1Q market round-up: MREITs and large caps rejoice

BY ALEX CHONG

With the Bank of Japan pursuing negative interest rates in January, joining its counterparts in the eurozone and Switzerland in slashing interest rates below zero, investors were forced to choose between accepting potentially negative returns or allocating capital to riskier assets. According to Bloomberg, more than US$7 trillion or 29% of global developed sovereign bonds offer yields below zero, meaning investors who buy the bonds and hold them to maturity will not get all their money back.

Negative interest rates in Europe and Japan, coupled with the dovish stance adopted by the US Federal Reserve, seem to have lifted risk appetite and driven liquidity to emerging markets, including Malaysia. Year to date, the MSCI AC Asia ex-Japan Index has seen a rebound of 2.1% while the FBM KLCI is up 1.3%, thanks to a gradual recovery in oil prices from a multi-year low in January (see Chart 1).

Indeed, MIDF Research’s fund flow report shows that foreign investors have turned net buyers of Malaysian equities with a cumulative year-to-date net inflow of RM5.9 billion, albeit relatively low compared with the net outflow of RM19.5 billion for the whole of 2015. Over in the bond market, foreign investors purchased RM11.5 billion of ringgit debt securities in March, driving the five-year Malaysian Government Securities (MGS) yield further down to 3.4% from a one-year high of 4.1% last August.

One of the prime beneficiaries of falling MGS yields are perhaps Malaysian real estate investment trusts (MREITs), which offer higher yields of 5% to 8% compared with those offered by government bonds. Specifically, retail REITs with strong underlying assets such as IGB REIT (high occupancy rate), as well as Pavilion REIT and Sunway REIT (visible acquisition pipeline) have fared pretty well — their unit prices are up 12% to 16% year to date. Looking ahead, analysts opine that MREITs will continue to benefit from the fall in MGS yields if there are further delays in Fed policy rate hikes.

MREITs are certainly not the sole beneficiary.

As shown in Chart 2, large caps led the pack in terms of share price performance in the first quarter of the year (1Q2016) with a 1.5% gain, beating mid caps’ 1.2% increase and a negative return of 1.4% seen by small caps. Based on various sectors’ performance in 1Q2016, it seems that although investors have turned bullish, they are selective when it comes to stock picking and they go for three things — blue chips, defensive earnings and cheap valuation.

Conglomerates were obviously the big winners (see Chart 3). Genting Bhd saw a 35.5% surge in its share price — a rare performance that has not been seen since 2013 — while Hap Seng Consolidated Bhd was up more than 20% to an all-time high of RM7.75 in March. Tenaga Nasional Bhd, the second largest Bursa Malaysia-listed company by market capitalisation, rose 4.7% in 1Q2016. One of the largest vertically integrated utilities in Asia, the state-controlled firm is the top pick of many analysts with its 2016 earnings before interest and taxes (Ebit) expected to rise to RM8.6 billion, double the level six years ago.

For banks, now trading at 2008 financial crisis valuations, asset quality and size seemed to be the share price drivers in 1Q2016. Hong Leong Financial Group Bhd and Alliance Financial Group Bhd, two cheaper banks with the lowest gross impaired loan ratios after Public Bank Bhd, gained 16.6% and 11.2% respectively. Meanwhile, the share prices of the country’s two largest banks by assets, Malayan Banking Bhd and CIMB Bank Bhd, were also up by about 7%.

Developers, which are also trading at trough valuations, have fared fairly well too. IOI Properties Group Bhd and Sunway Bhd, two of the country’s largest property developers, saw their share prices rise 20.2% and 12.3% respectively in 1Q2016. The share prices of smaller players such as MKB Bhd, Matrix Concepts Holdings Bhd and LBS Bina Group Bhd also gained between 2% and 12%, thanks in part to their affordable housing focus.

In contrast, export-oriented technology stocks and glove makers were hit hardest by the increased confidence in the ringgit, losing some 22.2% and 12% respectively of their market value in the first quarter. While there have been no signs of weakening earnings thus far, the real test lies in the upcoming 1Q2016 quarterly results — to be released next month — which will capture the impact of the stronger ringgit. Investors should keep a close eye on companies with resilient external demand as much of the negative sentiments may have already been priced into their current share prices.
Even in the first few weeks of 2Q2016, many of the best-performing large caps continued their upward march. While bulls cite cheap valuations and further monetary easing by major central banks as reasons to be bullish, bears say earnings are still seeing downward pressure amid the volatile markets. This begs the question, is the perfect storm finally over or is it simply a dead cat bounce?

In a recent note to clients, CIMB Research says the US dollar could be the key that determines the performance of global equity and commodity markets this year. The research house is of the view that the recent strengthening of Asian currencies such as the ringgit is only a short-term rebound. The US dollar, which has been trading sideways in the past year, could consolidate for another few months before experiencing a strong and sharp rally in the second half of 2016.

The bullish multi-year super cycle of the US dollar is not likely to end anytime soon. But analysts recommend taking a shorter investment horizon and keeping an eye on the greenback amid heightened market volatility, which came about due to the contest between cheap money and weaker earnings.

Other analysts advocate overweighting cash to take advantage of any volatility that creates a once-in-a-decade opportunity to accumulate quality assets at attractive prices.

In the meantime, all eyes will be on the Fed’s statement when it meets on April 26 and 27. It could offer more clarity on the direction of future rate hikes, which would influence the US dollar.
Headline: 1Q market round up MREITs and large caps rejoice

Media Title: The Edge

Date: 18 Apr 2016

Circulation: 23,635

Section: Corporate

Article Size: 695 cm²

Journalist: ALEX CHONG

PR Value: RM 35,898