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|---|---|---|
| DATE | : | 30 DEC 2017 |
| PUBLICATION | : | THE STAR |
| SECTION | : | BUSINESS |
| HEADLINE | : | LOCAL BOURSE TO PLAY CATCH-UP |
| CATEGORY | : | MENTION |
| MEASUREMENT | : | 356CM² |
| TONE | : | NEUTRAL |
| REMARKS | : | NIL |


# Local bourse to play catch-up

## Underperformance in 2017 gives room for the stock market to strengthen further

**Salient points**

- Valuation of Malaysia's equity market seems attractive
- FBM KLCI set to end higher next year
- Robust economy supports corporate earnings growth

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THE Malaysian equity market may have underperformed its global and regional peers in 2017. But looking at it from the bright side, this could well indicate room for the local stock market to play catch-up going into 2018.

After all, Malaysia still has pretty good fundamentals that could support and propel its benchmark stock index to a higher level next year. That seems to be the view shared by most brokerages.

According to several research houses polled by StarBizWeek, the laggard performance of the Malaysian equity market has resulted in attractive valuations vis-a-vis the regional markets. And with positive factors such as a still-undervalued ringgit and a robust economy supporting corporate earnings growth, they are of the view that the FTSE Bursa Malaysia KL Composite Index (FBM KLCI) is set to end on a stronger note in 2018.

Affin Hwang Capital Research, for one, says it remains positive on the FBM KLCI, as it sees further room for global equity markets to rally in 2018.

"The FBM KLCI, which has lagged behind its regional peers, should finally play catch up," the brokerage points out.

"Low foreign ownership in the equity market, a still undervalued ringgit, the return of corporate earnings growth and attractive valuations, form the basis for our views on stronger returns for the FBM KLCI in 2018.

"Improving consumer and business sentiment and a pre-election rally could also aid the performance of the FBM KLCI," the brokerage explains.

In a similarly optimistic tone, AllianceDBS Research argues that Malaysian equities remain attractive at present valuations.

"After underperforming regional markets in 2017, FBM KLCI is trading inexpensively near its mean price-earnings of 15.0 times.

"With earnings recovery gaining traction, preference for equity over fixed-income investment in rising interest rate environment and recovering foreign flow, we see better days ahead for Malaysian equities in 2018," the brokerage says.

AllianceDBS Research reckons that amid the synchronised global economic growth, the surprisingly strong Malaysian gross domectic product (GDP) growth has failed to re-rate the Malaysian equity market, as earnings delivery in 2017 has lagged expectations, while consumer sentiment remains downbeat.

"But this is expected to change going into 2018.

"An election-friendly Budget 2018, the lag effect of strong economic growth, strong external demand and recovering crude oil prices will be the impetus to drive a stronger FBM KLCI earnings growth and recovery in consumer sentiment ahead of the 14th general elections (GE14) which is expected to be held in the first quarter of 2018," it says.

According to AmBank Research, the impending GE14 is the main cause of FBM KLCI's lacklustre showing in 2017, noting that underperformance of a market ahead of a key election where the market resides is nothing new.

"We believe the major underperformance of the local equity market versus its regional and global peers during the final months of 2017, could rightfully be seen in a positive light – that the market was just doing its job by pricing in a higher market risk premium ahead of the GE14, which will have to be held by August 2018," the brokerage explains.

**2018 Outlook**

| Brokerages | FBM KLCI target (end-2018) | Overweight sectors |
|---|---|---|
| AmBank Research | 1,900 | Banks, building materials, construction, manufacturing, power, small & mid caps |
| Affin Hwang Capital | 1,854 | Banks, insurance, construction, gaming, rubber, utilities, oil & gas, small & mid caps |
| AllianceDSB Research | 1,870 | Banks, electronic manufacturing services, healthcare, oil & gas |
| TA Securities | 1,835 | Banks, gaming, telecommunications, transportations |
| CIMB Research | 1,880 | Construction, utilities, rubber gloves, oil & gas, and small caps |
| Maybank Investment Bank | 1,840 | Automotive, gaming, oil & gas, petrochemical, utilities |

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**2017 Stock Market Performance**

| Markets | Benchmark Index | Closing as at Dec 29 (points) | Year-to-date gain |
|---|---|---|---|
| Malaysia | FBM KLCI | 1,796.81 | 9.5% |
| Thailand | SET Index | 1,751.93 | 13.4% |
| Indonesia | Jakarta Stock Exchange Composite Index | 6,355.65 | 19.5% |
| Philippines | Philippine Stock Exchange Composite Index | 8,558.42 | 25.1% |
| Vietnam | Ho Chi Minh Stock Index | 984.24 | 48.0% |
| Singapore | FTSE Straits Times Index | 3,406.57 | 18.2% |
| Hong Kong | Hang Seng Index | 29,919.15 | 36.0% |
| South Korea | KOSPI Index | 2,467.49 | 21.8% |
| China | Shanghai Composite Index | 3,307.17 | 6.6% |
| Japan | Nikkei 225 | 22,764.94 | 19.1% |
| India | S&P BSE Sensex Index | 34,040.35 | 27.7% |

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Noting that additional market risk premium ahead of the GE14 has more or less been priced into the local equity market, AmBank Research says there remains plenty of positive factors to propel the market higher in 2018.

"In our opinion, investors should not overlook a slew of positive factors that should drive the local equity market higher.

"These include a mild and gradual rate hike cycle in developed economies; a strengthening ringgit backed by firming crude oil prices and Bank Negara's stance, which has turned a little more hawkish; and a robust Malaysian economy," it says, adding that it expects the country's GDP to expand 5.5% in 2018, compared with 5.9% in 2017.

AmBank Research also expects the cyclical upturn in corporate earnings to help bring down FBM KLCI's valuations, thus making the market more palatable to investors.

### Choppy waters

The FBM KLCI ended the year yesterday at 1,796.81, up 17.71 points, or 1%. The pick-up was driven by last-minute buying on window-dressing activities.

Year-to-date, the FBM KLCI gained 9.45%.

Despite the positive outlook for 2018, TA Securities and CIMB Research seem to have a more cautious view.

TA Securities expects macro uncertainties to limit upside, while CIMB Research says 2018 will be a more volatile and challenging year, compared to 2017.

Where the two brokerages differ is, TA Securities projects a strong FBM KLCI performance in the first half of 2018, before losing momentum in the second half, while CIMB Research expects the market to be choppy in the first half of the year, before rising further in the second half.

"2018 is expected to be a mixed bag, with the impending GE14 driving up the FBM KLCI in the first half ... on the local front, the resilient economy, corporate earnings recovery, crude oil price stability and FBM KLCI's undemanding valuation vis-à-vis regional peers are valid drivers for the equity market. A BN victory would be another plus factor to hold up market sentiment momentarily on continuity in policy matters," TA Research says.

"Any rally could fizzle out in the second half of 2018 without the active participation of foreigners as continued monetary tightening in the US and the beginning of similar measures in Europe will squeeze out liquidity in emerging markets. Geopolitical shock represent a clear and present danger for financial markets," it adds.

CIMB Research, on the other hand, expects local and foreign direct investments to improve in the second half of 2018, post-GE14, after pricing in key market challenges in the first half of the year.

"The key challenges include slower GDP growth in 2018, potential cost pressures for Malaysian businesses, impact from disruptive technologies and potential earnings risks for banks and utilities due to changes in accounting standards (MFRS9 for banks) and regulations (for utilities)," the brokerage says.

"Factors that could boost market prospects in the second half of 2018 stem from a potential relief rally and increased foreign funds inflow into Malaysia post-GE14; better corporate earnings; a slew of construction job awards and potential Chinese investments; and IPO activities picking up pace post-GE14," it adds.

As it stands, global fund managers such as BlackRock Inc, T. Rowe Price Group Inc and OppenheimerFunds Inc have already indicated their intention to invest in emerging markets in 2018.

It remains to be seen, though, how much Malaysia's equity market (as well as its bond market) can benefit from the sustained interest of these major global fund managers in emerging markets.

### Where to put money?

Among the top sector picks by local brokerages, banks, utilities, oil & gas, construction and gaming seem to be the more popular choices.

Another category that warrants attention is small and mid-cap stocks, thanks to the Government's mandate to government-linked investment funds to invest in this category.

According to analysts, banks are expected to see a cyclical upturn in earnings backed by stronger loan growth, steadier margins, increased fee income, and healthy asset quality. They expect limited impact from the new accounting rule of MFRS9, as most banks are well-capitalised and have sufficient liquidity.

The utilities or power sector is favoured for its defensive earnings and potential benefits from a stronger ringgit, while the oil & gas sector seems to be headed for a rebound, with investment activities expected to pick up pace, as crude oil prices continue to strengthen, and potentially some mergers & acquisitions could materialise.

As for the construction sector, continued infrastructure spending by the Government, as well as projects related to the Belt and Road initiative, are expected keep the sectorial outlook favourable, while the gaming sector, specifically, casinos, is expected to benefit from the return of Chinese VIP volume as well as positive news flow.

Top stock picks by brokerages, however, may not necessarily originate from their respective overweight sectors.

For CIMB Research, its top big-cap picks are Tenaga Nasional Bhd (TNB) for utilities exposure, Dialog Group Bhd for its robust earnings growth, and Axiata Group Bhd on expectations of an earnings rebound in 2018 and 2019.

The brokerage's top small caps are CCK Consolidated Holdings Bhd on its plan to improve its margin by moving into a more profitable product mix as well as a beneficiary of the stronger ringgit, Berjaya Food Bhd (BFood) on its plans to dispose its loss-making overseas entities as well as benefitting from a stronger ringgit, and Bonia Corp Bhd on earnings recovery from closure of loss-making boutiques.

Affin Hwang Capital's preferred large cap picks are Malayan Banking Bhd (Maybank), Hong Leong Bank Bhd and TNB. The brokerage also favours Inari Amertron Bhd, Globetronics Technology Bhd, Top Glove Corp Bhd, Serba Dinamik Holdings Bhd, Apex Equity Holdings Bhd, HSS Engineers Bhd, Jaya Tiasa Holdings Bhd, Scicom MSC Bhd and UMW Oil & Gas Corp Bhd (UMWOG).

Maybank Investment Bank Research's (MaybankIB) list comprises a mix of value with growth, with its top buys for 2018 being Petronas Chemicals Group Bhd, Genting Bhd, IOI Corp Bhd, Hong Leong Financial Group Bhd, Gamuda Bhd, Yinson Holdings Bhd, Cahya Mata Sarawak Bhd, Bermaz Auto Bhd (BAuto), and YTL REIT.

"Our equity strategy for Malaysia in 2018 is still a defensive portfolio as core holdings," MaybankIB says.

The brokerage remains cautious for 2018, as it is mindful that amid the positive global macros and momentum, there are still pockets of risks – financial imbalances and instability and geopolitics – that could affect market performance.