Key Risks & Opportunities in 2H'2021

Anticipating What's Ahead

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Geopolitical risks will continue to persist as one the main headwinds for markets as the world gradually recovers from the COVID-19 pandemic. Even during the pandemic, we have seen the spectre of nationalism rear its ugly head as countries battle to win the vaccination race.

If the recent G7 summit was anything to go by, investors may have already gotten a sneak preview of what's to come for the rest of the year.

"US President Joe Biden increasingly looks like he could be President Xi Jinping's worst nightmare. Together with his administration, the US has a well-thought-out process on how to contain the rise of China. We may see more pressure coming from Western countries," Dato' Teng Chee Wai, Managing Director of Affin Hwang AM recently said in his opening remarks at the company's online webinar on the 19 June 2021.

"As part of the growth equation, China cannot be removed or ignored by global investors. The country has grown leaps and bounds to potentially emerge as the largest global economy in the years to come. On past experience, it can be seen that even during Trump's administration, Chinese President Xi Jinping is unwilling to take cave in to pressure by the US," Teng adds.

While an all-out-war between the two countries isn't the market's base-case, there will certainly be more geopolitical noises for investors to decipher, according to Teng.

Though of course, the biggest elephant in the room for markets is the hidden risk of inflation. Bond yields spiked to new highs this year sparking inflationary fears that could force policymakers to think about tightening again.

The last time this happened was in 2013 (aka taper tantrum) which sent markets into a tailspin and jolted risk-assets. Could we see the return of such tapering fears as central bankers' toy with tightening? Teng thinks maybe not because of the market's ability to price-in and discount new information.

"The beauty about markets is that it has the ability to discount and react in a different way to the same event. This is because of its ability to price-in and adjust to new information. For example at the peak of the COVID-19 crisis in 2020, global markets everywhere tanked. But this year, even with cases close to 90,000 per day in India, its stock market reached an all-time high.

"As such even if there is a period of tapering sometime towards 2022/23, my sense is that the ability of the market to discount the event ahead will be even faster. As such, markets may quickly adjust as interest rates normalise," Teng states.

Teng believes that some inflation will be healthy especially on the back of the pandemic when growth was anaemic as economic activities came to a standstill.

“Having inflation is not a bad thing for markets. But having runaway inflation could be a problem. However, I don’t believe we are in this phase yet. There is still plenty of capacity. If you strip out the more volatile components such as food and oil price inflation, then the data does not seem as scary as it suggests,” Teng adds.

[Political Risk Lingers in Malaysia]

On the domestic market outlook, Teng is cautiously optimistic as the country ramps-up its vaccination rollout. Though, he adds that more strategic efforts need to be done to encourage vaccine acceptance amongst the population to reach the targeted 60% herd immunity by end-September.

“So far only 13 million Malaysians have registered for the vaccine. With a total population of over 33 million, we probably have to do more to achieve our herd immunity target. We might have to dangle some carrot or sticks to encourage sign-ups. But nevertheless, the vaccines are arriving and hopefully we will see more parts of the economy reopening,” said Teng.

Of course, conversations about any matters of opening would not be complete without a question on when Parliament itself would reopen and convene. Looking beyond the current political stalemate due the Emergency, Teng thinks that political risk will be here to stay as the country’s political democracy matures.

“2018 was a major milestone in the country’s political journey. Beyond just the formation of a new government after 60 years, there was an establishment of new political realities. Similar to what Indonesia went through in 1998 during the Asian Financial Crisis, Malaysia is going through a similar transition period.

“Following President Suharto’s loss of power then, there was a period of political wilderness which swept across the country as different figureheads took turns to rule with some more disappointing than others. Today, Indonesia is a very different country than what it was. It has moved ahead, where they now have separate presidential and legislative elections. Their political system has also progressed in terms of maturity and is more transparent,” Teng states.

Even with an election taking place in Malaysia, Teng does not expect a singular party to dominate results or have a clear majority to form government. “There will not be a simple. In all likelihood, we will have a coalition government again composed of many political parties that have different objectives. To have them work together at the same table and come to any sort of agreement, will require plenty of compromise,” Teng opined.

Though he hastens to add that as a developing country, Malaysia needs a strong government to project policies and encourage foreign investments.

Against such an environment, Teng told audiences that the team is maintaining a selective approach in its portfolios through a basket of secular growth, cyclical and recovery themes.

"Reflecting the equity team’s view, we like banks as a recovery play when the economy gradually reopens. There is also higher demand from telcos for faster speed internet on the back of work-from-home arrangements. The adoption of cloud storage in data centres are also rising.

“We also like the export sector, but valuations are expensive. Electronics manufacturing services (EMS) and semiconductors are also strong beneficiaries of the cycle and demand remain strong,” Teng states.

[ESG Becoming Mainstream]

Teng also elaborated on the prevalence of environmental, social, governance (ESG) themes which have increasingly come to the forefront. This year, the share price of top players in the glove and plantation industry tumbled because of allegations of labour abuse. Teng believes that ESG is something investors can no longer afford to ignore in their portfolios as seen from how markets have reacted.

“With a wider adoption of ESG, the price points of corporates will be affected as more financial institutions begin their own ESG screening processes. The days of investing into companies that make money regardless of their social or governance impact is coming to an end. Over the next few years, we will see a shift as the new investment reality of ESG kicks-in.

“Inherently, this also encourages good behaviour among corporates. The best way to do it would be through self-governance to portray a better image to global buyers and investors,” Teng shared.