The Russia-Ukraine conflict and its implications for Malaysia markets

What happened?

On 24 February 2022, Russia deployed its military into Ukraine, marking a significant escalation in the Russia-Ukraine conflict. In respond, the US, UK, EU and several other countries condemned Russia's actions and imposed sanctions on Russia, focusing on Russian banks and individuals. The situation is fluid at the moment and conditions may change rapidly depending on the events that will unfold over the next couple of weeks.

Impact on the Malaysia equity market appeared shallow and short-lived; the FBM KLCI was down [1]0.77% on 24 February 2022, in line with global risk-off sentiment. However, FBM KLCI rebounded 1.13% the following day, erasing all losses from the previous session, to approach the psychological resistance of 1,600 points.

Malaysia bond market was also relatively calm, with yields largely unchanged amid light buying flows. This was in contrast to the volatile swing in the US Treasury (UST) market, which saw yields plunging initially from safe haven trades but swung back up later due to inflationary fears. The price action of USTs appeared to show conflicting dynamics at work. On one hand, risk-off sentiment bodes well for bonds but on the other hand, inflationary fears reduce the allure of bond investments.

Our thoughts

The Russia-Ukraine conflict has minimal direct repercussions to the Malaysia economy as both nations only accounted for [2]less than 1% of total trades and Malaysia's financial exposure to Russia and Ukraine are limited. However, there are indirect implications in the form of higher commodity prices and global inflationary pressure given both Russia and Ukraine are major oil and natural gas producers.

Commodity prices has climbed higher since the conflict emerged a few weeks ago and the escalation of conflict sent commodity and energy prices soaring. We expect elevated prices to linger for as long as the conflict is unresolved, which ultimately is beneficial for commodity-producing countries like Malaysia.

At the same time, inflationary pressure caused by the higher energy and commodity prices as well as sanctions-related supply disruption can potentially obstruct economic growth, which complicates monetary policy decisions, especially for the European Central Bank.

Impact from geopolitical crises on financial markets had typically been short-lived in the past. Nonetheless, there are multitude of ways in which the conflict can play out. Protracted military campaign and uncertainties relating to the final outcome of the conflict are likely to result in heightened market volatility over the near term.

Malaysia equity strategies

We maintain the strategy for our Malaysia equity strategies; we believe in keeping well-diversified portfolios between growth/technology as well as recovery/yield segments to help us ride through this volatile period.

Our tilt towards commodities since the beginning of the year has benefited the portfolios as fear of supply disruption continues to drive commodity prices up. We believe investment themes that are highly correlated with inflationary trend will continue to do well in the short to medium term.

The overall impact to Malaysia equity market should be contained over the longer term; we intend to take the opportunity from any market weakness to bottom-fish on stocks, whose fundamentals are still intact and valuation has become more attractive.

With the US Federal Reserve expected to remain hawkish, growth stocks may continue to be under pressure. Hence, we will continue to rotate certain weight from the sector into recovery stocks with the aim to reduce portfolio volatility, favouring financial, commodities and utilities. These sectors are supported by 1) cheaper valuation; 2) relatively

[1] Source: Bloomberg
[2] Source: Hong Leong Investment Bank Research, "Ukraine-Russia conflict: Implications to Malaysia", 25 February 2022

attractive dividend yield and 3) laggard recovery play.

We also believe in keeping selective tech stocks that will continue to grow and remain long-term structural winners. These stocks will help us sustain our performance when market rebounds eventually.

Malaysia fixed income strategies

The Malaysian bond market has demonstrated remarkable resilience relative to global bond markets and current market valuation has largely priced in rate hike expectation - Bank Negara Malaysia is expected to start hiking Overnight Policy Rate in 2H 2022 - as well as local supply-demand dynamics. However, sentiment remains lacklustre as rate hike expectations and inflation uncertainties weigh on market sentiment.

Our portfolio is positioned defensively at this juncture, with short portfolio duration, to brace against volatility and market risks. That said, we are less negative on the local bond market compared to last year and intend to lengthen portfolio duration gradually once global markets stabilize.

We believe income return continues to be the primary driver of our fixed income portfolio returns and have positioned our investment portfolio to leverage on corporate bonds for yield enhancement. Focusing on corporate bonds also provide better price stability as any upward movement in rates will be buffered by credit spreads.

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