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Whither the market

Value headwind, valuation tailwind

FBM KLCI: 1,638.40 points

2019 Year-end Target: 1,720 points

Peer Comparisons

From early January to mid-June 2019, the FBM KLCI was a plain laggard with sub-zero performance in comparison to the positive returns chalked by key regional indices. However, when we expand the performance horizon from beginning of 2018 until mid-June this year, even at -8.8% return, the local equity barometer actually outperformed the Chinese as well as broader Asia-Pacific benchmarks.

FBM KLCI: Return performance against regional indices until 14 June 2019

	2018 (A)	YTD-2019 (B)	(A x B)
FBM KLCI	-5.9%	-3.1%	-8.8%
FTSE All-Asean	-12.1%	5.2%	-7.5%
CSI300	-25.3%	21.4%	-9.3%
MSCI Asia-Pac ex-Japan	-16.2%	46.1%	-11.1%

Source: Bloomberg, MIDFR

In gist, the FBM KLCI has been playing "catch-down" thus far this year in view of its massive return outperformance in 2018. The defensive return characteristic of the local benchmark is empirically proven (refer to pages 27-30 of [2019 Outlook] dated 17 December 2018) thus its performance profile since early 2018 is simply a testament to its defensiveness.

Likewise, the relative price movements of FBM KLCI also exhibited its defensiveness. As per the chart below, the local benchmark catapulted ahead of the pack in the month of July last year. In this regard, recall that it was in July 2018 that the US President Donald Trump actually implemented (after months of threats) the tariffs on China for its alleged unfair trade practices.

FBM KLCI: Price movements against regional indices until end-May 2019

Source: Bloomberg, MIDFR

On the other hand, during the first four months of this year, as the trade tension cooled down, the FBM KLCI entered into a period of underperformance. Moving into May 2019, as President Trump again ratcheted up the US-China trade spat (plus a possible tech war), the FBM KLCI again emerged as a regional outperformer.

Latest Corporate Earnings

The latest 1QCY19 corporate earnings again failed to excite hence the diminution in our aggregate FBM KLCI forward earnings estimates for both FY2019 and FY2020. Consequent to the reduction in our aggregate forward earnings estimates, we recently (vide 1QCY19 Earnings Wrap dated 4 June 2019) cut our 2019 baseline target for the local benchmark from 1,800 point to 1,720 points.

As of mid-June, it is noteworthy that the consensus-derived FBM KLCI earnings for 2019 is expected to only marginally surpass the 2016 performance. Another notable observation is that the forward 2020 earnings is expected to be only a tad better than the level recorded in 2017.

FBM KLCI: Historical & Consensus-derived Forward Earnings

	EPS	YoY (%change)
CY2020(F)	105.03	6.59
CY2019(F)	98.54	23.82
CY2018	79.58	-23.83
CY2017	104.47	6.30
CY2016	98.28	4.39
CY2015	94.15	-12.98
CY2014	108.19	1.93

Source: Bloomberg, MIDFR

Furthermore, in line with the range bound earnings trend of the past 5 years, the FBM KLCI had also traded sideways largely between 1,600 to 1,900 points range during the same period. Going forward, basing on the prevailing consensus-derived forward earnings, we expect the multiyear trading range to hold at least for the remainder of 2019.

Having revised our FBM KLCI 2019 baseline target, however we also take cognizant that equity price is a function both underlying value and valuation (*price = value x valuation*). Granted, the performance of corporate earnings (which is a key measure of underlying value) may have been less than buoyant lately hence the decision to cut our baseline target for this year.

Nevertheless, in anticipation of a burgeoning tide of world's financial liquidity, we believe valuation expansion is a bona fide risk to our baseline outlook on the local benchmark.

Key Dynamic: Burgeoning Liquidity

In above regard, we reiterate our view (refer to page 20 of 2Q19 Outlook dated 20 March 2019) that the key underlying dynamic of 2019 is "the cessation of monetary policy conflict (i.e. tightening versus easing) [particularly] among the world's three major central banks." Unlike in the previous year, we can now expect a more concurring 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, it must be highlighted that the potentially virtuous impacts of the shifting dynamic are not limited to buttressing the real economy but also (more immediately) towards the valuation of risk assets.

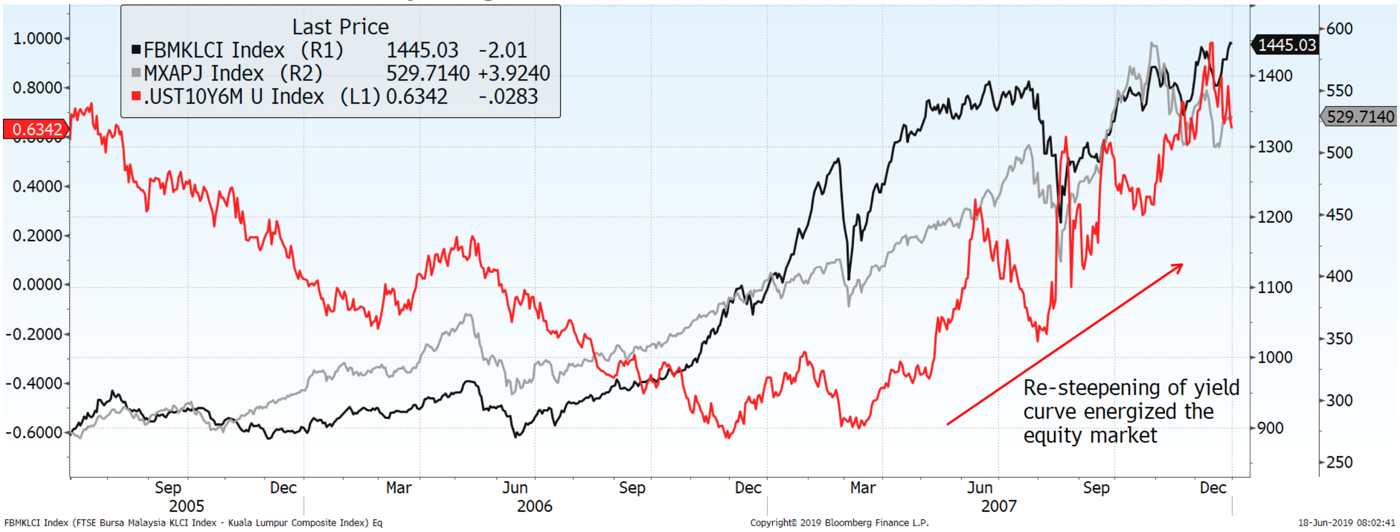
We can also expect the monetary and fiscal authorities to unstintingly react, as always, to any intensification in the level of incoming threats. Hence the recent escalation in the US-China trade spat, and made worse by the introduction of a tech dimension to the squabble, may going forward result in (1) an increasingly dovish monetary position among the world's central banks, as well as (2) a potentially less restrictive fiscal policy stance among the world's governments.

On above score, a progressively easing monetary position would result in, either or both, the lowering of key benchmark rate and the (re-)steepening of yield curve due to central bank's open market purchases (thereby injecting liquidity) especially of shorter duration issues.

As earlier stated, a burgeoning tide of world's financial liquidity could lead to the expansion of risk assets valuation, i.e. a "melt-up" scenario.

One business cycle ago, recall that the re-steepening of UST yield curve in 2007 arguably engendered 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.

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 brought forth 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.

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 improved 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" (we discussed this scenario in Uptick 2019: Last Hurrah? dated 26 November 2018) as transpired in 2008 and earlier on in 1997.

In above regard, we should take cue from a recent 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."

Policy Reactions

In the United States, investors are now betting the US Fed will move to cut rates as early as in July 2019. In what appears to be a result of trade-related uncertainties, the economy recently recorded a slowdown in ISM manufacturing as well as weaker than expected jobs report for May. Earlier on, the US Fed Chair signaled an openness to cut interest rates if necessary.

In Europe, due to "rising threat of protectionism", the ECB postponed the timing of a possible first rate hike (previously as early as end summer 2019) to the second half of next year at the earliest. It also announced a new round of monetary stimulus, i.e. the third round of targeted longer-term refinancing operations (TLTRO-III).

In China, its central bank governor recently said (in a Bloomberg interview) if the trade war deepens, "we have plenty of room in interest rates, we have plenty of room in RRR rate, and also for the fiscal, monetary policy toolkit, I think the room for adjustment is tremendous."

FBM KLCI TARGET

Despite having reasoned the above, we guided our FBM KLCI target to reflect the tepidness of the most recent corporate earnings performance. Hence we reiterate our **2019 FBM KLCI baseline target at 1,720 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

DISCLOSURES AND DISCLAIMER

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.