Malaysian Markets

- **Equities:** In July, the Kuala Lumpur Composite Index (KLCI) rose for the 13th straight month and gained 1% to close at 1,374 points whilst the Kuala Lumpur Syariah Index (KLSI) rose 4% and the FTSE Malaysian Small Cap Index rose 9% to end at the month at 986.5 points. As indicated by the indices, lower-liners and small-caps (rotational plays) meant this segment outperformed large-cap and Syariah stocks within Bursa Malaysia.

- Although the KLCI rallied to all-time high of 1,392.18 points on 24 July, Bursa Malaysia was subsequently dragged down by local profit-taking and a huge sell-down by investors across the region amidst concerns on defaults among US sub-prime mortgages and a potential global credit crunch having adverse impact on financial markets.

- Going forward, the Malaysian market is expected to be volatile on the back of uncertainties in the US economy and defaults among sub-prime mortgages. However, Bursa Malaysia could be a safe haven for global portfolios as it is inexpensive relative to the region. Catalysts include the 2008 Budget, further policy shifts to boost the property market, better-than-expected corporate results for the quarter ended June and the nation's general election. These will pave the way for more positive news flow going forward. We remain positive and will continue to focus on thematic plays and dividend yielding stocks.

- **Fixed Income:** Inflation remained at a three-year low of 1.4% in June (1.4% in May), slightly lower than market consensus of 1.5%. As inflation is generally under control, Bank Negara Malaysia (BNM) left its Overnight Policy Rate (OPR) unchanged at 3.5%, holding rates for the 10th consecutive time after its recent policy meeting.

- Going forward, the local bond market is expected to be quiet amid the volatile global market. The direct exposure to US sub prime housing woes is almost non-existence among local financial institutions and corporate, thus providing support to the local market. With the overall increased in emerging market risk aversion, the Ringgit is expected to trade in line with its regional counterparts. The bonds are expected to trade within current range going forward, unless there are significant moves in local currency. Inflation remains benign and with flushed liquidity in the system, these factors will support Bank Negara's decision to keep OPR at 3.50%.

Global Markets

- Global markets were volatile, as attention was centered on the US housing market. Fears of the sub-prime woes' contagion effect resurfaced, causing a flight to quality into bonds. Coupled with lower US economic growth forecast for the fourth quarter (trimmed by policy makers from 2.5%-3.0% to 2.25%-2.5% because of weaker-than-anticipated homes construction), **US Treasuries** yields fell. The 2, 5, and 10-year US Treasury ended the period at 4.52% (-34bps), 4.56% (-36bps), 4.74% (-28bps) respectively.

- While US Treasuries' prices rallied, **global equity markets** as represented by the MSCI World Index fell 2% amidst the sub-prime woes, and may stay volatile in the short-term amidst potential fallout from the US sub-prime debacle.

- In the **alternative asset class** segment, global infrastructure and property securities were not spared either from the weaknesses in global equities. Despite the negative sentiment, news flow and indicators pointed towards sustained activities in mergers and acquisitions and privatization in infrastructure (e.g. Macquarie's takeover of Global Tower Partners, the modernization of Istanbul's second airport). Property fundamentals remain buoyant (particularly in the office and retail segments), with valuations in major real estate investment trust markets now trading at below fair values after the recent fall in property securities prices.

- **Emerging markets** equities rose (MSCI Emerging Markets: +5% in July alone), as worries over global interest rates and the health of the US housing market gave way to robust economic growth. Posting strong GDP growth were a number of emerging economies in Asia and Europe, while Brazil's economy expanded after 16 consecutive rate cuts. Notwithstanding the positive macro-economic fundamentals, emerging markets may be volatile in the near term along with global equities due to the US sub-prime issues.