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Discovering the silver lining of the local market

Examining fund flows vs. foreign shareholding levels

FBM KLCI: 1,616.02

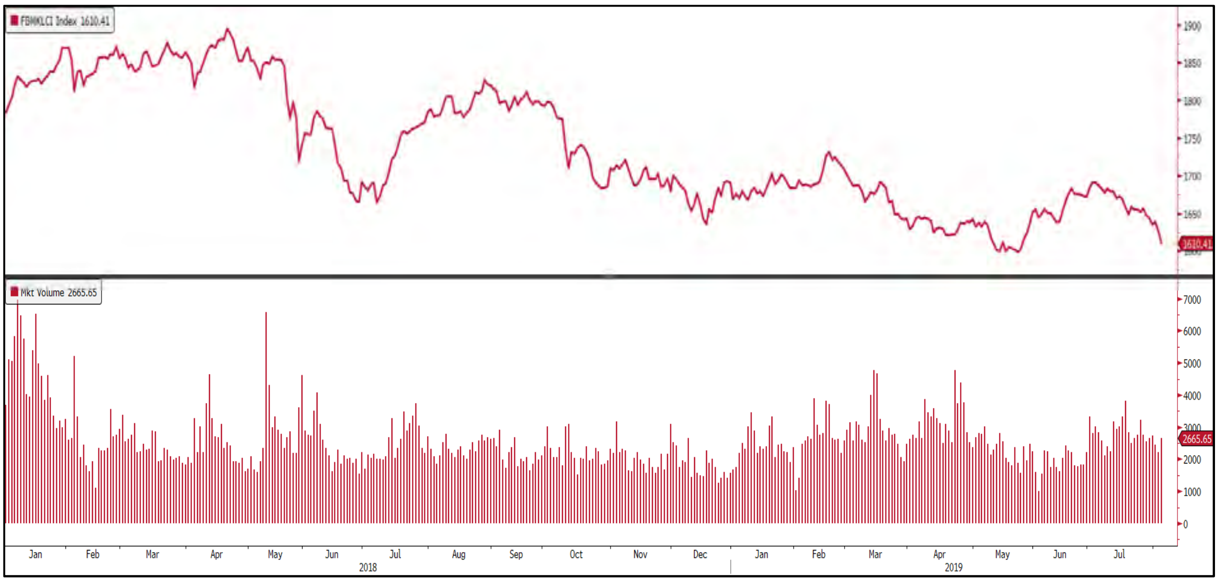
(2019 Year-end Target: 1,720 points)

- **Year-to-date total overall market volume is higher by 3.6% at 2.64b shares a day compared to what was seen for the whole of 2018**
- **Average daily traded was still at a healthy level of slightly above RM2.03b shares a day despite the year-to-date net foreign outflows**
- **The FBM Small Cap Index and FBM 70 Index have substantially outperformed the FBMKLCI Index on a year-to-date basis, recording gains of 15.8% and 8.1% respectively.**
- **Out of the total net inflows in 1H2019 which amounted to approximately RM5.0b net, major beneficiaries consist mainly of utilities, healthcare and oil and gas related stocks.**
- **Total market capitalization of the all listed companies in Bursa Malaysia, was up by 2.1% from RM1.63 trillion to RM1.66 trillion between 4Q18 and 2Q19, showing the attractiveness of our markets despite the cumulative net outflow of foreign funds seen so far in year 2019**
- **We reiterate our FBM KLCI year-end 2019 target at 1,720 points which equates to PER19 17.5x**

2019: The story so far

- **FBM KLCI movement so far this year.** The FBM KLCI has been on a gradual uptrend for the first two months of the year where it hit 1,731 points on February 21 before trending down thereafter. Nevertheless, the year-to-date total overall market volume is higher by 3.6% at 2.64b shares a day compared to what was seen for the whole of 2018. As of 5 August 2019, the FBMKLCI has lost 4.7% so far for the year amidst continuing foreign net outflows affected by ongoing external developments which are also impacting other global markets. Earnings of the FBMKLCI are expected to grow by 6.3%yoy in FY2019 as per the Bloomberg consensus.

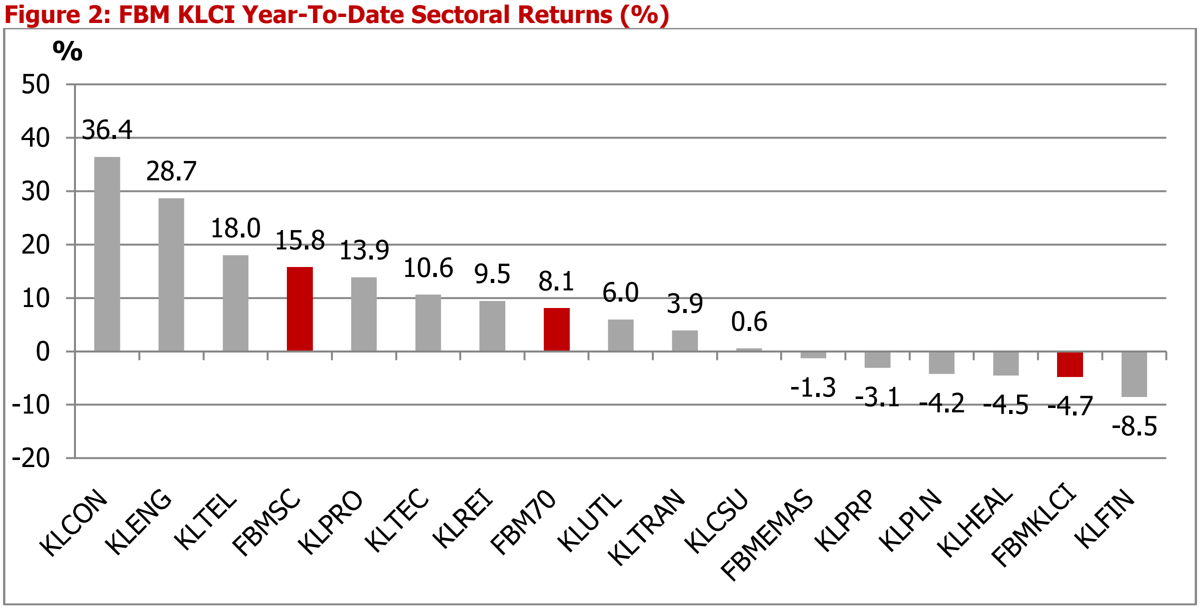
Figure 1: FBM KLCI versus Total Market Traded Volume



Source: Bloomberg

- **Sectoral gainers outnumber decliners on Bursa.** The FBM Small Cap Index and FBM 70 Index have substantially outperformed the FBMKLCI Index on a year-to-date basis, recording gains of 15.8% and 8.1% respectively. Meanwhile, 9 out of 13 sectors on Bursa have recorded a year-to-date gain with construction, energy and telecommunications leading gainers, advancing by more than 10.0%. Hence, it came to no surprise that the advance in the FBM Small Cap index and FBM 70 Index were mainly attributable to construction stocks. For example, nearly half of the top 10 gainers in the FBM Small Cap Index and FBM 70 Index were construction companies.
- **Financials, healthcare and plantation were major laggards on FBMKLCI**. On the other hand, year-to-date decliners were led by the financial services sector with a -8.5% loss or a decline. The other two major laggards were healthcare and plantation which saw a decline of -4.5% and -4.2%respectively on a year-to-date basis. With the FBMKLCI Index having seven banks as their constituents which are also heavyweights, the drop of the FBMKLCI Index was inevitable.
- **Despite the negative returns, we remain positive on banks.** We noted that banking income performance in 1QCY19 have been slightly muted due to net interest margin (NIM) compression. This came mostly from deposit competition and may be exacerbated in later quarters by the OPR cut.
- **However, we believe that this issue has been overplayed**. The impact of the OPR cut to NIM will normalise as deposits were also re-priced lower. Besides, we believe that there are still positives for banks such as the downtrend of expenses and the low credit cost. This should be able to alleviate the weakness in income. Hence, we maintain our POSITIVE view on the sector as we are still cautiously optimistic of the overall banking sector. As such, it is more tactful to view the local bourse on a sectoral level rather than an index level to generate returns.

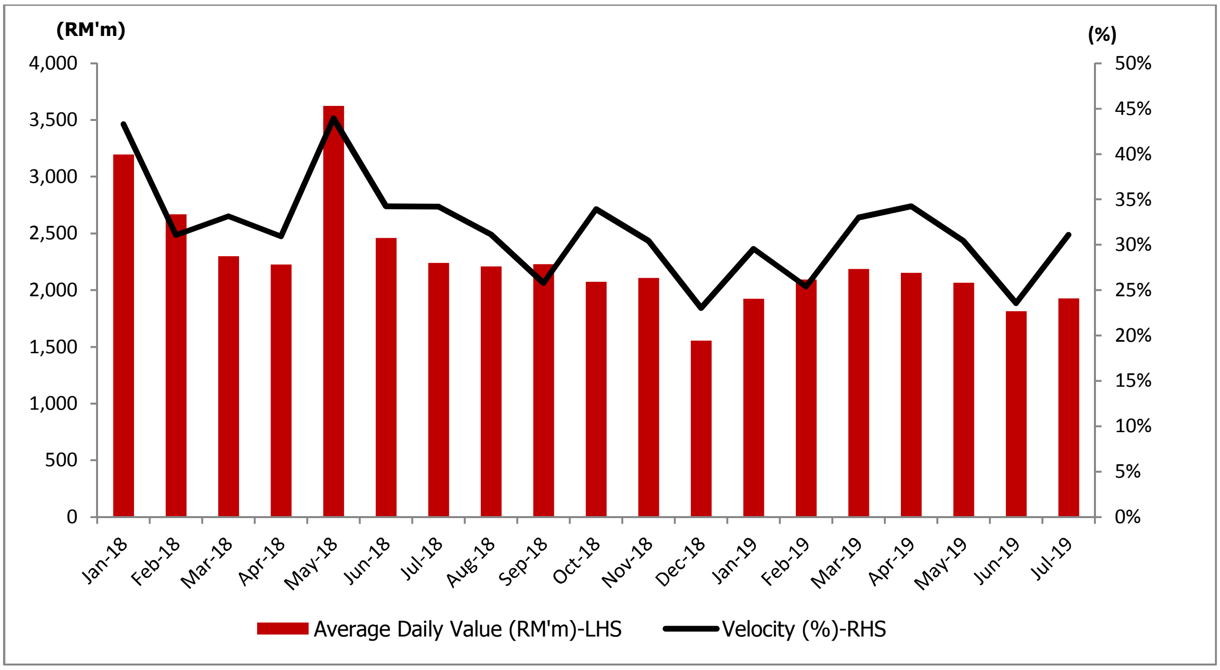
Figure 2: FBM KLCI Year-To-Date Sectoral Returns (%)



Source: Bloomberg, MIDFR

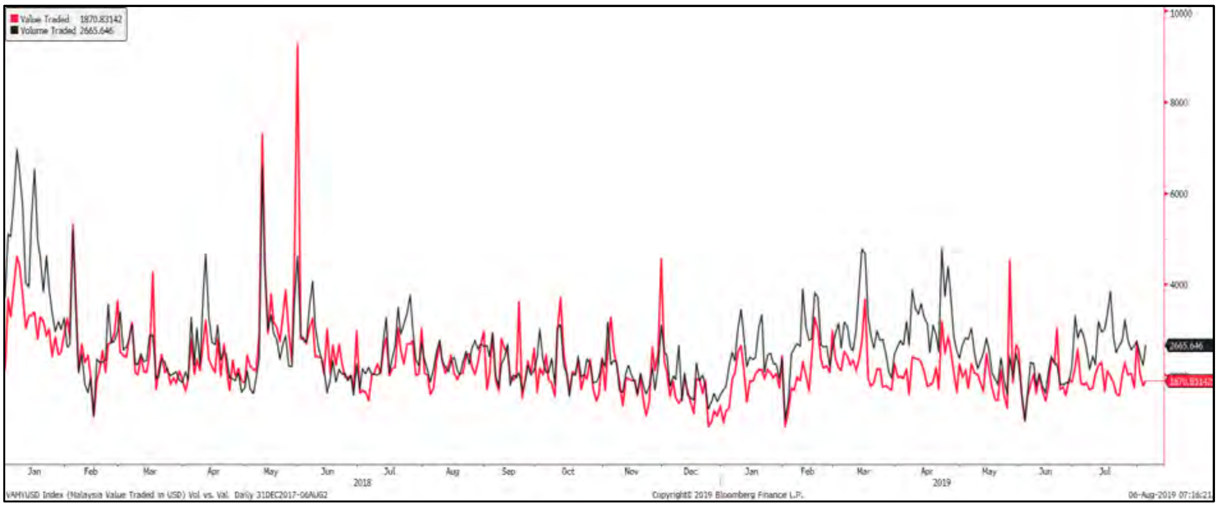
- **ADV remains commendable in 2019 despite being lower than last year.** We note that the average daily value (ADV) traded declined by -15.1% compared to amount seen for the whole of 2018. However, the ADV traded was still at a healthy level of slightly above RM2.03b shares a day despite the year-to-date net foreign outflows. According to Chart 3, the volume traded has been higher than value traded, except during the end of May where the rebalancing of MSCI occurred. Such trends indicate an increase in appetite of investors buying into mid and small cap counters shown by the year-to-date advance of the FBM Small Cap index.

Figure 3: Average Daily Value versus Velocity



Source: Bloomberg, MIDFR

Figure 4: Value Traded (RM'm) versus Volume Traded (Million)

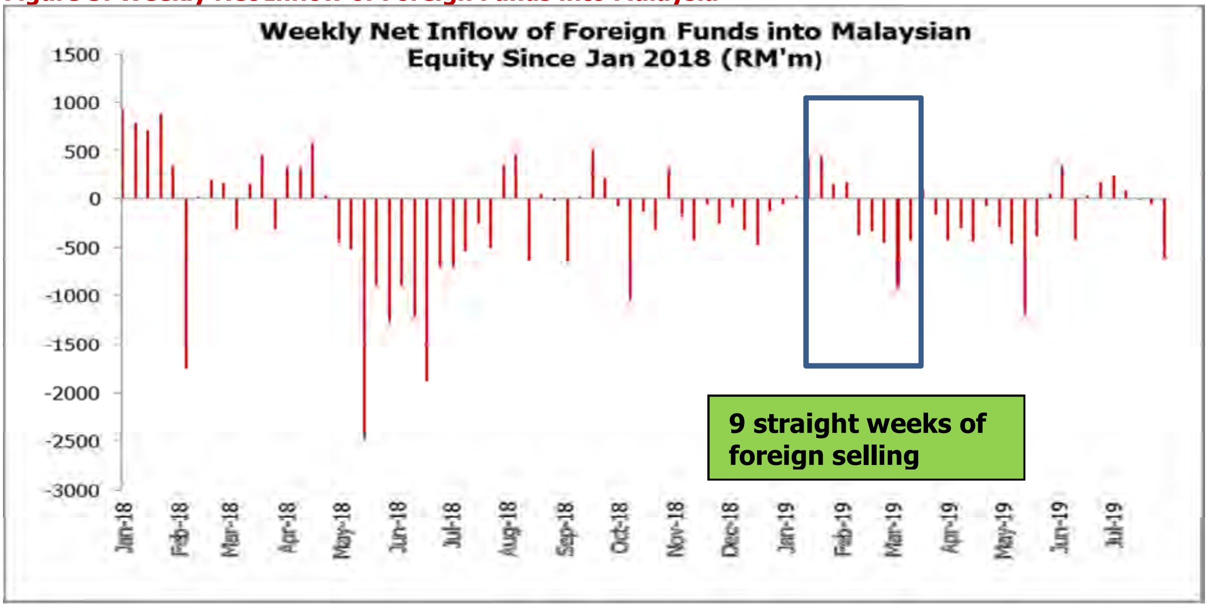


Source: Bloomberg, MIDFR

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

- **Foreign net outflow in Malaysia.** Foreign investors have taken a breather on Bursa thus far this year. They had been net sellers in 19 out of the 31 trading weeks in 2019 so far. Indeed the aggregate net outflow of foreign funds so far this year amounted to -RM5.0b. This cumulative net inflow in 1H19 makes up 43% of last year's foreign net outflow of RM11.69b.
- **Longest selling streak since May-July 2018.** Foreign investors were net sellers for 9-straight weeks from March 29 to May 24, the longest since the 13-week selling streak in May to July 2018. During this period, as anticipated, the FBM KLCI almost hit the 1,650 mark on June 28. In fact, it has already been five months of foreign net selling out of seven months this year.
- **Decrease in value traded coincided with foreign funds outflow.** There was a spike in high value trading days, occurred at the end of May which was partly attributable to the increase in trading activity following the rebalancing of the MSCI index.

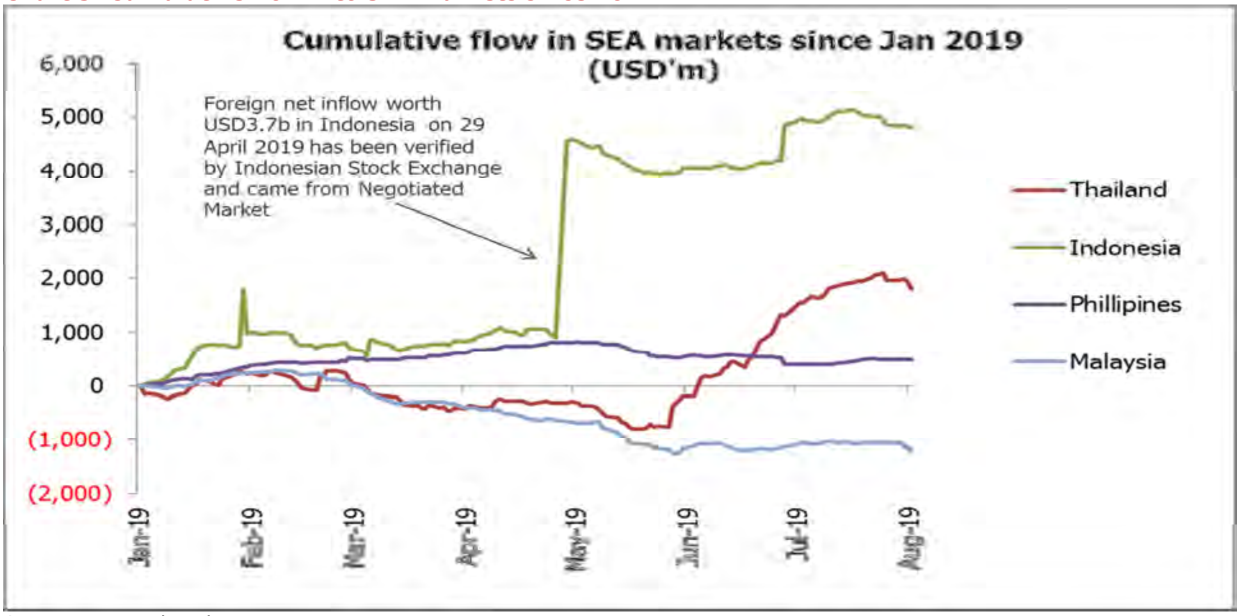
Figure 5: Weekly Net Inflow of Foreign Funds into Malaysia



Source: Bursa

- **Malaysia is the only market with a cumulative foreign net outflow in SEA.** In contrast, the other six Asian markets we monitor (Korea, Thailand, Indonesia, India, Taiwan and the Philippines) have seen a foreign net inflow so far for the year with India being the largest. However it is notable that the level of foreign net inflows has tapered amidst jitters caused by the ongoing trade war between the U.S and China.

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 1H2019 which amounted to approximately RM5.0b net, major beneficiaries consist mainly of utilities, healthcare and oil and gas related stocks.

- **Optimism on utilities.** Among the favourites, **Tenaga (BUY, TP: RM14.40),** saw inflows amounting to RM8.4b despite the disposal of 85m shares by Khazanah Nasional Berhad earlier this year. We opine the increase in foreign shareholding levels for Tenaga was sustained by the internal reorganisation involving the transfer of its: (1) Generation business (Genco) (2) Retail business (Retailco) into two new and separate subsidiaries. The main T&D (transmission and distribution) operations will remain under Tenaga, thereby creating essentially three distinct entities within the group. The exercise is expected to be completed by 3Q20. The key idea is to allow for a more focused management, capital allocation and to allow the respective units to gain better agility and adapt to potential changes in the marketplace ahead of MESI 2.0.

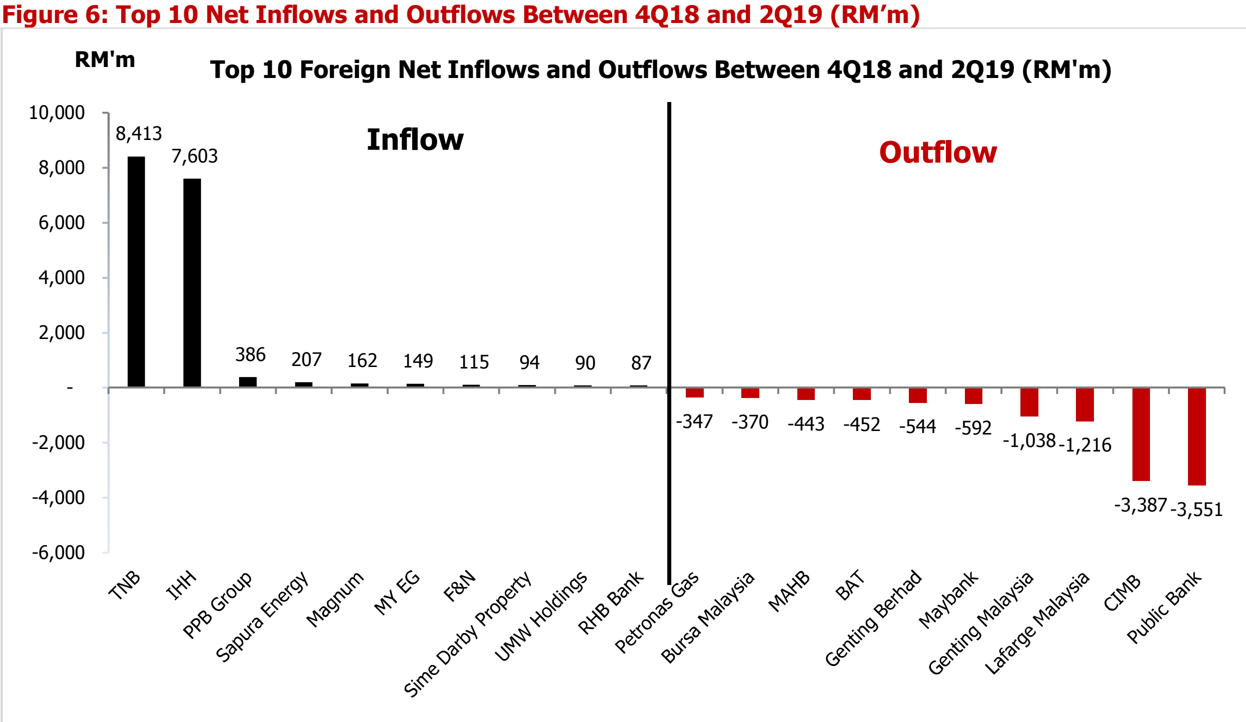
- **IHH foreign shareholding lifted by Mitsui's increasing its shareholding level.** In November 2018, Khazanah Nasional berhad disposed its 16% stake in **IHH Healthcare Berhad(BUY;TP:RM6.66)** worth RM8.42b to Japan;s Mitsui & Co. Ltd. The transaction clearly shows the confidence of Mitsui in the growth of the IHH platform. We acknowledge that the group is facing near term business headwinds particularly in the form of weak Turkish Lira as well as legacy issues within Fortis business. Nonetheless, we are maintaining our BUY recommendation as we are confident of IHH's ability to response to these challenges. Management has taken active efforts to reduce the Lira foreign exchange impact while adopting a discipline turnaround plan for Fortis. We believe that the strong cashflow generative markets like Singapore and Malaysia will continue to support group's performance in the near term.

- **F&N, a consumer stock favoured by foreign investors. Fraser & Neave Holdings Berhad (NEUTRAL; TP:RM33.78)** Despite the challenging domestic market condition in view of competitive price pressures and intensifying competition, we believe that the group's earnings growth will continue to grow, driven by the: (i)continued strong export growth and; (ii) improved cost efficiency as a result of cost optimisation efforts. In addition, the postponement of the imposition of excise duty on sugar sweetened beverage from 1st July 2019 instead of the 1st April 2019 would help the company to better manage the impact. Nonetheless, we expect that the impeding excise duty at RM0.40 per litre on ready-to-drink beverages that contain sugar exceeding 5.0g per 100 millilitres will have a minimal impact on F&N's bottom line due to the: (i) lower overall contribution of soft drink segment to the group's earnings and; (ii) ongoing reformulation of the sugar content for most of its products to be below 5.0% while maintaining the same taste.

- **RHB Bank bucked the trend amongst banks to be in the top 10 beneficiary of foreign inflows.** While other banks namely Maybank, Public Bank and CIMB experienced foreign outflows, **RHB Bank (BUY;TP:RM6.35)** saw a foreign inflow worth RM87m between 4Q18 and 2Q19. For 1QFY19, gross loans for RHB Banking group expanded +5.6%yoy to RM170.1b, better than the industry average while management expects that the GIL ratio will improve in the coming quarters as those R&R accounts are reclassified as performing. We believe that the CASA growth target will be challenging to meet given the competitive deposits environment but management expect traction from its mobile banking solution and transactional banking will lend support to the growth.We believe that the latest approval by Bank Negara Malaysia for the RHB Banking group to commence negotiations with Tokio Marine Asia Pte Ltd for its latest proposed disposal of up to 94..7% of its equity interest in RHB insurance will allow for greater focus on its core banking business. We do note that details are still scarce. Nevertheless, we could expect the Group to book in gains from the disposal in FY20. Therefore, we are positive on this latest development due to the potential gains and the fact that the Group could devote more resources to strengthening its core banking business.

- **Slew of contract wins make Sapura Energy favoured by foreigners. Sapura Energy Berhad (SEB) (NEUTRAL;TP:RM0.34)** also announced a series of 10 new contract wins with a combined value of RM1.002b for both its E&C as well as drilling segments with a delivery timeframe between FY20-FY26. Among the notable wins include: the provision for transportation and installation of its first ever wind turbine substructures in Taiwan as well as; its maiden entry into Egypt for transportation and installation works in the Gulf of Suez. SEB has also entered into a long-term frame agreement with PETRONAS for six years to provide provision for engineering, procurement and construction (EPC) of fixed offshore structure works which include both >7,500MT and <7,500MT structures. This brings its YTD contract wins to RM2.3b and a total orderbook of RM17.3b. we are expecting more meaningful earnings to be recognized during the year due to the recent contract wins and pick-up in activity levels for both its E&C and E&P segment from 2HFY20 onwards. We are also expecting the increase in number of operational rigs (from five currently to eight in 2HFY20) under its drilling segment to positively contribute to its earnings.

Figure 6: Top 10 Net Inflows and Outflows Between 4Q18 and 2Q19 (RM'm)



Source: Bloomberg,MIDFR

- **Banks had the largest dip in foreign shareholding level. Public Bank Berhad (BUY, TP: RM27.20), CIMB Group (BUY;TP: RM6.80)** and **Malayan Banking Berhad (BUY;TP:RM11.00)** experienced a massive foreign outflow between 4Q18 and 2Q19 worth more than RM500m This is particularly after seeing the spike in loans growth. We believe that this could moderate the issue of NIM compression. Moreover, the impact of the OPR cut to NIM will normalise. Besides, we believe that there are still positives for banks such as the downtrend of expenses and the low credit cost. This should be able to alleviate the weakness in income. Furthermore, we opine that banking stocks in general are currently undervalued given its fundamentals remains intact. Therefore, we view the selloff by foreigners to be unjustified.

- **Demand for contraband products hurt sin stocks.** Sin stocks categorized under consumer discretionary such as British American Tobacco faced outflows amounting to –RM452m. The main deterrent for foreigners to acquire **British American Tobacco (NEUTRAL, TP: RM28.80)** is sales volume contraction for legal cigarettes that has been a drag to its earnings. This is due to the fact to the volume share of illicit cigarettes remains high at 60.0% since 1QFY18.

- Furthermore, the challenging operating environment is further exacerbated by the launch of its competitor's tobacco heated product and the switch from premium and aspiration brands to value for money (VFM) brands such as Rothmans which commands lower margin.

- **Weak demand for building materials. Lafarge (ACCEPT OFFER, TP: RM3.75)** had the second largest outflow amounting to RM92m. We find the takeover offer by YTL as a positive event for investors. Largely, we believe the offer to be attractive considering the negative results booked by Lafarge since FY17. In a broader sense, the takeover action is strategically positive for the industry, allowing for further capacity cuts and more stable pricing environment. However, with the industry utilization remains well below its 5-year average; we expect that it would take a while before demand eventually picks up enough to close the gap.

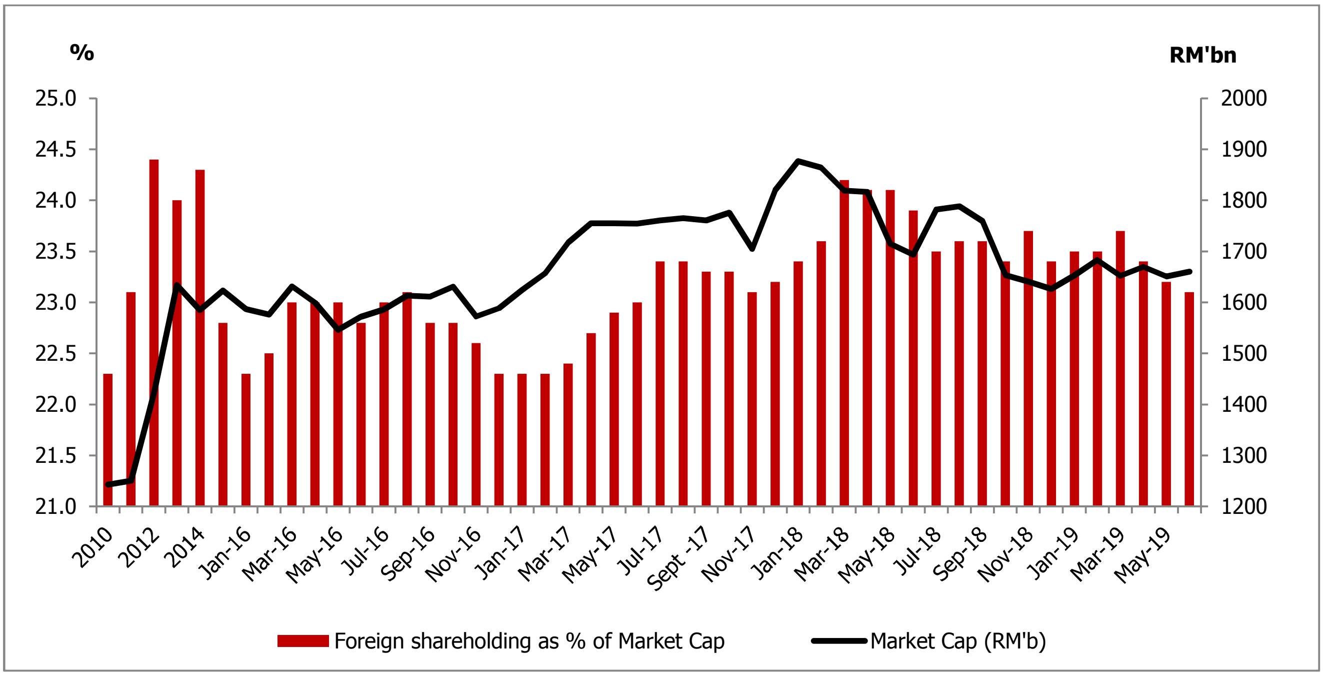
- **Gaming sector also seeing outflows.** Malaysian conglomerate, **Genting Bhd** (Not Rated) recorded the fourth highest outflow during the period between 4Q18 and 2Q19 worth RM1.04b. Its casino and resort operating arm, **Genting Malaysia** (Not Rated) also recorded a foreign outflow of RM544m. Latest developments show that Genting Malaysia entered into a restated Memorandum of Agreement granting the company a license to use certain Fox Intellectual properties in the former's Outdoor Theme Park at Resorts World Genting. However the issue of Genting Malaysia withdrawing its application for the judicial review of the Ministry of Finance's decision tin amending the 2014 tax incentive approval in December 2017 which may lead to higher corporate tax rates in the near term.

- **Airport operator saw a tad bit of outflows.** We opine that this was mainly due to the stark recovery in its share price which gained by more than 20% since April 2019, leading to some foreign investors cashing in gains. Overall, we continue to believe that the departure levy will not be a dampener on passenger traffic growth. This is premised on our latest findings, in addition to our previous analysis highlighted in a report dated 15 April 2019. Therefore, we believe that **MAHB (BUY, TP: RM9.43)** will be able to maintain its upward trajectory especially in terms of passenger growth. This is amidst the relaxation of visa policies for Chinese and Indian nationals visiting Malaysia which we opine may be extended in the following year in conjunction with 'Visit Malaysia Year 2020'. Hence, we reiterate our optimism that MAHB passenger numbers will surpass the 100m mark in 2019, while maintaining a relatively conservative growth rate of 3.5% at 102.5m.

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 slight tapered 0.3ppts to 23.1% as of June 2019 compared to 23.4% as of December 2018. 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 necessarily a reason to worry.

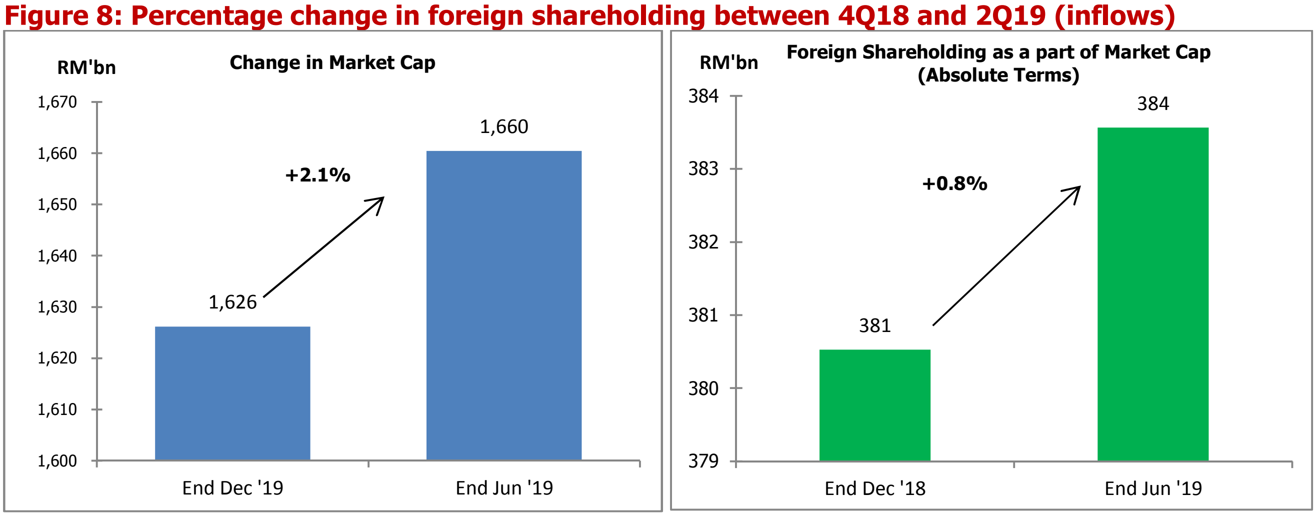
Figure 7: Foreign shareholdings based on market capitalisation (%)



Source: Bursa Malaysia, Bloomberg, 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.

Figure 8: Percentage change in foreign shareholding between 4Q18 and 2Q19 (inflows)

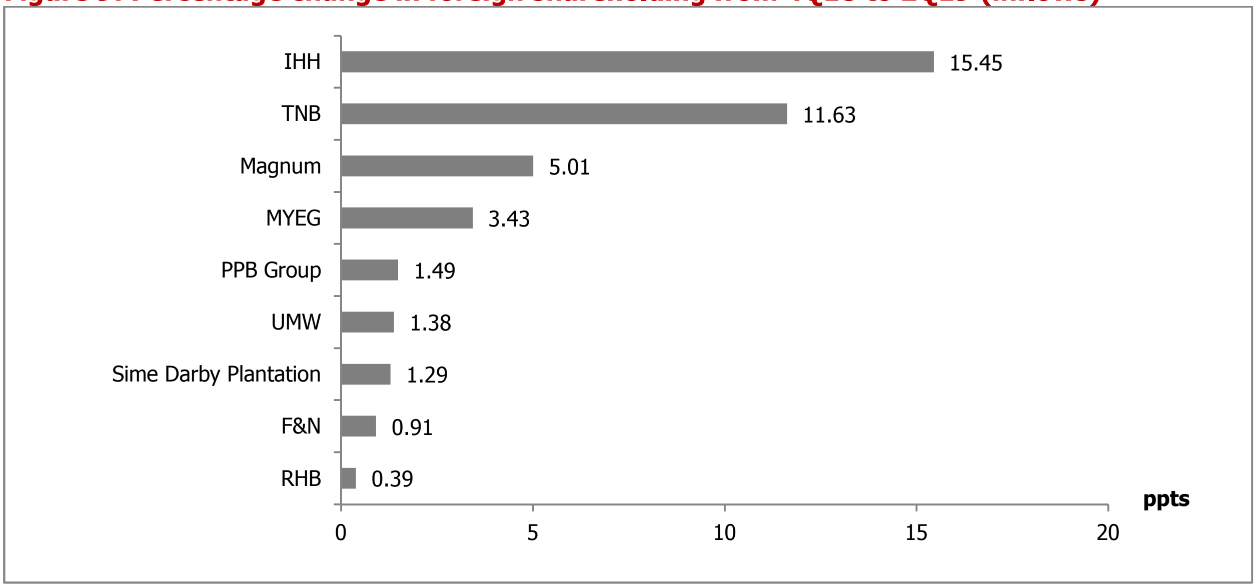


Source: Bloomberg, Bursa

- **Foreign shareholders share ownership is up 0.8% since end 2018.** Comparing the value of shares owned by foreign shareholders, the values have gone up 0.8% from RM381 billion as at end 2018 to RM384 billion as at end June 2019. And if not of the Mitsui increasing its stake in IHH, the value would be on a declining trend. Meanwhile the total market capitalization of the all listed companies in Bursa Malaysia, has only gone up by 2.1% from RM1.63 trillion to RM1.66 trillion over the same period.

- **Percentage of foreign shareholding levels remain on the uptrend for some listed companies.** 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 percentage of foreign shareholding levels from the shares outstanding. **IHH Healthcare, Tenaga Nasional Berhad** and **Magnum**, for example, as saw a net increase of percentage of foreign shareholding up by 15.45, 11.63 and 5.01 ppts respectively where calculations are based on the list of foreign shareholders seen from Bloomberg. It is notable that these three stocks are also in the top five stocks with the largest value of foreign inflow between 4Q18 and 2Q19. Meanwhile, companies such as Sapura Energy recorded a -3.02ppts decline in terms of percentage of foreign shareholding during the period under review despite having fourth largest value of foreign inflow between 4Q18 and 2Q19 due to the rights issue to reduce the group's hefty borrowing of RM16.55b or 1.6x net gearing.

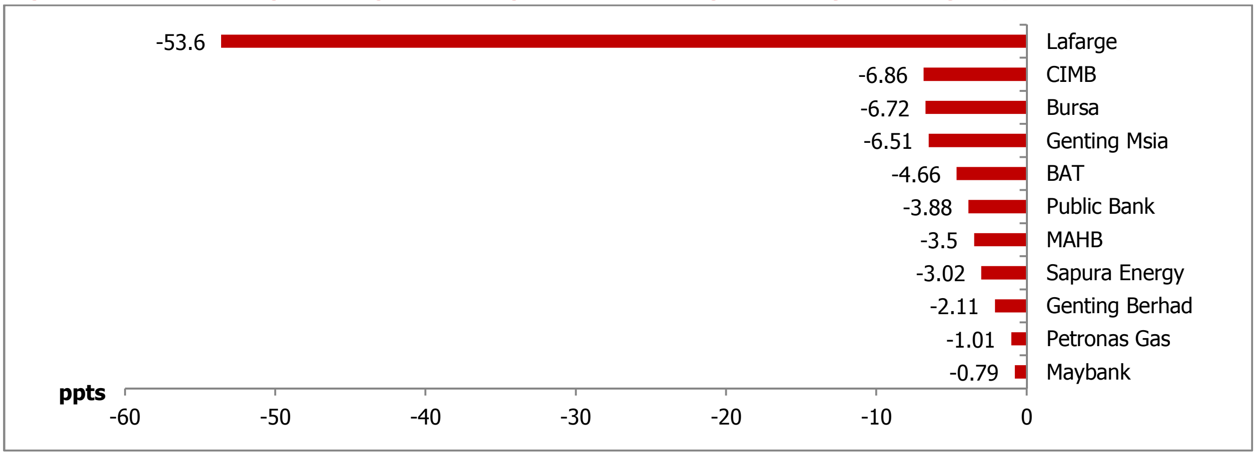
Figure 9: Percentage change in foreign shareholding from 4Q18 to 2Q19 (inflows)



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. Lafarge Malaysia for example, saw its percentage of foreign shareholding level decline by -53.6ppts following the 51% equity stake takeover by YTL Cement Berhad. Looking at the top 10 list of stocks with the biggest decline in percentage of foreign shareholding levels are companies that we are positive on such as MAHB, CIMB, Maybank and Public Bank and hence, the exit of foreign investors could be due to profit taking activity.

Figure 10: Percentage change in foreign shareholding from 4Q18 to 2Q19 (outflows)



Source: Bloomberg

What shall we expect to see in the near future?

- **2019 FBM KLCI target at 1,720 points for now**. The US Fed is expected to be less aggressive in regard to its monetary stance this year which may be positive to EM currencies (including Ringgit) as well as to commodity prices. Moreover, the slowing China's economy may prompt more stimulus measures (both monetary and fiscal) by the local authorities with positive spill over effects to the broader region. Meanwhile, we are sanguine on the prospect of de-escalation in the ongoing US-China trade spat as both parties are seen as seeking acceptable solutions to the dispute. Domestically, the macro picture remains healthy with GDP growth expected at 4.9% this year while corporate earnings growth at circa middle single-digit. All factors considered, our FBM KLCI year-end 2019 target remains at 1,720 points, pending the outcome of the on-going 2Q CY2019 results season. And there is a bias towards downward revision, considering the increasing number of below consensus results seen so far and also heightened trade war and other geopolitical issues.

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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.