Maybank Asset Management

PERFORMANCE & MARKET OUTLOOK

MONTHLY REPORT: MARCH 2018

Fund Manager Commentary: Market Volatility Returns but Fundamentals Still Positive

Both fixed income and equity markets have been turbulent triggered by the sharp increase in interest rates. The US 10-year Treasury rates rose about 50bps from 2.40% at the start of the year to 2.90%.

Investors are concerned that interest rates will rise further and higher rates are usually not positive for investment assets. We believe that the driver of the interest increases has been the tax cuts in the US that would lead to the budget deficit rising to above 4% from 3.5%.

Going forward, we expect volatility to continue over the next 2-3 months as investors digest the impact of the higher interest rates. Financial markets have also not been helped by a potential trade war as the Trump Administration is raising tariffs for imports and there are risks that its trading partners like the EU and China retaliate. Despite the volatility, we maintain our overall strategy where we are positive on equities but more cautious on fixed income.

Looking at the fundamentals, the global economy is still healthy with the US ISM manufacturing for February 2018 coming in above 60 indicating manufacturing activities are robust. Over in Asia, exports and industrial production are still posting robust figures supporting the view that the synchronized growth thesis is intact.

Macro Update

Regional Equities

While equity markets have seen a correction, we are still positive. We have to bear in mind, that equity markets have been on strong and steady uptrend since the start of 2017 with markets up between 20- 40%. Even 2018 was one of the strongest starts in recent memory, with markets up as high as 12% in January. So, we are of the view that the rise in interest rates was just a catalyst for profit taking and does not portend a downturn in equity markets.

Valuations for Asian stocks are still supportive, trading at 13x Price-Earnings Ratio (PER), at a significant discount to developed world equities. In addition, the strong economy is showing in the recent economic earnings, with many cyclical sectors including banks announcing results that were better than expectations.

Malaysia Equities

The low beta nature of Malaysian equities meant that the stock market escaped relatively unscathed from the market correction. The stock market was also assisted by strong results from the banking sector with index heavyweights Maybank and CIMB announcing full year 2017 results that exceeded earnings expectations.

The one issue that is capping upside in the stock market has been the uncertainty surrounding the upcoming General Elections. The date has not been announced and investors have been more cautious preferring to wait until there are clearer signs on the timing. We are taking a cautious approach given the uncertainty and taking profits on small caps and switching to the blue-chips.

Indonesia Equities

The stockmarket has been relatively flat in 2018 with corporate results more mixed. The removal of energy subsidies has been a drag on the consumer and therefore earnings at consumer related stocks were relatively disappointing. With various regional elections due in 2018, the Jokowi administration is rolling-out more consumer friendly policies to boost consumer spending. So far, some of these plans have actually had a negative impact on the market. For instance, Moody‘s, the rating agency, warned that the Government’s plans to freeze power and fuel prices in 2018 could have a negative impact on the country’s credit rating. The stock markets promptly dropped as this was viewed as a reversal of reforms that would lead to a weakening of the country’s finances. We continue to expect volatility and will focus on cyclical sectors that have lagged the market.

Regional Fixed Income

For fixed income portfolios, we have been relatively defensive since the start of the year in view of the tight interest rate spreads and rising interest rate environment. While we were well positioned, we were still taken by surprise by the pace of the rise in interest rates. At this point we are moving to a more defensive positioning by reducing duration in the portfolios. Though we are cautious, value is emerging amidst the drop in the fixed income markets and will be waiting for the right timing before taking a more constructive view.

Overall, US interest rates may rise further from 2.90% currently to as much as 3.20 but we do not expect a sustained rise as inflation still remains controlled around the 2% levels. We believe that the recent hike in interest rates was due to the expectations of higher budget deficits from the cut in taxes due to Trump’s tax reform initiatives.

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