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Brighter days ahead?

The Edge, Malaysia

YEAR IN REVIEW

Brighter days ahead?

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A year of surprises — that is how bond and equity fund managers describe 2023 — but it was better than 2022, they say. On a brighter note, most of them are optimistic about 2024 on the back of the US Federal Reserve cutting interest rates and avoiding a hard landing for the economy.

For bond fund managers, the biggest surprise this year was the resiliency of the US economy. "It was expected to be the 'most telegraphed recession in history'. But the strength of the economy surprised on the upside," says Alexis Lavergne, fixed income investment specialist at Janus Henderson Investors.

He adds that the bond market was also puzzled by the lagged impact that the Fed's rate hiking cycle had on the broader economy as non-farm payrolls came in twice as high as anticipated in early October, illustrating how "good news" in normal times became "bad news" for bond markets. Strong employment data and stubbornly high inflation were likely to warrant a hawkish Fed stance.

Ng Lee Peng, group head of investment at Opus Asset Management Sdn Bhd, agrees with Lavergne's view. She says the market was expecting the US to enter a recession towards the second half of the year (2H2023) and investors were pricing in rate cuts.

"We were expecting the federal funds rate (FFR) to peak by 2H2023, but expected rate cuts to only happen in 2024. I guess we were right on that," she says.

However, it was still a volatile year to navigate. Although the global bond market did better than last year, the US Treasury market saw a record loss of 12.5%.

The Malaysian bond market, however, did pretty well. From end-2022, Ng had been suggesting that it was time for investors to enter the bond market. At end-November this year, the FTSE BPAM All Bond Index was up 5.73% compared with 1.5% last year.

For Goh Wee Peng, CEO of AmFunds Management Bhd, 2023 has been a year of two halves. The local bond market had rallied on anticipation of the interest rate set by Bank Negara Malaysia reaching the terminal policy rate (or long-term targeted rate), which proved correct.

Yet, the joy was short-lived as developed-market bond yields steepened due to strong economic data and a large supply of long-duration Treasury bonds. The local market soon gave back some of its gains in 1H2023 when long-end bond yields steepened.

JANUS HENDERSON

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> > Lavergne, Janus Henderson

"Picking up pennies in front of a steamroller" is how Goh describes this year's market. It references strategies where one collects small premiums with carefully devised strategies against a backdrop of relatively big risks.

"While we anticipated earlier developments in the local bond market, our projection did not account for the persistent strong inflation data and strong economic data that drove local bond yields higher all the way into 3Q2023. Nevertheless, we managed to control the situation by de-risking ahead of unfolding events," she says.

THE YEAR AHEAD

Fund managers expect at least two rate cuts by the Fed in the second half of 2024. Even so, the battle with inflation remains a long and progressive one.

Lavergne sees tremendous opportunities for high-quality securitised assets, including AAA-rated collateralised loan obligations (securities backed by a pool of debt), agency mortgage-backed securities (agency MBS are MBS issued by government-sponsored enterprises), commercial MBS and asset-backed securities.

"They offer more attractive spreads — compared to their long-term averages — than investment-grade or high-yield corporate bonds," he says.

Ng believes the FFR has peaked and will maintain at 5.25% to 5.5% until 2H2024. Rate cuts are ex-

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AMFUNDS

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> Goh, AmFunds

pected to only happen in 2H2024 at the earliest, by 50 to 70 basis points (bps), barring any unexpected event. A shallow or short recession could occur. All these make bonds an attractive investment, she says.

"'Cash is king' was the phrase to describe the global bond market last year. Next year, we are extending the phrase to 'cash is king, but bond is better'," she adds.

Ng's conviction for fixed income next year is even greater as 2023 nears its end. "We continue to favour high-grade corporate bonds and avoid credit with a high gearing and weak balance sheet. While government bonds may perform, especially if there's a rate cut, we are cognisant that supply will continue to be heavy. This is true for both MGS (Malaysian Government Securities) and UST (US Treasuries)."

Meanwhile, AmFunds' Goh favours short-duration bonds as compared to taking directional exposure at the long end of the yield curve. The firm may revisit its call by the end of 1Q2024, if it sees macroeconomic data deteriorating severely from the current levels.

"Domestically, due to interest rate differentials, we do not expect rate-sensitive foreign investors to revisit this part of the region in the immediate term. As such, the supply of government bonds will have to be absorbed domestically," she adds.

Goh cautions investors to look out for the divergence of interest rates between the US and the European Central Bank and the Bank of England. "The euro and British pound may once again face downside risk against the US dollar.

"For investors who are keen to invest in hard currency, we still advocate a short-duration US dollar exposure strategy where investors can continue to benefit from the high FFR."

PROPERTY SECTOR BACK IN FOCUS

Not surprisingly, equity fund managers have also been keeping an eye on monetary and fiscal policies that impact the stock markets.

Chue Kwok Yan, CEO and chief investment officer (CIO) at KAF Investment Funds Bhd, describes last year as the "fiscal-monetary policy tug of war".

"In the past, fiscal policy loosening was usually less timely in response to economic weakness. But what we are facing now is the opposite. Central banks are trying to tighten conditions, but governments have been keeping the fiscal spending lid open since the pandemic," he says.

As for David Loh, deputy head of equity at AHAM Capital, it was a year of transition and surprises. Besides the US, all eyes were on China as investors harboured high expectations on the reopening of its economy post-pandemic. But the optimism quickly diminished when its exports deteriorated sharply.

"The property sector, which makes up a substantial chunk of its economy, also suffered from a credit crisis. Investors' confidence was low throughout and China's market corrected sharply, as the much-anticipated stimulus packages from the government have not come through in a significant way," he says.

On the local front, it was again a tale of two halves. The stock market struggled in the first half of the year, but a notable shift occurred in the later part of the year, marked by a ramp-up in policy implementation. Foreign investors finally turned net buyers from July.

This year has been one for overcoming challenges, looking past the bumps and seizing the opportunities, says Patrick Chang, CIO of Principal Malaysia and CIO of Principal South East Asia overlooking equities in the region.

He singles out the unexpected collapse of financial entities in the US and European Union, including Silicon Valley Bank, Signature Bank and Credit Suisse, as the biggest surprise this year. In China, major property developers such as Country Garden and Evergrande defaulted on bond repayments. And in the Middle East, there is the latest tension between Israel and Hamas.

Yet, amid these issues, the market also experienced a surprising resurgence thanks to technology stocks, on the back of market optimism surrounding ChatGPT, artificial intelligence (AI) and high-end chip manufacturers.

Important lessons have been learnt and fund managers are positioning themselves for a better year in 2024.

For Chue, he and his team's best call was on YTL Corp Bhd and YTL Power International Bhd, while their worst was on the technology sector as a whole. "This serves as a lesson and timely reminder that consensus views tend to be lagging. Hence, the ability to form one's opinion, independent of the sway of the consensus, is the key ingredient to outperforming the market," he says.

AHAM CAPITAL

"The property sector, having gone through a prolonged downcycle, is poised for a recovery next year, supported by a healthy economy and low unemployment rate."

> Loh, AHAM Capital

Chue adds that any weakness in the US economy next year could be balanced by China's resurgence, and that the overall situation should be beneficial for emerging economies like Malaysia. "Investors should be able to find opportunities in companies that are expected to report stronger earnings and well positioned to benefit from trends, such as [supply chain] diversification, renewable energy and higher spending from Petronas."

On the other hand, AHAM Capital is proud of its early positioning in the healthcare sector, especially its decision to buy into KPJ Healthcare Bhd a year ago when its share price had risen substantially as its earnings were robust. Yet, it remained cheap as compared to recent merger and acquisition deals done in the same space.

The worst call Loh and his team made was being overly negative on the construction sector, which caused them to overlook the sector's subsequent rebound.

Loh has an optimistic outlook on 2024, a view he has maintained since 2H2023. "Our central view is anchored on political and currency stability, which were the two main factors that triggered massive [fund] outflows recently."

Also, the valuation of the local market is cheap and corporate earnings will grow in tandem with the economy, he says, adding that the relaxation of the country's visa policy could provide another tailwind to the local tourism sector and economy.

Two key investment themes next year are property and renewable energy, adds Loh. "The property sector, having gone through a prolonged downcycle, is poised for a recovery next year, supported by a healthy economy and low unemployment rate. We have observed encouraging signs as some new properties were snapped up over the weekend of their launch as compared to the lengthy marketing period needed previously.

"Even after the decent run-up [in share prices] this year, we still see strong upside as sector valuation remains way below its heyday," he says.

On the renewable energy sector, Loh's positive view is underpinned by the government's National Energy Transition Roadmap and its ambitious RM600 billion plan to encourage the sector's growth.

From a portfolio perspective, Principal's Chang is neutral on equity and bonds, and has a preference for income-focused funds. The firm emphasises quality, growth and income in stocks and credits. It is also exercising caution with US dollar assets and believes that Asian equities and fixed income present more value in the short term.

Bonds are appealing to Chang as the Fed's hiking cycle is likely to end soon. He sees potential for capital gains in the event of weaker economic growth and maintains a preference for investment-grade bonds with longer durations.

With regards to equities, Chang prefers quality and dividend-paying stocks for their defensive characteristics. "We also favour an income-focused approach to ride out volatilities arising from geopolitical tensions, inflationary issues and recessionary concerns." ■

KENNY YAP/THE EDGE

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> Ng, Opus

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SUMMARIES

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