



MARKET UPDATE

Equity Review Outlook

- It was a bullish month for the equity market in January. The KL Composite index notched up higher to close at 1189.35 and registered a gain of 8.5%. Strong performance in Malaysia was led mainly by the blue chips although we saw some laggards such as Maybank, Telekom and Plus playing catch up. Technically, the Asian equity markets are looking over bought, including Malaysia, after a tremendous rally since third quarter of last year and this has taken some of the regional equity markets closer to their highest levels since the 1997-98 melt down. During the month, the KLCI outperformed the MSCI Asia ex Japan which fell by 1.3%.
- All eyes were on a couple of merger and acquisition developments, in particular, in the banking and finance sector. Utama Banking group (UBG) received Bank Negara's approval to start negotiations for the sale of its stake in RHB in January. So far, parties interested in acquiring a stake in the bank were reportedly to be Primus Pacific Partners, Kuwait Finance House and EON Capital. While it is still premature to determine the eventual outcome of these negotiations at this juncture, the sale of UBG's stake signifies a step closer to resolve the long overdue RHB's debt problem and to streamline the banking group's shareholding structure. Meanwhile, the proposal to merge Utusan and NSTP was scrapped during the month following a widespread protest from the ruling Umno party. This came as a disappointment to the investors as a merger between the two Malay newspaper leaders was expected to help create synergy of the two operationally ill newspaper companies. Other major M&A development during the month includes the on going talks between Proton and third parties such as General Motors or Volkswagen on the proposed partnership between the two companies.
- On the economic front, the Bank Negara kept the overnight policy rate unchanged at 3.5% in its January's Monetary Policy Meeting. This was in line with the market's expectation. Meanwhile, inflation remained subdued in December as the headline CPI only rose by 3.1% yoy in the month as compared to 3% yoy in November. For the whole of 2006, CPI rose by 3.6% versus 3.1% in 2005. In view that the Malaysia GDP growth will remain stable in 2007 while inflation is likely to be contained going forward, we expect the Bank Negara to maintain interest rate at this level in the foreseeable future.
- During the month, the market reacted negatively following an announcement by MSCI about likely changes to the calculation and components of its index by introducing an "Enhanced Standard Index" for large caps and "Enhanced Small Caps Index" respectively. As a result, the weightage of Malaysian large caps is expected to fall from 2.6% of the emerging markets (EM) weighting to 2.3% of total EM. Meanwhile, the weighting of small caps would increase from an estimated 0% to 0.2% of total EM. MSCI would also delete 5 stocks from the current 60 and add 37 total 92 in the two new indexes.
- Going forward, we expect the equity markets to remain buoyant although intermittent periods of correction and consolidation are inevitable. However, we have not seen any data or developments that would suggest such periods of consolidation or correction to be anything more than a bull market correction. Markets seem to have absorbed the increasingly consensus view that a Fed rate cut in the 1st half of 2007 is unlikely. As we view things, equities markets continue to be in a sweet spot with global growth remaining robust and inflationary pressures still moderate. Potential blind spots which we have been monitoring, and will continue to monitor include a build-up of inflationary pressures such as strong wage growth and a resurgence of pricing power; and/or a sharper deceleration in global growth. With regards to global growth, the US and Chinese economies would be the key areas of focus.

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MARKET UPDATE

Fixed Income Review Outlook

- The Fed has decided to keep the Fed Fund Rate ("FFR") unchanged at 5.25% during the FOMC meeting on 31st January. The rationale for this was that inflation is slowing modestly while the economy is showing signs of stabilization. The Fed's statement triggered a rally in the bond market after a month long of bearish tone, as the market now expects the central bank to keep FFR unchanged in the near future. Nonetheless, the Fed still has a tightening bias in terms of the monetary policy setting as the high level of resource utilization has the potential to sustain inflation pressures. International crude oil price edged higher towards month end due to the colder than expected weather in the US. The US Treasuries yield curve moved upward with the 2, 5 and 10-year UST ended at 4.92% (+11bps), 4.80% (+11bps) and 4.81% (+11bps) respectively.
- In line with market expectations, Bank Negara has kept its Overnight Policy Rate (OPR) at 3.50% for the sixth meeting in a row during the January Monetary Policy Committee meeting. In the accompanying statement, it shows that Bank Negara expects the growth to remain steady while inflation to remain moderate in the near future. Against such a backdrop, it is to be believed that Bank Negara is unlikely to adjust the OPR anytime soon. The December CPI came in at 3.1%, which was within the market's expectation. With the inclusion of this final inflation number for 2006, the full year 2006 CPI rose by 3.6%. The strength of the Ringgit continued to attract foreign investors, keeping bond yields well supported at current levels. The Ringgit yield curve steepened slightly where the 3, 5 and 10-year MGS ended at 3.72% (+9bps), 3.80% (+10bps) and 3.88% (+10bps) respectively.
- In January, the Bank Negara's debut bond switch was well received by investors with a total of RM952m 3.2-year MGS swapped into the market at an average yield of 3.68%. The excess supply of the 3.2-year MGS, on top of the weaker US Treasuries had led to a slight correction in the MGS market. During the month, there was a re-opening of the 5.4-year MGS with a size of RM 3.5 billion. The issue drew strong interests with a bid-to-cover ratio of 2.15 times at an average yield of 3.731%. On the PDS front, MARC has downgraded Malaysian Merchant Marine, MK Land, Glomac and Peremba Jaya in January. New issuances of the month included Aeon Credit and E&O Property, which are both bank guaranteed issuances.
- We expect the bond market to remain range bound in February with an upward bias in long term bond yields. We expect foreign liquidity to support short-term yields as inflows remain strong as the RM breached the 3.50 RM/USD level in early February. On the longer-end, however, there will be a new issue of a 10-year MGS which could see bidders coming in at higher yields. Given that Chinese New Year is around the corner, trading liquidity is likely to slow down in the coming weeks. Primary issue is likely to remain subdued in the holiday shortened month. As such, we have been locking in profits, and look to re-enter the market at higher yields.

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