



CHALLENGING DRIVE

3Q 2019 OUTLOOK & STRATEGIES



Maybank Asset Management

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Our 2Q 2019 Review

TRADE WAR TURBULENCE

Asian equities started off the month of April with positive momentum but momentum later stalled and snowballed into a sharp correction in the month of May, thereby ending the rally that began early this year. The key driver of the correction in May was a re-escalation of the US-China trade war with tariffs raised by both sides and the US placing Chinese telecom giant Huawei on a trade blacklist.

Sentiment deteriorated amidst the threat of further intensification (e.g., possible tariffs on an additional US\$325bn of Chinese imports, possible blacklist of 'unreliable' foreign entities in China, possible restrictions on rare earth mineral exports to the US, etc). Most equity markets posted negative absolute returns in May, with key indices such as the MSCI World index (-6.1% in USD terms), the S&P500 index (-6.6% in USD terms) and the MSCI Asia ex-Japan index (-8.9% in USD terms) posting their worst monthly performance so far this year.

While we had turned a little more cautious and expected markets to take a breather at the end of 1Q19, we could not have anticipated US President Trump's actions nor the severity of the rout that followed. Our premise for turning more cautious then was that Asian equity valuations were fair (12X forward P/E inline with historical average) post the rally year-to-date March 2019.

Following the sharp sell-off in the month of May, Asian equity markets have seen some recovery in the month of June on expectations that the US Fed could cut rates in the future and on hopes of some progress towards resolving the US-China trade war at the G20 meeting.



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Meanwhile, market expectations of a US Federal Reserve rate cut have rapidly intensified since the re-emergence of US-China trade tensions in early-May, amidst a backdrop of already cooling global growth and muted inflationary pressure. The US Federal Reserve has also largely toed the line, becoming increasingly dovish as the year progressed.

Most recently, at the FOMC meeting on 18-19th June 2019, the Fed delivered rather dovish guidance, including a marked reduction in the 'dot plots' with seven out of the 17 policymakers projecting a 50bp reduction this year. Indeed, in 2Q19 alone yields on the benchmark 10-year US Treasuries have fallen ~40bps to around 2.00% at time of writing (end-2018: 2.68%). This trend of lower yields is mirrored across most Asian local currency bonds markets.

Asian USD credits have also performed well, with the JP Morgan Asian Credit Index (JACI) returning +7.4% YTD, including +2.5% in 2Q19 amidst the rally in US Treasuries while credit spreads tightened 25bps since the start of the year, albeit widening by 7-8 bps in 2Q19. Lower US interest rates are positive at the margin for Asian fixed income as fund flows return to emerging markets and currencies stabilise, while at the same time providing central banks in the region a window of opportunity to ease monetary policy to support economic growth and liquidity conditions.

Our 2019 Investment Strategy

CHALLENGING DRIVE

KEY THEMES	OUR ASSESSMENT	MARKET IMPLICATIONS & STRATEGY
GROWTH SLOWS	<p>We expect to see slower global growth in 2019. The reasons for slower global growth are manifold. Financial conditions are tighter and the US-China trade war has dampened confidence and increased uncertainty thereby stalling corporate decision making and investment. In addition, export growth is likely to be muted on subdued demand and as a result of prior front-loading of exports (ahead of tariff implementation) in 2018.</p> <p>While China may struggle, as a managed economy, we believe it will succeed in maintaining GDP growth at c.6%. Similarly in Asia, we expect trend or slightly below-trend growth in most economies.</p>	<p>Neutral for equities and mixed for fixed income (positive government bonds, less so for credits).</p> <p>Favour ASEAN over North Asia for equities and local currency fixed income.</p> <p>Prefer Asian credits with high carry.</p>
	<p>US growth momentum will slow as the effects of past fiscal stimulus fade. We do not expect a recession in 2019, albeit that remains a possibility in 2020 (as implied by the inversion of the US yield curve).</p> <p>We expect policy makers, in general, to be more pro-active in boosting the domestic economy. More populist policies may be introduced in countries with upcoming elections in 2019 (e.g., Thailand, Indonesia, India). The Chinese government may respond to the threat of slower growth by relaxing its stance on various issues (e.g., RMB depreciation, property cooling, deleveraging/financing) and increasing fiscal spending. Note that much of the growth slowdown in China can be attributed to the government's various regulatory clampdowns in recent years which has unfortunately now coincided with the trade war.</p>	
INFLATION MUTED; LOWER OIL PRICES	<p>We expect inflation to remain muted in 2019. While there may be a bounce in oil prices in the short term (off the current low base), overall we would expect lower oil prices in 2019 as US shale supply comes on stream. In addition, food inflation should remain benign barring weather shocks.</p> <p>Slower global and capex growth will also weaken commodity demand and prices. The US-China trade war may also prove to be deflationary outside the US. China-made goods will be cheaper with a weaker RMB and China could divert (i.e., dump) its goods to other countries. In contrast, the trade war may increase inflation pressures in the US given more costly imports of consumer goods.</p> <p>Given excess capacity in most of the region, we see little price pressure stemming from capacity constraints.</p>	<p>Negative on most oil plays.</p> <p>Lower oil prices positive for India, Indonesia, the Philippines and Thailand.</p>

CHALLENGING DRIVE

KEY THEMES	OUR ASSESSMENT	MARKET IMPLICATIONS & STRATEGY
MONETARY POLICY CONTINUES TO TIGHTEN BUT CLOSER TO THE END; A WEAKER USD	<p>While we expect the Fed to continue to hike in 2019, we believe the rate hike cycle is largely coming to an end in 2019. Normalization will continue as US core inflation remains close to 2% but mounting growth concerns will eventually lead to a pause in hikes.</p> <p>With the flattening US yield curve and given growth risks, we expect the USD to be weaker and correspondingly most Asian currencies to be stronger in 2019.</p> <p>With the exception of China which will ease in order to support its slowing economy, we expect monetary policy to be neutral in most of Asia.</p> <p>We see less pressure on Asian central banks to hike rapidly given a benign inflation environment and less currency pressure from a weaker USD.</p> <p>While we were correct in our initial assessment at the start of the year that the Fed rate hike cycle would come to an end, rather than just pausing, the Fed could now cut rates given mounting growth concerns amidst the escalation of the US-China trade war. Likewise, some Asian central banks might also consider a loosening of monetary policy.</p>	<p>Prefer US government bonds and Asian local currency government bonds.</p> <p>Favor REITs and high dividend yielding stocks.</p> <p>Favor Asian currencies over the USD. Favor beneficiaries of weaker USD</p>
MORE VOLATILITY; GEOPOLITICS MATTER	<p>We expect markets to remain volatile in 2019 given the uncertainty and risks to growth. For fixed income, we expect continued refinancing pressure.</p> <p>Binary outcome of US-China trade war will require nimble trading to capture opportunities or preserve capital. The US-China trade war is not just about the economics of trade but increasingly seems to be about containing the rise of China which makes any meaningful resolution difficult.</p> <p>While general elections in India, Indonesia and Thailand are likely to see the incumbents returned to power (albeit with an uncertain majority), there is always the risk that the unexpected could occur.</p> <p>Other sources of geopolitical risks include Brexit; elections in Europe (namely, in Germany and Italy); ECB tapering and Middle East tensions.</p>	<p>More tactical trading.</p> <p>High cash allocation from time-to-time.</p> <p>Once election uncertainty is out of the way, India and Indonesia might rally.</p>
GLOBAL TRADE / SUPPLY CHAIN REFORM	<p>With the US-China Trade War, companies will diversify their production bases. Some MNCs and local Chinese companies have already begun relocating their production from China which could benefit some ASEAN countries. These activities to diversify production bases will accelerate. However, this process may take some time depending on the availability of associated supply chains and infrastructure.</p> <p>Restructuring of the global trading architecture. The Multilateral system of trade has underpinned the global trading system and was represented by the WTO. The multilateral system worked by getting consensus from all countries. It was generally fair imposing the same tariffs across all countries with certain concessions given. This has broken down given the lack of support from the US and as world has become more complex world it is now hard to get agreement amongst all countries. Countries now prefer to pursue bilateral FTAs.</p>	<p>Favor selected exporters that benefit from production shifts away from China.</p>

Our 3Q 2019 Asia Ex-Japan Outlook

EQUITIES



We continue to favour the more domestic-oriented ASEAN markets over the more trade-oriented North Asia amidst an environment of slowing global growth and US-China trade tension.

While we had been cautious on Asian equities at the end of 1Q19, we have turned more negative given the escalation in the US-China trade war. Global macroeconomic data has been increasingly subdued and there is a risk that the continuation of the US-China trade war could tip already-slowng global economies into a recession.

Despite the correction seen in May, Asian equities are still not cheap as earnings have been downgraded as well. Asian equities are trading at 13X forward P/E (versus historical average of 12X) and there could be further earnings downgrades given the macroeconomic uncertainties.

As such, we prefer to be defensive and have reduced our equity exposure accordingly. That said, a potential positive catalyst for markets could be the de-escalation or resolution of the

US-China trade war but the situation is fluid and difficult to predict. Should a successful resolution take place, then we would have to be nimble and alter our defensive strategy as the resolution should revive global economic growth.

We continue to favour the more domestic-oriented ASEAN markets over the more trade-oriented North Asia amidst an environment of slowing global growth and US-China trade tension. In addition, lower oil prices (as US shale supply comes onstream) would benefit most ASEAN countries, with the exception of Malaysia. Twin-deficit ASEAN countries, such as Indonesia and the Philippines, should also see less currency pressure and less need for rate hikes given a dovish US Fed.



Key Highlights:

1. Risk that the continuation of the US-China trade war could tip already-slowng global economies into a recession.
2. Asian equities are still not cheap trading at 13X forward P/E.
3. We continue to favour the more domestic-oriented ASEAN markets
4. In the event of a trade war resolution, we should see global economic growth revived, and no longer be defensive.

Our 3Q 2019 Asia Ex-Japan Outlook

FIXED INCOME



We still like the LCY debt markets in Indonesia and India from both carry and currency appreciation perspective over the medium term.

As expectations rapidly changed from interest rate hikes last year to no hikes in 1Q and now interest rate cuts in 2Q, we maintain our constructive view on Asian fixed income, both in LCY debt and USD credits.

Key events to watch in the near term include the G20 Summit in Osaka on 28-29 June and the US FOMC meeting on 30-31 July, where the Fed is widely expected to reduce the fed funds rate by 25bps to 2.00-2.25%.

In particular, we still like the LCY debt markets in Indonesia and India from both carry and currency appreciation perspective over the medium term. Furthermore, elections in both countries have delivered the expected results and hence continuity in terms of policies and implementing pro-growth measures.

Despite the strong performance YTD, we also continue to see value in Asian USD credits from a carry perspective with investment grade bonds at 4.0% and high yield bonds at 7.4%, as spreads remain decent and US Treasuries yields expected to stay low for longer.



Key Highlights:

1. We continue to have a constructive view on Asian fixed income, both in LCY debt and USD credits.
2. Elections in both countries have delivered expected results ensuring continuity in policies and pro-growth measures.

2019 3Q OUTLOOK

INDONESIA



3Q 2019 Indonesia Outlook

EQUITIES



Sharp shifts in market sentiments in May proved the vulnerability of risky assets amid slight changes in macro and geopolitical sentiments especially for Indonesia.

Indonesia's equities saw more downside volatility in 2Q19 which was in line with our previous outlook. The pre-election rally ended one month before the results, which was followed by corrections. However, the magnitude of this correction surprised us given that it was amplified by negative macro geopolitical developments in early May.

Soon after the slump, we saw a constructive change from both a geopolitical front and a monetary policy stance globally, leading risky assets to regain most of, if not all of the losses. Nonetheless, sharp shifts in market sentiments in May proved the vulnerability of risky assets amid slight changes in macro and geopolitical sentiments especially for Indonesia.

Moving forward into 3Q19, local sentiments improved as turmoil caused by the presidential election was omitted. However, Indonesia still lacks positive domestic catalysts. On the external front, there are several important events that matter in the near term. Firstly, the trade war itself is a major conundrum that is looming over Indonesia's markets - a positive trade truce may benefit IDR through less contagion risk, but it may adversely impact Indonesian exports if China decide to purchase more U.S coal. On the flipside, where truce is beyond horizon, IDR would be negatively affected.

However, global economies plan to launch fiscal and monetary stimuli thus pressuring BI to slash rates and the Fed's easing pace may heavily impact BI's rate decision as markets have

priced in a rate cut to take place in July. Weak domestic growth and inflation paved a way for rate cuts while the current negative private balance would make Indonesia's policy makers remain cautious about being ahead of the curve. We must also highlight that a supply-side fiscal push through tax incentives would boost equity markets. However, markets are cautious as they patiently wait for the new ministerial cabinet to be appointed later this year.



A supply-side fiscal push through tax incentives would boost equity markets.

3Q 2019 Indonesia Outlook

EQUITIES

Indonesian big caps have already bottomed out since Nov '18 while liquidity improved. Nevertheless, Indonesia's macroeconomic conditions remain vulnerable to external pressures whereas high momentum stocks that typically outperform during business expansion cycles remain subdued, confirming that the market is still in a doubtful stance in the short-medium term.

Accordingly, our JCI target remains at 6,450 – 6,675 with our positioning leaning to a neutral stance with tactical positioning on both bond-proxy (banks, real estate and construction) and market stocks. We are slightly more constructive as compared to 2Q19 as we foresee more upside risks if macro conditions improve, indicated by narrowing yield spread following potentially favourable outcome from the G20 summit.

As sentiments improve, we plan to allocate more on high momentum stocks given significant upsides as compared to other equity classes or factors. In the event of an unfavourable outcome, we will reserve our flexible and tactical positioning.

Accordingly, our JCI target remains at 6,450 – 6,675 with our positioning leaning to a neutral stance.



3Q 2019 Indonesia Outlook

FIXED INCOME



Jokowi's win was a sentimental booster for the bond market as well as for Indonesia's overall economic outlook.

We recently saw that the euphoria which arose from the presidential election result was short-lived as a result of the accusations volleyed by the opposition. Consequently, volatility loomed over the markets for almost three months until the Constitutional Court dismissed the legal challenge made by opposing candidate, Prabowo Subianto.

Finally, the court upheld the Electoral Commission's final vote tally, which declared the incumbent Jokowi and Ma'aruf Amin as emergent winners. This news provided a positive sentiment for the bond market as well as for Indonesia's overall economic outlook, given reignited optimism that the elected government would continue its planned pro-business reforms. In his first

term, President Jokowi focused on infrastructure development which impressed the mass. For his second term, we are inclined to focus on human resource and labour market reforms to push investments. Indonesia's central bank, Bank Indonesia (BI) is still holding the benchmark rate at 6.00% to date but policymakers are keeping tabs on a rate cut in the future.

In 2Q19, local currency was stable, fluctuating within the range of IDR 14,100 – IDR 14,500 per USD, in line with most Asian currencies. IDR's stability proved BI's commitment to the country's economy, imbuing local and foreign investors with confidence to remain invested in Indonesia. However, although the demand for Govvies plummeted in 2Q19 we firmly believe that demand will rise again.

Looking ahead, we are overweight IDR bonds as we expect the 10-Yr bonds to push yields lower, hovering around 7.00% – 7.25% by year end 2019.



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