Global Markets Research

Fixed Income

Monthly Perspective – October 2019

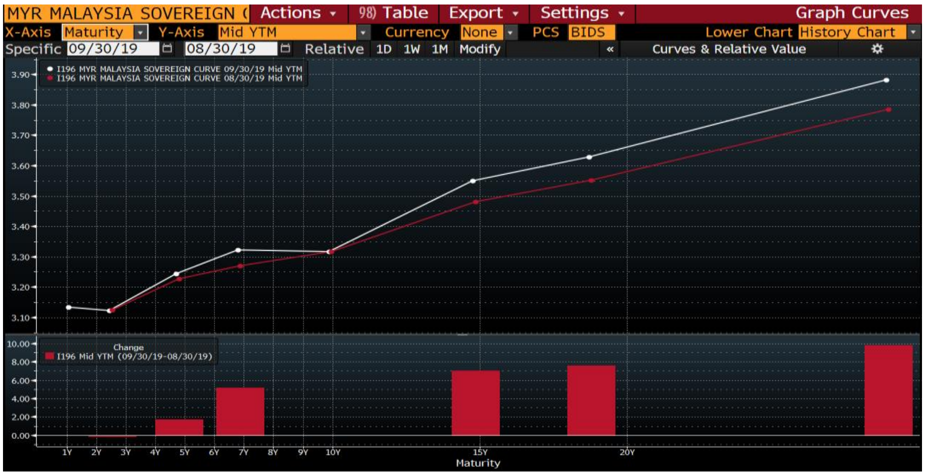
MYR Bond Market

Recapping the month of September

US Treasuries (UST's) ended weaker in September despite another 25bps rate cut by the Fed at its FOMC meeting on 18th September as investors did not flock to the safe-haven assets in droves following the Fed's non-committal stance for additional cuts for the year. Other risks and concerns over the horizon include US-China trade tariff deadlock, slowing global growth and Brexit issues. Benchmark **UST yields reversed prior month's trend; ending higher between 11-17bps.** The UST yield curve bear-flattened up to 5Y with the front-end UST 2Y yield rising 11bps MOM at 1.62% levels whilst the 10Y, which depicts as a benchmark for US mortgage rates and inflation, saw greater volatility in August; ranging between 1.46%-2.14% levels and spiked 17bps at 1.67%. The yield curve which inverted at end-August reverted to normal with both the 2y10y ending @ 4bps. The US Dollar meanwhile was again a clear winner as it advanced against most G10 currencies, with the Dollar Index charging to 99.4 levels; highest since late 2016-early 2017 period. The US job numbers (NFP) for September provided markets with mixed signals punctuated a 50-year low in unemployment rate despite weak ISM manufacturing and non-manufacturing data for September.

On the local front, **MYR govvies** saw foreign holdings inch upwards in September following two straight months of steady levels in July and August. The percentage of foreign holdings of MYR government bonds (MGS + GII + SPK) rose to 22.9% or RM169.5b of total outstanding issuance. (Aug: RM169.0b or 22.8%). Foreign purchases of overall MYR bonds was up by RM908m at RM189.1b; as opposed to prior month's marginal drop of RM89m. Secondary market volume fell sharply by one-third to RM65.7b (Aug: RM102.3b on earlier concerns on MYR govvies exclusion risks in the FTSE Russell WGBI (bonds have steadied since then as FTSE Russell maintained status quo until March 2020). **Overall benchmark MGS/GII bonds were mostly weaker with yields higher between 0-10bps save for the short-end GII papers.** The 5Y MGS 4/23 edged 1bps higher at 3.24% whilst the much-watched 10Y MGS 8/29 closed virtually unchanged at 3.32% levels. Corporate Bonds/Sukuk saw levels of foreign holdings hovering at RM12.0b levels since April as institutional investors comprising mainly of pension funds, insurance companies and asset/fund management companies were somewhat less active; resulting in a drop in secondary market volume of RM10.9b for September.

MYR sovereign curve (MGS)



Source : Bloomberg

NFP data in September provides lukewarm relief; not compelling enough to impact interest rate outlook nor a continued bond rally…

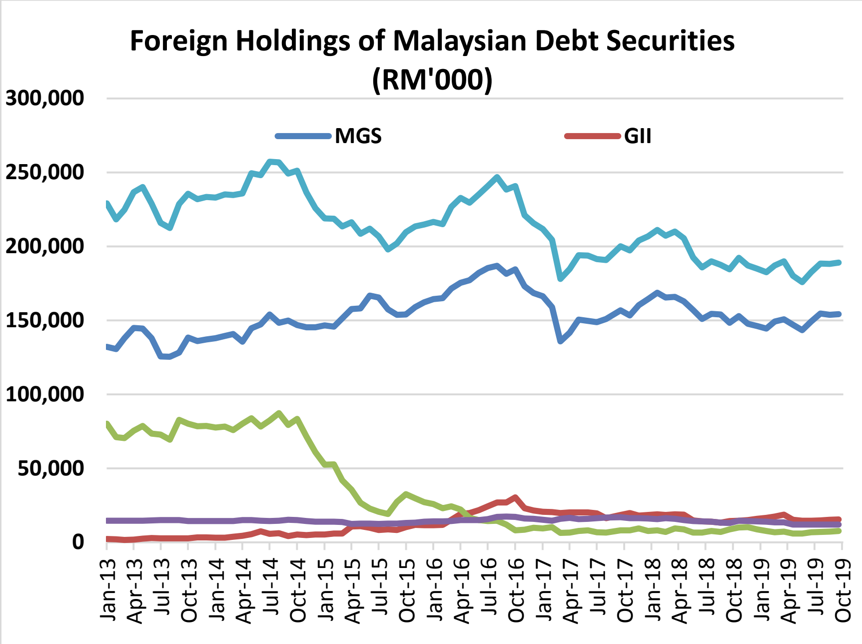
September Non-Farm Payrolls ("NFP") of 136k did not severely dent market expectations of 145k. This brought the average gain YTD to 161k, compared with 223k throughout 2018. We note that the unemployment rate has improved to a record 50-year low of 3.5% and believed to be largely attributable to the steady participation rate of 63.2% for the month. The below consensus flat print on average hourly wages of 0.0% MOM (previous month: +0.4%) and +2.9% YOY (previous month: +3.2%) however contrasted with the above data; causing the Fed to re-re-assess its overall lower interest rate outlook going forward.

The Fed cut rates by 25bps to 1.75-2.20% as widely expected in its September FOMC meeting; in what remains to be seen whether this is a tipping point for a "crawling" or a "stalling" economy. The **Fed's dot plot reflects a pause** on interest rate for the remainder of 2019. However the **market odds (via readings from the Fed Fund Futures)** took a dip post-NFP data release in what seems to be a trimming of a 3rd straight cut this month to **81% for a 25bps rate cut in October and 93% by end-December** according to a Bloomberg survey. Another reliable source i.e. CME Fed Watch Tool reflects an 86% chance of a 25bps rate cut instead for October. The Fed's **preferred inflation measure** for August i.e. the personal consumption expenditure (PCE) core index **dipped to 0.1% MOM** from 0.2% prior month**; but rose 1.8%** YOY from 1.6% prior month; (the core index which strips out the volatile food and energy costs is a better gauge of future developments). The Fed is poised to start expanding its balance sheet again, but it won't be classified as full-blown quantitative easing as they are likely to be focused on T-bills and serves to steady the funding/money markets.

Slight uptick in foreign holdings of MYR bonds in September despite initial FTSE Russell WGBI concerns….

Foreign holdings of MYR bonds improved by RM908m or 0.5% in September to RM189.1b. The non-resident holdings of MGS rose by RM462m from RM153.7b to RM154.2b (representing 37.5% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw an uptick of RM516m to RM169.5b (representing 22.9% of total outstanding) amid net maturities of RM2.0b for the month (Aug: net issuances of RM4.0b). Hence the hypothetical increase in both absolute and percentage holdings.

Local govvies got a reprieve at least until March 2020 when FTSE Russell decided to maintain Malaysia in the WGBI late last month. However the non-removal of this uncertainty coupled with the cautious outlook following the continued inclusion of Malaysia in the US Treasury Department's Semi-Annual Currency report/list in May for monitoring purposes may raise concern for investors despite the steady holdings in foreign holdings and performance of MYR bond asset class. **YTD, overall MYR bonds saw a further rise in foreign holdings to RM4.3b but a bigger slide in net equity outflows of RM7.9b** in the first nine (9) months of 2019. On the currency side, the MYR strengthened by 0.4% at 4.1877 levels as at end-September but closed mostly mixed-to-stronger against most Asian currencies. However at the time of writing, USDMYR is trading at 4.1965 amid dollar strength.



Source: BNM, HLB Research

OPR stays pat as per our house view; the undertone remains neutral due to broad-based sector expansion, gnawing inflation, stable labor market and wage growth…

BNM's monetary policy committee maintained the OPR at 3.00% as expected at the 5th MPC meeting of the year on the 12th of September, whilst keeping its economic growth forecast for this year between 4.3%-4.8% stating that the stance of monetary policy remains accommodative and supportive of economic activity. The MPC will continue to assess the balance of risks to domestic growth and inflation; whilst raising concerns about the possible impact of trade disputes and the geopolitical landscape on financial markets. (Re-cap: The last policy move was a 25bps cut in May 2019). **Our full year estimate for 2019 GDP growth remains unchanged at 4.7% levels** (1Q2019: 4.5%; 2Q2019: 4.9%; 3Q2019: estimated @4.6%) supported by moderate growth in domestic-led demand. However the risks to our projections would include the worsening external environment that may pose a risk to an OPR pause. Hence, protracted downside risks to growth imply the door for further policy easing is not completely closed as much depends on the evolvement of risks and financial conditions. Any imminent Fed rate cut(s) could raise the odds of another adjustment in the OPR should domestic growth weaken more than expected.

MYR government bond auctions saw contrast in bidding metrics for the 7Y MGS and 15Y GII bonds in Sep….

The two (2) government bond tenders concluded for the month of Sep 2019 under the auction calendar included re-openings for the 7Y GII 7/26 that saw one of the lowest YTD bids totaling a mere RM3.63b which resulted in a poor BTC ratio of 1.21x; followed by the much better reopening of the 15Y GII 6/38 (BTC ratio: 3.195x). Overall weighted average BTC for the month tanked to ~2.0x mainly due the investors staying mainly sidelined for the 7Y auction. A poor month indeed compared to both the YTD BTC ratio of 2.64x and also the entire 33 auctions for 2018 which notched a BTC ratio of 2.29x. At the time of writing investors were again seen to bid at higher yields for the 10Y MGS 8/29 auction reopening which ended with a massive tail of 15bps; averaging 3.407% on a BTC ratio of a mere 1.23x.

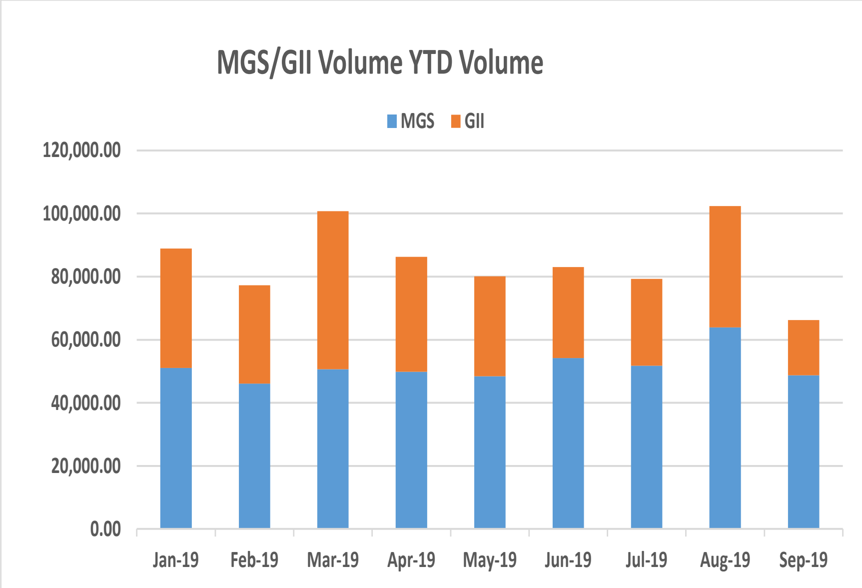
MGS/GII issuance pipeline in 2019

No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Projected Issuance Size (RM mil)	Actual Auction Issuance (RM mil)	Private Placement	Auction Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	10.5-yr New Issue of GII (Mat on 07/29)	10	Jan	Q1	8/1/2019	4,000	3,500	1,500	3,500	4.067	4.110	4.130	4.135	86.1%
2	7.5-yr New Issue of MGS (Mat on 07/26)	7	Jan	Q1	14/1/2019	4,000	3,500	500	7,000	2.216	3.890	3.906	3.914	8.2%
3	5-yr Reopening of GII (Mat on 11/23)	5	Jan	Q1	30/1/2019	3,500	4,000		11,000	1.974	3.845	3.862	3.873	19.0%
4	10.5-yr New Issue of MGS (Mat on 08/29)	10	Feb	Q1	14/2/2019	4,000	4,000	1,000	15,000	2.536	3.867	3.885	3.893	31.6%
5	15-yr Reopening of GII (Mat on 06/33)	15	Feb	Q1	27/2/2019	3,000	2,000	1,000	17,000	3.906	4.360	4.370	4.375	33.9%
6	3-yr Reopening of MGS (Mat on 03/22)	3	Mar	Q1	7/3/2019	3,500	3,000		20,000	3.132	3.470	3.483	3.487	70.0%
7	20.5-yr New Issue of GII (Mat on 09/39)	20	Mar	Q1	14/3/2019	4,000	2,500	2,000	22,500	2.758	4.445	4.467	4.480	14.5%
8	30-yr Reopening of MGS (Mat on 07/48)	30	Mar	Q1	21/3/2019	3,500	2,000	2,000	24,500	1.718	4.550	4.591	4.629	25.0%
9	7-yr New Issue of GII (Mat on 03/26)	7	Mar	Q1	28/3/2019	4,000	4,000		28,500	2.330	3.699	3.726	3.745	21.2%
10	15-yr Reopening of MGS (Mat on 11/33)	15	Apr	Q2	5/4/2019	4,000	2,500	1,000	31,000	2.792	4.058	4.065	4.071	40.0%
11	5.5-yr New Issue of GII (Mat on 10/24)	5	Apr	Q2	12/4/2019	4,000	3,500		34,500	2.313	3.627	3.655	3.669	64.7%
12	7-yr Reopening of MGS (Mat on 07/26)	7	Apr	Q2	29/4/2019	3,000	3,000	500	37,500	1.510	3.735	3.757	3.777	75.0%
13	30.5-yr New Issue of GII (Mat on 11/49)	30	May	Q2	14/5/2019	3,000	2,000	2,000	39,500	3.298	4.625	4.638	4.663	100.0%
14	10-yr Reopening of MGS (Mat on 08/29)	10	May	Q2	23/5/2019	3,500	4,000		43,500	1.840	3.810	3.836	3.852	22.0%
15	15.5-yr New Issue of GII (Mat on 11/34)	15	May	Q2	30/5/2019	4,000	2,500	1,500	46,000	3.380	4.105	4.119	4.126	44.4%
16	5-yr New Issue of MGS (Mat on 06/24)	5	Jun	Q2	13/6/2019	4,000	4,000		50,000	2.489	3.466	3.478	3.484	8.3%
17	20-yr Reopening of GII (Mat on 09/39)	20	Jun	Q2	27/6/2019	3,000	2,000	2,000	52,000	4.275	4.070	4.074	4.079	59.1%
18	15-yr New Issue of MGS (Mat on 07/34)	15	Jul	Q3	4/7/2019	4,000	3,500		55,500	3.437	3.805	3.828	3.835	73.5%
19	7-yr Reopening of GII (Mat on 3/26)	7	Jul	Q3	12/7/2019	3,000	3,000	500	58,500	2.874	3.568	3.582	3.586	70.0%
20	30-yr Reopening of MGS (Mat on 07/48)	30	Jul	Q3	26/7/2019	2,500	2,000	1,500	60,500	2.490	4.170	4.181	4.208	100.0%
21	5-yr Reopening of GII (Mat on 10/24)	5	Aug	Q3	8/8/2019	3,500	3,000		63,500	4.137	3.329	3.345	3.349	10.7%
22	20-yr Reopening of MGS (Mat on 06/38)	20	Aug	Q3	14/8/2019	3,000	3,000	1,000	66,500	3.150	3.745	3.753	3.758	81.1%
23	10-yr Reopening of GII (Mat on 7/29)	10	Aug	Q3	29/8/2019	3,500	3,000		69,500	2.000	3.290	3.318	3.330	80.0%
24	7-yr Reopening of MGS (Mat on 07/26)	7	Sep	Q3	19/9/2019	3,500	3,000		72,500	1.210	3.350	3.392	3.433	81.3%
25	15-yr Reopening of GII (Mat on 11/34)	15	Sep	Q3	27/9/2019	3,000	2,000	500	74,500	3.195	3.603	3.632	3.643	20.0%
26	10-yr Reopening of MGS (Mat on 08/29)	10	Oct	Q4	7/10/2019	4,000	3,000		77,500	1.233	3.330	3.407	3.480	35.0%
27	20-yr Reopening of GII (Mat on 09/39)	20	Oct	Q4		3,000								
28	5-yr Reopening of MGS (Mat on 06/24)	5	Oct	Q4		3,000								
29	3.5-yr New Issue of GII (Mat on 05/23)	3	Nov	Q4		4,000								
30	20.5-yr New Issue of MGS (Mat on 05/40)	20	Nov	Q4		3,500								
31	10-yr Reopening of GII (Mat on 07/29)	10	Nov	Q4		3,000								
32	15-yr Reopening of MGS (Mat on 07/34)	15	Dec	Q4		2,500								
	Gross MGS/GII supply in 2019					94,500		18,500						

Source: BNM, HLB Research

Trading volume for MGS/GII plunged in September…

Trading volume for MYR govvies i.e. MGS + GII bonds plunged sharply to ~RM65.6b in September compared to prior month's RM102.3b. Interest was seen mainly across the short-end up to the bellies with substantial and frequent trades done in the off-the-run 19-21's (RM19.0b for these tenures or forming ~29% of overall volume). This was followed by both the 7Y benchmarks (RM7.2b or 11% of total trades) and 10Y benchmarks (RM4.7b or ~7% of total trades). The month under review continued to the long-ends lost steam for both the 20Y MGS 6/38, 20Y GII 9/39, 30Y MGS 7/48 and GII11/49 benchmarks which saw lower total volumes of ~RM2.4b (Aug: RM6.6b) as investors opted short duration. Both local institutional investors/offshore parties were mostly sidelined due to FTSE Russell WGBI concerns and lack of leads way ahead of the upcoming Malaysian National Budget 2020 to be unveiled in October as yields ended richer between 0-10bps across the curve as the appeal of safe-haven assets took a backseat for the month despite the continued dovish-tilt by global central banks.



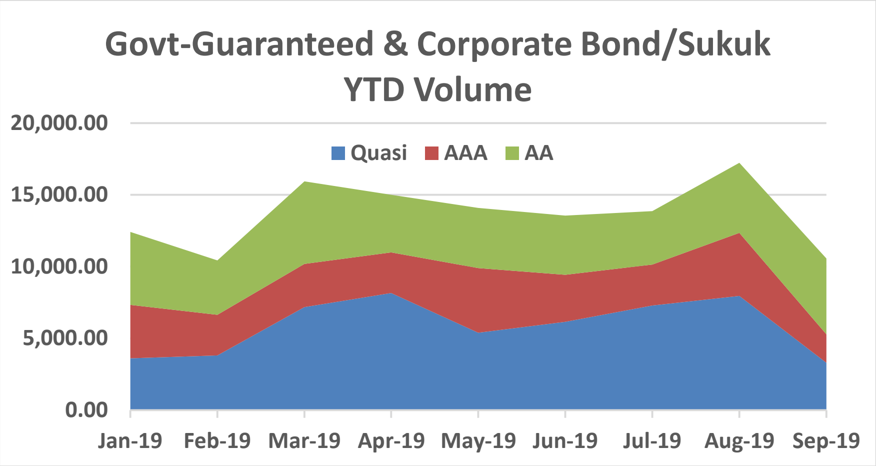
Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk similarly saw lower traction…

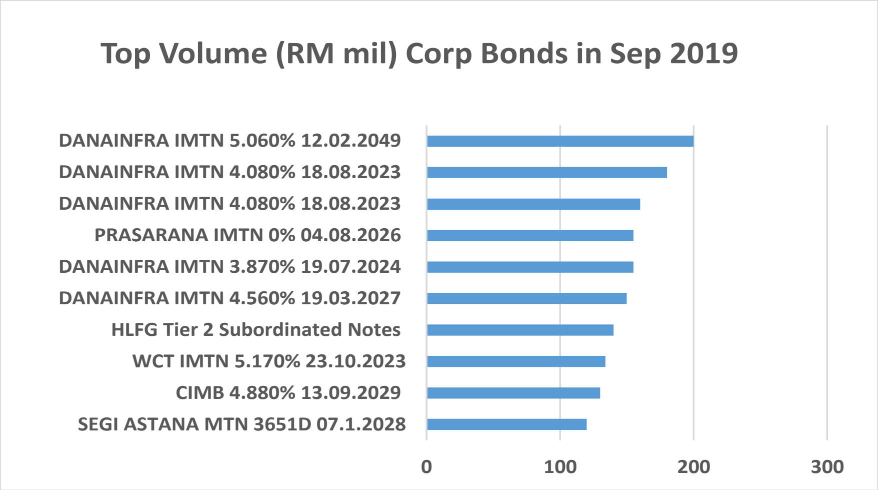
In the secondary market, Corporate Bonds/Sukuk (including Govt-Guaranteed bonds for our ease of classification) saw lower secondary market trading volume on weaker momentum as volume notched ~ RM10.9b in September (a 38% drop) compared to RM17.7b the prior month. Earlier fears emanating from the uncertain decision on Malaysian bond in the FTSE Russell WGBI contributed to the overall decline in interest from portfolio/fund managers; causing yields to generally close mix for the month. However the elevated global trade tensions and anticipated slowdown in global growth impacted overall volume in sovereigns and quasi-government bonds (GG) but saw investors move higher up the credit curve in September.

Investor appetite for AA-rated bonds drew a pleasant surprise as decent traction outperformed other bond categories with almost 10% rise; thus contributing 50% of overall volume in September (August: 28%). The largest drop in interest was seen in both the govt-guaranteed (GG) and AAA-segment which tapered by more than half. The long-dated govt-guaranteed DANAINFRA 2/49 topped the monthly volume; spiking 19bps for the month compared to previous-done levels at 4.08% followed by AA3-rated SUNWAY Treasury Sukuk Sdn Bhd which made its maiden trade at 3.94%; compared to its coupon of 4.90% when issued in Dec 2016. This was followed by another GG bond i.e. DANAINFRA 8/23 which rallied 14bps instead at 3.32%. (We have discounted the transacted volumes for WCT 2020 bonds as for buyback purposes pursuant to its new issuances in the 1st week of October).

Appetite in the pure credit space was seen in a wide range of bonds namely conglomerates, infrastructure-related names including telecommunication, toll and energy sub-sectors. AAA-rated AMAN 23-27, , PLUS 20-30, DANGA 20-33, TENAGA (incl. TNB Northern) 24-38, SARAWAK HIDRO 20-31, together with AA-rated MMC Corp 20-28, BGSM 19-25, SEB 25-35, EDRA Energy 22-34 and YTL Power 21-27 also continued to be actively traded. In the banking space, decent frequency of trades were noticed for both SABAH Development and Credit papers. (Note: we have excluded single-A rated and non-rated papers in the illustration below).



Source : BPAM, Bloomberg, HLB Research



Source : BPAM, Bloomberg, HLB Research

Primary issuance print in September boosted by following names:

Notable issuances in Sep-19	Rating	Amount Issued (RM mil)
Ara Bintang Berhad	NR	1,108
CIMB Islamic Bank Berhad	AA1	800
DanaInfra Nasional Berhad	GG	2,500
DiGi Telecommunications Sdn Berhad	AAA	900
Fortune Premiere Sdn Berhad	AA2	200
MDSA Resources Sdn Berhad	NR	16
HUBLine Berhad	NR	2
IJM Land Berhad	A2	200
Kuala Lumpur Kepong Berhad	AA1	2,000
Liziz Standaco Sdn Berhad	NR	31
Lembaga Pembiayaan Perumahan Sektor Awam	GG	3,000
Magnum Corporation Sdn Berhad	NR	185
Malayan Banking Berhad	AA3	2,800
OSK I CM Sdn Berhad	NR	100
Pac Lease Berhad	AA3	180
Potensi Angkasa Sdn Berhad	NR	10
Trinity Asia Ventures Berhad	AA3	52
Tropicana Corporation Berhad	NR	248
WCT Holdings Berhad	A2	617
Xinghe Holdings Berhad	NR	5
		14,953

Source : BPAM, Bloomberg, HLB Research

Total fresh issuances for all ratings of Corp Bonds/Sukuk spiked three-fold to ~RM14.9b (Aug: RM4.81b) due to surge in quasi-government issuances by GLC's, banks and also smallish corporations. The three (3) prominent bond issuances consist of LPPSA (GG) 21-29Y tenures totaling RM3.0b with coupons ranging from 3.69-86%.This was followed by DANAINFRA's (GG) 7-30Y tenures amounting to RM2.5b with coupons between 3.34-90% levels and Maybank's RM2.8b AA3-rated perpetual bonds with coupon of 4.08-13%.

Outlook for Oct

Investors will be "cautiously optimistic" in current dovish environment due to slowing economic outlook….

The weighted average BTC for the two (2) auctions in September slipped to a mere 2.0x (August: 3.10x). The MYR bond market saw weaker demand on lesser bids; and is expected to continue to range sideways despite the appeal of safe-haven assets following the trend in many EM and global bond markets. BNM's continued decision to stay pat on the OPR at the September MPC meeting was based on its stance of current monetary policy that remains conducive to sustainable growth and price stability. It stated that the resilience of private spending alongside stable labor market and wage growth which are expected to remain supportive of the economy activity. The nation's diversified exports are also expected to mitigate the impact of softening global demand. Although the USDMYR pair has edged marginally to 4.1965 levels at the time of writing from recent 4.1855 levels end of last month; this is a result of USD strength**.** The FTSE-Russell-related risk of outflows of up to US$4 billion by passive funds and an additional US$2-4 billion by active funds is now sidelined until March 2020 following FTSE Russell's decision to keep Malaysia status quo in its September review. The Malaysian regulators are working hard to provide a deeper and more liquid bond market by engaging Principal Dealers to provide quotes for off-the-run-bonds, enhancing hedging opportunities including the ease of FX Forward transactions and the establishment of Appointed Overseas Offices (AOO) to improve MYR accessibility. Nevertheless, **we expect yields to generally drift sideways for October.**

Kinks within the curve reveal both the 7Y and the previously mentioned 20Y space for MGS along with the 6-7Y, 15Y GII bonds seeing decent values. We note that there is a higher amount of maturities i.e. RM11.8b worth of maturities for MYR govvies in October (September: RM8.0b). Demand for Ringgit Corporate Bonds/Sukuk along the GG segment are looking better at 10-22bps spreads although not compelling a buy yet as yields re-adjust higher following earlier weaknesses in underlying MGS. We note interest is slowly emerging considering supply constraints and stickiness on portfolio requirements and guidelines. Expect spillover down the credit spectrum especially with the AA-part of the curve attracting attention with interest spanning into more liquid names in conglomerates, utilities, energy and toll-related names.

Markets pricing in another one (1) more Fed rate cut this year…

The UST movements in September saw the curve bear-flatten up to 5Y with the UST 10Y seeing a more volatile trading range of 68bps (August: 54bps) as the bond market gave up prior month's gains. This bond trend was also seen across global bond markets as the Fed displayed a non-committal stance on further interest rate cuts. Meanwhile the world watches with intent the resumption of US-China trade discussions at the time of writing with President Trump expected to delay or potentially scrap the extra 5% tariff on $250 billion in Chinese imports this month. While average YTD monthly job gains of 161k this year are down from 223k in 2018, the sufficient pace along with the jobless rate of a 50-year low at 3.5% and decent wage growth may neutralize the recent weaker ISM manufacturing and non-manufacturing numbers. Inflation expectations together with the outlook for looser monetary policy may still keep the bond bears away for this month. Both the Fed and investors will be watching for clues on economic growth, job creation, wages and inflation whilst keeping an eye on unresolved trade issues with

China and major BREXIT event. UST's are expected to find support under the current scenario for October 2019 amid muted inflation and softer global growth. The US yield curve; a reliable recession predictor, which briefly flirted with inversion at end-August has reverted back to normal following two(2) successive rate cuts of 25bps each..

We opine that the case for a rate cut versus no cut is tilted to the later based on the full impact of earlier cuts yet to flow into the financial system for now and also due to dovish-Fed dissenters in recent updated Dot Plot projections. **We view the shorter-end to be particularly vulnerable and foresee the mid-to-longer term maturities as an effective tool against a risk asset sell-off. The 10Y is expected to range between 1.65-1.80% whilst finding support at 1.80% levels.**

In the Credit/Corporate space, Investment grade (IG) debt may well see red flags appear due to potential stalling in the global economy; with profit margins that may prove challenging. In addition to cutting duration**, we opine that boosting the credit quality of his portfolio will minimize risk and consequently prefer to keep credit quality high and duration low at 1-6Y. We continue to prefer avoiding the HY sector due to potential stretched balance sheets.**

Investors may still find IG issuances that offer slightly increased spreads of ~120bps (August 110bps) and above as YTD returns hit 14% (reference is made to the Bloomberg Barclays US Aggregate Index for Investment-grade corporate bonds).

Hong Leong Bank Berhad
Fixed Income & Economic Research, Global Markets
Level 8, Hong Leong Tower
6, Jalan Damanlela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my