Maybank Asset Management

PERFORMANCE & MARKET OUTLOOK

MONTHLY REPORT: JULY 2018

Fund Manager Commentary: Trade tensions a Drag

Financial market volatility extended into June, as global trade matters have been dominating the headlines. After some flip-flopping, the US will now impose tariffs of 25% on USD50bn of Chinese exports to the US in early July. This magnitude of tariffs is manageable, but recent statements from the US administration threaten to escalate this to a full blown trade war. Trump has indicated that they would be looking to impose tariffs on another USD200bn of goods, accounting for approximately 40% of total China exports to the US.

Global economic growth is holding up well at this moment, with the US showing the best data, but we see the uncertainty over trade causing economic growth to slow in the next 6 months due to two key contributing factors. Firstly, the direct impact of tariffs increase costs lowering profit margins of the companies that are involved in the supply chain of these exports, including manufacturers, suppliers and distributors. The direct impact will also see consumers having to pay higher prices on the products, as the exporters try to pass on the tariffs to consumers. Secondly, the indirect impact of tariffs will see companies being more conservative in their business plans given the uncertainty. All of these factors will lead to weaker corporate earnings and slower economic growth.

With its open economies, Asia would be more vulnerable to these trade tensions (see chart below). The more export-driven countries, such as Korea, Malaysia, Singapore and Taiwan, will be hit the hardest. Our positioning has therefore turned more cautious on the **equity market** due to the higher likelihood of a trade war and the risks of lower corporate earnings and economic growth that it could bring. For **fixed income**, we are already defensive and shortening duration, favouring investment grade credits, given the headwinds from rising interest rates and tight credit spreads at the beginning of 2018.

As a result of the current correction, there is value in both Asian equities and fixed income markets. Asian equities are trading at a PER of just 12x which makes them attractive relative to developed world equities. Similarly, Asian fixed income markets offer value with Investment Grade bonds providing yields of 4.5% and above. Nonetheless, given the challenges, we will wait for a positive catalyst before becoming constructive on equities and fixed income markets.

Macro Update

Malaysia Markets

The stock market in Malaysia has seen a sharp correction post the general election. The market has undoubtedly been dragged down by regional concerns emanating from trade tensions, but another factor has been the uncertainty with regards to the incoming government's economic policies. Various infrastructure initiatives are being reviewed by the new government and those announcements have negatively affected the construction sector, as some projects have been cancelled or deferred.

The Pakatan Harapan government is still in its early days, having only been in power for a little over a month. Understandably, there will some hiccups during these initial stages, as the new administration finds its footing.

Valuations for the Malaysia market are now more attractive after the recent decline, but at this time are still not compelling based on regional comparisons. We see a similar situation with the currency and domestic fixed income market. The Ringgit has weakened, post the elections, on regional and domestic concerns, returning to above RM4.00/USD, while bonds have seen a modest drop as interest rates have risen.

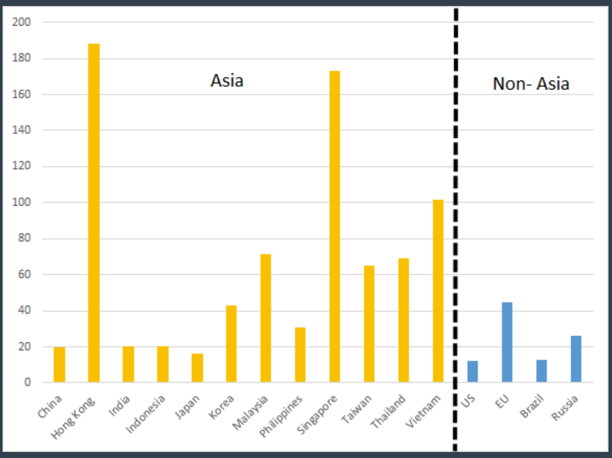
Indonesia Markets

The equity market has not been immune to the regional downturn, though Indonesia's economy is more domestically oriented and less export based. The stock market has been affected by the investment outflows from global investors pulling their funds out from Emerging Markets, including Asia. **Indonesia is seen as more vulnerable, given the twin current account and fiscal deficit.** As a result, Indonesia has been one of the weakest equity markets in Asia.

Likewise, the investment outflows have resulted in a weakening of the Rupiah and a correction in Indonesian bonds. The currency has depreciated past IDR14,000 levels. The Central Bank has sharply hiked interest rates 3 times, between May and June, by an aggregate of 100bps in a bid to stabilise the currency.

Asian countries have relatively high exposure to trade

Chart: Exports to GDP (%)



Source: World Bank, Index Mundi | Period: 2017