

PHILLIP MUTUAL BERHAD

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An Overview of Fixed Income Outlook in 2023

Fixed income markets experienced a sharp selloff in 2022, but this has led to improved yields and valuations. As attention shifts from inflation to slowing growth and the potential for a recession, fixed income's defensive nature may attract more investors. Looking forward to 2023, we expect that inflationary pressures will stabilise, providing a favourable environment for fixed income investments. Additionally, global central banks are expected to slow down or cease their monetary policy tightening, which is likely to bolster the performance of fixed income assets.

On the domestic front, Malaysia growth outlook to risks is said to be balanced in 2023, with a projected growth rate of 4.0% bolstered by an improved labour market and government support. Meanwhile, market participants are generally expecting that Bank Negara Malaysia (BNM) to have concluded its monetary tightening cycle and will keep the overnight policy rate (OPR) at the range of 2.75%-3.00%, indicating at most 1 more rate hike, for the remainder of the year. According to BNM, the global growth outlook remains subject to downside risks such as higher than-anticipated inflation outcomes and a sharp tightening in financial market conditions. We agree with this assessment and foresee that volatility will persist due to ongoing inflationary pressures, weaker global growth, and elevated supply of local bond.

Despite these challenges, we believe there is an opportunity for investors to add high-quality fixed income assets to their portfolios at appealing valuations. We see attractive investment opportunities in high-quality domestic corporate credit segments, with attractive risk-return profiles in some segments of the asset class. We believe Malaysia's fixed income market offers an attractive risk-reward profile, with abundant domestic liquidity and local bond yields having priced in sufficient rate hikes, making bonds being traded at very attractive levels.

Moreover, we anticipate that the demand for Malaysian bonds will rise due to the expectations of a less aggressive pace of Fed tightening, leading to a USD strength topping out. The Fed may be less motivated to hike rates going forward following further moderation in US inflation and the cooling job market, with rate cuts potentially on the cards towards the end of this year. Similarly, Malaysian sovereign bonds are well placed to benefit from a renewed global risk-on appetite due to their comparatively high yields. As interest rates are projected to remain steady, we favour long-duration bonds that offer higher yields than short-duration bonds. This is because the longer maturity of the bond exposes the investor to greater interest rate risk, which is compensated for by higher yields. Furthermore, holding longer-duration bonds can act as a safeguard against decreasing interest rates.

Fund Manager's Commentary on the Fixed Income Market in March 2023

In March, the US Treasuries (UST) rallied massively after Silicon Valley Bank incurred heavy deposit withdrawals from its customers totalling USD42bn on March 9 and prompt the regulators to shut down the bank on March 10. This is the biggest bank failure since the 2008 financial crisis. Another bank that faced a similar fate was Signature Bank. The 2-yr UST yield plunged from 4.58% to 3.84% while the 10-yr UST was down by 23bps to 3.69% as investors expect the banking turmoil will pause the Federal Reserve (Fed) from more aggressive rate hikes. Another scandal affecting the bond market was the announcement from Credit Suisse on its annual net loss of 7.3bn Swiss francs. Unfortunately, another 25bps rate hike in the March FOMC

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meeting failed to stop the yield to fall further as the investors are still concerned about the spill-over effect of the AT1 bonds issued by Credit Suisse. The 10-yr UST was down by 22bps after the meeting to touch 3.28%. The Fed Fund Rate target range was 4.75% -5.00% after the March FOMC meeting. The Fed viewed the implication from the latest bank crisis would likely to slow down the economy, however, it will not lead to a broader financial meltdown. At the closing, the 2-yr UST was down 75bps m-o-m to close at 4.06%, while the 10-yr and 30-yr UST was down 44bps and 26bps m-o-m to 3.48% and 3.67%, respectively.

On the domestic bond market, Malaysia Government Securities (MGS) was actively traded as investors snapped government bonds as a safe-haven investment following the bank crisis in the US. The Monetary Policy Committee (MPC) kept the OPR unchanged at 2.75% in March, a second pause since January. In the Annual Report 2022, Bank Negara Malaysia (BNM) indicated that the central bank would maintain an accommodative stance but believed that domestic inflation remained a concern. Upside risks to inflation include worsening geopolitical conflict leading to higher commodity prices, extreme weather conditions, stronger-than-expected demand from China and higher input costs due to exchange rate developments. At the close, the 3-yr MGS decreased by 15bps m-o-m to close at 3.35% while the 10-yr decreased by 12bps to close at 3.90%. However, as for the 30-yr MGS, it increased by 7bps m-o-m to close at 4.45%.

Why should you add Fixed Income into our portfolio?

Fixed income investments have several advantages. Firstly, they offer a reliable income source through coupon payments made by the issuer, which can serve as a buffer against the volatility of the equity market and reduce portfolio risk. Moreover, fixed income can act as a hedge against inflation by providing a fixed rate of return that retains its value even in the face of rising inflation. Lastly, fixed income investments provide diversification benefit in a portfolio as they have a low correlation with equities, potentially decreasing the overall portfolio risk and generating a favourable risk-adjusted return for investors.

Our offerings

Phillip Mutual Berhad offers a comprehensive list of local and global unit trust funds that may suit your investment preferences and financial goals. Our recommendation for unit trust funds with fixed income exposure is as follows:

1. Phillip Dana Murni *

- ✓ Category: Malaysia Fixed Income Fund
- ✓ As of 31 March 2023: +1.2% YTD, outperforming benchmark of Maybank 12-Mth Islamic FD Rate by 50bps
- ✓ Asset Allocation: 68% (Sukuk); 32% (Islamic Money Market)
- ✓ Fund Size: RM13.3mil

2. Phillip SELECT Balance

- ✓ Category: Malaysia Balanced Fund
- ✓ As of 31 March 2023: +1.3% YTD, outperforming benchmark of 60% FBM100 & 40% 3-Mth KLIBOR by 270bps
- ✓ Asset Allocation: 56% (Equities); 44% (Fixed Income + Cash)
- ✓ Fund Size: RM26.0mil

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**3. Phillip Asiapac Income**

- ✓ Category: Asia Balanced Fund
- ✓ As of 31 March 2023: +0.6% YTD, a shy away from benchmark of 40% MSCI Asia Pac Ex-Japan & 60% 3-Mth KLIBOR by 150bps
- ✓ Asset Allocation: 46% (Equities); 54% (Fixed Income + Cash)
- ✓ Fund Size: RM8.2mil

Note: * indicates Syariah

Our Portfolio Strategy

Looking ahead, our domestic bond yields have generally risen to pre-pandemic levels, suggesting opportunities for yield pick-up. We will continue to monitor the bond yield movement closely to capture opportunities in selected bonds to lock in attractive yields.

Here are some strategies for managing our fixed income funds:

- ✓ Diversify portfolio allocation i.e. sectoral and credit risk.
- ✓ Participate in new issuance with a good credit rating and higher spread than peers.
- ✓ Increase the Sukuk Portfolio duration to take advantage of future rate cut by the Federal Reserve.

Please click on the [link](#) to learn more or email us at phillipmutual@phillipcapital.com.my if you require any further information.

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