20 August 2015

Tough Time in Early Second Semester due to a Broad Based Sell Off

What We Want to Highlight:

- Entering the second semester this year, people hoped for a better economy that would translate to a better investment environment, however, unti 19 August 2015 the fact shows that it is the other way around.
- A couple of main problems turns out to be more prolonged than what people had expected.
- Even our government realized that things turned out to be not as rosy as expected that they decided to reshuffle some names among the ministerial cabinet.
- Among 9 sectors under Jakarta Composite Index, there is no single sector posted a positive return during the beginning of this 3Q15. Jakarta Mining Index is still struggling to make a turnaround in the midst of continuous sell-off in the commodity prices, ranging from Coal, Tin and Nickel. Meanwhile, Jakarta Trade Index posted a relatively better performance compared to the others, driven by the outstanding performance from UNTR (11.5% Weight to JAKTRAD).

What are The Main Problems:

We try to classify our main problems into three categories:

- ### Currency War

- What happened last week when China devalued its currency definitely started a new window of currency war among all other currencies in the world, particularly emerging market currencies. After the announcement from China, those currencies which are heavily exposed to the Chinese economies followed the weakening trend of Yuan. The currencies ranging from Russian Ruble, Brazilian Real, Malaysian Ringgit, Taiwanese Dollar and Indonesian Rupiah have been depreciating against the “mighty” USD.
- A lot of comments and analysis keep coming in regarding what happened to China. We see this devaluation move as a natural action of a country in the middle of current broad based weak economic growth across the globe. Protectionism towards domestic producing goods is the basic rational reason behind a devaluation of a currency. Therefore, it is pretty clear to say that even China has been struggling to maintain the pace of growth that they have been enjoying for almost a decade. Several monetary loosening policies such as decreasing interest rate, increasing the bank’s reserve requirement and, most recently, devaluing the currency that China government has been implementing are the facts that they have started to worry about the domestic growth. These things have become the global concern as the world still does not know for sure how far China devalue its currency. Until then, **we would still expect high volatility in the global currencies market, particularly emerging market**.

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- ## Lack of Growth

- Our second most important concern is the lack of growth across nations around the globe. The most notable one, again, comes from China economy. China GDP growth has slowed to 7% in 2Q15 from 11.9% in 1Q10. The charts below show that China weakening growth trend more apparently. What makes it even worrying is the current weakening economy growth seems to be widespread across the globe. The latest export number from all major exporter countries in the world confirm the argument. For example, China July export growth number shows a decrease of 8.3% YoY, which is the fourth decrease in 5 months since 1Q15. At the same time, the US export numbers have never posted a single positive growth since 1Q15. The most recent 2Q15 United States export growth shows a decrease of 3.6% YoY.

- Therefore, all this data shows that, at the moment, most countries in the world has been conducting protectionism towards their own domestic economy by carefully managing the effect of the currency war discussed above. **This condition definitely not a good story for those countries that are still relatively relying more heavily on the export industry to support their economy growth**

Chart 1 : World GDP Growth (YoY)

Source: Bloomberg, Sinarmas Investment Research

Comment:

The world GDP growth, as shown by Bloomberg, reached its peak of 4.32% in 2Q10, then after has been showing a decel-erating pace of growth until it reached 1.72% in 1Q15.

Emerging Markets(per USD)		1 Mon
Russian Ruble	RUB	-14.55
Turkish Lira	TRY	-8.64
Colombian Peso	COP	-8.64
Brazilian Real	BRL	-8.49
Malaysian Ringgit	MYR	-7.38
Chilean Peso	CLP	-6.88
Taiwanese Dollar	TWD	-4.02
South African Rand	ZAR	-3.66
Mexican Peso	MXN	-3.58
Indonesian Rupiah	IDR	-3.26
Thai Baht	THB	-3.04
Chinese Renminbi	CNY	-2.96
South Korean Won	KRW	-2.95
Indian Rupee	INR	-2.41
Peruvian New Sol	PEN	-2.3
Singapore Dollar	SGD	-2.27
Philippine Peso	PHP	-2.19
Argentine Peso	ARS	-1.07
Hong Kong Dollar	HKD	0
Polish Zloty	PLN	1.56
Romanian Leu	RON	2.43
Hungarian Forint	HUF	2.84
Bulgarian Lev	BGN	2.86
Czech Koruna	CZK	3.07

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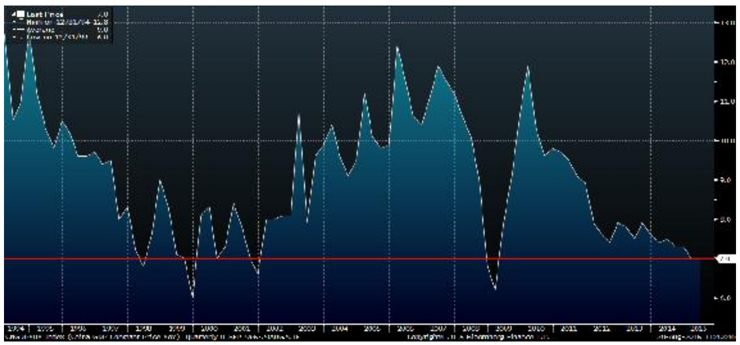
Chart 2 : China GDP Constant Price YoY since 1994



Comment:

China GDP Growth shows the slowest pace in 5 years. The reading shows 7.0% in 2Q15, which reflects back to 2008 level.

Chart 3 : The United States Consumer Price Index (YoY%) since 1965

Comment:

The chart shows that even The US has never experienced such low inflation besides those times in 2009 when the global financial crisis (GFC) occurred. The last reading of US CPI is -0.03%.

- ## Inflation / Deflation

- The last topic of the day is about deflationary pressure that are affecting most countries as the result of two issues discussed above. This is a new era of deflationary pressure really matters the most when most countries are trying to devalue their currency to make their export cheaper off-shore, lack of growth has been widespread, coupled with the unending faltered of commodity prices across the board.
- The development of the current “Godzilla” El Nino seems to impact less to the soft commodity prices so far. We are aware that the current El Nino diagnosed to be the worst ever in history, however, the concern on lack of global demand overweight the weather concern at the moment.
- This broad based deflationary pressure has made the Fed to revisit their guidance once again regarding when is the right time to hike the Fed Funds Rate from such a historically low base.
- The uncertainties regarding the Fed decision could become clearer on September 18th 2015 during the FOMC meeting. Before the uncertainty becomes clearer, we still expect that **defensive approach** is the best option of investment at the moment.

Source: Bloomberg, Sinarmas Investment Research

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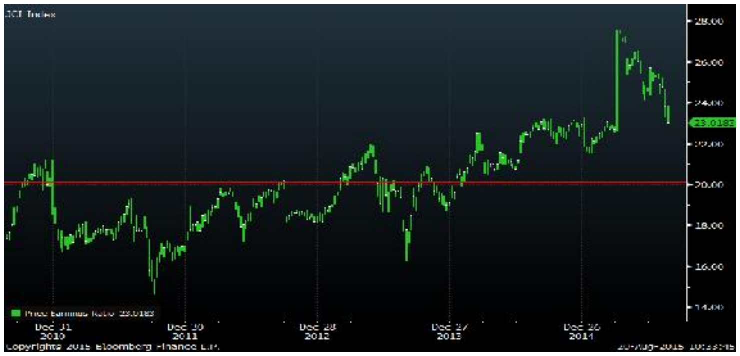
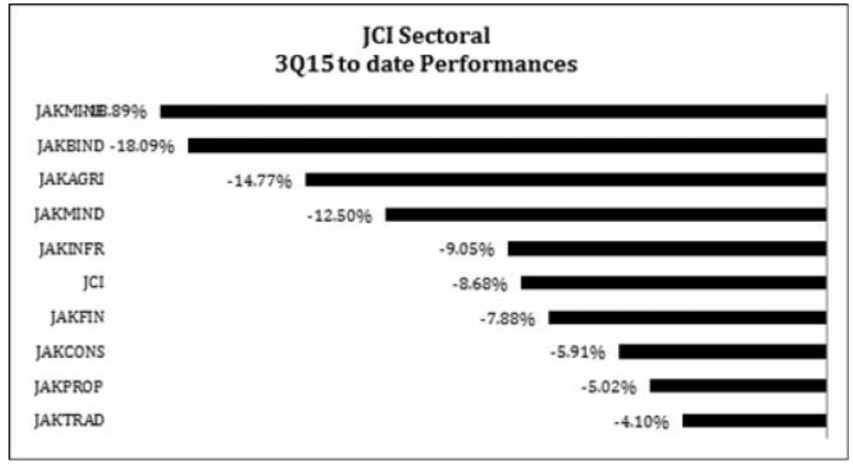
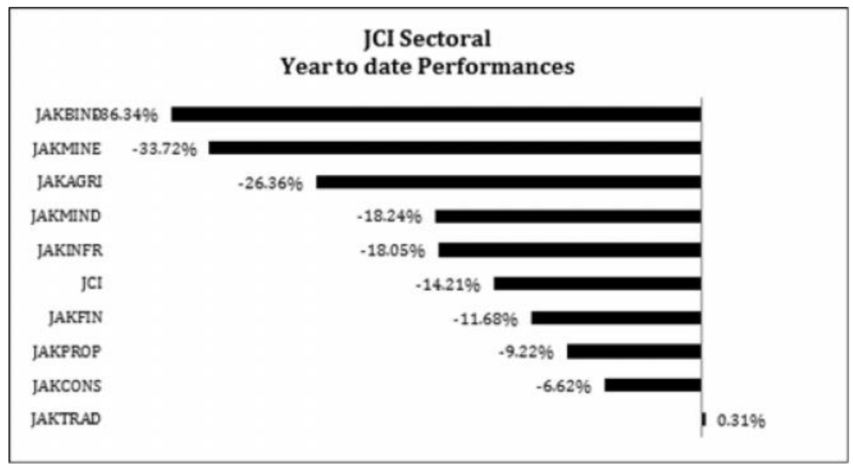
Chart 4 : JCI TTM Price Earnings Ratio 5 Year Period



Comment:

JCI has a median 5 year TTM PE of 20.10x. Currently our index is trading at TTM PE 23.0x.





Source: Bloomberg, Sinarmas Investment Research

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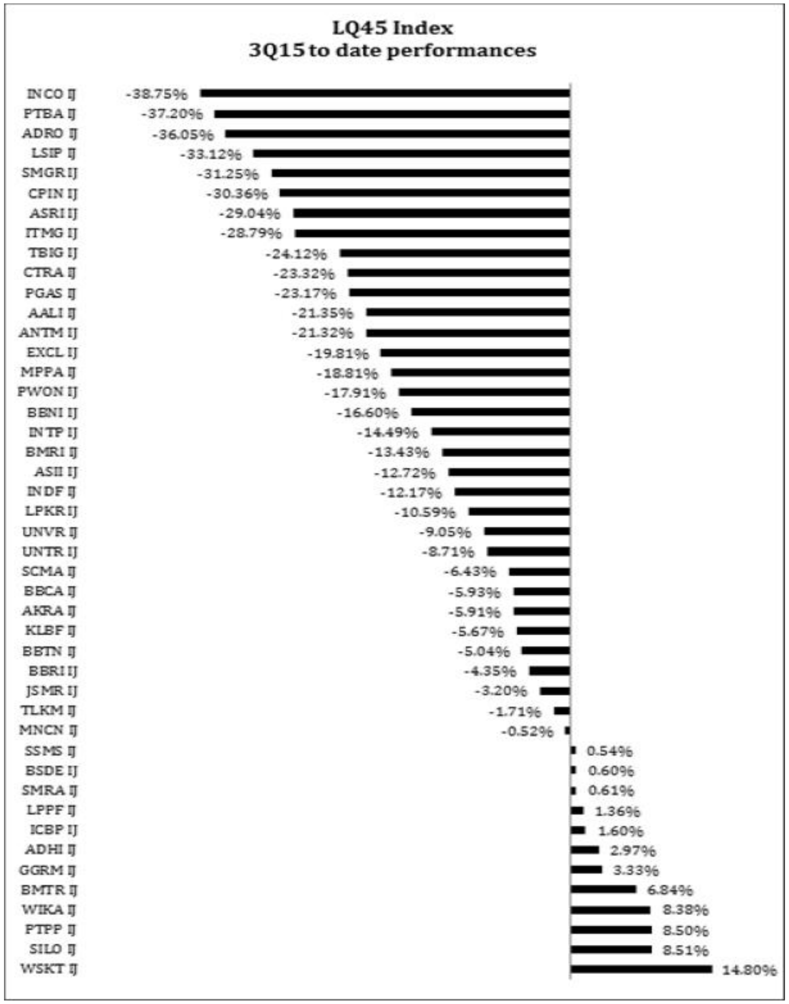

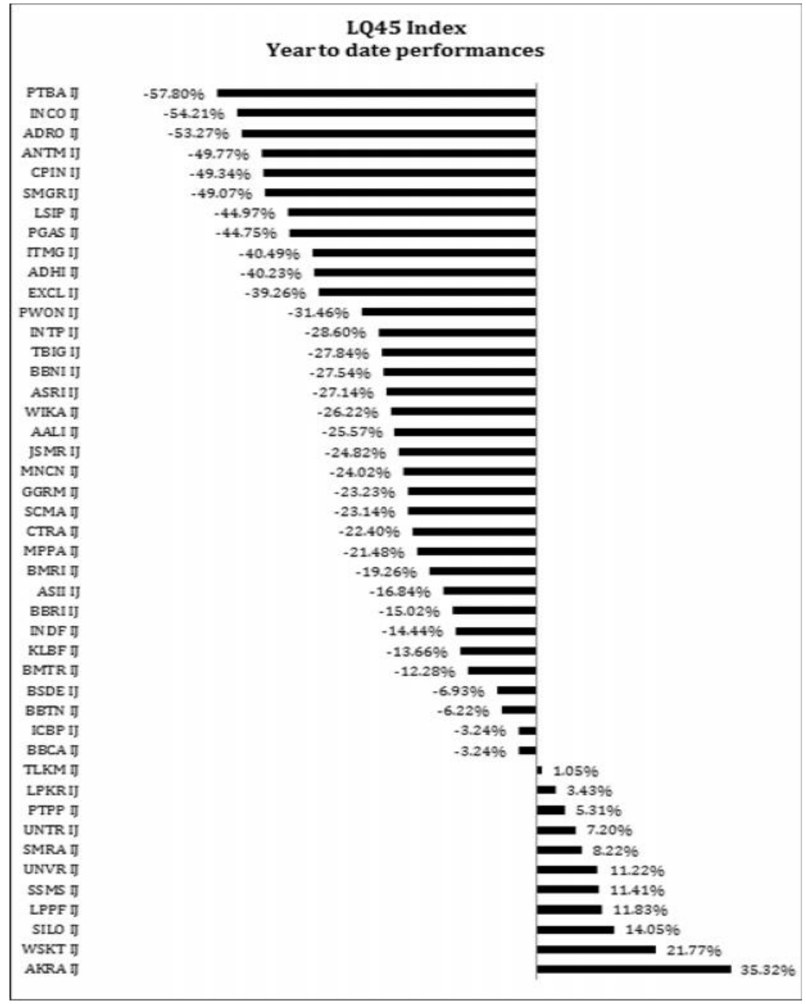

Source: Bloomberg, Sinarmas Investment Research

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