Equity Beat

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FBM KLCI

FBM KLCI: 1,778.88

No change to its likely path in 2014

(2014 Year-end Target: 1,900 points)

CORRECTION BECKONS

Unexpected decline in China's manufacturing output... The market felt somewhat perturbed last Thursday as China's Flash Manufacturing PMI unexpectedly signalled contraction, the first in 6 months. While it not really raised a big red-flag, the sub-50 number nonetheless reignited investors' concern over China's macro trajectory as well as the overhanging risks with regard to both its official and 'shadowy' banking system.

…arguably sparked capital flight from vulnerable emerging economies. And it seems the worries spilled over into other emerging markets such as Argentina, South Africa and Turkey in the form of extreme currency volatility. It is noteworthy that these countries are suffering from twin-deficits in both their fiscal and current accounts.

US stocks are ripe for correction after a gravity-defying performance last quarter. On Wall Street, the Dow Jones Industrial Average (DJIA), which is ripe for a meaningful correction after a spate of new all-time highs in November and December last year, tumbled on Friday. Investors fled from equities and foreign currencies into the safety of assets like US Treasury. The yield of 10-year US Treasury plummeted (i.e. price went higher) to 2.72%. It was traded at 3.03% end last year. In unison, Asian equity markets traded lower on Monday with the FBM KLCI retreated -23.69 points (-1.31%) to close at 1,778.88 points.

RECAP OF OUR STATED VIEWS

In our Strategy note dated 8 January 2014, we offered the following views with regard to equity market direction this year, its downside range as well as potential event risks (which we deemed as not imminent) that may jeopardize our rather sanguine outlook:

> "The FBM KLCI shall continue on its upward trajectory on favourable macro conditions. The FBM KLCI is expected to remain in the upper half of its secular upward trajectory during the next 12 months, supported by expectations of (i) gentler yet still robust domestic growth momentum, and (ii) brightening external economic conditions.

FBM KLCI: Secular Trend Channel

Source: Bloomberg, MIDFR

Potential downside would be limited to 1,750-1,700 points range... The largely favourable macro scenario shall limit the downside on the FBM KLCI to between 1,750-1,700 points range, beneath which resides the lower half of its secular trend channel. The lower half domain was last visited, albeit briefly, in 2H11 pursuant to the downgrade of US sovereign rating to AA+ by S&P as well as worsening sovereign debt situation in Europe.

…as major event risk is presently deemed as not imminent. Presently, we see no fundamental triggers for a revisit to the lower half of FBM KLCI secular trend channel. But then again, like in the past, the timing of the actual trigger can evade the scrutiny of the most seasoned market watchers. Furthermore, the list of the potential triggers can never be exhaustive, but some of the plausible suspects include **(i)** the breakdown of China's shadow banking system (with attendant consequences on property prices and overall output growth), and **(ii)** massive currency (capital) flight particularly from countries suffering the twin (external and fiscal) deficits. However, at this juncture, we deem their probability of occurrence as low."

REITERATE OUR STATED VIEWS

Events of last week not likely morph into major event risks. In spite of what had transpired during the past week, we opine that **(i)** the less than favourable China's Flash Manufacturing PMI number does not signify that its economy is about to fall off the cliff (as our house view is that China would successfully avert an economic hard-landing this year), and **(ii)** the recent currency (capital) flight from countries suffering the twin (external and fiscal) deficits would not become out of control that it may result in a widespread contagion to other emerging market currencies.

Expect DJIA trend support to hold on favourable macro outlook. As for the DJIA, our trend analysis suggests a downside support at 15,000 points level with the market upward trend duly supported by US favourable macro trajectory.

Reiterate: Market lower bound remains at between 1,750-1,700 points range. We expect the FBM KLCI to remain in the upper half of its secular upward trajectory during the next 12 months (refer to Chart above). While we do not think the recent correction has played itself out just as yet, on the downside, we reiterate our view of the local benchmark support levels at between 1,750-1,700 points range.

Reiterate: Market upside may be capped by liquidity, earnings, monetary and valuation factors. While we do not expect a doomsday scenario to transpire this year, nor do we expect the FBM KLCI to repeat its rather stellar performance last year. We opine so on the premise that **(i)** the incessant albeit measured withdrawal of foreign liquidity (pursuant to the commencement of QE3 taper) to continue on in the months to come, **(ii)** relatively muted FBM KLCI earnings growth of circa 10% in 2014, **(iii)** expectation of a hike in the OPR, as well as **(iv)** Malaysia's relatively weak albeit improving current account situation, may put a cap to the prevailing above-mean market valuation going forward.

NO CHANGE TO LIKELY PATH IN 2014

We reaffirm our FBM KLCI 2014 year-end target of 1,900 points. Hence, our rather modest FBM KLCI baseline 2014 year-end target of 1,900 points, with the upper and lower bounds at 1,980 points and 1,840 points respectively.

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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 *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.