EXECUTIVE SUMMARY

Still Reasonable Growth in 2011. After a good year where the Malaysian economy is expected to grow by 7.3%, we continue to see reasonable growth into 2011 at 5.8%. We see the Government being focused on private sector growth and supportive of efforts to promote domestic consumer spending and spurring private investment. These twin factors should begin to take over the role of driving the Malaysian economy as Government spending tapers off inline with fiscal consolidation.

Continue to see the market rallying on 3 Factors. After rising more than 20% at its highest in 2010, we still see the Malaysian market rallying to new highs in 2011 with our KLCI fair value at 1648 points. We believe this rally will be driven by 3 key factors:

- **Still respectable Earnings** at 16% growth for 2011 with most sectors expected to record at least 10% growth. Banks and Domestic consumption driven sectors such as Aviation, Healthcare and Property should see decent quality earnings with little downside surprises. We expect earnings surprises and upgrades to support the market in 2011.
- **A wave of Election related news** which will excite the Construction, Property and Oil & Gas sectors. Ahead of General Elections which we expect in 2011, we see a slew of infrastructure related news such as the start of the KL MRT, the extensions for the LRT and the various property development projects around KL
- **A flood of liquidity from Quantitative Easing.** While the continued printing of money does justify longer term fears for the global economy, in the medium term, we see a flush of liquidity coming to Asia with its still higher growth rates. Bigger cap blue chips should be the beneficiaries including the Banking and Gaming sectors.

We like 6 sectors. Taking cognizance of the 3 factors above, we see 6 sectors outperforming the KLCI especially in the 1H of 2011. We see quality earnings driving the **Banking, Consumer (including Aviation & Healthcare) and Property** sectors ahead as domestic consumption and strong retail sentiment should sustain for the next 6 months. The election theme is a natural driver for the **Construction** and Property sectors especially with the slew of news related to the Greater KL National Key Economic Area and the various Property sector mergers to undertake key developments such as the Sungai Buloh land and Warisan Merdeka. This time around we also see the **O&G** sector as being a beneficiary as we believe the Government will fast track spending on the domestic O&G sector given the increased economic multiplier of the sector to the broader economy. While quantitative easing will see money coming Malaysia's way thus benefiting most blue chips, we remain Neutral on the Plantation and Telco sectors given the lack of broader growth catalysts and therefore recommend the 2 largest sectors where we are Overweight on namely Banks and **Gaming** specifically Genting Bhd.

Bigger Top Buys. In terms of our Top Buys, they are extracted from our favourite sectors. We have generally selected bigger cap companies as our Buys for 2011 given our expectation for a further 10% appreciation in the index. Only 1 small cap company (< RM1.5bn market cap) has made it to our Top Buy list for 2011.

TOP BUYS BIG CAPS

Stock	Price RM	Target RM	Mkt Cap RMm	Volume '000	PER (x)		FY0 ROE %	FY1 DY %	Rel. Performance %			P/NTA (x)	Rating
					FY1	FY2			1-mth	3-mth	12mth		
Malayan Banking	9.10	10.07	64,410.0	10,034.7	13.9	12.5	15.4	5.4	2.9	6.9	13.8	2.4	BUY
CIMB Group	8.38	9.77	62,286.9	9,690.5	16.7	13.7	16.1	1.5	4.3	3.1	9.2	3.73	BUY
Axiata	4.45	5.80	37,580.9	14,192.2	11.4	10.2	11.2	4.5	-1.6	-1.3	22.3	2.0	BUY
Genting	10.04	13.81	37,277.5	7,188.5	15.1	12.8	8.2	0.7	-2.3	4.2	21.3	2.58	BUY
AirAsia	2.40	3.32	6,651.1	8,277.5	10.4	8.7	19.3	-	-4.8	36.6	66.7	2.2	BUY

TOP BUYS MID / SMALL CAPS

Stock	Price RM	Target RM	Mkt Cap RMm	Volume '000	PER (x)		FY0 ROE %	FY1 DY %	Rel. Performance %			P/NTA (x)	Rating
					FY1	FY2			1-mth	3-mth	12mth		
Kencana Petroleum	2.06	2.57	3,417.2	6,328.1	17.8	14.0	18.0	1.0	11.3	14.3	21.1	4.7	BUY
SP Setia	5.19	6.38	5,277.2	2,064.4	22.8	19.1	8.5	3.5	2.7	7.8	17.0	2.4	BUY
QL Resources	5.70	6.88	2,252.5	222.8	18.5	15.5	23.2	1.4	13.8	18.1	52.0	4.3	BUY
KPJ Healthcare	3.70	4.62	2,053.1	970.1	16.5	14.9	19.8	3.6	-1.2	-6.2	65.4	3.9	BUY
Sunway Holdings	2.05	2.72	1,240.4	1,215.9	8.5	7.4	16.0	1.2	6.5	18.9	32.0	1.5	BUY

Share price as at 18 November 2010

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ECONOMICS

The Many Faces of "Quantitative Easing" or "QE"

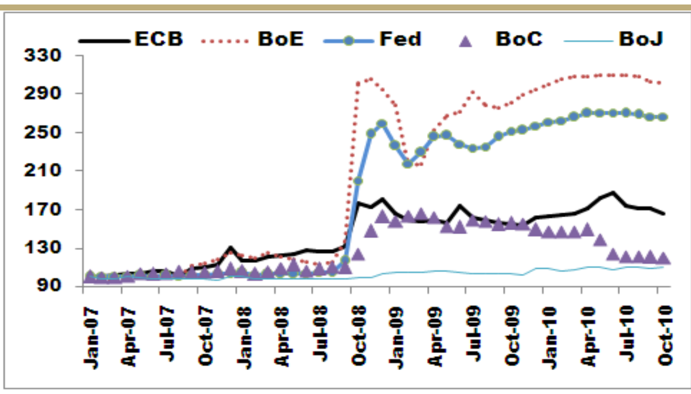
QE in the spotlight. To stabilize an economy during normal times, the brunt of responsibility usually falls on monetary policy. Generally, central banks in advanced economies harness the policy interest rate to achieve a desired outcome; however, when short-term nominal interest rates hit the zero-bound, other less conventional measures must be introduced to provide further accommodation beyond the usual channels. These include deliberate communication to "talk down" longer-term interest rates, various forms of liquidity provisions and asset purchases. The focus of this piece will be on asset purchases, often referred to as "quantitative easing" or "QE".

The many faces of QE. Even though the QE description has been used widely by the media, interestingly, there is no commonly accepted definition for this term. Often, the QE expression refers to the policy approach adopted by the Bank of Japan (BoJ) between 2001 and 2006, when it conducted outright purchases of government securities (the asset-side of the balance sheet) financed by the creation of bank reserves (the liability-side). The BoJ QE policy focused exclusively on the liabilities portion of its balance sheet with specific targets on bank reserves or simply reserves. Unfortunately, the QE experiment pursued by the BoJ was futile, in part because the central bank was too hesitant and sluggish. In early 2009, however, Fed Chairman Bernanke describes the recent policy approach as "credit easing" or "CE", because of the emphasis on the asset-side of its balance sheet. Nevertheless, the Bank of England (BoE), which has also embarked on £200bn of asset purchases and enlarged its balance sheet, refers to its program as QE. Conceptually, any expansion in a central bank's balance sheet via asset purchases can be loosely termed QE. Still, there are crucial differences across central banks, for example the range of assets to be purchased, the frequency of the purchases and so on.

QE pros and cons. As with any nonconventional policy, there are known and unknown considerations. When a central bank embarks on QE, it reduces the supply of assets and alters the balance sheet composition of sellers. With imperfect asset substitution, this typically shrinks the risk premium (by reducing duration risk) of the asset purchased, which in turn raises its price and lowers its yield. This could spillover positively into prices of other longer-duration assets, like corporate bonds and equities, and provide stimulus to the economy. While QE might in theory affect bank lending, the dynamics of this channel are less clear-cut. And the net response of the currency to QE, while weaker initially, should be ambiguous over time. Still, the actual effects of QE on the economy (unemployment and inflation) are difficult to quantify. Also, communicating the actual QE policy stance and determining an appropriate amount to purchase could become a challenge. Some have noted that under *certain circumstances*, an enlarged balance sheet and too much excess reserves could pose a threat to future inflation.

Flushed with liquidity. While all five central banks in advanced economies expanded their balance sheets recently, only the Fed, BoE and BoJ have embarked primarily on asset purchases or QE conceptually. In terms of absolute size, the BoE and Fed take the lead. At its November meeting recently, the Fed, as expected, will resume longer-term Treasury purchases and dilate its balance sheet to actively pursue its dual mandate. The scale and timing of the purchases ($600bn by end-2Q2011) are subject to frequent review. If completed as planned, the stock of domestic securities held by the Fed could increase to roughly $2.65tn by mid-2011.

Figure 1: The asset-side of central banks' balance sheets



Source: CEIC, ECB, Fed, BoC, BoJ and BoE. Note: All data herein has been indexed to 100=Jan 2007

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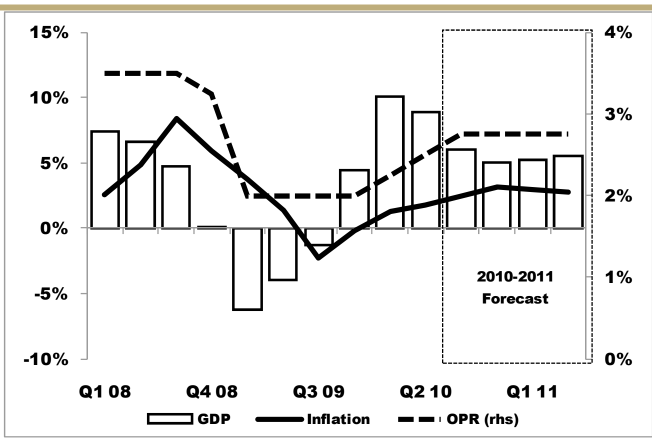
Malaysia: Realigning Growth Strategy

A weaker 2H2010. Malaysia recorded real GDP growth of 9.5% in 1H2010 as the economy recovered from a contraction following the global financial crisis in 2008-2009, a pace similar to that seen in 2000 (Malaysian growth averaged 9.2% from 1992-1997 but fell to 3.9% from 1998-2009). Nevertheless, slower external demand and the unwinding of fiscal stimulus measures around the globe are likely to translate into growth moderation in 2H2010, with our growth forecast currently standing at 5.5% y-o-y. Inflation is unlikely to pose a significant threat in 2010 following milder increment in fuel prices (+2.7%) compared to 2008's hike of around 40%. Our 2010 inflation forecast is 2.2%, with some downside risk in the light of a slower rate of increase in food prices. Bank Negara Malaysia has consequently paused on its streak of raising rates since September this year at 2.75% and is likely to wait for a firmer recovery in the country's export markets before resuming on its monetary policy tightening.

Still reasonable growth in 2011. For 2011, the Malaysian government expects growth to continue strongly, albeit slower than 2010's growth, at 5%-6%, with key sectors such as manufacturing and services expected to grow at 6.7% and 5.3% respectively. Our 2011 forecast is for growth to come in at 5.8%, with manufacturing and services sector output expansion forecast at 6.0% and 6.8% respectively. Inflation is expected to average 2%-3% in 2011, according to the 2011 Budget statement, while our forecast for inflation in 2011 remains unchanged at 2.5%. The key reasons for inflation remaining stable and relatively capped in our 2011 forecast are the lack of indications on the timing of the fuel subsidy removal next year as well as the deferment in implementing the goods and services tax.

Government focused on private sector growth. Budget 2011 (forecast to register -5.4% of GDP), unveiled in October, vindicated our view that it will be supportive of domestic consumer spending and also emphasized the government's strategy to reinvigorate private investment expenditure to support the Malaysian economy's growth going forward. This is consistent with our expectation of the contribution of net exports diminishing next year as overseas demand is likely to slow going forward. With Government spending is also expected to taper off amidst fiscal consolidation, the economy would become more reliant on the other two engines of growth, namely domestic consumption and fixed investment. We like the idea of a meatier role for private fixed investment to sustain growth going forward as contribution from domestic consumer spending would provide limited upside to growth potential (its overall share to GDP has reached more than 50% while its historical average was only around 48%). To achieve the desired 6.0% economic growth target as set out in the 10th Malaysia Plan, we think the country needs to beef up investment spending to about a 4%-point contribution (equivalent to an average of 17.0%-18.0% y-o-y growth). One word of caution on Budget 2011 is that with slower growth anticipated for the next couple of years, the Government's target of cutting the deficit to below 3% of GDP would be even tougher. This is especially so in light of the further postponement in implementing the GST, which means there would be no expansion in terms of Government's tax base going forward. Secondly, Budget 2011 was also silent on plans to reduce fuel subsidies.

Figure 2: Malaysia Economic Outlook – Growth to return to trend but not inflationary



Source: CEIC, OSK-DMG

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MARKET OUTLOOK

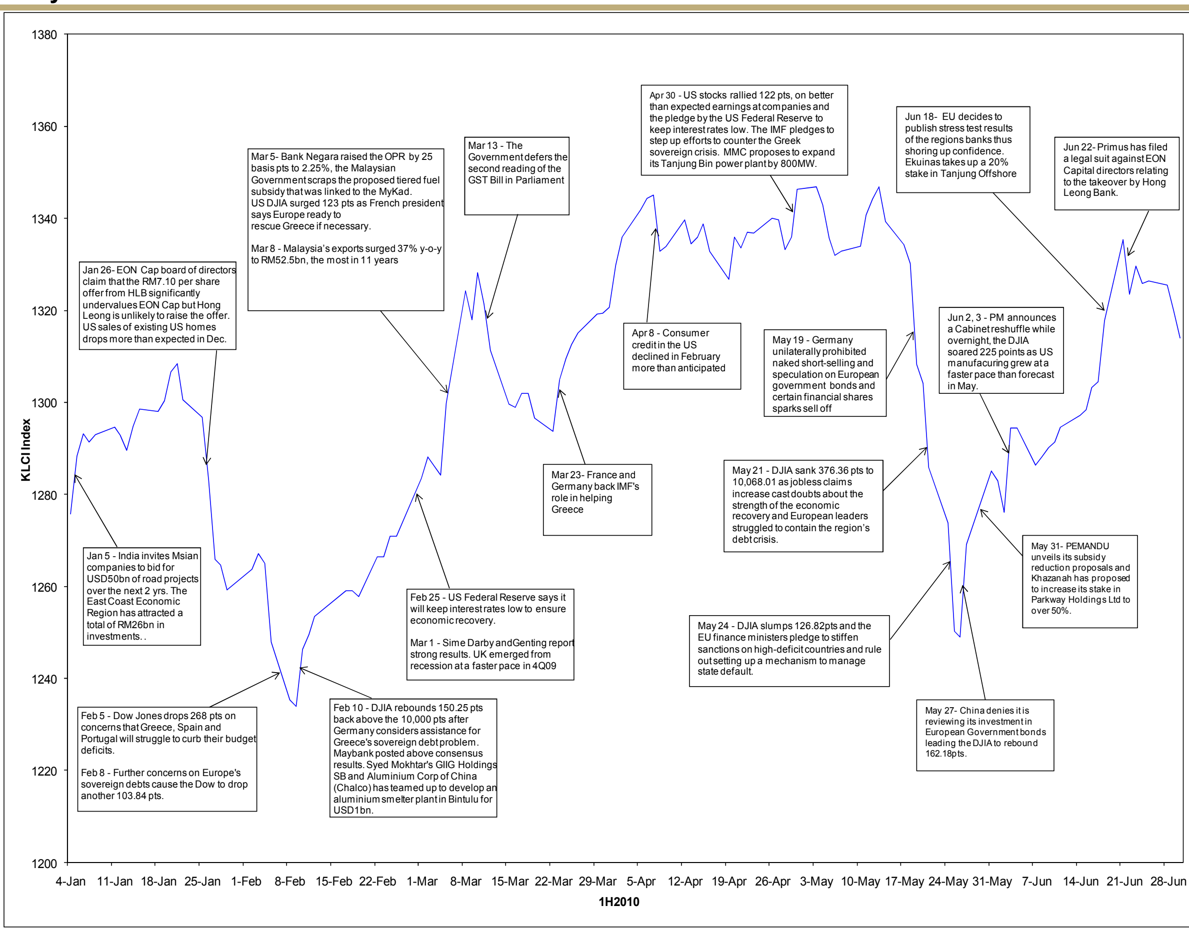
2010 Review – Rallying to a Record

A Good Year. After a strong 2H2009, 2010 turned out to be an even better year for the KLCI, which surged from below 1280 pts to a record high of above 1530 pts. In getting there, we observe that the Malaysian market went through 3 distinct phases:

- Dominated by foreign factors
- Ringgit driven
- Economic Reform takes over.

Dominated by foreign factors. Between January and June, the Malaysian market generally took the cue from foreign market, which were dominated by 1 key factor - the European debt crisis. Fears that Greece would not be able to service its sovereign debts spread to the so-called “PIGS” countries, namely Portugal, Ireland, Greece and Spain in the Euro zone. All 4 were seen as peripheral countries within the Euro zone and fears that they would default led to a general sell-off of their bonds as well as riskier equities worldwide. At the same time, concerns of fiscal tightening in China emerged as the Chinese government slapped restrictions on new lending while regulation tightening was the concern in the US as the US President proposed to restrict proprietary trading among deposit holding banks. Only the concerted efforts by the larger European economies of France and Germany in February and March, together with the International Monetary Fund (IMF), helped gradually restore market confidence. As such, even as China imposed tighter regulations to cool down its property market, only China and Hong Kong’s stock markets were affected, with the rest of the world trending higher up to May. Nonetheless in May, global markets again took a dive after Germany unilaterally decided to prohibit naked short selling on European government bonds and certain financial shares, sparking fears that central banks were no longer acting in concert. It was only after China denied that it was reviewing its investments in European government bonds and the EU decided to publish the stress test results on its banks that confidence was restored in June.

Figure 3: Key Events and KLCI movements in 1H2010

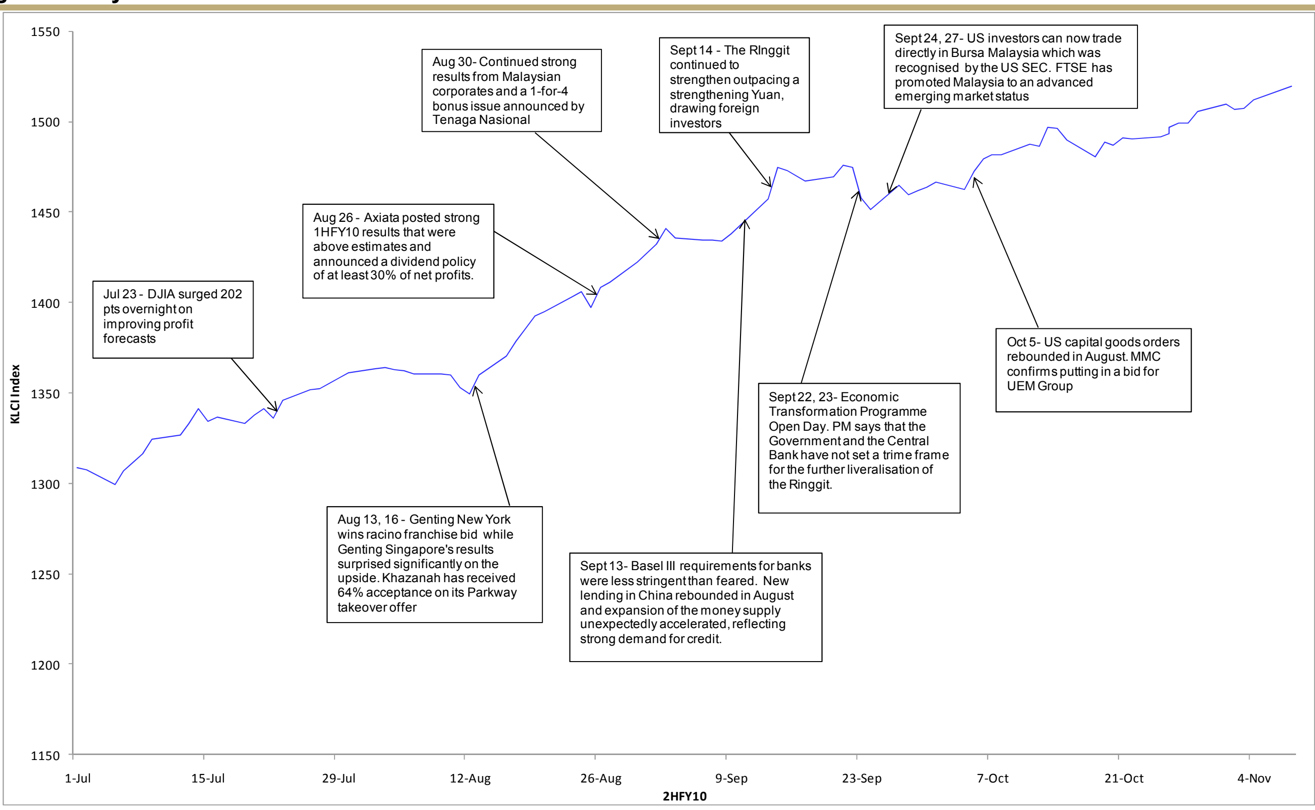


Source: Various

Ringgit-driven. The second phase of the KLCI's surge in 2010 began in June when both regional and domestic factors started to figure strongly, apart from just global factors in the 1st half. The catalyst was China's decision to allow greater flexibility in the Yuan exchange rate. While China first announced that it was considering allowing the yuan to be tradable against the Russian ruble, Korean won and Malaysian ringgit in April, the inflow of hot money into Malaysia on hopes for a stronger Ringgit in line with a potentially stronger Yuan began in earnest in June. With global markets still initially jittery, this money flowed into Malaysian Government securities and some consumer stocks. In fact, during the months of June and July, defensive consumer stocks saw a rerating that lifted them to multi-year highs and a significant expansion of their PER multiples. The Ringgit story continued to drive the market up until mid-September when the PM and Bank Negara's Governor effectively denied allowing offshore trading of the Ringgit. This led to the Ringgit immediately losing ground vis-à-vis its regional peers while still strengthening against the US dollar.

Economic reform takes over. The third phase of the KLCI's ascent in 2010 generally overlapped with the second phase as it too started in June with the unveiling by the Performance Management and Delivery Unit (PEMANDU) of its subsidy reduction proposal on 31 May followed by a cabinet reshuffle in early June. These 2 events marked the start of what would eventually be viewed as renewed focus on economic reforms, which culminated in the launch of the Economic Transformation Programme (ETP) in October. Coupled with strong earnings by banks in August, the excitement surrounding the ETP and its associated infrastructure projects such as the KL Mass Rapid Transit (MRT), the high speed rail and others, helped to spur the KLCI towards new highs and eventually surpassing its historical high of 1524 pts reached in early 2008. With foreign investors now taking a look at Malaysia again on hopes of more economic reforms and greater economic integration with Singapore, the political scene also stabilized in late 2010 with the Barisan Nasional winning the 12th and 13th by-elections after having taken a beating since the 2008 general elections. All in all, with the economic reform theme driving the economy ahead and foreign investors' interest in Malaysia, we see the strong possibility of a General Election being held in 2011, as well as the strong market momentum continuing into 1H2011. We also see domestic themes playing a more prominent role in the upcoming months as Malaysia's market decouples slightly from global drivers.

Figure 4: Key Events and KLCI movements in 2H2010



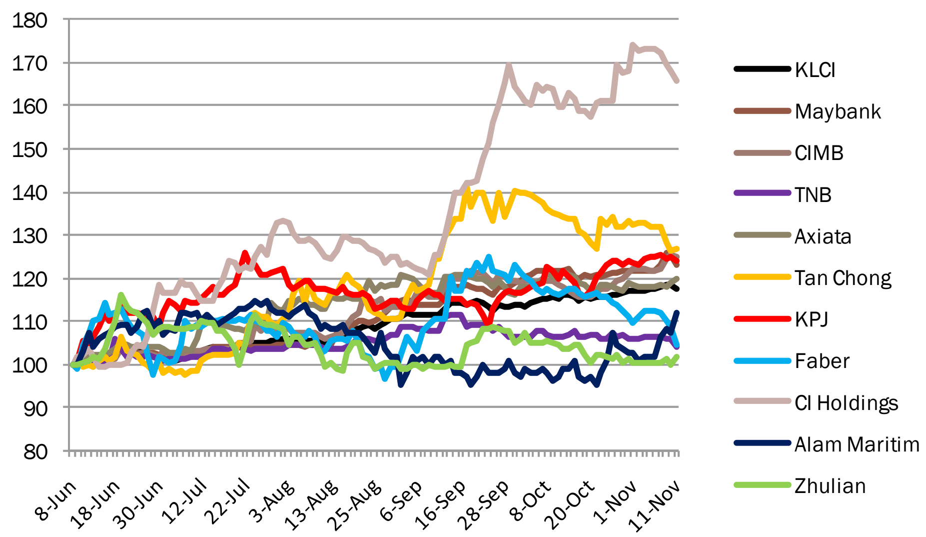
Source: Various

Key themes. In the broader context of the Malaysian market, we identify 6 themes that were prevalent in 2010, namely:

- **Stop-start economic reform**. Economic reforms got off to a poor start in 2010 with the delay in the second reading of the Goods and Services Tax (GST) bill and postponement of subsidy cuts on natural gas. It was only in July that economic reform moves restarted with a small subsidy cut on petrol. However, things picked up steam with the Open Day of the ETP and foreign investors starting to take a re-look at Malaysia towards the end of the year, with economic reform activities in terms of new private investment looking to pick up in 2011.
- **Strengthening political support for the Government**. In the aftermath of the March 2008 General Elections in which the incumbent Barisan Nasional (BN) coalition lost its two-third majority, things had looked politically shaky for the ruling government. However, things definitely appear to be swinging in favour of the BN since then, going by its two recent by-election wins. While the Pakatan Rakyat (PR) coalition has won 8 of the 13 by-elections since March 2008 compared to BN's 5, BN has won 3 out of the 4 by-elections in 2010. This definitely serves as a confidence booster for BN to hold the next general election soon.
- **Return of infrastructure spending**. As opposed to the earlier focus on agriculture and the distribution of developments to 5 development corridors across Malaysia by the Tun Abdullah Ahmad Badawi administration, the current administration seems to be returning to the Tun Mahathir era of large-scale infrastructure projects largely centered on urban areas such as the KL MRT and the various property developments proposed around the Klang valley such as the Sungai Buloh land, Sungei Besi airport and the development of Kampung Baru.
- **Moderate fiscal tightening**. While there were hopes as well as concerns that the current administration would tighten the screws on the economy with subsidy cuts, the eventual cuts that materialized were muted. Compared to PEMANDU's proposal to raise petrol prices by over 8% along with electricity tariffs and toll rates, we eventually saw a small hike in petrol price of less than 3%, no change in electricity tariffs and our toll rates being frozen for 5 years. As such, the current Government's emphasis seems more on growth rather than balancing the budget.
- **Return of overseas investors**. The strengthening of the Ringgit in mid-2010 and the increasing pace of economic reform coupled with the global slush of liquidity have again brought foreign investor interest back to Malaysia. We are seeing greater foreign inflows into our market as well as more visits by foreign fund managers to Malaysia's shores.
- **Privatisation**. The final key theme of 2010 was the privatization of many listed companies. Although there are many reasons put forth for the spate of privatizations including capital flight from Malaysia, we believe the main reason was the ample liquidity that provided cheap financing, which allowed companies' substantial shareholders to privatise what they felt were undervalued companies. Companies that were privatized or in the midst of privatization in 2010 include:
  - MEASAT
  - Tanjong
  - Astro
  - PLUS
  - UBG
  - Sunrise
  - EONCap
  - Hume Industries
  - Malaysian Mosaic
  - Titan Chemicals

Top Buys performed reasonably. Out of our Top 10 Buy calls for 2H2010, 6 outperformed the KLCI namely CIMB, Maybank, Axiata, Tan Chong, KPJ Healthcare and CI Holdings. The ones which underperformed were Tenaga Nasional, Alam Maritim, Faber Group and Zhulian due to a delay in electricity tariff hike, a dearth of O&G contracts, uncertainty in concession renewal and poor performance in MLM peer Hai-O's results respectively.

Figure 5: Performance of OSK Research's Top 10 Buy calls for 2H2010



Source: Bloomberg

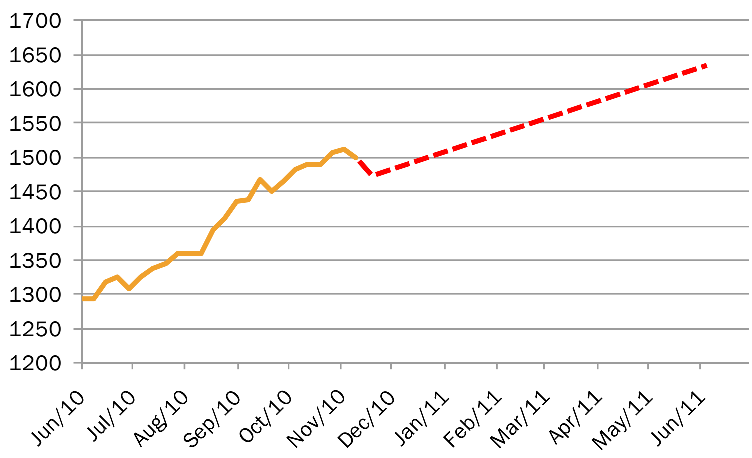
2011 Outlook – 3E's Drive the Market

A Continued Rally. After rallying for some 250 points, or over 19% at the high for 2010, we still see the KLCI scaling new heights for 2011. Our 2011 KLCI fair value is 1648 pts, based on 16x PER on 2011 KLCI earnings. This provides an upside of some 10% upside on the benchmark's current level, and we remain Overweight on the market. We see the local bourse scaling higher by 3 key factors:

- **Earnings**. Earnings remain resilient, with continued growth in 2011 after a stellar rebound in 2009. With an estimated net profit growth of 16% among KLCI component stocks under our coverage, we see fundamental reasons why the market should continue to rise in 2011.
- **Elections**. As the possibility of an early general election looms in 2011, we believe that the news flow on infrastructure developments will remain strong and keep the market afloat on expectations of new contracts.
- **Easing**. With USD60bn promised by Japan and a further USD600bn from the US coupled with continued record low interest rates in the developed world, we believe the flood of liquidity will continue to drive global equity markets higher. We see Malaysian counters with high liquidity naturally becoming the targets of some of this money.

We discuss each of these factors in more detail in the following sections.

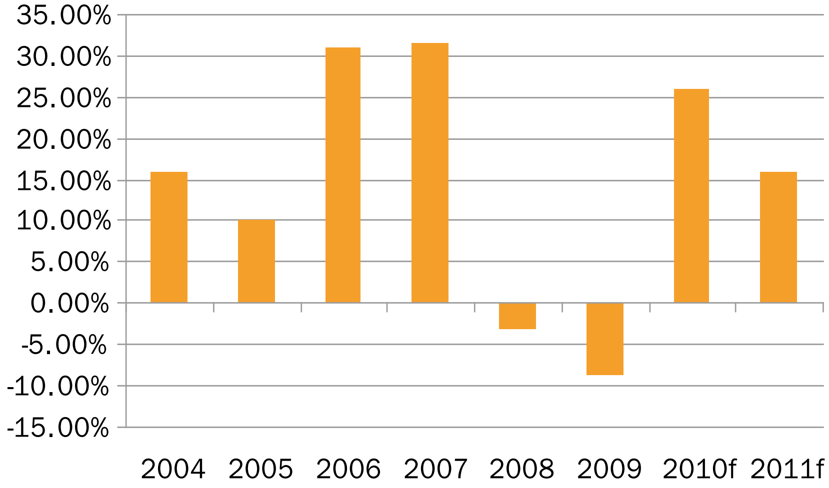
Figure 6: OSK Research's expectations of the KLCI's trend in 1H2011



Source: OSK Research

Earnings – Still Respectable. Despite the flush liquidity and good news flow expected for 1H2011, we feel that for the market to trend higher, the fundamentals must be intact in that the listed companies in Malaysia must be able to report net profit growth in the coming months. In this, we are not disappointed. After contracting in 2008 and 2009, KLCI components' net profit growth rebounded strongly in 2010 with an expected 26% growth rate. We expect this growth to moderate somewhat in 2011 to a still decent 16%.

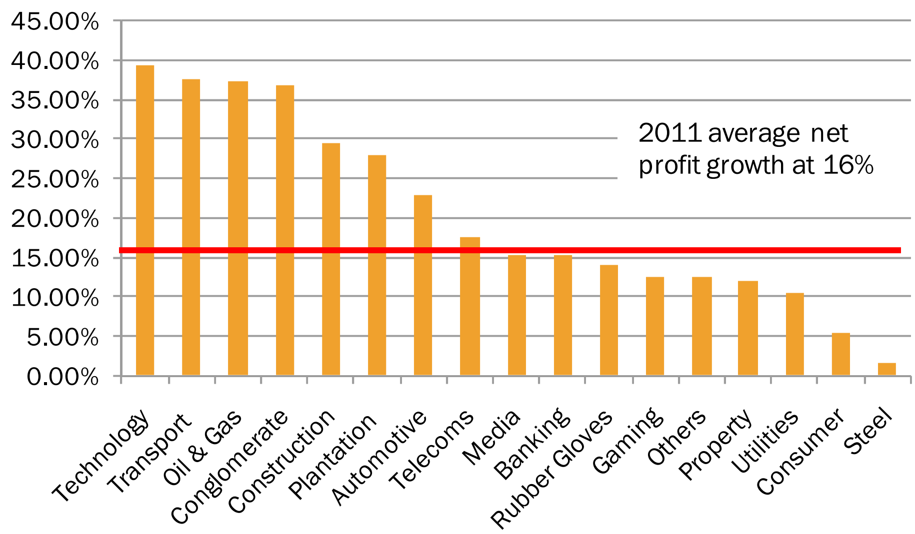
Figure 7: 2011 KLCI earnings growth still expected to be decent at 16%



Source: OSK Research

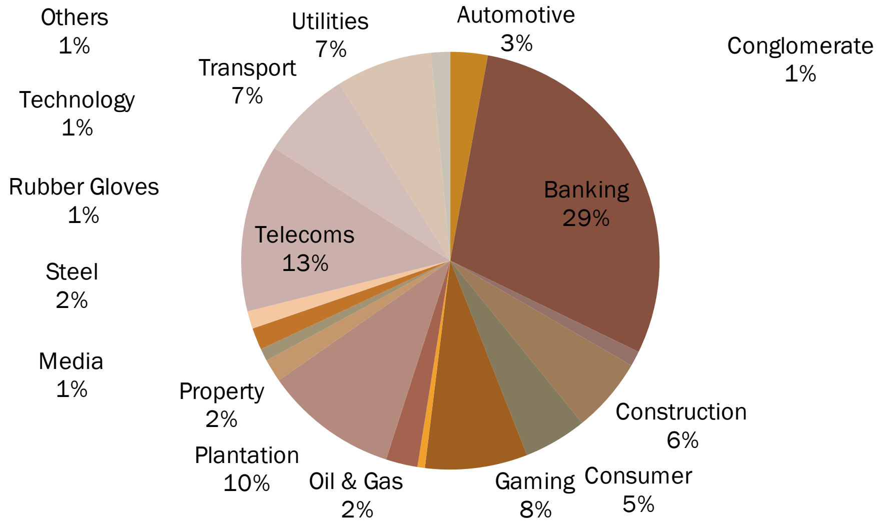
Decent growth across almost all sectors. Taking a cross section of the sectors in the next figure, we note that almost all sectors are expected to post decent growth in 2011, except perhaps the steel sector as the change of industry structure to a quarterly pricing for iron ore will limit iron makers' ability to benefit more from spreads while steel makers will face muted volume growth and margin normalisation. The top growth sectors such as technology and transport remain Neutral calls as their valuations have somewhat factored in some of this growth. Instead, we prefer quality growth that is likely to be repeated further into the future. We see growth for sectors such as Banking, Consumer, Healthcare and Property continuing into 2012 with few negative surprises. All but the consumer and steel sectors are expected to post more than 10% growth in net profit. 2011 profits (excluding Petronas Chemicals which has yet to list at the date of writing) are still dominated by the Banking, Telco and Plantation sectors with the Gaming and Utilities sectors coming next.

Figure 8: Most sectors appear on track to post decent earnings in 2011



Source: OSK Research

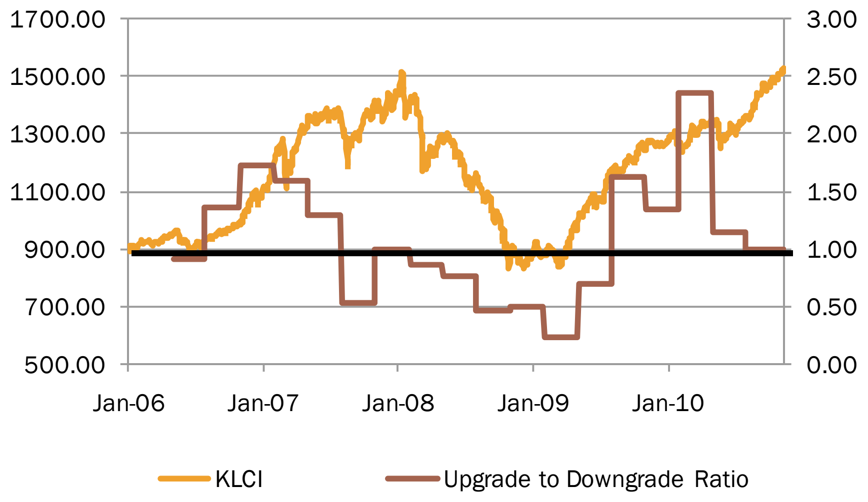
Figure 9: Corporate profits still dominated by Banks and Telcos



Source: OSK Research

More importantly, February may be the season for upgrades. While our expectations of there being more downgrades than upgrades during the 3Q results season still hold, we believe that upgrades could dominate again either starting in the 4Q10 or 1Q11 results, which will be in February and May 2011 respectively. As shown in the following figure, the performance of the KLCI remains closely related to the Upgrade to Downgrade ratio and a slew of upgrades in February, or at the latest by May, will help move the market up again. As such, we feel that the 2011 corporate earnings will be a factor fuelling the market rally to new highs, particularly for sectors with quality earnings that are unlikely to report negative surprises such as the Banking, Consumer, Healthcare and Property sectors.

Figure 10: KLCI still tracks the Upgrade to Downgrade ratio. The ratio is expected to turn up either in 4Q10 (February) or 1Q11 (May)



Source: OSK Research

Elections: A wave of news. When we first highlighted in March 2010 our expectations for an early general election in 2011, we were met with great skepticism. However, since then, the stabilizing political outlook for the Barisan Nasional coalition as well as the numerous hidden hints such as delaying the GST and statements made during the recent UMNO General Assembly, have many convinced that there would possibly be a general election in 2011. If indeed this were the case, we expect to see a strong flow of news related to construction and property developments in the run-up to the election to create multiple feel-good factors for the economy and the 'rakyat' to enhance the ruling government's chances of re-election.

The swing in by-elections. The stabilizing outlook for the BN coalition was most evident in the swing in the by-election results held since March 2008, with BN winning 3 out of the last 4 by-elections although PR still maintains the lead with 8 total by-elections to BN's 5. We summarize the vote swing in the following by-elections.

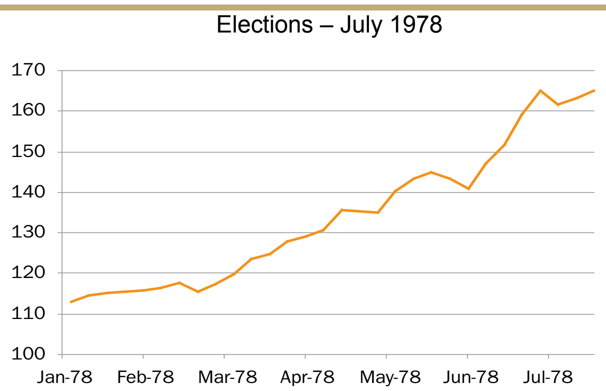
Figure 11: The swing in by-election results to BN's favour

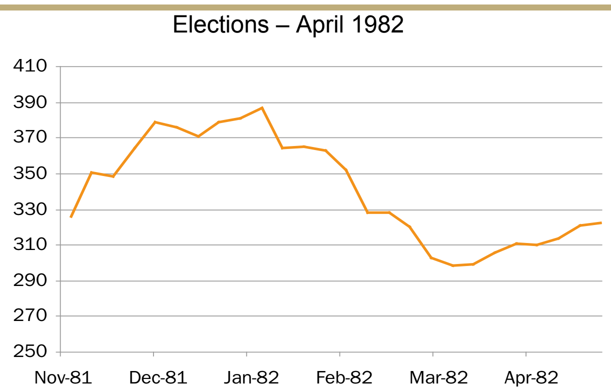
		Pakatan Rakyat	Barisan Nasional
Permatang Pauh	Aug-08	X	
Kuala Terengganu	Jan-09	X	
Batang Ai	Apr-09		X
Bukit Gantang	Apr-09	X	
Bukit Selambau	Apr-09	X	
Penanti	May-09	X	
Manek Urai	Jul-09	X	
Permatang Pasir	Aug-09	X	
Bagan Pinang	2009		X
Hulu Selangor	Apr-10		X
Sibu	May-10	X	
Galas	Nov-10		X
Batu Sapi	Nov-10		X

Source: Various

Accompanied by market rallies. As summarized in the following figure, there had been a market rally sometime in the prior 6 months in 6 out of the last 8 elections. We expect this impending election to be no different as part of the confidence-building ahead of a general election is the 'feel good' factor in the stock market.

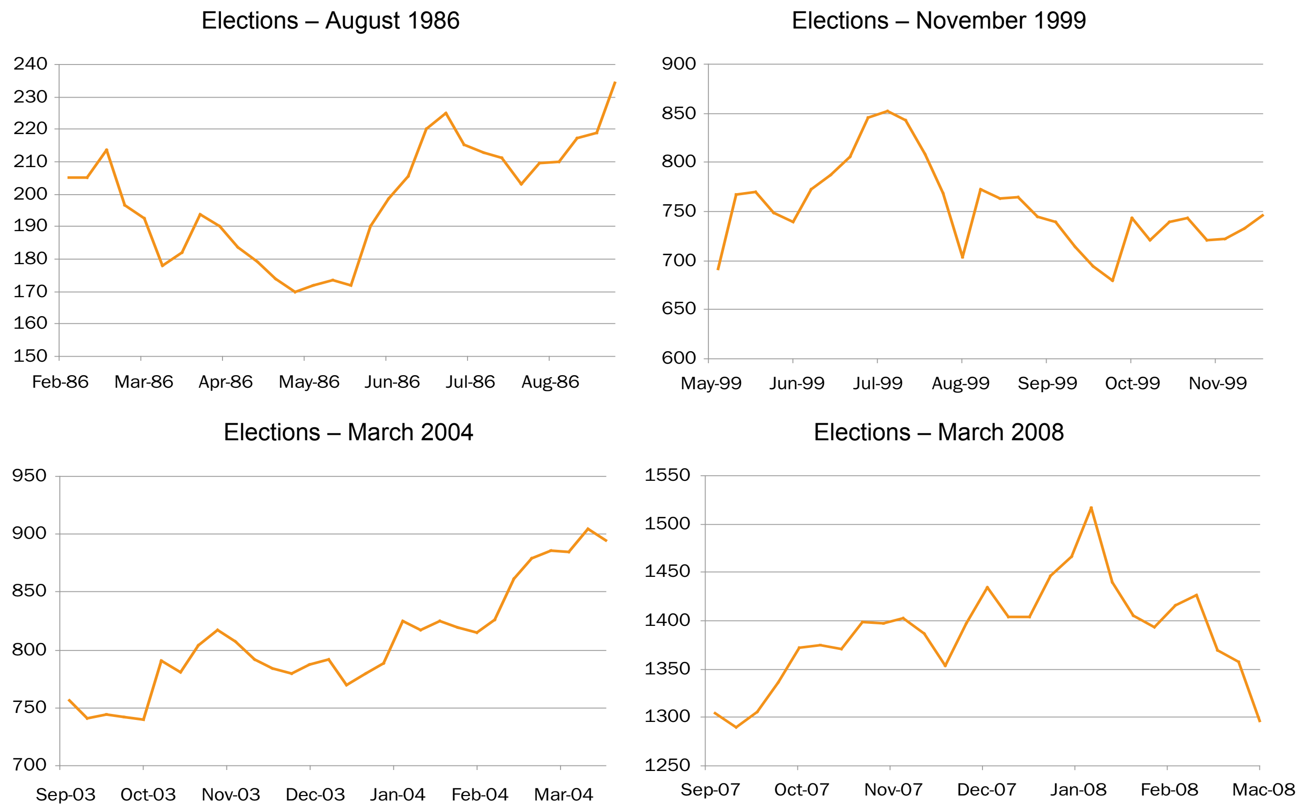
Figure 12: Market rallies were seen sometime in the 6 months prior to general elections in 1978, 1982, 1986, 1999, 2004 and 2008





Source: Bloomberg

Figure 12: Market rallies were seen sometime in the 6 months prior to the general elections in 1978, 1982, 1986, 1999, 2004 and 2008



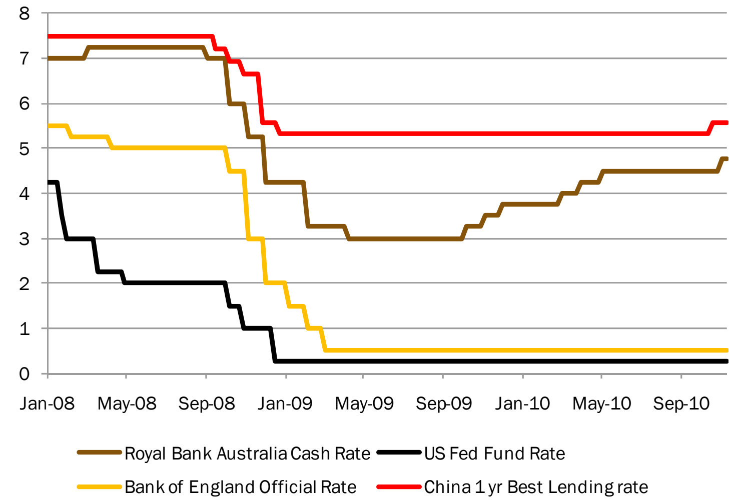
Source: Bloomberg

Good news in the ETP. We believe that most of the good news ahead of the election will be part of the implementation of the ETP, including the official Government approval and launch of the KL MRT, the contract award of the LRT extensions and the kicking off of the development of the 3,000 acres in Sungai Buloh as well as the start of the KL International Financial Centre in Pasar Rakyat, all of which are part of the Greater KL National Key Economic Area. Of course, the ETP should not be viewed purely as part of an election campaign as many of its components form part of a longer term plan to bring development to Malaysia, including the KL-Singapore high speed railway, the Tanjung Pengerang oil terminal and the PJ Healthcare metropolis. Nonetheless, the getting off the ground of the ETP's more prominent components will definitely enhance sentiment in the short term.

Construction and Property the Big winners. In the run-up to an election, we see the Construction and Property sectors benefiting from the positive news flow. Sarawakian players in particular may race ahead of the broader market as the Sarawak state elections are still generally seen to be held ahead of the general election.

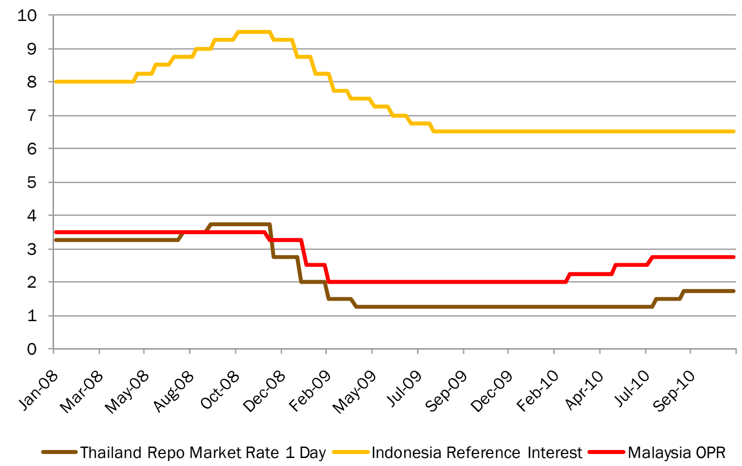
Easing – Flood of liquidity. As we explained in the economics section of this report, quantitative easing (QE) generally refers to the expansion of the balance sheets of central banks through the acquisition of government-related securities. With QE being carried out by the US, the UK and Japan, coupled with continued low interest rates in most OECD countries, we expect flush liquidity to continue for the early part of 2011. Some of this liquidity will make its way to Malaysia, which as explained in the 2010 review, is seeing a return of foreign interest on the back of a stronger Ringgit and the Government's proposed economic reforms. While we see some tightening among Asian economies given their stronger growth and moderate inflation, we believe that the US and Japan will have no choice but to suppress their interest rates for an extended period and therefore, money should find its way to Asia due to the region's stronger fundamentals as well as higher interest rates.

Figure 13: Most developed economies have maintained low interest rates (%) except for Australia



Source: Bloomberg

Figure 14: Slight uptick in South East Asian interest rates (%)



Source: Bloomberg

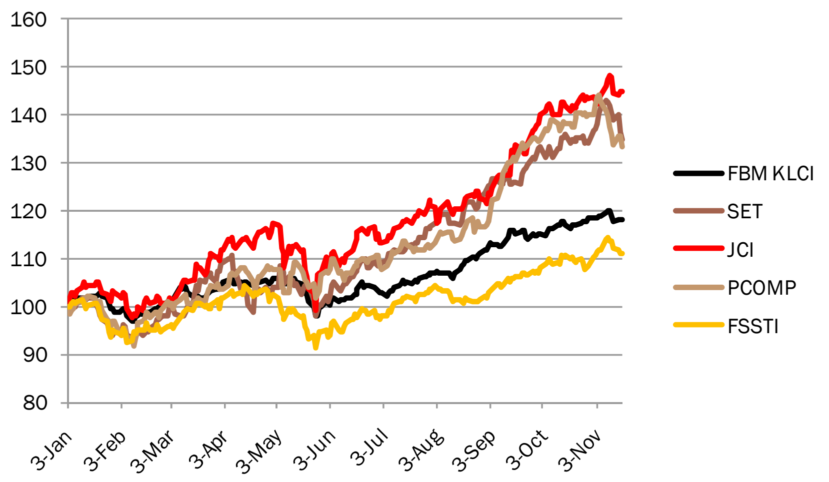
Malaysia still looks good. While we expect Bank Negara Malaysia (BNM) to only raise the Overnight Policy Rate (OPR) again in 2H2011 and the Ringgit weakening somewhat against the US dollar, we still see the local market as a magnet from a regional perspective. Firstly, from a PER perspective, although Malaysia may still be more expensive than Thailand, Hong Kong and Singapore, it is now cheaper than Indonesia, and the gap between Malaysia and Thailand and Singapore has narrowed considerably. While historically Thailand used to trade at half of Malaysia's PER, it is now trading at less than 15% lower than the KLCI. On the same note, while Malaysia recorded decent gains in 2010 with YTD gains of above 17%, it is still lagging way behind markets in Indonesia, Thailand and Philippines, which have surged by more than 30% YTD. As such, we feel that as foreign investors broaden their horizons to cheaper markets, Malaysia will pop up on their radar screen.

Figure 15: Malaysia still reasonably priced on a regional basis

Index Exchange	Market Cap (USD billion)	YTD gains (%)	Historical PER	Estimated PER	Div Yield (%)
DJIA	3530.00	7.42	13.62	13.18	2.53
FTSE 100	2586.35	7.53	17.54	11.95	3.09
Shanghai Composite	2782.21	-11.68	19.25	16.94	1.4
Nikkei 225	2361.51	-7.11	19.01	17.43	1.79
Hang Seng	798.36	8.20	14.8	15.1	2.62
FT Strait Times Index	391.85	10.79	12.8	15.79	2.65
Stock Exchange of Thai Index	278.39	39.82	14.94	14.47	3.23
Jakarta Composite Index	337.80	44.13	31.58	17.91	1.81
Bursa Malaysia KLCI	148.41	17.23	17.97	16.08	2.88

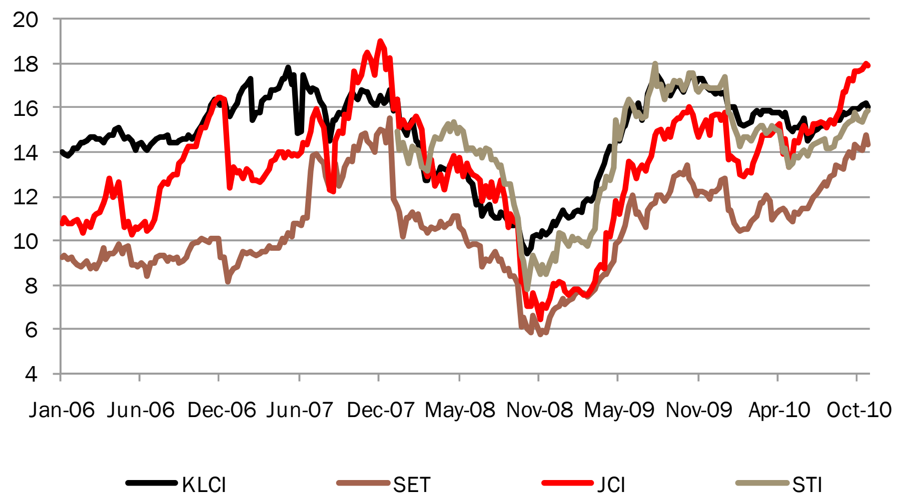
Source: Bloomberg

Figure 16: Malaysia's benchmark index lags its regional peers



Source: Bloomberg

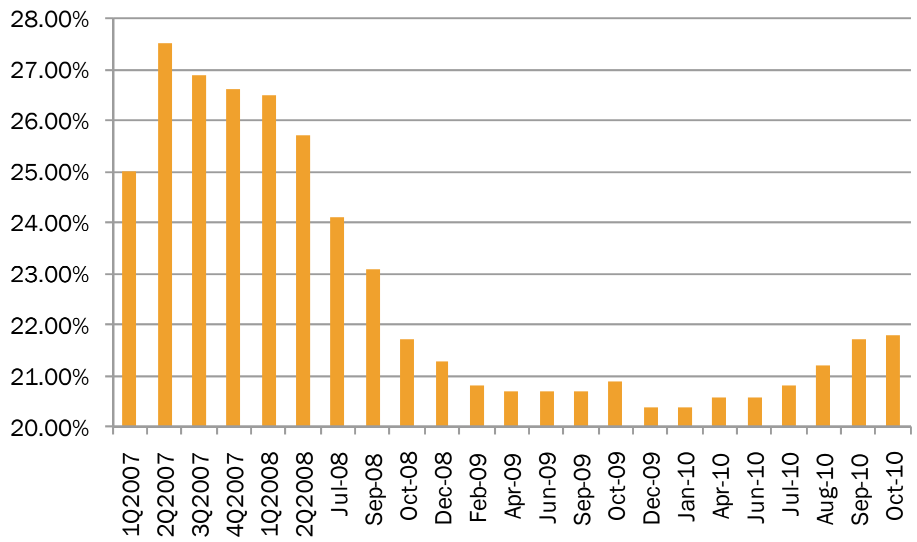
Figure 17: Malaysia's PER has expanded far less than its peers



Source: Bloomberg

Foreign investors still under own Malaysia. Based on information from Bursa Malaysia, although foreign ownership in the Malaysian market has picked up recently and risen to 21.8% in October, this is nonetheless significantly off its recent high of 27.5% in 2Q2007. As such, we believe there are still significant buying opportunities in the local bourse as the tide of liquidity sweeps Asia.

Figure 18: Foreign ownership in the Malaysian market still significantly below its peak in 2007



Source: Bursa Malaysia

Banks and Gaming sectors the big beneficiaries. The foreign investors brought in by the liquidity wave will naturally target the large market capitalized stocks with high trading volume. This is to ensure that they can cash out in the event liquidity dries up. As such, the beneficiaries of this hot money would be the banks and gaming counters, on which we have overweight calls.

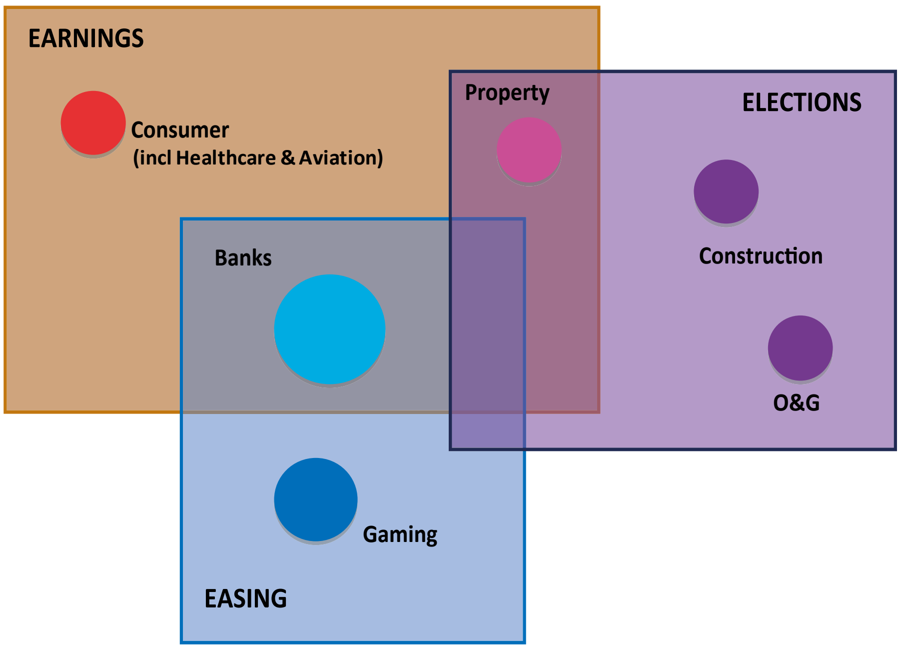
Market Strategy – The 3Es of 6 Sectors

Focus on 6 sectors. Looking at the 3Es of Earnings, Elections and Easing which we see as drivers of the Malaysian market for 1H2011, we identify 6 sectors that could provide above-benchmark returns, namely:

- **Earnings.** As we mentioned earlier, for the Earnings theme, we are looking at sectors with quality earnings that we are confident on. These 3 sectors are:
  - **Banking.** We see the banking sector continuing to record strong loans growth of 9% on the back of reasonable economic growth of 5.8% in 2011. At the same time, the buoyant equity market and the need to raise financing for the various ETP projects should see strong non-interest income for banks. A continuation of hikes in the OPR in the 2H2011 should also see Net Interest Margins rise again. Finally, some banks possess the potential to raise their dividend payouts as part of their capital management efforts. All in, we see banks continue to post strong earnings for 2011.
  - **Consumer (including Healthcare and Aviation).** With strong economic growth continuing in 2011 bolstered by a slew of infrastructure developments announced by the Government, we expect buoyant consumer sentiment in 1H2011. Discretionary spending should increase and this spells good news for stocks in the Consumer Retail segment, as well as the Healthcare and Aviation sectors. At the same time, many of the companies in the Consumer Food segment are expanding their capacity, such as CI Holdings enlarging its non-carbonated segment and QL Resources expanding regionally. As such, we see strong earnings growth for 1H2011 for consumer stocks as well as those in the healthcare and aviation sectors.
  - **Property.** As earlier property launches were delayed due to the 2008/2009 recession, we see lackluster earnings growth for the sector in 2011 as unbilled sales dwindle. Nonetheless, it cannot be denied that physical property prices had risen significantly in 2010, which has spurred recent launches of high end property developments. We see demand for such properties sustained throughout 1H2011 and hence the quality of earnings should also be strong, with little downside particularly for developers focused on higher end properties.

- **Elections.** For this theme, news flow is key and we see a lot of this in terms of contracts being announced and awarded. While the construction and property are sectors normally associated with elections, this time around we also see the O&G sector also getting a slice of the action:
  - **Construction**. Without a doubt, we expect more construction projects to be announced in 2011. We still await the KL MRT as well as the LRT contracts, while other possibilities are the remainder of the Pahang-Selangor interstate raw water transfer contracts, the 1000MW Janamanjung power plant award as well as the contract to build the 100-storey tower in Warisan Merdeka.
  - **Property**. With the potential for development of the Sungai Besi airport, Sungai Buloh land, KL International Financial Centre and Kampung Baru, government-linked property players will probably have their hands full over the next 2 to 3 years. We believe news of this sort will keep investors focused on selected property plays despite the lack of quick win profit recognition. We believe that the recent spate of Mergers & Acquisitions among property players is also inline with this theme as property players build up capacity to handle the upcoming slew of projects.
  - **Oil & Gas**. Our premise for this sector being a beneficiary of an early election is that the O&G sector increasingly enjoys a higher multiple on the Malaysian economy. We expect some wealth effect from the award of new offshore contracts to trickle through the economy and therefore a greater willingness to give out new awards in 2011 as oil extraction enhancement efforts are stepped up to sustain Malaysian O&G production. With most of the listed O&G players being service providers, 1H2011 should be an exciting time.
- **Easing**. Finally for this theme, the flush of liquidity in global markets will also make its way to Malaysia and the Big Caps will be the natural recipients. While the biggest sectors in the FBM KLCI are Banking, Plantations, Telecoms and Gaming, we remain Neutral on the Plantations and Telecoms sectors and advise investors to look at the 2 sectors where we are Overweight.
  - **Banking.** At over 35% of the market cap of the KLCI, banks will naturally soak up the most inflows generated by foreign interest, particularly for the larger, more liquidly traded banks such as CIMB and Maybank.
  - **Gaming.** At over 9% of the market cap of the KLCI and driven by heavyweight and foreign darling Genting, the flush of liquidity will be positive for the sector.

Figure 19: 6 Sectors to Outperform the Market



Source: OSK Research