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## The October downswing

*Cyclical or secular?*

KLCI: 1,767.77

*Maintain end-2015 Target: 1,970 points  
Revised end-2014 Target: 1,850-1,800 points*

### SELL OR BUY ON WEAKNESS

The recent equity market downswing started on Wall Street arguably in reaction to a small cut in IMF's global growth outlook for 2015. This was coupled with a deeper than expected decline in German's monthly industrial production. It is also notable that at about the same time, another risk asset, namely crude oil futures, was also breaking below its key price support levels.

From another angle, the Wall Street main averages, i.e. DJIA and S&P500, were ripe for a meaningful correction after a spate of new all-time highs in earlier months. For this reason, the above events offered the necessary excuses for the market to let off steam.

As far as the world's growth outlook is concern, output is expected to accelerate next year. Despite the recent cut, the IMF is predicting that global GDP will improve to 3.8% as compared to a 3.3% expansion estimated for this year. On the local front, Malaysia's GDP is expected to grow between 5-6% next year.

Against this macro backdrop, we believe that the underlying *secular trend of the equity market is likely to remain upward sloping going forward.*

Having said that, empirical evidences show that even amidst period of economic expansion, the market can never be immune to intermittent cyclical correction. However, under this circumstance, which can be unnerving, it is advisable to not overreact and succumb to the market's inexplicably rising fear. Be reminded that more often than not, the pullback is essentially a manifestation that earlier market expectations may have exceeded the unfolding reality. Accordingly, the prevailing valuation needs to be duly corrected.

Thus we recommend buy on weakness of the stocks that fulfil your fundamental requirements, i.e. inherent earnings quality, good earnings growth potential, and/or attractive valuation.

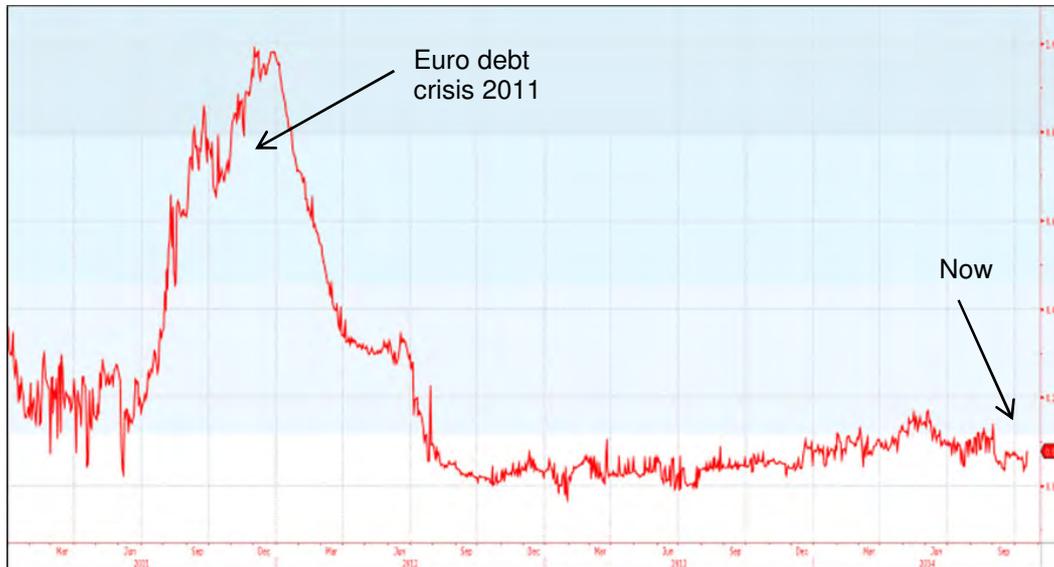
### DOWNSIDE TO THE MARKET

We opine that the short-term local market undertone shall continue to be dictated by the prevailing vagaries on Wall Street.

From technical perspective, we expect the DJIA to hold above the 15,500 points level lest it breaks its secular trend line. It closed yesterday at 16,117 points. Our initial investigation found no forward indications of any imminent systemic dislocation that may warrant the expiration of its current trend support. On the contrary,

- As mentioned earlier, the IMF expects global output growth to accelerate from 3.3% this year to 3.8% in 2015.
- Interestingly, the same IMF recently revised upward its growth expectations for the US to 2.2% this year and 3.1% for 2015.
- Furthermore, despite further cut to the already tepid Eurozone growth expectation, we are seeing no heightened risk of systemic dislocation as was witnessed during the 2011 Euro debt crisis. This view is evidently supported by the benign 3-Month Euribor-OIS spread.

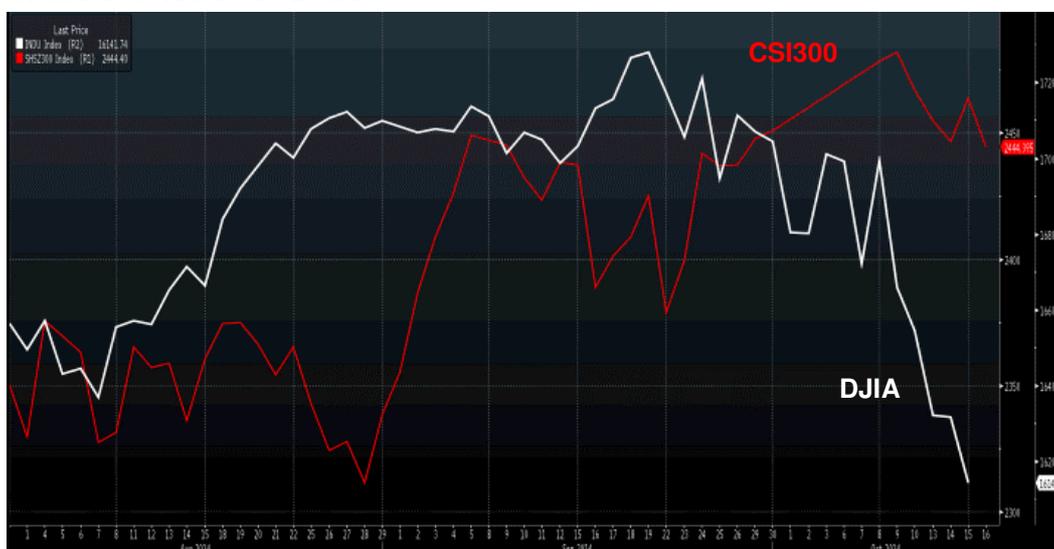
## 3-Month Euribor-OIS Spread



Source: Bloomberg, MIDFR

- But how has China reacted to the recent pullback in world's equity market? As a matter of fact, its stock market is showing a limited reaction to the selloff. Thus to place the blame for the market pullback on China's domestic prospects may not hold water.

## China's CSI300 vs. DJIA



Source: Bloomberg, MIDFR

Hence we reckon the current pullback as short-term cyclical.

In a Strategy note dated 8 January 2014, we offered our views with regard to the equity market this year in which we stated, among others, that the "Potential downside [to the KLCI] would be limited to 1,750-1,700 points range..." We reiterate that same view.

Taking cue from the earlier cyclical market pullback, such as the one in January 2014 which was triggered by capital flight from "Fragile 5" countries and contraction in China's PMI number, the ensuing recovery may be nearly as swift.

## TARGETS

Therefore, while it is admitted that our current year-end target of 1,900 points may seem lofty under the prevailing market sentiment, we believe its achievement will only be delayed by only up to 3-6 months. Furthermore, we expect the KLCI shall end the year at above the psychological level of 1,800 points.

We thereby revise our FBM KLCI 2014 year-end target to 1,850-1,800 points range. But at the same time, we reiterate our FBM KLCI 2015 year-end target at 1,970 points. 

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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.