Kenanga Investors

Date: 4 March 2019

Holding power is key to prevailing in volatile times

Focus Malaysia (2 March 2019)

By Ismitz Matthew De Alwis

- **Don't** be unduly worried over the pessimistic outlook as they are probably priced in already
- **Embark** on a defensive strategy, right stock pick and portfolio diversification to stay resilient

Three negative indicators in recent times have further heightened prevailing weaknesses in the Malaysian economy over the short- to medium-term, to say the least. The RAM Business Confidence Index (RAM BCI) polled weaker sentiment in the first half of 2019 among the 3,500 firms surveyed in Malaysia. The rating agency's first and second quarter 2019 Corporate and SME Indices fell to a respective 55.1 (4Q2018-1Q2019:55.7) and 51.0 (4Q2018-1Q2019: 53.5) – their lowest levels since the inception of the RAM BCI two years ago. While an index value of above 50 still denotes positive sentiment, the current downtrend suggests that businesses have a less upbeat outlook on 2019.One of the key factors driving firms' sentiment on 2019 is the weak economic prospects during the period.

The number of firms citing "weak economic conditions" as their main challenge within this period spiked to 41.0% and 41.2% of the overall firms surveyed in their respective segments; this is also the most frequently cited challenge for both segments. Decelerating domestic growth, uncertain global demand and investment activities as well as a lack of positive catalysts – including the relatively neutral Budget 2019 – all play a part in the generally weaker business sentiment in the next six months. Next, a survey by the Malaysian Institute of Economic Research (MIER) reveals that Malaysia's business and consumer sentiments continued to slip for the second consecutive quarter in 4Q2018. The MIER 4Q2018 Consumer Sentiments Index (CSI) sank below the threshold of 100 points to 96.8 points (3Q2018: 107.5 points), while its Business Conditions Index (MIER BCI) slipped to 95.3 points (3Q2018:108.8 points).

MIER executive director Emeritus Prof Dr Zakariah Abdul Rashid attributes the lower CSI to bearish sentiment on job and income conditions, while inflationary expectations edged up. The MIER BCI's dismal performance was prompted by declines in sales, production, new local orders, new export orders, capital investment and capacity utilisation, among others. Thirdly, the Nikkei Malaysia Manufacturing Purchasing Managers Index (PMI), a measure of business conditions in the country's manufacturing sector, hit 46.8 in December 2018 (November 2018: 48.2), the lowest level since the survey started in July 2012. Readings above 50 indicate an expansion while those below 50 indicate a contraction. Although the index has risen to 47.9 in January, this still marks the fourth straight month of contraction.

NOTHING NEW

Although RAM Holdings Bhd, MIER and the Nikkei Malaysia PMI have raised concerns over the sustainability of the Malaysian economy moving forward, their findings are not something surprising nor are they attesting to the fact that all is bleak in the country's economic, financial and business fronts. Brushing aside political noises, more negative outlook can surely be expected in the coming days as the country grapples to rebuild its economy post the 14th General Election, narrow its fiscal deficit and strengthen its financial position (i.e. international reserves as well as exchange rate against the greenback).

Moreover, investors need not be traumatised by the revelation of bleak prospects given Malaysia is not alone in this predicament. Equity markets the world over – whether in developed economies or emerging markets – have been engulfed in a prolonged state of volatility since mid-2017. This being the case, global data in recent times have also unveiled the global PMI sinking to a near two-and-a-half-year low at the start of 2019, no thanks to a slowdown in China's manufacturing performance which dragged the country's PMI to a near three-year low. An issue of bigger impact will be the consequences in the event a US-China trade war peace deal fails to materialise on the deadline of the 90-day truce on March 1.

Doubts have recently re-surfaced on the hesitation of US president Donald Trump's refusing to meet with China's President Xi Jinping to reach an amicable solution once and for all. If that happens, the current tax on goods imported from China (a market value estimated at US$200 bil [RM814.1 bil] annually) will surge to 25% from 10%, only to trigger a tit-for-tat rebuttal which will put the global economy in a chaotic state. Considering that a potential Sino-American trade deal is already baked into stock prices, this may result in a sell-off rather than a rally in tandem with the market adage of "buy the rumour, sell the fact." This can further exacerbate into an environment of global growth slowdown with interest rates resuming their upward momentum, even if the Federal Reserve has been sounding dovish of late (presumably not to disrupt the bullish stock market trend).

HOLDING POWER

In times of market instability – with many uncertainties lurking at our doorstep – holding power is inevitably the best form of resilience. While holding power – coupled with defensive strategy and the right stock pick – does not guarantee consistent profit in times of high volatility, it does provide that little advantage of enabling investors to hold onto their investment till the storm has subsided. In the long run, possessing strong holding power means being able to make wiser investment decisions as it relieves investors from the pressure of anticipating quick returns. In this regard, investors have the liberty to indulge in fundamentally sound undervalued counters whose price depreciation is only temporary.

Rather than deploying the herd mentality to chase after stocks when they are uphill bound – often only ending up 'catching falling knives' – it surely pays a handsome dividend to pursue the contrarian action of purchasing blue chip stocks which have dipped in value substantially or stocks with the best prospect of staging a swift rebound. Investor extraordinaire Warren Buffet sums up the right time to bargain hunt with this highly-prized observation: "Be fearful when others are greedy and greedy when others are fearful." However, holding power does not mean walking out of the woods unscathed given investors may have to leverage investing wisdom – by foregoing ego and emotions – to part company with certain favoured stocks where their financial health has deteriorated beyond repair.

PORTFOLIO DIVERSIFICATION

Often confused with 'holding power' is the idea of 'holding cash' (i.e. stashing cash in multiple fixed deposit accounts) which is regarded as one of the safest forms of financial instruments due to it being readily available as an emergency reserve. Even with this as a major advantage, the notion that 'cash is king' has its limitation in that inflation reduces one's purchasing power over the longer term. Secondly, investors would have missed the opportunity to reap the decent gains that equities provide. Although equities are more volatile than most other assets, they do provide the best returns over the long term. Equities aside, investors can select from a wide array of financial instruments, ranging from both traditional assets in the likes of real estate to unit trust, bonds, currencies or commodities, to modern investment tools such as exchange traded funds and cryptocurrencies (i.e. bit coin and its so-called 1,500 cryptocurrency peers).

Portfolio diversification essentially levels out the impact of systemic and unsystematic risks by assuming the losses that may result from poor performances of individual investments. Rational investors are expected to select a proper allocation of assets to match their investment profile (aggressive or conservative), thus optimising the return on their portfolio. In a nutshell, aggressive investors tend to assume a higher level of risk by targeting higher returns, whereas conservative investors seek to preserve their earnings by maintaining the value of their portfolio. Nevertheless, investing in different classes of assets allows investors to expand into international markets or different sectors and potentially lower their portfolio risk.

ENDS

Ismitz Matthew De Alwis *is the executive director and CEO of Kenanga Investors Bhd and president of the Financial Planning Association of Malaysia (FPAM).*

Article Source:
Focus Malaysia (2 March 2019)

- **Don't** be unduly worried over the pessimistic outlook as they are probably priced in already
- **Embark** on a defensive strategy, right stock pick and portfolio diversification to stay resilient

Holding power is key to prevailing in volatile times

By Ismitz Matthew De Alwis

Market players must have the financial strength to hold on to their portfolios in tough times even as they hunt for undervalued buys

Three negative indicators in recent times have further heightened prevailing weaknesses in the Malaysian economy over the short- to medium-term, to say the least. The RAM Business Confidence Index (RAM BCI) polled weaker sentiment in the first half of 2019 among the 3,500 firms surveyed in Malaysia.

The rating agency's first and second quarter 2019 Corporate and SME Indices fell to a respective 55.1 (4Q2018-1Q2019: 55.7) and 51.0 (4Q2018-1Q2019: 53.5) – their lowest levels since the inception of the RAM BCI two years ago. While an index value of above 50 still denotes positive sentiment, the current downtrend suggests that businesses have a less upbeat outlook on 2019.

One of the key factors driving firms' sentiment on 2019 is the weak economic prospects during the period. The number of firms citing "weak economic conditions" as their main challenge within this period spiked to 41.0% and 41.2% of the overall firms surveyed in their respective segments; this is also the most frequently cited challenge for both segments.

Decelerating domestic growth, uncertain global demand and investment activities as well as a lack of positive catalysts – including the relatively neutral Budget 2019 – all play a part in the generally weaker business sentiment in the next six months.

Next, a survey by the Malaysian Institute of Economic Research (MIER) reveals that Malaysia's business and consumer sentiments continued to slip for the second consecutive quarter in 4Q2018.

The MIER 4Q2018 Consumer Sentiments Index (CSI) sank below the threshold of 100 points to 96.8 points (3Q2018: 107.5 points), while its Business Conditions Index (MIER BCI) slipped to 95.3 points (3Q2018: 108.8 points).

MIER executive director Emeritus Prof Dr Zakariah Abdul Rashid attributes the lower CSI to bearish sentiment on job and income conditions, while inflationary expectations edged up. The MIER BCI's dismal performance was prompted by declines in sales, production, new local orders, new export orders, capital investment and capacity utilisation, among others.

Thirdly, the Nikkei Malaysia Manufacturing Purchasing Managers Index (PMI), a measure of business conditions in the country's manufacturing sector, fell 46.8 in December 2018 (November 2018: 48.2), the lowest level since the survey started in July 2012.

Readings above 50 indicate an expansion while those below 50 indicate a contraction. Although the index has risen to 47.9 in January, this still marks the fourth straight month of contraction.

Nothing new

Although RAM Holdings Bhd, MIER and the Nikkei Malaysia PMI have raised concerns over the sustainability of the Malaysian economy moving forward, their findings are not something surprising nor are they attesting to the fact that all is bleak in the country's economic, financial and business fronts.

Brushing aside political noises, more negative outlook can surely be expected in the coming days as the country grapples to rebuild its economy post the 14th General Election, narrow its fiscal deficit and strengthen its financial position (i.e. international reserves as well as exchange rate against the greenback).

Moreover, investors need not be traumatised by the revelation of bleak prospects given Malaysia is not alone in this predicament. Equity markets the world over – whether in developed economies or emerging markets – have been engulfed in a prolonged state of volatility since mid-2017.

This being the case, global data in recent times have also unveiled the global PMI sinking to a near two-and-a-half-year low at the start of 2019, no thanks to a slowdown in China's manufacturing performance which dragged the country's PMI to a near three-year low.

An issue of bigger impact will be the consequences in the event a US-China trade war peace deal fails to materialise on the deadline of the 90-day truce on March 1. Doubts have recently re-surfaced on the hesitation of US president Donald Trump's refusing to meet with China's President Xi Jinping to reach an amicable solution once and for all.

If that happens, the current tax on goods imported from China (a market value estimated at US$200 bil [RM814.1 bil] annually) will surge to 25% from 10%, only to trigger a tit-for-tat rebuttal which will put the global economy in a chaotic state.

Considering that a potential Sino-American trade deal is already baked into stock prices, this may result in a sell-off rather than a rally in tandem with the market adage of "buy the rumour, sell the fact."

This can further exacerbate into an environment of global growth slowdown with interest rates resuming their upward momentum, even if the Federal Reserve has been sounding dovish of late (presumably not to disrupt the bullish stock market trend).

Holding power

In times of market instability – with many uncertainties lurking at our doorstep – holding power is inevitably the best form of resilience.

While holding power – coupled with defensive strategy and the right stock pick – does not guarantee consistent profit in times of high volatility, it does provide that little advantage of enabling investors to hold onto their investment till the storm has subsided.

In the long run, possessing strong holding power means being able to make wiser investment decisions as it relieves investors from the pressure of anticipating quick returns.

In this regard, investors have the liberty to indulge in fundamentally sound undervalued counters whose price depreciation is only temporary.

Rather than deploying the herd mentality to chase after stocks when they are uphill bound – often only ending up 'catching falling knives' – it surely pays a handsome dividend to pursue the contrarian action of purchasing blue chip stocks which have dipped in value substantially or stocks with the best prospect of staging a swift rebound.

Investor extraordinaire Warren Buffet sums up the right time to bargain hunt with this highly-prized observation: "Be fearful when others are greedy and greedy when others are fearful."

However, holding power does not mean walking out of the woods unscathed given investors may have to leverage investing wisdom – by foregoing ego and emotions – to part company with certain favoured stocks where their financial health has deteriorated beyond repair.

Portfolio diversification

Often confused with 'holding power' is the idea of 'holding cash' (i.e. stashing cash in multiple fixed deposit accounts) which is regarded as one of the safest forms of financial instruments due to it being readily available as an emergency reserve.

Even with this as a major advantage, the notion that 'cash is king' has its limitation in that inflation reduces one's purchasing power over the longer term.

Secondly, investors would have missed the opportunity to reap the decent gains that equities provide. Although equities are more volatile than most other assets, they do provide the best returns over the long term.

Equities aside, investors can select from a wide array of financial instruments, ranging from both traditional assets in the likes of real estate to unit trust, bonds, currencies or commodities, to modern investment tools such as exchange-traded funds and cryptocurrencies (i.e. bitcoin and its so-called 1,500 cryptocurrency peers).

Portfolio diversification essentially levels out the impact of systemic and unsystematic risks by assuming the losses that may result from poor performances of individual investments.

Rational investors are expected to select a proper allocation of assets to match their investment profile (aggressive or conservative), thus optimising the return on their portfolio.

In a nutshell, aggressive investors tend to assume a higher level of risk by targeting higher returns, whereas conservative investors seek to preserve their earnings by maintaining the value of their portfolio.

Nevertheless, investing in different classes of assets allows investors to expand into international markets or different sectors and potentially lower their portfolio risk.

Ismitz Matthew De Alwis is executive director and CEO of Kenanga Investors Bhd and the current president of the Financial Planning Association of Malaysia (FPAM)