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Cautiously Optimistic on 2022

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By Cecilia Kok

IT has been a lacklustre year for Malaysia's equity market.

Battered by series of setbacks – such as the reimposition of lockdowns due to rising Covid-19 cases; political uncertainties that eventually resulted in the change of Prime Minister; forced labour allegations against certain manufacturers, including glove players; and a sluggish economy, among others – the benchmark FBM KLCI is looking to end 2021 in the red.

The FBM KLCI, which comprises the top-30 largest companies on Bursa Malaysia by market capitalisation, has so far lost about 7% since the beginning of the year.
That puts it the second worst-performing market in Asia after Hong Kong's Hang Seng Index, which has lost about 15% year to date.

The Malaysian equity market appears to be fraught with even more challenges in the year ahead due to domestic factors such as earnings risk and political uncertainties as well as external headwinds such as a a change in United States monetary policies and rising geopolitical tensions.

StarBizWeek caught up with six fund managers to get their take on what they think is in store for the stock market in 2022, and how they plan to navigate the risk in equity investing.

UOB Asset Management (Malaysia) executive director and CEO Lim Suet Ling sees the possibility of local institutional investors turning net buyers of Malaysian equities in the year ahead vis-a-vis their net selling position thus far in 2021.

Lim says positive flows from local institutional investors will provide support to the local equity market in 2022 amid the anticipated volatility.
Lim reveals that her team's strategy is to focus on companies that would benefit from economic reopening and strong commodity prices, as well as those that command undemanding valuation

Affin Hwang Asset Management senior portfolio manager David Loh says his team, on the other hand, is adopting a more "defensive" strategy for 2022, as they remain cautious on the prospects for the local equity market in the year ahead.

Ismitz Matthew De Alwis, Executive Director & Chief Executive Officer of Kenanga Investors Berhad

Loh says his team is looking at holding higher levels of cash to cushion against volatility, while giving them the flexibility to reinvest when market conditions improve.

He points out that the group sees opportunities in banking and technology stocks.
Eastspring Investments Bhd investment services manager Ang Hin Yik, meanwhile, prefers small and mid-capitalisation (cap) stocks to large caps, citing better opportunities.

Ang is also cautious on the prospects for the domestic stock, as he reckons earnings growth would likely take a hit because of the introduction of the prosperity tax for 2022.

Nevertheless, Ang remains positive on the technology, industrial and consumer sectors. Ang points out that environmental, social and governance (ESG) factors will also be an important market driver.

RHB Group Asset Management managing director and CEO Eliza Ong expects an uptrend in the equity market that will come with bouts of volatility due to US tapering and inflationary concerns, among other things.

Ong says her group's strategy is to focus on the reflation theme and continue to be positive on the economic reopening theme.

Ong is generally positive on the Asian region, noting her optimism on companies that are at the leading edge of technological innovation and those that would benefit from the global move towards supply chain resilience and independence.

Kenanga Investors Bhd executive director and CEO Ismitz Matthew De Alwis is similarly positive on the outlook for the Asian market in general, particularly China/Hong Kong and Asean (including Malaysia).

De Alwis is, however, wary about inflation risks, and the detrimental effects rising prices have on markets and economic growth.

In terms of stock selection, De Alwis is positive both on secular growth tech companies and certain cyclical/value sectors such as tourism, travel, consumer, property and financials.

De Alwis is also paying attention to companies that will benefit from the increasing shift towards the ESG elements.

As for Principal Islamic Asset Management CEO and Principal Group head of Islamic business Datuk Paduka Syed Mashafuddin Syed Badarudin, preference will only shift to Asia in the second half of 2022.

Mashafuddin reveals that his group still favours developed markets towards end-2021 and into the first six months of 2022, noting that developed economies are expected to continue registering resilient growth and robust corporate earnings during this period.

Despite the pandemic and political uncertainties, Mashafuddin sees opportunities in financials, consumer discretionary, basic materials and selective technologies such as fifth generation (5G), fintech, healthtech and greentech. He also likes sustainable investing.

Below are excerpts of the question and answer with the fund managers:

How do you see the equity market going into 2022?

Lim: Our view is that the Malaysian equity market next year would be supported by economic reopening (after long periods of movement restrictions in 2021), higher commodity prices (especially for oil and palm oil) and undemanding valuation.

However, in comparison to its Asean peers, earnings growth for Malaysia in 2022 appears to be on the lower end, partly due to the one-off impact from the prosperity tax. This could pose a challenge in terms of attracting foreign portfolio inflows.

Nevertheless, we see scope for improvement in local institutional flows in 2022, as compared to their net selling totalling RM9.9bil year-to-date in 2021.

This expected improvement in fund flows would provide support to the domestic bourse.

Loh: A confluence of factors that has emerged recently is prompting us to be more cautious going into 2022. The discovery of the Omicron variant is a perfect reminder to the world that the pandemic is far from over.

Initial optimism from economic reopening has been wiped out by the introduction of prosperity tax in Budget 2022.

As earnings growth has always been the primary driver of market, its absence makes it difficult to envisage a bullish year ahead.

To make matters worse, the US Federal Reserve (Fed) is contemplating accelerating its tapering programme, underpinned by strong inflation data.

The effect of such a move will pull back liquidity and exert pressure on emerging market currencies, making us a less attractive investment destination.

Ang: We think Malaysia lacks positive catalysts to drive the market as corporate earnings will take a hit in 2022. This is a result of the Cukai Makmur, or prosperity tax, as announced in Budget 2022. This will dampen earnings growth for yet another year.

Nevertheless, Malaysia's macro outlook should be more positive going into 2022, given the high level of Covid-19 vaccination rates among adults and similarly good trends for the adolescent age group.

If Covid-19 cases in Malaysia and globally can be contained, reopening plays may continue to perform well.

The risk of domestic political tensions seems contained until mid-2022, as the Pakatan Harapan coalition had earlier agreed to a "cease-fire" at least until then.
Externally, there is the risk of a stickier US inflation, which may result in accelerated Fed tapering and faster US rate hikes. These could result in outflow of funds from emerging markets.

Mashafuddin: Despite the pandemic and political uncertainties, the market in 2022 will still offer opportunities in certain sectors, including financials, consumer discretionary, basic materials and selective technology.

At the same time, we believe that there are opportunities in both emerging and developed markets.

With Malaysia's vaccination rate already exceeding 78%, we believe investors are anticipating for the economy to reopen in a more sustainable manner, which will provide a much-needed boost to the sentiment and market.

Ong: While the reopening of the country's economy could drive corporate earnings, the introduction of Cukai Makmur next year could dampen growth.

We expect the earnings of large market capitalisation stocks to be impacted by the one-off tax in 2022. The impact, however, may not be as severe as expected as the fundamentals of most companies are now in a better condition.

Growth of global gross domestic product (GDP) for 2022 will likely to remain above the long-term historical average, thereby supportive of the global equity markets.

However, we believe that the uptrend in the equity market is not likely to be smooth and volatility is expected to persist due to the following:

> Concerns over high US and global inflation;

> Rising US and global government bonds yield;

> US tapering in 2022;

> China's power shortage from third quarter of 2020, which would have a short-term negative impact on the recovery in the global economy in the first half of 2022;

> Continued concerns over Covid-19; and

> Geopolitical tensions.

Another factor that may have an impact on the direction of the market is the recent resurgence in the new Covid-19 cases globally due to the waning effects of the vaccines, lack of vaccination in some countries and possible mutation of the virus overtime.

This development may lead to certain countries re-implementing lockdowns, though these might not be as widespread as in early 2020.

In such a scenario, the supply chain bottlenecks and labour shortage problems might take longer to resolve and would slow down the pace of the economic growth. Having said that, we do not foresee global growth to collapse even in this case.

De Alwis: We are still positively biased in our market outlook, particularly in the first half of 2022. Growth outlook remains on an improving trend and rates are still low. These in general are positive for global equities. Region-wise, we favour emerging market equities as the recovery picks up pace.

Considering that lockdowns had persisted in several emerging Asian economies throughout 2021, we believe these nations should recover quicker when the re-opening prompts a resurgence in economic activity.

In addition, China's challenges in 2021 such as growth slowdown, policy tightening, property defaults and power shortages should abate in 2022. China's policy could also shift to an easier bias as leaders assess the slowing growth data.

As a result, we are more positive on China/Hong Kong and Asean (including Malaysia) for 2022.

How sustainable is the current economic recovery?

De Alwis: Overall, the global economy is likely to continue on its path to recovery after a contraction in 2020. Based on Bloomberg's consensus forecast figures, global GDP will still expand at a decent pace of 4.4% in 2022 after a projected expansion of 5.8% in 2021.

Despite this, the growth dispersion between countries could be high, as the leaders of 2021 take a step back, while the laggards catch up.

Emerging markets look set to pick up, while developed markets such as the United States slow slightly from a high base of growth in 2021.

With regards to the pandemic, the Omicron variant could pose some downside risk to growth through renewed restrictions. But there are also some mitigating factors such as better treatment options, with the development of anti-viral pills from Merck and Pfizer; as well as rising vaccination rates.

Mashafuddin: In general, for the first half of 2022, we expect global growth to continue to be driven by economic reopening, the rundown of excess savings, and business restocking.

But we expect GDP growth rates to normalise in the second half of 2022, with accumulated savings mostly exhausted, quantitative easing reduced and economic reopening largely completed.

Ong: The global economy is expected to see one of its fastest paces of recovery in 2021. However, this is unlikely to repeat in 2022, as the global economy transitions into a more normalised state of growth.

We expect major developed markets to continue growing through the middle of 2022, before gradually moderating as the positive government policy impulses wane. Along with rising core inflation, this should result in a moderate monetary policy tightening eventually.

Asia in general has controlled the spread of the Covid-19 pandemic more effectively than the developed markets, but this came at the cost of higher restrictions.

Going into next year, Asia – which had been the laggard in reopening, particularly South-East Asia and India – is set to see growth accelerating as removal of restrictions is expected to drive revival of economic activities.

Rising vaccinations in Asean, in particular Malaysia, would pave the way to sustainable economic recovery.

The significant fall in Covid-19 cases has led to governments opening up the economy gradually. We have seen manufacturing activities recover, with the Asean manufacturing purchasing managers' index (PMI) improving to 53.6 in October from 50.0 in September.

Malaysia's manufacturing PMI improved to 52.2 in October from 48.1 in September.

The global economy is still growing, judging by the recent JP Morgan global manufacturing PMI, which improved to 54.3 in October from 54.1 in September. This would support economic recovery and gradually ease the supply-chain disruptions arising from the earlier lockdowns.

In our opinion, the recovery in manufacturing activities would also support the performance of export growth for Asean countries.

How do you view the inflation risk?

De Alwis: Prices have been rising, driven by recovering demand, issues in supply chain and rising commodity prices.

If this proves to be non-transitory and persists well into 2022, it might have a detrimental impact on growth and markets.

Inflation affects the market negatively via rising cost pressures for companies and also prompts central banks to tighten monetary policy; hence market focus towards the second quarter of 2022 would likely shift towards the timing of the first rate hike by the Fed and guidance for the future pace of hikes.

Mashafuddin: Our expectation is that inflation will likely begin to moderate or reverse in the second half of 2022, alongside easing pressure on the supply chain. We expect supply-demand mismatches will be resolved, as demand shifts back from manufactured goods towards services.

We also expect energy prices to stabilise, as new production capacity comes online in key regions. This will reduce the pressure on consumers, interest rates and corporations, thus supporting equities.

Ong: High US inflation is the main concern for the economy and the financial markets in 2022. The Fed has projected an upward inflation trajectory of 4.2% annual gain in 2021, which is stronger than the previous estimate of 3.4%.

However, the Fed still expects inflation to moderate to 2.2% in 2022. Core inflation is also anticipated to rise sharply to 3.7% and ease to 2.3% in 2022.

The Fed acknowledged that inflation is elevated but this is largely reflecting factors that are expected to be transitory.

The main risk now is whether the inflation will trend down in 2022 as projected. Higher inflation may put pressure on central banks to hike interest rates in the near future, sooner than expected.

The Fed had said it would only decide on whether to begin raising its key short-term interest rate after the tapering exercise is completed, which is expected to be in the first half of 2022.

This raises concern about whether the Fed would be behind the curve if they are not acting fast enough in view of the escalating inflation expectations.

The base case held by investors generally is that the current inflation pressures are due to disruptions in the supply chain from factory closures, tight labour supply

and delays from transportation bottlenecks following the lockdowns triggered by the Covid-19 pandemic.

In addition, the reopening of the economy has driven strong demand for goods. Most of the companies have resorted to hiking the prices of goods produced to offset the increase in the costs of production and transportation.

We expect supply chain disruptions to be gradually resolved and demand for goods to moderate as services spending rebounds and the peak fiscal boost fades.

The supply-demand imbalances in the goods sector would moderate enough for prices (inflation) to begin to normalise next year.

Inflation in Asean is still benign and the rise in manufacturing production costs is not likely to impact corporate earnings negatively.

Asean corporate earnings have been strong in 2021 despite the lockdown and previously high Covid-19 cases.

How would you approach the equity market in light of the anticipated challenges for 2022?

Ang: For 2022, we see more opportunities in the small and mid-cap space compared to large caps.

We continue to see opportunities in the technology, industrial and consumer sectors but remain very selective as valuation is a key consideration.

We expect ESG factors to continue being an important market driver.

Lim: We would position ourselves in companies that could benefit from some of the factors we discussed earlier (economic reopening, higher commodity prices and undemanding valuation).

The reopening of the economy after long periods of movement control in 2021 is positive for sectors such as retail.

Besides that, we are also looking at sectors that could benefit from higher commodity prices. We see opportunities in selected oil and gas-related companies, whose stock price performances are positively correlated to improvement in crude oil prices.

We also like the manufacturing sector, particularly technology-related names. Many of these companies are export-focused and they are set to ride on the rebound of the global economy. Some of these companies are also benefitting from secular trends such as trade diversion as a result of US-China tensions.

Loh: We will adopt a more defensive position going into 2022, with an emphasis on liquidity and quality. Cash levels have been raised, which will provide us a cushion against volatility as a well as the flexibility to redeploy when market conditions improve.

In 2022, the most important thing to watch is the development of Covid-19 treatments, especially one that is effective against all known variants including Omicron. This could set the tone for a firm transition into an endemic phase of the virus globally and result in a more sustainable economic reopening.
Our key themes are:

> Banks – on expectation of higher rate cycle and improving asset quality; and

> Technology – on strong earnings visibility, driven by secular growth trends, and it being more insulated against recent tax hikes.

De Alwis: In terms of stock selection, we remain positive both on secular growth tech companies and certain cyclical/value sectors such as tourism, travel, consumer, property and financials.

We think there is still a long runway for growth in the tech sector with various development in areas such as virtual reality, electric vehicles, artificial intelligence/machine learning, 5G and Internet-of-Things (IoT).

These developments continue to benefit both the tech giants listed in the United States and the myriad of companies that make up the supply chain in Asia as well as Malaysia.

Additionally, the shift towards ESG will continue and this will benefit companies in sectors such as electric vehicles, battery technology and renewable energy. With regards to cyclicals, opportunities will be more stock specific as selected regions progress along the reopening timeline.

Mashafuddin: Our house view remains favourable around the reopening plays, laggards as well as sectors with structural or secular growth stories such as green policies, e-commerce, cloud computing and IoT.

Our approach in terms of stock selection for next year is focused on certain sectors which include financials, consumer discretionary, basic materials and selective technology such as 5G, fintech, healthtech and greentech.

In addition, we focus on quality companies, with strong business moat and market share gainers; and winners of the economic recovery.

We favour sustainable investing, supported by carbon neutral pledges, the US rejoining the Paris Agreement, and substantial inflows into ESG funds and exchange-traded funds.

We are conscious of events that are worth noting such as the progress of policy tightening, particularly in the developed economies, inflation and the emergence of new Covid-19 variant.

The market volatility is a constant reminder of the value of being diversified across markets and sectors.

We believe that there are opportunities in both emerging and developed markets. We continue to advise investors against hasty shifts in investment decision and recommend staying invested.

We are in favour of developed markets moving to year-end and the first half of 2022.

Developed economies are expected to continue registering resilient growth and robust corporate earnings.

Our preference is likely to shift to Asia during the second half of 2022.

With vaccination rates in Asia rising rapidly, leading to enhanced economic reopening, we expect economies in the region to regain growth leadership in the second half of 2022 (and better corporate earnings) leading to further improvement in capacity utilisation. This will help ease supply bottleneck and inflationary pressures.

Ong: One of the key drivers' of 2022 growth will be the reduction of Covid-19-related restrictions.

Although the virus will continue to be a concern, the increasing access to vaccinations, booster shots, treatments and medications should mitigate the magnitude of the downside risk. These will likely support further recovery in sectors such as travel, entertainment and the consumption of other services.

So, our strategy is to focus on the reflation theme and continue to be positive on the economic reopening theme. The continuous improvement of the Covid-19 situation should lead to governments globally gradually reopening their economies in 2022. The path, however, will most likely be uneven and bumpy.

Asean countries are gradually relaxing lockdowns and cross-border travels as vaccination programmes gain pace.

We expect demand to improve on the back of economic reopening and ease of restriction mobility.

As the economy moves from recovery phase to expansion phase, it brings along an acceleration in core inflation. Therefore, we expect monetary and fiscal policy normalisation.

Sectors such as industrial and commodities should benefit during the expansion phase.

The improvement in the economy and the possible rise in interest rates would likely benefit the banking sector. The improvement in loan growth and likely lower provision due to the improvement in the economy would be positive for banking sector's earnings. In addition, inexpensive valuations would also support banking stocks.

Apart from this, with the closure of the COP26 (the 26th Conference of Parties of the United Nations Framework Convention on Climate Change), an annual global climate summit, more nations had committed to reach net-zero emission, along with three key pledges – reduction in coal emission and methane emission, and deforestation.

Our portfolio, therefore, continues to be positive on this structural shift that would benefit carbon-neutral industries.

We are also positive on Asian companies that are at the leading edge of technological innovation, which would, among others, include the upstream technology hardware sector, electric vehicle sector and battery supply chain.

We are also investing into Asian companies that will benefit from the global move towards supply chain resilience and independence as the world becomes more bifurcated and politically more complicated.

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Source:

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MARKETS

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stock market outlook 2022

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This advertisement has not been reviewed by the Securities Commission.

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