FUNDAMENTAL FLASH

2022 Market Outlook | A Year of Transition

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Prepared by Affin Hwang Asset Management

If the outlook for markets were to be summed up in single word it would be ‘transition’.

That was the constant refrain used by Dato’ Teng Chee Wai, Managing Director of Affin Hwang Asset Management when sharing his views on markets at a recent online webinar held on the 11th December.

“2022 is set to be a year of transition for markets as investors contend with normalisation of growth rates and monetary policy tightening. We expect to see a lot of crosswinds and periods of transition especially with regards to policy.

“While we don’t expect a rout for markets like during early-2020 at the height of the pandemic or 2008-GFC, some form of correction is anticipated. In fact, Asian stock markets have already started consolidating,” Teng said in the webinar which saw more than 1,500 attendees.

Foremost, markets are angsty about slowing growth rates which are projected to come down in 2022. Since reopening from the great lockdown, GDP data and earnings have vaulted strongly as businesses clamber to make up for lost time and meet renewed demand.

Flashpoints

- 2022 will be a transition year for markets as growth rates normalise and monetary policy tightens.
- Inflationary pressures should recede on the back of easing supply bottlenecks and lower commodity prices.
- China’s policy focus is shifting from that of regulatory tightening to now supporting growth as its economy wanes.
- Malaysia will be a stock picker’s market with banks, technology and healthcare as potential beneficiaries.

Teng adds that such supernormal growth rates is partly an aberration because of the distortion caused by the pandemic. As such growth rates are expected to come down from such high levels, though should still remain above trend.

Earnings growth rate will also normalise and is expected to average between 6%-9% globally in 2022.

Policy & Pandemic

Another key flux for markets to adjust is tighter monetary policy conditions as global central banks look to start turning the taps to reduce liquidity.

After injecting blockbuster stimulus to keep the economy afloat during the pandemic, Teng believes that some form of policy tightening is imminent as central banks seek to tamp down inflation.

“Based on what we are seeing today, clearly the balance sheet of central banks have peaked. As we all know, a lot of the market movements have been supported by abundant liquidity and easy money pumped in by global central banks.

“As liquidity dries up, there will be certainly be an effect on markets as well an adjustment period. Central banks in emerging markets have already begun tightening and developed markets are expected to follow suit next year,” Teng said.

At its recent policy meeting in December, Fed Chair Jerome Powell declared that inflation was a key risk to economic growth. He also signalled to markets that the Fed would speed up its tapering of bond purchases that would pave the way for 3 rate hikes in 2022.

Teng also pointed out that inflation has become not just an economic problem but also a political one in the US.

“The popularity of US President Joe Biden is inversely correlated to inflation data. As such there is also some implicit political pressure to do something,” he adds.

On the debate whether inflation is transitionary or persistent, Teng believes that easing supply bottlenecks and lower commodity prices will eventually help cool down inflation.

Table 1: Growth Slowdown

BLOOMBERG SURVEY OF ECONOMISTS
GDP GROWTH EXPECTATIONS

	2021*				2022*				2023*	2021**	2022**	2023**
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1			
US	6.3%	6.7%	2.1%	4.9%	4.5%	4.0%	3.2%	2.6%	2.4%	5.5%	3.9%	2.5%
EURO AREA	-1.2%	8.7%	9.1%	2.8%	3.2%	3.2%	2.8%	2.4%	2.0%	5.1%	4.2%	2.3%
UK	-5.5%	23.9%	5.3%	4.5%	4.1%	3.2%	2.4%	2.4%	2.0%	7.0%	5.0%	2.1%
JAPAN	-4.1%	1.5%	-3.0%	5.3%	4.5%	3.1%	2.0%	1.3%	1.2%	2.0%	2.6%	1.3%
CANADA	4.9%	-3.2%	5.5%	4.7%	5.0%	4.5%	3.8%	2.8%	2.7%	5.0%	4.1%	2.6%
AUSTRALIA	7.4%	2.8%	-7.4%	7.4%	8.0%	5.7%	4.1%	3.2%	2.8%	3.9%	3.8%	3.0%
BRAZIL	4.9%	-0.4%	0.9%	1.9%	0.6%	0.3%	0.5%	1.2%	1.5%	5.0%	1.3%	2.2%
CHINA	0.8%	4.9%	0.8%	4.9%	5.7%	6.1%	5.7%	5.3%	4.7%	8.0%	5.3%	5.3%
INDIA***	...	...	...	...	...	...	...	...	...	9.2%	7.5%	...
RUSSIA	...	...	...	...	...	...	...	...	...	4.2%	2.5%	2.1%
G7****	1.8%	7.2%	3.6%	4.5%	4.1%	3.6%	2.9%	2.3%	2.1%	5.0%	3.9%	2.2%
G7**** EX. US	-2.9%	7.6%	5.3%	4.1%	3.8%	3.3%	2.6%	2.1%	1.8%	4.4%	3.9%	1.9%

* QUARTERLY RATE OF CHANGE, ANNUALIZED.
** ANNUAL RATE OF CHANGE.
*** THE 2021 FORECAST FOR INDIA REFERS TO THE APRIL 2021-MARCH 2022 PERIOD, WHILE THE 2022 FORECAST REFERS TO APRIL 2022-MARCH 2023.
**** INCLUDES US, CANADA, JAPAN, GERMANY, FRANCE, ITALY, AND THE UK.
SOURCE: BLOOMBERG FINANCE L.P.
NOTE: ACTUAL VALUES FOR Q1 AND Q2 OF 2021 ARE USED FOR ALL COUNTRIES. FOR G7 COUNTRIES, THE EURO AREA, AUSTRALIA, AND CHINA, ACTUAL VALUES ARE USED FOR Q3 AS WELL.

Source: BCA Research, as of 2 December 2021

"If inflation remains sticky and we are seeing growth slowing down, then we could see stagflation globally. That would be the worst outcome for markets as far as asset prices are concerned. However, our base-case is that inflation is transitionary.

"Port congestions are starting to ease and commodity prices have rolled over. If this trend continues, input prices will come down, though there will be some lag effect," he said.

At the webinar, Teng also cautioned about headwinds arising from COVID which has lingered close to 3 years now.

He asserts that it is too early to make a conclusion yet on the effects of Omicron that has triggered a fresh wave of border closures. Early studies so far show that the new strain is more infectious, but does not cause serious symptoms.

"These are positive signs for markets at the moment. But we never know if another variant emerges and if it could lead to an increase in hospitalisation rates. Governments will then have little choice but to restrict movements for its citizens again" Teng says.

"A major disruption like a total lockdown isn't the base-case for now. Though, there will probably be a need to make adjustments as we go along. This is something the population needs to accept and be more disciplined to contain the spread of infections especially in Europe.

"However, developments of new medical treatments such as oral pills can help in the fight against COVID. This would lay the planks for a more sustainable reopening of the economy once we have a complete medical arsenal that is effective against all known variants," according to Teng.

He also pointed out that should Omicron turn out to be more destructive that what the market anticipates, there could be room for the Fed to adjust their policy and hold back from tightening too much.

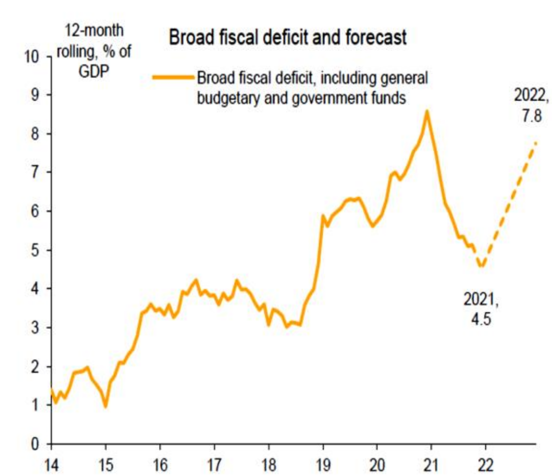
China - 2022's 'Wild Call'

Shifting gears to Asia, Teng also addressed the elephant in the room that is China which has been battered by regulatory headwinds. In the past year, the Chinese government has cast a wide regulatory dragnet that has targeted a range of sectors including education, technology, and e-commerce.

These include stock market darlings like Tencent and Alibaba which suffered heavy losses as the government seeks to regain back control from the internet giants. However, recent policy signals by Beijing suggest that the worst of the tightening cycle is over.

"The focus of policymakers in Beijing is shifting from that of regulatory tightening to now supporting growth. China's economy is seeing signs of slowing down especially the property sector which forms a large component of GDP growth.

Table 2:China's Fiscal Policy Turning Expansionary



Source: Macquarie, as of 6 December 2021

“We expect this to elicit some form of policy response by the government to ensure stable economic growth especially heading into its 20th Party Congress in 2022,” he tells audiences.

This was evident at a recent Central Economic Work Conference held in early-December, where top leaders in China repeatedly stressed the need for ensuring economic stability.

Policymakers are seeking to counter the effects of weaker demand, supply chain disruptions as well as a slowdown in the property sector.

“China’s stock market will be one of the wild calls for 2022 after its sharp fall. It will remain a liquidity-driven market where the losses can be significant if conditions tighten.

“However, it can also potentially surprise. My view is that China is a 2H’2022 story. Though, this is dependent on how the government reacts to the various challenges the economy is facing,” he said.

Malaysia – Staying Selective

Closer to home, Teng believes that it will be a stock picker’s market for local investors as Bursa languishes behind other regional peers.

With foreign shareholding at an all-time low, much of the exuberance have faded especially on the back of a strong US dollar environment which makes emerging markets like Malaysia unattractive.

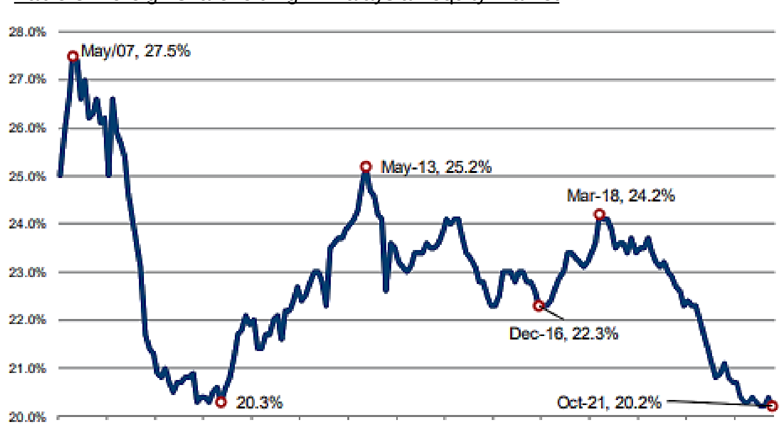
Though, Teng also views this as a blessing in disguise as the domestic market will not be susceptible to sudden foreign outflows.

“The technicals are more favourable with limited foreign selling that can take place. Instead, the direction of the market will be influenced more by local players including retail investors as well as institutional investors that have grown massively in size and are looking for opportunities to deploy,” he adds.

In terms of sector opportunities, Teng says that as a firm it is positive on banks which are expected to benefit from a rising interest rate cycle as well as improvement seen in asset quality.

Whilst banks have seen their earnings growth diluted to the recent prosperity tax or ‘Cukai Makmur’ introduced in Budget 2022, the impact will be one-off. He adds that valuations of the sector is also attractive with banking stocks trading at a discount to its book value.

Table 3: Foreign shareholding in Malaysian equity market



Source: CIMB as at 30 November 2021

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Technology and exporters are another key segment that could see potential upside underpinned by strong earnings visibility driven by secular growth trends such as 5G, electric vehicles (EV) and solar energy. Majority of the sector is also insulated against the impact of the prosperity tax.

However, Teng warns that many exporters and tech counters are seeing a lot of pressure now due to ESG headwinds especially pertaining to the welfare of foreign workers.

“If corporates are not vigilant in managing this issue well, there will be risks as we’ve seen recently such as the loss of customers or export bans,” he adds.

Against a volatile backdrop, Teng says that as a firm it is cautiously positioned for 2022.

While, there will be pockets of rally and trading opportunities, there is a need for markets to first cross some of these bumps arising from slower growth and tighter monetary policy, before it can stage a more sustainable and extended rally.

“The risk is also that policymakers make the mistake of tightening too early and too much in the early stage of the recovery.

“Though, our read is that central banks are erring on the conservative side due to the lingering effects of COVID which could persist, unless we find something that significantly breaks through and the world can really move on from the pandemic,” he said.

On inflection points, Teng sees retreating inflation and a less hawkish Fed as potential turnarounds for the market to improve. He adds that Asian markets could see stronger support on the back of policy easing by China.

“Beijing needs to show leadership on policy easing in Asia and be able to convince markets that it is responding to the reality on-the-ground that its economy is slowing down more than expected.

“Once we see these inflections points turning and market conditions improve, we could deploy more,” Teng concludes.

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