



**“IS THIS A GOOD TIME TO INVEST IN MALAYSIAN
PROPERTY?” IS INFLATION, THE TIGER IN THE FOREST??”**
By Dr. Christopher K.L. Shun, CFP[®], RFP[™]

Recently since January 2010 there has been much euphoria as it appears that a serious rally is in the making with the following cocktail of ingredients making for a strong brew of “irrational exuberance” in our local Malaysian equity markets.

- 1) Excessive Liquidity – local financial institutions flushed with excess liquidity with little alternative homes for investment. Also interest rates are beginning to creep upwards.
- 2) Upgrading by S&P 500 for the Malaysian Sovereign credit rating to A- putting Malaysia above the credit rating of Thailand and on par with South Korea This has led to many foreign institutional investors seeking to rebalance and invest in our local market in order to improve the quality of their regional equity portfolios.

- 3) Sentiment now recently in **2010**, has turned remarkably bullish as we see momentum trading and theme plays begin to emerge in the KLCI especially after a long hiatus in 2006- 2008.

Whilst the equity market is making "**hay whilst the sun shines**", it is timely to adopt a wider perspective to see what the future augurs for the fixed asset markets namely commodities and real direct property.

Correlation Analysis

Academic research has often corroborated intuitive acumen that there is a **high correlation** between the equity markets and property markets in Asia and particularly **Malaysia**. Academic research undertaken by the author over the Asian region has revealed that over an 18 year tenure from January 1992 to December 2009, the average positive correlation between the Malaysian equity property market is **76.54%** and when compared against neighbouring Singapore (89.18%), Hong Kong (92.52%) and Philippines 56.45%. This research elucidates that the Asian region has a very close link between their respective equity and property markets. Thus one can safely conclude that a 20% increase in the Malaysian Equity market would adduce a 15.3% increase in the Malaysian Property market. A similar magnitude of decline if the equity market was to reverse with a 20% decrease. This was borne out in the Malaysian Property slump of 1998 to 2000.

When one was to compare regional Asian volatility over the period, Malaysian Property afforded a **16.36%** monthly standard deviation with the average monthly returns of 0.52% which when annualized at 6.24% is a very respectable return given an 18 year tenure which straddled the Asian Financial Crisis (AFC) from 1998 to 2000 (Refer to Exhibit 1)

Exhibit 1: Correlation Matrix for Asian Equity and Property markets

Asset Class	Monthly	Monthly	Correlation Matrix							
	Expected Return	Volatility	SingaporeS	MalaysiaS	PhilippinesS	Hong KongS	SingaporeP	MalaysiaP	PhilippinesP	Hong KongP
Singapore Stocks	0.29%	8.11%	1.0000	0.5744	0.6044	0.7365	0.8918	0.5716	0.4543	0.7442
Malaysia Stocks	0.73%	10.89%	0.5744	1.0000	0.5647	0.5039	0.5108	0.7654	0.2886	0.4960
Philippines Stocks	-0.62%	10.62%	0.6044	0.5647	1.0000	0.5970	0.6304	0.4431	0.5645	0.6433
Hong Kong Stocks	0.72%	8.87%	0.7365	0.5039	0.5970	1.0000	0.7340	0.4956	0.3454	0.9252
Singapore Prop. Indices	0.65%	12.93%	0.8918	0.5108	0.6304	0.7340	1.0000	0.5306	0.5189	0.7760
Malaysia Prop. Indices	0.52%	16.36%	0.5716	0.7654	0.4431	0.4956	0.5306	1.0000	0.1990	0.4503
Philippines Prop. Indices	0.26%	13.09%	0.4543	0.2886	0.5645	0.3454	0.5189	0.1990	1.0000	0.4417
Hong Kong Prop. Indices	0.87%	12.59%	0.7442	0.4960	0.6433	0.9252	0.7760	0.4503	0.4417	1.0000

Source: Dr. Christopher Shun, CFP® (2010)

Note: The S (Stockmarket) indices are based on the MSCI Stock Market Index from January 1992 to December 2009 (18 Years or 216 months) for the four Asian countries. The P (Property) is extracted from the Global Property Research Institute in Amsterdam, Netherlands. They have tracked the Property Indices for over 40 countries and for the four Asian countries I selected the data is also from January 1992 to December 2009 (18 years or 216 months).

A Case for Property

The amazing discovery is that now for once we have solid empirical proof of what our forefathers have always known intuitively, that is the Property market is very **highly correlated** with the Equity markets in South-East Asia. This is certainly not the case in Australia, U.K. and U.S. Therein in the developed markets lies the diversification benefit of adding a Property portfolio to the Equity portfolio given that the low correlations allows for lowering the level of risk for a given level of returns or for a given level of risk, maximising the returns on the Efficiency Frontier.

Thus with the theoretical antecedent firmly established by empirical backing and historical experience, what are we to make for the future of the Malaysian property market now that the Equity markets have began their heady climb upwards?

Clearly as the night follows the day and winter follows autumn, it would not be unwise to make the proposition that the fixed property asset market will rise in tandem at least by 76% and that now would be an ideal time to undertake a focused search for property as an alternative investment class.

However, what we might forget is that lurking in the background is benign inflation. Having been conditioned for the last 2 years (2008-2009) to deflationary pressures created by a prolonged recession in the Western economies and equity market stagnation in Asian economies, it would be appropriate at this juncture to pause and peruse the history of the Malaysian interest rate environment since 1980 to examine interest rates behaviour over a 30 year period. This would give insight going forward what we should expect.

Interest rates, the friendly cousin of Inflation

As we study the interest rate regime over the last 31 years, data extracted from the Bank Negara website Exhibit 2) reveals some interesting points for consideration. Firstly, although the current Base Lending Rate is currently at **6.30%** since **13th July 2010**, the average Base lending rate over 31 years is **7.86%** and the average lending or borrowing rate over the same tenure is **9.23%**. This implies that Malaysian interest rates are still at a **three decade low**.

EXHIBIT 2: AVERAGE LONG TERM INTEREST RATES

ANALYSIS OF AVERAGE BASE LENDING RATE AND AVERAGE LENDING RATE
FOR COMMERCIAL BANKS FOR THE PAST 31 YEARS

Year	Average BLR at end period	Average Lending Rate at end period
1980	8.50	10.22
1981	8.50	12.07
1982	8.50	12.34
1983	10.75	11.64
1984	12.25	12.80
1985	10.75	12.10
1986	10.00	12.02
1987	7.50	9.73
1988	7.00	8.95
1989	6.99	8.70
1990	7.49	8.99
1991	8.68	9.72
1992	9.29	10.29
1993	8.22	9.65
1994	6.83	8.24
1995	8.03	9.28
1996	9.18	10.12
1997	9.53	10.63
1998	10.61	12.13
1999	6.79	7.75
2000	6.79	7.80
2001	6.50	7.52
2002	6.50	7.52
2003	6.00	6.85
2004	6.00	6.85
2005	6.00	7.00
2006	6.75	7.75
2007	5.55	6.55
2008	5.80	6.80

2009	6.05	7.05
2010	6.30	7.30

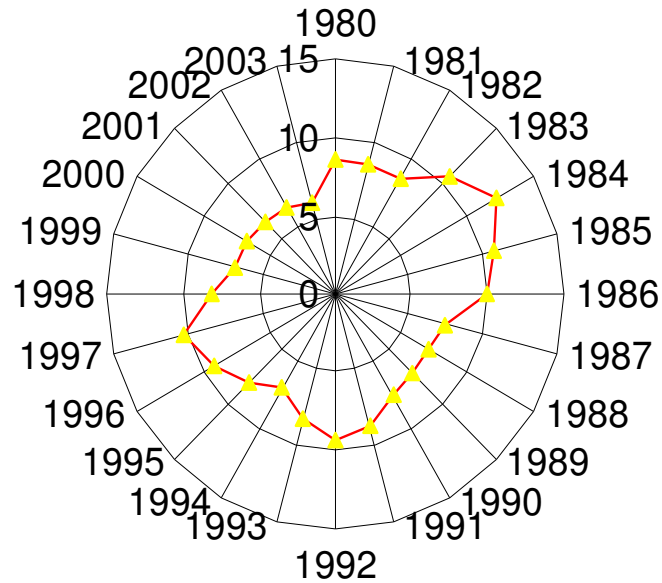
(Source: BNM website)

Average Base Lending Rate (ABLR) for 31 years = **7.86%**

Average Lending Rate (ALR) for 31 years = **9.23%**

Further quantitative analysis by the author via a Spider Chart (Exhibit 3) reveals that the current interest rates are almost touching the innermost circle of interest rate band at 5.0% when it once was in the third concentric circle of 15% back in 1984.

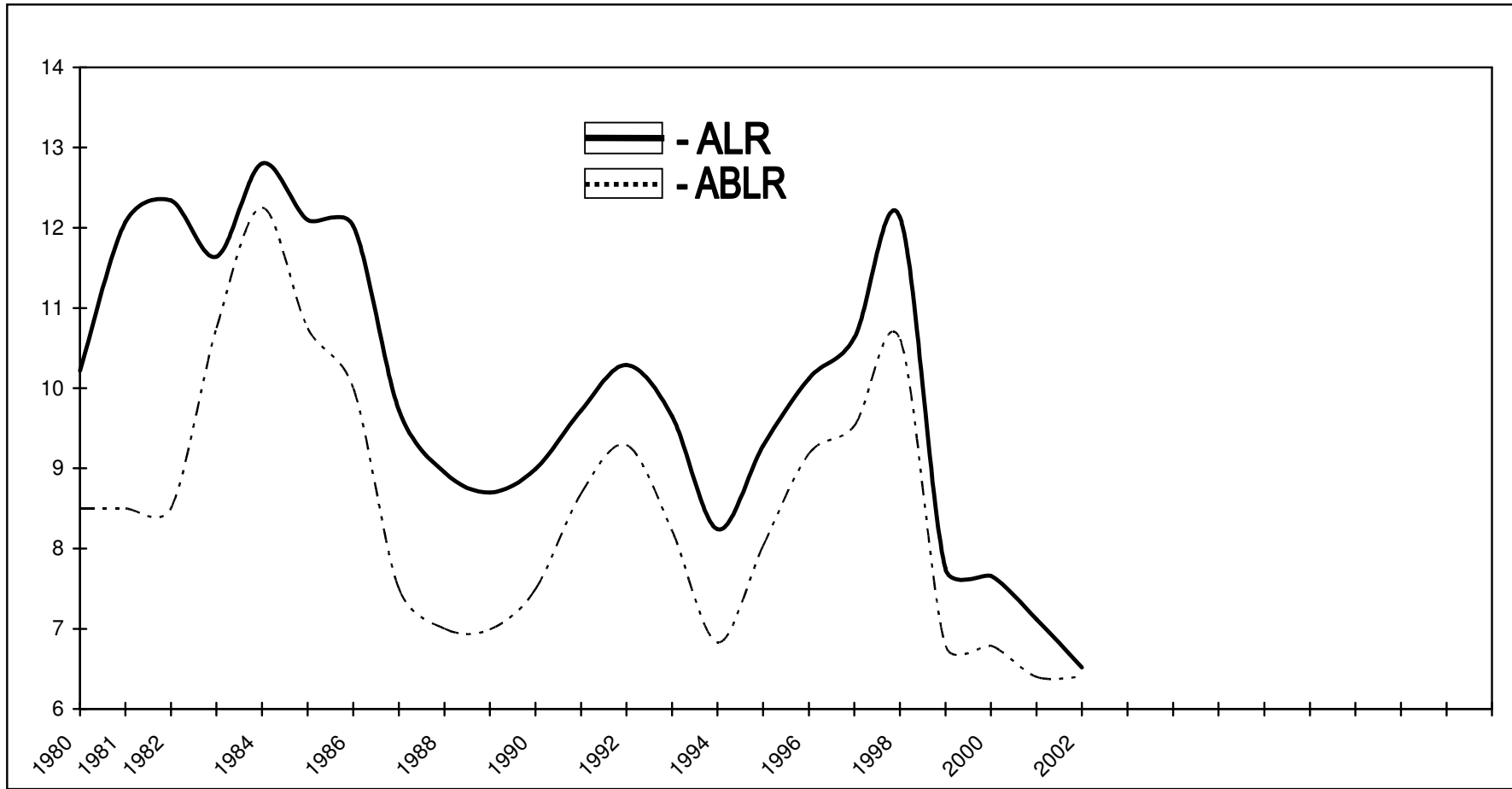
Exhibit 3 Spider Chart of Interest Rates



Source: Dr. Christopher Shun, CFP® (2005)

This is further borne out in (Exhibit 4) which reveals that the Analysis of Lending interest rate trends has reached its lowest bottom.

Exhibit Four: ANALYSIS OF LENDING



ALR - Average Lending (Borrowing) Rate.
ABLR - Average Base Lending Rate.

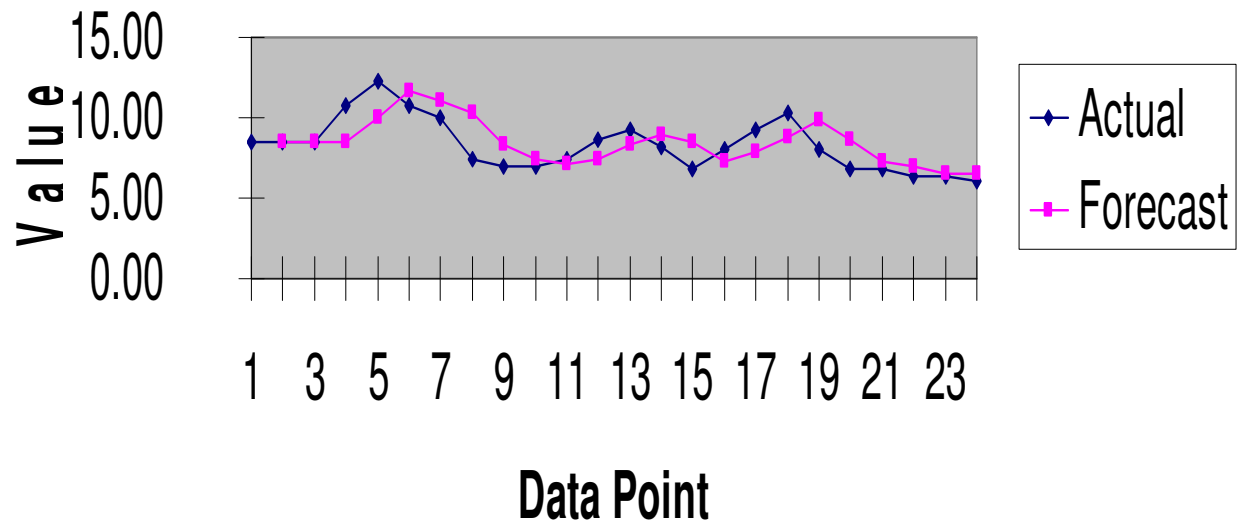
Inflation Alert

Any student of economics will advise that interest rates are affected by both domestic and external factors. Excessive domestic liquidity has kept interest rates low, and a brief glance of external factors indicates that interest rates worldwide have bottomed and that inflation had been kept in check due to shallow economic troughs in the Western markets although the Asian markets namely China and Korea are showing signs of overheating.

As the asset bubbles begin, the menacing cousin to interest rates namely *inflation* will make its courtesy call. This is further reinforced when the author undertook an Exponential Smoothing Analysis (Exhibit 5). The Exponential Smoothing analysis tool predicts a value based on the forecast for the prior period, adjusted for the error in that prior forecast. The tool uses the smoothing constant, the magnitude of which determines how strongly forecasts respond to errors in the prior forecast. The crux of the analysis is that interest rates are forecasted to trend upwards.

What this portends is that at the first sign of inflation rearing its head, the Western economies of America and Europe will start to jack up their interest rates and Asia will follow suit almost instantaneously. In fact, I would argue that Asian economies like China and Hong Kong, Malaysia and India have an inherent advantage given their currencies are firmly pegged to the US dollars. The overall 20% plus depreciation of the US Dollar since 2008 against the Yen and Euro and Aussie/New Zealand Dollar will give rise to burgeoning trade surpluses in these emerging economies. This overwhelming tide of liquidity will first make its way into the equity markets and then spill over into the Property markets and Commodity markets. This will first be met with euphoric delight as investors lock in capital gains and it won't be surprising to see the wild gyrations of the 1993 SUPERBULL in the Malaysian equity and property markets making their appearance once more in 2010/2011.

Exhibit 5: Exponential Smoothing



Source: Dr. Christopher Shun, CFP® (2005)

Conclusion

This whole premise of this article is to make the case for property investors to take cognizance of the fact that interest rates and inflation will trend upwards shortly and that one should consider moving into *fixed assets, particularly landed property*, which are proven hedges for inflation. Whilst in the past there is a premium for liquidity, one can argue that there now is a discount.

In Japan, savers have to pay Japanese Banks to keep their money with negative interest rates, once inflation arrives at our shores, the only viable option would be to be long in stable and tangible assets and short in cash which will be eroded by inflation.

A viable solution should be for investors to use their existing property and borrow long at fixed interest rates as some of the financial institutions have very attractive fixed interest rates packages and then using the equity released to further invest in income yielding properties to preserve the capital gains. The author is actively undertaking this strategy therefore putting his money where his mouth/pen is.

Remember that in the forest the tiger is king but when the tiger comes into town, a pack of mangy mongrels can send the tiger packing with its tail between its legs. **SoDon't let inflation be the tiger in your forest !!**

CONCLUSION: NOW IS A GOOD TIME TO INVEST IN LANDED PROPERTY AS A HEDGE FOR INFLATION !

About the Author:



Dr. Christopher Shun Kong Leng, CFP[®], RFP[™]
Group Managing Director
Capital Sanctuary Sdn. Bhd.

Dr. Christopher Shun Kong Leng, CFP[®]RFP[™], is the *Group Managing Director* of the **Capital Sanctuary Group** of companies. He is the only public company director (*Group Deputy Managing Director* of Menang Corporation (M) Berhad), who is a practicing Securities Commission Licensed Financial Planner since 2005. He is also a Risk Management (RM) practitioner and conducts seminars on Financial and Operational Risk Management in Malaysia and Singapore. He teaches Corporate Social Responsibilities (CSR) in Shanghai and Suzhou, China. He has been an invited Visiting Scholar at the Wharton School, University of Pennsylvania, and a Visiting Lecturer at Department of Real Estate, National University of Singapore (NUS).

Dr. Shun is responsible for the introduction and implementation of Risk Management for numerous Malaysian GLCs like Perbadanan Putrajaya (PPj), Kumpulan Perubatan Johor (KPJ), MiDF, Cahya Mata Sarawak (CMS), Malaysian Industrial

Estates Limited (MIEL) and Lembaga Lebuhraya Malaysia (LLM). Dr. Shun is an Emerging Markets Real Estate specialist in South-East Asia wherein, his area of research is in Property Risk Management, Property Portfolio Management, Islamic Financing and Property Finance.

Dr. Shun qualified in Singapore as a **DiSC®** Behavioural Trainer in 2009, wherein he attained demonstrated competence in the application of DiSC® Personality types for Corporate organisations. Dr. Shun earned the **Doctor of Business Administration** (Real Estate Portfolio Management) from the Henley Business School, University of Reading (UK) in 2005, the **Master of Science in Management** from the Sloan School, Massachusetts Institute of Technology (MIT) in 1991 and **Bachelor of Science in Business Administration** (Summa Cum Laude) and **Bachelor of Arts in Economics** (Magna Cum Laude) both, from Boston University, (USA) in 1987.

Dr. Shun is an ardent fan of the maxim that an effective property practitioner who cuts his “**teeth on theory**” never gets **obsolete** !