Market Review and Outlook 2016

By Danny Wong

Closing this year, ongoing to 2016

The future is hardly predictable. At this time last year, who would have anticipated the 2015 that we had?

This year saw a range of tumultuous financial events, both local and international, ranging from the depreciation in the ringgit to China's stock market crash and the continuing plunge in crude oil prices.

The MSCI Asia Ex-Japan Index (MXASJ) down 11.30% for the year 2015. Among regional bourses, China and Japan were the leading performers rose more than 9.0% while Singapore, Thailand and Jakarta were the laggards that lost 12%-14%. The FBM KLCI outperformed most regional SEA bourses, down 69 points or 3.90% to close at 1,693.

As we cannot anticipate such black swans – unpredictable events that leave major impacts – the only thing we can do is keep our investments in check and balance and educate ourselves on what to expect the following year.

Although pessimists would easily call 2015 a bear year for Malaysia, economic conditions in 2016 might not necessarily deteriorate. The shocking outcome of the Organization of the Petroleum Exporting Countries (OPEC) meeting earlier this month, which resulted in the production ceiling for oil being lifted, had analysts and research houses forecasting crude oil prices falling below USD30 a barrel. With oil prices seen remaining at current seven-year lows for the first half of 2016, the Malaysian Ringgit is expected to remain at current levels. The Ringgit has been trading in range of 4.20 against the US Dollar for the past two months after falling from between 3.40 to 3.70 per dollar in the first half of 2015. The central bank should also maintain interest rates at current levels, which have been holding steady at 3.25 since July 2015.

As such, the weaker Ringgit is seen keeping consumer sentiment damp this year, but the silver lining is that this bodes well for exporters, as shipments are now cheaper for buyers holding foreign currencies. Therefore, our stock picks for this year remain focused on exporting oriented companies, such as those in the semiconductor, IT and construction industries.

Additionally, as state-owned investing company ValueCap Sdn Bhd will come into full operations this year, it may be on the lookout for undervalued large caps. Local media report that the investment holding company will focus on companies with good dividend returns and are defensive in nature from six sectors: banking, consumer industries, plantations, property, construction and services.

Moving onto the second half of this year, corporate earnings are seen recovering due to a low base effect. As company performances last year deteriorated across the board, the benchmarks of revenue and net profit have a low threshold to cross to make it to positive territory.

Additionally, crude oil prices and currencies which have taken a beating last year are expected to recover slightly. Reports have cited Credit Suisse analysts saying that most emerging market currencies have already priced in the impact of the US Federal Reserve rate hike, and are expected to hold or strengthen throughout 2016.

2015 has also seen analysts calling out US stocks as being overvalued. The US stock market has tripled in value since its all-time low in 2009, and it is predicted to remain overvalued in 2016. Hence, further outflows from the US can be expected this year. Big caps are expected to perform, such as stocks in the banking, telecommunications, infrastructure construction and consumer related sectors. Deep undervalued property stocks are also seen gaining in the next 12 months.

Overall, the upcoming year should fare better than what we saw this past 2015. We are unlikely to have foreign outflows at levels seen in the last two years. As most of the negative events of last year have already been priced into this year's forecasts, we can expect to see a better year ahead, fingers crossed!

Fixed Income

Market Review & Outlook

2nd Half 2015 in Quick Review.

The second half of 2015 was characterised by a few key events in the financial world. From the largest economy in the world, we waited with bated breath what seemed like eternity for the first United State (US) rate hike in more than nine years (after seven years of zero interest rates policy) in mid December 2015, signalling a battered economy recovered. Leading the world in an ultra easy rates policy regime with three Quantitative Easing (QE) Programs, the US 'printed money' its way out of economic doldrums. Unemployment halved from 10% to 5% while housing statistics, consumption and Gross Domestic Product (GDP) recovered. Some light at the end of the tunnel but not out of the woods. Which brings us to, not in any particular order, the second significant event; the slowing growth of China.

China's growth story has been nothing short of spectacular. Ten years ago, China's GDP was barely 20% the size of the US GDP. At the end of 2014, it recorded a size 60% that of the US. However, they became victims of their own success building global expectations of their enormity and insatiable appetite for everything from raw materials to high end technological gadgets. An expanding base was part to blame for the rapid decline in annual GDP growth rate. Less than four years ago, double digits growth data was a norm. Q3 and Q4 2015 registered 6.9% and 6.8% GDP growth respectively. The only other times it dipped blow 7% in the last thirty years were during the Asian Financial Crisis and at the start of the sub-prime crisis.

Another contributing factor to the state of economic affairs stem from falling commodity prices, most so, oil prices, the third critical event of the year. China's rush to modernise the nation began in the 80's. This first phase is now at its tailend and is evolving to one that is consumption based. Absorbing global supply of raw materials waned coinciding with falling commodity prices. Declining China growth is also blamed for plunging oil prices this half year. Beginning 18 months ago, Brent crude oil slid from over USD100 per barrel to close 2015 below USD40. Other factors are the strong USD (3.20 mid 2014 against MYR vs 4.30 at end of 2015), increased supply (from unyielding Organization of the Petroleum Exporting Countries (OPEC) oversupply and impending oil from Iran following lifting of economic sanctions) and marked increase in US oil reserves. Many industries and economies were inflicted by this fall. Malaysia was one of them.

Apart from these external headwinds, Malaysia continue to be embroiled in political instability and embarrasing financial scandals. International rating agencies were on our backs, as our oil revenue dependant budget raised doubt on our ability to retain fiscal discipline. As foreign funds exited our system, MYR weakened from 3.80 to test Asian Financial crisis levels circa 4.45 to USD. It closed the year at 4.30. Local funds and individuals followed suit placing strains on liquidity in banking system. KLIBOR (KL Interbank Offered Rates) and Interest Rates Swap (IRS) creeped up urging a reaction from Bank Negara Malaysia (BNM). Banks desire to comply with Basel III requirements did not help by raising deposit rates to shore up high quality liquid assets.

2016 Outlook

Global connectivity is not just about technology and telecommunication but the intertwined interdependance amongst economies. With the US economy operating at practically full employment, the other Federal Reseve objective of attaining 2% inflation rate remains elusive. Urgings of higher Federal Reserve Fund rates in 2016 can and will be tempered by the slow growth of the rest of the world in particular the other major economies like the Eurozone, Japan and China. Japan and the European Union (EU) appear to be in the later half of downturn cycle after implementations of over two years 'Abenomics' and 'Draghi' inspired QE since early 2015. China cut official rates five times to 4.35% in 2015 and reduced reserve ratio four times to 17.5%. With still ample space to cut rates, China is only mid cycle and have more to go. In addition to the possibility of further enforced devaluation in months to come, competitive devaluation and the ensuing domino effects may be anything but a stabilizing factor.

Oil price will continue to be an important influence this year. The drop in price has already rendered shale oil production unsustainable. However, the quantity from this source is small relative to the onslaught supply of Iran's oil reserves as well as US fourty year high reserves. Hence downward pressure of oil price remains elevated with target range of USD25-35 per barrel. To most, declining oil price is good news as it reduces operating cost of many businesses.

In Malaysia, BNM remains wedged between maintaining a healthy positive interest rates differential between MYR / USD assets and needing to stimulate our economy by lowering cost of borrowing. Statutory Reserve, at 4% at end 2015 is an option for BNM to reduce cost while keeping positive carry of MYR assets.

To the masses, the impact of Good and Services Tax (GST) (implemented in April 2015) is telling with reduced disposable income. A year ago, rising oil prices raised inflation. Many had hoped that the fall in oil price this year would translate to lower pump prices and in turn lower cost of business and compensate for GST inflated prices.

For the interested, I have attached the following table that tracks the price of RON 95 at the pump against cost of Brent crude oil in MYR terms. Although the government announced that they use the MOPS (Mean of Platts system) to calculate, I have used simple average cost for the month assuming that they should not differ too much. Assuming that a barrel is roughly equivalent to 159 litres, it is not too difficult to arrive at the conclusion that we are paying more than we should.

Brent Crude Oil (USD)	Month	USD/ MYR	Brent Crude Oil (MYR)	Av Cost RON95 per litre	At the pump nex mth	Multi-plier	Margin (RM)
79.85	Nov'14	3.3441	267.03	1.68	2.26	1.3457	0.581
63.36	Dec'14	3.4803	220.51	1.39	1.91	1.3772	0.523
51.24	Jan'15	3.5835	183.60	1.15	1.70	1.4722	0.545
59.32	Feb'15	3.5926	213.10	1.34	1.95	1.4549	0.610
57.10	Mar'15	3.6809	210.17	1.32	1.95	1.4753	0.628
61.77	Apr'15	3.6356	224.57	1.41	1.95	1.3807	0.538
65.92	May'15	3.6036	237.55	1.49	2.05	1.3721	0.556
64.15	Jun'15	3.7391	239.87	1.51	2.15	1.4251	0.641
57.12	Jul'15	3.8011	217.12	1.37	2.05	1.5012	0.684
48.33	Aug'15	4.0497	195.71	1.23	1.95	1.5843	0.719
48.58	Sep'15	4.3087	209.32	1.32	2.05	1.5572	0.734
49.29	Oct'15	4.2681	210.38	1.32	2.05	1.5493	0.727
45.93	Nov'15	4.3086	197.91	1.24	1.95	1.5667	0.705
38.85	Dec'15	4.2811	166.34	1.05	1.85	1.7684	0.804