MARKET COMMENTARY

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As Asian equity markets are likely to remain volatile, we remain cautious, and patiently look for opportunities to accumulate quality stocks into periods of market weakness.

Nonetheless, there have been some fundamental changes, the US Dollar outlook and clarity on Malaysia's fiscal concerns, which we feel necessitate a change in investment positioning.

CARTOON BY: HEDGEYE

OUR HOUSE VIEW

Caution Remains, But Positive News Flow At The Margin

- Equity markets are rebounding from deeply oversold levels. High hopes are pinned on Central Bankers' support measures. Equally, there is still much caution, a question mark on the ineffectiveness of current reflation and future policies. Market volatility is likely to persist.
- China's painful economic transition will continue to throw out mixed data-points. However, the greatest concern over China has been its currency; fear that escalating capital flight will bring about the next global crisis. One data-point does not confirm a trend but February's foreign reserves was the slowest rate of decline and much better than expectations. Let March's foreign reserves confirm the direction.
- We cannot help but reiterate a point brought up in last month's newsletter because the thesis remains valid this month. A potentially weak US Dollar will give Asian Central Banks more room and confidence to ease monetary policy more aggressively. This, combined with a reflating China, is a potent recipe for emerging market outperformance.
- The current market volatility of various asset classes had forced most investors to look for higher returns and many are turning to Asia as a viable destination. We have seen around RM1.7 billion in net foreign participation in March in the local equities market as compared to the net outflow in the previous year. In tandem with this, the Malaysian Ringgit had improved to RM4.09 at one point in time and currently hovering around the RM4.10 level.

PERFORMANCE OF KEY INDICES

FIGURE 1

	AS AT 29.02.16	1 MTH (% change)	YTD 2016 (% change)	PER 2016
D. JONES	16,516.5	0.3	-6.2	15.7
NASDAQ	4,558	-1.2	-10.0	29.1
DAX	9,495.4	-3.1	-11.6	21.4
KLCI	1,654.8	-0.8	-2.3	17.8
USD / MYR	4.20	1.3	-2.1	-

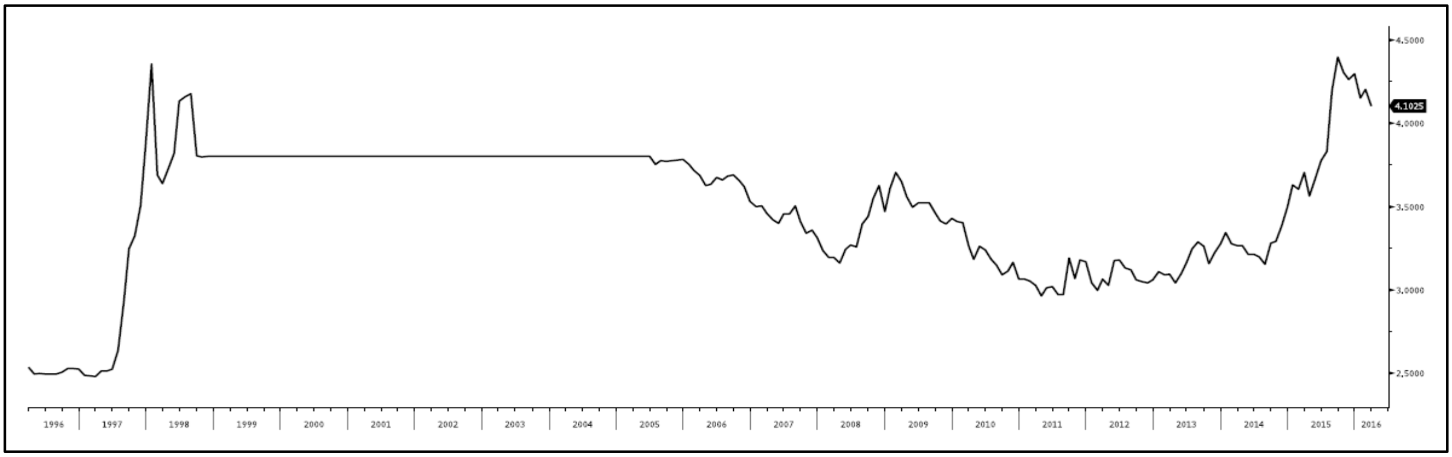
SOURCE: BLOOMBERG (AS AT 29/02/2016)

CUSP OF A SHIFT IN PORTFOLIO POSITIONING FOR MALAYSIA

Time For A Stronger Ringgit

Asian equity markets may still be enduring from the lingering effects of a massive sell-off since the beginning of 2016. Interestingly, while regional currencies have emerged relatively unscathed, the Malaysian Ringgit also happens to be the second best performing Asian currency, after the Indonesian Rupiah.

FIGURE 2: USD/MYR CURRENCY (1996 – 2016)



SOURCE: BLOOMBERG (AS AT 14/03/2016)

This Change In Sentiment Is Fundamental

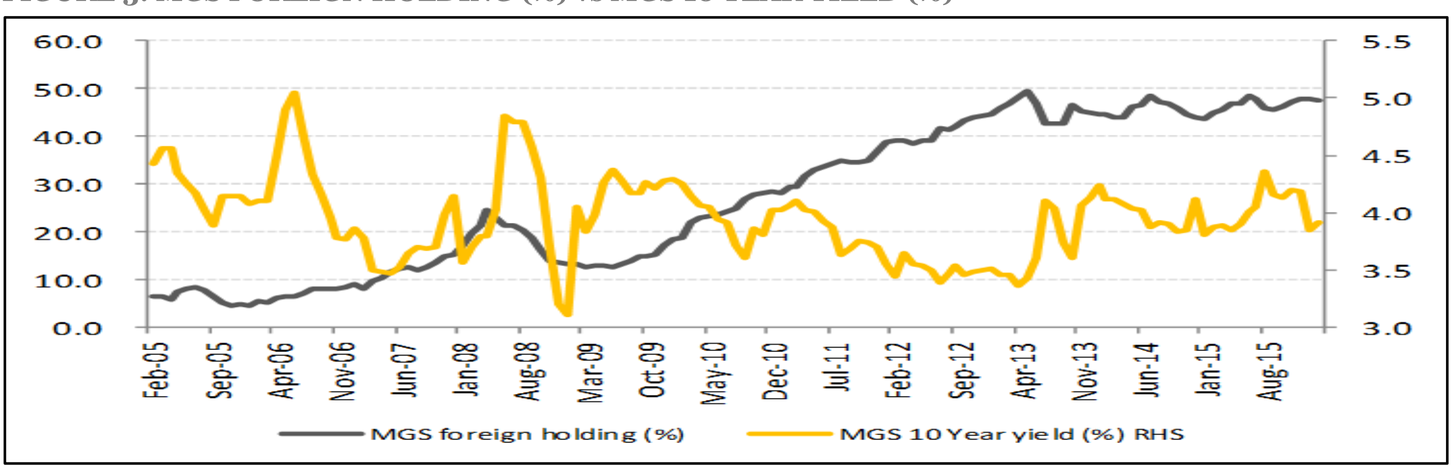
Sentiment is partly driven by the expectations of a pause in the normalization of US interest rates and therefore potentially a structurally weaker US Dollar.

However, it is equally important that some domestic macro indicators have turned for the better. Malaysia's 4Q15 GDP growth was a slower +4.5% yoy but private consumption rebounded resiliently. Malaysia's current account surplus also widened. A recalibrated Budget with a more realistic fiscal deficit in alignment with the falling crude oil price leaves potential upside on the table if there is to be a rebound in crude oil price.

The Bond Market Agrees

Since the beginning of the year, the 10-year Malaysia Government Securities (MGS) yield has compressed back below 4%. Funds are returning to Malaysia as evidenced by the pickup in foreign ownership level of MGS.

FIGURE 3: MGS FOREIGN HOLDING (%) vs MGS 10 YEAR YIELD (%)



SOURCE: MAYBANK KE SECURITIES PTE LTD

US Dollar Beneficiaries Vulnerable

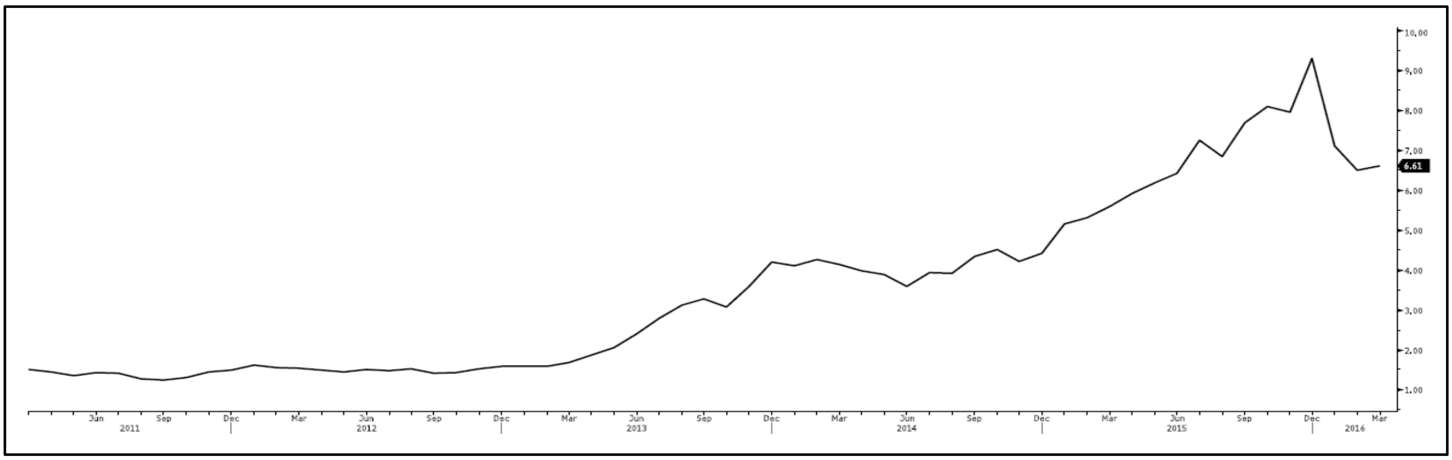
An over held trade among investors is the beneficiaries of a strong US Dollar. This would largely be the export oriented sectors such as rubber gloves companies and technology companies that sell their products in US Dollar and benefit from the translational gains into the Malaysian Ringgit, as reported in the earnings.

Operationally, there will be those companies that are competitive in their respective fields through continuous improvements in operational efficiency. These companies will continue to do well without the benefit of the currency.

However, there will also be those companies that are simply riding on the coattails of the currency from which they might never ever be profitable in their own right. As Warren Buffett famously said, "it is only when the tide goes out that you learn who has been swimming naked".

Nonetheless, lofty expectations and valuations leave no room for error. As over owned stocks, both good and poor quality companies are vulnerable to any sell-off when the view of a stronger US Dollar changes. There will be opportunities to buy back into quality exporters once the selling is exhausted.

FIGURE 4: KOSSAN RUBBER INDUSTRIES BERHAD (2011 – 2016)



SOURCE: BLOOMBERG (AS AT 14/03/2016)

Consumer Companies Are The Winners

Conversely, the beneficiaries of a strong Malaysian Ringgit weak US Dollar are the consumer companies. These companies also benefit from the positively revised Budget (Please refer to our previous Market Commentary: Issue 7 - February, 2016).

SELECTED HOLDINGS

FIGURE 5

STOCKS	BLOOMBERG TICKER	PRICE (RM)	PER 2016	EPS ($) 2016	GROWTH (%) 2016	P/BVPS 2016	DY (%) 2016
QL RESOURCES BHD	QLG MK EQUITY	4.26	24.62	0.17	13.07	3.35	1.00
SPRITZER BHD	SPZ MK EQUITY	2.38	11.90	0.20	20.48	1.43	2.10

SOURCE: BLOOMBERG CONSENSUS DATA (AS AT 15/03/2016)

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