Introduction

Being a trusted guide requires a deep understanding of the economies, markets, products, services and above all, your clients' business goals. SMART International Holdings, Inc. continues to pursue a primary advisor/business strategist's role in the areas of global investment strategy, asset allocation, performance analysis, investment product development, wealth management, cross-border business, project initiatives, market regulatory and infrastructure development and capacity building for market intermediaries.

By becoming a trusted guide for our clients, we earn the privilege to serve them with expertise in a wide array of services and products to create solutions specifically designed to suit their business appetite and risk tolerance levels.

The year 2008 was a challenging year for us, on account of sharp depreciation of asset prices and the near collapse of the global financial system. The onset of global recession caused uncertainty about improvement in the asset prices and created panic and fear among investors.

We continue to advise our clients to persevere in this uncertain period and follow the path of fundamental valuation and business principles in these difficult times. We continue to harness our in-house capabilities and develop our niche business areas covering global investment strategy, asset allocation, performance analysis, product development, cross-border business initiatives and capacity-building in capital markets. We strongly believe that once the dust of recession settles down towards the end of 2009, a stronger and more vibrant global economy will emerge from lessons of the past.

The Deep End of Today's Market Economy

Today almost all the world economies are mixed market economies with a varying degree of capitalist and socialist policy elements ingrained in them under set political ideologies. The capitalist and socialist policy elements emanating from the political agendas of different countries/ideological groups have created numerous barriers to the pricing of goods and services which should ideally be driven by demand and supply. An ideal free market needs complete absence of government regulation, subsidies, artificial price pressures and government-granted monopolies, and no taxes or tariffs other than what is necessary for the government to provide protection from coercion and theft, as well as maintain peace, and property rights. Technically, such an ideal situation is not possible but political forces should be directed towards achieving such a stage. In the interim, there will be a lot of turbulent encounters with pricing anomalies created by artificial demand and supply situations and failed policy initiatives.

Credit Crisis and the Financial Market Turmoil

Currently we have encountered a threat to global growth prospects on account of policy initiatives that created an asset bubble that was long overdue to burst. The bigger that bubble became, the larger was its crippling impact on the global financial system, as has been visible in recent months. The root cause of this was sub-prime lending and their securitization. This was a moral hazard that allowed unregulated mortgage lending, artificially low borrowing costs and spiraling leverage. The devastating impact of it became opaque as these mortgages were sliced and diced and sold via securitization to third parties on the pretext of risk diversification. Industry data suggests that between 2000 and 2006, nominal global issuance of credit instruments rose twelve-fold to US$ 3 trillion and this activity became intense since 2004 as investors look for higher return in a falling interest regime. However, early signals by rating agencies during the summer of 2007 when they started downgrading billions of dollars of these securities caused the prices to tumble, making these securities no more attractive. This caused a chain reaction from the market to highly leveraged investment banks and further, to the traditional banking system. The situation was severe where major financial institutions and the so-called universal banks without shedding such risks have transferred them among their own business lines. As more and more investors became reluctant to participate in the money markets, the sub-prime credit problems turned into a systemic liquidity crunch. Thereafter, a vicious deleveraging spiral got under way. As banks started selling assets to improve their balance sheets, that hit asset prices which in turn, hurt those balance sheets again on account of mark-to-market pricing of assets. Major financial institutions started tumbling. As reported by the IMF's World Economic Outlook in October 2008, the mark-to-market losses were a whopping $ 1.4 trillion and writedowns by financial institutions could be in the range of $ 1.23 to $ 1.68 trillion until we see restoration of confidence in the financial system.

The governments of most of the countries, developed as well as developing, have taken immediate steps to contain the damage caused by the credit crisis and large scale defaults and bankruptcies. These include liquidity and lending guarantees, interest rate cuts, bank deposit guarantees, bank recapitalization, asset purchase, short selling restrictions etc. As of mid-November 2008, it was estimated that the new loans, purchases, and liabilities of the Federal Reserve, the US Treasury, and FDIC, brought on by the financial crisis, totalled over $5 trillion: $1 trillion in loans by the Fed to broker-dealers through the emergency discount window, $1.8 trillion in loans by the Fed through the Term Auction Facility, $700 billion to be raised by the Treasury for the Troubled Assets Relief Program, $200 billion insurance for the

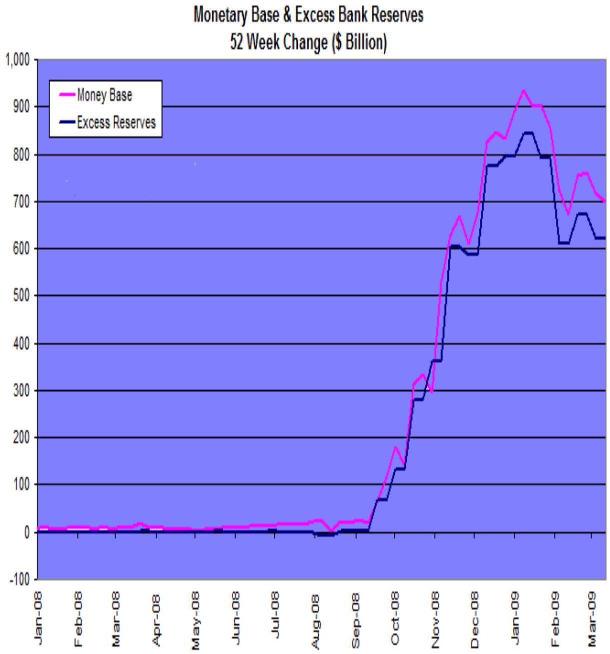
GSEs by the Treasury, and $1.5 trillion insurance for unsecured bank debt by FDIC. Additionally, the IMF has come forward to provide financial help as well as other technical support to avert any further crisis. The IMF is also working on measures that could rebuild confidence in complex financial instruments.

The root cause of the current problem is pricing of goods and services and their impact on production and growth. If the cost of production goes up, goods and services will certainly become dearer and consumption will rise, leaving little capital for reinvestment purposes. This will hamper growth. John Maynard Keynes put it the right way, when he said 'I define the marginal efficiency of capital as being equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price.' He further added that 'Now it is obvious that the actual rate of current investment will be pushed to the point where there is no longer any class of capital-asset of which the marginal efficiency exceeds the current rate of interest. In other words, the rate of investment will be pushed to the point on the investment demand-schedule where the marginal efficiency of capital in general is equal to the market rate of interest.' The same views were expressed by Marshall when he described 'marginal net efficiency of a factor of production' and Fisher explains 'rate of return over cost' in his *Theory of Interest*. However, these theories on which the edifice of investment, production and growth matrix are built, left many complex issues unresolved. Most important among them are rate of interest- whether it is deduced from future return expectations or externally, time value of money or simply called inflation, technological obsolescence or discoveries and above all the dynamism of the complex economies in which each and every investment decision is made at every stage. We do not wish to enter into a discussion on the complexity of the issues involved but on simple principles described above, the lack of which has created this present crisis. The first and foremost policy mistake made was reducing the rate of interest (the prime rate by the US) to make capital cheap. As we must realize Keynes' words when he said 'The significance of such changes in expectation lies in their effect on the readiness to produce new assets through their reaction on the marginal efficiency of capital. The stimulating effect of the expectation of higher prices is due, not to its raising the rate of interest (that would be a paradoxical way of stimulating output — in so far as the rate of interest rises, the stimulating effect is to that extent offset), but to its raising the marginal efficiency of a given stock of capital. If the rate of interest were to rise pari passu with the marginal efficiency of capital, there would be no stimulating effect from the expectation of rising prices.

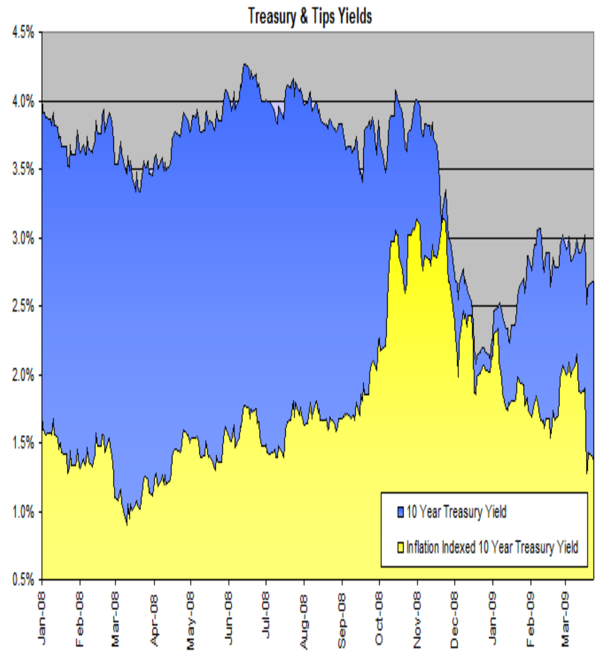
Recession

We are familiar with the term recession and we have experienced it before in 1980, 1990-93, 1998 and in 2001-2002. The credit crisis has just accentuated the recessionary pressure. The major reasons include a decade long of high commodity prices (particularly high oil and food prices, due to a dependence of food production on petroleum, as well as using food crop products such as ethanol and biodiesel as an alternative to petroleum), global inflation and increasing unemployment. In February 2008, Reuters reported that global inflation was at historic levels, and that domestic inflation was at 10-20 year highs for many nations. "Excess money supply around the globe, monetary easing by the Fed to tame financial crisis, growth surge supported by easy monetary policy in Asia, speculation in commodities, agricultural failure, rising cost of imports from China and rising demand of food and commodities in the fast growing emerging markets," have been named as possible reasons for the inflation. In mid-2008, IMF data indicated that inflation was highest in the oil-exporting countries, largely due to the huge growth of foreign exchange reserves without monetary policy interventions. However, inflation was also growing in countries classified by the IMF as "non-oil-exporting LDCs" (Least Developed Countries) and "Developing Asia", on account of the rise in oil and food prices. Inflation was also increasing in the developed countries, but remained low compared to the developing world.

The global economies have started pumping in huge funds into their financial systems to protect them from the near collapse situation. However, this may result in expansion of money supply. We have already witnessed a rapid rise in the US monetary base, caused by the Fed's actions to shore up the financial sector. But the surplus has not succeeded in expanding bank lending, most of it finding its way back to the Fed, deposited as excess reserves. Banks are trapped by their inability to find sound customers who want to borrow: the private sector are selling off assets and reducing debt. The bond market is betting they will fail, with TIPS and treasury yields declining in anticipation of low inflation. Unless there is a genuine credit off-take, the outcome would be high unemployment, low commodity prices, low stock prices and a longer than expected recession leading to deflation.



Source: St Louis Fed and FRB H3, not seasonally adjusted



Source: FRB H15

Unemployment level has been rising with drastic job cuts across the globe. It is estimated by the International Labour Organization that the global unemployment figure could go beyond 200 million by the end of 2009.

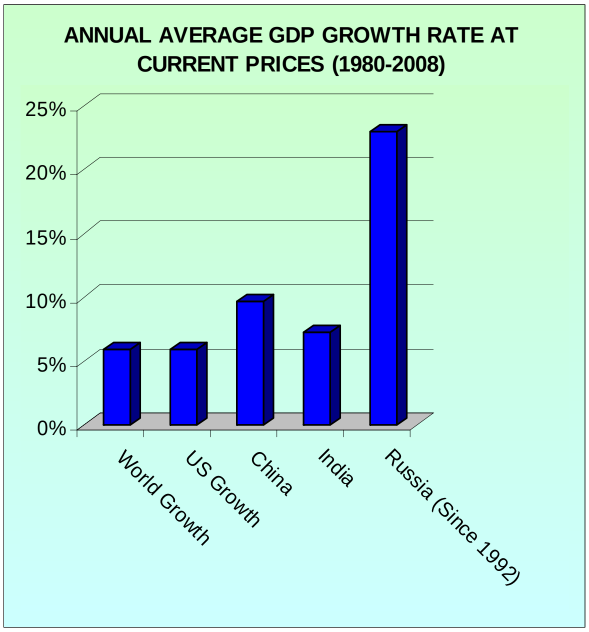
Global trade has been on the decline. In mid-October 2008, the Baltic Dry Index, a measure of shipping volume, fell by 50% in one week, as the credit crunch made it difficult for exporters to obtain letters of credit.

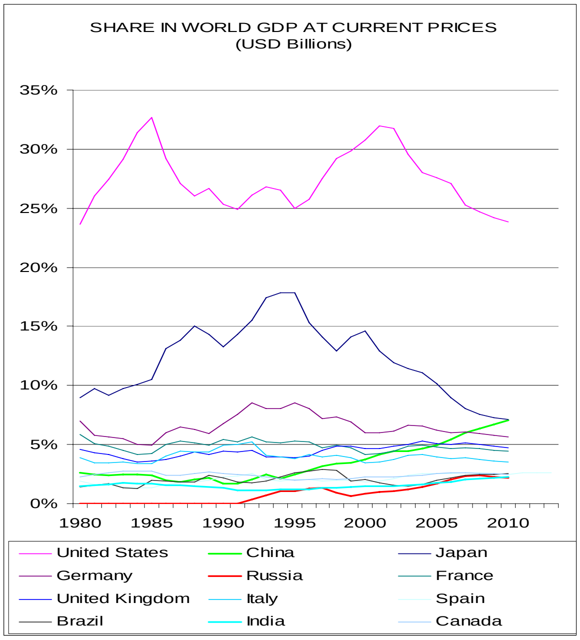
Of course, the credit crisis has a major bearing on the current economic downturns in major economies of the world, which has resulted in a global recession.

We are currently at the lower end of a growth cycle with the immediate impact of a credit crunch making capital the scarcest commodity. This situation is going to change when, first and foremost, we establish a more robust regulatory framework for complex financial instruments and bring commodity prices to more acceptable levels, so that investors regain their lost confidence in the financial system and marginal efficiency of capital stimulates fresh investments.

We are optimistic about the future of the global financial system and global growth prospects. The action taken so far by various governments- mainly support to bolster their banking systems and reduction of prime interest rates- is going to bring down commodity prices in the absence of proportionate demand off-take in the short-term. This will significantly induce fresh investments towards the end of 2009 and we can see a revival in the global economy in 2010.

According to the IMF's recent estimates, the world economy is expected to grow by 3.4% in 2008 at current prices but will significantly slowdown to 0.5% in 2009. As we may recall the world economy has grown at an average rate of 5.87% per annum and the US economy has grown at an average rate of 5.94% per annum, while the rapidly growing major economies such as China, India and Russia (since 1993) have grown at an average rate of 9.65%, 7.26% and 22.92% per annum since 1980, on account of which, the US economy which had a 31.97% share in global GDP at current prices in 2001, has seen its share declining to 24.71% in 2008. The second largest economy Japan which had a share of 17.82% in global GDP at current prices in 1995 has seen it declining to 7.53% in 2008. On the other hand, China which had a 2.17% share in GDP at current prices in 1993 has seen its share of GDP rising to 6.33% in 2008, followed by Russia which had a 0.63% share in 1999 has seen it rising to 2.43% in 2008 and India which had a 1.16% in 1992 has seen it rising to 2.09% in 2008.

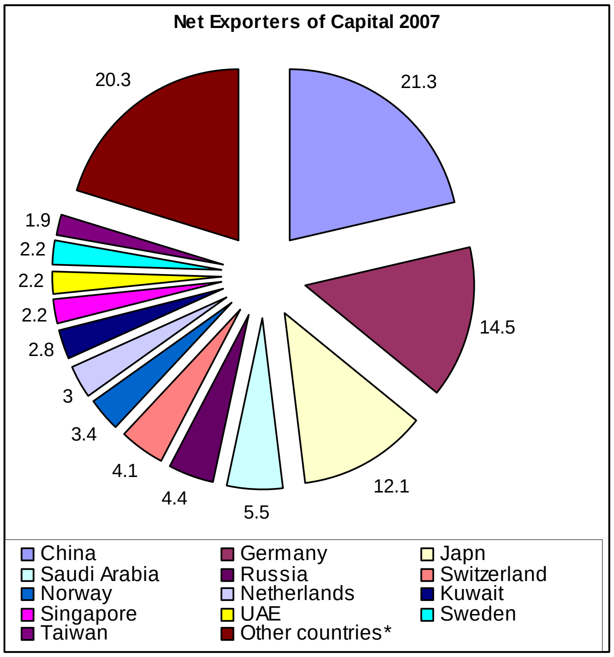


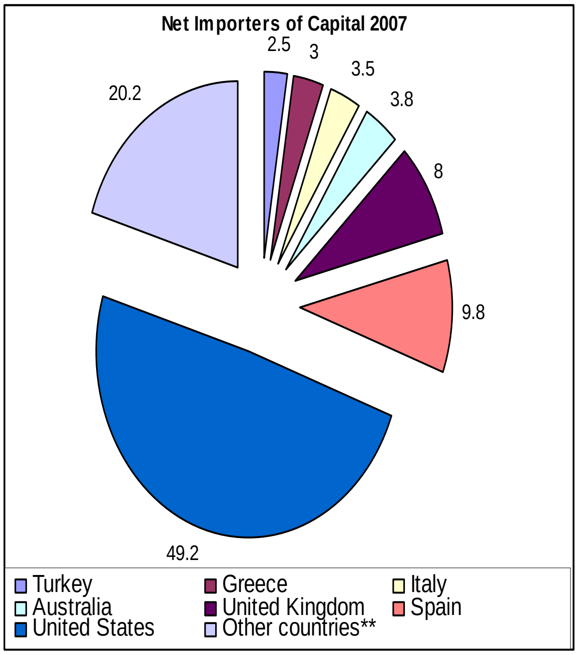


Source: Based on IMF revised data as per Jan 28, 2009 World Economic Outlook, data are available for Russia from 1992. SMART Research

This has resulted in further dispersion of economic resources and benefits and we expect this trend to continue once the current recessionary phase is over.

Moreover, there has been a paradigm shift in the direction of net investment flows over the past years which has increased the supply of capital, particularly in the USA which is a major net importer of capital in 2007. The increasing net inflow of capital into the USA in the absence of a proper structural framework has led to the housing bubble and the present credit crisis. Once a proper structural framework is put in place as interest rates moderate, capital will flow into productive investment avenues across the globe.





Source: IMF Global Financial Stability Report October 2008. Other countries* include all countries with shares of total surplus less than 1.9 percent. Other countries** include all countries with shares of total deficit less than 2.5 percent.

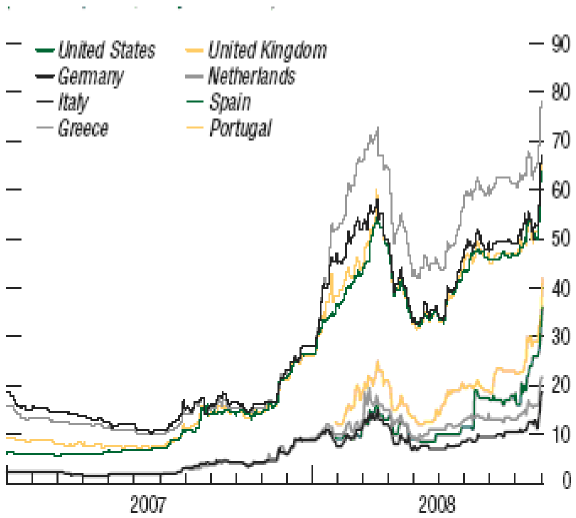
This cycle may take about 2-3 years expectedly from an USA economic turnaround beginning towards the end of 2009 gradually spreading to other developed economies including the rapidly developing economies and other developing countries.

The Loss of Confidence and Outlook for Financial Assets

Fixed Income

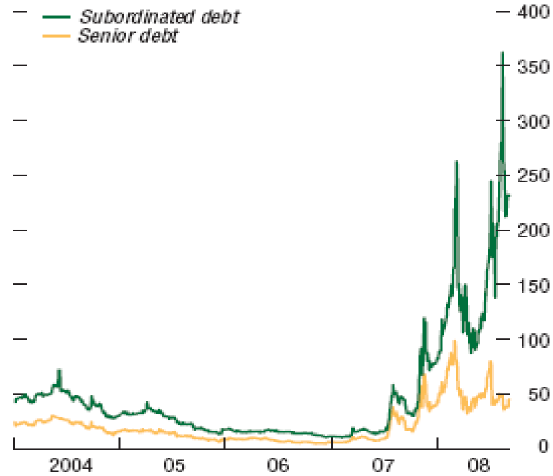
The fixed income markets suffered the immediate and most severe impact of the credit crisis and global recession on account of massive asset deleveraging, price declines, and unprecedented fall in investor confidence level. Credit spreads spiked to distressed levels. Since the beginning of October 2008, spreads on sovereign debt doubled, returning to 2002 levels, with more than a third of the countries in the benchmark EMBIG index trading at spreads above 1,000 basis points. Reflecting concerns about deterioration in fiscal positions and uncertainty regarding the effectiveness of the government actions, mature market sovereign CDS spreads have widened. Reflecting a more explicit government guarantee, senior and subordinated agency debt and agency-backed MBS debt spreads tightened relative to both treasuries and interest rate swaps and default risk fell. The risk premia on the GSEs' regular short-term discount note and longer-term debt auctions declined, thus enabling the GSEs to continue to guarantee new mortgages.

Sovereign Credit Default Swap Spread (in basis points, 10-yr tenor)



Source: Bloomberg

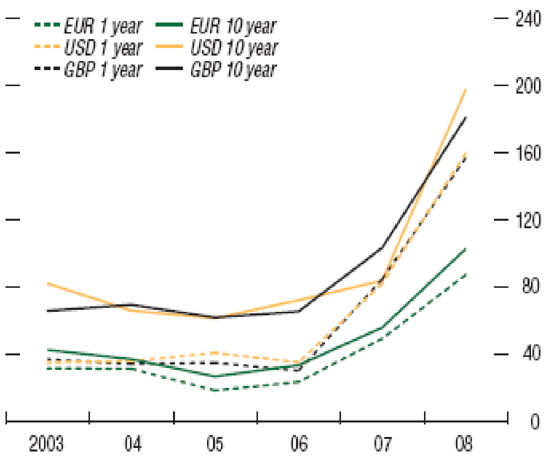
Credit Default Swap Spreads on Government-Sponsored Enterprise Debt
(in basis points, 5-yr tenor)



Source: Datastream

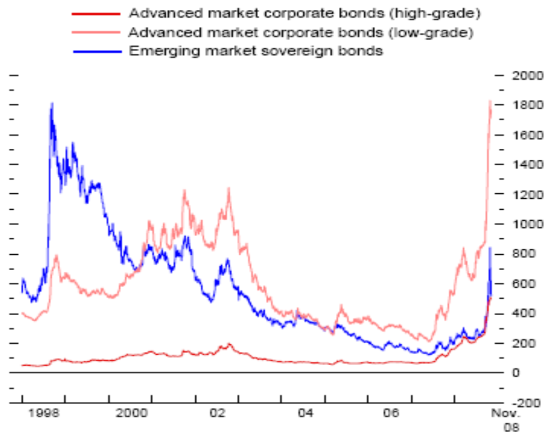
Simultaneously, refinancing risk and costs have increased, as longer-term wholesale financing has become less available, leading to greater bank reliance upon short term funding (overnight and weekly).

AA Rated Bank Bond Index Spreads Relative to Government Bonds
(in basis points)



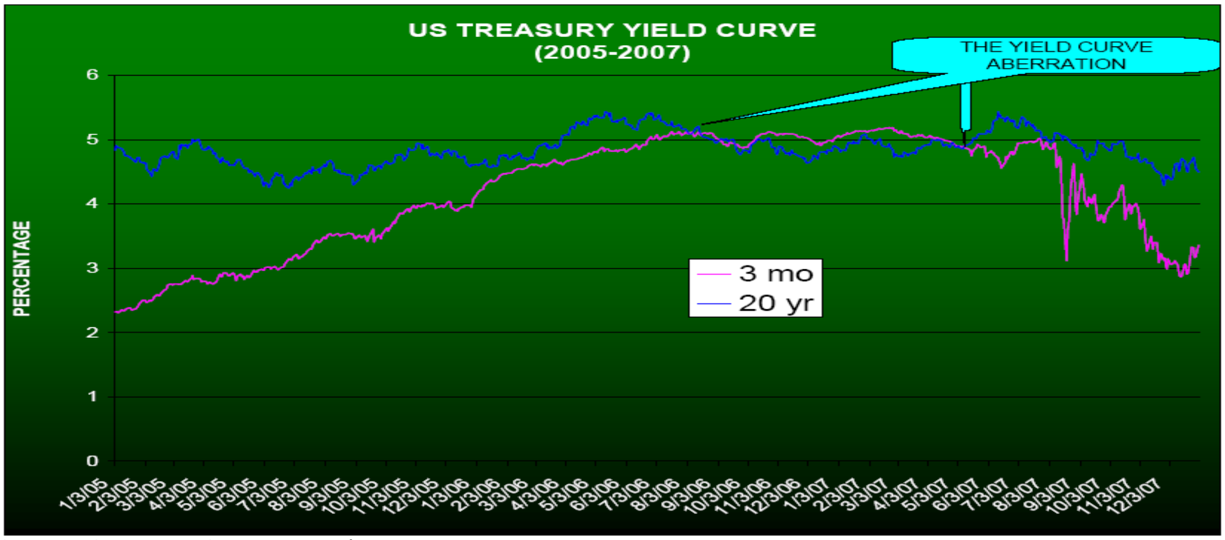
Source: Bloomberg

Advanced and Emerging Markets: Sovereign and Corporate Bond Spreads, 1998-2008
(In basis points)



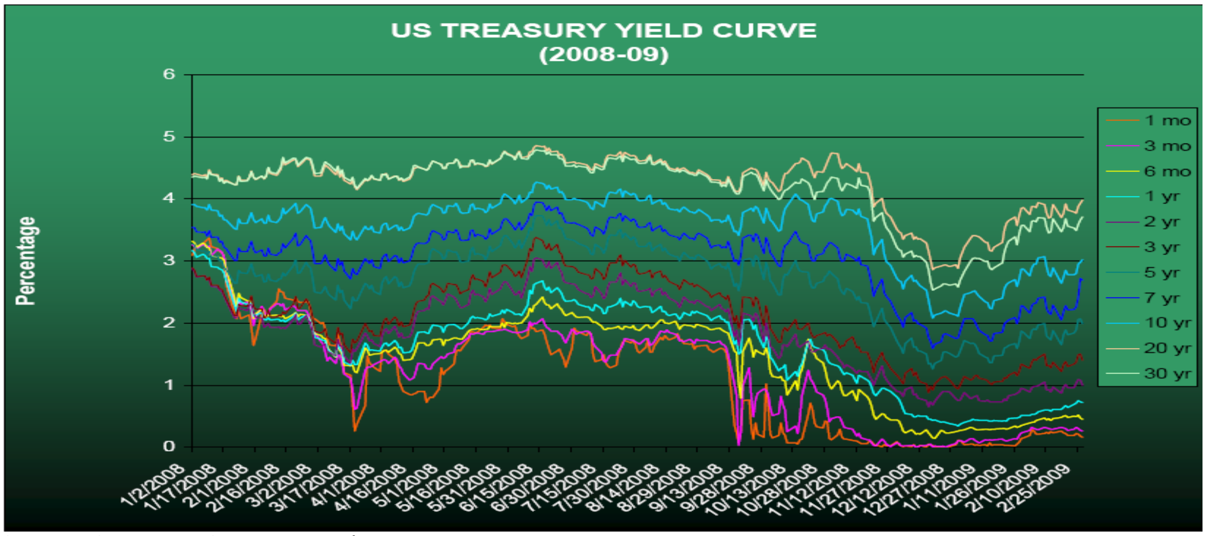
Sources: Bloomberg Financial Markets; Datastream; JP Morgan; KMV;Thomson Reuters; and IMF staff calculations.

The clue to today's financial crisis can be compared back to July 2006, when surging yield on 3-months Treasury surpassed yields on long-dated 20-year's Treasury, defying the very basics of time value of money, baffling everyone and creating a credit bubble.



Source: US Treasury, SMART Research

The fixed income markets were in turmoil during the last quarter of 2008. However, recent comprehensive policy measures such as purchase of distressed assets, use of public funds to recapitalize banks and provide comprehensive guarantees, and a coordinated reduction in policy rates by major central banks, have brought in some solace to investors. Though there is still a lot of risk aversion, the yield curves are smoothening and improving gradually, particularly since the beginning of this year, showing some sign of rationality and confidence in the financial assets.

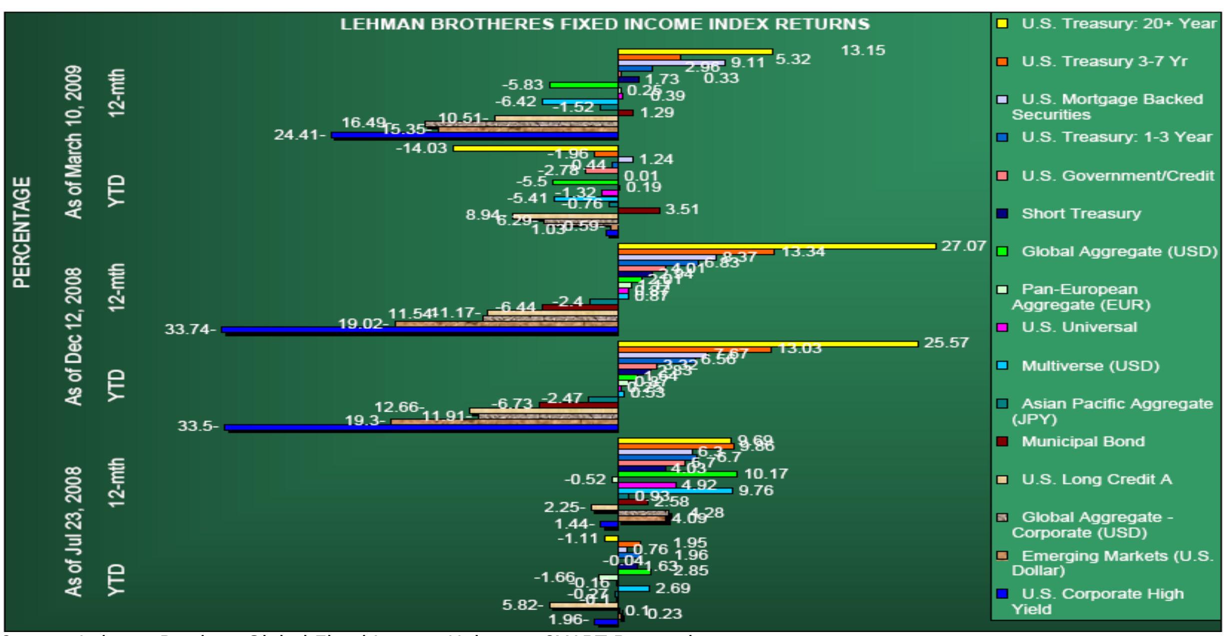


Source: US Treasury, SMART Research

However, investors are still pricing in expectations of much higher corporate default rates, as well as higher losses on securities and loans, in part, because the credit and liquidity risk has now spread to emerging markets, increasing recapitalization needs.

Looking at the substantial swings in the return trends of global fixed income securities between July 2008, December 2008 and March 2009, US long-dated Treasuries both above 20 years and between 3-7 years, appear to be a safe haven. Though US mortgage-backed securities have improved their returns over the period between July 2008, December 2008 and March 2009, at this stage we find it difficult to consider them as an investment option. Alternative to US Treasuries, we would rather recommend investing in the multi-universe and global aggregate indices. US Corporate High Yields were the worst hit at this stage and given the credit crisis that has not spared even the top run of the US multinationals, we would avoid Corporate High Yields as well. This is in line with extremely low business and consumer confidence, high corporate refinancing risks and financial market turmoil with vanishing liquidity. The spread between US Treasury Bills and LIBOR rates were at an all-time high of 200 basis points, i.e., four times higher than its 10-yr average in November 2008 and still continue to remain high above 100 basis points. However, over the recent 3 months we have noticed some reversal of trends in risk appetite as U.S. Corporate High Yield, Emerging Markets (U.S. Dollar) and Municipal Bond indices have performed better than the Global Aggregate - Corporate (USD), Multiverse (USD), Global Aggregate (USD), U.S. Treasury: 1-3 Year, U.S. Treasury 3-7 Yr and U.S. Treasury: 20+ Year.

Global Fixed Income as of March 10, 2009

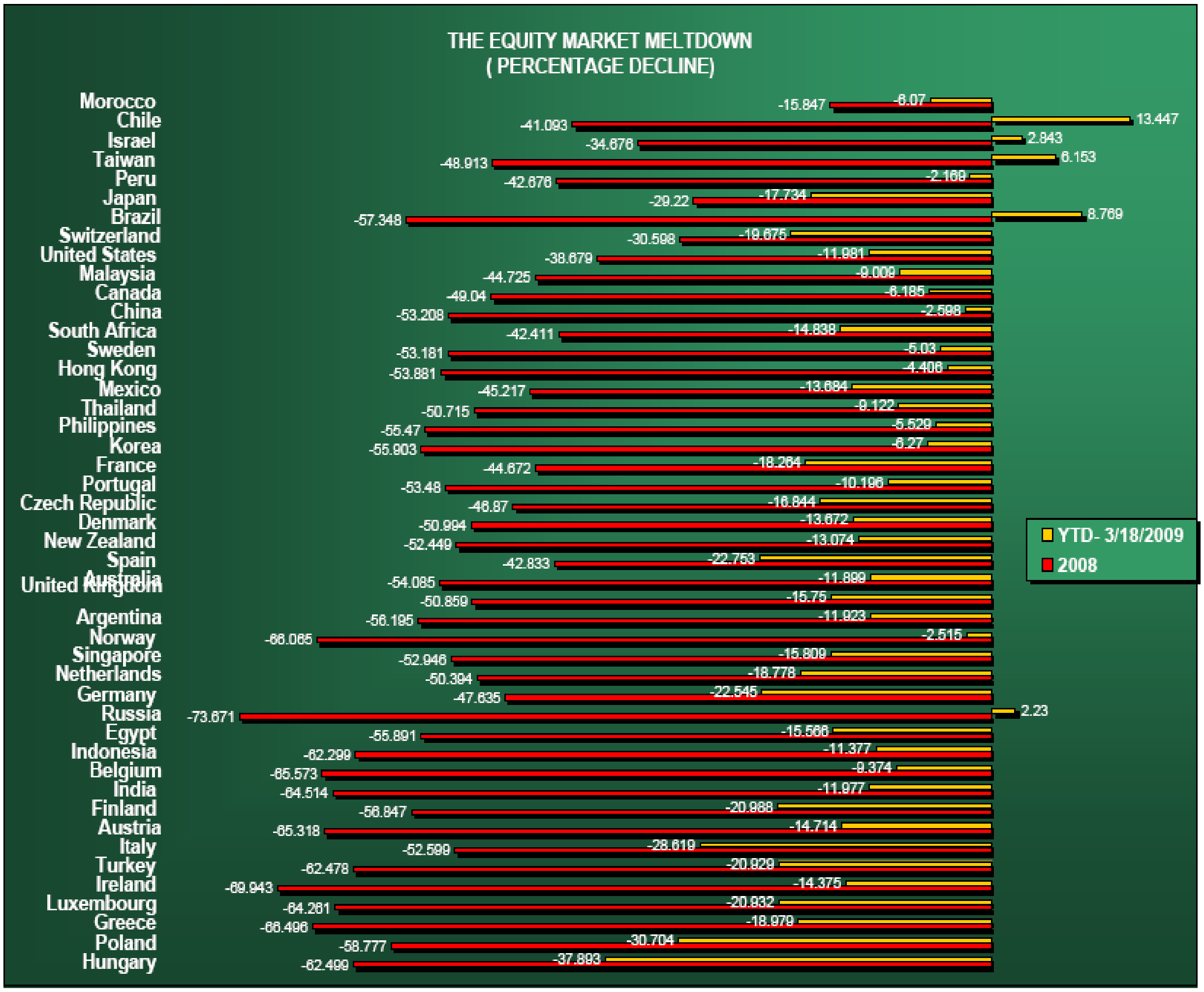


Source: Lehman Brothers Global Fixed Income Universe, SMART Research

Equities

The credit crisis and global financial market turmoil shattered global equity markets. A mild business cycle during the 1990s and the early 2000s coupled with available of cheap credit, promoted corporate growth at increased leveraging camouflaged by spiraling equity valuations. However, as the sub-prime crisis hit the balance sheets of major financial institutions, there was a cascading effect on asset prices. Once the fixed income market was hit hard with written-down sub-prime assets creating a huge vacuum and sending tremors through the financial markets, the highly valued equities sitting on debt fell like a pack of cards sending leverage ratios soaring and exposing the underlying vulnerability. The onset of the global recession worsens the situation.

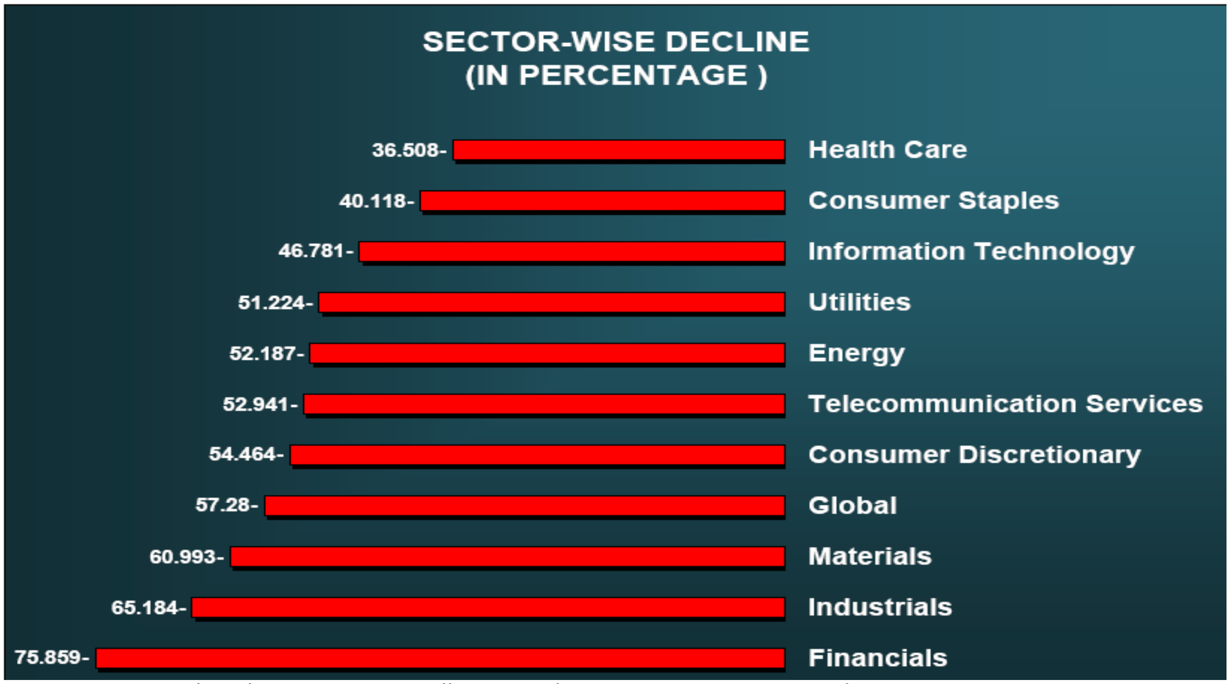
Global Equity Market Meltdown as of March 18, 2009



Source: S&P Broad Market USD Indices, March 18, 2009, SMART Research

All major global equity benchmark indices hit a 52-week low on September 29-30, 2008 and continued to slide further through October losing $ 29.09 trillion in market capitalization over the previous year end. Equity markets around the world continued to plunge further through 2009. As on March 18, 2009, the US market has fallen by 50.66% over the year 2007. Over the same period, the Italian market has fallen by 81.22%, Germany by 70.18%, UK market by 66.61%, Australia by 65.98%, Spain by 65.59%, New Zealand by 65.52%, France by 62.94% and Japan by 46.95%. Among the emerging markets, Hungary recorded the highest fall of 110.39%, Poland 89.48%, Greece 85.48%, India 76.49%, Russia 71.44%, Argentina 68.12%, South Africa 57.25%, Brazil 48.58%, China 55.81%, Chile 27.65% and Morocco 21.92%. During the current year until March 18, 2009, some markets witnessed revival with Chile recording the highest gain of 13.45%, followed by Brazil with 8.77%, Taiwan 6.15%, Israel 2.84% and Russia 2.23%. On a regional basis, so far since 2007 year end, European emerging markets were the hardest hit with a decline of 78.16%, followed by Eurozone with 70.46%, Asia Pacific Ex-Japan with 63.89%, Latin America with 49.95% and Middle East and Africa with 49.16%. Both developed and emerging markets were more or less equally affected with a decline of 56.95% and 57.63%, respectively.

Sector Wise Decline as on March 18, 2009 (since 2007-end)



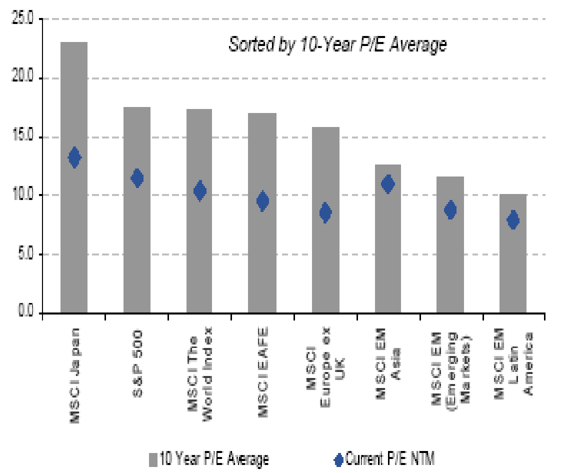
Source: S&P Broad Market USD Sector Indices, March 18, 2009, SMART Research

On a sectoral basis, the financial sector was the hardest hit with a decline of 75.86%, followed by Industrials with 65.18% and Materials with 60.99%, while Health

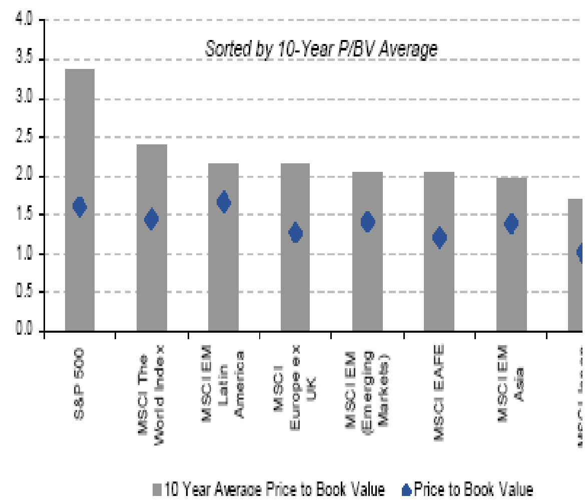
Care was the least affected with a decline of 36.51%, followed by Consumer Stables with 40.12%, Information Technology with 46.78% and Utilities with 51.22%.

After the sharp fall in global equity markets, most of them look quite attractive in terms of valuation, both on an absolute and relative basis. As valuations hover around levels closer to the previous recessionary periods, at this point, the downside risk is limited. Most regions, price to book and price to earnings ratios have traded below historical averages and dividends are in excess of sovereign debt rates.

Price to Earnings Historically Low



Price to Book Value Historically Low

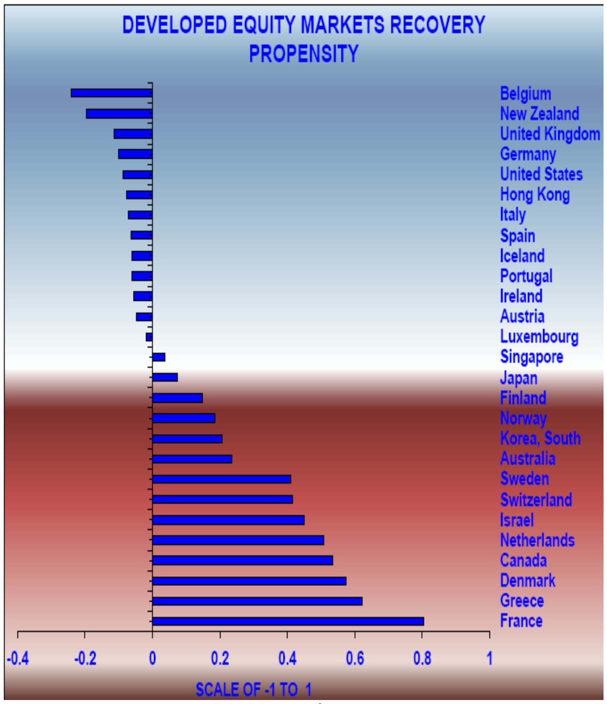


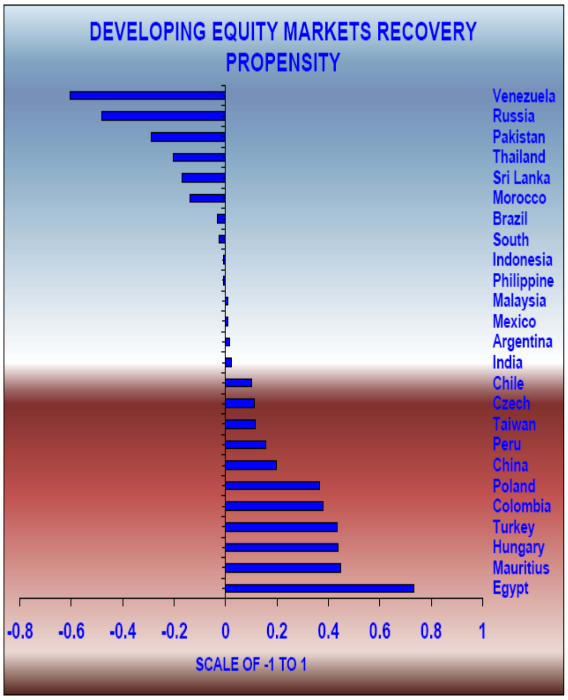
Source: FactSet, EcoWin, IBES Aggregates

However, globally, earnings continue to be revised lower with a further downward bias until the first quarter of 2010. Keeping in view the impact of current credit crisis and global recession on corporate earnings particularly during 2009 and the underlying economies' strength to come out of it, we have measured the propensity of global equity markets recovery. Markets with positive values closer to 1 are expected to revive faster while countries with negative values may drift further and may take longer time to revive.

On a Sectoral basis, the most favoured sectors during this downturn are Health Care, Information Technology and Consumer Staples. However, on a long-term basis, the earnings growth of Financials will be much higher once the recession is over.

PROPENSITY OF GLOBAL EQUITY MARKETS RECOVERY





Source: SMART's own research

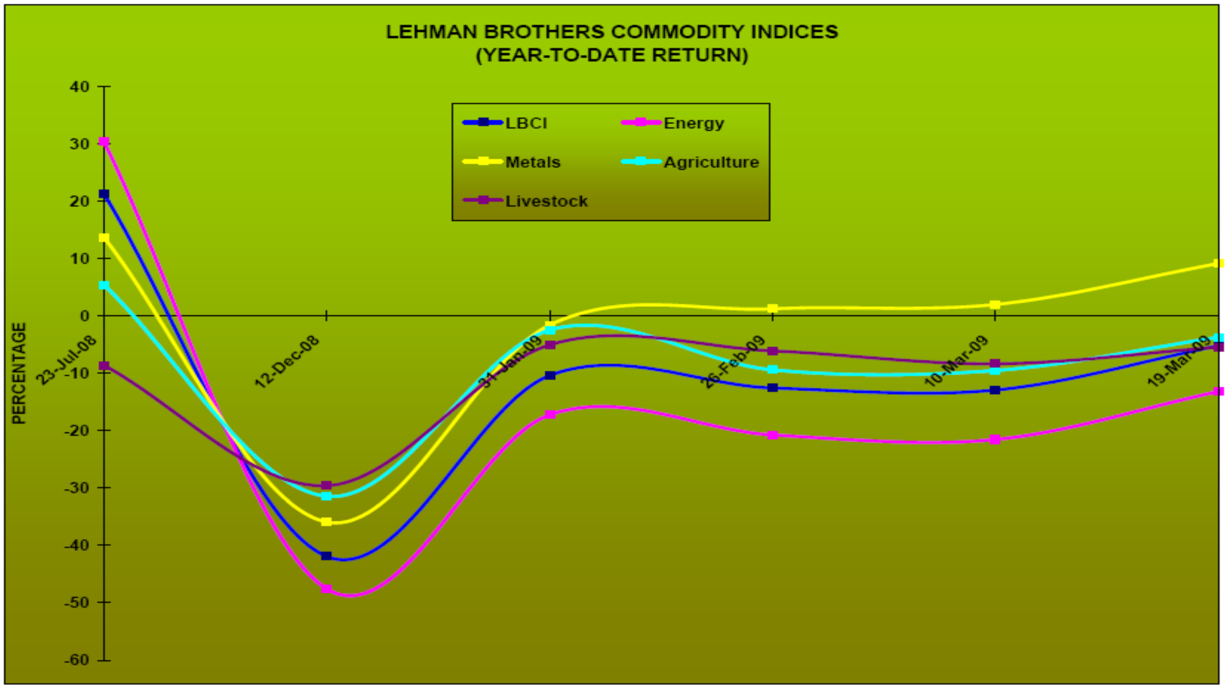
On a regional and sectoral preference the following asset allocation for equities is recommended for most part of 2009, though we will be revising our asset allocation again at the end of second quarter and third quarter.

MSCI All Country World	S&P 500	MSCI Europe Ex-UK	MSCI Japan	MSCI UK	MSCI Emerging Markets	MSCI BRIC
16.62% Financials	16.24% Information Technology	19.67% Financials	17.87% Financials	24.06% Energy	21.54% Financials	27.57% Energy
12.72% Energy	15.75% Health Care	13.46% Health Care	17.51% Industrials	17.64% Consumer Staples	15.06% Energy	23.57% Financials
11.66% Health Care	14.16% Energy	11.14% Industrials	17.13% Consumer Discretionary	14.01% Financials	13.39% Telecom Services	13.1% Telecom Services
10.9% Consumer Staples	13.02% Consumer Staples	10.96% Consumer Staples	12.54% Information Technology	11.78% Health Care	13.26% Materials	12.92% Materials
10.83% Information Technology	10.59% Industrials	9.1% Utilities	8.12% Utilities	8.24% Telecom Services	11.06% Information Technology	5.82% Industrials
10.28% Industrials	10.34% Financials	8.72% Consumer Discretionary	7.59% Materials	7.21% Materials	7.68% Industrials	4.95% Consumer Staples
8.5% Consumer Discretionary	8.32% Consumer Discretionary	8.64% Telecom Services	7.03% Health Care	6.07% Utilities	6.03% Consumer Staples	4.76% Utilities
6.49% Materials	4.57% Utilities	7.38% Energy	6.21% Consumer Staples	5.35% Consumer Discretionary	4.73% Consumer Discretionary	3.82% Information Technology
6.09% Telecom Services	3.86% Telecom Services	5.91% Materials	4.73% Telecom Services	5.31% Industrials	4.18% Utilities	2.77% Consumer Discretionary
5.78% Utilities	3.15% Materials	4.31% Information Technology	1.27% Energy	0.33% Information Technology	3.08% Health Care	0.71% Health Care

Source: MSCI, FactSet, EcoWin. All numbers may not add to 100% due to rounding.

Alternative Assets- Commodities

Weakening global demand is depressing commodity prices. Oil prices have declined by over 50 percent since their peak, retreating to levels not seen since early 2007—reflecting the major global downturn, the strengthening of the U.S. dollar, and the financial crisis—despite the decision by the Organization of Petroleum Exporting Countries to reduce production. In line with market developments, the IMF's baseline petroleum price projection for 2009 has been revised down to \$50/barrel for 2009 and \$60/barrel for 2010 (from \$68 and \$78 per barrel, respectively, in the November WEO Update). Similarly, metals and food prices have fallen from their recent peaks. While this eases the burden on households in advanced economies and emerging economies in Europe and Asia, it lowers growth prospects in many other emerging economies. The combination of stabilizing commodity prices and increasing economic slack will help to contain inflation pressures. In the advanced economies, headline inflation should decline to below 1½ percent by the end of 2009. In emerging economies, inflation is also expected to moderate, albeit more gradually. However, in a number of these countries, inflation risks are still manifest, as higher commodity prices and continued pressure on local supply conditions have affected wage demands and inflation expectations.



Source: Lehman Brothers Commodity Indices, SMART Research

The Lehman Brothers Commodities Index which had a year-to-date (YTD) gain of 21.34% as of July 23, 2008 has gone into a YTD loss of 41.9% by December 12, 2008. Its Energy Index has fallen from an appreciation of 30.45% to a loss of 47.55%, i.e.

78%, while the Metal Index has fallen from an appreciation of 13.74% to a loss of 35.92%, over the same period. The Agriculture and Livestock indices have seen a down swing of 36.88% and 21% respectively, over the same period. During the current year, commodity prices continued to fall until the second week of March during which we could notice some sharp revival particularly in metal prices, mainly on account of large scale bail out and stimulus packages announced by the US and other major developed countries.

Though the recent trend is encouraging for commodities investors, the huge uncertainty over a global economic recovery and falling interest rates and inflation will expectedly keep commodities prices down for most of 2009. This is good news for a faster global recovery as it will induce consumption but bad news for commodities investors. As the economies show some sign of recovery towards the last quarter of 2009, we may see some recovery in the commodities market, until then the only commodity that may hold on to recession and shine further is gold. At this stage, gold is considered as the safest asset and the currency of last resort.

Source: Netdania

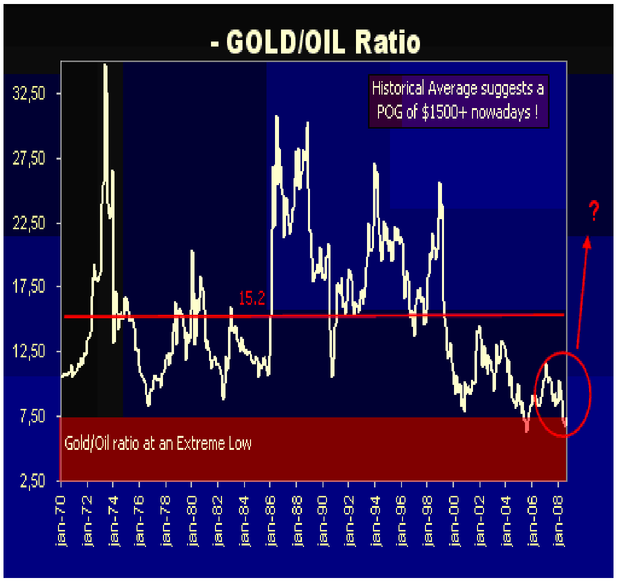
Source: Netdania

Spot gold is consolidating around $920-$960 levels and would test the $1000 level very soon. In the long term, breakout above the broadening descending wedge formation would offer a target of 1200; calculated as 900 + (1000 - 700). Gold has behaved out of character over the past few months, diverging from its usual relationship. Performance against the dollar is normally inverted: when the dollar strengthens, gold falls and vice versa. Gold made a typical response from 2006 to mid-2008: making a strong bull trend when the dollar weakened. In late 2008, however, the dollar reversed and started to strengthen. Gold initially weakened, as expected, but then rallied, testing its previous highs even while the dollar continued to rise, mainly on account of structural weaknesses in the US.

Gold is rising despite a strong dollar because the investing public is looking for safety, buying both the dollar and gold in their need for security. There is an alternative scenario, however, which is driving the current divergence. If the US federal government pulls the inflation lever, gold prices will soar. Inflation is a tempting solution, especially with massive federal debt, enormous contingent liabilities, collapsing housing prices, and a banking sector on life support.

Gold has strong correlation with crude oil as they tend to support each other, for two good reasons: (1) when oil prices are high, oil producers usually plow some of their profits into gold; and (2) when oil prices are high, inflation is likely to follow boosting demand for gold as an inflation-hedge. Even today, a sizable percentage of oil revenue ends up invested in gold. As oil prices rise, much of the increased revenue is invested as it is surplus to current needs and much of this surplus is invested in gold or other hard assets.

Source: Netdania



Source: Netdania

There are two strong points that will work well in gold's favour at this stage. First, in this global financial market turmoil and recession, gold is the currency of last resort. Secondly, as economies recover, inflation will increase and gold will act as a hedge against inflation.

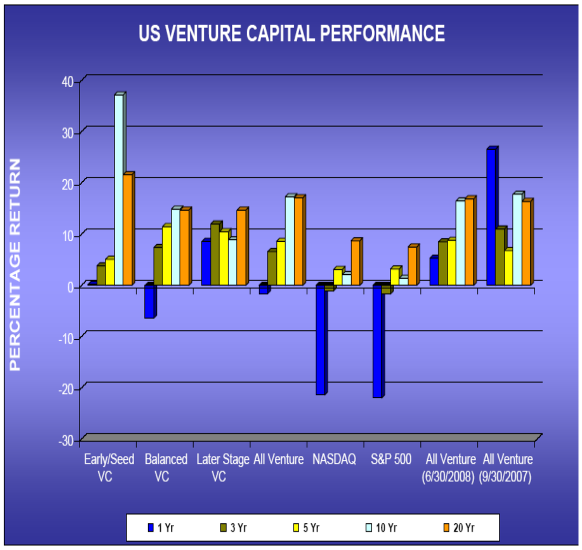
Typically, at this stage we would suggest a higher allocation for gold until gold reaches $1,200-$1,500 level and gradually bring down such allocation in favour of other commodities over the next three quarters.

Private Equities

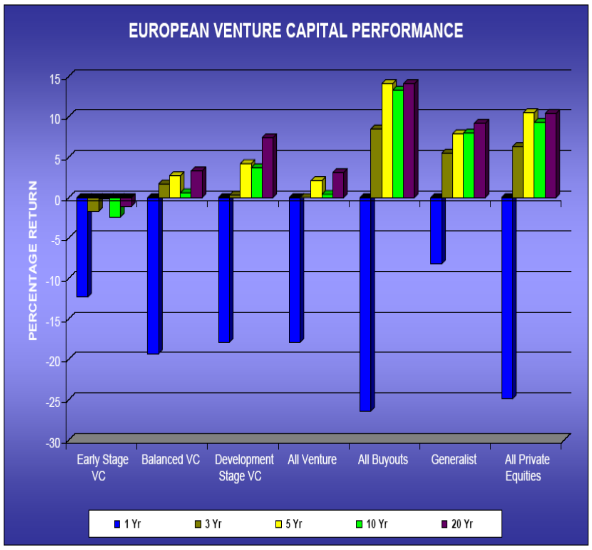
Private equity has grown over the years as a major component of the alternative investment universe mainly on account of its diversification benefits, high return-high risk profile and low correlation with public equity markets. However, the investment strategy of a private equity makes a huge difference to its correlation with public equity during bearish market periods. For example, IPOs are the most important exit channel for early stage investors and early stage investments have negative correlation with excess returns over public equities in bearish market conditions. Similarly, buyout funds exhibit low or negative correlation with public equities. In contrast, late stage investments exhibit a significant positive relation with excess returns over low public equity returns.

Investing in private equities is more suitable to institutional and high net worth investors for their capacity to hold on to their investments during adverse business and market cycles. More importantly, investing in private equities should be in alignment with an investor's liquidity needs in addition to his risk/return preferences and diversification requirements.

Over the years, private equities have provided much higher return than public equities. Over a 20-year period, the average return on private equities was 16.9 per cent (through June 30, 2008) per annum in the US and 10.4 per cent in Europe as against an average return of 8.7 per cent in NASDAQ and 7.5 per cent in S&P 500. During 2008, the performance of private equities was also adversely affected on account of the global financial turmoil and recession. Though private equities in the US managed to provide better return than NASDAQ and S&P 500, their counterparts in Europe provided abysmal returns.

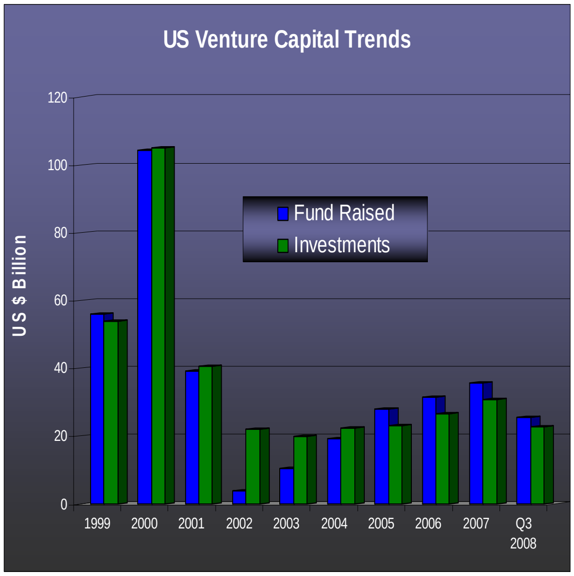


Source: NVCA and Thomson Reuters

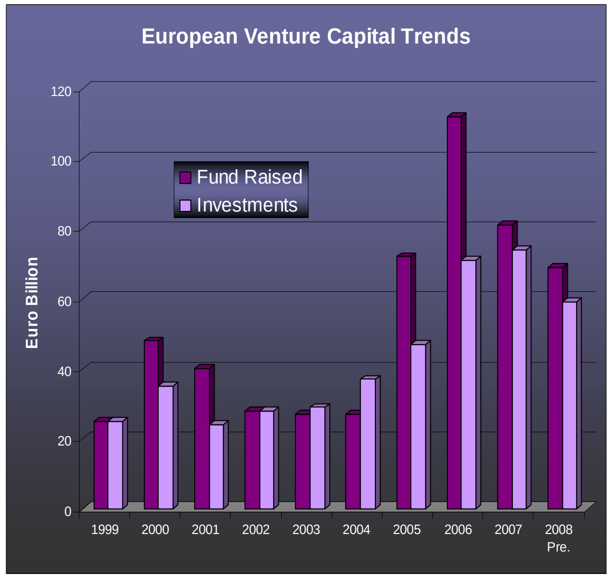


Source: European Venture Capital Association

Both, fund raising and investments peaked in the US during 1999 and 2000 prior to the technology bubble but witnessed a decline in activity thereafter. On the other hand, both fund raising and investments continued to increase in the European region particularly during 2005 and 2006 but continued to decline thereafter, though approximately thrice the amount of funds raised and invested in the US were from Europe during the recent two years.

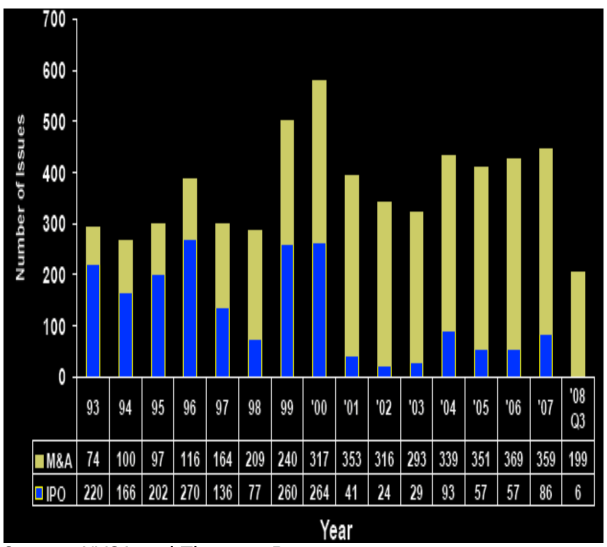


Source: NVCA and Thomson Reuters



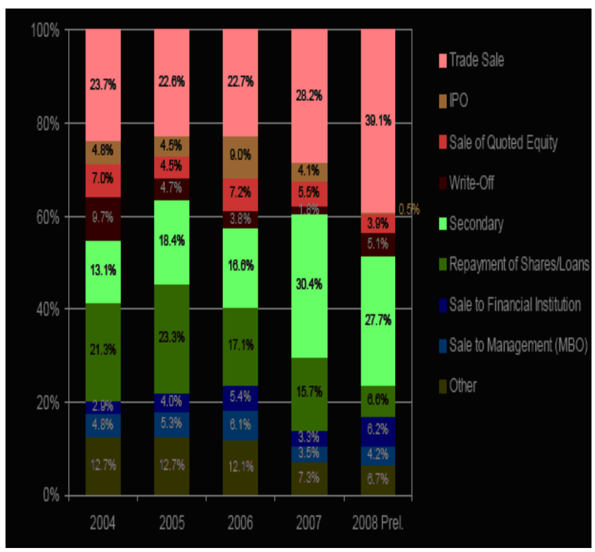
Source: European Venture Capital Association

As expected, on account of turmoil in public equity markets, IPOs as an exit option dried down considerably during 2008 both in the US and Europe, while Trade Sales and Mergers and Acquisitions took center stage.



	93	94	95	96	97	98	99	'00	'01	'02	'03	'04	'05	'06	'07	'08 Q3
M&A	74	100	97	116	164	209	240	317	353	316	293	339	351	369	359	199
IPO	220	166	202	270	136	77	260	264	41	24	29	93	57	57	86	6

Source: NVCA and Thomson Reuters

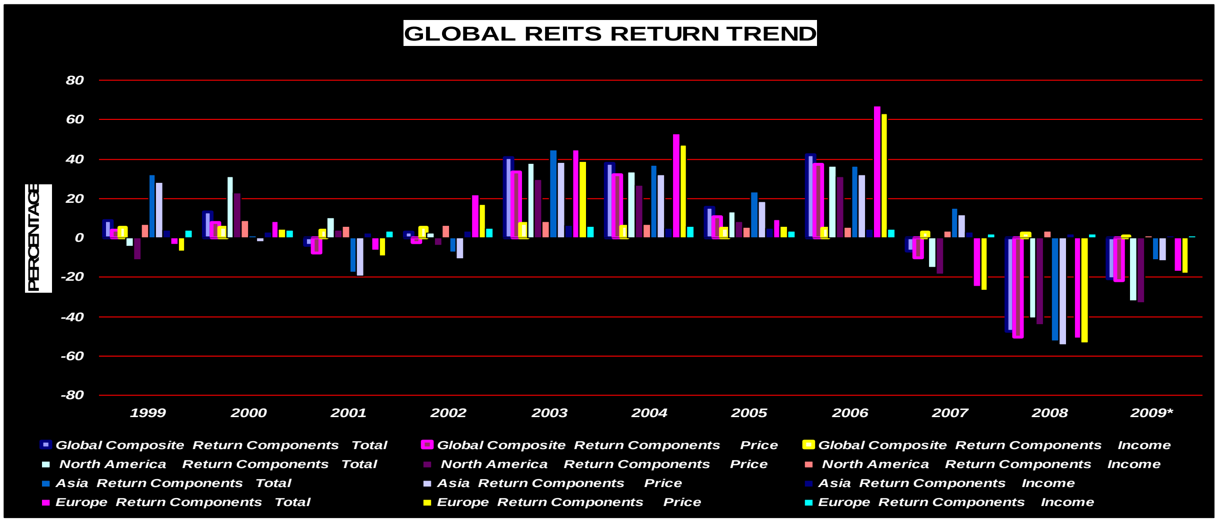


PEREP Analytics for 2007-08 figures, industry statistics. Divestments are at cost, not proceeds

Going by the trends in the public equity markets, we expect that both, fund- raising and investment activities through private equities route will considerably slow down in 2009. Since Seed and Early stage investments require higher risk appetite, investments in those segments will decline considerably. On the other hand, majority of investments will be in late stage and special situations such as mergers and acquisitions. We may witness another year of heightened mergers and acquisitions during 2009 and the number of such transactions will be relatively higher compared to the value of such transactions mainly on account of declined equity value. The expected return from private equities may further decline in 2009 and institutional investors may reduce their allocation to private equities. We may see some revival in private equity activities and return expectations in 2010.

Real Estate

Investment in real estate is widely recognized as one of the four primary core asset classes, representing about 50% of global wealth and approximately US$ 600 billion as of 2008 even after the massive decline in real estate value over the past three years. Investment in real estate can take any form, through private equity to real estate investment trusts (REITs). REITs are more transparent in terms of valuation and have higher liquidity as they are traded. REITs provide a way to realize the economic benefits of real estate, obtain stable, consistent income and long-term growth.

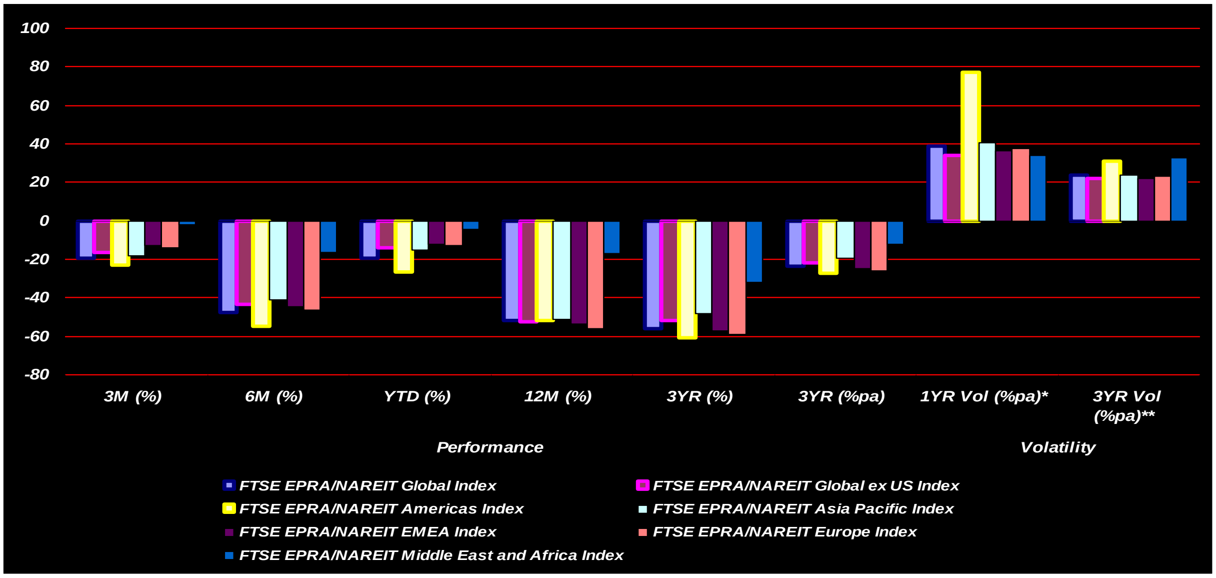


Note: '*' Year to Date as on March 27, 2009
Source: FTSE EPRA NAREIT GLOBAL REIT INDICES, National Association of Real Estate Investment Trusts® , European Public Real Estate Association® , FTSE™, FTSE Group, data as at 27 February 2009 and SMART Research

REITs also provide portfolio diversification beyond stocks and bonds and increase the overall return and at reduced risk. Traditionally, real estate as an asset class has low correlation with other assets.

Source: Seeking Alpha and SMART Research

However, the correlation between REITs and the broader markets has been moving higher recently. In fact, the correlation between REITs and the major equity indices is currently at, or near, all-time highs. As of May 1, 2008, the correlation between the MSCI REIT Index and the Dow Jones Industrial Index was 0.745. The correlation with the NASDAQ Composite Index was 0.706, while the correlation with the S&P 500 Index was 0.771. As seen in the chart below, the correlation of REITs to the broader markets has mostly run on five-year cycles. A past cycle began with REITs showing a relatively low correlation to the broader markets, and then correlation increases for three to four years, and then finally, moves down for one year.



Note: * Based on daily total returns and annualised based on 260 trading days in a year. ** Based on monthly total returns.
Source: FTSE Group, data as at 27 February 2009

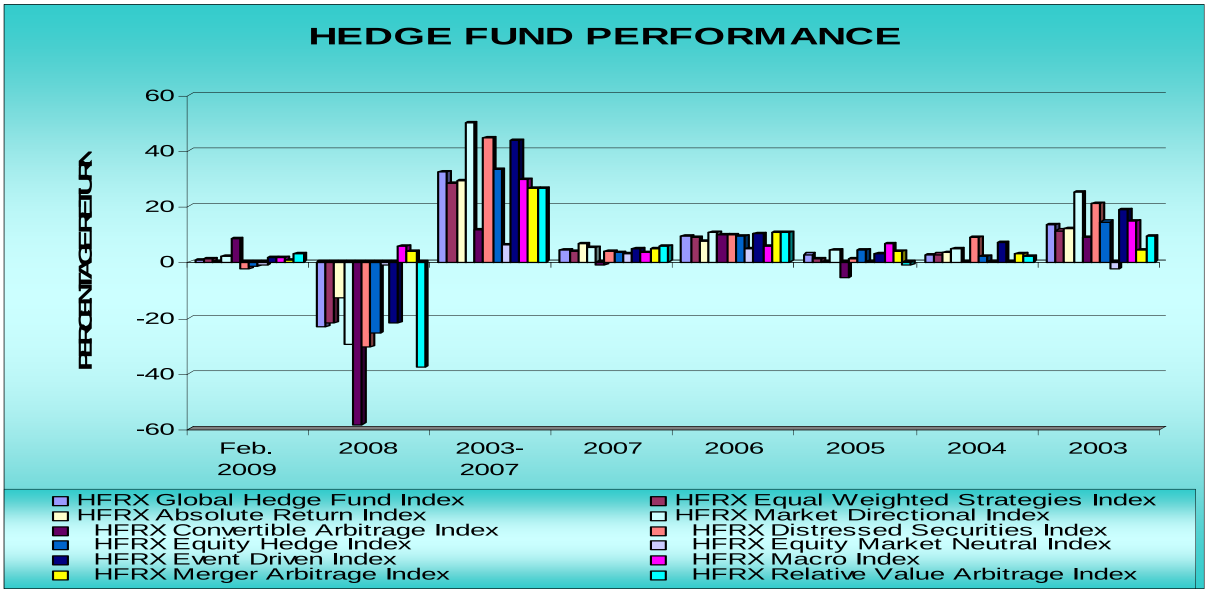
However, REITs are equities, thus they are exposed to the same type of economic and market risks and the current global financial market turmoil and recession. Though recently their correlation with equities is growing, over a long term for say 25-30 years, there does appear to be a systematic low correlation of REITs to the broader markets.

Hence, investing in real estate for portfolio diversification and enhancing return at reduced risk is extremely important for highly diversified global portfolios.

Though the global real estate markets have declined over the past few years, the cost and availability of capital remain top concerns for investors as illiquidity in capital markets continues to drag down real estate investment sales. We are expecting a turnaround in the situation towards the end of 2009 and believe that investment in real estate will provide excellent returns over the next five-year period.

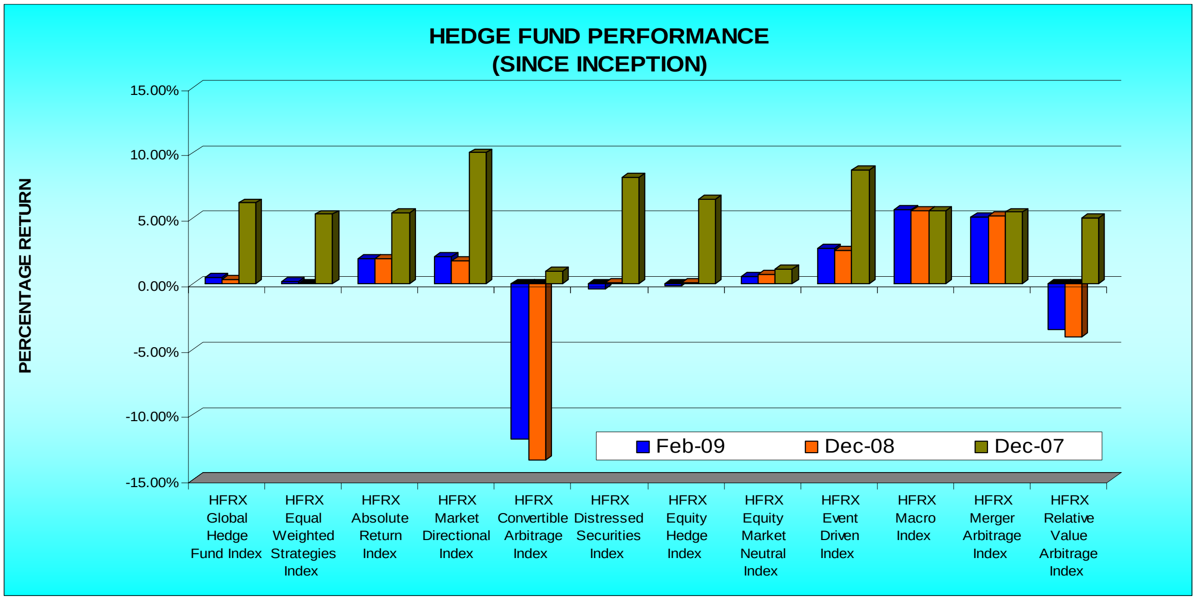
Hedge Funds

The sub-prime assets problem and global financial markets turmoil wiped out the hedge fund industry's growth and brought the assets under management to $ 1.4 trillion as wary investors withdrew as much as $525 billion during the second half of 2008.



Source: Data from HFRI, SMART Research

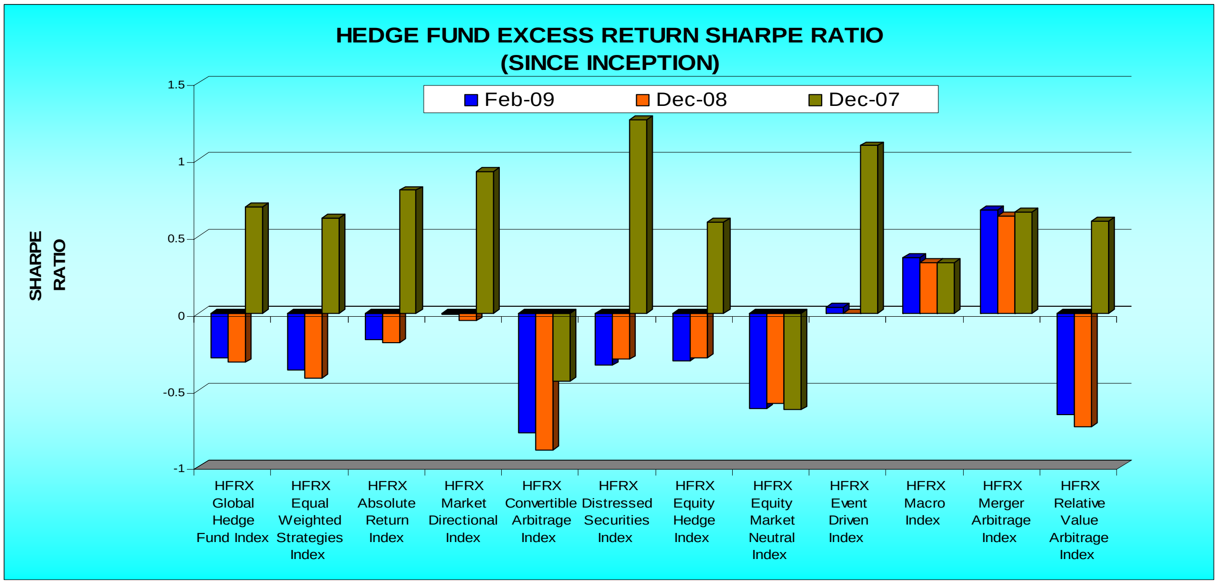
The HFRI Global Hedge Fund Index fell by 23.25 percent in 2008 which was the second calendar year decline since 1990. Though the Index revived in January, it again fell in February adding just 0.71 per cent during the first two months of 2009. Looking at the past years' return trend, the sharp fall in most of the hedge fund strategies during 2008 has wiped out past five years' gains. However, HFRX Macro Index, HFRX Merger Arbitrage Index, HFRX Event Driven Index and HFRX Market Directional Index have provided excess return over risk-free rates despite the recent sharp fall.



Source: Data from HFRI, SMART Research

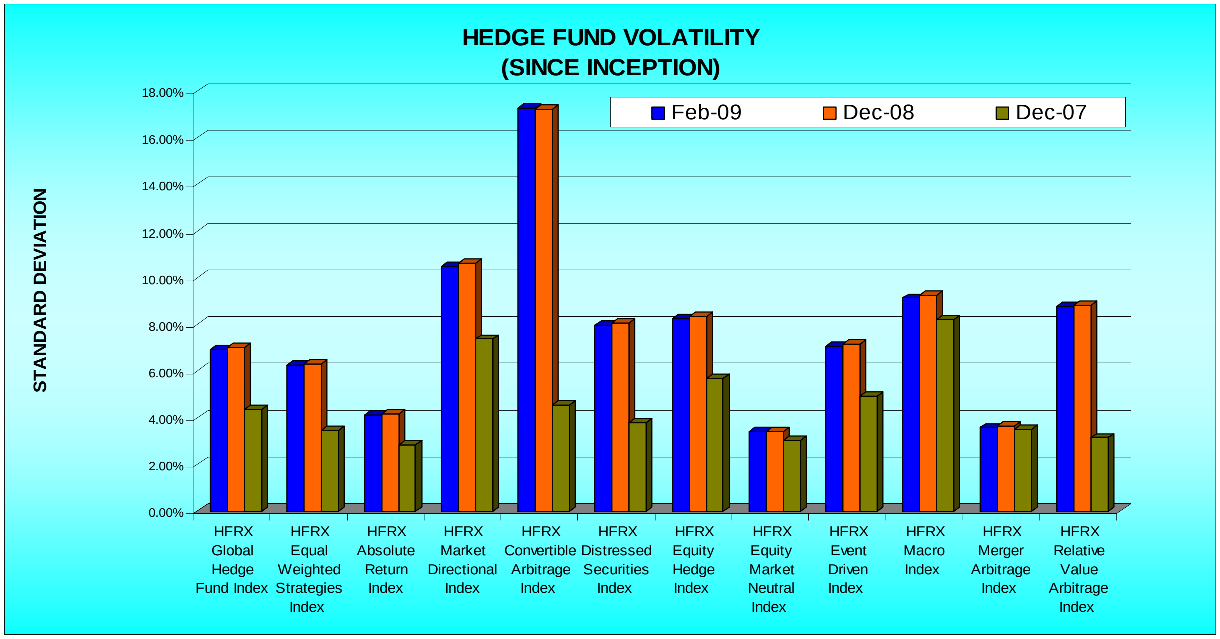
The performance of hedge funds was badly hit mainly on account of the uncertainty caused by the sub-prime assets, financial market turmoil and huge asset write-downs, excessive volatility and their inability to borrow funds for margin requirements or the so called creation of a "margin spirals". Such 'margin spirals' were particularly visible in the sub-prime mortgage asset-backed-securities market during the events surrounding the liquidation of hedge funds related to Bear Stearns Asset Management in July 2007 and other structured credit hedge funds in early 2008.

However, hedge funds as an asset class is still very attractive as compared to other traditional assets. Though strategy wise, various hedge funds have provided different returns at different risk levels, they are a must for a diversified portfolio as some of the strategies particularly macro, merger arbitrage and event-driven are low risk.



Source: Data from HFRI, SMART Research

They are also less correlated to conventional asset classes and market downturns. For example, the HFRI Merger Arbitrage Index maintained an above 5 per cent return with a standard deviation of around 3.55 per cent per annum and a Sharpe ratio of 0.65 throughout since its inception. Similarly, the volatility of the HFRI Macro Index is less than twice its return, and its Sharpe ratio is 0.33 since its inception.



Source: Data from HFRI, SMART Research

Asset Allocation Strategy

So, both money managers and intelligent investors have a lot of homework to do before they come to play on the turf of asset allocation and portfolio optimization. Money managers across the world are constantly looking for opportunities in various investment segments and spinning products that they feel will outsmart markets. More hedge funds, ETFs, real estate and private equity funds are being added to the basket of assets every year, than probably the underlying returns from these assets.

Asset allocation and portfolio optimization is more than just an econometric framework of historical risk and return optimization. It is about adopting the right methodology to forecast risk and return with some lead indicator and finding an appropriate benchmark. It is also about comparing performance of investment products and fund managers for consistency of superior return without the peer group or survivorship or end-of-period bias.

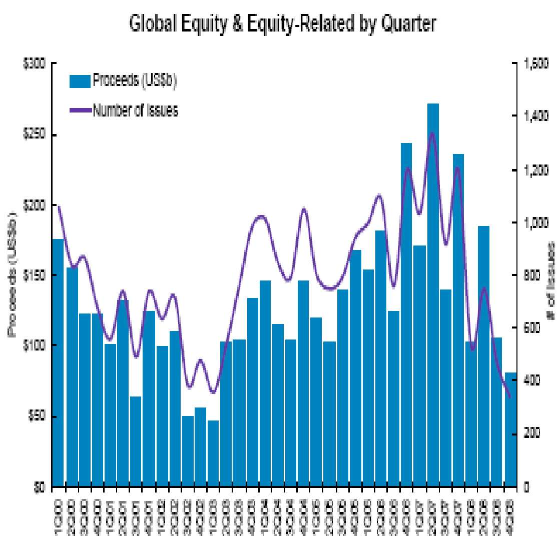
In order to avoid these common errors, we develop customized policy benchmarks that are truly reflective of a client's Investment Policy Objectives and Asset Allocation Strategy. Our custom benchmark is a composite benchmark that is produced by weighting a set of asset class indices that appropriately captures both forward-looking market systematic factors and managers' skills within a risk-return optimization framework. Once the custom benchmark is built, it is easier for us to evaluate the performance of a fund manager against it and segregate a fund manager's performance that is attributable to his idiosyncratic skills or style such as investing in the right style, active stock-picking, sector bets, or market timing from the general market or asset class performance. We perform attribution analysis over various rolling-windows of 12 months to 36 months both on in-sample and out-of-sample basis using the Bayesian Black-Litterman Approach in order to ascertain consistency in performance and style.

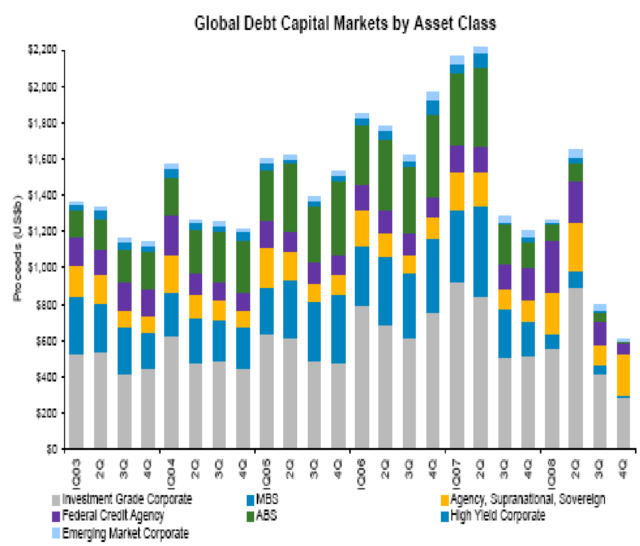
Our **Investment Advisory Services Group** is fully equipped to provide global investment strategy and asset allocation advices to company-sponsored mutual funds and discretionary managed account services for high net worth individual and institutional clients including foundations, pension funds, endowment funds, corporations, institutions and business houses. It also assists in-house investment managers in structuring customized investment products and solutions either in generic or fund of funds (FoF) version and offers off-the-shelf investment products.

Taking a step further, our Wealth Management Division adopted a theme of 'Lifestyle, Freedom and Legacy' to provide one-stop comprehensive wealth management solutions to high net worth investors and business families in the areas of customized investment products, trust formation and management, tax, health, estate and philanthropic planning. We tailor customized wealth management solutions based on initial confidential feedback on risk-return profile, consumption and life-time goals from the clients. We have built a strong network of third-party solution providers both in onshore and offshore jurisdictions to carry out a client's wealth management objectives.

Global Capital Markets

The financial meltdown, sharp decline in equity prices and recessionary spiral had its adverse impact on the capital markets as well. Volume-wise, it was the worst year in the last 13 years as global equity and equity-related underwriting volume in 2008 fell to US$470.7 billion, the lowest level since 2003 when volume was US$384.8 billion. There were just 2,063 equity capital markets issues in 2008, the fewest since 1991 when there were just 1,813 offerings. Global IPO volume slowed drastically in 2008, falling 71.2% from the previous year to US$84.6 billion from 508 issues. By volume, 2008 represents the slowest year for global IPO issuance since 2003 when issuance totaled US$53.1 billion; by number of IPO issues, 2008 is the slowest year since 1990 when 293 offerings came to the market. In total, IPOs accounted for a modest 18.0% of global equity and equity-related activity compared to 36.1% in 2007. Noticeably, the balance sheet salvage operations in the financial sector, mainly by banks and insurance companies, witnessed record issuance volumes mainly due to follow-on and convertible offerings which increased by 17.6% to US$233.7 billion in 2008, from US$198.8 billion in 2007.





Source: Thomson Reuters

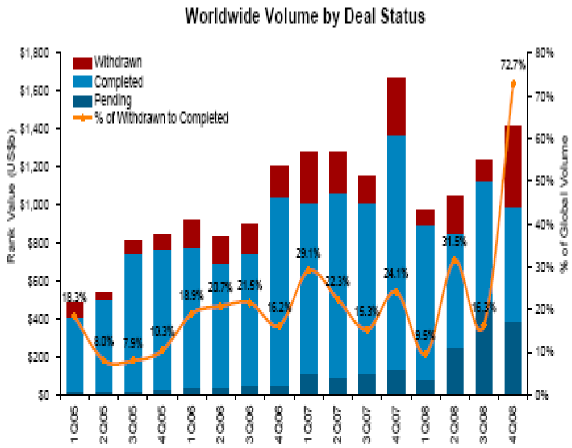
As the momentum of global credit markets meltdown increased, the volume of debt new issues slowed to a halt during the fourth quarter of 2008, posting the slowest full year period since 2002. For the full year 2008, global debt underwriting activity totaled US$4.2 trillion, a 38% decrease from 2007. The market for asset-backed and mortgage-backed securities, including collateralized debt obligations, registered an

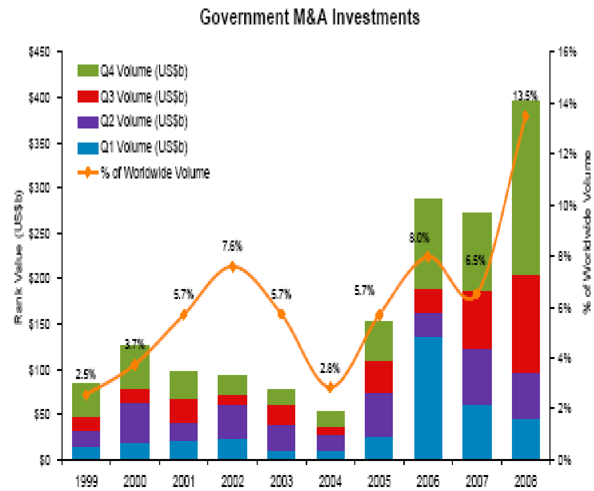
81% decline over 2007 volume. High yield and investment grade corporate bond issuance declined year-over-year by 77% and 22%, respectively, as corporate bond volume was dragged down by a complete slowdown of issuance by non-financial issuers in the United States.

For the full year 2008, corporate debt issuance accounted for 52% of overall volume compared to 44% during the comparable period in 2007. The Agency and Sovereign debt market experienced the biggest increase in volume during full year 2008 accounting for 36% of all new issues compared to 18% last year at this time. Securitizations comprised just 12% of overall volume, down from 37% of total activity last year at this time. Issuers from the Financial sector dominated global debt volume during full year 2008 with 59% of overall proceeds, down from 77% last year at this time. Deals from the Consumer Staples and High Technology sectors registered the largest percentage gains over last year at this time, with volume for the year up 31% and 20%, respectively. Leading the declining industries were Healthcare and Real Estate deal volume, falling 61% and 58%, respectively, compared to the year ago period.

Ending five consecutive years of M&A growth, the volume of worldwide mergers and acquisitions totaled US$2.9 trillion in announced deals during 2008, a decrease of 29.6% from 2007 totals and the lowest level for annual deal activity since 2005. Worldwide announced M&A for the fourth quarter of 2008 totaled US$555.8 billion, a 34.6% decrease from the third quarter of 2008 and down 37.1% from announced merger volume in the fourth quarter of 2007. Highlighting the difficult dealmaking environment, was a spike in the number of withdrawn M&A transactions, which hit an all-time record in 2008. There were 1,194 worldwide M&A transactions that were cancelled during the year, the highest level since 2000.

Based on the location of the target company, M&A activity in Europe declined 27.3% over the year-ago period to reach US$1.2 trillion during 2008, while Africa/Middle East saw a decline of 39.6%. Deals in Japan decreased 37.9%, and deal volume in the United States fell 37.2%, accounting for one third of worldwide volume, down from 37% during 2007. Bolstered by robust deal activity in China and South East Asia, volume in Asia Pacific decreased by just 8.7% and was the only region with single-digit annual percentage declines. Dealmaking activity in the Financials, Energy and Power and Consumer Staples sectors combined for just over half of worldwide merger activity during 2008. Activity in the Industrials and High Technology sectors topped all industry groups, by number, with over 5,000 deals announced during full year 2008. During the fourth quarter, dealmaking activity was marked by a flurry of government investments in major financial institutions. Overall investments by government entities totaled US$396 billion during 2008, or 13.5% of worldwide M&A. Government stakes arrived with increasing frequency throughout the year with nearly US$200 billion invested in the fourth quarter alone.





Source: Thomson Reuters

As we proceed through 2009, global capital markets activities are going to slow down considerably. Unless the stock markets witness improvement in valuations, the equity capital market is expected to remain dull throughout this year. However, the debt capital market may witness increasing activity that will bolster sovereign and financial institutions strength and help companies with strong balance sheets to take advantage of falling interest rates. Global M&A activity fell 33 percent in the first quarter of 2009 from the year-ago quarter, as the economic recession has dampened dealmaking. We may however, may witness a sharp increase in the number of M&A deals towards the second half of the year.

Our **Capital Markets Advisory Services Group** has positioned itself as a comprehensive player to take advantage of this evolving scenario. We apply macro vision and highly sophisticated quantitative valuation models based on different growth matrices to find out the right strategic fit. We work on assigned mandates for large globally-oriented companies on a highly confidential basis. We also scout for potential acquirers who are looking for strategic acquisitions in a particular industry or country. Starting from deal sourcing until it is finally consummated, we supervise and co-ordinate the whole process including overseas fund-raising programs, listing and public floatation, market-making and regulatory compliance.

As the future points towards increasingly large number of complex financial transactions globally, both markets and market intermediaries need to harness their skills to handle such transactions in an extremely competitive environment. In a continuously evolving market place scenario where demutualization, for-profit market organizations, cross-border convergence, vertical and horizontal integrations have taken center-stage, competition among existing stock exchanges or marketplaces has grown more than ever. Developed markets or exchanges are striving to grab market share and attract companies across the continent in fast developing countries such as China and India. They are even following the acquisition route to grab market share so that they can reduce cost and improve productivity by leveraging on existing infrastructure such as trading system, information dissemination mechanism, clearing houses, expertise in introducing new products and even growing into related product areas where their existing infrastructure could provide a ready launching pad.

Market consolidation has also gained pace recently. In the near future, we will witness more and more vertical and horizontal integration of market places around the world, whether it is acquisition of market places and order-driven platforms, or entry into strategically related markets such as, trading in derivatives, foreign exchange and commodities and clearing and settlement operations.

As technology, consolidation, cost reduction, synergy, market share and speed become the buzz words, geo-political boundaries of markets are vanishing into oblivion. In such a situation, both markets and market intermediaries need to reassess their unique strength and business strategy in order to protect their territories and stay afloat.

Rapid deployment of technology, complex products and global uncertainties have also increased market risks across the globe. Markets are more uncertain and volatile now, then ever. It is therefore important that market risks are reassessed and realigned on a continuous basis with the organization's evolving business strategy.

Our deep understanding of global economies, markets, intermediaries and investment products has helped us to focus on these niche areas where we can provide our expertise and value-added services. Our Capital Markets Capacity Building Services Division provides consulting services in the areas of capital market regulations and development, establishment of stock/commodity exchanges, alternative trading systems, stock depositories, on-line trading, straight-through-processing, index development and benchmarking, and market-risk assessment. We assist clients in providing market assessment and development reports, technology and vendor selection, project implementation, recruitment and training in the areas of market regulations and setting up of market intermediaries. We often work with other partner agencies in undertaking and delivering projects related to development, modernization and regulation of capital markets.

Our Financial Risk Solutions Services Division provides comprehensive and customized credit risk, market-risk and asset-liability risk solutions according to the Basel II norms to various financial institutions such as banks, large investment companies, pension funds and insurance companies.

Our Training and Other Capital Markets Services Division conducts various training programs and courses at its state-of-the-art facility in Mumbai, India. It provides both residential and non-residential programs for various global certification courses of recognized institutions, training in financial and risk management software, process engineering programs and executive development programs in the financial services industry. It also provides customized on-site training and development programs as per client's request. Currently we are in the process of setting up a state-of-the-art knowledge process outsourcing (KPO) facility in Mumbai and another in Bhubaneswar, India. These facilities will be managed by our Indian associate company TRANSOCEANIC FINANCIAL ENGINEERING PRIVATE LIMITED and will be used for transaction processing, research, business development and relationship management for our in-house as well as our clients' requirements.

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