Kenanga Investors

Date: 23 November 2016

Ask The Experts:

24% Potential upside for Asian Equities in two years

Fundsupermart.com.my (18 November 2016)
YouTube (22 November 2016)

Mr. Christopher Kok, Senior Portfolio Manager of Kenanga Investors Berhad comments about the outlook for the Malaysian economy for the second half of 2016.

View video: https://www.youtube.com/watch?v=tLYVaN3oDCg&feature=youtu.be

1. **What is your outlook for Asian equities in the next two years?**

   We are bullish on Asian equities, because we think that the Asia region is one of the few regions that will bring growth moving forward. If you look at developed markets like US and Europe, they are actually showing 2% growth forecasted in the next two years whereas Asia's forecast GDP growth is about 5% to 6% and corporate earnings growth should be even stronger than that. Therefore, it is one of the only regions where investors may experience growth for their investments. Although there are risks generally arising from high debt particularly in China, we think the government has the capability and willingness to contain it for now.

2. **Fundsupermart Research Team made a bold call of 40% upside potential for Asian equities by end of 2018. Do you agree with their call?**

   We can get a gauge of the return by looking at the MSCI Asia ex-Japan index as a measure of the market. We know that return is a function of both the earnings and the multiple that is paid on those earnings. Looking at the consensus forecast, companies in the index are expected to post earnings growth of 12.5% in 2017 and 11% in 2018. Assuming the earnings multiple does not change, we thus see a roughly 24% upside in 2-years driven from earnings alone.

   The earnings multiple would be harder to predict. Two of the key things that determine this are the long term growth and the risk. For the multiple to expand, it would require realization of new growth avenues or a dissipation of risk that currently surrounds the market. While we think there is some scope for multiple re-ratings as domestic demand and liquidity gain critical mass, this is a long term trend which might take longer than the next 2 years.

3. **Within Asia, is there any particular country or sector that you are bullish about?**

   We are positive with the tech and internet sector across North Asia (China, South Korea and Taiwan) as new secular trends like flexible OLED, automated driving and virtual reality continue to drive demand. These key factors will continue to provide earnings growth for companies moving forward.

   For the internet sector, e-commerce is still forecasted to grow at double-digit CAGRs for the next few years. Asia's massive population of >4bn people provides tremendous opportunities for internet companies to achieve scale.

   In South East Asia, we like Indonesia due to decent growth (>5% forecasted) alongside structural reforms such as improving the ease of doing business, infrastructure and also tax collection. Meanwhile, inflation has fallen to multi year lows of about 3% - 4% which enables an easier monetary policy. A recent tax amnesty programme is also expected to boost government revenue by as much as USD9-10bn while also improving liquidity in the domestic economy. Additionally, there should be cyclical support as commodity prices bottom out.

4. **What are the key risks that investors should be aware of? How is your strategy positioned to mitigate these risks?**

   Into 2017, global monetary policy is still the key to watch as it will have an impact on capital flows into Asian markets. Diverging monetary policy in the US and Euro region would lead to a stronger USD and would be negative for emerging markets. Historically, movements in the USD have been highly correlated with the performance of Asian stock markets. Although we think this will become less important in the future as Asian markets become more domestically driven, it will still remain correlated in the medium term.

   Another key risk is stability in China, the largest economy in Asia as total debt to GDP (Public + Households + Corporates excluding financial) has exceeded 250% of GDP. The risk point lies in corporate debt, while the government and households still remain relatively lowly geared. Keys to monitor are the property market, capital outflows and the amount of liquidity in the system.

For Kenanga, our strategy as always remains bottom-up driven and concentrated in companies which show structural growth. Hence we tend to dislike companies which are affected by government policy. We also place emphasis on the quality of the company, and prefer companies with earnings stability and strong balance sheet. Hence, we think these companies are able to weather any downturn relatively better. We constantly monitor key macro trends as well, for example; the Chinese property market and its currency movements to ensure that we are well positioned for any market movement.

5. **Malaysian equities didn't perform well this year. What are the reasons for the lack-lustre performance? With oil prices stabilizing and 2017 budget out, is there any catalyst?**

   Malaysian equities have suffered because earnings growth has slowed down. This is partly due to low commodity prices. Going forward into 2017, earnings growth is predicted to experience a turnaround as GDP growth is also expected to rebound after three consecutive years of slowdown. GDP growth decelerated from 6% in 2014 to 5% in 2015 and to an estimated 4.1% for 2016. Next year, we forecast a rebound to 4.4%. Though this may seem like a small increment, it is nevertheless a change in trend; there is an actual increase after two years of downtrend. As corporate earnings are leveraged to overall growth in the economy, we should also see a similar trend there which will be positive for the market. Additionally, this is supported by improving commodity prices and also an accommodative monetary and fiscal policy.

6. **Which unit trusts would you recommend investors to take advantage of in rising Asian equity markets?**
   Our Kenanga Asia Pacific Total Return Fund ("KAPTRF") is weighted predominantly into North Asian markets while our Kenanga ASEAN Tactical Total Return Fund ("KATTRF") funds gives investors exposure into structural themes in ASEAN markets such as rising infrastructure spending and rising consumption. As we are also positive on Malaysia in 2017, investors can also position themselves in Kenanga Malaysian Inc Fund ("KMIF"). For more specific mandates like dividend we recommend the Kenanga Premier Fund ("KPF"), while for small-caps we recommend the Kenanga Growth Opportunities Fund ("KGOF").

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Ask The Experts: 24% Potential Upside for Asian Equities in two years

Christopher Kok, Senior Portfolio Manager - Investments of Kenanga Investors Berhad shares with us his outlook for Asian equities.

1. What is your outlook for Asian equities in the next two years?
Christopher is bullish on Asian equities because the Asian region gives good growth going forward. GDP growth for Asia is forecasted to be 5-6% and corporate earnings growth should be even stronger than that.

2. Fundsupermart Research Team made a bold call of 40% upside potential for Asian equities by end of 2018. Do you agree with their call?
In terms of earnings, forecast is about 11-12% growth for each of the next two years. So if you put that together, you get about 24% return based on earnings alone. For multiples to expand, we need a good reason for why long term growth should be higher than usual or risk is lower compared to the historical past. For now, he does not really see that yet. Thus, the return will be driven more by earnings growth. But the good news is that thereâs probably more upside to that earnings forecast for now.

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