3Q2022 Macro Outlook & Advisory House View

Inflationary Times, Difficult Markets

FORWARD Your Wealth

CIMB

CIMB BANK BERHAD 197201001799 (13491-P) | CIMB ISLAMIC BANK BERHAD 200401032872 (671380-H)

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3Q2022 Asset Class Outlook

ASSET CLASSES		SHORT TERM OUTLOOK (3 - 6 MONTHS)		LONG TERM OUTLOOK (6 - 12 MONTHS)		Change of view (Previous → Current)
		UW	OW	UW	OW	
FIXED INCOME			●		●	We upgrade short term to OVERWEIGHT, longer term to NEUTRAL as (1) markets have already priced in much of the Fed hikes (2) inflation rate is likely peaking (3) as we are entering into an environment where there are potential risk to growth, we think some form of allocation to fixed income is appropriate at this level of yields. Fixed income is still the ultimate hedge against recession, although not our base case for now, but is a risk. However, monetary policy tightening remains a headwind for bond investors. We think US fed fund rate will peak at 3.75% in early next year. For Malaysia, we expect 2 more OPR hikes in 2022 to reach 2.50%; 3 hikes in 2023 as the economy recovers.
EQUITIES	LOCAL EQUITY		●		●	We remain NEUTRAL both short & longer term. We cut our end-2022F KLCI target 1568 (from 1,647) to account for earnings risks rising from US recession fears. Malaysia's macro outlook should be more positive for 2022, given the high vaccination rate and easing restrictions should support reopening. Higher commodity prices (crude oil, palm oil & natural gas) bodes well for Malaysia. Key potential catalysts: (1) Government's incentives to boost the tourism sector post lockdown (2) Normalization in consumer spending leading to strong rebound in consumer sector (3) KLCI valuation is relatively cheap (4) Markets are generally bullish on oil price forecast (5) EPF withdrawal schemes coming to an end (6) Foreign equity shareholdings near decade low. Key risks: (1) Covid variant, waning effect of vaccines (2) negative earnings impact from Cukai Makmur (3) political uncertainty as general election GE15 could be called in 2022 (4) ongoing supply chain disruptions – from lockdowns, extreme weather, energy transition, worker shortage (5) Inflation – cost pressures (6) ESG related risk and opportunities.
	REGIONAL EQUITY		●		●	We remain OVERWEIGHT both short and longer term. Regional equity could perform better in 2022 as (1) the worst is likely over for Chinese equities on attractive valuation, reopening from lockdown, signs of policy easing & regulations turning more supportive - potential removal of US tariff on Chinese products (2) rising commodity prices is tailwind for Asian commodity exporters through rising terms of trade, stronger growth, and improvement in fiscal and current account balances (3) Asia especially China and ASEAN provide value opportunities (4) a potentially weaker USD would help. Key risks are (1) Covid-19 variant (2) aggressive FED rate hikes, resulting in very strong USD (3) higher government bond yields drive financing cost higher - bad news for earnings (4) sustained inflationary pressure (5) geopolitical tensions (6) Chinese American Depositary Receipts (ADRs – offshore listing Chinese companies) de-listing.

Note: UW=UNDERWEIGHT, OW=OVERWEIGHT, BLACK DOT=NEUTRAL.
NEUTRAL allocation equals to the Model Portfolios Allocation for respective risk profiles.

3Q2022 Asset Class Outlook

ASSET CLASSES		SHORT TERM OUTLOOK (3 - 6 MONTHS)		LONG TERM OUTLOOK (6 - 12 MONTHS)		Change of view
		UW	OW	UW	OW	Previous → Current
EQUITIES	US EQUITY		●		●	We remain short term NEUTRAL, longer term OVERWEIGHT. As rates rise, exposure to Tech sector may be a headwind to the US market on a relative basis. But as we look at the impact of high commodity prices, US is less vulnerable compared to other Developed markets. In a world where growth is scarce - where people worry about peaking growth momentum, and potential recession risk - US can be a relative safe haven.
	EUROPEAN EQUITY	●			●	We remain short term UNDERWEIGHT as Europe is at risk of stagflation/recession as a complete shut-off of Russian commodities exports would be dramatic. We remain longer term NEUTRAL as (1) European equity is trading near the record discount to US (2) The Recovery Fund has began to be implemented (3) recovering job market. The question is over the duration of the Russia-Ukraine conflict.
	JAPAN EQUITY		●		●	We remain NEUTRAL as outlook appears unexciting, especially if Japanese Government Bond yields remain static due to Bank of Japan constraints. Economists believe that the policies of the new administration will be less focused on growth, and more on wealth redistribution. A weakening Yen could help cushion the Japanese stocks' downside risk.
ALTERNATIVE	GOLD		●		●	Our gold forecast is trending lower due to rising real interest rates environment through 2022, with assumption of subsiding geopolitical risks and growth recovery post pandemic resumes. (Gold 4Q2022F: USD1800/oz). However, we have a NEUTRAL weight on Gold (both short and longer term) as it is an effective portfolio diversifier during periods of equity volatility - given its appeal as a hedge against inflation, geopolitical risk, pandemic risks, increasing recession risk and potential risks resulting from large fiscal spending. Key potential catalysts: (1) upside surprises in US inflation (2) Fed reluctance to move ahead with rate hikes (3) unexpected weakness in global growth (4) potential flare-ups in geopolitical tensions. Key risks: (1) swift de-escalation of Russian-Ukraine crisis (2) faster than expected economic growth with manageable inflation, resulted in higher real interest rate, i.e increasing opportunity cost of holding gold.
	OIL		●		●	Our oil forecast is bearish due to due to assumption of Geopolitical risk de-escalating into year end, a less rosy global growth outlook and higher oil production / supply. (WTI 4Q22F: 95 USD/bbl). However, we have a NEUTRAL weight on Oil (both short and longer term) as it is increasingly playing a role of a portfolio diversifier, in particular an effective hedge against Russian-Ukraine crisis. Crude oil is supported by (1) Tight oil supply (even before the Russian oil supply shock) (2) stronger demand from economic recovery (3) geopolitical risk (4) the shift away from more polluting energy, and the lack of readily accessible renewable energy, is driving demand towards a cleaner hydrocarbon substitutes such as crude oil. Key risks are (1) swift de-escalation of Russian-Ukraine crisis (2) release of US oil reserve (3) increased US shale production (4) slower-than-expected recovery in demand (including air travel) (5) US-Iran nuclear deal that could return ~4mbpd of Iranian oil to the market.

Note: UW=UNDERWEIGHT, OW=OVERWEIGHT, BLACK DOT=NEUTRAL.
NEUTRAL allocation equals to the Model Portfolios Allocation for respective risk profiles.

KEY POINTS:

- CIMB forecasts the US economy to slow down in year 2023, but not expecting a recession in our base case scenario, on still strong job market and robust household finances.
- Both equity and bond market, to some degree, have priced in, or reacted to the US fed's rapid pace of policy normalization, as evidenced by weaker stock price, relatively more attractive stock valuation multiples, higher bond yields and elevated volatility in both equity and bond markets.
- US fed would consider pausing its tightening policies when business activities start to slow down, job market and inflationary pressure showing more signs of tapering off.
- Investors should stay invested, maintain a diversified investment portfolio with mixture of fixed income, equity and alternative asset classes to stabilize portfolio return volatility, and review investment portfolio for opportunity to average cost into equity asset classes at better entry levels.

Where's the bottom of equity market? – based on past event of US Equity "Bear Markets" and "Economic Recessions".

TABLE 1 - US S&P 500 Equity Bear Market (eg, From Peak to Through declined more than 20%) since 1970s.

Equity Bear Market		Length (Months)	Decline (%)	Economic Recession (Yes / No)	Economic Recession Periods
Start	End				
Jan-73	Oct-74	21	-48%	YES	Nov 73 to Mar 75
Nov-80	Aug-82	21	-27%	YES	Jul 81 to Nov 82
Aug-87	Dec-87	4	-34%	NO	-
Jul-90	Oct-90	3	-20%	YES	Jul 90 to Mar 91
Mar-00	Oct-02	30	-49%	YES	Mar 01 to Nov 01
Oct-07	Mar-09	17	-57%	YES	Dec 07 to Jun 09
Sep-18	Dec-18	3	-20%	NO	-
Feb-20	Mar-20	1	-34%	YES	Feb 20 to Apr 20
Jan-22	?	5#	-24%	?	
Average		12.5	-36%		
Average - Equity Bear market & Economic Recession		15.5	-39%		
Average - Equity Bear market without Economic Recession		3.5	-27%		

The US market reached all time high on 3 Jan 2022, and turned into a bear territory as of 17 June 2022. Bear market is the term used to describe when the equity markets are down 20% or more from their most recent all-time high.

Referring to TABLE 1, there were 8 occasions when the US S&P 500 index plunged into the "bear market", of which, 6 occasions (75% of times), the economy entered into recession. Whereas, the another 2 occasions (25%), the economy avoided recession. The equity sell-off periods (bear market) would typically be longer, on average about 15.5 months, with sharper correction of average -39%, when it coincided with economic recession. The exception was during COVID-19 outbreak, where the equity sell-off period lasted for just 1 month, as the central banks and government across the globe came up swiftly with massive fiscal and monetary easing measures.

Source: Bloomberg Data as of # 17 June 2022.

Another 2 equity "bear market" occasions where there were no economic recession, the sell-off periods were shorter at average of 3.5 months, with shallower correction of -27%.

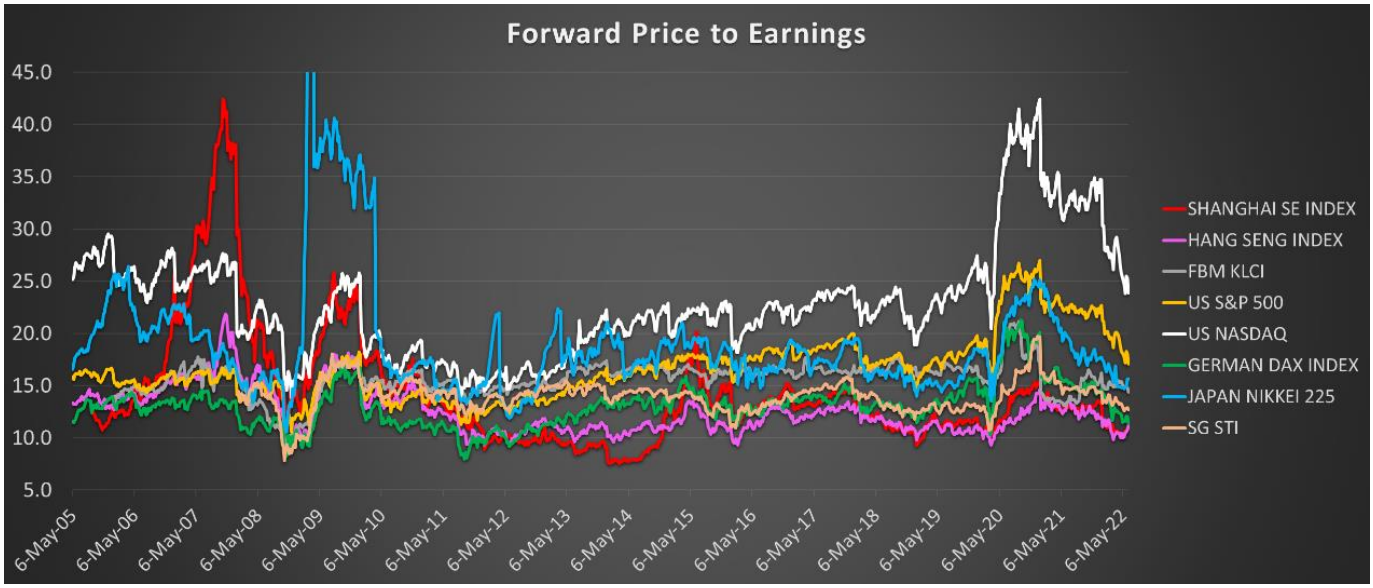
Since early this year, the S&P 500 has corrected about 24%, as investors are increasingly worrying about the hawkish US central banks (e.g. aggressive rate hike and liquidity withdrawal), high inflationary environment that could impact corporate earnings, geopolitical uncertainty and hence, significant economic slowdown (or recession).

As we saw the bond yield (based on US government bond) went up from below 2% in the beginning of the 2022 to currently 3.2%, and MSCI World Equity index declined by around 23%, bringing the stock market valuation (e.g. based on forward Price to Earnings multiples) lower than their long term averages (refer to TABLE 2).
We will be discussing more in the following sections on our asset class preference and selected investment strategies to help investors navigating through another episode of high volatility period.

TABLE 2 - Major equity indices valuations have come back down to long term average during heightening volatility

Selected Equity Indices	Forward Price to Earnings Ratio As of 17 June 2022	5-Year Average	10-Year Average
China Shanghai Composite	11.4	12.3	11.9
HK Hang Seng	10.9	11.7	11.4
MY FBM KLCI	14.0	16.2	16.2
US S&P500	16.1	19.9	18.1
US Nasdaq Composite	22.7	27.7	24.0
Germany Dax Index	10.9	14.6	13.7
Japan Nikkei 225	14.6	17.9	17.7
VIX (Volatility Index)	31.1	19.3	17.2

CHART 1 – Selected Equity Index Historical Valuations



Source: Bloomberg – 17 June 2022

US Fed will need to see inflation slowing down

Having completely misjudging the inflation trajectory last year, the Fed is now behind the curve and need to hike aggressively. On 15th June, the Fed hiked its official rate by 75 basis points (bps) to 1.75%, the biggest move since 1994. In addition, the Fed's balance sheet, which soared to about USD 9 trillion (as the central bank tried to shelter the economy from the pandemic in Mar 2020), would be allowed to decline by USD 47.5 billion per month in June, July and August and by up to USD 95 billion per month starting in Sept 2022, effectively reducing some liquidity in the financial market.

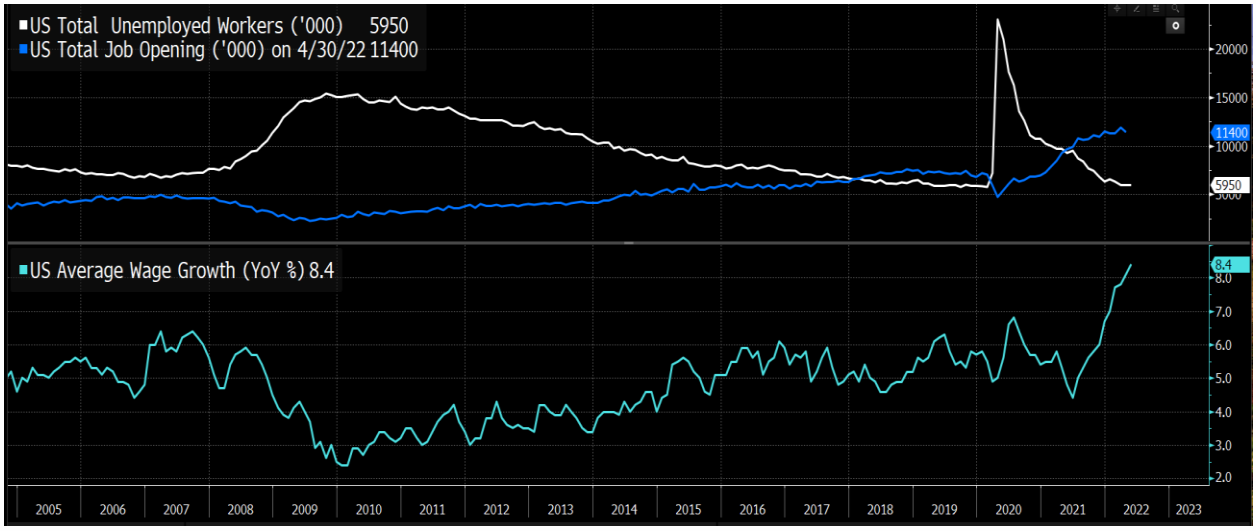
The Fed chairman made it clear that the central bank's action is not intended to tip the economy into recession. The objective here is to bring down inflation expectation, with trade off of slower economic growth and rise in unemployment rate.

"If you were to get inflation on its way down to 2%, and unemployment up to 4.1%, that's still a historically low level, with inflation well on its way to 2%, I think that would be a successful outcome." Jerome Powell said.

However, the Fed stop short of forecasting a recession although Powell did say that factors beyond its control (referring to Russian-Ukraine conflict and the risk of even higher commodity prices) could make the outcome worse in his post-meeting press conference.

Therefore, before the Fed pause the rate hike cycle, it will need to hike rate until economic activities decelerate, with a slowdown in hiring. Subsequently, or hopefully, the wage growth starts to taper off from currently high of 8.4% year-on-year (refer to CHART 2).

CHART 2 - Number of job opening and wage growth need to decelerate to bring down inflationary pressure



How much rate hike has the bond market priced in by the end of 2022?

The bad news is, the US fed is determined to tackle inflation by continuous rate hike in the subsequent Federal Open Market Committee meetings (FOMC or in layman term - the interest rate meeting), and as mentioned by the Fed chairman, next hike could be 50 to 75bps. These news flow would cause bouts of volatility in the financial markets. The next meeting scheduled on 27 July, 21 Sept, 2 Nov and 14 Dec 2022.

Source: Bloomberg – 17 June 2022

The good news is, based on the Fed fund rate future contracts, the market has so far priced in closed to another 200bps rate hikes by the Fed by end of 2022. The 10-year US government bond yield currently stood at 3.23% as of 16 Jun 2022 (year to date increased by +172bps or +1.72% points). The opposite direction was happening to the equity market, when S&P500 equity index has come down by -23.5% since 3 Jan to 17 June 2022. This could mean when economic activities continue to slow down and the inflationary pressure were to taper down, the Fed would be expected to slow down the pace of rate hike.

Why is this US government bond yield important? When the 10-year US government bond yield goes up, so do the interest the Americans need to pay on credit cards, mortgage, auto loans and other borrowings, making borrowing more expensive, hence, could weigh on economic growth, vice versa.

CHART 3 – Average monthly VIX (Equity volatility) compared to US Inflation rate (YoY%). Historically speaking, equity volatility tends to decline when inflation rate stabilizes.

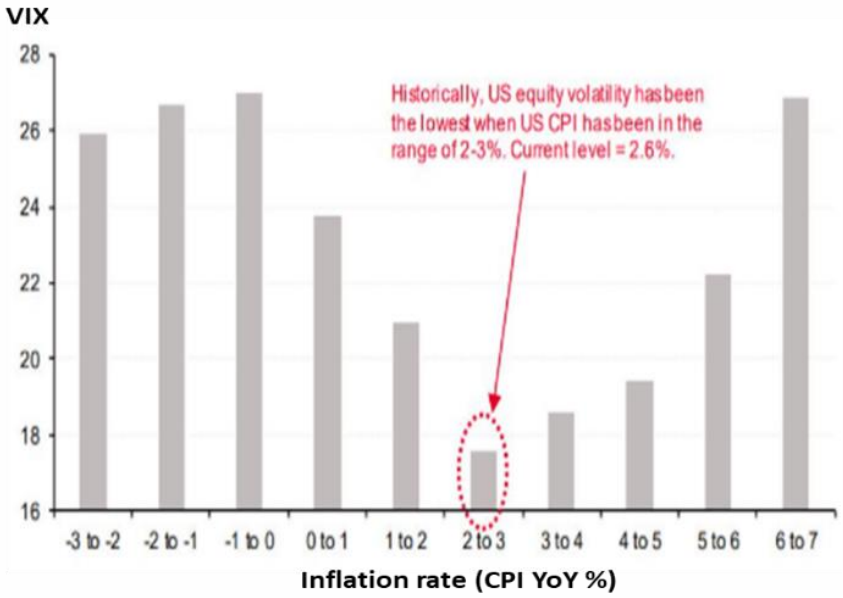
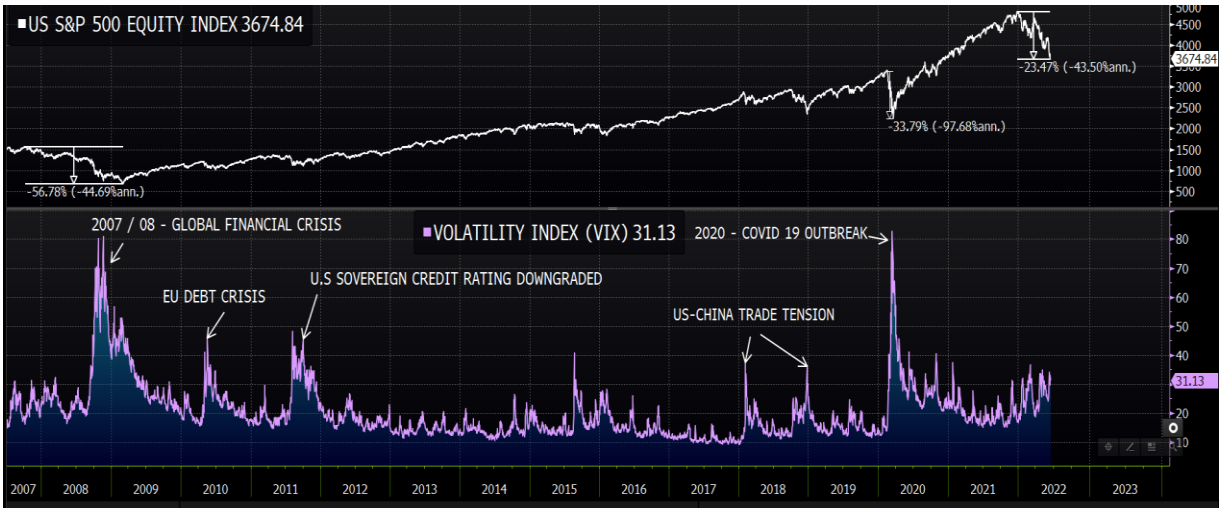


CHART 4 – US S&P 500 Equity index compared to volatility (VIX) index



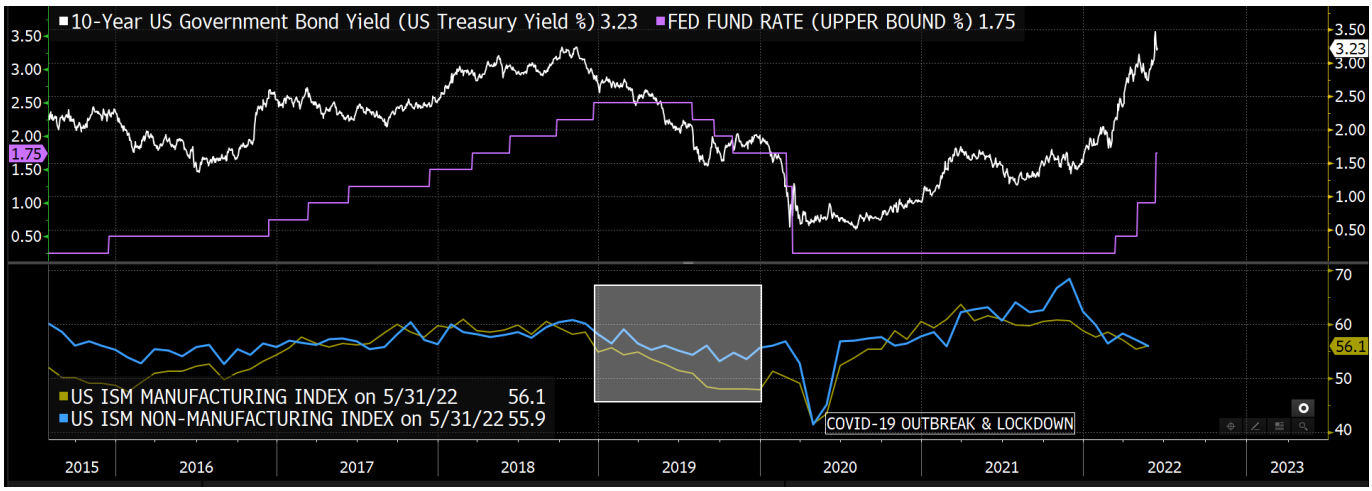
Source: Bloomberg – June 2022

So, when would the central bank pause its rate hike cycle?

If referring to CHART 5, the rapid spike up in the 10-year US government bond yields, in part due to market pricing in the US fed would hike the Fed fund rate swiftly and, would continue to the bring down the US manufacturing and non-manufacturing activities. The general rule of thumb, if the ISM (Institute for Supply Management) index stay above 50, it represents growth or expansion while below 50 represents a contraction.

As the US Fed chairman mentioned, the intention of the tightening measures is not to tip the economy into recession, but to bring down the inflationary pressure (e.g., which is to first, seeing the business activities slowing down and so on…). As a result, only when the US ISM data getting closer to the 50 level (or lower), and/or there are more signs of job market as well as the inflationary pressures slowing down, the market could then be expecting the Fed to pause its tightening stances, therefore, could help turning the existing low market sentiment around and also, stabilizing the financial market volatility.

CHART 5 - US Fed fund rate, 10-year US government bond yield and the business activities.



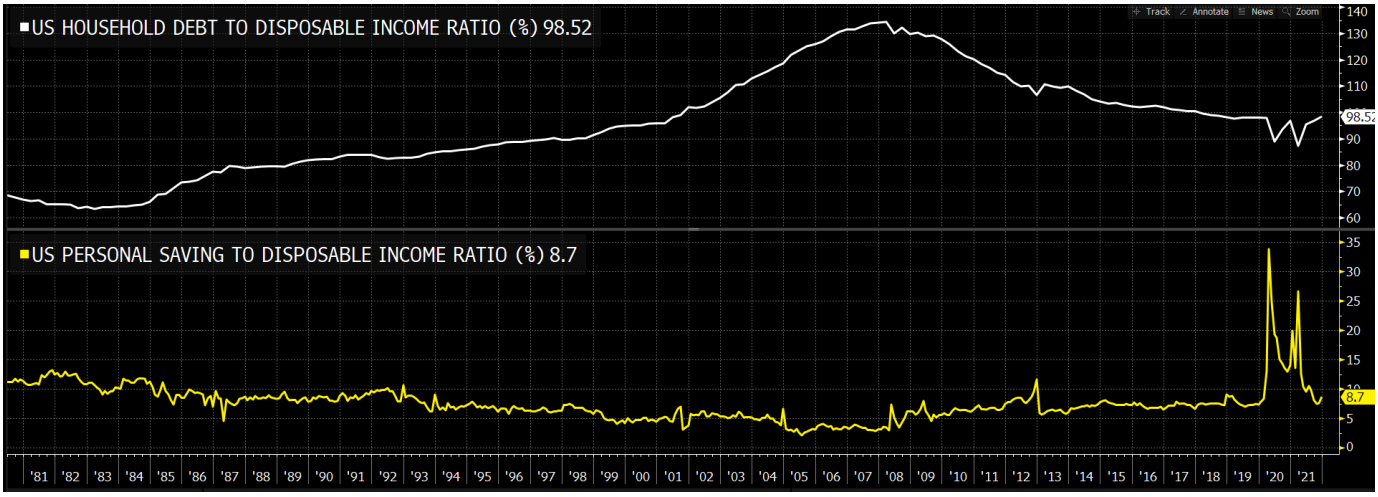
Source: Bloomberg, CNBC – 17 June 2022

Can the American withstand higher borrowing cost?

The US fed official cut their outlook for 2022 GDP growth to 1.7%, down from previous 2.8% in March 2022, while adjusting inflation rate higher to 5.2% in 2022, from previous 4.3%. The US fed statement stated - "Job gains have been robust in recent months, and the unemployment rate has remained low."

The US Treasury Secretary, Janet Yellen (also the former fed chief), said that the U.S. economy remains strong despite rising prices and that a solid labour market and robust household finances should be able to continue to propel consumer spending.

CHART 6 - US Household debt has come down since the 2007 / 08 global financial crisis, while US consumer saving ratios, though has declined, but still relatively higher historically speaking.



Investment Portfolio Recommended Strategies

Investors should stay invested, maintain a diversified investment portfolio with mixture fixed income, equity and alternative asset classes to stabilize portfolio return volatility, and review investment portfolio for opportunity to average cost into equity asset class at better entry levels or increase fixed income / alternative asset classes exposure.

Source: Bloomberg – Dec 2021.

INVESTMENT STRATEGY: PORTFOLIO DIVERSIFICATION

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KEY POINTS:

Benefits of portfolio diversification:

- Minimizing the risk of loss
- Provides return stability
- Peace of mind

During periods of high volatility, investors are encouraged to stay invested through Investment Portfolio diversification that commensurate with investors' risk profiles. Why?

Investment portfolio diversification helps:

1) Minimizing the risk of loss - A diversified portfolio could help to reduce potential huge losses at times of uncertainty. If one asset class perform poorly during the investment periods, other asset classes may perform better. The chart / table shows the annualized return and maximum drawdown (from the highest to the lowest points) of the respective investment approach in single asset class as compared to a Balanced investment portfolio.

2) Provides Returns Stability - investment does not always perform as expected, a diversified investment portfolio avoids relying upon one source of asset class for return.

3) Peace of Mind - investors tend to "time" the market and get emotional during high volatility periods. A diversified investment portfolio helps to reduce the time spent to study the market and going through emotional stress, yet, achieving a realistic investment return over a longer period.

In conclusion, a well-diversified investment portfolio could help to reduce the return volatility and helps investors to achieve a more stable expected return over a long run.

The following chart and table shows if investors invested in single asset class as compared to a diversified investment portfolio – let's take a "Balanced" risk profile model portfolio that consists of 46% in Bond, 52% in equity and 2% in alternative asset classes.

CHART 7- Historical portfolio return

	Cumulative Return Since Inception (%)	Annualized Return since inception (p.a %)	Maximum Drawdown During 2007 to 2009 (%)
100% in Equity Asset	+333.6%	+6.4%	-57.1%
100% in Bond Asset	+185.4%	+4.5%	-25.6%
100% in Commodity Asset	-37.7%	-2.0%	-56.7%
BALANCED Model Portfolio	+258.0%	+5.6%	-39.2%

Source: Bloomberg Data - Indexes and Portfolio Returns are re-based at 100 since Aug 1996.

Note:
1. Equity value based on MSCI World Equity Index, Global Bond value based on Barclays Global Aggregate Bond Total Return Index and Commodity based on Bloomberg Commodity Index
2. Investment Portfolio composition based on CIMB Wealth Management Balanced Risk Profile Model Portfolio (46% Bond, 2% Alternative, 52% Equity).
3. Maximum drawdown measures the highest level to the lowest level between 2007 and 2009 period.

KEY POINTS:

- We upgrade short term recommendation to **OVERWEIGHT** (from NEUTRAL), and upgrade longer term recommendation to **NEUTRAL** (from UNDERWEIGHT).
- Recent spike up in yield presents yield pick-up opportunity.
- Slow-down in economic growth activities should help temper inflationary pressure and the pace of central bank's tightening policies.
- Fixed Income could be a useful diversification tool in investors' portfolios.

Rapid rise in yield presents yield pick-up opportunity

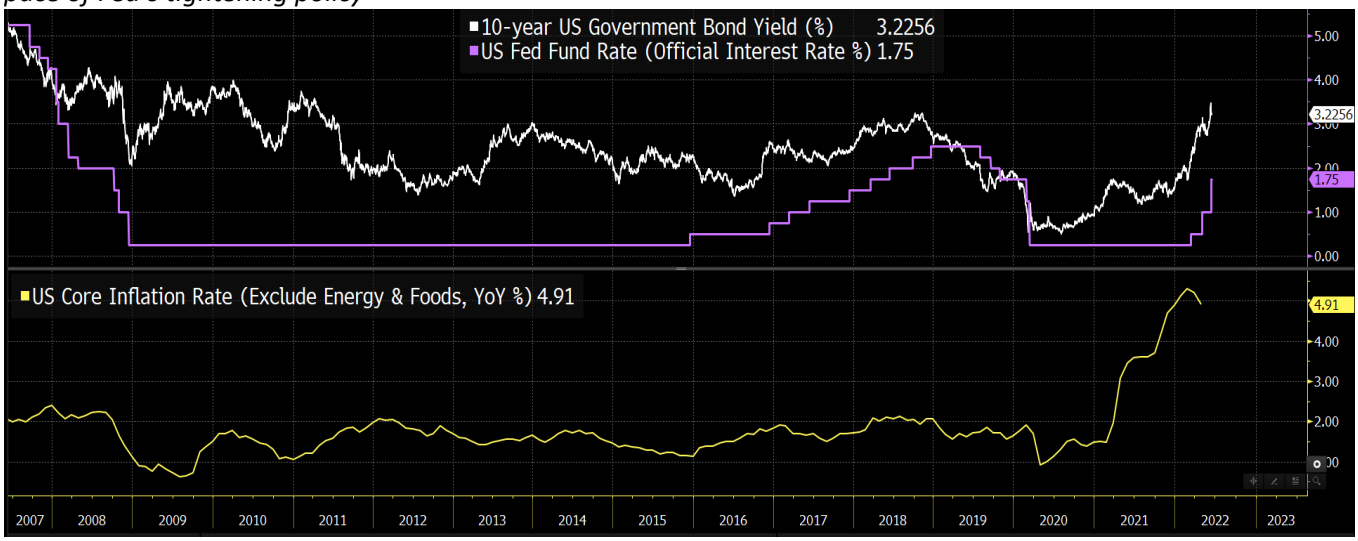
The sharp sell-off in the bond market due to increasing expectation of US central bank rate hike to tame down inflationary pressure has opened an interesting opportunity to invest in fixed income asset class at meaningfully higher starting yields compared to recent history (refer to CHART 8).

As discussed in previous section, while the market has priced in close to another 200bps (2% points) fed fund rate hike by end 2022 and reflected in the more attractive yield now, interest rate volatility could remain high as monetary policy and geopolitical dynamics evolve.

We think growth headwinds such as higher borrowing cost, increasing commodity prices could exert a dampening effect on inflation. Therefore, this could be a feedback loop that will ultimately temper the pace of the central bank's tightening policy so long the long term inflation expectation is well anchored.

We upgrade Fixed Income asset class to OVERWEIGHT in the short term and NEUTRAL in the longer term. We think investors should allocate fixed income into their respective investment portfolios, depending on the investors risk appetites. Based on the historical correlation between different asset classes, Fixed Income / Bond asset class (based on the higher credit rating bond index) tend to show weaker correlation with the higher risk asset such as the Equity, underscoring its usefulness as a diversification tool (refer to TABLE 3). In view of higher economic and policy risks, it's prudent for investors to maintain a defensive posture and allocate into higher quality fixed income instruments, preferably with shorter to medium term duration bond (less than 7 years).

CHART 8 - Increasing borrowing cost could act as a dampening effect to inflationary pressure, hence, tempering the pace of Fed's tightening policy



Source: Bloomberg – 17 June 2022

TABLE 3 - Correlation matrix between asset classes

Selected Indices	**MSCI WORLD EQUITY INDEX**	**US S&P500 EQUITY INDEX**
GOLD (USD / OZ)	0.13	0.04
GLOBAL BOND (Investment Grade)	**0.19**	**0.07**
SHANGHAI COMPOSITE EQUITY INDEX	0.24	0.18
FBM KLCI	0.51	0.39
HANG SENG EQUITY INDEX	0.72	0.58
JAPAN NIKKEI 225 INDEX	0.75	0.66
GERMANY DAX EQUITY INDEX	0.86	0.80
US S&P500 EQUITY INDEX	0.95	1.00
MSCI WORLD EQUITY INDEX	1.00	0.95

Source: Bloomberg data, based on weekly index returns from June 2007 to May 2022.

KEY POINTS:

- We remain **OVERWEIGHT** both short and longer term.
- The worst is likely over for Chinese equities on attractive valuation (refer to Table x), reopening from lockdown, signs of policy easing & regulations turning more supportive - potential removal of US tariff on Chinese products
- Prefer Chinese "Onshore" listed companies over Offshore Chinese equities on less exposure to official common prosperity risk.
- China will continue to focus on developing new infrastructure such as 5G, AI, IoT and data center as well as the strategic sectors such as semiconductor, quantum computing and biotech.
- Continued opening up of China capital market to foreigners should attract more liquidity moving forward.
- Key risks are (1) Zero COVID policy (2) aggressive FED rate hikes, resulting in very strong USD (3) sustained inflationary pressure (4) geopolitical tensions (5) Risk of offshore Chinese listed companies being de-listed from the US stock exchanges.

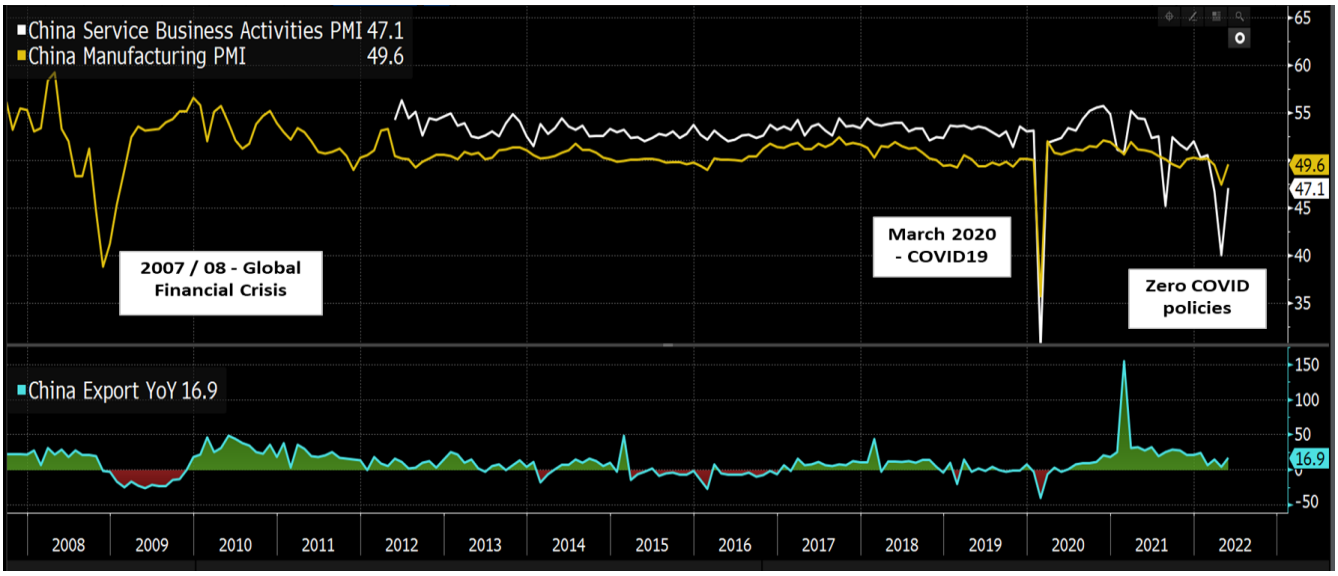
Is the worst behind us?

China service business activities and manufacturing in the month of May rebounded (refer to CHART 9), as COVID restriction gradually eased. The latest industrial production also shows sign of recovery, though the property market continues to struggle amidst the imposition of the 3-Red lines regulation, which set out the conditions limiting the amount of debt that property developers could raise.

Some COVID restrictions in Shanghai were eased in June 2022, allowing factories to gradually resume production and logistics bottlenecks to ease. However, regular virus testing and other stringent controls continued to hinder consumer activity across the country.

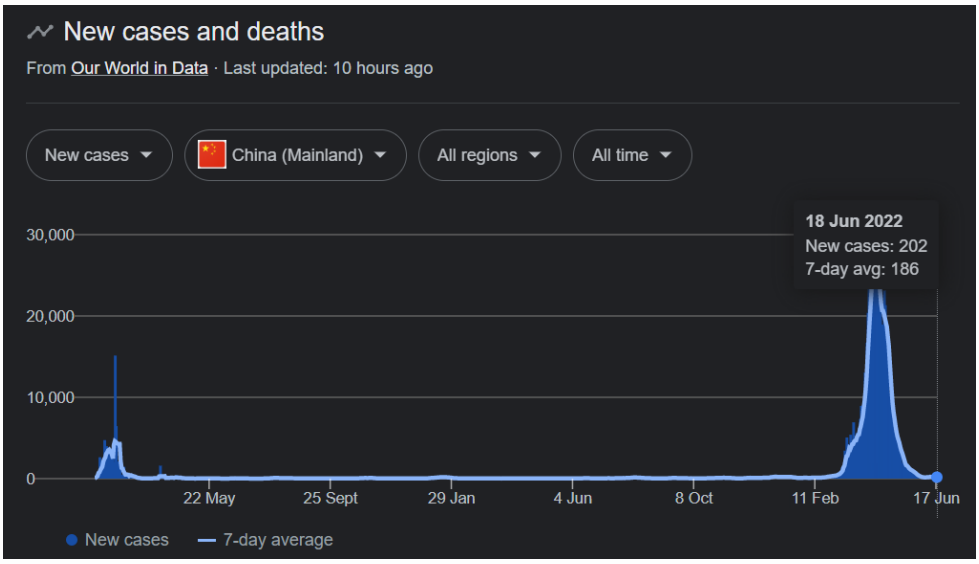
Chinese aluminium output hit an all-time high and steel production rose to its strongest in a year, as industrial activity rebounded from the worst of the virus restrictions. Steel producers are gearing up for increased infrastructure spending, while aluminium companies have seen a surge in export demand.

CHART 9 - China business activities recovering in May 2022



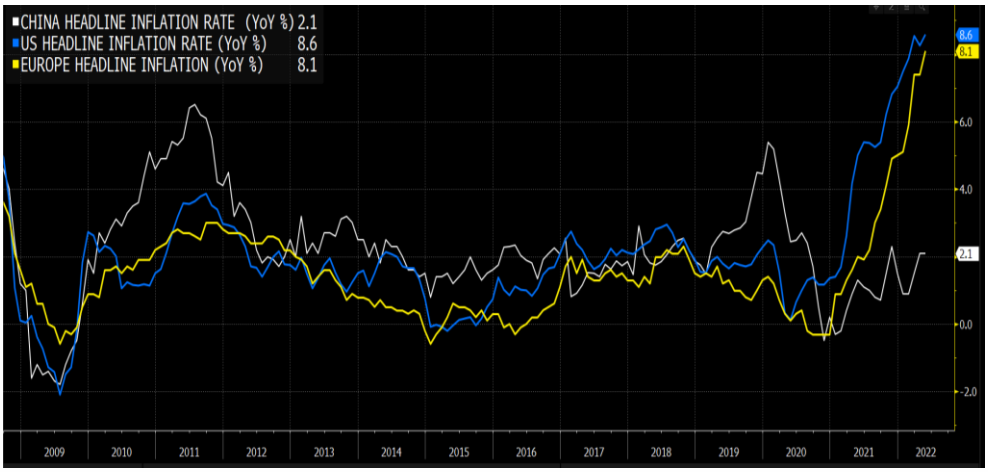
Source: Bloomberg – May 2022

CHART 10 – China COVID-19 Cases



Ample room for loosening policies to achieve GDP growth target of 5.5% in 2022

CHART 11 – China relatively lower inflation (due to slower growth) provide room for loosening policies.



While the central banks in the western world continue to tighten monetary policies to control inflation, the Chinese lower headline inflation provides room for loosening policies. President Xi Jinping has made stability a priority ahead of a twice-a-decade party congress later this year at which he's expected to secure a precedent-breaking third term in office. The People's Bank of China has cut interest rates, reduced the amount of cash banks must hold in reserve, and boosted credit expansion in the economy. With official GDP growth target of 5.5% for 2022, this could indicate the central bank would likely to continue its loosening stance to achieve growth target.

China vowed policies to boost financial markets and increase economic growth as it attempted to ease investor fears on risks from the property market, overseas listings and internet companies. Regulators in China and the US have achieved positive progress on the issue to resolve their differences over the auditing of Chinese companies whose shares trade in the U.S. markets, and are working to formulate a detailed cooperation plan, according to a Xinhua report on 16 Mar 2022.

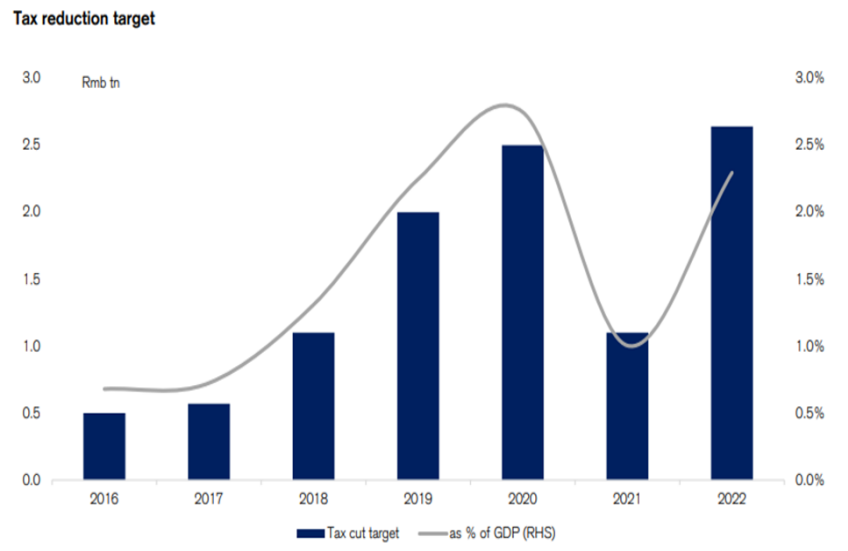
Source: Bloomberg – June 2022

Regarding its property sectors, the central government has rolled out some easing measures, including lower mortgage rates, down-payment and faster home loan procedures, to help improve sentiment. On February 18, Heze became the first city in China's northern Shandong province to introduce easing measures, with four major banks lowering the minimum deposits for home purchases to 20% from 30%. Within the next two weeks, eight more cities, including Nantong in the eastern Jiangsu province, Greater Bay Area city Foshan and Chongqing, one of four centrally administered municipalities in the country, lowered their down payment requirements. Regarding the tech sector, there are more signs of regulatory easing, which is an important employer of young people. Regulators approved more games and are reportedly preparing to lift the ban on ride-sharing giant Didi. In June, there are 60 new game titles approval by the National Press and Publication Administration. It's an acceleration from April with 45 game titles approval.

TABLE 4 – Selected China Fiscal and Monetary Loosening Policies

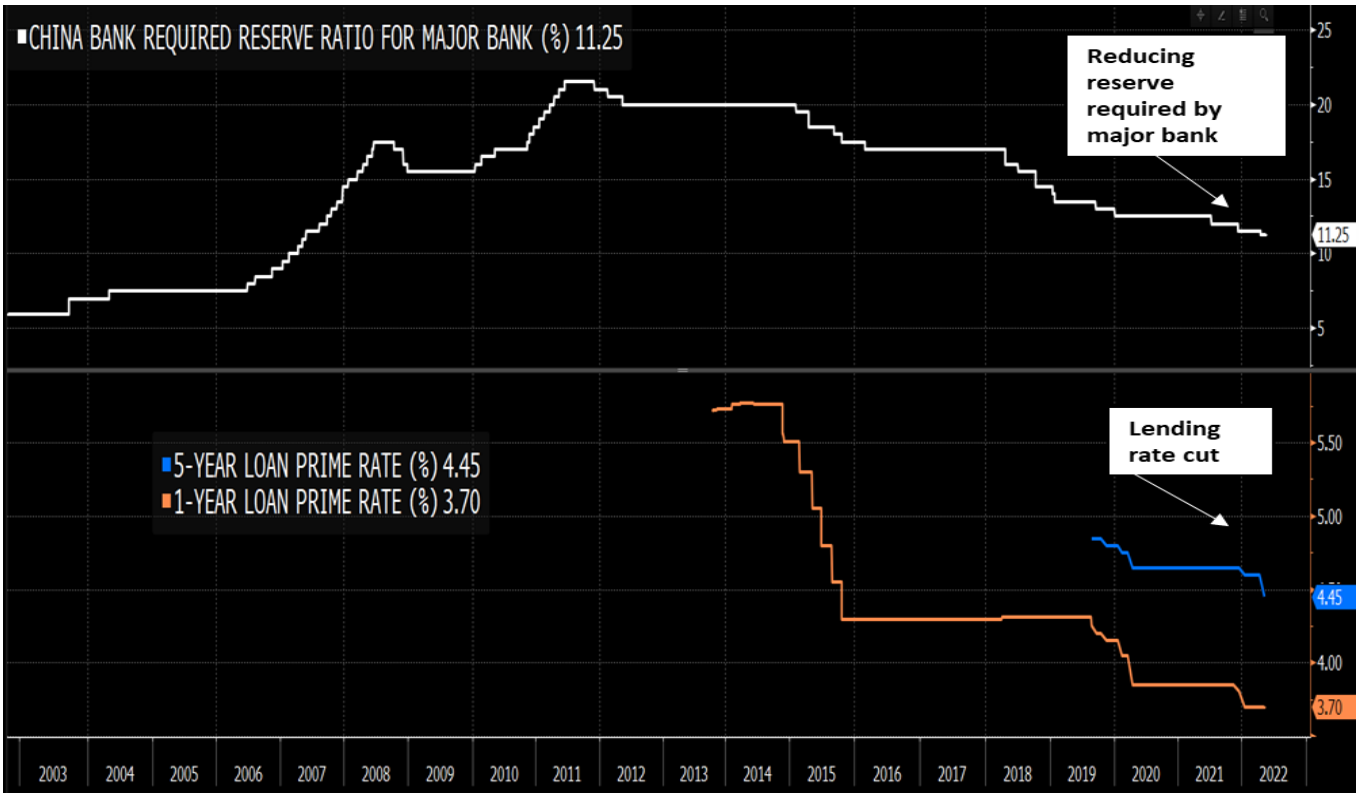
Department	Focus	Key Measures
State Council	Overall Economy	✓ Boosts total tax rebate amount by **Rmb 140 bil (USD 21 bil)** ✓ Cuts car purchase tax by **Rmb 60 bil (USD9 bil)** ✓ Increases **Rmb 150 bil (USD 22.6 bil)** loans for civil aviation industry and supports the industry to issue **Rmb 200 bil (USD 30 bil)** bonds ✓ Supports issuance of **Rmb 300 bil (USD 45 bil)** railway constriction bonds
PBOC (Central Bank)	Overall Economy, Property	✓ **Cut 5-year Loan Prime Rate (LPR)** to 4.45% from 4.6% ✓ Cut mortgage rate floor for first-time home buyers to 0.2% below LPR

CHART 12 – China aims to provide more tax relief than 2020 to kick start the lacklustre growth, impacted by the year-long regulatory crackdown and zero-COVID policy.



Source: WIND, Credit Suisse – 25 May 2022

CHART 13 – China central bank is expected to loosen further.



Source: Bloomberg - 30 May 2022

KEY POINTS:

- We remain **NEUTRAL** both short & longer term.
- We cut our end-2022F KLCI target 1568 (from 1,647) to account for earnings risks rising from US recession fears.
- Malaysia's macro outlook should be more positive for 2022, given the high vaccination rate and easing restrictions should support reopening. Higher commodity prices (crude oil, palm oil & natural gas) bodes well for Malaysia.
- Key potential catalysts: (1) Government's incentives to boost the tourism sector post lockdown (2) Normalization in consumer spending leading to strong rebound in consumer sector (3) KLCI valuation is relatively cheap (4) Markets are generally bullish on oil price forecast (5) EPF withdrawal schemes coming to an end (6) Foreign equity shareholdings near decade low
- Key risks: (1) COVID variant, waning effect of vaccines (2) negative earnings impact from Cukai Makmur (3) political uncertainty as general election GE15 could be called in 2022 (4) ongoing supply chain disruptions – from lockdowns, extreme weather, energy transition, worker shortage (5) Inflation – cost pressures (6) ESG related risk and opportunities.

Economic activity improved in 1Q22 on greater mobility

Malaysia's 1Q22 GDP grew 5.0% yoy, beating our and market expectations as economic reopening gained momentum. The 1Q22 recovery raises hopes for a robust 2Q22 GDP ahead. However, the risk of a global slowdown has also risen. On balance, we maintain our 2022 GDP at 6.2% yoy, while we project two OPR hikes of 25bps each in 2H22 to end the year at 2.50%.

2023 budget could come early

The pre-budget statement has come early this year – on 3 Jun vs. 31 Aug last year. This could suggest that elections are likely around the corner and the government may want to push for an early budget. Thus far, checks with parliamentary schedule show that 2023F Budget will be tabled on 28 Oct. Nevertheless, we do expect an expansionary 'election' budget, with issues such as GST likely to be tackled post-election by the new government.

Malaysia Market strategies to fit challenging times

In the very near term, we expect the market to remain volatile given the uncertainties over inflationary pressure, Ukraine-Russia war and global monetary tightening. In view of the current conditions, we recommend investors to take shelter in sectors that offer defensive earnings - utilities, telco, healthcare, consumers and/or top high-dividend-yielders. We continue to like the banks as a beneficiary of the rising interest rate cycle. As market stabilizes, we expect the KLCI to trade range bound as the market weighs the positives from a recovering economy against potential margin squeeze due to the inability to pass on rising costs to consumers. We see downside for KLCI supported by an inexpensive FY22 P/E relative to its historical P/E, as well as dividend yields of 4.1% for 2022F.

End-2022F KLCI target = 1,568 pts

We cut our current end-2022F KLCI target to 1,568 pts (based on a 12.8x P/E, or 2.5 standard deviation below its three-year average P/E on 2023F earnings) from 1,647 pts (based on 13.5x P/E) to account for additional earnings risks rising from US recession fears. Another concern for Malaysia is political uncertainties as GE15 is due to be held by 14 Sep 2023, which could dampen market sentiment.

CHART 14 - GDP by expenditure & production components

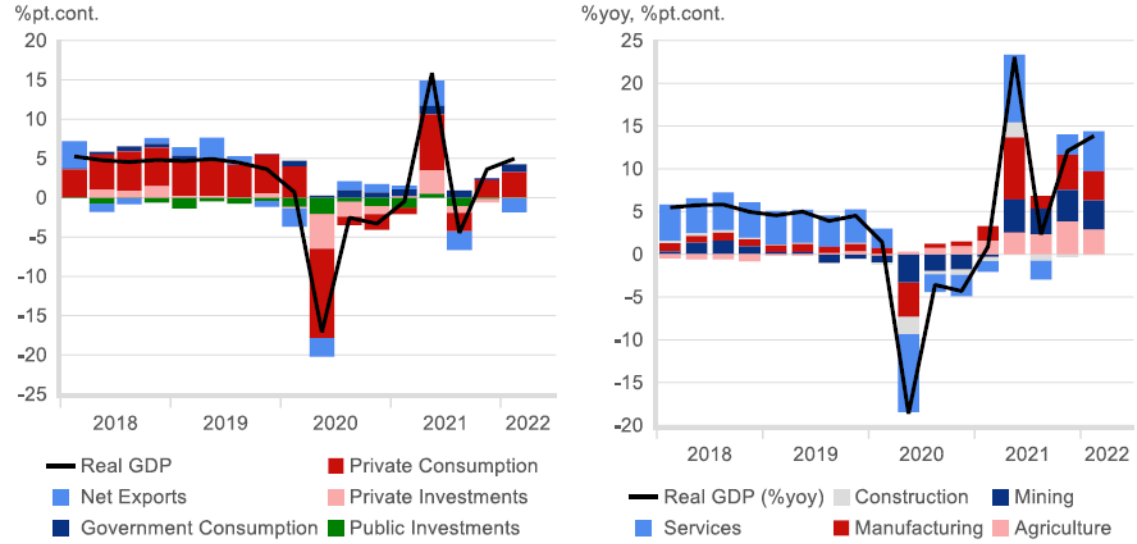


CHART 15 - FBMKLCI's 12M forward core P/E and standard deviation

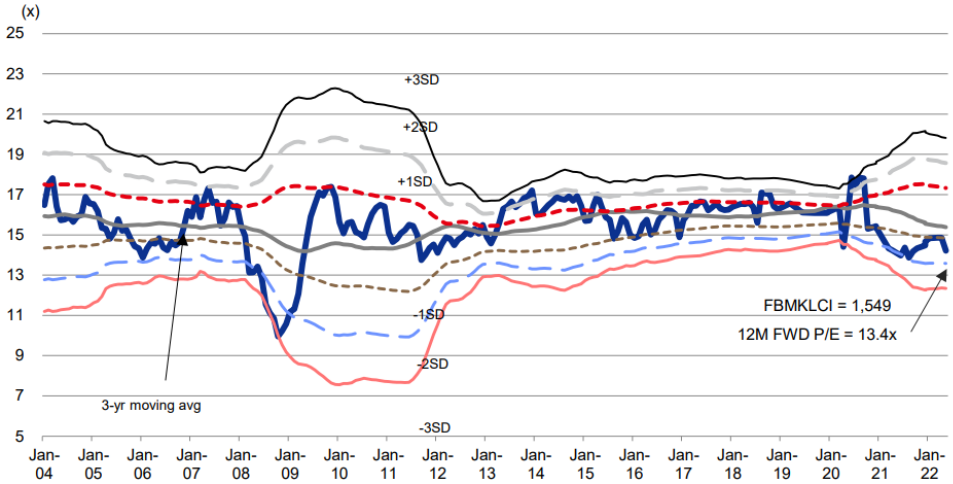


CHART 16 - Foreign shareholding in the Malaysian equity market

Source: CIMB Treasury & Markets Research, CGS-CIMB – May, June 2022

KEY POINTS:

- We maintain **NEUTRAL** for both short and longer term, our gold forecast is USD 1800 (per troy ounce) by end-2022, due to rising real yield through 2022.
- However, gold could be an effective portfolio diversifier during periods of increasing equity volatility, as shown in its weaker correlation to the risky assets.

Why gold price drop?

Gold price levels have been side-way between USD 1800 to USD 1885 since early May 2022, after coming off from the recent peak of USD 2070 on 8th Mar 2022, mainly due to sharp rise in nominal bond yield.
The rising nominal bond yield was the result of a hawkish US federal reserve on hiking its fed fund rate (the official interest rate) in order to control inflation as discussed in earlier sections. These chain effect causes real yield (nominal bond yield minus inflation) to rise and a strong USD. USD index spike up more than +6.5% since early Mar 2022 (USD value against a basket of currencies). Moving forward, we expect gold to remain in a narrow range bound with the tone set from the US federal reserve remain tilted to the "hawkish" side.

CIMB maintain NEUTRAL on Gold in near to longer term

However, we maintain the "NEUTRAL" on gold as the precious metals still presented an effective hedge to the overall investment portfolio, as shown in the low correlation of this precious metal with other riskier asset class (refer to TABLE 5).

In addition to that, amidst increasing risk of monetary policy and economic recession, the continue tightening in the central bank measures concurrently implementing both by reducing liquidity in the banking system via balance sheet reduction and interest rate hike, though not intended to tip the US economy into recession, but could increase the risk of a sharper slow-down in overall GDP growth. Therefore, these could trigger bouts of volatility in the equity market. Historically speaking, times of sharp correction in the US S&P 500 equity index would attract flow into the Gold, effectively acting as a safe haven.

TABLE 5 – Correlation matrix between Gold and other risky asset have been low, historically speaking

Selected Indices	Gold (USD / Oz)
JAPAN NIKKEI 225 INDEX	-0.06
GERMANY DAX EQUITY INDEX	0.01
US S&P500 EQUITY INDEX	0.04
SHANGHAI COMPOSITE EQUITY INDEX	0.10
FBM KLCI	0.12
HANG SENG EQUITY INDEX	0.13
MSCI WORLD EQUITY INDEX	0.13
GLOBAL BOND (Investment Grade)	0.47
Gold (USD / Oz)	1.00

Source: Bloomberg data based on weekly returns from June 2007 to June 2022

TABLE 6 – Gold acted as safe haven at times of heightening equity market volatility

Dates of S&P500 Biggest Declines	S&P500	GOLD
21 Sept 1976 - 6 Mar 1978	-19.40%	59.79%
28 Nov 1980 - 12 Aug 1982	-27.11%	-46.18%
25 Aug 1987 - 4 Dec 1987	-33.51%	8.35%
16 Jul 1990 - 11 Oct 1990	-19.92%	6.81%
17 Jul 1988 - 31 Aug 1998	-19.34%	-6.43%
27 Mar 2000 - 9 Oct 2002	-49.03%	14.18%
9 Oct 2007 - 9 Mar 2009	-56.78%	25.00%
10 May 2011 - 3 Oct 2011	-19.01%	9.37%
20 July 2015 - 11 Feb 2016	-14.06%	13.70%
2 Oct 2018 - 24 Dec 2018	-19.58%	5.48%
19 Feb 2020 - 23 Mar 2020	-33.92%	-3.63%

Source: Bloomberg - Sept 2021

KEY POINTS:

- The Russia-Ukraine war would accelerate the roll-out of renewable energy investment
- Hence, ESG investment theme will continue to gain global investors attention

While COVID-19 accelerated the adoption of technology among industries and sectors, the war between Russia-Ukraine would likely accelerate the roll-out of renewable energy investment, especially in the European Union countries. After the invasion of Ukraine by Russian forces, Europe is at risk of sliding into an energy crisis triggered by much of the continent's reliance on Russian gas, which arrives via pipelines. Among Europe's major economies, Germany imports around half of its gas from Russia, Italy would also be among the most impacted at a 46%. The European Union announced on 8 Mar 2022 it will reduce its purchases of Russian gas by two-thirds before the end of the year, in response to the country's invasion of Ukraine. Here's the selected ways how they could achieve it.

- ✓ Accelerating the rollout of renewables, both wind and solar, and heat pumps. For solar, the EU should accelerating the rollout of rooftop solar systems up to 15 terawatt-hours this year, which would save 2.5 billion cubic meters of gas. The European Commission promised a more full communication on the EU's solar strategy in June. The EU also proposes rolling out 10 million heat pumps in the next five years.
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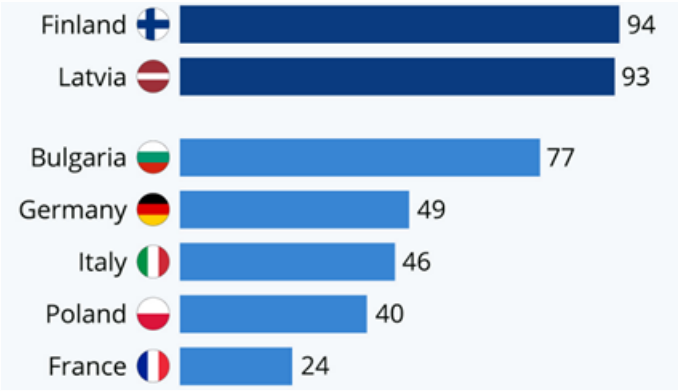
CHART 17 – % Share of the European countries gas supply from Russia (2020)



Note: Ukraine buys its gas from the EU since 2015.

Source: Statista, European Union Agency for Cooperation of Energy Regulators – 2020.

The Recent UN Climate Change Conference

The UN Climate Change Conference COP26 has taken encouraging steps towards additional major climate pledges and policy agreements to further the development and deployment of technologies that can help deliver a significant reduction in CO2 and methane emissions, as well as restore and protect the world's natural capital. The principal areas of focus at COP26 includes:

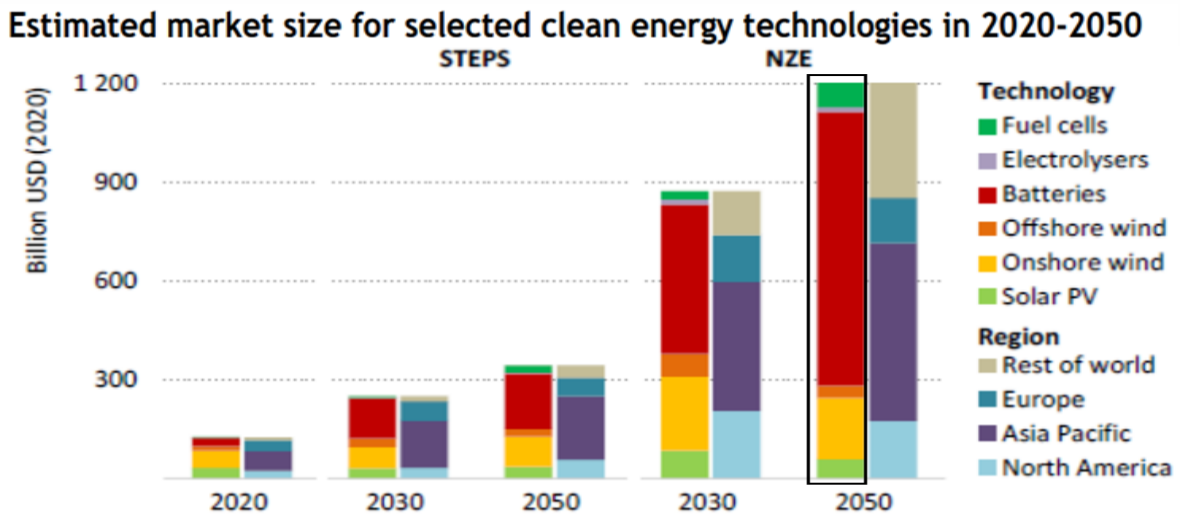
- Green hydrogen
- Residential solar energy
- Offshore wind energy development
- Energy storage to reduce carbon emissions
- Practical packaging solutions to reduce plastic pollution
- Land-based fish farming to address fish depletion
- Sustainable farming methods to protect the world's soils.

Major Commitment from the Major Players

In the US, President Joe Biden pledged for a clean energy revolution through recommitting the US to the Paris agreement on climate change, proposing US electricity production carbon-free by 2035 and the country to achieve net zero emission by 2050 by spending USD 2 trillion on upgrading 4 million buildings to improve energy efficiency, upgrading public transport by investing in electric vehicle manufacturing and charging points.

In China, President Xi has also announced commitment to achieve carbon neutrality by 2060. There are 3 clusters: power (essentially focused on solar and wind), mobility (the electrical vehicles ecosystem) and environmental industries (including carbon capture and storage, waste management and engineering firms active in boosting energy efficiency).

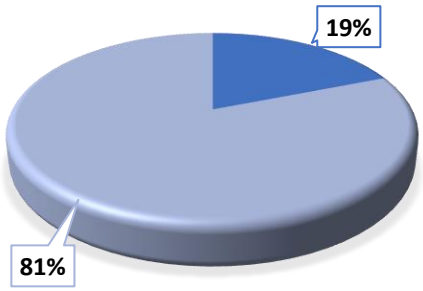
CHART 18 - Investments are increasingly being directed towards clean energy rather than traditional fossil fuels, under the Stated Policies Scenario (STEPS) and Net Zero Emissions by 2050 (NZE)



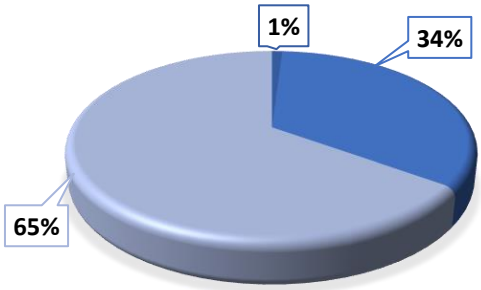
Source: IEA World Energy Outlook 2021, UN foundation.org

2H2022 Model Portfolio

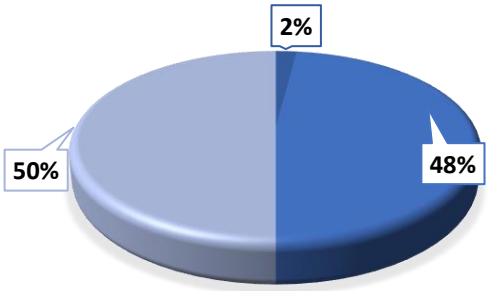
DEFENSIVE



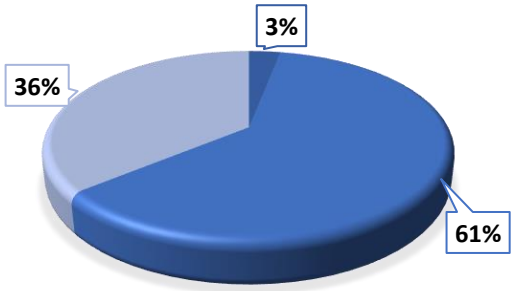
CONSERVATIVE



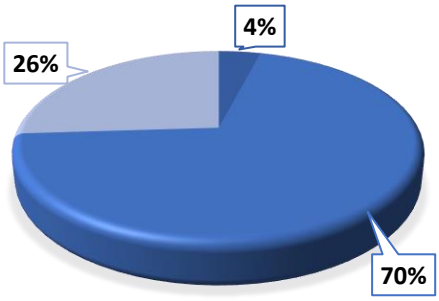
BALANCED



GROWTH



AGGRESSIVE



ASSET CLASSES:

- Equity
- Fixed Income & Money Market
- Alternative

Source: CIMB Investment Research & Wealth Advisory.
Note: Equity includes Local Equity, Regional Equity & Global Equity. Alternative includes Gold & Crude Oil.

GLOBAL & REGIONAL FORECAST

CIMB

Economic forecasts

	2019	2020	2021	2022	2023
GDP growth					
US	2.1	-3.4	5.7	2.7	2.0
Malaysia	4.3	-5.6	3.1	6.2	4.5
Indonesia	5.0	-2.1	3.7	5.3	5.2
Singapore	1.3	-5.4	7.9	3.9	2.8
Thailand	2.3	-6.1	1.6	4.1	2.5

	2019	2020	2021	2022	2023
Inflation					
US	1.8	1.2	4.7	7.8	3.2
Malaysia	0.7	-1.1	2.5	3.4	2.5
Indonesia	2.8	2.0	1.6	3.8	3.1
Singapore	0.6	-0.2	2.3	4.7	2.1
Thailand	0.7	-0.8	1.1	4.6	1.7

Policy rate forecasts

	3Q22	4Q22	1Q23	2Q23	3Q23
Policy rates					
US (upper bound)	3.00	3.50	3.75	3.75	3.75
Eurozone	0.50	1.00	1.25	1.50	1.75
Malaysia	2.25	2.50	2.75	3.00	3.25
Indonesia	3.75	4.00	4.25	4.50	4.75
Thailand	0.75	1.00	1.00	1.25	1.50

Commodity price forecasts

	3Q22	4Q22	1Q23	2Q23	3Q23
Commodity prices (average)					
Brent (USD/bbl)	110	105	100	95	90
WTI (USD/bbl)	100	95	95	90	85
CPO (RM/ton)	4,750	4,600	4,400	4,000	3,800
Gold (USD/oz)	1,850	1,800	1,780	1,750	1,730
Copper (USD/ton)	9,000	9,000	8,900	8,800	8,500

Rates forecasts

	3Q22	4Q22	1Q23	2Q23	3Q23
Bond yields					
UST 2Y	3.10	3.05	3.00	3.00	2.95
UST 10Y	3.40	3.35	3.30	3.25	3.15
MGS 3Y	3.75	3.60	3.50	3.40	3.20
MGS 10Y	4.20	4.05	4.00	3.90	3.80
IndoGB 2Y	5.80	6.00	6.00	5.90	5.80
IndoGB 10Y	7.70	7.70	7.50	7.40	7.30
SGS 2Y	2.80	2.85	2.80	2.75	2.70
SGS 10Y	3.30	3.30	3.25	3.25	3.20
Thai GB 2Y	1.80	1.75	1.70	1.70	1.60
Thai GB 10Y	3.20	3.00	2.90	2.90	2.70

Currency forecasts

	3Q22	4Q22	1Q23	2Q23	3Q23
Currencies					
DXY	104	98	96	95	96
EURUSD	1.04	1.07	1.09	1.12	1.13
USDJPY	135	133	129	127	125
GBPUSD	1.18	1.20	1.24	1.27	1.28
AUDUSD	0.70	0.72	0.74	0.75	0.75
USDCNH	6.72	6.72	6.68	6.65	6.60
USDIDR	14,750	14,600	14,500	14,400	14,300
USDMYR	4.35	4.20	4.15	4.15	4.13
USDSGD	1.37	1.35	1.32	1.31	1.32
USDTHB	35.00	34.40	33.80	33.60	33.80

Stock Indices – Year end Target

	2022
Malaysia KLCI	1,568
Indonesia JCI	7,950
Singapore FSSTI	3,506
Thailand SET	1,750

Source: CIMB Treasury & Markets Research, CGS-CIMB Research – 23 Jun 2022.

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