

What the Economy Holds

And what's in store for stock investors.

By Clarence YK Ngui

CRYSTAL ball-gazing into 2005, *Malaysian Business* solicited the views of research heads and fund managers on how the economy will likely perform in the new year and what investors can expect. Questions included prospects and challenges for 2005, industries and sectors that would benefit, and lists of favoured stocks. Following are excerpts of their response.

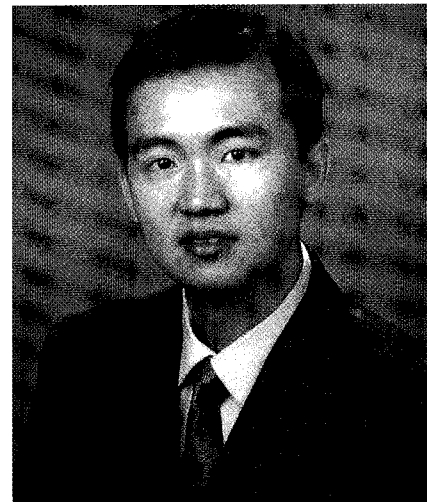
SCOTT LIM

Chief Investment Officer
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We believe that Malaysia's economic prospects depend on the economic policies of the United States. If President George Bush moves ahead with tax and healthcare reforms, these tax cuts would be able to sustain consumer spending. Strong US consumer spending would drive global demand, and for Malaysia, it would mean a boost in exports. An economic growth of 5-6% would then be achievable.

Although domestic prospects are satisfactory, local demand is still not strong enough. Malaysia is still very much an open economy for which high growth rates hinge on strong exports.

More importantly, 2005's economic prospects would depend on crude oil prices. Although prices have fallen back in recent weeks, this may only be a short-term correction. Certainly, if future oil prices



continue their upward trend, worldwide demand, especially consumer consumption, might be affected as inflationary pressures build up. High oil prices might affect Malaysia's economic growth.

Nevertheless, US policies would play the

most important role in the Malaysian economy; we are still highly dependent on US consumption patterns. In the meantime, we expect local demand to continue being strong.

Among sectors to watch out for are the local banking industry, construction, as well as utilities and water-related companies. Next year might be a good year for the construction sector as more new projects would come on board. The electronics/semiconductor sector is poised for rapid expansion in the second half of 2005 when China is expected to push for higher growth.



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Under prevailing economic conditions, prospects for the stock market in 2005 look favourable. Activities in the oil and gas sector are expected to be sustained with rising energy demand and high oil prices, which are expected to average around US\$40 per barrel in 2005, while mergers and acquisitions (M&A) involving banks and government-linked companies may continue to spur interest in the stock market.

Furthermore, the kick-off of water privatisation and the 50-year water master plan valued at RM70 billion would benefit water and construction players. This sector is already feeling the pinch of a 9.1% contraction to RM28.3 billion in 2005's development expenditure.

However, there are signs of cooling demand for Malaysia's exports, especially electronic products that make up 45% of its manufactured exports. A dip in exports could push down Gross Domestic Product (GDP) growth for 2005 below the official forecast of 6%.

There are also indications of creeping inflation with the government cutting oil subsidy and a possible increase in energy and water tariffs.

Investors also have to worry about a possible hike in interest rates since they are hovering at historical lows. Monetary policy tightening will increase borrowing costs and trim corporate earnings; hence

the end of the equity party

The high oil prices act as a double-edged sword. With the mining sector (under which oil falls) contributing only 7% to the GDP, the negative impact on consumer sentiment globally would weigh more on demand for Malaysian products than the positive price effect.

Besides these challenges, Malaysia also has to manage its peg with the US dollar, especially in the face of a possible revaluation of the Chinese renminbi. Revaluation of the ringgit would hurt exporters that sell their products in dollars, especially the electronics and plantation companies, but would benefit companies that have foreign borrowings like Telekom and Tenaga.

On the political and health fronts, pockets of terrorism will continue to be a cause for concern with the re-election of United States President George W Bush and the demise of Palestinian President Yasser Arafat. There is still a possibility of a resurgence of the Severe Acute Respiratory Syndrome and bird flu in the first quarter of 2005.

Our sector picks include the banking sector, which is already classified as overweight due to the expanding economy, which would mean banks would be doing well and benefiting from the growth. Furthermore, M&A activities would pick up momentum in 2005.

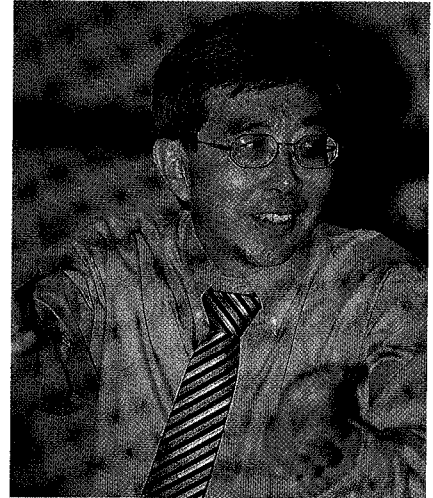
We have a neutral stand on the education sector as its long-term prospects look bright given the importance of human resource development in the country's success story and the transformation of Malaysia into an education hub.

We also believe the construction sector would be underweight in 2005. The sector has been the major loser due to cutbacks in development expenditure. Companies that rely solely on local jobs will face fewer or smaller available contracts amidst rising competition that could have an adverse impact on their margins.

Nonetheless, specialised companies in water, waste-water and road maintenance will prevail.

For power and technology, the internal cost rationalisation exercise and potential increase in tariff are expected to benefit Tenaga Nasional while semiconductor demand is expected to contract in 2005,

resulting in an underperforming industry. However, for the telcos, the recent integration exercise is expected to provide economies of scale, improve Ebitda (earnings before interest, taxation, depreciation and amortisation) margins and profitability of the industry.



TAN TENG BOO

Managing Director
Capital Dynamics

If Bursa Malaysia is able to attract foreign investors, we are confident that the stock market rally can be sustained. It very much depends on how we can attract these investors. If the foreigners are confident of Malaysia, they will return, or they would invest their funds in regional bourses.

For the market to sustain an upward trend, we believe local blue-chip companies like Tenaga Nasional, MAS, Sime Darby and Telekom will have to improve their corporate performance. These companies have promised reforms in the past. In 2005, we must see the results of these promises.

We forecast 2005 will see a slowdown in the world economy. However, we believe the following years of 2006 and 2007 would be much better. Certainly, the upward trend in the world economy would begin in end-2005.

Much also depends on crude oil prices. If prices are stable, then the world economy would see a general improvement as well as buck the trend of a global slowdown. We forecast that crude oil prices would not surge as high as in 2003 and 2004, but would hover between US\$45 and US\$55

Summary of Choice Stocks For 2005

Company	Share Price*	Rationale
Aluminum Company of Malaysia	RM1.56	Moving into the manufacturing of higher valued aluminium products.
AMMB Holdings	RM3.42	Stronger loan growth, stabilising margins, and lower loan-loss provisioning.
Commerce Asset-Holding	RM4.84	Stronger loan growth, stabilising margins, and lower loan-loss provisioning.
DiGi.Com	RM5.40	Currently the smallest telecommunications player, but with a rapidly increasing market penetration.
Fraser & Neave	RM4.90	Solid fundamentals and a strong balance sheet.
IJM Corporation	RM4.54	Specialised companies in water, waste-water and road maintenance will benefit from water-related construction projects.
KNM Group	RM2.07	Earnings growth from Dubai's investments and better position in the manufacturing of niche petroleum equipment.
Lion Diversified	RM1.63	Strong upside from Parkson China's retail operations.
Malaysia International Shipping Corp	RM14.00	Focusing on lucrative energy transportation.
Maxis Communications	RM8.95	Expansion potential in the Indian subcontinent.
Petaling Garden	RM1.51	Resilient, two properties in Bandar Sri Petaling and Glenmarie would have high profit margins.
Ranhill	RM6.70	Specialised companies in water, waste-water and road maintenance will benefit from water-related construction projects.
SEG International	RM2.68	Largest education provider in terms of profits and enrolment figures and its earnings base is diversified enough for it to weather cyclical trends.
Scomi	RM1.60	Potential earnings from recent acquisitions.
Telekom Malaysia	RM11.90	Potential expansion overseas.
Tenaga Nasional	RM11.50	Internal cost rationalisation exercise and potential increase in tariff.
Transmile Group	RM8.00	Regional expansion in 2005.

* as of Nov 22, 2004

a barrel, which would ultimately provide a boost for the global economy

C K NGU

Head of Research
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We expect 2005 to be a year of slower economic growth. Reason: 2004 was a high-growth year, thus 2005 would have to start on a much larger base. It would be a challenge for Malaysia to repeat a similar high growth rate in 2005.

The issue of crude oil prices remains vital for the Malaysian and world economies. At the moment, it is still too early to forecast the price trend. Being the winter season in the Northern Hemisphere, traditionally the demand for oil would be high; we can only get a clearer picture of the oil price trend in early 2005.

Nonetheless, the impact of higher crude oil prices would certainly put a dent on corporate earnings in 2005. High crude oil prices would ultimately translate into higher cost and would result in inflationary



pressures in the Malaysian economy.

Besides rising costs, there is also the uncertainty of the valuation of the ringgit. Any revision, whether upwards or downwards, would have a significant impact on Malaysian companies and thus the nation's economy.

Naturally, if the ringgit were revalued, exports would take a dip as cost of sales

would increase due to currency conversion. Nevertheless, Malaysian companies with debts in US dollar would gain, which in turn would make capital expenditure worth considering.

We believe the telecommunications, utilities, oil and gas and water-related companies would stand to benefit the most in 2005, especially the latter two. For instance, an expected infrastructure expansion would boost the water-related sector while increased spending in exploration and production and the discovery of new oil fields would benefit the oil and gas companies.

However, the automotive and commodities sectors would not be as bullish. For automotive companies, the uncertainty of Afta and import tariffs remain; these companies' outlook hinges on how the Malaysian Government restructures its import duties in early 2005. Commodities, especially palm oil, would also face challenges in a slowing world economy. **mb**