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INVESTMENT ADVENTURES IN EMERGING MARKETS

ASIA

# Could Malaysian Equities See a Modest Recovery in 2020?

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While 2019 was a positive year for emerging markets overall, Malaysian equities underperformed amid a confluence of macroeconomic and geopolitical factors. However, Franklin Templeton Emerging Market Equity's Edward Pang and Ismar Izhar suggest there could be a mild recovery opportunity for equity investors in 2020, driven by an improving corporate earnings outlook.

A confluence of factors negatively impacted Malaysian equities in 2019. Slower global growth, geopolitical uncertainties, and a range of domestic challenges impacted investor sentiment, including negative corporate earnings, and the increasing fears of political stability in Malaysia.

Although some market commentators might consider these to be disrupting factors in 2020, we think a recovery in corporate earnings, accommodative monetary policy and low foreign securities ownership should likely limit the downside risk of Malaysia's equity market.

Amid some challenging earnings growth in 2018 and 2019, we have reasons to believe there could be a recovery in earnings growth in 2020 in some particular sectors, largely driven by:

- Accommodative government policy and incentives, especially those that encourage digitization and automation of business processes, which could improve corporate productivity and efficiency;
- Increasing volumes of electronics produced as the world marches towards the adoption of fifth-generation (5G) technology;
- Further signs of a trade diversion to Malaysia, as foreign companies seek to pivot manufacturing services away from China;
- Multiplier effects from the revival of mega construction projects, announced during the recent 2020 budget; and
- A potential recovery in the country's commodity exports, such as palm oil, crude oil and gas.

We also see a number of long-term secular growth drivers in Malaysia, such as rising consumer spending, which should benefit a number of companies. Higher dividend yields represent another bright spot for investors in Malaysian equities—as they have been growing over the past few years amid a return of capital to shareholders.

Our bottom-up approach allows us to stay nimble, and actively search for companies where we see sustainable earnings power and trade at a discount to their intrinsic value. As such, we tend to favor companies with sustainable business models and strong, predictable cash flows, as they tend to remain resilient in times of uncertainty.

## Three Themes We're Watching in Malaysia

While Malaysia's equity market could remain volatile amid continued uncertainties in early 2020, we see three positive long-term investment themes.

***Theme #1: Consumption Growth***

Malaysia's growing middle class translates to rising affluence, driving a premiumization of goods and services that we've seen take place in other emerging markets. Malaysia boasts a young, working population, which has seen a rise in its discretionary income. We expect this rising domestic consumer wealth to continue to lift demand for goods and services. In addition, the country appears poised to benefit from the "Visit Malaysia Year 2020" initiative the government has promoted to increase international tourism.

***Theme #2: Trade***

In our view, Malaysia is well-positioned to tap potential opportunities resulting from trade diversion from China, due to the ongoing US-China trade tensions. We've seen domestic businesses continue to secure new contracts and receive additional orders from new customers and brand owners, despite the disruptions to global trade in general. It was announced in the latest Malaysian budget that one of the main government initiatives would be on boosting transport infrastructure. In particular, the maintenance of all roads leading to Port Klang, the world's 12th busiest container port.

### ESG IN FOCUS IN MALAYSIA

Since the beginning of the decade, Malaysian corporates have seen material improvements in environmental, social and governance (ESG) practices, which can have a material impact on the value of companies and securities. Examples of ESG factors include corporate governance structure and controls, shareholder rights issues, product safety, employee health and safety practices, increasing corporate social engagement with various stakeholders, and shifting towards better environmental practices. Malaysia's government has deemed ESG to be very important, recently announcing a Sustainable and Responsible Investment Roadmap.

***Theme #3: Technological Innovation***

We favor Malaysian companies that are experiencing digital transformations in their respective industries. In our view, the technology sector stands to benefit from the introduction of a 10-year tax break on high value-added activities. Earlier this year, one of Malaysia's largest mobile network operators partnered with China's Huawei to launch a 5G telecommunications network once the technology becomes available. We'd expect to see industries such as manufacturing, agriculture and health care to be transformed by the introduction of 5G—they could become global competitors in the years ahead.

From our on-the-ground observations, we see some reasons to be enthusiastic about Malaysian equities, despite a challenging 2019. We think domestic factors could drive Malaysian growth in 2020 and beyond, particularly when infrastructure projects and government initiatives start to kick in for a conducive business environment.

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## *Important Legal Information*

## What Are the Risks?

All investments involve risks, including the possible loss of principal. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Bond prices generally move in the opposite direction of interest rates. Thus, as prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline.

Investments in foreign securities involve special risks including currency fluctuations, economic instability and political developments. Investments in emerging markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets. Investments in fast-growing industries like the technology sector (which historically has been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement.