SOUTH EAST ASIA

MALAYSIA – 3.0 STARS (ATTRACTIVE)

- Exports accelerated 20.6% y-o-y in April, following a 24.1% increase y-o-y in Mar
- Imports increased 24.7% y-o-y in April, following a 39.4% growth in Mar
- Trade Balance improved to RM8.75b in April from RM5.41b in Mar
- Industrial Production expanded by 4.2% y-o-y in April
- CPI moderated to 3.9% y-o-y in May 2017 as compared to the prior 4.4% y-o-y in April
- Nikkei Malaysia PMI fell to 48.7 from previous reading of 50.7

MARKET OUTLOOK

As of 23 June 2017, KLCI companies were expected to post EPS of 107.96, 114.13 and 120.77 for 2017, 2018 and 2019 respectively, representing earnings growths of 7.6%, 5.7% and 5.8% for the three respective years. These translated into PE ratios of 16.5x, 15.6x and 14.7x for 2017, 2018 and 2019 respectively. As a whole, KLCI index's 2017 earnings estimates saw an upgrade of 1.5% over the month. Over the same period, analysts continue to hold a positive view about the outlook for Financials, where we can see an upward revision on earnings of 1.71%. During the recent earnings season, the financial sector delivered decent financial results, with majority of the industry players posting positive year-on-year earnings growth. The outlook for Financials sector remains bright backed by healthy loan growth and improving earnings growth amid lower provision as well as better cost control. On the other hand, Telco stocks remain as the laggards among the KLCI constituents as the sector recorded the worst quarterly earnings among other sectors, with all four constituents showing negative earnings growth for the first quarter of 2017. Overall, the outlook remains challenging for the telco sector due to the issue of intense competition and margin compression.

Malaysia's exports continued its double-digit growth trend in April, escalating by 20.6% y-o-y. This growth in exports was mainly due to the increasing demand from China, Japan, EU and US, with the shipments to these nations expanding by 50.6%, 44.7%, 26.5% and 11% respectively. Malaysian exports were partially lifted by the weakening Ringgit on y-o-y basis. On top of that, higher commodity prices as well as the expansion in the electrical and electronics sector (E&E, +22.2% y-o-y) were the main drivers for the growth in the local export. In fact, as the global technology grows rapidly, we will be expecting to see further improvement for the E&E sector and it should continue to be the driver of demand for local exports.

The KLCI Index increased by 0.48% in June 2017, however, with the upward revision in FBM KLCI's earnings growth, the estimated PE for 2017 has declined slightly over the month. As a result, the KLCI index is currently trading at 16.5x estimated PE, which is slightly higher than our fair PE of 16x. After this first quarter earnings' season, a majority of the local listed companies posted improving earnings growth and positive earnings surprises, hence, we believe that the momentum in the equity market is likely to carry on into the second half of the year underpinned by improving corporate earnings and fundamentals of our local economy. With the current fair valuation, the local stock market is expected to deliver a rather reasonable return for an investment horizon of 3 years, relative to other indexes. As such, we have maintained the star rating for Malaysia **at 3.0 stars "Attractive".**

RECOMMENDED FUND:
KENANGA GROWTH FUND
EASTPRING INVESTMENT EQUITY INCOME FUND
KENANGA SYARIAH GROWTH FUND
EASTSPRING INVESTMENTS DANA AL-ILHAM

MALAYSIA (3.0 STARS – ATTRACTIVE)

Why we like it

1. Growth remains reasonably decent
    - With improving global economic condition, Malaysia's economy could still see decent growth in 2017 (4.3% to 4.8%), supported by recovery in private consumption, modest expansionary fiscal spending, increasing external demand and a pick-up in foreign direct investment from China, India and Saudi Arabia.

2. Institutional liquidity to support local equity market
    - Historically, there is strong participation of institutional funds within the local market which will continue to serve as a buffer to cushion market performance should any selloff occur.

3. Portfolio inflows on Undervalued Ringgit – A Tailwind to Local Equity Market
    - According to Bank for International Settlements (BIS), the real effective exchange rate for Ringgit is standing at 86.87 as of end-May 2017. This indicates the MYR could be undervalued by 13.13%, which may appear to be attractive enough to induce foreign investors to flow back into the equity market, serving as a positive factor that could support equity market performance in 2017.
    - In fact, foreign investors have been net buyers in Malaysia equity markets for 21 out of 24 weeks in 2017. On a cumulative basis, the net purchase from foreign investors amounted to RM 10.3 billion. The robust foreign buying will remain supportive to our local stock market.
    - On top of that, the local bond segment also recorded RM 15 billion of inflows during April and May 2017 with a healthy bid-to-cover ratio of 3.3 times for the Malaysian Government Securities (MGS) auction. The increasing foreign inflows into local equity and bond market indicates increasing foreign confidence, hence it will remain supportive to the local market.

4. Earnings downgrades cycle looks nearing a bottom
    - After multiple rounds of earnings disappointments and forecasts cuts in 2016, the earnings downgrades have eased recently and a downgrade cycle is likely nearing a bottom, in our view.
    - During the recent earnings season, the index constituents reported total earnings of approximately RM 15.9 billion for 1Q 17, having a year-on-year growth of about 18.6%. On top of that, there are more than 50% of the top 30 companies that covered by analysts have outperformed the forecasted results.
    - As economic growth is projected to pick up, the outlook for corporate earnings looks brighter ahead. Our expectations are for corporate profits to regain positive momentum and grow at a moderate pace in 2017, ending the two-year earnings recession in 2015 and 2016.

What we don't like

1. Accelerated debt level - A structural challenge to growth
    - According to Bank for International Settlements (BIS), total debt to GDP ratio for Malaysia is estimated to be 244.2% as of end December 2016 – a level similar with some of the developed economies. While high level of debt does not always signal looming disasters, it suggests a structural challenge to growth, with rapid credit expansion to boost growth could risk debt sustainability while deleveraging would be a headwind to growth. We see the latter being a more possible outcome.

2. Modest Upside Potential
    - Despite the fact that Malaysia's market has underperformed some of its peers under our coverage in first half of 2017, valuations for the KLCI Index are still at a slight premium compared to what we deemed as fair.
    - With valuations at a slight premium now, expected returns for the KLCI is likely to be modest at best, considering earnings growth should be the major contributor to equity return, which we expect to come in at mid-single digit next year.