Global Markets Research

Fixed Income

Monthly Perspective – Aug 2019

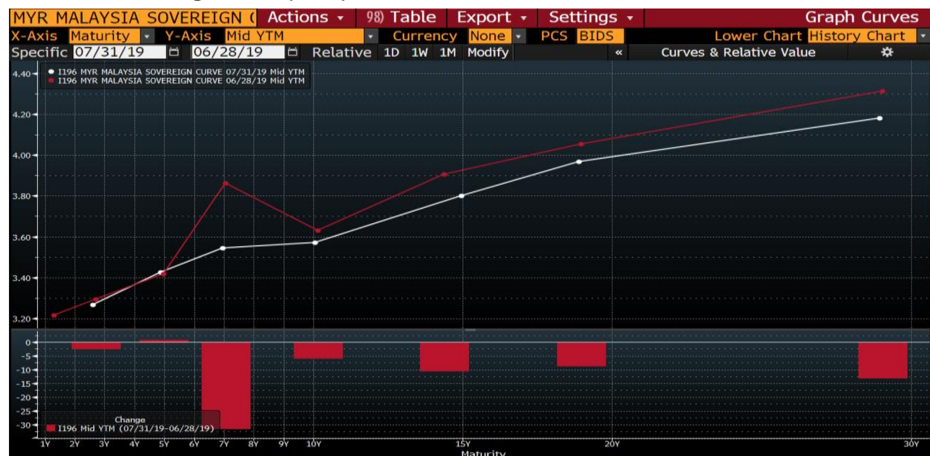
MYR Bond Market

Recapping the month of July

US Treasuries (UST's) saw the front-end sell-off and end generally weaker in July following 25bps rate cut by the FED in its FOMC meet on 31st July. This was due to disappointment following hints by Powell that the move was more to facilitate a mid-cycle or insurance adjustment to monetary policy and ensure the economic expansion continues. Benchmark **UST yields reversed prior month's trend; ending higher between 1-11bps** save for the mid-to-long ends. The UST yield curve bear-flattened as the front-end UST 2Y yield spiked 11bps MOM at 1.87% levels whilst the 10Y, which depicts as a benchmark for US mortgage rates and inflation, saw greater volatility in July; ranging between 1.69%-2.14% levels and closed 1bps higher at 2.02%. The front-end from 3-months to 10-years remains firmly inverted for almost two months with the spread narrowing from -9bps to -5bps post FOMC statement. Likewise the 2s10s spread narrowed from 23bps to 12bps. The US Dollar meanwhile was a clear winner as it advanced against all G10 currencies, with the Dollar Index has charging to 98.5 levels; highest since mid-2017. (At the time of writing: 97.6). Solid US payrolls for June was overwhelmed by tepid inflation (below 2.0% target) and other risks like trade tariffs, Brexit and geopolitical risks which boosted appeal for safe-haven assets like UST's.

On the local front, **MYR bonds** saw foreign holdings spike for the 2nd month in a row in July as secondary market volume maintained at about RM79.8b (May: RM81.5b) due to continued demand for yield-carry and also safe-haven bids mainly by onshore real money amid nagging global growth concerns. Foreign holdings of total MYR bonds spiked by RM5.7b MOM to RM188.3b; adding to the prior month's increase of RM5.8b. The percentage of foreign holdings of MYR government bonds (MGS + GII + SPK) rose to 22.2% or RM169.4b of total outstanding issuance. (June: RM163.8b or 21.5%). **Overall benchmark MGS/GII bonds rallied further with yields down between 2-30bps.** The 5Y MGS 4/23 moved 10bps lower at 3.42% whilst the much-watched 10Y MGS 8/29 ended 15bps lower from 3.78% to 3.63% levels. Corporate Bonds/Sukuk however saw levels of foreign holdings maintain at ~RM11.8b as bulk of holdings remain with institutional investors comprising pension funds, insurance companies and asset management companies that chased yields lower on high sustained secondary market volume of RM14.6b in July.

MYR sovereign curve (MGS)



Source : Bloomberg

Decent NFP data in July but slipping velocity going forward and muted inflation may be a prelude to further potential rate cuts…

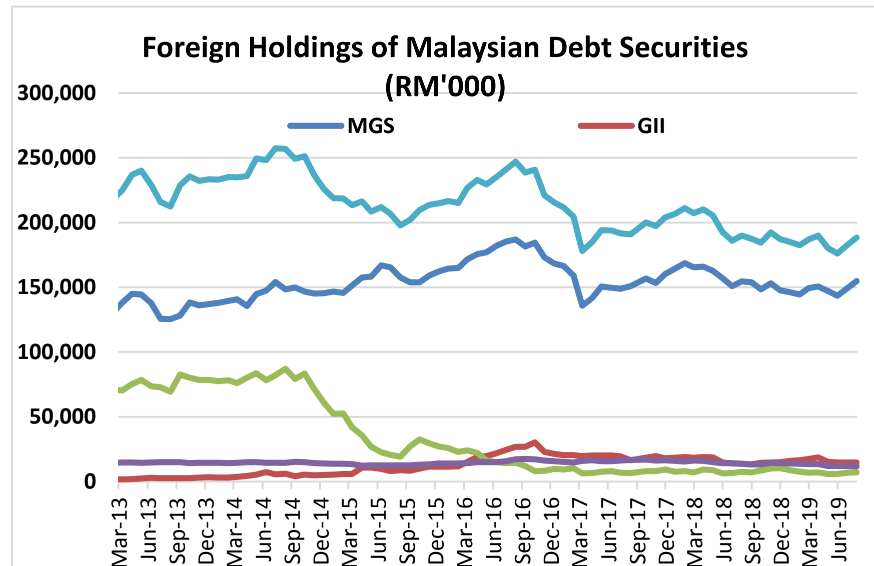
July Non-Farm Payrolls ("NFP") met market expectations of 164k (June: revised slightly lower from 75k to 72k) but a shorter workweek and downward revisions to the prior two months made the overall outcome non-event somewhat. The pace of hiring may appear to be slipping despite being-in-line with the YTD trend. The unemployment rate too held steady up from 3.6% to 3.7% and believed to be largely attributable to the decent participation rate of 63.0% which was also slightly higher by 0.1% for the month. However the continued decent print on average hourly wages i.e. +0.3% MOM (previous: +0.2%) and +3.2% YOY (previous: +3.1%) was a key indicator showing 12 solid months of YOY gains above the 3.0% threshold that may conflict with the lower interest rate outlook.

The Fed cut rates by 25bps to 2.00-2.25% as widely expected in its July FOMC statement; a turning point for global monetary policy. However it is believed that the Fed left the door open for additional easing. Despite the current **Fed's dot plot reflecting a status-quo stance** on interest rate outlook for 2019; the **market odds** for a **September rate cut of 25bps is between 72-81%** according to both Bloomberg survey and CME Fed Watch Tool at the time of writing. The Fed stated that in view of the implications of global developments for the economic outlook as well as muted inflation pressures, the FOMC decided to lower the target range for the Federal Funds Rate to 2-2.25%. This action supports its view that sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2% objective are the most likely outcomes, but uncertainties about this outlook remain. U.S. economic growth slowed less than expected in 2Q as a surge in consumer spending blunted some of the drag from declining exports and a smaller inventory build, which could further allay concerns about the economy's health. Report from the Commerce Department showed business investment contracted for the first time in more than 3 years and housing declined for a 6th straight quarter. **2Q GDP increased at a 2.1%** annualized rate, stepping down from an unrevised 3.1% pace in the January-March period. Domestic inflation remains muted; whilst wages are rising but not enough to put much pressure on inflation. The Fed's **preferred inflation measure** for June i.e. the personal consumption expenditure (PCE) core index climbed at **0.2%** from prior month whereas the YOY figure remained steady at **1.6%;** (the core index which strips out the volatile food and energy costs is a better gauge of future developments) The firming of core CPI for July may challenge the Fed's view that a return to its 2.0% inflation target will take longer than envisaged. Meanwhile, the Fed will stop shrinking its balance sheet this August, much earlier than previously announced to ensure an easier monetary policy. This entails the re-investment of $83b of UST's over the next two (2) months including the $28b that would have run off. (The average daily figure of UST holdings by the Fed dropped $1.81b to about $2.09 trillion).

Foreign holdings of overall MYR bonds spiked in July for 2nd month in a row…

Foreign holdings of MYR bonds continued to rise back-to-back in July by RM5.7b or 3.1% to RM188.3b. The non-resident holdings of MGS increased by RM5.6b to RM154.7b in July (representing 38.3% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw a rise of RM5.7b to RM169.4b (representing 22.2% of total outstanding) amid net issuances of RM2.0b for the month (June: RM8.0b).

The recent US Treasury Department's Semi-Annual Currency report in May that placed Malaysia on the US Treasury's Monitoring List followed by news in April on FTSE Russell index's intention to underweight MYR bonds come September may cause concern for investors despite the improvement in foreign holdings and yield performance of MYR bonds. YTD overall, both MYR bonds saw a net increase in foreign holdings of RM3.5b and unchanged net equity outflows of RM4.7 respectively in the first seven (7) months of 2019. On the currency side, the MYR strengthened by a mere 0.16% at 4.1265 levels as at end-July and also against most Asian currencies. However at the time of writing, USDMYR is trading at 4.1825 amid dollar strength.



Source: BNM, HLB Research

OPR stays pat but MPC notes downsize risks and will monitor risks to inflation and domestic growth….

BNM maintained the OPR at 3.00% at the 4th MPC meeting of the year on the 9th of July, stating monetary policy remains accommodative while it continues to monitor risks to inflation and domestic growth. (Note: The last policy move was a 25bps cut in May 2019). We expect 2Q2019 GDP growth to surprise slightly on the upside at 4.8% levels (1Q2019: 4.5%) as net export contribution to overall GDP could remain in slightly positive territory. However the worsening external environment is posing greater risk to our house view for an OPR pause. Nevertheless our full year estimate of GDP growth remains at 4.7% going forward. The latest inflation data for July still reveals a stable and muted YOY inflation data 1.4% (core: 2.0%). Protracted downside risks to growth imply the door for further policy easing is not completely closed as much depends on the evolvement of risks and financial conditions. Any imminent Fed rate cut(s) could raise the odds of another adjustment in the OPR should domestic growth weaken more than expected. The current low level of rates has allowed MYR bonds to rally; thus allowing existing portfolio investors to reap gains but also diminish the current yield appeal of MYR bonds by new investors.

MYR government bond auctions saw strong demand in July for the 15Y MGS and 7Y GII bonds….

The three (3) government bond tenders concluded for the month of July 2019 under the auction calendar included the new issuances for the 15Y MGS 7/34 that saw massive RM12.0b worth of bids resulting also in an impressive BTC ratio of 3.44x; followed by the reopening of both the 7Y GII 3/26 (BTC ratio: 2.874x) and the 30Y MGS 7/48 (BTC ratio: 2.49x). Overall weighted average BTC for the month **maintained at ~ 3.02x** mainly due the stronger 15Y MGS auction. This continues to stand out when compared to both the YTD BTC ratio of 2.69x and also the entire 33 auctions for 2018 which notched a BTC ratio of 2.29x). Tenders for the month received strong bids from mainly local institutional investors followed by foreign inter-banks. At the time of writing we the reopening of 5Y GII 10/24 on 8th of August saw the 2nd highest total amount of bids at RM12.4b on a BTC ratio of 4.14x.

MGS/GII issuance pipeline in 2019

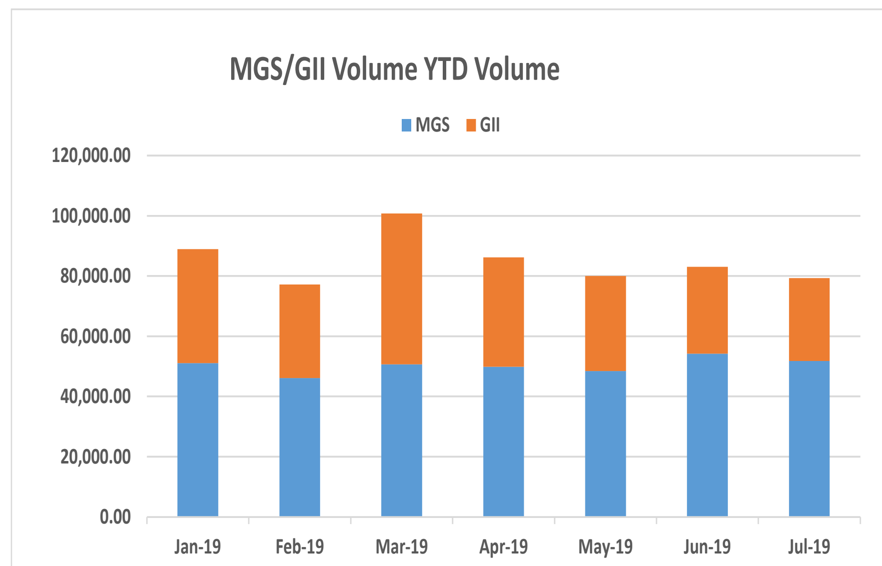
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Projected Issuance Size (RM mil)	Actual Auction Issuance (RM mil)	Private Placement	Auction Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	10.5-yr New Issue of GII (Mat on 07/29)	10	Jan	Q1	8/1/2019	4,000	3,500	1,500	3,500	4.067	4.110	4.130	4.135	86.1%
2	7.5-yr New Issue of MGS (Mat on 07/26)	7	Jan	Q1	14/1/2019	4,000	3,500	500	7,000	2.216	3.890	3.906	3.914	8.2%
3	5-yr Reopening of GII (Mat on 11/23)	5	Jan	Q1	30/1/2019	3,500	4,000		11,000	1.974	3.845	3.862	3.873	19.0%
4	10.5-yr New Issue of MGS (Mat on 08/29)	10	Feb	Q1	14/2/2019	4,000	4,000	1,000	15,000	2.536	3.867	3.885	3.893	31.6%
5	15-yr Reopening of GII (Mat on 06/33)	15	Feb	Q1	27/2/2019	3,000	2,000	1,000	17,000	3.906	4.360	4.370	4.375	33.9%
6	3-yr Reopening of MGS (Mat on 03/22)	3	Mar	Q1	7/3/2019	3,500	3,000		20,000	3.132	3.470	3.483	3.487	70.0%
7	20.5-yr New Issue of GII (Mat on 09/39)	20	Mar	Q1	14/3/2019	4,000	2,500	2,000	22,500	2.758	4.445	4.467	4.480	14.5%
8	30-yr Reopening of MGS (Mat on 07/48)	30	Mar	Q1	21/3/2019	3,500	2,000	2,000	24,500	1.718	4.550	4.591	4.629	25.0%
9	7-yr New Issue of GII (Mat on 03/26)	7	Mar	Q1	28/3/2019	4,000	4,000		28,500	2.330	3.699	3.726	3.745	21.2%
10	15-yr Reopening of MGS (Mat on 11/33)	15	Apr	Q2	5/4/2019	4,000	2,500	1,000	31,000	2.792	4.058	4.065	4.071	40.0%
11	5.5-yr New Issue of GII (Mat on 10/24)	5	Apr	Q2	12/4/2019	4,000	3,500		34,500	2.313	3.627	3.655	3.669	64.7%
12	7-yr Reopening of MGS (Mat on 07/26)	7	Apr	Q2	29/4/2019	3,000	3,500	500	38,000	1.510	3.735	3.757	3.777	75.0%
13	30.5-yr New Issue of GII (Mat on 11/49)	30	May	Q2	14/5/2019	3,000	2,000	2,000	40,000	3.298	4.625	4.638	4.663	100.0%
14	10-yr Reopening of MGS (Mat on 08/29)	10	May	Q2	23/5/2019	3,500	4,000		44,000	1.840	3.810	3.836	3.852	22.0%
15	15.5-yr New Issue of GII (Mat on 11/34)	15	May	Q2	30/5/2019	4,000	2,500	1,500	46,500	3.380	4.105	4.119	4.126	44.4%
16	5-yr New Issue of MGS (Mat on 06/24)	5	Jun	Q2	13/6/2019	4,000	4,000		50,500	2.489	3.466	3.478	3.484	8.3%
17	20-yr Reopening of GII (Mat on 09/39)	20	Jun	Q2	27/6/2019	3,000	2,000	2,000	52,500	4.275	4.070	4.074	4.079	59.1%
18	15-yr New Issue of MGS (Mat on 07/34)	15	Jul	Q3	4/7/2019	4,000	3,500		56,000	3.437	3.805	3.828	3.835	73.5%
19	7-yr Reopening of GII (Mat on 3/26)	7	Jul	Q3	12/7/2019	3,000	3,000	500	59,000	2.874	3.568	3.582	3.586	70.0%
20	30-yr Reopening of MGS (Mat on 07/48)	30	Jul	Q3	26/7/2019	2,500	2,000	1,500	61,000	2.490	4.170	4.181	4.208	100.0%
21	5-yr Reopening of GII (Mat on 10/24)	5	Aug	Q3		3,500								
22	20-yr Reopening of MGS (Mat on 06/38)	20	Aug	Q3		3,000								
23	10-yr Reopening of GII (Mat on 7/29)	10	Aug	Q3		3,500								
24	7-yr Reopening of MGS (Mat on 07/26)	7	Sep	Q3		3,500								
25	15-yr Reopening of GII (Mat on 11/34)	15	Sep	Q3		3,000								
26	10-yr Reopening of MGS (Mat on 08/29)	10	Oct	Q4		3,000								
27	20-yr Reopening of GII (Mat on 09/39)	20	Oct	Q4		2,500								
28	5-yr Reopening of MGS (Mat on 06/24)	5	Oct	Q4		3,500								
29	3.5-yr New Issue of GII (Mat on 05/23)	3	Nov	Q4		4,000								
30	20.5-yr New Issue of MGS (Mat on 05/40)	20	Nov	Q4		4,000								
31	10-yr Reopening of GII (Mat on 07/29)	10	Nov	Q4		3,000								
32	15-yr Reopening of MGS (Mat on 07/34)	15	Dec	Q4		3,000								
	Gross MGS/GII supply in 2019					101,000		17,000						

Source: BNM, HLB Research

Trading volume for MGS/GII remained strong in July…

Trading volume for MYR govvies i.e. MGS +GII bonds maintained somewhat at ~RM79.8b in July compared to prior month's RM81.5b. Interest was seen across the curve especially on the longer ends late in the month with substantial frequency of trades and nominal amounts done in the off-the-run 19's (forming ~RM8.0b or 10% of total trades), 20-21's (forming RM16.0b or 20% of total trades), 10Y benchmarks (forming RM5.2b ~7% of total trades) and also 5Y benchmarks (forming ~RM4.0b or 5% of total trades). Interestingly however the month under review saw interest move extend out to the long-ends with the 20Y MGS 6/38, 20Y GII 9/39 and 30Y MGS 7/48 benchmarks which saw eye-catching volumes of ~RM6.1b in total as investors long duration. Yields ended richer by 2-30bps across the curve. Both local institutional investors/offshore parties were mainly net buyers for MYR govvies in July in view of

appeal of safe-haven assets and yield-carry requirements amid dovish central bank language in US which is spilling over to EM Asia including Malaysia.



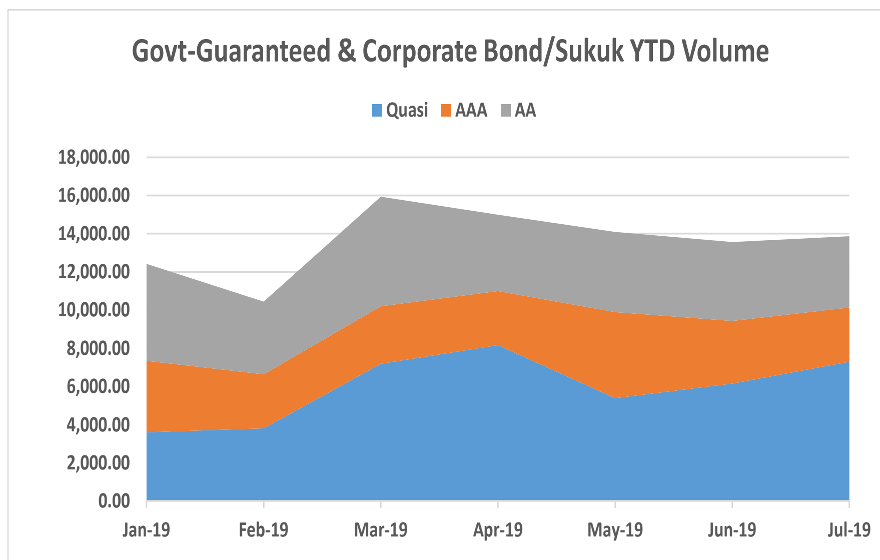
Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk continue to see sustained demand…

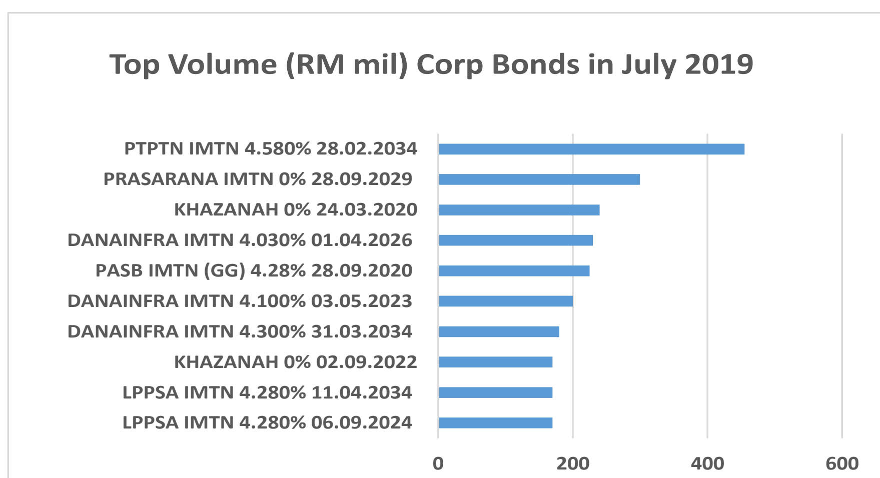
In the secondary market, Corporate Bonds/Sukuk (including Govt-Guaranteed bonds for our ease of classification) saw strong secondary market trading volume on sustained momentum at ~RM14.6b in July; almost similar to RM14.3b prior month. Solid demand from local fund managers/portfolio investors was evident as active bids in the secondary market prevailed; causing yields to generally drift lower yet again between 3-23bps for quality credits rated AA and above with the smallest and largest movement in yields captured by the GG and AAA-segment respectively. Elevated global trade tensions and anticipated slowdown in global growth has ignited global bond rally thus sparking a spillover into Corporate Bonds/Sukuk in July.

Investor appetite for GG saw stronger traction again MOM; increasing to 57% in June (June: 45%) whilst AAA-rated bonds dropped from 24% to 20% of overall transactions partly due to government's strong commitment to reduce its debt obligations of GG and stickiness for the month. Govt-guaranteed PTPTN 2/34 and PRASA 9/29 topped the monthly volume; closing 9bps lower at 3.94% and 4bps at 3.79% respectively for the month compared to previous-done levels. This was followed by another GG bond i.e. short-end KHAZANAH 3/20 and DANA 4/26 which declined 2bps each to close at 3.26% and 3.58% respectively.

Appetite in the credit space was mainly seen in a wide range of bonds namely conglomerates, infrastructure-related names including telecommunication, toll and energy sub-sectors. AAA-rated TENAGA 33-37, SARAWAK Hidro 21-31, GENM Capital 23-28, PLUS 21-33, DANGA Capital 20-33 together with AA-rated KESTURI 20-32, DUKE/LDF 28-38, SEB22-39, EDRA Energy 25-38, YTL Corp 26-34 and YTL Power 21-28 continued to see active trading. In the banking space, decent frequency of trades were noticed for both SABAHDEV, SABAH CREDIT and AFFIN Bank bonds. (Note: we have excluded single-A rated and non-rated papers in the illustration below).



Source : BPAM, Bloomberg, HLB Research



Source : BPAM, Bloomberg, HLB Research

Primary issuance print in July boosted by the following names:

Notable issuances in July-19	Rating	Amount Issued (RM mil)
Cagamas Berhad	AAA	100
Notable Vision Sdn Berhad	AAA	95
Premier Auto Assets Berhad	AAA	85
Toyota Capital Malaysia Sdn Berhad	AAA	150
Zamarad Assets Berhad	AAA	80
Sabah Credit Corporation	AA1	50
Public Bank Berhad	AA1	1,500
Zamarad Assets Berhad	AA2	28
Bumitama Agri Ltd	AA3	700
CIMB Thai Bank Public Company Limited	AA3	550
Premier Auto Assets Berhad	AA3	20
Sports Toto Malaysia Sdn Berhad	AA3	390
DRB-Hicom Berhad	A1	200
Lafarge Cement Sdn Berhad	A1	100
Notable Vision Sdn Berhad	B2	95
Notable Vision Sdn Berhad	C3	287
Padiberas Nasional Berhad	NR	1,000
Dynamic Gates Sdn Berhad	NR	185
Hektar Black Sdn Berhad	NR	95
Premier Auto Assets Berhad	NR	40
Sunway Treasury Sukuk Sdn Berhad	NR	300
Boustead Holdings Berhad	NR	650
Brecon Synergy Sdn Berhad	NR	200
		6,900

Source : BPAM, Bloomberg, HLB Research

Total fresh issuances of all ratings of Corp Bonds/Sukuk dropped to ~RM6.9b (June: RM8.4b due mainly to lesser issuances by GLC's and banks. Again, there were no GG issuances since Tabung Haji's issuances via the SPV, Urusharta Jamaah Sdn Bhd. The prominent issuances involved Padiberas Nasional (unrated) and Public Bank's (AA1) bond issuances which altogether saw strong demand for ~ RM2.5b in total consisting of 3Y and 10NC5 bonds.

Outlook for Aug

Investors will have to adjust expectations and prepare to seek for lesser values whilst adding on positions…

The weighted average BTC for the three (3) auctions in July maintained at a solid 3.02x mainly due to the strong new issuance of 15Y MGS 7/34 bond auction (June: 3.08x). The MYR bond market was well-bid and is expected to hold steadfast on appeal of safe-haven assets; following the trend in other EM and global bond markets. We opine that BNM's decision to stay pat on the OPR at the recent July MPC meeting following a 25bps cut in May could change if policy makers see weakness in the economy arising from dwindling global trade. This may be seen to provide further support to the local bond market (To re-cap BNM has reiterated that the stance of monetary policy remains accommodative and supportive of economic activity) and that the MPC will continue to assess the balance of risks to domestic growth and inflation, to ensure that the monetary policy stance remains conducive). Although the USDMYR pair has weakened to 4.1800 levels at the time of writing from recent 4.1200 levels last month; this is a result of USD strength rather than MYR weakness. While this should be cheaper entry and augur well for foreign investor's appetite for MYR bonds, the following fears of uncertainties going forward based need to be addressed:

- The recent US Treasury Department's Semi-Annual Currency report, stating that Malaysia along with eight (8) other countries were placed on the US Treasury's Monitoring List that warrants close attention for their currency practices and macroeconomic policies. (The other countries include China, Japan, Korea, Germany, Italy, Ireland, Singapore and Vietnam).
- Norway's US$1.0 billion Sovereign Wealth Fund (SWF) plans to omit emerging market (EM) bonds from its fixed-income benchmark. Earlier in April, the Norwegian sovereign wealth fund's reputed reduction in exposure to emerging market bonds is expected to be gradual with the fund's exposure to Malaysian govvies at US$1.96 billion (RM8 billion). Norway's sovereign wealth fund will streamline its US$300 billion (RM1.23 trillion) fixed-income portfolio by cutting emerging market bonds from the benchmark index it tracks. Currently worth US$1.05 trillion (RM4.31 trillion), Norway's Government Pension Fund Global has invested around 30% into fixed income with the balance 70% invested in equities. In terms of size, Malaysia is the third largest country with exposure to the fund after South Korea and Thailand.
- FTSE Russell has Malaysia on the watch list for potential exclusion from the World Government Bond Index (WGBI) in September. This could pose a risk of outflows to the tune of US$4 billion by passive funds and an additional US$2-4 billion by active funds, should FTSE Russell drop Malaysian bonds

from the World Government Bond Index (WGBI). Although the WGBI index excludes GII bonds, this could translate into a potential outflow risk of US$6-8 billion, or about RM24-33 billion.

Despite the above, MYR bonds are expected to overcome the above-mentioned hurdles with yields set to decline further in August, similar to June-July period as both local and some foreign investors showed confidence in the ability of regulators to deepen and provide better liquidity in both Bonds and Ringgit.

With a possibility of another OPR rate cut in November, kinks within the curve may provide value to investors. There is lesser amount of maturities i.e. RM6.0b worth of maturities for MYR govvies in July unlike June. Both the 7Y and 20Y MGS bonds do offer values whilst the 7Y-9Y and 15Y space are believed to be temporary "kinks" that may be rewarding. Demand for Ringgit Corporate Bonds/Sukuk along the GG segment do not look compelling at 5-15bps spreads over MGS but will continue to attract plenty enquiries considering supply constraints and lesser slippage. We expect spillover to the AAA and AA-rated space with interests in more liquid utilities, energy and toll-related names on better liquidity, credit and yield-play purposes.

Fed dot plot showing a pause for 2019 but bond traders expect another two (2) more rate cuts this year…

The UST movements in July saw the curve flatten on the front –end with the UST 10Y seeing a more volatile trading range of 45bps (June: 18bps) as the bond market held steady on the mid-long-ends. This followed rallies seen across the curve the past few months on expectations of an interest rate cut by the Fed. Meanwhile President Trump will impose a 10% tariff on $300 billion in Chinese imports that aren't yet subject to U.S. duties come 1st September. A key barometer that has been largely ignored in place of labor and wages i.e. **manufacturing** is gaining importance due to recent reports of US's share of global GDP which has shrunk from 22% in 1990 to 15% this year. Meanwhile, the share of US corporate profits coming from overseas ventures has risen from 18% in 1990 to 22% this year.

The so-called "tug of war" mentioned in our previous monthly report between the case for a rate cut versus no cut is now tilted to the former based on the following glaring points :

- Low and muted inflation
- Global uncertainties on economic growth due to trade-related issues
- Dovish-Fed dissenters including updated Dot Plot projections
- Geopolitical situations involving Iran, North Korea etc

Growth and inflation expectations together with the outlook for monetary policy and the term premium may "stump" the bond bears for now. The Fed will be looking at economic growth, job creation, wages and inflation whilst keeping an eye on unresolved trade issues with China and events like BREXIT. Nevertheless UST's are expected to find support under the current dovish-like situation for 2019 amid muted inflation and softer global growth. The US yield curve has been inverted on the front-end for more than a month now with the 3m10y spread at it widest and will be closely monitored as a recession predictor.

We are have turned neutral from bullish on UST's as market expectations of the Fed easing may be deemed excessive. Hence the shorter-end may be particularly vulnerable. Whilst the US yield curve remains inverted, we foresee the longer-term maturities as an effective tool against any risk asset sell-off. The 10Y is expected to range between 1.55-1.75% whilst finding support at 1.75% levels.

In the Credit/Corporate space, Investment grade (IG) debt may well see its slowest pace of monthly issuance in August, followed by absence of maturities to fuel growth of the indices. Investors may still find IG issuances that offer lesser spreads of ~ 100bps and above despite the strong performance of this space which has sent yields to an almost 2Y low. The easier monetary policy has ensured the sustainability of this cycle which potentially undergo less stress. We prefer to avoid the HY sector due to potential stretched balance sheets.

Hong Leong Bank Berhad
Fixed Income & Economic Research, Global Markets
Level 8, Hong Leong Tower
6, Jalan Damanlela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my

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