



Market Outlook



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Fed Watch (Monetary Policy)

* Tapering has begun and will continue

- QE3 US\$85Bn asset purchase reduce by US\$10Bn in Dec
- Expect similar tapering pace and end of QE3 by late 2014
- Yellen and Fischer taking over as the new Fed Chair and Vice Chair
- Focus on forward guidance but this will potentially be a source of volatility as numbers like US unemployment hovers now at 6.7% near the 6.5% levels that the Fed has indicated it will review its policy



US Economic Pulse

* Growth momentum to continue and dominate

- Growth over taper fears will lead
- Economic data pointing momentum to continue
 - ADP Dec number 238K vs Nov 229K
 - Jobless claims decreased to 326K vs previous 328K
 - Retail Sales increase 0.2% vs. expected 0.1% despite the storm
 - Dec NFP 74K Vs expected 197K
- Reduce drag from fiscal tightening with new budget deal
- Boom in shale gas improving US competitiveness



US Risk

❖ US equities grinding higher but...

- 75% of 2013 gains were on PE expansion
- Valuation no longer has a strong buffer against downside
- Potential disappointment from Corporate Earnings
- Mid term elections and continue hung Congress
- Debt ceiling issue still looms (7th Feb 2014 and extraordinary measure will push the ceiling up till early Mar)
- Potential miscommunication by the Fed of its forward guidance



US Outlook

❖ US equities grinding higher but...

- Expect normalize return of 5% to 10% in 2014
- More volatility on the way up, bigger swings both up and down
- Wealth effect driven by both higher equities, housing value and improve employment outlook will help spur consumption
- Less political uncertainty may also help unlock capital expenditures from corporate
- Spillover effect to benefit Asian exports



Eurozone Headlines

❖ **From Austerity to Modest Economic Recovery**

- GDP rose just 0.1% in Nov compare to 0.3% previously
- Factory output grew faster 52.7 from 51.6 in Nov (highest in 31 months and above consensus of 51.9)
- Further easing of fiscal austerity
- Stronger corporate balance sheet and pent up demand from the long recession will help fuel this economic recovery

❖ **Dovish ECB and potential monetary easing**

- Inflation has been on the low side and this may prompt the ECB to ease monetary policy to fight deflation

Eurozone Spotlight

❖ Risk and issues to watch for

- ECB AQR, which is a stress test on the Eurozone banking system. If done in a credible manner could help restore confidence in the financial system
- Upcoming European Parliament election could bring in some “Eurosceptic” parties and bring some policy uncertainties
- End of Portugal bailout programme could be an important indicator for of what is to come for other PIGS nation



Eurozone Outlook

❖ Shifting from Crises Mgmt to Recovery

- ECB maintain biases to ease to support the recovery amid a benign inflation levels
- Even though the Eurozone is still a long way to recovery, the positives are it will not be the cause of major swings in the medium term and there is still some upside on this one



Japan Headlines

* **Abenomics in action**

- Large Corporate business sentiment hitting 6 year highs 
- SME Index on business conditions finally turn positive after 6 years on weaker yen, firm domestic demand and stimulus
- Japanese Core machine orders rose 1.2% in Nov doubling Oct
- Increasing corporate expenditure and wages is key to the Japanese recovery

* **Dovish BOJ**

- BOJ stands ready to ease to support the recovery if the consumption tax takes its toll on the growth momentum 

Source: Bloomberg, Reuters, HSBC Research

Japan Outlook

❖ Still looking positive

- The Nikkei looks set to climb higher but at a more normalized way after more than 48% gain in 2013
- Confidence is finally coming back to the world's third largest economy after more than a decade of deflation
- As US tapers and BOJ starts easing it will help weaken yen or keep the yen weak hence helping Japanese exports and the Nikkei



China Headlines

* An Economy in Rebalancing



- China credit growth slows on curbs by government
- Lower growth targets for Chinese provinces and national target could come in at 7% GDP growth for 2014
- HSBC Dec Flash PMI at 3 month low of 50.5 from Nov's 50.8, below expectations of 50.9
- External demand from recovering developed economies is set to help hold steady the growth momentum

China Risk

* Execution risk

- More market oriented development of its capital market
- Look at controlled default of some small corporate/banks onshore to allow pricing default risk (absent now)
- Always the risk that things can still spiral out of control and spillover to something larger

* Slower than expected Growth

- Given the obsession with the headline GDP growth lower than market expectation will have a negative impact



China Outlook

* **Short term pain for long term gain**

- The structural adjustment to a sustainable consumption growth model is taking longer than expected and could weigh on the market from time to time
- A lot of positives in the Chinese reforms packages announced during the Third Plenary but the devil is always in the execution and be a source of volatility in the short term
- Still expecting 2014 GDP to be within the range of 7% to 7.5% (above what they announce)

Piecing it altogether

* A year with increase volatility

- DM equities will likely do better than EM Equities
- Within EM countries, there will be pockets that will do better like Singapore, Korea and Taiwan who are more expose to US growth
- Bottom up approach more important than top down selection
- Sector likes include Offshore & Marine sector, Selective Plantation, Construction and Technology





Thank You !

Other Risk

* Thailand

- The extended protest has already started to affect the real economy through its tourism sector and there could be potential further clashes and/or military intervention but Thailand GDP is small hence do not expect much spillover effect to other regional economies

* Frosty China and Japan relationships

- This Frosty relationship that spans from the Diaoyu island to China's Air Defense zone is a common feature of China and Japan relationship as the two vie for dominance but given the deep rooted economic relationship between the two, economic considerations will still come first

China's Third Plenary

* **Reform-oriented leadership**

- There are several important structural reforms announced to lift China's GDP potential and help abate some of the fears that the world has on the Chinese

* **Major reforms include**

- Changes in the Hukou and Population reforms (to promote Urbanization, alleviate declining working population and promote a domestic consumption economy)
- A greater role for the private sector (efficient resource allocation)
- Financial sector liberalization (to mitigate the problem of shadow banking due to negative yields in deposit rates)

Source: Bloomberg/Deutsche