MARKET INSIGHT

AS AT 26 May 2015 UNLESS OTHERWISE STATED

Factors that cause KLCI to shed almost 6% since end April 2015……….

The KLCI has corrected sharply since mid May, post the weak debut of Malakoff, the largest IPO since Oct 2013. Sentiment for Malakoff was poor as it was reported in the media that Malakoff was considering to acquire 1MDB's power assets. However, management subsequently denied this, and prices have since stabilized.

Nevertheless, the KLCI has corrected 2.8% since the end of April amidst poorer than expected reported corporate earnings, after 7 consecutive quarters of earnings downgrades, indicating that we have not seen the end of the earnings downgrades as yet. The 11th Malaysian Plan whilst reaffirmed the vision of building Malaysians to be a high income nation, the key is always implementation risk.

As indicated in our previous month's market outlook, we had expected that news flow on 1MDB will likely continue to be on investors' minds, but recent rumours of Tenaga potentially taking over 1MDB's power assets as part of a plan that could eventually include the unbundling of TNB's business into three separate entities : generation, transmission and distribution. This plan is apparently expected to be tabled to the Cabinet next month. The above plan is unexpected especially the news to unbundle Tenaga's businesses to facilitate this. The market power pooling proposal is not new and given the new plant ups and the new PPAs Tenaga has entered into recently, revisiting this is a surprise, as the energy commission was still in the midst of trying to make the Fuel cost pass through (FCPT) work. Our take is that any forced acquisition on Tenaga's part of 1MDB's power assets will be negative not just for Tenaga but for corporate Malaysia as a whole. Corporate governance which Malaysia has worked so hard to clean up will be in the spotlight again.

In addition, we had also highlighted the risk of the rating agency Fitch's decision on Malaysia's sovereign rating which may be announced in June. Based on earlier comments made in the media, the outlook for this rating does not seem favourable.

We were already adopting a cautious stance, and believe the difficult step the government is taking towards fiscal consolidation is a necessary one, and does not preclude the fact that there are still interesting investment ideas in Malaysia. The short term volatility is an unfortunate outcome of politics and the lack of transparency. In the short term, we expect equity markets to remain volatile and any correction would serve as an opportunity to accumulate fundamentally strong stocks on weakness.

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