POST-GE14 *Market Outlook*

13 MAY 2018

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Equity & Fixed Income Strategy

Following the victory for the opposition Pakatan Harapan ("PH") in Malaysia that ends the Barisan National leadership, we expect market volatility on the domestic equity and bond markets as well as the Malaysia Ringgit currency when the markets open on Monday, 14 May 2018. However, we expect the market to rebound. Similar government changes in other countries only saw brief market corrections. For example, the Thai military coup in 2014 was followed by a market rebound within a week. (Stock Exchange of Thailand, 9 June 2014). Similarly, the Brexit sell-off lasted only several days. “Britain’s top share index closed on Thursday at its highest level for 2016, having completely rebounded from a substantial sell-off in the wake of the country’s vote to leave the EU.” (Reuters, 30 June 2016)

Furthermore, in our opinion, PH is not a totally inexperienced government. In addition to Mahathir who was a Prime Minister for 22 years, PH is comprised of a varied talent pool of politicians who have the experience to steer the economy. In addition, Malaysia has strong liquidity support in the form of large local government funds on the back of robust macroeconomic fundamentals.

The key point here is – both foreign and local investors favour political change if tangible policies such as transparency and corporate governance remain at the forefront of the new government agenda. In Malaysia, much of the market expects PH to deliver concrete and credible policies to move the country forward. PH’s track record in Penang and Selangor should further reassure the market of their ability to govern. This could be a positive medium term surprise if this were to happen as foreign investors welcome “structural changes” to the economy.

Although there are perceived policy uncertainties from the new government, we expect investors to wait for more details before assessing the impact to the market. The first 100 days are likely geared towards fulfilling party pledges such as the abolishment of the 6% GST and reintroduction of petrol subsidies which could lead to lower government revenues as GST accounts for RM44 Billion or 18% of revenue collection. These moves could narrow the government’s revenue base if implemented without other changes or plans.

In our opinion, the change in government should not interrupt the strength in exports as global growth continues to be strong in 2018. At its Monetary Policy Committee (MPC) meeting on 10/5/2018, the MPC of Central Bank Malaysia decided to maintain the Overnight Policy Rate (OPR) at 3.25 percent. MPC issued a monetary policy statement, “Despite financial market volatility due to external developments, domestic financial markets have remained resilient. Malaysia’s economic fundamentals are strongly anchored. The domestic economic outlook remains positive, the financial sector is strong and monetary and financial conditions are supportive of economic growth in the post-election environment.”

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Malaysia Equity Outlook & Strategy

Prior to the election results, we have been de-risking the domestic portfolios by reducing exposure in the construction sector, small caps and focused on large cap companies that were likely beneficiaries of a cyclical recovery.

However, in our opinion, there are some sectors that could be impacted by fiscal consolidation and improvements in transparency in certain sectors. We believe Construction / Infrastructure-related names could be impacted e.g. Chinese investments in mega projects related to the Belt and Road Initiative. Certain companies in the plantation, automotive and services sectors may be reviewed by the new government.

In conclusion, we believe that any market selloff could offer brief buying opportunities in quality names. Our domestic portfolios continue to invest in big cap companies with strong fundamentals, and to focus on medium to long term investment themes such as Financials, Consumer, Technology and Industrial sectors. We maintain our view, that despite the short volatility, investors should relook at the longer term where risk premiums may potentially reduce as a result of better governance.

Malaysia Fixed Income Outlook & Strategy

Similar to the equities market, we are expecting market volatility (albeit limited) in the MGS/MGII market as well as MYR currency foreign exchange in the short term as foreign investors digest the new political developments. Initially, the increase in volatility may lead to a weakening of both the MGS bonds and MYR currency before staging a rebound. We expect local players who have been exhibiting strong demand for fixed income, to step in and support the market, while the foreign investors stay sidelined until they become more comfortable with the new government and its new policies. In the medium term, we expect foreign inflows may return to the Malaysian market due to its strong economic fundamentals such as:

- Expected stable monetary policy conditions for the rest of 2018 on the back of strong economic growth and stable inflation;
- Relatively stable (and growing) foreign reserve position;
- Greater contribution from oil revenues given higher average oil prices in 2018 partly driven by US-Iran geopolitical tension and global growth; and
- Current foreign exchange rules have helped reduce the MYR volatility since the start of 2017 and this may provide comfort to foreign investors to reposition at higher levels.

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Foreign fund flows typically result in both the MGS and MYR foreign exchange to trade in positive correlation as investors tend to park proceeds in the MGS market given their MYR positioning.

As mentioned above, international rating agencies may place Malaysia on a watch but sensible fiscal policy changes should prevail at the end of the day (e.g. change in tax revenue regime to be cushioned by new sales and service tax receipts as well as realignment of the developmental spending budget). Fitch Ratings (11 May 2018) has reaffirmed its ‘A-’ rating on Malaysia’s long term foreign currency and local currency international default rating (IDR) with a ‘stable’ outlook post GE14, citing the country’s promising economic environment and growth prospects.

We will be closely monitoring for future credit rating direction changes for issuers based on obtaining a clearer view on the specifics of the implementation of Pakatan Harapan’s broader fiscal, regulatory and structural initiatives going forward. The Malaysia PDS/Sukuk space will likely see lower price volatility initially in comparison to the MGS/MGII markets as local investors adopt a wait and see approach where less trading in those names keeps prices relatively stable. However, over the longer term, individual issuers may either benefit or see head winds from the new government policies. A key consideration for our PDS trade strategy will be driven by federal policy developments, which may or may not have an impact on the underlying credit profile of an issuer and in-turn be a key determinant to our credit buy/sell calls going forward.

Despite the above, it is important to note that the Malaysian bond market (like any other in the world) plays a crucial and integral role in capital fund raising for both the private and public sectors. We expect the government’s policies to take this into account and do not foresee drastic changes that would jeopardize this vibrant capital funding source.

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