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FBM KLCI & other regional indices

Narrowing valuation disparity but headwinds linger

FBM KLCI: 1,859.52

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

After a brilliant 2013, which saw an expansion in its relative valuation,... In our Strategy note dated 8 January, we highlighted “the glaring disconnects between the valuations of the local benchmark vis-à-vis its regional counterparts...” Furthermore, in our Strategy note dated 16 January, we spoke on the impending normalization of index valuation as well as its “...direct bearing on the price performance of the respective indices.” Of particular interest was “the FBM KLCI which commanded the richest relative current year PER valuation among its peers...” We concluded then that, “after a brilliant 2013 performance, FBM KLCI may potentially underperform its peers in 2014.”

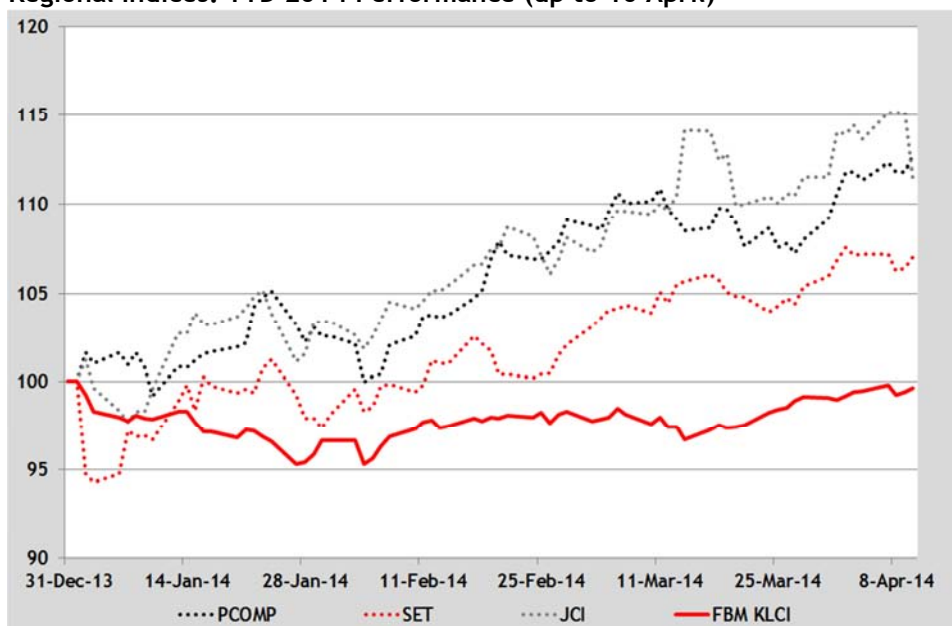
Regional Indices: 2013 Performance

	(% Change)
JCI	-1.66
SET	-7.73
PCOMP	+0.49
FBM KLCI	+10.54

Source: Bloomberg, MIDFR

...the FBM KLCI is underperforming its peers so far in 2014. As of yesterday, Malaysia’s FBM KLCI has retreated by -0.4% thus far this year against year-to-date gains of +11.5%, +7.0% and +12.7% by Indonesia’s JCI, Thailand’s SET and Philippines’ PCOMP respectively. The respective outperformances of JCI and SET were despite (i) Indonesia being lumped into the so-called ‘Fragile 5’, and (ii) the heightened political squabble in Thailand between the pro- and anti-Thaksin factions.

Regional Indices: YTD 2014 Performance (up to 10 April)



Source: Bloomberg, MIDFR

Normalization of index valuation thus far has narrowed the SD disparity... Based on latest data, the normalization process has in fact taken hold as the disparity in market valuation of FBM KLCI against other regional indices is narrowing. From the Table below, it is rather apparent that the year-to-date change (up to end last week) in the standard deviation (SD) of PER of FBM KLCI (+0.16) had lagged that of other regional indices (JCI: +1.10; SET: +1.14; PCOMP: +0.72). Consequently, the SD of FBM KLCI is becoming much less out-of-line particularly against the JCI and SET. Nevertheless, the price earnings growth (PEG) of FBM KLCI failed to match the improvement shown in its SD relative to others. At 1.71, its PEG is still way above the other regional peers.

Regional Indices: Standard Deviation (SD) of PER & Price Earnings Growth (PEG)

	FBM KLCI	JCI	SET	PCOMP
SD (YTD change)	+0.16	+1.10	+1.14	+0.72
SD (end last week)	+0.84	+0.61	+0.78	+1.37
SD (start 2014)	+0.68	-0.49	-0.36	+0.65
PER	16.4	15.3	13.3	18.2
PER (+1SD)	16.7	16.2	13.8	17.3
PER (Mean)	15.0	13.9	11.6	14.7
PER (-1SD)	13.4	11.6	9.5	12.1
PEG	1.71	0.87	1.01	1.19

Source: Bloomberg, MIDFR; Note: Data for Mean & SD of PER calculations ranged from 2006 to present

...but FBM KLCI potential upside may be capped by liquidity, earnings and monetary/macro factors. With the improvement in relative SD and despite the hitherto elevated comparative PEG, going forward, we foresee a less pronounced FBM KLCI underperformance (or even intermittent streaks of outperformance) vis-à-vis its regional peers. Having said that, we reiterate our view that the potential upside of FBM KLCI may be capped by the following headwinds: (i) incessant, albeit measured, withdrawal of foreign liquidity pursuant to the ongoing QE3 taper, (ii) relatively muted FBM KLCI earnings growth (consensus earnings has turned south pursuant to the recent reporting season) of circa 7% in 2014, (iii) 'expectation' of a hike in the OPR, as well as (iv) Malaysia's relatively weak albeit improving current account situation.

Reiterate FBM KLCI 2014 year-end baseline target of 1,900 points. Hence, we reiterate our rather modest FBM KLCI baseline 2014 year-end target of 1,900 points. 

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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.