Investment Outlook

June 2020

In alliance with CIMB

Road to Recovery

Countries around the world are gradually easing their restrictions to allow economies to recover. However, the road to recovery remains riddled with uncertainty.

Amidst such uncertainty, it's important to stay on the pulse of the current economic climate. Which is why our investment experts placed a stethoscope into the beating heart of the economic landscape to put together this market outlook for your benefit. Here at Principal, we're committed to providing you with timely market insights to help you navigate today's market conditions.

Summary

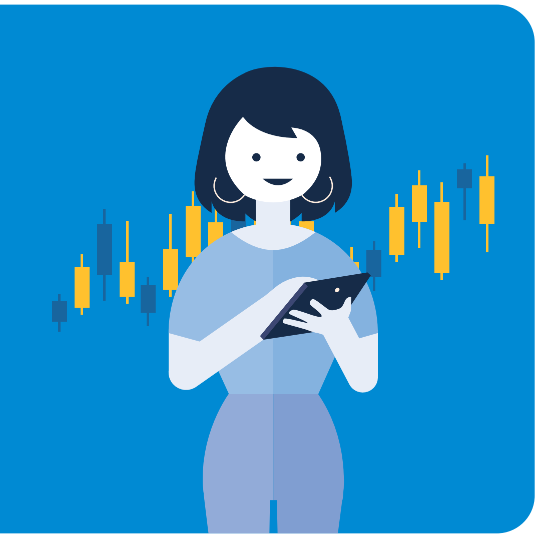
- Around the world, economies are gradually re-opening for business in stages– a move supported by the large pockets of liquidity created from monetary loosening, quantitative easing measures (QE), and fiscal stimuli packages introduced by governments.
- We remain positive on Asian equities on a 12-month basis. This is due in part to attractive valuations, and the fact that Asian economies have more room for the introduction of new policies as opposed to other economies.
- We've added ASEAN names into our portfolio strategy in anticipation of a broader recovery.
- We're increasing exposure to equities relating to fixed income, as policymakers are likely to take a momentary pause from announcing new measures. This is to allow them to assess the impact of the policies implemented earlier.

Market focus in the near term

We've entered into a phase of gradual economic recovery from COVID-19

- Fiscal and monetary support-policies throughout US, Europe and Asia
- Outlook of consumer demand in developed regions

However, we're monitoring the possible resurgence of US-China trade tensions that could impact markets



What should investors do?

- Stay invested, but make sure your portfolio is diversified across asset classes (and meets your risk tolerance)
- Income/Dividend focus
- Stay focused on your long-term goals

What should you focus on?

If you're a conservative investor:

- Malaysian bond funds
- Well balanced income-focused funds

If you're an investor with a stomach for risk:

- Growth-oriented funds that offer exposure to growth areas in China, Asia-Pacific, Global Technology and ASEAN regions
- Aggressive Malaysian funds

Macro Overview

Market	Overview	Recommendation
Developed Market Equities	• Purchasing Managers' Indexes (PMI) of developed markets expected to likely accelerate throughout Q2 and Q3 of 2020 as countries further ease restrictions. • Recent improvement in US employment data hints at a faster-than-anticipated economic recovery. • Proposed EU recovery fund expected to help European countries recover faster. • Aggressive monetary easing by central banks would continue to support equity markets. • We have a neutral allocation for US, Europe and Japan.	**Hold**
Asian Equities	• We've added ASEAN names into our investment portfolio as part of anticipation for a broader economic recovery. • With long-term implications in consideration and signs by our experts, we've decided to overweight our portfolios in China and Singapore as both are expected to outperform their sector averages. • Focus is centered on darling companies that have a long and stellar history of wins, with favorable supply discipline, little competition, and possess significant brand equity.	**Buy**
Malaysian Equities	• The capital market is flushed with liquidity following interest rate cuts and the ensuing introduction of a RM295 billion fiscal stimulus package by the government. • We've raised equity allocation to 90% by buying into Banks and Plantation sectors, as well as value stocks as a proxy for post-pandemic recovery. • We're centering our focus on quality stocks with resilient earnings and historically stellar track records.	**Hold**
Malaysian Bonds	• The Overnight Policy Rate (OPR) has experienced a cumulative reduction of 100bps over the past 5 months. Movement and direction of the OPR will be dependent on the effectiveness of stimulus measures rolled out so far. • Low interest rates due to accommodative monetary policies are likely to continue given the political uncertainties, and weak 2Q20 data.	**Hold**

Global Overview

Paired with the volatile political climate of the US, the economic challenges caused by the pandemic sent ripples across global markets. However, risk assets are beginning to look past headwinds. Recent data revealed positive economic reactions across the board to stimulus efforts by respective governments, and the gradual reopening of businesses.

The US economy received the economic equivalent of an adrenaline shot, with incomes experiencing a 10% (US$2tn) month-on-month surge since April from unemployment cheques. However, the pace of layoffs in the US has begun to slow as parts of the US reopen– and the better-than-expected US unemployment figures in May additionally help paint a better picture of external demands.

Additionally, global economic activities proxied by Purchasing Manager's Indexes (PMI) are most likely to see rapid acceleration over 2Q-3Q 2020 as major countries begin to re-open their markets.

The Positives

- Risk sentiment (risk appetite) among investors has recovered sharply, due to the combined positive affirmation and effects of stimulative fiscal policies introduced by governments.
- The aggressive balance sheet expansion by major central banks has helped pushed liquidity into all types of risk assets, including equities.
- Considering that inflation is not a threat and that economies and job markets have not healed fully, governments and policymakers are unlikely to table moves to withdraw stimulus efforts anytime soon.
- China's manufacturing and service sectors have started to show visible signs of life and are slowly recovering, providing a precursor of what a path to recovery may look like for other re-opening economies.

The Risks

- Some governments like India and Pakistan are easing lockdown measures despite a high reporting of COVID-19 cases. Countries that reopen economies before the number of COVID-19 cases plateau and decrease could potentially bring about a second major resurgence of the pandemic to neighboring countries, and to the world.
- Due to social distancing mandates that reduce business utilization, efficiency and functions to a sub-optimal level, the productive capacity of economies are exposed to risk of permanent damage.
- Though the US-China conflict remains relatively lukewarm for now, tensions may resurface and increase as we approach the US presidential elections in November.

Our Strategy

There certainly are short-term risks when it comes to expensive equity valuations and geopolitical uncertainty– which is why we're taking a market-neutral approach across US, Europe and Japan.

Asia-Pacific Overview

Due to the record low interest rates of stimulus efforts by governments and the aggressive quantitative easing by central banks, the initial pace of reflations is expected to be strong– and will most likely provide a positive backdrop for equities throughout the Asian-Pacific region.

The deterioration of US-China trade relations remains a key risk for Asian equities, as the political rhetoric could intensify further as we approach the US presidential elections in November. However, the trade dispute is expected to stop being a headline risk as we cross into Q1 2021.

- Global economic activities proxied by PMI are most likely to accelerate rapidly over 2Q-3Q 2020 as major countries begin to re-open their markets.
- In the land of the rising sun (Japan), equities trade at 13.8x forward– 12M PER, above the 5-year average of 13.0x.

There's the risk of a second wave of the COVID-19 virus– but the widespread awareness and considerably-higher level of tactical preparedness of countries within the Asian-Pacific diminishes the risk of a second chapter to the pandemic. The recovery of business prospects and equity performances are expected to continue to broaden across sectors and regions throughout the Asia Pacific. In the near term, sectors within the ASEAN regions that stand to gain immediate benefits from this broadening include:

- Gaming sector
- Financial sector
- Industrial sector
- Service sector

Public scrutiny of GDP	Acceleration of deglobalization
The arrival of the pandemic sent a flurry of heavy-hitting blows on the economy, adversely affecting the financial standings of governments– which prompted citizens to closely monitor public debt levels for assurances that their country is going to pull through. As a result, account deficits as % of GDP and sustainability of public debt level will most likely become subjects of great scrutiny for the foreseeable future.	Due to the pandemic, demand for energy, food, pharmaceuticals, and basic manufacturing rose at an unprecedented rate. This surge in demand pushed countries into scrambling across international waters to fulfill the gap in supply. As a result, sovereign countries have become more acutely aware of the importance of having domestic supply chains. Moving forward, this newly-refreshed awareness could see sovereign countries focusing efforts on establishing stronger domestic supply chains– further accelerating deglobalization.

Who can capitalize on these trends? / Who stands to gain from these trends?

Within Asia, larger and more advanced economies like China and Korea are better positioned to navigate through and capitalize on these emerging trends as opposed to their Asian Pacific counterparts.

Our Strategy

We rate Asian equities as a strong BUY over a 12-month horizon. We've added ASEAN names to our investment portfolio in anticipation of the broadening economic recovery

Our focus is on stocks that are:

- Likely to emerge earlier from the crisis.
- Niched companies, with long-term winning potential, favourable supply discipline and little competition.
- Beneficiaries of super-low interest and discount rates (that are likely to continue for a long time after the pandemic eventually ends).

Malaysia Overview

Q1 2020 saw the growth of the Malaysian GDP declining to 0.7% (from 3.6% in Q4 2019) as lockdown mandates severely impacted macroeconomic conditions. The ensuing disruption to global supply chains caused by the pandemic also triggered a near-freefall drop in exports by 7.1%.

While the Malaysian GDP is expected to slide further as we approach the end of Q2 2020, recovery is expected to begin in the Q3 2020 as the nation transitions from the Movement Control Order (MCO) to the Recovery Movement Control Order (RMCO).

Implemented from the 9th of June to the 31st of August 2020, the RMCO comes after the Conditional Movement Order Control (CMCO) and is poised to set the stage for a much broader economic recovery. Nearly all business activities have been allowed to resume, though the pace of recovery will likely be gradual as social distancing mandates remain a norm for the foreseeable future.

- On top of the RM260bn Prihatin Economic Stimulus Package, the Malaysian government unveiled an additional RM35bn stimulus package on the 5th of June to further aid the economic recovery process.
- Earlier in May, the central bank cut the Overnight Policy Rate (OPR) further by 50bps to 2.0% to ensure the nation's monetary stance remains accommodative.
- The KLCI is currently trading at 2020 and 2021 PE of 19.7x and 16.6x respectively– a mark(s) that's well above its 10-year mean valuation of 15.4x. However, with the exception of glove sectors, the index is trading at 2020 and 2021 PE of 18.3x and 15.3x respectively. The consensus is looking beyond 2020 for recovery from the pandemic.

Our Strategy

Equities

- We're buying Malaysian equities in a short-term perspective, given the telltale signs of a swift earnings rebound come 2021.
- From a short-term perspective, investors will be focused on post-pandemic recovery where value sectors may start to outperform quality and growth.
- Riding on the wave of optimism, we're taking a tactical approach by buying into the Bank and Plantation sectors, as well as selective stocks as proxy for a post-pandemic recovery.

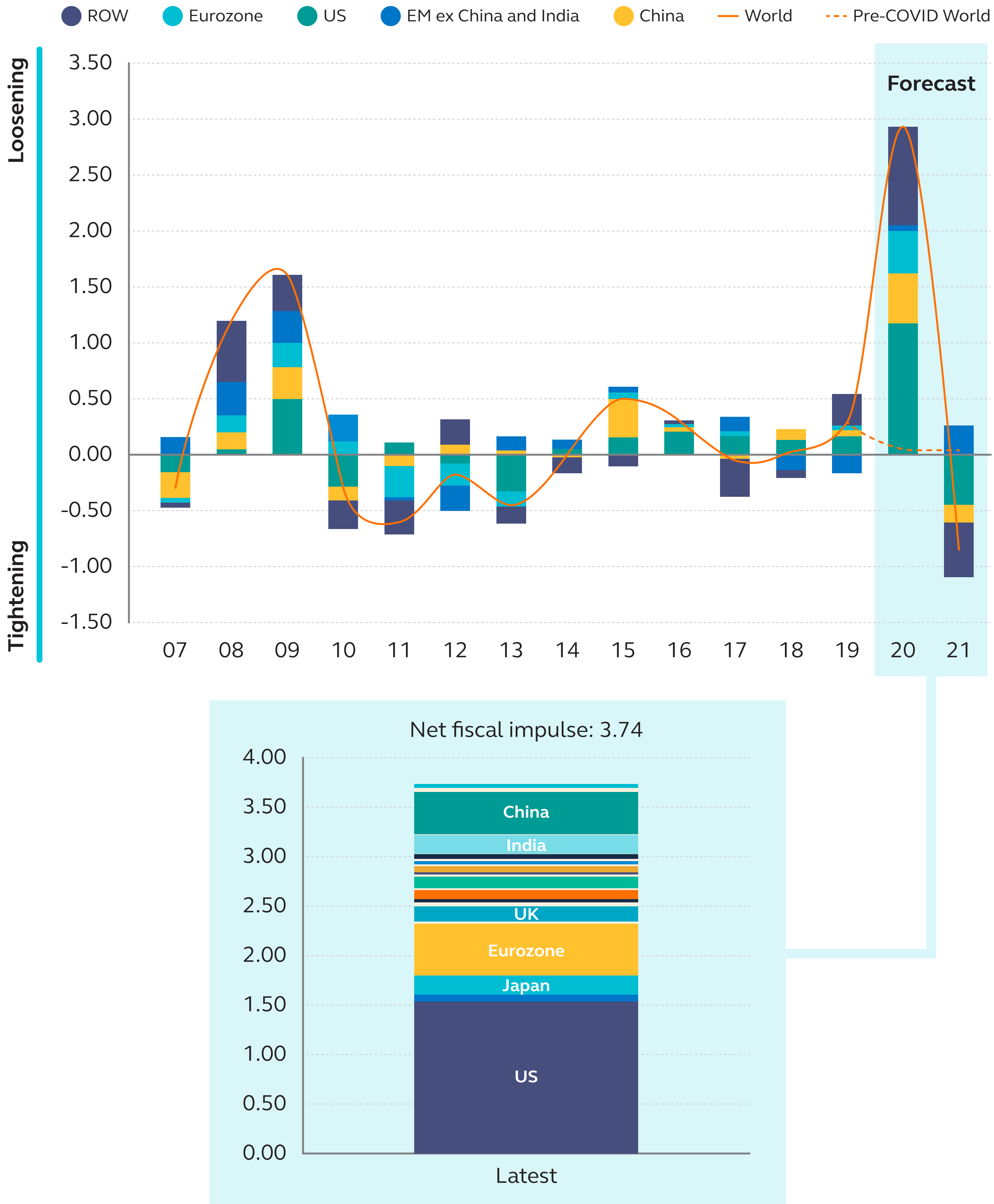
Fixed Incomes

- Following the 100bps reduction in OPR within 5 months, we have a firm conviction that the OPR direction ahead will be heavily data-dependent, and that interest rates are likely to stay accommodative for a longer period.
- Credit selection during these uncertain times remains key. We will continue to be selective in issuers with stronger and more resilient credit metrics that can weather the current economic climate (with a preference on quasi-sovereigns, and highly rated papers)

Appendix

Fiscal policymakers have started to take action

Change in cyclically adjusted primary fiscal balance as % global GDP



Source: UBS, 14th April 2020

US' consumption to pick up in May as mobility restrictions are lifted

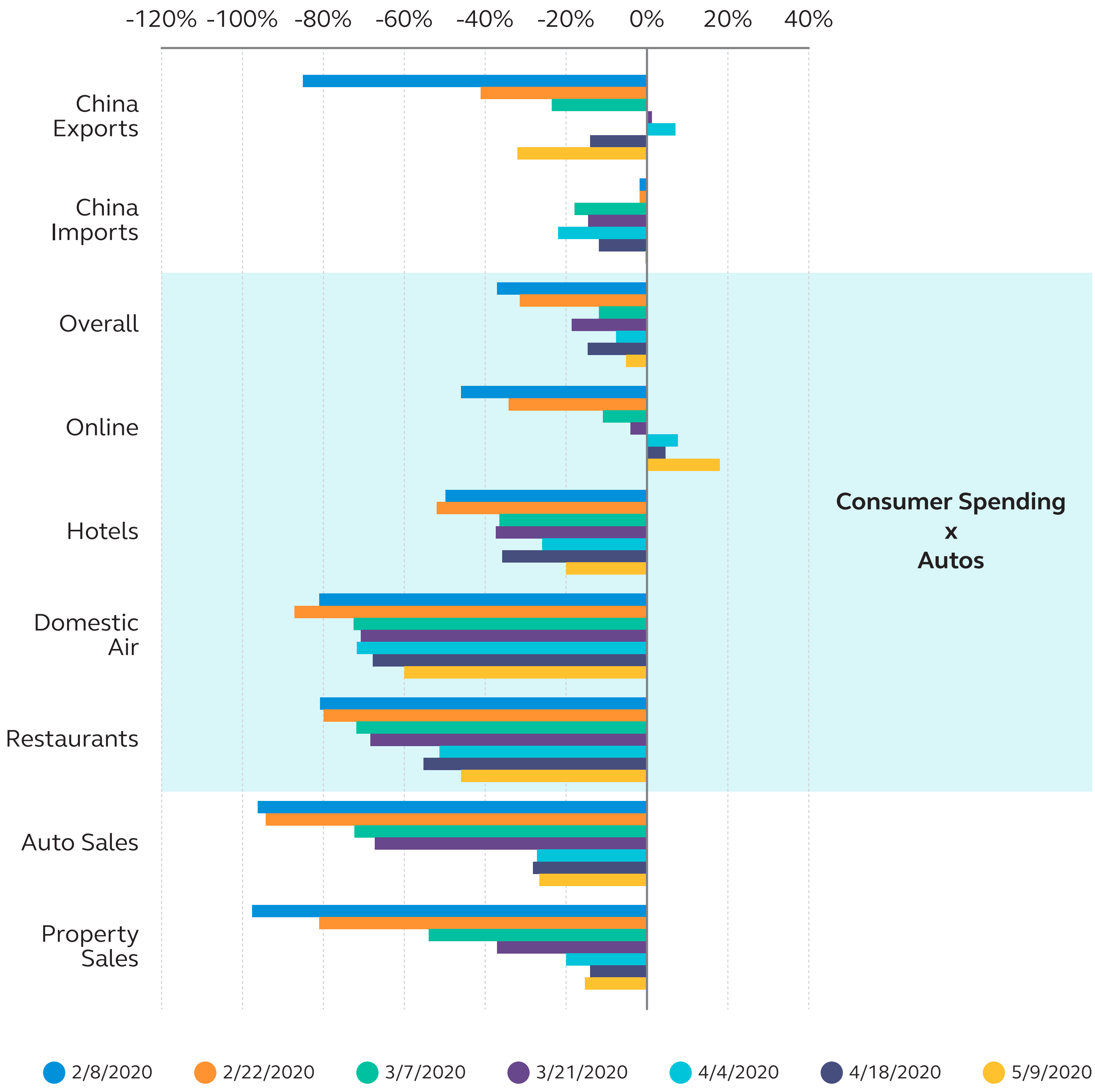
COVID-19 Economic Impact: US (Activity Level vs Normal)

- Home improvement category is seeing strong growth as people stay home.
- Auto sales picked up significantly recently.
- Home sales proxies continue to show improvement.
- We see only slight improvement in retail sales ex autos.
- Restaurant sales remain similar to last week (down 25%), though full-dining restaurants have started to open in some states.
- Hotel occupancy remains at its lows with occupancy down 56%.

Source: UBS, Google Trends, ShowingTime, Womply, Bloomberg, Principal compilation, 3rd May 2020

Can China restart its economy without a relapse, while minimizing new cases of the virus?

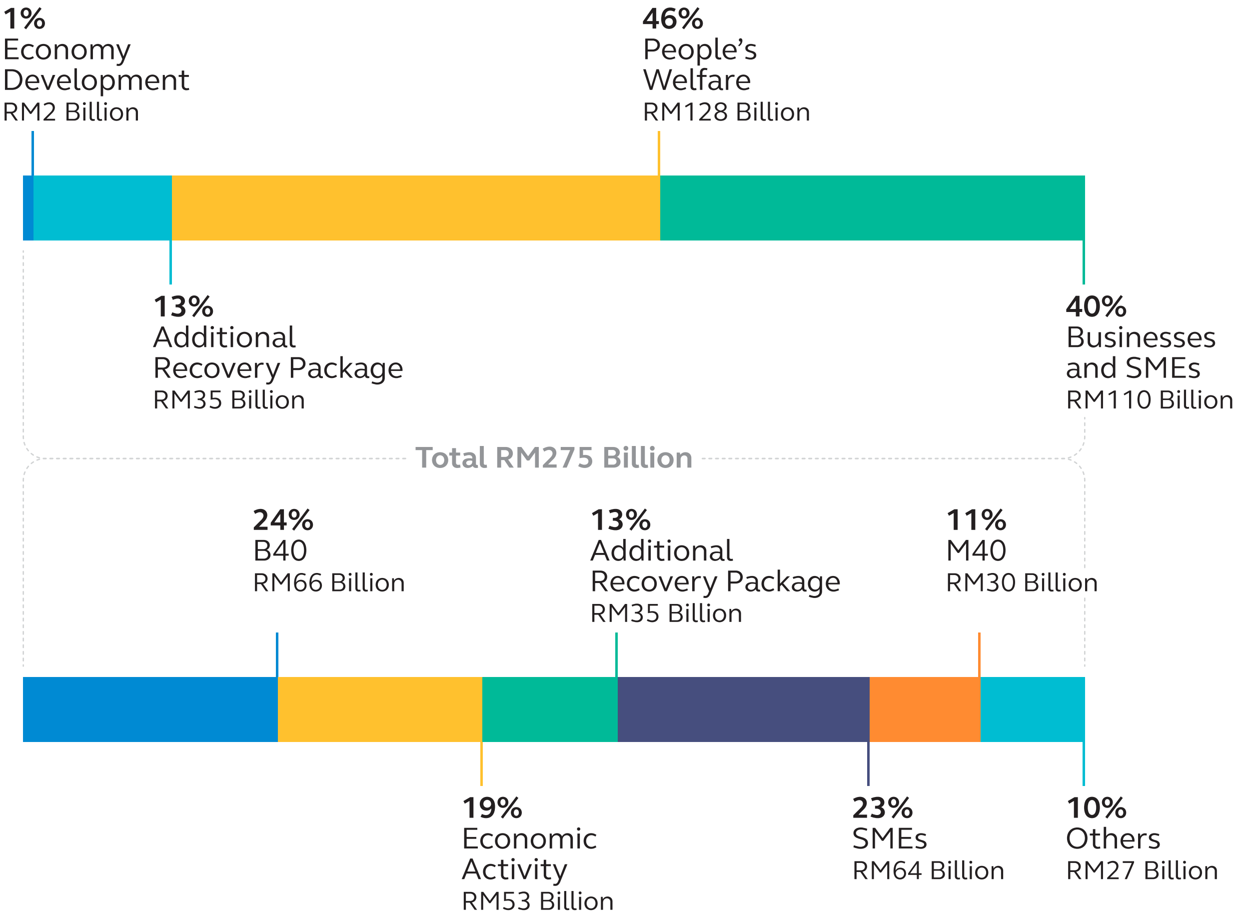
China activity normalization since Chinese New Year



Source: UBS Evidence Lab, Bloomberg, May 2020
*UBS Big Data Nowcasting estimates, which tracks consumer spending data and port activity in China, points to normalizing economic activity in China

Malaysia launched a RM35 billion stimulus to strengthen the recovery process

Breaking down the RM275 billion stimulus package



B40
- Akaun 2 KWSP RM25 billion
- Bantuan Perihatin National RM8.8 billion
- Subsidi Upah RM4.7 billion
- Moratorium Pinjaman RM24 billion
- Penjawat Awam RM1.2 billion
- Electricity RM100 million

Economic Activity
- Small Projects RM2 billion
- Bailout Funding RM50 billion
- Food Funding RM1 billion

Additional Recovery Package
- RM5 billion for Wage Subsidies
- RM2 billion Upskilling Programs
- RM1 billion SME Tourism
- Stamp Duty Exemption for First-home Purchase
- Sales Tax Exemption for CKD and 50% Tax Break for CBU
- Export Duty Exemption for Palm Oil (July to Dec)
- Tax Break for Corporate Spending and Upgrading Premises

SMEs
- Loan Moratorium RM35 billion
- KWSP and Human Resources Development Fund (HRDF) RM10.4 billion
- Government Gurantee Schem (SJPP) RM5 billion
- BNM Special Relief Facility RM3 billion
- Income Tax Deferement
- Wage Subsidy Programme will be Increased by RM7.9 billion
- Micro SME RM2.1 billion

M40
- Loan Moratorium RM18 billion
- Akaun 2 KWSP RM10 billion
- Bantuan Perihatian National RM1 billion
- Civil Servant RM500 million
- Electricity RM200 million

Others
- T20 KWSP RM5 billion
- PRS RM700 million
- T20 Loan Moratorium RM21 billion
- T20 Electricity RM200 million

Source: Department of Statistics Malaysia Official Portal, 8th June 2020