MCO 2.0 & State of Emergency

After days of speculation, Prime Minister (PM) Muhiyiddin Yassin announced that the Malaysian government will tighten COVID-19 restrictions to manage the spread of the pandemic in view of the latest resurgence of infection. For the same reason, the King also declared a state of emergency for the entire nation until 1 August 2021. In this investment note, we examine the potential implications from these two events on the Malaysian financial markets.

Movement Control Order (MCO), which is the strictest form of mobility restrictions locally, is reimposed on 5 states and all federal territories for at least two weeks from 13 January 2021 to 26 January 2021. These areas where MCO is imposed account for about two-third of Malaysia's gross domestic product (GDP). Another 6 states remain under Conditional Movement Control Order (CMCO) while two other states will see softer restrictions under Recovery Movement Control Order (RMCO), which is the mildest form of mobility restrictions.

PM Muhiyiddin has clarified that civil government and public administration will continue as normal during the state of emergency. Curfew will not be imposed, and businesses are allowed to operate with no additional restrictions.

Instead, declaring a state of emergency enables the King to enact ordinances that can help in the battle against COVID-19. During the PM's speech to clarify on the state of emergency, he made references to ordinances that may enable the government to gain access to the nation's private healthcare system for the treatment of COVID-19 patients as well as ordinances that empower the military to aid the police force in the enforcement of law and border control during this period.

Another thing to note is the Parliament and State Legislative Assemblies will not convene during this period. Elections and by-elections will also be put off until the state of emergency is over.

Impact on economy

The first round of MCO in March 2020 affected growth significantly with 2Q 2020 GDP down 17.1% year-on-year (yoy)[1]. Impact to economy from the current MCO may be less due to the following reasons:

i) The mobility restrictions for MCO appear to be less restrictive, allowing the opening of more sectors of the economy.

ii) The world is not in synchronised lockdown this time round. Hence, external demand should offer some respite.

iii) Past experiences in handling MCO should help prevent a similar collapse in economic activity. Well-established SOPs, improved logistics and upgraded infrastructure for a "work-from-home" workforce translate to less disruption to businesses. Mental preparedness and awareness by the public ought to help too.

iv) Stimulus measures have been implemented and largely remain in place.

v) The prospect of vaccine should limit downside in business and consumer confidence.

Impact on fixed income market & strategies

Our long-term outlook for the local bond market is unchanged as most of the macro determining factors are still intact. Extended low interest rate environment, rotation of investments from developed markets into emerging markets as well as attractive valuation continue to support Malaysian bonds. On the other hand, prospects of economic recovery and unfavourable supply-demand dynamics weigh on the market. Overall, yields are likely to drift higher throughout the year but will be anchored by policy rate.

Note: [1] Department of Statistic Malaysia, 14 August 2020

Over the past few months, Bank Negara Malaysia has been quite reluctant to bring policy rates lower and the bank governor had noted that debt-fuelled growth may not be sustainable and focus should shift to structural policies. However, higher downside risks to economic growth due to MCO increase the likelihood of central bank cutting rates again.

There were also calls for additional fiscal stimulus to counteract the effects of this round of MCO. However, fiscal policy in Malaysia is already expansionary, with pressure to deliver medium-term fiscal consolidation given that Malaysia's sovereign rating was recently downgraded by Fitch and placed on negative outlook by S&P. We believe the Ministry of Finance will tread carefully on this end.

Meanwhile, declaration of emergency provided a period of respite from the political noises, which we view as positive for the market in the short-term.

Aside, credit condition remains manageable, though downside risks persist on the back of high COVID-19 infections and MCO.

We believe that income return will be a major driver for portfolio returns this year and have positioned our investment portfolio to leverage on corporate bonds for better income return.

Impact on equities market

The equities market already started declining since the middle of December as a result of spike in Covid-19 cases and expectations of tighter mobility restrictions.

Given that equities market is typically forward-looking, market may take the view that imposition of MCO will reduce COVID-19 infection rate, which in turn, implies that market could stabilize and rebound upwards shortly after MCO is imposed. If we refer to what transpired in the first round of MCO which started on 18 Mar 2020, KLCI troughed on 19 Mar 2020 and rebounded after that. Also, the declaration of emergency offered a period of respite from political noises, which should provide better stability to the market.

We remain positive on the mid-term prospect of the equities market as the overall economic trajectory for Malaysia is positive, i.e. recovery in 2021/2022, supported by availability of vaccines.

To a large extent, local equities market will be influenced by global and local geopolitical development, progress on the control of COVID-19 pandemic and vaccine development. Economic recovery is uneven and as a result, performance of the equities market will unlikely be broad-based across all sectors. This necessitates an investment strategy where sector and stock selection are the keys to performances.

We maintain a barbell strategy for our investment portfolio – staying with defensives to cushion against market volatility while bottom-fishing to position well for an economic recovery. We are focused on looking out for fundamentally sound stocks, particularly those that are beneficiaries of the key investment themes which we have identified: deglobalization, digitalization, structural change to China's economy and climate change.

Disclaimer

A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange trading suspensions and closures, and affect portfolio performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future, could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other preexisting political, social, and economic risks. Any such impact could adversely affect the portfolio's performance, resulting in losses to your investment

Investing involves risks, including the potential loss of principal. Financial markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. These risks are magnified for investments made in emerging markets. Currency risk is the risk that fluctuations in exchange rates may adversely affect the value of a portfolio's investments.

The information provided does not take into account the suitability, investment objectives, financial situation, or particular needs of any specific person. You should consider the suitability of any type of investment for your circumstances and, if necessary, seek professional advice.

This material, intended for the exclusive use by the recipients who are allowable to receive this document under the applicable laws and regulations of the relevant jurisdictions, was produced by, and the opinions expressed are those of, Manulife Investment Management as of the date of this publication and are subject to change based on market and other conditions. The information and/or analysis contained in this material has been compiled or arrived at from sources believed to be reliable, but Manulife Investment Management does not make any representation as to their accuracy, correctness, usefulness, or completeness and does not accept liability for any loss arising from the use of the information and/or analysis contained. The information in this material may contain projections or other forward-looking statements regarding future events, targets, management discipline, or other expectations, and is only as current as of the date indicated. The information in this document, including statements concerning financial market trends, are based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. Manulife Investment Management disclaims any responsibility to update such information.

Neither Manulife Investment Management or its affiliates, nor any of their directors, officers, or employees shall assume any liability or responsibility for any direct or indirect loss or damage or any other consequence of any person acting or not acting in reliance on the information contained herein. All overviews and commentary are intended to be general in nature and for current interest. While helpful, these overviews are no substitute for professional tax, investment, or legal advice. Clients should seek professional advice for their particular situation. Neither Manulife, Manulife Investment Management, nor any of their affiliates or representatives is providing tax, investment, or legal advice. This material was prepared solely for informational purposes, does not constitute a recommendation, professional advice, an offer, or an invitation by or on behalf of Manulife Investment Management to any person to buy or sell any security or adopt any investment strategy, and is no indication of trading intent in any fund or account managed by Manulife Investment Management. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Diversification or asset allocation does not guarantee a profit or protect against a loss in any market. Unless otherwise specified, all data is sourced from Manulife Investment Management. Past performance does not guarantee future results.

Manulife Investment Management

Manulife Investment Management is the global wealth and asset management segment of Manulife Financial Corporation. We draw on more than a century of financial stewardship to partner with clients across our institutional, retail, and retirement businesses globally. Our specialist approach to money management includes the highly differentiated strategies of our fixed-income, specialized equity, multi-asset solutions, and private markets teams, along with access to specialized, unaffiliated asset managers from around the world through our multimanager model.

These materials have not been reviewed by and are not registered with any securities or other regulatory authority, and may, where appropriate, be distributed by the following Manulife entities in their respective jurisdictions. Additional information about Manulife Investment Management may be found at manulifeim.com/institutional.

Australia: Hancock Natural Resource Group Australasia Pty Limited, Manulife Investment Management (Hong Kong) Limited. **Brazil:** Hancock Asset Management Brasil Ltda. **Canada:** Manulife Investment Management Limited, Manulife Investment Management Distributors Inc., Manulife Investment Management (North America) Limited, Manulife Investment Management Private Markets (Canada) Corp. **China:** Manulife Overseas Investment Fund Management (Shanghai) Limited Company. **European Economic Area and United Kingdom:** Manulife Investment Management (Europe) Ltd.**,** which is authorized and regulated by the Financial Conduct Authority**;** Manulife Investment Management (Ireland) Ltd., which is authorized and regulated by the Central Bank of Ireland **Hong Kong:** Manulife Investment Management (Hong Kong) Limited. **Indonesia:** PT Manulife Aset Manajemen Indonesia. **Japan:** Manulife Investment Management (Japan) Limited. **Malaysia:** Manulife Investment Management (M) Berhad 200801033087 (834424-U). **Philippines:** Manulife Asset Management and Trust Corporation. **Singapore:** Manulife Investment Management (Singapore) Pte. Ltd. (Company Registration No. 200709952G). **South Korea:** Manulife Investment Management (Hong Kong) Limited. **Switzerland:** Manulife IM (Switzerland) LLC. **Taiwan:** Manulife Investment Management (Taiwan) Co. Ltd. **United States:** John Hancock Investment Management LLC, Manulife Investment Management (US) LLC, Manulife Investment Management Private Markets (US) LLC, and Hancock Natural Resource Group, Inc. **Vietnam:** Manulife Investment Fund Management (Vietnam) Company Limited.

528927