

What Can We Expect in 2005?

After a year of false starts and false sightings of bulls, the landscape seems to be changing. Will Bursa Malaysia finally rumble?

>> By James S and Clarence Y K Ngui

ARE the bulls back? Well, judging from the recent pick-up in trading volume on Bursa Malaysia and the Kuala Lumpur Composite Index (KLCI) hitting 918.95 points, a four-and-a-half-year high, they very well might be.

Most analysts and market strategists believe that the shape of the economy is certainly conducive for a market rally ahead. The easing of crude oil prices, the potential re-peg of the ringgit and encouraging foreign fund inflows could provide the much-needed catalyst for the bourse to resume its rally in 2005.

China's interest rate hike by 27 basis points for the first time in nine years and

the widening of the yuan trading band have invited strong speculative news flow of a likely adjustment of the ringgit peg to the US dollar. And if one believes in the 12-year cycle theory, the rally could be the big one that investors have waited for so long.

According to MIDF Sisma Securities, under the prevailing economic conditions, prospects for the stock market in 2005 look favourable.

The local research house notes that economic activities, especially oil and gas, are expected to be sustained with rising energy demands, while mergers and acquisitions (M&A) involving banks and government-linked companies may continue to spur an interest in the stock market.

Avenue Securities Research suggests that the fall in oil prices should ease the worry of any acceleration in local price inflation and the cost of doing business.

On a technical note, the research house points out that oil prices could in fact fall further (which should spur global equity markets) as the Light Crude Oil chart has shown a bearish engulfing reversal pattern (see Figure 1).

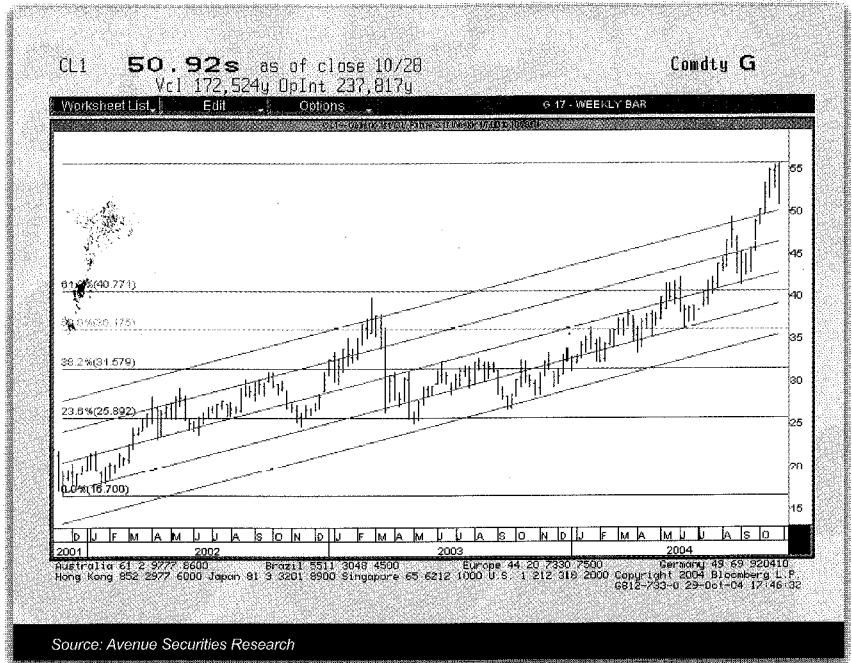
It says that coupled with its overbought condition (surpassing the upper confine of the 2-standard deviation channel), the commodity could have already topped out and is now in the midst of pulling back towards its 23.6% Fibonacci Retracement (FR) level and the 38.2% FR level of US\$46.46 and US\$40.77 respectively.

AmResearch shares the view. Its research report dated Oct 22 says the recent crude oil price rally could be characterised as being in a Wave 3 (based on Elliott Wave analysis) scenario and a breach of the US\$50/barrel price level signals that the commodity has entered Wave 4. Under such a scenario, oil prices could fall back to the US\$40 to US\$45 a barrel levels.

This decline could take as long as a year to complete, which in turn favours an

FIGURE 1: PRICE MOVEMENT OF CRUDE OIL

Weekly Charting of Light Crude Oil (NYMEX) (as of Close on Oct 28)



slacken global economic growth, there are others (like us) who are upbeat, as such a move would invariably increase currency appreciation pressure, hence the need to

OSK Investment Research in its recently published report, *Ringgit Peg: The Day of Reckoning*, also believes that the voices of a ringgit peg adjustment are getting louder, amplified by China's rate hike which, as mentioned earlier, is the first in nine years.

The wind of change politically also adds to speculation that the exit of the ringgit peg (at least from the old level) would send the strongest message that Malaysia is serious in shedding its old image and transforming itself into a 'New Malaysia'.

Market Outlook: Bullish and More

Apart from the external catalysts, technically speaking, Avenue Securities Research sees further improvement in the KLCI. It says the KLCI has overcome its five-year downtrend movement and seems to have completed a triangle breakout (see Figure 2) with an upside measurement target of 1080, coinciding with the 76.4% FR of its down move from 1332.04 to 261.33.

From an Elliot Wave perspective, the research house believes that the KLCI is at the beginning of an emerging bull market sustainable over the next few years as indicated by its current Major Wave 3 move (which has been ongoing since May

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equity market rally in 2005 as worry over high oil prices, which dampened the market earlier, has diminished.

Malaysia is also likely to benefit from the rate hike in China and the possible revaluation of its yuan peg to the US dollar. Quoting Avenue Securities Research:

China raised its benchmark interest rates by 0.27 percentage point to 5.58% for one-year lending and 2.25% for deposits. While some economists are bearish about this move as it would

revisit China's peg of its renminbi that may in turn magnify Malaysia's stance to re-look at its rigid RM/US\$ peg, which has been the main point of debate for so long.

C K Ngu, head of research at TA Securities, believes that a revision of the ringgit peg would have a significant impact on Malaysian companies and the economy. 'If the ringgit is revalued, exports would take a dip as cost of sales would increase due to currency conversion,' he says.



Will Bursa Malaysia deliver the goods in 2005?

2003 from the 614 level). The stockbroker's preferred wave count is as follows:

- Major Wave 1 (261.3-1021.2, Sept 1998-Feb 2000)
- Major Wave 2 (1021.2-547.7, Feb 2000-May 2001), assuming failure in Sub-wave C
- Major Wave 3 (614.0-?, March 2003-?)

Under this set of wave count, Avenue strongly believes that the underlying market should be technically and structurally bullish. Hence, it expects the KLCI to hit its upside target projections of 1200.53 (123.6% FE), 1311.47 (138.2% FE) and 1401.14 (150.0% FE) (see Figure 3) in its future rallies.

The research house has also done a potential simulation of the probable movement of the KLCI in the future. From its simulated KLCI path, the research house obtained a normal distribution of the KLCI for the remainder of the year. The simulation results (see Table 1) clearly suggest that the KLCI could stage a strong

rally to as high as 1100.

At 95% confidence level, it says the KLCI is likely to fluctuate between 736.7 and 1016.8 within a 14-month time frame.

Judging from the probability study, one could also deduce that the probability for the KLCI overcoming its 919-level resistance is 26.7%, which far outweighs

FIGURE 2: MONTHLY CHARTING OF THE KLCI

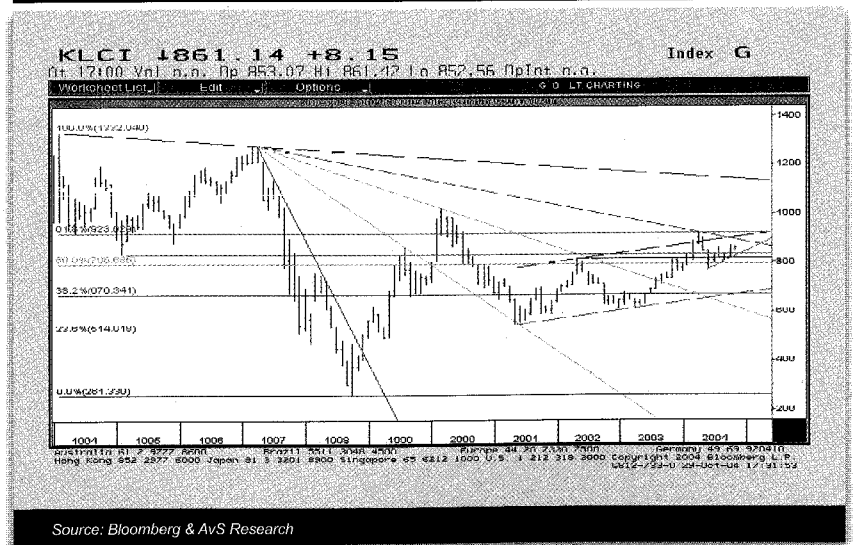


Table 1: Distribution of Simulated KLCI

	1	2	3	4	5	6	7	8	9	10	Average
Mean	887.9	878.6	858.6	876.9	907.0	865.4	858.9	878.2	863.0	893.0	876.8
Standard Deviation	54.9	67.4	50.1	72.5	102.2	74.0	42.0	93.4	87.2	70.8	71.4
Kurtosis	-0.5	2.1	-0.2	0.2	0.8	0.9	-0.1	1.3	0.4	0.1	0.5
Skewness	0.2	1.2	-0.1	-0.5	1.1	0.2	0.4	1.2	0.7	0.4	0.5
Range	269	373	266	401	528	492	219	508	460	367	388
Minimum	770	751	721	651	731	678	766	735	665	737	720
Maximum	1039	1124	987	1052	1260	1170	985	1243	1125	1104	1109
Count	3001	3001	3001	3001	3001	3001	3001	3001	3001	3001	3001
At 95% Confidence Level, KLCI Is Ranging											
Between	780.3	746.6	760.4	734.9	706.6	720.4	776.7	695.2	692.2	754.2	736.7
And	995.5	1010.6	956.7	1019.0	1107.4	1010.4	941.2	1061.2	1033.8	1031.8	1016.8
Probability of KLCI <=	766.5	766.5	766.5	766.5	766.5	766.5	766.5	766.5	766.5	766.5	766.5
=	1.4%	4.8%	3.3%	6.4%	8.5%	9.1%	1.4%	11.6%	13.4%	3.7%	6.3%
Probability of KLCI >=	919.0	919.0	919.0	919.0	919.0	919.0	919.0	919.0	919.0	919.0	919.0
=	28.6%	27.5%	11.4%	28.1%	45.3%	23.5%	7.6%	33.1%	26.0%	35.7%	26.7%

Source: AvS Research

the probability of the index breaching its 766.5-support at 6.3%.

Sectors Outlook: A Mixed Bag

Nonetheless, it appears that to outperform the next rally, investors would probably have to choose the right sectors and stocks as, based on the strategy and investment reports by most of the research houses, the outlook for the various counters remains mixed.

The chief investment officer of CMS Dresdner, Scott Lim, feels that stocks to look out for include those in the local banking industry, utilities and water-related companies. He also favours the electronics/semiconductor sector, considering an expected increased demand from China, especially in the second-half of 2005.

Most analysts believe that banking stocks and the banking sector are looking good

despite a tough operating environment arising from intense competition and liquidity surplus. Avenue Securities Research continues to maintain an overweight rating for the sector on the back of:

- i. possible M&A activities;
- ii. as a proxy to economic growth; and
- iii. its significant weighting of about 20-25% of total market capitalisation of the bourse.

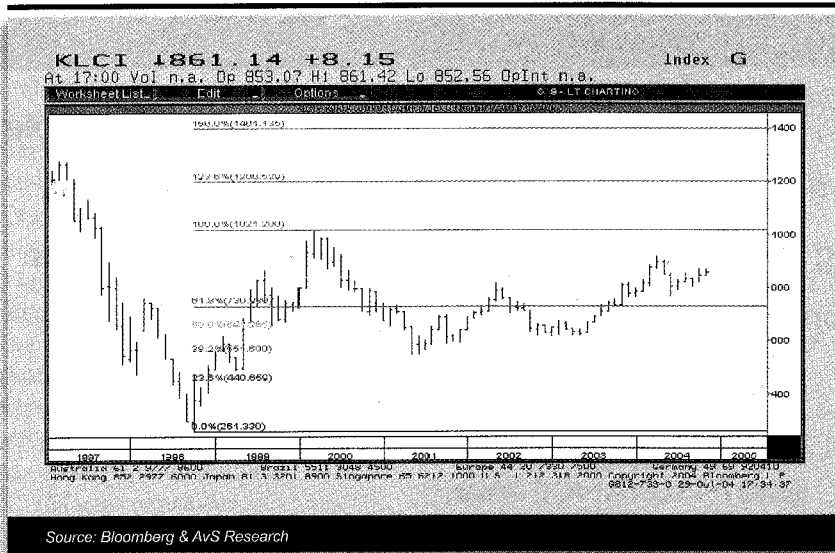
Automotive stocks, on the other hand, are looked upon with caution. Research houses such as OSK Investment Research and Maybank Securities Research reckon that such stocks are not likely to be attractive as the industry is still awaiting the new Asean Free Trade Area (Afta) guidelines and government policies on the matter to enable assemblers and dealers to formulate strategies.

The uncertainties over the Government's post-2005 auto policy are, as such, likely to dampen sentiment for automotive stocks.

Construction and property stocks too may not do as well given a lack of new catalysts and growth drivers amidst declining order books and an oversupply situation.

Thematic play on oil and gas stocks is likely to be weak in line with the fall in oil prices. Plantation stocks could benefit from a mild El Nino weather phenomenon, but the upside could be limited due to a prevailing cyclical

FIGURE 3: POTENTIAL TARGETS OF MAJOR WAVE 3 BASED FIBONACCI EXPANSION TARGETS



bear cycle for crude palm oil prices.

Other sectors such as consumer, utilities and gaming are viewed as relatively stable. Their stocks are well known for defensive and dividend plays.

Stock Picks Remain Crucial

Stock picks remain crucial as market participants would have probably noticed by now that while the market seems bullish, only selected stocks are really performing exceptionally.

Such stocks are likely to be blue chips as foreign funds make their way back to Malaysia in anticipation of the strengthening of the ringgit peg. Also included are thematic stocks or sectors, and second and third liners that have seen their prices bashed heavily.

Core Holdings

Avenue Securities Research in mid-3Q04 had come out with one interesting research report entitled *Better Safe Than Sorry*. In it, it highlighted the key characteristics of stocks that are resilient but not necessarily outperforming the market (see Table 2).

Based on those characteristics, the research house reckons that Tanjong, Top Glove, Public Bank, MISC, Guinness Anchor, NCB Holdings, Malakoff, Star Publications and OYL Industries fit the bill (see Table 3).

GLCs Will Be the Thematic Play

As mentioned above, the market rally could still be concentrated on blue chips and theme play on government-linked

Table 2: Key Characteristics of Resilient Stocks (For Core Holding)

Key Characteristics	Winners	Losers
Div Yield	> 3.5%	< 1.6%
Div payout	> 33%	No min.
Market cap	Big-caps	Small-caps
Trading vol	Mix vol.	Mix vol.
Beta	Low < 1.0	High > 1.0
Alpha	+ve	-ve
Earnings growth	Consistent	Volatile
3-CY CAGR	> 10%	Volatile
Margin	Up	Down
ROE	> 10%	< 10%
ROA	> 5%	< 5%
Net gearing	Low	High
Altman Z-score	> 1.8	< 1.8
Valuation	Low	High
PER*	< 15x	> 30x
P/BV*	n.m.	n.m.
P/Sales*	< 2.0x	> 2.0x
P/CF*	n.m.	n.m.
EV/EBITDA*	< 8.0x	n.m.
EV/Sales*	< 2.0x	> 2.5x

*3-CY weighted average
Source: Avenue Securities Research

companies (GLCs).

According to JP Morgan Equity Research, the restructuring and reform of GLCs in Malaysia is a key re-rating catalyst for the KLCI.

The research house reckons that via improvement of their cash utilisation, further M&A activities and strong government support for their reforms, GLCs are expected to deliver higher returns in the future.

It prefers Telekom Malaysia and Tenaga Nasional for their highest upside potential, while Bintulu Port is the top mid-cap pick for possible GLC reforms. Meanwhile, Maybank and Sime Darby could potentially spring some upside surprises.

Tan Teng Boo of Capital Dynamics feels that the performance of blue-chip companies like Tenaga, MAS, Sime Darby and Telekom are vital for a sustainable economic uptrend.

However, he says, these companies have to improve their corporate performance and deliver their promised reforms and restructuring in 2005.

For another bet, Avenue Securities Research reckons that one should look for some laggards among the

GLCs. It quotes in its research report of Sept 21:

YTD, KLCI has delivered a commendable 12% total returns – driven by strong performance among big-cap stocks, particularly GLCs like Tenaga and Telekom (which have yielded total returns of > 15% YTD).

As the strong performance appeared to be sentiment-driven on expectations that those GLCs will deliver in the future (in

Table 3: Stocks Fit For Core Holdings

Stock	Price (RM)	Mkt Cap (RM mil)	Vol* ('000)	Beta	PER (x)		FY ₀ -FY ₂ CAGR %	PEG (x)	FY05 ROE %	FY05 DY %	Rel. Performance %			P/BV (x)	Rating
					FY04f	FY05f					1-mth	3-mth	12-mth		
Tanjong	13.00	5211.1	553.0	0.95	12.1	11.8	8	1.5	17.6	4.4	4.2	8.1	18.1	1.8	M/P
Top Glove	7.40	687.9	140.3	0.79	18.7	14.4	36.7	0.5	28.4	2.3	3.1	-5.6	118.5	4.6	O/P
Public Bank	6.35	20914.1	2516.7	0.93	18.8	16.8	12.5	1.5	12.7	1.7	3.1	5.7	30.6	2.0	O/P
NCB	2.42	1137.6	81.9	0.75	10.3	8.9	17.8	0.6	7.6	5.8	5.2	7.9	2.2	0.7	O/P
Malakoff	6.35	5598.5	1180.2	0.74	12.6	10.5	10.2	1.3	15.4	4.1	3.1	15.6	19.2	2.5	M/P
Star	6.45	2090.9	296.1	0.69	17.4	15.3	11.6	1.5	19.5	5.4	-2.6	1.9	-13.3	2.5	M/P

Note: Share prices as at July 30, 2004. * Six-month average. f - forecast

Source: Avenue Securities Research

Table 4: A List of Tradable Stocks Based On Technical Perspective

Trading Stocks	Last Price (RM)	Support (RM)	Resistance (RM)	Remarks
M PLant	2.32	2.20-2.15	2.50-2.60	Accumulate at support level to as low as RM2.15.
Mutiara	0.95	0.92-0.89	1.10-1.15	Accumulate at current level.
Scomi	1.30	1.20-1.15	1.45-1.50	Accumulate at support level.
DRB Hicom	2.11	2.00-1.90	2.50-2.60	Accumulate at support level.
Oilcorp	1.02	0.95-0.90	1.15-1.25	Accumulate at support level only as indicators approaching oversold territory.
George Kent	0.74	0.70-0.65	0.85-0.90	Indicators are recovering. Accumulate at current level.
Affin	1.57	1.50-1.45	1.70-1.80	Indicators are overbought. Accumulate at support level.
RHB Cap	2.02	1.90-1.80	2.20-2.40	Accumulate at support level. Indicators have staged a negative crossover.
Redtone	2.05	1.95-1.90	2.20-2.30	Accumulate at current level. Indicators already at the oversold region.
Opcom	1.19	1.15-1.12	1.30-1.40	Accumulate at current level. Indicators staging positive crossovers.
Laggards				
Kian Joo	2.42	2.30-2.20	2.65-2.75	Accumulate at current level. Indicators are extremely oversold.
MAHB	1.41	1.35-1.30	1.55-1.60	Indicators have yet to signal a technical rebound. Accumulate at support only.
Asiatic Devt.	1.81	1.70-1.65	2.10-2.20	Indicators are easing. Accumulate at support level only.
Bandaraya	1.86	1.80-1.70	2.20-2.30	Indicators are neutral to positive. Accumulate at current level.
UEM Builders	1.12	1.05-1.00	1.25-1.30	UEM Builders is easing in the near-term. Accumulate at support level.
Ranhill Utilities	2.40	2.30-2.20	2.60-2.70	Accumulate at support level as indicators have staged negative crossovers.
Dreamgate	1.72	1.65-1.60	1.90-2.00	MACD signal line flattening. Accumulate at current level.
PPB Oil Palm	3.32	3.20-3.10	3.50-3.70	Indicators are at the overbought region. Accumulate at support level.
Lion Industries	0.94	0.90-0.85	1.10-1.20	Indicators are seen easing from neutral to oversold zone. Accumulate at support.
Inti Universal	1.65	1.60-1.50	1.80-1.90	Accumulate at support level as indicators are mixed to negative.
Accumulate on weakness				
YTL Power	1.74	1.65-1.60	1.90-2.00	Stochastic indicator is seen easing at the neutral zone. Accumulate at support.
Commerce	4.60	4.50-4.40	5.30-5.50	Indicators overbought. Reduce holdings and accumulate at support zone.
IOI Corp	9.15	8.80-8.70	9.70-9.90	Indicators are still easing. Accumulate only at the support level.
Tenaga	11.00	10.70-10.50	11.50-11.60	Indicators are overbought. Reduce holdings and accumulate at support zone.
Maybank	10.90	10.70-10.60	11.40-11.50	Maybank is already overbought. Accumulate lower at the support zone.
Telekom	11.20	10.80-10.50	11.60-11.80	Negative crossover of the indicators will signal an interim reversal.

Source: Maybank Securities Research

terms of earnings), we can find no compelling reason why other non-performing GLC stocks (like Proton Holdings, Plus Expressway, NCB Holdings, UMW Holdings, DRB-Hicom and Kumpulan Guthrie) should not start playing catch-up.

On Sept 27, the same research house in another report pointed out that apart from the GLC laggards, investors should also look for value big caps with sound fundamentals and cheap valuations, and which are trading closer to historical lows and offer good stock liquidity profile (if one emphasises capital gains).

In this aspect, the research house prefers Magnum Corporation, DiGi.Com, PPB Oil

Palms, Malayan Banking, Commerce Asset-Holding and Proton Holdings.

Early Positioning For Lower Liners

While the lower liners have been underperforming the big-cap stocks thus far, investors who prefer mid-to-small-cap stocks could also accumulate these stocks into weakness now to position themselves for the strong market ahead as the rally in blue chips is likely to spill over to the lower liners.

Maybank Securities Research in its 4Q04 strategy report features some mid-to-small-cap stocks, including some GLCs, that have staged breakouts above the

downtrend channel and look good for a move to the upside. The stocks are shown in Table 4.

So are corrections like the one at the week's closing of Nov 19 cause for concern? CMS Dresdner's Lim says there are still a lot of uncertainties.

'Although domestic demand and consumption remains upbeat, Malaysia's economic prospects depend largely on the economic policies of the United States,' he says.

'If the US has a strong consumption pattern, Malaysian exports would see a strong boost. Then, a strong economic growth of 5-6% would be more than achievable.' **mb**