Malaysia Market Strategy
All done for now?

Equity Strategy

Malaysia

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Taking stock of Malaysia's performance YTD – macro-driven
In US dollar terms, Malaysia has been among the best performing markets in Asia YTD, rising 12% (against the 3% of MSCI APxJ). Most gains YTD have been due to currency movements, with the ringgit appreciating 11% (best performing currency against the US dollar YTD), while the KLCI is up only 1% in local terms. We believe the recent FX gains (off a sharp sell-off in 2015) have mostly been driven by external macro events; that is, China's FX stabilisation, US Fed policy rate expectations being pushed further out, and an oil price rebound from the 12-year low of US$26/bbl (Brent) leading to improved risk appetite for Malaysia assets.

Still dealing with baggage – earnings remain under pressure
On the earnings front, corporate Malaysia is still adjusting to weaker consumer spending (due to goods and service tax (GST) introduction, subsidy rationalisation, and a weaker ringgit), while rising input costs could put pressure on profit margins. Inflation rose above 4% YoY in February 2016. Consensus earnings downgrades for the equity market continued through end-March 2016 and '16 and '17 earnings growth are now 5.2% and 8.6% from 7.1% and 8.6%, respectively, a month earlier.

Stock rotation has occurred
While the KLCI has only moved 1% YTD, there has been rotation into underperforming cyclical companies and sectors (banks and property) over the past four months. Thus, the undervaluation of the cyclical sectors that we highlighted at the beginning of the year has largely played out. PE valuations are now looking slightly stretched as the market is trading on a 16.4x forward PE, which is a +1.6x standard deviation and at a 23% premium to the region. In our view, Malaysia's outperformance is mostly done for now, unless there are unexpected positive catalysts (such as oil prices continue to rally in the near term, the Trans-Pacific Partnership agreement is ratified earlier than anticipated, the earnings cycle improves).

Preferred stocks – earnings visibility and/or high dividend yield
Our preferred list includes: 1) Bursa Malaysia, Berjaya Sports Toto, BAT Malaysia and YTL Power for resilient earnings and reasonably high dividend yield; 2) Astro, Berjaya Food, Genting, IJM and Public Bank for earnings growth visibility. We include Digi in our preferred list, given recent underperformance and remove AirAsia after the recent share price rally. On our least preferred list, we have Lafarge, IHH, Telekom Malaysia, Top Glove and Maybank. We have added CIMB and RHB Capital to our least preferred list to reflect our view on the sell-off of outperforming cyclical stocks.

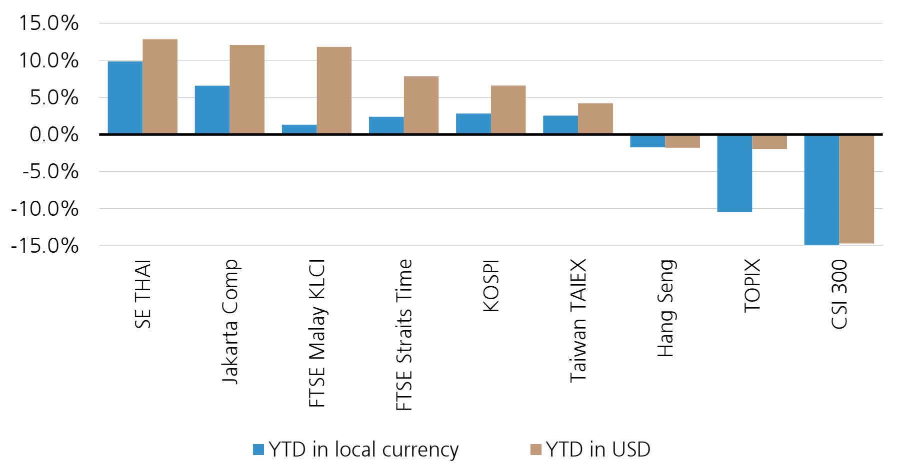
Figure 1: Most and least preferred stocks

	BBG Code	Rating	Mkt cap (RM m)	Price (RM)	PE (x) 2016E	PE (x) 2017E	Div. Yield 2016E	P/BV 2016E	ROE FY16E	PT (RM)	Upside %
Preferred picks											
Berjaya Food	BJFO.KL	Buy	719	1.90	17.40	14.47	2.3%	1.54	8.64	3.20	68%
Berjaya Sports Toto	BSTB.KL	Buy	4192	3.11	11.60	10.90	7.3%	5.41	48.57	4.00	29%
Genting	GENT.KL	Buy	33973	9.14	17.80	15.67	0.4%	0.99	5.70	11.60	27%
YTL Power Int'l	YTLP.KL	Buy	11653	1.51	9.61	8.73	6.6%	0.94	9.62	1.85	23%
Astro Malaysia	ASTR.KL	Buy	15042	2.89	22.73	19.45	3.6%	25.32	95.13	3.50	21%
Digi.com	DSOM.KL	Buy	36232	4.66	19.59	18.71	5.1%	65.38	344.60	5.60	20%
BAT (Malaysia)	BATO.KL	Buy	15384	53.88	17.34	16.98	5.6%	24.57	151.28	64.00	19%
Tenaga Nasional	TENA.KL	Buy	81268	14.40	11.23	10.48	2.5%	1.50	14.40	16.80	17%
Public Bank	PUBME.KL	Buy	73446	19.02	15.44	14.65	2.8%	2.17	14.67	21.50	13%
IJM	IJMS.KL	Buy	12697	3.54	14.71	12.88	2.6%	1.34	10.60	4.00	13%
Bursa Malaysia	BMYS.KL	Buy	4760	8.90	22.83	21.96	4.1%	5.81	25.70	9.80	10%
Least preferred											
RHB Capital	RHBC.KL	Sell	19217	6.25	11.06	10.52	2.7%	0.79	7.33	4.60	-26%
Lafarge MC	MYCS.KL	Sell	7605	8.95	28.90	24.15	3.3%	2.45	8.50	7.60	-15%
Telekom Malaysia	TLMM.KL	Sell	25178	6.70	27.46	26.00	3.6%	3.27	11.81	5.75	-14%
IHH Healthcare	IHHH.KL	Sell	54855	6.67	52.90	50.83	0.4%	2.37	4.55	6.10	-9%
Top Glove	TPGC.KL	Sell	6436	5.13	17.16	18.30	2.9%	3.25	21.59	4.85	-5%
Malayan Banking	MBBM.KL	Sell	88214	9.03	12.93	13.50	5.7%	1.38	10.84	8.60	-5%
CIMB Group	COMM.KL	Sell	41528	4.87	10.58	9.08	3.9%	0.96	9.30	4.80	-1%

Above data as of 20 April 2016. Source: Bloomberg, company estimates

Reviewing Malaysia's performance YTD

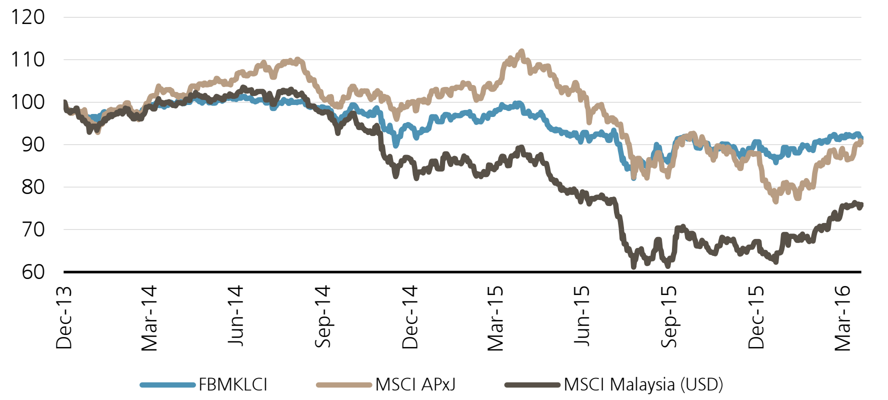
Figure 2: Regional performance



Source: Bloomberg

In US$ terms, the Malaysian equity market has been one of the best performers in Asia YTD at 11.8%

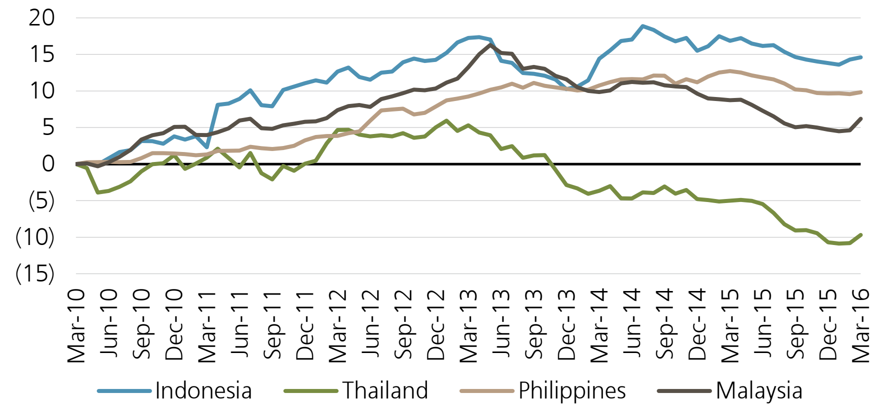
Figure 3: MSCI Malaysia (RM and US$) vs MSCI APxJ



Source: Bloomberg

Most of the gains have been on currency movement; the KLCI is up only 1% YTD

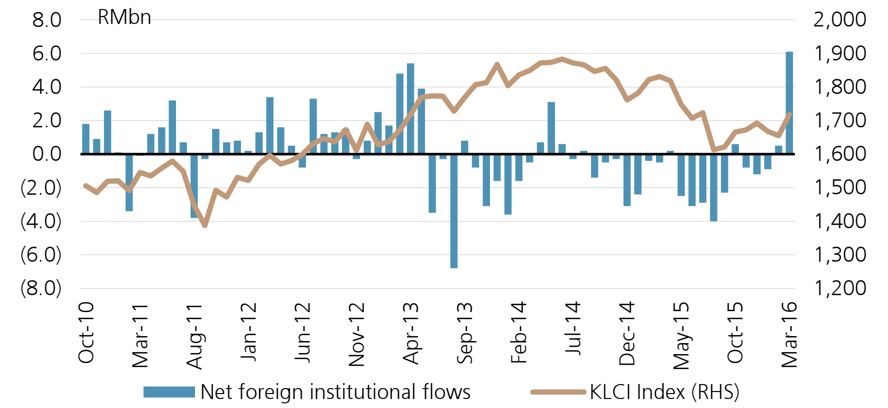
Figure 4: ASEAN net foreign flows into equities (US$ bn)



Source: Bloomberg, Bursa Malaysia

The rally is not just a Malaysian phenomenon as other ASEAN markets such as Thailand and Indonesia have also benefited from net inflows into the equity market. We believe the portfolio inflows have been driven by external macro events of US Fed policy rates expectations being pushed further out and China FX stabilisation in recent months

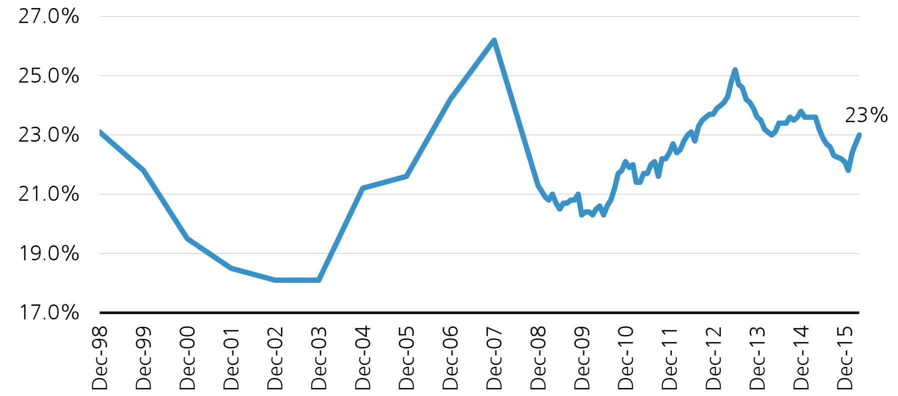
Figure 5: Equity market net foreign flows vs KLCI index



Source: Bloomberg, Bursa Malaysia

The Malaysian equity market had the largest inflow over a single month since April 2013

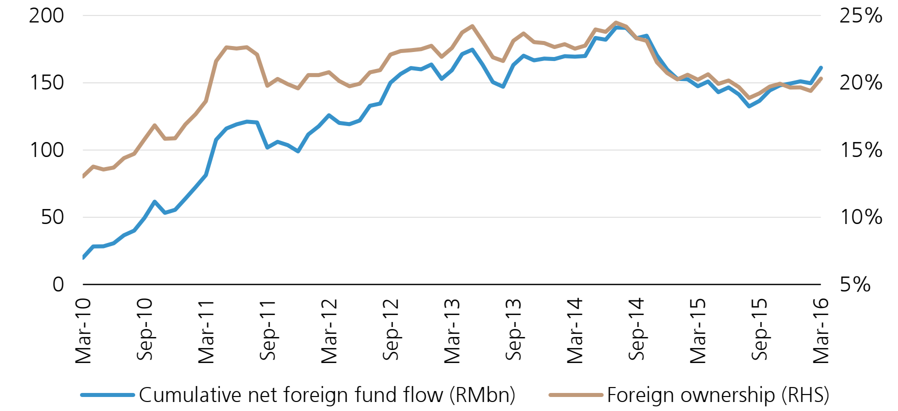
Figure 6: The Malaysian equity market foreign ownership level



Source: Bursa Malaysia

Foreign ownership rebounded back to 23% as of March 2016

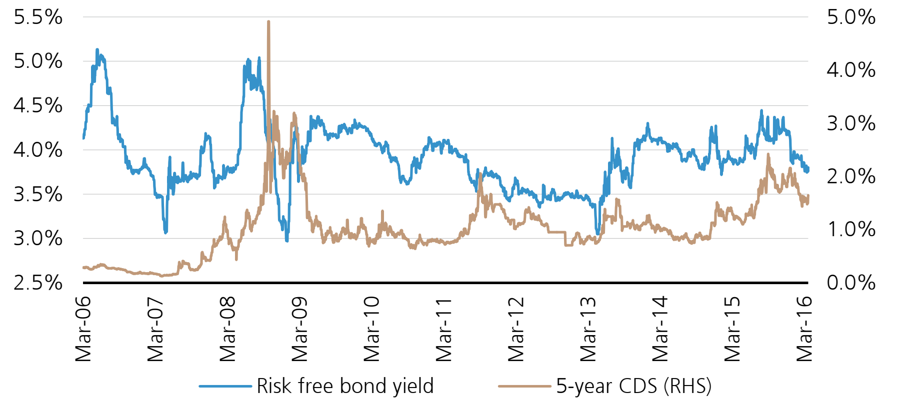
Figure 7: Total debt securities—cumulative foreign fund flow



Source: CEIC, BNM

The debt capital markets in Malaysia have also seen inflows. A financial resolution on the 1MDB debt problems, the 2016 budget recalibration announcement, and oil price rebound from the US$26/bbl low have helped restore investor confidence

Figure 8: Malaysia's 10 year Malaysia Government Securities (MGS) yield and 5-year credit default swap (CDS) rate



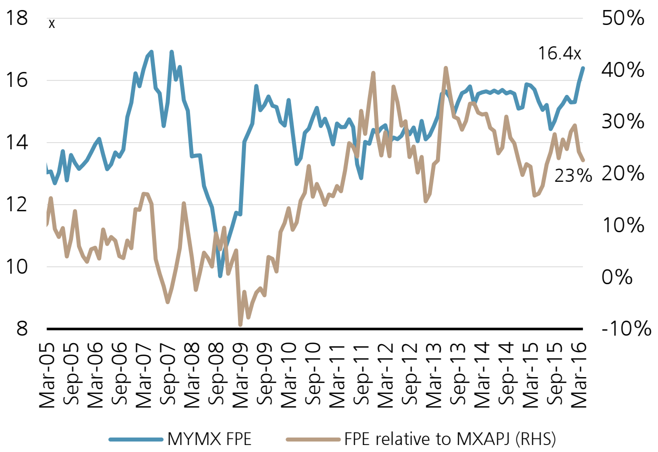
Source: Bloomberg

Our risk free rate benchmark, i.e. the 10-year MGS bond yield is now trading at 3.5% vs Dec-15 of 4.2% while the CDS rate is now 1.6% vs 1.8% for the same period

We attribute the recent blip in 5-yr CDS rates to new developments in 1MDB's debt obligations, which have not been resolved as we go to print

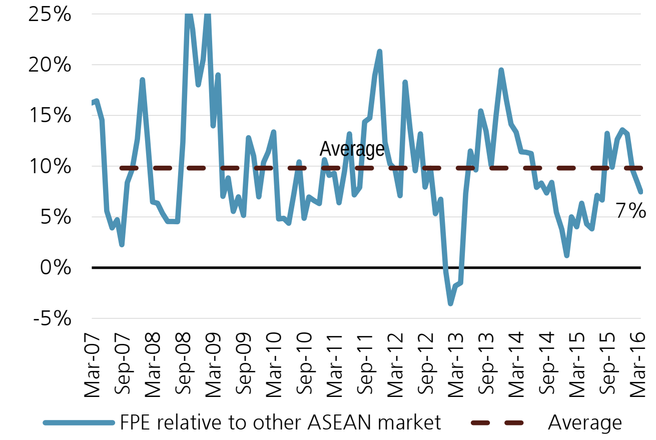
Valuations are looking relatively stretched...

Figure 9: Malaysia 12m forward PE and PE relative to MSCI Asia ex-Japan



Source: Bloomberg (after Dec 2006(, MSCI (before Dec 2006)

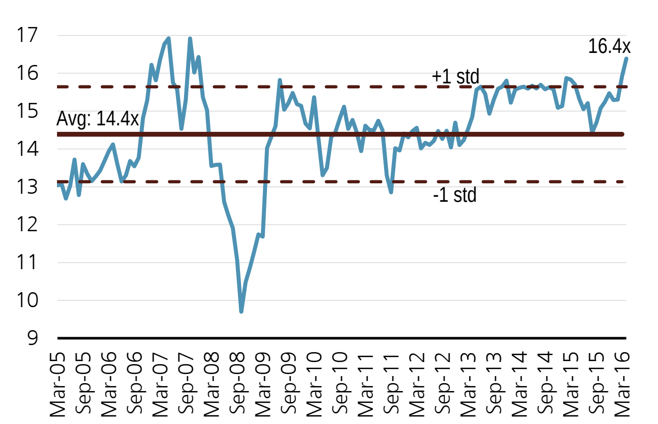
Figure 10: Malaysia's forward PE premium relative to other ASEAN markets



Source: Bloomberg

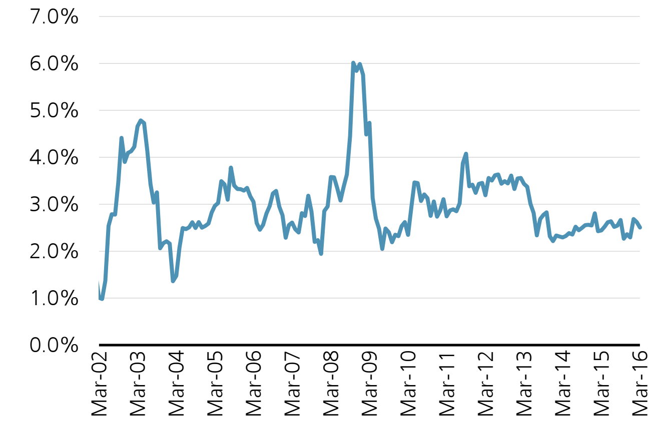
Malaysia's premium relative to the MSCI Asia ex-Japan is currently 23%, while relative to ASEAN markets, the premium is 7%.

Figure 11: MSCI Malaysia 12m forward PE (x)



Source: Bloomberg (after Dec 2006(, MSCI (before Dec 2006)

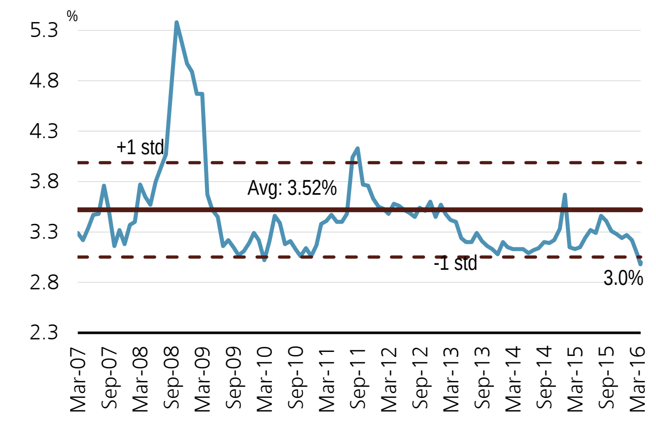
Figure 12: Implied risk premium (inverse PE-risk free interest rate)



Source: Bloomberg

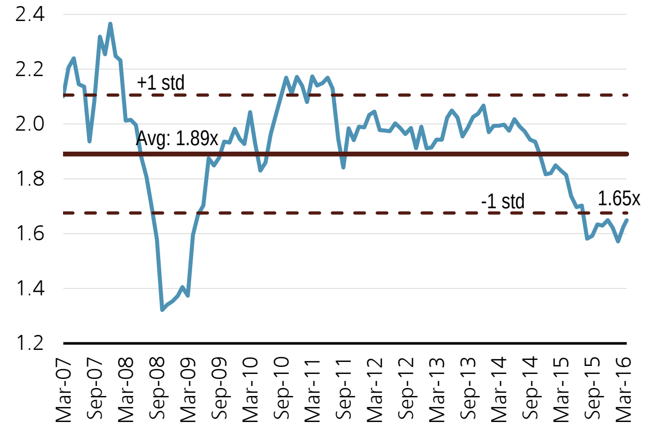
On a domestic front, the forward PE of 16.4x is at a +1.6x standard deviation level, which we believe already prices in anticipation of stronger earnings growth (Trans Pacific Partnership agreement and Patronomics).

Figure 13: MSCI Malaysia 12m forward dividend yield



Source: Bloomberg

Figure 14: MSCI Malaysia 12m forward P/BV (x)

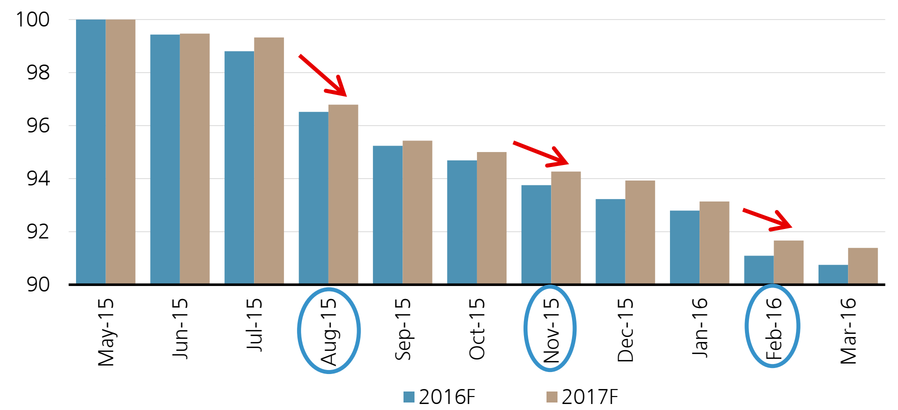


Source: Bloomberg

The market's dividend yields are also close to a -1 standard deviation low.

...while earnings growth remains under pressure

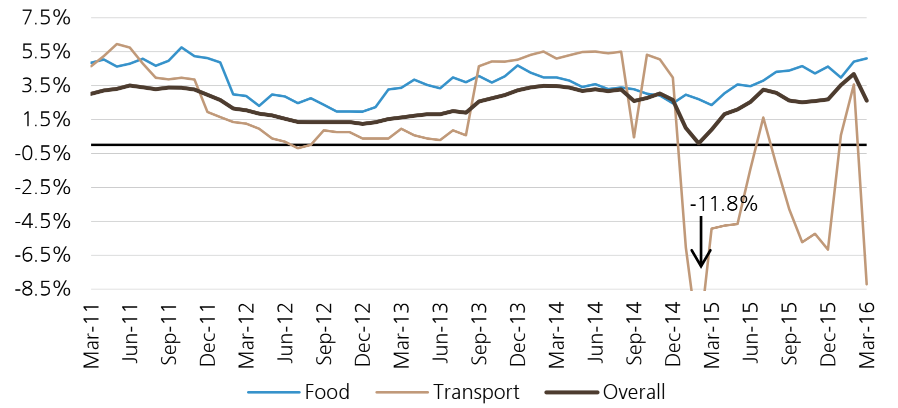
Figure 15: Consensus earnings estimates for KLCI (aggregate)



Note: Earnings rebased to 100; Circled months are when quarterly results were reported
Source: Bloomberg, UBS

Consensus estimates are still trending down, albeit the pace of decline appears to be moderating

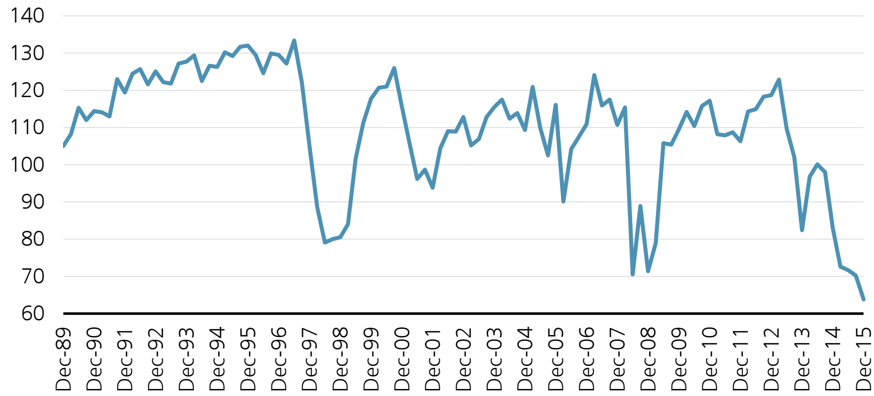
Figure 16: Inflation YoY change



Source: CEIC

However, inflationary pressure continues with corporate Malaysia adjusting to: 1) GST introduction on 1 April 2015; 2) ongoing subsidy rationalisation on toll rates, electricity tariffs, petrol prices and various food items; and 3) significant ringgit weakness in 2015

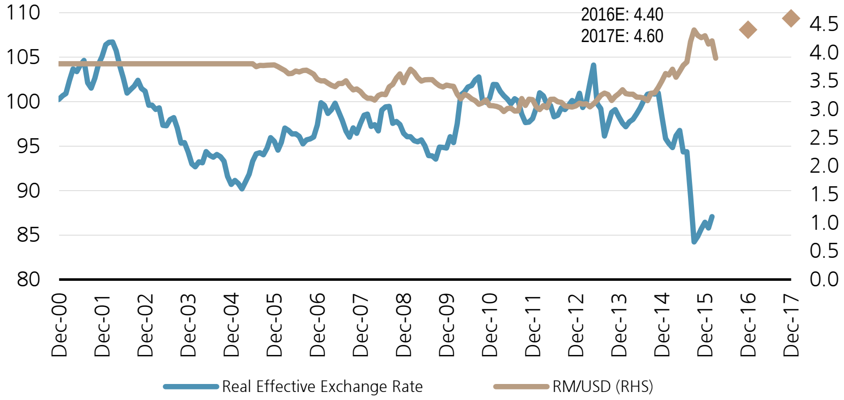
Figure 17: Consumer sentiment index



Source: MIER, CEIC

Consumer sentiment is at its weakest for the past 25 years

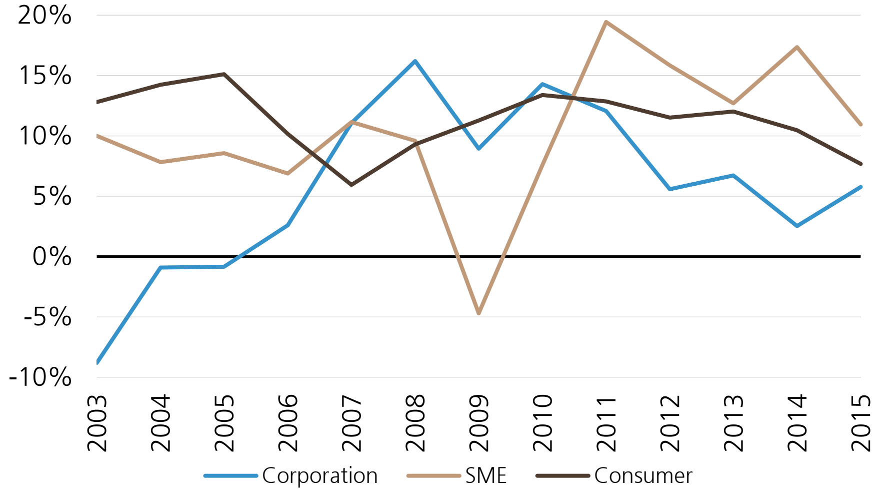
Figure 18: RM/USD and the Ringgit's real effective exchange rates (REER)



Source: Bloomberg, CEIC, UBS estimates

Despite the rebound of the ringgit YTD, the domestic economy (i.e. consumers and corporates) would still need to adjust to the sharp fall in the currency over the past 12 months. Our ringgit/US$ forecast remains 4.40/US$ for 2016

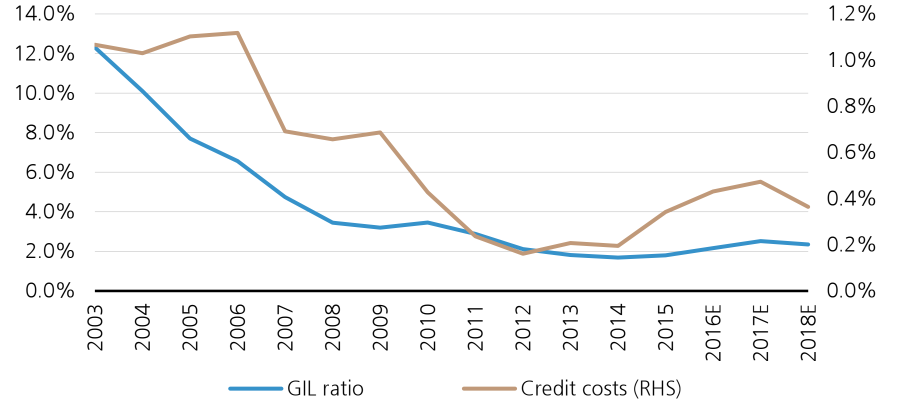
Figure 19: Loan growth by segment



Source: Bank Negara Malaysia

For the banking sector, we expect loan growth to decelerate to around 7% in 2016

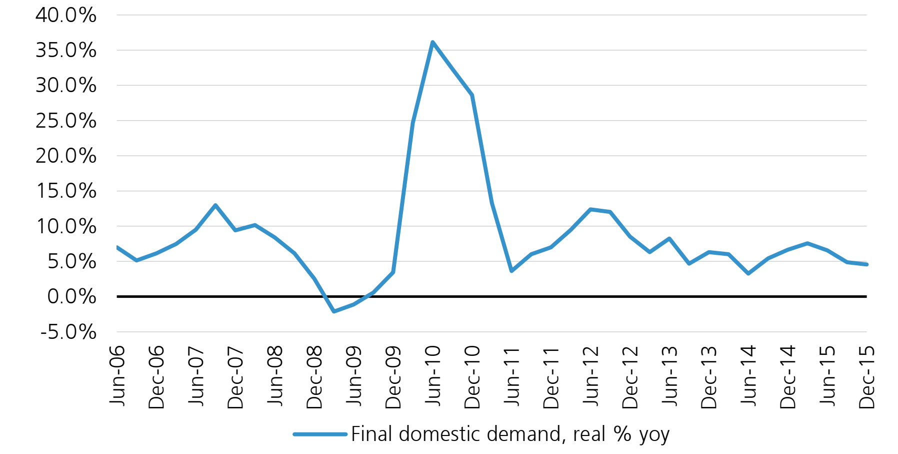
Figure 20: Gross impaired loans ratio vs credit costs (UBS universe)



Source: Company data, UBS estimates

While credit costs are likely to trend higher

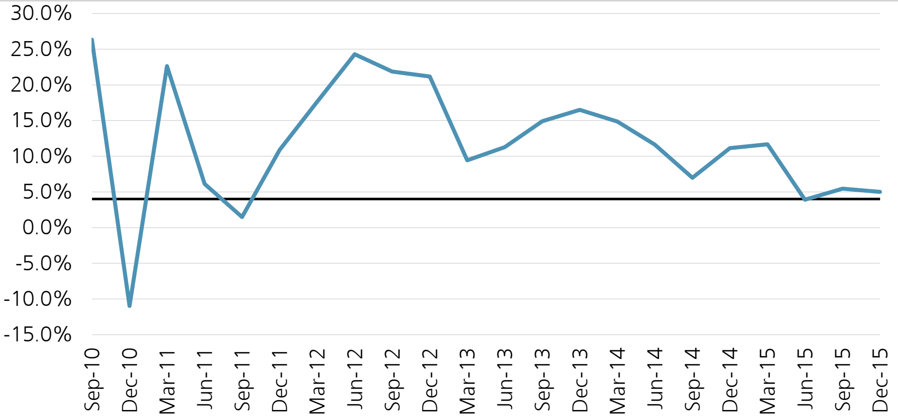
Figure 21: Malaysia's domestic demand growth



Source: CEIC

UBS expects the Malaysian economy to grow 3.6% in 2016, as domestic demand slows

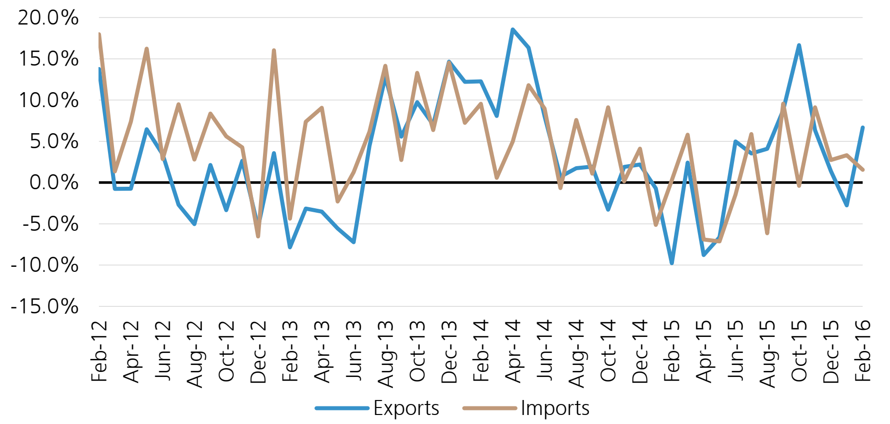
Figure 22: Malaysia's private investment YoY growth



Source: CEIC

We believe the pace of investment growth has decelerated, due to 1) lower capex in the upstream oil and gas sector; 2) slower construction activity (both residential and non-residential). This has been offset by investment in the manufacturing sector (mainly export-oriented industries). Both UBS and government expectations are that growth could trend below the 5.5% long-term average

Figure 23: Malaysia's imports and exports growth



Source: CEIC

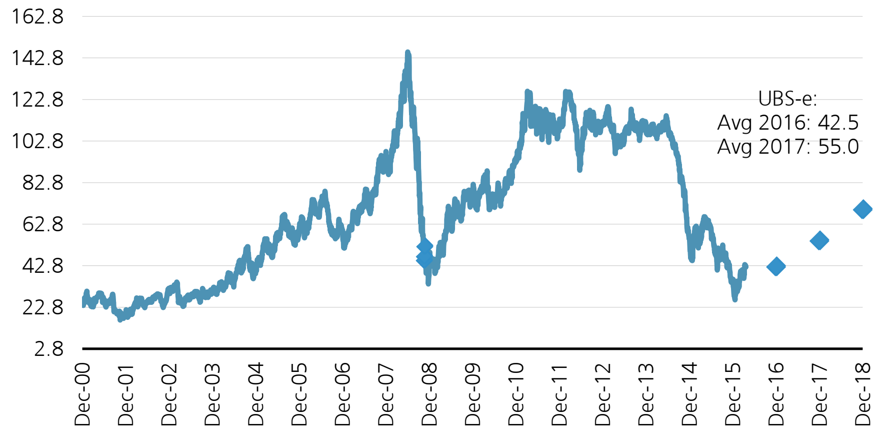
The export sector has so far benefited from the weak ringgit. In the longer term, we estimate the Trans Pacific Partnership (TPP) initiative, effective 2018, could boost exports growth by 12% per annum due to access to the US, Canada, Mexico and Peru markets

Figure 24: Malaysia's export growth trend of main sectors

Source: MITI, UBS estimates

Manufacturing exports have benefited from the weaker Ringgit while, mining-based exports are still languishing

Figure 25: Brent crude oil price (RM/litre)



Source: Bloomberg

The oil price is now in line with the UBS forecast for end-2016

Figure 26: Earnings growth based on MSCI universe – consensus vs UBS

	MSCI MY weighting	Consensus 2016F	Consensus 2017F	UBS 2016F	UBS 2017F
Malaysia		5.2%	8.6%	4.7%	8.6%
Energy	2.8%	8.7%	11.5%	3.0%	23.1%
Materials	4.5%	2.7%	7.9%	-7.2%	9.9%
Industrials	15.4%	14.4%	11.3%	11.7%	13.4%
Consumer discretionary	9.4%	-4.3%	17.4%	-1.9%	16.2%
Consumer staples	8.7%	21.9%	9.3%	21.7%	9.6%
Financials	30.2%	3.5%	8.0%	1.1%	4.5%
- Banks & diversified financials		3.5%	7.9%	1.1%	4.5%
- Real estate		2.5%	10.6%	2.5%	10.6%
Telecommunication services	10.5%	2.9%	5.5%	3.9%	8.9%
Utilities	14.6%	-0.3%	4.0%	7.7%	6.7%
Health Care	3.9%	19.6%	18.5%	12.9%	7.0%

Source: MSCI, IBES consensus, UBS estimates

Our earnings growth forecasts for 2016 is 4.7% and 8.6% for 2017. We think there is further risk of downward earnings revisions in H216, as the new minimum wage rate of RM1,000 is introduced and the moratorium on selling prices (due to the Price Control Anti-Profiteering Act 2011) is lifted on 1 July 2016

Sideways at best for now

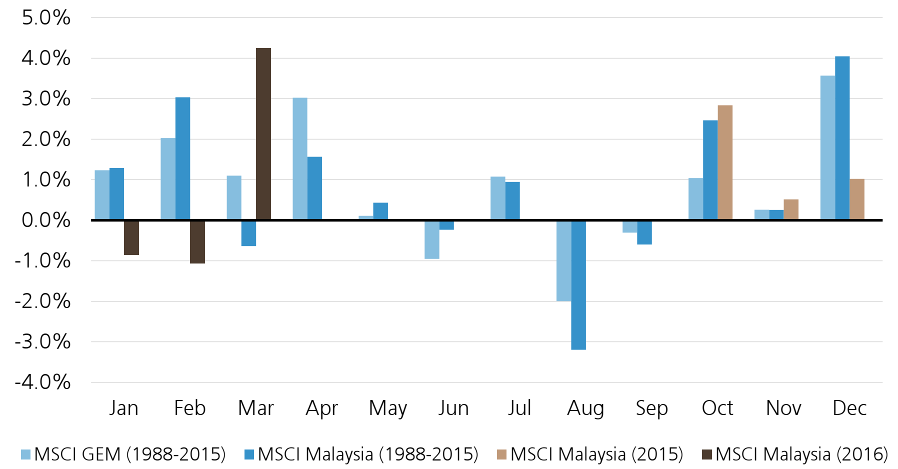
From a point of excessive pessimism six months ago, investor sentiment on Malaysia has improved recently. We believe the reasons for this are:

- With the Fed likely to defer the rate of policy rate hikes for 2016 (UBS now forecasts two hikes of 25bp versus four hikes previously), oil prices and the ringgit appear to have bottomed—oil prices appear to have stabilised, rebounding from their 12-year low of US$26/bbl and is now at US$42/bbl.
- The government has positively responded to the oil/currency 'crisis' by increasing disclosure on public finances, while taking proactive measures to drive fiscal reform (including further liberalisation of industries (power) and cutting back on public expenditure.
- 1MDB's recent sale of the power and property assets to foreign parties.
- Longer-term growth outlook is clearer with Malaysia being a signatory to the Trans Pacific Partnership (TPP) agreement

However, the current forward PE valuation of 16.4x already reflects improved investor optimism, in our view. We think Malaysia's valuation looks stretched relative to history. Also on a relative basis, it does not look cheap as it trades on a forward PE premium of 23% to the MSCI Asia ex-Japan indices. In our view, there remains significant unresolved macro issues which may concern investors over the next six to 12 months, including: 1) the timing and likelihood of the TPP ratification process (see Alice Fulwood's note on the TPP); 2) ongoing developments in the 1MDB situation; 3) a smooth leadership transition at Bank Negara; and 4) the outcome of the 2018 general elections, although the timing may be 24 months away.

Malaysia's performance has probably peaked for now, given that the recent rally has not been supported by earnings upgrades so far. Our view is consistent with Nial's latest views on the recent rally in ASEAN dated 18 April 2016 where Malaysia remains Underweight from a regional perspective.

Figure 27: Average monthly performance since 1988—MSCI Malaysia vs MSCI Emerging market

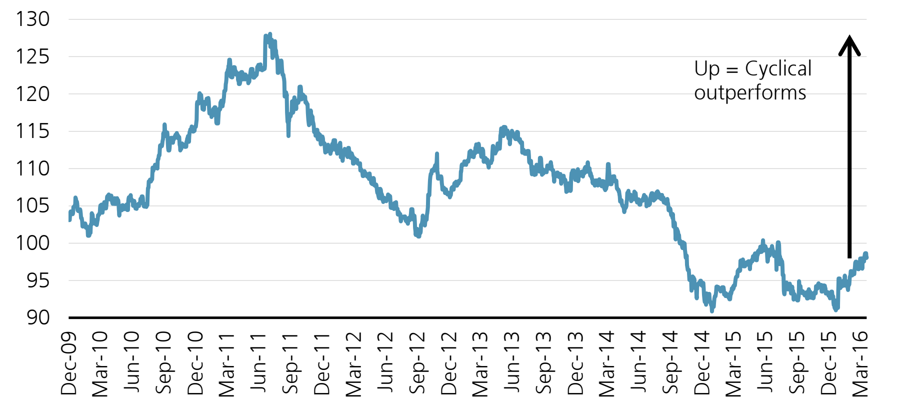


Source: Bloomberg, MSCI

Typically, emerging market performance (and Malaysia) is stronger in the first few months of the year and towards year-end. So far, the Malaysian market has more or less played out to form

So, how should we be positioned within Malaysia?

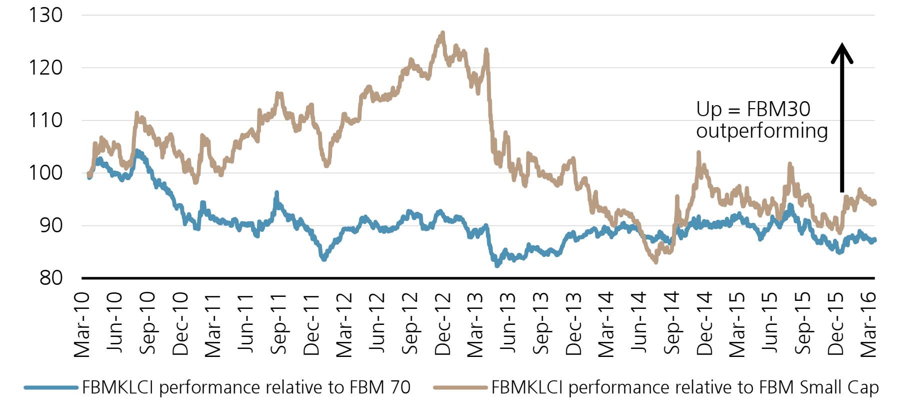
Figure 28: MSCI Malaysia – Cyclical vs defensive performance



Source: Bloomberg, MSCI, UBS

At the start of 2016, we were concerned about the divergence in the performance of cyclical and defensive companies. It appeared that cyclicals had already priced in the concerns about the weakening economy and slowing earnings growth trajectory. Since then, cyclicals have rebounded strongly

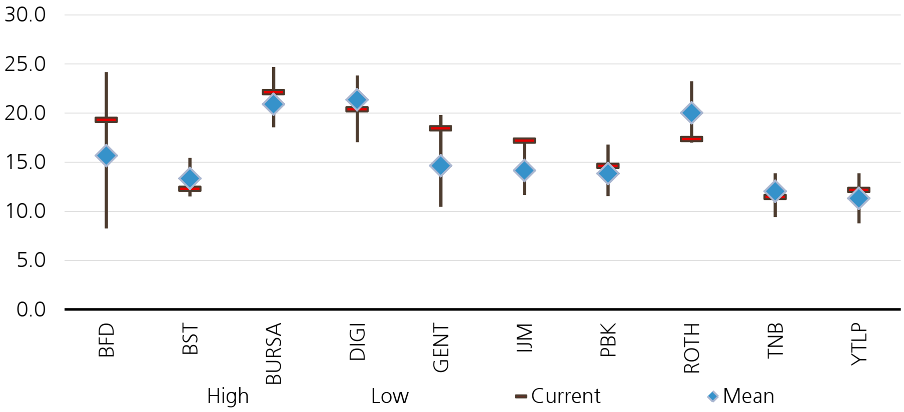
Figure 29: FBM30 big-cap versus FBM70 mid-cap and FBM small-cap performance



Source: Bloomberg

Also, during the past three months, the large caps have rebounded slightly, while the share prices of the smaller cap companies (especially the exporters) have fallen due to a weaker ringgit

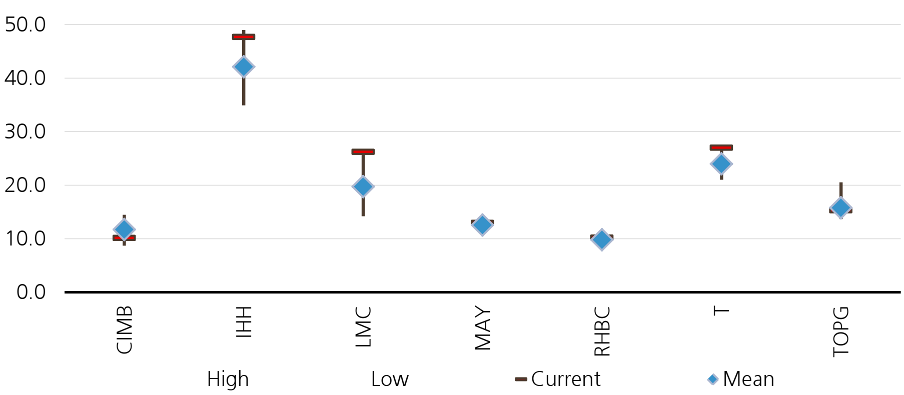
Figure 30: Most-preferred-12-month forward PE vs 5-year mean and trading range (consensus)



Source: Bloomberg

Rotation is key. We would now go relatively defensive, given the outperformance of the cyclicals. We include Digi into our preferred list, given recent underperformance

Figure 31: Least-preferred-12-month forward PE vs 5-year mean and trading range (consensus)



Source: Bloomberg

As per our recently released sector report, we believe the recent rally by banks is likely to be short-lived as ROE remains under pressure. We downgrade Maybank, CIMB and RHB Cap

Figure 32: Share price performance of MSCI Malaysia and UBS universe of stocks

	YTD	6-month	1-year	2015		YTD	6-month	1-year	2015
AirAsia	65.9%	40.8%	-8.9%	-52.6%	Westports Holdings	1.5%	-2.3%	2.2%	22.6%
Genting	24.5%	27.3%	-0.7%	-17.2%	IHH Healthcare	1.4%	4.1%	11.4%	36.5%
Hap Seng Consolidated	18.1%	21.8%	73.2%	41.1%	FBM KLCI	1.0%	0.2%	-8.3%	-3.9%
Malaysia Airport	17.5%	17.7%	-3.8%	-12.8%	Lafarge	0.8%	-0.8%	-12.3%	-9.0%
AFG	14.0%	12.2%	-15.1%	-24.3%	Hong Leong Bank	0.6%	-1.8%	-1.8%	-0.5%
RHB Cap	10.2%	4.5%	-19.5%	-22.9%	Genting Plantations	-0.4%	2.9%	5.6%	6.3%
Hong Leong Financial Group	8.9%	3.5%	-8.7%	-14.0%	IOI Corp	-0.9%	1.4%	0.0%	-7.1%
Tenaga Nasional	8.1%	12.3%	-0.7%	-3.5%	Telekom Malaysia	-1.2%	-2.3%	-10.4%	-1.5%
Malayan Banking	7.5%	4.9%	-4.9%	-8.4%	Dialog Group	-1.3%	-3.1%	-4.8%	6.7%
CIMB Group	7.3%	-0.4%	-22.3%	-18.3%	Petronas Gas	-3.6%	-3.8%	-4.5%	2.4%
Mah Sing	6.9%	17.4%	-6.4%	-12.3%	BAT	-3.9%	-14.2%	-19.1%	-13.9%
IOI Properties	6.7%	13.2%	9.6%	-4.4%	Petronas Dagangan	-4.4%	1.1%	12.5%	46.9%
Bursa Malaysia	6.6%	6.8%	0.5%	3.1%	MISC	-5.0%	-1.1%	-3.3%	29.8%
Gamuda	5.2%	1.9%	-6.3%	-7.0%	UEM Sunrise	-5.4%	-9.4%	-21.5%	-20.6%
IJM Corp	4.7%	7.6%	-4.1%	2.9%	Petronas Chemicals	-8.0%	3.2%	10.8%	33.4%
Astro Malaysia	4.7%	-1.4%	-12.4%	-8.9%	Axiata	-8.7%	-8.3%	-16.7%	-9.1%
KL Kepong	4.5%	5.8%	5.4%	0.4%	7-Eleven Malaysia	-8.9%	-3.2%	-15.4%	4.4%
WCT	3.7%	20.1%	-4.1%	6.4%	Eco World	-10.2%	-5.7%	-27.9%	-14.7%
Sp Setia	3.4%	-1.2%	-6.8%	-3.0%	SapuraKencana	-12.4%	-17.3%	-35.2%	-12.9%
YTL Corp	3.2%	7.3%	-3.6%	-1.3%	Maxis	-12.8%	-12.5%	-17.3%	-0.7%
Public Bank	2.7%	2.3%	-3.4%	1.2%	Felda Global Ventures	-13.5%	-14.5%	-30.8%	-21.6%
PPB Group	2.5%	4.1%	2.0%	11.2%	UMW Holdings	-13.6%	-15.8%	-38.1%	-28.2%
Genting Malaysia	2.5%	4.9%	0.9%	7.6%	Digi.Com	-13.7%	-18.2%	-25.1%	-12.5%
YTL Power	2.0%	-1.9%	-1.9%	0.0%	Berjaya Food	-18.5%	-13.6%	-34.5%	-24.8%
Berjaya Sports Toto	2.0%	-4.0%	-5.1%	-12.5%	Hartalega Holdings	-22.7%	-7.8%	12.0%	69.0%
Sime Darby	1.9%	-8.8%	-15.5%	-15.7%	Bumi Armada	-24.0%	-21.3%	-38.0%	-6.4%
KPJ Healthcare	1.7%	0.9%	0.7%	14.1%	Top Glove	-24.3%	13.0%	88.7%	200.4%
AMMB Holdings	1.5%	-5.9%	-29.2%	-31.4%					

Note: Above data as of 20 April 2016. Source: Bloomberg

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12-Month Rating	**Definition**	**Coverage**[1]	**IB Services**[2]
Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	**Definition**	**Coverage**[3]	**IB Services**[4]
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
AirAsia[13]	AIRA.KL	Buy	N/A	RM2.14	20 Apr 2016
Astro Malaysia Holdings	ASTR.KL	Buy	N/A	RM2.89	20 Apr 2016
BAT (Malaysia)	BATO.KL	Buy	N/A	RM53.88	20 Apr 2016
Berjaya Food Bhd[13]	BJFO.KL	Buy	N/A	RM1.90	20 Apr 2016
Berjaya Sports Toto	BSTB.KL	Buy	N/A	RM3.11	20 Apr 2016
Bursa Malaysia	BMYS.KL	Buy	N/A	RM8.90	20 Apr 2016
CIMB Group Holdings Berhad[7]	CIMB.KL	Sell	N/A	RM4.87	20 Apr 2016
Digi.com	DSOM.KL	Buy	N/A	RM4.66	20 Apr 2016
Genting Malaysia	GENM.KL	Neutral	N/A	RM4.49	20 Apr 2016
IHH Healthcare Berhad	IHHH.KL	Sell	N/A	RM6.67	20 Apr 2016
IJM Corporation	IJMS.KL	Buy	N/A	RM3.54	20 Apr 2016
Lafarge Malayan Cement	LAFA.KL	Sell	N/A	RM8.95	20 Apr 2016
Malayan Banking[7]	MBBM.KL	Sell	N/A	RM9.03	20 Apr 2016
Public Bank[7]	PUBM.KL	Buy	N/A	RM19.02	20 Apr 2016
RHB Capital[7]	RHBC.KL	Sell	N/A	RM6.25	20 Apr 2016
Telekom Malaysia	TLMM.KL	Sell	N/A	RM6.70	20 Apr 2016
Tenaga Nasional[4, 5]	TENA.KL	Buy	N/A	RM14.40	20 Apr 2016
Top Glove[13]	TPGC.KL	Sell	N/A	RM5.13	20 Apr 2016
YTL Power International	YTLP.KL	Buy	N/A	RM1.51	20 Apr 2016

Source: UBS. All prices as of local market close.
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