MARKET UPDATE

Equity Review Outlook

- The broad market notched up higher in February mainly driven by second and third liner stocks. During the month, we also saw renewed interest in construction stocks ahead of the Ninth Malaysian Plan that will be unveiled by end of March. All in, the KLCI index rose by 1.6% or 15 points to close at 929 points while the broader KLEMAS moved up 2% or 4 points to 213 points.

- Fourth quarter results continued to let down although, as a whole, the breath of disappointment has narrowed slightly. UMW and DIGI announced better than expected earnings but this was short lived by poorer than expected earnings from Telekom, CAHB and losses from MAS. While there is still downside risk, we think earnings are close to trough levels. Earnings outlook may not be as bearish as perceived, thus setting the stage for positive surprise.

- The tussle between Southern Bank Behad (SBB) and Bumiputera-Commerce (BCB) continued with more twists and turns during the month as shareholders of SBB pressed BCB for higher offer price. To recap, BCB made a General Offer for shares of SBB at RM3.08 cash and RM1 redeemable convertible unsecured loan stock of BCB per share of SBB. As we move into the 2^{nd} quarter of the year, we expect more merger and acquisition activities taking place and this should help retain investors' interest in the equity market.

- Although the hike in petrol and diesel prices, which was announce on 28^{th} February, was not surprising, many were taken aback by the timing and quantum of the increase (30 sen versus 10 sen in the previous hike). While the fuel price increase may dampen consumer sentiment, the government's decision to delay the implementation of the Good and Services Tax (GST), which was originally proposed for implementation on 1^{st} January 2007, should help to soften retail price pressures marginally. For the whole of 2006, we expect inflationary pressure to inch up higher to about 3.7% as compared to 3% in 2005.

- The fourth quarter GDP which grew 5.2% came in lower than market expectations of 5.7-8%. For the whole of 2005, GDP expanded 5.3%. This is in line with consensus estimates but higher than official's projection of 5%. At the same time, BNM raised the Overnight Policy Rate (OPR) by 25 basis points to 3.25%. With escalating domestic inflationary pressure going forward, we expect OPR to increase further by 25 bps to 3.5% in the next three to six months.

- In terms of investment strategy, we favor defensive and high dividend yielding stocks as our core holdings. We will also participate in thematic plays, such as renewable energy sector, merger and acquisition activities, and increase our exposure in overseas investments to enhance portfolio returns. Short-term catalysts include the much-awaited 9th Malaysia Plan that will be unveiled on 31 Mar as well as the imminent electricity tariff adjustment for Tenaga.

MARKET UPDATE

Fixed Income Review Outlook

- In February, there was no FOMC meeting held in the US. Instead, the spotlight was on the first speech given by New Fed Chairman Ben Bernanke at the congress. Bernanke's statement was in tune with his predecessor Alan Greenspan, where Fed's focus will continue to be on achieving growth on the back of stable prices. His concern over inflation has dented the hope for an end to the Fed rate hike anytime soon. Economic data is mixed showing sign of slowing in housing sector and consumer spending, while the services sector still remain robust. This mixed economic data complicated the prediction of Fed's next move. World crude oil price dipped below US$60 per barrel in mid February but rebounded back to US$64-65 per barrel due to the escalating Iranian Nuclear issues. The US treasury curve remained inverted with 2-years and 10-years yields both closed at 4.68% (Jan 06 – 4.52%) and 4.55% (Jan 06 – 4.52%) as at end February 2006.

- Malaysia sovereign bond market was mostly sidelined throughout the month waiting for the BNM's interest rate decision. Besides the active trading along the 5-year segment, secondary market trading was extremely thin. The Ringgit was also strengthening in February, appreciated by 1.1% in February to RM 3.70 against USD. This also drew some foreign buying into the MGS market. However on February 22, BNM called for an OPR rate hike, pushing the benchmark rate to 3.25%. There was little reaction in the bond market to the 25bps hike in OPR, because the market was already very long in cash and the hike has been anticipated by investors. January CPI came in lower at 3.2%, comparing to market consensus of 3.5%, due to the fact that the index has been rebased from 2000 to 2005.

- During the month, primary bond issues have also been fairly tight for both the MGS and Corporate Bond segment. BNM has issued a RM 400 million 1-year Sukuk Ijarah to ease its money market operation and to provide price benchmark for short dated Islamic papers. On the MGSs, BNM auctioned a small RM 1 billion of 5-year notes, and privately placed RM 200 million to selected investors. The gross MGS offerings for the month was much smaller than what the market had initially thought. The 3-year and 5-year MGS closed slightly higher at 3.58% (Jan 06 – 3.54%) and 3.74% (Jan 06 – 3.67%) respectively.

- On the Private Debt Securities front, Khazanah issued an AAA rated, RM2.2 billion 5-year Islamic Medium Term Note and RM 1 billion 6 months Commercial Paper through its wholly owned subsidiary Rantau Abang Capital Berhad. The proceeds from this issue will be used to fund Khazanah's investment, refinancing its borrowings and as working capital. Given the strong credit and limited supply, the issue drew strong demand as the CP was oversubscribed by 6 times and the MTN by 2.2 times.

- For US, the next Fed meeting will be held on March 28. Guided by Bernanke's speech, it is expected that the Fed Fund Rate will continue to have a 25bps hike, taking the benchmark rate to 4.75%. Given that the Malaysia market is long in cash and primary bond issues have been fairly thin, Ringgit bond market's sentiment would be able to improve from its current state. The next BNM policy meeting will only be held in late April, therefore provide additional layer of support to the market throughout 1Q06. Inflation risks will continue to be high due to the recent fuel hike and the pass through effects that follow. If water and electricity tariffs hike were to materialize, there is a risk that CPI will break above 4%. We believe that Malaysia bond market is complacent on potential rate hike, and also expecting higher inflation going forward. We revised the Malaysia CPI forecast for the year to 3.80-4.00% and looking at another 25 – 50 bps hike in OPR in 2006. In terms of strategy, we will continue to maintain our short portfolio duration strategy and maintain higher cash position at this time.

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