TRADEVIEW
CAPITAL

A Glass Half Full

Commentaries: Q2, 2022 (April to June 2022)

Dear Valued Clients,

Global equities fell sharply and market weakness was broad-based during the quarter. The risk-off narrative that weakened investment sentiment revolved around themes such as runaway inflation, aggressive tightening of monetary policies, Russian invasion of Ukraine (entering its 128^{th} day) and Covid lockdown in China. Economic data were weak while inflation continued to prompt the US Federal Reserve (Fed) into a more aggressive path of rate hike.

The FOMC has hiked its target range for the benchmark rate by 150bps over the course of just three meetings through June—including a 75bps hike in the most recent meeting. Furthermore, the FOMC indicated that it will pursue a further 175bps of rate hikes before the end of 2022 and 25-50bps in 2023. Year-to-date, the S&P 500, Dow Jones & Nasdaq declined 20.6%, 15.3% and 29.5% respectively, placing them in (or close to) bear market territory.

The latest inflation data in the US (headline CPI) - increased 8.6% YoY in May 2022, representing the highest level since December 1981. This was primarily driven by higher fuel and service prices. Additionally, market sentiment is also affected by geopolitical uncertainty and the ensuing disruption to supply chains. Concerns over the global growth outlook, particularly the rhetoric surrounding potential US recession (even Fed Chair Jerome Powell does not rule out this possibility), have taken over headlines on a daily basis. Energy and food supply disruptions have worsened, and consumers are experiencing direct impact of price shock in their daily lives.

On a bright side, we see signs of lockdown easing and ramp-up of stimulus measures in China. We believe China will be a key focus market over the next six months. To note, the Chinese market has rebounded and is coming close to entering a technical bull market, whereby CSI has risen by 18.5% from the trough in May 2022 (though full year, it is still down by 9.7%).

Energy was the best performing sector during the quarter. Rising energy demand amidst normalizing global economic activities, coupled with supply curbs due to geopolitical issues and tightening environmental policies have kept crude oil and gas prices at an elevated level. Within the agriculture space, despite record run from the start of the year, the prices for corn, wheat, soybean oil and crude palm oil (CPO) have started to retrace. The same can be seen across commodities such as tin, copper, steel among others.

We believe that inflation could moderate in the coming months, in part because some of the transitory factors that are constraining supply chain should ease, while the anticipated softening of global economy could lessen demand. This softening should be enough to allow the US Fed to eventually pause the hiking cycle. Looking ahead, all eyes will be on the release of US CPI data on July 13 which could determine the pace of Fed rate hike.

Back in Malaysia, though performance is not as bad as global indices, it is mirroring the selloff with FBMKLCI declining by 9.0% year-to-date. Malaysia's GDP is expected to grow +6.2%/+4.8% YoY in 2022/2023, respectively according to Bloomberg estimates. However, the CPI is expected to grow +2.6%/+2.2% YoY over the same period and a weaker Ringgit will induce "imported inflation", making the potential inflation rate worrying. These may trigger a more hawkish monetary policy stance from Bank Negara Malaysia which might raise the Overnight Policy Rate to defend the Ringgit and tame domestic inflation (CPI rose by 2.8% YoY in May, above market expectation of 2.7%). Corporates may also embark on costs cutting measures to mitigate inflation headwind, and this could lead to slower consumer spending.

We concur that domestic inflation is relatively milder thanks to price controls and subsidy. Yet, this comes at a great cost. Projected consumption subsidy expenditure is RM77.3 bn in 2022, the highest ever borne by the Malaysian government. Recent implementations, including new ceiling price for chickens and maintaining electricity and water tariffs, call into question the sustainability of such model. We believe this is just a temporary measure to tame short-term inflation, with the objective of opening a window for general election to take place. For us, impending election is a major risk that we have kept in our mind all this while, which explains the high cash holdings of our portfolio.

Not all are doom and gloom. FBMKLCI is currently trading at an attractive valuation of around 14x FY22 PE, which is one standard deviation below 5-years historical average. With the potential reopening of China - Malaysia's largest trading partner - the recovery in Chinese demand growth and tourist arrivals may eventually benefit our economy. The return of foreign labor serves as another market catalyst which could help to ease a key bottleneck faced by labor-intensive industries such manufacturing, property and construction.

All in all, markets will remain volatile. Locally, aside from political uncertainty, there could be risk from corporate earnings disappointment during the August reporting season. Hence, we continue to overweight cash and will seize any profit-taking opportunities. Also, we will 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 is simply to protect your capital.

Sincerely,

Tradeview Capital