2018 OUTLOOK

MALAYSIA

CRUISING BUT BE ALERT

THEMES

SYNCHRONIZED GROWTH CONTINUES

MONETARY POLICY MOVES TOWARDS TIGHTENING

INFLATION TO PICK UP BUT WILL STILL BE LOW

TECHNOLOGY DISRUPTION CONTINUES

Maybank Asset Management

Happy New Year

to our valued clients and business partners.

At the start of 2018, we take this opportunity to prepare you for the currents and ripples in the investment landscape.

First, let's look over the past year which has been fairly generous but not without surprises. We had projected 2017 to be 'Bumpy But Better' and true enough, there were jolts here and there but no major bruises.

2017 left us in good shape to venture forth confidently.
While 2018 appears calm and definitely welcoming, our theme this year sums it up - 'Cruising But Be Alert'.

As stable, strong or buoyant the investment market may be, we'd advice you to keep a watchful eye on a few global and domestic factors.

For the Equities and Fixed Income markets, we leave you with a 2017 Review, 2018 Outlook and Strategy. May our views help you plan a successful year ahead.

An Overview :

SYNCHRONISED GROWTH CONTINUES TO SAIL WITH MODEST ROOM TO NAVIGATE.

We expect the global growth that began in 2017 to continue at least through the first half of 2018.

In developed markets, we forecast more modest growth post the surprisingly strong growth acceleration these markets have enjoyed in 2017, while the US and Eurozone are more advanced along the recovery cycle.

> China: slower but steady China could also see slower growth albeit we expect growth to be largely stable. Despite fears that policy measures/reforms *(e.g., a crackdown on polluting industries)* may limit near term growth, we believe the government will manage the reform-growth balance given China remains a command economy.

> ASEAN: machinery and infrastructure take it up a notch. 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. Synchronised global growth and continued export recovery will likely spur machinery and equipment investment. In addition, after a prolonged slump, a step up in infrastructure investment will complement the trade-sparked private investment recovery.

> New policies could do the trick. We expect 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 in US. Headwinds in ASEAN. While monetary policy in the US looks set to tighten further in 2018, we expect the pace of tightening to be gradual and do not anticipate a severe impact on Asia. Nevertheless, this remains a headwind for Asian markets and in particular ASEAN which tends to be more sensitive to US rates.

> The needle won't move much from low.
In general, we see slightly higher rates in Asia ex-Japan in 2018 albeit rates will still remain relatively low. In line with still low money market rates, local currency liquidity will continue to be good. Robust domestic inflows could help offset reduced foreign fund flows into Asia (as a result of tighter monetary conditions). Low rates have enabled the expansion of equity valuation multiples. Going forward, earnings growth/momentum should be a more important driver of share price performance in 2018.

> Inflation making a modest comeback but oh... so shy. Inflation has surprised on the downside in most of Asia in 2017. Thus, we could see a slight pick-up in 2018 off a low base, given rising prices of oil and China-centric hard commodities (e.g., steel). Barring weather shocks, we expect food inflation to be benign. However, inflation likely to remain low with wages growth remains muted. Technology disruption will continue to put downward pressure on wages as automation encourages companies to substitute labour with capital. Low inflation will allow policy makers the leeway to calibrate a smooth normalisation of monetary policy.

> Watch out traditionalists. Tech disruptions are still trending. We expect the trend of disruptive technology to continue, thereby displacing traditional/ 'old economy' roles. Some tech companies have an implied zero cost of capital resulting in an uneven playing field with the traditional incumbent players. These tech companies are able to lower prices sacrificing profitability for market share while putting the incumbents under severe pressure. With technology enabling productivity growth, we are positive on medium-to-long term economic growth. China internet is more profitable with better growth prospects given economies of scale and early adoption by consumers.

KEY IMPACTS

POSITIVE

- → For equities and fixed income
- → For domestic demand, machinery/ equipment and infrastructure
- → For fixed income securities as the reach for yield will continue
- → For oil and selective hard commodities
- → For tech sector; more selective on consumer retail

MIXED

- → For fixed income; higher rates generally negative for FI

NEUTRAL

- → For equities; focus on earnings momentum; greater emphasis on active investment management

Upside RISKS

Favourable policies to boost economic growth.

In Asia, governments have increased infrastructure spending while in the US, there are hopes that President Trump's tax reform plans would boost economic growth. An improving economic outlook could also stimulate increased capital expenditure/business investment.

US tax reform as the booster.

Tax reforms may lift business investment leading to stronger economic growth in the US.

Downside RISKS

Weaker-than-expected economic growth.

The business cycle is mature and we are into the 10th year since the last downturn in 2008. The business cycle will not be repealed and downturns will follow upturns with the only uncertainty being timing.

Asset bubbles popping.

The low interest rate environment has led to asset bubbles as the search for yield has pushed prices of various asset classes including real estate, private equity and European high yield. With global debt levels high, a deflation of asset bubbles may lead to a crisis.

Higher-than-expected inflation.

Current inflation expectations are low but with commodity prices up and labour markets relatively tight, this could lead to an inflation scare. There is a risk that wages may rise sharply if workers take advantage of the tighter job markets and force employees to increase pay.

Geopolitical tensions.

This is on the rise given political instability in Middle East, North Korea and even in Europe.

Abdul Razak Ahmad – Chief Investment Officer (Malaysia)
Syhiful Zamri - Chief Investment Officer (Islamic)

MALAYSIA EQUITIES

2017 REVIEW

The year that gained traction

2017 was expected to show a strong recovery after an unprecedented 3 consecutive years of negative returns for equity markets in 2014, 2015 and 2016. True enough, equity markets experienced a sharp recovery starting from January until the end of October 2017. The MSCI Asia ex-Japan index delivered more than 30% returns and the Malaysian market also delivered positive returns of more than 6.5%, albeit the KLCI index lagged its regional peers. The positive sentiment was partly due to a renewed expectation of less aggressive rate hikes by the US Federal Reserve in 2017 after President Trump's rhetoric on low interest rates dissipated. The KLCI index recovered from its low of 1,620 after the Trump presidential election scare in late 2016 and continued to recover in 2017. The KLCI index hit the year high of 1,792 points in mid June, as election risks subsided with centrist Macron winning the French election, thereby affirming the fate of a more united European Union.

However in July, the Malaysian market plateaued after the news that some Arab countries had cut ties with Qatar and UK Prime Minister Theresa May failed to secure a majority in UK's snap poll, suggesting escalating geopolitical risks. At the same time, there was continuous instability in North Asia due to the persistent threat from North Korea nuclear missile tests. The US Fed also firmed up another rate hike in June and the IMF cut 2017 economic growth estimates for the US in the same month.

And it got better...

KLCI index in mid-June hit

1,792

points

Short-lived lull in July

Several factors contributed to a levelling-off period

MALAYSIA EQUITIES

2017 REVIEW

Malaysian GDP numbers continued to surprise on the upside, delivering 5.7% in 1H2017 against an earlier official target of just 4.3% to 4.8%.

China, Malaysia's largest trading partner, also delivered better-than-expected GDP growth of 6.9% in 2Q17. Nevertheless, these strong economic numbers did not translate into much better market performance due to escalating North Korean tension.

When the market sensed that the elections would be delayed, especially when PM Najib was ready to present the Budget 2018 in October and when UMNO was readying for its General Assembly in December, some investors quickly locked in some profit since the expected pre-election rally might not occur in 2017. The market recovered at 1,796 points amid a strong 3Q17 GDP of 6.2% and stronger export numbers. The smaller caps, which were the top performing counters in the 1H17, started to give back some of their performance in the 2H17.

During the tabling of the 3Q17 GDP figures, BNM also highlighted again the severity of the current property oversupply situation and the potential bubble bursting in property market, which could affect other sectors of the economy. BNM warned that the glut in office space and shopping complexes in major states could worsen with incoming supply, potentially becoming more severe than what was seen during the 1997/98 Asian Financial Crisis.

It said that one in three offices would be vacant by 2021, and that 140 new malls would enter the market by that year.

The Cabinet ordered the Kuala Lumpur City Hall *(DBKL)* to freeze approvals for four types of developments starting from November 1. These are shopping complexes, offices, serviced apartments and luxury condominiums that are priced at over RM1 million.

The threat of aggressive supply and better-than-expected GDP numbers may leave BNM with little option but to increase the OPR in 2018. The market was quick to reflect this scenario and we saw some adjustments taking place, with investors taking risk off the table in November.

The strengthening of the Ringgit by more than 10% up until the end of December had foreign investors worrying about potential currency losses in the event the current strengthening proved to be short lived. The correction in the equity market escalated as the market seemed to be expensive, trading at around 1.0x to 1.50x standard deviation in USD terms. However, following the widely anticipated 25 bps interest rate hike by the US Federal Reserve on 13 December 2017, the local bourse started to move higher, buoyed by buying interest on blue chips, especially banking stocks. The index continued its climb to close at 1,796 as at 29 December 2017, supported by window dressing activities as well as foreign flows.

Volatile market in 2H17

Later part of the year, the market recovered strongly

1,796

points amid a strong 3Q17 GDP

6.2%

Strengthening of the Ringgit

By more than

10%

till end December

Potential bubble trouble

Measures were taken to nip the property oversupply situation

2018 OUTLOOK

MALAYSIA EQUITIES

2018
OUTLOOK

Overall, 2018 appears pleasantly calm. But best to remain cautious.

2018 will be greeted with a more cautious tone following a strong market recovery in 2017. Earnings delivery is very critical to sustain investors' confidence given expectations have built up as the market recovered from a low base in 2016 and gained traction in 2017. The strong GDP growth numbers of above 5.7% in 2017 should also underpin the potential strong earnings growth for corporates. Malaysia also should benefit from commodity prices strengthening in 2018. Higher oil and palm oil prices should lend support to economic growth and lead to a turnaround in corporate profitability. Hence, the equity market should be able to deliver its average long term returns of between 8% to 10% in 2018. However, we should remain cautious as some markets are already at peak valuations and at all-time highs. As a result, there could be some market volatility. On the currency front, we believe that the Ringgit appreciation, albeit small, may continue in 2018. This is underpinned by stronger commodity prices, as for example every USD1 increase in crude oil price will boost government income by RM300 million.

MALAYSIA EQUITIES

2018 STRATEGY

We believe investors should remain invested in sectors with resilient and visible earnings growth in 2018.
Earnings delivery and execution of strategies will be crucial as expectations from the investing community have built up during 2017. We expect exporters and global suppliers to do well as synchronised global growth will provide a conducive environment for global trade to expand, especially when the earlier threat of Trump's protectionism is dissipating.
As the government has already announced higher budgets for operational expenditure in 2018, we would also focus on companies which will benefit from an improvement in domestic consumption, for example consumer staples and financials.
Some laggards in 2017, for example utilities, telecommunications and plantations, may play catch up since investors could fall back to these low-beta and strong cash-generation counters to cushion any fall in the market (for example from geopolitical uncertainties). Therefore, while we should be overweight on growth sectors, these steady yielding companies should anchor the portfolio to weather any potential volatility, especially in the run-up to the general election, which is expected to be in the second quarter of 2018. We believe that the second half of 2018 should provide more positive returns to investors once election uncertainty is over.
Our base case expectation for the KLCI index is at 1,893 by 2018 year-end, implying 5.4% upside from 29 December 2017 close of 1,796. This is based on the 7-year average forward PER of 15.8x, which is reasonable considering equity investors' low expectations and cautious sentiment in an election year. In the event policy consistency is maintained with the incumbent government winning with an increased majority, market valuation may expand, and the KLCI index could hit 2,000 points.
The three main factors that underpin the cautious sentiment in 2018 are heightened geopolitical risk especially in the Middle East, higher rates in the US pressuring OPR or local rates, and continued volatility in financial markets with investors unwinding their risk positions in favour of safe haven assets given some markets are already at their peak valuations.
We believe that crude oil prices will continue to form a new base around current levels and rise going forward as the agreement by OPEC members and Russia to cut production may be extended if necessary. Strong crude oil prices are also critical for Saudi Arabia to list its national oil company, Aramco, which could be as early as end of 2018.
Hence, we should expect oil price to strengthen slightly, averaging around USD55-70 per barrel in 2018.
The year 2018 may see some large sized initial public offerings *(IPO)* e.g. the MMC port division, since the market's valuation is above its long term average. Despite a challenging year due to global headwinds, we believe that Malaysia is well positioned to face volatility given ample market liquidity, as represented by the large pension funds, life insurance providers and other institutional investors.

Remain in sectors with resilient earnings growth

Focus on companies in domestic consumption

Utilities, telcos and plantations good to weather potential volatility

3 Reasons to stay cautious :

- Heightened geopolitical risks.
- Higher rates in the US pressuring OPR and local rates.
- Volatility in financial markets with investors unwinding their risk positions.

MALAYSIA EQUITIES

KEY THEMES 2018

THEMES	IMPACT	POSITIONS
ELECTION YEAR	Government opex spending will be accelerated as committed in Budget 2018.	Continue to overweight election beneficiaries, domestic consumption plays and the construction sector.
INTEREST RATE ADJUSTMENT PERIOD	Conducive for corporate earnings' growth and accommodative environment for M&A activities.	Overweight stocks with strong cash generation, and M&A potential or corporate exercise.
SYNCHRONISED GLOBAL GROWTH	Export and trading activities to expand and benefit manufacturers and global suppliers.	Continue to overweight competitive exporters, especially global suppliers.
IMPROVEMENT IN COMMODITY PRICES	Earnings to bottom out for plantation and oil & gas players.	Overweight plantation stocks and selective participation in oil & gas service providers.
HEIGHTENED GEO-POLITICAL RISK	Investors unwind their risk positions in favour of safe haven assets *(e.g. gold, Japanese Yen, government bonds)* or capital flight back to US markets.	Neutral position in dividend yielding and defensive stocks in 2018 to weather volatility.
SUSTAINABLE CORPORATE EARNINGS	Improvement in valuation multiples for Growth stocks. Value stocks continue to look attractive.	Overweight sectors with strong visibility, such as consumer staples and construction sector. Higher alpha from growth stocks.

Source: Maybank Asset Management as of 31 December 2017

Ben Eeh – Head of Fixed Income – Malaysia
Najib Nordin - Fixed Income Portfolio Manager

MYR FIXED INCOME

2017 REVIEW

Malaysian Government Securities : a flattened yield curve

As at year-to-date, the Malaysian Government Securities (MGS) yield curve has bull flattened on the expectation of stronger growth, a benign inflation outlook and the appreciation of the ringgit relative to regional currencies. The benchmark 10-year MGS which started the year at 4.26% fell by 40 basis points (bps) to a low of 3.83% at end-August before correcting to a peak of circa 4.10% in early November. Since then, and up to the beginning of December 2017, the MGS has rallied on the back of stronger-than-expected 3Q GDP data, sustained trade surpluses and the meeting of the lower fiscal deficit target. The unexpected hawkish shift in November's MPC statement had also provided a much-needed tailwind to boost the Ringgit with renewed portfolio fund flows to local bonds. This is in addition to the support from trade flows from the mandatory conversion of export proceeds.

Malaysian Government Bond : yields a higher return

Corporate Bond : prices remained stable

For the MYR credit market, 2017 was a better year for investors as Malaysian government bond yields gave a higher y-o-y return of 4.65% up to November 2017 compared to 3.40% in 2016. Corporate bond prices, meanwhile, stayed relatively stable throughout the year despite higher volatility in MGS prices compared to the previous year. The notable bond performance was also partly due to the appreciation of the Ringgit, which recorded gains of approximately 9.0% YTD. While most of the returns were contributed by coupons, the downward shift in sovereign curves contributed about 0.91% YTD in capital gains. Supply in the corporate bond market was flush in 2017, dominated by high grade borrowers, mainly those with Government guarantees, AAA and AA rating categories.

10-YEARS MGS

4.26%
start of 2017

3.83%
end Aug

4.10%
early Nov

MYR Government Bonds Total Returns

4.65%
up to Nov

MYR FIXED INCOME

2018 OUTLOOK

All the forces that shaped the Malaysian Bond market last year will carry on in 2018.

For 2018, the forces that will shape the outlook of the Malaysian bond market will largely be the same as last year; ie the US fiscal policy, Federal Open Market Committee's (FOMC) interest rate path, European Central Bank (ECB) tapering, Malaysia's fiscal health and MYR performance, as well as the foreign fund flows given the high foreign ownership of Malaysia government bonds. BNM's hawkish change in the tone of their MPC statement suggests that it may be ready to hike OPR to 3.25% in 2018, given the strong GDP growth and labour demand which have increased the odds of demand pull inflation pressures. Headline inflation, as measured through the Consumer Price Index (CPI), is expected to ease to 2% in 1H18 due to high base effects, but will likely rise thereafter to test the upper ceiling of BNM's official 2.5-3.5% forecast range before moderating back to 2.5-3% for the rest of 2018. Resilient domestic demand and continued capital spending by both the private and public sectors, as well as election spending will likely anchor the GDP forecast of 5.0% to 5.5% in 2018.

GDP Forecast

Resilient domestic demand.
Capital spending by private and public sectors.
An expected forecast of

5.0%
to
5.5%
in 2018.

What key obstacles may affect regional market performance?

Under-pricing the Fed rate hike path and escalation of China liquidity risks will likely be the key obstacles for regional markets to perform in 2018. As it stands, the Fed has proven that it does not require inflation to be at 2.0% to deliver 2, and very likely 3 hikes in 2017. Thus, if a modest upward shift is established in its inflation trajectory amidst a tightening labour market and improving output gap, this could cause yields to re-price higher. Meanwhile, although China's stability in 2017 has been key to the outperformance of regional markets in 2017, it may not necessarily remain so in 2018. As China's debt concern mounts and its deleveraging drive continues, whether the regulator can curb rising debt without triggering systemic risk remains to be seen. However, we expect oil prices to be range bound in 2018, hovering between USD50 to USD70 per barrel as risks to the upside and downside appear to be broadly balanced. While OPEC supply cuts have helped to support oil prices, any significant increase in prices are capped by the ability of shale oil producers to come back onstream.

Under-pricing Fed rate hike path

Escalation of China liquidity risks

Oil prices expected to be range bound
USD50
to
USD70
per barrel

MYR FIXED INCOME

All good... but it's wise to exercise some caution.

Despite these scenarios, we think that the local bonds will remain well supported in the first quarter on the back of the stronger Ringgit tailwind, benign inflation and local demand dynamics. However, as US inflation bottoms out and domestic uncertainty increases as we near the general election, we believe exercising some caution would be prudent. Since the unexpected hawkish shift in BNM's statement, there has been renewed portfolio fund flows to local bonds. The return of these flows have been sizeable and was estimated to be in the region of MYR10bil in November. Furthermore, as activity was mostly seen to be in the front-end (← 3 years), it is likely that the nature of these funds are fast-money offshore accounts positioning for Ringgit appreciation. As foreign positioning in the front-end tends to be less sticky, we think more value can be found in the longer end, with its generous yield pickup and some cushion against correction albeit with lower liquidity.

Local bonds expected to be supported on the tailwind of the stronger Ringgit, a benign inflation, and local demand dynamics.

KEEP AN EYE OPEN

...on the effects of US inflation and rising domestic uncertainties in the wake of a general election.

Total government bond supply for 2018 is expected to be similar to 2017, at MYR107 billion, to fund the national budget deficit of MYR39.8bil and government bond maturities of MYR66.8bil next year. Given GII's rise in prominence in the local bond market, we expect GII issuance to exceed that of MGS in 2018, with a MGS:GII issuance mix of 45:55 in the next 3 years. Gross Private Debt Securities (PDS) supply is expected to be slightly lower at around MYR95-100 billion as some issuance might have been brought forward to 2017 on expectation of a higher rates environment in 2018.

We will continue to focus on good credits with a decent issue size for trading opportunities in the secondary market.

On the tenure, we prefer the medium to long term papers as we believe the flattening of the curve in second half of 2018 will be key to our performance.

Nonetheless, we will be very selective in building our portfolio during the first half of 2018 in order to take advantage of the flattening of the yield curve.

MYR FIXED INCOME

KEY THEMES 2018

THEMES	IMPACT	POSITIONS
US FED INTEREST RATE HIKES TO CONTINUE	Govvies yield curve to be most affected by US rate hike.	Underweight government bonds and raise cash to take position on bargains.
POTENTIAL OPR HIKE; THOUGH MONETARY POLICY TO REMAIN ACCOMMODATIVE	Shorter tenor bonds tend to be most affected. Long term yields may flatten on positive macro story, DM bond sentiment and Ringgit outlook.	Overweight duration once the rate hike theme plays out.
BENIGN GLOBAL AND DOMESTIC INFLATION	Positive for bonds. Inflation to moderate in 1H18 on base effects, but to rebound in 2H18.	Overweight PDS, but to tactically invest in Govvies when value emerges.
RINGGIT TAILWIND TO SUPPORT FOREIGN FUND FLOWS	Lower bond yields, particularly in the front-end as foreign flows position for Ringgit appreciation.	Overweight duration before turning neutral once the curve has flattened.