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Gradual moderation in market valuation

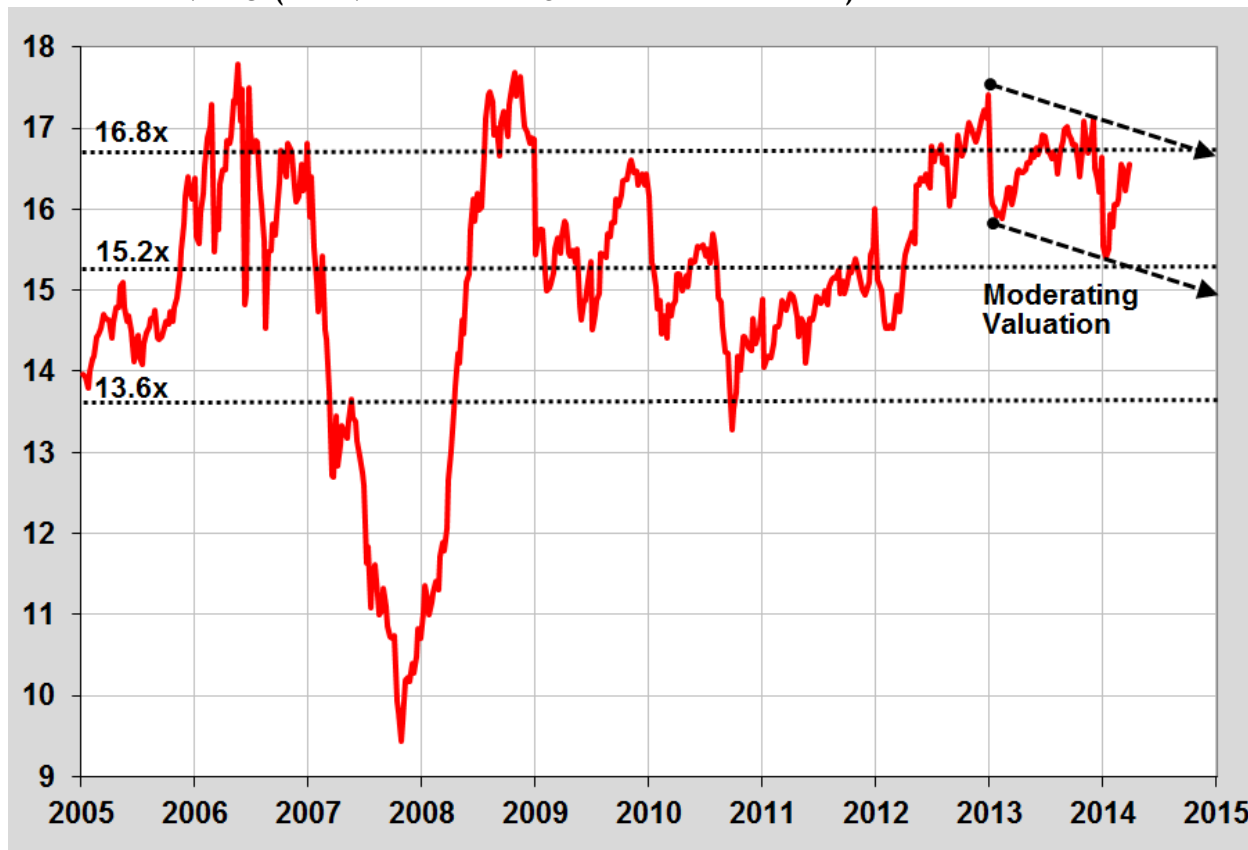
KLCI: 1,831.97

...to be buttressed by improvement in earnings sentiment

(2015 Year-end Target: 1,900 points)

Trend-wise, market valuation is gradually moderating. Despite the recent cyclical upswing in market valuation, trend-wise, the downward momentum of FBM KLCI price earnings ratio (PER) towards its long-term mean remains intact. Hence we expect the gradual moderation in PER multiple of the market benchmark to persist going forward. Having said that, we may continue to observe intermittent spikes and troughs as the multiple makes its way towards the mean levels of 15.0x. In other words, the mean reverting process (i) may take a couple of years to complete, and (ii) could see PER oscillations in between.

PE Ratio of FBM KLCI (with Mean and +/- 1-Standard deviation lines)

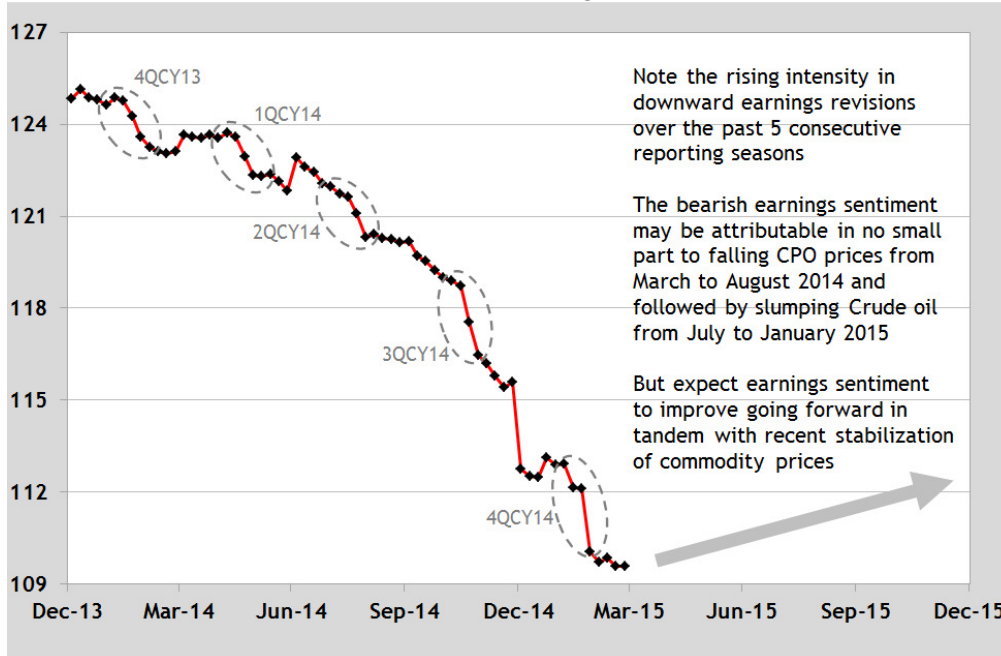


Source: Bloomberg, MIDFR

After one year of disappointment, expect better earnings sentiment... Recall that the FBM KLCI forward earnings underwent almost incessant downward revisions since the first quarter of 2014. The bearish earnings sentiment may be attributable in no small part to falling crude palm oil (CPO) prices from March to August 2014 (from circa RM2,700pmt to RM2,100pmt; -22%) and followed by crude oil from July last year to January 2015 (from circa USD110pb to USD50pb; -55%). It is notable that both Plantation and Oil & Gas companies, the direct casualties of slumping commodities, represent approximately a quarter of the aggregate capitalization of FBM KLCI constituents.

...in line with more settling commodity prices. Thus in tandem with the recent stabilization of commodity prices, we expect earnings sentiment to improve going forward. Furthermore, this optimism is also premised on the still robust domestic demand as well as improving external conditions.

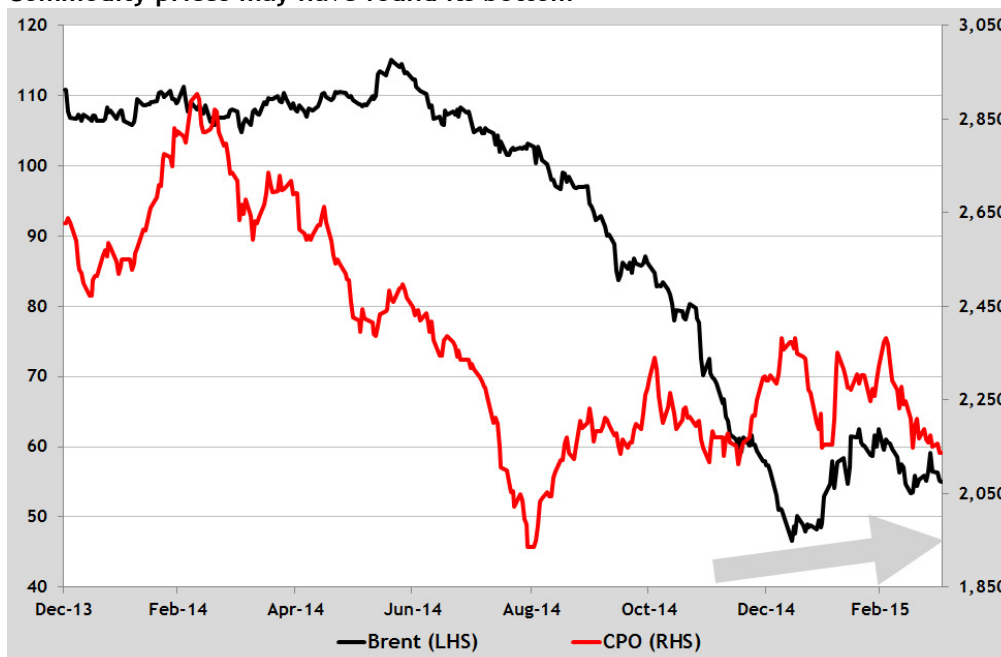
FBM KLCI: Revisions in Consensus 2015 Earnings Estimate



Source: Bloomberg, MIDFR


FBM KLCI may also be supported by favorable external tailwinds. The People's Bank of China has cut interest rates twice during the past half year. It may deliver more monetary easing in coming quarters as the government is bent on keeping economic growth at or above its 7.0% target for this year. In the US, Chair Janet Yellen statement on 27 March signaled that the Fed will be cautious about its policy deliberations. While she expects interest rates to rise this year, subsequent increases shall be gradual. Moreover, European economic sentiment continued to recover on improving data. This is exemplified by Euro-area economic sentiment which rose in March to the highest level since the third quarter of 2011, or near the onset of Euro debt crisis.

Commodity prices may have found its bottom



Source: Bloomberg, MIDFR

Crude oil may have found its bottom in January this year with the subsequent price rise corresponded to the monetary easing by major economies of Eurozone and China. It was further buoyed by the events in Middle East, most notably the direct involvement of Saudi Arabia, world's top oil producer, as well as other Arab Sunni states in a cross border conflict with neighboring Yemen. The bottoming commodity prices may arguably soften the pressures on Malaysia's fiscal position. In addition, the favorable external tailwinds could also mean better days ahead for the ringgit. And by extension, the local equity market may benefit from positive flows of foreign funds.

Reiterate FBM KLCI 2015 year-end target at 1,900 points. Thus we reiterate our FBM KLCI 2015 year-end target of 1,900 points, which is equivalent to (i) 3.8% gain from end-1Q15 level, and (ii) 17.3x PER multiple of 2015 earnings. However, as we expect the 2015 earnings revisions going forward to be generally flat or even upward-biased, the resultant PER valuation of our 2015 year-end target may turn out to be lower than 17.3x. 

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STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> 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 <i>fall</i> 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.