MNCS Top Picks

Stocks	TP (IDR)	Rating
ASII IJ	7,425	BUY
ARNA IJ	1,100	BUY
BBRI IJ	5,500	BUY
BMRI IJ	8,900	BUY
BSDE IJ	1,500	BUY
CTRA IJ	1,300	BUY
DSNG IJ	800	BUY
ERAA IJ	1,000	BUY
MAPI IJ	1,000	BUY
UNTR IJ	33,700	BUY

Key Takeaways

- Downside risks for global economy and market : 1) higher inflation and aggressive tightening; 2) heightened geopolitical tension; 3) Covid-19
- Albeit the risks, Indonesia's economy has shown to be resilient on the back of solid macro data : 1) mobility; 2) CCI & PMI; 3) liquidity; 4) international trade and 5) currency as well as sovereign risk
- Risk for domestic economy is potential higher inflation due to : 1) soaring commodity prices such as cooking oil; 2) rising cigarette prices as well as 3) VAT hikes from 10 to 11%
- Maintain outlook with several adjustment on inflation, risk free and interest rate forecast FY22F.
- Domestic equity outlook remains positive on the back of 1) solid macro data; 2) foreign flows 3) potential benefit from geographical rebalancing due to escalating geopolitical tension with JCI target for FY22F at 7,650 (+20% EPS growth implying 15.4x FY22F P/E)
- We take out BBNI IJ, EXCL IJ, TLKM IJ, TOWR IJ from our top picks and add DSNG IJ, MAPI IJ as well as UNTR IJ

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2Q22 Economic Outlook & Equity Strategy

"We identify 3 major risks for 2022 including : 1) inflation and monetary tightening; 2) heightened geopolitical tensions; 3) Covid-19 virus that keeps mutating derailing growth prospect. Albeit the downside risks, we believe Indonesia's economy could maintain its positive outlook. However risk for domestic economy is potential higher inflation on the back of rising commodity prices, yet expecting sound policy to foster growth and stability."

Tirta Widi Gilang Citradi – Economist & Fixed Income Analyst

"Maintain positive outlook for Indonesia's equity with our bull case of 7,650 of JCI target implying +20% EPS growth/15.4x FY22F P/E. We believe global geopolitical outlook to overweight Indonesia's equity causing inflows to be the key catalyst on top of solid economic condition. We prefer banks, property, retailers and sectors that are positively impacted by commodity boom."

Victoria Venny Nawang Setyaningrum – In Charge Head of Research

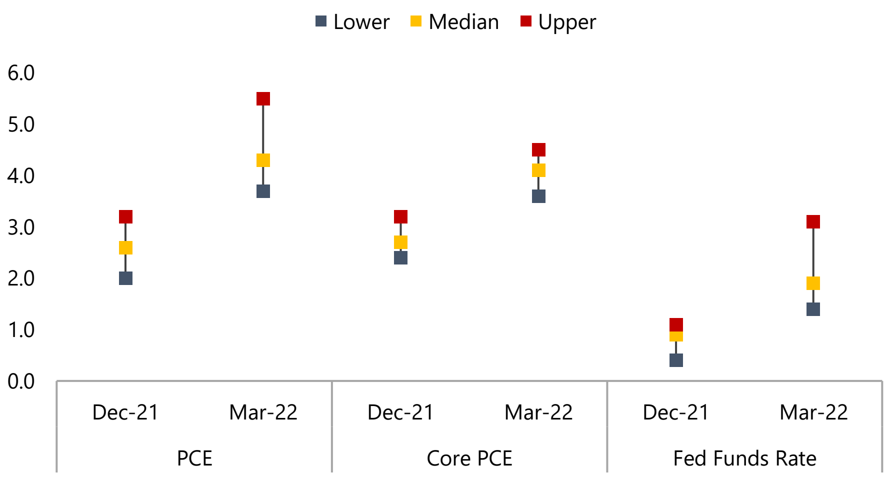
Inflation & Central Bank Response

More than a decade high of consumer prices has become everyone's top of mind recently. Although inflationary pressure has become a downside risk for growth prospect, it seems that central banks around the world differ in taking a policy response. Given the US CPI jumped to +7.9% YoY in Feb-22, Fed decided to raise FFR by 25 bps in Mar-22 after concluding its liquidity injection (tapering off). Elsewhere, ECB also plan to end its stimulus by 3Q22. Unlike the Fed and ECB, BoE has taken earlier cycle of tightening. BoE has raised its policy rate 3 times since 4Q22. Meanwhile BoJ seems to maintain its dovish stance on monetary although officials confirm higher risk for inflation.

Higher Inflation Means More Aggressive Tightening for US

The Fed revisited up its PCE inflation outlook for FY22F by 170 bps in Mar-22. The implied FFR target for FY22F is at 1.9% (Exhibit 1). The Fed also lowered GDP growth forecast due to high inflation. It should be noted that based on Powell statement, he signaled US central bank could come with more aggressive tightening by increasing 50 bps and starting to reduce its balance sheet that would further tighten financial condition. Fighting inflation is now US central bank top priority.

Exhibit 1. Fed sees higher inflation and rate for FY22F (%)

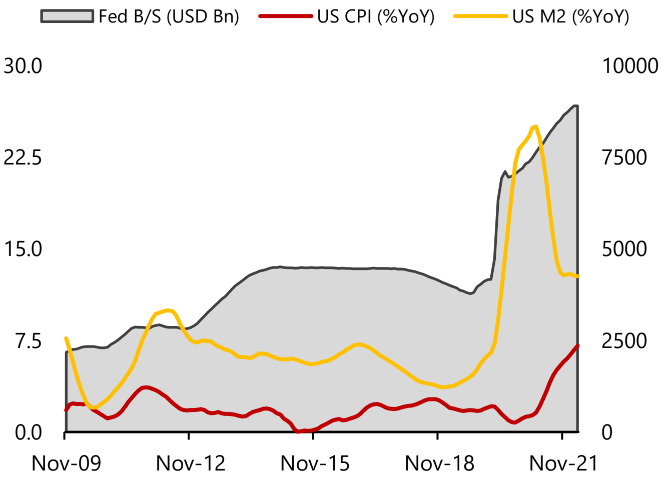


Source : Fed's Summary of Economic Projection Mar-22

Behind US Inflation Figures

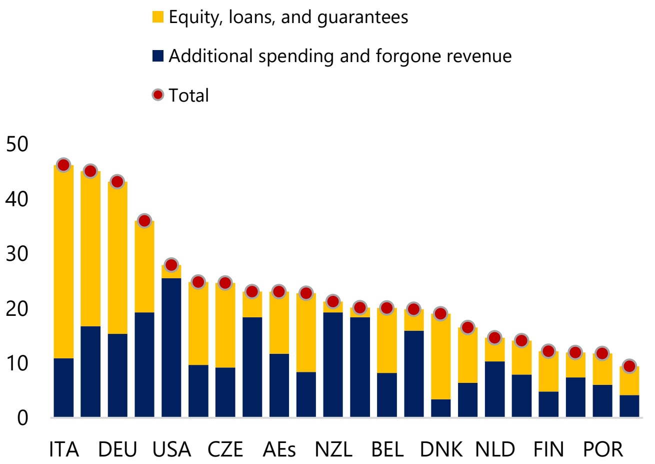
We believe US policy to favor higher consumer prices. This time QE has a more significant inflation impact than in 2008 GFC. Expansive fiscal and monetary policy were directed to cushion the economic stall during Covid-19 crisis. Note that the pace and size of QE was much more significant. Fed's B/S expanded to a nearly USD9tn. US M2 consistently grew by double digits since May-20 (Exhibit 2). In addition, as of Oct-21 according to IMF calculation, US fiscal stimulus size were estimated around 28% GDP and 91% of which came to compensate forgone revenue by household and businesses (Exhibit 3). On the other hand, strict policy measures during Covid-19 that limit mobility and economic activity has brought disruption in production and supply chain resulting a widened supply and demand gap. These factors justified US high inflation story.

Exhibit 2. QE, M2 growth & inflation in US



Source : Bloomberg, The Fed, MNCS

Exhibit 3. Expansive fiscal policy during Covid-19 (%GDP)



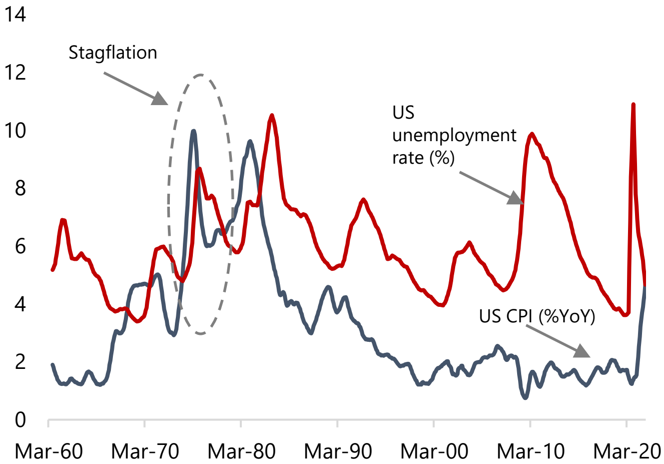
Source : International Monetary Fund, MNCS

The Fed Behind the Curve & Risk of Stagflation

Given the jump in US inflation figures, debate over the Fed has been behind the curve escalates. Some believe it would lead to a stagflation indicated by high inflation and unemployment with lower growth prospect, a condition faced by US economy in 1970s. Indeed we see that stagflation risk is rising given the labor shortage in US (Exhibit 4). However, we think the answer to whether Fed has been behind the curve is not straightforward and much more complicated.

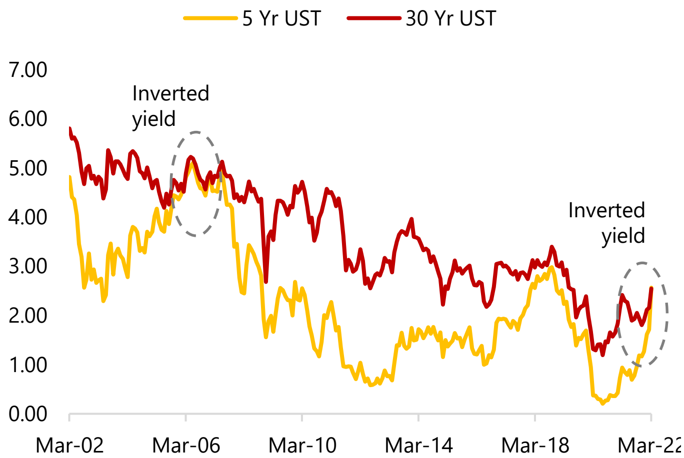
Note that during Covid-19, US central bank made adjustment on its policy framework by letting inflation to overshoot above its target temporary. And now inflation keeps on rising to a multi decade highs even far beyond Fed's upper projection. However, although there was a phenomenon of inverted yield curve (5-30 year UST yield spread turned to negative) (Exhibit 5 & 6) that sparks jitter on potential upcoming recession recently, the long term inflation expectation remained well anchored around Fed's target (Exhibit 7). Moving forward, we believe Fed's clear guidance to remain crucial to influence inflation expectation as well as bond market behavior. We also think that under this challenging circumstance, monetary policy evolution is likely going forward.

Exhibit 4. Risk of stagflation is rising



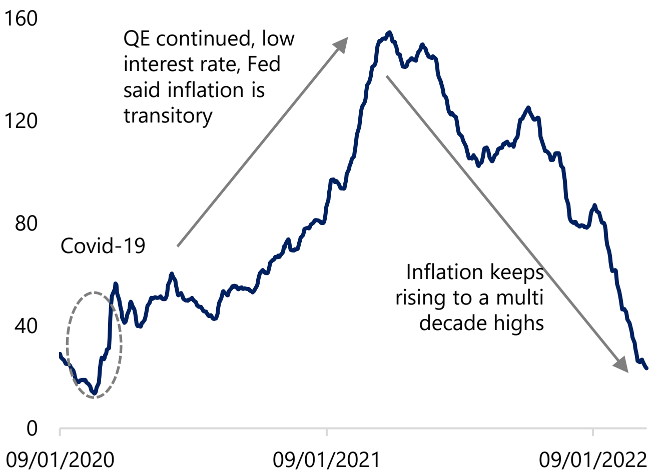
Source : Bloomberg, MNCS

Exhibit 5. Inverted yield curve (5-30 year UST in %)



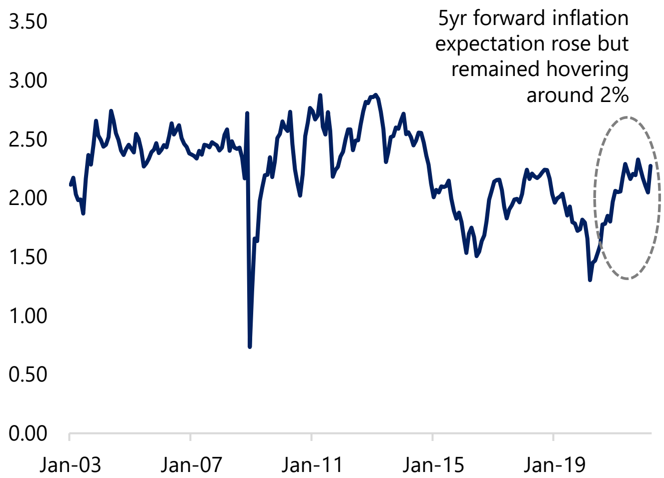
Source : Bloomberg, MNCS

Exhibit 6. Spread between 2-10 year UST narrows (bps)



Source : Bloomberg, MNCS

Exhibit 7. LT inflation expectation remains anchored (%)

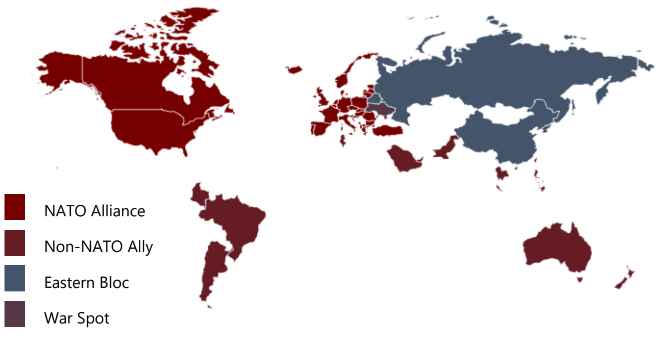


Source : Bloomberg, MNCS

Russia & Ukraine Crisis & Soaring Commodity Prices

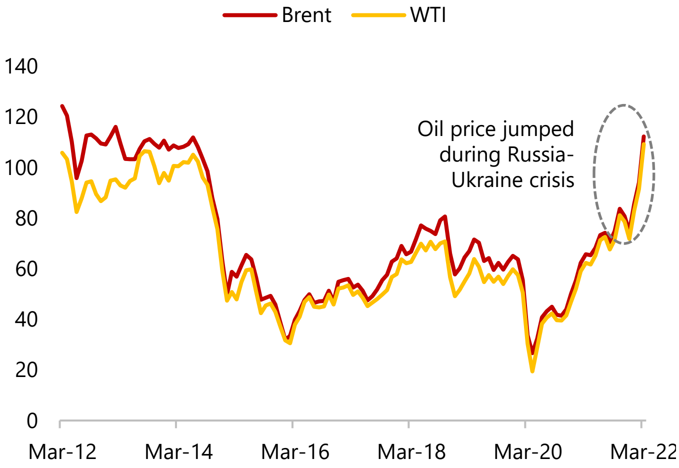
Russia's invasion over Ukraine marked a balancing act between East and West power as NATO plans to continuously expand its footprint to Eastern Europe (Exhibit 8). The war has lasted for a month since the first strike began in late Feb-22. Now ceasefire talks between two countries continue, yet Russia's economy suffer from sanctions imposed by Western countries. CRA downgraded Russia sovereign rating to junk, while its economy also challenge by high inflation, Ruble continue to depreciate. On the other hand, Russia-Ukraine conflict also propelled energy and food prices higher on the back of expected supply disruption. Brent crude futures keeps hovering around USD100/barrel (Exhibit 9). Even before the crisis begin, global oil balance booked a deficit of 1mbpd (Exhibit 10). Wheat and other agricultural commodities also jumped to a multi year highs during conflict (Exhibit 11). Higher commodity prices lead to a further pressure on consumer prices and may result to a more persistent inflation and complicate policy making. All in all, heightened geopolitical tensions has become another downside risk for global economy to which we believe would translate to higher inflation due to supply shock.

Exhibit 8. NATO vs Russia over Ukraine



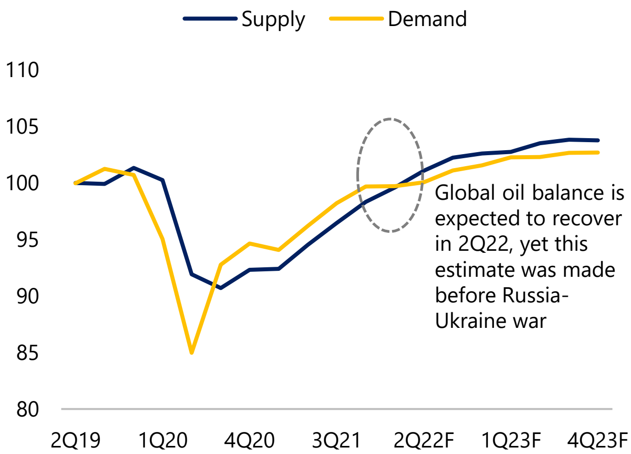
Source : Various Sources, MNCS

Exhibit 9. Multi year highs oil prices (USD/barrel)



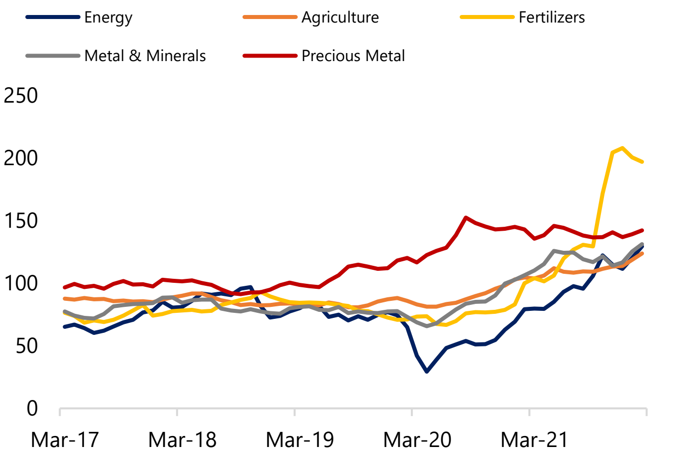
Source : Bloomberg, MNCS

Exhibit 10. Global oil balance recorded a deficit (mbpd)



Source : International Energy Agency (IEA), MNCS

Exhibit 11. Soaring commodity prices (index)

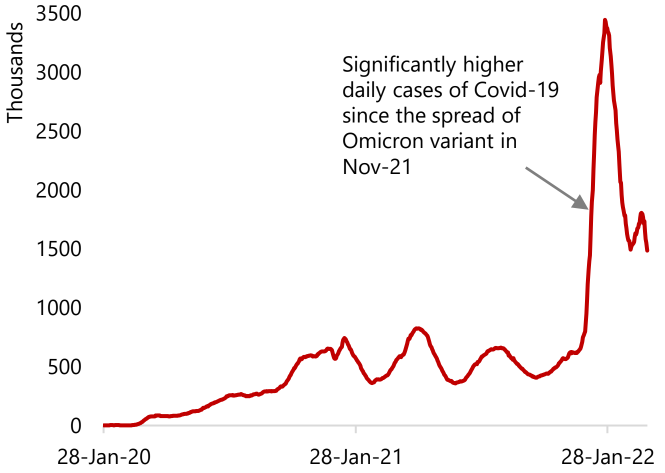


Source : World Bank Pink Sheet, MNCS

Covid-19 to Remain a Threat

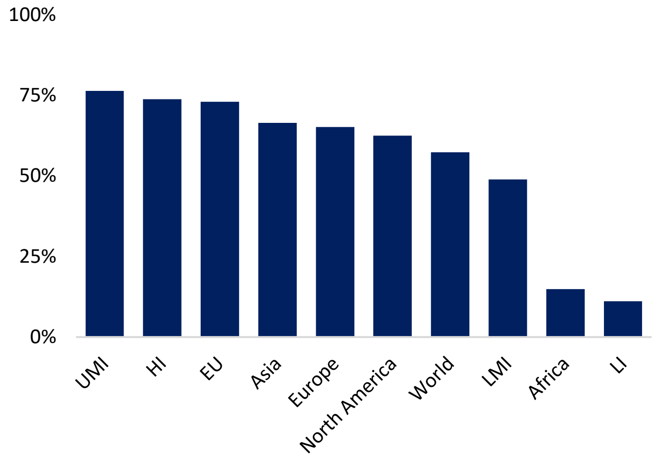
Covid-19 virus continues to mutate, bringing another threat and challenge for the world economy to recover fully. Although the 4^{th} wave seems to end soon and the curve already flattened (Exhibit 12), the high mutation rate and vaccine disparity across the globe could result to different path of recovery with low income economy to suffer the most. Note that vaccine coverage as total people fully vaccinated from the population in higher income countries have reached above 75% while in low income countries, vaccine coverage is still far below 50%, particularly in Africa with only 15% coverage (Exhibit 13). Furthermore, China as the 2^{nd} largest economy also stroke by another Covid-19 wave recently. The daily cases in China hit the worst since the pandemic begin. We think that zero Covid-19 policy maintained by Chinese government would bring a further pressure on economy.

Exhibit 12. The 4th wave seems to end soon (cases/day)



Source : Our World in Data, MNCS

Exhibit 13. Vaccine disparity challenge (%vac/pop)

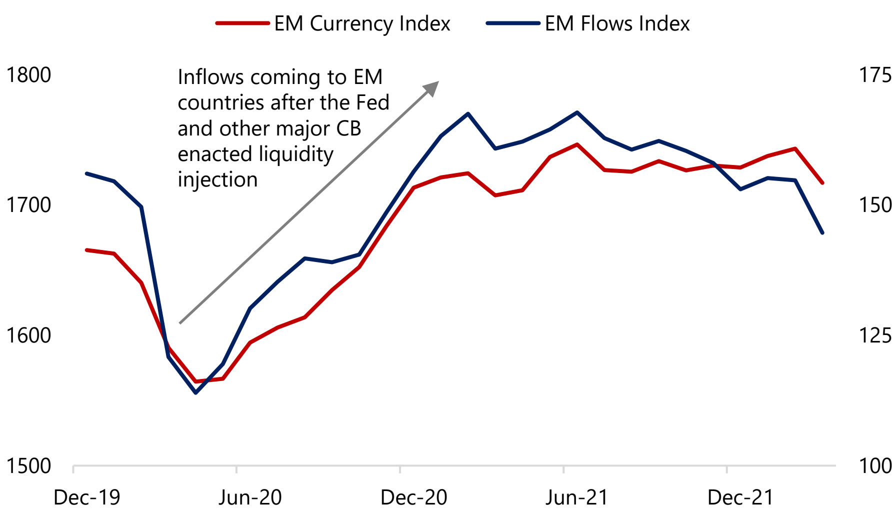


Source : Our World in Data, MNCS

Weakening Outlook for EM?

Inflows have been back to emerging market countries since Apr-20. Fed policy to cut rate to zero lower bound and enacting massive QE causing ample global liquidity. Along with depreciating USD, emerging market currencies strengthened, yet recent downside risks coming from inflation, geopolitical tensions and Covid-19 seems to trigger flow reversal (Exhibit 14), majority of EM currencies have weakened recently amidst Fed tightening policy. On the positive side, higher commodity prices also benefit EM countries trade balance to record a surplus.

Exhibit 14. Flow reversal & EM currencies depreciation (index)

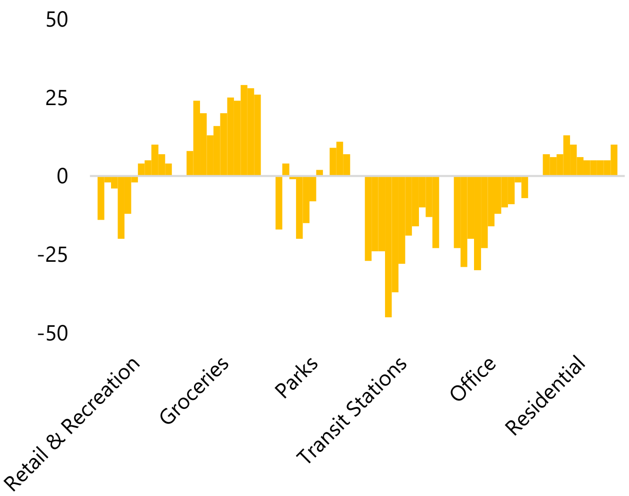


Source : Bloomberg, MNCS

Domestic Economy : Maintain Outlook on Solid Macro Data

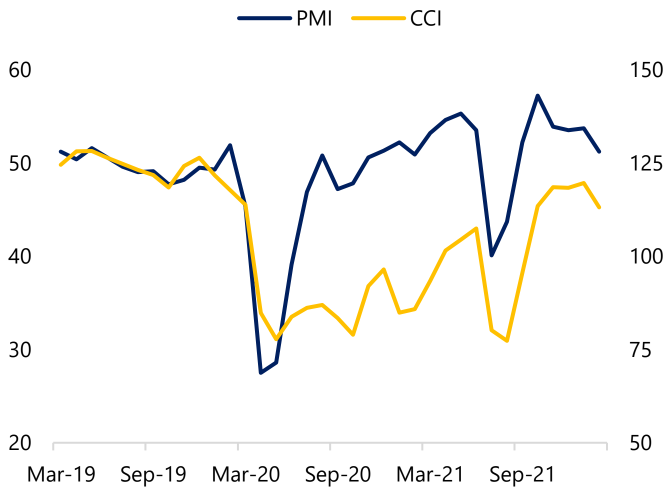
- **Mobility :** despite the 3rd wave outbreak striking in early 2022, public mobility was slightly impacted. Even though the scale of the 3rd wave due to Omicron variant spread is very similar to 2nd wave, mobility across retail and recreation, groceries, parks, transit stations and office showed an encouraging data (Exhibit 15). We believe the key driving factors for this development are : 1) effective policy; 2) less severe impact of Omicron variant; and 3) more adapted economy on the back of aggressive vaccination program.
- **Consumers and businesses :** although sentiment was weakening and manufacturing activity slowing, yet consumer optimism is still solid and factory activity remains in expansionary mode (Exhibit 16).
- **Liquidity :** banking credit gradually picking up as demand also recover along with M2 growth that we believe are adequate to support economic recovery (Exhibit 17).
- **International trade :** trade balance surplus continued in 2M22 on the back of higher exports than imports. Indonesia booked a trade balance surplus of USD4.78bn during 2M22 primarily driven by higher commodity prices such as coal and CPO as well improving demand (Exhibit 18).
- **Currency risk :** IDR is one of the best performing Asia's currency so far. IDR managed to only depreciate marginally (<1%) against USD compared to other currencies thanks to trade balance surplus and ample reserves. IDR only depreciated significantly against AUD due to USD0.48bn trade balance deficit with Australia (Exhibit 19 & 20).
- **Sovereign risk :** the 10-year Indo GB yield rose along as 10-year UST spiked. However spread between two assets narrowed due to stable IDR and risk premium (CDS) as well as better budget deficit outlook driven by fiscal consolidation agenda (Exhibit 21).

Exhibit 15. Sligh impact on mobility during 3rd wave (%)



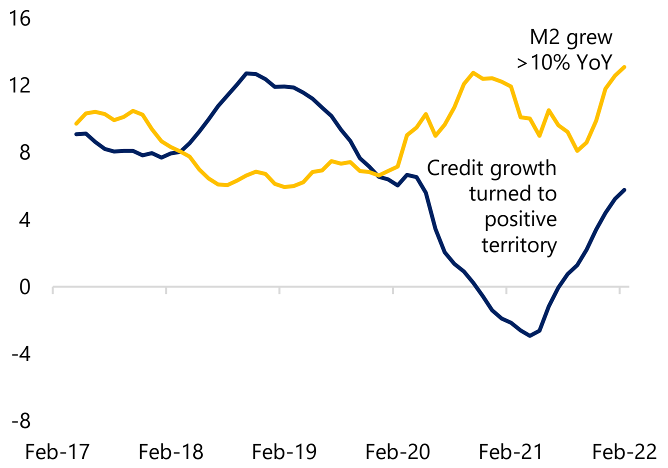
Data from Apr-21. Source : Google Mobility Report, MNCS

Exhibit 16. CCI (RHS) & PMI (LHS) remain encouraging



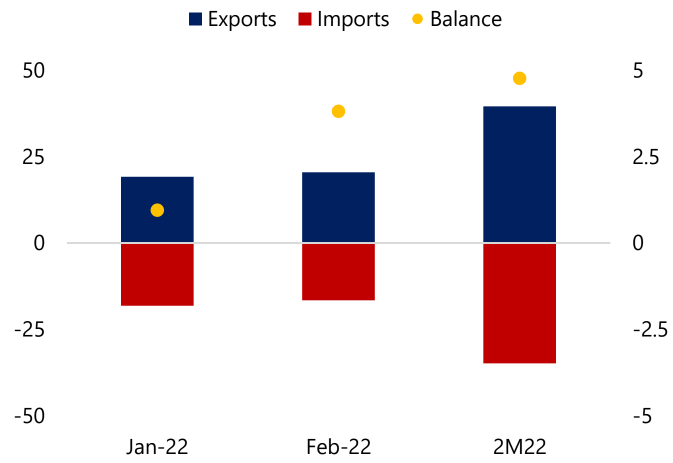
Source : Bank Indonesia, Markit, MNCS

Exhibit 17. Credit gradually pick up & M2 still grow



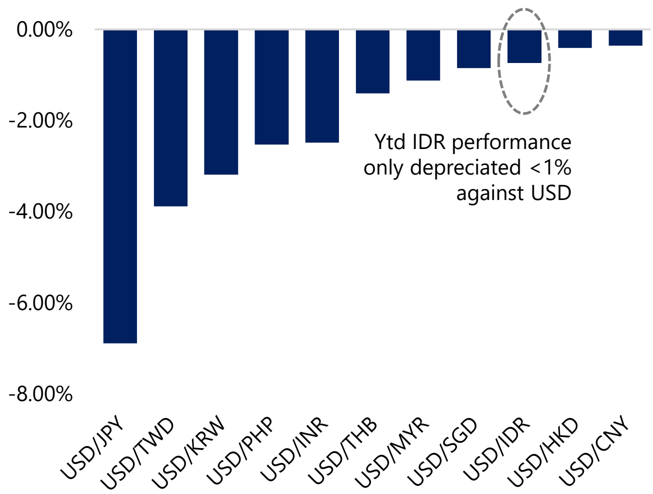
Source : Bank Indonesia, MNCS

Exhibit 18. Indo recorded a trade surplus in 2M22



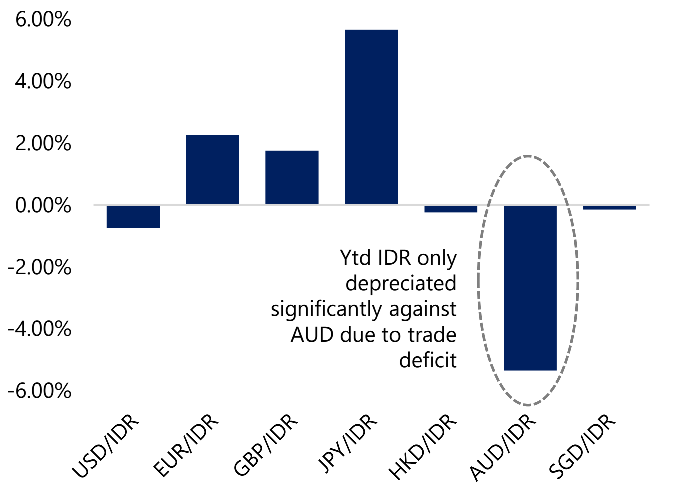
Ex-Im (LHS), TB (RHS) Source : Statistics Indonesia, MNCS

Exhibit 19. IDR one of the best performing against USD



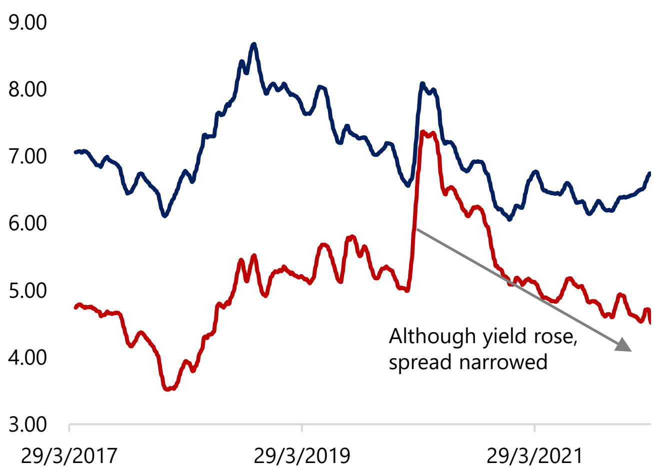
Source : International Energy Agency (IEA), MNCS

Exhibit 20. IDR only depreciate significantly against AUD



Source : World Bank Pink Sheet, MNCS

Exhibit 21. Narrowing spread between Indo-US yield (%)



Source : Bloomberg, MNCS

Be Ready for Higher Inflation

In the last two years, inflation figures in Indonesia were low and manageable, yet as economic condition improved, consumer prices started to pick up in the 3Q21 and continue to rise up until now. Going forward, we believe that higher inflationary pressure is likely given several factors such as : 1) higher commodity prices such as cooking oil and fuels; 2) rising tobacco excise duty and 3) VAT hike from 10% to 11% starting from Apr-22.

Under assumption of cooking oil price to float around IDR20,000-25,000/liter; 3-4% cigarette price increase and 1 percentage point higher VAT, inflation rate for FY22F would be at 3.04-3.69% YoY using our baseline and upper scenario. This marks an upper target of BI ITF at 2-4%. Note that this does not include fuel price increase that may trigger inflation to be higher. Thus, we believe 2-3x rate hike each by 25 bps would be justified for BI to maintain attractive positive real rates to keep the price and currency stable along with reserve requirement increase from 3.5% to 6.5%.

Outlook

We maintain positive outlook for key macro data with several adjustment made particularly related to inflation, rates as well as yield on government bond. We expect inflation to shift towards the upper band of BI's ITF and this may result in higher government bond yield as domestic investors are still dominant needing higher compensation. In order to maintain attractive yield, we think 2-3x 7 day reverse repo rate hikes is justified (Exhibit 22).

Exhibit 22. Key Macro Data Forecast

Key Macro Data FY22F	Previous Forecast			New Projection		
	Lower	Base	Upper	Lower	Base	Upper
Real GDP Growth (%YoY)	5.0	5.1	5.2	4.8	5.1	5.3
Inflation (%YoY)	2.6	2.8	3.0	3.0	3.4	3.7
Risk Free/10-yr Indo GB (%)	6.5	6.8	7.0	6.5	6.9	7.2
Interest Rate (%)	3.8	3.8	4.0	3.8	4.0	4.3

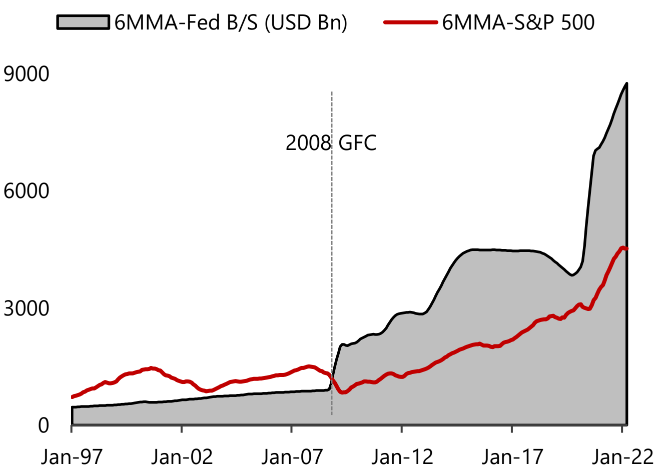
Source : MNCS

2022 : Bad for Equity?

Unlike in 2021 which DM stock markets recorded a strong performance, as 2022 unfolded, the risky assets tumbled and growth equity such as tech stocks suffered the most. We believe this came after higher inflation outlook and more aggressive tightening (rate hikes & B/S reduction) as stocks were positively correlated with Fed's B/S (Exhibit 23) and the relationship becomes stronger after 2008 GFC (Exhibit 24). It should be noted that equities particularly tech stocks were also negatively correlated with rates at least in the last 5 years (Exhibit 25).

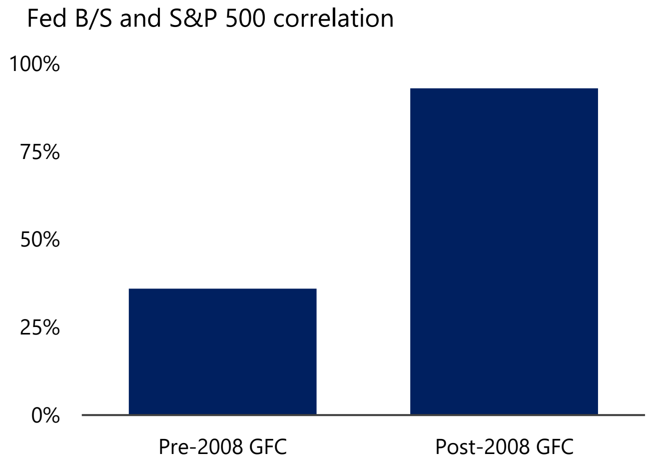
Interestingly, unlike DM stocks that suffered losses during 1Q22, EM equities outperformed. Some of them were even showing higher return lower risk behavior. We also note that JCI still managed to have positive return even with the lowest volatility (Exhibit 26).

Exhibit 23. S&P 500 positive correlation with Fed's B/S



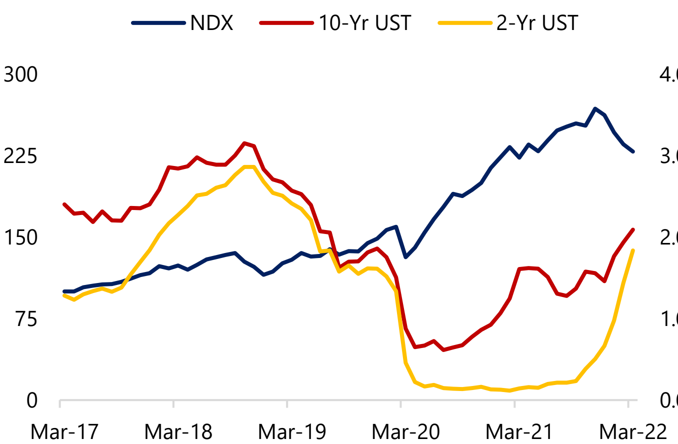
Source : Bloomberg, MNCS

Exhibit 24. Stronger correlation after 2008 GFC



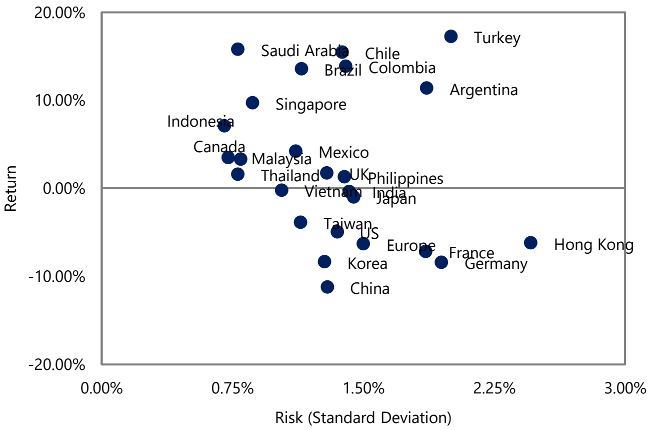
Source : Bloomberg, MNCS

Exhibit 25. Nasdaq negative correlation with rates



NDX (LHS), rates in % (RHS) Source : Bloomberg, MNCS

Exhibit 26. DM equities underperforming EM

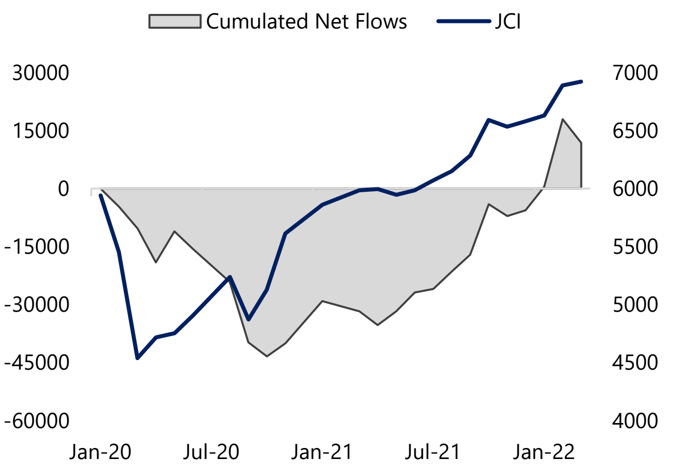


Source : Bloomberg, MNCS

Domestic Equity Outlook

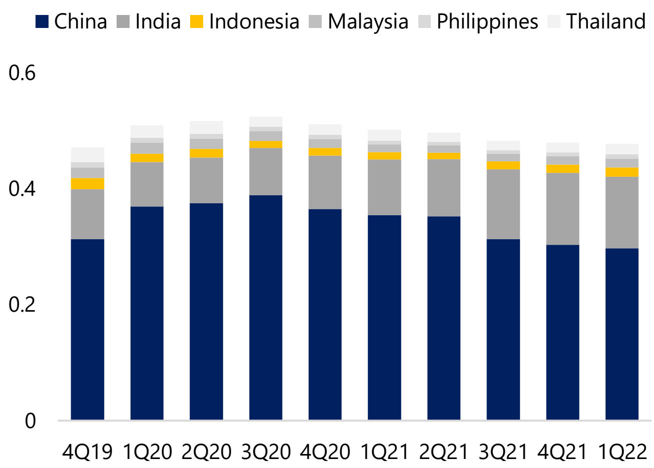
Throughout 1Q22, >IDR30tn foreign flows were coming to Indonesia's equity supporting JCI to record an all time high level several times (Exhibit 27). From the macro perspective, low currency risk and affirming investment grade rating as well as higher commodity prices to have trickle down effect on riskier assets such as equities. Furthermore, positive economic outlook also support possible double digit growth of EPS this year. We also think that recent heightened geopolitical tension to favor domestic equity through geographical asset rebalancing. Worth noting that Indonesia's weight on MSCI EM equity rose along with other ASEAN countries and India while China weight decreased (Exhibit 28). Maintain our bullish view for domestic equity with the JCI target of 7,650 implying +20% EPS/15.4x FY22F P/E (Exhibit 29).

Exhibit 27. Inflows keep coming to Indonesia's equity



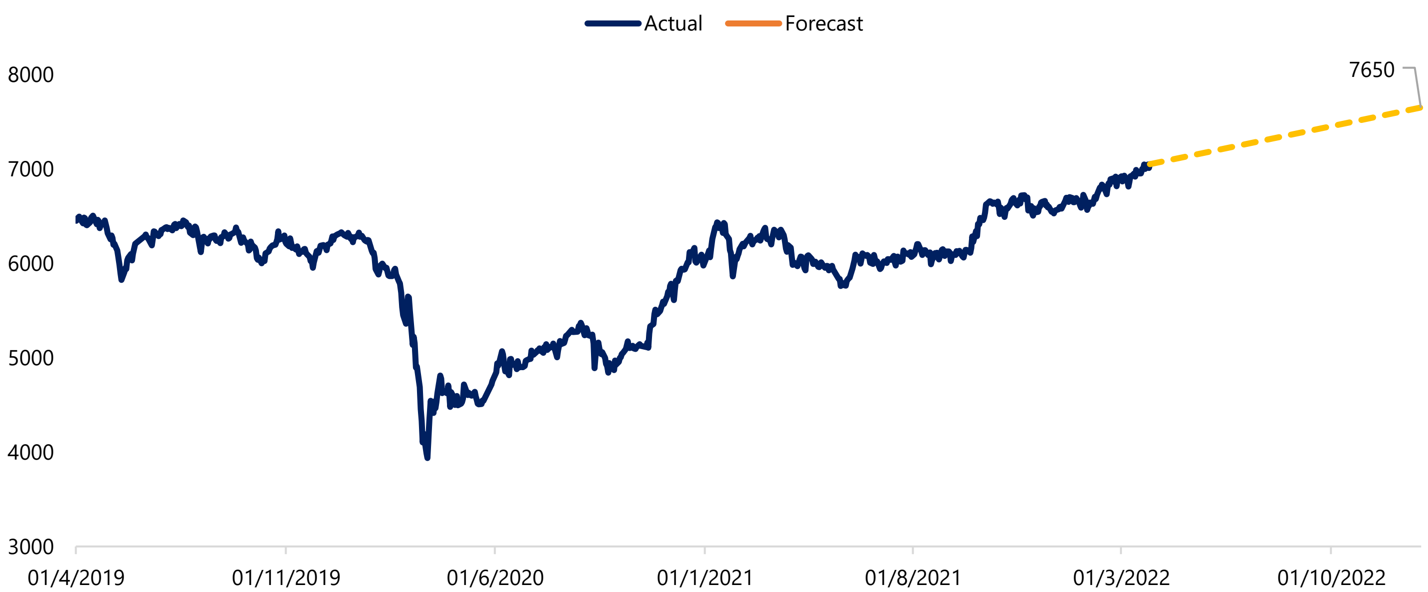
JCI (RHS), Inflows in IDR Bn (LHS) Source : Bloomberg, MNCS

Exhibit 28. Domestic equity weight on MSCI EM increase



Source : Bloomberg, MNCS

Exhibit 29. MNCS JCI Target for FY22F

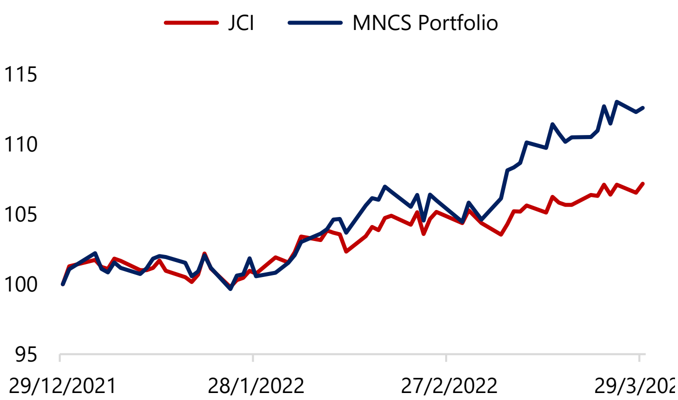


Source : Bloomberg, MNCS

1Q22 Strategy Results

Our hypothetical equity fund strategy that employed ff-adjusted market cap for weighting and setting aside 3% to 3-months IDR TD has delivered superior performance with 12.6% return outperforming JCI by 543 bps (Exhibit 30). Our top pick from banking sectors (BBRI IJ, BBNI IJ & BMRI IJ) which accounted 44% portfolio allocation has delivered strong return of 17%. This return was similar to ASII IJ which contributed to 14% of our hypothetical equity fund. Note that our alpha stock (ARNA IJ) which weight was 10% from total fund also delivered solid gain of 12%. Telco & Tower top picks (TLKM IJ, EXCL IJ and TOWR IJ) with 14% weight only book moderate return of 5% which was dragged down by EXCL IJ of -15% return given 3% weight of fund allocation. Meanwhile at the same time our property (CTRA IJ & BSDE IJ) and retail (ERAA IJ) top picks which accounted 15% weight on our portfolio also recorded a moderate growth of 6% and 3% respectively. Please see Exhibit 31 for further detail.

Exhibit 30. Our top picks successfully deliver 13% return



Source : Bloomberg, MNCS

Exhibit 31. Details on weight of our portfolio allocation

Stocks	Weight	Return	Strategy
BBRI	19%	15%	Sectoral : Banking
BBNI	15%	24%	Sectoral : Banking
ASII	14%	17%	Lagging Value Stock : Diversified
BMRI	10%	12%	Sectoral : Banking
ARNA	10%	12%	Value & Alpha Stock
TLKM	9%	13%	Sectoral : Telco & Tower
CTRA	7%	9%	Sectoral : Property
BSDE	5%	2%	Sectoral : Property
EXCL	3%	-15%	Sectoral : Telco & Tower
ERAA	3%	-3%	Lagging Value Stock : Retailers
TOWR	2%	-5%	Sectoral : Telco & Tower
3M TD	3%	3%	Cash
Portfolio	100%	13%	

Source : Bloomberg, MNCS

2Q22 Strategy Guidance

For 2Q22 we change our top pick and rebalance portfolio allocation. We takeout BBNI IJ, TLKM IJ, TOWR IJ and EXCL IJ as the share prices have nearly reached our TP. Our top picks reflect our view on sectoral allocation benefitting from recent economic condition, finding lagging value stock and alpha stock. We also consider potential EPS growth, ESG practice, beta as well as the inclusion of stock to index fund (EIDO). We recommend 95-97% stock allocation and 3-5% of IDR TD for the fund. We increase weight for BSDE IJ (from 5% to 7%) and ERAA IJ (from 2% to 5%) as current share prices are significantly discounted from the intrinsic value giving large room for Margin of Safety. We also add DSNG IJ, MAPI IJ and UNTR IJ in our top picks replacing the previous mentioned rebalanced stocks on the back of several consideration.

- **DSNG IJ :** 1) highly committed in ESG practice; 2) strategy to maintain margin by securing fertilizers stock amid soaring price; 3) strong exports performance; 4) low Beta stocks and 5) potential + EPS growth FY22F.
- **MAPI IJ :** 1) expecting higher mobility during Ramadhan momentum and higher commodity price to benefit MAPI IJ; 2) CAPEX resumption to pre-pandemic level.
- **UNTR IJ :** 1) expecting commodity boom to benefit UNTR IJ; 2) significantly discounted from its intrinsic value; 3) low Beta stock.

All in all we try to position our portfolio to deliver superior risk adjusted return in every economic condition and cycle. Please see Exhibit 32 for further detail on our stock picks and recommended portfolio allocation.

Exhibit 32. Top Picks & Recommendation

Stocks	Current Price	Target Price	Upside Potential	P/E		P/B		Beta	EIDO	Weight (%)	Rating
				FY22F	FY23F	FY22F	FY23F				
ASII	6,650	7,425	12%	13.7	13.2	1.4	1.3	1.33	Yes	15%	BUY
ARNA	895	1,100	23%	11	10.3	3.5	3.1	0.82	No	9%	BUY
BBRI	4,710	5,500	17%	15.4	11.2	2.2	2.0	1.42	Yes	19%	BUY
BMRI	7,875	8,900	13%	9.6	8.1	1.5	1.3	1.38	Yes	10%	BUY
BSDE	1,035	1,500	45%	13.1	11.4	0.6	0.5	1.33	Yes	7%	BUY
CTRA	1,055	1,300	23%	15.0	13.5	1.1	1.1	1.51	Yes	7%	BUY
DSNG	660	800	21%	11.4	10.0	0.9	0.9	0.99	No	8%	BUY
ERAA	585	1,000	71%	7.5	6.9	1.1	1.0	1.60	Yes	5%	BUY
MAPI	860	1,000	16%	18.3	15.7	1.9	1.7	1.38	Yes	5%	BUY
UNTR	25,875	33,700	30%	10.4	8.9	1.3	1.2	1.02	Yes	10%	BUY

Source : Bloomberg, MNCS

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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