Market Review & Outlook

November 2020

(as at 31 October 2020)

Overview

US

- All eyes are on the US Presidential Election on 3 November. At time of writing (2:00 pm Malaysian time, 6 November) the results remain too close to call. Lengthy delayed, inconclusive or contested results would be expected to result in a rise in political uncertainty and therefore risk-off sentiment.
- Advance estimate of 3Q2020 GDP show record GDP growth of 33.1% QoQ annualised (2Q2020: -31.4% QoQ annualised). However, this is seen mainly as rebound from 2Q2020 lockdowns and generally meets consensus expectation of 32.0% QoQ annualised. Growth going forward is expected by most economists to be at a slower annualised pace of 3% to 6% in 4Q2020.
- The labour market showed continued recovery, but has some way to go towards full recovery. Initial jobless claims fell by 40,000 for the week ended 24 October to 751,000 (prior week 791,000), while continuing claims fell by 709,000 for the week ended 17 October to 7,756,000 (prior week 8,465,000). ISM Manufacturing Report on Business Employment index also supports the picture of labour market; crossing into expansionary territory for October at 53.2 pts (September: 49.6 pts).
- Activity remained expansionary ISM Manufacturing PMI at 59.3 pts for October (September: 55.4 pts), preliminary Markit US Services PMI at 56.0 pts (September: 54.6 pts) and preliminary Markit US Composite PMI at 55.5 pts (September: 54.3 pts).

EU

- Eurozone 3Q2020 GDP advance estimate surprised very strongly on the upside at +12.7% QoQ (consensus expectation: +9.6% QoQ, 2Q2020: -11.8% QoQ) and -4.3% YoY (consensus expectation: -7.0% YoY, revised 2Q2020: -14.8% YoY). However, a new wave of COVID-19 infections and related renewed lockdowns across Europe dampens prospects normalization of growth in 4Q2020.
- The ECB kept its policy setting unchanged at its 29 October meeting, but signalled that more monetary stimulus was on the way, likely an expansion of the Pandemic Emergency Purchase Programme along with other existing tools.
- Activity indicators show that manufacturing continued to expand in October with the Markit Eurozone Manufacturing PMI at 54.8 pts (September: 53.7 pts) while services fell deeper into contraction with the Markit Eurozone Services PMI at 46.9 pts (September: 48.0 pts).
- Eurozone headline CPI continued to indicate deflation for a 3rd month in-a-row at -0.3% YoY for October (September: -0.3% YoY). Core inflation sustained at a trough of +0.2% YoY for October (September: +0.2% YoY). The weak inflation continued to reflect delayed summer-sales, the depressed global energy price level, a cut in VAT in Germany, and demand weakness related to the stronger EUR and travel-related services.

Malaysia

- BNM kept the OPR unchanged at 1.75% at its 3 November meeting. BNM sees significant improvement in economic activity in 3Q2020 from -17.1% YoY contraction in 2Q2020, with full year 2020 GDP performance to fall within official estimate of -3.5% to -5.5%. We see that BNM is maintaining its Neutral policy stance but standing ready to step-in with extraordinary stimulus in the event of further economic shocks.
- Deflation persisted in September with headline CPI falling -1.4% YoY (August: -1.4% YoY, January – September: -1.1%) on continued decline in transport prices at -9.9% YoY (August: -9.9% YoY), while food prices inflation remained subdued at +1.4% YoY (August: +1.3% YoY). Core CPI change was fairly stable at +1.0% YoY (August: +1.1% YoY).
- September trade data points to better 3Q2020 GDP following the weak 2Q2020 GDP print. September exports grew 13.6% YoY (August: -2.9% YoY) while imports remained in contraction at -3.6% YoY (August: -6.5% YoY). Trade surplus rebounded to RM22.0b in September back to the peak levels in July (RM25.2b) and June (RM20.9b) from RM13.2b in August. In terms of longer term outlook, trade performance continues to look volatile with no certainty that the external sector growth can be sustained through 4Q2020.

Equities

GLOBAL EQUITIES

Global equity market underwent a sell-off in October prompted by worries over rapid rise in the number of new COVID-19 cases in several major economies, which raises prospects of another wave of lockdowns prompting investor concern over economic recovery. Uncertainty over the outcome of the US Presidential election, coupled with dwindling hopes for the next US fiscal stimulus package further weighed the already fragile sentiment. Dow Jones Industrial Average Index slipped 4.6% % while Euro Stoxx 50 Index retreated by 7.4%.

ASIA PACIFIC EQUITIES

China's Shanghai Stock Exchange Composite Index and Taiwan's TAIEX Index posted a marginal gain of 0.2% and 0.3% as initial market rebound on the back of strong corporate results releases faded due to heightening concerns about the global economic recovery. In China, economic data releases continued to up pace and the country is likely to be the only major world economy to post annual growth this year. Hong Kong shares closed 2.7% higher in October, driven by a recovery in China shares against the improving macro backdrop. Meanwhile, KOSPI Index dipped 2.6% as investors went risk averse, driven by worries over the country's rising s new COVID-19 infections, raising fears that the pandemic may inflict more damage on the economy.

While the economic outlook is improving, the pace of recovery is expected to enter a new phase in which growth is expected to be slower in the coming months. Coupled with stretched valuations as well as US-China tensions, sentiment could stay cautious. Investment strategy is to stay defensive, focusing on companies with stronger balance sheets as well as companies that have stable earnings delivery and sustainable dividend payout, while selectively taking opportunity of market weakness to position in cyclical stocks on the back of improving economic outlook going into next year.

ASEAN EQUITIES

ASEAN equities ended October marginally higher at +0.4% MoM in USD terms driven by mixed sentiment. There was generally strong economic indicators pointing to a strong 3Q2020 recovery in economic activity and something of a pause in US trade hostility during the month, but tempered against caution in the run-up to the US Presidential elections and volatility in the US market from the on-again, off-again COVID-19 stimulus package negotiations in the US.

ASEAN equity market performance was not uniform across countries in October. Those that closed moderately lower in USD terms were Singapore (-1.7% MoM), Malaysia (-2.5% MoM) and Thailand (-3.4% MoM). Investor interest appears driven by country specific data with equity markets ending the month higher in the Philippines (+7.8% MoM) where the current account is set to forge a surplus this year; in Indonesia (+5.3% MoM) which has in early October passed its potentially investor friendly Omnibus Law; and Vietnam (+2.2%) which is one of few economies this year expected to end in significant GDP growth.

In terms pricing, by forward P/E multiples at end-October, the 2 most expensive ASEAN markets at Philippines at 18.1x and Thailand at 17.2x. In terms of standard deviation (SD), the Thailand has become significantly expensive trading at +1.8 SD above its 10-year average, while the Philippines is also a bit pricey now trading at +0.8 S.D above its 10-year average. The rest are relatively fairly valued, in order of attractiveness; Malaysia (-0.3 S.D), Indonesia (-0.2 S.D), Vietnam (+0.3 S.D) and Singapore (+0.4 S.D).

While investor sentiment is still supported by ample liquidity and low interest rates, uncertainties about the impact of the pandemic to economy, the US-China geopolitical rivalry and from the US Presidential election remain. Not discounting a potential disruption for a 2nd wave before a credible vaccine is found, we maintain our defensive stance preferring quality and yielding stocks while keeping a good amount of cash to capture any opportunities and tactical trades. We maintain neutral views on all ASEAN markets.

MALAYSIAN EQUITIES

The KLCI lost -2.5% MoM in October. This is in line with weakness in global equities where the Dow Jones declined -4.6% MoM. The mid- and small-caps were more resilient where the FBM70 declined -1.0% MoM but FBMSC Index rose 0.5% MoM. Sector wise, Energy and Construction were the worst performing sectors, plunging -9.9% MoM and -5.7% MoM respectively. Technology and Healthcare were the best performing sectors, up by 8.4% MoM and 7.1% MoM respectively. The top three gainers in KLCI components stocks were Hartalega (+11.3% MoM), Press Metal (+6.8% MoM) and Petronas Chemical (+4.3% MoM) while the worst performing stocks were Petronas Dagangan (-12.7% MoM), MISC (-12.1% MoM), and Tenaga (-9.1% MoM).

Globally, new COVID-19 cases per day were at record high and on rising trend at 506k cases near end-October, approximately a 62% increase MoM. Global major economies that saw a rising trend included US, UK, France, Germany, and Italy. Malaysia reported a sudden surge in new cases that continuously surpassed 800 towards end-October. On top of rising COVID-19 cases, vaccine development suffered setbacks when leading vaccine makers Eli Lilly and Co, Johnson & Johnson, AstraZeneca Plc, put their vaccine clinical trials on pause due to safety concerns. Nevertheless, China seemed to be leading in the search for a vaccine, claiming that 60,000 people had been injected with its COVID-19 vaccines so far and no one has reported severe adverse reactions. China is expected to produce up to 610 million doses of COVID-19 vaccines by the end of this year.

President Trump ended talks with Democratic leaders on a new stimulus package, although Fed Chair Jerome Powell made the strongest call yet for greater fiscal spending to avoid damaging the economic recovery. Stocks tumbled after Trump called an end to months of hard-fought negotiations between the administration and Congress. Democrats had most recently pushed a USD2.2tr package or ~10% of GDP that failed to garner Republican support in the House, while the White House had endorsed USD1.6tr.

Domestically, in response to the surge in COVID-19 cases, the Malaysian government has announced a 4-week Conditional Movement Control Order (CMCO) starting from 14 October in Sabah, Labuan, Selangor & KL and Nilai. All economic, industry & manufacturing activities are still allowed to operate as usual subject to Standard Operating Procedures (SOPs) while schools and entertainment outlets will be shut. Cross-district movements & outdoor exercises are not allowed. On top of that, the National Security Council (NSC) has instructed employees of public sector and industries under the MITI places under the CMCO to work from home from 22 October onwards.

Brent crude oil price dropped -8.5% MoM to USD37/bbl as global demand is expected to remain weak in view of the resurgence of new COVID-19 waves across the world.

Foreign institutional investors net sold RM670m worth of Malaysian equities in October, bringing YTD net outflow to RM23.0b. In terms of value traded in the Bursa Malaysia, local retail dominated with 36% market share, bigger than local institution at 29% market share. Foreign institutional share has dwindled to 14%.

Strategy

While we expect the economy to recover in 2H2020, albeit at a modest pace, the outlook and pace of recovery is now highly uncertain, with rising COVID-19 cases which has led to the CMCO in several states of Malaysia, raising concerns on potential earnings disappointment. In addition, lingering political uncertainty, could also significantly impact Malaysia's economic and social systems, due to policy disruption and stalling economic reforms. On the global front, the US election outcome weighs heavily among investors. We remain cautious on the equity market and expect volatility to continue despite ample liquidity. Our strategy remains to target good dividend yielding stocks to provide a stable income stream and preservation of capital, and selectively taking opportunities of material market weaknesses to position ourselves within our preferred sectors, namely, consumer (non-discretionary), technology, gloves and REITs.

Fixed Income

ASIAN BOND MARKETS

The overall Asian dollar market saw return performance remain negative in October at -0.19% MoM (September: -0.61% MoM). The Asian dollar Investment Grade space was similarly in marginal negative territory with return at -0.02% MoM (September: -0.30% MoM). The more volatile Asian dollar High Yield index saw a more significant negative return at -0.58% MoM but also moderating from September's -2.01% MoM.

By country, the Asian dollar market continued its consolidation as in the previous 2 months. There were only 3 gainers, namely India (+0.53% MoM), Indonesia (+0.17% MoM) and the Philippines (+0.29% MoM). The top 5 losers were Thailand (-0.83% MoM), Singapore (-0.42% MoM), Malaysia (-0.38% MoM), Hong Kong (-0.13% MoM), South Korea (-0.13% MoM).

We see that the consolidation in the Asian dollar bond space continued for a 3rd month on higher risk-off sentiment as a jump in COVID-19 cases in the region prompted movement restrictions. Record debt sales in October in many countries in Asia including China, also weighed on cautious investor sentiment ahead of the US elections. That said, we see that Asian bond value continue to be underpinned by fundamental factors of, a) relative success in control of the pandemic in the region, b) policymakers continued standby of further heavy fiscal stimulus packages to mitigate the negative economic pressures of COVID-19, c) the lower for longer monetary policy stance that still skews dovish across Asia, and d) government support for bond markets in the region.

In regional local currency sovereign bonds, only 2 markets under our coverage saw negative returns, namely South Korea (-0.77% MoM) and Hong Kong (-0.05% MoM). The top 5 gainers were Indonesia (+1.95% MoM), India (+1.72% MoM), Singapore (+0.69% MoM), Malaysia (+0.43% MoM) and China Onshore (+0.33% MoM).

The sharp rebound in Indonesia and India were driven by domestic factors. In Indonesia, the passing of the Omnibus Law on 5 October was the driver of foreign buying. In India, the central bank expanded liquidity operations with the raising of the size of open market operations to INR200b, stepping-in to buy state debt and supporting corporate bonds via INR1tr long-term repo operations, that improved foreign investor sentiment. Other regional markets benefitted from generally strong economic indicators pointing to a strong 3Q2020 recovery in economic activity, amid a volatile USD during the month.

In terms of FX, the USD upside on strong 3Q2020 economic recovery was capped by potential large new COVID-19 stimulus being negotiated within the US government. Long-run USD weakness is underpinned by various bearish hypotheses such as a) potential extraordinary policy easing by the US Fed should growth concerns build-up in the US, b) the widening US twin deficits, and c) some erosion of the USD's reserve asset status. We see that these bearish hypotheses will take a long time to play-out, with the USD maintaining its resilience in the meantime. We also have some expectations of strength in the USD on periods of profit taking or global risk-off sentiment given the volatile global economic environment.

MALAYSIAN BOND MARKET

October saw thin trading activities of Malaysian Government Securities (MGS) and Government Investment Issue (GII), with combined trading volume of RM59.0b, the lowest monthly volume for 2020 to date (2020 YTD monthly average: RM92.3b). Investors were side-lined ahead of heightened uncertainties surrounding BNM's monetary policy decision, US presidential election, and tabling of Malaysia's 2021 fiscal budget, all of which are scheduled on the first week of November.

Despite a neutral Monetary Policy Statement (MPS) in the previous month, dovish expectations on BNM's monetary policy were reignited in October, following the reinstatement of Conditional Movement Control Order (CMCO) on selected states to combat a spike in new Covid-19 cases. Short-term to intermediate-term MGS and GII yields fell as much as 25bps as a result. However, concerns on additional fiscal stimulus (hence more sovereign bond issuances) to combat the new Covid-19 wave intensified, which led to higher long-term MGS yields (by as much as 8bps). Long-term GII yields fell by 5bps instead, as spread against MGS normalised from +20bps to +10bps. Both MGS's and GII's yield curves steepened over the month.

Foreign holdings of MGS and MGS/GII in September (latest available) fell to 38.8% and 23.8% respectively (August: MGS 39.2%, MGS/GII 24.0%), largely attributed to increase in total outstanding of MGS and GII. September saw net inflow of RM1.1b into MGS/GII market, bringing YTD net inflow to RM4.4b. Malaysia's international reserve also improved in September to USD105.0b (August: USD104.4b) on the back of Ringgit's stability. Malaysia's September CPI registered at -1.4% (YoY), in line with BNM's statement of muted inflationary pressure.

There were three sovereign fixed income auctions in October amounting to RM14.5b notional, increasing government's YTD gross issuance to RM133.8b notional. The 3-year GII re-opening, 10-year MGS new issuances, and 5-year GII re-opening registered healthy bid-to-cover ratio of 3.10, 1.99, and 2.00 times respectively. There were no private placements of MGS or GII during the month.

Corporate yield curves steepened across AAA, AA, and A space, attributed to sharper decline in short-term yields versus long-term yields. However, credit spread widened as corporate yields did not fall as much as MGS yields, due to a significant increase of corporate issuances in October amounting to RM12.0b (YTD monthly average: RM6.0b) amid lower interest rate environment. This month's corporate issuers were mainly from the financial sector.

Notable corporate issuers include: Alliance Bank Bhd, Bank Islam Malaysia Bhd, Bank Pembangunan Malaysia Bhd, Cagamas Bhd, Imtiaz Sukuk II Bhd, Malayan Banking Bhd, Maxis Broadband Sdn Bhd, Padiberas Nasional Bhd, Pengerang LNG (Two) Sdn Bhd, Perbadanan Kemajuan Pertanian Negeri Pahang, RHB Bank Bhd, and Sunway REIT Unrated Bond Bhd. Notable government guaranteed (GG) issuers include: Prasarana Malaysia Bhd and Perbadanan Tabung Pendidikan Tinggi Nasional (PTPTN).

Strategy

Market Outlook

Despite BNM keeping the OPR unchanged at 1.75%, we maintain our constructive view on the fixed income market, anchored by continued accommodative monetary policy due to downside risks to growth and subdued inflationary pressures amidst the on-going pandemic.

Concerns of expected increase in bond supply are largely mitigated by the steepness in yield curve, where long-term yields provide better risk-adjusted reward (for both yield pick-up and potential upside) as monetary policy direction is unlikely to reverse in the near future.

Portfolio Duration

Our strategy remains to be overweight 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. Opportunities may arise in primary auctions during weak market sentiment, where bonds may be collected at a discount.

Security Selection

For asset allocations, we continue to favour corporate bonds over government bonds due to attractive credit spreads and their defensive nature during times of heightened volatility. Credit spreads are expected to tighten on the back of low government bond yields, as investors seek yield enhancement to boost portfolio returns.

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.
