SMALL CAPS SET TO REBOUND FROM COVID-19 SETBACK

Small-cap stocks set to outperform despite lagging large caps during the recent market downturn

By Lee Min Keong

Last year was a bountiful year for many small-cap stocks on Bursa Malaysia as they outperformed their large-cap counterparts.

The small and mid-cap space offered investors an impressive 27% gain vs –4.4% for the large-cap FBMKLCI in 2019.

In general, investing in small caps is seen as more high risk than large caps given the volatility of their share price movements. However, with the higher risk comes the potential for greater returns when small caps start breaking out.

As the Covid-19 pandemic roiled equity markets around the world, the large caps on the local bourse turned the tables on the small caps, at least in the short-term.

Maybank Asset Management Malaysia Sdn Bhd (MAM Malaysia) chief executive officer Ahmad Najib Nazlan notes that year-to-date (as at 2 June 2020), the smaller-cap companies have underperformed the large caps due to the many negative events that had happened (e.g. domestic politics, oil price collapse and the pandemic).

"However, with most of these events being discounted in their share prices, we believe the smaller-cap companies can outperform their larger-cap peers moving forward as these events subside," he tells *Smart Investor*.

"Small-cap stocks tend to be more volatile/ riskier than large-cap stocks as they do not have the resources of larger companies, and are therefore more vulnerable to negative events and bearish sentiments.

"However, they have greater growth potential and can offer better returns over the long term," Najib adds.

As the economy recovers, Maybank Asset Management's preferred sectors in the small-cap space are healthcare, technology and industrial sectors. "We believe that these sectors will continue to see growth in the longer term (under the Global Industry Classification Standard)," he says.

strong secular growth prospects.

"While for fixed income, we took the opportunity to redeploy our cash into high quality high grade bonds in Asia as the yields offered during that period were very attractive," he adds.

Ahmad Najib Nazlan

Factors for the outperformance

For MGMAI, Najib says the portfolio dynamically and flexibly asset allocate across multiple asset classes such as shariah compliant equities, sukuk, gold and cash.

"In essence, the dynamic asset allocation strategy enables the portfolio to capture any potential upside in financial markets as well as protect it against any the downside risks.

"For example, when we entered 2020, we had a high allocation to equities given the US-China trade deal and a dovish US Federal Reserve. However, in January we turned defensive and quickly reduced our allocation to equities and raised cash.

"In March, during the sell-off, opportunities emerged and we deployed cash to both equities and sukuks to capture the upside. This has helped the portfolio to deliver strong returns during the period."

Similarly for MMSF, it employed a defensive strategy and was underweight duration relative to Thomson Reuters Bond Pricing Agency Malaysia (TRBPAM) Sukuk Index and maintained adequate cash levels for possible buying opportunities as yields had become attractive after the sell-off in March.

MMSF also benefitted from its overweight position in corporate sukuk over Government Investment Issue (GII) which have contributed to the better performance.

In the case of MMSC, Najib says this award winning small-cap fund held steady to the strategy of employing a high conviction approach with the support of its team of analysts.

"During the MCO period, particularly from March to May, MMSC was able to outperform its benchmark as the fund is is very much focused on healthcare and technology-related companies which saw a strong rebound.

As lockdowns ease, Najib believes sectors exposed to a rebound in consumer spending, and those that are beneficiaries of the increase in fiscal stimulus, would be best placed to benefit from the recovery.

"Investments should gradually return as manufacturers rebuild their inventory and government spending picks up. Technology and healthcare will continue to do well."

DEPLOYING AN EFFECTIVE ASSET ALLOCATION STRATEGY

Given there remains a lot of risks and volatility in the financial markets, MAM Malaysia chief executive officer Ahmad Najib Nazlan says an effective asset allocation strategy is an efficient way to tactically navigate the current challenging market condition.

In the near to medium term, MAM Malaysia is positive on fixed income and prefers it over equities as the unprecedented stimulus by major central banks have provided ample liquidity in the system. Furthermore, with interest rates expected to stay lower for longer, yields from fixed income funds could offer investors an attractive proposition, Najib says.

"Although we are neutral on equities over the near to medium term, equity funds can potentially provide decent returns in the longer-term. Recently, despite corporate earnings being downgraded, the supportive liquidity environment fuelled the recovery in equity markets.

"Therefore, at this current juncture, valuations are elevated and we view that the risk reward as being unattractive," he adds.

In the longer-term, as economies starts to recover gradually, there's value when investing into equities. "Hence, allocating into equity funds with a good portfolio mix of growth and high dividend yielding stocks could be beneficial for investors in the long-term."

Moreover, a multi-asset fund with a dynamic and flexible asset allocation strategy could also benefit in this market environment as the fund manager would be able to seek the right mix of assets to perform through different market environments, says Najib.

"As economic activities restarts, a dynamic asset allocation could capture any potential upside while managing downside risks as the markets remain uncertain due to the Covid-19 risks and ongoing geopolitical concerns," he adds.