Monthly Perspective – June 2019

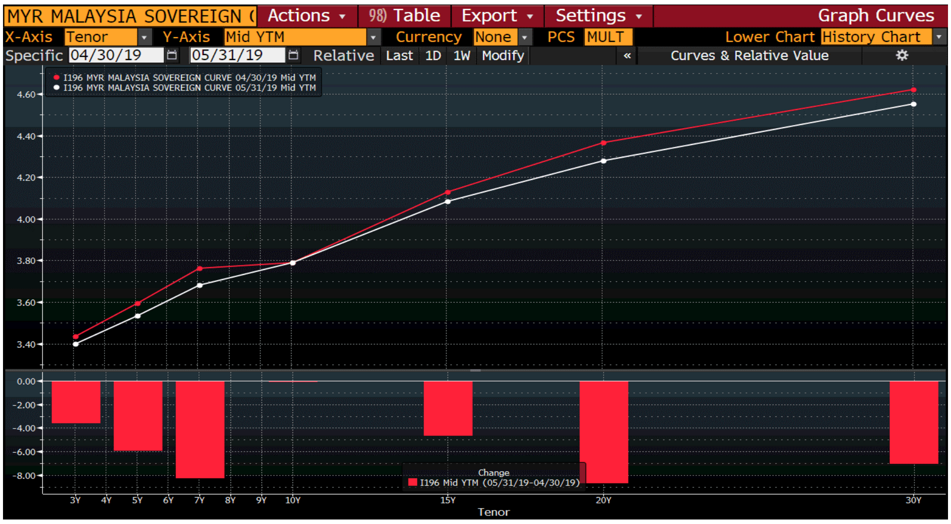
MYR Bond Market

Recapping the month of May

US Treasuries (UST's) *rallied on safe-haven bids; a trend seen in worldwide global sovereign bonds amid global trade tensions and anticipated slower economic growth. Benchmark* ***UST yields ended sharply lower between 35-38bps*** *as the curve shifted lower; with significant inversion still persisting on the front-end. The deterioration in US payrolls for May coupled with weaker manufacturing data and inflation outlook (which remained below policy-makers' 2.0% target) boosted demand for UST's. The front-end UST 2Y yield moved a massive 33bps lower MOM at 1.92% levels whilst the 10Y, which depicts as a benchmark for US mortgage rates and inflation indicator, saw massive volatility in May; ranging between a low of 2.13% and a high of 2.54% levels and rallied 37bps sharply lower at 2.13%. The UST yield curve continued to see a sharper inversion on the front-end whilst the 2s10s spread maintained ~about 24bps. The US Dollar meanwhile ended stronger against most G10 currencies save for the Yen and Swiss Franc, pushing the Dollar Index slightly higher to 97.8 levels.*

On the local front, ***MYR bonds*** *saw continued drop in foreign holdings in May amid a tapering of secondary market volume of RM80.8b (April: RM90.9b) due to further concerns emanating from the US Treasury Department's Semi-Annual Currency report, for which Malaysia along with eight (8) other countries were placed on the US Treasury's Monitoring List that warrants close attention for their currency practices and macroeconomic policies. Foreign holdings of total Malaysian debt securities dropped for the 2nd consecutive month in May, by RM4.2b MOM to RM175.9b; reversing February and March inflows of RM7.5b. The percentage of foreign holdings of MYR government bonds (MGS + GII + SPK) fell to 20.9% or RM158.0b of total outstanding issuance. (April: RM162.3b or 21.9%).* ***Overall benchmark MGS/GII bonds yields rallied between 2-10bps.*** *The 5Y MGS 4/23 moved 6bps lower at 3.53% whilst the much-watched 10Y MGS 8/29 edged ~2bps lower from 3.79% to 3.77% levels. (The 10Y saw a low-high range of 3.73-90% levels). Corporate Bonds/Sukuk however saw levels of foreign holdings maintain at ~RM12.0b. Institutional investors were net buyers causing yields to grind lower on decent volume of RM14.5b in May versus RM16.0b prior month despite the holiday-shortened month.*

MYR sovereign curve (MGS)



Source : Bloomberg

Weak NFP data for May and ongoing low "transitory" inflation is "fanning" potential rate cuts…

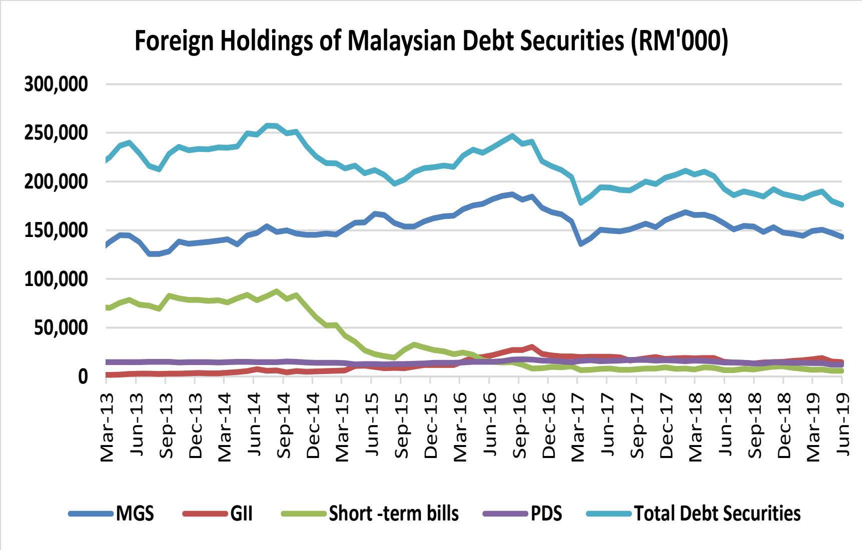
May Non-Farm Payrolls ("NFP") surprised on the downside with the printing of 75k new jobs compared to market consensus of 185k (April: revised downwards to 224k from 263k) thus pointing to a weaker labor market and snapping the prior months strong hiring. The pace of hiring confirmed the 2nd such time this year that jobs' creation resulted below 100k; and lifted the odds of a rate cut in the US between 17-20% in June and between 78-83% for July according to both Bloomberg survey and CME FedWatch Group. Nevertheless the labor market remains steadfast and wage growth keeps pushing higher with the overall economy still looking healthy on a relative basis considering the weakness in overseas economies. The unemployment rate remained at a record low of 3.6% and believed to be largely attributable to the participation rate of 62.8% which was maintained for the month. However the continued soft print on hourly wages i.e. 0.2% MOM (previous: +0.2%) and of 3.1% YOY (previous: +3.1%) states that the pace of improvement has somewhat cooled and with persistently low inflation; hence vindicates an outlook on a potential interest rate cut.

The US central bank left rates unchanged at 2.25-2.50% as widely expected in its May FOMC statement which stated that economic growth has slowed from its solid rate whilst signaling then that rates may stay pat this year with a potential rate hike only in 2020. The current **Fed's dot plot however still reflects a status-quo stance** on interest rate movement i.e. (note that the Fed was projecting two rate hikes during early-part of 2019) with the next FOMC meet on 19th June, next week. The Fed's meeting minutes in May observed that the patient approach to determining future adjustments to the target range for the Fed Funds Rate would likely remain appropriate for some time with Powell adamant about any decision being "data-dependent". However market observers believe that the Fed may take a dovish stance as global risks weigh on the economic outlook amid muted inflation outlook and global trade issues. The Fed's preferred inflation measure for April i.e. the personal consumption expenditure (PCE) price index was lower at 1.5% YOY whilst the core index (which strips out the volatile food and energy costs) was maintained at 1.6%. Fed officials and policy-makers are expressing concerns that long-term inflation expectations could be below 2.0% target. Meanwhile, the balance sheet tapering/roll-off is still scheduled to be end by September, awaiting more details at the June FOMC meeting.

Foreign holdings of overall MYR bonds nosedived again in May on foreign portfolio adjustments…

Foreign holdings of MYR bonds slipped for the second month in a row in May i.e. by another RM4.2b or 2.3% to RM175.9b following two (2) earlier consecutive increases in the months of February and March. The non-resident holdings of MGS was substantially lower by RM3.8b to RM143.4b (representing 35.8% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw a drop of RM4.3b to RM158.0b (representing 20.9% of total outstanding) despite a spike in issuances of ~RM12b for the month; the highest in recent times.

The recent report in May on the US Treasury Department's Semi-Annual Currency report, mentioned Malaysia along with eight (8) other countries that were placed on the US Treasury's Monitoring List followed by news in April on the Norwegian Sovereign Fund and FTSE Russell index's intention to underweight MYR bonds saw a decline in foreign holdings. YTD overall, MYR bonds saw a net decrease in foreign holdings of RM8.9b in the first five (5) months of 2019 while equities saw a further net outflow of RM4.8b. On the currency side, the MYR weakened by 1.3% at 4.1900 levels as at end-May and also against most Asian currencies save for the Korean Won and Chinese Yuan. However at the time of writing, USDMYR is trading at 4.1595 amid pullback in the USD.



Source: BNM, HLB Research

MPC may not discount further OPR cuts from present 3.00% on both global & domestic concerns…

BNM adjusted the OPR lower from 3.25% to 3.20% at the 3rd MPC meeting of the year on 7th of May, envisaged downside risks to growth from heightened uncertainties in both global and domestic environment, trade tensions and extended weakness in commodity-related sectors. (Note: The last policy move was a 25bps hike in January 2018 whilst the last rate cut was in July 2016). Slower 1Q2019 GDP growth of 4.5% (4Q2018: 4.7%) had also added to the concerns going forward. The rather stable and but muted headline and core inflation data of 0.2% and 0.5% YOY respectively, had allowed the central bank to shape that policy decision; helped to a certain extent by the price ceiling on domestic fuel prices until the middle of this year. The lower rates which has allowed bonds to rally allowed existing portfolio investors to reap gains but also diminish the fresh yield appeal of MYR bonds by new investors. We opine that the government will not take any chances on US tariff threats to global demand and would embark on the need for degree of monetary accommodativeness. Hence the tone has turned neutral-bearish; suggesting that further rate cuts cannot be discounted for the year.

MYR government bond auctions saw strong demand in May for 15Y and 30Y GII bonds….

The three (3) government bond tenders concluded for the month of May 2019 under the auction calendar included the new issuances of both the 30Y GII 11/49, 15Y GII 11/34 and also the reopening of 10Y MGS 8/29. Overall weighted average BTC for the month **strengthened to 2.64x** mainly due to both the strong GII auctions which compensated for the mere 1.84x for the much-watched auction for the 10Y MGS 8/29. (Compare this with both the YTD auction of 2.37x and also the entire 33 auctions for 2018 which notched a BTC ratio of 2.29x). Tenders for the month received decent bids from mainly institutional investors. The subsequent auction at the time of writing in June include the new issuance of 5Y MGS 6/24 that will gauge mainly inter-bank players' interest for this duration.

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	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	3,500	500	38,000	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	40,000	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		44,000	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	46,500	3.380	4.105	4.119	4.126	44.4%
16	5-yr New Issue of MGS (Mat on 06/24)	5	Jun	Q2		4,000								
17	20-yr Reopening of GII (Mat on 09/39)	20	Jun	Q2		3,000								
18	15-yr New Issue of MGS (Mat on 07/34)	15	Jul	Q3		4,000								
19	7-yr Reopening of GII (Mat on 3/26)	7	Jul	Q3		3,000								
20	30-yr Reopening of MGS (Mat on 07/48)	30	Jul	Q3		2,500								
21	5-yr Reopening of GII (Mat on 10/24)	5	Aug	Q3		3,500								
22	20-yr Reopening of MGS (Mat on 06/38)	20	Aug	Q3		3,000								
23	10-yr Reopening of GII (Mat on 7/29)	10	Aug	Q3		3,500								
24	7-yr Reopening of MGS (Mat on 07/26)	7	Sep	Q3		3,500								
25	15-yr Reopening of GII (Mat on 11/34)	15	Sep	Q3		3,000								
26	10-yr Reopening of MGS (Mat on 08/29)	10	Oct	Q4		3,000								
27	20-yr Reopening of GII (Mat on 09/39)	20	Oct	Q4		2,500								
28	5-yr Reopening of MGS (Mat on 06/24)	5	Oct	Q4		3,500								
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		4,000								
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		3,000								
	Gross MGS/GII supply in 2019					104,000		13,000						

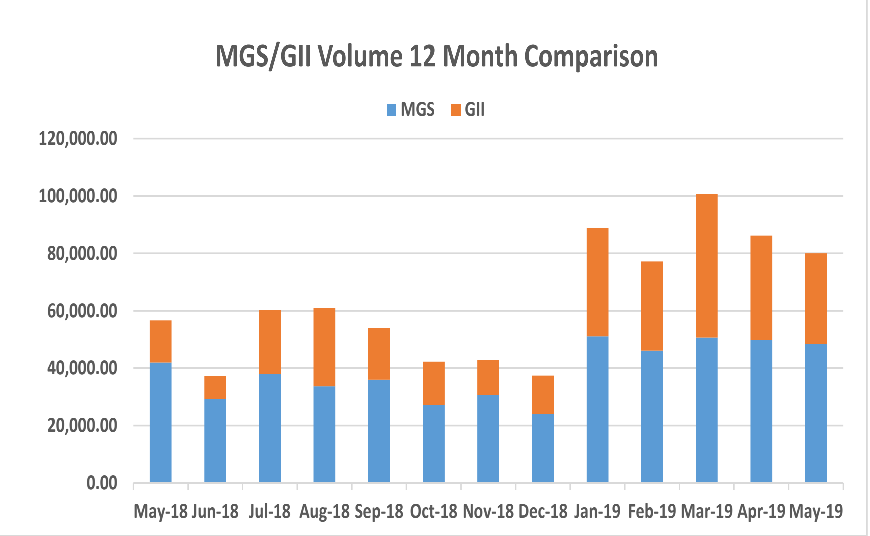
Source: BNM, HLB Research

Trading volume for MGS/GII retracted in May…

Trading volume for MYR govvies pulled back yet again by 11% from RM80.8b in May compared to prior month's RM90.9b. Decent traction was seen across the curve with substantial frequency of trades and nominal amounts done in the short off-the-run 19-20's (ended sharply lower between 11-25bps forming almost 15% of total trades) and benchmark 10Y MGS/GII bonds (which ended between 1-5bps forming almost 7% of total trades). The off-the-run 10Y bonds also saw active trades (i.e. 28's which ended lower between 1-3bps forming ~5% of total trades). Nevertheless the limelight was grabbed by the 7Y MGS 7/26 benchmark (auction/reopening in April) which witnessed the highest volumes churned amounting to ~RM4.5b). It is believed that mainly local investors were net buyers for MYR govvies in May due to risk-off sentiments despite the continued reduction in foreign holdings of local bonds led by April's announcement and reports by:

- Norway's US$1.0 billion Sovereign Wealth Fund (SWF) which plans to omit emerging market (EM) bonds from its fixed-income benchmark; and
- FTSE Russell that placed Malaysia on the watch list for potential exclusion from the World Government Bond Index (WGBI).
- Fitch's concerns on government's RM6.0b bail-out of FELDA.

The recent US Treasury Department's Semi-Annual Currency report, mentioned Malaysia along with eight (8) other countries were placed on the US Treasury's Monitoring List that warrants close attention for their currency practices and macroeconomic policies. (These countries include China, Japan, Korea, Germany, Italy, Ireland, Singapore and Vietnam). Despite the above, the month under review saw Malaysian bonds well-bid with yields reaching lower yields of between 2-10bps compared to April as local investors showed confidence in the ability of regulators to deepen and provide stronger liquidity in both Bond and Ringgit market.



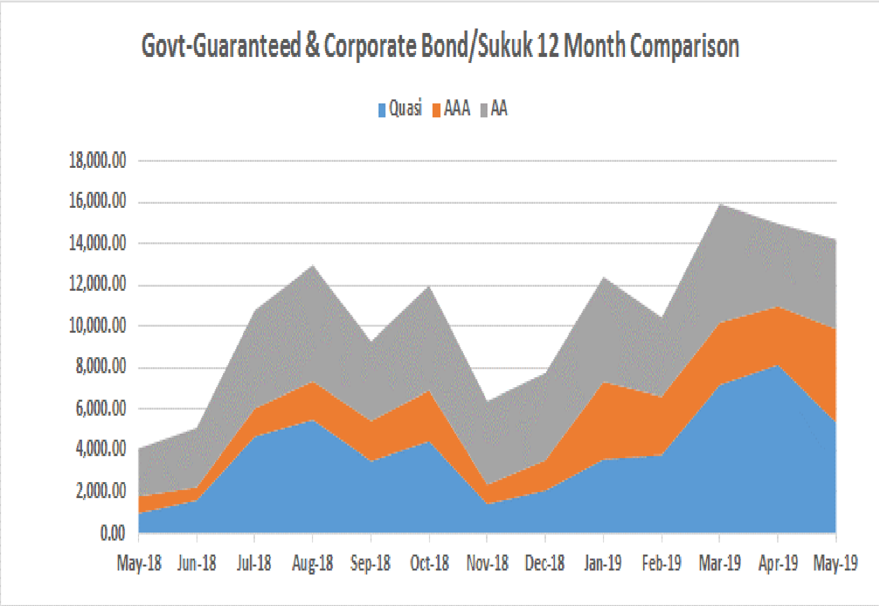
Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk continue to register good demand…

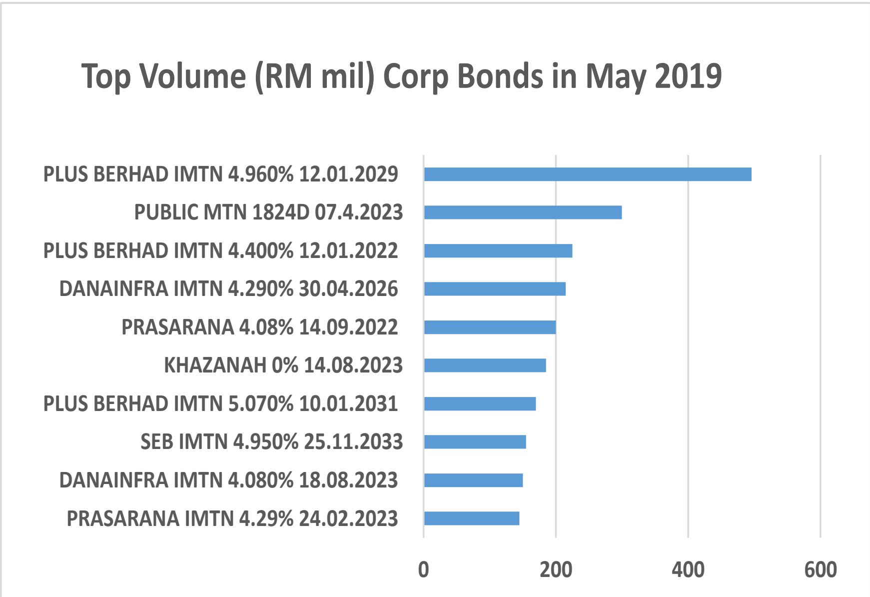
In the secondary market, Corporate bonds/Sukuk (including Govt-Guaranteed bonds) saw secondary market trading volume saw decent demand on sustained momentum from RM16.0b in April to RM14.5b in May. Mainly local fund managers/portfolio investors continued to actively bid in the secondary market for credit yield spreads with relatively decent liquidity. (Government-guaranteed bonds i.e. GG papers have been grouped together for ease of reference). The elevated global trade tensions and whispers of a possible US rate cut in view of anticipated slowdown in global growth saw most global bonds rally and generally saw the spillover into Corporate Bonds/Sukuk in May.

Investor appetite for GG saw somewhat softer traction MOM; decreasing to 38% in May (April: 45%) whilst AAA-rated bonds rose from 19% to 32% of overall transactions partly due to static supply and stickiness of GG bond issuances for the month. AAA-rated PLUS 29 and banking giant PUBLIC 4/23 topped the monthly volume; closing 7bps lower at 4.20% and 3.90% (maiden trade; coupon 4.45%) respectively for the month respectively compared to previous-done levels. This was followed by both PLUS 22 which rallied 26bps to close at 3.89% and DANAINFRA 4/26 which rose 4bps instead at 3.91%.

Appetite in the credit space was mainly seen in a wide range of bonds namely infrastructure-related bonds including telecommunication, toll and energy sub-sectors of the infrastructure segment. AAA-rated TELEKOM 23-35, MANJUNG 19-31, PLUS 20-33 together with AA-rated SEB 22-32, EDRA Energy 23-38, Southern Power 24-33, YTL Power 23-28 continued to see active trading. In addition to that we note two (2) other popular bonds i.e. MMC Corp 23-27 and DANGA 20-33 also making its foray into the secondary market space. In the banking space high frequency of trades were noticed for both SABAHDEV and SDBB bonds for the 2020-2026 tranches. (Note: we have excluded single-A rated and non-rated papers in the illustration below).



Source : BPAM, Bloomberg, HLB Research



Source : Bloomberg, BPAM, HLB Research

Primary issuance print in May boosted by the following names:

Notable issuances in May-19	Rating	Amount Issued (RM mil)
Country Garden Real Estate Sdn Berhad	AA3	70
Danum Capital Berhad	AAA	2,000
Damansara Uptown Retail Centre Sdn Berhad	NR	607
Eco World International Berhad	NR	270
Hektar Black Sdn Berhad	NR	32
KYS Assets Sdn Berhad	NR	5
Mercedes-Benz Services Malaysia Sdn Berhad	AAA	250
OSK I CM Sdn Berhad	NR	164
Putrajaya Bina Sdn Berhad	AAA	380
RHB Islamic Bank Berhad	AA3	500
Seri Mutiara Development Sdn Berhad	NR	40
Southkey Megamall Sdn Berhad	NR	70
Sunway Berhad	NR	150
True Ascend Sdn Berhad	NR	50
Urusharta Jamaah Sdn Berhad	NR	27
YTL REIT MTN Sdn Berhad	NR	10
Urusharta Jamaah Sdn Berhad		27,000
		31,625

Source : BPAM, Bloomberg, HLB Research

Total fresh issuances of all ratings of Corp Bonds/Sukuk leaped to ~RM31.6b (April: RM11.2b); largely due to issuances of ~RM27.0b by Urusharta Jamaah; an SPV by FELDA. There were no GG issuances as opposed to prior month. Another prominent issuance involved Khazanah Berhad's Islamic funding conduit i.e. DANUM Capital Berhad with a substantial RM2.0b size rated AAA; consisting of 4-15Y bonds.

Outlook for June

Investors expected to re-evaluate and seek emerging values…

The weighted average BTC for the three (3) auctions in May improved to a solid 2.64x mainly due to the strong 15Y and 30Y GII bond auctions. (Compare this with both i.e. the entire 33 auctions for 2018 which notched a BTC ratio of 2.29x and also the previous month i.e. April's BTC ratio of 2.14x) as the bond market was well-bid on safe-haven bid similar to most EM and global bond markets. BNM's earlier dovish-like comments which resulted in the recent OPR cut in early-May is seen to provide additional support to the local bond market. The USDMYR pair which has strengthened to 4.1600 levels from recent 4.1900 levels is reflective of slightly better market conditions; but subject to further, trade and portfolio flows.

To recap, the challenges for Malaysia's bond market in 2019 has so far been based on "external noises". US Treasury Department's Semi-Annual Currency report, for which Malaysia along with eight (8) other countries were placed on the US Treasury's Monitoring List warrants close attention for their currency practices and macroeconomic policies. (The other countries include China, Japan, Korea, Germany, Italy, Ireland, Singapore and Vietnam). In April, the Norwegian sovereign wealth fund's pullout from emerging market bonds is expected to be gradual as the exposure level is low. The fund's exposure to Malaysian govvies is US$1.96 billion (RM8 billion), representing 5.4% of total foreign holdings in Malaysian Government Securities (MGS) of RM147.1

billion as at end-April 2019. Norway's sovereign wealth fund will streamline its US$300 billion (RM1.23 trillion) fixed-income portfolio by cutting emerging market bonds from the benchmark index it tracks. Currently worth US$1.05 trillion (RM4.31 trillion), Norway's Government Pension Fund Global has invested around 30% into fixed income with the balance 70% invested in equities. In terms of size, Malaysia is the third largest country with exposure to the fund after South Korea and Thailand. Likewise, Malaysia could also face an outflow risk of about US$4 billion by passive funds and an additional US$2-4 billion by active funds, should FTSE Russell drop Malaysian bonds from the World Government Bond Index (WGBI). If FTSE Russell decides to remove Malaysia from the WGBI, foreign selling which is assumed to have abated of late may be expected to embark on yield-carry exercises which may benefit MGS (Malaysian Government Securities) bonds as currently the WGBI index excludes GII (Government Investment Issue). Nevertheless, the GII curve will inevitably be affected if foreign selling weigh on the MGS curve. This means a potential outflow risk of US$6-8 billion, or about RM24-33 billion. We expect a relatively quiet month in May with local institutional buying and foreign portfolio readjustment influencing the bond levels and the curve in particular whilst regulatory authorities are expected to deepen and provide consistent liquidity. Meanwhile there are no maturities for MYR govvies in May similar to April.

Following the recent OPR cut, some parts of the curve exhibit values. Both the 7Y and 15Y MGS bonds are seeing better values whilst investors are reminded to take notice of the continued rich valuations in the 10Y part-of-the curve. Demand for Ringgit Corporate Bonds/Sukuk along the GG segment will continue to be strong (between 15-25bps spreads to MGS) considering the present government's intention to restrain supply to manage the country's fiscal deficit. Nevertheless the AAA and AA-rated space encompassing infrastructure, toll and energy-related related bonds continue to provide yield-carry due to partial inelasticity of yield movements and liquidity "insurance" despite the rather captive primary market by local portfolio managers and institutions.

Although Fed dot plot shows a pause in potential rate hike for 2019; bond traders expect rate cut going forward…

The UST rally in May saw the curve shift lower with the UST 10Y saw a wider trading range of 51bps (April: 15bps) as the bond market rallied on expectations of an interest rate cut by the Fed. Nevertheless the earlier initial dovish outlook on muted core inflation was later deemed to be "transitory" by the Fed; causing market participants to be somewhat "confused". Hence, latest revisions by the Fed dot plot on interest rate outlook in 2019 reveal a pause with a possible tilt to a rate cut instead of the previous expectations of up to two (2) rate hikes early in the year; allowing UST's to find strong support. At the moment, the main variables that bond traders use to compute yields i.e. growth and inflation expectations, outlook for monetary policy and also the term premium) may signal trouble for bond bears. The four (4) factors that go into the basic construct of where 10Y yields will go paint a red arrow pointing downwards. The Fed will be looking at growth, job creation, wages and inflation whilst keeping an eye on trade matters with China, Europe and also other events like BREXIT.

The current dovish-like situation for 2019 amid muted inflation and softer global growth based on the ongoing debacles pertaining to trade tariffs will see investors and traders' alike battle the market with futures traders seen to increase their "short-positions" versus the record high primary dealer holdings**. The US yield curve which is inverted on the front-end based on 3m10y is supposedly an accurate recession predictor**

The shorter-ends potentially offer better reward than short-term funds as the US yield curve remains inverted and there may still be room for lower rates as markets price in Fed's easing of interest rate policy. The 10Y is expected to drift sideways between 2.10-2.25% whilst finding support at 2.30% levels.

In the Credit/Corporate space, despite new High Yield issuance leaping in May, investors may find Investment Grade issuances (save for Industrial-related bonds which may be exposed to ratings-risk due to heavy CAPEX activities and lower operating profit) to be safer and potentially undergo less stress with room to move to ~140-160bps spreads, as these corporates are better-equipped to weather funding constrains in the event of a global economic slowdown.

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