

Market Insights from Principal

Helping you navigate today's markets

We realize that we're weathering a market storm. But, we believe in the fundamentals and know there are opportunities in every market condition. We're here to help you navigate this ride through portfolio diversification that align with your risk tolerance. Our perspectives and recommendations below.

Wave of worry

Investors began 2020 with hopes for strengthening global growth, but tempered by high valuations and pockets of geopolitical risk. The latter saw investors having to re-evaluate risk, potential elevated volatility and lower returns.

In early February, worries quickly turned to COVID-19 (coronavirus), which was spreading through China leading to quarantine measures. Yet, while Asian markets dropped, United States and European markets shrugged off concerns, allocating the problem squarely on Asia's shoulders and continuing to register new record market highs by mid-February.

Coronavirus fears grow

In late-February, COVID-19 fears took a firm grasp of markets as investors realized the risk wouldn't be isolated to Asia. The shock-originally expected to weigh on global growth through a hit to China's 1Q GDP growth figure - was likely to impact activity across the global economy as governments began to consider mimicking China's "Draconian measures" in their own countries. In turn, earnings forecasts are revised lower. In addition, concerns of empty grocery shelves, school closures, and travel bans weighed on markets, and pushed them into negative territory.

What next?

While policymakers can't stop the spread of coronavirus, they still have an important role to play. The U.S. Federal Reserve (Fed) delivered a second inter-meeting cut on 15 March, lowering the target range for the federal funds rate to 0% - 0.25%, a level unseen since 2015.

They accompanied this move with a decision to increase its holdings of Treasury securities by at least USD500 billion and its holdings of agency mortgage-backed securities by at least USD200 billion. The Fed also introduced several liquidity and funding measures, including lowering the spread at the discount window and encouraging banks to use their capital and liquidity buffers.

What do we think?

The Fed's move is a 4-pronged strategy to:

1. Mitigate the potential slowdown in U.S. economic activities;
2. Supply liquidity to the economy to allow continuity and transactions to be executed;
3. Ensure the credit market continue to function properly and corporates can source funding at reasonable cost; and
4. Lastly, sustain consumer confidence and mitigate job losses.

After the coordinated monetary policy actions by the U.S. and other major economies' central banks; we would be looking for a global fiscal response. This would target parts of the economy that need it most.

When can investors expect the bleeding to stop?

Market timing has generally proven difficult for investors; the timing of events such as those caused by the spread of COVID-19 can be erratic. Within Principal's multi-asset investment capability, we have universal agreement on the key indicator to a more stable investment market: **Investors need to believe the virus is behind us.** Once this proves true, we believe global markets will begin to recover.

Our investment recommendation

We recommended split strategy encompassing 60% Equity and 40% Fixed income. We would progressively buy into equities during corrections, while Fixed Income provides stability through the storm.

Equity: Large cap, high quality defensive growth stocks are favoured.

- Domestic-driven stocks would benefit from fiscal stimulus and are less exposed to external demand risks.
- Prefer Asian equities to developed markets as new cases of COVID-19 have peaked in Asia (especially Greater China) as compared to Western developed markets which are experiencing acceleration in new cases.
- Valuations of Asian equities are also cheaper (Price-to-Earnings Ratio at 11.8x vs 15.5x, Price-to-Book Ratio at 1.35x vs 3.0x) and has been lagging developed markets' performance since 2011.

Fixed Income: Central banks of Malaysia, Indonesia and Thailand are expected to cut interest rates further.

- Prefer Investment Grade to High Yield.
- Prefer corporate credits with strong balance sheet and cashflow.
- Duration is at Neutral for Indonesian and Thai portfolios while Malaysia is slightly above.

Our thoughts by region

Region	Strategy
Global	Assume the viral outbreak in developed markets is contained, with new confirmed cases peaking in a matter of months. We are Neutral on a global basis. <ol style="list-style-type: none"> 1. Slight overweight of U.S. owing to relatively better economic condition and a more favourable valuation. 2. Underweight Europe and Japan because of weak economic momentum and poor earnings.
Asia Pacific ex Japan	<ol style="list-style-type: none"> 1. Rate Asia Pacific equities as a BUY on a 12-month horizon. 2. Pull-back on COVID-19 fears should be seen as buying opportunities. Stock in China to benefit from credit and fiscal stimulus. 3. Chinese market has outperformed YTD as China has successfully prevented the spread of COVID-19 and allowed economic activities to recover. 4. Defensive portfolio positioning – buy more REITs and cut exposure to financials. Move towards large cap, high quality, defensive growth and domestic companies in the tech space. 5. In ASEAN, prefer Singapore and Indonesia. Sector-wise, overweight technology, industrials and selected financials.
Malaysia	For Equities <ol style="list-style-type: none"> 1. We are tilting the barbell approach from growth bias to capital preservation mode. 2. Sector in focus will be those with defensive and high yielding qualities. For Fixed Income <ol style="list-style-type: none"> 1. Malaysia's bond market supported by expectations of lower interest rate and ample liquidity in the system. 2. Defensive portfolio, focusing on high-grade names for credit protection as well as a neutral duration stance. 3. Take the opportunity to invest in government bonds and government related bonds, in view of the recent correction. 4. Credit selection remains the key for portfolio returns and will continue to “cherry-pick” issuers with stronger and more resilient credit metrics.

Takeaway

Investors have long known that staying the course is one of the most important things to do – it’s just emotionally hard to execute. At this junction, we advocate investors to avoid panic-actions and stay focused on their long-term investment goals and objectives. If they invest regular, buy the dip and rebalance their portfolios, they’ll end up benefiting from market corrections in multiple ways. What we recommend:

- **For conservative investors** – funds in mixed assets with a combination of growth and income either globally or regionally diversified.
- **For investors with higher risk tolerance** – focus on growth-oriented funds that offer exposure to growth areas in Asia, China and Global REITs.

Fund recommendations by risk profile

Conservative	Moderately Conservative	Moderate	Moderately Aggressive	Aggressive
Universal				
1.Principal Islamic Money Market	1.Principal Bond 2.Principal Islamic Lifetime 3.Principal Islamic Lifetime Sukuk 4.Principal Islamic Global Sukuk	1.Principal Balanced Income 2.Principal Global Multi Asset Income 3.Principal Balanced 4.Principal Global Preferred Securities	1.CIMB-Principal Equity 2.Principal Global Real Estate 3.Principal DALI Global Equity	1.Principal Global Technology 2.Principal Asia Pacific Dynamic Income 3.Principal Asia Pacific Dynamic Mixed Asset 4.Principal China Direct Opportunities 5.Principal Greater Bay
Shariah-compliant				
1.Principal Islamic Money Market	1.Principal Islamic Lifetime Enhanced Sukuk 2.Principal Islamic Lifetime Sukuk 3.Principal Islamic Global Sukuk	1.Principal Islamic Lifetime Balanced 2.Principal Islamic Lifetime Balanced Growth	1.Principal DALI Asia Pacific Equity Growth 2.Principal DALI Global Equity 3.Principal DALI Equity	1.Principal Islamic Small Cap Opportunities 2.Principal Islamic Asia Pacific Dynamic Equity 3.Principal Islamic Malaysia Opportunities

* Fund recommendations are based on market dynamic as of March 2020 and subject to changes from time to time.

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The price of units and distributions payable, if any, may go down as well as up.

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