



Investment Outlook 2017

Personal Financial Services

山重水复疑无路，
柳暗花明又一村。

After endless mountains and rivers that
leave doubt whether there is a path out,
suddenly one encounters the shade of a
willow, bright flowers and a lovely village.



Peaceful Lanna by Jakgrid Mooninta
UOB Painting of the year 2015 — Established category gold award



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IMAGE ON LEFT PAGE
Peaceful Lanna by Jakgrid Mooninta
UOB Painting of the year 2015
(Thailand) — Established category
gold award

Throughout history, Thai murals have depicted the life and culture of Thai people. In *Peaceful Lanna*, the lives of the Lanna people in Northern Thailand are seen through the colourful murals. The window in the painting looks out to a landscape that reflects the ideal, serene life of the Lanna people.

Mr Mooninta is an independent artist based in Chiang Mai, Thailand. He received honourable mentions for his works in the 3rd White Elephant Art Award in 2015 and had his work included in the 2nd White Elephant Art Award exhibition in 2014.



Sense. Think. Do.

EDITORIAL



“What lies behind us
and what lies before
us is incomparable to
what lies within us”

The year 2016 had many interesting moments. It started with a downtrend from world's equity markets led by oil and continued decline in Chinese market. Interestingly, February marked the lowest point and markets picked up by treading carefully through Brexit and the US presidential election. Dow Jones continuously hit all-time highs, marking its current level just shy of the magical 20,000. 2016 was definitely a momentous year with big changes in the political as well as economic scenes. However some investors emerged unscathed and even gained during these times through employing diversified portfolio and multi asset strategies.

Sense. Think.

Entering 2017, unprecedented shifts in the political scene could reshape the investment landscape. We hold the view that the wave of populism would continue into the New Year and possibly even strengthen with time. Furthermore, with governments embarking on fiscal spending, unconventional monetary policy could be nearing its end.

Do.

At UOB, our unique investment philosophy combines an evergreen strategy that builds your core foundation and the nimbleness to capture market opportunities arising from the changing landscape. You will find more details of our philosophy in this publication. We will also share our sense of the world, and our strategy to navigate the new year.

As Ralph Waldo Emerson once said “What lies behind us and what lies before us is incomparable to what lies within us”. The world is evolving, the future is unpredictable. Our promise to be “Right By You” has never been more important.

Chung Shaw Bee

Personal Financial Services
Singapore and Regional Head,
Deposits and Wealth Management

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Our Investment Philosophy and Sense of the World



While the investment landscape can be treacherous, we still need to meet our life goals. Equipping oneself with the right tools and mindset will enable a person find new paths. In this section, we introduce our investment philosophy and how we sense the world's changing dynamics.



Our Investment Philosophy

Smart investing begins with a solid core foundation that generates passive income. This foundation provides you with the flexibility to take on smart risk when market opportunities arise.

Build Passive Income

Anchored on the principle of diversification, our strategy is less dependent on market cycles. This is fundamental to any investment plan as it can better weather different economic conditions. Sensible risk management is of top priority.

Sources of passive income

Common sources of passive income include CPF Life, savings and property rental income. However, these sources may not be sufficient and could require active management.

Additional sources of passive income like insurance, dividends from stocks, coupon from bonds and income-generating unit trusts can give potentially higher return. Income-generating unit trusts also have benefits of diversification and are professionally managed.

Consider adopting approaches that:

- 1 Diversify portfolio risks across a wide array of assets to maximise risk adjusted returns
- 2 Are disciplined and structured in identifying attractively priced assets
- 3 Engage a risk-based methodology to control volatility and reduce downside risks
- 4 Are backed by extensive research coverage and resources
- 5 Involve active management and monitoring of your investment portfolios

This methodology allows you to:

- 1 Achieve a better peace of mind, without needing to worry about market fluctuations
- 2 Do less frequent reviews and rebalancing

Capture Market Opportunities

Market opportunities present themselves from time to time. At UOB, we scan the universe and bring you the best investment ideas. These ideas are based on our conviction underpinned by 3 key drivers, with consideration of the associated challenges.

KEY DRIVERS

Valuations

Buy low, sell high

+

Trend

Window of opportunity

+

Business cycle

Macroeconomics influence

+

KEY CHALLENGES

Balancing drivers with consideration of the risks involved.

Consider what can potentially derail the investments and the possibility of them occurring

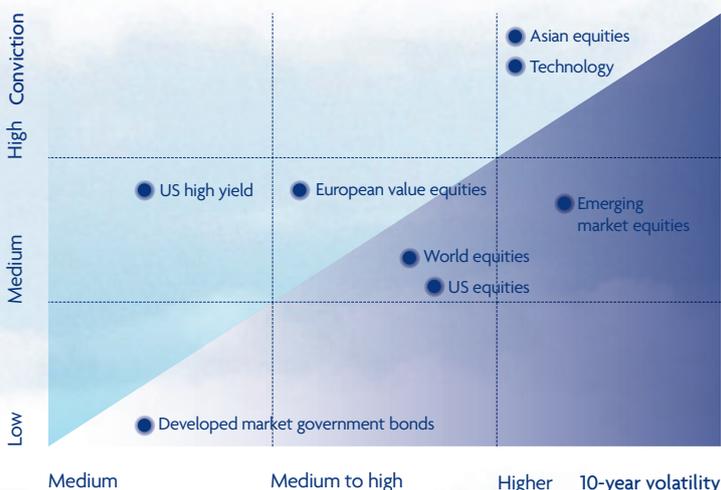
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OUR CALL

These factors will help us decide if the risk of a particular asset class is being adequately compensated and whether it will be a good investment

Investment Universe

The map provides you an overview of the financial market opportunities. It also shows you our ranked convictions and help you to understand the risk you are taking when capturing these opportunities.



● Zone that risk is adequately compensated for

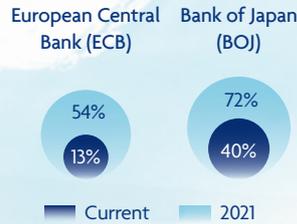
● Zone that risk is NOT adequately compensated for

For illustration purposes only

01 Shift from Monetary to Fiscal Policy

Central banks implemented unprecedented monetary policy. Economies are flooded with liquidity while interest rates remain depressed.

The room for further easing is limited. Central banks will own most of the government bonds by 2021.



Policy makers are recognising the limitations of monetary policy. Central banks have called for governments to step up fiscal spending efforts.



Our Roadmap

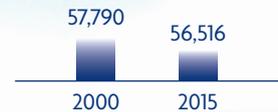
Years of global accommodative monetary policies from major central banks have helped to support the global economy. Global inflation remained relatively benign as growth was sluggish. However, recent developments in economic, political and social fronts are redefining the investment landscape.

02 Rise of Populism

Globalisation thrived over last two decades. International borders opened up and trade boomed, benefitting the global economy.

However, the average person in the advanced economies suffered. Between 2000 and 2015, median household income dropped 2% in the US.

US household median income (US\$)

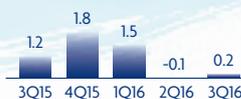


03 Confluence of Supply and Demand Factors

Oil suffered from oversupply and global recovery was slow. Inflation has been kept at low level.

Oil prices have since stabilised. The supply and demand have become more balanced.

Oil Surplus (Mn barrels per day)



Unemployment rate is at a post-crisis low. The US economy is near full employment and wage growth is picking up.

Wage growth



Trump's victory may accelerate fiscal spending.



"We're going to rebuild our infrastructure, which will become, by the way, second to none. And we will put millions of our people to work as we rebuild it."

Donald Trump, US President-elect

Governments plan to increase infrastructure spending to boost growth.



USD 1 trillion
Over next decade on roads and airport



GBP 100 million
Over next five years on transport and energy



RMB 4.7 trillion
Over next three years on transport infrastructure



YEN 6.2 trillion
Over next two years on tourism infrastructure

Unhappiness and dissent catalysed changes in political landscape.

The successful pro-Brexit and Trump campaigns bore stark similarities.



Rising populism could lead to more protectionist measures.

Consumers may end up paying more to buy from the less cost-competitive domestic companies.



Higher Inflation

Led by robust fiscal spending, economic activities could pick up and lead to tighter labour market. Higher wages tend to encourage stronger consumption, which is likely to push inflation higher.

Drivers for higher inflation are aligned.

Combination of stabilising oil prices and higher wages puts upward pressure on inflation.





Understanding Macro Trends

KEY TAKEAWAYS

Unconventional monetary policies seem to be reaching their limits. The shift to fiscal measures such as increased government infrastructure spending could provide powerful impetus for economic activities and boost productivity in the longer-term.

Populism is a recent phenomenon in the developed nations. Dissent amongst the middle class led to unexpected outcomes in the political landscape. Rising populism and increased protectionist measures could translate into consumers paying more for their goods and services.

Confluence of supply and demand factors is influencing the inflation outlook. Oil prices have recently found a floor with the recent OPEC deal. Improving US employment picture has led to an increased demand for resources. The convergence of these factors put upward pressure on inflation.

The above three points suggest that the world is transiting to a new regime. Rising expectations of inflation (and growth) necessitates revisiting one's investment portfolio to sense the dangers and opportunities in this new environment.

01 SHIFT FROM MONETARY TO FISCAL POLICY

Monetary policies have been the primary tools in stimulating global growth since the financial crisis in 2008. Unconventional monetary tools such as quantitative easing and negative interest rates were adopted in an effort to jump start the economy.

While these tools have achieved varying degrees of success, policy makers are recognising the diminishing effectiveness of such policies. A sustained fiscal push looks more compelling. As such, central banks and IMF have stepped up the call for governments to increase the fiscal spending efforts.

“Monetary policy does not exist in a vacuum... Other policies (fiscal policies and structural reforms) matter a great deal”

Mario Draghi, President of ECB

Furthermore, following the implementation of austerity programmes after the 2008 financial crisis and the 2011 European debt crisis, budgets for affected governments are now in better conditions. As a result, these governments now have the room and reason to pull the fiscal lever.

Indeed, governments around the globe have collectively pledged to adopt expansionary fiscal policy, particularly to increase infrastructure spending. In Japan, Prime Minister Shinzo Abe postponed the consumption tax hike on top of announcing a series of new stimulus packages. Germany has revealed plans to pump more capital into defence, security and resources for refugees while reducing taxes at the same time. There is also an additional 21 key initiatives in 10 policy areas of the European Commission's Investment Plan for Europe (EC IPE) which are aimed to create a more investment-friendly environment.

In the short term, expansionary fiscal policy could translate into higher demand for goods and services. As a result, inflation could be pushed upwards. In the longer term, well-executed fiscal policies could help improve productivity and growth for the economy.

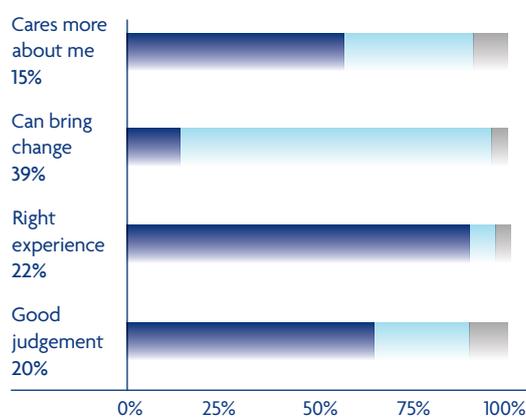
02 RISE OF POPULISM

Though globalisation has proven a powerful mean to promote growth and reduce poverty, its benefits of globalisation are not equally distributed. This has fuelled public discontentment against existing policies and institutions. As a result, politicians are inclined to adopt more populist stance and by extension, protectionist measures.

Brexit is a prime example of this phenomenon. Strong anti-immigration and anti-EU sentiments have driven the rise of populist parties in the country. This desire to exit the EU is reinforced by the public's belief that, as the second largest economy in the European bloc, UK will retain its bargaining powers even if it exits the union. In particular, existing trade ties with Eastern European countries are unlikely to dissolve overnight. In actuality, the negotiation process is unlikely to be smooth-sailing and trade relations between UK and members of the single market are likely to change.

Which candidate quality mattered most?

24558 respondents



■ Clinton ■ Trump ■ Other/no answer

CNN exit polls, 23 November 2016

US Trump Presidency is another matter which echoes this issue. Breakdown of the voters showed that the ability to bring change was the most important characteristic they looked for in a candidate. Indeed, Trump has proposed a number of populist and revolutionary policies. However, such moves do not come without a cost. For example, the proposed import tariff of 45% on Chinese goods, if materialised, could affect raw materials and manufacturing sectors in Asia. Protectionist efforts to bring back jobs to the US could eventually translate to higher costs and inflation.

03 CONFLUENCE OF SUPPLY AND DEMAND FACTORS

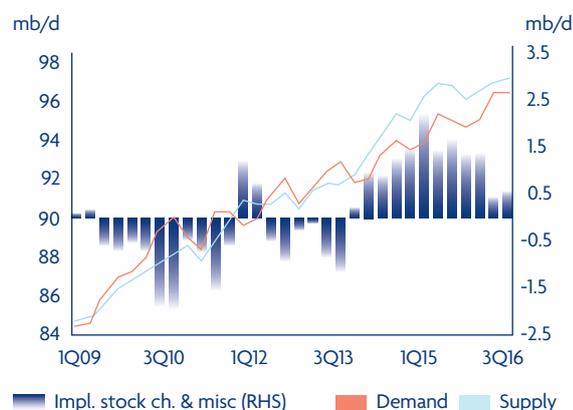
Oil prices have stabilised

Oil prices have stabilised. Oil prices have more than halved in the past two years after Saudi Arabia raised output steeply in an attempt to drive higher cost producers such as US shale producers out of the market. While this pricing tactic helped to curtail US shale output growth, revenues of oil-dependent economies including Saudi Arabia and Russia were hurt.

The Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC producers agreed on 10 December 2016 to reduce production by about 3.5% to 32.5 million barrels per day (mbd). The deal will place a floor for oil prices but the upside is likely to be capped with the possible re-emergence of higher-cost producers.

Demand/supply balance until 4Q16*

*OPEC production assumed at 32.3 mb/d in January (three month average) followed by a gradual ramp-up of incremental Iranian production to 600 kb/d in June. Production is held at this level thereafter.



International Energy Agency, World Energy Outlook, 16 November 2016

Wage growth is picking up

Since the labour market bottomed in 2010, the US has added more than 15 million jobs. The unemployment rate fell steadily from 10% post the financial crisis to current rates of 4.6% (as of November 2016). This exceeds Federal Reserve's projection of 5% long term natural rate of unemployment.

Average hourly wage is also steadily rising at more than 2.5%, higher than current inflation of 1.7%, implying higher real disposable income to the households. This could translate to higher consumer spending. For instance, recent data also suggest that American consumers are buying cars and houses at the highest levels in a decade. This could lead to further upward push to both growth and inflation.



Key Events in 2017



A “Hard Trump” scenario where the new president pushes through with protectionist policies could hurt global trade. This spells trouble for trade-dependent economies, particularly in emerging markets. In comparison, a “Soft Trump” outcome, our base case, implies more nuanced policy changes and better collaboration prospects between the US and its partners.

QUARTER 1

JAN

19 JAN
● ECB Meeting

20 JAN
● US Presidential Inauguration

▲ Donald Trump will be sworn into office and will give his inaugural address which will set forth his intentions as the President.
★ Expect more volatility as the world interprets the President's intentions.

22 — 29 JAN
● French Socialist Party Primaries

▲ The ruling party, Socialist Party (SP) has yet to select its candidate. The strength and popularity of this candidate will determine the balance of power between SP, National Front (NF) and the Republicans Party (RP) in the elections. Currently, fragmentation in SP favours victory by RP or NF.

31 JAN — 1 FEB
● Federal Open Market Committee (FOMC) Meeting

FEB

3 FEB
● European Union (EU) Informal Meeting of the 27 head of States or Government

▲ EU leaders will gather without Britain in preparation for summit in March.

- ▲ Description
- ★ Implication

MAR

9 MAR
● ECB Meeting

14 — 15 MAR
● FOMC Meeting

15 MAR (TENTATIVE)
● Netherlands General Elections

▲ Rising party Partij voor de Vrijheid (PVV), a right leaning populist party, is strongly anti-EU.
★ If PVV becomes the majority party, it could launch a referendum on the country's EU membership like the UK.

25 MAR
● EU Summit in Rome

▲ The meeting, which coincides with the 60th anniversary of EU's foundation, will shed light on the direction of EU.
★ The proximity of the summit with UK's deadline to trigger Article 50 could cause heightened volatility as markets attempt to digest the implications for the union.

END MAR
● Deadline for UK to trigger Article 50

▲ Activation of Article 50 will start the 2 year timeline for negotiators to complete Britain's exit from EU.
★ Headwinds for UK markets and potentially for European markets as well.

QUARTER 2

APR

21 — 23 APR
● Spring meetings of World Bank Group and IMF

23 APR
● French Presidential Elections (1st round)

▲ If SP is unable to field a strong candidate during its primaries, the elections run is likely to skew towards RP and NF.
★ Given the reservations about globalisation and multiculturalism from both RP and NF presidential candidates, victory by either could lead to a more inward-looking France.

27 APR
● ECB Meeting

MAY

2 — 3 MAY
● FOMC Meeting

European politics

With upcoming elections in France, Germany and Netherlands, anxiety in the European political scene could trigger swings in the markets. Unexpected outcome from binary events can drastically impact sentiments.

Inflation overshoot

If inflation rises too fast, central banks may be forced to tighten the monetary policies more aggressively than expected. Higher interest rates may derail the already anemic economic growth.

QUARTER 3

JUL

8 JUL
G20 Summit
in Hamburg

20 JUL
ECB Meeting

25 — 26 JUL
FOMC Meeting

SEP

7 SEP
ECB Meeting

SEP (TENTATIVE)
● Federal Election
in Germany

▲ Ratings of Chancellor Angela Merkel have suffered because of the refugee crisis. In contrast, support for populist party and far-right Alternative for Germany (AFD) has been growing.

19 — 20 SEP
● FOMC Meeting

QUARTER 4

OCT

13 — 15 OCT
Annual meetings
of World Bank
Group and IMF

26 OCT
ECB Meeting

OCT/NOV
19th National
Congress of the
Communist Party
of China

▲ Party delegates will elect new leadership during the congress. Notably, majority of the Politburo Standing Committee, the top leadership committee, are expected to retire during this congress.
★ The implications on China's future direction may jolt Asia markets.

31 OCT — 1 NOV
● FOMC Meeting

DEC

12 — 13 DEC
● FOMC Meeting

14 DEC
ECB Meeting

7 MAY

● French Presidential
Elections (2nd round)

▲ A second run-off between the top two candidates will be held if there is no outright majority in the first run.

25 MAY
OPEC Meeting

26 — 27 MAY
G7 Summit in Sicily

JUN

8 JUN
ECB Meeting

11 JUN
● French General
Elections (1st round)

13 — 14 JUN
● FOMC Meeting

18 JUN
● French General
Elections (2nd round)

22 — 24 JUN
Jackson Hole Meeting

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Positioning for the Year Ahead



The new investment landscape promises novel opportunities and dynamics. However, we must not forget to be cautious in our excitement to explore the newfound territories. We should remain mindful of the potential risks and always seek to understand the terrains before venturing in. Careful planning and thoughtful positioning will help us reap the opportunities intelligently. In this section, we share our thoughts on positioning for the new year ahead, as well as our best ideas and strategies.



Themes and Ideas

2017 ushers in a new regime. On the economic front, better inflation expectations will lend support for interest rates to normalise. Unprecedented shifts in the political scene could drive changes in international ties.



PREPARE FOR RISING INFLATION

The combination of shift toward fiscal policy, rise in protectionism and uplift from wage and oil prices paints a cohesive story for inflation this year. This pickup will give central banks the basis to hike interest rates. Investors hence need to protect their investments, particularly fixed income, from rising rates.

STRATEGIES

Reduce interest rates sensitivity

Switch into short duration products or products with low correlations to interest rates.

Increase income buffer

Edge down the capital structures of fundamentally strong names, or going for higher yielding products with low duration.

SOLUTIONS

Floating rate notes

Coupons are linked to benchmark rates and reset periodically.

Securitised debt

Have lower correlation to interest rates than traditional fixed income instruments.

Short duration high yield bonds and subordinated bonds

Additional yield helps to buffer for potential rate hikes.

CAPTURE GROWTH

In the US, the combination of low growth and inflation will favour equities over fixed income.

A protectionist, anti-globalisation stance portrayed by Trump elicits concerns on a traditionally trade-dependent Asia. However, improving fundamentals and relatively cheap valuations warrant exposure to the region.

STRATEGIES

US sectorial play

Not all sectors benefit equally from a reflationary environment. Policy changes could also have sector-specific impacts.

Protect against idiosyncratic risks in Asia

Focus on assets and sectors with more immunity to upsets in global events.

SOLUTIONS

US Financials and Industrials

Financials could see their profitability improve as rates move higher and if regulations are relaxed. Industrials could benefit from higher spending in infrastructure and capital investments.

Asia, but low volatility

Invest in assets which are less volatile and in sectors that are more domestically-driven.

HARNESS THE UNDERCURRENTS

The reflationary story is clear in US, providing Federal Reserve the support to tighten monetary policy.

Elsewhere in developed economies, growth and inflation are lacklustre, though commodity exporters may benefit from stabilising oil prices.

In Asia, potential risks from a constricted trade channel and dollar strength could dampen growth outlook.

STRATEGIES

Green for greenback

Better outlook in the US and divergence in monetary policy will boost US dollar strength.

Monitor sideways oscillations

BOJ is expected to remain accommodative but the yen's status as a safe haven currency may partially offset weakening due to continued easing.

A stabilising commodity market broods well for commodity currencies. However, concerns over China slowdown could limit upside potential.

Beware of pressured currencies

Prospects in Europe and the UK could be weighed down by a busy political calendar and growth uncertainties.

US dollar strength and potential trade policy changes are likely to cap Asian currencies strength.

SOLUTIONS

Long US dollar and short pressured currencies

We expect US dollar to strengthen against European bloc currencies (euro, sterling) and Asian bloc currencies (Chinese yuan, Singapore dollar and Southeast Asia currencies).

Await for clarity on Japanese yen and commodity currencies

Japanese yen and commodity currencies (Australian dollar and New Zealand dollar) may not necessarily weaken against US dollar.



Asset Class Focus

FIXED INCOME

With inflation likely to increase in 2017, prices of traditional fixed income products will be pressured. Investors should be selective about credits and also consider other options to reduce interest rate sensitivity and take advantage of rising interest rates.



KEY TAKEAWAYS

Investors should position their portfolios in anticipation of higher rates

Cushion interest rate impacts by reducing interest rate sensitivity

Reducing duration of the portfolio could help curtail price declines caused by higher rates. Floating rate note is an example of low duration instrument.

Position your portfolio for higher inflation

Rising inflation is a key concern for fixed income investors. With Federal Reserve normalising its policy rates and inflation expectations creeping up, both the short end rates and long end rates are expected to move higher. Federal Reserve fund rate is targeted to reach 1.5% by end of 2017 from current 0.75% level, and 10-year Treasury yield could hit 3.0% from current 2.5%. Higher rates could erode the values of the traditional fixed income assets. Hence, investors should consider strategies that help position for this change.

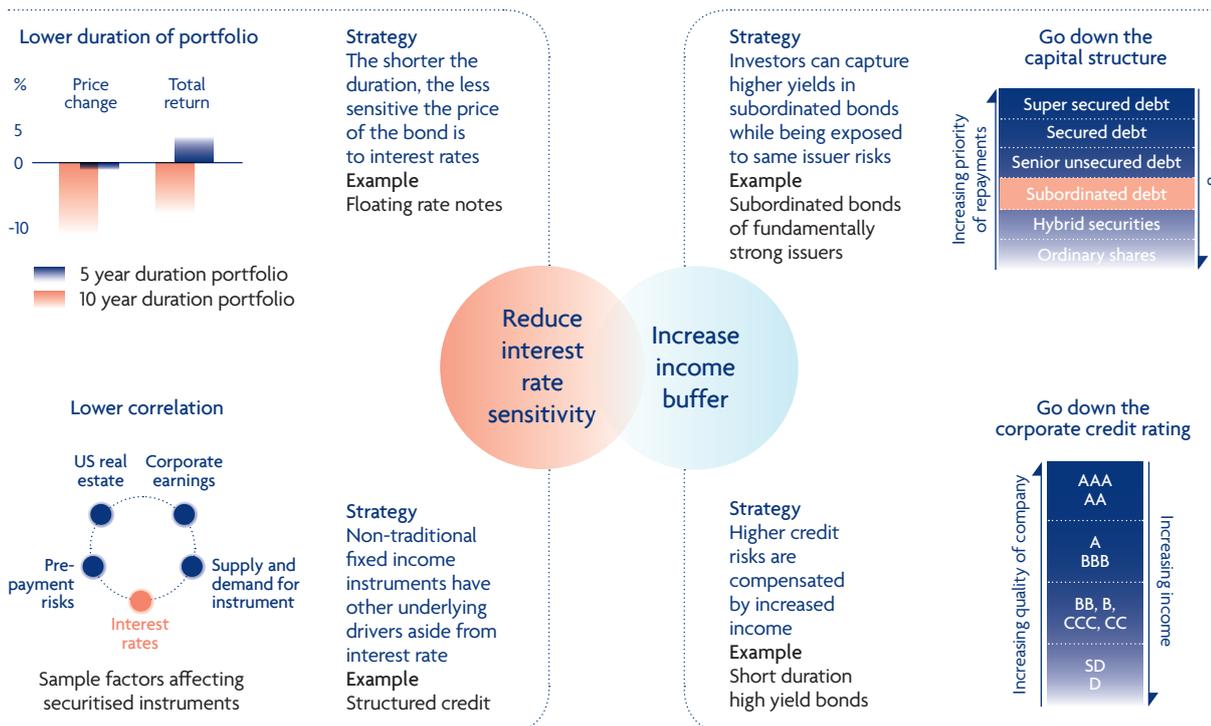
Reduce interest rate sensitivity

Investors could insulate their portfolios from rising rates by decreasing its overall interest rate sensitivity.

One way of reducing interest rate sensitivity is by switching out from products with higher duration and into products with lower duration. In a rising rates environment, products with high duration tend to suffer significant price declines that could not be compensated by the coupons received. Investors may experience negative total return when they sell the products or get stuck holding these low-yielding instruments.

Floating rate note is an example of a low duration fixed income instrument. The product features coupons which are reset periodically based on its referenced benchmark rates, such as the London Interbank Offered Rate (LIBOR). When the referenced benchmark rate rises, coupons on the floating rate note will be revised higher, offering hedge against rising rates.

How to position for higher inflation?



KEY TAKEAWAYS

Securitised debt are less correlated with Treasury yields and can fare well in a rising rate environment

Aside from low duration products, investors could also explore non-traditional fixed income instruments that have lower correlations to Treasury yields. Securitised debt, for instance, derives a significant portion of their values from the real estate market. A gradually increasing interest rate in the US signals an improving economy, which bodes well for the real estate markets and could push up prices for securitised debts.

Increase income buffer to mitigate impacts of higher rates

Increase income buffer
Another strategy through which investors can prepare for rising interest rates is by investing in products with higher coupons. The extra cash flows could help offset negative price impacts from higher rates.

Subordinated and short duration high yield bonds offer higher coupons with limited additional risks

To secure higher coupons without taking on excessive risks, investors can move down the capital structure of fundamentally strong issuers. For example, investors can consider buying subordinated debt instead of senior debt. In exchange for a lower priority of repayment when default occurs, investors get higher coupons on subordinated bonds while essentially being exposed to the same issuer risks. Alternatively, short duration high yield bonds offers attractive coupons. Though such bonds entail higher issuer risks, they typically have short maturities which makes it easier to evaluate risks of default.



Asset Class Focus

EQUITIES

Led by optimism in the US, inflation expectations in major markets have picked up. The boost from increased fiscal policies could also benefit growth and support equity markets. In such reflationary environment, equities generally perform better than fixed income.



KEY TAKEAWAYS

Potential tax cuts and trade deal renegotiation are of primary interest to the markets

Proposed tax cuts and increased government spending from President-elect Trump has boosted growth expectations. However, impacts from a more inward-looking US are unclear and remain a key concern. A “Hard Trump” scenario, in which Trump pushes through protectionist deals at the expense of trade partners, could be undesirable for the global economy as a whole.

Sectorial play is key in an expensive US market

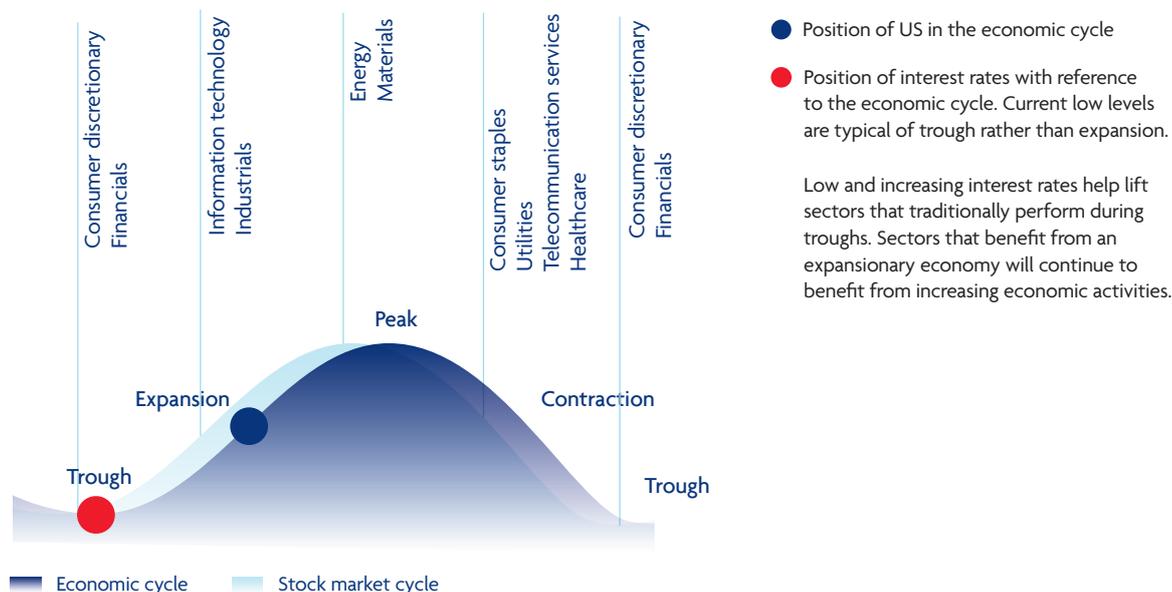
Solid reflation in the US

The reflation story is clear in the US, helped along by Trump’s bold promises. Unfortunately, US equity valuations are rich and getting richer, limiting potential upside for broad market investment. The key is to invest in sectors that benefit most directly in the new investment regime and policy environment. In general, we prefer to rotate out of expensive defensive and bond-like proxies and into more cyclical, growth-oriented sectors.

Financials and Industrials sectors should benefit from a reflationary environment

Financials should see better profitability as interest margins improve following increase in interest rates. The sector could receive further boost if regulations are relaxed under the new US administration. Increased infrastructure spending, driven by an expansionary fiscal stance and an expanding economy, should support the Industrials sector.

Understanding the current economic and interest rate environments can help guide your investments



KEY TAKEAWAYS

A “Hard Trump” outcome could affect prospects in Asia

Asian fundamentals are supportive. Asset valuations are attractive versus developed markets

Ride Asia growth by employing low-volatility strategies and focusing on domestically-oriented sectors

Asia’s inner beauty

In a “Hard Trump” scenario, a protectionist stance by the US could cast shadows on prospects in Asia. Given the region’s traditional dependency on global trade for growth, the possibility of constricted trade channels and depressed earnings could cause investors to shy away.

Despite these potential threats, Asian fundamentals remain attractive and merit investors’ attention. The largest Asian economies aside from Japan, namely China, India and Indonesia, are projected to be amongst the world’s fastest in terms of growth this year. Furthermore, ongoing structural reforms in India and Indonesia could stimulate growth in their domestic sectors, which accounts for a significant portion of their economic activities. In addition, Asian equity valuations are at discount relative to developed counterparts and at fair levels versus its own historical prices. These circumstances therefore support the case for investing in the region.

On the other hand, under a “Soft Trump” scenario, increased infrastructure spending from the US could speed up recovery in global manufacturing and trade, benefiting Asian economies. While a “Soft Trump” outcome is our base case, we still advocate caution. Our advice is to invest in Asia by employing a low-volatility approach and focusing on domestically-oriented sectors. A conservative investment stance could help insulate investors from heightened volatility, should trade relationships turn sour, while allowing them to take part in the Asian growth story.



Asset Class Focus

FOREIGN EXCHANGE

Recent positive US employment data and economic indicators suggest a stronger growth outlook and possibly higher inflation. Federal Reserve is likely to further diverge from other major central banks like ECB and BOJ — embarking on a moderately faster interest rate hike path than previously estimated.

This leads to the relative outperformance of the US dollar against other currencies around the world.



KEY TAKEAWAYS

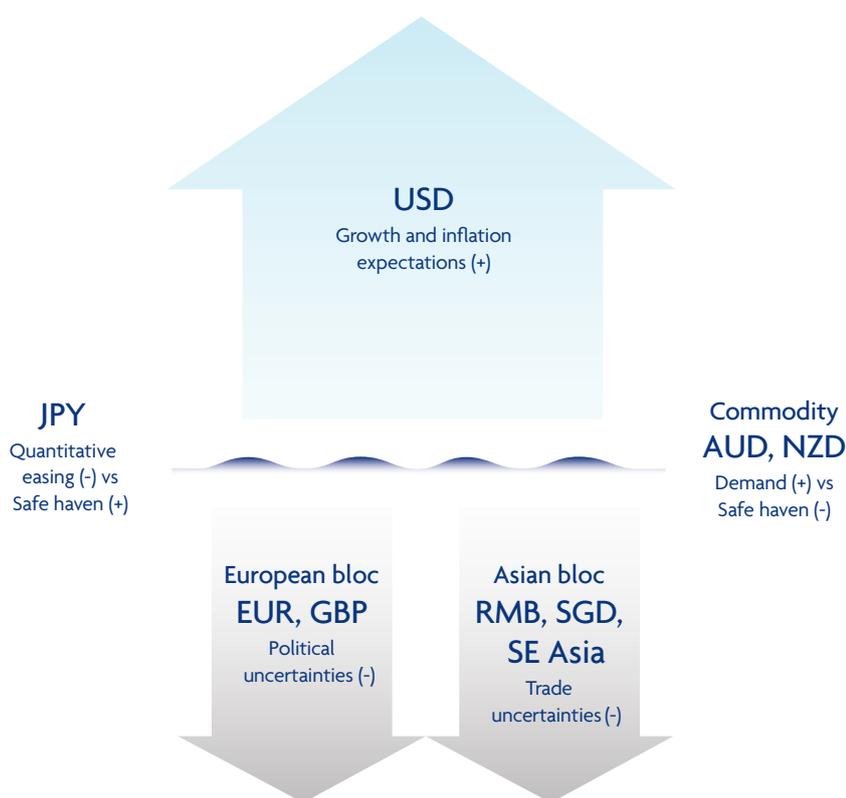
US dollar strength could continue in the medium term

Commodity currencies could be supported by improved demand for resource. However, upside is limited due to potential slowdown in China.

US dollar Trumps the rest

The prospects for a higher growth and rise in US interest rates makes the US dollar more attractive than other G10 currencies. Also, Trump policy-pledges on tax-cuts and infrastructure spendings represent a macro-shift towards a positive stimulus to the US. Expansionary fiscal policies could reflate the US economy and may hopefully lead to stronger growth accompanied by higher inflation. These considerations will be sufficient for the Federal Reserve to accelerate their rate normalisation path, thereby widening the monetary divergence of the Federal Reserve versus the rest of the G10 central banks.

Commodity currencies could benefit from improved demand for resources due to global infrastructure spending. Both Australian and New Zealand central banks have cut their interest rates to historical low levels in a bid to stimulate their economies. On the flipside, if China's demand for commodities continues to slow due to its on-going transformation away from manufacturing, it may limit the upside potential of commodity currencies.



KEY TAKEAWAYS

Yen to weaken on further quantitative easing

The Out-Trumped

BOJ is likely to continue using unconventional tools such as quantitative easing and controlling interest rate yield curve in a bid to pull the economy out of deflation. Yet, after four years of unprecedented easing, the Japanese economy showed limited improvements.

The divergence in BOJ's monetary policy vis-a-vis the Federal Reserve normalising rates favour a weakening Yen preference. However, when investors take safety during times of stress, Yen could be bid up due to its safe haven status.

Euro and Sterling are likely to underperform on political uncertainties

ECB has pledged to extend its asset purchase programme beyond March 2017. However the pace of purchase will be reduced from EUR 80 billion to EUR 60 billion per month from April 2017 till December 2017. The extension could help cushion the volatility from a busy European political calendar. Political uncertainties like the Netherlands, French, German elections and the UK implementation of Article 50 could depress investors' sentiments on the euro and sterling.

Asian currencies could underperform on concerns over trade impacts due to anti-globalisation

The Asian central banks' neutral policy stances create divergence from a more aggressive Federal Reserve. This could lead to general weakening of Asian currencies against the US dollar. Furthermore, investors may be concerned over Trump and other anti-globalisation trade negotiations that could potentially weigh on Asian economic growth prospects.



Menanam Padi di Langit (Planting Rice in the Sky) by Andy Firmanto
UOB Painting of the year 2015 — Established category bronze award



Country Focus

SINGAPORE
MALAYSIA
THAILAND
INDONESIA
CHINA

Thanks to the resilience and ingeniousness of the Asian people, Asian economies have survived many crises throughout the history. Each time, Asian economies emerged stronger. While the global economic outlook set for turbulence, we are confident ultimately Asian economies will make through. In the last section, we will highlight risks and opportunities of each of the five countries — Singapore, Malaysia, Thailand, Indonesia and China.

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IMAGE ON LEFT PAGE

Menanam Padi di Langit (Planting Rice in the Sky) by Andy Firmanto
UOB Painting of the year 2015 —
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It is human nature to search for solutions. *Planting Rice in the Sky* captures the eternal optimism of considering even those options which seem unworkable in an effort to ensure our survival.



Singapore

MODEST RECOVERY IN AN UNCERTAIN GLOBAL TRADE RELATIONSHIP



KEY TAKEAWAYS

Singapore faces challenges from both internal and external forces. Weak business and consumer sentiments continue to weigh on domestic growth while external trade growth is sluggish.

Government efforts, in the form of fiscal stimulus supporting the recommendations from the CFE, could help boost short term growth and lay the foundations for the longer term strategic growth strategies.

Singapore dollar may continue to be under pressure as GDP growth is projected to stay weak.

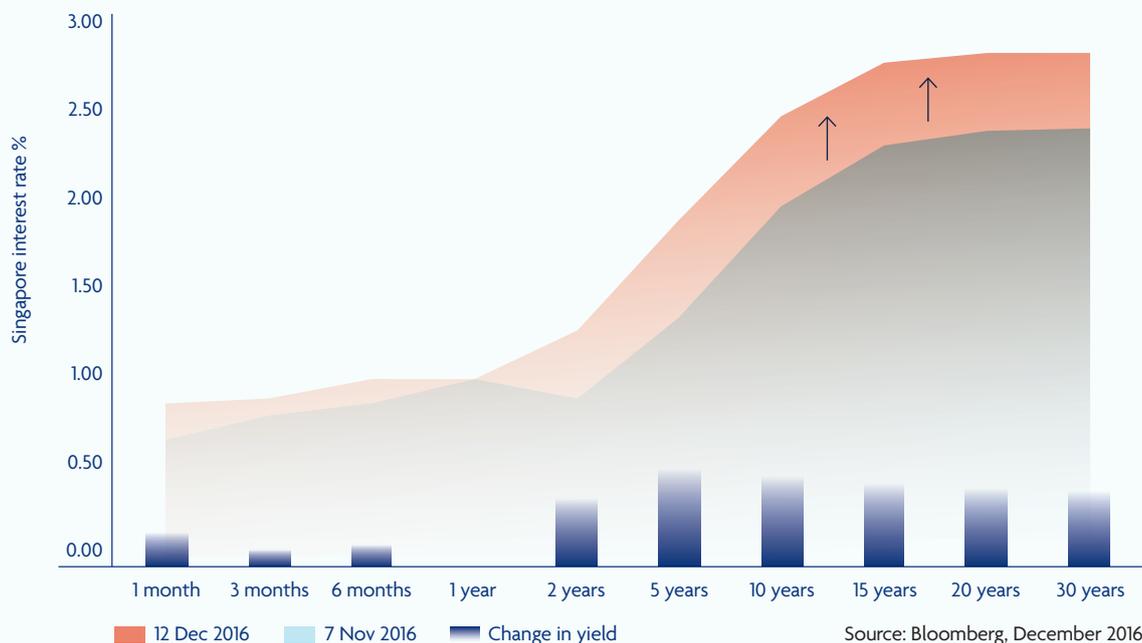
Singapore's open economy faces headwinds from a potential slowdown in global trade. Factors such as weaker business sentiment and higher retrenchment adds to the somber growth outlook. This means that the Monetary Authority of Singapore (MAS) will continue to keep their current monetary stance of a "zero appreciation of the SGD NEER" for an extended period. However, it seems the central bank's hands are tied in relation to any further easing as core inflation has been creeping higher over the past few months.

The role of stimulating growth could now rest on the shoulder of the government. There is an anticipation of more fiscal stimulus, tying in with key strategic recommendations from the Committee for Future Economy (CFE). The CFE aims to keep Singapore economy competitive by helping to position Singapore for the future, as well as identify areas of growth with regard to regional and global developments. This should help boost short term growth while helping to build the foundations for longer term growth. The recommendations from the committee are expected early 2017.

In the short run, Singapore economy may enter into a technical recession (as defined as two consecutive quarters of GDP decline). The third quarter GDP last year inked -2.0% quarter on quarter. Recent leading indicators like monthly retail sales point to a weaker fourth quarter growth. It will therefore be important for the government to introduce short term stimulus to tide through the current rough patch, whilst addressing the longer term structural issues to guide Singapore's future.



Singapore interest rate curve has steepened, in line with US interest rates. Such movements are usually indicative of higher interest rate expectations



Asset Class	Views
Equities	Selectivity is important to participate in the Singapore equity market. The bright spots may be Singapore bank stocks as they are likely to benefit from a steeper yield curve. This improves net interest margins and in turn translates to stronger earnings. Another area to monitor is the commodity stocks, which could benefit from the commodity price rebound on improved global demand from infrastructure spending.
Fixed Income	The Singdollar corporate bond market has suffered five defaults since November 2015, representing SGD 1.1 billion. This is the wake-up call for Singdollar bond investors who have not witnessed bond defaults since 2009 till the recent spate. This calls for investors to critically assess the default risks of the bonds in their portfolio. In addition, investors may want to buffer their portfolios from rising interest rates. Shorter maturity bonds and subordinated bonds of good quality companies are ways to reduce interest rate risks.
Foreign Exchange and Rates	Singapore dollar is likely to continue to decline against the strong US dollar. For now, the weak economic story means that the MAS will continue to keep their current monetary stance of a “zero appreciation of the SGD NEER” for an extended period. The direction of Singapore Interbank Offered Rate (SIBOR) will be primarily driven by the changes in US LIBOR, which is expected to trend higher.



Malaysia

MALAYSIAN ECONOMY IS EXPECTED TO GROW MODERATELY HIGHER FROM 4.2% IN 2016 TO 4.5% IN 2017



KEY TAKEAWAYS

We are neutral on the broad equities market and choose to be selective. Exporters could benefit from stronger US dollar and weaker Ringgit as margins improve due to currency effects. Infrastructure companies with order books related to government projects such as Mass Rapid Transit (MRT) and High Speed Rail (HSR) are also likely to do well.

Bonds are likely to rebound after the recent sell-down, which pushed bond yields to attractive levels. Bank Negara Malaysia (BNM) is expected to continue a dovish monetary policy stance.

Further Ringgit weakness is expected as the bullish dollar trend continues.

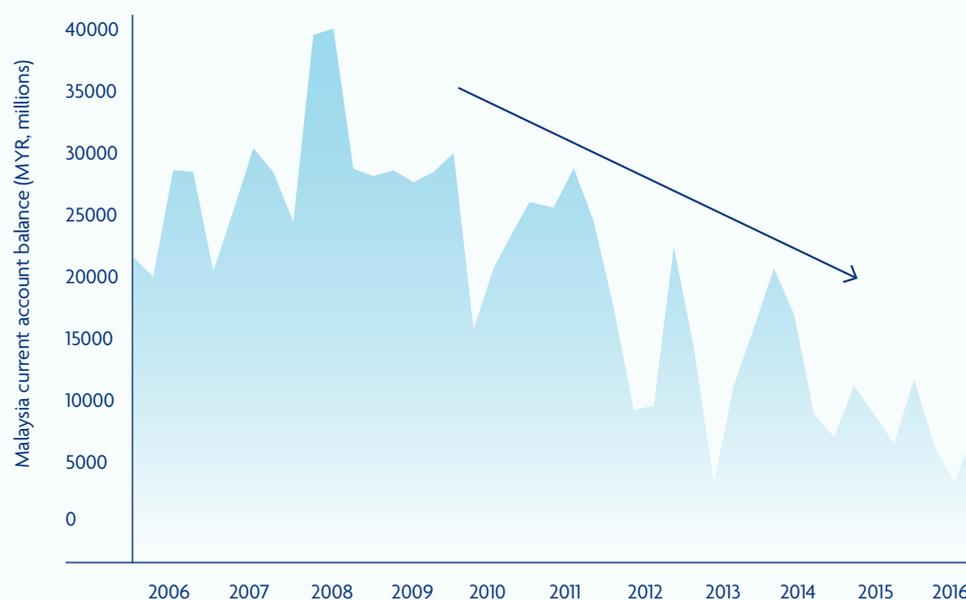
Two-third of Malaysia's economy is driven by consumption, as such both public and private sector spending will continue to be the prime lever of growth. In 2017, commodity exporters which benefit from increased global demand, may outperform. If oil prices continue to climb, this may contribute positively to the Malaysia's economy.

One key highlight for Malaysia economy this year is the commencement of a large-scale project called myCorridor, of which the government has identified five economic growth corridors to develop these strategic investment regions. This will be in the form of public-private partnerships which is likely to attract foreign investments.

In view of the headwinds on growth, Malaysia needs to continue to manage the balance between monetary and fiscal measures to support growth, ensure stable inflation, manage financial risks and maintain fiscal prudence. Foreign reserves has declined due to portfolio outflows amid foreign selling of bonds and equities. This led to Malaysia's foreign reserve cover of short term external debt to be the lowest, compared to regional peers. We expect Bank Negara Malaysia (BNM) to maintain neutral stance on the overall economy as exposure to external debt might be a strong constraint for rate-cuts.



Malaysia current account balance has been declining. Currently it is at the lowest levels in a decade



Source: Bloomberg, December 2016

Asset Class	Views
Equities	Overall, we are selective on opportunities in Malaysia's equity market. Exporters might benefit from stronger US dollar and weaker Ringgit, while infrastructure companies with order books related to government projects such as Mass Rapid Transit (MRT) and High Speed Rail (HSR). will benefit with the acceleration of the projects.
Fixed Income	Positive – Malaysian bonds are benchmarked against the Malaysian Government Securities (MGS) which were sold down after Trump's election victory but has eased recently. We expect a recovery in bonds after the recent sell-down pushed bond yields to oversold and attractive levels. Furthermore, as the risks to growth are tilted to the downside, we expect BNM to continue its dovish monetary policy stance which should be supportive to bonds.
Foreign Exchange and Rates	Ringgit might continue to have weakness as the bullish dollar trend continues. We have revised our foreign exchange outlook under the assumption of a "soft" Trump scenario. Near-term we expect USDMYR to overshoot previous highs before some consolidation this year. While the BNM is likely to stay focused on managing growth risks this year, the pressure to ease rates could be limited by volatility in the financial markets and a weaker Ringgit. We believe the policy rates would remain largely unchanged around 3% until the end of 2017.



Thailand

STABLE ECONOMIC GROWTH EXPECTED TO CONTINUE, DRIVEN BY DOMESTIC DEMAND, GOVERNMENT SPENDING, AND TOURISM)



KEY TAKEAWAYS

Despite global political landscape, low level of foreign holding in bonds should lead to cushioned impact.

Thai Baht could have further downside as the central bank is likely to keep its policy rate relatively stable compared with the rising trend from Federal Reserve.

Moderate economic growth driven by internal factors should keep Thai Equity Market less susceptible to volatility created by external noise.

Thailand's economic growth is expected to be driven by various fiscal programs focused in private consumption. Tourism in Thai which contributes approximately 10% of GDP could be further stimulated by government program to increase domestic tourism and it is expected to remain on track to grow by 10% in 2017. This will offset lower revenue coming from the decline of European tourist spending in the country.

The first-car tax rebate program ending in third quarter 2016 could also liven up the second hand cars market quite strongly. While government subsidies to farmers and low income earners is expected to stimulate consumption from rural areas. These consumption programs offset the concern coming from decline in foreign direct investment of auto manufacturing industries due to political uncertainties.

Given relatively stable economic backdrop and manageable inflation, the Bank of Thailand (BOT) is expected to keep its rate unchanged. Consensus for earnings growth is expected to remain at 12% after the country's benchmark index SET had a good run in 2016 with foreign fund flowing back nearly 100 billion Baht (after 3 consecutive years of outflow).



Increasing tourism in Thailand will continue to be a driver for the economy



Source: Bloomberg, December 2016

Asset Class	Views
Equities	Thai stock market with heavy weight on energy sector will continue regain its footing as oil price stabilise. Domestic and tourism related sectors are likely to outperform due to high spending. Meanwhile telecommunication sector will face fierce competition and increased depreciation from new bandwidths. In the banking sector, non performing loans should peak around the first half of 2017.
Fixed Income	Recent rapid rise in US treasury yield pushed Thai 10 year bond yield up to 2.74%. As BOT is expected to keep its policy rate unchanged, manageable inflation backdrop and low-level foreign debt holding, the impact for bonds market should be minimal. We favour short term tenor bonds in an expected gradual rising yield environment.
Foreign Exchange and Rates	With Federal Reserve continue raising its rate and BOT expected to remain on hold with policy rate (1-day-repo) at 1.5%, monetary divergence might continue to affect the foreign exchange environment of Thailand. Backed by strong current account surplus and foreign exchange reserve, any Thai Baht movement will be cushioned in the event of any disruption move in the market.



Indonesia

OPTIMISM IN PRUDENCE THROUGH UNCERTAIN TIMES



KEY TAKEAWAYS

US is Indonesia's largest export destination and fifth-largest import source, any changes by the country's government towards global trade would affect the nation's net export.

Indonesian Rupiah is expected to remain stable with the support from tax amnesty's repatriated fund and improving foreign reserves.

The Non-Performing Loan for corporate lending that stays above 3% remains the underlying concern for Standard & Poor's (S&P) to upgrade the nation's sovereign debt to investment grade.

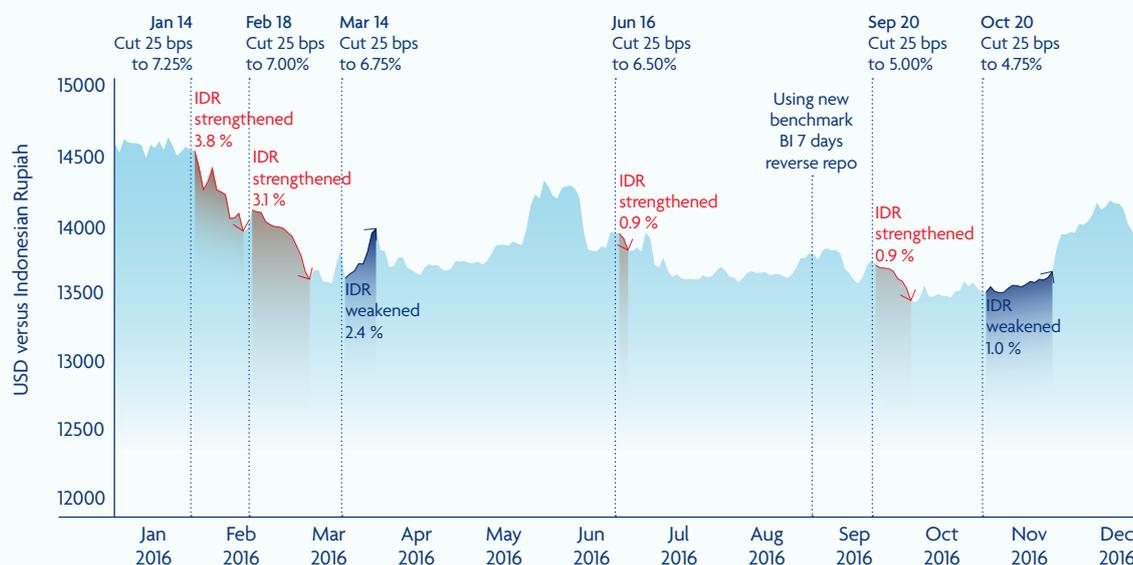
Slowing government spending realisation and cuts in government budget in Revised State Budget 2016 remain the key issue that affects the GDP growth rate of Southeast Asia's largest economy. The resource-reliant economy has also been affected negatively by low global commodity prices and the weak demand by its major trading partners.

On a positive note, the implementation of tax amnesty since mid of 2016 has helped the government secured more than IDR 98 Trillion in state revenue. This serves as a cushion to support the aggressive infrastructure spending plan amid budget shortfall. The launch of the 14 financial packages also come into effect to boost the economy.

The central bank is expected to remain easing-bias after delivering 150 bps rate cut last year. With exports making less than 20% of its GDP in 2015, Indonesia is less vulnerable to the potential risk of protectionism policies. The government reform agenda towards massive infrastructure investment may drive demand in construction, building materials and heavy equipment sectors. Recovering commodity prices such as coal, palm oil, oil and gas are expected to improve the nation's trade balance.



Indonesian Rupiah remains resilient despite rate cuts by Indonesia central bank



Source: Bloomberg, December 2016

Asset Class	Views
Equities	Infrastructure and deregulation could remain the key priorities for the government this year. The ease of doing business, weaker Rupiah and lower cost of fund are expected to attract more investments both internally and externally. Correction in consumer stocks and upward earnings projection in mining sector also give attractive valuation for local equities.
Fixed Income	Local currency government bonds, with large yield differential against both US Treasuries and Indonesia inflation, are still considered some of the most attractive inflation-adjusted investments. The requirement for the insurance company and pension fund to invest at least 30% of the portfolio in government bond and the plan to reduce capital gain tax for bond to zero percent implemented by the government may boost the bond's demand in the coming year.
Foreign Exchange and Rates	The central bank has cut interest rate six times in 2016. With inflation remaining under control, the central bank is comfortable with the current rate. Having current benchmark rate (7-days reverse repo) at 4.75%, we expect Bank Indonesia (BI) to at least maintain the rate in first half of 2017. Improvement in the trade balance and increasing foreign reserve are expected to offset the downward pressure and maintain the currency within the target range set by the government.



China

'L-SHAPED' ECONOMY TREND WILL CONTINUE IN 2017



KEY TAKEAWAYS

Uncertainties of Trump's policies may have negative impacts on Asian market including China via trade and currency channels.

The continued capital outflow and Yuan depreciation could weaken the confidence of China's economic stability.

Larger local debts and higher corporate leverage are still the concerns in the bond market, but the improvement in local debt swaps and debt-to-equity could ease these concerns.

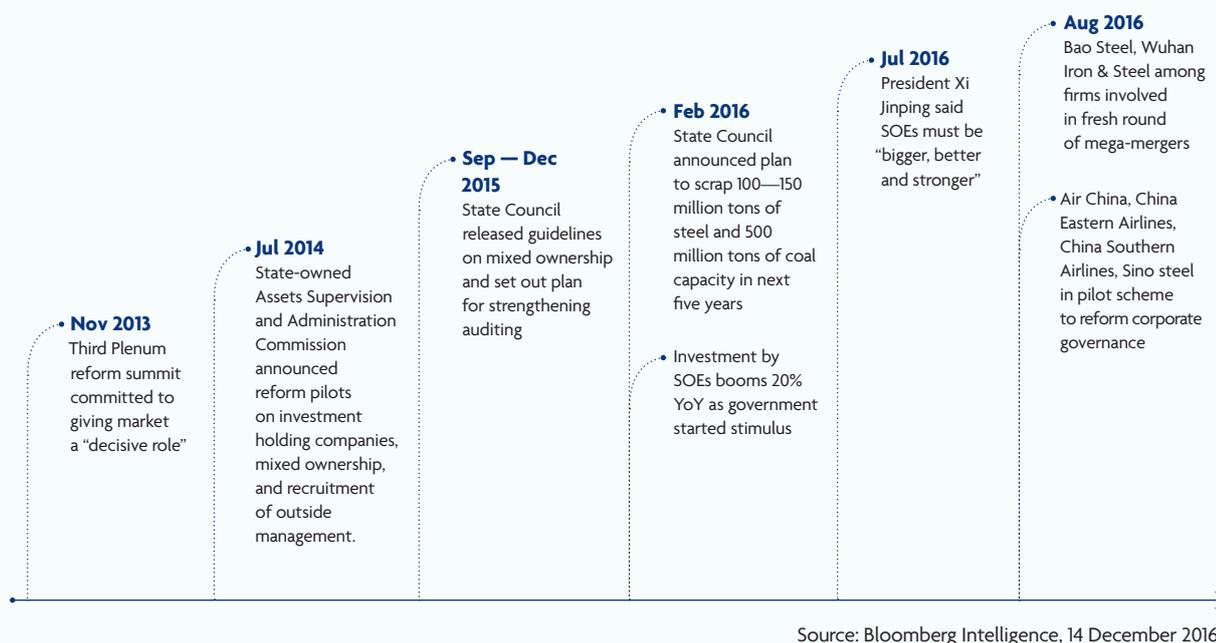
The economic indicators show that China's economy has stabilised in recent months. Both industrial production and fixed asset investment improved moderately. However, the decline in retail sales growth suggests that domestic demand is still weak while the severe overcapacity also drags down the growth expectations. Therefore, we expect that China's L-shaped economic trend will continue this year.

Recently, the government has accelerated the process of capacity reduction, especially in the steel and coal industries, and State-Owned Enterprises (SOEs) reform. This capacity-reduction is expected to boost the steel and coal industries. The metric for Producers Price Index in October 2016 reached the highest level since 2014, which could translate to higher inflation in the first quarter of 2017.

The rising inflation expectations and continued capital outflow could limit the room of further monetary easing. Thus, we believe People's Bank of China (PBOC) is likely to remain the neutral and slightly tighten policy stance in the first half of 2017, while the fiscal stimulus lever may speed up.



SOEs reform momentum has been robust



Asset Class	Views
Equities	The acceleration of structural reforms will be the main driver for Chinese equities in 2017, and corporate earnings are expected to improve, especially in some “New Economy” industries, such as Consumption, Healthcare and Information Technology. SOEs are expected to benefit from a faster reform process, which are likely to improve SOEs’ efficiency, transparency and competitiveness. Meanwhile, Shenzhen-HK connect program may provide new flows into the stock market.
Fixed Income	With higher Federal Reserve rates and the tight corporate spreads, local bond market is expected to be under pressure in the near term. This is amplified by higher local inflation, which is expected to kick in during the first quarter of 2017 due to government’s action in reducing capacity in sectors such as steel, coal and cement. However, the sell-off in the bond market may provide a good entry point for long term investors.
Foreign Exchange and Rates	Yuan is likely to remain under pressure against US dollar, as higher inflation expectation in the US may force the Fed to adopt a more hawkish stance. On policy rates, scope for PBOC is constrained by the surge in US Treasury yields. We expect PBOC to keep its benchmark interest rates and Reserve Requirement Ratio (RRR) rates unchanged at current levels.

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