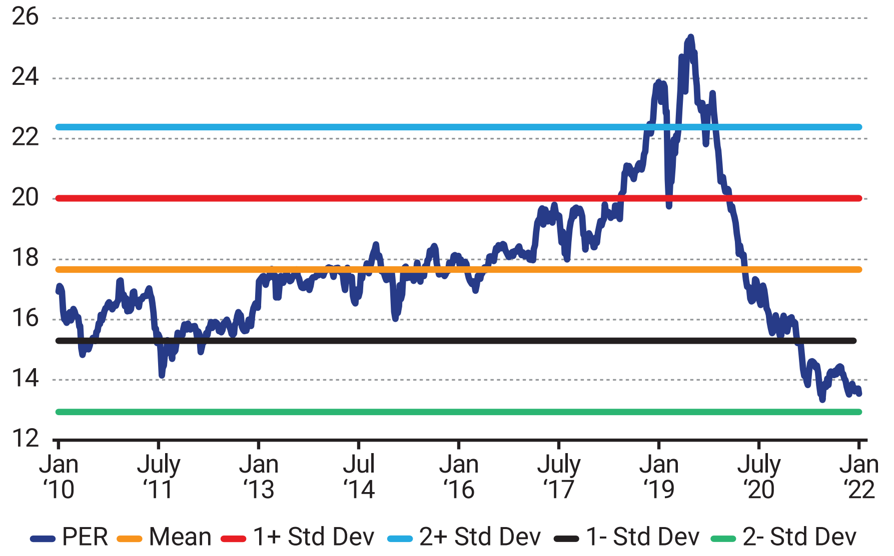
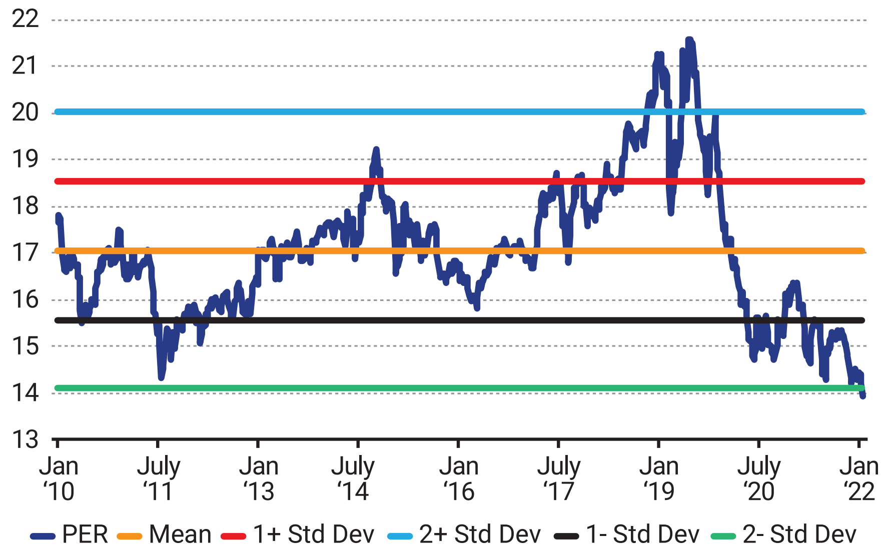
FBM 100 Forward P/E



Source: CGS-CIMB Research, Company Reports

FBM KLCI Forward P/E



Source: CGS-CIMB Research, Company Reports, Bloomberg

TheStargraphics

bill needs to be reviewed promptly to provide some fiscal buffer.

"Alongside public expenditure, the government should continue to introduce business-friendly policies aimed at incentivising private sector investments, which is an area that has been showing progress under the unity government," he adds.

All of the factors, he reckons, will lead to a stronger economy and better corporate earnings which can then serve as key catalysts for the stock market.

"If we can establish political stability, Malaysia certainly presents itself as an attractive market replete with opportunities. From a currency and valuation standpoint, the market is undervalued with both indicators running at multi-year lows.

"Notwithstanding macro noises, the domestic economy continues to display resilience, as evidenced by its solid gross domestic product showing.

"Economic strength will be boosted further once tourism inflows revert to pre-pandemic levels," he said.

Yoong concurs adding that the flow of information from listed companies to retail and institutional investors has to be improved.

For instance, there is little coverage of micro and small cap stocks, he says. He suggests that Bursa funds reports written on such companies in order to get their stories out to the investing community.

He notes that the current government has made "great strides" in improving public machinery and reducing leakages.

"However, Malaysia is far from perfect and this is reflected in the majority of our stock prices on Bursa. It is likely stock prices will rise when domestic and global economic conditions improve. We are convinced that interest rates will come down over the next 12 to 18 months."

"I am confident that people investing in the shares of well-managed companies with sound balance sheets, trading at current depressed prices, will be greatly rewarded in the next three to four years."

In its note to clients, CGS-CIMB Research also says that improved prospects for the domestic economy as a result of the reopening of the country post pandemic, gradual normalisation in Chinese and other tourist arrivals, and better policy implementation are likely to serve as market catalysts.

"The best way to play this is via the liquid financial services sector where valuations are attractive at 9.8 times 2023 PE and just one time price to book value."

The research house adds that construction and materials is a sector that is a good proxy to the domestic economy and potential beneficiary of consistent-policy implementation.

"Despite the estimated 30% recovery in 2022, our forecasts imply a further 11% and 17% net profit expansion over this year and next year.

"Real estate and real estate investment trusts, while benefiting from stronger domestic demand, are potential reflationary beneficiaries should there be a continued period of US dollar weakness," it says.

It also has an "overweight" call on healthcare due to its positive stance on IHH Healthcare Bhd which accounts for almost 90% of the sector's market capitalisation.

Additionally, CGS-CIMB Research is bullish on oil service players as it says order visibility is improving, rental rates and utilisation have risen and valuations are reasonable.

Nevertheless, the research house says that it is "neutral" on energy and materials because of its cautious stance on two petrochemical stocks and Petronas Dagangan Bhd which come under its coverage.

Second half of 2023 likely to be better

By KEITH HIEW
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SOME analysts and fund managers are adamant that the local bourse is undervalued and most importantly, has been underperforming.

A cursory search on *Bloomberg* reveals that the FBM KLCI's current price-earnings ratio (PE) has generally kept pace with its regional peers.

Understandably, issues often raised regarding the local exchange surround why the FBM KLCI has been underperforming.

Commenting on the matter, Rakuten Trade head of equity sales Vincent Lau tells *StarBizWeek* that the PE of the FBM KLCI has been supported by its heavy weightage on banking stocks as well as the exchange's listing ground rules which focus heavily on the market capitalisation of a constituent and its liquidity.

"For the longest time, we were seen as a stable and defensive market which has contributed to our PE standing, but as of now we are trading near the lowest point since Oct 13 last year when the market was around 1,373 points.

"Investors could also be adopting a wait-and-see attitude due to the upcoming state elections," he says.

Nevertheless, Lau says there is still ample value in the FBM KLCI if investors were to look outside the PE figure, and that it is cheap compared with its historical levels, although he opines that the generally mediocre results of corporate Malaysia for the first quarter of 2023 (1Q23) could also have played a role in the local market's insipid performance thus far.

Tradeview Capital chief investment officer Nixon Wong echoes Lau's views, while expounding on the apparently popular notion that the FBM KLCI is a "cheap" market.

He says the index has often been perceived as "defensive" with relatively lower volatility due to the significant presence of government-linked companies among component stocks that make up the exchange.

"When people view Malaysia as attractive or cheap, they typically compare it with its historical valuation trend, noting an average forward one-year PE of 15 times, compared to the current ratio of around 14 times.

"It was even lower, around 12.8 times, prior to a recent 5% to 6% downward revision of corporate earnings following a lacklustre first quarter result season," he explains.

In contrast, Wong says markets such as the Hang Seng Index (HSI) and Straits Times Index tend to have lower PE ratios due to higher policy risks and volatility, resulting in market participants assigning a higher risk premium.

On Hong Kong, Rakuten's Lau points out that the HSI could also have been dragged down by the Chinese factor, as China has reportedly been facing a slowdown in exports, while its much-vaunted reopening effects from December 2022 have also been losing steam of late.

"There is also the much publicised tensions between China and the United States, resulting in heated competition particularly in the tech industry. However, the HSI has had a slight rebound this month and we acknowledge that it is looking attractive and good for value at the moment," says Lau.

Turning his focus back to Malaysia, Tradeview Capital's Wong observes that since the beginning of the year, foreign investors have been net sellers due to redirection of fund flows into the United States, negative repercussions resulting

Price-earnings ratios of regional indices (as of June 7, 2023)

FBM KLCI	**14.8**
Hang Seng Index	10.4
Straits Times Index	12.9
JCI	14.5
Stock Exchange of Thailand	20.8
KOSPI	15.3
Nikkei 225	31.7
Shanghai Shenzhen HSZ	13.9
ASX200	14.7

Source: Bloomberg TheStargraphics

from a slower-than-anticipated recovery in China – which has had spillover effects on Malaysia – as well as concerns regarding political instability in the domestic market ahead of the upcoming state elections.

On the other hand, both he and Lau are confident that despite the challenges, there is still optimism that the second half of the year will witness a positive recovery.

"This expectation is based on the anticipated growth driven by healthy domestic consumption, the gradual return of tourist arrivals, and the positive impact of an improving Chinese economy. Furthermore, favourable outcomes in the state elections could potentially pave the way for the recovery of the FBM KLCI," Wong predicts.

Meanwhile, citing US-based fund flow analysis firm Emerging Portfolio Fund Research (EPFR) Inc and data from Bursa Malaysia Bhd, chief executive for abrdn Islamic Malaysia Sdn Bhd Gerald Ambrose says there is "persuasive" evidence that funds have been exiting Malaysian equities.

Ambrose says the latest quote for foreign equity participation in Malaysia is at 20%, a post-Asian financial crisis low.

Concurring with Lau and Wong on the "cheap compared to history" notion, he says: "Strategic holdings account for 69% of this 20%, leaving a mere 6.2% as active foreign participation. Just how low can we go? Latest data on FBM KLCI has predicted a PER of 13.5 times for 2023 and consensus EPS (earnings per share) growth is 5.9%.

"Price-to-book ratio, at 1.3 times, is also at a post-Asian financial crisis low. So while Indonesia and Singapore may have lower PERs, the FBM KLCI is two standard deviations below its 10-year average. That is cheap."

Ambrose believes a lack of liquidity and a dearth of companies that can portray an attractive image are likely reasons for the FBM KLCI's flattish performance in 2023 so far.

Of particular note is his argument that many of the country's positive dynamics are not found in the top local index but are perhaps contained in smaller companies.

"It is not a secret that most institutional funds investing in Malaysian equities comfortably beat the FBM KLCI, as many of the large liquid companies with big floats (regular shares a company has issued to the public that are available for investors to trade) are not exhibiting much growth.

"For example, if we see a relatively small cash-rich company with positive cash flow with a competitive advantage, is well-managed, as well as having a three-year EPS compounded annual growth rate of 7% or more, it would be wise to buy and hold the shares of this company instead of a larger and more liquid one," he says.