

Climbing the Wall of Worry

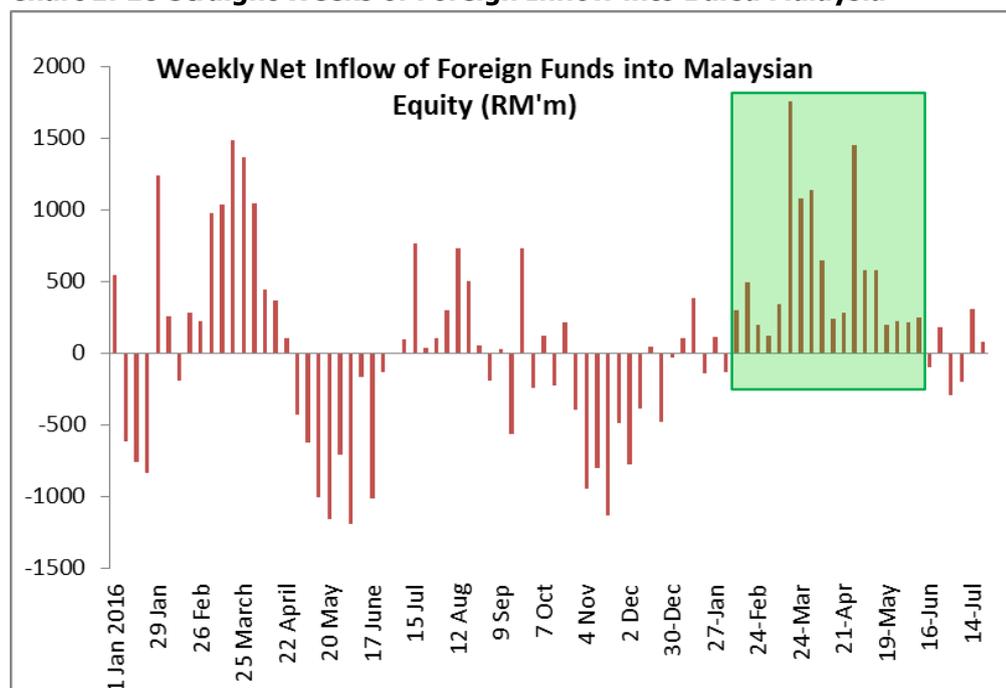
FBM KLCI: 1,766.00 points

Earnings recovery to resuscitate price momentum

2017 Year-end Target: 1,830 points

The FBM KLCI retreated from its YTD high of 1,796.75 points... Foreign investors were net buyers for 18-straight weeks from February 10 to June 9, the longest streak since 1H13. During this period, [as anticipated](#), the FBM KLCI broke above its nearly 2-year trading band and thenceforth moved on to chart an upward trajectory where it almost hit the 1,800 mark on June 16, crested at 1,796.75 points.

Chart 1: 18 Straight Weeks of Foreign Inflow into Bursa Malaysia



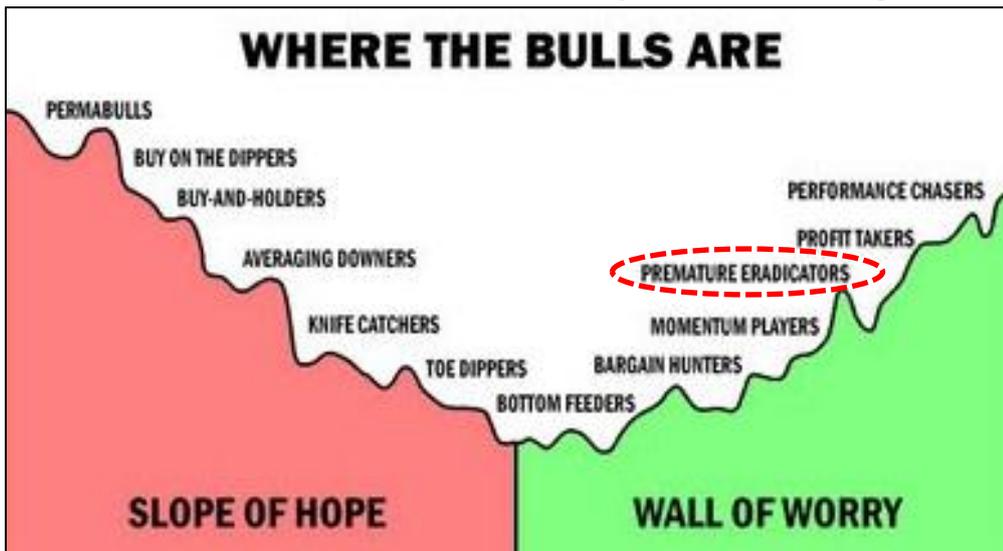
Source: Bursa Malaysia preliminary statistics, MIDFR

...as so-called *premature eradicators* trimmed their exposures... From being *bottom feeders* in late last year to *bargain hunters* earlier this year and on to become *momentum players* in the last quarter, some investors are presently deemed as *premature eradicators* as attested by the recent price pullback. As geopolitical factors took centre stage, the so called premature eradicators began reducing their exposures in Malaysia equities.

...arguably prompted by external geopolitical 'noises'. The tapering of foreign inflows saw the FBM KLCI retreated from its YTD high of 1,796.75 points to hover above 1,750 levels currently. Amongst the geopolitical 'noises' that have affected market sentiment are (i) disputes between Qatar and Arab nations, (ii) the test launch of Intercontinental Ballistic Missile (ICBM) by North Korea, and (iii) Theresa May's failure in securing the parliamentary majority in UK snap election.

We believe the market is still in the midst of climbing a wall of worry despite the recent tapering of foreign flows. On this score, it is important to note that there has been no period of sustained selling so far (only 5 weeks of attrition in 2017).

Chart 2: Premature Eradicators – The mid-stage of a wall of worry

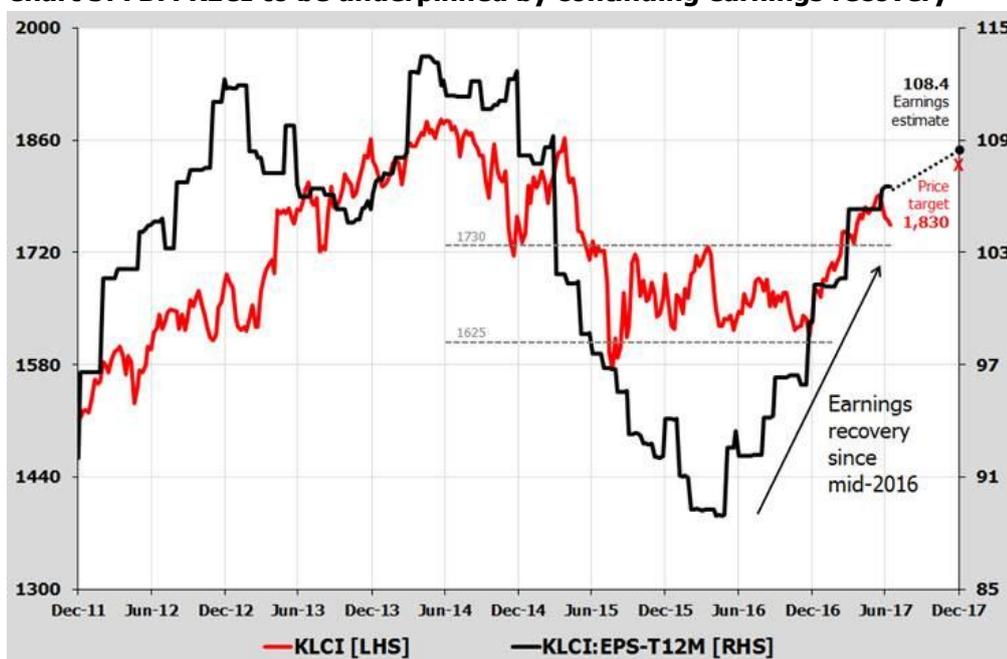


Source: Hedgefolios

Hence the recent pullback is deemed as temporary. At the beginning of 2Q17, the FBM KLCI took a breather as it retraced to the 1,730 levels amid geopolitical risks, i.e. the US Navy headed towards North Korea waters due to concerns over its weapons program. As soon as the geopolitical noises faded, the FBM KLCI bounced back up to levels near 1,800 points. Likewise, we deem the current pullback to be temporary as the market fundamental underpinning is still positive. Above all, the market earnings recovery since mid-2016 to date has been rather incessant is likely continuing.

Underpinned by continuing recovery in corporate earnings,... On that account, the (Bloomberg consensus) FBM KLCI earnings integer is estimated to grow by 7.1%yoy to 108.4 points in 2017 and to rise further by a projected 6.0%yoy to 114.9 points in 2018. It is also noteworthy that its 12-month trailing earnings integer now stands at 106.7 points.

Chart 3: FBM KLCI to be underpinned by continuing earnings recovery



Source: Bloomberg, MIDFR

...further upward revisions in forward earnings estimates,... Hence, at this juncture, the FBM KLCI earnings integer is estimated to increase by merely 1.7 points (from 106.7 to 108.4) during the remainder of this year. We can thus imply that the market is expecting the pace of earnings recovery to taper off fairly perceptibly

in the months to come; a view which may be somewhat at odds with the expectation of a still upbeat macro performance going forward. On this score, [as earlier foreseen](#) (consensus 2017 earnings integer was at 106.6 in late June and has since been revised to 108.4 presently), we continue to believe there is a better than an even chance for the prevailing 2017 earnings estimate to be further tweaked upwards in the coming months.

...and supported by improving macro environment,... On a macro level, optimism is rekindled by the consensus-beating output growth in major Asian economies such as China which is evident by its 6.9%yoy GDP growth in 2Q17. In addition, the outlook for Malaysia's economy remains sanguine with our in-house GDP growth estimate for this year being revised upward to 5.1% (from 4.9% earlier) supported by robust external performance and resilient domestic demand. Against the backdrop of improving macro environment, we foresee restricted downside risks (in terms of earnings and consequently price) to the equity market.

...the market is expected to regain upward thrust in the final trimester of the year. In gist, we foresee the FBM KLCI regaining its upward thrust in the final trimester of 2017 to be propelled by (i) continuing earnings recovery, (ii) further upward revisions in earnings expectations, and (iii) macro resilience. Having said the above, we remain mindful of intermittent cyclical price pullbacks that may take place as a result of transient situational issues amid the ever-present noises surrounding the market.

We reiterate our FBM KLCI 2017 year-end target of 1,830 points. We reiterate our year-end 2017 FBM KLCI baseline target of 1,830 points which equates to PER17 of 16.9x and +1.0SD. On this score, the baseline target valuations may further decline going forward in view of the potential upward revisions in earnings. Moreover, we maintain our lower and upper target range of 1,770 and 1,890 points respectively. 

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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.

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.