MARKET COMMENTARY

September, 2016 / Issue 14

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The Malaysian economy may still have its difficult moments. Nonetheless, the Malaysian equity market and the Malaysian Ringgit have turned out to be more resilient than expected.

There remains scope for monetary easing. There also remains opportunities for selected sectors and stocks to outperform the broad equity market.

CARTOON BY: HEDGEYE

OUR HOUSE VIEW

Asia's Destiny In Her Own Hands (Part 2)

- Asian equity markets may have just registered two consecutive months of positive gains but we believe that we are at the cusp of a secular uptrend for Asian equity markets. This time round, the sustainability is well backed by domestic improvements; most importantly a stabilizing China economy but also supported by recoveries across most parts of Asia.
- There is a shorter-term fixation mentality in the volatility of the monthly US economic data-points. However, it is fair to conclude that the US economy is on a clear path of improvement, even if the pace of the recovery is less quick than expected. In fact, this 'Goldilocks' scenario is positive for Asia as the US economy remains a barometer of global economic stability and a source of demand for Asian exports. It also means that the US interest rate normalization cycle should be flatter and further extended in duration than originally anticipated. Noises that lead to any profit-taking bouts should be seen as buying opportunities.
- The local equity market is expected to remain volatile in the short to medium term in a tight trading range while awaiting fresh catalysts. Given persistent subdued consumer sentiment and depressed crude oil prices, we do not expect any uplift in corporate earnings in the near term.

PERFORMANCE OF KEY INDICES

FIGURE 1

	AS AT 31.08.16	1 MTH (% change)	YTD 2016 (% change)	PER 2016
D. JONES	18,454.3	0.1	4.8	17.8
NASDAQ	5,223.0	1.2	3.1	41.0
DAX	10,657.6	3.1	-0.8	24.1
KLCI	1,678.1	1.5	-0.9	18.3
USD / MYR	4.05	-0.3	-5.6	-

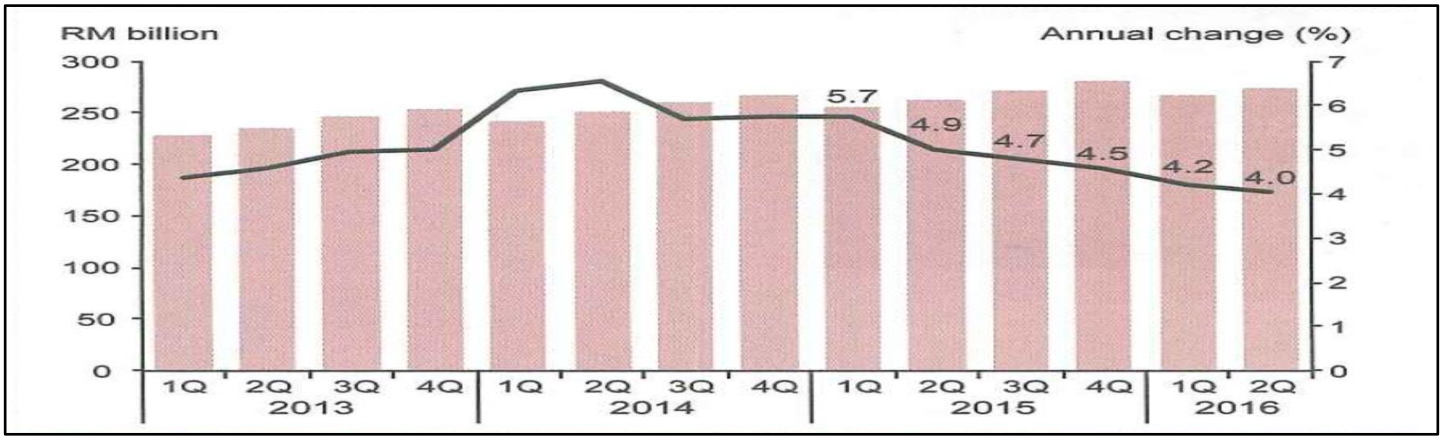
SOURCE: BLOOMBERG (AS AT 31/08/2016)

DARK BEFORE DAWN BUT THERE ARE OPPORTUNITIES

As Bad As It Gets? And Largely Anticipated

In our Market Commentary August 2016 Issue 13, we flagged a possibly weaker 2Q2016 GDP growth number for Malaysia. Indeed, Malaysia's economic growth for the second quarter of 2016 slowed to +4% yoy, from +4.2% yoy in the first quarter of 2016.

FIGURE 2: MALAYSIA'S GDP

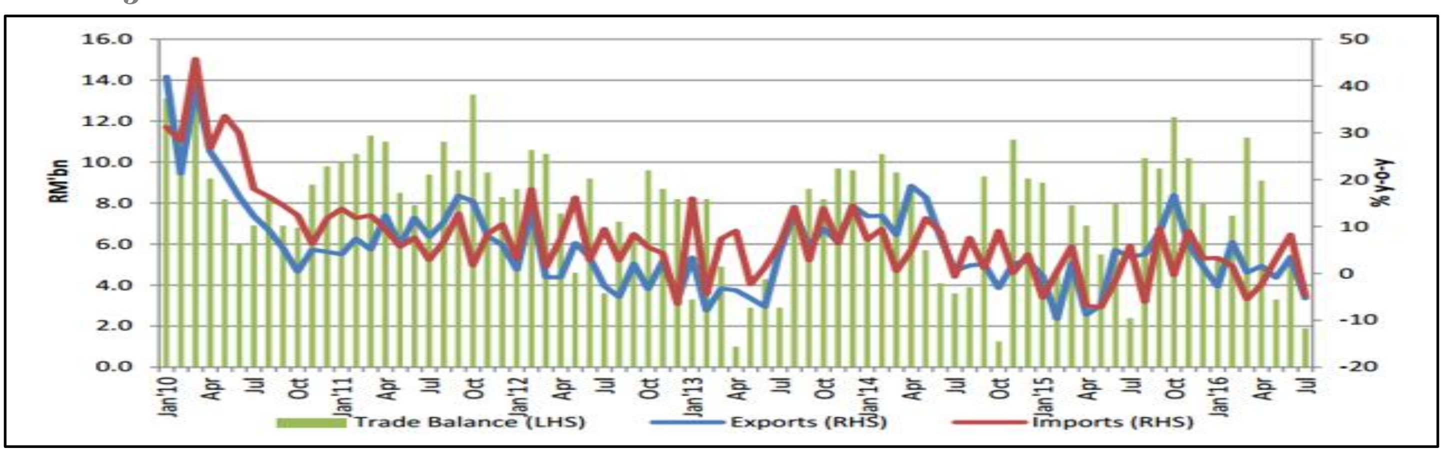


SOURCE: THE EDGE (05/09/2016) & BNM

Interestingly, Bank Negara has chosen to keep its 2016 GDP forecast unchanged, between 4% to 4.5%. This would mean that the GDP growth rate, which has been decelerating over the last four quarter, should stabilize at worst or even pickup in the second half of the year to hit the higher end of the target range.

That said, trade numbers for third quarter of 2016 remain poor, suggesting some downside risk to Bank Negara's GDP forecast, especially that BNM has kept the lending rate unchanged at its September monetary policy meeting.

FIGURE 3: MALAYSIA'S EXTERNAL TRADE

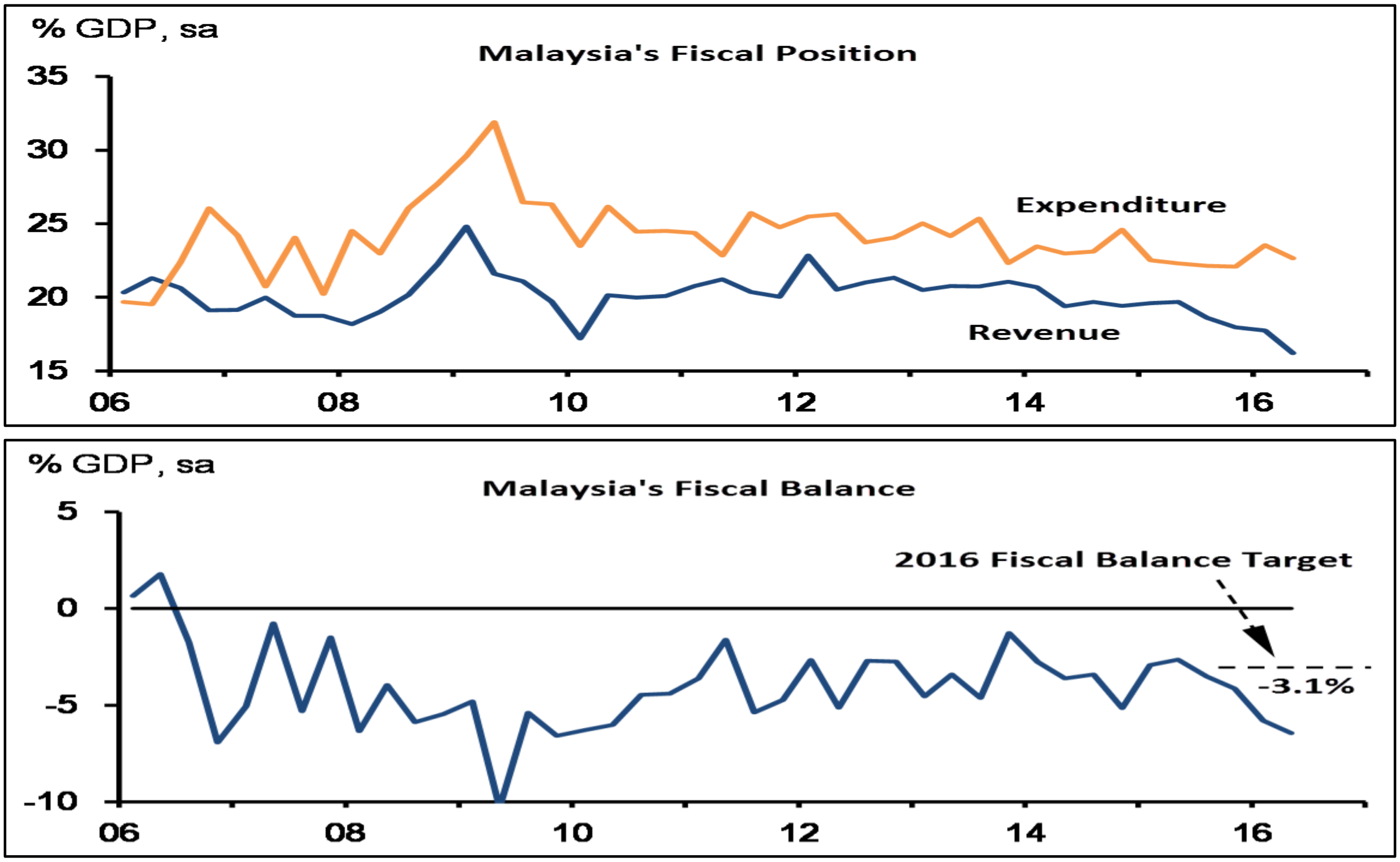


SOURCE: DOS (BIMB SECURITIES)

There is now also an increasing concern that Malaysia may breach its revised -3.1% fiscal deficit target. Malaysia's fiscal deficit target was a surprising -5.6% in the first half of 2016, caused by a combination of lower revenues and higher expenditures.

Achieving the stated fiscal deficit target will be a key interest point for the remainder of the year. More importantly, the target will need to be achieve through the raising of revenues as any significant cut-back in expenditure will have a negative impact on GDP growth.

FIGURE 4: MALAYSIA'S FISCAL POSITION AND BALANCE



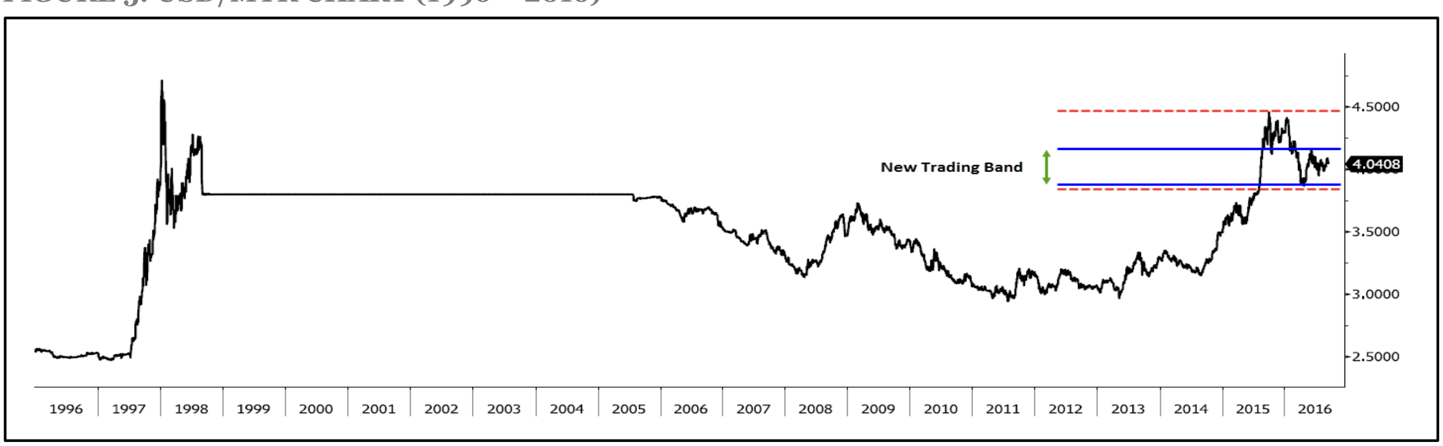
SOURCE: BNM, DOS, MOF, & JP MORGAN

<u>Currency Resiliency Bodes Well For Confidence</u>

In such circumstances, we would usually expect to see downward pressure on the Malaysian Ringgit, as we experienced in 2015 over the slew of negative events, from the 1MDB issue to the collapse in oil price.

Yet, as we have also highlighted in the previous Market Commentary, the Malaysian Ringgit has been surprisingly resilient.

FIGURE 5: USD/MYR CHART (1996 – 2016)



SOURCE: BLOOMBERG (AS AT 08/09/2016)

This currency resiliency is critical towards the formulation of economic policies and the tools available to achieve the economic goals. Without this currency resiliency, it will be very difficult to be constructive towards the Malaysian equity market.

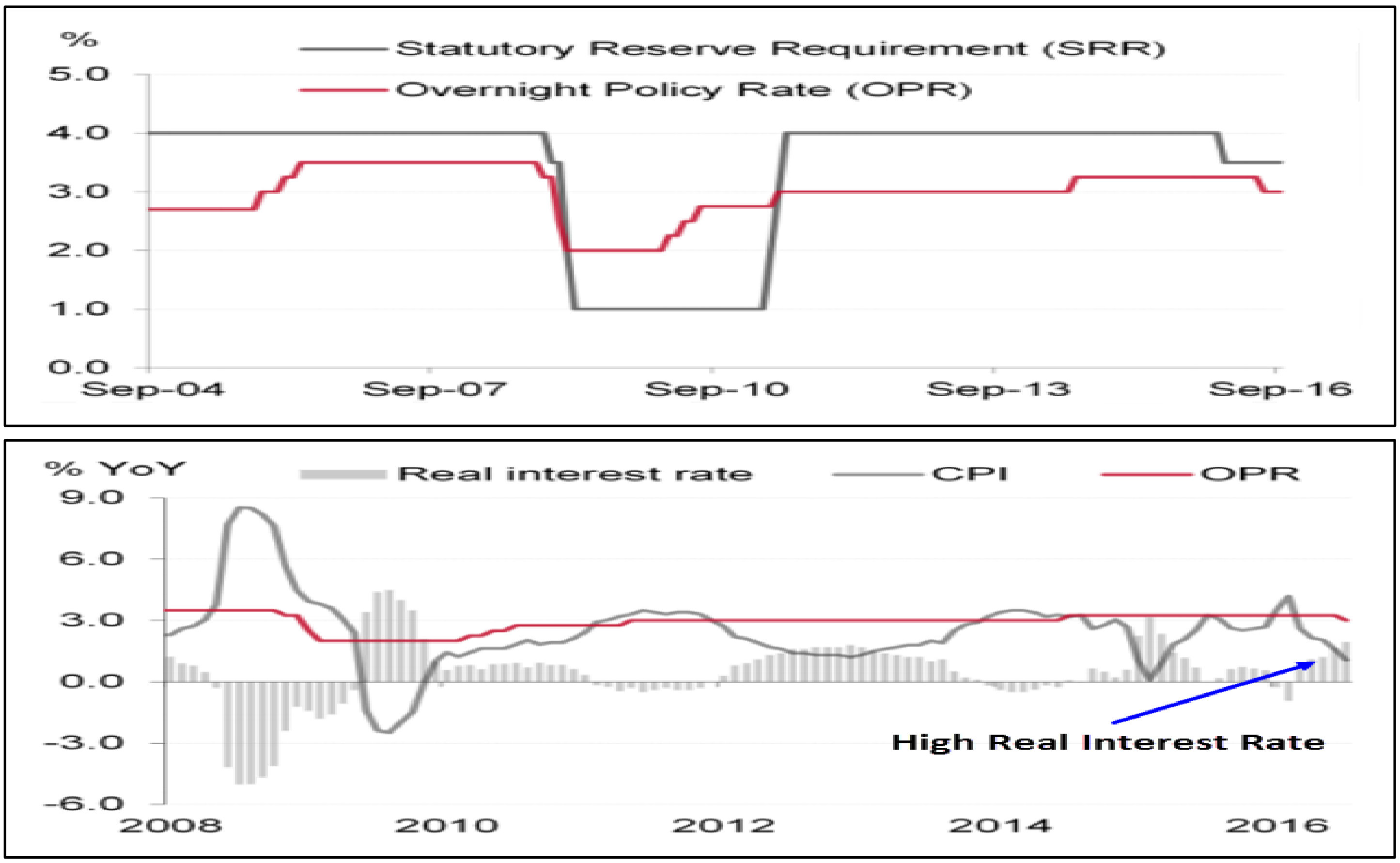
<u>Monetary Easing Will Continue</u>

While most observers were expecting Bank Negara to cut lending rate another time at its monetary policy meeting on 7th September 2016, it may not have been such a surprise that the decision was to maintain the status quo.

It was a prudent move especially with the US Fed FOMC meeting coming up on 22nd September 2016 that Bank Negara stays put. If the US Fed is to surprise the market with an interest rate hike, that may put unwanted and renewed pressure on the Malaysian Ringgit.

The sensible thing for Bank Negara to do, is to allow the last lending rate cut to work through the economy and decide post the US Fed FOMC meeting on the next course of action. If the US Fed decides to keep interest rates on hold come 22nd September 2016, we should expect Bank Negara to cut lending rate for a second time in its November 2016 monetary policy meeting. Real interest rates remain prohibitively high as inflation stays benign. Also, a reduction in the Statutory Reserve Requirement (SRR) is likely.

FIGURE 6: OPR vs SRR AND REAL INTEREST RATES & CPI INFLATION



SOURCE: DOS, BNM, & KENANGA

<u>Portfolio Positioning</u>

In Market Commentary August 2016 Issue 13, we discussed the theme 'The Scarcity Chase for Yield'. Our positive stance remains unchanged, with this pause in monetary easing giving us a window of opportunity to accumulate yield plays, in particular REITs.

We would also like to take this opportunity to introduce another set of ideas. One way the Malaysian government can increase revenues is through an uplift in dividend payout from government related entities. A stock like TNB would come to mind, a combination of earnings growth from increased power capacity and increase in dividend payment.

SELECTED HOLDINGS

FIGURE 7

STOCKS	BLOOMBERG TICKER	PRICE (RM)	PER 2016	EPS ($) 2016	GROWTH (%) 2016	P/BVPS 2016	DY (%) 2016
TENAGA NASIONAL BHD	TNB MK EQUITY	14.44	11.15	1.30	19.40	1.56	2.01
ELK DESA RESOURCES BHD ***	ELK MK EQUITY	1.22	9.38	0.13	-10.40	0.66	2.66
AEON CREDIT (M) BHD	ACSM MK EQUITY	15.00	8.79	1.71	14.77	2.29	3.96

*SOURCE: BLOOMBERG CONSENSUS DATA (AS AT 09/09/2016). *** DATA IS HISTORICAL (FY 2016)*

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