FUNDAMENTAL FLASH

Midyear Outlook: Navigating the New Normal

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As we approach the midyear mark in 2020, what is the outlook for markets for the rest of the year? In the following interview Teng Chee Wai, Managing Director of Affin Hwang AM shares his views on the current investment landscape and investing in the new normal.

1. **Global markets have staged a strong rebound since the equity rout in March following pandemic fears due to COVID-19. But are we out of the woods yet? What is your outlook for the 2H'2020?**

The easy money has already been made in the 1H'2020. Benchmark gauges have recovered substantial losses since the market rout in mid-March due to unprecedented stimulus measures injected by governments and central banks. Such stimulus largesse have buoyed markets and led to a liquidity-driven rally.

However, it cannot be denied that there is a strong disconnect between the stock market and the real economy. As such, investors need to be mindful of the risks and be prepared for further volatility especially if there is a resurgence in COVID-19 cases.

Although the number of daily new cases may rise again as economies re-open, we are seeing a number of positive developments that may help prevent infection and mortality rates from rising back to its peak in March/April for many countries.

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The general public is much more careful now by wearing masks in public areas and maintaining hygiene as they adapt to a new normal. Thus, behavioural changes within society can help the stem the spread of infection.

The supply of masks and PPEs are also much higher today than a few months ago as manufacturers increase production to meet demand. Hospitals and medical facilities are also much more prepared after increasing ICU beds and ventilators.

Governments have also ramped-up contact tracing capabilities that will help in the process of reopening economies. The research and development process to find a cure is also gathering pace with a number of vaccines already in Phase 2 trials.

2. US-China geopolitical tensions have also resurfaced which led to some weakness in risk-assets. Is this a key risk for markets especially with US Presidential Elections looming ahead?

The upcoming US Presidential Elections will be a key risk event that will be closely monitored by investors. With Trump's approval ratings slipping below the 40% range, we may start to see Trump ramping-up political rhetoric and be more aggressive in his foreign policy stance.

China often becomes an easy punching bag for both Democrats and Republicans to shore up political support and be seen as strong presidential candidate among US citizens.

Over the long-term, the US-China conflict is a structural issue and will likely persist. Besides economic growth, China is also growing its technological capability, military strength and geopolitical influence. As China rises, it will increasingly be viewed as a threat to the US dominant superpower position in the global arena.

3. What about Malaysia? Will current stimulus measures be enough to aid economic growth?

The Malaysian government has already introduced a swathe of stimulus measures to help prop-up growth and support small-medium enterprises (SMEs) through wage subsidy programmes. Market expectations are that the government could introduce more fiscal stimulus targeted towards the technology sector and drive digitalisation in the economy. As we have seen, the COVID-19 pandemic has forced various businesses to adopt technology and helped pushed innovation to the forefront.

However, there is fiscal constraints with lower oil prices now that places additional pressure on the government's finances. Though, ample domestic liquidity would allow the government to easily tap the bond market to finance its stimulus package.

In terms of monetary policy, Bank Negara Malaysia (BMM) has taken a dovish stance and lowered the overnight policy rate (OPR) to shore up financial liquidity in the system. The central bank is expected to take a wait-and-see approach to see the effects of its OPR cuts before lowering rates again at its upcoming July monetary policy meeting. However, bond investors are pricing-in another 25-50 bps rate cut in the 3Q or 4Q'2020.

Whether the local economy and stock market stages a U-shaped or V-shaped recovery, it will be gradual. It will take time before consumption patterns and production capacity normalises again.

Though, there are positive signs as we move towards the recovery movement control order (RMCO) period and see more easing in terms of lockdown with various businesses such as cinemas and gaming outlets starting to re-open.

4. With global lockdowns starting to ease and the economy rebooting. Is it a good time to look at value stocks again such as airlines and banks?

Whilst there may be opportunities in some of these sectors, investors should also be careful to avoid any value traps. The travel sector would probably be the last industry to recover from COVID-19 as airline fares would take some time to normalise back to pre-COVID-19 levels. It is also important to look at the balance sheets of some of these companies especially if they have high amounts of debt.

Banks are likely to be pressured also with non-performing loans (NPLs) expected to rise over the few quarters, but not significantly. Most banks are much more well capitalised now to weather through the storm unlike during the 2008-GFC.

Over the next few years, growth will become a scarcity commodity as global growth rates expected to be toned down. As such, investors should expect a narrower swathe of sectors and companies that would continue to perform strongly.

For now, the markets are attributing a high premium to growth companies that have recurring income in nature. This could include cloud storage companies that derive consistent subscription income that investors are prepared to pay high multiples for. Finding good growth companies will no longer be cheap.

5. How should investors position their portfolios in the 2H'2020 and beyond?

Whilst the markets have run ahead, some investors are keen to chase returns due to fear of missing out. Whether the current market rally is sustainable or not would depend on different factors including risk of a second wave and progress of vaccine trials.

If we are able to prevent COVID-19 cases from rising significantly, the market may push ahead buoyed by ample liquidity. However, markets can pull back sharply again should there be a rise in cases which is something investors would have to get used to.

Though, we believe that governments are more prepared now in containing the spread of infection with first-hand experience in dealing with the pandemic. Front-line workers also have more resources including contact-tracing capabilities to impose targeted quarantine measures.

In this environment, it is imperative that investors stay disciplined and focus on things they can control such as their asset allocation and diversification. Timing will be difficult as moves in the stock market will be sharp and quick.

Instead, investors should practice good asset allocation to ensure that they are comfortable with the level of risk they are taking with their portfolios. More conservative investors, can focus on more yield positions as interest rates are expected to stay lower-for-longer.