MARKET COMMENTARY

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This month, we will touch upon the investment merits of the Indonesian equity market and why we remain positively positioned.

CARTOON BY: HEDGEYE

OUR HOUSE VIEW

<u>Still Positive on Asian Equity Markets</u>

- We stay steadfast in our view of a potential multi-year bull market for Asian equity markets. As the months of this rally unfold, we are mindful of the risk of set-backs, particularly with uncertainties over the US Fed's unwinding of its asset purchase program and closer to home, the North Korean geopolitical tension closer to home.
- Incrementally, positive vibes have built upon an even more gradual US interest rate normalization cycle than earlier envisaged. A more benign unwinding of the asset purchase program to be detailed will only serve to support this virtuous equity cycle.
- Our own Asian economic cycle appears to be still gathering momentum with a stellar second quarter earnings reporting season, particularly coming out of Hong Kong and China. We are likely to see further upgrades to earnings expectations, which in turn should continue to justify this equity market rally.
- We expect the local market to trade range bound in the month of September on the back of weak buying momentum among the institutional investors as a direct result of the current geopolitical tensions and lack of major domestic catalysts to drive the market higher. Nevertheless, any corrections in the market is a good opportunity to rebuild our equity positions

PERFORMANCE OF KEY INDICES

FIGURE 1

	AS AT 31.08.17	1 MTH (% change)	YTD 2017 (% change)	PER 2017
D. JONES	21, 948.1	0.3	11.1	18.9
NASDAQ	6, 428.7	1.3	19.4	40.7
DAX	12, 055.8	-0.5	5.0	17.5
KLCI	1, 773.2	0.8	8.0	16.8
USD / MYR	4.27	-0.2	-4.8	-

SOURCE: BLOOMBERG (AS AT 31/08/2017)

WHO WILL BE RIGHT ABOUT INDONESIA?

There lies a potentially great opportunity, i.e. make or break, investment case in the Indonesian equity market.

The Disconnect Between Bonds, Currency, and Equities

On May 19, 2017, the largest credit rating agency S&P Global Ratings raised Indonesia's credit rating to investment grade, bringing them in line with the other two main rating agencies, paving the way for more investor interest into Southeast Asia's largest economy and the world's fourth most populous country.

S&P's upgrade was what it sees to be prudent fiscal management on top of a successful tax amnesty program, reducing Indonesia's vulnerability to systemic shocks. Since then, Indonesia's 10-Year bond yields have compressed substantially, reflecting the improved credit rating.

FIGURE 2: INDONESIAN 10 YEAR GOVERNMENT BOND YIELD (2012 – 2017)

SOURCE: BLOOMBERG (DATA AS AT 13/09/2017)

Indonesia, as with most emerging economies, suffered in year 2013 from the first negative effects of the US Fed's intention to normalize its asset purchase program, the event now commonly known as the Taper Tantrum. There is still considerable room for bond yields to compress, notwithstanding the fact that, the bond yields of Indonesia's immediate investment grade neighbours are much lower.

Asia's 10 Year Government Bond Yields	
China	3.64%
Malaysia	3.83%
Philippines	4.95%
Thailand	2.40%
Vietnam	5.38%

Since then, on August 22, 2017, Bank Indonesia surprised investors by cutting its benchmark seven-day repo rate from 4.75% to 4.5%, citing subdued inflationary pressure and a need to support economic growth.

It is interesting to note the reaction of the currency, the Indonesian Rupiah, to the benchmark rate cut. The Indonesian Rupiah has gone from strength to strength with a sharper move to the upside in the last few sessions.

FIGURE 3: U.S. DOLLAR - INDONESIAN RUPIAH CROSS RATE (2012 – 2017)

SOURCE: BLOOMBERG (DATA AS AT 13/09/2017)

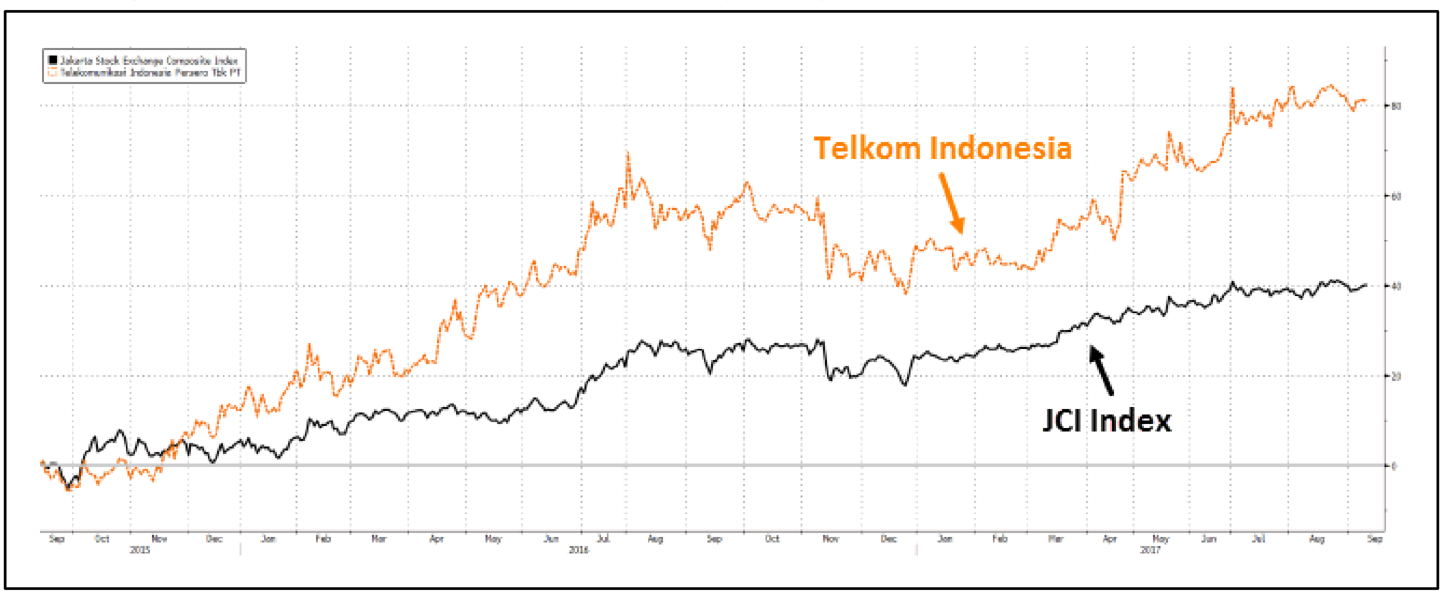
One dilemma Central Bankers faces is the fear of a loss of confidence and the exodus of capital. In this case, the rate cut decision was taken positively by investors, that it could be the catalyst for a bump-up in economic growth momentum.

Despite the recovery, the Indonesian Rupiah, as with bond yields, remains substantially below the levels prior to Taper Tantrum. Similar to the bond market, there is still a long way to go for the continuous appreciation of the Indonesian Rupiah.

<u>When Will Equity Investors Regain Their Confidence?</u>

Given the much improved economic fundamentals of the country, we expect the Indonesian equity market to start to mirror the moves of the bond and FX markets.

FIGURE 4: JCI INDEX vs TELKOM INDONESIA (2015 – 2017)

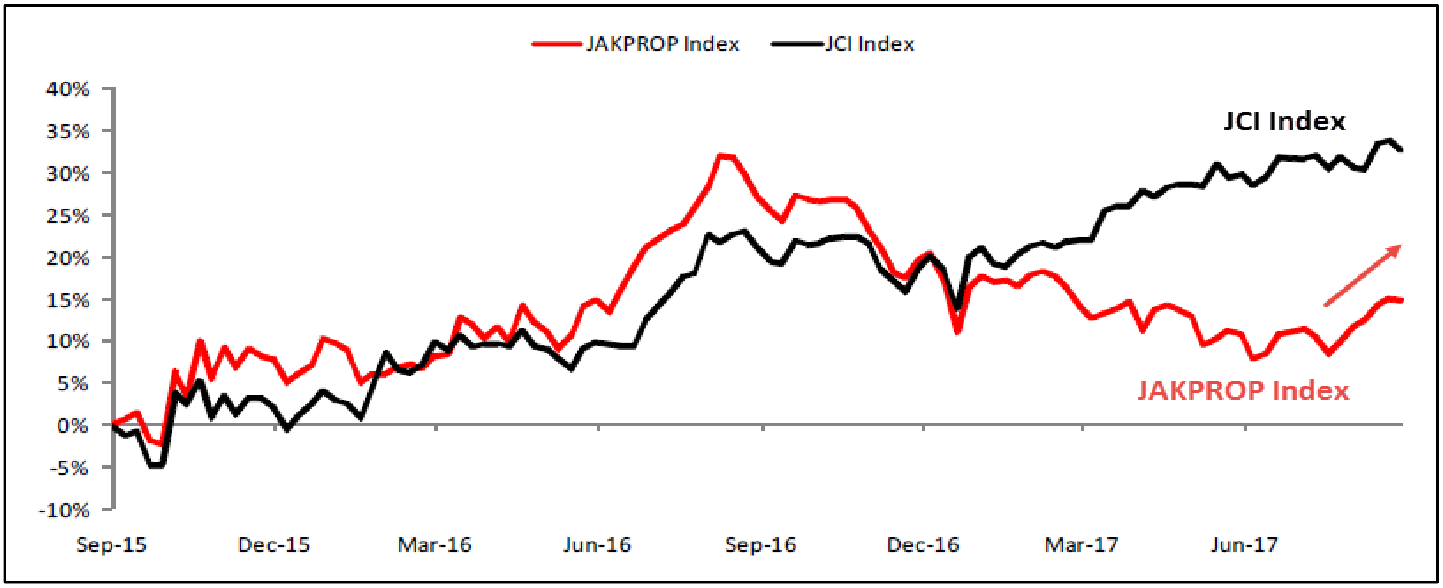


SOURCE: BLOOMBERG (DATA AS AT 13/09/2017)

Clearly, the Indonesian equity market has yet to reflect the same optimism judging by the narrowness of the turnaround. A dichotomous situation has emerged, with the likelihood of passive index investing having led to a small number of large index names leading the market.

We are of the view that as economic momentum picks up, there should be a broadening of the market rally. Hopefully, confidence-driven and interest rate sensitive sectors such as real estate should start to outperform.

FIGURE 5: JAKPROP INDEX vs JCI INDEX (2015 – 2017)



SOURCE: BLOOMBERG, SINARMAS INVESTMENT RESEARCH

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