

Principal Islamic Asset Management (Ireland) (PLC)

Islamic ASEAN Equity Fund

I Class August 2022

Market Review

The Dow Jones Islamic ASEAN index moved higher in August, up 2.06% month-on-month (m-o-m). Stronger markets were seen across ASEAN - Thailand (4.29%), Indonesia (3.12%), Singapore (2.77%), Philippines (0.22%) except for Malaysia (-1.02%). Notable macro developments were:

- 1) Singapore's Purchasing Managers' Index (PMI) was marginally lower from 50.3 in June to 50.1 in July. The July Consumer Price Index (CPI) expanded 0.2% m-o-m, translating to a headline inflation 7.0% year-on-year (y-o-y). While July expanded less by 0.6% y-o-y from 2.6% y-o-y in June.
- 2) Indonesia's consumer prices rose higher by 4.9% y-o-y in July as compared to 4.4% y-o-y in June. While PMI was higher at 51.7 vs 51.3 in previous month. Exports rose 32.0% y-o-y and imports rose 39.9% y-o-y in July. Indonesia's 2Q22 Gross Domestic Product (GDP) settled at 5.44% y-o-y above expectation of 5.17%.
- 3) Malaysia's July CPI trended higher at 4.4% y-o-y from 3.4% y-o-y in previous month. Exports rose further by 38% y-o-y in July to MYR134.1b from 38.8% y-o-y in June marking 12 consecutive months of double digit growth. The trade balance ended at MYR15.5b lower than the surplus of MYR21.9bn in June. Malaysia GDP surged to 8.9% y-o-y on economic reopening, stronger than the 5.0% y-o-y print in 1Q22.
- 4) Thailand PMI accelerated further in August to 53.7 from 52.4. July CPI marginally eased to 7.6% y-o-y from 7.7% in June, translating to core inflation of 3.0% y-o-y. July exports moderated to 3.4% y-o-y from 11.9% y-o-y in June while imports rose higher at 25.3% y-o-y from 24.5% y-o-y in previous month. The current account for July stood at -\$4,1b, widening from \$1.9b in previous month. Thailand GDP in 2Q22 expanded to 2.5% y-o-y from 2.3% y-o-y in 1Q22.
- 5) Philippine's consumer prices in July expanded by 0.8% m-o-m flat from 0.9% in June. Export fell sharply to only 1% y-o-y in June from 6.4% y-o-y in May. Overseas foreign worker (OFW) remittances grew 4.4% in June from 2.0% y-o-y in May. Foreign exchange reserve balance fell to \$98.8b from \$100.9b in June.

Despite the external noises, ASEAN economies extended their recovery. Tourist arrivals are stronger than expected even though China has not given up on their zero Covid policy. In terms of export, Singapore, Vietnam and Malaysia have the highest exposure to US, EU and China, however, Malaysia's will be more resilient as they are more exposed to auto-related sector and has higher exposure to China than to US/EU. After being perceived behind the curve, Bank Indonesia and Bank of Thailand finally raised 25 basis point (bps) to 3.75% and 0.75%, respectively. Philippines' Bangko Sentral ng Pilipinas (BSP) also continued hiking another 50bps to 3.75% after the recent 75bps hike. Central bankers in Malaysia, Indonesia and Thailand focus more on growth.

Results season has concluded with more beats than misses, but as mentioned before, the commodities names have seen their best in terms of earnings revisions. The one worth highlighting is financials, whereby the managements were guiding for higher profitability despite the risk of recession is rising.

Foreign flows to ASEAN (exc. Philippines) turned positive in August as ASEAN outperformed the region and global markets. Better than expected 2Q earnings, lower oil prices, softer-than-expected US July inflation print, broader property sector challenges in China and heightened cross-strait tensions have fueled resumption of inflows to ASEAN equities. Due to rising tensions at North Asia, according to JP Morgan, EM funds increased allocation to ASEAN to 6.5% (5% December 21). JP Morgan observed a similar trend in 2014-15, when ASEAN allocation moved from 150bps UW to 100bps OW in EM funds.

USD continued to strengthened against ASEAN FX except for Thai Baht. Philippines Peso (-1.79%) was the worst performer followed by Singapore Dollar (-1.19%), Malaysia Ringgit (-0.56%) and Indonesia (-0.07%). Thai Baht (+0.94%) outperformed. In terms of seasonality, ASEAN is in seasonal weak period whereby equity will see negative return during August-September period based on historical statistics.

Fund Review

The Fund posted a return of 1.83% m-o-m in August, trailing against the index of 2.06%. For the month, at the country level, the key underperformance was contributed by Thailand and Singapore. At the sector level, Staples and Info Tech contributed negatively to performance, offset by positive performance from the Healthcare and Energy sector. Since the fund's inception, the Fund underperformed against the benchmark by 0.84%.

Portfolio Outlook and Strategy

Developed markets' central banks stronger than expected resolve to fight inflation led to weaker equity markets overall especially in US and Europe. Key issues for the market are (1) how much more tightening by the Federal Reserve (Fed) is necessary (2) will the US economy see a soft or hard landing; and (3) when will China recover. The US Fed has signalled that they will continue to tighten financial conditions until inflation convincingly slows. While we see signs of slowing, particularly in the housing sector, labour markets remain very tight and suggest an economy that is still growing at or above potential.

In China, the debate is about what policymakers will do after the political dust settles post the 20 Party Congress in October (to begin in October 16). There is hope for more clarity and conviction on adjusting stimulus policies and zero-Covid after the meeting. In the meantime, stimulus is broadly offsetting the drag from property, lockdowns and softening global demand. In August, the People's Bank of China cut policy rates and in late August, the State Council announced a Rmb1tn fiscal stimulus. It will be important to monitor how consumer confidence evolves.

MSCI ASEAN is currently trading at 14.2x forward 12 months Price-to-Earnings Ratio, which is slightly above the 5-year historical average of 14.1x. Singapore and Thailand are trading above historical average. The former is due to the inclusion of SEA Ltd.

Table 1: Foreign fund flows

FF Nett Flows (USD'mil)	Malaysia	Indonesia*	Philippines~	Thailand	Vietnam^	Total
Aug22	460.4	508.3	(152.8)	1,603.3	77.0	2,496.2
YTD22	1,761.8	1,309.1	(704.6)	3,836.3	65.0	6,267.6
2009 - YTD22	(4,483.6)	7,788.8	3,001.8	(19,853.3)	924.4	(12,622.0)

*¹ There were approximate inflows of \$4 billion in 2019 due to BDMN acquisition by MUFJ and MAPA IPO.

*² There were approximate inflows of \$1.4 billion in May 2020 due to Bank Permata acquisition by Bangkok Bank.

^ A consortium led by KKR invested \$650 million of Vinhomes in June 2020.

~ KKR acquired \$192 million stake in First Gen Corporation in late June 2020 and JERA bought \$1.58 billion stake in the Aboitiz Power.

Source: Bloomberg

ASEAN commenced the month with further rebound before profit taking activities took place. After the recent rebound, we took profit on selective reopening plays such as banks, airport, property developer, and some commodities names. Cash raised will be deployed when we see the opportunity. As mentioned above, ASEAN markets are entering into seasonally weak period in terms of equity performance.

We believe ASEAN equities continue to provide investors a combination of recovery plays and long-term structural themes. Hence, we have adopted a barbell approach of cyclicals and growth. As reopening progresses in ASEAN, we focus on quality companies in cyclical sectors and sectors benefiting from reopening such as tourism-related. Cyclical sectors include financials, consumer, real estates. We also continue to like structural growth themes of ASEAN internet, technology and supply chain shift, with a focus on quality growth companies at reasonable valuation.

Risk Considerations

Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed.

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