Manulife Investment Management

Investment Note

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Rising yields and market rotation

Sharp rise in global bond yields since mid-February rattled bond investors and sent equities market into a topsy-turvy mode. This note shares insights on what is behind the market moves and their implications to the Malaysian financial markets.

2021 was touted as the year of global economic recovery and many investors welcomed the year with an extra dose of optimism. What is there not to like? Vaccine is on its way to rescue nations from the clutches of COVID-19 while monumental amount of fiscal stimulus and ultra-loose monetary policies are fuelling economic recovery.

The market expected yields to rise this year and it did. What many did not expect is the speed of the rise and the way the gradual ascent in yields gave way to a disorderly selloff in global bonds, which triggered sharp correction in pockets of the financial markets, including segments of the equities and commodities markets.

Initial selling of US Treasuries was driven by reflation trade, i.e. quick bout of inflation to bring prices back to their long-term trend, as the economy recovers. However, President Biden's USD1.9 trillion stimulus package[1] pushed reflation trades into full throttle, stoking fears that higher inflation will force the Federal Reserve (Fed) to hike rates earlier than what it had indicated.

Spikes in yields decrease the valuation of stocks, especially high-growth stocks, and therefore reduced their attractiveness. This led to volatility in the equities market and prompted investors to rotate out of expensive, high-growth stocks such as those in tech sector, into cyclical stocks which benefit from reopening of economy and strengthening of business cycles.

We do believe that markets have overemphasised the inflation aspect of the Fed's mandate. The Fed's Chair Jerome Powell has said that the US economy is still a long way from its employment and inflation goals, and further progress will take time. Although cost pressures have emerged in commodity markets with resurgent demand and supply disruption, underlying price pressures generally remain mild, reflecting sizeable spare capacity and weak labour market. In short, there is no compelling reason for the Fed to hike rates at this juncture.

[1] Source: www.cnbc.com

Impact on Malaysia equities market

Development in the Malaysia equity market tracked that of global markets closely. Technology sector, which has done well year-to-date driven by global demand for chips, took a breather. Glove stocks also saw selling pressure as COVID-19 cases trended downwards on the back of faster vaccination rollout. Instead, the market flocked to cyclical value stocks in the financials, energy and material sectors.

We view the market correction as transitory and remain positive on the prospects of the equities market, thanks to anticipation of eventual global and local economic recovery. We have highlighted before that performance of the equities market will unlikely to be uniform across sectors and the road to recovery will remain a bumpy one; current market development only serves to reinforce this opinion.

Structurally, we believe that key investment strategies identified earlier, such as deglobalization, digitalization, climate change and economy reopening, remain intact and will continue to anchor the basis of our investment decisions. In the current investment climate, sector and stock selection are keys to investment performances.

Impact on Malaysia fixed income market

Malaysia fixed income market was not spared in the global bond rout this time round and Malaysian Government Securities (MGS) yields have risen between 28 basis points and 73 basis points year-to-date 11 March 2021[2]. Upward pressure on bond yields persists due to optimism in vaccine-aided economic recovery, which encourages rotation to risk assets and raises inflation expectation. At the same time, brighter economic prospects have decreased the likelihood of further cuts in Overnight Policy Rate (OPR) though OPR is expected to remain low for some time to facilitate economic recovery. Within Malaysia, the MGS market is also weighed down by unfavourable supply-demand dynamics.

On the other hand, the risk-reward profile of MGS has changed significantly after the sell-off, now that investors are compensated with much higher yields. MGS, especially long-dated ones, are cheap relative to historical levels and relative to regional bonds. The market appears oversold and it is likely that yields may retrace downwards once the dust settles. An environment of prolonged low policy rate should anchor bond yields and continues to lend support to the bond market. Apart from that, strong global liquidity and low foreign holdings are viewed as positives for the bond market.

[2] Source: Bloomberg

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