

16 March 2016

KFM Investment Committee Report

The KFM Investment Committee met this week, and the following summarises our view of the markets over the next six months.

MARKET OUTLOOK (6 MONTHS)

	Current Measure	Previous View	Current View
PNG Macro Environment			
Real GDP Growth (2015) <i>Source: PNG Budget</i>	9.9%	→	↓
Inflation (trailing 12m) As at December 2015 (NSO)	6.4%	↑	↑
PGK/USD	0.3265	↓	↓
PGK/AUD	0.4317	→	→
PNG Cash & Fixed Income			
28 days CBills	1.18%	→	→
182 days TBills	4.76%	→	→
5 year GIS	11.33%	↑	↑
10 year GIS	11.16%	↑	↑
PNG Equities			
KSI	3,373.1	→	→
KSI Home	9,120.6	→	→
Global Macro Environment			
Implied World Growth 2016 <i>Source: World Bank</i>	3.4%	→	→
International Cash & Fixed Income			
US 10Y Bond yield	2.0%	↑	↑
International Equities			
MSCI ACWI	US\$181.3	→	→
Commodities			
Oil (WTI) (barrel)	US\$38.5	→	→
Gold (troy ounce)	US\$1,259.4	→	→
LNG (mmBtu)	US\$4.5	→	↓

KFM INVESTMENT COMMITTEE MEMBERS

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PNG Macro Environment

Considering the price assumptions made in the 2016 Budget in comparison to the current market which is still lower than the budget, KFM believes that GDP growth will be lower than the budget forecast of 4.3% largely due to the impact of decline in global commodity markets and affected key market sectors such as agriculture, energy, mining and resources. **National Statistics Office announced the CPI update for December quarter was 1.9% putting 2015 inflation at 6.4%. KFM believes inflation will increase over the next six months largely driven by the Kina's continuing downward momentum against the USD**

PNG Kina

The PNG Kina has continued to depreciate against the USD over the last 12 months to levels now below pre-trading-band stage mainly due to a strong US dollar and disparity between supply and demand for foreign currency in the PNG FX market. And with the official FX reserves now at a 5-year low of US\$1.8bn compared to US\$2.6bn twelve months ago, we maintain the view that the Kina will continue its downward momentum in relation to the US\$ and will fluctuate in relation to other foreign currencies over the next six months.

PNG Cash & Fixed Income

KFM maintains that short term rates will remain flat at current levels. Subscription activity for government securities was subdued reflecting weak investor appetite for longer dated stock over the last six months. Nevertheless, the materialisation of the sovereign bond issuance remains uncertain while **noting that no inscribed stocks were issued in the past two months and as such, long term rates are expected to see an increase over the next six months.**

PNG Equities & Property

Business adaptability in the current environment; subdued economic activity, FX restriction and competition will be the key to overall performance, with the exception of industries which could be affected by external factors. KFM expects equities to remain largely flat driven by a divergence in the performance of the market's larger constituents. Based on data analysis, KFM maintains its view that property market will come under pressure amidst increasing stock and competition.

Global Macro Environment

The downward economic momentum in China, weak commodity prices and geopolitical tensions in Europe and Middle East will continue to effect slow global economic growth. **The Fed announced their decision to hold rates steady and reducing their expectations for growth, inflation. The ECB continues its efforts to help boost the economy however markets remain unmoved about the effectiveness of measure taken. KFM maintains the view that global growth will remain subdued in light of continued diverging economic growth trends around the world**

International Cash & Fixed Income

KFM maintains its view that most bond yields will remain at current low levels supported by low inflation, weak economic fundamentals, expansionary monetary policies and strong US dollar. Meanwhile US Bond prices are expected to decline off the back of the increase in rates following indications of a strengthening labour market in the long term

International Equities

Whilst we expect volatility in the interim, fuelled by investors' risk-averseness amidst geo-political tensions, and an anticipated, gradual tightening of the Fed's Monetary Policy, we remain cautiously optimistic on equities over the longer term as an asset class supported by expansionary policies in regions of subdued growth, and increasing confidence in the US

Commodities

In light of slowing global growth and continued mismatch between oil supply and demand, KFM expects oil prices to remain under pressure. Although gold prices continue to exhibit volatility, we still expect prices to remain flat. Also affected by slowing global growth is the price of copper, a key commodity with its wide range of industrial uses. **LNG prices will continue to remain under pressure in light of uncertainty around demand levels noting recent decline in energy import levels in Japan and South Korea and increase in number of LNG producers with Australia expected to overtake Qatar as top LNG producer by 2018.**

Sources: BPNG, 2016 PNG Budget, NSO, IMF, World Bank

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