

Wealth transfer in the stock market (?)



Key Takeaways

- Global stock market performance varied throughout 2022 with stock in AE underperformed due to its characteristics in heavy tech sector weight
- Stock market indexes in commodity dependent countries were performing better this year, including JCI
- Historically, JCI showed positive long term co-movement with coal & CPO prices
- We believe amidst highly volatile market environment during monetary policy adjustment JCI would be more resilient than in the past and compared to other stock indexes
- Strategy implication, add commodity related stock to optimize risk adjusted return & hedge against inflation
- We like UNTR IJ on the back of : positive correlation with commodity prices, good earning quality & healthy leverage ratio

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Challenging environment in the global stock markets

Global stock market returns varied from -40.2% (Russia) to +28.3% (Turkey) during this year. However, world equity markets dipped in negative territory with median returns of -5.03% ytd. Advanced economies stock market underperformed with US S&P 500 fell >12% while median returns for EU stock indexes were -11.5% ytd. Monetary policy tightening was all to blame for stock market sell off throughout this year. Note that Fed has raised FFR 2x by 75 bps, first in Mar-22 by +25 bps and the later in May-22 by +50 bps. The characteristics of mature market with heavy weight of tech sector were behind recent market turmoil in the midst of monetary policy adjustment (Exhibit 1).

High commodity prices favor EM stock markets to outperform

Interestingly, EM stock market indexes in which countries are highly dependent on commodities were better performed than those in low dependency economies. The top-10 best performer of stock market indexes ytd were countries which 62-72% of their total exports are commodity based (Exhibit 2). It seems that there is a wealth transfer phenomenon from non-producing commodity countries to producing & exporting ones during the boom cycle. Although we see a positive correlation between commodity prices and stock returns in commodity dependent countries this year, we think it's too early that high price is solely to depict behavior in equity market. Comprehensive analysis employing macro (output growth & outlook, inflation trajectory, monetary policy, risk free rate changes, currency volatility & stability) as well as micro factors (earning quality and outlook) need to be assessed in order to gain deeper insight to elaborate recent stock performance.

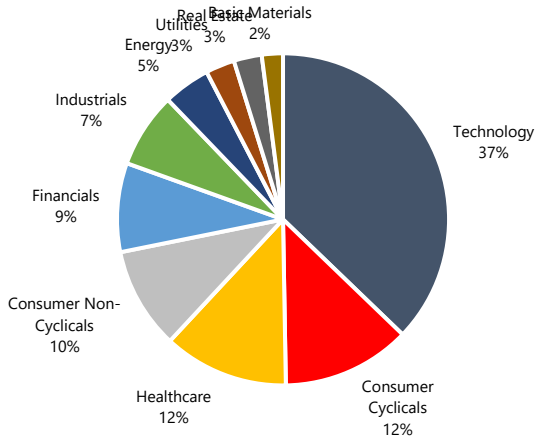
Historical positive correlation between JCI performance and commodity boom

It is worth noting that Covid-19 has brought a tight supply condition boosting commodity prices. Agricultural & metal minerals commodity prices index jumped 1.6x and 1.8x respectively compared to pre-Covid-19. Meanwhile energy prices index has soared 2x from pre-pandemic (Exhibit 3). Historically, high prices in the commodity markets will bring more good than harms to Indonesia's economy from various channels (currency stability channel, government budget balance, trade channel, household purchasing power channel and thus output channel). We also noted that there is long term strong positive correlation ($R > 0.5$) between domestic stock market return and coal as well as CPO prices as both commodity account >27% Indonesia's total exports (Exhibit 4). Albeit high inflation environment and aggressive tightening that trigger volatility, we believe Indonesia stock market would be more resilient than those in the past and compared to peers. Therefore we maintain our view to overweight stocks over bond given such conditions.

Strategy implication : add UNTR IJ

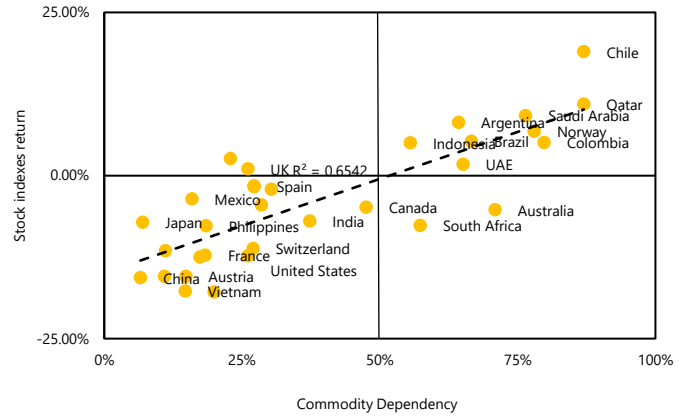
We recommend to add commodity related equity stock in the portfolio to optimize risk adjusted return as well as to hedge against inflation. We continue to like UNTR IJ on the back of several factors. First, we see a positive co-movement between UNTR IJ and coal price (Exhibit 5). Second, positive earning outlook for FY22F, note that UNTR bottom line grew +131% YoY in 1Q22 implying 32% run rate of consensus estimate, given the improvement in all business segments (Exhibit 6). Lastly, we also like UNTR due to its consistency to maintain healthy leverage ratio (debt/EBITDA <1.5x in the last decade) which we believe is important for companies to face higher borrowing cost going forward.

Exhibit 1. Heavy weight of tech sectors burdened S&P 500



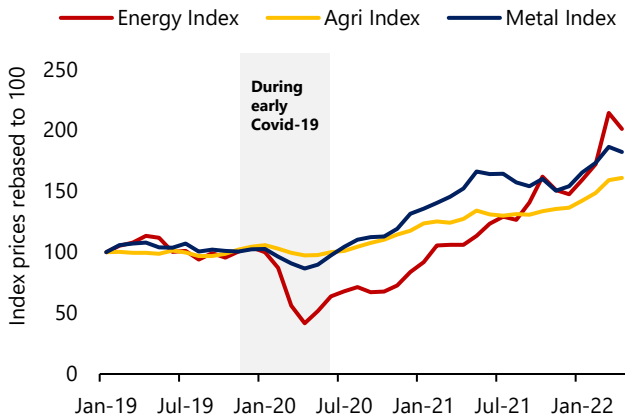
Sources : Bloomberg, MNCS Research

Exhibit 2. Stocks in commodity dependent countries outperformed



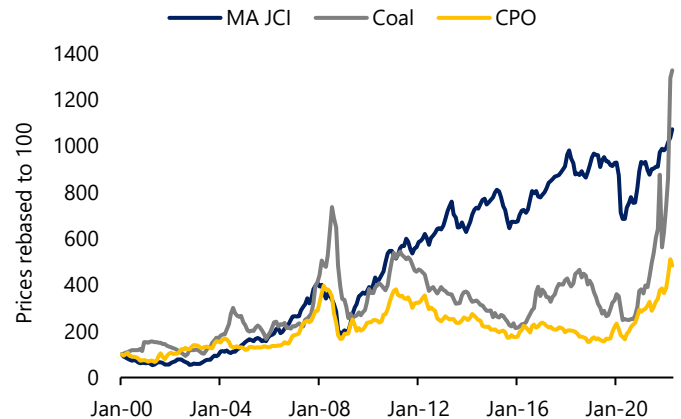
Notes : as of 24-May. Sources : IDX, UNCTAD, MNCS Research

Exhibit 3. Commodity prices soared >1.5x from pre-Covid-19



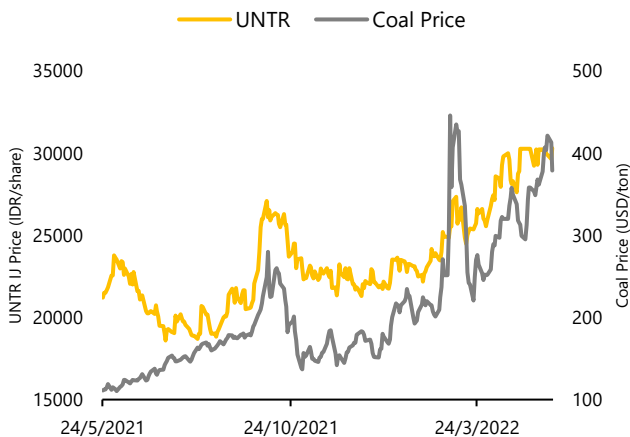
Sources : World Bank, MNCS Research

Exhibit 4. LT positive correlation between JCI and coal & CPO prices



Notes : Monthly Average (MA). Sources : Bloomberg, MNCS Research

Exhibit 5. Positive co-movement between UNTR & coal price



Sources : Bloomberg, MNCS Research

Exhibit 6. UNTR IJ improving financial performance in 1Q22

Revenue Breakdown (IDR bn)	1Q22	1Q21	Change
Construction Machinery	9,661	4,349	122%
Mining Contracting	8,469	6,969	22%
Coal Mining	7,587	3,958	92%
Gold Mining	1,987	2,242	-11%
Construction Industry	274	380	-28%
Energy	1	-	
Total Revenue	27,979	17,898	56%
Gross Profit	7,037	3,536	99%
Net Income	4,321	1,867	131%

Sources : Companies, MNCS Research

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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