Malaysian Update

March 11, 2008

ELECTION RESULTS

The result of the general election held on Saturday 8 March was unexpected. Barisan Nasional (BN), the coalition party led by Prime Minister Abdullah Badawi, lost its two-thirds majority but retained a simple majority in Parliament, controlling 62% of Parliamentary seats. This is sufficient for the BN to form the federal government and continue to set government policies. However, without the two-thirds majority, it will not be able to make changes to the constitution without the support of opposition parties. The ruling coalition also lost control of 5 out of Malaysia's 13 state governments. This is the BN coalition's worst performance to date, marking only the second time since independence 51 years ago that it lost its two-thirds majority.

Market reaction to this event in the short-term will likely be negative, especially given the political uncertainty at federal and state levels. The market suffered a sharp sell-down, with the KLCI index down more than 9% during the first trading session following the election results.

However, the medium- to long-term impact on the economy is difficult to gauge at the moment, as it largely depends on whether the federal government will disperse funding to those opposition-led states. It is also questionable whether the opposition would be able to govern in those states. With the two industrial powerhouse regions (Selangor and Penang) and the Federal Territory of Kuala Lumpur under opposition control now, any move to cut funding to these states would no doubt affect economic growth and employment in the entire country. While it is difficult to predict the political outcome, we think it is unlikely that funding will be cut; neither the BN nor the opposition parties want to see a sharp slowdown in economic activity. Furthermore, the opposition parties have declared that they will pursue market-friendly policies in states they control.

Nevertheless, we felt that selected sectors/stocks could be at risk due to the changing political backdrop. There could be uncertainty over the implementation of some infrastructure projects in opposition held states, which could affect the construction sector. Within the gaming sector, the Numbers Forecast Operators (NFO) may risk having their outlets closed in Islamist controlled states such as Kedah. Sentiment towards utilities and the state government related sectors such as water projects and property could also be undermined.

Our current Malaysia strategy is neutral and slightly defensive, with a relatively low risk portfolio. We had felt that the domestic economy was fairly resilient, but we were cautious of stock market sentiment, which was already turning somewhat more fragile. Stock-specific disappointments had been followed by swift and sharp price corrections and investors had been generally toning down their market expectations. The market is now trading on a PER of 14 based on projected 2008 earnings, but analysts are likely to take the opportunity to downgrade stocks. Hence, we are likely to maintain our current positions.

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