Equity Market Outlook in 2019

2018 had been a turbulent year for investors. Escalating U.S.-China trade tensions and rising interest rates in the U.S. triggered a sell-down in the developed markets as well as emerging market (EM) stocks and currencies.

A resolution of U.S.-China tensions and an end to the U.S. interest rate hikes would result in investor confidence returning to global equity markets in 2019. Meanwhile, resilient world economic growth and discounted market valuations are supportive of equity markets in the event of a prolonged trade war.

Investors can adopt strategies such as portfolio diversification, Ringgit Cost Averaging and observing a long-term investment horizon to ride through current market uncertainties.

Factors Affecting Market Sentiment in 2018: Recent Developments

(a) U.S.-China Trade Tensions

The U.S. imposed two rounds of tariffs on US$250 billion worth of goods imported from China along with an additional plan to levy tariffs on another US$267 billion worth of Chinese imports. However, U.S. President Donald Trump agreed to hold off plans to raise tariffs from 10% to 25% on US$200 billion of Chinese goods effective 1 January 2019 at the G-20 Leaders' Summit in Argentina, giving the markets some respite.

This truce, which is valid for 90 days, may or may not last depending on how the two countries are able to resolve their differences, ranging from investment restrictions to intellectual property rights.

(b) U.S. Interest Rate Hikes

A vibrant U.S. economy may be positive for global growth, but the uptrend in U.S. interest rates has resulted in volatile trading conditions in emerging markets. The four interest rate hikes in 2018, which raised the Federal funds rate target range from 1.25%-1.50% to 2.25%-2.50%, had caused the US$ to strengthen and foreign funds to withdraw from emerging markets. As a result, regional stock markets ended the year in the red (Table 1).

The Federal Reserve (Fed) chairman, Jerome Powell, indicated that **the current U.S. interest rate is close to 'neutral' - an important turn from remarks he made previously.** The markets reacted positively, interpreting this to mean a slower pace of tightening for U.S. interest rates in 2019.

Table 1: Performances of Major Stock Indices

Markets	Stock Index Performance* (%) 2017	2018
U.S.		
Nasdaq	+28.2	-3.9
Dow Jones Industrial Average	+25.1	-5.6
North Asia		
Taiwan	+15.0	-8.6
Hong Kong	+36.0	-13.6
South Korea	+21.8	-17.3
MSCI China	+52.5	-20.3
ASEAN		
Indonesia	+20.0	-2.5
Malaysia	+9.4	-5.9
Singapore	+18.1	-9.8
Thailand	+13.7	-10.8

Source: Bloomberg *In local currency

Markets firmed amid improved earnings growth and global economic outlook.

Markets fell on higher U.S. interest rates and U.S.-China trade tensions.

Factors to Monitor in 2019

The following are five key factors that are anticipated to impact equity markets in the year ahead:

(a) Gross Domestic Product (GDP) Growth

The first factor to monitor is the pace of an economy's growth. U.S. GDP growth is expected to moderate from 2.9% in 2018 to 2.6% in 2019. Meanwhile, the major economies in North and South-East Asia are projected to register sustained growth in 2019, as shown in Table 2.

Table 2: Real GDP Growth Outlook

%	2018F	2019F
U.S.	2.9	2.6
North Asia		
China	6.6	6.2
Taiwan	2.7	2.3
South Korea	2.6	2.5
ASEAN		
Malaysia*	4.8	4.9
Singapore	3.3	2.7
Indonesia	5.2	5.1
Thailand	4.2	3.9

Economic growth is mainly supported by consumer spending in the U.S. and Asian economies.

Source: Bloomberg consensus
*Economic Outlook 2019, Ministry of Finance

(b) Developments on U.S.-China Trade Issues

Investors will continue to keep track of trade developments between the U.S. and China following the 90-day truce which ends by February 2019. Economic responses between the U.S. and China will be closely monitored.

In the event that the U.S.-China trade war is resolved, investor confidence will return to equity markets in the year ahead. However, if the U.S.-China trade tensions escalate, global economic growth could slow and markets may continue to remain volatile.

Meanwhile, China is likely to continue with more monetary and fiscal policies to support economic growth. Companies based in China may start to relocate part of their operations to the South-East Asian region to benefit from lower tariffs and cheaper labour costs.

(c) Corporate Earnings Outlook

Another key factor that underpins the performance of equity markets is the earnings prospects of listed corporations. On the domestic front, Malaysia's large-cap stocks are projected to see positive earnings growth in 2019, led by the financial, consumer staple and healthcare stocks. Earnings growth in other Asian markets is expected to be underpinned by resilient consumer and infrastructure spending as well as growth in the e-commerce sector.

In the U.S., earnings growth is anticipated to moderate in 2019, as the earnings boost from tax cuts implemented by the Trump administration in 2018 will not recur.

(d) U.S. Interest Rate Outlook

The pace of U.S. interest rate hikes will depend on the resilience of U.S. economic activities, which have recently shown signs of moderation. The Federal Open Market Committee (FOMC) had in its December meeting projected the Federal funds rate to reach the targeted range of 2.50%-3.00% by end-2019, indicating that the U.S. interest rate level is close to neutral.

This development is viewed positively for the financial markets, especially for emerging market stocks, bonds and currencies. On the upside, emerging markets could see a return of fund inflows, currency strength and market re-rating once investor sentiment improves.

(e) Market Valuations

The commonly used price-earnings (P/E) ratio shows the relationship between a company's stock price to its earnings per share. When stock market valuations are higher compared to their historical averages, equities are generally "overvalued" or expensive, and vice versa.

Due to the global market correction in 2018, P/E valuations in regional and global markets have generally fallen below their historical averages. This provides opportunities for long-term investors to invest in selected markets at cheaper valuations (Table 3).

Table 3: Valuations of Selected Markets

Markets	Forward P/E Ratio (x)	Premium/Discount to Historic Average (%)	Dividend Yield (%)
Global			
U.S.	14.3	-9.5	2.3
North Asia			
South Korea	8.6	-20.4	2.4
China 'H' Shares	7.4	-19.6	4.6
Hong Kong	9.8	-19.0	4.1
Taiwan	12.5	-18.3	4.9
MSCI China	10.0	-13.8	2.9
ASEAN			
Singapore	11.7	-17.0	4.4
Indonesia	14.5	-5.2	2.4
Thailand	13.5	-2.9	3.6
Malaysia	15.9	-	3.4

Source: Bloomberg   As at 31 December 2018

Market valuations are below their long-term averages.

What Should Investors Do?

(a) As global and regional markets may remain volatile amid higher interest rates and the uncertainty over the U.S.-China trade talks, unit trust investors are advised to **diversify their portfolio across domestic, regional and global equity funds as well as fixed income funds**.

(b) Investors should also **adopt Ringgit Cost Averaging**, which involves making regular investments through Public Mutual's Direct Debit Authorisation (DDA) or Regular Investment Instruction (RII) facilities. Adopting a **long-term investment horizon** will also help investors ride through market cycles.

(c) Investors who require recurring income and more stable returns should include a higher proportion of bond/fixed income funds in their investment portfolios.