Cloudy Vision 20/20

3Q2020 Outlook & Strategy

Maybank Asset Management

Welcome to our 3Q 2020 Outlook & Strategy Report

20/20

3Q2020 Outlook & Strategy

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2Q2020 Asia Ex-Japan Market Review

Liquidity and fiscal support fuelled recovery of equity and fixed income markets.

Following the sharp COVID-19-induced sell-off in March, Asian equity and fixed income markets rebounded in 2Q2020, aided by the collective measures from central banks and governments worldwide to supply liquidity and to provide fiscal support to the economy. The US Federal Reserve alone has injected more than USD3trn through quantitative easing (QE) policies to support purchases of financial assets. The Fed's balance sheet (Chart 1) has grown to USD7trn - equivalent to more than 50% of the US economy.

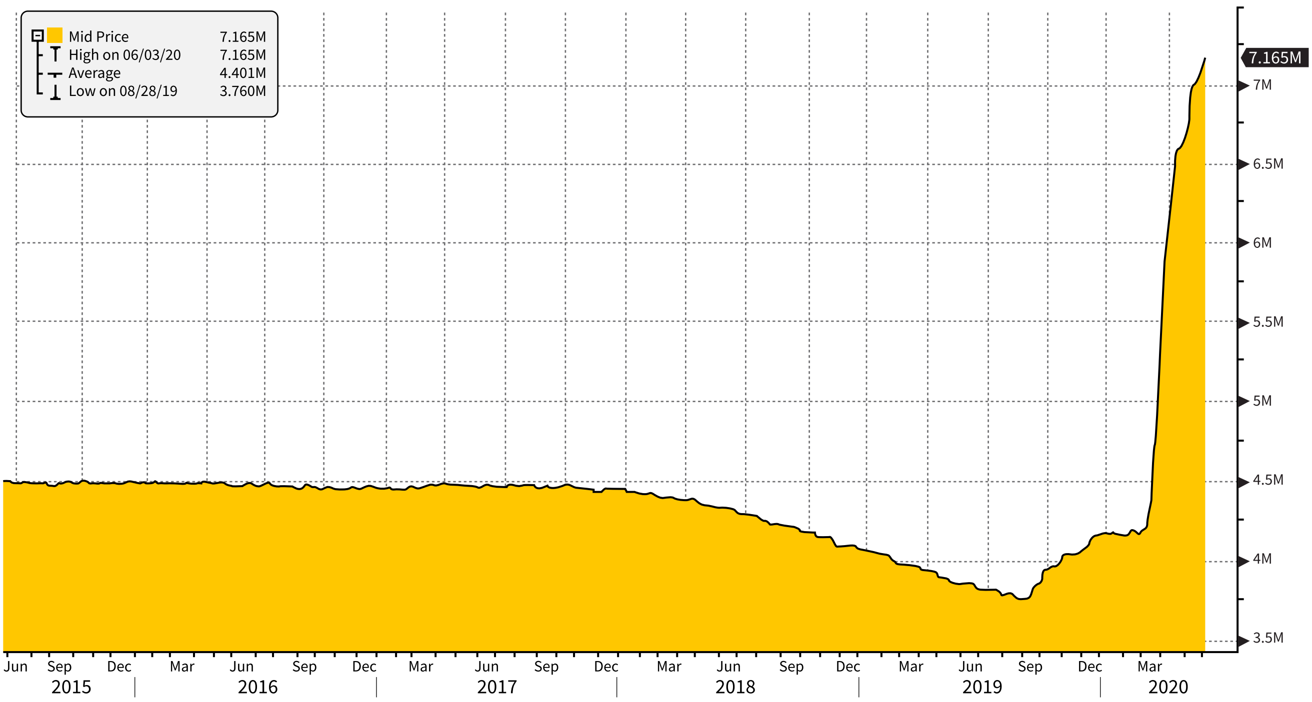

Chart 1: Federal Reserve Balance Sheet increased USD3trn since Mar 2020

(Source: Bloomberg , June 2020)

Despite the downward revision in growth and corporate earnings expectations, the bull rally in 2Q2020 continued as markets took heart from flattening infection curves in several key countries. The anticipation of easing lockdown measures and news on possible treatment options sustained positive market sentiment. Increased retail investor participation was also cited as a contributing factor to the performance of some markets (e.g. Thailand, Malaysia, and the US).

Tensions between the US and China re-escalated in 2Q2020 with the Trump administration blaming China for the spread of COVID-19 and imposing further restrictions on Huawei. Hong Kong's new security law provided further impetus with US

President Trump threatening to revoke Hong Kong's preferential status. So far, equity markets have ignored the negative news from the US-China tensions and weak macroeconomic data due to the favourable liquidity environment provided by the governments and central banks.

Asian bond markets also enjoyed a strong recovery on the back of central banks' fiscal and monetary stimulus bazookas. As the world suffers the worst recession in history since the Great Depression in the 1930s, the main focus of governments globally were to stimulate the economies and preserve jobs. Direct support for bonds also came in the form of governments and corporate bond buying programs that extended to include even high yield bonds. Both the US and the European central banks pledged to do "whatever it takes" to avoid a global financial meltdown.

With this deep and wide safety net, it was unsurprising that bonds rallied in 2Q2020 after the drastic sell-off in March 2020. The JP Morgan Asia Credit Index* delivered 6% in total returns during 2Q2020 and this eradicated all of March's losses. For 1H2020, the JP Morgan Asia Credit Index is now up 2.1% overall with investment grade outperforming with 3.3% returns versus non-investment grade still in the red with -1.35%.

JP Morgan Credit Index as of 25th June 2020.

"Equity markets have ignored **the negative news from the US-China tensions and weak macroeconomic data due to the** favourable liquidity environment provided by the governments and central banks."

Key Themes for 2020

Cloudy Vision 20/20 made cloudier by COVID-19

KEY THEMES	OUR ASSESSMENT	MARKET IMPLICATIONS & STRATEGY
Global Growth Uncertainty	• A recession in 2020 with growth picking up in 2H2020 as lockdowns end. • Growth uncertainty to persist with COVID-19, politics and trade policy being unpredictable swing factors. • Policy makers look to boost their domestic economies via fiscal spending. • Positive factors: supportive monetary/fiscal policy. • Negative factors: corporate decision- making/ investment slows as consumption decelerates (on diminished confidence and cash preservation).	• Favour a trading-oriented/tactical stance. • Favour fixed income over equities on better risk- reward. • Expect dividend cuts. • Focus on structural themes that are less dependent on global macro- economic conditions e.g., 5G, technology change/ trends, policy beneficiaries. • Favour Asian currencies and gold over USD.
Continuing Trade Tension and Tech War	• US protectionist trade stance and global trade tension to remain an overhang. • Meaningful US-China trade war resolution unlikely as underlying issues extend beyond the economics of trade. • Ongoing US-China tech war to continue given US/ China rivalry, national security and intellectual property concerns etc. • Corporates hedge against the risk of rising trade friction by reconfiguring regional supply chains. • Risk of trade friction broadening out to other countries (e.g., on currency manipulation accusations, re-routing of trade flows to circumvent tariffs).	• Favour a trading-oriented/ tactical stance. • Favour beneficiaries of production shifts away from China. • Focus on more domestic demand stories as it will be less exposed to global supply chain disruptions from the US-China tensions.
Accomodative Monetary Policy	• Monetary policy to remain accommodative globally amidst benign inflation as governments focus on stimulating growth and preserving jobs. • Interest rates expected to remain low for longer. • Expect a weaker USD. We are bearish on USD from a medium term perspective as Fed's Balance sheet expansion will continue till 2021. • Negative output gaps (given excess capacity) and economic worries (weakening demand) to keep inflation subdued.	• Markets are unlikely to re- visit the drastic sell-off levels in March given supportive liquidity environment. • Bullish on duration for fixed income. • Favour long-end sovereign and quasi- sovereign bonds. • Prefer selective Asian currencies over USD like THB, SGD, IDR and INR • We like gold as an asset class due to very low to negative rates globally and higher fiscal stimulus across the globe.
More Volatility; Geopolitics Matter	• Markets to remain volatile given uncertainty thereby requiring nimble trading. • Sources of geopolitical risk include, amongst others: US Presidential elections, US-China tensions, North Korea, Brexit, Latin America/Middle East political instability etc.	• Bullish on duration for fixed income. • Favour long-end sovereign and quasi- sovereign bonds.

Our 3Q2020 Asia Ex-Japan Equity Outlook & Strategy

Neutral on equities on high valuations. There's a disconnect between financial markets and economic reality.

There appears to be a disconnect between financial markets and economic reality with markets rallying despite the uncertainties. This rally has been due to the supportive liquidity environment. **Asian equities are trading at almost 15X forward P/E (versus historical average of 12X, see Chart 2) and we now view the risk-reward as being unattractive.** The economy remains weak and valuations are elevated amidst a re-escalation in geopolitical tensions. P/E valuations are high because the market has surged even as corporate earnings have been downgraded in-line with the weak economy (Chart 2, red line). US equity markets are even more overvalued and are approaching the tech bubble valuations in 2000 (Chart 3). US markets have benefited the most from the excess liquidity as it has been the closest to the source of liquidity, principally the US Federal reserve.

We believe that the global economic recovery will be uneven and slow unless a COVID-19 vaccine or an effective treatment is found. While Asia is largely ahead of the rest of the world in terms of infection curves, the world remains intertwined and thus a synchronized recovery will be difficult.

The risk remains that a second wave of COVID-19 will result in a more prolonged hit to the global economy. Geopolitical risks are another risk factor given the re-escalation of the US-China tensions and the upcoming US Presidential elections.

> **"We believe that the global economic recovery will be uneven and slow unless a COVID-19 vaccine or an effective treatment is found."**

However, we are not outright bearish given the still buoyant liquidity conditions. We are tactically neutral as market technicals have also improved. **We are Neutral on Asian equities and we favour a tactical trading stance, being nimble to revise our positions as the situation calls for. At present, we favour value stocks as well as those with strong secular growth prospects. We also like stocks that are more domestically oriented as they will be less exposed to the supply chain and travel disruptions resulting from the escalating US-China tensions and COVID19 respectively.**

Chart 2: Asia (MSCI Asia Ex Japan Index) PER (dark line) Valuations and Earnings (Red line)

Source: Bloomberg, June 2020

Chart 3: US (S&P500) PER Valuations (dark line) and Earnings (blue line)

Source: Moody's, Maybank AM Singapore as of April 2020.

Our 3Q2020 Asia Ex-Japan Fixed Income Outlook & Strategy

Positive on fixed income, default risks priced in.

Even after the strong bond performance in 2Q2020, we remain Positive on fixed income for 2020. As we emerge out of a deep recession and attempt to re-open economies, the recovery will likely be gradual and uneven. Apart from trying to fight an invisible and highly infectious COVID 19 without a vaccine or a proven treatment, the recent re-emergence of geopolitical tensions globally makes a V-shaped recovery even more elusive. Under such an environment, interest rates are expected to remain lower for longer, which will be positive for bond returns.

The key risk for bond investments during a recession is default risks. While we are cognisant that default rates will increase in FY2020, we believe that the risks can be managed. Moody's has predicted that default risk for high yield bonds in Asia Pacific to rise from 2% in FY2019 to 6% FY2020. This compares favourably with US and Europe where Moody's has predicted default rates of 14% and 8% respectively.

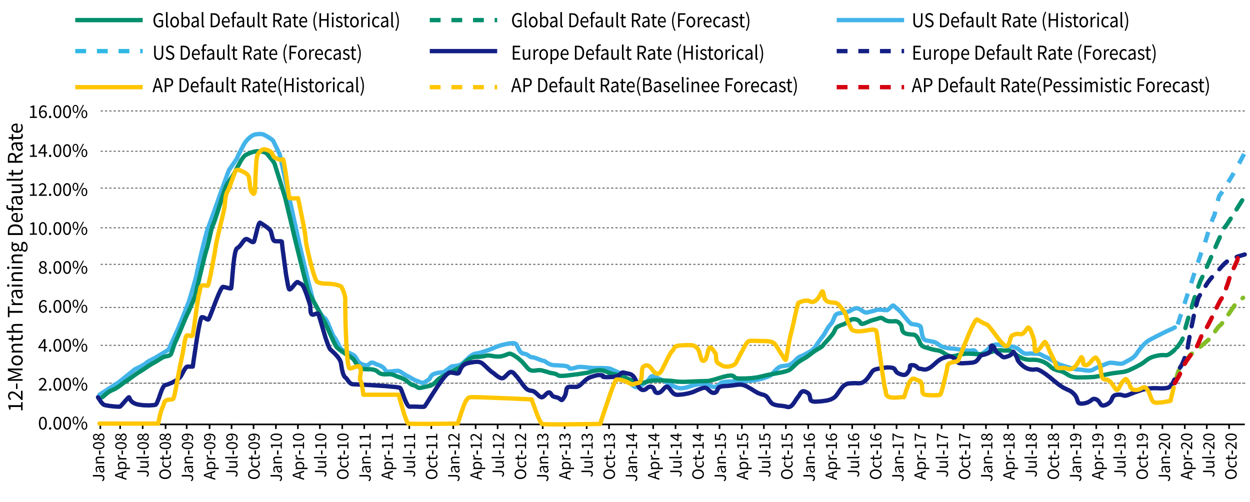

Chart 4: 12-month Asia Pacific high-yield non-financial company default rate

Source: Moody's, Maybank AM Singapore as of April 2020.

We believe present valuations compensate adequately for taking credit risks in the current environment. Current safe investments such as US Treasury bonds are at very low yields. The excess yield, otherwise known as the credit spread, that we can get from buying corporate bonds versus government bonds is much wider now compared to FY2019 and the five year historical spread.

Chart 5: JP Morgan Asia Investment Grade Credit Spread

Source: Bloomberg, JP Morgan, Maybank AM Singapore as of June 2020.

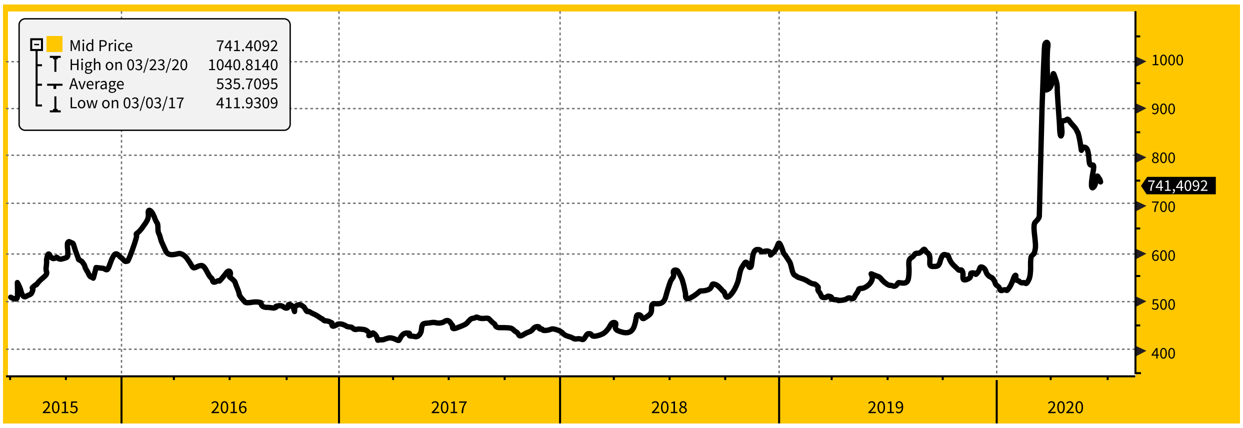

Chart 6: JP Morgan Asia High Yield Credit Spread

Source: Bloomberg, JP Morgan, Maybank AM Singapore as of June 2020.

For FY2020 we expect total returns of 4% to 5% for Asia USD credit bonds. We like long duration given interest rates should stay low and will position for this trade using **investment grade quasi-sovereigns or SOEs.** We will hold some high yield bonds for good carry, focusing on stronger high yield credits rated BB- and above, at shorter duration between 3 to 4 years. Shorter maturity high yield bonds tend to have better liquidity versus high yield bonds with longer maturities. Given that credit spreads are wide, we do not need to extend to long dated high yield bonds for attractive bond carry.

> "Interest rates are expected to remain lower for longer, **which will be positive for bond returns**"

Our 3Q2020 Global Sukuk Outlook & Strategy

Sukuk market to continue to recover

Like other fixed income markets, the Sukuk market also experienced a sell-off in March, with the Dow Jones' Sukuk Total Return Index returning -5.3% for that month before rebounding to 2.8% and 2.6% in April and May respectively.

In the Middle East space, the conventional bond market was the first to revive as sovereigns like Qatar, Abu Dhabi and Saudi Arabia printed bonds with significant new issue concessions. The Sukuk market followed as soon as risk sentiment continued to recover. Bahrain was the first issuer post the recovery to issue USD denominated Sukuk in May, which drew strong demand from investors.

Subsequent USD Sukuk issuances from the Emirate of Sharjah, Dubai Islamic Bank over the month of May to June have also managed to perform well despite tight pricings, a testament to the structurally tight supply situation in the space. In addition, Indonesia had managed to print a 30-year Sukuk to meet investors' demands for duration in this low yield environment. The 30-year Sukuk is hard to come by, as such tenors were not historically preferred.

We believe the Sukuk market will continue to recover into 3Q2020. We believe credit spreads will continue to grind tighter into 2H2020. Credit spreads of GCC Investment grade names remain wider relative to history despite the recovery and with low UST yields expected to stay for a while longer.

Dow Jones' Sukuk
Total Return Index returning

-5.3%

for that month before rebounding to

2.8% & 2.6%

in April and May respectively.

"We expect Global Sukuk issuances to be **in the range of USD-140-50bn in 2020**"

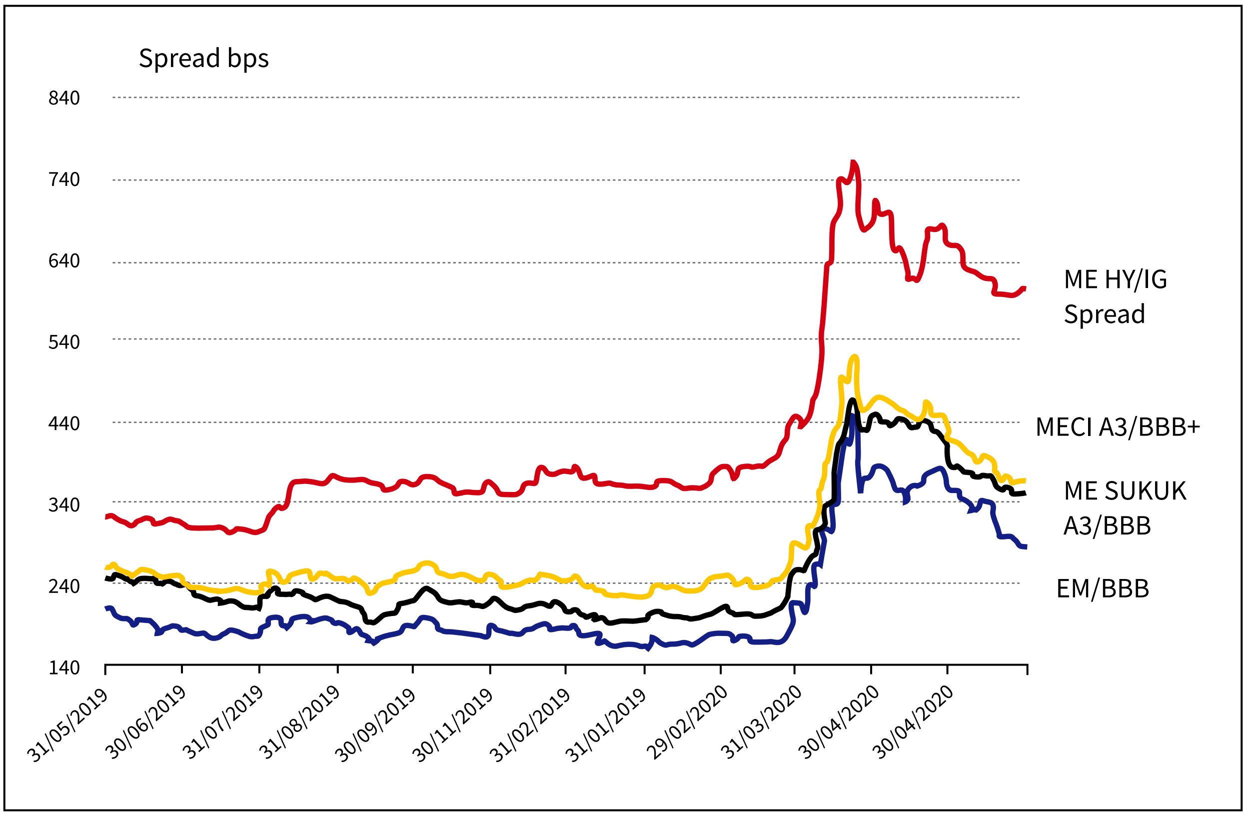

Chart 7: Credit spreads of Sukuk market

Source: Bloomberg, June 2020

We will continue to favour IG names over HY as bulk of the issuances in the GCC space (ex-sovereigns) are in the GCC real estate sector. This sector is still suffering from falling home prices, low rental rates and the oversupply situation. In the IG space, we continue to favour financials given the high government ownership/support and a good spread pick up over the sovereigns. We also remain positive in the Sukuk AT1 perpetual space given the confidence that the issuer will call them on their first call dates, following First Abu Dhabi Bank's decision to call their conventional AT1 perpetual in May.

We expect Global Sukuk issuances in 2020 to be in the range of USD140-150bn in 2020, from around USD130bn in 2019, driven in part by global sovereign Sukuk issuances increasing moderately to USD 75-90bn in 2020 from USD71bn in 2019, on both lower oil revenues and increased budget spending due to the impact from the COVID-19 shutdowns.

GLOBAL SUKUKS : RECOMMENDATIONS	
Malaysia	• Current Account to deteriorate slightly given lower oil prices (USD 40/bbl for 2H2020) and lower trade from COVID-19; MYR likely to appreciate against USD in 3Q2020 as real yields remain positive and weaker USD environment. • Prefer short end MGII for carry and currency appreciation potential given flat curve; avoid duration given potential for increased supply. • Market weight on USD Malaysia sovereign, SOE Sukuks, and overweight on local currency Sukuk.
Indonesia	• IDR to stay in the range of 13800-14200 on stable external balances. • Prefer short dated IDR Sukuks for carry as increased sovereign funding needs may drive domestic yield curve steeper; 10 year yield forecasted at 7.5-7.6% by year end from 7.10% now. • Inflation is expected to remain stable and IDR real yields remain positive despite likelihood of another policy rate cuts from 4.25% currently. • Market weight on USD INDOIS Sukuks and overweight on local currency Sukuk.
Saudi Arabia	• Market weight on KSA Sovereign Sukuks. • Supply of sovereign conventional bonds and Sukuks can be absorbed given JPM Index Inclusion. • Prefer IG over HY Saudi names as increase in VAT rate to 15% from 5% effective July 2020 is likely a drag on consumers and corporates.
UAE	• Residential real estate market may have bottomed but any recovery is likely to be slow • Rescheduling of Expo 2020 into 2021 to delay recovery. • In the UAE HY space, overweight bank AT1s for carry given expectation of profitability and strong capital ratios even as NPLs build up; First Abu Dhabi bank calling their AT1 perp in May gives confidence to this sector in contrast to European bank AT1 sector. • Overweight financials given strong government ownership/support and sovereigns as UAE best positioned to weather this current oil price downturn.
Qatar	• Market weight on Sukuks issued by Qatari financials. • Overall Sukuk supply from Qatar should remain limited in 2020.
Oman	• Financing needs of Oman to remain heavy despite sales of stakes in SOEs. • Underweight OMAN USD Sukuks on impending supply risks, which has seen no supply in 1H2020. • Downgrade risks remain high given increased strain to budget on lower oil prices.
Bahrain	• Bahrain's sovereign and quasi-sovereign conventional bonds and Sukuks to remain supported despite tight levels for its B+ rating. It has strong support from Saudi and UAE. • Government's fiscal position set to improve given existing reforms in place and USD 10bn support package form UAE and Saudi. • Over weight on Bahrain's USD sovereign Sukuks as yield is attractive for carry.
Turkey	• Underweight USD TURKSK Sukuks on tight valuations and high susceptibility to geo- political risks.
Kuwait	• Continue to like Kuwaiti Banks AT1 perps for carry given limited supply vs UAE banks.

Indonesia

2Q2020 Indonesia Market Review

First wave of infections paused 2Q2020 rally

From March's low to the end of 2Q2020, the Indonesian equity and fixed income markets rallied due to the economy reopening. However, Indonesia remains in the midst of its first wave of infections and currently has to face threats of the global second wave.

The government prepared IDR600-680tn worth of stimulus packages to tackle the Covid-19 pandemic. With the recent stimulus, the fiscal deficit target widened to 6.3% of GDP, well above its prior legal limit, although much of it came from lower revenue. Bank Indonesia (BI) will finance some of it through Quantitative Easing (QE).

Furthermore, Bank Indonesia (BI) has lowered its benchmark rate by 75bps YTD to 4.25% and still sees room for another rate cut by 25bps more. The most recent cut was more based on benign inflation and latest GDP growth projection at 0.9% - 1.9% from a previous 2.3%. Moreover, the central bank has re-emphasised its commitment to support the budget deficit by financing through government bond purchases in the primary market and to continue providing sufficient liquidity in the system to support the banking loan restructuring program. Up until this moment, the central bank sees the liquidity condition as adequate.

The most recent cut was more based on benign inflation and latest GDP growth projection at

0.9% - 1.9% from a previous 2.3%

Our 3Q2020 Indonesia Equity Outlook & Strategy

Neutral as earnings expected to be weak but possible liquidity driven rally

“Unless a successful vaccine is distributed, **full scale operations may only be possible at the end of the year or in 1Q2021.**”

The recent correction in the equity markets were due to the increased geopolitical risks and the resurgence of second wave threats. Nonetheless, we think the government cannot afford to re-implement the same lockdown as previously implemented as economic costs would be astronomical. **Hence, looser restrictions and more stimulus packages from the government are on the cards, considering its fiscal deficit is still far away from the target.**

We are Neutral on Indonesian equities as we expect earnings to be weak and recovery to be slow, considering the regional discrepancies in the economic reopening pace as Large Scale Social Restriction (LSSR) lifting will be unsynchronized. **Unless a successful vaccine is distributed, full scale operations may only be possible at the end of the year or in 1Q2021.** This will cause a gradual stimulus execution.

Fiscal policy remains the main growth driver while monetary policy maintains the financial stability. The stronger IDR in the past months may entice more rate cuts however an oversold USD as well as an accelerating fiscal deficit in 2H2020 coupled with heightened global market volatility provide less reasons to do so, unless political pressure jumps in.

At this current juncture, although we are less upbeat as compared to April on a further rally, we remain opportunistic to ride emerging opportunities. We avoid skewing portfolios too much to defensives, given the possibility of a liquidity driven rally. Sector wise, we are being tactical. **We’re bullish for cyclical laggards such as selected banks, industrials, infrastructure and selected commodities, while maintaining core focus on telco and fast moving consumer goods (FMCG) for defensive play.**

Our 2Q2020 Indonesia Fixed Income Outlook & Strategy

Trading opportunities in fixed income space, volatility remains high

For Fixed Income, we have upgraded our view from being defensive in the last 3 months to Neutral. As more rate cuts are expected from BI, we view that interest rates to remain low for longer and fixed income instruments could provide a good yield pick-up for investors.

On IDR, Indonesia relies heavily on foreign financing for both current and fiscal balances, requiring strong policy coordination. This demands a balancing act between providing a sufficient stimulus without jeopardizing IDR's stability due to enormous deficit. Thus far, given BI's well-equipped tools to ensure IDR stability through foreign exchange (FX) multi support, bilateral agreements and massive swap facilities, such financing issues remain well managed.

Furthermore, the money printing effect on inflation is less of a concern currently, as BI's QE size is considered small as compared to Indonesia's GDP, while net private credit demand is still depressed thus lowering money velocity. Hence, we expect that policy execution and fiscal deficit will accelerate in 2H20.

Therefore, although volatility in the market remains high, we see some trading opportunities in the fixed income market. The demand for government papers (govvies) in the primary market has been predominantly derived from fears regarding the pandemic. Such demand reached IDR105tn in the primary market around mid-May, and has stabilised since. **We prefer to take positions in benchmark series of medium tenors. In the corporate space, some AAA state owned enterprises (SOEs) have started issuing bonds while demand on the shorter tenors started showing as well.**

We expect that policy execution and fiscal deficit will accelerate in 2H20.

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