Tread Carefully but With Optimism.

Commentaries: Q4, 2022 (October to December 2022)

Dear Valued Clients,

2022 has been a tough and rough year with most markets registering negative returns over factors like recessionary fear, inflationary pressure, tightening policies, geopolitical tensions, and political uncertainties. This was despite the market recovery in fourth quarter (4Q22) after a milder inflation data reported in November 2022 and also China's shift away from its Zero Covid policy. The Dow Jones Index, S&P500 and Nasdaq registered a decline of 8.8%, 19.4% and 33.1% respectively, while the North Asian markets were mostly negative as well, for instance Korea (-24.9%), Taiwan (-22.4%) and Hong Kong/China (-15.1% to -18.6%), with the exception of some ASEAN countries such as Jakarta (+4%), Singapore (+4%) and Thailand (+0.7%) fared much better on the back of economic reopening boosting consumer spending, higher commodity prices and still accommodative monetary policies.

The Federal Open Market Committee had hiked its target range for the benchmark rate in 2022 by a total of 425bp to a range of 4.0%-4.5%, the highest since early 2008. This has yet to come to an end. The expected terminal rate would be around 5%. Inflation remains the core subject matter for US markets as it forces the Federal Reserve to prioritize price stability over the economic expansion which clouded the prospect for corporate profits and capital asset prices.

On another side of the world, effects from China reopening are difficult to predict. Due to China's abrupt reversal of its Covid Zero policy, one may argue that China reopening is positive for trades, tourism and commodities demand/prices. The flip side may be worst as a result of rising Covid-death and infections which could force China government to reconsider its path of reopening.

Nevertheless, People's Bank of China (PBOC) pledged to support domestic demand and maintain "effective" growth of credit. Monetary policy "will focus on stabilizing growth, employment and prices, as well as supporting the expansion of domestic demand". PBOC also reiterated it will provide stronger backing to the real economy, keep prices basically stable and step-up targeted stimulus for key areas and industries damaged by the pandemic. It also said it would meet the property industry's reasonable financing needs, and push forward mergers and acquisitions in the sector. We believe China's economy could face rough time in the next few months before seeing signs of recovery from the reopening given the surging Covid infections, however it is likely to recover swiftly thereafter with stimulus measures from China's government. We gain some exposure into China via an ETF (to minimize stock and sector specific risk) and shall look into deploying cash into specific stocks once we see better clarity on the economic recovery of the country.

Local equities have performed relatively well in view that FBMKLCI declined by only less than 5%, outpacing other major Asian counterparts. The major positive news locally would be the declaration of Dato' Seri Anwar Ibrahim as the 10th Prime Minister to form a unity government. FBMKLCI recovered by around 2% post GE15 but did not move up in a more meaningful way (retraced from the day following the appointment of Anwar as the new PM) that most were hoping for. The recovery has been largely capped, in our view, by several other road bumps including the re-tabling of Budget 2023 and policy directions of new government, which caused uncertainties at this juncture. Several newsflows on targeted subsidy schemes that involve the telco and power sector; this caused investors to become more uncertain about policy implementations that might be pursued on other sectors as well.

Nevertheless, we remain optimistic and believe the downside of our stock market is limited. Firstly, the recent recovery of stock market was still rather muted and secondly market valuation remains attractive (given some uptick in consensus 2023 earnings estimates) - both suggesting that weaker economic growth may have already been priced in. Thirdly, with the new government who is having both (1) managing cost of living and (2) improving economic growth as its main agenda / priorities, we see more room for the implementation of economically-friendly and growth-accommodating policies which may potentially support further corporate earnings recovery and attract more inflows from foreign investors to support the market.

On valuation, FBMKLCI is trading at 13x 12-month forward PE which is much lower than the 3-year average of 14.8x even after the removal of major political overhang locally. This could be attributable to the global headwinds which may have a negative impact to local market. With the expectation that US recession could happen in 2023 and causing slowdown in global demand, the pessimism among the investment community is warranted. Given the severe retracement of the stock markets in 2022, investors are turning more conservative as the strategy to preserve capital kicks in. Nonetheless, we think the removal of political overhang bodes well for local market and expect investor sentiment to be largely restored over the medium term coupled with the potential inflows from foreign investors.

While our stock market tends to still be positively correlated to the global market, the local market which has always been viewed as a relatively defensive market is likely to be less volatile. We are optimistic on the local equity market for the reason that the domestic economic downturn might not be as deep or long-lasting as feared; private consumption should remain robust with any subsidy rationalization likely limited in scope, while KLCI earnings growth set to accelerate from 2022 in the absence of one-off Cukai Makmur tax and earnings drag from glove sector, plus the formation of a more stable government bodes well for improved governance and expedited policy making. Coupled with the cheap market valuation (relative to historical average), we believe the Malaysian stock market is in a good position to outperform peers heading into 2023. We will be buyer on market weakness.

As we are entering a new period of high interest rates, high inflation and slowing growth along with heightened geopolitical tensions and supply chain disruptions, higher volatility will continue to exist and thus we are likely to keep a balanced portfolio (with healthy cash level) by having a mixture of defensive, value, and dividend yielders, while also adopting a more tactical strategy on selective growth stocks to generate more active returns and seize any profit-taking opportunities. We have begun to deploy cash into stocks, both local and foreign, where we believe valuations now offer attractive entry points and continue the effort to extend our investment horizon for companies with healthy fundamentals such as strong earnings growth prospect, positive cash flow generation, net cash-to-low-debt balance sheet, and sustainable dividend payout. It is for this same reason; our performance is resilient and outperforming the market. Our focus as always, is to protect your capital.

Thank you for entrusting us with your monies and we looking forward to growing your capital in 2023. We wish you all Happy New Year and may 2023 be a better year for us all.

Sincerely,

Tradeview Capital