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FROM THE FIXED INCOME DESK

Monthly Outlook

Summary

- USTs ended lower in October. Better US economic data and a hawkish statement from the Federal Open Market Committee (FOMC) bolstered expectations of a December interest rate hike. 10-year UST yields rose about 23 basis points (bps) to 1.83%.

- China's economy grew by 6.7% in the third quarter, although performance indicators were mixed. Retail sales and money supply growth edged higher, while exports and imports fell. Separately, more cities announced property tightening measures over the month.

- The Reserve Bank of India cut its benchmark interest rate by 25bps in response to lacklustre global growth. Bank Indonesia also cut its benchmark rate by 25bps, its sixth reduction this year, on the back of lower-than-expected third quarter growth.

- In Thailand, King Bhumibol Adulyadej passed away on 13 October. The uncertainty of how his death would affect Thailand's political situation initially weighed on sentiment, but early signs of a peaceful succession plan led the currency to recover much of its weakness by month-end.

- Overall Asian credits ended lower, despite tighter credit spreads, as yields of USTs rose. Risk-free rates globally rose over concerns that major central banks may signal a less accommodative policy stance going forward. Asian high grade underperformed high yield in October.

- The number of new issues remained elevated in October. There were 27 new bonds issued – amounting to USD 15.1bn – within the high-grade space. Meanwhile, the high-yield segment saw 12 new issues amounting to USD 3.7bn.

- We continue to favour Indian, Malaysian and Indonesian bonds as demand could be buoyed by more monetary easing from the respective central banks. Demand for the Indonesian Rupiah is also likely to be supported by the repatriation of funds under the tax amnesty programme. In contrast, we expect Philippine bonds and the Peso to lag.

- Volatility is likely to pick up in the near term on the back of key risk events such as the US presidential elections and the FOMC meeting in December. It remains to be seen if the recent moves higher in risk-free rates have dampened overall demand, although in-region demand for Asian credit should be supported by robust fund flows into EM hard currency debt.

Asian Rates and FX

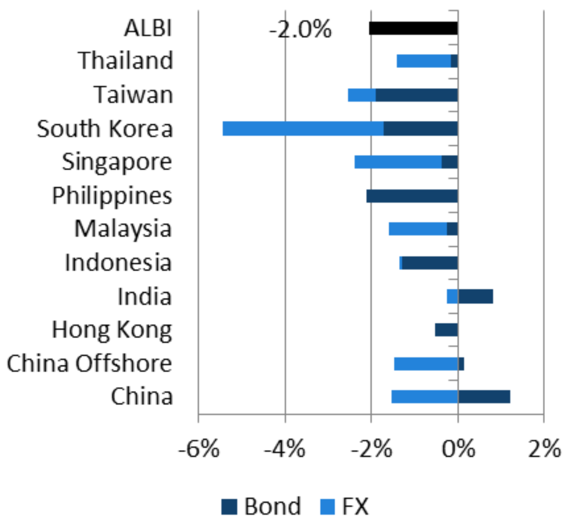
Market Review

- USTs ended lower in October

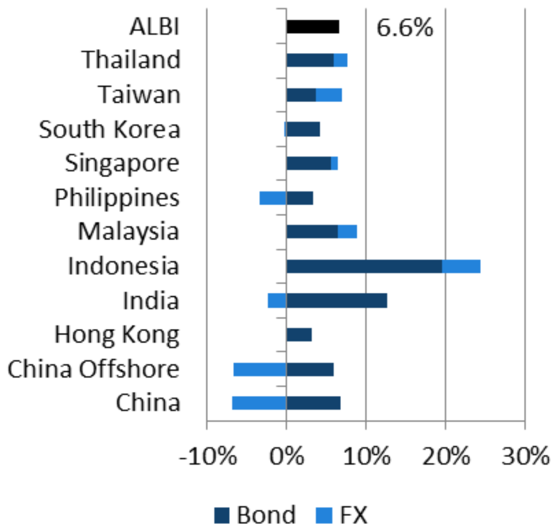
USTs ended lower in the month, with the yield on the 10-year UST note rising about 23 basis points (bps) to 1.83%. Better economic news and further suggestion that the US Federal Reserve (Fed) is moving closer to raising interest rates drove yields higher. The US Labour Department reported a net increase of 156k jobs in September, and simultaneously revised August's jobs number higher by 16k. Retail sales climbed by the most in three months, and the US ISM manufacturing index returned to growth after the previous month's contraction. Third quarter GDP growth in the US was revised higher, indicating that the economy grew at the fastest pace in two years. Meanwhile, minutes from the September FOMC were largely hawkish, and comments from Fed officials in the month bolstered expectations that the US central bank would raise interest rates in December.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 October 2016



For the year ending 31 October 2016



Note: Bond returns are in local currencies while FX and ALBI returns are in USD. Past performance is not necessarily indicative of future performance. Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 October 2016

- Chinese GDP growth came in at 6.7% in the third quarter

China's economy grew at an annual rate of 6.7% in the third quarter, matching the rate posted in the previous quarter. Economic performance indicators in September registered mixed. Retail sales edged up, helped by cuts in vehicle taxes, and investment by private firms grew 2.5% in the first nine months of 2016, faster than the 2.1% growth in the January-August period. Money supply growth edged up in September, and aggregate financing rose to RMB 1.72tr. Strength in mortgage loans continued, although loans demand from the corporate sector also picked up. Meanwhile, exports fell more steeply than expected in September, marking a sixth consecutive month of declines. Imports similarly dropped, reversing a 1.5% increase in the previous month.

- Reserve Bank of India (RBI) and Bank Indonesia (BI) cut interest rates

In the first-ever decision by the newly created monetary-policy committee headed by new Governor Urjit Patel, the Indian central bank cut its benchmark interest rate by 25bps. According to the RBI, the move "is consistent with an accommodative stance of monetary policy", and was made in response to sluggish global growth. It further noted, among other things, "risks in the form of BREXIT, banking stress in Europe, rebalancing of debt-fueled growth in China" as skewing the outlook "to the downside". Meanwhile, Bank Indonesia similarly cut its benchmark interest rate in the month. This follows a similar quarter-point cut last month, and is the sixth time that the monetary authority has reduced borrowing costs this year. According to the central bank, "economic growth in the third quarter tended to be lower than expected." BI expects economic growth for the entire year to register close to 4.9%.

- Monetary Authority of Singapore (MAS) left FX policy unchanged

The MAS stood pat on its zero appreciation policy for the Singapore dollar, although the accompanying monetary policy statement was relatively downbeat. According to MAS, "growth in the Singapore economy has weakened and is not expected to pick up significantly in 2017." On the other hand, it sees core inflation rising slightly from around 1% this year to an average of 1-2% in 2017. The decision came on the same day that advance estimates revealed the economy expanded just 0.6% year-on-year (YoY) in the third quarter, sharply lower than expectations, as growth was dragged down by weaker manufacturing and services sectors.

- Thai King passed away after a seven-decade reign

King Bhumibol Adulyadej, a unifying figure in a deeply polarized Thailand, passed away on 13 October. News of the revered king's failing health had initially weighed on investor sentiment since the start of October, which saw the Thai Baht depreciating almost 3% in two weeks. The uncertainty of how his death would affect Thailand's political situation led investors to be skeptical of holding Thai assets. However, investor confidence was restored after early signs that a peaceful succession plan will be in place and also after Prime Minister Prayuth Chan-Ocha reiterated that the timetable for democratic elections in 2017 will remain. This allowed the currency to recover much of the weakness by month-end.

Market Outlook

- Overweight Indian, Malaysian and Indonesian bonds; cautious on Philippine bonds

We expect global liquidity to sustain the demand for carry the rest of the year. Within the region, we expect Indian, Indonesian and Malaysian bonds to outperform. Despite lowering rates further in October, Bank Indonesia has left the door open for additional easing. Meanwhile, against a backdrop of benign inflation, we believe that monetary authorities in India and Malaysia have room to cut interest rates to spur domestic growth. In contrast, we expect Philippine bonds to underperform, as we see the Bangko Sentral ng Pilipinas remaining on the sidelines for the foreseeable future.

- Prefer IDR and INR; underweight KRW and PHP

The success of Indonesia's tax amnesty program has benefited demand for the Indonesian Rupiah. Strength in the Indian Rupee is likely to be sustained by inflows into Indian securities, buoyed by the lower trend in inflation. Meanwhile, we are cautious on the Philippine Peso, as we see it underperforming regional currencies in the near-term, prompted in part by greater political uncertainty. Similarly, we expect the Korean Won to be vulnerable to sluggish global growth. Moreover, weak domestic growth increases the risk of policy moves designed to spur economic activity, which is likely to further dampen sentiment towards the Korean Won.

Asian Credits

Market Review

- Asian credits ended lower in October

Overall Asian credits ended lower, despite tighter credit spreads, as yields of US Treasuries (USTs) rose. Asian high-grade returned -1.09%, underperforming Asian high-yield which returned 0.38%. High-grade was impacted by sharply higher US treasury yields with the 10-year US treasury yield rising 23 basis points (bps) over the month. Asian high-yield also saw spreads tightening by around 22bps compared to 4bps for high-grade spreads. Risk-free rates globally also rose over concerns that major central banks may signal a less accommodative policy stance going forward.

- China announced more property tightening measures

In China, more cities announced property tightening measures, which ranged from prohibiting purchases by certain residents, to suspending mortgages and raising down-payment requirements. In addition to this, the People's Bank of China (PBoC) also reportedly instructed banks to tighten lending standards for the housing sector. State media also reported that Chinese regulators have requested that the China Securities Regulatory Commission (CSRC) and the National Development and Reform Commission (NDRC) tighten developers' funding channels (including issuance of onshore and offshore bonds, and H-share listings). Meanwhile, towards the end of the month, credit rating agency Standard & Poor's - citing concerns about the rise in non-performing loans in Indonesia - said that it may not be ready to upgrade the country's sovereign rating in the near future.

- Malaysian prime minister pledged to narrow budget deficit

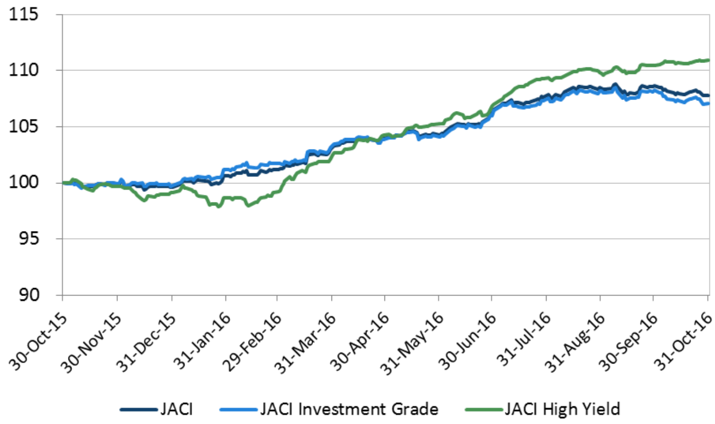
Malaysian Prime Minister Najib Razak reiterated the government's commitment to achieve a near-balanced budget by 2020, as he presented the 2017 budget. He declared that in the face of low oil prices and rising global risks, infrastructure projects and cash handouts will help underpin growth next year. The government projects the economy to expand 4-5% in 2017, with the fiscal shortfall narrowing to 3% of GDP (from 3.1% this year).

- New supply in the high-grade space remained robust

The number of new issues, particularly in the high-grade space, remained relatively elevated in October. There were 27 new bonds issued – amounting to USD 15.1bn – within the high-grade space. Meanwhile, the high-yield segment saw 12 new issues amounting to USD 3.7bn in the month.

JP Morgan Asia Credit Index (JACI)

Daily returns for the period from 30 October 2015 to 31 October 2016



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 31 October 2016

Market Outlook

- Key risk events in November and December to dictate returns

Return volatility is likely to pick up in the coming months as key risk events loom. While the US Federal Open Market Committee (FOMC) is expected to remain on hold in November, the closely and contentiously fought US presidential elections will dominate attention in early November. This will be followed by the Italian referendum on constitutional reforms in early December, as well as the US FOMC meeting on 13th and 14th December, when the FOMC is expected to raise rates. For high-yield China property, tightening onshore funding channels with concerns over more tightening measures to come is likely dampen sentiment. While spreads are not expected to gap significantly wider, tepid risk sentiment into these risk events is likely to bias spreads to leak wider in the near-term.

- Technicals slowly but surely eroding

The supply of new issues is expected to remain heavy as issuers attempt to issue in the coming weeks before key monetary policy meetings. The resurgence of high-yield new issuance in recent months, with some at tight valuations, is likely to continue to weigh on technicals. While in-region demand for Asian credit should remain intact with fund flows into EM hard currency debt continuing to be robust, it remains to be seen if the recent moves higher in risk-free rates have dampened overall demand as total returns slip.

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