Market Review and Outlook

August 2022

Market Review

The MSCI World Index reversed its uptrend in the previous month by declining 4.33% mom during the month under review. This was brought about by the actions of various central banks which reaffirmed their fervent commitment to rein in inflation. In the United States (US), the Dow Jones Index fell by 4.06% mom as the Federal Reserve (Fed), at their annual Jackson Hole symposium, reiterated their stand in the fight against inflation and made known that they were even prepared to endure some near-term economic pain to achieve their goal. On the economic front, despite suffering 2 previous quarters of negative gross domestic product (GDP) growth qoq, some positive signs are beginning to show. The July 2022 ISM Manufacturing Purchasing Managers Index (PMI) reading was expansionary at 52.8, July 2022 unemployment rate edged down 0.1 ppt mom to 3.5% while July's US Consumer Price Index (CPI) eased to +8.5% yoy after peaking at +9.1% yoy in June 2022. In Europe, the Stoxx 50 Index also dropped 5.15% mom despite exhibiting 2Q22 GDP growths of +3.9% yoy and +0.6% qoq, due to the fiscal efforts of the European governments since the advent of the Russia-Ukraine conflict. However, economic uncertainty was still present with the Eurozone Flash Composite PMI deteriorating further to 49.2 in August 2022 as compared to 49.9 in July 2022. Apart from that, inflation fears might still be stoked by Russia's recent and indefinite shut down of the Nord Stream 1 as Gazprom could no longer provide a timeframe for restarting deliveries after discovering an 'oil leak' with the Russian government blaming sanctions imposed for hampering maintenance efforts. This could encumber Europe's efforts in securing fuel for the impending winter and might further buoy energy prices. On the other hand, to contain inflation while sustaining employment, the Bank of England's Monetary Policy Committee (MPC) voted to raise the Bank Rate by 0.5 ppt to 1.75%. In China, the Shanghai Composite Index eased by 1.57% mom, due to mixed economic data. On one hand, the July 2022 Caixin China PMI Composite Index was expansionary at 54.0 but on the other, August's manufacturing PMI was contractionary at 49.4 and retail sales momentum in July 2022 eased by 0.4 ppt mom to +2.7% yoy which was below consensus expectations. In addition, the Chinese economy was also reeling from Covid-19 lockdowns and a property downturn. To spur growth, the People's Bank of China (PBOC) lowered its 1-year loan prime rate (LPR) by 0.05 ppt to 3.65% and its 5-year LPR by 0.15 ppt to 4.30%.

For bonds, after last month's yield rally post-July FOMC, US Treasury (UST) yields continued their upward trend in August. USTs underperformed after US key data exhibited signs of weakness and was also fuelled by the Fed's Chairman, Powell's hawkish testimony at the aforementioned Jackson Hole Symposium on 25-27 August 2022. In his speech, Powell affirmed that the Fed will use tools forcefully to attack inflation that is running near its highest level in more than 40 years. While higher interest rates, slower growth, and softer labour market conditions will bring down inflation, Powell added that the actions will also bring some pain to households and businesses. He also expressed that a failure to restore price stability would mean far greater pain. This led to investors increasing their bets on more rate hikes in the next FOMC meeting. The 2-year UST yield being particularly sensitive to interest rate expectations, rose to a high of 3.49%, its highest since late 2007. Benchmark 10-year UST yield also rose 54bps to close the month high at 3.19% but remained well shy of their mid-June top of 3.47%.

During the month under review, Brent oil price continued its downwards trajectory by 12.3% mom to USD96.49/bbl, driven by weaker Chinese demand while the G7 nations threatened to impose a price cap on Russian oil. Crude palm oil (CPO) price also slid by 6.1% mom to RM4037/MT due to higher inventory levels and the move by the Indonesian government to extend its zero-export levy on all palm oil products until end October 2022 in a bid to boost CPO exports as well as cut back on the oversupply of fresh fruit bunches.

In contrast to its broader global peers, the ASEAN stock markets instead continued to enjoy positive performances in August 2022. The Stock Exchange of Thailand surged +3.97% mom as the country registered a 2Q22 GDP growth of +2.5% yoy which was +0.3 ppt qoq. In addition, its July 2022 S&P Global Thailand PMI Manufacturing registered an expansion with a reading of 52.4. Due to the inflation concerns and a robust economic recovery stimulated by tourism, the Bank of Thailand's (BoT) MPC raised its policy rate by 0.25% to 0.75% for the first time in almost four years (since December 2018). The Jakarta Composite Index also rose by +3.27% mom as Indonesia enjoyed a 2Q22 GDP growth of +5.44% yoy. Bank of Indonesia also raised its benchmark interest rate by 0.25 ppt to 3.75% for the first time since 2018 in a pre-emptive move to mitigate the inflation risks arising from non-subsidised fuel and food prices. Back home, the FBMKLCI climbed +1.33% mom on the back of a strong +8.9% yoy GDP growth in 2Q22 which was also above consensus expectations. Malaysia's June 2022 industrial production growth was also encouraging at +12.1% yoy, being a marked improvement over the previous month's +4.1% yoy. Foreign funds also helped to support the market with a RM2.1b net equity inflow in August which brought the YTD sum to RM8.3b. However, the Ringgit weakened to RM4.4755: USD1.00 in August from RM4.4508: USD1.00 in July. Lastly, Singapore's Straits Times Index edged up +0.31% mom, helped by the financial sector which stood to benefit from improved net interest margins amidst the rate hike environment. From an economic perspective, July's non-oil domestic exports (NODX) grew by +7.0% yoy albeit at a slightly lower momentum as compared to the +9.0% yoy in June 2022.

With regards to the domestic bond market, the Malaysian Government Securities (MGS) yield curve steepened as the 3-year MGS fell 14bps to 3.36% while the 5-year to 15-year MGS was higher by 3 to 9bps. The longest end of the curve was well supported by real money investors with the 20-year MGS yield down by 4bps while the 30-year MGS yields stayed unchanged. While the market remained somewhat in thin liquidity post-Jackson Hole Symposium, local bond activities during the month came with some bargain-hunting activities as the market expected a showdown in the current tightening cycle by Bank Negara Malaysia (BNM) in 2023 should there be slower growth. Although GDP grew 8.9% yoy in 2Q 2022 which brought GDP growth in the 1H 2022 to 6.9% yoy, Finance Minister, Tengku Zafrul mentioned that the government remained cautious on the second half of year performance "as the economic outlook is still subjected to risks of slower growth due to global economic uncertainty, caused primarily by the prolonged Russia-Ukraine conflict, as well as China's economic slowdown following the implementation of strict COVID-19 containment measures." He added that higher inflationary pressures due to expected increases in commodity and food prices, as well as ongoing global supply chain disruptions, were factors that might impact global growth. Meanwhile, July headline CPI inflation recorded 4.4% yoy from June's 3.4% yoy, matching the median estimate in a Bloomberg survey, with the increase primarily driven by a record increase in the cost of food. On 8 September, the Monetary Policy Committee (MPC) proceeded to raise the Overnight Policy Rate (OPR) by 25bps to 2.50% as widely expected. The decision was made based on the positive growth prospects for the Malaysian economy.

Foreign funds turned net buyer in August with a purchase of RM5.6b of Ringgit bond holdings (July: -RM3.5b). This decreased YTD outflows to RM1.2b. Foreign share of both MGS and MGS+MGII climbed to 36.1% (July: 35.5%) and 23.5% (July: 23.3%) respectively. Malaysia's foreign reserves contracted by USD1.0b to USD108.2b as of end-August 2022 (July: USD109.2b).

Market Outlook

We opine investors would keep a vigil on global inflation concerns and the elevated geopolitical risks brought about by the Russia-Ukraine conflict. In China, there have been lingering fears that their dynamic zero Covid-19 policies could cripple economic growth especially with the latest lockdown in Chengdu. Apart from that, there are domestic political concerns which may precipitate from the often-mentioned 15th General Election (GE15) which must take place before the end of September 2023. There is a possibility that the GE15 may be brought forward earlier as the Pakatan Harapan's Memorandum of Understanding (MoU) of Transformation and Political Stability with the government expired in July 2022. To that end, the government has brought forward the tabling of Budget 2023 by three weeks to 7 October 2022. According to the Finance Minister, this budget is expected to focus on sustainable subsidy management and also to strengthen the country against increasing inflation pressures.

For equities, we maintain our prudent yet sensible posture towards our equity market's longer term growth trajectory and, where possible, would direct monies into fundamentally good investments. We would also engage in some trading activities should market volatility present us with good opportunities. We are partial towards sectors exhibiting robust growth prospects but remain cognizant for signs that market volatility might necessitate a shift of investment direction.

Locally, bond yields are expected to remain volatile in tandem with the UST yield movements. Although the US has entered into a technical recession, the markets have continued to remain jittery over the potential aggressive Fed rate hike path as US inflation remains elevated due to still high commodity prices and supply disruptions. The Fed has indicated that it is still committed to achieving its targeted inflation rate of approximately 2.0% and economic data will be scrutinized heavily to determine the next rate hike. On the other hand, local monetary policy is expected to remain accommodative to support sustainable economic growth in an environment of price stability as BNM reassured that economic developments and inflationary conditions would be monitored continuously and any rate hike would be done in a measured and gradual manner.

We are of the view that the risk-reward of MGS has improved with the Ringgit rates market well priced for BNM normalisation but we are also mindful of the bond market volatility arising from both external and internal fronts, which would impact local yields. The risk remains if domestic inflation surprises on the upside and foreign portfolio outflow accelerates. We would however maintain our strategy to accumulate bonds at favourable valuations skewing towards good quality names.