MARKET COMMENTARY

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The KLCI should be able to maintain the current upwards momentum as the index is still in the early stage of a new upcycle after 3 years of a down cycle. Nevertheless, in terms of valuations, it's getting relatively more demanding and as a result the market is likely to consolidate in order to move higher. However the market is likely to see several headwinds in the coming months such as companies earning growth, the US Fed de-gearing exercise and GE 14.

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OUR HOUSE VIEW

Staying The Course For A Break Up In Asian Equity Markets?

➢ Our central thesis from a year back was a potential multi-year bull market for Asian equity markets. In any multi-year market cycles, there remains the risk of mini-corrections, more so at an important inflexion point. In this instance, North Korean geopolitical tension closer to home have taken a bite off the Asian equity market rally.

➢ Outside of the US, the economic recovery appears to be picking up in Europe, Japan, and China, more than enough weight to offset any malaise out of the US. And our own Asian economies are also clearly on a secular recovery path.

➢ Again, high base comparison effects may create choppy moments in the second half of the year. Our longer-term positive view remains unchanged.

➢ Looking ahead, while mild corrections for the Malaysian equity market are expected in the second half of 2017 due to external noises arising from the US monetary tightening bias, weakness in crude oil prices, and hiccups from China's deleveraging process, market sentiment is expected to remain buoyant.

PERFORMANCE OF KEY INDICES

FIGURE 1

	AS AT 31.07.17	1 MTH (% change)	YTD 2017 (% change)	PER 2017
D. JONES	21,891.1	2.5	10.8	18.7
NASDAQ	6,348.1	3.4	17.9	38.8
DAX	12,118.3	-1.7	5.6	17.0
KLCI	1,760.0	-0.2	7.2	16.8
USD / MYR	4.28	-0.3	-4.6	-

SOURCE: BLOOMBERG (AS AT 31/07/2017)

CAN THE KLCI SUSTAIN ITS UPTREND MOMENTUM?

In our view, the KLCI should be able to maintain the current upwards momentum as the index is still in the early stage of a new upcycle after 3 years of down-cycle. Nevertheless, in term of valuations, it's getting relatively more demanding and as a result the market is likely to consolidate in order to move higher.

Among reasons to support our hypothesis are outlined below.

Downtrend Has Reached Its Pivotal Point

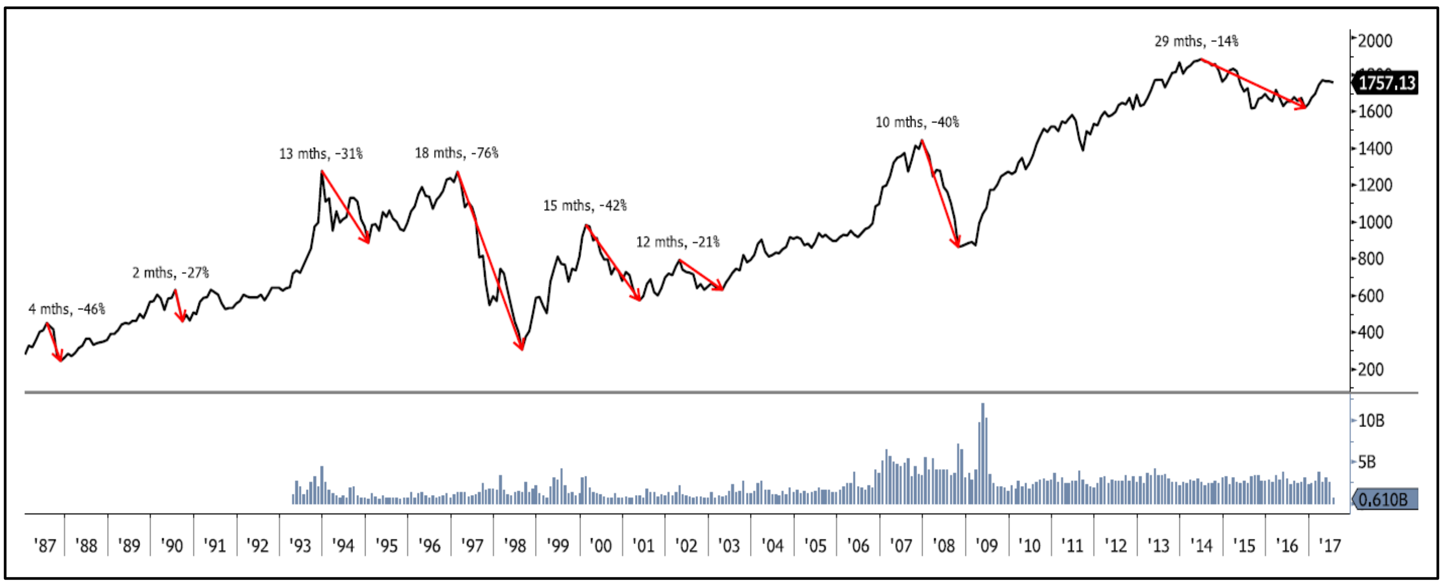
Based on Figure 2, there has been 8 down cycles since 1987. The average duration of a down cycle was 12 months. The average decline was 37%. Typically, down cycles tend to be shallower and shorter than upcycles.

In the recent down cycle, the market fell by a modest 14%. However, the correction lasted for an unprecedented 29 months. The KLCI reached a peak of 1,886 (Jun '14) and bottomed at 1,617 (Dec '16).

In contrast, the second longest downtrend lasted for 18 months. This occurred during the 1997/98 Asian financial crisis when the stock market fell by 76% from peak (Feb '97) to trough (Sep '98).

Thus, the KLCI is in a new upcycle. The longest correction in 30 years ended in 2016.

FIGURE 2: KLCI's DOWNCYCLES IN THE LAST 30 YEARS



SOURCE: BLOOMBERG & AISB

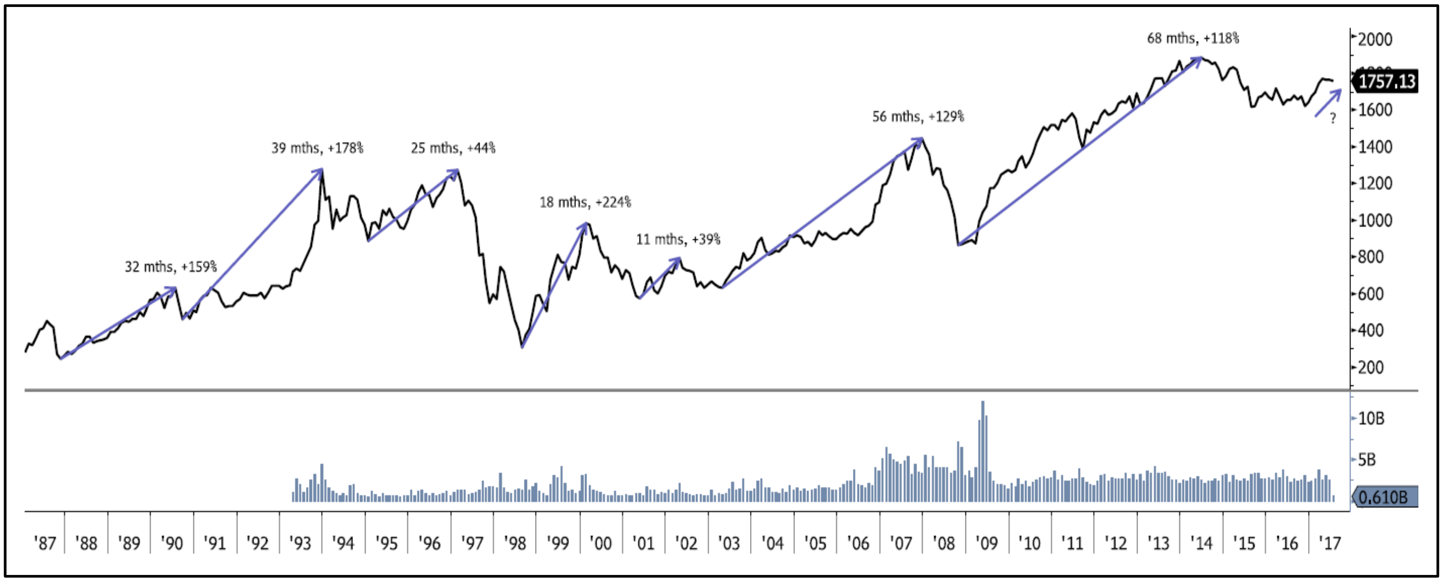
A New Upcycle Is Underway

Second, market upcycles tend to last for some time. Since 1988, there has been 7 upcycles (see Figure 3). The average upcycle lasted for 36 months. The average appreciation in these upcycles was 127%.

In my view, this upcycle started in December of 2016. It is therefore only in its 7th month. In the last 30 years, the shortest upcycle was 11 months (2001-02). The longest was 68 months (2008-2014).

Historical data would support the view that this upcycle has many more months to go.

FIGURE 3: KLCI's UPCYCLES IN THE LAST 30 YEARS



SOURCE: BLOOMBERG & AISB

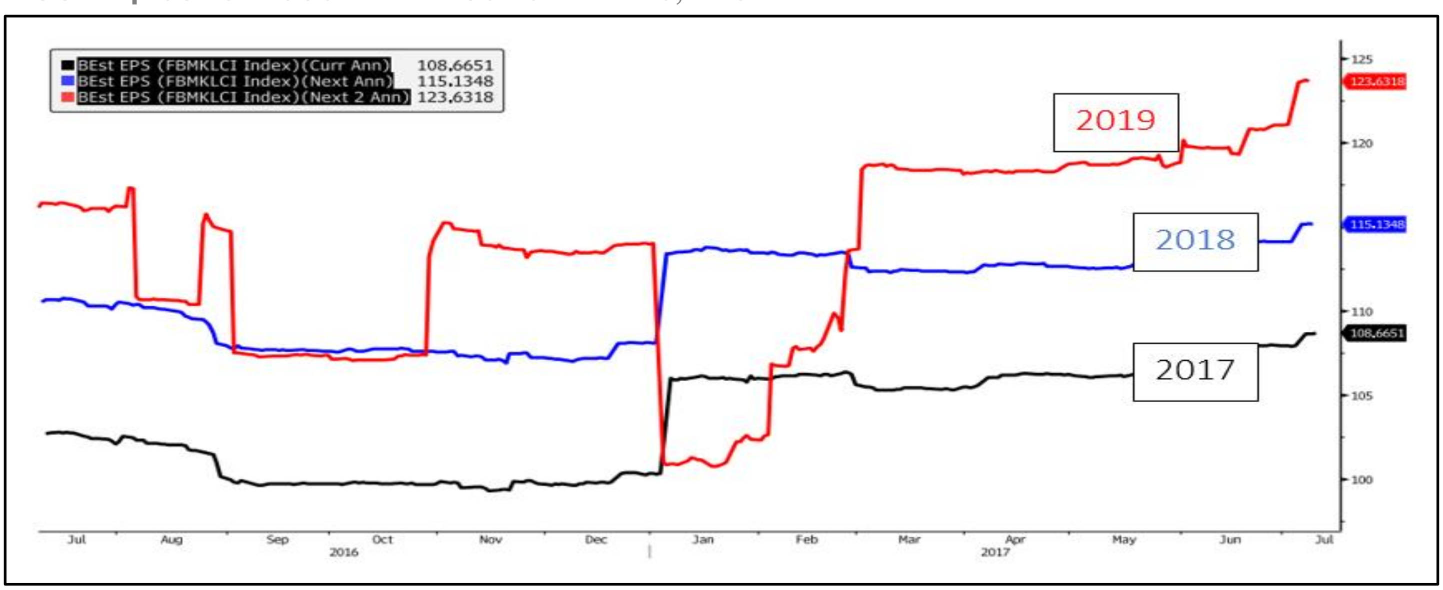
Earnings Underpin The Rally

Third, the street has revised *up* their earnings expectations for the market. This contrasts with previous years when analysts were revising *down* their earnings estimates.

As Figure 4 shows, analysts started to upgrade their forecasts in January this year. Consensus raised its forecast again in June after the first quarter reporting season. The KLCI's 2018 EPS integer has been revised up by cir.7% from 107 (Dec '16) to 115 (Jul '17). This approximated the cir.8% rise in the KLCI from the bottom (Dec '16). In other words, positive earnings revisions have been a fundamental driver for the market's rally.

Furthermore, with a low base in 2016, we are likely to see mid-to-high single digit market earnings growth in 2017. This contrasts with the flat to negative earnings growth in the last three years.

FIGURE 4: CONSENSUS EARNINGS ESTIMATES, KLCI



SOURCE: BLOOMBERG & AISB

Funds Flow

Fourth, foreigners remain significantly underweight in Malaysia. The foreign net inflow of RM 10.2 billion in the first six months of 2017 may appear large. However, this is only 34% of the net outflow of RM 29.7 billion that took place between 2014 and 2016. The current interest in Malaysia remains below the levels seen in the years after the global financial crisis.

This is corroborated by the foreign shareholding of 22.3% on Bursa at the end of 2016. Even accounting for the foreign net inflow of $10.2 billion in the first half of 2017, foreign ownership is not expected to be much higher than 21-22%. This is due to the 10% rise in Bursa's market capitalisation from RM 1.59 billion at end-2016 to RM 1.75 billion at end-June 2017. There is room for foreign ownership to increase if we consider that the peak in foreign shareholding was 27.5% in 2007.

A More Challenging Second Half

The market is likely to see several headwinds in the coming months.

First, the market's 2017 PE multiple has risen to circa 16-17x which is in-line with its 5-year mean of 16x. Earnings will need to catch up before the market can move higher.

Second, the US FED is expected to shrink its $4.5 trillion dollar balance sheet by Q417. This has driven the recent uptick in US bond yields. Higher US bond yields will put pressure on equity prices. It may also result in capital flowing out of emerging markets like Malaysia.

The recent correction was unusual in terms of duration. Stock market cycles including bear phases must come to an end.

Lastly, we are getting ever closer to GE14. The issue is not the outcome but the uncertainty leading up to it. Markets dislike uncertainty and this will be an overhang for the KLCI. GE14 must be called before August 24, 2018.

In summary, the market's first-half rally had strong fundamental drivers. The upcycle remains intact. But for the next leg-up, the stock market will need to get through a few near-term challenges.

SELECTED HOLDINGS

FIGURE 5

STOCKS	BLOOMBERG TICKER	PRICE (RM)	PER 2018	EPS 2018	GROWTH (%) 2018	DY (%) 2018
SOUTHERN STEEL	SSB MK EQUITY	2.13	6.67	0.24	9.09	1.55
HIAP TECK	HTVB MK EQUITY	0.38	5.77	0.07	133.30	0.80

SOURCE: BLOOMBERG (DATA AS AT 24/08/2017) & AISB

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