



MARKET UPDATE

Equity Review Outlook

- The Malaysian equity market staged a resilient turnaround in March after its sharp correction at the end of February and beginning of March. The KLCI rose for the 9th straight month and managed to post strong gains despite plunging below 1,100 points in intra-day trade in early March. The KLCI oscillated in line with the performance of regional markets and Wall Street but gained a stronger footing towards the later part of the month when positive policy measures were announced. For March, the KLCI rose by 4.2% to 1,247 outperforming the MSCI-ex Japan which closed 3.0% higher M-o-M.
- February CPI rose at a slightly slower pace of 3.1% Y-o-Y compared to a 3.2% growth in January. The Ringgit hit a 10-year high of RM 3.45/USD on March 26 on the back of positive response to various liberalization measures and expectations that the government would lift the ban of offshore Ringgit trading in the later part of this year, as foreign reserves continued to grow (reserves grew 2.1% in February to USD 86.9bn). In view of the government's accommodative fiscal and monetary policies and initiatives to create a conducive business expansion environment, the FDI rose 48% Y-o-Y to USD 6.1bn, the highest level since 1997.
- Among the market liberalization measures announced in March was the much anticipated abolishment of the 33-year old Real Property Gains Tax. Other liberalization policies which spurred interest in the market include the relaxation FIC rules on the Islamic financial service sector and measures to progressively reduce Khazanah's stake in Government Linked Companies (GLCs).
- Besides that, the Prime Minister announced various incentives for the newly launched Iskandar Development Region (IDR) to transform Southern Johor to a more attractive investment destination. Among the incentives deployed are total exemptions from rules of the Foreign Investment Committee (FIC), which include requirements on compulsory bumiputra equity. IRDA-status companies will also enjoy exemption from corporate income tax for 10 years from commencement of their operations before the end of 2015.
- The revival of the RM10bn Northern Double Tracking project was also a welcome boost to the construction sector. Other projects expected to come on stream include the RM12bn bullet train, the RM9bn Bakun power transmission and the RM3.8bn interstate water transfer.
- On the corporate front, Bursa Malaysia will introduce Direct Market Access (DMA) and will be establishing an Exchange Traded Fund (ETF) by the end of the year, while 4 WIMAX winners have been announced, namely YTL-e Solutions, Green Packet, Redtone and Asiaspace Dotcom.
- Contract award momentum in the oil and gas sector is also expected to pick-up and size of contracts should at least double as the industry progresses towards the high-capex development stage underpinned by deepwater development.
- Going forward, we maintain our positive view of the market although we caution that some volatility may be present in the short term as markets have rebounded strongly while the economic data coming out of the US remains patchy. However, intermittent correction may be a good time to accumulate value stocks as long term economic fundamentals are still supportive. Downside risks include further unwinding of the yen carry trade, and the negative multiplier effect that could emerge from a softer US housing market. Notwithstanding short term volatility, we believe the upward trend in share price performance remains intact

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MARKET UPDATE

Fixed Income Review Outlook

- The US Federal Reserve kept its key policy rate at 5.25% as expected in the month of March, maintaining that the US economy is likely to continue expanding at a moderate rate. There was a slight caution towards increased inflation risk. There was also concern over the recent sub-prime mortgage delinquency crisis spilling over to the general economy. Nonetheless, the recent unemployment rate and initial jobless claims appeared low and fell below market expectations, dousing fear of an increased slowdown in the economy. The recent Fed Fund Futures shows a 22% odds that the Fed would cut interest rates by 25bps to 5% by end June as compared to 76% in end Feb. As a result, the US treasuries yield curve tilt upwards with the 2, 5 and 10-year UST ending at 4.53% (-11bps), 4.53% (+1bps) and 4.65% (+8bps) respectively.
- Bank Negara's announcement on the liberalization of the foreign exchange administration had brought about increased interest from foreign investors on our local financial market. The Ringgit strengthened substantially towards the second half of March due to inflows of foreign funds and was last traded at around RM 3.45 per USD. The February CPI came in lower than expected at 3.1% yoy. The market had initially forecasted the CPI to be at 3.3%. The expected inclusion of MGS into the Citigroup World Government Bond Index in July 2007 was also a contributing factor for more buying interest in the government market.
- In March, Bank Negara issued a new 3-year GII with a size of RM3.5 billion and reopened another RM3.5 billion 3-year MGS. The issuances were well received by the market as both issuances attracted a bid to cover ratio of 2.57 times and 2.857 times respectively. The GII was picked up at an average yield of 3.570% while the MGS was tendered at an average yield of 3.497%. In contrast to the US Treasuries, MGS rallied in March as the 3 and 5-year MGS yields were driven below the Overnight Policy Rate ("OPR"). The 3, 5 and 10-year MGS ended at 3.42% (-18bps), 3.45% (-18bps) and 3.51% (-26bps) respectively.
- On the PDS front, there were a number of rating downgrades on single-A rated bonds, notably Tracoma Holdings Bhd, Degem Bhd, PECD Berhad and Sutera Harbour Resort Sdn Bhd. On a more positive note, Bumiputera Commerce Holdings Bhd and CIMB Investment Bank Berhad both had rating upgrades. Maxis Communications Bhd issued a 5 and 10-year, AAA rated, Medium Term Notes each with a nominal value of RM500 million. While the PDS market lagged the MGS rally, it eventually caught up with the bullish sentiment as investors seek higher yield pick up.
- Going forward, we believe the bond market will continue to be well-supported on the back of excess liquidity globally, the positive outlook on the economic fundamentals as well as Ringgit strength. Inflation in Malaysia is likely to trend lower in the coming months to below 3%yoy. The tightness in supply to meet the strong demand is another factor driving bond yields lower. Having said that, we remain mindful of the development of the US economy which will have an impact on local financial markets.

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