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KLCI set to touch 900, says JP Morgan (HL)

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THE Kuala Lumpur Stock Exchange (KLSE) Composite Index (KLCI) could rise to between 850 and 900 points this year, amid expectations of higher corporate earnings, companies' expansion, and stable interest rate and currency, according to investment bank JP Morgan.

And investments by Valuecap Sdn Bhd, the government-backed asset management company, may be a strong catalyst to attract investors to re-look KLSE-listed companies with strong growth potential.

"The upside depends on whether foreign funds will follow Valuecap's lead

this year," JP Morgan head of research for Malaysia Tan Pye-Sen said.

He was speaking at a media briefing for senior economists and equity research analysts on Malaysia's economy and outlook for 2003 in Kuala Lumpur yesterday.

Valuecap is an institutional investor with RM10 billion to spend and backed by some of the biggest institutional funds in the country. It is equally owned by Khazanah Nasional Bhd, Permodalan Nasional Bhd and Kumpulan Wang Amanah Pencen.

Second Finance Minister Datuk Jamaludin Jarjis said Valuecap is created

to ensure that the market properly reflects the actual value of a company,

fairer valuation of its cash flow, profit and loss account and balance sheet.

"Note that Valuecap came into being in a blaze of publicity. That's transparency," Jamaludin said in his speech at a meeting with institutional investors and fund managers in Putrajaya yesterday.

Meanwhile, Valuecap's chief executive officer Sharifatu Laila Syed Ali was quoted by Bloomberg as saying that Valuecap wants to capitalise on some value in the market as markets have slid to very low levels.

"We search for value. There are ways to do it, but we have got some very specific mandates. So it's not going to be something broad-based," she said.

JP Morgan's Tan expects the RM10 billion under Valuecap to be invested over a period of one to two years. He said the impressive gains chalked up

by the KLCI for the past few days are mostly credited to the entrance of Valuecap.

He expressed confidence that the outlook for the next few months would be good, and expects the KLCI to hover around the 750-point level in the short-to-medium term.

Since Valuecap started operations more than a week ago, the KLCI has gained 6.3 per cent, or 39.78 points. It ended yesterday's trading at 666.36 points, down 4.17 points from Friday's close.

Tan also noted that foreign portfolio investors have shifted their asset preference from equities to bonds, which further strengthens the role of Valuecap as a catalyst for share prices in 2003.

JP Morgan is forecasting Malaysian corporate earnings to grow 13 to 15 per cent this year, although consensus forecast appears too bullish at 20 per cent.

It said more Malaysian companies are expected to expand their operations overseas, and they include both large and smaller companies.

"This implies that local sources of growth, or at least expectations of earnings growth, are declining," said Tan, noting that industry and local retail investors are also looking elsewhere for growth opportunities.

JP Morgan also estimates foreign portfolio outflows at RM3.4 billion for the past nine months since the KLCI peaked in April last year. This is 75 per cent of the RM4.6 billion of inflows between the third quarter of 2001 and the second quarter of 2002.

Meanwhile, JP Morgan senior economist Rajeev Malik expressed confidence that Bank Negara Malaysia is unlikely to cut the present interest rates, which is higher than the US rates.

"The inflation rate has settled around 2 per cent in recent months. We expect Bank Negara to stand firm in 2003, although benign inflation and excess liquidity in the domestic financial system offer room to ease," he said.

Net interest margin of listed banks has been under pressure in the last three years, coming down from 3.2 per cent in 2000 to 2.9 per cent in 2002.

Analysts expect further squeezing this year when banks merge with their respective finance arms this year. Both entities will need to first realign their current differing basis lending rates (BLRs).

Banks' BLR now stands at around 6.4 per cent as compared to finance companies' 7.4 per cent.

Rajeev said the investment bank also supports the view of Prime Minister Datuk Seri Dr Mahathir Mohamad that the ringgit peg will remain intact.

"In addition, the Budget 2003 is prudent, emphasising fiscal consolidation and medium-term debt sustainability," Rajeev said.

Malaysia pegged the ringgit at RM3.80 to the US dollar as part of a wide range of measures to stem the effect of the Asian financial and economic crises of 1997.

On a possible fiscal stimulus to shield the economy from any fallout from a possible US-Iraq war, Rajeev said Malaysia can afford a pump-priming exercise provided it ranges from 0.5 to 1 per cent of gross domestic product (GDP).

David G. Fernandez, JP Morgan's head of Asia Sovereign Research, said the investment bank expects Malaysia to regain an "A" for its foreign currency ratings by the end of this year.

He based this on a combination of political stability and improving fundamental factors.

"(Early last year) we called Malaysia the Asia's next candidate for ratings upgrade based on the progress on restructuring and reduced vulnerability of external shocks.

"Investors took note of our call well ahead of the actual upgrades by Standard & Poor's (S&P) in August 2002 and Moody's Investors Service the following month."

Malaysia has a long-term currency rating of Baal by Moody's and BBB+ by S&P.

Similarly, Fernandez said JP Morgan has consistently recommended investor clients to overweight Malaysian dollar-denominated bonds, a recommendation that has stood for over 12 months running.

"Malaysia is the only country in Asia that JP Morgan is overweight for fixed income investments.

"Our recommendation is vindicated by the superior performance of Malaysia, with a tightening of bond spreads giving investors one of the highest returns among Asian credits and among global high-grade credits," he added.

JP Morgan said the Malaysia's GDP is likely to be driven by higher domestic consumption and smaller negative contribution from net exports.

It puts the full-year GDP forecast for 2003 at 5.2 per cent, which is above the market consensus of 4.5 per cent but below the Government's forecast of 6 to 6.5 per cent as stated in the Economic Report 2002/03.

The investment house estimates that GDP grew by 4 per cent in 2002.

On the political scene, Rajeev said the market expects smooth transition of the prime ministership to Deputy Prime Minister Datuk Seri Abdullah Ahmad Badawi, with the business-friendly policies not expected to change.

"The appointment of Jamaludin as the Second Finance Minister has further erased the uncertainty over who would take up the post.

"This will strengthen the economic team although signals for an early election in 2003, rather than 2004, are appearing. Overall, we believe the market has already priced in a smooth transition," Rajeev added.