

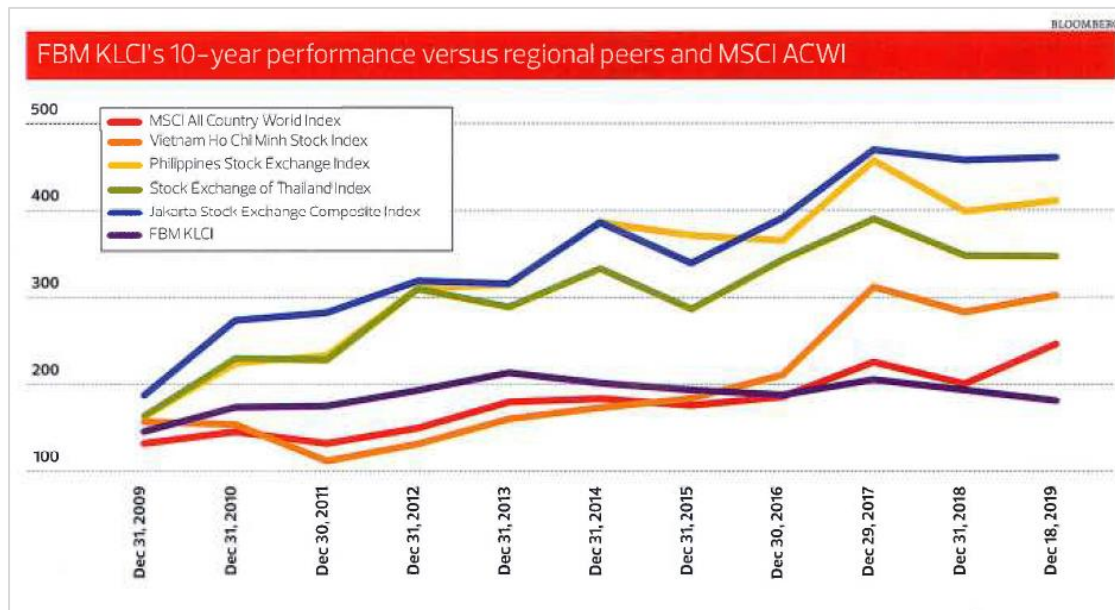
## The best of times, the worst of times

*The Edge Malaysia (30 December 2019)*

By Kuek Ser Kwang Zhe

It has been a story of two halves for the Malaysian stock market over the past decade. While the first five years saw healthy growth and listing activity, the other five years saw the market lose about half its gains, due to factors such as poor corporate earnings and low oil prices.

"We were doing quite well in the first half of the decade, when the global economy was still recovering strongly from the 2008 global financial crisis. The listing of a few companies also attracted foreign investors' attention to the local market," says Lim Tze Cheng, head of research at EquitiesTracker Holdings Bhd. For instance, the listing of Petronas Chemicals Group Bhd in November 2010 was the largest initial public offering (IPO) in Southeast Asia that year.



It raised RM12.8 billion from the market. Felda Global Ventures Holdings Bhd was listed on June 28, 2012, and raised RM10.4 billion from investors. It was the second largest IPO in the world that year after Facebook Inc.'s US\$16 billion listing. IHH Healthcare Bhd was listed a month later and became the third largest IPO of the year. In the second half of the decade, things took a turn for the worse.

Quoting Charles Dickens' historical novel, Lim says the local market was like "a tale of two cities" and faced many challenges. "Anything that could go wrong did go wrong." For instance, oil prices plunged from more than US\$100 a barrel to a low of about US\$30 a barrel from December 2014 to January 2016,



mainly due to slowing economic growth in China. In January 2017, crude palm oil prices started falling from more than RM3,000 per tonne to a low of about RM1,900 two years later on the back of an oversupply in the market.

The 1Malaysia Development Bhd scandal and the implementation of the Goods and Services Tax by the previous government in 2015 also dragged down the local market. "The new tax regime, coupled with a weaker ringgit, caused imported inflation and weak domestic consumption. Companies' earnings were affected while the cost of doing business rose. The market fell [as a result]," says Lim.

Kenanga Investors Bhd CEO Ismitz Matthew De Alwis also describes the stock market performance over the past decade as two-tiered. "[The FBM KLCI] had a good run in the first five years, when it was 38% up. But it suffered a 9.4% drop in the next five years." For the FBM KLCI, the peak came at the end of 2013, after rising 22.91% to 1,866.96 points from 1,518.91 points at the start of the decade. In the second half of the decade, the benchmark index rose in 2017 before falling steadily for the next few years.

By Dec 9, it had fallen to 1,562.71 points, losing about half the gains it made in the first five years of this decade. Maybank Asset Management Sdn Bhd CEO Ahmad Najib Nazlan says the growth investing strategy outperformed value investing by leaps and bounds in the first half of the decade, when the local market was still recovering from the global financial crisis. Small and mid-cap companies were the main beneficiaries as their bottom lines improved significantly. Ahmad Najib describes the time when oil prices crashed as the most challenging period of the past 10 years for fund managers.

Many oil and gas companies had to close while existing ones were restructured. Just as oil prices were slowly rising from the bottom last year, the country saw its first change in government in more than six decades. Soon after, the new Pakatan Harapan-led government reviewed more than 100 infrastructure projects introduced by the previous administration and made changes to the leadership of government-linked companies. The government also rolled out new plans and policies to improve broadband quality while lowering prices and liberalising the energy sector, among others. All these changed the business fundamentals across industries, forcing fund managers to review their investment strategies, says Ahmad Najib. "Some of our investment theses were no longer applicable. That was another challenging period for us," he adds.

### LAGGING BEHIND REGIONAL PEERS

The local stock market underperformed other bourses in the region over the last decade. Apex Investment Services Bhd CEO Clement Chew points out that as at Nov 29, the FBM KLCI had only generated a return of 23% in ringgit terms in the past 10 years. He says it is a mere 1% in US dollar terms. The performance of the local bourse lagged behind its regional peers including the stock markets of Thailand, Indonesia and the Philippines. The Stock Exchange of Thailand Index, Jakarta Stock Exchange Composite Index and Philippines Stock Exchange Index were up 117%, 137% and 154% respectively in local currency terms during the period. In US dollar terms, the three indices were up 139%, 58% and 130%. Investors should not be surprised by the FBM KLCI's underperformance.

Corporate earnings, which are the main driver of performance in the local market, had been mostly negative from 2013 to 2018, with 2017 being the exception. In the past six years, corporate earnings in Malaysia fell about 9% while those in Thailand went up 40%. Corporate earnings in Indonesia and the Philippines increased 32% during the period, says Chew. "Malaysian corporations have been experiencing an earnings drought in the past six years, which is unprecedented."

EquitiesTracker's Lim says the local market tends to be driven more by corporate earnings than re-ratings. The FBM KLCI tends to underperform when corporate earnings are bad, he points out. A back-

test of the past 15 years would show that about 7 out of 10 times, the index performed well when corporate earnings were good, he adds. A rerating means investors have a different view of a specific market due to its prospects. Good prospects mean its stocks and indices are being traded at higher price-earnings ratios (PERs), and vice versa. The FBM KLCI has been trading at a PER of about 16 times in the past 10 years. The valuation has not changed much, says Chew. "We have been stuck in the same trading band for a long time. The local market used to be traded at a 30% to 40% premium compared with Asia ex-Japan five years ago and beyond. Now, our premium is down to 10% to 15%. We have been de-rated instead," he adds.

On the other hand, other bourses have enjoyed an upward rerating in the past three years. Ultimately, the question is whether the local market will become even less attractive to foreign investors going forward, says Chew. "When I joined the financial industry in the 1990s, Malaysia took up almost 20% of the MSCI Emerging Markets Index. Today, we are less than 2%. You can see how things have changed," he points out. "Has the kind of attraction the local market used to enjoy evaporated over the years? This is a question worth posing."

### A STOCK-PICKER'S MARKET

Despite the FBM KLCI's lacklustre performance, investors would still have enjoyed good returns had they invested in the right companies, most of which are not components of the index. As at end-November, 102 stocks with a market capitalisation of more than RM500 million yielded capital gains of more than 10%, not including dividends, says Chew. Of those stocks, 21 would have generated a return of 20% to 30% while 35 would have provided a return of more than 50%. "Last year, there were 30 stocks that gave returns of more than 10%. There were 118 in 2017 and 60 in 2016," he adds. Chew says there are always investment opportunities in the market, but investors would need to identify them. "The Malaysian market has been one for stock-pickers most of the time."

De Alwis concurs with Chew. When the local stock market started falling at end-2014, some small and mid-cap companies and exporters did perform well. These companies included glove manufacturers and semiconductor players that provided electronics manufacturing services and outsourced semiconductor assembly and test services. "These semiconductor companies benefited from a weakening ringgit and were riding robust smartphone sales and supply chain upgrades. These resulted in a brisk expansion in their revenue and margins. Those who invested in these companies would have received good returns between 2013 and 2015," he says.

### MARKET OUTLOOK

De Alwis says the outlook for next year is quite cloudy as the US economy's growth is set to slow further as the effects of fiscal stimulus and tax cuts that boosted the economy in recent years fade. China's economic growth is expected to lose more steam due to its heavy debt burden while the EU's low economic growth rate is expected to continue and become the norm. The good news is that central banks are expected to cut interest rates further to support global growth. The US Federal Reserve has cut the key policy rate three times this year while the European Central Bank has promised to reintroduce its quantitative easing programme.

The People's Bank of China is already loosening its monetary policy, says De Alwis. "Hence, we see a fairly neutral environment next year. The upside is capped by slowing economic growth and a debt hangover while the downside is supported by enhanced liquidity provided by central banks," he adds. EquitiesTracker's Lim says a US recession, which could lead to a global recession, is unlikely to happen in the current low interest rate environment. "If you look at all the major recessions that have happened since the 1930s — big and small ones — 70% of them were caused by the Fed hiking interest rates. It is

now cutting rates." In fact, Apex's Chew expects global growth to rebound next year on the back of the loose monetary policies of central banks. He says the Manufacturing Purchasing Managers' Index globally has started to stabilise since the middle of the year while inventories around the globe have been run down. Those inventories need to be rebuilt. "We kind of went through a growth pause in the last 18 months. The global economy could see better growth," says Chew.

In Malaysia, fund managers expect corporate earnings and market performance to fare better in 2020 due to monetary policy easing implemented globally and a low base effect. Chew expects the corporate earnings drought to continue at least until the first quarter of next year, but he hopes that things will improve after that. "This could happen if global growth rebounds on the back of monetary policy easing," he says. Ahmad Najib expects market performance to improve in 2020 due to a low base effect.

Eastspring Investments Bhd investment services manager Ang Hin Yik shares that view. He says stock-picking remains essential for investors to generate their desired returns. They could keep an eye on defensive counters and laggards that have a brighter earnings outlook next year. "The dividend investing theme should continue to be favoured as the rate easing cycle is expected to continue into 2020, especially if bond yields fall below [stock] dividend yields. Laggard [counters] with a better outlook next year are also attractive, especially those with improved earnings visibility, earnings quality and resilience," says Ang. Fund managers favour companies in the banking, oil and gas and semiconductor sectors. Ahmad Najib says the share prices and earnings of large-cap banks were severely affected when Bank Negara Malaysia lowered the overnight policy rate in May.

The performances of these banks could improve as the country's economy grows and corporates start to incur capital expenditure again, two years after the last general election due to market uncertainties. Devan Linus Rajadurai, founder, CEO and chief investment officer at MTC Asset Management. The fund management company likes banks that are adopting new technologies successfully. For instance, a local bank has rolled out an e-wallet that has gained good traction in the market. Devan calls this the evolution of the old economy. "Local banks are well capitalised and pay good dividends. What's more, some of these traditional companies are revolutionising themselves with tech and are doing better than start-ups," he says. "A lot of money has gone into the private markets, investing in start-ups such as Uber, Lyft and Grab. What if this money flows into public-listed companies because they are doing better than start-ups? We are quite excited about this."

De Alwis likes the semiconductor sector as it is expected to benefit from a quicker rolling out of 5G, artificial intelligence, Internet of Things hardware upgrades and the 3D sensing driving camera module. He also sees value in oil and gas companies as the sector begins to pick up. An increase in demand for such assets and services across the industry's value chain has been observed recently. De Alwis says palm oil companies are also attractive as a shortage in supply is expected next year due to falling yields and the slow pace of replanting.

Meanwhile, demand is rising due to greater palm oil biodiesel usage in Indonesia. EquitiesTracker's Lim likes semiconductors and glovemakers. He says the semiconductor sector is staging a comeback amid trade war uncertainties. "The orders for semiconductor chips dropped recently, but the volume started to pick up last month. There is a limit to how long businesses can hold back their orders [while the global economy is still growing]." In October, China created a US\$29 billion state-backed fund to invest in the semiconductor industry. This was done to reduce its dependence on US technology, according to Bloomberg. Lim says the fact that the two largest economies — the US and China — are competing with each other in the technology space ultimately benefits the semiconductor industry as a whole.

He also favours the glove manufacturing sector in anticipation of distributors placing large orders with local glove companies. "There is a trend among distributors to stock up [inventory] for the next one to two

years. Then, they utilise the stock and buy again. That is why glove players tend to do well for a year or two, then their share prices drop and go back up again," he says. "My take is that in 2018/19, the distributors were still utilising [their existing] stock. The buying trend will come back next year." The key risk going forward, say fund managers is a prolonged US-China trade war that impacts global economic growth. However, they believe the monetary policy easing of central banks should address such concerns. But what if global growth turns out weaker than expected or a black swan event happens? Chew says central banks, especially the Fed, have a limited toolkit to fight an economic slowdown. "Although banks are more capitalised today, what else can central banks do if a black swan event happens and economic growth weakens? Before 2009, the Fed funds rate was 5%. When the next downturn comes, the US central bank is likely to start at a 1.5% to 1.75%. Its hands are quite tied."

## GLOBAL STOCK MARKETS SEE POSITIVE PERFORMANCE

Global stock markets have performed positively in the last decade, underpinned by steady economic growth. The MSCI All Country World Index, a broad measure of equity market performance around the world, had risen about 80% over the past 10 years (as at Dec 5) while the global economy experienced an average growth of about 3% per annum over the same period, according to the World Bank. A key contributor to such growth is monetary easing policies implemented by central banks that have enabled companies and consumers to borrow cheaply, says Devan Linus Rajadurai, founder, CEO and chief investment officer at MTC Asset Management, a boutique fund management firm based in Malaysia that invests in blue chips globally.

"The growth has been prudent and steady as memories of the subprime mortgage crisis remain fresh in the minds of corporate leaders and people. This has contributed to positive market performance globally," he adds. Even recently, stock markets in various parts of the world fared relatively well, says Devan, As at Dec 5, the S&P 500 and Dow Jones Industrial Average shot up about 24% and 18% year to date respectively while the US economy is enjoying its longest expansion in the country's history of more than 10 years. The International Monetary Fund (IMF) expects the US economy to grow at 3% this year. The Shanghai Composite Index rose about 17% during the period while China's economy is expected to grow about 6.2% this year, according to the IMF's forecast. The Euro Stoxx 50 Index (an index designed by the Deutsche Borse Group that tracks blue-chip stocks' performance in the region) and Nikkei 225 Index have risen about 22%. The IMF expects the EU's economy to grow at 1.4% this year and Japan at 0.8%.

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## Article Source:

The Edge Malaysia (30 December 2020)

**PW4**  
DECEMBER 30, 2020  
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BY KUEK SEK KWANG ZHE

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"We were doing quite well in the first half of the decade, when the global economy was still recovering strongly from the 2008 global financial crisis. The listing of a few companies also attracted foreign investors' attention to the local market," says Lim The Cheng, head of research at EquitiesTracker Holdings Bhd.

For instance, the listing of Petronas Chemicals Group Bhd in November 2010 was the largest initial public offering (IPO) in Southeast Asia that year. It raised RM12.2 billion from the market.

Felda Global Ventures Holdings Bhd was listed on June 29, 2010, and raised RM1.4 billion from investors. It was the second largest IPO in the world that year after Facebook Inc's US\$1.6-billion listing. IHH Healthcare Bhd was listed a month later and became the third largest IPO of the year.

In the second half of the decade, things took a turn for the worse. Quoting Charles Dickens' historical novel, Lim says the local market was like "a tale of two cities" and faced many challenges. "Anything that could go wrong did go wrong."

For instance, oil prices plunged from more than US\$100 a barrel to a low of about US\$30 a barrel from December 2014 to January 2016, mainly due to slowing economic growth in China. In January 2017, crude palm oil prices started falling from more than RM7,000 per tonne to a low of about RM1,000 two years later on the back of an oversupply in the market.

The Malaysia Development bhd scandal and the implementation of the Goods and Services Tax by the previous government in 2015 also dragged down the local market. "The new tax regime, coupled with a weaker ringgit, caused imported inflation and weak domestic consumption. Companies' earnings were affected while the cost of doing business rose. The market fell [as a result]," says Lim.

Kenanga Investors Bhd CEO Ismitiz Matthew De Ara also describes the stock market performance over the past decade as "tortured." "The FBM KLCI had a good run in the first five years, when it was up 38% but it suffered a 9.4% drop in the next five years."

For the FBM KLCI, the peak came at the end of 2013, after rising 22.91% to 1,866.96 points from 1,518.51 points at the start of the decade. In the second half of the decade, the benchmark index rose in 2017 before falling steadily for the next few years. By Dec 9, it had fallen to 1,562.71 points, losing about half the gains it made in the first five years of this decade.

Maybank Asset Management Sdn Bhd CEO Ahmad Najib Nadeem says the growth investing strategy outperformed value investing by leaps and bounds in the first half of the decade, when the local market was still recovering from the global financial crisis. Small and mid-cap companies were the main beneficiaries as their bottom lines improved significantly.

Ahmad Najib describes the time when oil prices crashed as the most challenging period of the past 10 years for fund managers. Many oil and gas companies had to close while existing ones were restructured. Just as oil prices were slowly rising from

the bottom last year, the country saw its first change in government in more than six decades. Soon after, the new Pakatan Harapan-led government reviewed more than 100 infrastructure projects introduced by the previous administration and made changes to the leadership of government-linked companies.

The government also rolled out new plans and policies to improve broadband quality while lowering prices and liberalising the energy sector, among others. All these changed the business fundamentals across industries, forcing fund managers to review their investment strategies, says Ahmad Najib.

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The local stock market underperformed other bourses in the region over the last decade. Apex Investment Services Bhd CEO Clement Chew points out that as at Nov 29, the FBM KLCI had only generated a return of 20% in ringgit terms in the past 10 years.

He says it is a mere 1% in US dollar terms. The performance of the local bourse lagged behind its regional peers including the stock markets of Thailand, Indonesia and the Philippines.

The Stock Exchange of Thailand Index, Jakarta Stock Exchange Composite Index and Philippines Stock Exchange Index were up 117%, 137% and 154% respectively in local currency terms during the period. In US dollar terms, the three indices were up 139%, 58% and 130%.

Investors should not be surprised by the

FBM KLCI's 10-year performance versus regional peers and MSCI ACWI

FBM KLCI's underperformance. Corporate earnings, which are the main driver of performance in the local market, had been mostly negative from 2013 to 2018, with 2017 being the exception.

In the past six years, corporate earnings in Malaysia fell about 9% while those in Thailand went up 40%. Corporate earnings in Indonesia and the Philippines increased 20% during the period, says Chew. "Malaysian corporations have been experiencing an earnings drought in the past six years, which is unprecedented."

EquitiesTracker's Lim says the local market tends to be driven more by corporate earnings than re-ratings. The FBM KLCI tends to underperform when corporate earnings are bad, he points out. A back-out of the past 15 years would show that about 7 out of 10 times, the index performed well when corporate earnings were good, he adds.

A re-rating means investors have a different view of a specific market due to its prospects, good prospects mean its stocks and indices are being traded at higher price-earnings ratios (P/E), and vice versa.

"The FBM KLCI has been trading at a P/E of about 16 times in the past 10 years. The valuation has not changed much, says Chew.

"We have been stuck in the same trading band for a long time. The local market used to be traded at a 30% to 40% premium compared with Asia ex-Japan five years ago and beyond. Now, our premium is down to 60% to 15%. We have been de-rated instead," he adds.

On the other hand, other bourses have enjoyed an upward re-rating in the past three years. Ultimately, the question is whether the local market will become even less attractive to foreign investors going forward, says Chew.

"When I joined the financial industry in the 1990s, Malaysia took up almost 20% of the MSCI Emerging Markets Index. Today, we are less than 2%. You can see how things have changed," he points out.

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10%, not including dividends, says Chew. Of these stocks, 70 would have generated a return of 20% to 30% while 35 would have returned a return of more than 10%.

"Last year, there were 20 stocks that gave returns of more than 10%. There were 118 in 2017 and 60 in 2018," he adds.

Chew says there are always investment opportunities in the market, but investors would need to identify them. "The Malaysian market has been one for stock-pickers most of the time."

De Alwis concurs with Chew. When the local stock market started falling at end-2018, some small and mid-cap companies and exporters did perform well. These companies included glove manufacturers and semiconductor players that provided electronics manufacturing services and outsourced semiconductor assembly and test services.

"These semiconductor companies benefited from a weakening ringgit and were riding robust smartphones sales and supply chain upgrades. These resulted in a brisk expansion in their revenue and margins. These who invested in these companies would have received good returns between 2013 and 2018," he says.

### MARKET OUTLOOK

De Alwis says the outlook for next year is quite cloudy as the US economy's growth is set to slow further as the effects of fiscal stimulus and tax cuts that boosted the economy in recent years. China's economic growth is expected to lose more steam due to its heavy debt burden while the EU's low economic growth rate is expected to continue and become the norm.

The good news is that central banks are expected to cut interest rates further to support global growth. The US Federal Reserve has cut the key policy rate three times this year while the European Central Bank has promised to reintroduce its quantitative easing programme. The People's Bank of China is already loosening its monetary policy, says De Alwis.

"Hence, we see a fairly neutral environment next year. The upside is capped by slowing economic growth and a debt hangover while the downside is supported by enhanced liquidity provided by central banks," he adds.

EquitiesTracker's Lim says a US recession, which could lead to a global recession, is unlikely to happen in the current low interest rate environment. "If you look at all the major recessions that have happened since the 1930s – big and small ones – 70% of them were caused by the Fed hiking interest rates. It is now cutting rates."

In fact, Apex's Chew expects global growth to rebound next year on the back of the loose monetary policies of central banks. He says the Manufacturing Purchasing Manager Index globally has started to stabilise since the middle of the year while inventories around the globe have been run down. These inventories need to be rebuilt.

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Ahmad Nabil expects market performance to improve in 2020 due to a low base effect. Eastspring Investments Rhd investment services manager Ang Hin Yik shares that view. He says stock-picking remains essential for investors to generate their desired returns. They could keep an eye on defensive counters

## Global stock markets see positive performance

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Even recently, stock markets in various parts of the world fared relatively well, says Devan. As at Dec 5, the S&P 500 and Dow Jones Industrial Average shot up about 2.4% and 3% year-to-date respectively while the US economy is enjoying its

longest expansion in the country's history of more than 50 years. The International Monetary Fund (IMF) expects the US economy to grow at 2% this year.

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