STRATEGY

FBM KLCI 2020 Target: 1,680 pts

Coronavirus: More liquidity on the horizon

KEY INVESTMENT HIGHLIGHTS

- **US and European markets at near all-time high levels**
- **Whereas East Asian markets mostly struggling to return to March 2018 levels**
- **The disparity in price performance attributable to differing monetary policy stance**
- **The coronavirus epidemic may force PBOC to heighten monetary accommodation**
- **The equity market may be in cautious mood until the outbreak subsides**
- **Additional financial liquidity may help to drive market thereafter**
- **Maintain FBM KLCI 2020 baseline target at 1,680 points**

EAST VERSUS WEST

In our earlier Strategy report dated 31 December 2019, we lamented over the comparatively muted response by East Asian monetary authorities to the prevailing economic slowdown. In China, despite its GDP growing at multi-decades low, the PBOC has been especially measured in its monetary policy reaction. The China central bank has thus far (since the onset of US-China trade spat in March 2018) decided to cut its LPR policy rate by a relatively miniscule 15bps (from 4.30% to 4.15%) in total.

In the US, despite its hitherto buoyant economic performance, the US Fed decided on multiple rate cuts totaling 75bps in 2019. Whereas in Europe, the ECB reacted to the economic slowdown by postponing an earlier planned timeline of rate hikes and instead announced the resumption of liquidity injections via TLTRO III program.

In regard above, it is notable that while key European economies, namely France and Germany, were teetering on the brink of technical recession (i.e. France 4Q19 GDP contracted -0.1%; Germany 2Q19 GDP contracted -0.2%), the Euro region STOXX600 index began to rally off a cyclical low in the first quarter of last year and eventually achieved a new all-time high in mid-January 2020.

The apparent disconnect between prevailing fundamentals and price performance can be ascribed to liquidity-induced valuation expansion in European equities during the past year. Stateside, the S&P500 and other key Wall Street indices also made new all-time highs on multiple occasions until as recent as this week.

On the other hand, most East Asian indices are struggling even to return to the March 2018 (being the starting point of the ongoing trade spat and ensuing macro slowdown) levels. Meanwhile, earlier this week, the local benchmark FBM KLCI briefly fell into bear territory (i.e. decline of more than 20% from the peak, or approximately 1,518 points).

In this regard, we can argue that the underperformance of East Asian equities benchmark MSCI Asia-Pacific ex-Japan (MXAPJ) vis-à-vis US (S&P500) and European (STOXX600) counterparts during the past year can be partly attributed to the relative lack of aggressiveness in monetary policy reaction by the PBOC (being the most dominant central bank in East Asia) to the prevailing economic slowdown.

We earlier reckon, without a more accommodative monetary stance, the East Asian region may continue to be beset by the relative lack of liquidity-induced macro reflationary prospects.

However, unexpectedly, the forward push for a more aggressive monetary easing [by the PBOC in particular] may have been recently triggered by a deadly virus.

MORE LIQUIDITY ON THE HORIZON

The coronavirus epidemic is still evolving. Up until now, hundreds of people have died with more than twenty thousand reported cases. These numbers, mostly China-based, are expected to rise.

While the immediate fallout from the outbreak on China's economy (i.e. travel bans, flight cancellations, value-chain disruptions, business/consumer sentiments) is inevitable, we expect the monetary/fiscal authorities to duly react to mitigate any medium to longer term economic implications.

We opine there is now a higher likelihood for the PBOC to take a more accommodative monetary stance in order to provide a backstop to the impending economic fallout from the coronavirus epidemic. Hence we would not be surprised to see more meaningful cuts in the key LPR policy rate going forward. In addition, depending on the severity of the virus outbreak, other regional central banks may also react in tandem.

Having said the above, our baseline scenario is for the coronavirus outbreak to be brought under control within the next six months, i.e. similar to the duration taken to contain the 2002/3 SARS epidemic.

FBM KLCI: Market reaction to SARS epidemic in 2002/3

Source: Bloomberg, MIDFR

Thus, as in year 2002/3, we envisage that the equity market would be trapped in a cautious mood during the next 3 to 5 months. However, the additional region-wide financial liquidity (from further rate cuts by PBOC in particular) may help to lend downside support. As the total number of infected cases begins to dwindle, the market shall thereafter regain upward momentum and recover to levels prior to the onset of the outbreak.

Looking further forward into the second half of this year, we reckon the additional financial liquidity would continue to propel the regional equity markets higher with the local benchmark FBM KLCI scaling towards our 2020 baseline target.

At this juncture, pending further insights over the coronavirus epidemic, we reiterate our year-end 2020 baseline target for the FBM KLCI at 1,680 points.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.