2018 OUTLOOK

MIND THE GAP

THEMES

CROSSING FROM **QUANTITATIVE EASING**
TO **QUANTITATIVE TIGHTENING**

Maybank
Asset Management

An Overview :

ASIA ex JAPAN EQUITIES

ASIA ex JAPAN FIXED INCOME & CURRENCY

We are leaving the QE harbour for a QT frontier. Bring out the binoculars please.

2018 OUTLOOK

Judy Leong, CFA - Co-Head Reginal Fixed Income

ASIA EX JAPAN (AxJ) USD CORPORATES

2017 REVIEW

The year sailed through with a glowing report card:

- Strong economic expansion
- Benign inflation
- Light positioning
- Accommodative monetary policies

The best performer goes to...

Equities! With returns from

35%

for Emerging Markets to over

40%

for Asia.

The financial market closed FY2017 with all risk assets delivering strong returns for the year.

Looking back at 2017, all the stars were aligned for an extreme Goldilocks environment with strong economic expansion, accommodative monetary policies, benign inflation and light positioning. Excluding the highly controversial digital currencies as an asset class, equities was the obvious star for the year, with spectacular returns ranging from 35% to over 40% in USD for Emerging Markets and Asia respectively.

The Index using MSCI Asia ex Japan as reference:

+42% FY2017

- a third of gains from stronger earnings revision
- a third from higher price earnings valuation
- a third due to Asian currency appreciation versus the USD

Going from Trumphoria into 2017, the equity market made a decent performance. Relative to Asia, equity markets in developed countries underperformed but the S&P 500 still registered a respectable 22% return FY2017.

November. This was partly due to the fact that the S&P500 started its rally back in November 2016 when Trump won the US Presidential elections. **Here's what happened :**

In the last two months of 2016, Trumphoria and his widely tweeted trade protectionist policies caused the S&P500 Index to rally 5% while MSCI Asia dropped 5%. Hence Asia started the year relatively cheaper and has since caught up in FY2017. All-in, the equity bulls were proven correct for FY2017, kudos to them.

ASIA EX JAPAN (AxJ) USD CORPORATES

2017
REVIEW

Fixed income returns paled in comparison, but still better than expected. In the beginning of FY2017, we were expecting, at best, total returns of 2%, with three interest rate hikes and some spread widening to erode, some carry from weighted bond yields of around 4%. Actual market returns proved our outlook to be too bearish. **JP Morgan Asia Credit Index "JACI" reigned in total returns of 5.78% as of end FY2017.** Despite three rate hikes, the US 5 year sovereign bond went up only 28 basis points while the US 10 year Treasury actually went down 4 basis points. The yield curve flattened. Despite another record year of USD 270bn new bonds issuance in FY2017, which is an increase of 67% versus FY2016, credit spreads stayed very resilient and actually tightened 15 basis points. Within the context of a low yield environment and historically low volatility, as a stable asset class, total returns of circa 5% for fixed income is pretty decent.

FY2017 had its fair share of political and risk events.
The central banks' balance sheet unwinding from US and Europe, French elections in April, Greek debt crisis in July, the ongoing US-North Korean tensions since August, German Federal elections in October, Brexit discussions, the new Fed chairman appointment in November, multiple Trump policies hiccups and the still unresolved US debt ceiling.

Adopted a shrug-it-off attitude.
The financial markets "shrugged off" many of these risk events during the year and any selloffs were quickly reversed. Going into year end, there has been some weakness in equities and bonds. The JACI had its first negative month in November, initially driven by some profit-taking and year end illiquidity which then cascaded into a stronger selling tone when China's local government funding vehicles "LGFV" rushed to utilize their offshore bond regulatory quota before they expired in end FY2017 and had to print at higher yields. Credit bonds were repriced lower by the new supply.

Still a clap on the back.
Fixed income with returns circa

5%

given low yield and
low volatility environment.

Ending the year a little weak JACI clocked its first negative for the month of November.

ASIA EX JAPAN (AxJ) USD CORPORATES

2018 OUTLOOK

What to expect after many years on QE?

As global growth continues into 2018 and quantitative tightening is applied, the adjustment may cause interest rates to rise.

As we embark on QT...

Growth expected to slow and consolidate at current levels.

Downside risks

to our expected returns are if inflation picks up faster than expected and US tightens more aggressively, which may result in negative bond returns for FY2018.

Upside risks

would be that growth optimism falters, inflation risks dissipates and the markets reverts to pricing in lower interest rates again during the second half FY2018.

Once again, we are projecting total returns of just 2% to 3% for USD Asia credit bonds. Because...

Our key concern : we are shifting from a prolonged period of global coordinated quantitative easing to entering a period of rising interest rates and tightening financial conditions. Thus far only the US has been gradually but consistently raising interest rates. As global growth continues in FY2018 and central banks start to embark on quantitative tightening globally, financial markets that have been pampered by multiple years of loose monetary conditions may knee-jerk and cause interest rates to overshoot.

US 10-Year Treasury to consolidate at around 3%.
While we do expect interest rates to muddle upwards due to increasing inflation, we do not believe that the US 10 year Treasury will reach the historic average levels of 4% to 5% in the near future but believe it will peak and consolidate around 3%. The US is already in its eighth year of recovery hence it is already in the late growth stage or at best entering mid-cycle growth. While we are not expecting a recession yet, we do expect growth to slow and consolidate at current levels and hence the Fed to stop tightening sometime.

Optimistic? Not quite. Historically during periods of strong economic growth, a sell-off in Treasuries was partially mitigated by credit spreads tightening as corporate credit profiles became stronger. However, we are currently at historically low spreads. In addition, technicals may be weak due to continued strong new supply in FY2018 especially given China Inc.'s voracious appetite to tap the offshore bond market. Therefore, despite low default rates and stable credit fundamentals, we are not quite as optimistic on credit spreads for the new year.

Risks in mind, here's our forecast:
Interest rates to rise between 20 to 40 basis points.
Credit spreads to widen between 10 to 30 basis points.

Overall, we expect JACI to deliver total returns between 1% to 3% for FY2018.

ASIA EX JAPAN (AxJ) USD CORPORATES

KEY THEMES 2018

THEMES	IMPACT	POSITIONS
FROM QE TO QT – MIND THE GAP !	The market may panic and interest rates overshoot. However, the US is already at the mid/late growth cycle and we expect softer growth going forward. Expect yield curves to steepen before flattening. 10 year Treasury to peak at 3% and consolidate around 2.8%.	Start with a fairly neutral duration position and then move to overweight 7 year to 30 year bonds after curve has steepened in 2H2018. Underweight low/no step-up perpetual bonds and perpetual bonds with no resets. Selectively buy into corporate perpetual bonds with high resets for carry.
GLOBAL GROWTH – LOWER BUT LONGER	Credit fundamentals to remain stable and we expect bond defaults to remain low. Potential spread widening from heavy new supply is negative for bonds. Chinese bonds, which have been the cheapest bonds in the IG bucket, will continue to be cheap.	While interest rates will trend higher, interest coverage can remain adequate from healthy margins. High yield has underperformed IG bonds on a spread basis. Selectively buy into stronger high yield bonds for carry. Generally positive on cyclical sectors such as oil and gas, mining and steel.
CREDIT SPREADS ARE AT HISTORIC TIGHTS		The current tight credit spreads environment does not differentiate much between weak and strong credits. Overall prefer to overweight investment grade bonds over high yield bonds.
EXPECT SUPPLY TO REMAIN AGGRESSIVE FROM CHINA		We expect a lot of supply from China LGFVs in the 3 to 5 year space and also a lot of supply in the 5 year corporate perpetual space. Avoid the weak LGFVs. Selectively buy into corporate perpetual bonds with high resets for carry.

ASIA EX JAPAN (AxJ) USD CORPORATES

EXPECTED TOTAL RETURN FOR JACI FY2018

Source JP Morgan as of 30th Nov 2017

JACI Yield 4.22

JACI weighted duration 4.81

Expected Total Return for JACI FY2018

US Treasury rises by	Credit spread rises by: -10	0	10	20	30	40	50	60
-20	5.51	5.08	4.65	4.22	3.79	3.36	2.93	2.50
-10	5.08	4.65	4.22	3.79	3.36	2.93	2.50	2.07
0	4.65	4.22	3.79	3.36	2.93	2.50	2.07	1.63
10	4.22	3.79	3.36	2.93	2.50	2.07	1.63	1.20
20	3.79	3.36	2.93	2.50	2.07	1.63	1.20	0.77
30	3.36	2.93	2.50	2.07	1.63	1.20	0.77	0.34
40	2.93	2.50	2.07	1.63	1.20	0.77	0.34	-0.09
50	2.50	2.07	1.63	1.20	0.77	0.34	-0.09	-0.52
60	2.07	1.63	1.20	0.77	0.34	-0.09	-0.52	-0.95
70	1.63	1.20	0.77	0.34	-0.09	-0.52	-0.95	-1.38
80	1.20	0.77	0.34	-0.09	-0.52	-0.95	-1.38	-1.81
90	0.77	0.34	-0.09	-0.52	-0.95	-1.38	-1.81	-2.25
100	0.34	-0.09	-0.52	-0.95	-1.38	-1.81	-2.25	-2.68

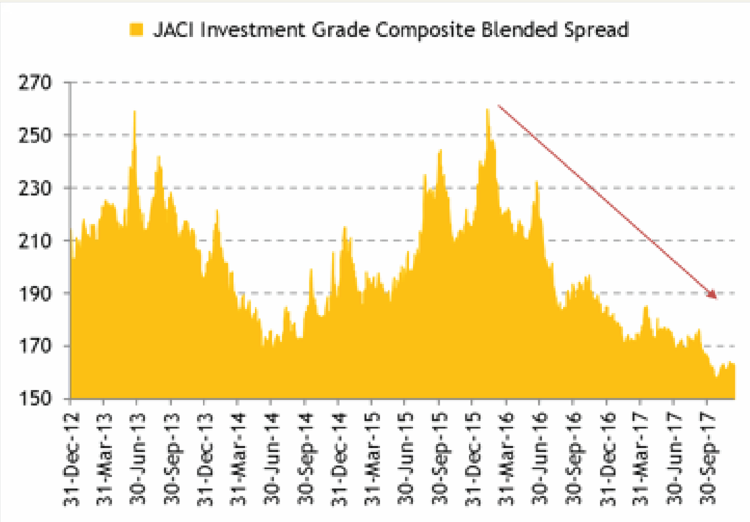
Source: Bloomberg, MAMS as of 31 Dec 2017

Total Return	JACI	JACI IG	JACI HY
FY2010	10.61%	7.91%	15.48%
FY2011	4.12%	4.92%	2.85%
FY2012	14.27%	11.31%	20.42%
FY2013	-1.37%	-2.56%	1.97%
FY2014	8.32%	9.00%	6.10%
FY2015	2.80%	2.16%	5.20%
FY2016	5.81%	4.48%	11.24%
FY2017 (end Nov)	5.60%	5.33%	6.60%

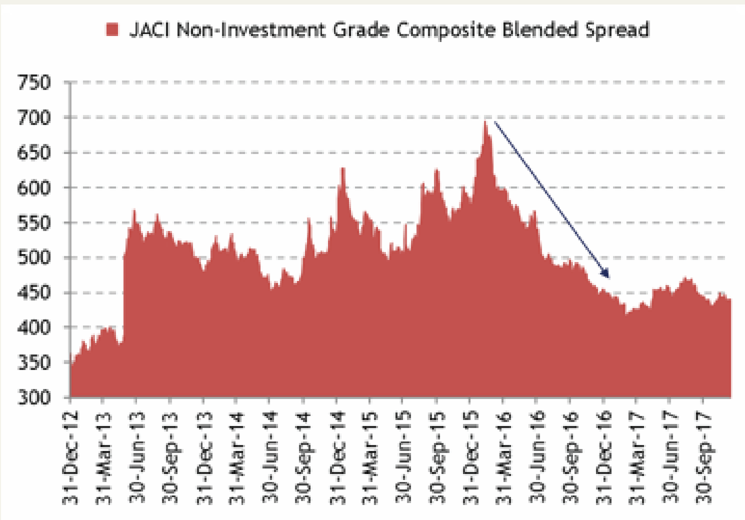
Source: Bloomberg, JP Morgan as of 31 Dec 2017

ASIA EX JAPAN (AxJ) USD CORPORATES

JACI Credit Spreads



IG spreads have been tightening since FY2016 and are at all historic 5 year lows.



Non-IG spreads tightened in FY2016 but have stayed relatively unchanged in FY2017. One can find selective value in strong high yield bonds.

Source: JP Morgan as of 31 Dec 2017

Robin Yeoh, CFA – Head, Regional Investment
Christina Hee, CFA – Regional Head of Research

ASIA EX JAPAN EQUITIES

2017 REVIEW

2017 proved to be a good year for Asia ex-Japan equity markets. The MSCI Asia ex-Japan Index returned a stellar 38.7% *(41.8% including dividends)* year to-date *(as at 29 December 2017)* on a relatively smooth trajectory. While most of our 2017 themes did in fact play out, where we were mistaken was that the path was not volatile as we had originally expected.

Markets were surprisingly sanguine in spite of geopolitical risks.

Apart from some minor corrections, markets rose quite steadily throughout the year on the back of a continuing 'Goldilocks economy' of synchronised global growth and low inflation.

ASIA EX JAPAN EQUITIES

2018 OUTLOOK

A good momentum at the start and a challenge in the second half.

We expect the positive momentum in markets from 2017 to carry on, at least through 1H2018, given ongoing synchronised global growth amidst a benign inflation and rates backdrop. However, tighter financial conditions may prove more of a challenge in 2H2018 and hence we favour North Asia over South Asia given the latter's greater sensitivity to rising rates.
While Asian equity market valuations are at the upper end of their historical trading range, we see this as fair given the improving macro fundamentals. Relative to the US, Asia still looks attractive, trading at a 25% discount on a forward P/E basis compared to its historical average discount of 14%. *(See Chart 1)*

LIMITED

We see limited room for further P/E multiple expansion given already elevated valuations and a rising rate environment. Accordingly, we anticipate earnings growth/momentum to drive returns in 2018.

FAVOURED

- High growth sectors especially those with structural rather than cyclical drivers (technology, internet, Chinese tourism etc.)
- Capex beneficiaries (construction companies, machinery/equipment providers), as we foresee an investment revival, spurred by government infrastructure spending and private capex in line with an export recovery.
- Metals & mining sector not just as indirect capex beneficiaries but also as beneficiaries of supply discipline and more environmentally friendly policies in China.
- Interest-rate sensitives such as banks and insurance companies as beneficiaries of steeper yield curves.

CAUTIOUS

Staying alert on the real estate sector as physical property prices could come under pressure.

ASIA EX JAPAN EQUITIES

2018 STRATEGY

Overweight China and India.

In keeping with our focus on earnings growth/momentum, we would overweight China and India even after their strong run-up in 2017, given expectations of robust mid-to-high teens earnings growth over the next two years. In China while there is a risk of growth moderating in the short term due to government-driven reforms, we believe that the government will manage the reform-growth balance and these reforms will be structurally positive for the economy. Furthermore, there is a strong underlying secular growth trend, driven by technology and the internet, which will help alleviate any growth slowdown. The inclusion of A-shares into the MSCI indices *(the weights of which we believe will rise over time)* and ease of trading facilitated by the Stock Connect link between Hong Kong and mainland China markets also bode well for increased fund inflows into China.

In India we expect growth to rebound in 2018 in the aftermath of demonetisation and GST introduction in 2017. We are positive on a number of policies/initiatives that have been undertaken e.g., affordable housing, infrastructure project rollouts, state-owned bank recapitalisation etc. and expect the government to continue its pro-growth stance with an eye on elections in 1H2019. That said, given already elevated valuation multiples, India is vulnerable to correction should it fail to deliver earnings-wise.

Neutral on Korea. Underweight Taiwan.

Nevertheless, we would still favor the tech sector within these markets. Our relative preference between these two tech-heavy markets would be Korea which could also see a domestic consumption recovery following the introduction of populist government policies and an easing of political tension with China. An improvement in the attitude towards shareholder returns could also help narrow Korea's valuation discount. Amidst complacent markets, an escalation of North Korean tension remains a risk albeit an unpredictable one. In the case of Taiwan, we think the market lacks catalysts hence our underweight stance.

Underweight Hong Kong.

Hong Kong is typically more sensitive to rising rates and where residential property prices remain stubbornly high. However, Hong Kong remains a beneficiary of continuing southbound flows via the Stock Connect link, which could support the market.

China and India

Continue to remain well-supported by strong domestic inflows given a high savings pool and low household penetration of equities.

The upside for Korea

A domestic consumption recovery and improvement in attitude towards shareholder returns.

ASIA EX JAPAN EQUITIES

2018 STRATEGY

Overweight Indonesia.

We see Indonesia as having a better combination of earnings growth and more attractive valuations relative to its other ASEAN peers. Indonesia has lagged the region in 2017 and we see value in beaten-down sectors e.g., construction, property, telecommunications etc. Upcoming elections *(i.e., regional elections in 2018, general elections in 2019)* could see more populist policies being introduced which should aid a consumption recovery, but also pose some uncertainty given the past defeat of President Jokowi's ally in the 2017 Jakarta gubernatorial elections.

Underweight Thailand.

Similarly, we expect pre-election stimulus and uncertainty in Thailand which is expected to hold its first-ever post-coup elections in November 2018 under the revised constitution. Exports and tourism will remain the bright spots in the economy and we might see a domestic consumption recovery following the end of the year-long mourning period. However, given stretched valuations, we would underweight Thailand.

Neutral on the Philippines.

President Duterte's tax reform plan and planned rollout of infrastructure projects is a positive as it will accelerate infrastructure investment that is sorely needed in the Philippines. However, this is balanced by the fact that the Philippines is vulnerable to rising rates given a widening current account deficit and budget deficit. These concerns will also put downward pressure on the Peso.

Neutral on Singapore.

Key segments of the economy *(e.g., exports, real estate, banking)* will continue to do well. The banking sector, an index heavyweight, is the prime beneficiary of rising rates and rising oil prices have alleviated asset quality concerns.

Neutral on Malaysia.

Rising oil prices, an export recovery, the rollout of infrastructure projects, pre-election handouts and a stronger currency all bode well for the domestic economy. The market may remain subdued in the run up to the general elections which is widely expected to be held in late 1Q18 or early 2Q18. This soft performance is in-line with past elections as the uncertainty will see investors remain cautious on the market. We believe that a win for the incumbent government will be good for the markets as investors prefer stability and the strong economy combined with renewed certainty will certainly provide a boost to investor confidence.

Indonesia

Good combo of earnings growth and valuations.

Thailand

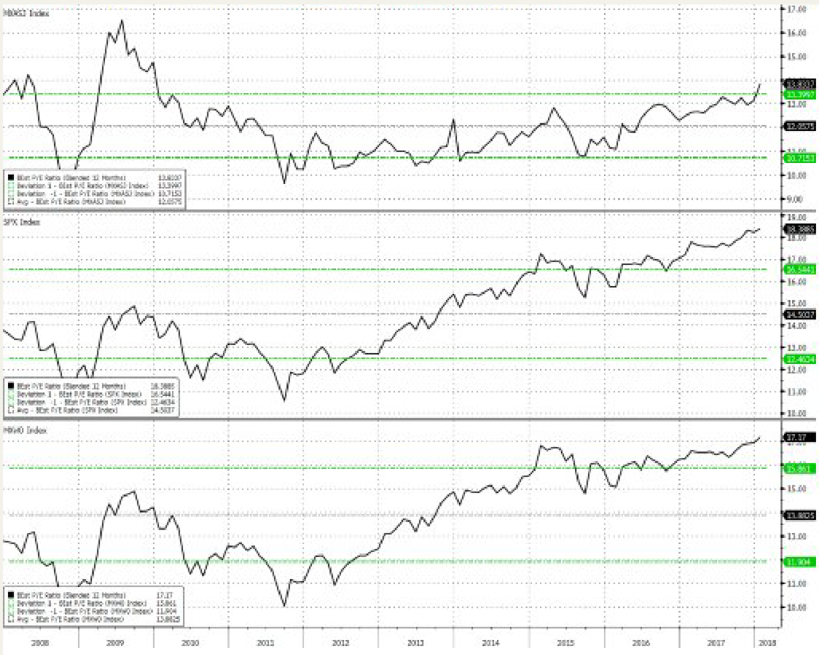
Sunny tourism and export economy but stretched valuations.

The Philippines, Singapore and Malaysia

Projects rollout as planned. Looking well.

ASIA EX JAPAN EQUITIES

CHART 1:
HISTORICAL PER VALUATIONS VERSUS AVERAGE FOR ASIA, S&P500 AND WORLD



Asia (MXASJ Index) trading close to +1 S.D. above average

S&P500 (SPX Index) > + 1 S.D. above average

Developed world (MXWO Index) > + 1 S.D. above average

Source: Bloomberg, Period Jan 2008 - Dec 2017

CHART 2:
PER VALUATIONS OF ASIA AND SELECTED DEVELOPED COUNTRIES

Source: Bloomberg, Period Jan 2011 - Dec 2017

ASIA EX JAPAN EQUITIES

CASE	ASSUMPTION / RISK	MARKET IMPLICATIONS AND STRATEGY
BASE CASE	• Synchronised global growth. More modest growth in developed markets. Stable growth in China and ASEAN. • Investment revival spurred by continues export recovery and a step up in infrastructure spending. • Pro-growth / populist government policies, especially in countries with upcoming elections. • Gradual pace of monetary policy tightening. • Inflation to pick up but still low. • Technology disruption.	• Overweight: China, India, Indonesia. Underweight: Taiwan, Thailand, Hong Kong. • Prefer high growth sectors e.g., tech/internet; capex beneficiaries and interest-rate sensitives such as banks and insurance companies. • MSCI Asia ex-Japan target 770, based on 13X 2019E EPS of 59 *(8%)*
GOOD CASE	• Better-than-expected economic growth. Increased capital expenditure / business investment. • Successful execution of policies to boost growth e.g., US tax reform plans.	• MSCI Asia ex-Japan target 870, based on 14X 2019E EPS of 62 *(22%)*
BAD CASE	• Weaker-than-expected economic growth. • Faster-than-expected pace of monetary policy tightening. • Negative inflation surprise. • Heightened political tension / geopolitical risks. .	• MSCI Asia ex-Japan target 630, based on 11X 2019E EPS of 57 *(-12%)*

Based on MSCI Asia ex-Japan Index closing price of 713.45 on 29 Dec 2017.

ASIA EX JAPAN EQUITIES

2018 THEMES

Synchronised growth continues: We expect the synchronised global growth that began in 2017 to continue at least through the first half of 2018. **(1)** Developed markets could see more modest growth in 2018 as the US and Eurozone are more advanced along the recovery cycle. **(2)** Growth in China to be largely stable despite fears that policy measures/reforms may limit near term growth. **(3)** In ASEAN, growth is expected to be stable with the export-driven growth recovery in 2017 broadening to domestic demand and private investment in 2018.

Investment revival: (1) Synchronised global growth and continued export recovery will spur machinery and equipment investment. **(2)** We expect a step up in infrastructure investment after a prolonged slump.

Pro-growth/populist government policies: We foresee policy makers to be more pro-active in boosting the domestic economy with a focus on job creation and increased infrastructure spending. More populist policies may be introduced in countries with upcoming elections in 2018 and 2019 *(e.g., Thailand, Indonesia, India)*.

Tighter monetary policy: US monetary policy tightening will be a headwind for Asian markets, especially ASEAN, but we do not anticipate a severe impact, given we expect the pace of tightening to be gradual. Despite slightly higher rates in 2018, domestic liquidity to remain supportive.

Inflation to pick up but still manageable: A pick-up in inflation off a low base, but will remain low, in part due to technology disruptions which will lower wage growth. Low inflation will allow policy makers the leeway to calibrate a smooth normalisation of monetary policy.

Technology disruption continues: The trend of disruptive technology continues, displacing traditional/'old economy' roles and enabling better productivity and profitability.

Risks: (1) Weaker-than-expected economic growth.
(2) Faster-than-expected pace of monetary policy tightening.
(3) Higher-than-expected inflation. **(4)** Geopolitical risks.

Range of targeted returns

Equity returns for 2018 will be more modest compared to 2017. The MSCI Asia ex-Japan Index to return 10% in USD terms, largely in line with expected EPS growth. The strong returns for 2017 were driven both by P/E multiple expansion and earnings growth. With equity markets now at fair valuations, earnings growth/momentum, rather than P/E multiple expansion, will be a more important driver of share price performance in 2018. Our 2018 year-end MSCI Asia ex-Japan Index target is 770 based on 13X 2019E P/E. Total return would be 11%, that is potential price appreciation of 8% coupled with dividend yield of c.3%. We see a potential bear MSCI Asia ex-Japan Index target of 630 *(11%)* and a bull target of 870 *(22%)*.

Rachana Mehta, CFA – Regional Co-Head of Fixed Income

ASIA EX JAPAN (AxJ) LOCAL CURRENCY FIXED INCOME & CURRENCY

2018
OUTLOOK

The good, the threats and the hikes.

We remain constructive on Asia in 2018 with global growth remaining firm but entering into a mature phase. The pickup in the global growth cycle starting from developed economies since late 2016 has more room to run as its effects continue to spill over to emerging markets *(EM)*. Our constructive view on Asia also hinges on our stable outlook on China, which is expected to grow at a slightly lower pace; from 6.8% in 2017 down to 6.5% in 2018 as it pursues quality growth while continuing to rein in domestic corporate leverage. Given this backdrop, GDP growth in EM Asia in 2018 is expected to remain at 6.0%, unchanged from 2017. However, we believe inflation in Asia will pick up slightly from higher commodity and oil prices and cost pass through effects due to improved domestic demand. Back in 2016, our concern for a more antagonistic stance in US trade policy over 2017 did not materialize, but we think there is a risk that this hostile stance could crop up again in 2018.

In our opinion, the biggest threat to Asia LCY bond and FX market is a rise in the perception of a more synchronised tightening of monetary policy by G3 central banks. At present, only the FOMC is normalising policy while the ECB and BOJ are still in easing mode. With global risk assets at historic highs in many markets and a sustained pickup in the global growth cycle, the chances of the ECB and BOJ reducing their stimulus is higher, with rumours that the BOJ is potentially open to revising their "Yield curve control" framework. Also, the new composition of the FOMC board may bring in voting members with a more hawkish bias, with the implication being a stronger USD and steeper curves.

Looking back at 2017, it was a continuation of 2016's theme in the hunt for carry but in an environment with lower volatility. As such, many local bond markets in Asia bull flattened with decent FX appreciation. For instance, the US VIX Index was 14.04 in late 2016 but looks to end 2017 around 9.6, underscoring the reduction in volatility. In Asia, Markit Iboxx Asia Local Bond index has returned 9.9% YTD as at Nov 2017 compared to 1.2% for 2016. Likewise, hard currency EM bond markets also posted strong returns with JPM EMBIG returning 9.1% -9.5% p.a. over the last 2 years.

Fund flows into Emerging Market debt funds *(both FX and LCY)* have been strong in 2017 and should moderate slightly in 2018 although we do not see a repeat of the "taper tantrum" of 2H 2013. **Given the back drop of still benign inflation trajectory and supportive growth prospects, we expect Asian fixed income to hold up in 2018 although return expectations will have to be dialled back given the very strong performance over the past 2 years.**

Room to grow

Global growth effects to spill over to emerging market.

Unchanged melody

GDP growth still

6.0%

The threat

A rise in perception on tightening monetary policy.

ASIA EX JAPAN (AxJ) LOCAL CURRENCY FIXED INCOME & CURRENCY

2018 OUTLOOK

As 2016 – 2017 has been a period of outperformance in Asian LCY bond markets due to the hunt for carry under the backdrop of moderate growth and low inflation, there is likely some pressure for domestic central banks to increase interest rates in 2018. South Korea has already started the ball rolling by hiking rates in November 2017.

2018 Rate hikes : Common across Asia with different impacts.

We still like the LCY debt markets in Indonesia and India more from a carry perspective. First, inflation in both countries should remain muted with low pass through effects from the recent hike in oil prices. RBI and BI are likely to keep rates steady. In terms of growth, India is expected to return to its longer term growth rate of 7.0-8.0%, compared to 6.2% in 2017 as it exits from the impact of de-monetisation.

In addition, we also expect Singapore's MAS to pursue a stronger SNEER exchange policy in 2018 in response to a pick-up in growth and inflation. On the other hand, rate hike trajectory in the Philippines should be higher given strong domestic growth and the associated increase in credit lending over the past years. Inflation is also likely to move higher thus triggering a response from the central bank. USDPHP is projected to remain weak in 2018 as the pace of rate hikes might not be enough to attract foreign flows. Likewise in Malaysia, where a continued pickup in growth and inflationary pressures is likely to bring about 1-2 hikes by BNM.

Despite the outlook for a broadly stable year, fundamentals of many Asian currencies remain challenging as they grapple with an environment of high debt, worsening demographics and sluggish productivity. The pickup in growth in EM Asia in 2017 was more due to external demand from DM and less from improved domestic demand. The same situation underlies our 2018 outlook.

We expect most of the Asian currencies to trade range bound or weaken in first half of 2018, on the back of a stronger outlook for the USD. We expect MYR and KRW to outperform USD, due to a pickup in growth from continuing global trade revival. INR and IDR remain our favourite longs in the first half of 2018 as these are relatively insulated from US policy and we think that RBI and BI will likely hold rates constant over 1H 2018.

While country allocation remains important, the main source for local currency bond returns in 2018 will come more from carry rather than FX appreciation or duration gains, considering the very strong returns in 2017. As of 30 November 2017, IBOXX Asian local bond index had a year-to-date performance of 9.9%, compared to 1.73% for 2016. The continuance of broad USD strength and rising interest rates in 2018 will create volatility for local bonds and currencies. However, we expect a slightly positive return in the coming year driven by India, Indonesia.

Indonesia & India
To keep steady rates.

Singapore
A strong SNEER exchange policy.

The Philippines & Malaysia
To expect rate hikes.

The wrestle
How will currencies cope in a high debt, slow productivity environment?

ASIA EX JAPAN (AxJ) LOCAL CURRENCY FIXED INCOME & CURRENCY

MARKIT ASIAN LOCAL BOND INDEX (IBXXALBI)

Source: Bloomberg (Period 31 Dec 2012- 31 Dec 2017)

Cumulative Return from 31st Dec 2012 to 31st Dec 2017: 7.1%

ASIA EX JAPAN (AxJ) LOCAL CURRENCY FIXED INCOME & CURRENCY

ASIAN MARKET OUTLOOK

	INTEREST RATES	CURRENCY
CHINA	We expect China to keep its stable policy and we would like to maintain a neutral stance on Chinese bonds. We are bearish on duration for the first quarter as we expect inflation to go higher and with Fed hikes and tighter liquidity onshore, expect the yield curve to steepen. However, in the second half, as US rates stabilize, we expect Chinese government bond yields to rally.	We prefer neutral CNH against USD for the first quarter. However, as US rates stabilize after the first half, we expect CNH to outperform in the second half given higher carry.
INDIA	We are neutral on duration in India and expect RBI to remain neutral. We await better levels to go long for 10 year Indian bonds at around 7.75%.	We expect INR to appreciate given structural reforms in India. Also if the BJP wins state elections in 2018, we expect the currency to rally by 1-2%. INR carry is attractive and hence we are bullish on INR in 2018.The tailwinds are higher oil prices and negative election outcomes.
INDONESIA	Cautious sentiment is likely to prevail as the market digests volatility from Fed's lifting of rates. Also next year will be election year in Indonesia and we expect volatility to go up in second half of the year. We are neutral on duration from a long term perspective as structural reforms continue in Indonesia and carry is still attractive.	Fundamentals for the IDR have improved, thanks to the correction in external imbalances. We expect Indonesia to be upgraded next year at least by one of the rating agencies. Also if Indonesia will be included in the Local Currency Index, it will be a boost to the currency. We like IDR from a carry perspective.
KOREA	We expect a steepening of the yield curve in the first quarter which will present an opportunity to establish long duration exposure for the second half.	We are bullish on KRW due to stronger global growth and inflation outlook. Also KRW will have an appreciation bias due to a huge current account surplus. The central bank is also comfortable with a stronger KRW. The key risk is a flare up in North Korea tension.
SINGAPORE	The front end of the SGD yield curve remains anchored by steady to tighter MAS policy of keeping the SGD NEER band and slope unchanged. We expect short end rates to go higher and the curve to be initially steeper, followed by flattening in the second half of 2018. The correlation at the back end of the curve with US rates will likely persist, but we expect long end Singapore rates to outperform US treasuries in 2018.	We expect MAS to tighten its monetary policy in the first half of 2018 due to stronger global growth. However Singapore faces challenges in terms of trade and lower structural growth. As a result, we expect SGD to remain neutral against the rest of G3 currencies. Also US companies' repatriation of their offshore earnings will cause SGD to weaken in the first half of 2018.
MALAYSIA	Yields have stabilized in Malaysia due to stronger growth and lower inflation. We expect the central bank to raise rates by 25 bps in 2018. Next year is an election year in Malaysia and hence we expect volatility in the second half of 2018. We expect a steeper curve initially followed by a flatter curve at the end of 2018 due to stronger oil prices and MYR.	The current account balance has improved in 2017 and we expect it to continue to improve as we expect higher oil prices in 2018. Our top currency pick in 2018 is MYR due to stronger global growth and higher oil prices.

ASIA EX JAPAN (AxJ) LOCAL CURRENCY FIXED INCOME & CURRENCY

ASIAN MARKET OUTLOOK

	INTEREST RATES	CURRENCY
THAILAND	We expect Bank of Thailand to remain neutral in 2018. However we expect the curve to steepen due to lifting of rates by the Fed.	We are neutral to positive on THB due to its current account surplus and stronger global growth.
PHILIPPINES	We expect the central bank Bangko Sentral ng Philipinas (BSP) to raise rates in 2018 due to higher inflation and we expect the curve to steepen due to lifting of rates by the Fed.	We are negative on PHP in the first quarter of 2018. We expect BSP to maintain weaker PHP to support exports amid competitive devaluation.

KEY HIGHLIGHTS FOR 2018

> Strong US growth and inflation
> Strong US dollar against G3 currencies due to repatriation and tax reforms
> Stronger fiscal policy in the US and tax reforms
> Higher commodity and oil prices
> High volatility in global markets
> Interest rates: 10Y US Treasuries to sell off by 25 bps in the first half
> Yield curve: Steeper curves in the US and Asian region in the first half of 2018

RISKS FOR 2018

> Elections in Malaysia, Indonesia and India
> Higher inflation and oil prices
> Europe and Japan starts tightening monetary policy
> Geopolitical risks in the Middle East and North Korea

TRADES FOR 2018

> Duration: First half 2018

- Neutral duration in Thailand, India, Indonesia
- Short duration in Singapore, Korea, Philippines,
- China and Malaysia

> Currencies: First half 2018

- Bullish on INR, IDR, MYR and KRW
- Neutral on THB, SGD
- Negative on PHP, TWD, JPY,CNH