



MARKET UPDATE

Equity Review Outlook

- In a nutshell, March was an exciting month with numerous announcements on the long awaited government policies. These encompass disclosures on the National Automotive Policy, key performance indicators by the top 15 government-linked companies (GLC), capital markets liberalization including the reintroduction of restricted short selling and the 9th Malaysia Plan. While the broad market remained buoyant in most part of the month, it succumbed to selling pressure towards month end as speculators unwound positions to lock in short-term gains. For the period under review, the KLCI index eased 0.2% or 2 points for the month to close at 927 points while the broader KLEMAS index was flat at 213 points.
- During the month, the government revealed the National Automotive Policy that was consistent with the NAP framework announced in mid October last year. Not surprising, the new policy lowered tariffs especially for the complete-knocked-down passenger cars and reiterated incentives for the regional set up in the country. This is inevitable as the pendulum of global competition is now swinging in favor of countries with competitive manufacturing landscapes such as China and Malaysia is not spared. Following the announcement, some car manufacturers also lowered retail prices of certain models by 1% to 15%. We expect more rationalization in the local automotive industry in the near future.
- The release of key performances indices (KPIs) by some of the GLCs marked another milestone for the GLC restructuring. Companies like Proton, Maybank, Sime Darby, Golden Hope Plantations, Kumpulan Guthrie, Mas as well as Tenaga revealed their targeted KPIs in March. At first glance, the move appears encouraging as it increases transparency.
- Meanwhile, the 9th Malaysia Plan was released on 31st March 2006 for the period from 2006 to 2010. Total development expenditure was increased to RM220 bn, 29% higher over the 8th Malaysia Plan allocation. This included some large-scale projects as well as allocation for smaller jobs. Hence, large contractors like Gamuda, UEM Builder, Road Builder and IJM should also benefit. Again, risk lies on implementation. This, however, should be mitigated with increased involvement of the Prime Minister's department and engagement of parties such as Khazanah to co-ordinate part of the plan.
- In the last FOMC meeting on 28th March 2006, the US FED increased rate by 25 bps to 4.75% for the 15th consecutive time. While this is within consensus expectation, it is interesting to note that FED has signaled further tightening going forward. At the point of writing, the Malaysia-US interest rate differential has widened further to about 150 bps. Coupled with our view that the core CPI will notch higher going forward, we envisage that OPR will rise further to 3.75% by year-end from 3.25% currently. The next monetary policy committee meeting is on 25th April 2006.
- In terms of investment strategy, we reiterate our defensive stance and favor high dividend yielding stocks as our core holdings. We continue to participate in thematic plays, such as renewable energy sector, merger and acquisition activities, and increase our exposure in overseas investments for alpha returns. Short-term catalyst is the imminent electricity tariff adjustment for Tenaga.

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MARKET UPDATE

Fixed Income Review Outlook

- In the last FOMC meeting on February 28, the US Fed has raised the Fed Fund Rate ("FRR") by 25 basis points to 4.75%. While the rate hike was broadly expected, the Fed's signal for more rates hikes dismayed market players. Bernanke indicate that further policy firming may be needed to contain the potential inflationary pressures, stemming from increased in resource utilization and higher energy and commodities prices. This spooked the market, lifting the US Treasuries curve by 12-30 basis points across board. The US Treasury curve ended flat with UST 2, 5 and 10-year Treasuries at 4.80%, 4.81% and 4.85% respectively.
- The US economic data was mixed, new home sales also fell more sharply than expected in February. On the other hand, US consumer remains resilient despite higher interest rates and energy prices. Given the Fed latest statement, we now believe that the Fed will have at least one to two more rates hikes to go before the end of the US monetary tightening process. This will bring the FFR to 5.0-5.25%. The next FOMC meeting is on 10 May 2006.
- In Malaysia, the MGS bond market traded sideways in early March but turned bearish in end March with more hawkish Fed outlook. Bank Negara Malaysia ("BNM") released its 2005 Annual Report with a higher GDP growth forecast of 6% for 2006 led by stronger exports and resilient domestic demand. It also expects a higher inflation rate of 3.5-4.0%. BNM stressed that it will not use exchange rates to achieve its monetary policy objectives, suggesting more room for interest rates to increase. Ringgit strengthened against USD and hit the high of 3.685 end of March. BNM's foreign exchange reserves rose by US\$0.6bn to US\$72.9bn as at 15 March 2006. The 3-year MGS ended the month at 3.67% (+9bps), 5-year MGS at 3.75% (+1bps) and 10-year MGS at 4.12% (unchanged).
- February CPI was steady at 3.2% but we expect March inflation to rise towards the 4% mark as the impact of the fuel price hike on 28 February passes through the economy. Given the possible electricity and water hikes this year, there will be more inflationary pressure and further rate hike is inevitable. We expect OPR to reach 3.75% by end of 2006. However, BNM may pause in the April 25 monetary policy meeting before further hikes later this year.
- To finance the RM200 billion spending under the 9th Malaysia Plan, the government need to raise RM106 billion from domestic borrowing over the next 5 years. This suggests that MGS supply is likely to increase going forward. Year to date, the MGS supply has been small with a total of RM5.1 billion MGS issued. The government has pushed back its initial plan to balance the budget deficit by 2008 but aims to narrow the budget deficit to 3.4% of GDP by 2010. We expect a robust primary PDS market in the infrastructure and utility sectors.
- BNM auctioned RM2.5bn 10-year MGS which drew a strong bid cover ratio of 2.71 times at an average yield of 4.262% on 14 March. The MGS were subsequently traded to 4.12% on strong demand from local investors. It was an active primary PDS market with AAA-rated Rantau Abang Capital and Valid Ventures; AA2-rated Penang Bridge; A1-rated Petra Perdana and Road Builders. MARC has also downgraded Malaysian Merchant Marine, MK Land Holdings, Ambang Sentosa and Intelbest Corporation. There were also 3 defaults from the Talam Group namely Perspektif Perkasa, Maxisegar and Europlus. We do not hold any of these bonds. With the string of rating and defaults in the single A segment, demand for higher rated AAA and AA-rated bonds will remain strong as investors flight to quality.
- In terms of investment strategy, we are still cautious on the bond market. We believe our portfolios are well positioned to cushion the impact of further interest rate hikes. While we believe rate hike is inevitable, Bank Negara would manage it on a gradual basis. On credit quality, our investment continues to be tilted towards AAA and AA-rated bonds, and very selectively on good quality A-rated bonds. We will continue to participate in primary issues and look for trading opportunities to enhance the portfolios' returns.

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