CHALLENGING DRIVE

2019 OUTLOOK & STRATEGY

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Our 2018 Review

A Turbulent Year Has Passed...

Without exception, 2018 was a challenging year as almost all asset classes delivered negative returns. The year started off well for equity markets as the tailwind from synchronised economic growth in 2017 saw markets having one of the best starts in recent years. Asian stock markets rose by between 5-10% in January alone.

However, rising interest rates negatively impacted bonds and hence fixed income funds early in the year. There were concerns that the strong economic growth would force the US Federal Reserve to raise interest rates more aggressively. Overall financial market conditions deteriorated soon after as the US triggered trade tensions with China and the rest of the world.

As a result, Asian equity markets peaked in 1Q2018 and dropped for much of the year. Negative news flow from the US-China Trade War was compounded by a noticeable slowdown of the economy in China as the government sought to bring shadow banking and the bubble of unregulated peer to peer lending under control.

Fixed income markets saw a double whammy of higher interest rates leading to interest rates on the benchmark 10 year Treasuries breaching the critical 3.0% levels from just 2.25% at the start of 2018. Credit spreads for bonds also widened significantly due to the US-China Trade War and slowing Asian economies.

KEY HIGHLIGHTS FOR 2019

1. Slower global growth from 3.3% in 2018 to around 3.0% in 2019;
2. Inflation to remain tame
3. USD strength to moderate in 2019
4. Oil prices to remain low in the range USD 50-70/bbl
5. Interest rates: 10-year UST to trade between 2.5-3.25% in 2019
6. Yield curve: UST curve to remain flat in 1H19 but could steepen in the front end from 2H19
7. ECB and BOJ to remain accommodative
8. China to implement marginal easing measures
9. No negative surprises for Indonesia and India elections

KEY RISKS FOR 2019

1. Negative surprises for elections in Indonesia, India
2. Hard landing in China
3. Credit spreads blow out in US and Europe
4. US economic data remains strong, prompting FOMC to be more aggressive in rate hikes
5. US-China trade tensions to find meaningful resolution
6. Oil prices to trade above USD 80/bbl
7. Geopolitical risks in the Middle East and Europe

OUR 2019 OVERALL INVESTMENT STRATEGY

On a risk-reward basis we would tilt it towards fixed income for 2019.

On a risk-reward basis we would tilt it towards fixed income for 2019. With the higher interest rates and wider spreads, yields for Asian investment grade bonds are attractive at between 4.5-6.0% (from just 3.3% in 2017). These returns are decent bearing in mind the likely risks investors will have to face in 2019. For investors who are able to take currency risks, local currency bonds in India and Indonesia will be preferred.

Peaking US interest rates will mean that Asian central banks will face less pressure to raise domestic interest rates. In fact, given the lack of inflationary pressures there is some flexibility to reduce interest rates. In addition, peaking US rates will also mean the possibility of stronger Asian currencies as investors have less reason to move money to the US. Therefore, an investor in Asian local currency bonds will enjoy the high prevailing yields and may benefit from lower domestic interest rates plus a gain from the currency appreciation.

Yields for Asian investment grade bonds are attractive.

Asian stocks are cheap, trading at a forward PER of just 11x and at a 20-30% discount.

For equities, Asian stocks are cheap both on an absolute and relative basis, trading at a forward PER of just 11x and at a substantial 20-30% discount to US valuations. The headwinds of slower growth will cap upside as corporate earnings may disappoint in 2019. However, with the extremes of valuation we feel that downside is limited so long as the US does not fall into recession. We also note that should the trade wars resolve amicably, Asian equities could recover sharply given the trough valuations. We like REITs as the likely pause of interest rates in 2019 and continued economic growth (albeit slower) will be positive for high dividend yielding stocks.

Just like for bonds, we would favour ASEAN equities. ASEAN countries are more domestically oriented especially Indonesia and Philippines and therefore are less exposed to the Trade Wars.

Moreover, Indonesia and Philippines are more sensitive to interest rates as both countries run twin deficits (budget and current account deficits). With peaking US interest rates, the Central Banks in Indonesia and Philippines will have more leeway to support the domestic economy. Lastly, Indonesia and Philippines are oil importers and muted oil prices will reduce the pressure on the current account deficit.

So in summary, we expect a challenging year in 2019 but there will be opportunities given the attractive valuations for Asian fixed income and equities. We would like thank you for your support amidst the difficult market environment. At Maybank Asset Management, we will continue to work hard to obtain the investment returns for our customers and also provide investment solutions, both new and existing products that would meet the individual needs of our clients.

OUR 2019 OVERALL INVESTMENT STRATEGY

CHALLENGING DRIVE

Themes	Our Assessment	Market Implications & Strategy
Growth Slows	We expect to see slower global growth in 2019. The reasons for slower global growth are manifold. Financial conditions are tighter and the US-China trade war has dampened confidence and increased uncertainty thereby stalling corporate decision making and investment. In addition, export growth is likely to be muted on subdued demand and as a result of prior front-loading of exports (ahead of tariff implementation) in 2018. While China may struggle, as a managed economy, we believe it will succeed in maintaining GDP growth at c.6%. Similarly in Asia, we expect trend or slightly below-trend growth in most economies. US growth momentum will slow as the effects of past fiscal stimulus fade. We do not expect a recession in 2019, albeit that remains a possibility in 2020 (as implied by the inversion of the US yield curve). We expect policy makers, in general, to be more pro-active in boosting the domestic economy. More populist policies may be introduced in countries with upcoming elections in 2019 (e.g., Thailand, Indonesia, India). The Chinese government may respond to the threat of slower growth by relaxing its stance on various issues (e.g., RMB depreciation, property cooling, deleveraging/financing) and increasing fiscal spending. Note that much of the growth slowdown in China can be attributed to the government's various regulatory clampdowns in recent years which has unfortunately now coincided with the trade war.	Neutral for equities and mixed for fixed income (positive government bonds, less so for credits). Favour ASEAN over North Asia for equities and local currency fixed income. Prefer Asian credits with high carry. Favour domestic-oriented names / defensives over cyclicals.
INFLATION MUTED; LOWER OIL PRICES	We expect inflation to remain muted in 2019. While there may be a bounce in oil prices in the short term (off the current low base), overall we would expect lower oil prices in 2019 as US shale supply comes on stream. In addition, food inflation should remain benign barring weather shocks. Slower global and capex growth will also weaken commodity demand and prices. The US-China trade war may also prove to be deflationary outside the US. China-made goods will be cheaper with a weaker RMB and China could divert (i.e., dump) its goods to other countries. In contrast, the trade war may increase inflation pressures in the US given more costly imports of consumer goods. Given excess capacity in most of the region, we see little price pressure stemming from capacity constraints.	Negative on most oil plays. Lower oil prices positive for India, Indonesia, the Philippines and Thailand.

OUR 2019 OVERALL INVESTMENT STRATEGY

CHALLENGING DRIVE

Themes	Our Assessment	Market Implications & Strategy
MONETARY POLICY CONTINUES TO TIGHTEN BUT CLOSER TO THE END; A WEAKER USD	While we expect the Fed to continue to hike in 2019, we believe the rate hike cycle is largely coming to an end in 2019. Normalization will continue as US core inflation remains close to 2% but mounting growth concerns will eventually lead to a pause in hikes. With the flattening US yield curve and given growth risks, we expect the USD to be weaker and correspondingly most Asian currencies to be stronger in 2019. With the exception of China which will ease in order to support its slowing economy, we expect monetary policy to be neutral in most of Asia. We see less pressure on Asian central banks to hike rapidly given a benign inflation environment and less currency pressure from a weaker USD.	Prefer US government bonds and Asian local currency government bonds. Favor REITs and high dividend yielding stocks. Favor Asian currencies over the USD. Favor beneficiaries of weaker USD
MORE VOLATILITY; GEOPOLITICS MATTER	We expect markets to remain volatile in 2019 given the uncertainty and risks to growth. For fixed income, we expect continued refinancing pressure. Binary outcome of US-China trade war will require nimble trading to capture opportunities or preserve capital. The US-China trade war is not just about the economics of trade but increasingly seems to be about containing the rise of China which makes any meaningful resolution difficult. While general elections in India, Indonesia and Thailand are likely to see the incumbents returned to power (albeit with an uncertain majority), there is always the risk that the unexpected could occur. Other sources of geopolitical risks include Brexit; elections in Europe (namely, in Germany and Italy); ECB tapering and Middle East tensions.	More tactical trading. High cash allocation from time-to-time. Once election uncertainty is out of the way, India and Indonesia might rally.
GLOBAL TRADE / SUPPLY CHAIN REFORM	With the US-China Trade War, companies will diversify their production bases. Some MNCs and local Chinese companies have already begun relocating their production from China which could benefit some ASEAN countries. These activities to diversify production bases will accelerate. However, this process may take some time depending on the availability of associated supply chains and infrastructure. Restructuring of the global trading architecture. The Multilateral system of trade has underpinned the global trading system and was represented by the WTO. The multilateral system worked by getting consensus from all countries. It was generally fair imposing the same tariffs across all countries with certain concessions given. This has broken down given the lack of support from the US and as world has become more complex world it is now hard to get agreement amongst all countries. Countries now prefer to pursue bilateral FTAs.	Favor selected exporters that benefit from production shifts away from China.

OUR 2019 ASIA EX-JAPAN OUTLOOK

EQUITIES

Post the 2018 market sell-off, Asian equities are looking more attractive from a valuation perspective. Asian equities are trading at 11.2X forward P/E (versus historical average of 12X) and at a 26% discount to US equities (versus historical average of 14%). Coupled with the prospect of the Fed ceasing its rate hike cycle in 2019, expectations for a weaker USD and benign inflation, we expect Asian equities to outperform developed markets in 2019. We see Asia as a beneficiary of fund inflows as investors rotate from developed markets into emerging markets.

We expect markets to be volatile in 2019, thereby necessitating more tactical trading and high cash holdings from time-to-time. We also see value in having some defensive names and high dividend yielding stocks as a portfolio hedge.

Key risks in 2019 include the outcome of the US-China trade war (which could move either way - resolution or escalation); a possible US recession in 2020 (as implied by the inversion of the US yield curve); and geopolitical risks. In the event of a US market correction (perhaps driven by US recession fears), Asian equities will not remain unscathed but may decline less given their relative underperformance in 2018 and the relative valuation gap.

We would favour the more domestic-oriented ASEAN markets over North Asia given expectations of slower global growth and US-China trade war risks. In addition, lower oil prices would benefit most ASEAN countries, with the exception of Malaysia. Twin-deficit ASEAN countries such as Indonesia and the Philippines should also see less currency pressure given a weaker USD and consequently less need for rapid rate hikes. With Indonesia and the Philippines being some of the biggest beneficiaries of the aforementioned factors and given relatively better earnings growth versus regional peers, we would overweight both Indonesia and the Philippines. The upcoming elections in Indonesia should also be positive from the standpoint of boosting consumption (given pre-election spending) and removing political uncertainty (barring a shock election result).

Case	Assumption / Risk	Market Implications & Strategy
BAD CASE	1. Weaker-than-expected economic growth. 2. Further trade war escalation. 3. Negative inflations surprise. 4. Heightened geopolitical tension.	• MSCI Asia ex-Japan target 570, based on 10.5X 2020E EPS of 54 (-5%).
BASE CASE	1. Slower global growth but no US recession nor China hard landing. 2. Trade war continues without severe escalation. 3. Muted Inflation; lower oil prices. 4. The Fed continues to hike but rate hike cycle comes to an end in 2019. In Asia (ex-China), monetary policy is neutral. 5. Weaker USD, stronger Asian currencies. 6. No severe geopolitical incidents.	• Overweight: India, Indonesia, Phillippines. • Underweight: Hong Kong, Taiwan, Korea, Thailand. • Neutral: Others. • Favour ASEAN over North Asia. • Favour domestic-oriented names / defensive over cyclicals. • MSCI Asia ex-Japan target 640, based on 11.6X 2020E EPS of 55 (+6%).
GOOD CASE	1. Better-than-expected economic growth. 2. Easing of trade tensions.	• MSCI Asia ex-Japan target 680, based on 12X 2020E EPS of 57 (+13%).

Based on MSCI Asia ex-Japan Index closing price of 602.10 on 14 December 2018.

OUR 2019 ASIA EX-JAPAN OUTLOOK

LOCAL CURRENCY FIXED INCOME & CURRENCY

We expect global GDP growth to slow from around 3.3% in 2018 to around 3.0% in 2019. The key driving forces for slower GDP growth will be a late-cycle US economy, Trump's 2018 tax cuts wearing off, end of QE, and the slowdown in global trade. Growth in China is expected to slow from 6.5%-6.6% in 2018 to 6.0%-6.1% in 2019, which brings EM Asia GDP growth to below 6.0%. Despite slower growth in the coming years for Asia, we are cautiously optimistic on Asian local government bonds and currencies as USD strength is likely to abate due to a pause in Fed hikes and lower crude oil prices. Additional factors that are helpful towards EM Asian local currency (LCY) bonds bonds and FX include light positioning, cheap valuations, high real yields and tame inflation in EM Asia in 2019.

Slower global GDP growth by 0.3%.

"Recovery begins from the darkest moment."

- John Major, Former British Prime Minister.

We had highlighted previously that the biggest threat to Asia LCY and FX markets was the perception of synchronised tightening by the G3 central banks. While only the Fed had hiked rates over 2018, the impact of liquidity withdrawal had caused EM currencies to weaken considerably. However, as we are writing this, the market seems to be having a rethink about the trajectory of Fed rate hikes as yields have declined from October's high and given the inversion in the front end of the yield curve. Indeed, for 2019, our base case is for the Fed to hike probably twice through 2019 if economic data remains firm. However, we should provide for the possibility that the Fed may only hike one time if trade tensions escalate. Meanwhile the ECB and BOJ are expected to remain accommodative at least through 1H19, with latest macro data leaning on the weaker side.

ASIAN LCY GOVERNMENT DEBT AND FX: PICKS AND PANS FOR 2019

Government Bonds (LCY)	-2	-1	0	+1	2
China			●		
India				●	
Indonesia				●	
Korea				●	
Singapore				●	
Malaysia			●		
Taiwan			●		
Thailand			●		
Philippines				●	

FX	-2	-1	0	+1	2
China			●		
India				●	
Indonesia					●
Korea		●			
Singapore			●		
Malaysia		●			
Taiwan		●			
Thailand			●		
Philippines				●	

OUR 2019 ASIA EX-JAPAN OUTLOOK

LOCAL CURRENCY FIXED INCOME & CURRENCY

We still like the LCY debt markets in Indonesia and India from both carry and currency appreciation perspective.

We still like the LCY debt markets in Indonesia and India from both carry and currency appreciation perspective. **The valuation in terms of real yield and real effective exchange rates are highest in these two countries**. We expect inflation in both countries to remain muted and fall due to lower oil prices. Also we expect the Fed to pause next year which will be positive for these economies as they will be able to ease monetary policy by the end of 2019. In terms of growth, India is expected to return to its longer term growth rate of 6.5-7.5%, compared to 6.2% in 2017 as it exits from the impact of demonetisation. Indonesia is also expected to grow between 5.0-5.5% in 2019.

Meanwhile for the Philippines, growth is expected to remain strong due to infrastructure investment and consumption while inflation expectations have been held in check after the BSP raised rates by 150 bps from 1H18 to 4.75%. Furthermore, November's headline inflation has also slowed to 6.0% from 6.7% earlier and looks likely to decline even further given lower oil prices. For 2019, we also like Philippines as we expect inflation in the Philippines to gradually come down in 2019 due to declining oil prices and the 150 bps of aggressive hikes by BSP in 2018.

In anticipation of slowing growth and reduced inflationary pressures, Singapore's MAS is likely to keep its SNEER exchange policy stable in 1H19.

For Malaysia, our call of MYR outperforming EM Asia FX has panned out, with USDMYR recording a YTD loss of 3% vs. -13% for USDINR, -8% for USDIDR and -6% for USDPHP. While the MYR remains cheap in the long run, we think low oil prices and slowing trade will impact balance of payment prospects, preventing the MYR from appreciating further.

Despite the outlook for a volatile year, fundamentals of many Asian currencies remain challenging as they grapple with an environment of high debt, worsening demographics and sluggish productivity. The pickup in growth in EM Asia in 2018 was more due to external demand from DM and less from domestic demand. However, we expect this to reverse in 2019 as we expect domestic-driven South East Asian economies to do well and export-driven North Asian economies to weaken. We expect South East Asian currencies with high real yield to outperform North Asian currencies. The risk to this outlook is a quick resolution of US-China trade tensions.

Malaysia
MYR stable for now.

Singapore
Strong SNEER exchange policy.

India
Growth rate to return to 6.5-7.5%.

Indonesia
Expected to grow 5-5.5% in 2019.

Philippines
Inflation to come down.

While country allocation remains important, local currency bond returns in 2019 will come from carry, modest FX appreciation and duration gains. The expectations of a Fed pause and weaker USD will be most favourable for South East Asian countries after a dismal 2018.

OUR 2019 ASIA EX-JAPAN OUTLOOK

USD CORPORATES

We are projecting a total return of 3% to 5% for JACI in FY2019. We think interest rates can go up by between 20 to 60 basis points but this can be easily absorbed given current JACI yield of 5.22% (as of 20 Dec 2018). We think that current yields are attractive and there is no need to take on too much risk for additional return.

Our recommendation is to have the majority (i.e., 50%) of the fund be invested in stable investment grade five year bonds, 10% in long end investment grade quasi-sovereigns, 20% in high yield with 20% in cash for trading opportunities.

FY2019: LIGHT AT THE END OF THE TUNNEL

Key themes	Maybank AM Assessment	Positions
Value has emerged in Bonds	Bond yields have risen by 100bps to 300bps in FY2018. Investment grade bonds at 4.5% and high yield bonds at 8%; bonds offer attractive value given historical volatility of less than 2%. Higher yields provide a buffer against a mild sell-off in interest rates.	• Bond portfolios gradually move from cash to bonds. • Balanced portfolios overweight bonds versus equities.
Fed to pause late FY2019/ early FY2020	The ongoing trade war during FY2018 weighed heavily on business sentiment, hindering future growth. US is already at a mid/late growth cycle. Inflation remains benign. Oil price peaked in October 2018 and has fallen over 30% from the peak.	• Yield curve remains flat. Prefer to buy less than 5-year bonds for carry. • Selectively buy into investment grade corporate perpetual bonds with high resets for higher carry. • Opportunistically trade long end quasi-sovereign bonds.
Growth to Slow but No Recession	US to avert a recession in FY2019 as Fed pauses after 1 to 2 hikes. China to continue to roll out targeted easing measures to support growth as they try to counter growth headwinds from both domestic deleveraging and external stress from the trade war escalation. Credit fundamentals to remain stable and bond defaults to remain low as China implements new policies to support the private sector such as introducing credit insurance, mandatory loan quota to the private sector, targeted cut in banks' reserve requirement ratio etc.	• Selectively add high yield exposure. • Access to funding is key. Prefer liquid balance sheet such as property sector. • Prefer Indonesia and China as risk-reward is attractive.
Volatility to remain	While fundamentals look attractive for bonds, technical factors such as fund flows and supply pressure can overwhelm. Continued equity weakness can dampen risk appetite for credits despite attractive yields. Geopolitical headwinds continue, from US-China trade war, elections, Brexit, ECB tapering, Middle East tensions.	• Keep 50% of the funds in 5-year investment grade bonds for attractive stable carry of 4% to 5%. • Keep 20% in short dated high yield and 10% in long end quasi-sovereigns. • Maintain 20% in cash for opportunistic trading.

2019 OUTLOOK

INDONESIA

INDONESIA 2019

EQUITIES

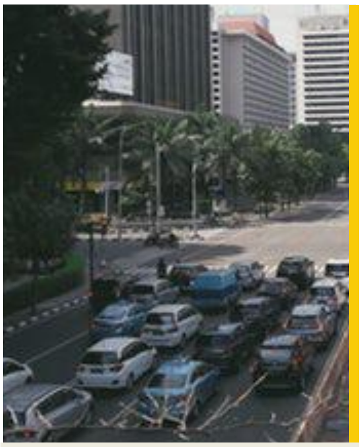
OUR OUTLOOK

Risk-wise, we think that 2019 could still be challenging as there are several variables at play that can change market sentiment abruptly.

1) Aside from the oil factor, the USD peaking thesis depends on global monetary policy convergence which may not happen as expected if a slowing US economy is accompanied by much slower EU and China growth in the short term.

2) This, if exacerbated by US-China trade tension, may drag down global growth and burden Indonesia's trade balance despite lower oil prices. Meanwhile, too weak oil prices will be negative for Indonesia's fiscal position in an election year when public spending is set to pick up.

3) Ultimately, the market has started to price in the downside risks to growth as implied by the yield curve. The biggest risk yet unpriced is if strong US employment growth continues amidst low unemployment which will create a tight labor market that can dampen growth and result in higher inflation. If this condition occurs at a time when growth is already slow then stagflation risk increases risk aversion for equities and bonds as both will tend to correlate positively during that period.



Ultimately, the market has started to price in the downside risks to growth as implied by the yield curve.

However, the current global backdrop has constructive tones for Indonesia.

1) Friendlier oil price should be supportive for IDR and foreign money sentiment.

2) Indonesian government bond yield spreads with US Treasuries have reached neutrality while Fed rate hikes may pause. Furthermore,

3) potential global monetary policy convergence (in late 2019) could imply that BI's rate-hike cycle is nearing its peak and USD strength is limited.

4) Smaller rate hikes, muted IDR depreciation as well as pocket-friendly fuel prices could provide relief for public and household balance sheets. Domestically we may see better consumption growth in 2019 due to more expansive fiscal spending preceding the election despite possible higher subsidised fuel price.

Both the Indonesian bond and equity markets may benefit from rotation trades out of DM into EM due to their attractive yield and growth expectations. The JCI is still attractive vs. regional peers despite the recent rally given a long period of foreign capitulation, attractive valuations and earnings growth. Historically, the JCI has posted significant relative outperformance over regional peers in the 3-6 months prior to the last three presidential elections. This may also hold true this time barring any spikes in oil price (due to excessive oil supply cuts) and deteriorating trade balance (due to worse-than-expected global growth exacerbated by US-China tension).

All in all, Indonesia's growth looks to have peaked this year and may flatten next year with slower numbers potentially in the near-term as price corrections in major exported commodities may pressure the trade balance and growth. Downside risks have indeed increased compared to 2017 as financial conditions are tighter. However, some of the downside is already priced in. In addition, there has been significant capitulation in the JCI in the past year resulting in attractive valuations. This coupled with a short-term catalyst in the form of Presidential elections forms the basis for a trading opportunity. Hence, we are looking at 2019 as a tactical trading year as volatility will persist, driven by political factors that will dominate the market at least until 1Q19.

INDONESIA 2019

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OUR STRATEGY

Going into 2019, we are positioning our portfolio for heightened volatility by being tactical so as to limit negative payoffs from negatively skewed returns in the event of headwinds resurfacing from USD strength, rising oil prices, worse-than-expected global growth slowdown and US inflationary shocks (that may prompt the Fed to tighten aggressively). On the other hand, external pressures have settled down and a more constructive tone has emerged, allowing us to be reasonably optimistic. Although we are in a riskier situation compared to end-2017 from a business and asset cycle perspective, we see a valuable trading opportunity ahead for Indonesian equities - to capitalise on possible rotation out of DM into EM and the positive effects of the pre-Presidential election period.

A victory for Jokowi in the next Presidential election (in Apr-19) would provide a boost to investment confidence.

We see 2019 is a trading year at first but may turn more strategic once important political and geopolitical events settle down and depending on fundamental data and central banks' actions. A victory for Jokowi in the next Presidential election (in Apr-19) would provide a boost to investment confidence as reforms will be expected to continue (which will be positive for growth and the balance of payments), albeit some of the upside will be priced in in the pre-election period. This along with geopolitical events (i.e., US-China truce and Brexit deadline) will be a turning point for our strategic positioning.

We would favour banks, consumer and basic industry over healthcare, energy and mining.

In terms of portfolio allocation, we increase our tactical portion by favouring index and bond-proxy stocks (from a top-down perspective) that are beneficiaries of foreign inflows and peaking rate-hike cycle at the expense of more structural allocation. As the economic cycle matures, we are tilting our bottom-up positioning into quality, market and momentum. We will add more value stocks at the expense of quality if the economic recovery becomes more certain and vice versa if recession risk rises.

We would favour banks, consumer and basic industry over healthcare, energy and mining. Nickel and crude palm oil stocks offer sizeable trading opportunities in the short-term given the recent correction. Real estate may pick up the pace in the later part of 2019 as the rate cycle matures and with possible incoming FDI (as a spillover effect of US-China trade tension) or should Jokowi win the election.

In the event of a risk-off scenario, our sector allocation will be tilted in favour of telcos, consumer and defensive big caps. We also prefer more liquid stocks as part of our tactical trading strategy to enable our portfolio to withstand a hostile environment while capitalising on trading opportunities.

EQUITIES

Scenario	Assumption / Risk	Market Implications and Strategy
BAD CASE	US-China trade truce falters with further escalation worsening a global growth slowdown and pressuring Asian currencies. Global growth divergence is prolonged as US slows down further but EU and EM slow much faster thus increasing recession risk. Oil price spikes and domestic inflation climbs faster than expected. Tight US labor market results in rising wage inflation while growth slows forcing the Fed to be hawkish and creating stagflation risk. Domestic politics and policies go badly dampening reform and investment confidence.	Year-end JCI target of 5,750 (6.9% downside) which implies 12.1x 2020 consensus P/E. A de-rating back to 2015 bottom. 2019F EPS of 429; 2020F EPS of 475
BASE CASE	GDP to grow by 5.1-5.2% in 2019. CAD peaked in 3Q18 and see mild improvement in 2019 amidst soft landing of the global economy. US-China trade war does not escalate much from here. Oil price stays flat with a benign increase in inflation. US inflation expectations are met and the Fed does not turn more hawkish from here. Long-term economic cycle matures slowly.	Year-end JCI target of 6,575 (6.5% upside) based on 13.8x 2020 consensus P/E. A slight 5% de-rating from current multiples to take into account modest earnings growth risk. 2019F EPS of 429; 2020F EPS of 475
GOOD CASE	Global convergence happens faster with slowing growth in China and improving growth in other EMs and EU, while US soft landing will pave the way for weaker USD and stronger ADXY. Presidential election result allows reform continuity and provides an investment boost. Oil price stays flat with a benign increase in inflation. US-China trade tension de-escalates from here, lowering trade balance and currency risk.	Year-end JCI target of 7,175 (16.2% upside) which implies 15.1x 2020 consensus P/E. A re-rating back to the half-way point between 2018 peak and bottom. 2019F EPS of 429; 2020F EPS of 475

INDONESIA 2019

FIXED INCOME

OUR OUTLOOK

While global macro volatility will remain in 2019, we expect it to be less volatile domestically. We see potential downside to our inflation and interest rate forecasts should the low oil price sustain in 2019. We expect GDP growth to be steady at above 5% in 2019, backed by consumption and investment spending.

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Even though elections do not appear to have a direct correlation to the overall economy, during the 2014 election campaign spending added around 0.2% – 0.3% to headline growth. We expect the elections to be smooth and peaceful. The 2 candidates are running on similar platform for economy: infrastructure, industrialisation, SME development, logistics, income distribution and human capital quality.

We expect inflation to be slightly higher than 2018 due to higher fuel, food price and a low base, we believe that the recent oil price correction will not stop the government from hiking fuel prices in 2019.

With the ongoing US policy normalisation and the tone from the latest FOMC meeting, we expect the tightening cycle may be nearing an end, therefore we forecast only 50bps of policy rate hikes in 2019 from 6% to 6.5%.

OUR STRATEGY

We continue to remain cautious on the market and plan to be defensive to neutral on duration. The volatility of the Rupiah will be a big factor influencing the bond market. With high volatility, we see opportunities to trade in government bonds. Also, we prefer high rated, AA – AAA, and liquid corporate bonds.

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