Phillip Singapore Monthly – July24

Mid-caps and REITs start to rally

PhillipCapital

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SINGAPORE | STRATEGY

5 August 2024

- Singapore equities rose 3.5% in July. It was the best monthly performance this year, more than doubling this year returns to 6.5%. Best performing sectors were marine, transport and REITs. The consumer sector was the weakest.
- Rising expectations of an interest rate cut by the Federal Reserve is fuelling a re-rating of REITs. There was a major rally in US REITs on expectations of improving financing for US commercial properties. US office REITs listed on SGX jumped 25% to 65% in July.
- As we enter a monetary easing cycle globally, we are Overweight on REITs. China remains the weak spot for Singapore companies with real estate and consumer exposure. We are also concerned of a credit provisioning cycle underway in Hong Kong as property prices continue to deflate. Sectors with growth in Singapore are construction, marine, transport and defence. Semiconductor stocks face a de-rating as tech stocks get pummelled in the US.

Review: Singapore equities enjoyed a broad-based rally in July (Figure 7). The 3.5% gain in July pushed the market to year-to-date gains of 6.5%. Singapore REITs were the best performer amongst major asset classes (Figure 5) and major Asian equity markets (in local currency terms – Figure 6). Technology stocks have undergone a significant correction in the US. Magnificent 7 (equal weight) stocks rallied almost 50% this year to their peak in early July. They have since dropped 15%. Investors are jittery over the return on investments from AI infrastructure. Google says the "risk of underinvesting (in AI) is dramatically greater than the risk of overinvesting". This means immediate returns are secondary. Meta then announced it was giving away for free its open-source Llama 3 generative AI model. It is hard to compete with free. We view the spike in AI infrastructure as a race for artificial general intelligence by big tech. The marginal cost of AI will come to almost zero. Imagine a doctor (or equity analyst) with complete and exhaustive knowledge of all medical literature and constantly improving himself.

Economy: Singapore's GDP rose 2.9% YoY in 2Q24. The strongest growth came from construction (+4.3%) and IT and financial services (+5.6%). Manufacturing eked out a positive 0.5% gain after contracting last quarter. Most economic indicators in Singapore are trending sideways (Figures 8 to 10). We do expect manufacturing to pick up pace in 2H24 as US retailers look to build up inventories ahead of the US Presidential elections (Figure 11). In the US Presidential elections, the betting odds of a Kamala Harris win have surged, overtaking Biden at his peak of 41% in late April (Figure 12). The Trump trade of short Treasuries and long US dollar is unwinding.

Sectors: Most REITs are still reporting a decline in dividends due to rising interest rate expenses. We think the headwind from interest expenses will peak this year. The interest rate hedges will unwind and most of the debt will be repriced to current market rates. REITs become attractive in a falling rate environment because interest rate expenses start to fall, property valuations rise as cap rates decline and their yields turn more attractive than other fixed income alternatives. Bank results have so far met expectations with wealth management fees driving earnings.

Recommendation: We believe an interest rate cut by the Federal Reserve in September is a near certainty. Our initial reservation was it would be too political to cut with Presidential elections around the corner. But the Fed Chairman said a rate cut "could be on the table" in September. Markets are pricing three interest rate cuts this year (Figure 13). We are therefore Overweight on REITs. On banks, we believe valuations are turning expensive following the recent rally and as rate cuts place pressure on margins. We also worry about a looming provisioning cycle in Hong Kong. Hang Seng Bank non-performing loans ratio is at a 25-year high (Figure 14). We view the bank with the lowest exposure to Hong Kong is UOB. In our model portfolio - Phillip Absolute 10 – Singtel was the biggest gainer with a 12% rally in July. The only decline was in Cromwell REIT with a 0.7% contraction (Figure 18).

July 2024 performance

Figure 1: Banks still resilient

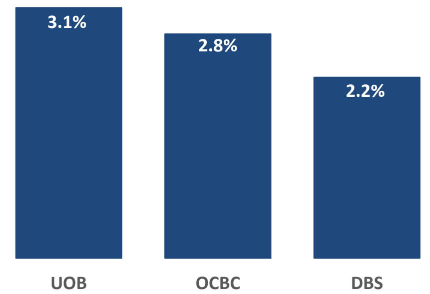


Figure 2: Marine and transport gains

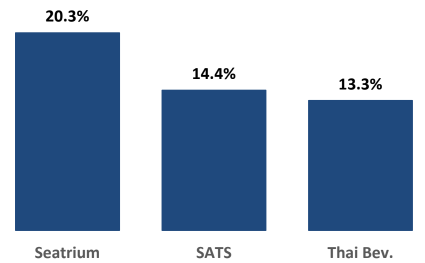


Figure 3: Consumer names were weak

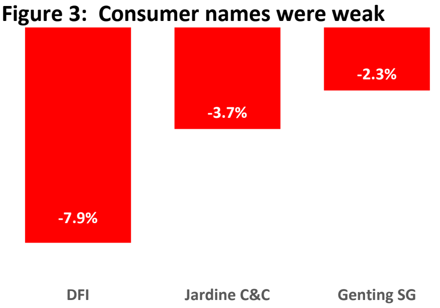
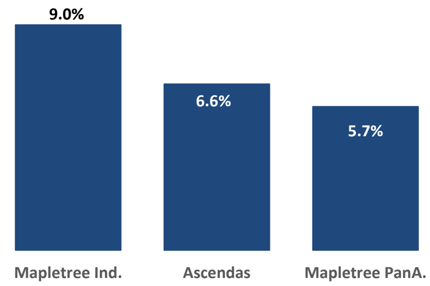


Figure 4: Rebound in REITs



Source (Fig 1-4): PSR, Bloomberg, 31July24

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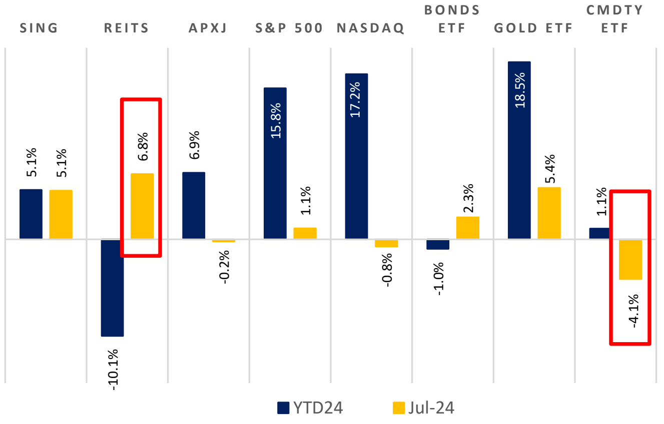
Corporate Insight Webinars: Audience Analytics (6Aug), Paragon REIT (7Aug), Elite UK REIT (13Aug), Zixin Group (14Jun), First REIT (20Aug), BHG Retail REIT (21Aug), Uni-Asia Group (23Aug), Keppel REIT (27Aug), VinFast (28Aug)
https://www.poems.com.sg/education/events-seminars/

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)
SG REIT	5.2%	2.9%	-9.0%	65
SG Mid-cap	5.1%	3.2%	-0.7%	92
India	3.8%	10.3%	14.7%	2,327
Singapore	3.5%	4.8%	6.5%	386
Philippines	3.2%	-1.3%	2.6%	157
Indonesia	2.7%	0.3%	-0.3%	753
SG Financials	2.6%	4.9%	15.5%	178
ASEAN 6	2.6%	0.5%	1.2%	1,979
SG Small-cap	1.9%	0.9%	-6.3%	22
Malaysia	1.8%	2.7%	11.3%	240
Thailand	1.3%	-3.6%	-6.9%	442
Vietnam	0.8%	3.8%	11.1%	199
Shanghai	-1.1%	-5.5%	-1.3%	6,124
S Korea	-1.3%	2.6%	4.0%	1,546
Hong Kong	-2.0%	-2.3%	1.8%	2,575
Japan	-2.5%	0.5%	15.3%	21,333
Taiwan	-3.5%	9.0%	24.0%	2,220

Source: PSR, Bloomberg

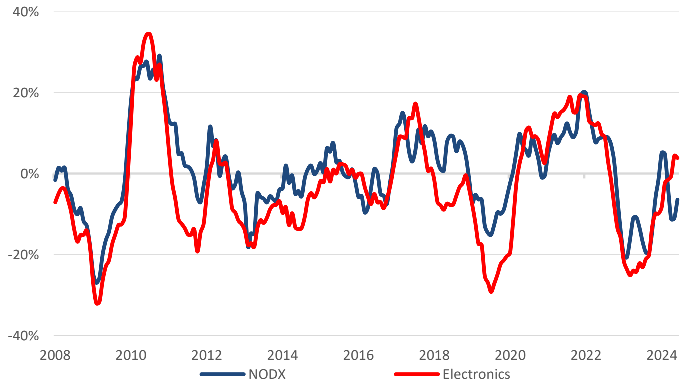
Figure 7: Only conglomerates suffered losses

PSR (147 companies)	1 Mth Perf.	3 Mth Perf.	YTD Perf.
Commodities	**2.0%**	-1.3%	-4.3%
Conglomerate	**-0.4%**	-2.3%	-5.3%
Consumer	**2.8%**	-2.2%	-10.9%
Finance	**2.6%**	4.9%	15.8%
Healthcare	**0.4%**	1.3%	3.8%
Electronics/Services	**1.5%**	0.1%	-2.2%
Property/Const.	**1.6%**	-1.2%	-9.6%
REIT - Hospitality	**2.5%**	-1.0%	-9.5%
REIT - Industrial	**5.4%**	2.2%	-11.8%
REIT - Office	**7.6%**	3.4%	-5.2%
REIT - Retail	**4.5%**	4.3%	-5.6%
REIT - Others	**8.0%**	5.0%	-8.5%
Shipping	**13.2%**	28.5%	42.7%
Telecomm.	**11.1%**	26.8%	22.8%
Transportation	**2.7%**	7.4%	5.8%
	3.6%	5.3%	6.1%
Singapore	3.51%	4.8%	6.5%

Source: PSR, Bloomberg

Figure 8: Tepid recovery in exports after the decline in 2023

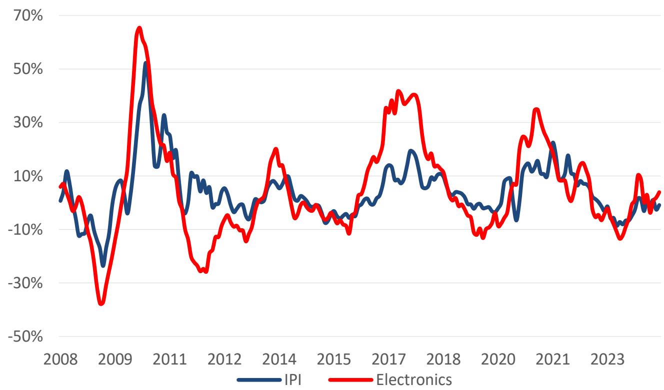
SG: NODX and Electronic Exports (3MMA YoY)



Source: PSR, CEIC

Figure 9: Manufacturing contracted 0.8% YoY

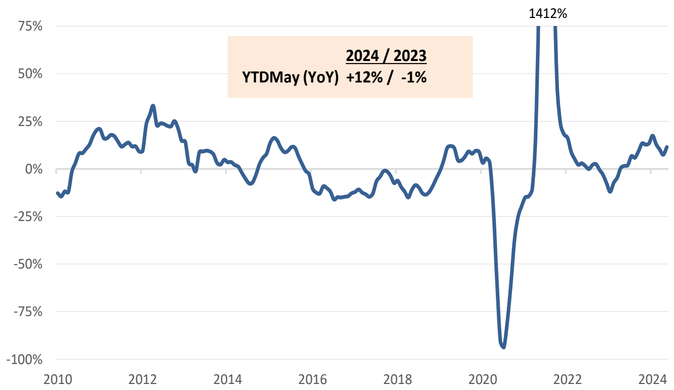
SG: Industrial production (3MMA YoY)



Source: PSR, CEIC

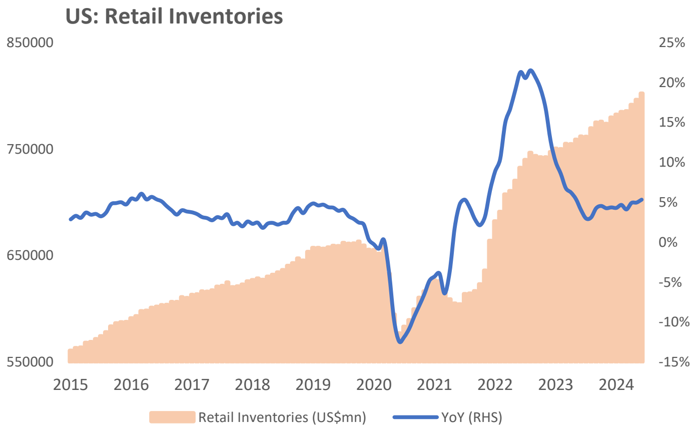
Figure 10: Demand for construction materials is strong

Ready Mixed Concrete Demand (3MMA % YoY)



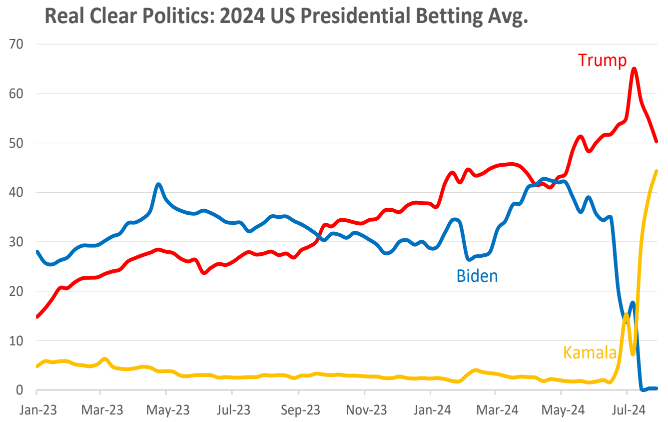
Source: PSR, CEIC

Figure 11: Inventories climb back up at a faster pace



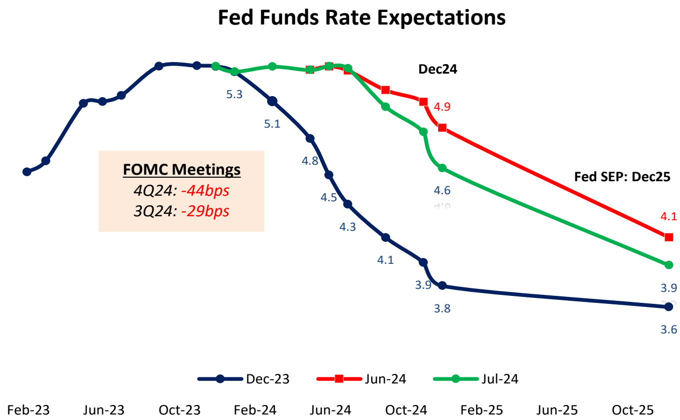
Source: PSR, CEIC

Figure 12: Spike in expectations of a Kamala win



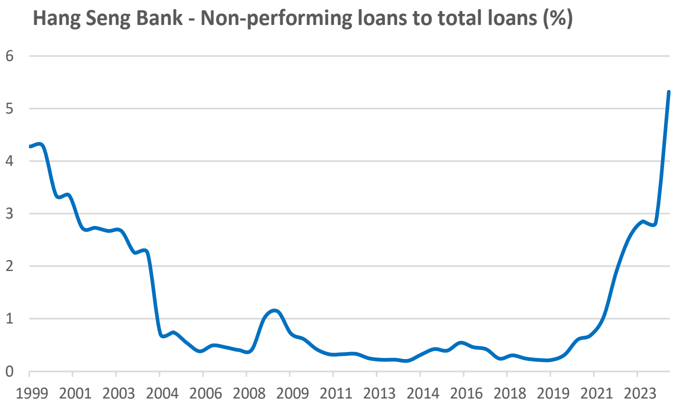
Source: PSR, Bloomberg

Figure 13: End July, expectations are for three rate cuts in 2024



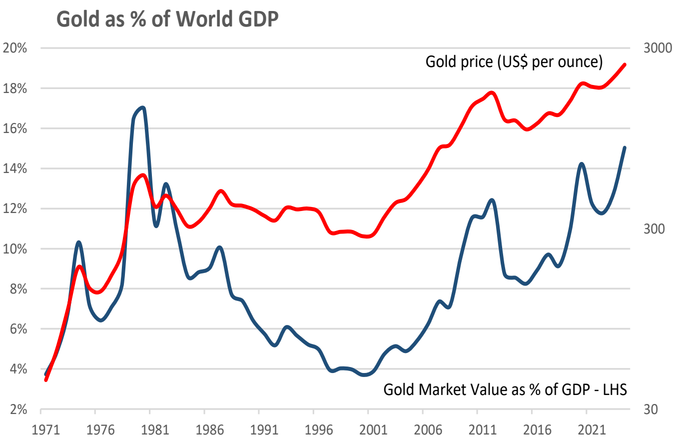
Source: PSR, Bloomberg

Figure 14: Risk of provisioning cycle in Hong Kong



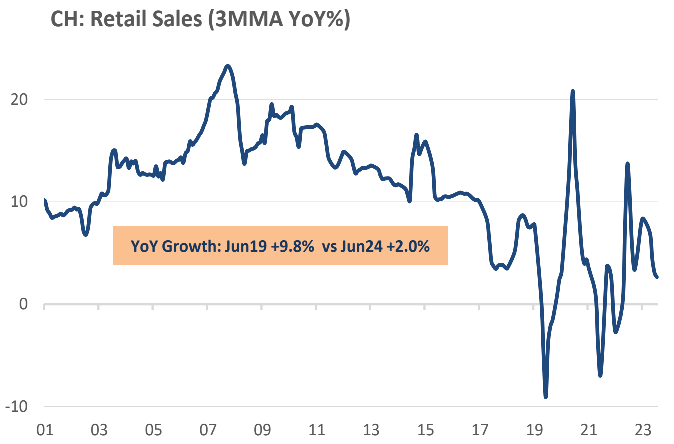
Source: PSR, Bloomberg

Figure 15: Gold price looks elevated on a historical basis



Source: PSR, Bloomberg, Our World in Data

Figure 16: China retail spending only 2% YoY vs 9.8% pre-pandemic



Source: PSR, CEIC

Phillip Absolute 10

Our model portfolio rose 2.9% in July. It underperformed the market by 60 basis points. There were gains across the portfolio led by Singtel. The only decline was at Cromwell REIT. We find Cromwell REIT's forward dividend yield attractive at almost 10%. Furthermore, the ECB is expected to cut interest rates by another 50 basis points this year. Valuation of the portfolio for June rose 0.6%, the first in 2 years. The stock is trading at a 33% discount to its book value. CapitaLand Investment has been a disappointment due to the sluggish environment in China. We take a longer-term view of the company as it is building up a global fund management and hospitality franchise.

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	2.9%	3.5%
Aug24		
Sep24		
Oct24		
Nov24		
Dec24		
YTD	2.7%	6.5%
Out/(Under)perf.		-3.7%

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

Figure 18: Phillip Absolute 10 performance till July 2024

Company	1M	3M	YTD	Rating	Target Px (S$)	Share Px (S$)	Upside	Mkt Cap (US$m)	Dvd. Yield
Yield									
Cromwell REIT (EUR)	-0.7%	-6.7%	-2.1%	**Buy**	**1.91**	1.39	37%	848	11.3%
DBS Group	2.2%	4.8%	20.5%	**Buy**	**38.50**	36.59	5%	77,442	4.8%
OUE REIT	3.8%	0.0%	-5.3%	**BUY**	**0.33**	0.270	22%	1,104	7.7%
Dividend / Earnings Growth									
China Aviation	2.9%	-4.8%	1.1%	**Buy**	**1.05**	0.89	19%	566	3.1%
ST Engineering	1.2%	8.7%	12.6%	**Accumulate**	**4.90**	4.38	12%	10,165	3.7%
Valuetronics	0.8%	8.5%	7.6%	**Buy**	**0.76**	0.640	19%	195	3.5%
Re-rating Plays									
CapitaLand Investment	1.9%	1.9%	-14.2%	**Buy**	**3.38**	2.71	25%	10,076	4.4%
ComfortDelGro	3.0%	-7.4%	-1.4%	**Buy**	**1.63**	1.38	18%	2,224	4.8%
Singtel	12.0%	29.4%	24.7%	**Buy**	**3.44**	3.08	12%	37,848	3.4%
Keppel Ltd	1.9%	-4.2%	-6.8%	**Accumulate**	**7.98**	6.59	21%	8,857	5.2%
Average	2.89%	3.0%	3.7%				19%		5.2%

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

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

Top 10 Gainers		Top 10 Losers	
Prime US REIT	65.0%	Samudera Shipping	-21.4%
Keppel Pacific Oak	53.0%	Dasin Retail Trust	-20.8%
Dyna-Mac	38.6%	Frencken Group	-20.2%
Manulife US-REIT	25.0%	Del Monte	-19.4%
17LIVE	21.8%	Vicplas	-16.7%
Seatrium	20.3%	KSH	-16.7%
CNMC	17.1%	Rex International	-16.4%
Q&M	16.7%	OUE	-11.6%
SATS	14.4%	HC Surgical	-10.5%
Thai Beverage	13.3%	Southern Alliance	-9.1%

Top 10 SPDR Gainers		Top 10 SPDR Losers	
Seatrium	20.3%	DFI	-7.9%
SATS	14.4%	Jardine C&C	-3.7%
Thai Bev.	13.3%	Genting SG	-2.3%
Singtel	12.0%	Sembcorp Ind.	-2.1%
YZJ	9.8%	Mapletree Log	-0.8%
Mapletree Ind.	9.0%	Jardine Matheson	-0.5%
Ascendas	6.6%	SIA	0.6%
Mapletree Pan Asia	5.7%	ST Eng.	1.2%
Venture Corp.	5.3%	HK Land	1.2%
CICT	4.5%	Keppel	1.9%

Source: Bloomberg, PSR

Weekly Equity Strategy Commentary

Week 27	Key economic news last week was May core PCE inflation in the US. The rise of 2.6% YoY was within market expectations. It is the lowest inflation reading in more than three years, or April 2021 when US interest rates were still at the zero bound. The futures market is pricing a 44-bps rate cut this year. There is a 75% probability of a rate cut in December. Our expectations remain for one rate cut in December. September and November will be viewed as too political unless we get huge disinflation. In Europe, the narrative is moving towards 2 more rate cuts this year. REITs have become a more attractive relative bet. Most REITs hedge their interest rate on a 3-year basis. We are entering the 2nd year since the first-rate hike in March 2022. The headwind of surging interest expenses and unwinding of the hedges will largely end by this year. Rental growth can begin to outpace interest expenses. Furthermore, the first cut in interest rates will also signal a peak in rates, providing clarity for real estate investors and thereby sparking more transaction activity. We favour Cromwell REIT as the ECB turns more aggressive in loosening monetary policy. OUE REIT pays an attractive yield with a deeply discounted Singapore portfolio. CapitaLand Investment will benefit from increased real estate transaction activity. Following the Presidential debate, betting averages for Trump winning the Presidency spiked 3% points to 54.3%. Biden fell collapsed by almost 17% points to 19%. A Trump Presidency will raise expectations of upward pressure on inflation and more trade wars. Tax cuts expiring in 2026 are likely to be extended and there will be political pressure to cut interest rates. Betting averages have climbed for Gavin Newsom (4% to 9%) and Kamala Harris (2% to 5%). The new cloud model of selling Nvidia GPU (or AI chips) as a computing service was pioneered by CoreWeave and Lambda Labs. Nvidia literally provides a blueprint or reference on how to build and run it. Nvidia benefits not just from selling the GPUs but also from reducing the bargaining power of hyperscalers. GPU-as-a-service is now being launched by several SGX companies. It started with Singtel and Nvidia in March. Last week, ST Engineering announced its new data centres that can accommodate AI workloads. Valuetronics [BUY, TP S$0.76] went a step further with a small S$10mn investment in GPU-as-a-service in Hong Kong using China-developed GPUs. There are plans for a much larger investment if this initial investment is successful. GPU-as-a-service will work in the near term due to the shortage of GPUs. The challenge is de-risking when prices of these GPUs start to fall and technology obsolescence creeps in. A path all electronics will eventually face.
Week 28	US payrolls in June added 206,000 jobs, slightly ahead of the 191,000 forecast. Behind the headline numbers remains a slowing economy. Almost 75% of the jobs added were government and healthcare related. This is above the 2023 average of 56% and pre-pandemic (2017-19) 28%. The unemployment rate also ticked up from 4.0% to 4.1%. The concern now is the Sahm rule: Where the average unemployment rate rises 50bps or more above the lowest 3MMA over the previous year, the economy is in recession. The difference is now 40 bps. A slowing economy and rate cuts lead to our overweight rating on REITs. The S-REIT index is now trading at an attractive 6.5% dividend yield with the worst in interest expense headwinds ending this year. We initiated coverage on First REIT with a BUY recommendation and target price of $0.30. The dividend yield is attractive at 9.6% anchored by 15 hospitals in Indonesia. Healthcare is a structural growth industry in Indonesia. Its major tenant, Siloam Healthcare, registered an earnings growth of 30% YoY in 1Q24. The two major risks for First REIT are the Indonesia rupiah and Lippo Karawachi (LPKR). We think the downside in rupiah is capped by the minimum annual rent escalation of 4.5%. LPKR still subsidises the rent and accounts for 35% of rental income by tenant mix. This will gradually decline as Siloam contributes more via the performance-based rent. Another de-risking is LPKR de-leveraging by selling a 10.4% stake in Siloam for US$240mn to CVC Capital. We think Siloam will eventually look to repurchase all its hospitals from First REIT to reduce or cap its rental expenses. Singapore-listed companies have multiple asset exposure in the UK. It includes hotels, offices, student housing, transportation and renewable energy. UK government finances are tight. Debt to GDP is 101%. The new Labour government's four key initiatives are to build more houses, reduce immigration, fund new green infrastructure and lower the huge backlog in healthcare access. The pure-play UK company under our coverage is Elite UK REIT [BUY, TP GBP0.32]. The macro-optimism for Elite will be more social spending under Labour compared to the austerity programmes under the previous government. Around 93% of its rental income is from the UK Department for Work and Pensions. Another macro catalyst is interest rate cuts. Inflation has already hit the Bank of England's 2% target, but interest rates remain at a 16-year high of 5.25%. Expectations are for at least 1 rate cut this year. CDL [BUY, TP S$6.87] has 20% of its assets in the UK. Plans to build more homes, if successful, could negatively impact rented homes and student accommodation in the long term. On transport, ComfortDelGro [BUY, T S$1.63] could benefit from plans to privatise more bus services and integrate more services.
Week 29	Core US CPI in June rose 3.3% YoY, a tad below expectations of 3.4%. Dragging down inflation is the 1.8% YoY contraction in goods prices. Most encouraging is shelter inflation slowing to 5.2% YoY, the 15th consecutive month of decline. Market expectations is now shifting towards two rate cuts this year. A 93% probability of a rate cut in September and 83% in December. Recent J Powell testimony is for inflation to be on a "path sustainably to 2% and not at 2%" before it has the confidence to start cutting interest rates. Tactically, the macro setup is positive for REITs or longer-duration fixed-income securities. The upcoming Fed meeting on 31 July could see early hints of an impending rate cut. REITs in our model portfolio are Cromwell REIT [BUY, TP EUR1.91] and OUE REIT [BUY, TP S$0.33]. Following

	the shooting incident, Trump's Presidential election betting odds spiked 7% points to 63%. Biden is now 15% followed by Kamala 10%. Last week, we had a series of strategy and economic presentations by our other ASEAN equity research teams. The investment theme in Malaysia is based on a major investment cycle into data centres, infrastructure (LRT, highways), and oil and gas. The sector overweights are construction and oil and gas service companies. Thailand is faced with a weak currency due to its low interest rate differential with the US. Beneficiaries of a weak currency are healthcare, (food) exporters, and tourism. Indonesia provided more of an economic overview. The dual fiscal and current account deficit will continue to place pressure on the rupiah as capital leaves the country. The economy is expected to slow down in 2H24 and be dependent on government support and commodities exports. In summary, an added benefit of the Fed cutting interest rates is to narrow the differential with ASEAN thereby supporting the currency.
Week 30	There were two major corporate restructurings last week. Singtel's 25% owned Intouch was merging its assets (essentially a 40.4% stake in Advanced Info) with Gulf Energy Development power assets into a NewCo. Both are listed on the Thai stock exchange. In a nutshell, Singtel ends up with a 9% stake in the NewCo with S$135mn special dividends. We saw the deal as a positive. It provides Singtel with greater liquidity and the opportunity to dispose of its S$2.3bn Intouch stake under a much larger NewCo. The next deal involved Thai Beverage swapping its 28.8% stake in Frasers Property (FPL) for a 41.3% stake in Fraser and Neave (F&N). It will increase Thai Beverage stake in F&N to 69.6%. The deal was a non-event. We believe it only removes the earnings volatility from FPL property development and fair value changes. More interesting was parent TCC Assets direct stake in FPL rise from 58% to around 87%. It does make privatization easier as there will be lower leakages to other minority shareholders when it partially owned FPL. There is also a "fair and reasonable" price of S$1.89 from the share swap ratio. F&N also turns into a privatization candidate because, over the past 18 months, Thai Beverage has privatised 2 listed beverage companies (Sermsuk and Oishi) at premiums of 27-28%. The fair value from the share swap is S$3.55, almost triple the current S$1.29. AI-related semiconductor names continue to report stellar earnings. TSMC's 2Q24 revenue jumped 33% YoY to S$20.8bn followed by a 36% jump in earnings. TSMC is guiding a 32% YoY growth in revenue for 3Q24 driven by smartphone and AI-related demand. It raised full-year revenue guidance growth from mid-20% to slightly above mid-20%. Growth was more modest for ASML. 2Q24 revenue at EUR6.2bn was the top end of its guidance but still down 10% YoY. The 3Q24 guidance is for a 5% growth in revenue. The stock sank 10% on news that the US government is urging the Netherlands and Japan to place more curbs on exporting semiconductor equipment. ASML sells 49% of its equipment to China. TSMC then fell on Trump's comments on Taiwan. Geopolitics is creating an overhang and tail risk again for semiconductor stocks. China concluded its Third Plenary in a 3700-word communique filled with principles to reform, develop and modernise. In a nutshell, it can be summarised as "high-quality development." Only one sentence was related to real estate and local government debt. It seems the authorities are not looking for any major stimulus soon, but the reforms seem targeted to be completed by 2029 (the 80th anniversary of the People's Republic of China). Meanwhile, data from China is still poor. Retail sales decelerated to 2% YoY in June. A major contraction from the 10% growth pre-pandemic. Property sales in June were on their 32nd month of decline (YoY terms). An area where the consumer is spending is travel. Flights handled by Shanghai Pudong are up 38% YoY in May. The beneficiary of higher overseas travel from this airport will be China Aviation. .
Week 31 Jonathan Woo Senior Research Analyst	Macro data out of the US last week is likely going to reaffirm market expectations of a Fed holding interest rates steady during its Aug24 meeting next week. Real GDP climbed to 2.8% in 2Q24, up from 1.4% in 1Q24, and was driven by a combination of higher consumer and government spending. Jun24 Core PCE, which is the Fed's favoured inflation gauge, was unchanged from May24 at 2.6%, coming in slightly above expectations of 2.5%. We still believe that the probability of a Fed cut in Sep24 remains low (even as markets are pricing in an 88% cut) because: 1) inflation is trending slower than anticipated, 2) the still hot US economy, 3) the 18Sep24 meeting is likely too close to the Presidential Election. The first 2 Magnificent-7 stocks (Google + Tesla) announced 2Q24 earnings last week. Tesla missed earnings estimates on weaker margins and uncertainty around its stalling EV business (2Q24 Adj. EPS -42% YoY), while Google beat on both top and bottom lines thanks to resilient Ad revenues and accelerating AI-related Cloud growth (2Q24 EPS +31% YoY). The S&P 500 closed the week -0.8%, while the tech-heavy Nasdaq was -2.6%. We believe that investors were looking for a reason to take profit off most tech stocks given high expectations and stretched valuations – which is likely to persist into next week with most of the other Magnificent-7 stocks on deck. Sector gainers for the week were Utilities (+1.5%), Healthcare (+1.4%), Materials (+1.4%), and Financials (+1.3%), while the laggards were Consumer Discretionary (-2.8%) and Technology (-2.1%). In Singapore, inflation dipped back to Mar22 levels, with Jun24 CPI +2.4% YoY (vs May24 +3.1% YoY), and Core CPI +2.9% YoY (vs May24 +3.1% YoY). This softer print was mainly due to a dip in private transport costs and probably some weakness in home prices. Private residential prices for 2Q24 showed a +0.9% QoQ gain, its weakest since 3Q23. Landed homes increased +1.9% QoQ, while condo prices were only +0.6% QoQ, hit by contractions (-0.3% QoQ) in the

	Core Central Region (CCR). MAS left its monetary policy settings unchanged for a 5th meeting and raised the low end of its FY24e GDP range to 2-3%, up from 1-3%. It also lowered FY24e headline CPI expectations to 2-3% while maintaining the Core CPI forecast of 2.5-3.5%. MAS also expects core inflation to "step down more discernibly" in 4Q24, and into 2025.

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