

Fears that the Malaysian stock market is near to becoming overvalued are causing cautious investors to increase cash positions, reports **Tan Lee Hock**

# Value stocks hard to find

THE macro-economic picture for Malaysia has improved in recent months with growth very much in place. Most of the positive news already has been factored into the stock market, which is one reason why shares have been consolidating for several weeks.

Fund managers say it is harder to find value in local stocks and a number are increasing their cash positions. One is Dr Tan Chong Koay, chief executive of Kuala Lumpur-based fund house Pheim Asset Management (PAM).

"The market valuations have run up quite a bit, so we are now more cautious about prospects in the months ahead," he said. PAM manages about US\$200 million, mostly drawn from institutions and private clients. Of that, about \$95 million is invested in the company's flagship fund, the closed-end Malaysian Emerging Companies Growth Fund (MECGF), which has nearly doubled in value since its launch in early 1994.

**Question:** Given the current state of the local economy and the level of interest rates, what is your most optimistic forecast for Malaysian equities this year?

**Answer:** I think it'd be asking a lot for the main index to rise by more than 15 per cent this year. If that is achieved, it is in line with growth in corporate profits. And if that were to happen, it would take the Kuala Lumpur Composite Index (KLCI) to 1,440 points, higher than the market's peak of 1314.46 points recorded on January 5, 1994. On this note, I should say that the market is now trading at relatively high valuations. Already, shares on the main board are trading at a

historic P/E ratio of 30 times while companies on the second board are at an even higher historic P/E ratio of 55 times.

**Q:** So, for a prominent value investor like yourself, these are challenging times?

**A:** Definitely. I can't find companies on the second board that are trading at about 15 times earnings, or at least not the last time I looked. That's how much values have run-up in the last rally. That means we are now much more selective in our stock pickings.

**Q:** On this same note, how much premium should be attached to Malaysian shares compared to regional markets, given the prevailing conditions?

**A:** There is no doubt that Malaysian shares should enjoy a premium compared to, say, shares in Thailand. Our economic numbers have certainly improved over the past year. The trade deficit is down to MS600 million (about HK\$1.86 billion) for 1996, versus MS9.4 billion for 1995. Inflation is under control at 3.5 per cent for 1996. The gloom that many analysts predicted for the economy in December 1995 did not come to pass, so I think overall we are in good shape. The appreciation of the ringgit since the end of 1996 partly reflects the improved climate.

**Q:** What was the investment strategy that led to the outperformance of the Malaysian Emerging Companies Growth Fund by 68.43 per cent (compared to the main market index) over a period of 32 months from June 1994 to February 1997?

**A:** Stock selection was a key factor, but market timing also was critical. The fund has done well in spite of the several market crises over the past two



● **TIME FOR CAUTION:** Fund manager Tan Chong Koay sees Malaysia's stock index rising no more than 15 per cent this year. He is bullish about the Philippine market.

years. We are also strong believers in taking profits when market valuations are excessive. We do not hesitate to buy when we think any share is undervalued and are always prepared to temporarily underperform the market.

**Q:** For the months ahead, what is your strategy?

**A:** We have already increased our cash and fixed-income positions significantly, reflecting our defensive stand. Combined, they are now close to 40 per cent and I expect to maintain this position in the coming months.

As for equities, I have drastically reduced the fund's exposure to second board stocks, from 25 per cent last year to less than 4 per cent now. We'll see how second board stocks move this year, but we are not optimistic. As I said, many of them are over-priced right now. As a result, we have turned our focus to companies listed on the main board for growth this year. One should not be fully invested at all times. Part of the investments are in small and mid-sized companies.

**Q:** What is the rationale for investing in small and mid-sized companies?

**A:** They are the ones that I

feel will outperform the market in the year ahead. We always look for companies with good earnings potential, strong management and a healthy balance sheet. At the same time, the share price of the company must be right.

**Q:** Are there any stocks that you still like right now?

**A:** We still have investments in a company called Pintaras Jaya (a construction company) and a technology stock, MCSB Technology Systems. We like both for their management and their vision. We bought MCSB towards the end of 1994 at an average cost of MS7.81 a share. As of today (March 13), the share price is MS23.70. For Pintaras Jaya, our average cost was MS4.83 a share. It is now MS12.60.

**Q:** But don't you think investing in second board stocks isn't prudent? After all, it is well-known that the board is a den of speculators.

**A:** Yes and no. Yes, because there are stocks that have gone up astronomically and later there's the inevitable price collapse. For us, we look to valuations, as I have mentioned before. There are few opportunities just now so we are not invested.

**Q:** How do you overcome

the liquidity problem for second board stocks?

**A:** As a general rule, my approach is to buy in early and sell early. That way, you won't be caught holding the baby. Of course, that is easier said than done. This is why I am never fully invested in a market even though it is red-hot. It takes a lot of discipline to do this.

**Q:** Do you enjoy certain advantages – given your long experience and standing in the local market – that foreign fund managers don't?

**A:** On the point of access to information, I think all the managers of closed-end funds that invest in Malaysia are as equally placed as us. I don't think we enjoy any distinct advantages in this respect.

**Q:** I understand that you also manage an Asean fund. Which markets do you think look attractive?

**A:** The Philippines is at the top of our list. We are pretty bullish on a range of mid-sized companies there that have been largely ignored by institutional investors.

We are also selectively buying into Thailand, which we feel offers selective buying opportunities.

*Tan Lee Hock is editor/publisher of the Asia Asset Management Report.*