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Bear market beckons?

Macro outlook may restrict market downside

KLCI: 1,601.70 points

2015 Year-end Target: Under review

FBM KLCI STILL IN BULL TERRITORY

The usual definition of a bear market is when the following criteria are concurrently met: The benchmark indexes decline by at least 20 percent from their recent peaks or 12-month highs, i.e. enter bear territory, and for at least a 2-month period. The following table lists the extent of FBM KLCI percentage change during the current downturn as well as the -20 percent threshold, based on (i) its prevailing 12-month high, and (ii) its all-time peak in July last year.

FBM KLCI

	High *(Date)*	**Low** *(Date)*	**Change%**	**-20% Threshold**
Over the past 12 months	1,879.53 *(29/8/14)*	1,503.68 *(25/8/15)*	-19.99	1,503.62
Since all-time peak on 8 July 2014	1,896.23 *(8/7/14)*	1,503.68 *(25/8/15)*	-20.70	1,516.98

Source: Bloomberg, MIDFR

FBM KLCI dipped into bear territory, temporarily. The FBM KLCI was actually dipping into bear territory early Tuesday morning before buying support emerged and quickly pulled the benchmark index out of the red zone. The ensuing technical rebound managed to lift the FBM KLCI more than 80 points away from the bear threshold levels. Therefore, despite the massive August drumming, it is notable that the local bourse has yet to decisively enter into the bear territory, let alone to be classified as a bear market.

MALAYSIA: Consensus GDP forecasts (as of 21 August)

	2015	**2016**
Median	4.90%	5.00%
Mean	4.80%	4.90%
High	5.50%	6.10%
Low	4.00%	3.30%
Median (previous survey in May)	4.80%	5.10%

Source: Bloomberg; Note: 27 contributors (25 foreign & 2 local institutions)

Macro outlook may restrict market downside… Empirically, a bear market generally occurred in reaction to drastic deterioration in the macro economic performance such during the 1998 crisis and 2008 economic downturn. However, severe cyclical pullback not amounting to a bear market may take place as a result of other situational issues which are affecting market sentiment even amidst continued healthy macro growth. Hence, as the outlook for Malaysia's economy remains rather sanguine with consensus GDP growth for this year and next expected at 4.9% and 5.0% respectively, we do not foresee the market turning bear anytime soon.

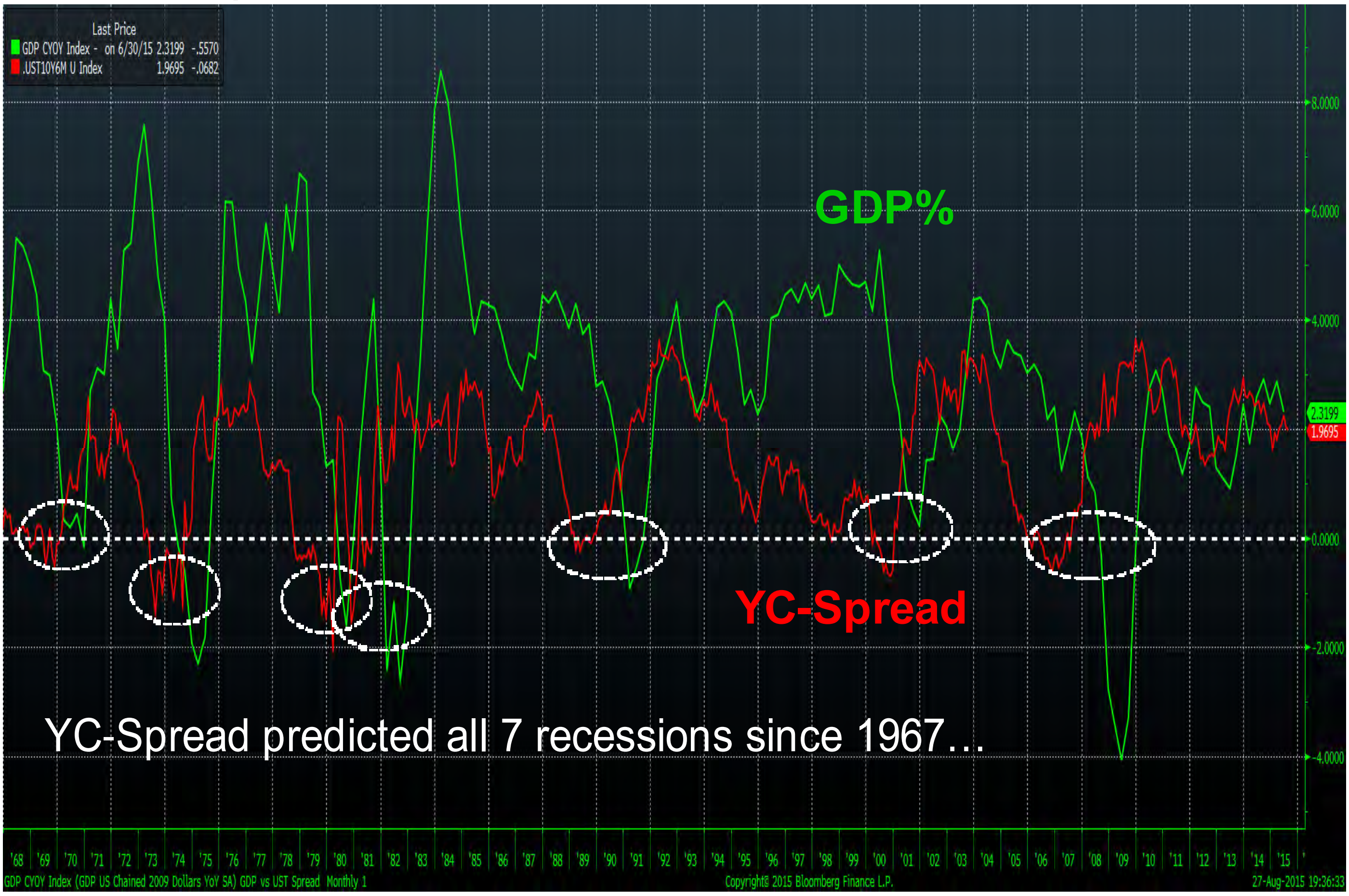
...unless Ringgit situation continues to exacerbate. Having said that, as alluded in our Strategy note titled "Ringgit performance and FBM KLCI" dated 21 August 2015, it is important for the currently distressed Ringgit to regain its course and re-track the major G7 currencies (notably Euro and Japanese Yen). We reckon any prolonged failure of the Ringgit to regain its course may result in an unfavourable shift in Malaysia's macro prospects and, by extension, the corporate earnings outlook.

Secular trend path of FBM KLCI dependent on earnings growth performance. We reiterate our assertion that historical observations between earnings and price are conclusive with regard to the nature of their secular direct relationship. This is despite the ever present 'noises' from short-term price volatility which, as mentioned earlier, is influenced by market sentiment and other situational issues. Hence our assessment on the likely forward secular trend path of the FBM KLCI is highly dependent on the expected earnings growth performance during the next 12 to 18 months. At this juncture, the consensus 2016f FBM KLCI earnings still points toward a recovery whereby growth is forecasted to return to a healthy, and more normal, level of circa 9.4% (2015e: -3.0%).

IS WALL STREET TURNING BEAR?

After the recent selloff on Wall Street, some investors are beginning to question the robustness and sustainability of US economic recovery. On this score, let's look at the US Treasury (UST) market for what we deem as a reliable and near definitive answer. Bear in mind that the UST yield curve spread (YC-Spread) correctly predicted all seven previous US recessions since 1967 (arguably a better track record than perhaps all known economists both in the present and past).

UST Yield Curve Spread versus GDP Growth



Source: Bloomberg, MIDFR

US Govy market expects continued macro growth. At least until this juncture, the YC-Spread remains well in the positive. This can be interpreted as the UST market believing the US economy will continue to grow into the foreseeable future. Hence the secular trend direction of the US equity market should likewise remain upward sloping.

US equity market undergoing cyclical pullback to correct excessive valuations. In early May this year, US Fed Chair Janet Yellen predictively remarked, "I would highlight that equity market valuations at this point generally are quite high," and added "There are potential dangers there." Thus what happened recently on Wall Street can arguably be characterized as a cyclical pullback (on quite an extreme bout) to recalibrate its relatively lofty market valuations.

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BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* 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 *fall* 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.