STRATEGY

FBM KLCI Target: 1,680 points

Macro reflation & Re-steepening Yield Curve

KEY INVESTMENT HIGHLIGHTS

- **We reiterate our view that valuation expansion is a bona fide risk to world's equity market**
- **Key underlying dynamic of 2019 is the concurrent dovishness among the world's central banks**
- **Lead signs of macro reflation emerging**
- **Prospect of macro reflation may engender re-steepening of yield curve**
- **Empirically, re-steepening yield curve coincided with the so-called "melt-up" in equity market**
- **FBM KLCI neckline breach is likely transient hence a buying opportunity**
- **At current juncture, maintain our 2019 FBM KLCI baseline target at 1,680 points**

In spite of the less than buoyant equity market sentiment prevailing, we reiterate our view that valuation expansion is a bona fide risk to world's equity market (including our baseline outlook on the local benchmark).

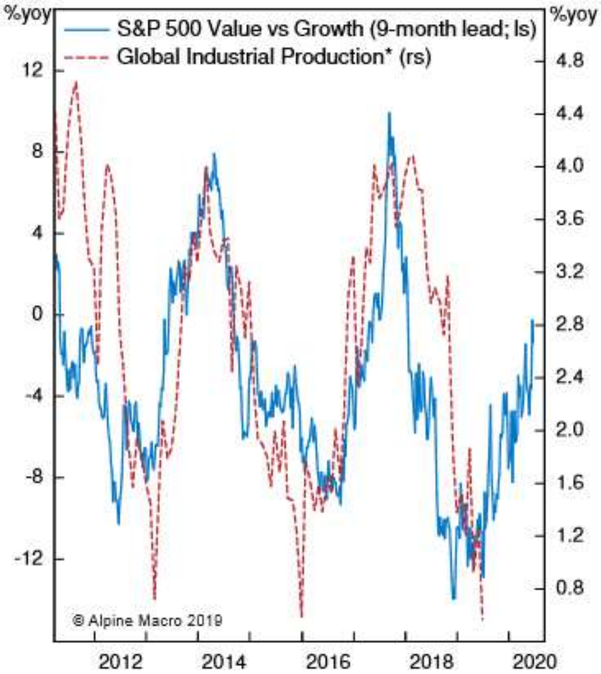
In above regard, we must again restate that the key underlying dynamic of 2019 is the concurrent dovishness [particularly] among the world's three major central banks. Unlike in the previous year, we now witness a more concurring broad monetary policy stance by the US Fed, PBOC and the ECB (as well as, by extension, other smaller central banks including Bank Negara Malaysia). On this score, we must highlight that the potentially virtuous impacts of the shifting monetary dynamic (i.e. burgeoning tide of world's financial liquidity) are not limited to buttressing the real economy but also towards the valuation of risk assets.

Additionally, we can expect the fiscal authorities to also react to material threats to the macro conditions. Hence, going forward, we may as well see a less restrictive fiscal policy position among the world's governments. Empirically, an easing monetary stance and a less restrictive fiscal position (either separately or together) would engender a reflationary effect to the macro performance.

Lead signs of macro reflation

It is notable that value stocks tend to outperform growth stocks circa three quarters ahead of the recovery in industrial production growth. On this score, we must highlight that the equity market is implicitly betting on an imminent reflation in the world's economy (see Chart below).

Value versus Growth stock performance: A lead signal to Industrial production growth

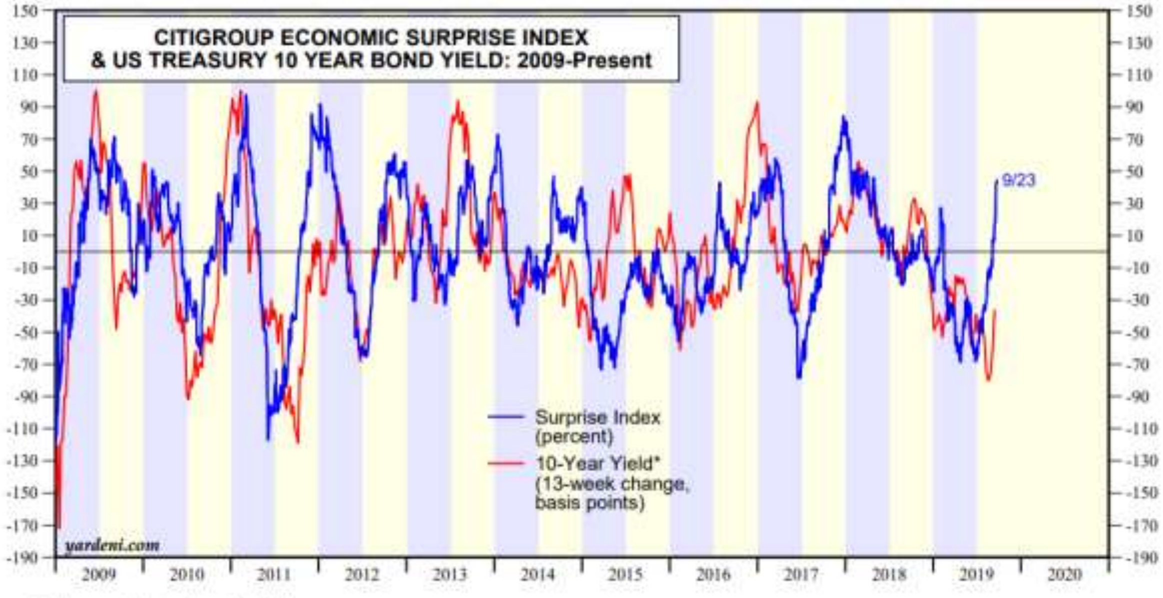


*Source: Netherlands Bureau for Economic Policy Analysis (CPB)

Moreover, domestically, Malaysia's leading economic index improved 1.4%mom in July 2019 after 2 months of negative streak. Similarly, on year-on-year basis, the leading index increased by 0.4%. Hence our economist expects a better economic performance for Malaysia in 2H19.

Another market signal in regard to the macro reflationary prospect may be manifested by the re-steepening of bond yield curve as the long-end of the curve begins to underperform the shorter-end. Consequently, a more risk-on attitude (in view potential macro recovery) coupled with a burgeoning tide of financial liquidity would lead to an expansion of risk assets valuation, i.e. a "melt-up" scenario.

The correlation between Citigroup Economic Surprise Index & 10-Year UST Yield



* Average for the week ending Friday.
Note: Blue shaded areas denote first half of each year.
Source: Federal Reserve Board and Citigroup.

The recent rise in Citigroup economic surprise index may herald a rebound in long-term government bond yield (see Chart above). Thus, barring a sharp reversal in the economic surprise index, the anticipated re-steepening of UST yield curve may be forthcoming by the end of this year.

Re-steepening Yield Curve

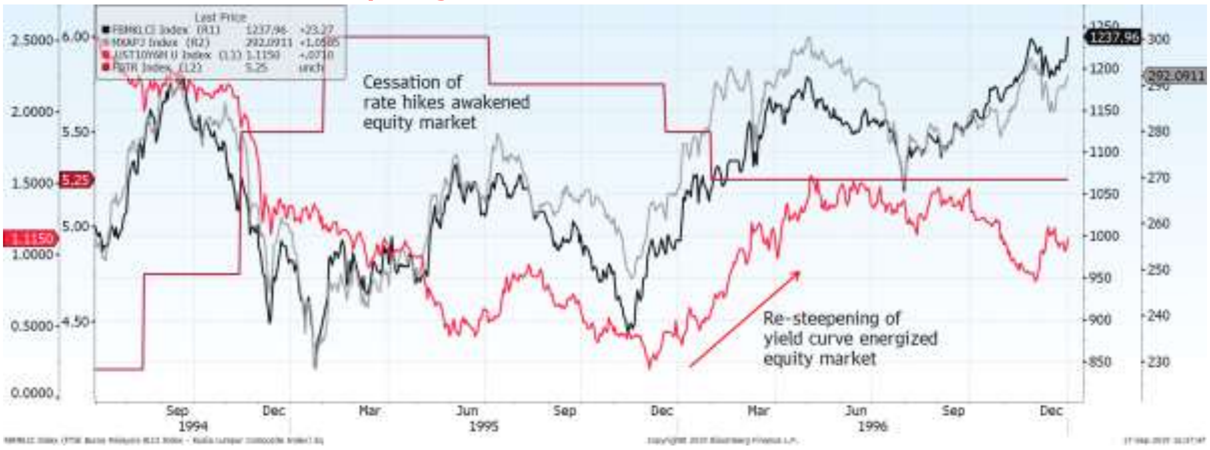
One business cycle ago, recall that the re-steepening of UST yield curve in 2007 coincided the so-called melt-up situation as evident by massive rallies in world's equity and other risk assets. On the local front, the FBM KLCI broke above 1,000 points resistance level and sprinted to a new all-time high of more than 1,400 points in 2007. Valuation-wise, the 12M Training PER of FBM KLCI expanded from 13.4x in December 2006 to 17.8x in June 2007.

FBM KLCI: Reaction to re-steepening of UST curve in 2007

Source: Bloomberg, MIDFR

Even earlier on, circa two business cycles ago, the re-steepening of UST yield curve in 1996 also signaled the melt-up state which saw the local benchmark catapulted from mere 900 points in late 1995 to more than 1,200 points in 1996. Valuation-wise, the 12M Trailing PER of FBM KLCI expanded from 16.5x in November 1995 to 21.8x in November 1996.

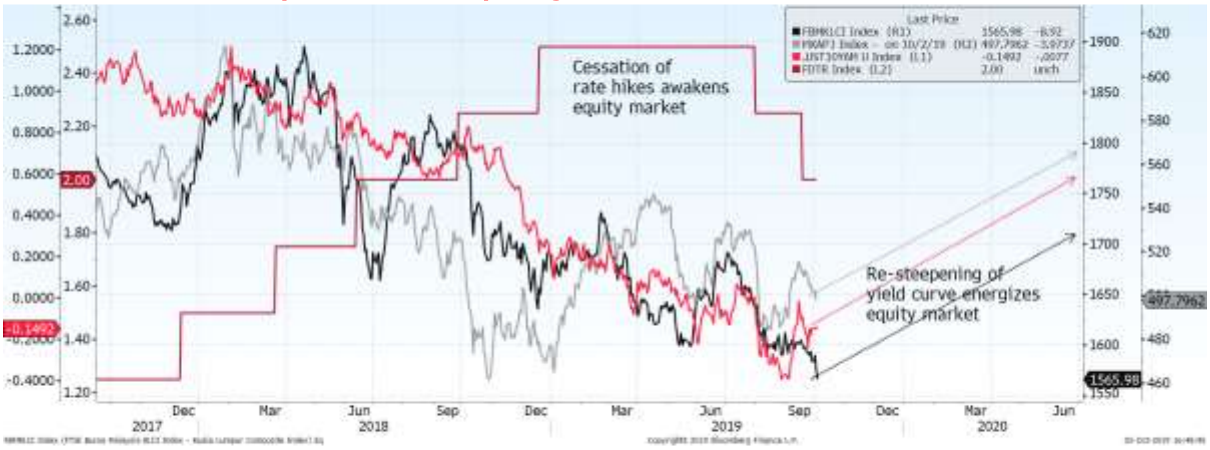
FBM KLCI: Reaction to re-steepening of UST curve in 1996



Source: Bloomberg, MIDFR

However, a successful (or failed) handover from liquidity-to-fundamentals, i.e. liquidity injections resulted in sustainably reflated fundamentals (or otherwise), can only be determined between one to a few years after the melt-up scenario. It must be highlighted that a failed handover would turn what initially deemed as a melt-up rally into a "last hurrah" as transpired in 2008 (worldwide) and earlier on in 1997 (in east Asian region).

FBM KLCI: Reaction to potential re-steepening of UST curve in 2019/20 ?



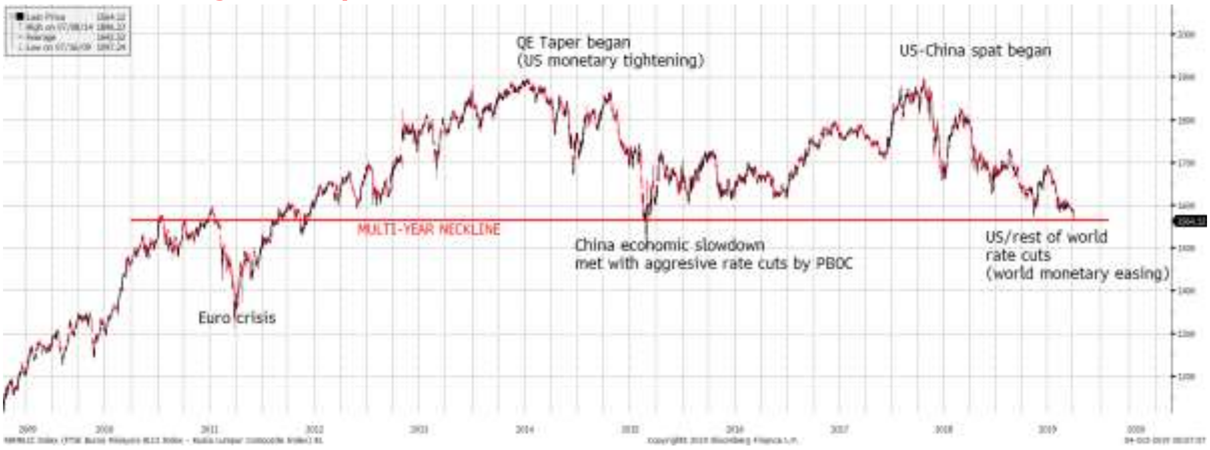
Source: Bloomberg, MIDFR

In above regard, we should take cue from an earlier remark by the US Fed Chair Jerome Powell that the "business cycle has not been repealed." However, he also added that "there is no reason [yet] why this economy cannot continue to expand."

FBM KLCI Target

As discussed in above, we are rather sanguine on the prospect of imminent macro reflation. Nonetheless, the FBM KLCI is currently teetering at the multi-year neckline levels. We expect any neckline breach to be transient hence a buying opportunity.

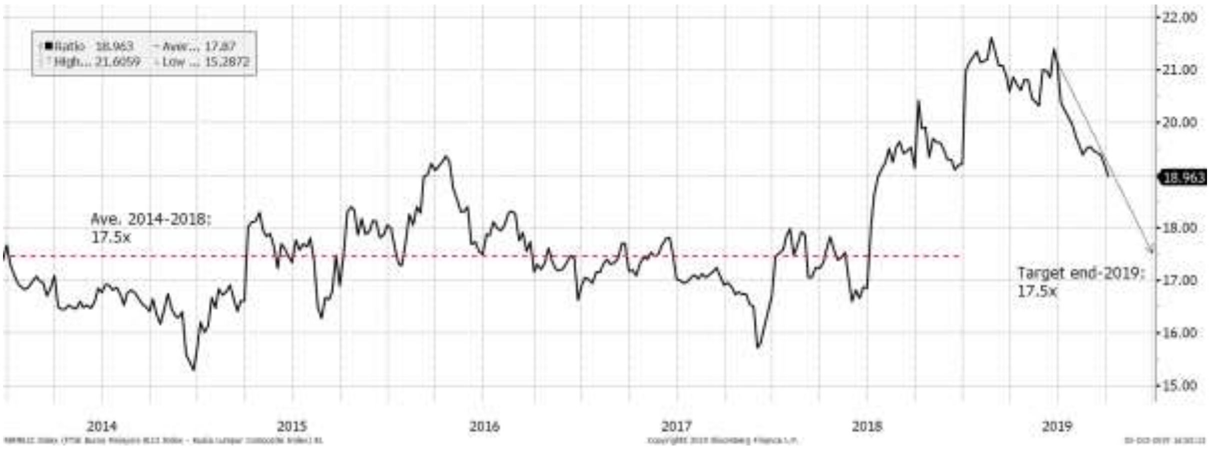
FBM KLCI: Trading at multi-year neckline



Source: Bloomberg, MIDFR

At current juncture, we maintain our **2019 FBM KLCI baseline target at 1,680 points** or consensus-derived PER19 of 17.5x, which is at par to its 5-year (2014-18) average multiple.

FBM KLCI: Historical PER



Source: Bloomberg, MIDFR

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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.