

# flash

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For distribution to Areca Capital Sdn Bhd's clients.

## A DAWN OF HOPE



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Dear Investors,

As we welcome the Ox-picious year 2021, we see the light at the end of the tunnel for life to go back to normal with the introduction of vaccines. Amidst these trying times, this pandemic had brought about a change in the way we function in order to adapt to new conditions and in achieving our day to day the goals . Some of the socio-economical changes have developed habits that have become perpetual in our everyday lives.

In this volume of Flash, Edward and I share our thoughts on the pathway to Malaysia's economic recovery and our take on the new norm.

Happy Reading!

A handwritten signature in black ink, appearing to read 'Danny Wong'.

Danny Wong  
Chief Executive Officer  
Areca Capital Sdn Bhd

## REVIEW AND OUTLOOK

We saw a wild ride in markets for 2020 as result of COVID-19; the spread, the attempted containment through strict global and economic lockdowns, the uncertainties from its aftermath. As showcased by the rollercoaster ride in equity markets, from start of 2020 to end-March 2020, MSCI World and MSCI Asia-ex Japan index recorded -21.7% and -18.6% respectively. However, for the full year, both reversed to record +14.3% and +22.5% gain in respective terms.

The rally has been mainly focused on the technology, healthcare and Work-from-Home (“WFH”) beneficiaries. The Malaysian index eked out 2.4% in RM terms as the sectors are not index heavyweight, relatively speaking. In terms of foreign flow, Malaysia saw a net outflow of ~RM24.6b, with almost 60% bought by local retailers. Signs of foreign outflow stabilising close to year-end may indicate comparatively less outflow in 2021 or even a return of foreign interest.

Going forward in 2021, we are still optimistic on local equities – with an emphasis on sector and stock selection.

We believe the low interest rates and flush of liquidity benefit equity prices. With the unprecedented global monetary & fiscal stimulus unleashed which is estimated at \$18tril or ~13% of global 2019 GDP, the ample liquidity will lend a hand to continued equity inflows and prices. Moreover, as interest rates remain exceptionally low, this will support the currently stretched valuation levels.

Globally, vaccine rollout is underway and so we can expect herd immunity to be achieved soon. This sets the stage for a global economic recovery and this will eventually spill-over to Malaysian shores. The global economy is expected to reverse from contraction in 2020 to 7% growth in 2021.

As life returns to normal, this would benefit the majority of the traditional businesses and sectors which are services-based. The bulk of the rally in 2020 has so far been constrained to the work-from-home beneficiaries. Despite the resurgence in Covid cases and MCO 2.0, these would only serve to defer the economic recovery. Will the pandemic recovery plays make a comeback once these are over? We believe it is a case of sooner, rather than later. Markets always look ahead. Moreover, we think that the declaration of Emergency has actually removed the near term political uncertainties.

We retain our positive stance on the technology sector. Digitalisation and automation catalysed by the pandemic will continue to be a structural trend. Tech investments will accelerate with 5G adoption and work-from-home capabilities more important than ever since the pandemic.

However, several risks remain:

If vaccines distribution were delayed due to logistics complication, supply problems or other reasons. In Malaysia, would there be a possible extension of MCO and hence a negative effect on businesses highly dependent on foot traffic? Our portfolios have little exposure to these and have largely sold off our shares in those. There is also risk of an earlier-than-expected withdrawal of monetary support from central banks in the event inflation rears its ugly head and grow at a much sharper than expected pace.

### Conclusion

**We reiterate that Equity remains the preferred asset class given the opportunity to participate in the sharp economic and corporate earnings recovery and growth. However, as mentioned earlier, despite a more certain route towards recovery, it will be uneven across different sectors; further exacerbated by MCO 2.0.**

**Hence we believe rotation and selective play to still be the required theme for 2021. More importantly however, fund manager skills will remain as the order of the day (or year of the Ox)**



# FIXED INCOME MARKET REVIEW & OUTLOOK

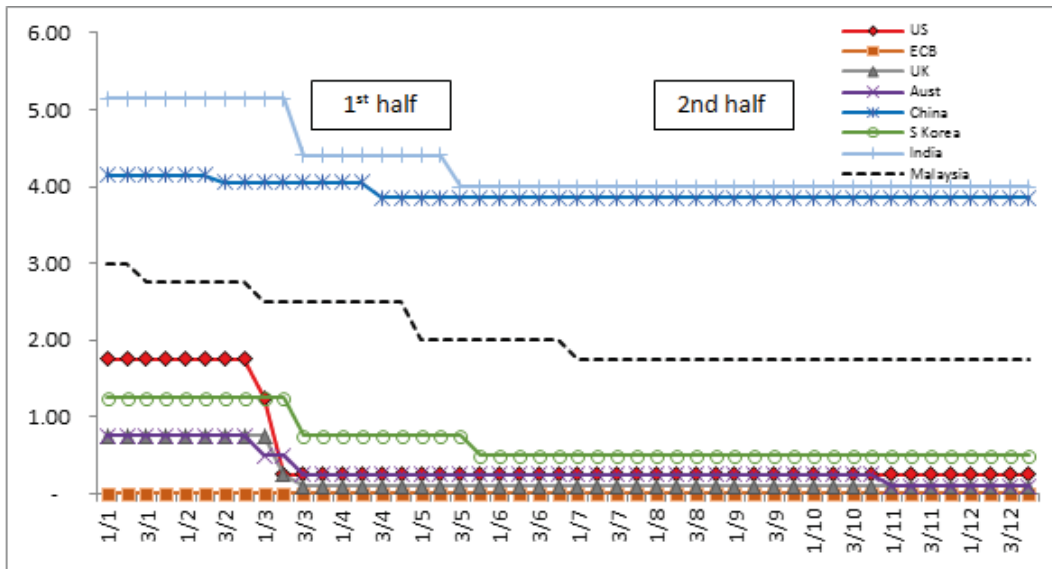
BY EDWARD ISKANDAR TOH



A year has passed since the first incidence of a new strain of virus in Wuhan, later officially named Covid19. Much has evolved since then. After multiple waves of virus attacks, several versions of mutations, more than 80 million cases, 1.8 million deaths and various degrees of human mobility restrictions globally, we have yet again prevailed. However, our physical health was hampered, mental and emotional health severely tested and economic well-being adversely impacted.

Global central banks did as much and as swiftly as could be done to alleviate economic burdens. Advanced economies floored policy rates to lighten borrowing cost.

Rush to zero occurred in the first half of 2020.



Fiscal spending has since picked up significantly. IMF records show that additional global fiscal spending to counter Covid-19 pandemic has reached US\$13 trillion as at end of 2020.

Amidst the pain and suffering, this pandemic has taught us that we can do things differently if we need to. Some of the socio-economic habits developed may even become permanent. We have indeed been thrust to adapt under unprecedented conditions. Some damage to economic sectors may also have long lasting and broad implications while other imbalances have been made worse for example the widening of wage gaps.

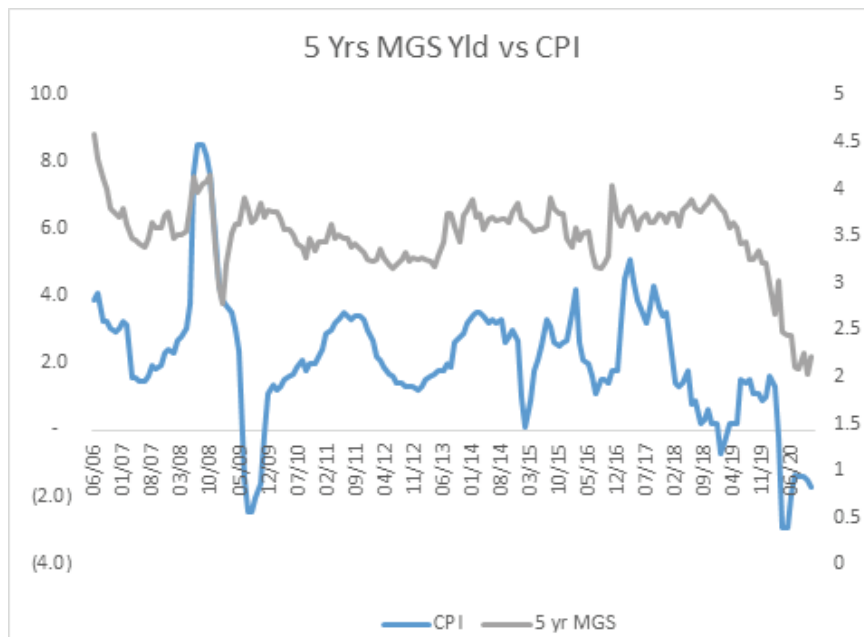
As envisioned in the previous instalment of FlashNews, a vaccine will likely be found and administered by the end of the 2020. After the mandated requirement of successful Phase3 testing, Pfizer/BioNTech was the first to announce the discovery of a vaccine, followed shortly by Moderna. AstraZeneca with Oxford collaboration then announced their version of vaccine which seem most practical currently as it requires only 2°C for transportation and storage compared to -40°C and -20°C for the earlier two. Prior to that, the Russians were the first to announce their Sputnik vaccine but without the Phase 3 testings. China also have 2 vaccines by Sinopharm and Sinovac and India has one which are all at the verge of being approved. At the time of writing, Johnson and Johnson is close to launching their vaccine which is said to be not only storable in room temperature but requires only one dose. While inoculations have begun in various countries like Brazil, Russia and Indonesia, the UK was the first to officially start mass vaccination program in early December.

Meanwhile, many countries including Malaysia were hit with second or third wave of infections. Despite the spread being 10 times higher in number of daily cases compared to the peak of the first wave in June 2020 with 277 cases, the grim seem less ominous. Could it be that we have become desensitized or jaded by the year-long bleakness or is the discovery of vaccine providing that little spark of hope that the pandemic's end is nigh. There is an acceptance of the presence of the virus while we balance our concerns with the need for continued commercial activities.

In contrast, fixed income products benefited from the suppression in yields. Interest rates plunged as the world weathered tough times and awaited good news. With the discovery of vaccines and inoculation; and potentially the end of a largely miserable year; economies will start to grind up. The depressed numbers produced last year only mean that all data will mathematically show major spikes. Though recovery will be patchy with some industries picking up quicker than others; consumption, GDP growth and inflation will appear ground shaking. We have to be aware of the low base effect as sentiment begins to pick up pace. At this juncture I will reproduce an updated chart that was displayed here 6 months ago.

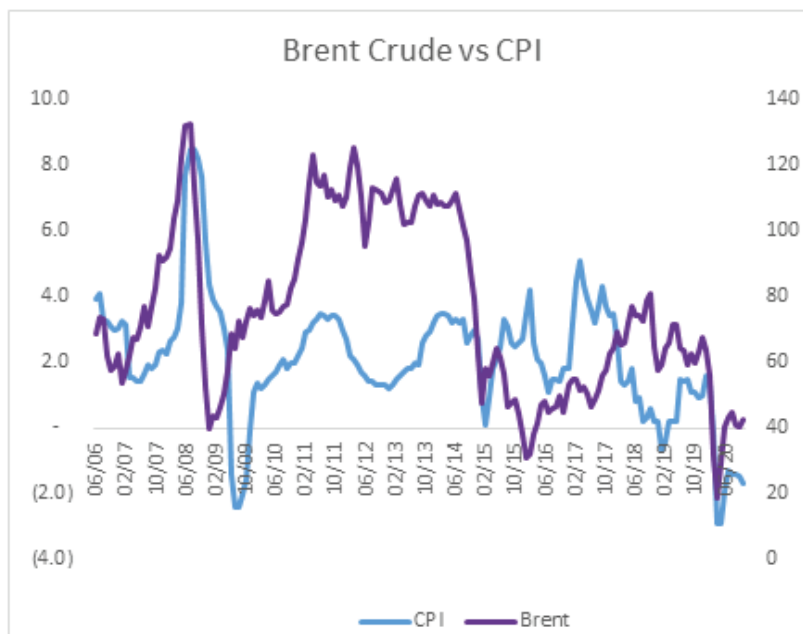
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# FIXED INCOME MARKET REVIEW & OUTLOOK (CONT'D)



The chart above plots Malaysian inflation (measured by Consumer Price Index) against 5 years Malaysian Government Securities (MGS) (benchmark with the deepest liquidity) for the last 14 and a half years. It is visually in sync while its correlation is a credible 0.47. As noted before, we conclude that a declining inflation may encourage lower Government bond yields and a rising inflation can equally instigate higher yields.

There is a strong probability that when inflation picks up, MGS yields will follow soon after. That leaves the question as to when inflation will rise. One possible indicator is oil prices. We know that fuel and fuel related sectors form a significant portion of the Malaysian CPI basket.



Again the chart above shows a general synchronicity between Brent crude price movements and domestic CPI. Though Correlation coefficient stands at 0.3, it is sufficient to provide some guidance. Brent crude hit a low of US\$19.30 per barrel in April. It closed the year at US\$51. With that said, we do expect inflation to pick up from the early Q2.

Bank Negara Malaysia cut 1.25% in total early in 2020 and has stayed pat since July. Taking the stance of allowing the benefits of lower rates to work into the economy and not be reactive, they are now more data dependent. There is sufficient room for rate cuts if the economy gets battered further.

We believe that economic activity will pick up by the second half of 2021 as rate of vaccinations gain momentum. There will be temptations to suggest that BNM may raise rates but we believe they are likely to hold back for as long as possible so that recovery can turn to sustained growth.

Investors will have to be realistic about expectations of returns moving forward compared with 2020 which reaped the benefits of sharp declines in interest rates. We will gain from a projected low and stable interest rates environment but any accelerated gains from further decline in rates are limited. We will maintain a short duration strategy for now to ride out the next phase in interest rates cycle.

# ACTIVE FUNDS – ARE THEY WORTH THEIR FEES?



WRITTEN BY:

WONG CHAW CHERN SENIOR MANAGER, PRIVATE INVESTMENT

The long-standing debate between the Actively-managed and Passive funds have not slowed down with time. Yet, not all arguments put forth, may have aged like fine wine. What is clear however, is that passion or sensationalism should never get in the way of objectivity. As we wade into the debate, here's our two cents' worth of analysis.

For context, Actively-managed funds are mostly your everyday unit trust funds, which are managed by Fund managers seeking to beat the index, for example, the S&P500 or the MSCI Asia ex Japan. For the purpose of the article, we'll refer to these as the Active funds.

On the other hand, Passive or index funds are designed to track a specific market or index. ETFs or Exchange Traded Funds also fall under the passive category. These are open-ended investment funds that are listed on the stock exchange, combining the features of an index fund/passive strategy and a stock.

## Luck Or Skill – Here's What The Facts Say

“Active funds struggle to beat their respective index” is an old narrative that seemingly gets repeated everywhere and by everyone. Could it simply be a case of, “I heard it somewhere before, so it must be true?” Utilising data from Refinitiv Lipper, we put the theories to the test.

Table 1: The Malaysian Category					
	Past 3 years	Past 5 years	Past 10 years	Past 15 years	Past 20 years
Percentage number of Unit Trust Funds beating the <b>Market</b> [1]	87.50%	88.89%	92.05%	92.96%	87.80%
Total Number of Unit Trust Funds in the <b>Category</b> [2]	104	99	88	71	41
Data as at 31 <sup>st</sup> October 2020 Returns are denominated in <b>Malaysian Ringgit (MYR)</b> , performance calculated based on NAV to NAV, net of management fees and assumes reinvestment of distribution. [1] <b>Market:</b> The market index as represented by the local Malaysian index [2] <b>Category:</b> All Unit Trust Funds under <b>Lipper – Equity Malaysia</b> , additionally classified under “Non Index-Tracking”. Source: Lipper for Investment Management					

Breaking down the numbers, say over the past 10 years (which is from 31st October 2010 until 31st October 2020), the analysis clearly shows that out of the 88 Mutual Funds classified under the Equity Malaysia category, around 92% of them has beaten the Malaysian index.

That means 9 out of 10 Malaysian Unit Trust Fund has performed better than the market during that period.

Proponents of the Passive camp may argue that Active Funds beating the market is down to luck. Now, given the tenure of the time period analysed, imagine the hundreds and thousands of decisions that would have been made during the 10, 15 even 20-year time period analysed. Over all these time periods, we find that not just a few but a large majority of Actively-managed funds successfully beat the local index or market returns.

In short, in a contest between skill and luck, you decide which have it been down to.

## Here's The Bigger Picture

But one swallow does not make a summer. Here's the rest of our analysis based on the Asian and Global experience. Returns, from henceforth are denominated in US Dollar terms.

Table 2: The Asian category					
	Past 3 years	Past 5 years	Past 10 years	Past 15 years	Past 20 years
Percentage number of Unit Trust Funds beating the <b>Market</b> [1]	64.07%	66.35%	80.73%	88.55%	88.79%
Total Number of Unit Trust Funds in the <b>Category</b> [2]	462	422	301	166	107
Data as at 31 <sup>st</sup> October 2020 Returns are denominated in <b>US Dollar (USD)</b> , performance calculated based on NAV to NAV, net of management fees and assumes reinvestment of distribution. [1] <b>Market:</b> The Asian index as represented by the MSCI AC Asia Pacific ex Japan [2] <b>Category:</b> All Unit Trust under <b>Lipper Global – Equity Asia Pacific ex Japan</b> , additionally classified under “Non Index-Tracking”. Source: Lipper for Investment Management					

We continue to see that the Actively-managed Asian funds have also been quite successful. Although the numbers have generally declined compared to the Malaysian experience, they are still quite admirable given the enlarged size of the investible market. Nevertheless, given a longer term period of 20 years, the majority or 88.79%, out of the 107 funds have beaten the market returns.

Table 3: The Global category					
	Past 3 years	Past 5 years	Past 10 years	Past 15 years	Past 20 years
Percentage number of Unit Trust Funds beating the <b>Market</b> [1]	42.42%	42.93%	45.88%	64.23%	68.87%
Total Number of Unit Trust Funds in the <b>Category</b> [2]	3,583	2,914	1,894	1,107	591
Data as at 31 <sup>st</sup> October 2020 Returns are denominated in <b>US Dollar(USD)</b> , performance calculated based on NAV to NAV, net of management fees and assumes reinvestment of distribution. [1] <b>Market:</b> The Global index as represented by the MSCI AC World [2] <b>Category:</b> All Unit Trust under <b>Lipper Equity Global</b> , additionally classified under “Non Index-Tracking”. Source: Lipper for Investment Management					

Globally, over the past 10 years, less than half or only 45.88% out of the 1,894 Funds beat the index returns. If we stretch the period out to 20 years, the numbers slightly improve; 68.87% out of 591 Funds outperform.

## A Fairer And More Objective View

Keen readers would have noticed that as we expanded the scope of our analysis from Asia to Global markets, the number of Actively-managed funds beating their index start to dwindle. Why is that the case, you may ask?

In our view, one of the plausible explanation for the underperformance of the Global funds is due to the efficient market hypothesis (EMH). Levels of market efficiency can differ significantly, from one market to another. For Developed Markets, market efficiency may be greater. The MSCI AC World which represents our Global index, has around 85% weight allocated to Developed Markets in countries like the US, Japan, UK and European countries.

On the contrary, in Emerging Markets like Asia or Malaysia, market inefficiencies still persist for now. These may come from a myriad of factors, like smaller-capitalized stocks, which are under-researched or the lack of deep and liquid capital markets. Where pockets or areas of inefficiencies exist, active managers are able to exploit these and turn it to their advantage. The under-researched stock could turn out to be a hidden gem while any knee jerk selling can be a good buying opportunity for those who have done their homework.

The numbers don't lie. If that's the case however, the next question is why does the Passive versus Active argument still persist, even in Malaysia?

In our opinion, most analysis on the underperformance originated from overseas. These are not wrong; the EMH theory could explain why active managers are having a harder time while the passive investing concept has been gaining strong traction – but in more efficient markets, in this case, Developed Markets.

Any global literature adapted, has to be reflective of the local context. Blind acceptance without proper research would be akin to one waiting in vain, for autumn or winter here in Malaysia.

## Do You Have The Time Or Ability To Beat The Market?

One of the points of contention between the Passive and Active, or even the Do-It-Yourself or DIY camps has always revolved around the fees. Without paying active managers an extra 1-2% p.a in fees, indeed, there is always the avenue of you managing your own investments. You could buy your own stocks or Passive Funds (remember you need to choose them first!) to track market returns.

Numerous investing workshop and webinars have been conducted by the regulators and licensed intermediaries to educate the retail investors in recent years. In the era of smartphones, the wealth of information available at your fingertips is astounding, but in no way should these relieve you from doing your homework when investing. On the contrary, be even more vigilant to discern the right information from the misleading ones.

Allow us to humbly add – a day of browsing through Google for medical tips do not make you an accomplished doctor. Imagine making an incorrect diagnosis of supposed illness and compounding it with the wrong self-medication. Would certain things be better left to the professionals? That is why, the straight-forward notion of buying low and selling high may ultimately turn out to be easier said than done.

Myopically, most tend to think of fees as a pure cost. None seem to think of the value it provides.

The quote, “If you focus on the trees, you might end up losing sight of the forest”, seems apt in this scenario.

From our experience, our group of investors simply do not have the time to monitor the ups and downs of the market or stocks. Some may not have the interest to do so, in the first place! They are working professionals like lawyers, accountants and even business-owners. Time after working hours is better spent with their family and loved ones.

For them, the value lies in the convenience and most importantly, to leverage on other people's skill-sets and time.

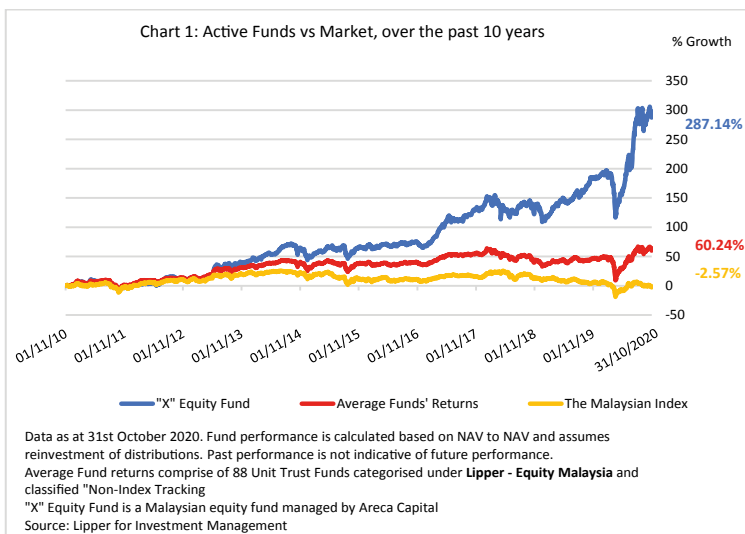
As Fund Managers, we conduct stringent research on our target companies to uncover the next hidden gem. That means many hours of peering through annual reports and presentations, understanding the industry that the companies operate in, their peers, suppliers or distributors, and even site visits to interview the management team on the prospect and outlook.

We do these so you don't have to.

Looking back at the results from **Table 1**, over the past 10 years, 92.05% of Funds beat the market. And over the past 15 and 20 years, 92.96% and 87.80% of Funds beat the market.

Here's to add to that battle between Active and Passive: **Chart 1** assumes the local index represents an index-linked ETF. It is more than a fair-enough representation because by design, a passive fund simply tracks a specific market (without looking to out-do the specific market's returns). Moreover, we do not take into account factors like:

- 1) Tracking error – which is the lag effect due to the ETF's need to re-balance its underlying stock position to be in line with the index.
- 2) Fees – Yes, ETF do incur fees too besides their management fees. Certain index-tracking ETFs utilise daily re-balancing mechanism (to reduce tracking error). This requires buying and selling underlying assets or contracts which actively involve transaction fees.



Can Malaysian Fund Managers add value? We rest our case.

# ANTICIPATING GREATER HEIGHTS

Just like every calm after a storm, as we wait for better days to settle, the year 2021 looks promising in bringing about positive changes in everyday life and the economy. So, let's be positive, stay strong and prepare yourself for better things to come!



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