AREA CAPITAL

flash

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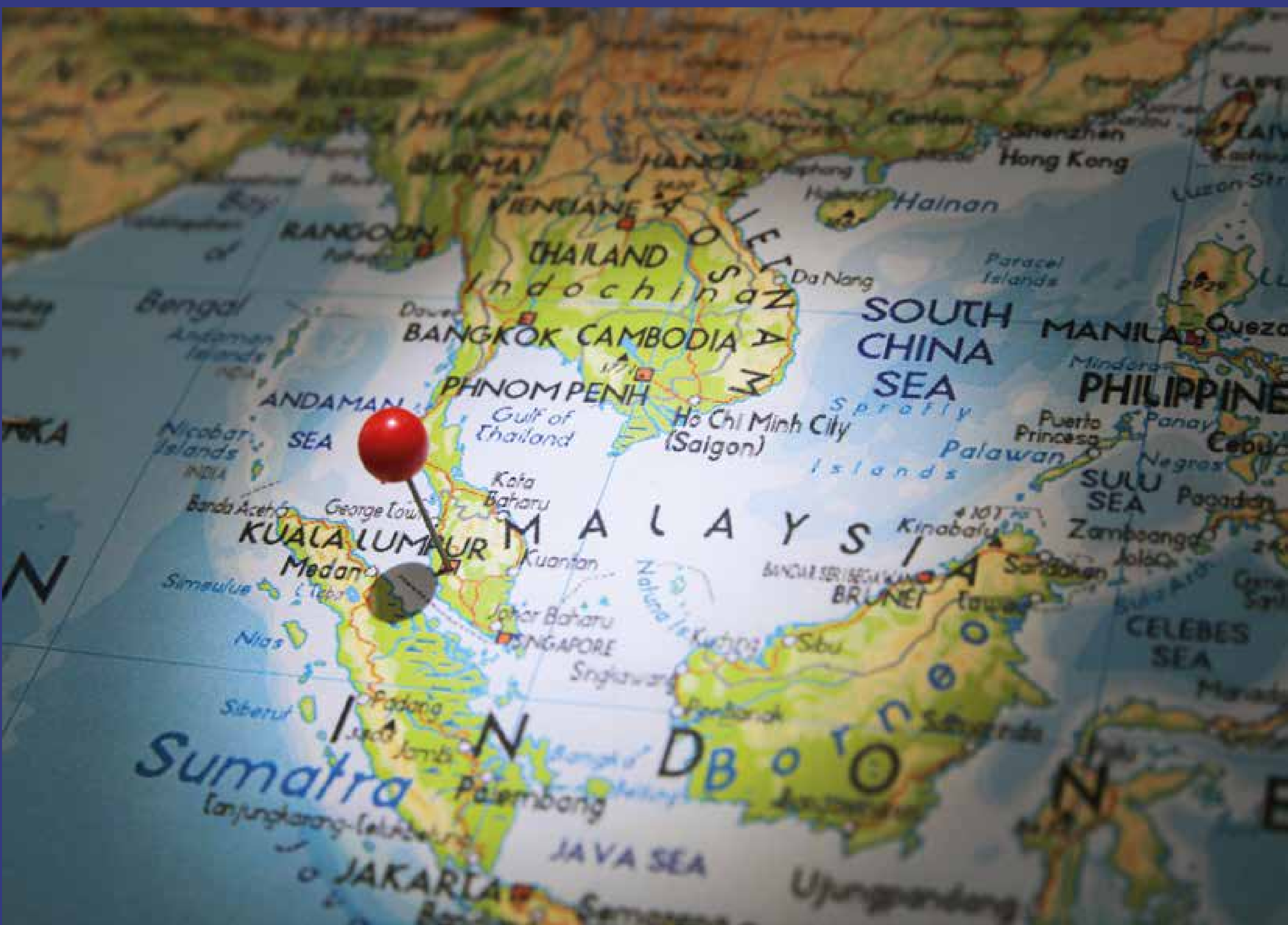
The Diamond In The Rough



From the desk of Danny Wong

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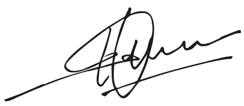
Dear Investors,

Despite the trade war rhetoric and yield curve inversion which sparked fears of a global recession, global and regional markets powered ahead. Malaysia equities however, continues to lag behind its peers while the local bond market could be painting a different picture.

What does 2020 bring and with it, are there any opportunities? As our theme suggests – Where is the diamond in the rough? In this volume of Flash, Edward and I share our views and insights if 2020 could be a year of flourish and where are the markets headed?

The number one risk to wealth in the minds of most people, is a financial crisis, but true wealth management encompasses wealth accumulation, protection and distribution. Could most people be overlooking other factors as well? We analyse that in our article.

Happy Reading!



Danny Wong
Chief Executive Officer
Areca Capital Sdn Bhd

Market review and Outlook for 1H 2020

By Danny Wong

REVIEW AND OUTLOOK

180-degree abrupt turns were prominent features of 2019. The year kicked off with global equities staging a sharp V-shape rebound emerging from the depth of the last year end correction all the way to hitting new record highs towards year end. The US Federal Reserve went from hiking interest rates to cutting rates during the year. The tweets from US President Donald Trump went from trade war to a trade detente with China. At home, our expectations of improving political stability and policy clarity has evolved into escalating political uncertainty as the transition of power from an incumbent Prime Minister to Anwar Ibrahim-current PKR leader-remains undetermined.

Global markets, as represented by the MSCI AC World index rallied 24.1%, led by the Developed Market; US, Europe and Japan. US Indices in the likes of S&P 500 and NASDAQ chalked up gains of 28.9% and 35.2% respectively, in US Dollar terms. MSCI Asia ex Japan followed suit with an admirable 15.4% gain, supported by rises in the Chinese and Taiwanese markets.

Looking ahead, can the gravy train keep humming along in the backdrop of slowing demand?

Investors grow edgy as there are increasing fears of a global recession to mark an end to the currently protracted market expansion. Despite the initial scare from the yield curve inversion which took place in August this year, there have been no strong indicators of recession. Factors that usually precede a recession such as financial market stress, overly excessive inflated asset prices, are not present or blaring red signals yet. However, we do expect a global slow-down especially in the Developed Markets region – as evidenced by the continued interest rate-cutting or easing monetary policies to sustain their economies.

Asia, in our view, remains the engine of growth. Investors can potentially play that theme via Emerging Market equities. Within that space, Malaysia could catch an interest among professional investors. Despite the global market rally this year, Malaysia has persistently remained at the bottom of the pack throughout 2019 – lost 6.0%.

For the foreign flows in equity, Malaysia recorded its second consecutive year of foreign fund outflow: 2019 at circa RM11.0bil, 2018 at RM11.7bil. Barring an inflow of RM10.6bil in 2017, the preceding 3 years (2014 – 2016) saw a combined outflow of RM29.7bil.

In 2020, the tables could turn as Malaysia plays catch-up. The laggard play theme is supported by 2 key factors: a combination of undemanding stock prices and low Ringgit. Putting ourselves in the shoes of other fund managers, the risk-reward ratio can be attractive to invest in Malaysia. Furthermore, GDP growth will be supported by the mega projects like Bandar Malaysia, Pan Borneo Highway, Central Spine Road, Rapid Transit Johor-Singapore, etc. In the current world of diminishing growth, anything more than 5% growth in GDP is alluring to investors.

Our Strategy for Malaysia

We continue to advocate an Asset Allocation approach for investing. We expect the 25-basis points rate cut at the start of 2020 to be supportive of growth. For Equity, our strategy revolves around a mixed exposure in:

1) Large cap stocks with strong and sustainable dividend payout.

2) Mid and small cap stocks on future proof theme (eg: Technology, 5G beneficiaries, exporters), the construction sector as well as the defensive consumer sector.

We believe that the balanced approach would allow us to take advantage of any large cap rebound; which may be short-lived, while still remaining invested in the small-mid cap play in selected themes.

At the time of writing, the coronavirus outbreak which originated from Wuhan, China is dampening investors' sentiment on equity markets, with unquantifiable global economic impact from reduced trades and tourism activities at the moment. We think tourism related stocks such as airlines, airports, hotels and casinos may be negatively impacted. On the contrary, healthcare stocks such as pharmaceuticals, glove makers and hospitals will benefit from such an event.

Conclusion

We reiterate the importance of an Asset Allocation approach – remaining invested between Bonds, Equity and Cash. It is more crucial than ever to remain flexible and agile when investing in current volatile market conditions. Viewing the glass as half-full, we believe that volatility provide opportunities for the astute investor. Being flexible will allow us to be able to seize opportunities or react accordingly to ever-changing market conditions.

Fixed Income

Market review & outlook

By Edward Iskandar Toh

As the super economies jostled, the smaller untethered ones ebbed and flowed to keep afloat. That was 2019.

There seem to be an increasing possibility that global growth rate is grinding to a lulling long low. Or an extended horizontal 'L'. Mathematically, as the base grows, the rate of increase per unit will decrease if the absolute increase is constant or grows at a slower rate than the increase in the base. Jargon for: unless there are new untapped economic frontiers, it will be hard pressed to observe high growth rates in any developed or developing economies. Case in point, China. For more than 30 years, China's growth rate were in the double digits. Despite it tapering down to 6.1% in 2019, it is still considered an impressive growth rate today. In fact in absolute terms, it grew by a larger quantum than that of the United States 3 out of 4 times in the last 8 years. Hence the bane of President Trump where which he instigated a US concocted rift in an attempt to forestall the Chinese juggernaut. That said, balance is good and preferred. Counterpunching between 2 superheavyweights is deemed healthier to a world of economic dominance by a single party.

However, there is a difference between healthy robust competition and brawling by erecting trade barriers. 2019 was a year largely characterized by the on and off trade rift between the US and China, depending on the whim of the US president and his thumb. In between, there were the intermittent reprisals of geopolitics in the form of tensions and wars with the usual nemesis in North Korea and Iran, of which led to a 'war crime' like unilateral elimination of the latter nation's top army general early this year. An instigation many feared would escalate into an unnecessary war. Thankfully, Iran appeared to have taken the high road and averted a calamity.

Economically, the US was buoyed by effects of a one-time corporate tax cut added to the continuous swirling of the remnants of Quantitative Easings of yesteryears. In spite of strong labour data and a fairly stable but low inflation rate throughout the year, under constant executive pressure, The Federal Reserve kept the gravy train chugging with three rate cuts of a quarter percent each, all in the latter half of the year. The Dow Jones Index continued to hit multiple highs.

China too used monetary policies to tamper the effects of tariffs imposed, reducing benchmark lending rates thrice from 4.50% to 4.15%. Significantly, the reserve requirement ratio was reduced from 14.5% to 13% in 2019 with another 50 basis point cut at the start of 2020. Every 0.5% reduction releases about ¥800 bil or US$115 bil into the system demonstrating the central banks acknowledgement of impending slowdown.

Turning to homeland Malaysia, negative factors throughout the year with regards to Malaysia's credit standing threatened to jeopardise our growth further. Instead of departing in droves, foreign investment community on the contrary showed their confidence in Malaysia's economy with net inflow of MYR20.7 bil into the fixed income market, debunking the myth that Malaysia is losing its gleam as a preferred investment destination. This was the first net inflow in six years. We remain relevant and are still on the map of global fund managers. In the year ahead, this has the potential of asset class switching from fixed income if outlook towards risk improves.

The usual ingredients of optimism and caution are not too different at the start of every year. But a bang indeed the year began with. While the bushes raged Down Under and locusts infests acres of farms in Africa; the US raised tensions by sending a remote drone on an assassination mission to the middle-east. Then came the Novel Coronavirus from China. The old adage of 'when America sneezes, the world catches a cold' may have to be tweaked to reflect China's increase in dominance as economically and literally.

Amidst the current xenophobic frenzy and 'despise all that is China' sentiment, it may be apt to just take stock of the situation and put things into perspective. These are some of the recent identifiable outbreaks

Outbreak	Year	Origin	Deaths
Nipah	1998	Malaysia	105
SARS	2002	China	774
H1N1 swine flu	2009	US / Mexico	284,500
MERS	2012	Saudi Arabia	862
Wuhan	2020	China	813
Seasonal flu	Annual		300,000

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Like the previous outbreaks, the fear of the unknown would likely dent several industries. The longer a vaccine is not yet discovered, the greater the impact on the economy especially to countries that are reliant on industries that will be directly impacted by that fear ie: travel, hotel, leisure as examples.

However, this year's interest rates outlook will more likely be influenced by economic and geopolitical factors as always. Events to look out for throughout the year include the US elections, middle-east tensions and the ongoing US-China trade rift.

Historically, the Federal Reserve has taken an accommodative stance in the last three months prior to the voting day in seven of the last eight US elections. Besides, inflation remains unthreatening and will leave the Federal Reserve with little impetus to do otherwise in this cycle.

China on the other hand have ample room to go in this accommodative rate phase. They are likely to lower both Reserve Ratios and benchmark Long-Term Policy rates to support declining numbers in the year ahead. More so with the drastic measures taken to address the recent flu outbreak. The lockdown of Wuhan not only directly hinders China's economy but others as well as supply chains are massively interrupted.

As for Malaysia, the challenges of adapting to a disruptive trade war has been bitter-sweet. While we enjoy the benefits of trade diversion and relocation of some industries, we also suffer the fallout of reduced trade. As such, growth remain a challenge with no reason to expect anything other than an easy interest rates environment necessary to support our economy. Looking ahead, Malaysia also stands to gain from investment diversion. When compared with regional peers, only Indonesia and Philippines have higher average deposit rates than Malaysia.

	Indonesia	Thailand	Vietnam	Philippines	Singapore	Malaysia
Av Depo Rates	4.25%	1.29%	4.68%	3.12%	0.20%	3.10%
Price per sq m	USD2,400	USD5,500	USD2,600	USD3,000	USD19,000	USD3,000
Ease of Doing Biz Index	73	21	70	95	2	12

Qualitatively, two areas that may be of interest to potential investors are the cost of real estate and World Bank Index for ease of doing business. Malaysian real estate is relatively cheaper when compared with regional capitals. The cost of an apartment in Kuala Lumpur is more expensive than only Jakarta and Ho Chi Minh City. The recent long drawn demonstrations in Hong Kong have encouraged many real estate investors to look towards Malaysia as an alternative. Regulatory obstacles have also been reduced to enable a business friendly environment. In this World Bank Index, we rank 12 globally, second only to Singapore in this region.

Hence, with the exception of the uncertainty to our premiership succession plans, Malaysia is arguably a favoured destination for institutional as well as individual investors. With a supportive monetary policy expected to prevail, fixed income as an asset class will benefit from these advantages.

Financial Crisis isn't the only killer of wealth

Written by:

WONG CHAW CHERN Manager, Private Investment

It is undeniable, financial crises risk wiping out a huge portion of our wealth. Painful memories of the more recent financial crises like 1997 Asian Financial Crisis and the 2008 Global Financial Crisis spring to mind. Everyone is afraid of the next "Big One". And as the current market expansion continues, investors from all walks of background; retail to professional, grow increasingly edgy. They are nervous of any signs that may potentially prick the bubble of market expansion.

However, besides the attention-grabbing headlines of a financial crisis, lies their less glamourous 'siblings' who can inflict equal if not more damaging consequences to your wealth. Let's examine some of these:

1. Being overly speculative

It is no surprise that speculating is a high risk game. Punters usually buy into penny stocks and rely on hot stock tips. Small initial successes eventually lead to even bigger bets in their pursuit of high monetary gains. When markets turn or the 'hot stock' cools off, things can turn ugly and fast. In behavioural finance, the disposition effect explains how investors tend to sell quickly their winning position while continue holding onto losing position. This stems from their unwillingness to accept the loss and hoping (in vain) that the situation would turn. This could be another explanation why their small profitable positions (no matter how frequent) get overshadowed by just one or two large losses.

Engaging in overly excessive market timing by moving in and out of the stock/equity market harbours risk as well. The triumvirate of 'analysis' via economic news headlines by media, gut feeling and emotional decision-making usually mean that all does not end well with excessive market timing. Timers usually end up buying high (at the peak of market optimism) and selling low (at the time of greatest market panic).

2. Short-term thinking

Unfortunately, some of us may have a very short investing time frame. How many times are we guilty of asking, "So how much percentage returns are we expecting from the equity market this year?". Short-termism is an internal constraint that may be stopping some from investing in equity. They are too worried about the day-to-day market movement or whether their capital is guaranteed. Because of that, many turn to the lower yielding Fixed Deposits or Capital-guaranteed products which gives them better peace of mind.

Unwittingly, they are now exposed to another silent killer of wealth – inflation. 2 key points to know about inflation. First, in a 4% inflationary environment, what used to cost RM1,000 is going to cost RM1,216.65 in 5 years' time. The effects become even more pronounced over time. Second, and probably the more crucial part is the fact that the headline inflation rate (recorded as the CPI or Consumer Price Index) often differs from the actual inflation experienced by the average man on the street.

If the latter is higher, then purchasing power will be further eroded. In that sense, that safe low risk, low return vehicle may turn out to be low return but high risk instead – as the person risks out-living his retirement funds!

3. Uncertainties of life events

Understandably, most people focus on financial and investment matters but one crucial area which has always been overlooked (at their own peril) is proper estate planning. Consider this, in families where financial matters are usually made by 1 key decision maker, most of the time the remaining family members are not found to be too financially-savvy.

This could have major consequences. Unexpected events do occur and sometimes, at the unlikeliest of times. For example, what if the key decision maker is no longer there but he or she had not made any wealth distribution plans before passing on. The burden of financial management now falls on the relatively ill-equipped family members – opening the doors to a myriad of unfortunate possibilities. Will others try to take advantage of them? Will the beneficiaries spend the newfound wealth unnecessarily and in spendthrift ways? On another extreme level, could the lack of planning cause a bickering among the beneficiaries or children on who should receive what? Or worse, would lack of planning cause the family's assets to be frozen out of reach of the beneficiaries at a time when they need them most? As you can see, lack of estate planning could all have grave repercussions to the family wealth.

Our Recommendations

Investment-wise, it is important to start with the objectives or your life goals in mind; whether they be saving for retirement, children's education etc. If you are investing for your retirement which is still 10-20 years away, investing in equities would provide a better risk-reward potential. Having a long term mind-set when investing mean that short term fluctuations should not bother you. Focus on the fundamentals and turn off the noise. Remember, the world has never been short of news, but bad news sells.

We always encourage an Asset Allocation approach - which is a strategy where you divide your investment portfolio among asset classes. Taken in the context of Unit Trust Funds for simplicity, allocate the percentage and composition of Bond Fund and Equity Funds according to your investment objective, risk appetite, required rate of return etc. From thereon, maintain the strategic Asset Allocation of your portfolio and stay invested throughout the market cycles. Avoid making any drastic moves unless they are warranted, rebalance periodically and make small tactical adjustments when necessary. Always keep your investments aligned to your long term goals. Most of us are investing for the long haul.

In terms of estate planning, proper planning can go a long way towards preventing any unwanted occurrences. If either retaining control of your wealth even after planning to distribute it away or wanting a more tailored approach towards your estate planning, a Private Trust may what you are looking for. A Private Trust combined with a Will is a powerful combination to address your estate planning needs.

Conclusion

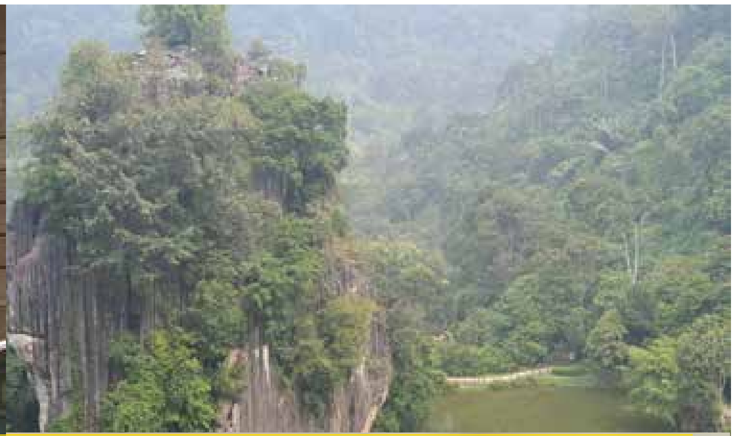
We believe that successful investing is about keeping it as simple and disciplined as possible. This combined with the flexibility and ability to respond to ever-changing dynamics of the investment climate are key virtues in today's market conditions.

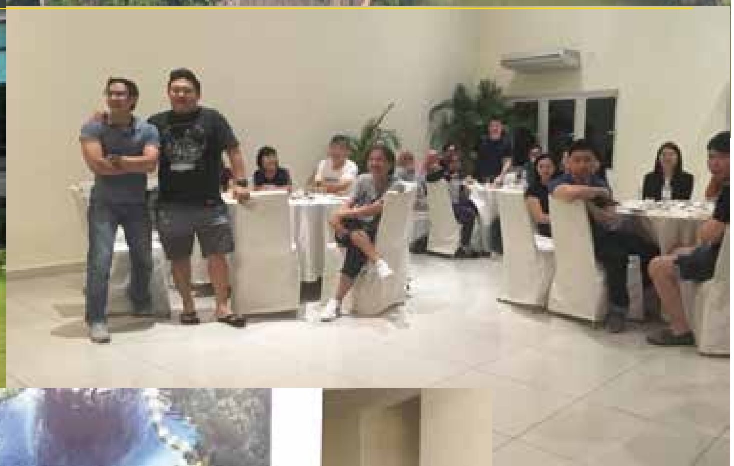
Contrary to popular and long-held belief, Private Trusts are not reserved exclusively for the rich. Neither are the fees staggeringly high nor the assets required to be in the mind-boggling tens of millions of ringgit range. In some cases, RM500,000 could be enough to set up a Private Trust.

However, it is important to consult a financial adviser or investment professional like Areca Capital in order to specifically tailor the investment portfolio or Private Trust to your needs.

ARECA TREASURE HUNT

An overnight getaway with a day out for Areca Treasure Hunt was an interesting activity to reinforce teamwork skills of the team behind Areca Capital. The 204KM road trip treasure hunt challenged the team members to solve riddles, fulfil tasks and look for clues at each stop point to solve for answers of questionnaire which finally lead them to The Haven Resort and Hotel, Ipoh. Areca Capital believes strongly in a close-knit culture and teamwork as its vital backbone amidst its workforce as well as its valued clients. It was truly a day of fun and learning to remember!





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