March Outlook – Short-lived Risk-On Environment?

SUMMARY

- **Markets buoyed by trade deal anticipation.** Stock markets mostly rose in Feb-19, on trade war optimism as Trump extends China tariff deadline after 'substantial' progress, with a tentative meeting between the leaders scheduled in late March. Meanwhile, economic growth globally continues to moderate particularly in manufacturing and exports, thus, solidifying the ECB's and Fed's dovish policy shift. Separately, the US-North Korea nuclear summit failed to reach any agreement.
- **Malaysia reported deflation in Jan-19 for the first time since 2009 global crisis due to low fuel prices.** CPI contracted 0.7% YoY in Jan-19, the first drop in over nine years after hovering below 1% YoY in the previous seven months. According to the latest Business Tendency Survey, the overall business performance dropped to the lowest since 1Q17 with main dragging sectors are construction, mining, manufacturing and services sectors. Also, Malaysia's PMI manufacturing dipped to 47.6 in Feb-19, pointing to a sharp deterioration in the sector's business conditions.
- **Both the Malaysian equity and bond markets rallied in Feb-19 after the Fed turned more dovish coupled with optimism on the US-China trade talks.** With positive spillover effect from the global markets, our KLCI has experienced post CNY rally before profit taking activities kicked in toward month end. However, Malaysia KLCI performance still lags behind the whole world. On the other hand, the local bond market continued its rally as the yield curve shifted lower MoM on foreign inflows. This had partly contributed to the strengthening ringgit against the USD.
- **Macro – Too far too fast**. Just as 2018 turned out to be nightmares to global investors, financial markets have turned and shown a spectacular performance during Jan-Feb '19. A déjà vu to early 2017 where equities, bonds, commodities and most financial assets rose in tandem. How could that be possible? We think that the risk-on environment globally is a temporary phenomenon in light of the ongoing downside to the economic activity surprise index. Export orders have weakened further, pointing to world trade growth of just +1% YoY and similar to the trend seen back in 2015-16. We are of the view that any near-term positive development from China-US trade talks, if any, is still unable to reverse the downtrend to be seen in 1H19.
- **Equity – First consolidate, then hopefully followed by a rally towards end Mar-19.** Firstly, we still continue to see our market flushed with liquidity despite after a strong pre- and post-CNY rally. Therefore, we expect a potential round 2 of high beta sectors play which include construction, O&G and property sectors to certain extent. Nevertheless, we continue to emphasize to adopt a trading stance in light of liquidity driven rally and let's not be the last to leave the bandwagon.
- **Fixed Income – MGS yield curve appears too flat.** Given the more cautious policy statement from MPC coupled with the unexpectedly more dovish stance during the ECB policy meeting in early Mar-19, we foresee yields at the shorter-end of MGS curve to fall circa 3-8bps from the end-Feb records while the 10y MGS level to hover around 3.80-3.90% level. As such, we are expecting a mild bullish steepening MGS curve as the current spread for the 3Y/10Y MGS has narrowed from their historical 5y average of 58bps to 37bps.

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