A POSITIVE VIEW
ON THE MALAYSIAN MARKET

Local investors should start shifting their focus from overseas markets to the Malaysian markets again, be it equities or bonds. According to Danny Wong, CEO of Areca Capital Sdn Bhd, long-term investment themes include technology and ESG (environmental, social and governance) investing. Wong, who helms the fund house with assets under management of about RM3.7 billion, is positive on the Malaysian market next year because of several positive catalysts. As a result, the firm deployed a considerable amount of cash into the local markets in the fourth quarter of the year.

"I'm positive on the Malaysian market, be it equities or bonds, next year. Our flagship Areca equityTrust Fund had about 30% of cash reserves earlier this year and our Dividend Income Fund had about 40%. In December, the level went down to about 10% to 15%. We have been buying into the market slowly."

A key global event that Wong monitors closely is the US Federal Reserve's interest rate decision. The central bank could start lowering interest rates next year, in tandem with expectations of easing inflation and a potential recession in the US. It could drive foreign funds to Asian countries, including Malaysia, which would still be enjoying positive economic growth.

He is also keeping an eye on the reopening of the China economy, which could see business activities picking up quickly in the world's second-largest economy. Chinese tourists could start travelling abroad, especially to Southeast Asia, consuming a considerable amount of goods and services.

"The China government has started to allow some activities to take place, including marathons and the reopening of Shanghai Disneyland. Covid-19 restrictions have also been relaxed in major cities such as Shanghai, Hangzhou and Guangzhou. Even football and World Cup activities are back on the streets," says Wong.

"I'm pretty sanguine that China will slowly open up next year. When it does, the Chinese tourists will be back [in Malaysia]. You will see revenge spending, just like we did. That will come. Our economy has been doing well without Chinese tourists so far. Chinese tourists flocking here would be an additional boost to the local economy."

Moreover, the ringgit is expected to strengthen from the current level of about RM4.41 against the US dollar (USD) to RM4.20 next year when the Fed starts lowering interest rates, which would make the local market more appealing to foreign investors.

Malaysian equities are attractive from a valuation standpoint. Wong says the local equity market, in general, is valued at one standard deviation below its five-year historical average. It could rise next year due to favourable external and internal factors.

"The valuation of the local equity market is actually quite low. Foreign holdings as well. It used to be at about 23%, and it is now just slightly above 20%. There is upside for foreign fund flows to come in," he adds.

The newly elected unity government has an important role to play in ensuring the positive development of the local market and economy. Stability is key, he says. "The local market could stage a comeback and stock prices could rise. This would also depend on the stability of the new government and if it is serious about fixing the problems in our economy. Local equities would surely do well if that happens."

The key risk, however, is that a recession could happen in the US next year. Market sentiment could be weighed down by negative news flow from the West even though Asian countries, including Malaysia, would still be enjoying positive growth.

But Wong is not too worried. Should a recession materialise, it is expected to be a short one that could last two to three quarters, based on historical data.

Asset allocation would play an important role in ensuring investors stick to their long-term investment plan to ride through market swings. "The recession in the US would be a technical and very short one, if it happens. One should focus on the long term and follow through with one's investment plan," he advises.

"It is important to have a balanced portfolio that can withstand market volatility and generate good returns over the long term. You can talk to the professionals if you are unsure how to achieve it."

FIXED INCOME UNDER FOCUS, BUT BEWARE OF CREDIT RISK

Against such a backdrop, sectors that Wong likes include consumer, financial and technology in Malaysia and China. He favours the consumer sector as the country's economy is healthy and continues to improve even when the tourism sector hasn't fully recovered. The reopening of China's economy, which would see Chinese tourists visiting Malaysia again, would be a tailwind for the industry.

The financial sector, mainly banks in Malaysia and China that are paying decent dividend yields at their current share prices, is another beneficiary of higher consumer spending and improving economic health. Their prices could rise further when interest rates normalise, providing investors with capital gains on top of dividend distributions.

Real estate investment trusts (REITs) are also attractive, given their dividends. Wong is selective when it comes to local REITs and only picks those that are well positioned to benefit from the reopening of the Chinese economy, such as those with good exposure to central business districts.

While Malaysian REITs that focus on office space are facing some challenges due to the overhang in the property sector, it is not the case in Singapore. Office REITs have done well in the city state this year as multinational corporations and businesses moved their headquarters from Hong Kong to the island republic.

"A number of companies in Hong Kong moved their offices to Singapore during the prolonged lockdown period. These included banks, asset management firms and other businesses," says Wong. Areca Capital has invested in Singapore REITs (S-REITs) for some time and continues to increase its exposure to the sector.

Malaysian Government Securities (MGS) is another area that Areca Capital is placing its bet on. It is one of the investment instruments with the lowest risk in the country and is actively traded in the market.

Wong says that at one point, the 10-year MGS was trading at a price that generated a yield of about 4.4%, which was very attractive and rare, for investors.

"You hardly see the 10-year MGS being traded at that level. Given the state of the global and local economy, an investor that holds on to it for a year could potentially gain a double-digit return when interest rates start falling again. The yield has run up so high," he adds.

However, one has to watch out for credit risk, which is the probability of borrowers defaulting on loan repayments, as the global economy is likely to have a bumpy ride in the shorter term.

It is based on these views that Areca Capital offers a suite of products that aim to help investors generate positive returns over the long term.

Other than its flagship products, Areca equityTrust Fund and Areca Dividend Income Fund, the firm launched the Areca REIT Leverage Fund (ARLF) in December last year that amplifies investors' exposure to S-REITs for stable income and good returns. With potential leverage of up to 100% of its net asset value (NAV), ARLF aims to outperform its benchmark of an absolute return of 4% to investors with a minimum investment of RM50,000 or S$50,000.

"Next year or so, we expect some recovery in the S-REITs' share prices, which may bring potential capital gain," says Wong.

There is also the potential launch of a fund with a leverage feature, which will leverage the 10-year MGS as the risk-reward ratio is increasingly attractive. The fund will slowly buy up more government securities in anticipation of another one to two rate hikes by Bank Negara Malaysia, which could drive MGS prices down and yields higher.

"We will deploy more into MGS moving forward as the rate-hike cycle might not be done yet. REIT prices may continue to go down. In general, their prices have gone down by roughly 15%, and the fund is slightly positive. Its performance is expected to continue to improve," says Wong.

Foreign currency bonds, mainly USD-denominated bonds, are not as attractive, he says, mainly due to the anticipation of a strengthening ringgit against the greenback.

"I won't encourage investors to go into this space. Certain corporate bonds with strong names could give you a yield of 10%. But if the ringgit strengthens from RM4.40 to RM4.20 against the US dollar, you would have already lost 4.5% in returns. Why take this kind of risk? Unless you're spending the investment money in the US dollar as well."

THE ESG AND DIGITAL BANK PLAY

Two structural long-term investment themes that Wong is particularly confident about are the fast-growing ESG and technology trends.

Recently, he assembled five analysts to focus on the climate change-related segment, enhance its ESG screening and evaluation processes, and devise new investment strategies to capitalise on the sustainable investing trend.

In fact, the firm will soon launch a climate fund that invests in renewable energy companies and firms operating in traditional sectors, but are making a serious effort to be more environmentally friendly and improve business efficiency.

Wong sees massive opportunities in ESG investing as the Malaysian government has announced its plan to reduce carbon intensity by 45% across the economy by 2030. It is also committed to achieving net zero greenhouse gas (GHG) emissions by 2050.

"Both timelines are not too far away if you think about it. A massive amount of money needs to be injected into this area by our government and businesses, if we are to achieve both objectives in line with the global trend," he says.

The enhanced ESG valuation and screening method will be gradually incorporated into the other funds of the firm, he adds.

Wong says the firm is a true believer in ESG and sustainability, and that it is not launching the fund for the sake of riding the market trends. "We have, in fact, reduced our exposure to a big-cap energy company that still utilises a lot of fossil fuel and increased our holdings in a smaller-cap solar panel company."

He is also a believer in technology, as much as he is a believer in the sustainable investing trend. This explains why Areca Capital invested in several financial technology (fintech) start-ups alongside its investors.

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These start-ups are Versa, a licensed online platform that offers investment products and portfolios; MobyPay, a buy now, pay later (BNPL) service provider; and DearTime, a digital life insurer in the Bank Negara Malaysia Fintech Regulatory Sandbox. Each start-up helps the firm extend its services to different verticals in the wealth management ecosystem.

The firm is also developing its robo-advisory platform internally that allows investors to put money in exchange-traded funds globally based on the investment themes of the day.

In the bigger picture, Areca Capital is hoping to work with digital banks starting next year and sell its products and services to them and the masses, especially the younger generation. "We have constantly engaged with the digital banks as they are expected to be rolled out next year," says Wong.

Investing in start-ups is about preparing the firm for the future, when the younger investors grow up and become the main savers and spenders of the economy. Today's investors from the younger generation like to do things online and make decisions based on their own research. They conduct their daily activities using their smartphones and like getting things done instantly. Instead of owning tangible assets such as real estate like their parents, they prefer to invest in liquid assets based on specific themes and principles of the day, Wong observes.

"The younger generation is different. My parents, who are baby boomers, saved and invested for survival, to put food on the table. Come to my generation, we are slightly better off, and we want to own tangible assets, like buying properties. We all bought properties in the 1980s and 1990s.

"Come to the millennials and younger generation, many of them live in the gig society. They like technology and think and behave differently. Instead of owning tangible assets, they look at things like climate change and the environment. They want convenience and to be treated fairly. They value freedom and fairness. When it comes to investment, they ask questions like, 'Is it doing good for the climate or not?' Or 'Are companies treating their workers well?' They are very different."

The products and services of the start-ups can cater to the needs of the younger generation. "This is why we are funding these start-ups. The digital banks and younger generation will need them in the future," he adds.