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**Maybank AM is neutral on Malaysian equities in the third quarter as the economy remains vulnerable.**

By Maybank Asset Management\*

The Malaysian equity markets are moving into 3Q2020 with a more cautious stance as some sectors or stocks are stretched in terms of valuations. We are expecting central banks globally to come in full force together with governments to ensure that there is ample liquidity.

We are neutral on Malaysian equities considering the vulnerability of the Malaysian economy from two main events that may hit the country in 3Q2020:

- 1) snap elections; and
- 2) a second wave of Covid-19 pandemic.

We expect some weaknesses in the equity markets which may drag the FBMKLCI down to around the 1,430 level, before a more sustainable recovery.

The Recovery Movement Control Order (RMCO) has provided a much-needed relief for the economy and further support for our base case where we think that a recovery may be imminent in 2H2020, especially towards the year-end after the immediate weakness or profit taking activities expected in 3Q2020.

Also, the massive foreign outflows amounting to RM15.8 bil YTD is expected to taper off as foreign shareholdings are now at historical lows of 21.7%. The strong recovery of equities despite the huge foreign outflows may also prove that local liquidity is abundant ensuring continued support for equities.

Any signs of foreign inflows will provide a catalyst for an equity market recovery. In addition, oil prices are expected to stabilise and strengthen further if the Covid-19 pandemic is under control and if the agreement for production cuts by major oil producers (US, Russia and Saudi) can be upheld.

The current US\$40/barrel for Brent is sufficient for Malaysia to maintain its expected deficits whilst continuing to provide the planned stimulus for the economy as the official oil price assumption is around US\$30/barrel for 2020.

We still favour sectors and companies that could benefit from the "New Normal" post Covid-19, namely gloves, technology and plastic manufacturers.

Although we may see economic vibrancy post lockdowns, certain practices and SOPs will still need to be enforced to safely contain a potential second Covid-19 wave.



## Challenges facing financial sector

The banking or financial sector, which was the worst performing sector in 2Q2020, is still struggling to attract investor confidence.

This was mainly due to the potential squeeze in net interest margin (NIM) and concerns over asset quality, especially when the moratorium for loan instalments ends in August 2020, which could lead to impairments as banks would need to ensure collection resumes smoothly in September.

Modification loss from non-charging of additional interest on hire purchase loans during the moratorium period could also erode banks earnings resulting in lower dividends.

## Value emerging in oil palm and construction sectors

CPO prices have also been dampened by the low crude oil price environment and diminishing demand-supply dynamics (e.g. the delay in biodiesel implementation, weak consumer sentiment and lower production in 2020).

Value is emerging for the sector as crude oil prices have recovered and demand for palm oil has started to pick up after lockdowns.

We expect CPO prices to be around RM2,400/MT, hence we see value in some undervalued big caps with low production cost and good growth outlook.

The government is expected to proceed with high multiplier and impactful projects swiftly such as MRT3 (Mass Rail Transit 3) and HSR (KL-Singapore High Speed Rail) in 2021 to revitalise the economy given the expected low growth expectations. Therefore, there's also some value in the construction sector.

Billions of ringgits worth of infrastructure development projects in Sarawak are also likely to roll out ahead of the upcoming state election.

After the recent consensus earnings revisions and massive liquidity injections by the government and BNM, we estimate a negative earnings growth of -9.2% in 2020 and strong recovery of earnings by 14.7% growth in 2021.

Hence, our base case scenario is for the FBMKLCI to trade at their seven year +1 standard deviation price earning-ratio (PER) of 15.7X at a target of 1,466 for year-end 2020.

## Fixed income outlook & strategy

We are neutral on Malaysian fixed income. With an impending negative global GDP growth on the horizon, we expect official GDP numbers for Malaysia to fall within the range of -2.0% to 0.5%.

After the latest overnight policy rate (OPR) cut of 50 bps in May to 2%, we believe that Bank Negara Malaysia (BNM) may adopt a wait-and-see approach until the next July Monetary Policy Committee (MPC) meeting as the impact of recent cuts and stimulus provided to the economy may not yet be visible.

Hence, BNM may reserve further rate cuts for later in the year if economic recovery isn't up to expectations or if a second wave Covid-19 poses renewed concerns.

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We foresee that any recovery will be gradual and in need of low interest rate support to ensure easy access of capital by corporates to restart their economic activities. Hence, we expect this low interest rate environment to be maintained for as long as it's needed given that inflationary threat is almost non-existent.

Therefore, this situation provides a conducive environment for the bond market which can still provide a good yield pick-up. We do not expect another major shock to the bond market similar to the one we saw in mid-March as the Malaysian government and central banks globally are ready to pump in more liquidity if needed.

Furthermore, we expect foreign inflows to continue following the May inflow of RM1.5 bil after the massive foreign outflow of RM22 bil in 1Q2020. With foreign holdings at just above 20% for Malaysian Government Securities (MGS), the threat of another large foreign outflow is reduced.

Therefore even if FTSE decides to drop Malaysia from the World Government Bond Index (WGBI) in September 2020, the effect would be minimal as current foreign holdings are already at an all-time low.

We are more selective on credits now, we prefer liquid AAA for trading and AA primaries for yield pickup as valuations are no longer cheap.

We also expect more aggressive issuances of Private Debt Securities (PDS) in 3Q2020 as economic activities restarts and issuers look to lock in good long-term rates. We are overweight PDS over govvies (government papers) as volatility in govvies is likely to persist.

*\* Excerpts from Maybank Asset Management's 3Q 2020 Outlook & Strategy Report*

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