More volatility in Year of The Tiger

Standard & Poor's recently issued a comprehensive report on Malaysia and the 25 top stocks it was looking to outperform the market in the Year of the Tiger. Below is an excerpt of that report.

S&P's picks

	Company	Sub-industry	Market value (RM mil)
1	Genting	Casinos & gaming	25,120
2	QSR Brands	Restaurants	922
3	Help International	Education services	166
4	Carlsberg Brewery	Brewers	1,390
5	KL Kepong	Agricultural products	17,460
6	United Plantations	Agricultural products	2,820
7	Alam Maritim	Oil & gas services	935
8	Wah Seong	Oil & gas services	1,580
9	Allianz Malaysia	Multi-line insurance	700
10	AMMB	Diversified financial	14,390
11	CIMB Group	Diversified banks	43,860
12	SP Setia	Real estate	4,050
13	Kossan Rubber	Healthcare supplies	970
14	Supermax	Healthcare supplies	1,350
15	AirAsia	Airlines	3,670
16	Mudajaya	Construction	2,020
17	Sime Darby	Industrial conglomerates	50,240
18	Sunway Holdings	Construction	805
19	Notion Vtec	Electronic components	462
20	Unisem	Electronic components	1,060
21	Sino-Hua-An	Diversified metals	544
22	Malaysia Steel Works	Steel	204
23	Subur Tiasa	Forest products	439
24	Axiata	Wireless telecommunication	28,120
25	Tenaga Nasional	Electric Utilities	34,210

AS we enter the Year of The Tiger, we can expect more volatility, especially with the current market valuations providing lesser room for disappointment.

Stock picking is likely to be more important this year, with fewer bargains available particularly as headwind builds.

Although share prices are not as cheap as in early 2009, forward price-to-earnings ratios (PERs) remain undemanding and we believe equities will remain favourable, given the limited alternatives.

We have selected 25 Malaysian stocks that we expect to outperform the FTSE Bursa Malaysia KL Composite Index (FBM KLCI) this year.

We maintain FBM KLCI target at 1,400 points in 2010 for an 11% return, pricing the index at 16 times market consensus earnings for this year.

However, the broader market and recurring income growth are stronger at 31% and 27% respectively.

While we do have a preference for cyclical issues, with 18 of 25 of our picks in cyclical sectors, in terms of market capitalisation, the larger sizes of defensive stock picks means that defensive issues make up 35.7% of our recommended portfolio, mirroring the FBM KLCI.

Based on valuation grounds and growth prospects, we are "overweight" on the banking and healthcare sectors in Malaysia.

We are "underweight" on the telecoms sector.

We see limited change in our overall macro outlook that would change the positive view for the banking and healthcare sectors we have held since mid-2009.

We continue to believe that cyclical sectors should outperform in 2010 in view of the recovering global economy and benefits from ongoing Government stimulus measures.

While we note that the Bursa Malaysia Finance Index was one of the best performing groups in 2009, it has in the past continued to outperform in the second year of a recovery after a global market crash and recession.

The healthcare is a relatively small sector in Malaysia but its components consist of dominant global manufacturers of medical and related gloves.

We see lingering concerns over flu pandemics, including the potential risk of a resurgent H1N1 virus that should sustain demand for rubber gloves.

With comfortable valuations and healthy earnings growth and return on equity (ROE), this sector is our preferred non-cyclical play.

We see potential in the plantation industry but believe that valuations have built in higher palm oil prices.

This leaves the risk of disappointment higher and as such, we maintain our "marketweight" view on the consumer staples sector.

For energy, while we are "overweight" on the sector globally, we are "neutral" on the Malaysian energy sector. This is because the local energy sector comprises solely of services companies which may face margin pressure with excess supply in jack-up rigs and other support services to weigh on day rates.

The 25 stocks picked in the portfolio is meant to be fixed, meaning that it will not undergo any changes for the full year.

The analysts have chosen stocks they believe will be the best poised to benefit from the economic recovery and with relatively comfortable valuations to hold up against the increased volatility in the market.

We have also stuck to managements that we believe have proven track records and/or have selected companies that are the dominant players in their fields.

Disappointment may come from falling margins. Unusually high 2009 margins may not be sustainable if sales do not pick up.

We anticipate around 10% rise of fuel and raw material costs, and we believe that most of this can be passed or absorbed by currency translation gains and more than offset by improved efficiency.

A greater than 10% rise would warrant a more significant reassessment of earnings.

Another key risk is volatile exchange rates and a sharp fall in the US dollar, which may send commodity and energy prices up.

Conversely, a strengthening US dollar may drive repatriation of funds back into the United States and out of emerging Asia.

Geopolitical and pandemic risks remain a possibility.

Unexpected defaults (along the lines of Dubai World) and worse-than-expected commercial property debt troubles may dampen financial sector confidence and lower risk appetite.