BY DANNY WONG

FBM KLCI – TURNING OF THE TIDE?

(dated 5 Jan 2017)

2016 ultimately turned out to be another challenging year. Any meaningful market recovery failed to gain traction. Black swan events like Brexit and the Donald Trump election win proved to be more than mere speed bumps along the way. However, we opine that the Donald Trump administration's policy may not be as extensive as the market has feared.

The FBM KLCI is now on track for a third straight annual loss. For the year 2014, 2015 and 2016, the local index has declined -5.66%, -3.90% and -3.00% respectively; or a cumulative loss of 12.06% since year 2014. (Closing for 2013: 1,866.96; 2014: 1,761.25; 2015: 1,692.51; 2016:1641.73)

From a valuation standpoint, Malaysia currently stands at circa 1.60x Price to Book, below its mean of 1.80x and hovering fairly close to the 2008' Financial Crisis levels at 1.47x. FBM KLCI's dividend yields stood at circa 3.20%, among the highest in the region. **We think that the domestic market has priced in a lot of negative events; the downside should be rather limited.** There is always sunshine after the rain. There are a few factors that support the case for a turnaround.

Corporate earnings are in their 3rd year of consecutive decline. In the last two quarters, we have seen signs of earnings having bottomed out. As predicted, **consumer sentiment** as measured by MIER has also bounced off its lows.

IPOs have traditionally generated a great deal of excitement. The RM1 billion garnered in 2016 represents less than a quarter of the usual amount raised in the preceding years of 2014 and year 2015. We think that year 2017 will be a turnaround year for new issuances. **Potential de-merging of big conglomerates** will lead the way.

Cashed up local funds are primed to deploy their cash ie: local investment funds, Valuecap and the newly established RM3 billion funds by GLICs for small and mid-cap companies.

Election play theme – the current government's term ends in June 2018 and there are heightened expectations that the 14th General Election will take place in 2017. Potential election spending may benefit certain stocks.

RINGGIT MALAYSIA – WHAT'S NEXT?

Persistent capital outflows over the past three years have taken its toll on the Ringgit. Although the USD is expected to retain its strength over the medium term, we reiterate our stance that the RM remains undervalued and oversold in current conditions. Mark Twain's quote - ***Reports of my death have been greatly exaggerated***, seems apt. The Ringgit will likely to remain volatile, but we identify some key catalysts that could support the local unit:

1) Ringgit / Oil relationship - The ringgit has decoupled from oil and if it starts moving in tandem with crude again it should be poised for a sharp recovery. **Refer to Chart 1**.
2) China's investment – Prime Minister Datuk Seri Najib Razak's visit to China resulted in projects close to RM143 billion being signed. The RM55 billion East Coast Rail Line (ECRL) set to be built and financed by China is expected to start next year.
3) Bank Negara Malaysia's (BNM) new forex measures – Analysts estimated that there could be around RM90 billion held by local exporters in foreign currencies. Conversion of such funds will bolster our foreign reserves. (BNM international reserves stand at RM405.5 billion).
4) Repatriation of overseas assets by government funds/corporate.

STRATEGY

Continuous outflows from Bursa since year 2014 meant that cumulative foreign inflows into our Equity market since year 2010 has whittled down to RM4.7 billion. Nevertheless, in the same period, foreign holdings in our sovereign debt Malaysia Government Securities (MGS) continued to rise. These are funds which are more long-term in nature. **Refer to Chart 2**. From a global fund's perspective, Malaysian assets are deemed attractive. Hypothetically, if a foreign fund were to hold a 10year MGS at a 4.33% yield for a one year period and hinging on a rebound in the RM, it could potentially be sitting on a handsome profit. A circa 10% gain by our estimates.

Indicators are pointing towards a better 2017 and long term investors will accumulate in advance. Retaining a cautiously optimistic stance for the new year, we will maintain an overweight into big caps and high dividend yielders. We see even more value emerging after the Donald Trump selloff. We are positioning ourselves for a market rebound.

Chart 1: Ringgit and Oil Relationship - RM poised for recovery?

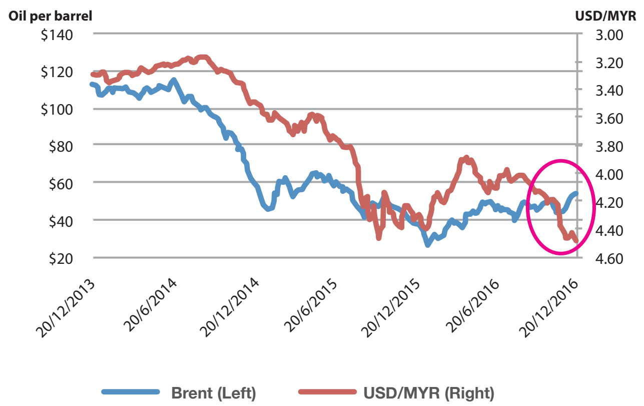
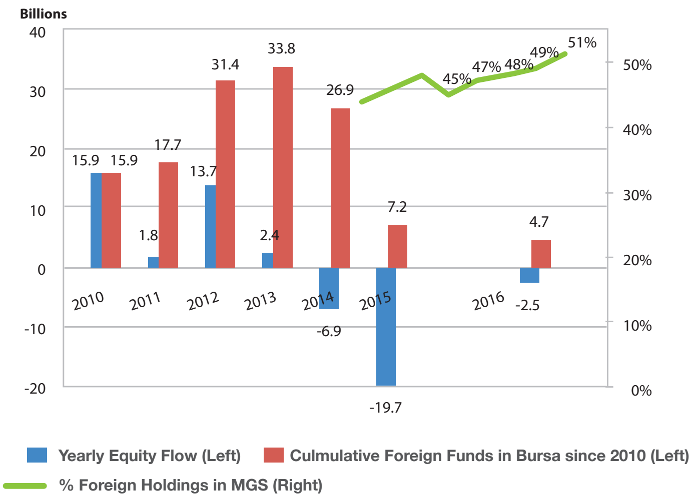


Chart 2: Foreign Flows into Bursa and Foreign Holdings In Malaysian Government Securities (MGS)



Source: Maybank KE, Bank Negara

THE LAST SIX MONTHS...

BY EDWARD ISKANDAR TOH

In the aftermath of the surprise decision to leave the European Union (EU), Theresa May became only the second female Prime Minister of the United Kingdom (UK) succeeding David Cameron who resigned as promised. She is to lead the UK in the process of 'Brexit' which some estimate to take more than two years. Inevitably, rating agencies downgraded the UK and the GBPound plunged from 1.50's to 1.20s against USD. Against the MYR, it fell from 6 to near 5 before recovering to 5.50s. To mitigate the 'Brexit' impact, the UK cut benchmark rates to a historic low of 0.25%, broaden bond buying program to include corporate bonds and deepen the size of Quantitave Easing (QE) to 435 billion Pound from 60 billion Pound. Meantime, the European Central Bank (ECB) kept rates unchanged throughout the year while extending their QE program to beyond March 2017 albeit reduced size of 60 billion Euro from 80 billion Euro monthly. Japan followed with introduction of additional fiscal budget and adjusted their monetary policy to 'yield curve' focused.

China on the other hand stayed relatively quiet compared to the start of the year with their economy recording a full year growth of 6.70%, lowest since 1990 but within their government's and market expectation.

The Organization of the Petroleum Exporting Countries (OPEC) finally agreed to cut production late November in an effort to drain global glut helping to prop oil price up. Non-OPEC members were also coaxed to comply.

Then came the United State (US) elections results that perplexed most predictions and put the world on a tentative pause. With many of his campaign sound bites controversial and provocative to the world at large, US President Donald Trump's presidency promises to be anything but conventional.

In Malaysia, the Overnight Policy Rate (OPR) was surprisingly cut by 25 basis points (bps) to 3.00% in what seemed to be a pre-emptive move in July. The National Budget announced in October had fiscal discipline but little goodies to the 'man on the street'. It did little to pacify the MYR doubters as anticipated declining interest rates differential added to the negative effect of the reduction of the Morgan Stanley Capital International (MSCI) Emerging Market Index weight for Malaysia from 3.25% to 2.92% in early June. Donald Trump's victory further reinforced the notion that fiscal expasion stimulus will be introduced, hence a quicker than expected firming of US interest rates which led to a swift reversal of 'carry trades' transactions exarcebating MYR performance which was already battered due to the ignominy that surrounds 1Malaysia Development Berhad (1MDB). MYR slid 12% to just below 4.50 from 4.00 against USD, 8% against AUD$ from 3.00 to 3.25 and 3% against SGD$ from 3.00 to 3.09 in the second half of 2016 alone. Compounding this was the selldown of Malaysian bonds by foreign investor totalling MYR24 billion in the last two months of 2016, reversing all that we gained in the year with a MYR1 billion net negative at the year close. As a result Malaysia Goverment Securities (MGS) yields rose almost 1 percent before recovering to a net rise of 50 bps against half a year ago while corporate bonds rose about 50bps before ending the year with a net 20bps higher. Reserves remained healthy at MYR424.2 billion or USD94.6 billion sufficient to finance 8.8 months of retained imports and is 1.3 times the short term external debt. Some of it was used to smoothen and floor the sudden withrawal of MYR at critical points.

WHAT'S NEXT...

Which brings us to, "what is next?" I am one to usually see things 'half glass full'. Despite the negativity that was last year; the KLCI ended in negative territory, the MYR weakened against most majors and many of our neighbours and the bond market saw a net outflow for the year, we pulled through the year fairly unscathed. Our fixed income portfolios returned a decent positive that outperformed benchmarks and deposit rates.

As for interest rates outlook, there are factors that may hint of some upward pressure but there are equal number of mitigating factors that may weigh on the possibility of even a rate cut.

Factors to be considered :

Supply pressure:

	2017	2016	2015
Budget Deficit	3.0%	3.1%	3.2%
Net Required (RM'bil)	40.3	38.7	37.2
Maturities	66.8	47.3	55.3
Gross Issuance	107.1b	86.0b	92.5b

Table 1
Despite a lower budget deficit percentage announced, a larger size of MGS issuances will be required because of the sizeable maturities in 2017.

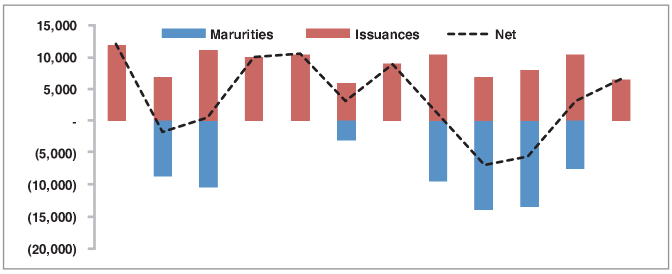


Table 2
The second diagram shows the projected issuance layed over scheduled maturities. Some may envisage rate hike pressure when there is a net issuance for the month namely April to July and November and December.

Conventionally, larger supply will pressure rates to rise. However, in this case, Bank Negara Malaysia (BNM) may want to keep borrowing cost low. Rate hike pressure may be negated by BNM's macro view of limiting overall cost. A rate cut during net issuing months may do the job.

Interest Rates Differential
The market is optimistic that Donald Trump will likely push through fiscal expansion with tax cuts and infrastructure rebuilding. This is seen as inflationary and Gross Domestic Product (GDP) boosting. Thus the hawkish view of at least two US rate hikes in 2017. This will narrow the positive interest differential that Malaysia has over the US and some worry will trigger further outfow and weaken our currency. History has proven that there is little corelation between currency strength and interest rates differential.

Low Domestic inflation
Rising petrol prices will be a contributing factor. However, fuel constitute less than a quarter of the inflation basket. Inflation is expected to remain muted circa 2.50% for 2017 though higher than 2016's 2.10%. This grants BNM room to cut if need be.

Elections
The 14th General Elections has to be carried out by June 2018. Throughout 2017, there will be speculation of early elections. A buoyant stock market and happy populace is preferred.

Weaker disposable income
As cost of living rise, disposable income is squeezed affecting the mid to lower income most. Coupled with the likelihood of elections, the authorities may be tempted to reduce borrowing cost, hence putting more money into the pockets of the people and smiles on their faces.

Foregn ownership
With a net outflow in 2016 and MYR at its weakest ever since the '98 Asian Financial Crisis, foreigners may see the attractiveness again.

In closing, there is a slight pick up in global GDP led by the gradual recovery of the US economy. There is also evidential uptick in inflation as commodities are seen to have bottomed out with Brent crude oil price stabilised in a USD41-USD57 range. There are many questions and uncertainties. Many emanate from what policies the new US President may practise. From fiscal to monetary, trade to environment, social to education, they will all have widespread global impact.

Should we now always expect the unexpected as proven in 2016? Is the trend of predictability and polls something to be dismissed entirely. Other significant events that are scheduled to occur in 2017 include elections in several EU nations namely France, Netherlands and Germany and National Congress in China (where the leaders of the Central Committee are elected). Closer to home, the possibility of Malaysia's 14th General Elections could materialise as the deadline of June 24th 2018 (two months prior to the end of a five year term) draws near. The uncertainties mentioned may just encourage the need for a sustained, stable and low interest rates environment hence favourable to our bond portfolios.