# A RETURN TO AB-NORMALITY

# 2Q2021

## OUTLOOK & STRATEGY

Maybank Asset Management

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# 1Q2021 REVIEW

"The high participation rate of many 'first-time' retail investors contributed to the volatility in markets..."

In line with our view, Asian equities began the year on a positive note on anticipation of a global reflation, as Covid-19 vaccinations were rolled out and given the confirmation of the Democratic sweep of Congress. The prospects of US fiscal stimulus further fed buoyant markets.

**Throughout the quarter, however, there were bouts of correction driven by concerns over overextended markets, quantitative easing (QE) taper fears, and inflationary expectations leading to rising bond yields.** Also, the high participation rate of many 'first-time' retail investors contributed to the volatility in markets - the most notable example of which were the short squeezes in selected US stocks in January, which fuelled hedge fund unwinding of long positions, thereby exacerbating the sell-off.

**From mid-February onwards, the market narrative was dominated by concerns over rising interest rates** due to rising commodity prices and concerns over higher inflation. This caused the benchmark UST 10-Year yield to rise to 1.75%. Investors' fear was on the basis that if inflation rise, interest rates will have to rise to quell inflation. For instance, oil prices have already hit USD60 per barrel, more than doubling from the lows in 2020. As a result, interest rates have been rising in anticipation of higher inflation. The benchmark UST 10-Year has gone up to around 1.60% from just 0.90% in 2021 and up 110bps from the lows in August 2020.

**If inflation becomes entrenched, investors are anxious that interest rates will have to rise to quell inflation.** Higher interest rates will in turn lead to reduced investment appetite into risk assets including equities (See Exhibit 1). There is also the element of profit-taking after a strong run and rotation from outperformers (e.g., tech) into laggard cyclicals. So far we have seen a correction in the Asian markets of 8% from the peak but stock markets are still positive year to date.

**Exhibit 1:** US 10-year Treasury Bond Yields (black line) and Asian equities (gold line).
Sharp rise in interest rates has seen equity markets correct.
| Source: Maybank Asset Management, Bloomberg | Period Mar 2019- Mar 2020

**Exhibit 2:** Oil Prices (Brent) have doubled since the lows in 2020
| Source: Bloomberg, Maybank Asset Management | Period Mar 2020- Mar 2021

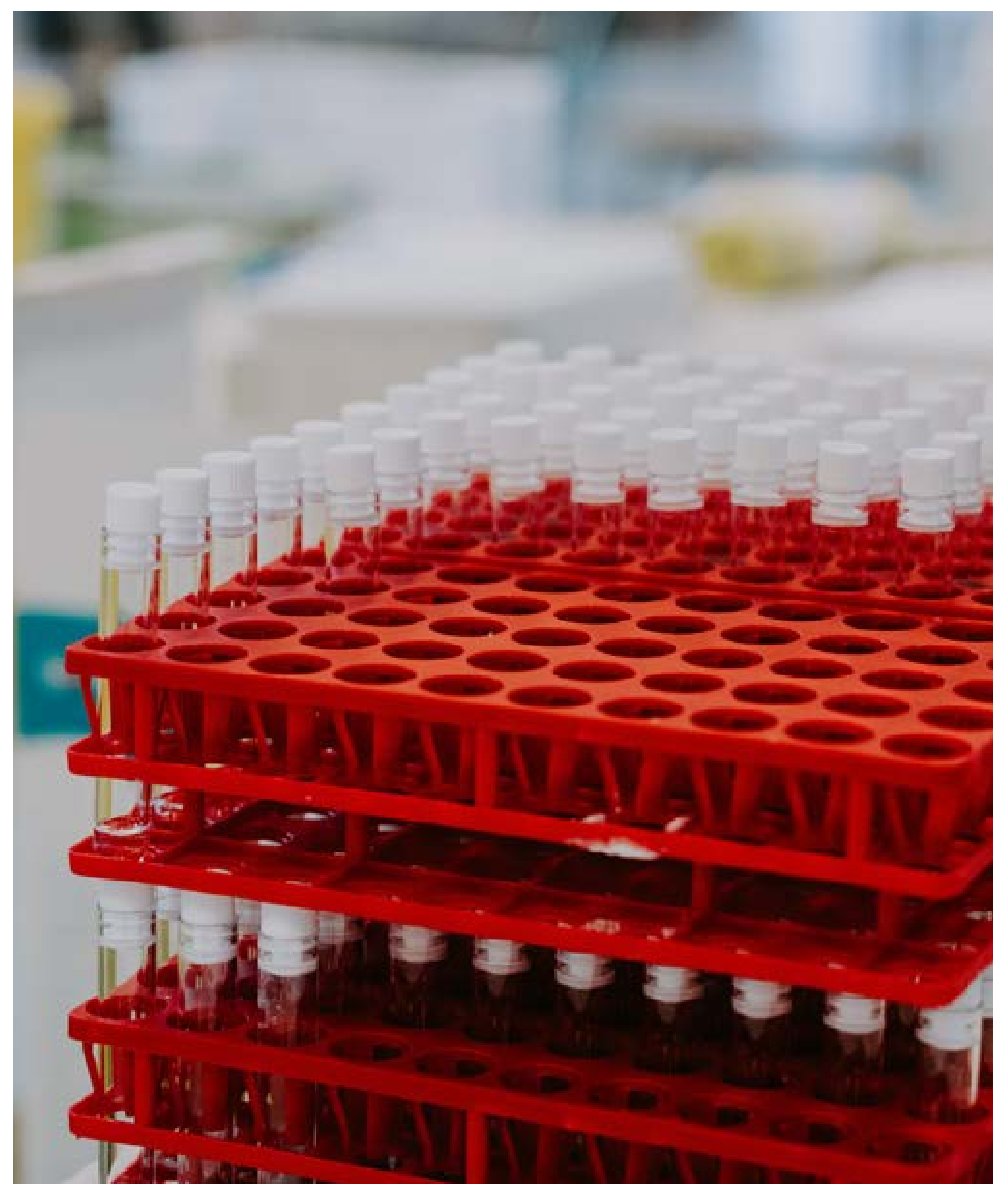
> "The reality was not as rosy as we expected...we saw a sharp sell-off with the UST 10-Year rising from 1% start of the year, to peak at 1.75% mid-March."

**We started the year being optimistic on fixed income credits, based on two main anchor points.** Firstly, we expected the successful roll-out of vaccines will help economies and businesses to re-open faster, spurring recovery and growth. This would be positive for risk assets, including corporate bonds and corporate credit spreads would tighten.

**Secondly, we expected that even as economies recover, major central banks will not reduce their asset purchasing programmes or raise interest rates any time soon.** Overall, we expected a calmer 1H2021 and market to only start pricing in rates hikes gradually from 2H2021 onwards. This would provide a stable environment for bond investors to earn 3% - 4% total returns for FY2021.

**However in 1Q2021, the reality was not as rosy as we expected.** In 1Q2021, we saw a sharp sell-off with the UST 10-Year rising from 1% start of the year, to peak at 1.75% mid-March, piercing through pre-COVID-19 levels. Currently, it is hovering around the 1.6% levels. The weakness persisted even after the Fed and ECB reaffirmed that they remain committed to keep liquidity flushed by maintaining asset purchases and keeping interest rates low.

On the credit front, things have also been challenging especially for Chinese high yield and weak local government entities. The unexpected default and restructuring of several high profile issuers, including Yongcheng Coal and China Fortune Land resulted in investors selling down bonds from weak provinces such as Henan, Yunan and Hebei.



Within high yield, Chinese credits sold off the most, followed by Indonesian high yield. Indian high yield remained resilient especially their renewables as they are well sought after by ESG funds.

**Exhibit 3:** 10yr UST at 1.508% as at end-Jan 2020
| Source: Bloomberg, Maybank Asset Management | Period March 2016- Mar 2021

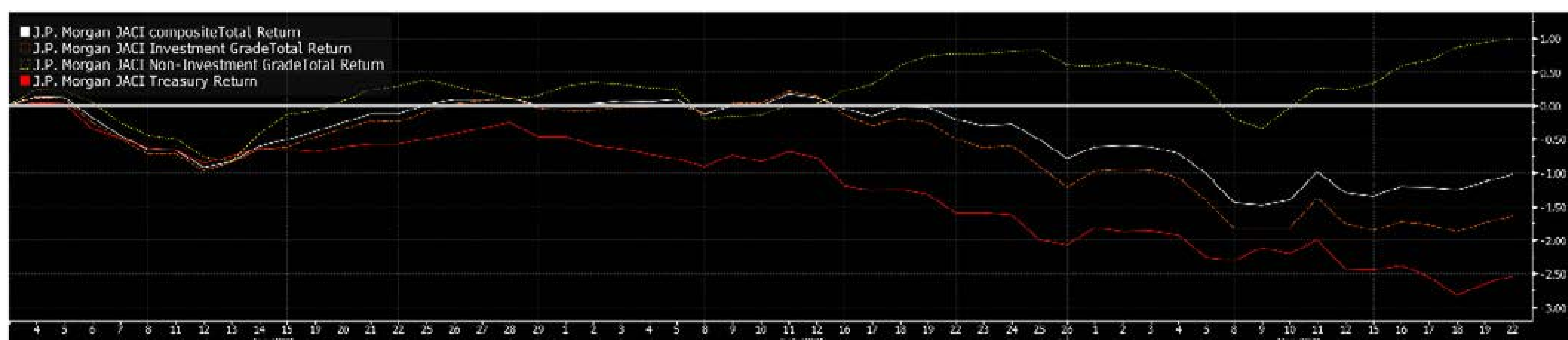



**Exhibit 4:** JP Morgan Asia Credit Index (JACI)
| Source: Bloomberg, Maybank Asset Management | Period Dec 2020- Mar 2021

**The JP Morgan Asia Credit Index (JACI) fell about -1% year-to-date as of 22nd March 2021.** The bulk of the negative returns came from investment grade bonds due mainly from the Treasury sell-off. While high yield bonds delivered about 1% total returns, the returns are paltry in context of high yield bonds which are trading at 7% yields.

Overall, it was a challenging quarter for Asian markets. The sharp sell-off in Treasuries reversed risk appetite across major asset classes and disrupted the positive returns momentum carried over from FY2020. However, we still maintain our Outlook & Strategy for 2021 and we think Asia would be the focus this year. Hence, we have a positive view on Asian equities, fixed income and currencies.

On the credit front, things have also been challenging especially for Chinese high yield and weak local government entities, which saw investors selling down bonds from weak provinces such as Henan, Yunan and Hebei.

# OUR 2021 INVESTMENT THEMES

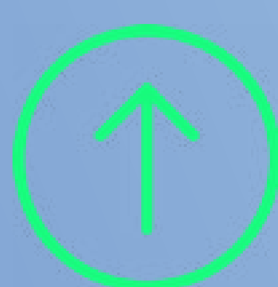
| THEMES | OUR ASSESSMENT | IMPLICATIONS / STRATEGY |
|---|---|---|
| **Biden Presidency with Split Congress** | • US is divided with extreme polarization of views.<br>• Fiscal stimulus will be delayed and its quantum pared down.<br>• More quantitative easing, keeping rates lower for longer, as the US Fed picks up the slack (given the impasse on fiscal stimulus).<br>• Less hostile US-China relationship but tensions would remain.<br>• Weaker USD on improving global growth and negative real rates. | • A divided US is positive for Asia in the long term. Reversal of US outperformance on inflows into Asia.<br>• Positive for Asian credits and currencies.<br>• Mixed for local government bonds. Positive for China and Korea (which could also benefit from inclusion into the FTSE bond index).<br>• Positive for equities. Risk being equity market dependency on stimulus.<br>• Rotation to Value from Growth equities.<br>• Weak USD to benefit commodities, Asian equities and currencies. |
| **Global Growth Recovery** | • Recovery in global growth off low base.<br>• Return to normalcy given COVID-19 vaccine development/ achieving herd immunity (in certain locations).<br>• Greater room to rebound in worst hit economies.<br>• Positive news flow on vaccines will be a positive catalyst for markets.<br>• Earnings growth to be key driver of returns.<br>• Recovery in demand and prices for commodities such as oil, copper. | • Positive for risk assets i.e., equities and fixed income.<br>• Better ASEAN performance which has lagged North Asia in recovering from the pandemic.<br>• Rotation to cyclicals (e.g., industrials) from defensives, COVID-19 beneficiaries (e.g., healthcare, home entertainment).<br>• Favor commodity plays e.g., selected mining companies, oil and gas plays. |
| **Lower Rates for Longer but Steeper Yield Curve** | • Accommodative monetary policy globally amidst still- fragile economy.<br>• US Fed keeps rates lower for longer to compensate for reduced fiscal stimulus.<br>• Long end of the yield curve (for US Treasuries and local government bonds) to steepen given higher fiscal deficits. | • Positive for ASEAN currencies.<br>• Low real and nominal rates supportive of elevated equity valuations.<br>• Positive for gold given low opportunity cost of holding gold and its fiat currency status (amidst an expanding monetary base).<br>• Prefer high yield over high grade bonds. |
| **Volatile Market** | • Markets to remain volatile given uncertainty (e.g., vaccine development/distribution, US fiscal stimulus) and risks to growth.<br>• Sources of geopolitical risks include Brexit, political uncertainty in some emerging markets, US-China tensions etc. | • More tactical trading.<br>• High cash allocation from time-to-time. |
| **Technology Disruption** | • Structural trend of disruptive technology, digital economy, work-from-home to continue. | • Technology names may suffer from rotation into cyclicals/value in the short term but this may prove to be a buying opportunity. |
| **Sustainability** | • Structural trend of sustainability, ESG to continue.<br>• Governments to commit more to sustainability e.g., to be carbon neutral by 2050.<br>• Biden Presidency may curtail development of shale resources and benefit 'green-energy' plays. | • Positive for 'green-energy' plays e.g., electric vehicle plays, renewables.<br>• Mixed for oil plays given demand risks but also supply curtailment.<br>• Structural de-rating of less ESG-friendly equities e.g., tobacco, gambling. |

# GROWTH SCENARIOS IN 2021

### Downside Risks

- Resurgence in COVID 19 cases prompting further lockdowns.
- COVID 19 vaccines efficacy and availability issues, logistics/operational challenges.
- Re escalation of US China tensions.
- 'Hard' Brexit geopolitical & economic disruption.
- Regulatory risks e.g., in the tech sector.
- Political risks e.g., in Malaysia (that could see snap elections).
- Unanticipated withdrawal or faster-than-expected tapering of stimulus.

### Upside Risks



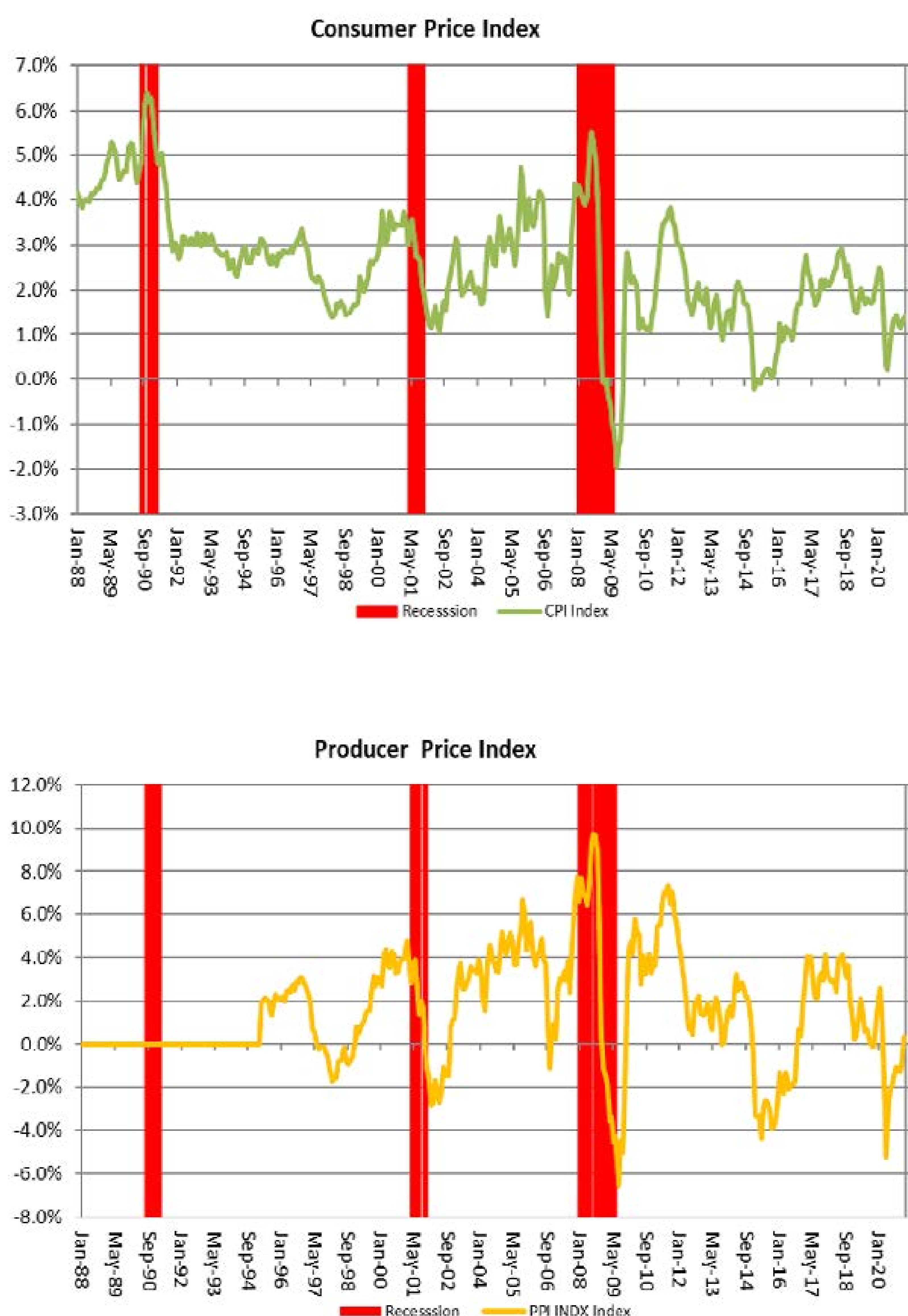
- Faster-than-expected return to normalcy on better-than-expected vaccine development and distribution.
- Stronger-than-expected policy support.

| SCENARIOS | ASSUMPTIONS / RISKS | IMPLICATIONS / STRATEGY |
|---|---|---|
| **Base Case** | • Global growth recovery off low base with policy support and virus impact gradually fading. Vaccine development in 1Q2021 with distribution from 2H2021 onwards.<br>• Less hostile but still tense US-China relationship. | • Focus on Asia.<br>• Positive for Asian equities (including REITs).<br>• Positive for Asian fixed income. Favour high yield over investment grade.<br>• Positive for Asian currencies. |
| **Good Case** | • Robust economic recovery on strong policy support and faster-than-expected return to pre-COVID-19 normalcy. Vaccine development in 1Q2021 with distribution from 2Q2021 onwards.<br>• A more amicable-than-expected US-China relationship. | • Focus on Asia.<br>• More positive for Asian equities.<br>• Neutral for Asian fixed income. Favor high yield over investment grade.<br>• Overweight equities vs. fixed income. Positive for Asian currencies. Underweight gold. |
| **Bad Case** | • Rebound in global growth falters.<br>• COVID-19 pandemic rages on with sporadic lockdowns. Vaccine development/distribution delayed.<br>• Re-escalation of US-China tension. | • Negative for Asian equities.<br>• Positive for Asian fixed income. Favor investment grade over high yield.<br>• Underweight Asian currencies. Overweight gold. |

# ASIA EX-JAPAN

# 2Q2021 ASIA EX-JAPAN EQUITIES OUTLOOK & STRATEGY

**Exhibit 5:** Measures of Inflation usually rebound sharply post-recession and presently remain at the low end of the scale
| Source: Bloomberg Maybank Asset Management | Period: Jan 1988 - March 2021




**While rising commodity prices may lead to an inflation scare and a correction in risk assets, we remain sanguine.** Rising (but still low) inflation will not be unduly detrimental for equities in the medium-term if accompanied by improving growth.

We view this post-recession rebound in inflation and interest rates as being normal in the course of an economic recovery. Looking at previous recoveries (see Exhibit 3) we find that inflation does go up but this is because of the low base in economic activity during the downturn.

Inflation measures like the US Consumer Price Index (CPI) and the US Producer Price Index (PPI) did rebound following the economic recovery post the Global Financial Crisis (GFC) in 2008. However that was not the start of a new era of high inflation. On the contrary, it was the start of a disinflation where inflation was in a range of between 1% to 3% and appeared to be on a downtrend all the way to 2020.

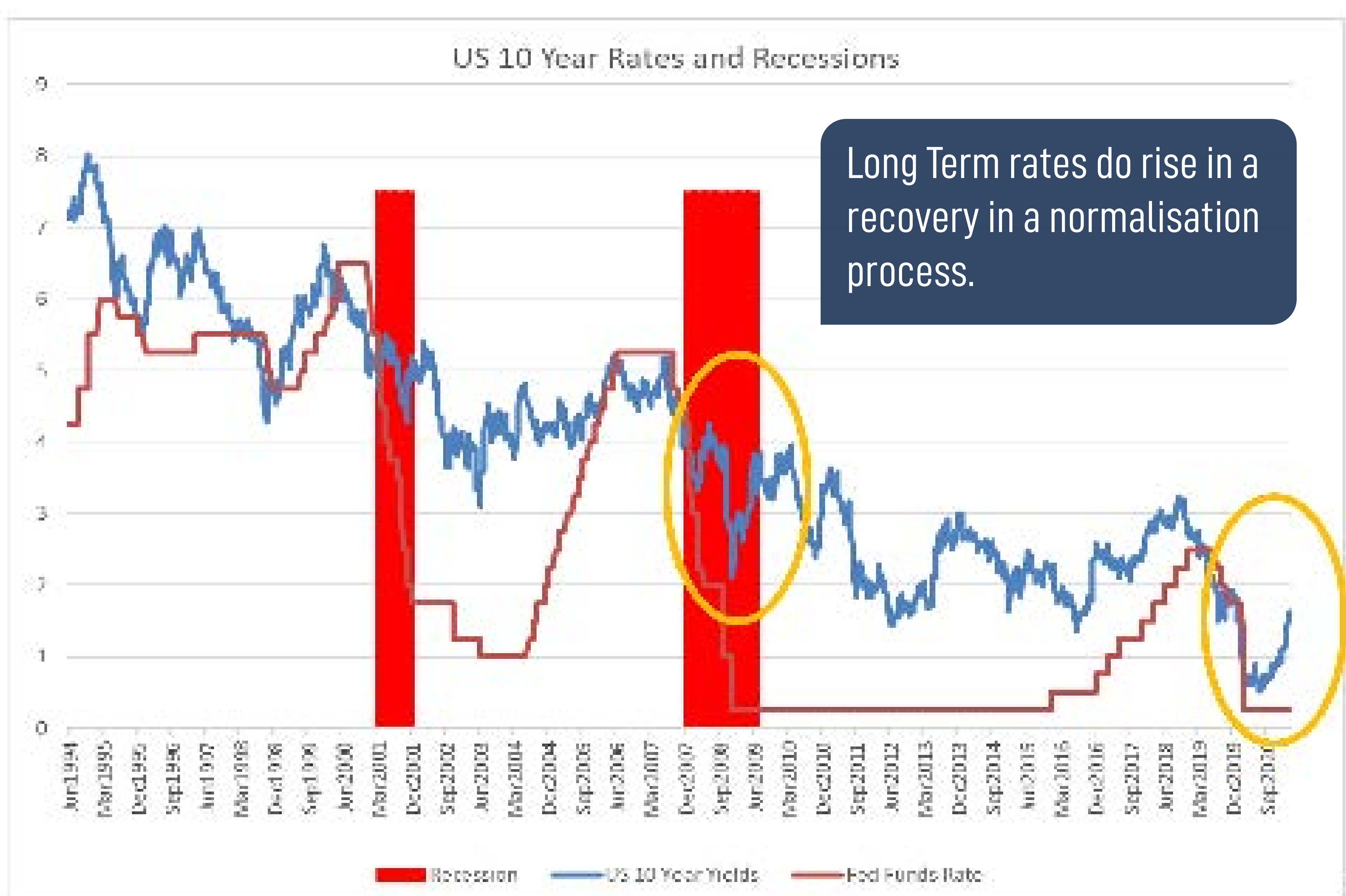



**Exhibit 6:** US 10 Year rates ( Blue Line) and US Fed Funds (Red line)
| Source: Bloomberg, Maybank Asset Management | Period: Jun 1994- Mar 2021

Now what about interest rates? Similarly, the benchmark US rates do rise in an economic recovery but this is because rates are normalising from the low rate prevalent during economic downturns.

Taking the example from the GFC, UST 10-Year rates rose sharply from about 2.0% during the depths of the recession to about 4.0% (See Exhibit 6, blue line) during the initial recovery phase in 2010 but rates were in a downtrend from there onwards. Short rates as indicated by the US Fed funds rate (See Exhibit 6, red line) remained anchored at close to zero from the GFC until the later part of 2015.

After the initial economic rebound, inflation and rates will normalise at relatively low levels.

**Based on this perspective, while inflation and rates could rise further from here we do not expect a sustained spike in inflation.** It is likely that after the initial economic rebound, inflation and rates will normalise at relatively low level. Rates could rise by another 40-50bps to 1.8-2.0% to normalised pre-COVID-19 levels.

This could trigger further corrections but should not derail the overall market recovery. Higher interest rates after the GFC did not disrupt the recovery. On the contrary as the economy recovery gained traction, corporate earnings increased and propelled equity markets in an uptrend till COVID-19 struck in 2020.

**Given our expectations of benign inflation in the medium term we expect monetary policy to remain accommodative.** The US Federal Reserve continues to reiterate its stance of no rate hikes until 2023 even in the face of a temporary rise in inflation above the 2% threshold (given the low base for year-on-year comparison). It took 7 years for the Federal Reserve to raise short term rates in the last expansion and we believe the Fed will be reluctant to hike rates too soon.

Therefore we are not overly concerned about the recent correction as some profit-taking was inevitable given the stellar run in markets last year.

The backdrop for Asian equities in 2021 remains promising on expectations of a global growth recovery, less-hostile US-China relations and still-accommodative monetary and fiscal policy. While valuations are elevated, this is compensated by still-ample liquidity. Asia remains relatively more attractive compared to the US and following the recent correction, we see value emerging in selected names especially in the tech sector. We were positive on the cyclical old economy and value stocks at the start of the year. However, we now have to be more selective as some of these stocks have already rallied strongly and are anticipating a full recovery.

**We remain structurally positive on the tech sector in the mid-to-long term** but now prefer Taiwan (over Korea), where we continue to see strong corporate earnings. We remain neutral on China but underweight Hong Kong in the face of its stagnation over time as its importance to China diminishes. We are neutral on India with its elevated valuations supported by strong domestic liquidity.

The backdrop for Asian equities in 2021 remains promising with a global growth recovery, less-hostile US-China relations and still-accommodative monetary and fiscal policy.

**Within ASEAN, we would overweight Indonesia and the Philippines as laggards in pandemic recovery.** In addition, the passing of the Omnibus Law in Indonesia is positive for structural reforms that would benefit the economy and encourage foreign direct investment. In the face of delayed travel resumption, we are neutral on Singapore but underweight Thailand given the underlying political tension. We are neutral on Malaysia – although a beneficiary of higher oil prices, we are watchful of political developments.

We continue to expect a challenging investing environment in 2021 with occasional volatile periods. Risks include a delayed return to normalcy (on vaccine distribution challenges), high valuations and overreliance on fiscal and monetary stimulus.

- Indonesia: Overweight
- Philippines: Overweight
- Malaysia: Neutral
- Singapore: Neutral
- Thailand: Underweight

We continue to expect a challenging investing environment in 2021 with occasional volatile periods.

# 2Q21 ASIA EX-JAPAN FIXED INCOME OUTLOOK & STRATEGY

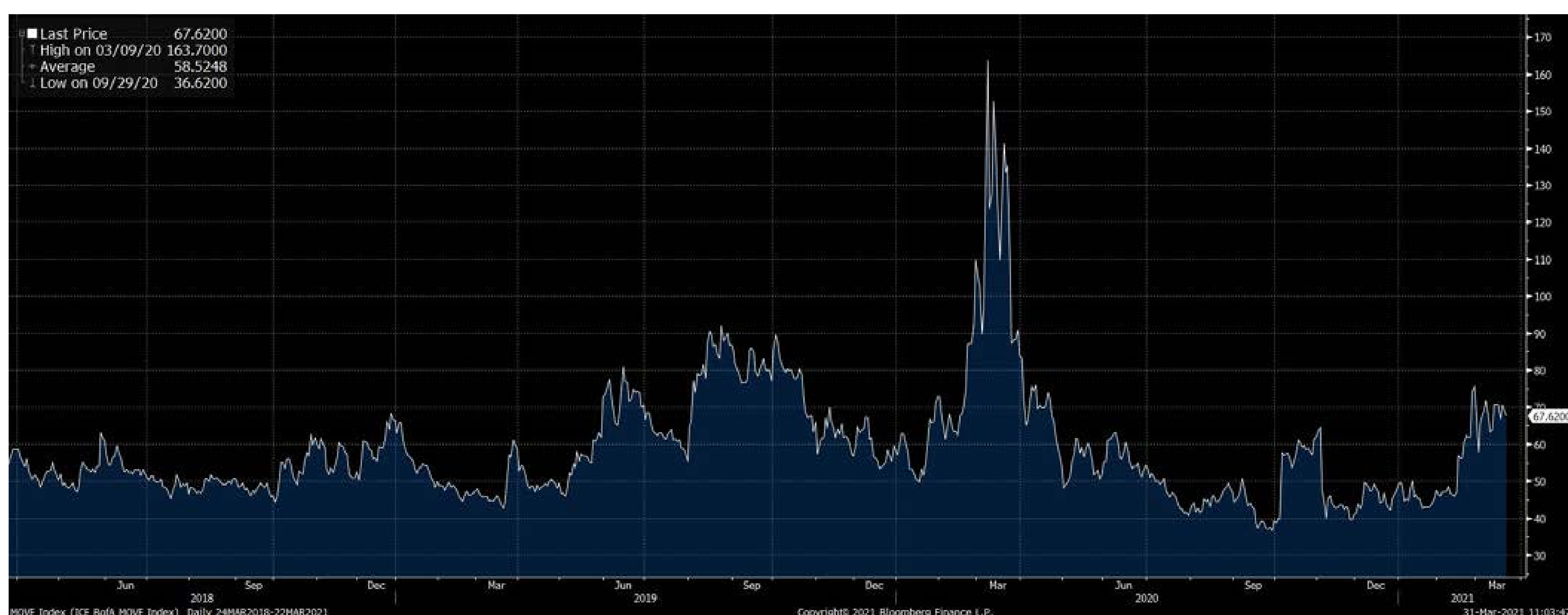



**Exhibit 7:** MOVE Index
| Source: Bloomberg, Maybank Asset Management | Period: Mar 2018 - Mar 2021

After a disappointing 1Q2021, can we still expect positive returns for Asia Fixed Income for FY2021?

**To generate positive returns, we first need the US treasury yields to stabilise.** With the UST 10-Yr yield hovering at 1.6% - 1.7% levels, we are back at the pre-COVID-19 mark, even when both the Fed and ECB have not reduced tapering or even hinted at raising interest rates yet. **We think that the UST 10-Yr yield could peak at 2%, after which most of the selling should be done.** Following this, the sentiment should stabilise and bonds can start generating positive performance again.

Nevertheless, we continue to remain cautious. While we feel that President Biden's signature USD 1.9trn stimulus bill (The American Rescue Plan Act) has been fully priced in, President Biden is now talking about a new infrastructure bill targeting USD 3trn.

The UST 10-Yr yield could peak at 2%, after which most of the selling should be done.

We have not seen any market reaction to this new stimulus package yet. Hence, we would prefer to remain underweight on duration for now. We would want to see the Treasury volatility decrease (Move Index) and inflation expectations stabilise (5 year breakeven rates) before we consider moving to neutral or overweight for duration.

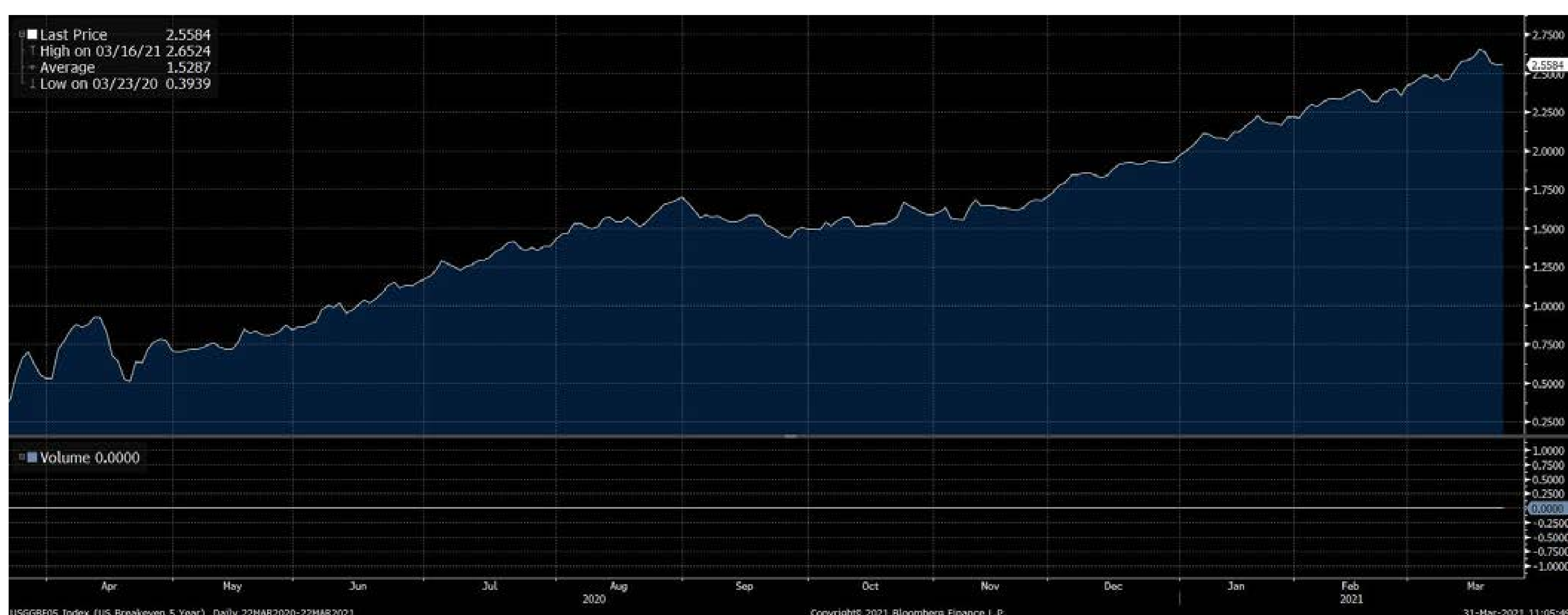



**Exhibit 8:** What markets are pricing in for the 5 year breakeven.
| Source: Bloomberg, Maybank Asset Management | Period: Mar 2020 - Mar 2021

Asia Credit HY Bond Index Yield: 7.15%

US Credit HY Corp Bond Index Yield: 4.41%

EU Credit HY Corp Bond Index Yield: 3.38%

**Exhibit 9:** Global Credit Bond Yield - High Yield
| Source: Bloomberg, Maybank Asset Management | Period: Jul 2020 - 8 Mar 2021

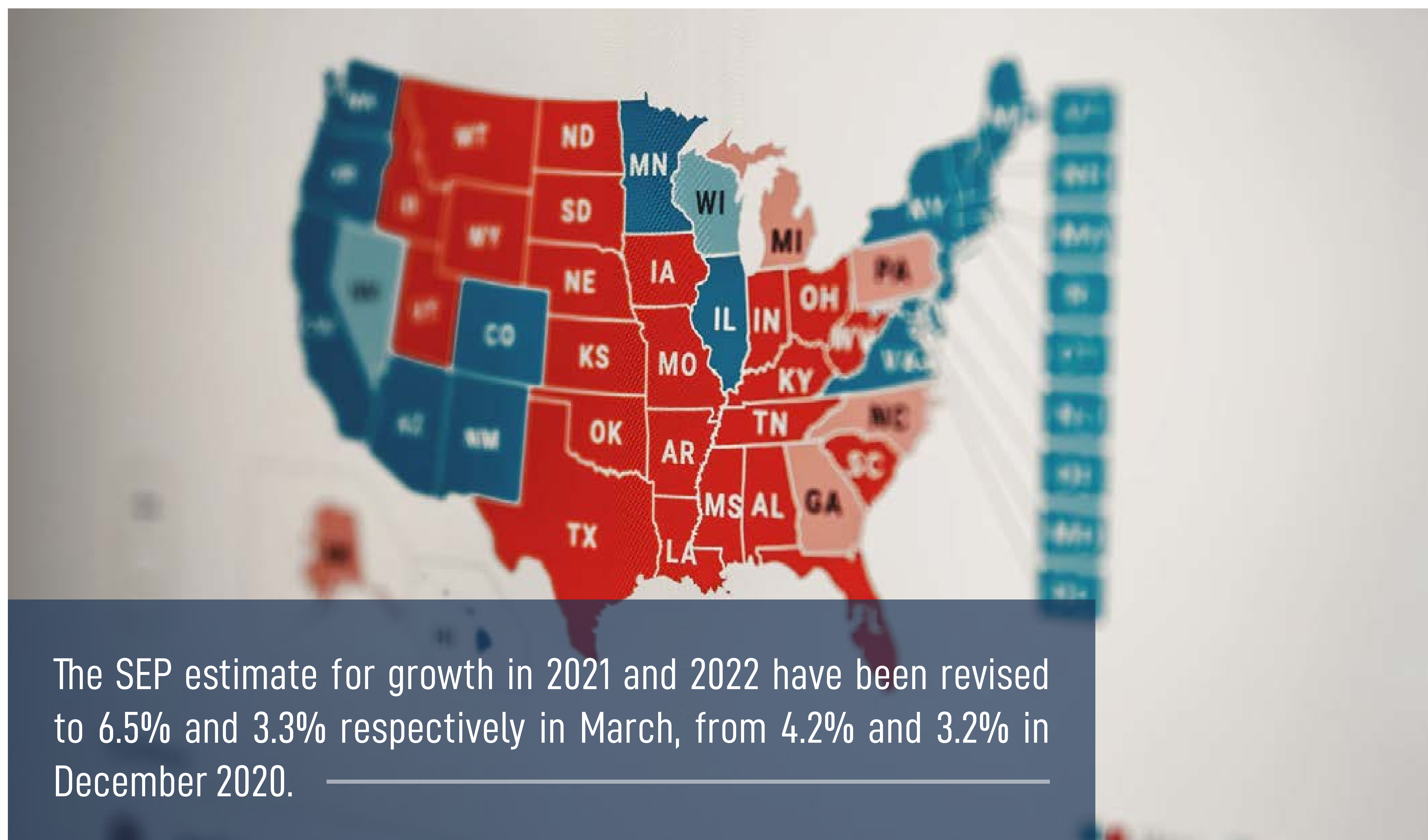
**Once US interest rates stabilise, we feel that Asian credit spreads should start to tighten and Asian high yield bonds should outperform.** Comparatively, Asian corporate high yield bonds continue to offer much better value versus US and Europe.

Expected default rates in Asia are lower than US and Europe, yet we are paid more to invest in Asian corporate USD bonds. Both US and Europe credit bonds have rallied more versus Asia in FY2020 due to the US and Europe asset purchase program that is still ongoing.

**As economies reopen and growth improves, US and Europe credit bonds may face selling pressure** due to the tapering of asset purchases. Hence overall we feel that Asian credit bonds should be able to deliver positive returns for the rest of FY2021.

Overall we feel that Asian credit bonds should be able to dveliver positive returns for the rest of FY2021.

# 2Q21 LOCAL CURRENCY BONDS & FX OUTLOOK




The SEP estimate for growth in 2021 and 2022 have been revised to 6.5% and 3.3% respectively in March, from 4.2% and 3.2% in December 2020.

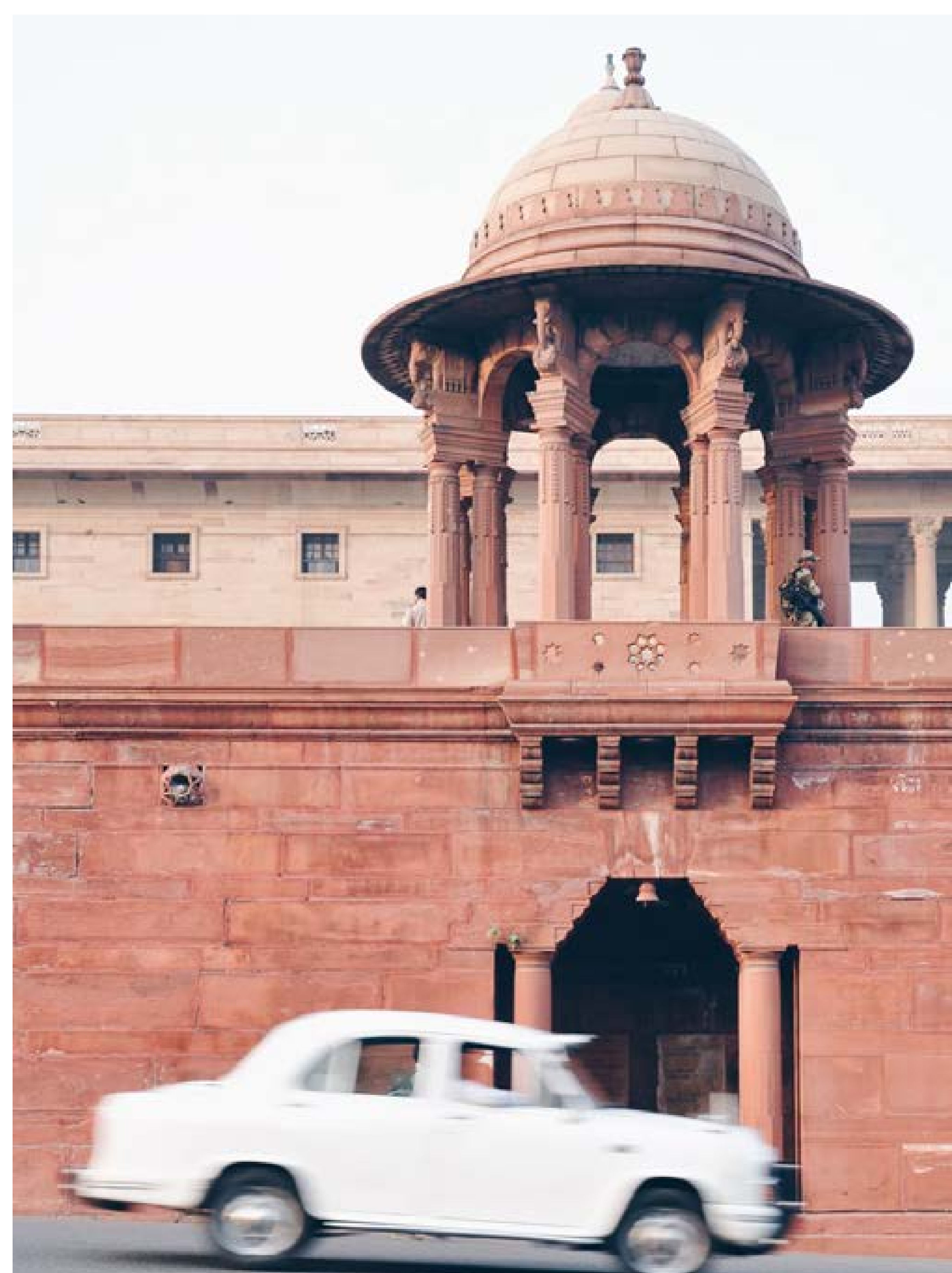
**The USD's strength in the first quarter caught the market by surprise,** as the market rapidly priced in higher inflation expectation amidst strong growth prospects. This was mainly due to Democrats winning slim control of Congress in early January's Georgia senate runoff election and the new USD 1.9trn fiscal stimulus introduced by the Biden administration amidst vaccine roll out.

**For the USD to potentially stop rising, we believe we would at least need to see inflation data in the US stabilising beyond impacts brought by COVID-19**, with the 5 year/5 year forward inflation stabilising around 2.20-2.30%. Moreover, upside risks to inflation remains given the scale of this new fiscal stimulus.

Despite clear USD strength to stay in the near term, the impact to USD/Asia Pacific currencies is not felt evenly and there remains pockets of resilience. Also, relative to other emerging market (EM) regions, USD/Asia Pacific currencies remain more resilient relative to Latin America as well as Central and Eastern Europe, Middle East and Africa (CEEMEA.)

**Other important factors supporting EM Asia FX and local currency bonds are the positive real yields and cheap real effective exchange rates.** This episode of rates sell-off led the USD to strengthen, resembling 2Q2013's taper tantrum, although valuations are cheaper now.

**In Asia, our top picks remains INR, AUD, NZD and SGD.** India stands out among EM Asia given the expected high pace of growth rebound yet the pace of current account deterioration remains measured this year. Besides, India's inclusion into major EM debt indices would also be beneficial for INR on passive flows in the medium term.



For the THB and PHP, we expect them to stay weak going into 1H2021. This is primarily due to the slow reopening of the tourism sector in Thailand and the relative lack of strong fiscal stimuli as well as slowness in vaccine roll out in the Philippines.

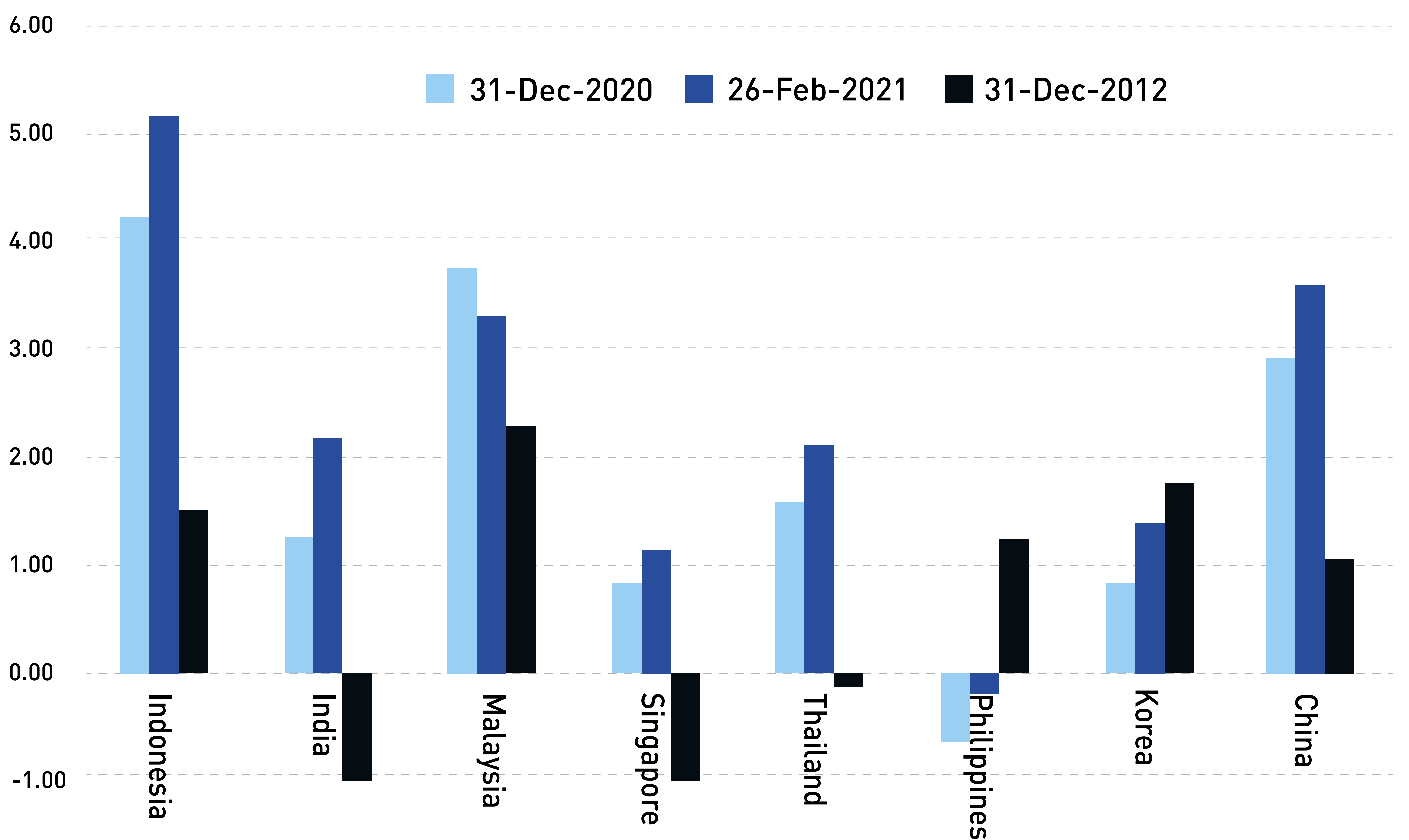


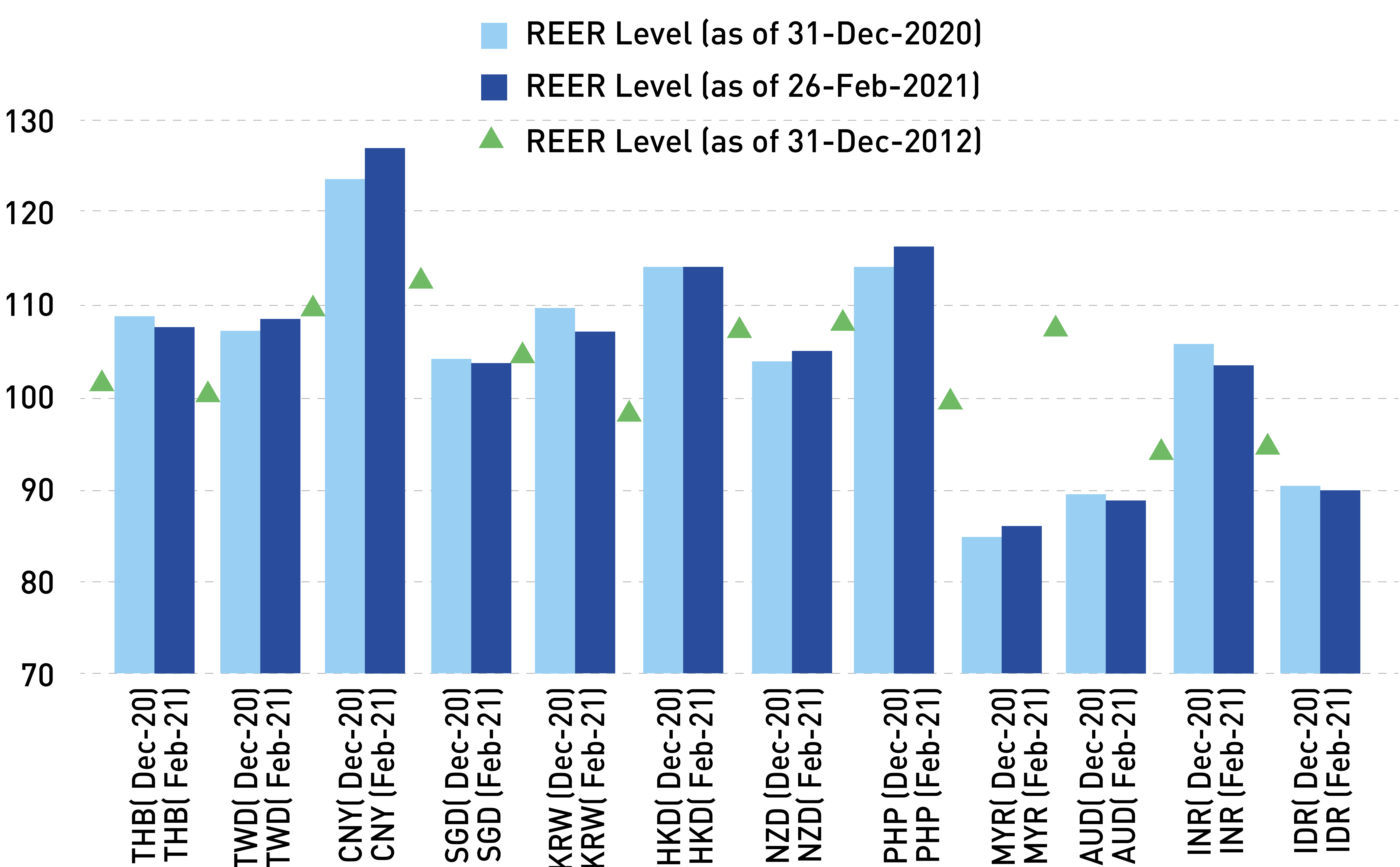

**Exhibit 10:** 10 Year Local Government Bond Real Yield (Current and 2013 Taper Tantrum)
| Source: Maybank Asset Management Singapore, Bloomberg & JP Morgan.

Our forecasts for THB and PHP in 1H2021 are to range at 31.40-31.50 and 49-49.20 respectively. Meanwhile for the IDR and MYR, we expect them to stay range bound within 14,000-14,500 and 4-4.15 respectively.

**For Asian Local rates, we still prefer to position ourselves in the short end of the curve,** given our view that the long-end UST yields have yet to find a footing and also a higher supply is anticipated in these domestic economies.

Year to date, most of Asia's local government yield curve has sold-off about 50-80 bps along the belly to the intermediate end of the curve.

**Exhibit 11:** Asian LCY Real Yields and Real Effective Exchange Rate Change
| Source: Maybank Asset Management Singapore, Bloomberg & JP Morgan.



| COUNTRY | INTEREST RATES | CURRENCY |
|---|---|---|
| **China** | Still like the Chinese long end bonds as real rates remain positive. Importantly, the onshore market remains buffeted from the global yields rising pressure. Also being part of the bond Index, we expect more inflows in the local markets given China's inclusion into FTSE Russell bond indices. | We expect CNH to weaken in 2nd quarter due to higher rates and outflows from equity markets and conservative Chinese growth. |
| **India** | Persistent negative real yields and still high supply are negative factors though RBI's implementation of "Operation Twist" to keep long end yields anchored. Prefer short end for carry. | Overweight given strong inflows to persist; forcing RBI to ultimately allow INR appreciation, medium term inclusion of IGBs into Emerging Market bond indices also a positive. |
| **Indonesia** | Prefer short term INDOGB for carry given range bound IDR; BI is likely to participate in primary bond auction in 2021, supporting long end yields. | Neutral on IDR given strong USD pressure to persist near term. |
| **Korea** | Prefer to stay in the short end given low real yields relative to Singapore and China; Prospect of further yield curve steepening in 2H 2021 with higher fiscal spending and more bond issuances. | Neutral on KRW given strong USD pressure to persist near term. |
| **Singapore** | Neutral on Singapore rates in near term due to sell-off. Long term we are bearish as we expect more supply driven by infrastructure/green bonds. | Neutral on SGD for second quarter but bullish on SGD for the year as MAS may tighten policy in the second half as reflation theme manifests. |
| **Malaysia** | Neutral on MGS given real positive yields. Prefers short end for carry. | Neutral to slight overweight on MYR from long term perspective given improved trade and higher oil prices; Risk of snap elections is high, likely in 2H 2021 which may be negative in the short term. |
| **Thailand** | Neutral on Thailand local bond market given low yields and limited supply; BOT might pursue yield curve control in 2021. | Neutral to negative on THB for second quarter. BOT is concerned about THB strength amidst weaker recovery in 2021; Political risks remain uncertain. |
| **Philippines** | Negative on Philippine local bond market given higher fiscal deficit. | Negative on PHP due to higher fiscal deficit. |
| **Taiwan** | Neutral on Taiwan local bond market given low yields. | Neutral on TWD given valuations and easing of tech exports. |

**Exhibit 12:** Asia Interest Rates and Currency Outlook

# 2Q2021
# GLOBAL SUKUK OUTLOOK

We continue to prefer BBB rated credits in the GCC space following wider reflation theme.

**Global Sukuk as an asset class has outperformed conventional bonds year to date.** Bloomberg Barclays GCC Sukuk index returned -0.24%, while in contrast, the JACI index's return was -1.22%.

In terms of total sukuks outstanding, the global sukuk market has reached USD 550bn in 2019, of which USD 144bn is represented by international sukuks with Malaysia, Saudi Arabia and Indonesia constituting 47%, 22% and 13% respectively.

**We estimate that total sukuks outstanding would have increased around 13 - 15% to reach USD 630bn by 2020.** Despite the increase in size, the majority of them are in local currencies and hence the international sukuk supply will remain limited. For instance, the Gulf Cooperation Council (GCC) credit market has grown tremendously in the last 5 years to USD 486bn, but only about USD 122bn are hard currency sukuks.

As credit spreads have already normalised, returns this year will come more from carry and new issuances. We continue to prefer BBB rated credits in the GCC space following wider reflation theme. **We also remain constructive on GCC Real Estate** generally given liquidity conservation, fundamentally strong business models and conservative leverage – Aldar, Emaar, MAFUAE in the investment grade (IG) space; DARALA, DAMAC, MEERAS in the high yield (HY) space.

For GCC IG Banks, we continue to prefer the subordinate debts across AT1 and Tier 2 versus seniors given the added carry. GCC banks continue to exhibit strong buffers (high government ownership and high NIMs to absorb increase in provisions). We foresee M&A in the sector to continue given secular themes of costs and persisting efficiency management.

**We are bullish on sukuk for 2021, given limited supply and short duration.** Entering into 2Q2021, we turn slightly neutral on sukuks and would prefer to hold more cash to take advantage of market weaknesses and extending duration when we are convinced long-end UST yields have found a stable footing.

We are bullish on sukuk for 2021, given limited supply and short duration.

Lastly for crude oil, we expect prices to trade in the USD 60-70 per barrel range throughout 1H2021 as inventories are reduced whilst being supported by output restrictions from OPEC+.

| COUNTRY | RECOMMENDATIONS |
|---|---|
| **Malaysia** | • Current Account improved in 2020 to 3.8% GDP despite hit to trade as demand declined; 2021 recovery.<br>• MYR outperformed in Q420 on USD weakness and cheap valuations which will persist into 2021. Target USDMYR to trade 4.10 to 4.20 on broad USD strength.<br>• Prefer short end MGII for carry while real yields remain positive.<br>• Market weight on USD denominated Malaysia sovereign, SOE Sukuks – Malaysia may face downgrade pressure in 2021 following Fitch's downgrade to BBB+ but impact will be minimal.<br>• Continue to like local currency Sukuk with periodic MYR weakness; opportunity to add.<br>• Expect FTSE Russell to keep Malaysia in its World Government Bond Index come March 2021's review . |
| **Indonesia** | • USDIDR expected to trade 14,000 - 14,500 in 1H2021.<br>• Prefer short-dated IDR INDOIS despite recent curve steepening as supply remains heavy and long end rates globally have yet to find stale footing.<br>• Prefer long end of INDOIS USD Sukuk after the sell-off. |
| **Saudi Arabia** | • Market weight on USD KSA Sovereign Sukuks as supply remains limited.<br>• Supply of sovereign conventional bonds and Sukuks can be absorbed given JPM Index Inclusion.<br>• 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** | • Residential real estate market might have bottomed but any recovery is likely to be slow.<br>• In the UAE HY space, continue to overweight bank AT1s for carry given strong support to redeem on their call dates; Neutral to slightly overweight on GCC HY real estate names (Damac, Meraas) as default risks remain controlled due to strong liquidity.<br>• Overweight financials given strong government ownership/support and sovereigns as UAE best positioned to weather this current oil price downturn. |
| **Qatar** | • Market weight on Sukuks issued by Qatari financials, Prefer banks AT1 for carry.<br>• Overall Sukuk supply from Qatar should remain limited in 2021.<br>• Overweight OMAN USD Sukuks due to lower deficit in 2021 and focus on reforms by the new government. |
| **Oman** | • Overweight OMAN USD Sukuks due to lower deficit in 2021 and focus on reforms by the new government. |
| **Bahrain** | • 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<br>• Government's fiscal position set to improve given existing reforms in place and USD 10 bn support package form UAE and Saudi<br>• Remain overweight on BHRAIN and MUMTAK USD sukuks for carry. Opportunistic add in weakness. |

**Exhibit 13:** Asia Interest Rates and Currency Outlook

# INDONESIA

# 1Q2021 INDONESIA MARKET REVIEW

**The Jakarta Composite Index (JCI) started 2021 on a strong note** following the Democrat's sweep in the US elections and the start of the vaccination programme. Such events helped the index climbed to a high of 6,430 (+7.5% MTD) on 20th January. Nonetheless, the long holiday at end-2020 caused Indonesia's Covid-19 cases to spike with hospitalisation rates overwhelming the healthcare system. On top of that, a spike in VIX level and China's tightening, led to foreign selling out of risky assets. These led to the first sell-off driven by retail investors causing major correction in JCI in the last week of January.

**In February, several positive developments provided support for the financial market.** Vaccination deployment progress and the implementing regulations of the Omnibus Law boosted confidence on Indonesia's structural reforms, which brings hope that the investment activities would recover. These masked Indonesia's soft 4Q20 GDP numbers, recorded at +2.19% YoY with less encouraging quarterly improvements, bringing the FY20 GDP number to -2.07% YoY.

On the other hand, inflation remained muted and Indonesia's current account continued to record a surplus for two consecutive quarters supported by improving trade balance. This led Bank Indonesia (BI) to cut the 7-Day Reverse Repo Rate (7DRRR) by 25bps to 3.50% in 1Q21.

**On the fiscal relief side, the Pemulihan Ekonomi Nasional (PEN) program budget increased by c.49%** standing at IDR619tr (c.3.5% of GDP), similar to FY20's realised PEN budget. The Ministry of Finance (MoF) maintains the 2021 budget deficit target at 5.7% of GDP with budget cuts, expected in other areas such as infrastructure and other spending.

**However, going into the end of 1Q21, the positive sentiment for Indonesia's market was rattled** by the persistent rise in UST yields which were mostly driven by the increase in US real rates, as proxied by US TIPS, instead of inflation expectations which was the case during October 2020 until January 2021.

Bank Indonesia (BI) to cut the 7-Day Reverse Repo Rate (7DRRR) by 25bps to 3.50% in 1Q21.

The rise in inflation expectations typically benefit value and cyclical assets within a reflation theme in contrast with the rise in US real yields, which is a negative factor as it represents higher risk premium for policy uncertainty. This condition coupled with robust USD and US equities have led the Indo 10-Yr Bond Yields to march higher to 6.78% (+89bps QoQ) and IDR to depreciate to USDIDR 14,525 levels (-3.4% QoQ), lowering valuation for equities.

**The rise in UST yields caused a narrowing in Indonesia's bond yield differential to US bond yields** which now stands at below 5-year average, an unattractive proposition for foreign investors to add duration risk in Indonesia. For equity, in unconfirmed domestic news, the BPJS-TK fund may reduce its equity and mutual holdings which has shaken domestic investors' confidence, overshadowing positive developments on Indonesia's pandemic situation as Covid-19 cases subside and vaccination rates accelerate, albeit still lagging behind developed countries. All in all, the market corrected in March with the JCI closing the quarter flattish to 2020 levels.

# 2Q2021 INDONESIA EQUITIES OUTLOOK & STRATEGY

**Going into 2Q21, we are tactical in the near-term as earnings revisions are bottoming-out and are expected to have positive surprises.**

Vaccination rates have started to accelerate but the rollout programme has seen logistical hurdles including issues in securing supplies in a timely manner, placing pressure on the government to meet the inoculation target set for 1Q22. With the current vaccination rate, reaching herd immunity within the targeted timeframe seems farfetched.

**This would signal that ongoing mobility restrictions will remain,** which will hinder the full potential of the economic recovery in the near-term and will likely be back-loaded into year end. At the same time, the US economy is set to outperform the global economy in the near-term providing support for flows into USD on higher UST yields.

We expect Bank Indonesia's support to be more for liquidity and macroprudential measures.

Indonesia's longer term outlook will depend on its Omnibus Law success in attracting FDI to counter the eventual tapering from the Fed.

**However, we are more confident in Indonesia's equity outlook.** We maintain our positive stance on the medium term, given the global recovery narrative to continue, JCI's inexpensive valuation in relation to the region, and supportive domestic policies. However we expect that upside potential for equity has lowered. As deflationary effects should start to dissipate and imports are set to pick up post vaccination rollout, we expect Bank Indonesia's (BI) support will be more for liquidity and macroprudential measures as Indonesia's yield differential to the US is already on average level.

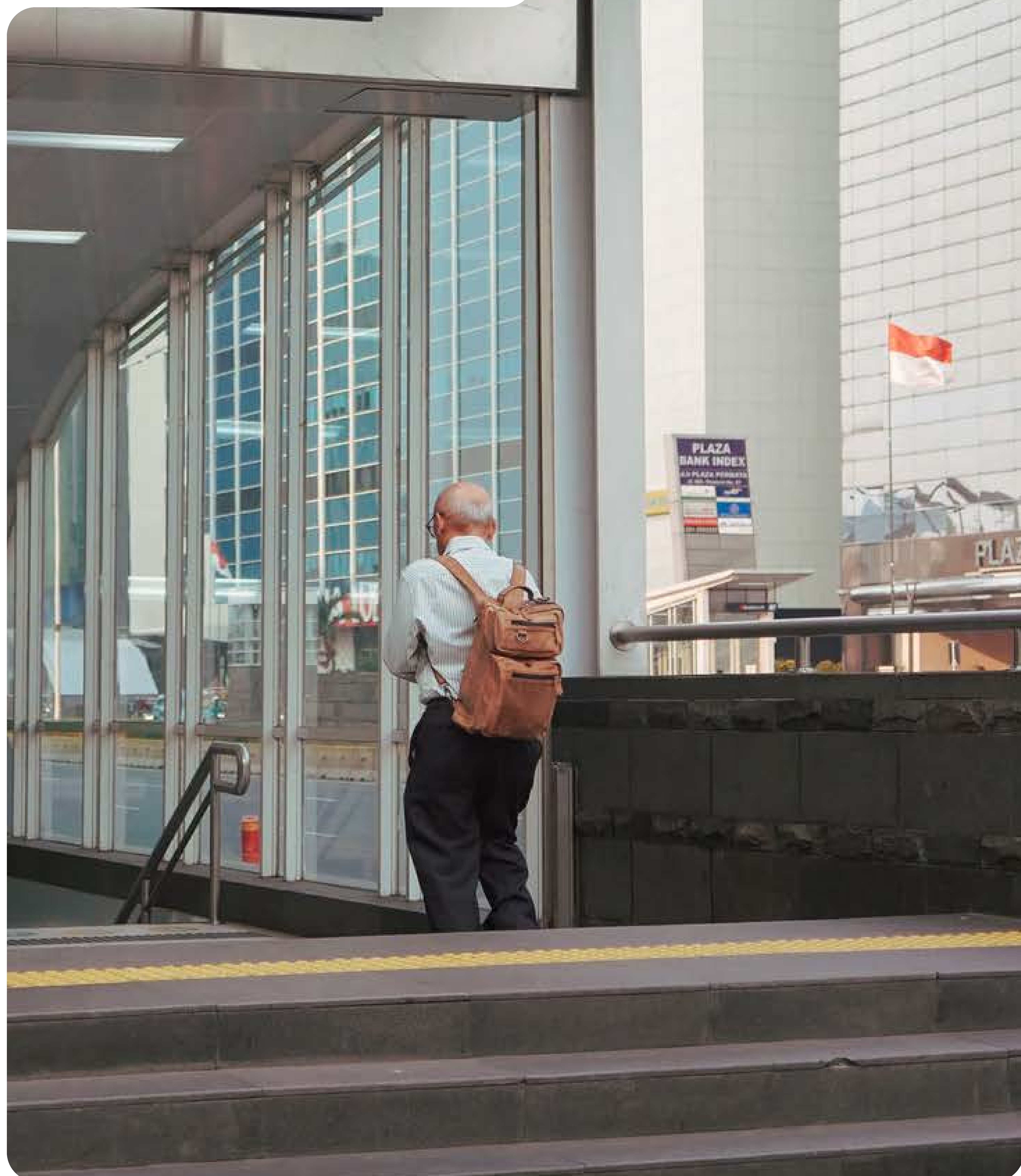
In this case, liquidity factor in the monetary side that has been supporting equity valuation re-rating has become neutral from positive, as yields rises while domestic inflation remains muted. This leaves economic and corporate fundamentals as the next driver.

**Accordingly, the introduction of several domestic policies from BI such as reduced down payment for automotive loans, relaxation of LTV/FTV ratio and mortgage disbursement for property market** will likely push the demand side as credit growth has been lacklustre, while banking liquidity remains very high. Coupled with acceleration in vaccination rate, business confidence should gradually pick up as already suggested by recent positive data in cement and automotive sales as well as PMI.

This in turn, will lead to upward revision in earnings as a catalyst in the mid-term. Hence, we believe that domestic policies are already in the right place, while execution in a timely manner is key to ensure a catch up of Indonesia's economy recovery to the global trend.

Our positive stance on the mid-term, however, does not come without risk as it relies on the thesis that global growth to catch up with the US and without US overheating. The latter is still less likely to happen. Indonesia's longer term outlook will depend on its Omnibus Law success in attracting FDI to counter the eventual tapering from the Fed.

In this case, we increase our interest on discretionary stocks and remain to prefer domestic cyclicals such as banks, industrial and property sectors. Commodities name has become attractive for trading purposes, albeit inflection point is nearby.



# 2Q2021 INDONESIA FIXED INCOME OUTLOOK & STRATEGY

**The narrative for 1Q21 was mainly on the stimulus and disruptions from the rising US Treasury yields.**

Domestically, the government has increased the 2021's PEN stimulus to IDR 699tn vs. IDR 580tn in 2020. The healthcare stimulus budget rose to IDR 176tn from IDR 63.5tn, mainly to support the free vaccination programme. The social protection budget also remains high at IDR 157.4tn to support the lower income purchasing power. Overall, the government has observed the effectiveness of each PEN stimulus program last year and will use obtained data to determine the budget reallocation this year. From the external factors, the increasing inflation and tapering expectation in the US have pressured the bond market since mid-Feb 2021.

the MoF will not change its financing strategy too much this year, especially with its stance that the fiscal deficit will remain at 5.7%.

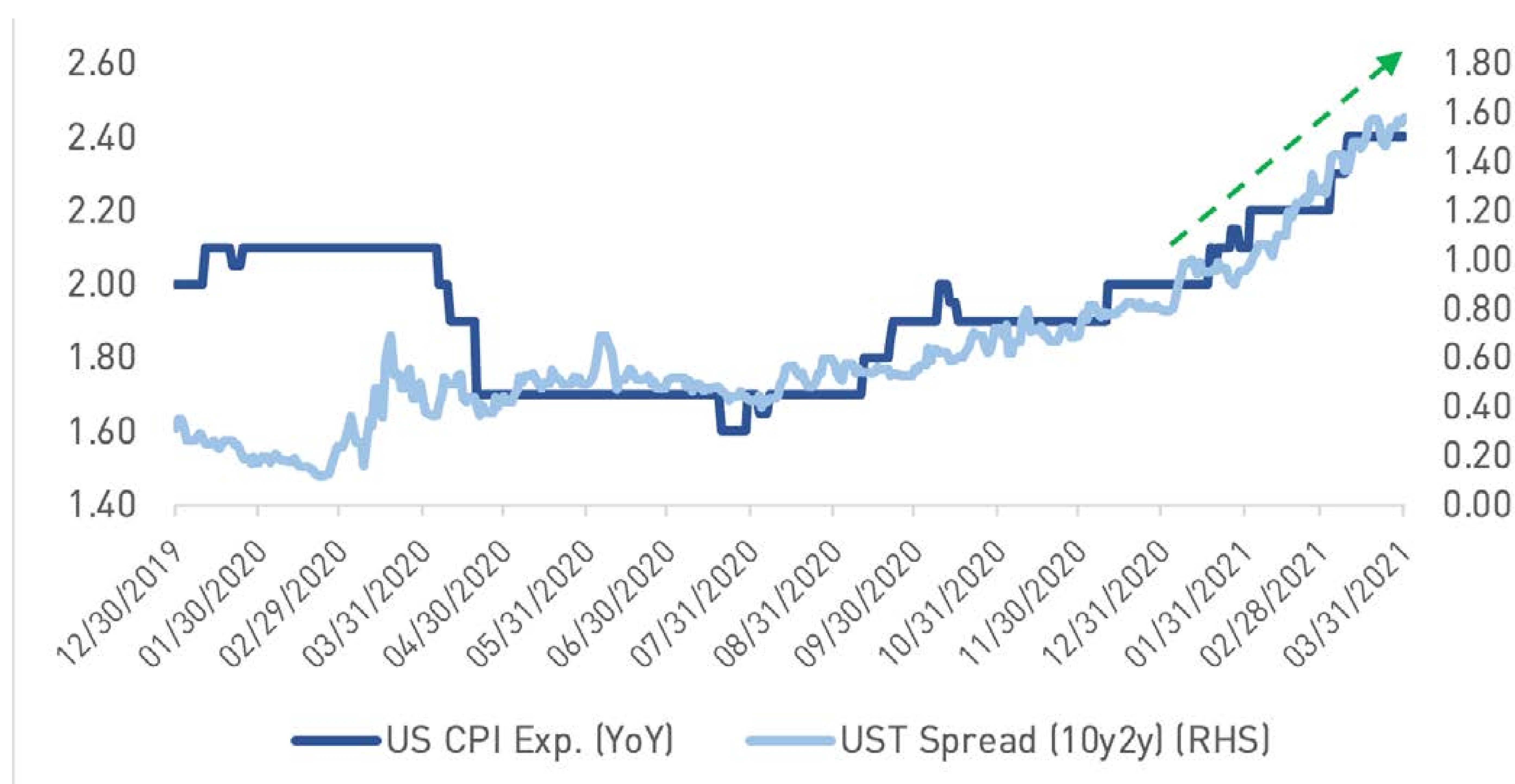



**Exhibit 14:** US Inflation exp. (yoy) vs UST Spread.
| Source: Maybank Asset Management Indonesia, Bloomberg.

**Nevertheless, the current yield of the Rupiah Government bond remains below the 2021 fiscal budget's assumption of 7.29%**; thus, the MoF will not change its financing strategy too much this year, especially with its stance that the fiscal deficit will remain at 5.7%. In fact, the MoF has started to front-load the bond issuance early this year.

**The government will also prioritise market mechanism on the bond issuance** and carefully coordinate and manage the amount of BI's contribution in the fiscal financing through the primary market. However, if it is necessary for BI to participate more in the bond auction going forward, we believe BI would have the capacity, as the amount of BI's buying (primary and secondary market) is relatively low. As of 16th March 2021, the total of BI's buying was amounted to IDR 73tn, as compared to IDR 467tn in 2020.

**On the progress of the Omnibus Law on the financial sector, the banking sector assets only account for around 55% of GDP**, lower than its EM peers. The markets would like to

see more consolidation in the sector, wherein the Financial Service Authority (OJK) has introduced several consolidation measures. The banking sector also needs to move toward digitalisation.

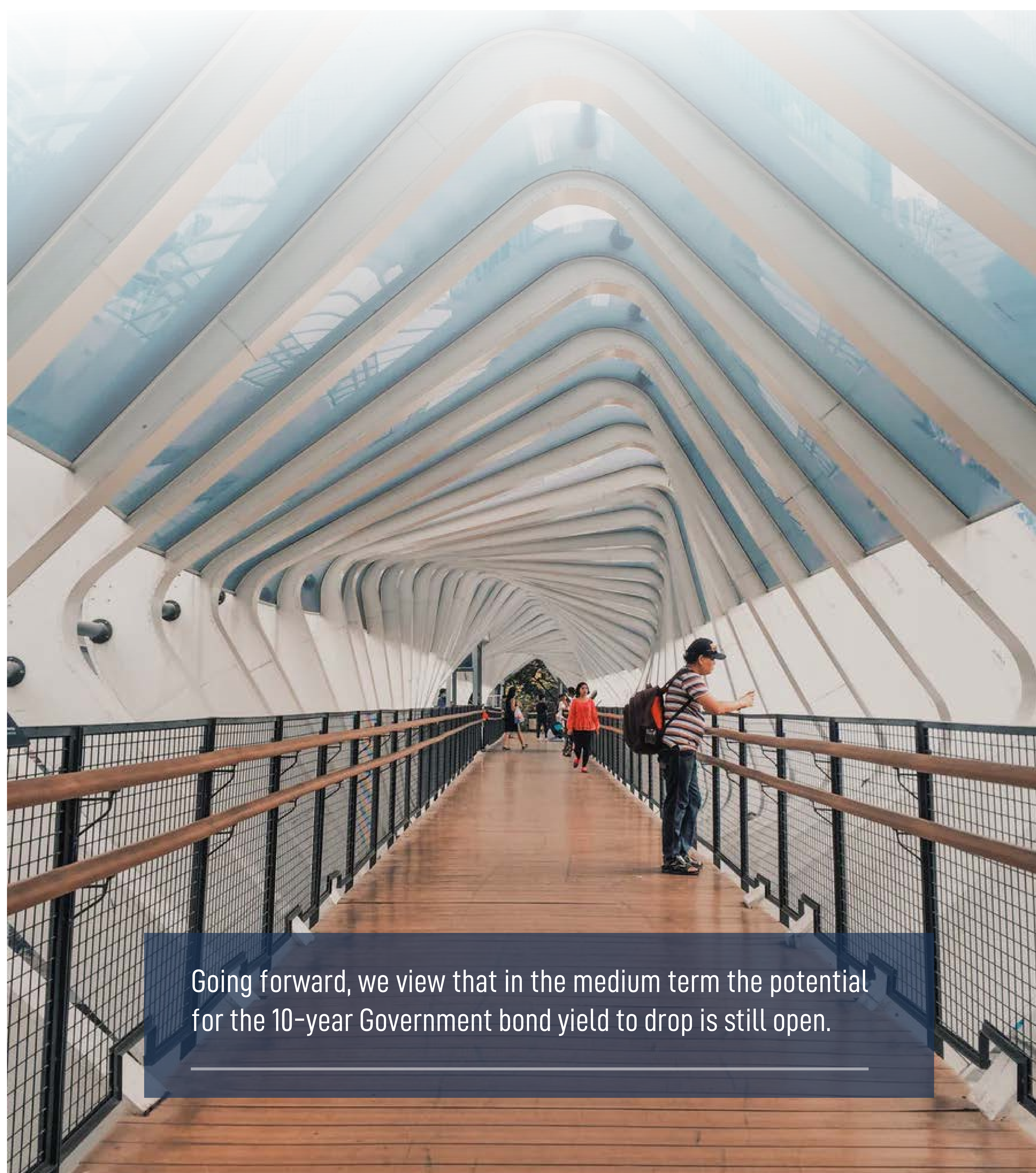
Furthermore, other financial sector indicators are lagging, such as stock market capitalisation (50% of GDP), insurance capitalisation (2%), and pension fund assets (6%). Thus, a more solid set of regulations are needed to improve the middle class' confidence in saving or even investing in diversified financial products. The government is working with the Parliament to push the Omnibus Law on the financial sector to this year.

Going forward, we view that in the medium term the potential for the 10-year Government bond yield to drop is still open, supported by improving macroeconomic data, as well as an attractive level of real yield for Indonesia, as compared to other Asian countries.

Therefore, although we are currently neutral in our strategy. We are still positive in the long term and cautiously monitoring the market to make adjustments accordingly.

| No | Country | Sovereign Rating | | | 10y Bond Yield | YtD Change | CPI (YoY) | Real Yield |
|---|---|---|---|---|---|---|---|---|
| | | Moodys | Fitch | S&P | 30-Mar-21 | | | |
| 1 | **South Africa** | Ba2 | BB- | BB- | 9.54 ↑ | 0.67 | 2.90 | 6.64 |
| 2 | **Indonesia** | Baa2 | BBB | BBB | 6.79 ↑ | 0.83 | 1.37 | 5.42 |
| 3 | **Brazil** | Ba2 | BB- | BB- | 9.26 ↑ | 2.33 | 5.20 | 4.06 |
| 4 | **Thailand** | Baal | BBB+ | BBB+ | 1.95 ↑ | 0.62 | -0.08 | 2.03 |
| 5 | **Vietnam** | Ba3 | BB | BB | 2.45 ↑ | 0.13 | 1.16 | 1.29 |
| 6 | **India** | Baa3 | BBB- | BBB- | 6.15 ↑ | 0.26 | 5.03 | 1.12 |
| 7 | **South Korea** | Aa 2 | AA- | AA | 2.08 ↑ | 0.38 | 1.50 | 0.58 |
| 8 | **Filipina** | Baa2 | BBB | BBB+ | 4.20 ↑ | 1.38 | 4.50 | -0.30 |

**Exhibit 15:** Real yield compared to peers.
| Source: Maybank Asset Management Indonesia, Bloomberg.



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