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Avoid buying Malaysian small caps now, top manager says

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The surge in Malaysian small caps over the last few months may be reason enough to avoid buying many of them now. PHOTO: BLOOMBERG

[KUALA LUMPUR] The surge in Malaysian small caps over the last few months may be reason enough to avoid buying many of them now.

So says Gan Eng Peng, head of equities at Affin Hwang Asset Management Bhd, citing an 18 per cent gain in the the FTSE Bursa Malaysia Small Cap Index since November. Stocks in the measure are up more than twice as much as those in the large-cap benchmark, as a government plan to support the sector coincided with an emerging-market rally.

"We're always on the lookout for ideas which are fresh, turnaround situations and deep value plays," said Mr Gan, whose Asia ex-Japan small and midcap fund has returned 34 per cent over the past year to beat 96 per cent of its peers. "With the recent run in the index, this is getting harder to come by." Prime Minister Najib Razak's budget pledge in October to establish a 3 billion ringgit (S$947.4 million) fund to invest in small and mid-sized companies and promote research on them stirred interest in the sector. Malaysia as a whole has benefited as faster economic growth and rebounding commodity prices helped push developing-nation equities to the highest levels since mid-2015.

Foreign investors are returning, pumping US$1 billion into Malaysian stocks so far this year, following a three-year run of outflows in which they pulled US$7.7 billion. Credit Suisse Group AG went overweight on the country's stocks last week, calling it "perhaps the most unloved mainstream emerging market."

The Swiss lender cited positive earnings revisions, economic forecasts and an undervalued ringgit among reasons for its optimism.

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The small-cap gauge dropped 0.2 per cent in Kuala Lumpur on Friday, retreating from its highest close since April 2015 on Thursday, while the FTSE Bursa Malaysia KLCI Index declined 0.1 per cent.

Seed money for the small-cap fund will come from government-linked companies, according to the budget. Some smaller companies aren't receiving the attention they deserve, and an independent research scheme will start next quarter to address this, Ranjit Ajit Singh, chairman of the Securities Commission Malaysia, said at a March 9 briefing.

While the 3 billion ringgit fund isn't that big, the government's willingness to support the sector is improving sentiment and boosting demand from institutional investors, said Ang Kok Heng, chief investment officer at Phillip Capital Management Bhd in Kuala Lumpur.

While this has pushed some small and midcaps "beyond our targets," there are still good buys out there, said Mr Ang. These include JAKS Resources Bhd, Gabungan AQRS Bhd, Ekovest Bhd and ViTrox Corp Bhd, he said.

The surge has also pushed up the 12-month price-to-earnings ratio on the small-caps gauge to 11.6, near the highest level since August 2014. That's still well below the ratio of 16.2 for the Kuala Lumpur Composite Index, which comprises the biggest 30 companies.

The government plans are contributing to the small-cap surge, along with the earnings turnaround and the cheap ringgit, said Jason Chong, chief investment officer at Manulife Asset Management's Malaysian unit in Kuala Lumpur.

While the planned fund and research scheme might aid small caps in the future, it's not driving gains at the moment, said Affin Hwang Asset's Gan. Small caps are more sensitive to growth expectations and are also benefiting from "the global return of animal spirits in risk markets," he said.

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