



MARKET UPDATE

Equity Review Outlook

- December was a quiet month in terms of news flow ahead of festive celebrations. Market continued to set a bearish undertone, as most investors remained cautious of the outlook in 2006. The long awaited window dressing activities at year-end came and gone without much fanfare as KLCI closed slightly below the psychological mark of 900 points. During the month, the KLCI index rose 4 points or 0.4% to 899.8 points while the broader KLEMAS stayed unchanged at 204 points.
- The third quarter reporting season continued to exhibit signs of weakness. MAS, that is under close watch by foreign investors to gauge the pace of GLC reform, disappointed investors with 1st half losses of RM648 mil. This was due to increasing operating costs and declining yield. While the group has embarked on an operational and financial improvement programme, it is expected to take time and hence market expects losses to persist into 2006. This is another blow to GLC reform after the disappointing sets of results of Proton and Tenaga last month. While there is still downside risk, we think earnings are close to trough levels. If this holds water, earnings outlook may not be as bearish as perceived, thus setting the stage for positive surprise.
- On a positive note, we saw a surprising twist of fate for Proton in December as Volkswagen AG (VW) is said to have dropped its demand for a controlling stake in the former, thus paving the way for both parties to resume on a revised deal. This was perceived positively as a partnership with VW will give Proton a new perspective going forward in an environment of increasing competition and eroding margins from higher component costs.
- Moving into 2006, we expect a slower but fairly stable growth of 5% in 2006. We will continue to monitor some key headwinds that affected last year's global GDP such as high oil prices, interest rate cycle, inflationary pressure, China slow down and potential global bird flu epidemic. As we have mentioned before, we are seeing early signs of oil prices trending lower, peaking US interest rate cycle and a sustainable China's economic growth of 8-9% in 2006. While all these are at early stages, it may potentially give a significant boost to the global economy going forward. On the domestic front, significant government pump priming under the 9th Malaysian Plan is another wild card for domestic economic growth.
- In terms of investment strategy, we remain cautious and defensive at least through the first quarter of 2006. Hence, we favor stocks that are high dividend yielding, may potentially be involved in merger, acquisition and restructuring activities and trading at steep discounts to their fair valuations. At the same time, we seek investment opportunities outside Malaysia for alpha return on our portfolios.

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MARKET UPDATE

Fixed Income Review Outlook

- For 13th consecutive times, US Fed hiked the Fed Fund Rate (FFR) by 25bps to 4.25% in the FOMC meeting on 13 December 2005. The hike was no surprise. The removal of the word “accommodative” in the Fed December statement and the inversion of the US Treasury yield curve (2-year and 10-year at 4.36% and 4.34%) seemed to suggest the near to the end of Fed monetary tightening regime. An inverted curve historically signals a slowing economy or a recession.
- However, inflation threat is looming. Rising crude oil prices and strong housing number towards the end of December spells a potential increase of FFR in January, before Alan Greenspan steps down as the Fed Chairman. Crude oil price rose above US\$60 per barrel on higher demand for heating fuel as the temperature in Northern Hemisphere dropped.
- Malaysia sovereign bond market had a muted reaction to the Overnight Policy Rate (OPR) hike as the market has already reacted to the expectation of the rate hike weeks before. With the uncertainty out of the way, the MGS bond market stabilized somewhat. However, as year-end approaches, trading volume thinned substantially. The 3-year and 5-year MGS was down ended the year at 3.46% (Nov 3.49%) and 3.70% (Nov 3.78%) respectively.
- During the month, Bank Negara issued a RM2 bn 5-year Government Investment Issue (GII) tender and RM1bn 3-year MGS. This brought the total issuance on government securities to a total of RM31.5 billion, RM 8 bn short from the total government securities issuance amount budgeted for 2005.
- The primary and secondary PDS market was rather quiet in December. The PDS market had a delayed reaction to the rate hike and bond yields continued to rise. The lack of liquidity further added to the wide bid-ask and volatile bond prices. Towards the final week, we saw a lot of PDS traded on window dressing activities. We expect the primary market to return in January 2006 after the market is more stabilized and trading activities picks up after the holiday seasons.
- Bank Negara released the 2006’s Monetary Policy Committee (MPC) meeting schedule to enhance the communication of monetary policy. We view this as a positive move to provide greater transparency to the capital market. There will be eight scheduled meetings for 2006. In December, the MPC has decided to maintain the OPR at its current level of 3.0%.
- The November CPI came in higher than expected at 3.5% (October CPI of 3.3%). The higher prices were captured in food, transport, beverages and tobaccos. The December inflation is expected to remain at 3.4-3.5% level due to the year end festivities and delayed impact of fuel price hike earlier on.
- The foreign reserves numbers also continue to fall to USD72.0 bn as at 15 December 2005 (USD73.1bn on 30 November). Going into 2006, with inflation still a threat and falling reserves numbers, the bond market is expected to remain lackluster in early 2006 as the market is starting to price in another OPR hike in 1Q2006. In terms of strategy, we have reduced our portfolio duration further and maintain higher cash position at this time of volatility. Meanwhile, we will look for opportunities to focus on new primary issues when the opportunities arise.

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