THEMATIC REPORT

Authors:
MIDF Research Team
research@midf.com.my

Hope in the shadow of fear

KEY INVESTMENT HIGHLIGHTS

- **Waves of headwinds locally and abroad**
- **Challenging global economy amid multiple headwinds**
- **Covid-19 suppresses global demand**
- **Investors seeking 'return of capital': A hallmark of extreme risk aversion**
- **US-led world's equity selloff but China outperformed thus far in March**
- **Expect rest of the world to replicate China's success in bringing new cases of Covid-19 under control**
- **Fiscal policy responses have been swift in tandem with monetary actions**
- **If the world is seen to skirt recession, the equity market may find its lows sooner than later**
- **Cut our FBM KLCI target to 1,480 points**

Waves of headwinds

A month of trauma. This past month has been traumatic, not to say the least for the markets. One after the other, multitude of headwinds began hitting globally and domestically. These affected general sentiments, not just investors, but the global community as well. Fears began to take hold. It has had a great impact to global markets and ours are not spared. It came to a point that even the subject of a recession has been discussed. However, despite all this we believe that there is still hope.

Two external and one domestic events. We noted that there had been three events which had exacerbated the sentiment of fear; two external and one domestic. Essentially these are; (i) novel coronavirus (Covid-19) pandemic; (ii) the sudden drop in oil prices; and (iii) domestic politics.

Now it is a pandemic. Covid-19; what started in China has now flared up globally. Cases were first reported in China and were the World Health Organization (WHO) was informed on 31 December 2019. We understand that the first case could go as far back as November 2019. Confirmed cases in China breached past the 1,000 mark on 25 January 2020 and quickly escalated to past the 10,000 mark on 1 February 2020, and 50,000 mark on 13 February 2020. As for the rest of the world, the spread seems to be delayed. The number of confirmed cases reached past 1,000 only on 19 February 2020. However, as with the cases in China, it quickly escalated to reach past 5,000 cases on 28 February 2020 and subsequently over 10,000 cases on 2 March 2020.This sudden spike in cases and over multiple geography led to the WHO declaring Covid-19 as a pandemic on 11 March 2020, causing panic in the markets and fears to intensify.

Domestic politics did not help. Prior to the second wave of Covid-19 in Malaysia, we were also hit by some uncertainty in domestic politics. On 24 February 2020, according to the Chief Secretary to the Government, the Yang di-Pertuan Agong has accepted the resignation of the 7th Prime Minister (PM7), Tun Dr Mahathir Mohamad. As a result of the political uncertainty, FBM KLCI ended its world's longest bull run on the same date, as per our report; The End of World's Longest Bull Market. It was not until a week before a new 8th Prime Minister (PM8) was appointed made in accordance with Article 43(2)(a) of the Federal Constitution. While it appears that the political situation in Malaysia continues to be on tether hooks, we believe it has stabilized for now. Moreover, Malaysia is now appearing to be more concern on containing the Covid-19 outbreak.

Oil price war. An acrimonious OPEC+ alliance meeting with Russia on 8 March 2020 to discuss deeper production cuts for the year has sent the world into a sudden supply-demand shock. The alliance which is due to expire at the end of this month came to an abrupt end which terminated the four-year pact between the 14 OPEC countries and Russia. This has resulted in more than 20% plunge in both oil price benchmark Brent and WTI to USD36pb and USD32pb respectively on the same day. The plunge was the worse since 2016 when OPEC+ alliance was formed when oil price was at USD39.6pb. However, we have to highlight that in our report Another oil crash in the making?, we opine that the current low oil price environment which resulted from Saudi's retaliation against Russia's decision to opt out of production cuts will not prolong.

Challenging global economy amid multiple headwinds. Global growth is expected to dip in 2020, possible in the range of 2.0-2.8%. The expansion pace will be lower than the rate in 2019 of 2.9%. Slowdown in global growth is mainly due to the unexpected headwind, fear effects of Covid-19 which started in world's second largest economy, China. Lower demand, supply chain disruption and weak market sentiments put pressure on global growth in 2020. In addition, oil war between Saudi Arabia, Russia and the US will result in commodity prices to remain shallow.

Combination of effects; bear market territory. As a result of all the headwinds, we also saw other equity markets fell into bear territory especially after the pandemic announcement by WHO. The Dow Jones fell -18.0% to 21,197.90 over the next two days from date of the announcement, and declined -39.4% from its peak of 29,551.42 (which was reached on 12 February 2020). Similarly Nikkei, DAX, CAC and MSI Asia ex Japan saw retracement of -43.5%, -50.5%, -50.7% and -25.5% respectively. In fact, the FBM KLCI had entered the bear market much earlier as highlighted by our report; The End of World's Longest Bull Market. Moreover, the VIX index (a so-called fear barometer) went ballistic to heights last seen in late 2018 which was also a period of heightened worries over prospect of an impending economic slowdown. This bear market and as the VIX index suggest, have had exacerbated the fears that globally we might be entering a recession just over the horizon. However, we do not believe that this is the case. This is due to the fact that we are still expecting economic growth globally and domestically, and our observation of signs of improvements in China.

One will linger more than the others

Covid-19, the most lingering effect. Of all the headwinds we are currently facing, we opine that the Covid-19 pandemic will linger the most. This is due to the fact that we expect supply disruptions coming from lockdowns, first in China and subsequently in Italy and other parts of Europe. Demand is also expected to weaken due to the quarantine, either official or self-imposed. Nevertheless, the containment strategy is thought to still be the best strategy to fight the Covid-19 pandemic.

Covid-19 suppresses global demand. Global manufacturing PMI plunged to 47.2 points in Feb-20, the weakest since 2009. Manufacturing PMI of emerging economies declined to below 50 points after 7-straight months recording at expansionary levels. China was impacted the most as manufacturing PMI dropped by almost 10 points to 40.3, the lowest in 16-year low. Japan, Malaysia, Singapore and Thailand among others, was also affected by geographical factors. We view global demand to grow at weak pace in 1H20 particularly due to the Covic-19 fear effects. Easing monetary policy and stimulus package adopted by most of economies affected are mainly benefiting domestic-oriented sectors in each economy. However, we expect 2H20 to see a rebound in global demand if Covid-19 subsides and signs of recovery increased.

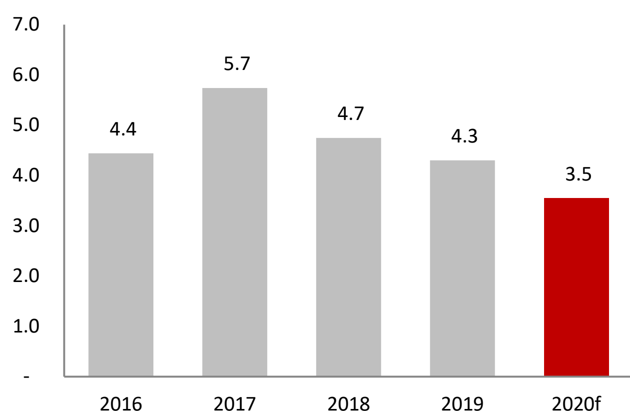
Significant slowdown expected in 2020. We foresee Malaysian economy to continue expanding in 2020 but at a moderating pace of 3.5%yoy compared to 4.3%yoy in 2019 as more challenges emerge. We expect that our economic growth will be influenced by the headwinds we face, which in addition to Covid-19, includes slowing global demand, threat of protectionism, recession fears, global financial stability, commodity prices, inflationary pressure and labor market.

Modest private consumption. Household spending will be supported by low inflationary pressure, stable labour market, OPR cuts and government stimulus package particularly through Rakyat-centric measures. The measures include the reduction in EPF contribution rate to 7% from 11% and additional RM100 assistance for BSH recipients, among others which will result in an increase of disposable income for employees. However, household expenditures are likely to be affected by ongoing Covid-19 as Malaysia enters the second wave of the outbreak. As fears increase, consumers may choose to stay away from shopping malls and put their vacation plans on hold, reducing their economic activities. This could render the stimulus to be less meaningful than intended. This will lessen spending and eventually contribute less to the overall economic growth. Hence, we foresee private consumption to grow at a slightly softer pace of 7%yoy in 2020 (2019: 7.6%yoy). Similarly, services sector will experience a slowdown, growing at 5.2%yoy (2019: 6.1%yoy) dragged down by weak tourism activities due to Covid-19.

Mining sector to stay in negative territory. Volatility in commodity prices is influencing the performance of commodity-based sectors particularly of mining sector. Crude oil prices have already moved downward starting this year due to the softer demand coming from Covid-19. The oil price war has exacerbated the situation. At current price level, we expect the Malaysian government's coffer will be affected as well. Nevertheless, the opening of PFLNG 2 in 2Q20 would

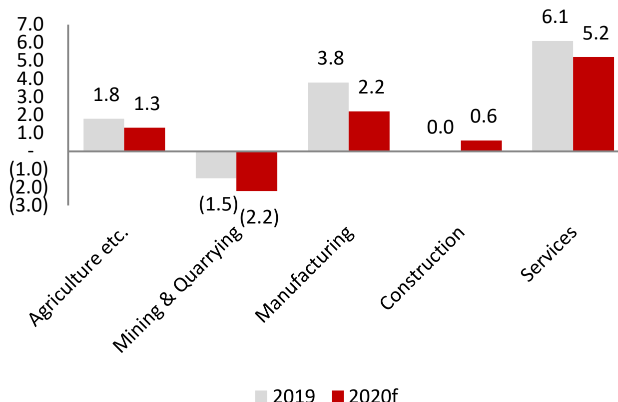
cushion some of the impact to the overall mining sector performance. We foresee mining sector to contract further by -2.2%yoy (2019: -1.5%yoy). Meanwhile, agriculture sector is expected to continue growing but at moderating pace of 1.3%yoy despite higher average price estimated for CPO at RM 2450mt (2019: RM 2079mt). Pressure will be more on the demand side, from India and China.

Chart 1: GDP Annual Growth Rate (YoY%)



Source: CEIC, MIDFR

Chart 2: GDP Growth by Sector (YoY%)



Source: CEIC, MIDFR

Hope in the seas of fear

Fiscal policy responses have been swift. In order to moderate the economic impact of the Covid-19, we observed that governments globally have responded swiftly with fiscal stimulus package. This include Malaysian Government's announcement of RM20b package. Below is the non-exhaustive list of stimulus package announced at the time of writing:

Table 1: List of Announced Stimulus Package

Country	Amount
Malaysia	RM20b
Singapore	SGD6.4b
Hong Kong	HKD120b
South Korea	KRW11.7t
Japan	JPY1.4t
Indonesia	IDR120t
Thailand	THB400b
Australia	AUD17.6b
United Kingdom	GBP30b
Italy	EUD25b
United States of America	USD50b

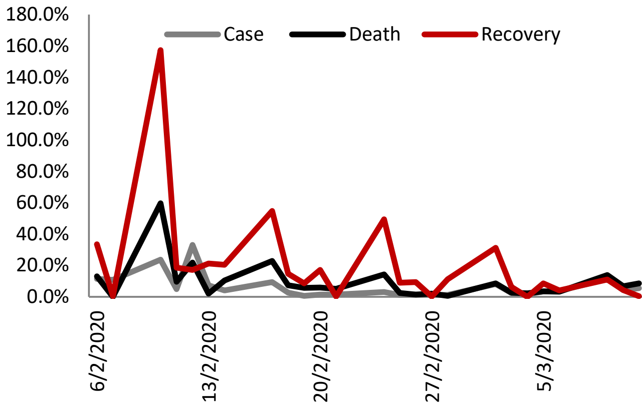
Source: Various

In tandem with monetary actions. As anticipated in our report, Coronavirus: More Liquidity On The Horizon, the world's monetary authorities are now reacting to potential fallout of the Covid-19. The US Fed made an upsized 50bps unscheduled (in between meetings) rate cut two weeks ago and another 100bps unscheduled rate cut together with USD700b worth of quantitative easing (QE) on Sunday to dampen the economic impact of the virus on the US as well as the world's economies. In tandem, other central banks (including the Bank Negara Malaysia) were also injecting more financial liquidity into their respective money markets. In addition, we opine the PBOC increase its monetary stance to be more accommodative in order to provide a backstop.

Sanguine; Covid-19 to subside in 2H20. Despite the flare up of cases in Europe and the US, we are sanguine at the prospect that Covid-19 will be contained. Based on available data on Covid-19, we foresee the effects of the fears will wane in 2H20 given that recovery rate is on improving trend while death rate remains below 5%. In addition, we opine

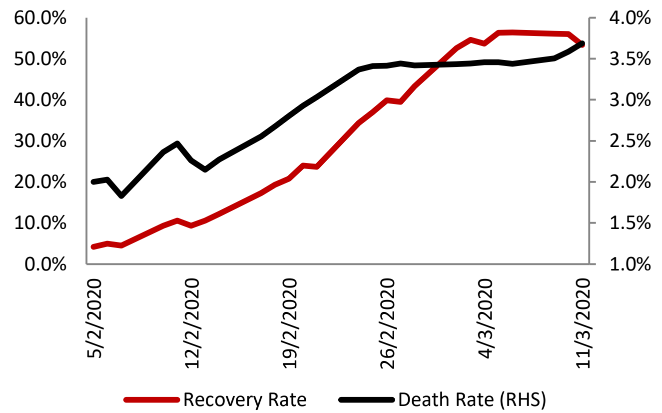
that the economic activities in China are recovering, predicated on the latest container throughput movements. In our view, the fear effects in the US and EU may prolong until the end of 1H20 and began to subside in Jun-20.

Chart 3: Daily Growth (DoD%)



Source: Bloomberg, WHO, John Hopkins University, MIDFR

Chart 4: Death Rate vs Recovery Rate (%)



Source: Bloomberg, WHO, John Hopkins University, MIDFR

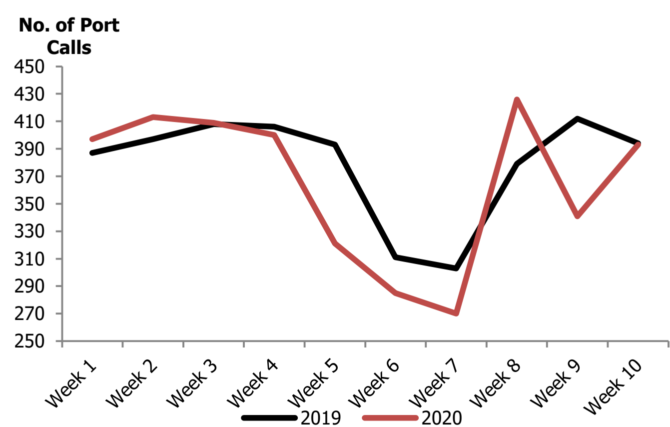
There are continuing signs that operations are returning to normal in China. Weekly container vessel calls at key Chinese ports showed a reduction of over -20.0% between 20 January 2020 and 6 February 2020 according to Alphaliner. Operations were also suspended at Wuhan's Yangtze river port which experienced a dramatic reduction in port calls, as disclosed by Lloyd's List Intelligence. However, during the week ended 8 March 2020, container throughput at China's eight major ports recorded a +9.1% jump according to China Ports and Harbours Association. The numbers of container-related vessels call at the major container hub of Shanghai and Yangshan have picked up and are again tracking figures seen this time last year. In addition, other ports along the Yangtze River which include Nanjing, Wuhan and Chongqing witnessed a container throughput growth of more than +10.0% during the same period.

Container throughput in key Chinese ports reached a trough in the middle to late February 2020 before rebounding. Using the port of Zhoushan, the third largest container port in the world by annual handling capacity as an example, the average waiting time for container vessels spiked to more than 60 hours in the week of February 11-17. This coincided with the travel curbs on workers returning from the prolonged Lunar New Year holiday, forcing ports to operate with limited manpower. According to data released by Shanghai International Shipping Institute, this was around 15 hours longer than the week before the holiday, and nearly 20 hours more than the average in early January before the travel restrictions. Nevertheless, we understand that the turnaround times at Zhoushan and other ports are starting to improve as more container crane operators, customs officers, tugboat pilots and other key logistics links slot back into place. Resultantly, we believe that the recent spike in container throughput at Chinese ports will support Malaysian ports.

Chart 5: Container throughput at Port of Zhoushan,

Source: Zhoushan Port, Shanghai International Shipping Institute

Chart 6: Port Calls at Shanghai and Yangshan Port



Source: Lloyd's List Intelligence

Swift and timely crude oil production cut inevitable. In the current low oil price environment as well as; the intensifying number of infected cases recorded worldwide due to Covid-19; we view that a potential oil production cut in the near term is inevitable at this juncture. The fear that is currently permeating through the oil and gas industry across the world has brought forward the need for a swift and timely action to bring some form of stability back to the oil price. Much of this stems from the fact that the oil price is currently unsustainable for long-term production mainly due to cost of producing a barrel of oil typical range between USD30pb to USD40pb. We also understand that this cost runs higher for the US shale oil producers which typically requires oil price to be at least USD48pb to USD54pb to break-even.

Potential spending cuts. In the past week, major oil producers have started to indicate potential spending cuts, of up to 30% from the initial planned 2020 CAPEX, in their respective bid to reduce production. Numerous North American oil producers such as: Diamondback Energy Inc., Occidental Petroleum Corp and Marathon Oil Corp have announced deeper spending cuts last week amidst the falling oil price. There were also talks in the market that the US shale oil producers are requesting for up to 25% price reduction from their respective service providers to cushion the impact from the low oil price on earnings in the coming quarters.

Expecting lower drilling activities. Drilling activities are expected to be lower than initially expected during the beginning of the year with oil producers anticipated to start pulling-the-plug on several rigs. The rig count, which acts as an early indicator of future production, saw an average drop of 208 rigs in 2019. Week-on-week data from Baker Hughes and Enverus Drillingsinfo shows while there was one new addition to oil rigs; two gas rigs were pulled out from production last week. Refer to Table 2 below.

Table 2: Weekly US oil and gas drilling rig summary as of 13th March 2020

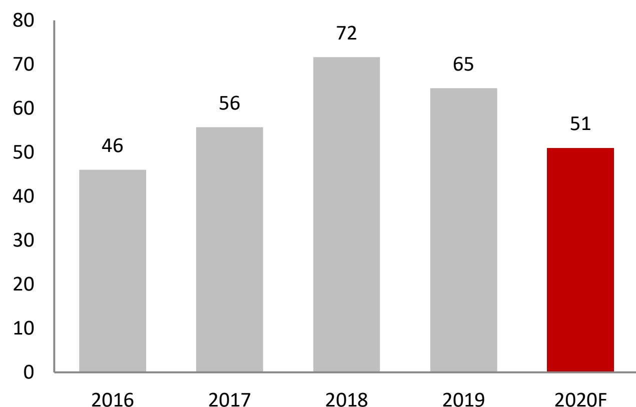
Rig Type	13th March 2020	6th March 2020	% changes WoW	15th March 2019	% changes YoY
Oil	683	682	0.15	833	(18.0)
Gas	107	109	(1.83)	193	(44.6)
Disposal/Other	2	2	-	0	n.a
Land	771	768	0.4	1001	(23.0)
Inland/Barges	2	2	-	3	(33.3)
Offshore	19	23	(17.4)	22	(13.6)
Horizontal	713	708	0.7	907	(21.4)
Vertical	31	34	(8.8)	54	(42.6)
Directional	48	51	(5.9)	65	(26.2)
Total US Drilling Rigs	**792**	**793**	**(0.1)**	**1026**	**(22.8)**

Source: Baker Hughes Co, Enverus Drillinginfo, MIDFR

US crude oil production to decline in 2021. In addition, the US Energy Information Administration (EIA) has forecasted US crude oil production to average at 13.0mbpd in 2020 which is a 0.8mbpd higher than 2019. However, this is expected to decline in 2021 to 12.7mbpd as a result of the low oil price, which will mark the first US crude oil production decline since 2016. Note that, production cut will take at least four to six months to flow into the market. EIA is also expecting US crude oil production to start declining beginning in May from 13.2mbpd to 12.8mbpd in December 2020. This, we opine will assist to arrest the declining crude oil price in 2020. We are banking on an aggressive production cut from the non-OPEC producers at this juncture given that: (i) details on the next course of action to be undertaken by the OPEC remains scarce and; (ii) Saudi being the only country in the world with the lowest cost of production that can withstand the low oil price environment will impact the decision coming from OPEC.

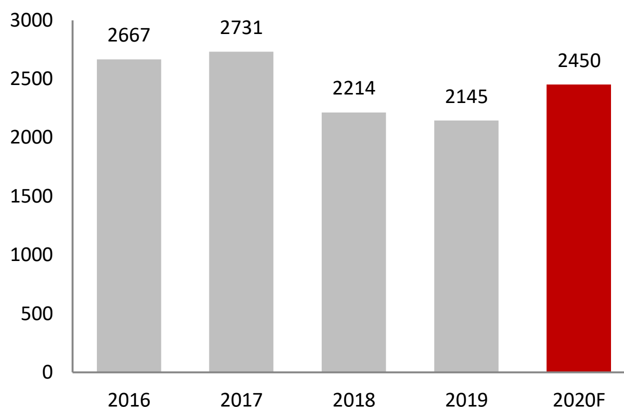
Oil and CPO forecast. For 2020, we forecast crude oil price to average at USD51.0pbd and CPO at RM2450. CPO is projected at higher price due supply concerns as Indonesia plans to shift part of its palm oil production for domestic usage whereas demand from India and China remain strong for the agriculture product.

Chart 7: Brent Crude Oil Price ($ per barrel)



Source: BLOOMBERG, MIDFR

Chart 8: CPO Price (RM Per Tonne)



Source: BLOOMBERG, MIDFR

Similar to 1987?

RETURN OF CAPITAL: A HALLMARK OF EXTREME RISK AVERSION

The sentiment in the world's financial market was that of return of capital rather than return on capital, a hallmark of extreme risk aversion.

Under the above situation, investors would have the tendency to channel additional financial liquidity provided by the monetary authorities towards safe haven assets (of no or little principal risk) particularly government bonds. Hence we were witnessing an unprecedented depression in government bond yields (i.e. continued rise in government bond prices) with the benchmark 10-year US Treasury plummeted to an all-time low level (daily close) of 0.54%. Similarly, the local 10-year MGS yield dropped to the lowest (daily close) on record at 2.75%.

The consensus year 2020 EPS estimate for FBM KLCI was cut to 95.6 which warrant a downward revision to the benchmark's target. Moreover, we cut our year-end 2020 baseline PER valuation target for the FBM KLCI to 15.5x which equates to -2.0SD (standard deviation) of its 5-year (2014-18) historical average. **Thus, we accordingly revised our year-end 2020 baseline target for the FBM KLCI from 1,600 points to 1,480 points.**

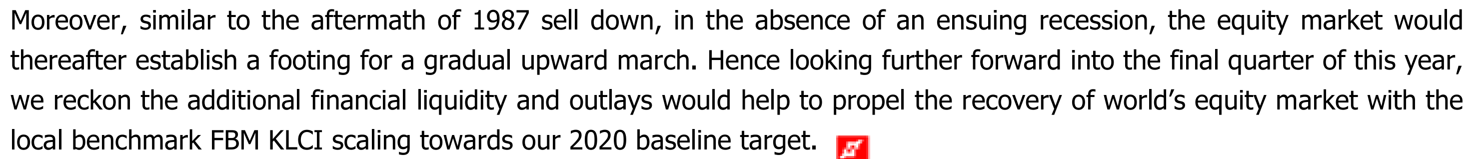
GOING FORWARD…

Despite the recent flare up in new cases of Covid-19 outside China, our baseline scenario is for the outbreak to be brought under control within the next four to six months, i.e. similar to the durations taken by (i) China to bring new Covid-19 cases under control, as well as (ii) the world's to contain the 2002/3 SARS epidemic.

Thus, the equity market would be trapped in a cautious mood or even occasionally under extreme risk aversion perhaps until the third quarter of this year. However, the additional worldwide monetary liquidity (from further rate cuts by major central banks) as well as fiscal outlays may help to lend downside support.

As the total number of infected cases begins to dwindle, we envisage the equity market shall thereafter regain some upward momentum together the tapering of risk aversion among investors. In this regard, we must take note that despite the recent massive sell down in world's equity, China stock market suffered the least with month-to-date return of -4.3% in March as investors were rather sanguine at the progress made in containing the spread Covid-19. In comparison, the US (S&P500) and European (STOXX600) markets were down thus far this month by -12.3% and -20.4% respectively.

Meanwhile, the local FBM KLCI retreated -8.33% thus far in March. In gist, the prevailing selloff in world's equity markets has acted as a valuation leveler between the, until recently, outperforming US and European bourses vis-à-vis the emerging markets as discussed in our earlier report: Valuation Expansion: Asia In Footsteps Of US/Europe?.



Moreover, similar to the aftermath of 1987 sell down, in the absence of an ensuing recession, the equity market would thereafter establish a footing for a gradual upward march. Hence looking further forward into the final quarter of this year, we reckon the additional financial liquidity and outlays would help to propel the recovery of world's equity market with the local benchmark FBM KLCI scaling towards our 2020 baseline target.

APPENDIX

MIDF Research Macroeconomic Forecast Figures for 2020 (%)

(YoY%) Unless Stated Otherwise	**2016**	**2017**	**2018**	**2019**	**2020[f]**
Real GDP	4.4	5.7	4.7	4.3	3.5
Govt. Consumption	1.6	5.5	3.2	2.0	3.0
Private Consumption	5.8	6.8	7.9	7.6	7.0
Gross Fixed Capital Formation	2.5	6.1	1.3	(2.1)	(1.3)
Govt. Investment	(0.8)	0.5	(5.0)	(10.8)	(6.5)
Private Investment	4.4	9.1	4.4	1.5	0.7
Exports of goods & services	1.3	8.8	2.2	(1.1)	0.4
Imports of goods & services	1.5	10.3	1.3	(2.3)	0.6
Net Exports	0.3	(3.9)	14.6	8.9	(1.3)
Agriculture etc.	(3.6)	5.8	0.2	1.8	1.3
Mining & Quarrying	2.3	0.5	(2.6)	(1.5)	(2.2)
Manufacturing	4.4	6.1	5.0	3.8	2.2
Construction	7.5	6.8	4.3	0.0	0.6
Services	5.7	6.2	6.8	6.1	5.2
Exports of Goods (f.o.b)	1.2	18.8	7.3	(1.7)	0.6
Imports of Goods (c.i.f)	1.9	19.7	5.2	(3.5)	1.4
Trade Balance	88.1	98.5	123.8	137.3	130.8
Consumer Price Index	2.1	3.8	1.0	0.7	0.5
Current Account - %of GDP	2.4	2.8	2.1	3.6	2.7
Fiscal Balance - % of GDP	(3.2)	(3.1)	(3.7)	(3.5)	(3.8)
Federal Government Debt - % of GDP	51.9	50.1	51.2	52.5	54.8
End of Unless States Otherwise	**2016**	**2017**	**2018**	**2019**	**2020[f]**
Brent Crude Oil (Avg)	46.0	55.7	70.0	64.3	51.0
Crude Palm Oil (Avg)	2,630	2,690	2,320	2,079	2,450
USD/MYR (Avg)	4.14	4.30	4.00	4.14	4.18
USD/MYR	4.46	4.08	4.10	4.09	4.25
Overnight Policy Rate (%)	3.00	3.00	3.25	3.00	2.25

Source: MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.