Maybank Asset Management

PERFORMANCE & MARKET OUTLOOK

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Fund Manager Commentary: Talk of Trade Wars Continue, But No Need to Panic

Financial markets are volatile once again, affected by the news of a potential trade war between China and the US after US President announced tariffs on Chinese imports.

This year both the periods of turbulence have been triggered by Trump's policies and this is a risk that we have highlighted in the past. At the end of January, Trump announced the US Tax cuts that would boost corporate earnings but lead to a widening budget deficit. As a result, interest rates rose as the bond market adjusted to the fact that the US would issue more government debt in order to fund the higher budget deficits. The interest rates as represented by the benchmark US 10 year Treasuries rose by about 50bps from 2.40% to 2.90%. The pace of the interest rate increase was sharp, taking just a month to reach 2.90% and this triggered a correction in the equity markets.

On this occasion President Trump has announced that the US will impose tariffs on Chinese imports that are estimated to affect USD60bn of Chinese imports. For perspective, US imports about USD480bn per year from China so the tariffs affect 12% of total Chinese imports. In retaliation, China has announced tariffs that would affect USD3bn of US imports. For context, China imports USD170bn per year from the US and therefore the Chinese tariffs are relatively small accounting for less than 2% of total US imports.

Clearly, a global trade war would be negative for the Global economy as it will reduce trade and may increase prices for the consumer resulting in slower economic growth. So far the sums mentioned are not small but appear to be manageable (10% of total Chinese exports to the US and 3% of total US exports to China) and therefore at this time there is no need to panic. Furthermore, there is a 30 day consultation period and this gives some time for China to negotiate.

While uncertainties on this issue may continue for some time given the lack of details (e.g. products targeted etc), we believe that ultimately negotiations will result in some form of compromise that would allow President Trump to demonstrate that he has achieved a 'better deal' with China. At this stage, we do not believe that the situation will escalate into a full blown trade war as China's response has been relatively controlled but we will continue to monitor the situation.

As mentioned above, we will have to see if the protectionist policies will have a detrimental impact on the Global economy in the coming months.

Macro Update

Regional Equities

For stocks, protectionism moves by either parties is negative as investors are concerned that this will lead to a trade war dampening economic growth leading to weaker corporate earnings. China exporters especially in the tech hardware space will be affected the most. In general, North Asia is more exposed as they are part of the global supply chain and furnish a lot of the intermediate components that go into the end product that is finished in China and exported to the US. There are some opportunities in the equity markets as the selling has been indiscriminate with stocks that are not affected correcting as well. For the moment, we still maintain our positive outlook on equity as the underlying economic growth still appears robust but will be alert to gauge if the economic momentum slows from these protectionist measures.

Regional Fixed Income

The situation is more nuanced for fixed income markets. This risk off period has resulted in investors moving towards more conservative assets including sovereign bonds pushing down overall interest rates by 20bps benefiting fixed income assets. However, the gains from lower interest rates are offset by the widening corporate bond spreads that have expanded due to risk aversion. So we do expect long end of corporate bonds to be more volatile. However given the backdrop of tariffs and trade protectionism, Fed may hike only 2 more times rather than 3 times which will benefit government bonds and short dated good quality corporate bonds for yield enhancement.

Malaysia

For Malaysia, the low beta nature has meant that the stock market is relatively unscathed from the market correction and domestic issues including the timing of the General Elections appear to be more central.

Nevertheless, Malaysian industries involved in China’s supply chain of E&E products and technology could be affected by the tariffs, which are concentrated on alleged intellectual property theft by Beijing. KL Technology Index is reflecting this concern and being the worst performing index in KLSE with 21% drop year to date. According to a report by Asian Development Bank (ADB), they estimate about 41.9% of total Emerging East Asia (EEA) exports are consumed by G3 countries (euro area, Japan and the US).

Indonesia

Indonesia is also less exposed compared to North Asian markets as Indonesia is less integrated into the global supply chain with very little intermediate exports that find their way to the finished product manufactured in China. Although Indonesia should not be impacted directly by US-China trade war, it is more prone to dumping by China or other South East Asia countries. The risks ahead are i) a more volatile IDR which means higher risk premium; ii) Potential outflow from EM as many countries are trading with US and may be subject to tariff; iii) Outflow from passive EM funds can also happen which affect Indonesia involuntarily. Both central banks’ normalization and significant increase in US deficit may increase risk premium for UST and affect real yield spread for Indonesian bonds in the short term. Hence, going forward, with additional risk premium for holding IDR denominated assets are baked in, corporate earnings’ achievements will be more important to support the market from any sell-offs. Indonesia may also benefit from commodities or manufactured goods that could not compete with China before tariff.

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