

Indonesia: Jokowi under pressure as the vested interests fight back
Singapore: Clear signs of economic deceleration

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Indonesia: Reformist president faces backlash from unreformed segments of the system

- The anti-corruption commission, the one institution which voters rated as credible in Indonesia, might soon be effectively neutered following a series of setbacks including strange charges brought by the unreformed police against senior anti-corruption officials and a number of court rulings which could severely limit the effectiveness of the commission's investigative work.
- President Jokowi appears to be struggling to defend the commission, constrained by his party leadership, his lack of a parliamentary majority and the conduct of institutions he does not fully control such as the police.
- The implications are potentially serious: If the momentum against reform continues unchecked, Jokowi will fail as a reforming president.

Singapore: Broad-based weaknesses portend a weak 2Q15

- We expect a weak 2Q15 on the back of a decelerating economy buffeted by myriad headwinds. Industrial production, exports and the labour market have been lacklustre.
- Singapore's external trade figures are worrying, and could point to a structural loss of competitiveness, with a possible relocation of activity. The downturn in trade consequently means that manufacturing and wholesale trade are adversely affected.
- The sectoral weaknesses in wholesale and retail trade, real estate and financial services means that approximately 40% of overall GDP is facing potential contractions.
- However, some positives are emerging: the fortunes of the G3 economies are looking up, government spending is expected to be elevated and a recent report reflected the enduring attractiveness of Singapore as an investment destination.

Key Drivers of Asian Economies

Variable	Development/Assessment
Financial market risks are growing	
US economy	<p><u>Improving prospects but not enough to change expectations of Fed policy</u></p> <ul style="list-style-type: none"> ▪ Conference Board Leading Indicator rose 0.7% m/m in May 15, similar to the 0.7% increase m/m in Apr 15. ▪ Housing recovery building momentum: The home builders' confidence index soared from 54 in May 15 to 59 in June. Current and future sales expectations registered their highest levels since 4Q05. Housing starts fell in May but this was off an unusually strong April number, the April-May numbers were still the strongest since early 2008. ▪ Consumer sentiment firmed: The University of Michigan index surged from 90.7 in May to 94.6 in June. ▪ But current industrial production remained weak, falling 0.2% m/m in May, after falling 0.3% m/m in April, the 6th month of contraction.

Variable	Development/Assessment
	<ul style="list-style-type: none"> ▪ Deflationary fears ebbed: CPI inflation at 0.4% m/m or 0.0% y/y in May 15, from 0.1% m/m and a decrease of 0.2% y/y in Apr 15 respectively. <u>Fed policy remained unchanged in Jun 15</u> ▪ The Federal Reserve Bank signals turned a tad more dovish in its latest policy statement. Despite an improving economy, the Fed downgraded forecasts for economic growth and unemployment this year. The “dot plot” of Fed governors’ expectations of policy rates for the end of this year also showed a dovish tilt compared to the previous meeting. ▪ Implications: The Fed’s policy signals are making markets complacent about the pace of policy normalization, which is a grave mistake. Should the economy rev up as is almost certain, the recalibration of market expectations could be abrupt and much more destabilising. Should rates continued to be held at depressed levels, financial risks such as asset bubbles could be exacerbated.
<p>Eurozone: Greek bailout talks</p>	<p><u>Make or break talks on Monday</u></p> <ul style="list-style-type: none"> ▪ Financial markets remained largely nonchalant despite discomfiting signals from talks over Greece’s bailout package and an accelerating pace of withdrawals of deposits from Greek banks: an estimated €4.2bn last week, or about 3% of total deposits, with EUR1bn withdrawn on Thursday alone. ▪ After negotiations between Greece and its creditors collapsed and an emergency EU summit meeting was called for 22nd June, German Chancellor Merkel warned Greek Premier Tsipras to present a revised Greek proposal before the summit started or face a crisis. Over the weekend, Tsipras presented Merkel, French President Hollande and EU Commission President Juncker with such a proposal but it is not clear how far that proposal went in meeting the creditors’ demands. ▪ Tsipras is under huge domestic pressure to cut a deal. Thousands protested outside Parliament calling on the government to ensure that Greece remained within the Eurozone. Even the Greek central bank urged the government to accept the deal offered by creditors. ▪ Implications: Markets are banking on a last minute compromise but the risk of miscalculation by either the Greek government or the creditors is high. Our view is that a half-compromise involving deferring some hard decisions is possible – that would buy time but it would not represent a resolution, while keeping uncertainty high.
<p>Negotiations on multilateral trade pacts stalling</p>	
<p>RCEP negotiations making little headway</p>	<p><u>RCEP negotiations stalling, unlikely to meet end-2015 target</u></p> <ul style="list-style-type: none"> ▪ The 8th round of negotiations for the Regional Comprehensive Economic Partnership (RCEP) was hobbled by differences over the level of tariff cuts. It is increasingly unlikely that the RCEP will be able to be concluded by the end of 2015.

Variable	Development/Assessment
	<ul style="list-style-type: none"> ▪ Implications: The RCEP brings together ASEAN with its six current free trade agreement partners. Because the US is not part of RCEP, a delay may not bode well for China’s geostrategic goals of limiting US hegemony in the wider Asia–Pacific region.
Trans–Pacific Partnership (TPP)	<p><u>President Obama salvaged trade bill</u></p> <ul style="list-style-type: none"> ▪ Obama needs Congress to pass the bill giving him “fast track” or Trade Promotion Authority (TPA) to negotiate trade agreements without Congress questioning its details. Because the Trade Adjustment Assistance (TAA) package that was once considered an integral part of the TPA process had been voted down by the House, the TPA bill had seemed to be in trouble. Now, the House has unbundled the TAA from the TPA bill, passing the latter. ▪ Implications: If the Senate passes the TPA bill as expected on 23 Jun, the prospects for the TPP to be concluded would be enhanced. However, if opponents find some way to scuttle the TPA bill, then the TPP would fail and this will severely compromise the US’s strategy to remain a dominant power in the Asia–Pacific.
Rising risks in nuclear–armed nations	
Russia–NATO relations	<p><u>Russia boosted nuclear arsenal in retaliation against NATO</u></p> <ul style="list-style-type: none"> ▪ Russia said it would buttress its nuclear arsenal by 40 more advanced ballistic missiles, in response to NATO’s military exercises in the Baltic Sea and the potential deployment of military heavy equipment by the US in the region. ▪ Implications: Russia is using the threat of its enhanced nuclear muscle to offset the US’s considerable lead in conventional military technology. Russia is determined to show that it will not wilt in the face of Western sanctions and a worsening economy. By prompting concerns in Europe over escalating tensions and a second Cold War, it hopes to coax the Europeans to break ranks with the US and become more accommodating to Russia’s demands.
North Korean risks	<p><u>North Korea at risk of famine</u></p> <ul style="list-style-type: none"> ▪ North Korea’s state news agency announced that the country was suffering its worst drought in a hundred years, drying up more than 30% of rice paddies. The United Nations estimates that certain crop harvests are at risk of falling by 50% in drought–stricken areas. Food shortages in the country will worsen unless UN agencies offers more support for the isolated country. ▪ Implications: The North Korean regime is unpredictable in the best of times. North Korean leader Kim Jong–un could well engage in belligerent acts to distract his people’s attention away from the failure of his domestic policies.
Policy challenges in Asia	

Variable	Development/Assessment
Pressure mounting on Jokowi	<p><u>Unpopular reforms to test Jokowi's support from voters</u></p> <ul style="list-style-type: none"> President Jokowi is looking to remove electricity subsidies for middle class households from 2016, with savings deployed to help the poor. Implications: The move risks alienating a middle class that is already upset over the removal of fuel subsidies. <p><u>Control of food prices unlikely to stem inflation</u></p> <ul style="list-style-type: none"> In a move to reduce the volatility of food prices, Jokowi has allowed the government to impose price controls on basic food and other essential goods. Such interventionism is unlikely to be effective due to the difficulty of enforcing price controls. It does not resolve the food supply problem directly and could have adverse effects if the policy deters investment which would have otherwise led to increased production.
MERS outbreak	<p><u>Korea getting to grips with MERS: Thailand affected but containing it</u></p> <ul style="list-style-type: none"> The number of new infections in Korea is dropping, with none reported on Saturday and just 3 on Sunday. The WHO is now optimistic that the MERS virus is under control. Stimulus measures have helped mitigate the effect of MERS on business. Thailand confirmed its first case of the virus last week but has reported zero new infections since then, suggesting that Thai measures to contain the spread have been effective.
Mixed signals in Indian economy	<p><u>Industrial activity up but still weak; other data is better</u></p> <ul style="list-style-type: none"> Industrial production accelerated, from 2.5% y/y in March to a still-low 4.1% y/y in April while the trade deficit narrowed to USD10.4bn in May 15, up from a deficit of USD11.0bn in Apr 15. The Indian Meteorological Department is now sounding a more positive note on the progress of the monsoon, so critical in a country where only around 47% of agricultural land is irrigated. The Agriculture Ministry raised the Minimum Support Prices (MSP) of key agricultural crops by a cautious amount which will help contain fears of food inflation. It is another indication that the Modi government will abjure populist policies to woo farmers in sharp contrast to its predecessor. Implications: Prudent policies are positively working to rein in inflation which will in turn provide RBI the space to further cut rates in order to boost growth, if needed.
Elections Update	
Taiwan's presidential elections	<p><u>Pro-China Hung to represent KMT, DPP's Tsai no longer a shoo-in</u></p> <ul style="list-style-type: none"> Hung Hsiu-chu won the KMT's primary election after garnering an average approval rating of 46% and will probably be the KMT's candidate in the January 2016 presidential election facing the DPP's Tsai Ing-wen and independent candidate Shih Ming-teh.

Variable	Development/Assessment
	<ul style="list-style-type: none"> ▪ Tsai's position as frontrunner for the Presidency is now at risk. First, Hung's KMT rivals Eric Chu and Wang Jin-pyng have thrown their support behind her, meaning that the KMT is likely to be more united now. Second, Hung's feisty and outspoken style has allowed her to gain on Tsai in polls despite her pro-China stance. ▪ Implications: The election is still several months away, giving time for Tsai to up her game. While Hung's preference for a closer relationship with China will endear her to China, it is not clear how well it will play among voters who are increasingly suspicious of China.
<p>Philippines</p>	<p><u>Grace Poe now the front runner in May 2016's presidential elections</u></p> <ul style="list-style-type: none"> ▪ Although Grace Poe has yet to announce her candidacy for the Presidency, she has already ousted Vice-President Binay as front runner in surveys, securing 30% support in a Pulse Asia poll. ▪ Implications: Binay's setback is partly due to allegations of corruption which his opponents have continued to hurl against him. As Poe is an ally of President Aquino, her potential victory brings hope of policy continuity and could thus be seen as positive by markets.
<p>Political developments could be destabilising</p>	
<p>Hong Kong's electoral reforms</p>	<p><u>China-backed electoral reforms rejected, backlash from China</u></p> <ul style="list-style-type: none"> ▪ Pro-democracy lawmakers voted down China's plan for direct elections for the territory's Chief Executive from a slate of candidates restricted to only those it approves of. The 2017 election will thus revert to the status quo, with the CE chosen by a 1,200-member electoral college of pro-establishment figures. ▪ Implications: China cannot sit still after this slap in its face. Hardliners in China will demand tougher action against critics in Hong Kong and the mood there is likely to darken over time.
<p>Malaysian political risks</p>	<p><u>Opposition coalition crumbling aids PM Najib face Mahathir's challenge</u></p> <ul style="list-style-type: none"> ▪ The opposition Pakatan Rakyat (PR) coalition combining the multi-ethnic PKR, Islamist PAS and secular/mainly Chinese DAP has broken up following disagreement between PAS and the DAP over PAS's determination to implement Islamic law in Kelantan state. ▪ The defeat of moderates in PAS's recent leadership elections is encouraging the moderate wing to break away from PAS. Their new party is likely to replace PAS in the PR coalition. The conservative religious leadership in PAS is inclined to cut a deal with UMNO. ▪ Meanwhile, ex-Premier Mahathir has pressed his attack on Premier Najib, this time challenging the latter to a live debate on television. ▪ Implications: Najib can now claim to his UMNO party that his tactics have helped break the PR threat to their hold on power. The PR won more votes but fewer seats than UMNO's BN coalition in the 2013 elections, raising hopes that it would unseat the BN in the next

Variable	Development/Assessment
	<p>election. If the majority of PAS's parliamentarians choose to support BN in parliament, the BN could command a two-thirds majority which it lost in the 2008 elections.</p> <ul style="list-style-type: none"> Nonetheless, Najib's opponents have continued to make allegations of financial shenanigans in government-linked agencies, hoping that the drip-drip of allegations will eventually destroy his credibility. So long as these allegations point to large losses in highly-leveraged government-backed entities, concerns over the financial and fiscal implications will hurt the Ringgit.
Thailand: new constitution	<p><u>Interim charter passes NLA, draft charter given more time</u></p> <ul style="list-style-type: none"> The National Legislative Assembly (NLA) voted 203-0 to pass the amendments to the interim charter, providing citizens with the option to vote on the draft charter. Meanwhile, the Constitution Drafting Committee (CDC) has been offered a 30-day extension to submit the completed draft charter, thus giving them more time to consider issues which have been raised by the NRC.

Indonesia: President Jokowi under pressure as the vested interests fight back

President Joko Widodo (Jokowi) is potentially a transformative leader who could threaten the interests of entrenched groups that have benefited from the corruption and cronyism prevalent in the country. These vested interests have been mounting an increasingly successful campaign to cripple his ability to make reforms that threaten their position.

Anti-corruption campaign compromised

One example is how vested interests, which resent the success of the Anti-Corruption Commission (KPK), are using their influence over key institutions to neuter the KPK. The actions of the National Police Commission (Police) and inconsistent rulings from Indonesia's unreformed judicial system threaten to render it ineffective or even potentially staffed with officials of questionable commitment to the fight against corruption.

- The KPK has lost its fight against an unreformed police:** In January 2015, Jokowi was pressed by his party leadership to nominate Budi Gunawan for the post of police chief. Following this, the KPK announced Budi as a corruption suspect which caused his nomination to be eventually revoked, an act that angered the police force. Key KPK personnel involved in the investigation – Bambang Widjojanto and Abraham Samad – were soon arrested and charged by the Police Commission on charges whose nature puzzled observers. The South Jakarta District Court ruled controversially in Budi's favour in his pre-trial hearing in February 2015. Jokowi then again found himself under pressure from his own party leadership to acquiesce when Budi was nominated by the police as deputy chief.

- **Weakness exacerbated by Constitutional Court ruling.** Soon after, Indonesia's Constitutional Court ruled that plaintiffs could file pre-trial petitions challenging the status of their charges, exposing a large loophole in Indonesia's judicial system that KPK suspects could use to wriggle out of most charges.
- **More charges against key KPK personnel:** Adding to the charges against Bambang Widjojanto and Abraham Samad, Novel Baswedan – a lead KPK investigator responsible for persecuting senior police officials and brother of a reformist cabinet minister – has also been charged by the Police for offences which many find strange. Whereas a number of KPK suspects were left uncharged using the pre-trial petition, Baswedan's petition was denied and he now faces trial. A recent ruling in favour of former tax director general Hadi Poernomo who had been charged by the KPK over an alleged bribery case further raised concerns that the KPK had been rendered ineffective.
- **KPK could be further compromised:** Jokowi has now established a new KPK selection committee, which was welcomed by anti-corruption activists. However, the Police Commission and the Attorney General's Office have now nominated candidates for KPK commissioner posts, giving rise to speculation as to whether their nominees, would truly uphold the KPK's mandate. Moreover, the KPK is now facing revisions to the 2002 Law on KPK which could further weaken its effectiveness. Lawmakers are questioning the extent of KPK's wiretapping power and other amendments, which could greatly diminish KPK's authority to effectuate anti-corruption measures.

A lack of response from Jokowi?

The president has yet to use the moral authority of his office to defend the KPK. Although he has expressed his verbal support for the KPK and signed a Presidential Instruction (Inpres) on preventing and combating corruption in May, little else has been done. The KPK Selection Committee will submit a shortlist of 8 candidates for the 5 Commissioner posts, but it remains to be seen whether Jokowi's choices reflect his reform agenda, or he chooses to defer to his party leadership again. If he fails to reverse the momentum against the KPK, the risk is that his own credibility will be fatally impaired.

Singapore: Clear signs of economic deceleration

The government's official forecast for economic growth in 2015 stands at 2%–4% but we think 2Q15 growth will be in the ballpark of 1.5%. Moreover, the key issue for Singapore is not so much the headline GDP growth, but the nature of the underlying forces driving that growth – are they deflationary, and do they create new risks to the economic well-being of Singaporeans or of key constituencies such as the small-medium enterprise (SME) sector? In particular, is the anecdotal evidence of more companies relocating suggestive of a wider problem of sliding competitiveness due to the confluence of high rents, foreign labour restrictions and an uncertain global climate?

More evidence that economy could be at a tipping point

A review of the latest data shows multiple headwinds afflicting the economy including weak global demand, crimped productivity growth and a tight labour market:

- **Both activity and demand indicators are weak:** Domestic and foreign demand for goods and services has been lacklustre, with no clear signs of a pickup. As Table 1 shows, this is reflected in declining exports and industrial production. Retail sales excluding automobiles are also surprisingly weak, given the tight labour market which should be boosting consumer confidence.

Table 1: Selected economic indicators

% y/y	Jan 15	Feb 15	Mar 15	Apr 15	May 15
Exports	-1.6	-16.1	0.6	-9.4	-10.0
Industrial Production	1.2	-3.3	-5.5	-8.7	
Retail Sales ex-Autos	-9.0	13.6	-3.4	-0.7	

Source: Calculated by Centennial Asia Advisors using CEIC Database

- **Combination of low unemployment and falling employment:** Employment contracted in 1Q15 by 6,100, the first contraction in five years. It is not clear how much of the fall is due to the economic slowdown and how much is caused by government curbs on the employment of foreign labour. Clearly weaker demand is hurting sectors such as manufacturing (especially offshore and marine); retail trade; real estate services and accommodation & food services. However, the decline in employment in construction could have been caused by the restrictive labour policies.
- **Real estate deflation persists:** Even before a sharp rise in interest rates and before the forecast glut in supplies really hits the market, residential property prices, sales volumes and rentals are weakening.

The downturn in external trade is worrying:

- First, non-oil domestic exports (NODX, a measure of non-oil manufacturing activity) decreased 0.2% y/y in May 15, down from 2.2% in Apr 15 with the key electronics NODX, registering a drop of 2.5% y/y in May 15. Precipitous falls in the disk drives, parts of ICs and parts of PCs segments (highlighted in red in Table 2) suggest a more worrying, structural cause – the relocation of activity out of Singapore.
- This would be fine if there were correspondingly large increases in other manufactured exports suggesting that new activities were coming in to replace contracting ones, but there is no evidence for this in the trade data. However, figures from fDi Markets show Singapore ranked highest among cities in the world for the amount of inward greenfield investments. As these greenfield investments translate into production over time, NODX could recover.
- Second, non-oil re-exports (NORX, a measure of Singapore's entrepot activities) is falling again, after a weak rebound in early 2015 despite reasonable growth in the regional hinterland which is the main market for Singapore's entrepot hub.

- Third, the declining trend in non-oil retained intermediate imports (NORII, a lead indicator of near term exports) suggests continued weakness in export trends going forward.

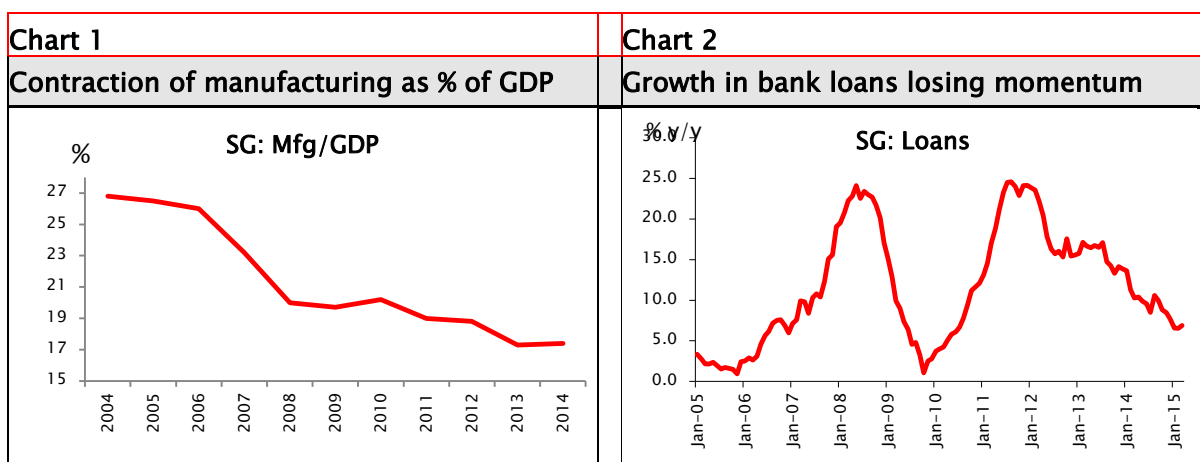
Table 2: Downturn in external trade

% y/y	Jan-15	Feb-15	Mar-15	Apr-15	May-15
Exports	-1.6	-16.1	0.6	-9.4	-10.0
Re Exports	9.0	-3.3	-1.5	-5.8	-4.9
Re Exports: Oil	-41.4	-52.4	-35.5	-48.8	-35.5
Re Exports: Non Oil	12.7	1.0	0.4	-2.1	-2.7
Domestic Exports	-10.9	-26.1	2.6	-12.6	-14.4
Domestic Exports: Oil	-33.3	-46.7	-22.4	-34.9	-33.3
Domestic Exports: Non Oil (NODX)	4.3	-9.7	18.5	2.2	-0.2
NODX: Electronic Products (EP)	5.0	-12.5	10.4	-4.0	-2.5
NODX: EP: Disk Drives	-19.3	-35.3	3.0	1.7	-29.0
NODX: EP: ICs	32.0	-4.4	24.4	0.7	9.8
NODX: EP: Parts of PC	-27.9	-33.7	-8.6	-19.9	-26.4
NODX: EP: Parts of ICs	-70.2	-68.2	-73.6	-75.1	-69.6
NODX: EP: Diodes, Transistors	31.7	0.3	16.1	9.0	27.2
NODX: Non Electronic Products	4.0	-8.6	21.5	4.7	0.8
NODX: Chemicals: Pharmaceuticals	25.9	-22.4	65.9	7.5	-0.6
NODX: Chemicals: Petrochemicals	-17.5	-30.9	-13.4	-9.1	-14.7
Imports	-13.4	-20.5	-14.8	-14.3	-19.6
Non-Oil Retained Imports of Intermediates	-64.5	-23.1	-18.0	-26.0	-12.2

Source: Calculated by Centennial Asia Advisors using CEIC Database

Assessment: Marked sectoral declines portends a very weak 2Q15

There are two important conclusions from the review above. First, GDP growth in 2Q15 is likely to be very weak – approximately 1.5% by our forecasts. Second, the confluence of contractionary forces could suggest further weakness in the economy – unless there is a very strong global recovery.



Source: Calculated by Centennial Asia Advisors using CEIC Database

First, it is clear that 2Q15 growth will be mediocre at best. **Approximately 40% of GDP** will potentially be adversely affected by the various sectoral contractions while no sector is delivering very strong growth:

- **Manufacturing sector weakness:** The declines seen in NODX and the loss in competitiveness that this suggests bodes ill for the manufacturing sector which has seen an unprecedented decline in its share of GDP in a short space of time, from 26% in 2004 to just 17% in 2014 (Chart 1). A hollowing out of the manufacturing sector will hurt a range of services and manufacturing sub-contractors.
- **Wholesale and retail sector weakness:** Wholesale trade is expected to suffer from the drop in NORX while weakness in retail sales ex-autos, coupled with falling tourist numbers, points to a declining retail sector. The wholesale and retail sector is about 17.5% of GDP.
- **Real estate weakness:** The fall in property sales, is a big negative for the real estate sector, which makes up about 47% of the business services sector which in turn constitutes approximately 15% of overall GDP. The construction sector (5% of GDP) will also be negatively impacted. This means that the softening of the property market will result in about 12% of GDP contracting.
- **Vibrant finance and insurance sector potentially losing its lustre:** The growth in bank loans is losing momentum, as seen in Chart 2. The average daily trading value of equities on the Singapore Exchange (SGX) is also on the decline, averaging USD563.7mn a day in 2014, down 25% from 2013 (Table 3). There is also a dearth of new listings on SGX in 2015. The finance and insurance sector is 12.5% of GDP.

Table 3: Daily Turnover Value of Equity Markets (USD mn)

Year	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
2010	359.2	336.9	74.8	778.1	608.0	56.8
2011	387.4	398.1	91.3	761.5	641.8	23.2
2012	330.4	367.5	116.5	698.7	681.3	29.3
2013	404.6	465.6	167.2	756.5	1065.5	35.3
2014	340.2	451.6	133.3	563.7	872.0	70.5

Source: Calculated by Centennial Asia Advisors using CEIC Database

Second, the negatives – loss of manufactured export competitiveness, loss of entrepot trade competitiveness, real estate deflation, corporate sector restructuring – affecting the economy will feed off each other in a contractionary dynamic, threatening growth in 2H15.

Implications: policy needs to be more stimulating:

- The Monetary Authority of Singapore (MAS) has stated its intention to stand pat on monetary policy, and shows no signs of shifting its position. The earliest point at which we might see an easing of MAS's exchange rate-based policy is October.

- Macro-prudential measures to cool a once-overheating real estate sector look less and less needed. We would not be surprised to see some cautious and gradual easing of these measures soon.

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