MARKET UPDATE

Equity Review Outlook

- It was a bumpy ride in February when the Malaysian equity market, along with global equity indices corrected sharply during the last week of the month. After reaching a high of 1283 points on 23rd February 2007, the market tumbled to close at 1196 points, 0.6% higher than January's close of 1189 points. This was a slight outperformance compared to the MSCI-ex Japan which fell by 1.2% for the month. The selldown was triggered by a >9% plunge in the China shares on concerns that the authorities were taking steps to clamp down on stock market excesses in the A-share market, which is dominated by domestic investors. Although equity markets had been due for a correction, the timing of it took many by surprise as it hit just after the market began notching up record volumes of >RM4bn a day with some retail participation.

- In spite of the weaker market performance, Malaysia's economic fundamentals appear to be firm, with the GDP rising by 5.7% Y-o-Y in 4Q06 vs. market expectations of 5.6%, led by fixed investment and private consumption. Exports continued to post decent growth, rising by 6.2% Y-o-Y, after a 17.5% surge in November. January CPI numbers remained relatively benign at +3.2% Y-o-Y – not surprisingly, the Central Bank left the key overnight policy rate unchanged at 3.5% but signaled that a rate cut was not likely. The ringgit climbed to hit fresh highs on February 6 at RM3.492/USD as the Central Bank indicated that it was comfortable with the "orderly appreciation" of the ringgit. The local currency finished the month at RM3.5030/USD.

- The recent "merger & acquisition fever" took a breather In February, although German Industrial Gas producer Linde AG made a RM1.14bn takeover offer for the remaining 55% stake it does not own in Malaysian Oxygen for RM15/share. It is still not clear who will emerge as the winner of the bidding war for UBG's stake in RHB and RHB Capital, with rumours that there could be a joint bid between the interested parties.

- Corporate results have generally been in line or above expectations, notably MAS which has turned around under the leadership of CEO Idris Jala, BCHB Holdings, which continues to provide upward moving ROE guidance and Maxis, whose profit of RM2.1bn was up 28% y-o-y arising from its strong performance in India.

- Going forward, although risk aversion has risen, we maintain our positive view on the market and expect this correction to be transitory. Economic fundamentals remain supportive as inflation is benign and although global growth is slowing, this has become a widely known fact and so far, the moderation has been conducive to the central banks maintaining a relatively easy monetary policy. We do not expect the deceleration to culminate in an economic recession. Equity valuations also remain reasonable, especially vis-à-vis bonds, with bond yields further compressing recently due to a flight to quality. Risks to our view including a severe unwinding of the Yen carry trade, a significant slowdown in the Chinese economy and a hard landing in the US. We will be monitoring all these risks carefully. On balance, although the short term outlook for the market may be clouded by volatility and falling risk appetite, we believe the upward trend in share price performance remains intact.

Suite 12-03, 12th Floor, Menara Keck Seng, 203 Jalan Bukit Bintang, 55100 Kuala Lumpur
Tel: 03-21421881 Fax: 03-21431881 Toll Free: 1 800 88 7080

MARKET UPDATE

Fixed Income Review Outlook

- The Fed Fund Rate ("FFR") remained at 5.25% since there was no FOMC meeting in February. US inflation remained benign, while the economy continues to show signs of a moderate slowing. During the month, the January unemployment rate came in a tad higher at 4.6% comparing to the consensus of 4.5%. This sparked more concerns regarding the slowdown of the economy, which might induce the Fed to cut rate in August 2007, as discounted by the FFR futures market. International crude oil price was trading rangebound at USD58 per barrel but shot up to a high of USD62 per barrel towards month end on gasoline supply concern. The US Treasuries yield curve moved downward with the 2, 5 and 10-year UST ended at 4.64% (-28bps), 4.52% (-28bps) and 4.57% (-24bps) respectively.

- In line with market expectation, Bank Negara has kept the Overnight Policy Rate ("OPR") at 3.50% during the Monetary Policy Committee meeting in February. The decision made was premised on the current level of interest rates is in line with the medium-term outlook for growth and inflation. January CPI came in slightly higher at 3.2% yoy comparing to the market expectation of 3.1%. In general, the local bond market was relatively quiet due to the festive seasons, but the market saw buying interests towards month end when the meltdown in global equity market occurred. The weakening equity market also spurred selling in the short-term bills, pushing rates up 10-15bps. The Ringgit continued to strengthen throughout the month, but weakened towards month end due to the correction in the equity market. The Ringgit yield curve performed positively in line with the US where the 3, 5 and 10-year MGS ended at 3.60% (-12bps), 3.63% (-17bps) and 3.77% (-11bps) respectively.

- In February, Bank Negara issued a smaller than expected 10-year MGS with a size of RM2.5 billion and a RM0.5 billion 10-year Callable MGS. The issuances were well received by the market as the 10-year MGS drew a bid-to-cover ratio of 2.13 times at an average yield of 3.814%, while the callable attracted a bid-to-cover ratio of 1.96 times with an average yield of 3.856%. On the PDS front, MARC has downgraded Oilcorp, DRB-HICOM, Stenta Films, Tracoma and Jana Niaga in February. On a positive tone, MARC has also upgraded Mulpha and MAA's issuances during February.

- The local bond market is expected to remain well supported due to the current equity market correction and the demand-supply dynamics. After a relatively quiet month in February, there are more new issuances in the pipeline, which includes Maxis, KL Sentral and Nucleus Avenue. Also, on the MGS side, the fear of limited supply of government debt will continue to keep the market well supported. In March, there will be a reopening of the 3-year MGS and a new issuance of the 3-year GII. We will be participating in some of these issues for better yield pick up.