Index Targets Under Review

Underlined by Increasingly Hawkish US Rate Outlook

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Strategy Report

KEY INVESTMENT HIGHLIGHTS

- Fed rate hikes expected later this year despite lower energy prices in reaction to the US-Iran MOU last week.
- Interest rate outlook shifted from dovish to hawkish, initially owing to the primary effect of higher energy prices but lately attributable to its secondary effect.
- Bond market implicitly applauds the prospect of rate hike as attested by falling medium-term inflation expectation.
- Ringgit weakened against US Dollar consequent to the prospect of Fed rate hike.
- Foreign funds net sold local listed equities consequent to the weaker Ringgit.
- Higher likelihood of US rate hike would adversely impact our currency performance, fund flows, and equity valuations.
- Review (potential cut) FBM KLCI end-2026 price target of 1,800 points (or PER26 of 15.6x).
- Review (potential cut) FBM Emas Shariah end-2026 price target of 13,100 points (or PER26 of 18.9x).
- Review (potential cut) FBM70 end-2026 price target of 18,900 points (or PER26 of 18.0x).
- Revised figures shall be released in our 2HCY26 outlook report next week.

FROM DOVE TO HAWK:

Fed hikes expected despite lower energy prices

Despite substantially lower crude oil prices in reaction to the US-Iran MOU last week, the interest rate futures market recently implies (as per CME FedWatch aggregated probabilities) a 90% chance of +25bp rate hike in September and a 53% chance of another +25bp rate hike in December 2026.

Progression from cuts to hikes

The interest rate outlook shifted from dovish to hawkish this year, initially due to the primary effect of higher energy prices, but lately because of secondary effects.

January to mid-March: 2 cuts
The year started with a dovish US Fed rate outlook.

Mid-March to early-April: 1 cut
However, the Fed rate outlook began to turn less dovish as energy prices shot up due to supply constraints with the closure of the Straits of Hormuz.

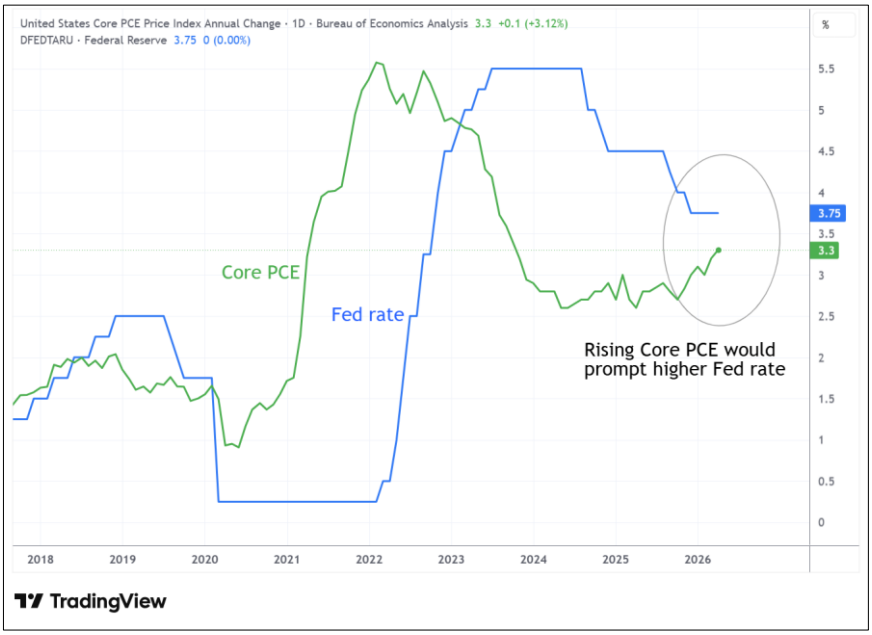
Early-April to mid-May: Neutral
As the Middle East conflict prolonged, the Fed rate outlook subsequently turned neutral.

Mid-May to mid-June: 1 hike
By mid-May, the Fed rate outlook became hawkish in reaction to the releases of hotter than expected April CPI, PPI, and export/import prices data.

Mid-June to present: 2 hikes

Last week, the Fed rate outlook became even more hawkish. A likely reason is that the Fed sharply raised its latest median core PCE inflation forecast for 2026 to 3.3% (up from 2.7% in March) as core PCE figures have trended higher over the past several months.

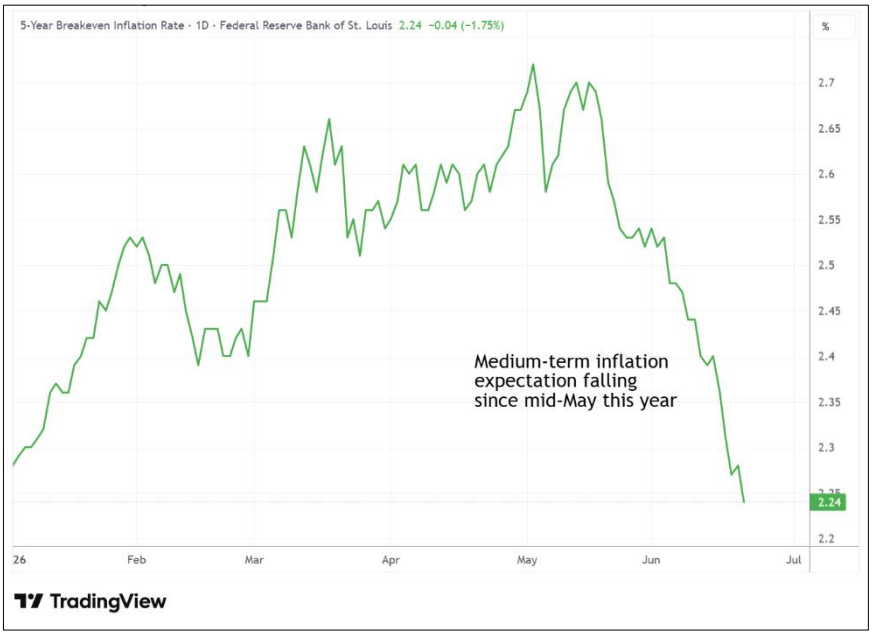
CORE PCE & FED RATE



Meanwhile, the bond market is implicitly applauding the prospect of Fed rate hike. The 5-year Breakeven Inflation Rate (a measure of medium-term inflation expectation: 5-Y UST minus 5-Y TIPS) has been declining from mid-May level of 2.7% to below 2.3% recently. In essence, the Fed inflicts short-term pain for medium-term gain by anchoring inflation expectations.

Rate hike to anchor inflation expectation

5-Y BREAKEVEN INFLATION



Weaker Ringgit against US Dollar

Consequent to the prospect of Fed rate hike, the greenback began to strengthen against major currencies with the US Dollar index (DXY) rose from May low of around 98 points to 101.4 points recently, the highest level since May last year. Similarly, Ringgit weakened against US Dollar as USD/MYR rate climbed from May low of circa 3.91 to 4.15 recently, the highest level since November last year.

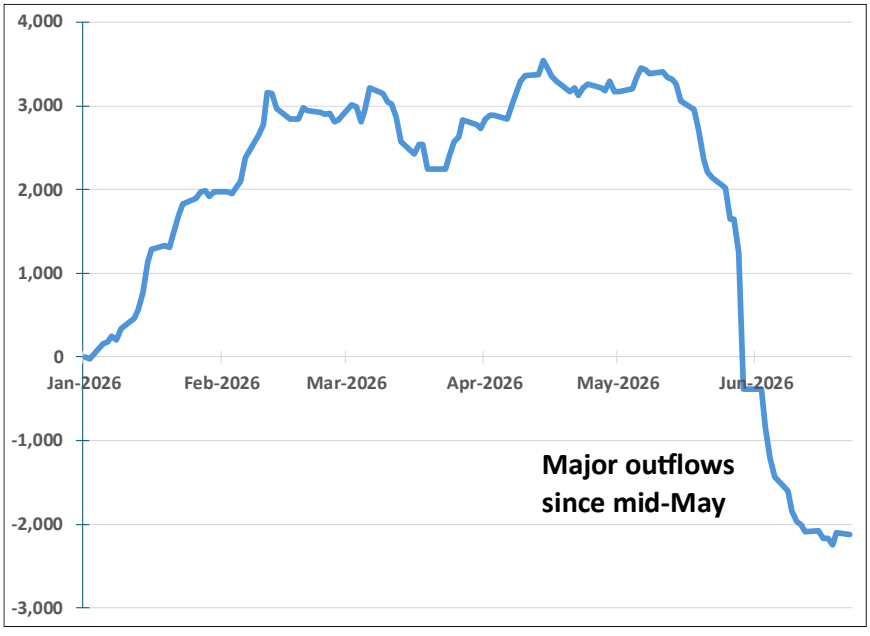
USD/MYR RATE



Major outflows during past month

Consequent to the weaker Ringgit, foreign funds net sold local listed equities. Since mid-May, the cumulative amount was -RM5.4b. Moreover, total foreign fund flow year-to-date dropped from above +RM3b around mid-May to below -RM2b recently.

FOREIGN FUND FLOWS



Source: Bursa Malaysia, MBSBR

MARKET OUTLOOK:

Favourable Middle East outcome thus far

Our baseline scenario (as outlined in 2QCY26 outlook report) foresaw the benchmark Brent crude oil at USD100-120pb during the peak conflict period, and subsequently averaged USD90pb for the year as conflict intensity starts to unwind. Thus far, the actual outcome is more favourable than expected with Brent crude oil recently trading at USD77pb.

Supported by underlying fundamentals

Against the above backdrop, we reckon FBM KLCI would retain its upward mid-term price trend underpinned by expectations of (1) continued healthy GDP growth, as well as (2) earnings growth recovery in 2026.

FBM KLCI



Headwinds from US rate hike

However, the higher likelihood of US rate hike would adversely impact our currency performance, fund flows, and equity valuations. Consequently, the upward mid-term price trend of the FBM KLCI could lose momentum.

Review targets (negative bias)

Therefore, we are reviewing (potential cut) our FBM KLCI end-2026 price target of 1,800 points (or PER26 of 15.6x). Likewise, we are reviewing (potential cuts) our FBM Emas Shariah and FBM70 end-2026 price targets of 13,100 points (or PER26 of 18.9x) and 18,900 points (or PER26 of 18.0x), respectively.

The revised figures shall be released in our 2HCY26 outlook report next week.

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STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	The stock price is expected to rise by >10% within 3 months after a Trading Buy rating has been assigned due to positive news flow.
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	The stock price is expected to fall by >10% within 3 months after a Trading Sell rating has been assigned due to negative news flow.

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