Market Review & Outlook

September 2020

(as at 31 August 2020)

Overview

US

- On 27 August, at the Jackson Hole policy symposium, the Fed announced a revised approach to inflation and the labour market. The Fed will target inflation to average at 2% over time, signalling a tolerance of inflation moderately >2% if there has been a previous period of <2% inflation. At the same time the Fed will tolerate employment at or above the real-time estimates of its maximum level if there are no signs of unwelcome inflation pressure.
- The second estimate of 2Q2020 GDP at -31.7% QoQ annualised, was marginally better that the advanced estimate of -32.9% QoQ annualised, driven marginally better private sector data. Personal Consumption at -24.76% QoQ annualised (advance estimate: -25.05% QoQ annualised), Gross Private Investment at -8.66% QoQ annualised (advance estimate: -9.36% QoQ annualised), Net Exports at +0.90% QoQ annualised (advance estimate: +0.68% QoQ annualised), while Government Consumption remained unchanged at +0.82% QoQ annualised.
- Headline activities indices printed generally positively for August with ISM Manufacturing PMI at 56.2pts (consensus expectation: 54.8pts, July: 53.6pts) and ISM Services PMI remaining in comfortable expansionary territory at 56.9pts (consensus expectation: 57.0pts, July: 58.1pts). However, the employment component of these activities indicators, though improving, remain contractionary at 46.4pts (July: 44.3pts) for Manufacturing and at 47.9pts (July: 42.1pts) for Services.

EU

- There are signs of weakness in the euro area's recovery, with activity indicator Markit Composite PMI turning to contraction in August for Spain at 48.4pts (July: 52.8pts) and for Italy 47.1pts (July: 51.6pts). In the euro area as a whole, Markit Manufacturing PMI sustained in expansion at 51.7pts (July: 51.8pts, June: 47.4pts) while Markit Services PMI that relate to activity the larger services sector saw activity ease at 50.5pts (July: 54.7pts, June: 48.3pts).
- Retails Sales also posted unexpected weakness in July at -1.3% MoM (consensus expectation: +1.0% MoM, June: +5.7% MoM) and +0.4% YoY (consensus expectation: +1.9% YoY, June: +1.3% YoY).
- While COVID-19 stimulus measures are expected to provide significant support for consumer demand in 2H2020, current 2nd wave rise of COVID-19 cases and related rising fears of higher unemployment would provide some drag to growth.

Malaysia

- Malaysia's 2Q2020 GDP printed at -17.1% YoY and -16.5% QoQ SA significantly disappointing consensus expectation of -10.9% YoY and -11.4% QoQ SA (1Q2020: +0.7% YoY and -2.0% QoQ SA). The Malaysian economy meets the technical rule-of-thumb for recession, with 2 consecutive quarters of QoQ contraction in GDP.
- With the significantly weaker performance of 2Q2020 GDP that has prompted the BNM to revise GDP expectations downwards to -3.5% to -5.5% from +0.5% to -2.0% previously (with forecast of rebound in the range of +5.5% to +8.0% in 2021) along with ample policy space from low inflation for the year, we see high chance for BNM to cut more than 25bps in 2H2020 in a single or several policy actions as early as the 10 September MPC meeting, depending on the slack in the output gap.
- Mainly driven by smaller decline in transport costs, deflation eased in July at -1.3% YoY (consensus expectation: -1.3% YoY, June: -1.9% YoY) moderating further from the -2.9% YoY troughs of April and May.
- Malaysia posted a record high trade surplus of RM25.2b in July (June: RM20.9b) with exports supported by improved palm oil prices and the jump in the rubber products segment. However, with July exports growth moderating to 3.1% YoY (June: +8.0% YoY) and imports contracting further at -8.7% YoY (June: -5.6% YoY), the outlook for trade activity remains negative.

Equities

GLOBAL EQUITIES

The equity market moved higher in August, propelled by encouraging economic momentum and prospects of a prolonged low interest-rate environment. Positive news flows about potential vaccines and treatments for COVID-19 and signs of progress towards further economic stimulus provided further support to the risk on mode. The Dow Jones Industrial Index advanced 7.6%. The strong performance was despite intensified tensions between US and China and rising coronavirus cases in the US. Similarly, Euro Stoxx 50 Price Index gained 3.1%.

Brent crude oil price rose 4.6% MoM to USD45/bbl as global COVID-19 new cases showed improvement.

ASIA PACIFIC EQUITIES

Equity markets in mainland China and Hong Kong posted a 3rd straight month of gains in August. Economic data releases from China signalling that that the country's ongoing economic recovery are gathering strength, helped boost corporate earnings expectations and appetite for risk assets. Shanghai Composite Index gained 2.6% while Hang Seng Index was upped 2.4%. South Korea's KOSPI Index rose 3.4%. This was despite growth concern resulting from resurgence of COVID-19. Meanwhile, Taiwan's TAIEX Index ended the month with a decline of 0.6%, dragged down by technology sector due to further restriction on Huawei's access to US technology.

The upward trend in the equity market has been fuelled by accommodative policy measures from governments and central banks, further supported by economic indicators that are pointing to an improving economic outlook. Downside risks mainly are geopolitical issues and macro weakness on potential of pandemic resurgence. We focus on companies with stronger balance sheets as well as companies that have stable earnings delivery and sustainable dividend payout while selectively positioning in cyclical stocks on the back of improving economic outlook going forward.

ASEAN EQUITIES

ASEAN equities continued to tick up higher, closing August with a 0.7% MoM gain in US Dollar terms. Positive news about potential vaccines and treatments for COVID-19 and flattening global new cases buoyed sentiment. ASEAN equity markets closed mixed in August with Vietnam emerging as the best performer, staging a strong 10.4% MoM rebound in US Dollar terms after slumping 3.1% MoM following a resurgence of new COVID-19 cases in July. It was followed by Indonesia (+2.5% MoM) and Singapore (+1.2% MoM). Settling at the bottom, Malaysia was down 3.2% MoM, followed by Thailand (-0.8% MoM) and the Philippines (+0.7% MoM). ASEAN currencies closed mostly stronger against the greenback with the ringgit leading the pack with 1.8% MoM gain followed by the Philippine peso (+1.3% MoM) and Singapore dollar (+1.0% MoM). Meanwhile, Vietnam dong was flat and settled at the bottom followed by Indonesian rupiah (+0.3% MoM) and Thai baht (+0.6% MoM).

In terms of forward P/E multiples, Thailand emerged as the most expensive ASEAN market. The Thai market is now trading at +2.7 S.D above its 10-year average, followed by Malaysia (+2.1 S.D) and Indonesia (+1.0 S.D). Meanwhile, the Philippines (-0.3 S.D) continues to be the cheapest and only ASEAN market that is trading marginally below its 10-year mean, followed by Vietnam (+0.4 S.D) and Singapore (+0.6 S.D).

We maintain our neutral views on all ASEAN markets after dialling back Indonesia and the Philippines from underweight to neutral last month. While investors' 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.

MALAYSIAN EQUITIES

The KLCI lost 4.9% MoM in August, despite the Dow Jones surging 7.6% MoM. The mid/small caps were more resilient where the FBM70 and FBMSC Index were up by 1.7% and 5.0% MoM respectively. Sector wise, Construction and Finance were the worst performing sectors, down by -4.5% and -4.0% respectively. Technology and Healthcare were the best performing sectors, up by 11.3% and 7.5% MoM respectively. The top three gainers in KLCI components stocks were Press Metal (+7.6%), Telekom Malaysia and Top Glove while the worst performing stocks were Hap Seng (-19.6%), Hartalega (-18.5%), and Petronas Chemical.

Globally, new COVID-19 cases had flattened at 266k cases as at end-August, a slight decline from last month. New cases in US have shown a declining trend in August, to around 32k cases per day, less than half from last month. Countries that still show worrying increasing trends were India and Indonesia. South Korea has reported sudden surged in new cases peaking at 441 new cases per day but seems to have been brought under control. Russia announced the approval of COVID-19 vaccine but was warned by World Health Organisation to follow established guidelines and go "through all the stages".

The US-China technology war escalated as President Trump issued executive orders banning US transactions with Chinese tech firms Tencent and ByteDance. Tencent owns Chinese messaging app WeChat, and ByteDance is the Beijing-based parent company of the popular short video-sharing app TikTok, which has 80 million monthly active users in the US. On top of that, the US Bureau of Industry and Security further restricts Huawei and its affiliates access to items produced domestically and abroad using US technology.

In Malaysia, the Prime Minister has announced that the recovery phase of Malaysia's COVID-19 movement control order (RMCO) will be extended to 31 December 2020 and tourists will remain barred from entering the country.

Foreign institutional investors net sold RM1.5b worth of Malaysian equities in August, bringing YTD net outflow to RM20.1b.

Strategy

During the month of August, global markets, in particular the US market continued to do well despite the COVID-19 pandemic being far from over. The US market recouped almost all its losses on YTD basis and continue to remain strong while the economy continued to face uncertainties from 1) the impact of COVID-19; 2) the worsening US-China trade relations and; 3) the upcoming US Presidential election. With the factors mentioned above, we believe being defensive in the near term would protect the downside of the portfolio if a correction occurs.

In the local market scene, the weaker 2Q2020 corporate results were expected as the quarter incorporated the full impact of MCO during the said period. During the 2Q2020 corporate results season, we saw almost all sectors except gloves and technology experience earnings declines. While we believe some corporates may have seen the worst (provided no further COVID-19 resurgence), recovery could be bumpy and slow, especially with RMCO being extended to the end of 2020. Our cautiousness on the market remains. Nevertheless, we believe that there are pockets of opportunities in the market that would provide reasonable returns to our portfolios.

We remain focused on sectors that will benefit from this pandemic period while anchoring the portfolio with good dividend yielding stocks to provide a stable income stream. We will be selective in our investment based on a bottom-up approach within our preferred sectors, namely, consumer (non-discretionary), technology, gloves, selective construction, telcos, plantation and REITs.

Fixed Income

ASIAN BOND MARKETS

The overall Asian dollar market saw return performance ease significantly to +0.21% MoM (July: +2.53 MoM). The Asian dollar Investment Grade space also saw a similar drop in return at -0.15% MoM (July: +2.46% MoM), while the more volatile Asian dollar High Yield index sustained its return at +2.21% MoM (July: +2.50% MoM).

By country, in contrast to the past 4 months when all markets saw strong gains, performance significantly weakened with only 3 gainers in August, namely in more speculative markets India (+1.70% MoM), Hong Kong (+0.34%), China (+0.11% MoM) and South Korea (+0.08% MoM).

We see that after 4 months of risk-on rally, the Asian dollar bond saw some profit taking in August. We see that there is potential for rebound 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) continued heavy fiscal stimulus packages to mitigate the negative economic pressures of COVID-19, c) on expectation of dovish monetary policy trend 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 positive return, namely Indonesia (+1.19% MoM) and Philippines (+0.39% MoM). We see that the sell-off in local currency markets is likely prompted by profit taking, while laggard markets of Indonesia and Philippines still had room to run in August.

Following the August profit taking, we see that there is potential for resurgence of market risk-on sentiment for Asian bonds continuing as the region's economies generally move on to 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, August saw continued bearish sentiment (though less than in July) on the USD driven by second wave surges of COVID-19 cases in the US coupled with general global risk-on sentiment during the month. 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 hypothesis 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 global risk-off sentiment given the volatile global economic environment.

MALAYSIAN BOND MARKET

The Malaysian Bond markets generally weakened in the month of August in tandem with US Treasuries as investors turned cautious and took profit. MGS curve bear-steepened tracking the US Treasury sell-off amid a) higher supplies at the longer tenures (10Yr & 30Yr), b) the Fed's decision of not adopting yield curve control and c) fears of rising inflationary pressure following Fed's revision on longer-run goals and monetary policy strategy. While MGS yields at the longer-end increased by 8-28bps (MoM), MGS yields at the front-end declined by 3-9bps (MoM) reflecting market expectation of another OPR cut in BNM Monetary Policy Committee (MPC) meeting in September.

US Treasury yields of 10yr and 30Yr ended the month higher by 18bps and 28bps respectively. The bear steepening of the US Treasury yield curve was mainly attributed to FOMC's adjusted strategy of achieving inflation of average 2% in the long run. Given that inflation has been running below 2% for a period, Fed would adopt appropriate monetary policy to achieve inflation above the 2% target for some time. MGS yields were affected by the US Treasury movement as well as the risk of further fiscal stimulus as the Government stands ready to further stimulate economy if needed. Also, investors were cautious with upcoming decision of FTSE Russell review on World Government Bond Index (WGBI) this September. Recall that, FTSE has kept Malaysia on its watch list for exclusion from WGBI given its concern over MYR bonds accessibility. It is worth noting that BNM has been taking measures to improve bond liquidity in Malaysian markets. The tepid market sentiment was seen at the reopening of 20yr MGS 5/40 with RM5.5b in size which garnered only BTC of 1.47x. The month ended with 20yr MGS closed at 3.5%, an increase of 28bps (MoM).

The compressed yields and risk of increasing supplies in Govvies have shifted investors' appetite to corporate bonds especially in the AA space for the yield pickup. The average AA rated corporate yields went down by 4-11bps (MoM) for tenures of 10yr and below, while the ultra-long ends of AA curve were flattish. Actively traded names were TG excellence (-1bps MoM) and SPG 31s (-9bps MoM), amongst others.

Going into the month of September, we expect another round of OPR cut by BNM in the MPC meeting on 10 Sep. We expect BNM stance to remain dovish and stand ready to further support economic recovery as necessary. Following BNM's downward revision on Malaysia's GDP 2020 forecast to a range of -3.5% to -5.4% in 2020, BNM highlighted that there is still room for additional targeted policy measures. Local bond yields are likely to remain low while volatility would persist amid bond supply risks and the impending FTSE Russell decision on whether Malaysian Government bonds would remain in the WGBI index.

Strategy

Market Outlook

We remain broadly optimistic on the local bond market as we expect bond yields to remain supported by BNM's dovish stance amid downside growth risks in 2020/ 1H2021 would necessitate further OPR cuts by BNM. That said, uncertainties lie ahead with the risk of resurgence in COVID-19 cases globally during winter and local economy recovery slower than expected could instigate further fiscal stimulus. As such, bond markets are likely to be mildly volatile amid risk of bond supplies and the impending FTSE Russell decision on Malaysian Government bonds in WGBI index.

Portfolio Duration

We continue to overweight duration to express the expectation that interest rates will remain low for the foreseeable future and the possibility of further rate cut in late 2020/2021. Meanwhile, we will realize gains for some of the MGS/GII holdings while employing relative value positioning along the yield curves to take advantage of the market volatility.

Security Selection

We are actively looking for high grade papers for core holdings, while adding selective high yield names for yield pick-up. Focus will be on acquiring corporate bonds that have lagged MGS yield movement and which will provide yield pick-up in a low interest rate environment. 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.
