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FBM KLCI

KLCI: 1,888.69

The paradox of weak earnings sentiment and lofty valuation

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

- **FBM KLCI valuation remains elevated vis-à-vis its regional peers...** The current year PER multiple of FBM KLCI now stands at 16.9x. With a standard deviation (SD) of 1.09 and Price Earnings Growth (PEG) of 1.79, the valuations of FBM KLCI are relatively stretched vis-à-vis its regional peers. On both yardsticks, the local benchmark was higher than most other markets in the region including the broader MSCI Asia-Pacific ex-Japan (MSCI-APxJ) Index.

FBM KLCI: Valuations against regional markets

	FBM KLCI	FSSTI	JCI	SET	MSCI-APxJ
PEG	1.79	1.56	0.82	0.98	1.28
SD	1.09	0.21	0.64	1.36	-0.36
PER	16.9	14.4	15.4	14.6	12.8
PER (+1SD)	16.7	15.8	16.2	13.8	15.5
PER (Mean)	15.1	14.1	13.9	11.7	13.5
PER (-1SD)	13.4	12.4	11.6	9.6	11.5

Source: Bloomberg, MIDFR Note: Data for Mean and SD calculations from Jan 2006 to present

- **...as well as against other international markets.** Even against other international markets, the FBM KLCI stood out as among the most expensive in valuation term. While it may be argued that the SDs of the international markets were comparatively higher, however, the high SDs were justified by higher expected forward earnings growth as attested by their lower PEGs.

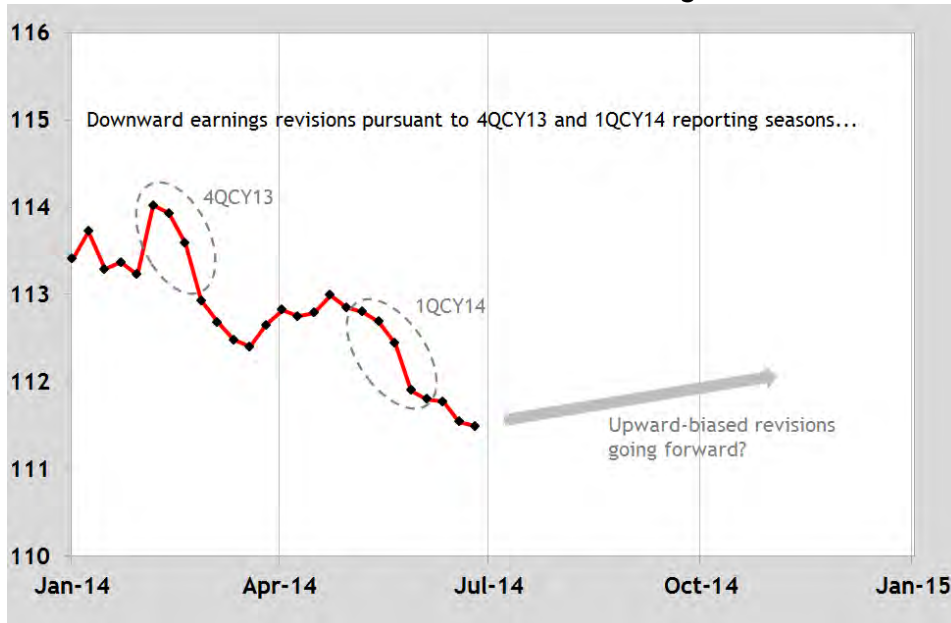
FBM KLCI: Valuations against international markets

	FBM KLCI	S&P500	Euro Stoxx	FTSE100	MSCI-World
PEG	1.79	1.48	1.04	1.57	1.38
SD	1.09	1.44	1.83	1.68	1.25
PER	16.9	16.6	14.5	14.2	16.0
PER (+1SD)	16.7	16.0	13.1	13.1	15.6
PER (Mean)	15.1	14.5	11.4	11.6	14.0
PER (-1SD)	13.4	13.1	9.6	10.1	12.4

Source: Bloomberg, MIDFR Note: Data for Mean and SD calculations from Jan 2006 to present

- **Downward revisions in earnings estimate so far this year...** The current year consensus earnings estimate of FBM KLCI has seen numerous down revisions particularly pursuant to the past two reporting season, i.e. 4QCY13 and 1QCY14. Consequently, the 2014 EPS estimate has declined almost incessantly from 113.41 in early January to 111.49 in end-June.

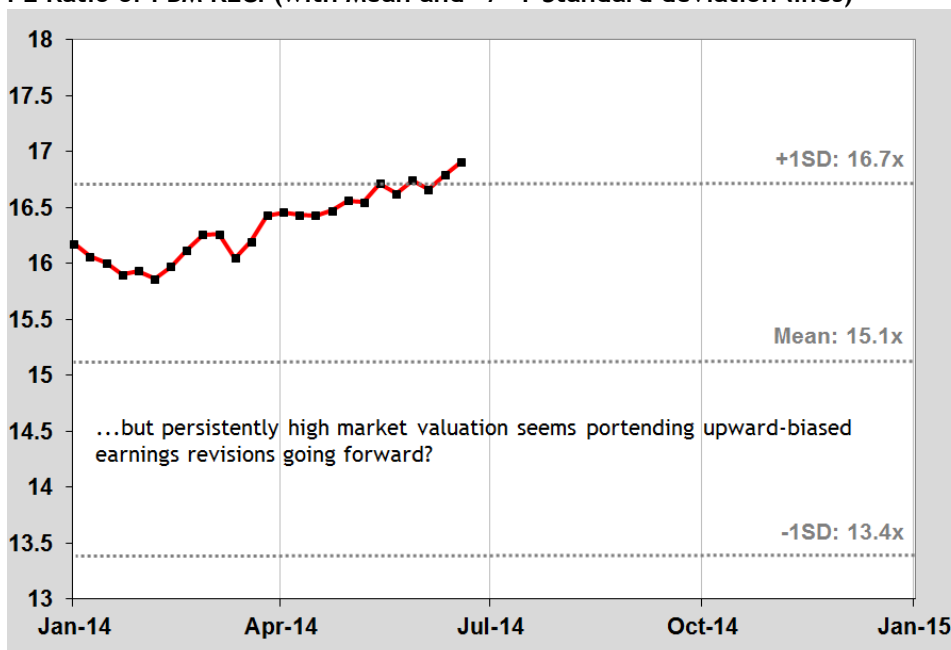
FBM KLCI: Revisions in Consensus Current Year Earnings Estimate



Source: Bloomberg, MIDFR


- **...have pushed market valuation higher...** The spate of downward earnings revisions is not a healthy situation particularly in light of the prevailing above mean valuation. The valuation expansion was rather persistent and would not have escaped the attention of investors. Hence it was quite perplexing that the price feedback to the lowering of earnings expectations was rather muted. But nonetheless, looking from a glass half full perspective, it seems that investors are still hopeful of generally upward-biased earnings revisions going forward.

PE Ratio of FBM KLCI (with Mean and +/- 1-Standard deviation lines)



Source: Bloomberg, MIDFR Note: Data for Mean and SD calculations from Jan 2006 to present

- **...as investors seem anticipating upward-biased earnings revisions going forward.** This ostensible earnings optimism is arguably premised on the still healthy domestic demand conditions as well as improving expectations in the external sector, underpinned by (i) broader economic recovery in the US, and (ii) bottoming out in the Eurozone, as well as (iii) a soft-landing in China.

- **FBM KLCI near-term upside may be contained by the lofty valuation.** Despite the investors' seeming optimism, the prevailing reality is that earnings continued to disappoint so far this year. At 111.49, the 2014 estimated earnings represent a modest 6.3%yoy growth over 2013 figure. With such tepid earnings growth level and coupled with the already high valuation, we foresee rather limited fundamental impetus for the FBM KLCI to chart substantially higher ground.
- **Reiterate FBM KLCI 2014 year-end top-down target at 1,900 points.** Thus we reiterate our FBM KLCI 2014 year-end target of 1,900 points, which is equivalent to 17.0x PER multiple of 2014 earnings. 

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BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

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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.