It's Tough but Still Successfully Manage to Deliver Superior Strategy

Key Takeaways

- Russia-Ukraine conflict sent a signal of further production and supply chain disruption in commodity market particularly in energy and food commodities.
- Surging commodity prices such as oil and wheat could increase inflationary pressure which already high.
- Global investors still overweight equity over bond and cash in their global balanced fund during high inflation and geopolitical risk.
- Interestingly, EM equities performed better in term of return and volatility compared to DM stocks throughout 2022.
- JCI lead with gain of 4.66% on the back of massive foreign inflows. Key catalyst include : manageable inflation, lucrative valuation, sound macro policy and opportunity in corporate action.
- Our strategy since the beginning of 2022 focus on 4 pillar : 1) ESG and foreign flows; 2) M&A story in telco and tower sector; 3) sector benefitting from low interest rate as well as 4) value stock.
- Our stock picks (portfolio) has delivered superior return outperforming the benchmark by 440 bps ytd.

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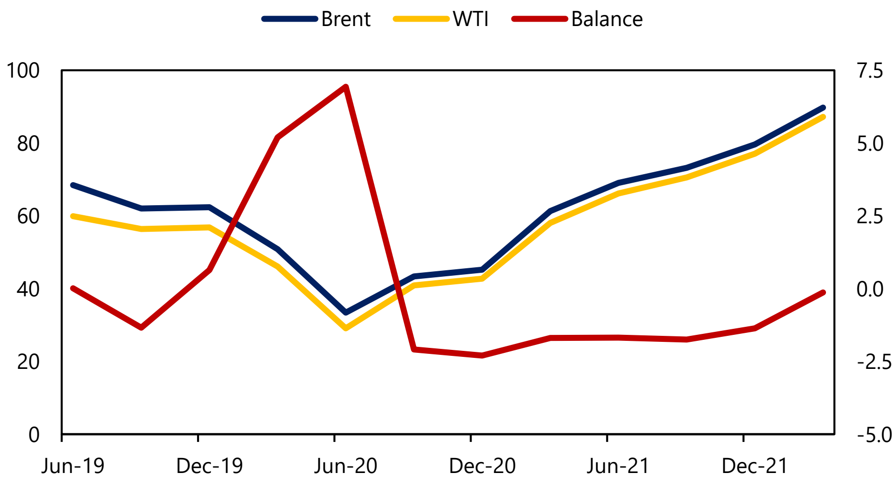
Russia-Ukraine Crisis & Market Response

We still remember that inflation risk has not gone, but we are now facing another threat. It is almost a week since Russia invaded Ukraine. It began with Putin recognition the independence of two pro-Russian breakaway regions in eastern Ukraine on February 22. Two days later, Russia announced its special military operation in eastern region. Missiles attacks were targeted to various Ukraine cities including its capital Kyiv. Conflict continued to escalate. On February 25 Ukraine president Volodymyr Zelensky ordered the military mobilization and banning all males aged 18-60 from leaving the country. A serious battle was reported on February 26 in Kyiv. Some of infrastructure including gas pipeline, oil depot and even Zhuliany Airport had been bombed by Russian military forces.

In response to the attacks, western countries started to impose economic sanctions against Russia targeting elites, banks and CB also Russian companies. Given the sanctions from NATO's countries, Russia's financial assets tumbled. Russia stock index dropped 30% in the last 5 trading days. Furthermore its benchmark 10-year sovereign bond yield jumped to 12.81% marking the highest level of more than 5 years. Meanwhile Russian currency Rouble has depreciated 28.14% against USD. As a result of sharp depreciation, Russian central bank raised the benchmark policy rate to 20% from 9.5% and telling firms to sell FX while its intervention has been stopped due to sanctions.

Jitter also sparked to commodity markets as the conflict is seen to be disrupting oil, vegetable oil and grain trade flows. In the oil markets, Brent crude prices soared to more than US$ 100/bbl. We noted that Russia accounted for 11% of global oil supply and also the member of OPEC+. The reason behind increasing oil price that war may deteriorate outlook on futures oil supply and demand balance. It should be noted that since the pandemic strike global oil market tightened with a negative balance causing its price to rally (Exhibit 1).

Exhibit 1. Oil Price (USD/bbl) and Supply-Demand Balance (mbpd)



Notes : Oil price is calculated using quarterly average at LHS and Balance at RHS.
Sources : Bloomberg, EIA and MNCS

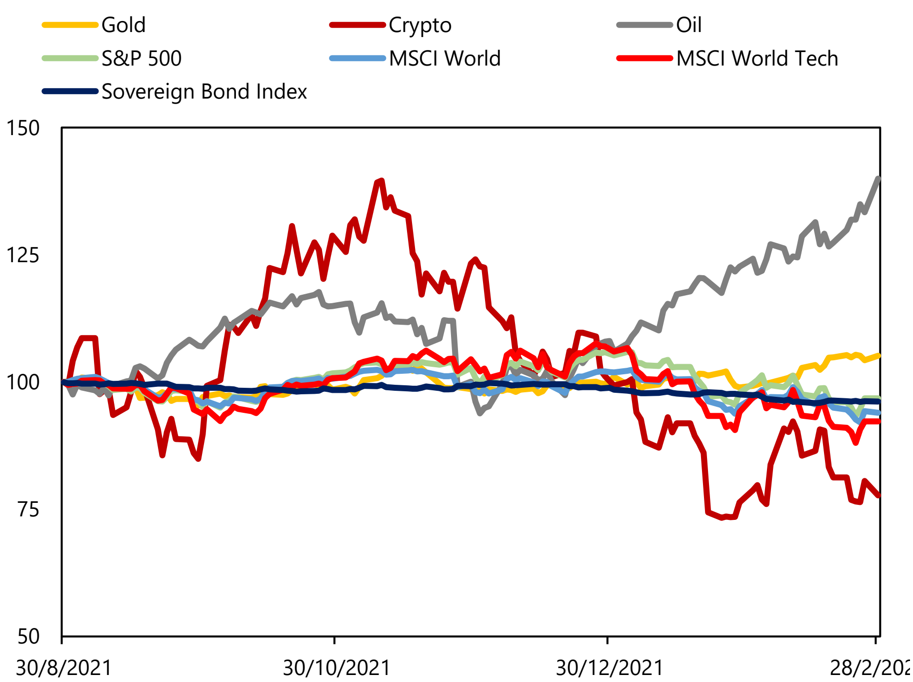
Meanwhile grain price such as wheat jumped to a nearly a decade high as both Russia and Ukraine contributed nearly 30% from global exports market. The continuation of crisis could pose another threat for inflation outlook since price of food and energy becoming more expensive and the effect to spill globally and as a result, high inflationary pressure could persist even longer. We think this may trigger more aggressive tightening. If it is not followed by clear communication and guidance, market would react negatively. The impact would be more severe in some EM countries facing : 1) high inflation and 2) high external debts causing currency volatility is highly and rising risk premium.

The Worst is Over?

It is worth noted that risk posing global economy is now on geopolitical tensions, on top of higher and more persistent inflation. On Monday February 28, Russia and Ukraine confirmed that both countries had concluded the first talk. This talk may indicate a progress, however it is too early to say that the worse has been over. We need to understand what Putin want from Ukraine to not joining NATO in order to minimize the presence and influence of western countries in eastern Europe. Officials from Ukraine said that more talks is soon to hold, so that we better to be more cautious and continue to focus on the development.

Even before Russia-Ukraine crisis exploded, market started to priced in economic vulnerability due to inflation since the beginning of 2022. Safe haven asset such as gold is rising while riskier and growth assets such as stocks and cryptocurrencies tumbled. Oil price rose 40% ytd; gold increased 5% ytd while crypto index suffered with 22% lost ytd. This depicted a contrast picture compared to 2021, where risky asset class significantly outperformed others (Exhibit 2).

Exhibit 2. Asset Class Performance with Aug-21 = 100



Sources : Bloomberg and MNCS

We believe geopolitical tensions could disrupt production and supply chain so that it will trigger a widening gap of supply demand balance resulting in inflation. We continuously monitor how global investors think and act in terms of strategy in response to this condition.

Based on Reuters polling, investors seemed to place a bet on equity while reducing bond and cash in their balanced portfolio. Based on asset allocation polls, equity proportion increased to 50% from total balanced portfolio in 2H21 (vs 49% in 1H21).

In addition, the proportion of bonds and cash to 43% in 2H21 (vs 43.7% in 1H21). Please see Exhibit 3. In time of high inflation cash will underperform since the purchasing power will erode along with currency devaluation against goods and services. Higher inflation will also reduce real yield making investing in bond is less attractive.

Exhibit 3. Asset Allocation Polling of Global Balanced Fund

Balanced Fund	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22
Equities	49.0%	49.5%	49.8%	49.8%	48.7%	49.5%	50.1%	49.9%	49.8%	50.3%	50.3%	50.3%	50.1%
Bonds	40.1%	39.8%	39.7%	39.5%	40.3%	39.6%	39.3%	39.7%	39.7%	39.0%	39.0%	39.1%	39.3%
Government Securities	*57.4%*	*58.8%*	*59.5%*	*58.6%*	*59.1%*	*58.5%*	*58.4%*	*54.7%*	*55.3%*	*52.7%*	*53.8%*	*54.3%*	*53.3%*
High Yield	*11.6%*	*11.5%*	*11.4%*	*11.5%*	*9.7%*	*9.9%*	*9.4%*	*8.6%*	*7.7%*	*7.6%*	*8.2%*	*8.2%*	*8.7%*
Investment Grade Corp	*26.0%*	*24.7%*	*24.0%*	*24.6%*	*26.0%*	*26.1%*	*26.4%*	*30.2%*	*31.4%*	*30.5%*	*27.9%*	*27.9%*	*29.2%*
Other Credit	*5.0%*	*4.9%*	*5.0%*	*5.4%*	*5.2%*	*5.5%*	*5.8%*	*6.4%*	*5.6%*	*9.2%*	*10.1%*	*9.6%*	*8.9%*
Cash	3.9%	3.6%	3.8%	4.0%	4.0%	3.9%	3.9%	3.6%	3.7%	3.8%	3.7%	3.6%	3.6%
Property	1.5%	1.5%	1.4%	1.4%	1.4%	1.4%	1.4%	1.3%	1.4%	1.4%	1.3%	1.3%	1.3%
Alternatives	5.4%	5.6%	5.3%	5.3%	5.6%	5.6%	5.3%	5.5%	5.4%	5.5%	5.8%	5.7%	5.7%

Sources : Reuters Polls and MNCS

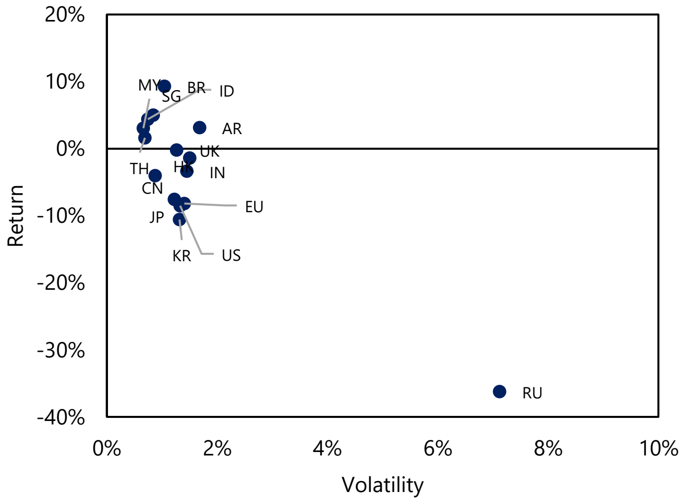
Interestingly EM Equities Performed Better

It is interesting to see that with the recent risk from heightened geopolitical tensions and probability of aggressive monetary tightening which historically trigger flight to quality phenomenon, riskier assets such as equity in EM countries performed better in terms of returns and its volatility throughout 2022.

In the domestic market, JCI recorded an increase of 4.66% year to date, delivering superior return compared to equity assets in DM countries which saw a negative return during the same period (Exhibit 4).

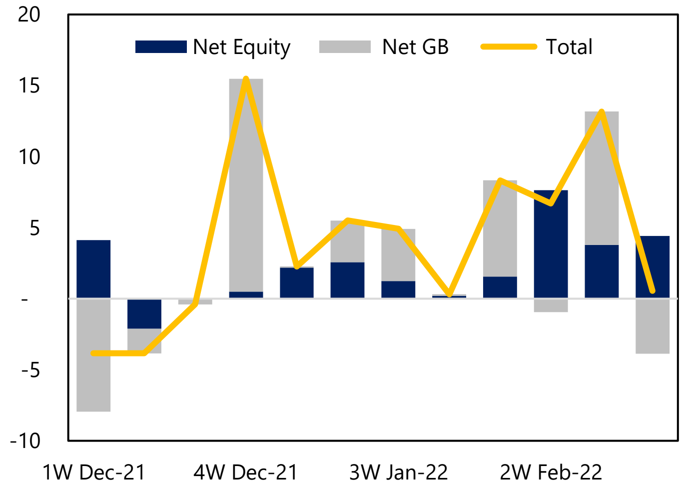
Impressive performance of domestic stock market is also supported by : 1) massive foreign inflows ; 2) attractive valuation compared to frothy market in DM economies; 3) low and manageable inflation outlook amid commodity boom; 4) sound macro policy to support growth, stability and sustainability as well as 5) corporate transformation agenda mainly through M&A that boosted valuation.

Exhibit 4. Ytd EM Equity Indices Return vs Volatility



Sources : Bloomberg and MNCS

Exhibit 5. Foreign Flows to Domestic Financial Assets



Sources : Bloomberg, DJPPR and MNCS

Tracking Our Strategy which Focus on 4 Pillar : Superb!

Since the beginning of 2022, our equity strategy is based on 4 key pillars to deliver a superior strategy in the 1Q22. Those 4 pillars include :

Pillar 1 : ESG and Foreign Flows

Although it is still early in Indonesia, foreign investors are heavily focus on sustainability and ESG rating in stock picking. Therefore we selected stocks which meet at least 4 criteria of our ESG framework including : 1) having roadmap toward ESG and sustainability; 2) having ESG and sustainability committee; 3) focus on ESG and sustainable portfolio and 4) high sustainability rating.

Pillar 2 : M&A Story

We understand inorganic growth through M&A if successfully executed with well design strategy and seasoned management team would deliver value to shareholder. We focus on telco and tower sector after taking into account several things such as : 1) market landscape and 2) positive outlook amid rising data demand and consumption.

Pillar 3 : Sector Benefitting from Low Interest Rate Environment

We added property sector in our portfolio and selected stocks which have portfolio of small sized residential. It is worth noted that there are several key catalysts for property sectors which we believe will boost companies financial performance and share prices. Those are among others : 1) rising commodity boom; 2) low interest rate environment in Indonesia seems to sustain longer at least up until 1H22 on the back of IDR stability and manageable inflation; 3) relaxed macroprudential policy through low LTV and DP as well as 4) government stimulus to relax VAT.

Pillar 4 : Value Stocks

We defined value stock as share prices are undervalued and did not reflect its future prospect after considering its fundamental top down approach.

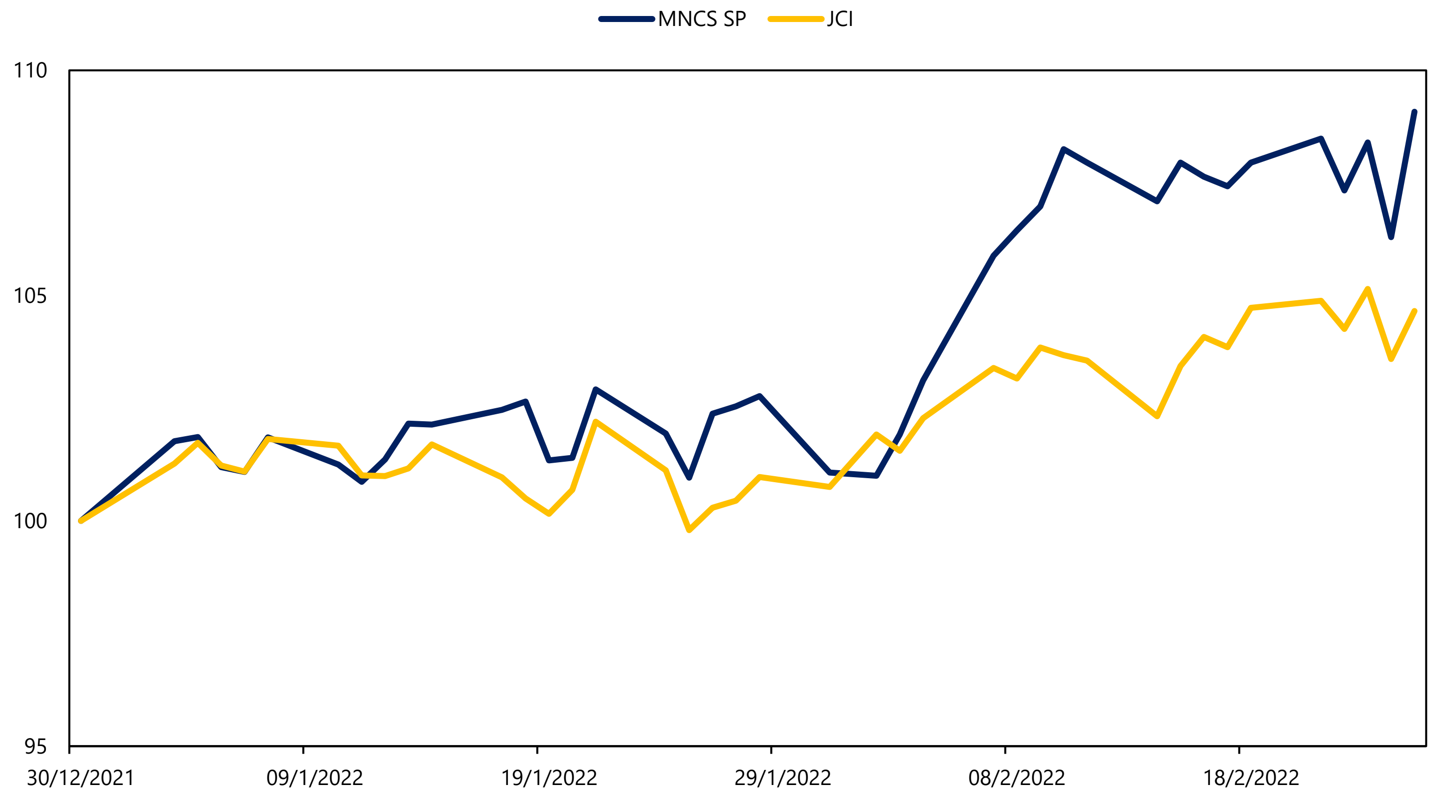
Our portfolio comprised of 11 stocks for the abovementioned pillars which can be seen in Exhibit 5. We constructed a portfolio of those stocks and adjusting market cap, liquidity as well as free float share for weighting. Interestingly we succeed to deliver superior return compared to broad based market index. Our portfolio has a return of 9.1% ytd and outperforming JCI for 440 bps (Exhibit 6).

Exhibit 5. MNCS Stock Picks

Pillars	Stocks	Rationale
ESG & Foreign Inflows	BBRI IJ BMRI IJ BBNI IJ	1) Meeting our ESG framework; 2) large market cap and blue chip, 3) positive outlook on banking sectors in 2022 with stronger CASA, higher credit and lower CoC after implementing frontloading provisioning strategy in 2021
M&A Story in Telco & Tower	TLKM IJ EXCL IJ TOWR IJ	1) Post ISAT-Hutch merger will likely to trigger consolidation among player to strengthen position in the market; 2) positive outlook on telco sectors
Sectors Benefitting from Low Interest Rates	BSDE IJ CTRA IJ	Expecting accommodative policy and stronger purchasing power to translate into higher EPS in 2022
Value Stocks	ASII IJ ERAA IJ ARNA IJ	1) ASII : well diversified large conglomerate with portfolio benefitting from macro environment including commodity boom and low interest rate; 2) ERAA : omnichannel strategy to strengthen position in the market of tech savvy and mobile consumer; 3) ARNA : sector related to property and our alpha stocks

Sources : MNCS

Exhibit 6. MNCS Stock Picks (Portfolio) vs Market Index 2022



Sources : Bloomberg and MNCS

What's Next?

The recent move in Indonesia's financial market seemed to tell us that Russia-Ukraine conflict is not a big deal. However, note that Indonesia relied on Ukraine for cereals import. In 2021, Indonesia is estimated to imports cereals from Ukraine with the total value of USD0.95bn. Higher grains and cereals price will also impact Indonesia. This may trigger cost pushed inflation, yet again Indonesia is also one of EM countries exporting both hard and soft commodities. Therefore higher certain commodity prices would not erode purchasing power significantly.

In addition, higher commodity prices combined with undisrupted domestic production should benefit Indonesia and strengthen its position in the global market. Exports remained elevated with imports started to catching up. However trade balance still recorded a surplus so far. Higher exports value was not only affected by soaring price but also rising demand. Throughout 2021, exports of mining related commodities jumped 92.15% YoY.

This year two top exporting commodities from Indonesia namely coal and CPO still managed to book double digit growth in term of nominal price with coal soared +65.73% ytd and CPO jumped +34.11% ytd. Some part of commodity exporting countries such as Australia and Malaysia still haunted with production disruption partly due to weather and Covid-19 related measures.

All in all, for a tactical strategy we also see commodity related sectors attractive and expecting to benefit from current condition. We like commodity related sectors which focus on delivering ESG and sustainability strategy such as in companies which have portfolio in Nickel to establish renewable energy resources.

MNC Research Industry Ratings Guidance

OVERWEIGHT: Stock's total return is estimated to be above the average total return of our industry coverage universe over next 6-12 months

NEUTRAL: Stock's total return is estimated to be in line with the average total return of our industry coverage universe over next 6-12 months

UNDERWEIGHT: Stock's total return is estimated to be below the average total return of our industry coverage universe over next 6-12 months

MNC Research Investment Ratings Guidance

BUY : Share price may exceed 10% over the next 12 months

HOLD : Share price may fall within the range of +/- 10% of the next 12 months

SELL : Share price may fall by more than 10% over the next 12 months

Not Rated : Stock is not within regular research coverage

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