STEADY AS SHE GOES

Though still lagging behind its regional peers, the Malaysian stock market is making steady progress on the back of more robust economic growth and improved fundamentals

■ By Mayban Securities Sdn Bhd

THE KLCI NOTCHED A DECENT GAIN of 6% for the third quarter but was overwhelmed by the much better performance on the broader market as the Second Board rose 12% and the Mesdaq market index rose 40%. Trading activity was centred mainly on mid-caps, lower liners and especially the oil and gas counters, technology stocks on the Mesdaq market, as well as water-related stocks. As thematic plays reigned supreme during the third quarter, even the Marriot Hotel bombing in Jakarta on Aug 5 hardly slowed down the market's uptrend.

At the beginning of the third quarter, the July rally in very active trade extended the gains of the previous two post-SARS months before profit-taking set in by end July. The market took a breather, declining to almost 700 on the KLCI but bargain hunters emerged in August to latch onto thematic plays of oil and gas, against the backdrop of a surging Mesdaq market.

Oil and gas stocks were given a boost in Budget 2004 on Sept 12 with the proposal to set up a consortium of companies to explore marginal oilfields and the discovery by Murphy Oil of its second and third fields in the past two months gave added impetus for spectacular gains

Table 1: Comparative PER

Country	PER04	PER05
China	17.1	14.4
Singapore	15.5	14.0
Hong Kong	15.3	14.1
Taiwan	14.3	12.5
Malaysia	13.9	12.3
Philippines	3.0	11.2
Thailand	10.3	9.2
Indonesia	8.3	6.8
Korea	8.2	7.3

Source: Multex

of oil and gas related stocks.

Mesdaq market's rise of 40% this quarter gave it a total gain of 73% this year, beating second-placed Thailand with 62%. However local heavyweights performed more modestly, as the KLSE CI's 6% gain still lagged behind regional markets.

Equity market still has further upside

With Datuk Seri Abdullah Badawi taking on the premiership on Nov 1, Malaysia will begin a new chapter after 22 years under Datuk Seri Dr Mahathir Mohamad's successful tenure. Though Abdullah will inherit Mahathir's legacy of administration, it is the difference in style that will make the political transition a historic event from the foreign investors' perspective (see side-bar).

Malaysia already has all the ingredients for a buoyant equity market to prevail: rising GDP with robust external trade coupled with an expanding domestic private investment in a low interest rate environment. Add to that the element of improved investor sentiment as witnessed by the high trading volumes, oversubscription and good performance of IPOs, the equity market can be expected to be well-supported going forward. Foreign portfolio funds, many of which had unfairly avoided the country before, could now return to give a boost to the market.

GDP growth set to rise further in 2004

In the recent quarter, we upgraded our GDP forecast for 2004 to 6.0% from 5.5%, due to better manufacturing sector growth, in particular, the rising demand in the semiconductor sector. The accelerating economic recovery coupled with the banking sector's higher loan growth rate and improving asset quality is expected to spur greater earnings growth.

Tourism and consumer spending, now getting back on track after the SARS episode, will also contribute towards generating higher corporate profits. Our forecast is for net earnings in 2004 to grow by 12.1%.

Risk mostly external

With no major negative factors plaguing the market, fundamentals factors are riding on the accelerating recovery of the local economy that will lead to better earnings growth. As such, the downside risk will largely be more externally-driven rather than domestic. As always, the major risk is if the US recovery stalls or its bullish markets become unsustainable. The strength of Asian currencies could also have repercussions locally if the ringgit is pressured. Other factors that could prevent a market uptrend would be a rising incidence of terrorist acts.

Valuations not excessive

Though the KLCI has risen a commendable 13.5% this year, the performance has been moderate compared to many regional markets, and while momentum is centred on mid-cap and lower liners, the larger caps still have room to rise. Historically, the KLSE is at attractive levels as it is trading at PER04 of 13.9 times.

Even on a regional basis, Malaysia's valuations are still fair, placing it in the middle of the ranks of regional markets (Table 1). Thailand, despite its huge gains this year, is still attractive for foreign investors. In general, the Asean markets except Singapore have been cheaper than Malaysia, but Indonesia and Philippines do have additional country risk. With Asian markets showing fewer bargains, foreign fund managers have been searching for alternative destinations. And Malaysia can stand to gain in this respect.

We are maintaining our year-end fair value at 770 as in our recent quarter. As before, we reckon that the current market is momentum-driven and if the sentiment on second liners spills over to the bigger caps, the market could be pushed to around the 800 region by year-end.

STRATEGY

Rising On Positivism

THE positive factors that were evident in the recent quarter are still present to drive the equity market ahead. The May economic stimulus package did its job and Budget 2004 topped this with a few incentives.

In fact, our expectation of a bullish market going forward has been reinforced with the upgrading of the GDP forecast for 2004 to 6%. With the government's easy monetary policy st4ill in place, capital gains would preferred, so we advise investors to take the opportunity to participate in a moderate upside on the KLSE. We would advise caution on excessive trading of lower liners, which though short-term profitable, could take a tumble due to overstretched valuations. Let's take a look at the sub-sectors:

BANKING

Better loan growth and falling NPLs

The rising pace of the economy is projected to spur loan growth of the banking sector to 6.8% in 2003 and 6.5% in 2004. GDP growth of 4.5% in the second quarter of 2003 is expected to improve further to 4.9% in the second half of the year. Other measures are expected to improve, giving better bottom lines for banks. Investment banking business stands to gain as incentives in the sector grow.

We like the retail segment as consumer spending grows. Incidence of bad loans will fall, causing NPL to consolidate at 6-6.5% by end 2003. With the urgency of the second round of consolidation put on the back burner for now, banks will strive for internal efficiencies and intra-bank integration. Though bottom lines will still benefit from lower loan loss provisions and writeback of interest in suspension, we still expect net interest income to increase in tandem with the improving economy as margins stabilise and asset quality strengthens.

Retail banks to continue to do well

A recovery in consumer spending and the economy traditionally flows directly to better performance of the financial sector. The main beneficiaries of consumer spending and the improving economy will be retail banks, particularly those which been have aided by prudent management and sound asset quality. Banks offering fixed rate financing can still command decent margins.

WATER

Government involvement a boost

Water-related stocks have been of interest of late and though several have risen substantially, the more reasonable valuations and potential for further upside make them better alternative to many of their oil and gas counterparts. This is especially so with recent government involvement and a boost in development spending. Water concessionaires are the safest bet with their steady income stream.

CONSTRUCTION.

Still a lot of jobs around,
and overseas as well

Though headline numbers in the recent Budget 2004 show that development spending of RM30 billion for 2004 will be 21% lower than in 2003, the scenario is far from bleak. With healthcare and transport capturing higher allocations, opportunities still abound for many of the listed construction companies, especially the larger ones, which incidentally are also growing their foreign order books. The focus is on companies in the water-related sector, those dominant in East Malaysia, especially Sarawak, and companies with foreign order books.

SEMICONDUCTOR.

Demand in Asia Pacific strongest

Demand for semiconductors is beginning to gain traction. The latest revised sales forecast from the Semiconductor Industry Association confirms our view of a demand recovery. While we believe forecast sales growth of 16.8% for 2004, from 10.1% in 2003, can be achieved, we are even more optimistic since demand will be focused in Asia Pacific, which is benefiting from a trend of operations shifting to the region.

GAMING.

Post SARS, consumer spending
to boost gaming sector

The better economy and stock market wealth effect are expected to encourage greater punting activities. Solid companies with good management in the gaming sector will stand to gain. The government's tourism promotions will also help the gaming sector.

CONSUMER

Consumer stocks still
good dividend play

The consumer products sector was slapped with higher duties in the recent Budget.

However, we believe tobacco players offering good dividend yields will hold up better than the breweries which may see sales growth dwindle from the price hike. ID