January Outlook – Risk On Mode Favors EM Assets

SUMMARY

- **Positive growth momentum in the US and Europe saw the Fed and the ECB raising their growth outlook for the US and Eurozone in 2018 respectively.** Importantly, the Fed sticks to its projection for 3 hikes in 2018, despite upgrading its GDP growth forecast to 2.5% in 2018, from 2.1% forecasted in Sep-17. Meanwhile, the ECB revised its GDP forecast upwards to 2.4% YoY and 2.3% YoY in 2017 and 2018, and inflation is also revised marginally higher to +1.4% YoY in 2018. On the contrary, China signaled less emphasis on growth, pledging to focus on "critical battles" against financial risk, pollution and poverty in the next 3 years.
- **Easing manufacturing activity and inflation in Malaysia in Nov-Dec.** Malaysia's manufacturing PMI contracted to 49.9 in December, from a 43-month high of 52.0 in November as business conditions in the sector broadly stagnated. Meanwhile, headline inflation rose by 3.4% YoY in November, easing from 3.7% YoY in Oct-17. So far, the average inflation rate of 2017 is 3.9% YoY. Separately, Moody's affirms Malaysia's A3 rating with a stable outlook while BNM's international reserves up slightly at USD101.9bn as at Nov 30, 2017. The reserves position was sufficient to finance 7.5 months of retained imports and was 1.1x the short-term external debt.
- **Window dressing activity was seen in both local equity and bond markets.** As expected, KLCI upped close to 80 points on window dressing activities happened mainly in the 2nd and 4th weeks of Dec. The KL Finance Index was the clear outperformer versus the KLCI. Over to the bond market, the MGS curve bull steepened in December as the rally on shorter-end curve was underpinned by the ringgit's continued strength against the USD given market expectations on the OPR hike during BNM MPC meeting on 25 Jan.
- **Macro – Positive global growth not without headwinds.** Global outlook for 2018 anticipates a continuation of the recent trends of higher growth, steady inflation and rising Advanced Economy policy rates. For EM assets in 2018, we identify 3 main backdrops which support fund inflows to EM: 1) better corporate earnings on the back of global growth in 2017-18; 2) "Dovish" FOMC guidance despite incorporating potential growth to be boosted by fiscal stimulus which leads to the USD weakness. Also, Trump administration might start work on the Infrastructure Bill following its success in major tax reform. These 2 bills would eventually deepen the US's fiscal deficit, thus, further limiting the USD strength ahead; and 3) rising hard commodity prices have strengthened EM currencies.
- **Equities – We foresee the positive sentiment towards KLCI especially driven by banks** of which bottom lines would be enhanced by the largely anticipated OPR hike by BNM during the 25 Jan. MPC meeting. We shall therefore, gradually reduce equity exposure post MPC meeting as we take the view that the 14th General Elections could happen between March and April where investors, including foreigners, might take a cautious stance before elections. Our base case assumption is, of course, BN will still be able to win the incumbent elections and form the Federal government to carry through economic policies. Our KLCI target for 2018 is slightly higher than consensus at 1,890 based on 16.9x FY18 consensus EPS. The PE of 16.9x is slightly above mean of 16.6x.
- **Fixed Income & FX – MGS yields should see upside pressure in 1H18** due to the imminent OPR hike in Jan-18, election uncertainties as well as ample supply of govvies especially in April and May. **T**he 10y MGS yield has now benefited from foreign inflows alongside the strengthening ringgit. However, we do expect profit taking activity to kick in post Jan-18 MPC meeting. Over to the ringgit, 4 main backdrops which support its recovery mode: 1) stable US Fed policy move; 2) stable to positive-biased hard commodity prices; 3) the expected steady growth in China; and 4) risk-on mode which favors EM currencies.

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