

Whither the Uncertainty

...Of Trump Presidency, Brexit and China's Reform

FBM KLCI: 1,666.51

(2017 Year-end Target: 1,830 points)

Trump inauguration on the 20th. On Friday 20th January, Donald Trump will officially take over the Oval Office as the 45th President of the United States of America in an official swearing-in ceremony on the steps in front of Capitol Hill, Washington DC. He will then proceed to give his inauguration speech, which will be followed by a luncheon and the motorcade to the White House. The day ends with the inauguration ball, in which the new president and the first lady would be in attendance.

But Trump "uncertainty" a bane to the market. Even before he took office, Trump has been courting controversy with his statements and tweets. He accused the intelligence community of leaking information about an unsubstantiated report on compromising information the Russians have accumulated against him, commented that "One China" policy was negotiable, called Obamacare a lie, promising to bring down drug prices, proposed a 35% tax on imported cars and warned about the US dollar currency being too strong; causing a lot of ire among investors in the capital market, resulting in a higher volatility in the capital market, and halting the rise of the benchmark Dow Jones Index, short of breaching the 20,000 points level.

Theresa May speech on Brexit. Following her election as Leader of the Conservative Party, and her subsequent appointment as the Prime Minister of the United Kingdom on 13th July 2016, after the Brexit Referendum, the world listens to her much awaited speech on the Tuesday 17th January. She revealed her approach to the negotiations with EU, among others, pushing for comprehensive free trade agreements, having a customs union agreement with EU, policies to control influx of immigrants, and finally leaving the final deal between UK and EU on the voting block at the UK House of Parliament. To formally start the Brexit, UK has to invoke Article 50 of the Lisbon Treaty, after which gives the UK and EU two years to agree the terms of the split. Theresa May intends to trigger this process by the end of March 2017.

Mixed opinions on Post-Brexit impact. While the UK looks set to gain the flexibility to set its own policies on the immigration, customs and own trade deals with countries without having to follow EU's path, critics of Brexit warned that there will be ill effects as well. Their key concern includes UK losing its attractiveness as key gateway and as based of corporate headquarters, and having less leverage when negotiating for trade pacts; hence increasing the cost of doing business in the UK. In addition, if the protracted process of negotiations takes years to complete; the uncertainties this may bring, is bad of business.

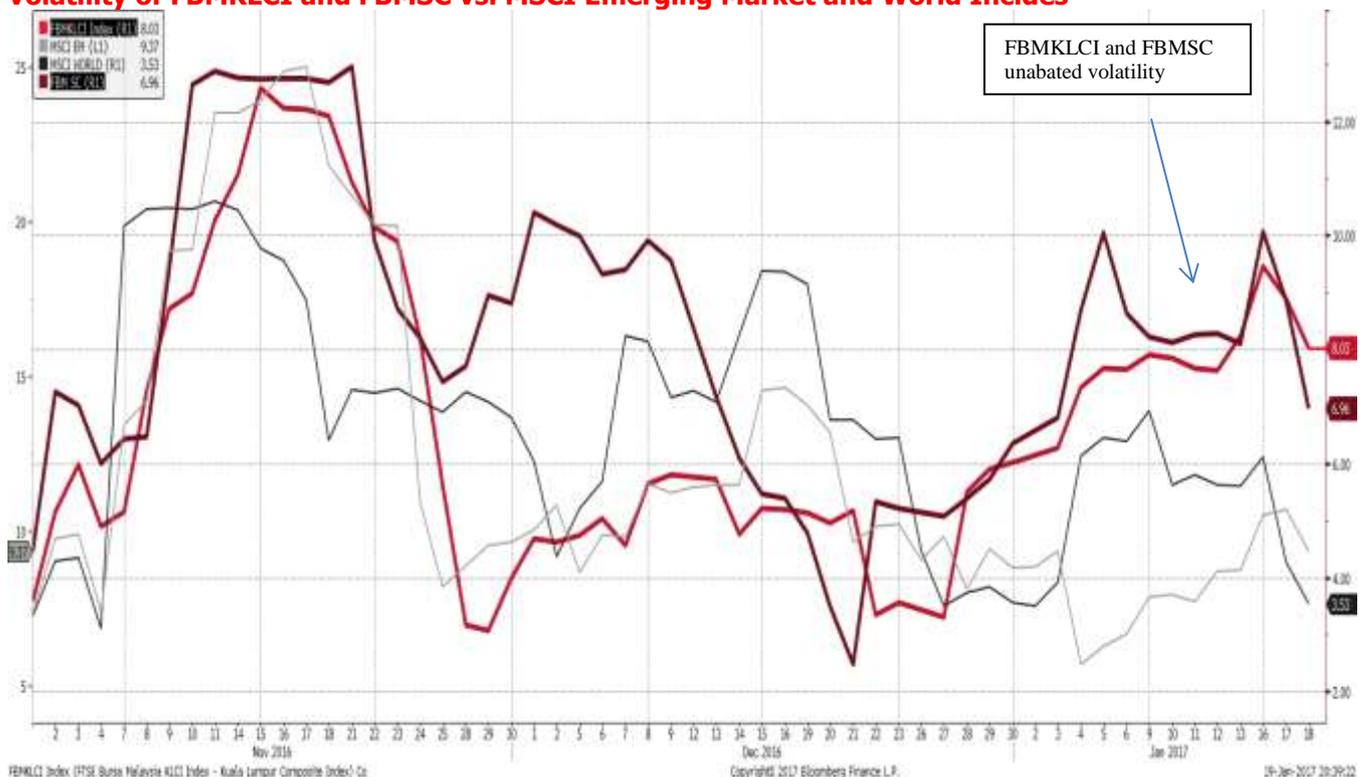
Transformation of China's economy. China's will continue its reform in hope of finding a sustainable long term growth for the country, including administrative power delegation to lower levels of the government, fight against corruption and innovation driven development. The rolling out of massive infrastructure projects, state owned enterprise (SOE) reform and its "One Belt One Road" (OBOR) initiatives have indicated the seriousness of China's ambitions.

Reform comes at a price. Massive infrastructure projects calls for increased demand of raw materials such as iron ore and coal, and the side effects of pollution and threat of global warming, as a result of unchecked have cause anger among developed countries. But at the same time, with China's increasingly working towards closing inefficient factories, including steel plants, to address the environmental issues, there are concerns whether it would result in a further slowdown of its' economic growth. And the side effect it will bring to the rest of the world, especially for countries with high dependency on trades with China. At the same time, with Trump highly critical of China, the possibility of increasing strain in the relationship of the world's two biggest economic powerhouses, could affect world's economic growth and hence fuelling the uncertainties of the direction of the capital market, in the near term.

EQUITY MARKET PERFORMANCE

The above factors have not added uncertainties over the direction of the capital market, but also inadvertently results in the domestic equity market experiencing higher volatility, as pressure mounts of our local Ringgit currency and commodity prices, namely oil and crude palm oil. These concerns have affected the outlook of the companies listed on the stock exchange. And of late, our market, have seen an unabated period of high volatility as compared to stabilizing prices, in general, of the both the emerging and world benchmark indices.

Volatility of FBMKLCI and FBMSC vs. MSCI Emerging Market and World Incides



Despite the price volatility, our market have only been moving sides ways with a decline of 5.9 points (-0.4%), since 1st Nov 2016. Meanwhile, our ASEAN peers saw mixed performance at a mode defined magnitude with Singapore's Straits Times Index (FSSTI) and Thailand's SET Index (SET) saw gains of 6.6% and 3.7% respectively while Indonesia's Jakarta Composite Index (JCI) saw a decline of 2.2%.

ASIAN INDICES (18 JAN MARKET CLOSE)

Indices	Value (1 Nov 16)	Value (18 Jan 17)	Change (points)	Change (%)
FBMKLCI	1670.9	1665.0	-5.9	-0.4
FSSTI	2813.7	3000.2	186.5	6.6
SET	1504.5	1560.8	56.3	3.7
JCI	5416.0	5294.8	-121.2	-2.2
HSI	23147.1	23098.3	-48.8	-0.2
SHCOMP	3122.4	3113.0	-9.4	-0.3
KOSPI	2007.4	2070.5	63.1	3.1

Source: Bloomberg, MIDFR

TRADING STRATEGY

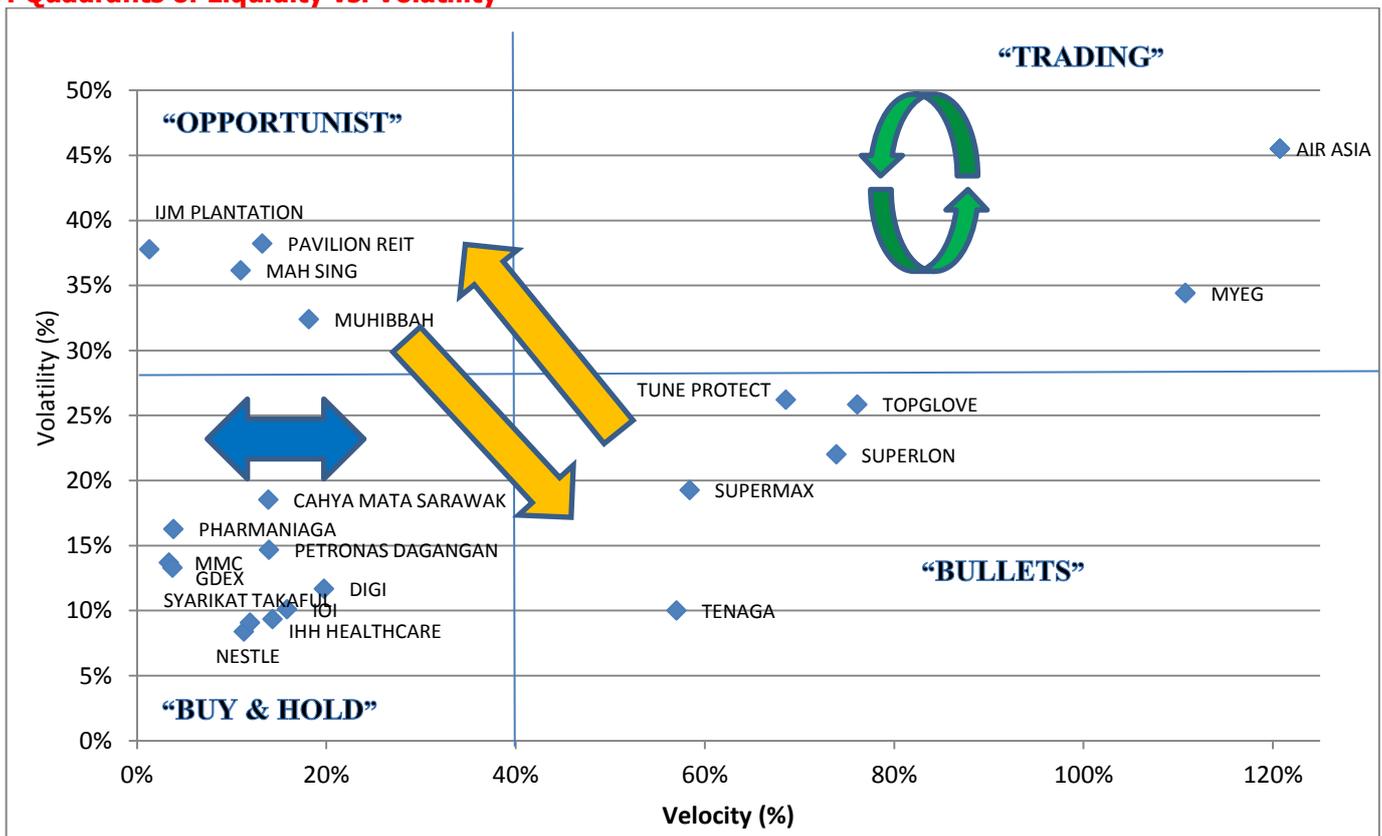
Therefore the question is where would the market going in the near term and where would opportunities arise, in our local bourse? We reckoned that uncertainties would continue to be on the cards, with external risks playing an important factor in determining the movement of the Malaysian Ringgit, external demand of our exports and cost of our imported goods. Hence, we opine that that with further certainty on the external front will only be seen on 2Q CY 2017 the earliest, from (i) Clarity of Trump’s policies, (ii) Triggering of Article 50 for Brexit and (iii) Further update from China’s reform and improving relationship with the US.

Meanwhile, a flattish market in the near team doesn’t bode well for a buy and hold strategy. With corporate challenging earnings growth in the near term, companies might hold off providing generous dividends until the later quarters of the year. In light of the challenges of deriving returns for the portfolio, we would recommend a trading strategy based on the following two measures, derived from the Bloomberg terminal:

- Velocity – we have used the share turnover velocity (which is a ratio of traded share turnover to market capitalization) as a measure of liquidity of stock. Traded share turnover is calculated by summing up the total value of each trade (share price x traded volume).
- Volatility – the volatility of share price movements using the running 10 day volatility measures calculated by the Bloomberg terminal.

Analysing the listed companies listed in Bursa Malaysia for the two measures, for the months November and December 2016, we then constructed a two by two matrix and would like to propose the following trading strategy based on the four quadrants.

4 Quadrants of Liquidity vs. Volatility



Source: Bloomberg, MIDFR

Quadrant 1 – Low Velocity + High Volatility = “OPPORTUNIST”

This “Opportunist” quadrant describes stocks that are relatively have low traded volume and highly volatile price movements. Stocks sitting in this quadrant includes Pavilion REIT (NEUTRAL, TP = RM1.68), Mah Sing (NEUTRAL, TP = RM1.57), IJM Plantations (NEUTRAL, TP = RM3.30), Muhibbah (BUY, TP =RM3.05)

All of these are great stocks to be included in the portfolio, but due to low liquidity, investors have to scan the market sentiment and wait for an opportunistic time to buy these stocks, wishing for Lady Luck to show herself. An example would be the emergence of irrational sellers looking for a quick exit, selling the stock at lower prices.

Quadrant 2 – Low Velocity + Low Volatility = “BUY and HOLD”

This quadrant describes stocks that are relatively have low traded volume and less price movements. Stocks sitting in this quadrant includes DIGI (NEUTRAL, TP = RM5.02), Nestle (NEUTRAL, TP = RM82.82), GEDEX (BUY, TP = RM2.06), Pharmaniaga (BUY, TP =RM5.80), IOI (BUY, TP = RM5.30).

We recommend stocks sitting in this category for a BUY and HOLD strategy, considering the makeup of the stocks in this quadrant, from a mixture of dividend play and also companies have a strong strategic shareholder with a growth upside. The low velocity also indicates a relatively tightly held shareholding structure and low float. Therefore, a situation of pessimistic and weak market sentiment, will present an opportunity to add the stock into an investor portfolio. And it would also act as the defence against portfolio value erosion.

Quadrant 3 – High Velocity + Low Volatility = “BULLETS”

This “Bullets” quadrant describes stocks that are relatively have high liquidity and low price volatility. Stocks sitting in this quadrant includes TNB (BUY, TP = RM16.80), Top Glove (NEUTRAL, TP = RM5.15), Tune Protect (BUY, TP =RM2.18), Superlon (BUY, TP = RM2.89).

We recommend stocks sitting in this quadrant to be use as “Bullets” or financier for the execution of the “Opportunist” trading strategy, i.e. selected holdings of the stocks in the former quadrant can be sold with the proceeds to be used to acquire stocks in the latter quadrant. And vice versa, since at higher velocity, and lower price volatility, an investor could still get back the shares at reasonable price.

Quadrant 4 – High Velocity + High Volatility = “TRADING”

This “Trading” quadrant describes stocks that would be prime for active trading strategy, due to their characteristics of having a relatively have high liquidity and high price volatility. Stocks sitting in this quadrant includes Air Asia (BUY, TP = RM3.45), My EG (BUY, TP = RM1.89), Air Asia X (BUY, TP = RM0.50).

We recommend stocks sitting in this quadrant for inclusion into a trading portfolio. With ample liquidity and a healthy newsflow driven price volatility, a trading portfolio would be ideal to generate returns amidst a “flattish” movement of the benchmark indices. Liquidity would support ease of trading movement and the newsflow would provide the incentive to take trading position towards sell “high” and buy “low” investment decision process.

CONCLUSION

Uncertainty fuels volatility, but market will likely move sideways. Uncertainties over the impact of external geopolitical events in US, UK and China, will likely result in a highly volatile movement of prices across asset class. And we foresee that in the near term, market will move sideways temporarily, awaiting clear signal on what’s in store for the future.

Where to generate returns? By assessing the velocity (liquidity) and volatility of stock price movements, there are pockets of pocket of opportunities in the local market, taking advantage of the movement of market sentiment and also the external and internal newsflow. The 4 quadrants derived from the velocity and volatility data, is one tool that can be used in search of enhancing portfolio returns whilst preserving portfolio value during this period of uncertainties.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

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.