



MARKET UPDATE

Equity Review Outlook

- The equity market remained buoyant in April despite rising interest rate and inflationary pressure. The KLCI rose by 2.4% or 22 points for the month to close at 949 points while the KLEMAS rose by 3.3% to 220 points. Better performance of the broader market stems from resilient performances of the regional markets such as Singapore, Hong Kong and Indonesia as well as strong speculative interest in the small to mid cap stocks listed on the KLSE. Taking a cue, the Mesdaq stocks were again the star performers during the month as the index surged by 9.3% to 122 points. On news flow, April was relatively a quiet month.
- Contrary to the expectations of most investors, the market managed to shrug off the effect of the recent interest rate hike. In April, the central bank (BNM) increased OPR by 25 bps in order to contain inflation that hit a high of 4.8% yoy in March. Following this, commercial banks raised deposit rates by an average of 15 bps. On the surface, this appears to be margin accretive to the banks. However, this may not be sustainable in the long run as heighten competition among the financiers will eventually erode the initial margin improvement.
- DIGI surprised the market with its stellar 1st quarterly performance. The group announced a capital repayment of 60 sen and posted robust subscriber growth for the quarter. Meanwhile, Tenaga reported stronger earnings, up by 29% yoy, on the back of stronger ringgit and lower effective tax rate. Management, however, warned investors on the increasing fuel as well as repair and maintenance costs that may drag margins going forward. All eyes are now drawn to the possibility of an electric tariff hike in the next two months. If materialized, this will boost the group's earnings significantly. Last hike was 8.3% in 1997.
- On the economic front, Bank Negara's international reserve rose by RM4.33 bn, or 1.59% to RM275.9 bn as at 14th April from RM271.6 bn as at 31st March. The reserve position is sufficient to finance 7.9 months of retained imports and was 6.3x the short term external debt. Meanwhile, March Consumer Price Index (CPI) surged higher than expected by 4.8% Yoy mainly driven by the 30 sen fuel price hike in February.
- Externally, the price of a barrel of crude oil hit the peak of \$75, putting upward pressure on production costs, especially in oil-dependent economies. In spite of this, global inflationary pressure remains subdued on the back of the ongoing globalization, rationalization and ensuing productivity gains.
- 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

- There was no FOMC meeting in April. The next meeting will be on 10 May 2006, where the market participants are expecting the Fed to hike the Fed Fund Rates (FFR) by 25bps to 5% for another time. The recent economic data shows that inflationary risk still exists in the US. The inflation rate, industrial production, new home sales and job creation figures are still on the rise. However, the Fed might halt after the May meetings as the Fed Chairman Ben Bernanke has hinted that the Fed would consider a pause in rate hike campaign should the economic results continue to show sign of cooling down. International crude oil price surged to a high of US\$75 per barrel during April due to the supply constraint at Nigeria and also the escalating political tension between US and Iran. The US Treasury curve steepened slightly with UST 2, 5 and 10-year Treasuries at 4.86% (+4bps), 4.91% (+10bps) and 5.05% (+20bps) respectively.
- In Malaysia, the bond market sold off significantly in April due to 1) surprisingly high inflation number, 2) unexpected OPR hike and 3) larger than expected GII Issue. March CPI came out at a 6 years high of 4.80%, largely contributed by the 18% rise in the transportation component due to the recent petrol hike. In response to that, Bank Negara (BNM) hiked the OPR by 25bps to 3.50% during the MPC meeting on April 25, citing the heightening inflationary risks. This was the 3rd rate hike since November 2005. With the CPI forecasted to be in the range of 3.50-4.00% for 2006, BNM Governor stated that the OPR is still below its neutral level, indicating that there is more room for further rate hikes in the future. Following the release of Dr. Zeti's hawkish comments at the end of April, bond prices closed lower. Ringgit continues to strengthen against USD after the OPR hike and hit the high of 3.62 in April. BNM's foreign exchange reserves rose by US\$0.8bn in 2H March to US\$73.7bn as at 31 March 2006. The 3-year MGS ended the month at 4.02% (+5bps), 5-year MGS at 4.24% (+49bps) and 10-year MGS at 4.50% (+38bps).
- BNM has issued a larger than expected 3-year GII issue during the month. The issue size of RM3.5bn is well above the RM1-2bn quantum the market has accustomed to. The GII drew a bid-to-cover of 1.82 times and was sold at an average yield of 3.895%. The PDS market was rather quiet given the volatility of the MGS market as the corporate bond market usually lags behind the movement in MGS. Supranational Asian Development Bank has issued a 5-year RM500m bond in April at a yield of 4.40%, which translate to about MGS plus 20bps. AA1-rated Bank Pembangunan Malaysia has launched a RM1 bn bond during the month as well. There were several upgrades during the month where IOI Corp Berhad was upgraded from AA3/P1 to AA2/P1, Texchem Resources was upgraded from BBB1 to A3 and ELITE was upgraded from AA3 to AA2. Despite the positive news on the rating side, it was announced that C3-rated Gula Perak Berhad did not meet the required deposits into its sinking fund due to insufficient funds.
- In terms of investment strategy, we are still cautious on the bond market. We intend to shorten our portfolio duration further as we believe that the OPR hike is not over. While we believe another 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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