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FROM THE FIXED INCOME DESK

Monthly Outlook

Summary

- US Treasury (UST) yields ended July mixed: yields of shorter maturities climbed, while those of longer maturities fell. Towards the month-end, a relatively dovish Federal Open Market Committee (FOMC) statement, coupled with data that showed the US economy grew less than expected in the second quarter, prompted yields to drop. 2-year UST yields ended the month about 7 basis points (bps) higher compared to end-June, while 10-year yields ended about 2bps lower.

- Korea's economic growth picked up in the second quarter, driven by private consumption and fixed asset investment. The central bank left interest rates unchanged, but trimmed its growth and inflation forecasts for 2016.

- In Singapore, advance estimates revealed that economic growth in the second quarter registered 2.2% year-on-year. Strength in the manufacturing sector offset weakness in the construction sector. Elsewhere, Bank Negara Malaysia lowered its overnight policy rate by 25bps to 3.0%, and left the door open to further rate cuts.

- Asian credits rallied in July, as credit spreads tightened. The global search for yield, prompted by expectations that the US Federal Reserve (Fed) will keep interest rates on hold in the next months, drove strong inflows into emerging market debt.

- The China Banking Regulatory Commission (CBRC) reportedly proposed tighter rules for wealth management products (WMPs). According to reports, apart from caps on the investment of WMP proceeds in equities, smaller banks with weaker capitals may be prohibited from placing funds raised into shares and "non-standard" assets.

- In Indonesia, President Joko Widodo's second cabinet reshuffle was positively received by markets. Among the key changes was the appointment of Dr Sri Mulyani Indrawati as the new finance minister.

- Activity in the primary market picked up in July, particularly within the high-grade space, where a total of USD 12.45bn was raised from 23 new issues. Meanwhile, there were 13 new issues amounting to USD 5.75bn within the high-yield space.

- The global search for yield is likely to support demand for Indian, Malaysian and Indonesian bonds. Meanwhile, we maintain our neutral view on Hong Kong, Korea, Singapore and Thai bonds, on their relatively high correlation to USTs. However, we are cautious on the MYR, which is likely to be vulnerable to risk aversion in markets.

- The policy direction of major central banks, as well as commodity prices, will be key drivers of sentiment in the near term. While continued inflows and a "lower-for-longer" monetary policy environment should be supportive of credits, spreads could stay at the tighter range for a while yet.

Asian Rates and FX

Market Review

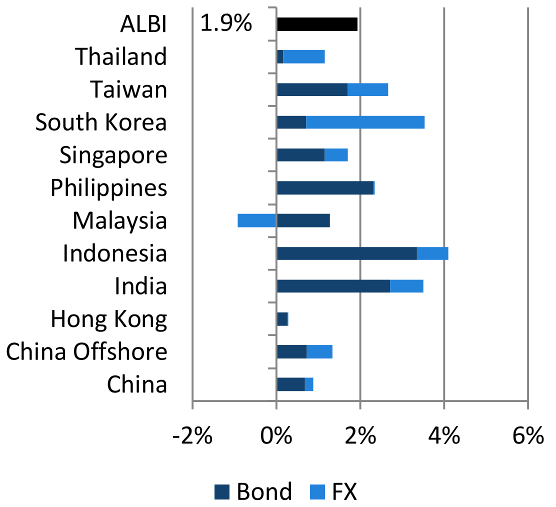
- US Treasuries (USTs) ended in mixed trading

July saw UST yields ending in mixed trading. Yields of shorter maturities climbed, while those of longer maturities fell. USTs initially shrugged off a stronger-than-expected US jobs report at the start of the month, rallying on expectations of further global monetary and fiscal easing, following the BREXIT vote. Subsequently, a string of better-than-expected economic data - including retail sales, industrial production, housing starts and home sales - revived bets that the US Federal Reserve (Fed) may tighten as early as September, sending yields higher. Towards the end of the month, a relatively dovish Federal

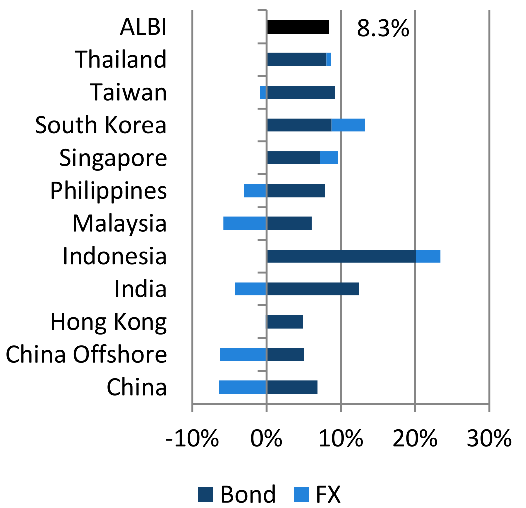
Open Market Committee (FOMC) statement, coupled with data that showed the US economy grew less than expected in the second quarter, prompted yields to drop. Overall, 2-year UST yields ended the month about 7 basis points (bps) higher compared to end-June, while 10-year yields ended about 2bps lower.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 July 2016



For the year ending 31 July 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 July 2016

- Economic growth in Korea picked up; BoK trimmed growth and inflation forecasts

Growth in the Korean economy picked up speed in the second quarter compared to the first three months of 2016. Private consumption and fixed asset investment contributed positively to growth, while net exports reduced second-quarter GDP by 0.3%. The central bank left interest rates unchanged in the month, although it trimmed its growth and inflation forecasts for 2016 slightly - to 2.7% (from 2.8%) and 1.1% (from 1.2%), respectively.

- Singapore economy expanded 2.2% in 2Q16; MAS suggested no change in monetary policy

The government's advance estimates revealed that economic growth in the second quarter registered 2.2% YoY in Singapore – rising slightly from an upwardly revised 2.1% in the first three months of 2016. The increase in economic activity was led by the manufacturing sector, albeit offset by weaker construction sector growth. Meanwhile, the Monetary Authority of Singapore (MAS) suggested that its monetary policy stance is likely to remain unchanged for the rest of the year. It noted that a policy adjustment would have to be predicated on "a marked deterioration in the global economy or significant shift to the inflation outlook."

- Bank Negara Malaysia (BNM) lowered interest rates

Malaysia's central bank lowered its overnight policy rate by 25bps to 3.0%, and left the door open to further rate cuts. Although BNM expects private consumption to be supported by government measures as well as growth in employment and incomes, it cited downside risks to external growth stemming primarily from the impact of the BREXIT vote. Headline CPI inflation in June dipped to 1.6% YoY from 2.0% in May, with the "transport" inflation component posting a marked decline as a result of fuel price adjustments effected last year. For 2016, BNM lowered its headline CPI forecast to 2.0-3.0% from 2.5-3.5%.

Market Outlook

- Overweight Indian, Malaysian and Indonesian bonds

On the back of expectations that the Fed will keep interest rates on hold in the next months, the global search for yield is likely to support demand for Indian, Malaysian and Indonesian bonds. Apart from offering relatively higher yields against regional peers, the central banks in these countries have kept doors open for further monetary easing should there be need to spur domestic growth, encouraging us to hold an overweight view on the bonds. Meanwhile, we maintain our neutral view on Hong Kong, Korea, Singapore and Thai bonds, on their relatively high correlation to USTs vis-à-vis other regional bonds.

- Expect IDR to outperform MYR

We continue to expect the Malaysian Ringgit to be vulnerable to risk aversion in markets. The continued slippage of Malaysia's current account and its relatively low FX reserves are our reasons to expect the underperformance of the currency. Meanwhile, we maintain the view that the Indonesian Rupiah will outperform, as a more favourable domestic demand outlook for Indonesia provides support for the currency. Furthermore, the approved tax amnesty program will likely bring inflows into Indonesia in the remaining months of 2016, but whether the projected additional tax receipts will meet the government's target remains to be seen and would need to be closely monitored.

Asian Credits

Market Review

- Asian credits ended the month higher

Asian credits rallied in July, as credit spreads tightened. The global search for yield, prompted by expectations that the US Federal Reserve (Fed) will keep interest rates on hold in the next months, drove strong inflows into emerging market debt. Asian high-grade returned 1.25% and Asian high-yield corporates gained 1.91%, despite a mixed performance in US Treasuries (USTs).

- China to propose tighter rules for WMPs; Indian goverhment injected capital into state-run banks

The China Banking Regulatory Commission (CBRC) reportedly proposed to tighten rules for wealth management products (WMPs). According to reports, apart from caps on the investment of WMP proceeds in equities, smaller banks with weaker capitals may be prohibited from placing funds raised into shares and "non-standard" assets. Meanwhile, India's finance ministry announced that 13 public sector banks will receive capital boost of about INR 230bn from the government, with State Bank of India getting the biggest share.

- Indonesian president reshuffled cabinet

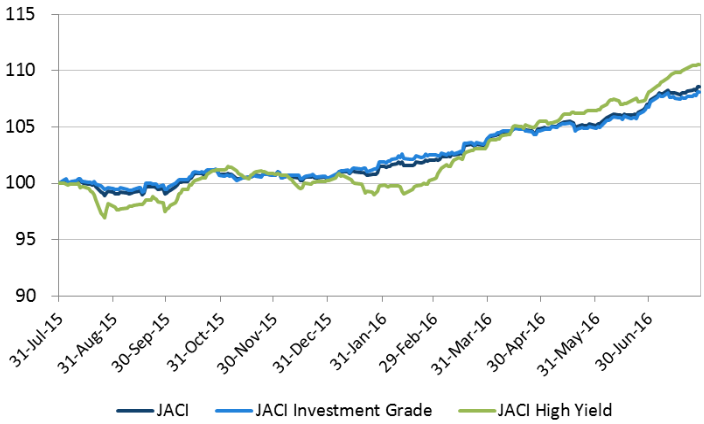
During the month, President Joko Widodo announced his second cabinet reshuffle, which was positively received by markets. Among the key changes was the appointment of Dr Sri Mulyani Indrawati as the new finance minister. Dr Sri Mulyani is currently Managing Director at the World Bank, and had served as Finance Minister during Susilo Bambang Yudhoyono's presidency. Incumbent finance minister Bambang Brodjonegoro will move to head the economic planning agency and Thomas Lembong will take the helm at the board of investment, while Coordinating Economic Minister Darmin Nasution maintains his post.

- Pick-up in primary market activity

The primary market was active in July. The pick-up in activity was particularly evident within the high-grade space given buoyant sentiment, where a total of USD 12.45bn was raised from 23 new issues (from only 9 in June). Meanwhile, there were 13 new issues amounting to USD 5.75bn within the high-yield space.

JP Morgan Asia Credit Index (JACI)

Daily returns for the period from 31 July 2015 to 31 July 2016



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

Market Outlook

- Central bank policy direction, declining commodity prices bear monitoring

A key driver of sentiment has been the easy monetary policy stance by a number of major central banks. While unlikely that the easy policy stance will be reversed anytime soon, it remains to be seen whether spreads can continue to tighten if significant further easing is not on the cards in the near-term. Commodity prices of late, in particular crude oil, have also given up a fair amount of gains since their February lows. Further sharp declines could reverse some of the positive sentiment towards commodity-related credits.

- Positive technicals continue to have the upper hand over valuations

Persistent and strong inflows into emerging market assets, including Asian hard currency bonds, have resulted in spreads rallying sharply. Spreads of a significant amount of issues are trading through year-to-date tights. While continued inflows and a "lower-for-longer" monetary policy environment should be supportive of credits, spreads could stay at the tighter range for a while yet. However, it does seem that valuations might have gotten ahead of fundamentals, considering the uncertain and volatile environment.

Important Information