

01/09/2002

No more palpitations?

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NOBODY can fault remisiers and retailers for not having given the market a second glance in recent months.

For remisiers, commissions have been under pressure and volumes, thin. Some are contemplating leaving while many are on the lookout for second jobs. As for retailers, many have been left holding stocks that were bought during the euphoria of 2000, or worse still, the 1993 bull-run. Since mid-2000, the Kuala Lumpur Stock Exchange (KLSE) has been trading on a bearish trend.

The Composite Index (CI), the leading indicator of the KLSE, has been trading at a tight range of between 705 and 730 points for more than a month. The tight trading range indicates that the stockmarket is at a crossroad. Generally, the mood has been glum.

Tan Teng Boo, one of the country's most successful fund managers, in a rare bullish call, recently declared that the good times are likely to roll again. A value investor who heads Capital Dynamics, an equity research and fund management company, Tan is bullish on the KLSE from a longer-term standpoint.

'The ride may be choppy ... something like the 1998-2001 cycle, catching investors by surprise, but the longer-term trend will be up,' he told a limited audience at a seminar organised by Capital Dynamics recently.

Tan is noted for his independent analysis and timely warnings. Among others, he warned of a global crisis and deflation as early as October 1997, predicted the 2001 recession in the US and Malaysia early on and forecast the bottom for the KLSE in April 2001.

Another fund manager, Dr Lee Chee Kuon of Alpha Asset Management, echoed Tan's views. Lee says that apart from the 'bad accounts' and weak US market which affects global markets, things are looking good for the KLSE.

It started with Enron seven months ago, and the spate of accounting fiascos coming out of large US companies have laid bare the weakness of corporate America. America has proven that it is certainly not the last bastion of corporate governance.

The over-stated earnings of companies have further caused the slide of the Dow Jones Industrial Average (DJIA) that started with the burst of the technology bubble in 2000. The S&P 500 that tracks the 500 largest companies in the world's biggest economy has retreated by more than 50 per cent from its peak of 1,527 points in March 2000. The technology driven National Association of Securities Dealers Automated Quotation (Nasdaq) had dropped more than 70 per cent from its peak of 5,048 points in March 2000.

Franklin Tan, head of research at OCBC Securities in Kuala Lumpur, believes that there is a case for the CI to de-couple from the DJIA, given that the domestic economy has already gone through four years of financial rehabilitation.

'So, we are ahead of the curve. A rally in the stockmarket is, however, premature at this stage, unless calm and certainty return. Further, Malaysia's exports, IPI (Industrial Production Index) and consumer confidence are still holding up well - so that's good,' he said. 'There is a strong likelihood for the KLCI to gradually de-couple from the volatility of Wall Street as investors look for value plays.'

Apart from the fragile stockmarket in the US, other worries include the delay in Japan's banking system reforms and public sector finance. The

deflationary impact that China's cheap goods will have on other economies, the deflationary pressures caused by the Internet, and the continued over-capacity in the semi-conductor sector have also dampened sentiments.

On the local front, about 90 companies with deficits in shareholders funds, the last of the remnants from the carnage caused by the Asian currency crisis in 1997/98, are likely to be de-listed by end-August. But this has already been discounted by the market.

Last year, there were a few fund managers, including Capital Dynamics, who were watching the economic numbers closely for fear of a global depression such as the one in 1930. But now, said Tan, that fear has diminished.

For a depression to occur, said Tan, there had to be two elements; deflation and debts. Debts remain in abundance in developed economies such as Japan and developing economies in Latin America. The Internet and the opening of China's cheap exports are sources of deflation.

So, with both determinants present, why should a depression not occur?

Among others, Tan cited that a depression would not occur because the role of the government in the economy is much bigger nowadays, providing stability in the process. He also said money supply in every economy, including Japan, is rising unlike during the Great Depression. 'Despite the steep stockmarket plunge, housing starts and car sales, two major economic sectors, are really far from depression or even recession levels,' he maintained.

Putting aside the string of depressing stories, Tan professed that value investors should cast aside their fears and start looking at the KLSE. He outlines eight reasons why the sunny days are beckoning the KLSE:

- \* the improving Malaysian economy,
- \* rising corporate earnings,
- \* rising money supply,
- \* continued easy credit that has fuelled domestic demand,
- \* the current crisis in Latin America which will benefit Asia,
- \* low foreign funds on the KLSE, which means there could be some buying in the future by foreigners,
- \* better corporate governance and transparency of companies compared to other countries, and
- \* the political succession issue which has been partially solved.

Despite the travails of the global economy, Malaysian economic growth is on track for a 3.5 per cent to four per cent increase. Real gross domestic product grew at 3.8 per cent in the second quarter. The quarterly results also indicate that the earnings of most companies are on the uptrend.

Money supply has also been on the rise. M1, the broad money supply indicator, increased by 14.2 per cent in the second quarter this year. A year ago, it increased by only 4.4 per cent. As noted in the past, a rise in money supply often resulted in the rise of the KLSE.

Domestic demand, propelled by increased car sales and residential properties, has continued to grow due to easy availability of credit. The performance of domestic demand is making up for the lack of private investments.

On the external front, the crisis in Latin America could turn out to be good news for Asia. Recently, Brazil received a US\$ 30-billion package from the International Monetary Fund. Brazil joins Argentina, the other notable economy of Latin America, to be mired in crisis. It is perceived that funds flowing out of the Americas may find their way to Asia.

The current level of foreign participation on the KLSE is already low. During its heyday, the KLSE was among the top bourses in Asia. Foreign participation was more than 20 per cent. But since capital controls were imposed on Sept 2, 1998, foreigners have generally shunned the KLSE. The

foreigners, who are mostly Singaporeans and pockets of investors from Taiwan and Hong Kong, will come back when the bulls hit the market like in 1999/2000. 'This (absence of foreign investors) could be a source for future buyers,' said Tan.

Foreign investors are mostly made up of institutional funds which look at other factors besides earnings. Of grave importance are elements such as corporate governance in listed companies and political stability.

The spate of revelations from the US has put the Malaysian authorities in good light. Malaysian companies have to file quarterly reports on their performance, a feature that is only now being introduced in other countries such as Singapore and Hong Kong.

On the issue of political succession, Prime Minister Datuk Seri Dr Mahathir Mohamad has already laid out plans for his exit in October next year. The transition process is both lengthy and well-planned.

Franklin believes that the KLSE has an even chance of playing 'catch up' because the broad market valuation is still affordable as it is trading at a price earnings (PE) multiple of 14.6x and 13.1x for financial year (FY) 02 and FY03 earnings. The valuation, he said, compares well with its historical 10-year PE multiple of 19x.

He also said that technical indicators are generally oversold and the weak trading volume suggests that the downside risk may be limited for now.

Lee said that if there were no more shocks from the US and Brazil, then the improvement in economic indicators would start to show in the third quarter. 'The recent ruling where chief executives have to swear by their accounts would have flushed out the companies with funny accounts. It is a nightmare going through the accounts of big companies in the US. We only have to take their (chief executives) word for it that the accounts are clean,' he said.

'If the (banking and economic) system in the US holds up and there are no more shocks from Brazil, then the KLSE should up well,' he continued. 'The Budget would also determine how well the KLSE holds up. A budget that attracts investments would be good.'

Franklin said that among the catalysts that could spark a rally in the near term are improved corporate earnings, the Budget and rumours of an interest rate cut. 'But I suspect that the month of September will be a cautious period due to the 9/11 anniversary. Hence, the market could be quiet,' he said.

As for Tan, the 1997-98 and the 2001 bear markets are parts of a protracted bear market - something akin to the 1981-1986 period. 'If we are right, then we are bullish on the longer term. However, despite the positive outlook, we have to warn that the situation is fluid and investors have to monitor the developments,' he cautioned.

Value investors have probably not bothered to look at the market for months. Apart from the ringgit peg that has been a dampener for foreigners, other global factors have also put off many investors. The volatility in the US, the omnipresent threat of a US-Iraq war, international terrorism and global deflation have all contributed to ailing worldwide equity markets.

But value investors always buy when others shy away. That is the difference between making money and losing money in the market. The KLSE has long been on the sidetrend. Perhaps, it warrants a second look now.