Market Chat

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3Q20 Review and 4Q20 Outlook

Strategy

Loui Low Ley Yee
louilow@msec.com.my
(603) 2201 2100 (ext 215)

Embrace the winter - with gloves and healthcare stocks

- **Although economy is likely to contract in 2020, we think several stimulus measures across the globe should be able to cushion the downside risk and market players are expecting a recovery in 2021; similar case for Malaysia.**
- **For local exchange, we opine the trading activities will hover around gloves and related proxies and healthcare stocks without any meaningful drop in Covid-19 cases. Besides, trade diversions and trade catalyst should turn out well for 4Q20.**
- **We have picked CAREPLS, ESCERAM, DNONCE, PECCA, TOMYPAK, AME, WEGMANS and BURSA for this quarter.**

FBMKLCI	1598.75
Support	1480
Resistance	1550
Consensus target	1696

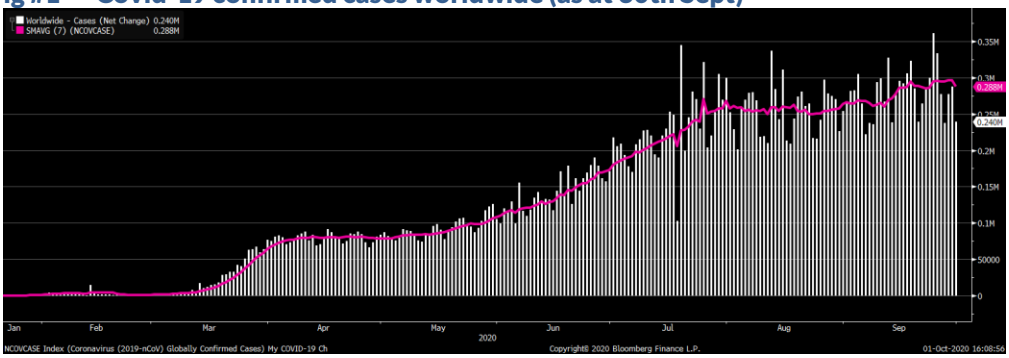
Indices	**3Q20 (%)**
FBM KLCI	**0.3%**
FBM Small Cap	**8.2%**
FBM ACE	**60.8%**
Healthcare	59.1%
Technology	34.3%
Plantation	5.1%
Ind Products	2.4%
Consumer	-0.2%
Utilities	-0.6%
Financial Services	-1.8%
Property	-2.0%
Telco & Media	-3.5%
Transport & Logistics	-4.2%
Energy	-4.9%
REITs	-5.0%
Construction	-5.2%

4Q20 Stock picks	**CL**	**S1**	**R1**	**R2**
CAREPLS	2.90	2.97	4.03	4.54
ESCERAM	0.935	0.97	1.38	1.60
DNONCE	0.58	0.60	0.755	0.86
PECCA	1.25	1.28	1.50	1.60
TOMYPAK	0.675	0.71	0.87	1.00
LCTITAN	2.00	2.08	2.56	2.80
AME	1.75	1.82	2.12	2.27
WEGMANS	0.285	0.30	0.405	0.42

Economic review and outlook

- **Winter is coming - unchanged narrative on Covid-19 situation**. Since Covid-19 outbreak early this year, the confirmed cases have not been subsiding. Furthermore, some countries have gone into second wave, which translates to second round of lockdowns or curfew mode; i.e. in Europe and UK. For short- to mid-term, we believe this situation could pressure business activities and economy could remain tepid for another quarter before we can see a meaningful recovery moving forward.

Fig #1 Covid-19 confirmed cases worldwide (as at 30th Sept)



Source: Bloomberg

- **Contraction phase for economy in 2020…** Based on Bloomberg consensus, the World GDP is likely to decline -3.9% (vs. -3.8% on 14th Aug) before recovering 5.2% (vs. 5.10% on 14th Aug) in 2021. Meanwhile, Malaysian economy could decline -4.7% in 2020 before recovering by 6.0% in 2021. Also, World Bank has downgraded Malaysia's GDP growth outlook to by -4.9% (vs. previous forecast of -3.1%) for 2020.

Fig #2 Real GDP growth rate

Regions	**Actual**							**Forecast**		
	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
World (YoY%)	3.5	3.6	3.5	3.4	3.9	3.6	2.9	-3.9	5.2	3.6
Malaysia (YoY%)	4.7	6.0	5.1	4.5	5.7	4.7	4.3	-4.7	6.0	4.2
US (YoY%)	1.8	2.5	3.1	1.7	2.3	3.0	2.2	-4.4	3.7	2.9
Eurozone (YoY%)	-0.2	1.4	2.0	1.9	2.6	1.8	1.3	-8.1	5.5	2.6

Source: Bloomberg

- **…and low interest rate environment to persist.** As the Covid-19 pandemic has translated to sluggish business environment following lockdowns in several countries across the globe, the Federal Reserve's tone has turned dovish with the interest rate path to be kept near the 0-0.25% range at least until 2023.

- **Meaningful recovery may only be seen in 2021.** The Covid-19 confirmed cases are still on the rise, coupled with the work-in-progress vaccine globally, we believe economic activities (i.e. tourism, aviation, and etc…) could stay soft at least for the rest of the year. Hence, breaking the Covid-19 chain and positive developments of an effective vaccine will be crucial for a meaningful economic recovery moving forward. Nevertheless, we believe the several stimulus measures that have been implemented by most of the countries during this year could cushion the downside risk at least for now.

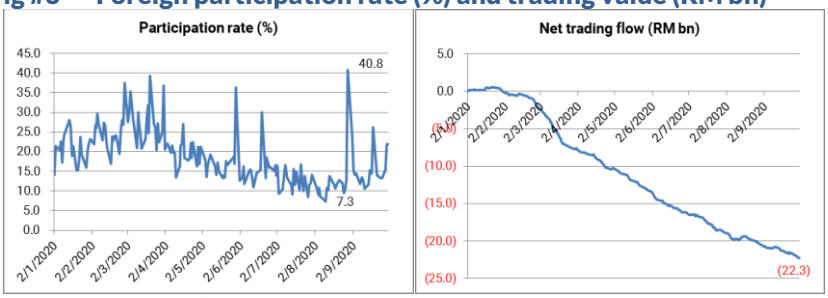
Market review and outlook

- **Market getting toppish after V-shape recovery in 1H20…** Global markets have recovered since mid-Mar, which was contributed by the unlimited liquidity injection and dovish stance by the Federal Reserve until 2023 and similar actions by global central bankers. However, market is fairly toppish at this juncture as the MSCI World Index and S&P500 are trading at 28.7x and 26.0x vs. 10Y average PE of 18.3x and 18.2x, respectively, while FBM KLCI is trading at 22.1x PE vs. 10Y average PE of 17.4x. We think it has reached the equilibrium (at least for the near term) and we may need stronger catalysts to move the markets higher from this point.

- **…and investors are looking beyond 2020.** Malaysia has gone through a tough period in 1H20 after the Covid-19 pandemic outbreak and all the SOP-induced behaviours (i.e. social distancing, wearing of face mask, avoiding crowded places) as well as the travel restrictions may pose downside risk to our economy. However, we are still hopeful to have a recovery in 2021 (provided there is no further MCO throughout the whole country) as our Covid-19 situation are being contained more effectively within the ASEAN region and the reopening of business activities since CMCO and RMCO period should be able to limit the downside risk for 2020.

- **Heightened volatility amid the recent political developments…** Meanwhile, the recent political developments may give rise to some volatility in the stock market as we have observed during the change in administration in 1Q20. Market went into a knee-jerk selling mode and selected technology, construction and politically linked counters being sold down furiously; selected counters have recovered since then.

Fig #3 Foreign participation rate (%) and trading value (RM bn)



Source: Bloomberg (as at 30Sep20)

- **…resulted in further outflow of foreign funds.** As at 30th September 2020, foreign net outflow stood at RM22.3bn (2015: oil crisis foreign outflow was c.RM19.5bn).

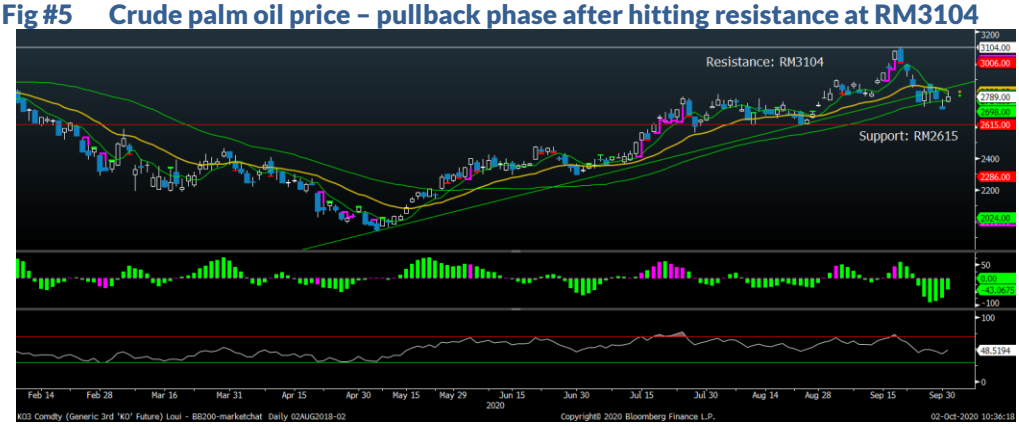
- **Brent oil down…** For Brent oil, it has not been a good year since the Covid-19 outbreak, contributing to the weaker demand globally amid lockdown restrictions in the US and Europe, coupled with the resurgence of Covid-19 cases as well as trade tensions between China and the US. The crude oil price remained below the recent resistance of USD46.5 (traded to the lowest point near USD15.98 level in Apr-20).

Fig #4 Brent oil price – range bound trading with a downward bias tone

Source: Bloomberg

- **…but palm oil up.** Meanwhile, after the CPO hitting the RM1,939 (May-20) it has recovered swiftly towards RM3,104 (Sep-20) recently on the back of the resumption of demand seen from major consumers, including China and India. Also, the potential of La Nina hitting in the second half is likely to dampen any prospects of increase in production, which may support the CPO price at least towards year end.

Fig #5 Crude palm oil price – pullback phase after hitting resistance at RM3104



Source: Bloomberg

- **Winners and losers.** In 3Q20, there are only few winning sectors, led by Healthcare 59%, followed by Technology 34% and Plantation stocks 5%. For the laggards, we have Construction index, REITs and Energy index fell 5% each.

4Q20 Strategy – key investment themes

- **Embracing the winter with gloves…** Without any significant decline in Covid-19 confirmed cases globally as well as mixed vaccine progress, we believe market participants will expose themselves in glove segment due to (i) high certainty on the earnings as well as (ii) higher potential of dividend payout from record earnings.

- **…glove proxies, healthcare and PPE segment.** Glove proxies that include raw materials, formers, manufacturing line and equipment for glove sectors as well as healthcare sector and PPE segment will benefit under the Covid-19 environment. Since 1Q20, several companies has diversified their core business into personal protection equipment (PPE), we believe those companies that executed earlier would be able to capture some earnings from the new business ventures.

- **Pharmaceutical and vaccine related theme.** Also, traders are advised to look out for opportunities under this theme as the vaccine news may emerge and mass production could be in 2021. Although earnings will not be seen until later stage, traders could participate in trading them based on the news flow. Stocks may include PHARMA, DPHARMA, BINTAI and SOLUTN.

- **Plastic/ paper manufacturers – elevated demand amid Low-Touch-Economy.** We believe after Covid-19 outbreak, consumer behaviours such as eating out and shopping in the malls are likely to change and this would provide more demand for takeaways/ food deliveries as well as e-commerce boom.

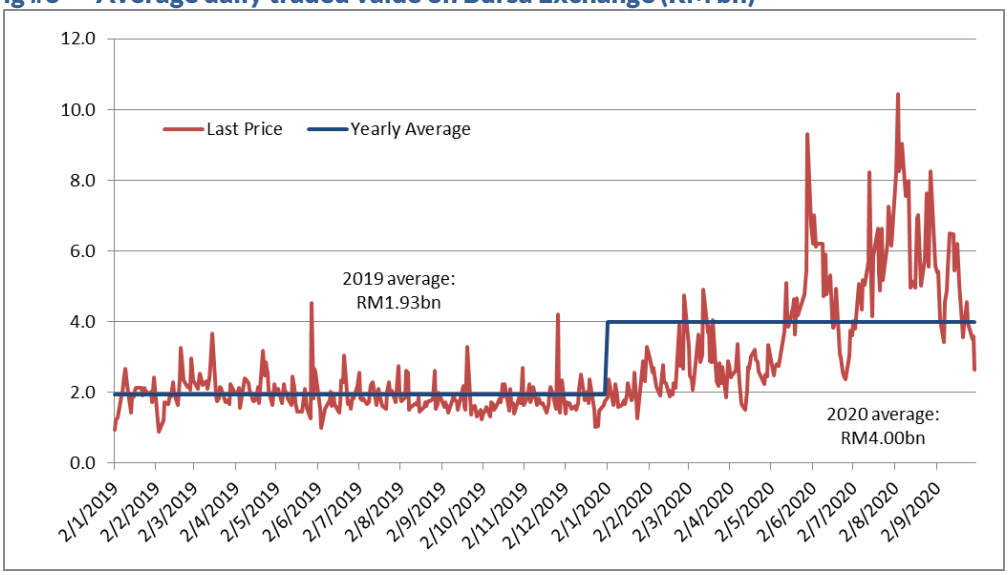
- **EMS/ Technology players – trade diversion theme.** With the unsettled trade war between the US and China, MNCs may lookout for manufacturing lines outside of China (expedited after Covid-19 outbreak) in order to reduce the dependency on China. Hence, MNCs will explore their production facilities in other countries, contributing towards the "1+1" movements, i.e. having one production facilities in China and one in other countries; this is expected to flow some job orders out from China to other regions. On a side note, the Semiconductor Industry Association (SIA) announced worldwide sales of semiconductor were USD35.2bn in July-20 (+4.9% YoY, +2.1% MoM), while World Semiconductor Trade Statistics organisation projects (in July) annual global sales will increase 3.3% in 2020 and 6.2% in 2021.

- **The new normal – work-from-home (WFH) trend.** With more corporates encourage their employees to WFH, more money will be spent on home improvements and upgrading of workstations at home, translating to more furniture purchases.

- **Plantation sector – lifted by CPO price.** Average CPO price for 3Q20 stood at RM2,688 (+27% YoY, +20% QoQ), which could boost plantation earnings in quarters to come. Overall, plantation stocks had decent quarterly results in 2Q20 underpinned by firmer CPO price.

- **Significant increase in trading activities.** YTD average daily traded value (ADTV) has increased to RM3.96bn in 2020 (2019: RM1.93bn); this could be due to (i) low interest rate environment, (ii) short selling ban and (iii) the emergence of new traders throughout MCO; retailers' inflow stood at RM11.5bn (as of end-Sep) and participation rate is within 30-40% range recently.

Fig #6 Average daily traded value on Bursa Exchange (RM bn)



Source: Bursa Market Place (as of 2Oct20)

- **High dividend yield and net cash companies**. Besides, traders should look for defensive characteristics stocks, which have solid net cash position as well as steady dividend paymaster for trading and investment purposes.

Sector and stock picks for 4Q20

- **Glove: HARTA (TP: RM18.44), CAREPLS, COMFORT**
- **Healthcare, glove proxies and PPE: OPTIMAX (Non-rated TP: RM1.00), LUXCHEM, ESCERAM, PECCA, OCNCASH**
- **Plastic/ paper packaging: TGUAN, SCGM, TOMYPAK, ORNA, DNONCE**
- **Trade diversions - EMS/ technology sectors: ATAIMS, AME**
- **Furniture: WEGMANS, SPRING**
- **Plantation: KMLOONG (TP: RM1.74)**
- **Stock exchange: BURSA**
- **Defensive (net cash or strong dividend yields): HAIO, CIHLDG, LCTITAN**

CAREPLS – Small but encouraging glove player

- **CAREPLS** produced Latex Exam, Nitrile Exam and Surgical gloves and has manufacturing facilities in Seremban.
- Throughout this period of Covid-19 pandemic, it has benefited from the elevated demand of glove globally and made an exponential growth in its core PATAMI from RM1.1m in 1Q20 to RM20.8m in 2Q20.
- We think the Covid-19 cases will only subside once (i) Covid-19 vaccine is in mass production or (ii) breaking the Covid-19 chain, thus the earnings certainty will remain for the near term.

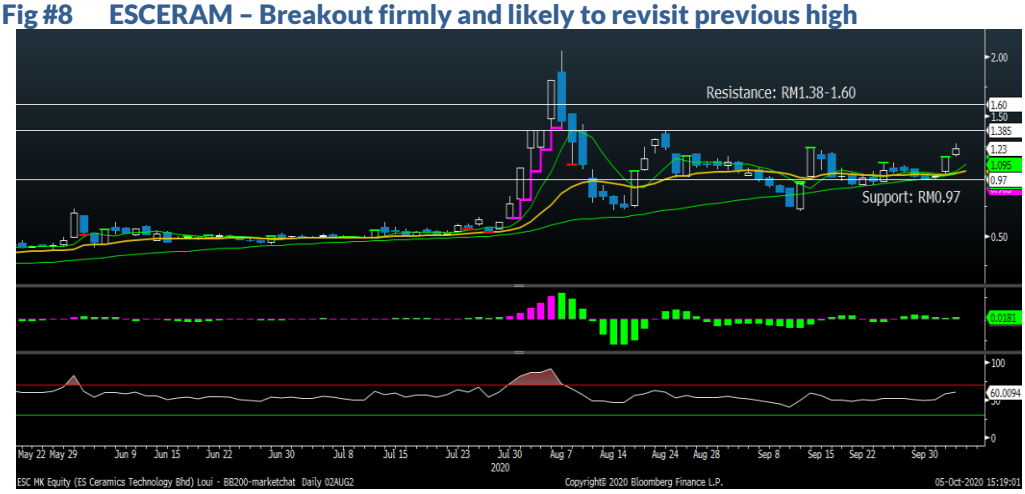
Fig #7 CAREPLS – Uptrend move in the making after the breakout

Source: Bloomberg, M+ Online

ESCERAM – Growing with gloves

- **ESCERAM** is producing formers for various ranges of gloves for more than 20 years. Also, it has grown into a heavyweight former manufacturer in Malaysia and ESCERAM has operation in Southern Thailand with its own manufacturing plant.
- The increase in demand for glove should also benefit glove companies to expand their manufacturing lines, eventually boosting demand for glove formers.

Fig #8 ESCERAM – Breakout firmly and likely to revisit previous high



Source: Bloomberg, M+ Online

DNONCE – Benefiting from higher demand for gloves

- **DNONCE** is engaged in (i) healthcare, (ii) electrical and electronic and (iii) manufacturing industries. DNONCE being one of the key suppliers of glove packaging boxes (located in Sadao, Thailand) has benefited from it. Its production capacity has increased by 50% and should generate decent earnings growth moving forward; do note that it has registered net profit of RM3.8m in 1Q21.

- Besides, DNONCE may also ride along the E&E segment on the back of the current global digitalisation trend expedited by the Covid-19 pandemic. As mentioned earlier, World Semiconductor Trade Statistics organisation projects (in July) annual global sales to increase by 3.3% in 2020 and 6.2% in 2021.

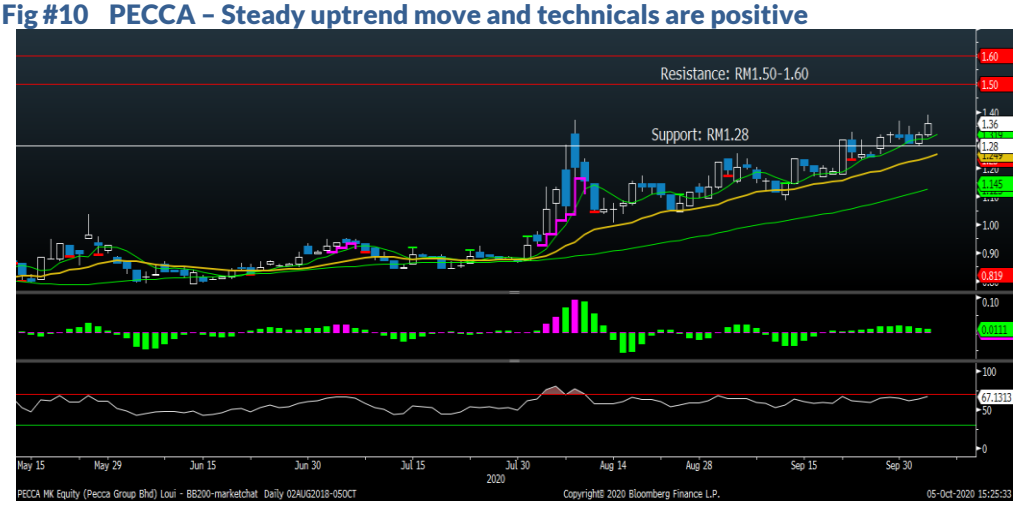
Fig #9 DNONCE –Sideways trend breakout and may revisit RM0.755-0.86

Source: Bloomberg, M+ Online

PECCA – Recovery trend in automotive and benefit from PPE segment

- **PECCA** is the largest and leading automotive leather upholstery player in Malaysia and its clients include Proton, Perodua, and etc.
- During the Covid-19 pandemic, it has diversified its business into the PPE, which is a necessity under this environment. We expect this to offset the slower growth in its core business and likely to remain relevant under this period.
- Nevertheless, automotive sector has noted some recovery since the RMCO period and its net cash should provide some stability to the group to sail through these trying times.

Fig #10 PECCA – Steady uptrend move and technicals are positive



Source: Bloomberg, M+ Online

TOMYPAK – Changed in F&B consumption patterns during pandemic

- **TOMYPAK** is one of the leading flexible packaging manufacturers in Malaysia and its clientele include MNCs such as Nestle, Maggi, Kraft foods and etc. These products are likely to be in the uptrend tone, expedited by the Covid-19 pandemic (storing more packed food and less frequenting of restaurants).
- In TOMYPAK's recent quarterly results, its core PATAMI stood at RM4.0m in 2Q20 vs. loss of -RM2.7m in 2Q19 due to a shift in F&B consumption patterns as well as increase in sales to international customers.

Fig #11 TOMYPAK – Flag breakout after the recent consolidation phase

Source: Bloomberg, M+ Online

LCTITAN – Raw material for plastic and glove

- **LCTITAN** produces (i) polyolefin such as Polyethylene (PE) and Polypropylene (PP) and (ii) olefin such as Ethylene & Propylene, which its derivatives are like Butadiene, Tertiary butyl Alcohol, Benzene & Toluene.
- With the rising demand for gloves under Covid-19 and increasing plastic usage due to the shift of consumer behaviours, we believe the ASP for LCTITAN's products will be on an upward trend. Meanwhile, LCTITAN has a solid balance sheet, its net cash per share stood at c.RM1.67 (~76% of share price).

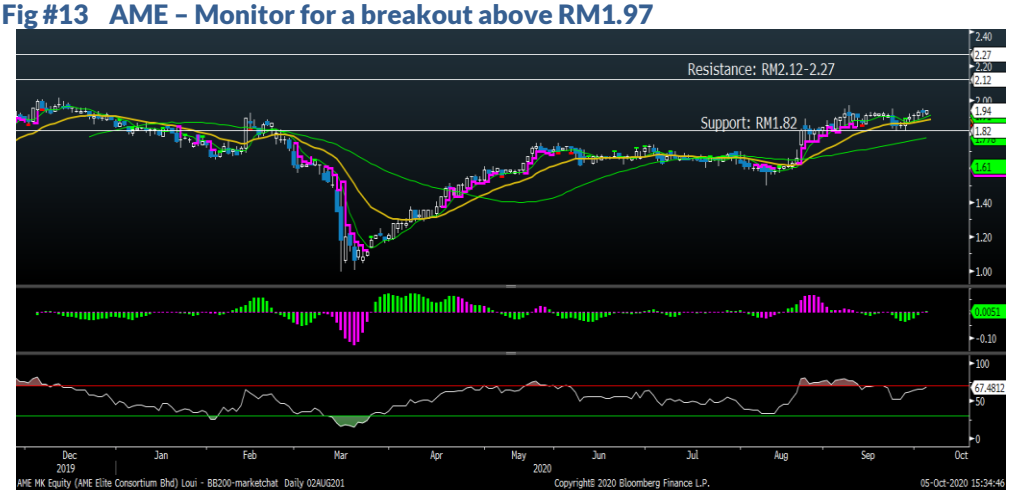
Fig #12 LCTITAN – Trend change after resistance breakout

Source: Bloomberg, M+ Online

AME – Beneficiary of trade diversions and trade war theme

- **AME** involved in industrial property development, construction, engineering services and property management services provider, which specialised in development of industrial parks and construction of large scale manufacturing plants.
- The potential catalyst for AME will be the trade diversion talks and the current trade war between the US and China may anticipate MNCs to scout around regions outside of China for new manufacturing facilities on the back of risk diversification, following the lockdown after Covid-19 pandemic.

Fig #13 AME – Monitor for a breakout above RM1.97

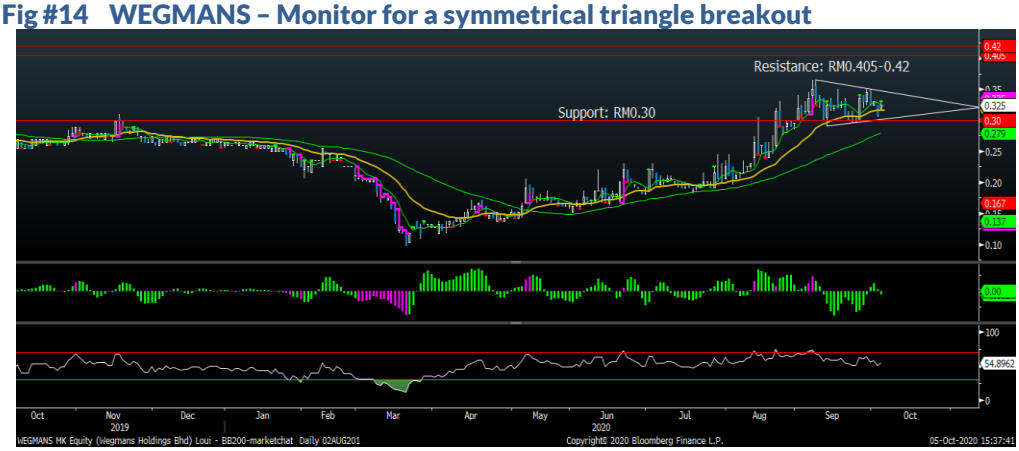


Source: Bloomberg, M+ Online

WEGMANS – Increasing stay-home trend and home improvements

- **WEGMANS** is a home furniture manufacturer, which involved in design manufacture and sale of home furniture products. Its customers are mainly wholesalers, retailers, chain stores and traders.
- The management expects the revenue contribution from the US exports to climb to 70% (from 45%) due to robust demand (production is full until CNY next year).
- The recent expansion has doubled its capacity, and its utilisation rate is expected to reach 70%. However, the risk is the labour shortages under this environment.

Fig #14 WEGMANS – Monitor for a symmetrical triangle breakout



Source: Bloomberg, M+ Online