

More foreign inflows expected

Foreigners have been net buyers on Bursa for eight straight weeks, drawn back by improving macro environment, stabilising ringgit, catch-up potential



by Wei Lynn Tang

IT'S hard not to notice a slew of strategy update reports in the past few weeks from foreign brokers such as Credit Suisse, Deutsche Bank, UBS and JP Morgan. The stark similarity is that they are mostly bullish on Malaysia.

The general consensus is foreign investors are now taking a closer look at the country due to the improving macro environment, stabilising ringgit, earnings recovery in sight, and the fact that it has been shunned for so long.

Notably, foreign fund inflows have contributed to the recent rally in the local benchmark index. In fact, MSCI Malaysia's 6% gains year to date (YTD) has achieved UBS' return expectations for this year.

According to MIDF Research, foreign investors have been net buyers on Bursa for eight straight weeks. Will this continue? Is the rally sustainable?

"Foreign holding as of end-2016 was 22.3%. In the last 10 years, the peak was 27.5% in 2007. Based on this, foreign ownership can rise further," Apex Investment Services Bhd CEO Clement Chew tells *FocusM*.

"Another way to look at it is a total of RM29.7 bil (money from) equities flowed out of Malaysia between 2014 and 2016. YTD, RM4.7 bil has flowed back. Based on this, another RM5 bil of inflows this year should be very achievable," he says.

This is based on an average inflow of RM10 bil per year, hypothetically – a reversal from the last three years.

Chew, who spent almost 20 years with JP Morgan, says while foreign investor sentiment has been driven by Malaysia's catch-up potential, this foreign interest is still not widespread. In fact, it is a far cry from the days when the country saw positive sentiment.

This is justified by the fact that emerging market investor weightings in Thailand and Indonesia are currently much higher than Malaysia's.

Malaysia, as Chew puts it, is one of the most underweighted markets among emerging markets.

Worst appears to be over

Add this to the fact that "ownership of emerging market equities is still low relative to developed markets," he says.

But is this a good enough reason? What will entice foreign investors to continue pumping in money into Malaysia's equity market, and more importantly, for them to stay invested?

Credit Suisse's March 15 report on "Buying Malaysia: the ultimate contrarian trade" has garnered market attention.

It has turned positive on Malaysia for



A more stable ringgit has helped to bring foreign investors back to the equity market

10 reasons. Among them are that equities have undershot their typical association with relative value creation, and earnings revisions have turned positive for the first time in close to five years.

A week later, Deutsche Bank in its report says it is time to revisit Malaysia, saying the worst seems to be over, and that structural growth is now in sight.

Among the few themes it highlighted is that China's committed RM144 bil infrastructure spending is edging closer to realisation, with most contracts to be awarded in the second half of the year.

A spillover will also be seen in our property rental market.

Based on Deutsche Bank's recent checks with local property agents, the influx of Chinese expatriates on the back of Chinese-funded projects has led to a rise in Chinese rental demand.

Gamuda Bhd and IJM Corporation Bhd are among the favourites of Credit Suisse, Deutsche Bank, UBS and JP Morgan. These shares have risen 8% and 6%, respectively, in the past two months.

Meanwhile, for alpha picks this month, UOB KayHian likes Ann Joo Resources Bhd, Ekovest Bhd, Kerjaya Prospek Group Bhd, VS Industry Bhd and YTL Power International Bhd.

Earnings upgrades remain elusive

UBS says the rally YTD is purely fuelled by a re-rating of valuation multiples, without a corresponding growth in earnings forecasts. "This leaves the market vulnerable in our view," the research house says in a March 24 note.

It highlights Malaysia's earnings trajectory – lagging that of Asia ex-Japan, where earnings troughed in the middle of last year and have since rebounded by 3% – which continues to bounce along its bottom.

As such, UBS has an underweight position on Malaysian equities in its Asia ex-Japan tactical asset allocation.

That said, it points out that Malaysia's fundamentals are improving – evident by the Q4 2016 results season where the MSCI Malaysia index's constituents reported a 2% annual growth in net profit and a 1% increase in revenue.

From a stand-alone valuation

“Malaysia has historically traded at a 30% premium over Asia ex-Japan in terms of forward P/E valuations. This premium has compressed to 26%. Mean reversion of the valuation gap implies 4% upside for MSCI Malaysia, all else being equal.”

– UBS



Chew says Malaysia is one of the most underweighted among emerging markets

standpoint, UBS deems Malaysian equities expensive relative to its own history.

From a regional standpoint, however, Malaysia is currently trading below the research house's long-term valuation premium versus the region.

"Malaysia has historically traded at a 30% premium over Asia ex-Japan in terms of forward P/E valuations. This premium has compressed to 26%. Mean reversion of the valuation gap implies 4% upside for MSCI Malaysia, all else being equal," UBS notes.

Most funds share the view that Malaysia is poised to deliver positive earnings growth this year, thereby giving the equity market an uptick, reversing the last three straight years of negative returns.

"Consensus currently projects MSCI Malaysia earnings growth of 5.2% in 2017, followed by a further 6.9% in 2018. However, unless these earnings growth forecasts are raised, we see little fundamental reasoning for the market to trade convincingly higher," UBS says.

Apex's Chew does not expect any major earnings upgrades in the next six months, up until the fourth quarter, having seen sell-side analysts just upgrading their forecasts in the December/January period.

Chew is nonetheless optimistic that

earnings growth will be positive this year – partly due to a low base effect from last year, and that expectations have been brought down in the last three years.

"Exporters are benefiting from the cyclical upturn in global PMIs. Also, companies in sectors such as plantations, construction and financials are expected to do better this year. The modest growth we will see this year is also due to some underlying improvement in business conditions," he says.

Malaysia saw its February exports surging 26.5% on-year to almost RM72 bil, as demand from China rose.

PNB restructuring – what's next?

A common theme cited by research houses since the end of last year is the restructuring of Permodalan Nasional Bhd (PNB), which could serve to excite the market.

Already, Sime Darby Bhd and UMW Holdings Bhd's demerger exercises, along with the improvement in the broad equity market, have enhanced the total value of PNB's strategic companies by RM20 bil YTD. PNB sees this as a positive response from the market.

PNB chairman Tan Sri Abdul Wahid Omar, in a recent media briefing, reiterated PNB's priorities in unlocking value in its strategic companies, hence moving to its core companies.

PNB holds controlling stakes in Malayan Banking Bhd, SP Setia Bhd, Chemical Company of Malaysia Bhd and MNRB Holdings Bhd.

Asked on the possibility of taking some of these companies private, and relisting them, Chew says: "It is possible. I think if we look back in history, this was exactly what Sime had done with companies like Consolidated Plantations in the 1990s, and Tractors Malaysia. If there were any undervaluations in any of their companies (where they have majority stakes in), it will be a plausible option for them."

He adds that there is value in three undervalued sectors currently – automotive, property, and oil and gas.

Chew cited KWAP's recent RM887 mil investment for a 20% stake in Eastern & Oriental's second phase of Seri Tanjung Pinang project as an example of prospects in the property sector.

For Deutsche Bank, it prefers exposure in Maybank due to its disciplined lending, and Bursa Malaysia Bhd for its improved market velocity.

In the meantime, time will tell if this rally is sustained, with all eyes on the upcoming Q1 2017 earnings season – which will ultimately drive further foreign fund inflows. *FocusM*