Renewed global investor interest in Southeast Asia

BY **Aishah Mustapha**

The local bourse, represented by the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI), has had a good rally over the past year. But as it passed the psychologically important 1,500 points on Oct 29, investors are asking what will happen next. Has the rally peaked? Is it sustainable?

To put things into perspective, Malaysia is not the only country that's seeing a bull run, say analysts and fund managers. In fact, the 18.45% rise in the FBM KLCI so far this year has trailed Thailand's SET Composite Index's 38.07% increase and Indonesia's Jakarta Composite Index's 42.27% gain.

"It's too narrow to just focus on Malaysia's stock market. This is not just about Malaysia, but about renewed global investor interest in Southeast Asia," says a fund manager.

He explains that with lower yields and returns in the developed markets, a positive, sustainable macro-economic story in the emerging markets will attract more foreign capital inflows, which benefits Malaysia.

There has been an influx of foreign capital into the region's emerging markets. On the local bourse, foreign funds increased trading activities from last year, according to Bursa Malaysia data tracked by an analyst.

In October last year, foreign institutions accounted for 24.83% of the total value traded, contributing RM6.8 billion in buying trades and RM6.2 billion in selling trades.

In October this year, foreign institutions accounted for 26.49% of the total value traded, with RM10.6 billion in buying trades and RM8.8 billion in selling trades. In September, they were net buyers with RM11.7 billion worth of trades.

Foreigners have also increased holdings of the Malaysian Government Securities (MGS). According to data from Bank Negara Malaysia, foreigners held around RM67.98 billion of MGS as at end of September. This is an increase from RM45.04 billion held as at end of January this year.

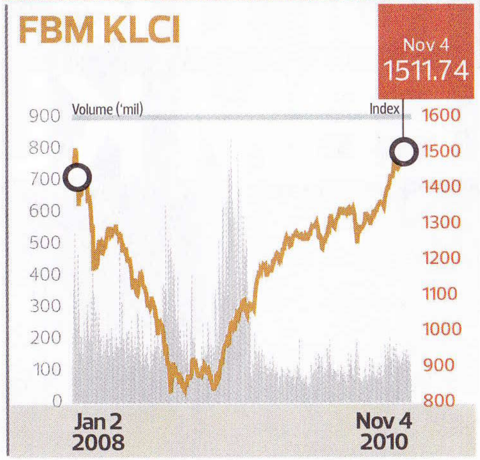
A local fund manager says the low interest rate trend seen globally has prompted investors to park their money in emerging markets, which offer higher potential returns.

"Interest rates are quite low all across the globe, and this is creating consumer inflation and asset inflation ... which is why capital is flowing to this region in search of better yields. The appreciation in regional currencies and a robust capital market environment offer them a good place to put their money.

"As long as interest rates are kept low globally and our currency appreciates, this should continue to fuel the local market rally. In the US, interest rate is almost zero now, and so is Japan's," he notes.

Meanwhile, a further increase in US dollar supply is expected, following the announcement last Wednesday of a second round of "money printing" or quantitative easing, dubbed QE2.

"With QE2 coming in, you can expect more liquidity to come into the market. As to whether



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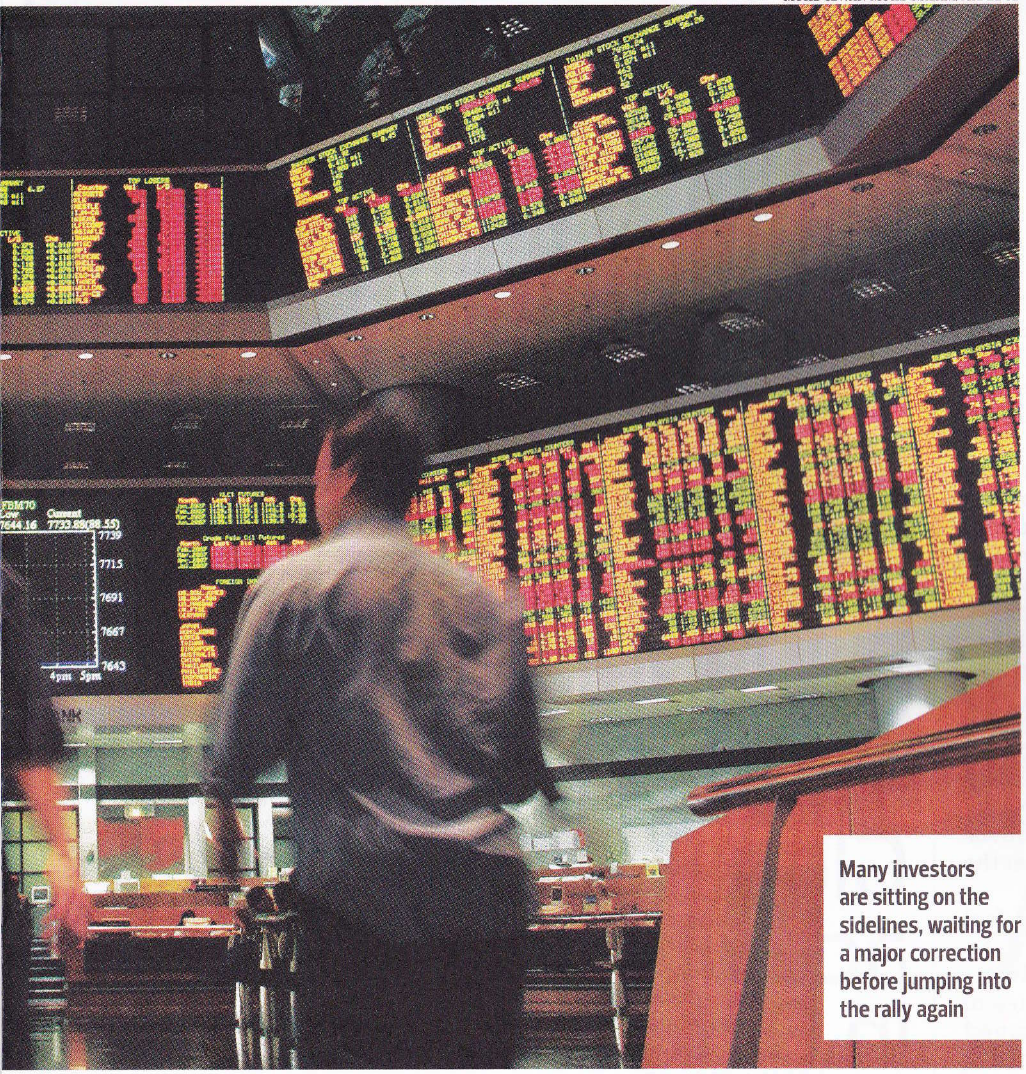

Many investors are sitting on the sidelines, waiting for a major correction before jumping into the rally again

Emerging market indices riding high

INDEX	DEC 31, 2009	NOV 3, 2010	YEAR TO DATE CHANGE (%)
FBM KLCI	1,272.78	1,507.60	+18.45
Singapore Straits Times Index	2,897.62	3,224.97	+11.30
Jakarta Composite Index	2,534.356	3,605.67	+42.27
Stock Exchange of Thailand Index	734.54	1,014.20	+38.07
Shanghai SE Composite	3,277.139	3,030.99	-7.51
Hang Seng Index	21,872.50	24,144.67	+10.39
Bombay Stock Exchange Sensex 30 Index	17,464.81	20,465.74	+17.18
Dow Jones Industrial Average	10,428.05	11,215.13	+7.55
S&P 500 Index	1,115.10	1,197.96	+7.43

QE2 has already been factored into the market, it remains to be seen," he adds.

The first round of quantitative easing saw the US Federal Reserve buy US$1.7 trillion worth of treasury and mortgage-backed securities between December 2008 and March this year to lower interest rates and boost consumption after the US economy suffered a gridlock due to the credit crunch that began in 2008.

The Fed has announced a smaller amount of quantitative easing of US$600 billion this time around. It will be buying about US$75 billion worth of Treasury bonds per month until the second quarter of 2011.

This of course would mean another wave of foreign capital inflows in emerging markets. But due to a smaller QE2, emerging markets should see less of an impact.

In a Nov 3 interview with CNBC, HSBC Private Bank head of investment strategy for Asia Arjuna Mahendran said central banks in emerging markets "would heave a sigh of relief" as the potential capital inflow would be more manageable if less than US$1 trillion was injected into the US banking system.

A Macquarie Equity Research report seems to concur with this view. "We believe a smaller-than-expected QE exercise will pose only a temporary challenge for continued medium-term Asian equity upside," it says.

It adds that emerging markets will continue to benefit from foreign capital inflows with or without a substantial amount of quantitative easing. The pattern is expected to continue if QE2 is substantial.

However, because the Fed bought bonds and treasury bills in the first round of quantitative easing, the bond market rally will end without a substantial QE2.

"A resulting bond sell-off would cough up considerable quantities of liquidity which would then look for a new asset class to park itself in. Moreover, because a treasury sell-off would steepen the yield curve — that is, long-end yields rising, implying stronger growth and inflation prospects — the money exiting bonds will likely seek exposure in more inflation-sensitive and growth-sensitive assets. Asian equities would fit the bill on both counts," it says.

Another local fund manager believes that there is another reason behind the bull run on Bursa aside from foreign capital inflows.

"Malaysia's fundamentals have stabilised somewhat, especially if you look at consumer sentiment. It has improved from last year. Last year, people were holding on tightly to their money. If you couple that with the foreign money coming in, that's a lot of good things happening at the same time for our bourse. I can't say whether this is sustainable. I don't think anybody can since there are a lot of factors at play here," he says.

In view of the hot money coming in, several central banks have tried to curb the prospect of inflation by raising interest rates.

In a recent *Financial Times* report, Bank Indonesia deputy governor Budi Mulya says the bank is examining several proposals to control the surge of capital inflows into the country. These include lengthening the one-month minimum holding period for its treasury bills and extending the minimum duration of bank term deposits from two months to 12.

Meanwhile, the Reserve Bank of India has raised its benchmark interest rates for November — the sixth consecutive month it has done so this year due the threat of inflation.

Last week, Bank Negara finally announced a maximum loan-to-value ratio (LVR) of 70% on third-house purchases. This is expected to moderate the excessive investment and speculative activity in the residential property market, which has resulted in higher than average price increases in certain urban locations, it said in a statement.

As the local bourse continues to rally, it can't be denied that part of the reason is the continuing foreign capital inflows. Once the flows stabilise, what will happen on the local stock market remains to be seen. However, one thing is for certain — the last thing investors want to see happen is a repeat of the 1997/98 financial crisis, when foreign funds left the country in haste. E