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Asian markets to see correction post-US rate hike

Maybank Asset Management maintains positive outlook for Malaysia and Asia

by Dinesh Immanuel

WEAK economic data and the US Federal Reserve's impending move to raise interest rates will continue to cast a long shadow over global equity markets. Global funds are unsure how the market will react once the Fed raises its benchmark rate. Worst still, investors appear to be unable to time the hike.

The performance of global equity markets and large fund investment decisions this year reflect just that. Capital flows in and out of Asia portray reactive investment strategies by large global funds as opposed to proactive longer term investment decisions. Erratic capital flow also heightened volatility in Asian markets.

The local market is not spared. Riding on poor sentiment and selling pressure, the FBM KLCI broke the 1,800-point support level on May 12, raising concerns of continued downward bias moving forward.

With this as a backdrop, two of Maybank Asset Management's (MAM) fund managers, Abdul Razak Ahmad and Robin Yeoh Yern Jin, share their views in an email exchange with ***FocusM***. Abdul Razak is MAM Malaysia's chief investment officer while Yeoh is MAM group's regional head of equities. They also explain MAM's investment strategy for Malaysian equities this year.

"When the US finally hikes interest rates there may be a correction in Asian markets," says Yeoh. Despite this, Abdul Razak opines that the Malaysian equity market will end this year on a positive note, riding on improving global conditions and the local economy.

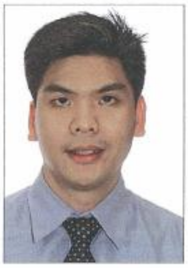
The following are excerpts of the email interview:

***FocusM:* What is the consensus expectation on the US interest rate hike?**

Yeoh: The consensus expectation is for the Fed to hike rates in Q3 2015 by 50 basis points (bps). The Fed is in a difficult situation as the soft macroeconomic data has limited its options. It appears that the Fed would like to normalise interest rates by raising it but has been constrained thus far by the lacklustre economic recovery since the global financial crisis.

Interest rates have been kept at 25bps since the financial crisis in 2008, and seven years have passed. As it stands, US gross domestic product (GDP) growth in Q1 was just 0.2%, indicating that the US economy is still weak. This means any increase in interest rates may tip the economy into a downturn.

Abdul Razak says the Malaysian equity market will end this year on a positive note, riding on improving global conditions and the local economy



When the US finally hikes interest rates there may be a correction in Asian markets, says Yeoh

But if the Fed does not raise rates, there is a risk that the Fed will be left with very few (options), should the US goes into the next (economic) downturn.

How will the market react once the US Fed makes a decision on interest rates?

Yeoh: When the US finally hikes interest rates there may be a correction in Asian markets. Asia is a subset of emerging markets and is typically viewed as a more risky asset class among large global investors. A hike in interest rates may see a period of risk aversion by investors leading to a sell-off in emerging market and Asian markets in the short term.

The correction may be more limited this time compared to the last interest policy-driven correction in 2013. In 2013, scares of higher interest rates saw markets in Asia fall by between 7% to 25%. This is because a lot of Asian currencies have already weakened to crisis levels, implying that the markets have discounted a portion of the upcoming hike in US interest rates.

How have Asian indices performed so far this year?

Yeoh: In general, Asia has done well with most Asian markets recording positive gains. Asian markets have generally benefited from monetary easing by central banks around the world.

Strong gains were seen in the Chinese and Hong Kong markets. The two markets were up by more than 10%, as these two markets have benefited from the Shanghai-Hong Kong Stock Connect (SHKSC). Chinese stocks listed in Hong Kong surged after domestic Chinese mutual funds were given access to Hong Kong-listed Chinese stocks under the SHKSC. These Chinese funds exploited the valuation gap where the Hong Kong-listed shares were trading at a huge discount to the companies listed in Shanghai.

Stock market performance was more muted in Asean with Singapore and Malaysia up modestly. Thailand and Indonesia on the other hand were flat to slightly down.

Asean corporate earnings have been relatively disappointing on the back of weaker-than-expected GDP growth in Q1. In addition, investors may have also been switching out of Asean markets to North Asian markets. For the rest of the year we continue to expect modest gains in Asian markets but Q3 may be volatile.

Though markets are up, the underlying economic data globally has been weak.

What are the good signs in key sectors?

Abdul Razak: The positives are:

1. The construction sector will be catalysed by the rollout of the 11th Malaysia Plan. The government has committed RM250 bil on development expenditure;
2. The exports sector is gaining from the weak ringgit and improving demand from overseas, benefiting glove manufacturers and technology stocks;
3. The utilities sector is benefiting from lower commodity prices, aside from their resilience and visible earnings growth;
4. Consumer staples and REIT sector gems may shine in the volatile market environment, especially high-yielding and defensive stocks;
5. Oil and gas stocks' value has emerged following last year's correction. We believe that the gradual recovery in crude oil prices will support earnings.

Please explain your KLCI outlook this year.

Abdul Razak: We are expecting the KLCI to end the year higher than current levels at 1,900 points (a 5% upside). This will be mainly due to:

1. Stabilising corporate earnings results post-GST implementation and other cost adjustments. The lower corporate tax rate will also lead to a higher profit, all other things being equal;
2. Higher domestic consumption growth coinciding with the lower personal income tax rate;
3. The 11th Malaysia Plan which will lead to higher public and private spending and investment;
4. The stabilising of crude oil and palm oil prices will give the government more flexibility in terms of managing the economy; and
5. The relatively weak ringgit will continue to help Malaysia's export competitiveness. FocusM