Global Macro Asset Strategy - Update

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Upgrade Indonesia equities to OW.

by Ng Weiwen & Joshua Tan
Products: ETF | CFD | Unit Trusts

12 April 2013
Phillip Securities Research Pte Ltd

Revised table summary of Asset Strategy (Pg.9), with ETF and CFD instruments to trade the outlook (Pg.10). Tactical trading without front-load sales charge is available with a Phillip UT WRAP account.

Animal spirits have been on the rampage. Ytd, equities (+7.8%) have outperformed fixed income (+0.9%), commodities (-1.4%) and gold (-6.4%). In terms of our global macro asset strategy, we have been spot on thus far for our broad call of Overweight (OW) equities, Marketweight (MW) bonds, MW commodities and Underweight (UW) gold.

The risk, however, of profit taking (correction) this 2Q13 for Equities has risen, given softness in US and various other data. We do still believe a pull-back in equities offers an attractive opportunity to accumulate our OWs in US, CN & HK (on compelling valuations), ID, PH, TH (resilient domestic demand) and SG (construction boom, attractive dividend yield). No change to our view it's still a year for stocks.

In this note, we also upgrade Indonesia equities from MW to OW on account of the following:

- **(i)** **Pace of rupiah depreciation has eased for now- in part due to BI interventions. Furthermore, a possible rate hike (within this year) to curb inflationary pressures could also stem capital outflows.**
- **(ii)** **Strong Investment Cycle, coupled with healthy domestic consumption**

We also wish to warn that the US economy is entering a soft patch: coincident indicators like employment, sales, shipment data is consistent with our expectations that 1H13 GDP will be weak due to the payroll tax hike, sequester. The recent US rally has also not been earnings driven, thus leaving the S&P500 vulnerable to a correction. However, forward looking indicators suggest that the 2H will be stronger – investment, housing are still on positive trends, plus the trade deficit is narrowing steadily. Thus we maintain OW on the US with one eye that any correction represents a buying opportunity.

Our Oct12 OW calls on Greater China has generated 8.8%, 3.9%, and 9.3% (China A shares, H shares and HK) so far. The gains would have been larger if not for a series of events: property curbs, shadow banking curbs and bird flu. Underlying though, the Chinese economy is on track for a gradual recovery and inflation is under control. Looking ahead, the new Chinese leadership needs to translate rhetoric to concrete reforms, otherwise markets –if left disappointed- will certainly not spare the rod.

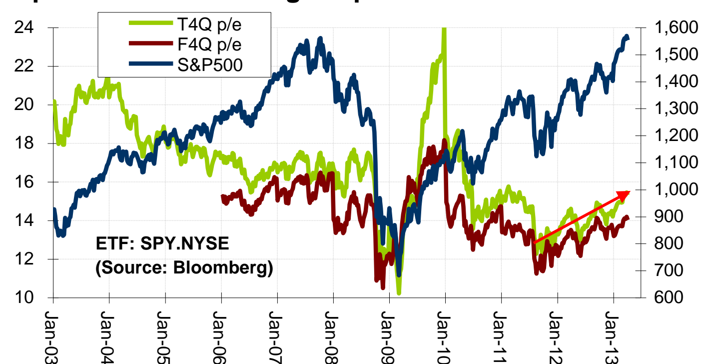
In the EZ, the fragile political and economic stability was rocked by the Cyprus bail-in as well as Italy's political impasse where both risk events still have broader financial systemic implications.

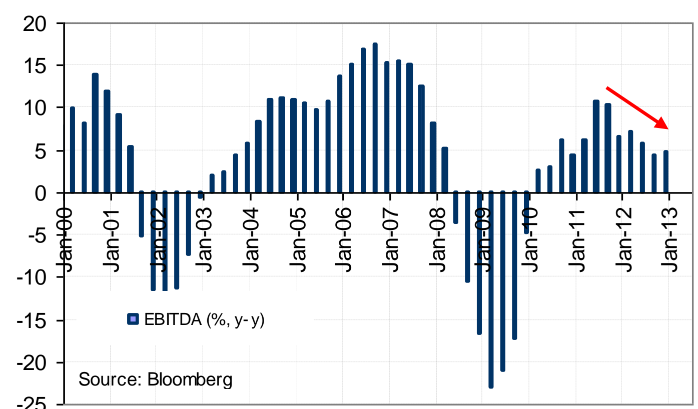
EQUITIES (OW)

US

In the US, S&P 500 and DJIA have reached record highs. While we are OW on US equities, we do not rule out a possible pull back even though April tends to be a seasonal strong month for equities. For one thing, this rally is looking more like a multiples expansion rally, than earnings driven, as the rate of ebitda growth has slowed while p/e has risen by 20% (compare charts below).

For US equities, the recent rally is due more to p/e expansion than earnings expansion

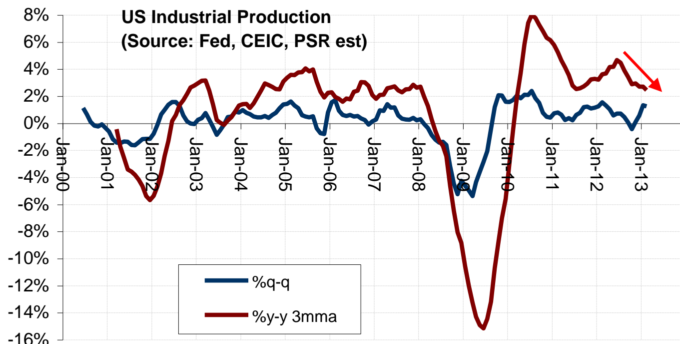


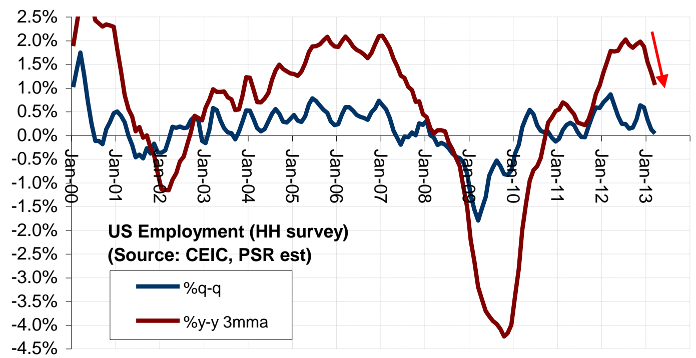


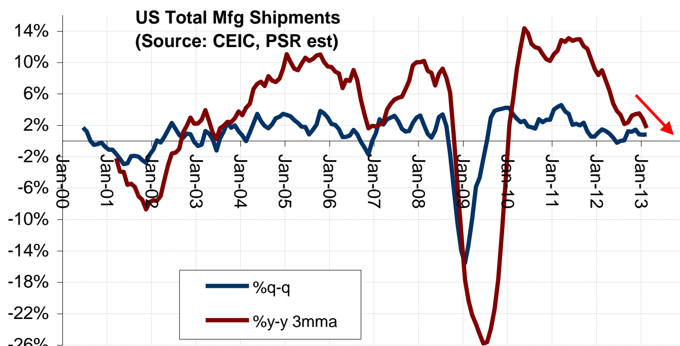
At the same time, coincident indicators (see charts below), which describe the economy as it is now (not where it will be) indicate we are in a soft patch.

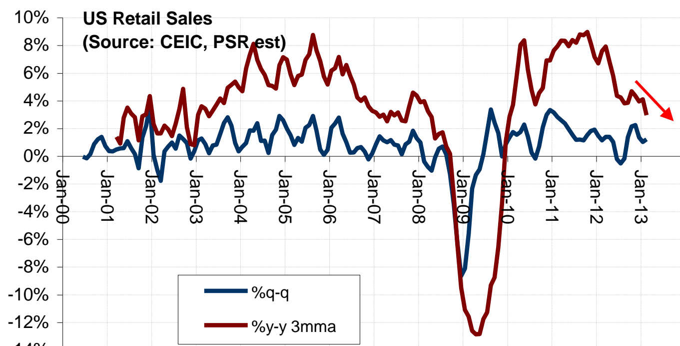
MCI (P) 145/11/2012
Ref. No.: SG2013_0068

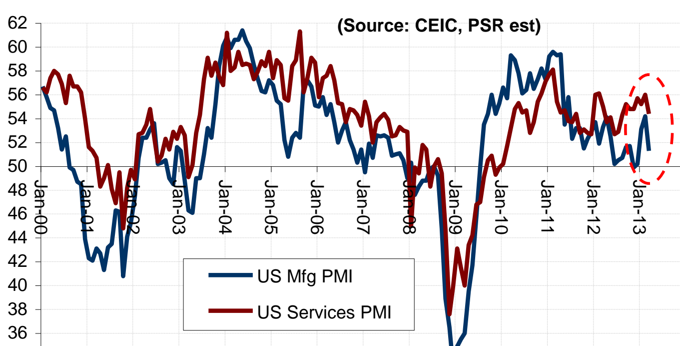
US industrial production, sales, PMIs, employment





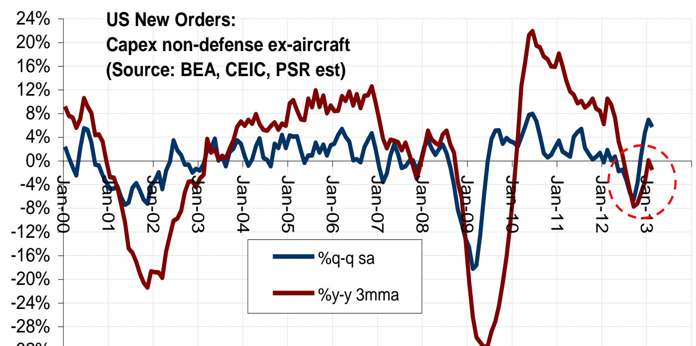


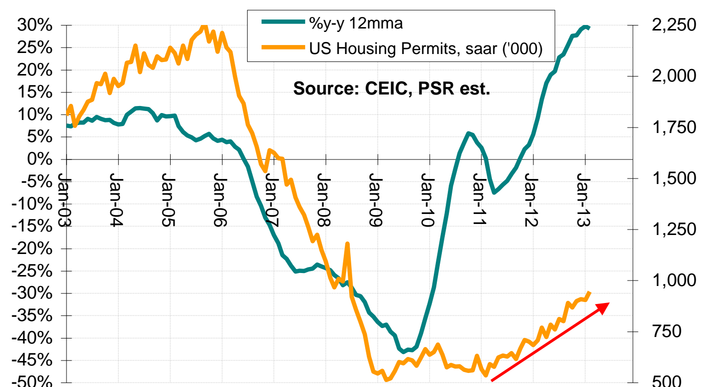


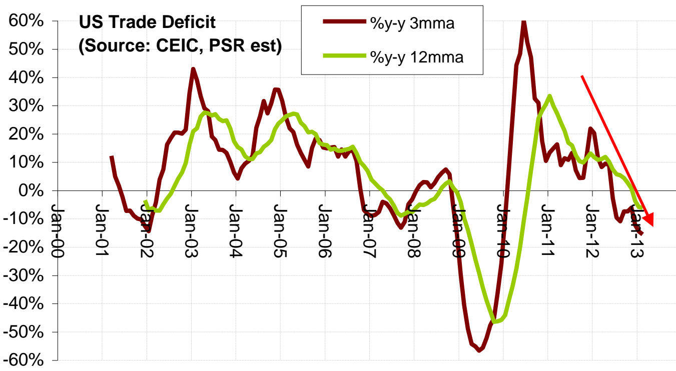


Thus the confluence of slowing earnings, and slowing economy does pose the threat of a correction in the near term. Furthermore a negative catalyst could be that the US needs to raise its US$16.4tn debt limit after 18th May and we might once again see another replay of political brinkmanship closer to the date.

However, we maintain OW on the US and view corrections as buying opportunities as we do believe the US economy will rebound in 2H13, so long as new orders for core-capital goods and housing continues rebounding, and the US trade deficit continues to narrow due to the current energy revolution in the US (charts below).





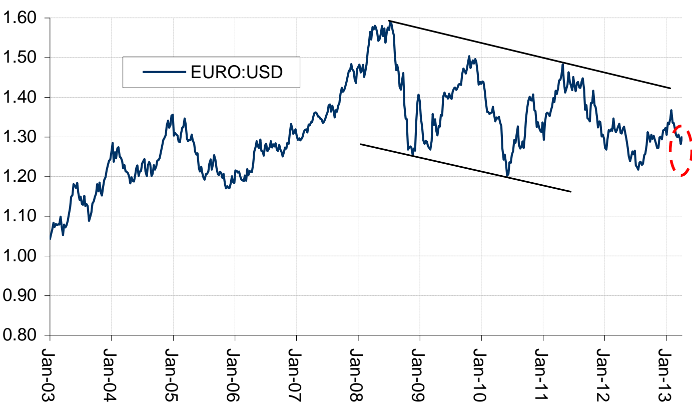


[Pls refer to our US Macro Strategy Report, dated 20 March for more details]

EZ

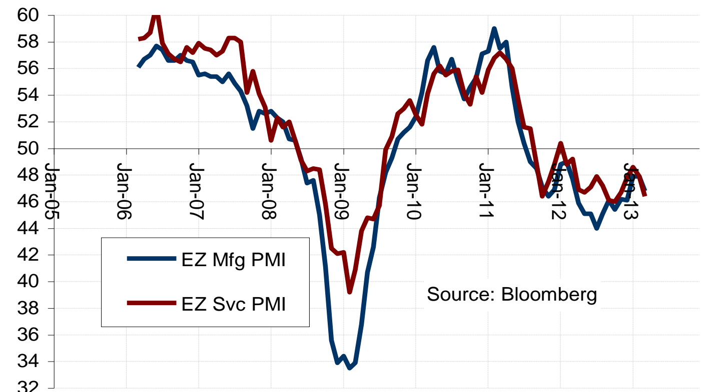
Downside risks on the EZ front have increased and the EZ crisis could once again rear its ugly head this summer, with fundamental problems not being addressed, but rather buried within fire fighting.

Cypriot banks have re-opened- albeit with capital controls enacted. Cyprus exit from the EZ does not seem to be a distant possibility. Already, markets are not too optimistic with EUR/USD breaking below key support of 1.30 and renewed selling pressure could see the EUR/USD test the Nov 2012 low of 1.2657 (chart below). We reckon capital controls are likely to stay there for a long time (as was in the case of Iceland). Cyprus is also on the brink of a potential credit rating downgrade. Specifically, Fitch Ratings has placed its credit rating on Cyprus on watch for a potential downgrade from its current B rating after S&P downgraded Cyprus' credit rating by one notch to CCC last week.



Who's next? Cyprus bail-in risks broader capital flight from other EZ members, particularly Slovenia, Italy (embroiled in a political impassae with no coalition government yet at this juncture) and Spain. Even banks with healthy balance sheets are unlikely to be spared in this confidence crisis though the ECB stands ready with its OMT as the main crisis management mechanism in the worst case scenario. Thus we can expect more crisis related news, which can induce downside volatility, but if the past is anything to go by, markets globally will be expecting strong political will to keep the EZ together, followed by the ultimate "safety net" in the OMT.

We are UW the EZ so far which has proved "wrong" given that MSCI Europe has returned 3.5% this year, however we maintain this call predicting it will finish the year underperforming as the economy is still not gaining much traction (chart below).



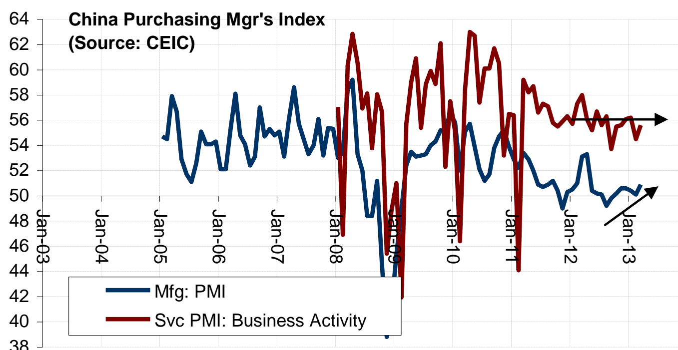
Structural impediments of currency mismatch with labor productivity (Euro too cheap for Germany, too expensive for peripherals), a debt burden that compounds as fast as nominal GDP, and all this amidst tight fiscal consolidation under the new fiscal compact will continue to weigh on the EZ. While it is always attractive to go contrarian in a crisis, with the EZ, the possibility of economic upside revisions seem low to us, maintain UW. Risk to this call is aggressive loosening by the ECB which may prompt us to upgrade to MW.

Japan

Is Japan entering into a new structural bull market? Well, the recent rally in the Nikkei could kick start a virtuous cycle of reflation which starts from asset prices, followed by increased wages as well as higher consumption which will bode well for the Japanese economy.

But a weak Yen, cheap credit, along with massive fiscal deficits are not solutions to structural problems, which is what Japan really needs. These structural reforms would include eliminating protectionism for certain domestic industries which breeds inefficient firms, as well as addressing its unfavourable demographics to ensure a sustained revival of the Japanese economy.

A structural bull run requires more than just weaker Yen; structural micro reforms are also necessary.



On a relative basis, we are still MW Japan in view of Japan's structural headwinds as well as the possibility that total returns when translated to US$, will be eroded – to a large extent- by a much weaker JPY.

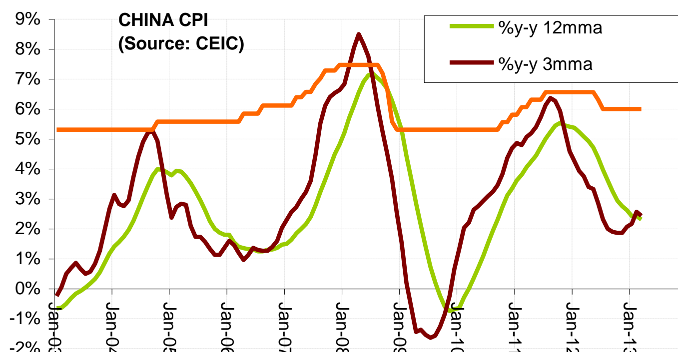
[Pls refer to our Global Macro Strategy Report, dated 4 March for details]

Greater China

Greater China equities in recent weeks have taken a beating on shadow banking curbs as well as property curbs in certain cities. Banks and property counters have been hit hardest and since these form the majority in indexes have dragged down the overall. China capped the share of non-standard debt instrument at 35% of the wealth management products. Smaller banks are likely to be adversely affected and implementation as usual will be tricky. As we have indicated in our recent GMAS report, the shadow banking system, property bubble in some tier one cities, collectively do pose an incipient risk to the economy. While the tightening is welcome in terms of addressing these risks, the fear is that it will also do damage to the nascent recovery.

So far the recovery is still on track, the broad-based gains in the March NBS and Markit PMIs suggest that China is on track towards a modest recovery. Manufacturing PMI is on a modest rebound while services PMI continues to expand at a faster rate (chart below). Looking ahead, no change to the story of China's moderate rebound as the country rebalances from manufacturing to services, from traditional export drivers to domestic demand drivers such as consumption as well as investment associated with the nation's continued urbanisation process.

China's inflation also remains in check, thus reducing the risk of an interest hike which would have repercussions on the entire economy, as opposed to the sector specific measures so far.



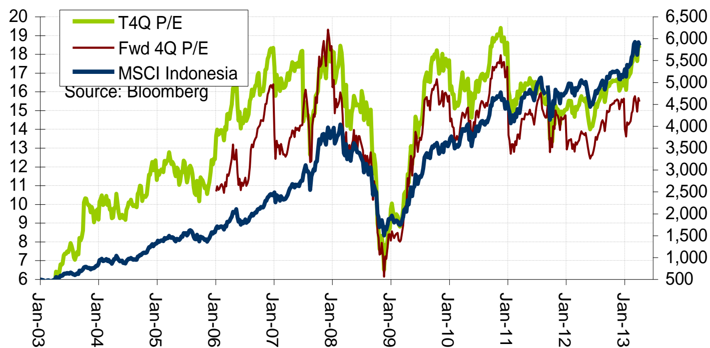
We called OW for Greater China last Oct12, and saw gains of as much as 20%, 17% and 16% (A share, H share, Hang Seng), But the recent spat of mentioned tightening, and then bird flu has resulted in an exacerbated sell-off, returns since Oct are now 8.8%, 3.9% and 9.3%. At this juncture though, all 3 indexes are consolidating at key support regions (CSI300 ~2500, HSCEI ~10.5k, Hang Seng ~21.75k), hence a rebound could be in order should the recovery story hold and inflation remain in check, hence we are maintaining our OW ratings on all 3 indexes.

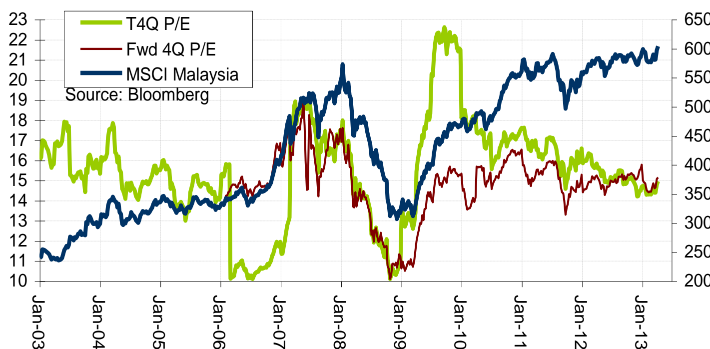
[Pls refer to our Global Macro Strategy Report, dated 4 March for details on China's shadow banking risk]

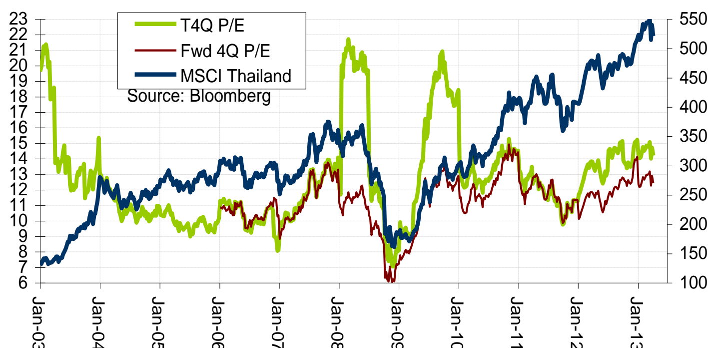
ASEAN

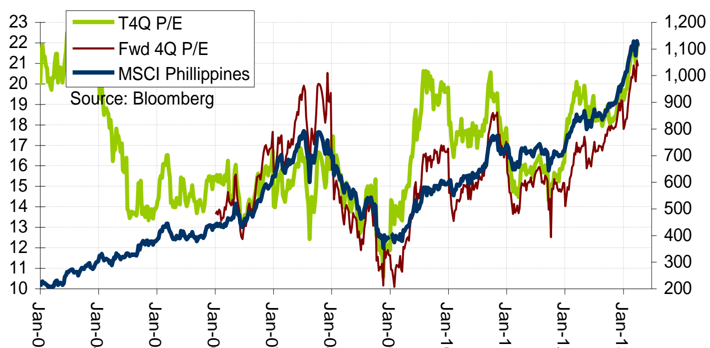
ASEAN equities have in general performed well this year, the uptrend continues on back of resilient domestic demand. Our OW on Phillippines (+17.9%ytd) and Singapore (+4.5%ytd) have been accurate, as well as a MW on Malaysia (+2.3%ytd). Thailand (+1.7%ytd) has underperformed our OW but we remain confident that the recent correction will only build a base to push higher. We upgraded Indonesia (+11.9%ytd) equities to OW from MW in Morning Note 11th April 2013, albeit a bit late. Asean economies should continue to be buoyed by

resilient domestic demand. But we are keeping a close watch on inflationary pressures.





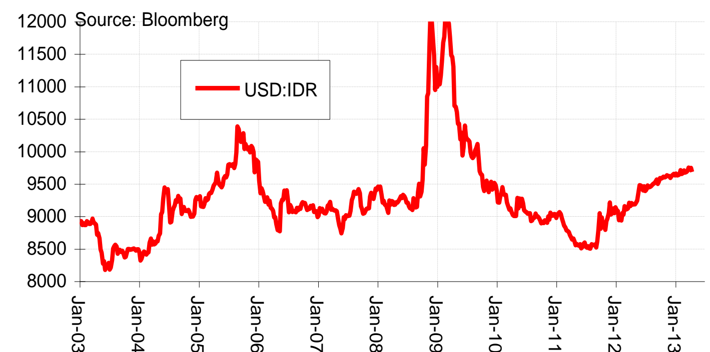


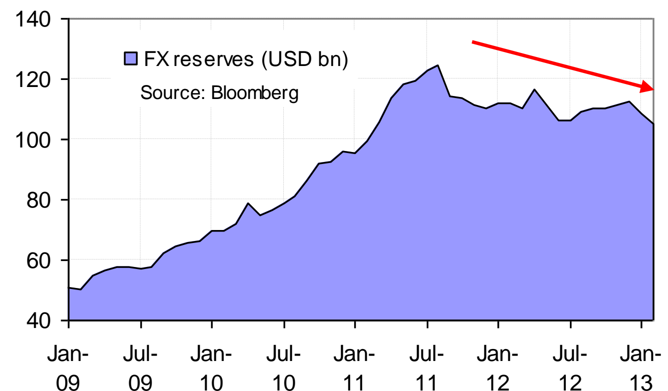


Indonesia

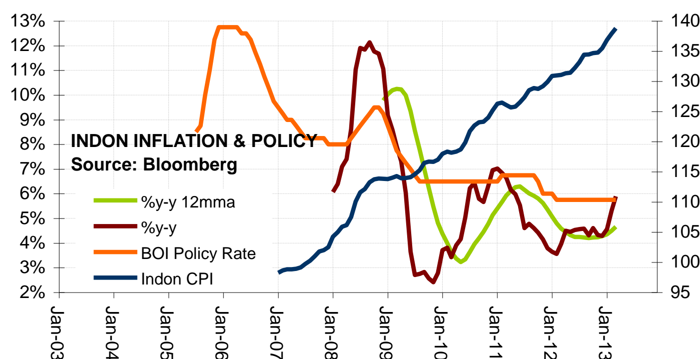
We have always been positive on Indonesia's economic outlook on domestic factors. Fixed investment is to remain robust on infrastructure investment related to the targets set out in the Masterplan for the Acceleration and Expansion of Economic Development of Indonesia (MP3EI) in 2011. Major infrastructure projects in the pipeline include: the six Jakarta Urban Toll Roads, Soekarno-Hatta airport, Jakarta MRT and Monorail, plus various ports. Foreign direct investment is expected to be robust as investors ride on the 'rise of the middle class' with investments shifting form the mining sector into the consumer goods segment such as food and beverage as well as electronics. Already, L'Oreal, Nestle, Procter & Gamble and Foxconn have significant investments in Indonesia.

What however held back the market in 2012 was the weakening rupiah resulting in capital outflows. In contrast Indonesian equities have rallied this year in response to support for rupiah, which has remained stable this year at around 9700 level largely as a result of Bank Indonesia's active intervention. Reserves have consequently been run down to a 23rd month low (charts below),.





While we are late in upgrading Indonesia, better late than never as they say. We do see further Rupiah appreciation as inflationary pressures are building up. Headline inflation accelerated from 5.3% in Feb to 5.9% y-y in March (almost a record 2-year high), breaching the upper limit of the central bank's target range of 3.5-5.5%. By contrast, core inflation - which strips out volatile food and fuel prices- eased from 4.29% in Feb to 4.21% in March.



Should the fuel price hike be implemented, inflation could well surprise on the upside. Nonetheless, we think the odds of a fuel price hike are low at this juncture as crude oil price is expected to remain soft. Furthermore, the administration is confronted with the thorny issue of how to cut back on fuel subsidies in view of next year's impending elections without incurring the wrath of the electorate.

Still, we reckon that Bank Indonesia might hike its benchmark interest rate or its overnight deposit facility rate (FASBI) within this year.

A policy rate hike at the upcoming monetary policy meetings – from record low levels of 5.75% since Feb 2012- might bolster the rupiah and stem possible capital outflows. This is likely to have a positive effect on Indonesian equities.

Inflationary pressures are building up in ASEAN.

- **Philippines** risks an asset bubble forming. Philippines' sovereign rating was recently upgraded to investment grade by Fitch on account of strong external balance as well as robust economic growth. Reckon S&P and Moody's are likely to follow suit soon. In the near term, Philippines could see larger capital inflows as the upgrade opens up a pool of potential investors. But Philippines will be confronted with challenges such as managing a stronger peso as well as risks of an asset bubble if not managed prudently. On balance, the market reaction is likely to be muted as the writing is already on the wall. Specifically, we raised the possibility of Philippines achieving investment grade as early as last year in our ASEAN macro strategy report. Since then, Philippines equities have already rallied quite a fair bit and govt bond yields have fallen below many other investment grade sovereigns (with dubious credit quality).

In Philippine, the central bank stood pat, maintaining benchmark policy rates at 3.5% in March. Looking ahead, odds of a rate cut are low at this juncture in view of resilient domestic demand, with benign inflation to boot. But we do not rule out the possibility of the BSP either reducing policy rates or performing RRR cuts to temper the appreciation of the Philippine peso, rather than stimulating growth per se.

- In **Malaysia**, there are still upside risks to the inflation outlook - which is largely domestically driven.

(i) First, it is likely that subsidies for food (eg. flour, sugar, cooking oil) and fuel (diesel, petrol) –major drivers of headline inflation – will get scaled back after the 13th General Elections.

(ii) Second, minimum wage hikes. In May 2012, PM Najib introduced the minimum wage of RM900 for Peninsular Malaysia and RM800 for those in Sarawak, Sabah and Labuan. Most firms will have to start paying the minimum wage in six months, while small companies with have a year to comply. As the wage hike is not premised on higher productivity, the upside risk to inflation is that the increase in money could outpace the growth in output, firms which are able will likely decide to pass on the costs to consumers.

(iii) Third, the proposed goods and services tax –aimed to broaden the tax base- might be implemented after the 13th General Elections. This comes as the government needs to better manage public debt which is expected to rise from 51.8% of GDP in 2011 to 53% in 2012, just a whisker shy of the federal debt-to-GDP ceiling of 55%.

The 13th General Elections is drawing near. Markets have priced-in the ruling coalition, Barisan Nasional (BN) retaining a simple majority. Do note that Malaysia's resilient domestic demand driver would not fundamentally change overnight, even if the opposition garners an outright victory. In fact, uncertainties that result from this pull back can be perceived as an opportunity to enter the market. We might upgrade Malaysia to OW if BN gathers a strong mandate.

We continue to OW Singapore in spite of a subdued economic performance ytd. Manufacturing output declined 0.7% m-m sa in Feb, following the 9.1% contraction in the preceding month. Ex-BMS, manufacturing output also fell by 0.7% m-m sa. Specifically, the electronics cluster - which accounts for around a third of total manufacturing output- continued to slump by 14% y-y 3mma in Feb, compared to 8.6% contraction in the preceding month. Headline inflation accelerated from 3.6 y-y % in Jan to 4.9% in February, owing higher private road transport costs. Nonetheless, the spike in Jan COE premiums is likely to be transient. Private road transport cost and accommodation cost accounted for more than three-quarters of headline inflation. Excluding these 2 components, MAS Core Inflation inched up 0.7%-ppt m-m to 1.9% y-y.

Looking ahead, accommodation cost pressures and wage-cost pass through are likely to persist, resulting in headline inflation to stay elevated around 3.5 - 4.5% this year. While a stronger Singapore dollar might not be able to fully mitigate domestic drivers of inflation, we expect MAS to continue to stand pat -maintaining a modest and gradual appreciation of the S$NEER, notwithstanding recent subdued economic data.

Thus, we continue to OW Singapore equities on account of the following: (i) with one of the few AAA quality

investment grade sovereign rating, (ii) relative attractive dividend yield of around 3%, (iii) currency translation gains to boot and (iv) significant exposure to EMs which will mitigate any slowdown in the advanced economies.

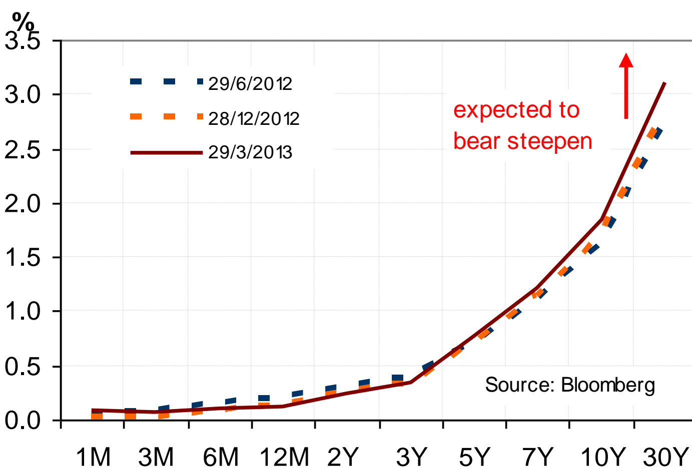
FIXED INCOME (MW)

Maintain UW Treasuries and US Investment Grade Corporate Debt on account of poor reward to risk ratio.

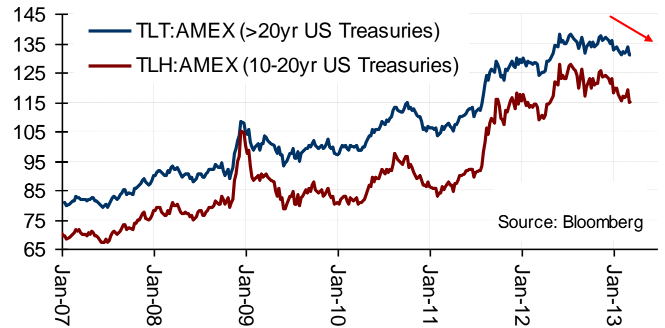
In view of encouraging (albeit tepid) signs of a global cyclical upturn and resilient domestic demand, the inevitable question will be: When will the Fed pull away the QE punchbowl and what happens after that? To be sure, an exit from the LSAP may trigger a knee-jerk selloff of risk assets, but as such a move actually signals a strengthening economy, we could eventually see a cycle out of bonds into stocks.

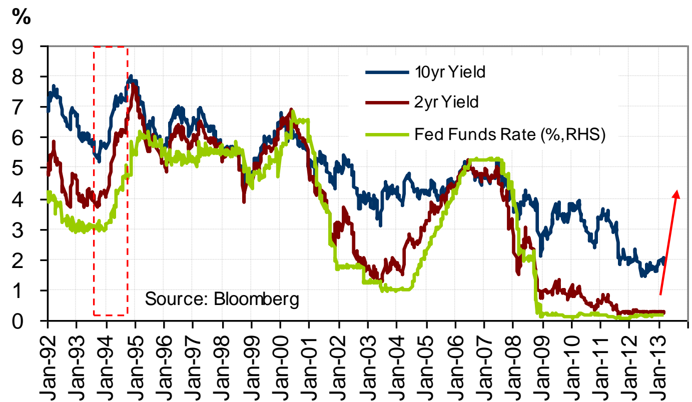
The US Treasury yield curve has also continued to bear steepen (consistent with our 21st Dec US Macro Strategy), with long-term bond yields rising faster due to improving sentiment on the US economy following the cyclical upturn, while yields at the short end remain anchored. Furthermore, rates at the long-end of the yield curve could go even higher, especially if the sequester is watered down and Congress reach a bipartisan medium-term deficit reduction plan. **As US investment grade corporate debt tends to track US treasuries, we maintained UWs for both of them.**

US Treasury yield curve have continued to bear steepen, with long-term bond yields rising faster

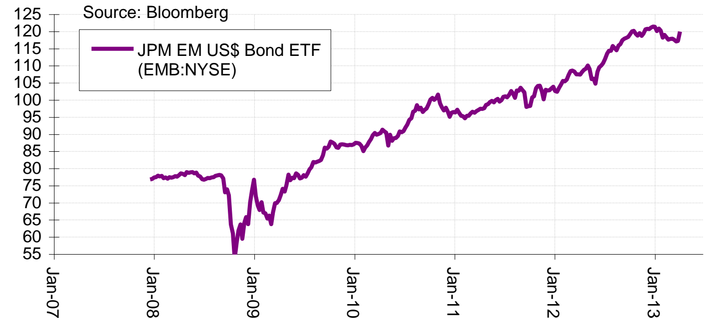


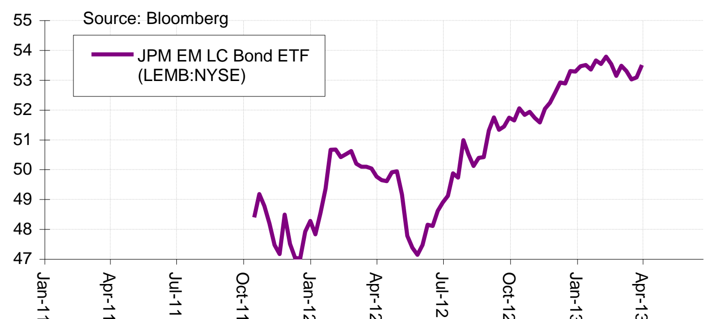
Little upside to US Treasuries as they are highly sensitive to interest rate hikes





Maintain UW EM-Asia US$ and MW EM-Asia LC debt.





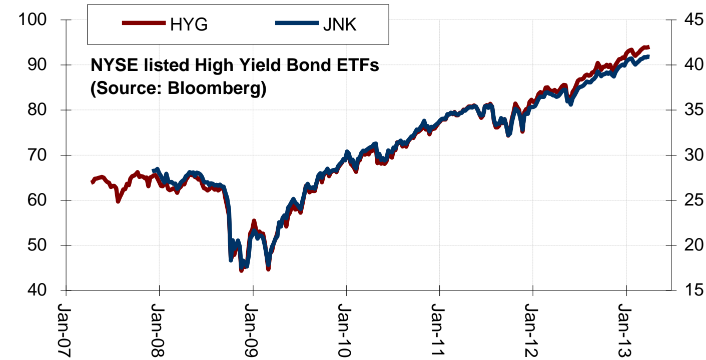
In the high yield space maintain MW to both US Corporate High Yield and EM-Asia High Yield fixed income on account of the following:

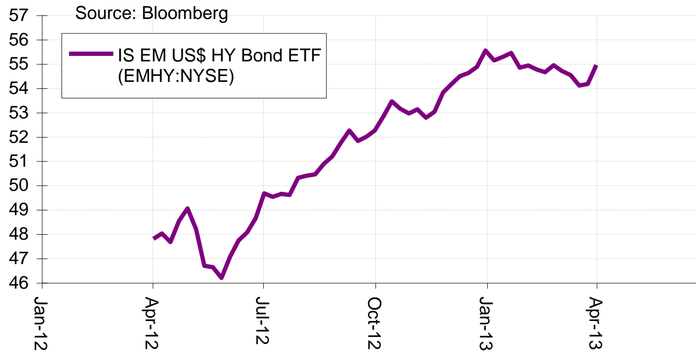
(i) Market's relentless search for yield has resulted in the high yield space to be overcrowded and such desperation might have possibly resulted in some investors to overlook

the significant credit risk that accompanies such products that are of relatively lower credit quality.

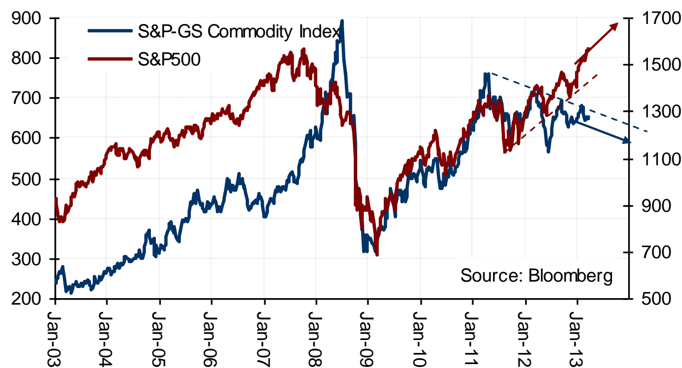
(ii) High-yield fixed income was flat, with a -0.01% (est) total return ytd on average. We reckon that there are better investment alternatives out there, such as equities.

Prices of High-Yield fixed income may have peaked, warranting a downgrade to Market weight





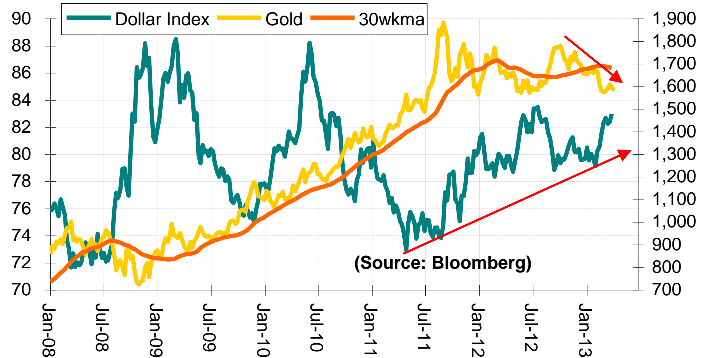
COMMODITIES (MW)



Commodities have been a laggard in this risk rally (chart above) and that has vindicated our MW rating on this asset class. At this juncture, we continue to prefer to express our views on an improving global economy (barring downside risks) on the back of liquidity glut with OWs on Asia equities rather than commodities (industrial metals) per se on a relative return basis.

GOLD (UW)

We maintain our UW on gold. The current risk-on environment for equities and stronger USD (due to improving US trade balance) is a negative for gold.



Phillip Securities Research: Asset Allocation Strategy

Returns incl. Yield	2012	2012 total return		2013	2013 total return	
Bonds						
US Treasuries	OW to UW 9th Oct	7.0%	correct	UW	1.0%	correct
US MBS	OW	4.6%	wrong	OW to UW 23rd Jan	0.1%	correct
US Corp IG	OW to MW 9th Oct	16.4%	correct	UW	0.9%	correct
US Corp HY	OW	19.9%	correct	OW to MW 18th Feb	2.8%	correct
EM-Asia US$ IG	OW	19.5%	correct	OW to UW 23rd Jan	0.0%	correct
EM-Asia LC IG	OW	13.4%	correct	OW to MW 23rd Jan	1.0%	correct
EM-Asia HY	OW	30.6%	correct	OW to MW 18th Feb	0.8%	correct
simple average:	OW	15.9%	correct	MW	0.9%	CORRECT
Equities						
World	MW	15.4%	correct	OW	7.8%	CORRECT
US	UW to MW 21 Dec	13.8%	shld have MW in Jun not Dec!	MW to OW 18th Mar	10.6%	late to upgrade
EZ	UW	17.9%	wrong	UW	3.7%	<= reassess after Italy
JP	-			MW	31.9%	OW short term
Korea	MW	12.7%	correct	MW	-3.6%	wrong, downside to MW call
Taiwan	MW	12.2%	correct	MW	0.7%	correct
China-A	OW 22 Oct	7.8%	timely!	OW	3.0%	8.8% return since OW 22 Oct
China-H	OW 22 Oct	17.8%	caught 2nd move	OW	-5.6%	3.9% return since OW 22 Oct
HK	OW 8 Oct	26.1%	caught 2nd move	OW	2.7%	9.3% return since OW 8 Oct
SG	OW	23.5%	correct	OW	4.5%	correct
MY	MW	13.4%	correct	MW	2.3%	<= reassess after elections
TH	OW	29.6%	correct	OW	1.7%	short term correction we think
ID	MW	11.3%	correct	MW to OW 11th Apr	11.9%	late to upgrade
PH	OW	36.8%	correct	OW	17.9%	correct
India	UW	29.3%	wrong	UW	-4.9%	correct
Commodities	UW	-3.4%	correct	MW	-1.4%	CORRECT
Gold	UW 25th Oct	-2.9%	correct	UW	-6.4%	CORRECT

OW = Overweight | MW = Marketweight | UW = Underweight (Souce: PSR, Bloomberg); 11 Apr 2013

Global Macro, Asset Strategy Team, Phillip Securities Research

OW = Overweight ; MW = Neutralweight ; UW = Underweight

Broad Asset	Sub-Asset	Rating	ETF	Phillip CFD
Bonds (MW)	US Treasuries	UW	TLH.AMEX / TLT.AMEX	
	US Mortgage Backed	UW	VMBS.AMEX / MBG.AMEX	
	US Corp	UW	VCLT.AMEX / LQD.AMEX	
	US Corp High Yield	MW	HYG.AMEX / JNK.AMEX	
	EM US$ Govt	UW	EMB.AMEX	
	EM LC Govt	MW	LEMB.AMEX	
	EM US$ HY Corp & Govt	MW	EMHY.AMEX	
	Asian US$ Govt & Corp	UW	N6M.SGX	
	Asian LC Govt & Corp	MW	N6L.SGX	
	Asian US$ Corp HY	MW	O9P.SGX	
Equities (OW)	US	OW	SPDR S&P 500 (SPY:AMEX)	US SP 500 Index USD5 CFD (S&P500) / Wall Street Index USD1 CFD (DJIA)/ US Tech 100 Index USD5 CFD
	Europe	UW	SPDR Stoxx 50 (FEU:AMEX)	
	Australia	-	iShares MSCI Australia (IOZ:ASX)	
	Japan	MW	Lyxor Japan TOPIX (CW4:SGX)	Japan 225 Index JPY100 CFD (Nikkei 225) / Tokyo Index JPY1000 CFD (Topix)
	S.Korea	MW	DBXT - MSCI Korea (IH2:SGX)	
	Taiwan	MW	DBXT - MSCI Taiwan (HD7:SGX)	Taiwan Index USD20 CFD (MSCI Taiwan)
	China A shares	OW	CSI300 (83188.HK) / SSE 50 (JK8.SGX)	FTSE China A50 Index USD1 CFD
	China H shares	OW	HKCEI (2828.HK)	H Shares Index HKD5 CFD (HSCEI)
	HK	OW	Hang Seng (2800.HK)	Hong Kong 40 Index HKD5 CFD (Hang Seng)
	Singapore	OW	SPDR STI (ES3:SGX)	STI SGD5 CFD / S'pore Index SGD20 CFD (SMSCI)
	Malaysia	MW	DBXT - MSCI Malaysia (LG6:SGX)	FBM KLCI MYR10 CFD
	Thailand	OW	DBXT - MSCI Thailand TRN (LG7:SGX)	
	Indonesia	OW	DBXT - MSCI Indonesia (KJ7:SGX)	Indonesia Index USD1 CFD (MSCI Indon)
	Phillippines	OW	DBXT - MSCI Philippines (N2E:SGX)	
	Vietnam	MW	DBXT - FTSE Vietnam (HD9:SGX)	
	India	UW	iShares MSCI India (I98:SGX)	India50 Index USD1 CFD (S&P CNX Nifty)
Commodities		MW	Lyxor Commodity 10$US (A0W:SGX)	
Gold		UW	SPDR Gold ETF (O87:SGX or GLD:AMEX)	

CIMB ASEAN40 ETF (QS0:SGX for S$ or M62:SGX for US$) — applies to Singapore, Malaysia, Thailand, Indonesia, Phillippines

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