September 2016

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FROM THE FIXED INCOME DESK

Monthly Outlook

Summary

- USTs ended marginally lower in August as the market adjusted to the possibility of a Fed rate hike, buoyed by sustained resilience in the labour market. 2-year and 10-year UST yields ended the month about 15 and 12 basis points higher respectively.

- In India, Urjit Patel was appointed as the next RBI Governor, taking the helm for the next three years. Meanwhile, the GST bill was passed in parliament while the government set an inflation target of 4% for the next five years.

- S&P upgraded South Korea's long-term sovereign rating one notch to 'AA' with a 'stable' outlook. This was achieved as a result of the country's sustained growth and flexible fiscal and monetary policies.

- Asian credits ended the month higher as credit spreads tightened. On the back of expectations that the Fed will keep interest rates on hold in the next months, the global search for yield drove strong inflows of USD29bn year-to-date (YTD) into emerging market debt.

- JP Morgan has announced that by the end of October, sukuk instruments will be eligible for inclusion in various Emerging Market indices, a move that should increase the investor base of such instruments going forward.

- August saw a lower number of new deals of investment-grade credits, with the high-grade space raising only USD4.65bn from nine new issues. Conversely, activity in the high-yield segment picked up, with 17 issues amounting to USD5.1bn.

- Supported by relatively higher yields compared to the region and expectations of further monetary easing to stimulate domestic growth, we continue to overweight Indian, Malaysian and Indonesian bonds. Meanwhile, we maintain our neutral view on Hong Kong, Korea, Singapore and Thai bonds on their relatively high correlation to USTs.

- On the currency front, we favour Indonesian Rupiah and Indian Rupee as a result of buoyant domestic demand. Singapore Dollar and Korea Won are expected to underperform within the region as these trade-reliant economies remain vulnerable to sluggish global growth.

- The outcome of upcoming central bank meetings, in particular the FOMC meeting, is expected to be the key driver of returns in the coming month. So far, the easy monetary policy stance by a number of major central banks has been seen influencing sentiment and any reversal from this trend is likely to incite some downside volatility.

Asian Rates and FX

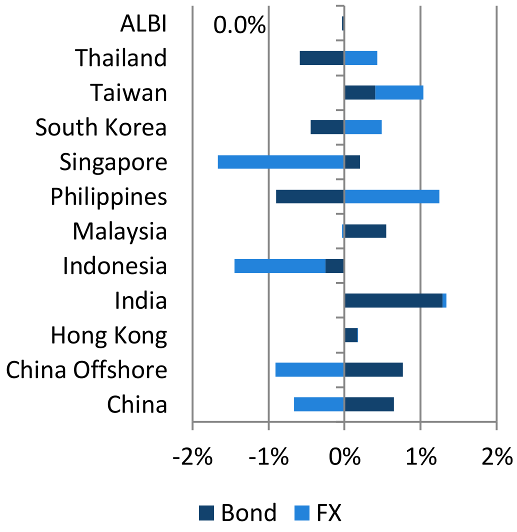
Market Review

- USTs ended lower

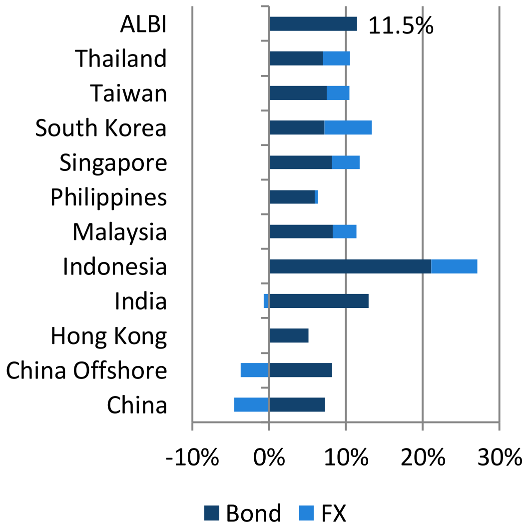
USTs ended marginally lower in August as markets adjusted to the possibility of an earlier Fed rate hike. The US Labour Department reported a surge in hiring in July, with US employers adding 255,000 jobs in the month, following an upwardly revised 292,000 new jobs in June. Three weeks later, Fed Chairwoman Janet Yellen stated that "the case for an increase in the federal funds rate has strengthened in recent months", citing "continued solid performance of the labour market". This, together with follow-up remarks by Vice Chairman Stanley Fischer that the chairwoman's comments were "consistent" with the possibility of two rate hikes this year, were interpreted as a September hike is back on the table. During the month, 2-year and 10-year points on the UST yield curve ended the month about 15 and 12 basis points (bps) higher compared to end-July.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 August 2016



For the year ending 31 August 2016



Note: Bond returns are in local currencies while FX and ALBI returns are in USD. Past performance is not necessarily indicative of future performance. Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 August 2016

- India appoints the RBI Governor, passes the GST constitutional amendment bill and sets inflation target

Indian Prime Minister Narendra Modi appointed Reserve Bank of India (RBI) Deputy Governor Urjit Patel as the next RBI Governor. Mr. Patel is scheduled to take the helm for three years, effective 4 September 2016. Meanwhile, India's Upper and Lower Houses of Parliament passed the constitutional amendment for a Goods and Services Tax (GST) to be implemented. The standard GST rate will unify all indirect taxes into one – a move which the government hopes will bring significant efficiency gains. A majority of the state assemblies need to ratify the legislation before it can be implemented and a GST Council (which will decide on, among other things, the GST rate, threshold and exempted products) will need to be established. Lastly, the government announced that it will be targeting a CPI inflation of 4% (+/- 2%) for the next five years which, according to policymakers, takes into consideration the country's output gap and exchange rate stability.

- S&P upgrades South Korean rating

Credit rating agency Standard & Poor's (S&P) raised South Korea's long-term sovereign rating one notch – to 'AA' – with a 'stable' outlook. Among other factors, S&P cited the country's steady growth and flexible fiscal and monetary policies as reasons for the upgrade. Notably, South Korea now ranks one level higher than China and two levels higher than Japan.

Market Outlook

- Overweight Indian, Malaysian and Indonesian bonds

On the back of expectations that the Fed will keep interest rates on hold in the next months, the global search for yield is likely to support demand for Indian, Malaysian and Indonesian bonds. We hold an overweight view on these bonds as they offer relatively higher yields against regional peers and the central banks in these countries have kept doors open for further monetary easing should there be need to spur domestic growth. Meanwhile, we maintain our neutral view on Hong Kong, Korea, Singapore and Thai bonds, on their relatively high correlation to USTs vis-à-vis other regional bonds.

- Prefer IDR and INR to SGD and KRW

Going forward, we expect global growth to remain sluggish, with trade-reliant economies such as Singapore and Korea expected to remain vulnerable. Consequently, we expect the Singapore Dollar and Korean Won to underperform regional peers. Meanwhile, countries that benefit from resilient domestic demand will insulate their economies from the weak external environment. Hence, our preference for currencies such as the Indonesian Rupiah and Indian Rupee.

Asian Credits

Market Review

- Asian credits ended the month higher

Asian credits registered gains in August, despite higher UST yields, as credit spreads tightened. Asian high-grade returned 0.72% and Asian high-yield returned 0.44% supported by continued inflows into emerging market debt, including Asian credit and in-region demand.

- Asia credit continued to be supported by strong inflows into EM hard currency debt; Sukuk instruments to be eligible for inclusion in JPM indices

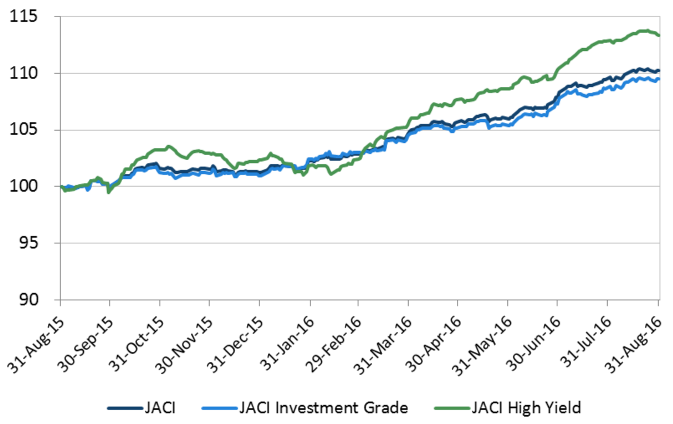
EM hard currency flows have continued strongly in recent months, with year-to-date (YTD) inflows at USD29bn. However, the pace of inflows moderated towards the end of the month. Meanwhile, JP Morgan (JPM) said that beginning 31 October 2016, Sukuk instruments (i.e. Shariah-compliant instruments) will be eligible for inclusion in its various Emerging Market (EM) indices including the JP Morgan Asia Credit Index (JACI), which should increase the investor base of such types of instruments going forward.

- Slower primary market activity

The month saw a lower number of new deals of investment-grade credits. There were a total of nine new issues – amounting to USD 4.65bn – in the high-grade space. Meanwhile, primary activity for high-yield segment picked up with 17 issues (including taps of existing issues) amounting to USD 5.1bn.

JP Morgan Asia Credit Index (JACI)

Daily returns for the period from 31 August 2015 to 31 August 2016



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 31 August 2016

Market Outlook

- Central Bank policy is key driver in September

A key driver of returns in the coming month is likely to be the direction on monetary policy given the slew of major central bank meetings in September, especially the Federal Open Market Committee (FOMC) in the third week. A key driver of sentiment has been the easy monetary policy stance by a number of major central banks. Any reversal is likely to incite some downside volatility. However, a sharp widening in spreads does not seem likely given the still robust demand backdrop for credit.

- Expect pick-up in supply to offset some positive demand technicals

The supply of new issues is expected to increase in the coming month following the summer lull, especially in the investment grade space. The pick-up of new issues should erode some of the positive technicals from a period of lower supply. The recent pick-up in high-yield issuance, with some at expensive valuations bears monitoring. If this persists, the positive backdrop of a market with negative net supply is likely to be questioned.

Important Information