2018 OUTLOOK

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.

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.

MALAYSIA

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.

INDONESIA

Bagus Adi Yoga Prawira – Head of Indonesia Research

INDONESIA EQUITIES

2017
REVIEW

Events that coloured the Indonesian equities report card : A few surprises and some as expected

There were several key domestic and international events which supported the Indonesian equity market performance of +19.9% YTD, some of which were within our expectations, while others came as a surprise.

Key domestic events **1)** Indonesia's credit rating upgrade to investment grade by S&P. **2)** Surprise rate cuts in 3Q. **3)** Stubbornly weak consumption data. **4)** Strong earnings growth driven by contractors, banks, telcos and commodities. **5)** Strong trade balance and contained current account deficit *(CAD)*. **6)** Manageable inflation which lowered bonds' risk premium and provided a buffer for equity re-rating. **7)** Heightened political tension which culminated in the blasphemy case of former Jakarta governor Ahok prior to the Jakarta gubernatorial elections.

Key global events **1)** a China-driven reflation. **2)** Global growth synchronisation for the first time in the last decade. **3)** The Fed's dovishness which led to a weaker USD environment favoring Emerging Market *(EM)* assets.

The year started with a scarcity of catalysts as the market was still digesting Trump's policy implications and its timeline. There were concerns that the planned expansionary US fiscal policy would result in sharply higher interest rates. As a result, small and mid-cap stocks performed better driven by domestic retail participation while the large caps lagged as foreign and domestic institutional investors remained on the sidelines. However, it became more apparent that fears of the US reflation trade would not be realized. The Fed turned out to be more dovish than expected and appetite for EM assets re-emerged on the belief that interest rates would stay lower for longer.

In addition, China's supply-driven reflation fuelled a commodity price recovery that benefited commodity-exporting countries like Indonesia.

In contrast to consensus' expectations, we had some doubts about the US reflation trade as we believed Trump's policies would take much longer to be implemented. With Developed Markets *(DM)* in the late stage of the economic cycle, we thought that DM central bankers would raise rates at a gradual pace in order not to inadvertently tip their economies into recession. Thus, given the benign interest rate environment, we were well prepared for inflows into the local bond market and passive inflows through Emerging Market *(EM)* ETFs. Given strong risk appetite, the inflows from EM ETFs into the Jakarta stock exchange more than offset the foreign outflows from the Indonesia equity ETFs *(EIDO)*.

Given a favorable global environment for emerging markets including Indonesia, the large caps, which were supported by inflows from ETFs, started outperforming the small caps going into late 1Q17 to mid 2Q17. Large caps with a turnaround story *(banks, United Tractors (UNTR), industrials)* were the strong outperformers. Towards the middle of 2017, there were significant domestic events. One was the Jakarta gubernatorial elections where early favourite and President Jokowi's favoured candidate, Ahok, lost.

Indonesia 2017
Equity market performance
+19.9% YTD

Who did better?
At the start, driven by domestic retail,small and mid-cap stocks performed well, but...

Wait a minute...
Entering late 1Q17 to mid 2Q17, the large caps were the strong performers.

INDONESIA EQUITIES

2017 REVIEW

Going into the elections and after...

Domestic factors started to come into play in the run up to the Jakarta gubernatorial elections in Apr-17 which was then followed by the S&P upgrade. The outcome of the Jakarta gubernatorial elections did not quite surprise us but what was unexpected was the muted market reaction. In this case, we might have overestimated the impact of local political events against a broader picture of the economy and we did not account for the unexpected S&P upgrade given a volatile political situation.

What came after that was the energy subsidy cut *(i.e., hikes in electricity price)* which was deemed rational given the low inflation environment. However, we did not anticipate that this would have such a negative impact on domestic demand as it did. While Indonesia's current account deficit did improve, this was due largely to a lack of import appetite *(given increased tax scrutiny of importers)* and slow budget disbursement. All in all, the government-driven investment cycle was not enough to counter subdued private sector sentiment. This led to a muted recovery in consumer names *(both staples and retail)*, leading to earnings downgrades for several large cap consumer names that halted the market rally.

Decent 2Q17 results from large cap banks and commodity counters *(especially UNTR)* sustained an overall neutral market which translated into sideways price action in 2Q-3Q17. The market was supported by domestic investors as local pension funds still had room to allocate monies to equities, given a large increase in their liabilities.

In addition, most of the large local mutual funds had ample cash *(c.90%)* and were not inclined to reduce equity allocations further since they had already been relatively neutral to bearish. Risk appetite on small-caps *(e.g. Indah Kiat, Barito Pacific and some commodity stocks)* flourished.

In 3Q17 going into 4Q17, we saw global growth recovering in a synchronized pattern for the first time in the last decade which fuelled rallies in most markets. 3Q17 results were not as disappointing as typically expected during this seasonally weak period. The market's 19.9% YTD return was driven largely by earnings growth which explains the JCI's robust performance despite global and domestic political noise. Interestingly, the realized historical volatility of the JCI as measured on a 12-month rolling basis was at a decade low.

In summary, earnings growth has been quite strong and earnings expectations were not revised down significantly *(with only consumer-related and property names being downgraded)*; hence, JCI performance was fundamentally driven by earnings growth rather than a valuation multiple re-rating. We are currently in the mid-to-late stage of a global cyclical upturn while the domestic credit cycle has bottomed. Meanwhile, a strong trade balance and tame inflation *(despite cuts in energy subsidies)* has buoyed investor confidence in the BI's and government's policy credibility and a stable IDR. We believe the aforementioned factors have lowered the expected risk premium in holding Indonesian bonds and equities. Given that bond yields have fallen more than the earnings yield, we maintain our upside bias for the Indonesian equity market. We are positive as the domestic cyclical growth story remains favourable compared to developed markets which are at a later stage in the recovery cycle.

Surprise!

Yes, it was a volatile political situation but what followed was an unexpected S&P upgrade.

And more...

An energy subsidy cut left an unexpected negative impact on domestic demands.

Going into 4Q17

The previous quarter's results were reasonably good for a seasonally weak period.

19.9% YTD.

Upside bias for equity market

Remaining positive with a favourable domestic cyclical growth.

INDONESIA EQUITIES

2018
OUTLOOK

In constructing our view, we consider three key variables: macroeconomics, liquidity and corporate fundamentals/valuation. We provide the positives and negatives of each variable as follows:

1. Macro

THE POSITIVES	THE NEGATIVES
Increased government spending and disbursement to create an economic multiplier effect, supported by adequate room for higher deficits.	**Delayed asset quality improvement** as loans-at-risk remain elevated, with potentially more downgrades, especially following the end of BI's relaxation policy. This would provide less incentive for banks to lend, halting the recovery in the credit cycle.
More support for the grassroots economy through higher social spending *(i.e., a populist stance)*, which could boost consumption and stimulate investment demand.	**Material shift in domestic political dynamics** that could end the progress of current structural reforms and dampen investment appetite.
Indonesia's improved Balance of Payments *(i.e., strong trade balance alleviating CAD problems, sustained FDI inflows supporting the net financing balance sheet)* leading to ample FX reserves, coupled with manageable low inflation, provides a buffer for capital outflow risk.	**Elevated oil prices whilst other commodities lag** could be detrimental for the CAD, and raise IDR volatility and the risk premium of holding Indonesian assets in general.
A greater likelihood of improving asset quality for banks, a bottoming of the credit cycle and hence a further pick up in GDP growth.	**Hard-nosed tax office efforts to chase more revenues** could create serious hurdles for a consumption recovery if not properly communicated.
Faster infrastructure projects execution prior to the 2019 presidential elections to boost GDP growth through higher raw material needs and improved loan demand.	**China's growth to slow more than expected** which could lead to a correction in commodity prices and dampen global growth. The China reflation trade has been a key reason for market rallies in Asia, especially Indonesia.

INDONESIA EQUITIES

2018
OUTLOOK

2. Liquidity

THE POSITIVES

Less room for foreign active funds to sell compared to the previous market crash. Based on Bloomberg data, there has been net equities outflow of ~IDR33tn *(USD2.4bn)* ytd although many of these trades are crossing transactions between related parties which we suspect are due to reshuffling activities as a result of the tax amnesty. On the other hand, there has been ~IDR9tn net inflow from ETFs *(after ~IDR0.9tn outflow from EIDO ETF)*. Hence, on the whole, we believe the data shows that the foreign active funds have reduced their positions in Indonesia.

Domestic liquidity remains sufficient. M2 growth trends remains promising while current LDR is proof of the ample liquidity in the banking system. Given BI's macroprudential measures on LFR and RIMP *(intermediation ratio)*, domestic liquidity should remain ample for both real and financial sectors. Through RIMP implementation, liquidity in the bond market should improve as banks would take on the 'lender' role; thus creating a buffer for equity re-rating in the event of capital outflows.

Local pension funds' liabilities to grow further. In a low yield environment, these pension funds tend to increase their equity allocation, away from money markets, to chase better returns in order to match their liability needs. Moreover, in the bond market, local pension funds need to comply with an OJK regulation to increase their proportion of fixed-income investments to 50% by next year, which again should provide a buffer in the event of capital outflows.

THE NEGATIVES

Policy normalisation in DM markets, if these differ from market expectations could create volatility in risky assets such as EM countries like Indonesia given heavy foreign ownership and illiquid domestic markets.

Trump's tax reforms and all other policies if successfully implemented during the peak of the US economic cycle could lead to a significant US budget deficit, sending US Treasury yields higher than expected and lowering the real rate differential between Indonesia and the US. Combined with a possible shift in domestic political dynamics, this could create more volatility in the IDR and drive capital outflows.

INDONESIA EQUITIES

2018
OUTLOOK

3. Corporate fundamentals/market valuations

THE POSITIVES

Positive trajectory of corporate earnings. Earnings growth has been reasonable overall and quite strong for certain sectors *(banks, commodities, telcos and contractors)*

Valuations are not lofty compared to 2008, 2013, and 2015. JCI's valuation remains at a 3-year mean. In addition, relative to the MSCI Asia ex-Japan, the JCI is currently trading at 1.43x P/B which is -2STDEV below its 5YR average despite an improving trend of relative ROE since mid-2016.

Corporate guidance on capex started to pick up lately indicating better private investment appetite next year.

Adequate buffer for equity re-rating on normal parity. Current real interest rate differentials between Indonesia and the US stand at c.2% level, justifying the narrow spread between Indonesian bonds and US bonds. As long as the real rates differential is sufficiently positive, we think that market valuations *(fixed income and equities indirectly)* should remain normal.

THE NEGATIVES

Should the credit and asset cycles fail to pick up, earnings (which are supported by the banks) may be downgraded.

Increase in IDR volatility could hurt the economy as Indonesia is still dependent on imports and could warrant a de-rating of equity valuations given that the real rates spread is close to zero.

A standstill in structural reforms caused by a shift in domestic political dynamics and a slowdown in China or globally could also dampen the private capex recovery.

INDONESIA EQUITIES

2018
STRATEGY

Venture forth optimistically but be watchful and prudent.

We remain cautiously optimistic on Indonesian equities but think that some market correction to ~6,150 is plausible given the overbought condition in a 12m rolling basis. However, the trend is still positive and quite strong, hence we think that a 'buy on dips' strategy with sector rotation play could extend for longer – this remain our base case strategy. We would adopt a barbell approach, especially on finance, consumer, retail, basic industrials and commodities-related sectors, although for the latter, we prefer to play alpha names. Macro, corporate fundamentals and valuation factors are tilted to the positive side, but there are liquidity risks such that the market could easily correct to the previous support level if liquidity dries up. However, a potential upside in active foreign flow coming in and higher nominal growth expectation in 2018 should bode well for small-mid caps stocks that have underperformed in the past year.
In terms of cyclicals which are also value plays, we are looking to build positions in construction & property and big-ticket discretionary *(e.g., Astra)*. We are already overweight and remain overweight on basic industrials but selectively so on alpha names rather than large caps.
For trading purposes, mining still offers some short term opportunities, although we prefer to be selective on fresh stories *(e.g. ELSA, PTRO, MEDC, INDY)*. We would prefer to marketweight infrastructure given lofty valuations and underweight agriculture due to a lack of catalysts. However, we would be opportunistic for short term trading whenever possible. Lastly, for momentum plays, we remain positive on the finance and consumer sectors.
We set our base index 12 month target at 6,525 *(2.7% from end-2017)*, with support at 5,925-6,150, back in Nov-17. However, the market was heavily propped up by 6.8% in Dec-17 leading to potential de-rating risk. Nevertheless, if the multiples stays, we believe another c.8-10% upside (higher than our base target) for the market to c.6,800-7,000 *(7,000 is our best case target index set back in Nov-17)* is possible since we think banks could still grow by mid-teens *(c.15%)* in 2018 and a c.8-10% growth is still c.3-5% below consensus' expectation *(i.e., a 30% downgrade in earnings expectations)*. As banks contribute c.29% of JCI weight, even assuming no multiple re-rating, 15% earnings growth would contribute 4.35% return for the market, ceteris paribus. The other c.3-4% return could easily come from other sectors such as the consumer sector *(c.1.1% return contribution) and infrastructure (c.1.2%) return contribution)* on conservative assumptions. Note that this already assumes a -15% earnings growth for the mining sector in line with consensus expectations that might be too conservative. Even if all other sectors were to disappoint, we could still achieve c.7-8% growth for the market. On a more positive note, a sustained commodities up-cycle should lead to consensus upgrades for commodities' stocks EPS growth expectation. This will make a 7,000 target price achievable under no de-rating scenario *(our best case)*. On the other hand, we do think that most of the returns will tend to be front-loaded as more risks may emerge in 2H18. However, should the market break below the support level, it may start pricing in our bear case scenario as mentioned below. We have a bear-case index target of 5,400-5,500, with support seen at 5,000.

Indonesia equities 2018

A trend that is expected to be positive and quite strong. Still, the word is

'cautiously'.

'Buy on dips' strategy

This remains the strategy on sector rotation play.

To overweight or underweight?

Overweight commodity-related, consumer cyclicals and banks. Marketweight infrastructure. Underweight agriculture.

INDONESIA EQUITIES

SCENARIO	ASSUMPTION / RISK	MARKET IMPLICATIONS
BASE CASE	• GDP to grow 5.1%-5.3% in 2018 driven by higher government spending, stable consumption, recovering investment and a sustained positive trade balance. • Nominal GDP growth to be driven by better consumption and ample domestic liquidity, which should eventually result in further credit growth. • Banking credit growth and asset quality should be recovering. • China reflation trade maintained together with a sustained *(relatively)* low risk premium for Indonesia equities and bonds. • Gradual monetary policy normalisation by global central banks.	• FY18-19 EPS growth 9-13% • Year-end Jakarta Stock Exchange Composite Index (JCI index) target of 6,525, forward PE of 15.3x *(3-year avg)*
GOOD CASE	• GDP growth beyond 5.3% on the back of stronger consumption and private investment coupled with upward trending commodity prices. Trump's tax reform does not result in huge dollar repatriation and a significant budget deficit. • Global growth remains in sync with the China reflation trade. Gradual global monetary policy normalisation and well-anchored expectations of CBs monetary policy direction. • Incumbent government proves to be successful in uniting domestic political and social interests. • Further upgrades from credit rating agencies, and much improved FDI in the manufacturing sector.	• FY18-19 EPS growth c.13% • Jakarta Stock Exchange Composite Index (JCI Index) target of 7,000, forward PE of 16.6x *(3-year +0.5 Stdev)*
BAD CASE	• Consumption and investment fail to recover, leading to GDP growth below the 5% level. • Severe domestic political disturbances with a real shift in political dynamics. • USDIDR hitting 14,000 levels or higher driven by severe portfolio outflows caused by both negative external and domestic factors. • Lack of foreign direct investment *(negative funding gap)* which is insufficient to offset CAD. • China 'reflation' trade faltering and commodities turning bearish. • Trump's tax policies fully implemented in a peak cycle US economy, leading to excessive USD strength and budget deficits Risk of narrowing Indonesia's real rate differential with the US to below zero. • Global CBs are deemed to be late in tightening monetary policy, resulting in aninverted yield curve, with markets pricing in the possibility of a recession.	• FY18-19 EPS growth c.5-13% • Jakarta Stock Exchange Composite Index (JCI Index) target of 5,500, forward PE of 13.7x *(3-year -1.5 Stdev)*

INDONESIA EQUITIES

2018 THEMES

First half of 2018

• With index having reached all-time high in 2017 and maintaining its overbought level since late beg-2Q17, a healthy correction to 6,000-6,150's level is plausible. In such conditions we prefer to play sector/style rotation in a barbell approach and start to look for value-proposition play given light corporate data points until end of Jan-18.

• Higher government social spending should start to kick in by 1Q18, boosting consumer confidence and market sentiment, as there will be more fiscal room due to less deficit in 2017. Additionally, year 2018 will be full of political events that may result into higher velocity of money.

• Trump's tax policies may gain momentum and create volatility and capital outflow risk due to higher US bond yields and USD strength. At this stage, Indonesia govvies spread parity with US govvies will be tested given our real rate differential remains sufficiently positive.

• China's 'reflation' trade thesis breadth should be tested at this stage as data points of industrial production and deleveraging effect would be more instructive. In this case, a late-stage equity bull-cycle will tend to coincide with an up-cycle in commodities market *(especially energy and industrial metals)*. This should be in-line with greater confidence of G3 countries Central Banks for monetary policy normalisation on higher nominal growth expectation, signalling an end of bond bull market.

• Positively, we anticipate resilient buffer against capital-outflow risk in 1H18 due to low domestic inflation due to high-base effect, less supply of bonds, ample FX reserves, and plentiful ammunition for local pension funds to buy bonds.

• Additionally, optimism could be reignited after the 4Q17 and 1Q18 results whereby any inline and above achievements could lead to 2018 earnings upgrades. Only potential caveats would be banks asset quality development and consumer companies data points.

• We would look further more on cyclical-value play at this stage *(especially mid-small caps)* as we think BI is unlikely to cut rates further despite a low inflation in order to guard against IDR weakening and in confidence of higher nominal growth ahead. At this stage, we expect more macroprudential measures to be at play.

US and China

Trump's tax policies may create volatility and capital outflow risk. While China's 'reflation' trade may be tested.

Nonetheless...

We expect a resilient buffer against capital outflow risk.

At this stage

We look for cyclical-value plays and expect more macro-prudential

INDONESIA EQUITIES

2018 THEMES

Second half of 2018:

- We believe 2H18 would be a trickier period where consensus' earnings expectations and the credit upcycle will be tested as any ill effect from BI's stance to hold policy rates would become visible.

- At this stage, monetary policy normalisation by most DM central banks *(CBs)* will be more apparent and could induce volatility across markets. The key here is the Fed's balance sheet normalisation plan in the face of Trump trade war stance on China as well as the ECB's and BoJ's tightening plans.

- Risks could materialise as the central banks are hiking rates against late-cycle inflationary pressures. Although our base case does not include a recession due to the central banks' cautious stance (given structurally low inflation expectations), a market correction does not require one. Possible margin compression globally due to higher commodity prices could provide a reason, especially during historically low levels of volatility and low CDS rates for countries like Indonesia. The US and EU yield curves will be the yardsticks as to whether the CBs are ahead or behind the curve.

- Anything that could go wrong domestically might happen at this time as more political noise is expected as the 2019 Presidential elections draw near. However, we expect that the incumbent will try to accelerate the rollout of his policies and avoid any mistakes, which can be another positive factor for the market if done properly.

Domestic political climate

2019 Presidential election is approaching with uncertainties in tow.

Richard Nadapdap – Head of Fixed Income - Indonesia
Zaki Aulia - Fixed Income Portfolio Manager

INDONESIA FIXED INCOME

2017 REVIEW

The Indonesian bond market had a positive 2017 for 3 major reasons.

First, in May17, S&P finally upgraded Indonesia's rating to investment grade. The S&P upgrade was long awaited since Fitch and Moody's had upgraded Indonesia to investment grade in December 2011 and January 2012 respectively. Second, inflation was successfully tamed. By mid-year, the CPI had only rose by 2.35% YTD, and 2.87% by Dec17, so FY17 CPI would likely be at 3.0%, which is far below CPI expectations of 4.0%-4.5% at the beginning of 2017. This leads to the third reason, i.e., Bank Indonesia *(BI)* reduced the benchmark rate twice or by 50bps from 4.75% to 4.25%, which was considered as a brave move and a sign of confidence by many investors. These three factors have brought foreign inflows to the domestic bond market of IDR 130.4tn by October17 which was higher than the FY2016 figure of IDR 107.3tn. Throughout the year, foreign holdings in government bonds ranged from 39.0% - 40.0%. The yield curve shifted lower across tenors by 110 – 160 bps. The yield of the IDR 10yr bonds fell from 7.70% to 6.50%, and touched 6.30% in Sep17. As for new issuances of corporate bonds, after the announcement of the rating upgrade, demand increased significantly. Most of these IPO bonds were 3 to 5 times oversubscribed, especially high rated bonds, SOE bonds, and government-related debt. The favorite 3yr corporate bonds with AA- *(double A Minus)* to AAA *(Triple A)* bonds are offering yields of 100-150 bps lower compared to the previous year. The performance of the Rupiah *(IDR)* was relatively stable. It fluctuated between IDR 13,300 – 13,600 per USD. Indonesia CDS are also hovering at all-time low levels.

Foreign inflows to the domestic bond market.

Demand increased for new issuances of corporate bonds.

2018 OUTLOOK

INDONESIA FIXED INCOME

2018 OUTLOOK

We expect 2018 to remain a positive year for IDR bonds. We think that the volatility will most likely come from external factors. We expect GDP growth to pick up slightly to 5.3% and 5.4% in 2018 and 2019 respectively. Stronger commodity prices will translate into higher net exports contribution to overall GDP growth. Meanwhile, investment growth will continue its gradual recovery. Investment growth is likely to average 5.5% in 2018 and 2019, which is decent, considering the average 4.7% recorded in 2013-16. Support from the government's infrastructure push remains the dominant driver. Out of the government's 37 priority infrastructure projects, 17 are already in the construction phase, with total pledged funding amounting to about US$250bn. Ahead of the 2019 national elections, we expect fiscal policy to remain accommodative. There is a risk that the government will resist higher energy prices, even if crude oil prices were to continue rising next year. The political landscape may heat up in the run-up to the 2019 national elections. A total of 171 regional / provincial elections will be held in June 2018 and may provide important cues for the 2019 national elections.

We believe CPI inflation may reach 4.0% and 4.5% in 2018 and 2019 respectively. We expect BI to start hiking rates again in Q4 2018, bringing the policy rate back to around 5% by mid-2019. Anticipation of a stronger USD may mean that higher domestic interest rates are necessary. An excessively weak IDR is likely to be a drag on GDP growth. Arguably, Indonesia is now better positioned to withstand the risks from uncertainties in global markets.

INDONESIA FIXED INCOME

2018 OUTLOOK

Potential developments in 2018 and 2019 that could significantly affect the domestic economy.

First, the trend among major central banks, especially the United States, Eurozone, Britain, and possibly Japan, to start tightening monetary policy. As this has long been predicted by the market, the response of global financial markets may not be too negative. We continue to expect more capital inflows to emerging markets, including Indonesia.

Secondly, we see that China, which over the past year and until the beginning of this year was at risk of experiencing a serious economic slowdown (hard landing), seems to have succeeded in reaching a more sustainable growth rate, albeit in the lower range of 6%. This is positive for commodity demand albeit commodity prices will still remain below that seen pre-2008.

Third, we note that increased risk-taking and risk-tolerant behaviour has raised fears of a possible financial crisis of a global scale as that of 2008. However, we do not see a significant increase in crisis risk, at least for 2018. Interest rates in the United States and other major countries will rise much more slowly compared to 2005-2008, thus allowing the market to adjust to tightening monetary policy in stages.

Tightening monetary policy among major central banks

China reaching a sustainable growth rate

No increase in crisis risk.

2018 STRATEGY

We plan to be overweight on duration in 1H18 and may switch to a more defensive stance as we enter 2H18 depending on the inflation numbers.

The volatility of Rupiah will be a big factor influencing the bond market. With the volatility, there will be opportunities to trade in 2018.

INDONESIA FIXED INCOME

KEY THEMES 2018

THEMES	IMPACT	POSITIONS
THE FED RATE CONTINUE TO RISE	Higher volatility on govies and Rupiah.	Neutral on govies. Take positions at attractive yield levels.
POSSIBILITY BENCHMARK RATE HIKE	Yield curve shifts higher.	Be defensive entering 2H18.
HIGHER INFLATION BUT STILL MANAGEABLE DESPITE CENTRAL BANK LOWER ITS TARGET RANGE TO 3.5% +/- 1.0%	Low inflation in 1H18, but will pick up in 2H18.	Neutral on duration and lengthen it on tactical correction.

SINGAPORE

Mark Chua, CFA – Portfolio Manager

SINGAPORE EQUITIES

2017 REVIEW

Singapore was one of the first to reap from a synchronised global growth. Indeed, 2017 was a good year.

After a disappointing 2016, 2017 turned out to be a good year for the Singapore economy. The government's forecast for 2017 GDP growth was revised upwards twice, to 3.0 - 3.5%, from their initial 1.0 - 3.0% forecast. Being a small, open economy, Singapore was among the first to benefit from a synchronised recovery in global exports. The manufacturing sector showed robust growth, driven by the Electronics and Semiconductor industries. The economic recovery soon spread to other domestic sectors such as Real Estate. During the third quarter, we saw Residential property prices increase on a quarterly basis, for the first time since September 2013, and precipitating a wave of collective sales for older residential apartments. Prime Office properties continue to transact at rich valuations driven by strong demand from large institutional investors.

GDP forecast revised twice Upwards to

3.0% -3.5%

Robust growth

Starting with the manufacturing sector, followed by domestic sector with a boost in real estate.

Equity markets fared well, with the MSCI Singapore index up 22% from January to end December.

At this time last year, we had advised investors to position for a gradual economic recovery as the Singapore equity market was trading at an acceptable valuation in line with its historic average. Equity markets are forward-looking and equity prices start to rise well before any evidence of the economic recovery. This phenomenon was seen in the first half of the year, as share prices of cyclical sectors started to rise, for example in Banking, Real Estate and the Offshore Marine. By the second half of the year, we started to see more evidence of the economic recovery through data on business loans, physical property prices, new offshore marine orders, as well as in corporate earnings.

In the first half of 2017, equity prices started to rise. The second half of the year showed even more economic recovery.

2018 OUTLOOK

SINGAPORE EQUITIES

2018 OUTLOOK

Major segments of the Singapore economy such as Exports, Real Estate and Banking are doing well.

Cyclical momentum is firming and this should spread out to support a gradual recovery in labour markets. We can expect to see stronger consumption power supporting economic growth in the next phase. We do not expect the government to tighten monetary policy unless there is more evidence of inflationary pressures. However, a potential risk which may trigger macro-prudential measures is if the heady pace of en-bloc collective sales was to continue unabated.

Outside of Singapore, a global economic recovery is picking up pace. Major economies such as the US, Europe, China and Japan are growing. We are expecting global interest rates to rise gradually as the US Federal Reserve normalises monetary policy, which is consistent with an improving economy. However, geopolitical tensions have risen, especially on the Korean peninsula, in the Middle East, and within nations in the form of rising popular discontent.

For Singapore equities, we would advocate more caution as equity valuations are elevated at 1 standard deviation above its historic mean. Expectations are high and there could be periodic corrections if earnings do not turn out to be as strong as expected or if geopolitical tensions flare up. We have a mid to high single digit growth target in 2018. At 15 times Price Earning *(P/E)* multiple, Singapore appears attractive relative to equity markets in the US or Europe.

SINGAPORE EQUITIES

2018 STRATEGY

Giving more attention to valuations.

In 2018, we will focus our stock picks on companies which have earnings growth at reasonable valuations. Market valuations have risen meaningfully and higher expectations have been incorporated into equity prices. In this environment, it is important to pay more attention to valuations.
At the same time, we have to be aware that technology trends are in flux and new entrants are disrupting traditional industries. Business valuations using traditional financial metrics may not be sufficient and need to be supplemented with an understanding of business models and potential competitive risks from new entrants. These market conditions will make 2018 a challenging year for security selection, but we take it as a challenge and an opportunity for active managers to add value to their client portfolios.

Going overweight or underweight... Jack, be nimble.

In terms of sector allocation, we would advocate Overweight positions on Real Estate, Manufacturing, Neutral positions on Financials, Gaming, and Underweight positions on Transport and Consumer Staples. We expect volatility would remain high, and would suggest investors remain nimble in the view of potential changes to the macroeconomic and geopolitical landscape.

Watch out :

Business valuations using traditional metrics are insufficient especially in an environment with new competitive entrants and technology disruptions.

SINGAPORE EQUITIES

SCENARIO	ASSUMPTION / RISK	MARKET IMPLICATIONS AND STRATEGY
BASE CASE	• GDP to grow 1.5 - 3.5% in 2018 with recovery in financial services and offshore oil & gas sector. • Non-oil domestic exports to show high-single digit growth in 2018. • Low inflation of 2.0% expected in 2018. The MAS to maintain its policy of zero appreciation of the SGD.	• FSSTI target 3,598 based on 14.0x 2019 EPS of 257 *(+5.7%)*
GOOD CASE	• Better than expected recovery in external demand, driven by the US, Europe and China, which will be positive for exports. • Robust economic data outweighing interest rate hike concerns. • Relaxation of macro-prudential measures in the property sector. • Supportive fiscal policies from the US and successful tax reform package.	• FSSTI target 3,855 based on 15.0x 2019 EPS of 257 *(+13.3%)*
BAD CASE	• Heightened external headwinds on slowing US growth, Europe debt crisis re-emerges and/or China "hard landing". • Policy misstep by the Fed or other DM central banks, leading to disorderly outflow from EM. • Inflation climbs faster than expected. • Unexpected fall in property prices/demand putting pressure on financial position and corporate earnings.	• FSSTI target 3,341 based on 13.0x 2019 EPS of 257 *(-1.8%)*

Note: Return calculations based on FSTE Straits Times Index ("FSSTI") 29 December 2017 close of 3,402.92.
Source: Bloomberg as of 29 December 2017

Notes:
REITs refers to Real Estate Investment Trusts
MSCI refers to Morgan Stanley Capital International
DM refers to Developed Markets
EM refers to Emerging Markets
Feds refers to the United States of America Federal Reserves
GDP refers to Gross Domestic Product
SGD refers to Singapore Dollars
YTD refers to year-to-date

Joyi Wu – Credit Analyst / Portfolio Manager
John Lim – Credit Analyst / Portfolio Manager

SINGAPORE FIXED INCOME

Macro

2017 Delivered above expectations.

Concluding 2017, the year had been better than expected on the back of demand pickup in G3 economies while China's growth held stable. This had helped to drive up demand in manufacturing, financial services, wholesale trade and transport/logistics. Back in late 2016, MTI's initial forecast for 2017's growth was "1%-3%". However, by November, this figure is projected to at "3%-3.5%", slightly above the initial 3%. Inflation had been low, with MAS's core inflation expected at 1.5% for 2017.

Growth forecast was re-projected

3.0%-3.5%

2018 Key influences in Asia with a domestic impact.

Looking into 2018, some themes in Asia stand out and will have a domestic impact.
1) Growth to be sustained as the global business cycle continues its expansion since late 2016 but enters a mature phase.
2) Inflation to rise, both from sustained growth and higher commodity and oil prices.
3) China to continue to exert a significant influence via the "One-belt, One-road" initiative.

Singapore's growth for 2018 is expected to range from 1.5% to 3.5%, with a projected moderation in tech-related manufacturing to be balanced out by other sectors. Core inflation is estimated at 1%-2% in 2018 with the likelihood of upside surprises.

On idiosyncratic developments, the fallout from the oil & gas services sector will likely abate and prevent a deterioration in the banking system's NPL. The private property market was buoyant in 2017 with aggressive land bidding activity spilling over into a series of high-profile collective sales. These activities add to concerns of already high existing housing stock that waits to be absorbed and hence the possibility of macro-prudential regulations to cool the market in 2018 cannot be ruled out. Lastly, the Singapore-KL HSR project tender will be finalised in 2018 which might see a Chinese consortium winning the bid.

Expected growth

1.5%-3.5%

Estimated inflation

1%-2%

Oil & gas fallout will likely subside.

The 2017 aggressive property market may lead to macro-prudential regulations this year.

SINGAPORE FIXED INCOME

Rates & FX

2017 Reporting an impressive performance.

In 2017, both SGS and SGD swap curves had mirrored the flattening trends in other economies' bond markets, with yields at the front end increasing to reflect FOMC rate hikes while yields at the intermediate to long end tightened.
The SGD had appreciated 6.8% against the USD over the past 11 months, marking its performance in middle of the pack relative to other Asian currencies *(TWD, THB, KRW and MYR had posted stronger performances YTD)*.
Nevertheless, this is an impressive performance considering the strength of the SGD relative to peers.

SGD appreciated

6.8%

against the USD

SGS & SGD curve swapping

Yields at the front increased.
Yields at the intermediate/ long end tightened.

2018 Contributors to a steeper SGS curve.

For 2018, we believe the SGS curve can experience steepening pressures due to the following contributing factors:
1) 2017 has been a year of flattening bond curves *(especially in USA)*. If inflation picks up above market expectations, the momentum could reverse. 2) There remains 4 vacancies in FOMC governors for US President Trump to fill, with the potential for more "hawkish" members to be appointed and 3) an active 2018 SGS issuance calendar with 9 auctions being arranged vs. 7 in 2017 4) Shift in monetary policy in Europe and Japan

For our FX outlook, we believe the impact from US rate hikes will likely be limited due to higher domestic inflation and tightening of monetary policy by MAS, thus keeping USDSGD supported and range within 1.34 to 1.37 in Q1 2018.

US effect on FX

US rate hikes will have limited impact.
US tax reforms, if passed, may weaken SGD

SINGAPORE FIXED INCOME

Credit

2017 Comfortable and generally stable.

2018 Optimistic that stability still owns the day.

In 2017, we have seen the banking system's NPL levels rise although absolute NPL levels remain very comfortable. News of an unrated bond issue default by Nam Cheong brought volatility into the unrated bond space, but investment grade rated issues remained generally stable as the credit impact was viewed as manageable. Heading into 2018 this should stabilise given higher oil prices and the restructuring of debt in the offshore marine sector. 2018 is also the year where IFRS 9 will be implemented and hence we will see a hit to banks' earnings although overall capitalization levels will remain strong.

Gross SGD bond issuance *(ex-SGS & MAS bonds/bills & CDs)* year-to-date reached SGD 25.2 billion as of 8th December 2017 and will finish the year above 2016's gross amount of SGD 19.1 billion. Companies were actively re-financing and strengthening their financial capital as rates fell post the US election at end of 2016. Despite the MAS encouraging rated issuance, a larger percentage i.e., 68% of issues came unrated in 2017, compared to only 60% in 2016.

The majority of the unrated issues still came from financial institutions and real estate. In the rated space, the majority of the issues are investment grade. Financial issuers and real estate issuers together account for 77% of the total amount of rated issues in 2017 year-to-date, with government related entities taking another 14%. We expect the issue pipeline to remain buoyant in 2018, as we believe the global economy will improve and borrowers will be motivated to issue before the expected Fed rate hikes.

Capitalisation levels will still be strong in 2018

Despite IFRS 9 affecting banks' earnings.

Bond issuance as of December 2017

SGD 25.2 billion

Buoyant forecast

As global economy improves, there's confidence in borrowers to issue.

SINGAPORE FIXED INCOME

SCENARIO	ASSUMPTION / RISK	MARKET IMPLICATIONS AND STRATEGY
BASE CASE	• Federal Open Market Committee *(FOMC)* to continue its hikes in 2018 *(2-3 hikes)*, ECB and BoJ to sound more positive on economy. • Growth in Asia to remain firm as the global business cycle matures; some slowdown in China expected as the cooling measures of the housing market takes effect. • Oil prices to remain at US$50-US$70 per barrel, as global oil supply gets absorbed. • Inflation to rise slightly although pressures will be contained.	• Curve to experience some steepening. • Continue to prefer credit over government bonds. • Expect MAS to tighten monetary policy in first half of 2018. • USDSGD to range 1.34-1.37 in 1st quarter of 2018. We expect slightly weaker SGD due to one-off repatriation tax benefits for US companies' offshore earnings.
GOOD CASE	• Inflation pressures to remain low amid steady growth. • Tech-related *(such as electronics)* demand proves stronger than expected and triggers a revival in domestic demand, which leads to better economy and labor market. • Higher than expected oil prices benefit the marine & offshore engineering sector.	• Yield curves to continue stay flat as per 2017. • Credit spread tightens following the better economic conditions, prefer credit over government bonds. • SGD to remain range bound.
BAD CASE	• Oil/commodity prices to continue to rise in 2018, putting Asian economies under higher inflation and balance of payment pressures. • G3 central banks to sound less accommodative on monetary policy, nomination of more hawkish leaning members in FOMC.	• Rates curve to experience stronger steepening pressures. • Asian currencies like INR, IDR and SGD to weaken.

STRATEGY

- **Rates:** Curve likely to see some steepening pressure so would prefer to stay at the shorter end.
- **Credit:** Broadly stable with tightening potential if growth surprises on the upside.
- **Currency:** USDSGD to stay supported, hovering between 1.34-1.37 in the near term.

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GDP refers to Gross Domestic Product
SGD refers to Singapore Dollars
YTD refers to year-to-date
NPL refers to non-performing loan
UST refers to United States Treasury