September Outlook – EM Assets To Perform Given Real Yields & US Uncertainties

SUMMARY

- **The recovery of the global manufacturing sector gathered pace in Aug-20.** The JPM Global Manufacturing PMI stood at a 21-month high of 51.8 in Aug-20, up from 50.6 in Jul-20 and above the neutral 50.0 mark for the second successive month. China, the U.S., Germany, the UK, India and Brazil were some of the larger industrial nations to register expansions of output. The JPM Global Composite PMI was also lifted to 52.4 in Aug-20 (Jul-20: 51.0).
- **BNM maintained the OPR at 1.75% in Sep 2020 MPC meeting.** The committee noted there was improvement in economic activity on the global and domestic front, while also cautioned that growth outlook remain subject to significant downside risks. BNM noted that the current monetary policy stance is appropriate and accommodative given the subdued outlook for growth and inflation. Hence, we do not foresee further OPR cut in 2H20 unless conditions worsen significantly. Globally, the sell-offs of safer assets were underpinned by "risk-on" momentum arising from Fed's new policy framework that was revealed during the Jackson Hole symposium that would allow inflation to run above 2% for some period of time.
- **Bond market review - The local yield curve bull steepened** as the shorter-end was fuelled by expectations of September OPR cut after the release of worse-than-expected 2Q GDP contraction while the 10Y was tracking global yield uptick - especially towards month-end. Meanwhile, foreigners continued to increase holdings of MGS with RM3.2bn inflows in August (July: +RM7.7bn), bringing foreign holdings to MGS outstanding at 39.2%. This was however, moderated by outflows from GII, PDS and short-term instruments.
- **Macro – EM currencies to rebound and benefitting EM assets.** Despite the USD weakness, most EM's real FX rates remain depreciated since the start of Covid-19 pandemic due to risk adversity. Weaker EM real FX rates will probably not last unless there is stronger evidence that EMs have suffered a relative productivity loss against AEs. Thus, more upside than downside risks for EM assets. Furthermore, the median EM policy rate is now at 3%, the lowest on record. However, EM central banks are reluctant to cut rates further, if unnecessary, because they fear a dent to hard-won credibility and exchange rate weakness more than they do recession.
- **Equities – Gloves & PPE still dominate retail trades.** We notice retail trades had dropped by more than 50% from its peak last month after huge profit taking activities on the non-big 4 gloves as well as other PPE players. And, there were also days where O&G, plantation and wood based companies' share prices tried to pick up but there was no strong follow through like gloves and PPE companies few days after, indicating some retailers may be stuck at higher prices while some had their trades turn into losses following the fierce non-big 4 gloves and PPE companies' share price pullback in mid Aug. Nevertheless, we expect institutional funds to be more active going forward due to window dressing by GLCs fund closing, portfolio re-positioning pre & post Budget 2021 and also look forward for local and global economic recoveries.
- **Fixed Income –** Escalating US-China trade tensions, Covid-19 resurgence & vaccine news, geopolitics as well as US political headlines leading to the November elections are expected to add to market volatility. Local yields are expected to see upticks in the absence of further OPR cuts, expected economic recovery towards year-end, higher incoming supply of govvies (net issuance of estimated RM18bn from Sep-Dec 2020) and slowing net inflows into EPF coffers. As such, we are revising our 10Y MGS yield target higher for year-end from 2.60% to 2.90% while retaining the 3Y yield target at 2.10%.

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