By Koh Liang Choon,
Head of Fixed Income, Asia

ASIAN FIXED INCOME OUTLOOK

March 2018

Summary

- In February, US Treasuries (USTs) succumbed to a further sell-off, with yields rising across the curve prompted by better US economic data. Further pressure on US Treasury (UST) yields came from passage by US Congress of a budget deal that provided significant further loosening of fiscal policy, as well as US Consumer Price Index (CPI) that beat market expectations. Overall, 10-year UST yields ended the month at 2.86%, about 16 basis points (bps) higher compared to end-January.

- Overall, Asian credits suffered further losses in February as credit spreads widened and UST yields rose. As concerns of returning inflation escalated, a sharp correction in global equities ensued. Although the broad-based sell-off was relatively brief, it was enough to unnerve investors, resulting in outflows to Emerging Markets fixed income, which in turn, contributed to the widening in credit spreads.

- Within the region, GDP growth was generally robust in 4Q2017. Both monetary authorities in the Philippines and India maintained their policy rates unchanged, and raised their 2018 inflation forecast. Singapore's budget set out an expansionary fiscal policy while the Philippine central bank reduced the reserve requirement ratio (RRR) by 1% to 19%.

- Activity in the primary market quieted down in February, as Asia celebrated the Chinese New Year holidays. Market volatility in the UST market also contributed to the slowdown in issuance. The month saw only USD 15.95bn new supply from a total of 39 issuers (from USD 32.3bn from 69 issuers in January).

- We continue to be positive on Indonesia bonds on the back of index inclusion into global indexes, manageable inflation and accommodative monetary policy. On the currency front, we prefer the Malaysian Ringgit (MYR) and Singapore Dollar (SGD) over the Philippine Peso (PHP). Robust growth and higher oil prices should provide support for the MYR, while we expect the Monetary Authority of Singapore (MAS) to take on a hawkish stance in April. In contrast, we maintain that the PHP will underperform regional peers in 2018 due to the country's deteriorating current account trend.

- Asian credit spreads have remained range-bound and are on the expensive side. With spreads at the tighter end, it is unlikely that any compression can compensate for another sharp rise in UST yields. However, with the macro backdrop in Asia still healthy, a material widening of spreads is not likely, barring an abrupt rise in UST yields or a severe weakening in Asian currencies.

Asian Rates and FX

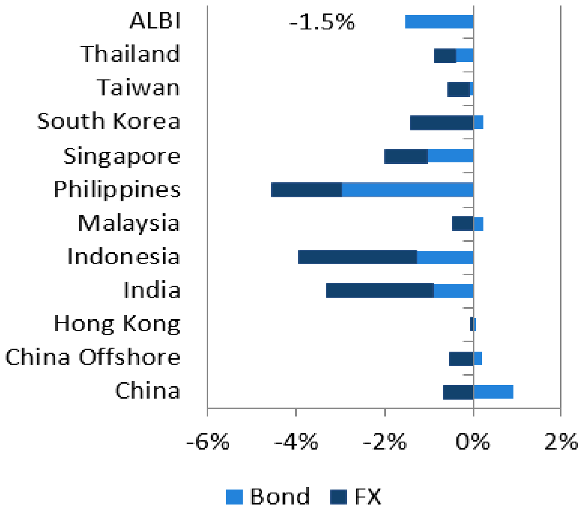
Market Review

Another weak month for USTs

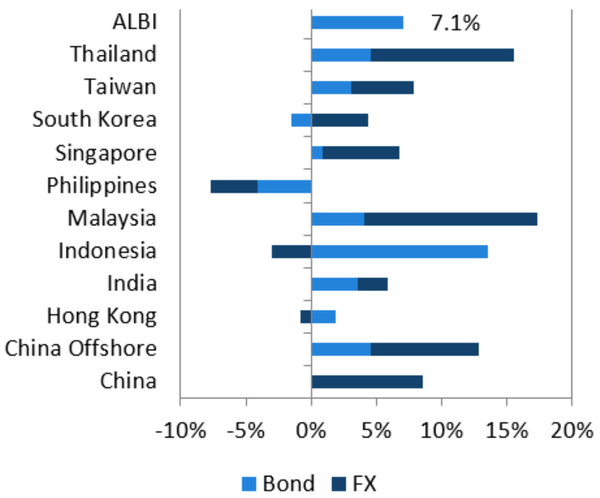
USTs succumbed to a further sell-off in February, with yields higher by about 11 to 20 bps across the curve. The shift higher in yields was prompted by better US economic data. In particular, the January employment report reflected a jump in average hourly earnings, suggesting that tight labour market conditions have begun translating to wage gains. Escalating concerns over returning inflation prompted a sharp correction in global equities. Although the broad-based sell-off was relatively brief, it was enough to unnerve investors, resulting in outflows to Asia fixed income. Further pressure on UST yields came from passage by the US Congress of a budget deal that provided significant further loosening of fiscal policy, and US CPI that beat market expectations. Overall, 10-year UST yields ended the month at 2.86%, about 16 bps higher compared to end-January.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 28 February 2018



For the year ending 28 February 2018



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 28 February 2018

Note: Bond returns refer to ALBI indices quoted in local currencies while FX refers to local currency movement against USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Regional economies registered robust growth in the fourth quarter of 2017

In the last three months of 2017, growth in Malaysia edged down to a still-robust 5.9% year-on-year (YoY) (from 6.2%). Private consumption and fixed investment growth moderated, offsetting a rise in government consumption growth. Economic activity in Thailand similarly cooled in the fourth quarter, but remained solid at 4.0%. The moderation was prompted mainly by a contraction in the agricultural sector, although manufacturing sector growth also slowed. In Indonesia, growth in the same period rose to 5.2%. A pick-up in domestic demand and restocking offset the drag from net exports. Fixed investment growth accelerated, on the back of a surge in machine & equipment investment. Elsewhere, Singapore's economy grew at a faster pace than earlier thought in the fourth quarter, following upward revisions to performance of both services and construction sectors, which more than offset the downward revision to manufacturing sector growth.

Monetary authorities in the Philippines and India raised their 2018 inflation forecast

The Bangko Sentral ng Pilipinas (BSP) maintained its policy rates unchanged in the month, despite the significant jump in the January CPI print. However, the central bank did, meaningfully raise its 2018 inflation forecast, to 4.3% from 3.4%. Notably, the revised forecast breached its 2-4% target range, and despite the upward revision, the BSP still noted that risks to the inflation outlook remains tilted to the upside. Similarly, the Reserve Bank of India left key rates unchanged, but noted that there are upside risks to inflation stemming from higher oil and other commodity prices, potential increases in minimum support prices, and the increase in customs duty among other things. The Indian central bank also revised up its inflation projection to 5.1% for the first quarter of 2018. Notably, the decision was not a unanimous one, with the lone dissenter voting for a 25bps hike.

Indian government revised fiscal deficit

Indian Finance Minister Arun Jaitley unveiled the annual budget for Fiscal Year (FY) 2019 (year ending March 2019). Policies announced were aimed largely at helping poor people through farming subsidies and a massive health-care programme. The government expects growth to print 6.8% for the current FY, accelerating to between 7-7.5% next year. For FY18, the fiscal deficit overshot the government's 3.2% target set last year, coming in at 3.5% of GDP. For FY19, Mr. Jaitley said that the government expects the deficit to narrow to 3.3% (up from an earlier target of 3%).

Singapore's budget set out an expansionary fiscal policy

Singapore's Finance Minister Heng Swee Keat delivered the Fiscal Year 2018 budget speech, where he stated that the government is projecting a small deficit of 0.1% (of GDP) this year, from an upwardly revised fiscal surplus of 2.1% in 2017. The finance minister attributed last year's bumper surplus to the MAS and SGD 2.0bn from stamp duty collections (prompted mainly by the pick-up in the property market). Some of the pro-growth measures announced include the extension of the Wage Credit Scheme, enhancements to the Corporate Income Tax rebate, deferments of foreign worker levy hikes and a one-off SG Bonus comprising cash transfers for all citizens aged 21 and above in 2018. The budget speech also focused on medium-term fiscal sustainability, with the finance minister announcing a 2% raise in the Goods and Services Tax (GST) rate, to be implemented some time in 2021-25.

The Philippine central bank cut banks' reserve requirement ratio (RRR)

The Bangko Sentral ng Pilipinas (BSP) announced that it will cut the RRR by 1% to 19% for all banks and non-bank financial institutions with quasi-banking functions. The central bank said that it believes that "sufficient progress in its shift towards the use of market-based monetary instruments" has been attained. It further added that "the BSP now has ample scope to mitigate the potential liquidity impact of a phased reduction in the reserve requirement via offsetting auction-based monetary operations." The reduction in the RRR has been a long-standing goal for the bank, although the timing of the announcement was largely unexpected.

Market Outlook

Positive on Indonesia bonds

In the near-term, we foresee flows into Indonesian bonds to be supported by the inclusion of IDR-denominated bonds into the Bloomberg Barclays Global Aggregate Index. Moreover, inflationary pressures remain fairly anchored, and monetary policy remains accommodative. However, we are cognizant that foreign bond positioning in Indonesia has seen a sizable build-up since last year. Consequently, a continued rise in global yields would be a constraint for the space.

Prefer Malaysian Ringgit and Singapore Dollar over the Philippine Peso

Robust growth in Malaysia and higher oil prices support our positive view on the MYR. Authorities are also likely to encourage MYR strength heading into elections. Meanwhile, the MAS has paved the way for a return to an upward-sloping SGDNEER band in 2018. Although we now push back our expectation for FX policy adjustment to October, the MAS may still take on a hawkish stance in April, which will provide support for the currency. In contrast, we maintain that the PHP will underperform regional peers in 2018, as concerns on the country's deteriorating current account trend remain due to the infrastructure build-out.

Asian Credits

Market Review

Asian credits ended lower in February

Overall Asian credits suffered further losses in February, as credit spreads widened and UST yields rose. Asian high-grade returned -0.92%, and Asian high-yield corporates returned -0.45% outperforming from the shorter duration and higher carry. Better US economic data triggered the move higher in UST yields. In particular, the January employment report revealed a jump in average hourly earnings, suggesting that tight labour market conditions have started to translate into wage gains. As concerns of returning inflation escalated, a sharp correction in global equities ensued. Although the broad-based sell-off was relatively brief, it was enough to unnerve investors, resulting in outflows to Emerging Markets fixed income, which in turn, contributed to the widening in credit spreads.

Indonesia proposed to regulate domestic coal price; weak sentiment towards India banks

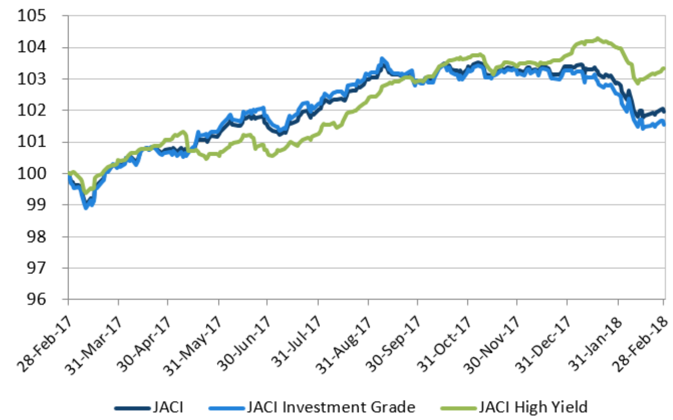
During the month, Indonesia's Energy and Mineral Resources Ministry announced that it will be introducing a new domestic coal price formula to curb production costs of government-owned Perusahaan Listrik Negara (PLN), which has a monopoly on electricity distribution in the country. According to the ministry, the revision is needed as the government has decided not to increase electricity rates for the rest of the year. The new formula is likely to mainly impact local coal miners with a focus on domestic sales. Meanwhile, sentiment towards India banks weakened in February. Disappointing earnings results from State Bank of India, together with negative headlines around Punjab National Bank, elicited selling interest in Indian financial names. However, the widening in credit spreads was not particularly significant.

Primary market quieted down

Activity in the primary market quieted down in February, as Asia celebrated the Chinese New Year holidays. Market volatility in the US Treasury market also contributed to the slowdown in issuance. The month saw only USD 15.95bn new supply from a total of 39 issuers (from USD 32.3bn from 69 issuers in January). There were 17 issues amounting to about USD 10.28bn within high-grade, including a USD 3bn sukuk issuance from Indonesia, and 22 new issues amounting to around USD 5.67bn within high-yield.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 28 February 2017



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 28 February 2018

Market Outlook

Direction of UST yields and new issuance pipeline remain worries

Despite the volatility across various asset classes and upswing in UST yields, Asian credit spreads have remained range-bound and remain on the expensive side on a historical basis. With spreads at the tighter end of the historical range, it is unlikely that any compression can compensate for another sharp rise in UST yields. However, with the macro backdrop in Asia still healthy, a material widening of spreads is not likely, barring an abrupt rise in UST yields or a severe weakening in Asian currencies which does not seem likely in the near-term. The pipeline of new issuance across high-grade and high-yield is expected to be heavy in March. This should again dampen any spread tightening as worries over redemptions remain, with volatility expected to remain high.

Important Information

This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute investment advice or a personal recommendation and it does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this material will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual stocks, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association/Japan Securities Dealers Association.

United Kingdom and rest of Europe: This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules).

This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the FCA (122084). It is directed only at (a) investment professionals falling within article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, (as amended) (the Order) (b) certain high net worth entities within the meaning of article 49 of the Order and (c) persons to whom this document may otherwise lawfully be communicated (all such persons being referred to as relevant persons) and is only available to such persons and any investment activity to which it relates will only be engaged in with such persons.

United States: This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments. This document should not be regarded as investment advice. This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. Nikko Asset Management Asia Limited is a regulated entity in Singapore.

Hong Kong: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

Australia: Nikko AM Limited ABN 99 003 376 252 (**Nikko AM Australia**) is responsible for the distribution of this information in Australia. **Nikko AM Australia** holds Australian Financial Services Licence No. 237563 and is part of the Nikko AM Group. This material and any offer to provide financial services are for information purposes only. This material does not take into account the objectives, financial situation or needs of any individual and is not intended to constitute personal advice, nor can it be relied upon as such. This material is intended for, and can only be provided and made available to, persons who are regarded as Wholesale Clients for the purposes of section 761G of the Corporations Act 2001 (Cth) and must not be made available or passed on to persons who are regarded as Retail Clients for the purposes of this Act. If you are in any doubt about any of the contents, you should obtain independent professional advice.

New Zealand: Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562) is the licensed Investment Manager of Nikko AM NZ Investment Scheme and the Nikko AM NZ Wholesale Investment Scheme.

This material is for the use of researchers, financial advisers and wholesale investors (in accordance with Schedule 1, Clause 3 of the Financial Markets Conduct Act 2013 in New Zealand). This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this material, who are not wholesale investors, or the named client, or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet (available on our website www.nikkoam.co.nz).

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Bank group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.