

ARECA
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flash

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STAYING AGILE



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Dear Investors,

As we hope for the stock market to roar in this tiger year, let's not panic but stay agile with this unprecedented political chaos in a pandemic world. We learn to ride through the storms as every cloud presents a silver lining.

In this issue of Flash, Edward and I share our insights on the equity and fixed income markets for the first half of 2022.

Stay safe, stay healthy. Happy reading!

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A handwritten signature in black ink, appearing to read 'Danny Wong', written over a thin horizontal line.

Danny Wong
Chief Executive Officer
Areca Capital Sdn Bhd

REVIEW AND OUTLOOK

We write this now as we welcome the first few days of 2022. We hope you've all enjoyed a good break after months of being at home, whether this is strolling down the beaches of Langkawi or eating your way through Penang or Ipoh.

As we have talked about in our 2nd half outlook for 2021 – there was indeed light at the end of the tunnel. And this has been made possible through our vaccination drive. In Malaysia, close to 98% of adults and 87% of adolescents have been fully vaccinated – making up the 78.5% of our population who have taken both jabs. Based on government data, about 20% of Malaysians would have taken their booster jabs as well. These are certainly encouraging numbers.

The road however has not entirely been smooth-sailing. The 'arms race' between the coronavirus and vaccines continues. New variants with exotic-sounding names like Omicron, Deltacron, Flurona have been popping up almost as fast as the next study on booster jabs and their published results. In response, some countries have even started 4th booster shots. As cases continue to skyrocket in the US, Europe, there are worries that Asia will soon be hit by another resurgence in cases. No surprise, then, that we see booster shot appointments picking up.

As a flashback to how markets have performed in 2021, the US market as represented by the S&P 500 continues to breach new highs. It returned 26.89% for the year. It's followed by some Asian representatives like Taiwan and India, which generated 23.66% and 21.99% respectively. Asia as a whole, however, has disappointed. The MSCI AC Asia ex Japan showed returns of -6.36% while our Malaysian index fared only slightly better, losing 3.67%.

Looking ahead to 2022, there are risks in regards to higher global inflation. In the US, this has spiked to above 6% levels over the past few months, which are 30-year highs. This has spurred fears of stagflation. We do not see stagflation as a possibility, at least not in this part of the world, Asia. Moreover, we expect inflation to eventually subside as the supply chain bottleneck (which has been one of the main contributors to the inflationary pressure) abates with the economic reopening.

There are also worries that the US tapering and rate normalisation will be a dampener to markets. Flashbacks of the taper tantrum in 2013 may come to mind, where S&P 500 fell around 5%. However, following the Federal Reserve's latest comments on the bond tapering, there have been no adverse reactions in the equity market. This time around, a lot of guidance has been given from the central banks. There are still risks – what if the Feds start tapering faster than expected or what if they embark on a more aggressive interest rate hike?

Picking up from where we left off earlier, indeed, new covid variants pose a concern to the optimism surrounding the economic re-opening so far. But we believe that governments and businesses should be more familiar in dealing with the stop-start nature and the infection compared to when covid first hit. Moreover, with vaccinations in place, any severe lockdown should be averted as long as our healthcare system is able to cope.

Hence our view remains. Economic recovery, although it's been delayed and postponed, will eventually come. For our Malaysian portfolio strategy, we continue to employ a barbell strategy focused on both the reopening plays and the growth angle.

- Consumers returning to their favourite kopitiam, restaurants, cafes and shopping malls will help improve businesses. We foresee the 4th quarter corporate earnings when it is released, to reflect positive effects of the reopening. The economic reopening plays in our portfolio consists of the banks and consumer sectors.
- On the other hand, the recovery in the global economy and long-term technology trends will help our exporters in the technology and industrials. Advancement and innovation in 5G, Artificial Intelligence, Internet of Things, Electric Vehicles will also continue to support some of our local players that have already tapped into these.

MARKET REVIEW AND OUTLOOK FOR 1H 2022

(CONT'D)



For our Chinese equity portfolio, we continue to remain long term positive on the world's 2nd largest economy premised on the consumption and technology theme.

- We do not support the notion that the Chinese government is against these Big Tech businesses. We think of these measures as more akin to laying down the house rules in which these businesses operate in. China is also in the phase of engineering its own de-leveraging path, as evidenced by the Evergrande issue. All in all, although the negative effects of the Common Prosperity initiatives continue to be felt, in the pursuit of a more sustainable and equitable growth, the market will develop in a healthier and more inclusive direction.



- We strongly believe that despite the current uncertainties, the major trends, proven business models and winners do not go away overnight.

We look forward to 2022 as recovery takes hold. Risks and uncertainties will be ever-present, as they always have been. We continue to maintain our flexibility and agility in our Asset Allocation, sectors and stocks selection.

Source: From various compilations. Returns are recorded in the countries' respective currencies, as of 31st December 2021. Article written on 6th January 2021.

FIXED INCOME MARKET REVIEW & OUTLOOK

BY EDWARD ISKANDAR TOH



Inflation, Inflation, Inflation.

First there was the pandemic, fear gripped and spread. Then the vaccines came along bringing hope. Gradually, beginning some time at the end of first quarter 2021, some countries began to reopen their economies. But the mutants came along and infection waves 2, 3 and 4 followed. As we learned to live with the virus, more nations stepped up nervously to re-crank up the growth engines. Other challenges as a result emerged. Wages were pressured up in the scramble for labour while global supply chain was disrupted by the uneven reopening causing bottlenecks.

Central banks reacted to accommodate the slowdown and subsequent pick up. The accompanying interest rates policies and the resultant yield curve becomes a logical cycle of low rates followed by rate hikes. What is a bit trickier is the timing and the quantum.

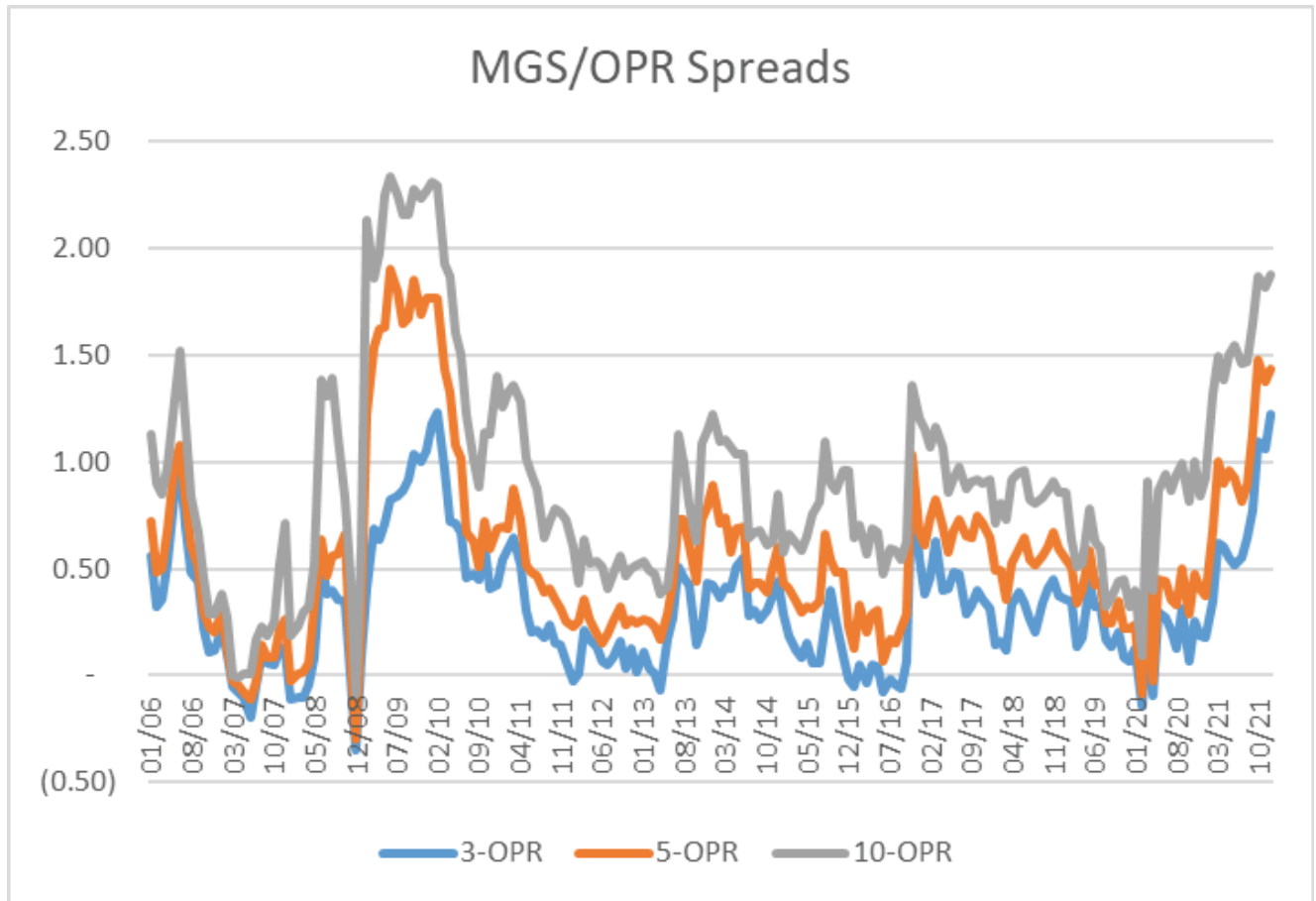
The quantitative easing programs undertaken by the US Federal Reserve to address the impact during this pandemic stacks up to approximately US\$4 trillion to date. Naturally, these excess funds that flush the system, initially to aid the loss of commercial activities but later; if not withdrawn will likely fuel higher demand and drive prices up. All throughout the year, the narrative has been one of patience towards the expected and anticipated higher inflation. The obvious explanation being 'low base effects'. The long runway of preparation for the market to usher in the imminent withdrawal of the enforced liquidity injections came to naught when the Fed turned hawkish in December when confronted with multi months-long of decade-highs CPI data.

Now that we believe the process of economic normalisation will occur this year, we can expect chatter on inflation to dominate and the need to pacify that before it gathers momentum. As it is, many central banks have made reactive as well as pre-emptive rate hike moves in recent months including South Korea and the United Kingdom. The trend will most likely continue. China on the other hand appear to be on a slightly different cycle. Recent rates easing moves have gotten many confused and wondering. Is there something really wrong with China's economy? Or is there a larger agenda in China's greater scheme of things? The official reasons offered have ranged from economic slowdown, rising household debts and property sector woes. Some have whispered that China is discouraging 'hot' money from US and Europe. Whatever the reason, one must remember that China is indeed a rising economic giant; 17% (in 2020) of global economy going on 20% (estimate for 2021) against the US's economic influence of 24%. We must be mindful of how China views growth and not just how the US and EU views it.

For fixed income investors, it is not all doom and gloom. Amidst the outlook of economic recovery and higher rates this year, there is a strong possibility of overshoot especially when we anticipate inflation to continue to rise and continue to hit new highs at least until March this year. Traders and economists will worry and as in often the case over exuberance and finicky reactions causes over compensations and over counter compensations translating to oversold and overbought positions.

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FIXED INCOME MARKET REVIEW & OUTLOOK (CONT'D)



Similarly in Malaysia, MGS yields have risen by 1% across the board when compared to a year ago. Simplistically this would mean the market expects rates (Overnight Policy Rate) in general to go up possibly by the same quantum.

The table above shows the spread between risk free MGS against OPR. The last 15 years show an average of 30, 50 and 90 basis points for the 3, 5 and 10 year benchmarks. Their respective peaks in this period observed are 120, 190 and 230 basis points. Currently they stand at 120, 140 and 190 basis points at the higher hand of the range. In my opinion this displays a case for an oversold environment.

Apart from Areca's strategy of shortening duration, this oversold positions will occasionally present itself as opportunity for us to trade and prosper from. We look forward to a year of careful positioning and opportunistic trades amidst rising rates.

GOLF WITH KELLY TAN

We are pleased to have collaborated with Malaysian professional golfer Kelly Tan to host a 5-days golf event for our valued investors and fellow golfers. Here are some snapshots of the event:



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