10 August 2017 | Strategy

To Know Malaysia is to Love Malaysia

Examining fund flows vs. foreign shareholding levels

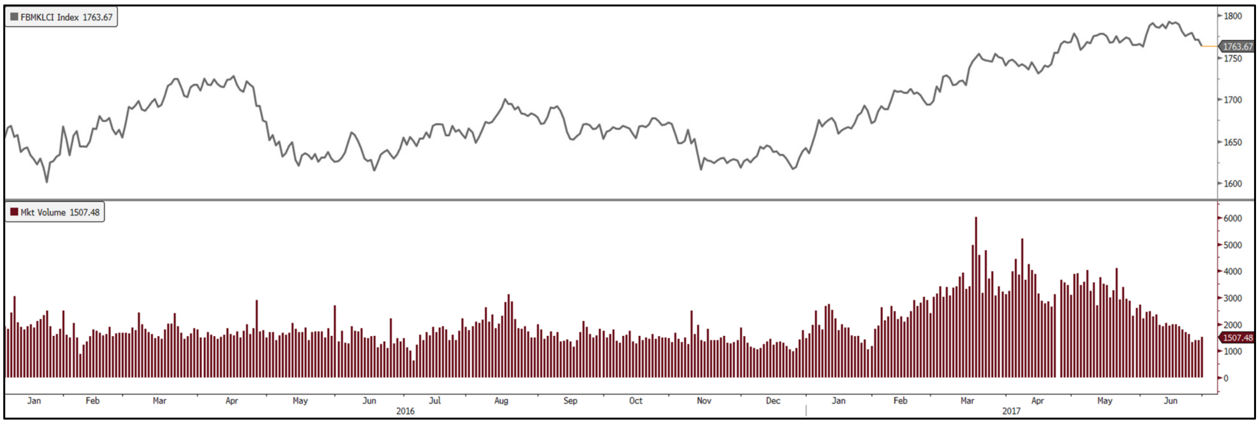
FBM KLCI: 1,777.94

(2017 Year-end Target: 1,830 points)

2017: The story so far

- **FBM KLCI on trajectory trend since early this year.** The FBM KLCI has been on a gradual uptrend since the beginning of the year where it almost hit 1,800 points on June 16. In tandem with the rise of the benchmark index, overall market volume also did rise more than 30% higher on year on year basis, before trending down sometime in June. Year-to-date, as of 9 August 2017, the benchmark index has gained 8.2% on the back of the strong foreign inflows. Furthermore, earnings of FBM KLCI is expected to grow in FY2017 and FY2018 as per the (Bloomberg consensus) FBM KLCI 2017 estimate of 108.4 points, the earnings integer is expected to increase further, albeit slightly.

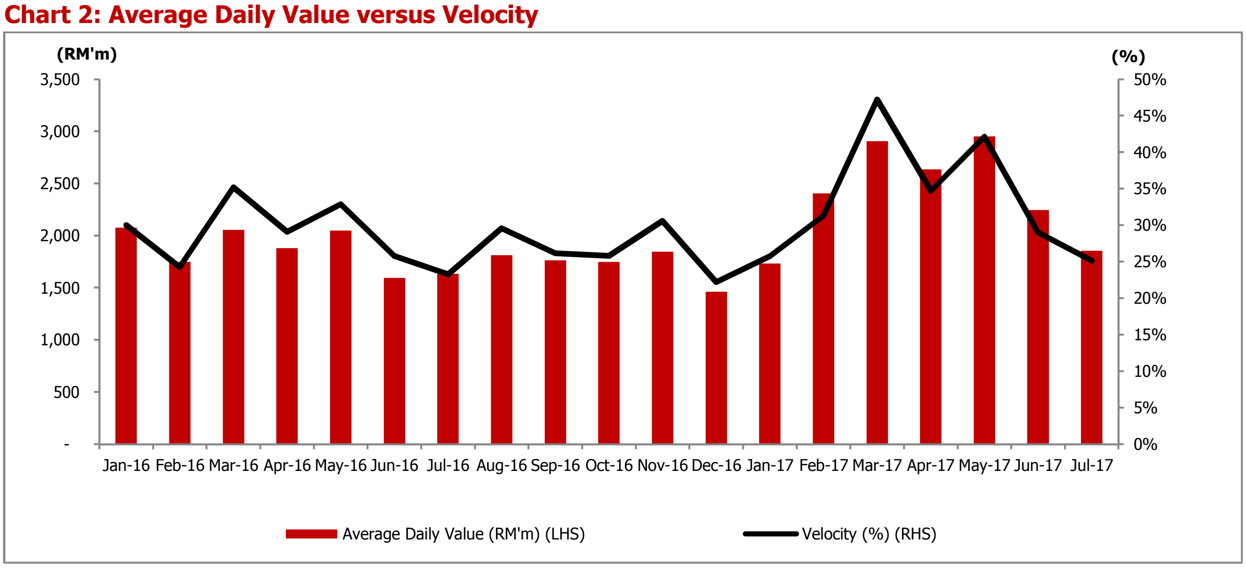
Chart 1: FBM KLCI versus Total Market Traded Volume



Source: Bloomberg

- **ADV is also higher in 2017.** Similar to the movement of the volume traded, the average daily value trade (ADV) is also seen higher so far, at daily average of above RM2.0bn this year, as net foreign inflows saw a favorable increase for the year to date.

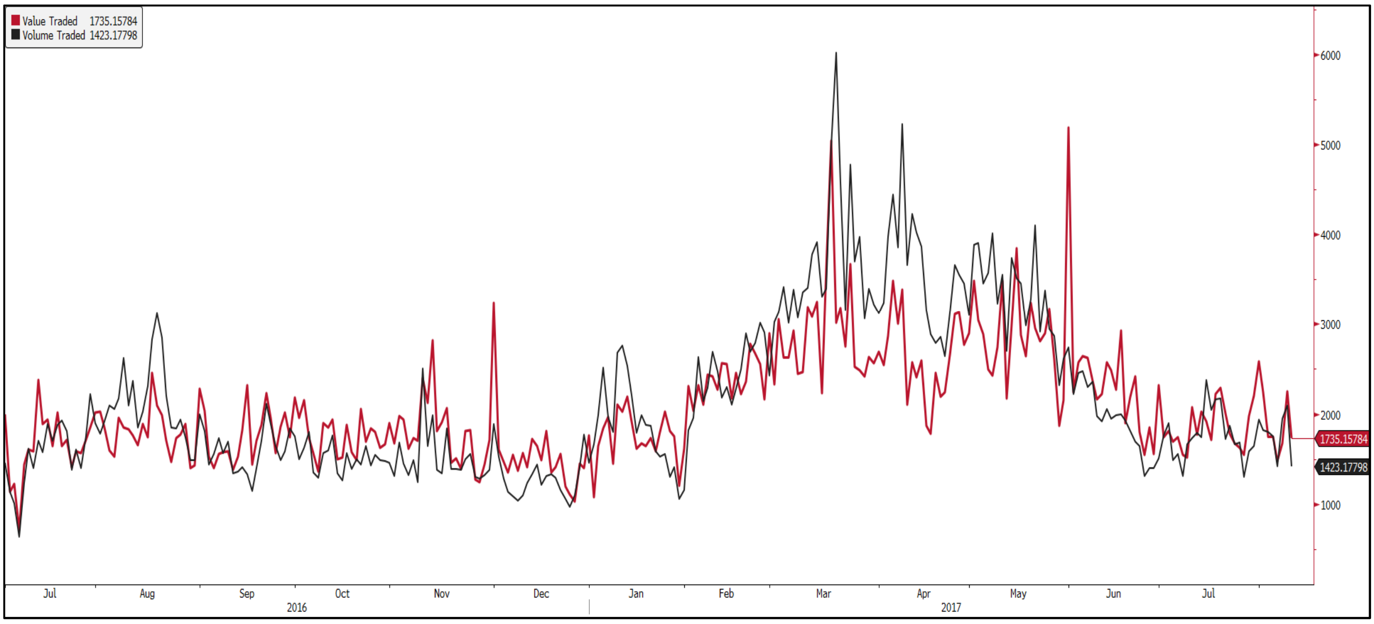
Chart 2: Average Daily Value versus Velocity



Source: Bloomberg, MIDFR

- **Value traded has been relatively higher this year.** The year 2017 so far has seen a significant increase in trading activities in the local bourse compared to year 2016. On the year to date basis, average daily trading volume has reached 2.6 billion shares a day, up 57% from the 2016 average (1.8 billion shares/day) and average daily traded value has rose a staggering 31% to RM2.4 billion a day (2016 : RM1.7 billion/ day). According to Chart 3, the value traded has been higher than volume traded, except for a the period between February till May which saw an increase in appetite of investors buying into mid and small cap counters. All in all, interest in big stocks stayed strong fuelling for the upward movement of FBMKLCI index this year.

Chart 3: Value Traded (RM'm) versus Volume Traded (Million)



Source: Bloomberg, MIDFR

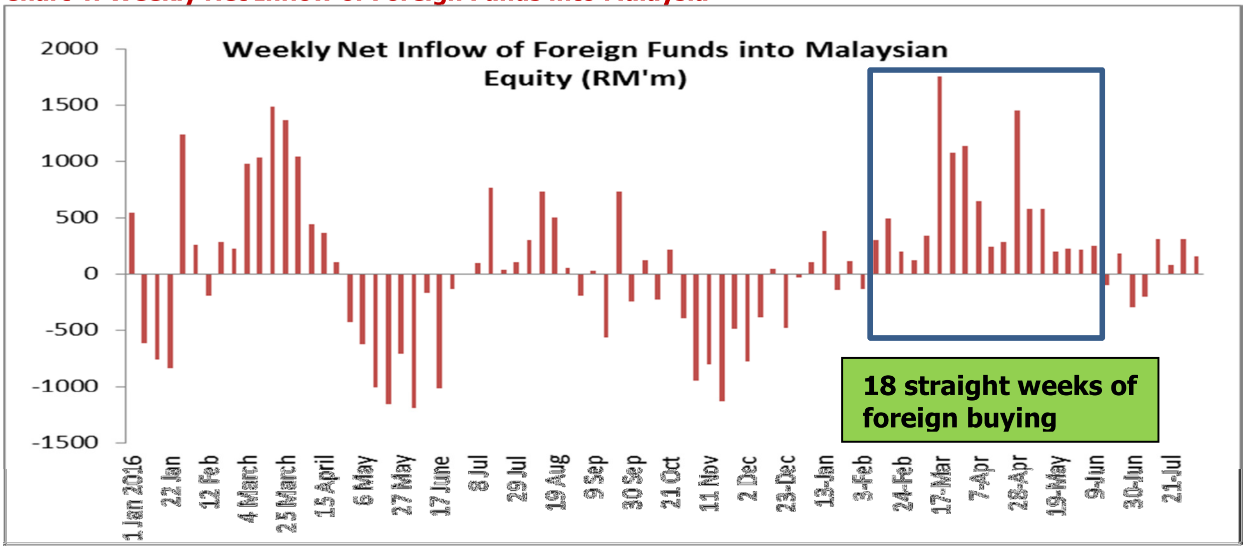
What's new about the inflow of foreign funds this time around?

- **Highest foreign net inflow since 2013.** Foreign investors have been making a comeback on Bursa thus far this year. They had been net buyers in 26 out of the 31 trading weeks in 2017. 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.

- **Longest buying streak since 2013.** Foreign investors 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. In fact, it has already been 7 straight months of foreign buying this year.

- **Increase in value traded coincided with foreign funds inflow.** There were two spikes on high value trading days, the first spike in mid-March was accompanied by an influx of foreign net inflow to Malaysia equities especially into blue chips, whereby the daily net inflow recorded was the highest so far in 2017, which amounted to RM816m net. Meanwhile, the second spike which occurred at the end of May was partly attributable to the increase in trading activity following the rebalancing of the MSCI index.

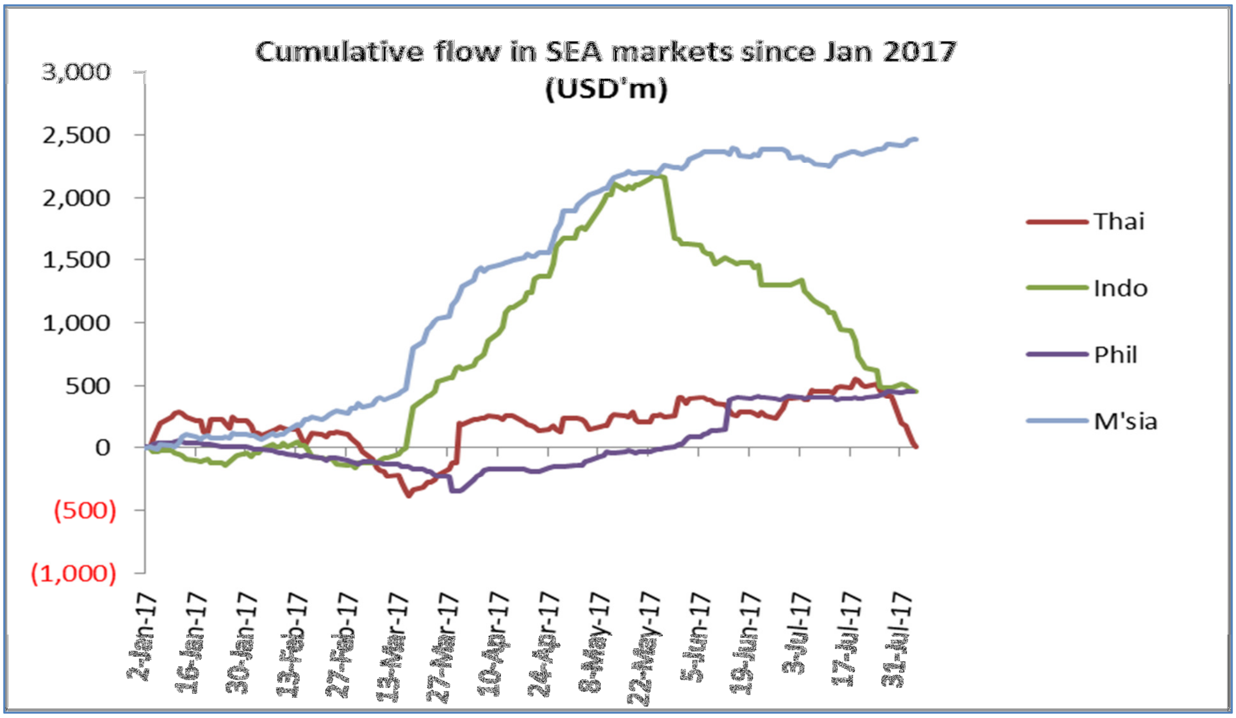
Chart 4: Weekly Net Inflow of Foreign Funds into Malaysia



Source: Bursa

- **Malaysia is the largest beneficiary in SEA.** To date, Malaysia has outpaced most of its peers in being the beneficiary of net inflow of foreign funds. Despite Indonesia following closely between March and May, its trend has been on the reverse of late. Whist the numbers have been tapering for Malaysia the past month, we are still in a very strong position, with the cumulative net inflow nearing USD2.5 bn mark.

Chart 5: Cumulative flow into SEA markets since 2017.



Source: Bursa, Bloomberg

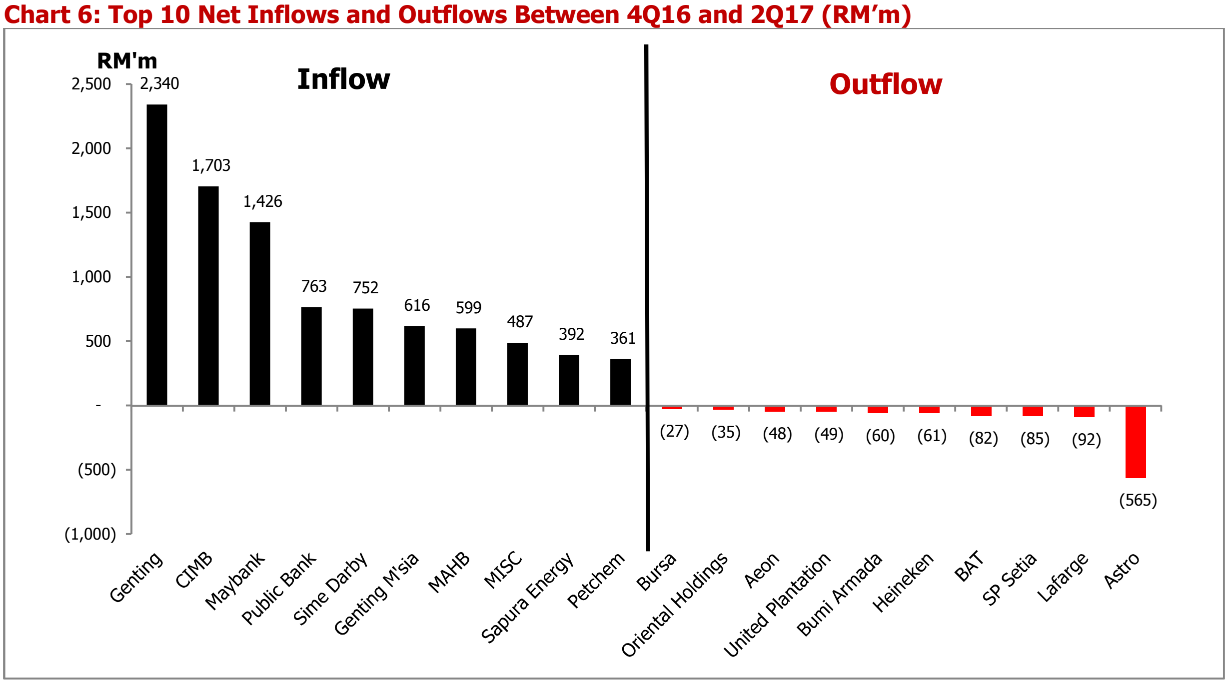
Which counters benefited from the net inflow of foreign funds?

- **Main beneficiaries of inflow.** Out of the total net inflows in 1H2017 which amounted to approximately RM10.2b net, major beneficiaries consist mainly of banking, oil and gas, and gaming related stocks.

- **Optimism on banking counters underpinned by earnings growth.** Among the favourites, **CIMB** (Hold, TP: RM7.10), **Maybank** (Buy, TP: RM10.30) and **Public Bank** (Buy, TP: RM23.30) saw inflows amounting to RM1.7b, RM1.43b, RM0.76b respectively from 4Q16 to 2Q17. Since then, their foreign shareholding levels have been on an upward trajectory and should improve. The expectations of an earnings recovery is mainly contributed by the lower credit cost when compared to last year. In 2QCY16, majority of banks embarked on aggressive proactive provisioning especially for its exposure in the Oil and Gas industry. However, with oil prices stabilising, we expect lower provisions and possible writebacks on some of the loans. In addition, we expect loans growth to be better while NIM have either stabilised or improved slightly, contributing to better topline and earnings for the quarter.
- **Oil and gas related companies favoured amid extended output cuts.** It is worthy to note that under oil and gas related activities, downstream players were not the only beneficiary of fund inflows but also integrated oil and gas services providers along with shipping providers. Downstream players such as **Petronas Chemicals** (Hold, TP: RM7.58) may have attracted foreign funds partly due to (i) high plant utilisation rate (PUR) of 99% (compared with 92% in 1QFY16); (ii) strong average selling prices of its products which grew by +22%yoy and; (iii) higher production and sales volume(+16%yoy). Meanwhile integrated oil and gas services providers such as **Sapura Energy** (Hold, TP: RM1.71) appeared attractive despite the decline in earnings for 1QFY18 due to the potential remaining cash injection of around USD63m from the cessation of Berantai RSC by June 2017, that will be able to weather the tough operating environment whilst seeking for more opportunities. From the shipping aspects of oil and gas, **MISC**'s (Hold, TP: RM7.43) LNG segment is expected to remain stable, as MISC takes delivery of its third Seri C-Class LNG vessel at the end of the third quarter, offsetting the dry docking of Puteri Intan Satu for refurbishment at end-3QFY17 and the Puteri Firus commencing its option extension which are at lower rates. Meanwhile, the offshore segment is projected to perform steadily, with major decommissioning of assets completed in 2016

- **Gaming sector also attracting inflows.** Malaysian conglomerate, **Genting Bhd** (Non Rated) recorded the highest inflow during the period between 4Q16 and 2Q17 worth RM2.34b. Its casino and resort operating arm, **Genting Malaysia** (Non Rated) also recorded inflow of RM0.62b. The overall earnings driver in 2017 for Genting Bhd will be the Genting Integrated Tourism Plan (GITP) expansion programme.

Chart 6: Top 10 Net Inflows and Outflows Between 4Q16 and 2Q17 (RM'm)



Source: Bloomberg,MIDFR

- **Astro had the largest dip in foreign shareholding level. Astro Bhd** (Buy, TP: RM3.64) experienced the largest outflow between 4Q16 and 2Q17 worth -RM565m, a stark difference compared to other nine top companies which registered outflows below –RM100m. The large outflow attributed to Astro could probably be due to the decline in its revenues related to advertising, subscription and licensing during the quarter ended April 30.

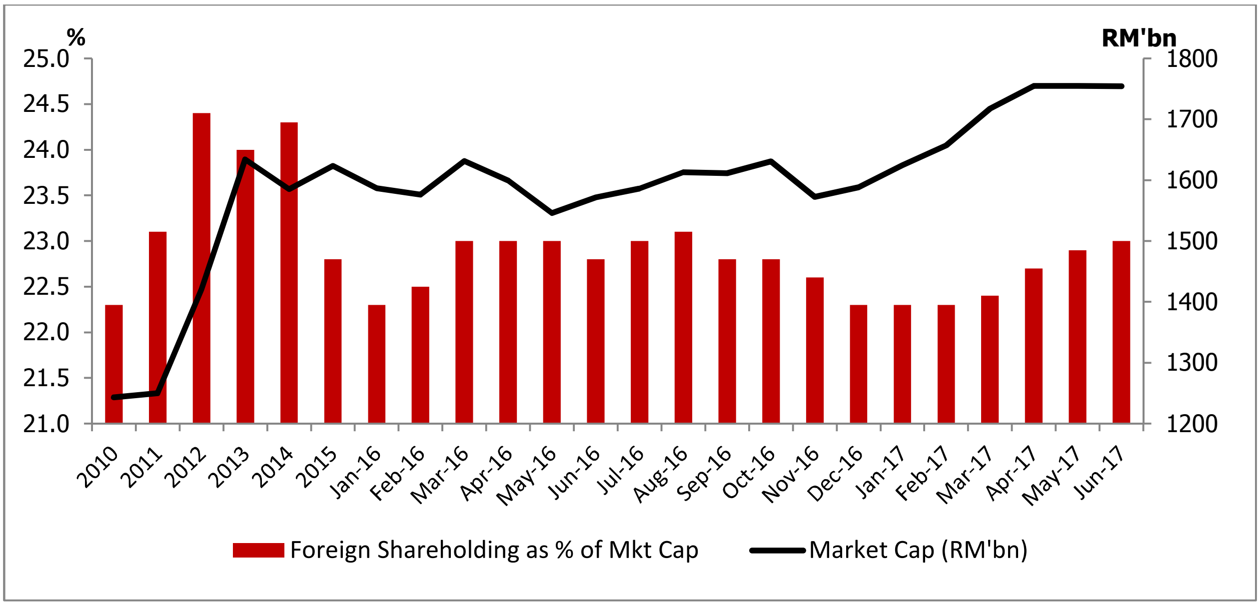
- **Demand for contraband products hurt sin stocks.** Sin stocks categorized under consumer discretionary such as British American Tobacco and Heineken faced outflows amounting to –RM82m and –RM61m respectively. The main deterrent for foreigners to acquire **British American Tobacco** (Hold, TP: RM48.60). Sales volume contraction for legal cigarettes that has been a drag to its earnings. This is due to the fact that we are expecting the resilience in demand for illicit cigarettes to persist throughout 2017 as the tobacco industry's volume continues to contract for the sixth consecutive quarter. Heineken also faced a challenging environment as contraband products continue entering the local market which poses a threat to the revenue and the government as a whole.

- **Weak demand for building materials. Lafarge** (Sell, TP: RM3.80) had the second largest outflow amounting to RM92m. Price competition and persisting production from other cement manufacturers leads to oversupply of cement which muted demand. Hence, building materials sector is inundated with excess supply of cement especially for Ordinary Portland Cement (OPC) where it is competing in a homogenous market.

How much has the foreign shareholding level change this year?

- **Investors should not fret over the foreign shareholding downtrend.** Based on Bursa's data, the percentage of foreign shareholdings based on market capitalisation in the local bourse has climbed 0.7% to 23% as of June 2017 compared to 22.3% as of December 2016. While this is arguably still far from the the post-financial crisis high of 25.2% in May 2013, we would like point out that this is not necessary a reason to worry.

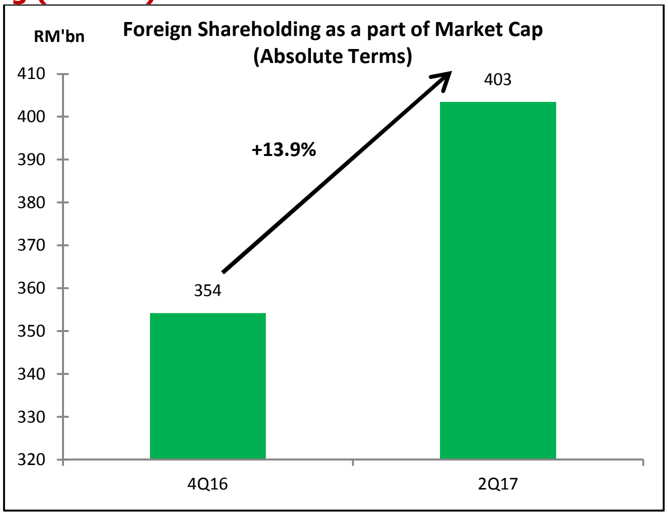
Chart 7: Foreign shareholdings based on market capitalisation (%)



Source: Bursa, MIDFR

- **Small percentage % reflected by large change in absolute terms.** Since 2013, the total market capitalization of the public equity market of Bursa Malaysia has been on the rise, assisted by a slew of IPOs in the recent years, at a magnitude of close to RM200 billion. Thus it would be a fair to look at foreign shareholding level from the absolute value of shares they owned, rather than judging it from the percentage statistics alone.

Chart 8: Percentage change in foreign shareholding (inflows)

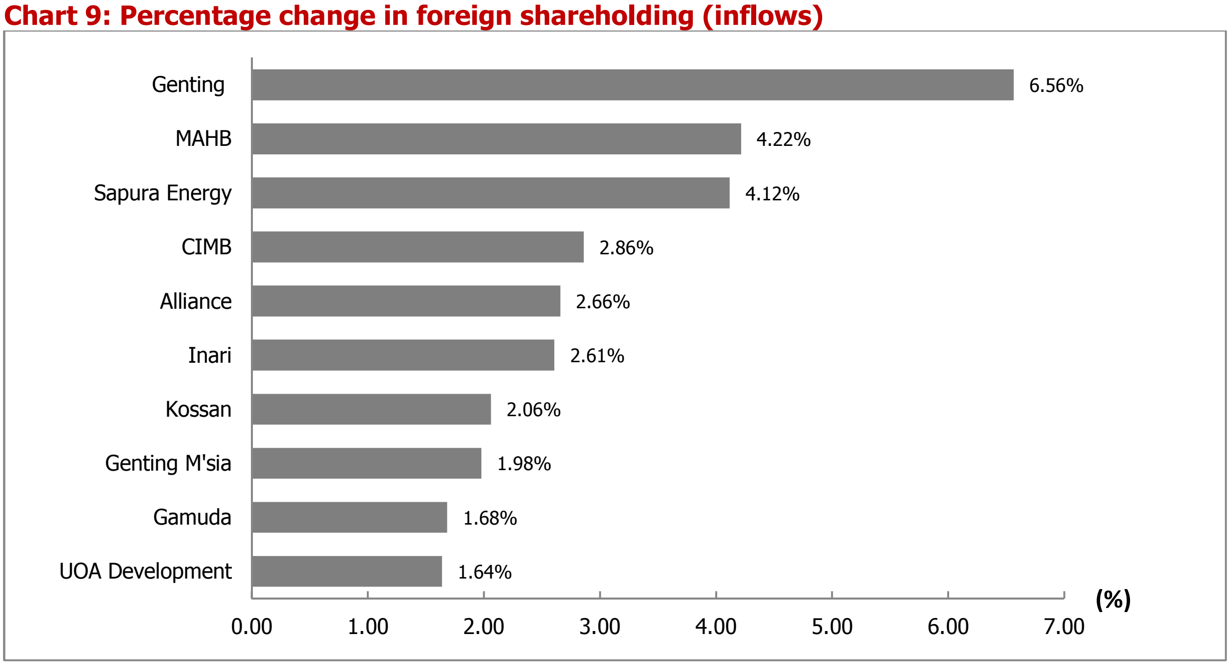


Source: Bloomberg, Bursa

- **Foreign shareholders share ownership is up 14% since end 2016.** Comparing the value of shares owned by foreign shareholders, the values have gone up 13.9% from RM354 billion as at end 2016 to RM403 billion as at end June 2017. Meanwhile the total market capitalization of the all listed companies in Bursa Malaysia, has only gone up by 10.4% from RM1.6 trillion to RM1.7 trillion over the same period. This shows the attractiveness of our markets which follows the commendable numbers for the cumulative net inflow of foreign funds seen so far in year 2017.

- **Foreign shareholding levels has been on the uptrend.** Whilst people can argue that the net foreign inflow numbers is also influenced by the rising share price, we also found that the some of the top beneficiaries of the net inflow of funds recording a significant increase in their respective foreign shareholding levels. **Genting, MAHB** (Buy, TP: RM9.98) and **Sapura Energy**, for example, as saw a net increase of percentage of foreign shareholding up by 6.6%, 4.2% and 4.1%. This is based on the list of foreign shareholders seen from Bloomberg.

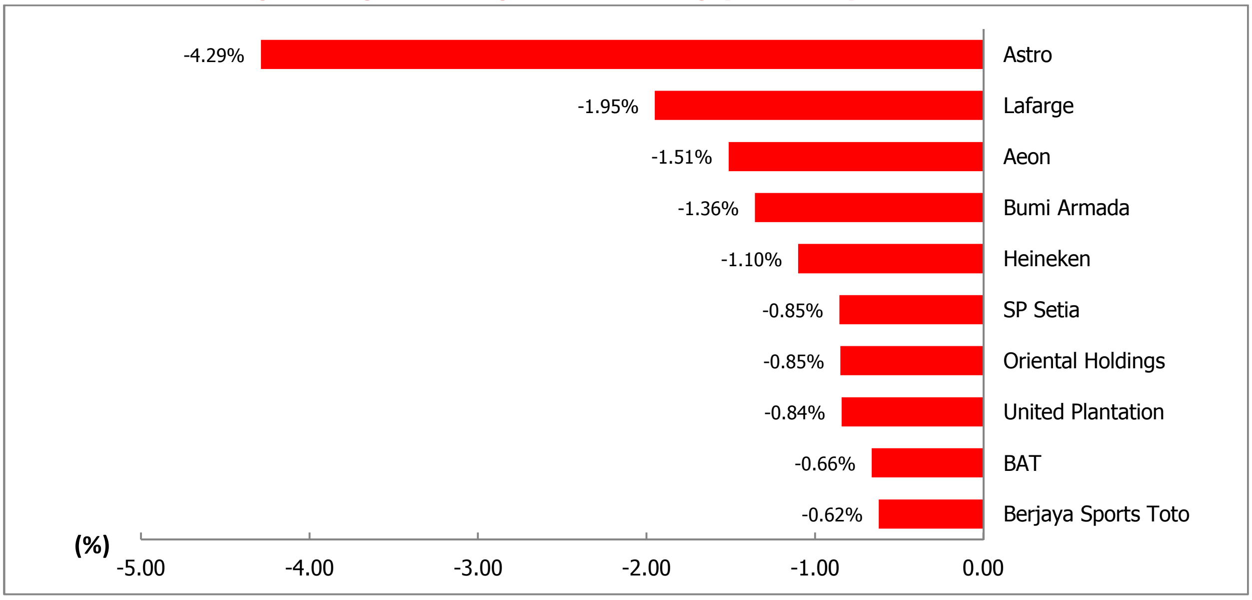
Chart 9: Percentage change in foreign shareholding (inflows)



Source: Bloomberg

- **Not all news are good news**. Amidst the cheer, we also notice that there are noticeable trends of foreign shareholders exiting some of the listed counters. Astro for example, saw it's foreign shareholding level declining by 4.3%, followed by **Lafarge, Aeon** (Hold, TP: RM2.21) and **Bumi Armada** (Hold, TP: RM0.71), which fell 2.0%, 1.5% and 1.4% respectively. Looking at the top 10 list, we reckoned that these are attributable by the challenging operating climate of companies operating in the Media, Consumer Retail and Upstream Oil & Gas, all of which are facing lower Adex numbers, challenging retail landscape and inability to secure long term contracts for its assets, respectively. However, it is comforting to know that out of 100 top counters we looked at, only 24 counters recorded a net outflow of foreign funds.

Chart 10: Percentage change in foreign shareholding (outflows)



Source: Bloomberg

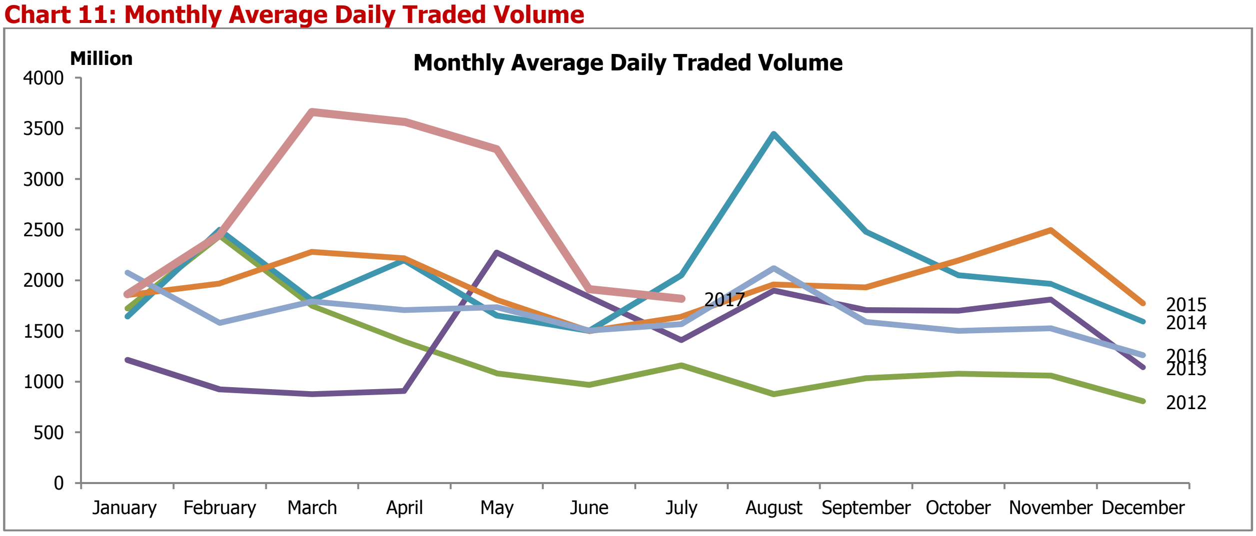
What shall we expect to see in the near future?

- **Moving forward…**From an external point of view, foreign inflows will depend on geopolitical risks happening around the world. For instance, at the beginning of 2Q17, the FBM KLCI took a breather as it retraced to the 1,730 level amid geopolitical risks, i.e. the U.S. navy headed towards North Korea waters due to concerns on its weapons program. But as soon as geopolitical tensions faded, the FBM KLCI crept up to levels near 1,800 points. Henceforth, we deem the effects of geopolitical tensions to be rather temporary. Amongst other geopolitical factors that have affected the market are i) disputes between Qatar and Arab nations ii) the launch of the Intercontinental Ballistic Missile (ICBM) by North Korea and iii) Theresa May's failure in securing the majority in U.K snap election.

- **On macroeconomic side…..**exports have registered a double digit growth for 1H2017. At the same time, exports growth has outpaced imports growth for the past 2 consecutive months in May and June. Looking ahead, Malaysia's external trade performance will remain upbeat albeit moderating in the second half of the year due to favorable global market condition and modest recovery in commodity prices. We also foresee Malaysia's inflation to grow moderately for the second half of 2017 given that cost-driven factors are tapering off, looking at overall 2017 GDP growth of 5.1% and an upbeat exports growth of 14.5%, while also optimistic that our ringgit currency with strengthened to RM4.20 level to 1 USD by year end. Therefore, this will bode well in terms of the local market sentiment which could attract foreign funds to Malaysian shores. With the general election looming, we reckon that there is further excitement in store.

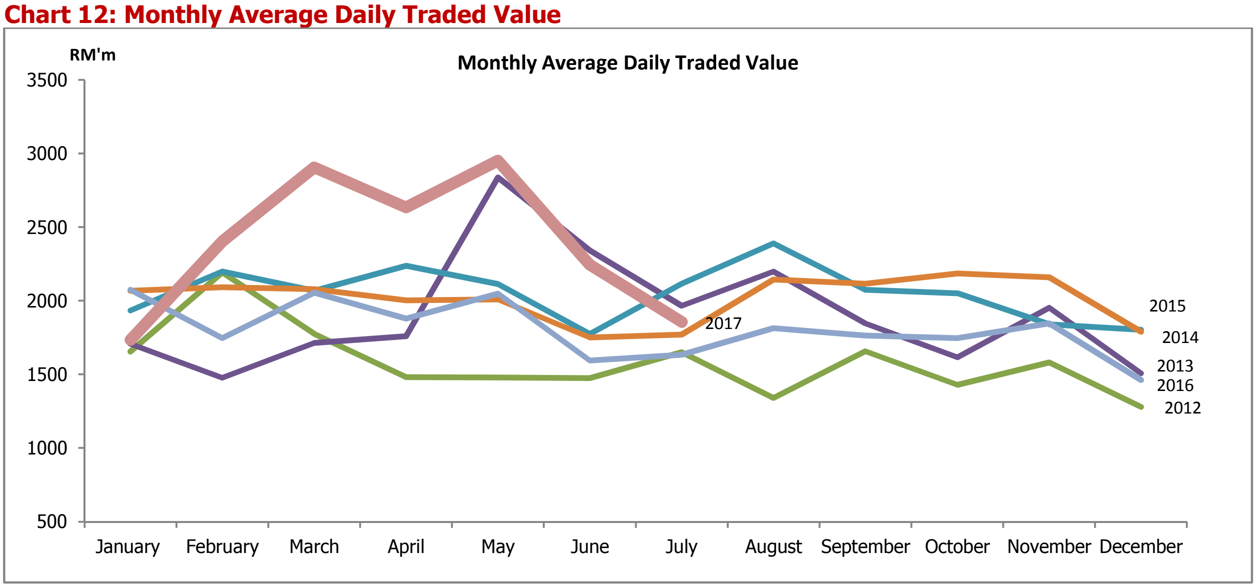
- **For the remaining of 2017**, we expect both volume and value to taper slightly to trade around the range of 1.5b to 2.0b and RM1.7b to RM2.2b respectively. Looking at the trends of volume over the past few year, volume and value tends to taper during the second half of the year especially towards the year-end festive season.

Chart 11: Monthly Average Daily Traded Volume



Source: Bloomberg, MIDFR

Chart 12: Monthly Average Daily Traded Value



Source: Bloomberg, MIDFR

- **FBM KLCI year-end target unchanged at 1.830 points.** Market is expected to be on the uptrend, albeit at a slower climbing pace than that seen during the first half of the year, underpinned by the continuous earnings expansion this year and also for year 2018. We remain positive on the following sectors: Automotive, Aviation, Banking, Construction, Logistics, Power and Technology. And we reiterate our FBM KLCI 2017 year-end target of 1,830 points which equates to PER17 of 16.9x. After all, Malaysia is home to the world's longest bull market.

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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.