Kenanga Investors

Date: 17 August 2024

Diversify on volatility

StarBiz 7 (17 - 23 August 2024, Vol. 57)

The recent market correction was more of a technical one, driven by the unwinding of the yen carry trade and profit-taking following strong performances in most markets this year.

Going forward, investors will keep a close eye on inflation, employment figures and other economic data in the US. The Federal Reserve will assess the economic performance before deciding on monetary policy.

Weaker jobs data and slower inflation could allow see the Fed cutting rates earlier and more aggressively. Investors will also keep a keen eye on the US presidential election in November.

Investors are generally concerned over Donald Trump's proposal of 60% import tariff on China and 10% on the rest of the world. The high import tariff policy could be inflationary for the US and affect China's economy negatively.

Locally, investors will watch for:

- Continual fiscal reform measures by the government (e-invoicing, RON95 subsidy rationalisation, etc);
- Rollout of pro-growth and eco- nomic policies, including New Energy Transformation Roadmap, National Semiconductor Strategy, Johor-Singapore Special Economic Zone, major infrastructure projects (Penang LRT, Pan Borneo Highway in Sabah, various airport expansion, etc);
- FDI inflows, including semiconductor/E&E investments and data centres; and
- Many investors are also watching for the ringgit's pivot before investing into Malaysia. Following the weaker US economic outlook, the ringgit has gained strength against the US dollar and this may encourage more foreign inflows into domestic financial markets.

Global markets will likely remain volatile in the short term, driven by a combination of concerns about global growth, carry trade unwind and geopolitics.

As growth slows in the US, market opinion could fluctuate between a soft and hard landing. Key economic indicators, such as payrolls, unemployment and jobless claims will be keenly monitored to gauge the strength of the US labour market.

Additionally, the Fed's response to these economic conditions, particularly its interest rate decisions, will play a critical role in shaping market reactions.

The current market consensus anticipates a 25 to 50 basis point cut in interest rates during the Fed’s September meeting with a further two to three cuts by the end of the year. The best outcome for equities would be a modest slowdown in growth, together with monetary easing by the Fed.

However, if data deteriorates significantly to indicate a hard landing, global equities could face renewed pressure while fixed income would be a preferred place to hide.

In Malaysia, markets should remain supported on improving fundamentals and liquidity. GDP growth is gaining momentum on the back of an investment upcycle. This is supported by drivers such as infrastructure project rollouts, data centre investments, rising FDI and improving exports.

Towards year-end, the market will be eyeing further policy developments such as the property measures, wage policy, subsidy rationalisation and also details on the Johor-Singapore Special Economic Zone.

Given the potentially volatile environment in the shorter term, we recommend investors adopt a diversified portfolio approach. Fixed income could be used to hedge the risk of a slowdown in the US while also benefiting from interest rate cuts.

Nonetheless, for investors with a longer-term perspective, we still advocate a “buy on weakness” approach to take advantage of market pullbacks. We favour high-quality stocks where the structural growth drivers are still intact such as the global technology sector.

For Malaysia, we remain positive on the equity market this year despite recent volatility as we expect strong GDP growth on an investment upcycle, improving policy execution on infrastructure projects and rising FDI.

Sectors we continue to like include financials, construction, property, new energy and utilities. Additionally, we continue to like the technology sector as the key beneficiary of long-term growth trends such as AI, EVs and supply chain relocation.

Mitigate risk, diversify portfolio

Stay invested, and ignore the gyrations of early August. It was mainly caused by the Bank of Japan raising the benchmark interest rate, leading to a sharp increase in the yen, thus unravelling the yen carry trade, which is mostly over now.

It has been a record year of elections globally. This, as well as conflicts in Ukraine and the Middle East, will remain a major concern for investors. This will also include risks in policy shifts as governments change hands or incumbents choose to implement initiatives to stay in power.

Geopolitical concerns will continue to have an impact on trade and the global supply chain, as evident from shifts around the world.

AHAM Capital's associate director of equities Lim Chia Wei and investment writer Lee Sheung Un believe market drawdowns, such as the one on Aug 5, present opportunities for investors with a long-term perspective.

"History has shown that market downturns, while challenging in the moment, have the potential to reward disciplined investors who stay the course," they say.

AHAM Capital recommends gradually averaging into the market through regular investments over time, regardless of market conditions. "By consistently investing, particularly during downturns, investors can take advantage of market dips and lower the purchase price of their investments," they say.

Growth will certainly slow in the US, it is only by how much and when. US policymakers' response to economic conditions, and on the federal funds rate, will ripple through the capital markets, where the impact will also be dependent on the probability of a recession as well as the severity of the slowdown.

There is a strong case to start cut- ting the benchmark US interest rate after the Aug 15 release of data showed fewer people filed for unemployment benefits and retail sales remained robust. Coupled with the gradual slowdown in consumer prices, CME Group's FedWatch is showing the target rate leaning towards a 25bps cut in September. The current US tar- get market rate is 5.25% to 5.50%.

The FedWatch gauge shows the probability of another 25bps cut in November and there is a split between expectations of a 25bps and 50bps cut in December, depending on the pace of the US economy's slowdown.

The latest US data not only reinforces expectations of a rate cut in September but also reassures investors that the economy remains robust, with the soft-landing target still in sight. This helped boost Asian markets, which started off Aug 16 strongly and remained buoyant at midday, tracking US markets, with the Nasdaq gaining more than 2% the day before.

Given all the news flow and data, investors will be looking for leads on what to do next.

Tradeview Capital CEO Ng Zhu Hann advises that in times of uncertainty or heightened volatility, it is better to avoid risky assets and opt for safer, low beta investments such as dividend yielding equities or fixed income securities, especially if investors are not able to keep up with the pace of change.

“Many professionals often try to time the market and move their stock allocations between sectors. In my humble view, all sectors regardless will be impacted during a sentiment driven panic. It’s like everyone is rushing for the exits so no sector can be insulated entirely,” he points out.

Ng says besides staying away from overvalued growth stocks, it is better to put a good percentage of investments into liquid assets that can be easily cashed out should there be a sudden need for capital.

“For those who are sitting in profit position, it is good discipline to always increase cash position by locking in gains along the uptrend. Especially when the stock market has been rallying significantly for the first half of 2024, there is ample room to lock in gains along the way. Overcoming greed in good times is the best way to secure your downside during bad times,” he adds.

Kenanga Investors CIO Lee Sook Yee recommends a diversified portfolio approach, noting that fixed income could be used to hedge the risk of a slowdown in the US while also benefiting from interest rate cuts.

“Nonetheless, for investors with a longer-term perspective, we advocate a buy-on-weakness approach to take advantage of market pullbacks,” she says, adding that investors should look to stocks with structural growth drivers still intact such as global technology stocks.

For Malaysian equities, Kenanga Investors continues to like financials, construction, property, new energy, technology and utilities.

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Source:

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Diversify on volatility

LEE SOOK YEE

Kenanga Investors Bhd chief investment officer

■ Investors will keep close eye on US economic data

■ Global markets will likely remain volatile in the short term

■ Strong GDP growth expected for Malaysia

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Going forward, investors will keep a close eye on inflation, employment figures and other economic data in the US. The Federal Reserve will assess the economic performance before deciding on monetary policy.

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By FINTAN NG

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- Geopolitical concerns will continue to have an impact on trade and the global supply chain
- Growth will certainly slow in the US, it is only by how much and when
- 'Better to put a good percentage of investments into liquid assets'

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