Traders Spectrum

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From the Chartroom

Malaysian equities could still offer promising returns despite the presence of visible risk forces. As investors recalibrate their risk-reward expectations in response to a rocky investment landscape, there is still money to be made through exposure in preferred sectors and undervalued laggards from a bottom-up perspective. Technically speaking, after staging a rebound from our major support area of 1,650-1,700, the benchmark FBM KLCI may face intermittent weaknesses initially before scaling higher highs going forward, probably peaking somewhere inside our unchanged technical resistance targets of 1,900-2,000.

3Q13 was volatile just like the previous quarter. The key market barometer swung from a high of 1,811.65 in late Jul to as low as 1,660.39 in late Aug before making a V-shaped recovery to settle at 1,776.16 last Friday. With only one more day to go this quarter, this is barely above its end-2Q13's closing of 1,773.54.

Regional equities saw a similar choppy performance. Quarter-to-date, the top performers were China shares listed in Hong Kong (+12.7%), Hong Kong (+11.6%) and Korea (+8.0%) while Indonesia (-8.2%), Thailand (-2.4%) and Philippine (-1.3%) posted negative returns. Major US stock indices were up (by between 2.3% and 11.1%) during the same period.

And since end-2012, Malaysia is the fourth best performing market with a year-to-date increase of 5.2% – ranked after Japan (+42.0%), Philippine (+9.8%) and Taiwan (+6.9%). At the bottom of the list, China shares listed in Hong Kong (-8.2%) was the only one among the 11 Asian bourses tracked by us to be in the red, below the next two underperformers Korea (+0.7%) and Singapore (+1.4%).

How global equities will fare for the rest of the year will be contingent on the intensity of the liquidity force. This follows the US Federal Open Market Committee (FOMC)'s decision to continue the purchase of securities at a similar pace of USD85b per month as the policymakers want to await further evidence of a sustained US economic recovery before unwinding the monetary stimulus measures.

It is also worth stressing that the asset purchases program is not on a preset course and any moderation in the pace will only be made after evaluating the incoming data on the US economy, unemployment rate and inflation conditions, while the monetary policy will remain highly accommodative for the foreseeable future.

Nevertheless, it is inevitable that the tapering process will begin sooner or later. As the US Federal Reserve walks a tightrope to avoid falling into a self-reinforcing trap – trying to juggle between phasing out the quantitative easing policy and preventing the adverse consequences of rising bond yields/mortgage rates from ricocheting back into the real economy – the liquidity-driven rally may prolong for a while more.

Should the US Federal Reserve decide to further defer its gradual monetary normalization plan in the upcoming FOMC meetings (scheduled on 29-30 Oct and 17-18 Dec), we may see a partial return of the foreign funds exodus to Asian equities.

Prior to this, heightened fears of premature liquidity withdrawals have led to a repatriation of foreign money especially from emerging equity markets. Between Jun and Aug, net foreign fund outflows were estimated at USD3.0b in Thailand, USD2.8b in Indonesia and USD0.6b in Philippine. Nevertheless, there are preliminary signs of a reversal as foreigners turned net buyers again amounting to USD349m in Thailand, USD39m in Indonesia and USD610m in Philippine so far this month.

Back home, after pulling out USD3.3b from Malaysian equities (Jun-Aug) and USD7.6b from our domestic bonds market (Jun-Jul), we will get to check on the trading pattern of foreign investors in Aug/Sep when the monthly data is released this week. And whether they will be inclined to buy or sell more of our local stocks going forward will also depend on emerging domestic factors.

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Key events to watch out for in 4Q13 include: (a) the pipeline of sizeable initial public offerings – namely Westports Holdings (mid-Oct), UMW Oil & Gas Corporation (end-Oct), IOI Properties, Berjaya Auto and Karex (all targeted for listing before this year-end) – with their debut performances indicating investors' risk appetite; (b) UMNO party elections (due on 19 Oct), as the attention shifts to the battle for the third highest echelon of leaders following the no-contest victory at the top two posts in the leading component member of the ruling coalition; and (c) Budget 2014 (scheduled on 25 Oct), which will be closely scrutinized in view of growing worries over escalating government debts.

In particular, investors will be eager to know how the federal government intends to plug its budget deficit gap while simultaneously pumping in money to keep the momentum of its major economic transformation projects going. Amid talks of possible implementation of a goods and services tax (GST), an overhaul of personal income/corporate tax structure and other ways to increase additional revenue, the government's top challenge now is do a fine balancing act. Raise taxes or roll back the subsidies too much and ordinary Malaysians (who are already facing mounting costs of living) will have even less disposable income to spend, which in turn will hurt private consumption. On the other hand, overcutting public expenditure may slow down the economy given the multiplier effects.

Yet, maintaining status quo is no longer an option. Should Malaysia's debt situation deteriorate deeper, the risk of a downgrade in sovereign credit ratings will inevitably trigger a chain of adverse economic consequences (i.e. rising borrowing costs, depreciating Ringgit, inflationary pressures).

From a fundamental perspective, our stock market valuation – at a 2014 P/E multiple of 15x – is currently not overly expensive, hovering near its historical mean (since 1998) and within the regional range of 11x-16x. This could cushion downside risks in the near term.

Technically speaking, the FBM KLCI – riding on positive momentum – is on course to scale greater heights. Our self-developed trading system – which runs on embedded formulas based on selected technical concepts and filters and is statistically verified by back-testing the historical results – is still signaling that the bellwether could extend its uptrend ahead (as discussed in our 3Q13 From The Chartroom write-up).

For this trading program, a 20% bullish rule has been set. When the FBM KLCI meets our pre-set criteria, buy indicators will be generated on the chart. To pass the test, the index must climb above 20% from the trigger points for them to be counted as valid signals. Otherwise, if the index declines by at least 20% initially, then a false signal is registered, whichever comes first (with their reliability subject to statistical significance tests).

Referring to Appendix 1, between 1979 and 2011, a series of 25 buy signals have appeared on the FBM KLCI weekly chart. 24 of them – or a probability rate of 96% – have correctly predicted subsequent gains of >20% in the benchmark index. The latest emergence of Buy Signal No 28 in Sep this year – in addition to the outstanding Buy Signal No 26 and No 27 in mid- and end of last year with all three yet to pass or fail the 20% rule test – therefore anticipates further upsides in the FBM KLCI.

If they keep to our rule of advancing by more than 20% first, by marking up 20% from the three trigger points, this trading tool is suggesting the bellwether could eventually ascend to the targeted minimum thresholds of 1,879, 1,978 and 2,133 respectively (Appendix 1b), although the timing to do so is vague.

Meanwhile, our local bourse might have hit a market bottom already after sliding from a high of 1,826.22 in early May to a trough of 1,660.39 in late Aug, which was within our previously set major support area of 1,650-1,700. The turn-up was reinforced by the timely bounce-up of the FBM KLCI from: (a) a long-term positive sloping trend line (in blue on Chart 1), repeating the pattern of ensuing rebounds from previous pullbacks by the index; (b) its 300-day moving average (MA) line (in green on Chart 2), which has cushioned prior index falls since the beginning of 2012; and (c) 1,655, being the 33% retracement level when measured from a trough of 1,310.53 in late Sep 2011 to a peak of 1,826.22 in early May this year.

At last Friday's closing of 1,776.16, the bellwether has now recouped 115.8-point or 7.0%, inching closer to its all-time peak of 1,826. Despite facing short-term selling pressures, the FBM KLCI is expected to extend its recovery pattern ahead. As it attempts to enter into the uncharted territory, the benchmark index could subsequently push to test a tough resistance barrier at 1,825.

An ensuing breakout will then propel the bellwether to plot fresh record highs and resume its 4½-year rally (from a trough of 836.51 in mid-Mar 2009) going forward. Our major resistance targets and support lines for the FBM KLCI – as it whipsaws its way to higher highs and higher lows – remain intact at 1,900-2,000 and 1,650-1,700, respectively. With upside potential (ranging between 7%-13%) outweighing downside risks (of 4%-7%), we reaffirm our bullish technical pattern for Malaysian equities (with preferred sectors like banking, construction and oil & gas likely to outperform).

Chart 1: The FBM KLCI could have hit a bottom at 1,660 already

Chart 2: The FBM KLCI technical outlook

First Key Support: 1,700 | First Major Resistance: 1,900
Next Key Support: 1,650 | Next Major Resistance: 2,000

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Appendix I (a): Buy signals generated by our 20% trading system

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Appendix I (b): Buy signals generated by our 20% trading system

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