

US inflation easing in May but Fed stays cautious on rate cut outlook

Easing inflation pushed the Nasdaq and S&P500 stock indexes to record highs, well outperforming the DJIA index so far in 2024, as renewed enthusiasm over artificial intelligence and shifting interest rate expectations continue to favor the large US growth stocks over their peer medium/small growth and value stocks. US stock markets also well outperformed European markets, which are weighed down by rising political risks amid the strong showing by far-right parties in the European Parliament elections, as well as EM equities. US inflation reading this week, for both the consumer and producer prices, were lower than expected. The headline CPI was unchanged in May while core consumer inflation rates of 0.2% MoM and 3.4% YoY were lower than consensus expectations of 0.3% and 3.5%, respectively. For the producer prices, core PPI inflation rate of 0% MoM (2.3% YoY) was well below expectations of 0.3%. However, the benign inflation data in May appeared to have little impact on the outcome of Fed's two-day policy meeting, which concluded a few hours after release of the inflation data. While acknowledging a modest further progress on inflation in May, the Fed stays cautious and the FOMC's Fed funds rate projection estimates just one rate cut in 2024 (vs. three rate cuts it projected in March) albeit still maintaining the longer-term projected Fed funds rate of 3.1% for 2026. Although Fed meeting outcome was already expected, as markets have priced in a delayed Fed easing cycle after stubborn US inflation in January to March 2024, the bond market reacted positively to the inflation data as 10-yr US Treasury yields fell by 21bps to 4.22% this week. Other economic data released this week revealed a higher than expected jobless claims data (242K vs. 225K expected), while US consumer sentiment turned out to be much weaker than expected. Elsewhere in Europe, the pan-European Stoxx 600 Index fell by 2.39% and bond yields surged on the back of rising political uncertainty. In China, stock markets were weighed down by a lower than expected consumer inflation of 0.3% MoM in May, as it reveals deflationary pressures continued to weigh on the China's economy.

In Indonesia, the JCI fell 2.36% amid continuing net foreign selling of Rp4.50Tn (YTD: -Rp19.58Tn), while the bond market was hit by net outflows of Rp1.48Tn this week. Given the equity outflows, our top ETF picks underperformed the JCI this week: XIHD (-4.98%), XIPI (-5.05%), XISR (-5.74%), and XI ML (-3.99%), thus continuing their trend of underperformances since the month of April 2024.

The Week Ahead – US Retail Sales, Indonesia Trade and BI Rate Decision

The key economic data to focus next week are China Retail Sales (Mon 09:00), US Retail Sales (Tue 19:30), Indonesia Trade Balance (Wed 11:00), Indonesia Rate Decision (Wed 14:30), US Initial Jobless Claims (Thu 19:30), US S&P Global Manufacturing & Services PMI (Fri 20:45).

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, although the Fed Fund's rate is now already at its peak, market expectations of Fed rate cuts in 2024 have been scaled back to just one time this year, from previous expectations of three rate cuts, due to sticky inflation problem. As such, we also lower our 2024 JCI target to 7,400 (from 7,800) as we shift our 7,800 JCI target to 2025.

Recommendation

Our top ETF picks for 2024 are ETF XIHD (High Dividend), XIPI (Pefindo i-Grade), XISR (SRI Kehati), and XI ML (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 8-10% for our ETF picks in 2024 - we expect this to come from our JCI target 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	38,589.16	-0.54%	2.39%
S&P 500	5,431.60	1.58%	13.87%
Nasdaq	17,693.43	3.27%	17.87%
FTSE 100	8,146.86	-1.19%	5.35%
DAX	18,020.49	-2.89%	7.57%
Nikkei 225	38,854.50	0.44%	16.11%
Hang Seng	17,941.78	-2.31%	5.25%
Shanghai	3,032.63	-0.61%	1.94%
MSCI World	3,492.05	0.38%	10.19%
MSCI Emerging Markets	1,076.89	0.35%	5.19%

JCI Sector Indices	Last	1W	YTD
Property & Real Estate	602.53	-2.18%	-15.63%
Consumer Cyclical	705.02	-3.84%	-14.17%
Transportation	1,217.61	-3.77%	-23.97%
Industrials	897.71	-4.89%	-17.92%
Technology	3,102.40	-5.32%	-30.06%
Infrastructures	1,437.56	-0.12%	-8.44%
Financials	1,302.66	-3.64%	-10.67%
Consumer Non-Cyclicals	687.22	-1.58%	-4.87%
Healthcare	1,421.83	-0.65%	3.32%
JCI	6,734.83	-2.36%	-7.40%
Energy	2,207.37	-2.44%	5.07%
Basic Materials	1,300.16	-3.50%	-0.56%

Rates and Bonds	Last	1W	YTD
UST 2Y Yield	4.71	-18 bps	46 bps
UST 10Y Yield	4.22	-21 bps	34 bps
Ind GB 10Y Yield	7.14	23 bps	66 bps
USDIDR	16,486.50	209.70	1,089.50
CDS Indo 5Y	72.08	-0.63	1.86

Foreign Fund Flows	1W	YTD
Equity Regular Market (Rp)	-4.50Tn	-19.58Tn
Government Bond Market (Rp)	-1.48Tn	-37.26Tn

Commodities	Last	1W	YTD
WTI	78.49	4.13%	9.55%
Brent	82.60	3.91%	7.22%
CPO (Malaysia)	3,946.00	-0.75%	9.31%
Coal (New Castle)	135.15	1.62%	-7.68%

Funds and ETFs		Last	1W	YTD
ETF	Theme			
RLQ45	LQ45	986.12	-4.20%	-9.52%
XIIT	IDX30	492.15	-5.27%	-11.80%
XIJJ	JII	575.11	-3.70%	-5.31%
XISI	SMinfra18	324.26	-6.62%	-12.90%
XISR	SriKehati	421.04	-5.74%	-12.86%
XIHD	IDXHIDIV20	604.08	-4.98%	-8.82%
XIPI	Pefindo I-Grade	222.69	-5.05%	-7.91%
XI ML	MSCI Indo Large Cap	265.54	-3.99%	-12.10%
XIID	IDX30	466.74	-5.09%	-13.62%
XIFE	FTSE ESG Indonesia	104.92	-4.45%	-11.58%
XIIC	Consumer Related	928.53	-3.90%	-8.97%
XIIF	Rate Sensitive	482.10	-4.59%	-8.94%
XISC	BUMN Stocks	667.93	-5.33%	-7.15%
XISB	Sovereign Bonds	492.98	-1.21%	-1.18%

Conventional				
RDMP	Equity	799.65	-4.87%	-10.23%
RPCF	Balanced	2,478.73	-3.83%	-6.76%
RDPCDA*	Balanced	932.27	-3.37%	-5.92%
RDPCDB	Balanced	918.67	-3.40%	-6.68%
RDPO 2*	Fixed Income	1,128.40	0.10%	2.28%
RDPU 2	Money Market	1,475.15	0.09%	2.13%

*Reinvested Dividend

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	17.8	52.0	10.3	17.8	1.85	11.9	5.0	1.14
2 XIIT	18.9	57.5	11.7	10.8	1.07	11.5	5.3	1.07
3 XISC	25.7	43.1	4.1	14.4	12.76	9.7	6.8	1.33
4 XISR	31.4	55.6	5.0	7.5	0.57	11.8	5.5	1.11
5 XIIF	19.7	49.5	10.7	9.7	10.35	11.9	5.6	1.29
6 XISI	44.2	26.1	14.5	14.0	1.23	9.3	6.9	1.04
7 XIPI	14.6	64.8	16.2	3.5	0.87	15.2	4.2	1.18
8 XIIC	29.4	34.8	28.3	6.0	1.63	12.2	5.0	1.18
9 XIHD	24.7	55.3	3.5	14.5	2.08	10.0	6.2	1.12
10 XIJI	30.6	11.5	14.1	38.8	5.02	14.3	3.5	1.10
11 XIIML	9.7	84.0	0.0	5.7	0.60	11.5	5.8	1.11
12 XIID	18.9	57.6	11.8	10.8	0.89	12.5	5.3	1.07
13 XIFE	22.3	65.7	5.3	4.5	2.17	10.9	5.5	1.14
Index								
IDX80	31.7	40.4	15.7	12.2		10.6	4.9	
JCI	23.2	34.3	16.5	13.5		11.3	5.0	

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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