Global Markets Research
Fixed Income Alert

MYR Govvies - A Brief Valuation Perspective

Overview
The MYR government bond market remains dynamic, forming an extremely important asset class for investors with participation dominated by the depth and varied institutions consisting of both local and foreign institutions. This includes pension funds and GLIC's such as EPF, KWAP, PNB, KHAZANAH, LTAT, LUTH and even entities such as SOCSO and PETRONAS. The active participation of inter-bank participants including principal dealers and offshore entities form the spectrum of investors that rely on both liquidity and yield in their portfolio management activities.

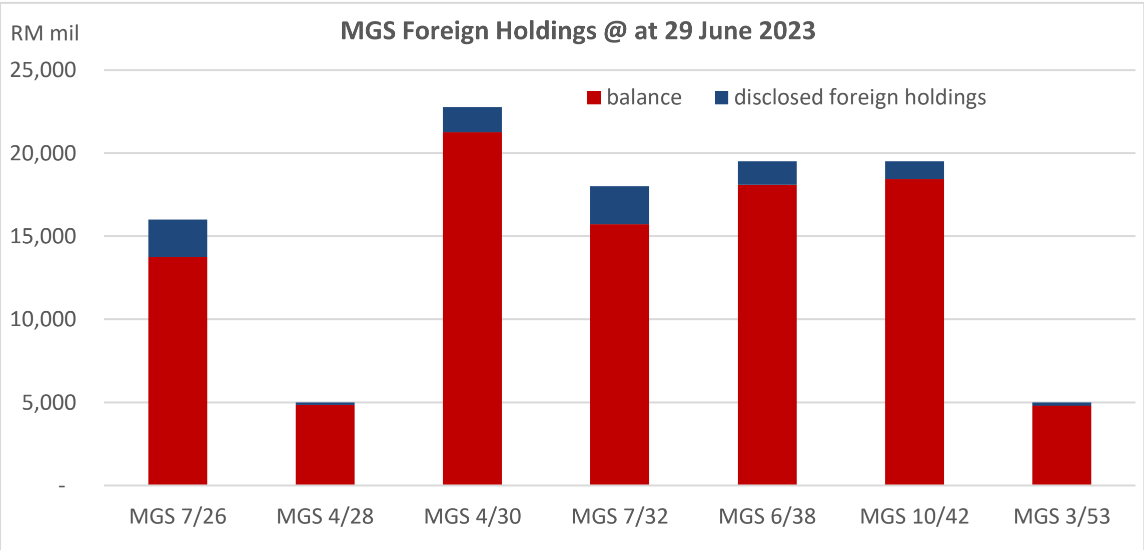
In the light of re-emerging hawkish vibes emanating from stronger-than-expected US 1Q2023 GDP, robust US labor market and persistently stubborn inflation in the US coupled with the weaker MYR levels seen of late, investors may have shown reluctance in seizing opportunities in the MYR sovereign bond space, where we note some of the opportunities may emerge from the perspectives enlisted below.

Spreads to 3-month KLIBOR
We note that current 5Y, 7Y, 10Y, 15Y and 20Y benchmark spreads to 3-month KLIBOR (current 3.45%) remain deeply compressed between 30-45bps more than historical mean values (43-105bps). Hence, the upside risk to yields is prominent if global rates remain in hawkish mode for the year.

Spreads to OPR
We also note that the current relative spreads to OPR (current 3.00%) are also relatively tight i.e.; between 51-57bps compared to historical mean values (110-172bps)

Relative valuation between MGS and GII
Due to minimal spreads of between 1-10bps between the two categories based on the near super-imposition of both charts, we opt to favor MGS over GII at present. In addition to that, MGS is easily a favorite from a liquidity perspective and international index benchmarking indices such as FTSE Russell WGBI and EMGBI, Barclays, S&P among others.

Foreign shareholdings in selected MGS benchmarks
We note higher foreign holdings in MGS in both the 3Y MGS 7/26 and 10Y 7/32, rendering the possibility of slightly higher volatility.

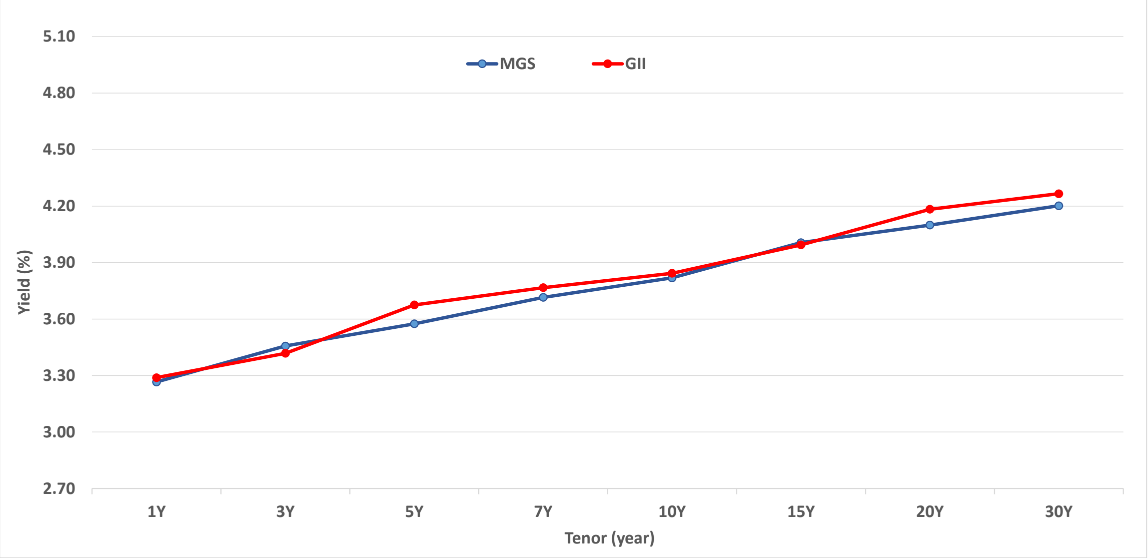


Source: Bloomberg, HLBB Global Markets Research

Term Premium on the curve

Despite both the MGS and GII the yield curves forming an almost straight upwards sloping line (instead of normal curves displaying convexity), from a term premium perspective (refer to simplified graphical illustration below), we note some relative value in the following tenures:

- 5-7Y MGS/GII
- 15Y MGS
- 20Y GII



Source: BPAM, HLBB Global Markets Research

Conclusion

Unless Fed funds terminal rates peak in the not-too-distant future (which was widely believed to be possible based on Fed-dated OIS pricing and consensus), we believe that any rally in local govvies would result in momentary profit-taking activities. **Nevertheless, any preference for govvies would prompt us to favor 5-7Y MGS/GII, 15Y MGS and 20Y GII at this juncture. Expect higher volatility in 3Y and 10Y benchmarks based on sizeable foreign holdings of between 12-14%. In short, our take is~ "BUY into relative spreads between GII and MGS, BUY into term premium attractiveness, and exercise the option to Sell into the rally"**

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