INVESTALK

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WHAT'S IN

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PRIMEtalk

Capital Guaranteed Funds - How do they add value?

Singapore has seen in the last few years a rapid growth in capital guaranteed funds (or more broadly speaking, structured products). The "peace of mind" that comes with the notion that one's capital is secure appears to be valuable for investors in an environment plagued by uncertainty - due to terrorist fears, market volatility, epidemic fears, erratic oil prices etc.

While investors voted in favour of this, it is not quite evident that such products add much more value to investors beyond psychological assurance. The suspicion is that capital guaranteed funds may provide little more than capital security, with little or no actual performance. So do capital guaranteed funds really add value?

The answer to that question is not different whether it is an equity fund, bond fund or capital guaranteed fund. While there are equity and bond funds/managers that add value to investors, not all of them do. Similarly, capital guaranteed funds are not necessarily doomed to fail, but neither are they "guaranteed" for success (or performance). There is no free lunch and this principle applies equally to capital guaranteed funds as they do to other forms of investments, and investors need to be aware of that.

Having said that, capital guaranteed funds can indeed provide more than just capital security. There is empirical evidence[1] to suggest that capital guaranteed funds can consistently deliver a performance better than the risk-free rate if they are well-designed and priced in a competitive manner.

A product promising incredible returns based on unrealistic market conditions is just that – Incredible. On the other hand, capital guaranteed funds built on a fundamentally reasonable market scenario will stand a real chance to potentially generate real returns to investors.

Capital guaranteed funds often use complex derivatives which are not easy to price. The more competitive the pricing of these tools, the more likely it is that investors' interests are served.

At the end of the day, the best assurance for investors that a capital guaranteed fund can perform is not very different from what you would expect from an equity or bond fund – Transparency.

The clearer you are about the expected risks and returns of a product, the surer you will be that you will not end up with a "lemon". While there is no free lunch, some lunches are less costly than others.

Source: 1 BNP Paribas Asset Management Singapore Limited. As of November 2005.

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BNP Reg. No. 199308471D

DISCOVER why Dividends are an important source to your Investment Returns

Dividends - A Significant Source of Investment Returns

There have been a growing number of dividend-paying unit trusts in Singapore. The United Sure Balanced Income Fund recently launched by UOB Asset Management Ltd aims to pay a distribution of 4.5% in one year. What lies behind the strong rise in investors' interest in dividends?

Equity returns may have two parts: dividends and capital gains. Most stock market investors focus on capital gains, i.e. the rise in stock prices, and generally do not take into account dividends when calculating total returns.

The neglect of dividends is not surprising as, in emerging markets like Asia, dividends traditionally form a less significant part of total returns. This is because when economic growth rates are relatively high, earnings can often generate greater returns if reinvested back into the company as opposed to being distributed to shareholders.

In developed markets, where economies are more mature, dividends have historically formed a more significant part of total returns, and make up an important criterion for investors when assessing the potential total long run return of a stock.

Renewed Attention on Dividends

Dividend yielding stocks have gained strong favour with investors recently for a number of reasons. The first reason is purely cyclical. As the profit cycle enters into a mature stage, there is often rotation out of cyclicals like basic materials and technology into more defensive sectors like utilities and consumer staples. The latter sectors are typically mature industries and hence, usually have higher dividend payout ratios. Utilities typically offer a yield of 4% to 6% which make them comparable to government bond yields.

Corporate cash flow is high

The second and more interesting reason for the renewed attention towards dividends is the exceptional good health of companies today. Although earnings momentum is slowing, companies throughout the world are forecast to be more profitable, with higher cash flow and less debt for 2005. Data for the S&P 500 companies shows that the cash flow is so high that there have been increases in dividends, new capital investment, and share buybacks.

In Asia, dividends have also been gaining more attention as payouts in the region have been steadily growing, which is unusual for an emerging market. Since mid-2002, the dividend yield for Asian equities has been higher than the average weighted interbank rate^.

It is our view that Asian companies will be able to continue raising dividend distributions. Operating cashflow has consistently risen and is now up 135% since the Telecom, Media & Technology (TMT) bubble in 2000. Despite a recent increase in capital expenditure, Asian companies are still forecast to remain net cashflow positive^.

Structural demand

The third reason for the current focus on dividends is structural in nature. In the ongoing low interest rate environment, institutions like pension funds are diversifying their holdings in the continued search for yield. The popularity of equity asset classes like REITs is due in part to their potential ability to provide a regular stream of dividend income. Dividend yield stocks are also likely to be sought for the same reason.

Finally, the important thing to remember is that dividend yield is only one component of a company's total return. Understanding the company which aims to pay dividends is still crucial. If a company has sound fundamentals, its share price should have the potential to rise even if it pays healthy dividends.

Source: ^ CLSA Asia-Pacific Markets

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UOB Asset Management Ltd Company Reg. No. 198600120Z

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VALUEtalk

CONGRATULATIONS to our GrowthPath Early Bird Winners!

GrowthPath
The core investment that adjusts as you grow

United Overseas Bank is pleased to announce the winners of our GrowthPath Early Bird Draw, conducted on 31 October 2005.

1st Prize:
Travel Package for 2 to Europe
Tan Thiam Lye Stanislaus
(IC No. XXXXX294B)

2nd Prize:
42" LG Plasma TV
Tan Pin Neo Maggie
(IC No. XXXXX172A)

3rd Prize:
Sony Video Camera
Lee Chooi Wei (IC No. XXXXX518A)

4th Prize:
Samsung E640 Mobile phone
Ang Khah Hiang (IC No. XXXXX006D)

5th Prize:
St Gregory Spa Package
Chan Chee Kin (IC No. XXXXX517G)

6th Prize:
Dining for Two at Top of the M Restaurant
Lawrence Lee (IC No. XXXXX149Z)

7th Prize:
S$100 Takashimaya Vouchers
Ng Swee Keat (IC No. XXXXX756D)

8th Prize:
S$50 Takashimaya Vouchers
Chia Geok Har (IC No. XXXXX277Z)

NOTE: Winners have been notified by post at their last known mailing address.

Look out for the winner of BMW 320i to be announced on 20 Jan 2006.

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SMALLtalk

FINANCIAL 101: Insurance Glossary

Whole-life insurance

With whole-life insurance, you get lifelong protection. You pay premiums throughout your life, but these can be changed to a limited period. The policy will pay out the sum insured and any bonuses you have built up (if any) when you passed on or become totally and permanently disabled (if this benefit is provided).

This plan is suitable for long-term savings if you would like the insurance company to invest on your behalf.

Term insurance

With term insurance, you get protection for a set period. It pays the sum insured only if you passed on or become totally and permanently disabled (if this benefit is provided) during this period.

Endowment insurance

With endowment insurance, you get both protection and savings. The policy pays the sum insured and any bonuses you have built up at the end of the set period of time (maturity date), when you passed on or become totally and permanently disabled if it happens during this period.

Source: Your Guide to Life Insurance - Issued by Life Insurance Association

MARKET OUTLOOK - What we may expect in 2006

Global Equities

Although global growth in 2005 is generally lower than that of 2004, the underlying tone has not felt like much of a slowdown. Although there have been some pockets of weakness, the underlying tone has been strong led by US employment growth and expansion in household income, and strong cash flows in the corporate sector globally. Monetary growth in China has re-accelerated, and with signs of domestic recovery in Japan, a slightly more balanced pattern to global activity is emerging. All these are happening amidst a flattening US yield curve, and a spiraling oil and commodity prices.

On the outlook of continued economic expansion in 2006, equity markets should remain well-supported given reasonable valuations. With the exception of Asia and pockets of growth in Europe, companies exposed to corporate expenditure would appear better placed, and this is reflected in the positioning of our portfolios. The risks, however, are that inflationary pressures are greater than expected, and that liquidity tightens sharply.

However, our focus remains very much stock-specific. We believe that the backdrop of gradually slowing overall growth will continue to reward an emphasis on companies with their own secular growth dynamic which confers a visibility of earnings growth and a sustainability of competitive advantage.

Asian Equities

Although supported by valuations that are attractive relative to other regions, Asia is facing a weaker environment owing to gradually rising interest rates and slowing global growth. Inflationary pressures, driven principally by high oil and commodity prices, will continue to put upward pressure on interest rates and worries about the sustainability of current consumption trends in both the USA and Asia are likely to continue. This, combined with concerns about a slowdown in China, leaves us cautious on the region.

We have shifted portfolios away from the more export-oriented companies, and are overweight domestic plays such as banks, retailers, and other consumer discretionary stocks. At a country level, funds are overweight South-East Asian stock markets which we view as increasingly attractive after recent under performance and given the less cyclical nature of these markets, there should be less vulnerability to a slowdown in the US consumer/global economy.

We remain underweight Australia, despite the more defensive nature of the market relative to the rest of Asia, as valuations are stretched and the housing and consumer debt bubbles have significant further unwinding to come. We are underweight China and Hong Kong where earnings look vulnerable to a cyclical slowdown, expectations are too high, and valuations (in the case of Hong Kong) are expensive.

Global Bonds

Over the longer-term, we are positive on the outlook for bond markets, as we expect the higher oil price to act as a 'tax on growth' and as long-dated bonds find support from structural demand. In Europe, the market currently expects two interest rate hikes in 2006. We believe this is excessive, given that the European Central Bank have limited scope to raise rates in the near-term, and the lack of longer-term inflationary pressures within the economy.

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