Western Asset Management September 2017

SINGAPORE FIXED INCOME REVIEW

MARKET REVIEW

In September, the Singapore bond market saw declines; most of the curve saw yields rising, led by the front end of the curve, alongside a bear-steepening of the US Treasury (UST) curve. The Asian Local Bond Index (ALBI) Singapore Government Bond Index declined by 0.25%, bringing year-to-date gains to 3.98%.

The UST curve bear-steepened, with long-end yields rising more than the front end. The 3-month yields rose by 5 basis points (bps) while 1-year yields were higher by 7 bps. 5-year USTs were wider by 23 bps to 1.94%, while the yield on 10-year USTs was higher by 22 bps at 2.33%.

Singapore government securities (SGS) outperformed USTs, with capitulation driven by onshore investors in view of the bear-steepening of the UST curve. The belly outperformed, with the yield on 3-month bills widening 2 bps to 1.19%, while the 1-year yield was 3 bps higher at 1.23%. The 2-year yield was higher by 12 bps at 1.39%, the 5-year yield widened by 9 bps to 1.65%, while the 10-year was 7 bps higher at 2.15%. At the long end, the 30-year SGS widened 9 bps to 2.50%.

The August Consumer Price Index (CPI) eased to 0.4% year-over-year (YoY) from 0.6% in July, below consensus of 0.6%. The print of 0.4% was the lowest since the start of this year due to easing food and transport prices. Core inflation eased to 1.4% YoY from 1.6% previously, on the back of lower food and retail inflation. Food inflation eased to 1.2% YoY from 1.4% previously, the lowest since 2010 levels, weighing on headline CPI. Transport prices eased to 1.4% YoY from 2% previously, on the back of fading base effect from the expiry of 1-year road tax rebates in August 2016. Industrial production (IP) growth remained robust at 19.1% YoY in August, only slightly lower than the 21.2% growth in July (consensus: 16%). On a seasonally adjusted month-over-month (MoM) basis, IP growth moderated only slightly to 0.6% from 0.9% in July. August IP growth was boosted by the volatile biomedical sector, where output rose by 25.1% YoY after growth of 4.5% in July. Excluding this sector, IP growth was 17.8% YoY from 25.3% in July. Also, electronics IP growth remained robust at 38.7% YoY in August, albeit slowing from 49.4% in July, led by still-strong growth in semiconductor output (55.7% in August from 68.1% in July).

August non-oil domestic exports (NODX) numbers surprised on the upside, printing at 17.0% YoY versus a market consensus of 11.8% YoY and a previous print of 7.6% YoY. NODX expanded by 4.5% MoM as opposed to the contraction experienced the previous month at 3.3%. The better-than-expected figure was largely due to outperformance in the semiconductor sector.

OUTLOOK

The Federal Open Market Committee (FOMC) left the fed funds rate target range unchanged and announced that balance sheet runoff will begin in October, as widely expected. The median dots in the Summary of Economic Projections continued to show a third rate hike this year and three hikes in 2018. The FOMC affirmed its stance of its well-telegraphed balance sheet adjustment in line with its "Policy Normalization Principles and Plans," which was introduced at its June meeting. "The Committee now judges that it is appropriate to begin implementing its balance sheet normalization program." The committee said that the economy continues to expand at a modest pace, led by household spending and business investment. Bonds remain supported, quite the contrary of what markets were expecting, anchored by a macroeconomic environment of low inflationary pressure, moderate growth, low UST yields and no urgent sense of hawkishness out of major central banks. In Asia, late-September's selloff in risk was reminiscent of last year's selloff after Donald Trump got elected, with the tax reform proposal and an extension of the debt ceiling driving UST yields and the US dollar higher. That stated, we remain comfortable with the broader structural backdrop in terms of low inflationary pressure and benign structural global growth. Asian markets vulnerability remains low driven by stronger fundamentals compared to previous episodes. The latest

PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

export Purchasing Manager's Index (PMI) and manufacturing PMI continue to point towards resilience across most of Asia, with growth momentum sustaining into 4Q17. The Asian Development Bank (ADB) has upgraded growth forecasts for developing Asia to 5.9% in 2017 and 5.8% in 2018.

Consumption demand that boosted Asia exports in the early 2000s doesn't look set to return given the shift in demographics and accompanying consumption shifts. Asia, however, has already been adapting to this shift since post 2008, with export volume growth below 5% (this versus the 15% Asia was used to before 2008). Asia's strength remains its heterogeneous nature with a diversity of both high-income and emerging economies, with technological and developmental stage diversity and, on the whole, positive demographics, with declining working-age populations in certain economies offset by large and emerging young populations in others. As a share of global trade, Asia now stands at 25% or more than twice that of the US at 11%. Interestingly, while 15% of Asian exports go to the US, 21% of US exports go to Asia. More importantly, intra-region trade is now the predominant driver of exports, with intra-region trade at around 50%, an all-time high as the region becomes more interdependent. Asia remains in a relative sweet spot, with diversified drivers of growth anchored by China, India and Southeast Asia. It is a region that should continue to dominate global growth, tending to benefit from the upside while being insulated against a significant downside. India, Indonesia and the Philippines remain well poised within the easy-growth category on the back of large, young and lower-income populations.

Singapore continues on its path of restructuring in view of the shifting competitive landscape and domestic demographic challenges. There remains an urgent need to position the economy as well as the labour force higher up the value chain given the constraints of labour implied by tighter immigration policy. The recent report by the government's Committee on the Future Economy concluded that growth is likely to average 2%-3% per year over the next decade, down from a previous expectation of 3%-5%. With little political room to maneuver in terms of immigration, growth will have to come from productivity, which has remained dismal at 0.6% per year for the past decade. The government has downshifted its productivity growth forecast to 1%-2% over the next decade, instead of the previous aim of 2%-3%. Public sector infrastructure projects will be brought forward to start in FY2017 and FY2018 to help mitigate the slowdown in private-sector construction.

Medium growth remains moderate, driven by stabilisation in external demand. Growth continues to be broad based, supported by manufacturing, services and construction sector demand. The service sector remains a key pillar supporting employment, at 73% of total employment, picking up the decline in the older manufacturing sector. Singapore continues to be anchored by its fundamental strength, with an estimate of sovereign foreign net assets at around 90% of GDP as of year-end 2016, according to Fitch. With its balanced fiscal policy mandate and its high current account surplus—projected at 19% of GDP for 2016, or an average of 18% for the past five years—structural underpinning remains firm. Household debt remains constrained by high mortgage levels—at 75.3% as of year-end 2016, up from 73.8% at year-end 2015—with mortgages at 56.8% of GDP. This and a more-hawkish Fed monetary policy stance provide little room for monetary policy easing by the Monetary Authority of Singapore (MAS). The burden of growth support will continue to be on the fiscal and administrative side of the house. We expect the MAS to hold its neutral SGD nominal effective exchange rate (NEER) bands amidst a modestly improved outlook for global growth and inflation.

We are cautious of the rapid expansion of the Singapore credit market and the relatively low level of risk premium the market is pricing into bonds issued by new entrants. We remain highly selective and will place a strong emphasis on sound credit fundamentals as a key premise. We believe our long-term approach will allow us to ride out any volatility in the next few months and we will seek to minimize our risk exposure. In terms of strategy, we continue to adopt a tactical approach to positioning across the SGS curve in view of global growth headwinds and monetary policy divergence among central banks. We will seek to bolster carry-through exposure in high-quality corporate and bank credits.

PLEASE REFER TO THE IMPORTANT INFORMATION ON THE FINAL PAGE.

LEGG MASON
GLOBAL ASSET MANAGEMENT

Brandywine Global
Clarion Partners
ClearBridge Investments
EnTrustPermal
Martin Currie
QS Investors
RARE Infrastructure
Royce & Associates
Western Asset Management

Legg Mason is a leading global investment company committed to helping clients reach their financial goals through long term, actively managed investment strategies.

- US$752 billion* in assets invested worldwide in a broad mix of equities, fixed income, alternatives and cash strategies
- A diverse family of specialized investment managers, each with its own independent approach to research and analysis
- Over a century of experience in identifying opportunities and delivering astute investment solutions to clients

* As of 31 August 2017.

IMPORTANT INFORMATION

Source: Western Asset Management. This document is issued by Legg Mason Asset Management Singapore Pte. Limited in Singapore (“Legg Mason”) (Registration Number (UEN): 200007942R). This document is for information only and does not constitute an offer or invitation to the public to purchase any shares in any fund in Singapore.

This document is for information only and is not intended to provide investment advice. All data, opinions, estimates and other information are provided as of the date of this document and may be subject to change without notice. Where past performance is quoted, such figures are not indicative of future performance. Investors intending to subscribe for any units or shares of a fund should refer to the Fund’s most current offering document. **INVESTMENT INVOLVES RISKS**. Please refer to the offering documents for further details, including the risk factors. Although information has been obtained from sources that Legg Mason believes to be reliable, no guarantee can be given as to its accuracy and such information may be incomplete or condensed and may be subject to change at any time without notice.

Any views expressed are opinions of the respective investment affiliates as of the date of this document and are subject to change based on market and other conditions without notice and may differ from other investment affiliates or of the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. The mention of any individual securities/ funds should neither constitute nor be construed as a recommendation to purchase or sell securities, and the information provided regarding such individual securities/ funds is not a sufficient basis upon which to make an investment decision. Portfolio allocations, holdings and characteristics are subject to change at any time. Legg Mason, its affiliates, officers or directors, may have an interest in the acquisition or disposal of the securities mentioned herein. Distribution of this document may be restricted in jurisdictions, other than Singapore. Any person coming into possession of this document should seek advice for details of, and observe such restrictions (if any).

Neither Legg Mason nor any officer or employee of Legg Mason accepts any liability whatsoever for any loss arising from any use of this document or its contents. The information in this document is confidential and proprietary and may not be used other than by the intended user. This document may not be reproduced, distributed or published without prior written permission from Legg Mason.

The contents of this document have not been reviewed by any regulatory authority in Singapore.