Apex INVESTMENT SERVICES BERHAD (420390-M)
20 years and beyond

Portfolio Manager's View

27 October 2021

Fund Management Department

Regional

1. The US Federal Reserve has struggled to overshoot its 2% inflation target since the Global Financial Crisis of 2008. That was until now, where the market worry has shifted to a hyperinflation scare. Hyperinflation it is not, for the supply chain bottlenecks that have proven more persistent is still in our view event driven rather than structural. However, we are of the opinion that a re-calibration (higher) of this 2% inflation target is appropriate now. The reason is China. Beginning with China's devaluation of her currency the RMB in 1994 and her ascension into WTO in 2001, China has exported deflation to the rest of the world with her low cost manufactured goods. This new China will start to export inflation to the rest of the world. We must expect inflation for the coming years to be structurally higher than we have been used to for the last 25 years.

2. Last weekend, US Federal Reserve Chair Jerome Powell appeared in a seminar held by the South African Reserve Bank where he acknowledged that inflation risk is rising yet the US Fed can still afford to be 'patient'. It is our view that policy normalisation is impossible. Interest rate hikes will fall behind inflation, the result an extended period of low to negative real yields. ECB President Christine Lagarde said that supply chain bottlenecks have made the

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Just-In-Time (JIT) economic model a problem for Europe. Just as businesses will need to keep more excess inventory, this same JIT concept will apply to Central Bankers too, the need to keep excess liquidity in financial systems to prevent unexpected and intolerable dislocations

3. Make no mistake, US and China are recoupling. Both US Treasury Secretary Janet Yellen and US Trade Representative Katherine Tai have spoken to China's Vice Premier Liu He recently. The readouts from both camps highlighted the need to strengthen communication and improve coordination. Separately, a US Commerce Department report revealed that US$100 billion worth of export licenses have been granted to Huawei Technologies and Semiconductor Manufacturing International Corporation (SMIC) of China. Despite both companies on the US Blacklist, it appears to be mere rhetoric. It may not be far-fetched to imagine that the US and China may be contented to let the Phase One trade deal inherited from the Trump years to run its course. This will be hugely positive for China. At the risk of being devilish, this is the perfect combination of letting the rest of the world help to reflate China's economic growth yet retaining a tighter grip on her own domestic excesses.

Malaysia

1. The KLCI closed at 1,591 @ 21.10.21, an increase of +3.9% MoM. Last week, REITs (+1.9%), Technology (+1.1%) and Banks (+1.0%) were the best performing sectors. In contrast, Metals & Mining (-3.7%) and Healthcare (-2.1%) were the worst performing sectors. Year-to-date @ 21.10.2021, the KLCI has retreated by -2.2%.

2. The Outsourced Semiconductor Assembly & Testing (OSAT) industry is benefiting from unprecedented demand. In company briefings, the management of OSAT companies report that they are locking in long term supply deals at higher prices with their main customers who are urgently looking to lock-in the assembly and test capacity for their chips. Historically, OSAT players lacked bargaining power due to the cost-savings from yearly improvement which are shared with their customers. Also, excess capacity and price competition made price increases by OSAT difficult. With the consolidation of players in the OSAT industry in recent years and disciplined capex moving forward, capacity will remain tight and OSAT players are expected to sustain better terms and firmer pricing in the quarters ahead. The strong demand and tight supply conditions for OSAT companies are expected to persist well into 2022.

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3. World Semiconductor Trade Statistics (WSTS) reported its August 2021 sales increased by 30.2% YoY (vs 29.8% YoY for July-21) and 3.8% MoM (vs 2.0% MoM for July-21). Exhibit 5 shows that growth in global semiconductor sales is still trending upwards. There has been 7 cycles since 1997. The average duration of an upcycle is 31 months while the average duration from start to the peak of the upcycle is 12 months. We are in the 18th month of the current upcycle (Exhibit 6). Based on the chip supply shortages, we do not foresee a peak in the semiconductor industry until 2H 2022 or 2023.

4. Seagate Technology released its Q1FY22 earnings on 22.10.2021. The global leader by market share for HDD and SDD memory drives reported revenues increased by +35% YoY/+3% MoM and net profits by +152% YoY/+17% QoQ respectively. Management has revised its growth guidance upwards from high single-digit to low double-digit growth in FY2022, driven by strong and stable demand from cloud hyper scalers such as Alibaba, Amazon, Facebook and others. This demand is expected to flow down the supply chain and benefit component manufacturers for HDDs such as DUFU in Malaysia.

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5. The government through the Human Resources Ministry has approved SOPs for the return of foreign workers. However, the quota and dates for entry will be determined and approved on a case-by-case basis. The move is a step in the right direction as Malaysia, which is reliant on foreign labour, looks to reopen its economy. We see this as a positive for Malaysia's plantation sector which has been suffering from a shortage of workers throughout the pandemic which has caused a shortage of global Crude Palm Oil (CPO) supplies.

6. Lately, we have been surprised by a growing confluence of positives for Malaysia.

   This includes rising Brent crude prices which have climbed to a 7-year high of US$86/bbl, lifted by the shortage of natural gas and a tight oil market ahead of the winter months (see Exhibit 7). This is a blessing for the government's coffers. It helps to alleviate the significant pressure on the country's fiscal deficit which have been weighed down by the spending on Covid-19 recovery measures. Brent crude has averaged US$69/bbl year-to-date, well above the government's assumption of US$42/bbl in the **2021 Budget**. Saudi Aramco's CEO Amin Nasser was quoted as saying - "If there's aviation pick-up next year, that spare capacity

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will be depleted. It is now getting to the situation where there is limited supply – whatever is left that is spare is declining rapidly." (p.g 15, The Edge Morning Brief, 27.10.2021). OPEC next meets on 4th Nov 2021. *We have a decent weight in the oil and gas sector* and *several names which should benefit from the strength in Brent crude prices*.

Malaysia is currently enjoying good demand for its exports. Total exports in Aug-21 grew by 18.4% YoY while the trade surplus of RM 21.4 bil was the 2nd highest in the last 10 months. Prices for Malaysia's commodity exports are extremely high. An interesting point is the robust external position is being driven by commodity exports (e.g. O&G, palm oil, LNG etc) **AND** manufacturing exports (e.g. petrochemicals, rubber products, electronics and electrical products). Both segments are doing well at the same time.

In addition, foreigners have turned net buyers of Malaysia equities in 10/11 weeks. This is consistent with inflows of USD104 bil into Emerging Markets year-to-date as at 20.10.2021. This has been driven by low investor weightings, rising vaccination rates (enabling a reopening of economies), global recovery and signs of a peak in USD. The political uncertainty In Malaysia has taken a back-seat *for now* while the withdrawals from EPF withdrawal schemes are reaching a tail-end.

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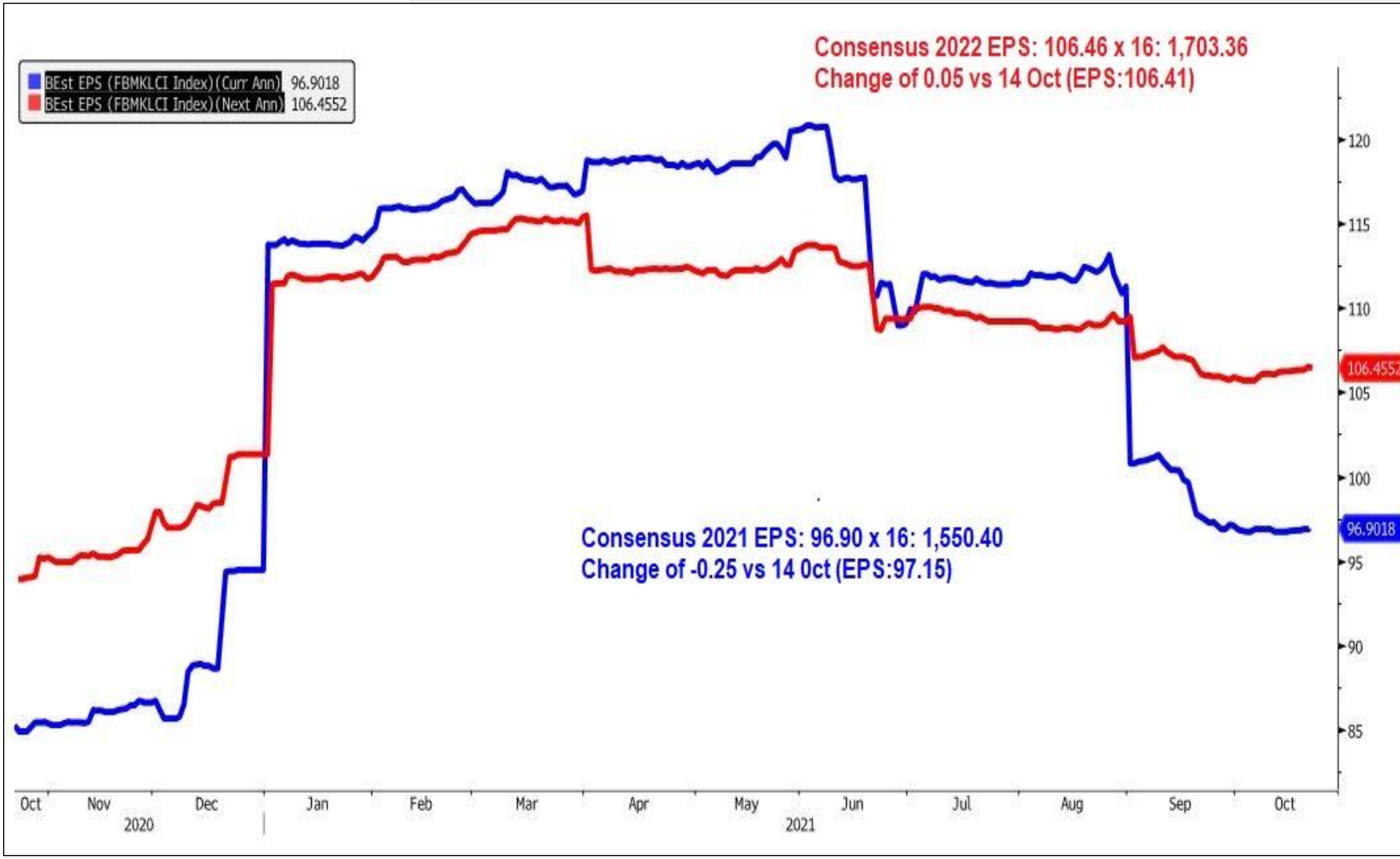
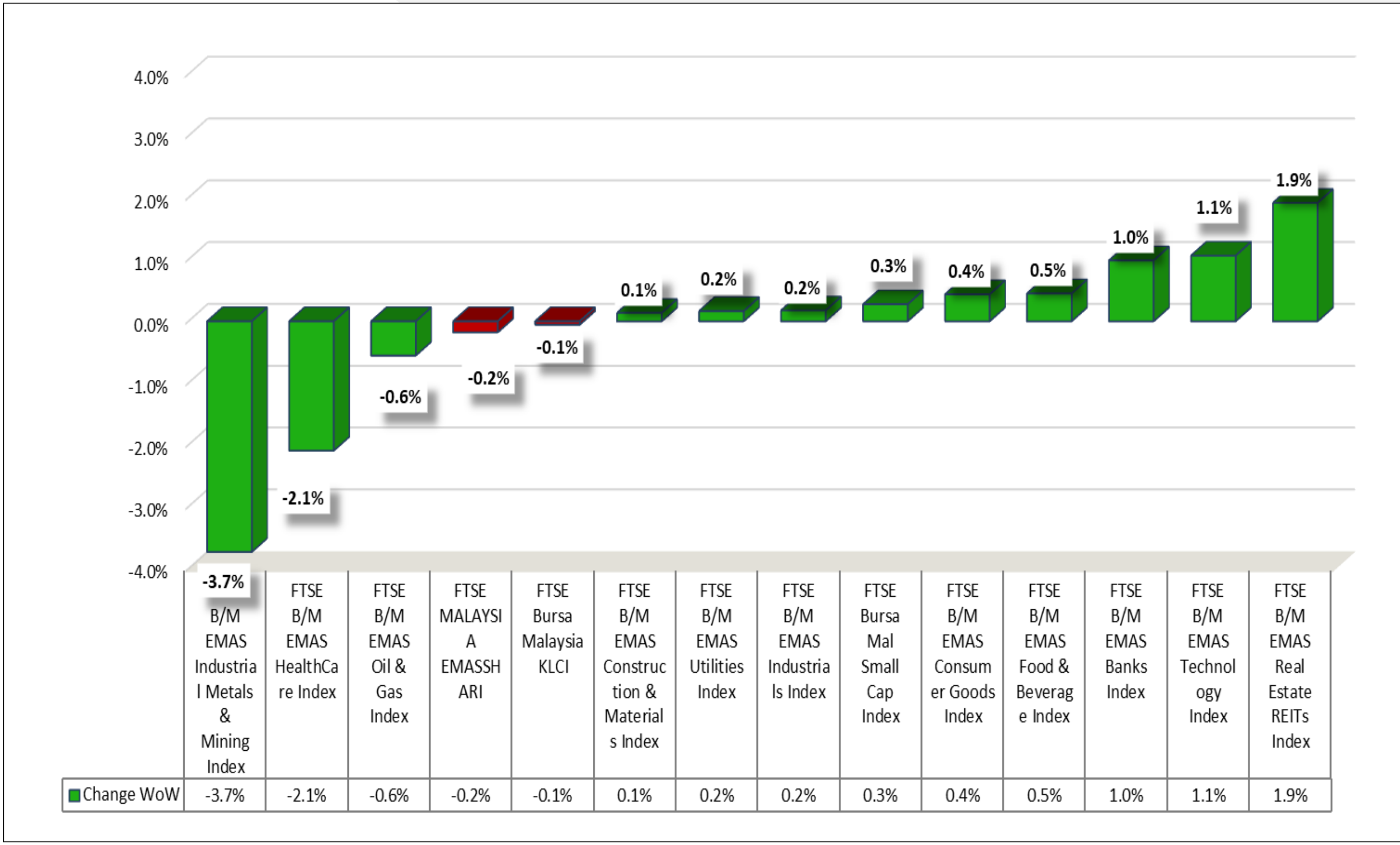
7. The year-to-date decline in the KLCI has reinforced Malaysia’s valuation argument. Based on KLCI at 1,591 @ 21.10.2021 and assuming a market eps integer of 97/106 for 2021/2022, the market is trading at a PER of 16.4x/15.0x respectively (see Exhibit 8 & 9). This is -1 standard deviation below its long-term mean of 16x for FY22. The market PBR of 1.5x (at 7-year mean) and DY of 3.75% (at between 7-year mean and +1SD) are also supportive of the stock market (see Exhibit 10 & 11). Finally, Malaysia is trading at par with Asia ex-Japan’s PER – at the low end of its 5-year range of 0% to +40% premium (ex-Pandemic in 2020) (see Exhibit 12).

Exhibit 1 : FBMKLCI Consensus Earnings Per Share (EPS) @ 21.10.21



(Source: Bloomberg)

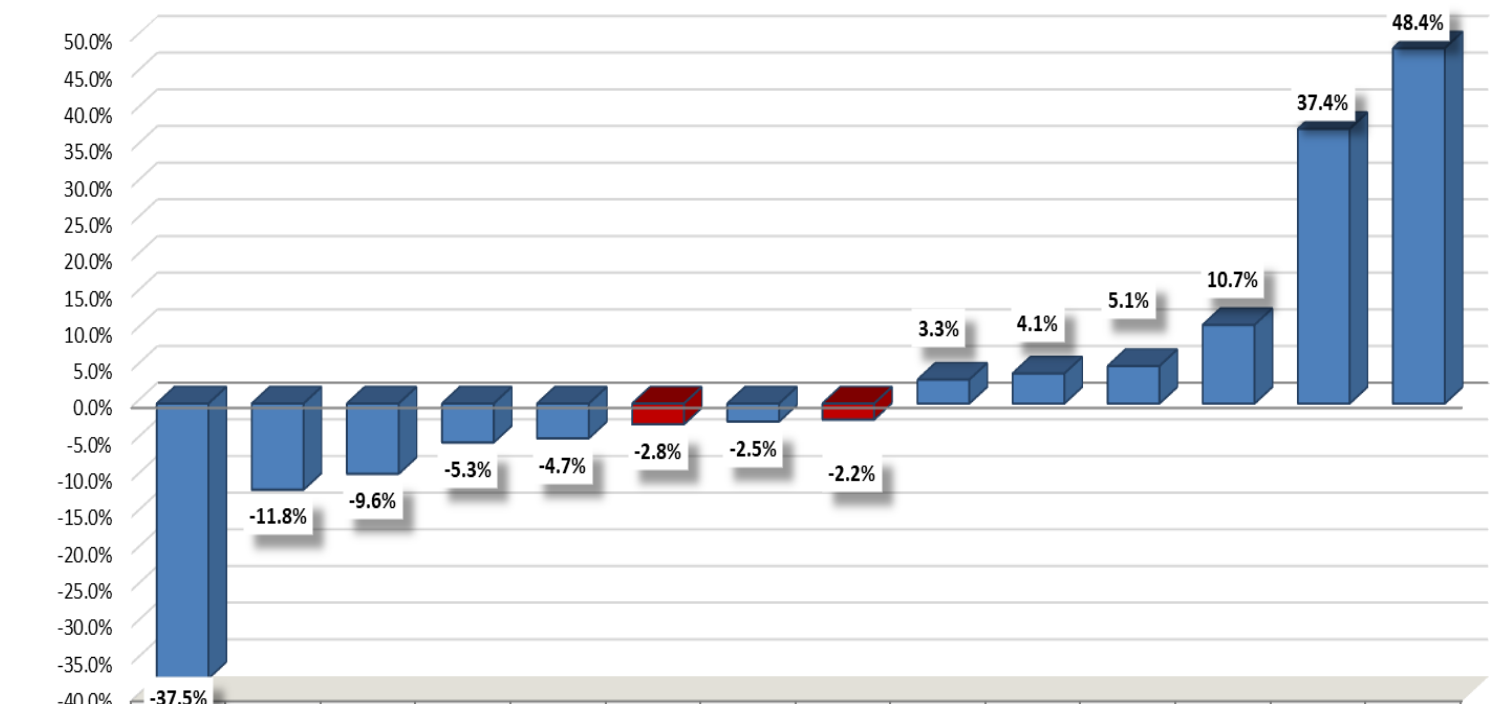
Exhibit 2 : Sector Performances (Week-on-Week) @ 21.10.21



	FTSE B/M EMAS Industrial Metals & Mining Index	FTSE B/M EMAS HealthCare Index	FTSE B/M EMAS Oil & Gas Index	FTSE MALAYSIA EMASSHARI	FTSE Bursa Malaysia KLCI	FTSE B/M EMAS Construction & Materials Index	FTSE B/M EMAS Utilities Index	FTSE B/M EMAS Industrials Index	FTSE Bursa Mal Small Cap Index	FTSE B/M EMAS Consumer Goods Index	FTSE B/M EMAS Food & Beverage Index	FTSE B/M EMAS Banks Index	FTSE B/M EMAS Technology Index	FTSE B/M EMAS Real Estate REITs Index
Change WoW	-3.7%	-2.1%	-0.6%	-0.2%	-0.1%	0.1%	0.2%	0.2%	0.3%	0.4%	0.5%	1.0%	1.1%	1.9%

(Source: Bloomberg)

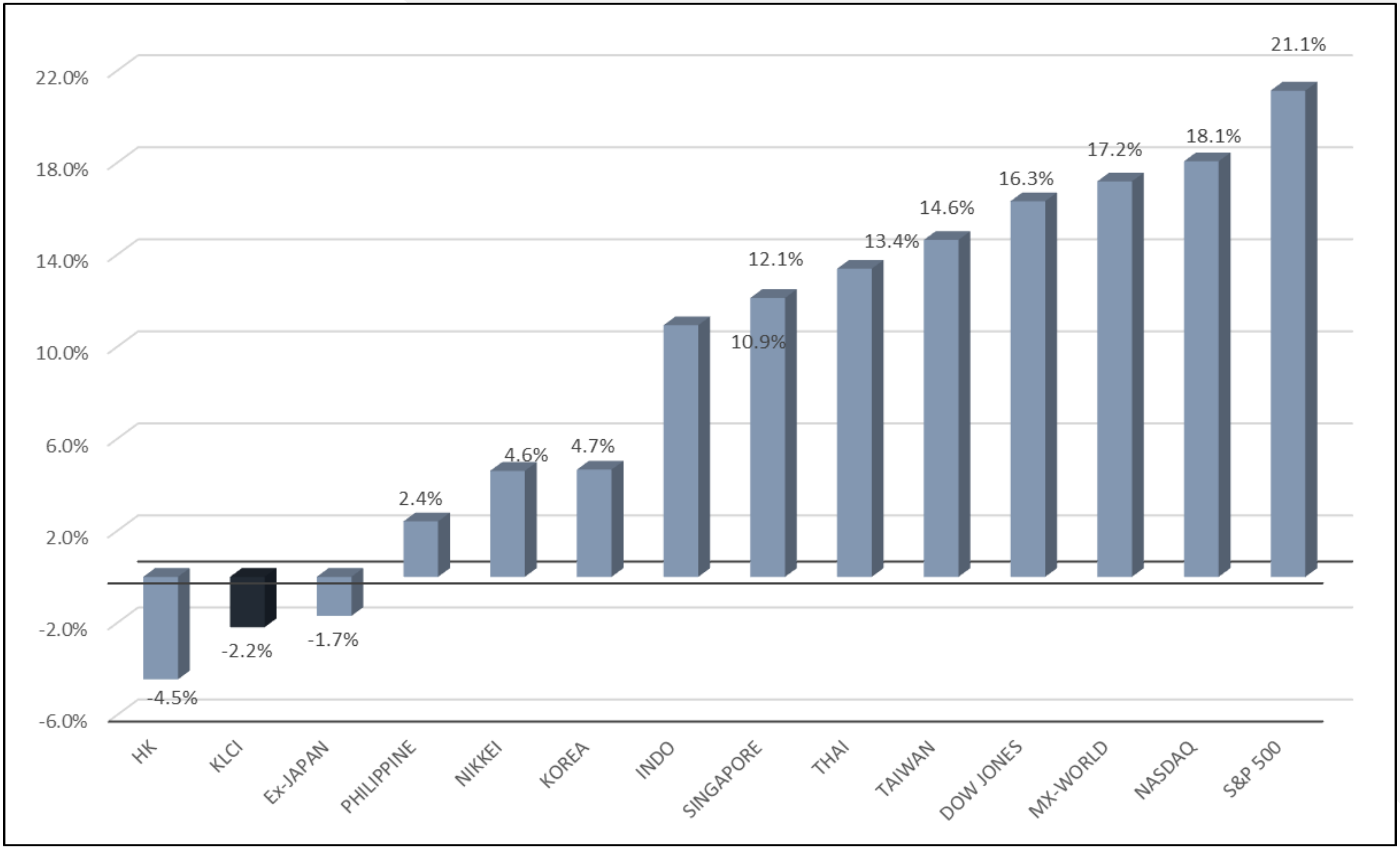
Exhibit 3 : Sector Performances (Year-to-Date) @ 21.10.21



	FTSE B/M EMAS HealthCare Index	FTSE B/M EMAS Oil & Gas Index	FTSE B/M EMAS Construction & Materials Index	FTSE B/M EMAS Food & Beverage Index	FTSE B/M EMAS Consumer Goods Index	FTSE MALAYSIA EMASSHARI	FTSE B/M EMAS Utilities Index	FTSE Bursa Malaysia KLCI	FTSE B/M EMAS Real Estate REITs Index	FTSE B/M EMAS Banks Index	FTSE B/M EMAS Industrials Index	FTSE Bursa Mal Small Cap Index	FTSE B/M EMAS Industrial Metals & Mining Index	FTSE B/M EMAS Technology Index
Change YTD	-37.5%	-11.8%	-9.6%	-5.3%	-4.7%	-2.8%	-2.5%	-2.2%	3.3%	4.1%	5.1%	10.7%	37.4%	48.4%

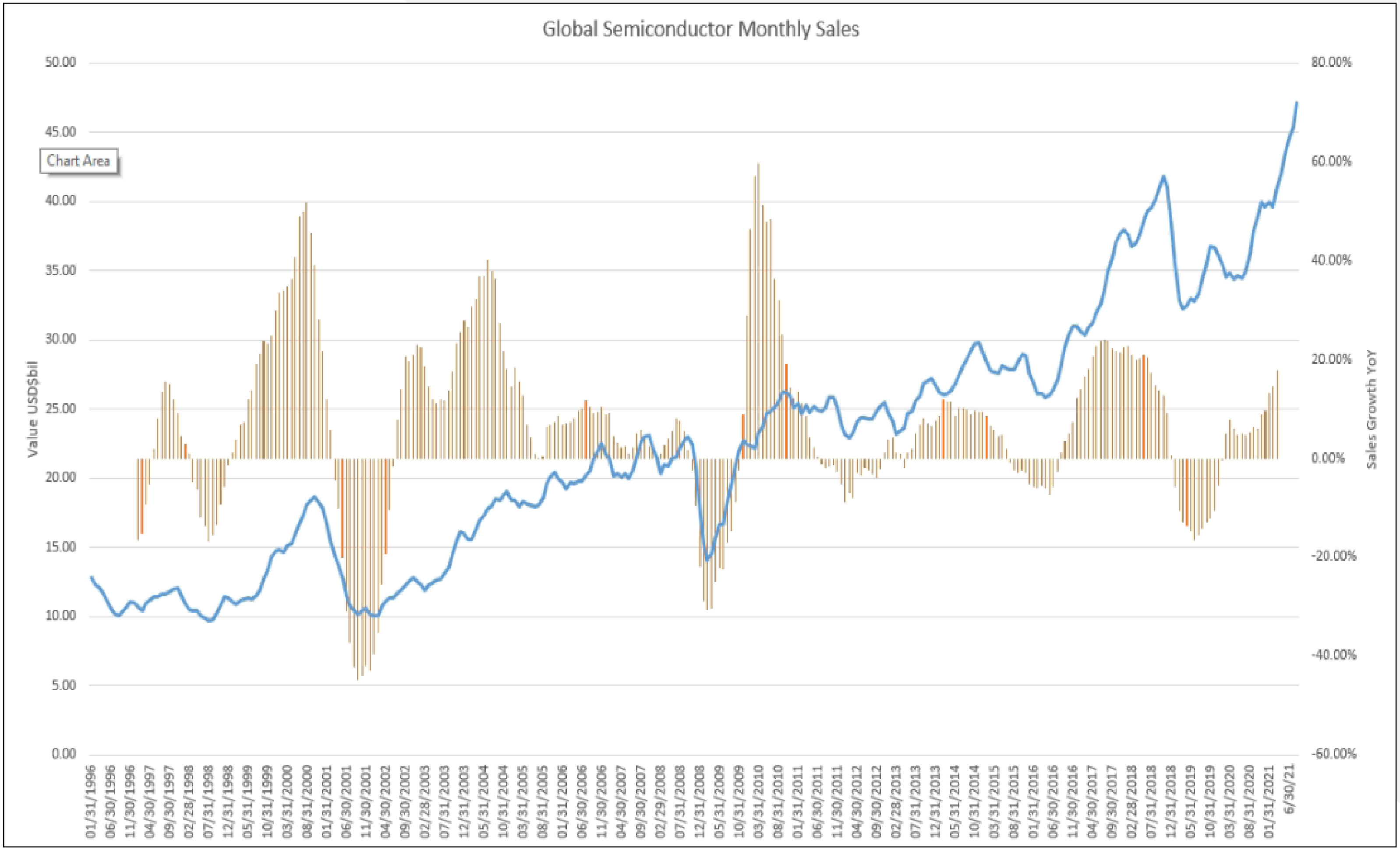
(Source: Bloomberg)

Exhibit 4 : Performance of Indices (Year-to-Date) @ 21.10.21



(Source: Bloomberg)

Exhibit 5 : Global Semiconductor Monthly Sales Chart



(Source: AISB & Bloomberg)

Exhibit 6 : Global Semiconductor Sales Cycles

Semiconductor Sales Cycles

	Dates			Duration (Months)			Monthly Orders
	Start	Peak	End	Start to end	Start to peak		% Increase to Peak
1	06/30/1997	08/31/1997	02/28/1998	9	3		2%
2	02/28/1999	08/31/2000	02/28/2001	25	19		66%
3	08/31/2002	06/30/2004	09/30/2008	74	23		49%
4	12/31/2009	03/31/2010	06/30/2011	19	4		4%
5	12/31/2012	02/28/2014	06/30/2015	31	15		5%
6	09/30/2016	06/30/2017	12/31/2018	28	10		11%
7	*03/31/2020*	*01/31/2021*	*02/28/2021*	*18*	*18*	*	30%
	Average -excluding current cycle			31	12		23%

* *Current cycle*

(Source: AISB & Bloomberg)

Exhibit 7 : Historical Brent Crude Oil Price

(Source: Bloomberg)

Exhibit 8 : KLCI 2021 Best PE Ratio

(Source: Bloomberg)

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