

Fed's rate cut is likely but not so early in 2024 given robust US economy

US and European stocks advanced further as DJIA, S&P500, Stoxx 600 indexes all rose to new all-time highs after US blowout jobs growth, which also drove US yields and dollar higher this week. US stocks corrected on Wednesday after Fed Chair Jerome Powell stated Fed wants greater confidence that inflation will continue to ease before lowering rate and as such, a March rate cut is unlikely. However, US stocks rebounded strongly in the following two days after upside earnings surprises from Apple, Amazon, Meta on Thursday and unexpectedly strong jobs report on Friday. The US economy added 353,000 nonfarm jobs in January, which doubled consensus estimate, as also the case for average hourly wage growth of 0.6% MoM (4.6% YoY). Meanwhile, unemployment rate held steady at 3.7%, well below the Fed's median forecasts of 4.6%, and is not far from a 50-year record low of 3.4%. As such, chances of a rate cut is diminishing although markets still expect Fed to cut rate by 25bps during its May meeting with 60% probabilities. This roller coaster stock market movement was also seen in the bond market where 10-yr US yield dropped to 3.86% on Thursday before it rebounded to close the week at 4.02% (-11bps), while US Dollar Index rose to its year-to-date high of 103.96 although still below last October's high of 107 when 10-yr yields were at near 5%. This week's other economic data also points to a strengthening of US economy as ISM Manufacturing PMI improved to 49.1 in January 2024, above forecasts of 47.0, and it was the highest since October 2022. Elsewhere, Euro Area economy stalled in Q4 2023 (Q3: -0.1% QoQ), which is better than 0.1% fall expected, while China's manufacturing activity continued to contract in January 2024, as expected.

In Indonesia, the JCI rebounded by 1.42% this week amid returning fund inflows of Rp3.02Tn, after two weeks of net foreign selling, while the local bond market reversed to a net outflow of Rp5.83Tn. This week's foreign buying boosted NAVs of our ETFs, including XIML (+4.36%), XIFE (+3.82%), XIPI (+3.77%), XISR (+3.42%), and XIHD (+3.38%), which all well outperformed the JCI market index so far in 2024, as also in the prior two years.

The Week Ahead – Indonesia GDP Growth Rate, Various Fed Speeches

The key economic data to focus next week include Indonesia GDP Growth Rate (Mon 11:00), EU PPI Inflation (Mon 17:00), US ISM Services PMI (Mon 22:00), EU Retail Sales (Tue 17:00), China Inflation Rate (Thu 08:30), and US Initial Jobless Claims (Thu 20:30).

Investment Conclusion

Fed's aggressive rate hikes had been a key risk for global markets since 2022 and investor concerns have shifted from inflation to growth to inflation again amid surprisingly resilient US economy. However, with the Fed Fund's rate now already at peak and a Fed pivot widely expected in March 2024, we see positive catalysts for JCI to achieve our 2024 target of 7,800 (vs. 7,273 at end of 2023) given Indonesia's stable economy, financial markets and currency, as reflected in its declining sovereign risk premiums. Indonesia's equity market has lagged global developed markets in 2023, partly because it had outperformed in 2022. Our 2024 JCI target of 7,800 is based on our P/E target of 13x, in line with the long-term (> 20 years) historical average P/E valuation.

Recommendation

Our top ETF picks for 2024 are ETF XIHD (High Dividend), XIPI (Pefindo i-Grade), XISR (SRI Kehati), and XIML (MSCI Indonesia Large Cap) – which are unchanged from our 2023 top picks. We believe these ETFs will benefit the most from our expectation of returning foreign inflows into Indonesia's stock market. In 2023, these semi-broad ETFs produced returns of 9.52%, 16.87%, 9.24%, and 8.50%, respectively, outperforming for the second year in a row the total returns of our broad-based ETFs (RLQ45 and XIIT), and especially against our narrow-based (thematic) ETFs - we view the latter ETFs as better suited for short-term trading to benefit from sector rotation, not for long term core holdings.

We target returns of 10-12% for our ETF picks in 2024 - we expect this to come from our 7,800 JCI target (+7.2%) plus dividend yields of 3-5%. The derating of Indonesian big cap stocks valuation to an average P/E of 12x post pandemic, versus a historical mean of 16x in 2009-2019, has raised importance of dividend yields to equity returns, in our view. Our ETF Fund Guide is on page 2.

Global Stock Indices	Last	1W	YTD
DJIA	38,654.42	1.43%	2.56%
S&P 500	4,958.61	1.38%	3.96%
Nasdaq	15,628.95	1.12%	4.11%
FTSE 100	7,615.54	-0.26%	-1.52%
DAX	16,918.21	-0.25%	0.99%
Nikkei 225	36,158.02	1.14%	8.05%
Hang Seng	15,533.56	-2.62%	-8.88%
Shanghai	2,730.15	-6.19%	-8.23%
MSCI World	3,247.64	0.98%	2.48%
MSCI Emerging Markets	988.21	0.32%	-3.47%

JCI Sector Indices	Last	1W	YTD
Property & Real Estate	690.78	-1.57%	-3.28%
Consumer Cyclical	857.21	0.99%	4.36%
Transportation	1,561.00	-1.30%	-2.53%
Industrials	1,088.65	0.37%	-0.47%
Technology	4,094.79	0.51%	-7.68%
Infrastructures	1,526.94	-0.41%	-2.74%
Financials	1,495.04	-1.59%	2.52%
Consumer Non-Cyclicals	701.14	0.66%	-2.94%
Healthcare	1,345.94	2.59%	-2.20%
JCI	7,238.79	1.42%	-0.47%
Energy	2,076.88	-1.85%	-1.14%
Basic Materials	1,286.32	0.11%	-1.62%

Rates and Bonds	Last	1W	YTD
UST 2Y Yield	4.37	2 bps	12 bps
UST 10Y Yield	4.02	-11 bps	14 bps
Ind GB 10Y Yield	6.52	-13 bps	4 bps
USDIDR	15,731.20	-88.80	334.20
CDS Indo 5Y	74.32	-1.18	5.28

Foreign Fund Flows	1W	YTD
Equity Regular Market (Rp)	+3.02Tn	+5.82Tn
Government Bond Market (Rp)	-5.83Tn	+0.16Tn

Commodities	Last	1W	YTD
WTI	72.28	-7.35%	0.88%
Brent	77.30	-7.48%	0.34%
CPO (Malaysia)	3,764.00	-2.54%	0.24%
Coal (New Castle)	116.00	-8.73%	-20.77%

Funds and ETFs		Last	1W	YTD
ETF	Theme			
RLQ45	LQ45	1,108.36	3.29%	1.69%
XIIT	IDX30	565.12	3.41%	1.28%
XIJ	JII	607.17	1.79%	-0.03%
XISI	SMIInfra18	379.16	1.69%	1.85%
XISR	SriKehati	496.57	3.42%	2.77%
XIHD	IDXHIDIV20	680.84	3.38%	2.76%
XIPI	Pefindo I-Grade	249.37	3.77%	3.12%
XIML	MSCI Indo Large Cap	309.78	4.36%	2.55%
XIID	IDX30	545.80	3.39%	1.01%
XIFE	FTSE ESG Indonesia	120.75	3.82%	1.76%
XIIC	Consumer Related	1,026.92	2.23%	0.67%
XIIF	Rate Sensitive	542.79	2.86%	2.52%
XISC	BUMN Stocks	741.73	2.84%	3.11%
XISB	Sovereign Bonds	500.07	0.99%	0.24%

Conventional				
RDMP	Equity	913.31	2.95%	2.53%
RPCF	Balanced	2,702.89	2.45%	1.67%
RDPCDA	Balanced	1,009.85	2.01%	1.91%
RDPCDB	Balanced	1,001.52	1.98%	1.74%
RDPO 2	Fixed Income	1,089.10	0.09%	0.12%
RDPU 2	Money Market	1,450.57	0.08%	0.43%

Summary of Investment Characteristics & Valuation of ETF Funds Portfolios

Name of ETF Funds	Fund Characteristics (% of Portfolio)					P/E (x)	Dividend Yield	Beta to JCI
	Defensive	Rate-Sensitive	Dom. Cyclical	Commodities	Cash	2023F	2023F	
1 RLQ45	23.4	55.6	10.4	8.2	2.42	15.4	4.1	1.14
2 XIIT	22.7	57.5	9.8	8.8	1.26	14.1	4.5	1.07
3 XISC	22.2	46.0	6.0	12.2	13.66	13.2	5.5	1.33
4 XISR	30.7	60.0	5.3	3.4	0.53	13.9	4.8	1.11
5 XIIF	20.1	58.9	9.8	7.5	3.77	13.9	5.0	1.29
6 XISI	42.8	28.5	15.0	12.7	0.97	12.5	5.6	1.04
7 XIPI	16.9	66.6	12.5	3.2	0.93	17.6	3.9	1.18
8 XIIC	28.2	36.9	21.3	3.2	10.45	15.1	4.2	1.18
9 XIHD	19.6	61.3	1.7	12.4	4.99	12.0	5.3	1.12
10 XIJI	41.7	13.8	22.0	19.1	3.35	13.1	3.8	1.10
11 XIML	14.5	80.3	0.0	2.0	3.21	14.0	5.0	1.11
12 XIID	22.7	57.5	9.8	8.7	1.30	15.4	4.7	1.07
13 XIFE	23.5	64.8	6.8	4.5	0.39	13.9	4.6	1.14
Index								
IDX80	32.5	42.7	14.1	10.7		12.9	4.7	
JCI	25.3	39.1	14.7	12.8		13.9	4.2	

Remarks:

*Red: Overweight to IDX80; Black: Neutral to IDX80; Green: Underweight to IDX80

Characteristic Classification :

*Defensive : Consumer Goods, Media, Telecommunication, and Infrastructure

*Rate Sensitive : Banks and Auto

*Dom. Cyclical : Cement, Property, Construction, Animal Feeds, and Retail Trade

*Commodities : Coal Mining, Metals & Oil Mining, Plantation and Misc. Industries

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