REGIONAL MARKET OUTLOOK

China
Hong Kong
Singapore
Malaysia
Indonesia
Brunei
Vietnam
Thailand
Cambodia

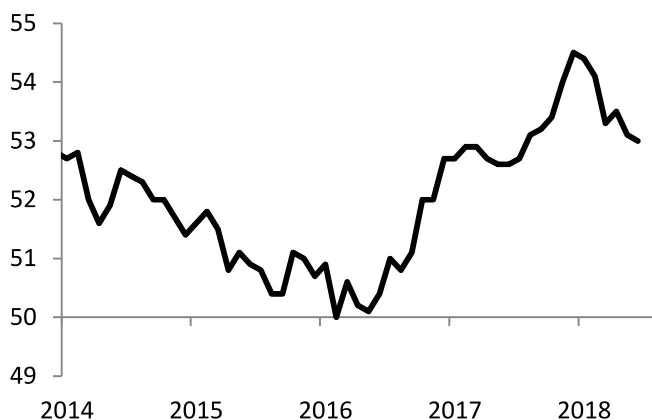
Quarter 3, 2018

TOGETHER WE PROGRESS

Economic Highlights

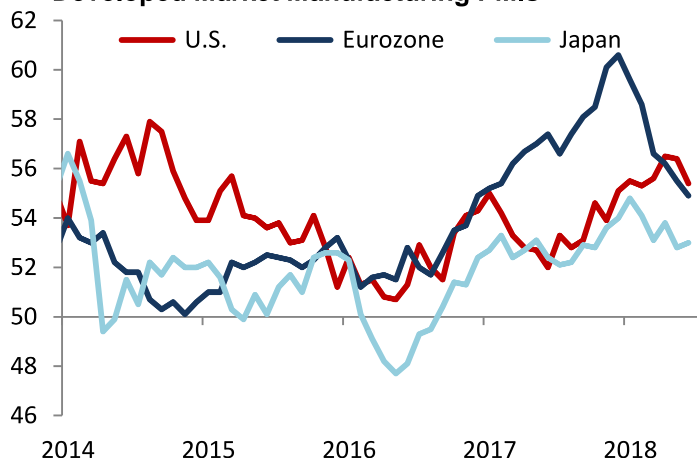
Global PMI

JP Morgan Global Manufacturing PMI



Source: RHB AM, Bloomberg, 10 July 2018

Developed Market Manufacturing PMIs

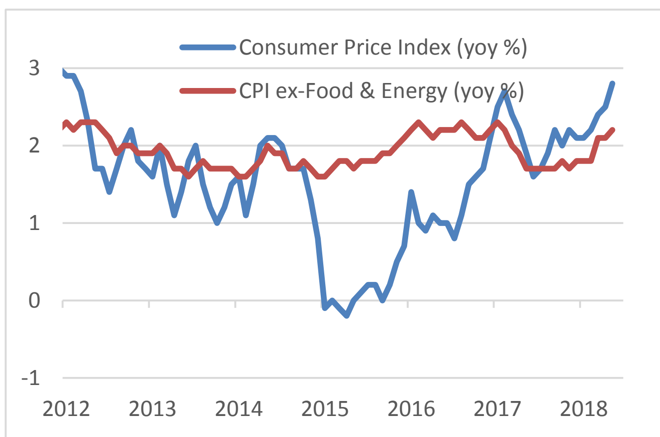


Source: RHB AM, Bloomberg, 10 July 2018

- JP Morgan Global Manufacturing PMI eased to 53.0 in June from 53.1 in May. The average reading for 2Q of 53.2 indicates a mild growth deceleration vs 1Q's 53.9.
- In 2Q, we saw a stronger US PMI offseted by a softer PMI in Europe and Japan.

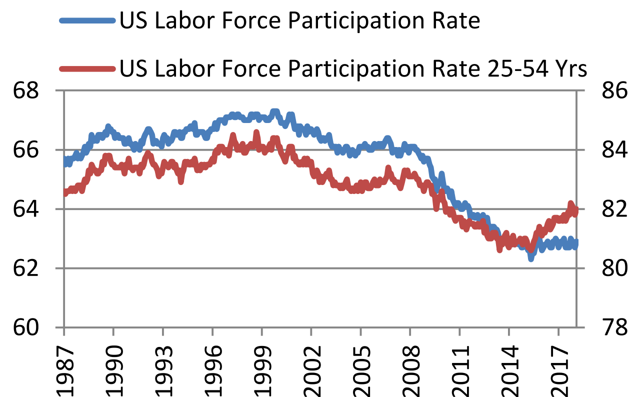
US

2017 US Core CPI Index



Source: RHB AM, Bloomberg, 10 July 2018

Labor Market remained strong



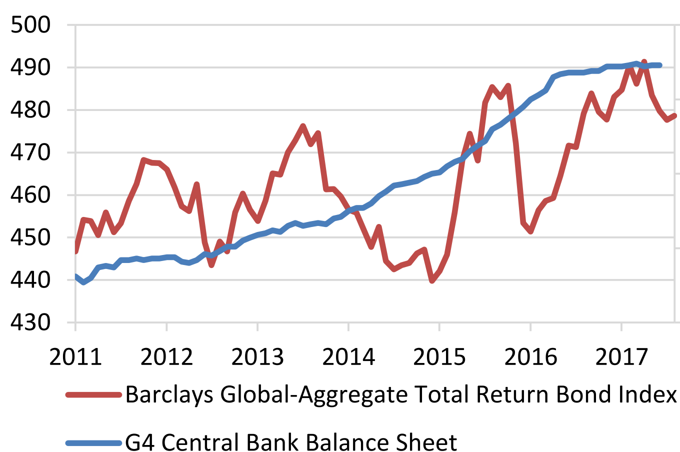
Source: RHB AM, Bloomberg, 12 January 2018

- Inflation rose in 1H 2018 amid higher energy prices and stronger labor market feed through to consumer prices.
- The US Fed has continued to increase interest rates gradually. Market expects at least one to two more hikes this year.
- Further rate hikes or strengthening of the USD will be negative for Asian Equities.

Economic Highlights

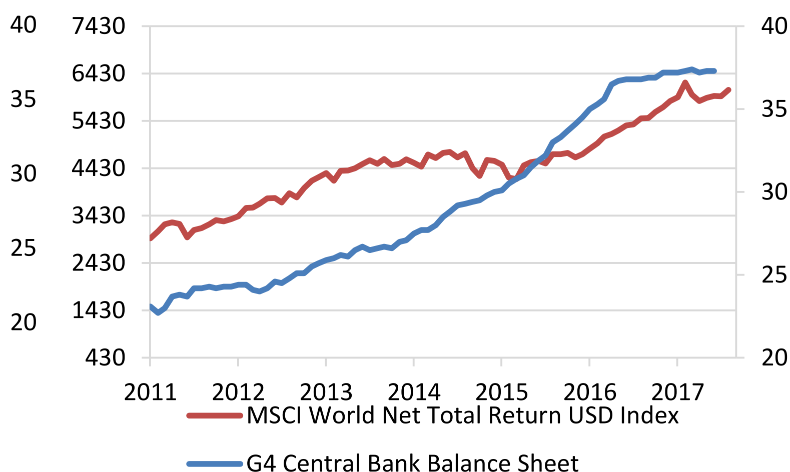
Global

Barclays Global-Aggregate Total Bond Return Index vs G4 Central Bank balance sheet (% of GDP)



Source: RHB AM, Bloomberg, 10 July 2018

MSCI World Net Total Return Index vs G4 Central Bank balance sheet (% of GDP)

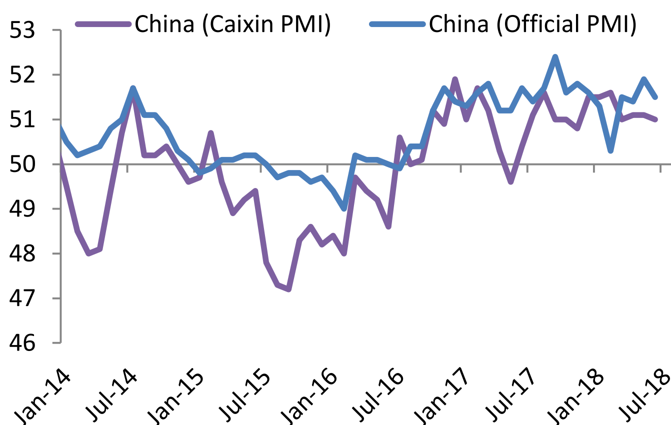


Source: RHB AM, Bloomberg, 10 July 2018

- G4 central banks have supplied a dramatic amount of liquidity since the GFC and has remained relatively stable in % of GDP terms this year.
- Main asset classes appear to have benefitted from the liquidity expansion supplied by the central banks.
- As central banks start to tighten policy, markets are set to face headwinds.

China

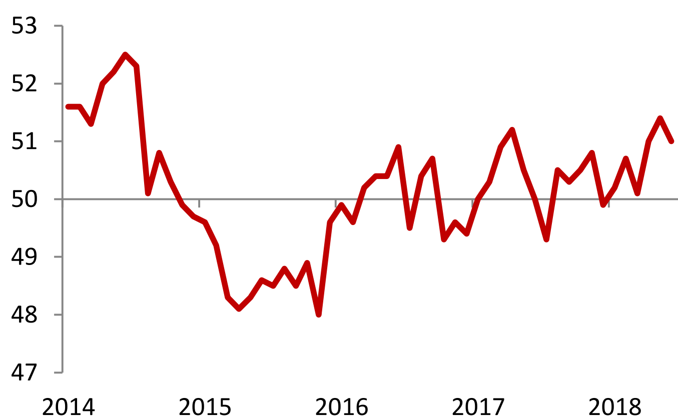
China PMIs (Caixin)



Source: RHB AM, Bloomberg, 10 July 2018

ASEAN

Manufacturing PMIs



Source: RHB AM, Bloomberg, 10 July 2018

- China's Caixin and official PMIs remained expansionary amid slower than 1Q 2018.
- Manufacturing PMI remains expansionary in most part of Asia except for Korea and Malaysia.

Equity Market

Global

For the second quarter of 2018, global equity return was relatively flat for equity investors, but the divergence between major indices as well as the volatility during the three months were widened. The S&P500 rose +2.9% with the US dollar appreciated 5% (DXY) against its major trading partners. European bourses was performing well in April but fell short in May as political risk arose in Italy and close the second quarter up by only +1.0% (Euro Stoxx). Italian FTSE MIB fell (-3.5%) while the German DAX30 (+1.7%) and the French CAC40 (+3.0%) posted gains.

The second quarter was filled with political noise, but ultimately, investors held their nerves and continued to push risk assets higher. In May, we saw political crisis in Italy and Spain which saw the respectively equity bourse fell by 9.2% and 5.2% respectively in the month of May. On 15th June, the Trump administarion initiated the anti trade policy with an annoucement of a 25% tariff on Chinese products. Unfortunately, China sent back strong retaliatory message sending the financial markets on a risk off mode once again. The Shanghai composite was down 3.8% on the 18th of June on the back of the news.

On the macro-economic front, the activity picture remains strong. Leading indicators signal sustained growth and businesses remains confident. The global manufacturing PMI remained solid with average reading of 53.9 in 2Q (1Q was 53.2). In 2Q 18, we saw a stronger manufacturing PMI in the United States which was offset by a softer PMI in both Eurozone and Japan.

IMF maintained global growth forecasts in their World Economic Outlook update in April at 3.9% in both 2018 and 2019 up from 3.8% in 2017. The Atlanta Federal Reserve estimate that US GDP is on track for 3.8% growth for the second quarter of 2018. Full year growth of 2.9% was maintained by both IMF and consensus expectation. With growth traction and rising inflation, Federal Reserves will be keen to withdraw stimulus.

Business confidence in Germany has been moderating since its peak in November 2017 according to the Ifo institute survey and Japanese Tankan surveys has also eased since the quarter ending December 2017. Nonetheless, the level of business confidence has only moderated slightly and remained relatively high in historical for both Germany and Japan. With the increasing tensions on the anti-trade policy, one could hope that the recent revival in capital investment can be continued.

The recent equity valuation are attractive as investors stayed cautious amid the uncertainty brought up by the ongoing trade disputes. The likely timeline that President Trump would pursue is by the end of 3Q as this would be used as leverage to cement the US November midterm elections. Till then, financial markets would be challenging and investors will continue to focus on companies which exhibit earnings visibility and defensive qualities.

Malaysia

1Q18 corporate results were weak due to higher input costs, strong Ringgit and slower economic activity. Almost half of the corporate results came in below expectation due to either costs pressure or lower revenue. The recently concluded GE14 saw net foreign selling of RM5.6bn in May 2018, the highest since August 2013 and followed by RM4.9bn in June 2018. Cumulatively net inflows were RM13bn from January 2017 to April 2018. Foreigners are likely to stay out of Malaysian equities until more clarity is unveiled by the new administration (expected mid-August 2018 when PH has been 100 days in office). We are of the opinion that we have seen the bottom for KLCI. However, the KLCI might not perform and expected to trade range bound until end of August.

Singapore

1Q18 corporate results saw financials and industrial sectors leading the positive EPS revision. Despite the sell off in the second quarter , the Singapore equity markets outperformed the rest of the ASEAN markets. In July, the government recently announced further tightening measures on the Singapore property market. This is a bid to curb aggressive land bidding by developers and also rising property prices. These measures include a further 5% tightening of LTV limits for all housing loans and also a 5%-15% additional buyer stamp duties for all buyers of second or subsequent properties. These measures will likely see a decline in transaction volume. Overall, we believe the Singapore equity market will likely rebound in the 3Q given that the market was oversold in the last quarter.

Indonesia

The Jakarta Composite Index (JCI) fell 10% in 1H18. Macro concerns continue to surround Indonesia with a possibility that the current account deficit might move closer to 3%. The Indonesia Rupiah breached the 14,000 again and the central bank raised its interest rate by 50bps in an attempt to stabilize the Rupiah. Bank Indonesia has signalled that they would rather stabilize the currency at the expense of pursuing economic growth. It was also announced loan-to-value of the first mortgage can be up to 100% from previously 85%-90%, a relaxation measure in the housing sector. President Joko Widodo allies also led in key regional elections in late June i.e West, Central and East Java.

North Asia

Global equities (-0.12%) ended 2Q18 in a muted fashion. Developed markets Australia (+4.3%) and US (+3.1%) have closed 2Q in green, while Asia ex Japan (-6.2%) and HK/China (-4.3%) equities markets got hurt by the looming trade war sentiment. China is relatively better off than its ASEAN peers (-12.3%) despite being in the epicentre of trade wars. Trump administration announced a 25% tariff on Chinese products effective 6th July. Unfortunately, China sent back strong retaliatory message driving financial markets into a risk off mode. The trade tensions saw a risk off scenario with the UST 10 years recovered to close the month of June at 2.86%, unchanged from the end of May.

The Dollar Index (DXY) strengthened by +5% in the 2Q18.The strength of the dollar has been a key headwind for emerging markets equity performance. In contrast, Asian currencies have been less affected compare to the rest of emerging markets like Brazil, Turkey and Mexico etc.

IMF estimates that a 10% rise in import tariffs in both the US and the rest of the world leads to a 1% fall in world trade and 0.5% fall in world GDP. HK, Singapore, South Korea, and Taiwan would be the hardest hit in Asia should a full-scale trade war break out.
Overall, we continue to see PMI remained in expansionary territory amid slower for both US and Asia while improved in Europe. US flash composite PMI eased slightly to 56.0 in June from 56.6 the previous month, while Eurozone flash composite PMI improved +0.7pts to 54.8 due to stronger services PMI. In Asia, China's PMI Caxin eased by 0.1pts at 51 while ASEAN slipped 0.4pts to 51 in June.

The recent 50bp RRR cut will inject an estimated of RMB 700bn liquidity into the system effective 7 July. Central government spending has been prudent in the first few months of 2018. The government is running a surplus of nearly RMB 400bn as of end May thus we do see ample firepower to beef up fiscal policy in the 2H18. In light of the more cautious view on external environment, this shift to a more easing bias provide support to China's economic growth amidst uncertainty in the external environment. We expect further RRR cuts near term to maintain the liquidity condition.

Currently, we view this sell off as a blanket selling across all the emerging market and have more or less discounted the threat of a trade war. Unless there is a massive escalation into a full blown threat, we do see value emerging in the China equity market especially in resilient sectors like consumption, healthcare and internet technology. It is good to note that the government has indicated more policy easing measures in coming months. The statement out from the first monetary policy committee (MPC) meeting on the 28 June indicate shift in policy stance to “reasonably adequate” liquidity conditions and soften its tone on deleveraging. On top of RRR cut, there are levers that China can pull to ensure growth including: 1) increasing commercial bank loan quotas, 2) employing “asymmetric” strategy in RMB market intervention, and 3) tax cut for affected sectors etc.

Equity markets will start focusing on earnings as we enter into 3Q. Currently, based on consensus estimate, Chinese companies are expected to deliver a robust set of results, while Korean companies are selective depending on its export exposure in its revenue. Therefore, for the sectors with a longer term structural growth, we can reasonably expect them to start gaining upside momentum post results. Overall, that will be a positive driver for 3Q equity outlook.

Global Bond Market

U.S. Treasuries

US Treasury ("UST") 10-year yields started the month of June 2018 below 2.90%, at 2.87% due to Italian political turmoil, however began its ascension higher to reach 2.975% (2Y was +3bps to 2.524%) within a week on worries that the European Central Bank ("ECB") may wind down its EUR 2.55 trillion (USD $3 trillion) Quantitative Easing ("QE") program earlier than the anticipated September 2018 timing, which triggered a broad selloff in German Bunds and core European government bonds, spilling over to the US Treasuries. After brief attempts to head higher to above 3%, we ended the month with a rally to 2.86% as the second round of escalating trade tensions between the 2 biggest economies in the world weighed on global growth sentiment. The UST issued a total of $715bio of bills and bonds in the month of June 2018 mainly in the front end bills of 1 to 6 month tenor.

On June 12th, US President Donald Trump and North Korean leader Kim Jong Un capped off a historic summit in Singapore to commit to North Korea's complete denuclearization in exchange for "unspecified" security guarantees from the US.

In terms of significant economic data release, the Institute of Supply Management ("ISM") Manufacturing Index for May 2018 printed at 58.7, up 1.4% from April. Nonfarm Payrolls ("NFP") in the United States released for May 2018 showed the economy added 223,000 new jobs against 190,000 consensus estimate. Average Hourly Earnings edged up 2.7% slightly higher than with consensus estimates of 2.6%. On inflation, the United States Personal Consumption Expenditure ("PCE"), the Fed's preferred measure of inflation, registered 2% YoY growth for May 2018, while headline Consumer Price Index ("CPI") rose 2.8% YoY (Non-Seasonally adjusted), versus 2.5% in April while core CPI rose 2.2%, slightly higher than last month's reading of 2.1%. Unemployment Rate fell to new lows as well at 3.8%YoY for May 2018 (Previous month was 3.9%). U.S. trade deficit fell to a seven-month low in April of $46.2bio (expectations were for $49bio) which further strengthened views that the Federal Reserve would raise short-term interest rates at least twice more this year.

Credit Market

The Federal Open Market Committee ("FOMC") meeting on June 13th was one of the key risk events this year, with the FOMC unanimously raising the Fed Fund Target Rates ("FFTR") by 25bps to 1.75-2% corridor as widely expected and communicated.

Salient points from the press conference:

- Jay Powell intends to remove the forward guidance from the policy statement that have been the mainstay since Bernanke and instead stresses on keeping an accommodative and appropriate policy stance
- From January 2019, each FOMC meeting would have a press conference at the end as a way for the Fed to communicate their rationale for the decision
- FFTR median raised to 2.4% (from 2.1%) for the end of 2018, 3.1% by the end of 2019 and 3.4% by the end of 2020
- Raises Interest on Excess Reserves ("IOER") to 1.95% from 1.75% as stated in May minutes, to be 5bps below the upper bound of the FFTR as a technicality to help keep the effective federal funds rate within the range
- PCE is still the Fed's preferred measure of inflation, targeting a sustained 2% symmetric level for the medium term
- Inflation has been high due to oil prices, and if the Fed sees it persistently above or below 2%, will use the appropriate monetary tools accordingly
- Sees long run unemployment rate to be below 4.5%
- Aware of the yield curve flattening but its natural due to fed hiking rates, and in terms of the long term yields, they are more determined by term premia which has been low by past standards and embedded expectations for future rates based on current interest rates

Outside of the US, in the G10 space, the ECB kept their policy rate unchanged for at least till the end of summer of 2019 and indicated that they will terminate the Asset Purchase Program ("APP") by December 2018 instead of September 2018 as most of the market participants were expecting. Bank of Japan ("BOJ") kept policy rates unchanged at -0.10% as widely expected as well.

At the end of June 2018 close, the benchmark 2-, 5-, 10- and 30-year UST were last traded at 2.53% (May-2018: 2.43% +10bps), 2.74% (2.70%; +4bps), 2.86% (2.95%; -9bps) and 2.99% (3.12%; -13bps) respectively. The US Treasury bond yield curve had bull flattened significantly from May, on flight to safety, while front end continues the march higher due to the rate hike.

Ringgit Sovereign Bond

Malaysian Ringgit ("MYR") continued to depreciate in June 2018 against the United States Dollar ("USD") despite Brent crude continuing to rally another 6% for the month. USDMYR climbed from 3.9798 at the start of the month and closed the end of the month at 4.037, representing a -1.437% total return, however, this was in general to all Asian currencies as USD continued appreciating with the US Dollar Index ("DXY") breaking above 95.0 levels, levels not seen since July 2017. Overall, MYR was the 4th best performing Asian currency closing just below Philippine Peso while naturally Japanese Yen and Hong Kong Dollar were the better performing currency for June 2018. Local government bonds bull-flattened in line with the move in US Treasuries with the long end closing 3 basis points ("bps") lower month-over-month while 10-year Malaysia Government Securities ("MGS") closed the month almost flat from last month. At month-end closed, MGS yields 3-, 5-, 7-, 10-, 15-, 20- and 30-year MGS were reported at 3.635% (May-2018: 3.697%), 3.86% (3.824%), 4.07% (4.019%), 4.204% (4.202%), 4.632% (4.623%), 4.871% (4.902%) and 4.889% (4.926%) respectively. The Government Investment Issues ("GII") – Shariah compliant version of MGS mirrored the same pattern with its MGS counterpart with the long end of the curve rallying 3bps lower, breaking back below 5% yields while the belly of the curve was barely changed. At month end close, the 3-, 5-, 7-, 10-, 15-, 20- and 30-year GII were reported at 3.642% (May-2018: 3.742%), 4.021% (4.012%), 4.176% (4.159%), 4.31% (4.316%), 4.733% (4.764%), 4.97% (5.001%) and 4.984% (5.009%) respectively.

On the local economic front, Malaysia's CPI for May 2018 was 0.2% higher month on month (seasonally adjusted), printing at 1.8% YoY vs 1.4% YoY previous month in line with estimates of 1.8% YoY with pass through of crude oil prices mainly leading the move higher while the other components were broadly benign. The effects of the Goods and Services Tax ("GST") reduction effective June 01 2018 would likely be reflected in the next couple of months reading and would likely register a lower number. April Industrial Production printed at 4.60%, higher than estimates of 4.4%, and higher than last month's 3.1% reading, while April Trade Surplus registered higher than expectations at MYR 13.07bio although its slowed from last month's 14.69bio surplus, attributed to a stronger rise in imports (+9.1%YoY vs last month -9.6%YoY) while Exports accelerated +14% YoY. From +2.2% YoY in March. Sequentially, both exports and imports slowed with imports contracting more sharply than exports, falling 7.9%3m/3m, seasonally-adjusted-annual-rate ("SAAR"), reflecting some underlying slowing in trade activity.

Ringgit Corporate Bond

On the Ringgit corporate bonds, despite the festival month during June 2018, trading activities witnessed some improvement compared to a month before as the post-election noises guided the yield higher and created investment entry value for the under-invested books which have sidelined prior to the election. In addition, quarter-end period provided some trading activities in the local bond market. The average daily volume improved slightly to RM267 million during the month compared to a lackluster RM189 million achieved in previous month of May. As usual for this month, most of the trading activities were skewed towards AA space which saw about 53% of the trades changing hands followed by Government Guaranteed (“GG”)/AAA by 42% and single-A or lower by 5%.
Within Government Guaranteed (“GG”)/AAA space, the longer-dated Danainfra with a tenor ranging from 10-year to 30-year garnered more than RM450 million transaction volume with the yield moved lower by an average of 3 basis points month-over-month. Volume was also seen in the shorter-tenor Cagamas up to 5-year which traded on average by 5 basis points lower at for the amount of RM180 million. Elsewhere in AA-rated space, Southern Power Generation (“SPG”) papers were the most actively traded during the month with yield moved lower by 2 basis points for a cumulative amount of RM430m. On top of that, Triplc Medical Sdn Bhd also garnered some RM180 million trading interest with yield adjusted lower by approximately 5 basis points during the month. For the A-rated universe, UMW Holdings Perpetual paper rallied another 17 basis points month-over-month with RM35 million changing hands and closed at 6.00%.
In the primary market space, we saw moderate fresh primary issuances for the month of June and issuance momentum may remain subdued in the near term given uncertainties in the changing domestic landscape post-election. Hong Leong Financial Group (“HLFG”) issued their RM500m sub-ordinated debt paper which closed at a final yield of 4.93%. Notable issuance during the month coming from Genting Malaysia which raised a total of RM2.6 billion in size. Investors were attracted by the decent yield pick-up over AAA credits. The 5y, 10y and 15y notes were sold at a final price of 4.98%, 5.30% and 5.58% respectively. The 5-year was the biggest in issuance size at RM1.4 billion, followed by 10-year at RM0.75 billion and 15-year at RM0.45 billion.

Outlook & Strategy

The sharp rally in safe haven assets was fuelled on escalating trade tensions brewing up again between the US and China, rattling markets. Aside from this there was also some key events happening in the Emerging Market Space. The Standard & Poor’s 500 Index (“SPX”) closed at 2,718 (-0.66% MoM) while the SPX Volatility Index (“VIX”) rose above 15 towards the end of the month to close at 16.09.

Credit Market

The Organisation of Petroleum Exporting Countries (“OPEC”) meeting on Friday 23 June in Vienna concluded with Suhail Mohammed Faraj Al Mazrouei, the current head of OPEC and energy minister of the United Arab Emirates, announcing that the group would increase its output to the maximum allowed under the terms of a production agreement struck in 2016 to address fears of a global supply crunch due to outages in Venezuela.

Turkey elections held on 24th June was won by the incumbent Adalet ve Kalkinma Partisi (“AKP”) party, with Erdogan claiming victory with 52.5% of the presidential votes and AKP having 42.5% of the parliamentary votes with 99.1% of ballots counted. Given the selloff in Turkish assets and the central bank having to raise rates to halt the depreciation of the Lira leading up to the election, the immediate knee jerk reaction on early trading post elections saw Turkish lira firm up by up to 1.9% (4.5881) against the USD.

Indonesia raised 7-day reverse repo rates again in June by 50bps to 5.25%, making it the third hike in 2 months, with the latest 50bps hike an effort to pre-emptively address the IDR depreciation. IDR had sold off against the USD from 13,872 at the start of the month to 14,330 (-3.3% decline). We think that at these current levels with bond yields and currency at near all-time highs, that valuation is starting to look attractive and would likely offer significant buffer against both higher US real rates and to cushion against the pickup in inflation onshore.

In China, the on the People’s Bank of China (“PBOC”) over the weekend on 24th June had announced a required reserve ratio (“RRR”) cut of 0.5% for large state banks, 12 national joint-stock commercial banks and some mid-sized and small banks to support debt to equity swap projects and increase loans to small businesses, effective from 5 July 2018 (which is also one day before the first round of US tariffs on Chinese goods begin). This would lead to freeing up liquidity of up to a total of RMB700bio (~USD$107bio). The market interprets the decision as sending a strong signal of the Chinese government’s commitment to maintain stable economic growth and contain any systemic risk. If the trade conflict escalates further, it is possible that the PBOC will loosen monetary policy to strengthen financial services to the real sector, push forward structural reforms and better balance the targets of stabilising growth, which may help to alleviate investor concerns to a certain extent. In the surface of it the RRR reduction should help property developers and commercial banks.

Credit Market

We still retain our core view that Advanced Economy (AE) rates (with the exception of QE countries like Europe and Japan) will creep higher this year, and we're expecting 10y treasuries to trade around 3% in the near to medium term on the fiscal deficit and debt burden. That said, dampening the surge in US yields would depend on how the "global trade war tensions" play out. Our broader global bond strategy is to take profit on bonds that have surpassed their fair values given current valuations and redeploy the cash into undervalued government bonds or credits for repositioning.

On the local front, with the neutralization of Good and Service Tax ("GST") to 0% from 1st of June 2018, preliminary calculation suggested that the average headline CPI could come in below 2% for 2018. This figure is well below Bank Negara Malaysia ("BNM") comfort threshold of 2.5%. With inflation to taper lower this year baring any significant whipsaw in prices of oil and lower Malaysia GDP forecasted for 2018, BNM is expected to maintain the OPR at 3.25%. It is also the government's preference to implement policies that are "for the people" in view of the challenges due to rising costs over these years. Nevertheless, we will derive a better picture of the economic and policy guidance when the newly appointed Bank Negara Malaysia governor chairs her first MPC on 11 July 2018.

The appointment of Nor Shamsiah is much lauded as it demonstrates continuity in BNM's monetary and fiscal policies. On the other hand, the reaffirmation of Government to achieve fiscal deficit to Gross Domestic Product ("GDP") at 2.8% indicates some fiscal flexibility as the revenue from higher oil prices seeing to be supportive at this juncture as well as commitment for expenditure rationalization within the government's ministries and agencies. Correspondingly, with an objective to reduce public debts and reviewing of some higher cost infrastructure projects, if delivered successfully, is a credit positive in medium to long-term for Malaysia.

In terms of strategy, we view the recent upward adjustment of yields as a trading opportunity to tactically acquire bonds for investments since we do not anticipate further rate hikes domestically for this year. Furthermore, in terms of corporate bonds, we saw only a few issuances of primary bonds after the recent general election as quite a significant number of planned infrastructure projects would be reviewed to reign in control on the country's debt burden. These factors bode well for the supply and demand dynamics of the local bonds market that will cap further deterioration in yields for corporate bonds segment while lending support to secondary market trading Therefore, strategically, we will tactically invest in bonds where we see yields as attractive vis a vis its decent credit fundamentals; notwithstanding higher participation in new issuances to ride on the re-pricing of yields to boost overall portfolio yield.

Commodity Market

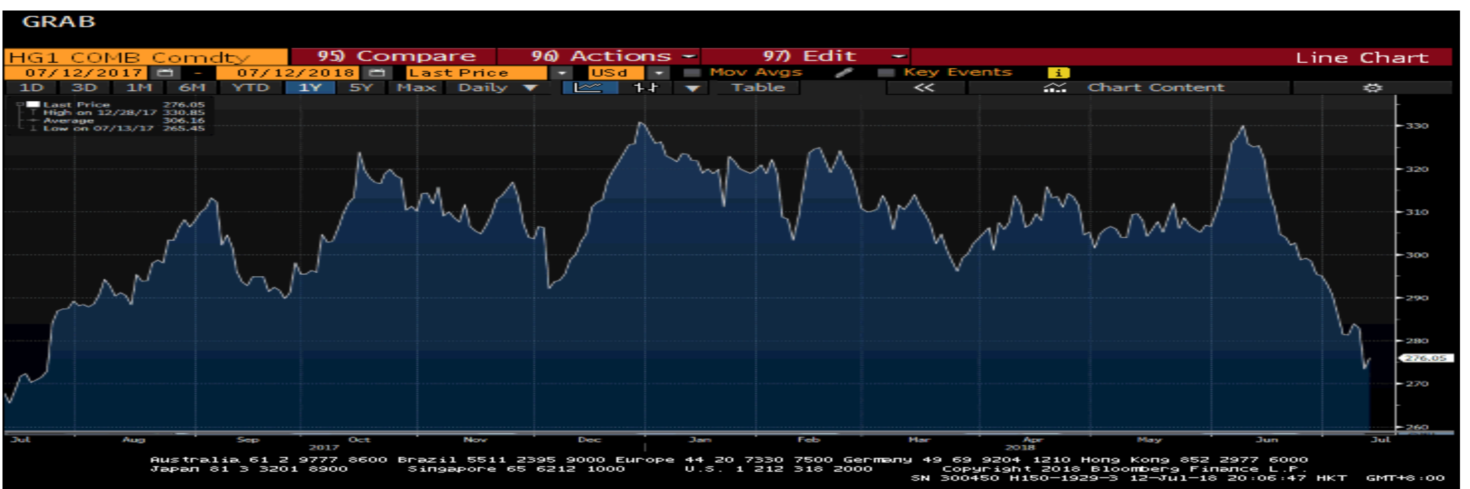
Oil

WTI ($/bbl)

Source: Bloomberg. July, 2018.

Market will have to adjust to additional barrels coming out of OPEC as well as potential return of Libya supply. However, demand is supported evidenced by sharp inventory drawdown, it should provide price support into 2H18, hence we expect oil prices to hold within our range for the rest of the year.

Copper



Copper has underperformed within the commodity complex. After a stellar +30% increase in 2017, copper has declined -15% since the beginning of the year. Demand for copper is highly correlated to economic activities. We expect production and sales of air conditioners to improve in 2H18 in China, driven by solid property sales and new starts GFA. Air conditioner output still increased 11% YoY in January-April, 2018, much better than that of refrigerators (-19%) and washing machines (-7%). As such, after this correction, we expect copper to start finding its footing once macro starts to normalise. On a longer term, in response to higher price in every mining cycle, we are starting to see copper producers' supply response at $3.10/lb copper price hence the copper deficit from 2022 is likely to be filled.

Commodity Market

Gold

Source: Bloomberg. July, 2018.

During the 2Q18, base metal prices have taken a leg lower due to dollar strength and global trade war uncertainty. Relative to base metals, precious metals have seen a slightly softer impact over same period (Gold -5.5%, Silver -1.5%). The US Dollar Index is up 5% over 2Q18.

With high level of political swing factors and a 10 year bull run, gold seems to be the safe haven to be in. However, the strong dollar has tempered its path to move higher. We believe that most of the USD strengthening in the past quarter is explained by changes in the global growth outlook. Should the trade wars escalate into a slowing in the global economy then a stronger dollar may be here to stay.

Looking into the carry trade thesis, US Fed announced a 0.25ppt benchmark rate hike to 1.75–2.0% on June 14.They have indicated four interest rates hikes for 2018. A further 2 possible hikes might negatively impact gold prices. It is estimated that a 25bp rise in interest rates could cause a US$70 decline in gold prices, but the negative impact of interest rate hikes on gold prices may decrease amid inflation pressure.

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