Market Review & Outlook

October 2020

(as at 30 September 2020)

Overview

US

- The US Fed followed through with its change in policy framework at the 15-16 September FOMC meeting. The target rate was kept unchanged at 0.00-0.25%, while policy statement included forward guidance that inflation would need to moderately exceed 2% for some time before monetary policy would be tightened.
- The US Fed also premised policy tightening on the economy achieving full employment signalling that it does not expect to hike even if unemployment improved to the 4% level (unemployment, August: 8.5%).
- US activity indicators show strong recovery for a 2nd month with latest September Markit PMI for Manufacturing at 53.2pts (August: 53.1pts), Services at 54.6pts (August: 55.0pts), Composite at 54.4pts (54.4pts). Similarly, ISM Manufacturing PMI also indicates continued recovery in activity at 55.4pts for September (August: 56.0pts).
- However, ISM Manufacturing Report on Business Employment index continues to indicate contraction at 49.6pts for September (August: 46.4pts) signally still weak labour market conditions.
- Both initial and continuing jobless claims eased for the week ended-26 September, with initial claims printing at 837,000 for the week ended 26 September (prior 1,408,000) and continuing claims at 11.8 million (prior: 12.7 million revised). However, the data comes with a caveat of California using the previous week's numbers given the state's 2 weeks suspension of new applications to improve its system and clear backlogs.

EU

- The ECB kept policy rates unchanged at their 10 September policy meeting. During the month, the ECB's 6-member governing council expressed divergent views on the need for further stimulus, but weakness in latest inflation numbers raises the likelihood of policy easing within this year.
- Euro-area headline inflation turned negative in August at -0.2% YoY (July: +0.4% YoY) for the first time since mid-2016 and continued into September at -0.3% YoY. Core inflation set a record low in August at +0.4% YoY and even lower in September at +0.2% YoY. The weak inflation print reflects delayed summer-sales, the depressed global energy price level, a cut in VAT in Germany, and also demand weakness related to the stronger EUR and travel-related services.
- There is significant concern that the demand weakness reflected in inflation puts the EU in a vulnerable position going into the 2nd wave of COVID-19 surge.

Malaysia

- At its 10 September meeting, BNM kept the Overnight Policy Rate (OPR) unchanged at 1.75%. Based on the language of the Monetary Policy Statement, we see that BNM is signalling a clear Neutral policy stance in describing the current OPR level as appropriate and accommodative. In its Monetary Policy Statement, BNM sees that economic activity continues to recover from the trough in April this year.
- There was continued deflation in August with change in headline CPI of -1.4% YoY (Jul 2020: -1.3% YoY; Jan-Aug 2020: -1.0% YoY) on continued decline in transport prices, while food prices printed a smaller rise. On a MoM basis, CPI growth is also decelerating at +0.2% MoM (Jul 2020: +0.7%). Core CPI was stable at +1.1% YoY (Jul 2020: +1.1% YoY; 2019: +1.1% YoY).
- Suggesting a fragile global supply chain recovery; August exports and imports fell -2.9% YoY (July 2020: +3.1% YoY) and -6.5% YoY (July 2020: -8.7% YoY) respectively. On a MoM basis, exports and imports also contracted -14.5% and -2.2% respectively after rebounding in June-July 2020. Trade surplus normalised to RM13.23b (roughly at late-2019 pre-pandemic level) after the surge in June (RM20.9b) and July (RM25.2b).
- Manufacturing activity has gone into contraction with Markit Malaysia PMI for manufacturing at 49.0pts in September and 49.2pts in August (July: 50.0pts).

Equities

GLOBAL EQUITIES

Equity market started off the month of September on a weaker note, following a sell-off in the highly valued technology sector. Rising number of global coronavirus cases and political unease ahead of the presidential election on 3 November further dented sentiment. The deadlock in the US legislature on the passing on a new fiscal stimulus package, which could hamper economic recovery, was also an overhang. Dow Jones Industrial Index ended September with a decline of 2.28%, the largest monthly decline since March. Similarly, Euro Stoxx 50 Index declined by 2.41% as a surge in coronavirus infections prompted some countries to implement stricter containment measures and signs that the economic recovery may be stalling weighed on stocks.

ASIA PACIFIC EQUITIES

Negative sentiment on concerns that a global recovery will falter amid the lack of a fresh stimulus package in the US and the spike in coronavirus cases in Europe spread into Asian equities. The Hang Seng Index dropped by 6.82% while the Shanghai Composite Index slipped 5.23%. Sentiment was also rattled with deepening technology conflicts between US and China. Meanwhile, Taiwan's TAIEX Index ended 0.60% lower while South Korea's KOSPI Index ended returned 0.07%. This was despite higher volatility in the technology and internet-related stocks.

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 valuation as well as US-China tensions, sentiment could stay cautious. While staying defensive with portfolio tilt continuing to remain defensive, focusing on companies with stronger balance sheets well as companies that have stable earnings delivery and sustainable dividend payout, market weakness is an opportunity to accumulate given improving economic and corporate earnings growth going into next year coupled with ample liquidity.

ASEAN EQUITIES

ASEAN equities fell sharply in September with -5.9% MoM decline in US Dollar terms driven by moderate general risk-off sentiment that prevailed during the month in the run-up to US Presidential elections, along with bouts of US trade hostility during the month.

ASEAN equity markets closed mostly down in September with worst performer being Indonesia retracing -7.0% MoM in US Dollar terms after gaining 1.7% MoM in August. This is followed by Thailand (-5.6% MoM), Singapore (-2.6% MoM), Malaysia (-1.3% MoM) and the Philippines (-0.5% MoM). The exception was Vietnam that continued rally at 2.7% MoM in September, though fading from the 10.4% MoM surge in August.

In terms of forward P/E multiples, Thailand remains the most expensive ASEAN market. The Thai market is now trading at +2.7 S.D above its 10-year average, with the rest relatively fair in order of attractiveness with Indonesia (-0.1 S.D), Philippines (-0.1 S.D), Malaysia (+0.1 S.D), Singapore (+0.4 S.D) and Vietnam (+0.4 S.D.).

While investor sentiment is still supported by ample liquidity and low interest rates and further buoyed by positive news about potential COVID-19 vaccines, uncertainties about the impact of the pandemic to economy, the US-China geopolitical rivalry and the upcoming US Presidential election remain. Not discounting a potential 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 -1.3% MoM in September. This is in line with general weakness in global equities where the Dow Jones declined -2.3% MoM. Sentiment for the mid/small cap was more bearish where the FBM70 and FBMSC Index plunged -4.2% and -6.3% MoM respectively. Sector wise, Healthcare and Energy were the worst performing sector, plunging -11.9% and -10.9% respectively. Construction and Property were the best performing sectors, up by 0.9% and 0.3% MoM respectively. The top three gainers in KLCI components stocks were Hong Leong Financial Group (+15.7%), Sime Darby (+13.7%) and Hong Leong Bank while the worst performing stocks were Genting Bhd (-9.4%), Genting Malaysia (-8.8%), and CIMB.

Globally, new COVID-19 cases were stable at 223k cases near end-September. New cases in US had stabilized in September to around 43k cases per day. Countries that still showed worrying increasing trend were India and Indonesia. Malaysia reported sudden surged in new cases which consistently surpassed 100 cases towards end Sep. Leading COVID-19 vaccine maker, AstraZeneca Plc stopped giving shots of its experimental coronavirus vaccine after a person participating in one of the company's studies got sick, a potential adverse reaction.

US-China technology war tension continues as the US Presidential election draws closer. The Department of Defense is in discussions over whether Semiconductor Manufacturing International Corporation (SMIC), China's largest manufacturer of semiconductors should be added to the Commerce Department's entity list.

BNM decided to leave the policy rate unchanged in the September MPC meeting, holding the OPR at 1.75%. The Malaysian government will implement additional assistance under the RM10b Prihatin Supplementary Initiative Package (Kita Prihatin). The Kita Prihatin package targets several main groups, namely the bottom 40% income group (B40), middle 40% income group (M40), local workers in various fields and micro-traders in various fields. The stimulus widens budget deficit by 0.7% of GDP as the government seems to focus on stimulating economy and not on deficit. Political instability continued as talk among party sources said that Dato' Seri Anwar has gained majority support in Parliament, with Sin Chew Daily claiming in a report that the Port Dickson MP has the backing of 123 MPs out of 222 in the lower House.

Brent crude oil price dropped -9.6% MoM to USD41/bbl as demand recovery was hampered by persistent COVID-19 outbreaks globally. Local retail participation in the Bursa trading value remained high at 35% compared to 15% for foreign institutional investors.

Foreign institutional investors net sold RM2.0b worth of Malaysian equities in September, bringing YTD net outflow to RM22.0b.

Strategy

In September, global equity markets were broadly lower on the back of risk-off stance following the impending US elections in November, and unrelenting waves of the pandemic. While the economic data in US and Europe were generally better than expected, the profit taking during the month does appear valid and anticipated. 2Q2020 is deemed the trough for the year, but the subsequent recoveries are still expected to be slow, as global economies a still cautious over the ability to effectively control the pandemic. We still expect most equity markets to be driven by the developments over the pandemic (including the progress in developing a vaccine), US elections & the US-China tensions. We anticipate limited market upside in the immediate term.

The local equity market performed similarly weaker. The KLCI was weaker by -1.38% in September, with continued lack of foreign support. Retail investors' participation also slowed following the loan moratorium to end by 30 September 2020. Fear of new waves of the COVID-19 pandemic also heightened after the number cases spiked in Kedah, Sabah and Selangor. Dato' Seri Anwar Ibrahim also added to the cautious mood when he declared that he has enough support from the MPs to lead the government. We expect limited upside catalyst for the local bourse, but see some trading opportunities in range bound.

We are maintaining our focus on defensive sectors that provide good dividends and the limited sectors that will benefit from this pandemic including selective consumer (non-discretionary), technology, gloves, telecommunication, plantation and REITs and construction.

Fixed Income

ASIAN BOND MARKETS

The overall Asian dollar market saw return performance fall significantly in September to -0.61% MoM (Aug: +0.21% MoM). The Asian dollar Investment Grade space also saw a similar drop in return at -0.30% MoM (Aug: -0.15% MoM), and the more volatile Asian dollar High Yield index saw also saw a reversal in its return at -2.01% MoM (Aug: +2.21% MoM).

By country, the Asian dollar market generally saw consolidation as in the previous month. There were only 3 gainers, namely the Philippines (+0.39% MoM), Korea (+0.13%) and Hong Kong (+0.03% MoM). The top 5 losers were Thailand (-1.05% MoM), Malaysia (-0.84% YoY), Indonesia (-0.74% YoY), China (-0.52% YoY) and India (-0.47% YoY).

We see that after 4 months of risk-on rally, the Asian dollar bond began consolidation in August and continued into September. We see that there is potential for rebound after this consolidation phase, as Asian bonds continue to be underpinned by fundamental factors of a) the re-opening up of economies in the region during the month as COVID-19 numbers fall, 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 skews dovish across Asia, and d) government support for bond markets in the region.

In Regional local currency sovereign bonds, only 3 markets under our coverage saw negative return, namely China Onshore (-0.24% MoM), Philippines (-0.91% MoM) and Malaysia (-0.45% MoM). We see that the local currency market has rebounded from the August sell down, due to dollar weakness in September. The top 5 gainers were South Korea (+1.10% YoY), Singapore (+0.87% YoY), India (+0.79% YoY), Hong Kong (+0.70% YoY) and Thailand (+0.66% YoY).

We see that despite USD strength during the month, the local currency market has rebounded on market risk-on sentiment for Asian bonds as the region's economies in generally continued in September on the recovery stage of crisis management of COVID-19, along with governments continuing to stand ready with large fiscal stimulus spending or monetary easing to mitigate potential domestic and external economic shocks.

In terms of FX, the USD saw some rebound in September from its general downtrend that started in May on the net effect of funds outflow from Asian dollar asset to the US market, offset by mild gains in Asian local currency assets. Long-run USD weakness is underpinned by various bearish hypotheses such as a) expectations of further extraordinary policy easing by the US Fed as 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

In the month of September, sentiments remained soft in Malaysian bond markets amidst BNM's neutral policy stance in the latest MPC meeting, heightened political uncertainty, and the FTSE Russell annual review decision.

On 10 Sep 2020, BNM kept the Overnight Policy Rate (OPR) unchanged at 1.75%. In describing the current OPR level as appropriate and accommodative, BNM signalled a neutral policy stance in its Monetary Policy Statement. BNM also reiterated its expectation of inflation to average negative in 2020 on substantially lower global oil prices, and average higher in 2021, within the earlier projected ranges. Underlying core inflation is expected to be subdued amid spare capacity in the economy.

In the trading session following the policy decision, the MGS/GII market weakened and saw the sovereign curves bear flattened with yields up 4-6bps at the front end of the curve. The weakening trend persisted through much of the month with yields grinding higher across the curves. The strong bear flattening push at the short end was balanced by real-money investors picking up value at the long end of the curve, and month-end strong rebound driven by rebalancing flows as well as better-than-anticipated result at the last auction of the month.

Heightened political uncertainty from the Opposition Leader Anwar Ibrahim's surprise claim of majority support in the Parliament and the Sabah State Election; as well as the announcement of additional RM10b fiscal stimulus (implying higher MGS/GII supply while lower need for further OPR cuts) apparently weighed on overall market sentiments.

Another much anticipated event was the announcement of FTSE Russell's annual review decision (25 September 2020): to include China into its World Government Bond Index (WGBI) starting October 2021, subject to final confirmation in March 2021; while retaining Malaysia on the Watch List for potential exclusion from the WGBI. Following weeks of mostly bearish movements, the market's immediate reaction to the development was lukewarm, yields were up 1-3 bps following the announcement.

Overall, the MGS/GII markets ended the month with yields up about 5 to 30 bps across the curves (except for 15-year and 20-year MGS which saw yield compression) on thinner liquidity. Total traded volume was recorded at RM72.8b (August: RM84.3b). The auctions of 7-year MGS, 30-year GII, and 5-year MGS garnered bid-to-cover (BTC) ratios of 1.538x, 1.359x, and 2.803x respectively, reflecting revival of market interest at the last auction which helped spur the month-end rally.

In the corporate bonds space, credit spreads tightened considerably at the front end as a result of fast rising MGS/GII yields while some widening was observed at the longer end. Primary issuance pipeline saw increased activity as corporate issuers sought to tap the market in current low-rates environment; and to shore up liquidity in the face of challenging economic prospect. Corporate issuers that priced their bonds during the month include DanaInfra, Malaysia Rail Link, Maybank, and Bank Rakyat; while potential issuances in the pipeline include Bank Pembangunan, Malaysia Airports Holdings, Alliance Bank, Danga Capital, and Pengerang LNG (Two) Sdn Bhd.

Foreign fund flows data released during the month showed that there had been inflows of RM3.0b into the MGS/GII market in August (July: RM7.8b), lifting total foreign holdings of MGS/GII to 24% (July: 23.5%). Following the strengthening to 4.11 in mid-September, USDMYR ended the month flat at ~4.16. The latest

CPI data release showed that deflation continued in August with CPI reading of -1.4% YoY (Consensus: -1.3%; July 2020: -1.3%).

Strategy

Market Outlook

Despite recent market weakness, we maintain our constructive view on the bond markets as we expect interest rates to remain low amidst uncertain growth prospect. Given the historically low OPR level and expected increase in bonds supply, we do not expect a repeat of the 2019-1H2020 stellar performance. Nevertheless, current steep yield curves still present attractive opportunity to pick up value and capture potential upside from further monetary policy easing.

Portfolio Duration

Although BNM maintained the OPR at 1.75% at its recent MPC meeting after a series of consecutive rate cuts, we remain overweight portfolio duration given our view that interest rates will remain low in the near future. As such, we will position ourselves on the mid to long end of the yield curve with the steepness of the yield curve deemed to offer better relative value as compared to the shorter end.

Security Selection

We expect corporate bonds to outperform government bonds due to the wide credit spreads. With government bond yields at low levels, we anticipate credit spreads to tighten in the months ahead as investors seek yield pick-up in order to boost their portfolio returns.

Hence, we will focus on acquiring high grade papers for core holdings, while adding selective high yield names for yield pick-up. We will however implement more vigilant credit surveillance on corporate bonds, in view of the economic downturn and its impact on business earnings as well as consumer confidence.

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