



Cloudy Vision 20/20

3Q2020 Outlook & Strategy >>



Welcome to our 3Q 2020 Outlook & Strategy Report



Maybank
Asset Management



20/20

3Q2020 Outlook & Strategy

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2Q2020 Asia Ex-Japan Market Review

Liquidity and fiscal support fuelled recovery of equity and fixed income markets.

Following the sharp COVID-19-induced sell-off in March, Asian equity and fixed income markets rebounded in 2Q2020, aided by the collective measures from central banks and governments worldwide to supply liquidity and to provide fiscal support to the economy. The US Federal Reserve alone has injected more than USD3trn through quantitative easing (QE) policies to support purchases of financial assets. The Fed's balance sheet (Chart 1) has grown to USD7trn - equivalent to more than 50% of the US economy.

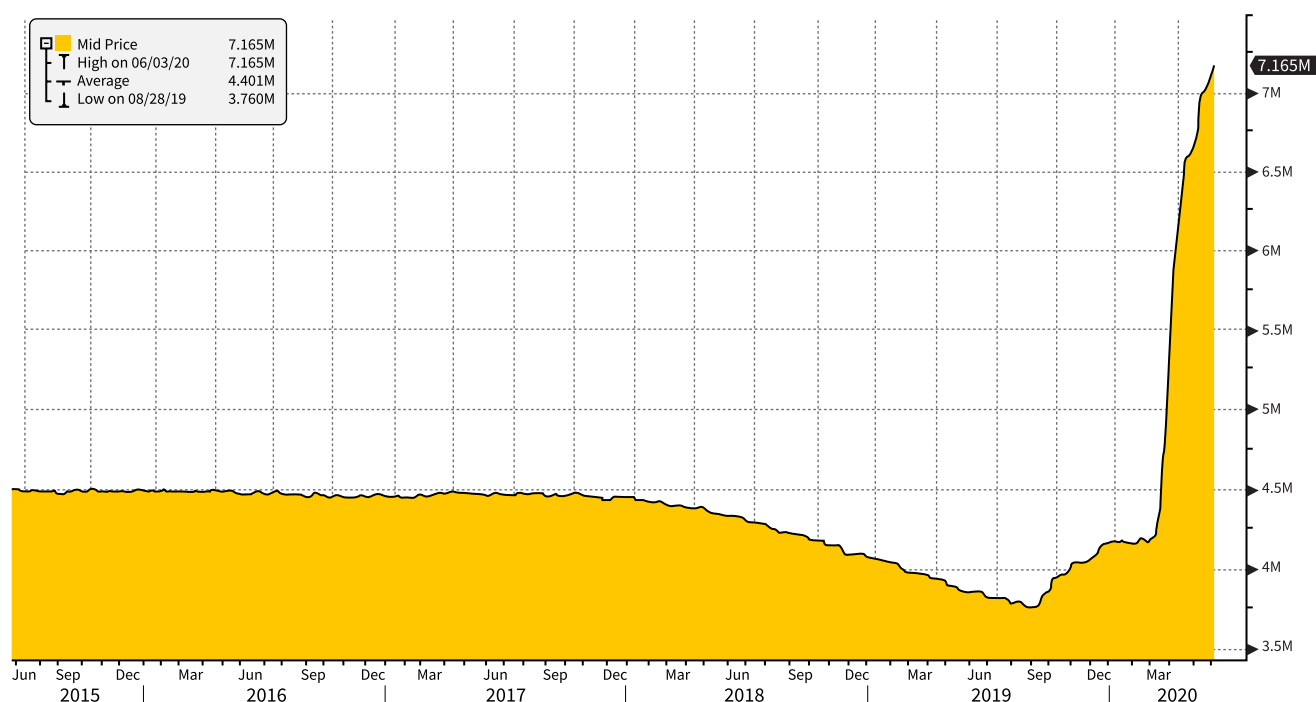


Chart 1: Federal Reserve Balance Sheet increased USD3trn since Mar 2020

(Source: Bloomberg, June 2020)

Despite the downward revision in growth and corporate earnings expectations, the bull rally in 2Q2020 continued as markets took heart from flattening infection curves in several key countries. The anticipation of easing lockdown measures and news on possible treatment options sustained positive market sentiment. Increased retail investor participation was also cited as a contributing factor

to the performance of some markets (e.g. Thailand, Malaysia, and the US).

Tensions between the US and China re-escalated in 2Q2020 with the Trump administration blaming China for the spread of COVID-19 and imposing further restrictions on Huawei. Hong Kong's new security law provided further impetus with US

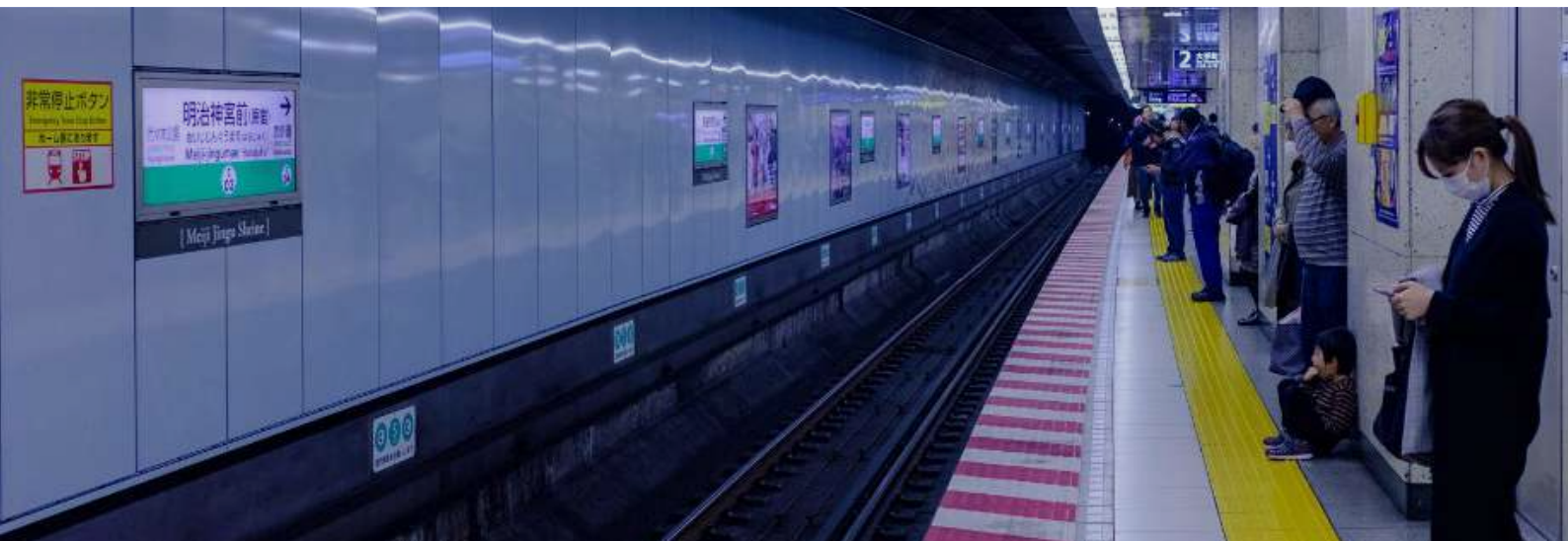
President Trump threatening to revoke Hong Kong's preferential status. So far, equity markets have ignored the negative news from the US-China tensions and weak macroeconomic data due to the favourable liquidity environment provided by the governments and central banks.

Asian bond markets also enjoyed a strong recovery on the back of central banks' fiscal and monetary stimulus bazookas. As the world suffers the worst recession in history since the Great Depression in the 1930s, the main focus of governments globally were to stimulate the economies and preserve jobs. Direct support for bonds also came in the form of governments and corporate bond buying programs that extended to

include even high yield bonds. Both the US and the European central banks pledged to do "whatever it takes" to avoid a global financial meltdown.

With this deep and wide safety net, it was unsurprising that bonds rallied in 2Q2020 after the drastic sell-off in March 2020. The JP Morgan Asia Credit Index* delivered 6% in total returns during 2Q2020 and this eradicated all of March's losses. For 1H2020, the JP Morgan Asia Credit Index is now up 2.1% overall with investment grade outperforming with 3.3% returns versus non-investment grade still in the red with -1.35%.

* *JP Morgan Credit Index as of 25th June 2020.*



“ Equity markets have ignored the negative news from the US-China tensions and weak macroeconomic data due to the favourable liquidity environment provided by the governments and central banks. ”



Key Themes for 2020

Cloudy Vision 20/20 made cloudier by COVID-19



| KEY THEMES | OUR ASSESSMENT | MARKET IMPLICATIONS & STRATEGY |
|--|--|---|
| Global Growth Uncertainty | <ul style="list-style-type: none"> • A recession in 2020 with growth picking up in 2H2020 as lockdowns end. • Growth uncertainty to persist with COVID-19, politics and trade policy being unpredictable swing factors. • Policy makers look to boost their domestic economies via fiscal spending. • Positive factors: supportive monetary/fiscal policy. • Negative factors: corporate decision-making/investment slows as consumption decelerates (on diminished confidence and cash preservation). | <ul style="list-style-type: none"> • Favour a trading-oriented/tactical stance. • Favour fixed income over equities on better risk-reward. • Expect dividend cuts. • Focus on structural themes that are less dependent on global macro-economic conditions e.g., 5G, technology change/trends, policy beneficiaries. • Favour Asian currencies and gold over USD. |
| Continuing Trade Tension and Tech War | <ul style="list-style-type: none"> • US protectionist trade stance and global trade tension to remain an overhang. • Meaningful US-China trade war resolution unlikely as underlying issues extend beyond the economics of trade. • Ongoing US-China tech war to continue given US/China rivalry, national security and intellectual property concerns etc. • Corporates hedge against the risk of rising trade friction by reconfiguring regional supply chains. • Risk of trade friction broadening out to other countries (e.g., on currency manipulation accusations, re-routing of trade flows to circumvent tariffs). | <ul style="list-style-type: none"> • Favour a trading-oriented/tactical stance. • Favour beneficiaries of production shifts away from China. • Focus on more domestic demand stories as it will be less exposed to global supply chain disruptions from the US-China tensions. |
| Accommodative Monetary Policy | <ul style="list-style-type: none"> • Monetary policy to remain accommodative globally amidst benign inflation as governments focus on stimulating growth and preserving jobs. • Interest rates expected to remain low for longer. • Expect a weaker USD. We are bearish on USD from a medium term perspective as Fed's Balance sheet expansion will continue till 2021. • Negative output gaps (given excess capacity) and economic worries (weakening demand) to keep inflation subdued. | <ul style="list-style-type: none"> • Markets are unlikely to re-visit the drastic sell-off levels in March given supportive liquidity environment. • Bullish on duration for fixed income. • Favour long-end sovereign and quasi-sovereign bonds. • Prefer selective Asian currencies over USD like THB, SGD, IDR and INR • We like gold as an asset class due to very low to negative rates globally and higher fiscal stimulus across the globe. |
| More Volatility; Geopolitics Matter | <ul style="list-style-type: none"> • Markets to remain volatile given uncertainty thereby requiring nimble trading. • Sources of geopolitical risk include, amongst others: US Presidential elections, US-China tensions, North Korea, Brexit, Latin America/Middle East political instability etc. | <ul style="list-style-type: none"> • Bullish on duration for fixed income. • Favour long-end sovereign and quasi-sovereign bonds. |

Our 3Q2020 Asia Ex-Japan Equity Outlook & Strategy

Neutral on equities on high valuations. There's a disconnect between financial markets and economic reality.

There appears to be a disconnect between financial markets and economic reality with markets rallying despite the uncertainties. This rally has been due to the supportive liquidity environment. **Asian equities are trading at almost 15X forward P/E (versus historical average of 12X, see Chart 2) and we now view the risk-reward as being unattractive.** The economy remains weak and valuations are elevated amidst a re-escalation in geopolitical tensions. P/E valuations are high because the market has surged even as corporate earnings have been downgraded in-line with the weak economy (Chart 2, red line). US equity markets are even more overvalued and are approaching the tech bubble valuations in 2000 (Chart 3). US markets have benefited the most from the excess liquidity as it has been the closest to the source of liquidity, principally the US Federal reserve.

We believe that the global economic recovery will be uneven and slow unless a COVID-19 vaccine or an effective treatment is found. While Asia is largely ahead of the rest of the world in terms of infection curves, the world remains intertwined and thus a synchronized recovery will be difficult.



The risk remains that a second wave of COVID-19 will result in a more prolonged hit to the global economy. Geopolitical risks are another risk factor given the re-escalation of the US-China tensions and the upcoming US Presidential elections.

“**We believe that the global economic recovery will be uneven and slow unless a COVID-19 vaccine or an effective treatment is found.**”

However, we are not outright bearish given the still buoyant liquidity conditions. We are tactically neutral as market technicals have also improved. **We are Neutral on Asian equities and we favour a tactical trading stance, being nimble to revise our positions as the situation calls for. At present, we favour value stocks as well as those with strong secular growth prospects. We also like stocks that are more domestically oriented as they will be less exposed to the supply chain and travel disruptions resulting from the escalating US-China tensions and COVID19 respectively.**





Chart 2: Asia (MSCI Asia Ex Japan Index) PER (dark line) Valuations and Earnings (Red line)

Source: Bloomberg, June 2020



Chart 3: US (S&P500) PER Valuations (dark line) and Earnings (blue line)

Source: Moody's, Maybank AM Singapore as of April 2020.

Our 3Q2020 Asia Ex-Japan Fixed Income Outlook & Strategy

Positive on fixed income, default risks priced in.

Even after the strong bond performance in 2Q2020, we remain Positive on fixed income for 2020. As we emerge out of a deep recession and attempt to re-open economies, the recovery will likely be gradual and uneven. Apart from trying to fight an invisible and highly infectious COVID 19 without a vaccine or a proven treatment, the recent re-emergence of geopolitical tensions globally makes a V-shaped recovery even more elusive. Under such an environment, interest rates are expected to remain

lower for longer, which will be positive for bond returns.

The key risk for bond investments during a recession is default risks. While we are cognisant that default rates will increase in FY2020, we believe that the risks can be managed. Moody's has predicted that default risk for high yield bonds in Asia Pacific to rise from 2% in FY2019 to 6% FY2020. This compares favourably with US and Europe where Moody's has predicted default rates of 14% and 8% respectively.

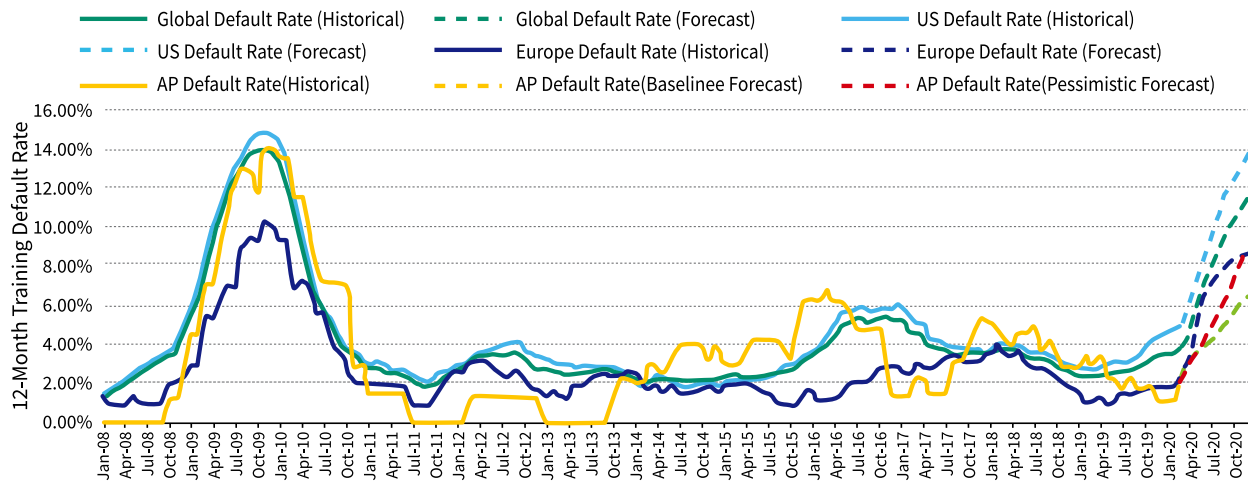


Chart 4: 12-month Asia Pacific high-yield non-financial company default rate

Source: Moody's, Maybank AM Singapore as of April 2020.

We believe present valuations compensate adequately for taking credit risks in the current environment. Current safe investments such as US Treasury bonds are at very low yields. The excess yield,

otherwise known as the credit spread, that we can get from buying corporate bonds versus government bonds is much wider now compared to FY2019 and the five year historical spread.



Chart 5: JP Morgan Asia Investment Grade Credit Spread

Source: Bloomberg, JP Morgan, Maybank AM Singapore as of June 2020.



Chart 6: JP Morgan Asia High Yield Credit Spread

Source: Bloomberg, JP Morgan, Maybank AM Singapore as of June 2020.

For FY2020 we expect total returns of 4% to 5% for Asia USD credit bonds. We like long duration given interest rates should stay low and will position for this trade using **investment grade quasi-sovereigns or SOEs**. We will hold some high yield bonds for good carry, focusing on stronger high yield credits rated

BB- and above, at shorter duration between 3 to 4 years. Shorter maturity high yield bonds tend to have better liquidity versus high yield bonds with longer maturities. Given that credit spreads are wide, we do not need to extend to long dated high yield bonds for attractive bond carry.

“ Interest rates are expected to remain lower for longer, which will be **positive for bond returns** ”

Our 3Q2020 Global Sukuk Outlook & Strategy

Sukuk market to continue to recover

Like other fixed income markets, the Sukuk market also experienced a sell-off in March, with the Dow Jones' Sukuk Total Return Index returning -5.3% for that month before rebounding to 2.8% and 2.6% in April and May respectively.

In the Middle East space, the conventional bond market was the first to revive as sovereigns like Qatar, Abu Dhabi and Saudi Arabia printed bonds with significant new issue concessions. The Sukuk market followed as soon as risk sentiment continued to recover. Bahrain was the first issuer post the recovery to issue USD denominated Sukuk in May, which drew strong demand from investors.

Subsequent USD Sukuk issuances from the Emirate of Sharjah, Dubai Islamic Bank over the month of May to June have also managed to perform well despite tight pricings, a testament to the structurally tight supply situation in the space. In addition, Indonesia had managed to print a 30-year Sukuk to meet investors' demands for duration in this low yield environment.

The 30-year Sukuk is hard to come by, as such tenors were not historically preferred.

We believe the Sukuk market will continue to recover into 3Q2020. We believe credit spreads will continue to grind tighter into 2H2020. Credit spreads of GCC Investment grade names remain wider relative to history despite the recovery and with low UST yields expected to stay for a while longer.

Dow Jones' Sukuk
Total Return Index returning

-5.3%

for that month before rebounding to

2.8% & 2.6%

in April and May respectively.

“ We expect Global Sukuk issuances to be in the range of **USD-140-50bn** in 2020 ”



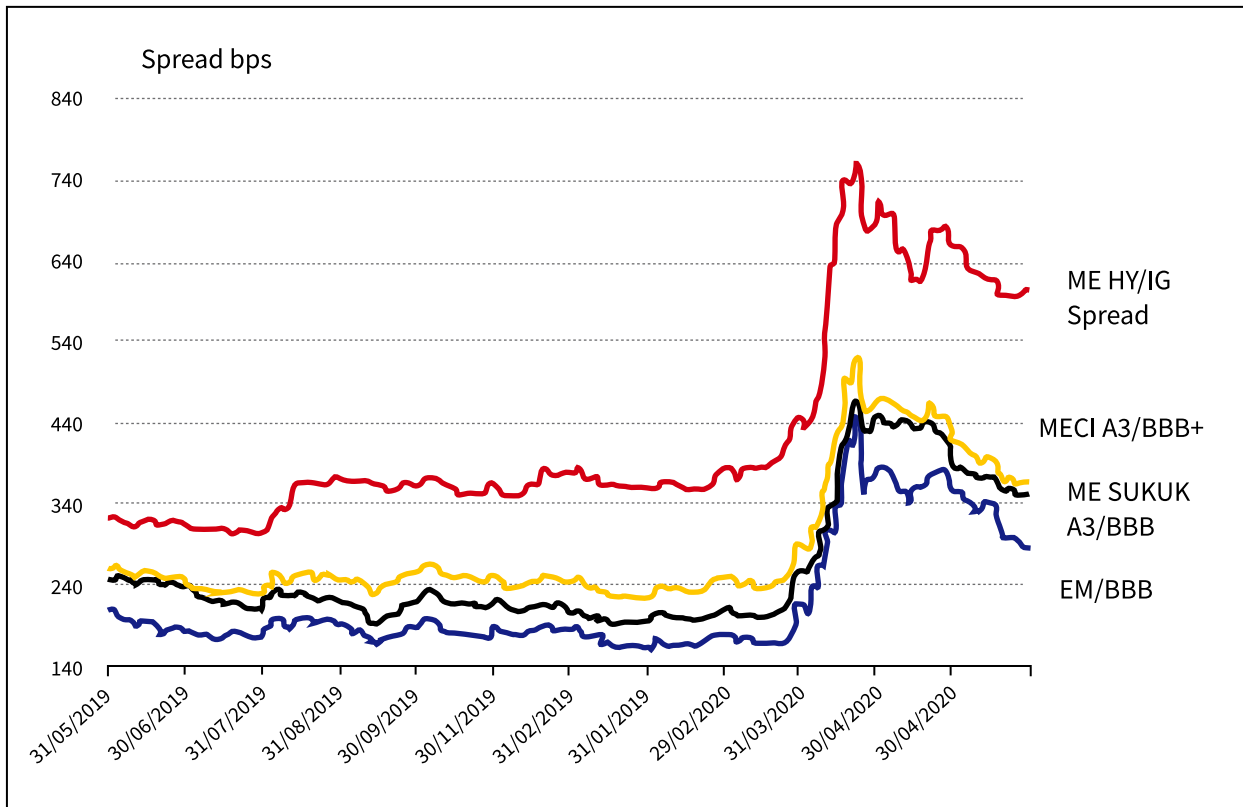


Chart 7: Credit spreads of Sukuk market

Source: Bloomberg, June 2020

We will continue to favour IG names over HY as bulk of the issuances in the GCC space (ex-sovereigns) are in the GCC real estate sector. This sector is still suffering from falling home prices, low rental rates and the oversupply situation. In the IG space, we continue to favour financials given the high government ownership/support and a good spread pick up over the sovereigns. We also remain positive in the Sukuk AT1 perpetual space given the confidence that the issuer will call them on their first call dates, following First

Abu Dhabi Bank’s decision to call their conventional AT1 perpetual in May.

We expect Global Sukuk issuances in 2020 to be in the range of USD140-150bn in 2020, from around USD130bn in 2019, driven in part by global sovereign Sukuk issuances increasing moderately to USD 75-90bn in 2020 from USD71bn in 2019, on both lower oil revenues and increased budget spending due to the impact from the COVID-19 shutdowns.



GLOBAL SUKUKS : RECOMMENDATIONS

| | |
|---------------------|--|
| Malaysia | <ul style="list-style-type: none"> • Current Account to deteriorate slightly given lower oil prices (USD 40/bbl for 2H2020) and lower trade from COVID-19; MYR likely to appreciate against USD in 3Q2020 as real yields remain positive and weaker USD environment. • Prefer short end MGII for carry and currency appreciation potential given flat curve; avoid duration given potential for increased supply. • Market weight on USD Malaysia sovereign, SOE Sukuks, and overweight on local currency Sukuk. |
| Indonesia | <ul style="list-style-type: none"> • IDR to stay in the range of 13800-14200 on stable external balances. • Prefer short dated IDR Sukuks for carry as increased sovereign funding needs may drive domestic yield curve steeper; 10 year yield forecasted at 7.5-7.6% by year end from 7.10% now. • Inflation is expected to remain stable and IDR real yields remain positive despite likelihood of another policy rate cuts from 4.25% currently. • Market weight on USD INDOIS Sukuks and overweight on local currency Sukuk. |
| Saudi Arabia | <ul style="list-style-type: none"> • Market weight on KSA Sovereign Sukuks. • Supply of sovereign conventional bonds and Sukuks can be absorbed given JPM Index Inclusion. • Prefer IG over HY Saudi names as increase in VAT rate to 15% from 5% effective July 2020 is likely a drag on consumers and corporates. |
| UAE | <ul style="list-style-type: none"> • Residential real estate market may have bottomed but any recovery is likely to be slow • Rescheduling of Expo 2020 into 2021 to delay recovery. • In the UAE HY space, overweight bank AT1s for carry given expectation of profitability and strong capital ratios even as NPLs build up; First Abu Dhabi bank calling their AT1 perp in May gives confidence to this sector in contrast to European bank AT1 sector. • Overweight financials given strong government ownership/support and sovereigns as UAE best positioned to weather this current oil price downturn. |
| Qatar | <ul style="list-style-type: none"> • Market weight on Sukuks issued by Qatari financials. • Overall Sukuk supply from Qatar should remain limited in 2020. |
| Oman | <ul style="list-style-type: none"> • Financing needs of Oman to remain heavy despite sales of stakes in SOEs. • Underweight OMAN USD Sukuks on impending supply risks, which has seen no supply in 1H2020. • Downgrade risks remain high given increased strain to budget on lower oil prices. |
| Bahrain | <ul style="list-style-type: none"> • Bahrain's sovereign and quasi-sovereign conventional bonds and Sukuks to remain supported despite tight levels for its B+ rating. It has strong support from Saudi and UAE. • Government's fiscal position set to improve given existing reforms in place and USD 10bn support package from UAE and Saudi. • Over weight on Bahrain's USD sovereign Sukuks as yield is attractive for carry. |
| Turkey | <ul style="list-style-type: none"> • Underweight USD TURKSK Sukuks on tight valuations and high susceptibility to geo- political risks. |
| Kuwait | <ul style="list-style-type: none"> • Continue to like Kuwaiti Banks AT1 perps for carry given limited supply vs UAE banks. |



Singapore

Our 2Q2020 Singapore Review

In 2Q2020, both the equities and fixed income markets recovered from the severe market correction in March 2020. Although more economies entered economic lockdowns, strong supportive measures from central banks and governments worldwide helped the market look forward to an eventual economic re-opening.

2Q2020 saw a sharp rebound from March's sell-off, given the relief brought by the massive fiscal and monetary stimulus globally to minimise the impact of Covid-19. This is the same in Singapore, where the government, over four budget announcements has committed to spend up to SGD93bn. To fund this amount, the government will draw down SGD52bn from past reserves, making this the second time since independence. Of the total SGD93bn, 80% of this amount will come mainly in the form of salary



support schemes and rental waiver for businesses. The government is expected to run a budget deficit of SGD39.2bn or 11.4% of GDP this year.



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On the monetary policy front, Monetary Authority Singapore (MAS) had announced in end-March (instead of the usual April schedule), the shifting of the appreciation pace of the SGD Nominal Effective Exchange Rate (NEER) to 0% and to re-centre the mid-point while keeping the trading band unchanged.

“ The Singaporean government, over four budget announcements **has committed to spend up to SGD93bn** ”

Singapore Government Securities (SGS) rallied during this quarter by 20-25 bps across the curve. Corporate bonds' recovery was gradual in April and May, but caught up with the rally in international markets in June. Credit spreads recovered around half of March's sell-off in 2Q2020.

Our 3Q2020 Singapore Equities Outlook & Strategy

Bearish on Singapore equities, risk-reward not attractive

Entering 3Q2020, we see an increasing disconnect between the improving equities market and worsening economic situation. **We had revised our 2020 Singapore GDP forecast down to -7.0% from -0.5%.** Although the economy is re-opening, the pace is gradual and our concern is that many small businesses will have trouble re-starting. While liquidity risk has been lowered, solvency risks remain high. Many of the government's support measures have only helped with debt deferral but not debt forgiveness. Fortunately, exports had been stronger than expected due to good performance from pharmaceuticals and gold exports.

On the other hand, the equities market is enjoying a rather strong ride. The Singapore index price has risen whilst earnings estimates for the constituent index companies have been lowered. The resulting Price to Earnings (P/E) ratio has actually increased to more than one standard deviation above historical average. Hence, **we are bearish on Singapore equities as the risk-reward does not look**

attractive to us and we would urge investors to be cautious going into the 3Q2020.

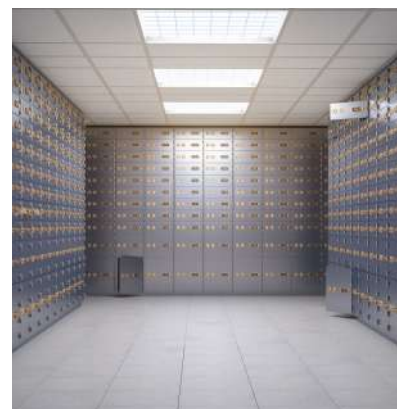
For our investment strategy, we are looking to position our portfolios defensively. We favour stocks with consistent income streams, stable dividend yield stocks, policy stimulus beneficiaries, as well as companies with strong balance sheets/good cash flows.

“ **We favour stocks with consistent income streams, stable dividend yield stocks, policy stimulus beneficiaries, as well as companies with strong balance sheets/good cash flows** ”

In terms of sector allocation, we would advocate **Overweight positions on consumer staples due to resilient consumer demand amidst economic uncertainty.** We have **downgraded Real Estate Investment Trusts (REITs) from Overweight to Neutral** as the



sector has done well and valuations and dividend yields are fair in a low interest rate environment. **We are also Neutral on banks due to potential higher credit costs from the weak economy,** although we do acknowledge that Singapore banks have strong capital positions. The communication services sector is likely to be valued for its stability as competitive pressures ease in the weak economic environment.



Our 3Q2020 Singapore Fixed Income Outlook & Strategy

Overweight SGD credit space, prefer investment grade vs high yield

Despite the massive stimulus package provided by the Singapore government, recovery will be slow on the back of disrupted economic activities and dampened consumer confidence, not to mention that Singapore is an open economy highly reliant on trade. **For 2020, we expect the Singapore economy to shrink around -4% to -1%.**

We expect global rates to remain low for longer. Hence we are bullish on duration. In addition, SGS supply will be manageable despite the large stimulus package, as the Government will fund more using its past reserves. Hence, we remain constructive on SGS given its attractive yield pickup over US treasury bonds, both on an outright basis and on a currency-adjusted basis.

After a drastic 6% weakening of SGD in 1Q20 vs USD, USDSGD has recovered around half of it this quarter and is expected to end the quarter around its current level at 1.39. Given our view of a more weakened USD to come, **we believe that the SGD has room to appreciate another 2-3% against the USD in 2H2020.**

In the SGD credit space, we prefer to overweight credit mainly from a valuation point of view. However, we prefer investment grade issuers due to their good onshore funding access and stronger balance sheet to withstand the growth slowdown. We underweight high yield in SGD space given the expected cautious sentiment among investors.

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We remain constructive on SGS given its attractive yield pickup over US treasury bonds, both on an outright basis and on a currency-adjusted basis.

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