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It may be the right time for investors to begin positioning for a cyclical recovery

BY **KAMARUL AZHAR**

The first quarter has not been good for Malaysia. The Covid-19 outbreak and political turmoil are threatening its economic stability. The price war between oil producers Russia and Saudi Arabia has further roiled financial markets.

These calamities have caused billions of ringgit to flow out of the stock market. The FBM KLCI closed last Thursday at 1,427.8 points, about 10% lower than the start of the year.

The difference between a recent high that the FBM KLCI hit at 1,896.03 on April 20, 2018, and the lowest of 1,414 last Tuesday is 25% — plunging the market into bear territory.

On Wall Street, news reports proclaim the end of the 11-year bull run as both the Dow Jones Industrial Average and S&P 500 dived into bear market territory last Wednesday. A bear market is defined as a 20% drop from a recent high.

Has the market hit rock bottom, and if it has, should investors start to accumulate equities, taking advantage of the low prices of certain stocks to ride the next bull-charged market? Or, is Bursa Malaysia entering a prolonged bear market?

Kaladher Govindan, senior vice-president of TA Research, believes the FBM KLCI is already in a bear market.

"I believe we are at the tail end of a bear cycle that started in July 2014," he says.

"Thus, it is my view that investors should not panic but recognise the current correction as an opportunity to accumulate on weakness to ride the next bull cycle that probably will last for another decade."

From the intra-day high of 1,896.23 — the highest the FBM KCLI has ever hit and just a tad higher than the recent high of 1,896.03 on April 20, 2018 — on July 8, 2014, the FBM KLCI has fallen about 25% to last Thursday's close.

Within this period, however, the FBM KLCI has seen many ups and downs. Between July 10, 2014, and Aug 24, 2015, it lost 19% of its market capitalisation due to the plunge in crude oil prices brought about by the price war between conventional crude producers such as Saudi Arabia and Russia against unconventional producers in the US.

However, after a "ceasefire" was achieved among oil-producing countries on production caps, crude oil prices started to climb again. The FBM KLCI mirrors that movement, with the benchmark up 23.7% between Aug 24, 2015, and April 19, 2018.

However, it fell again into bear territory after hitting its April 20, 2018, high, as the 14th general election campaigning went into full swing and the subsequent loss of Barisan Nasional for the first time in history. Since then, the index has fallen 25% to last Thursday's close.

Nevertheless, the question remains — has the FBM KLCI hit rock bottom? As more economists are expecting a technical recession in the first half of the year, due to the plunge in crude oil prices and the effects from Covid-19, will there be further declines in the FBM KLCI?

A comparison of the recent performance of the FBM KLCI with three other periods of great economic challenges that Malaysia faced over the last 40 years shows that the current downward trend is not as deep.

Between Aug 10, 1987, and Dec 7, 1987, when Malaysia was hit by the commodity price crash, including tin — then one of the country's mainstay export items — the KLCI fell 52.54% to 223.12 points.

About a decade later, the 1997/98 Asian financial crisis hit the then Kuala Lumpur Stock Exchange (KLSE) hard, with the benchmark KLCI losing 53.52% of its capitalisation during the two-year period. Some of the largest companies on the KLSE then had to be bailed out by the government.

About 10 years later, the bourse entered another bear market, after the country was hit by the global financial crisis. Between Jan 11 and Oct 29, 2008, the KLCI lost 45.3% of its value, to hit 829.4 points.

Therefore, there are fears that this downward trend is just a precursor to more declines on Bursa. An analyst who declines to be named says there are still events that are yet to happen and, if they materialise, the market could fall even further.

"I think it would be hard for the new government to decide on major policies such as the Goods and Services Tax, ratification of trade deals and recalibration of the federal budget, which all need to go through parliament," says the analyst.

"Already, the reconvening of parliament will be delayed until May, which means no decisions on major policies. And even when it sits, no major policy changes will be discussed as attention will still be on politics."

After being booted out of Putrajaya through political manoeuvres, some Pakatan Harapan politicians have taken to the road to take their cause to the people.

There are rumours that a snap election could be called soon, if the Perikatan Nasional government cannot get things moving in parliament as it does not have a strong majority. The sudden change in the government has caused jitters among investors as it is not known what kind of economic and social policies the new government will adopt. The inclusion of PAS in the governing coalition caused sin stocks to lose billions in market value when the bourse opened on March 2.

Deals that have been announced but not yet signed, such as the acquisition by the government of the four highway concessions partly owned by Gamuda Bhd for RM6.2 billion, could also be up for review, the analyst believes. The 18% reduction in the toll rates for all highways owned and operated by PLUS Expressways Bhd and the subsequent 20-year extension of concession period to 2058 could also be up for reconsideration.

"It is a bit of a waste of time, really, for all those involved in the negotiations of the deals if, at the end of the day, the new government is not going to acknowledge them and scrap the plans altogether," he says.

At the same time, the plunge in crude oil prices since early this month also put the government's fiscal position at risk as the Pakatan Harapan government had assumed an average crude oil price of US$62 per barrel this year when it crafted Budget 2020 last year.

However, year to date, the benchmark Brent price has averaged US$57.08 per barrel. According to Vincent Loo, economist at KAF Research, every US$1 drop in the Brent price will result in a decline of RM300 million in the government's revenue.

"About RM7 billion to RM10 billion of government revenue will be lost if oil prices stay at US$30 to US$40 per barrel for the rest of the year. This adds about 0.4 to 0.6 percentage point to the 2020 budget deficit of 3.4% of gross domestic product, causing the deficit to balloon to 3.8% to 4% of GDP," says Loo in a March 11 report.

Under the current circumstances, there is probably a need for the government to rationalise spending or revise the budget estimates higher, he says.

If the government chooses the latter, doing so would put the sovereign credit rating at risk of a downgrade if fiscal consolidation targets are derailed, he adds.

All of these situations, coupled with the expected technical recession in the first half of the year, are likely to send the local bourse further downhill, says the analyst who spoke to *The Edge* anonymously. A technical recession is defined as two consecutive quarters of economic contraction.

Still, there are opportunities to buy

Whether the stock market is already at the tail end of a bear market or it has yet to hit rock bottom, there

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Component stocks of the FTSE Bursa Malaysia KLCI, ranked based on price-to-earnings ratio (lowest to highest)

COMPANY	LAST PRICE (RM)	YTD PRICE CHANGE (%)	TTM P/E (TIMES)	5-YEAR AVERAGE P/E (TIMES)	NET DEBT/ (CASH) (RM BIL)	FREE CASH FLOW (RM BIL)
AMMB Holdings Bhd	3.43	-12.28	6.64	10.12	NA	1.52
Genting Bhd	4.30	-28.93	8.20	17.28	0.81	-0.38
Hong Leong Financial Group Bhd	14.02	-17.04	8.31	11.27	NA	-7.29
RHB Bank Bhd	5.50	-4.84	8.89	12.61	NA	0.91
CIMB Group Holdings Bhd	4.27	-17.09	9.51	11.64	NA	0.85
Genting Malaysia Bhd	2.61	-20.67	10.18	10.88	3.62	-0.27
Hong Leong Bank Bhd	14.62	-15.49	11.27	13.49	NA	1.93
Malayan Banking Bhd	8.28	-4.17	11.29	12.39	NA	-10.58
Public Bank Bhd	16.20	-16.67	11.41	14.85	NA	0.67
Petronas Chemicals Group Bhd	4.65	-36.73	13.29	18.20	(9.47)	3.32
Sime Darby Bhd	1.85	-16.67	13.68	50.41	0.85	0.86
Tenaga Nasional Bhd	12.42	-6.33	14.61	14.14	62.32	5.92
Petronas Gas Bhd	15.40	-6.77	15.73	20.82	(0.12)	2.06
Malaysia Airports Holdings Bhd	5.89	-22.50	20.93	36.81	3.61	1.88
PPB Group Bhd	17.58	-6.69	21.70	20.63	(0.85)	0.66
MISC Bhd	7.50	-9.81	21.73	19.05	6.12	3.32
Digi.Com Bhd	4.21	-5.61	22.72	24.22	4.69	1.34
Petronas Dagangan Bhd	19.90	-13.22	24.03	27.74	(3.14)	2.07
Axiata Group Bhd	3.94	-4.83	26.30	394.00	21.61	2.28
Maxis Bhd	5.25	-1.32	27.29	24.73	8.37	1.54
Hap Seng Consolidated Bhd	8.60	-13.83	29.45	20.13	4.21	-0.07
Dialog Group Bhd	3.25	-5.80	31.35	30.41	0.79	-0.12
Press Metal Aluminium Holdings Bhd	4.33	-6.88	35.81	27.24	3.35	0.41
Kuala Lumpur Kepong Bhd	20.00	-19.35	36.05	30.41	2.82	0.63
IOI Corp Bhd	3.92	-14.97	37.46	129.19	2.24	0.79
Top Glove Corp Bhd	6.51	38.51	46.92	23.87	2.17	-0.09
Nestle (Malaysia) Bhd	139.20	-5.31	48.91	39.84	0.45	0.50
Hartalega Holdings Bhd	6.57	19.89	54.21	34.22	0.19	0.19
IHH Healthcare Bhd	5.56	1.65	67.32	76.20	6.38	1.63
Sime Darby Plantation Bhd	4.46	-18.17	857.53	–	7.50	-0.07

Companies with market capitalisation of at least RM5 billion, ranked based on price-to-earnings ratio (lowest to highest)

COMPANY	LAST PRICE (RM)	YTD PRICE CHANGE (%)	TTM P/E (TIMES)	5-YEAR AVERAGE P/E (TIMES)	NET DEBT/ (CASH) (RM BIL)	FREE CASH FLOW (RM BIL)
Serba Dinamik Holdings Bhd	1.83	-16.82	5.87	NA	1.99	-0.77
IOI Properties Group Bhd	0.98	-20.97	8.04	10.22	9.75	-0.10
BIMB Holdings Bhd	3.60	-18.18	8.04	10.60	NA	7.41
Astro Malaysia Holdings Bhd	1.00	-21.26	8.20	22.30	2.94	1.67
Sunway Bhd	1.62	-10.00	11.09	10.67	4.52	-0.14
Gamuda Bhd	3.30	-15.38	11.51	17.50	3.29	0.93
Sunway Real Estate Investment Trust	1.85	1.65	14.27	12.48	3.02	-0.38
IJM Corp Bhd	1.77	-18.43	15.28	20.78	4.63	-0.89
Batu Kawan Bhd	14.66	-15.94	17.56	14.39	3.05	0.73
Time dotCom Bhd	9.45	2.49	17.58	16.80	(0.73)	0.30
LPI Capital Bhd	14.28	-5.43	17.79	16.46	(0.42)	0.31
United Plantations Bhd	25.70	-2.21	18.84	16.67	(0.46)	0.20
Pavilion Real Estate Investment Trust	1.72	-1.15	19.91	18.38	1.85	0.25
Westports Holdings Bhd	3.50	-16.86	20.20	23.53	1.03	0.90
Telekom Malaysia Bhd	3.44	-9.95	20.48	35.65	5.56	2.13
IGB Real Estate Investment Trust	1.90	0.53	21.32	19.29	0.99	0.35
Heineken Malaysia Bhd	23.24	-14.31	22.43	21.49	0.09	0.31
Carlsberg Brewery Malaysia Bhd	24.64	-16.19	25.89	22.22	0.00	0.31
Fraser & Neave Holdings Bhd	29.70	-14.75	26.53	28.34	(0.45)	0.45
Kossan Rubber Industries Bhd	5.30	27.40	30.17	26.84	0.42	-0.04
Yinson Holdings Bhd	6.20	-4.32	33.07	15.23	1.86	-0.20
KLCCP Stapled Group	8.20	3.80	41.53	40.16	1.46	0.83
QL Resources Bhd	8.06	-0.86	54.58	35.79	0.93	-0.05
Genting Plantations Bhd	9.17	-13.33	55.27	41.07	1.64	-0.17
YTL Corp Bhd	0.81	-17.35	82.95	27.45	31.92	0.18

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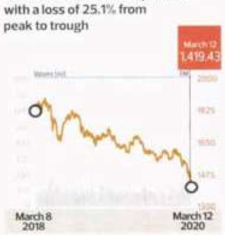
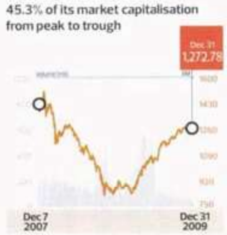
A comparison of the performance of the FBM KLCI between April 2018 to now, the 2008/09 global financial crisis, 1997/98 Asian financial crisis and the commodity market crash of 1987

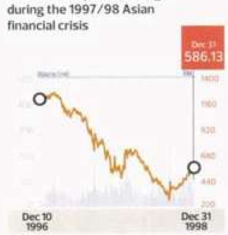
The FBM KLCI has been on a downward trend since April 2018 with a loss of 25.1% from peak to trough



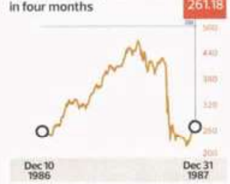
During the 2008/09 global financial crisis, the KLCI lost 45.3% of its market capitalisation from peak to trough



The benchmark index fell 79.34% from peak to trough during the 1997/98 Asian financial crisis



But the steepest plunge in the history of the KLCI could be during the 1987 commodity market crash, when the index lost 52.5% of its market capitalisation in four months



are still opportunities for investors. Their main consideration when deciding on an investment in the stock market is to choose fundamentally strong companies.

According to TA Research's Kaladher, investors should make decisions based on what stocks they hold. They should dispose of overvalued stocks and look for a portfolio of defensive stocks, value plays and growth stocks to ride the next upcycle, he says.

"I believe the coronavirus and glove beneficiary story is overdone. So, it is not a sin to sell overvalued glove players and switch exposure to grossly undervalued oil and gas stocks," he says in an email response to *The Edge*.

Dr Mohd Afzanizam Abdul Rashid, head economist at Bank Islam Malaysia Bhd, says that while the oil and gas sector will be most severely impacted by the current oil price shocks, investors should still exercise due diligence before arriving at any conclusion.

He says the capital expenditure of Petroliam Nasional Bhd (Petronas) has come down drastically over the last few years, from RM64.7 billion in FY2015 to RM50.4 billion FY2016. Thereafter, its investment picked up with FY2019 capex at RM47.8 billion from RM46.9 billion the preceding year.

"And looking at the Petronas Activity Outlook 2020-22, a slew of contracts will be expiring in the next three years or so. In that sense, irrespective of the prevailing crude oil prices, there will be companies that will be getting contracts from Petronas as the oil fields/facilities will need to be maintained," says Afzanizam.

"Not to mention the need to find new oilfields via exploration and production activities. The downstream industries also look promising as Pengerang projects have been fully operational.

"Oil and gas is not a sunset industry. Therefore, there is always a value proposition to investors. It's a buyers' market as investors have plenty of choices in terms of investing in companies in the oil and gas space."

Without recommending any specific stock, Kaladher also says exporters are benefiting from the weak ringgit while high-yielding stocks are benefiting from the current low interest rate outlook. Measures to increase private consumption will also boost consumer stocks, especially food and beverage players.

"With governments and central banks around the globe actively pursuing expansionary fiscal and looser monetary policies respectively, markets will be pricing in the new growth potential and look ahead once the noise over the coronavirus subsides, possibly by 2H2020," he says.

"Opec and Opec+ have to compromise on their hardened stance, eventually for mutual benefit, otherwise it is going to be a lose-lose situation for both of them if they drag crude oil prices lower to gain market share and kill US shale players, which have adapted since the last oil crisis."

Alexander Chia, regional equity research head of RHB Research, in a March 10 report, says longer-term investors should begin positioning for a cyclical recovery. This involves gradually accumulating stocks in the banking, oil and gas, construction, plantation, gaming and rubber products sectors.

"The elevated risks and uncertainty mean that, in the near term, the priority for investors is the preservation of capital — with core holdings in defensive sectors, resilient high-yield stocks, glove makers and more reasonably priced consumer names," says Chia.

"Our base-case assumption is for the Covid-19 outbreak to be contained within 1H2020 while we expect oil markets to begin rebalancing in 2H2020."

While the low crude oil prices will have an adverse impact on the government's fiscal condition, RHB Research expects a positive effect on sectors such as aviation, consumer products, gaming, ports and logistics, rubber products and technology.

The research house has "buy" calls on Hartalega Holdings Bhd with a target price of RM7.55, Serba Dinamik Holdings Bhd (RM2.82), Astro Malaysia Holdings Bhd (RM1.93), Time dotCom Bhd (RM11), Guan Chong Bhd (RM3.45), Allianz Malaysia Bhd (RM18.20), Duopharma Biotech Bhd (RM1.88), RCE Capital Bhd (RM2.20), Mynews Holdings Bhd (RM1.45) and Power Root Bhd (RM2.80).