

4E Journal (Vol 15, 2014)

Market Outlook - Current Weakness Presents Buying Opportunity

by Lee Sook Yee (Chief Investment Officer)

MARKET OUTLOOK

July - September 2014

Current Weakness Presents Buying Opportunities

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1. Performance Review (1H 2014) – Strong Momentum Overall

Indices Performances as at July 31, 2014 (Local Currency)

Index	July 31, 2014	% Change 2013	% Change Q1 2014	% Change Q2 2014	% Change July	% Change YTD
S&P BSE SENSEX INDEX INDIA	25,894.97	9.0%	5.7%	13.5%	1.9%	22.3%
JAKARTA COMPOSITE INDEX	5,088.80	-1.0%	11.6%	2.3%	4.3%	19.1%
PHILIPPINE SE INDEX	6,864.82	1.3%	9.1%	6.5%	0.3%	16.6%
STOCK EXCH OF THAI INDEX	1,502.39	-6.7%	6.0%	8.0%	1.1%	15.7%
MSCI AC ASIA x JAPAN	598.66	0.7%	-1.1%	6.2%	3.3%	8.6%
TAIWAN TAIEX INDEX	9,315.85	11.8%	2.8%	6.1%	-0.8%	8.2%
SINGAPORE STRAITS TIMES INDEX	3,374.06	0.0%	0.7%	2.1%	3.6%	6.5%
HANG SENG INDEX	24,756.85	2.9%	-5.0%	4.7%	6.8%	6.2%
S&P / ASX 200 INDEX AUSTRALIA	5,632.91	15.1%	0.8%	0.0%	4.4%	5.2%
SHENZHEN CSI 300 INDEX	2,350.25	-7.6%	-7.9%	0.9%	8.6%	0.9%
EURO STOXX 50 Pr	3,115.51	17.9%	1.7%	2.1%	-3.5%	0.2%
DOW JONES INDUSTRIAL AVG	16,563.30	26.5%	-0.7%	2.2%	-1.6%	-0.1%
NIKKEI 225	15,620.77	56.7%	-9.0%	2.3%	3.0%	-4.1%
FBM KLCI	1,871.36	10.5%	-1.0%	1.8%	-0.6%	0.2%
FBM 100	12,651.62	11.4%	-1.0%	1.8%	-0.2%	0.5%
FBM SHARIAH	13,383.98	13.3%	0.7%	1.8%	0.0%	2.5%
FBM SMALL CAP	19,066.40	36.7%	9.1%	4.7%	6.3%	21.5%

- The best performing markets (year-to-date) was India (+22.3 percent) and Indonesia (+19.1 percent), as optimism heightened after new governments were elected.
- Other ASEAN markets also did well – Philippines (+16.6 percent) and Thailand (+15.7 percent).
- China / Hong Kong rebounded in the last few months, from a loss in 1Q2014 to end July at +6.2 percent for the Hang Seng Index and +0.9 percent for the Shenzhen CSI (China Securities Index)
- The FBM KLCI is "flatish" (year-to-date) but it was the best performer in ASEAN last year.



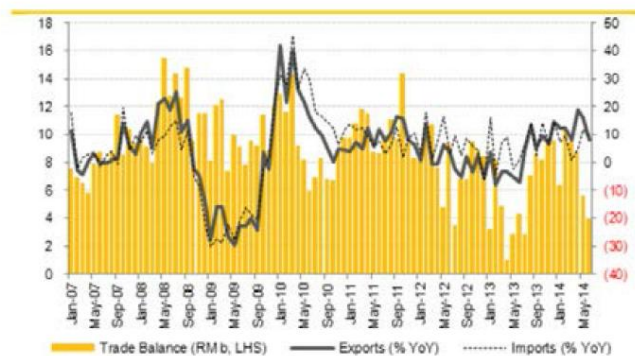
2. What macroeconomic themes do you see happening in Malaysia?

One of the key themes this year has been the strength of export recovery, which contributed to the strong gross domestic product (GDP) growth of 6.2 percent in Q12014; the strongest in ASEAN. The sustained export recovery will more than compensate for the moderation in domestic demand growth, supporting an overall GDP growth of around 5.5 percent in 2014. (Malaysia is actually one of very few in ASEAN that will see stronger year-on-year GDP growth this year).

	2012	2013	2014F	2012	2013	2014F	2012	2013	2014F
	% yoy			% share			% contribution to GDP		
Consumption	7.1	7.3	5.8	63.7	65.3	65.5	4.5	4.7	3.8
Private consumption	7.7	7.6	6.5	50.6	52.0	52.4	3.8	3.8	3.4
Public consumption	5.1	6.3	3.0	13.2	13.4	13.1	0.7	0.8	0.4
Investment	19.9	8.2	10.3	26.8	27.7	29.0	4.7	2.2	2.9
Private investment	21.9	13.6	15.0	15.1	16.9	18.4	3.0	2.1	2.5
Public investment	17.1	0.7	3.0	11.3	10.9	10.6	1.7	0.1	0.3
Domestic demand	10.6	7.6	7.1	90.6	93.1	94.5	9.2	6.9	6.6
Exports of goods and services	-0.1	-0.3	5.0	95.0	90.5	90.1	-0.1	-0.3	4.5
Import of goods and services	4.7	1.9	6.7	86.5	84.2	85.2	4.1	1.7	5.6
GDP at purchasers' value	5.6	4.7	5.5	100.0	100.0	100.0	5.6	4.7	5.5
Agriculture	1.0	2.1	2.5	7.3	7.1	6.9	0.1	0.2	0.2
Mining and quarrying	1.4	0.5	1.0	8.4	8.1	7.8	0.1	0.0	0.1
Manufacturing	4.8	3.4	5.5	24.9	24.5	24.5	1.2	0.8	1.3
Construction	18.1	10.9	16.0	3.5	3.7	4.1	0.6	0.4	0.6
Services	6.4	5.9	5.8	54.6	55.2	55.3	3.5	3.2	3.2
GDP at purchasers' value	5.6	4.7	5.5	100.0	100.0	100.0	5.6	4.7	5.5

Source: Bank Negara Malaysia, Affin estimates

Malaysia: Export Growth, Import Growth & Trade Balance



Source: Department of Statistics, Maybank KE

“One of the key themes this year has been the strength of export recovery, which contributed to the strong gross domestic product (GDP) growth of 6.2 percent in Q12014; the strongest in ASEAN.”

On the other hand, inflation expectations are also building up. This, coupled with rising household debt, has prompted the central bank to announce a 25 basis points rate hike on July 11, 2014, marking the first hike in three years. Given that interest rates are still relatively low, and judging by the central bank's hawkish tone, we would not rule out another hike of 25 basis points before year end.



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3. How much further upside is there for investors and are valuations still appealing?

Speaking of valuations, we must admit the current levels are not particularly compelling. The market now trades at 17x this year, falling slightly to 16x next year. Relative to other countries in ASEAN, Malaysia is now the second most expensive market after Philippines. If we were to peg the index at 16.5x next year's earnings, it would be at 1,980, which is approximately a five percent upside from the current levels.

4. What about the earnings outlook?

After the recently concluded Q12014 reporting, market earnings have been downgraded to around 5 percent this year by consensus. But it is expected to improve to around 10 percent in 2015. The improvement in earnings growth is board-based, driven by sectors like banks, plantation, consumer, construction and manufacturers as well as oil and gas.

5. What are some of the risks that may materialise?

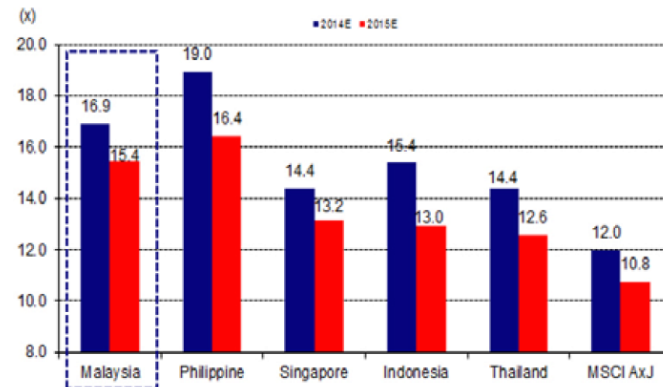
Any unexpected slowdown in U.S./Europe/China may present a risk to Asia including Malaysia. Also any sudden withdrawal of liquidity is a key risk as that has been a leading supporter of risk assets including equities. That aside, any escalation in geopolitical tension, be it in Russia/Ukraine/Middle East could also cause a major sell-off in the market.

6. Where are the investment opportunities at the moment?

Although the composite index as whole presents little upside due to the high index valuations, we still see good value propositions in individual stock levels. So stock picking remains the key. At present, we continue with oil and gas (which will go on to form the core holdings due to robust capital expenditure (CAPEX) programme underpinning earnings growth), construction (beneficiary of the government's Economic Transformation Programme) and exporters/manufacturers (external demand especially for ICT and semi-conductors, etc.). Timing wise, we believe the current weakness in Q32014 presents a buying opportunity for a stronger Q42014. ^{MS}

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PE Valuation Comparison: KLCI vs ASEAN-5 vs MSCI AxJ



Source: Bloomberg

Cumulative ETP Investment:
One-fifth of committed investment has been realised as of end-2013

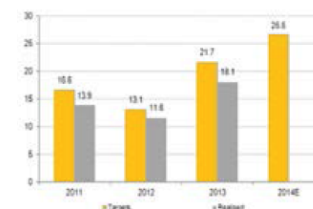


Source: PEMANDU (ETP Annual Reports 2011-2013)

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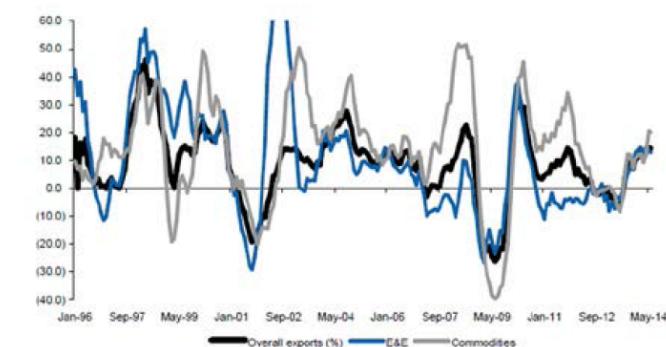
"The improvement in earnings growth is board-based, driven by sectors like banks, plantation, consumer, construction and manufacturers as well as oil and gas."

Annual ETP Investment: Targets vs Realised, 2011-2014E



Source: PEMANDU (ETP Annual Reports 2011-2013)

Exports of Electronics & Electrical are one of the drivers



Source: CEIC, KAF estimates