

Malaysia: Back on the Radar Screen

May 23, 2000

After more than 18 months of effective pariah standing in the eyes of the global investment community, Malaysia once again regains pedigree status.



Ahmad Rejal Arbee [RA], (Berita Harian Sdn Bhd)
An alumnus of the Malay College Kuala Kangsar, *Berita Harian's* Group Editor Rejal Arbee is a seasoned and decorated newsman. The former Editor-in-Chief of Bernama has also served in many capacities in an illustrious career that spans almost four decades. Among them: Editor of *Business Times*, Group Editor of Berita Publishing, the publication arm of the New Straits Times Group and the Editor-in-Chief of the Sun Media Group. He has also served as chairman of the Malaysian Press Institute, secretary-general of the Organization of Asia Pacific News Agency and board member of the Manila-based Press Foundation of Asia. For his outstanding services in journalism, Rejal was awarded the South Korean press Koh Jai Wok Memorial Award. He is also the recipient of the Johan Setia Mahkota, SSA (Selangor) and AMK (Kedah) awards.



Melvyn Boey [MB], (Pesaka Jardine Fleming Sdn Bhd)
Trained in the London School of Economics, Melvyn Boey joined Pesaka Jardine Fleming in May 1999 and covers the motor and gaming sectors. Prior to Jardine Fleming, Melvyn, a chartered financial analyst (CFA) worked with Schrodgers Investment Management. In his personal capacity Boey is a conservative investor and only puts money in stocks that have strong balance sheets.



Scott Lim [SL], (CMS-Dresdner Asset Management Sdn Bhd)
U.S.-trained Scott Lim joined CMS Dresdner Asset Management Sdn Bhd in June 1998 as a fund manager. He has six years experience in managing Malaysian and regional equity portfolios, working previously for Dr Tan Chong Koay's boutique fund management firm Pheim Asset Management and Premier Capital Management. He graduated from the University of Wisconsin at Madison, with distinction in Finance.



Tan Teng Boo [TTB], (Capital Dynamics Sdn Bhd)
Tan Teng Boo, the founder and Managing Director of Malaysia's first independent investment advisory firm Capital Dynamics calls himself "the perpetual student of the stock market". The reason: no matter how well one might think he has mastered the market, there are always surprises. That may be true, but Tan who has been involved with the market for the past 28 years has, over the years, created a reputation for himself as being prudent, yet ironically often able to outperform the Malaysian equity benchmark of the Kuala Lumpur Composite Index (KLCI). His weekly stock market report - *i-Capital* - has been in circulation since 1989. Tan is also founder and MD of Capital Dynamics Asset Management, a licensed fund manager. He is an economics graduate from the University of Sussex.

THE MODERATORS



Rajen Devadason [RD], (RD Book Projects)
Rajen Devadason is an award-winning journalist. As staff writer, of *Malaysian Business* magazine, he won the Malaysian Press Institute's award for best economic journalism in 1992 and the Citibank Pan-Asia business journalism award, which included a stint at New York's Columbia University and visits to the White House, World Bank and the US Federal Reserve. His first book *Your A-Z Guide to the Stock Market* was published in 1997 and since then he has seen a new book out each year. Devadason holds a Bachelor of Science (Hons) degree in Physics and Computing from King's College, University of London, and is a member of MENSA UK. He currently writes two distinct financial planning columns - a print column for *Malaysian Business* magazine and an online one for zoomFinance - and is overworked as a financial planning trainer-cum-consultant.



Steven K C Poh [SP], (i2Media Sdn Bhd)
Ex-journalist Steven Poh is the CEO of i2Media Sdn Bhd, an online content and electronic community developer. He was formerly business correspondent for *Asiaweek* magazine and General Manager/Senior Consultant of a KLSE-listed software development house. He won the 1992 Malaysian Press Institute prize for best magazine writing while still at *Malaysian Business*. Also a former Press Fellow of Wolfson College at the University of Cambridge, Poh graduated with a Bachelor of Science degree in Communications (Journalism) from Southeast Missouri State University. He completed his Master of Science degree in Speech

On May 23, 2000, approximately a week before Malaysia was reinstated into the Morgan Stanley Capital International (MSCI) Indices, *zoomFinance* brought together a distinguished panel of industry experts to its head office in Kuala Lumpur's Golden Triangle to discuss the impact of the reinclusion to the local capital market.

Malaysia is said to be currently in an "over sold" position and technically the market should rebound. Within the week, punters are hoping for a trend northward. Also, interest rates remain low, creating an environment favourable for investment in equities. The country's economy, as measured by its gross domestic product (GDP) growth rate is also expected to exceed the official forecast of 5.8 per cent. And analysts expect the large liquidity build-up and strong earnings momentum to support the Kuala Lumpur Stock Exchange (KLSE) as it hopefully tests new highs.

Even so, foreign funds are unlikely to hop on the bandwagon immediately after the MSCI move. Among other things, Malaysia is said to be expensive relative to the rest of the region. Still, many fund managers would need to take a position on the KLSE due to the weightage given to it with the reinstatement. Just how the reinstatement will affect the local bourse remains to be seen.

zoomFinance Inaugural Round Table Forum

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RD: The MSCI will reinstate Malaysia into its indices in a week's time. For the sake of those who are not in tune with current events, let me ask a very basic question here: Why does the MSCI matter?

TTB: The MSCI is a benchmark performance indicator for fund managers. The MSCI has been around for a long time and has been accepted by both regional and global fund managers. Moreover, the mass media has given it a lot of attention. This combination has generated a lot of hype over it. Bear in mind, however, that measuring against an index is a relative exercise. We (Capital Dynamics) are in a minority camp because we are more concerned with absolute returns. In our view then, the reinstatement does not really matter.

MB: American and European fund managers are benchmarked against it (the MSCI). Admittedly, the retail participation in this country is very high. However, big institutions still wield a great deal of influence. A lot of them are benchmarked against the indices, and the MSCI is the most influential of the lot. Thus, when the MSCI announces changes in a country's weighting, it changes investors' perception of the country. Like it or not, the MSCI plays an important part in the performance of the stock market of Malaysia.

SL: As an institutional investor, it makes sense to measure relative performance according to country-weighting. With investments spread through the region, it is hard to value against absolute returns. Each country has different economic exposures. For example, Taiwan has more technology counters, but in Malaysia, there isn't such an exposure. So, it makes sense, that if you want more exposure to certain sectors, you will require some exposure to certain countries. If only absolute performance is used, it becomes hard to judge the performance of an individual fund manager. So performance relative to the MSCI is probably the only way to do it presently. MSCI runs the only influential indices at the moment.

RD: Do you think it's fair that a national economy should become so dependent on 'trigger-happy' fund managers who shoot from the hip? Should any country be so susceptible to what these fund managers decide on?

RA: When MSCI announced that Malaysia would be reinstated, the market shot up. In that sense, readers obviously need to be aware of the impact it will have. However, it is even more important for readers to know the nature of these investments. For instance, whether they are for the short- or long-run. In my opinion, when the nature of these inflows are short term, "big" players will typically drive the market up and wait for the retail investors to get excited. When the "big" players have made sufficient money, they will exit the market, causing it to turn downward,

leaving retail investors to bear the brunt of the losses. Therefore, it is important to report this news so that readers would know how to avoid getting their hands burnt.



RD: In a market like Malaysia, the Greater Fool Theory holds - A sells to B who sells to C, and the last person, usually the little guy, is the greatest fool of all. Nevertheless, when Malaysia again becomes part of the MSCI, shouldn't this reduce the nature of hit-and-run tactics, since they will no longer have justification to pull out?

TTB: The Japanese market has a significant weightage in the MSCI, but foreign investors have been very underweight. So being reinstated is not the end all and be all. Newspapers may report the MSCI reinstatement, but not the selling out of the foreign fund managers. This asymmetry works to the detriment of the small investors.

SP: We have seen the market recovering from a low of less than 300 points to a high of 1,013.27 in Feb 18. Without the MSCI, the market was still able to climb back. Can the market continue its recovery?

SL: The significance is that Malaysia is now worthy of investing in again. Most foreign funds have strict guidelines; so if Malaysia is not part of MSCI, they cannot invest in it. Foreign fund managers, who make their decisions remotely will not invest in the market if it is constantly subjected to sudden changes in policies, especially if the country is deemed to be hostile to the funds. The reinstatement will take away that perception. Also, by the reinstatement, it will be construed that corporate governance in Malaysia is improving. This change in perception is good for Malaysia because it puts foreign investors at ease. Do note that even without the reinstatement, there will be another pool of investors interested in Malaysia. This is evidenced in the number of FDIs (Foreign Direct Investments) which have been made to date. It is clear that the local economy has provided a conducive environment for them to expand and produce for export.

RD: Considering all the pain of 'hot money', isn't it safe to say that FDI money is far healthier and important to the long-term growth of the economy?

SL: True. FDI flows are more long-term in nature. Portfolio flows are more subjected to changes. For example, if investors perceive that an external shock may happen, they will reduce their exposure to equities. FDI investments, however, cannot be liquidated so easily.



RA: FDI is definitely much healthier. Capital flows are subjected to the whims and fancies of fund managers. They depend on market sentiment and the herd instincts [of investors], and do not reflect the real economy. When it is a [raging] bull market, people stop work to play the market. Productivity is affected.

SP: What kind of difference will Malaysia's reinclusion in the MSCI make this time round?

MB: It will put Malaysia on the radar screens of fund managers that have forgotten Malaysia for the past 18 months. With the MSCI reinstating Malaysia, they are forced to look again at Malaysia. If they do not put money here, and Malaysia outperforms, they will be answerable to their shareholders. Also, if the ringgit repeg, it will be a double whammy for them. These are real issues that fund managers in the U.S. have to think about when considering their bonuses. They have to at least look at Malaysia. They can be underweight, but they will be here.

RD: The KLCI is capitalised at RM500-600 billion which is currently the equivalent of about US\$150 billion. When talking about U.S. investment houses, what is the typical size of an investment fund?

TTB: Fidelity manages US\$1trillion. The Magellan fund itself has US\$100 billion under management.

RD: Those are very big sums of money. What are your guesstimates on how much more money will flow in as a result of this reinclusion? What kind of CI index level can we expect?



SL: It's difficult to put a number to it. Historically, during pre-crisis levels, 20 to 30 per cent of stocks were in foreign hands. If this level of investment was restored, then we are currently certainly undervalued. Brokers' research indicates that most foreign funds are at half their ('normal') weightings, but there is no single independent source to do a survey on it.

MB: Another factor to consider is that when Malaysia is reinstated, it will not be in the Developed Series Index, and hence less closely watched. MSCI has reclassified Malaysia and will reinstate it in the Emerging Markets series. It will now be less closely watched because of that reclassification.

RD: Is this a downgrade?

SL: Actually, MSCI has not made any comment on it. Moreover, there is debate whether Malaysia should have been part of the Developed Series Index in the first place.

RD: The silver lining here is that, maybe, competition in this series will not be so tough. Malaysia is definitely ahead of most other emerging markets.

TTB: We are really not bothered by the reclassification. It's a redundant exercise. Take for example, Warren Buffet's Berkshire Hathaway. It is not in the S&P500. Does that mean we should not be investing in it? Instead, we should look at the quality and the composition of the fund. The wrong type of investor, whether foreign or local, will create volatility. Do we want that type of investors? We should always look at the long-term. When you buy a share, do the fundamentals change so much in six months? I hope short-term funds that are coming in will be as little as possible! Investors must understand this: If they are happy with upside volatility, then they must be prepared for the downside as well.

RA: Whichever way you look at it, we are no longer masters of our own destiny. To a certain extent, what the government is saying is true, that we are being colonised - our own destiny is now being controlled by outsiders. The fact that Morgan Stanley has the power to reclassify an entire country is indicative of the extent of influence they have over us.



SP: A form of neo-colonialism indeed.

TTB: Capital International used to be an independent body until it was bought over by Morgan Stanley. Maybe they should go back to their independent status!

RD: When the Asian Meltdown happened, the Government decided to peg the ringgit at 3.80 to US\$1. The consensus view is that this represents a significant under-valuation and this has made us very competitive and contributed to our current account surplus. What is the likelihood of repegging and its impact on local investors?

MB: Our house view is that the ringgit will not be repegged. Generally, reserves are swelling and the current surplus is also growing. Repegging will occur when capacity utilisation is at a maximum and we need capital expenditure again to increase capacity. That's when we will need foreign money. However, utilisation is not at 100 per cent. Therefore, there is no pressure to re-peg. The consensus view is that if the ringgit is repegged, it will be at the 3.20 level. Right now, Penang, a major manufacturing centre, is experiencing a flow of wealth to personal consumption, where property prices are approaching pre-crisis levels. This shows that exports are bringing short-term wealth to the country.



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RD: If the primary reason to drive the Government to repeg is the eventual need to reimport to build our capital expenditure, then what is the current utilisation rate at?

MB: Obviously, it varies from one industry to another. Generally it's about 75 per cent. Therefore, there still exists some spare utility.

TTB: We are also of the view that there will be no repegging. The real question is what regime will we have in the longer term? Will it be fixed or floating? Do we want

to repeg the ringgit? Really, we are dealing with a moving target, because when dealing with exchange rates, we have to place the global economy in its entire context. Are you going to repeg when the U.S. is going to crash with a hard landing? If we repeg it at 3.20, will we later re-repeg it at 3.80 if we retain the fixed exchange regime when we have a fixed exchange regime? Decisions to repeg should not be made frequently. If it is frequent, then it is worse than a floating rate. Unless we can efficiently tackle issues like efficiency and productivity, only then should we revalue it.

SP: In any case, do you think the ringgit will ever recover to the 2.5 or 2.7 levels?

MB: Not over the next 18 to 24 months. In terms of real competitiveness, a 20 per cent appreciation will erode our competitiveness overnight.

TTB: If we look at exchange rates over the long-term, it is a function of productivity and efficiency of the economy. The only Asian countries that have seen their currencies appreciate over the past three decades are Japan, Taiwan and Singapore. It is of no coincidence that these countries have consistent current account surpluses.

R D: Let's steer the topic to something that will be more interesting to the retail punters. To each of our panelists, where do you see the market heading for the next six months? Can you give us a range?



SL: Investors in Malaysia are always obsessed with the index. That's not good. They should, however, look at the business they are investing into. The fact is that when you buy a stock, you are buying into a business that you think will perform. Because of the reinstatement, investors will look back at fundamentals. Since liquidity flows will probably not have a large impact, we have to look at the fundamentals. Over the last two years, we have recovered substantially. We have seen a peak in growth from year to year. Therefore, we have to be rational in thinking that we will not be growing at this level on a sustainable basis. Is the Government's projection of 5.6 per cent prudent? Only when we see an outperformance above the consensus view, will we see a surprise movement in the market.

RD: Hasn't the Government been consistently managing expectations by underestimating our growth figures?

MB: There has definitely been a degree of managing expectations on the Government's part. However, does GDP figures actually drive the stock market? It is interesting to note that a large component of the GDP is in exports, but a lot of exports are not from stocks in the KLCI. None of the top five market capitalised stocks on the KLSE (Telekom, Tenaga Nasional, Maybank, Petronas Gas and the Malaysian International Shipping Corporation) is export-oriented. Nevertheless, the impression and knock-on effect the GDP figures have on consumption will be reflected in the stock market. At present, the GDP growth seems quite sustainable at five to six per cent. On the KLCI, at 930, the index represents a potential 20 per cent upside over the next six months. Stock selection is still key, since a lot of good stocks are not index-linked stocks.

RD: Since 1993, with normal compounded growth, shouldn't the CI be at the 2,000 level? After all, the real economy has grown since then.

TTB: The market is more rational than one might think. From 1993 through 1996, our growth was driven by bank loans. This has disappeared. After 1993, the current account deficit was at worrying levels and growth was propelled by credit. Therefore, the real economy has not really grown, once the non-performing loans (NPLs) and bad debts have been stripped away. On the upside, the KLCI may reach 1,200. On the downside, it may hit a low of 800. Which scenario we ultimately encounter will largely depend on external factors, specifically the health of the U.S. market. If the U.S. market can stabilise, together with the MSCI reinstatement, the KLCI can hit 1,100 in six months.

RD: Assuming the upside is justified, what sectors should people be going for and what should they be avoiding?

SL: I am optimistic about Malaysia. If you believe in economic cycles, then you will conclude that the previous economic cycle has ended in the last crisis. Now we are on a new economic cycle. So if you believe that we are only two years into the cycle, then of course, this will create a lot of opportunities. Although the initial stage of an economic up-cycle is slow (close to one year now from the second quarter of 1999), I am pretty optimistic that it has already begun and will eventually pick up speed. The last economic up-cycle lasted for 10 years. It is anybody's guess how long the current cycle will last.

What investors should be looking for is investing in sectors which have a key market niche (for products or services). For example, Malaysia has carved a name on the world map as a well-known export base for semiconductors. There are a number of local companies which are sub-contracted by multinational companies as well as foreign technology companies for integrated circuit (IC) packaging and other electronic assembly works. If you believe that the technology boom will go on for many years to come, then this should add to the attractiveness of companies in this sector.

Having a market niche (for local companies) is even more important when low cost manufacturing centres are emerging in China. In quite a number of industries, entire manufacturing operations have shifted overseas, particularly to China. One good example is the local footwear industry, which has lost its competitiveness. Hence it is one sector we are avoiding. Therefore, investors should pay more attention to local manufacturing companies with strong market niches (in their products) and strong export bases. One company stands out: **OYL Industries**, a manufacturer and exporter of air-conditioning units. However, we are also starting to see its market share being eroded.

MB: I believe there is still scope for investing in one or two personal consumption related sectors. The reason: the real economy normally lags the run-up in the equity market by six to 12 or sometimes even 18 months. The wealth effect being generated by the recent run-up in stock prices will have a multiplier effect on personal consumption items, such as the purchase of cars and houses as well as consumer spending and gaming activities in general. Translating this into the KLCI,

putting the liquidity factor aside, I think one should look at the property and gaming sectors.

TTB: Our approach to stock selection is not based on sectors. We tend to look more at companies, which have quality management, strong balance sheets and reasonable business prospects. One company which we especially like, is **Inti Universal Holdings**. Although its paid-up capital is rather small, it satisfies our criterion as mentioned. We are also keen on "technology" stocks but not software or Internet e-commerce related ones. We believe e-commerce is not ready to take off viably in Malaysia yet. We are more interested in "technology" stocks, which are related to hardware such as **Malaysian Pacific Industries (MPI)**, **Kesmi** and **Globetronics**.



The added attractiveness of these stocks is their ability to be suppliers to global (foreign) multinationals, which is indicative of a certain efficiency level. This ability gives investors confidence. Each of them also has proven track records (whether is in business or management). For example, MPI has been established for almost two decades. Kesmi is part of a larger Singapore group, which has been around for quite some time. Former employees of Intel with many years of industry experience behind them, on the other hand, are managing Globetronics. Most of the time, it is a matter of pricing for technology stocks. That brings to us the question of what stage of the semiconductor recovery cycle we believe we are at now. If we believe that the recovery is still in its infancy, then it is justified to pay a higher price multiple for these stocks. Moreover, we also have to bear in mind whether any hard landing in the U.S. economy will have an adverse impact on the fragile recovery cycle underway.

SL: Having mentioned that investors should take a look at the export-oriented sectors with good market niches; one should also bear in mind that any hard landing in the U.S. economy will not augur well for these companies in Malaysia. Adding onto the stocks mentioned earlier, semiconductor companies such as **Unisem** and **Autoindustries Corporation (AIC)** are worth looking at too. With the upsurge of software applications coupled with their widespread use in various industries both locally and globally, one can clearly see potential in these "technology" stocks which supply to the hardware that produce those software. Whether or not these software companies will ultimately be profitable, the hardware components would be in use regardless. Hence, the growth in these hardware companies will be exponential and semiconductor companies are expected to ride on it as well.

MB: Some of the gaming stocks worth considering are **Genting** and **Tanjong**. They can use their existing infrastructure and leverage it using technology; in transforming into "click and mortar" businesses. For example, Genting could easily introduce online gaming and betting while Tanjong could offer telephone betting. This will enable them to tap into new markets or expand on their existing markets via different distribution channels at a time when gaming outlets are restricted by the government. One property stock I particularly like is **IOI Properties**. Putting liquidity constraints aside, it has very good developments going on in the Klang Valley. As for motor stocks, **UMW** and **Tan Chong** are worth taking a closer look. In the local motor industry, the movement of the Japanese yen has a substantial impact on the motor companies' bottom line. Since I believe there will be a weakening bias on the yen, companies with significant exposure to the yen such as UMW (the

Malaysian Toyota distributor) and Tan Chong (the Malaysian Nissan distributor) will see their profit margins expand.

RD: Which "technology" stocks will outperform the market in the next six months?

SL: There are not many "pure" technology stocks or start-ups listed in the Kuala Lumpur market to start off with when you compare to the U.S. The Internet boom in the U.S. has already been in place over a reasonably long time. Technology is here to help enhance business operations and improve distribution channels. At a time when many start-ups in the U.S. have failed or are failing (when you see more bankruptcies coming in especially in business-to-consumer [B2C] companies), we also see more technology stocks being set up locally here. Whether or not these new ideas are profitable here or what kind of business model is feasible, I think it is still too early to tell.

TTB: From what I can see, the buying of so-called "technology" stocks locally is driven by foreigners. For example, a good lot of **Mesiniaga** shares are bought by the Government of Singapore through GIC, at a reasonably high price too, and **CSA** by OCBC related companies. Moreover, a lot of these "technology" stocks are being held under foreign nominees. In my opinion, maybe they thought easy money could be made out of these stocks in Malaysia just like in U.S. and Europe. I still feel that the personal computer usage rate in Malaysia is very low. In addition, one also needs a computer before one can access Internet. Therefore, a "technology" company's business model ought to be realistic, whether it is based on current environment or in 10 years time. Putting all these considerations together, the B2C market is simply too small locally at the moment. I feel that our "technology" companies' business model would be driven more by the government in a government-to-business (G2B) environment.



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