Maybank Investment Strategy

August 2022

Summary

- Despite declining economic momentum, global equities rebounded in July with rising expectations of a less hawkish U.S. Federal Reserve (Fed) that will reduce the likelihood of a significant downturn. The MSCI All-Country (AC) World Index rose 7% with U.S. equities leading the gains. However, China stocks underperformed amid lingering uncertainties on the country's COVID situation and property sector.

- Meanwhile, the 10-year U.S. Treasury (UST) yield dipped 35 basis points (bps) to close at 2.65% in July as investors began to worry more about growth instead of inflation. Investment Grade (IG) credits also ended in positive territory while Emerging Market and Asia High Yield (HY) bonds lagged.

- As for commodities, West Texas Intermediate (WTI) crude prices dipped below USD 100/barrel as recession fears weighed on oil demand outlook. The persistent dollar strength also dampened gold prices.

Macro Outlook and Investment Strategy

- The recent reprieve in risk assets may be short-lived as it is likely premature to expect an early reversal of the Fed's policy tightening. While inflation may peak in 3Q, it will take time to normalise. In addition, we continue to see elevated corporate earnings risks with growth momentum likely to decelerate further.

- Given the above, we retain our defensive stance in asset allocation. We maintain underweight on equities with Europe being our least preferred market. Sectors wise, we would seek shelter in healthcare and consumer staples stocks which tend to have more resilient demand and lower earnings uncertainties during a recession.

- As for fixed income, we have turned overweight on sovereign bonds and expect the 10-year UST yield to trend towards 2.5% by year-end. In contrast, we are more cautious towards corporate bonds, particularly those in the HY segment as credit spreads could widen further in a downturn.

- Gold prices will likely remain range-bound until there are clearer signs of a softer dollar. Still, we would maintain some exposure in the precious metal as a hedge against recession, as well as geopolitical uncertainties. Apart from the ongoing Russia-Ukraine war, U.S.-China tensions could also re-escalate ahead of the U.S. mid-term elections in November.

August Outlook			
Asset Class *		Sector *	
Equity	-	U.S.	=
		Europe	-
		Japan	=
		Asia ex-Japan	=
Bonds	=	Sovereigns	+
		Developed Markets (DM) Investment Grade (IG)	=
		Developed Markets (DM) High Yield (HY)	-
		Emerging Markets (EM) IG	=
		Emerging Markets (EM) HY	-
		Asia IG	=
		Asia HY	-
Alternatives	=	Gold	=
		Oil	=
		Hedge Funds	=
Cash	+		

Source: Maybank Wealth Management Research
* Overweight : +, Neutral : =, Underweight : -

Asset Class	Changes to date (in USD currency)		
	Month	Quarter	Year
Equity			
MSCI USA	9.3%	9.3%	-13.7%
MSCI Europe	5.0%	5.0%	-16.4%
MSCI Japan	5.7%	5.7%	-15.5%
MSCI Asia ex-Japan	-1.1%	-1.1%	-17.1%
China	-9.4%	-9.4%	-19.6%
Hong Kong	-3.6%	-3.6%	-6.4%
Taiwan	3.3%	3.3%	-22.4%
Korea	5.8%	5.8%	-24.1%
India	9.4%	9.4%	-7.1%
Singapore	6.0%	6.0%	-13.3%
Malaysia	2.4%	2.4%	-8.9%
Indonesia	3.2%	3.2%	3.4%
Thailand	-1.9%	-1.9%	-8.5%
Philippines	2.2%	2.2%	-15.7%
MSCI EM	-0.2%	-0.2%	-17.6%
Bonds			
Barclays U.S. IG	3.2%	3.2%	-11.6%
iBoxx U.S. HY	5.9%	5.9%	-9.1%
Commodity			
Gold	-2.3%	-2.3%	-3.5%
Oil	-6.8%	-6.8%	31.1%

Source : Bloomberg | 31 July 2022

Macro Outline and Investment Strategy cont'd

- With the U.S. entering a technical recession in 2Q, some are hoping for the Fed to pause or even cut rates by early 2023. However, these expectations may be premature with inflation projected to remain high, with consensus estimating U.S. Consumer Price Index (CPI) to average 5.7% year-on–year (YoY) in 1Q23 (Figure 1). However, the risk reward for sovereign bonds is increasingly attractive with the shift from inflation concerns to growth fears becoming more pronounced even though near-term price volatility could persist.

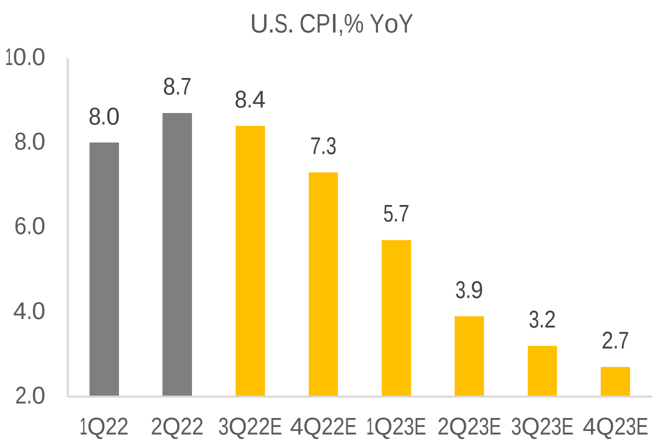
- While we have become constructive on sovereign bonds (mainly UST), we remain cautious on corporate bonds particularly those in the HY segment. Notably, we move to an underweight on Asia HY amid the unabating concerns on China property credits, as well as increased risks on India corporates. We also turned neutral on Asia IG bonds given the less attractive risk reward. Still, we see selected opportunities within the broader IG universe for defensive carry, particularly the quasi-government bonds and shorter-dated bonds (2-5 years) with a credit rating of BBB rating or better.

- The U.S. earnings season has been mixed to-date although we have observed increasingly cautious guidance on profits and future expansion plans. With rising cost inflation and softening demand, we see more downward pressure on profit margins (Figure 2). The deteriorating earnings outlook will likely limit the market upside even though the valuation is admittedly less demanding when compared to end-2021.

- The situation in Europe looks more dire with the region remaining highly vulnerable to a disruption in Russia's oil and gas supply. The increased political uncertainties in Italy could also weigh on sentiment. Meanwhile, the European Central Bank has to tighten more aggressively given the surging inflation even though economic activities are already softening. The macro headwinds will weigh on corporate earnings growth and drive the underperformance of European equities.

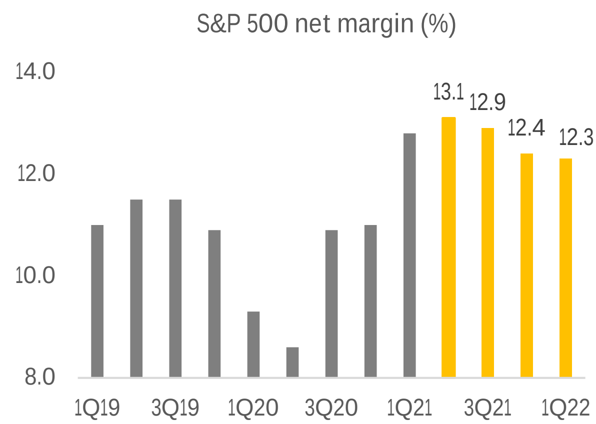
- On China, investors were somewhat disappointed by the lack of a significant stimulus package in the latest politburo meeting amid growing concerns on the economy. Notably, the government said it will focus on achieving the "best possible results" without mentioning its earlier GDP growth target of 5.5% in 2022. While the market is inexpensively valued, the upside may be capped until policymakers implement more concrete measures to stabilise the troubled property sector and shift away from the stringent zero-COVID strategy. For now, we retain our preference for Indonesia amid robust consumption activities. Bank Indonesia will also likely play catch up and hike rates by September, lending some support to the Rupiah.

Figure 1: Consensus is projecting U.S. CPI to remain above 3% for most of 2023



Source: Bloomberg | 31 July 2022

Figure 2: Downward trend of S&P 500 net profit margin is expected to persist



Source: Factset | 31 July 2022

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