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Strategy Report

2QCY25 Update Redux

Taking Account of Steeper than Expected Tariffs

KEY INVESTMENT HIGHLIGHTS

- While we had imputed the effect of tariff in our Malaysian GDP estimate and FBM KLCI target, similar with the markets, the tariff rate announced was higher than we initially expected
- Taking into account the hit to external demand, we revise down our projection for Malaysia's 2025 GDP growth to +4.0% (from +4.6% previously)
- Inflation is expected to remain under control this year. Hence, we expect OPR to remain unchanged.
- We adjust our average and end-year ringgit forecasts at RM4.34 (previous forecast: RM4.23) and RM4.25 (previous forecast: RM4.13), respectively
- We revise our FBM KLCI 2025 target to 1,590 points (from 1,670 points) or PER25 of 14.2x (from 14.8x)
- We are reiterating our defensive stance for stock selection strategy

MARKET REVIEW

We had expected the market volatility.

In our 2QCY25 update dated 26 March 2025, and our 2025 outlook dated 10 December 2024, we have stated that we expect this year to be a volatile year for the markets, mainly stemming from US policy decisions. This was evident when President Trump took office at end January, as there was initial indecisiveness of the tariffs by the US which have led to confusion and difficulties in assessing the scale of possible disruption to economic activities and corporate earnings.

US tariffs were higher than we expected.

Last Thursday (Malaysian time), Trump announced the tariff rate in a day he dubbed "Liberation Day". The US imposed a 10% baseline tariff that effectively ensures a tariff on any country. Meanwhile, more than 180 singled out and was hit with higher tariff. Malaysia was hit by a tariff of 24%, similar to Japan's rate, while Indonesia, Thailand, Vietnam and Philippines saw tariffs of 32%, 36%, 46% and 17% respectively. China was initially hit with 54% tariff, and due to its retaliatory tariff, the US imposed another 50ppt of tariff to bring it to 104%. The tariff went "live" yesterday at 12.01pm Malaysian time but were subsequently paused.

Global markets roiled at the tariff announcement, and now with more uncertainties with a pause.

The announced rate must have caught investors by surprise. Global equities market retreated since the announcement. Prior to the announced high tariff delay, US Dow Jones, S&P500 and NASDAQ have fallen -7.2%, -7.7% and -7.8% from last Thursday (3 April 2025) to Tuesday (8 April 2025) close. As of yesterday, FBM KLCI have retreated -7.8%.

Revising our GDP estimates for Malaysia and FBM KLCI target.

While we had imputed the effect of tariff in our Malaysian GDP estimate and FBM KLCI target, similar with the markets, the tariff rate announced was higher than we initially expected. As such, we believe it warrants a revision to our GDP estimates, FBM KLCI target and stock selection, which we laid out in this report. In addition, we have also formulated a third scenario to gauge the possible impact of a much severe contraction.

ECONOMIC & POLICY - Revision to Baseline Projection

Intensified trade war to affect global demand.

The announcement of reciprocal tariffs was higher than our earlier expectation, with Malaysia being hit by 24% albeit not as high as the rates charged on other regional countries. At the same time, retaliatory measures by China further intensified the trade war, which could hurt demand on both sides as costs increases will likely translate into higher selling prices. Although Malaysia's semiconductor industry is excluded from the reciprocal tariffs (for now), we admit that the tariff hikes will likely cause American demand to soften as the tariffs will begin to hit US importers from Apr-25. With these higher tariffs and elevated inflation, we foresee the US economic growth to moderate towards +1.4% this year.

Malaysia's baseline growth will be more moderate.

Taking into account the hit to external demand, we revise down our projection for Malaysia's 2025 GDP growth to **+4.0%** (from +4.6% previously). This revision reflects relatively smaller impact compared to the estimated up to -1.5%point indicated in our earlier note, which we assumed in that estimate a broader hit to Malaysia's total exports to the US without taking into account the exemption list. Nevertheless, the revision to our baseline forecast is based on a more moderate impact on exports to the US which will also be matched with slower imports growth, in anticipation of companies halting or delaying their production plans and investment decisions. We also tweak export growth outlook for several sectors such as agriculture, mining and manufacturing lower which will be affected by the weaker external demand. For the services sector, although growth remained robust supported by domestic demand, there will be some hit to transport and storage services from slower trade growth.

Optimistic outlook for domestic spending, with caution over tariff impact on jobs in certain sectors.

Domestic consumption will continue to be a key engine of Malaysia's economic growth. We believe stable domestic labour market with increased workforce participation and steady employment growth will continue to support household spending. We maintain our projection that the unemployment rate would average slightly lower at 3.1% in 2025 (2024: 3.3%). Even so, we remain vigilant to potential risks. Tariff-related disruptions may weigh on employment in export-oriented industries and pose a broader threat of wage stagnation, which could dampen domestic demand if left unchecked. As of 2024, approximately 17% of Malaysia's total workforce—or about 2.9 million workers—are employed in the manufacturing sector, which is highly exposed to external demand. The weaker external demand could also hurt employment in the agriculture (particularly plantation) and mining sectors as companies decide to slow down production.

No retaliation, more diplomatic approach by the government.

We applaud the government's calm and steady stance in addressing the reciprocal tariffs charged by the US. Apart from not raising tariffs on US imports, the government indicated that there will be meeting between representatives from Malaysia with the American counterpart at the end of Apr-25 to negotiate about the higher tariffs charged on goods imported from Malaysia. We concur with the government that the average tariffs imposed by Malaysia on the MFN basis is around 5%, which also contributes towards tax incomes for the government. This is way higher than the 47% tariffs claimed by the US government's estimate, even if the calculation includes other non-tariff trade barriers such as initiatives to protect local automotive industry, halal industry and so on. Nevertheless, the negotiations could ease the US trade rules in the coming period, although this may come with certain compromises and changes which Malaysia will have to carry out. More importantly, the absence of retaliatory measures minimizes risk for further tightening of trade rules by the US on goods sourced from Malaysia. On the other hand, it remains uncertain whether Malaysia's semiconductor industry would be among those that will be hit later by higher US tariffs.

No change to OPR expectation as inflation under control.

Inflation is expected to remain under control this year although we predict for Malaysia's inflation to increase towards 2.5% mainly attributable to price pressures from policy changes (e.g. expected hike in RON95 petrol price following introduction of targeted subsidy, expansion of SST coverage, higher minimum wage). However, food inflation will also add to overall inflation this year as CPO prices will likely remain elevated around RM4,300 per tonne. We are keeping our inflation projection for now, despite possible reduced inflationary pressures from lower crude prices as Brent crude recently fell below USD70pb after the US reciprocal tariff announcement. The low crude oil prices also present an opportunity to adjust petrol subsidy without having to raise prices too high. Demand pressures, on the other hand, remain under control with no spike in core CPI inflation albeit trending somewhat higher recently.

Still anticipating for ringgit to appreciate but at relatively slower pace.

The narrowing interest rate differential (on the back of more cuts by the Fed vis-à-vis no change to OPR setting by BNM) will support for ringgit to appreciate. However, we expect the appreciation pace will be relatively slower and not as steep as previously anticipated, as shown in our adjusted in our average and end-year ringgit forecasts at RM4.34 (previous forecast: RM4.23) and RM4.25 (previous forecast: RM4.13), respectively. On the flip side, the weakening of dollar and further rate cuts by the Fed will likely be delayed by the Fed's cautious and wait-and-see approach. On another note, with Malaysia's positive fundamentals support still robust domestic activities, we foresee increased inflows into Malaysia's capital market will also support for ringgit's appreciation.

Downside risks to growth outlook.

We view balance of risks more on the downside particularly with the heightened uncertainties on the external front which could pose more challenging outlook for Malaysia's trade and export-driven sectors. Further tightening of US trade policies, including possible duties imposed on semiconductor from Malaysia, will further curtail demand from the US. Retaliatory measures by other countries will also escalate geopolitical and trade tensions, reshaping global trade alliances and contributing to a more fragmented trade environment. This reconfiguration of global trade and supply chain could weaken global trade and investment activities at least in the short run. In addition, the ongoing geopolitical conflicts especially in the Middle East add another layer of risk and potentially disrupting trade routes. This could cause renewed rise in energy and food prices which would also fuel inflation. However, this may be mitigated by the potential oversupply as global demand softens as a result of the trade war. There is also risk from deteriorating market confidence as businesses face greater uncertainties from unexpected policy shifts. In other words, the heightened volatility in the financial markets will affect investment decisions, influenced by changing policy directions and growing concerns about the growth outlook. Meanwhile, the ringgit performance may be constrained by the strengthening of dollar backed by rising safe-haven demand amid renewed growth concerns.

Table 1: Macroeconomic Past Performances (%)

(YoY%) Unless Stated Otherwise	2021	2022	2023	2024	2025F
Real GDP	3.3	8.9	3.6	5.1	4.0
Govt. Consumption	5.8	5.1	3.3	4.7	5.0
Private Consumption	1.8	11.3	4.7	5.1	4.8
Gross Fixed Capital Formation	(0.7)	6.8	5.5	12.0	6.1
Govt. Investment	(11.0)	5.3	8.6	11.1	6.4
Private Investment	2.8	7.2	4.6	12.3	6.0
Exports of goods & services;	18.5	14.5	(8.1)	8.5	3.8
Goods Exports	21.4	11.0	(12.7)	5.5	2.5
Services Exports	(8.2)	58.3	33.0	25.9	9.9
Imports of goods & services;	21.2	16.0	(7.4)	8.9	2.5
Goods Imports	23.8	14.4	(11.7)	9.4	2.1
Services Imports	7.7	25.7	15.8	7.3	4.5
Net Exports	(4.0)	(1.5)	(16.2)	2.2	22.0
Agriculture etc.	(0.3)	1.3	0.7	3.1	0.3
Mining & Quarrying	0.9	3.5	0.5	0.9	(0.6)
Manufacturing	9.5	8.1	0.7	4.2	2.3
Construction	(5.2)	5.1	6.1	17.5	12.8
Services	2.2	11.0	5.1	5.4	5.1
Exports of Goods (f.o.b)	26.1	24.9	(8.0)	5.7	2.0
Imports of Goods (c.i.f)	23.3	31.0	(6.4)	13.2	1.6
Headline CPI Inflation (%)	2.5	3.4	2.5	1.8	2.5

(YoY%) Unless Stated Otherwise	2021	2022	2023	2024	2025F
Current Account, % of GDP	3.9	3.0	1.5	1.7	1.9
Fiscal Balance, % of GDP	(6.4)	(5.6)	(5.0)	(4.1)	(3.5)
Federal Government Debt, % of GDP	63.2	60.3	64.3	64.6	62.9
Unemployment Rate (%)	4.58	3.82	3.43	3.26	3.10
Brent Crude Oil (Avg), USD per barrel	71.5	102.0	82.2	79.9	63.0-70.0
Crude Palm Oil (Avg), MYR per tonne	4,486	5,262	3,813	4,194	4,300
USD/MYR (Avg)	4.14	4.40	4.56	4.56	4.34
USD/MYR (End-period)	4.17	4.35	4.59	4.47	4.25
MGS 10-Yr Yield (Avg)	3.23	4.07	3.86	3.83	3.68
MGS 10-Yr Yield (End-period)	3.59	4.04	3.73	3.84	3.60
Overnight Policy Rate (%)	1.75	2.75	3.00	3.00	3.00

Source: Macrobond, Bloomberg, MIDFR

MARKET STRATEGY

Our revised baseline scenario calls for continued macro and earnings growth…

In 2025, we expect Malaysia economy to remain healthy albeit with a downward revised GDP growth forecast of +4.0%. Along with the revised baseline GDP expectation, at this juncture we estimate the FBM KLCI to register a still healthy +5.6%yoy earnings growth in 2025.

…as well as easing liquidity environment.

Moreover, expectation of further rate cuts by major central banks (i.e. US Fed and ECB) together with additional stimulus (both monetary and fiscal) by China authorities should be overall positive to the world's financial liquidity situation in 2025. The rising world's financial liquidity will progressively be flowing to regions that offer attractive economic risk/return trade-off. Despite the incessant foreign fund outflows since 4QCY24, we expect the local and broader ASEAN equity markets shall in due course receive their fair share of the growing (financial liquidity) pie.

Burgeoning economic uncertainties nonetheless call for...

However, we believe the externally driven downside risks to the baseline macroeconomic outlook are burgeoning. Foremost are uncertainties engendered by the US tariff policy which may only exacerbate the recent underperformance of the US economy. In this regard, it is of note that the Atlanta Fed's GDPNow is anticipating a negative US GDP growth in 1QCY25.

…lower valuation with revised 2025 FBM KLCI target of 1,590 points.

At the time of writing (9 April), the FBM KLCI is at 1,400 points or PER25 of 12.5x, based on 2025 earnings estimate of 111.8 points. The benchmark is trading at a significant discount to its 10-year mean PER of 16.0x. Under prevailing circumstances, particularly rising macro risks engendered by the US tariff plan, we expect equity valuation to remain relatively depressed. We cut our FBM KLCI 2025 target to 1,590 points (from 1,670 points) or PER25 of 14.2x (from 14.8x).

"What-if" Scenario 3 (S3): A more severe slowdown in the US and global economy

Additional scenario analysis of a possible more severe slowdown. In our previous 2QCY25 update, we had formulated 2 possible scenarios of slower growth in the US to gauge the probable impact to Malaysia's GDP and FBM KLCI. Given that the tariff was much steeper than we anticipated, we formulated a third scenario of a more severe slowdown. It should be noted that these are only a scenario analysis and not our baseline expectation.

Rising risk of recession. Looking at the recent declines in financial markets, the deterioration in market confidence signals heightened concerns about the risk to global growth. In particular, there is a higher probability that the US economy will experience a sharper economic slowdown. The US aggregate demand could weaken as the higher import tariffs and cost increases will cause the US inflation to remain elevated. Essentially, the higher tariff is equivalent to imposing a higher tax on the American businesses and consumers.

Will the world go into a global recession? In our scenario analysis which we published in our recent quarterly outlook report, we assume 2 possible scenarios where technical recession could lead to the US growing below +1% or even experiencing a small contraction of -0.2% if the 2 quarter declines were to be followed by zero growth for a couple quarters. In a more severe contraction to the global trade, the collapse of global demand raises the risk of global recession.

Risk of sharper fall in US GDP. If the US economy were to experience a prolonged slowdown in demand, we believe this could be triggered by the reduction in consumer spending in response to the higher inflation and loss of employment as firms cutting their workforce as part of measures to cope with rising costs. This stagflation risk will complicate the Fed's policy reaction because sticking to curbing inflation will cause the Fed to delay from additional rate cuts. As a result, the tight monetary policy setting will also hurt confidence and adding more downside risk to the US consumption outlook. Relooking at the scenario estimates, we foresee a deeper decline could lead to the US experiencing a sharper decline of around -1.0%.

Brace for sharper slowdown. If other economies continue to retaliate against the US tariff hikes, the sharper decline in global demand will hurt Malaysia's economic growth more. With the -1.0% decline in the US GDP, Malaysia's economy could see slow growth of +0.5% where positive contributions from domestic economic activities will be almost offset by sharper decline in exports and weaker activities in trade-oriented sectors. In this scenario, we expect there will be some hit to domestic economy as sharper export slowdown on the back of weaker global economic growth will also result in workers especially those in the export-oriented industries to be laid off. At the same time, commodity and manufacturing sectors, as well as selected services sectors (such as storage and transport services and businesses serving the manufacturing and trade sectors) will also face less encouraging growth prospects. At the same time, lower prices and weaker demand will also constrain production of major commodities such as oil and gas and palm oil.

Table 2: Possible Scenarios of US GDP Growth and Impact on Malaysia's GDP in 2025 (%)

	US GDP Growth	Malaysia's GDP Growth
Baseline	1.4	4.0
Scenario 1: Technical recession in 1HCY25	0.7	2.7
Scenario 2: Mild contraction in 2025	(0.2)	1.2
Scenario 3: Sharper contraction in 2025 *(and slowdown in global economy and trade)*	(1.0)	0.5

Downside risks loom. We reckon there are downside risks even to the revised baseline 2025 macro and earnings expectations. The downside risks are mainly externally driven, namely (1) severe than expected impact of US tariff policy on world trade and the broader economy, as well as (2) potential escalation in the ongoing geopolitical conflicts in Europe and the Middle East.

Scenario analysis. In view of the looming downside risks, apart from our revised baseline, we generate three downside scenarios (S1, S2 and S3) incorporating the following projections for US and Malaysia GDP growth in 2025:

- Baseline: US and Malaysia GDP growth of +1.4% and +4.0% respectively.

- S1: US and Malaysia GDP growth of +0.7% and +2.7% respectively.

- S2: US and Malaysia GDP growth of -0.2% and +1.2% respectively.

- S3: US and Malaysia GDP growth of -1.0% and +0.5% respectively.

Earnings impact. Based on the above macro growth figures, the projected changes to FBM KLCI 2025 earnings are as follow:

- Baseline: Earnings points and earnings growth are 111.8 points and +5.6%yoy respectively.

- S1: Earnings points and earnings growth are 109.5 points and +3.4%yoy respectively.

- S2: Earnings points and earnings growth are 107.4 points and +1.4%yoy respectively.

- S3: Earnings points and earnings growth are 105.5 points and -0.4%yoy respectively.

PER valuation and price. Accordingly, the impact on FBM KLCI valuation as well as index targets for 2025 are listed below:

- Baseline: PER valuation and index target are 14.2x and 1,590 points respectively.

- S1: PER valuation and index target are 13.9x and 1,520 points respectively.

- S2: PER valuation and index target are 13.4x and 1,440 points respectively.

- S3: PER valuation and index target are 13.1x and 1,380 points respectively.

Chart 1. Technical Chart



STOCK SELECTION

More turbulence and uncertainties ahead.

The current turbulence in the market is much more than we anticipated. Having said that, our base case calls for continued growth prospects in the economy and equities market (from current position), as we expect that some adjustment down the road. Besides, we are not imputing any recession as yet. Nevertheless, we should note that we are cognizant of the potential downside risks.

Reiterate our defensive stance.

We also reiterate our defensive stance amid our expectation of bouts of increased volatility and uncertainty. Purely defensive stocks, such as those in REITs, utilities, healthcare, and consumer staples, tend to provide consistent dividends and stable earnings regardless of the overall market conditions. This stability and attractive dividend yields should moderate the downside risks, while not discounting the potential for price appreciation due to undervaluation.

Tweak to our top picks.

Besides defensive qualities as a criterion, we also add in other criteria which are focusing on domestically driven companies. This mean that we are selecting based on revenue source, currency of its cost, currency of its debt. This is in view of the tariffs and potential impact on exporters. We opine that this will ensure revenue and earnings stability, and lower revenue and currency risk. The criteria for our selection and our top picks are as follows:

1. More than 80% of revenue is in Malaysia, and/or
2. More than 80% of revenue source (clients, customers etc.) is in Malaysia, and/or
3. More than 80% of revenue is in ringgit, and/or
4. More than 80% of cost is in ringgit, and/or

Overall Top Stock Picks

	Rec.	Price (RM) @ 9/4/25	Target Price (RM)	Price Return	Dividend Yield	Total Returns	FBM ESG Rating	FTSE4Good?
F&N	BUY	23.30	36.77	57.8%	3.3%	61.1%	4	Yes
Hong Leong Bank	BUY	18.50	24.60	33.0%	4.5%	37.5%	4	Yes
Public Bank	BUY	4.09	5.35	30.8%	5.4%	36.2%	4	Yes
Pavilion REIT	BUY	1.36	1.69	24.3%	6.1%	30.3%	3	Yes
Petronas Dagangan	BUY	18.04	22.25	23.3%	6.6%	29.9%	4	Yes
Spritzer	BUY	1.41	1.75	24.1%	2.8%	26.9%	3	No
IHH	BUY	6.71	8.18	21.9%	1.6%	23.5%	3	Yes
TNB	BUY	12.82	15.13	18.0%	4.7%	22.7%	3	Yes
Sunway REIT	BUY	1.81	1.99	9.9%	5.2%	15.2%	3	No
KPJ	BUY	2.57	2.78	8.2%	1.9%	10.1%	4	Yes

Source: Bloomberg, MIDFR

Shariah Top Stock Picks

	Rec.	Price (RM) @ 9/4/25	Target Price (RM)	Price Return	Dividend Yield	Total Returns	FBM ESG Rating	FTSE4Good?
Malayan Cement	BUY	4.29	7.10	65.5%	2.3%	67.8%	3	No
Sunview	BUY	0.37	0.62	67.6%	0.0%	67.6%	-	No
F&N	BUY	23.30	36.77	57.8%	3.3%	61.1%	4	Yes
Bank Islam	BUY	2.25	2.95	31.1%	7.8%	38.9%	3	Yes
Pekat	BUY	1.10	1.51	37.3%	0.0%	37.3%	-	No
Petronas Dagangan	BUY	18.04	22.25	23.3%	6.6%	29.9%	4	Yes
Spritzer	BUY	1.41	1.75	24.1%	2.8%	26.9%	3	No
IHH	BUY	6.71	8.18	21.9%	1.6%	23.5%	3	Yes
TNB	BUY	12.82	15.13	18.0%	4.7%	22.7%	3	Yes
KPJ	BUY	2.57	2.78	8.2%	1.9%	10.1%	4	Yes

Source: Bloomberg, MIDFR

Mid-Small Caps Top Stock Picks

	Rec.	Price (RM) @ 9/4/25	Target Price (RM)	Price Return	Dividend Yield	Total Returns	FBM ESG Rating	FTSE4Good?
Malayan Cement	BUY	4.29	7.10	65.5%	2.2%	67.7%	3	No
Sunview	BUY	0.37	0.62	67.6%	0.0%	67.6%	-	No
F&N	BUY	23.30	36.77	57.8%	3.3%	61.1%	4	Yes
Leong Hup	BUY	0.58	0.90	55.2%	4.3%	59.5%	2	No
Bank Islam	BUY	2.25	2.95	31.1%	7.3%	38.4%	3	Yes
Pekat	BUY	1.10	1.51	37.3%	0.0%	37.3%	-	No
Pavilion REIT	BUY	1.36	1.69	24.3%	6.0%	30.3%	3	Yes
Spritzer	BUY	1.41	1.75	24.1%	2.5%	26.6%	3	No
Sunway REIT	BUY	1.81	1.99	9.9%	5.1%	15.0%	3	No
KPJ	BUY	2.57	2.78	8.2%	1.7%	9.9%	4	Yes

Source: Bloomberg, MIDFR

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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 Methodolog