Phillip Singapore Monthly – Aug24

REITs take leadership

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SINGAPORE | STRATEGY

3 September 2024

- Singapore equities were down 0.4% in August following the 3.7% jump last month. Sectors that outperformed were REITs, real estate and healthcare. Weakness was in cyclicals such as marine and transportation.
- Interest rate sensitive stocks were re-rated as the Federal Reserve is certain to cut rates in the upcoming 18 September FOMC meeting. The debate is whether it will be one or two rate cuts depending on upcoming payrolls.
- Despite the 9.4% rally over the past two months, REITs are still down this year. With the potential for six to seven rate cuts in the next 18 months, there is further upside for REITs. Banks earnings could surprise in 3Q24 fuelled by fee and trading income with the recent spike in equity and foreign exchange volatility.

Review: Singapore equities consolidated in August with a modest 0.4% decline (after the 3.7% gain last month. The market is holding on to its year-to-date gains of 6.3%. Singapore REITs leads the performance for the 2nd consecutive month with cumulative gains of 9.4%. It remains the best performer among major asset classes (Figure 5) and a strong performer in Asian equity markets (in local currency terms – Figure 6). Real estate has started to outperform on expectations of interest rate cuts. Hong Kong Land was up 16% in August. We think the rally is ahead of the fundamentals. Office vacancy rates in Central Hong Kong are still surging, rising 2.2% points to 12.1% in just the first six months of the year. Vacancy rates is up 6x from 2018's 1.8% since the student protest and pandemic began (Figure 8). In comparison, Singapore's CBD vacancy has been largely flat at 5.6% since 2018.

Economy: Macro conditions in Singapore are largely stable. Exports are down 2% till July this year but an improvement over the 2023 drop of 13%. Electronics exports have recovered by 3% after the 20% collapse in 2023 (Figure 9). Pharma and chemicals are still weak and contracted 17% this year. Tourist arrivals are still rising, with July rising 13% YoY to 1.6mn arrivals. All the growth was due to a 78% jump in China arrivals (Figure 10). Arrivals from Indonesia have started to contract.

Sectors: In our recent REITs sector report, 1H24 dividends per unit (DPU) announced by REITs contracted an average 12% YoY due to higher financing costs. Despite the weakness in DPU, REITs rallied. Rather than wait for DPUs to recover, markets are already re-rating the sector that lower interest expense will materialise or at least rates have peaked. In the Jackson Hole Symposium on 23rd August, Fed Chair Powell effectively announced interest rate cuts for the upcoming 18 September FOMC meeting. Powell said, "Time has come for policy to adjust". Whether it is two rate cuts will depend on payroll gains where expectations are for 164k jobs.

Recommendation: We remain overweight REITs and even banks. Banks reported earnings growth of around 6% YoY in 1H24, led by DBS and OCBC. Dividend yields are close to 6%. We think bank net interest margins are shielded from lower interest rates as they lock in their excess liquidity into longer duration (or tenure) assets. We think 3Q24 should be healthy as the recent volatility in equities and foreign exchange will drive fee and trading income. A peak in interest rate could see customers shift out of low margin deposits into investments. However, banks look like an overweight as we enter 2025. If markets start to price the four or five rate cuts in 2025 (Figure 11), bank's earnings will be vulnerable as interest margins will fall sharply. Sectors we like are construction and telecommunications. The construction industry will enjoy a huge boost in orders next year as the two integrated resorts start their expansion and refurbishment work totalling S$13-14bn and Terminal 5 construction kicks off. Our overweight on telecommunications is largely Singtel. The company is enjoying revenue growth from higher mobile prices in Australia and non-telco revenue such as NCS and data centres. Data centre capacity is expected to triple by 2026 and introduce GPU-as-a-Service. There are also aggressive $200mn p.a. cost cuts underway. The issuance of the 700MHz spectrum will be a negative for the mobile industry.

August 2024 performance

Figure 1: Banks modest correction

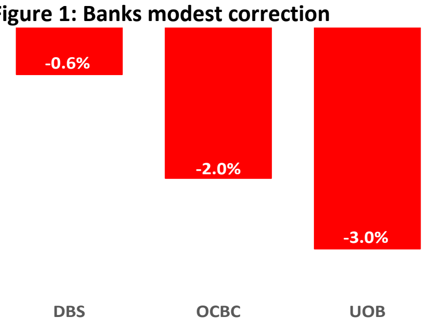


Figure 2: Interest rate sensitive jump

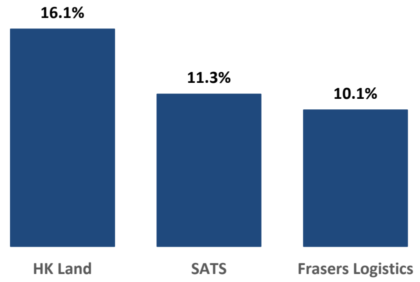


Figure 3: Cyclicals suffered

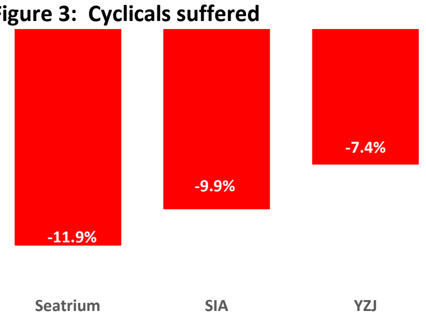
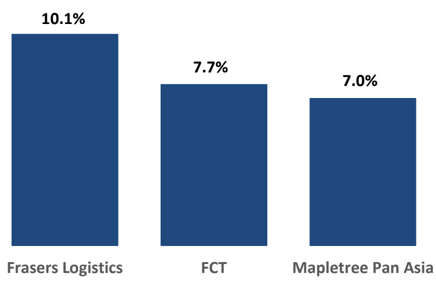


Figure 4: REITs



Source (Fig 1-4): PSR, Bloomberg, 30Aug24

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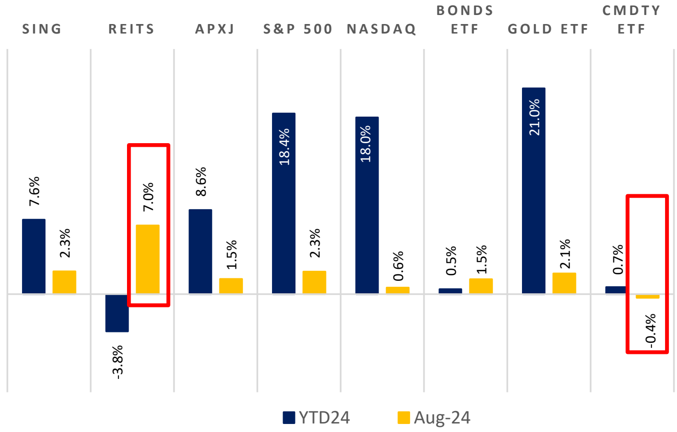
Corporate Insight Webinars: Hyphens Pharma (17 Sep 12 pm), 17LIVE (18 Sep 12 pm), ComfortDelGro (19 Sep 12 pm), KORE (24Oct 12 pm)
https://www.poems.com.sg/education/events-seminars/

Figure 5: REITs and Gold took the lead



Source: PSR, Bloomberg

Figure 6: REITs and mid-caps equities recovered

	1 Mth Perf.	3 Mth Perf.	YTD Perf.	Market Cap (US$ bn)
Indonesia	5.7%	10.0%	5.5%	844
Philippines	4.2%	7.2%	6.9%	169
SG REIT	4.2%	7.8%	-5.0%	71
ASEAN 6	3.8%	5.9%	4.8%	2,166
Hong Kong	3.7%	-0.5%	5.5%	2,682
Malaysia	3.3%	5.1%	15.4%	263
Thailand	2.9%	1.0%	-4.0%	495
Vietnam	2.6%	1.8%	13.6%	212
India	1.1%	12.0%	16.1%	2,401
SG Mid Cap	0.7%	4.5%	0.3%	98
Taiwan	0.3%	5.2%	24.2%	2,219
Singapore	-0.4%	3.2%	6.3%	396
SG Small Cap	-1.1%	0.0%	-7.1%	22
SG Financials	-1.1%	1.6%	14.3%	179
Japan	-1.2%	0.4%	15.5%	21,739
Shanghai	-3.3%	-7.9%	-4.5%	6,147
S Korea	-3.5%	1.4%	0.7%	1,578

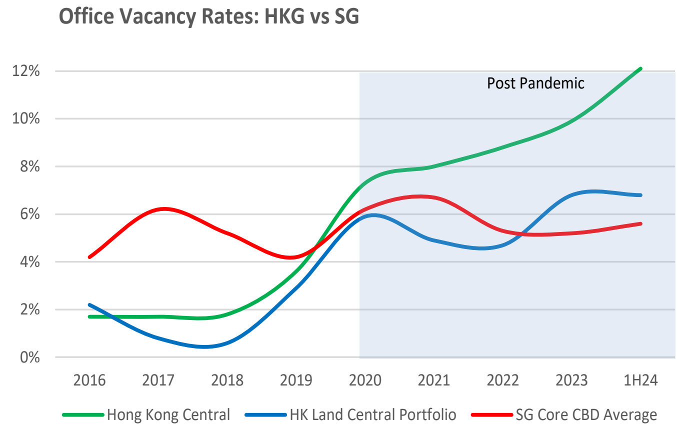
Source: PSR, Bloomberg

Figure 7: REITs, Property and Healthcare the gainers

PSR (147 companies)	1 Mth Perf.	3 Mth Perf.	YTD Perf.
Commodities	**-1.5%**	1.0%	-5.4%
Conglomerate	**1.0%**	0.4%	-3.9%
Consumer	**0.9%**	-0.3%	-9.8%
Finance	**-1.0%**	1.7%	14.6%
Healthcare	**3.1%**	4.6%	7.0%
Electronics/Services	**-3.0%**	-2.3%	-3.7%
Property/Const.	**3.7%**	2.5%	-6.1%
REIT - Hospitality	**0.3%**	0.1%	-9.5%
REIT - Industrial	**5.6%**	8.4%	-6.7%
REIT - Office	**3.4%**	8.8%	-1.8%
REIT - Retail	**3.7%**	8.7%	-2.2%
REIT - Others	**5.0%**	10.8%	-4.4%
Shipping	**-8.8%**	1.0%	31.7%
Telecomm.	**1.5%**	23.8%	24.8%
Transportation	**-3.8%**	1.1%	2.7%
	0.4%	4.4%	6.3%
Singapore	-0.38%	3.2%	6.3%

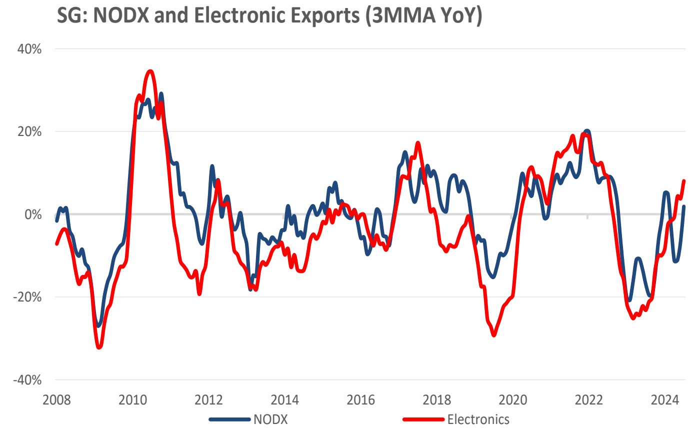
Source: PSR, Bloomberg

Figure 8: Vacancies in Hong Kong Central surge from 2019



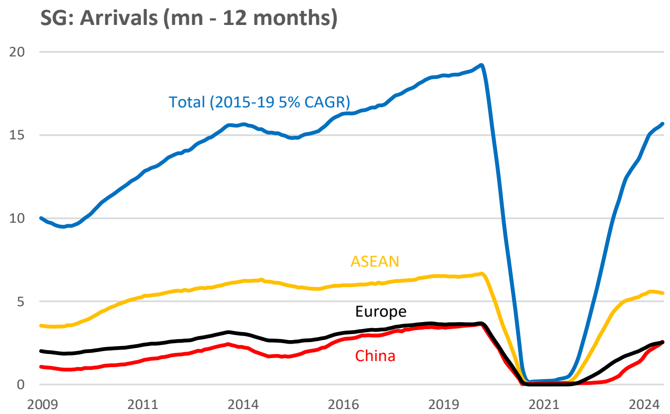
Source: PSR, Hong Kong Land

Figure 9: Till July, exports were down 2% YoY but electronics up 3%



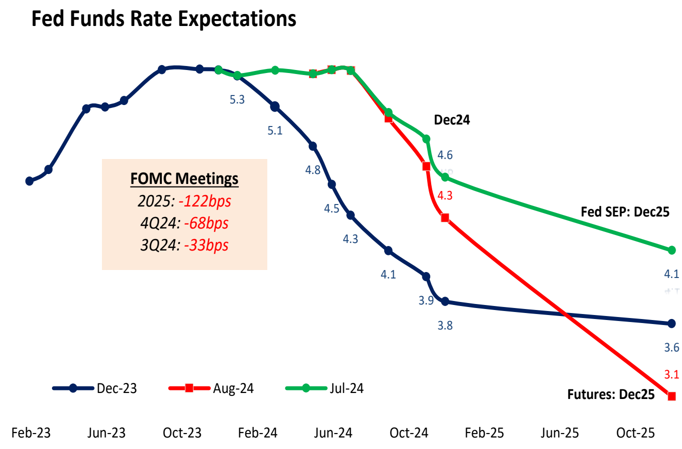
Source: PSR, CEIC

Figure 10: 15.7mn still 18% below 19mn pre-pandemic



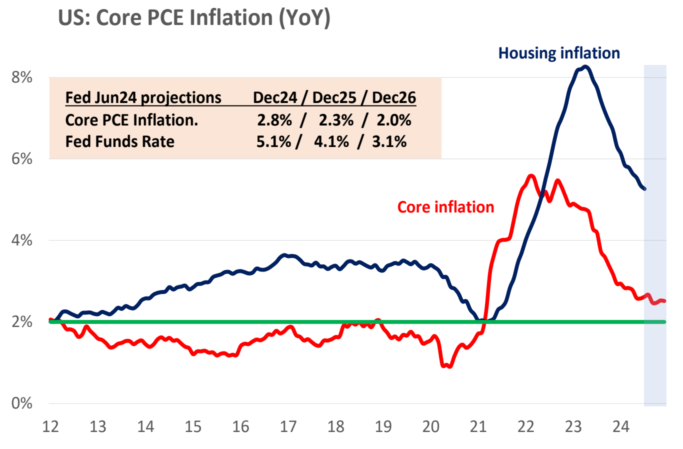
Source: PSR, CEIC

Figure 11: Market pricing 4 rate cuts in 2024 and almost 5 in 2025



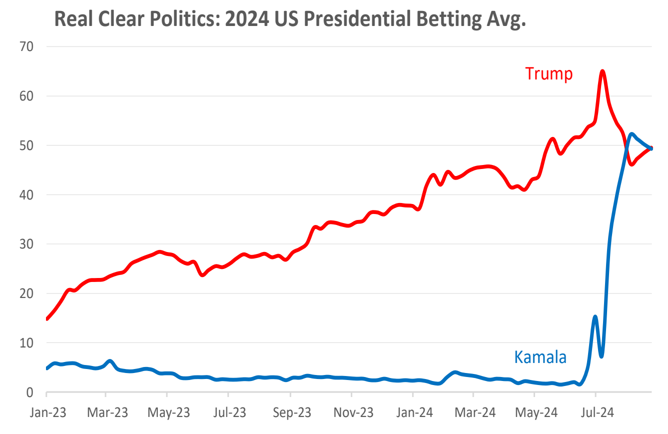
Source: PSR, Bloomberg

Figure 12: Inflation trending below Fed expectations



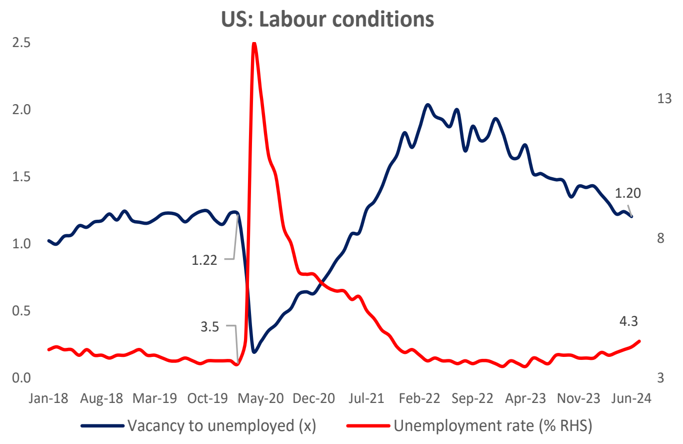
Source: PSR, Bloomberg

Figure 13: Tight race will cause uncertainty for the market



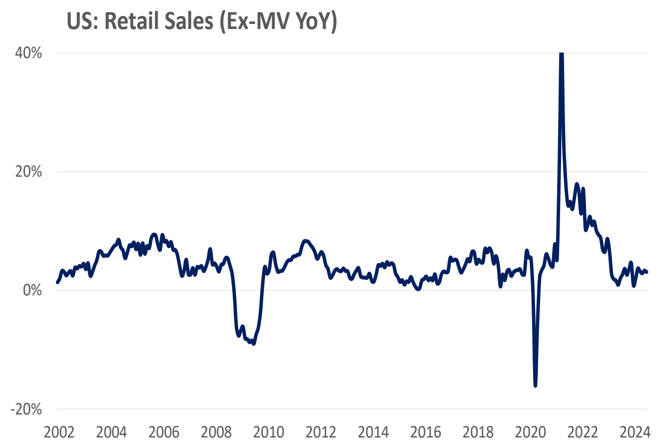
Source: PSR, Bloomberg

Figure 14: US unemployment higher than pre-pandemic



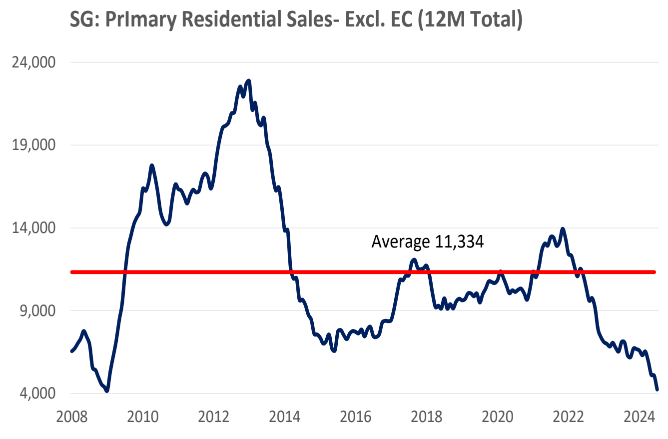
Source: PSR, CEIC

Figure 15: Retail sales +3% plus similar to pre-pandemic



Source: PSR, CEIC

Figure 16: New launch sales at global financial crisis lows



Source: PSR, CEIC

Phillip Absolute 10

Our model portfolio was down 0.2% in August, modestly outperforming the market. REITs were the largest gainers led by OUE REIT and Cromwell REIT. In our model, we favour the high beta overseas REITS (Cromwell European) or deeply discounted Singapore assets REITs (OUE Commercial, Suntec REIT). The weakest were Keppel Ltd and small caps (Valuetronics and China Aviation). Without healthy property sales, Keppel Ltd earnings are depressed. 1H24 adjusted PATMI was down 25% YoY to S$346mn. Real estate core earnings fell almost S$170mn. The key catalyst will be the monetisation of its legacy assets, Rigco and Floatel. We wait patiently. China Aviation reported a doubling of 1H24 earnings to US$42mn and yet sentiment was weak.

4Q23 - Add: ST Engineering, Singtel; Remove: CDL, SGX
1Q24 - Add: Valuetronics, China Aviation Oil; Remove: CapitaLand Ascott Trust, PropNex
2Q24 - Add: DBS, Cromwell European REIT; Remove: OCBC, Frasers Centrepoint Trust
3Q24 - Add: OUE REIT; Remove: Thai Beverage

Strategy commentary: We have added more dividend yield into the portfolio. Interest rate cuts are not just a signal of easing monetary conditions but slowing global growth. Our portfolio will turn more defensive in such an environment.

Figure 17: Monthly movements

	Absolute 10	SING
Jan24	-0.9%	-2.7%
Feb24	-0.9%	-0.4%
Mar24	0.7%	2.6%
Apr24	1.5%	2.1%
May24	-0.2%	1.3%
Jun24	-0.3%	-0.1%
Jul24	3.3%	3.7%
Aug24	-0.2%	-0.4%
Sep24		
Oct24		
Nov24		
Dec24		
YTD	2.9%	6.3%
Out/(Under)perf.		-3.3%

Source: Bloomberg, PSR, Performance is for illustration only and excludes brokerage fees, dividends, and monthly rebalancing costs.

Figure 18: Phillip Absolute 10 performance till August 2024

Company	1M	3M	YTD	Rating	Target Px (S$)	Share Px (S$)	Upside	Mkt Cap (US$m)	Dvd. Yield
Yield									
Cromwell REIT (EUR)	3.6%	1.4%	2.1%	**Buy**	**1.91**	1.45	32%	904	10.8%
DBS Group	-0.6%	1.0%	19.7%	**Accumulate**	**38.50**	36.36	6%	79,371	4.8%
OUE REIT	7.4%	7.4%	1.8%	**Buy**	**0.33**	0.290	14%	1,223	7.2%
Dividend / Earnings Growth									
China Aviation	-2.8%	-1.7%	-1.7%	**Buy**	**1.05**	0.86	22%	568	3.2%
ST Engineering	0.7%	6.5%	14.4%	**Accumulate**	**5.00**	4.45	12%	10,649	3.6%
Valuetronics	-7.0%	-4.0%	0.8%	**Buy**	**0.76**	0.600	27%	189	3.6%
Re-rating Plays									
CapitaLand Investment	0.4%	1.9%	-14.2%	**Buy**	**3.38**	2.71	25%	10,377	4.4%
ComfortDelGro	1.4%	2.2%	1.4%	**Buy**	**1.63**	1.42	15%	2,361	4.7%
Singtel	1.6%	26.2%	26.7%	**Accumulate**	**3.44**	3.13	10%	39,670	3.4%
Keppel Ltd	-7.1%	-8.2%	-12.7%	**Buy**	**7.60**	6.17	23%	8,553	5.5%
Average	-0.24%	3.3%	3.8%				19%		5.1%

Source: Bloomberg, PSR ^ Dividend yields are historical for all stocks

Figure 19: Snapshot of Top 10 gainers and losers in August

Top 10 Gainers		Top 10 Losers	
Dasin Retail Trust	77.3%	AEM	-24.4%
Keppel Pacific Oak	30.0%	ARA US Hospitality	-23.3%
Silverlake Axis	29.3%	Yoma	-16.4%
Manulife US-REIT	22.2%	Marco Polo Marine	-15.5%
RH Petrogas	19.4%	Banyan Tree	-14.3%
Elite Comm.	16.3%	Nanofilm Tech	-12.4%
Hong Kong Land (US$)	16.1%	Seatrium	-11.9%
Centurion	14.2%	Southern Alliance	-11.1%
17LIVE	13.0%	Geo Energy	-10.3%
Valuemax	12.0%	Clearbridge	-10.0%

Top 10 SPDR Gainers		Top 10 SPDR Losers	
HK Land	16.1%	Seatrium	-11.9%
SATS	11.3%	SIA	-9.9%
Frasers Logistics	10.1%	YZJ	-7.4%
SGX	9.9%	Venture Corp.	-7.2%
FCT	7.7%	Keppel	-7.1%
Mapletree Pan Asia	7.0%	Genting SG	-5.3%
Jardine C&C	6.6%	UOB	-3.0%
DFI	6.3%	OCBC	-2.0%
Ascendas	5.9%	CDL	-1.5%
Mapletree Ind.	5.6%	Wilmar	-1.3%

Source: Bloomberg, PSR

Weekly Equity Strategy Commentary

Week 32	If Powell's comments that "a reduction in policy rate could be on the table ... in September" did not convince everyone a rate cut was inevitable, the recent job disappointing jobs data certainly did. US payrolls in July only added 114k against the expectation of 176k. Around 70% of jobs were government related compared to pre-pandemic 28%. Labour conditions are now worse than pre-pandemic. Unemployment rate of 4.3% is the highest in 33 months and higher than pre-pandemic 3.6%. The Sahm rule is also raising the debate of an impending recession in the US. The markets reacted dramatically. Nasdaq dropped 2.4% and 10-year Treasuries collapsed 19 basis points to 3.79% on Friday. The futures market is now pricing four rate cuts by the Fed in 2024. The current environment is positive for REITs. Interest rate expenses can start to fall, property valuations rise as cap rates decline and their yields turn more attractive than other fixed-income alternatives. Falling yields will remove the shine on banks and interest margins could come under pressure. We also worry about a looming provisioning cycle in Hong Kong. Hang Seng Bank's non-performing loans ratio is at a 25-year high. Big tech has suffered a sell-down from expectations of a weaker macro environment and concern over the returns on their spending in AI. We hold a view that the spike in AI infrastructure is a race for artificial general intelligence (AGI). A practical example of AGI is imagining a doctor (maybe equity analyst) with complete and exhaustive knowledge of all medical literature and constantly improving himself or herself. Google summarised the big tech view of AI infrastructure with the comment that the “risk of underinvesting (in AI) is dramatically greater than the risk of overinvesting”. We can only guess how other big tech responded after this comment. Meta then announced it was giving away for free its open-source Llama 3 generative AI model. How does anyone compete with free? The marginal cost of AI will go down to near zero. If AI spending is strategic and returns secondary, it is positive news for Nvidia and the entire supply chain.
Week 33	It was a wild week. Nikkei collapsed 12.4% on Monday, followed by a 10.2% recovery on Tuesday. The S&P 500 volatility index (or VIX) almost tripled to 64.9 on Monday together with US equities falling 3%. For the week, there was hardly a blip, Nikkei is down 2.5%, US equities flat and the VIX is down 13%. The toughest part of last week's sell-down was to unpack the sequencing or triggers of how a yen spike could trigger US equities to sell down. Weak jobs and the Fed cutting more aggressively was not a total surprise. The crowded carry trade was to borrow low-interest rate yen and buy Japanese equities and US dollars. With poor US data and Japan raising rates, there was a massive unwinding of position. A trigger to the severity of Japan equities sell down was the 18-year high of shares on margin in Japan at JPY4.98tr (or US$34bn). Another source of selling was likely foreigners holding Japanese equities at a record 31.8%. How much of these foreign holdings were on carry trade margin is unclear. Critically, the collapse in Japanese equities then pushed the VIX index. The sudden spike in VIX meant multiple hedge fund strategies had to unwind or margin call. The largest are risk parity and target volatility funds. Such funds have a target volatility (not returns). When equities volatility spikes, equities need to be sold to lower the fund's overall volatility in favour of bonds. Dispersion strategies of short index vol and long individual equity vol could also be hit by margin calls. Another strategy is trend following that scale up bullish bets when volatility is low. Finally, there are funds that short long-dated VIX. VIX curve tends to be upward sloping because many investors buy such "insurance" against a market sell-down. As times passes, there are roll-down profits. The underlying of all these short volatility strategies was to improve a fund’s Sharpe ratios. We had Volmageddon in February 2018, now it's Vol-yen-geddon (we made it up), where yen carry trade and options not fundamentals led the market sell-off.
Week 34	It has been a hectic week of Singapore companies reporting results. Let me give the theme or trends behind the results. In telecommunications, mobile prices are rising in multiple countries namely, India, Thailand and Australia. This is helping Singtel but currency headwinds are pushing back growth. For instance, the rupiah is down 7% against the Singapore dollar on a YoY basis. In contrast, StarHub is facing mobile price competition from MVNOs (those operators with no network) and Simba launched its broadband service early this year. In the property sector, new home sales have been horrific, down 50% due to project delays (not by developers, but by someone else). Developers are now rushing to launch to avoid stamp duty penalties, clogging up the 20.5k unsold inventory and competition from cheaper land sites. HDB resale prices are buoyant with attractive grants, the rising price of new BTOs and cheaper than new launch units. HDB prices are up 42% in 4 years supporting the upgraders into private property. For conglomerates, the huge gains from selling excess gas and electricity into Singapore spot markets are over. Earnings will be stable from long-term power contracts. Growth will come from new renewables capacity in India and China for Sembcorp Industries. Keppel is facing sluggish earnings due to the decline in development earnings. Monetization of the legacy rig business will be the key catalyst. In transport, the ComfortDelgro taxi business registered a 48% YoY growth in earnings growth as the Zig platform captures high margin commissions and platform fees. ST Engineering is also enjoying 30% growth in its aircraft maintenance business. Aircraft are flying longer due to rising air travel and delays in the delivery of new aircraft. Finally, small caps have been rallying due to their stellar earnings. Dyna-Mac is benefiting from the surge in the

	construction of FPSOs (basically, floating refineries for deepwater). Riverstone's huge market share in clean room gloves for electronics is delivering 55% earnings growth. Oiltek's record oil book in palm oil refining and biodiesel plants is also delivering earnings growth of 50%.
Week 35	Fed chair Powell has effectively announced interest rate cuts for the upcoming 18 Sept FOMC meeting. At the recent Jackson Hole Symposium, Powell said, "Time has come for policy to adjust" and "inflation .... appears to be on a sustainable path to our 2% objective". Our base case is a 25 basis point rate cut unless payrolls (released 6 Sep) come in much weaker than expected (est. +114k). Global monetary easing is underway with Europe and UK likely to ease further as recent wage growth data point to a sharp deceleration. After the rate cuts, we expect the months of October and November to be sluggish. We believe uncertainty over upcoming US elections plus soft data in the US will keep investors sidelined. Sectors to ride out the weakness are REIT, land transport, telecommunications and construction. We continue with our review of 1H24 results. Of the four major semiconductor stocks, Frencken and Grand Venture were the best with earnings growth of 45-50% YoY in 1H24. Frencken earnings were boosted by new products from its lithography customer as it shifted more of its supply chain from Europe to Asia. We believe the momentum can be sustained into 3Q24. However, 4Q24 may be a challenge from the high base where Chinese customers were front-loading orders heavily last year. Grand Venture benefited from its semiconductor equipment test customer enjoying an uplift in orders for advanced memory (or HBM) used in AI. 2025 can be even stronger when its front-end customers start to contribute. But the stock looks expensive at 18x PE FY24e annualised. UMS 1H24 earnings fell 34% YoY to S$19.1mn. Orders from its existing major customer was weak. UMS likely lost market share in this customer by almost 20% points to slightly above 50%. Any recovery is likely 2H25 because the new customer in Penang is not ramping up as scheduled. The worst hit was AEM, with a 96% collapse in 1H24 net profit to S$895k (not typo). Guidance is also weak, with a 13 to 22% decline in revenue for 2H24. Its existing key customer (90% of semiconductor revenue) demand remains soft. Growth could resume in 2025 as new customers are expected to contribute triple-digit millions in revenue. These customers include memory and AI GPU. In summary, of the four, Frencken has the best momentum near term with attractive valuations.

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