FLASH NOTES

13 May 2019

BATAVIA PROSPERINDO ASET MANAJEMEN

# It takes two to tango

BATAVIA Institute

For Professional & Institution Investors Only

Recent US-China trade talks had ended without any deal amid rising market expectation. At the same time, US$200bn of US imports from China is taxed at 25% now, up from 10% previously.

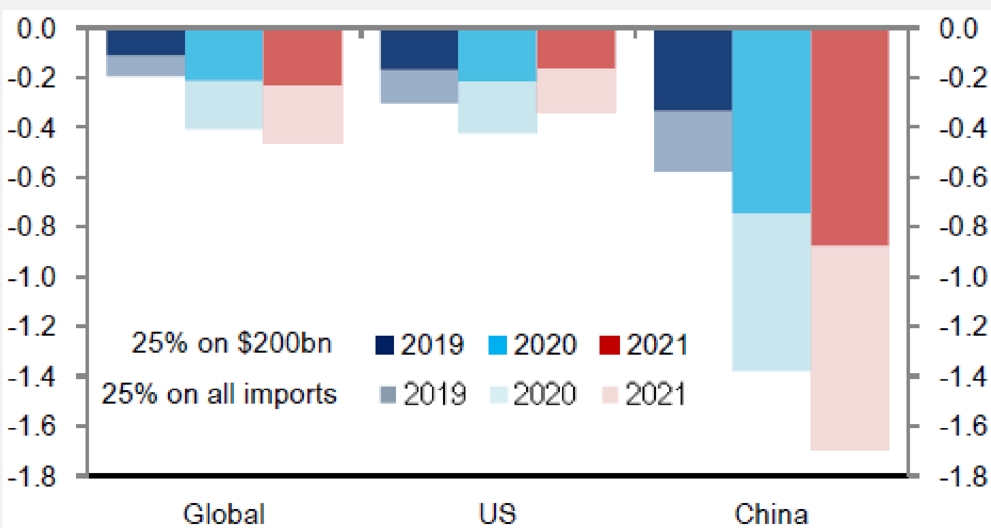
**NEXT**: Retaliation from China is likely to happen. Meanwhile, there is possibility that US may expand the higher tax to all Chinese products. On the positive side, another round of talks may still happen and China will be ready with various stimulus to counter further economy slowdown.

## What do we think?

Higher economy uncertainty definitely come from this recent development. But, we still believe the possibility of future US-China (partial) trade deal remain high, as it's in both sides self-interests, i.e. domestic economy (for China) and equity/stock indexes (US). Nonetheless, it's fair to say that the chance is lower than last week and we will not surprise if it gets worse before the deal happen.

Oxford Economics estimate the impact of tax increase (from 25% to 10%) on the US$200bn list would lower China growth by another 30-90bps, 20bps for US and 10-20bps for global economy in the next 3 years. But, further escalation (25% implied to all Chinese imports) would lower global growth up to 40bps (see the table below). This will increase the likelihood of global recession substantially.

**Cumulative impact to GDP growth under different tariffs scenarios (%)**




*Source: Oxford Economics and Citi Research*

Despite Indonesia is not heavily exposed to trade, relative to exporter countries (Korea, Taiwan, Japan, Thailand, etc), but we can't avoid the sentiment/fund flow. Risk-off event will trigger fund outflow and worsen by seasonal high demand of USD domestically. Hence, the first and immediate impact to

Indonesia and other Emerging Market (EM) countries may come from financial market (equity, bond and FX).

## What to do?

### Equity

Currently we have a negative view on the index. Uncertainty on trade talks, lower than expected GDP and upcoming index (MSCI and FTSE) rebalancing will fill the negative sentiments toward JCI for this month. This might reduce the risk appetite for EM and we might see outflow from Indonesia market. However, we think this will create a good opportunity window to collect strong fundamental stocks since we still believe trade talks should resolve in the future. In the meantime, we will have 84%-92% equity weighting range where our preferred sectors will be Auto, Finance and Infrastructure. Currently our index is traded at 14.4x 12months rolling PE where -1STD should be traded at 5900.

### Fixed Income

Latest development on US-China trade negotiation had successfully turn off global risk appetite. Lower global growth, stronger USD, and less appetite for EM bonds are the potential outcome should this trade negotiation resulted in a trade wars between two biggest economy in the world. Until this issue resolved, we are cautious on bond market and reducing portfolio duration to neutral.