

# Bradley, Foster & Sargent, Inc.

## Quarterly Market Commentary

July 2012

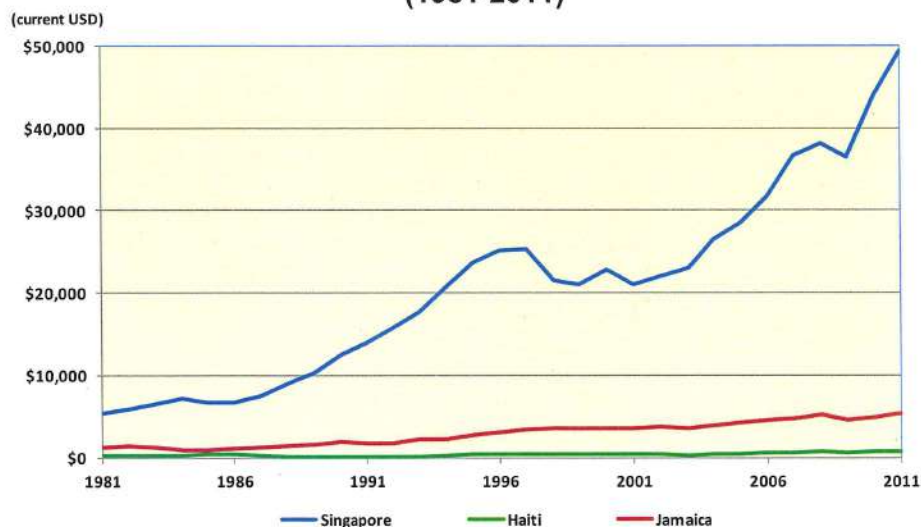
### Singapore: Economic Miracle

There is no Asian model as such, but there are fundamental differences between East Asian Confucian and Western liberal societies. Confucian societies believe that the individual exists in the context of the family, extended family, friends, and the wider society, and that the government cannot and should not take over the role of the family. Many in the West believe that the government is capable of fulfilling the obligations of the family when it fails, as with single mothers. East Asians shy away from this approach. Singapore depends on the strength and influence of family to keep society orderly and maintain a culture of thrift, hard work, filial piety, and respect for elders and for scholarship and learning. These values make for a productive people and help economic growth.

Lee Kuan Yew, Singapore Prime Minister, 1959-1990

With many countries in the developed world struggling with large continuing fiscal deficits and excessive levels of debt, we continue to develop our investment discipline in the equity markets of some of the key emerging markets. Investment professionals from Bradley, Foster & Sargent, Inc. have visited three of the four BRIC countries, and we have written quarterly market commentaries on all four. In recent weeks, two of our Portfolio Managers and our Director of Research traveled to Asia, and the first stop on the trip was Singapore. We were well aware of Singapore's remarkable economic progress over the last 50 years, but to see the gleaming, soaring, modern city-state was astonishing. Its transformation from a poor, subtropical island with a per capita GDP of around \$2,200 in the early 1960s to an economic powerhouse with one of the highest per capita GDPs in the world is nothing short of miraculous. The chart below chronicles Singapore's amazing growth:

**GDP per Capita: Singapore vs. Haiti and Jamaica  
(1981-2011)**



Source: Bloomberg

## History of Singapore

The history of modern Singapore began in 1819 when Sir Stamford Raffles established a British port on the island, which lies at the southern tip of the Malay Peninsula. The island is of considerable strategic importance, as Singapore controls the Strait of Malacca – the most direct and navigable sea route between India and the South China Sea. It also has an excellent deep water harbor. At the time, Singapore had a population of approximately 1,000 souls. It became a British colony in 1865 with the population having grown to 60,000, the ethnic majority being Chinese.

World War I bypassed Singapore, but as the power of Imperial Japan grew in the 1920s and 1930s, Britain turned Singapore into a significant military stronghold. Within days of its attack on Pearl Harbor, Japan landed in Northern Malaya and within two months, had conquered the Malay Peninsula. In February, 1942, the Japanese forces attacked “Fortress Singapore.” Two weeks later, Lt. General Percival surrendered Singapore to General Yamashita of the Imperial Japanese Army. The fall of Singapore and its 130,000 Indian, Australian, and British troops was the largest surrender of British-led forces in its history. The Japanese ruled Singapore with an iron fist, acting particularly ruthlessly with the Chinese population. At the end of World War II, the British returned, and the first steps towards self-government were taken in 1948 with local elections. Shortly after the elections, an armed insurgency by Communist groups in Malaya and Singapore broke out, and this so-called “Malayan Emergency” lasted for almost a decade.

### Lee Kuan Yew

The more recent history of Singapore largely hinges on the life of Lee Kuan Yew – one of the most influential Asian statesmen during the last half century. Lee is a fourth-generation Singaporean. Born in 1923, both his parents came from prosperous middle-class Chinese families. He attended Raffles Institution where he competed against the top high school students from Singapore. During the Japanese Occupation, he learned Japanese and worked for the Japanese military as a translator of Allied broadcasts, English being his native tongue. He was closely watched by the Japanese secret police and narrowly escaped being executed in the infamous Sook Ching massacre. After the war, he read law at Cambridge University in England, graduating with a rare Double Honors. Returning to Singapore, Lee and several of his colleagues formed the People’s Action Party (PAP) in 1955. Always a pragmatist, Lee brought the PAP into an alliance with several pro-communist trade unions in order to agitate for the end of British colonial rule. Singapore achieved self-governance under British rule in 1959, and Lee Kuan Yew became its first prime minister, as the PAP won 43 of 51 legislative seats.

During the next decade, the political situation in Singapore was tense and in constant flux. In 1963, Singapore entered into a Federation with Malaya. It was a short-lived merger, as the Malaysian government was anxious about the political challenge of Singapore’s Chinese majority. In 1964, there were serious race riots in Singapore between Chinese and Malays on Muhammad’s birthday, with many killed and wounded. The Malaysian parliament voted to expel Singapore from the Federation, and shortly thereafter, the Singapore parliament voted to withdraw, too. Soon thereafter, the British government announced that it would end its military presence in Singapore. At that time, British military spending in Singapore accounted for 30% of Singapore’s GDP. Moreover, Singapore had to contend with the military threat posed by nearby Indonesia with the largest Muslim population in the world, the hostility emanating from factions in Malaysia, and the pro-China Maoist revolutionaries in Singapore. Moreover, Singapore had no national resources and depended even for its water on a hostile Malaysia. It was a challenging situation. Lee Kuan Yew and his government focused on three priorities: national security, the economy, and social issues.

In the area of national security, Singapore declared a foreign policy of neutrality. It instituted a two-year national service requirement which is still in effect. It requested military advice and assistance from other countries, especially Israel, and it built a modern air force and military defense force. It was one of the founders of ASEAN – Association of Southeast Asian Nations. In analyzing Lee Kuan Yew’s strategy and initiatives in regard to the economy and social issues, it is useful to divide them into two groups: 1) specific projects or industries, and 2) political philosophy and cultural principles. In the former, Singapore had an early goal of becoming a regional financial center, and it has succeeded. It also invested heavily in its deep water container port such that Singapore’s enormous port is the busiest in the world. It also developed into a major oil refining hub for Asia, and through its expertise in the energy sector, it became a major builder of marine drilling rigs. It built a world class airport and airline so that it is a traveler’s hub in Asia. As its work force became more sophisticated, Singapore took steps to attract multinational high-tech and pharmaceutical firms. It is now seen as the gateway to the emerging nations of Indonesia, the Philippines, and Malaysia.

To develop a prosperous and cohesive society, Lee Kuan Yew and the PAP adhered to the following political, economic, and cultural values and principles:

- |                                      |   |
|--------------------------------------|---|
| The rule of law                      | Ownership society                       |
| Property rights                      | Investing in education and technology   |
| Confucian values                     | One language (English), many tongues    |
| Strong work ethic                    | Financial incentives to affect behavior |
| Uncorrupt highly paid civil servants | Funded Social Security accounts         |
| Ease of doing business               | Funded private “Medisave” accounts      |
| Low tax structure                    | Strong emphasis on environment          |
| Strong currency                      | Absence of crime                        |

The picture below shows what Lee Kuan Yew and his Singaporeans have achieved since its first days of independence in 1965 when its per capita GDP was approximately \$2,200:



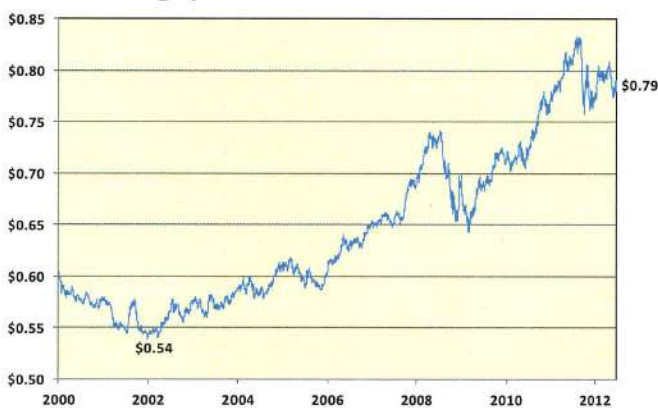
Notwithstanding its economic miracle, Singapore has a loud chorus of Western critics. The most frequent criticism is that Singapore is a “soft authoritarian” state – or more harshly, a benevolent dictatorship. This charge is leveled because the PAP has never lost an election since independence. The media complains that rights of the press are curtailed, and indeed, the media must play by different rules in Singapore. No individual or institution can own more than 5% of a newspaper or media company, and the media can be and is frequently sued for slander or libel (U.K. law prevails). However, there is no internet or media censorship. Remembering the destruction that the opium trade caused in China in the 19th century, drug traffickers receive the death sentence. Even chewing gum is illegal. Moreover, criminals often receive public canings. Lee Kuan Yew’s answer to the charge of being a “soft authoritarian” is as follows:

“Authoritarian means one has not got the consent of the people to your policies. My policies have been endorsed by the electorate every 4 or 5 years by a clear majority, never below 60%. I do not consider myself authoritarian.”

## Market Indicators

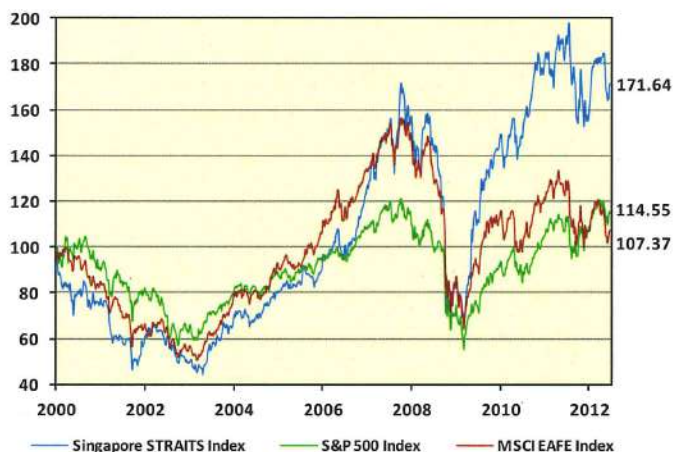
How have investors in the Singapore stock market fared during the long, global secular bear market that began in 2000? The following charts show the significant appreciation of the Singapore dollar against the U.S. dollar as well as the strength of the Singapore stock market (in U.S. dollar terms) compared with both the S&P 500 and MSCI EAFE:

**Singapore Dollar vs. U.S. Dollar**



Source: Bloomberg

**Straits Times Index vs. MSCI EAFE and S&P 500**



As the chart above shows, the Singapore dollar has appreciated 32% during this 12½-year period. A U.S. investor in the Singapore Straits Times Index would have shown a total return 50% in excess of the total return of the S&P 500. What risks does the U.S. investor face in investing in Singapore? Firstly, geopolitical. Singapore is a city-state with only 5.5 million citizens on an island of less than 300 square miles. While roughly the same population as Norway or Denmark, Singapore is nevertheless a tiny country when compared to its large Muslim neighbors Indonesia and Malaysia. It depends on the U.S. military umbrella. Secondly, Singapore is largely a trading nation, and an economic downturn in the economies of its main trading partners – Malaysia, Hong Kong, Indonesia, and China – will be reflected and could be amplified in Singapore. Politically, the death of Lee Kuan Yew might cause difficulties, but Lee appears to have passed the torch to his son, the current prime minister, and others in the PAP, so this risk would seem to be manageable. On the positive side, Singapore ranks as the easiest country in the world in which to do business. Its lack of corruption is world-renowned. The mixture of Confucian values and the Chinese work ethic combined with the rule of law and trustworthy accounting makes it a magnet for foreign investment. Furthermore, it has rock-solid financial solvency with the sum of its foreign exchange reserves and assets in its sovereign wealth funds exceeding its GDP. It has a fully-funded Social Security system. Thus it is likely that its currency will remain strong over the longer term and the credit rating on its sovereign debt remain AAA. In brief, we at Bradley, Foster & Sargent, Inc. judge Singapore to be one of the most attractive foreign markets in which to invest currently, providing low political and currency risk and the appealing possibility of continued long-term outperformance of the U.S. stock market.

## Bradley, Foster & Sargent, Inc.

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