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Post GE14: Short Term Volatility to Present Buying Opportunities Amid Longer Term Optimism

Commentary by Lee Sook Yee, Chief Investment Officer

The opposition coalition, led by former PM Tun Dr Mahathir, has claimed victory in GE14, winning 121 (including Warisan) out of the 222 parliamentary seats and ending the 61-year political era ruled by BN.

The initial market reaction is likely to be negative, as transition to a new government is unprecedented for Malaysia and hence perceived as representing a significant market uncertainty. With consensus having priced in a "status quo" outcome and the market having outperformed ahead of elections, a knee-jerk sell down on both equities and bonds is likely when markets re-opens on Monday, 14th May. Foreign participation in equities and bonds are reportedly still at record highs and the Ringgit was one of the best performing currency YTD.

We are uncertain about how sharp the initial correction may be but if GE12 (when the opposition obtained a big win) was any guide, a drop of more than 5% (100 points) is not inconceivable on the first trading day. However we believe the pullback, while sharp would not last too long as the investors view the change of government as an endorsement of progressive and democratic movements and that Malaysia is able to withstand a major political shift and potentially come back stronger. The soon-to-be-formed cabinet led by Mahathir is not inexperienced, and is expected to consist of former seasoned statesmen with proven ability to govern the country. The worries, however, are centred around some of the populist measures in the manifesto including the abolishment of GST and reintroduction of fuel subsidies, all of which are interpreted as having a negative bearing on the government's fiscal positions. Additionally, pledges have been made to review the viability of some mega infrastructure contracts including the HSR and ECRL. In this regard, the construction sector looks particularly vulnerable, translating into a slowdown in private investment, at least temporarily.

However, we are of the view the new government is sensible enough to be steadfast in restoring investor confidence in the coming days. The formation of a credible cabinet with the right credentials in itself may serve as a catalyst, whilst elaboration of further plans especially on economic issues are further impetus.

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At the point of writing, the incoming government has issued its first 100 days fiscal plans to address wide spread concerns on fiscal deficit and debt levels. Lending further support to our belief that the sell down could prove short-lived are regional occurrences where negative market reactions associated with events like the Thai military coup, Brexit, Donald Trump winning the US presidency were short in nature with markets subsequently rebounding and exceeding previous highs.

Beyond the near-term political focus, the country remains an attractive investment destination given that the economy is growing at one of the fastest pace in recent years and corporate earnings are set to rebound after 3 years of decline. Whilst the Ringgit may temporarily soften, it could resume its strength given the prospects of stronger growth and inbound investment. Domestic liquidity remains abundant whilst GLC reform stories could gather further momentum post the installation of the new government.

In terms of portfolio strategy, we intend to take advantage of the market weakness to bottom fish on stocks which remain fundamentally attractive regardless of the change in government. These include selective stocks in banking, oil and gas (given the recovery in oil price), consumer discretionary (prime beneficiary of populist measures like wage hike and GST abolishment) and exporters like tech, EMS players and glove manufacturers (beneficiary of renewed currency weakness). We are reviewing our positions on the contractors but would largely be biased towards top-slicing only the fundamentally weaker counters. Overall, our cash reserves of between 15-20% would enable us to bottom fish on our conviction ideas, whilst partially closing our underweight positions on the index heavyweights amidst the sell down. Once the political dust has settled, we believe that the strong fundamentals and 'democratic dividend' would prevail to re-rate the market towards a stronger 2H.

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