May Outlook – Macro vs Market Reality

SUMMARY

- **The outbreak of Covid-19 caused substantial disruption across the global economy.** The JPM Global Manufacturing PMI rose to 47.6 in Mar-20, slightly up from 47.1 in Feb-20. This was almost entirely due to stabilisation of the China PMI (50.1 from 40.3 in Feb-20). Excluding China, PMI reading was 46.6, its lowest level since May-09. Meanwhile, the JPM Composite index fell to a 133-month low of 39.4 in March with global services contracting at record rates.
- **BNM cut the OPR rate by 50bps to 2% as largely expected and keeps open the option for further cuts in 2H20.** The MPC noted that global economic have "weakened significantly", and will "exert a large drag" on the domestic economy, with labour market conditions expected to "weaken considerably". Meanwhile, we opine BNM might use alternate policy levers to substitute for OPR cuts where high household debt would likely a pose a hurdle.
- **Bond market review -** Local yields fell in April with the 3y and 10y MGS seeing monthly changes of 44bps and 51 bps to 2.40% and 2.86% respectively (Mar-20: 2.84% and 3.37%, respectively) on expectations of a drastic OPR cut.
- **Macro – W-shape recovery ahead.** After a bit of a China-led bounce in Mar-20, regional manufacturing stumbled again in Apr-20 as there was a drag in inventory built-up coupled with weak new orders. This situation is due to different economic lockdown timing implemented globally. Hence, the manufacturing pull-back in China last month, and the beginning of a W-pattern in manufacturing that has merged in Asia. Another risk faced by Asian economies is undeniably deflationary risk for the rest of 2020. This has laid down firm ground for policy rates to remain low if not lower in the next 12-18 months, thus, temporarily inducing some risk-on investment activities.
- **Equities – "Sell in May and go away" has been the tagline for our equity market year after year.** We think history will repeat itself again this year. Although our local market is flushed with liquidity, we should expect 2QCY20 results announcement of most corporate to be bad given the Covid-19 outbreak and lockdown in Mar and this should create negative trading sentiment in the market. Also, the recent rise in equity market was mainly driven by retailers as this is usually unsustainable since most of them do not have holding power. Furthermore, with the OPR cut this month, this will be negative to banks' earnings and a further sell down in banks will be negatively impactful to our market since banks make up 30% of index weightage. Do continue to stay defensive.
- **Fixed Income – As expected, BNM cut OPR by 50bps to 2% on 5 May, the lowest since Global Financial Crisis.** At the same time, BNM has also allowed MGS and GIIs to be included in banks' SRR requirement up to May 2021, which will inject some RM16bn liquidity in the system and provide support to local yields. As such, we expect yields to remain low this year, with the 10y MGS yield to remain around 3% as growth outlook remains bleak, deflationary pressures and the absence of Covid-19 vaccine for the year.

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