Mind the gap

Strategy

Malaysia Strategy

KLCI 1,673.92
@ 26 October 2016

POSITIVE (maintain)

KLCI Target: 1,760

Previous target: 1,746

It has not been a normal year in 2016 with the breadth of headwinds buffeting financial markets. We believe we are not alone in hoping for a more sedate 2017. Our assessment points to a Fed funds rate hike becoming a major focus in 2017. We build a DCF model to assess the impact of a Fed hike on the US stock market and the KLCI. We have highlighted before that Malaysia is on a significantly better footing to weather a Fed hike given its positive savings-investment gap, fiscal consolidation trajectory, high foreign reserves, positive interest rate differential over the US and ample liquidity in the financial system. Nonetheless, Malaysia's current account surplus narrowed in 2Q16, prompting fears of a further deterioration; our analysis indicates that this should mark the trough, barring further external weakness. We introduce our 2017 year-end KLCI target of 1,760 with reasonable upside from current levels. Hence, we remain Positive on Malaysia.

The long arms of monetary policy

Our DCF model for the US market shows that a 10bps rise in the 10-year US Treasury yield would cause a 2.5% de-rating in the S&P500. Likewise, a 10bps change in the 10-year MGS yield would have a 1.7% impact on the KLCI. However, as monetary policy is the autonomy of BNM, a rate hike in the US does not directly affect the KLCI. Instead, it is the relative PER that is the contention. Historically, the KLCI has traded at an average premium of 2.1% over the S&P500; it is now at a 7.4% discount. If the historical mean holds, the S&P500 would have to devalue by 9.3%, or about a 40 bps rise in the risk-free rate, before having an impact on KLCI.

Current account narrowing likely at the trough

The current account surplus in 2015 was RM34.7bn or equivalent to 3.1% of GNI, but narrowed to RM1.9bn in 2Q16, or 0.6% of GNI. The main surplus driver is the trade account. In 2015, the trade balance of RM91.6bn was due to four major components – LNG, palm oil, crude plus petroleum products, and E&E. All four made up RM156.4bn, or 171% of the trade balance. The key culprit is LNG contribution that has fallen 36% y-y for 8M16 due to the lag effect to Brent; export volumes have been relatively flat. In 2015, average LNG export price was estimated at RM34.80/mmbtu, but it fell to RM18.17 in May. However, it has since rebounded to RM21.70 in August and the upturn should continue with stable Brent prices. Also, we estimate that LNG export prices must fall below RM10, or US$2.40/mmbtu, before tipping the current account into a deficit.

Better 2017 macro conditions

The government forecast calls for GDP growth of 4-4.5% in 2016, rising to 4-5% in 2017, with inflation of 2-3% from 2.3% this year, the fiscal deficit falling from 3.1% to 3%, and a current account surplus of 1.1%, from 1.4%. Our own GDP expectation is 4.2% in 2016, rising to 4.4% in 2017. We see the Ringgit at RM3.95 to RM4 to the USD and expect the BNM to stand pat on OPR for 2016. The OPR outlook for 2017 would depend on external environment given the resilient domestic economy. IMF forecasts global growth of 3.1% in 2016 (vs. 3.2% in 2015), before rising to 3.4% in 2017.

Headroom available

After an EPS contraction of 4.2% in 2015, we see flat earnings in 2016 before accelerating to 6.3% in 2017. We are pleased that growth is broad based with 17 of the 18 sectors contributing positively. The KLCI is trading at an 18.1x 2016E PER and 17x 2017E PER. Our KLCI fair value is 1,656 for 2016 and we introduce our end-2017 index target of 1,760 points, from 1,746 for mid-2017 previously. Our top picks list is on the right, and follows from eight investment themes that we are introducing in this report.

Affin Hwang's 8 investment themes

1. Developed nation by 2020
2. Ongoing investment cycle
3. Large middle-income society
4. Shift from public to private services
5. Private consumption
6. Young demographics
7. Rapid earnings growth
8. High dividend yield

Source: Affin Hwang

Key market statistics

	2016E	2017E
GDP growth (%)	+4.2	+4.4
KLCI EPS growth (%)	0.0	+6.3

Source: BNM, Affin Hwang estimates and forecasts

Top calls for 2017

Stock	Rating	Price (RM)	TP (RM)
Top Buys			
GAMUDA	BUY	4.90	5.74
GENTING MALAYSIA	BUY	4.74	5.00
GLOBETRONICS*	BUY	3.56	4.88
INARI	BUY	3.33	3.54
IOI PROPERTIES	BUY	2.49	2.89
JAKS RESOURCES	BUY	1.03	1.60
KPJ	BUY	4.20	5.01
PAVILION REIT	BUY	1.75	2.00
PUBLIC BANK	BUY	19.80	21.20
SCICOM	BUY	2.07	2.74
SUNWAY CONSTRUCTION	BUY	1.65	2.03
TA ANN	BUY	3.50	4.67
TENAGA	BUY	14.32	16.50
TIONG NAM	BUY	1.66	2.10
UOA DEVELOPMENT	BUY	2.58	2.64
WCT	BUY	1.69	2.00
WESTPORTS*	BUY	4.32	4.90
YTL REIT*	BUY	1.20	1.60
Top Sells			
MCIL	SELL	0.69	0.50
MEDIA PRIMA	SELL	1.28	1.03
STAR	SELL	2.49	2.13
UMW-OG	SELL	0.86	0.73
UNISEM	SELL	2.59	1.98
TELEKOM*	SELL	6.60	5.85

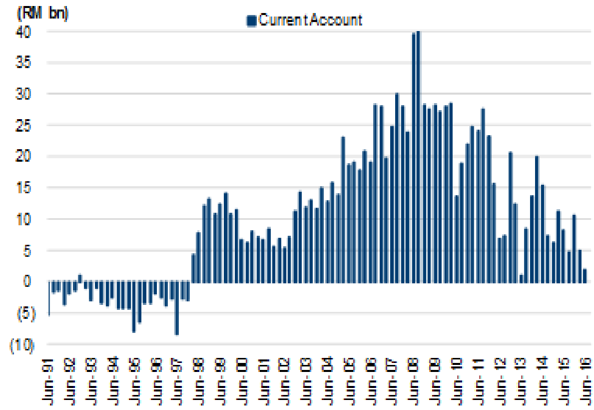
*new addition

Source: Affin Hwang, pricing as of 26 October 2016

Chue Kwok-Yan
(603) 2146 7618
kwokyan.chue@affinhwang.com

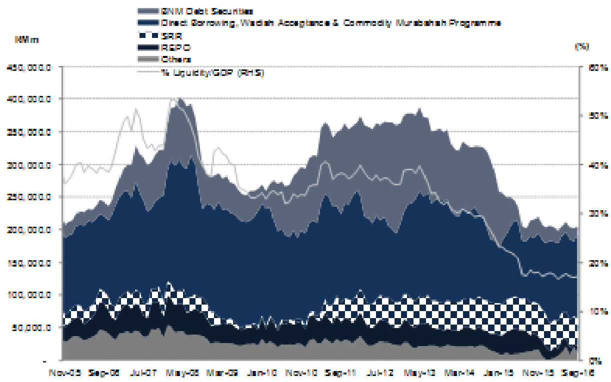
Focus Charts

Fig a: Malaysia's positive savings-investment gap



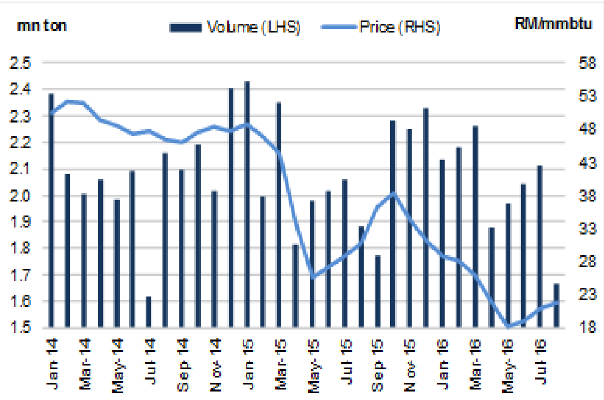
Source: BNM

Fig b: Excess liquidity residing in BNM



Source: Affin Hwang, BNM

Fig c: Realised LNG export price on the mend



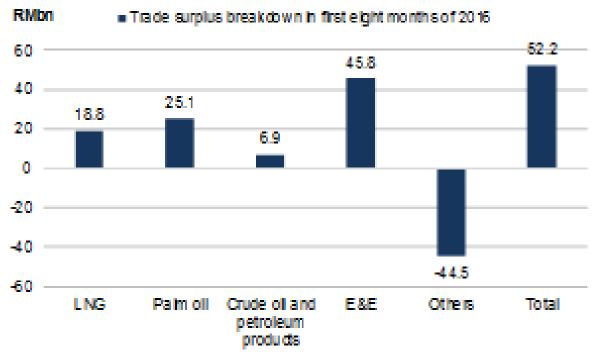
Source: Affin Hwang

Fig d: Impact of LNG on the current account surplus

	Unit	2015
LNG export volume	mmbtu	1,352,399,341
LNG export price	RM/mmbtu	34.80
Export value	RM bn	47
Current account surplus	RM bn	34
Assumed LNG export volume	mmbtu	1,352,399,341
Assumed LNG price	RM/mmbtu	10.00
Export value	RM bn	14
Difference from original export value	RM bn	-34
Net impact on current account	**RM bn**	**0**

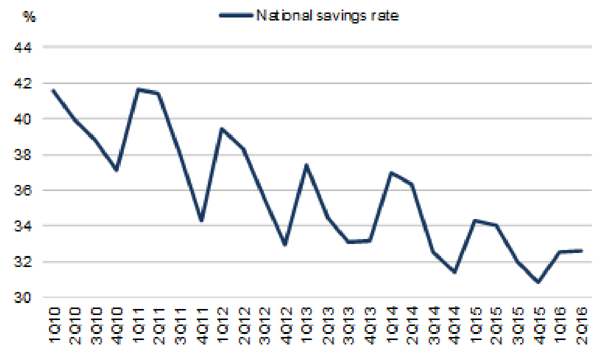
Source: Affin Hwang, BNM

Fig e: Malaysia's trade balance



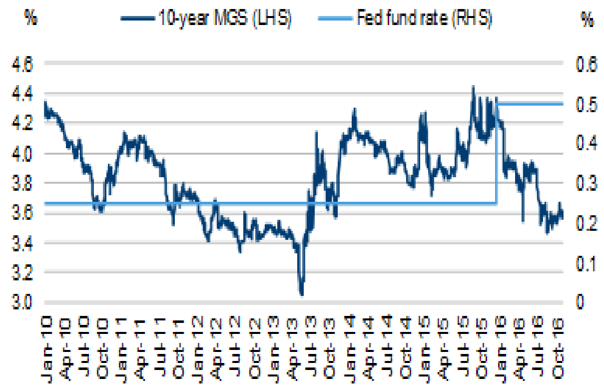
Source: Affin Hwang, BNM

Fig f: Malaysia's gross domestic savings rate



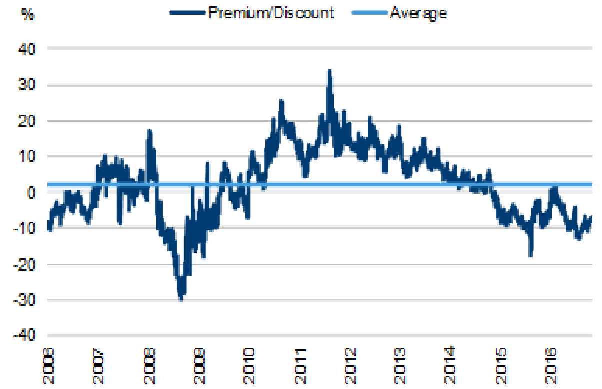
Source: Affin Hwang, BNM

Fig g: Divergence in 10-year MGS and Fed funds rate



Source: Bloomberg

Fig h: KLCI's average PER premium over the S&P500



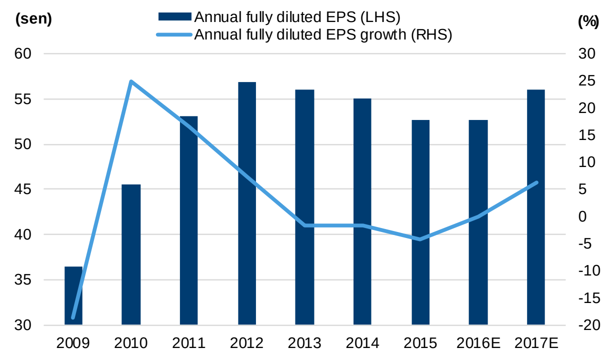
Source: Affin Hwang, Bloomberg

Fig i: Summary of macro forecasts

	2015	2016E	2017E
Date announced		21-Oct-16	21-Oct-16
GDP growth	5.0%	4% to 4.5%	4% to 5%
Inflation	2.1%	2.3%	2% to 3%
Fiscal deficit (RM bn)	37.2	38.7	40.3
Fiscal deficit (% GDP)	3.2%	3.1%	3.0%
Trade surplus (RM bn)	91.6	91.4	88.3
Current account surplus (RM bn)	34.7	16.4	14.8
Current account surplus (% GNI)	3.1%	1.4%	1.1%

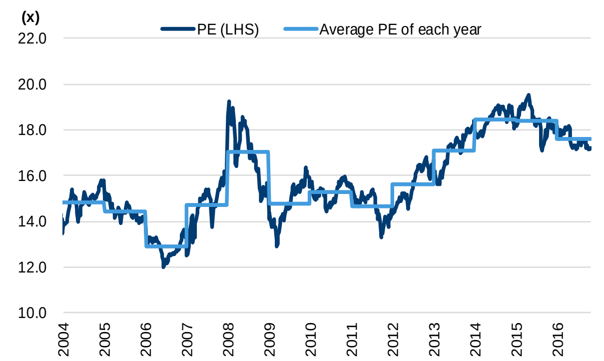
Source: MOF

Fig j: Fully-diluted EPS growth for Malaysia



Source: Affin Hwang

Fig k: Average yearly PER of the KLCI



Source: Affin Hwang, Bloomberg

Fig l: KLCI target computation

	Units	2016E	2017E
KLCI (26 Oct 2016)	pts	1,673.92	1,673.92
Market EPS	pts	92.50	98.35
Fully diluted PER (x)	x	18.1	17.0
Index Target			
Average fully diluted PER (x)	x	17.9	17.9
Current market EPS	pts	92.50	98.35
KLCI target	**pts**	**1,655.68**	**1,760.41**
Upside	**%**	**-1.1%**	**5.2%**
Revision			
Old KLCI target	pts		1,745.95
Change	%		0.8%

Source: Affin Hwang forecasts

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Executive summary

Setting the stage for 2017

It has been a tough year so far to say the very least. Just in the past five months, financial markets have had to navigate Brexit, a surprise Overnight Policy Rate (OPR) cut by the Bank Negara Malaysia (BNM) rising concerns on growth, a Fitch rating worry, slower global growth prospects, assessing the Bank of Japan's unorthodox monetary policy stance, and weak global trade. These are in addition to challenges faced at the start of this year, including China's economic slowdown, the devaluation in the Yuan, a sharp downward adjustment in commodities, sharp foreign outflows from Malaysia, the devaluation of the Ringgit and lingering effects of the goods and services tax (GST).

These are not conventional headwinds for an average year. Then again, 2016 has not been an average year. We are hoping that 2017 will turn out to be more sedate with a dissipation of some or most of these headwinds. Even if that is the case, we believe that the focus of financial markets will rest squarely on the Federal Reserve in the US on its funds rate trajectory.

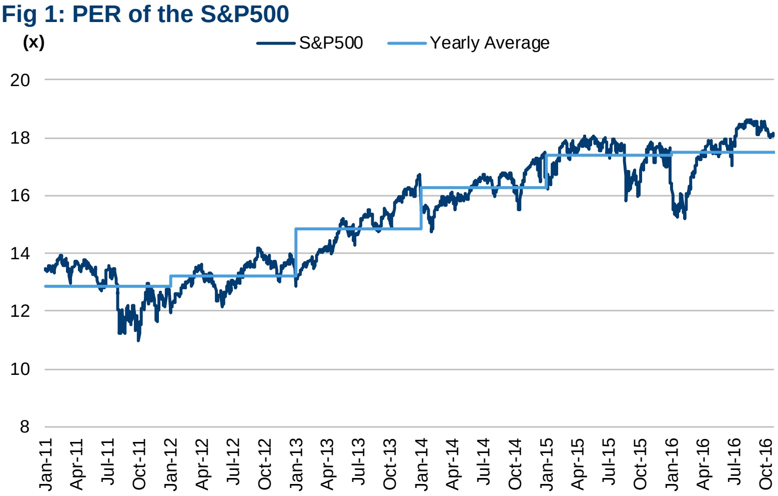
We highlight that Malaysia's economy has a significantly higher tolerance to Fed funds rate hikes than other emerging markets. This is due to its favourable characteristics with a positive savings-investment gap, fiscal consolidation trajectory, high foreign exchange reserves, and ample liquidity in the financial system. However, the most recent 2Q16 current account has demonstrated signs of weakness with narrowing surplus.

Therefore, our report examines in depth the existing state of Malaysia's current-account surplus. In particular, we believe that 2Q16 is likely the weakest point and we should see a rebound, unless global trade falls off significantly. While the macro impact should be manageable, we dedicate a significant portion of our analysis to the impact on the KLCI if the Fed raises US interest rates.

The Fed in focus

In 2017, the Fed funds rate hike is likely to remain a global focus. Ultra-easy monetary conditions have caused global market PERs to re-rate. For instance, Bloomberg data shows the S&P500 has seen its PER rise from an average of 12.9x in 2011 to 18.1x now. Hence, we think it is not unreasonable to ask about a possible de-rating in financial markets if interest rates were to rise.

Fig 1: PER of the S&P500



Source: Affin Hwang, Bloomberg

In order to examine the effects of the Fed funds rate hike, we have created a DCF model for the S&P500. The Fed funds rate hike simulation is done through the WACC by adjusting the risk-free rate for the US. The Fed funds rate is a short-term interest rate, and the biggest unknown facing financial markets is the extent of monetary policy transmission into long-term interest rates. Nonetheless, our analysis finds that every 10bps increase in the risk-free rate due to Fed funds rate policy transmission could create 2.5% downward pressure on the S&P500.

Fig 2: Sensitivity of S&P500 to risk-free rate

Change in rfr (bps)	WACC	Percentage change in S&P500
-50	7.2%	14.9%
-40	7.4%	11.6%
-30	7.5%	8.5%
-20	7.6%	5.5%
-10	7.7%	2.7%
0	7.8%	0.0%
10	7.9%	-2.5%
20	8.0%	-4.9%
30	8.1%	-7.2%
40	8.2%	-9.4%
50	8.3%	-11.5%

Source: Affin Hwang estimates

However, central banks are the sole authority of their respective currencies and the corresponding monetary policies tied to it. Hence, it becomes clear that while the US stock markets that are denominated in US Dollars are subject to the Fed funds rate, the BNM has full autonomy over the Ringgit and its own monetary policy fate. In fact, the surprise OPR cut by BNM in July has indicated that the OPR direction is more likely flat to lower, thus diverging from the US. As such, we have built a similar DCF model for the KLCI, and by simulating the OPR movement in the risk-free rate we can get a sense of the influence of monetary policy on the stock market. In our case, we find that every 10 bps change in the OPR could have a 1.7% impact on the KLCI.

Fig 3: Sensitivity of KLCI to risk-free rate

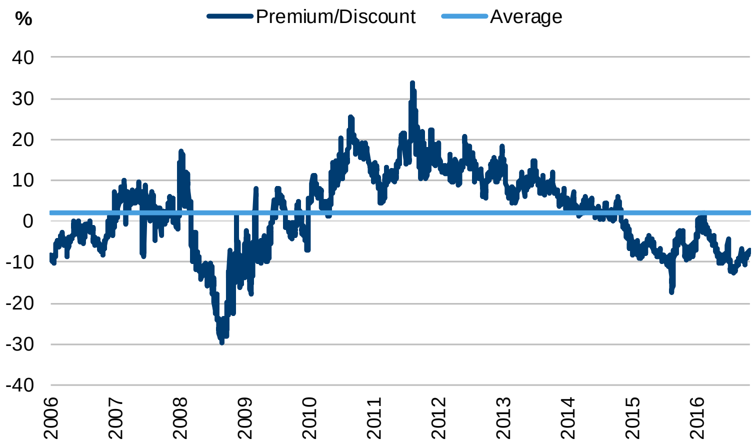
Change in rfr (bps)	WACC	Percentage change in KLCI
-50	11.0%	9.3%
-40	11.1%	7.3%
-30	11.2%	5.4%
-20	11.3%	3.5%
-10	11.4%	1.7%
0	11.5%	0.0%
10	11.7%	-1.7%
20	11.8%	-3.3%
30	11.9%	-5.0%
40	12.0%	-6.5%
50	12.1%	-8.0%

Source: Affin Hwang estimates

In theory, we should not be worried about tighter monetary policy in the US as the KLCI is Ringgit-denominated and thus should be independent of the Fed's policy rate. In reality, however, Malaysia is a small open economy with financial linkages to the rest of the world. As such, relative valuation comes into play and a de-rating in the S&P500 could make Malaysia look comparatively more expensive, which could in turn trigger a de-rating in the KLCI.

Historically, the KLCI has traded at a 2.1% premium to the S&P500 using the average PER from Bloomberg measured from 2006 until now. If the historical PER relationship is to hold, this means that a de-rating in the S&P500 could cause a similar size of fall in the KLCI.

Fig 4: Historical PER relationship between KLCI and S&P500



Source: Affin Hwang, Bloomberg

However, closer examination reveals an interesting relationship between the PERs of the two markets. While the KLCI trades at a historical premium of 2.1% over the S&P500, it is currently trading at a 7.4% discount. This makes sense, as the ultra-low interest-rate environment in the US relative to Malaysia should re-rate the S&P500 more than the KLCI. This suggests that some of the de-rating effects triggered by the Fed funds rate hike on the S&P500 could be well absorbed by the KLCI if the market observes the historical relationship with a reversion to mean over time.

In summary, we have identified three main factors that could determine the extent of the KLCI's de-rating triggered by the US Fed funds rate hike.

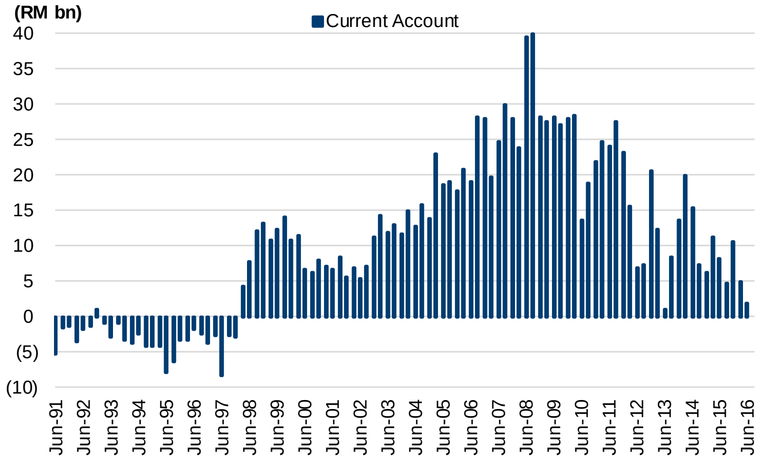
- The trajectory of the Fed rate hike.
- The amount of short-term rate hike transmitted into the risk-free rate.
- The relative PER valuation between KLCI and S&P500 now.

Fortunately, the Fed funds rate hike trajectory thus far is widely expected to be gradual, with possibly two rate hikes next year of 25bps each. It is impossible to compute the quantity of increase in the risk-free rate. Nonetheless, we are able to compute that the S&P500 could de-rate by 9.3% before it starts affecting valuation of the KLCI, assuming the historical premium of the KLCI holds true. This works out to about a 40 bps increase in the US risk-free rate.

Mind the gap

Unlike many other emerging markets, Malaysia's macro position is able to better withstand Fed funds rate hikes due to two differentiating characteristics. The first is its positive savings-investment gap and the second is the ample excess liquidity residing with the BNM. However, the current account surplus situation has deteriorated of late. It dwindled to RM1.9bn or just 0.6% of GNI in 2Q16, raising concerns that Malaysia could dip into a negative savings-investment gap.

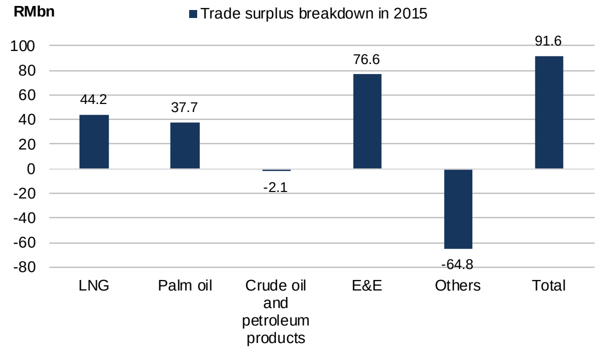
Fig 5: Savings-investment gap has weakened of late



Source: BNM

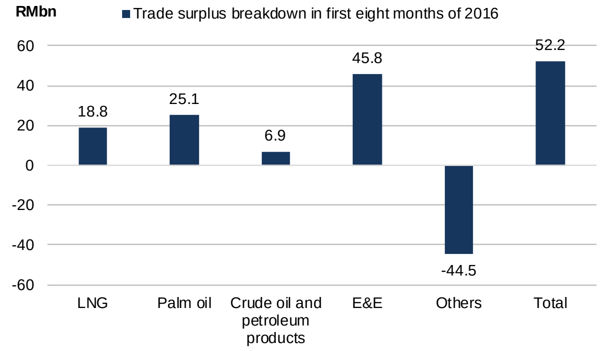
The 2015 current account surplus amounted to RM34.7bn, or 3.1% of GNI, and was wholly contributed to by the trade account, as the other three accounts were all in deficit. The 2015 trade account surplus was RM91.6bn. Of the four largest components, three are primary commodities (crude oil, LNG and palm oil), while one is manufactured goods (E&E). The sum of crude oil and petroleum products was in a deficit of RM2.1bn, LNG saw a net surplus of RM44.2bn, palm oil is estimated at RM37.7bn and E&E at RM76.6bn. In other words, the total net surplus by these four components is RM156.4bn, which more than surpasses the 2015 trade balance of RM91.6bn. For the first eight months of 2016, the total trade balance was RM52.2bn with the sum of the four largest components at RM96.7bn, or 1.85x more than the overall trade surplus.

Fig 6: Net trade contribution from top four items in 2015



Source: Affin Hwang, BNM

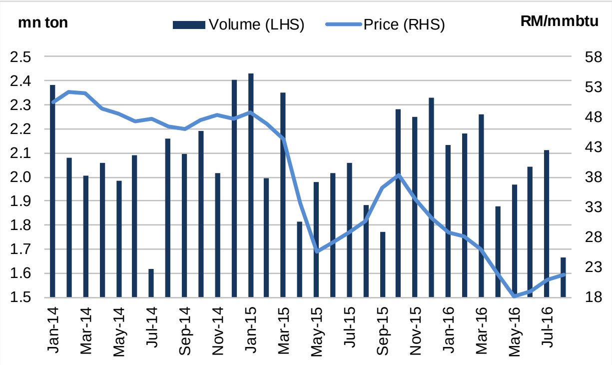
Fig 7: Net trade contribution from top four items in eight months of 2016



Source: Affin Hwang, BNM

Our analysis indicates an unlikely current account deficit with 2Q16 likely the trough. Closer examination shows that thus far the current account has been buffeted by a combination of low Brent prices, time-shift delays in lower LNG prices, and a drop in palm oil production volume. However, the Brent price has rebounded and palm oil production levels have recovered. Concerns about the convergence in Malaysia's LNG price and the low levels in the US have also subsided, with our estimate of a rebound in the LNG export price to RM20.98/mmbtu in July and rising further for the third consecutive month to RM21.70/mmbtu after falling to as low as RM18.17/mmbtu in May. Our analysis also shows that the LNG price must fall to below RM10/mmbtu for the current account to turn into a deficit, holding other variables constant. Unlike palm oil, crude oil and natural gas production levels have held up from a year ago, and as long as the E&E segment is resilient the current account situation should be comfortable. The latest Budget 2017 including an RM14.8bn current account surplus equivalent of 1.1% of GNI also provides comfort.

Fig 8: Realised LNG export prices



Source: Affin Hwang, BNM

Fig 9: LNG price analysis on current account surplus

	Unit	2015
LNG export volume	mmbtu	1,352,399,341
LNG export price	RM/mmbtu	34.80
Export value	RM bn	47
Current account surplus	RM bn	34
Assumed LNG export volume	mmbtu	1,352,399,341
Assumed LNG price	RM/mmbtu	10.00
Export value	RM bn	14
Difference from original export value	RM bn	-34
Net impact on current account	**RM bn**	**0**

Source: Affin Hwang

GDP growth likely has troughed

The latest GDP figure for 2Q16 announced back in August demonstrated a weakening of the economy to 4.0% from 4.2% in 1Q16. This represents the weakest growth rate since 3Q09, when the GDP contracted by 1.1%. However, we are hopeful that 2Q16 represents the trough for the economy. In fact, it is worth highlighting that while 2Q16 was slower, the underlying economic components demonstrated stronger growth. Private consumption, public expenditure, private investment and public investment expenditure all demonstrated stronger growth than in 1Q16, while the net export decline also slowed. On closer examination, the slower headline

GDP in 2Q16 was due to an inventory drawdown that subtracted 1.2ppts from growth even though the drag from next exports halved to 0.6ppts.

Fig 10: Malaysia's quarterly GDP growth

	2Q15	3Q15	4Q15	1Q16	2Q16	2Q15	3Q15	4Q15	1Q16	2Q16	2Q15	3Q15	4Q15	1Q16	2Q16
	%yoy					%qoq					% contribution pts to GDP growth				
GDP by Expenditure Components															
Total Consumption	6.5	4.0	4.5	5.1	6.4	1.0	6.1	6.1	-7.5	2.2	4.1	2.7	3.0	3.3	4.1
Private consumption	6.4	4.1	4.9	5.3	6.3	-0.4	6.9	-1.9	0.8	0.6	3.3	2.2	2.5	2.8	3.3
Public consumption expenditure	6.9	3.6	3.3	3.8	6.5	6.9	2.8	40.3	-32.7	9.8	0.8	0.4	0.6	0.5	0.8
Total Investment	0.4	4.2	2.7	0.1	6.1	3.9	-2.4	-1.2	-0.1	10.2	0.1	1.1	0.7	0.0	1.7
Private investment expenditure	3.9	5.5	4.9	2.2	5.6	11.4	-10.3	-23.8	34.3	15.2	0.8	0.9	0.6	0.4	1.1
Public investment expenditure	-8.1	1.8	0.4	-4.5	7.5	-12.5	19.6	45.8	-37.4	-1.5	-0.7	0.2	0.1	-0.4	0.5
Domestic Demand	4.6	4.1	4.0	3.6	6.3	1.8	3.6	4.0	-5.6	4.4	4.2	3.7	3.7	3.3	5.7
Net exports	-11.1	3.4	4.3	-12.4	-7.0	-10.7	10.5	-1.5	-9.9	-5.1	-1.1	0.3	0.4	-1.2	-0.6
Exports	-4.0	3.2	4.0	-0.5	1.0	-1.4	6.7	2.9	-8.1	0.0	-3.1	2.4	2.9	-0.3	0.7
Imports	-3.1	3.1	4.0	1.3	2.0	-0.1	6.2	3.5	-7.8	0.6	-2.1	2.1	2.6	0.8	1.2
Changes in inventories	NA	-88.0	-49.5	NA	NA	NA	NA	NA	NA	NA	1.8	0.7	0.5	2.0	-1.2
GDP (2010 real prices)	**4.9**	**4.7**	**4.5**	**4.2**	**4.0**	**2.5**	**3.2**	**3.2**	**-4.6**	**2.3**	**4.9**	**4.7**	**4.5**	**4.2**	**4.0**

Source: BNM

Looking ahead, we are hopeful that the domestic economy will remain strong, underpinned by healthy employment figures and wage growth. Another variable is the external environment, but we find comfort that trade generally improved in 2Q16 while more recent industrial production index and trade figures are indicate improvement in 3Q16. If economic activity is maintained, we think the 2Q16 GDP growth rate would likely be the trough.

Overall, we are forecasting GDP growth of 4.2% yoy in 2016 and strengthening to 4.4% yoy in 2017. We see inflation at 2.2% yoy in 2016. Our current account surplus forecast is RM15bn or 1.3% of GNI, and lastly we believe that the 3.1% fiscal deficit target is achievable.

Fig 11: Malaysia's GDP growth forecasts

	2015	2016E	2017F	2015	2016E	2017F	2015	2016E	2017F
	%yoy			% of GDP			% contribution point to GDP growth		
GDP by Expenditure Components									
Total Consumption	5.7	5.0	4.8	65.8	66.3	66.6	3.7	3.3	3.2
Private consumption expenditure	6.0	5.5	5.4	52.4	53.0	53.5	3.1	2.9	2.9
Public consumption expenditure	4.4	3.0	2.5	13.5	13.3	13.1	0.6	0.4	0.3
Total Investment	3.7	3.4	4.0	25.8	25.6	25.5	1.0	0.9	1.0
Private investment expenditure	6.4	4.5	5.0	16.9	16.9	17.0	1.1	0.8	0.8
Public investment expenditure	-1.0	1.5	2.0	8.9	8.7	8.5	-0.1	0.1	0.2
Domestic Demand	5.1	4.5	4.6	91.6	91.9	92.1	4.7	4.2	4.2
Net exports	-3.8	-0.8	2.8	8.6	8.2	8.0	-0.4	-0.1	0.2
Exports	0.6	1.1	2.0	72.9	70.7	69.1	0.5	0.8	1.4
Imports	1.2	1.3	1.9	64.3	62.5	61.0	0.8	0.9	1.2
Changes in inventories	-75.4	-53.4	0.0	-0.2	-0.1	-0.1	0.6	0.1	0.0
GDP (2010 real prices)	**5.0**	**4.2**	**4.4**	**100.0**	**100.0**	**100.0**	**5.0**	**4.2**	**4.4**
GDP By Kind of Economic Activity									
Agriculture, Forestry and Fishing	1.2	-2.8	2.0	8.9	8.3	8.1	0.1	-0.2	0.2
Mining and Quarrying	4.7	1.6	1.5	9.0	8.7	8.5	0.4	0.1	0.1
Manufacturing	4.9	4.3	4.5	23.0	23.0	23.0	1.1	1.0	1.0
Construction	8.2	8.3	8.0	4.4	4.6	4.7	0.3	0.4	0.4
Services	5.1	5.2	5.1	53.5	54.0	54.4	2.7	2.8	2.8
Import duties	18.6	13.8	-1.0	1.3	1.4	1.3	0.2	0.2	0.0
GDP (2010 real prices)	**5.0**	**4.2**	**4.4**	**100.0**	**100.0**	**100.0**	**5.0**	**4.2**	**4.4**

Source: BNM, Affin Hwang forecasts

Budget 2017 for measured growth

Budget 2017, announced end-October, was well-measured with balanced growth prospects for the country. We are heartened by indications of a better macro environment with likely stronger GDP growth while the current account is expected to stay in surplus, allaying concerns due to recent weakness. The fiscal deficit position is also expected to narrow.

The federal government believes 4-4.5% yoy GDP growth in 2016 is achievable and forecasts a 4-5% range for 2017. It sees relatively benign inflation of 2-3% yoy in 2017 from 2.3% yoy this year. Pressure on government finances should ease, with an expected 3.4% rise in revenue. The first revenue increase in two years would allow for a 3.7% rise in operating expenditures and 2.4% higher development expenditures. The total budget allocation of RM260.8bn is 3.4% higher than that of 2017. The fiscal deficit is expected to widen from RM38.7bn in 2016 to RM40.3bn in 2017 but improve from 3.1% to 3% as percentage of GDP. The presented figure for the trade balance has narrowed from RM91.4bn to RM88.3bn in 2017, thus dragging down the current account though still a surplus from RM16.4bn or 1.4% of GNI to RM14.8bn or 1.1% of GNI in 2017.

Fig 12: Summary of macro forecasts

	2015	2016E	2017E
Date announced		21-Oct-16	21-Oct-16
GDP growth (yoy)	5.0%	4% to 4.5%	4% to 5%
Inflation (yoy)	2.1%	2.3%	2% to 3%
Fiscal deficit (RM bn)	37.2	38.7	40.3
Fiscal deficit (% GDP)	3.2%	3.1%	3.0%
Trade surplus (RM bn)	91.6	91.4	88.3
Current account surplus (RM bn)	34.7	16.4	14.8
Current account surplus (% GNI)	3.1%	1.4%	1.1%

Source: MOF

Monetary policy and the Ringgit

The Ringgit has weakened from RM4.06 to the USD just prior to the FOMC meeting on 26 July 2016 to RM4.16 now. The recent weakening of the Ringgit is due to clearer indications of an impending Fed funds rate hike.

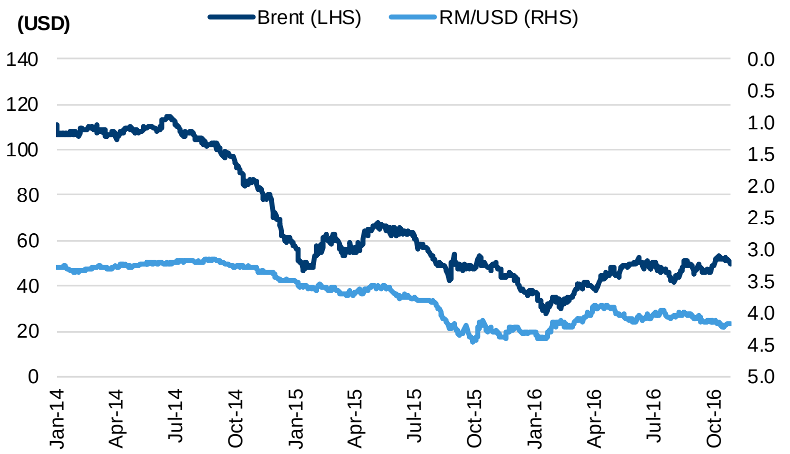
In the short term, the Ringgit is likely to be under some pressure given expectation of rising US interest rates. In addition, the bias of BNM monetary policy is on a holding to an easing pattern, thus presenting a potential divergence in policy where expectations of that happening may weaken the Ringgit.

However, the Brent price has gradually crept up to US$49.98/bbl and this is positive for the Ringgit. In fact, movement in the Brent price has a larger influence on the Ringgit than a gradual contraction in the interest rate differential (defined as the OPR less the Fed funds rate). The relatively mitigated influence of the interest rate differential is due to Malaysia's positive savings-investment gap, fiscal consolidation drive with high credit rating, strong investment drive, resilient domestic economy and ample liquidity in the financial system.

As such, the Ringgit should in general move in the same direction of the Brent price. The correlation is relatively strong as we can see from the Fig below and generally holds true. Yet just this year there have been two divergences. The first is post 25 April 2016 due to the technical default by a sovereign wealth fund in Malaysia creating uncertainty on cross default on Federal government bond. Even though the cross default did not happen, the market reacted to the initial uncertainty on the issue. At the time, the Ringgit weakened even though the Brent price was on an upward trajectory.

The second is the current divergence that started post the July 2016 FOMC meeting where the FOMC statement turned upbeat from the June 2016 statement with better economic data, particularly the rebound in strong jobs growth figure. The statement became even more defined post the September 2016 FOMC meeting.

Fig 13: Divergence in Brent and Ringgit

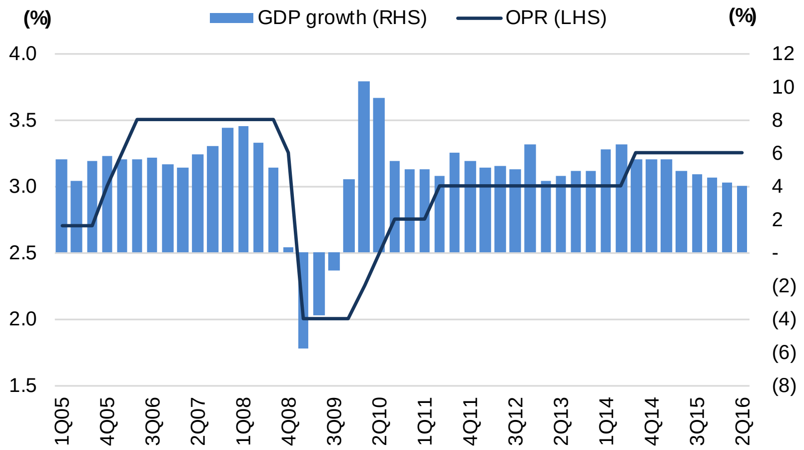


Source: Bloomberg

Over time, we believe that the historical relationship between the Ringgit and Brent price should hold. This means that either the Brent price has to weaken or the Ringgit has to strengthen. Much of this depends on global economic growth going forward, which at this juncture IMF is expecting a pick up in 2017 after a likely recent trough in 2016. Meanwhile, the EIA is forecasting average crude oil price of US$43/bbl in 2016, rising to US$51/bbl next year. Against this backdrop, our expectation of the Ringgit's fair value is RM3.95 to RM4.00 to the USD.

As the domestic economy remains resilient, we believe that the risk to overall GDP growth resides more in the external environment. Under this scenario, the trajectory of OPR by the BNM, in our view, will depend on their assessment of the global economy and world trade. At this juncture, world economic conditions may have improved and Malaysia's GDP has likely seen the trough in 2Q16. Hence, we believe the BNM's Monetary Policy Committee (MPC) is likely to stand pat on its OPR for the rest of the year. As for 2017, much depends on the external environment. If the IMF, WTO and EIA figures come through then there is a likelihood that the MPC will continue to hold the interest rate at 3%. However, one risk is the effect of Brexit when it really bites and its impact on global growth. If that is worse than expected, there is a chance that the MPC could act to drop the OPR by 25-50 bps, depending on its assessment of the severity of Brexit and its contagion effect, if any.

Fig 14: Malaysia's GDP growth and OPR

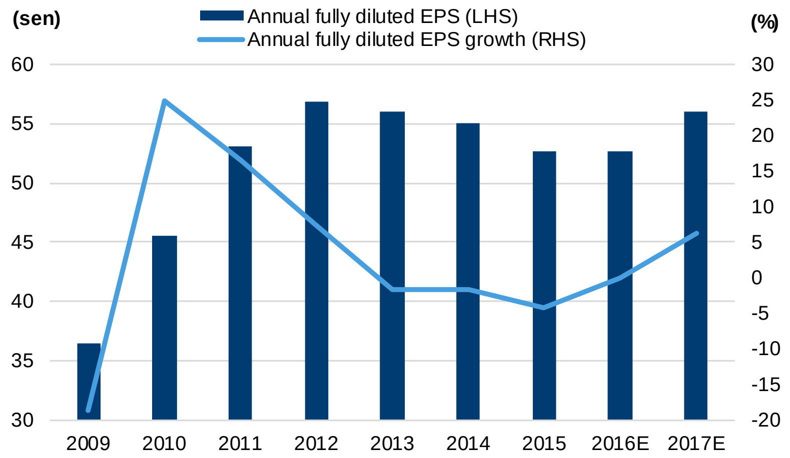


Source: Affin Hwang, Bloomberg

Protracted bad patch

The worst run in quarterly performance is still an ongoing affair. The 2Q16 results season has gone down in the books as the eighth consecutive quarter of net profit decline measured over the same period a year ago. In other words, the KLCI has now seen two years of profit decline that started with the 0.8% yoy contraction in 3Q14. At the trough, 1Q15 net profit contracted by 16% yoy. The latest quarter of 2Q16 saw a 5.1% yoy net profit fall but the rate of decline has improved from the 12.6% yoy in 1Q16.

Fig 15: Slower rate of decline in quarterly earnings



Source: Affin Hwang, Bloomberg

Looking into 3Q16, we are guarded but still think that the market earnings improvement from 2Q16 could be sustained, especially after the previous misstep in forecasting a turnaround. One reason is better economic activities. Second, the inflation rate has fallen and this could help sustain demand and put less cost pressure on households and businesses. Next, we hope that the large impairments taken by companies, especially those in the oil & gas sector, would ease with oil prices fluctuating in a narrow range. A relatively more stable Ringgit should also see less translation losses in companies with foreign currency exposure. The impact from the OPR cut in July would take time to transmit through the economy but it is a positive development nonetheless.

Earnings growth prospects for 2017

Our original forecast for 2016 fully-diluted EPS growth called for 7.4% YoY growth. At the peak, our 2016 growth rate rose to 8.5%. Unfortunately, the reality now is that we would be grateful if 2016 could just better the 4.2% contraction in 2015. We are now forecasting no expansion in earnings in 2016, but look for earnings growth to accelerate to 6.3% in 2017.

Fig 16: Contribution to growth

	Sector	Rating	Market Cap (RMm)	Weightage	Previous sector contribution to EPS growth 2016E (%)	Current sector contribution to EPS growth 2016E (%)	Sector contribution to EPS growth 2017E (%)
1	Auto & Autoparts Sector	UW	8,592	0.7	0.3	1.0	0.2
2	Banks Sector	N	279,593	22.8	(1.9)	(7.2)	2.8
3	Building Materials Sector	N	7,068	0.6	0.1	0.3	0.0
4	Const & Infra Sector	OW	31,987	2.6	(0.1)	(0.3)	0.1
5	Consumer Sector	N	51,399	4.2	(0.5)	(4.1)	1.5
6	Gaming Sector	OW	61,890	5.1	0.5	1.6	0.3
7	Healthcare Sector	OW	56,736	4.6	0.2	0.6	0.2
8	Media Sector	N	19,366	1.6	0.0	0.1	0.1
9	MREIT Sector	OW	28,534	2.3	0.2	0.7	0.0
10	Oil & Gas Sector	UW	81,790	6.7	(0.0)	0.1	0.1
11	Plantation Sector	N	130,460	10.6	2.1	6.3	0.5
12	Property Sector	OW	35,211	2.9	(0.2)	(0.5)	0.0
13	Rubber Products Sector	N	22,372	1.8	0.1	0.1	0.1
14	Technology Sector	N	9,825	0.8	(0.0)	(0.1)	0.0
15	Telecoms Sector	UW	154,240	12.6	(0.4)	(1.0)	0.3
16	Timber Sector	OW	3,445	0.3	(0.1)	(0.2)	0.0
17	Transport Sector	UW	69,668	5.7	0.2	0.8	(0.3)
18	Utilities Sector	N	173,322	14.1	0.8	1.7	0.3
	Others						
	TOTAL		**1,225,498**		**1.5**	**(0.0)**	**6.3**

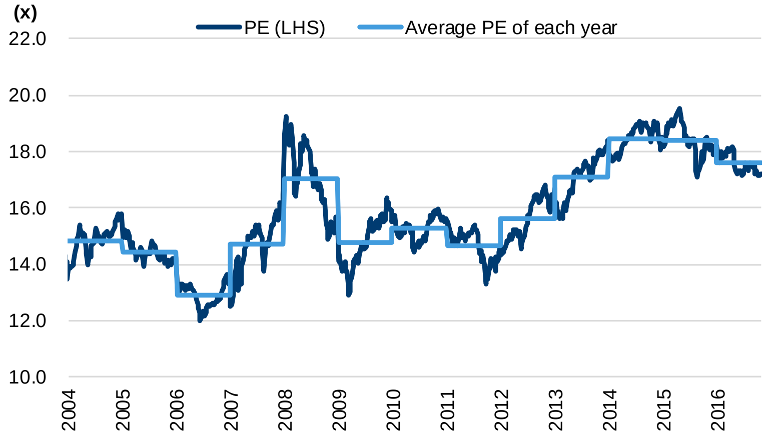
Source: Affin Hwang, Bloomberg

Nonetheless, there are two findings worth spotlighting. The first is that the top three sectors should contribute 4.8 ppts or 76% of our 6.3% growth for 2017. The three sectors are financials, consumer and plantations. While they are collectively driving more than three quarters of market earnings, we are pleased that the overall earnings base is broader based now; top three sectors contributed 13.4ppts in 2016 while market earnings were flat. The second is that our forecasts indicate 17 out of 18 sectors under coverage show positive earnings growth in 2017 with just the transport sector in contraction mode.

Stock market has re-rated

At 1,673.92 points, the KLCI is currently trading at a static PER of 18.1x in 2016E and 17x in 2017E, based on our stock coverage universe of 102 companies. On a 52-week forward basis, it is currently trading at 17.2x. Its average PER from 2013 onwards works out to 17.9x.

Fig 17: PER trend for the KLCI



Source: Affin Hwang, Bloomberg

But headroom still available

Based on the same 17.9x PER, we revise up our 2017 year-end KLCI target to 1,760.41 applied to our 2017 fully-diluted EPS forecast. Meanwhile, our 2016 target is set at 1,655.68 at the same 17.9x PER for 2016 EPS. Note that our last KLCI target of 1,745.95 was introduced in our Strategy Report, '***Battling perceptions***' published on 2 June 2016. At the time, the index target was based on a PER of 17.9x applied to our average 2016-17E fully-diluted market EPS. Hence, that was a mid-2017 target. Note that our new 1,760.41 figure now is a year-end 2017 target. Our key assumptions are as follows.

- The easy monetary conditions globally are likely to continue with gradual normalisation of interest rates by the Fed due to low inflation expectations.
- Historically, the KLCI trades at a 2.1% premium to the S&P500. We take this as the upper limit for the KLCI. In other words, the KLCI could not trade north of the 2.1% premium relative to the S&P500 after we assume a de-rating in the S&P500.
- However, the KLCI is now trading at a 7.4% discount to the S&P500. What this means is that the S&P500 can de-rate by 9.3% before it starts affecting the KLCI, assuming convergence of the premium to historical average. This translates to more about 40 bps rise in the risk free for the US.
- As such, we believe that the 17.9x average PER since 2013 could hold.

Fig 18: KLCI index target calculation

	Units	2016E	2017E
KLCI (26 Oct 2016)	pts	1,673.92	1,673.92
Market EPS	pts	92.50	98.35
Fully diluted PER (x)	x	18.1	17.0
Index Target			
Average fully diluted PER (x)	x	17.9	17.9
Current market EPS	pts	92.50	98.35
KLCI target	**pts**	**1,655.68**	**1,760.41**
Upside	**%**	**-1.1%**	**5.2%**
Revision			
Old KLCI target	pts		1,745.95
Change	%		0.8%

Source: Affin Hwang forecasts

Sector and stock strategy

Of the 18 sectors under coverage, we have identified six sectors as Overweight, eight sectors as Neutral and four sectors as Underweight. We have made three changes in the sector rating and that is the downgrade of Financials and Utilities from Overweight to Neutral and of Telecoms from Neutral to Underweight.

Fig 19: Positioning for the eighteen sectors under coverage

Overweight	Neutral	Underweight
Construction	Banks & Financial Services (↓)	Auto & Autoparts
Gaming	Building Materials	Oil & Gas
Healthcare	Consumer	Transports & Logistics
MREIT	Media	Telecoms (↓)
Property	Plantation	
Timber	Rubber Products	
	Technology	
	Utilities (↓)	

Source: Affin Hwang
Note: sectors upgraded (↑), sectors downgraded (↓)

Our stock coverage universe consists of 102 stocks with the recent addition of two stocks, namely Westports and YTL Hospitality REIT. The current breakdown is 33% (35% previously) of companies rated BUY, 43% (44% previously) rated HOLD and 24% (21% previously) rated as SELL.

Fig 20: Breakdown of our sector coverage by recommendation

Sector	Rating	% of market cap	Total mkt cap (RMbn)	Rating				% of rating				Rating as a % of mkt cap			
				Buy	Hold	Sell	Total	Buy	Hold	Sell	Total	Buy	Hold	Sell	Total
Auto & Autoparts	UW	0.7%	8,592	-	-	3	3	-	-	100	100	-	-	100	100
Banks & Financial Services	N	22.8%	279,593	1	6	3	10	10	60	30	100	27	68	4	100
Building Materials	N	0.6%	7,068	-	1	1	2	-	50	50	100	-	97	3	100
Construction & Infrastructure	OW	2.6%	31,987	7	1	-	8	88	13	-	100	99	1	-	100
Consumer	N	4.2%	51,399	1	5	3	9	11	56	33	100	10	86	4	100
Gaming	OW	5.1%	61,890	1	1	1	3	33	33	33	100	45	48	7	100
Healthcare	OW	4.6%	56,736	1	1	-	2	50	50	-	100	8	92	-	100
Media	N	1.6%	19,366	1	-	3	4	25	-	75	100	77	-	23	100
MREIT	OW	2.3%	28,534	3	2	-	5	60	40	-	100	44	56	-	100
Oil & Gas	UW	6.7%	81,790	2	4	2	8	25	50	25	100	2	27	71	100
Plantation	N	10.6%	130,460	-	4	3	7	-	57	43	100	-	46	54	100
Property	OW	2.9%	35,211	5	2	-	7	71	29	-	100	71	29	-	100
Rubber Products	N	1.8%	22,372	1	4	-	5	20	80	-	100	27	73	-	100
Technology	N	0.8%	9,825	4	2	2	8	50	25	25	100	55	25	20	100
Telecoms	UW	12.6%	154,240	-	3	1	4	-	75	25	100	-	84	16	100
Timber	OW	0.3%	3,445	3	-	-	3	100	-	-	100	100	-	-	100
Transports & Logistics	UW	5.7%	69,668	2	2	2	6	33	33	33	100	22	14	64	100
Utilities	N	14.1%	173,322	2	6	-	8	25	75	-	100	47	53	-	100
Total		100.0%	1,225,498	34	44	24	102								

Source: Affin Hwang

We have made five changes to our top picks list. We have removed CIMB, AFG, Aeon Credit, Sunway and Petra Energy, and replaced them with Westports and YTL Hospitality REIT (two recent initiations), as well as Globetronics (recent upgrade to BUY on valuation). In the process, we have trimmed our top picks list by 2 names. On our top sell list, we have included Telekom (poor earnings visibility) and removed MAHB.

Fig 21: Top buys and top sells lists

Stock	Rating	Price (RM)	TP (RM)	Upside (%)	Mkt Cap (RMm)	Core PE (x) CY16	Core PE (x) CY17	Core EPS Growth (%) CY16	Core EPS Growth (%) CY17	PBV CY16	PBV CY17	DPS(sen) FY16	DPS(sen) FY17	Div. Yield (%) FY16	Div. Yield (%) FY17	ROE (%) FY16	ROE (%) FY17
Top Buys																	
GAMUDA	BUY	4.90	5.74	17.1	11,869.1	20.6	18.1	(8.7)	13.9	1.7	1.6	12.0	12.0	2.4	2.4	9.6	10.4
GENTING MALAYSIA	BUY	4.74	5.00	5.5	28,144.0	19.1	16.9	14.5	13.3	1.3	1.3	7.1	7.7	1.5	1.6	7.0	7.5
GLOBETRONICS*	BUY	3.56	4.88	37.1	1,003.5	34.2	13.1	(58.0)	160.6	3.4	3.3	23.0	24.4	6.5	6.9	8.9	25.0
INARI	BUY	3.33	3.54	6.3	3,198.8	19.0	15.8	4.1	20.3	3.5	3.0	9.0	9.4	2.7	2.8	23.8	24.5
IOI PROPERTIES	BUY	2.49	2.89	16.1	11,014.8	11.2	11.5	4.8	(2.3)	0.7	0.7	8.5	8.5	3.4	3.4	7.4	6.2
JAKS RESOURCES	BUY	1.03	1.60	55.3	451.5	10.1	6.6	483.4	53.9	0.6	0.5	-	-	-	-	6.3	8.2
KPJ	BUY	4.20	5.01	19.3	4,464.7	30.2	28.0	26.2	7.9	3.0	2.9	7.5	8.0	1.8	1.9	9.5	9.7
PAVILION REIT	BUY	1.75	2.00	14.3	5,289.4	19.7	18.4	11.5	6.7	1.4	1.4	8.2	8.8	4.7	5.0	6.3	6.7
PUBLIC BANK	BUY	19.80	21.20	7.1	76,866.3	16.3	15.3	(7.2)	6.1	2.3	2.1	57.0	59.0	2.9	3.0	14.3	14.0
SCICOM	BUY	2.07	2.74	32.4	735.8	16.8	15.1	15.1	10.9	7.3	6.2	8.8	8.9	4.3	4.3	43.8	41.3
SUNWAY CONSTRUCTION	BUY	1.65	2.03	23.0	2,133.3	14.9	12.6	13.6	18.0	4.1	3.5	5.5	6.5	3.3	3.9	27.3	27.9
TA ANN	BUY	3.50	4.67	33.4	1,557.1	11.9	10.9	(38.1)	9.2	1.0	0.9	17.0	17.0	4.9	4.9	9.6	9.9
TENAGA	BUY	14.32	16.50	15.2	80,816.5	10.8	10.5	13.6	3.2	1.5	1.3	33.4	36.2	2.3	2.5	13.5	12.6
TIONG NAM	BUY	1.66	2.10	26.5	694.2	7.4	6.7	24.3	9.3	1.1	0.9	5.8	6.8	3.5	4.1	14.2	14.0
UOA DEVELOPMENT	BUY	2.58	2.64	2.3	4,211.7	11.6	9.7	(21.6)	19.8	1.2	1.1	12.0	14.0	4.7	5.4	9.8	11.1
WCT	BUY	1.69	2.00	18.3	2,124.9	20.1	14.2	(56.2)	41.7	0.9	0.8	6.0	8.0	3.6	4.7	3.7	5.5
WESTPORTS*	BUY	4.32	4.90	13.4	14,765.3	22.9	21.4	26.6	6.9	7.2	6.6	14.2	15.2	3.3	3.5	31.4	30.9
YTL REIT*	BUY	1.20	1.60	33.3	1,589.3	58.5	52.2	(55.8)	12.2	0.8	0.8	8.0	8.4	6.7	7.0	0.6	1.6
Top Sells																	
MCIL	SELL	0.69	0.50	(27.0)	1,155.8	10.9	11.0	(8.0)	(0.4)	1.2	1.1	4.3	4.4	6.3	6.4	11.1	10.3
MEDIA PRIMA	SELL	1.28	1.03	(19.5)	1,419.8	12.2	12.4	(15.2)	(1.9)	0.8	0.8	7.0	6.9	5.5	5.4	6.7	6.2
STAR	SELL	2.49	2.13	(14.5)	1,839.0	18.0	15.7	(23.9)	15.2	1.6	1.5	18.0	18.0	7.2	7.2	8.6	9.6
UMW-OG	SELL	0.86	0.73	(14.6)	1,848.5	(10.4)	(13.4)	61.9	(22.0)	0.5	0.5	-	-	-	-	(5.2)	(3.9)
UNISEM	SELL	2.59	1.98	(23.6)	1,900.6	13.0	15.2	(9.7)	(15.0)	1.7	1.7	12.3	10.2	4.7	3.9	13.5	10.9
TELEKOM*	SELL	6.60	5.85	(11.4)	24,802.4	32.4	31.1	8.7	3.9	3.2	3.3	18.4	19.1	2.8	2.9	11.2	10.6

*new addition

Source: Affin Hwang forecasts, Bloomberg

Affin Hwang's eight investment themes

A more stable 2017 with better growth prospects though risks exist, in our view, would enable the benefits of structural growth themes to manifest themselves. We have identified eight investment themes based on the suitability for investors.

The first is to play Malaysia as a developed nation by 2020. Plenty of infrastructure investments are taking place as Malaysia moves towards 2020 with the construction sector benefiting. Our top construction stock picks are **Gamuda**, **Sunway Construction** and **WCT**. This theme also encompasses investment in power assets to cater for the country's development needs and **Tenaga** is our top pick in the utilities sector. Banks as the financier such as **Public Bank** also stand to benefit. This also coincides with ***our second theme, which is the ongoing investment cycl****e* with higher capital expenditure by certain companies such as **Tenaga** and **Genting Malaysia**.

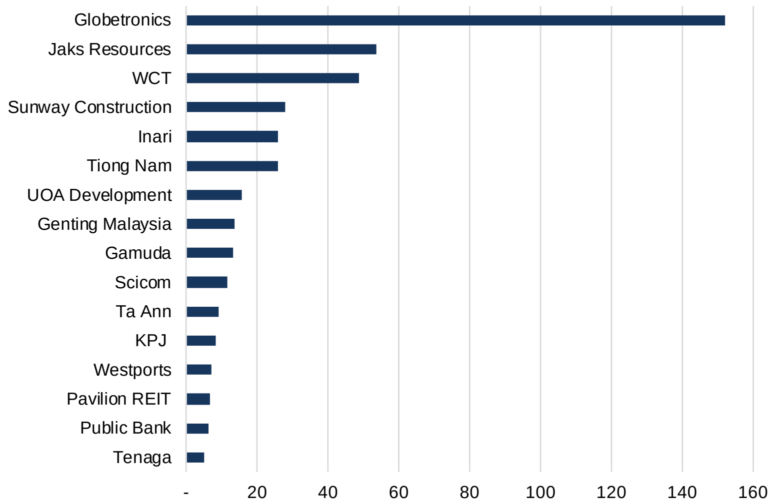
Our third thematic theme is the large middle-income society. Here, healthcare should benefit with better demand for private healthcare by the middle-income class and the name we like in the space is **KPJ**. We also see a gaming name such as **Genting Malaysia** as a key beneficiary of middle-income disposable-income expenditure on entertainment, while an MREIT such as **Pavilion REIT** caters to general spending exposure. An offshoot of this is ***our fourth theme of an increasing shift from public services to private services,*** such as for healthcare.

Our fifth theme is rise in private consumption size as a proportion of the economy. The gaming sector with Genting Malaysia once again comes to mind. The property sector is also a way to play this with our top property picks being **IOI Properties** and **UOA Development**. Once again, MREITs and the financial sector stand to benefit too.

Our sixth theme is the young demographics in Malaysia. Household formation is rapid, hence, the property sector offers good exposure to this theme. Gaming and financials are the other areas worthy of exposure.

The seventh theme that we have identified has to do with the rapid pace of earnings growth. This takes advantage of the Budget 2017 tax-break incentives for companies with profit growth at above 5%. Of our 18 top picks, the following are the stocks that fit the criteria.

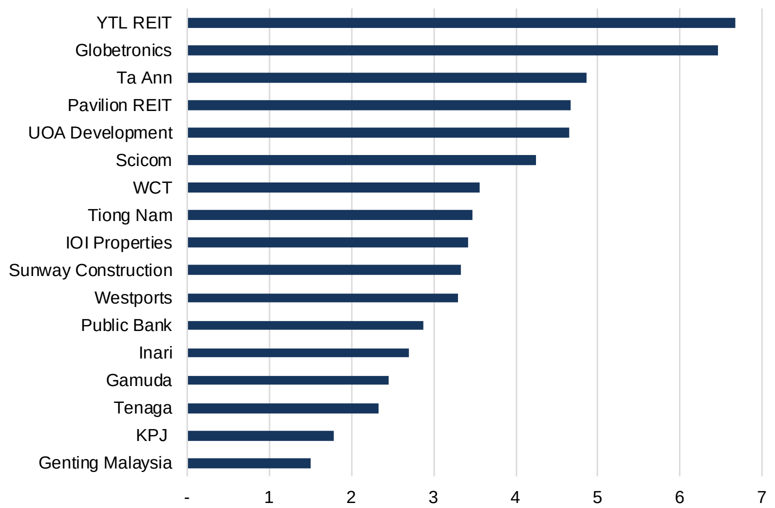
Fig 22: Top picks with 5% and more pre-tax profit growth in 2017E



Source: Affin Hwang estimates, Bloomberg

Lastly, ***we have identified high yield as our eighth theme*** and the following figure gives a ranking of our top picks by dividend yield.

Fig 23: High yielding stocks in our top pick list



Source: Affin Hwang forecasts, Bloomberg

An eventful year

Not even ended yet

The year has yet to end but already it has shaped up to be one of the most testing years for market participants. In the past 5 months alone, the market had to deal with Brexit, a surprise interest rate cut by the Bank Negara Malaysia (BNM), a Fitch Rating adjustment for Malaysia's Long Term Local Currency (LTLC) status, cuts in IMF growth, a slowdown in world trade, and an unorthodox monetary policy environment.

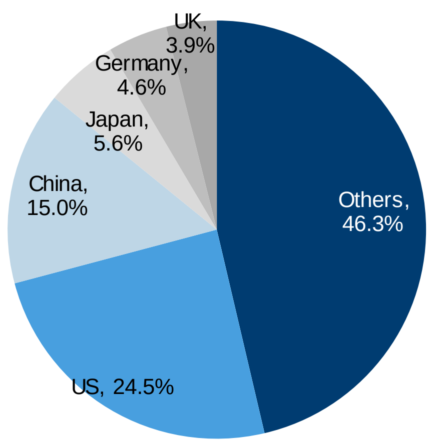
Brexit

The UK voted unexpectedly in favour of exiting the European Union (EU) in the Brexit referendum by a margin of 51.9% to 48.1% on 23 June 2016. The outcome took investors by surprise as exit polls by the end of the day indicated a majority against Brexit. As such, markets gyrated on 24 June 2016 as the results of the vote count was progressively unveiled indicating Brexiters gaining the upper hand.

In our view, there are no positives from the outcome. Any existing preferential treatment for a member of the EU would be rolled back and new barriers would be enacted for trade, employment, immigration, investments and capital flows, all of which have far-reaching consequences on the economy. The implications are extensive for GDP with valuable resources dedicated to dealing with the consequences when they could be deployed for productive growth. Worse still, renegotiating trade deals and treaties would be a long drawn-out affair, not to mention the tough stand by the EU given the likely upper hand in bargaining power and resentment towards the UK's exit. It is therefore unfortunate that the world's fifth largest economy is heading towards a period of more economic uncertainty that would trigger headwinds for global growth.

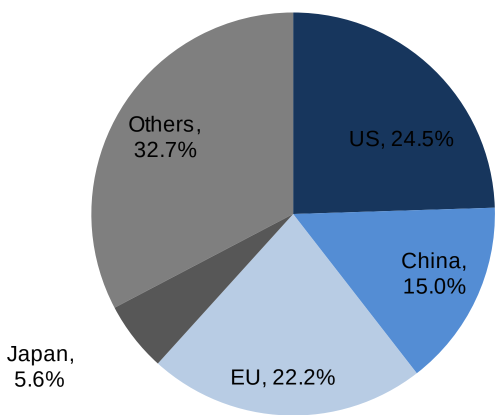
According to the IMF, global nominal GDP in 2015 was US$73.2tn. Anchoring nearly a quarter of this is the USA at US$17.9tn while China as the world's second largest economy makes up 15% or US$11tn. Being the world's fifth largest economy does imply potentially a large threat to world economic activity. However, the UK's US$2.8tn economy makes up only 3.9% of global GDP.

Fig 24: Global nominal GDP breakdown in 2015



Source: IMF

Fig 25: Fear of contagion to EU block



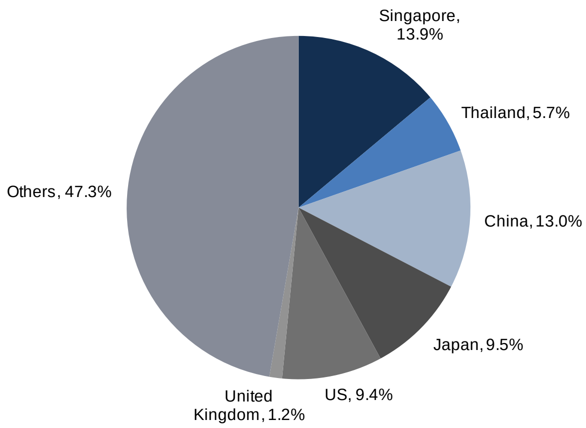
Source: IMF

In this regard, the impact from Brexit to global growth would likely be manageable if it is contained in the UK. In fact, the quick rebound in financial markets even surpassing pre-Brexit levels suggest that a contained impact from Brexit to the UK is the base case by market participants.

One risk worth highlighting, in our view, is if there were to be a contagion effect from Brexit. A precedent has been set now for relinquishing EU membership. If the core EU members are unable to hold the block together it could spawn referendums in other countries that could unravel the EU and the single currency, and extrication would be far more difficult than for the UK given their deeper integration. The EU as a whole comes closer to the US in size, and makes up 22.2% or US$16.2tn of the world economy. Hence, the risk to global growth is significant if this scenario were to pan out.

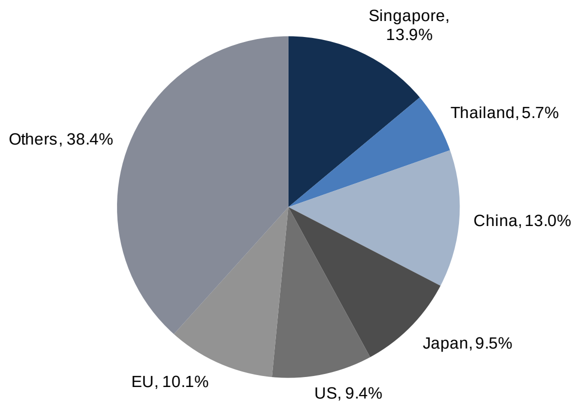
In the first scenario of a contained Brexit to just the UK, the direct impact on Malaysia would be relatively muted. In 2015, the UK was the destination for just 1.2% of total Malaysian exports; this works out to RM9.3bn. However, the impact from the second scenario is a lot more significant. If the repercussions were to spill over into the EU resulting in a hit to EU's growth, we could see as much as 10.1% of Malaysia's total exports being affected (including the UK portion); this works out to a substantial RM78.8bn.

Fig 26: Malaysian exports in 2015



Source: CEIC

Fig 27: Malaysian exports to EU in 2015

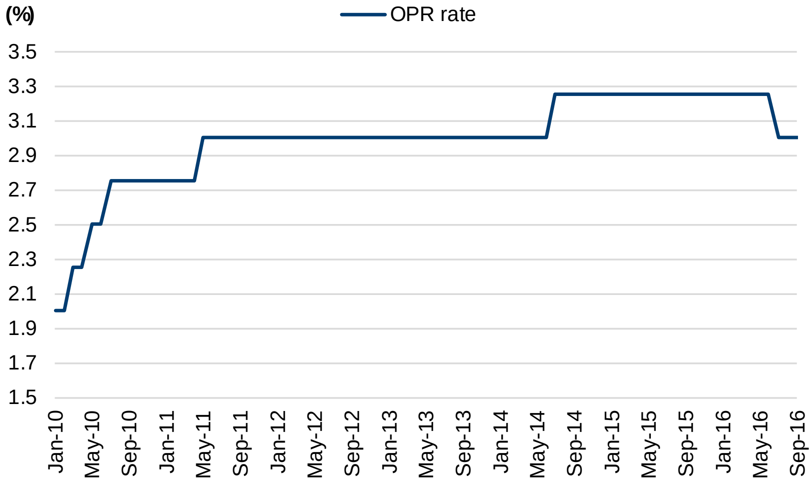


Source: CEIC

Surprise OPR cut

The BNM cut its Overnight Policy Rate (OPR) by 25bps to 3% on 13 July 2016. In the same Monetary Policy Committee (MPC) meeting, it guided down its inflation projection to 2-3% for 2016, from the 2.5-3.5% range previously, and expects inflation to remain stable in 2017. The price stability was attributed to energy and commodity price levels as well as low global inflation. Meanwhile, it pointed out that the effects of the Goods and Services Tax (GST) introduced on 1 April 2015 have dissipated. However, the statutory reserve requirement (SRR) remains at 3.5% subsequent to the 50bps cut in January 2016.

Fig 28: Overnight policy rate in Malaysia



Source: BNM

The unexpected cut got us worried at the time. We saw two possibilities then. The first is if preliminary numbers show 2Q16 real GDP slowing sharply from the 4.2% in 1Q16, thus warranting easing monetary conditions. This may be the case as the MPC policy statement said that looking ahead, growth momentum is moderating in the major economies and, it also pointed to increased downside risks post Brexit. In addition, we note that 1Q16 GDP saw a large build-up in inventories that added 2ppts to GDP growth; thus, our view at the time was that 2Q16 would most likely see this benefit lapse.

The second reason is if it is purely a pre-emptive measure given the flexibility accorded to BNM due to lower inflation expectation. This is plausible as well, given that the MPC statement acknowledged that the domestic economy remains strong with private consumption and investment being cornerstones to growth though uncertainties in the global environment could weigh on Malaysia. We are hopeful that the decision is based more on the latter, which is good for the equity market.

We were relieved that it turned out to be the latter judging from the 2Q GDP figure released thereafter. Although the 2Q16 GDP headline figure was the weakest since 3Q09, we found comfort that the underlying growth drivers were strong if we analyse the individual components of GDP (see Section 6: A sigh of relief). Hence, we see the surprise 25 bps cut as the BNM taking up an insurance policy against any unexpected slowdown stemming from Brexit.

However, some market participants are expecting another round of OPR cuts this year taking the view of weak economic activity. This means the 25 bps reduction would need to come at the sixth and final MPC meeting of the year on 23 November 2016. We take the view that BNM would stand pat for the rest of the year given the underlying strength in GDP.

Fitch

In the same month after the interest rate cut by the BNM, Fitch Ratings downgraded Petroliam Nasional Bhd's (Petronas) long-term foreign- and local-currency issuer default ratings (IDRs) to 'A-' from 'A'. Fitch said the rating actions follow the downgrade of Malaysia's long-term local-currency (LTLC) IDR to 'A-' from 'A', in line with the updated guidance contained in Fitch's revised Sovereign Rating Criteria dated 18 July.

At the time, the market misunderstood the Petronas rating downgrade as it was a government rating downgrade. In reality, Fitch Ratings' downgrade of Malaysian sovereign rating on 18 July is not specific to Malaysia as it streamlined its rating criteria. There were 23 downgrades in the Long-Term Local Currency (LTLC) ratings. Prior to this, all 23 sovereign ratings had LTLC ratings that were one notch higher than their Long-Term Foreign Currency (LTFC) ratings.

Under the new criteria, Fitch Ratings assessment is that credit risk profiles of sovereigns in local currency and foreign currency debt are typically aligned. Therefore, it no longer justifies these 23 sovereigns, including Malaysia, to have LTLC ratings at one notch higher than their LTFC ratings, respectively. Hence, the downgrade in the LTLC is to align it with each of their LTFC ratings. Post this downgrade, there are just 3 countries that have immediate LTLC ratings higher than their LTFC, namely, Chile, New Zealand and Peru. Given that this is a blanket change in criteria and not specific to Malaysia, we do not think that it is a significant development warranting an impact on the market.

Global growth

IMF published its bi-annual World Economic Outlook (WEO) forecasting global GDP growth to slow from 3.2% in 2015 to 3.1% in 2016 before rebounding to 3.4% in 2017. Note that these are unchanged from the July WEO flash update but down 0.1ppts each year from the April WEO publication. The main reasons for the reduction are Brexit and slower US growth.

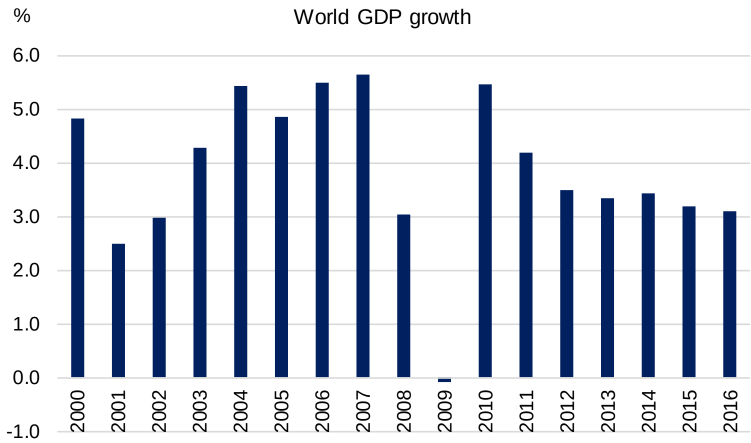
Fig 29: Global growth projections

	IMF				World Bank				OECD				ADB			
	Forecasts		*Change		Forecasts		*Change		Forecasts		*Change		Forecasts		*Change	
	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017
Global	**3.1**	**3.4**	**0.0**	**0.0**	**2.4**	**2.8**	**-0.5**	**-0.3**	**2.9**	**3.2**	**-0.1**	**-0.1**	**-**	**-**	**-**	**-**
Advanced economies	**1.6**	**1.8**	**-0.2**	**0.0**	**1.7**	**1.9**	**-0.4**	**-0.2**	**-**	**-**	**-**	**-**	**1.4**	**1.8**	**-0.1**	**0.1**
US	1.6	2.2	-0.6	-0.3	1.9	2.2	-0.8	-0.2	1.4	2.1	-0.4	-0.1	1.5	2.4	-0.4	-0.1
Euro Area	1.7	1.5	0.1	0.1	1.6	1.6	-0.1	-0.1	1.5	1.4	-0.1	-0.3	1.5	1.4	0.2	0.3
Japan	0.5	0.6	0.2	0.5	0.5	0.5	-0.8	-0.4	0.5	0.7	-0.1	0.3	0.6	0.8	0.1	0.0
Developing economies	**4.2**	**4.6**	**0.1**	**0.0**	**3.5**	**4.4**	**-1.3**	**0.0**	**-**	**-**	**-**	**-**	**5.7**	**5.7**	**0.1**	**0.0**
China	6.6	6.2	0.0	0.0	6.7	6.5	0.0	0.0	6.5	6.2	0.0	0.0	6.6	6.4	0.1	0.1
India	7.6	7.6	0.2	0.2	7.6	7.7	-0.2	-0.2	7.4	7.5	0.0	0.0	7.4	7.8	0.0	0.0
Asean-5	**4.8**	**5.1**	**0.0**	**0.0**	**4.9**	**5.0**	**0.3**	**0.2**	**-**	**-**	**-**	**-**	**4.5**	**4.6**	**0.0**	**-0.2**
Indonesia	4.9	5.3	0.0	0.0	5.1	5.3	0.0	0.0	-	-	-	-	5.0	5.1	-0.2	-0.4
Malaysia	4.3	4.6	-0.1	-0.2	4.2	4.3	-0.2	-0.2	-	-	-	-	4.1	4.4	-0.1	0.0
Philippines	6.4	6.7	0.4	0.5	6.4	6.2	0.0	0.0	-	-	-	-	6.4	6.2	0.4	0.1
Singapore	1.7	2.2	-0.1	0.0	-	-	-	-	-	-	-	-	1.8	2.0	-0.2	-0.2
Thailand	3.2	3.3	0.2	0.1	3.1	3.1	0.6	0.5	-	-	-	-	3.2	3.5	0.2	0.0

Source: IMF, World Bank, OECD, ADB

As for Malaysia, the IMF GDP growth expectation is 4.3% in 2016 (down 0.1ppts from April) and 4.6% in 2017 (-0.2ppts from previous). Separately, the World Bank revised down Malaysia's GDP to 4.2% in 2016 (from 4.4%), 4.3% in 2017 (-0.2ppts) and 4.5% in 2018 (-0.2ppts) citing subdued global demand on its open economy, while acknowledging the strong domestic economy.

Fig 30: Global GDP growth trend



Source: IMF

What this means is that global growth at 3.1% in 2016 is now the weakest since 2009. A year ago, we were hopeful of a rebound in global growth as IMF was looking at 3.5% expansion then. That did not materialise and it exerted pressure on Malaysia's external trade. We were forecasting 4.5% GDP growth for 2016 a year ago before moderation of global GDP forced us to taper down our forecast to 4.2% for 2016.

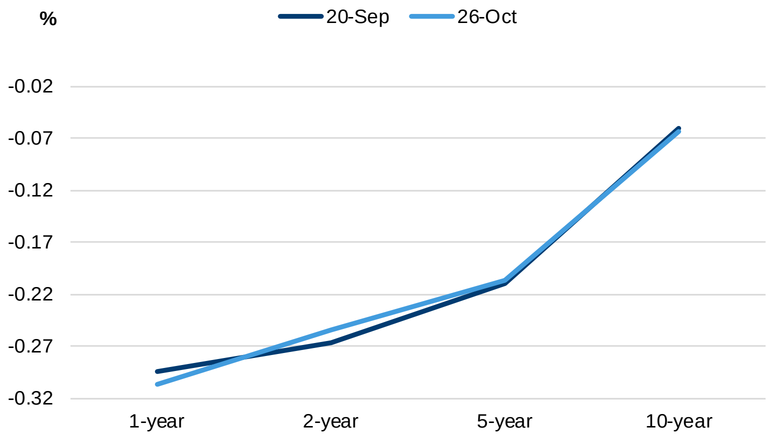
Bank of Japan's big monetary laboratory

In its 21 September 2016 monetary policy meeting, the Bank of Japan (BoJ) surprised the markets just like back in January 2016 when it announced negative deposit rates. In September, the BoJ decided on the following: (1) keeping the deposit rate it charges banks unchanged at 0.1%; (2) scrapping the annual target of 80 trillion yen bond purchase; and (3) introducing yield curve control by targeting the 10-year Japanese Government Bond (JGB) at a yield of around 0%. Overall, these are all positive developments, in our view.

Firstly, BoJ did not expand deeper into negative interest rate, which is unpopular with investors as it erodes the banks' profitability causing bank stocks to fall, thus dragging down the Nikkei 225. Secondly, while it scrapped the 80 trillion yen bond purchase target, it has indicated that it intends to continue purchasing bonds by the same amount until inflation hits 2%, effectively continuing with quantitative easing.

Lastly and most significant of all is the introduction of yield-curve management, which is positive for bank shares and the stock market. The 10-year JGB had been trading at a negative yield, but post the BoJ announcement the yield has turned positive. This is good news for banks because it enables banks to make better profits from a wider interest rate spread countering the negative deposit-rate effect.

Fig 31: JGB yield curve



Source: Bloomberg

Global trade

It turns out that some of the world economic slowdown was due to global trade. According to the World Trade Organisation (WTO), global trade volume is expected to moderate to just 1.7% in 2016, based on its latest estimates released end-September 2016. This was down from 2.8% projection earlier. In addition, it has also pared its 2017 world trade volume forecast from 3.6% previously to between 1.8% and 3.1%, the first time that it has given a range rather than a specific figure.

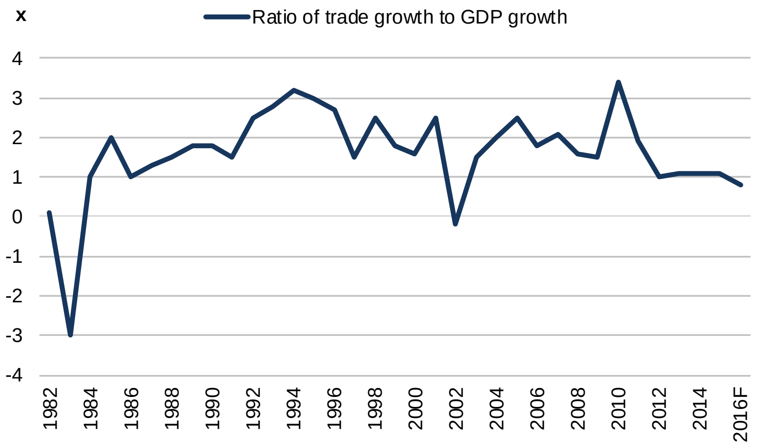
Fig 32: WTO's trade projections

	2012	2013	2014	2015	2016P	2017P
Volume of world merchandise trade	2.2	2.4	2.8	2.7	1.7	1.8-3.1
Exports						
Developed economies	1.1	1.7	2.4	2.8	2.1	1.7 - 2.9
Developing economies	3.8	3.8	3.1	3.2	1.2	1.9 - 3.4
North America	4.5	2.8	4.1	0.8	0.7	1.6 - 2.9
South and Central America	0.9	1.2	1.8	1.3	4.4	3.1 - 5.5
Europe	0.8	1.7	2	3.7	2.8	1.8 - 3.1
Asia	2.7	5	4.8	3.1	0.3	1.8 - 3.2
Other regions	3.9	0.6	0.1	3.9	2.5	1.5 - 2.6
Imports						
Developed economies	0.1	0.2	3.5	4.6	2.6	1.7 - 2.9
Developing economies	4.8	5.6	2.9	1.1	0.4	1.8 - 3.1
North America	3.2	1.2	4.7	6.5	1.9	1.9 - 3.1
South and Central America	0.7	3.6	2.2	-5.8	-8.3	2.2 - 3.7
Europe	1.8	0.3	3.2	4.3	3.7	1.8 - 3.1
Asia	3.7	4.8	3.3	1.8	1.6	2.0 - 3.3
Other regions	9.9	3.5	0.5	-6.0	-2.8	0.6 - 1.0

Source: WTO

The reason for the introduction of a range of growth is due to the breakdown of the historical relationship between global trade and world GDP growth. According to a WTO analysis, global trade volume has historically expanded at 1.5x world real GDP growth at market exchange rates. If the 1.7% world merchandise trade growth forecast by WTO comes through in 2016, it would be the first time in 15 years where the ratio has fallen below 1x.

Fig 33: Weakening relationship



Source: WTO

Indeed, global merchandise trade values, for both exports and imports, have turned contractionary in October 2014 compared to a year ago and have been doing so for 21 consecutive months until July 2016. This trend underlines the protracted softness in the global GDP. One silver lining though is the latest August 2016 trade figure that shows a return to growth for both exports and imports. As the idiom goes, one swallow does not make a summer, hence we are aware that it is just one month of figure. We await more data points in the future to see if this trend holds. If it does, it spells of a positive development for global economy.

Fig 34: World merchandise export and import value growth

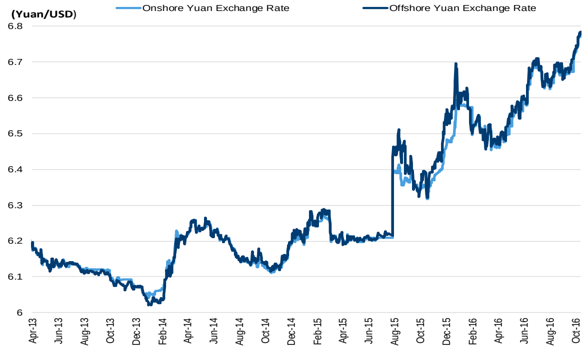
Source: WTO

Similarly, the IMF has also highlighted that trade growth has slowed since 2012 relative to both its historical performance and to overall economic growth. It provided a few explanations including more subdued investments, China's economic rebalancing away from investment to consumption, slower trade liberalisation and uptick in protectionism, moderating reduction in trade costs and slower formation of cross-border production chains, while a more structural reason is the increase in non-tradable demand alongside growing wealth and aging population.

But other concerns have subsided

Beyond these, we are relieved to note that most of the major concerns at the start of 2016 have subsided. The sharp plunge in financial markets and commodity prices at the onset of this year was due to fears emanating from China. Markets were spooked by the devaluation of the Yuan and the sharp contraction in its foreign exchange reserves. Indicators of the two have shown moderation. For instance, the offshore and onshore Yuan exchange rates are trading in a tight range while China's foreign exchange reserves have stabilised at US$3.2tn.

Fig 35: Reigning in offshore Yuan



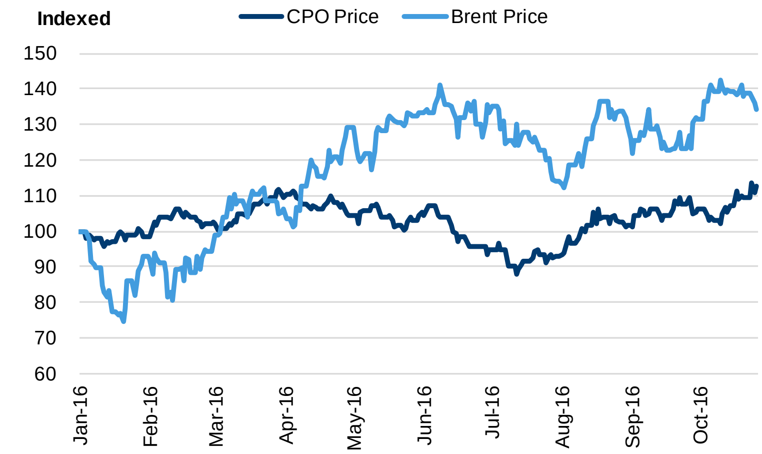
Source: Bloomberg

Fig 36: China's foreign reserves

Source: Bloomberg

Besides China, commodity prices have shown a sustained rebound especially for Brent and palm oil. The former has fallen by as much as 26% but rebounded to up 34% from the start of the year, while the latter declined by 12% before recovering to 14% higher now.

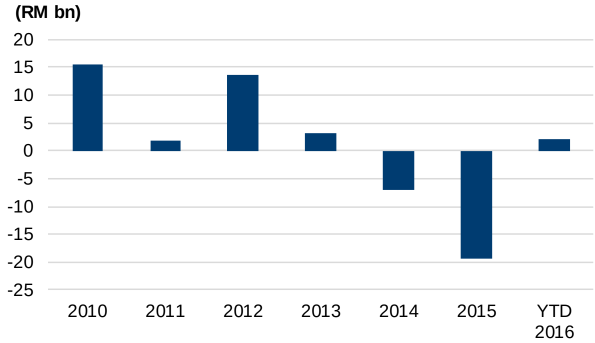
Fig 37: Commodity prices have rebounded



Source: Affin Hwang, Bloomberg

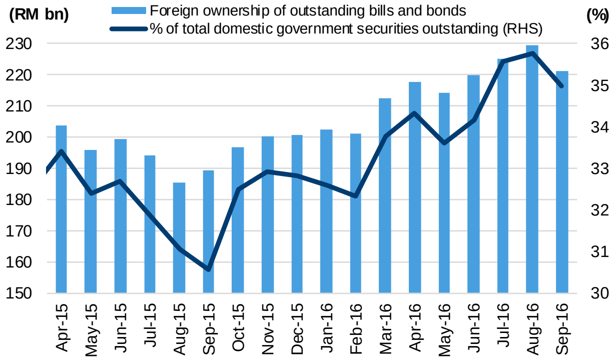
The strong foreign capital outflows in 2014 and 2015 from Malaysia continued into 2016, becoming a major concern for financial markets. Yet even those have subsided. The RM6.9bn outflows in 2014 and RM19.5bn in 2015 have turned around to a net inflow of RM2.4bn so far this year. Meanwhile, foreign holdings in total government domestic debt securities have also risen from 32.8% at the start of the year to 35% now (as of September 2016).

Fig 38: Foreign inflows have turned positive for Bursa



Source: Bursa

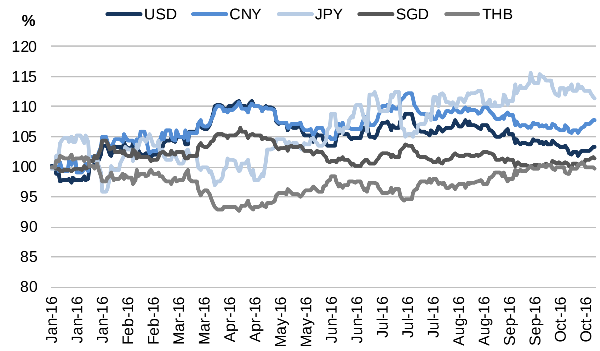
Fig 39: Foreign ownership of domestic government securities



Source: BPAM, BNM

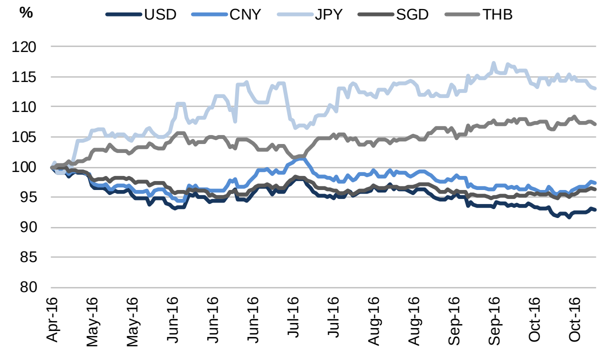
Despite the recent strength in the US Dollar, the Ringgit has actually not done too badly this year. Measured from the start of 2016, the Ringgit is actually up against four of its top five trading partners now (just marginally lower against the Baht). However, its strongest level so far this year was on 20 April. If we measure from that point forth, then the Ringgit has strengthened against two (Yen and Baht) but weakened versus three (USD, Yuan, SGD) of its top-five trading partners' currencies.

Fig 40: Ringgit against top-five trading partners, ytd



Source: Bloomberg

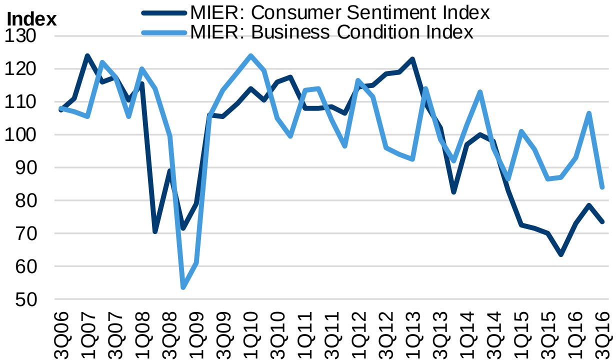
Fig 41: Ringgit since 20 April 2016



Source: Bloomberg

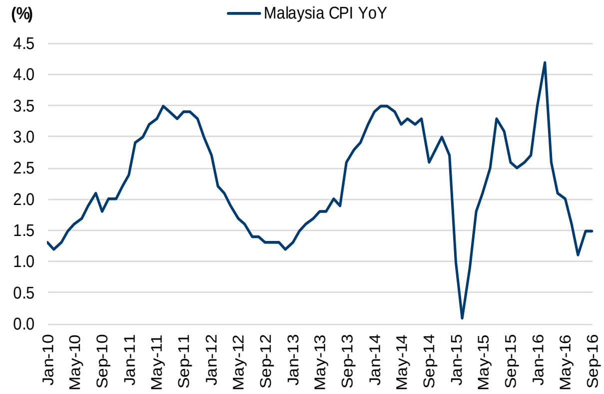
At the start of the year the effects of the GST introduction on 1 April 2015 were still hanging over the economy, especially with the consumer sentiment index hitting a low of 63.8 points in 4Q15; latest is at 73.6 in 3Q16. In addition, the business-condition index has also rebounded post GST to 106.4 points in 2Q16 before weakening back to 83.9 in 3Q16. Lastly, cost-push inflation due to the GST increased to as high as 4.2% in February 2016, but has since moderated to 1.5% in September.

Fig 42: Consumer Sentiment and Business Condition Indices



Source: MIER

Fig 43: Inflation



Source: BNM

Mind the gap

The emerging market conundrum

In our strategy report, '*Battling Perceptions*,' published on 2 June 2016, we highlighted that the Fed funds rate hike would time and again come back into focus for the rest of this year and throughout 2017. Naturally, a key element of the Fed funds rate hike is the impact it would have on emerging markets.

Typically, emerging markets have very high economic growth. This is due to the lower GDP base but in part is also a function of high investment requirements to build capacity in the economy, which in turn enables a higher natural rate of growth. However, the rapid pace of investment rollout usually outstrips the pace of savings accumulation, rendering emerging markets with a negative savings-investment gap.

Essentially, a shortfall in savings means that emerging markets are unable to fully finance their domestic investment requirements with domestic savings. The deficit would need to be filled by foreign inflows, be it foreign direct investments or foreign portfolio flows. An offshoot of the deficit in savings is fluctuating liquidity conditions, as foreign flows, especially portfolio monies, are usually less sticky and more volatile.

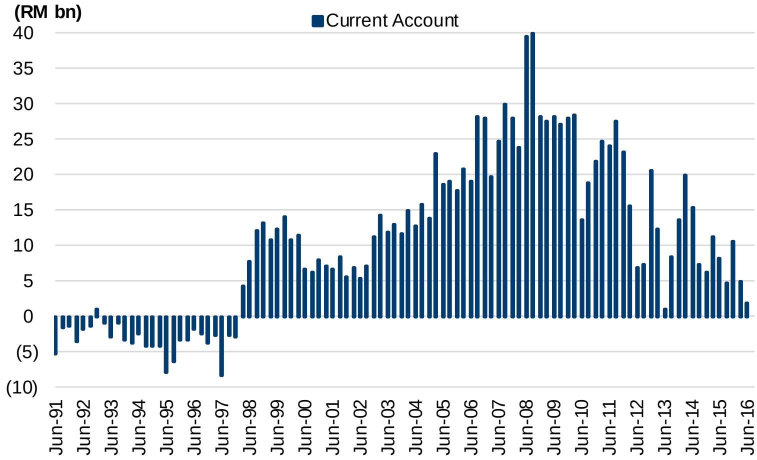
If the Fed bumps up interest rates, yields on US Dollar-denominated assets would likely increase. A high enough yield could prompt a withdrawal of funds from emerging markets. This would in turn tighten domestic liquidity, increase the cost of funds and, if the situation is serious enough, render emerging markets unable to finance critical investments. Under such a scenario, emerging market central banks may need to react quickly by increasing their policy interest rates to re-attract foreign funds into the country in order to provide enough liquidity for the proper functioning of the financial system. However, a higher interest rate may crimp economic activities over time, thus putting pressure on growth.

The misconception about Malaysia

Malaysia is classified as an emerging market and hence many see it in the same light as the situation we have described above, where a higher Fed funds rate could prompt an outflow of funds from Malaysia, crimp liquidity and could force the central bank to raise rates.

However, Malaysia possesses two key characteristics that set it apart from most emerging markets. The first is that it runs a positive savings-investment gap. In fact, it has been not just running one since 1998, but Malaysia has been recording a current account surplus every quarter since 1Q98, or an uninterrupted 70 quarters.

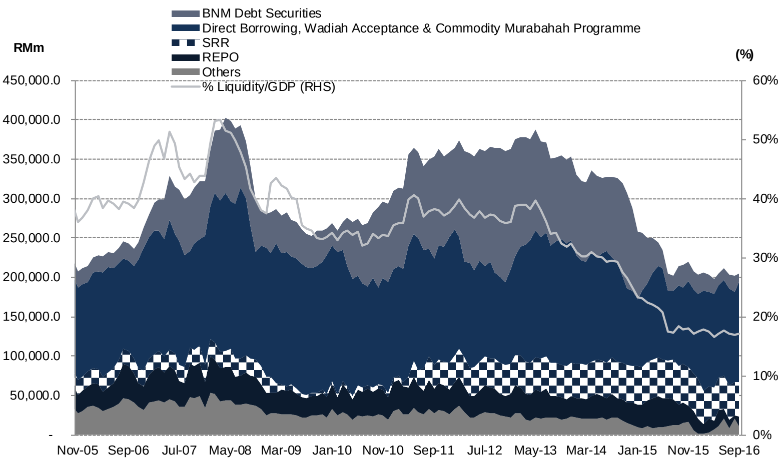
Fig 44: Malaysia runs a positive savings-investment gap (June 1991 to June 2016)



Source: BNM

The other differentiating factor is Malaysia's liquidity position. Its trade surplus underpins the current account position and draws foreign currencies into the domestic economy. In turn, it boosts the liquidity in the financial system and with the additional supply of money puts pressure on short-term interest rates in Malaysia. In order for BNM to maintain its interest rate stance, it has to mop up the excess liquidity in the financial system by issuing paper to the financial institutions, hence tightening liquidity in the system and neutralising downward pressure on the short-term interest rate.

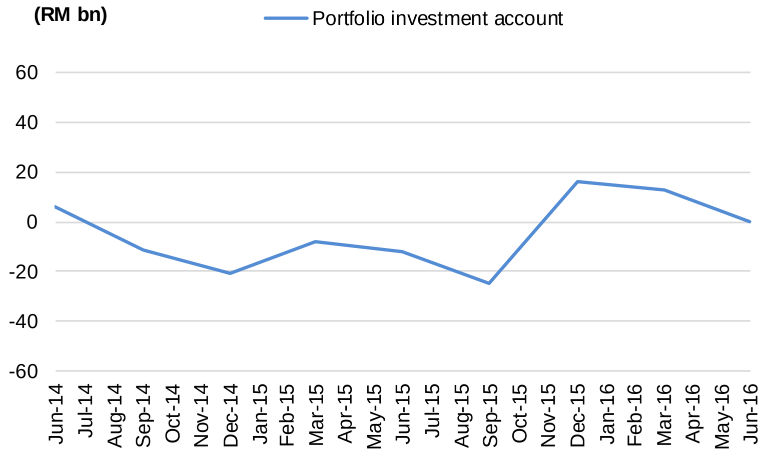
Fig 45: Excess liquidity residing in the BNM



Source: Affin Hwang, BNM

We estimate that currently the excess liquidity residing in the BNM is RM205bn as of end-September 2016, equivalent to 17% of GDP. This is a large number and remains healthy despite the huge outflows from Malaysia since 2H14 triggered by the sharp reduction in crude oil prices. In particular, we observe that the Portfolio Investment Account of the Balance of Payments has seen five quarters of consecutive outflow since 3Q14 to 3Q15. Over this period, RM75.6bn exited Malaysia. This coincided with the sharp reduction of excess liquidity in BNM. At its peak, this stood at RM402bn, or 51% of GDP.

Fig 46: Large outflows from Portfolio Investment Account of the Balance of Payments (June 2014 to June 2016)



Source: BNM

But current account surplus has deteriorated

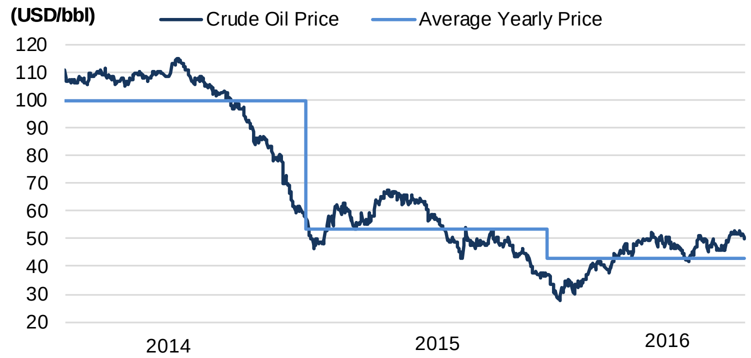
Indeed, Malaysia has a strong and unbroken current account surplus track record since 1998. However, that in itself is not a guarantee of a positive savings-investment gap in the future. In fact, Malaysia's current account position has seen a noticeable narrowing in the surplus. The latest 2Q16 current account surplus is RM1.9bn, or 0.6% of the quarter's GNI, representing the second-lowest on record; the lowest was RM1bn in 2Q13, at 0.4% of GNI. The excess liquidity sitting at BNM provides a good buffer, but it means nothing if the current account turns negative and begins chipping away at the excess, as BNM continues to inject this pool of reserves back into the market to ensure the uninterrupted and smooth functioning of the financial markets.

The recent pressure on the current account can be easily attributable to commodity prices. Malaysia's GDP structure is unique, as it is blessed with commodities while also having a rather diversified economy. It benefits from three major commodities – oil, gas and palm oil. A portion of these commodities is consumed domestically, but the country's relatively small population base also means that there is surplus production. Hence, Malaysia is a net energy exporter. At the same time, it also engages in a significant portion of its CPO production as trade. With this in mind, it is easy to see why Malaysia's current account surplus has deteriorated.

Crude oil

Crude oil prices are in a multi-year down cycle. In 2014, the average Brent crude oil price was US$99/bbl. This dropped to US$54/bbl in 2015. The Brent price has been very volatile so far this year. At the start of 2016, global concerns about China and its impact on the global economy sent oil prices down to a low of US$27.88/bbl on 20 January 2016. This was good news for net energy importers but not countries with excess crude production.

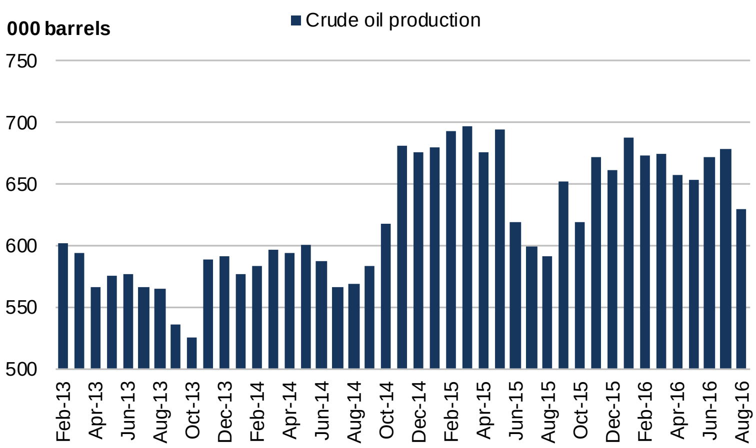
Fig 47: Brent price trend



Source: Affin Hwang, Bloomberg

While prices are lower than a year ago, production levels in Malaysia have not deteriorated. For the first eight months of 2016, Malaysia produced an average 666k bbls/day (simple mean of the monthly average production) or marginal 1.5% higher versus a year ago. This represents the fifth consecutive year of expansion in production subsequent to the trough reached in 2011. Note that Malaysia's production levels peaked in 2008 at 688k bbls/day (full calendar year average) but has come down to a trough of 570k bbls/day by 2011. The lowest average production figure since 2007 was in May 2011 of 489k bbls/day while the highest was at 734k bbls/day in January 2008.

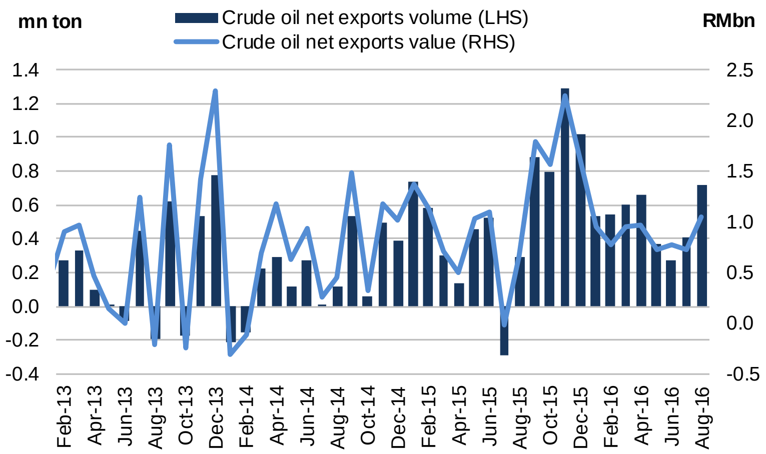
Fig 48: Malaysia crude oil production



Source: BNM

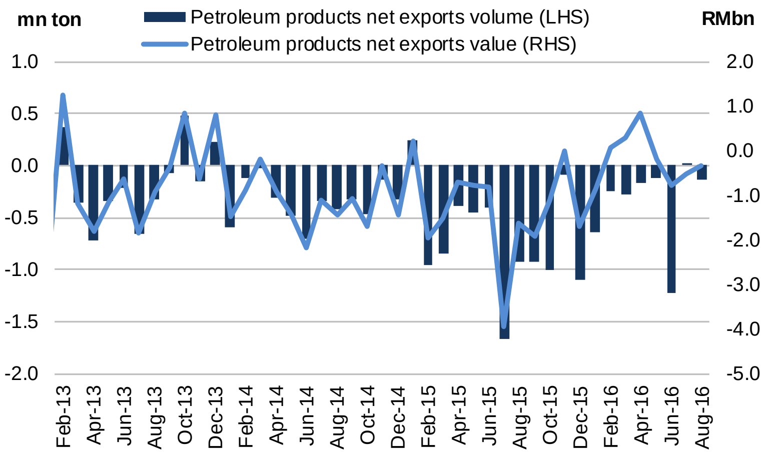
Malaysia has traditionally been a net exporter of crude and this remains the case until today. However, it did dip into a deficit if we take into account the total of crude and petroleum products. The combination of growing demand for energy domestically and aging oil fields caused this to happen in 2014 and 2015. As such, the government redirected exploration and production efforts back to Malaysia. That has paid off as Malaysia was successful in discovering and commercialising new oil fields, the biggest of which is the Gemusut-Kakap with a peak production capacity of 135k bbls/day. This was a significant discovery, as at the time of its discovery represented 25% of total production in Malaysia.

Fig 49: Malaysia has traditionally been a net exporter of crude oil…



Source: CEIC

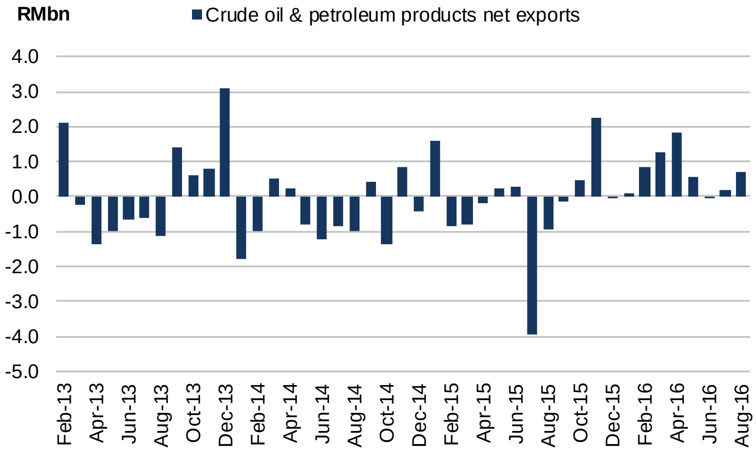
Fig 50: …but not always the case for trade in petroleum products



Source: CEIC

In Ringgit terms, Malaysia's net export of the crude and petroleum products narrowed from RM4.1bn in 2012 to just RM849m in 2013 before turning into net import of RM6.4bn in 2014 and RM2.1bn in 2015. Thus far, 2016 looks like a turnaround with cumulative net export of RM5.4bn in the first eight months of the year.

Fig 51: Malaysia returns to being a net crude and petroleum product exporter in terms of value

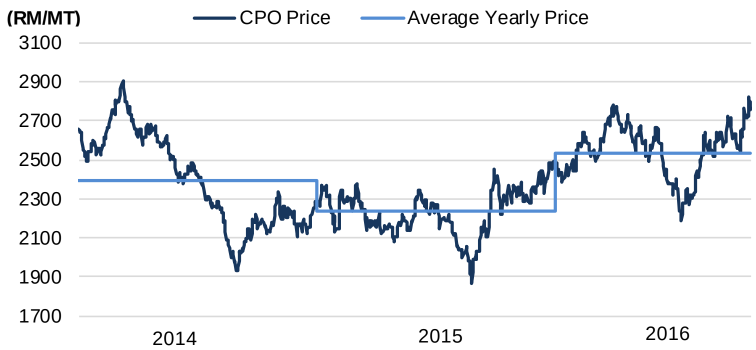


Source: Affin Hwang, CEIC

Palm oil

Palm oil experienced a correction in 2015 with an average price of RM2,235/tonne but has rebounded in 2016 with an average of RM2,534 thus far. But unlike crude, the palm oil industry has been hit by sharp decline in production volumes due to the El Nino phenomenon that caused hot and dry weather in South East Asia.

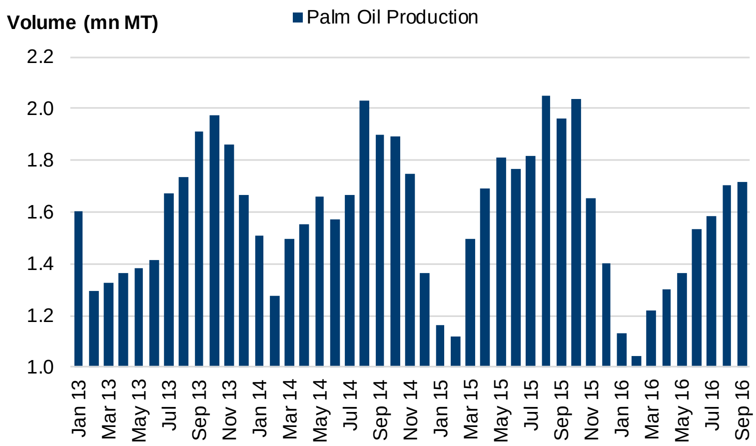
Fig 52: Palm oil prices have rebounded…



Source: Affin Hwang, Bloomberg

As a result, Malaysia's palm oil production declined by 15.3% so far this year to 12.6m tonnes versus 14.9m tonnes for the same period (first nine months of the year). The good news is that the El Nino has passed. However, the effects continue to linger given the biological stress that requires time for the trees to recover. The natural rehabilitation process has begun and we note that palm oil volumes have rebounded recently. For instance, palm oil production has been on a consistent uptrend with each passing month with the latest September production figure reaching 1.72m tonnes, the highest so far this year. Nonetheless, this is still down 12.5% from September 2015 suggesting the rehabilitation process is far from over.

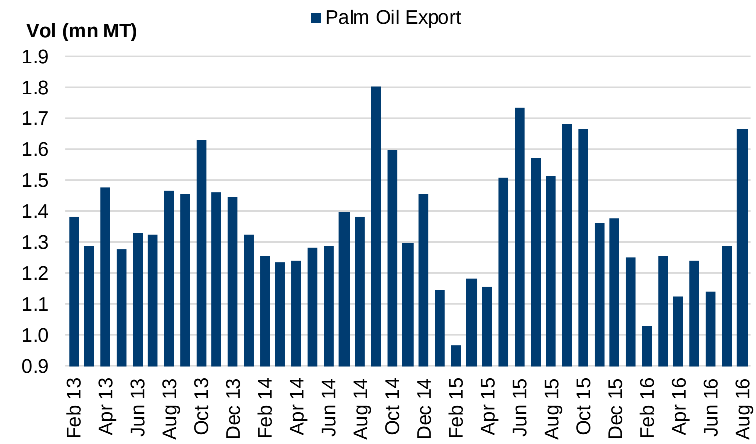
Fig 53: …but production levels are down



Source: BNM

Consequently, palm oil exports mimicked the production levels, falling 7.2% yoy for the first eight months of the year. However, the 1,666k tonne export volume in August is the highest so far this year though this is still down 9.9% yoy. Hopefully, the pace of exports continues to increase in tandem with the recovery in production.

Fig 54: Palm oil exports



Source: BNM, CEIC

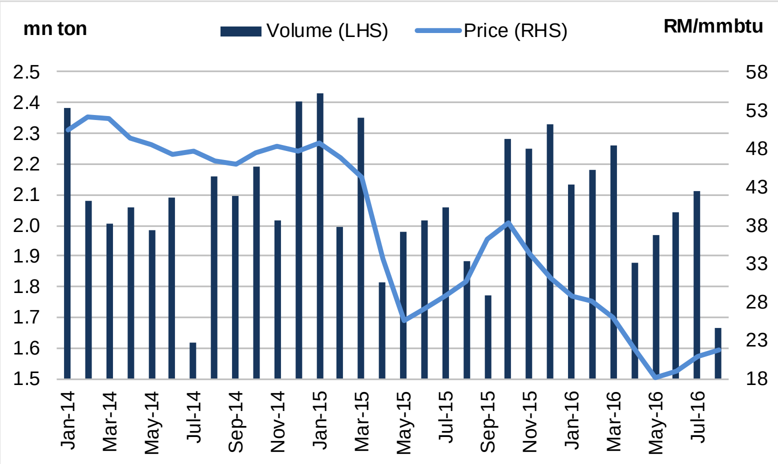
LNG

The last major commodity for Malaysia and the most important of all is liquefied natural gas (LNG). Unlike Brent, there is no single international price benchmark for LNG. This is because LNG prices are regional in nature, which means there could be large discrepancy between two areas, such as Asia and the US. One key differentiating factor from crude oil is that significant facilities are required to transport LNG. At source, the exporter must have the facility to turn natural gas into liquid for transportation, thus the need of a liquefaction plant. Meanwhile, the importer at the end destination must have the capability to convert LNG back to gas state thus the requirement of a regasification plant. The heavy capital investments and the need for energy security in supplies dictate long-term negotiated agreements between supplier and off-taker thus creating different market prices for LNG.

In Malaysia's case, Japan is the single largest destination for LNG. The off-take agreements are confidential but the general principles address security of supply and pricing. The price reference is based on the Japanese Crude Cocktail (JCC) benchmark. However, LNG prices typically trends alongside Brent price with a 3-6 months delay. Hence the decline in Brent price also hurt LNG but on a time-shifted basis.

The good news is that the realised LNG export prices seem to be on a recovery mode. We estimate that the average export price for Malaysian LNG in 2015 was RM34.80/mmbtu but has fallen to a low of RM18.17/mmbtu in May 2016. That was four to five months after Brent price hit its lowest level of US$27.88 on 20 January 2016. Prices have since rebounded with the latest realised average price of RM21.70/mmbtu recorded in August, the third consecutive monthly rise. This means that the trough for LNG price could be behind us if Brent prices remain stable at current levels.

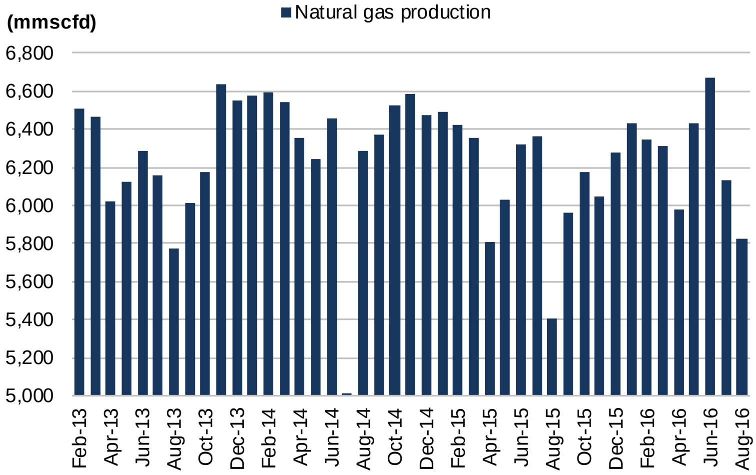
Fig 55: Realised LNG export price on the mend



Source: Affin Hwang, BNM

Just like crude oil, natural gas production levels in Malaysia have not fallen in 2016 despite lower prices. Average production for the first eight months was 6,266 mmscfd (simple mean of the monthly average production) representing 2.1% rise from the same period in 2015. Natural gas production was highest in 2014 at 6,334 mmscfd (full calendar year average) hence the current 6,266 mmscfd (though eight-month average) is not far away from peak production. The lowest recorded was 4,290 mmscfd in August 2012, while the highest was in fact just a few months ago in June this year of 6,673 mmscfd.

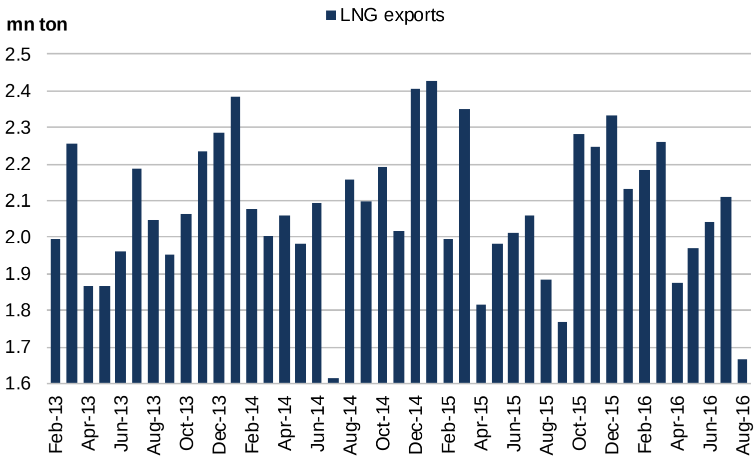
Fig 56: Malaysia natural gas production



Source: BNM

Meanwhile, gross exports of LNG have sustained thus far in 2016. Total exports for the first eight months of the year amounted to 16.2m tonnes (estimated at about 873 million mmbtu). This was marginally lower by 0.4% compared to the same period last year. For 2015, Malaysia exported 25.2m tonnes (about 1.35 billion mmbtu) of LNG, which is the highest volume on record, while we have to go back before 2004 to see export volume lower than 20m tonnes.

Fig 57: Malaysia LNG exports



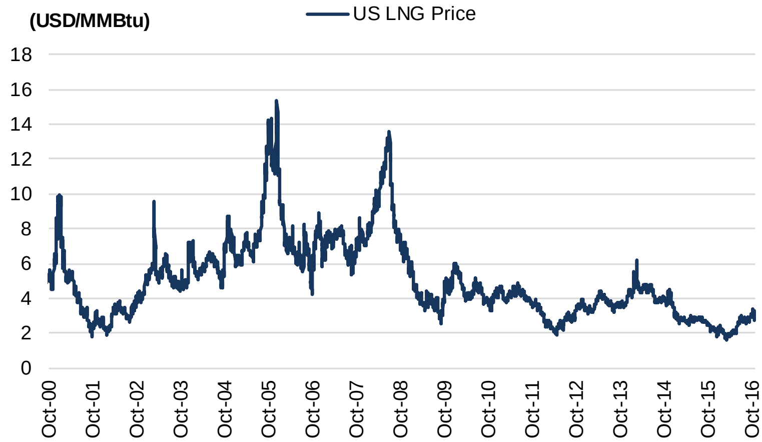
Source: BNM

Savings-investment gap unlikely to turn into deficit due to LNG

We find comfort that Malaysia's savings-investment gap should be able to remain in surplus if the existing situation in commodities persists. Brent oil prices even though lower than last year have rebounded from its lows to US$49.98/bbl. In addition, CPO prices are higher while production levels are expected to increase with dissipating effect of El Nino. Lastly, the time shift effect on LNG prices seems to have passed with LNG prices trending upwards in tandem with earlier on rebound in Brent price.

However, the less transparent nature of LNG pricing has caused some jitters especially since LNG prices in the US are lower than in Asia. For instance, LNG is quoted at US$2.72/mmbtu in the US for August average versus RM21.70/mmbtu for Malaysian exports (or equivalent to US$5.39). US LNG is trading at US$2.76 now, lower than the US$3.34 quoted on 13 October 2016. This raises the question what if Malaysian export price falls to the same level as in the US. As explained in the LNG section previously, LNG prices are regional in nature and it is related to international Brent price as part of the JCC benchmark. Hence the premium to the US LNG price, currently.

Fig 58: US LNG price trend



Source: Bloomberg

Nonetheless, we do a scenario analysis for domestic LNG export prices to plunge, and the corresponding stress that it would exert on the current account position. In doing so, we use the following information.

The 2015 base data for analysis are as follows:

- LNG exports for 2015 is estimated at 1.35 billion mmbtu.
- LNG exports price for 2015 is estimated at an average of RM34.80/mmbtu.
- Current account surplus in 2015 was RM34bn.

The assumptions for our analysis are as follows:

- LNG exports in 2016 to be the same as last year at 1.35bn mmbtu.
- The other components of the goods and services account, primary account and secondary account of the current account remains the same as in 2015.

In our scenario analyst for current account, we note the export value of LNG in 2015 works out to be RM47bn. At the same LNG export volume but at RM10/mmbtu average export price gives an export value of RM14bn. This is a shortfall of RM34bn versus 2015 and corresponds to the current account surplus in 2015. Putting it another way, LNG prices have to drop to RM10/mmbtu or US2.40/mmbtu for Malaysia's current account to be balanced, assuming that the rest of the components remain constant. The current US LNG price is US$2.76/mmbtu, and provides some buffer on the downside even if we assume that prices in Asia and the US will converge.

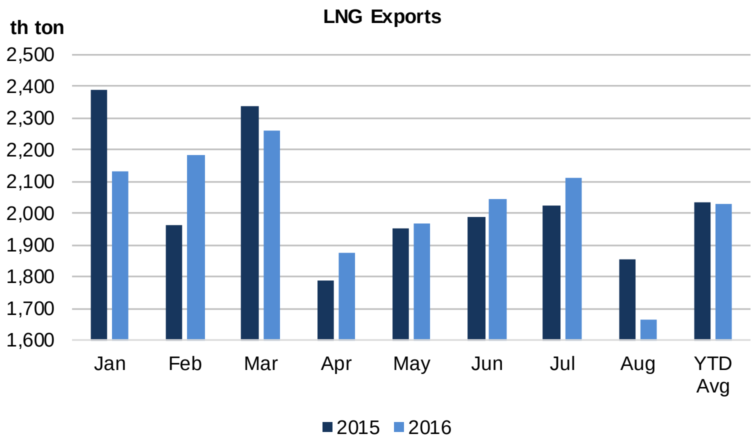
Fig 59: Impact of LNG price on the current account surplus

	Unit	2015
LNG export volume	mmbtu	1,352,399,341
LNG export price	RM/mmbtu	34.80
Export value	RM bn	47
Current account surplus	RM bn	34
Assumed LNG export volume	mmbtu	1,352,399,341
Assumed LNG price	RM/mmbtu	10.00
Export value	RM bn	14
Difference from original export value	RM bn	-34
Net impact on current account	**RM bn**	**0**

Source: Affin Hwang, BNM

Of course, the analysis works only if the volume of LNG export remains the same as 2015. This is the case thus far with cumulative exports in the first eight months of the year making up 65% of 2015. In other words, export volume is tracking the 2015 numbers on an annualised basis. In fact, the way the analysis is constructed has additional buffers to the current account contribution. This is because the analysis assumes no changes in LNG import volume. In reality, reduction in export volume should see a fall in imports as well given some of the excess production would be redeployed for domestic consumption.

Fig 60: Comparing LNG exports in 2015 versus 2016

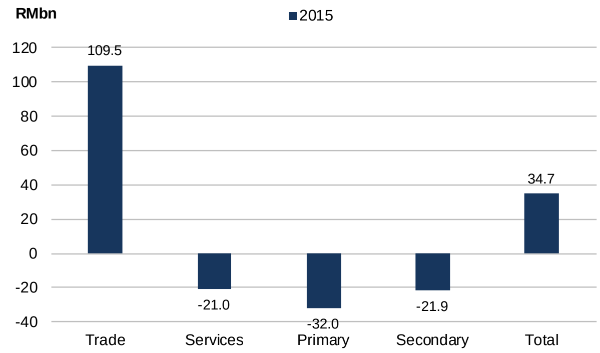


Source: BNM

Current account composition

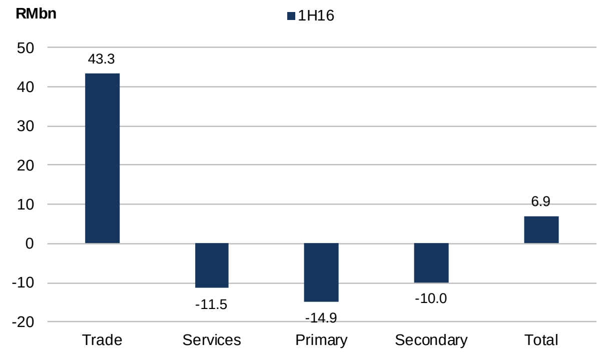
The current account surplus is of course not just dependent on crude oil, palm oil and LNG, though they are the biggest commodities influence. These are part of the trade account but the current account also encompasses the services account, primary as well as secondary income accounts. However, the trade account is by far the largest among the four. In fact, trade is the only account that contributes positively to the current account, while the other three subtracts from it.

Fig 61: Current account breakdown (2015)



Source: BNM

Fig 62: Current account breakdown (1H16)

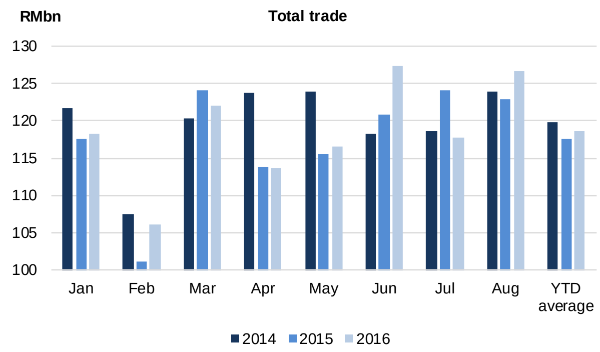


Source: BNM

Trade account

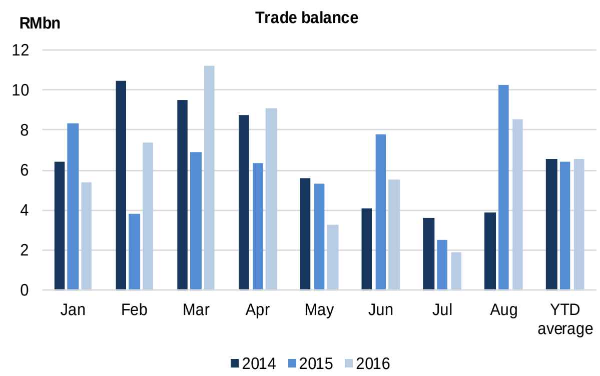
In 2015, Malaysia's total trade amounted to RM1.47tn or equivalent to 127% of GDP with a net trade surplus of RM91.6bn. Thus far in 2016, total trade in the first eight months amounted to RM948.8bn or up by a marginal 0.7% yoy. Trade balance though was RM52.2bn or down 3.7%.

Fig 63: Total trade (2014-16)



Source: CEIC

Fig 64: Trade balance (2014-16)

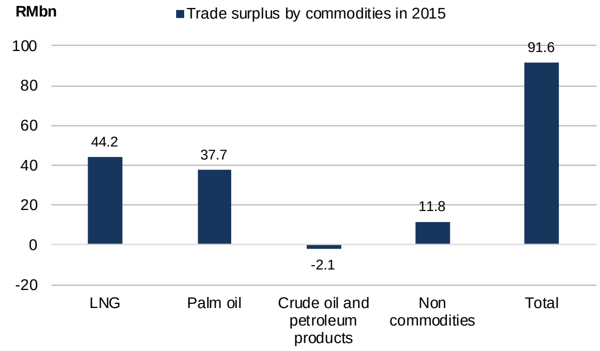


Source: CEIC

Of the three major commodities discussed, the net trade of LNG provided the largest RM44.2bn positive balance to the RM91.6bn total trade surplus in 2015. Palm oil is significant, which we estimate to have contributed a net balance of RM37.7bn. Lastly, crude oil contributed RM13.7bn in net trade surplus in 2015. However, if we look at the sum of crude oil and petroleum products it shows a deficit of RM2.1bn for 2015.

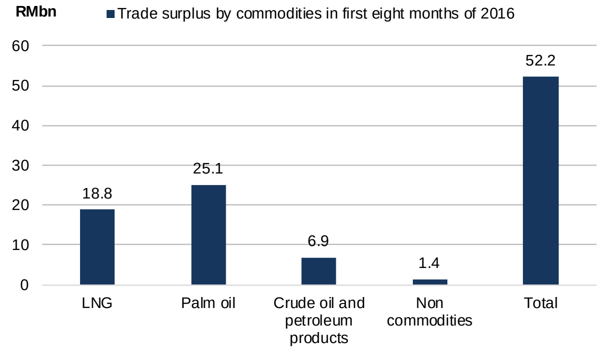
In other words, LNG and palm oil made up a substantial portion of the trade surplus in 2015. It is a bit different so far in 2016 where palm oil has surpassed LNG with contributions of RM20.8bn and RM17.2bn, respectively. However, the sum of crude oil and petroleum products has swung into a net surplus of RM4.7bn. The above three commodities made up nearly all of the total RM43.7bn trade surplus for the first seven months of 2016.

Fig 65: Trade surplus by commodities in 2015



Source: Affin Hwang, BNM

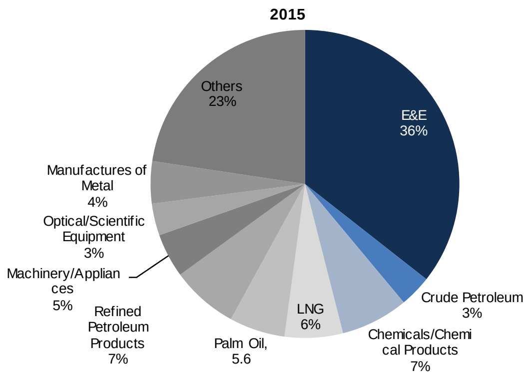
Fig 66: Trade surplus by commodities in the first eight months of 2016



Source: Affin Hwang, BNM

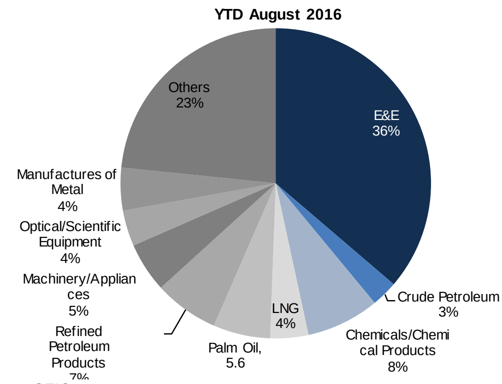
However, Malaysia's economy is fairly well diversified which reflects in its trade composition. There are non-commodities that are important to Malaysia's trade balance. Of this, the most significant is electrical & electronics (E&E). In 2015, 35.8% of Malaysia's total exports came from E&E. This figure is 36.3% for the first eight months of 2016.

Fig 67: Breakdown of exports 2015



Source: CEIC

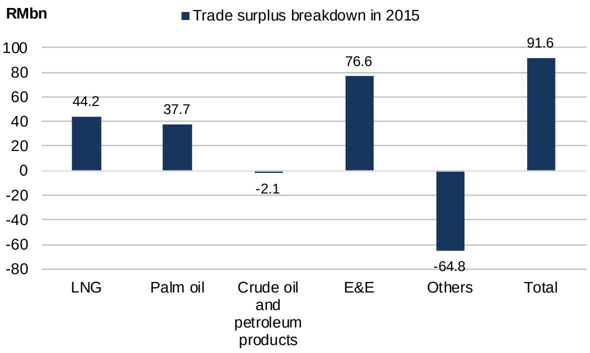
Fig 68: Breakdown of exports 2016 ytd



Source: CEIC

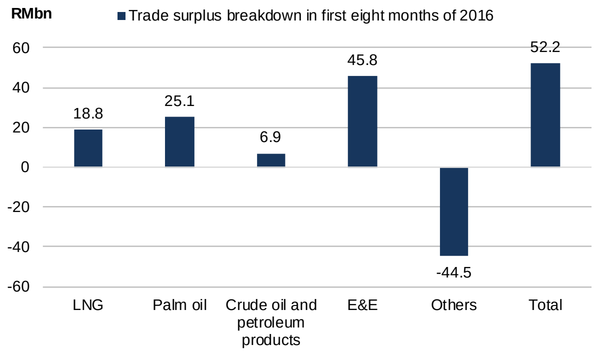
Trade balance from E&E in 2015 amounted to RM76.6bn while so far in the eight months of 2016 it is RM45.8bn. Hence, this constituted a substantial 84% of 2015 trade balance and 88% of 2016 thus far. The key point here is that while commodities are important, the overall health of the trade account also depends on other economic sectors. This in turn means that global trade conditions are just as important to sustain a healthy trade balance even if commodity prices are stable.

Fig 69: Size of E&E trade balance in 2015



Source: Affin Hwang, BNM

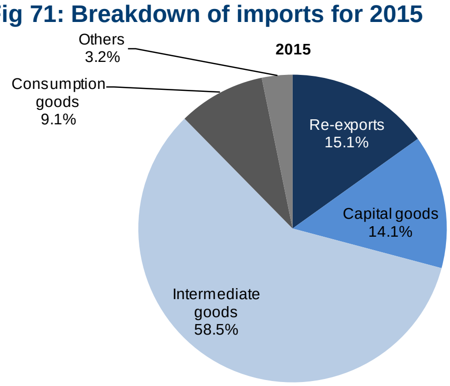
Fig 70: Size of E&E trade balance in 2016 ytd



Source: Affin Hwang, BNM

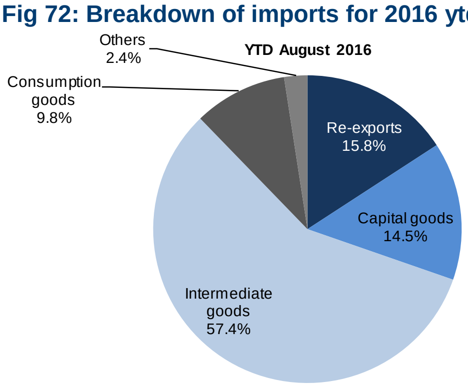
Lastly, we also provide the 2015 and year-to-date 2016 total import figures. By far the largest component of imports is intermediate goods, followed by re-exported goods, capital goods and others.

Fig 71: Breakdown of imports for 2015



Source: BNM

Fig 72: Breakdown of imports for 2016 ytd



Source: BNM

At one end of the spectrum is re-exports that constituted 15.0% of total imports in 2015 (ytd: 15.7%). This portion of imports could decline in tandem with exports if external demand weakens. At the other end of the spectrum is capital goods import, which is stickier even if external demand weakens given that domestic investment or capital expenditure that is in motion is difficult or costly to cancel or delay.

Meanwhile, consumption goods could swing either way. An environment of weak external demand but strong domestic economy could see exports declining but consumption goods import continuing to grow. In this ~~likely~~ scenario it could put pressure on the overall trade balance. However, the proportion was relatively small at 9.1% of 2015 total imports (ytd: 9.8%).

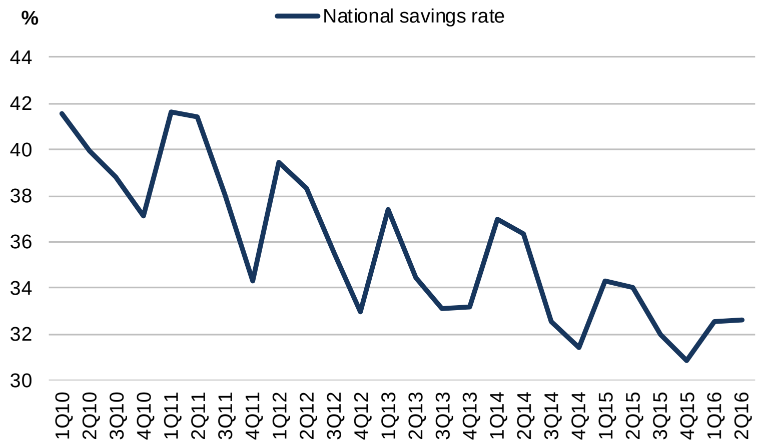
Intermediate goods are essentially imported items that are value added in Malaysia. The subsequent goods could be end-products or still at intermediate stage but be closer to end production- stage that could be either consumed in Malaysia or exported. It is difficult to estimate what proportion of value-added intermediate products is destined for exports. As such, if demand for Malaysian exports fall, the export part of intermediate imports would fall too. However, products that are destined for local consumption when domestic economy is strong while exports demand is weak could put pressure on the trade balance. This segment of imports as a whole was a substantial 58.2% of the total in 2015 (ytd: 57.2%).

In summary, Malaysia's trade is diversified and is a reflection of its economic structure. The export of LNG and palm oil, which like most other primary commodities, forms a large part of Malaysia's trade surplus while the sum of crude oil and petroleum products have returned to being positive contributor to net trade thus far in 2016. Major non-commodity trade with an outsize contribution to the trade surplus is E&E. While commodity prices have strengthened, we believe external demand needs to remain conducive to ensure non-commodities exports are healthy and that Malaysia's trade balance does not come under undue pressure.

National savings rate

As Malaysia is a savings nation, naturally it will be interesting to know how robust its savings rate is. Our calculation shows that Malaysia is indeed a highly prolific saver. Its gross domestic savings was as high as 41.7% in 2010, and have never dipped below 30%. One key observation is that the savings rate has recovered from a recent low of 30.9% and rebounded to 32.6% now.

Fig 73: Malaysia's gross domestic savings rate



Source: Affin Hwang, BNM

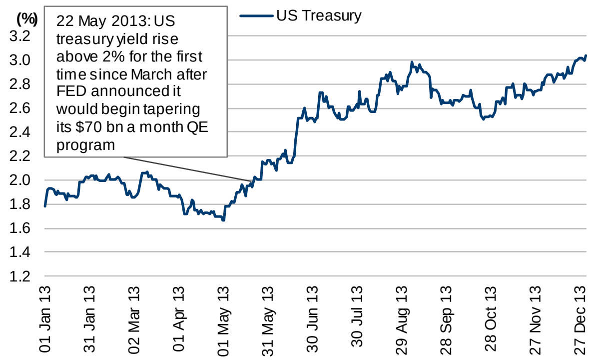
The long arms of monetary policy

Effects on financial markets

A comprehensive assessment of the savings-investment gap, ample excess liquidity residing in the banking system, the role of commodities, and the state of the trade account indicates that Malaysia's economic fundamentals are resilient to weather the expected imminent Fed funds rate hike. We believe this puts it at a significant advantage over many other emerging markets, which as a category in general is typically the worst affected by higher interest rates in developed nations.

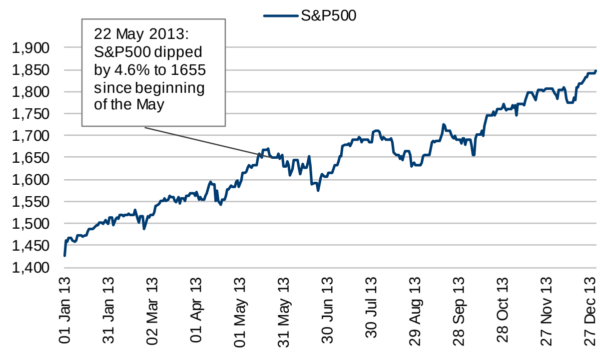
However, the impact of a Fed funds rate hike on financial markets is more pronounced, as the level of interest rates has a direct correlation to the risk-free rate that in turn influences the valuation of financial markets. We do not need to go back too far to see that in play. Back in 2013, US Treasury yields rose while stock markets fell as they reacted to concerns about the Fed's reduction in the amount of money it was injecting into the economy. The yield on the 10-year US Treasury rose above 2% or 30bps points above the low in 2013 up to that point, while the S&P500 dipped by 4.6% in May alone.

Fig 74: Taper tantrum on 10-year US Treasury (2013)



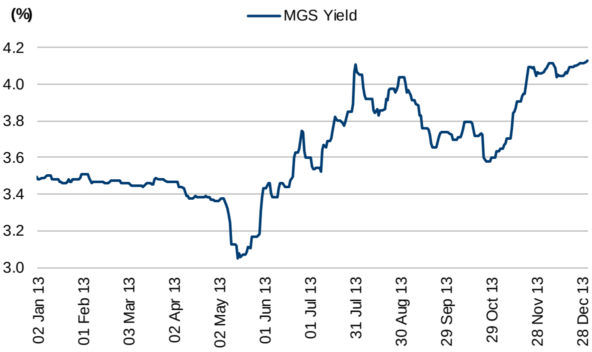
Source: Affin Hwang, Bloomberg

Fig 75: Taper tantrum on S&P500 (2013)



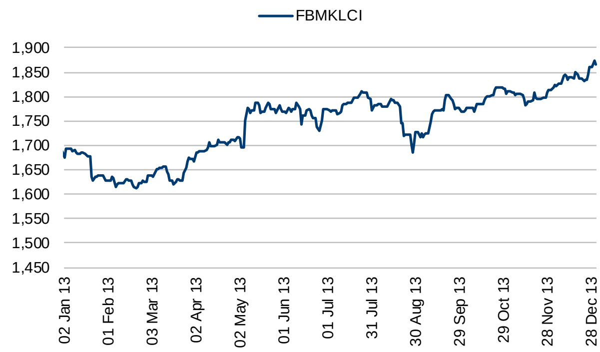
Source: Affin Hwang, Bloomberg

Fig 76: Reverberation on 10-year MGS (2013)



Source: Bloomberg

Fig 77: Reverberation on KLCI (2013)



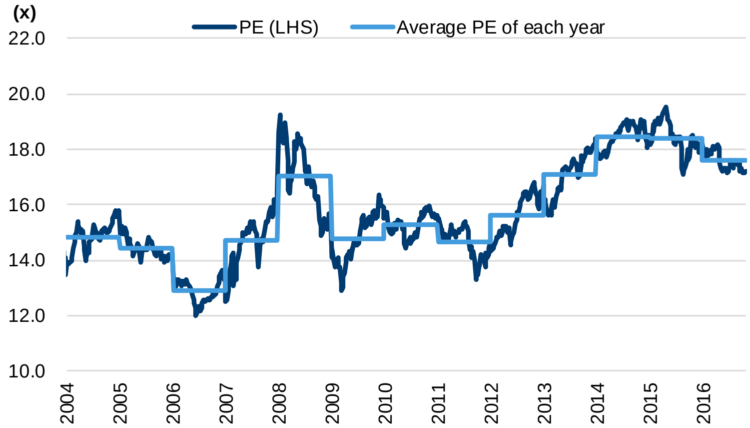
Source: Bloomberg

Although the QE tapering by the Fed was a US event, it had reverberations around the world and Malaysia was not spared. Despite strong investor sentiment post Malaysia's Thirteenth General Election results, the Malaysian 10-year MGS yield weakened 30bps by the end of May while the stock market also softened, but by 0.8%.

State of Malaysia's stock market

Currently, Malaysia is trading at 17.2x one-year forward PER. This is based on the portfolio of 102 stocks under coverage in our stock universe where we are expecting 6.3% yoy fully diluted EPS growth in 2017 following flat EPS in 2016. What we can clearly observe is that the stock market has re-rated. It was trading at an average of 14.6x in 2010 before a sustained re-rating to 18.2x in 2015. Thus far the average PE in 2016 is 17.4x, and as indicated earlier this is premised on no growth for fully-diluted EPS in 2016, but rebounding to 6.3% yoy growth in 2017. Of course, the 2016E PER is dependent on growth expectation since it is a 12-month forward PER computation. Obviously, better-than-expected growth would make the PER lower and more attractive, while disappointing growth would mean that the PER valuation is more expensive than our PE chart currently suggests.

Fig 78: Average yearly PER of the KLCI (2004-16 YTD)

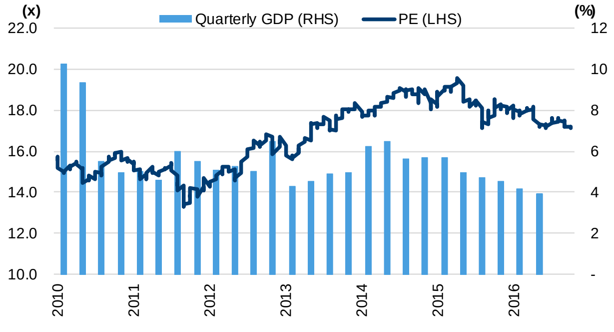


Source: Affin Hwang, Bloomberg

For listed companies, managements strive for a high PER as a PER re-rating is prestigious, indicating that the market is valuing the company more for each unit of profit. Similarly, a high PER for the market is a compliment as it means investors are willing to pay more to gain exposure in that particular market.

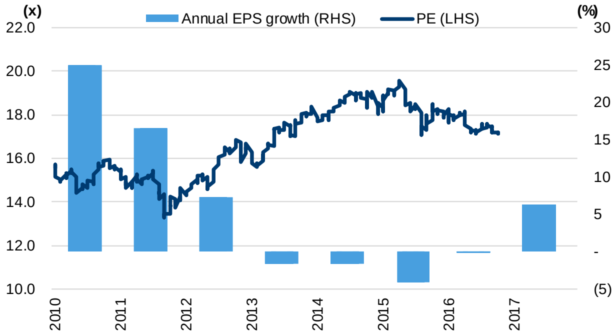
Typically, a re-rating is premised on favourable macro conditions and/or strong earnings growth. Over the re-rating period, we find that Malaysia's GDP has been decent but may not have been structural or rapid enough to support the long-term re-rating. Similarly, the bottom-up earnings growth trajectory while positive does not seem able to support the re-rating.

Fig 79: PER trend vs. GDP growth (2010-16 YTD)



Source: Bloomberg, BNM, Affin Hwang

Fig 80: PER re-rating and EPS trend (2010-16 YTD)

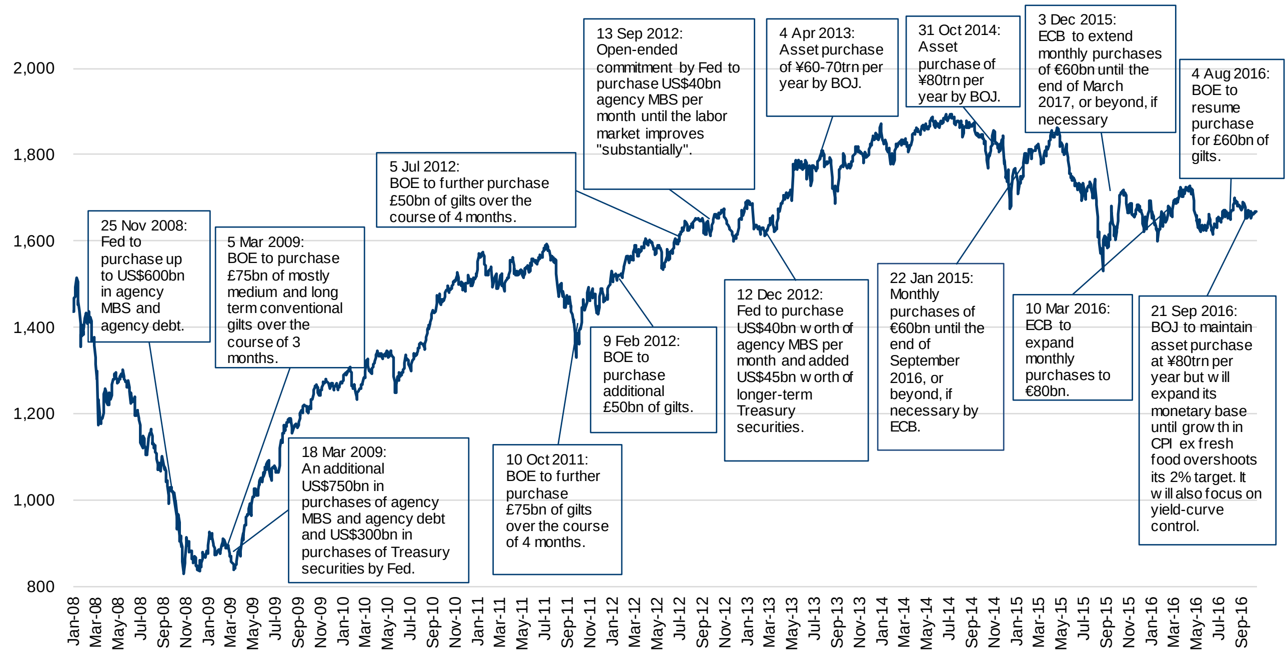


Source: Bloomberg, Affin Hwang

Side effects of loose monetary policy

The period of the Malaysian market re-rating coincided with the monetary policy easing by the developed world. It began with the Fed announcing in late November 2008 the intended purchase of US$600bn in mortgage-backed securities. This is one major cause of the Malaysian stock market re-rating. However, the impact is not just on Malaysia but also on global financial markets.

Fig 81: Various QE programs by global central banks



Source: Affin Hwang, Bloomberg

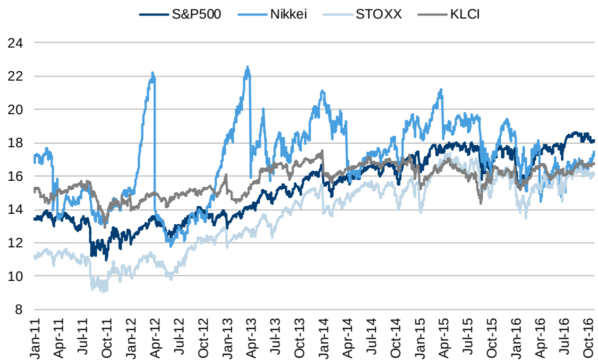
Fig 82: Quantitative easing measures

Date	Central bank	Description
25-Nov-08	US Federal Reserve	Fed to purchase up to US$600bn in agency MBS and agency debt.
5-Mar-09	Bank of England	BOE to purchase £75bn of mostly medium and long term conventional gilts over the course of 3 months.
18-Mar-09	US Federal Reserve	An additional US$750bn in purchases of agency MBS and agency debt and US$300bn in purchases of Treasury securities by Fed.
10-Oct-11	Bank of England	BOE to further purchase £75bn of gilts over the course of 4 months.
9-Feb-12	Bank of England	BOE to purchase additional £50bn of gilts
5-Jul-12	Bank of England	BOE to further purchase £50bn of gilts over the course of 4 months.
13-Sep-12	US Federal Reserve	Open-ended commitment by Fed to purchase US$40bn agency MBS per month until the labor market improves "substantially".
12-Dec-12	US Federal Reserve	Fed to purchase US$40bn worth of agency MBS per month and added US$45bn worth of longer-term Treasury securities.
4-Apr-13	Bank of Japan	Asset purchase of ¥60-70trn per year by BOJ.
31-Oct-14	Bank of Japan	Asset purchase of ¥80trn per year by BOJ.
22-Jan-15	European Central Bank	Monthly purchases of €60bn until the end of September 2016, or beyond, if necessary by ECB
3-Dec-15	European Central Bank	ECB to extend monthly purchases of €60bn until the end of March 2017, or beyond, if necessary
10-Mar-16	European Central Bank	ECB to expand monthly purchases to €80bn.
4-Aug-16	Bank of England	BOE to resume purchase for £60bn of gilts.
21-Sep-16	Bank of Japan	BOJ to maintain asset purchase at ¥80trn per year but will expand its monetary base until growth in consumer price index excluding fresh food overshoots its 2% target. It will also focus on yield-curve control.

Source: Affin Hwang

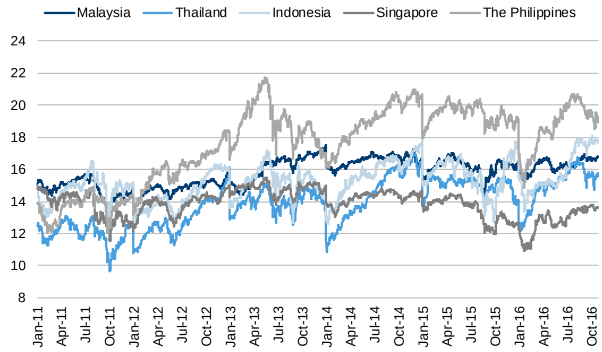
Using forward PER based on Bloomberg data for apples-to-apples comparisons for calculation methodology across markets, we see that the US stock market has re-rated over this period. The same is true for the EU and Japan stock markets. Similarly, we find that other regional markets in South East Asia such as Indonesia, Philippines and Thailand have done the same. This implies that the re-rating is not isolated to Malaysia and there are larger forces at play. In this instance, it is likely due to the loose monetary policy in the developed nations.

Fig 83: PER of developed markets plus Malaysia (2011-16 YTD)



Source: Bloomberg

Fig 84: Forward PER of SEA nations (2011-16 YTD)



Source: Bloomberg

Concerns abound on tightening

It is natural, therefore, to ask what happens if interest rates increase. This is especially so as the Fed in the US is on a tightening trajectory. The concerns are magnified by the expansion in the US market PER with the three major stock market indices striking new record highs this year, even though earnings have lagged. The tapering tantrum three years ago is also not too distant, thus lingering in the minds of some market participants.

In theory, higher interest rates are negative for the valuation of companies and should see stock PERs and market PERs falling even if there is no change in profitability level. The key concept here is that the risk-free rate increases and thus reduces the valuation of equities.

In order to examine the impact of the Fed funds rate hike on the US market, we first look at the weighted average cost of capital (WACC) and see how a higher interest rate affects the discounted cash flow (DCF), assuming that there is no change in operating profit, earnings and free cash flows.

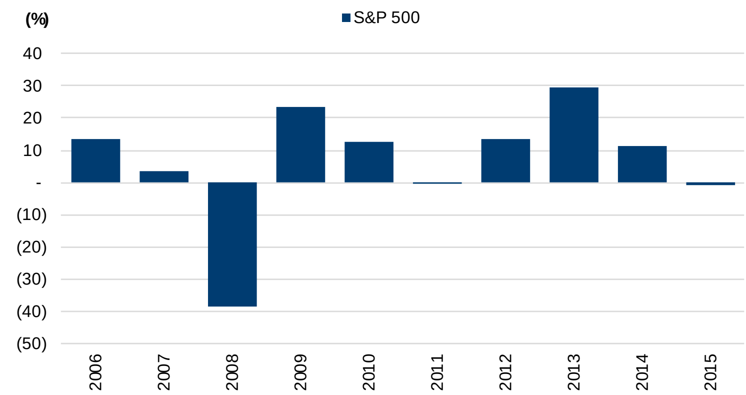
Weighted average cost of capital

There are six components of WACC.

Let us begin with discussing the **risk-free rate**. This refers to the annual return an investor can receive that does not carry any risk of losses. In other words, the investor is guaranteed the annual yield and principle upon maturity. The often-used risk-free rate is the 10-year Treasury benchmark. At the moment, the yield on the US 10-year Treasury is 1.79%.

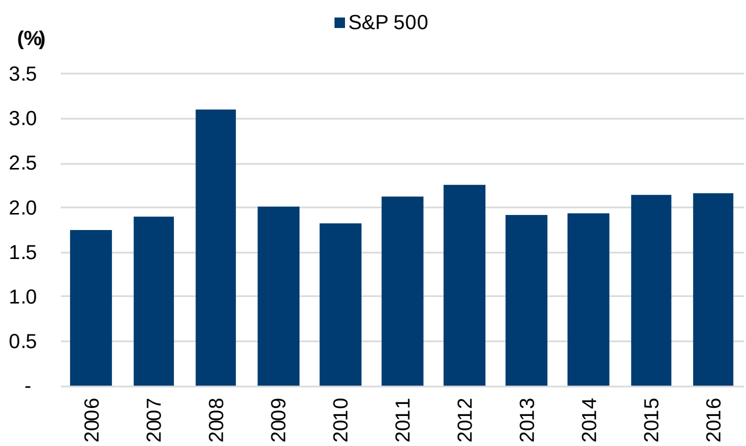
The second component is the **market-risk premium**. Investors who take on additional risks expect to be compensated with higher returns. Hence the market-risk premium refers to the extra return to investors above the risk-free rate that are expected given additional risks in exposure to the equity market. Hence, the sum of the risk-free rate and the market-risk premium is the total return from the market. Mathematically, the market-risk premium can also be calculated as total return from the market less the risk-free rate.

Fig 85: Annual return from S&P500 (2006-15)



Source: Affin Hwang, Bloomberg

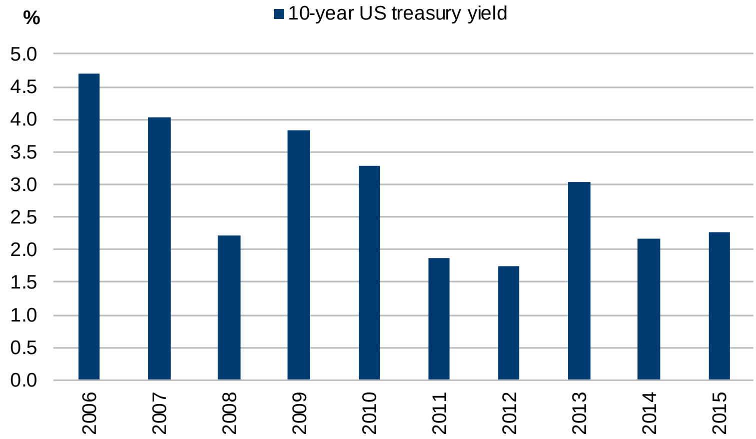
Fig 86: Annual dividends from S&P500 (2006-16 YTD)



Source: Bloomberg

In estimating the market-risk premium, we calculate the annual return from the S&P500, which is a simple measure of the index value at the end of the respective year as measured against at the start of the year. Adding to this value is the annual dividends paid to get the total return from the S&P500. The last step is to subtract from the total returns the 10-year Treasury yield each year. We take the average over the past ten years, which gives a figure of 6%.

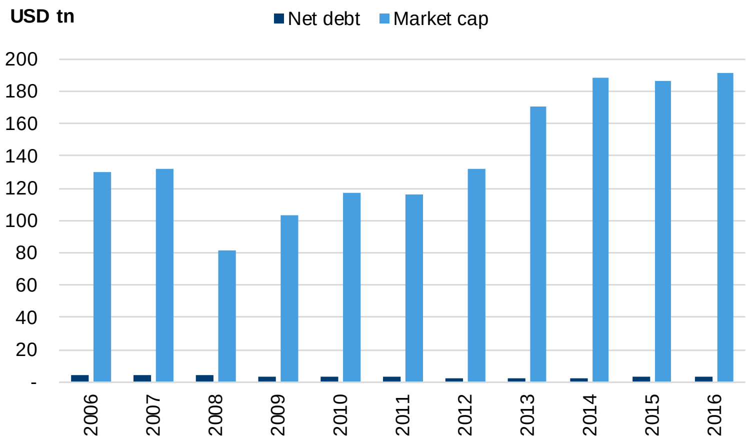
Fig 87: Year-end 10-year US Treasury yield (2006-15)



Source: Bloomberg

The third component of WACC is **capital structure**. We use net debt as a ratio of capital, the latter defined as net debt plus the market value of equity. Bloomberg data shows that the S&P500 in aggregate has a current capital structure of just 1.7% debt in relation to the market value of its capital.

Fig 88: S&P500 capital structure (2006-16 YTD)



Source: Bloomberg

The fourth element is **equity beta.** It is a measure of the riskiness of the equity instrument relative to the stock index. The stock index is defined as having a beta of 1, which in theory is essentially constructed to fully diversify company-specific risk, leaving only the undiversified market risk. The equity beta of a stock is essentially the percentage movement of the stock price for every equal percentage movement of the stock index. A beta more than 1 means an index movement of one percent would trigger a larger than one percent movement in the equity instrument and vice versa. Hence a larger-than-1 beta means the equity instrument is riskier than the index. In our case, we use an equity beta of 1 as we are examining the S&P500 index itself.

The fifth component is the **debt premium.** This is the additional premium over the risk-free rate that companies need to pay for their debt. The sum of the debt premium and the risk-free rate equates to the cost of debt. We have pegged the debt premium at 0.7% based on the average of a few blue chip companies in the index.

The last element of WACC is the **corporate tax rate.** The current tax rate in the US is 35%.

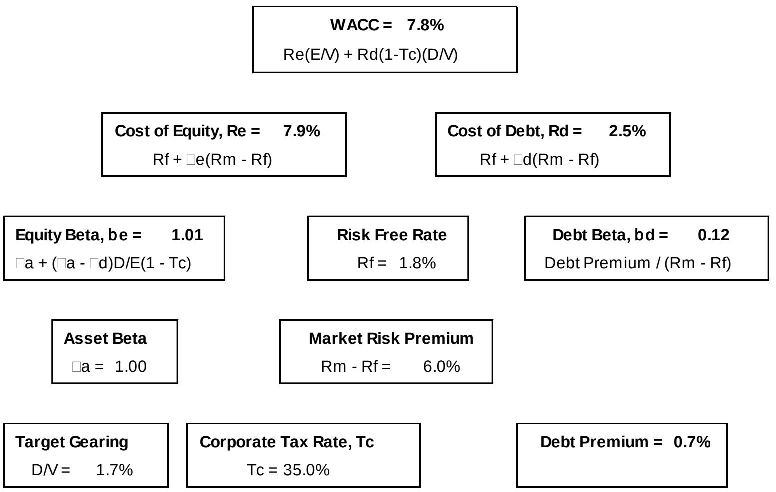
Fig 89: Components of WACC

WACC	%	7.8%
RFR	%	1.79%
MRP	%	6.04%
Beta	Numeric	1.0
Capital Structure - Debt	%	1.7%
Corporate tax rate	%	35.0%
Debt premium	%	0.7%

Source: Affin Hwang

Overall, we have identified for the S&P500 a risk-free rate of 1.79%, market risk premium of 6%, debt-capital structure of 1.7%, equity beta of 1, debt premium of 0.7% and corporate tax rate of 35%, giving a WACC for the S&P500 of 7.8%.

Fig 90: Summary of WACC



Source: Affin Hwang

Discounted cash flow

We set up a DCF to model the S&P500 value. In doing so, we deal with index value rather than USD and model the DCF to give 2,139 points, which is the S&P500 level as of the close on 26 October 2016. In other words, we are consistent with the notion that markets are efficient and are perfect, with the current index level reflecting the actual value of the market.

Expounding more on our DCF model, we set index points as a proxy for the free cash flow (FCF) of the S&P500. In this way, we do not need to deal with the components of the FCF (EBIT, depreciation, working capital, capex and taxes). In addition, we base our nominal FCF growth assumption on the Fed's projections of real GDP growth and inflation. For instance, the 2017 median forecast of real GDP growth projection by the Fed is 2%. Meanwhile, it has a median PCE inflation of 1.9% in 2017. As such, our 2017 nominal FCF growth is the sum of real GDP growth and inflation, giving a total of 3.9%. The same methodology is applied with different nominal FCF growth annually until 2019, coinciding with the Fed's series of median forecasts available. From 2020 onwards, we use the longer run median projection of the Fed, which is 1.8% real GDP growth and 2% PCE inflation. The duration of the DCF is ten years before going terminal.

Fig 91: DCF model for S&P500

	Year	0	1	2	3	4	5	6	7	8	9	10	Terminal
	Unit	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	
Model Free Cash Flow	Index	83	86	89	93	96	100	104	108	112	116	120	125
NPV of FCF	Index	83	80	77	74	71	69	66	64	61	59	57	3,160
Terminal growth rate	%	3.8%											
NPV of forecast	Index	678.9											
NPV of terminal value	Index	1,497.6											
EV	Index	**2,176.4**											
Net debt	Index	37.0											
Equity value	Index	**2,139.4**											
Current S&P500 (26 Oct 2016)	Index	2,139.4											
Check	Index	0.0											
% change	%	0.0%											

Source: Affin Hwang estimates

Overall, we are able to simulate the current S&P500 index value of 2,139 points. This is based on the earlier estimated WACC of 7.8% and a 3.8% terminal growth rate that is consistent with the longer-run projection by the Fed.

Monetary policy transmission

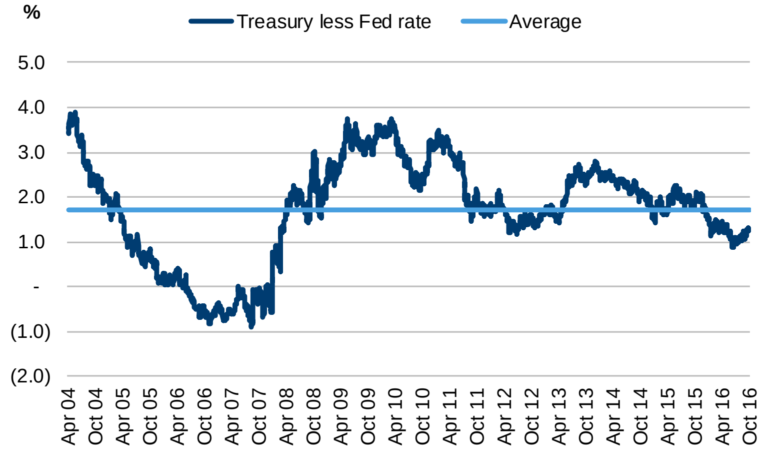
Before embarking on the impact of higher interest rates on the S&P500, it is worth noting that central banks control short-term interest rates but do not explicitly target long-term rates (note that the recent BoJ target for the yield curve is non-conventional) as their policy tool. This is because the long-term rate is often susceptible to a large variety of other forces and makes it more difficult to hold steady as the policy rate. On the other hand, the short-term rate can be easily controlled by the central banks, which makes it a more effective reference rate for monetary policy. Also, directionally the level of short-term rates does influence the level of long-term rates, which makes setting short-term rates a useful tool.

In other words, often the long-term rates go through a price discovery process. Hence even if the Fed increases the funds rate by 25 bps, it does not automatically mean that the yield on the 10-year Treasury would rise by the same amount. The transmission in the changes of short-term rates into long-term interest rates is very complex as it depends on a large variety of factors, which all have variable influences depending on circumstances. Some non-exhaustive examples include expectations of inflation, economic growth, employment, depth of capital markets, effectiveness of monetary policy, global trade, geo-political risks, and influences of the same conditions of other nations.

Short-term versus long-term interest rates

We look at the short-term interest rate transmission to long-term by examining the spread between the US 10-year Treasury yield and the Fed funds rate. Historically, we find the average spread between the two to be 1.71%. The current Fed funds rate is 50bps. If the historical average is to hold, then the yield should be 2.21%. However, the current 10-year Treasury yield is 1.79%. This is 43 bps lower than the long-term average. The unusual circumstance is probably the reason for the generally lower interest rates now. This is because inflation expectations are low, aggressive quantitative easing is still expanding global money supply and growth expectations are still slow.

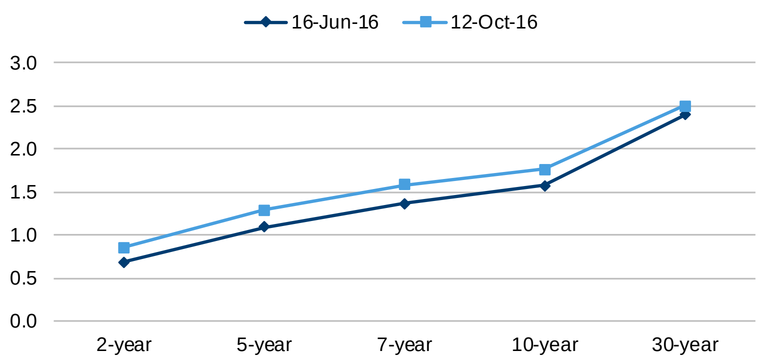
Fig 92: Spread between US 10-year Treasury yield and Fed funds rate (2004-16 YTD)



Source: Affin Hwang, Bloomberg

There are two other brief comments on interest-rate transmission. We look at the yield curve from mid-June 2016, immediately post the FOMC statement where the job creation numbers in the US have slowed substantially from 160k in April to just 38k in May. We compare that with the current one and find that the yield curve has shifted upwards. This means that the market has begun pricing in further interest rate normalisation by the Fed. Hence the interest transmission into longer-term rates might have already happened even before the event itself.

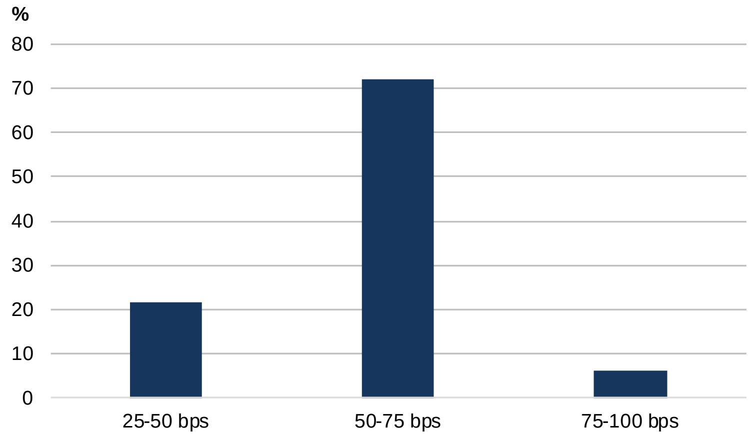
Fig 93: Yield curve has shifted upwards, reflecting rate hike



Source: Bloomberg

In fact, market expectations now point towards a rate hike at the December FOMC meeting. According to CME Group's FedWatch Tool, there is now a 78.3% probability of a rate hike in December, with a 72% chance of a 25 bps hike.

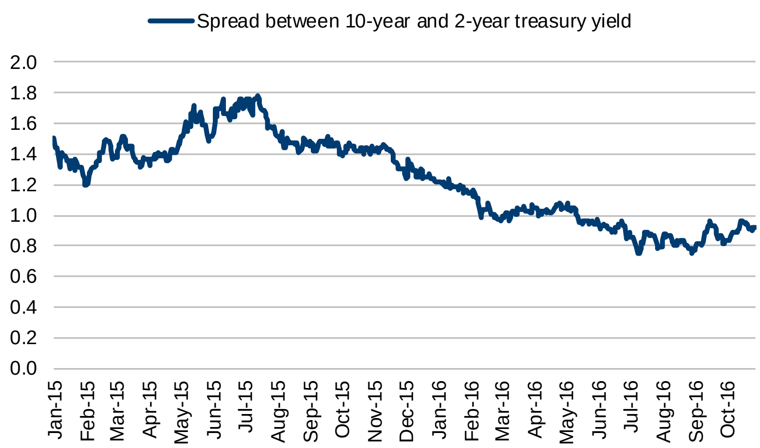
Fig 94: Market expectations of Fed rate hike



Source: CME Group

The other comment on interest rate transmission is that the spread between the ten-year and two-year US Treasury yields have in fact narrowed from mid-June 2016 versus now. While the entire yield curve has shifted upwards indicating an interest rate hike, the flatter yield curve now versus mid-June 2016 could mean that investors are still viewing an environment of low interest rate and/or tepid growth prospects.

Fig 95: Spread between 10-year & 2-year Treasury yield (2015-16 YTD)



Source: Affin Hwang, Bloomberg

Overall, it is not possible to pinpoint the exact quantum of the transmission of short-term rate changes into the long-term 10-year US Treasury bond yield. Hence this is the limitation, as we are unable to tell how much a Fed funds rate rise would translate into an increase in the 10-year US Treasury yield.

Simulating interest rate hike by the Fed

Armed with the WACC and DCF models above, we can now simulate the effects of a Fed funds rate hike on the S&P500. The influence of a Fed funds rate hike manifests itself in WACC. It affects WACC because higher interest rate reduces bond price and increases the yield. Hence a higher yield for the 10-year Treasury increases WACC and thus reduces the equity value of the S&P500.

We limit the Fed funds rate hike to just the WACC variable in our DCF calculation. This is realistic, in our view, as over the very short term the FCF expectations do not change. Of course, over the longer term a higher interest rate could have an impact on FCF, which affects the DCF. It could also have effects on capital structure and the expected return from the S&P500 that may change WACC. But these take time to permeate through to form new expectations.

Fig 96: Simulating a 10bps rise in the risk-free rate for the S&P500

	Year	0	1	2	3	4	5	6	7	8	9	10	Terminal
	Unit	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	
Model Free Cash Flow	Index	83	86	89	93	96	100	104	108	112	116	120	125
NPV of FCF	Index	83	80	77	74	71	68	66	63	61	59	57	3,082
Terminal growth rate	%	3.8%											
NPV of forecast	Index	675.6											
NPV of terminal value	Index	1,446.6											
EV	Index	**2,122.2**											
Net debt	Index	37.0											
Equity value	Index	**2,085.2**											
Current S&P500 (26 Oct 2016)	Index	2,139.4											
Check	Index	-54.3											
% change	%	-2.5%											
WACC	%	7.9%											
RFR	%	1.89%											
MRP	%	6.04%											
Beta	Numeric	1.0											
Capital Structure - Debt	%	1.7%											
Corporate tax rate	%	35.0%											
Debt premium	%	0.7%											

Source: Affin Hwang estimates

Hence plugging increments in the risk-free rate into our DCF model shows how much the S&P500 could de-rate. For instance, we find that a 10bps increase in the risk-free rate would cause the S&P500 to fall by 2.5%. We provide below a sensitivity analysis on changes in the S&P500 for every 10 bps rise in the risk-free rate.

Fig 97: Sensitivity of S&P500 to risk-free rate

Change in rfr (bps)	WACC	Percentage change in S&P500
-50	7.2%	14.9%
-40	7.4%	11.6%
-30	7.5%	8.5%
-20	7.6%	5.5%
-10	7.7%	2.7%
0	7.8%	0.0%
10	7.9%	-2.5%
20	8.0%	-4.9%
30	8.1%	-7.2%
40	8.2%	-9.4%
50	8.3%	-11.5%

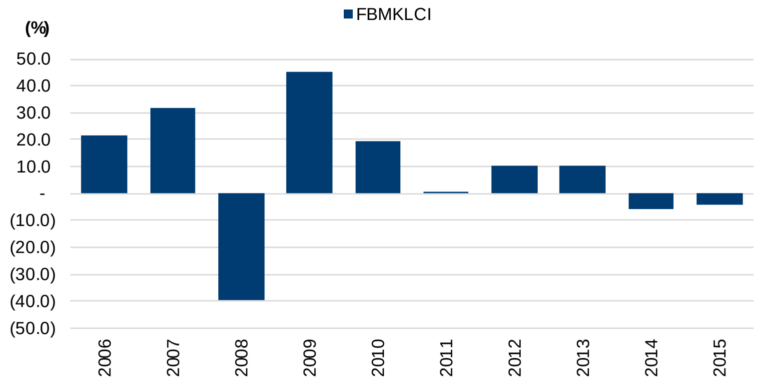
Source: Affin Hwang estimates

Simulation of OPR impact on KLCI

We apply the same exercise we did on the S&P500 to the KLCI.

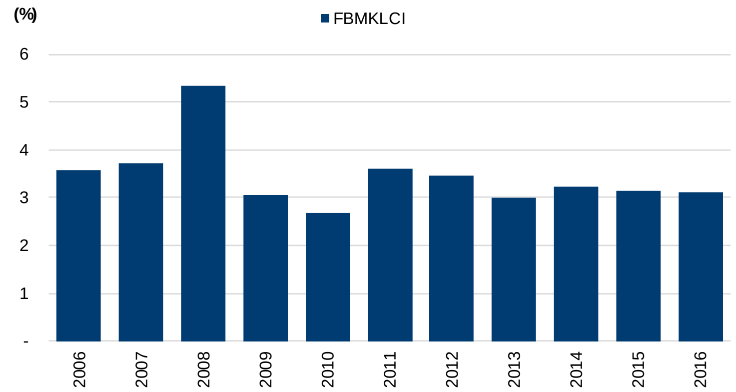
The first is to estimate WACC. The current 10-year MGS yield is 3.57%, which we use as the risk-free rate. Next we calculate the market-risk premium using the market return plus the market-dividend yield less the risk-free rate. We calculate market return base on the average annual return of the KLCI. This is added to the annual dividend yield before subtracting the ten-year MGS yield. The average figure for the past ten years give a market-risk premium of 8.7%. The capital structure is the current net debt over enterprise value for the KLCI, which based on Bloomberg data indicates 13.2%. As it is an index, equity beta is taken as 1, debt premium is taken at 0.7% and the corporate tax rate at 24%. All these work out to an overall WACC of 11.5%.

Fig 98: Annual return from KLCI (2006-15)



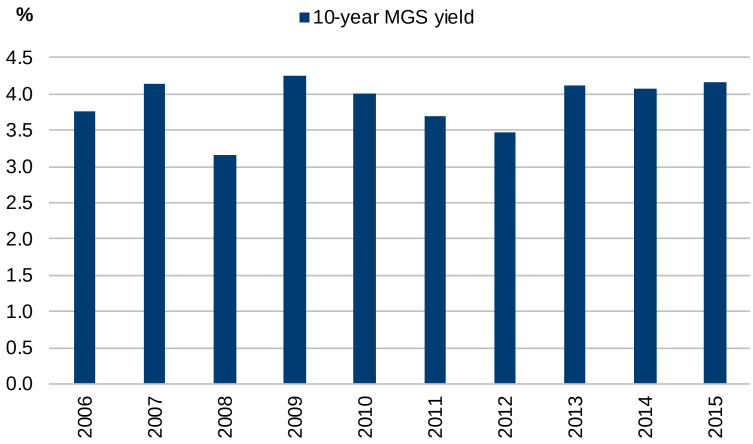
Source: Affin Hwang, Bloomberg

Fig 99: Annual dividends of KLCI (2006-16 YTD)



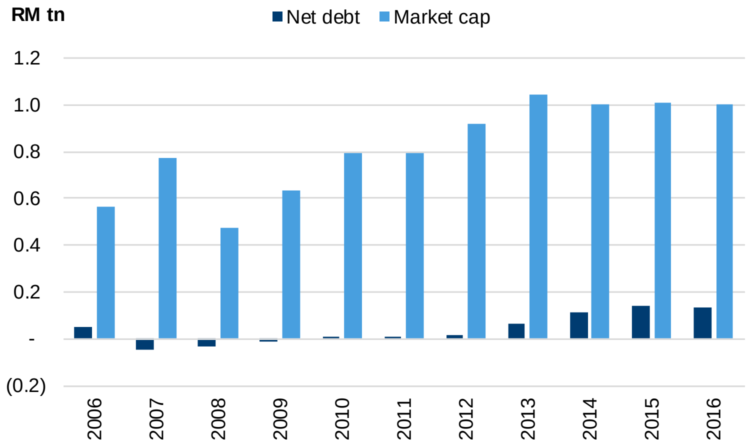
Source: Bloomberg

Fig 100: Annual 10-year MGS yield (2006-15)



Source: Bloomberg

Fig 101: Capital structure (2006-16 YTD)



Source: Bloomberg

Fig 102: KLCI WACC

WACC = 11.5%
Re(E/V) + Rd(1-Tc)(D/V)

Cost of Equity, Re = 12.8%
Rf + □e(Rm - Rf)

Cost of Debt, Rd = 4.3%
Rf + □d(Rm - Rf)

Equity Beta, be = 1.06
□a + (□a - □d)D/E(1 - Tc)

Risk Free Rate
Rf = 3.6%

Debt Beta, bd = 0.08
Debt Premium / (Rm - Rf)

Asset Beta
□a = 0.96

Market Risk Premium
Rm - Rf = 8.7%

Target Gearing
D/V = 13.2%

Corporate Tax Rate, Tc
Tc = 24.0%

Debt Premium = 0.7%

Source: Affin Hwang

We construct our DCF for the KLCI using the same methodology as for the S&P500. We approach FCF growth using the same formula of real GDP growth plus inflation. There is no median forecast by the BNM like that given by the Fed. Hence we assume Malaysia convergences to the US PCE inflation over the long term of 2%. Note that the past ten-year average works out to inflation of 2.6%. As for real GDP growth, we are guided by the IMF figure of 5% expansion for the medium term of 2021 before we assume tapering by 0.2ppts every year until it reduces to 6% at terminal. The duration of our DCF is ten years.

Fig 103: DCF model for KLCI

	Year Unit	0 2016	1 2017	2 2018	3 2019	4 2020	5 2021	6 2022	7 2023	8 2024	9 2025	10 2026	Terminal
Model Free Cash Flow	Index	118	124	133	142	152	163	174	186	198	210	222	231
	Index	118	112	107	103	98	94	90	86	82	78	75	2,987
Terminal growth rate	%	4.0%											
NPV of forecast	Index	926.4											
NPV of terminal value	Index	1,002.1											
EV	**Index**	**1,928.5**											
Net debt	Index	254.6											
Equity value	**Index**	**1,673.9**											
Current FBMKLCI (26 Oct 2016)	Index	1,673.9											
Check	Index	0.0											
% change	%	0.0%											

Source: Affin Hwang

Finally, using the risk-free rate to mimic the rise or fall in the short-term interest rate and its transmission to long-term rates gives an estimate of an 1.7% fall in the KLCI for 10bps in interest rates in our DCF model.

Fig 104: Simulating a 10bps rise in the risk-free rate for the KLCI

	Year Unit	0 2016	1 2017	2 2018	3 2019	4 2020	5 2021	6 2022	7 2023	8 2024	9 2025	10 2026	Terminal
Model Free Cash Flow	Index	118	124	133	142	152	163	174	186	198	210	222	231
	Index	118	111	107	102	98	94	90	86	82	78	74	2,945
Terminal growth rate	%	4.0%											
NPV of forecast	Index	921.7											
NPV of terminal value	Index	978.4											
EV	**Index**	**1,900.1**											
Net debt	Index	254.6											
Equity value	**Index**	**1,645.5**											
Current FBMKLCI (26 Oct 2016)	Index	1,673.9											
Check	Index	-28.4											
% change	%	-1.7%											
WACC	**%**	**11.7%**											
RFR	%	3.67%											
MRP	%	8.69%											
Beta	Numeric	1.0											
Capital Structure - Debt	%	13.2%											
Corporate tax rate	%	24.0%											
Debt premium	%	0.7%											

Source: Affin Hwang

Fig 105: Sensitivity of KLCI to risk free rate

Change in rfr (bps)	WACC	Percentage change in KLCI
-50	11.0%	9.3%
-40	11.1%	7.3%
-30	11.2%	5.4%
-20	11.3%	3.5%
-10	11.4%	1.7%
0	11.5%	0.0%
10	11.7%	-1.7%
20	11.8%	-3.3%
30	11.9%	-5.0%
40	12.0%	-6.5%
50	12.1%	-8.0%

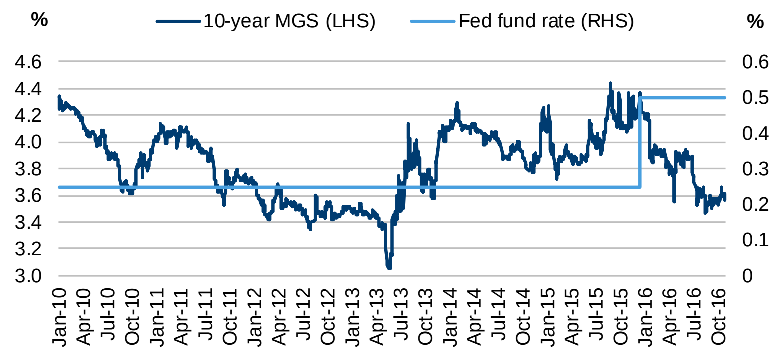
Source: Affin Hwang

But Ringgit is fiduciary of the BNM and not the Fed

Thus far, notice that we did separate analyses for S&P500 and KLCI. Respective central banks have independent monetary policies, as the economic conditions of each country are different. One key feature of central banks is that they are the sole source of their national currencies. Hence monetary policy is effective as long as it is applied to their own currencies for which they have the full control of supply.

In the case of Malaysia, the BNM has full jurisdiction of the Ringgit and hence monetary policy is directed at maintaining the price of the Ringgit at its policy rate. Naturally, this begs the question that since the local equity market is Ringgit-based and is fully controlled by the BNM, it is independent of the Fed and hence the stock market should not be affected by a rate rise in the US. This is true especially if we look at the recent correlation between the 10-year MGS and the Fed funds rate. We can see that post the December 2015 Fed funds rate hike, the 10-year MGS yield actually came down. A large part of that is due to the OPR cut by the BNM in July this year.

Fig 106: Divergence in 10-year MGS and Fed funds rate



Source: Bloomberg

In addition, as the BNM just cut its OPR in July, the popular market view is that the OPR trajectory is likely to be flat to lower rather than an increase as in the case of the Fed.

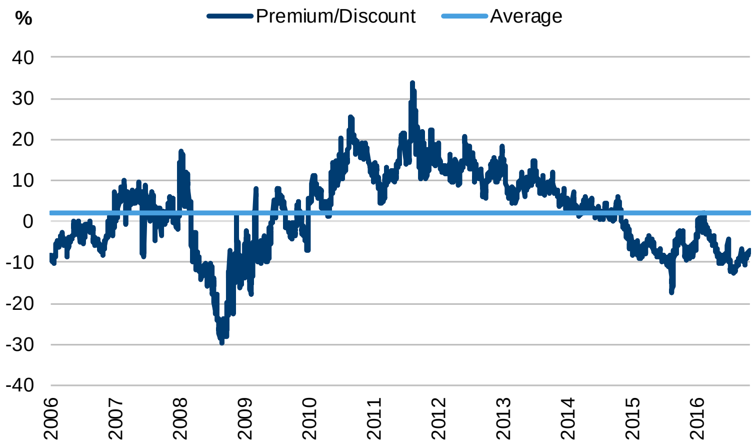
Financial linkages

However, Malaysia is a small open economy with financial linkages to the rest of the world. While it has autonomy over its own monetary policy, it does not have control over the valuation of markets, which undergoes a price discovery process.

While a higher risk-free rate in the US post a Fed funds rate hike should not have a direct effect on Malaysia's stock market, a fall in the US market valuation could render Malaysia's stock market more expensive. This could prompt a rebalancing of funds, bringing valuations back to equilibrium and thus putting pressure on Malaysia's equity market.

Based on Bloomberg data (for consistency in comparisons), the KLCI has historically traded at a 2.1% premium to the S&P500, measured from 2006 until now. Hence the KLCI could decline by the same amount as the S&P500 if the market decides that the PER premium of the KLCI should remain the same and not widen.

Fig 107: KLCI's average PER premium over the S&P500 (2006-16 YTD)



Source: Affin Hwang, Bloomberg

Yet further examination unveils more insight beyond the historical average premium. The KLCI is now trading at a 7.4% discount to the S&P500. This information is relevant as it draws up the possibility that at the initial stage of a Fed funds rate hike, the potential de-rating in the US market may not necessarily mean a pullback in Malaysia's stock valuation, if all else holds constant. Of course, this is premised on the assumption of the historical relationship between the valuation of S&P500 and KLCI where the PER would gravitate towards the mean over time.

Trajectory of Fed funds rate hike

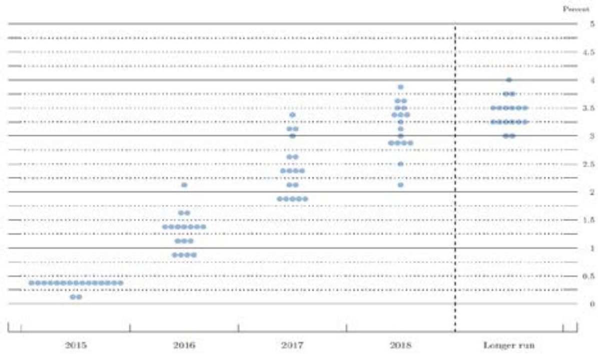
So far we have established that while Malaysia determines its own monetary policy, its financial markets are not independent of a US Fed funds rate hike due to the financial linkages and relative valuations. Hence a rise in US interest rate would likely have an impact on the KLCI.

While a Fed funds rate hike is one major consideration, another variable is the gradient of the rate increase. Clearly, a larger interest rate indicates a higher risk-free rate and a greater de-rating. The reverse is true where a slower rate of hike by the Fed is supportive of market valuation.

Hence the comforting news is that while the Fed is on a policy normalisation path, expectations of the pace of interest-rate hikes has moderated significantly. The Fed officially signaled the start of rate normalisation in its Dec 2015 FOMC meeting by raising the funds rate from its range of between 0% and 0.25% by 25bps to between 0.25% and 0.50%.

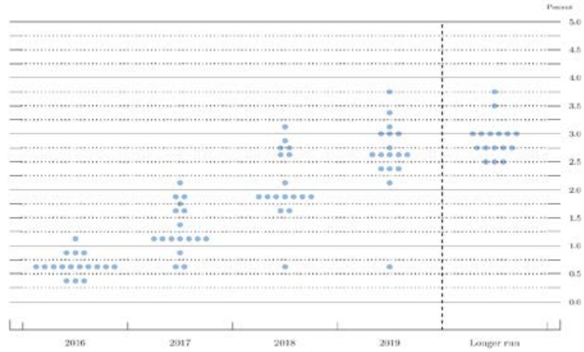
During that time, the Fed also released its assessment of the appropriate monetary policy based on FOMC member views. These were summarised in a dot plot and, at that time, the trajectory was another 100bps increase in the Fed funds rate, possibly over the course of four FOMC meetings at 25bps hikes each in 2016. However, that has significantly moderated to the most likely rate of just one hike this year of 25bps, based on the dot plot released post the September 2016 FOMC meeting.

Fig 108: FOMC member dot plot Dec 2015



Source: Fed

Fig 109: FOMC member dot plot September 2016



Source: Fed

As it stands now, the latest dot plot suggests a 25bps hike in 2016 followed by just another 50bps increase in 2017 likely over the course of two FOMC meetings.

In conclusion

We believe the Fed funds rate hike will continue to be a major consideration dominating financial markets in 2017. We have shown that while Malaysia has autonomous monetary policy, the financial linkages to global financial markets, particularly the relative valuation to the S&P500, means that the domestic equity market is not impervious to Fed funds rate hikes.

We go on to show that a 10bps rise in the Fed funds rate could have a 2.5% de-rating effect on the S&P500 based on our DCF model, all things being constant. Assuming that the relative PER between the S&P500 and KLCI remains unchanged, it suggests that the KLCI's valuation could also fall by the same amount.

However, there are three reasonable considerations worth highlighting with respect to the impact of the Fed funds rate hike on the KLCI.

- The trajectory of the rate hike
- The amount of short-term rate hike transmitted into the risk-free rate
- The relative valuation between S&P500 and KLCI currently

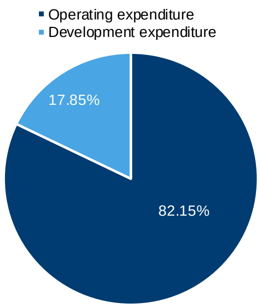
The good news is that the rate-hike trajectory is more gradual now than before. In addition, as we found our earlier that while the KLCI historically trades at a 2.1% premium to the S&P500, it has dipped into a discount of 7.4% now. Taken together with the moderate gradient of rate increase, it could mean that the relative valuation effect on the KLCI could be counterbalanced, assuming that the historical PER premium of the KLCI holds over time. For instance, the S&P500 needs to decline by more than 9.3% from the current level before affecting the KLCI, assuming that the historical average premium holds true. This translates to about a 40bps rise in the risk-free rate for the US.

In conclusion, our analysis thus far suggests that a Fed funds rate hike in 2017 would be manageable for the KLCI if it is in the region of a 40 bps rise in the US 10-year Treasury yield. While there would be pressure for emerging markets, we believe it is unlikely to trigger a sustained decline in Malaysia's equity market.

Budget 2017

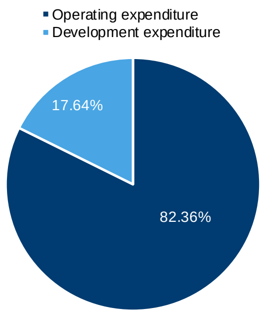
In the just announced Budget 2017 on 21 October 2016, the theme was 'Ensuring Unity and Economic Growth, Inclusive Prudent Spending, Wellbeing of the Rakyat'. Total budget for 2017 is RM260.8bn, which is RM8.7bn or 3.4% higher than in 2016 (excluding RM2bn in contingent development expenditure). Of this figure, 82% is allocated for operating expenditure with the balance 18% for development expenditure. Although a larger base, operating expenditure enjoys 3.7% higher allocation in 2017 versus 2016 while development expenditure sees 2.2% rise in its budget.

Fig 110: Breakdown of total budget in 2016



Source: MOF

Fig 111: Breakdown of total budget in 2017



Source: MOF

Government macro forecasts for 2017

The Federal government is confident of achieving GDP growth of 4-4.5% for 2016 while it is forecasting 4-5% range for 2017. Meanwhile, it sees inflation at 2.3% in 2016 and within the range of 2-3% for 2017. The fiscal position of Malaysia is expected to continue to improve with fiscal deficit estimated to come down from 3.1% in 2016 to 3% in 2017. The trade surplus is anticipated to decline slightly from RM91.4bn in 2016 to RM88.3bn in 2017. In tandem with that, the current account surplus is envisaged to also weaken from RM16.4bn or 1.4% of GNI in 2016 to RM14.8bn or 1.1% of GNI in 2017.

Fig 112: Summary of macro forecasts

	2015	2016E	2017E
Date announced		21-Oct-16	21-Oct-16
GDP growth (yoy)	5.0%	4% to 4.5%	4% to 5%
Inflation (yoy)	2.1%	2.3%	2% to 3%
Fiscal deficit (RM bn)	37.2	38.7	40.3
Fiscal deficit (% GDP)	3.2%	3.1%	3.0%
Trade surplus (RM bn)	91.6	91.4	88.3
Current account surplus (RM bn)	34.7	16.4	14.8
Current account surplus (% GNI)	3.1%	1.4%	1.1%

Source: MOF

A year of recovery in 2017

Despite a tough fiscal 2016, the Federal government is likely to achieve its 3.1% fiscal deficit from 3.2% in 2015. Its commitment to fiscal consolidation is apparent with a further drop to 3% deficit in 2017.

Fig 113: Federal government Budget 2017 fiscal position

RM bn	2015	2016	2017
Date announced	21-Oct-16	21-Oct-16	21-Oct-16
Revenue	219.1	212.6	219.7
Operating expenditure	217.0	207.1	214.8
Operating surplus	2.1	5.5	4.9
Gross development expenditure	40.8	45.0	46.0
Less: Loan recovery	1.5	0.8	0.7
Net development expenditure	39.3	44.2	45.3
Overall balance	**-37.2**	**-38.7**	**-40.3**
Overall balance (% of GDP)	**-3.2%**	**-3.1%**	**3.0%**

Source: MOF

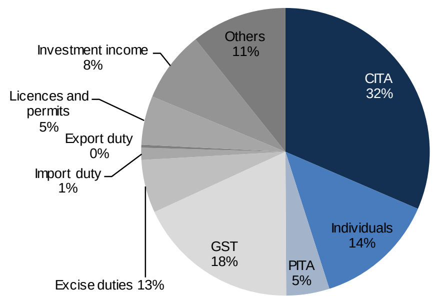
The difficult 2016 means that Federal government revenue will likely contract for the second consecutive year, but 2017 is shaping up to be a year of recovery. Federal government revenue is expected to rise 3.4% to RM219.7bn or just within earshot of the RM220.6bn record high figure in 2014. The more sanguine figure is due to expected rise in income tax collection from companies. This jives with our view of a general recovery in corporate earnings. Note that non-oil revenue is estimated at just 14.6% of total revenue in 2016 but declining further to 13.8% in 2017.

Fig 114: Budget 2017 revenue

RM bn	2015	2016	2017	2016 (%)	2017 (%)
Date announced	21-Oct-16	21-Oct-16	21-Oct-16		
CITA	63.7	63.2	69.2	-0.8%	9.5%
Individuals	26.3	28.2	29.9	7.0%	6.0%
PITA	11.6	8.5	10.6	-26.3%	24.9%
GST	27.0	38.5	40.0	42.5%	3.9%
Excise duties	11.9	11.8	13.1	-0.7%	11.1%
Import duty	2.7	2.7	3.0	0.1%	9.9%
Export duty	1.0	0.8	0.7	-21.8%	-10.1%
Licences and permits	12.5	11.8	12.1	-5.6%	1.8%
Investment income	32.8	23.3	17.6	-29.0%	-24.5%
Others	29.5	23.7	23.5	-19.5%	-0.8%
Total	**219.1**	**212.6**	**219.7**	**-3.0%**	**3.4%**

Source: MOF

Fig 115: Budget 2017 revenue breakdown



Source: MOF

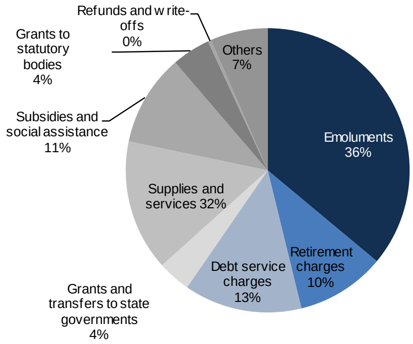
The rise in revenue has accorded the Federal government more room to manoeuvre. This is apparent with its allocation of 3.7% rise in operating expenditure. We notice that the major expenditure components have seen a rebound in spending bar subsidies and social assistance, and grants to statutory bodies.

Fig 116: Budget 2017 operating expenditure

RM bn	2015	2016	2017	2016 (%)	2017 (%)
Date announced	21-Oct-16	21-Oct-16	21-Oct-16		
Emoluments	70.1	73.9	77.4	5.4%	4.8%
Retirement charges	18.9	19.0	21.8	0.6%	14.6%
Debt service charges	24.3	26.6	28.9	9.7%	8.4%
Grants and transfers to state governm	6.9	6.9	8.1	0.1%	16.3%
Supplies and services	36.4	29.7	32.0	-18.3%	7.8%
Subsidies and social assistance	27.3	24.6	22.4	-9.6%	-9.0%
Grants to statutory bodies	15.5	12.9	9.4	-16.4%	-27.4%
Refunds and write-offs	0.9	0.9	0.8	-2.4%	-13.2%
Others	16.8	12.5	14.0	-25.7%	12.5%
Total	**217.0**	**207.1**	**214.8**	**-4.5%**	**3.7%**

Source: MOF

Fig 117: Budget 2017 operating expenditure breakdown



Source: MOF

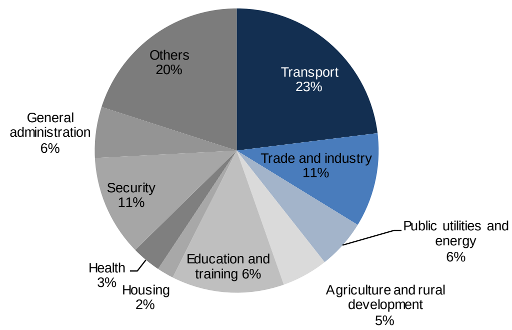
Development expenditure is more measured with just RM1bn rise in allocation for 2017 or 2.2% higher than 2016. The bulk of the rise comes from the transport segment, possibly for more spending on direct government funded projects such as the massive Pan Borneo Expressway. There is also a large rise for spending in general administration.

Fig 118: Budget 2017 development expenditure

RM bn	2015	2016	2017	2016 (%)	2017 (%)
Date announced	21-Oct-16	21-Oct-16	21-Oct-16		
Transport	6.7	8.4	10.6	25.8%	25.9%
Trade and industry	5.6	6.0	4.9	6.3%	-17.8%
Public utilities and energy	3.6	3.3	2.6	-10.1%	-21.0%
Agriculture and rural development	3.1	2.9	2.4	-7.3%	-16.0%
Education and training	4.8	3.9	5.9	-18.6%	52.4%
Housing	2.0	2.5	0.9	23.3%	-64.9%
Health	1.4	1.5	1.5	2.7%	3.4%
Security	4.8	5.0	5.3	6.0%	4.9%
General administration	1.6	1.5	2.7	-2.7%	75.3%
Others	7.2	10.0	9.2	40.1%	-8.3%
Total	**40.8**	**45.0**	**46.0**	**10.4%**	**2.2%**

Source: MOF

Fig 119: Budget 2017 development expenditure breakdown



Source: MOF

2016 report card

In all fairness, the assessment of the Federal government's performance of the Budget 2016 has been more than satisfactory especially if we take into consideration the headwinds faced by Malaysia at the start of this year. One year ago as the Prime Minister tabled the Budget 2016, the Federal government was forecasting GDP growth of 4-5%, inflation of 2-3%, fiscal deficit of 3.1%, trade surplus of RM73.2bn and a current account surplus of RM11.3bn or 0.9% of GNI for 2016.

Fig 120: Comparing against original Budget 2016 a year ago

	Original	Now
Date announced	**23-Oct-15**	**21-Oct-16**
GDP growth	4% to 5%	4% to 4.5%
Inflation	2% to 3%	2.3%
Fiscal deficit (RM bn)	38.8	38.7
Fiscal deficit (% GDP)	3.1%	3.1%
Trade surplus (RM bn)	73.2	91.4
Current account surplus (RM bn)	11.3	16.4
Current account surplus (% GNI)	0.9%	1.4%

Source: MOF

Just three months later the Federal government announced a Recalibrated Budget 2016 in late January 2016 as it reacted to the sharp plunge in oil prices that went from US$47.99/bbl on the date of the Budget 2016 tabling on 23 October 2015 to a low of US$27.88/bbl on 20 January 2016.

Nonetheless, the performance has been satisfactory based on the latest 2016 Federal government forecast released in tandem with the Budget 2017. Assuming that these numbers are achievable, we see very little deviation from the original figures released a year ago. The GDP growth range is narrower than previous but this in line with the Recalibrated Budget 2016 in January this year. Inflation is on track to come in at the lower end of the range at 2.3%. Fiscal deficit is contained at 3.1% of GDP while the trade surplus could actually widen by RM18.2bn or 24.8%. Current account surplus could also benefit with a larger surplus of RM5.1bn to RM16.4bn or equivalent to 1.4% of GNI from the earlier projected 0.9%.

While the government expects the fiscal deficit at 3.1% to be achievable, the figures behind the headline numbers are slightly weaker. Government revenue is expected to fall 1.7% short of the Recalibrated Budget 2016. In response, the Federal government plans to underspend operating expenditure by an equal 1.7%, which neutralises the drop in revenue to give a relatively unchanged operating surplus. There is no revision in development expenditure.

Fig 121: Budget 2016 report card on overall fiscal position

RM bn	Original	Recalibrated	Now
Date announced	**23-Oct-15**	**28-Jan-16**	**21-Oct-16**
Revenue	225.7	216.3	212.6
Operating expenditure	215.2	210.7	207.1
Operating surplus	10.4	5.6	5.5
Gross development expenditure	50.0	45.0	45.0
Less: Loan recovery	0.8	0.8	0.8
Net development expenditure	49.2	44.2	44.2
Overall balance	-38.8	-38.7	-38.7
Overall balance (% of GDP)	-3.1	-3.1	-3.1

Source: MOF

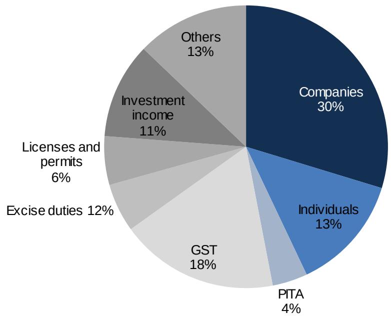
If we compare the government's most current forecast versus the original Budget 2016, revenue is down 5.8%. The culprit is corporate income taxes, which are 15% below original budget. We suspect the poorer-than-expected corporate earnings in 2016 stemming from poorer oil & gas, palm oil and exports could be the reason for the shortfall.

Fig 122: Budget 2016 revenue comparison

RM bn	Original	Now	Difference
Date announced	23-Oct-15	21-Oct-16	(%)
Companies	74.4	63.2	-15.0
Individuals	30.3	28.2	-6.9
PITA	9.3	8.5	-8.7
GST	39.0	38.5	-1.3
Excise duties	12.4	11.8	-4.9
Licenses and permits	12.6	11.8	-6.2
Investment income	21.5	23.3	8.6
Others	26.2	27.3	4.2
Total	**225.7**	**212.6**	**-5.8**

Source: MOF

Fig 123: Current fiscal 2016 revenue breakdown



Source: MOF

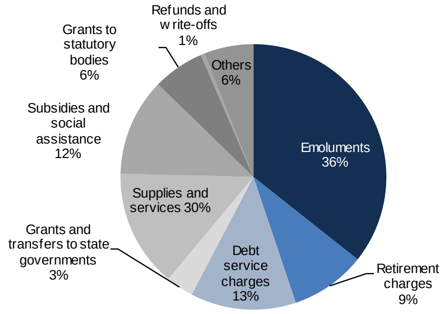
Meanwhile, the Federal government's operating expenditure has also fallen with government cutting back on supplies and services, as well as fall in subsidies and social assistance with tightening of the belt on the back of the revenue shortfall. However, emoluments were up mainly due to special financial assistance to public servants in January and June 2016 as well as salary adjustments in July 2016.

Fig 124: Budget 2016 operating expenditure comparison

RM bn	Original	Now	Difference
Date announced	23-Oct-15	21-Oct-16	(%)
Emoluments	70.5	73.9	4.8
Retirement charges	19.5	19.0	-2.6
Debt service charges	26.6	26.6	0.0
Grants and transfers to state governm	7.6	6.9	-8.9
Supplies and services	36.3	29.7	-18.2
Subsidies and social assistance	26.1	24.6	-5.6
Grants to statutory bodies	12.9	12.9	0.3
Refunds and write-offs	0.9	0.9	0.0
Others	14.8	12.5	-15.5
Total	**215.2**	**207.1**	**-3.8**

Source: MOF

Fig 125: Current Budget 2016 operating expenditure



Source: MOF

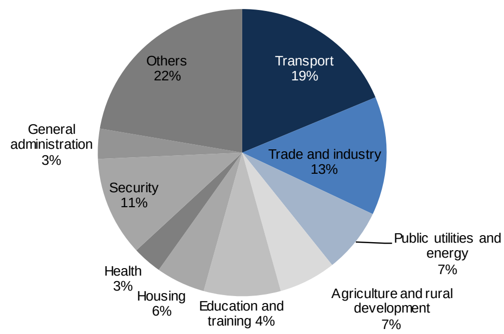
Lastly, development expenditure is RM5bn or 10% lower than the original figure one year ago. The decline is due to non-physical projects and those under feasibility study. While it is a large drop from the original figure a year ago, it was unchanged from the Recalibrated Budget 2016 announced in January of this year.

Fig 126: Budget 2016 development expenditure comparison

RM bn	Original	Now	Difference
Date announced	23-Oct-15	21-Oct-16	
Transport	8.4	8.4	-0.2%
Trade and industry	8.3	6.0	-28.2%
Public utilities and energy		3.3	
Agriculture and rural development	3.4	2.9	-15.2%
Education and training	4.7	3.9	-17.4%
Housing	2.6	2.5	-4.3%
Health	1.8	1.5	-16.8%
Security	5.0	5.0	0.6%
General administration	1.6	1.5	-4.3%
Others	14.2	10.0	-29.1%
Total	**50.0**	**45.0**	**-10.0%**

Source: MOF

Fig 127: Current Budget 2016 development expenditure



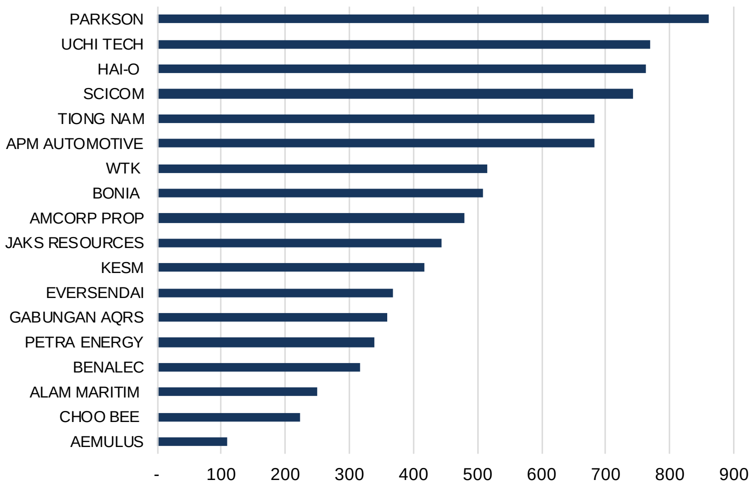
Source: MOF

Three key thrusts

Three notable initiatives have wide implications. One such thrust is invigorating the capital markets. The government has proposed government-linked investment companies to set aside money into a special fund of up to RM3bn to invest in potential small and mid-cap listed companies. In support of that, it plans to introduce small and mid-cap research scheme to conduct research on 300 such listed companies. Separately, the government announced setting up of Capital Market Research Institute with initial funding of RM75m, to maintain Malaysia as an international Islamic financial centre by giving stamp duty exemption on instruments in foreign currencies, and one-off increase in additional existing incentive by RM500 for the Private Retirement Scheme.

A screen of companies under our coverage universe returns 17 companies with market caps below RM1bn. Of this, eight have buy recommendations and four are part of our top pick list.

Fig 128: Small and mid-caps under our coverage



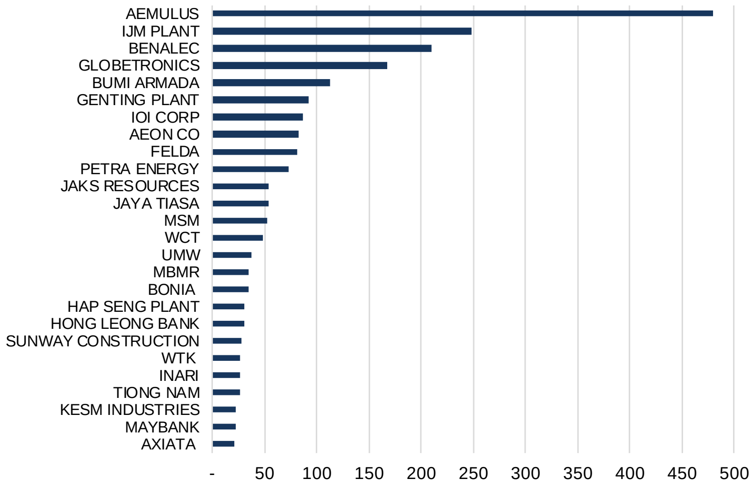
Source: Affin Hwang, Bloomberg

Another initiative is to reduce the corporate tax rate, which is currently at 24%, by between 1ppt and 4 ppts for year of assessments 2017 and 2018 on incremental profit under the following schedule.

- 23% tax rate on incremental profit if chargeable income grows by 5% to below 10%.
- 22% tax rate on incremental profit if chargeable income grows by 10% to below 15%.
- 21% tax rate on incremental profit if chargeable income grows by 15% to below 20%.
- 20% tax rate on incremental profit if chargeable income grows by 20% or more.

This is positive news for 2017 and 2018 earnings for companies that have strong growth profiles, in our view. Of the 102 companies under our coverage, we estimate that 62 companies would benefit in 2017. On our count, there are 14 companies with 1ppt benefit, 15 companies with 2ppts uplift, seven companies that should see 21% tax rate and 26 companies with 4ppts reduction in tax rate.

Fig 129: Companies with the quickest pace of PBT growth in 2017



Source: Affin Hwang estimates, Bloomberg

Lastly, the 1Malaysia People's Aid (BR1M) program has been expanded for 2017 and should benefit about 7m people. Besides BR1M, the government is also rewarding the 1.6m government servants with RM500 per person as special assistance payable in early January 2017. Government retirees will receive RM250 each.

Fig 130: The BR1M program

Categories	Income	2017 Budget
Household	e-Kasih	**RM1,200** (2016: RM1,050)
	<RM3,000	**RM1,200** (2016: RM1,000)
	RM3,001-RM4,000	**RM900** (2016: RM800)
Single Individual	RM2,000 and below	**RM450** (2016: RM400)

Source: MOF

Other sound initiatives include stimulating private investment, helping to increase exports, accelerate tourism, and entrepreneur development. Lastly, the subsidy bill is RM10bn, of which RM1.6bn is for cooking gas subsidy and RM1.3bn for paddy farmers.

Specific sector and company implications

There is a large emphasis to 'Increase Home Ownership'. More details of this is in the Property commentary but the focus is on helping affordable housing and first time home buyers with most initiatives for prices of up to RM300,000. We believe the key beneficiaries are construction companies undertaking these projects such as Gabungan AQRS.

A key initiative on 'Public Transport' is implementation of the 600km East Coast Rail Line connecting Klang Valley to the East coast, estimated at RM55bn. Key beneficiaries could be the larger construction companies such as Gamuda, IJM, and MMC.

On the flipside, the 'Digital Economy' thrust should accord subscribers double the speed for fixed-line high-speed broadband at the same price effective January 2017. In addition, prices would be reduced by half within the next two years. We believe this is bad news for Telekom Malaysia if there is no mitigating or counterbalancing incentives given to Telekom to compensate for the loss of revenue.

Lastly, 'Strengthening Fiscal Sustainability' entails a stamp duty at 4% for instruments of property transfer more than RM1m from 1 January 2018. This may spur transactions for the next 14 months prior to the new duty taking effect but is long term negative for the property sector.

Our take on Budget 2017

In conclusion, we believe that this is a measured Budget 2017 with balanced growth for the prospects. On the macro front, we are heartened that the Federal government has a similar view to ours in that we see better economic growth in 2017. Also, we believe that the current account should stay in surplus and the government figures lend credence to our view. The reduction in fiscal deficit is comforting and should appease rating agencies. We also expect the pressure on the government finances to ease as fiscal revenue is expected to rebound in 2017, which allows some loosening of purse strings on expenditure while still maintaining a reduction in the fiscal deficit. In essence, the Budget 2017 points to better macro conditions. We have not made any changes to our macro forecasts post Budget 2017. Our real GDP growth forecast remains at 4.2% for 2016 and 4.4% for 2017.

Meanwhile, the initiatives for the market is more muted. Recapping, the major positives for the stock market are the corporate tax rate incentive (all sectors and stocks), additional large infrastructure project in the East Coast Rail (construction sector) while the major negative is broadband pricing (Telekom) and new stamp duty tax category for property transactions above RM1m. Overall, we consider Budget 2017 as slightly positive.

In comparison, our GDP growth forecast is 4.2% this year and 4.4% for 2017. Our inflation expectation is 2.2% for 2016. The 25 bps OPR cut in July took us by surprise and we view that as a one-off event, as the BNM probably decided to take out an insurance policy for slower global growth accorded to it from the policy flexibility due to low inflation.

Fig 131: Malaysia's GDP growth forecasts

	2015	2016E	2017F	2015	2016E	2017F	2015	2016E	2017F
	%yoy			% of GDP			% contribution point to GDP growth		
GDP by Expenditure Components									
Total Consumption	5.7	5.0	4.8	65.8	66.3	66.6	3.7	3.3	3.2
Private consumption expenditure	6.0	5.5	5.4	52.4	53.0	53.5	3.1	2.9	2.9
Public consumption expenditure	4.4	3.0	2.5	13.5	13.3	13.1	0.6	0.4	0.3
Total Investment	3.7	3.4	4.0	25.8	25.6	25.5	1.0	0.9	1.0
Private investment expenditure	6.4	4.5	5.0	16.9	16.9	17.0	1.1	0.8	0.8
Public investment expenditure	-1.0	1.5	2.0	8.9	8.7	8.5	-0.1	0.1	0.2
Domestic Demand	5.1	4.5	4.6	91.6	91.9	92.1	4.7	4.2	4.2
Net exports	-3.8	-0.8	2.8	8.6	8.2	8.0	-0.4	-0.1	0.2
Exports	0.6	1.1	2.0	72.9	70.7	69.1	0.5	0.8	1.4
Imports	1.2	1.3	1.9	64.3	62.5	61.0	0.8	0.9	1.2
Changes in inventories	-75.4	-53.4	0.0	-0.2	-0.1	-0.1	0.6	0.1	0.0
GDP (2010 real prices)	**5.0**	**4.2**	**4.4**	**100.0**	**100.0**	**100.0**	**5.0**	**4.2**	**4.4**
GDP By Kind of Economic Activity									
Agriculture, Forestry and Fishing	1.2	-2.8	2.0	8.9	8.3	8.1	0.1	-0.2	0.2
Mining and Quarrying	4.7	1.6	1.5	9.0	8.7	8.5	0.4	0.1	0.1
Manufacturing	4.9	4.3	4.5	23.0	23.0	23.0	1.1	1.0	1.0
Construction	8.2	8.3	8.0	4.4	4.6	4.7	0.3	0.4	0.4
Services	5.1	5.2	5.1	53.5	54.0	54.4	2.7	2.8	2.8
Import duties	18.6	13.8	-1.0	1.3	1.4	1.3	0.2	0.2	0.0
GDP (2010 real prices)	**5.0**	**4.2**	**4.4**	**100.0**	**100.0**	**100.0**	**5.0**	**4.2**	**4.4**

Source: BNM, Affin Hwang forecasts

We have kept our Ringgit view where we believe that it should end the year at RM3.95 to the USD. This is premised on a sustained current account surplus, positive interest-rate differential over the developed world including US Treasury yields and large foreign exchange reserves. However, short-term Ringgit movements would be dictated by immediate portfolio-fund flows.

Our current account surplus expectation is RM15bn for 2016, or estimated at about 1.3% of GNI. This is due to our expectations of slower manufactured products with the tepid global trade environment. Also, we believe that the government's 3.1% fiscal deficit target for 2016 is achievable with a pick-up in revenue momentum in 2H16 especially with a higher Brent price.

Fig 132: Key Economic Forecasts

	RMbn	%yoy	RMbn	%yoy	RMbn	%yoy
DOMESTIC PRODUCTION						
Gross Domestic Product (constant 2010 prices)	**1,062.8**	**5.0**	**1,108.0**	**4.0-4.5**	**1,159.5**	**4.0-5.0**
Agriculture	94.1	1.2	91.1	-3.3	92.4	1.5
Mining and quarrying	95.1	4.7	96.2	1.1	97.5	1.4
Manufacturing	244.2	4.9	254.1	4.0	264.4	4.1
Construction	46.6	8.2	50.7	8.7	54.9	8.3
Services	568.9	5.1	601.0	5.6	635.1	5.7
NATIONAL INCOME AND EXPENDITURE						
Gross National Income (constant 2010 prices)	**1,125.1**	**5.2**	**1,197.2**	**6.4**	**1,285.9**	**7.4**
Final Consumption expenditure	778.2	7.0	830.5	6.7	895.3	7.8
Public	152.0	3.1	153.3	0.9	155.0	1.1
Private	626.2	8.0	677.2	8.1	740.4	9.3
Gross fixed capital formation	302.9	5.4	320.3	5.7	340.5	6.3
Public [1]	104.1	0.6	107.7	3.4	110.5	2.6
Private	198.8	8.1	212.6	6.9	230.0	8.1
Exports of goods and services	820.5	0.5	829.4	1.1	858.2	3.5
Imports of goods and services	731.9	2.5	753.7	3.0	781.2	3.7
Gross National Income (constant prices)	**1,038.5**	**6.8**	**1,077.6**	**3.8**	**1,128.1**	**4.7**
Gross National Savings (current prices)	**325.0**	**0.0**	**342.7**	**5.5**	**365.8**	**6.7**
Per capital income (current prices, RM)	**36,078**	**3.6**	**37,812**	**4.8**	**39,699**	**5.0**
FEDERAL GOVERNMENT FINANCE						
Revenue	**219.1**	**-0.7**	**212.6**	**-3.0**	**219.7**	**3.4**
Operating expenditure	217.0	-1.2	207.1	-4.5	214.8	3.7
Current account surplus	2.1	-	5.5	-	4.9	-
Development expenditure (net)	39.3	2.2	44.2	12.5	45.3	2.4
Overall Deficit	**-37.2**	**-**	**-38.7**	**-**	**-40.3**	**-**
% to GDP	-3.2	-	-3.1	-	-3.0	-
Domestic borrowings (net)	38.9	-	38.4	-	-	-
Foreign borrowings (net)	0.7	-	1.2	-	-	-
Change in assets	-2.5	-	-0.8	-	-	-
	RMbn	**% GDP**	**RMbn**	**% GDP**	**RMbn**	**% GDP**
Federal Government Debt [2]	**630.5**	**54.5**	**655.7**	**53.2**	**-**	**-**
Domestic debt	**609.1**	**52.6**	**628.8**	**51.0**	**-**	**-**
Treasury Bills	4.7	0.4	4.5	0.4	-	-
Investment Issues	214.0	18.5	230.0	18.7	-	-
Government Securities	340.1	29.4	365.9	29.7	-	-
Housing Loan Fund	50.3	4.3	28.4	2.3	-	-
Offshore borrowing	**21.5**	**1.9**	**27.0**	**2.2**	**-**	**-**
Market loan	15.2	1.3	20.3	1.6	-	-
Project loans	6.3	0.6	6.7	0.6	-	-
BALANCE OF PAYMENTS (NET)						
Current Account	**34.7**		**16.4**		**14.8**	
Goods	109.6		97.9		100.1	
Services	-21.0		-22.1		-23.1	
Income	-32.0		-35.4		-37.4	
Current transfers	-21.9		-23.9		-24.8	
Financial Account	**-52.0**		**-**		**-**	
Net Errors & Omissions	**21.1**		**-**		**-**	
Overall Balance	**3.8**		**-**		**-**	

	2015 [9]		2016 [9]		2017 [10]	
	RMbn	%yoy	RMbn	%yoy	RMbn	%yoy
EXTERNAL TRADE						
Total Exports	**777.4**	**1.6**	**785.7**	**1.1**	**806.5**	**2.7**
Manufactures	625.4	6.5	648.6	3.7	667.2	2.9
Agriculture	67.2	-2.8	68.0	1.2	69.1	1.6
Mining	80.2	-22.9	64.4	-19.7	65.9	2.3
Total Imports	**685.8**	**0.4**	**694.4**	**1.3**	**718.2**	**3.4**
Capital goods	95.6	-0.3	97.2	1.7	101.6	4.2
Intermediate goods	399.5	-2.1	401.3	0.5	418.0	4.5
Consumption goods	62.4	24.1	68.7	10.1	71.8	4.5
Total Trade	**1,463.1**		**1,480.1**		**1,524.7**	
Balance of Trade	**91.6**		**91.4**		**88.3**	
	Index	%yoy	Index	%yoy	Index	%yoy
PRICES						
Consumer Price Index (2010=100)	112.8	2.1	114.7 [4]	2.3 [4]	-	2.0-3.0
Producer Price Index (2010=100)	102.2	-7.4	99.7 [4]	(2.7) [4]	-	-
	('000)	%yoy	('000)	%yoy	('000)	%yoy
LABOUR						
Labour Force	14,518.0	1.8	14617.0 [5]	0.6 [5]	-	-
Unemployed (Unemployment Rate, %)	450	(3.1)	501.6 [5]	(3.4) [5]	-	(3.2) [6]

[1] *Includes investments of Non-Financial Public Enterprises (NFPEs)*
[2] *For 2016, data is at end-June 2016*
[3] *January to August 2016*
[4] *First half of 2016*
[5] *Forecast by Economic Planning Unit (EPU)*
[6] *Excludes transactions by financial institutions*
[7] *Market indicative yield*
[8] *Annual rate of appreciation (+) or depreciation (-) of the RM*
[9] *Estimate*
[10] *Forecast*

Source: MOF

A sigh of relief

2Q16 headline GDP growth slows further

On 12 August 2016, Bank Negara Malaysia (BNM) announced that 2Q16 headline real GDP growth had decelerated further to 4% yoy, taking over from 1Q16 the unflattering label of slowest economic expansion since the 1.1% yoy contraction in 3QCY09. The weaker overall real GDP growth stemmed from tepid net trade and a lack of stock replenishment.

Fig 133: Malaysia's quarterly GDP growth

	2Q15	3Q15	4Q15	1Q16	2Q16	2Q15	3Q15	4Q15	1Q16	2Q16	2Q15	3Q15	4Q15	1Q16	2Q16
	%yoy					%qoq					% contribution pts to GDP growth				
GDP by Expenditure Components															
Total Consumption	6.5	4.0	4.5	5.1	6.4	1.0	6.1	6.1	-7.5	2.2	4.1	2.7	3.0	3.3	4.1
Private consumption	6.4	4.1	4.9	5.3	6.3	-0.4	6.9	-1.9	0.8	0.6	3.3	2.2	2.5	2.8	3.3
Public consumption expenditure	6.9	3.6	3.3	3.8	6.5	6.9	2.8	40.3	-32.7	9.8	0.8	0.4	0.6	0.5	0.8
Total Investment	0.4	4.2	2.7	0.1	6.1	3.9	-2.4	-1.2	-0.1	10.2	0.1	1.1	0.7	0.0	1.7
Private investment expenditure	3.9	5.5	4.9	2.2	5.6	11.4	-10.3	-23.8	34.3	15.2	0.8	0.9	0.6	0.4	1.1
Public investment expenditure	-8.1	1.8	0.4	-4.5	7.5	-12.5	19.6	45.8	-37.4	-1.5	-0.7	0.2	0.1	-0.4	0.5
Domestic Demand	4.6	4.1	4.0	3.6	6.3	1.8	3.6	4.0	-5.6	4.4	4.2	3.7	3.7	3.3	5.7
Net exports	-11.1	3.4	4.3	-12.4	-7.0	-10.7	10.5	-1.5	-9.9	-5.1	-1.1	0.3	0.4	-1.2	-0.6
Exports	-4.0	3.2	4.0	-0.5	1.0	-1.4	6.7	2.9	-8.1	0.0	-3.1	2.4	2.9	-0.3	0.7
Imports	-3.1	3.1	4.0	1.3	2.0	-0.1	6.2	3.5	-7.8	0.6	-2.1	2.1	2.6	0.8	1.2
Changes in inventories	NA	-88.0	-49.5	NA	NA	NA	NA	NA	NA	NA	1.8	0.7	0.5	2.0	-1.2
GDP (2010 real prices)	**4.9**	**4.7**	**4.5**	**4.2**	**4.0**	**2.5**	**3.2**	**3.2**	**-4.6**	**2.3**	**4.9**	**4.7**	**4.5**	**4.2**	**4.0**

Source: BNM

Real net exports continued their decline with a 7% yoy contraction in 2Q16, though this was better than the 12.4% yoy decline in 1Q16. The weakness emanated from tepid global trade where Malaysia's real exports grew by just 1% yoy in 2Q16 on the back of demand for manufactured goods, though this was still an improvement from the 0.5% contraction in 1Q16. At the same time, the recovery in investment spurred higher imports of capital goods while demand for intermediate goods also rose. Strengthening private consumption could have also played a part in higher imports. Real imports increased from 1.3% in 1Q16 to 2% in 2Q16.

The second drag on growth was a drawdown of stock levels. This was partly due to lower CPO production during the quarter, which fell 20.3% yoy, thus requiring the need to dip into inventories. Corroborating this suspicion is GDP by economic activity where the Agriculture, Forestry & Fishing saw a 7.9% yoy contraction in 2Q16 from a 3.8% decline in 1Q16 and subtracted 0.7ppts from growth in the quarter. Apart from that, recall that in 1Q16 there was a significant rise in stock levels that contributed 2ppts to real GDP growth. The high stock levels at the end of 1Q16 would have likely prompted manufacturers to cut back on production in 2Q16 only to be surprised by the strength of domestic demand.

The sharp reduction in stock levels subtracted 1.2ppts from GDP growth in 2Q16. This, together with weak net exports, cumulatively reduced 2Q16 growth rate by 1.8ppts.

Underlying strength is apparent

The headline figure masks the underlying strength of the domestic economy. Private consumption growth accelerated from 5.3% in 1Q16 to 6.3% in 2Q16. Back in 1Q16, we were worried about tepid private investment growth of 2.2% yoy but to our relief it rebounded to 5.6% in 2Q16. Similarly, public investment delivered an impressive turnaround from a 4.5% yoy contraction to a 7.5% yoy growth as government spending on projects took shape. Even public consumption expenditure was strong, rising 6.5% yoy versus 3.8% yoy in 1Q16. As a result, domestic demand growth accelerated from 3.6% yoy in 1Q16 to 6.3% in 2QCY16.

On the supply side, the strength in domestic demand was reflected in the Services sector that accelerated from 5.1% in 1Q16 to 5.7% yoy in 2Q16. Besides Services, the Mining & Quarrying as well as Construction sectors also demonstrated better output growth over the same period of comparison. Manufacturing growth weakened from 4.5% yoy to 4.1% with the slowdown probably due to the large overhang in stock levels from 1Q16. As mentioned earlier, Agriculture, Forestry & Fishing was a major drag due to a sharp fall in CPO production with a worse-than-expected El Nino impact on palm trees.

Fig 134: Malaysia's quarterly GDP growth by activity

	2Q15	3Q15	4Q15	1Q16	2Q16	2Q15	3Q15	4Q15	1Q16	2Q16	2Q15	3Q15	4Q15	1Q16	2Q16
	%yoy					%qoq					% contribution pts to GDP growth				
GDP by Economic Activity															
Agriculture, Forestry and Fishing	4.6	2.3	1.5	-3.8	-7.9	10.5	15.7	-11.4	-15.1	5.8	0.4	0.2	0.1	-0.3	-0.7
Mining and Quarrying	6.0	5.1	-1.3	0.3	2.6	-4.1	-5.9	8.6	2.3	-1.9	0.5	0.4	-0.1	0.0	0.2
Manufacturing	4.2	4.9	5.0	4.5	4.1	5.7	-0.1	4.2	-4.9	5.3	1.0	1.1	1.1	1.0	1.0
Construction	5.6	9.9	7.4	7.9	8.8	-6.0	10.7	-1.1	4.9	-5.3	0.2	0.4	0.3	0.4	0.4
Services	5.0	4.4	5.0	5.1	5.7	1.6	3.7	4.7	-4.7	2.2	2.6	2.3	2.6	2.8	3.1
Import duties	9.1	18.6	39.1	27.0	4.1	16.5	-0.5	14.9	-4.7	-4.5	0.1	0.2	0.4	0.3	0.1
GDP (2010 real prices)	**4.9**	**4.7**	**4.5**	**4.2**	**4.0**	**2.5**	**3.2**	**3.2**	**-4.6**	**2.3**	**4.9**	**4.7**	**4.5**	**4.2**	**4.0**

Source: BNM

Structure of the economy

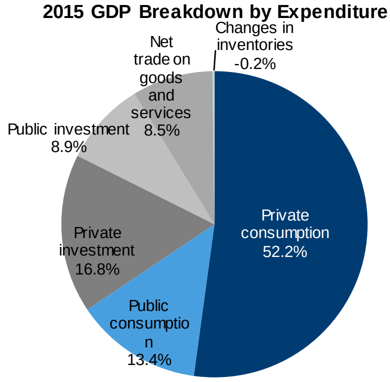
The structure of Malaysia's economy remains vibrant, in our view. The stronger growth in private consumption means it has gained size as a proportion of Malaysia's economy, making up 53.4% of the total in 1H16 from 52.2% in 2015. Going forward, private consumption will likely continue to be a strong pillar of growth for the Malaysian economy.

The second pillar would come from total investments. As of 1H16, total investments constituted 26.5% of GDP, increasing its size from 25.7% in 2015. We were worried that poor consumer sentiment and business confidence meant that private investment could be on a sustained decline with repercussions on future growth but 2Q16 proved the fear to be unfounded. It does seem that the government's effort to resuscitate investments as the country pushes towards developed nation status by 2020 is hardier than initially thought with the swift rebound in investment.

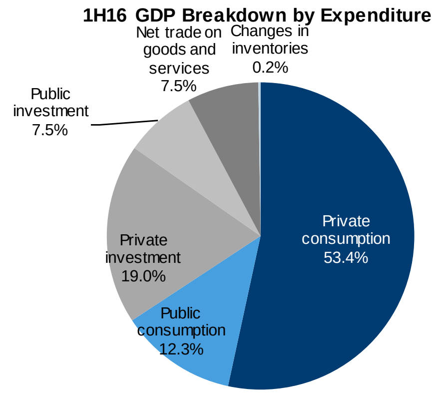
Net trade continued to lose momentum, shrinking from 8.5% of GDP to 7.5% in 1H16 due to external factors that are beyond control. Having said that, we believe Malaysia's infrastructure and export competitiveness are well positioned to capitalise on global trade when the recovery happens.

We are particularly pleased that the government has receded in its role in the economy making up 19.8% of the economy in 1H16, from 22.3% in 2015. As a result, private sector expenditure rose from 69% to making up 72.4% of economic activities. This is important as the government continues to take a step back to avoid crowding the economy and encourage private sector creativity to flourish.

Fig 135: Comparing structure of the real economy by expenditure



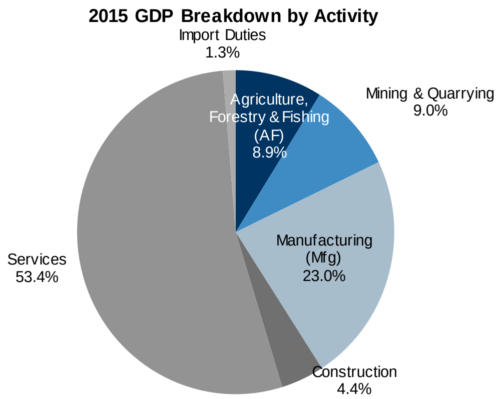
Source: Affin Hwang, BNM



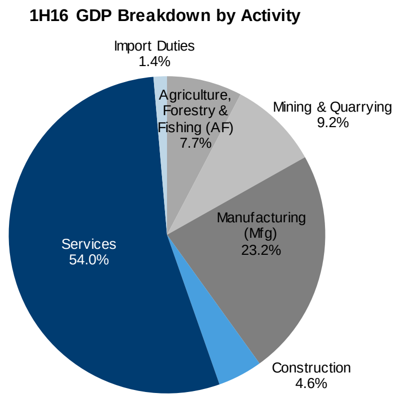
Source: Affin Hwang, BNM

On the supply side, the Services sector gained in share of importance at 54% in 1H16 from 53.4% in 2015, in tandem with strength in domestic consumption. Manufacturing, Construction, and Mining & Quarrying all gained share at the expense of Agriculture, Forestry & Fishing, which shrunk from 8.9% in 2015 to 7.7% in 1H16 due to a drop in CPO production. It is interesting to note that the Mining & Quarrying sector showed growth once again with higher production of hydrocarbons.

Fig 136: Comparing structure of the real economy by activity



Source: Affin Hwang, BNM



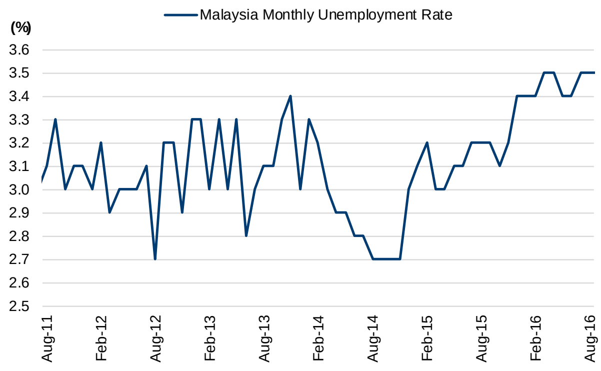
Source: Affin Hwang, BNM

Healthy labour market

We continue to track the health of the labour market in Malaysia given its wide and broad linkages to the economy and financial markets. It is therefore reassuring that the labour force remains healthy. The unemployment rate remained stable at 3.5% in August. The labour-force participation rate is also on a steady keel at 67.8% for the same month, indicating that the labour market remains vibrant.

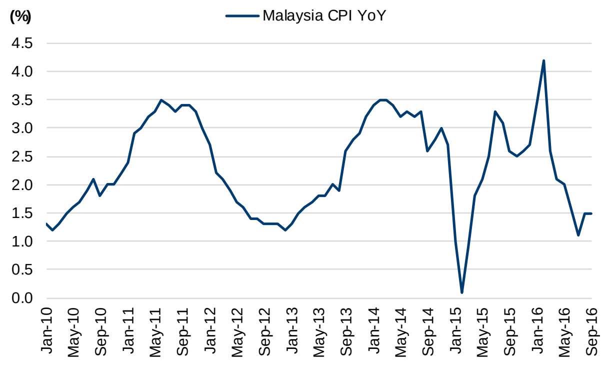
Equally important is that total employment in Malaysia reached another new record high in August in excess of 14.3m jobs, though just marginally better than the previous 14.2m in June. Coupled with healthy wages, this situation begins to paint a benign picture of the labour market. Wages grew by 3.5% in 2Q16, though a slowdown from the 4.4% posted in 1Q16, but is nevertheless conducive for consumption given that inflation moderated to just 1.5% in September 2016.

Fig 137: Unemployment rate



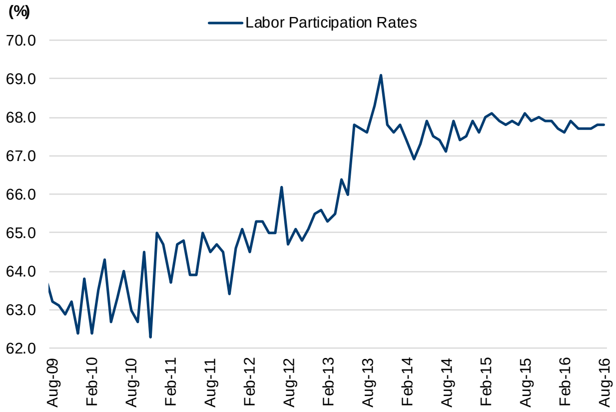
Source: BNM

Fig 138: Inflation



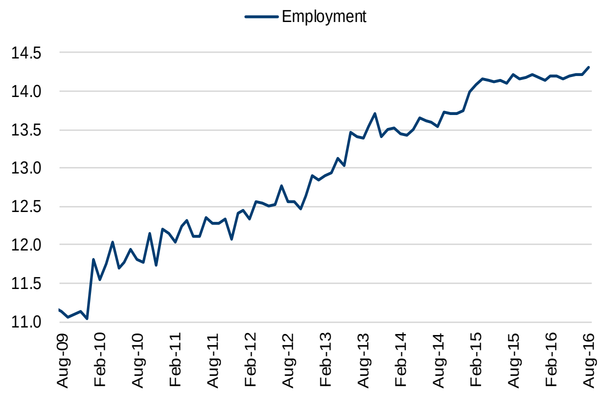
Source: BNM

Fig 139: Labour force participation rate



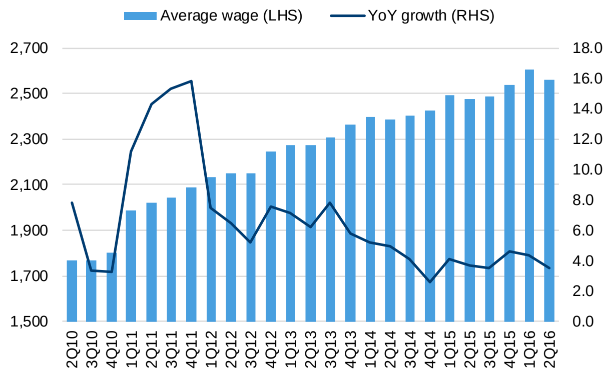
Source: BNM

Fig 140: Total employment



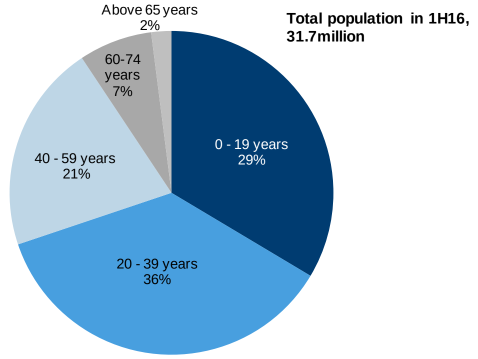
Source: BNM

Fig 141: Average payrolls



Source: Affin Hwang, BNM

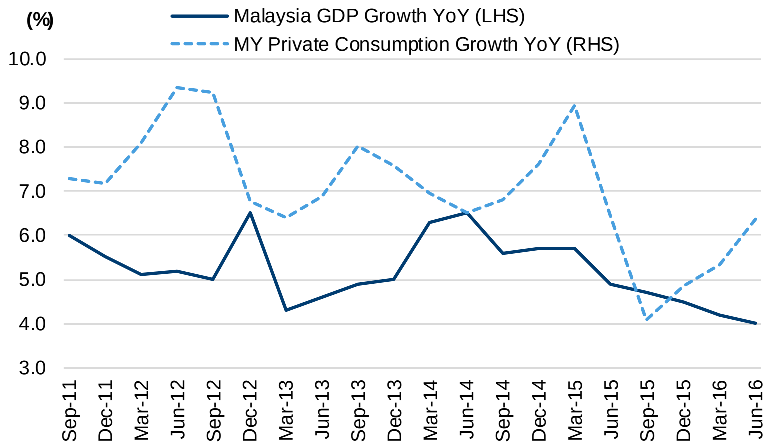
Fig 142: Young demographics



Source: BNM

The pick-up in private consumption is a further relief subsequent to the surprise and sharp slowdown to 4.1% yoy growth back in 3Q15. That figure represented the slowest pace of expansion since 4Q09 where private consumption grew by just 1.5%, as Malaysia was recovering from the 2009 Global Financial Crisis. However, private consumption has been on a sustained recovery since then with growth rebounding to 4.9% in 4Q15, 5.3% in 1Q16 and the most recent 6.3% in 2Q16.

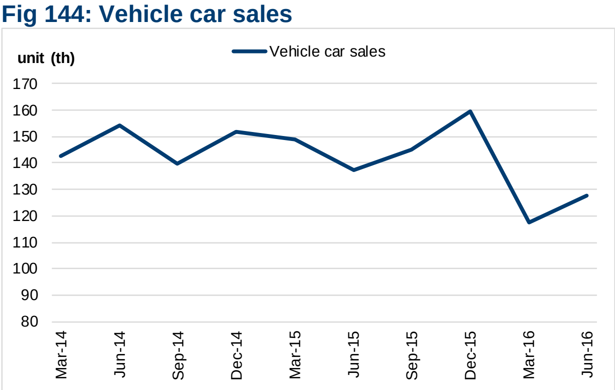
Fig 143: Sustained rebound since trough in 3Q15



Source: BNM

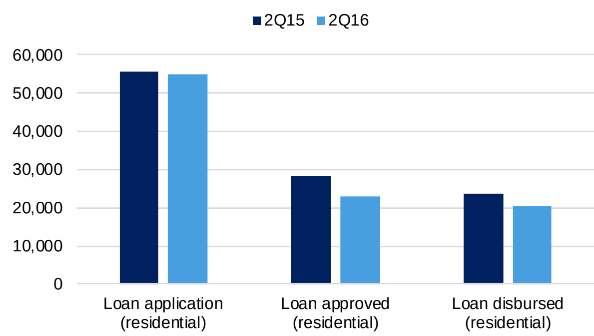
Note that the 6.3% growth in this latest quarter is despite a contraction in total motor vehicle sales in 2Q16 of 6.3% yoy, though this is an improvement from the 22% decline in 1Q16. At the same time, residential-loan approvals and disbursements in 2Q16 were both down 19.4% yoy and 12.9% yoy, respectively, indicating lower property activities. Loan-application levels were still high though with just a 1.3% yoy contraction in 2Q16, which is a sign that underlying demand for residential property is there.

Fig 144: Vehicle car sales



Source: Malaysian Automotive Association

Fig 145: Mortgage loans



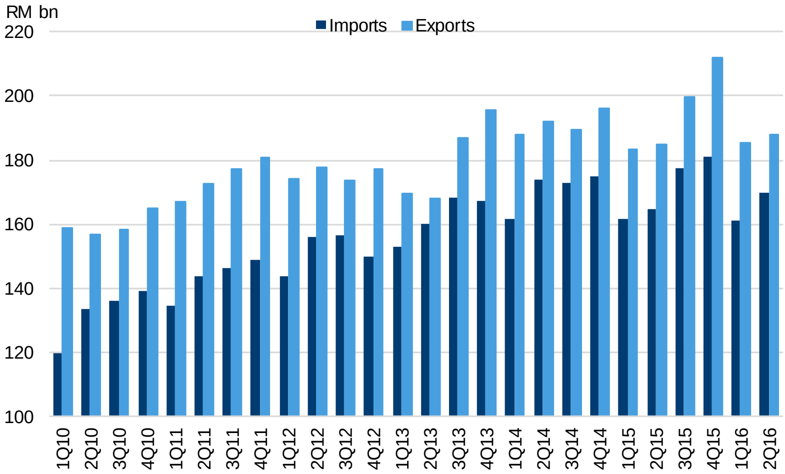
Source: BNM

Narrowing current account surplus

The current account surplus narrowed further to RM1.9bn or equivalent to 0.6% of GNI in 2Q16. This is a continuation from the weakness that started in 1Q16 where the surplus was RM5bn or 1.8% of GNI, dropping from RM10.5bn (3.6% of GNI) in 4Q15. The 2Q16 figure represents the second lowest quarterly surplus since 1998; the worst was in 2Q13 of just RM1bn or equivalent to 0.4% of GNI.

The deterioration of the current account surplus versus 1Q16 was due to a combination of narrower goods surplus marginally offset by lower services deficit. While the nominal value of gross exports improved from 1% in 1Q16 to 1.4% in 2Q16, the growth in gross imports at 3.1% outstripped that of exports resulting in a smaller surplus in the trade of goods. Gross imports contracted by 0.4% yoy in 1Q16.

Figure 146: Malaysia's nominal trade direction



Source: CEIC

Meanwhile, the primary and secondary accounts contributed to larger deficits in the current account. The former was a function of better profits generated and repatriated by foreign investments in Malaysia while the latter was due the bigger foreign worker base in Malaysia remitting cash back to their home countries especially ahead of the major Hari Raya Aidilfitri festival in early July.

Fig 147: Balance of payment

Balance of Payments (RMbn, unless stated otherwise)	2014	2015	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
Current account	**48.6**	**34.7**	**19.8**	**15.3**	**7.3**	**6.2**	**11.3**	**8.1**	**4.7**	**10.5**	**5.0**	**1.9**
(% of GDP)	**4.4**	**3.0**	**7.4**	**5.6**	**2.6**	**2.1**	**4.1**	**2.9**	**1.6**	**3.5**	**1.7**	**0.6**
(% of GNI)	**4.9**	**3.5**	**7.6**	**5.8**	**2.7**	**2.2**	**4.2**	**2.9**	**1.7**	**3.6**	**1.8**	**0.6**
Goods	113.3	109.6	31.2	27.4	25.7	28.9	27.7	23.6	27.2	31.1	23.5	19.8
Services	-10.7	-21.0	-0.2	-1.6	-3.9	-5.1	-3.5	-5.0	-6.0	-6.4	-6.8	-4.6
Income	-36.6	-32.0	-6.6	-7.8	-9.5	-12.8	-7.7	-4.6	-10.6	-9.1	-6.7	-8.2
Current transfers	-17.4	-21.9	-4.6	-2.8	-5.1	-4.9	-5.1	-5.9	-5.9	-5.0	-4.9	-5.1
Capital and financial account	**-79.6**	**-52.0**	**-38.0**	**-12.1**	**-2.1**	**-27.3**	**-29.8**	**4.6**	**-30.7**	**3.9**	**5.8**	**9.6**
Direct investment	-18.0	4.8	-14.4	-4.0	2.2	-1.8	-1.4	0.7	-0.2	5.8	3.7	5.3
Assets	-52.6	-37.2	-20.6	-16.5	-6.3	-9.2	-10.0	-17.6	-6.7	-2.9	-11.2	-3.8
Liabilities	34.6	41.9	6.2	12.5	8.5	7.4	8.5	18.2	6.5	8.6	14.9	9.1
Portfolio investment	-39.4	-28.2	-14.2	6.3	-11.2	-20.4	-7.9	-11.8	-24.4	15.9	13.1	0.1
Assets	-28.1	-9.1	-7.5	-10.4	-10.4	0.2	-7.4	-8.1	0.7	5.6	-5.9	-4.7
Liabilities	-11.2	-19.1	-6.6	16.7	-0.7	-20.6	-0.5	-3.7	-25.1	10.3	19.0	4.8
Financial derivatives	-1.0	-0.5	-1.5	0.2	0.0	0.2	0.0	-0.4	-0.1	-0.1	0.5	0.0
Other investments	-21.7	-26.8	-8.0	-14.6	6.7	-5.7	-20.5	17.3	-5.9	-17.6	-11.5	4.1
Errors and omissions	**-5.5**	**21.1**	**0.9**	**-4.2**	**-11.8**	**9.6**	**2.8**	**-4.3**	**43.0**	**-20.4**	**-38.4**	**-2.7**
Overall balance	**-36.5**	**3.8**	**-17.3**	**-1.0**	**-6.7**	**-11.5**	**-15.7**	**8.4**	**17.0**	**-6.0**	**-27.6**	**8.8**

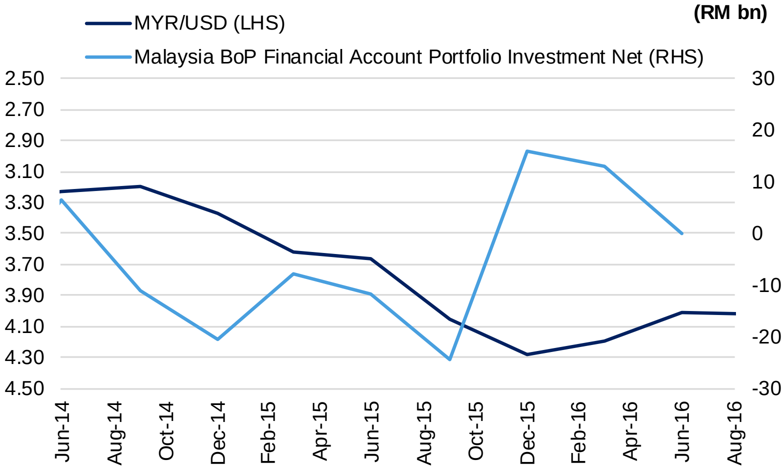
Source: MOF

Portfolio account reflects mixed flows

We observe that the portfolio account of the Balance of Payment saw severe curtailment in net inflows from RM13.1bn in 1Q16 to just RM0.1m in 2Q16. The main culprit is the sharp slowdown of non-resident net inflows to RM4.8bn, from significantly higher RM19bn in 1Q16. According to BNM, there was a net liquidation of equities by non-residents in 2Q16 but more than offset by higher demand for Federal government debts.

There were a few notable events in 2Q16 that influenced the portfolio flows. The quarter saw MSCI rebalancing its weightage resulting in a cut in Malaysia from 3.43% to 3.09%, prompting foreign liquidation in the equity market. In addition, the 1MDB default on interest payment on 25 April 2016 resulted in uncertainty prompting a selloff in government debt securities in May 2016. However, the subsequent clarification of no cross default on Federal government sovereign rating and better yield versus the developed world instruments prompted foreign fund flows back into Malaysia's government debt market.

Fig 148: Portfolio flows



Source: BNM, Bloomberg

Federal government fiscal position better in 2Q16

The Federal government revenue was down 14.1% yoy in 2Q16; surprisingly it was also down 2.7% qoq. The RM47.5bn registered in 2Q16 made up 22% of the RM216.3bn 2016 recalibrated revenue forecast by the government while 1HCY16 came in at 44.5%. It is now 22.3% in 2Q16 and 45.3% in 1H16 of the RM212.6bn new revenue forecast released in tandem with Budget 2017.

Operating expenditure was thankfully under control with a 0.5% yoy rise in 2Q16, a marked deceleration from the 3.5% in 1Q16. This was a direct result of the government's drive to reduce subsidies and leakages via grants and transfers. However, development expenditure rose 43.9% yoy as some of the government's infrastructure plans took shape. This was reflected in public investment growth of 7.5% yoy in 2Q16 (from 4.5% contraction in 1Q16) for real GDP by expenditure.

The net effect is a decline in the Federal government fiscal deficit from 6.1% in 1Q16 to 5% of GDP in 2Q16. While directionally on a declining trend, it is still elevated relative to the fiscal deficit of 3.2% in 2015 and the target of 3.1% for 2016. On an absolute basis, the fiscal deficit target of 3.1% of GDP translates to RM38.7bn. Thus far, the fiscal deficit has already ring in RM32.8bn for 1H16. In other words, there is only a difference of RM5.9bn extra in absolute deficit that the government can sink into for 2H16. Looking at it another way, the Federal government has used up 84.8% of its 2016 fiscal deficit allocation.

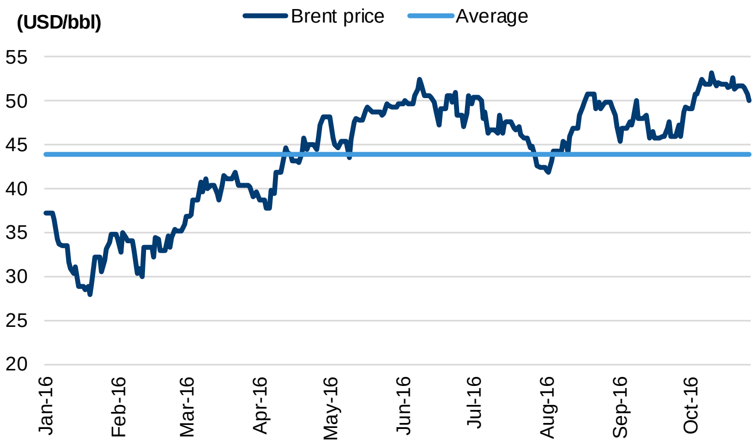
Fig 149: Federal government fiscal position

	2014					2015					2016	
	1Q14	2Q14	3Q14	4Q14	2014	1Q15	2Q15	3Q15	4Q15	2015	1Q16	2Q16
Revenue	49.2	52.7	59.1	59.6	220.6	51.5	55.3	56.3	56.0	219.1	48.8	47.5
% of annual growth	12.4	2.1	3.8	-2.3	3.4	4.8	4.9	-4.9	-6.0	-0.7	-5.3	-14.0
Operating expenditure	55.2	51.7	52.9	59.7	219.6	55.4	51.8	52.3	57.5	217.0	57.4	52.1
% of annual growth	10.6	5.2	-0.9	1.6	3.9	0.4	0.2	-1.2	-3.8	-0.1	3.5	0.5
Current balance	-6.0	0.9	6.2	-0.1	1.0	-3.9	3.4	4.0	-1.4	2.1	-8.6	-4.6
% of GDP	-2.3	0.3	2.2	0.0	0.1	-1.4	1.2	1.4	-0.5	0.2	-3.0	-1.5
Net development expenditure	7.0	7.0	8.1	16.4	38.5	7.9	7.3	8.7	15.5	39.3	9.2	10.4
% of GDP	2.6	2.6	2.9	5.7	3.5	2.8	2.6	3.0	5.1	3.4	3.1	3.5
Overall balance	-13.0	-6.1	-1.9	-16.5	-37.4	-11.8	-3.8	-4.7	-16.9	-37.2	-17.7	-15.0
% of GDP	-4.9	-2.2	-0.7	-5.7	-3.4	-4.2	-1.4	-1.6	-5.6	-3.2	-6.1	-5.0

Source: MOF

While the figure seems elevated, it is worth pointing out that it is a net absolute figure and a function of revenue and costs. In other words, a quarter of better revenue with lower expenditure could rapidly buffer the fiscal position. Revenue collection should improve in 2H due to a few reasons. The first is that the fiscal deficit of RM38.7bn assumes an average Brent price of US$30-35/bbl. However, the current Brent price is hovering at US$49.98 while the average year-to-date is US$43.90. Under this scenario, there should be additional revenue for the government in 2H.

Fig 150: Oil price so far this year



Source: Bloomberg

Meanwhile, we understand that GST registration has exceeded the 400k count that the government has set to achieve. Taken in combination with the better private consumption growth in 2Q16 onwards and 2H16 GST collection could also rise. The recent Budget 2017 released with the government maintaining a 3.1% fiscal deficit figure is also comforting that fiscal consolidation this year vis-à-vis 2015 could be achieved.

Flat line

Flat earnings in 2016

Our original forecast for 2016 fully diluted EPS growth was 7.4% in our strategy report titled, '***Finding a firmer footing***', published on 5 November 2015. We tracked our forecasts since then, and the rate of growth went up to as high as 8.5%, but has settled at just 1.5% post 2Q16 results season.

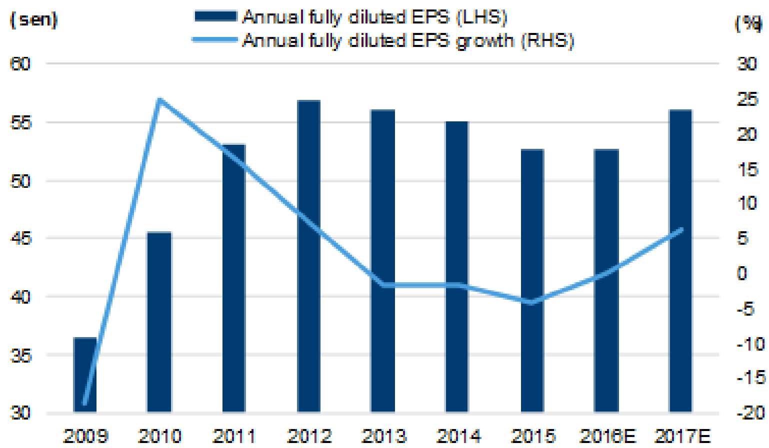
Fig 151: Tracking Affin Hwang's 2016E EPS growth expectations

Date	Report	2016E EPS growth
5-Nov-15	***Finding a firmer footing***	7.4%
3-Dec-15	***The Ringgit awakens?***	8.2%
20-Jan-16	***De-coupling***	7.8%
29-Jan-16	***Dodging a bullet***	7.8%
3-Mar-16	***Breathing space***	8.5%
2-Jun-16	***Battling perceptions***	3.0%
24-Jun-16	***Her subjects have spoken***	3.0%
14-Jul-16	***An insurance policy***	3.0%
6-Sep-16	***Waiting for the tide to turn***	1.5%

Source: Affin Hwang

It has come down further, and we now expect the earnings to be flat in 2016E versus 2015. We have recalibrated our expectation and are just hoping nothing untoward happens for the rest of the year so that 2016 EPS would not dip into a recessionary territory. If our forecast is accurate, it will still represent 4.2% contraction in 2015 to stabilisation in 2016 where optimism could hopefully return for a sustained recovery into 2017. Meanwhile, our 2017 fully diluted EPS forecast has gone up from 5.6% previously to 6.3% now, partly due to the lower base.

Fig 152: Annual fully-diluted EPS growth



Source: Affin Hwang forecasts

Note that these figures are based on our coverage universe of 102 stocks. There is some minor disparity in the figures given we have increased our coverage by two stocks since our previous report and have adjusted the numbers retrospectively to reflect the new coverage.

Overall, our stock coverage universe has increased by five companies compared to the year-ago period.

Contribution to growth

We continue to provide a breakdown of contribution to fully diluted EPS growth by sectors in order to provide better insight and transparency into where our forecast for a turnaround in growth is coming from. The three largest positive contributors for 2016E are plantation, utilities and gaming totalling 9.7 ppts. On the other hand, the three largest drags to EPS growth currently are financials, consumer and telcos with a total deduction of 12.3 ppts. Note that of the total 18 sectors under coverage, there are now eleven sectors with positive growth contribution totalling 13.4 ppts offset by 7 with EPS reduction totalling 13.4 ppts, thus pointing to flat EPS growth for 2016E.

Fig 153: Breakdown of 2016E and 2017E EPS contributions to growth by sector

	Sector	Rating	Market Cap (RMm)	Weightage	Previous sector contribution to EPS growth 2016E (%)	Current sector contribution to EPS growth 2016E (%)	Sector contribution to EPS growth 2017E (%)
1	Auto & Autoparts Sector	UW	8,592	0.7	0.3	1.0	0.2
2	Banks Sector	N	279,593	22.8	(1.9)	(7.2)	2.8
3	Building Materials Sector	N	7,068	0.6	0.1	0.3	0.0
4	Const & Infra Sector	OW	31,987	2.6	(0.1)	(0.3)	0.1
5	Consumer Sector	N	51,399	4.2	(0.5)	(4.1)	1.5
6	Gaming Sector	OW	61,890	5.1	0.5	1.6	0.3
7	Healthcare Sector	OW	56,736	4.6	0.2	0.6	0.2
8	Media Sector	N	19,366	1.6	0.0	0.1	0.1
9	MREIT Sector	OW	28,534	2.3	0.2	0.7	0.0
10	Oil & Gas Sector	UW	81,790	6.7	(0.0)	0.1	0.1
11	Plantation Sector	N	130,460	10.6	2.1	6.3	0.5
12	Property Sector	OW	35,211	2.9	(0.2)	(0.5)	0.0
13	Rubber Products Sector	N	22,372	1.8	0.1	0.1	0.1
14	Technology Sector	N	9,825	0.8	(0.0)	(0.1)	0.0
15	Telecoms Sector	UW	154,240	12.6	(0.4)	(1.0)	0.3
16	Timber Sector	OW	3,445	0.3	(0.1)	(0.2)	0.0
17	Transport Sector	UW	69,668	5.7	0.2	0.8	(0.3)
18	Utilities Sector	N	173,322	14.1	0.8	1.7	0.3
	Others						
	TOTAL		**1,225,498**		**1.5**	**(0.0)**	**6.3**

Source: Affin Hwang estimates and forecasts

As for 2017, we are forecasting 6.3% fully diluted EPS growth. Of this, the financials, consumer and plantations sectors provide the largest contribution. In total, they add 4.8ppts to market growth or a substantial 76% of what we forecast for 2017. The total number of sectors with positive growth increases to 17, with only the transport sector left with a negative contribution.

We highlight three characteristics of our 2017 EPS forecast. First, the heavyweight financials sector alone contributes 45% of the expected 6.3% EPS growth in 2017. However, this is after the 7.2 ppts EPS growth contribution reduction in 2016. In other words, the financial sector earnings are rebounding from a lower base.

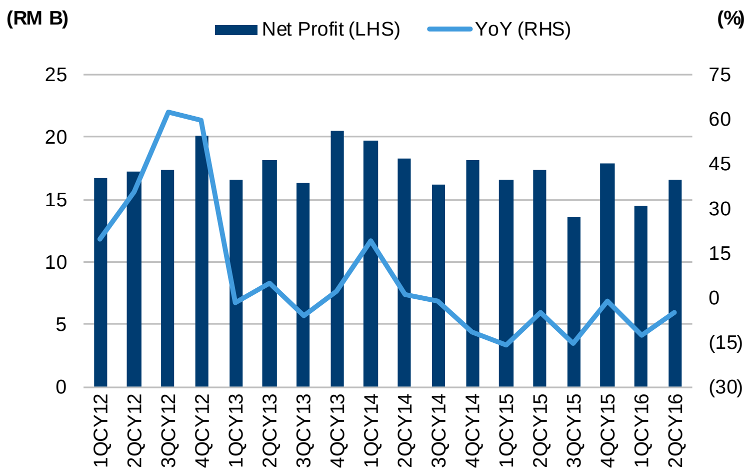
Second, the top three sectors anchor a large proportion of growth in 2017, though the figure is not as bad as 2016 when the top three sectors surpassed the overall market figure. Hence, we see broad-based growth with improvement in the still high concentration risk in 2017E vis a vis 2016E.

Lastly, we are pleased as we expect 17 of the 18 sectors under our coverage to provide positive growth contribution to the market in 2017E.

Protracted bad patch

While we are essentially seeing flat earnings in 2016 before returning to annual growth in 2017, the worst run in quarterly performance is still ongoing. The 2Q16 results season that ended in August 2016 has gone down in the books as the eighth consecutive quarter of net profit decline measured over the same period a year ago. In other words, the KLCI has now seen two years of profit decline that started with the 0.8% yoy contraction in 3Q14. At the trough, 1Q15 net profit contracted by 16% yoy while on an absolute basis the net profit was RM13.7bn. The latest quarter of 2Q16 saw a 5.1% yoy drop in net profit to RM16.6bn but the rate of decline has improved from the 12.6% yoy in 1Q16.

Fig 154: Slower rate of decline



Source: Affin Hwang, Bloomberg

Short-term earnings outlook for 3Q16

Previously, we had attempted to identify the potential inflection point for this dismal run. We were originally hopeful of a turnaround by 1Q16 at the very latest premised on an already diminished profit base in 1Q15 that corresponded to the sharpest 16% yoy contraction over this dismal period. However, that failed to materialise as sharp gyrations in China's financial market on the back of fears of economic distress, plunging crude oil prices and a weak Ringgit adversely impacted the profitability expectations in 1Q16.

Once bitten twice shy, we are naturally more guarded looking into 3Q16 but still think that the earnings improvement from 2Q16 could sustain. One reason is better economic activities. We highlighted earlier in

'Section 6: A sigh of relief' that although 2Q16 GDP growth of 4% is the slowest since 3Q09, the underlying trend is encouraging if we break it down into the components of the economy. In fact, we are hopeful that 2Q16 represents the lowest quarterly growth rate this year with a pick-up in the following two quarters. Second, the inflation rate has fallen and this could help sustain demand and put less cost pressure on households and businesses.

Next, we hope that the large impairments taken by companies, especially those in the oil & gas sector, would ease with oil prices fluctuating in a range. Absence of sharp gyrations in the Ringgit should also see less translation losses to companies with foreign currency exposure. The impact from the OPR cut in July would take time to transmit through the economy but is a positive development nonetheless.

However, risks still exist. The Ringgit has averaged RM4.05 to the USD in 3Q16 versus RM4.01 in 2Q16. So far, the Ringgit average has been relatively stable. However, the latest Ringgit exchange rate is weaker at RM4.16, which is on the back of rising expectations of an interest rate increase by the US Federal Reserve. Likewise, crude palm oil (CPO) prices that averaged RM2,601/tonne in 2Q16 has inched up slightly to RM2,632 in 3Q16, and whether the plantation sector profits rebound in this quarter will depend on the extent of the production recovery as palm trees continue to shake off the effects of El Nino. The Brent crude oil price has remained relatively stable thus far at an average of US$46.99/bbl for 3Q16 versus US$47.03 in the immediate preceding quarter, though it has strengthened to US$49.98 currently.

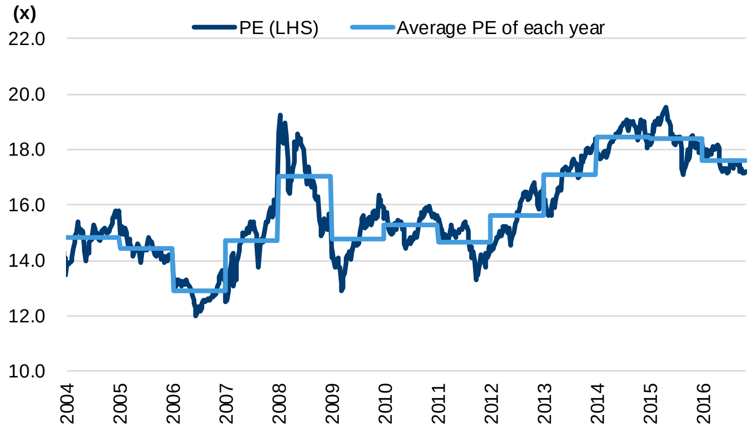
Lastly, the 2Q16 total net profit of our coverage universe was RM16.6bn, up 14.3% qoq. In 3Q15, the net profit figure was RM13.7bn, the lowest since 4Q11. At the very least, 3Q16 would have the benefit of a relatively lower base of comparison.

Some headroom

Malaysia's PER trend

At 1,673.92 (as of 26 October 2016), the KLCI is trading at static PER of 18.1x in 2016E and 17x in 2017E, based on our coverage universe of 102 companies. On a 52-week forward basis, it is currently trading at 17.2x. As we have pointed out in 'Section 4: The long arms of monetary policy', the Malaysian market has re-rated since 2010 in tandem with global indices due to the current low interest rate environment and depressed inflation expectations. Annual average PE hit a high of 18.5x in 2014, held relatively flat at 18.4x in 2015 but has thus far de-rated to 17.6x in 2016. Again, this makes sense as the Fed increased interest rate by 25 bps in December 2015.

Fig 155: PER trend for the KLCI



Source: Affin Hwang, Bloomberg

If we look at 2013 onwards, the average PER works out to 17.9x. As we pointed out earlier, as interest rates increase in the US, the 10-year US Treasury yield rises prompting a higher risk free rate, which in turn increases WACC and de-rates the S&P500, assuming everything else holds constant. We showed that this does not have a direct impact on Malaysia given that the BNM has autonomy over monetary policy and thus has a strong influence over the risk free rate. In addition, the positive savings-investment gap, fiscal consolidation trajectory, high foreign exchange reserves, and ample liquidity in the financial system further mitigates the effect of Fed funds rate hike on Malaysia. However, the financial linkages arising from the relative valuation of the KLCI to S&P500 is the indirect impact where a relatively cheaper S&P500 would put pressure on the KLCI.

New KLCI target

Under this scenario, it becomes more difficult to determine a fair PER to the KLCI. In order to do so, we make a few assumptions as follows.

- The easy monetary conditions globally are likely to continue with gradual normalisation of interest rates by the Fed due to low inflation expectations.
- Historically, KLCI traded at a 2.1% premium to the S&P500 (Bloomberg data). We take this as the upper limit for the KLCI. In other words, the KLCI may not trade north of the 2.1% premium relative to the S&P500 after we assume a de-rating in the S&P500.

- However, the KLCI is now trading at a 7.4% discount to the S&P500. What this means is that the S&P500 can de-rate by 9.3% before it starts affecting the KLCI, assuming convergence of the premium to historical average. This translates to about 40 bps rise in the risk free for the US.
- As such, we believe that the 17.9x average PER since 2013 could hold.

Hence, based on the same 17.9x PER, we revised up our 2017 year-end KLCI target to 1,760.41 applied to our 2017 fully diluted EPS forecast. Meanwhile, our 2016 target is set at 1,655.68 at the same 17.9x PER for 2016E EPS. Note that our last KLCI target of 1,745.95 for 2017E was introduced in our Strategy Report, ‘Battling perceptions’ published on 2 June 2016. At the time, the index target was based on 17.9x average 2016 and 2017 fully diluted EPS. Hence that was a mid-2017 target. Note that our new 1,760.31 figure now is a year-end 2017 target.

Fig 156: KLCI index target calculation

	Units	2016E	2017E
KLCI (26 Oct 2016)	pts	1,673.92	1,673.92
Market EPS	pts	92.50	98.35
Fully diluted PE	x	18.1	17.0
Index Target			
Average fully diluted PE	x	17.9	17.9
Current market EPS	pts	92.50	98.35
KLCI target	**pts**	**1,655.68**	**1,760.41**
Upside	**%**	**-1.1%**	**5.2%**
Revision			
Old KLCI target	pts		1,745.95
Change	%		0.8%

Source: Affin Hwang forecast

Sector and stock positioning

Recalibrating sectors

We have reassessed the 18 sectors under our coverage and have made three changes. The first is downgrading Financials from Overweight to Neutral as we believe that the earnings risks have risen as we move closer to introduction of IFRS9 in 2018. It also comes on the heels of our downgrade of CIMB and AFG to Hold given good share price run this year.

The second is downgrading Telecoms sector from Neutral to Underweight. For a long time, we had a negative bias on the telco sector from a top down perspective due to the impending intensifying competitive environment with two new entrants into the mobile space. However, from a bottom up perspective we had all four companies under our coverage on Hold recommendation, hence warranting a Neutral rating for the sector. The recent downgrade of Telekom Malaysia on the back of Budget 2017 government initiative for fixed line broadband means that we now have a sell recommendation in the sector hence tipping the bias to Underweight.

The last change is downgrade of Utilities from Overweight to Neutral. This is more tactical move for 2017 on our expectation for slower sector growth rates even though we have not made any changes to our outlook. Moreover, the number of companies with Hold rating is overwhelming at 75%. Post these changes, our 18 sectors are distributed along the lines of six at Overweight, eight that are Neutral and the remaining four at Underweight.

Fig 157: Positioning for the eighteen sectors under our coverage

Overweight	Neutral	Underweight
Construction	Banks & Financial Services (↓)	Auto & Autoparts
Gaming	Building Materials	Oil & Gas
Healthcare	Consumer	Transports & Logistics
MREIT	Media	Telecoms (↓)
Property	Plantation	
Timber	Rubber Products	
	Technology	
	Utilities (↓)	

Source: Affin Hwang
Note: sectors upgraded (↑), sectors downgraded (↓)

As usual, we have also given the breakdown of our stock coverage universe by rating. We base our sector ratings by reconciling the top down attractiveness of a particular sector with our bottom up recommendations. Note that we have initiated coverage on Westports and YTL REIT, and have thus expanded our stock universe to 102 companies. We now have 33% (35% previously) of companies rated Buy, 43% (44% previously) on Hold and 24% (21% previously) on Sell.

Fig 158: Breakdown of our sector coverage by recommendation

Sector	Rating	% of market cap	Total mkt cap (RMbn)	Rating				% of rating				Rating as a % of mkt cap			
				Buy	Hold	Sell	Total	Buy	Hold	Sell	Total	Buy	Hold	Sell	Total
Auto & Autoparts	UW	0.7%	8,592	-	-	3	3	-	-	100	100	-	-	100	100
Banks & Financial Services	N	22.8%	279,593	1	6	3	10	10	60	30	100	27	68	4	100
Building Materials	N	0.6%	7,068	-	1	1	2	-	50	50	100	-	97	3	100
Construction & Infrastructure	OW	2.6%	31,987	7	1	-	8	88	13	-	100	99	1	-	100
Consumer	N	4.2%	51,399	1	5	3	9	11	56	33	100	10	86	4	100
Gaming	OW	5.1%	61,890	1	1	1	3	33	33	33	100	45	48	7	100
Healthcare	OW	4.6%	56,736	1	1	-	2	50	50	-	100	8	92	-	100
Media	N	1.6%	19,366	1	-	3	4	25	-	75	100	77	-	23	100
MREIT	OW	2.3%	28,534	3	2	-	5	60	40	-	100	44	56	-	100
Oil & Gas	UW	6.7%	81,790	2	4	2	8	25	50	25	100	2	27	71	100
Plantation	N	10.6%	130,460	-	4	3	7	-	57	43	100	-	46	54	100
Property	OW	2.9%	35,211	5	2	-	7	71	29	-	100	71	29	-	100
Rubber Products	N	1.8%	22,372	1	4	-	5	20	80	-	100	27	73	-	100
Technology	N	0.8%	9,825	4	2	2	8	50	25	25	100	55	25	20	100
Telecoms	UW	12.6%	154,240	-	3	1	4	-	75	25	100	-	84	16	100
Timber	OW	0.3%	3,445	3	-	-	3	100	-	-	100	100	-	-	100
Transports & Logistics	UW	5.7%	69,668	2	2	2	6	33	33	33	100	22	14	64	100
Utilities	N	14.1%	173,322	2	6	-	8	25	75	-	100	47	53	-	100
Total		100.0%	1,225,498	34	44	24	102								

Source: Affin Hwang

The five biggest sectors under our coverage i.e. financials, utilities, telcos, plantation and oil & gas make up 66.9% of our universe market cap of RM1.23tn. Meanwhile, the RM1.23tn represents 71.9% of the total Bursa Malaysia market capitalisation of listed companies of RM1.71tn.

Fig 159: Summary of sector valuation

Sector	Rating	Market Cap (RMm)	EPS Growth (%)		PE (x)		EV/EBITDA (x)		Yield (%)		P/BV (x)		ROE (%)	
			2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E
Banks & Financial Services	N	279,593.4	(6.6)	8.8	13.8	12.7			3.7	4.0	1.5	1.4	9.8	10.3
Auto & Autoparts	UW	8,591.6	1,741.0	57.0	26.9	17.1	15.5	12.4	2.7	3.9	1.1	1.3	3.5	5.9
Building Materials	N	7,068.3	27.7	1.7	21.4	21.1	12.1	11.8	4.0	4.0	2.3	2.2	9.1	9.1
Construction & Infrastructure	OW	31,987.5	(10.5)	15.9	20.1	17.3	13.8	7.2	2.8	2.9	1.3	1.2	6.9	7.4
Consumer	N	51,399.3	(7.9)	10.0	24.0	21.8	13.6	10.6	4.1	4.5	17.1	18.3	21.4	32.8
Gaming	OW	61,889.8	19.0	10.3	17.4	15.8	6.3	5.3	1.1	1.1	0.6	0.6	4.4	4.6
Healthcare & Pharma.	OW	56,735.5	17.4	15.8	46.1	39.8	22.6	19.7	0.6	0.7	2.4	2.3	5.1	5.6
Media	N	19,365.9	6.6	14.0	20.3	17.8	8.2	1.6	5.0	5.4	5.5	4.9	20.7	21.1
MREIT	OW	28,534.3	30.1	2.0	19.1	18.7	14.6	13.6	5.4	5.6	1.1	1.1	6.1	6.5
Oil & Gas	UW	81,790.4	0.9	3.5	24.0	23.2	13.5	9.2	2.0	2.1	1.9	1.8	4.9	5.3
Plantation	N	130,459.9	27.2	4.9	20.7	19.7	13.9	7.9	2.7	3.0	2.2	2.3	9.1	10.7
Property	OW	35,210.6	(13.9)	4.1	11.8	11.3	9.7	6.9	4.0	4.2	0.9	0.9	7.8	7.9
Rubber Products	N	22,371.9	6.2	11.3	21.7	19.5	14.0	8.4	1.6	1.8	5.0	4.5	16.5	16.3
Technology	N	9,824.5	(9.0)	12.7	15.7	13.9	7.1	5.0	3.2	3.1	2.8	2.7	16.9	17.1
Telecoms	UW	154,239.7	(4.7)	4.6	24.0	23.0	10.6	10.0	3.0	3.2	4.8	4.7	18.2	18.8
Timber	OW	3,444.8	(34.5)	15.0	13.1	11.4	7.4	5.3	2.9	3.0	1.1	1.0	5.2	6.0
Transports & Logistics	UW	69,667.6	6.1	(6.5)	16.4	17.6	9.1	8.9	1.3	1.3	1.2	1.2	9.6	8.3
Utilities	N	173,322.4	2.8	1.6	15.2	15.0	7.4	4.4	2.6	2.6	2.0	1.8	10.5	9.9
Coverage		**1,225,497.5**	**(0.0)**	**6.3**	**18.1**	**17.0**	**11.9**	**8.4**	**3.1**	**3.3**	**2.1**	**2.0**	**9.0**	**9.4**

Source: Bloomberg, Affin Hwang forecasts; note: sector valuations are market-cap weighted and may differ from those in the respective sector parts of this report

Top buys

We have made three additions and five deletions from our top buys list. The three newcomers are Westports, Globetronics and YTL Hospitality REIT while the five deletions are CIMB, Aeon Credit, AFG, Sunway and Petra Energy.

The CIMB, Aeon Credit and AFG from the financials have done well this year, rising 10%, 23% and 10%, respectively. As such, upside to our target price has narrowed while uncertainty on earnings forecasts have arisen stemming from introduction of IFRS 9 that is likely to increase financial institutions' credit costs. This is due to additional profits that is required to be set aside for losses arising from the new 'expected loss model' rather than the existing 'incurred loss model' concept. Our original inclusion of Sunway was to provide blanket exposure to the mass-market property segment given its wide footprint of projects throughout the country. However, the introduction of IOI Properties as a top pick in our post-2Q16 Strategy report two months ago means that both companies are offering similar exposure with many development projects, shopping malls and investment properties portfolio. Moreover, valuation of both companies are similar in terms of PE and dividend yield but IOI Properties is 77% bigger than Sunway in market cap.

Westports. The new addition to our stock universe provides visible long term growth prospects as it plans to expand its port capacity from the current 11m TEUs to 16m by 2020. In addition, the government gazettes port rates in Malaysia and it received an upward revision of 15% in November 2015 in the first phase while the second phase of rate hike of 15% is scheduled for November 2018. Its key client is CMA CGM accounting for 37% of its throughput and is part of the Ocean 3 alliance formed last year with China COSCO and UASC. As such, the alliance has brought additional transhipment volume to Westports. One key difference between our view and the street is that we do not believe there will be substantial loss of business to Port of Singapore Authority (PSA) with CMA CGM's acquisition of Neptune Orient Lines (NOL). This is premised on the already congested port operations at PSA.

Globetronics. Globetronics is making reappearance in our top pick list after a five-month hiatus. At the time, we downgraded the stock to Hold given below expectation orders for its sensor business. However, recent indication of its new light sensor with proximity and ambient light feature that is intended for the entire smartphone and tablet spectrum may be gaining traction for commercialisation. We are forecasting sensor volume for the group to triple from 2016 to above 30m per month in 2017. The stock also offers attractive dividend yield of 6.5-6.9%.

YTL Hospitality REIT. This is a pure hospitality REIT with assets in Malaysia, Japan and Australia. Its brand names include Marriott in Australia and Hilton in Japan, while in Malaysia these include Marriott, Ritz-Carlton, and Vistana. One key characteristic of YTL hospitality REIT is that it offers stable recurring income with step up clauses from its master lease agreement with various companies of the YTL Group. These include most of its Malaysian assets and the Japan operations. There is no shortage of acquisition candidates given the large portfolio of hotel assets under the parent YTL Group that could be injected into YTL Hospitality REIT upon maturity. The yield on the stock is also attractive at 6.7-7%.

Top sells

As for our top sell list, the one change we have made is replacing MAHB with Telekom. While MAHB is still a Sell, we have removed MAHB on the premise that it could have less downside after the government approves hike in passenger service charges.

Telekom Malaysia. We downgraded Telekom post Budget 2017 as the fixed line broadband operator will be required to double the speed by January 2017 while keeping the package price unchanged. Holding everything constant, this should not have an immediate impact on revenue, as the package price is the same. However, there could be subscribers opting for packages with lower prices, while maintaining the same broadband speed. The bigger impact though will come within the next two years as the government has promised to reduce broadband prices by half, thus likely impacting Telekom's revenue unless there is a corresponding offset from higher volume, other government compensation or incentives.

Fig 160: List of our top buys and top sells

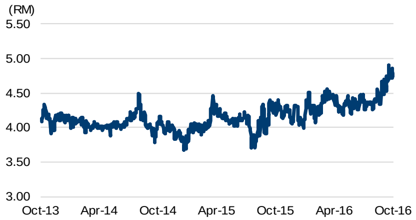
Stock	Rating	Price (RM)	TP (RM)	Upside (%)	Mkt Cap (RMm)	Core PE (x) CY16	Core PE (x) CY17	Core EPS Growth (%) CY16	Core EPS Growth (%) CY17	PBV CY16	PBV CY17	DPS(sen) FY16	DPS(sen) FY17	Div. Yield (%) FY16	Div. Yield (%) FY17	ROE (%) FY16	ROE (%) FY17
Top Buys																	
GAMUDA	BUY	4.90	5.74	17.1	11,869.1	20.6	18.1	(8.7)	13.9	1.7	1.6	12.0	12.0	2.4	2.4	9.6	10.4
GENTING MALAYSIA	BUY	4.74	5.00	5.5	28,144.0	19.1	16.9	14.5	13.3	1.3	1.3	7.1	7.7	1.5	1.6	7.0	7.5
GLOBETRONICS	BUY	3.56	4.88	37.1	1,003.5	34.2	13.1	(58.0)	160.6	3.4	3.3	23.0	24.4	6.5	6.9	8.9	25.0
INARI	BUY	3.33	3.54	6.3	3,198.8	19.0	15.8	4.1	20.3	3.5	3.0	9.0	9.4	2.7	2.8	23.8	24.5
IOI PROPERTIES	BUY	2.49	2.89	16.1	11,014.8	11.2	11.5	4.8	(2.3)	0.7	0.7	8.5	8.5	3.4	3.4	7.4	6.2
JAKS RESOURCES	BUY	1.03	1.60	55.3	451.5	10.1	6.6	483.4	53.9	0.6	0.5	-	-	-	-	6.3	8.2
KPJ	BUY	4.20	5.01	19.3	4,464.7	30.2	28.0	26.2	7.9	3.0	2.9	7.5	8.0	1.8	1.9	9.5	9.7
PAVILION REIT	BUY	1.75	2.00	14.3	5,289.4	19.7	18.4	11.5	6.7	1.4	1.4	8.2	8.8	4.7	5.0	6.3	6.7
PUBLIC BANK	BUY	19.80	21.20	7.1	76,866.3	16.3	15.3	(7.2)	6.1	2.3	2.1	57.0	59.0	2.9	3.0	14.3	14.0
SCICOM	BUY	2.07	2.74	32.4	735.8	16.8	15.1	15.1	10.9	7.3	6.2	8.8	8.9	4.3	4.3	43.8	41.3
SUNWAY CONSTRUCTION	BUY	1.65	2.03	23.0	2,133.3	14.9	12.6	13.6	18.0	4.1	3.5	5.5	6.5	3.3	3.9	27.3	27.9
TA ANN	BUY	3.50	4.67	33.4	1,557.1	11.9	10.9	(38.1)	9.2	1.0	0.9	17.0	17.0	4.9	4.9	9.6	9.9
TENAGA	BUY	14.32	16.50	15.2	80,816.5	10.8	10.5	13.6	3.2	1.5	1.3	33.4	36.2	2.3	2.5	13.5	12.6
TIONG NAM	BUY	1.66	2.10	26.5	694.2	7.4	6.7	24.3	9.3	1.1	0.9	5.8	6.8	3.5	4.1	14.2	14.0
UOA DEVELOPMENT	BUY	2.58	2.64	2.3	4,211.7	11.6	9.7	(21.6)	19.8	1.2	1.1	12.0	14.0	4.7	5.4	9.8	11.1
WCT	BUY	1.69	2.00	18.3	2,124.9	20.1	14.2	(56.2)	41.7	0.9	0.8	6.0	8.0	3.6	4.7	3.7	5.5
WESTPORTS	BUY	4.32	4.90	13.4	14,765.3	22.9	21.4	26.6	6.9	7.2	6.6	14.2	15.2	3.3	3.5	31.4	30.9
YTL REIT	BUY	1.20	1.60	33.3	1,589.3	58.5	52.2	(55.8)	12.2	0.8	0.8	8.0	8.4	6.7	7.0	0.6	1.6
Top Sells																	
MCIL	SELL	0.69	0.50	(27.0)	1,155.8	10.9	11.0	(8.0)	(0.4)	1.2	1.1	4.3	4.4	6.3	6.4	11.1	10.3
MEDIA PRIMA	SELL	1.28	1.03	(19.5)	1,419.8	12.2	12.4	(15.2)	(1.9)	0.8	0.8	7.0	6.9	5.5	5.4	6.7	6.2
STAR	SELL	2.49	2.13	(14.5)	1,839.0	18.0	15.7	(23.9)	15.2	1.6	1.5	18.0	18.0	7.2	7.2	8.6	9.6
UMW-OG	SELL	0.86	0.73	(14.6)	1,848.5	(10.4)	(13.4)	61.9	(22.0)	0.5	0.5	-	-	-	-	(5.2)	(3.9)
UNISEM	SELL	2.59	1.98	(23.6)	1,900.6	13.0	15.2	(9.7)	(15.0)	1.7	1.7	12.3	10.2	4.7	3.9	13.5	10.9
TELEKOM	SELL	6.60	5.85	(11.4)	24,802.4	32.4	31.1	8.7	3.9	3.2	3.3	18.4	19.1	2.8	2.9	11.2	10.6

Source: Affin Hwang forecasts, Bloomberg

Note: In our top Buys, we have added Globetronics, Westports and YTL REIT and removed AEON Credit, AFG, CIMB, Petra Energy and Sunway. In our top Sells, we have added Telekom and removed MAHB.

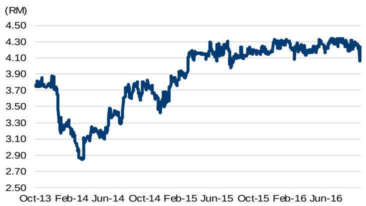
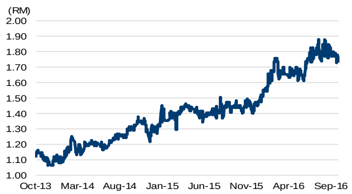
Please find below more details for our top buys and top sells.

Fig 161: individual top buys and top sells

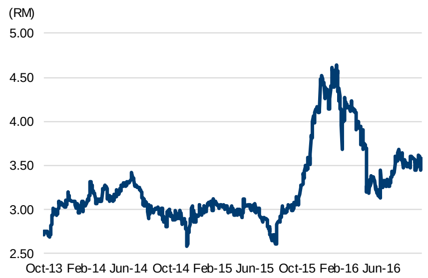
Top BUY	Rating	Analysts' Comments
GAMUDA (GAM MK) Target Price : RM5.74 Share Price as at : RM4.90 26 October 2016 	BUY	Gamuda is our top BUY among the large-cap Malaysian construction stocks with a fully-diluted RNAV-based 12-month target price of RM5.74. Gamuda and its partners have been appointed as the project delivery partner for the RM32bn Klang Valley Mass Rapid Transit Line 2 (MRT2) and RM27bn Penang Transport Master Plan (PTMP). MMC Gamuda Joint Venture was also awarded the RM15.47bn underground works contract for MRT2, while Naim-Gamuda JV clinched the RM1.57bn Pan-Borneo Highway (Sarawak) (PBH) package. The three projects should spur the long-term earnings growth of its construction division. The potential sale of its 40% stake in the Splash water supply concession will provide the funding for its PTMP project.
Genting Malaysia (GENM MK) Target Price : RM5.00 Share Price as at : RM4.74 26 October 2016 	BUY	We have a BUY rating on GENM as we believe that GENM, through its GITP program, will re-energise Genting Highland, providing growth that it was lacking previously. The main catalyst for the stock will be the opening of the facilities or amenities under GITP phase-1, which is expected to be completed by end-2017, with the opening of 20th Century Fox theme park. The opening of the theme park will certainly drive visitation growth, and also increase the overall spending per visitation. The key risk would be the delay in the opening of the theme park.

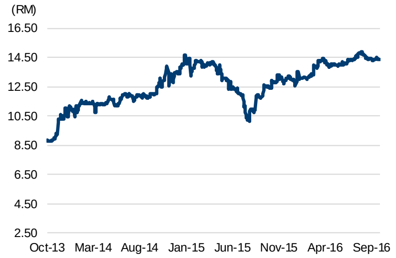
Top BUY	Rating	Analysts' Comments
Globetronics (GTB MK)* Target Price : RM4.88 Share Price as at : RM3.56 26 October 2016  *new addition to our top BUY list	BUY	With the stock price bottoming out and improving prospects from its sensor business, the risk-reward has turned increasingly favourable. We expect Globe's sensors division to record a robust revenue growth of +313% as a new light sensor is expected to be introduced in 2017E coupled with likely mass adoption of its on-going gesture sensor. BUY for target price of RM4.88 (based on 18x 2017E EPS) and attractive potential dividend yield of 7%. If the new light sensor is not designed into the new smartphone, there will likely be downside risk to earnings.
INARI AMERTRON (INRI MK) Target Price : RM3.54 Share Price as at : RM3.33 26 October 2016 	BUY	Inari is a leading RF test house in the region and is poised to further consolidate its position given its solid working relationship with its key customer Broadcom, also a leader in the RF industry. We project that Inari will achieve a 3-year forward net profit CAGR of 17% over 2016-19E, which we believe will continue to be driven by RF expansion in the near term. Longer-term, Inari is well positioned to benefit from the Internet of Things through its fiber-optic division. Trading at 13x 2017E EPS, we believe valuations are attractive considering its growth prospects and exposure to the explosive data story.

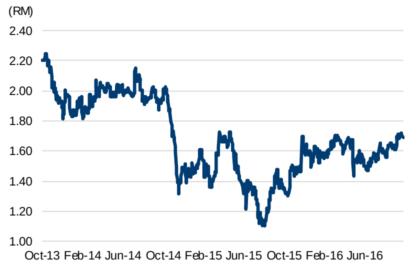
Top BUY	Rating	Analysts' Comments
IOI PROP (IOIPG MK) Target Price : RM2.89 Share Price as at : RM2.49 26 October 2016 	BUY	IOI Properties is seeing strong property development sales especially for The Triling@Clementi project in Singapore. It also benefits from the weak Ringgit on its overseas projects. The higher rental income and occupancy rate for its property investments such as the IOI Resort City will provide a steady stream of recurrent earnings. Its low net gearing puts the group in a strong position to expand via new land bank acquisitions especially in Xiamen, The China. FY17E PER of 12x is undemanding while the potential net yield of over 3.5% is attractive. BUY with a RM2.89 target price, based on a 40% discount to RNAV.
JAKS RESOURCES (JAK MK) Target Price : RM1.60 Share Price as at : RM1.03 26 October 2016 	BUY	We have a BUY rating on JAK. The catalyst for the stock would be when JAK gets the approval for the power plant's detail design from the Vietnam government. The approval is crucial, as it would allow JAK and its partner to ramp up construction work on site, which will be beneficial for JAK as earnings from the EPC contract will pick up pace too. The key risk is continued delay in obtaining the approval from the authority.

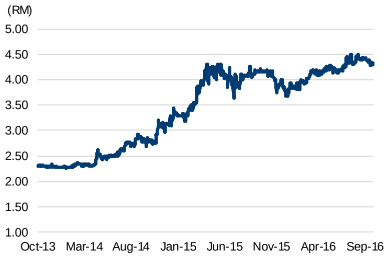
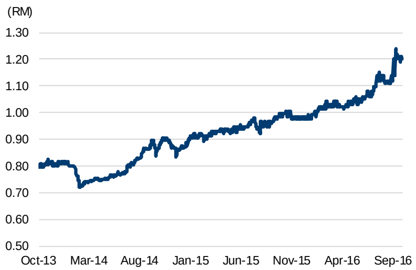
Top BUY	Rating	Analysts' Comments
KPJ (KPJ MK) Target Price : RM5.01 Share Price as at : RM4.20 26 October 2016  	BUY	We believe the private hospital industry has excellent growth prospects, based on expected secular demand growth for private healthcare. KPJ has clear expansion plans based on the expected secular demand growth in its key home markets. The group has laid out plans to develop eight new hospitals and expand eight of its existing hospitals, which will probably add a total of 1,645 beds to its network in Malaysia. Maintain our BUY rating on KPJ with a RM5.01 TP, based on SOTP valuation. We like KPJ for its strong expansion plan and its cheap valuation among regional peers.
Pavilion REIT (PREIT MK) Target Price : RM2.00 Share Price as at : RM1.75 26 October 2016  	BUY	Its retail mall asset (Pavilion Kuala Lumpur, 1.3m sq ft) is currently a major city-centre shopping destination and caters to the higher-income shoppers; hence it does not see a pullback in consumer spending despite the weak market sentiment. Management remains committed to doing yield-accretive AEIs. We believe that there will be more asset injections with the Pavilion Elite (250,000 sq ft), Pavilion Damansara (1m sq ft) and Pavilion Bukit Jalil (1m sq ft) in the pipeline. FY16-18E yields currently stand at 4.7-5.6%.

Top BUY	Rating	Analysts' Comments
Public Bank (PBK MK) Target Price : RM21.20 Share Price as at : RM19.80 26 October 2016 	BUY	PBK remains a defensive bank due to its sound asset quality (lowest gross impaired loan ratio of 0.52%), established franchise in retail banking (No.1 position) and well-capitalised balance sheet. Though the banking industry is faced with moderating loan growth, pressure on NIM and a rising risk of delinquencies, PBB's superior management execution strategies, which had overcome the headwinds during the global financial crisis in 2008-09, should stand the group in good stead. We believe that expansion in overseas operations (Cambodia), increased focus on fee-income generation (unit trust sales, forex structured products) and efficient cost management will offset negative operating factors such as NIM compression.
Scicom (SCIC MK) Target Price : RM2.74 Share Price as at : RM2.07 26 October 2016  *new addition to our top BUY list	BUY	Scicom specializes in business process outsourcing (BPO) and is an attractive e-government service play. The company has seen earnings increase by about 50% in FY14-15 and about 19% in FY16 after being granted the Education Malaysia Global Services (EMGS) contract which effectively commenced in 2013. Moving forward, we believe earnings should continue to expand due to the increase in international students, in line with the government's ETP target of 200,000 students by 2020 as well as margin improvement due to increasing economies of scale and the expansion in services provided. Another key catalyst would be the eventual extension of its e-government services to regional shores. Reaffirm BUY with a 12-month target price of RM2.74, based on a PER of 20x applied to our CY17E EPS. Key risk would be a loss of BPO customers and fewer-than-expected foreign students.

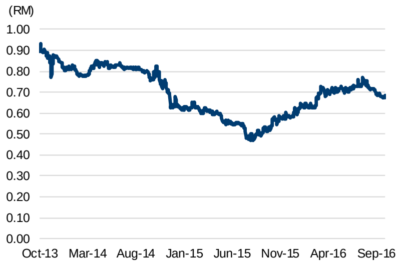
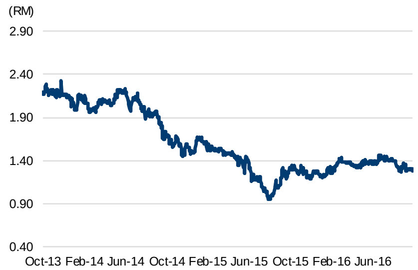
Top BUY	Rating	Analysts' Comments
Sunway Construction (SCGB MK) Target Price : RM2.03 Share Price as at : RM1.65 26 October 2016  	BUY	SCGB is among our top BUYs for mid-cap construction stocks with a RM2.03 target price, based on a 10% discount to its RNAV. We believe its prospects to win new infrastructure projects are good as a pre-qualified contractor for LRT Line 3 and commercial building projects to be rolled out this year. We think SCGB provides pure construction exposure to the cyclical upturn for the sector. Its precast concrete division benefits from the weak Ringgit as it derives revenue in SGD. We also believe that its strong net cash position will support a high dividend payout and attractive net yield of over 3% in FY16E.
Ta Ann (TAH MK) Target Price : RM4.67 Share Price as at : RM3.50 26 October 2016  	BUY	We continue to like Ta Ann for its rising plantation earnings prospects given the increasing matured plantation areas, and FFB and CPO production, as well as an attractive 2017E yield of 4%, in our view. Given the soft timber division, we expect Ta Ann's earnings contribution from the plantation division to surpass that of the timber business. We have a BUY recommendation for Ta Ann and our SOTP-derived 12-month target price is at RM4.67. This is based on 10x our 2017E EPS for its timber division and 15x for its plantation division, and 1x BV for its forest plantation.

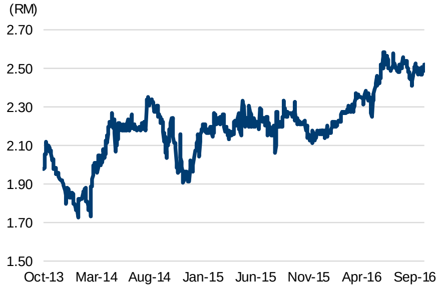
Top BUY	Rating	Analysts' Comments
Tenaga (TNB MK) Target Price : RM16.50 Share Price as at 26 October 2016 : RM14.32 	BUY	We have a BUY rating on TNB. The catalyst would be a higher dividend payout, when the government announces its new capital optimisation plan. The current payout is based on 40%-60% of the company's FCF. Post the implementation of the Imbalance Cost Past Through (ICPT) mechanism, the cash flow for TNB has become more predictable, which is supportive of a higher dividend payout in the future. The key risks would be if the government decides to suspend the ICPT, and to continue with the tariff rebates despite the higher fuel cost.
TIONG NAM (TNL MK) Target Price : RM2.10 Share Price as at 26 October 2016 : RM1.66 	BUY	We like TNL for the resilient and stable logistics and warehousing segment. Rising logistics outsourcing, growing e-commerce fulfilment and increasing cold room requirements should boost demand for TNL's strategically located storage space. A committed and transparent capacity expansion plan increases earnings visibility, while an improving services mix gives room for margin expansion. We expect TNL's capacity to grow at a 9% CAGR and its margin to expand on ongoing productivity gains and lower labour costs driven by the higher automation effort. Aside from logistics, the property development segment is a sizeable earnings driver. We expect the revenue cover of more than a year to sustain earnings visibility in the near term while future growth prospects will be underpinned by undeveloped land banks of more than 150 acres.

Top BUY	Rating	Analysts' Comments
UOA Development (UOAD MK) Target Price : RM2.64 Share Price as at 26 October 2016 : RM2.58 	BUY	We like UOA Development for its strong management, good product branding as well as net cash position (RM652m as at end-June 2016). Being a niche property developer focusing on mid to high-end mixed development projects in Greater Kuala Lumpur, UOA is seeing good take-up rates for launches despite the current weak market and tight bank lending conditions. The company targets to launch another RM1.5bn worth of properties in 2H16. The next key catalyst will be its Jalan Ipoh development, which is expected to mirror the success of the Bangsar South development. Our 12-month target price of RM2.64 is based on a 30% discount to its RNAV.
WCT (WCTHG MK) Target Price : RM2.00 Share Price as at 26 October 2016 : RM1.69 	BUY	WCT is one of our top BUYs among the mid-cap construction stocks with a 12-month target price of RM2.00 based on a 10% discount to its RNAV. WCT clinched RM3.4bn in new contracts in 2015 to extend its order book to RM5.6bn. We believe WCT's prospects to secure more local contracts have improved after it was pre-qualified to bid for the MRT2, LRT3, WCE and PBH projects. The potential construction and shopping mall REIT listings in 1H17 should unlock values and reduce its gearing. We expect a strong 3-year core EPS CAGR of 48% in FY16-18E.

Top BUY	Rating	Analysts' Comments
Westports (WPRTS MK)* Target Price : RM4.90 Share Price as at : RM4.32 26 October 2016  *new addition to our top BUY list	BUY	We expect Westports to be the prime beneficiary of ongoing shipping alliance consolidation and volume aggregation. Its cost advantages and superior productivity will likely continue to underpin its competitiveness against regional peers. Capacity expansion to boost its total annual handling capacity to 16m TEUs by 2020E, up from 11m TEUs presently, should accommodate strong volume growth with comfortable utilisation rates. The upcoming tariff hike revision in 2018 provides strong earnings visibility and likely significant yield improvements, and we forecast a 10% earnings CAGR for FY16E-2020E.
YTL Reit (YTLREIT MK)* Target Price : RM1.60 Share Price as at : RM1.20 26 October 2016  *new addition to our top BUY list	BUY	We are of the view that an investor buying into the stock is getting it cheaper than buying the physical assets, as implied by YTLREIT's P/NAV of 0.83x (30 June 2016). The commencement of a new step-up cycle in the Master Leases in November 2016 and potential asset injection (via YTL Hotels) are key catalysts. The stock has upside potential of 33.3% to our DDM-based 12-month TP of RM1.60 and offers investors FY17-18E DPU yields of 6.7-7.1%.

Source: Bloomberg, Affin Hwang

Top Sell	Rating	
MCIL (MCIL MK) Target Price : RM0.50 Share Price as at : RM0.69 26 October 2016 	SELL	We maintain our SELL rating on Media Chinese International Limited (MCIL), due to the: 1) weakness in its core print division; 2) potentially cautious ad spending in the Malaysia segment given the poor consumer sentiment and the uncertainties in the market; 3) potential ad spending slowdown in the HK/China market as advertisers cut their ad budgets in view of the slow property market as well as the slumping luxury retail sales; and 4) negative effects on hard copy circulation due to the continual shift in reader preferences to reading on mobile devices or over the Internet. Our 12-month target price on the stock is RM0.50, based on 8x 2017E EPS.
Media Prima (MPR MK) Target Price : RM1.03 Share Price as at : RM1.28 26 October 2016 	SELL	We are still less upbeat on Media Prima as earnings continues to disappoint. The weak consumer sentiment, continued market uncertainties coupled with the change in media consumption habits have impacted Media Prima's revenue. We are keeping our SELL rating on the stock with a target price of RM1.03, based on a PER of 10x 2017E EPS.

Top Sell	Rating	
Star (STAR MK) Target Price : RM2.13 Share Price as at : RM2.49 26 October 2016 	SELL	We remain cautious on Star because of: 1) the ongoing challenging outlook for the media industry with adex potentially affected in the quarters ahead from continued uncertainties in the market coupled with poor business and consumer sentiment; 2) it being adversely affected by the shift in adex revenue towards the broadcast segment from print; and 3) negative effects on hard-copy circulation due to the continual shift in reader preferences to reading on mobile devices or over the Internet. Maintain our SELL call on Star with a 12-month target price of RM2.13, based on 13.4x 2017E EPS.
UMWOG (UMWOG MK) Target Price : RM0.73 Share Price as at 26 : RM0.86 October 2016 	SELL	We remain short-term negative and continue to take a cautious stance on UMWOG. With six out of its eight NAGA rigs stacked, earnings outlook is looking rather bleak. We continue to expect UMWOG to register losses for the next 3 years. Based on our stress test, its financial health remains worrying as there appears to be a shortfall of RM246m in settling its short-term debt by taking into account its cash position and likely cash flow for the next 4 quarters. Maintain SELL on the stock with an unchanged TP of RM0.73 based on 0.5x 2016E P/BV.

Top Sell	Rating	
Unisem (UNI MK) Target Price : RM1.98 Share Price as at 26 October 2016 : RM2.59 	SELL	We continue to see high risk to earnings for Unisem given its exposure to the various semiconductor end-markets. The ongoing inventory problem, should it worsen, would accelerate this downturn. Meanwhile, PE valuations are rich and the stock lacks any re-rating catalysts, in our view. We reaffirm our Sell call based on a 12-month TP of RM1.98 (based on an unchanged target PBR of 1x now applied to our 2017E BVPS). Upside risks: better-than-expected demand and stronger-than-expected US$ appreciation.
Telekom Malaysia (TM MK)* Target Price : RM5.85 Share Price as at 26 October 2016 : RM6.60  *new addition to our top BUY list	SELL	While we like TM's dominant broadband position, we think that there is a high risk to earnings from its wireless ambitions. Webe is unlikely to positively turn around in the near term. Meanwhile, recent newsflow on lower broadband prices will likely negatively impact earnings. PE valuations at >30x 2016E core EPS are not compelling while dividend yields at 2.8-3.0% are unexciting. SELL with a 12-month DCF-derived target price of RM5.85 (WACC of 6.9% and terminal growth of 1%). The key risks are a higher-than-expected broadband demand and a quick turnaround in Webe.

Source: Bloomberg, Affin Hwang

Fig 162: Affin Hwang's stock universe

Company name	Rec	Price Current (RM)	Price Target (RM)	Upside /Downside (%)	Market Cap (RMm)	EPS Growth (%) 2016E	EPS Growth (%) 2017E	Core EPS Growth (%) 2016E	Core EPS Growth (%) 2017E	PE (x) 2016E	PE (x) 2017E	EV/EBITDA (x) 2016E	EV/EBITDA (x) 2017E	Yield (%) 2016E	Yield (%) 2017E	P/BV (x) 2016E	P/BV (x) 2017E	ROE (%) 2016E	ROE (%) 2017E
Auto & Autoparts					**8,592**	**1,741.0**	**57.0**	**92.9**	**48.1**	**26.9**	**17.1**	**15.5**	**12.4**	**2.7**	**3.9**	**1.1**	**1.3**	**3.5**	**5.9**
APM AUTOMOTIVE	SELL	3.33	3.10	(6.91)	671.15	11.5	7.0	12.5	7.0	9.7	9.0	3.0	2.3	5.9	6.0	0.6	0.6	6.7	6.7
MBMR	SELL	2.60	1.98	(23.85)	1,015.85	6.9	30.0	6.9	30.0	11.8	9.1	40.7	26.7	2.7	3.1	0.5	0.6	4.0	6.1
UMW	SELL	5.91	4.52	(23.52)	6,904.62	(667.6)	67.7	246.8	67.7	31.3	18.6	16.8	13.1	3.4	5.1	0.9	1.1	2.9	5.6
Banks & Financial Services					**279,593**	**(6.6)**	**8.8**	**0.5**	**11.5**	**13.8**	**12.7**			**3.7**	**4.0**	**1.5**	**1.4**	**9.8**	**10.3**
AEON CREDIT	SELL	14.64	10.00	(31.69)	2,108.16	10.2	12.1	10.3	12.0	8.9	7.9	0	0	4.3	4.8	2.3	1.9	27.7	26.1
AFG	HOLD	3.85	4.10	6.49	5,958.98	2.6	3.3	2.6	3.3	10.9	10.6	0	0	3.9	4.1	1.2	1.1	10.7	10.4
AMMB	HOLD	4.22	4.30	1.90	12,719.86	(5.0)	9.0	(5.0)	9.0	9.2	8.4	0	0	3.9	4.2	0.8	0.7	8.4	8.5
BURSA M'SIA	SELL	8.66	8.80	1.62	4,644.12	(5.4)	0.3	(5.5)	0.3	24.7	24.7	14.0	13.8	3.7	3.7	5.8	5.4	23.6	22.0
CIMB	HOLD	5.01	5.00	(0.20)	43,731.59	20.2	17.8	20.1	17.8	12.4	10.5	0	0	2.4	2.8	1.0	0.9	7.9	8.8
HONG LEONG BANK	HOLD	13.10	13.30	1.53	28,484.99	(4.7)	10.2	(2.6)	7.4	12.3	11.2	0	0	2.6	3.0	1.2	1.1	11.3	12.0
MAYBANK	HOLD	7.92	7.50	(5.30)	80,730.14	(17.2)	11.6	(18.7)	11.6	13.3	11.9	0	0	6.3	6.9	1.3	1.2	9.5	10.2
MBSB	SELL	0.94	0.78	(16.58)	5,421.85	(52.9)	14.3	(52.9)	11.9	22.3	19.5	0	0	1.4	1.5	0.5	0.5	4.7	5.0
PUBLIC BANK	BUY	19.80	21.20	7.07	76,866.34	(7.2)	6.1	(7.2)	6.1	16.3	15.3	0	0	2.9	3.0	2.3	2.1	14.3	14.0
RHB BANK	HOLD	4.72	5.00	5.93	18,927.42	14.5	3.6	(8.3)	(1.1)	7.1	6.9	0	0	2.1	2.3	0.5	0.5	7.4	7.9
Building Materials					**7,068**	**27.7**	**1.7**	**28.2**	**2.2**	**21.4**	**21.1**	**12.1**	**11.8**	**4.0**	**4.0**	**2.3**	**2.2**	**9.1**	**9.1**
CHOO BEE	SELL	2.00	0.94	(53.00)	219.80	78.3	19.6	51.6	19.6	20.6	17.2	7.5	6.5	3.0	3.0	0.5	0.5	2.4	2.9
LAFARGE	HOLD	8.06	8.60	6.70	6,848.54	27.5	1.6	27.5	1.6	21.4	21.1	12.2	12.0	4.3	4.3	2.2	2.1	10.0	9.9
Construction & Infrastructur					**31,987**	**(10.5)**	**15.9**	**(11.1)**	**18.0**	**20.1**	**17.3**	**13.8**	**7.2**	**2.8**	**2.9**	**1.3**	**1.2**	**6.9**	**7.4**
BENALEC	HOLD	0.39	0.53	37.66	312.54	84.9	122.2	88.2	122.2	28.5	12.8	13.1	4.7	3.0	6.5	0.6	0.5	1.9	4.0
EVERSENDAI	BUY	0.51	0.67	31.37	394.74	(154.0)	(346.2)	3.5	14.3	(13.1)	5.3	6.3	5.8	7.8	7.8	0.4	0.4	(3.0)	7.1
GABUNGAN AQRS	BUY	0.91	1.30	42.86	355.69	(383.3)	(2.4)	(1,044.4)	(2.4)	10.7	11.0	6.4	7.1	-	-	1.0	0.9	11.6	10.1
GAMUDA	BUY	4.90	5.74	17.14	11,869.14	(5.4)	13.2	(8.7)	13.9	19.3	17.0	18.2	9.5	2.4	2.4	1.7	1.6	9.6	10.4
IJM CORP	BUY	3.30	3.76	13.94	11,884.87	5.1	13.2	4.9	13.2	21.3	18.8	11.6	2.6	3.0	3.0	1.0	1.0	6.4	5.6
MRCB	BUY	1.40	1.46	4.29	2,912.30	(68.1)	(3.4)	(79.5)	55.3	23.7	24.6	18.9	16.2	1.8	1.8	1.2	1.2	5.6	5.1
SUNWAY CONSTRUCTION	BUY	1.65	2.03	23.03	2,133.29	12.8	18.0	13.6	18.0	14.9	12.6	7.3	5.4	3.3	3.9	4.1	3.5	27.3	27.9
WCT	BUY	1.69	2.00	18.34	2,124.90	(60.4)	56.6	(56.2)	41.7	22.2	14.2	16.8	13.9	3.6	4.7	0.9	0.8	3.7	5.5

Source: Bloomberg, Affin Hwang forecasts; note: prices as of close on 26 October 2016
Note: sector valuations are market-cap weighted and may differ from those in the respective sector parts of this report

Company name	Rec	Price Current (RM)	Price Target (RM)	Upside /Downside (%)	Market Cap (RMm)	EPS Growth (%) 2016E	EPS Growth (%) 2017E	Core EPS Growth (%) 2016E	Core EPS Growth (%) 2017E	PE (x) 2016E	PE (x) 2017E	EV/EBITDA (x) 2016E	EV/EBITDA (x) 2017E	Yield (%) 2016E	Yield (%) 2017E	P/BV (x) 2016E	P/BV (x) 2017E	ROE (%) 2016E	ROE (%) 2017E
Consumer					**51,399**	**(7.9)**	**10.0**	**(10.2)**	**16.5**	**24.0**	**21.8**	**13.6**	**10.6**	**4.1**	**4.5**	**17.1**	**18.3**	**21.4**	**32.8**
AEON CO	HOLD	2.80	2.70	(3.57)	3,931.20	(22.1)	79.7	(22.9)	79.7	37.8	21.1	9.0	6.8	0.9	1.6	1.8	-	4.8	0
BAT	HOLD	48.02	46.90	(2.33)	13,711.15	(28.9)	11.7	(29.0)	11.7	21.2	19.0	17.9	16.1	4.6	5.2	24.0	23.2	113.4	122.3
BONIA	SELL	0.65	0.47	(27.13)	520.06	(10.6)	30.8	(10.8)	21.4	16.5	12.6	7.8	3.2	1.0	1.6	1.0	0.9	5.9	7.3
CARLSBERG	HOLD	14.78	14.40	(2.57)	4,581.08	12.3	2.8	7.7	2.8	18.6	18.1	9.9	9.9	5.4	5.5	5.6	14.6	29.9	80.3
HEINEKEN	BUY	17.14	17.92	4.55	5,177.96	10.1	(17.2)	9.8	(17.2)	15.2	18.4	8.2	5.0	6.1	4.9	11.7	12.0	76.7	65.0
HAI-O	SELL	3.97	2.78	(29.97)	801.37	18.3	11.8	18.2	11.8	19.2	17.2	7.2	2.1	3.6	3.8	2.5	2.6	12.8	15.2
MSM	HOLD	4.89	4.72	(3.48)	3,437.57	(38.2)	53.0	(37.9)	53.0	19.8	12.9	9.1	6.9	3.3	5.0	1.5	1.5	7.4	11.8
NESTLE	HOLD	78.40	78.20	(0.26)	18,384.80	14.8	10.4	14.7	10.4	27.1	24.6	17.2	15.8	3.7	4.0	21.5	20.7	79.2	84.5
PARKSON	SELL	0.76	0.67	(11.26)	854.09	(55.0)	(958.8)	17.3	53.7	(88.8)	10.3	20.7	3.3	0.7	2.0	0.3	0.3	(0.4)	3.0
Gaming					**61,890**	**19.0**	**10.3**	**15.2**	**10.3**	**17.4**	**15.8**	**6.3**	**5.3**	**1.1**	**1.1**	**0.6**	**0.6**	**4.4**	**4.6**
BTOTO	SELL	3.19	2.88	(9.72)	4,309.79	(2.9)	2.1	(2.8)	2.1	13.6	13.3	9.1	2.9	6.0	6.0	4.8	4.5	35.5	33.4
GENTING	HOLD	7.85	9.00	14.65	29,436.09	25.2	9.4	20.1	9.4	16.8	15.4	4.9	4.4	0.4	0.4	0.5	0.5	3.0	3.1
GENTING MALAYSIA	BUY	4.74	5.00	5.49	28,143.96	11.9	13.3	14.5	13.3	19.1	16.9	9.0	7.8	1.5	1.6	1.3	1.3	7.0	7.5
Healthcare & Pharma.					**56,736**	**17.4**	**15.8**	**30.0**	**15.8**	**46.1**	**39.8**	**22.6**	**19.7**	**0.6**	**0.7**	**2.4**	**2.3**	**5.1**	**5.6**
IHH	HOLD	6.35	7.01	10.39	52,270.84	18.0	16.4	30.8	16.4	47.4	40.7	23.6	20.5	0.6	0.6	2.3	2.2	4.8	5.4
KPJ	BUY	4.20	5.01	19.29	4,464.67	11.4	7.9	26.2	7.9	30.2	28.0	15.7	14.3	1.8	1.9	3.0	2.9	9.5	9.7
Media					**19,366**	**6.6**	**14.0**	**(2.5)**	**10.9**	**20.3**	**17.8**	**8.2**	**1.6**	**5.0**	**5.4**	**5.5**	**4.9**	**20.7**	**21.1**
ASTRO	BUY	2.87	3.30	14.98	14,951.33	14.7	15.5	2.2	14.3	21.5	18.6	8.9	0.7	4.5	4.9	13.9	11.4	64.7	61.2
MCIL	SELL	0.69	0.50	(27.01)	1,155.76	(3.9)	2.0	(8.0)	(0.4)	11.2	11.0	6.5	1.5	6.3	6.4	1.2	1.1	11.1	10.3
MEDIA PRIMA	SELL	1.28	1.03	(19.53)	1,419.77	(16.1)	(1.9)	(15.2)	(1.9)	12.2	12.4	4.6	4.3	5.5	5.4	0.8	0.8	6.7	6.2
STAR	SELL	2.49	2.13	(14.46)	1,839.02	(23.4)	15.2	(23.9)	15.2	18.0	15.7	7.7	7.0	7.2	7.2	1.6	1.5	8.6	9.6
MREIT					**28,534**	**30.1**	**2.0**	**103.7**	**4.4**	**19.1**	**18.7**	**14.6**	**13.6**	**5.4**	**5.6**	**1.1**	**1.1**	**6.1**	**6.5**
AXIS REIT	HOLD	1.74	1.67	(4.02)	1,923.00	(1.2)	12.6	5.4	12.6	20.0	17.8	17.7	16.6	5.1	5.6	1.4	1.4	7.2	8.1
IGB REIT	BUY	1.62	1.62	-	5,651.01	15.1	7.8	15.1	7.8	19.2	17.8	15.0	14.0	5.7	6.2	1.5	1.6	8.0	8.7
KLCC	HOLD	7.80	8.00	2.56	14,081.60	39.2	1.0	596.4	1.2	18.6	18.4	13.5	13.6	4.7	4.9	1.2	1.2	6.3	6.3
PAVILION REIT	BUY	1.75	2.00	14.29	5,289.42	(14.5)	6.3	11.5	6.7	21.9	20.6	16.6	15.5	4.7	5.0	1.4	1.4	6.3	6.7
YTL REIT	BUY	1.20	1.60	33.33	1,589.27	(55.8)	12.2	(55.8)	12.2	58.5	52.2	14.1	6.8	6.7	7.0	0.8	0.8	0.6	1.6

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Company name	Rec	Price Current (RM)	Price Target (RM)	Upside /Downside (%)	Market Cap (RMm)	EPS Growth (%) 2016E	EPS Growth (%) 2017E	Core EPS Growth (%) 2016E	Core EPS Growth (%) 2017E	PE (x) 2016E	PE (x) 2017E	EV/EBITDA (x) 2016E	EV/EBITDA (x) 2017E	Yield (%) 2016E	Yield (%) 2017E	P/BV (x) 2016E	P/BV (x) 2017E	ROE (%) 2016E	ROE (%) 2017E
Oil & Gas					**81,790**	**0.9**	**3.5**	**(25.4)**	**8.2**	**24.0**	**23.2**	**13.5**	**9.2**	**2.0**	**2.1**	**1.9**	**1.8**	**4.9**	**5.3**
ALAM MARITIM	HOLD	0.27	0.36	35.85	244.98	(193.8)	(20.0)	(304.5)	(20.0)	(5.9)	(7.4)	950.8	806.1	-	-	0.3	0.3	(4.7)	(3.6)
BUMI ARMADA	HOLD	0.70	0.64	(8.57)	4,106.39	(180.0)	109.4	167.8	109.4	21.9	10.4	16.2	9.3	0.7	1.4	0.5	0.5	2.3	4.7
DIALOG	HOLD	1.53	1.45	(5.23)	8,119.82	7.3	12.7	9.8	18.8	25.9	23.0	22.5	10.1	1.6	1.8	3.4	3.0	13.4	13.6
MMHE	BUY	1.02	1.22	19.61	1,632.00	(3.7)	65.4	(71.7)	65.4	39.2	23.7	9.0	6.4	-	-	0.6	0.5	1.4	2.3
PCHEM	SELL	6.98	5.29	(24.21)	55,840.00	(11.1)	1.9	(11.0)	1.9	22.4	22.0	11.9	11.7	2.3	2.3	2.0	1.9	9.1	8.7
PETRA ENERGY	BUY	0.99	1.48	49.49	318.56	(24.4)	59.5	2.5	59.5	8.2	5.1	15.7	13.4	2.4	3.9	0.6	0.5	6.9	10.0
SAPURA KENCANA	HOLD	1.61	1.36	(15.53)	9,680.15	(111.6)	(35.9)	(79.8)	(13.8)	136.1	212.3	13.4	1.3	0.3	0.1	0.7	0.7	0.5	0.3
UMW-OG	SELL	0.86	0.73	(14.62)	1,848.51	(52.4)	(22.0)	61.9	(22.0)	(10.4)	(13.4)	23.4	19.5	-	-	0.5	0.5	(5.2)	(3.9)
Plantation					**130,460**	**27.2**	**4.9**	**30.3**	**29.0**	**20.7**	**19.7**	**13.9**	**7.9**	**2.7**	**3.0**	**2.2**	**2.3**	**9.1**	**10.7**
FELDA	SELL	2.27	1.41	(37.89)	8,281.31	34.4	118.6	17.0	118.6	52.8	24.1	17.7	12.2	3.5	3.5	1.3	1.2	2.4	5.1
GENTING PLANT	SELL	10.68	9.56	(10.49)	8,473.11	8.5	95.7	13.3	91.3	41.6	21.2	23.4	14.2	1.1	1.1	1.9	1.8	4.5	8.2
HAP SENG PLANT	HOLD	2.43	2.33	(4.12)	1,943.92	5.3	30.7	4.1	30.7	19.1	14.6	10.8	8.6	4.1	4.5	1.0	0.9	5.1	6.4
IJM PLANT	HOLD	3.45	3.53	2.32	3,038.00	153.2	58.5	90.3	62.6	28.9	18.3	16.7	2.9	2.5	2.9	1.7	1.6	6.0	8.8
IOI CORP	HOLD	4.50	4.15	(7.78)	29,078.17	150.4	41.4	79.6	19.4	29.1	20.6	17.9	7.7	2.2	2.7	5.0	4.5	17.6	22.4
KUALA LUMPUR KEPONG	HOLD	24.20	21.70	(10.33)	25,833.62	38.7	(11.4)	15.9	26.3	18.1	20.5	11.2	8.6	2.2	2.5	3.1	4.0	17.4	19.8
SIME DARBY	SELL	8.10	6.74	(16.79)	53,811.75	5.8	10.0	13.7	25.5	20.2	18.4	12.8	6.6	3.5	3.7	1.6	1.6	7.9	8.7
Property					**35,211**	**(13.9)**	**4.1**	**(1.4)**	**7.9**	**11.8**	**11.3**	**9.7**	**6.9**	**4.0**	**4.2**	**0.9**	**0.9**	**7.8**	**7.9**
AMCORP PROP	HOLD	0.79	0.89	12.66	476.42	10.6	64.2	15.1	64.2	6.0	3.6	8.1	3.2	6.8	11.0	0.4	0.4	7.3	10.8
E&O	BUY	1.64	1.98	20.73	2,069.75	(40.9)	37.8	(23.7)	32.0	48.6	35.3	49.2	9.6	1.2	1.2	1.5	1.4	2.1	3.2
IOI PROPERTIES	BUY	2.49	2.89	16.06	11,014.83	(8.9)	(12.5)	4.8	(2.3)	10.0	11.5	7.7	3.9	3.4	3.4	0.7	0.7	7.4	6.2
SP SETIA	HOLD	3.46	3.25	(6.07)	9,751.09	(8.6)	2.5	(4.2)	2.4	14.1	13.7	10.5	8.7	4.0	4.0	1.3	1.4	8.6	10.1
SUNWAY	BUY	3.03	3.90	28.71	6,222.46	(20.1)	12.1	(5.8)	12.1	9.7	8.6	9.2	8.1	3.3	3.6	0.8	0.8	8.0	8.5
TROPICANA	BUY	1.02	1.73	69.61	1,464.29	(11.7)	6.6	103.3	6.6	7.4	7.0	10.1	9.7	6.4	6.4	0.6	0.6	7.8	7.9
UOA DEVELOPMENT	BUY	2.58	2.64	2.33	4,211.73	(21.6)	19.8	(21.6)	19.8	11.6	9.7	5.9	5.5	4.7	5.4	1.2	1.1	9.8	11.1

Source: Bloomberg, Affin Hwang forecasts; note: prices as of close on 26 October 2016
Note: sector valuations are market-cap weighted and may differ from those in the respective sector parts of this report

Company name	Rec	Price Current (RM)	Price Target (RM)	Upside /Downside (%)	Market Cap (RMm)	EPS Growth (%) 2016E	EPS Growth (%) 2017E	Core EPS Growth (%) 2016E	Core EPS Growth (%) 2017E	PE (x) 2016E	PE (x) 2017E	EV/EBITDA (x) 2016E	EV/EBITDA (x) 2017E	Yield (%) 2016E	Yield (%) 2017E	P/BV (x) 2016E	P/BV (x) 2017E	ROE (%) 2016E	ROE (%) 2017E
Rubber Products					**22,372**	**6.2**	**11.3**	**7.0**	**10.4**	**21.7**	**19.5**	**14.0**	**8.4**	**1.6**	**1.8**	**5.0**	**4.5**	**16.5**	**16.3**
HARTALEGA	HOLD	4.88	4.00	(18.03)	8,008.86	11.3	9.4	10.7	9.4	29.0	26.5	16.6	3.8	1.4	1.5	5.1	4.4	17.4	16.7
KAREX	HOLD	2.49	2.50	0.40	2,495.91	6.4	13.3	4.9	18.3	36.0	31.8	21.8	10.8	0.5	0.5	4.9	4.3	13.6	13.7
KOSSAN	HOLD	6.88	6.40	(6.98)	4,399.54	0.3	16.0	0.4	16.0	21.6	18.6	17.7	15.5	2.4	2.7	4.0	3.6	18.6	19.4
SUPERMAX	HOLD	2.16	2.30	6.48	1,469.13	(17.5)	16.2	(17.5)	16.2	14.0	12.1	12.5	12.0	2.6	2.9	1.3	1.2	9.0	9.5
TOP GLOVE	BUY	4.78	5.40	12.97	5,998.47	19.1	5.1	16.9	5.1	16.3	15.5	9.2	5.8	3.1	3.2	3.2	2.9	19.9	18.9
Technology					**9,825**	**(9.0)**	**12.7**	**(1.4)**	**6.3**	**15.7**	**13.9**	**7.1**	**5.0**	**3.2**	**3.1**	**2.8**	**2.7**	**16.9**	**17.1**
AEMULUS	SELL	0.25	0.20	(18.37)	107.52	(75.9)	178.9	(76.0)	178.9	51.6	18.5	155.5	25.9	-	-	1.2	1.0	2.0	5.4
GLOBETRONICS	BUY	3.56	4.88	37.08	1,003.52	(62.9)	188.3	(58.0)	160.6	37.9	13.1	33.4	14.8	6.5	6.9	3.4	3.3	8.9	25.0
INARI	BUY	3.33	3.54	6.31	3,198.76	4.1	22.0	4.1	20.3	19.3	15.8	10.1	4.2	2.7	2.8	3.5	3.0	23.8	24.5
KESM	BUY	9.80	11.00	12.24	421.54	80.1	18.1	64.5	18.1	13.7	11.6	1.4	1.1	0.8	0.9	1.5	1.3	10.7	11.4
MPI	HOLD	8.00	8.25	3.13	1,679.07	3.0	(13.4)	2.6	(20.9)	11.7	13.6	3.3	1.8	2.7	2.5	1.9	1.8	16.6	13.8
SCICOM	BUY	2.07	2.74	32.37	735.79	16.0	9.6	15.1	10.9	16.6	15.1	13.1	5.8	4.3	4.3	7.3	6.2	43.8	41.3
UCHI TECH	HOLD	1.75	1.69	(3.43)	777.70	(5.8)	(0.8)	(16.2)	(0.8)	14.3	14.5	9.7	9.9	6.3	6.3	3.3	3.3	27.1	26.8
UNISEM	SELL	2.59	1.98	(23.55)	1,900.62	(6.5)	(17.5)	(9.7)	(15.0)	12.6	15.2	5.0	5.3	-	-	1.7	1.7	13.5	10.9
Telecoms					**154,240**	**(4.7)**	**4.6**	**(1.6)**	**6.7**	**24.0**	**23.0**	**10.6**	**10.0**	**3.0**	**3.2**	**4.8**	**4.7**	**18.2**	**18.8**
AXIATA	HOLD	5.08	5.50	8.27	45,345.18	(29.4)	20.3	(18.5)	20.3	24.5	20.4	8.7	8.0	3.3	3.9	2.0	2.0	8.4	9.8
DIGI	HOLD	5.02	5.09	1.39	39,030.50	(1.6)	0.9	2.2	(3.1)	23.0	22.8	14.7	14.3	4.3	4.4	56.9	56.9	247.2	249.9
MAXIS	HOLD	6.00	6.08	1.33	45,061.68	16.6	(1.5)	13.5	-	22.2	22.6	13.1	12.8	3.3	3.3	9.1	8.9	40.8	39.5
TELEKOM	SELL	6.60	5.85	(11.36)	24,802.37	21.9	(7.0)	8.7	3.9	28.9	31.1	8.5	8.0	2.8	2.9	3.2	3.3	11.2	10.6
Timber					**3,445**	**(34.5)**	**15.0**	**(14.7)**	**16.2**	**13.1**	**11.4**	**7.4**	**5.3**	**2.9**	**3.0**	**1.1**	**1.0**	**5.2**	**6.0**
JAYA TIASA	BUY	1.39	1.53	10.07	1,353.47	68.6	37.3	52.0	23.3	17.6	12.8	7.7	3.6	1.2	1.5	0.7	0.7	4.1	5.4
TA ANN	BUY	3.50	4.67	33.43	1,557.09	(41.4)	9.2	(38.1)	9.2	11.9	10.9	7.1	6.4	4.9	4.9	1.0	0.9	9.6	9.9
WTK	BUY	1.11	1.25	12.61	534.27	(42.3)	27.8	(50.2)	27.8	15.4	12.1	7.8	7.0	2.3	2.3	0.4	0.4	2.4	3.0

Source: Bloomberg, Affin Hwang forecasts; note: prices as of close on 26 October 2016
Note: sector valuations are market-cap weighted and may differ from those in the respective sector parts of this report

Company name	Rec	Price Current (RM)	Price Target (RM)	Upside /Downside (%)	Market Cap (RMm)	EPS Growth (%) 2016E	EPS Growth (%) 2017E	Core EPS Growth (%) 2016E	Core EPS Growth (%) 2017E	PE (x) 2016E	PE (x) 2017E	EV/EBITDA (x) 2016E	EV/EBITDA (x) 2017E	Yield (%) 2016E	Yield (%) 2017E	P/BV (x) 2016E	P/BV (x) 2017E	ROE (%) 2016E	ROE (%) 2017E
Transports & Logistics					**69,668**	**6.1**	**(6.5)**	**26.5**	**0.1**	**16.4**	**17.6**	**9.1**	**8.9**	**1.3**	**1.3**	**1.2**	**1.2**	**9.6**	**8.3**
AIRASIA	HOLD	2.80	3.13	11.79	7,792.05	141.8	(33.3)	205.0	(19.1)	6.0	8.9	6.8	7.9	0.8	0.5	1.2	1.1	24.0	14.5
AIRASIA X	HOLD	0.44	0.47	6.82	1,825.19	(189.6)	23.2	(169.6)	56.0	4.6	3.8	5.5	5.1	-	-	(5.4)	(2.4)	(115.8)	(63.6)
MAHB	SELL	6.50	5.40	(16.92)	10,784.75	(355.8)	133.3	(660.7)	133.3	197.0	84.4	8.7	7.9	0.2	0.4	1.5	1.4	0.7	1.7
MISC	SELL	7.58	6.70	(11.61)	33,835.55	(2.5)	(8.2)	(23.7)	(0.2)	14.1	15.3	10.3	10.0	1.4	1.3	0.9	0.9	6.5	5.7
TIONG NAM	BUY	1.66	2.10	26.51	698.84	22.5	9.3	24.3	9.3	7.4	6.8	5.8	1.3	3.5	4.1	1.1	0.9	14.2	14.0
WESTPORTS	BUY	4.32	4.90	13.43	14,731.20	27.6	6.9	26.6	6.9	22.9	21.4	14.3	13.4	3.3	3.5	7.2	6.6	31.4	30.9
Utilities					**173,322**	**2.8**	**1.6**	**8.4**	**0.4**	**15.2**	**15.0**	**7.4**	**4.4**	**2.6**	**2.6**	**2.0**	**1.8**	**10.5**	**9.9**
GAS MALAYSIA	HOLD	2.62	2.36	(9.92)	3,364.08	20.9	5.0	20.9	5.0	26.2	25.0	12.2	11.9	3.8	4.0	3.2	3.2	12.2	12.8
JAKS RESOURCES	BUY	1.03	1.60	55.34	451.51	7.6	53.9	483.4	53.9	10.1	6.6	8.4	5.4	-	-	0.6	0.5	6.3	8.2
MALAKOFF	HOLD	1.57	1.65	5.10	7,850.00	(1.8)	-	(12.8)	-	16.4	16.4	7.7	7.2	4.6	4.6	0.9	0.8	5.7	4.7
MMC	HOLD	2.35	2.35	-	7,155.89	(74.6)	2.9	17.6	2.9	17.2	16.7	29.0	28.0	1.7	1.7	0.6	0.6	3.6	3.6
PETRONAS GAS	HOLD	21.92	20.24	(7.66)	43,373.81	(10.0)	(2.0)	(10.1)	(2.0)	24.2	24.7	15.1	14.7	2.5	2.4	3.5	3.4	14.6	13.7
TENAGA	BUY	14.32	16.50	15.22	80,816.51	14.2	3.2	13.6	3.2	10.8	10.5	4.5	2.1	2.3	2.5	1.5	1.3	13.5	12.6
YTL CORP	HOLD	1.65	1.70	3.34	17,933.41	(0.5)	7.5	5.0	7.5	17.7	16.5	7.5	3.5	7.3	7.3	1.0	1.0	5.7	5.9
YTL POWER	HOLD	1.52	1.60	5.26	12,377.24	(0.3)	(0.7)	(3.5)	(0.8)	11.2	11.3	9.3	4.7	6.6	6.6	1.0	1.0	8.9	8.6
Market Total					**1,225,498**	**(0.0)**	**6.3**	**(1.8)**	**8.5**	**18.1**	**17.0**	**11.9**	**8.4**	**3.1**	**3.3**	**2.1**	**2.0**	**9.0**	**9.4**

Source: Bloomberg, Affin Hwang forecasts; note: prices as of close on 26 October 2016
Note: sector valuations are market-cap weighted and may differ from those in the respective sector parts of this report

2017 Outlook: Disruptive headwinds looming

We turn more cautious on the banking sector's outlook in 2017, due to challenges in driving growth and profitability, maintaining asset quality, meeting regulatory compliance, managing overhead and the adoption of new technologies, which are likely to dampen banks' profitability. We foresee challenges to meeting our earnings-growth targets of 14% yoy in 2017 and 6.3% yoy 2018. We note that there are downside risks to our BUY and HOLD calls. Hence, we downgrade the sector from OVERWEIGHT to NEUTRAL.

Downgrade to NEUTRAL; Macro and sector headwinds looming

In 2017, the spotlight should be on the banks' strategies to drive earnings growth and profitability, as they navigate through macro and sector-specific challenges, such as: i) sluggish industry loan growth (ytd to August 2016 1.9%); ii) continued NIM compression; iii) potential deterioration in asset quality; iv) mitigating fraud/cybersecurity; v) keeping up with fintech; vi) keeping cost-pressures in check; and vii) changing priorities in light of the IFRS 9 implementation by Jan-18. In fact, given the complexity and sophistication of the implementation of IFRS 9, we believe banking institutions could moderate or scale back expansion plans as they develop new expected credit-loss methodologies and models, and employ new systems and corporate-governance framework, which would determine profitability.

Earnings and industry outlook – visibility and momentum

In our view, there could be risks to our current core net earnings forecast of RM23.3bn (+13.9% yoy) for 2017 (vs. a 3.6% yoy decline in 2016E) as well as a 6.3% yoy growth in 2018. In 2017, more sluggish loan growth of low- to mid-single-digit growth, higher IT expenses and one-off impairments could derail banks' earnings.

Our view and strategy for 2017 – sector remains lacklustre

We reiterate our focus on banks with a steady amount of reserves (including regulatory reserves), with a good track record of asset quality and adequate capital buffers in light of looming uncertainties. While maintaining sector exposure, investors should also focus on banks with higher ROE generation (Public Bank, AFG, Hong Leong Bank, Maybank, CIMB), which also have a track record of generating consistent profits.

Sector Outlook

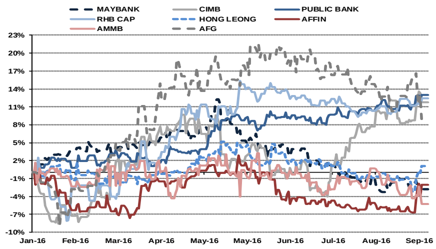
Banking

NEUTRAL (downgrade)

Absolute Performance (%)

	1M	3M	12M
AFG	(0.8)	(5.4)	+6.3
AMMB	(0.7)	(4.8)	(15.0)
CIMB	+4.8	+17.9	+3.9
HLBB	+2.3	+0.3	(1.6)
Maybank	+3.2	(2.5)	(8.4)
PBB	(0.9)	+0.8	+7.4
RHB Cap	+1.3	(7.9)	+2.5
MBSB	+1.6	+29.2	(40.7)
Affin (Not rated)	-	(0.1)	+12.8
BIMB (Not rated)	(0.9)	+1.4	(10.0)

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Tan Ei Leen
(603) 2146 7543
eileen.tan@affinhwang.com

Loh Jia Ying
(603) 2146 7546
jiaying.loh@affinhwang.com

Peer Comparison

Stock	Rating	Price (RM)	PT	Mkt Cap	Core PE (x)		Core EPS (sen)		P/BV (x)		ROE (%)		Net Yield (%)		Net DPS (sen)	
		26-Oct	(RM)	(RMm)	CY16E	CY17E	CY16E	CY17E	CY16E	CY17E	CY16E	CY17E	CY16E	CY17E	CY16E	CY17E
AFG	HOLD	3.85	4.10	5,871	10.9	10.6	35.2	36.4	1.11	1.05	10.6	10.1	3.8	3.9	14.5	15.0
AMMB	HOLD	4.22	4.30	12,720	9.5	8.4	44.5	50.2	0.79	0.73	8.6	9.0	3.7	4.0	15.5	17.0
CIMB	HOLD	5.01	5.00	43,732	12.4	10.5	40.4	47.6	1.00	0.95	8.2	9.2	2.4	2.8	12.0	14.2
HLB	HOLD	13.36	13.30	27,417	11.8	11.0	113.5	121.9	1.28	1.19	10.1	11.0	2.2	2.9	29.3	38.3
Maybank	HOLD	7.92	7.50	79,270	13.3	11.9	59.6	66.5	1.13	1.03	9.0	9.1	6.3	6.9	50.0	55.0
PBB	BUY	19.80	21.20	76,458	16.3	15.3	121.7	129.1	2.28	2.10	14.5	14.3	2.9	3.0	57.0	59.0
RHB	HOLD	4.72	5.00	18,927	8.8	8.9	53.5	52.9	0.84	0.78	9.3	9.1	2.1	2.3	10.0	11.0
Affin	Not rated	2.20	-	4,274	9.6	8.9	22.8	24.8	0.49	0.46	5.2	5.4	4.0	4.3	8.7	9.5
AEONCS	SELL	14.64	10.00	2,108	10.0	7.9	146.3	184.3	2.24	1.89	26.1	25.8	4.3	4.9	63.7	71.3
MBSB	SELL	0.94	0.78	3,783	22.4	19.6	4.2	4.8	0.81	0.79	4.2	4.1	1.8	1.8	1.7	1.7
Financial sector weighted average (ex MBSB, AEONCS, PBB)					**12.6**	**10.8**			**1.06**	**0.96**	**9.0**	**9.4**	**4.1**	**4.6**		
Financial sector weighted average					**13.2**	**11.6**			**1.20**	**1.09**	**9.6**	**9.8**	**3.7**	**4.1**		

Source: Affin Hwang forecasts, Bloomberg

Possible catalysts – upside and downside

Positive catalysts: A recovery in the economy and a decline in the budget deficit, government incentives to spur lending activity, a recovery in banks' credit costs (write-back of impairments and reclassification to performing assets), a rebound in the Ringgit and M&A activities.

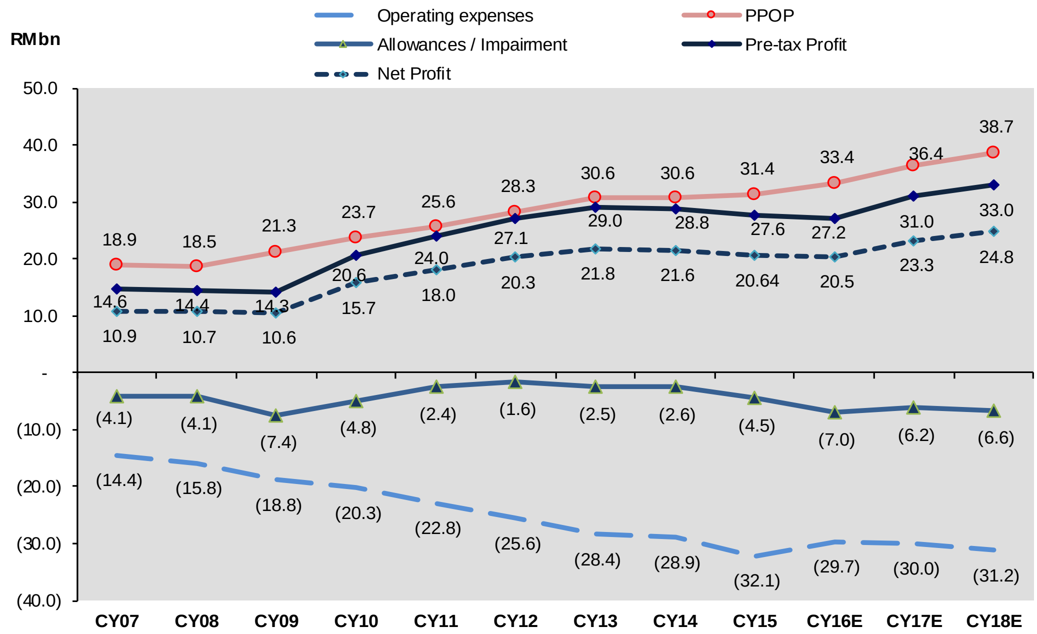
Negative catalysts: Emergence of a twin deficit (trade and budget) due to a further slide in oil and commodity prices, rising unemployment causing a spike in bank defaults, declines in real estate prices, and interest-rate cuts.

Valuation and recommendation, key stock ideas

We downgrade the Malaysian banking sector from **OVERWEIGHT** to **NEUTRAL** as we expect the earnings outlook to be muted in 2017-18. We believe banks will be repositioning their books for the implementation of the IFRS 9 standards while asset size growth should be muted. Based on these uncertainties, we would stick to banks with sound asset quality.

i) **Public Bank (PBK MK, BUY, TP: RM21.20 @ 2.25x CY17E P/BV**) remains a defensive bank due to its sound asset quality (lowest gross impaired loan ratio of 0.52%), established franchise in retail-banking (No.1 position) and well-capitalised balance sheet. Though the banking industry is faced with moderating loan growth, pressure on NIM and a rising risk of delinquencies, PBB's superior management execution strategies have proven that the group managed to overcome these headwinds during the global financial crisis in 2008-09. We believe that expansion in overseas operations (Cambodia), increased focus on fee-income generation (unit trust sales, forex structured products) and efficient cost management will offset negative operating factors such as NIM compression.

Fig 1: Malaysia banking sector: Earnings growth trend and 2016-18 forecasts



Source: Companu, Affin Hwang forecasts

Fig 2: Impaired loan coverage (incl. regulatory reserves)

Impaired Loan Cover (%) including regulatory reserves	As at Jun16
Affin	89.8
AFG	83.9
AMMB	81.2
CIMB	95.9
HLB	180.0
Maybank	73.6
PBB	246.6
RHB Cap	79.2

Source: Company data, Affin Hwang

Fig 3: Gross impaired loan ratio

Gross Impaired Loan ratio (%)	2QCY16
Affin	1.98
AFG	1.24
AMMB	1.69
CIMB	3.20
HLB	0.79
Maybank	2.34
PBB	0.49
RHB Cap	2.06

Source: Company data, Affin Hwang

Fig 4: Capital adequacy ratios

Capital ratios (%) (Group Level)	2Q16		
	CET1	Tier-1	Total Capital
Affin	12.1	12.1	14.9
AFG	11.8	11.8	16.3
AMMB	11.5	12.5	16.4
CIMB Group	10.7	12.2	15.6
HLB	12.7	13.1	14.7
Maybank	13.8	15.5	19.2
PBB	11.1	12.0	15.4
RHB Capital	13.0	13.3	17.2

Source: Company data, Affin Hwang

Fig 5: Credit cost (annualized), including impairments

Annuallized credit cost (bps)	1QCY16	2QCY16
Affin	(1.4)	2.0
AFG	0.2	20.1
AMMB	(26.5)	(29.3)
CIMB	70.2	88.3
HLB	6.0	(18.1)
Maybank	77.9	103.7
PBB	9.7	9.9
RHB Cap	21.2	82.3
Industry	**41.1**	**106.6**

Source: Company data, Affin Hwang

Oversupply persists

Oversupply persists in the cement sector on falling demand and new capacity additions in 2016. But the prospects for the steel industry have improved with the curtailing of production at several plants facing financial problems, while Chinese imports have declined. Building material demand should rise in 2017, as new infrastructure projects kick off, supporting a sector earnings recovery. We remain NEUTRAL on the sector with a HOLD call on Lafarge Holcim.

Likely key focus for 2017

The building material sector is facing falling demand in 2016 due to the near completion of major infrastructure projects and fewer new-property launches. Cement production declined 8.6% yoy to 10.3m mt in 1H16. Total additional cement/clinker production capacity of 5.2m mt p.a. (about a 29% increase in clinker installed capacity) from three companies was fully commissioned in 2016. This, coupled with falling demand, should continue to put pressure on average selling prices (ASP) in 2016 as the oversupply situation persists. But building material demand should pick up in 2017 with the acceleration of work on major infrastructure projects, such as the Klang Valley MRT Line 2 and LRT Line 3.

Earnings outlook – visibility, momentum and risk

We think earnings forecast risk for Lafarge remains high in 2H16 due to the current oversupply situation leading to stiff price competition to gain market share among the six major cement producers in the country. Merger integration costs and rising coal prices should also squeeze profit margins. We look for lower labour costs post-rationalisation and a recovery in cement demand to support an earnings rebound in 2017. Earnings for steel manufacturers likely have peaked in line with steel bar ASPs in 2Q16 and should ease as ASPs decline. We expect the fall in steel bar exports from China and the hike in steel import duties would help stabilise local steel bar prices and hence local steel company earnings in 2017.

Our view and strategy for 2017

Weaker building material demand from slower property development activities should partly offset growing demand from the infrastructure sector as works on major projects accelerate. As price competition is expected to remain stiff, this remains a key challenge for domestic cement manufacturers in 2017. We reiterate our **NEUTRAL** stance on the building material sector and our **HOLD** rating on Lafarge Holcim.

ASEAN peer comparison for cement manufacturers

Company	BBG	Rec	Shr Price (LC)	Tgt Price (LC)	Mkt Cap (USDm)	PER (x)		EV/EBITDA (x)		P/BV (x)		Div Yield (%)		ROE (%)		EPS gr (% yoy)	
						CY16E	CY17E	CY16E	CY17E	CY16E	CY17E	CY16E	CY17E	CY16E	CY17E	CY16E	CY17E
Lafarge	LMC MK	HOLD	8.08	8.60	1,645	40.3	28.5	16.2	13.1	2.2	2.2	2.2	3.0	6.2	8.1	(36.9)	41.7
Indocement	INTP IJ	NR	16,695		4,726	14.3	14.4	8.9	8.3	2.3	2.2	3.6	3.8	17.0	15.1	1.7	(1.1)
Semen Gresik (Persero) PT	SMGR IJ	NR	10,072		4,594	14.1	13.1	8.4	7.6	2.1	1.9	3.0	3.0	15.3	15.1	(3.4)	7.3
Holcim Indonesia TBK PT	SMCB IJ	NR	990		583	22.3	21.2	7.3	7.2	0.8	0.8	1.9	2.6	3.8	3.6	51.7	4.9
Siam City Cement	SCC TB	NR	298		1,958	13.9	12.8	9.9	9.2	2.7	2.4	5.1	5.3	19.5	18.9	8.2	8.7
Wgt Avg						**17.7**	**15.7**	**9.7**	**8.7**	**2.2**	**2.1**	**3.4**	**3.6**	**14.9**	**14.3**	**(1.6)**	**8.6**

Source: Bloomberg, Affin Hwang forecasts
Note: Closing prices as of 26 October 2016,

Sector Outlook

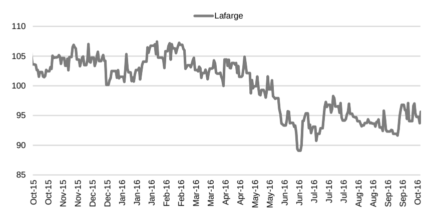
Building materials

NEUTRAL (maintain)

Absolute Performance (%)

	1M	3M	12M
Lafarge	+1.0%	+0.6%	-12.1%

Relative Performance (%)



Source: Affin, Bloomberg

Loong Chee Wei CFA
(603) 2146 7548
cheewei.loong@affinhwang.com

Possible surprises – upside and downside, and catalysts

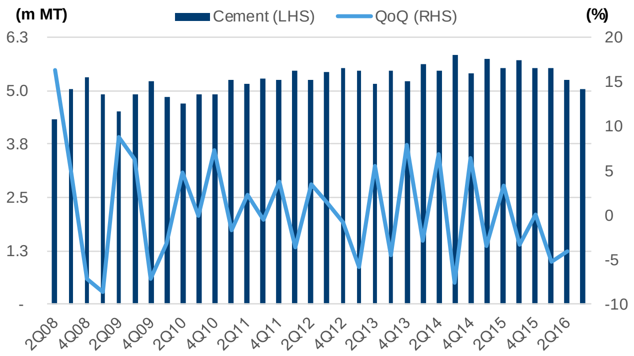
Possible upside for the cement companies could come from a rebound in net ASP (after rebates) if current stiff price competition eases. This would be a major catalyst for cement earnings given the high sensitivity to ASP changes. A further decline in Chinese steel imports would likely reduce competition for local steel manufacturers. China pledged to cut steel exports at the G20 meeting this year by closing down small inefficient plants. There could be higher cost pressure if raw material and fuel prices rise, which would be a key downside risk for the building material sector.

Valuation and recommendation, key stock ideas

We reiterate our Neutral call on the building material sector, as the oversupply situation has persisted while cost pressure is on the rise as commodity prices rebound.

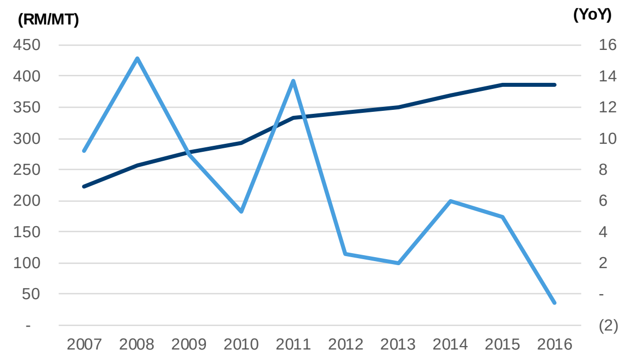
We have a HOLD call on **Lafarge Holcim** due to what we view as a reasonable FY17E net yield of 3%, but its PER remains high at 28x compared to its ASEAN peer average of 16x. The high PER is supported by strong FY17E EPS growth of 42% yoy.

Fig 1: Domestic cement production quarterly



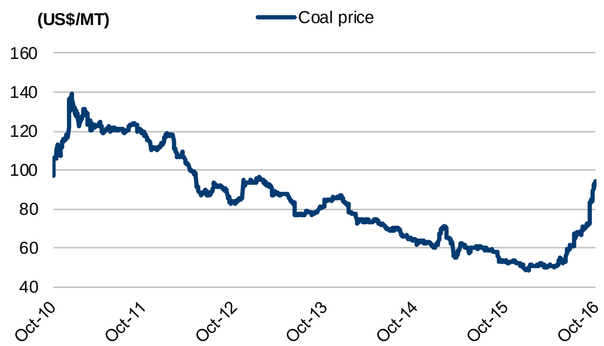
Source: CIDB, CEIC

Fig 2: Cement ASP



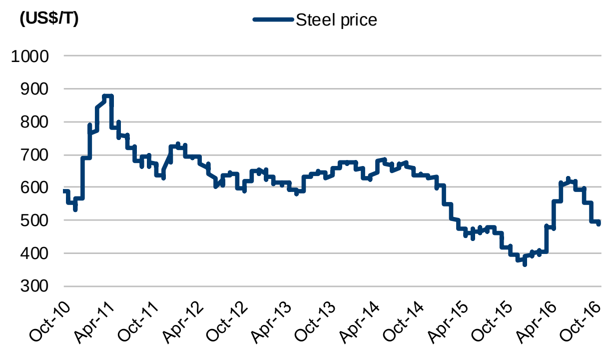
Source: Bloomberg, CIDB, CEIC

Fig 3: Coal price



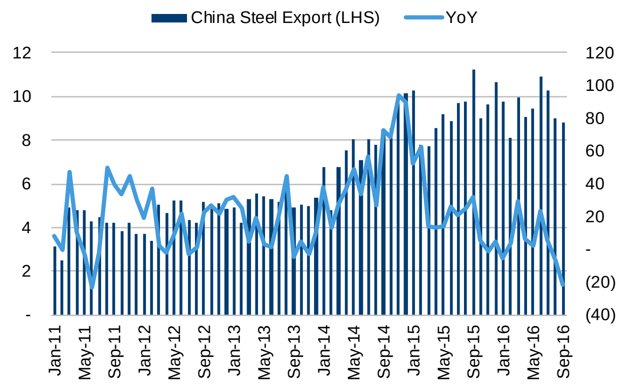
Source: Bloomberg

Fig 4: Steel price



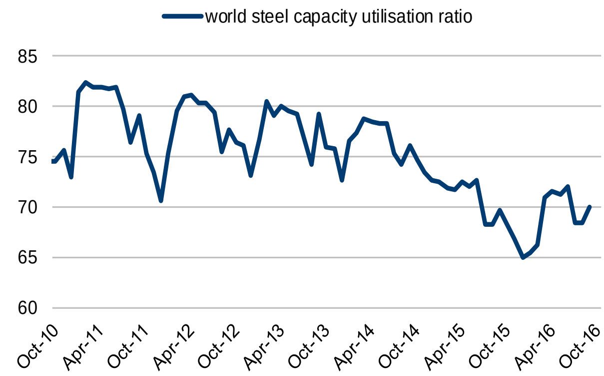
Source: Bloomberg

Fig 4: Steel price



Source: Bloomberg

Fig 6: Global steel capacity utilisation



Source: Bloomberg

Healthy pipeline

Most construction companies have record-high order books, which should spur core sector EPS growth to 15% yoy in 2017E, after staying flat in 2016E. With RM98bn in large-scale infrastructure projects likely to kick off in 2017, supporting the replenishment of the construction companies' order books, we remain Overweight on the sector. Our top picks are Gamuda, Sunway Construction and WCT.

Likely key focus for 2017

The implementation of the RM55bn East Coast Rail Line (ECRL) project under the recently-announced Budget 2017 highlights the government's continued thrust to expand the national-railway network. The plan will likely form part of China's One Belt, One Road initiative to strengthen bilateral ties by improving infrastructure and transport connectivity with other Asian countries. This is in addition to the Gemas-Johor Bahru Double Tracking project undertaken by a consortium of Chinese contractors. Local contractors will likely participate as subcontractors. Other major infrastructure projects to be launched are the RM9bn Light Rail Transit Line 3 and RM12.8bn Pan Borneo Highway (Sabah). The remaining civil packages for the RM32bn Mass Rapid Transit Line 2 project will likely be awarded in 2017. Another potential government project to be implemented is the RM3bn Central Spine Road.

Earnings outlook – visibility, momentum and risks

As most construction companies have record-high order books, their earnings visibility is good, in our view. Building-material prices remain stable currently and, hence, the risk of a hit to profit margins is low. We expect sector EPS to remain flat in 2016E as new contracts secured have not contributed significantly, while existing projects are at the tail end. We look for sector EPS growth of 15% yoy in 2017E driven by contribution from new projects and a recovery in property earnings.

Our view and strategy for 2017

The potential beneficiaries of the major infrastructure projects mentioned above would be Gamuda, Suncon, WCT and Gabungan AQRS. These companies, in addition to Mudajaya (not rated) and WZ Satu (not rated) are looking to submit bids. Overweight the construction sector. We see better values in mid and small-cap construction stocks. Our top sector picks are Gamuda (among large caps), Suncon and WCT (mid caps), Gabungan AQRS (small caps).

Sector Outlook

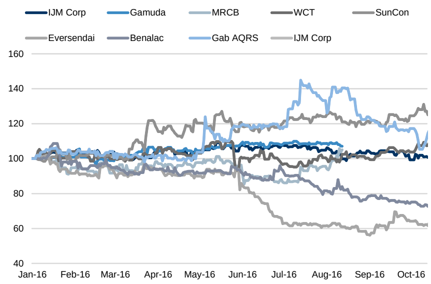
Construction

OVERWEIGHT (maintain)

Absolute Performance (%)

	1M	3M	12M
IJM Corp	+1.2	-1.8	-0.6
Gamuda	+2.3	+1.6	+7.8
MRCB	+6.2	+17.9	+16.0
WCT	+4.9	+6.9	+25.0
SunCon	+2.5	-0.6	+27.7
Eversendai	+4.1	+10.9	-35.4
Benalec	-6.1	-12.5	-34.2
Gab AQRS	-4.2	-17.3	+8.3

Relative Performance (%)



Source: Affin Hwang estimates, Bloomberg

Loong Chee Wei CFA
(603) 2146 7548
cheewei.loong@affinhwang.com

Peer Comparison

Stock	Bbg	Rating	Sh Pr (RM)	TP (RM)	Mkt cap (USD bn)	Core PER (x) CY16E	Core PER (x) CY17E	Core EPS gr (%) CY16E	Core EPS gr (%) CY17E	P/BV (x) CY16E	ROE (%) CY16E	DY (%) CY16E
IJM Corp	IJM MK	BUY	3.30	3.76	3.2	21.3	18.8	3.5	13.3	1.1	5.9	3.0
Gamuda	GAM MK	BUY	4.90	5.74	3.2	20.6	18.1	(7.7)	14.0	1.7	9.8	2.4
MRCB	MRC MK	BUY	1.40	1.46	0.8	33.7	24.5	218.6	37.5	1.1	3.1	1.8
WCT Hldgs	WCTHG MK	BUY	1.69	2.00	0.6	20.2	14.2	52.0	42.2	0.8	4.5	3.6
Sunway Construction	SCGB MK	BUY	1.65	2.03	0.6	14.9	12.6	5.0	18.6	4.1	29.4	3.3
Eversendai	EVSD MK	BUY	0.51	0.67	0.1	6.1	5.3	9.2	14.6	0.4	6.5	1.0
Benalec	BHB MK	HOLD	0.39	0.53	0.1	13.6	9.4	83.8	44.9	0.5	4.1	3.9
Gabungan AQRS	AQRS MK	BUY	0.91	1.30	0.1	10.7	11.0	NA	(2.9)	1.0	12.3	0.0
Malaysian wgt avg						**20.7**	**18.0**	**0.4**	**15.4**	**1.2**	**6.7**	**2.5**

Source: Affin Hwang forecasts, Bloomberg
Note: Prices as of close on 26 October 2016

Possible surprises – upside and downside, and catalysts

According to Construction Industry Development Board (CIDB) statistics, the revised construction contract awards had rebounded 7% yoy and 19% qoq to RM39.3bn in 1Q16. Contract awards fell 40% yoy and 56% qoq to RM17.2bn in 2Q16, but we believe this was due to reporting delays as new contract awards were high. According to news reports, work packages worth about RM23bn for MRT Line 2 and RM15-16bn for Pan Borneo Highway (Sarawak) were awarded mostly in 2Q16 but partly in 3Q16. We expect RM98bn worth of remaining packages for large-scale infrastructure projects launched and new ones to be launched to sustain the high level of contract awards in 2016-17.

The key catalyst for construction stock performance would be the roll out of major infrastructure projects announced that would drive construction-order-book expansion. Possible upside surprise would be the finalization of the agreement between the governments of Malaysia and Singapore by the end of this year. This would add the RM60bn Kuala Lumpur-Singapore High Speed Rail project in the long-term infrastructure pipeline.

Key sector risks would be profit margin erosion if building material and labour costs were to rise, property demand were to remain weak and project implementation were to be delayed.

Valuation and recommendation, and stock ideas

Suncon is a top sector pick among mid-cap names as its 2017E PER valuation of 13x is one of the most attractive, while its net dividend yield of over 3% looks reasonable, supported by high net cash backing of RM0.24/share (15% of market capitalization). Our 12-month target price is RM2.03, based on a 10% discount to our RNAV/share of RM2.26.

WCT's asset monetization and de-gearing plans should put the group in a stronger financial position to pursue new public-private partnership projects. Its current high 2017E PER of 14x is undemanding in our view, supported by strong three-year core EPS CAGR of 43% in 2016-18E. We reaffirm our BUY call and 12-month target price of RM2.00, based on a 10% discount to our RNAV/share of RM2.22.

Among the larger caps, with the project delivery partner and underground contracts for the MRT Line 2 secured, **Gamuda** should see a rebound in earnings in FY17E (July year end). We reaffirm our BUY call and RNAV-based 12-month target price of RM5.74.

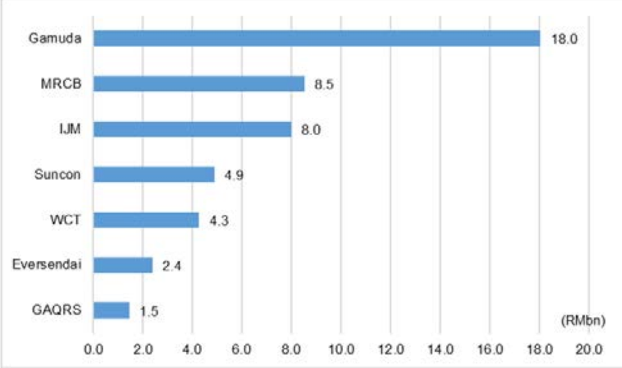
Gabungan AQRS is our top small-cap construction pick given the surge in current order book to RM1.45bn and the planned 2017 kick off for its One Jesselton waterfront property development project in Kota Kinabalu. We reiterate our BUY call and 12-month target price of RM1.30, based on 10% discount to our RNAV/share of RM1.44.

Fig 1: Balance of contract value to be awarded from 4Q16

Project	Cost (RMbn)	Potential listed co bidders
East Coast Rail Line	55.0	MMC, Gamuda, IJM, Fajarbaru, WZ Satu
Pan-Borneo Highway (Sabah section)	12.8	WCT, Suria Capital-GAQRS
LRT Line 3 (Bandar Utama-Shah Alam-Klang)	9.0	Suncon, IJM, Gamuda, Gadang, TRC
Klang Valley MRT Line 2 (Sg Buloh-Selayang-Putrajaya)	8.1	Gadang, Mudajaya, GAQRS, WCT
Southern Double-Tracking Rail	8.0	Gamuda, IJM, WCT, Fajar Baru
Central Spine Road	3.0	WZ Satu, UEM Edgenta
West Coast Expressway	2.1	IJM, WCT, WZ Satu
Total	**98.0**	

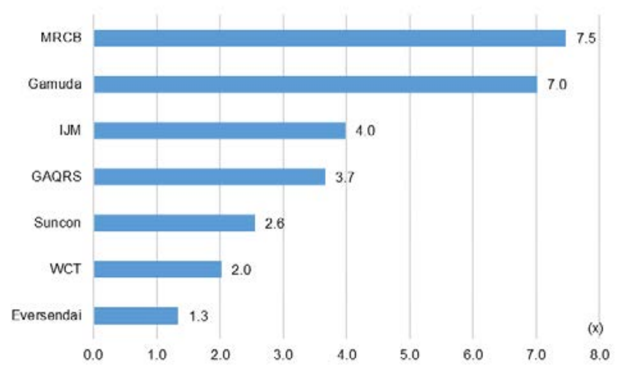
Source: MOF, Company, Affin Hwang estimates

Fig 2: Construction companies order book



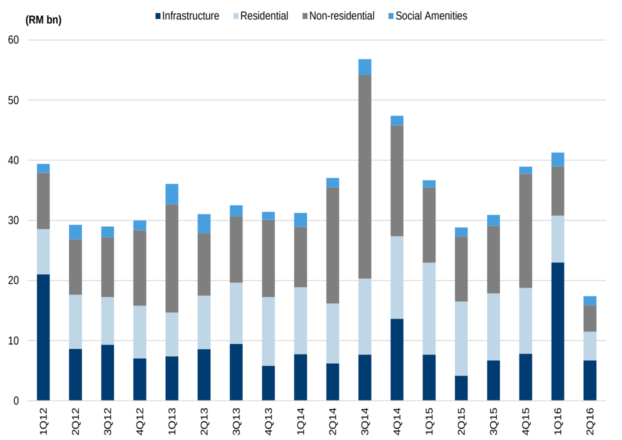
Source: Company, Affin Hwang estimates

Fig 3: Construction companies order book / revenue



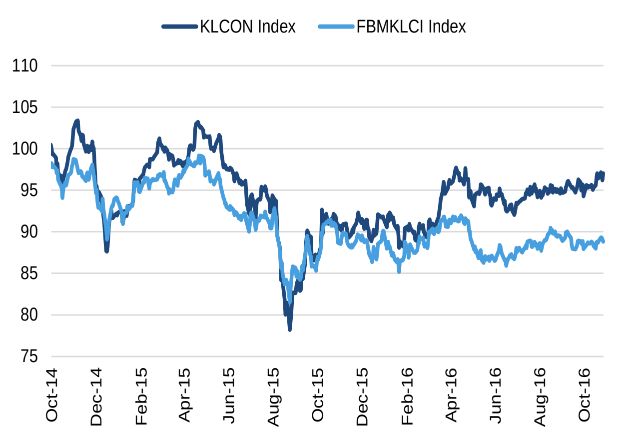
Source: Company, Affin Hwang estimates

Fig 4: Contract awards



Source: CIDB

Fig 5: KL Construction vs FBMKLCI



Source: Bloomberg

Sector Outlook

Consumer

NEUTRAL (maintain)

Gentle recovery of consumer sentiment

We believe that consumer spending will recover slowly in 2017, with the consumer sentiment index picking up slightly from its all-time low and positive initiatives by the government. We maintain our NEUTRAL sector rating and recommend stocks with solid track records and high dividend yields, with Heineken as our top pick.

Likely key focus for 2017

Our economics team forecasts private consumption to grow at 5.4% for 2017E (vs. 2016E: +5.5% and MoF's forecasts of 2017E: 6.3%, 2016E: 6.1%), from a high base effect. The consumer price index (CPI) is also expected to rise to 2.7% for 2017E (2016E: 2.0% vs MoF's forecasts of 2017E: 2-3%, 2016E:2-2.5%) given potentially higher transport costs and food prices partly due the removal of the cooking oil subsidy.

We view the recently announced Budget 2017 positively as a key initiative was the increase in BR1M by as much as 20% with an allocation of RM6.8b and special assistance of RM500 to all public servants that could benefit as many as 8.6m recipients. While sentiment among consumers has been subdued as seen through MIER's consumer sentiment index which has seen a downward trend and hitting an all-time low of 63.8 in 4Q15 since the global financial crisis, it has shown a slight pickup for two quarters to 78.5 in 2Q16. 3Q16 has seen a drop of 5 pts to 73.6, still below the 100-pts confidence threshold, but we remain positive that consumer sentiment will eventually recover, albeit slowly.

Earnings outlook – visibility, momentum and risks

1H16 proved to be a mixed bag of results with overall net earnings declining by 18% yoy, dragged down by BAT. Moving forward, the tobacco sector remains challenging with legal volumes declining by almost 30% as the excise led price hike caused consumers to switch to cheaper alternatives especially illicit cigarettes. We remain optimistic on the brewery sector as both Heineken and Carlsberg have actively increased efficiencies and offerings according to trends. Most retailers are likely to continue to see depressed margins and low growth due to the still challenging retail market. F&B counters should face increasing raw material prices such as sugar, coffee and milk powder, but this may be mitigated by ongoing efficiency measures. Seasonal festive spending still holds as the sector is likely to see a boost in earnings during festivities such as the Lunar New Year, Hari Raya and Christmas.

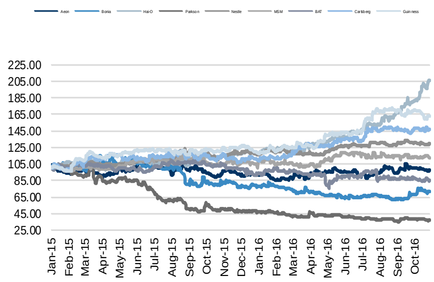
Our view and strategy for 2017

We expect domestic consumer spending to recover slowly in 2017, as consumer sentiment is expected to improve from its low base, supported by stable labor market conditions and a large young population. Overall, we maintain our **NEUTRAL** stance on the consumer sector. We advise investors who seek exposure to consumer stocks to focus on companies with defensive characteristics and attractive dividend yields.

Absolute Performance (%)

	1M	3M	12M
AEON	-2.1	+4.4	+2.2
BAT	+5.8	+5.8	-14.2
BONIA	-3.8	-3.2	-24.9
CAB	+1.7	+0.8	+19.7
GAB	-3.5	-7.0	+23.0
HAI-O	+15.1	36.9	+66.1
MSM	-0.2	+0.0	+1.7
NESTLE	-1.0	-0.8	+9.2
PARKSON	-1.9	-0.3	-26.8

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Yap Po Leen;
(603) 2146 7547
poleen.yap@affinhwang.com

Peer Comparison

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core P/E (x) CY16E	Core P/E (x) CY17E	EPS Growth (%) CY16E	EPS Growth (%) CY17E	EV/EBITDA (x)	P/B (x)	ROE (%) CY16E	ROE (%) CY17E	Net Div. Yield (%) CY16E	Net Div. Yield (%) CY17E
AEON	HOLD	2.80	2.70	3931.20	Dec	37.84	21.05	-22.9	79.7	9.0	1.8	5.6	9.5	0.9	1.6
BAT	HOLD	48.02	50.24	13711.15	Dec	21.19	18.97	-29.0	11.7	17.9	24.0	116.8	126.7	4.6	5.2
BONIA	SELL	0.65	0.47	520.06	Jun	16.54	12.65	-10.8	21.4	7.8	1.0	5.9	7.3	1.8	2.3
CARLSBERG	HOLD	14.78	14.40	4581.08	Dec	18.64	18.13	7.7	2.8	9.9	5.6	29.9	80.3	5.1	5.3
HEINEKEN	BUY	17.14	17.92	5177.96	Dec	15.22	18.39	9.8	-17.2	8.2	11.7	76.7	65.0	6.4	5.6
HAI-O	SELL	3.97	2.78	801.37	Apr	19.21	17.19	18.2	11.8	7.2	2.5	12.8	15.2	4.7	5.0
MSM	HOLD	4.89	4.72	3437.57	Dec	19.80	12.94	-37.9	53.0	9.1	1.5	7.4	11.8	5.5	5.6
NESTLE	HOLD	78.40	78.20	18384.80	Dec	27.10	24.55	14.7	10.4	17.2	21.5	79.2	84.5	3.8	3.9
PARKSON	SELL	0.76	0.67	854.09	Jun	-88.82	10.34	-17.3	n.m.	20.7	0.3	-0.4	3.0	2.2	2.2
WEIGHTED AVERAGE						**24.0**	**21.8**	**-10.2**	**16.5**	**13.6**	**17.1**	**21.4**	**32.8**	**4.1**	**4.5**

*Source: Bloomberg, Affin Hwang forecasts, *FY14 is actual, note: prices as of close as on 26 October 2016*

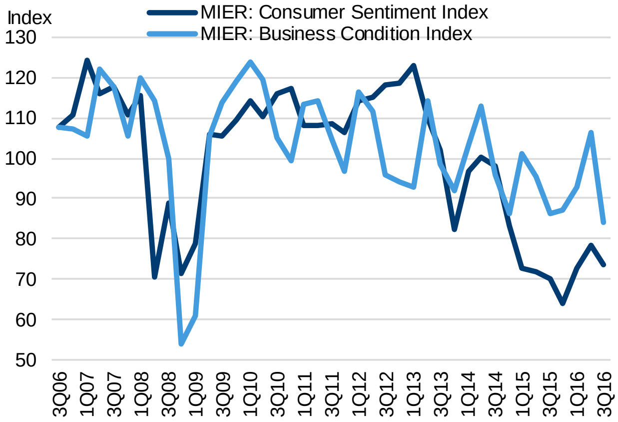
Possible surprises – upside and downside, and catalysts

Downside risks: i) mounting illicit trades; ii) further excise taxes for the brewery and tobacco sectors; iii) decline in consumer spending dragged down by a regional economic slowdown; and iv) a spike in commodity prices. Upside risks would be a better-than-expected spike in consumer sentiment.

Valuation and recommendation, key stock ideas

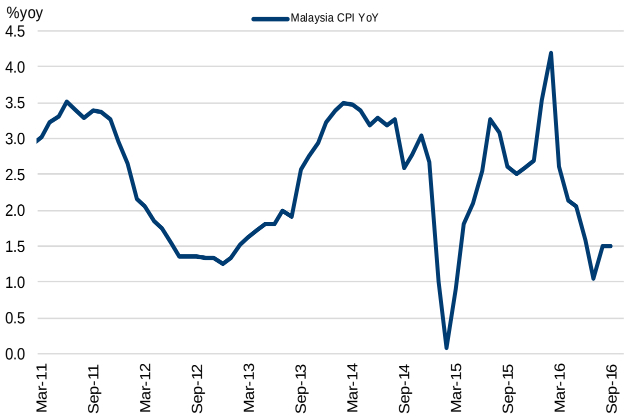
We maintain our HOLD call on both the non-discretionary consumer stocks under our coverage -Nestle (NESZ MK, HOLD) and MSM (MSM MK, HOLD) -as demand continues to grow, but caution that margins might be affected by raw material prices. We still remain cautious and have a SELL on retailers such as Bonia (BON MK) and Parkson (PKS MK) as while they are in the process of trying to turn around their business, this would likely take some time to take effect and meanwhile, they would need to continue to spend on marketing expenses due to the challenging retail environment. While HAI-O (HAIO MK) has seen improving earnings the past quarters, we feel that this has been priced in and have a SELL as its share price has moved above target price. We maintain AEON (AEON MK) at a HOLD as it would likely benefit from better consumer spending, especially among the bottom 40% of households due to the positive BR1M initiatives in the Budget 2017. While the tobacco sector is facing steep volume declines, share prices have fallen and we recently upgraded BAT (ROTH MK) to a HOLD as 2017-18E dividend yields of ~5% should sustain the share price and it is likely that a special dividend will be paid out next quarter due to the disposal of land. We remain positive about the brewery sector as both Carlsberg (CAB MK; HOLD) and Heineken have actively and successfully taken measures to operate more efficiently as well as diversified offerings according to market trends. Our top sector pick is Heineken (HEIM MK, BUY, TP: RM17.92).

Fig 1: MIERs consumer and retail index recovering



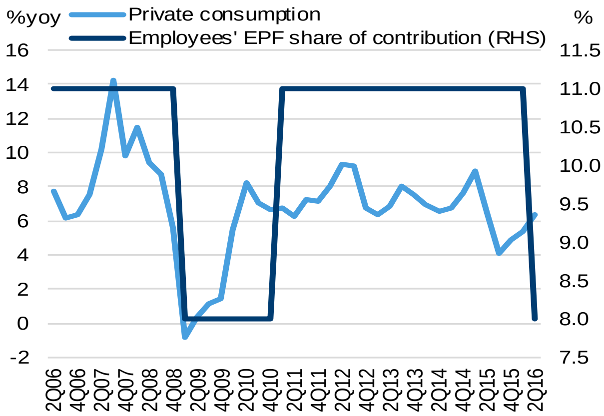
Source: MIER

Fig 2: Inflation at low levels



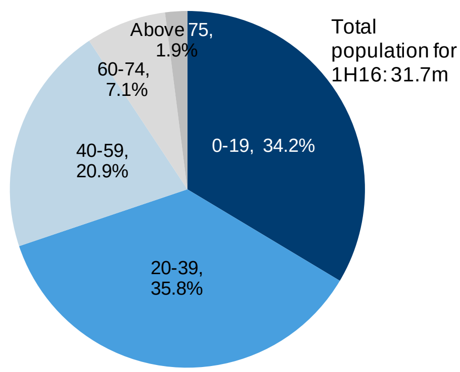
Source: BNM

Fig 3: Private consumption



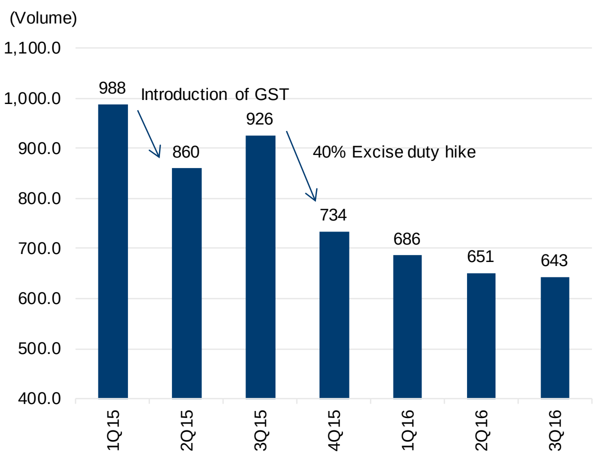
Source: BNM

Fig 4: 70% consisting of young population



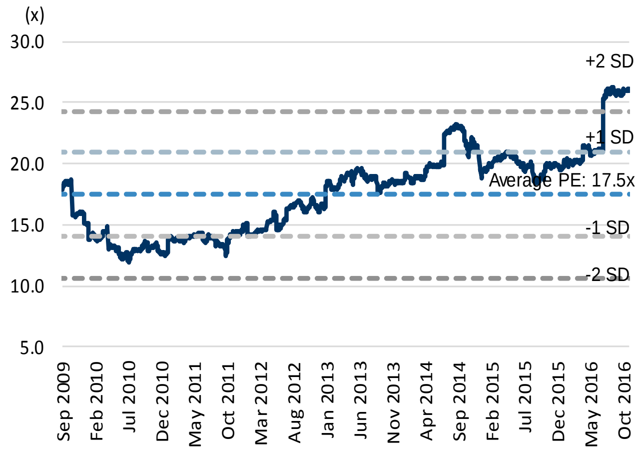
Source: BNM

Fig 5: Legal industry volume for tobacco declining



Source: BAT, Affin Hwang

Fig 6: KLCSU Index PE Ratio



Source: Bloomberg

Sector Outlook

Gaming

OVERWEIGHT (maintain)

Focus on company-specific catalysts

Although the gaming sector has had a good rally so far in 2016, we are still maintaining our Overweight call on the sector, as we believe the opening of the 20th Century Fox theme park will be a near-term catalyst for Genting Malaysia, indirectly benefiting Genting Berhad too. However, we recently downgraded Berjaya Toto to a SELL as its outlook continues to remain challenging.

Likely focus 2017

The focus for both Genting Malaysia (GENM) for 2017, will be on management ability to get Phase-1 of the GITP project completed on time. The 20th Century Fox theme park is expected to open by end of 2017, and we believe is the main catalyst that most investors are looking out for.

For Genting Berhad (GENT), apart from benefiting from the uplift in Genting Malaysia's share price, we believe that its company-specific catalyst will be on its plan for the USD$4bn Resort World Las Vegas, which is now scheduled to open in 2019. It is still not clear whether 2019 is a feasible target, as its previous plan was primarily targeting Chinese VIP customers from Asia to Las Vegas.

For Berjaya Sports Toto (BTOTO), we don't foresee any increase in betting duty for 2017, nor the government relaxing its stance on the license freeze for its outlet. Hence, it would be challenging for the company to deliver growth, while the illegal operators are offering higher payouts.

Earnings outlook – visibility, momentum and risks

For GENM, the biggest risk to its earnings comes from its international operations, due to the volatility in its QoQ earnings. The Malaysia casino operation remains a steady business; hence, the cash flow coupled with its balance sheet should be sufficient to finance capex at its GITP program.

For BTOTO, despite being in the gaming business, its outlook is more challenging given the current strict regulation on number forecasting. Its EPS growth for FY18-19 (April year end) is likely to remain flattish on our forecasts, as core operations have seen a decline in revenue over the past 3 years.

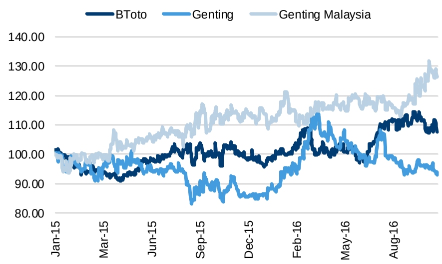
Our view and strategy for 2017

We believe the catalyst in 2017 for the sector will be company specific. And given the relative defensiveness of the sector, we don't think there is any significant downside risk to share prices in 2017, as we don't foresee any significant change in domestic consumption patterns.

Absolute Performance (%)

	1M	3M	12M
BToto	-4.8%	-3.0%	-2.8%
Genting	-2.9%	-12.8%	4.0%
Genm	5.1%	6.8%	8.0%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Ng Chi Hoong
(603) 2145 7470
Chihoong.ng@affinhwang.com

Peer Comparison

Stock	Rating	Sh Pr(RM)	TP(RM)	Mkt Cap (RMm)	Year end	PE (x) CY16E	PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	EV/EBITDA CY16E	EV/EBITDA CY17E	P/BV CY16E	P/BV CY17E	ROE (%) CY16E	ROE (%) CY17E	DY (%) CY16E	DY (%) CY17E
BTOTO	SELL	3.19	2.88	4,310	Apr	13.6	13.3	(2.9)	2.1	9.1	2.9	4.8	4.5	35.5	33.4	6.0	6.0
GENTING	HOLD	7.85	9.00	29,436	Dec	16.8	15.4	25.2	9.4	4.9	4.4	0.5	0.5	3.0	3.1	0.4	0.4
GENTING MALAYSIA	BUY	4.74	5.00	28,144	Dec	19.1	16.9	11.9	13.3	9.0	7.8	1.3	1.3	7.0	7.5	1.5	1.6
Simple Average				**61,890**		**16.5**	**15.2**	**11.4**	**8.3**	**7.7**	**5.0**	**2.2**	**2.1**	**15.2**	**14.7**	**2.6**	**2.7**
Weighted Average						**17.7**	**15.9**	**17.2**	**10.7**								

Source: Bloomberg, Affin Hwang forecasts; Note: Pricing as of close on 26 October 2016

Possible surprises – upside and downside, and catalysts

We think the biggest risk for GENM in 2017 is its RM1bn investment in First Light Resort & Casino in the form of promissory note, which carries around 15% interest rate per annum. The casino will appoint GENM as its manager for at least 7 years post completion as payment for the note with interest. However, due to some legal issues the construction of the casino site has now been suspended. If the casino owner, the Mashpee Wampanoag Tribe, fails to get a favourable ruling, GENM might be forced to write off its investment. PATAMI for GENM in 2016E is RM1.2bn.

For GENT, the key risk mainly arises from Genting Singapore (GENS SP, Not Rated), which is facing declining profits, from writing off VIP debts to extra costs needed to right-size its staff force.

The risk for BTOTO remains unchanged over the years, as illegal operators remain its biggest threat, as revenue for its domestic operation remains on a declining trend.

Key risks to our positive view on the sector would be: (i) relatively high foreign shareholdings; (ii) weaker-than-expected Chinese VIP arrivals at GENS; and (iii) weak luck factor.

Possible positive surprises include: (i) better-than-expected luck factor; (ii) faster-than-expected turnaround of Resorts World Bimini at GENM; and (iii) liberalisation of regulation to allow locals to enter casinos in South Korea.

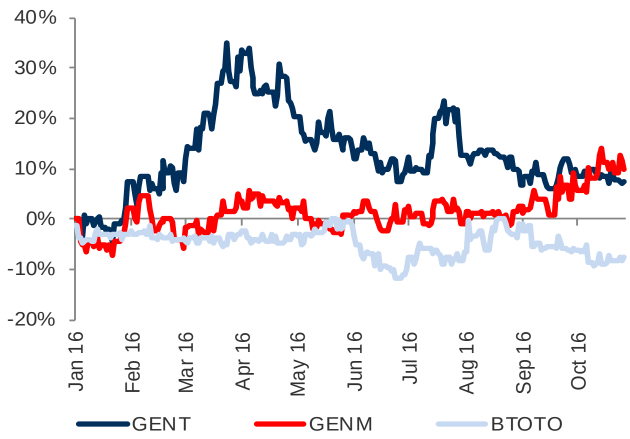
Valuation and recommendation, key stock ideas

Genting Malaysia (GENM MK) remains our top pick for the sector, as we believe that its share price has not fully incorporated the potential increase in visitation post the completion of GITP (Phase-1).

While Genting Berhad (GENT MK) would also benefit from the rise in GENM's share price, GENM is only 41% of its overall valuation on our estimates, as the gain would be diluted by the problem plaguing Genting Singapore, which is 32% of GENT's valuation. Hence, we are maintaining our HOLD call for GENT.

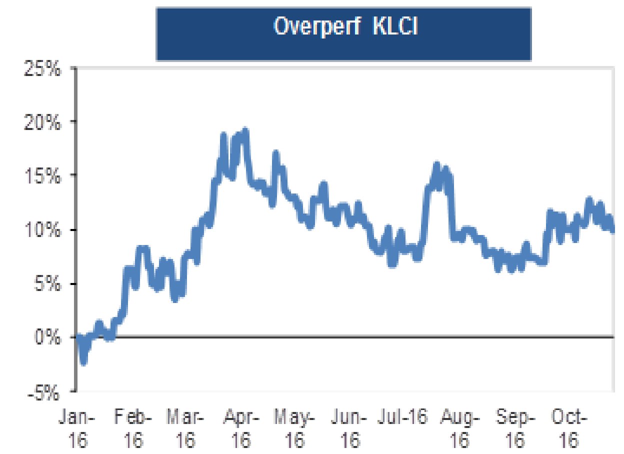
We recently downgraded BToto (BST MK) to a SELL, as we believe its rich valuation is not justifiable, as its FY17E PER is trading +1 SD above its historical mean, while its domestic operation is still on a declining trend, which could potentially lead to a cut in its dividend.

Fig 1: Gaming 2016 share price performance



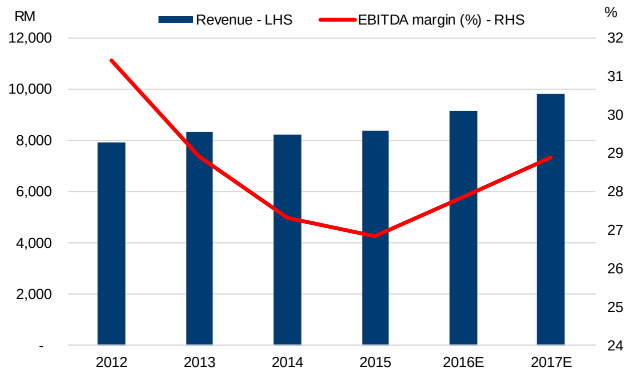
Source: Bloomberg

Fig 2: Sector performance relative to KLCI



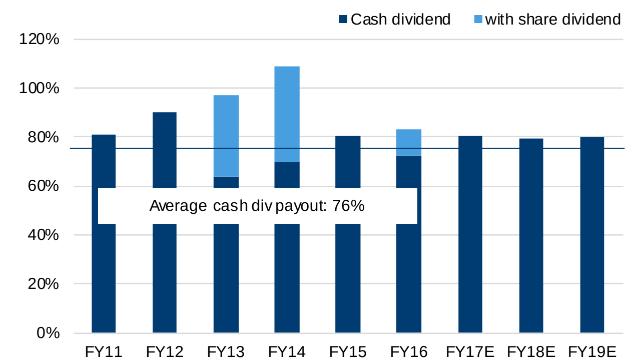
Source: Bloomberg

Fig 3: GENM revenue and EBITDA margin trend



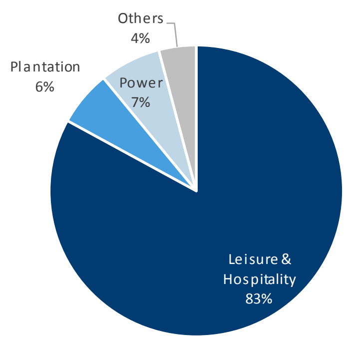
Source: Company, Affin Hwang forecasts

Fig 4: We are expecting Btoto payout to be around 80%



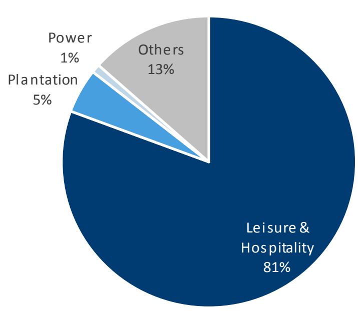
Source: Company, Affin Hwang forecasts

Fig 5: GENT's 2015 revenue breakdown



Source: Company

Fig 6: GENT's 2015 EBITDA breakdown



Source: Company

Securities

AFFIN HWANG CAPITAL

Daiwa Capital Markets

Pricey healthcare awaits

So far 2016 has been a challenging year for private healthcare operators, as operators have frozen the price hike in 1H16 to maintain price competitiveness due to weaker consumer sentiment. However, we believe that the overcrowding in public hospitals and the growing middle income population will continue to support private healthcare demand. Hence, we are maintaining our Overweight on the sector, with KPJ as our top pick in the space.

Likely key focus for 2017

The focus will be on the private operators' ability to rise prices for 2017, as operators have slowed down their price hike in 2016, in anticipation of lower demand from both cash-paying and corporate patients. Our checks have suggested that operators have reverted back to their previous pricing strategy, but it is not as aggressive as in previous years.

While the government has announced some initiatives during the budget 2017 to foster partnership with private organisations to operate non-profit hospitals, we don't foresee those hospitals being able to ease the overcrowding problem in public hospitals significantly.

Earnings outlook – visibility, momentum and risks

For 2017, earnings momentum is expected to recover, as the 2 operators under our coverage have resumed their price increase strategy in 4Q16. For KPJ, we are expecting higher earnings growth YoY, as the price increase should help to improve margins, and an increasing profit contribution of its new hospitals that were open in 2014-16. For IHH, it stands to benefit from the price increase, but not as significantly as KPJ, as its Malaysia operations contribute less than 30% of its EBITDA.

Our view and strategy for 2017

We are still positive on the overall outlook for healthcare operators in 2017, as the companies should be able to deliver stronger YoY earnings growth relative to 2016, given the price increases in 4Q16. The catalyst for the share price will likely rely on the execution capability of the respective management teams. Our top pick is KPJ, as we like its undemanding valuation and direct exposure to the Malaysia private healthcare market.

Valuation and recommendation, key stock ideas

Given the volatility of the market in recent times, we like the healthcare sector its defensive nature and recession-proof business model. Although valuations for both KPJ (KPJ MK) and IHH (IHH MK) are at a premium relative to their historical levels, they are still undemanding relative to their peers, with KPJ being the least demanding relative to its peers. Maintain Overweight for the sector.

Sector Outlook

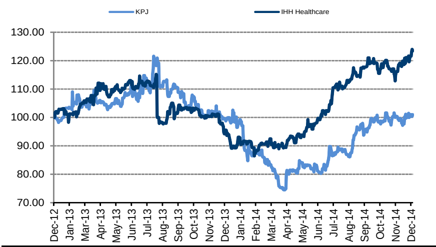
Healthcare

OVERWEIGHT (maintain)

Absolute Performance (%)

	1M	3M	12M
IHH	-0.6%	-4.2%	+21.5%
KPJ	-6.0%	-3.2%	-8.2%

Relative Performance (%)



Source: Affin, Bloomberg

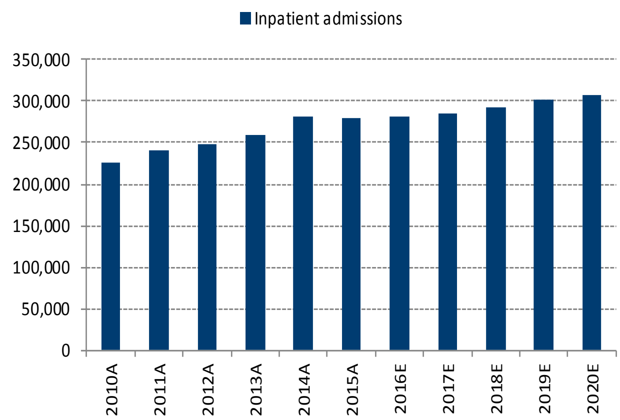
Chue Kwok-Yan
(603) 2146 7618
kwokyan.chue@affinhwang.com

Peers Comparison

	Rating	Sh Pr LC	TP LC	Mkt Cap (USDm)	Year end	Core PE (x) CY16E	Core PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	P/B (x)	ROE (%) CY16E	ROE (%) CY17E	Div. Yield (%) CY16E	Div. Yield (%) CY17E
KPJ Healthcare	BUY	4.20	5.01	1,053	Dec	33.2	31.4	8.8	5.7	2.9	8.9	9.0	1.6	1.7
IHH Healthcare	HOLD	6.35	7.01	12,547	Dec	47.5	40.6	22.3	16.9	2.3	4.8	5.4	0.6	0.7
Bangkok Dusit Medical	N/R	21.68	N/R	9,561	Dec	38.6	34.3	7.3	12.5	5.7	15.4	15.9	1.3	1.5
Bumrungrad Hospital	N/R	176.17	N/R	3,654	Dec	37.1	33.9	16.6	9.6	8.8	26.2	25.5	1.4	1.6
Apollo Healthcare	N/R	1,328.77	N/R	2,765	Mar	40.7	30.9	25.5	31.8	4.6	11.6	14.1	0.6	0.8
Raffles Medical	N/R	1.51	N/R	1,892	Dec	37.3	31.8	-0.6	17.2	4.0	11.6	12.2	1.4	1.4
Average				**31,471**		**41.9**	**36.2**	**13.3**	**15.6**	**4.4**	**13.1**	**13.7**	**1.1**	**1.3**

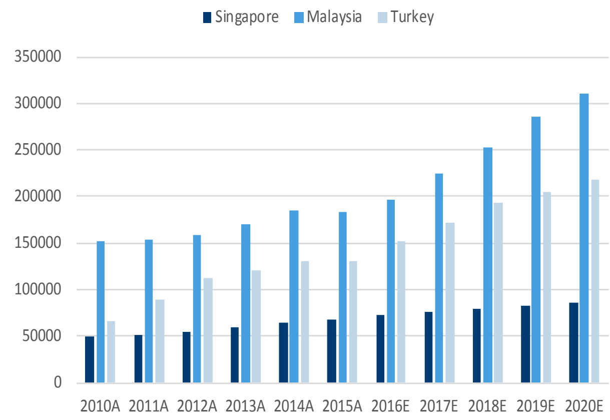
Source: Bloomberg, Affin Hwang forecasts
Note: Pricing as of close on 26 October 2016

Fig 1: KPJ inpatient admissions growth



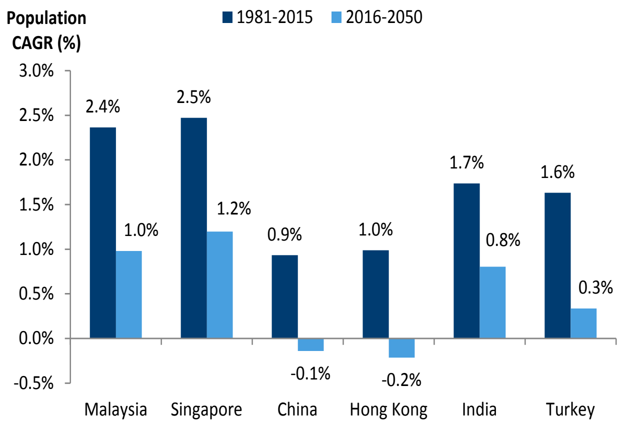
Source: KPJ, Affin Hwang forecasts

Fig 2: IHH inpatient admissions growth



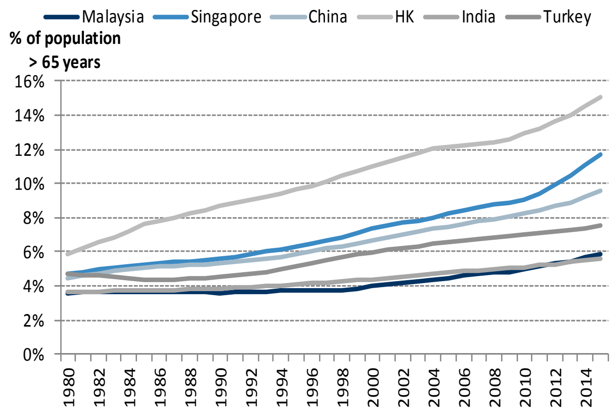
Source: IHH, Affin Hwang forecasts

Fig 3: Population CAGR in 1981-2050



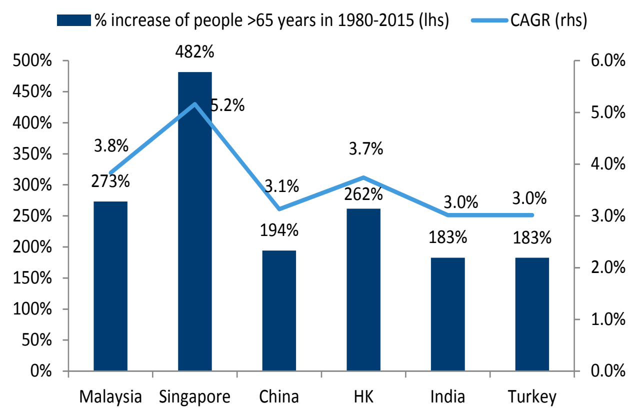
Source: CEIC, US Census Bureau

Fig 4: Rapidly aging population profile



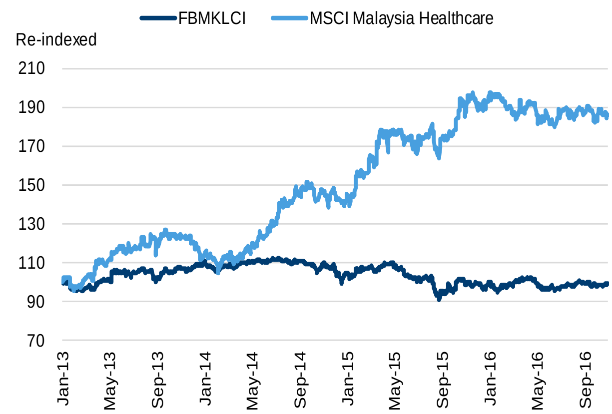
Source: CEIC, World Bank

Fig 5: Increasing number of aged population



Source: CEIC, World Bank

Fig 6: FBMKLCI vs MSCI Malaysia Health Care Index



Source: Bloomberg

Still lacking "feel-good" factor to spend

Sector Outlook

Media

NEUTRAL (maintain)

Media companies have been affected by the tough and challenging market environment. Broadly, we are still very cautious on the media sector as we believe weak business and consumer sentiment as well as the change in media consumption habits could continue to affect advertising revenue. Also, we think that there is lack of mega events in 2017 to boost adex. The positive is that newsprint average prices have been at a comfortable level of US$535/MT for the past year. As we see limited rerating catalysts, we remain NEUTRAL on the sector.

Likely key focus for 2017

We maintain our NEUTRAL stance on the Malaysia media sector. We believe that poor consumer and business sentiment, continued market uncertainties coupled with the change in media consumption habits have affected adex as advertisers remained cautious on their ad spending. On top of that, we opine that there is a lack of mega events scheduled in 2017 to boost adex. The shift in adex trend towards broadcast, especially for the pay-TV sub-segment and digital media will also likely to continue. Print media companies newspaper hard-copy circulation has been negatively affected due to a continual shift in reader preferences to reading on mobile devices or over the Internet. Also, it is still unclear on the digital-terrestrial television (DTTV) provided by MyTV Broadcasting. The STBs needed for viewers to watch DTTV programmes have yet to be launched. Notably, Malaysia is expected to end its simulcast period and start on full digital broadcasting in June 2018.

Possible surprises – upside and downside, and catalysts

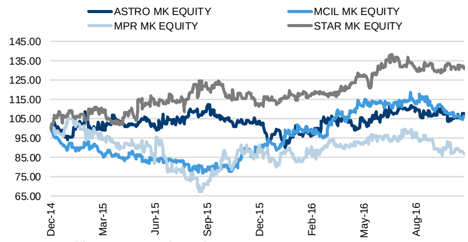
Positive catalysts (or upside risks) for the sector would be: 1) a significant improvement in domestic consumer and business confidence; 2) a significant improvement in newspaper hard copy circulation; 3) a sharp rebound in adex revenue; and 4) a sharp decline in newsprint prices.

Meanwhile, key dowside risks to our media sector call include: 1) a major drop in domestic consumer and business confidence; 2) a significant drop in newspaper hard-copy circulation; 3) a much lower-than-expected adex revenue; and 4) an unexpected increase in competition from other TV operators with the upcoming digital rollout ; 5) a significant appreciation of US$ against the RM would make newsprint prices more expensive.

Absolute Performance (%)

	1M	3M	12M
Astro	-2.4%	-3.4%	-2.4%
MPrima	-3.1%	-12.4%	-8.0%
Star	-3.9%	-4.2%	5.0%
MCIL	-1.4%	-6.2%	20.2%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Nadia Aquidah
(603) 2146 7528
nadia.subhan@affinhwang.com

Peer Comparison

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY16E	Core PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	EV/EBITDA (x)	P/BV (x)	ROE (%) CY16E	ROE (%) CY17E	Div. Yield (%) FY16E	Div. Yield (%) FY17E
Astro	BUY	2.87	3.30	14,929	Jan	21.2	18.6	1.8	14.1	9.7	26.1	99.8	92.0	4.2	4.5
Media Prima	SELL	1.28	1.03	1,420	Dec	12.2	12.4	-19.3	-2.2	4.5	0.9	6.9	6.4	5.5	5.4
Star	SELL	2.49	2.13	1,839	Dec	18.1	15.7	-23.3	15.7	8.8	1.7	9.0	10.6	7.2	7.2
Media Chinese	SELL	0.69	0.50	1,156	Mar	9.9	7.1	-6.7	2.0	5.2	1.4	13.7	13.0	6.3	6.4
Simple average						**15.3**	**13.4**	**-11.9**	**7.4**	**7.1**	**7.5**	**32.3**	**30.5**	**5.8**	**5.9**

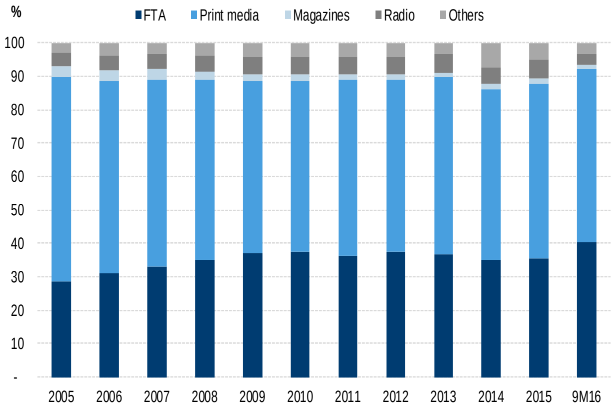
Pricing as of close on 26 October 2016
Source: Companies, Bloomberg, Affin Hwang forecasts
Notes: (1) for EV/EBITDA and P/BV, FY16E for Astro and Media Chinese, FY15E for Media Prima and Star;
(2) FY16 dividend yields for Astro and Media Chinese are actual.

Valuation and recommendation, key stock ideas

Our top pick for the media sector is Astro (ASTRO MK, BUY) with a DCF-based 12-month target price of RM3.30. We continue to like Astro as: 1) we expect a strong FY17-19E core EPS CAGR of 15.8%; and 2) we forecast a 4.5% FY17E dividend yield.

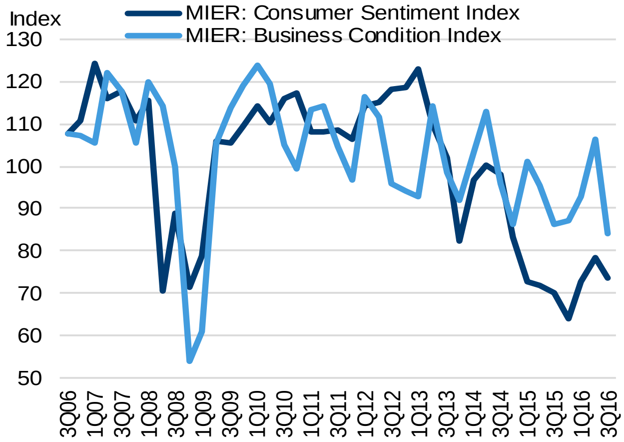
Meanwhile, due to weakness in the print media industry, we have SELL ratings for Star (STAR MK), Media Prima (MPR MK) and MCIL (MCIL MK). Star's 12-month target price is unchanged at RM2.13 (based on 13.4x our 2017E EPS), Media Prima's 12-month target price is unchanged at RM1.03 (based on 10x our 2017E EPS) and MCIL's 12-month target price is unchanged at RM0.50 (based on 8x our 2017E EPS).

Fig 1: Market share of adex



Source: Nielsen Media Research, Affin Hwang

Fig 2: Malaysia consumer sentiment



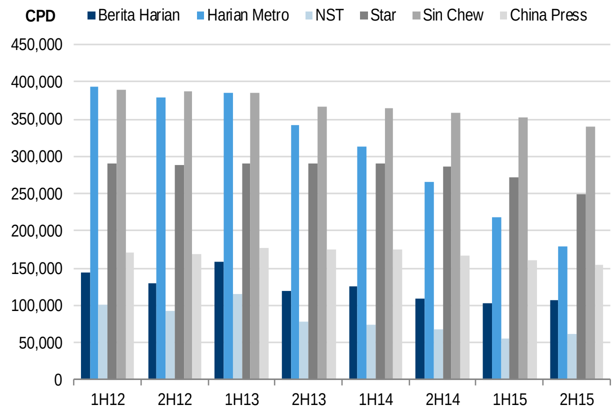
Source: MIER, Affin Hwang

Fig 3: Top-10 channel viewership

Rank	Station	1H16 %	Station	1H15 %
1	TV3	21.4	TV3	24.0
2	TV9	6.1	TV9	7.4
3	8TV	5.2	TV2	5.0
4	TV2	4.7	8TV	4.8
5	8TV	4.9	NTV 7	4.1
6	CERIA	4.3	TV1	3.9
7	NTV7	3.4	CERIA	3.0
8	RIA	3.1	RIA	2.7
9	DISNEY	3.0	PRIMA	2.7
10	TV1	2.9	SUN-TV	2.5

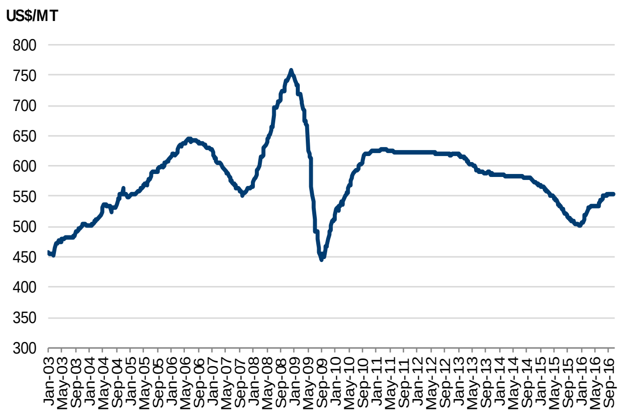
Source: Nielsen Media Research, Affin Hwang

Fig 4: Average daily circulation



Source: Audit Bureau Circulation, Affin Hwang

Fig 5: Newsprint prices



Source: Bloomberg, Affin Hwang

Fig 6: US$ against the RM

Source: Bloomberg, Affin Hwang

2017 Outlook: Safe and steady yields

We maintain our OVERWEIGHT stance on the Malaysian REITs sector in 2017 as the sector continues to offer attractive yields of 5.5% on average. We are selective with our stock picks, with a preference for YTL Hospitality REIT (FY17E yields of 6.7%) while still in favour of the retail REITs – IGB REIT and Pavilion REIT (FY17E yields of 6.0-6.2%). In our view, our stock picks (in the retail and hospitality sectors) continue to offer safe haven investments due to the stable income stream, recent/upcoming tenancy/lease renewals, high occupancy rates and near-term asset-injection plans.

Maintain OVERWEIGHT. Appetite for yields remain strong

We maintain our **OVERWEIGHT** on the Malaysian REITs (MREITs) in 2017 as we continue to see strong investor appetite for yields due to the low/negative interest-rate policies at some developed nations while uncertainties in a strong economic recovery have also driven investors to safe-haven investments. Meanwhile, we believe that the retail MREITs under our universe (IGB REIT and Pavilion REIT) will continue to see positive rental reversion in upcoming renewals, though likely to be in the high single-digit range (compared to mid-teens reversion in the past). The resilience of the REITs' tenancy/lease structure remains the key factor for consideration as the sector is plagued by threats of incoming supply in the office, retail and hotel markets.

Earnings and industry outlook – visibility and momentum

The 2017 earnings outlook for our MREITs universe remains intact; we are expecting a 6-8% yoy growth rate for IGB REIT and Pavilion REIT (given the full impact of chunky tenancy renewals in 2016), potentially a 12% yoy growth rate for Axis REIT (with recent acquisitions, new space commitments and rental renewals) and a relatively flat growth rate for KLCC Property and YTL REIT (but will likely be more significant in FY18E for YTL REIT). 2017E yields are expected to be slightly more attractive at an average of 5.9%, vs. 5.6% in 2016E. Apart from relying on organic growth and asset-enhancement initiatives (AEI), Pavilion REIT, Axis REIT and YTL REIT may have near-term asset-injection initiatives which would be a boost to earnings. On the industry outlook, the new supply of office space will be modest at 1.9m sq ft in 2016 and 1.3m sq ft in 2017 but from 2018-21 around 8.5m sq ft. For retail space, about 6.7m sq ft is coming into the market in 2016E and subsequently about 4.5m sq ft in 2017E. In the hotel market, an estimated 7,700 hotel rooms will be adding to the existing stock of 4,799 as at Dec15.

Sector Outlook

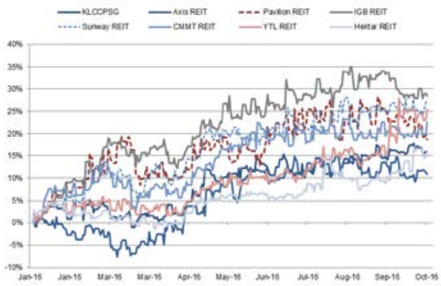
MREITs

OVERWEIGHT (maintain)

Absolute Performance (%)

	1M	3M	12M
KLCCPSG	+1.8	+2.9	+10.4
Axis	(1.1)	-	+4.2
Pavilion	(13.9)	(13.9)	+2.6
IGB	(3.0)	(1.8)	+23.7
Sunway	+2.3	+4.1	+15.0
YTL REIT	+8.9	+10.9	+15.1
MRCB-Quil	+1.6	+5.8	+10.3
Al-Aqar	(2.5)	-	+18.2
CMMT	+2.6	-	+16.1
AmFirst	+5.7	+6.4	+3.1

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Tan Ei Leen
(603) 2146 7543
eileen.tan@affinhwang.com

Yap Po Leen
(603) 2146 7547
poleen.yap@affinhwang.com

Peer Comparison

MREIT	Rating	RM 26-Oct	TP (RM)	Mkt Cap (RMm)	Year end	NAV (RM)	P/NAV (x)	Core PE CY16E	Core PE CY17E	DPU (sen) FY16E	DPU (sen) FY17E	Yield (%) FY16E	Yield (%) FY17E	Borrowings (RMm)	Assets (RMm)	Gearing (%)
Retail REITs																
KLCCPSG	HOLD	7.80	8.00	14,081	Dec	6.97	1.12	18.6	18.4	37.0	38.5	4.7	4.9	2,562.7	17,562.6	14.6
IGB REIT	BUY	1.62	1.70	5,614	Dec	1.07	1.51	19.3	17.8	9.1	9.75	5.6	6.0	1,222.8	5,103.6	24.0
Pavilion REIT	BUY	1.75	2.00	5,278	Dec	1.28	1.24	21.9	20.5	8.2	8.7	4.7	5.0	1,416.0	5,446.6	26.0
Hospitality REIT																
YTL REIT	BUY	1.20	1.60	1,589	Jun	1.45	0.83	57.1	60.0	7.9	8.1	6.6	6.7	1599.0	3621.9	44.1
Office REITs																
Axis REIT	HOLD	1.74	1.67	1,906	Dec	1.24	1.40	20.0	17.8	8.9	9.8	5.1	5.6	744.7	2,192.6	34.0
M-REITs Sector (Weighted average)							**1.21**	**18.9**	**18.0**			**5.1**	**5.3**			
M-REITs Sector (ex-KLCCPSG)							**1.26**	**19.0**	**17.8**			**5.3**	**5.5**			

* *For YTLREIT (FYE June) forecasts for FY17-18E instead are being presented above*

Source: Affin Hwang forecasts, Bloomberg

Our view and strategy for 2017 – go for prime REITs

We call for a selective focus on the few prime M-REITs which are backed by stable leases, prime assets and have a strong sponsor backing. For longer-term investors, MREITs with long-term leases and stable tenant profile such as YTL REIT and KLCCPSG will be able to deliver a steady earnings stream. Meanwhile, we see the recent change in the SC's guidelines to allow REITs to undertake property development activities including acquiring vacant land as a boost to future yields.

Possible catalysts – upside and downside

Positive catalysts: i) abolition of withholding tax on dividends for residents and non-residents; ii) revival in global real-estate sentiment; iii) inflow of funds; and iv) a downward shift in the overall bond-yield curve.

Negative catalysts: i) inflationary pressure on cost-of-living; ii) weaker retail sentiment caps higher rental reversion for retail REITs; iii) possible correction in asset prices due to rising vacancy rates (to 20% from 17-18% as at 3Q16) caused by the office and retail supply glut from 2017 onwards; and iv) higher refinancing rates.

Valuation and recommendation, key stock ideas

Amongst our universe, YTL REIT and Pavilion REIT currently have the most upside at 33% and 20.5%, respectively. Our brief investment thesis on the stocks are as follows:

ii) **YTL Hospitality REIT (YTLREIT MK, BUY, RM1.20, Target price: RM1.60).** We are of the view that an investor buying into the stock is getting it cheaper than buying the physical assets, as implied by YTLREIT's P/NAV of 0.83x (30 June 2016). The commencement of a new step-up cycle in the Master Leases in November 2016 and potential asset injection (via YTL Hotels) are key catalysts. The stock has upside potential of 33.3% to our DDM-based 12-month TP of RM1.20 and offers investors FY17-18E DPU yields of 6.7-7.1%.

iii) **Pavilion REIT (PREIT MK, BUY, RM1.75, Target price: RM2.11)** –Its retail mall asset (Pavilion Kuala Lumpur, 1.3m sq ft) is currently a major city-centre shopping destination and caters to the higher-income shoppers, hence does not see pullback in consumer spending despite weak market sentiment. Management remains committed to doing yield-accretive AEIs. We believe that there will be more asset injections such as the Pavilion Elite (250,000 sq ft), Pavilion Damansara (1m sq ft) and Pavilion Bukit Jalil (1m sq ft) in the pipeline.

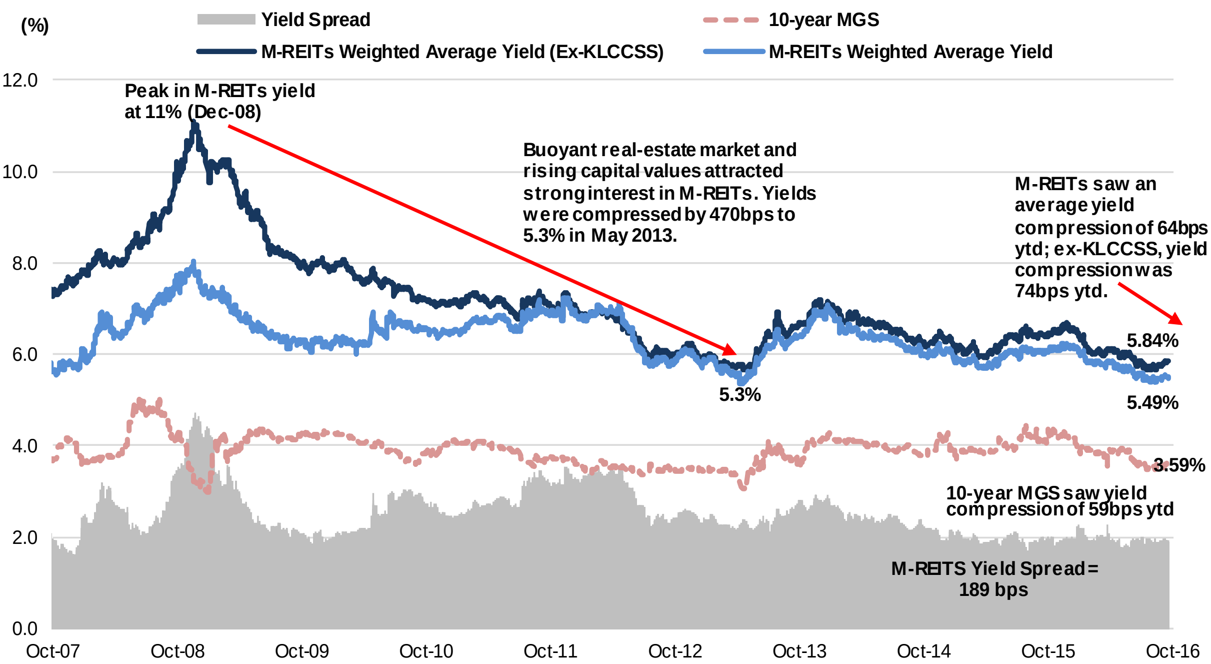
Fig 1: M-REITs peer comparison of different sectors

MREIT	Rating	RM	TP	Mkt Cap	Year	NAV	P/NAV	Core PE		DPU (sen)		Yield (%)		Borrowings	Assets	Gearing
		26-Oct	(RM)	(RMm)	end	(RM)	(x)	CY16E	CY17E	FY16E	FY17E	FY16E	FY17E	(RMm)	(RMm)	(%)
Retail REITs																
KLCCPSG	HOLD	7.80	8.00	14,081	Dec	6.97	1.12	18.6	18.4	37.0	38.5	4.7	4.9	2,562.7	17,562.6	14.6
IGB REIT	BUY	1.62	1.70	5,614	Dec	1.07	1.51	19.3	17.8	9.1	9.75	5.6	6.0	1,222.8	5,103.6	24.0
Pavilion REIT	BUY	1.75	2.00	5,278	Dec	1.28	1.24	21.9	20.5	8.2	8.7	4.7	5.0	1,416.0	5,446.6	26.0
Sunway REIT	NR	1.75	na	5,145	Jun	1.35	1.29	19.0	17.7	8.8	9.4	5.0	5.4	2,175.6	6,537.3	33.3
CMMT	NR	1.55	na	3,138	Dec	1.28	1.21	18.2	17.4	8.6	8.7	5.5	5.6	1,290.6	4,087.3	31.6
Hektar REIT	NR	1.64	na	657	Dec	1.46	1.12	13.5	13.4	10.5	10.5	6.4	6.4	507.7	1,127.3	45.0
Al-Salam REIT	NR	1.04	na	603	Dec	1.03	1.01	15.8	14.4	5.3	5.5	5.1	5.3	346.4	961.9	36.0
Weighted average							**1.23**	**19.1**	**18.3**			**5.0**	**5.3**			
Hospitality REIT																
YTL REIT	BUY	1.20	1.60	1,589	Jun	1.45	0.83	57.1	60.0	7.9	8.1	6.6	6.7	1599.0	3621.9	44.1
Office REITs																
Axis REIT	HOLD	1.74	1.67	1,906	Dec	1.24	1.40	20.0	17.8	8.9	9.8	5.1	5.6	744.7	2,192.6	34.0
UOA REIT	NR	1.73	na	732	Dec	1.66	1.04	15.0	14.8	10.0	10.0	5.8	5.8	381.8	1,138.8	33.5
Amanahraya REIT	NR	0.95	na	542	Dec	1.17	0.81	13.3	13.1	7.0	7.0	7.4	7.4	266.2	991.2	26.9
MRCB-Quill REIT	NR	1.27	na	840	Dec	1.32	0.96	15.5	14.9	8.4	8.7	6.6	6.9	689.4	1,609.7	42.8
Tower REIT	NR	1.20	na	337	Dec	1.94	0.62	14.3	13.9	6.0	6.0	5.0	5.0	0.1	568.3	0.0
Weighted average							**1.07**	**17.5**	**16.4**			**5.6**	**5.9**			
Industrial REIT																
Atrium REIT	NR	1.11	na	135	Dec	1.43	0.78	10.7	10.3	6.7	6.8	6.0	6.1	59.6	240.2	24.8
Healthcare REIT																
Al-Aqar	NR	1.55	na	1,079	Dec	1.23	1.26	18.8	18.2	6.6	6.7	4.3	4.3	653.6	1,608.4	40.6
M-REITs Sector (Weighted average)							**1.21**	**18.9**	**18.0**			**5.1**	**5.3**			
M-REITs Sector (ex-KLCCPSG)							**1.26**	**19.0**	**17.8**			**5.3**	**5.5**			

* *For YTLREIT (FYE June) forecasts for FY17-18E instead are being presented above*

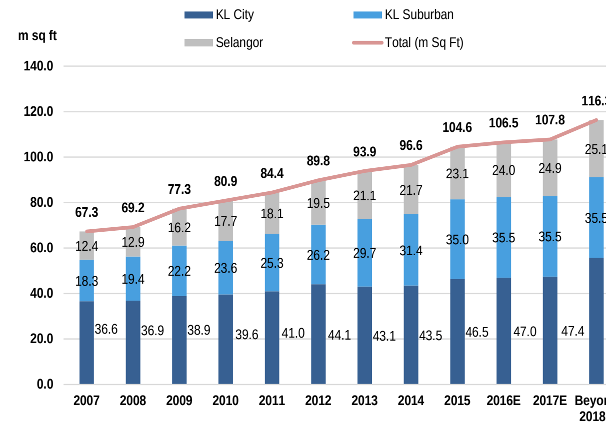
Source: Bloomberg, Company, Affin Hwang forecasts

Fig 2: M-REITs weighted-average sector DPU yield vs. 10-year MGS yield



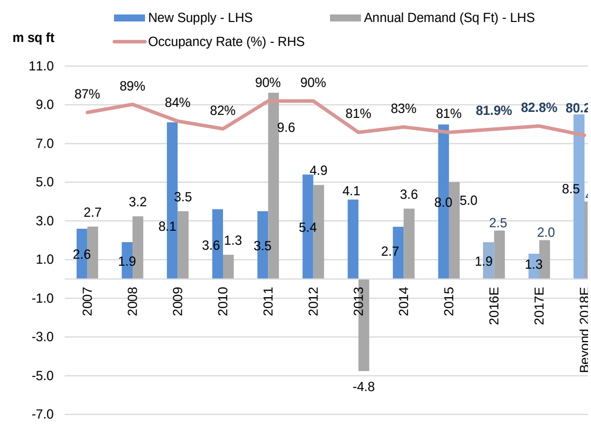
Source: Bloomberg, Affin Hwang

Fig 3: Klang Valley office space supply



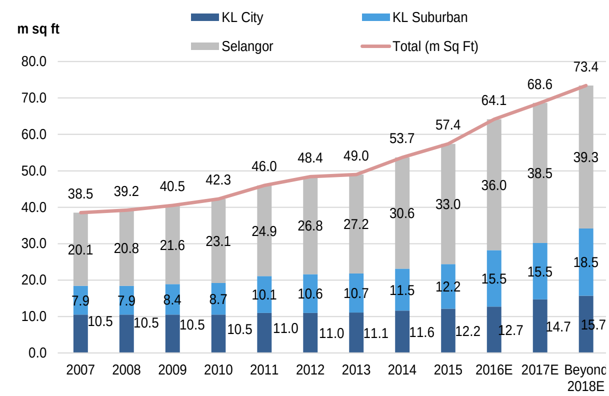
Source: Savills Research, WTW, Knight Frank, Affin Hwang estimates

Fig 4: Office space supply, demand, occupancy rate



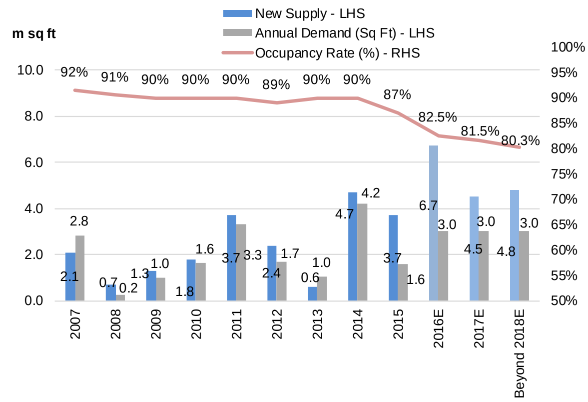
Source: Savills Research, WTW, Knight Frank, Affin Hwang estimates

Fig 5: Klang Valley retail space supply



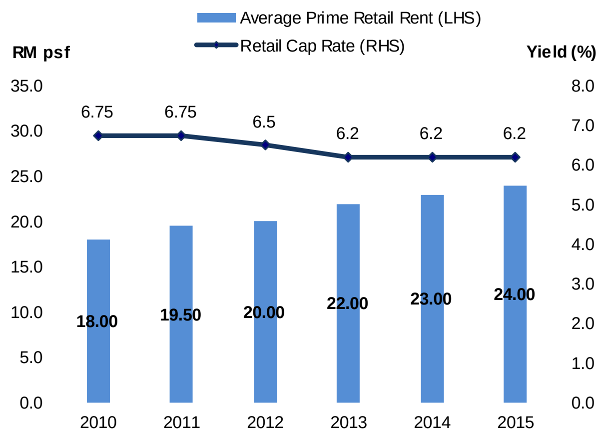
Source: Savills Research, WTW, Knight Frank, Affin Hwang estimates

Fig 6: Retail space supply, demand, occupancy rate



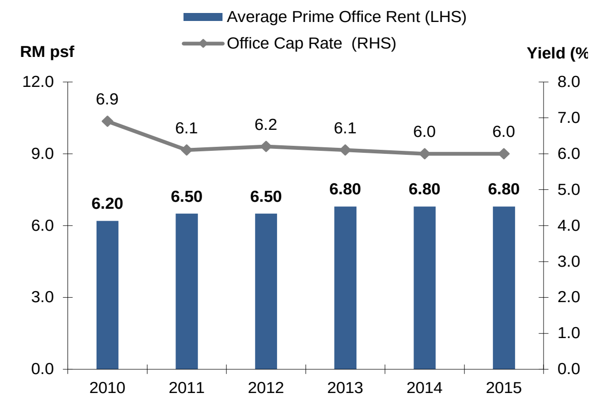
Source: Savills Research, WTW, Knight Frank, Affin Hwang estimates

Fig 7: Average price retail rental rate and cap rate



Source: WTW, Company data,, Affin Hwang estimates

Fig 8: Average price office rental rate and cap rate



Source: WTW, Company data, Affin Hwang estimates

* *There are other upcoming and on-going development projects, which we have not taken into account in the estimate of the future supply due to the lack of data*

Standing at a cross road

The sector continues to face headwind and earnings remain lacklustre as margins continue to be compressed and activities remain slow. Overall sector is guided to grow by -1% in 2017 for the time being, dragged down by heavyweights. For 2016, we have witnessed minor cracks in the Malaysia and Singapore O&G space from Perisai and Swiber. One of the key focus areas in 2017 would be to monitor the companies' near-term financial health to repay their short-term debt coming due. All in, we are still maintaining our Underweight sector call. For exposure, MMHE and PENB remain as the only two Buy calls in our universe.

Likely key focus for 2017

Moving into 2017, investors will likely continue to follow closely the crude-oil market for signals of prolonged stabilisation. Awaiting the November OPEC meeting, we expect oil prices to move sideways at current USD50-55/bbl levels. The Petronas dividend to the Malaysia government has been reduced from RM29bn in 2015 to RM16bn in 2016, and is expected to fall by another 20% to only RM13bn in 2017. Thus, Petronas capital spending is likely to remain prudent. One of the other inflexion points to note is possible M&A targets in the sector, which we have yet to see happen.

Earnings outlook – visibility, momentum and risks

Unsurprisingly against all the macro backdrop, sector earnings growth is looking to be at -1%, dragged down by the heavyweights. Based on our quarterly compiled contract flow (refer to Figure 1), contract values bottomed in 2Q16 at RM1,510m. Subsequently, contract flows rebounded sharply increasing by 3 fold qoq and 1.5 fold yoy to RM6,080m. Judging from the known domestic tenders pipeline, we do not foresee the 2Q16 situation repeating itself, which should be supported by the rollout of (i) 2017-18 (2+2 years) Pan Malaysia transportation and installation (T&I) packages and (ii) the marine, construction and maintenance batch of contracts.

Our view and strategy for 2017

That being said, with no visible sign in corporate earnings improvement, we remain Underweight on the sector. We remain cautious with drilling rig operators and shipbuilders in particular. We also highlight our concern with players with a huge call-out orderbook as they might face a further deferment and slowdown in their existing work.

Sector Outlook

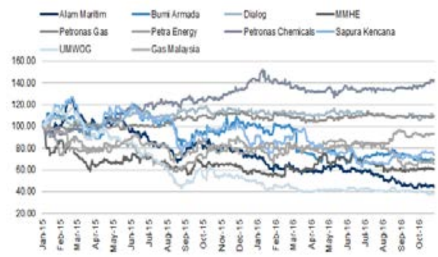
Oil & Gas

UNDERWEIGHT (maintain)

Absolute Performance (%)

	1M	3M	12M
PCHEM	4.2	5.9	9.4
PETGAS	0.1	-0.9	-5.8
SAKP	4.5	13.4	-24.1
DIALOG	1.3	0.0	-6.1
BUMI	0.0	-6.7	-27.5
GASMSIA	-0.4	10.1	10.5
UMW-OG	-2.8	-4.5	-28.2
MMHE	1.0	-5.6	-7.3
P.ENERGY	3.1	-20.2	-15.9
ALAM	1.9	-17.2	-44.8

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Chue Kwok-Yan
(603) 2146 7618
kwokyan.chue@affinhwang.com

Peers Comparison

Stock	Stock Ticker	Rating	Share Price (RM)	TP (RM)	Mkt Cap (RMm)	Year End	Core PE (x) FY16E	Core PE (x) FY17E	EPS Growth (%) FY16E	EPS Growth (%) FY17E	EV/EBITDA FY16E	P/BV FY16E (x)	ROE (%) FY16E	DY (%) FY16E
Petronas Chemical	PCHEM MK	SELL	6.98	5.29	55,840	Dec	22.4	22.0	(10.5)	1.9	9.3	2.2	10.5	2.3
Petronas Gas	PTG MK	HOLD	21.92	20.24	43,374	Dec	24.3	24.7	0.7	(2.0)	13.4	3.6	15.2	2.5
Gas Malaysia	GMB MK	HOLD	2.62	2.36	3,364	Dec	26.2	24.9	3.4	5.2	12.3	3.5	13.2	3.8
SapuraKencana ^	SAKP MK	HOLD	1.61	1.36	9,647	Jan	86.0	(89.4)	(81.2)	(75.3)	10.0	0.8	2.3	0.2
Bumi Armada	BAB MK	HOLD	0.70	0.64	4,106	Dec	21.7	10.4	(40.3)	108.0	13.6	0.5	2.9	0.7
Dialog ^	DLG MK	HOLD	1.53	1.45	8,115	Jun	24.5	21.3	24.3	15.1	17.6	3.1	13.8	1.6
UMW Oil and Gas	UMWOG MK	SELL	0.70	0.73	1,849	Dec	(8.5)	(10.9)	351.3	(21.8)	32.5	0.5	(8.1)	-
MMHE	MMHE MK	BUY	1.02	1.22	1,632	Dec	38.9	23.6	(50.4)	65.0	11.1	0.6	1.6	-
Petra Energy	PENB MK	BUY	0.99	1.48	318	Dec	8.2	5.1	2.1	59.4	5.0	0.6	5.2	2.4
Alam Maritim	AMRB MK	HOLD	0.27	0.36	245	Dec	(6.0)	(7.4)	nm	18.8	26.3	0.3	0.4	-
Mkt Cap simple average							**23.8**	**2.4**	**22.2**	**17.4**	**15.1**	**1.5**	**5.7**	**1.4**

^ FY16/17 column contains FY17/18 numbers due to different FYE

Source: Bloomberg, Affin Hwang forecasts; note: prices as of close on 26 October 2016

Possible surprises – upside and downside, and catalysts

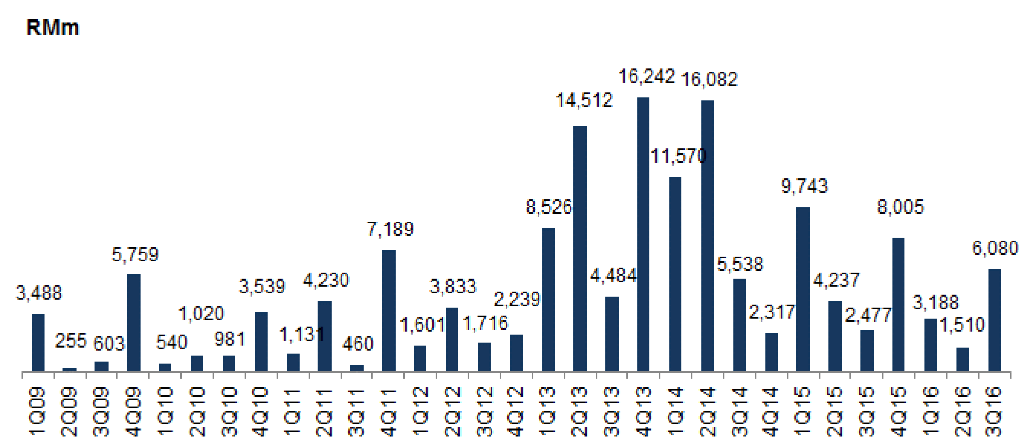
Key catalyst to a sector recovery would ultimately hinge on a recovery and stabilisation of crude oil prices. This would lead to a recovery in global sector capex, which would result in stronger-than-expected oil and gas contract flows and corporate earnings recovery.

Downside risks include further deterioration in crude-oil prices, continued scale back in global sector capex, any further impairment exercises and continued low activities, margin compression and cost overruns.

Valuation and recommendation, key stock ideas

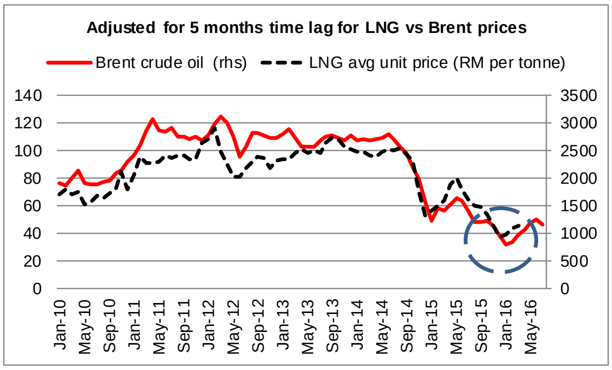
For O&G sector exposure, MMHE (MMHE MK, TP: RM1.22) and Petra Energy (PENB MK, TP: RM1.48) remain as our only two BUY calls. For MMHE, we like the name due to its strong parentage, attractive valuation and close to half of its market cap consisting of cash. Meanwhile, we mainly like PENB for its KBM-cluster RSC business. For bigger-cap exposure, our preferred exposure would be a company with clear long-term earnings visibility, preferably with a recurring-income business model like Bumi Armada (BAB MK, TP: RM0.64). We have a HOLD call on the stock, but advocate investors to monitor the counter closely.

Fig 1: Malaysia quarterly oil and gas contract flow



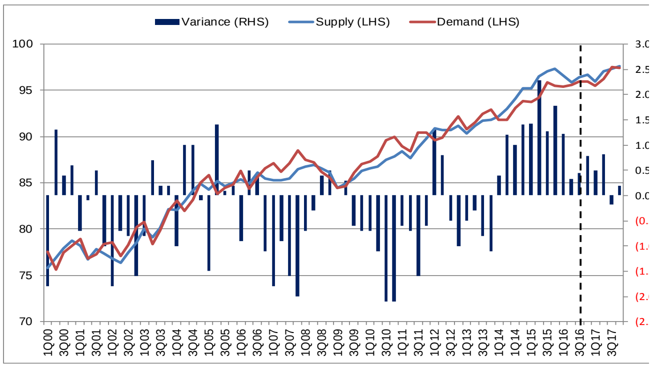
Source: Bursa Malaysia, Affin Hwang

Fig 2: Lag adjusted LNG vs Brent prices



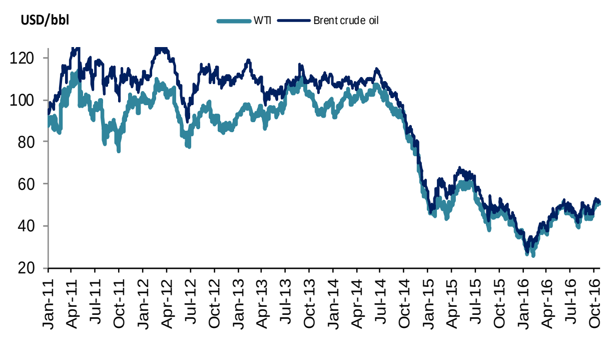
Source: Bloomberg, Affin Hwang

Fig 3: World Supply and demand dynamics



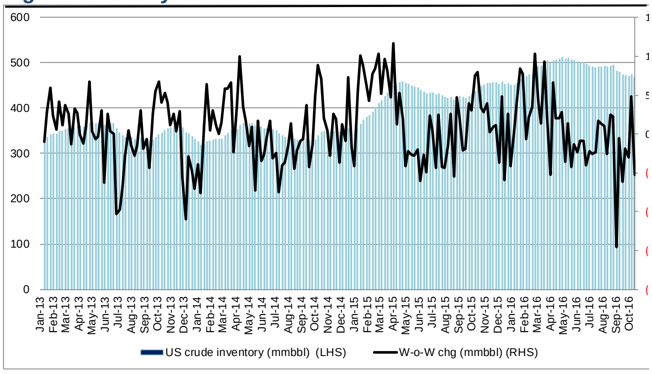
Source: EIA, Bloomberg, Affin Hwang

Fig 4: WTI and Brent prices



Source: Bloomberg

Fig 5: US weekly crude inventories



Source: Baker Hughes, Bloomberg

A better production year ahead

The average CPO prices in 2016 have been higher than in 2015 partly due to healthy demand and the decline in CPO production that brought inventory levels down. After the damages caused by the last El Niño, we are likely to see an improvement in production in 2017. We expect CPO ASPs to average RM2,400/MT in 2017E. As major producers and exporters, we expect Malaysia and Indonesia to remain committed to their biodiesel targets. We also see support from tighter stock-usage ratios for vegetable and palm oils. At current valuation levels, we maintain our NEUTRAL sector rating.

Likely key focus for 2017

2016 has been a tough year for the palm oil planters mainly due to the effect of El Niño phenomenon. The average CPO prices have been higher as compared to 2015 partly due to healthy demand from export countries like India and China as well as the decline in CPO production that brought inventory levels down. For 2017, we opine that the key focus will continue to be on: 1) magnitude of FFB yield and CPO production rebound; 2) world production of oilseeds and vegetable oils; 3) the extent of soybean oil premium; 4) crude-oil prices, which affect biodiesel economics; 5) progress in the implementation of biodiesel mandates in Malaysia and Indonesia; 6) any changes in policies, taxes and foreign land ownership; and 7) forecast of extreme weather conditions. Also, cost pressure may continue into 2017 as a stronger US$ increases fertilizer costs. We forecast CPO ASP at RM2,400/MT for 2017E (flat from 2016E assumption).

Possible surprises – upside and downside, and catalysts

Key risks to our forecasts include: (1) a strong recovery in the global economy boosting vegetable and crude-oil demand and prices; (2) a lower-than-expected soybean and palm-oil production; 3) an unforeseen sharp spike in cost of production (fertilizer, fuel and labour); (4) acute labour shortages affecting harvesting and planting activities; (5) unfavourable exchange rates resulting in forex loses in foreign operations; (6) an unfavourable/unfair policies; and (6) changes in export tax rates and regulations.

Key catalysts include: 1) a significant rebound in crude-oil prices; 2) a recovery in palm-oil exports; and 3) a strong commitment by the Malaysian and Indonesian government to achieve their biodiesel targets.

Sector Outlook

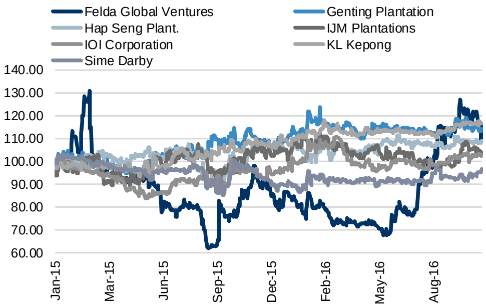
Plantation

NEUTRAL (maintain)

Absolute Performance (%)

	1M	3M	12M
SIME	5.5%	5.8%	-6.0%
IOI	0.2%	5.9%	3.5%
KLK	0.4%	4.8%	4.3%
FGV	-6.8%	19.5%	27.8%
GENP	-2.4%	1.3%	-0.7%
IJMP	-2.3%	7.1%	-3.3%
HAPL	-0.4%	4.8%	4.3%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Nadia Aquidah
(603) 2146 7528
nadia.subhan@affinhwang.com

Peer Comparison

Stock	Stock code	Rating	Sh Pr # (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY16E	Core PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	EV/EBITDA FY16E (x) ^	P/BV FY16E (x) ^	ROE (%) CY16E	DY (%) CY16E
Sime Darby	SIME.MK	SELL	8.10	6.74	53,811	June	23.0	18.4	10.7	25.3	12.8	1.6	6.8	3.7
IOI Corp	IOI.MK	HOLD	4.50	4.15	28,622	June	24.6	20.6	28.9	19.4	17.3	3.9	23.9	2.7
KL Kepong	KLK.MK	HOLD	24.00	21.70	25,620	Sept	25.6	20.3	7.1	26.3	11.8	2.6	10.1	2.1
Felda Global	FGV.MK	SELL	2.27	1.41	8,281	Dec	52.8	24.1	>100	118.6	16.0	1.3	2.5	3.5
Genting Plant	GENP.MK	SELL	10.68	9.56	8,425	Dec	40.6	21.2	(1.5)	91.3	23.1	2.0	5.0	1.1
IJM Plant	IJMP.MK	HOLD	3.45	3.53	3,041	March	30.2	18.6	56.5	62.6	15.6	1.9	11.8	2.9
Hap Seng Plant	HAPL.MK	HOLD	2.43	2.33	1,944	Dec	19.1	14.6	5.0	30.7	10.9	1.0	7.8	4.1
Wilmar *	WIL.SP	Not Rated	3.34	n.a	21,109	Dec	12.9	11.5	13.9	11.6	12.3	1.0	7.7	2.0
Golden Agri *	GGR.SP	Not Rated	0.39	n.a	4,046	Dec	14.2	14.2	100.0	0.0	10.1	0.6	3.6	2.1
Astra Agro **	AALI.IJ	Not Rated	15,600	n.a	24,565	Dec	19.1	15.7	117.5	22.1	8.4	1.8	14.5	1.7
Mkt Cap weighted average (excl FGV)							**25.3**	**19.4**	**14.4**	**29.7**	**14.4**	**2.4**	**11.5**	**2.9**

** S$ ** IDR # Share prices as at 26 Oct 2016 ^ FY17E for SIME, IOI and IJMP*

Source: Bloomberg, Affin Hwang forecasts

Valuation and recommendation, and stock ideas

We believe that weather has returned to normal in key planted areas. Given the effect of the last El Niño, damages that includes bunch failures, flower abortion and flower sex differentiation, production for 2016 until early 2017 is expected to remain weak. We maintain our CPO ASP assumption, target prices for plantation shares and sector NEUTRAL rating. Currently, we do not have any top pick for the plantation sector as we still do not have BUY-rated names in our coverage universe. IOI, KLK, IJMP and HAPL remain at HOLD. IOI's share price did rebound slightly after the RSPO certification suspension was lifted in August 2016. Meanwhile, we maintain our SELL calls on FGV, GENP and SIME. FGV's share price has rebounded substantially on optimism that the management refocus and the cost cutting measures should boost profitability. However, we opine that the rebound looks overdone.

Securities

Fig 1: Key palm oil statistics – September 2016

	Aug16 ('000 MT)	Sep16 ('000 MT)	mom change ('000 MT)	mom change %	Sep15 ('000 MT)	Sep16 ('000 MT)	yoy change ('000 MT)	yoy change %	YTD (Jan - Sep) ('000 MT) 2015	2016	%chg
Production	1,701.9	1,715.1	13.2	0.8	1,959.1	1,715.1	(243.9)	(12.5)	14,871.2	12,593.6	(15.3)
Export	1,823.6	1,451.1	(372.5)	(20.4)	1,680.5	1,451.1	(229.4)	(13.6)	12,733.4	11,957.0	(6.1)
Stock	1,464.1	1,547.2	83.1	5.7	2,641.6	1,547.2	(1,094.4)	(41.4)	2,641.6	1,547.2	(41.4)
Avg Price (RM/MT)	2,602.0	2,870.5	268.5	10.3	1,987.5	2,870.5	883.0	44.4	2,174.1	2,538.4	16.8

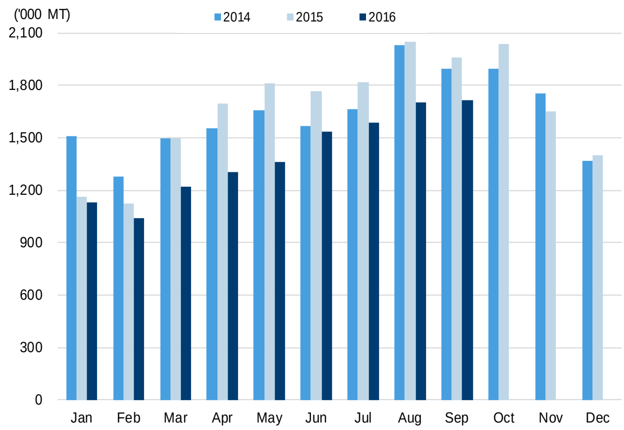
Source: MPOB

Fig 2: Exports to key destinations – September 2016

Destination (MT)	2015 Jul	2015 Aug	2015 Sep	2015 Jan-Sep	2016 Jul	2016 Aug	2016 Sep	2016 Jan-Sep	Change (%) Sep16 mom	Sep16 yoy	Jan-Sep16 yoy
China PR	290,209	194,876	192,537	1,957,667	210,781	298,723	197,555	1,318,212	(33.9)	2.6	(32.7)
India	351,515	263,946	357,156	2,518,581	189,858	439,652	262,301	2,320,039	(40.3)	(26.6)	(7.9)
Japan	30,087	45,219	60,153	404,432	43,638	36,109	31,144	320,706	(13.8)	(48.2)	(20.7)
Netherlands	154,156	143,371	109,834	1,055,119	100,585	109,018	88,829	726,452	(18.5)	(19.1)	(31.1)
Pakistan	40,310	101,950	57,766	543,758	60,649	84,015	92,258	605,333	9.8	59.7	11.3
United States	73,594	57,332	50,319	514,467	76,786	52,636	39,753	477,040	(24.5)	(21.0)	(7.3)
European Union	211,581	254,621	227,963	1,730,325	189,735	235,815	172,014	1,488,690	(27.1)	(24.5)	(14.0)

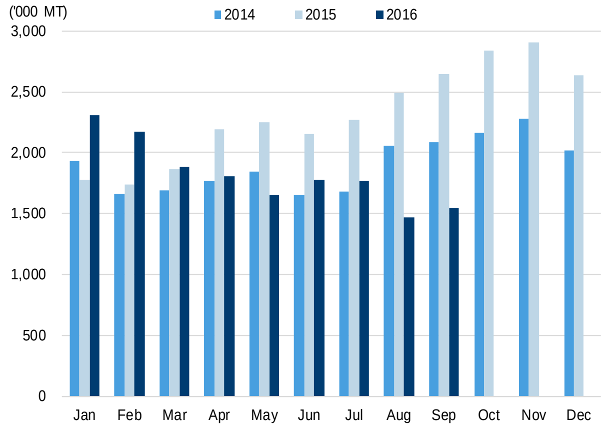
Source: MPOB

Fig 3: Monthly CPO production



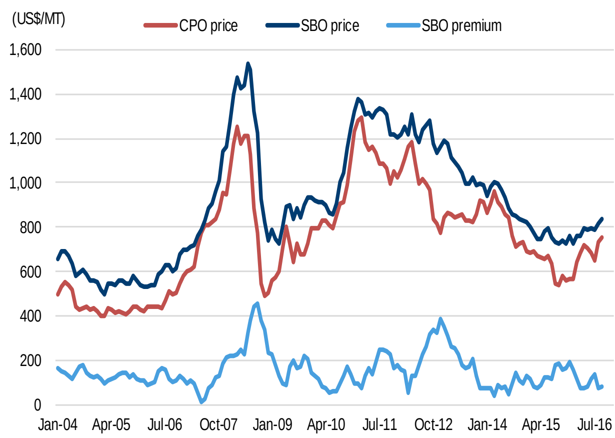
Source: MPOB

Fig 4: Monthly palm oil closing stocks



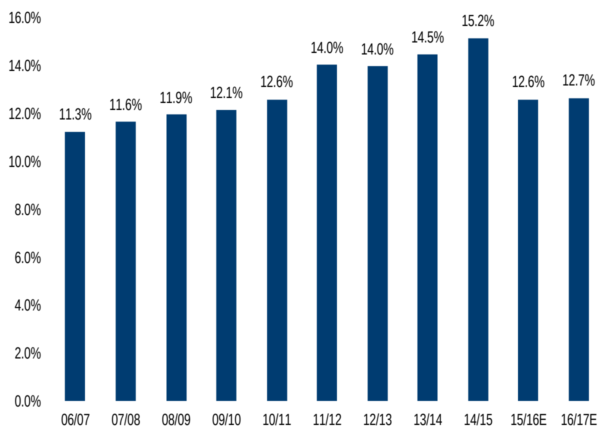
Source: MPOB

Fig 5: Soybean oil price, CPO price & premium



Source: Oil World, Bloomberg, Affin Hwang estimates

Fig 6: Stock/usage ratio of 17 Oils and Fats



Source: Oil World

Earnings rebound expected

The property market has undergone over two years of contraction in property-transacted volume due to tight bank-lending policies and cautious buyer sentiment. Property developers have been acceleratiing launches in 2H16 on expectations of pent-up home demand. We expect sector earnings are expected to fall 10% yoy in FY16 and rebound 8% yoy in FY17. We have an OVERWEIGHT call on the property sector. Our top BUYs are IOI Properties and UOA Development.

Likely key focus for 2017

Residential property transaction volume will likely be lower in 2016 compared to 2015, based on feedback from property developers. After peaking in 2011, transactions declined at CAGR of 4% to a low in 2015 and fell to a 7-year low of 49.6k units in 1Q16. The housing price index (HPI) growth has decelerated from a peak of 12.2% yoy in December 2012 to a low of 5.3% yoy in June 2016, narrowing the positive gap to CPI to a more sustainable 3.4ppt. We believe pent-up demand will drive a recovery in transactions in 2017. Property developers will likely focus on launching homes costing below RM700k to ensure affordability.

Earnings outlook – visibility, momentum and risks

We believe weaker sales for most developers in 2016 and profit-margin contractions will lead sector earnings to decline 10% yoy in 2016. Profit margins are under pressure due to competition, rising development costs and weak property-market sentiment, affecting product pricing and take-up rates. We expect a recovery in sales and more stable profit margins to drive an 8% yoy rebound in sector earnings in 2017.

Our view and strategy for 2017

We prefer property developers that have the highest exposure to the Klang Valley due to robust demand, supported by improving infrastructure (MRT Line 1 due to commence operation in mid-2017), high job creation and urban migration. The Penang market should remain stable due to its heritage attractions, land scarcity on the island and the relatively high savings rate of the local population. The Johor market should remain challenging due to the oversupply of high-end condominiums that are due for completion in 2016-17. Township developers are expected to see sustained local demand while high-end condominium developers should continue to face a challenging market environment.

Sector Update

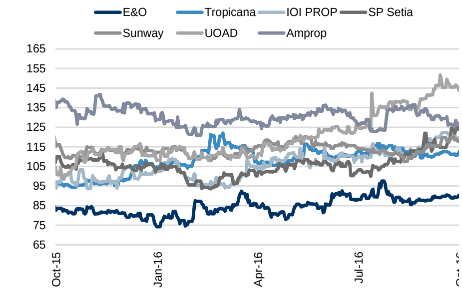
Property

Overweight (maintain)

Absolute Performance (%)

	1M	3M	12M
E&O	-3.0	-5.8	+3.8
Tropicana	0.0	-3.8	+5.7
IOI PROP	-0.8	+2.9	+13.4
SP Setia	-1.4	+15.0	+4.2
Sunway	-3.8	+2.7	0.0
UOAD	-0.4	+8.9	+24.9
Amprop	-3.7	-10.1	-9.1

Relative Performance (%)



Source: Affin Hwang, Bloomberg

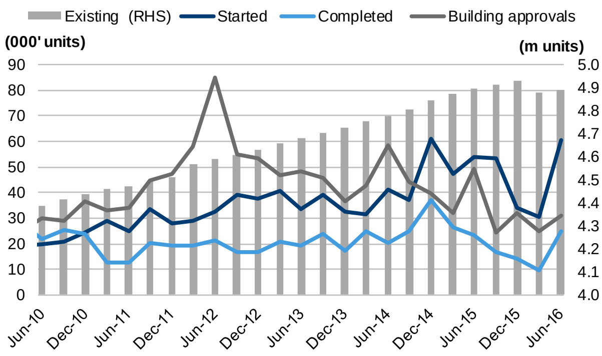
Loong Chee Wei CFA
(603) 2146 7548
cheewei.loong@affinhwang.com

Peer Comparison

Stock	Bbg	Rating	Sh Pr (RM)	TP (RM)	Mkt cap (RMbn)	Core PER (x) CY16E	Core PER (x) CY17E	Core EPS gr (%) CY16E	Core EPS gr (%) CY17E	P/RNAV (x)	P/BV (x) CY16E	ROE (%) CY16E	DY (%) CY16E	Year end
SP Setia	SPSB MK	BUY	3.46	3.25	9.8	13.3	13.0	(27.8)	2.5	0.7	1.3	9.8	3.4	Dec
IOI Prop	IOIPG MK	BUY	2.49	2.89	11.0	10.9	11.0	18.8	(0.9)	0.6	0.7	6.9	4.0	Jun
Sunw ay	SWB MK	BUY	3.03	3.06	6.2	9.7	8.6	(10.7)	12.2	0.6	0.9	9.0	3.3	Dec
UOA Devt	UOAD MK	BUY	2.58	2.64	4.2	11.6	9.7	(20.2)	20.0	0.7	1.2	10.5	4.7	Dec
E&O	EAST MK	BUY	1.64	1.98	2.1	45.0	33.8	(20.6)	33.2	0.4	1.2	2.3	1.2	Mar
Tropicana	TRCB MK	BUY	1.02	1.95	1.5	7.4	7.0	(10.4)	6.5	0.3	0.5	6.7	6.4	Dec
AmProp	APRO MK	BUY	0.79	0.89	0.5	6.0	3.6	9.5	64.2	0.4	0.4	13.0	6.8	Mar
Wgt avg						**13.0**	**12.0**	**(9.8)**	**8.2**	**0.6**	**1.0**	**8.1**	**3.7**	

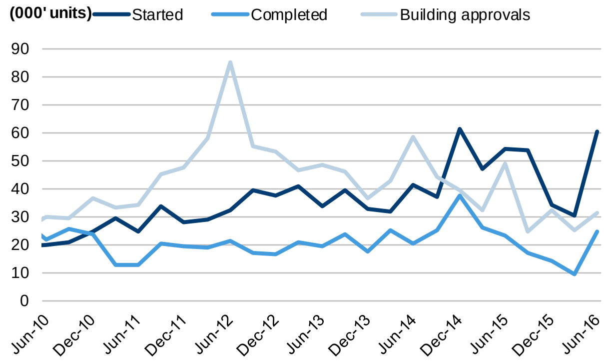
Source: Bloomberg, Affin Hwang forecasts
Note: prices as of close on 26 October 2016

Fig 1: Residential property stocks



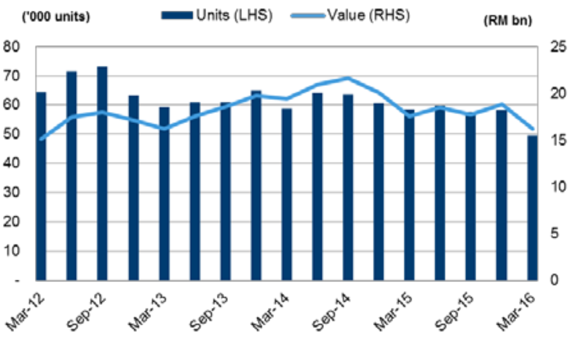
Source: CEIC, BNM

Fig 2: Planned supply houses in Malaysia



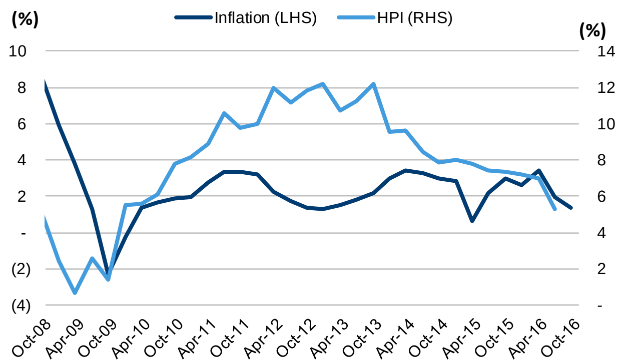
Source: CEIC, Napic

Fig 3: Malaysia residential property transactions



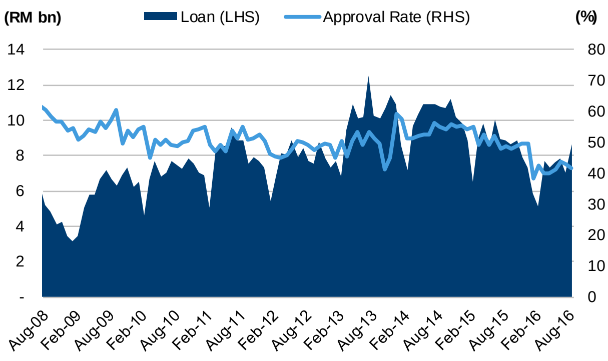
Source: CEIC, Napic

Fig 4: Headline inflation and housing price index



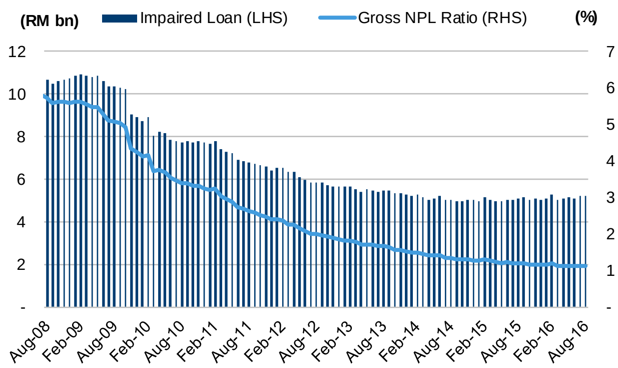
Source: CEIC, Napic, BNM

Fig 5: Residential property loan approval and rate



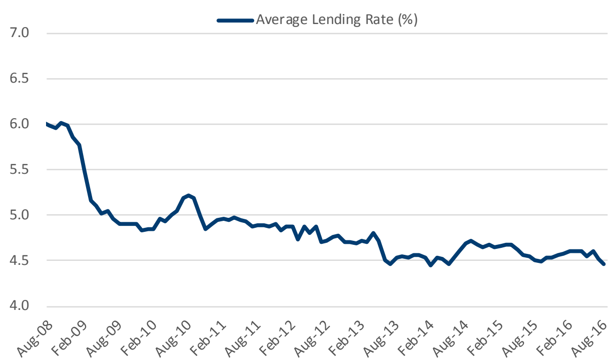
Source: CEIC, BNM

Fig 6: Residential property gross impaired loan and ratio



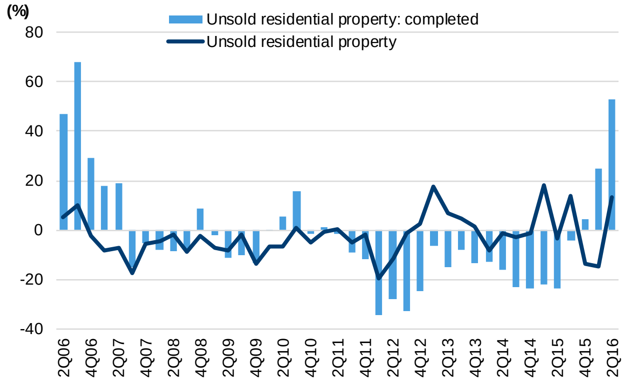
Source: CEIC, BNM

Fig 7: Average lending rate



Source: CEIC, BNM

Fig 8: Unsold residential property



Source: CEIC, Napic

Possible surprises – upside and downside, and catalysts

Amongst the possible upside surprise are stronger-than-expected property sales due to pent-up demand and the easing of tight bank lending requirements. Further interest rate cuts (following the 25bps cut this year) would likely reduce the financing costs for properties and stimulate demand. We remain cautious on the high-end condominium segment as well as property projects in Johor. Potential downside risks are sustained high residential loan rejection rates and weak property sales. The rising supply of unsold residential properties is also a concern.

Valuation and recommendation, key stock ideas

We reiterate our **Overweight** call on the property sector. Property stocks under coverage are trading at what we view as attractive 30-58% discounts to FY16E RNAV. The FY16-17E sector core PER of 12x is undemanding on expectations of a rebound in core earnings growth of 8% yoy in FY17.

We like Klang Valley-focused niche developer **UOA Development** with what we view as an attractive FY16E net yield of over 4%.

IOI Properties is our preferred pick as a township and integrated high-rise developer.

Staggered expansion to relieve ASP pressure

Sector Outlook

Rubber Products

NEUTRAL (maintain)

CY17 looks likely to be another competitive year for rubber gloves players with a projected 12% CAGR in capacity for CY16-19E, against the backdrop of consumption growth of 6-8%, barring any external systemic shock (Zika, Ebola). Market share gains via scale up in capacity expansion should continue to dominate headlines, which should trickle down to downside ASP pressure. However, expanding market share by major players and the oligopolistic nature of the industry could keep expansion plans staggered to maintain industry supply-demand dynamics and allow better demand absorption to avoid excessive glut. Cost control measures remain essential in light of limited ASP upside and unrelenting production costs increase. Maintain NEUTRAL outlook. Top Glove is our only BUY.

Big 4 to maintain global dominance

We expect Malaysia rubber gloves players to chalk up market share, now at 63% of total world production, to 65% by CY18E. High barriers to entry, proximity of raw materials, favourable weather conditions, subsidised energy costs and technological efficiencies should help to maintain Malaysian players' dominance in gloves manufacturing. Nitrile capacity in particular should experience a sharp rise in production output, led by aggressive capacity building by Top Glove and Hartalega in the segment.

Low penetration promotes underlying organic growth

Industry structural growth will continue to be underpinned by rising awareness, increasing hygiene standards and healthcare reforms. Gloves' essential usage as medical devices and cleanroom products are a demonstration of its demand resilience, which should provide a long-term consumption growth trajectory. Global gloves penetration per capita remains low in emerging economies as compared to the developed nations, which could provide underlying organic growth for gloves demand through education and implementation of minimum hygiene standards and mandatory use of gloves in medical services.

Transformation into a OBM giant

Karex specialises in condom manufacturing, and is a broader play for the rubber products. We like Karex for its strategic ambition to transform from an OEM manufacturer pure-play into a hybrid OBM manufacturer with superior brand equity. Karex has scaled up its OBM contribution (now at 10% of total revenue, with plans to double to 20% by CY20E), and is now focusing on consolidating numerous brands under its banners into a single brand identity. Rich valuations, however, offer limited upside for now.

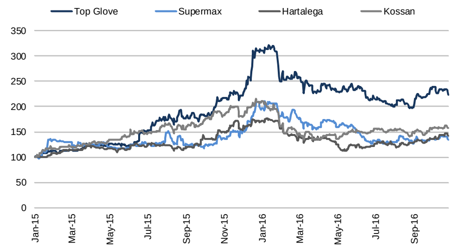
Maintain NEUTRAL

We maintain our sector rating at **NEUTRAL**, as a reflection of the lacklustre profitability growth profit vis-à-vis the sector valuations. The sector is now trading at 19x CY17E EPS, which is above mean valuations. We forecast 9% earnings growth for CY17 on the back of a 12% capacity CAGR for CY16-19E. **Top Glove** remains our only **BUY** call in the sector, as we like the stock for its balanced product mix and rising efficiency.

Absolute Performance

	1M	3M	12M
Hartalega	+6.1%	+11.4%	+6.0%
Karex	+2.9%	+2.9%	+7.6%
Kossan	+3.3%	+1.8%	-17.2%
Supermax	+1.4%	+1.9%	+5.3%
Top Glove	-0.8%	+11.2%	+3.2%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Coverage Summary

Name	Rating	Price (RM)	TP (RM)
Hartalega	HOLD	4.88	4.00
Karex	HOLD	2.49	2.50
Kossan	HOLD	6.88	6.40
Supermax	HOLD	2.16	2.30
Top Glove	BUY	4.78	5.40

Source: Affin Hwang, Bloomberg

Note: Closing prices as of 26 October 2016

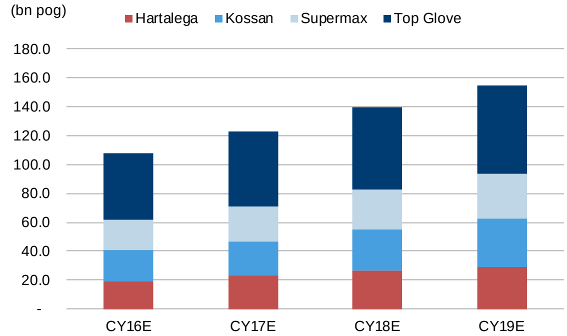
Aaron Kee
(603) 2146 7612
aaron.kee@affinhwang.com

Peers comparison table:

Company	Ticker	Rating	Price (RM)	TP (RM)	Mkt Cap (RMm)	Core EPS growth (%) CY16E	Core EPS growth (%) CY17E	Core PE (x) CY16E	Core PE (x) CY17E	Div Yield (%) CY16E	Div Yield (%) CY17E	ROE (%) CY16E	ROE (%) CY17E
Hartalega	HART MK	HOLD	4.88	4.00	8,008.1	12.3	9.3	29.0	26.6	1.4	1.5	17.8	17.4
Kossan	KRI MK	HOLD	6.88	6.40	4,399.8	0.3	16.0	21.6	18.6	2.4	2.7	18.8	19.7
Supermax	SUCB MK	HOLD	2.16	2.30	1,450.0	(18.8)	16.4	14.1	12.1	2.1	2.5	9.2	10.0
Top Glove	TOPG MK	BUY	4.78	5.40	5,996.5	23.9	3.1	15.9	15.5	3.1	3.2	20.2	18.9
Karex	KAREX MK	HOLD	2.49	2.50	2,496.0	10.2	18.7	36.9	31.1	0.5	0.5	13.5	13.7
Sector		NEUTRAL			22,350.3	9.1	9.1	20.7	19.0	2.2	2.4	17.1	16.9

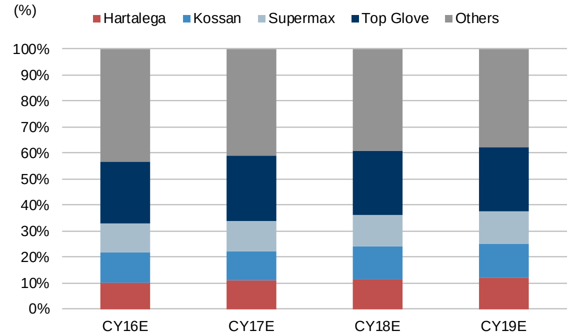
Source: Bloomberg, Affin Hwang forecasts; note: prices as of close on 26 October 2016

Fig 1: Projected capacity expansion



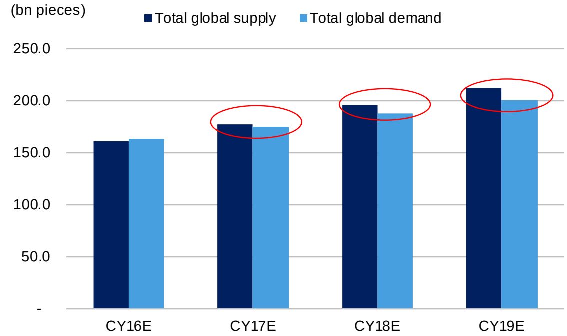
Source: Affin Hwang estimates, companies

Fig 2: Projected global market share



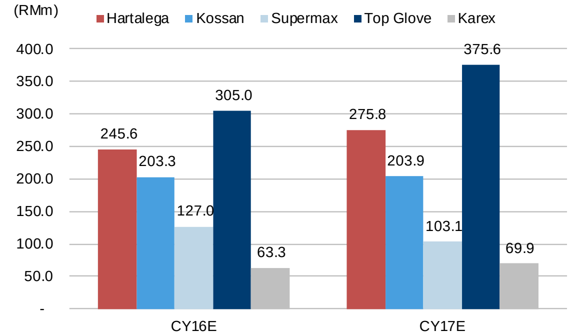
Source: Affin Hwang forecasts

Fig 3: Projected supply-demand of gloves



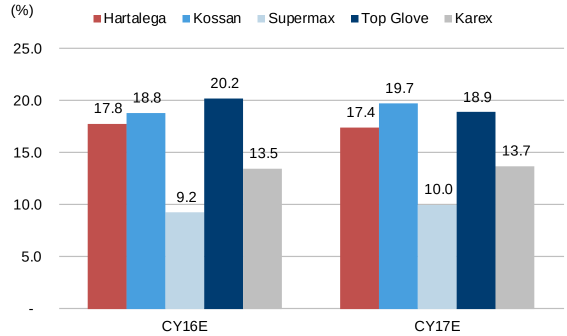
Source: Affin Hwang forecasts

Fig 4: PAT comparison



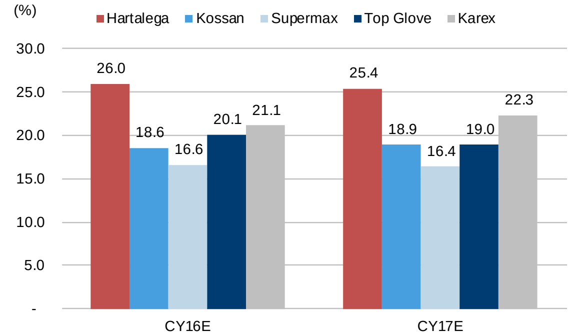
Source: Affin Hwang forecasts

Fig 5: ROE % comparison



Source: Affin Hwang forecasts

Fig 6: EBITDA margin % comparison



Source: Affin Hwang forecasts

Securities

AFFIN HWANG CAPITAL

Daiwa Capital Markets

Sector Outlook

Technology

NEUTRAL (maintain)

Pockets of opportunity

Although sector earnings growth is mediocre, and there is earnings risk from a global macroeconomic standpoint, we still see strong structural growth in the automotive and optical space. Demand for RF also remains robust because of technology enhancement and growing complexity. We maintain our Neutral call on the sector, with our top picks Inari and KESM as plays on the above themes. Scicom is favoured name in the non-semiconductor space.

Likely key focus for 2017

Ytd, the KL Technology Index (KLTI) has underperformed the broader FBMKLCI. This can be attributed to the strong performance of the KLTI towards the end of 2015, also at a time when the play was on exporters who were benefitting from a rapidly depreciating Ringgit then. We think that exporters would largely remain in focus as investors seek beneficiaries from a weak currency. However, more important is demand from end consumers and this would likely be a function of global macroeconomic conditions. Thus far, the economies in the Euro region and China remain relatively sluggish. Any further deterioration could prolong the inventory imbalance within the system. Weak consumer demand would also impact the already-slowing global smartphone sales. New technology or killer apps could spur demand and drive device sales growth. 2016 was exciting in terms of the introduction of augmented reality (Pokemon Go) and we think that there is further scope for growth in the area of virtual and augmented reality. While the Internet of Things (IOT) is likely to be still a number of years away, the best focus in the near term would be on strong consumption for data. Players within the optical space (Inari) come to mind.

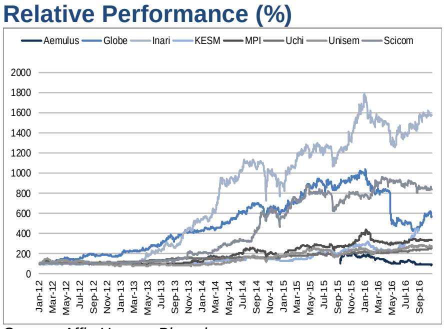
Earnings outlook – visibility, momentum and risks

We are expecting sector earnings to recover slightly from +0.9% to +2.9% yoy in 2017. Earnings growth is, however, due to a fairly mixed bag as we expect MPI and Unisem to register earnings declines in 2017 after a prolonged earnings upcycle. Because of their more diversified exposure to various end-consumer markets, we believe that earnings will remain at risk because of frail global economic conditions. If not for the weak RM, the impact from weak sales (on a US$ basis) would have been a drag on earnings much earlier. Conversely, we have Globe which is expected to register a strong 129% yoy rebound in earnings in 2017 due to the earnings slump it experienced in 2016. This was after sustaining weak demand for its products, while experiencing some delays in new-product launches. Inari and KESM are the only two companies that we believe will continue to post positive and strong earnings growth on a yoy basis in 2017E.

Absolute Performance (%)

	1M	3M	12M
Aemulus	-4.4%	+3.0%	-10.1%
Globe	+3.8%	+14.2%	-4.3%
Inari	+1.2%	+12.1%	-1.2%
KESM	+0.3%	+2.2%	+5.6%
MPI	+0.3%	+2.2%	+5.6%
Scicom	+0.3%	+2.2%	+5.6%
Uchi	+0.3%	+2.2%	+5.6%
Unisem	+0.3%	+2.2%	+5.6%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Kevin Low
(603) 2146 7479
kevin.low@affinhwang.com

Peer Comparison

	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY16E	Core PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	EV/EBITDA (x)	P/B (x)	ROE (%) CY16E	ROE (%) CY17E	Div. Yield (%) CY16E	Div. Yield (%) CY17E
Aemulus	SELL	0.245	0.20	108	Sep	107.2	18.8	-87.9	471.4	24.9	1.6	3.0	7.6	0.0	0.0
Globetronics	HOLD	3.56	3.58	1,002	Dec	34.1	14.9	-51.2	128.8	16.9	3.3	8.8	22.2	2.6	6.0
Inari	BUY	3.33	3.54	3,167	Jun	19.0	15.8	16.7	20.3	12.4	4.1	25.0	25.6	2.5	2.9
KESM	BUY	9.80	11.00	422	July	13.0	10.7	41.1	21.8	3.5	1.5	11.5	12.4	1.1	1.3
MPI	HOLD	8.00	8.25	1,679	Jun	11.0	14.2	4.4	-22.2	4.1	1.9	15.2	12.2	2.9	2.5
Scicom	BUY	2.07	2.74	736	Jun	16.8	15.1	16.8	10.9	12.4	6.7	43.3	41.4	4.3	4.1
Uchi	HOLD	1.75	1.69	764	Dec	14.3	14.5	-2.7	-1.3	10.1	3.1	22.6	21.2	6.3	6.3
Unisem	SELL	2.59	1.98	1,862	Dec	12.7	14.9	-8.9	-14.7	5.9	1.3	10.9	8.7	4.7	3.9
Average						**15.5**	**14.8**	**-0.8**	**5.0**	**11.3**	**2.9**	**17.5**	**18.9**	**3.1**	**3.4**

Source: Bloomberg, Affin Hwang forecasts *Note: Prices as of close on 26 October 2016*

Our view and strategy for 2017

Despite our concerns over weaker global semiconductor sales, we believe that there are still pockets of opportunity. Although broadbase exposure to the smartphone space may be a little less exciting considering the market saturation, we think a play on Inari and on the RF space remains relevant. Demand for its customer's RF components remains robust due to its customer's leading-edge proprietary technology. Penetration into the China-brand smartphone market will be a major growth driver, in our view. We also like exposure to the automotive segment within the semiconductor market. Touted to be stable with high barriers to entry, we believe that the automotive space, which is expected to register above-industry growth rates will continue to be spurred by increasing safety features, infotainment and upcoming autonomous vehicles.

Possible surprises – upside and downside, and catalysts

On the whole, semiconductor datapoints remain weak as SIA monthly sales remain on the decline. Although global sales registered a positive growth in August 2016, excluding this, sales have been contracting for the past 13 months. This is likely the reason behind SIA's guidance for weaker overall sales this year, which is expected to decline by -2.4% yoy (we note however that SIA is projecting a growth of +2% in 2017E). Poorer demand has been attributed to a combination of weak macroeconomic conditions in Europe, an ongoing inventory imbalance and also the appreciation of the US$ which has impacted the purchasing power of selected markets. Any, stronger-than-expected demand or improvement in global macroeconomic conditions would positively spur end demand and, thus, sales.

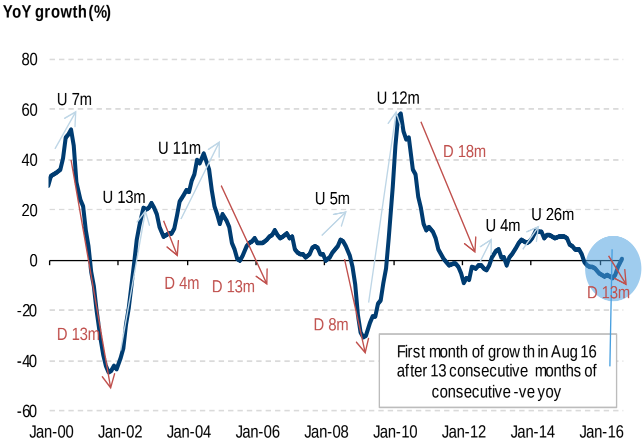
Valuation and recommendation, key stock ideas

For sector exposure, we like Inari **(INRI MK, BUY; TP:RM3.54)** for its RF growth story which would be led by 4G adoption (already moving to 5G) as well as the upgrade cycle. While contributions from its new plant, P21, will likely be immaterial in FY17 (June year end), the production ramp up of its data server chips at this facility makes Inari an attractive proposition in terms of a play on optical, and hence IoT.

KESM (KESM MK, BUY; TP: RM11) remains one of our high-conviction plays as it is poised to benefit from an automotive structural growth story which is underpinned by rising electronic content in vehicles and fully-autonomous vehicles in the near future.

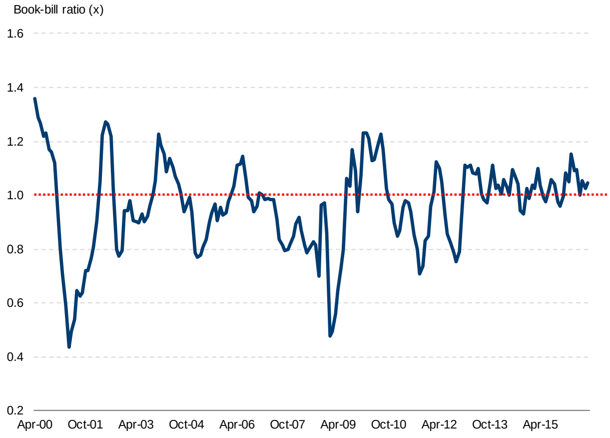
In the non-semiconductor space, we like **Scicom (SCIC MK, BUY: TP: RM2.74)** for the potential upside from its concession based earnings from EMGS as it upsells its ancillary services. The e-government service is being replicated and is highly scalable. Meanwhile, the BPO segment remains relatively resilient attracting a host of MNCs.

Fig 1: SIA global sales - Still early days to a recovery



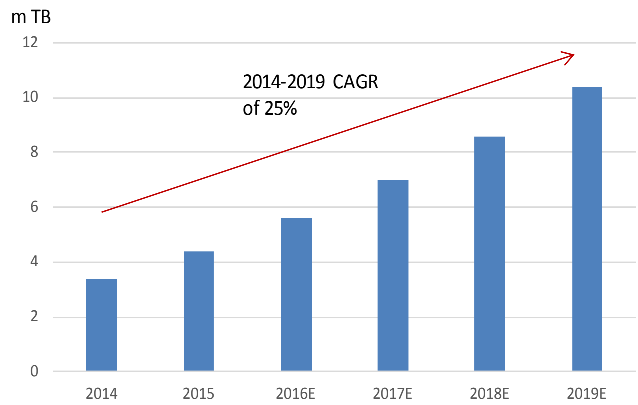
Source: SIA, Affin Hwang

Fig 2: Book-to-bill ratio still mix



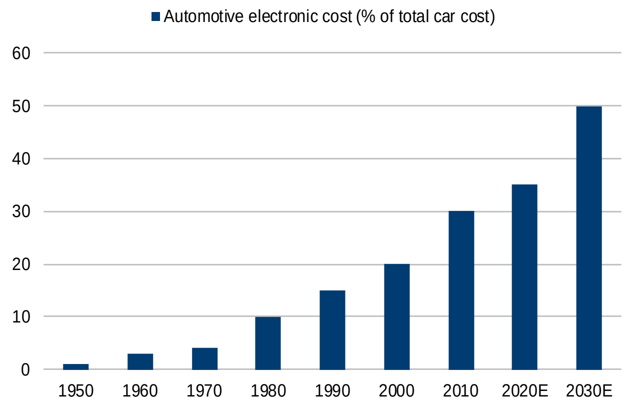
Source: SEMI, Affin Hwang

Fig 3: Global data centre IP growth



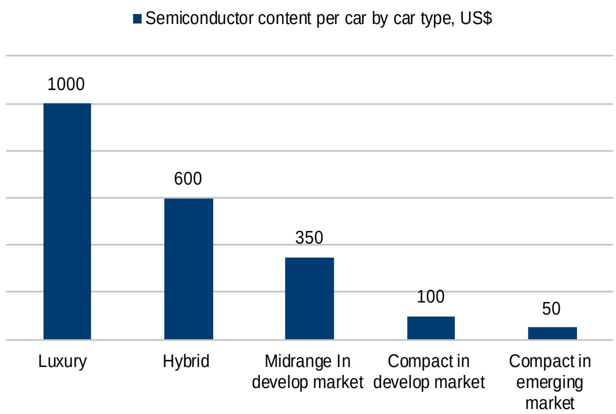
Source: Cisco

Fig 4: Rising semiconductor content in cars



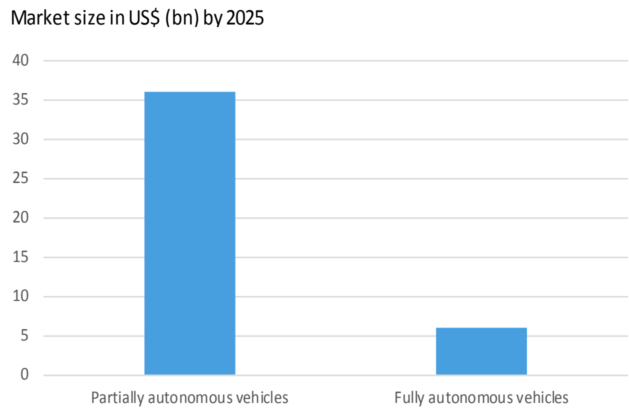
Source: PwC Global Semiconductor Report

Fig 5: Semiconductor content by type of car



Source: McKinsey

Fig 6: Projected size of global autonomous vehicles



Source: Statistica

One down, two to go

The telco sector has turned less favourable with increased financial commitment, competition while valuations are not reflecting this. Strong fund flows are the key culprit as this sector remains a key component to the KLCI and also one that remains to large Shariah funds. We nevertheless believe that sector dynamics have turned less favourable, leading to sufficient reasons for underperformance in the sector. Downgrading to Underweight.

Likely key focus for 2017

The Government's recent re-allocation of the 900Mhz and 1800Mhz spectrum managed to squeeze out a total of c. RM6.1bn (over the duration of the spectrum) from the 4 telco operators. The initial upfront commitment of RM2.6bn is due on 1 November 2016. This huge outlay will not be the last with another reallocation due by end-2016 for 2300MHz and 2600MHz bands along with the prized 700MHz (upon completion of the digitalization and migration of current broadcast operators). We do not expect future spectrum re-farming exercises (2100Mhz band due for renewal in 2018) to be cheap given the scarcity value and high ability (profitability) of telcos to absorb this commitment. The latter comes handy, especially, when the government is trying to achieve its fiscal deficit reduction target, giving more reasons to believe that the telcos will be further burdened going forward. On the competition front, clearly, the fourth player, U Mobile, has negatively impacted the sector's economics. Its aggressiveness has taken a toll on the incumbents's revenue and profitability in the past 2 years. Based on current trends and ytd performance, incumbents are set to post a third consecutive year of earnings decline.

Earnings outlook – visibility, momentum and risks

We are forecasting sector core earnings growth of +6.7% in 2017E, after registering 3 consecutive years of earnings decline. Nevertheless, our stronger growth assumption is largely led by Axiata where we expect earnings to jump 20% yoy, factoring an overall improvement in its domestic and regional units which have been a drag. Any unexpected competition could further delay this turnaround, thus posing further downside risk to the share price. Our earnings growth assumptions for DiGi, Maxis and TM are relatively more modest, on stable revenue and margin assumptions.

Our view and strategy for 2017

Sector valuations are near their peak while dividends yields are significantly lower, which in our view does not justify the premium valuations that the sector commands. Meanwhile, cellcos face increased earnings and CF risk from future spectrum re-farming exercises, while any further price competition could further erode the yield proposition that the telcos offer. We downgrade the sector to Underweight (from Neutral) on the unexciting prospects and high downside risk to FCFs and dividends.

Sector Outlook

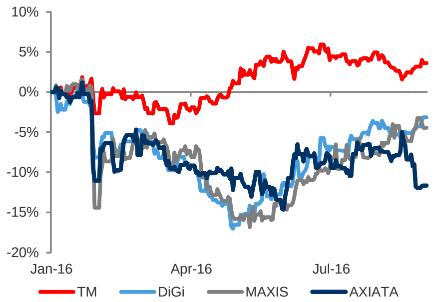
Telco

UNDERWEIGHT (downgrade)

Absolute Performance (%)

	1M	3M	12M
Axiata	-4.4%	+3.0%	-10.1%
Maxis	+3.8%	+14.2%	-4.3%
DiGi	+1.2%	+12.1%	-1.2%
TM	+0.3%	+2.2%	+5.6%

Relative Performance to KLCI (%)



Source: Affin Hwang, Bloomberg

Kevin Low
(603) 2146 7479
kevin.low@affinhwang.com

Peer Comparison

	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY16E	Core PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	EV/EBITDA (x)	P/B (x)	ROE (%) CY16E	ROE (%) CY17E	Div. Yield (%) CY16E	Div. Yield (%) CY17E
Axiata	HOLD	5.08	5.50	43,597	Dec	23.9	19.8	-11.8	20.4	6.5	2.0	8.4	9.9	3.3	3.9
Maxis	HOLD	6.00	6.08	45,035	Dec	22.6	22.6	1.8	0.0	11.8	9.5	45.2	39.9	3.3	3.3
DiGi	HOLD	5.02	5.09	39,031	Dec	23.0	22.8	-3.0	1.1	13.8	75.2	326.5	330.1	4.3	4.4
TM	SELL	6.60	5.85	24,803	Dec	32.3	31.1	-14.3	4.0	8.2	3.2	11.1	10.5	2.8	2.9
Average				**152,465**		**24.3**	**22.7**	**-5.8**	**6.7**	**10.1**	**22.5**	**97.8**	**97.6**	**3.4**	**3.6**

Source: Bloomberg, Affin Hwang forecasts. Note: Prices as of close on 26 October 2016

Possible surprises – upside and downside, and catalysts

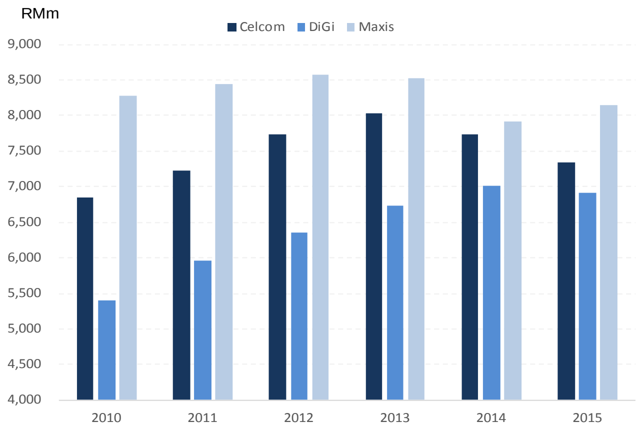
While the irrational competition has somewhat dissipated in recent months, we would not discount further threats from U Mobile which is now a more formidable player with enhanced spectrum allocation. On the other hand, competition from YTL's Yes and Webe remains rather elusive, although to be fair, the latter has only recently rolled out its services. TM's strong balance sheet and convergence ambitions also make Webe a real threat. Any rapid turnaround in Webe would remove the earnings drag on TM. In the recent Budget 2017, measures were also implemented to reduce broadband tariffs. Any better-than-expected demand for home broadband packages due to lower prices could also positively surprise.

From a fund-flow perspective, the Telcos are large cap, liquid and a Shariah compliant sector, which continues to benefit to its weighting and positioning as a stable FCF sector.

Valuation and recommendation, key stock ideas

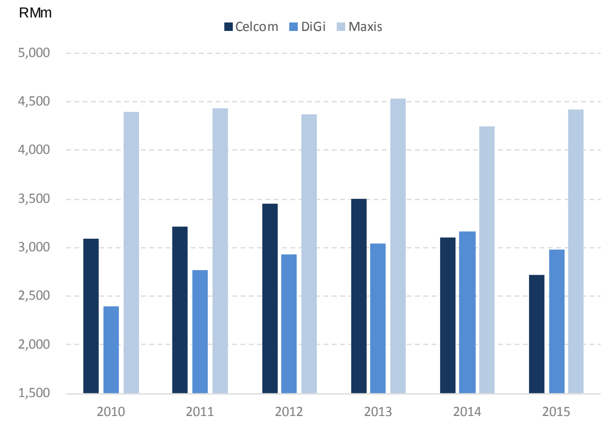
We prefer the cellcos over the fixed-line operators as we see higher room to by the operators to maneuver. Moreover, we see an imminent cut to profitability for TM's (T MK, SELL) broadband operations upon the implementation of the Budget 2017 measures. Meanwhile, the risk to earnings from its wireless ambitions remains high, and should remain a drag given its limited value proposition. For exposure, we have a preference for **DiGi (DIGI MK, HOLD, TP: RM5.09)** which should benefit from improved product offerings, network coverage and capex efficiency with its improved spectrum allocation. At the same time, gearing levels allow it to meet spectrum payments and, more importantly, sustain its dividend yield, which is incidentally also the best in the sector.

Fig 1: Cellco sector revenue impacted by U mobile…



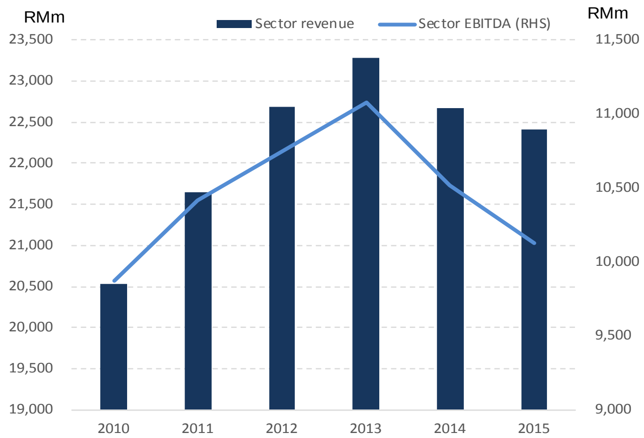
Source: MCMC, Affin Hwang

Fig 2: ..and likewise EBITDA



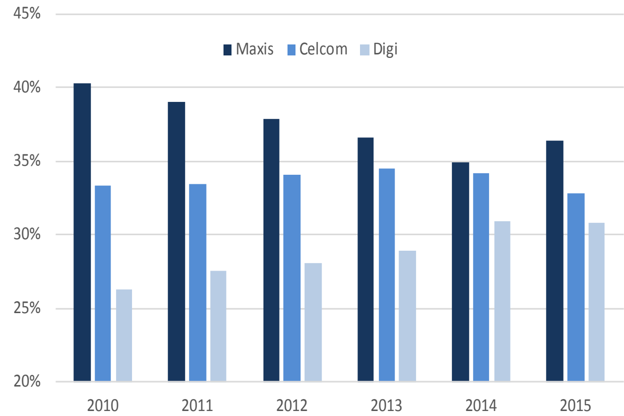
Source: MCMC, Affin Hwang

Fig 3: DiGi's revenue market share growing



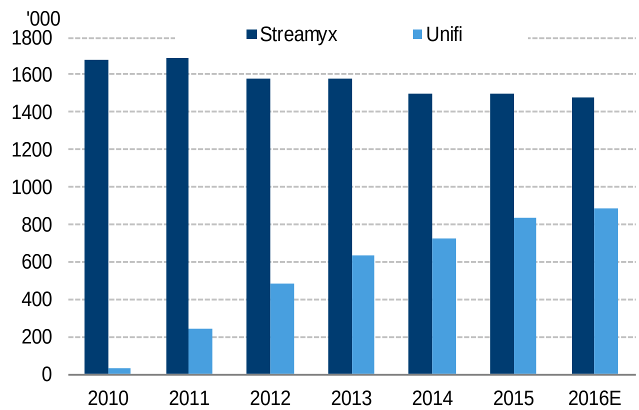
Source: Company, Affin Hwang

Fig 4: DiGi's revenue market share growing



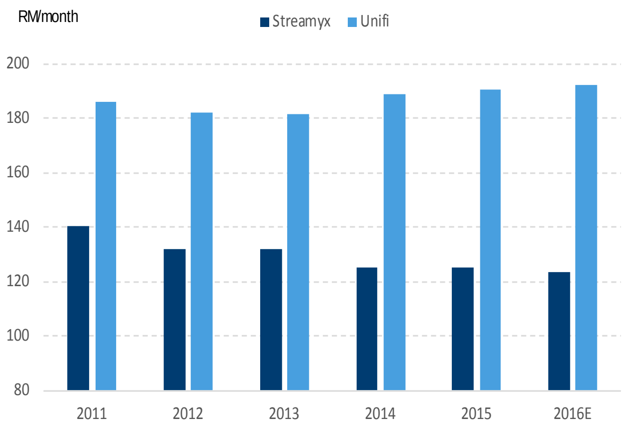
Source: Company, Affin Hwang

Fig 5: Strong high-speed broadband take-up



Source: Company, Affin Hwang

Fig 6: Unifi ARPUs have trended up



Source: Company, Affin Hwang

Earnings boost from palm-oil segment

We are still optimistic on the palm-oil plantation segment. We maintain our OVERWEIGHT stance on the timber sector mainly because of its exposure to the palm-oil division. FFB and CPO production for timber companies with plantation exposure is expected to continue to increase as more estates mature. The improving earnings from the palm-oil division are likely to offset the decline in contribution from the timber division, mainly due to lower exports of timber products and ASPs. For sector exposure, Ta Ann remains our preferred pick with a TP of RM4.67.

Likely key focus for 2017

The key focus in 2017 would largely concentrate on: 1) India and Japan's demand for timber products (both are key export markets of Malaysia logs and plywood); 2) Malaysia's log production and export quotas; 3) timber product prices; 4) the exchange rate of US$ against the RM; and 4) the increase in FFB and CPO production as well as the CPO price trend. Demand for timber products will likely stay lacklustre as big buyers like India are still cautious on their purchases and try to source for lower-cost timber products due to the depreciation of their currency against the US$. Japan's demand for plywood has also remained soft despite the steady new housing starts. We believe that there will not be any rush-in orders for plywood from Japan largely due to the change in plans to increase the consumption tax hike to 2019. For 2017, we are forecasting log ASPs at US$210-230/$m^3$ and plywood ASPs at US$480-510/$m^3$. In 2016, the contribution from the palm-oil division has improved and this has helped to offset the decline in the timber division. Going forward, we opine that the palm-oil division will continue to boost earnings given the increase in FFB and CPO production as more estates mature and production yield improves.

Possible surprises – upside and downside, and catalysts

Positive catalysts for the timber sector are: 1) a significant rebound in CPO prices; 2) a stronger-than-expected economic growth in key import markets (Japan, India and China), which should help boost timber demand; 3) a sharp reduction in competition from other major timber exporting countries; and 4) a significant strengthening of US$ against the RM.

Meanwhile, the key downside risks to our sector call would be: 1) major disruptions in log and palm-oil production due to extremely bad weather conditions; 2) a weaker-than expected economic growth in key export market; 3) a sharp drop in ASPs for timber, FFB and CPO products; 4) unfavourable policies curtailing palm-oil exports; and 5) weakness in currencies of key import markets curbing demand and pressuring prices.

Sector Outlook

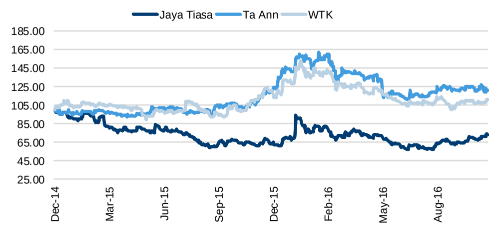
Timber

OVERWEIGHT (maintain)

Absolute Performance (%)

	1M	3M	12M
Ta Ann	-2.5%	5.7%	10.5%
Jaya Tiasa	6.1%	25.2%	10.3%
WTK	0.9%	2.8%	0.0%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Nadia Aquidah
(603) 2146 7528
nadia.subhan@affinhwang.com

Laila Razip
(603) 2146 7476
noramirah.razip@affinhwang.com

Peer Comparison

Stock	Stock code	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x) CY16E	Core PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	EV/EBITDA (x)	P/BV (x)	ROE (%) CY16E	ROE (%) CY17E	Div. Yield (%) FY16E	Div. Yield (%) FY17E
Jaya Tiasa	JT MK	BUY	1.39	1.53	1,346	Jun	15.8	28.8	41.2	23.0	10.4	0.7	2.6	4.2	1.2	1.6
Ta Ann	TAH MK	BUY	3.50	4.67	1,556	Dec	11.9	10.9	-22.9	8.9	5.8	1.2	10.5	10.5	4.3	4.3
WTK	WTKH MK	BUY	1.11	1.44	486	Dec	9.5	8.1	-13.8	16.6	4.6	0.34	3.7	4.2	2.3	2.3
Simple average							**12.4**	**15.9**	**1.5**	**16.2**	**6.9**	**0.8**	**5.6**	**6.3**	**2.6**	**2.7**

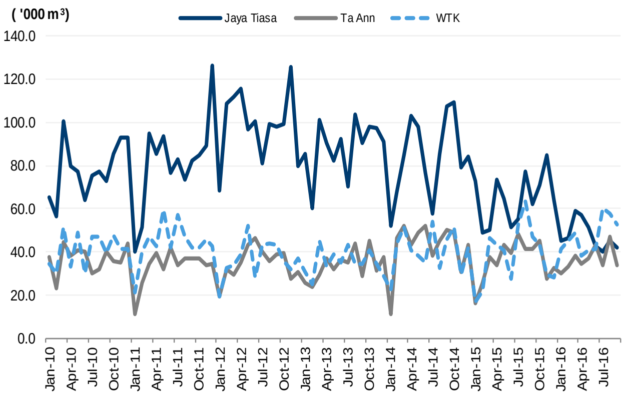
Source: Bloomberg, Affin Hwang forecasts Note: Prices as of close on 26 October 2016

Valuation and recommendation, key stock ideas

We are maintaining our OVERWEIGHT stance on the timber sector mainly because of its exposure to the palm-oil business. For timber companies like Ta Ann, Jaya Tiasa and WTK that have exposure to the palm-oil business, the continued increase in FFB and CPO production together with better CPO prices should provide an impetus for earnings growth. We believe that improving earnings from the palm-oil division is likely to help offset the decline in contribution from the timber division. We do not foresee a substantial upswing in the timber product prices as we believe buyers are more rational in their buying behaviour. We have BUY ratings for Ta Ann, Jaya Tiasa and WTK.

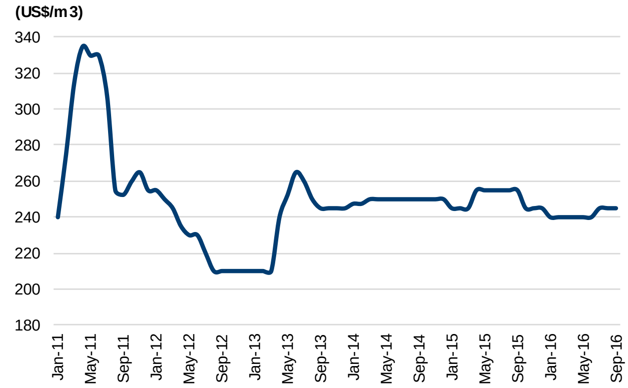
- **Jaya Tiasa** – We are positive on Jaya Tiasa as we believe its earnings should continue to grow going forward on the back of higher contribution from the plantation business. Our SOTP-derived 12-month target price for Jaya Tiasa is unchanged at RM1.53. This is based on an unchanged 11x CY17E PER for the timber division, a 15x CY17E PER for the plantation division, and 1x CY17E PBR for the forest plantation.
- **Ta Ann** – We continue to like Ta Ann for its rising plantation earnings given the increasing matured plantation areas, FFB and CPO production, coupled with an attractive 2017E yield of 4.3%, in our view. Our SOTP-derived 12-month target price for Ta Ann is unchanged at RM4.67. We value Ta Ann based on a 10x 2017E PER for its timber division, 15x 2017E PER for its plantation division and 1x 2017E PBR for its forest plantation.
- **WTK** – We maintain our BUY recommendation on WTK, as we continue to like theWTK for its future plantation earnings prospects with its first palm-oil mill likely to be completed by end of this year or early-2017. Our SOTP-derived 12-month target price for WTK is unchanged at RM1.25. WTK is valued based on 10x 2017E PER for its timber division, and 1x 2017E PBR for its forest plantation and palm oil.

Fig 1: Log production



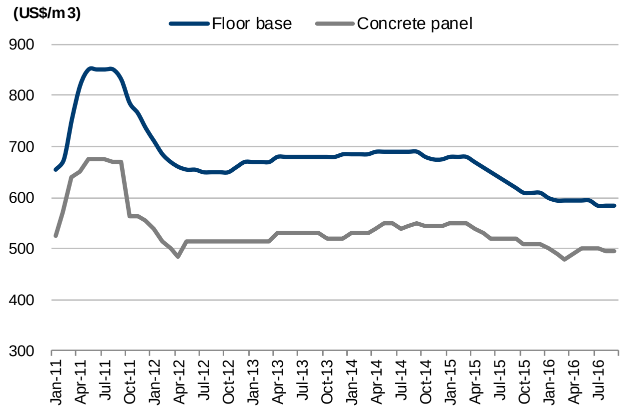
Source: Bursa Malaysia, Affin Hwang

Fig 2: Log prices



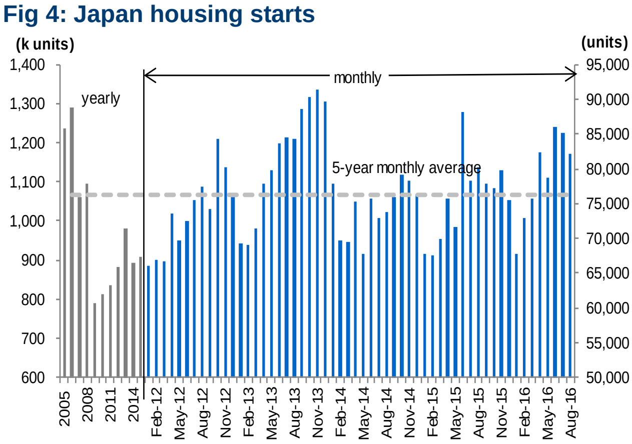
Source: Japan Lumber Report, Affin Hwang

Fig 3: Plywood prices



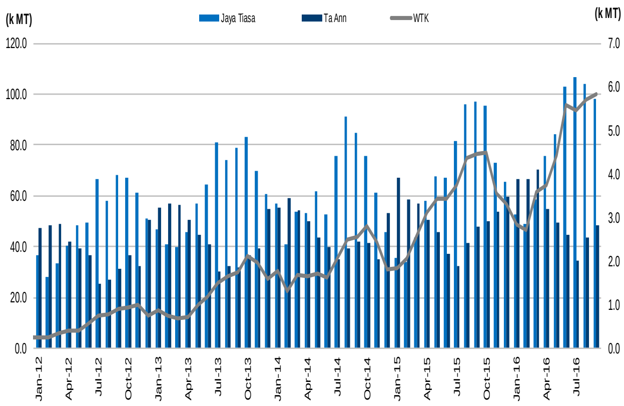
Source: Japan Lumber Report, Affin Hwang

Fig 4: Japan housing starts



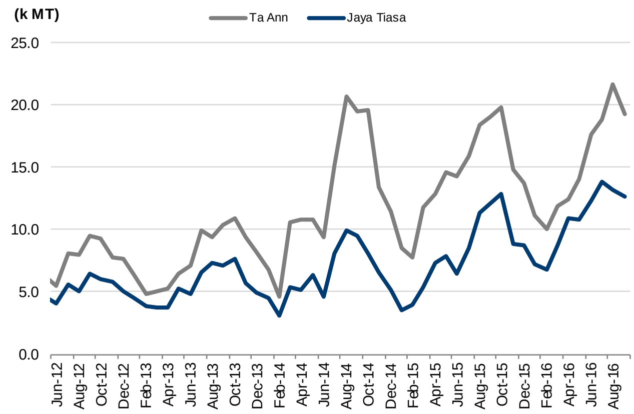
Source: Japan Lumber Report, Affin Hwang

Fig 5: FFB production



Source: Bursa Malaysia, Affin Hwang

Fig 6: CPO production



Source: Bursa Malaysia, Affin Hwang

Sector Outlook

Transport & Logistics

UNDERWEIGHT (maintain)

Losing steam

Sluggish global trade and slowing domestic growth will likely drag overall sector performance in 2017. Airlines are unlikely to repeat the robust performance seen in 2016, while the shipping industry is still mired in capacity glut. We do see pockets of strength and like port operator Westports for its solid earnings-growth profile and Tiong Nam, a leading logistics-solutions player. Maintain UNDERWEIGHT.

Airlines & Airports – hard to top 2016

2016 is a very strong year for AirAsia and AAX, with notable yield improvements from route rationalisation by Malaysia Airlines Berhad (MAB) and the steep fall in crude oil. We expect yields to peak in 2016 with a gradual decline in 2017, as competition is heating up with MAB slashing fares and Malindo Airlines adding capacity aggressively, especially for intra-Asean routes, which could drag overall RASK. We expect a slowdown in the Turkey operations to continue to plague MAHB's earnings, but the PSC hike is a welcome respite for its turnaround effort. Its Malaysia operations continued to exhibit resilience with double-digit growth, but this was largely weighed down by the disappointment in ISG.

Shipping & Ports – lower charter rates

We expect Westports' volume growth to benefit from ongoing shipping alliance aggregation, with a net incremental benefit from market access to new members in the Ocean Alliance while minimising container loss to PSA. Yield improvements are likely with the impending hike in port charges in 2018, while staggered capacity expansion to 16m TEUs by 2020E should boost gradual earnings growth. We maintain our bearish view on MISC, largely due to downside risks to petroleum charter rates, which could be a drag on group performance. Its offshore unit has been impacted by a low orderbook replenishment, while new LNG charters are being renewed at lower rates due to supply glut in the shipping industry.

Total logistics solution – growing capacity

We like Tiong Nam for its resilient and stable logistic segment while unbilled property sales should provide a buffer for earnings volatility. We see Tiong Nam as a strong beneficiary on the rising logistics outsourcing theme, where companies are embracing third-party logistics-service providers to manage their supply chain. The company's growing warehousing space should underpin volume growth, while rising cold-room contribution should provide underlying margin expansion.

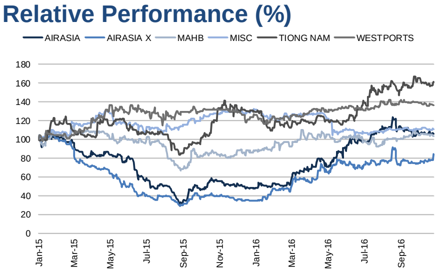
Maintain UNDERWEIGHT sector rating

We maintain our **UNDERWEIGHT** sector rating given unexciting earnings-growth catalysts, vs. valuations. By and large, the Transport & Logistics sector performance should continue to track Malaysia GDP given its high correlation, be it for movement of goods or people. Our economics team sees Malaysia's economy rising by 4.4% in 2017. For big-cap names, we like Westports (WPRTS MK) as an infrastructure pure-play, while Tiong Nam (TNL MK) is our small-cap pick (proxy to rising logistics outsourcing).

Absolute Performance (%)

	1M	3M	12M
AirAsia	+2.6%	-1.1%	+81.8%
AirAsia X	+14.3%	+15.8%	+114.6%
MAHB	-2.0%	+11.1%	+19.0%
MISC	+0.8%	+1.1%	-16.6%
Tiong Nam	-2.4%	+3.1%	+30.7%
Westports	-1.1%	+0.2%	+1.6%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

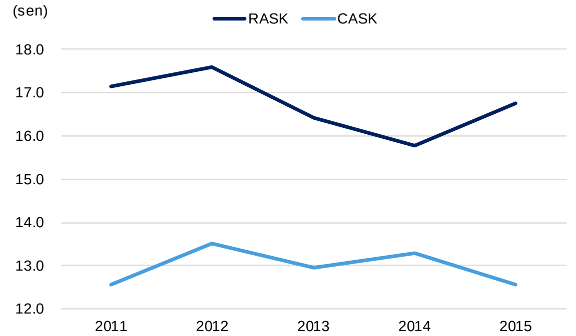
Aaron Kee
(603) 2146 7612
aaron.kee@affinhwang.com

Fig 1: Peers comparison table:

Stock	Rating	Price (RM)	TP (RM)	Upside (%)	Mkt Cap (RMm)	Core PE (x) CY16	Core PE (x) CY17	Core EPS Growth (%) CY16	Core EPS Growth (%) CY17	PBV CY16	PBV CY17	Div. Yield (%) FY16	Div. Yield (%) FY17	ROE (%) FY16	ROE (%) FY17
AIRASIA	HOLD	2.80	3.13	11.8	7,792.0	7.2	8.9	205.0	(19.1)	1.2	1.1	0.8	0.5	24.0	14.5
AIRASIA X	HOLD	0.44	0.47	6.8	1,825.2	5.9	3.8	(169.6)	56.0	(5.4)	(2.4)	-	-	(115.8)	(63.6)
MAHB	SELL	6.50	5.40	(16.9)	10,784.7	197.0	84.4	(660.7)	133.3	1.5	1.4	0.2	0.4	0.7	1.7
MISC	SELL	7.58	6.70	(11.6)	33,835.6	15.3	15.3	(23.7)	(0.2)	0.9	0.9	1.4	1.3	6.5	5.7
TIONG NAM	BUY	1.66	2.10	26.5	694.2	7.4	6.7	24.3	9.3	1.1	0.9	3.5	4.1	14.2	14.0
WESTPORTS	BUY	4.32	4.90	13.4	14,765.3	22.9	21.4	26.6	6.9	7.2	6.6	3.3	3.5	31.4	30.9

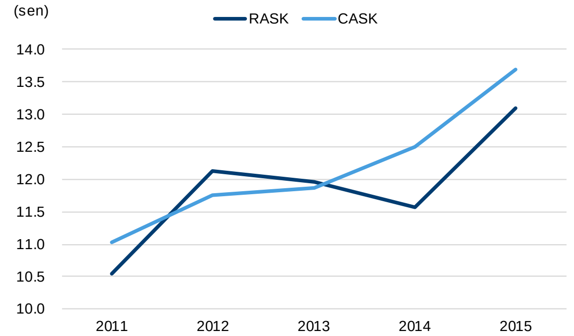
Source: Bloomberg, Affin Hwang forecasts; note: prices as of close on 26 October 2016

Fig 2: AirAsia operational statistics



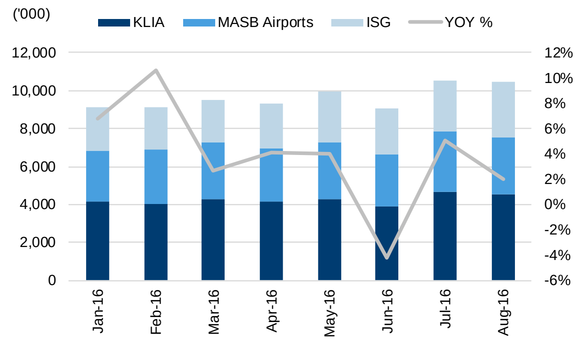
Source: Affin Hwang, AirAsia

Fig 3: AAX operational statistics



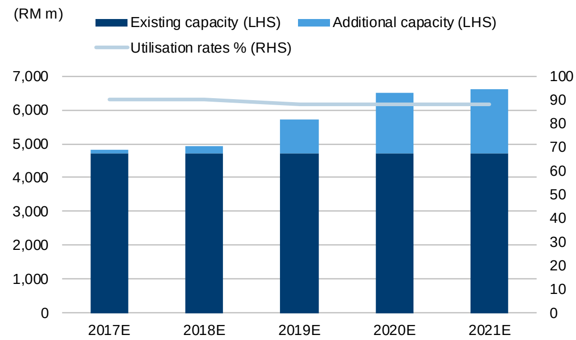
Source: Affin Hwang, AAX

Fig 4: MAHB passengers statistics



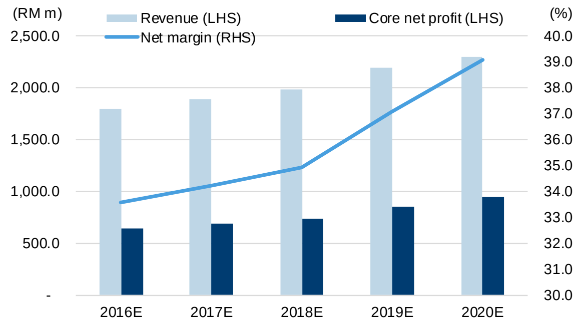
Source: Affin Hwang, MAHB

Fig 5: TNL projected capacity expansion



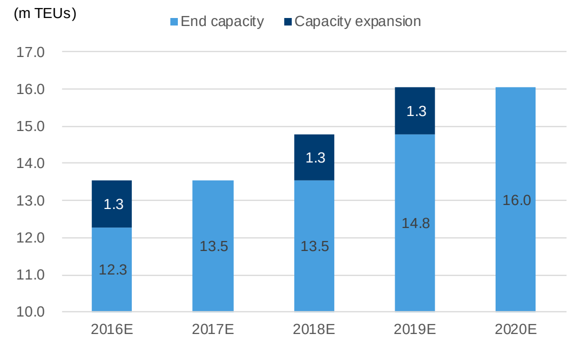
Source: Affin Hwang, Tiong Nam

Fig 6: Westports financials



Source: Affin Hwang forecasts

Fig 7: Westports projected capacity expansion



Source: Affin Hwang forecasts

Resilient amid the turbulence

The overall macro environment remains relatively unchanged since last year, as low interest rates and volatile equity markets have helped fuel the rally in the utilities sector's share prices in 2016. We believe that the sector is now being fairly valued; as such, we don't foresee significant upside in 2017. Hence, we are downgrading our call for the sector to Neutral.

Likely key focus for 2017

We believe 2017 will be a very interesting year for the utilities sector, as the focus should be on negotiations between Tenaga and the government on the renewal of its IBR for its transmision and distribution business, as the WACC was determined pre-2014 before the recent rate cut by BNM.

A lower WACC would certainly have an impact on the sector, due to a lower project IRR for future projects, but would have a more immediate impact on both Tenaga and Gas Malaysia, as their transmission and distribution contracts are due for renewal soon.

Earnings outlook – visibility, momentum and risks

There shouldn't be must surprises to the earnings for the power-plant operators as their proftiability is governed by the PPAs. We believe that TNB's earnings visibility remains intact, as there are still enough funds under the Tariff Stabilisation Fund to weather the current cost increase in fuel prices without the need to increase electricity tariffs.

If fuel prices were to remain at current levels, it is likely that the government would need to increase the electricity tariffs by the end of 2017, under the imbalance-cost pass-through (ICPT) mechanism. However, as we are expecting the Prime Minister to announce GE15 in 2017, a tariff hike in 2017 would be a very political sensitive issue, in our view.

Our view and strategy for 2017

We are downgrading our sector call from Outperform to Neutral, as most companies in our utilities coverage are now fairly valued, and have limited near and mid-term earnings-growth prospects. The yield of the sector is now around 4-5% for 2017E.

Sector Outlook

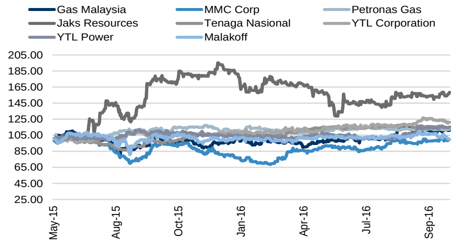
Utilities

NEUTRAL (downgrade)

Absolute Performance (%)

	1M	3M	12M
Gas Msia	-0.7%	9.2%	9.7%
MMC	3.1%	13.5%	3.1%
Pet Gas	0.1%	-1.3%	-5.6%
Jaks	0.9%	0.9%	-36.4%
Tenaga	-0.6%	0.1%	12.2%
YTL Corp	-8.9%	-1.8%	7.9%
YTL Power	-5.6%	7.0%	-1.9%
Malakoff	-6.0%	-5.5%	-11.4%

Relative Performance (%)



Source: Affin Hwang, Bloomberg

Ng Chi Hoong
(603) 2145 7470
Chihoong.ng@affinhwang.com

Peer Comparison

Stock	Rating	Sh Pr(RM)	TP(RM)	Mkt Cap (RMm)	Year end	PE (x) CY16E	PE (x) CY17E	EPS growth (%) CY16E	EPS growth (%) CY17E	EV/EBITDA CY16E	EV/EBITDA CY17E	P/BV CY16E	P/BV CY17E	ROE (%) CY16E	ROE (%) CY17E	DY (%) CY16E	DY (%) CY17E
GAS MALAYSIA	HOLD	2.62	2.36	3,364	Dec	26.2	25.0	20.9	5.0	12.2	11.9	3.2	3.2	12.2	12.8	3.8	4.0
JAKS RESOURCES	BUY	1.03	1.60	452	Dec	10.1	6.6	7.6	53.9	8.4	5.4	0.6	0.5	6.3	8.2	-	-
MALAKOFF	HOLD	1.57	1.65	7,850	Dec	16.4	16.4	(1.8)	-	7.7	7.2	0.9	0.8	5.7	4.7	4.6	4.6
MMC	HOLD	2.35	2.35	7,156	Dec	17.2	16.7	(74.6)	2.9	29.0	28.0	0.6	0.6	3.6	3.6	1.7	1.7
PETRONAS GAS	HOLD	21.92	20.24	43,374	Dec	24.2	24.7	(10.0)	(2.0)	15.1	14.7	3.5	3.4	14.6	13.7	2.5	2.4
TENAGA	BUY	14.32	16.50	80,817	Aug	10.8	10.5	14.2	3.2	5.8	3.7	1.5	1.3	13.5	12.6	2.3	2.5
YTL CORP	HOLD	1.65	1.70	17,933	Jun	17.7	16.5	(0.5)	7.5	7.5	3.5	1.0	1.0	5.7	5.9	7.3	7.3
YTL POWER	HOLD	1.52	1.60	12,377	Jun	11.2	11.3	(0.3)	(0.7)	9.3	4.7	1.0	1.0	8.9	8.6	6.6	6.6

Source: Bloomberg, Affin Hwang forecasts; Note: Prices as of close on 26 October 2016

Possible surprises – upside and downside, and catalysts

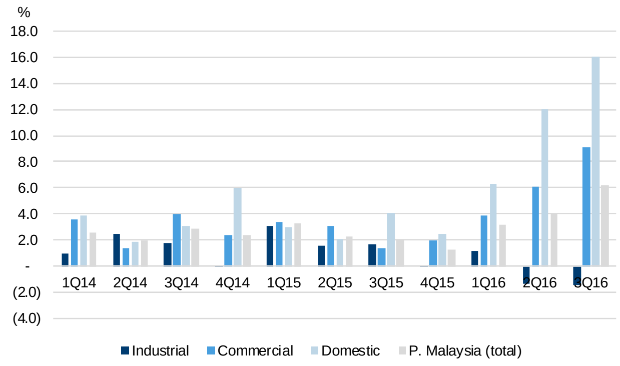
Key negative risks to our view on the sector would be: i) the government reluctance to increase tariffs despite having IPCT mechanism and ii) unscheduled power-plant shutdowns.

Possible positive surprises include: i) further unlocking of assets by MMC such as the ports business; ii) winning of new power projects or infrastructure concessions by YTL Corp; iii) Vietnam government approval of Jaks Resources's detailed power-plant plan.

Valuation and recommendation, key stock ideas

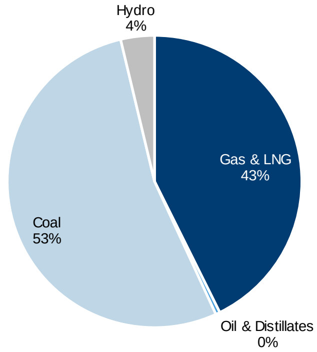
Tenaga (TNB MK, BUY, TP: RM16.50) remains our top pick as we believe the successful implemenation of the Incentive-Based Regulation (IBR) would re-rate the stock towards our target price. In our view, the government remains committed to the implementation of the ICPT.

Fig 1: Quarterly electricity demand growth



Source: Tenaga

Fig 2: Power generation mix



Source: Tenaga

Fig 3: Newcastle coal price trend

Source: Bloomberg

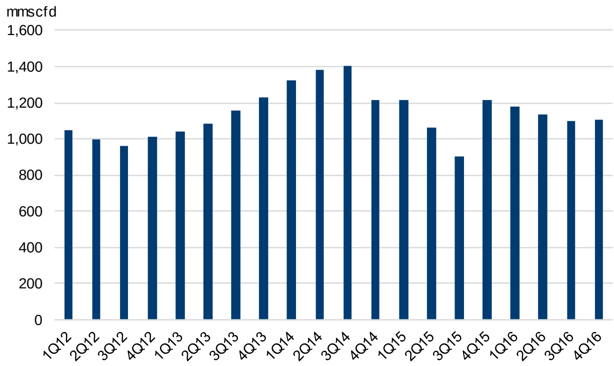
Fig 4: Henry Hub gas price

Source: Bloomberg

Fig 5: USD vs MYR

Source: Bloomberg

Fig 6: Daily gas allocation



Source: Tenaga

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In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of May 13th, 2016, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (https://www.fitchratings.co.jp/web/)

Additional information may be available upon request.

Japan - additional notification items pursuant to Article 37 of the Financial Instruments and Exchange Law

(This Notification is only applicable where report is distributed by Daiwa Securities Co. Ltd.)

If you decide to enter into a business arrangement with us based on the information described in materials presented along with this document, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, we will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction.
- In some cases, we may also charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident of Japan.
- For derivative and margin transactions etc., we may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by us.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.
  *The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with us.

Corporate Name:	Daiwa Securities Co. Ltd.
	Financial instruments firm: chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships:	Japan Securities Dealers Association, The Financial Futures Association of Japan
	Japan Investment Advisers Association
	Type II Financial Instruments Firms Association