4QCY22 Outlook

Waiting for the Pivot

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EXECUTIVE SUMMARY

- **Much like 2QCY22 performance, 3QCY22 ended in the same way, coinciding with the US Fed remaining hawkish due to stubborn high inflation data, continuing with a third consecutive +75bps hike in September. With an aggressive US Fed, it is not surprising that all major indices saw negative year-to-date (YTD) performance**
- **Global economic growth is projected to moderate to around +3% this year. As the low base effect wanes, the pace of growth this year will be back to more normalized levels after the robust +6.1% rebound last year**
- **We forecast Malaysia 2022 GDP growth at 6.6%. We foresee the positive growth momentum to continue in 2HCY22, looking at the continued pick-up in consumer spending, improved business activities, and even sustained growth in the external demand**
- **Valuation to remain depressed at below normal historical range. Cut FBM KLCI end-2022 target to 1,520 points (from 1,600 points) or PER22 of 14.8x**
- **Our preliminary expectation for next year is that global growth will slow down but not yet global recession. Meanwhile, US growth to slow further next year but China's growth to recover next year. As for Malaysia, we expect growth to moderate in 2023**
- **We now expect that the first pivot could happen later in Dec-22. We expect that the pivot may change the outlook of the market to a more positive one as it will cause valuation to gradual improve from current levels**
- **Preliminary FBM KLCI end-2023 target at 1,700 points or PER23 of 14.8x. While we believe the market would attach a downside risk to prevailing earnings forecast for 2023 as, despite the increasingly bearish world's macro expectations, the earnings forecast remains unwavering since the beginning of this year. Hence, we can expect market valuation to stay below the norm to account for the downside risk to forecasted earnings. Based on the prevailing earnings forecast, we introduce our preliminary FBM KLCI end-2023 target at 1,700 points or PER23 of 14.8x**

A. 3QCY22 PERFORMANCE – US FED KEEPS THROWING THE SPANNER

US Fed threw a spanner to the rebound – again. Much like 2QCY22 performance, 3QCY22 ended in the same way. A rebound in the FBM KLCI was observed after the downtrend in June-22 was short lived as the last month of 3QCY22 saw another pull back of the FBM KLCI. This coincided with the US Fed remaining hawkish due to stubborn high inflation data, continuing with a +75bps hike in September, the third consecutive hikes of such magnitude. With an aggressive US Fed, it is not surprising that all major indices saw negative year-to-date (YTD) performance.

Slower pace of pullback. While the US Fed action affected the performance of the FBM KLCI in 3QCY22, the pace was lower than what was observed in 2QCY22. FBM KLCI fell -9.0%qoq in 2QCY22, but it fell -3.2%qoq in 3QCY22. This could be due to waning surprise effect. The US Fed fund rate hike in 2QCY22 was the first +75bps hike and it very much surprised the market. However, the +75bps hike was a smaller surprise as US Fed Chairman had hinted that the US Fed will be aggressive "until the job is done" in relation to combating inflationary pressures.

Chart 1: Performance of FBM KLCI (as at 29 September 2022)



Source: Bloomberg, MIDFR

Table 1: Performance of Indices (as at 29 September 2022)

Indices	YTD performance as at end of-			Quarter-on-quarter performance		
	1QCY22	2QCY22	3QCY22	1QCY22	2QCY22	3QCY22
Jakarta	7.4%	5.0%	6.9%	7.4%	-2.3%	1.8%
Singapore	9.1%	-0.7%	-0.2%	9.1%	-9.0%	0.5%
Thailand	2.3%	-5.4%	-3.8%	2.3%	-7.5%	1.7%
UK	1.8%	-2.9%	-6.7%	1.8%	-4.6%	-3.9%
Nikkei	-3.4%	-8.3%	-8.2%	-3.4%	-5.1%	0.1%
FBM KLCI	**1.3%**	**-7.9%**	**-10.8%**	**1.3%**	**-9.0%**	**-3.2%**
Shanghai	-10.6%	-6.6%	-16.4%	-10.6%	4.5%	-10.5%
Philippines	1.1%	-13.6%	-16.7%	1.1%	-14.5%	-3.6%
Dow Jones	-4.6%	-15.3%	-18.3%	-4.6%	-11.3%	-3.5%
Euro	-6.5%	-16.5%	-21.5%	-6.5%	-10.7%	-6.0%
S&P500	-4.9%	-20.6%	-22.0%	-4.9%	-16.4%	-1.8%
Han Seng	-6.0%	-6.6%	-26.6%	-6.0%	-0.6%	-21.5%
KOSPI	-7.4%	-21.7%	-27.1%	-7.4%	-15.4%	-6.9%
NASDAQ	-9.1%	-29.5%	-29.4%	-9.1%	-22.4%	0.2%

Source: Bloomberg, MIDFR

Finance sector still a performer. On the sectoral indices performance, the Finance sector is still seeing positive on YTD basis. Although, it saw slight pullback in 3QCY22, we opine that it is still resilient. This could be due to the fact that Malaysia's GDP performance is expected to be stronger than first expected at the start of the year. Unsurprisingly, Healthcare was the worst performer given the difficulties seen in the Glove sector. Along with the performance of the Telecommunication and Industrial Product & Services sectors, it proved to be a weight to the FBM KLCI.

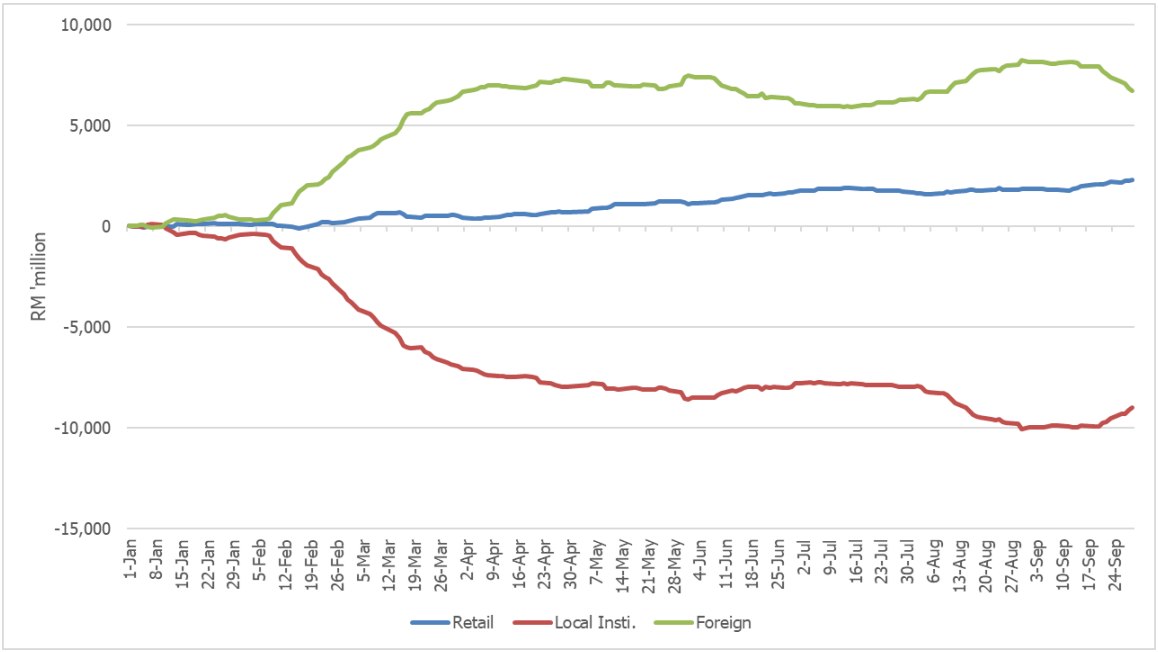
Table 2: Performance of Bursa Malaysia Sectoral Indices (as at 29 September 2022)

Indices	YTD performance as at end of-			Quarter-on-quarter performance		
	1Q	2Q	3Q	1QCY22	2QCY22	3QCY22
FBM KLCI	1.3%	-7.9%	-10.8%	1.3%	-9.0%	-3.2%
FBM70	-2.5%	-12.1%	-14.5%	-2.5%	-9.8%	-2.7%
FBM100	0.5%	-8.8%	-11.6%	0.5%	-9.2%	-3.1%
FBM Small Caps	3.4%	-9.7%	-13.1%	3.4%	-12.6%	-3.8%
Finance	7.8%	2.7%	2.0%	7.8%	-4.7%	-0.6%
Plantation	21.4%	5.3%	-0.7%	21.4%	-13.2%	-5.7%
Construction	4.8%	0.9%	-2.3%	4.8%	-3.7%	-3.1%
REITs	-0.5%	1.1%	-3.7%	-0.5%	1.6%	-4.7%
Consumer	0.5%	-3.5%	-4.2%	0.5%	-4.0%	-0.7%
Utilities	-1.7%	-4.7%	-4.6%	-1.7%	-3.1%	0.2%
Energy	1.9%	-1.5%	-4.6%	1.9%	-3.3%	-3.2%
Transport	-0.9%	-6.1%	-9.4%	-0.9%	-5.3%	-3.5%
Industrial	1.8%	-9.5%	-12.5%	1.8%	-11.1%	-3.2%
Telecommunications	0.8%	-13.4%	-13.2%	0.8%	-14.1%	0.3%
Property	1.3%	-10.4%	-16.2%	1.3%	-11.6%	-6.5%
Technology	-19.9%	-35.3%	-37.4%	-19.9%	-19.2%	-3.4%
Healthcare	-9.3%	-28.3%	-37.4%	-9.3%	-20.9%	-12.8%

Source: Bloomberg, MIDFR

Foreign funds net outflow coincided with US Fed decisions. Foreign fund net position YTD is still positive (cumulative net inflow) but we observed net outflows in recent weeks, amounting to RM1.45b. This coincided with the continuing hawkish language from the US Fed. However, the same trend was observed in end-May to June period before seeing a net inflow again. We believe that it is possible that we could see similar trend when the US Fed will eventually slower its pace of rate hike, the much awaited pivot.

Chart 2: Cumulative Fund Flow in Bursa Malaysia (as at 29 September 2022)



Source: Bursa Malaysia, MIDFR

US Fed had more say than geopolitics. We saw 3QCY22 also had fair share of geopolitics flare up. While the Ukraine-Russia conflict continued, we saw the visit of US Speaker Nancy Pelosi to Taiwan on 2 August 2022, bringing the world to concerns of an escalation in the Taiwan strait. Nevertheless, the market was muted and in fact it recovered from this incident 1 and half week on. Based on this, we conclude that US Fed action held the biggest sway to market performance, and its future decision.

Table 3: Performance of Indices after US Speaker Nancy Pelosi visit to Taiwan

Indices	2/8 to 12/8
Jakarta	2.0%
Singapore	0.9%
Thailand	2.1%
UK	1.2%
Nikkei	3.5%
FBMKLCI	**0.7%**
Shanghai	2.8%
Philippines	5.3%
Dow Jones	4.2%
Euro	1.1%
S&P500	4.6%
Han Seng	2.5%
KOSPI	3.6%
NASDAQ	5.7%

Source: Bloomberg, MIDFR

Waiting for the pivot from the US Fed. We had expected the US Fed to slower its pace of rate hike after the increase in its fund rate in July-22. Subsequently, our expectation was moved to the FOMC in Nov-22 as inflation stayed stubbornly high. At current juncture, we now expect that the first pivot could happen later in Dec-22 as the US Fed continued with its hawkish language, expecting the US Fed fund rate to end at 4.15% by end of the year. However, this will be much dependent on US inflation situation. We expect that the pivot may change the outlook of the market to a more positive one as it will cause valuation to gradual improve from current levels. We should note that corporate earnings growth seems stable for now as long as recession (although still a possibility in the US) is able to be skirted.

B. ECONOMIC OUTLOOK FOR 4QCY22

HEADING INTO ANOTHER GLOBAL SLOWDOWN AS INFLATION REMAINS HIGH

Global growth to moderate to 3% this year. Global economic growth is projected to moderate to around +3% this year. As the low base effect wanes, the pace of growth this year will be back to more normalized levels after the robust +6.1% rebound last year. After two years battling with the Covid-19 pandemic, improved public health and increased vaccination rate allowed countries to ease Covid-19 restrictions. The post-pandemic economic reopening, therefore, will result in increased consumer spending and business activities. Businesses will increase hiring and production to cope with the growing demand. Nevertheless, producers continued to indicate experiencing post-pandemic challenges such as rising prices and costs, shortage of raw materials and labour, and other supply constraints. Although the ongoing war in Ukraine remains one of the uncertainties affecting the global growth outlook, the recent correction in the global commodity prices at least signal stabilization in global supply chain condition.

2022 growth not as fast as previously anticipated. Several factors that emerged led to downgrade of global growth outlook for this year. While the war in Ukraine and the reintroduction of Covid-19 lockdown in China had led to downward revision to global growth outlook, the continued tightening of monetary policy by central banks in many countries

(including major economies like the US, euro area, and UK) has caused a shift in the narrative that the global economy may be experiencing slowing growth momentum heading into 2023. In other words, the 2022 growth outlook is projected to be more moderate than previously anticipated. The IMF, for example, already revised down several times from as high as +4.4% in its January projection to +3.2% based on its July World Economic Outlook. We foresee global demand to grow at slower pace which will constrained by the rising borrowing costs following policy tightening the monetary authorities that is intended to ease demand pressures on prices and bring down inflation from multi-year highs.

Rising global inflation despite recession correction in commodity prices. For many countries, inflation has been trending upward due to the rise in commodity prices, affecting global prices of food and energy. Although the concerns to certain extent eased due to the recent correction in commodity prices, the level of commodity prices remained elevated compared to previous years. This will still result in higher inflation this year, which can be explained by the recovery in demand after post-pandemic economic reopening and the supply constraints faced producers to cope with robust demand. According to our in-house view, we project crude palm oil price to average higher this year at RM5,000 per tonne (2021: RM4,437/tonne) and Brent crude oil to be around USD105pb (2021: USD70.90pb) this year. While inflation remains, the major focus affecting consumer and business sentiment globally, the global slowdown fear at least helped to ease upward price pressures. The concerns over weaker demand outlook have helped to bring down commodity prices from the recent highs. However, for European countries, the inflation concern and energy price could surge again due to uncertainty in the natural gas supply and increased demand during winter season. Meanwhile, countries, which rely on imported sources especially foods and energy, also face challenges from the weakening of local currencies due to the broad strengthening of US dollars. In other words, rising inflation this year is also linked to higher import costs, in addition to other supply and demand factors.

Hawkish policy stance to keep inflation under control. Central banks have started to raise interest rates to contain inflationary pressures through slowing demand. Demand recovery remains robust amid supply constraints because not only headline inflation in some economies have increased to multi-year highs, the core inflation has also trended upward indicating a broader price pressures beyond foods and energy. We foresee central bank will remain hawkish throughout this year as inflation remained at high levels, with more rate hikes to be considered until there is considerable decline in inflation as well as reduced pressures from strong demand. Although inflation remains the major focus among policymakers, the rapid rise in borrowing costs will pose near-term pains that will cause consumers and businesses to slow down spending and eventually contribute to slower inflationary pressures.

Risks remain on the downside. The balance of risks to global growth outlook remains on the downside. Several risks that could affect stability of global growth are continued rise in global inflation, the slow growth in China, renewed disruption to global supply, escalation of geopolitical tensions (including ongoing Russia-Ukraine war and recent China-Taiwan tension). The global Covid-19 pandemic has been less of a concern as countries moved to reopen their economies and international borders, but we cannot rule out possibility of reintroduction of tight containment measures should the public health condition worsens again. Looking at recent developments, another factor that could affect global growth is the increased volatility in the financial market. The elevated inflation especially in the US has led to expectations for further aggressive policy tightening. As the recession risk has not been ruled out, slowing demand will likely hurt global growth outlook which could begin as early as in the final quarter of 2022. Not to forget, severe and extreme weather condition could also affect economic activities in countries affected by floods, hurricanes, wildfire and even extreme cold winter.

Table 4: Central Bank Policy Rate by Selected Economies (%)

	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22
Malaysia	1.75	1.75	1.75	1.75	2.00	2.00	2.25	2.25	2.50
Indonesia	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.75	3.75
Philippines	2.00	2.00	2.00	2.00	2.25	2.50	3.25	3.75	3.75
Thailand	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75
Vietnam	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
South Korea	1.25	1.25	1.25	1.50	1.75	1.75	2.25	2.50	2.50

	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22
India	4.00	4.00	4.00	4.00	4.40	4.90	4.90	5.40	5.40
Japan	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
UK	0.25	0.50	0.75	0.75	1.00	1.25	1.25	1.75	1.75
Euro area	0.00	0.00	0.00	0.00	0.00	0.00	0.50	0.50	1.25
USA	0.00-0.25	0.00-0.25	0.25-0.50	0.25-0.50	0.75-1.00	1.50-1.75	2.25-2.50	2.25-2.50	3.00-3.25

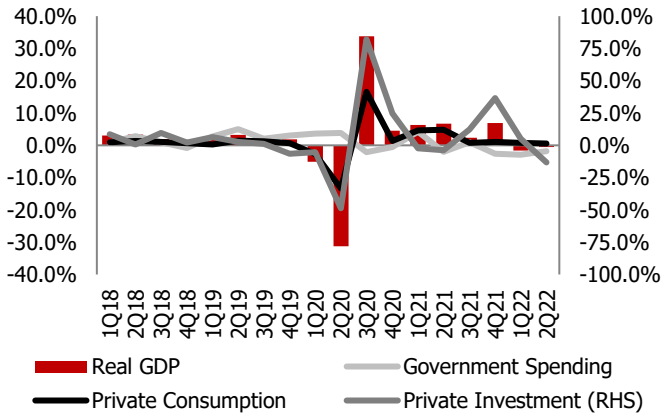
Source: Bloomberg, MIDFR

US: GROWTH OUTLOOK WEAKENS AS FED COMMITTED TO BRING DOWN INFLATION

Resilience signals possible soft landing. By technical definition, the US economy entered into recession after registering second consecutive of contraction in 2QCY22 (annualized -0.6%qoq; 1QCY22: -1.6%qoq) following downward drag from reduced inventory investment and decline in residential investment. Nevertheless, private consumption expenditures showed resilience, growing by +1.5%qoq in 2QCY22 and marking the eighth consecutive quarter of growth since 3QCY20. Even latest data suggests continued resilience in private consumption as shown by increased retail spending. We believe this reflects the positive income growth on the back of increased number of jobs added into the economy, and despite the Fed having started its policy tightening since Mar-22. While we could see consumer spending to sustain in 3QCY22 as consumers expressed improved sentiment in August and September, in response to correction in gasoline prices, and reduced inflation expectations, rising borrowing costs may restrict consumer spending plans in the near term. The momentum of growth could also slow due to slower business activities as the latest PMI readings already signal a more moderate expansion in manufacturing sector due to slower growth in production. Nevertheless, businesses are still optimistic on demand outlook and the recent improvement in services sector PMI both suggest the resilience in the US economy will likely continue. On this basis, we believe the US economy will likely experience a soft landing this year. Based on our estimate, we forecast the US economy will be able to register growth of around +1% this year (2021: +5.7%).

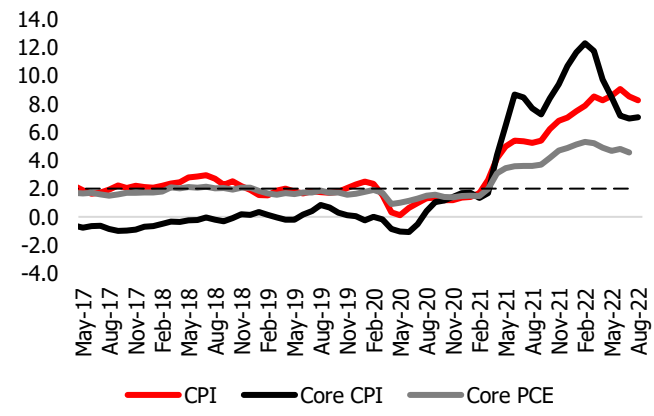
Elevated high inflation keeps Fed persistently hawkish. Despite the correction in gasoline prices, inflation in the US remained above the Fed's 2% longer-term price stability target. As a result, the Fed remains hawkish and committed to bring down inflation from more than 4 decades highs. In fact, recent data shows the price pressures have been broader, beyond food and energy prices, as robust demand and tight labour market also pose upward price pressures. While the Fed initially expected to begin tapering down its pace of tightening in the final quarter of the year, the expectations for the Fed to pivot have shifted to a latter period as the fed funds rate is expected to be raise higher than 4% by the end of this year. The Fed Chair and FOMC members also indicated steadfast commitment to bring down inflation, even if it leads to reduced possibility of soft landing and therefore higher risk of the US economy going into a recession. With the Fed is expected to remain hawkish going into the final quarter of the year, this explains the continued strengthening of the US dollars against other currencies even after another large 75bps hike that was decided after the Sep-22 FOMC meeting.

Chart 3: US GDP by Demand Side (Annualised QoQ%)



Source: Macrobond, MIDFR

Chart 4: US: CPI and PCE inflation (%)



Source: Macrobond, MIDFR

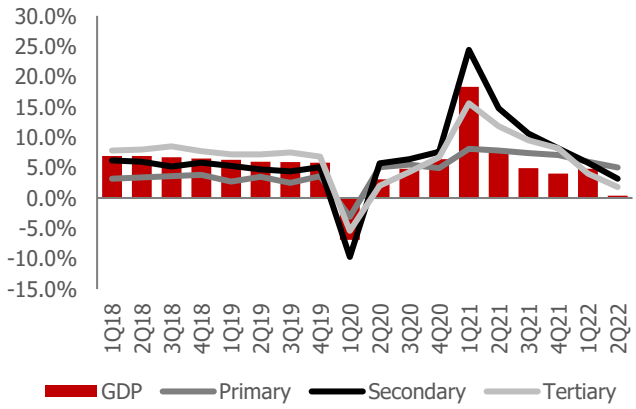
CHINA: REBOUNDING FROM THE ZERO-COVID POLICY AND LOCKDOWNS

A rather weak recovery from Covid-19 lockdowns. China's economic recovery after the lockdown imposed in 2QCY22 has been slower than expected. As a result, growth projection for this year has been revised down towards 3%, even slower than previously anticipated. At least the recent data update shows retail spending grew faster than expected, rising by +5.4%yoy in Aug-22 (Jul-22: +2.7%yoy; 2QCY22: -4.9%yoy) which was the fastest growth in 6 months. This is in line with the improving job market which led unemployment rate falling to 8-month low at 5.3% as of Aug-22. Although the growing domestic spending may continue on the back of relaxation of Covid-19 restrictions, the strength of growth may be constrained by the Government's commitment to the zero Covid policy and the imposition of Covid-19 lockdowns in selected areas in the country. The strict handling of Covid-19 pandemic has been the one of the key factors that makes it difficult for China's economy to achieve this year's official growth target of +5.5% set by the Government.

Slowing business activity will be a concern. Business activity in China was not significantly impacted by the Covid-19 lockdown earlier this year. The weak GDP growth in 2QCY22 (+0.4%yoy) was mainly due to decline in consumer spending, while industrial production managed to sustain positive growth (+0.6%yoy) during the quarter. Even the latest data shows China's industrial production growth accelerated to +4.2%yoy in Aug-22 (Jul-22: +3.8%yoy), which was better than expected driven by increased output in the manufacturing and utility sectors. However, the performance of China's imports remained sluggish after registering a weak growth of +0.3%yoy in Aug-22 (Jul-22: +2.3%yoy; 2QCY22: +1.7%yoy). The lower NBS Composite PMI reading, which fell to 3-month low at 51.7 in Aug-22, indicates slowing growth in business activities which was impacted by rising Covid-19 cases and tighter restrictions in several cities, and the effect of power rationing due to the worst heatwaves in decades. As a result, factory activity fell for the second consecutive month and services sector activity expanded at the slowest pace in 3 months. We view this as another temporary setback to China's economic growth because relaxation of the mobility restrictions will allow growth to pick up in the latter part of the year.

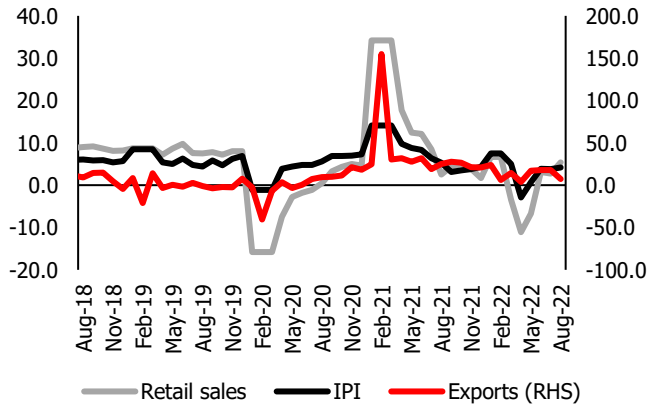
Government to provide more support to stabilize the economy. In response to the less encouraging growth outlook, China's government has stepped in to provide more supports to the economy. This includes measures such as shopping coupons or vouchers, reduced sales tax on purchases of passenger vehicles, and even reduction in the borrowing costs. The PBOC, for example, made announced another policy easing in Aug-22, reducing the 1-year and 5-year loan prime rates to 3.65% (-5bps) and 4.3% (-15bps), respectively. The reduction in interest rates was intended to boost loan demand and to support China's overall economic growth this year. In reaction to the weak investment in the real estate sector, state government-owned firm also stepped in to assist and finish several unfinished property developments projects in the country. Despite the Government's strict approach to contain Covid-19 infections, we expect more policy intervention and assistance will be rolled out to support China's growth this year.

Chart 5: China GDP by Industry (YoY%)



Source: Macrobond, MIDFR

Chart 6: China: Retail Sales, IPI and Exports (YoY%)



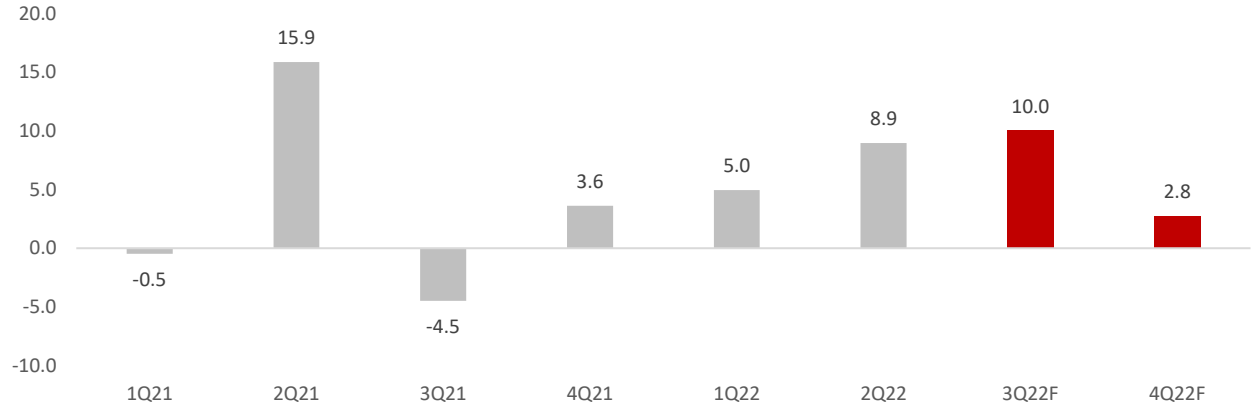
Source: Macrobond, MIDFR

MALAYSIA'S ECONOMY ON FIRM GROUND

We forecast 2022 GDP growth at 6.6%. Taking into account the stronger-than-expected growth in 2QCY22 which resulted in +6.9% expansion for 1HCY22, we had revised our 2022 GDP growth projection higher to +6.6% from +6.0% previously. We foresee the positive growth momentum to continue in 2HCY22, looking at the continued pick-up in consumer spending, improved business activities, and even sustained growth in the external demand. Further improvement in the labour market and better employment prospects will help to support consumption expenditures, although consumers are more cautious in their financial and spending plans in response to the rise in cost of living. We remain wary of the possible downward risks mostly from external developments such weak recovery in China's economy, risk of recession and sharper slowdown in the US (and the global economy), the ongoing war in Ukraine, escalation of geopolitical tensions, and high inflationary pressures globally from elevated commodity prices. Considering both upside and downside factors, we estimate Malaysia's GDP growth to register +4.2% for 2023, slight moderation from 2022.

GDP growth to normalised in 4QCY22. Based on current performances of macro data, we believe Malaysia's GDP growth to reach double-digit rate in 3QCY22. Technically, the high growth is attributed also by the low-base effects since Malaysians faced nation-wide lockdown in 3QCY21 following Delta-strain concerns. Despite of global uncertainties, external trade performances remained robust which driven by manufactured and primary products. We expect domestic demand to record solid growth amid continued improvement in labour market, stable inflationary pressure and supportive fiscal and monetary policies. Going into 4QCY22, we believe the GDP growth to be normalised as low-base effects will fade away. We project the economy to expand by +2.8%yoy and +3.2%qoq in the final quarter of this year amid continuous strong domestic economic fundamentals.

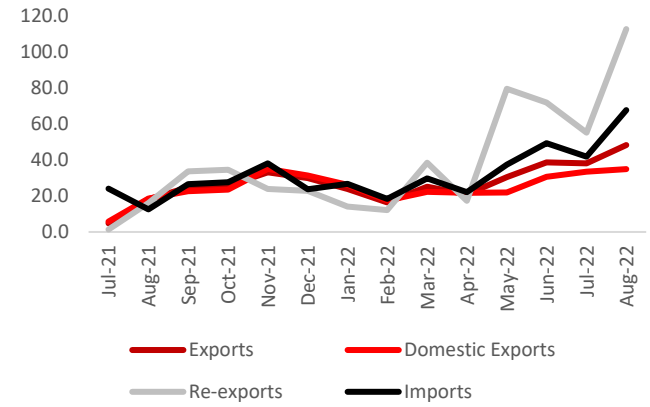
Chart 7: Real GDP Forecast (YoY%)



Source: Macrobond, MIDFR

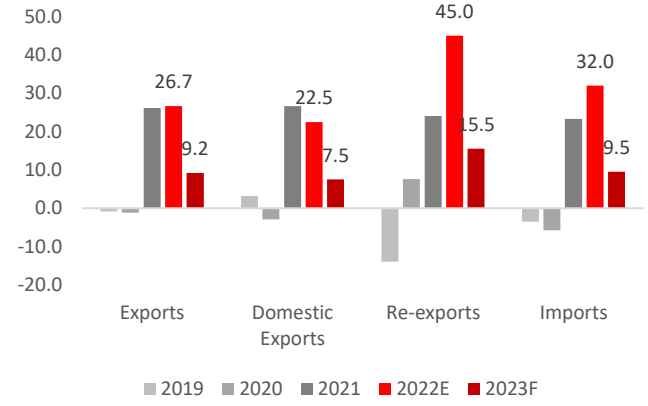
External trade continues on soaring. Average total exports growth for 8MCY22 was +30.2%yoy (8MCY21: +26.9%yoy). Both domestic exports and re-exports expanded strongly with average +26.1%yoy and +50.1%yoy respectively in the first eight months of this year. Despite of geopolitical concerns, external demand on Malaysia's products do not seem affected much. In fact, Malaysia stands to benefit from the elevated commodity prices via outbound shipment of palm oil, LNG and crude petroleum. Looking ahead, we view the external front still in challenging path particularly with global economic recession fear, inflation bite, tightening monetary policy in many countries and geopolitical risks in Asia. Hence, we foresee slight moderation in exports growth forecast at +26.7%yoy for 2022 and +9.2%yoy for 2023. As for imports, strong domestic demand and improving local activities led to higher inbound shipments, +36.6%yoy in 8MCY22 (8MCY21: +21.3%yoy). Imports growth forecast is set to touch +9.5%yoy, higher than exports as we view domestic demand to stay sturdy next year.

Chart 8: Robust External Trade (YoY%)



Source: Macrobond, MIDFR

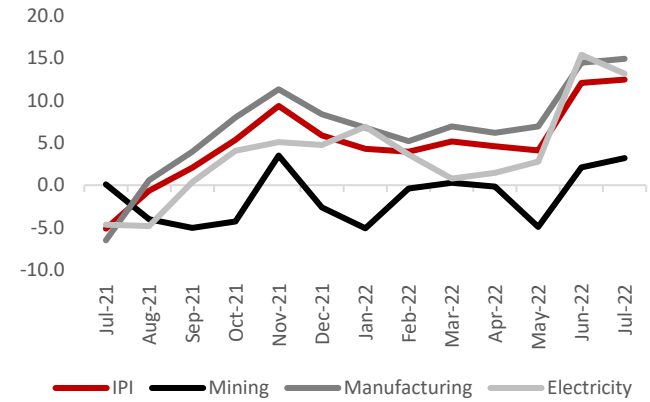
Chart 9: Exports Fob Forecast (YoY%)



Source: Macrobond, MIDFR

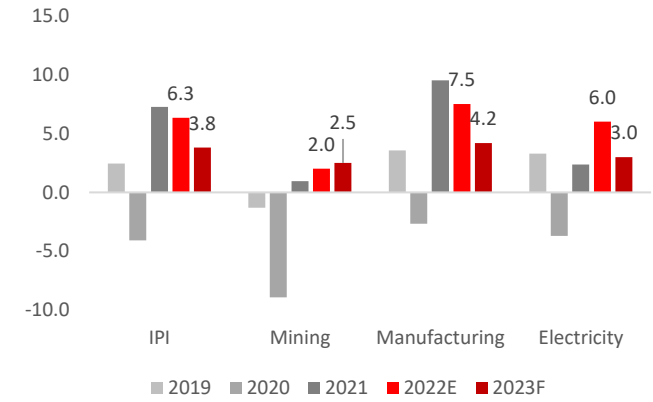
IPI growth forecast at +6.0% for 2022. As of 7MCY22, overall industrial production grew by average of +6.7%yoy. This was driven by manufacturing and electricity output growth of +8.8%yoy and +6.3%yoy respectively. Mining production remained in marginal contraction rate of -0.7%yoy. Looking ahead, we foresee IPI growth to soften in 2HCY22 particularly due to moderation in global growth, tightening monetary policies in developed markets and elevated input inflation. Hence, we expect factory output growth to decelerate slightly to +7.2%yoy for this year. On the flip side, we anticipate further rebound in mining production amid improvement from supply disruption and supportive global oil prices. As mentioned in our thematic report Mining Sector to Restarting Engine in 2HCY22, mining output is set to continue recovering underpin by elevated global energy prices which expected to sustain into 2023 and resumption of Gumusut-Kakap oilfields among others.

Chart 10: IPI Performances (YoY%)



Source: Macrobond, MIDFR

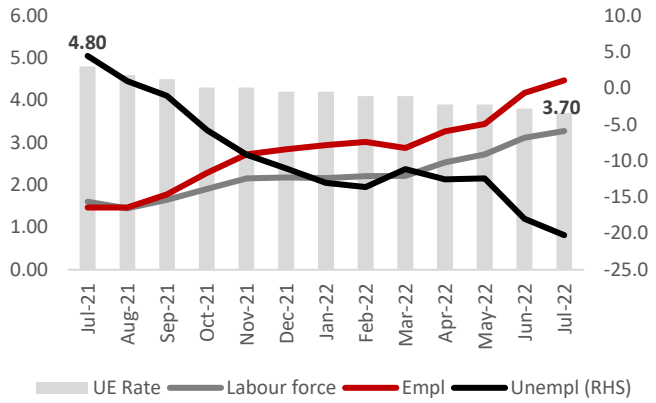
Chart 11: IPI Forecast (YoY%)



Source: Macrobond, MIDFR

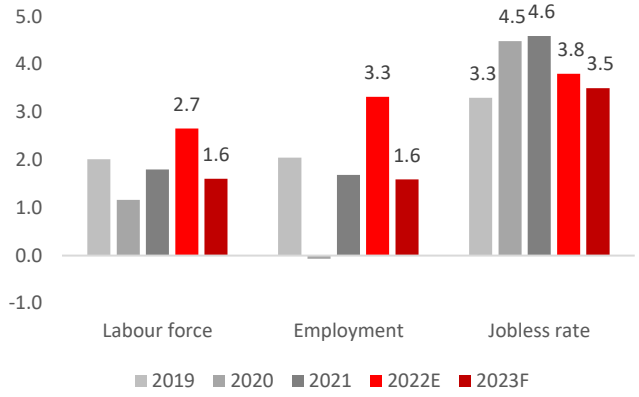
Unemployment rate stay on downward trend. Labour market in Malaysia is expected to strengthen further in 2HCY22 underpin by upbeat momentum in domestic economy and steady expansion in external sector. As of 7MCY22, average employment growth at +3.5%yoy (7MCY21: +1.3%yoy) while unemployment dipped by -14.4%yoy (7MCY22: +16.0%yoy). Jobless rate has fallen from 4.8% in Jul-21 to 3.7% after a year, reflecting positive effect from domestic reopening and strengthening domestic economic fundamentals. Going into 2023, we believe Malaysia's unemployment rate to decline further to 3.5% yet slightly higher than pre-pandemic level of 3.3%.

Chart 12: Unemployment rate vs. Job vacancy rate (%)



Source: Macrobond, MIDFR

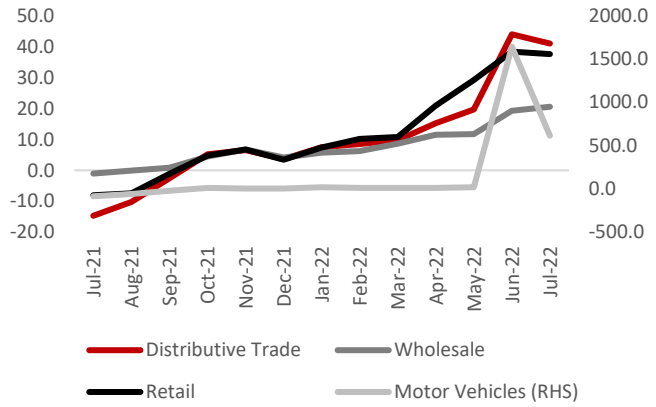
Chart 13: Labour Market Forecast (YoY%)



Source: Macrobond, MIDFR

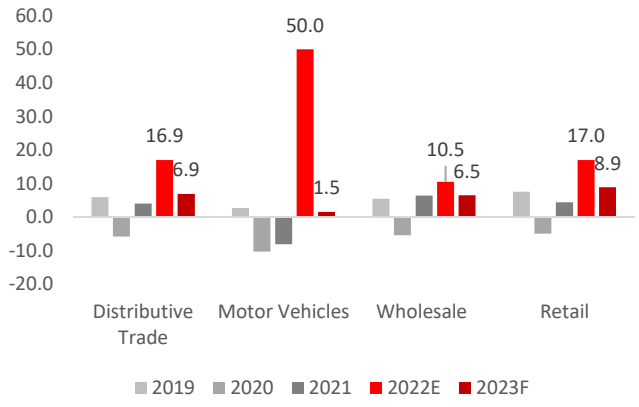
Pent-up demand continues. Malaysia's consumer spending is expanding strongly as reflected in retail trade sales growth of +21.6%yoy in 7MCY22. We believe the pent-up demand will continue until end of this year underpin by improving labour market, stable inflationary pressure and domestic economy reopening. Even though OPR is on the upward trajectory, we believe it would have minimal effect on domestic spending. OPR is set to reach 2.75% by end of this year, still below 2019's level of 3.00%. We believe Malaysia's monetary policy is on normalisation process rather than tightening path, possibly to reach the 3.00% by early of 2023. With the reopening of international borders, we noticed tourism-related activities are on uptick trend. Pre-pandemic, 50.7% of Malaysia's airports passenger traffic contributed by international travel, 25.0% by Asean and 25.7% by non-Asean destination. As of Jul-22, domestic destinations continued to dominate at 66.6% (2021: 81.5%) while international at 34.0% (2021: 18.4%) whereby 13.0% were non-Asean and 21.0% Asean.

Chart 14: Distributive Trade Sales, DT (YoY%)



Source: Macrobond, MIDFR

Chart 15: Consumer Spending Forecast (YoY%)



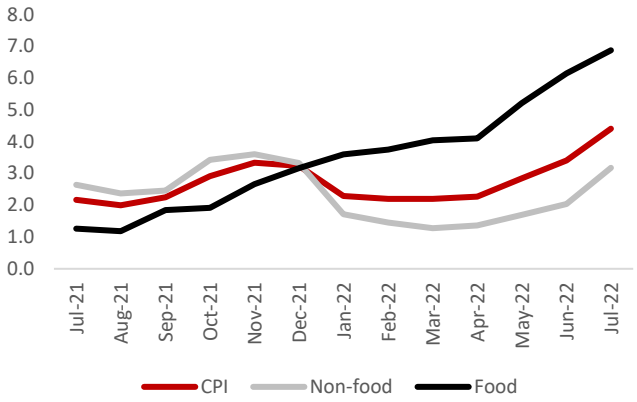
Source: Macrobond, MIDFR

Headline inflation surpasses +3.0% if food CPI above +5.0%. As mentioned in our thematic report Quantifying Fuel Subsidy Removal Effects, headline inflation would only average at +3.0% if food CPI grows at average of +5.0% in 2022. The headline inflation has been above +3.0% level since Jun-22 as food price growth touched above +5.0%, in line with our thematic study. However, the impact of food inflation spike is limited by the current fuel subsidy mechanism as fuel inflation stays under control.

We raise our average CPI forecast to +3.0% for 2022. In the environment of elevated global commodity prices, inflationary pressure in Malaysia is affected via higher food inflation. We expect food price growth to record at +5.5% this year (initial estimate: +4.5%) among others attributed by further depreciation of USDMYR. As for fuel subsidy, we believe

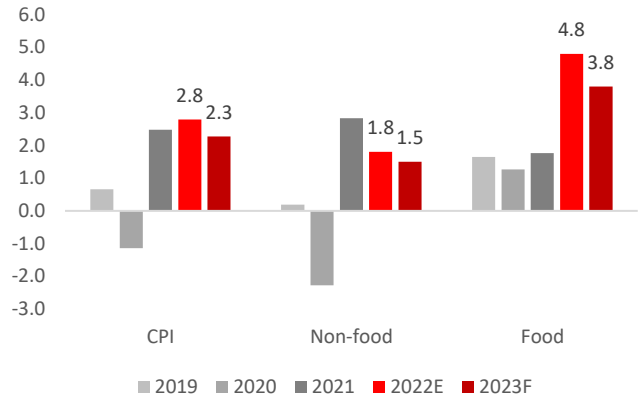
the government to maintain current mechanism at least until end of this year. With domestic demand firming, we upgrade our headline CPI forecast slightly by +0.2% point to +3.0% for 2022.

Chart 16: Food-led Inflationary Pressure (YoY%)



Source: Macrobond, MIDFR

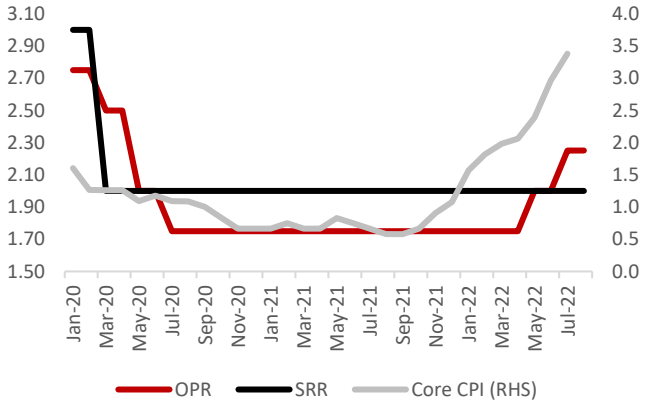
Chart 17: Inflation Forecast (YoY%)



Source: Macrobond, MIDFR

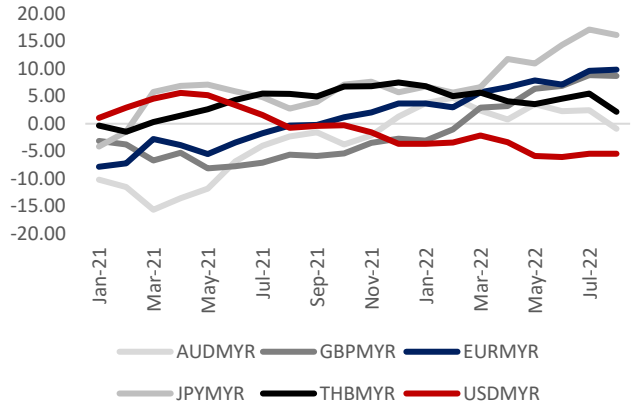
Ending the year with OPR at 2.75%. We believe the current focus of BNM's monetary policy setting is to ensure a sustainable recovery of Malaysia's economy. With the rising core inflation trend and stronger-than-expected domestic demand, we expect further policy normalisation will likely be carried out in Nov-22 MPC meeting (the final meeting this year) with another +25bps hike. However, the decision will be subjected to the stability of economic growth, the pace of price increases and further improvement in macroeconomic conditions, particularly a continued recovery in the labour market and growing domestic demand. From a medium-term perspective, the policy rate normalisation is needed to avert risks that could destabilize the future economic outlook such as persistently high inflation and a further rise in household indebtedness. Considering upbeat macro mom, we believe the central bank will further front-load its monetary bullet in the first MPC meeting in Jan-23 by another 25bps. With that, OPR will be back at 2019's level of 3.00%.

Chart 18: Monetary Policy (%) vs. Core CPI (YoY%)



Source: Macrobond, MIDFR

Chart 19: MYR against Major Currencies (YoY%)



Source: Macrobond, MIDFR

USDMYR to reach RM4.45 by end-2022. As the Federal Reserves opted for aggressive tightening monetary policy, USD appreciates stronger. Against the green-back currency, average MYR is expected to weaken from RM4.15 per USD1 last year to RM4.40 in 2022. However, MYR performed better than other major currencies as of 8MCY22. For instance, MYR gained +11.2%yoy against JPY, +6.7%yoy against EUR, +2.4%yoy against AUD and +4.1% against GBP. Fundamentally, MYR is in good position as domestic economy stays on upbeat momentum and as net exporter of crude petroleum, LNG and palm oil, Malaysia stands to benefit from the elevated global commodity prices. We believe the turning point for MYR to appreciate against USD is when the Fed to soften its monetary increment size. Based on the Fed's latest

projections, the interest rate to be raised by another 75bps in Nov-22 and 50bps in Dec-22. Hence, we expect USDMYR to enter appreciation path in Nov-22 onwards.

February 2023 will be the earliest time for GE15. As the Budget 2023 reading bring forward to 7th Oct-22, we foresee slim chance for GE15 to be held this year. Once the Budget 2023 tabled, it will take at least 1.5 months for debates and approval process. Plus, year-end monsoon season would not be suitable for GE15 to take place. We opine Feb~Mar-23 especially before Ramadhan would be the earliest time for the election to be held. With election next year, we believe this will give less impact on Budget 2023 disbursement and implementation processes.

Table 5: MIDF Research Macroeconomic Forecast Figures for 2022 (%)

(YoY%) Unless Stated Otherwise	2019	2020	2021	2022f	2023f
Real GDP	4.4	(5.5)	3.1	6.6	4.2
Govt. Consumption	1.5	5.0	5.3	3.1	2.3
Private Consumption	7.7	(4.2)	1.9	10.8	6.6
Gross Fixed Capital Formation	(2.1)	(14.4)	(0.9)	12.5	4.0
Govt. Investment	(10.7)	(21.2)	(5.0)	4.2	3.6
Private Investment	1.6	(11.9)	9.7	5.5	4.2
Exports of goods & services	(1.0)	(8.6)	15.4	8.3	2.9
Imports of goods & services	(2.4)	(7.9)	17.7	12.4	4.4
Net Exports	11.2	(13.7)	(4.1)	(34.5)	(23.8)
Agriculture etc.	1.9	(2.4)	(0.2)	2.5	1.0
Mining & Quarrying	(0.6)	(9.7)	0.3	1.3	1.1
Manufacturing	3.8	(2.7)	9.5	6.8	3.0
Construction	0.4	(19.3)	(5.2)	1.5	4.8
Services	6.2	(5.4)	1.9	8.0	5.4
Exports of Goods (f.o.b)	(0.8)	(1.1)	26.1	22.4	9.2
Imports of Goods (c.i.f)	(3.5)	(5.8)	23.3	29.5	9.5
Trade Balance (Ave) RMb per month	12.1	15.3	21.1	19.9	24.1
	2019	**2020**	**2021**	**2022f**	**2023f**
Unemployment Rate (%)	3.3	4.5	4.6	3.8	3.5
Headline CPI Inflation (%)	0.7	(1.1)	2.5	3.0	2.3
Brent Crude Oil (Avg, USD per barrel	64.6	41.6	71.5	105	96.5
Crude Palm Oil (Avg), MYR per tonne	2,145	2,775	4,486	5,500	3,500
USD/MYR (Avg)	4.14	4.20	4.14	4.40	4.35
USD/MYR (End-period)	4.15	4.06	4.21	4.45	4.30
Overnight Policy Rate (%)	3.00	1.75	1.75	2.75	3.00

Source: Macrobond, Bloomberg, MIDFR

C. MARKET OUTLOOK FOR 4QCY22

Factors that would affect the market. As per our second half outlook report dated 1 July 2022, we listed down five factors that would affect the local equity market going forward amid the backdrop of Malaysia's fledgling macro recovery. Going into 4QCY22, all the five factors remain.

1) Risk of US recession due to rapid interest rate hikes
2) The Russia-Ukraine war
3) China economic conditions
4) GE15

5) Waning threat of Covid-19

RECESSION RISK DUE TO RAPID INTEREST RATE HIKES

Recently, the US Fed turned more bearish in regard its US GDP outlook. Most prominently, the US Fed revised its 2022 GDP growth target sharply down from 1.7% to mere 0.2%. Mathematically, the new target implies potentially sizeable quarter-on-quarter (as well as year-on-year) GDP contraction in the final quarter of this year. Empirically, the short-term trajectory of equity market exhibited a high degree of correlation to quarterly sequential GDP performance.

US GDP: Growth Estimates

	QoQ	YoY	Annual
4Q22	-18.15%	-5.40%	0.20% **
3Q22	0.00% *	1.13%	
2Q22 (Actual)	-0.57%	1.71%	
1Q22 (Actual)	-1.57%	3.53%	

Assumptions: * 0% sequential growth in 3Q22; ** 0.2% annual growth in 2022 (based on US Fed target)

Hence, a further downside risk to the equity market in the final quarter should the US Fed's revised 2022 GDP growth target prevails. However, at the time of writing, it should be noted that market consensus pegged the 2022 GDP growth estimate at 1.6%. Moreover, the US Fed also revised down its 2023 GDP growth target from 1.7% to 1.2%.

Fed pivot being delayed. The US economy is already in a technical recession (i.e. 2 consecutive quarters of negative sequential growth) as both the 1QCY22 and 2QCY22 quarter-on-quarter growth came in at below zero levels. On this score, the risk of an outright recession in the US is rising due to the persistently aggressive US Fed. The timeline for so-called Fed pivot continued to be extended in response to the rather stubborn underlying price pressure at core levels. At current juncture, barring a negative surprise on the inflation front, the Fed pivot is estimated (based on CME Fed-Watch) to commence in the final month of this year.

RUSSIA-UKRAINE WAR

Contained theatre of war. The ongoing Russia-Ukraine war is expected to stay as that, an invasion by Russian military forces on Ukraine territory. Hence, the conflict is not foreseen to spread to other countries in the region.

Limited impact on Malaysia. Moreover, despite the heavy financial and trade sanctions imposed on Russia by the United States, the European Union and some of their allies, the economic blowbacks thus far vary from country to country depending on the level of their bilateral trades as well as the ability to re-channel trades. We believe this war would pose limited impact on Malaysia's economic and corporate earnings performance.

CHINA ECONOMY

Growth to lag Asian peers for the first time in decades. China's growth prospect remains beleaguered by its battered property market. Moreover, an export boom since the onset of Covid-19 is beginning to ebb. The market consensus GDP growth for this year was again recently lowered to 3.4% from 3.5%. For the first time since 1990, China's growth will likely underperform the rest of Asia.

Authorities would spare nothing to deter broader economic fallout. Going forward, the world's equity market may intermittently be beleaguered by worries over contagion risk of further weakness in China economy. Nonetheless, we believe the authorities in China would stand ready to inject the necessary amount of liquidity (both monetary and fiscal) to avoid a broader fallout thus limiting, at least in the short-term, the risk of cross-sectoral as well as cross-border contagion. In this regard, it must be highlighted the SHIBOR interbank rates came off rather drastically since a few months ago and fast approaching levels last seen during the onset of Covid-19 and global financial crisis in 2008/9.

GE15

Election in November? There is no consensus among political parties as well as key politicians on whether the GE15 should be held this year or next. While leaning towards next year, we however reckon there is a reasonable likelihood that the country may be heading to the national polls in the fourth quarter of 2022.

Major price action, if any, would come after GE15. The conventional wisdom was that our market would get excited with the mere mention of a general election. However, ever since GE12 in 2008, the major price action (either up or down) generally manifested not before but after the election results. Recall that the market staged a selloff post-GE12 in 2008 (when the incumbent lost two-third majority), a relief rally post-GE13 in 2013 (when the incumbent managed to retain simple majority) and a selloff post-GE14 in 2018 (when the incumbent finally lost). We believe investors are now more concerned about the resultant (political, societal, and economic) stability post-election, and less on pre-election goodies and promises.

Either neutral or positive outcome. During the past two years, the successive central governments have not been too stable (both being coalition of coalitions) with razor-thin majority in parliament. Hence, the country is approaching the next general election under a situation of rather high political fluidity. Nevertheless, we reckon the probable outcome of GE15 would be either neutral (i.e. another razor-thin majority government), or positive (i.e. a more stable majority government) to the country. Meanwhile, the possibility of a hung parliament is likely avoided with YDP Agong as the final arbiter with constitutional power to appoint a PM from among the MPs who he believes command majority support of the MPs.

Possibly positive. Outwardly, the state elections in Melaka, Sarawak and Johor are pointing towards a more stable majority government post-GE15. Nonetheless, the situation at national level is more complex and fluid according to some political watchers. However, either way, we believe the impact of upcoming GE15 on the equity market would be either neutral or positive.

COVID-19

Not over yet, but a waning threat. It is not over yet, but Covid-19 is a diminishing threat to the society and economy. During the past months, the number of daily infections as well as deaths continued to show flattening trend. Moreover, based on recent economic data, we are seeing improvements in Malaysia's macro performance concurrent with the opening of international borders and further upliftment to the remaining requirements/restrictions beginning 1 April this year.

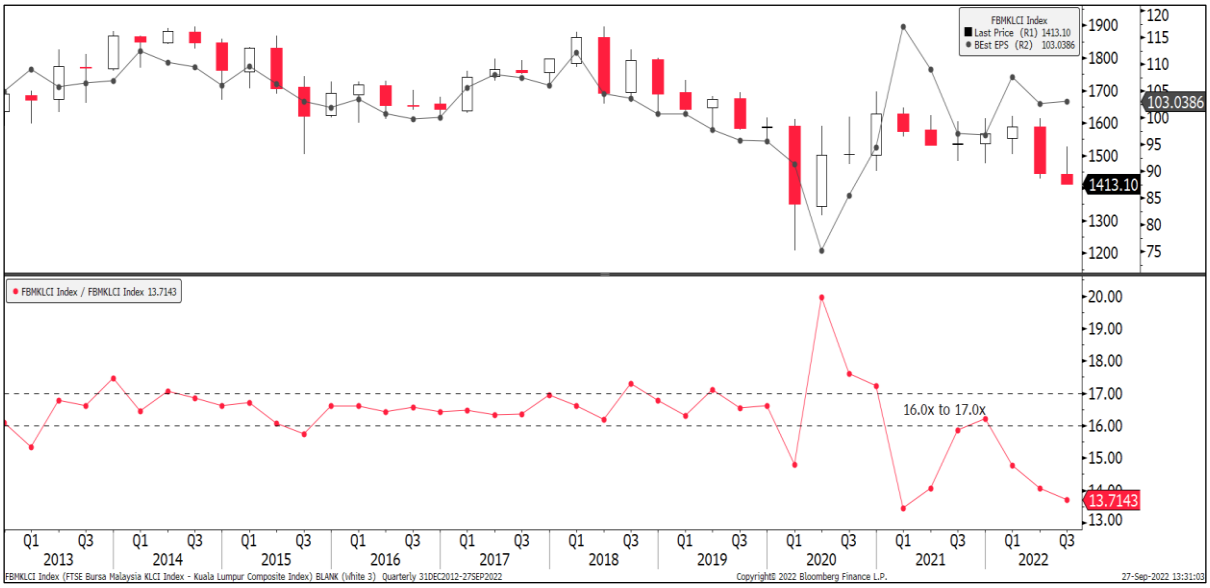
FBM KLCI END-2022 BASELINE TARGET

Baseline scenarios. Amid the backdrop of the mainly external headwinds, our baseline scenarios are as follow:

(1) the extended aggressive monetary tightening by the US Fed would heighten risk of economic slowdown and pose downside risk to equity prices, (2) the ongoing Russia-Ukraine war to remain confined within the territory of Ukraine with limited economic impact to Malaysia, (3) the authorities in China would take whatever (monetary and fiscal actions) necessary to avoid a broader fallout, thus limiting the risk of cross-border contagion, (4) general election, if called, may not result in negative price action post-election, and (5) Covid-19 is a diminishing threat to the society and economy.

Valuation to remain depressed at below normal historical range. We foresee a situation whereby the local equity market valuation remains rather depressed (at below normal historical range) due to the consequence of US Fed extended aggressive tightening on world's financial liquidity. Additionally, equity valuation could also be impacted by higher risk attached to earnings forecasts corresponding to heightened macro uncertainty.

FBM KLCI: Price, Earnings & Valuation (Current Year) – 16.0x to 17.0x



Source: Bloomberg, MIDFR (G658)

Empirically between 16-17x. The FBM KLCI normally traded at between 16.0x to 17.0x current year earnings. Accordingly, the end-2022 target point (based on the latest CY2022 earnings of 103.04 points) should range approximately at between 1,650 points to 1,750 points. However, at the time of writing, the FBM KLCI is trading at 1,413 points or PER22 of 13.7x.

Cut FBM KLCI end-2022 target to 1,520 points or PER22 of 14.8x. Moving towards the end of this year, we expect the local equity market valuation to crawl higher from current levels in line the expectation of continued positive GDP growth in 2023. However, lingering fear over further delays to the Fed pivot may result in equity valuation remains depressed at below normal historical range due to the negative effect of extended aggressive tightening on financial liquidity and macro performance. Therefore, we cut our FBM KLCI end-2022 target to 1,520 points (from 1,600 points) or PER22 of 14.8x.

STOCKS SELECTION

No changes to sector calls. We made no changes to our sector calls.The summary of our sector calls are as follows;

POSITIVE : Automotive, Banking, Construction, Consumer, Healthcare, Oil & Gas, Plantations, Technology, Media, REITS

NEUTRAL : Gloves, Power, Property, Telecommunication, Transportation (Aviation, Ports & Logistics)

MIDF Top Stock Picks (Rank by total return)

	Rec.	Price (RM) @ 30/9	Target Price	Price Return	Dividend Yield	Total Returns	FBM ESG Rating	FTSE4Good?
Dialog Group	BUY	1.99	3.96	99.0%	2.2%	101.2%	4	No
Globetronics	BUY	1.17	1.94	65.8%	8.1%	73.9%	3	No
KL Kepong	BUY	20.70	31.50	52.2%	2.4%	54.6%	4	Yes
Petronas Chemicals	BUY	8.39	11.93	42.2%	4.8%	47.0%	4	Yes
Inari Amertron	BUY	2.52	3.53	40.1%	5.7%	45.8%	4	Yes
IJM Corp	BUY	1.67	2.18	30.5%	3.6%	34.1%	4	No
Bermaz Auto	BUY	1.87	2.36	26.2%	7.3%	33.5%	4	Yes
Gamuda	BUY	3.93	4.71	19.8%	12.7%	32.6%	2	No
Maybank	BUY	8.58	10.41	21.3%	9.0%	30.3%	4	Yes
CIMB	BUY	5.13	6.16	20.1%	5.9%	26.0%	4	Yes

Source: Companies, Bursa Malaysia, FTSE, MIDFR

D. PRELIMINARY VIEW OF CY23

D.1 Economy

Slowdown but not yet global recession next year. The rapid policy tightening both in terms of the magnitude of rate hike at each meeting and the back-to-back decisions to keep raising interest rates led to fear of potential global recession next year. With the typical transmission period of monetary policy tightening between 6 to 9 months, the policy hikes conducted this year could result in global growth probably slowing even from 4QCY22 and at least going into 1HCY23. With major central banks are expected to continue hiking rates in the next few months, there is even possibility that the world economy could slow further going into the latter half of next year. This explains the growing concerns about global slowdown next year, not because of pandemic-related measures but one that is engineered intentionally to contain stubbornly high inflation risk. At the moment, we expect global economy will continue to moderate next year dragged down by the slower growth, and perhaps shallow recession, in the advanced economies, but the global growth will remain in the positives thanks to post-pandemic recovery that will result in continued improvement in spending and domestic economic activities.in emerging and developing countries. However, if advanced economies go into a deep and prolonged recession, trade-dependent and commodity-producing countries may be affected by the sharper slowdown in international trade. That will be a downside risk that could derail global growth outlook, potentially going back into negative territory after 2 years of post-pandemic recovery.

US growth to slow further next year. We foresee the US economy will experience slower growth next year taking into account the continued rise in borrowing cost and the Fed's ongoing commitment to aggressive policy tightening. Using the 6 to 9 months of transmission to real economy from any monetary policy adjustment, we estimate consumer spending may be constrained at least going into 1HCY23, and the slowing business activity may result in increased job losses next year. While the FOMC's central projection on average expects the US economy to grow stronger at +1.2% next year (FOMC's latest 2022 growth projection: +0.2%), we estimate that the US growth could moderate below 1% next year but building some recovery in the latter half of the year as we expect the Fed to pivot in its policy tightening in 1HCY23. But, if the downward adjustment was larger than expected or the growth momentum slows further going into 2HCY23, there is a possibility that the US economy would slow towards zero growth or possibly register a shallow contraction next year. On a positive note, the low positive growth is feasible achieved as easing inflation and tapering down of policy tightening will allow demand condition to stabilize in the second half of next year. Moreover, the Fed and the US government have the option to intervene and provide policy supports to minimize the effects of growth slowdown.

China's growth to recover next year. Unlike advanced economies which are facing higher risk of recession, we anticipate China's growth momentum to pick up heading into 2023. After China's growth this year being affected by the resurgence in Covid-19 infections, the relaxation of Covid-19 lockdowns will facilitate for better growth next year. Consumer spending will improve and pick up on the back of increased mobility, and business activity will also grow benefiting from the recovering domestic spending. Despite the positive outlook, several downside risks that could affect China's economic growth next year are sharp slowdown in global production and trade activities, escalation of geopolitical tensions and prolonged drag from weak investment in the real estate industry.

Malaysia to growth to moderate in 2023. Considering external headwinds and tightening monetary policy in many economies, we foresee Malaysia's GDP growth to moderate to +4.2% for next year. The softening growth is mainly due to deceleration in external trade performances as slower global demand is highly anticipated. On the other hand, we are optimistic that domestic economy to be fuelled by continuous upbeat consumer spending, further improvement in tourism-related activities and revival of infra projects. Going into next year, we believe food inflation as well as overall price growth to trend lower following moderation in global commodity prices and further easing in tight supply chain pressure, headline CPI forecast at +2.3% (2022F: +3.0%). On top of that, Ringgit is projected to appreciate from average RM4.40 per USD1 to RM4.35 as the Fed is set to taper down its hawkish stance in 2023. Consumer spending in Malaysia to stay steady underpin by stable inflation rate and jobless rate is set to decline further to 3.5% next year, among others thanks to strong economic recovery in post-pandemic and returning of non-citizen workers. In addition, we view that BNM's OPR to be fully normalised at 3.00% in 2023, creating a monetary space for the central bank in the event of worse-than-expected global economic slowdown.

D.2 Market

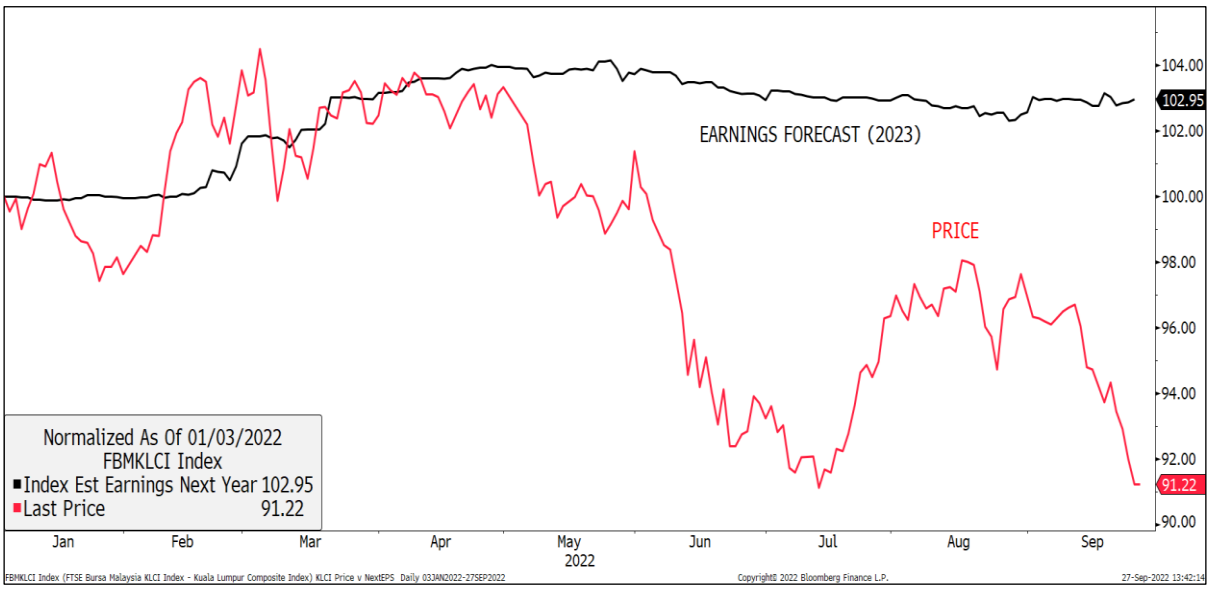
FBM KLCI: Historical & Forward Earnings

Calendar Year	Earnings (Points)	YoY (%change)
CY2023 (F)	114.87	11.48
CY2022 (E)	103.04	-1.28
CY2021	104.38	46.76
CY2020	71.13	-20.67
CY2019	89.66	-5.62
CY2018	95.00	-11.96

Source: Bloomberg, MIDFR

Going into 2023, despite rising recession risk in the US, we expect Malaysia's macro recovery to remain on track. Our preliminary forecast suggests Malaysia's GDP growth to moderate but continued rising at circa 4.2% in 2023. Along with the expectation of continued macro recovery, the market consensus is also forecasting the FBM KLCI to register +11.5%yoy earnings growth in 2023.

FBM KLCI: Indexed YTD performance of Price versus 2023 Earnings Forecast



Source: Bloomberg, MIDFR (G696)

Preliminary FBM KLCI end-2023 target at 1,700 points or PER23 of 14.8x. Having said the above, we believe the market would attach a downside risk to prevailing earnings forecast for 2023 as, despite the increasingly bearish world's macro expectations, the earnings forecast remains unwavering since the beginning of this year. Hence, we can expect market valuation to stay below the norm to account for the downside risk to forecasted earnings. Based on the prevailing earnings forecast, we introduce our preliminary FBM KLCI end-2023 target at 1,700 points or PER23 of 14.8x.

E. SECTOR OUTLOOK

AUTOMOTIVE

Firing on all cylinders..... Maintain POSITIVE

Strong 3Q22, but 4Q22 TIV could temporarily weaken from buyers opting for new year registration. We anticipate strong 3Q22 TIV, comparable to 2Q22 on a pick-up in production and recovery in component supply. However, we believe 4Q22 TIV could weaken sequentially as buyers might opt to push out registrations to the new year, therefore bumping up numbers in Jan-Feb23' instead. For now, we stick to our 607K CY22F TIV (+19%yoy), but we see some upside risk should the better-than-expected supply condition sustain, or should buyers stick to their original delivery plans.

Mixed outlook on cost. Separately, we expect underlying cost pressures to start easing in line with easing metal commodity price trends (e.g., iron ore, steel, aluminium) since early-to-mid 2022. However, we see higher forex risk in 3Q-4Q22 given the strengthening USD. This may pressure margins of players exposed to USD imports (i.e., Tan Chong Motor and UMW Holdings) in the near-term. Of the two, Tan Chong's exposure to the USD is more concentrated whereas UMW's exposure is diluted given earnings contribution from Perodua (which is highly localised), as well as earnings contribution from the equipment and manufacturing & engineering divisions. In contrast, players exposed to JPY imports (i.e., Bermaz Auto) should benefit from the weaker JPY trend.

No steep fall-off post-tax holiday, strong revenue visibility. At this point, we see little issue on the demand side. Key players are currently sitting on 7-12 months outstanding bookings which will last them well into CY23. Given that the new bookings continue to pour in (albeit circa 20% lower than during the tax-holiday) despite the end of the tax holiday on 30th June 2022, the order backlog carried from end-June is unlikely to subside significantly heading into CY23. This strong order backlog provides the sector with strong revenue visibility in the near-term. Furthermore, we gather that cancellation rate is insignificant so far with Perodua (being the largest player at the lowest price points in the market) indicating that cancellation rate for its customers is a mere 1%. Having said that, coming off a normalised base in CY22 and capped by production limits, we anticipate CY23F TIV to grow at a more moderate rate of 2%-4%yoy (vs. the +19%yoy growth expected for CY22F). For clarity, CY22's strong growth reflects production normalisation off a lockdown-impacted CY21.

Macro indicators looking positive in CY23. Positive macro indicators should further underpin the demand outlook. Based on our economics team's projection, GDP is expected to expand further by +4.2% in CY23 after a projected +6.6% growth in CY22. Meanwhile, inflation rate is expected to normalise at 2% from 2.8% in CY22, while unemployment rate is expected to improve further from 3.8% in CY22 to 3.6% in CY23. OPR is expected to remain in check at 3% in CY23 (from 2.75% end-CY22), which merely reflects a normalisation in the interest rate cycle back to pre-pandemic levels of 3.25% in line with the recovery economy.

Inventory levels remain low. Following almost two years of chip and component supply constraint, coupled with a strong rebound in demand, inventory levels remain very low in the industry. Our checks suggest players are on average sitting on circa 1 month of inventory (vs. the usual 3 months), which should reduce the risk of price competition/discounting. Meanwhile, the used car market is still seeing solid demand with double-digit growth projected for CY22-24 by the Federation of Motor and Credit Companies Association of Malaysia, which suggests trade-in values should remain favourable for new car buyers.

We remain POSITIVE on the auto sector premised on: (1) Strong revenue visibility underpinned by a large order backlog, (2) Gradual recovery in chip and component supply, (3) Easing underlying cost pressures from easing commodity prices, (4) Depressed sector valuation at 30%-40% below mean, (5) Sustained recovery in income and employment conditions, (6) Players are sitting on large net cash piles which suggests attractive dividend payouts. **BAuto (BUY, TP: RM2.36), MBM Resources (BUY, TP; RM4.28)** and **UMW (BUY, TP: RM4.88)** are our top sector picks. Key risks to our call are a worse than expected supply chain disruption, a prolonged spike in inflation and a weaker Ringgit.

BANKING

Still optimistic.....Maintain POSITIVE

Net interest margin (NIM) skewed towards the positive... NIMs have several core drivers, the most notable being OPR hikes. The lagged repricing of FDs coupled with the instantaneous repricing of variable rates push asset yields much faster than cost of funds, leading to improvements in NIM. Our internal forecasts include two further OPR hikes in the next 6 months. So far, most banks under our coverage (except for HL Bank and Bank Islam) have seen notable leaps in quarterly NIM in a sequential quarter basis.

Banking NIMs are also supported by the unwinding of modification losses, following the mass graduation of repayment assistance (RA) loans. As borrowers exit their restructuring programmes, they will be placed under a watchlist for over a year – if the bank becomes satisfied with the borrower's repayment ability, then they will unwind the modification loss for that loan. Note, however, the variability of quarterly unwinding volumes due to varied repayment schedules and the repayment capability of said borrowers.

...despite headwinds. The central concern to NIMs is deposit competition. Banks have already reported pockets of competition in the last results season, with a few (most notably HL Bank) opting to lock in long-term FDs since the beginning of CY22. With rising Loan/Deposit ratios, expect a continuing trend to support the sector's high loan growth appetite.

Another area of concern is the SME space, which has seen highly competitive take-up rates recently. Industry approval rates have come up to >45% in recent months, which is well above pre-pandemic range of ~35%. We remain slightly mindful of the aggressive growth in this place, given certain pockets in the SME loan space are vulnerable to lapses in loan health (evident especially in newly graduated RA loans).

We do note that sticky CASA deposits have contributed to impressive NIM growth, with banks across the board registering lower CASA growth rates as opposed to outright contractions. However, we worry that further OPR hikes may exacerbate CASA rundown in individual banks, leaving NIMs more vulnerable for contraction. We especially worry for banks with a higher CASA-to-deposits ratio (namely ABMB, CIMB and Maybank).

Strong loan growth figures expected to persist. Banks under our coverage have posted an impressive average domestic loan growth of +7.0%yoy in 2QCY22. Moving forward, loan growth numbers continue to look promising as banks recover their risk appetites, spurred by the reopening of international borders and further support for EPF withdrawals in 2QCY22.

Several banks have guided for the strong loan growth to persist throughout the year, with corporate customers expected to take center stage in the coming months. This is due to the reduced corporate funding in 1HCY22, given the volatile bond yields. As a result, we have revised our loan growth guidance for the year from 4.5-5.0% to ***5.7-6.0%*** in CY22.

We are especially positive on banks with sizeable loan exposure to foreign markets, most notably the liquidity-rich Indonesia. These include Maybank, CIMB, Hong Leong Bank and RHB. These banks have posted even more impressive loan growth figures than local-centric counterparts. Indeed, the average loan growth (incl. foreign exposures) is an even higher +7.4%yoy in the same time span. CIMB particularly is looking to see the most improvement as the loan book restructuring exercises in its regional markets have come close to an end, reducing loan contraction pressure in these segments.

Asset quality and provisioning trends are a bit harder to discern, but signs still optimistic. As expected, RA loan further improved on a sequential quarter basis in the recent results season. Most banks saw increased irritation in impaired loan segments, more so in the SME and corporate segments than in retail. While signs point towards no major asset quality deterioration (with several banks reducing their credit cost forecasts for the year), it is difficult to gauge the situation fully, with borrowers still in the process of exiting their restructuring programmes.

Outlook still positive. The banking sector's core pull are solid topline improvements and high dividend yields (>4%). While the brunt of improvement should stem from net interest income end, NOII should also see some lift from stronger fee income contributions. Asset quality and provisioning trends seem similarly optimistic for now. There are headwinds in

the form of normalizing operational costs and still-volatile trading and investment incomes, but we believe these are outweighed by the positives.

Top pick #1: CIMB (BUY, TP: 6.16). CIMB has several upsides: (1) As a proxy to the lucrative, liquidity-rich Indonesian markets (a pipeline of high-quality corporate loans is still expected in 2HFY22, (2) Removal of loan contraction pressure following the plateauing of Thai and Indonesian commercial loan restructuring, (3) One of the better local banks, ESG-wise, and (4) Decent dividend yield of 4.8% (assuming a payout ratio of 50%).

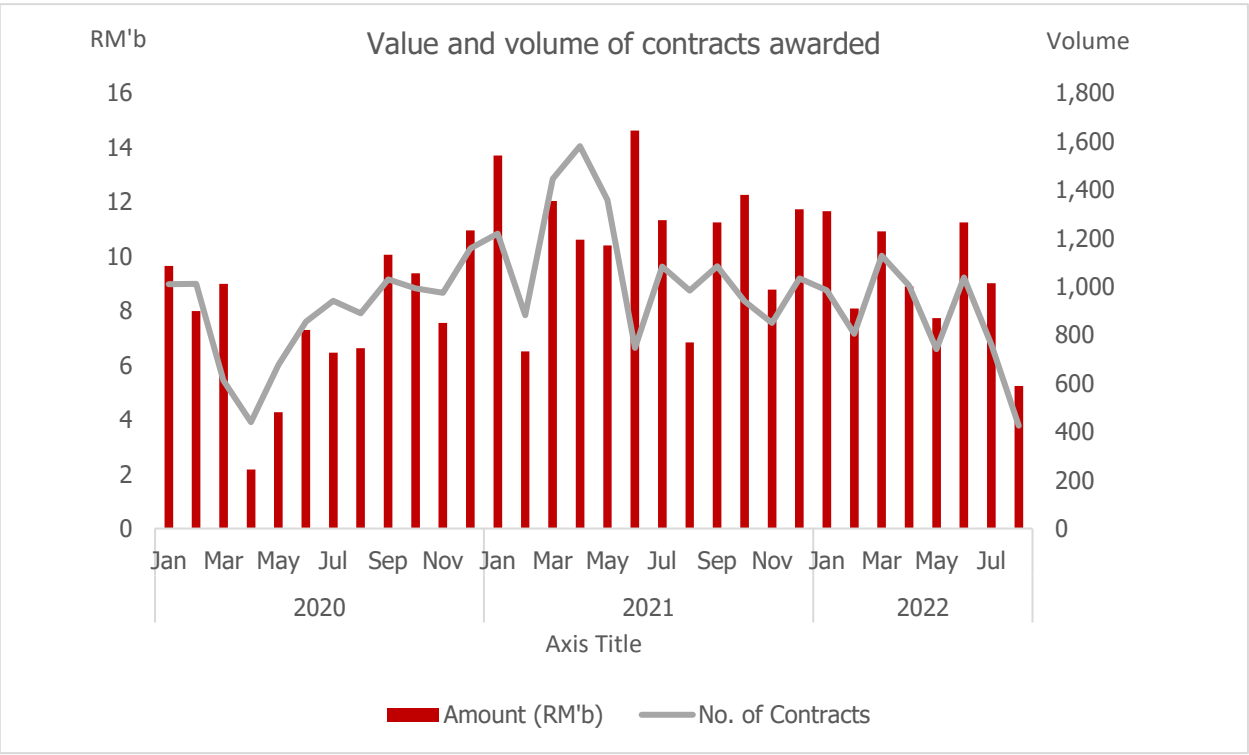
Top pick #2: Maybank (BUY, TP: 10.41). Maybank's upsides include: (1) High dividend payout ratio of 85% translating to leading FY22 dividend yield of 6.6%, (2) Regional ESG leader, (3) Strong loan growth in foreign segments expected to continue boosting loan growth, (4) FD paring exercises in foreign segments should result in lower cost of funds in coming quarters.

CONSTRUCTION

Cautious project rollouts.....Maintain POSITIVE

MRT3 to set the tone. The construction sector will be rather muted in terms of job flows for 4QCY22 in our view, as we believe that both civil and private jobs are being held back currently due to the uncertainties in the global economy and Malaysia's political scene, with an impending general election. This is on top of the raw material costs which still remain elevated despite the softening of some prices since July and high labour costs due to insufficient foreign labour. In Aug-22, only 425 domestic projects were awarded, worth RM5.24b, according to data from CIDB. This was a -23.3% decrease as compared to Aug-21. Year-to-date, a total of 6,883 contracts have been awarded, which were worth RM72.77b. Compared to the corresponding period last year, the magnitude of jobs awarded have declined -15.4%. Nevertheless, we would expect the awarding of the RM31b MRT3 tenders, likely in November or December, to kick things up a notch for FY23 onwards, on top of the infrastructure jobs that will potentially be announced during the tabling Budget 2023.

Chart 20: Value and volume of contracts awarded



Source: CIDB, MIDFR

Pick up in activities. As the economy has been allowed to resume in full force with the lifting of Covid-related restrictions, most businesses have been recording pick up in activities. The construction sector in particular, posted its first

GDP rebound into the positive region by +2.4%yoy in 2QCY22, after three consecutive quarters of contraction, on the back of higher value of work done at RM29.9b, a growth of +6.1%yoy. The bulk of work done was from civil engineering works (36.6%), non-residential building (31.4%), residential building (23%) and special trade activities (9%). We expect construction activities to remain strong for the remaining of 2022 as contractors strive to make up for progress loss on critical projects when restrictions were in place, which will see contractors recording higher progress billings. Our economics team forecasted a growth of +1.5% for the construction sector GDP in CY22.

Short-term pain. We are holding on to our view that the headwinds in terms of raw material costs and insufficient foreign labour are only short-term pains that would improve moving forward. The average prices of steel bars for example, have started to soften since Jul-22. Recall that average steel bar prices rose for 19 consecutive months from RM2,737.87 per tonne in Dec-20 to its peak of RM3,901.81 per tonne in Jun-22. The prices have since started to come off, last recorded at RM3,802.37 per tonne in Aug-22, based on DOSM's figures. Cement prices remained firm, last recorded at RM21.04 per 50kg bag. Though still at elevated levels, we view that raw material prices have peaked in June/July and are now starting to soften, which would allow margins to improve slightly in 4QCY22. As for labour costs, some contractors may incur higher labour costs by paying more for critical projects. We too, expect this situation to improve moving forward, as construction is among the sectors that are allowed to hire from all 15 permitted source countries.

A Budget reliant year. The upcoming tabling of the Budget 2023 is expected to play a huge role in determining the tone of the construction sector in CY23. Given that this will be seen as an election budget, we can expect several initiatives that will be Rakyat friendly and boosting economic recovery. We would think there is a slight change of mega infrastructure projects being announced given the Government's stretched finances and even if there is, it will be on a PFI or PPP basis. Among priority projects are flood mitigation projects and roads in Sarawak. Recall that Sarawak needs about 7,530km of new roads needs to be built to connect all rural areas while 3,487km of roads must be upgraded or rehabilitated. We also expect further clarity on road and highway projects, such as the Petaling Jaya Dispersal Elevated Highway (PJD Link), the Bangi-Putrajaya Expressway (BPE) and the Kuala Lumpur Northern Dispersal Expressway (KL Node), which was given approval in principle by the Government. We can also expect assistance to contractors in the form of an extension of the variation of price (VOP) mechanism to assist them in absorbing the higher building material costs incurred.

Softening prices. As building material prices are expected to soften, we can expect more private and smaller civil jobs to be rolled out in CY23, while the MRT3 keeps the main and sub-contractors busy. We would not expect any mega infrastructure projects that would overshadow the MRT3 for now. Even if there is any that would come within a fraction of MRT3's size of RM31b, it would be a huge plus for the industry. Contractors with larger appetites are expected to continue hunting for projects overseas to replenish their order books.

Maintain positive. Despite the headwinds in terms of raw material costs, shortage of foreign labour and the low number of jobs currently, our optimism stems from the upcoming award of the MRT3 tenders by the end of 2022 and the upcoming developments and projects that will be announced in Budget 2023. This would rejuvenate the construction sector in our view. Prospects are also looking good in Sarawak with positive job flows expected, especially due to its RM100b capital injection by 2030. Our preference in the sector are still the big boys with stronger balance sheets for now as they have deep pockets to take on infrastructure projects on a private finance initiatives (PFIs) public private partnership (PPPs), given the Government's stretched coffers and also contractors with good exposure overseas as a means of diversification. Our top picks are **Gamuda (BUY, TP: RM4.71), IJM Corp (BUY, TP: RM2.18) and Sunway Construction (BUY, TP: RM1.87).** These three are also the potential front runners of the main MRT3 packages.

CONSUMER

Cautiously optimistic..... Maintain POSITIVE

Flattening raw material costs in 4QCY22 backed by a recent decline in global commodity prices. Due to the significant shock to commodities markets caused by the Russia-Ukraine crisis, all consumer companies under our coverage recorded a substantial increase in the cost of raw materials. This was further dragged by the devaluation of the RM against the USD, which brought the price of raw materials higher as most raw materials are traded in US dollars. Department of Statistic Malaysia (DOSM) stated that Aug-22's food inflation continued to soar to a new record high of +7.2%yoy, in part

owing to the depreciation of RM (-5.5%yoy) amid the rate hike in the US. On a positive note, we noticed monthly basis for the food inflation data was already showing signs of moderation in Aug-22 at +0.3%mom (vs. June 22 at +1.2%mom and July 22 at 0.7%mom). This was consistent with the continued decline in the price of global agricultural commodities (Exhibits 2–6), and the easing of both local and regional supply chain disruptions. Our in-house economist projects headline CPI inflation to be 3.0%yoy in CY22 and 2.3%yoy in CY23. Going forward, we anticipate that 4QCY22's raw material costs were mostly stable compared to 2QCY22 and 3QCY22 due to a modest decrease in the price of global commodities.

Manageable energy costs ahead. Currently, Malaysia's thermal power plants produce electricity using conventional fuels like coal and natural gas. In 1QCY22, natural gas accounted for around 39.1% of Malaysia's total primary energy supply. Based on U.S. Energy Information Administration (EIA), the Henry Hub spot price for August was $8.80/m British thermal units (MMBtu), up from $7.28/MMBtu in July. The increased price in August was primarily due to the ongoing high demand for natural gas in the electric power industry. Moving forward, EIA expects the Henry Hub price to average around $9/MMBtu in 4Q22 before dropping to an average of roughly $6/MMBtu in CY23 as U.S. natural gas production rises. We could foresee an increase in the power tariff to meet the expense of sustaining the ICPT (imbalance cost pass-through) going forward as natural gas prices continue to rise globally. Since consumer manufacturing businesses are the biggest consumers of energy, rising electricity prices are exerting pressure on product pricing. According to our assessment, the growing cost of energy was still manageable because it only represented an average of around 3-4% of the overall production expenses for businesses in the consumer sector.

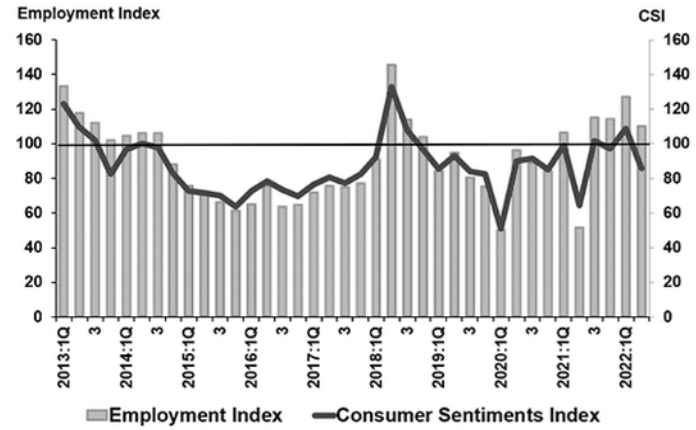
Ability to pass on costs varies among consumer companies. The cost of production should fully reflect the raise in the minimum wage to RM1,500 (from RM1,200) from 3QCY22 onwards. The companies under our coverage experience varying degrees of effect from the higher energy and labor expenses. This is depending on its capacity to manage or transfer the increased costs to the consumer by raising the selling prices in progressive increments while maintaining the sales volume. Due to sticky demand, consumer staples within our coverage, especially **F&N (BUY, TP: RM29.70)**, **QL Resources (BUY, RM5.62)**, and **NESTLE (NEUTRAL, TP: RM141.50)** have a stronger capacity to pass on the cost to the customer through price adjustment. However, **Leong Hup International (NEUTRAL, TP: RM0.47)** is vulnerable to a cost hike. This is mostly because of the ceiling price control in Malaysia for eggs and chicken which restricted its pricing ability. Consumer discretionary, on the other hand, has very little room to pass on the cost since any price change might weaken demand, which would lead to fewer sales for the companies.

Consumer demand for staples remain intact. Consumer demand for staples remains intact ahead. MIER's recent report noted that consumers are becoming more cautious about purchasing durable goods. Although the overnight policy rate (OPR) is on the upswing, it is still below the pre-pandemic level of 3.0%, so we think it will have little impact on domestic expenditure in the near term. Our in-house economists expect an OPR rate of 2.75% at the end of CY22 and 3.0% in CY23F. We anticipate that when the OPR rate rises over 3.0%, it will start to affect low-income and/or consumer groups with mortgage debt. Then, we may anticipate a decline in consumer spending as a result of increased borrowing costs that reduce consumer disposable income, particularly discretionary. Meanwhile, the consumer demand for staple goods remains inelastic.

Maintain POSITIVE with caution. We remain positive in 4QCY22 supported by the: (1) improving labor market, (2) stable commodity prices, (3) improved business activities following the reopening of the economy, (4) upcoming festive season, and (5) an increase in the minimum wage that could provide a cushion against rising inflation. Our positive calls remain selective with **QL Resources (BUY, TP: RM5.62)** as our top pick. We prefer QL because of its diversified revenue base across four divisions, protecting it from any downside risk. We also favor **F&N (BUY, RM29.70)** for its consistent product innovation to satisfy consumer demand and taste as well as the recent proposed acquisition of lading Permai Damai and Cocoaland (which could support its future earnings growth). We have a BUY for **AEON (BUY, TP: RM1.87)** due to its seamless adoption of the online-merge-offline (OMO) strategy. We remain cautious of **Panasonic Manufacturing Malaysia's (SELL, RM21.20)** earnings risk owing to its discretionary nature given customers are turning caution toward discretionary purchases underneath the rising cost of living and interest rate.

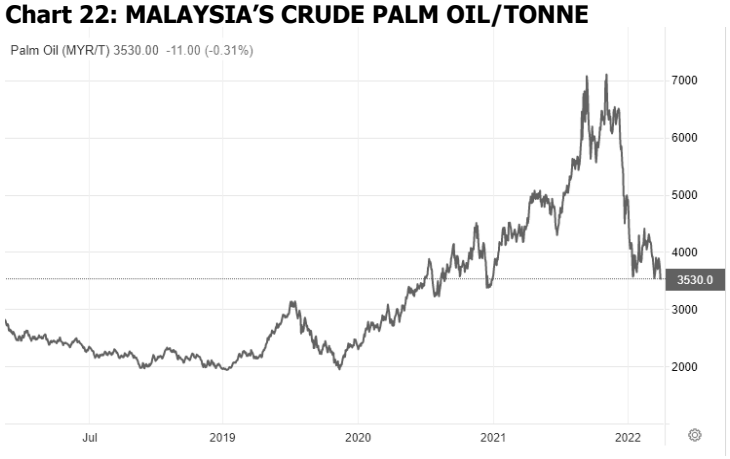
Downside risks are: (i) further decline in raw material costs, and (ii) weaker-than-expected consumer sentiments for both staple and discretionary products.

Chart 21: 2Q22's CONSUMER SENTIMENTS INDEX



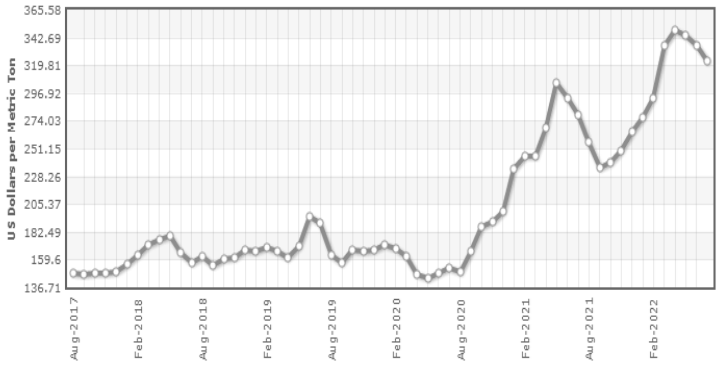
Source: MIER

Chart 22: MALAYSIA'S CRUDE PALM OIL/TONNE



Source: Trading economics

Chart 23: CORN MONTHLY PRICES (USD/mt)



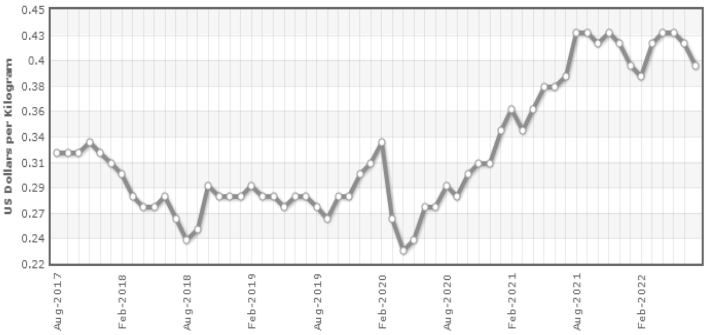
Source: Indexmundi

Chart 24: WHEAT MONTHLY PRICES (USD/mt)



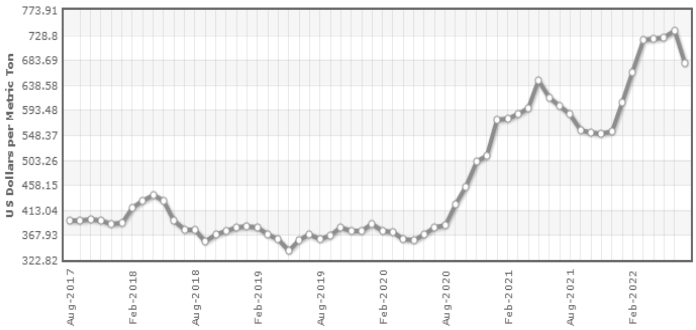
Source: Indexmundi

Chart 25: SUGAR MONTHLY PRICES (USD/kg)



Source: Indexmundi

Chart 26: SOYBEAN MONTHLY PRICES (USD/mt)



Source: Indexmundi

Table 6: VALUATION MATRIX

Name	Recc.	Price @ 27/9	TP	Upside (%)	Mkt Cap (RM'm)	PER (x)	EPS (sen)		Div.Yield (%)		Cash/Mkt Cap	Gearing
							CY22	CY23	CY22	CY23		
Consumer staples:												
Fraser & Neave Holdings	BUY	RM21.56	RM29.70	37.8%	7907.7	20.1	107.4	121.3	2.8	3.1	7.0	2.3
Nestle Malaysia	NEUTRAL	RM130.00	RM141.50	8.8%	30485.0	43.8	296.5	314.6	2.3	2.4	0.0	88.2
Leong Hup International	NEUTRAL	RM0.47	RM0.47	1.1%	1697.3	14.5	3.2	2.8	1.9	1.7	45.1	139.7
QL Resources	BUY	RM5.05	RM5.62	11.3%	12290.0	15.1	33.4	15.4	3.8	1.9	3.9	56.6
Spritzer	BUY	RM1.98	RM2.57	29.8%	414.5	5.9	33.4	15.4	9.8	4.7	25.9	1.3
Hup Seng Industries	BUY	RM0.69	RM0.79	14.5%	552.0	2.1	33.4	15.4	28.1	13.6	12.1	0.4
Simple mean						**16.9**	**84.5**	**80.8**	**8.1**	**4.6**	**15.7**	**48.1**
Weighted Avg.						**32.0**	**193.8**	**201.7**	**3.0**	**2.5**	**3.7**	**68.3**
Consumer discretionary:												
Aeon Co M	BUY	RM1.42	RM1.87	31.7%	1993.7	14.5	9.8	10.7	3.9	4.3	33.9	160.3
Padini Holdings	NEUTRAL	RM3.13	RM3.00	-4.2%	2059.3	19.8	15.8	20.3	2.0	2.9	34.9	43.9
Asia File Corp	BUY	RM1.70	RM1.96	15.3%	331.1	7.2	23.7	24.7	1.4	1.4	35.9	1.0
Panasonic Manufacturing Malaysia	SELL	RM23.20	RM21.20	-8.6%	1409.3	28.8	80.5	110.5	3.2	4.3	36.9	0.0
Simple mean						**17.6**	**32.4**	**41.6**	**2.6**	**3.2**	**35.4**	**51.3**
Weighted Avg.						**19.5**	**29.9**	**39.2**	**2.9**	**3.6**	**35.1**	**70.8**

Source: MIDFR, Bloomberg

GLOVE

Dire outlook.....Maintain NEUTRAL

ASPs continue to decline. The average selling prices (ASPs) of gloves have been dropping since the end of CY21. The downtrend is primarily due to an oversupply situation in the industry amid intense competition from China and aggressive capacity expansion by existing and newcomers during the pandemic. This was further impacted by the major buyer's lower purchases amid overstocking activities during the pandemic and the subsequent inventory adjustment after entering the endemic phase. Though the ASP's decline has slowed in the most recent quarter compared to the two before it, we remained cautious that the ASP may have reached pre-pandemic levels of USD20–25/1000 pieces before the uneven demand-supply dynamics returned to normal. We think that **Top Glove (SELL, TP: RM0.54)**'s recent increased in the average selling prices (ASP) for Oct-22 does not signify an improvement in ASPs due to the industry's continued supply-demand mismatches. We reckon that any potential price adjustments in the near term are likewise likely to be minimal. If that does happen, it would largely be used to disperse the greater expenses. Looking forward, we expect the falling trend to continue in CY23 until supply and demand are balanced. Local glovemakers continue to be impacted by the intense competition from Chinese glovemakers. Given that Chinese glovemakers are now offering nitrile gloves for less than USD20/1000 pieces while Malaysian glove makers are still selling above USD20/1000 pieces. The extraordinarily low prices (selling at a loss of USD16/1000pieces) from glovemakers that are departing the market further lowered the ASPs.

Reduced total production to curb oversupply of gloves. The major glove producers reduce their overall production capacity and postpone capacity development plans to reduce the current surplus issue. As a result, all companies under our coverage guided a flattish capacity growth for CY22. Malaysian Rubber Glove Manufacturers Association (Margma) expects the global demand for rubber at nearly 399 billion pieces for CY22 with the expectation that the supply-demand balance for gloves would be reached in the next 6 to 9 months. This is supported by the depletion of inventory in the pipeline which will bring about a normal equilibrium between production capacity utilization and global demand. However, we are aware that it may take a bit longer than for the supply-demand equilibrium to return to normal. Given that the current industry average utilization rate is below 50%, which is significantly lower than the pre-pandemic level of 85% and during the pandemic level of 80%.

Maintain **NEUTRAL** mainly due to: (i) declining ASP, (ii) a decrease in consumer demand, (iii) production capacity utilization rate remaining low at below 50%, and (iv) greater production costs brought on by increases in the minimum wage and natural gas prices. Our NEUTRAl call on **Hartalega (NEUTRAL, TP: RM2.58)** and **Kossan Rubber Industries (NEUTRAL, TP: RM1.28)** is supported by their respective net cash positions of 43.2% and 100.2% of market capitalization. We also prefer Hartalega for its higher utilization rate of 70%, which is far above the industry average of 50%. **Upside risk** are: (i) industry consolidation due to the recent declines in share price leading to a cheap

valuation, (ii) increasing demand as large buyers replenish their inventory, (iv) small players exiting the market, and (v) supply-demand equilibrium.

Table 7: VALUATION MATRIX

Name	Recc.	Price @ 27/9	TP	Upside (%)	Mkt Cap (RM'm)	PER (x)	EPS (sen)		Div.Yield (%)		Cash/ Mkt Cap	Gearing
							CY22	CY23	CY22	CY23		
Hartalega Holdings Bhd	NEUTRAL	RM1.61	RM2.58	60.2%	5,502.2	4.8	33.4	15.4	12.0	5.8	43.2	4.4
Kossan Rubber Industries Bhd	NEUTRAL	RM1.00	RM1.28	28.0%	2,551.6	9.0	11.1	11.1	4.0	4.0	100.2	9.9
Supermax Corp Bhd	SELL	RM0.67	RM0.65	-2.3%	1,758.9	3.8	17.5	9.0	2.6	1.4	172.4	13.2
Top Glove Corp Bhd	SELL	RM0.61	RM0.54	-11.5%	4,884.5	20.6	3.0	3.4	2.3	2.7	19.5	8.5
Simple mean						**9.5**	**16.2**	**9.7**	**5.3**	**3.5**	**83.8**	**9.0**
Weighted Avg.						**10.7**	**17.5**	**9.9**	**6.3**	**3.9**	**60.7**	**7.8**

Source: MIDFR, Bloomberg

MEDIA

Outlook remains positive..... Maintain POSITIVE

15th General Election (GE15) a potential catalyst. It is essential to highlight that the GE15, which is speculated to be called on 4QCY22 or 1QCY23, is the potential catalyst for the industry. Historically, the time running up to an election typically would garner higher traditional media buys. In 2018, the government ministries and political parties spent RM671.0m on media buys which accounted for about 12% of the year's total adex of RM5.80b. Hence, we believe it would help both Media Prima Berhad (MPB) and Star Media Group Berhad (Star) since their conventional media operations make up a significant portion of their topline. The adex-based revenues of the media firms under our coverage have begun to rebound in parallel with the reopening of the economy. Consumers are likely to spend more, driving companies to promote aggressively across all media. However, we remain cautious for next year, as consumer spending may be reduced if economic activity slows.

Weaker home shopping in the last quarter. MPB and Astro home shopping arms, which are Wow Shop and Go Shop respectively have experienced slower sales growth, owing to consumers preferring brick-and-mortar stores when the lockdown was lifted. We believe that this pattern will be transitory, with people shifting to online purchasing since it is faster and easier than the conventional approach. We anticipate increasing contributions from these areas as consumers become less conservative with their purchasing, although we remain cautiously optimistic about its pace given the e-commerce marketplace's highly competitive nature. Growth in these areas will be strongly dependent on how effectively media organisations diversify their services and improve their multi-platform strategies in the future.

Outlook CY23. Overall, we retain our **POSITIVE** outlook on CY23 for the media business, based on adex recovery as consumer spending increases and the economy continues to open up. In CY23, the adex for conventional media, i.e. publishing and broadcasting, might be boosted by the GE15 stated above. In combination with the paradigm shift in consumer behaviour, we anticipate an increasing trajectory in the home shopping and digital categories. However, we need to remain cautious on home shopping segments as its more prone to have a negative impact if consumer tightens their spending due to the inflationary pressure. Moreover, given the media firms' robust cash balances, we do not rule out any prospective merger and acquisition (M&A) activities to accelerate the transformation process and capitalise on market possibilities. We favour **MPB (BUY, TP: RM0.71)** as the Group has a diverse business segment and is one of the conventional media companies that would get a positive effect from the GE15.

OIL & GAS

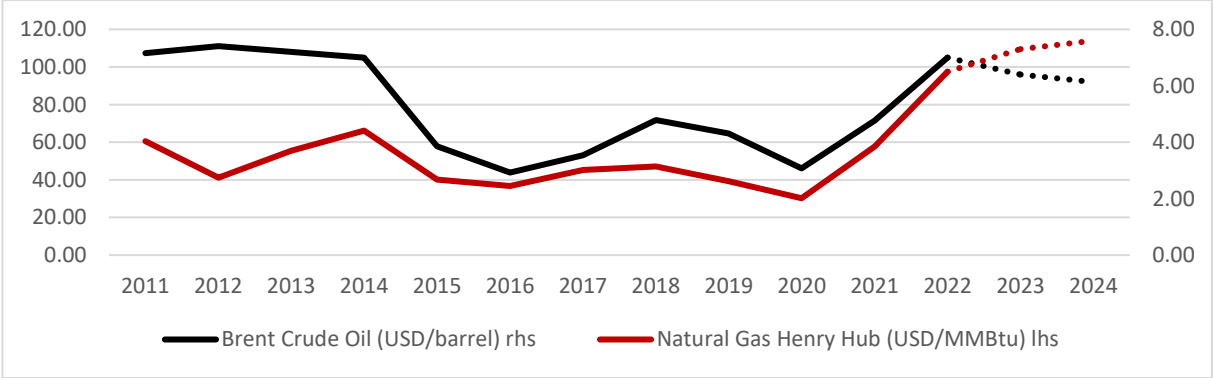
Expect production to ramp up..... Maintain POSITIVE

Supply shortage is expected to haunt the sector in the last months of 2022. OPEC+ had been plagued with shortfalls, with the latest in August amounting to a 3.9mbpd gap between quota to actual output. This is mainly due to an anticipated 2.4mbpd decline of Russian oil export once the energy embargo commences in December. Geopolitical tensions

in Europe, Middle East and East Asia, as well as divestments from fossil fuels in favour of a cleaner energy are expected to remain major risks to the movement of the oil and gas market. Meanwhile, demand for crude oil and natural gas is expected to recover on the back of laxed regulations over the Covid-19 pandemic as well as for the preparedness of the upcoming winter season. Hence, we expect production to ramp up on a global scale to make-do to the growing demand. We are also expecting Brent crude price to average USD98pb in 4QCY22. In consideration of all, we opine that 4QCY22 will continue to be a robust quarter for local oil and gas players, most notably for OGSE and freight, while shipyards and retail could be facing challenges on the uncertainty of a colder winter, regional geopolitical tensions and increasing inflation.

Peliminary 2023 outlook, generally, the sector is set to keep up with its resiliency. The shifting of the Covid-19 pandemic to small clustered endemic had regained the mobility of OGSE workers and reopened international borders, of which we believed will remain well into 2023. We forecasted Brent to average slightly lower to USD96pb in 2023, on the basis of demand recovery as well as a stabilized oil and gas supply. However, geopolitical tensions will continue to have a significant impact on the midstream, while a continuous interest rate hike will be a challenge to downstream operations. Meantime, energy transition will continue to be sought after in the name of energy security, albeit with a ballpark cost of USD1.5 trillion per annum.

CHART 27: Brent Crude Oil & Henry Hub Natural Gas (Forecast)



Source: Bloomberg, MIDFR

UPSTREAM

Exploration and production projects that are delayed due to Covid-19 lockdowns and strict regulations had begun commencing in 2022, and given that E&P operations take at least 3 years to commission commercial hydrocarbon from wells, we expect that the upstream will be resilient albeit the possibility of crude oil prices to be volatile between USD80-100pb due to ongoing geopolitical conflicts and tight global crude supply. OGSE companies is expected to be in high demand in tandem with improvement in drilling and well completion activities; subsequently increasing the support on material growth and pricing. The challenges to our local upstream, however, continue to be labour shortages and project divestments, as well as global inflation and supply chain disruption caused by increased raw material prices.

MIDSTREAM

LNG demand is expected to remain strong, with demand rising for Europe and Asia. As such, we believe freight demand for LNG carriers and FPSOs will increase in 2023. Storage farms for petroleum oil are also expected to improve in utilization, as crude oil prices are expected to stabilize in a pricing band higher than the oil and gas operations' optimum band of USD50-70pb. Meanwhile, services in the midstream operations is expected to allocate the capacity to raise prices in order to offset the cost of inflation, freight rates and taxes. Hydrocarbon price volatility remains to be the major risk to the midstream, with extreme weather and geopolitics to be a high uncertainty.

DOWNSTREAM

Retail and commercial fuel are expected to be in high demand, as domestic and international travels, and manufacturing operations continue to pick up. The petrochemical subindustry is also anticipated to remain robust in our local front, as Pengerang Integrated Complex – the primary hub for petrochemical in the region – commenced operations and is

forecasted to go fully online in 2023. Nevertheless, uncertainties remain, attributable by global inflation, regional geopolitical tensions and China's demand, particularly on petrochemicals.

MAINTAIN POSITIVE. Looking ahead to 2023, we opine that the strong world oil demand growth, along with the increase in non-OPEC supply, will continue to rebalance crude oil and natural gas prices, hence giving a generally positive outlook for the sector. Nevertheless, the downside to the forecast remains to be: (i) continuous lockdown impact on China's demand, (ii) global monetary tightening attributable to increasing inflation, (iii) unresolved geopolitical issues in Europe, Middle East and East Asia, and (iv) global supply tightening. Our TOP PICKS remained to be **Deleum (BUY, TP: RM0.98)** for Upstream, **Dialog Group (BUY, TP: RM3.96)** for Midstream and **Petronas Chemicals (BUY, TP: RM11.93)** for Downstream. We like these companies for their: (i) robust orderbook and balance sheet, (ii) resilient operations amid high crude oil price volatility and other uncertainties, (iii) strong business model and sustainability strategies, and (iv) healthy cashflows.

HEALTHCARE

Upsurge in inpatient visits..... Maintain POSITIVE

Hospitals globally had been seeing an upsurge in inpatient visits as well as an increased rate in surgeries, deliveries and specialized treatments. This is in tandem with the Covid-19 pandemic finally diffusing in most regions; allowing lockdowns to be lifted and movement and travels to be restored. Local and foreign patients had begun to flock in hospitals to received treatments that had been delayed or deterred due to the pandemic, including the return of medical tourism, and had since contributed to hospital profit since 1Q22. Meanwhile, pharmaceuticals had also seen a rise in demand for over-the-counter medicine on the back of consumer sentiments on the preparedness for communicable and seasonal diseases, as a precaution following the Covid-19 pandemic. In our local front, we are expecting the return of patients to continue to benefit both public and private healthcare sectors in 4Q22. Meanwhile, pharmaceuticals are expected to see a rebalance in supply and demand, as supply for OTC drugs, supplements and specialized medication are gradually replenished and restocked for both government and private subsectors.

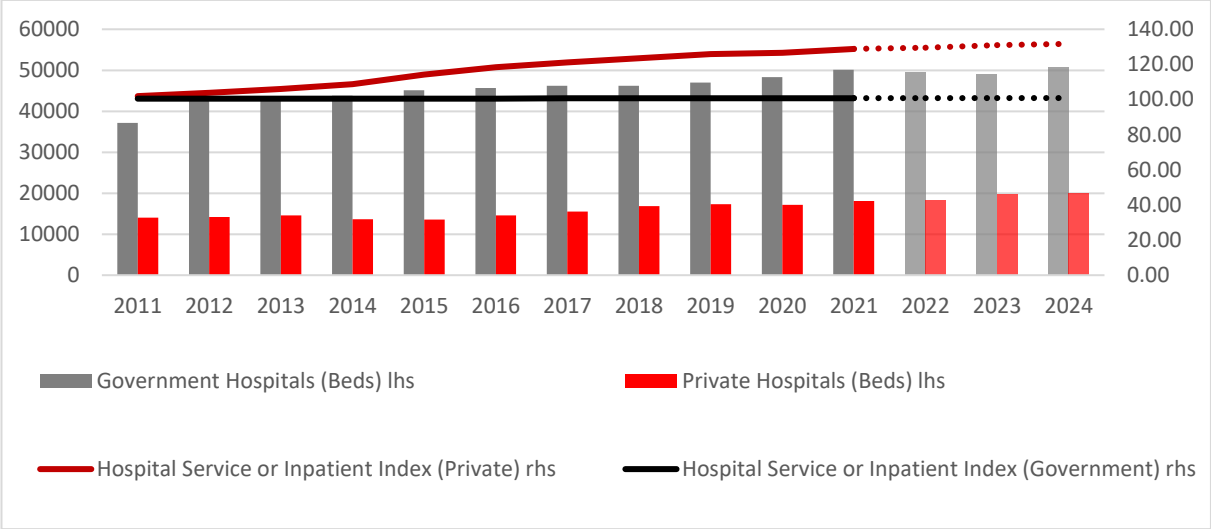
Preliminary 2023 outlook. With Covid-19 no longer an imminent threat to hospital operations, we opine that the hospital operations will be shifting towards treatments for non-communicable diseases (NCDs); more so with the increase in aging population in our local front. However, the turbulent market expected in 2023 will put the sector into pressure on finding revenue, most particularly for the medical devices and digital healthcare. It is estimated that healthcare software will cost to nearly USD9 billion, digital healthcare documentation to over USD2 billion and medical equipment with Artificial Intelligence (AI) and Internet of Things (IoTs) devices to increase to USD300 billion by 2025. The increase in interest rate hikes will also impact particularly on the admission into private healthcare systems and raw material supply for the manufacturing of pharmaceutical products. Additionally, the medical technology industry is expected to face challenges in fulfilling demand due to the persistent semiconductor shortages, which could render healthcare operations to either step backwards to older methods or devices, or spend more for alternative sources.

Nevertheless, we believe the sentiment on the healthcare sector will remain generally neutral coming into 2023, with a caution stance on sustainability issues regarding hospital equipment, as well as unforeseen local political and geopolitical risks that could disrupt the supply chain of medical care. Moreover, we are expecting that the local government to continue to upskill in equipment maintenance and increase in more readily accessible pharmaceutical products, under the guise of its relentless support on the local healthcare sector for the benefit of Malaysian citizens. We believe the support will continue into 2023.

Maintain POSITIVE. All in all, we maintain our positive stance on the healthcare sector, with deep caution on the disruptions that may occur due to: (i) interest rate hikes, (ii) semiconductor shortages, (iii) increasing labour cost, and (iv) continuous geopolitical tensions. We believe these risks, however, will be offset by the increasing demand for hospital treatments in line with the lessened severity of Covid-19 infections and increasing aging population, hence increasing rate of NCDs. On this note, our TOP PICK remains to be **IHH Healthcare (BUY, TP: RM7.96);** given the group's robust financial health forecasted on the strength of (i) returning inpatient visits to its hospitals and recovery of medical tourism,

(ii) continuous resiliency in its local and foreign businesses, and (iii) increasing demand for NCDs treatments in line with the endemic phase of Covid-19 and the increasing aging population.

CHART 28: Government and Private Hospital Beds and Inpatient Index (Forecast)



Source: Macrobond, MIDFR

PLANTATION

Look for efficiencies.....Maintain POSITIVE (with a downward bias)

No more supernormal earnings ahead. We estimate sector profitability to stabilise in 3Q through FY23, in parallel with CPO price reduction, as it appears that shaky CPO demand has now exceeded overall supply constraint quantum. The CPO price expected to trading sideways c. RM3,000/mt-RM4,500/Mt supported by price disparity between CPO against SBO price which is now around USD531 in July, which makes PO in competitive advantage. In addition, Malaysia's PO local productions are also recovering as shown in August MPOB data circa 2.1m Mt (+18.2%mom, +11.6%yoy and +8.2%ytd), and expected to continue healthier supported by gradual boots on the ground due to resolved in foreign labour issues which will boost manuring and upkeeping activities ahead.

Efficiencies are essential when operational costs rise. As European energy prices soar amidst on going Russia-Ukraine conflicts, this explains reasonably well the increase in NPK and other fertiliser prices. We expect that plantation companies will continue to incur high operational costs on the back of high fertilizer costs, but can be weather by prudent control over its fertiliser application and sourced from alternate supplier. As to-date, we observe average planter's production cost approximately RM2,000-RM2,500Mt, in which there still some margin can be fetch in our view.

Time to get selective. As we are in transitioning from **POSITIVE** to **NEUTRAL** call on CY23, we think it is time to take profit and minimize the risk of any shortfall in CPO prices ahead. Hence, we recommend investors to be more selective on stock selection and frontload stock's fundamental facing the headwinds (*Table 1 & 2*). Our selection stocks prioritized 1) high planted area (%), 2) fairly ideal average palm oil profile, 3) high FFB yield/mature and 4) high Oil Yield/ha. Our top picks owned sustainable EBITDA margin backed by high generation dividend yield. At the moment, any increase in price would give trading opportunities for plantation stocks, particularly those with a heavy reliance on CPO prices (Sarawak & Gen Plant).

Table 8: Operational Statistic

Companies	Planted Area		Immature		Mature		Average age (years)	FFB Yield /mature ha	Oil Yield/ha
	ha	%	ha	%	ha	%			
Sarawak Plant.	35,577	79	7,471	21	28,106	79	11.2	15.7	3.1
Sime Plant.	579,708	78	75,362	13	504,345	87	12.3	18.5	4.0
KLK	275,037	79	39,454	14	235,583	86	12.3	21.4	4.7
GenP	139,022	57	22,244	16	116,779	84	12.3	17.1	3.7
IOI	176,926	86	33,616	19	143,310	81	13.4	20.8	4.4

Source: Company, MIDFR

Table 9: Top Picks for 2H22-CY23

Companies	TP (RM)	Price (RM)	Mkt Cap (RM'm)	PER (x)		EBITDA margin (%)		Div Yield (%)	
		27-Sept 22		FY22	FY23	FY22	FY23	Y22	FY23
Sarawak Plant.	2.70	1.98	552.4	4.6	5.4	20.2	22.4	10.1	10.1
Sime Plant.	6.30	5.87	29,571.1	10.6	15.5	21.0	21.0	5.9	4.8
KLK	31.50	3.80	37,610.9	9.9	12.8	14.3	14.3	4.8	3.9
GenP	8.00	20.62	245,906.3	8.6	11.1	27.1	23.4	6.0	4.6
IOI	6.00	4.27	69,472.9	12.8	19.4	13.7	15.3	3.7	2.6
Sector			**383,113.5**	**9.3**	**12.8**	**19.3**	**19.3**	**6.1**	**5.2**

Source: Bloomberg, MIDFR

POWER

Upside capped, cost pressure persists.....Maintain NEUTRAL

Fuel prices remain elevated. While the price of most commodities has eased significantly off their peaks, energy commodity prices seem to be stickier and is expected to remain elevated moving into 4QCY22. Coal price had in fact hit a new record of USD460/MT in early-September given increased dependency on coal following the Russia-Ukraine war. The IEA sees coal consumption in Europe rising by 7% this year on top of last year's 14% surge with the continent now turning to seaborne coal from South Africa, Indonesia and Australia as it halts imports from Russia. The EU countries are also set to increase coal-based power production with Germany, Italy and Austria restarting offline plants to make up for natural gas shortages. Additionally demand from China has increased as record heatwaves dried rivers that produced hydro power.

Under-recovery to pick up further. The elevated fuel prices have resulted in Tenaga registering significant cost under-recovery. The group registered under-recovery of RM3.5b in 1QFY22 at coal price of USD166/MT, which increased further to RM6.3b as coal prices rose to USD221/MT in 2QFY22. Given a further significant rise in coal prices from 3QFY22, we expect under-recovery to balloon in 2HFY22. The continued strengthening of the USD against the Ringgit throughout the 2HFY22 further exacerbates the situation. The knock-on effect is a spike in Tenaga's receivables over the same period given a half-year lag in passing through the cost under-recovery to consumers, therefore negatively impacting operating cash flows. Tenaga has seen a gradual uptick in net gearing given increased short-term debt to finance elevated working capital needs. The ICPT pass-through that the Government has allowed and the amount committed to be subsidised by the Government so far only partially covers the under-recovery during the 1HFY22.

Players in the generation space and liberalised markets are better off. We stick to our opinion that generation players are better off in the current high fuel price environment given that fuel is a cost pass-through to the off-taker which is Tenaga. Players in this space include Ranhill Utilities (BUY, TP: RM0.67) and Malakoff (non-rated). Alternatively, players operating in liberalized electricity markets are also better able to pass through higher costs given the free-market nature of such electricity markets which allow for a better reflection of underlying cost in market prices compared to regulated markets. A play into liberalized electricity markets is YTL Power (BUY, TP: RM0.90), which operates in the

Singapore generation sector - the Singapore electricity market has seen spot electricity prices rise by 200%-300% since 4Q21 reflection higher fuel prices and tighter demand-supply.

Project resumption in the solar RE space. The Energy Commission recently approved a 4-year PPA extension (to 25 years) to winners of the LSS4 bidding cycle, which has seen project progress halted given rising material cost since the bids were placed in 3Q20. While the impact on project IRR is expected to be largely neutral (as the extension is meant to compensate for higher-than-expected capex while still maintaining the same levelized tariffs), the decision nonetheless, allows the LSS4 projects to resume progress. Commissioning of the LSS4 plants have also been extended to December 2023. This should be a near-term positive for the solar EPCC players and project owners. Separately, the Government has approved the allocation and redistribution of RE quota of 1200MW for solar resources towards implementation of programs under the existing mechanisms including NEDA and rooftop solar, as well as new methods such as solar park development, power supply to new data centers and green hydrogen generation. We expect more concrete details on this to be announced within 4Q22.

We remain NEUTRAL on the power sector; earnings are defensive in nature, but in a macro upcycle, upside potential is capped by regulatory revenue-caps while growth catalyst is lacking given an already large excess capacity in the system. Meanwhile significant cost under-recovery and a lag in ability to pass this through will constrain cash flows and dividend payout, in our opinion. In an environment of rising input cost for the power sector, we think players operating in liberalised markets or IPPs are safer bets. For the latter, fuel is cost pass-through to the offtaker with certainty in payment frequency, while players in the liberalised markets are better able to pass through higher costs given the free-market nature of such electricity markets. Our sector picks are **YTL Power (BUY, TP: RM0.90)** and **Ranhill Utilities (BUY, TP: RM0.67)**. Potential risk is (1) Aggressive carbon pricing rate introduction and the inability of players to pass this down to end-consumers, (2) A sharp fall in demand which would impact players in the liberalised electricity markets.

PROPERTY

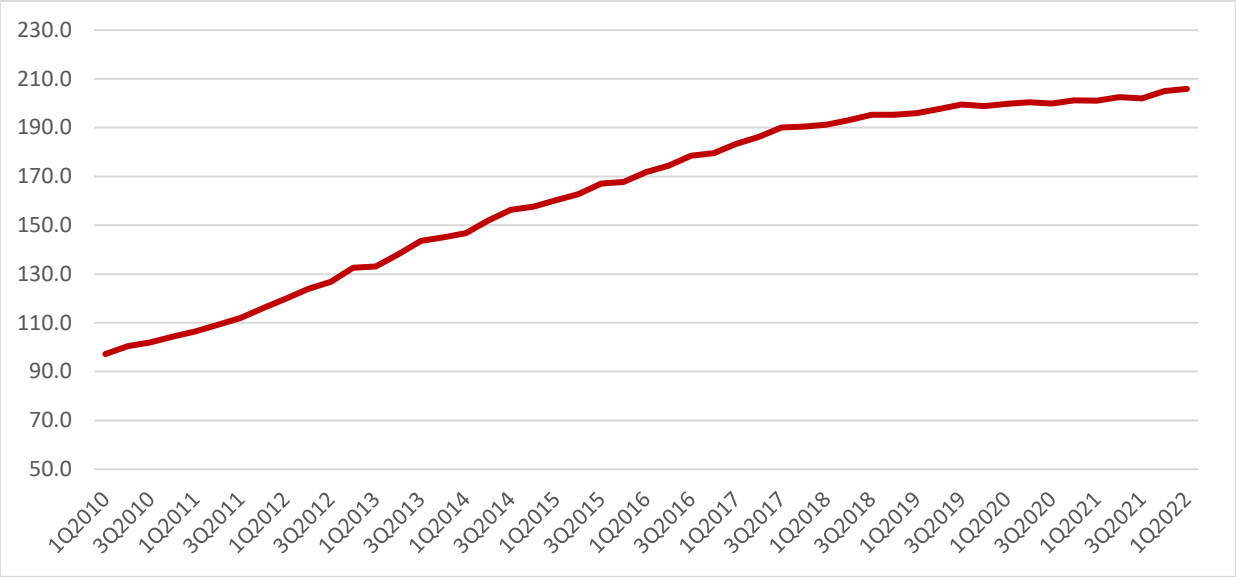
Flattish outlook .....Maintain NEUTRAL

New property sales momentum to sustain in 4QCY22. Most of the property companies reported new property sales that were largely in line with expectations in 2QCY22 as new sales momentum was supported by recovery in economic activities. Looking ahead, we expect new property sales momentum to sustain in 4QCY22 as economic activities continues to recover. Nevertheless, we do not expect strong momentum of recovery due to absence of strong catalyst to spur buying interest on properties. Besides, the hike in overnight policy rate (OPR) which increase house loan instalment and reduce buyer's affordability may partially drag buying interest.

Lingering labour issue and margin compression. Property companies have been facing issue of labour shortage which has dragged construction activities at project sites. That has negatively affected the progress billing of property companies. While we think that it may take a while to resolve labour shortage issue, we see that progress billing will still partially dragged by the lingering labour shortage issue. On the other hand, the rising raw material prices have stabilized. Nevertheless, we expect margin of property companies to be compressed slightly due to the higher raw material cost compared to a year ago.

Marginally better outlook for HPI in 2H22. According to data released by National Property Information Centre (NAPIC), House Price Index (HPI) up marginally to 205.9 in 1QCY22 from 205.0 in 4QCY21. The higher HPI could be attributed to the reopening of economic activities. Note that HPI experienced slight decline in 3QCY21 as economic activities were disrupted by Covid-19 pandemic. Looking ahead, we expect HPI should continue to recovery in 2HCY22 at a marginal pace due to normalizing economic activities and rising inflationary pressure.

Chart 29: House Price Index



Source: NAPIC, MIDF Research

Flattish outlook for CY23 with slight positive bias. Moving into CY23, we see new sales outlook to remain stable as we expect buying interest to stay supported by normalizing of economic activities. Nevertheless, we see lack of strong catalyst to spur buying interest for properties. Hence, we see neutral outlook for property companies in CY23. Having said that, we think that the potential reopening of more country borders in CY23 particularly China border may provide positive bias to the sector as we should see increase in foreign buyers.

Maintain NEUTRAL on property sector. Overall, we maintain our Neutral view on the sector for 4QCY22 and CY23 due to lack of strong catalyst to spur buying interest on properties. Besides, the lingering labour shortage issue and rising raw material cost are expected to lead to lower progress billing and slight margin compression to property companies as they may not able to fully pass on the rising cost to property buyers. Our top picks for the sector are **Mah Sing (BUY, TP: RM0.74)** and **IOI Properties Group (BUY, TP: RM1.29)**. We remain positive on Mah Sing due to its strategy of selling properties in the affordable price range. New sales outlook is also stable as new sales in 1HFY22 is well on track to hit new sales target of RM2b. We also positive on IOI Properties Group due to its better earnings outlook, driven mainly by investment properties division and turnaround of leisure & hospitality segments.

REITS

Recovery underway ..... Maintain POSITIVE

Stronger earnings in 4QCY22 on positive rental reversion and festive season. Retail REITs reported earnings recovery in 1HCY22 due to recovery in shopper footfall and significant lower rental assistance to tenants. Tenant sales improved and that led to rental reversion returned to positive territory. Looking ahead, we expect earnings of retail REITs to remain strong in 4QCY22 mainly due to positive rental reversion outlook. Besides, year-end shopping spree and holiday season should also support earnings of retail REITs in the form of higher turnover rents.

Hotel industry to spur by year-end holiday. Hotel industry is expected to stage a comeback in 4QCY22 as it should receive a boost from year-end holiday season and recovery of tourism sector. Hotel industry has been heavily reliant on tourism activities and will benefit from higher tourist arrivals. Besides, hotels should see higher banqueting sales as more functions such as wedding receptions are held in hotel. In this context, we expect REITs with exposure to hotel industry namely Sunway REIT and KLCCP Stapled Group to report improved earnings for hotel division in 4QCY22.

CY23 outlook remains positive. Outlook for REITs is expected to remain positive in CY23 as risk of another lockdown is low. As Malaysia is transitioning from Covid-19 pandemic to endemic, economic activities are expected to fully normalized in CY23 and that would support recovery of REITs. In addition, potential more country border reopening in CY23

particularly China is expected to benefit retail and hotel industry of Malaysia as that will lift tourist arrival significantly. In this context, we see REITs such as Pavilion REIT, KLCCP Stapled Group and Sunway REIT to benefit from higher tourist arrival in CY23 as their retail malls are tourist destinations.

Maintain POSTIVE on REITs. We maintain our Positive stance on REITs as we expect REITs especially retail REITs to continue post earnings recovery in 4QCY22 and CY23 due to improving shopper footfall and tenant sales. Our top picks for the sector are **IGB REIT (BUY, TP: RM1.78)** and **Sunway REIT (BUY, TP: RM1.68)** as we see earnings outlook to underpin by positive rental reversion outlook and good quality retail assets namely Mid Valley Megamall and Sunway Pyramid.

TELECOMMUNICATION

5G roll-out .....Maintain NEUTRAL

5G agreement is still up in the air. The Digital Nasional Berhad (DNB) and Ministry of Finance (MoF) are continuing to negotiate with the Mobile Network Operators (MNOs) for equity participation in DNB. The discussion seemed to be revolving around the deadline after multiple attempts to finalise the deal with the MNOs had failed. Malaysia's 5G agreements are expected to be finalised by 30 September, according to the Minister of Communication and Multimedia. To reiterate, U Mobile and Maxis declined to acquire an equity share in DNB, hence the Share Subscription Agreement (SSAs) would need to be revised again to accommodate only four MNOs; Telekom Malaysia (TM), YTL Communication (Yes), Digi, and Celcom. MNOs can still offer 5G access via a 5G access agreement which has a separate and independent track with the DNB stake's agreement.

JENDELA on track to achieve its target. In general, most of the telcos we cover saw an increase in subscribers and higher ARPU. Positive trends are being driven by the resumption of economic activity and the move to the endemic stage. We believe that this trend will continue till the end of the year. In addition, the Malaysian Communications and Multimedia Commission (MCMC) announced that JENDELA is on track to meet its Phase 1 goal by the end of the year. Up till 1HCY22, 7.2 million premises were fibre passed, representing 96% of the 7.5 million premises goal. Meanwhile, 4G coverage is presently 95.82%, fairly near to the aim of 96.9% 4G population coverage by the end of this year. Based on data from Ookla's speed test, MCMC has reported an average of 47.04Mbps (mean) in mobile 4G speeds, above its projected 35Mbps average speed. Malaysia presently has an average speed of 29.89Mbps based on the median estimate. Overall, we anticipate that solid 4G networks will provide a more seamless transition to next-generation 5G networks.

Outlook CY23. We think the government-mandated supply-driven SWN model might address the issue of cherry-picking more feasible places with better commercial or economic returns, bridging the urban-rural divide. The agreement on DNB equity stake and 5G access agreement may be finalised in CY22 and we expect that the MNOs would start to provide innovative solutions using the 5G technology to their customers in CY23. The SWN model should reduce service costs (price per GB) due to economies of scale and aid in the elimination of infrastructure duplication. MNOs will no longer be required to carry the enormous CAPEX cost of deploying 5G networks, with the emphasis shifting to service, quality of service (QoS), and product innovation. However, the uncertainty surrounding the equity stake and value in DNB for 5G rollout, Malaysia's slow 5G adoption rate due to a lack of 5G-compatible devices, an unready 5G ecosystem to accommodate mass commercial usage, and the sector's ongoing competitive cellular market environment posed downside risks to the sector at this point. As a result, we remain **NEUTRAL** on the sector, favouring our fixed-line player, **TM (BUY, TP:RM6.91)**, due to its extensive fibre infrastructure, robust demand for fixed broadband services, and a plethora of business opportunities under MyDigital Initiatives, and **Axiata (BUY, TP:RM4.59)** due to its regional exposure in the expanding market.

TECHNOLOGY

Long-term outlook is still intact..... Maintain POSITIVE

US CHIPS Act. The bill, which comprises about USD52b (RM231.5b) in subsidies and tax benefits for firms investing in semiconductor production in the United States, is intended to improve semiconductor supply security and competitiveness.

According to the Malaysia Semiconductor Industry Association (MSIA), the new bill will have no detrimental impact on Malaysia since the CHIPS Act is to encourage front-end fabs to be built in the United States. It is worth noting that the majority of Malaysian semiconductor enterprises are involved in chip assembly, packaging, and testing (back-end process). As a result, semiconductor assembly test factories and outsourced semiconductor assembly and test (OSAT) vendors who supply integrated circuit-packaging and test services would be the primary beneficiaries in Malaysia. Thus, we believe that the OSAT companies such as Inari Amerton Bhd, Unisem (M) Bhd and Globetronics Technology Bhd will benefit from the CHIPS Act. Furthermore, a slowdown in demand for televisions, laptops, and cell phones in 2023 is inevitable because customers already splurged on specific devices during the lockdown. However, demand for automotive and data centres remains high, supporting global information technology (IT) spending.

Moving towards digitalisation. The government's digital incentives, such as the RM200m allocated for the SME Digitalisation Grant Scheme, encourage SMEs to transition from traditional to online channels. As Malaysia seeks to focus, improve, and accelerate growth through increased automation and digitalization, we believe this ambition will benefit online service providers such as **MY E.G. Services Berhad (BUY, TP: RM1.23)**, whose bread and butter businesses, namely the road transport segment and immigration segment, along with its healthcare segment and current blockchain venture, have positioned the company to be the champion in any technological development. Furthermore, being the primary supplier of passports, it should auger well for **Datasonic Group Berhad (BUY, TP: RM0.57)** as borders are reopening. Moreover, Dson's income stream continues to diversify, particularly in the areas of digitization and payment support services.

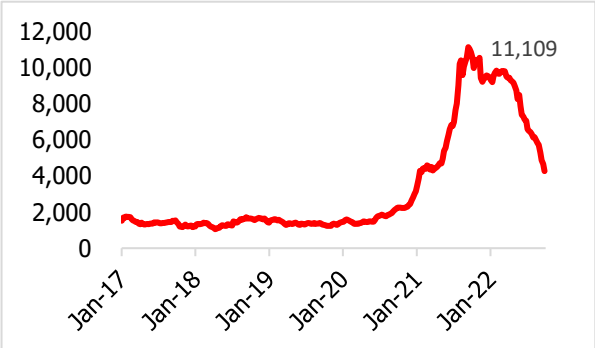
Outlook CY23. The advent of 5G technology, the increase in smartphone innovation, the emergence of digital solutions in business and the growing EV market will continue to propel the demand for semiconductors hence its outlook shall remain bright. All in all, we are maintaining our **POSITIVE** stance on the sector given, through innovation and invention, this sector continues to benefit from digital proliferation and is now integrated into all other sectors such as healthcare, financial, real estate, logistics and manufacturing. However, we opine that the slowdown in demand for televisions, laptops and cell phones will still be ongoing in CY23. However, demand for automotive, server and data centre are still solid at least up until next year. We continue to favour **DOGT (BUY, TP: RM4.58)**, one of the top 5 LED producers globally as the company is ideally positioned to benefit from the EV market's accelerating expansion. Due to its great product innovation, large client base, and increased LED consumption per car. We also prefer **Inari (BUY, TP: RM3.53)** because the Group's future as Malaysia's largest outsourced semiconductor assembly and test (OSAT) provider remains intact

TRANSPORTATION

Lacking catalyst.....Maintain NEUTRAL

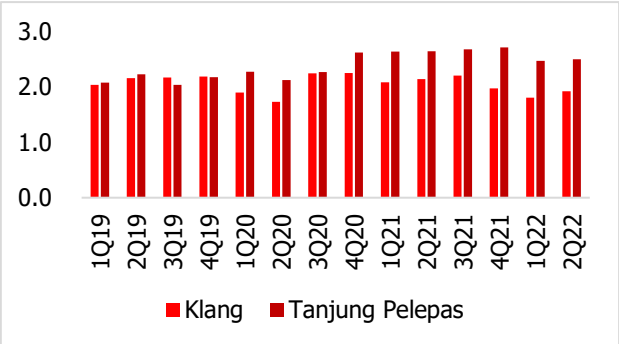
PORT & LOGISTICS

Chart 30: Freightos Baltic Index (USD/FEU)



Sources: Freightos & Bloomberg

Chart 31: Transshipment Container Volume (m TEU)



Source: Ministry of Transport

Ocean freight rates to continue moderating. As indicated by Freightos Baltic Index, ocean freight rates have begun normalising after peaking in mid-Sep-21 whereby year-to-date, it has retreated by -54.1%. The gradual normalisation in rates was thanks to some ease coming from improvements in port congestion, capacity and change in consumption patterns post-lockdowns. Despite during peak season for seaborne trade (Aug-Oct), the rates are still on a declining trend

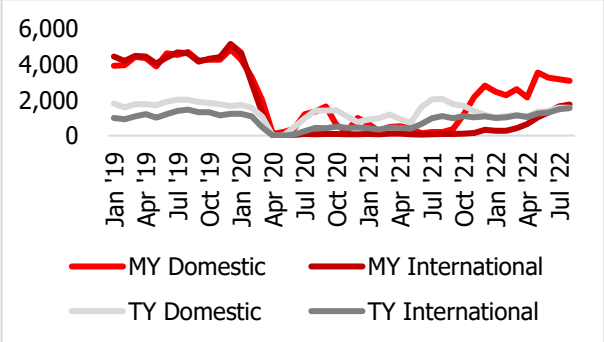
as cargo shippers have reportedly shipped holiday goods in advance. Ocean freight rates are currently hovering within the USD4,000-USD4,500 per FEU range, which are still about 3-4x higher than pre-pandemic levels. We expect shipping freight rates to continue declining going into CY23 as consumer demand moderates further, though they might remain elevated relative to pre-pandemic levels due to high fuel prices, amongst others. In the near-intermediate term, the rates could be pushed down further following the flurry of new vessel orders placed in the recent quarters which would soon be delivered.

Myriad of challenges for port operators. Container port throughput at the main transshipment ports saw a decline in 1HCY22 due to confluence of global supply chain challenges. **Westports' (BUY, RM4.00)** container throughput fell by -8.1%yoy during said period and we are expecting a full-year decline of -4.0%yoy in CY22, assuming a flat volume for 2HCY22. For CY23, we predict Westports' container volume to grow by +4.0%yoy from a low base this year, but we remain cautious on the bleak global economic outlook which might prompt exporters to be conservative in bulking up their volumes. We also remain wary of the prolonged lockdowns in China which could adversely impact Westports given that its transshipment volume mostly come from the region, with the Intra-Asia trade lane making up c.60% of its total throughput. Additionally, consumer demand might moderate further against a backdrop of high inflation, rising interest rates and depleting stimulus from the government. Nonetheless, we expect Westport to stage a rebound in earnings in CY23 due to the absence of Cukai Makmur. Key rerating catalyst would be the finalisation of the concession agreement for Westports 2, which is expected to be completed by 4QCY22 at the earliest.

Positive outlook for the logistics players. We are optimistic on the prospects of the logistics players under our coverage with **Swift (BUY, RM1.18)** and **Tasco (RM1.80)** as our top picks. We expect sustained growth in Tasco's throughput volume, supported by its well-diversified customer base as the economy continues to recover. As mentioned above, thought we expect freight rates to moderate, they are expected to remain high relative to pre-Covid levels and this would largely benefit Tasco's international business segment. On the other hand, Swift is among the key beneficiaries of healthy external trade and strong domestic economy largely due to its sizeable exposure in the container haulage business and its timely fleet expansion plan would enable it to capture the growth. With the continued shortage in warehousing space, most logistics players have been focusing on adding their capacity to leverage on more favourable rental rates for warehousing services. Swift's new and extended warehouses would increase its total warehouse capacity by +46% by end-CY22 and contribution from this segment is expected to meaningfully uplift its bottomline in the coming quarters. Likewise, we look forward to the construction of Tasco's 650,000 sq ft 4-storey warehouse under Phase 1 of the Shah Alam Logistics Centre (SALC) expansion plan by end-CY23 which should also contribute positively to its earnings once completed.

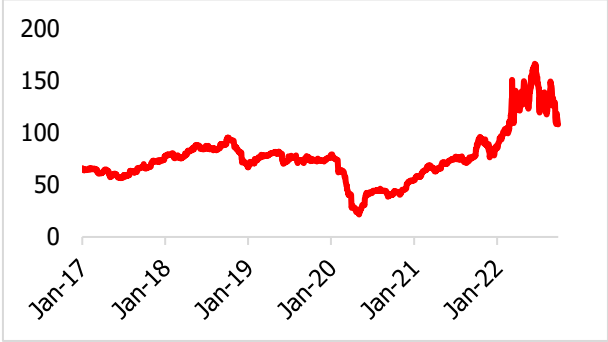
AVIATION

Chart 32: MAHB's Passenger Traffic Movement (Pax)



Source: MAHB

Chart 33: Singapore Jet Kerosene (USD/barrel)



Source: Bloomberg

8MCY22 recap. Based on the latest data released by **MAHB (BUY, RM6.77),** Malaysian passenger traffic in 8MCY22 recovered to 43% of 8M19 level (international: 21%, domestic: 65%), while the Turkish passenger traffic recovered to 84% (international: 105%, domestic: 70%). The recovery in international passenger traffic in both countries were partly supported by the summer holidays period, more Umrah trips following Saudi Arabia's visa relaxation, introduction of new routes by airlines as well as resumption of flights. Moreover, Malaysia has eliminated the need for traveller's card, pre-departure and upon-arrival tests, and the Home Surveillance Order (HSO) requirement starting from 1 August 2022 for

fully vaccinated travellers. On a more positive note, Malaysia's passenger mix has become more favourable at 64% and 36% for both domestic and international segments. Likewise, the passengers carried by Malaysia AirAsia (MAA) in 2QCY22 has recovered to 44% of its 2019 level and 3QCY22 would likely be stronger judging from the encouraging statistics recorded by MAHB at KLIA2 in Jul-22 and Aug-22, particularly the international segment.

Regaining altitude. We expect Malaysia's passenger mix to be closer to pre-pandemic levels of about 50:50 in the coming quarters as Malaysia has recently eased the entry procedures for foreign travellers and partner airlines have started accelerating capacity reinstatement to cater to demand as new routes are being introduced. We believe MAHB would return to the black in CY23 and our assumptions relative to the respective CY19 levels in CY22/CY23 are as follows: (i) MY international pax recovering to 30%/90%, (ii) MY domestic pax recovering to 70%/100%, (iii) TY international pax recovering to 100%/105% and (iv) TY domestic pax recovering to 75%/100%. Key catalyst for MAHB would be more regional countries that are currently partially open for tourism fully lifting their travel restrictions, particularly in Northeast Asia. Meanwhile, key event to look forward to for the sector is the discussion for the new operating agreement (OA) between MAHB and the government, which is expected to be concluded by 4QCY22. Meanwhile, **Capital A (NEUTRAL, RM0.61)** plans to have 157 operational aircraft by end-CY22 (or c.77% estimated utilisation rate) and it aims to reach full utilisation by 2QCY23. The airline's quarterly losses are expected to be narrower with the reinstatement of more domestic and international routes. Although jet fuel prices are still at elevated levels, it has been on a downtrend in the recent months and MAA still has the fuel surcharges in place to offset the additional fuel cost. Key headwinds for the local airlines including MAA are the long queues to get maintenance slots in order to bring back operational aircraft and the high costs associated with these maintenance services.

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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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology