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Looking Beyond Geopolitical Rhetoric

FBM KLCI: 1,754.37

2017 Year-end Target: 1,830 points

KEY HIGHLIGHTS

- **Key Geopolitical Events – US-North Korea, Elections and Referendums, Qatar Blockade, China Communist Party Congress**
- **Assessment of Impact on the Malaysian Economy**
  - **#1: Resilient economic data to provide a strong anchor**
  - **#2: Overseas earnings will likely to remain intact for Malaysian companies**
  - **#3: Expect volatilities from market overreaction, and also opportunities for bottom fishing**

A. The Brawl Between U.S and North Korea

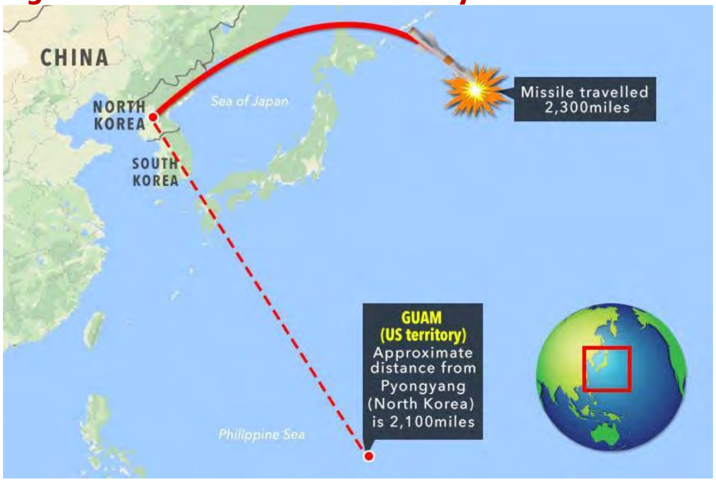
When was the starting point of the spat? The exchange of rhetorics between Pyong Yang and Washington started back in 9 April 2017 when the U.S Navy headed towards the western Pacific Ocean near the Korean peninsula in a show of power. This was in response to North Korea's launch of an intermediate ballistic missile for the first time since March off its east coast on 4 April 2017 which happened a day before President Xi Jinping's official meeting with President Trump in California.

Bigger tensions were fuelled on U.S's national day (July 4) when the hermit kingdom launched its first intercontinental ballistic missile (ICBM) named Hwasong-14. The hermit kingdom then surprised the globe before July ended with another launch of the same type of ICBM but able to reach as far as Alaska. As an act of retaliation, the troops of the U.S and South Korea conducted a combined event exercising assets included the firing of missiles into the territorial waters of South Korea to counter North Korea's actions.

"Fire and Fury" threat by the U.S. President Trump intensified tensions by pledging "fire and fury" to North Korea if it continues to intimidate the U.S after intelligence agencies discovered North Korea's capability to produce nuclear warheads that can be placed within missiles. North Korea certainly did not stay silent on President Trump's threat, aiming to attack U.S territories in Guam while stating that any reckless military provocation by the U.S. should be put to an end to prevent any military clashes.

Japan was also dragged into the brawl. North Korea launched another missile on August 28, this time flying for approximately 1,700 miles over the Hokkaido Island in Northern Japan before crashing into the Pacific Ocean, 700 miles from the coast of Hokkaido. Apparently, this missile launch served as a drill to attack Guam. Less than three weeks later on 15 September, a second ballistic missile was launched by North Korea that flew over Japan. The missile flew a longer distance of 2,300 miles a distance slightly larger than the U.S Airbase in Guam and Pyongyang in a show of force that Guam was within reach. A few days before the missile strike, North Korea did express threats on sinking Japan with a nuclear bomb and reducing the U.S into ashes and darkness as both nations supported a sanction over its nuclear test. Henceforth

Figure 1: Second Missile Launch By North Korea on 15 September 2017



Source:The Sun UK

President Trump takes the fight on social media. Another stage of rhetorics happened when President Trump posted a statement on Twitter on September 23, saying that the leaders of North Korea will not be around any longer. North Korea's foreign minister then responded by claiming that Posts was a declaration to war and defending its right to take down its fighter jets even if they were not within the North Korea airspace.

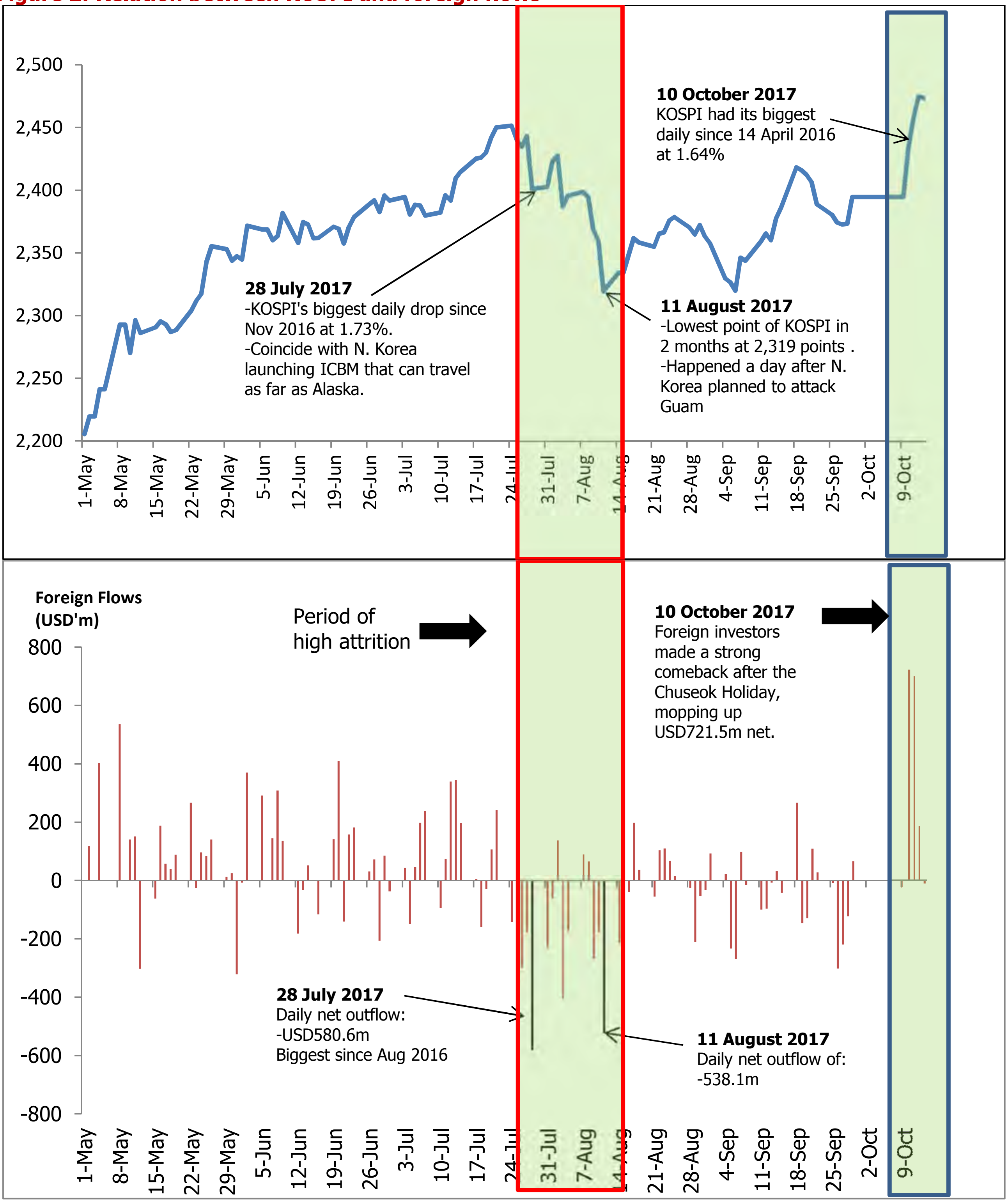
Latest exchange of threats between Washington and Pyongyang. President Trump took it again to Twitter, stating that "only one thing will work" after 25 years of failed negotiations between the U.S North Korea. No clear signals were made later by President Trump but it seems as though he is indicating that military action was a part of his plan. In response to Trump's latest Twitter post, China and Russia have called for restraint for the rogue state. Both nations have urged all parties regardless whether they are involved in the conflict or not to stay away from actions that may fuel the tensions.

Foreign flows into South Korea was badly impacted. South Korea was caught in the middle as it was not only neighbouring South Korea, but also an ally of the U.S. Having said that, foreign flows in to South Korean markets have been adversely affected when tensions peaked after North Korea launched an ICBM missile that could travel as far as Alaska on July 28. On the same day itself, foreign funds withdrew –USD580.6m net of equities from Korea, pushing the weekly outflow from South Korea to above the –USD1b level at USD1.55b, the biggest weekly attrition in almost 2 years. The surge of outflows on that day was in tandem with KOSPI's largest daily drop since November 2016 of 1.73%. Another huge outflow happened on August 11 which amounted to –USD538.1m, a day after North Korea plans to launch missiles towards Guam.

But lately, foreigners have made a roaring comeback. As geopolitical tensions have slightly eased, the amount of attrition has normalized to levels ranging from –USD200m to –USD500m. But on Tuesday after Korean markets reopened from a week long holiday, foreigners entered heavily as they loaded up a whopping USD721.5m net. Nonetheless, we reckon that caution should be taken as the joint naval drill by the U.S and South Korea this week prompted North Korea to renew threats to attack Guam

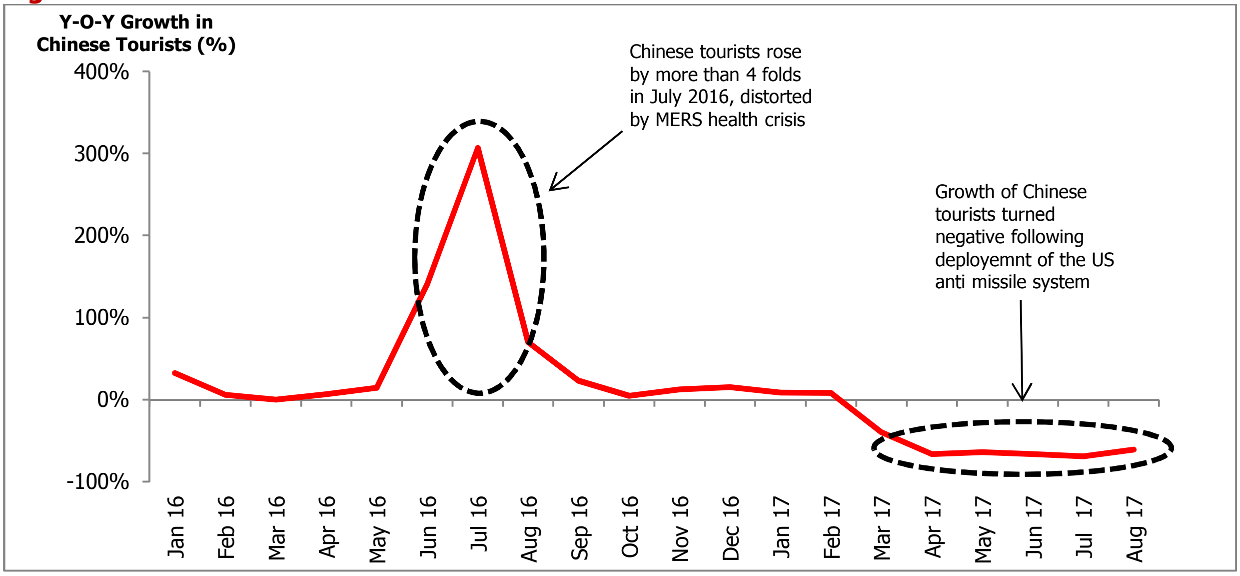
Mainland China tourists were on a decline. South Korea's tourism sector was also affected, shown by the significant decline in y-o-y growth of Chinese tourist arrivals. In 2016, the y-o-y growth of Chinese tourist arrivals was at an average growth of 30% with July being the outlier, affected by the MERS health crisis in 2015. However from March 2017, the y-o-y growth in Chinese tourists experienced a reversal of trend as it marched into the negative territory, remaining within ranges from -40%-60% until August. The reason behind the ravaged tourist numbers from China is ban on selling package tours to Korea in mid-March due to South Korea's deployment of the THAAD missile system, after President Moon gave in to the U.S by agreeing to apply more pressure to the North shifting to a hardline policy towards Pyongyang

Figure 2: Relation between KOSPI and foreign flows



Source: Bloomberg

Figure 3: Year-On-Year Growth of Chinese Tourist Arrivals in Korea



Source: Korea Tourism Organization

B. General Elections/Referendum – An unsurprising outcome

i. Recent Elections

Germany

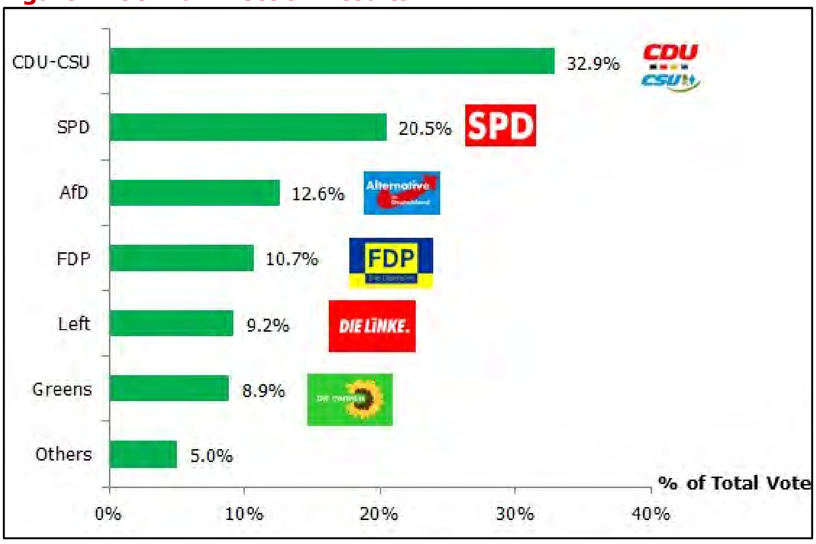
Second raft of elections. The second raft of elections occurred in September in two countries, Germany and New Zealand. In Germany, markets had a flattish start for the week following the smaller-than-expected Merkel victory where the Christian Democratic Union of Germany and Christian Social Union (CDU/CSU) only won 32.9% of the total vote. The euro meanwhile was badly hit, weakening to below the EUR/USD1.19 level on September 24, the lowest point since August 24.

Surprising victory for AfD. Alternative for Deutschland party (AfD) surprisingly came in third place with 12.6% of the vote after the Social Democrats, making it the first far-right party to enter parliament in about seven decades. As a consequence, Merkel will now have to form a governing coalition with other parties through a series of negotiations that may heighten political risk. So far Merkel is considering to join forces with 2 other parties, pro-business Free Democrats (FDP) and environmentalist Greens. But before forming such a coalition, the three parties would have to reach a common standpoint on a mix of issues including immigration, tax and environment. According to Merkel, individual talks with the potential partners will begin on October 18.

Support given for an immigration law. Merkel's own conservative bloc and prospective coalition partners have so far garnered support for an immigration law in order to handle Germany's immigrant issues. Over a million refugees and asylum seekers crossed into Germany in 2015 and most of them stayed in the country. Greens co-leader Cem Ozdemir, who has long argued for an immigration law, also welcomed the intervention of the president, considering that it would be wise step.

Merkel introduces a cap on refugee numbers. Merkel announced on Monday to put a ceiling on the number of refugees entering Germany at 200,000 per year in an attempt to form a three-way coalition with the other two parties mentioned earlier. However, Merkel is in a rather sticky situation as the FDP are welcoming the agreement with open arms while the Greens are not in favour of such limits imposed, posing a friction even before a coalition is formed.

Figure 4: German Election Results



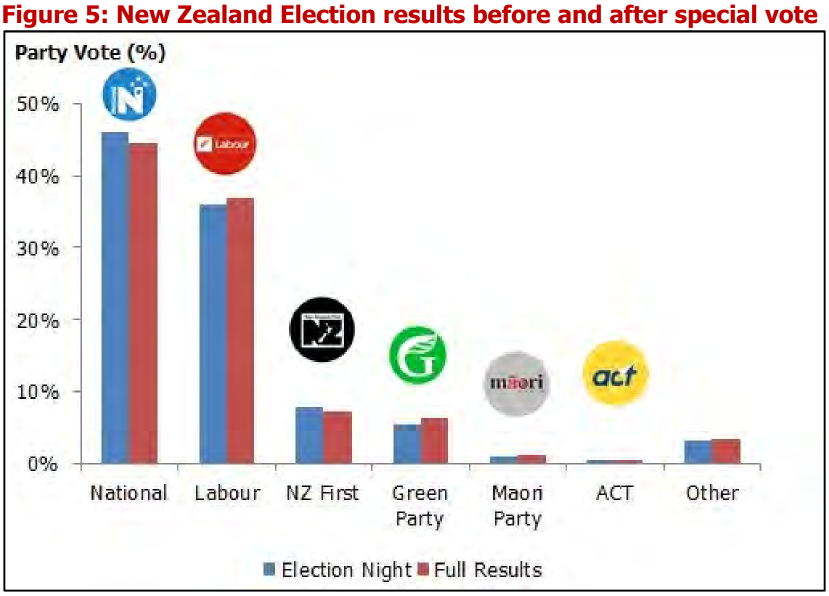
Source: German Federal Returning Officer

New Zealand

No clear mandate to any party. New Zealand's election on September 23 was no different than Germany's as there was no clear mandate delivered to any party. Majority of the seats were obtained by the National party, winning 58 seats out of the total 120 in the parliament, followed by 52 seats won by Labour/Green bloc, leaving the two major parties short of the 61 required to form a government in the 120-seat parliament.

Loss in seats by National Party. Even after two weeks after election day, the count of the final blocks of votes in the New Zealand election showed that two seats were handed over by the incumbent National Party to the Labour/Green bloc. Having said that, coalition blocs will still need to be formed by the major parties with the minor ones in order to govern the nation.

Figure 5: New Zealand Election results before and after special vote



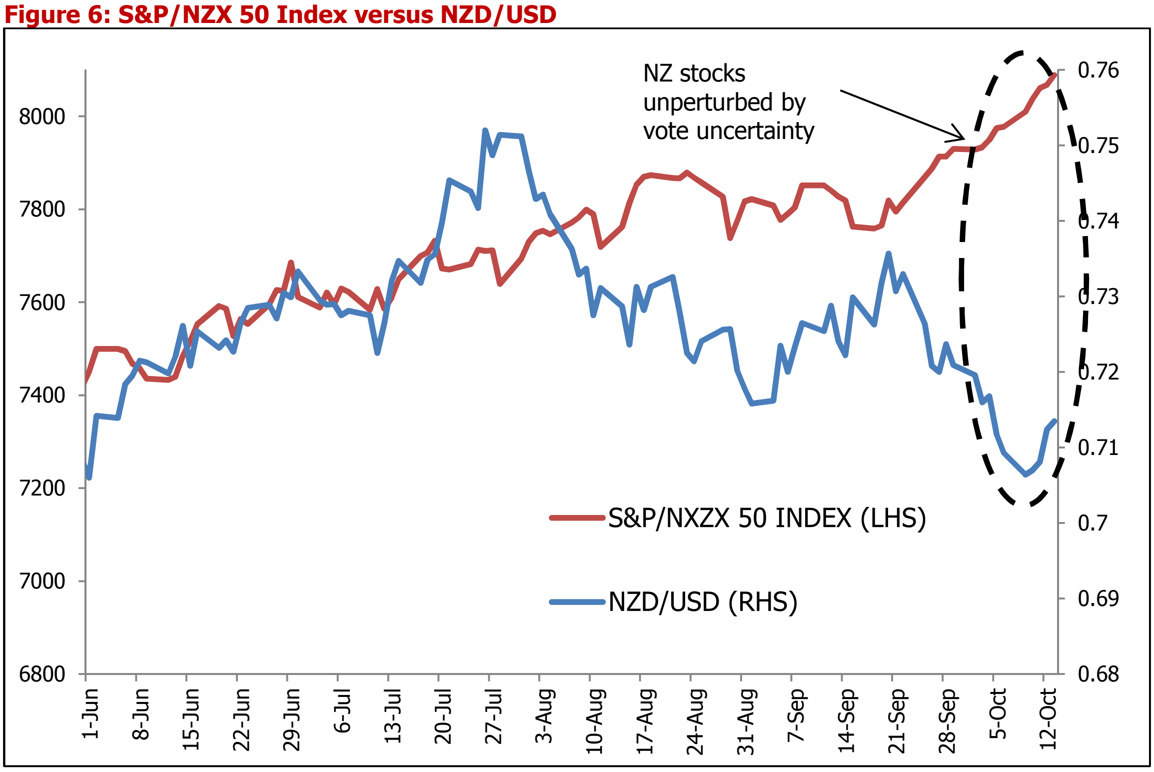
Source: New Zealand Electoral Commission

Winston Peters seen as kingmaker. As a consequence, both the National and Labour/Green bloc are now prompted to entice Winston Peters from the New Zealand First ("NZ First") party who unexpectedly won nine seats. Peters is now seen a kingmaker as a coalition with his party would enable both the National party and Labour/Green bloc to obtain a majority of 65 and 63 seats, respectively.

Formation of government delaye. With the final tally being known, real negotiations between NZ First and the two major parties began last week but uncertainty spiked when delayed his October 12 deadline to decide which party he chooses to join. Peters noted that the Nz First board will meet on Monday and assure that a decision would be made before the end of this week

Kiwi stocks shake off uncertainty. The New Zealand dollar has been resuming its downtrend since the election on September 23, hitting a four-month low at NZD/USD0.7064 last Monday but gained momentum after minutes of Fed's September indicated that policy makers were dovish while pending an announcement on the formation of the next government. On the broad market level, the S&P/NZX 50 advanced to a record high on Monday by breaching 8,000 points with dairy companies such as A2 Milk Co. and partner Synlait Milk Ltd led gainers with 2.80% and 1.20% worth of daily gains, respectively. Moreover, the S&P/NZX extended its record setting streak until last Friday, ending at 8,089 points. Henceforth, New Zealand shares are shrugging off uncertainty over the formation of the new government

Figure 6: S&P/NZX 50 Index versus NZD/USD



Source: Bloomberg

ii. Upcoming Elections

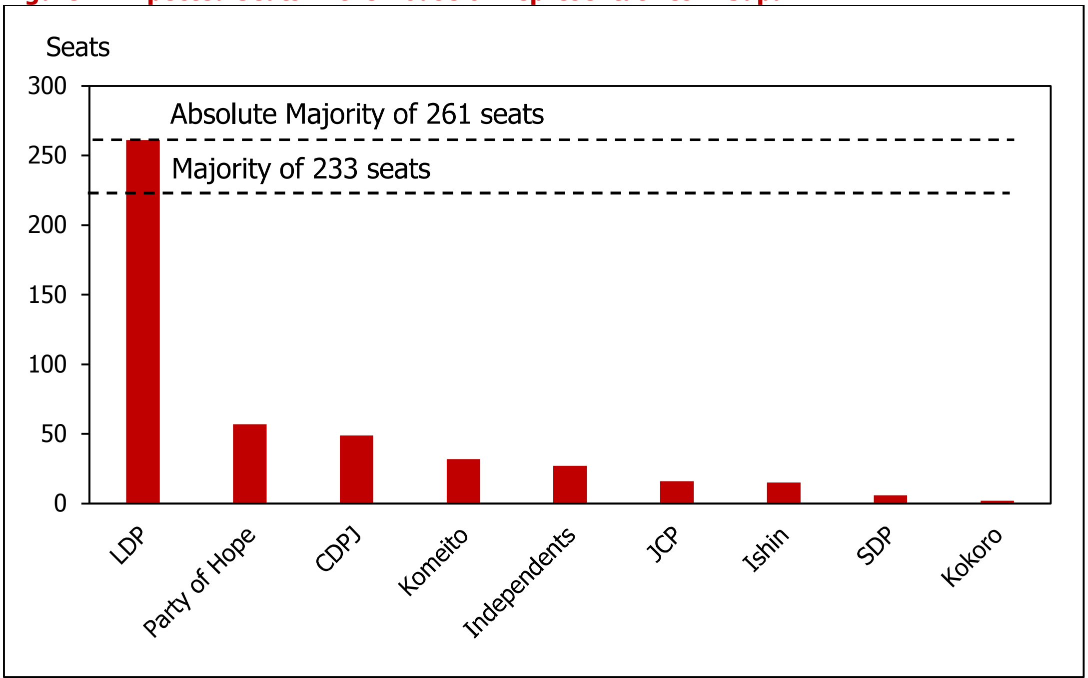
Japan

Snap election to secure mandate. Japan also hopped on the election bandwagon as Prime Minister, Shinzo Abe announced that a snap election will be held on October 22 in order to secure a fresh mandate to deal with the current challenges especially tensions arising from the Korean Peninsula and also two corruption scandals linked to him and his wife. Abe's Liberal Democratic Party (LDP) and coalition partner, Komeito held a supermajority of two thirds of seats in the lower house before the dissolution of House of Representatives was dissolved on September 28. 465 seats are up for grabs in Japan's two chamber parliament for this snap election.

Complicated political scene. Leader of newly formed opposition, the Party of Hope indicated that she will not be competing in the election. Japan's political scene became more complicated with the formation the Constitutional Democratic Party of Japan (CSDP) following the centre split of the DP which could slash the opposition vote and help Abe's coalition maintain its majority. It could prove to be a setback in an attempt to form a united front against Prime Minister Shinzo Abe's government by raising the possibility of a three-way battle between the ruling coalition, Koike's party and a force led by Edano in the CSDP.

Latest polls indicate Abe is heading towards victory. Campaigning period for the election began on October 10. Based on nationwide surveys were carried out by domestic media such as Kyodo News and the Yomiuri Shimbun last Tuesday and Wednesday, Abe is expected to win. The survey by Kyodo News showed that LDP is expected to win about 298 seats and its coalition partner to 30 seats leading to total of 319 seats which is more than two thirds of the total seats. A similar trend was also seen in the survey by Yomiuri Shimbun whereby the LDP will likely win with an absolute majority of 261 seats and 300 seats when combined with Komeito. Meanwhile, support for the Party of Hope is waning , only expected to win slighltly over 57 seats according to Yomiuri Shimbun's survey.

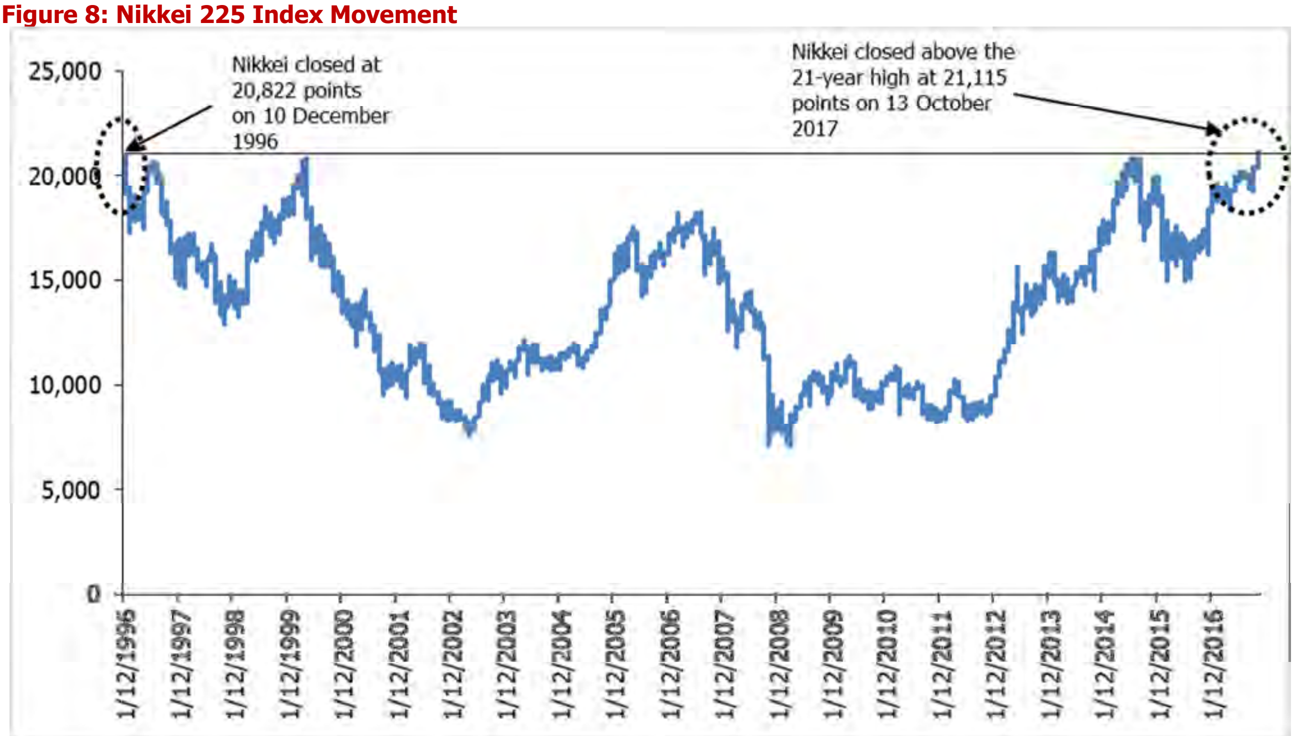
Figure 7: Expected Seats in the House of Representatives in Japan



Source: The Yomiuri Shimbun

Nikkei reacted positively during as campaigning period started. As polls indicated an increasing probability of Abe's LDP to garner a super majority in the upcoming snap election, sentiment in Japan was aided, lifting the Nikkei above its 21-year high to 20,954 point on Thursday. Optimism continued till Friday with Nikkei closing at a new high of 21,155 points.

Figure 8: Nikkei 225 Index Movement



Source: Bloomberg

Italy

Italy's looming elections. Another election that is coming its way would be the Italian election where mayoral elections were held back in June with the center-right Forza Italia party claiming triumph. Risk of populism has risen lately due to separations on the far-right. Matteo Salvini from the Northern League party might join forces with anti-establishment 5 Star Movement following a spat between Salvini and former Forza Italia leader, Silvio Berlusconi. In view of that, Italy's election could be one with a major risk as it could either pose a populist majority or a hung parliament The Italian parliament will automatically be dissolved on 15 March 2018 which is around 6 months from the date of this report.

iii. Series of Independence Referendums

As we all know, there has been a few nations which are seeking independence, be it from a union of countries or a country. We have highlighted three instances depicting the act of seeking independence from a country which are the Brexit, the Catalonian crisis and the Iraq-Kurdish separatist vote.

Brexit

Recap on Brexit. Back in June 2016, British citizens voted in favour of the U.K leaving the European Union which somewhat shocked the global community. Nine months down the line Theresa May triggered the Article 50 of the Lisbon Treaty which initiates the process for the U.K. to leave the EU which was then followed by a snap election on June 8 to seek a stronger mandate in the Brexit process as she resumed office following David Cameron's resignation. The snap election saw Theresa May's failure to secure an overall majority, giving rise to a hung parliament, prolonging the process of exiting the EU.

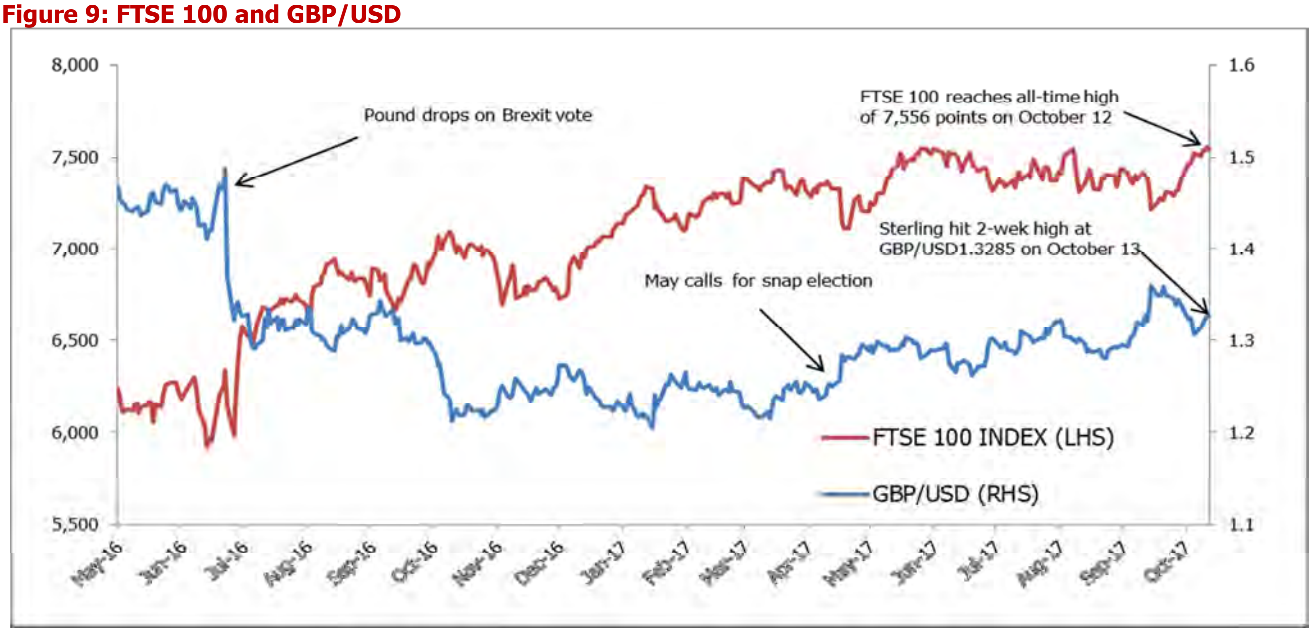
Banks potentially shifting jobs out from Britain. A direct impact of Brexit could be seen in the financial services industry. If Britain were to lose access to the European Single Market, it may prompt banks to move staff out of Britain as banks require a regulated subsidiary in the EU in order to offer products across EU members. So far, banks have called for a Brexit transition deal must be agreed between the UK and EU by Christmas to prevent banks from initiating their Brexit contingency plans. A transition deal is meant to be a period of time where the UK can gradually implement new laws and processes in light of Brexit, therefore preventing a cliff-edge moment of change.

First phase of talks showed mixed conclusions The first phase of Brexit talks began a month after the snap election, taking place in Brussels with the U.K represented by Brexit Secretary, David Davis and EU represented by Michel Barnier. The conclusion of the first set of talks was rather mixed; the UK gave an upbeat assessment by claiming that there are many common grounds while Barnier was dissatisfied with the lack of details from the UK's side. The first phase of negotiations centred around financial settlements of the UK to the EU to cover ongoing EU biggest commitments, the issue of the Irish border and citizen rights.

Second phase of talks delayed. The second phase of Brexit talks focusing on trade was scheduled to begin in October but has now been postponed after the EU negotiators believe that there was insufficient progress made in the first phase. The next phase should not start unless a major breakthrough is achieved The European Council of the 27 EU member states will decide later this month whether to give a mandate for further negotiations if "sufficient progress" has been made on citizens' rights, Northern Irish border and the financial settlement.

Brexit talks are at an "impasse". Last Thursday, Brexit Chief Negotiator, Michel Barnier noted that the progress of Brexit talks have come to a deadlock. Comments from Barnier saw the sterling nosedive to as low as GBP/USD1.3122 while the FTSE 100 edged higher to a record close of 7,556 points. Nonetheless on the following day, the sterling closed at its strongest point in 2 weeks at GBP/USD1.3285 on Friday following news that about a possibility that the U.K will remain in the European Union for the next two years as reported by German newspaper, Handelsblatt. Handelasblatt stated that the offer for the UK to remain in the EU single market for a two-year transitional period is conditional upon settlement of financial obligations to the EU and the signing of a divorce bill.

Figure 9: FTSE 100 and GBP/USD



Source: Bloomberg, MIDFR

Catalonian Independence Referendum From Spain

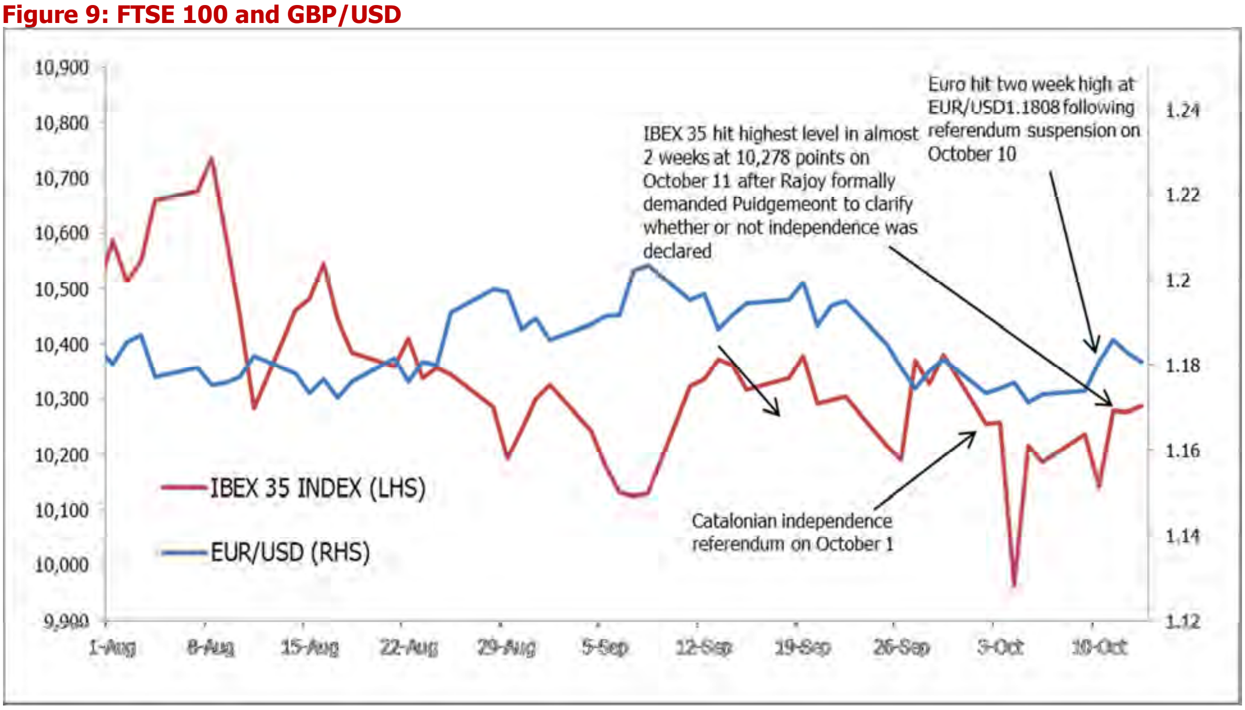
Catalonians voted for a yes in independence. In Spain, geopolitical uncertainty heightened following Catalonia's referendum to declare independence from Spain on October 1. The state even announced that a declaration of independence will be made within a matter of days from the referendum day despite being strongly rejected by King Felipe, the Spanish King as it will disrupt the unity of the country. Final results of the referendum showed 90% of the nearly 2.3m who voted were in favour for separating from Spain

New rules to enable relocation of banks. In response, the Spanish government passed a law to enable easier relocation of corporations around Spain, threatening Catalonia's business activities. Caixa Bank, Spain's third largest bank and Gas Natural, a Catalonian based utility company were among the companies that decided to shift their offices outside Catalonia. As a consequence, Spain's IBEX 35 index lost 2.0% for the week ended October 6, while CaixaBank and Sabadell Bank declined 3.8% and 6.2%, respectively for the week.

Relief rally amid suspension of referendum result. In the following week, Catalan President Carlos Puidgemont put a hold on declaring independence in the next few weeks on October 10 to schedule talks with Spanish Prime Minister Mariano Rajoy. The suspension provided a boost for sentiment in the Eurozone whereby the Euro currency surged to a two week high at EUR/USD1.1808.

Puidgemont given five days to clarify. A day after the declaration of independence was suspended, Prime Minister Rajoy made a formal demand to Puidement to clarify within five days whether independence was really decalred independence from Spain, Puigdemont has until 10 a.m. Monday to clear up his position. If he's found to be in violation of the law he'll be given another three days to back down. After that, Rajoy will trigger the legal procedures to force the Catalan administration from office. As the Spanish government started the process which could lead to the suspension of the Catalonian government under Article 155 of the Spanish Constitution, the euro extended gains to close 0.43% higher while the IBEX 35 Index ended at the highest point in almost 2 weeks at 10,278 points.

Figure 9: FTSE 100 and GBP/USD



Source: Bloomberg

Kurdistan Independence Referendum

Kurds vote for independence from Iraq. The Middle East was not left out from an exit referendum as Iraqi Kurds overwhelmingly voted in favour of Kurdistan's independence from Iraq on 25 September. Besides seeking independence from Baghdad, the referendum served to give a renewed mandate 92% of the 3.3m Kurds and Non-Kurds supported a secession according to the electoral commission.

Figure 10: Map of the Autonomous Region of Kurdistan

Source:USAID

Turkey disfavours the referendum. The first country to react was its neighbour, Turkey which had its President, Recep Tayyip Erdogan, threatening the blockade of oil exports from Iraqi Kurdistan, fearing the same would happen with Kurds insurgency in southeast Turkey near northern Iraq. In fact on the day the the Iraqi Kurds voted for the referendum, the Borsa Istanbul 100 Index experienced the biggest daily loss in 6 weeks at 1.78%.Confrontations also came from Iraq as threatened to deploy their army and seize oil fields in Iraq's northern Kurdish region.

Will oil supply be affected ? Erdogan's threat to the Kurds boosted Brent crude oil prices to USD59pb the highest since July 2015, the same day the voting took place. Meanwhile, Iraq ordered repairs for a disused pipeline from northern fields to a Turkish port of Ceyhan, to enable the export or crude without passing through the Iraq-Kurdish region, further isolating the independence seeking Kurds. The pipeline has a capacity of 250,000 to 400,000bpd with rooms for expansion. Interestingly, Iraq's September oil output was 30000bpd higher at 4.52mbpd despite escalating tensions from the Kurdish referendum. Henceforth, oil supply to Turkey from Iraq will face no disruption.

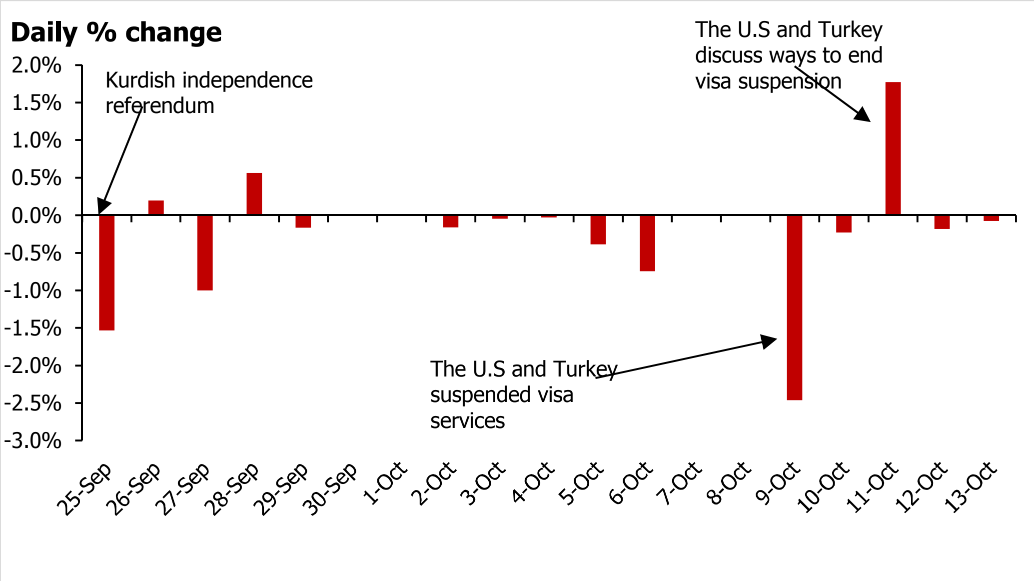
Kurds reluctant to cancel referendum result. As of last weekend, the Iraqi central government demanded Kurdish leaders to reject the result of the independence vote but failed to do so. Kurdish leaders strongly backed the independence while taking a conciliatory approach by ruling out any military intervention but are ready to defend the region from outside forces. The only tyoe of negotiation that will take place between the Kurds and Iraq would only be a joint delegation representing all Kurdistan parties.

Turkey ended up in a brawl with the U.S. Following the detainment of a U.S mission employee in Turkey, both the U.S and Turkey decided to mutually suspend visa services on October 9 . As a consequence, the Lira depreciated as much as 2.46% against the greenback to TRY/USD0.27, the weakest since mid April. The Borsa Istanbul Index was also affected, declining 2.73% the same day, the biggest daily loss since July 2016.

Discussions to end visa spat rekindled market sentiment. As U.S Ambassador to turkey, John Bass announced last Wednesday that the U.S and Turkey are negotiating deals to curb the visa suspension. The announcement spurred risk-on mood with the Turkish lira snapping eight straight of losses as it gained 1.77% to close at TRY/USD0.2741, the largest gain in a day since April 24.

U.S officials arrive in Ankara on Sunday. As situation was improving, John Bass made a remark regarding the Islamic State group during a press conference which was perceived as a veiled threat by Turkish officials, hey said the ambassador's comments suggest Turkey would face terrorist attacks from Daesh if the US was to end its campaign against the terror group. In efforts to restore the disrupted relations between the U,s and Turkey, diplomatic U.S officials visited Ankara to discuss recovery efforts.

Figure 11: Percentage Daily Change of the Borsa 100 Istanbul Index



Source: Bloomberg

<u>Qatar Crisis</u>

To recap, on 5 June 2017, Saudi Arabia together with the United Arab Emirates, Bahrain, Yemen and Egypt decided to cut diplomatic ties with Qatar over its alleged support for Iran and Islamist groups. Transport links to and from Qatar via land, air and sea have also been suspended. Even worse, the export of white sugar to Qatar from the UAE and Saudi Arabia has been stopped, pressuring consumers in times where demand for sugar is high during the fasting month of Ramadhan. As an immediate impact, people residing in Qatar have started to store food supplies in the event that further supply shortages were to happen.

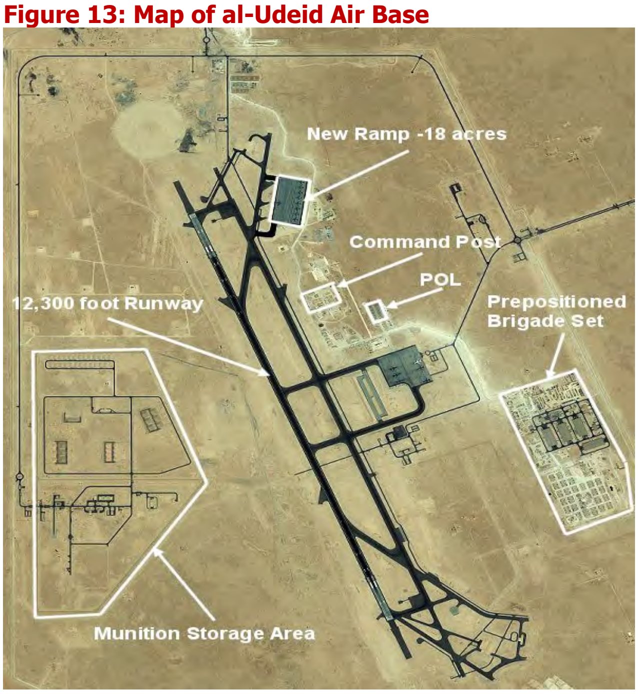
Strengthen ties with Turkey and Iran. 4 months down the line, Qatar has not succumbed to the demand of Saudi Arabia and its allies but instead strengthened ties with two countries in the wake of the gulf crisis; Turkey and Iran. Qatar maintained the Turkish military base in its land on grounds of ideology affinity with Muslim Brotherhood whereby the two countries gave support to the Mohammed Morsi government. Aside from that, a Qatar-Turkey military exercise serves as pre-emptive measures in the event that military intervention is required. As for relations with Iran, diplomatic ties were revived in August ties after Iran sent food to Doha and allowed Qatari planes to increasingly use the Islamic Republic's airspace.. Previously, relations between Iran and Qatar collapsed in January 2016 when Qatar withdrew its ambassador in solidarity with Saudi Arabia after Iranian protesters stormed the Saudi embassy in Tehran in protest at Saudi Arabia's execution of a prominent Shia cleric. Recently on October 3 2017, the foreign minister of Iran, Javad Zarif visits Qatar to meet its top official. During Zarif's visit in the Gulf state, Zarif urged a regional cooperation reiterating that Iran has promoted a dialogue system in the Persian Gulf which has not yet been recognizes by countries in the region.

U.S tries to act as a mediator. In the week before, military exercises held jointly by the U.S and its Arab nation allies over the gulf crisis were paused in efforts to leverage on its power to end the spat. One of the U.S's military official even noted that the brawl appeared as a hindrance towards the combat against the Islamic State. The reason behind this is that the southwestern side Doha is home to the al-Udeid air base, U.S's largest base in the Middle East which serves as a forward headquarters for the Central Command in the war against ISIS

Figure 12: Location of al-Udeid Air Base

Source CNN

Figure 13: Map of al-Udeid Air Base

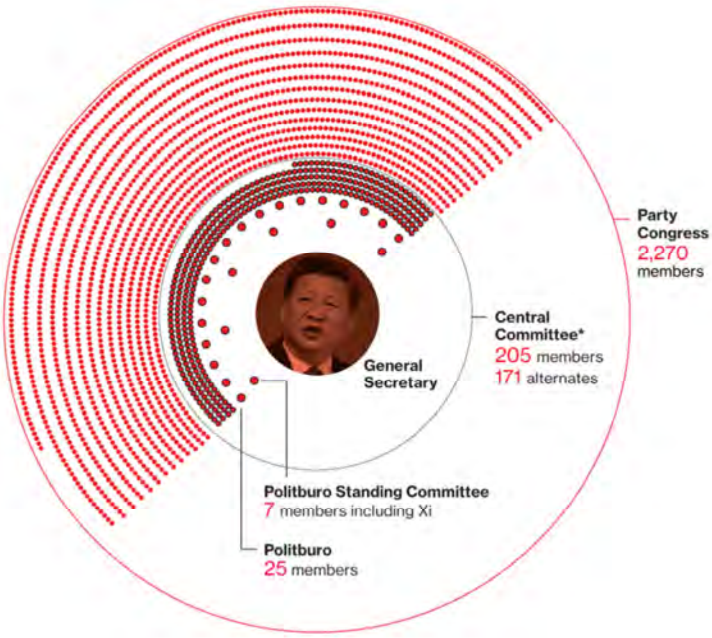


Source CNN

China's Direction Moving Forward

A meeting that will shape China's top leadership for the next 5 years. On October 18, China will witness the 19th Communist Party Congress, an event where around 2,300 delegates from China's ruling elite come together to select officials for the Central Committee consisting of 205 members. The Central Committee will in turn choose the 25-member politburo before revealing a new 7- member Politburo Standing Committee, which is the crux of political control in Chinese politics. Although the congress portrays a democratic exercise, most decisions are made beforehand behind closed doors

Figure 14: China's Circle of Power



Source: Bloomberg

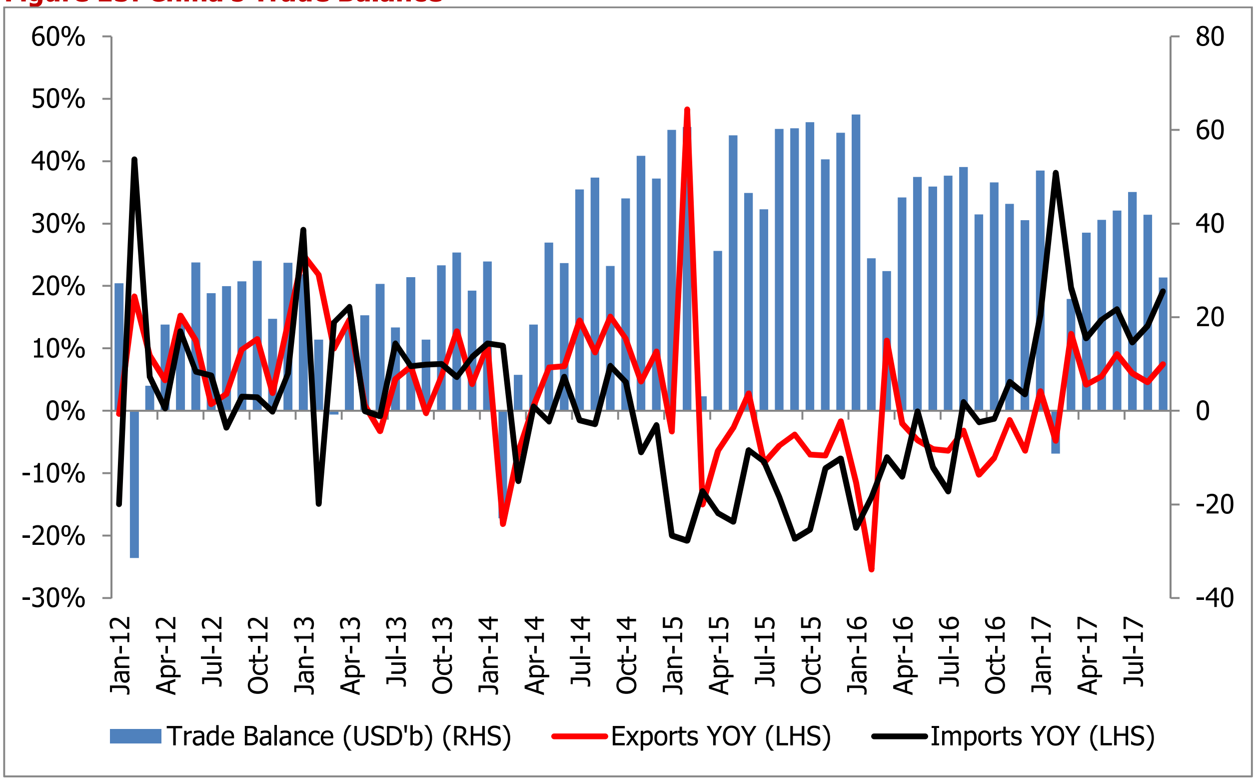
Congress becomes platform to solidify position. The Congress will be an avenue for President Xi to strengthen his position by means of placing loyalists in the party's upper ranks with a number of officials from the Politburo and Politburo Standing committee due for retirement based on age restrictions. In view of that, President Xi may go against the informal age limit of 64 years old by maintaining close ally, 69-year old Wang Qishan in office. With Wang still being in office, anti-corruption efforts will be led by Wang which is a way for Xi to threaten his key nemeses.

It will be Xi's last term according to tradition. President Xi will be starting this second term which is deemed to be his last, indicating that a successor will need to be appointed. But if President Xi does not name a successor within the top leadership, it signals that Xi prefers to remain in his post for an upcoming term. Retaining Wang by abolishing the age precedent will reinforce the possibility that Xi intends to go for a third term beyond 2022 when he is 72 years old.

Xi's ideology likely to be included in constitution. The people of China perceive President Xi as core figure who is comparable with the likes of liberator Mao Ze Dong and reformer Deng Xiaoping, who are the only political leaders to have their ideological contributions incorporated in the constitution. Moreover, Xi's party has been actively spreading the "Xi Jinping Thought" over the past year. Henceforth, an inclusion of Xi Jinping's ideology in the constitution would reflect Xi's strong influence which is on par with Mao Ze Dong and Xiaoping.

China showed a good economic data ahead of the Congress. Ahead of the 19th National Congress of the Communist Party of China, the Chinese external trade activities continue expanding at solid pace. In Dollar terms, Chinese exports grew by 7.5%yoy whereas imports increase by 19.1%yoy in September. Steady exports growth indirectly reflect global demand and trade activities remain optimistic while surge in imports growth tells that China's domestic economic activities especially consumer spending are growing at upbeat momentum.

Figure 15: China's Trade Balance



Source: Bloomberg

Chinese stock markets also took cue from positive economic data. As investors switch to defensive mode ahead of the Congress coupled with expectation of positive retails sales data in September, Chinese consumer and healthcare stocks staged a rally in Friday. Some of the stocks which performed well that day were Suning Commerce Group which closed at a 23-year high and Tonghua Dongbao Pharmaceutical which rose the highest in more than 2 years at 4.6%. Therefore it was no surprise that pushing the CSI 300 Index to a 28-month high of 3,921 points the same day.

C. Monetary Policy Direction Amid Heightened Geopolitical Risks

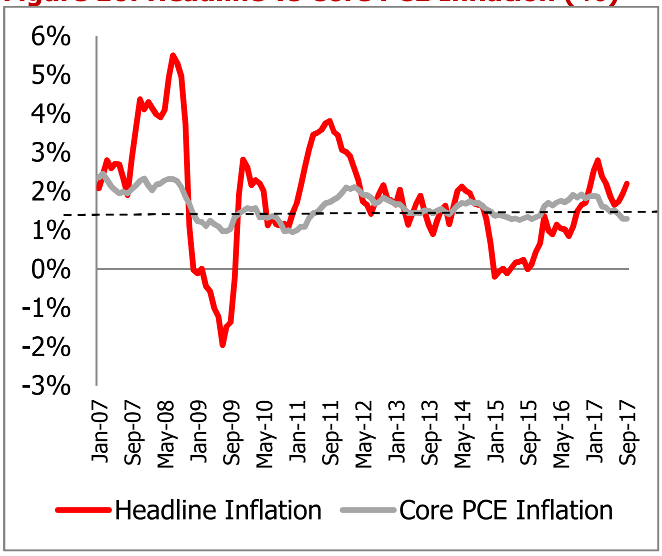
Dynamic global trade and improved labor conditions coupled with accommodative monetary policies and supportive fiscal stimulus in major developed countries are making global economy to consolidate toward healthy growth trajectory. A synchronized recovery in global economy observed in the last 3 quarter of 2017 is expected to persist toward year-end despite geopolitical risks lingering around the globe.

Economic performance has improved in most advanced economies with Euro area leading the pack. In Q2 2017, the Euro bloc economy expanded the most in over 6 years supported by robust domestic demand. Improved labor markets and positive wage growth help fueled the Euro bloc's domestic economy amid sticky prices movement. Monetary stimulus program spearheaded by European Central bank also help boost the Euro area domestic economy

However in the UK, the bleak prospect of post-Brexit era adds to more uncertainty about the future of the economy. Escalating prices, weakening currency and stagnant wage growth further dampen consumers' purchasing power amid Brexit negotiation. Uncertainty in regards of various contentious issues ranging from immigration to single market to EU bill further complicated the matter. The snail pace development of the ongoing negotiation will adversely affect businesses and private investment is expected to deteriorate in the upcoming months.

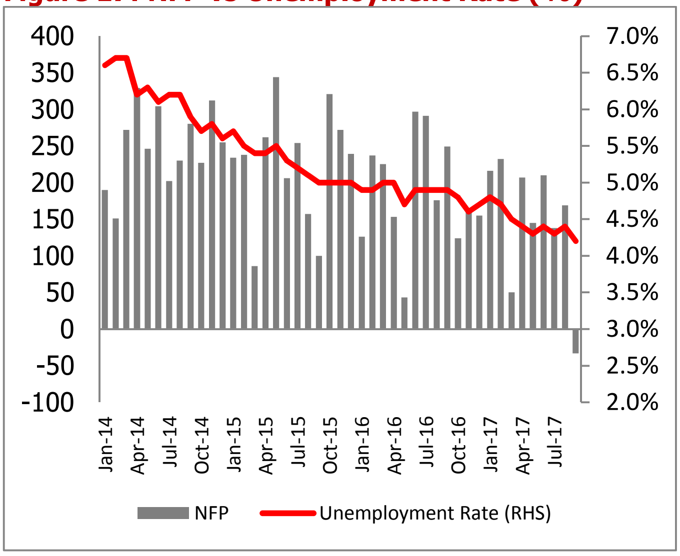
Overall, global monetary policy will remain divergence at least in the near term with most economies are continuing with their accommodative and supportive policy stance amid moderating growth. Unlike most countries, US has raised its federal funds rate in March and June and is expected to increase another one more this year as guided. Federal Reserve is on the tightening cycle with economic performance is expected to meet Fed's expectation amid sluggish price movement. The policy stimulus of low interest rate environment is also expected to gradually phasing out in other major economies. European Central Bank would begin wind down of its quantitative easing program in January with its asset purchase program to be continued at least 9 months after tapering. China however, is expected to maintain its loose monetary policy stance for the rest of the year.

Figure 16: Headline vs Core PCE Inflation (%)



Source: Bloomberg

Figure 17: NFP vs Unemployment Rate (%)



Source: Bloomberg

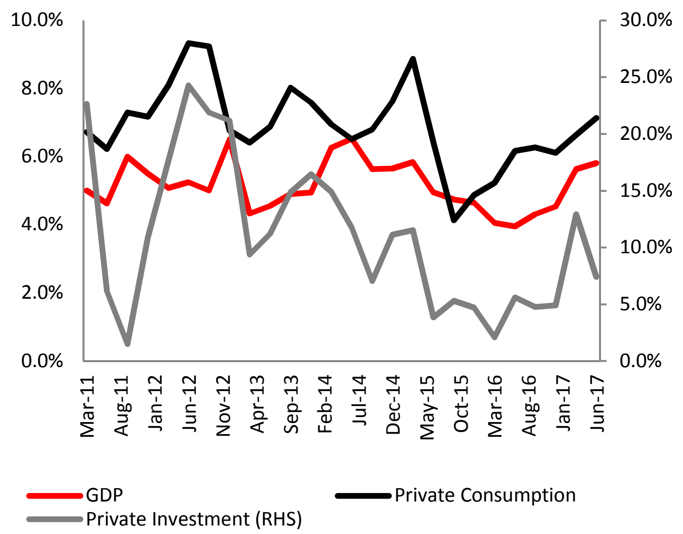
D. Malaysia : Looking Beyond the Geopolitical Impact

Economy

Trade activity resilient despite geopolitical risks. Exports performance beat market expectations. Exports expanded by 21.5%yoy in August, outpacing market expectations of 20%. It is the ninth consecutive months of double digit expansion in exports since December 2016. Imports grew 22.6%yoy in August, the first time outpacing exports growth in 3 months. Trade surplus widen close to RM10 billion, underpinned by strong exports sales and improving commodity prices. We view the continuous upbeat momentum in global as well as regional demands are still in play sustaining global trade activities to remain robust.

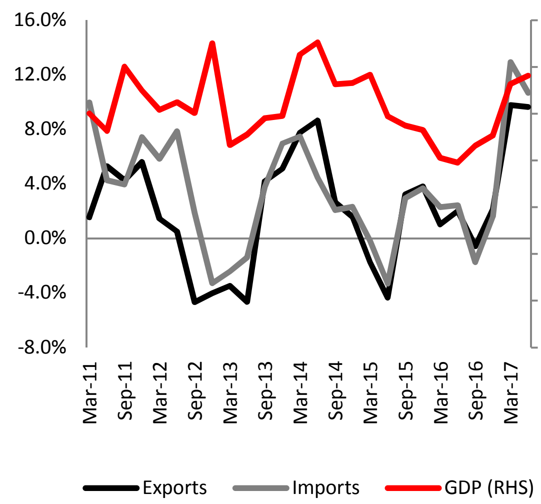
Soaring trade performance is a booster for GDP 2017. Export growth dropped to 30.9%yoy in July. The drop in exports expected due to the hampered palm oil exports by India's new import tariff which serves to protect India's local oilseed farmers. Continuous uptick in global demand in particular manufactured goods and optimistic market environment are major factors contributing towards resilient momentum in Malaysia's external trade performance**.** For eight consecutive months, exports have been growing by double digit rate. Business and consumer confidences in developed and emerging economies are indicating optimistic outlook for the coming months. For instance in August, IBD/TIPP economic optimism index in the US surged to 52.2 points, highest reading since March while China's Caixin manufacturing PMI rose to 51.6 points, fastest in five months. Encouraging developments in these two largest economies will have indirect positive spill over on Malaysia's products. The strong trade performance were observed in all sectors with E&E being the major contributor, followed by LNG, refined and crude petroleum products and chemical products.

Fig 18: Private Sector driving-up GDP growth (YoY%)



Source: DOSM; MIDFR

Fig 19: GDP vs External Trade (YoY%)



Source: DOSM; MIDFR

Malaysia's economic activities maintain on upward trajectory amid strong domestic spending and robust external trade performances. We opine private consumption and net exports will be the main drivers for the economic growth in second quarter of 2017. On the other hand, private investment is anticipated to moderate as compared to the last quarter. As for the whole year, we maintained our estimate of 5.1% GDP growth in 2017 while forecasting a 5.5% GDP growth in 2018

Current account to improve, reiterate USD/MYR forecast of 4.20 by year-end and introduce 2018 year-end forecast of USD/MYR4.10. We reckon current account will improve this year, bucking the downtrend established since 2011. In 2016, current account to GNI ratio was 2.2%. This could lend some support to Ringgit to strengthen from the current level of USD/MYR 4.20 by year-end of 2017. Higher commodity prices have so far translated into better terms of trade which in turn drive bigger trade surplus. For the first seven months of the year, trade balance reached RM51billion.

Sectoral Impact on Malaysia

Figure 20: Absolute value of overseas earnings in respective sectors (CY2016)

Source: Bloomberg

Overseas earnings of sectors. What we would like to draw from upon this chart is that there are many sectors in Malaysia that have earnings from the overseas. So, if there were any geopolitical elements existing in the country where the earnings originate, it could pose a risk to its earnings. Hence we would like to highlight stocks which have earnings overseas contained in the following sectors below

Construction

The construction sector is which categorised under capital goods derives the highest value in earnings from overseas with Muhibbah(BUY; TP RM3.45) being one of the top picks. Relating to the Qatar crisis, we actually view Muhibbah's Qatar venture as a catalyst to earnings upside instead of a wild card. Firstly, amidst the diplomatic row, Qatar Airways has announced in late September 2017 that it will triple its capacity in Hamad International Airport (HIA). This is a positive sign for Muhibbah implying future expansion for cargo terminal. We believe Muhibbah stands a strong chance to win transport related packages as they have strong track record building the catering facility for HIA (RM1.23bn) in 2007.

Aviation
Following the decline of inbound China tourists into South Korea due to the ban on Korean tour packages amid the diplomatic row between China and South Korea arising the deployment of the THAAD missile system, this may actually bode well for **Malaysia Airports Holdings Berhad (BUY, TP:RM9.98).** In addition Malaysia already has implemented the visa waiver programme for Chinese tourists, making Malaysia even more appealing. Despite September pax traffic at Malaysia airports came in 7.8m after two consecutive months (July and Aug) of pax traffic exceeding 8.3m, we expect expect 4th quarter numbers to better. With growth in the mid-single digit percentage growth likely, premised on China's Golden Week which is its peak travel period. In relation to MAHB's Sabiha Gokcen airport in Turkey, the visa suspension by both the U.S and Turkey could put a dent to tourist arrivals in that airport. Nevertheless, we think that the impact would not be significant and that the increase in passengers passing through its airports in Malaysia would be able to at least partly mitigate the impact on its earnings.

Automotive
The Ringgit has been trading between the range of USD/MYR4.22-4.23 which is already close to our in-house economics team year-end target of USD/MYR4.20. The current development underpins our bullish stance on the automotive sector and our view that FY17 earnings will be supported by the Ringgit's strength and more launches in 2H17. Main beneficiaries would be **Bermaz Auto (BUY; TP:RM2.55)** as its imports are 100% exposed to the Japanese Yen via CBUs whereas CKDs such as the CX5 and Mazda 3 models are purchased at a fixed ringgit price from 30% owned Mazda Malaysia Sdn Bhd (MMSB) which is the importer of Mazda CKD kits and assembler.To make this work, MMSB absorbs JPY volatilities from CKD imports which means that MMSB also benefits from the current ringgit strength. Every 1% change in the JPY impacts our FY17F by 1%.

Meanwhile UMW Toyota has the largest exposure to the USD given that all its imported CKD kits and CBUs from Thailand are transacted in USD. Given low localisation rates (of between 20%-60%) relative to the national makes (of 80%-95%), we estimate around half of total component costs are imported. Every 1% change in the USD impacts our FY18F by 4.7% for UMW (Group) **(BUY, TP: RM7.20)**

Banking
For the banking industry, **Maybank (BUY;TP:RM10.30)** and **CIMB(BUY;TP:RM7.10**) are two banks which have big exposure overseas especially neighbouring Indonesia. For instance, Maybank Indonesia is expected to continue to provide a boost to the Group's result. We were pleasantly surprised by the decline in interest expense despite lower CASA. Taking everything into consideration, we are optimistic on the Group's prospect for the rest of FY17 given that we expect lower provisions and the potential to maintain the momentum of loans growth and quality deposits growth. For CIMB Niaga, NIM continued to improve despite tepid loans growth, leading to strong NII growth and is expected to remain for the rest of the year. Aside from that, we also favour the asset quality which continues to improve and its strategy to scale down its auto and micro financing loans book. With Bank Indonesia's move to slash rates to 0.25% in September to lift lending and consumption, we believe that there is growth potential in Indonesia's economy, brightening prospects for the Indonesian arm of Maybank and CIMB.

Consumer
As the competition in the local consumer market remain tight, F&B players are going through a period of operating consolidation for their local business. Any unprofitable outlets for instance, were closed. As a result, more resources are being freed and reallocated in exploring untapped opportunities in overseas markets. Local consumer companies have seen increasing revenue contribution derived from overseas operation benefiting from this strategy mitigating the lackluster performance from the local operation. For **F&N (NEUTRAL;TP:RM25.47)** and **Oldtown (NEUTRAL;TP:RM3.10)**, revenue growth from overseas operation is encouraging in comparison to the domestic operation. However, we are not able to determine the size of the growth in overseas operation for Nestlé and Spritzer as the contribution from overseas is insignificant and hence, is not disclosed. Nevertheless, based on F&N and Oldtown's recent performance, we expect that the growth of the F&B companies in the near term is highly dependable on the performance of their overseas operation. Meanwhile for **Spritzer (BUY; TP:RM2.83)**, We expect brighter prospects in 2018 due to stabilising PET prices, stronger sales from Malaysia and lower marketing expenses in China.

Despite the growth in revenue of +32.0%yoy in the recent quarter which is in line with the sub-sector growth, **Padini's (NEUTRAL;TP:RM2.21)** net profit margin contracted approximately -2.1ppts yoy. The top line growth is mainly attributable to the opening of 14 new stores during the current 12-month period. Nevertheless, margins contracts due the pressures of rising input costs as well as selling and distribution expense while retail price need to be retained due to the stiff competition locally. Due to this, Padini is looking to expand its footprint in Cambodia in order to find new market to penetrate. It plans to open two to four stores in the next 12 months with investment of up to RM20.0m in Cambodia. We are positive on this development as it will provide a new area of growth for the company amidst the increasing purchasing power of Indo-China region.

Healthcare
With the recent U.S and Turkey visa spat that oulled down the Turkish Lira, it may not be a concern for **IHH Healthcare (BUY, TP:RM7.06).** IHH Healthcare has expanded its footprint in Europe via EUR125m acquisition of four hospitals and four medical centres in Bulgaria in June last year. In addition, First quarter of 2017 saw the opening of two new hospitals i.e Gleneagles Hong Kong as well as Acibadem Altunizade with the capacity of 500 and 350 beds respectively. In late FY18, IHH is slated to open the 350-beded Gleneagles Chengdu in China. Meanwhile there should be no concern over the impact of depreciating lira on the earnings of IHH, as revenues in Turkey is earned in the Euro Currency.

Plantation
The European Union is the second-largest palm oil export destination after India for Malaysia. But with palm oil under threat in Europe due to its environmental impact, coupled with geopolitical conflicts surrounding major European nations such as the U.K, Spain and Germany, demand from the region is expected to decline. Nonetheless, the Malaysian Palm Oil Council (MPOC) plans to tap into new markets such as Myanmar, the Philippines and even West Africa despite the EU resolution to limit import of palm oil. Meanwhile, recently **IOI Corp (BUY;TP:RM5.27)** has announced that it is selling 70% controlling stake in IOI Loders Croklaan (Loders) to Bunge Limited for Euro 297m plus USD595m, equivalent to RM3.94b. We view this positively, as margins for the downstream business isn't as lucrative as the upstream business and the proceeds can be used to expand its upstream business. This will definitely benefit plantation players such as **IOI Corp (BUY;TP:RM5.27)** and **Kuala Lumpur Kepong (BUY;TP:RM29.25)**.

Power
Regional expansion on the cards for power players i.e. **Tenaga (BUY, TP:RM16.80)** is on the lookout for regional opportunities after having acquired GMR Energy (India) and GAMA Enerji (Turkey) in the past 18months while YTL Power's expansion of its overseas operations via Tanjung Jati (Indonesia) and Attarat (Jordan), due for operations in FY21F, bodes well due to diminishing returns in Malaysian power generation. YTL Power is estimated to generate 15% and 19% equity IRR from Tanjung Jati and Attarat respectively vs. single digit returns domestically.

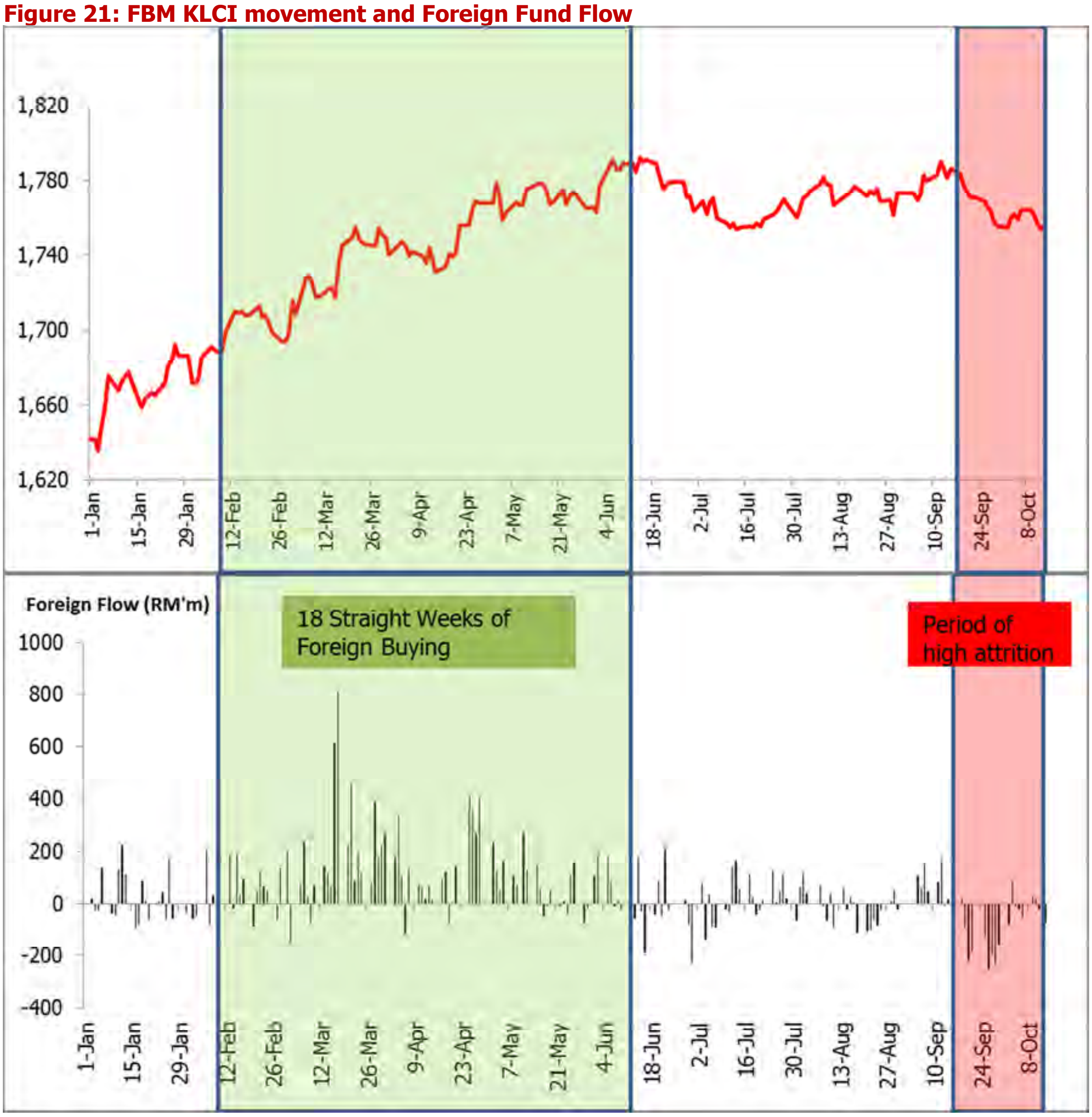
Telecommunications
Axiata (NEUTRAL;TP:RM5.28) owns various operating companies across Asia which include Indonesia, Sri Lanka, Bangladesh, Cambodia and Nepal. Moreover, it expanded its footprint in Pakistan via its 62.4% owned subsidiary, Edotco Group Sdn Bhd (edoctco) that acquired Tanzanite Tower Private Limited (Tanzanite) together with its portfolio of 700 towers in Pakistan for USD88.9m back in early August 2017. Subsequently on 30th August 2017, via Tanzanite, edotco is acquiring Pakistan Mobile Communications Limited (PMCL), with a portfolio of 13,000 towers from Deodar Private Limited (Deodar). In addition, edotco Pakistan private limited (EPPL), a wholly-owned subsidiary of edotco, entered into a share subscription and shareholders' agreement with Dawood Hercules Corporation Limited (DH Corp) who will hold a 45% stake in EPPL as strategic local partner. Upon completion, EPPL will a total portofolio of 13,700 towers in Pakistan.

Impact on the Overall Equities Market

1H17 attracted large inflows. To recap, 1H17 saw an influx of foreign flows within a day which amounted RM816m net on March 17. were net buyers for 18-straight weeks from February 10 to June 9, the longest streak since 1H13. During this period, as anticipated, the FBM KLCI broke above its nearly 2-year trading band and thenceforth moved on to chart an upward trajectory where it almost hit the 1,800 mark on June 16, crested at 1,796.75 points. Indeed the aggregate net inflow of foreign funds in the first 6 months of this year amounted to RM10.17b. This cumulative net inflow in 1H17 offsets approximately 30% of the total net outflow recorded in 2014-2016.

Reversal of trend 2H17. At the beginning of 2H17, tapering signs of foreign flows were becoming more prevalent while the FBM KLCI retreated from its 2.5 year high to now trade between the range of 1,755 to 1,760 points. Moreover, foreign flows into Malaysia have turned negative for the first time in August as foreign investors disposed –RM242m net.

Figure 21: FBM KLCI movement and Foreign Fund Flow

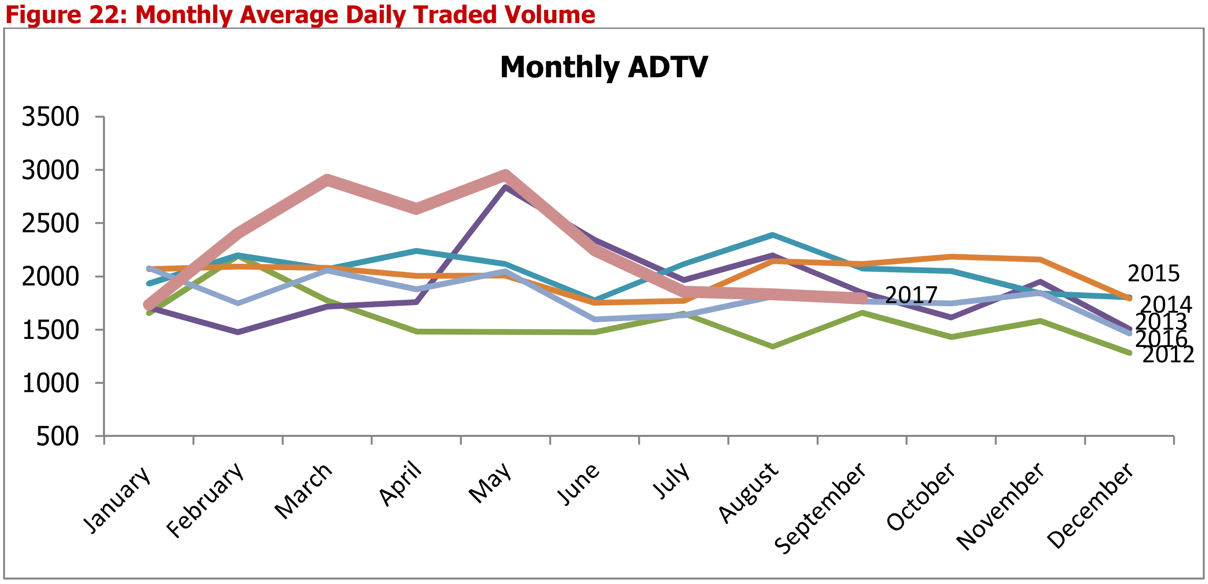


Source: Bursa Malaysia, Bloomberg

Selloff partly due to geopolitical tensions in Korean Peninsula. We reckon that the selloff in the 2H17 is partly due to the U.S and North Korea spat. For example, market sentiment was badly hit in August following the North Koreas's launch of an unidentified ballistic missile over northern Japanese island of Hokkaido. Another incident which involved North Korea claiming that President Trump's Twitter post as a declaration to war, coincided with biggest weekly selloff on Bursa which amounted to –RM967.3m net during the week ended September 29 with the highest weekly attrition Henceforth, there is no doubt that there is a spillover effect from Asian peers notably South Korea and Taiwan have recorded a long streak of selling in 2H17.

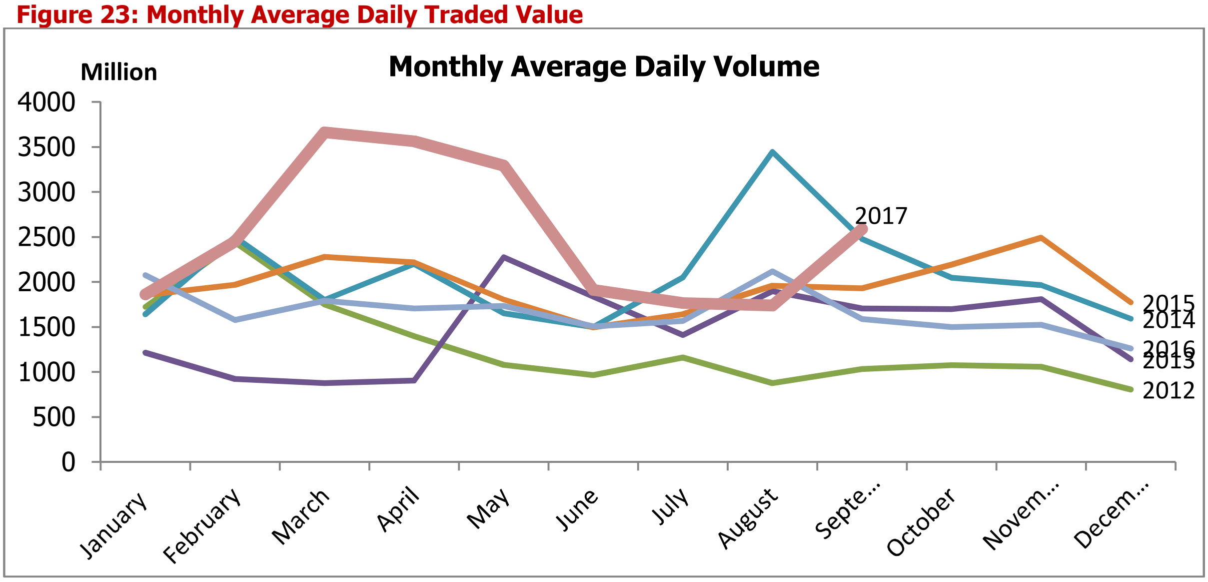
Moving forward, foreign flows will still depend on geopolitical risks around the world. For the remaining of 2017, we also expect both value and volume to taper slightly to trade around the range of 1.6b to 2.2b and RM1.0b to RM2.5b respectively. Looking at the trends of volume over the past few year, volume and value tends to taper during the second half of the year especially towards the year-end festive season

Figure 22: Monthly Average Daily Traded Volume



Source: Bloomberg, MIDFR

Figure 23: Monthly Average Daily Traded Value



Source: Bloomberg, MIDFR

FBMKLCI 2018 target of 1,900. We still expected market to see an uptrend next year albeit the concern over geopolitical issues, underpinned by continuous earnings expansion this year and also in 2018. And we reiterate our end 2017 target of 1,830 and introducing our end 2018 FBMKLCI target of 1900. We reckoned that the expected volatilities in reaction to the slew of geopolitical news will provide an opportunity for investors to pick up value stocks with good earnings potential or generous dividend yield over price retracements, caused by overreaction from negative market sentiment. While we are concern over potential capital flight, we do not think that it will result in major downward movement in our market. And we believe fundamentals data eventually will find its way to convince investors that there is still value in investing in our market.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.