Cloudy Vision 20/20

Maybank
Asset Management

2Q2020 Outlook & Strategy

Welcome to our 2Q 2020 Outlook & Strategy Report

Maybank Asset Management

20/20

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1Q2020 Asia Ex-Japan Market Review

A dismal and challenging quarter for the financial markets

The first quarter of 2020 proved to be a dismal and challenging quarter for the financial markets. After a challenging 2019, mainly due to the concerns surrounding the deterioration of global economic growth as the US-China trade war continued to escalate throughout the year, many were expecting some degree of recovery. **Unfortunately, things took a turn for the worse as 2020 prove to be unprecedentedly challenging.**

In January, Asian equity markets began the year on a positive note in anticipation of the signing of the 'phase 1' US-China trade deal. **However, the initial rally in equity markets proved to be short- lived as markets saw a sharp correction on concerns over the COVID-19 coronavirus viral outbreak and its detrimental effects on global economic growth.** Selling became disorderly across all asset classes in March as the sell-off snowballed when the pandemic spread beyond China to the rest of the world, triggering unprecedented measures such as travel curbs and lockdowns.

This volatile situation was intensified in March after the Saudi Arabia and Russia failed to reach an agreement on production cuts during the OPEC+ meeting. Instead, Saudi Arabia decided to pursue the maximum production strategy to exert pressure on higher cost producers and gain market share. Oil prices tumbled more than 20% in a single day.

For the Asian fixed income markets, mainly Asian USD bonds, the JP Morgan Asian Credit Index (JACI) was up more than 3% for the year until the first week of March. **Following the blowout in the Covid- 19 pandemic, Asian USD bonds also tumbled along with all other risk assets, erasing all gains and closing the quarter down, -3.79% as of 19th March 2020.**

> "In January, Asian equity markets began the year on a positive note in anticipation of the signing of the **'phase 1' US-China trade deal.**"

During this steep sell-off, we have seen investment grade bonds sold off by 5 to 10 points and non-investment grade bonds marked down by up to 30-40%. The mark down of prices was indiscriminate across all countries and sectors. Hence, we opine that that the drastic price drop on bonds were mainly due to lack of liquidity, as fund managers, investors and ETF funds all rushed for the exit door at the same time.

COVID-19 spread
outside of China

Oil price -20%
drop in a single day

> “All asset classes **sold off in March**”

Key Theme For 2020

The number 2020 is usually associated with perfect vision

Our overall theme for 2020 is "Cloudy Vision 20/20". The number 2020 is usually associated with perfect vision and for Malaysians, there will be some significance as 2020 is the year that Malaysia planned to reach developed nation status as part of the "Wawasan 2020" or Vision 2020 that was set forth by Tun Dr Mahathir in his stint as Prime Minister.

Given the unprecedented events that have shocked and impacted the financial markets this year, it seems that "Cloudy Vision 20/20" is a right theme to have this year.

The disruptive effects from the COVID19 coronavirus are likely to be pronounced and extended, and it will take considerable time for business and consumer confidence to recover.

Cloudy Vision 20/20

KEY THEME	OUR ASSESSMENT	MARKET IMPLICATIONS & STRATEGY
Impact of COVID19	**Weak Global growth with likelihood of recession given COVID19.** • Policy makers look to counteract the economic impact of COVID19 via fiscal spending. • Assumes partial US-China trade deal (but no major concessions), motivated by upcoming US Presidential elections amidst slower US growth (as past fiscal stimulus fade and given its late cycle stage). • Growth uncertainty to persist with politics, trade policy and the COVID-19 viral outbreak being unpredictable swing factors. • Positive factors: i. Supportive monetary/fiscal policy ii. Easing trade tension • Negative factors: i. Prolonged COVID19 will could lead to a financial crisis ii. Corporate decision making/investment slows (on diminished business confidence given uncertainty)	**Implications:** • Negative returns for 2020 given the COVID19 coronavirus. **Strategy:** • Focus on structural themes that are less dependent on global macro- economic conditions e.g., 5G, technology change/ trends, policy beneficiaries.

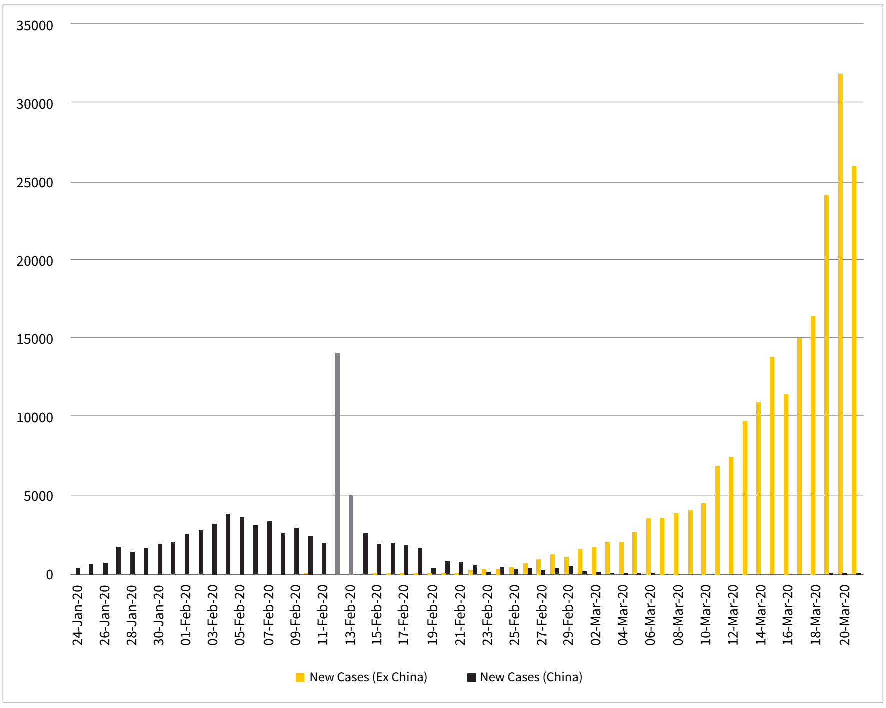
Our 2Q2020 Asia Ex-Japan Equity Outlook & Strategy

Revised our equity strategy in February and became more cautious

Entering 2020, we had been positive on Asian equities in 1Q20 given the prospect of a partial US- China trade deal and still-ample liquidity. While we were expecting markets to be volatile in 2020, we had expected equity returns to be front-loaded with uncertainty regarding upcoming US Presidential elections kicking in from 2Q20 onwards.

However, **with the emergence and rapid spread of the COVID-19 virus outbreak, we reversed our strategy in February and became more cautious.** New cases outside China were growing rapidly and we decided to take a more defensive view, increasing our cash positions for our funds.

Following the massive sell-off in 1Q20, we could potentially see a near term rebound in Asian equities but such a rebound may be short-lived unless we see a peaking of COVID-19 cases worldwide. We caution that bear markets (such as the one we are now in) may also see strong rallies occasionally.



New cases in China are trending lower, but new cases are growing outside of China
(Source: World Health Organization, 17 Mar 2020)

> For a more sustained rally, we would need to see **more aggressive fiscal policy response from governments** as well as a peak in COVID-19 cases worldwide.

For a sustained rally, we would need to see more aggressive fiscal policy responses from the government, accommodative monetary policies from central banks, as well as the stabilisation of the COVID-19 pandemic globally. We are cautiously optimistic for a better 2H20 after a dismal 1Q20. This is based on the premise of stability and in markets which may not have been troughed yet with value emerging.

The indiscriminate selling during the pandemic has created bargains and hence, better value buying opportunities. We will hold a high amount of cash to position our portfolios for the eventual recovery and will be redeploying the cash opportunistically.

We continue to favour stocks with consistent/ visible income streams, high/stable dividend yields, policy stimulus beneficiaries, 'stay-at-home' beneficiaries (e.g., e-commerce, online services) as well as companies with strong balance sheets/good cash flows.

"**We would expect a better**

2H20 after a dismal 1Q20"

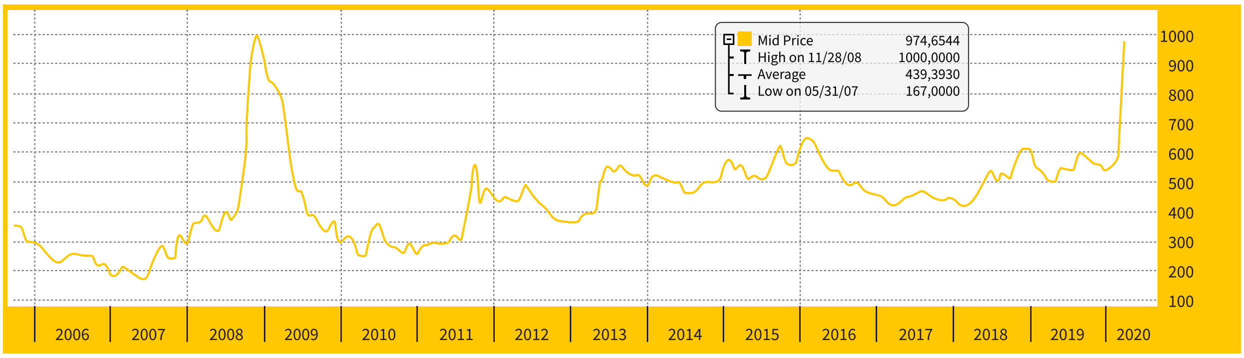
Our 2Q2020 Asia Ex-Japan Fixed Income Outlook & Strategy

Sharp mark down of bond prices is not a true reflection of underlying value

For the Asian USD fixed income space, the recent sell-off in USD bonds have caused high yield spreads to widen, to close at levels last seen during the Lehman crisis. We believe that the sharp mark down of bond prices is not a true reflection of the underlying value of the bonds. It is mainly due to the extreme liquidity stress as sellers overwhelmed the market.

In response to the liquidity stress in the markets, the US Federal Reserve (FED) established temporary dollar liquidity-swap lines with various central banks globally, expanding the rapid roll-out of financial-crisis-era programmes to combat the financial meltdown from the Covid-19 pandemic. In addition, the European Central Bank (ECB) created the Pandemic Emergency Purchase Program and the US Federal Reserve announced the Corporate Credit Facility Programme. These programmes are specifically designed to purchase corporate bonds to support the corporate bond markets.

With the above support, we believe that bond prices will recover to more reasonable levels in the future.



JP Morgan High Yield Index Credit Spread

(Source: Bloomberg)

While current bond yield levels look very attractive after the recent sell-off, we are waiting for markets to stabilise before adding more risk back into our bond portfolios. We are also more cautious as the situation on Covid-19 still looks precarious despite the global lockdown. On average, we have 20% cash in bond portfolios.

20%

Cash in bond portfolios

Indonesia

1Q2020 Indonesia Market Review

'Flight-to-safety' caused worst quarterly performance since 1998

JCI posted the worst quarterly performance since 1998, at -28% in 1Q20, driven by a double whammy hit of the Covid-19 outbreak and a strong USD as compared to the IDR as a 'flight-to-safety' stance re-emerged. The delayed response from the government in handling the pandemic crisis and acute USD funding risk, exacerbated the capital outflow from Indonesian markets as IDR depreciated significantly during the period. **The 10-year government bond's yield rose to c.8% at the end of March from January lows of c.6.6%.** On the other hand, Bank Indonesia (BI) has been more accommodative following the dovish stance of global central banks and injected liquidity domestically while fiscal policies remains conservative.

However, given the nature of the pandemic crisis, excessive monetary policy boost is ill-suited without a proper coordination of fiscal measures, especially for countries that relies heavily on external financing such as Indonesia. In turn, **the government has shifted its fiscal stance drastically into expansionary mode to follow other countries by enlarging deficits up to c.5% to provide a necessary relief for the economy,** albeit temporarily with the normalisation path to

take effect in the subsequent years. The funding will undoubtedly come from BI's quantitative easing as foreign investors shy away from risky countries while private sector remains in deficit due to the weakening cash flow.

In this case, **we see a neutral-negative impact on IDR in the mid-term** should the government decides to deploy foreign exchange reserves or bilateral loans with international institutions (e.g. ADB, World Bank, IMF) as it will complicate the situation given the new abundant supply of IDR. Nonetheless, we opine massive fiscal relief as necessary in ensuring Indonesia's economy remains well-functioning in the event of a global recovery and to avoid repercussions from excessive insolvency issues as well as an unemployment surge.

Our 2Q2020 Indonesia Equity Outlook & Strategy

Focus on stocks with strong balance sheets and market leaders

With the aforementioned factors, we expect the Indonesian government to utilise the momentum to front-load the fiscal relief given the early stage of USD funding shortage globally. On the other hand, the monetary policy rate stance may shift from an economic booster to a stabiliser in the financial market against capital outflow risks. This is due to the ongoing flight-to-safety and credit rating downgrade risks should the fiscal normalisation face obstacles such as further deterioration in revenue. **Therefore, we see fiscal policy as the core policy to maintain solvency and to soften the economic blow while Bank Indonesia (BI) maintaining adequate real interest rates differential.** Respectively, we expect a break in BI rate cut cycles and possibly a rate hike as the next move should the capital outflow risks increase.

In this case, **we are focusing on stocks with strong balance sheets and market leaders as the best candidate to weather the stormy environment,** for which growth forecast will be hugely uncertain with significant downside bias. Several names in consumers and telecommunication space are on our list as well as the biggest bank, BBCA, due to its ample liquidity. Opportunistically, we are trading commodity names with strong balance sheet and substantial net cash, such as several coal and metal names given a limited downside in their underlying commodity prices.

We expect that a massive liquidity injection from the central bank coupled with astronomical fiscal measures would only provide a tactical trading opportunity as both are not meant to boost growth (only a relief) given the nature of the pandemic crisis. Hence, a strong turn in the Covid-19 outbreak into a controllable situation would be a key catalyst for us to be bullish on the stock market and to look back into growth stocks as the economic activity normalizes. Until then, **maintaining adequate cash level on the portfolios to capitalise emerging opportunities with selected stock focus as mentioned above will be the best way to navigate through the stormy conditions.**

Our 2Q2020 Indonesia Fixed Income Outlook & Strategy

Current environment a mix of the 2008 and 1998 crisis

Indonesia's bond market started the year 2020 strongly. Expectations on a lower interest rate environment was realised in mid-Feb 2020 when the central bank lowered its benchmark rate by 25 bps to 4.75%. Prior to the decision, the demand for Indonesian government bonds broke the highest incoming bid record three times in a row to reach IDR 112 trillion. This shifted the yield curve lower by 50 bps across all tenors. The 10-year benchmark touched the lowest level this year, at 6.30% from 6.80% in the beginning of the year. In addition, the GDP growth of 5.0%-5.2% deemed achievable.

Everything changed in the beginning of March 2020 when the Covid-19 outbreak hit Indonesia and other countries outside of China. **Indonesia's central bank and ministry of finance have been actively accommodating the market by injecting liquidity through reverse auction and several relaxations on tax as well as banking required reserve ratio.** Also, the immediate rate cut of 25bps in March 2020 to 4.50%, was in line with Federal Reserve and other central banks globally. All the stimuli have brought the budget deficit to 3.0%, from previously 2.8%. We are still waiting for the parliament's approval to raise it to 5.0%.

The yield curve shifted higher across all tenors bringing the 10-year yields to 8.0% levels, though in the third week of March, it touched 8.60%. **Foreign investors were net sellers in March and foreign holdings had gone lower to 32.7% from 38.0% in the previous month.**

We see that the development of Covid-19 will drive the direction of the market as well as the volatility. **We see Indonesia's GDP growth by end 2020 to be in the range of 1.5%–3.0% as the best case and -0%-2.5% as our base case.** We see the current environment as a mix of 2008 and 1998 conditions in which both real sectors and financial markets took hits. **Therefore, we continue to be underweight and be defensive on the Indonesian bond market.** We would also stay short in duration until we see some positive development on the issues specifically the Covid-19.

The 10-year benchmark

6.30 %

The 10-year benchmark **touched the lowest level this year, at 6.30% from 6.80%** in the beginning of the year.

Budget deficit to

3.0 %

All the stimuli have brought the **budget deficit to 3.0%, from previously 2.8%.**

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