Market Review & Outlook

January 2021

(as at 31 December 2020)

Overview

US

- On 16 December, the US Fed continued its dovish guidance, with a commitment to continue buying bonds to support the economy until full employment and inflation sustains at 2%. The pace of bond purchases will continue to be at least USD120b per month, but the Fed did not guide any extension of duration. The FOMC voted to keep policy rates unchanged.
- Retail sales lost momentum in November at -1.1% MoM (expectation: -0.3% October: -0.1% MoM, September: +1.7% MoM) driven by dampened food service sales that fell 4.0% MoM and brick-and-mortar retails sales that fell 1.0% MoM, due to rising COVID-19 cases and increased restrictions across the country, while non-store sales were up a modest 0.2 % MoM.
- The pace of labour market recovery moderated in early November data, with Non-Farm Payrolls up 245k. While this is an increase for a 7th month in-a-row, it is the smallest increase over this period, as rehiring in leisure and hospitality and retail trade has stalled. The unemployment rate fell slightly to 6.7% from 6.9%.
- As counting has progressed, Democrats are projected to win both seats in the Georgia runoff elections on 5 January that will give them de facto control of Senate.
- Supporters of incumbent US President Trump stormed the US Capital Building to disrupt the certification of Electoral College votes on 6 January. The Capital Building was subsequently secured, the counting resumed and the US Congress ultimately certifying Joe Biden's victory in the US Presidential election.

EU

- At its 10 December meeting the ECB did not announce any additional major stimulus package, beyond some expansion of its debt purchase scheme and the continuation of provision of liquidity at ultra-low rates to banks that pass on the liquidity to companies. The ECB Governing Council also kept policy rates unchanged near zero. This prompted some risk-on sentiment, given that expectation of new major stimulus had been premised on the view that the ECB had concerns of a stalling economic recovery.
- Markit Eurozone Manufacturing PMI continued show strong expansion at 55.2pts (November: 53.8pts), thereby indicating strong economic recovery, while Services PMI saw some improvement but continues to indicate contraction at 46.4pts (November: 41.7pts). Composite PMI showed mild contraction in economic activity at 49.1pts (November: 45.3pts). Going forward, there is risk that activity may again stall as COVID-19 cases surge post-Christmas holidays.
- A post-Brexit trade deal between the UK and the EU was agreed upon on 25 December. The crux of the deal is that trade between the 2 sides will be tariff and quota free from 1 Jan 2021, but exporters and importers will face higher non-tariff barriers that include customs and border checks and additional regulatory and administrative requirements.

Malaysia

- Malaysia's export recovery remained resilient with mild upside surprise at +4.3% YoY for Nov 2020 (consensus expectation: +3.1 YoY, Oct 2020: +0.21% YoY, Sep 2020: +13.61% YoY). Exports to key trading partners remained solidly in expansion for Nov 2020 at +13.2% for China, +15.4% for Singapore and +24.6% for the US. However, import contraction accelerated at -9% YoY in Nov 2020 (Oct 2020: -6.0% YoY) which raising concerns of the sustainability of the export performance.
- Fitch had on 4 December 2020 downgraded Malaysia's sovereign rating by 1-notch to BBB+ while normalizing the rating outlook to Stable from Negative. Fitch has had a Negative outlook the Malaysian sovereign since 9 Apr 2020 premised on COVID-19 related stress on economic growth and public finances, along with political volatility that raised concerns of maintenance of governance standards. In response to the Fitch downgrade the Ministry of Finance (MoF), reiterated the government's commitment to fiscal consolidation and sustainability. In terms of governance, the MoF stated that the government remained committed to good governance and also pointed out that key legislation in relation to COVID-19 stimulus along with Budget 2021 have been passed during this period of political uncertainty.

Equities

GLOBAL EQUITIES

Dow Jones Industrial Index continued to surge in the last month of 2020, posting a gain of 3.27%. The positive momentum was supported by the rollout of new coronavirus vaccines and approval of the USD900b economic relief package by the Congress. This was despite bouts of volatility due to climbing COVID-19 cases. Similarly, Euro Stoxx 50 Index was upped 1.72% as optimism over coronavirus vaccines outweigh worries about the faster-spreading strain of the coronavirus which has triggered stricter lockdowns and travel bans throughout Europe.

ASIA PACIFIC EQUITIES

The North Asia market finished higher in December, tracking gains in the developed markets. Shanghai Stock Exchange Composite Index ended the month 2.40% higher while Hong Kong's Hang Seng Index returned 3.38%. Although sentiment was fragile on fresh tensions between the world's two largest economies; signs of accelerating growth in the region, coupled with Beijing's pledged to support economic recovery, provided support to the market. Korean stocks represented by KOSPI Index advanced 10.89% on higher visibility of economic recovery for 2021, following positive progress of domestic COVID-19 vaccinations. Taiwan's TAIEX Index gained 7.03%, with performance driven by the technology sectors on strong pricing outlook.

ASEAN EQUITIES

ASEAN equities rallied strongly in December with MSCI ASEAN Index higher by 3.7% MoM in USD terms tracking gains in developed markets, driven by continued prospects of vaccine-driven economic recovery coupled with the hope of less confrontational US trade policy under a Biden administration. ASEAN equity market performance was led by Vietnam (10.0% MoM), Indonesia (6.5% MoM), Philippines (5.1% MoM) and Malaysia (4.1% MoM), essentially the laggards of last month as the global equity rally picks-up steam.

In terms of standard deviation (SD), the 3 most expensive ASEAN markets are Thailand (+3.3 SD), Indonesia (+2.2 SD) and Philippines (+1.9 SD). Meanwhile, Singapore (+1.1 SD) and Vietnam (+1.2 SD) and Malaysia (-1.1 SD) look about fairly priced.

ASEAN economies are poised for a recovery in 2021 riding on the tailwinds of low interest rates, pro-growth fiscal policies and reduce trade uncertainty from the Biden administration. Combined with vaccine availability, the return of global funds to emerging markets and the rotation into cyclical and recovery stocks should keep the market optimistic and risk-on for at least the early part of 2021.

MALAYSIAN EQUITIES

The KLCI rose 4.1% MoM in December. This was in tandem with the positive global equities where the Dow Jones Industrial Index rose 3.3% MoM. Investors continued to be positive on the COVID-19 vaccines. The small caps were outperforming where the FBMSC Index rose 5.7% MoM. Sector wise, Energy and Finance were the best performing sectors, rising 11.1%, and 11.0% respectively. On the other hand, Healthcare sectors underperformed, down by -11.0% MoM. The top three gainers in KLCI components stocks were Press Metal (+19.9%), CIMB (+18.5%) and Public Bank (18.4%) while the worst performing stocks were Supermax (-32.5%), Hartalega (-15.7%), and Top Glove.

Globally, new COVID-19 cases per day in December were still climbing up but were showing sign of flattening and ended the year at 701k. The UK saw a sharp spike that hit record high of 56k new cases. Scientist in UK had identified a new variant of the COVID-19 that appears to be more contagious than, and genetically distinct from, more established variants. Initial studies of the new variant prompted Prime Minister Boris Johnson to tighten restrictions over Christmas, and spurred officials in the Netherlands, Germany and other European countries to ban travel from the UK. In Malaysia, the new cases showed a spike to record high of 2.5k as at 31 December. On the other hand, the US Food and Drug Administration (FDA) issued an emergency use authorization (EUA) for 2 vaccines so far- one by Pfizer and the other by Moderna. The EUA allows the vaccines to be distributed in the US.

The US Senate passed a large year-end spending bill combining USD900b in COVID-19 relief aid with USD1.4t in regular government funding and a bevy of tax breaks for businesses. On top of that, a Brexit deal was reached between European Union and United Kingdom. The UK achieved zero tariff, zero quota for goods with its main trading partner.

Brent crude oil price rose 8.8% MoM to USD52/bbl as news on COVID-19 vaccines approval by FDA boosted investors' confidence on economic recovery. As at end-December, world crude oil production had recovered to 94m bpd, which was approximately 92% of pre-COVID-19 level. OPEC+ has agreed to increase output by 500k bpd in January 2021 for 1 month only.

In Malaysia, Fitch downgraded Malaysia's rating from A- to BBB+ and reverted the outlook to stable, citing weakened key credit metrics as the depth and duration of COVID-19 crisis necessitated a strong fiscal response which inevitably weighed on its already high debt burden, and Fitch also stated that political uncertainties may cause policy uncertainty and affect the prospects of further improvement in governance standards. Perak Menteri Besar Ahmad Faizal Azumu had been voted out of office by its own coalition members led by UMNO. This reflected the fragile relationship between the ruling government coalition especially between Bersatu and UMNO.

Foreign institutional investors net sold RM0.6b worth of Malaysian equities in December 20, bringing 2020 net outflow to RM24.7b. In terms of value traded in Bursa, local retail dominated with 37% market share, bigger than local institution at 27% market share. Foreign institutional share' has dwindled to 14%.

Strategy

As we turn the page to 2021, we expect the market to be supported on improving prospects of COVID-19 vaccinations leading to extension of improving economic activity along with upwards earnings revision, accompanied by accommodative monetary and fiscal support. Nevertheless, with the increased valuation following the pace of the recent market gains as well as concerns over the resurgent of pandemic, the equity market may stage a pull-back in the near term. We remain constructive on equity as an asset class and will be buying on dips with preference tilting towards quality cyclical and recovery plays.

Fixed Income

ASIAN BOND MARKETS

The overall Asian dollar market saw return performance ease in December at +0.41% MoM after the previous month's rebound (November: +1.35% MoM, October: -0.19% MoM) following 2 months of negative returns. The Asian dollar Investment Grade space also saw a similar easing of return at +0.28% for December (November: +1.23% MoM). At the same time, the return performance of the more volatile Asian dollar High Yield Index eased similarly to +1.94% MoM in December from 2.58% MoM in November.

By country, it was the same story with return performance easing in December from the prior month's rebound. The top 5 gainers were India at +1.21% MoM (November: +2.99% MoM), Malaysia at +0.64% MoM (November: +3.56% MoM), Hong Kong at +0.61% (November: 1.22% MoM), Philippines at +0.35% MoM (November: +1.29% MoM), and the exception to the easing of return performance, China at +0.45% MoM (November: +0.42% MoM).

We see that the easing of return in the Asian dollar bond space is something of a retrace from the initial risk-on spike to a Biden victory in the US presidential elections and also the quieter trading period of the year-end holidays. However, we see that risk-on momentum remains from fundamental optimism for COVID-19 vaccine roll-out along with hopes of a less disruptive global trade environment under a Biden administration in the US. At the same time Asian bond value continues to be underpinned by a) regional governments continuing to stand ready with accommodative central bank and fiscal policy support to mitigate COVID-19, and other potential economic shocks and also b) relative success in control of the pandemic in the region.

In terms of FX, the USD weakened strongly over the month and into the 1st week of January on funds outflows from the US, as global risk-on sentiment continued with a) a Biden victory in US presidential elections, b) positive news on potential COVID-19 vaccines, c) focus by US Congress on fiscal stimulus. In the more medium-term, the Fed's stance of keeping policy rate lower for longer along with expectation of further COVID-19 fiscal relief from Democratic control of both houses of US Congress also adds to bearishness on the USD.

MALAYSIAN BOND MARKET

In the last month of 2020, Malaysian bond markets recovered from previous month's selloff with thinner trading volume, against the backdrop of year-end festive season and investors picking up value from steepened yield curves.

Early in the month, Fitch's downgrade of Malaysia sovereign rating, by 1 notch to BBB+/Stable from A-/Negative, caused knee-jerk selling across domestic fixed income and equity markets in the early trading session of the first trading day post-downgrade. However, the markets swiftly recovered in the trading days that followed. While there continued to be intermittent profit-taking activity during the month, overall the government bond markets ended the month on positive note.

Month-on-month, the MGS/GII curves bull flattened with yields drifting down 6-36 bps across the curves, largely regaining the lost ground from the November sell-off. On average, the 15-year to 30-year segment of the curves saw yields lower by about 30 basis points, as traders and investors were picking up value from the very steep yield curves. The month of December recorded trading volume of RM40b, compared to RM49b for November and the average monthly volume of RM84b for 2020. The only government bond auction in the month, the re-opening of 10-year GII benchmark with RM4.5b issuance size, garnered bid-to-cover (BTC) ratio of 2.619x, a marked improvement from previous 5 auctions where BTC all recorded at below 2.0x.

The strength in MGS/GII market was partially attributable to BNM's announcement of the 2021 auction calendar as well. While the number of auctions in 2021 will be higher at 37 (compared to 34 in 2020), the increase will be in 3-year and 5-year issuances, thus easing supply concern on the longer end of the MGS/GII curves. Out of the 37 auctions, 35 will be re-opening of existing MGS/GII bonds, reflecting BNM's on-going effort to improve liquidity in local government bonds market.

Along with quieter market activity in the MGS/GII market, primary corporate bond issuances also slowed to RM8.5b in December, from RM16.5b in November. Following the slew issuances taking advantage of low interest rates during 2020, existing pipeline has also turned quieter towards end of the year. Nevertheless, we expect the pipeline to get busy again as the new year unfolds, as policy rate is expected to remain accommodative to support economic recovery; and potentially improved investment appetite for corporate bonds for yield pickup and recovery plays. During the month, credit spreads in the AAA and AA rating segments widened 5-30 basis points, mainly as a result of relative stability in corporate bond yields while the MGS/GII market saw declining government bond yields.

Foreign fund flows data released during the month showed net inflows of RM1.8b into the MGS market in November, marking the 7th consecutive month of net foreign buying. As at end-November, foreign holdings of total outstanding MGS and GII stood at 24.6% (end-October: 24.5%). As the USD continued its weakening trend against Emerging Market currencies, USDMYR ended the month at 4.02 (end November: 4.07). The latest CPI data release showed that deflation worsened in November with CPI reading of -1.7% YoY (Consensus: -1.5%; October: -1.5%), justifying BNM's current loose policy stance and even room for further monetary easing.

Strategy

Market Outlook

2021 will be another year of accommodative Central Bank monetary policy as the economic fallout of the COVID-19 pandemic continues. The availability and rollout of COVID-19 vaccine to the general population will take time and any meaningful recovery is likely to be only in the later part of the year.

We expect BNM to maintain the OPR at its present level of 1.75% unless there is a significant deterioration in economic outlook. Bond yields would therefore trade range bound in the near term until the Central Bank signals a change in its assessment of the economy.

There will be continued concerns on the larger supply of government bonds in 2021 but this will be largely mitigated by the steepness in yield curve. Long-term investors such as pension funds and insurance companies will be attracted by the higher yields offered by the longer end of the yield curve which would keep yields supported.

Portfolio Duration

We remain overweight on portfolio duration relative to benchmark given our view of stable BNM policy rate with dovish tilt. Yield curve positioning and timing during periods of market volatility will be key determinants in delivering performance.

Security Selection

For asset allocations, we continue to favour corporate bonds over government bonds due to attractive yield pick-up. Focus will be on high quality corporate papers for core holdings, while leveraging on our vigilant credit process to add selective high yield corporate papers. We recognise the current economic downturn and will continue to assess its impact on corporate earnings and consumer confidence. Primary issuances will be a source of new price discovery as the supply pipeline is expected to be heavy as corporate issuers seek to take advantage of record low interest rates.
