Maybank | PREMIER

Beyond the turbulence

Market Review

Key Highlights

- Policies and political uncertainties have kept markets on edge.
- Risk assets continued to outperform bonds in an environment of healthy economic growth and strong corporate earnings.

As predicted in our 2018 investment outlook published in the beginning of the year, policies and politics indeed took center stage this year. On the policy front, fears of a global trade war intensified after U.S. President Donald Trump announced and implemented tariffs on steel and aluminum imports from Europe, Mexico and Canada. The tariff list was later broadened to include imported goods from China, and cars and automotive parts soon became the next target of “America first” trade agenda. In Europe, the recent establishment of an eurosceptic and populist government in Italy has heightened fears over the break-up of eurozone and a more confrontational stance towards the European Union.

Global equities staged a strong rally in January, fueled by optimism of a broad-based global growth and ongoing accommodative monetary conditions. This optimism was soon replaced by rising inflation risks, anxiety over trade disputes, a selloff in Emerging Markets and the Italian political upheaval. As a result, global equities as measured by MSCI All Country World Index lost 0.1% in the first half of 2018, which pales in comparison to the low double-digit returns in the first half of 2017. Within Equities, U.S. was the best performing market, underpinned by strong corporate earnings and solid economic growth. Meanwhile, Emerging Markets assets underperformed as higher U.S. interest rates and a stronger dollar have resulted in capital outflows pressures, particularly countries with current account or trade deficits such as India, the Philippines and Indonesia.

The fixed income market was pressured by the rising bond yields with the Bloomberg Barclays Multiverse Index falling 1.6% in 1H 2018. With the Federal Reserve Board (Fed) signaling another two interest rate hikes this year, the U.S. 10-year bond yields rose 45 basis points to 2.86% as at end-June 2018. The spread between the U.S. 10-year and 2-year bond yields also narrowed in 1H 2018, in-line with our expectations. We maintain our call that an inverted yield curve, which is a precursor to a recession, is not our baseline expectation for this year.

Commodities, with the exception on Gold, outperformed equities in the first half of the year. As a result of a gradually tightening market and increasing geopolitical risks, West Texas Intermediate (WTI) crude oil prices rallied by 22.7% in first half of 2018 to USD 74.15 per barrel while gold prices remained stuck in a trading range.

Overall, risk assets continue to outperform bonds in an environment of healthy economic growth and stronger corporate earnings, which are consistent with Maybank’s views.

Asset Class Performances

In USD currency	June	2Q18	1H18
Equity			
MSCI AC World	**-0.5%**	**0.7%**	**-0.1%**
MSCI U.S.	0.7%	3.5%	2.9%
MSCI Europe	-0.6%	-0.9%	-2.7%
MSCI Japan	-2.5%	-2.8%	-1.8%
MSCI Asia ex-Japan	-4.7%	-5.3%	-4.7%
China	-5.2%	-3.4%	-1.7%
Hong Kong	-4.9%	-1.2%	-2.5%
Taiwan	-1.4%	-6.1%	-0.7%
South Korea	-6.6%	-9.1%	-9.4%
India	-1.0%	-0.6%	-7.5%
Singapore	-7.4%	-7.5%	-4.9%
Malaysia	-2.8%	-11.4%	-3.9%
Indonesia	-7.3%	-12.2%	-18.4%
Thailand	-10.3%	-14.9%	-7.2%
Philippines	-5.7%	-11.1%	-21.2%
MSCI Emerging Markets	-4.1%	-7.9%	-6.5%
Bonds			
Barclays Multiverse	**-0.5%**	**-2.8%**	**-1.6%**
Barclays U.S. IG	-0.1%	-0.2%	-1.6%
iBoxx U.S. HY	0.4%	1.4%	0.3%
Commodity			
Gold	-3.5%	-5.5%	-3.9%
Oil	10.6%	14.2%	22.7%

Source: Bloomberg I 30 June 2018

Macro Economic Outlook

Key Highlights

- Global economic activity has peaked and the risks to the growth outlook are tilted to the downside.
- Key risks for the rest of the year include protracted trade disputes, a stronger dollar and rising geopolitical uncertainties.

The global economic upswing that began in the second half of 2016 remains relatively resilient, with global growth expected to hover above the long-term average of 3.7%. Economic growth in developing economies remains reasonably robust, underpinned by higher commodity prices and an anticipated rebound in India's economy. The economic development model in China is shifting from high-speed growth to high-quality development and a gradual slowdown in the Chinese economy is expected. Amongst the advanced economies, the U.S. is outpacing its peers, supported by the strong labour market, business investment and government spending. Meanwhile, Eurozone's GDP growth is expected to ease in 2018 after a strong year in 2017.

The U.S. economy expanded an annualised 2.0% in the first quarter of 2018 with U.S. leading indicators such as the Institute for Supply Management (ISM) non-manufacturing data in May showing broad strength. In view of the potential upside risks to U.S. economic growth, we currently foresee four instead of three rate hikes this year, at a quarter point increase each quarter. We believe that the Fed is likely to show some tolerance even when inflation moves above 2.0% in future, underlining a gradual rate hike outlook. We expect the European Central Bank (ECB) to continue to lag behind the Fed in unwinding the quantitative easing programme. With the recent upturn in oil prices, headline consumer price inflation has picked up. However, core inflation (headline excluding food and energy) is expected to remain soft in the near term, allowing other key central banks to maintain their accommodative monetary policy stances.

We see three key risks for the rest of the year. Firstly, the conclusion of the G7 Summit in June 2018 suggested that trade issues between the U.S. and its key trading partners will not be resolved in the near term. Our base case is that the U.S. and its trading partners will eventually reach a deal and avert a full-blown trade war. However, the prolonged trade uncertainty could affect business confidence and outlook on hiring and investment plans, creating downside risks to the economy. Secondly, the stronger U.S. economic outlook and interest rate differential between the U.S. and the other advanced economies suggest that the dollar may continue to edge higher in the months ahead. This could pressure Emerging Markets to support their currencies by hiking rates, adding to the stress on their economies. Lastly, there are a number of geopolitical issues to keep an eye on for the rest of 2018 as they may have the potential to keep volatility high. The U.S. mid-term Congressional elections in November could result in the Republicans losing control of the House, whereby a divided government will make passing legislation even more difficult. Other geopolitical risks include the tensions in the Middle East and U.S. sanctions on Iran. Overall, we believe that the risks to the growth outlook are now tilted to the downside.

Real GDP Forecast

	2017	2018E	2019E
World	3.8	3.9	3.6
U.S.	2.3	2.8	2.5
European Union	2.3	2.3	2.0
Japan	1.7	1.3	1.0
China	6.9	6.6	6.4
ASEAN	5.1	5.2	5.1

Inflation Forecast

	2017	2018E	2019E
World	3.0	3.5	3.4
U.S.	2.1	2.5	2.4
European Union	1.7	1.9	1.8
Japan	0.5	1.1	1.1
China	1.6	2.5	2.6
ASEAN	2.9	3.0	2.8

Rates Forecast

	2Q18E	3Q18E	4Q18E	1Q19E
Fed Fund Target (Upper band)	2.00	2.25	2.50	2.75
Fed Fund Target (Lower band)	1.75	2.00	2.25	2.50
ECB Deposit Rate	-0.4	-0.4	-0.4	-0.4
BOE Bank Rate	0.5	0.75	0.75	0.75
BOJ Target Rate	-0.1	-0.1	0.0	0.0

Source: Maybank Kim Eng, IMF I June 2018

Investment Strategy

Key Highlights

- Equity market returns are likely to be more constrained for the rest of the year. We downgrade equities to Neutral and raise cash to Overweight.
- We continue to Underweight bonds as global bond yields are likely to move higher in the months ahead.

Escalating trade disputes have kept markets on edge and the headwinds for global economic growth have increased. We are seeing increasing signs that global growth momentum would continue to level off, dragged down by uncertainties from trade tensions between the U.S. and its key trading partners, and the slowdown in emerging economies. The recent dollar strength has weighed on Emerging Markets debt and equity markets, and Emerging Markets central banks are starting to hike policy rates to stem capital outflows.

Equity market returns are likely to be more constrained for the rest of the year given the backdrop of moderating economic growth momentum and rising volatility. In addition, whilst corporate earnings have improved, we see limited room for earnings to meaningfully surprise on the upside from hereon. While we are less enthusiastic about the prospect for global equities, we are also encouraged by the fact that investors' expectations have re-aligned to more reasonable levels after the sell-off in February and equity valuations are less stretched now compared to beginning of the year. MSCI All Country (AC) World Index has corrected from the recent high of 17.7x 12-month forward earnings to 15.5x, which is closer to the 10-year historical average of 14.5x.

Against the backdrop of slower growth, we downgrade global equities to Neutral and raise cash to Overweight. We continue to Underweight bonds as global bond yields are likely to move higher in the months ahead, underpinned by a gradual upward drift in inflation and increased issuance of U.S. Treasuries to fund the widening deficit gap. We remain Neutral in our commodity price outlooks for oil and gold.

Within equities, our convictions in China and Singapore remain unchanged. On the other hand, we have turned more cautious on Japan due to concerns over the protracted trade tension given its significant foreign revenue exposure. As for corporate credits, we have strong relative preference for short duration bonds and Asian credits. We are cautious on Emerging Markets high yield bonds as the factors underpinning their weakness such as strong dollar and rising U.S. interest rates, are likely to continue to prevail in the second half of 2018.

Preferred Countries

China:

With China shifting towards a more consumption-based economy and innovative-driven development, sectors such as e-commerce, travel and technology would be the long-term beneficiaries.

Singapore:

Our positive view on Singapore is premised on improving macroeconomic fundamentals with inexpensive market valuations and rising earnings growth.

MSCI AC World Index 12-Month Forward P/E (x)

Source: Bloomberg I June 2018

Asset Class Overview

	UNDERWEIGHT	NEUTRAL	OVERWEIGHT
OVERALL POSITION			
Equities	☐	■	☐
Fixed Income	■	☐	☐
Commodities	☐	■	☐
Cash	☐	☐	■
- USD	☐	☐	■
EQUITIES			
U.S.	☐	■	☐
Europe	☐	■	☐
Japan	■	☐	☐
Asia ex-Japan	☐	☐	■
- China	☐	☐	■
- Hong Kong	☐	■	☐
- South Korea	☐	■	☐
- Taiwan	☐	■	☐
- India	■	☐	☐
- Singapore	☐	☐	■
- Malaysia	☐	■	☐
- Thailand	☐	■	☐
- Indonesia	☐	■	☐
- Philippines	■	☐	☐
FIXED INCOME			
Developed Market Investment Grade	■	☐	☐
Developed Market High Yield	☐	■	☐
Emerging Market Investment Grade	☐	■	☐
Emerging Market High Yield	■	☐	☐
Asian Investment Grade	☐	■	☐
Asian High Yield	☐	■	☐
COMMODITIES			
Gold	☐	■	☐
Oil	☐	■	☐

Source: Maybank Wealth Management I June 2018

Equities

Key Highlights

- Maintain Neutral stance on the U.S. and Europe.
- Be more selective in Asia ex-Japan and our preferred markets are China and Singapore.

U.S. equities have performed well in the first half of the year, as the economy remains on a relatively strong footing compared to the rest of the world. Analysts have sharply revised up their earnings estimates for S&P 500 companies in early 2018 to reflect the positive effect of higher oil prices for oil companies and corporate tax cuts. We believe that the U.S. equity market has already priced in a considerable amount of good news and hence, we are Neutral on the market.

Euro-area growth slowed in the first quarter. While the European Central Bank's officials have largely blamed it on transient factors such as cold weather and limited capacity, we are concerned that rising trade protectionism from the U.S. and currency fluctuations may weigh on the region's immediate outlook. The political uncertainties in Italy has also led to a spike in the sovereign rates of Italy, Spain and Portugal, which unveiled the vulnerabilities of the weaker peripheral European Union countries. Lastly, potential trade tariffs on the region's car and automotive parts by the U.S. administration, which is Germany's main export, will continue to pressure the manufacturers in Europe. Therefore, we see limited returns in Europe equity markets and advocate a Neutral stance.

With escalating trade tensions in the background, Japan may be the next target of trade talks with the U.S. as it has the third largest trade deficit with the U.S. at 12%. We downgrade Japan to Underweight as we believe Japan has lesser flexibility to negotiate as it relies heavily on the U.S. for its national security. In addition, in a bid to reduce the U.S. trade deficit, President Donald Trump may suggest that the Japanese Yen is undervalued against the U.S. dollar, fueling currency volatility, which is negative for Japanese equities.

We are turning more selective in Asia ex-Japan. Looking ahead, Asia's robust growth might be threatened as the potential strength of the U.S. dollar, rising tensions in global trade, and wider credit spreads could hurt consumer and business sentiments. Countries with widening current account deficits and require external funding remain vulnerable, such as the Philippines and Indonesia. These central banks may be forced to tighten monetary policies in order to maintain financial stability. Our convictions on China and Singapore remain unchanged. With China shifting towards a more consumption-based economy and innovative-driven development, sectors such as e-commerce, travel and technology would be the long-term beneficiaries. We expect the Chinese government to start fine-tuning their domestic tightening policies by further relaxation of the Reserve Requirement Ratio to support the small and medium-sized enterprises. We also expect the government to start increasing spending on infrastructure to support growth and we are likely to see more state-owned enterprise reforms in the months ahead. Our positive view on Singapore is premised on improving macroeconomic fundamentals with inexpensive market valuations and rising earnings growth.

Preferred Sectors

Financials:

The sector is well-positioned to benefit from interest rate rises and further deregulation in the U.S. Meanwhile, European and Chinese banks are also expected to be supported by a recovery in earnings, as well as undemanding valuations.

Technology:

We continue to see upside potential in the sector as it continues to post solid sales and earnings growth. The investment merits of technology extends well beyond pricing, where the growth of big-data, e-commerce and cloud-based solutions have changed the way traditional industries operate. These forces result in the technology sector exhibiting a strong secular growth profile.

Fixed Income

Key Highlights

- We continue to prefer Investment Grade names in the Emerging Markets and Asia space, as well as selective High Yield names in Developed Market and Asia.
- Carry remains the main component of returns in 2018.

In the credit space, our strategy remains broadly unchanged. We still prefer Investment Grade (IG) names in the Emerging Markets (EM) and Asia space for their relative value, and selective High Yield (HY) names in Developed Market (DM) and Asia for their higher component of carry.

The performance of IG bonds in both the DM and EM space continues to lag behind for different set of reasons. DM IG bonds with their lower credit spreads as rates rise, have continued to give weaker returns. EM IG bonds, on the other hand, have fallen victim to a strong dollar and rising U.S. interest rates. Nevertheless, the higher component of carry in EM IG bonds can help mitigate the impact of rising rates.

We believe that HY bonds can still provide a buffer against rising rates with their higher component of carry, and our preference remains in the DM HY bond space. However, we have downgraded EM HY bonds to Underweight. A stronger dollar and continued rise in DM interest rates means that pressure on EM is unlikely to disappear.

Asian credits have performed relatively well year-to-date and we retain our positive stance on this sector. We continue to like Asian credits for its resilience amid the recent spike in EM volatility, and for its relative value. The macro fundamentals of Asian credits have emerged to be in much better shape than comparable global EM peers. Asian credits also continue to offer a relatively higher yield than the other DM credits. The credit metrics for Asian corporates have improved over the past few years too and we have been seeing positive rating trends. Hence, we expect Asian credit spreads to end the year relatively unchanged, given their stable fundamentals. That said, we remain selective in Asian credits HY space. We would avoid weak Chinese industrials, small property developers and Local Government Financing Vehicles that have over-stretched balance sheets, and also issuers with opaque shareholding structures.

In our fixed income strategy, carry remains the main component of returns in 2018. The relatively flat Treasury and credit curves have made it more compelling for investors to look for bonds with a good component of carry. Hence, we prefer corporates over senior financials; Tier-2 and junior financial perpetual bonds of well-capitalised banks; selective Chinese state-owned enterprises (SOEs); and strong-structure corporate perpetual bonds. Floating Rate Notes (FRN) with a high reset margin is also preferred in the second half of this year. A diversification into FRNs can help protect and give investors a higher stream of income even as rates continue to rise. In the HY space, we like selective HY corporates from China and Singapore as these unrated and BB rated names can offer the best balance between return and risk. A diversified HY exposure approach through funds investment is also one of our preferred choices.

Preferred Sectors

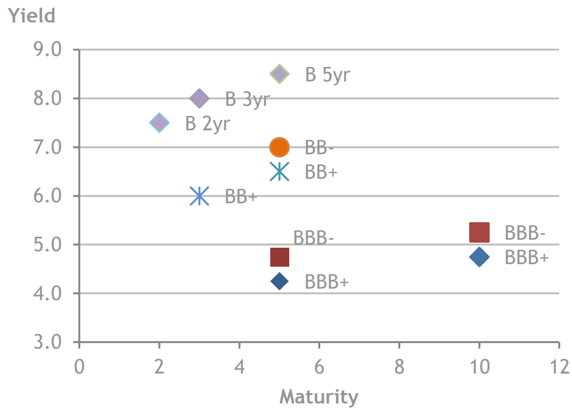
Financials:

Since the implementation of Basel-III, the capitalisation of global banks have gone from strength to strength. This remains the favoured sector as rising interest rates will also be beneficial for banks.

State-Owned Enterprises (SOEs):

We prefer Chinese SOEs and other government-linked corporates with established track records for their resilience amid the strong headwinds facing the credit market.

Asian credits median yield to maturity



Source: Bloomberg I June 2018

Currencies

Key Highlights

- The U.S. dollar is likely to remain mixed for the remainder of 2018, with more pronounced strength against Asia ex-Japan currencies compared to the major currencies.
- Monetary policy convergence is a theme to strategically position for into 4Q 2018.

The U.S. dollar is likely to remain mixed for the remainder of 2018. Against the major currencies, we believe that a milder downtrend is likely to remain in place for the second half of 2018, but we do not rule out bouts of U.S. dollar strength as witnessed in the past few months. We expect the dollar to remain strong against the emerging market and regional currencies due to concerns of ongoing trade tensions and tighter U.S. monetary conditions.

Monetary policy convergence remains a theme to strategically position for into the fourth quarter of 2018. Higher energy and commodity prices, as well as tighter labour markets in other developed countries including the United Kingdom, Australia and Eurozone, may translate into inflation and bring back the case of policy convergence at a later stage. This scenario would see other currencies' strength play catch-up. We see opportunities to buy EUR, AUD and GBP on dips.

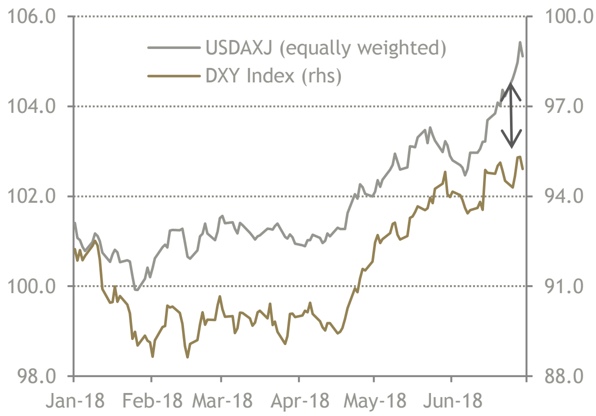
Though the European Central Bank (ECB) is expected to keep monetary policy stance status quo till summer of 2019, we see some chance that ECB may need to move earlier-than-expected (possibly within the next quarter) should inflation, growth and activity data continue to hold up well. We do not rule out the possibility that ECB may start to normalise deposit rate first at some stage, possibly as early as 4Q 2018, and this could be the catalyst for the next leg up for EUR. Monetary policy can still be accommodative to support growth even with a modest increase of 10 basis points on deposit rate to -0.3% from current levels of -0.4%.

The trade war has come at a time when China's domestic demand is starting to show signs of weakness amid deleveraging efforts and that could leave the Chinese yuan fundamentally weaker. We take that as a sign that China's monetary policy stance has tilted towards growth cushioning. In the event that China and the U.S. impose the trade tariffs on 6 July, another Reserve Requirement Ratio (RRR) cut in October 2018 cannot be ruled out. While the People's Bank of China (PBoC) could slow the depreciation in the Chinese yuan, USDCNY is still more vulnerable to the upside in the near future before tapering off into the last quarter of the year as economic data show improvement and trade tensions ease.

Most Preferred Plays

- Long EUR, GBP and USD versus short JPY on Developed Market monetary policy divergence.
- Long IDR versus short PHP and THB on South East Asia policy divergence and politics play.
- Short CNH versus long JPY as a hedge for escalation of trade protectionism.

Performance of DXY against major currencies and Asian currencies



Source: Bloomberg I June 2018

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