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Are GLICs crowding out dynamism in the local market?

BY **ALEX CHONG**

Having exited Asian markets en masse in recent years, foreign funds are returning to the region this year. The MSCI All Country Asia ex Japan Index has rebounded strongly, up 29% from the one-year low on Jan 21 (see Chart 1). Most regional bourses are riding these fund inflows. For instance, the Jakarta Stock Exchange Composite Index is up 17% year to date while Thailand's SET Index has gained 16%.

However, one country stands out: Malaysia. Having declined 1.4% this year, the FBM KLCI has been the worst performer in Asean. With gross domestic product (GDP) growth of 4% in 2Q vis-à-vis World Bank's global growth forecast of 2.4%, this raises the question as to why Malaysian shares are not performing.

"Malaysia has historically been a low beta market, hence its quantum of returns will not be as much as its neighbours. However, for this year, the FBM KLCI has been exceptionally weak — in ringgit terms, it is in negative territory while in US dollar terms, it is positive but in very low single digit," Teh Chi-cheun, CEO and executive director of Pacific Mutual Fund Bhd tells *The Edge*.

"From an economic perspective, one of the key reasons is that Malaysia is a net energy exporter while our neighbours are net importers. Looking at the average price of oil, on a year-to-date basis, it is substantially down compared to 2015. Our neighbours have benefited from the lower energy prices, while for Malaysia, it's the opposite."

"In addition, from an international investors' perspective, Indonesia's GDP growth is much stronger than Malaysia and significant reforms are being undertaken, which are incrementally positive for the country," he adds.

Nonetheless, others believe that there are structural issues that led to the underperformance of the FBM KLCI. Jonathan Reoch, director and lead strategist at BlackRock's Asian Equities team, told *The Edge* in an earlier interview that it is hard for foreign investors to find mispricing opportunities in the local stock market due the strong local ownership by government-linked investment companies (GLICs).

"For bottom-up investors like us, it's about relative valuation and whether companies can meet their earnings forecasts. While we still expect Malaysia to grow at 4%, it's difficult to see this growth translating into good company earnings. In terms of valuation, we find it (Bursa Malaysia) quite an expensive market relative to other regional markets, probably reflecting the strong pension system here. That does tend to mean that you don't get big opportunities as you do in [markets like] Indonesia, which relies much more on foreign fund flows," he explained.

In an efficient market-driven market, prices tend to move in tandem or at least in the same direction with valuations. As seen in Chart 2, this relationship by and large held until September last year. Since then, there has been a divergence between market prices and valuations. Interestingly, the government announced in last September the revival of equity fund ValueCap Sdn Bhd to help boost underperforming shares and stabilise the financial market.

Following the announcement, the market started to recoup some losses. For this purpose, RM20 billion will be injected into the fund, shared equally by the three GLICs, namely KWAP, PNB and Khazanah. KWAP, Khazanah and PNB had injected RM1 billion each when the programme started in December last year, with another RM3 billion to be injected in the state-owned fund this year.

According to data compiled by *The Edge* (see table), GLICs own an aggregate 39% equity interest of the FBM KLCI constituent companies, and nine of the 10 largest companies are government-linked corporations (GLCs). Given the dominance of the GLICs and GLCs in Corporate Malaysia, some argue the government directive to repatriate foreign investments back last year would only increase the size of the domestic captive funds and crowd out the dynamism in the local market.

However, Teh thinks this is not a serious issue as long as there is ample liquidity and trading. "Crowding out happens where large government participation stifles private sector participation. In this case, the concern will be if government funds just buy and hold the stocks and this stifles liquidity such that the market price cannot be found. As long as there is an ample free float and sufficient market participants that are willing to trade, it should not be an issue," he notes.

According to Bloomberg data, the Employees Provident Fund (EPF) invests 95% of its equity funds in Malaysian shares and the remaining 5% in the UK and Singapore. Other GLICs like Khazanah, Tabung Haji, PNB and KWAP have more than 99% of their equity funds invested in the local stock market. In contrast, Japan's Government Pension Investment Fund and Singapore's Temasek Holdings Pte Ltd allocate 57% and 56% of their equity funds in their respective domestic market.

There has been growing recognition among GLICs that it is risky to put all your eggs in one basket by only investing in the local market. EPF CEO Datuk Shahril Ridza Ridzuan told the media that the provident fund's overseas holdings helped diversify risks and buffer the weak ringgit and local stocks in 2015. Last week, Uber confirmed in a statement that it had received an investment from KWAP, the fund's first direct investment in a foreign company as part of its effort to become a diversified global investor.

Meanwhile, other market observers believe government's increased efforts to stabilise the local stock market could be signs of an early 14th general election and thus, are temporary in nature.

"The 2017 National Budget on 21 Oct could also be a pre-election budget with the 13th Parliament session to automatically dissolve on 24 June 2018. But an early polls cannot be ruled out after strong wins by the ruling Coalition in the recent Sarawak state and parliamentary by-elections, and to take advantage of a fragmented Opposition," writes Maybank Investment Bank in a recent note. E

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Who owns Corporate Malaysia?

NO	FBM KLCI MEMBERS	MARKET CAP (RM BIL)	EPF (%)	KHAZANAH (%)	PNB (%)	KWAP (%)	LTH (%)	PETRONAS (%)	TOTAL (%)	TOTAL (RM BIL)
1	Tenaga Nasional Bhd	81.3	15.3	28.3		1.8	1.4		46.8	38.0
2	Malayan Banking Bhd	78.1	15.3		42.4	2.7			60.4	47.1
3	Public Bank Bhd	75.6	12.0			1.0			13.0	9.9
4	Petronas Chemicals Group Bhd	53.9	9.0		4.4	3.0	1.3	64.4	82.1	44.3
5	IHH Healthcare Bhd	52.4	8.7	41.1	1.1				50.9	26.6
6	Sime Darby Bhd	49.9	11.2		42.6	3.3	2.6		59.7	29.8
7	Axiata Group Bhd	48.3	15.2	37.8	1.5	2.7			57.1	27.6
8	Maxis Bhd	46.6	8.8			1.2	1.7		11.8	5.5
9	Petronas Gas Bhd	42.9	10.4		2.8	5.7		60.7	79.5	34.1
10	CIMB Group Holdings Bhd	41	15.4	29.8	4.8	3.6			53.6	22.0
11	Digi.Com Bhd	39.2	11.6			3.4	1.4		16.3	6.4
12	MISC Bhd	33.5	6.5		5.6	2.5		62.7	77.3	25.9
13	Genting Bhd	30.2							0.0	0.0
14	IOI Corp Bhd	28	6.5			2.8			9.2	2.6
15	Hong Leong Bank Bhd	26.5	13.3	0.4					13.8	3.6
16	Genting Malaysia Bhd	25.9							0.0	0.0
17	Telekom Malaysia Bhd	25.6	14.2	28.7		5.0	2.1		49.9	12.8
18	Kuala Lumpur Kepong Bhd	25.4	11.3			1.6			12.9	3.3
19	Petronas Dagangan Bhd	23.2	5.1			0.6		69.9	75.5	17.5
20	PPB Group Bhd	19.3	7.1		1.2	3.5			11.9	2.3
21	RHB Bank Bhd	19.2	40.9		3.7	2.6			47.2	9.1
22	Hap Seng Consolidated	19.1							0.0	0.0
23	YTL Corp Bhd	19.1	6.5						6.5	1.2
24	Hong Leong Financial Group	18.3	2.1						2.1	0.4
25	Astro Malaysia Holdings Bhd	15.2	6.5		2.0				8.5	1.3
26	Westports Holdings Bhd	15.1	5.0		2.6	4.0			11.6	1.7
27	British American Tobacco Bhd	14.3	5.9						5.9	0.8
28	KLCC Stapled Group	14	2.1		0.8	1.0		75.5	79.3	11.1
29	AMMB Holdings Bhd	12.9	15.1		2.7	1.8			19.5	2.5
30	SapuraKencana Petroleum Bhd	9.3	13.9		6.5	3.5			23.9	2.2
	Total	1,003.4	107.4	82.4	65.7	20.5	5.0	108.5	38.8	389.6

CHART 1 BLOOMBERG

FBM KLCI exhibits lower volatility vs regional peers

One-year performance of FBM KLCI vs MSCI Asia ex-Japan (%)

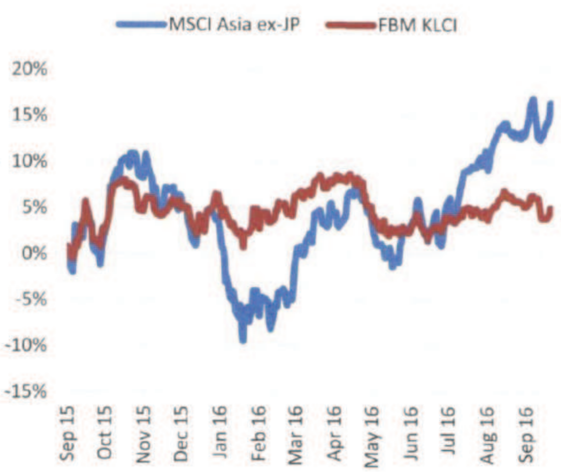

CHART 2 BLOOMBERG

Share price and valuation diverged in the past year

Three-year historical performance and valuation of the FBM KLCI