Market Review & Outlook

March 2020

(as at 29 February 2020)

Overview

US

- At the start of the month labour market data surprised strongly on the upside as non-farm payrolls printed at 225,000 new jobs in January 2020 (released on 7 February 2020) beating consensus expectation of 165,000.
- The strong 4Q2019 GDP growth was unrevised in the second estimate at 2.1% annualized QoQ in line with consensus expectation.
- However, concerns of global slowdown continued to drive risk-off sentiment in US markets, and further deepened in the in the last 2 weeks of the month. COVID-19 infections that have started to rise domestically, now at 66 confirmed cases in the US as at 1 March 2020) overshadowed other data.
- In an announcement outside its usual Federal Open Market Committee (FOMC) meeting schedule, the US Fed made a 50bps rate cut on 3 March 2020, bringing its target rate range to 1.00-1.25%. Going forward, we expect the US Fed to still influence the coordinated global monetary policy action, in the immediate term. As at 4 March 2020, US Fed futures are aggressively pricing in another 25bps to 50bps cut at the next FOMC meeting on 18 March 2020.

EU

- ECB President Christine Lagarde played down the economic impact of the COVID-19 epidemic in an interview on 27 February 2020, saying it was not yet causing lasting economic damage.
- There was a return of concerns of a 'no deal' Brexit, as the both the EU and the UK set out their mandates in a confrontational manner.
- Germany's economy narrowly avoided contraction in 4Q2019 with GDP growth unchanged from 3Q at 0.4% YoY on a calendar-adjusted basis. Full-year growth was revised up by 0.1% to 0.6% YoY.
- Investors positioned for a higher-spending UK budget in March 2020 under a new British finance minister Rishi Sunak. Sunak who was appointed on 13 February 2020 is in favour of higher fiscal spending so that there is less need for a further rate cut by the BoE.

Malaysia

- Malaysia's 4Q2019 real GDP printed at a disappointing 3.6% YoY (consensus expectation: 4.5% YoY), dragged down mainly by the sharp contraction in net exports by -9.8% YoY. Sector wise, Agriculture (4Q2019: -5.7% YoY) and Mining (4Q2019: -2.5% YoY) suffered contraction in 4Q2019, in line with Bank Negara Malaysia (BNM)'s statement on commodity sector supply disruption. Annual real GDP growth for FY2019 works out to be 4.3%, significantly disappointing consensus forecast of 4.5% and falling on the lower-end of BNM's estimated range of 4.3 -4.8% for 2019.
- The government announced an economic package that is worth MYR20b/about 1.3% of GDP (2020f: RM1.54tr). The impact on fiscal deficit is mitigated due to funding being a joint effort that involves government entities other than MoF. The impact on the fiscal deficit is officially estimated at only 0.2 percentage points, raising the 2020 estimate to 3.4% of GDP.
- On 3 March 2020, BNM delivered a second consecutive OPR cut of 25bps to 2.50%, in line with consensus expectation. With risks to growth skewed to the downside from COVID-19, global trade tensions along with some potential drag from developments in the domestic political arena, we see a high likelihood of a further 25bps rate cut by BNM. This could occur at the next MPC meeting but do note that the Central Bank has also announced policy action outside of its meeting schedule.

Equities

GLOBAL EQUITIES

Equity markets ended February in the sea of red on concerns of the global spread of the COVID-19 epidemic. The market had a gradual rise at the start of the month on encouraging economic data and favourable fourth quarter corporate results before sentiment took a nosedived in the final week. Fears that the global spread of the COVID-19 epidemic was intensifying has led to mounting worries of further slowdown in economic activities as well as corporate profit growth. The Dow Jones Industrial Average (the Dow) and Euro Stoxx 50 Price Index suffered a significant decline of 10.07% and 8.55% respectively.

Brent crude oil price dropped 13.1% MoM to close at US$50/bbl also on fear of global-scale COVID-19 outbreak that would dampen the outlook for global energy demand.

ASIA PACIFIC EQUITIES

Chinese equity suffered panic selling as trading resumed after the Lunar New Year Holiday, amid the escalating COVID-19 epidemic. Positive sentiment subsequently returned, supported by the Chinese government's fiscal and monetary policy to mitigate the fallout from the coronavirus outbreak. The declining number of new contaminations of COVID-19 towards month-end also soothed sentiment. The Shanghai SE Composite Index closed the month 3.23% lower, but off the month's low. The Hang Seng Index posted a decline by a small magnitude of 0.69%, on lessened daily infection rate. The government of Hong Kong also announced an expansionary fiscal budget, in an effort to stabilize the economy. South Korea's KOSPI Index declined 6.23%, amid rapid increased in confirmed COVID-19 cases in the country. Similarly, TAIEX Index also ended 1.77% lower. Technology stocks took the lead on concerns over disruption in global supply chain.

Given the uncertainty to the extent of economic fallout of the COVID-19 epidemic, the equity market is likely to go through a bumpier ride ahead. As such, investment strategy will remain tilted towards companies that have stable earnings delivery and sustainable attractive yield.

ASEAN EQUITIES

ASEAN equities continued to slump, closing the month of February with an 8.5% MoM decline in US Dollar terms amid rising concerns on COVID-19 spread following spikes outside of China, in new reported cases and deaths from the outbreak. All ASEAN markets ended the month in the red with the Philippines, Vietnam and Malaysia being the most resilient: all three were down 5.9% MoM in US Dollar terms. Meanwhile, Thailand suffered the most as it slumped 12.3% MoM, followed by Indonesia (-11.9% MoM) and Singapore (-6.5% MoM). All ASEAN currencies closed the month weaker against the US Dollar. Indonesian rupiah (-4.6% MoM) depreciated the most followed by Malaysian ringgit (-2.8% MoM) and Singapore dollar (-2.0% MoM). Vietnam dong emerged as the top performer as it closed flat against the US dollar with negative bias, followed by the Philippine peso (-0.1% MoM) and Thai baht (-1.3% MoM).

In terms of forward P/E multiples, Thailand remains the most expensive and the only ASEAN market that is trading above its 10-year average although valuation has de-rated to 0.2 S.D above mean. Following the recent sell-down, Indonesia (-1.6 S.D) has emerged as the cheapest ASEAN market followed by the Philippines (-1.5 S.D) and Singapore (-1.4 S.D). Meanwhile, Malaysia (-0.4 S.D) and Vietnam (-0.2 S.D) are trading slightly below their respective 10-year average valuation.

We remain Neutral on all ASEAN markets with the exception of Vietnam on which we have an Overweight call. We maintain our defensive stance preferring low-beta and high-yielding stocks as we expect markets to remain volatile in the near to mid-term due to the impact of COVID-19. The actual impact from the outbreak is rather hard to quantify for now and volatility would persist in the near term. We are watchful of the developments of the COVID-19 epidemic and seek value in quality names that we believe will emerge strongly from the sell-down.

MALAYSIAN EQUITIES

The KLCI registered a loss of 3.2% MoM in February, dragged down by the Dow which plunged 10.1% MoM. The bearish sentiment was most prevalent in mid/small cap where the FBM70 and FBMSC Index plunged 5.7% MoM and 4.1% MoM respectively. During the month, global markets were gripped by fear of the outbreak of COVID-19.

New cases of COVID-19 infection in China has shown improvement and stabilized around a few hundred cases a day. However, the situation in South Korea's was showing signs of deterioration, with reported new COVID-19 infections in excess of 500 in the last few days of the month. Italy and Iran are other areas of concern where new cases hit new high. China's Feb PMI was reported an all-time low of 35.7, significantly disappointing market consensus of 45.0 points and lower than 38.8 reported in 2008 during the global financial crisis.

Despite the signing of phase 1 trade deal, the rivalry of US and China continued in the technology space. The US has expanded its lawsuit against Huawei, accusing the Chinese telecoms giant of a "decades-long" plan to steal technology from US firms. Also, the US continues to mull cutting China's Huawei off from global chip suppliers such as Taiwan's TSMC. Most chip manufacturers rely on equipment produced by US companies such as KLA, Lam Research and Applied Materials.

Domestically, Malaysia saw the sudden collapse of the Pakatan Harapan Federal government when Parti Pribumi Bersatu (Bersatu) and 10 members of Parliament (MPs) from PKR broke away from the Harapan coalition to form a new coalition with the opposition led by UMNO and PAS. Amid the political turmoil, Pakatan Prime Minister (PM), Tun Mahathir resigned as PM, which led to the appointment of Bersatu President, Tan Sri Muhyiddin as the new PM. Subsequently, Tun Mahathir claimed that he had the backing of 114 MPs or 51% of the 222-strong parliament to continue as PM. Tun Mahathir is now demanding the commencement of Parliament session, scheduled on 9 March, to ascertain who really has the majority support of MPs.

Corporate Malaysia reported 4Q2019 results which fell short of expectation. KLCI's 2019 earnings declined -7.7% YoY. Nevertheless, analysts are now projecting KLCI earnings to turnaround with growth of 6.4% YoY in 2020.

Foreign institutional investors net sold RM1.98b worth of Malaysian equities in the month of February, bringing YTD net outflow to RM2.13b. Sector wise, Energy, Construction and Transport were the worst performing sectors, dropping between 7.3 to 8% MoM. The defensive REITs sector gained 1.5% MoM.

The top three gainers in KLCI components stocks were Hartalega (4.7%), Petronas Gas and Petronas Dagangan while the worst performing stocks were Petronas Chemical (-12.8%), Genting Bhd (-10.0%) and Sime Darby.

Strategy

Amidst the increasing spread of COVID-19 globally, the IMF has cut global growth forecast to 3.2% from 3.3%. In particular, the growth estimate on China has been cut to 5.6% from 6.0% this year on the disruption of economic activity in the country. In addition to the virus outbreak, the recent political developments in Malaysia have caught investors by surprise, adding further volatility. As developments are still fluid, the local equity market is not expected to stabilize in the short term due to the lingering uncertainty.

We believe foreign investors will continue to stay on the sidelines on Malaysia stocks, possibly resulting in a weaker ringgit, although this may be partly exacerbated by a stronger US dollar from a more risk-off stance globally. However, the volatile market does present buying opportunities as selective counters appear oversold. Nevertheless, our equity strategy is to remain defensive.

We maintain focused on seeking higher dividend-yielding stocks and sticking to fundamentally strong companies. As we focus on the local political developments, we see some relative value in sectors such as plantation, consumer (non-discretionary), oil & gas players involved in maintenance, selective construction and technology players, and REITs.

Fixed Income

ASIAN BOND MARKETS

The overall Asian dollar market posted 1.26% MoM return in February 2020 (January 2020: 1.74% MoM). The Asian dollar Investment Grade bonds continued to rally with a return of 1.56% MoM in February 2020 (January 2020: +2.09% MoM) supported by expectations of policy loosening in the region in the face of the COVID-19 public health crisis. However, the challenging growth environment dampened investor appetite in the Asian dollar High Yield space which saw negative return at -0.27% MoM in February 2020 (Jan 2020: +1.59%). By country, all markets under our coverage saw significant positive return for the month with the top three gainers being Thailand (+2.11% MoM), Hong Kong (+1.96% MoM) and Singapore (+1.89% MoM).

Regional local currency sovereign bonds in US dollar terms registered significant gains, similarly benefiting from expectation of policy loosening in the region and also catching-up by laggard markets. India led the pack with a gain of 2.61% MoM, followed by Thailand (+2.20% MoM) with Malaysia (+2.03% MoM) and South Korea (+2.03% MoM) tied at third place.

With investment flows from DM to EM that drove up returns in Asian bonds, occurring only recently in Jan 2020; investors look to have decided to remain invested in the region. The COVID-19 outbreak and escalation that really began at end Jan 2020 and is continuing has not dragged down the performance of the overall regional dollar market, rather with traders appearing to differentiated between weaker and more resilient credits on an individual issuer level rather than at country level.

The forex market remains subdued with dollar strength constrained, as traders still cognizant of the US government's strong signaling of a weak dollar policy in the previous months. We still see that other hard currencies to face strengthening bias that in this risk-off period, while the US dollar should remain subdued.

However this strength in hard currencies is still mitigated by the low-yield environment in DM markets that also provides resilience to Regional High Grade bonds from issuers not vulnerable to the COVID-19 outbreak.

MALAYSIAN BOND MARKET

The current bond market is experiencing a rally, as investors bet that fears over potential world pandemic may derail a global economic recovery. Global growth has already been stuttering due to US-China trade tensions last year. Rising COVID-19 cases in US and other parts of the world outside of China have put the potential recovery in disarray. In the month of February, the U.S 10-year US treasury yield dropped from the high of 1.65% to the low of 1.15% precipitated by safe haven flows.

Risk-off market sentiments and anticipation of further rate cuts by the US Federal Reserve (Fed) have sent the U.S 10-year treasury yield to an all-time low of 1.15% at the end of February.

In the local market, bonds continued to rally in tandem with the US Treasuries and in anticipation of another 25bps OPR cut in 2020. This rate cut was delivered on 3 March 2020 as BNM made a second consecutive cut to OPR of 25bps to 2.50%. The cut came shortly after the RM20b COVID-19 fiscal stimulus package which was announced on 27 February 2020. While foreign flows were affected by the ongoing political turmoil in the country, government bonds were seen strongly supported by local investors despite the spike in yields on the day of Tun Mahathir's resignation as the Prime Minister of Malaysia.

The MGS curve parallel shifted downwards by 18-35bps, fully pricing in a 25bps rate cut or more. Notable interest was seen at the belly of the curve, with large volume traded. As for the Government bond auctions, GII 11/49 (Size MYR2.5b), MGS 8/29 (Size MYR4b), and GII 10/24 (Size MYR4b) garnered strong interests with BTC of 2.328x, 2.036x and 2.776x respectively. Similarly, Government Guaranteed bonds and corporate bonds rallied across the curve.

Within the corporate bond space, primary issuances garnered strong interests, given the limited issuances. Notable issuances were 1) Top Glove, wholly-owned SPV TG Excellence Bhd, which gathered >5x book cover for its MYR1.3b Perpetual non-callable 5-year issuance and 2) Danum Capital (Khazanah funding vehicle), which raised MYR2b via 5Yr and 15Y IMTN issuances. The robust demand had led to an upsize of RM500m and tighter yields by 8bps from the initial guidance.

We remain bullish on the local bond markets as we expect BNM likely to reduce the key interest rate again by 25 bps. The global economic headwinds and weakening domestic growth are likely to persist mainly due to the still rapid rise of COVID-19 cases outside China. In addition, the ample market liquidity and scarcity in primary corporate issuances would continue to be supportive to our local bond markets.

Strategy

Market Outlook

Market has fully priced in the 25bps cut by Bank Negara but the Fed's emergency rate cut was unexpected. With the mild rally on the back of the latter, we expect investors to take some profit in near term. Having said this, a lack of new issuances in the pipeline and flush domestic liquidity will provide the support to local rates. Market direction will be dictated by factors such as external headwinds, weakening domestic growth and political uncertainties.

Portfolio Duration

We continue to overweight duration as liquidity in the market remains ample and yields are not expected to spike up sharply. We expect the yield curve to flatten further, given the benign inflation outlook and expected sluggish global growth.

Security Selection

We are actively looking for high grade papers for core holdings, while adding selective high yield names for yield pick-up.

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