March 22, 2017

The Fed Hikes Once Again! [16 March 2017]

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by iFAST Research Team

WEEKLY REVIEW

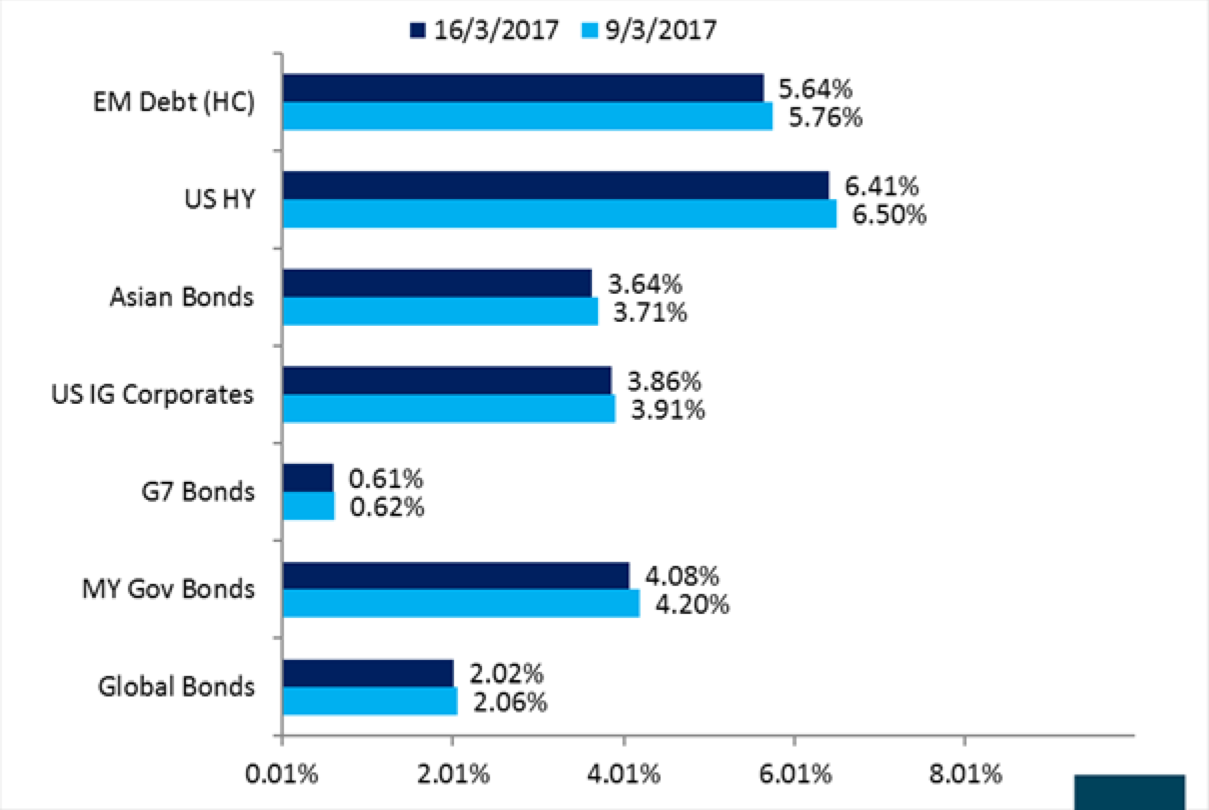
Following the Federal Open Market Committee's (FOMC) latest decision to hike benchmark rates in the US by 25 basis points (to a 0.75% - 1.00% range), yields in the fixed income markets fell across the board, with yields of global bonds declining by -4 basis points to 2.02%. G7 sovereign bonds saw yields fall slightly (by -1 basis point) to end the week with a 0.61% yield-to-maturity, while Malaysia government securities followed their G7 counterparts, with MGS yields declining by -12 basis points over the week. Over in the US credit space, yields of US investment grade corporate bonds fell from a prior 3.91% to 3.86% (by -5 basis points), while their counterpart in Asia (Asian bonds), saw yields decreased by -7 basis points, offering investors a 3.64% yield when the week ended on 16 March 2017.

In the riskier segments of bond markets, yields fell in both the US high yield bond market as well as the emerging market debt space. US high yield bonds now offer a 6.41% yield to investors as of 16 March 2017, significantly lower than levels seen more than 13 months ago in early-January 2016 following a worldwide equity market sell-off. Credit spreads in the US high yield bond market have also tightened substantially, indicating that valuations in the space have risen. While we acknowledged its still relatively attractive yields on an absolute basis, we would like to highlight that valuations have more than normalised.

On average, bond funds were up by 0.33% over the week.. Affin Hwang Select AUD Income Fund- MYR, was the best performer of the week, with positive return of 2.35% over the week. On the other hand, the Affin Hwang Aiiman Global Sukuk Fund - USD fell by -0.14% over the same period and emerged as the worst performer.

(Basis points figures might differ due to rounding-off)

CHART 1: YTMS ON VARIOUS BOND SEGMENTS



Source: Bloomberg, iFAST compilations | YTM in USD terms, except for MY Gov Bonds in MYR terms | *Denote by 10-year MY Gov Bonds, HC = Hard Currency

GLOBAL BOND MARKET

Last week, the Federal Reserve raised benchmark policy rates in the US by 25 basis points to a range of 0.75% – 1.00%, a move which was widely anticipated. Markets cheered the news, interpreting the Fed's latest move rather-dovishly and reacting positively, with equity markets rallying and bond yields falling (bond prices rising) post-announcement. Gold rallied intra-day as well, and the USD weakened broadly against many currencies. In their statement release, the US central bank reaffirmed its outlook on the US economy, stating that "household spending has continued to rise moderately while business fixed investment appears to have firmed somewhat", and that "inflation has increased in recent quarters, moving close to the Committee's 2 percent longer-run objective; excluding energy and food prices, inflation as little changed and continued to run somewhat below 2 percent." The Core PCE inflation target was revised 10 bps higher to a 1.8 – 1.9% range for 2017, with policy-makers emphasising that it will monitor for sustainable inflationary pressures. The Fed has also communicated via its Dot Plot assessment that 2 more rate hikes are on the table for 2017. In the press conference, Fed chair Janet Yellen reiterated that the Fed will wait for further clarity on potential policies coming out of Washington before readjusting its forecasts and stance.

Across the Atlantic in Western Europe, the Bank of England (BOE) made no changes to benchmark policy rates and its current asset purchase programme. Pointing out that consumption data have weakened recently but consumer confidence have held up, the UK central bank also estimated that "measures of overall activity growth have been resilient." The BOE also acknowledged that inflation has picked up, stating that the "MPC expects it to rise above 2.0% target over the next few months, before peaking at around 2.75% in early 2018 and drifting gradually back down towards the target thereafter… the projected overshoot entirely reflects the expected effects of the drop in sterling." Going forward, it remains to be seen if the BOE will tighten monetary policy as policy-makers are intending to look through current rising prices as long as its deemed acceptable and as focus is on Britain's transition leaving the European Union (EU).

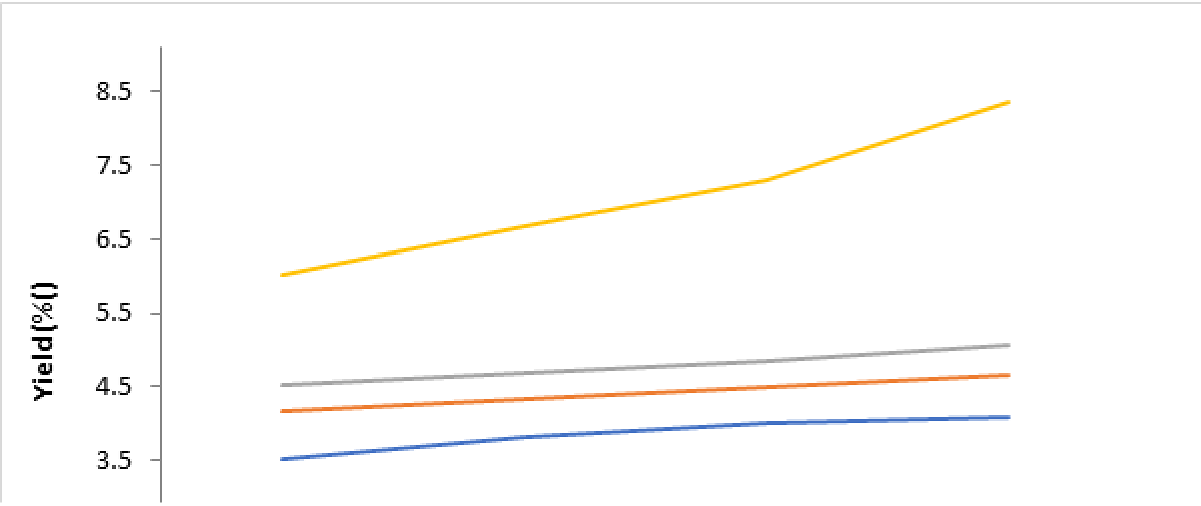
Over in East Asia, the Bank of Japan (BOJ) made no changes to its current stance and retained its target of 0.00% on the 10-year JGB. The BOJ also left its annual exchange-traded fund purchases at about JPY 6 trillion and J-REIT purchases at about JPY 90 billion. The central bank reaffirmed that Japan's economy is continuing its moderate recovery trend, and left its economic assessment unchanged from its previous meeting. Although labour market conditions remain tight in Japan (which is a positive for reflation), wage growth has been weak, with inflationary pressures in the country expected to pick up in a gradual manner in 2017 and 2018.

This week, policy-makers from Russia and Taiwan are scheduled to provide updates on their respective monetary policies and guidance. No change is expected to be made by the consensus.

We have been highlighting the risks of further increases in interest rates (and are still cognisant), and suggest investors **avoid longer-duration developed sovereign debt which is most susceptible to rising yields**, while **opting for shorter duration bond funds which are far less interest rate sensitive**. Local short duration bonds, such as the AmIncome Plus, are also a better alternative for investors who are seeking shelter from the volatility and uncertainty seen in financial markets in recent times, with yields that are relatively higher than that offered by developed sovereign bonds, providing an anchor of stability to a portfolio. As we have advocated, riskier fixed income segments, such as that of high yield bonds, should be combined with other safer bond segments, to ensure sufficient levels of diversification within one's fixed income allocation.

MALAYSIA BOND MARKET

CHART 2: YIELD CURVE – MGS AND MY CORPORATE BONDS



	3-yr	5-yr	7-yr	10-yr
MGS	3.52	3.82	4.00	4.09
AAA	4.17	4.33	4.49	4.66
AA2	4.51	4.68	4.85	5.06
A2	6.03	6.67	7.29	8.35

Source: Bloomberg, iFAST compilations. Data as of 19-Mar-17

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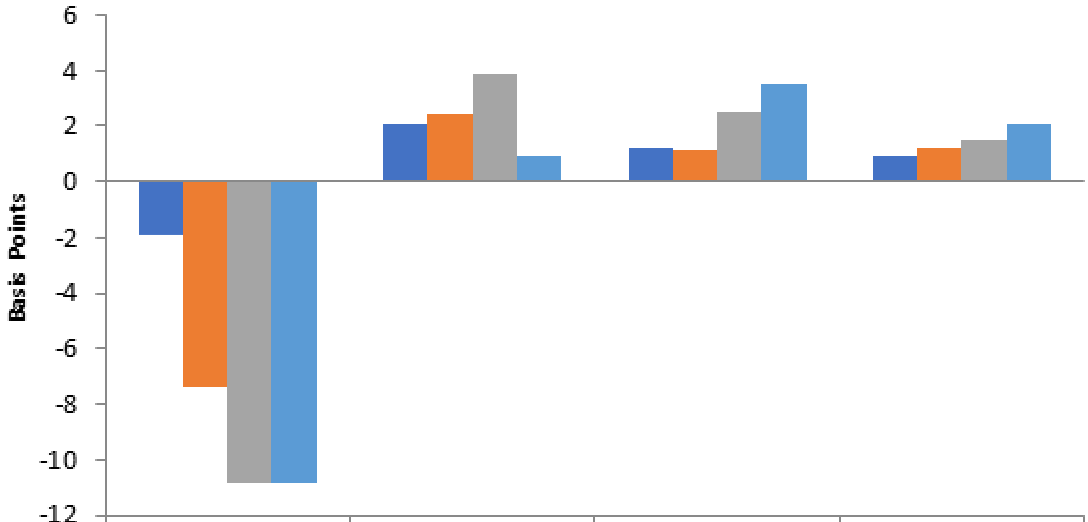
CHART 3: WEEKLY YIELD MOVEMENT – MGS AND MY CORPORATE BONDS



	MGS	AAA	AA2	A2
3-yr	-1.9	2.1	1.2	0.9
5-yr	-7.4	2.4	1.1	1.2
7-yr	-10.8	3.9	2.5	1.5
10-yr	-10.8	0.9	3.5	2.1

Source: Bloomberg, iFAST compilations. Data as of 19-Mar-17

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For the week ended 19 March 2017, MGS yields fell across all durations, with the 7-year and 10-year MGS seeing hefty declines in terms of their yields, both down by -10.8 bps over the week. In the secondary bond market, trading activities were up by 127.1%, with the Malaysian Treasury Bills segment taking up 45.8% of total trading activities.

Back to local front, RAM Ratings has reaffirmed the AA1(s)/Stable rating of Samalaju Industrial Port Sdn Bhd's (Samalaju or the Company) Sukuk Murabahah programme of up to RM950 million (the Sukuk). The rating is premised on an unconditional and irrevocable corporate guarantee extended by Samalaju's parent company, Bintulu Port Holdings Berhad (BPHB, rated AA1/Stable/P1). In view of BPHB's solid relationship with the Government of Malaysia, RAM Ratings believes that they would facilitate the success of the Sarawak Corridor of Renewable Energy while ensuring Samalaju meets its financial and operational obligations. RAM Ratings opines that the Company will continue to derive financial flexibility from BPHB and both the federal and state governments.

FIXED INCOME FUNDS TO CONSIDER:

Bonds – Malaysia:KAF Bond Fund

Bonds – Malaysia:Eastspring Investments Bond Fund

Bonds – Malaysia:RHB Bond Fund

Bonds – Malaysia:AmIncome Plus

Bonds – Malaysia (Islamic):AMB Dana Arif Class A-MYR

Bonds – Malaysia (Islamic):Libra ASnitaBOND Fund

Bonds – Asia excluding Japan:RHB Asian Total Return Fund

Bonds – Emerging Markets:RHB Emerging Markets Bond Fund

Bonds – Malaysia Foreign Exposed :AmDynamic Bond

The Research Team is part of iFAST Capital Sdn Bhd