EM equities set to shine

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Bright prospects for emerging market equities

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BY KUEK SER KWANG ZHE

Emerging market equities, particularly Indonesian property stocks, are starting to look attractive, says Apex Investment Services Bhd CEO Clement Chew. This is due to macro factors such as the stabilisation of emerging market currencies and lower foreign ownership of bonds and equities.

The US dollar is expected to remain rangebound following the Federal Reserve’s interest rate hike in December last year. The rate hike has helped stabilise emerging market currencies. Also, the massive capital outflow from emerging markets over the last three years is expected to result in less market volatility this year.

“If you look at the last six rate-hike cycles, the [US] dollar tended to be rangebound after the Fed increased the interest rate, which is what we are going through now. You can see that the ringgit and a lot of emerging market currencies have strengthened [and stabilised]. For instance, the rupiah has been steady against the US dollar after Indonesia cut its interest rate three times this year,” says Chew.

Another big thing in the last three years was the US$117 billion outflow from emerging market equities. This is something I like as you won’t have too much foreign ownership in the market. This means there will be less volatility and it is good for emerging markets. Chew likes Indonesia for its favourable “top-down picture”. Since Joko Widodo (better known as Jokowi) was elected Indonesian president in October 2014, the country’s stock market had rallied on the back of market expectation that he would implement major reforms, reduce red tape for foreign companies and push through critical infrastructure projects. But the market fell back a few months later as international investors’ expectations were not met.

However, investors have started to regain confidence in the market, owing to the progress made by the Indonesian government, says Chew. “We went on company visits. The people there are now more positive about the government [and the implementation of its plans],” he adds.

Chew is bullish on the Indonesian property sector and its potential because of the anticipated passage of the country’s tax amnesty bill in the third quarter this year. The implementation was originally planned for early this year to boost the government’s coffers by IDR60 trillion. The money will be used to boost government spending after its budget deficit of 2.53% of gross domestic product (GDP) last year exceeded its target of 1.90%.

Indonesia’s fourth tax amnesty bill since independence is expected to attract money kept overseas and net an additional US$4.4 billion in revenue this year. However, the talks between the administration and the House of Representatives on the policy have been delayed.

“We think there may be some opportunities when the policy is implemented. It will keep funds in Indonesia and the money will probably go into the property market,” says Chew.

This is because the Indonesian market lacks investment alternatives, so the property market is expected to be the beneficiary when the wealthy channel their money back to the country, he explains.

“With the new tax amnesty bill in place, the wealthy are also less likely to take money out of the country or...
under-declare their income,” he adds. “As experienced by many Asian countries, real estate investments have proven to be one of the best ways to protect and enhance the assets of the wealthy.”

Indonesia’s property sector is a laggard when compared with other sectors such as financial and consumer discretionary. These two sectors saw demand increase after the Indonesian central bank cut interest rates. But there has not been much change to the demand in the property sector.

Chew is also bullish on Thailand and South Korea. “With the more benign US interest rate normalisation cycle and Indonesia embarking on its monetary easing cycle, we expect Thailand to follow suit. We are also expecting the military-led government to accelerate infrastructure spending, providing a lift-off for economic growth,” he says.

“This optimism has been somewhat dampened by the recent decision of its central bank to bring down lending rates without a corresponding cut in deposit rates. But the infrastructure story remains viable as it is one of the more realistic options left for the Thai government to revive the economy.”

“As for South Korea, China has overtaken the US as its second largest export market. Therefore, South Korea will be a key beneficiary if China recovers against expectations. We favour sectors in South Korea that have a larger exposure to China.”

A WEALTH OF EXPERIENCE

Prior to joining Apex, Chew worked in the financial sector, notably with JP Morgan, for almost two decades. He started out as an equity analyst at Merrill Lynch in 1991 before being transferred to its New York office two years later to cover Asia ex-Japan sales. In 1995, he joined Robert Fleming & Co (now known as JP Morgan) as vice-president of the greater New York City area, in charge of Asian equity sales.

Chew decided to return to Malaysia in 1998. “My father passed away in 1997 and it made me realise that time with friends and family [back home] is precious. Like the saying goes, ‘All the gold in the world cannot buy you one more breath.’”

By the end of 1997, the Kuala Lumpur Stock Exchange had plunged from more than 1,200 points to less than 600 while the ringgit had lost 50% of its value. The Malaysian economy would reel from the Asian financial crisis the following year.

Chew was worried that he would have to give up his career advancement prospects. Moreover, the JP Morgan team in Malaysia was considerably smaller than what he was used to.

“I appreciated what I had in New York. There were dozens of fund management companies, investment banks and hedge funds there. You could choose where you wanted to work — sell equities or fixed income; be a fund manager, derivatives trader or compliance officer. When I decided to come back, everyone asked me whether this was the right thing to do,” says Chew.

“It was then that I reached out to one of my clients, who was with the Abu Dhabi Investment Authority running an Asian fund. He told me Malaysia would not disappear and would come back. ‘Go and do not worry,’ he said.

“I took a lot of assurance from what he told me. Later, it turned out to be one of Malaysia’s darkest times. But like he said, the country rebounded and recovered from the crisis. I have never regretted coming back.”

There was no reason to. Under his leadership, JP Morgan Malaysia expanded into stockbroking after it acquired a foreign broker’s licence in 2005. When Chew left for Apex, there were 120 people at JP Morgan Malaysia, compared with about eight in 1998. During his tenure at the company, his roles included chairman of JP Morgan Securities (M) Sdn Bhd and senior country officer and non-independent director of JP Morgan Chase Bank Bhd.

Chew sees his acquisition of a stake in Apex and joining the firm as CEO in December 2014 as a confluence of the people and events in his life. The opportunity came when the directors of MBM Resources Bhd — an investment holding company that trades in and distributes motor vehicles and related spare parts through its subsidiaries — approached him to jointly acquire a stake in Apex, which they wanted him to helm.

“I knew some of the first-generation directors at MBM when I was working with 1GB Corp Bhd many years ago. Some of the directors of 1GB were also directors of MBM. They were interested in the fund management industry and found me,” says Chew.

“Ng Seng Leong, a former colleague [at JP Morgan Group], was interested in the business when I approached him. He came back to Malaysia in 2014 [from Hong Kong] and joined the firm as head of investor portfolio management.”

Ng was previously managing director and head of trading at JP Morgan Asset Management in Hong Kong, managing about US$60 billion worth of assets.

Chew then persuaded Low Seow Che and Gary Lim to join the firm as investment committee members and regional fund managers. Low was chief investment officer at JP Morgan Investment Management in Singapore and an asset management firm called JF Asset Management in Hong Kong, where he managed an Asian portfolio with US$3 billion worth of assets. Lim was with OCBC Asset Management before joining Nomura Asset Management as deputy chairman of its stock selection committee.

Tan Keah Huat, who had been director of Apex since 2001, continues to serve as the firm’s executive director, while Dzulkarnine Datuk Kazim, who had been fund manager at Apex for many years, is now head of fund management.

“By combining our experience, we have investment and fund management experience of more than 140 years. This is our strength,” says Chew.

Apex may be a small player in the asset management industry, but things are set to change. The firm has revamped its investment and decision-making process, and Chew is looking forward to growing the business and strengthening its reputation in the country.

He says that by attracting talent and experienced fund managers to the firm, he is “deepening the bench” of the company. “Like in football terms,” he smiles.

Besides attracting talent, the team’s investment and decision-making process has changed since Chew took over as CEO. “In a multinational team environment, it
is about building consensus, meaning that if we want to make a decision, we come together to brainstorm and influence the decision through the power of our ideas,” he says.

The Apex team led by Chew has a morning meeting every day and portfolio meeting every week. At the former, they discuss the day’s news that could impact stock movements and at the latter, macro-development trends and fund strategies are discussed.

Looking at the performance of the company’s funds, Chew says seven out of the eight have saw a return of 6% to 9% last year. “This was a good start as the market was down 3% last year. But I think we need to improve when benchmarked against our peers in the industry. This is important.”

He adds that the eight funds include both conventional and shariah funds that invest in local and regional markets. He believes these offerings are sufficient for now so the firm will not be launching many new funds this year. “We will probably launch one or two regional wholesale funds,” he says.

Chew and his team are leveraging the corporate relationships they have built to attract more listed companies to invest in their money market funds. He is also eyeing high-net-worth individuals with private mandates of RM10 million and below.

“RM10 million and below is considered small to some big firms. But to us, we can take it and focus on smaller mandates. There is good potential in this segment. We are finding our niche in this space,” says Chew.

After all, the firm’s ultimate goal is to generate sustainable return for its clients. “We may not be the top player among our peers, but we want to generate steady and consistent returns for our clients. If we can have sustainability in our performance, we would have done a good service for our investors,” he says.

The asset management business is like the endurance horse race in Arab countries, says Chew. “The Arab royalty in the Middle East are very fond of this sport. The participants ride on a special breed of Arabian horse and ride across the desert for as far as 100km. It is all about endurance and stamina.

“There is a saying in this sport: ‘In an endurance race, if you try to win, you will not finish. But if you try to finish, one day you will win.’ I think the asset management industry is like that.”

**BOTTOM-UP STOCK PICKING**

Chew says the firm is not investing aggressively in the Malaysian market this year as companies’ earnings are expected to fall further, in line with the expected negative earnings of the MSCI World Index. He adds that Apex holds about 30% in cash, which is higher than its peers’ 12% to 18%.

“We are not aggressive this year. First, the revenue of companies are under: There is also pressure on them to grow sales. This is due to the weak consumer and investor sentiment. Second, the cost for most companies are high this year due to the weak ringgit and other input costs,” he says.

“It is a double dose for companies in general. Margins have been squeezed and earnings are under pressure – just like the last two to three years.”

Typically, the low base effect would see corporate earnings improve, but Chew believes it is unlikely to happen. “This is a valid question, but I would say the pressure on top line and costs are more pronounced this year than last year. This takes into account a slower economy, weaker consumer confidence and more cautious investment spending budgets. The removal of subsidies, imposition of GST, higher cost of imports due to the weak ringgit and higher wage costs are also part of the reason,” he says.

“From the start of the year, you will see some of the analyst projections saying that corporate earnings in the market are growing. But towards the end of the year, people will lower their projection from 7% to 8% growth to 4% to 5%. It will probably end up being negative,” he adds.

“Looking at the MSCI World Index, corporate earnings globally are expected to be negative and I would say the same for Malaysia. By the way, the country’s corporate earnings have been negative for the past three years.”

On the local front, Chew says the firm is using a bottom-up stock picking approach with corporate earnings expected to be disappointing this year. Consumer counters that have a sound management team and operations with good cash flow are what his team is looking for: They include small and mid-cap companies such as Spritzer Bhd and Three-A Resources Bhd.

Spritzer is the largest bottled water producer in the country and is well known for its Spritzer and Cactus brand of mineral water. The company is controlled by the Lim family, with about 60% equity interest held mainly through another listed entity, Yee Lee Corp Bhd.

The company’s revenue has grown every year since listing in 2000, navigating through hard times such as the 2008 global financial crisis. Net profit jumped from RM10 million to close to RM30 million this year.

Three-A Resources is an investment holding company with two wholly-owned subsidiaries, namely San Soon Seng Food Industries Sdn Bhd and Three-A Food Industries Sdn Bhd. The company manufactures liquid caramel, caramel colour, soya protein sauce and glucose syrup, among others.

“We like them because their products have quite inelastic demand [any change in demand will be relatively small even as prices increase]. The management is very good at what it does. The valuation is not too expensive either,” says Chew.

From a bottom-up perspective, Apex is also comfortable holding stocks in the oil and gas and crude palm oil industries, which were badly hit by the collapse in commodity prices last year. Chew likes Dialog Group Bhd for its good track record.

“We are a fans of the company because the management has a very good track record of executing projects. The world has an overcapacity in oil production and its tank terminals will be quite sought after. It is also expanding its terminal capacity in Pengerang, Johor,” he says.

“It has a competitive advantage [against its peers which have tank terminals in Singapore] as the cost of storing oil and gas products is much higher in Singapore,” he adds.

Chew likes companies that are expected to benefit from the strengthening of the ringgit this year such as Astro Malaysia Holdings Bhd and Tenaga Nasional.
We like stocks that were under pressure because of the weakening ringgit, such as Astro and Tenaga. A stronger ringgit will help ease Astro’s content cost, which is priced in the US dollar. It will also help slightly lower Tenaga’s interest expense cost for its US dollar debt,” he says.

Telecommunications and banking are some of the sectors Chew is overweight on. “Telcos are facing headwinds in terms of spectrum costs and higher operating costs. Competition has also intensified, forcing some of them to reinvent their business model. Telcos’ dividend yields have fallen and are less attractive than in the past,” he says.

“Meanwhile, banks are facing net interest margin pressure and lower loans growth due to a slower economy. Loan provisions are expected to increase and the capital market environment is sluggish.”

Chew is rather pessimistic about the global economy. He says the low and negative interest rates in the world’s major economies are distorting growth and productivity and destabilising the global economy.

He says Europe has moved into unprecedented negative interest rate territory and growth has not picked up. Abenomics, on the other hand, has failed to revive Japan’s economy so far. The central banks there have exhausted their monetary policy as there is no more room to cut interest rates to revive their economies.

This is despite the US economy recovering and China growing at a much lower rate than before. “What we have seen globally since the global financial crisis is that we have entered a period where growth has continued to be disappointing and below expectations, whether it is Japan or Europe and other forecasts. Global growth this year is expected to be about 3%, but it will most probably be 2% to 2.5%,” says Chew.

“World growth is not expected to be positive at the moment. We don’t see where the engines for growth are. Because of this, we have some yield plays, as interest rate expectations are scaled down.”
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