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'Limited impact as Malaysia is far from epicentre of negative events'

BY **ESTHER LEE**

Market practitioners around the world breathed a collective sigh of relief last week when some of the worst fears over the impact of the UK's exit from the European Union (EU) (Brexit) began to fade, although they have not completely vanished. World oil prices and stock markets resumed their routines and recovered nearly all the losses suffered in the wake of the Brexit vote on June 23.

Fund managers say the initial chaos in stock markets worldwide was a natural reaction, given that no one had expected the "leave" camp to secure victory.

"It was against our expectations that the British people would vote for Brexit. The corresponding market reaction was well deserved. Slower economic growth and the need for a cheaper and expanded monetary base translated into a weaker pound sterling. Heightened uncertainty and the rush to safe havens saw a stronger US dollar, yen and rates in general. Lower global growth translated into lower equities. All in all, markets were behaving as they should due to Brexit, which is healthy but not profitable," Affin Hwang Asset Management Bhd chief investment officer David Ng tells *The Edge*.

"What we were more worried about was the financial contagion as London is a major financial centre. Thankfully, this did not happen," he says.

The FBM KLCI was not spared from the market turmoil — it succumbed to investors' panic following the vote, but staged a rebound last week. After seeing a decline of 0.67% to 1,629.52 points between June 23 and June 27, the index closed higher for three consecutive days last week. On July 1, it closed down 7.86 points or 0.48% to 1,646.22 from the day before.

Danny Wong Teck Meng, CEO of Areca Capital Sdn Bhd, says the fast rebound proved that the Malaysian stock market is resilient and that the knee-jerk reaction was because Brexit's negative impact had been overplayed.

"There isn't much of a direct impact of Brexit on the Malaysian equity market ... perhaps only for a few companies, which have direct links to the UK," he says.

Ng concurs, saying that any negative impact will be felt through the unwinding of the financial markets but not so much on a fundamental basis, given that Malaysia is far from the epicentre of negative events.

"So net all, Brexit is negative and markets have reset after the event. The impact should fade in the next few days or weeks. However, that does not mean that the Malaysian market will take off as a result, as our local economic conditions remain weak, earnings outlook is poor and valuations are not compelling," Ng explains.

The immediate impact of the vote saw currencies such as the US dollar and yen appreciating on the back of their safe-haven status, while the pound sterling and euro tumbled. Most emerging Asian currencies rose last Friday, with the ringgit closing up 0.76% at 3.9983 against the US dollar.

Such sharp currency movements will have a diverse effect on emerging markets, says Bernard Ching, head of research at AllianceDBS Research Sdn Bhd. He adds that the uncertainty of the post-Brexit era will likely lead to more market interventions by central banks around the world in order to "steady the ship".

"In particular, we believe this may alter the US Federal Reserve's view on the pace of interest rate hikes," he says.

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With Brexit adding a new element of uncertainty to global growth, many now expect Bank Negara Malaysia to cut its overnight policy rate this year, thereby benefiting equities with more liquidity in the system.

"Lower interest rates for a longer time is rapidly being factored into the market. This is, of course, good for yield-driven stocks such as real estate investment trusts (REITs) and other dividend stocks," says Ng.

Wong expects the banking sector to benefit from a rate cut as borrowing cost will trend lower or when there is further reduction in the statutory reserve requirement, which would help boost liquidity in the short term.

He is also of the view that selected consumer stocks could benefit from lower interest rates as they would provide more spending power to consumers.

Nomura Research has upgraded Malaysia's equity market to "overweight" after the Brexit vote as the research house expects dimmer prospects for developed markets.

"The main reason for the upgrade is Brexit. What Brexit does is it changes the macroeconomic outlook. Firstly, it reduces the prospects of developed markets. Secondly, it reduces the prospect of policy tightening and in fact, it increases our expectations of policy easing," says Mixo Das, vice-president of Nomura Singapore Ltd.

Das prefers yield stocks that have some element of growth. His stock picks include Malayan Banking Bhd, IJM Corp Bhd, IHH Healthcare Bhd, Tenaga Nasional Bhd (TNB) and Karex Bhd.

In contrast, AllianceDBS' Ching believes a defensive strategy is likely to outperform a growth strategy, given that markets are in a risk-off environment in the near term.

"We favour defensive banks such as Public Bank Bhd and Hong Leong Bank Bhd, utilities such as TNB that have resilient earnings, and dividend yield stocks such as Sunway REIT and CapitaLand Malaysia Mall Trust.

"For growth stocks, our top picks are Gamuda Bhd, SKP Resources Bhd, Muhibbah Engineering (M) Bhd and Kimlun Corp Bhd. We advise investors to buy only on weakness. We maintain our end-2016 FBM KLCI target of 1,700 points, which implies 15.5 times 2017 PER and is derived using a bottom-up valuation approach," says Ching.

Kenanga Research says in a report that exporters such as Kossan Rubber Industries Bhd, SLP Resources Bhd, Thong Guan Industries Bhd and ViTrox Corp Bhd may return to investors' radar screen as the US dollar could appreciate further due to its safe-haven status.

Meanwhile, Affin Hwang's Ng says Malaysian automotive players, which are net importers, could also feel the pinch given that Brexit has brought about a rise in the US dollar and yen. He adds that the auto sector had already been softening prior to Brexit on the back of tighter hire-purchase approvals, elevated household debt and cautious spending.

He opines that he would be cautious about Malaysia's property companies with exposure in the UK, unless there is a pick-up in sales.

"The property market there had already been softening prior to Brexit. Post-Brexit, we have financial firms shifting their staff out, lower investment cycles, EU workers who are uncertain of their status in the UK and heightened volatility of the pound sterling — all these compounds the already oversupplied market," Ng explains. E