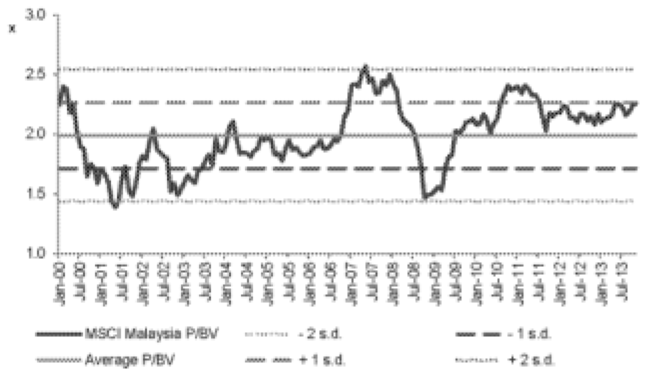
Malaysia – low-beta but fundamentally without merit

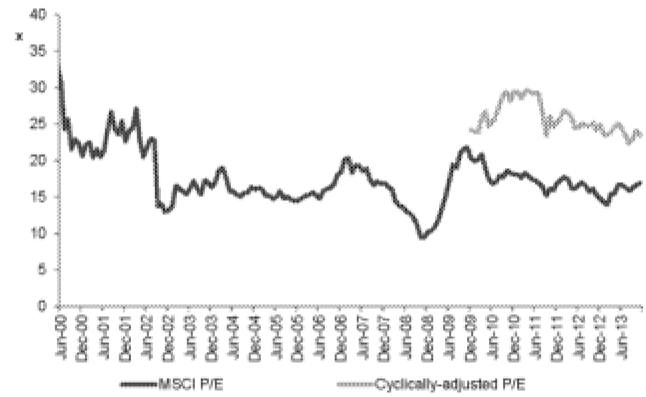
Malaysia has become widely perceived as the lowest beta market within the GEM universe from both a macroeconomic and a more market-related perspective, although in both cases, this belies some pretty serious structural flaws. From a macro context, Malaysia runs a heft current account surplus which obviates any concern about financing despite the steady increase in outgoing FDI flows which has taken place over recent years. Meanwhile the equity market is dominated on both the supply and demand side by state controlled companies and institutions, which as with the macro data, has meant that the level of dependence on foreign financing is extremely low. This has resulted in Malaysian equities moving to a premium valuation, both in absolute terms and relative to their own history (Figure 53 and Figure 54).

Figure 53: MSCI Malaysia – P/BV (x) since 2000



Source: Deutsche Bank, Bloomberg Finance LP

Figure 54: MSCI Malaysia – P/E (x) and CAPE (x) since 2000



Source: Deutsche Bank, Bloomberg Finance LP

We believe that this premium valuation is not warranted by the structural fundamentals, in particular rising debt at both the household and government levels. We are also fairly sceptical about the reform programme launched by the recently elected administration. The bulls cite the reduction of fuel subsidies and the introduction of a 6% Goods and Services tax in the recent budget, but the fiscal impact will be partly cancelled out by the new $3.2bn loan programme for Malays, the Bumiputera Economic Empowerment Scheme, which was introduced in September. Whilst it is difficult to underweight Malaysian equities against an overall bearish backdrop for the asset class, we would expect a negative return for dollar-based investors over 2014.

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