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LEAD STORY

Best way to ride the YEAR-END RALLY

Both the big and small to mid caps are currently trading at record highs. Should investors focus on the latter because they look more appealing or should they look at the former, which have better liquidity? See [Page 42](#).

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Betting on small and mid caps

BY ESTHER LEE

It is now the last trading month of the year. The market traditionally experiences a year-end rally before it bids goodbye to the year.

The benchmark index peaked at a record high last month, breaching 1,800 points. Similarly, the FTSE Bursa Malaysia (FBM) Small Cap Index is at record high levels now, hitting 15,880 points two weeks ago.

With both the big and small to mid cap stocks already at record high levels, this begs the question as to which is the better bet to ride the year-end rally, should there be one.

Notably, Credit Suisse highlights in a Nov 4 report that the premium gap between Malaysian big caps and small caps has dwindled to a mere 3% during the year, compared with the long-term premium average of 21%.

Maybank Investment Bank Research (Maybank IB) head Wong Chew Haan also observes the smaller valuation gap between the big caps and mid caps, stating that the current year price-earnings ratio (PER) gap between the FBM KLCI and the FBM Mid 70 Index has narrowed to three times now from seven times early this year.

The narrowing premium gap highlights the outperformance of the small caps and the fact that their valuations are getting more expensive. In such a scenario, do the mid caps and small caps have legs?

For instance, Prestariang Bhd, Dayang Enterprise Holdings Bhd and Datasonic Group Bhd have seen their share price more than double, if not triple or quadruple, year to date. Reflecting the share price rally, the FBM Small Cap Index has climbed nearly 37% YTD. Meanwhile, the FBM KLCI has risen 7%.

According to RHB Research Institute managing director Lim Chee Seng, it is common for high quality small to mid caps to outperform in a stable to rising market environment thanks to the increase in investors' risk appetite. Thus, the laggard small to mid caps look more appealing compared with the big caps due to the former's attractive valuations.

Lim says while some of the small to mid caps look pricey currently, there are still others with decent valuations that could see an upward trend.

"Many of the smaller to mid cap stocks under our coverage have gone up significantly by more than 20% over the last three months. Some [have increased] 30% to 40% or even more during that period. If you stretch it over a longer period, say YTD, many have doubled or close to doubled in share price," he says.

"Some may appear a little pricey at this stage until earnings catch up to the next level, but others are still trading at decent valuations and may

have room to trade up in the months ahead."

Meanwhile, Kenanga Research head of research Chan Ken Yew takes the view that better liquidity could be a factor that will lead to further improvements in the valuations of small to mid caps.

"The PER valuation of the FBM Small Cap Index has seen signs of expansion. It traded at about eight times forward PER in the early part of the year but is now trading around 11 times forward PER, representing a more than 35% increase.

"This PER expansion could be due to more vibrant investment sentiment and higher participation. Hence, better liquidity should be one of the possible factors to improve the valuation of small to mid caps."

Although mid caps with good fundamentals will continue to see an increase in price, Maybank IB's Wong says it is unlikely that they would reach the valuations of their big cap peers as the issue of liquidity remains an important consideration for institutional holdings.

Interestingly, during the Invest Malaysia conference in June, Prime Minister Datuk Seri Najib Razak had urged the Employees Provident Fund (EPF) and government-linked investment companies to step up their involvement and focus particularly on high-quality mid caps in his speech.

RHB's Lim opines that small to mid cap companies would still have seen a rise in their share price, regardless of the prime minister's call to government-linked investment companies to focus on these investments.

Wong concurs, saying that the EPF had been investing in quality small and mid caps even

before the prime minister's statement at the conference.

UOB Kay Hian Research head Vincent Khoo believes the current investment climate is supportive of the prime minister's call for more focus on high-quality mid caps, noting that global risk aversion is easing while Malaysian retail investors remain as net sellers in the market from the second half of the year until now.

"We reckon that the under-invested retail investor would be seeking to re-enter the market via the cheaper small to mid caps, which continue to trade at a wide PE multiple discount to large caps," he says.

Some of the common small to mid cap picks by strategists contacted include Cahya Mata Sarawak Bhd, Barakah Offshore Petroleum Bhd and Prestariang.

Cahya Mata Sarawak is deemed the best proxy for the fast expanding Sarawak Corridor of Renewable Energy. RHB Research Institute says in a report that the development is on track to propel

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the state's economy and directly boost the growth of all its business units. The research house has set a target price of RM7.55 for the stock.

According to Maybank IB's report, the newly listed Barakah Offshore is a front runner in the tender for the lucrative Pan Malaysia T&I contract, which is likely to be announced soon. Analysts covering this counter have set a target price of between RM1.30 and RM1.65 for the stock.

Meanwhile, Prestariang is the largest provider of ICT training, certification and software licence management and distribution in the country. The company has also diversified from the government sector to the oil and gas space. It has strong tie-ups with several technology and software providers and organisations,

including Microsoft, IBM, Oracle, Autodesk, EC-Council and Adobe. The target price on this stock ranges from RM2.47 to RM3.37.

While the small and mid caps are seen as hot and sexy, the big caps are still worth keeping a keen eye on, despite the narrowing premium gap they face.

Credit Suisse says in its report that although the premium gap between the big and small caps looks narrow now, the assumption is that it will normalise. Hence, this means that the big caps could outperform the small caps going forward.

Analysts point out that big caps such as SapuraKencana Petroleum Bhd, Genting Malaysia Bhd, Malayan Banking Bhd, Gamuda Bhd and Tenaga Nasional Bhd could be the likely candidates that will benefit from the year-end rally. **E**

FBM KLCI Top 10 companies by market capitalisation

| NAME | SHARE PRICE (RM) | YTD GAIN / (LOSS) | | MARKET CAP (RM BIL) |
|------------------------------|------------------|-------------------|--------|---------------------|
| | | % | RM | |
| Malayan Banking Bhd | 9.68 | 11.35 | 0.99 | 85.76 |
| Public Bank Bhd | 18.36 | 16.41 | 2.59 | 64.3 |
| CIMB Group Holdings Bhd | 7.59 | 3.6 | 0.26 | 58.2 |
| Sime Darby Bhd | 9.63 | 191 | 0.18 | 57.93 |
| Axiata Group Bhd | 6.7 | 7.01 | 0.44 | 57.38 |
| Tenaga Nasional Bhd | 9.91 | 44.51 | 3.05 | 55.82 |
| Petronas Chemicals Group Bhd | 6.63 | 7.09 | 0.44 | 53.44 |
| Maxis Bhd | 7.02 | 11.89 | 0.75 | 52.67 |
| Petronas Gas Bhd | 23.6 | 23.75 | 4.53 | 46.94 |
| DiGi.Com Bhd | 4.87 | (4.63) | (0.24) | 37.68 |

