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FX, Funds, 1MDB and the Spring pullback

KLCI: 1,726.86 points

Upturn seen subsequent to market absorption

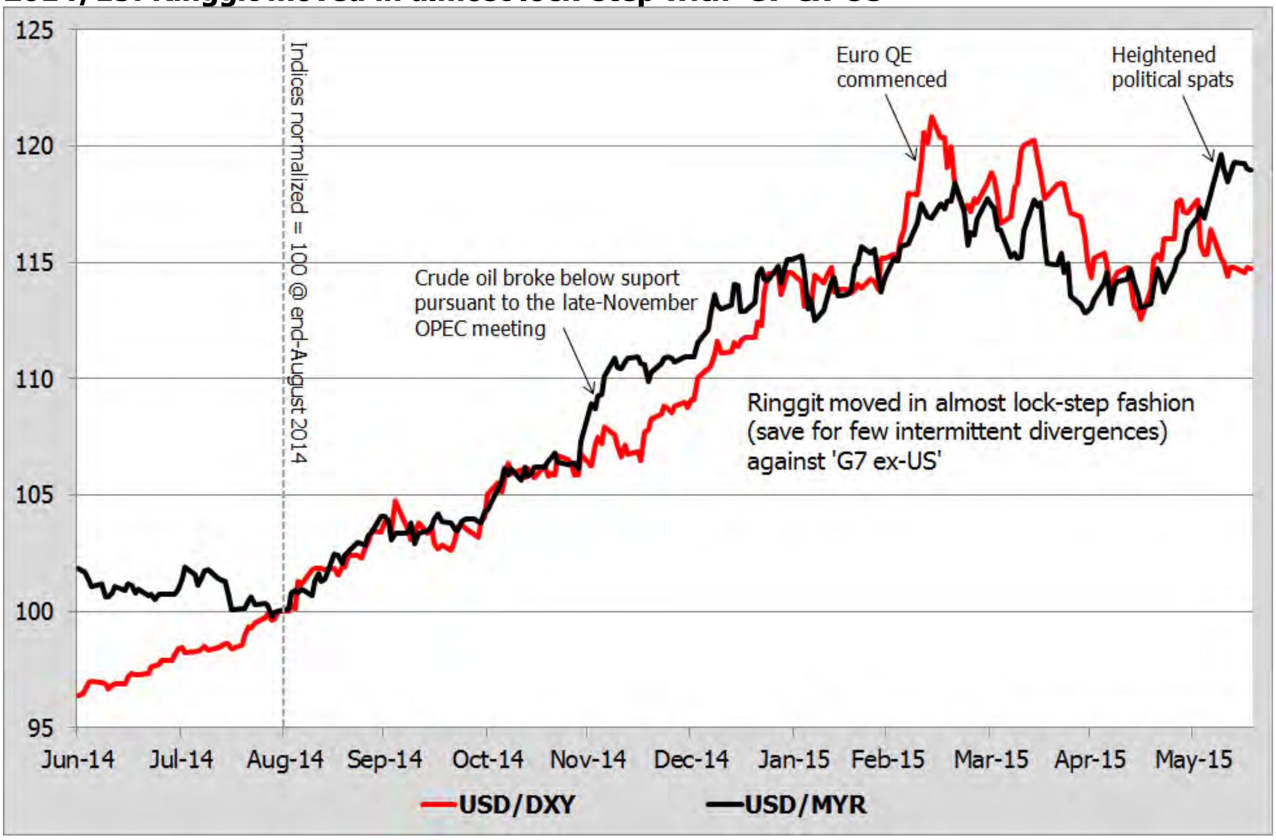
2015 Year-end Target: 1,900 points (under review)

WHITHER THE RINGGIT

Weaker MYR against USD… The US Dollar (USD) began its ascension vis-à-vis the currencies of other Group of Seven (G7) world's most industrialized countries in July 2014. A good proxy index to the G7 ex-US currencies is what known as the US Dollar Spot Index (DXY). Meanwhile, against Ringgit Malaysia (MYR), the rise of US Dollar started in September last year.

…but stable against DXY… On this score, it must be highlighted that both the USD/DXY and USD/MYR moved in almost lock-step fashion, save for few intermittent divergences (e.g. commencement of Euro QE in March 2015), with identical trend trajectory since September 2014. Consequently, it implies a stable relationship between the G7 ex-US currencies against Ringgit, i.e. DXY/MYR.

2014/15: Ringgit moved in almost lock-step with 'G7 ex-US'

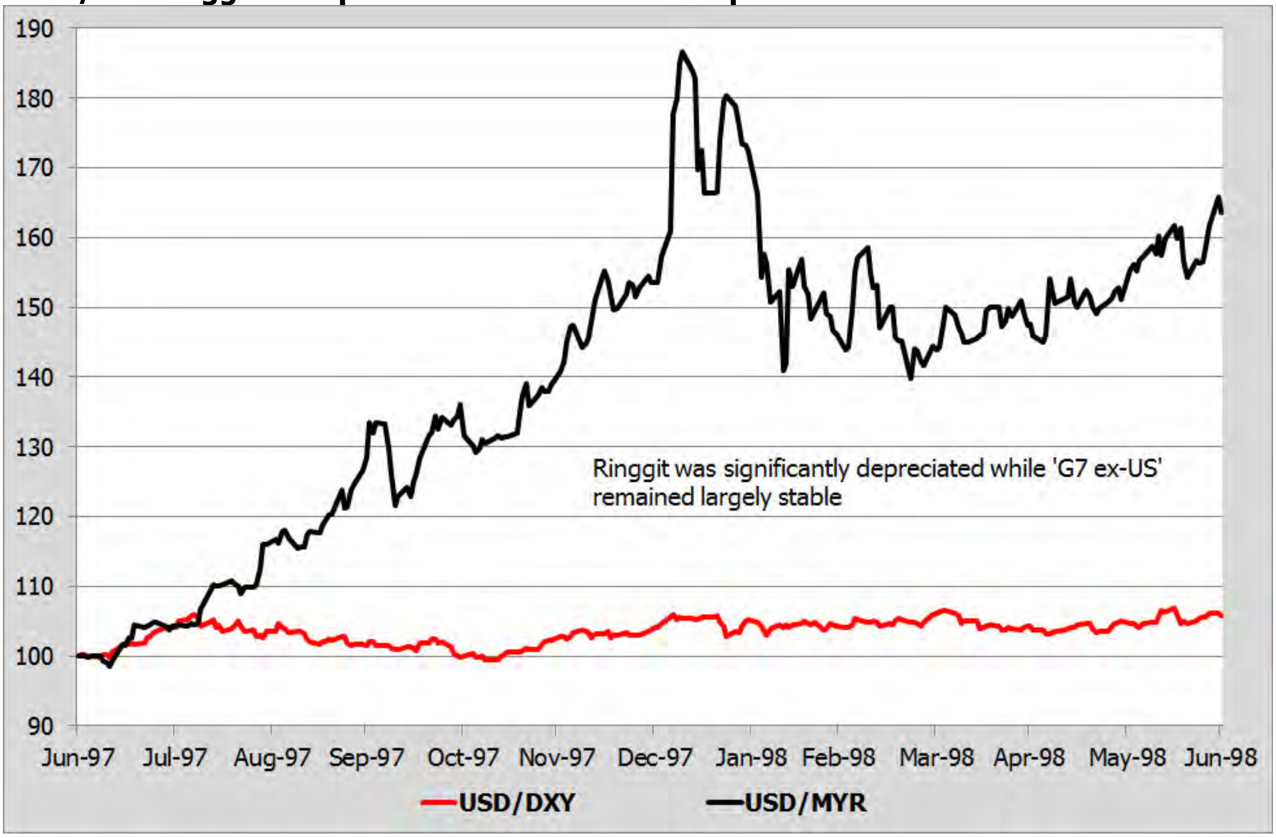


Source: Bloomberg, MIDFR

…should subdue the imported inflation effect. Hence despite the weakening USD/MYR, the ability of Ringgit to retain its value against the composite of G7 ex-US currencies should significantly limit the economic fallout insofar as the risk of heightened imported inflation is concerned.

Opposite happened during 1997/98. In contrast, the situation was totally different during the 1997/98 Asian financial crisis. The Ringgit was then significantly depreciated while other G7 currencies remained largely stable against the US Dollar. Therefore, it also resulted in a depreciated Ringgit against G7 ex-US currencies.

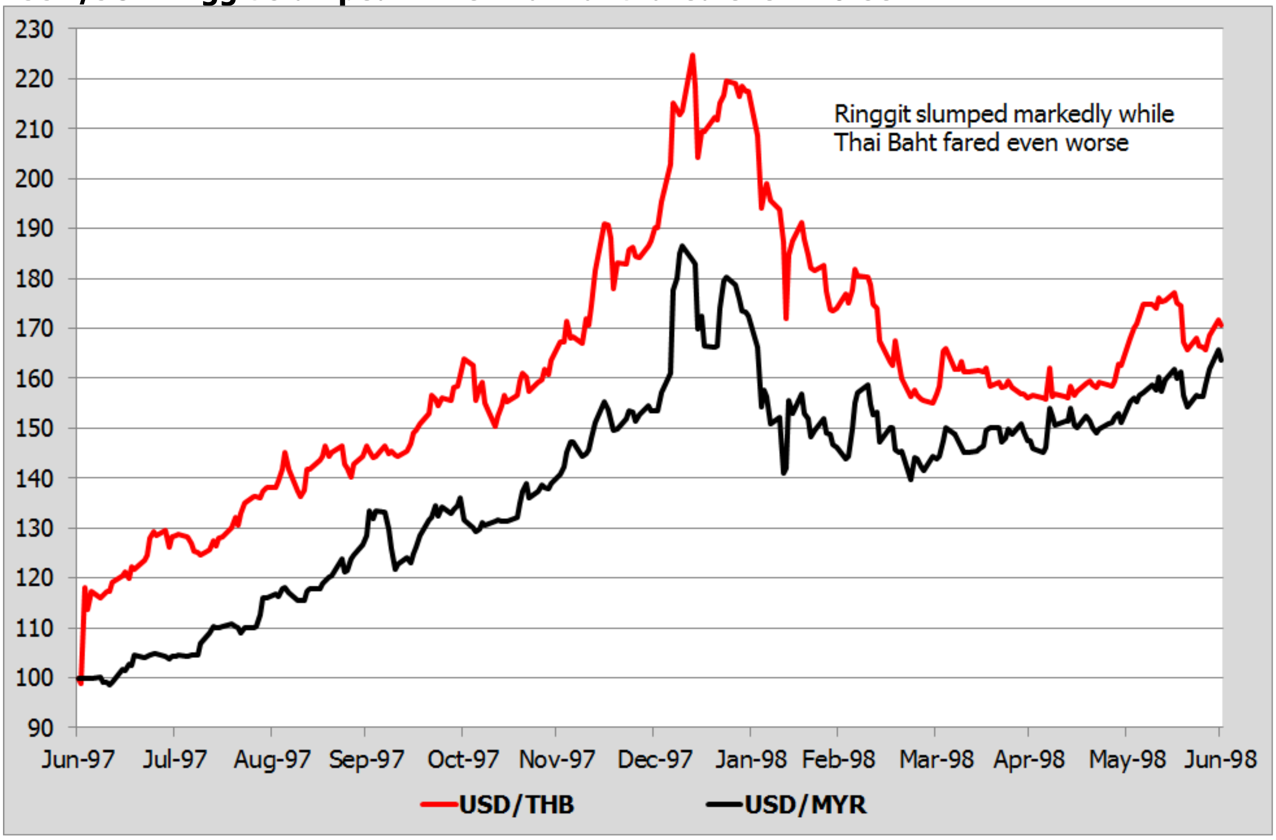
1997/98: Ringgit slumped while 'G7 ex-US' was quite stable



Source: Bloomberg, MIDFR

Weaker MYR against its regional peers… Another distinction is that while the Ringgit sank lesser or almost in tandem with its close regional peers vis-à-vis the US Dollar in 1997/98, the current episode sees the opposite taking hold. We are witnessing relative appreciation of other regional currencies against the Ringgit since September 2014.

1997/98: Ringgit slumped while Thai Baht fared even worse



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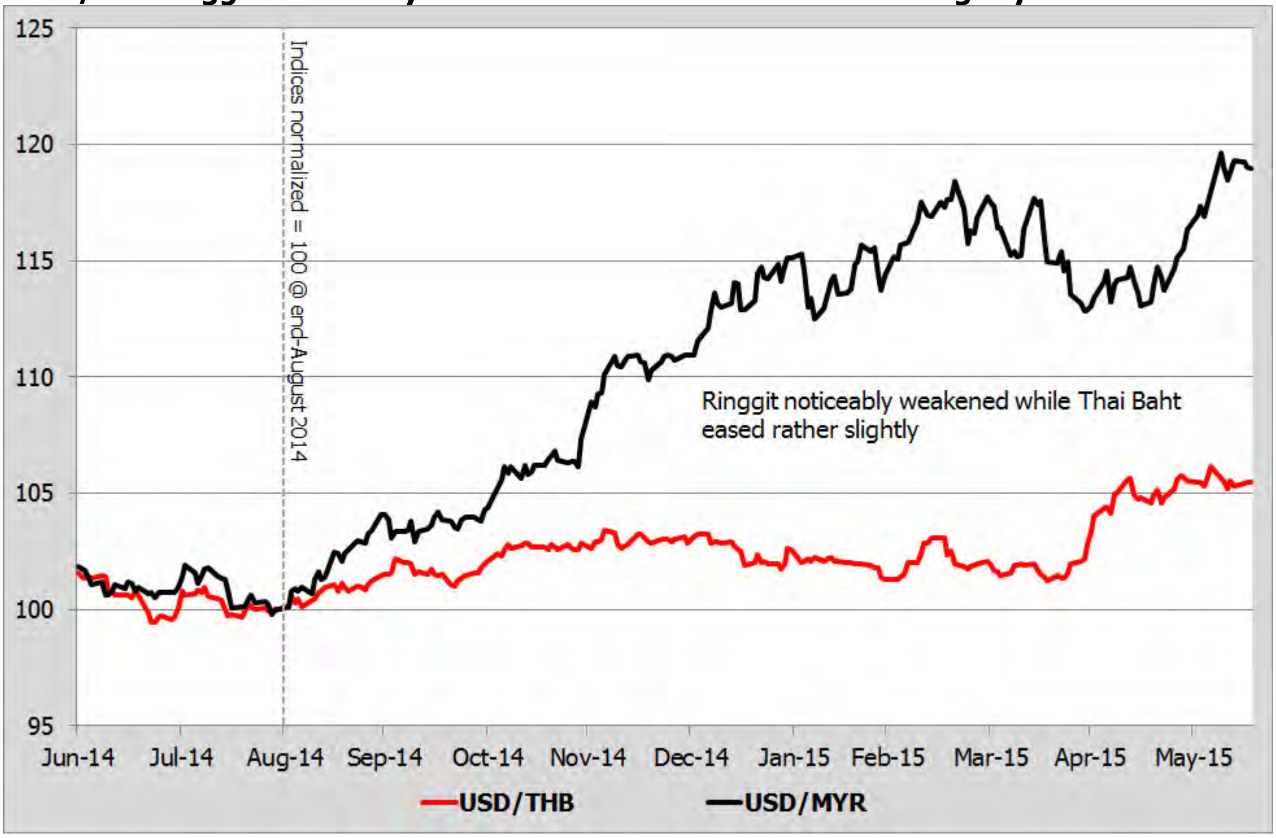
...may help to raise export competitiveness. As a trading nation (Malaysia ranked the 17th largest exporter in the world), a devaluing Ringgit against its regional rivals such as Thailand may help to raise the relative competitiveness of Malaysia's exports.

2014/15: Ringgit noticeably weakened while Thai Baht eased slightly



Source: Bloomberg, MIDFR

HEALTHY MACRO OUTLOOK TO UNDERPIN EQUITY SECULAR TREND

Continued macro expansion... Provided that the prevailing foreign exchange (FX) dynamics continue on to prevail, in our view, the weakening of Ringgit against US Dollar would not in itself result in material derailment of the nation's macro outlook. In addition, the recent stabilization of Brent crude oil prices at more than USD60 per barrel may even provide a fillip in view of the USD55 per barrel assumed under the government's revised budget for this year. Under the current scenario, our economist expects Malaysia's 2015 GDP growth to stay quite robust at 4.70% and its CPI rate to remain checked at between 2.0-2.5%.

...to buttress upward secular trend of equity market. Against the backdrop of continued economic expansion and healthy price situation, we expect the upward secular trend of the equity market to likewise remain intact into the foreseeable future.

LIQUIDITY AND POLITICAL RISKS EXERTING ON EQUITY INTERIM TREND

The ongoing liquidity-related cyclical pullback... Having said the above, in the interim, the market is expected to remain cagey due to the cyclical pullback which started in early May this year. We believe the downward price momentum is engendered by the persistent region-wide foreign equity funds outflows arguably in anticipation of the upcoming hike in US interest rates.

...is exacerbated by domestic problem. The negative momentum is further exacerbated by the heightening domestic political spats involving both intra- and inter-coalitions with matters relating to the beleaguered 1MDB taking center stage. The good news is that the economic fallout from 1MDB's extended leverage position is believed to be non-systemic, and we share the same belief. Meanwhile, the political implications are largely dependent on the outcome of ongoing official investigation. However, if the investigation results turned out to be less than satisfactory, the consequences may prove disruptive to the current political order.

FBM KLCI Secular Trend Channel

Source: Bloomberg, MIDFR

Cyclical upturn subsequent to market absorption of liquidity and political issues. We reckon the prevailing negative pressure on the short-term direction of local equity market would be neutralized (i) pursuant to the subsidence of foreign liquidity outflows, and (ii) as a result of non-disruptive outcome to the investigation on 1MDB. On this score, the pace of market absorption or normalization with regard to the outstanding issues would have a great bearing on the timing of subsequent cyclical upturn hence the attainment of our year-end FBM KLCI target.

FBM KLCI year-end target under review. We are aware that the risk is not insignificant for either or both issues to become protracted thus retarding the pace of normalization. Therefore, while we reiterate our long-standing view on the continuance of the upward secular trend of the FBM KLCI underpinned by sustained macroeconomic expansion, *we are putting our short-term 2015 year-end target of 1,900 points under review.*

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NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
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