



The Observer

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❖ Stock market headwinds in 2H2022

At a glance, Bursa Malaysia-listed companies seem to have priced in the numerous headwinds predicted for 2022 - from the prolonging Russia-Ukraine conflict to the US Federal Reserve's aggressive stance on interest rate hikes.

These challenges have overwhelmed the stronger economic growth as Malaysia re-opened its international borders on 1 April 2022 and even the surge in foreign fund inflows.

Historical market downturns in Malaysia

On 13 July, the FBM KLCI fell to its year-to-date (YTD) low of 1,411 points. As of end-July, the benchmark index was down 4.8% YTD or 13% from its post-COVID-19 peak level of 1,685 points on 12 December 2020.

Since 1995, the average duration of a Malaysian market downturn had been 13.6 months with the longest being 23 months. An analysis by CGS-CIMB Research revealed that the Malaysian market may have peaked on 12 December 2020 and appears to be on a downtrend after having fallen 13% from its peak.

Tracking the key sectoral index during the previous market downturn periods, it was found that the construction, property, finance and small-cap sectors (local cyclical sectors) tended to underperform the FBM KLCI.

Sectors that tend to perform better against the benchmark index in most instances during past market downturns are consumer, technology, telco, healthcare, and utilities.

It was also observed that the technology and transport sectors have gained the most since their COVID-19 lows (166% and 70% respectively) while the real estate investment trust and utilities sectors have gained the least (3% and 10% respectively).

Sectors that have pared down most of their gains from previous COVID-19 peaks were the healthcare, energy, and construction sectors (between 16% and 56%).

Key events to watch in 2H2022

Here are some headwinds that minority shareholders or retail investors should be wary of given that the wise have always cautioned against assuming that there are no crocodiles lurking in calm waters.

Although the FBM KLCI has firmed up from its YTD low of 1,411 points on 13 July, the market may not have bottomed out yet due to elevated risks from worldwide inflationary pressure, further interest rate hikes, a slowdown in China's economic growth, and escalating sanctions related to the Russia-Ukraine conflict. What more with the recent tensions between China and the US over Taiwan.

As such, it is expected that market sentiment will remain weak with downside risk in third quarter of 2022 as markets attempt to price in peak US interest rates. Thereafter, the market could be range-bound with potential upside if concerns over rate hikes or US recession risks subside and earnings risks for Malaysian corporates have been priced in.

This could offer trading opportunities for investors looking for bargains in the stock market over the medium term.

Some positive news for the local bourse is the return of foreign workers, better-than-expected tourist arrivals, easing inflationary pressure, a resolution to some of the ESG (environmental, social and governance) concerns relating to forced labour, and hopefully, a market-friendly Budget 2023.

Moreover, there is additional liquidity for domestic institutional funds like the Employees Provident Fund (EPF) following the end of its unprecedented one-off withdrawal schemes which totalled RM141 billion.

Other key events to watch out for in the 2H2022 are:

- Monetary policy decisions of central banks
- Potential fiscal stimulus measures to avert global slowdown/recession
- Potential 15th General Election (GE15) and its outcome
- Results seasons in August 2022 and November 2022
- 5G development
- Risk of any major COVID-19 or other outbreaks that may lead to imposition of lockdowns.

Overall, the market is expected to be volatile throughout the 2H2022 as it adjusts to the various challenges.

Beneficiaries of a weaker ringgit

The ringgit has depreciated by 6.3% YTD to RM4.425 against the greenback. Historically, a weaker ringgit tends to be negative for the FBM KLCI as it will trigger an outflow of foreign funds.

Nevertheless, analysts opine that the ringgit depreciation is probably nearing the end as the market has priced in the US Fed's hawkish stance and China's bearish outlook. On top of that, the return of foreign tourists should bring in the much needed inflows. This should benefit hospitality players.

A weak ringgit generally benefits exporters – from palm oil producers to rubber gloves, technology, oil and gas (O&G), shipping, furniture, timber and food or manufacturing companies with a high proportion of export earnings or where Malaysia has a competitive edge in terms of land, power, labour costs and investment incentives.

On the same note, this is also positive for companies that earn a high proportion of their revenue from foreign subsidiaries (e.g., IHH Healthcare Berhad, PPB Group Berhad and MISC Berhad).

On the contrary, a weak ringgit is a bane for auto players, airlines and consumer products companies if they are not able to pass on the higher costs to consumers due to weak demand. Other key losers of a weaker ringgit are companies with high foreign shareholding and high costs denominated in foreign currencies.

Beneficiaries of OPR hikes

The overnight policy rate (OPR) currently stands at 2.25% after two consecutive hikes in 2022 by Bank Negara Malaysia (BNM).

CGS-CIMB Research expects BNM to further raise the benchmark rate by another 25bps in September to end 2022 with a rate of 2.50%, followed by another two 25bps hikes in 1H 2023.

The research house foresees BNM to remain steadfast in policy normalisation even if that means a greater divergence from the more hawkish US Fed. In its view, BNM's key focus is to prioritise domestic growth and address inflationary pressures and it will utilise other approaches to handle currency volatility.

Overall, OPR hikes are positive for banks with potential expansion in net interest margin. Companies with high net cash balances could also benefit from higher interest income.

However, rise in interest rate is negative for cyclical sectors such as property, auto and consumer due to a decrease in consumers' disposable income. A rate hike is also negative for companies with high borrowings due to higher interest expense.

Potential GE15 beneficiaries

Another major market risk for investors is the impending general election.

Highly regulated sectors or companies dependent on government contracts are likely to see higher volatility pre-election and could potentially benefit post-election if there is more policy clarity.

They include telcos, utilities, e-government service providers, contractors and selected consumer-related companies given that the Government is likely to implement market-friendly policies like cash hand-outs and subsidies to assist consumers.

Economic outlook

Notwithstanding the headwinds ahead, analysts generally assign positive outlooks on Malaysia's economic growth.

CGS-CIMB Research maintained its 2022 GDP growth forecast of 6.2% while projecting the economy to expand 5.0% in 2023.

After recording better-than-expected GDP growth of 5.0% y-o-y in 1Q 2022 (3.2% in 2021), the research house expects a continual outperformance in the following quarters. Extensive subsidies have provided room for consumer spending despite rising inflationary pressure.

That said, Malaysia's economic growth may see signs of moderation towards the end of 2022 with challenges ahead such as the withdrawal of extraordinary policy support, the implementation of more targeted subsidy schemes, domestic political risks and global economic headwinds.

Further fiscal consolidation

The Malaysian government is expected to maintain its fiscal deficit projection at 6.0% of GDP in 2022 despite the Finance Ministry's recent guide of a record high subsidy bill of RM77.3 billion for 2022 compared to the budgeted RM33 billion announced in Budget 2022.

However, there are views that the government may consolidate its fiscal position in 2023, in view of the implementation of tax reform measures to broaden the government's revenue base and a re-orientation of fuel subsidy mechanism should commodity prices remain elevated.

Moreover, the government has indicated that a targeted fuel subsidy mechanism is in the works with the re-introduction of Goods and Service Tax (GST) currently being studied.

Devanesan Evanson
Chief Executive Officer

MSWG AGM/EGM Weekly Watch 8 – 12 August 2022

For this week, the following are the AGMs/EGMs of companies which are in the Minority Shareholders Watch Group's (MSWG) watch list.

The summary of points of interest is highlighted here, while the details of the questions to the companies can be obtained via MSWG's website at www.mswg.org.my.

Date & Time	Company	Quick-take
08.08.22 (Mon) 02.00 pm	Power Root Berhad (EGM)	Power Root has proposed to establish an employees' share option scheme (ESOS) of up to 10% of its issued shares to eligible directors and key employees of the Group.

		It also proposed to allocate ESOS options to all the directors on the Board including five independent directors.
10.08.22 (Wed) 10.00 am	Pertama Digital Berhad (EGM)	The Company is seeking an exemption from Bursa Malaysia from being an affected listed issuer under Para 8.03A of the Main Market Listing Requirements since it has acquired other businesses after disposing its interest in Be Top Limited to GIL for RM70 million. The Company had conducted the sale in 2019 and is in the process of culminating it.

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•With regard to the companies mentioned, MSWG holds a minimum number of shares in all the companies covered in this newsletter.

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