

## The small cap bounce

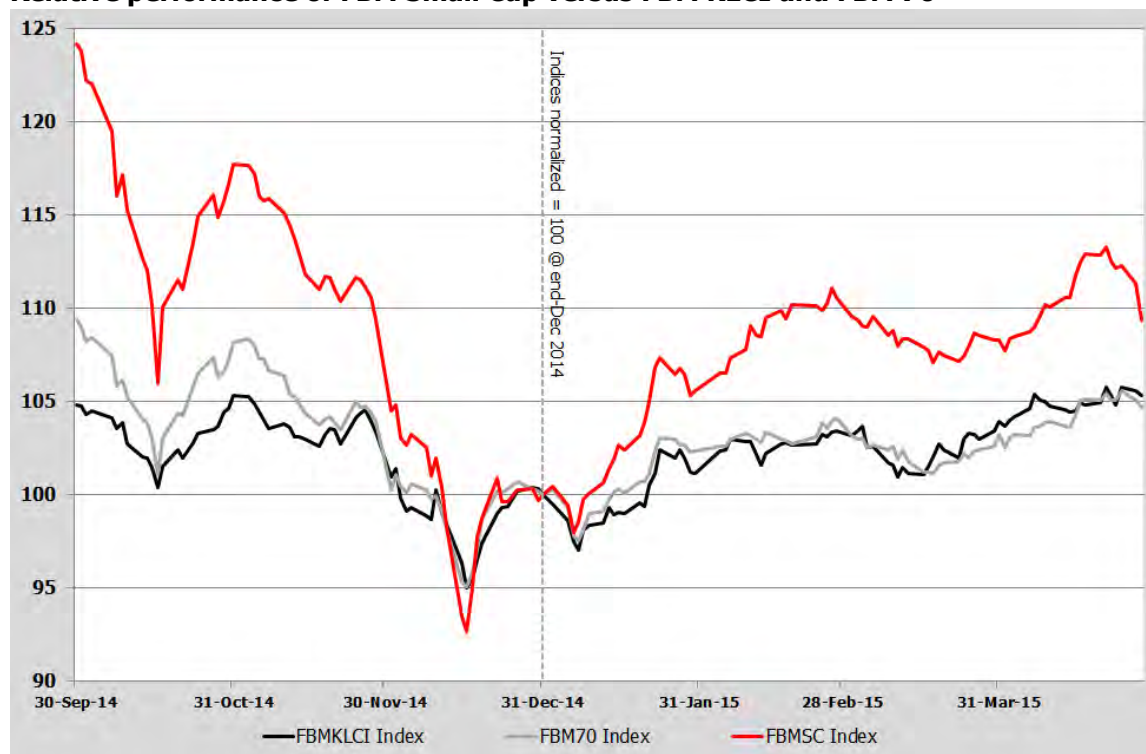
*Less ideal for buy-and-hold*

**KLCI: 1,855.06 points**  
**2015 Year-end Target: 1,900 points**

- **4Q14 pullback the most worrisome post-2008 but nonetheless 1Q15 recovery was rather swift**
- **Small cap stocks massively underperformed on the way down but failed to outperform as massively during ensuing recovery in 1Q15**
- **Small caps are generally less ideal for *buy-and-hold* unless supported by strong fundamental reasonings**

**4Q14 pullback the scariest post-2008.** The equity market pullback of 4Q14 was perhaps the most worrisome since the post-2008 recovery. This was so as the underlying causes, namely (i) slumping commodity prices particularly crude palm oil and crude oil, (ii) weakening Ringgit against US Dollar and other regional currencies, and (iii) the resultant outflow of foreign liquidity, hit on both the real economy and the financial market. This situation even prompted the authorities to announce revisions to the national budget as well as its growth estimates. This was unlike during the equity market pullback of 3Q11 where the direct effect was mainly towards the financial market.

### Relative performance of FBM Small Cap versus FBM KLCI and FBM 70



Source: Bloomberg, MIDFR

**The ensuing recovery in 1Q15 was not unexpected.** The equity market recovery in 1Q15 arguably came about upon the realization over the resiliency of the real economy and financial market to withstand lower commodity prices, weaker currency and volatility in capital flows. As stated in our 2015 Outlook report dated 10 December 2014, "...recent market reaction may have unduly amplified the impact of prevailing crude oil price on the nation's fundamentals" and "...the market to remain on a secular upward trend and regain its cyclical footing sooner rather than later". But despite the upturn, prevailing sentiment remained cautious with still heightened level of uncertainty.

**MIDF RESEARCH is a unit of MIDF AMANAH INVESTMENT BANK**  
**Kindly refer to the last page of this publication for important disclosures**


**Small cap stocks massively underperformed on the way down...** The equity market pullback of 4Q14 affected all stocks with those in the smaller cap category bore the heaviest brunt. This is attested by the stark performance divergence between FBM SC Index and FBM KLCI Index which represent the small cap and the heavyweight stocks respectively. The FBM SC slumped by -19.4% and the FBM KLCI declined -4.6% in 4Q14.

**...but failed to outperform as massively on the way up.** The equity market recovery in 2015 to-date, on the contrary, saw the FBM SC outperformed against the FBM KLCI. The FBM SC jumped +9.4% and the FBM KLCI rose by +5.3% thus far this year. However, it must be highlighted that the outperformance of FBM SC on the way up failed to commensurate its earlier underperformance on the way down. Thus, on the whole, the FBM SC did not perform as well and it remained in the deficit at -11.9% while the FBM KLCI actually posted a gain albeit marginally by +0.5% since end-Sep'14 to-date.

**Small cap stocks less ideal for buy-and-hold...** The contrasting performance, on the whole, between the FBM SC and FBM KLCI serves as a reminder that heavyweight stocks are the more suitable choice for buy-and-hold investment strategy. On the other hand, small caps stocks are generally more suited for trading purposes and less ideal for buy-and-hold particularly during period of heightened uncertainty. Also as stated in our 2015 Outlook report dated 10 December 2014:

**"Wither the small caps.** During period of heightened uncertainty, small and mid-cap stocks invariably do not perform well. The biggest uncertainty which may put a damper on these stocks moving forward is with regard to the dwindling risk appetite in view of the tightening financial liquidity. Hence only a stringent bottom up approach to small and mid-cap stocks selection is recommended."

**...unless supported by strong fundamental reasonings.** In short, we opine that exposure to small cap stocks (i) must adhere to strict trading disciplines (e.g. entry/exit triggers, stop-loss), or (ii) with buy-and-hold positions taken only when they are supported by strong fundamental reasonings (e.g. sustainable earnings expansion) – not because of failure to follow rule number (i). On this score, we reiterate our earlier view that only a stringent bottom up approach to small cap stocks selection is recommended.

**Maintain FBM KLCI year-end target of 1,900 points.** We maintain our FBM KLCI 2015 year-end target of 1,900 points, which is equivalent to (i) 2.4% gain from current level, and (ii) 17.3x PER multiple of 2015 earnings. However, as highlighted in our previous Strategy reports, we expect the 2015 earnings revisions going forward to be generally flat or even upward-biased. Hence the resultant PER valuation of our 2015 year-end target may turn out to be lower than 17.3x. 

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).  
 (Bank Pelaburan)  
 (A Participating Organisation of Bursa Malaysia Securities Berhad)

## DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

### 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.