eastspring investments

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FUND COMMENTARY

FIXED INCOME MARKET REVIEW AND OUTLOOK

December 2018

REVIEW

- On the economic front, November headline inflation moderated +0.2% YoY compared with +0.6% YoY in October. The moderation in headline inflation during the month was mainly due to lower Food & non-alcoholic beverages (Nov: +1.1% YoY, Oct: +1.2% YoY) coupled with lower transport costs (Nov: -2.3% YoY, Oct: +0.8% YoY). On the Other hand, core inflation increased by +0.5% YoY in November compared to +0.4% YoY in October. Inflation is expected to remain low in the remaining 2018 but is expected to edge up going into 2019 taking into consideration higher projected global oil prices and the floating of domestic fuel prices starting in 2Q19.

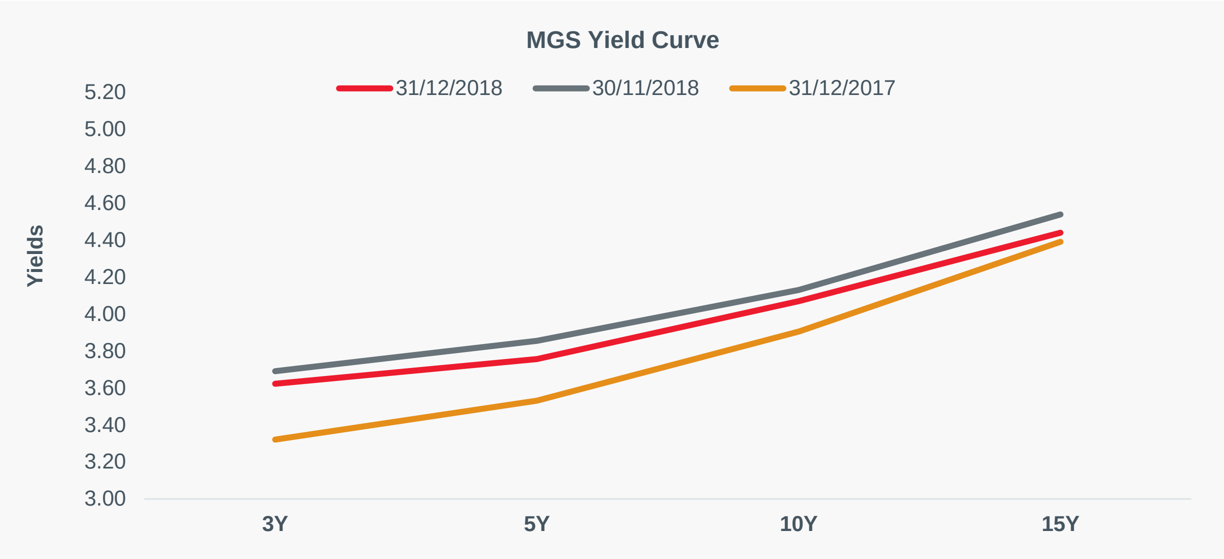
- Malaysia sovereign bonds yields for 3-, 5-, 10- and 15-years MGS decreased by 6-10bps in December to close lower at 3.62%, 3.76%, 4.07% and 4.44% respectively. In December, sovereign bonds yields moved lower due to strong buying interest from investors on the back of declining US treasury yields after the Fed conveyed a slightly softer tone. Separately, MGII yields 3- and 5-years moved lower by 10bps respectively to close at 3.68% and 3.83% while yields for the 10- and 15-years moved higher by 1bps and 2bps respectively to close at 4.24% and 4.61%.

- There were two government bond auctions in December:
  - RM2.0b re-opening of the 20-year MGII averaging 4.787% at a bid-to-cover ratio of 2.307x.
  - RM3.3b re-opening of the 3-year MGII averaging 3.775% at a bid-to-cover ratio of 2.426x.

- Meanwhile, trading in corporate bonds increased in the month of December with most trades concentrated in selected quasi-government and AAs rated bonds.

BENCHMARK	30/12/2017 Yield	30/11/2018 Yield	31/12/2018 Yield	MOM Change	YTD Change
3-year MGS	3.32%	3.69%	3.62%	-7 bps	+30 bps
5-year MGS	3.53%	3.86%	3.76%	-10bps	+23 bps
10-year MGS	3.91%	4.13%	4.07%	-6 bps	+16 bps
15-year MGS	4.39%	4.54%	4.44%	-10 bps	+5 bps

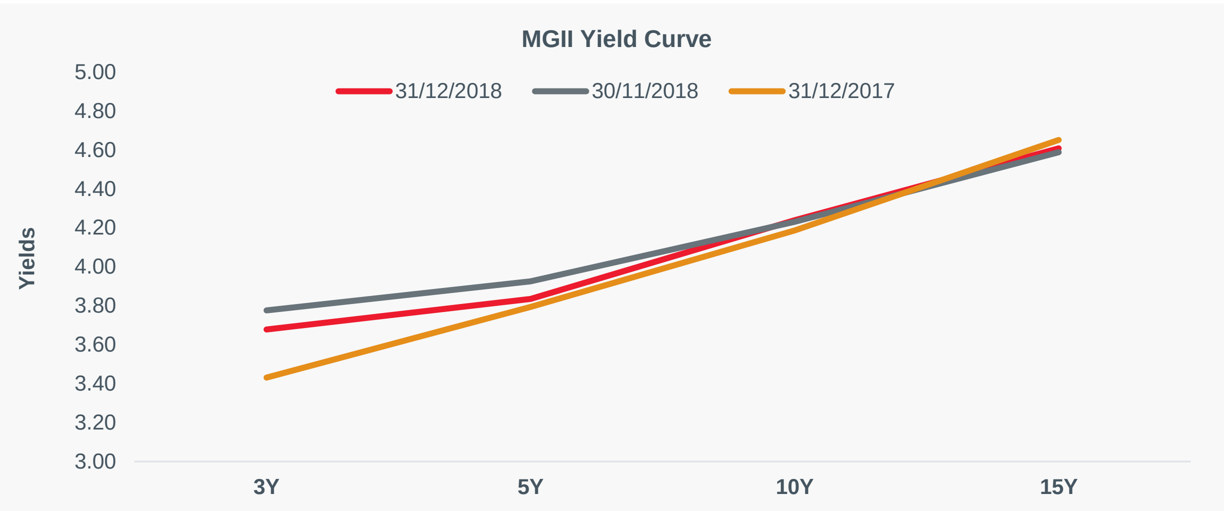
Source: Bloomberg



Source: Bloomberg

BENCHMARK	30/12/2017 Yield	30/11/2018 Yield	31/12/2018 Yield	MOM Change	YTD Change
3-year MGII	3.43%	3.78%	3.68%	-10 bps	+25 bps
5-year MGII	3.79%	3.93%	3.83%	-10 bps	+4 bps
10-year MGII	4.19%	4.23%	4.24%	+1 bps	+5 bps
15-year MGII	4.65%	4.59%	4.61%	+2 bps	-4 bps

Source: Bloomberg



Source: Bloomberg

OUTLOOK

- While 2018 started out with hopes of a strong global growth, it ended up with heightened global economic, policy and political uncertainty. Moving into 2019, we expect global headlines to be likely dominated by (1) continued intensity of an economic fallout from the US-China trade dispute and (2) the US Federal Reserve's rate tightening decisions and its impact on emerging market.

- As risk appetite sours on fears over a global slowdown, oil prices and US Treasury yields retreated sharply. WTI oil price has fallen by more than c.40% from its high for the year in early October 2018 while some part of the US Treasury yield curve has inverted at one point in December 2018, increasing speculation of a potential recession.

- That said, this did not stop the Fed from raising rates by 25bps to between 2.25%-2.50% in December 2018 (the fourth increase in 2018), narrowing the spread between 2- and 10-year Treasury yields significantly. In the latest FOMC statement, whilst the Fed highlighted that some further gradual increases are on the cards, it also lowered its outlook for the 2019 long-run funds rate to the range of 2.6%-3.1% from the earlier forecast of 2.9%-3.4%. While the Fed forecasts two hikes instead of three hikes in 2019, Bloomberg reported that the market is now pricing out any US rate hike in 2019. With several economic data including both the US ISM and Markit manufacturing indices falling sharply in December, sending a strong signal that growth in manufacturing activity is likely to moderate in 2019, we expect the Fed to be more cautious and data-dependent going forward.

- On the domestic front, external headwinds seem to be getting stronger as uncertainties are likely to prevail. Although Malaysia's economy is expected to remain relatively resilient, it is not immune to a weaker global growth as it will likely affect demand for commodities such as crude oil and palm oil, to which Malaysia relies upon quite heavily. With moderate growth, coupled with benign inflationary pressure, we expect Bank Negara Malaysia to maintain an accommodative monetary policy stance in 2019. That said, we do not discount the possibility of a downward rating pressure should the prolonged US-China trade dispute affect Malaysia's economic strength significantly, weakening its ability to meet its fiscal deficit target.

- In 2019, Government bond issuance is expected to be around RM115billion with 32 public auctions, equally split between MGS and MGII with 16 auctions each. The larger supply of sovereign bonds may create a surplus pressure in the market, but we expect domestic sovereign bond market to remain supported by ample liquidity and strong investor demand. In January, there will be three MYR government bond auctions, a new issuance of 10.5-year MGII, a new issuance of a 7.5-year MGS and a re-opening of 5-year MGII with no MGS/MGII maturity.

- On the corporate bond front, the market is expected to see a decent supply as issuers have stayed sidelined in the past several months. We expect demand for corporate bonds to be strong in 2019 due to scarcity of quality corporate bond supply.

Table 1: Indicative Rates	
	31-Dec-18
MBB O/N*	1.90%
MBB1-Week*	2.00%
MBB 1-Mth FD*	3.15%
MBB 6-Mth FD*	3.30%
MBB 1-Year FD*	3.35%
1-mth BNM MN	3.26%
3-mth BNM MN	3.29%
3-mth KLIBOR	3.69%
CP	
1-mth (P1)	n/a
3-mth (P1)	n/a

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3 yr	**5yr**	**7yr**	**10yr**	**15yr**
MGS	3.62	3.84	4.01	4.10	4.47
GII	3.67	3.85	4.10	4.25	4.57
Swap rate*	3.72	3.82	3.95	4.15	4.35
AAA	4.27	4.40	4.52	4.64	4.86
AA1	4.38	4.50	4.63	4.74	4.96
AA2	4.48	4.60	4.72	4.82	5.07
AA3	4.57	4.68	4.80	4.90	5.15
A1	5.31	5.67	6.01	6.36	6.98
A2	6.12	6.67	7.07	7.63	8.40
A3	6.94	7.58	8.05	8.73	9.57

Source: Bloomberg*/Bondstream