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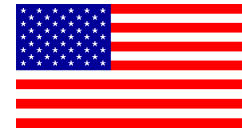
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Daphne CHIN
65-6323 1788
investment@FPAFinancial.com

UNITED STATES

Executive Summary

- ✦ The US economy grew by 3.3% for the whole of 2006 and rose by 2.5% annualised pace in Q4 2006. It is expected to record a slower economic growth this year.
- ✦ The housing market has been weak due to poor demand, as seen in the number of new and existing home sales. The Housing Market Index, a measure of builder confidence, has been below 50 since April 2006.
- ✦ Inflation reached 2.4% in February while core inflation was 2.7%. The Federal Reserve is expected to keep its Fed Funds rate unchanged for the moment but the likelihood of a rate cut some time later this year is possible.
- ✦ The US dollar is likely to remain weak vis-à-vis major currencies on the back of expected weaker economic growth this year.
- ✦ The yield gap analysis between the earnings yield of equities and bonds showed that it is in favour of equities. However, due to the concern over the slow down in the US economy and the weakness in the US dollar, we remain underweight in our exposure to the US market.
- ✦ We recommend that investors gain an exposure to the US stockmarket via the sectors funds, namely, [Fidelity Financial Services](#), [UOB United Global Healthcare](#) and [Henderson Global Technology](#).



Economic Review

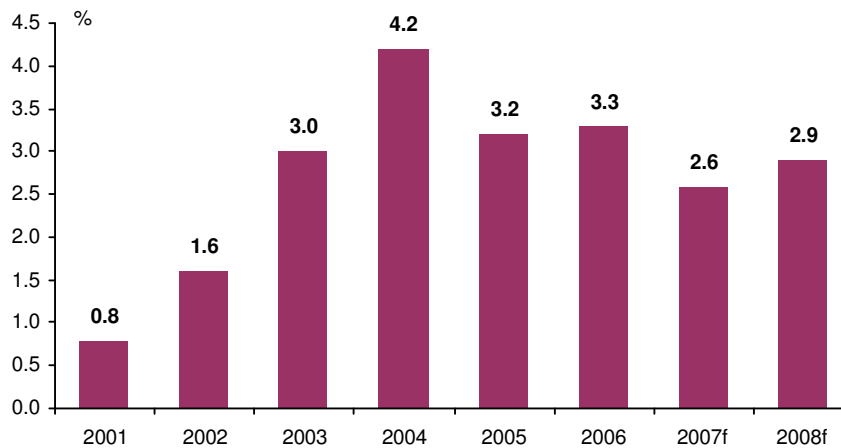
The **US economy** grew at an annualised rate of 2.5% in Q4 2006, according to the Bureau of Economic Analysis. The major contributors to the increase of GDP were personal consumption expenditures (PCE), exports and federal government spending (Exhibit 1). Real GDP was up by 3.3% for the whole of 2006 and most institutions, including The Economist, have forecasted a moderately slower growth this year (Exhibit 2). In a recent economic outlook by Ben Bernanke, the Chairman of Federal Reserve, he said that the weaker economic growth was on the back of poorer demand for homes.

Exhibit 1: Components of real GDP, seasonally adjusted at annualised rates

	2004	2005	2006	Q1 2006	Q2 2006	Q3 2006	Q4 2006
Real GDP	3.9	3.2	3.3	5.6	2.6	2.0	2.5
Personal consumption expenditure	3.9	3.5	3.2	4.8	2.6	2.8	4.2
Gross private domestic investment	9.8	5.4	4.3	7.8	1.0	-0.8	-15.2
Fixed investment	7.3	7.5	2.9	8.2	-1.6	-1.2	-9.1
Government consumption expenditures	1.9	0.9	2.1	4.9	0.8	1.7	3.4
Federal	4.3	1.5	2.0	8.8	-4.5	1.3	4.6
State and local	0.5	0.5	2.1	2.7	4.0	1.9	2.7
Net exports of goods and services							
Exports of goods and services	9.2	6.8	8.9	14.0	6.2	6.8	10.6
Imports of goods and services	10.8	6.1	5.8	9.1	1.4	5.6	-2.6

Source: Bureau of Economic Analysis, Q4 2006 final GDP release

Exhibit 2: Real GDP growth



Source: Bureau of Economic Analysis and The Economist

Personal income continued to increase by 0.5% mom in December while **personal savings** as a percentage of disposable personal income worsened to -1.2% (Exhibit 3), bringing the savings rate to -1.0% for the whole of 2006. Negative personal savings reflect personal outlays (including PCE, interest payments) that exceed disposable personal income.

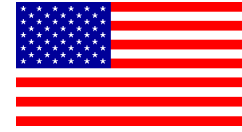
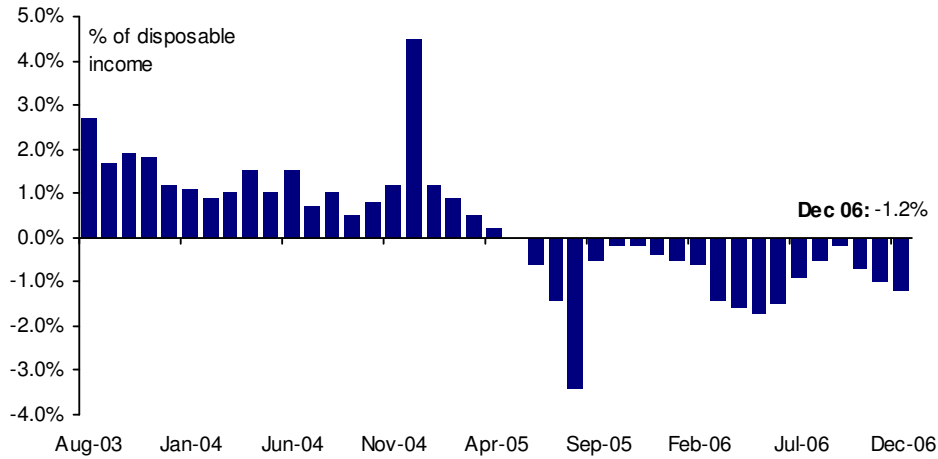


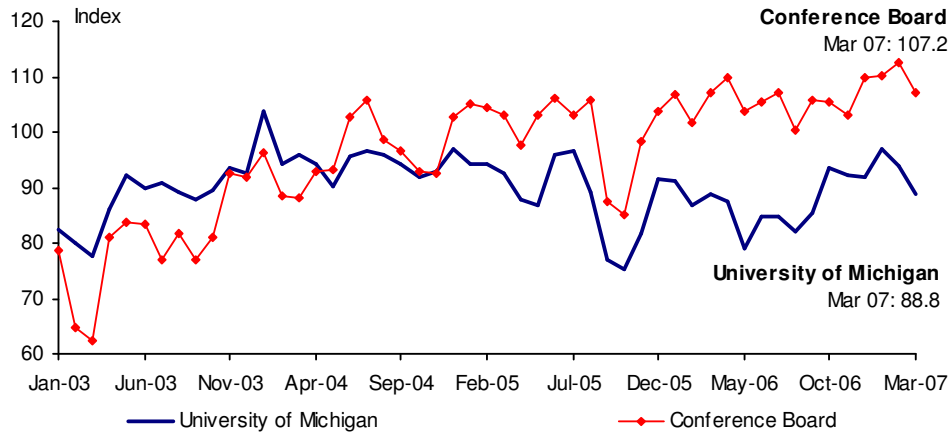
Exhibit 3: Savings rate



Source: Bureau of Economic Analysis

The Conference Board **consumer confidence index** plunged to 107.2 in March after recording a 5 ½-year high of 112.5 in February, which was dampened by the recent global stock market correction. A lower consumer confidence reading was also seen in the one released by the University of Michigan. It dropped to 88.8 in March from 93.8 in February (Exhibit 4).

Exhibit 4: Consumer confidence



Industrial production rose by 1.0% mom in February following a decline of 0.3% mom in January. This was due to increases in the manufacturing sector where there was higher production of motor vehicles and high technology goods. Production in the utilities component grew by 6.7% mom. As a result, industrial production rose by a healthier 3.4% yoy compared with the 2.6% yoy increase in January (Exhibit 5). **Capacity utilization** in the same month improved to an index of 82.0 from January's 81.4.

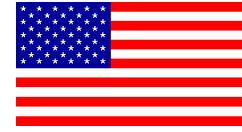


Exhibit 5: Industrial output

	Feb-07	
	% mom	% yoy
Industrial production index	1.0	3.4
Manufacturing	0.4	2.8
Mining	0.1	3.0
Utilities	6.7	9.6

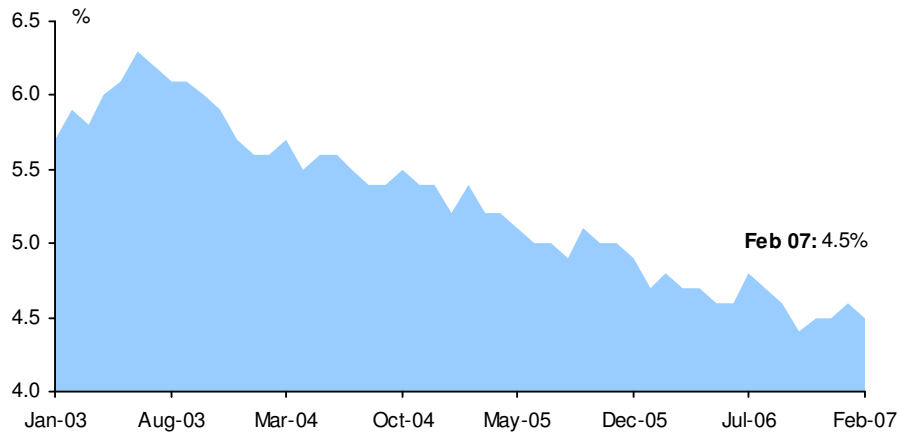
(Level)	Jan-07	Feb-07
Capacity utilisation	81.4	82
Manufacturing	79.9	80.1
Mining	91.2	91.2
Utilities	84.8	90.4

Source: Federal Reserve

The **ISM manufacturing index** rebounded unexpectedly in February to 52.3 following a sharp drop to 49.3 in January. New orders for manufactured goods, a component of the manufacturing index, also improved in February to 54.9 from 50.3 in the previous month. The services sector, which makes up about 90% of the US economy, recorded a poorer reading of 54.3 in February.

The labour market has recorded an **unemployment rate** of 4.5% in February, a 0.1 percentage point drop from the previous month, as shown in Exhibit 6. **Non-farm payroll employment** rose by 97,000 in February to 137.4 million persons. The increase is much lower compared with that in January (+146,000) and December (+226,000).

Exhibit 6: Unemployment rate



Source: US Department of Labour

Housing starts in February were down by 28.5% yoy but rebounded 9% mom to an annualized pace of 1.525 million units. **Building permits** declined 28.6% yoy and 2.5% mom to an annualized pace of 1.532 million units. **New home sales**, an economic indicator that measures sales of newly built homes, reported a decline of 3.9% mom to an annualised pace of 0.848 million units and continued to tumble on a year-on-year basis by 21.5% (Exhibit 7). The **Housing Market index** (HMI), an indicator for builder confidence as developed by the National Association of Home Builders (NAHB), dropped to 36 for the month of March from 39 in February. A rating of more than 50 means a greater number of positive responses versus negative responses from builders. The low reading is attributed to the slow down in housing market and higher delinquencies in the sub-prime mortgage lending market.

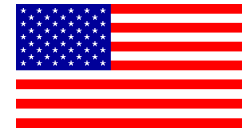
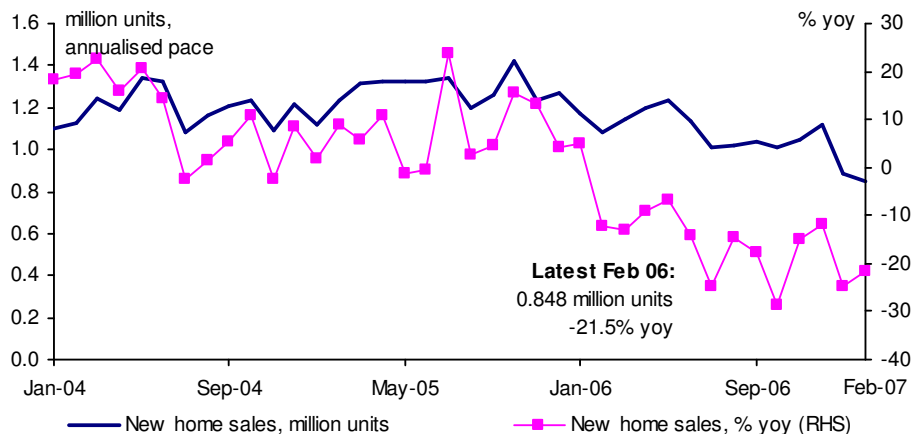


Exhibit 7: New home sales



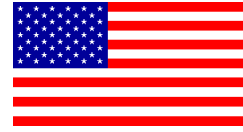
Corporate News

Motorola announced that it would likely to report losses in Q1 2007 in the range of US\$0.07 to US\$0.09 per share and that the profit outlook for the whole of 2007 might be worse-than-expected. This is on the back of likely lower-than-expected revenue generated from mobile phones due to price-cuts in order to maintain its market share amidst stiff competition. The company has meanwhile continued to improve its product ranges with the latest introduction of four new mobile devices. They included better and improved features like a 2.0 mega-pixel camera with landscape view, up to 2Giga-bytes of removable memory and high performance music features in one of the mobile phones, Motorokr Z6M.

Oracle Corp. posted a net profit increase of 34.6% yoy to US\$1.03 billion in its latest quarterly results. Revenue for the quarter surged 27% yoy to US\$4.41 billion out of which total new license revenue reached US\$1.39 billion due to new software applications and acquisition. It has announced an acquisition of Hyperion Solutions Corp, a leading global provider of performance management software solution, for US\$3.3 billion and this is likely to underpin Oracle’s future position in the high growth enterprise performance management market. It has also entered into a definitive agreement to purchase Tangosol Inc, a leading provider of reliable in-memory data-grid software maker. The purchase would help both companies create software applications that perform “real-time data analytics, grid-based in-memory computations and high performance transactions”.

Goldman Sachs recorded a 29% yoy increase in its latest quarterly net profit to US\$3.2 billion, on a growth of 22% yoy in revenue to US\$12.7 billion. This was attributable mainly to its Trading business, including equities, derivatives and commodities, where revenue surged 35% yoy to US\$9.4 billion. Financial Advisory and Underwriting businesses helped its Investment Banking arm chalk up US\$1.725 billion of revenue, equivalent to 17% yoy increase. **Lehman Brothers** reported net profit attributable to shareholders for the quarter ending February at US\$1.129 billion, an increase of 5.6% yoy on a 13% yoy surge in revenue. The businesses that performed well included Asset Management, which recorded a 19.7% yoy growth in revenue to US\$395 million. The revenue generated from Capital Markets Trading Business surged 15% yoy to US\$3.5 billion, helped by 42% yoy increase in equity trading to US\$1.3 billion.

Cardinal Health Inc., a medical services company in the healthcare industry, has launched a new product for hospitals and clinics using the new point-of-care technology to reduce medication errors to patients through its new Care Fusion® bedside verification application, Pyxis MedStation® units and Alaris® System IV pumps. It is the first company to create a complete suite of automated dispensing cabinets, smart infusion pumps and bedside bar-code verification systems. Earlier in January, it announced that it would be selling its



Pharmaceutical Technologies and Services (PTS) segment to The Blackstone Group for US\$3.3 billion in cash as part of its plan to focus on providing medical services to hospitals and clinics.

Ford Motor would be selling its British luxury carmaker, Aston Martin, to a consortium, which included Kuwait's Investment Dar and Adeem Investment Co for a sum of 479 million pounds. This sale was part of the company's restructuring strategy to increase liquidity and to be more focused on its core automotive business. Ford has also reached a long-term collaboration with Sony to provide audio systems for its vehicles sold in the US from 2008 onwards.

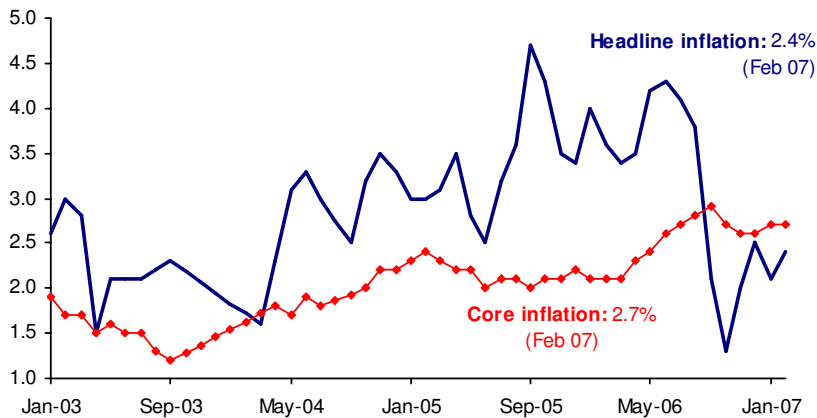
There have been rumours that private equity group, **Kohlberg Kravis Robert & Co. (KKR)**, is looking to acquire Canadian telecom company, Bell Canada, for CAD\$30 billion, which would be the largest takeover in Canada. The group together with billionaire Stefano Pessina, has meanwhile revised upwards its bid for UK drugstore chain, Alliance Boots, to US\$19.7 billion. It has also recently acquired TXU in a US\$45 billion buyout made in conjunction with Texas Pacific.

Interest Rates and Currency Outlook

The **consumer price index (CPI)** rose by 2.4% yoy and 0.4% mom in February. The year-on-year growth was higher than the 2.1% increase seen in January. The increase was attributed mainly to continual surge in the food and rental prices component. Core CPI, which strips out the energy and food prices, recorded an increase of 2.7% yoy, the same pace as in January (Exhibit 8). Rental prices surged last year due to an increase in rental housing instead of home purchasing due to high interest rates.

The Federal Reserve has kept its Fed Funds rate unchanged at 5.25% since June 2006. While it is expected to keep its rates on hold, the likelihood of a rate cut some time this year is not completely ruled out. A rate cut is likely given that the recent defaults of the sub-prime mortgage lending had led to fears that consumer spending would decline and slow down the US economy.

Exhibit 8: Consumer price index and Fed Funds rate



Source: Bureau of Labour Statistics, Federal Reserve

The **trade deficit** in January narrowed to US\$59.1 billion from December's US\$61.5 billion (Exhibit 9). This was on the back of a drop in imports of items such as automotive vehicle, consumer goods and machinery parts.

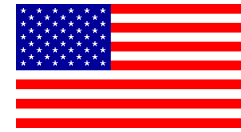
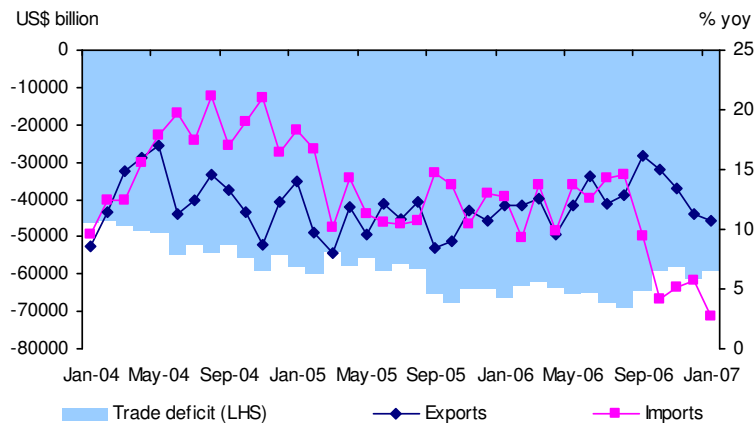


Exhibit 9: Trade deficit (US\$ billion)



Source: Bureau of Economic Analysis

The **current account** had a narrower deficit of US\$195.8 billion in Q4 2006, its smallest since Q3 2005's US\$185.4 billion. For 2006 as a whole, the deficit increased by 8.2% to US\$856.7 billion, which is equivalent to about 6.5% of GDP. The Congressional Budget Office commented that a reduction in the budget deficit would prove too optimistic and forecasted a deficit of US\$214 billion (1.6% of GDP) in fiscal year 2007, according to its March monthly review.

On foreign currencies, the US dollar is likely to remain weak vis-à-vis major currencies such as the Euro, Sterling, Japanese Yen and Asian currencies. Given the improving trade and current account deficits, the US dollar may trend sideways for the time being.

Stock Market Outlook

The recent US stock market correction was due mainly to the default of sub-prime mortgage lenders. The mortgage lenders, such as New Century Financial Corp., saw their shares collapse within a day amidst speculation that they would seek bankruptcy protection. It has announced that it would cease its loans service operations for Freddie Mac and has voluntarily agreed to stop lending.

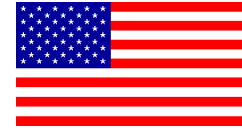
Freddie Mac has announced at the end of February that it would cease buying loans from sub-prime lenders, which are granted to homebuyers with poor credit histories. In addition, it would be limiting the use of low-documentation underwriting for sub-prime mortgage loans to help ensure that future borrowers have the ability to make payments and would not suffer from a "payment shock" due to an increase in interest rates. An example of a "payment shock" is when a borrower who received a US\$150,000 loan with an interest rate of 5.5% a few years ago is now faced with a much higher interest rate of, say, 10% when the interest rate is reset, leading to a huge increase in monthly payments, which he could not afford.

[US S&P 500 Earnings Yield Gap Analysis](#)

Based on the closing price of the **S&P 500 Index** of **1,417.23** points (270307), Earnings per Share (EPS) data as at 080307 from Citigroup and the 10-year US government bond yield of **4.62%** (270307), the earnings yields are as follows:

Trailing 12 months earnings yield of S&P 500 Index = $82.46 / 1,417.23 = 5.82\%$

Forward 12 months earnings yield of S&P 500 Index = $87.06 / 1,417.23 = 6.14\%$



Therefore, on a trailing basis, the equity market is cheaper than the bond market by 25.97%. On a forward 12 months earnings basis, the equity market is cheaper than the bond market by 32.90%.

In addition, we note that the dividend yield on the S&P 500 Index stocks of 1.78% is lower than the 3-month Treasury bill yield of 5.03%.

Funds Selection

We note that the yield gap analysis favours equities over bonds. However, it is not attractive to warrant an overweight in the US market due to concerns over the US economic growth and the weakening US dollar.

We do recommend exposure to the US market through the Financial, Healthcare and Technology sectors. **Fidelity Financial Services** fund is recommended for exposure to the financial services sector while **UOB United Global Capital** is recommended for those investing using CPF monies. As for the Healthcare and Technology sectors, the recommended funds are **UOB United Global Healthcare** fund and **Henderson Global Technology** fund respectively. The comparative performance of these funds is as shown in Exhibit 10. Exhibit 11 shows the geographical exposure of these funds.

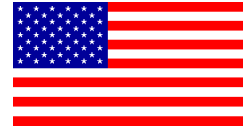
Exhibit 10: Comparative performance of our recommended funds

Fund	Bid-to-bid SGD Returns (%)				3-yr Annualised volatility	NAV/Bid price (SGD)
	1 mth	6 mths	12 mths	3 yrs		
Fidelity Financial Services	-3.9%	7.7%	10.1%	16.7%	10.5%	51.29
UOB United Global Healthcare	-2.3%	1.5%	3.5%	10.1%	9.2%	1.8162
Henderson Global Technology	-2.2%	3.8%	0.0%	4.0%	14.5%	1.36

Source: Fundsupermart prices and returns as at 27 March 2007

Exhibit 11: Country allocation of our recommended sector funds

Country allocation					
Henderson Global Technology			UOB United Global Healthcare		
		%			%
1	US	71.4%	1	US	64.1%
2	Taiwan	3.7%	2	Japan	10.8%
3	Japan	3.5%	3	France	3.9%
4	Korea	3.4%	4	Switzerland	3.4%
5	Netherlands	2.5%	5	Germany	2.5%
6	Finland	3.3%	6	UK	2.3%
7	Others	9.9%	7	Others	3.7%
8	Cash	2.3%	8	Cash	9.3%
	TOTAL	100.0%		TOTAL	100.0%
Fidelity Financial Services					
		%			%
1	US	30.4%	12	Netherlands	1.7%
2	Japan	14.4%	13	Norway	1.6%
3	UK	9.0%	14	Germany	1.3%
4	Italy	8.1%	15	Thailand	1.3%
5	Switzerland	5.4%	16	Luxembourg	1.1%
6	France	3.8%	17	Australia	1.1%
7	South Korea	3.0%	18	Russia	1.1%
8	Spain	2.7%	19	Sweden	1.1%
9	Cyprus	2.6%	20	Others	3.4%
10	Hong Kong	2.0%	21	Cash	3.0%
11	Brazil	1.9%			
	TOTAL	100.0%		TOTAL	100.0%



Source: latest available fund factsheets from the respective fund houses

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