

MONTHLY MARKET REVIEW MAY 2009

In May alone, the MSCI Far East ex-Japan index (MXFEJ) gained 13%, resulting in a 59% rise from its March lows as market momentum remained strong. We had earlier expected the market uptrend to become more gradual on the assumption that investors would become more discerning after two months of strong gains but this was clearly not the case. India and Singapore, the best performing markets in May made sharp gains of 36% and 24%, respectively, in US\$. In our view, this continued run-up is not an indication of euphoria but one of short term panic by investors caught by being underinvested and who are now trailing the market.

It was a stronger than expected month for Malaysia as the KLCI ended May 53 points or 5.4% higher to close at 1,044 points. Sentiment was driven by news of new construction contracts and positive CPO price outlook. Sectors which performed well included oil and gas, construction and banks. Although the announcement of 1Q09 GDP on May 27 was indeed weak at -6.2%, nearly double consensus estimates, the market took the bad news in its stride. Also, results released during the month were also not as bad as feared, and helped contribute to the market's firm performance. The market appreciated on heavy volume and was again broad-based, rotating between big cap blue chips and second and third-liner stocks. The broader market's performance was better than the KLCI as FBM Emas gained 6.8% to 6,984 points. Smaller caps also did better as FBM KL 2nd Board rose 6.2% to 4,575 points while FBM MDQ jumped 16% to 4,040 points. The average value traded on Bursa in May surged 50% m.o.m to RM1.84bn (RM1.23bn in Apr) per day. During the month, daily trading volume nearly touched 4bn units at its peak, its highest level in 27 months.

On the economic front, Bank Negara announced a sharp contraction in the 1Q09 GDP of -6.2% y.o.y. This prompted the government to revise downwards Malaysia's 2009 GDP forecast from a range of -1% to +1% previously to an expected contraction of 4% to 5%. Reflecting the weak GDP number, Malaysia's industrial output for Mar-09 declined 14.4% y.o.y, albeit at a smaller magnitude vis-à-vis prior month's 14.6% y.o.y drop. This was in line with the trend for Malaysian exports, which declined for the sixth consecutive month in Mar-09, by 15.6% y.o.y, albeit less than prior month's 16.0% tumble. Meanwhile, imports dropped 28.7% y.o.y, worse than Feb-09's 27.6% plunge, leaving a trade surplus of RM12.5bn. Despite the upsetting economic data, Bank Negara kept its overnight policy rate (OPR) at 2%. The MYR strengthened to MYR3.4865/USD from MYR3.556/USD as of 29 May 2009.

Although market momentum is strong, we are turning cautious on equity markets. Given the speed of the rise in such a short time frame, markets remain technically vulnerable in the near term. There are, however, also a few reasons to believe that the current rise in Asian markets will continue. First, economic indicators in Asia are indeed stabilising, or are even beating expectations in some instances. Although 1Q09 GDP across Asia contracted sharply year-on-year, many official 2009 GDP forecasts for Asian countries are much higher than that registered in the first quarter--a clear indication that policy makers in the region are predicting that the worst is over. At the time of writing, the IMF has just revised up Indonesia's 2009 GDP growth from 2.5% to between 3% - 4%. These upgrades are in sharp contrast to the economic downgrades just a few weeks ago and should lure more investors into the region.

Second, the success of Asian reflationary efforts stands in sharp contrast to the constraints faced by policy makers in developed economies in dealing with this economic crisis. For instance, while China has continued to reflate its economy with a relatively high degree of success, the UK has had its outlook put on negative ratings watch by Standard & Poor's, a rating agency. Although a negative ratings watch will not necessarily translate into a downgrade, it does highlight the

constraints faced by a number of developed countries and that developed economies remain vulnerable to a protracted period of sub-par growth. For global asset allocators, the macro-economic health and the policy traction of many Asian countries and their undemanding stock market valuations should stand out as attractive alternatives to developed markets where the economies are beset by deflationary problems and limited policy responses.

Third, with a relatively sound financial system, government pump priming efforts, a low interest rate environment, and returning domestic demand, many analysts have realised that Asia is not faced with deflation but inflation instead. This has led analysts to not only re-jig their valuation models but to cast away balance sheet-based valuation models like price-to-book measures and returned to income statement-based earnings & cash flow driven valuation models. Changes in these valuation approaches have resulted in large swings in target prices of individual securities. This has led to a continuation of the uptrend in equity prices as an increasing number of investors embrace this thesis.

Fourth, valuations in a few markets are still not excessive. On PER valuations, we continue to like Indonesia, Philippines, and Thailand. On other measures like Price-to Book and dividend yields, we like Singapore selectively. For other markets, following three consecutive months of rise, investors are likely to be more discerning and focus on more fundamental considerations like valuations. Following sharp run-ups, India and Taiwan are looking vulnerable to corrections.

June is likely to be a choppy month for Asian markets. In the absence of unexpected negative news, the market's momentum is likely to continue but, on the other hand, prices have risen to levels where investors who have been early in the rally may be tempted to take profits and perhaps rotate into laggards. The chances of a market consolidation are getting higher as stock valuations are getting pushed to levels which, in our view, reflect expectations of either a quick and sharp global economic recovery or a period of inflation or both. The global recovery, however, is likely to be long drawn and inflation may only be present in Asia, and not in developed economies.

Source: Pheim Unit Trusts Bhd