



First Capital
First Capital Research

EQUITY STRATEGY

“BUY INTO EQUITIES; REDUCE CASH EXPOSURE”

26th Dec 18

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POSITIVE but Cautious; INCREASE EQUITY EXPOSURE to 60% from 50%

Political uncertainty settles; But battle for policy certainty may continue

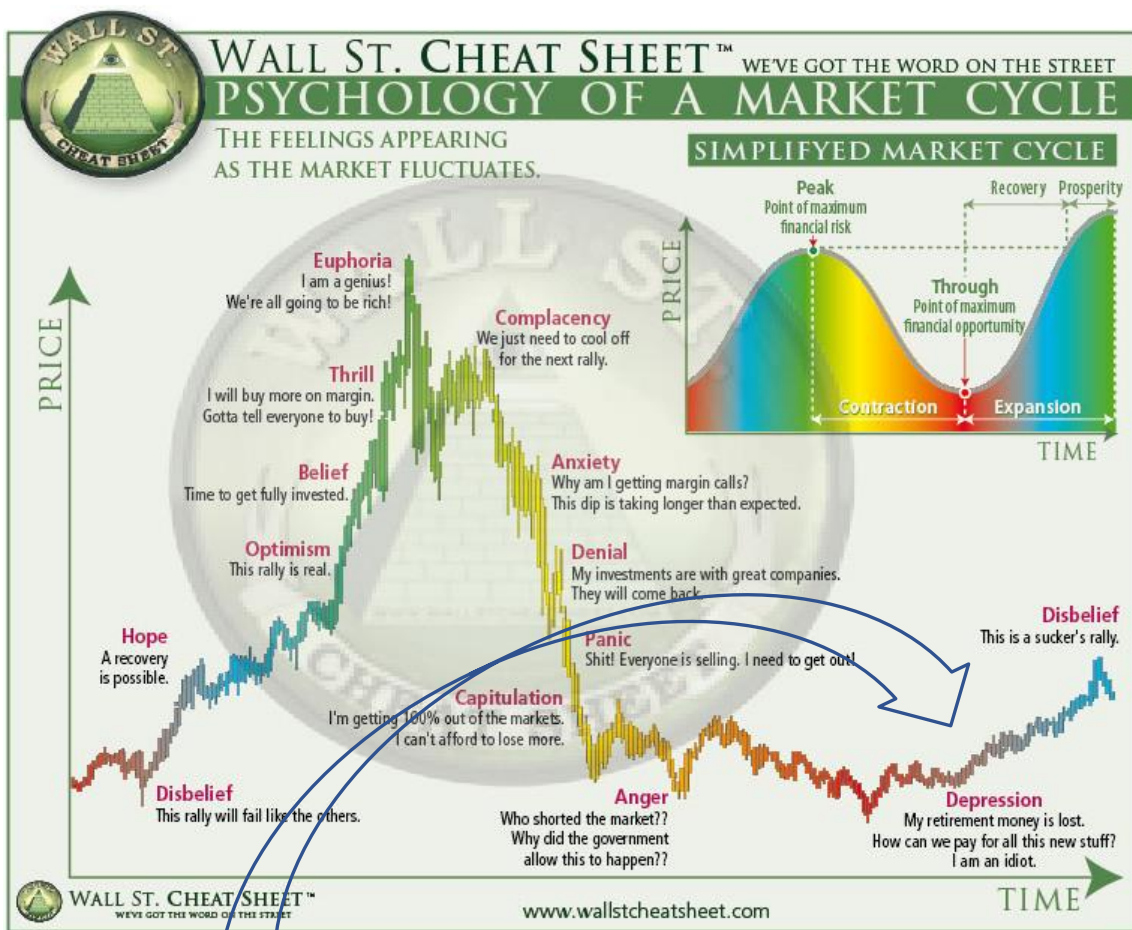
Following the re-appointment of “pre-October 26th Government” and passing of the Vote of Account in Parliament, the political uncertainty that prevailed over the last 8 weeks eased off, providing financial capability for the Government & its institutions to function beyond 31st Dec 2018. However, stability created, is likely to be temporary, as suggested by the differences that were prevalent in the process of appointing the new cabinet. We expect the divergent views between the President and UNF Government to continue to affect key policy decisions within the cabinet throughout 2019, up until the Presidential elections due in Jan 2020.

External sector turns positive favouring ASIA

Global growth is expected to slow down during 2019 primarily led by the possible impacts arising out of the trade war between the US and China coupled with the downgrade in growth expected in the US economy. The slowdown in the US economy is also likely to result in decelerating the Federal Reserve’s interest rate normalization process which may provide some breathing space for most weaker Asian economies. Global fund flow has already started to reverse towards Asia and emerging markets providing reasonable level of stability to Asian & other Emerging Markets.

Exposure increased to 60%; We are cautiously Bullish

Over the last 3 months (25-Sep to 24-Dec) we’ve maintained exposure at 50% considering earnings hit via depreciation and political unrest affecting sentiment of the market. However, during the period market gained by about 100-120 index points. As we step into 2019, we are witnessing the global fund flow reversing towards Asia and commodity prices crashing with the dip in oil prices benefiting the BoP position of Sri Lanka and positively affecting Cost of Living. We believe the events that have unfolded may benefit Sri Lanka and the equity market over the next few months positively impacting earnings and possibly leading to net foreign inflows. Thereby, we upgrade our equity exposure to 60% and upgrade ASPI volatility expectations to 6,000-6,500 (from our previous 5,800 – 6,200), assuming Market PER to be 8.5x – 9.5x.



Stock Market Cycle and Sri Lanka's Position

Stock markets usually pass through many phases as indicated in the chart. It very rarely reaches fair value, as a result, markets either overshoot or over-correct.

The ASPI, we believe has over-corrected and is currently passing through a depression phase and potentially on its way to a disbelief state.

Valuations suggest to be attractive relative to its peer countries strongly suggesting a healthy range of undervalued stocks. Most banks which account for 40% of the equity market is trading below its book value.

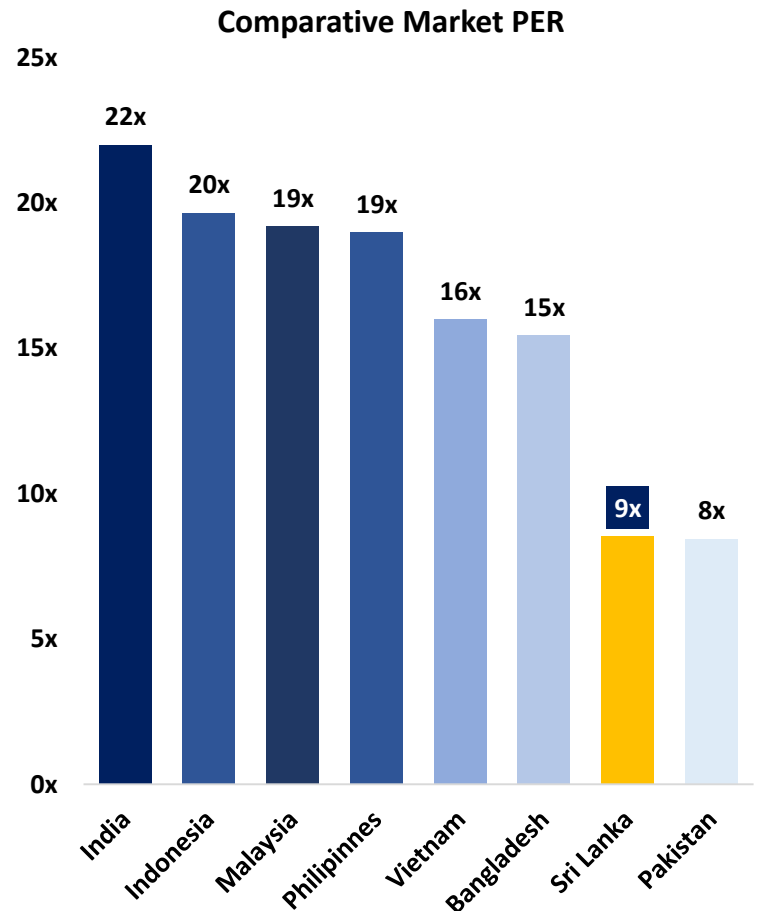
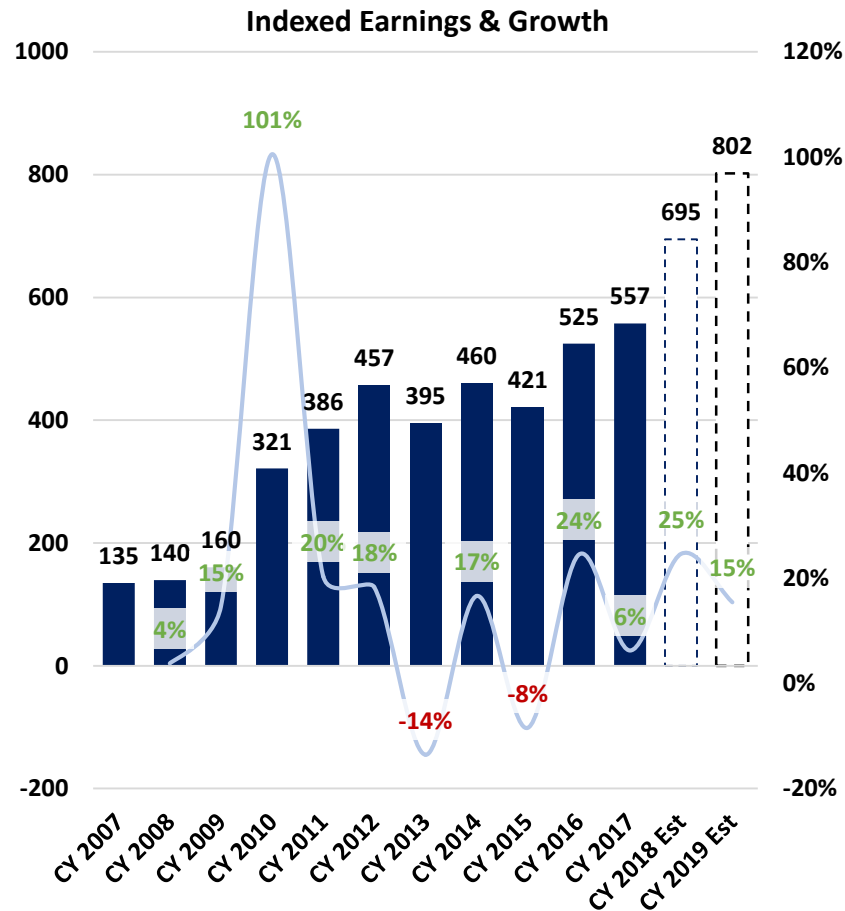
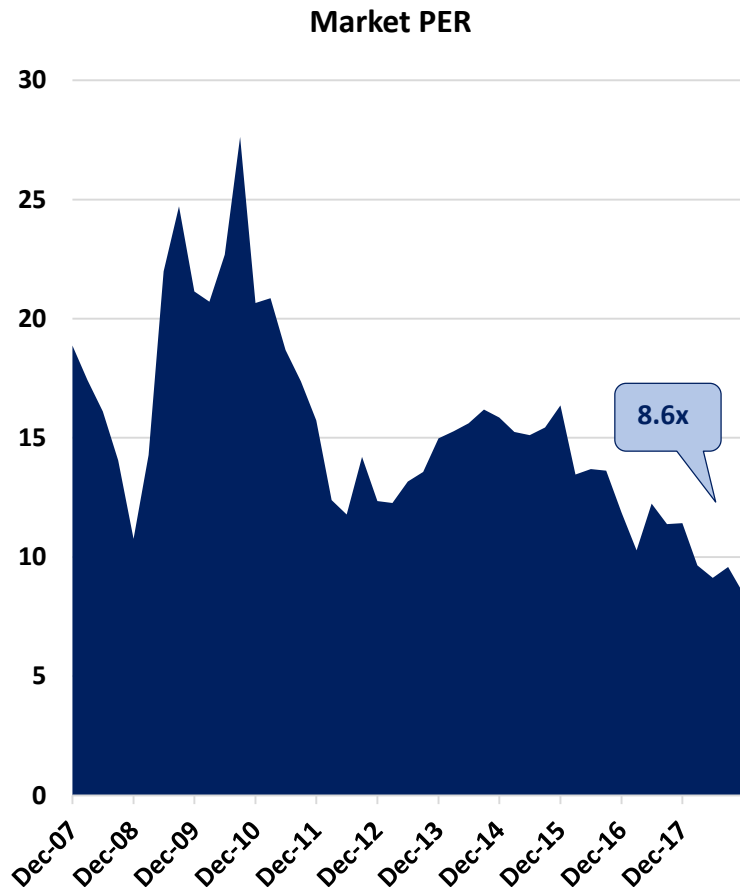
When the market enters such a phase it would be a matter of time before an unforeseen event or best known as a black swan event may lead to the market cycle to get converted to phase of "Hope" which begins a strong bull run.

Sri Lanka's current position is likely to be passing through the Depression stage

Equity Recommendations – Dec 2018

Increase Equity Exposure to 60% from 50%;

ASPI to be volatile between 6,000 – 6,500; If debt driven inflows delay can fall to 5,800



TOP PICKS for 2019

TOP TIER

FAIR VALUE 2019E /FY20E

<input type="checkbox"/> JKH	-	LKR	270.0
<input type="checkbox"/> COMB	-	LKR	152.0
<input type="checkbox"/> HNB	-	LKR	290.0
<input type="checkbox"/> DIAL	-	LKR	15.9
<input type="checkbox"/> PLC	-	LKR	20.0
<input type="checkbox"/> TJL	-	LKR	43.0
<input type="checkbox"/> LION	-	LKR	720.0
<input type="checkbox"/> NEST	-	LKR	2,050.0
<input type="checkbox"/> CARG	-	LKR	240.0

2ND TIER (LOWER LIQUIDITY)

<input type="checkbox"/> KFP	-	LKR	220.0
<input type="checkbox"/> CDB	-	LKR	150.0
<input type="checkbox"/> ALUM	-	LKR	18.0
<input type="checkbox"/> LOFC	-	LKR	7.0

Valuations have been rolled over to FY20E & 2019E respectively depending on the Financial Year

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