Phillip 4Q22 Singapore Strategy

Hibernating for winter

SINGAPORE | STRATEGY

4 October 2022

Review: The STI was up a modest 0.9% in 3Q22. Only a third of the component stocks managed to eke out gains. Banks were the outperformers (Figure 1), and so were selected cyclicals (Figure 2). REITs bore the brunt of the sell-down (Figure 3). They face multiple challenges. Higher interest rates and flat property cap rates translate to negative carry from acquisitions, stifling inorganic growth. We also expect refinancing costs to spike not just from higher rates but costlier hedging to keep interest rates fixed. The ability to maintain DPUs will be a challenge.

Outlook: Global growth continues to ease. Most macro indicators are at their lowest point since the pandemic began. There are no growth drivers on the horizon. Europe is facing a recession under the weight of skyrocketing energy prices. Energy rationing during winter could further depress the region. The Fed is intent on slowing the US economy with higher interest rates, while China remains gripped in a lockdown. Rising interest rates globally will deflate both valuations and earnings. We believe the US economy faces a high probability of a recession next year. Most leading indicators are flashing red, indicative of a coming recession (Figures 6 and 7). US corporates face the trifecta of an appreciating dollar, higher interest rates and rising material costs. And made worse by "just too much" inventory. In the past three recessions, earnings declined by around 20%. The forecast for 2022 is still mid-teens growth. Singapore's corporates are in much better shape, backstopped by a resilient domestic economy and rising interest rates bolstering bank margins.

After major fiscal spending on the pandemic, governments have smaller balance sheets to reinvigorate their economies (Figure 8). The UK is trying to spend its way out of recession and energy inflation. But the cost is a 20% collapse in its currency (Figure 9) and surging government bond yields (Figure 10). China appears to be the only government with a balance sheet to support its economy and indicators point to an economy bottoming out (Figure 11). Another promising sign is the peaking of inflation. Headline inflation in the US is highly correlated to commodity prices (Figure 12), which have crested. However, it is not time to rejoice. Firstly, the critical core inflation is stubbornly high from rising rents (Figure 13) as the housing supply is still constrained. Secondly, oil prices are weak following massive selling of US strategic petroleum reserves (Figure 14). But that will end in November. Thirdly, for the Fed to pause its hiking cycle, core inflation needs to decline meaningfully and sustainably. A condition several months away (Figure 15). To address both the global plight of weak economic growth and stubborn inflation, capital expenditure needs to be revived. Investments will come from more onshoring of manufacturing capacity to buttress supply chains. They will also stem from a restoration of energy independence for security and climate agendas. Notable sectors that benefit from this in Singapore are semiconductor equipment makers and oil and gas vessel yards or owners.

Recommendation: We are bearish this quarter. We are stepping out of the casino for a coffee break. The typical equity hedge during a bearish phase is bond-like stocks such as REITs. But REITs are no longer a shelter with the steep ascent in interest rates. In general, a 2% point rise in interest rate requires mid-teens growth in property income just to maintain dividends. It is an insurmountable hurdle with accretive acquisitions using debt no longer available. To hedge out downside risk, we have added Singapore Exchange (SGX) to our model portfolio. We are buying volatility for the coming quarter. SGX benefits from rising rates due to its collateral float from member balances. On top of that, volatility in the market will drive up trading volumes. Banks are still Overweight for us. Variable-rate loans and the low-cost float of CASA deposits (current accounts and savings accounts) are rare beneficiaries of steepening interest rates. On REITs, we believe a more opportune time to Overweight the sector is early next year. Fed hikes at the current pace are not sustainable as we see a recession on the horizon. The FOMC's December meeting could be a pivotal moment for that notorious Fed pivot to lowering rates or at least wait and watch.

3Q22 performance

Figure 1: Banks were outperformers

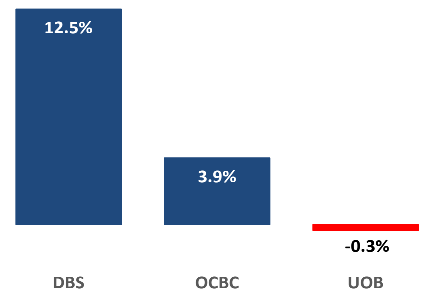


Figure 2: Top gainers during the quarter

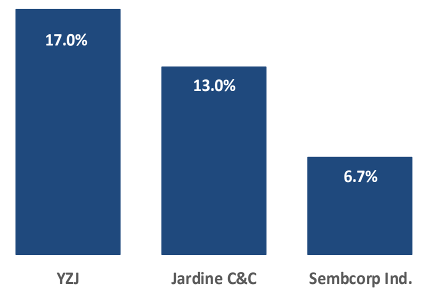


Figure 3: REITs remain under pressure

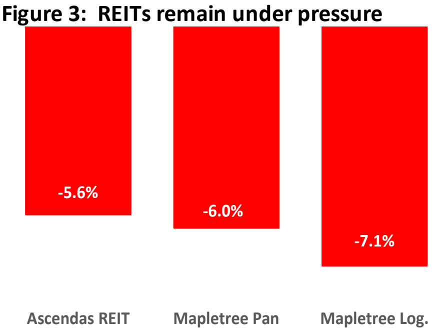
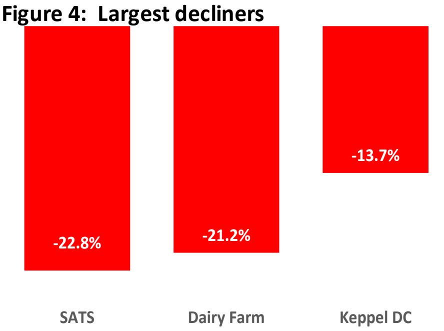


Figure 4: Largest decliners



Source (Fig 1-4): PSR, Bloomberg, 30 Sep 2022

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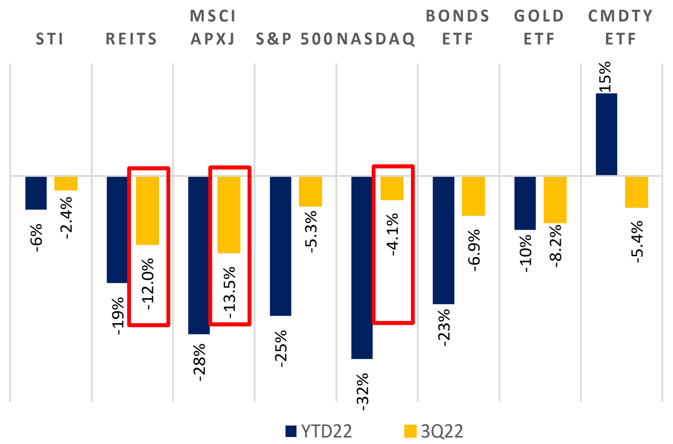
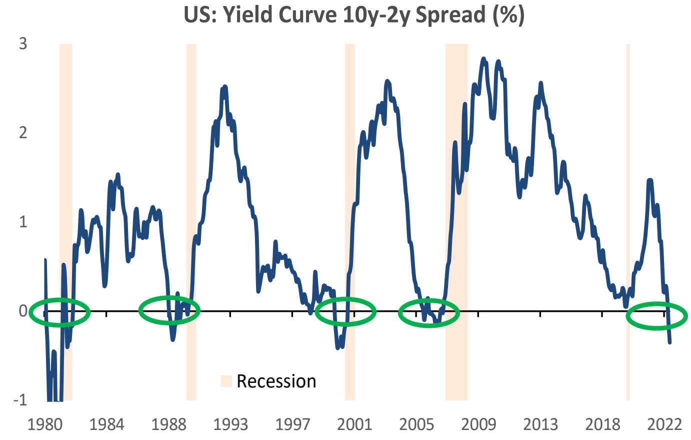
Figure 5: Sell-down Asian tech and SREITs



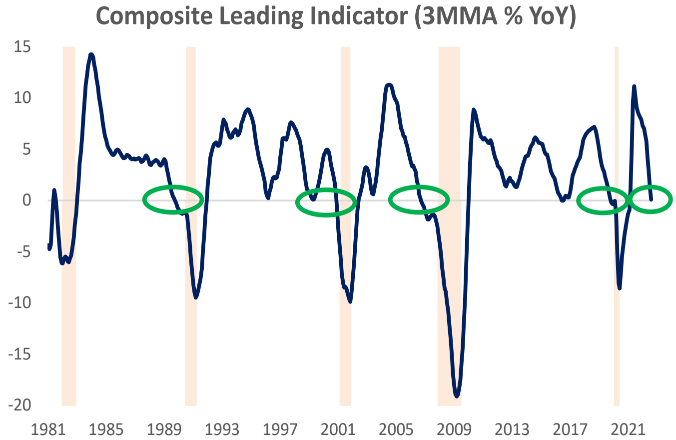
Source: PSR, Bloomberg

Figure 6: 3rd consecutive month on yield curve inversion



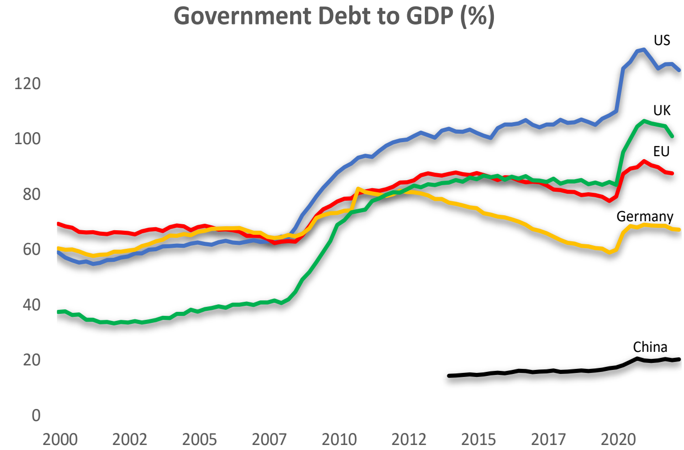
Source: PSR, CEIC

Figure 7: CLI has turned negative, pointing to a recession ahead



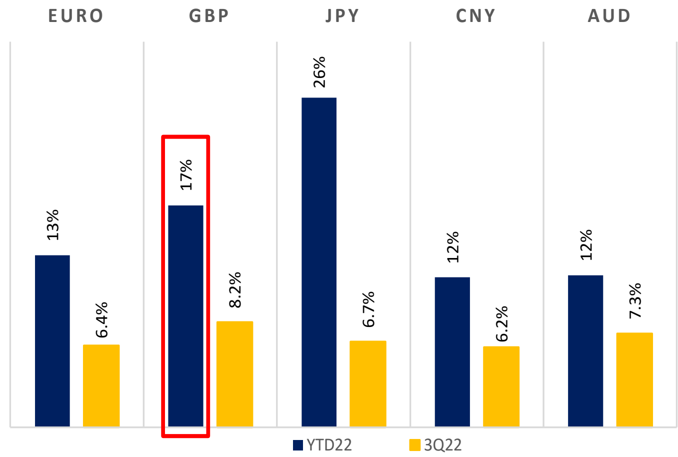
Source: PSR, CEIC

Figure 8: Government spending already surged from pandemic spend



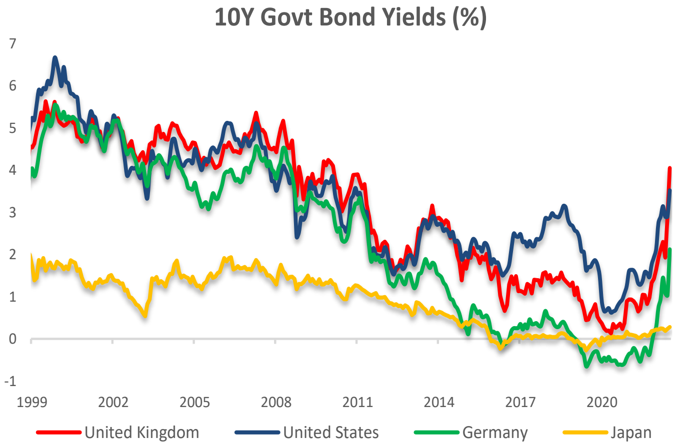
Source: PSR, CEIC

Figure 9: British pound is down 17% this year



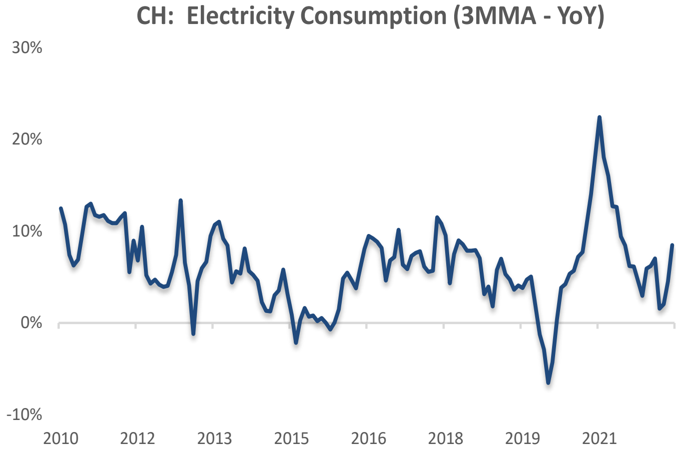
Source: PSR, CEIC

Figure 10: UK bond yields experienced the largest spike in yields



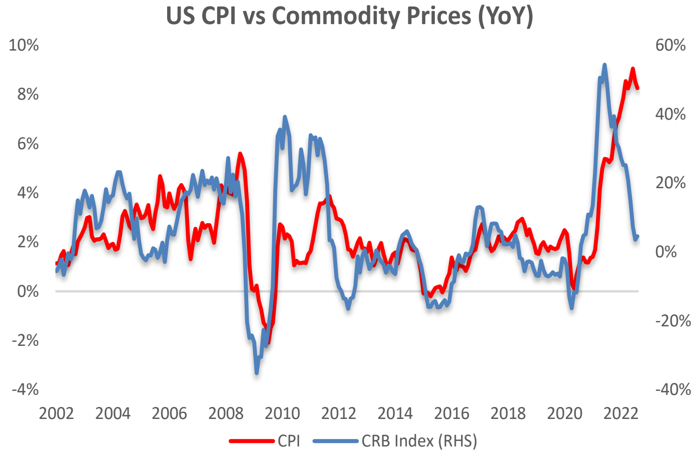
Source: PSR, CEIC

Figure 11: Early signs of improving economic activity



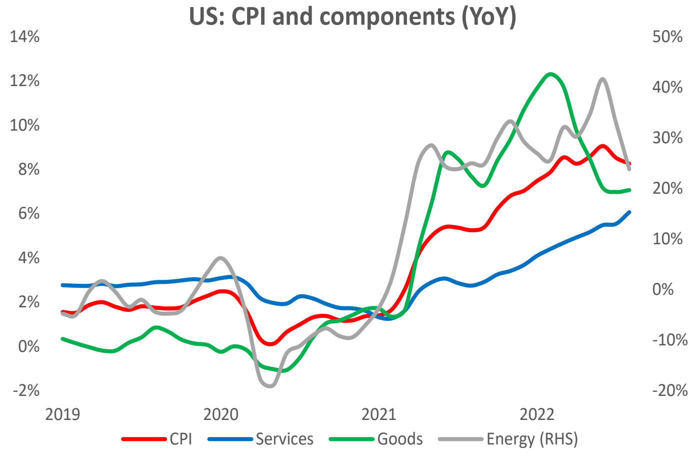
Source: PSR, CEIC

Figure 12: Commodity prices have peaked and will drag down CPI



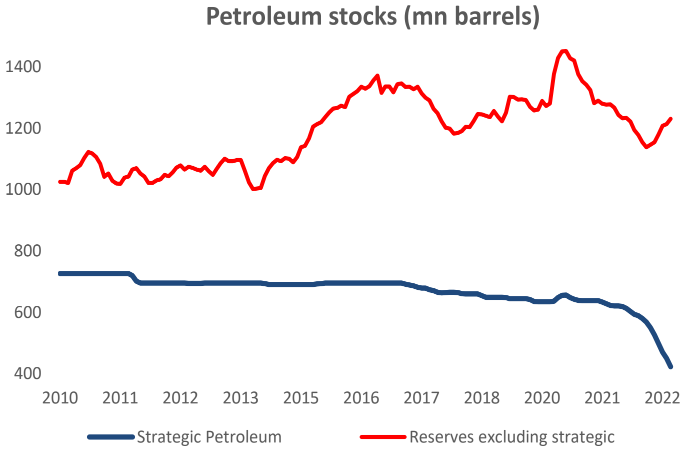
Source: PSR, CEIC

Figure 13: Stubborn rising services due to shelter or housing rent



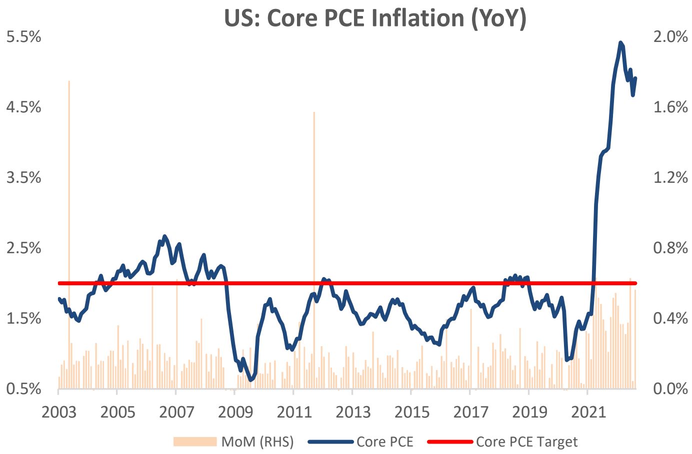
Source: PSR, CEIC

Figure 14: The US selling 1mn bopd since April 2022



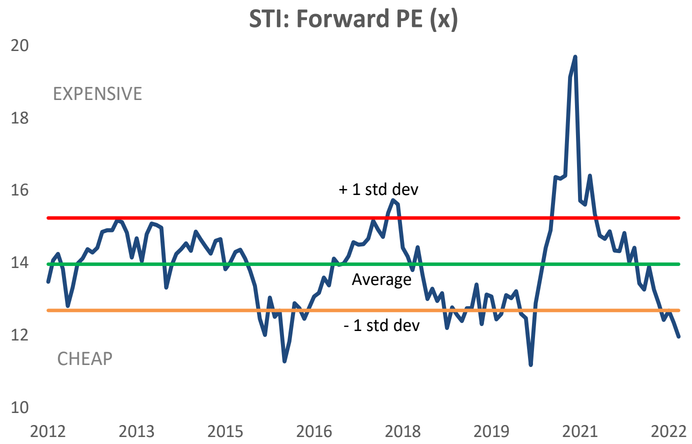
Source: PSR, CEIC

Figure 15: Core inflation far from targeted 2%



Source: PSR, CEIC

Figure 16: Singapore valuations at attractive levels



Source: PSR, Bloomberg

Phillip Absolute 10

During the quarter our model portfolio was down 3.8% YoY. Large cap bank and conglomerates registered positive gains led by a 12.5% rise in DBS. Our mid-cap stocks were pummelled. Del Monte was the worst performer with a 17% drop followed by a 15% decline by Asian PayTV. Del Monte's results were weaker than expected due to short-term excess inventory. Nevertheless, we expect it normalise and selling price hikes to drive earnings recovery. Asian PayTV suffered from the de-rating of bond-like equities and the weak Taiwan dollar.

1Q22 - Add: Del Monte Pacific; Delete: Thai Beverage / 2Q22 - Add: OCBC; Delete: Q & M Dental
3Q22 - Add: Singtel; Delete: Frasers Centrepoint Trust / 4Q22 - Add: SGX; Delete: Asian PayTV

Strategy commentary: We are bracing the portfolio for further weakness in economic conditions made worse by rising interest rates. Bank margins will improve as rates rise and our re-opening beneficiaries include ComfortDelgro, Singtel and CapitaLand Ascott. The rest of the portfolio enjoy resilient earnings growth, cheap valuations or corporate restructuring catalysts.
Deletions from our model: We removed Asian PayTV. Rising interest rates will continue to de-rate leveraged dividend paying stock (or bond proxies). We added Singapore Exchange to hedge out further volatility in the coming quarter. The lack of IPOs and tepid volumes in the equities exchange will hurt SGX. Nevertheless, we expect the rise in volatility will push up derivative and fixed income volumes.

Figure 17: Monthly movements

	Absolute 10	STI
Jan22	0.0%	4.0%
Feb22	1.1%	-0.2%
Mar22	3.7%	5.1%
Apr22	1.4%	-1.5%
May22	-3.7%	-3.7%
Jun22	-1.4%	-4.0%
Jul22	0.7%	3.5%
Aug22	0.1%	0.3%
Sep22	-4.6%	-2.8%
Oct22		
Nov22		
Dec22		
YTD	-2.9%	0.2%
Out/(Under)perf.	-3.1%	

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

Stock commentaries

Company	Comments
1. Ascott Res. Trust	We believe travel is in the midst of a recovery. Catalysts include the reopening of China and Japan to leisure travel and opportunistic divestments at a premium to valuations.
2. SGX (New)	Catalysts include continued growth from new acquisitions and higher treasury income as the higher interest rates start to kick in. Volatility in the market could also increase trading and clearing revenue.
3. DBS	With the highest CASA ratio, DBS is the major beneficiary of rising interest rates. We expect a benign provisioning cycle coupled with stable loan growth and a steady increase in NIMs and NII to boost profits.
4. Del Monte	As consumer wallets shrink due to inflation, consumers in the US are relying on more meals prepared at home. It benefits Del Monte canned vegetables, fruits and broth categories.
5. HRnetGroup	With 700 recruiters across the region, the company will benefit from the rise in volume, salaries and expansion into new geographies.
6. OCBC	OCBC is our preferred pick amongst the three banks due to attractive valuations, upside in dividend from a 15% CET 1 and lower provisioning as the Indonesian and Malaysian economies recover.
7. Singtel	The three share price catalysts are the rebound in roaming revenue, recovery in emerging markets and restructuring or monetization of assets and mobile holdings.
8. CDL	A pipeline of more than 2,000 units with 1,931 units set to be launched in the next two years to ride the resilient Singapore residential market. Another catalyst is the strategic review of its hospitality portfolio, which should narrow the discount to RNAV (40% discount).
9. ComfortDelgro	Our proxy to reopening theme with the huge operating leverage and share price is still 40% below pre-pandemic levels and net cash balance sheet of S$578mn.
10. KeppelCorp	Re-rating catalyst is obtaining the requisite approvals for the SMM deal, the release of the combined entity integration plan and the earlier-than-expected potential upward revision of its capital recycling plan.

Figure 18: Phillip Absolute 10 for 4Q22

Company	1M	3M	YTD	Rating	Target Px (S$)	Share Px (S$)	Upside	Mkt Cap (US$m)	Dvd. Yield
Yield									
CapitaLand Ascott	-10.1%	-14.0%	-4.9%	**Accumulate**	**1.24**	0.98	27%	2,351	4.4%
SGX (new)	-0.3%	0.0%	1.7%	**Buy**	**11.71**	9.46	24%	7,054	3.4%
Dividend / Earnings Growth									
DBS	2.4%	12.5%	2.2%	**Buy**	**41.60**	33.39	25%	59,884	3.6%
Del Monte Pacific	-8.8%	-17.3%	-23.5%	**Buy**	**0.69**	0.31	123%	420	5.5%
HRnetGroup	-3.3%	-4.5%	-8.1%	**Buy**	**1.18**	0.74	59%	515	5.5%
OCBC	-2.2%	3.9%	3.8%	**Buy**	**14.22**	11.83	20%	37,046	4.5%
Singtel	1.5%	5.1%	14.7%	**Accumulate**	**3.05**	2.66	15%	30,599	3.5%
Re-rating Plays									
City Developments	-6.5%	-6.7%	14.5%	**Accumulate**	**8.86**	7.60	17%	4,803	1.1%
ComfortDelgro	-6.4%	-5.7%	-5.7%	**Buy**	**1.80**	1.32	36%	1,993	3.2%
Keppel Corp.	-4.4%	7.1%	35.7%	**Buy**	**8.95**	6.95	29%	8,485	4.7%
Average	-3.80%	-2.0%	3.1%				37%		3.9%

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

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