SOUTH EAST ASIA

MALAYSIA – 3.0 STARS (ATTRACTIVE)

- Exports accelerated 30.9% y-o-y in Jul 17, following a 10.0% increase y-o-y in Jun 17
- Imports expanded 21.8%y-o-y in Jul 17, following a 3.7% growth in Jun 17
- Trade Balance increased to RM 8.03 b in Jul 17 from RM 9.89 b in Jun 17
- Industrial Production grew by 6.1% y-o-y in Jul 17
- CPI expanded to 3.7% y-o-y in Aug 17 as compared to the prior 3.2% y-o-y in Jul 17
- Nikkei Malaysia PMI improved to 50.4 from previous reading of 48.3

MARKET OUTLOOK

As of 25 September 2017, KLCI companies were expected to post EPS of 107.13, 113.63 for 2017, 2018 respectively, representing earnings growths of 6.8%, 6.1% for the two respective years. These translated into PE ratios of 16.5X and 15.6X for 2017 and 2018 respectively. As a whole, KLCI index's 2017 earnings estimates saw a downgrade of -0.9% over the month. The consumer discretionary sector saw the biggest earnings downgrade amongst all, down by -2.8% over the same period. Within the sector, Genting Malaysia Berhad posted the largest earnings downgrade of -8.9%. In fact, the earnings downgrade was mainly because the company registered quarterly earnings lower than the consensus estimate in 2Q 17. Therefore, majority of the analysts were revising the full-year earnings estimate for the company. On the other hand, following the strong 2Q earnings growth and an upward earnings revision last month, Petronas Chemical Group Berhad continued to receive earnings upgrade this month (+0.88%), underpinned by strong ethylene price and the recovering polyethylene (PE) spreads. The PE spreads are seeing near-term recovery due to low inventory. Moreover, the recent Hurricane Harvey had led to about 40% shutdown of US ethylene capacity. These factors are likely to provide further tailwinds to the various chemical products where Petronas Chemical Group Berhad is likely to be the potential beneficiary.

Malaysia's manufacturing sector returned to expansion territory with Purchasing Managers' Index surging to 50.4 points from the previous month's 48.3 points. August's data portrayed a strong picture for the Malaysia manufacturing sector with overall operating conditions improving for the first time since April 2017. The growth was supported by stronger external demand with improving new demand orders particularly from China, South East Asia and Middle East. On top of that, manufacturing output also increased at the fastest rate since February this year amid highest business optimism in August since December 2013. As such, given the improving consumer sentiment (MIER Consumer Sentiment Index at 2-year high level) in 2Q 17 which might help to drive the domestic demand for the second half coupled with the strong external demand, Malaysia's manufacturing sector is likely to remain in expansion territory in the following months of 2017.

Malaysia's July industrial production surprised market participants by accelerating 6.1% year-on-year. Local industrial production expanded at the fastest rate in eight months, underpinned by a broad-based expansion where all three sub-sectors, namely manufacturing (+8.0%), electricity (+7.9%) and mining (+0.2%) sectors, posted positive growth rates. Unsurprisingly, the manufacturing sector was the main driver for the growth in July, whereas industrial production, with Electrical and Electronics Products (+10.5%) and Food, Beverages and Tobacco (+19.2%) registered double digit growth rates. All in all, the better than expected industrial production following a series of strong economic data such as second quarter GDP growth, Malaysia's exports and PMI suggested a better prospect for stronger economic growth for Malaysia in 2H 2017.

The KLCI Index fell by -0.36% in September 2017, causing the estimated PE for 2017 to increase slightly over the month. As of 25 of September 2017, the KLCI index was trading at 16.5X estimated PE, which is slightly higher than our fair PE of 16.0X. We continue to have a positive view on the local equity market underpinned by improving fundamentals of the local economy. With the current fair valuation, the local stock market is expected to deliver a rather reasonable return for investment horizon over the next 3 years on a relative basis. As such, we maintained our star ratings for Malaysia **at 3.0 stars "Attractive".**

RECOMMENDED FUND:
ABERDEEN MALAYSIAN EQUITY

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MALAYSIA (3.0 STARS – ATTRACTIVE)

Why we like it

1. Growth remains reasonably decent
    - Malaysia's economy posted broad-based expansion in 2Q2017, with all sectors delivering positive growth rate. On top of that, consumer and business confidence were picking up in the second quarter, suggesting a more encouraging growth in the following quarters of the year.
    - On the external front, Malaysia's exports grew at a double digit growth rate for seven consecutive months. In addition, the pick-up in foreign direct investment from China, India and Saudi Arabia is likely to support the local economic activity.

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. Foreign fund inflows on undervalued Ringgit – A tailwind to local equity market
    - According to Bank for International Settlements, the real effective exchange rate for Ringgit is standing at 85.97 as of end July 2017. This indicates Ringgit could be undervalued by 14.03%, 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 29 out of 38 weeks in 2017. On a cumulative basis, the net purchase from foreign investors amounted to RM 10.6 billion. The robust foreign buying will remain supportive to our local stock market.

4. Monetary policy is likely to remain accommodative
    - Although the US Federal Reserve is tightening monetary policy, the local central is likely to maintain the still accommodative monetary policy given abating inflationary pressures. As such, it is likely to provide support to the local economic growth and local equity market.

5. 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 RM15.1 billion for 2Q 2017, having a year-on-year growth of about 3.3%.
    - As economic growth is projected to pick up, the outlook for corporate earnings looks brighter ahead. Our expectation is that corporate profit to regain positive momentum and grow at a moderate pace in 2017, ending the two-year earning 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, 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 a looming disaster, 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
    - As end of August, the valuation for KLCI Index is still trading at a slight premium compared to what we deemed as fair. As such with valuation is at a slight premium now, equity return for 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.

3. Malaysia equity market is susceptible to external uncertainties
    - Malaysia as one of the emerging countries is more susceptible to the external uncertainties especially the geopolitical issue. Increasing political uncertainty might lead to substantial foreign funds outflow which might hurt the local equity market.

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