Kenanga Investors

Date: July 2020

Where To Put Your Money In A Recovering Economy

Smart Investor (July/August 2020 issue)

By Lee Min Keong

As Malaysia resumes economic activities, fund managers identify key sectors you can invest in and the laggards to avoid.

As Malaysia starts reopening after the lockdown caused by the Covid-19 pandemic and enters the Recovery MCO period, the economy is also on the mend.

Bursa Malaysia, like most stock exchanges around the world, has been on a tear, retracing a significant chunk of the losses from the late February and March market crash.

The FBM KLCI, which fell nearly 400 points to a low of 1,219.72 points — its lowest since the Global Financial Crisis in October 2009 — has since rallied to reach 1,511.24 points on June 22, erasing nearly all its losses this year.

The Bursa Malaysia Small Cap Index meanwhile bounced back 4,450.74 points to 12,140.01, from this year's low of 7,689.27.

Stock broking houses also saw a surge in the number of new trading accounts since March. Rakuten Trade, the fully digital equities broker, saw a 100% month-on-month rise in its April new trading accounts opening, with 11,000 new accounts activated. Over 64% of that were opened during the first phase of the Movement Control Order period. Year to date, net retail investments on Bursa Malaysia have increased to RM5.83 bil, compared with RM2.45 bil for the whole of last year. Local institutions made a net investment of RM8.21 bil. Trading value hit a record high of RM9.3 bil on May 29 following the surge of retail interest in the local equities market, despite prevailing economic uncertainties.

Risk off or risk on?

Many investors in Malaysia and major economies like the US and the EU are expecting a V-shaped recovery for the economy. Bullish retail investors may have priced in the likelihood that the battered Malaysian economy is well on the road to recovery after the various stimulus packages by the government, totalling about RM300 bil. And these retail investors have helped fuelled the rebound by the local bourse.

KENANGA INVESTORS BERHAD
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This was something noticed by Kenanga Investors Bhd CEO and executive director Ismitz Matthew De Alwis. “During the movement control order (MCO), retail investors – bolstered by reduced statutory deductions and loan moratoriums – caused a surge in trading activity in order to make quick profits within the first quarter of 2020.

“This is not typical behaviour and seems to be driven by investors’ extra time and resources which will now be slowly phased back to normal following the recovery MCO (RMCO),” he tells Smart Investor. In contrast, institutional investors and fund management firms are taking a more measured approach as they see significant risks that could potentially derail equity markets in coming months.

De Alwis says that global markets are expected to remain volatile in the near term. “Investors will have a better gauge on the depth of recession and damage to corporate earnings after the release of economic data and corporate results for first quarter. “There are also renewed worries on US-China trade tensions as US President Donald Trump mounted attacks on China’s handling of Covid-19 pandemic.

“With economic data still worsening and downside risk to corporate earnings, we continue to stay defensive but will buy on weakness,” he adds.

IDENTIFYING THE LAGGARDS

In any rising market, there will be listed companies in certain sectors or industries which will lag behind. So, which are some of these laggards?

FSMOne research analyst Shawn Low Tian Hao says within the local equity market, the large-cap segment potentially faces more headwinds in the times ahead. “The large-cap segment consists of 30% banking exposure, which prospects are clouded by deteriorating asset balance sheets as well as compressed net interest margins.

“Similarly, commodity-related industries, which account for about 8% of the large-cap index, are looking at moderation in earnings as commodity prices took a dip amid weaker global aggregate demand. These sectors are expected to weigh on the earnings prospect of the large-cap segment in the near-term,” he points out. Aside from weaker earnings prospects, Low thinks the recent change in the domestic political scene has likely kept foreign investors on the side lines, which limits the headroom for the large-cap segment.

Kenanga Investors Bhd CEO and executive director Ismitz Matthew De Alwis says it’s no surprise the most likely laggards would be “the travel and hospitality sectors as consumers would understandably take time to resume partaking in such services due to the pandemic”. He also says crude palm oil (CPO) demand is also expected to slow due to lower global consumption from the coronavirus breakout. “The recovery of CPO production going forward may also pressure CPO price outlook. Therefore, we will look to trim exposure to the plantation sector,” he adds.

Covid-19 second wave a major risk factor

De Alwis says the pandemic is expected to weigh heavily on 2Q2020 gross domestic product (GDP) growth and continue to spill over into second half of this year. He notes that the Ministry of Finance, via its National Economic Recovery Plan (Penjana) documents, stated that growth could fall as much as 4.7% this year.

“Though the government has decided to lift the conditional movement control order (CMCO) and replace it with the recovery MCO (which continues to Aug 31), we remain cautious of a possible second wave of Covid-19 infections. News reports indicate clusters of coronavirus infections have occurred in countries which have managed to suppress the outbreak and started reopening such as Germany, Italy, South Korea and China. In the US, a number of states report record breaking daily infections following a botched reopening.

“As always, we recommend diversification when it comes to ensuring a well-balanced portfolio to cushion plunges in market movement and to capitalise on sudden highs,” says De Alwis. He says investors would do well to ensure that their portfolio comprises of investment products that possess different risk levels and yields. “This will ultimately lower risk as different asset types will react differently under the same economic conditions,” he explains.

He says Kenanga Investors prefers defensive sectors such as utilities, consumer staples and healthcare while maintaining an overweight in technology as earnings growth remains strong. “In the near term we will adopt a trading strategy to benefit from the market volatility. “We maintain overweight in North Asian markets as China is on track to gradually re-open the economy while the virus is also contained in Taiwan and South Korea,” he adds.

The beneficiaries of a recovery

To Eliza Ong Yin Suen, managing director/CEO, and head of RHB Group Asset Management, the Covid-19 situation is “first and foremost a health crisis and the situation will be prolonged until we find an effective cure or vaccine”. “As such, our view is that countries and regions that are able to control the Covid-19 pandemic will be better positioned to recover economically. We think Asia and in particular China will be in a good position in the post Covid-19 world as they re-start the economy over the coming quarters,” she tells *Smart Investor*.

On the type funds that will benefit from a resumption of economic activities, Ong says: “We believe that fixed income funds would benefit from the easing of the lockdown restrictions with the restarting of economic activities to navigate through the recession and limit the negative implications of a prolonged recession. “We are comfortable with our current positioning in the funds and with lower inflation outlook this year, we think the period of lower rates will last longer and this shall be lending support towards the local fixed income space,” adds Ong.

Focus on technology and China

In the current market conditions, getting your asset allocation right is crucial to protect and grow your portfolio.

FSMOne research analyst Shawn Low Tian Hao advocates investors have a proper mix of equities and fixed income in their portfolios with respect to their risk profiles. “For instance, an investor with a balanced risk appetite should have 50% exposure to equities and fixed income respectively in a neutral allocation. “Recently, we reduced our 5% overweight position in equities vis-à-vis fixed income to 2.5%. At this juncture, we think it is prudent to rebalance some profits from equities into fixed income as the run-up in equities over the recent weeks have buoyed valuations to higher levels.

“Nevertheless, we are maintaining a slight overweight position to ensure portfolios continue to participate in any further upside going forward,” shares Low. He adds that FSMOne is positive on the long-term prospects of the semiconductor sector, where most players reside within the small-to-mid cap segment. “Before the virus outbreak, global technology megatrends such as artificial intelligence and 5G initiatives are already underway across various regions. “The current pandemic has likely accelerated the adaptation of technologies within consumers and companies, where social distancing measures and movement restriction orders fuelled demand for technology products and capacity, which leads to higher demand for electrical and electronic parts.

He also sees the waning strength of the ringgit as beneficial for export companies which account for a significant part within the small-tomid cap segment. “As many of the export companies earn (US) dollar-based revenues, a weaker ringgit could translate to higher profits.” On which regional markets are likely to outperform, Low says the recovery scenarios for the respective regional markets are heavily dependent on the recovery timeline and the coronavirus containment progress.

China can tap into its fiscal pockets for additional stimulus

Nevertheless, Low remains positive on China's growth prospects as policymakers have introduced a series of monetary and fiscal policies to help the economy weather through the downturn sparked by Covid-19.

"The Chinese economy has emerged from the virus in a 'first in, first out' manner, and could continue to take the lead in economic recovery this year. As the economy starts to recover, we expect Chinese equities to outperform its regional peers in the coming year. "Since China started opening up its domestic economy, retail activity is improving and end demand has been recovering, which points to a brighter business prospects and earnings visibility. Currently, China is quickly returning to normalcy, evidenced by the sharp rebound in manufacturing and services PMI (Manufacturing Purchasing Manager's Index) over the past two months, he adds.

BUILDING PORTFOLIO RESILIENCE WITH GOLD

Most fund managers and financial advisers advocate diversification and asset allocation for any investment portfolio. However, that may not fully protect you from market risk in a post Covid-19 world where uncertainty and volatility continue to loom large. In the midst a global recession, making your investment portfolio highly resilient is more important than ever before. In a recent report, BlackRock – the world's biggest asset management firm – advocated having gold as a source of portfolio resilience.

Wei Li, iShares EMEA head of investment strategy at BlackRock, said gold is an attractive asset as uncertainty and volatility remain dominant themes for investors. She said gold will be an attractive diversifier as it has "a low correlation to equities". "In a climate of uncertainty, portfolio resilience is more important than ever: the ultimate shape and timeline of the post-pandemic economic recovery remains uncertain, the trajectory for company earnings is murky, and macro data shows signs of further deterioration.

"This leaves ample room for volatility and sharpens focus on building resilience through a higher allocation to gold. The short-term outlook for gold shines due to its role as a portfolio diversifier." She added that over the longer term, the precious metal may benefit from strategic tailwinds from pressure on bond yields through large central bank quantitative easing programmes and a lower-for-longer rate environment.

"For investors looking to diversify within equities, gold producers may also be well positioned to benefit," she said. Li said the diversification benefits could increase the longer gold is held within portfolios. Over a five-year period, gold's correlation to global equities averages near zero, she added. At the time of the report, gold prices were up more than 15% since the start of the year while global equity markets are down nearly 15%. Gold touched a nearly nine-year high of US$1,810 on July 7. In April, Bank of America raised its 18-month gold-price target to US$3,000 an ounce -- more than 50% above the all-time high of US$1,920 – in a report titled "The Fed can't print gold".

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