the 2008 Beijing Olympics. Thus, we continue to hold the China funds in our model portfolio (short term).

We have also selected a mixture of Asian and emerging markets bonds that have posted stable performances. These funds are among the best performing funds in the fund recommended list. We maintain the same asset allocations for the bond funds for 4Q 06 and 1Q 07. The model portfolios for 4Q 06 and 1Q 07 are listed below:

Name of Fund	Asset Allocation (Percentage) for Different Types of Investors					
	Aggressive		Balanced		Conservative	
	4Q 06	1Q 07	4Q 06	1Q 07	4Q 06	1Q 07
China Funds						
HSBC Chinese Growth	9	9	6	6	2	2
Fidelity China Focus Fund	9	9	6	6	2	2
DWS China Equity	9	9	6	6	2	2
SGAM Golden China	9	9	6	6	2	2
UOB United Greater China	9	9	6	6	2	2
Asian Funds						
Aberdeen Pacific Equity	6	2	4	2	2	1
Schroder Asian Growth Fund	6	2	4	2	2	1
Phillip Asia Pacific Growth	6	2	4	2	2	1
UOB United Asia	6	2	4	2	2	1
Aberdeen Asian Smaller Companies	6	2	4	2	2	1
European Funds						
Aberdeen European Opportunities Fund	0	6	0	3	0	1

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Henderson European Property Securities Fund	0	8	0	4	0	2
Subtotal (Equity Funds)	75	75	50	50	20	20
DBS Shenton Income Fund	5	5	15	15	20	20
Schroder ISF Asian Bond	5	5	10	10	20	20
UOB United Global Emerging Markets Portfolio SGD	5	5	10	10	20	20
Aberdeen Asian High Yield	5	5	10	10	15	15
Subtotal (Bond Funds)	20	20	45	45	75	75
Cash	5	5	5	5	5	5
Total	100	100	100	100	100	100

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Model Portfolio (Long Term Period of One to Five Years)

For the long term period, we would recommend that investors select a diversified portfolio of Asian and European equities funds. This would allow investors to achieve better performances and lower volatility over a longer period.

Having recovered from the Asian financial crisis, Asia continues to be the leading base for the production of industrial goods for the rest of the world. As Asian economies grow and consumers become more affluent, there will be higher demand for goods and services globally. Companies that invest correctly in the various growth sectors will report better profits and their share prices can rise over the long term. Thus, Asia funds are expected to perform over the long term.

As mentioned earlier, the European economies are growing strongly again after several years of weakness. There are also mergers and acquisitions taking place among European companies, which could lead to a rise in the valuations of companies. Exports to Asia and U.S. are still growing with many European companies setting up their operations and offices in Asia. We would also hold European funds in our long term portfolios.

China funds are not included in the portfolios as they are more volatile and the strong performances are likely to continue only for the short term period of about one year. The model portfolios for 4Q 06 and 1Q 07 are listed below:

Name of Fund	Asset Allocation (Percentage) for Different Types of Investors					
	Aggressive		Balanced		Conservative	
	4Q 06	1Q 07	4Q 06	1Q 07	4Q 06	1Q 07
Asian Funds						
Aberdeen Pacific Equity	8	8	5	5	2	2
Schroder Asian Growth Fund	8	8	5	5	2	2
Phillip Asia Pacific Growth	8	8	5	5	2	2
UOB United Asia	7	7	5	5	2	2
Aberdeen Asian Smaller Companies	7	7	5	5	2	2
European Funds						
Aberdeen European Opportunities Fund	12	12	8	8	3	3

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Henderson European Property Securities Fund	13	13	9	9	4	4
Subtotal (Equity Funds)	75	75	50	50	20	20
DBS Shenton Income Fund	5	5	15	15	20	20
Schroder ISF Asian Bond	5	5	10	10	20	20
UOB United Global Emerging Markets Portfolio SGD	5	5	10	10	20	20
Aberdeen Asian High Yield	5	5	10	10	15	15
Subtotal (Bond Funds)	20	20	45	45	75	75
Cash	5	5	5	5	5	5
Total	100	100	100	100	100	100

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