# Phillip 3Q23 Singapore Strategy

*Slower for longer*

## SINGAPORE | STRATEGY

2 July 2023

**Review:** Singapore's equity market drifted downwards in 2Q23 with a decline of 1.6%. Despite record earnings, banks disappointed over worries about the sustainability of their interest margins (Figure 1). Conversely, SIA's share price witnessed a stellar performance after reporting record profits (Figure 2). The underperformers in the quarter were cyclicals and stocks with disappointing earnings (Figure 4).

**Outlook:** We believe the global economy faces two headwinds. Firstly, limited progress in taming core inflation, which is primarily influenced by the services sector, where wages are the largest cost input. The robust labour market is keeping wages high (Figure 5). We think the labour market strength especially in the US can persist, keeping the Fed hawkish. Worker numbers only returned to pre-pandemic levels in June 2022. The underlying growth rate in employment is still below trend (Figure 6). Furthermore, a significant portion of the hiring is occurring in non-economically sensitive sectors such as education, government and healthcare. An even larger worry is a negative feedback loop between wages and prices. The UK is experiencing the worst labour disputes on record (Figure 7). Workers will initially demand higher pay to recoup their current loss of real income. If inflation persists and inflation expectations become unhinged, their wage demands will be to compensate for future losses. Then a negative spiral will begin. Central banks in developed countries are undergoing a synchronised hike of interest rates to short-circuit this inflation threat (Figure 8).

Secondly, higher rates will only exacerbate the current weak economic conditions. Most economic indicators, in particular from the U.S., are either heading toward or are already in recessionary territory. Consumer demand (Figure 9), corporate spending (Figure 10), loans growth (Figure 11), exports (Figure 12), imports (Figure 13) and PMIs, are all sliding downwards. Higher for longer interest rates will only lead to slower for longer global economies. We maintain our view that a recession in the US is likely. Anyone predicting a recession has been vilified by most US equity bulls. Excluding the magnificent seven stocks, S&P 500 would have been largely flat this year. We believe US resilience is due to (i) AI pushing some tech stocks to 184x historical PE; (ii) Fed support of commercial banks with lending of US$285bn (50% below US$560bn GFC peak support, Figure 14); (iii) optimism over the job market fuelling expectations of a soft landing. All the Nasdaq gains this year are from PE expanding from 27x to 36x.

**Recommendation:** We adopt a defensive posture on Singapore equities focusing on dividend yields from banks and REITs. Bank dividends will still grow this year, supported by the windfall in interest margins and excess capital. High-interest rates will remain a headwind for DPU growth in REITs but the current 6% yield is attractive considering interest rates are close to peaking. Amongst REITs, hospitality REITs offer the highest opportunity for organic growth in DPU. Travel should still enjoy growth supported by outbound travel from China, which is only around 20% of pre-pandemic levels (Figure 15). Domestic travel has been the priority in China, already reaching 94% of pre-pandemic levels. RevPAR in Singapore remains robust and breaking new records. Stocks in our model portfolio, Phillip Absolute 10, that provide exposure to an expanding hospitality sector are CapitaLand Ascott and CDL. Despite the expected strength in travel, we are cautious on SIA [Reduce, TP S$6.80] due to increased competition from other Asian airlines as their capacities rebound, contraction in air cargo due to weaker global trade and cash-flows impacted by redemption on its convertibles, and fleet renewal and purchase of Vistara. In contrast to developed countries, China is following a separate economic trajectory. The central bank is easing monetary policy (Figure 16) and there are plans for stimulus targeted at the consumer and property sector. While growth in China may be slower than expected, the recovery post-Covid is still progressing. Stocks that benefit from a recovering China include CapitaLand Investment and Sasseur REIT. In our model portfolio, we are replacing DBS with Thai Beverage. We think the sell-down is unwarranted and valuations for Thai Beverage are looking more attractive at these levels.

**2Q23 performance**

**Figure 1: Another sluggish quarter for banks**

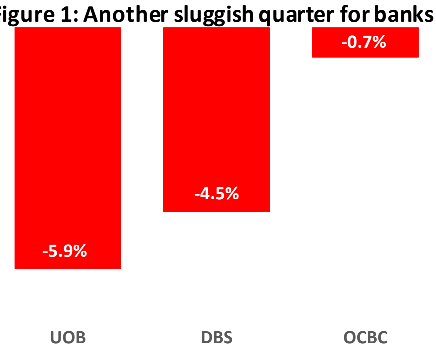



**Figure 2: It was "a great way to fly"**

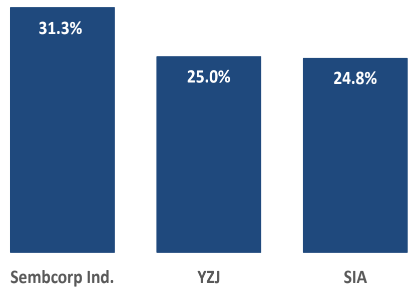



**Figure 3: Raising equity hurts**

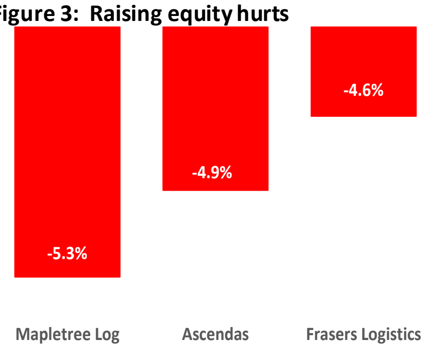
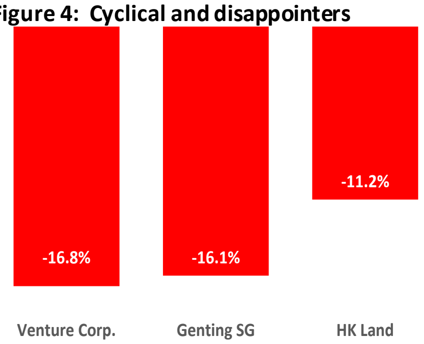



**Figure 4: Cyclical and disappointers**




*Source (Fig 1-4): PSR, Bloomberg, 30June23*

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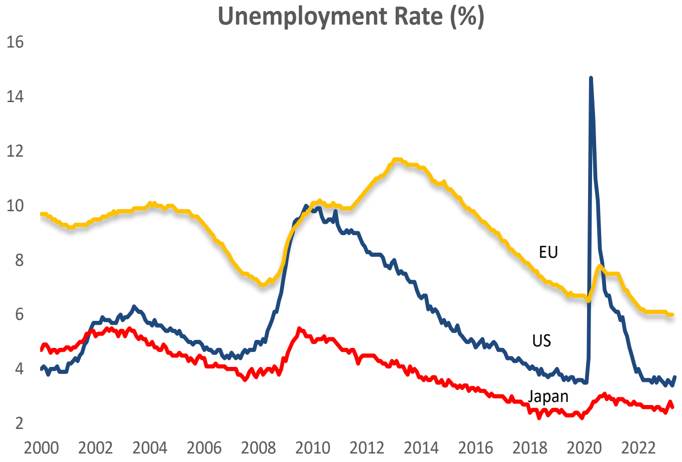
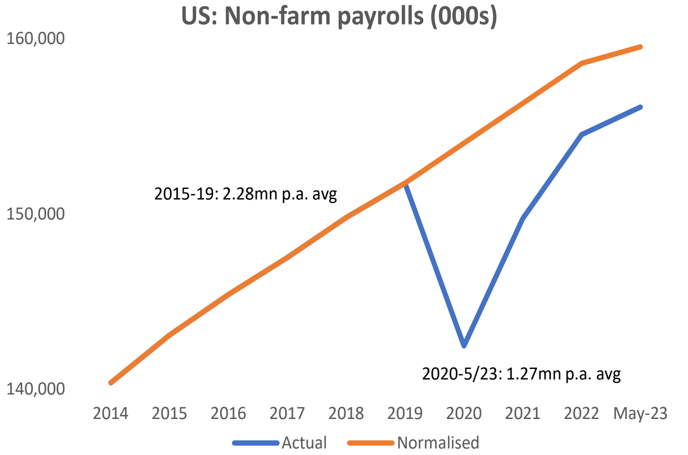
**Figure 5: Labour markets remain vibrant**



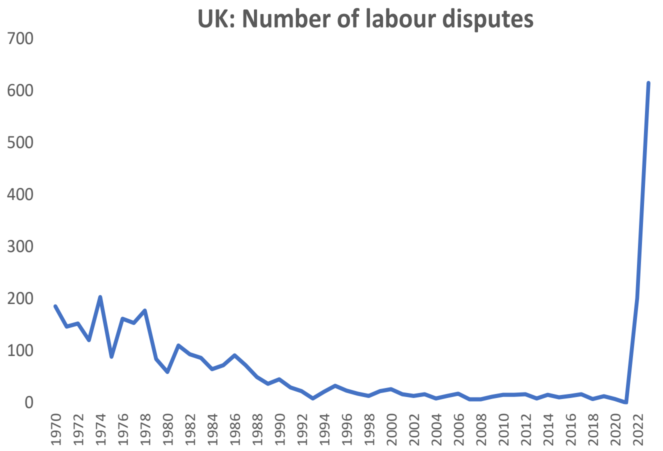

*Source: PSR, CEIC*

**Figure 6: The pace of new hiring is still below pre-pandemic levels**



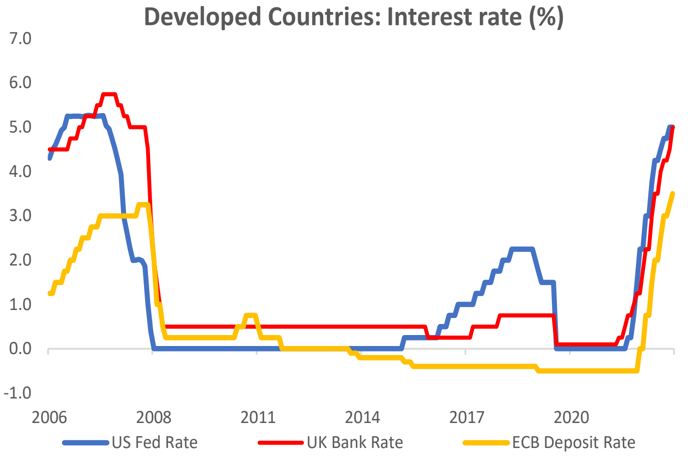

*Source: PSR, CEIC*

**Figure 7: Risk of uncontrolled negative wage spiral in the UK**



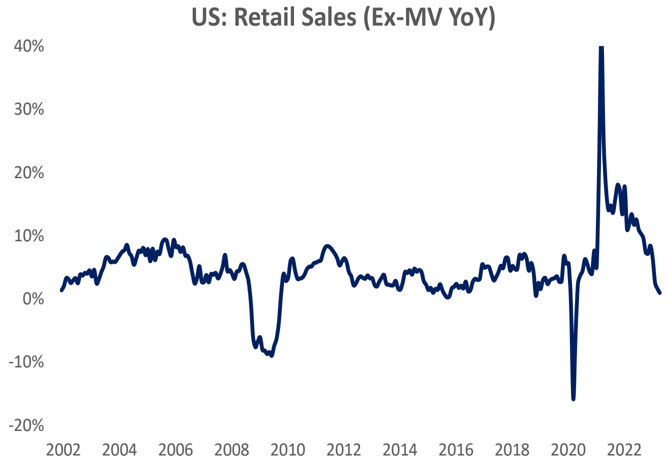

*Source: PSR, CEIC, Office of National Statistics*

**Figure 8: Synchronised raising of interest rates still underway**




*Source: PSR, CEIC*

**Figure 9: US consumer spending is slipping down fast**




*Source: PSR, CEIC*

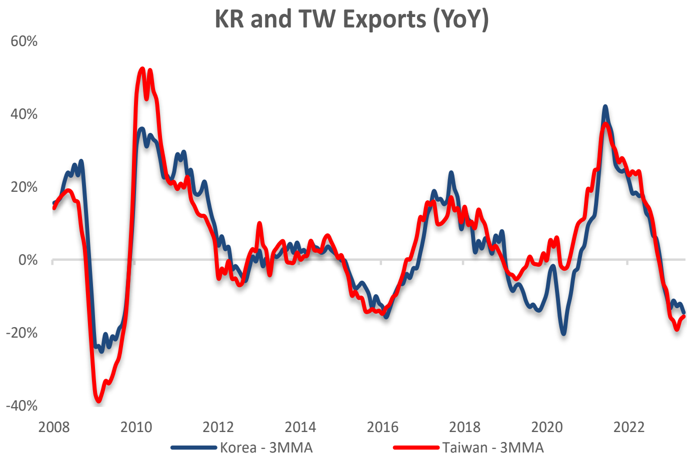
**Figure 10: Corporates are also pulling back on their spending**


*Source: PSR, CEIC*

**Figure 11: Bank failures are triggering a credit contraction**

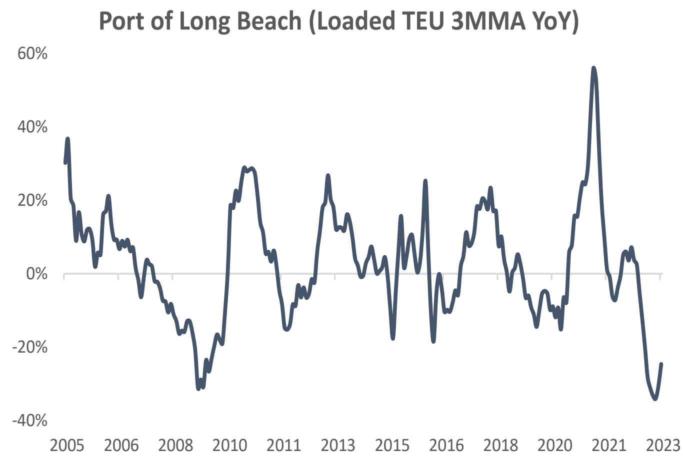

*Source: PSR, CEIC*

**Figure 12: Asian exports in their 7th to 8th month of contraction**



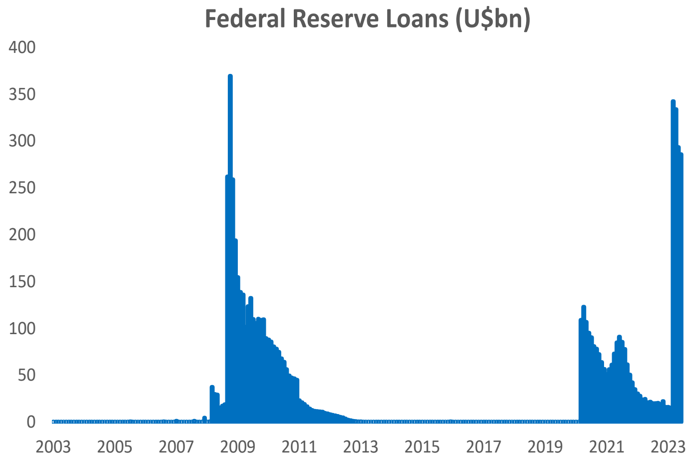

*Source: PSR, CEIC*

**Figure 13: Contracting less after the recent collapse**



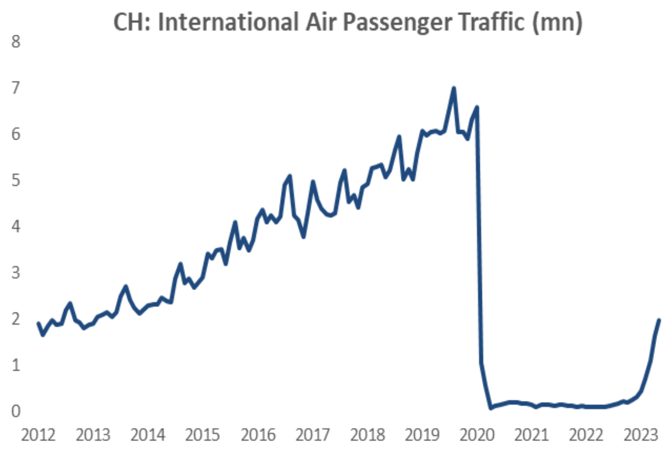

*Source: PSR, CEIC*

**Figure 14: Fed has bailed out the commercial banks**



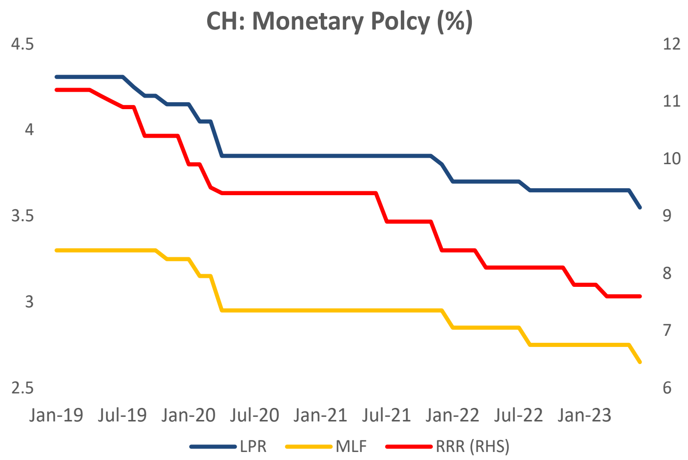

*Source: PSR, CEIC*

Figure 15: Outbound travel only at 20% of pre-pandemic levels




*Source: PSR, CEIC*

**Figure 16: In contrast, China is easing monetary policy**




*Source: PSR, CEIC*

## Phillip Absolute 10

During the quarter our model portfolio was up a modest 0.6% YoY. Property names were the largest drag on performance. CapitaLand Investment (CLI) and City Developments (CDL) were down 9% and 8% respectively during the quarter. Property cooling measures on residential property announced on 27 April will dampen demand. Worse affected are high-end properties where stamp duties for foreigners doubled to 60%. CDL delayed the launch of a project. CLI suffered from weaker than expected recovery in China.

**4Q22 - Add:** SGX; **Remove:** Asian PayTV
**1Q23 - Add:** Prime US REIT; **Remove:** Singtel
**2Q23 - Add:** FCT, PropNex, CLI; **Remove:** Prime US REIT, Del Monte Pacific, HRnetGroup
**3Q23 - Add:** Thai Beverage; **Remove:** DBS

**Strategy commentary:** Our model portfolio is anchored around a high dividend yield as we enter a period of economic slowdown. Areas of growth stem from hospitality and China consumer.
**Changes to model:** We removed DBS from our model in the near term. Record earnings did not spark any positive price action. We believe the share overhang stems from uncertainty over the direction of interest margin. We added Thai Beverage on its attractive historical valuations and unwarranted sell-down due to the proposed anti-monopoly laws.

**Figure 17: Monthly movements**

| | Absolute 10 | SING |
|---|---|---|
| Jan23 | 4.8% | 3.5% |
| Feb23 | -4.3% | -3.1% |
| Mar23 | -4.5% | -0.1% |
| Apr23 | 4.5% | 0.4% |
| May23 | -5.5% | -3.4% |
| Jun23 | 2.1% | 1.5% |
| Jul23 | | |
| Aug23 | | |
| Sep23 | | |
| Oct23 | | |
| Nov23 | | |
| Dec23 | | |
| YTD | -3.4% | -1.4% |
| Out/(Under)perf. | | -2.0% |

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

**Stock commentaries**

| Company | Comments |
|---|---|
| 1. CapitaLand Ascott | We forecast growth in ADRs to moderate as it has already surpassed pre-pandemic levels in some markets, and the driver for RevPAU growth going forward will be higher occupancy. |
| 2. FCT | Provides a stable dividend yield of 5.5% from high occupancy (99.2%), healthy tenant sales and stable rental reversions. |
| 3. SGX | Earnings growth from a higher interest rate environment. Other catalysts include continued growth from derivatives volumes and fees and lower expense growth for FY23e. |
| 4. OCBC | OCBC is our preferred pick among the three banks due to attractive valuations and yield of ~6.5%, buffered by a well-capitalised 15.9% CET 1, and fee income recovery from China's re-opening. |
| 5. PropNex | Property cooling measures will dampen volume expectations, especially from the high end. The stock is still trading at an attractive dividend yield of 7% based on an operating cash flow of S$50mn and net cash of S$139mn. |
| 6. ThaiBev.(New) | We believe the sell-down is unwarranted. The proposed anti-monopoly law is to allow small-scale brewers to enter the liquor industry. Thai Beverage will still maintain its scale advantage in cost, marketing and distribution. |
| 7. CapitaLand Inv. | The real estate investment and lodging management business should continue to recover on the re-opening and recovery in China. CLI is targeting at least $3bn of divestments in FY23. |
| 8. CDL | On track to launch two mass market projects despite cooling measures. Hospitality reported a 65% YOY jump in RevPAR and building recurrent income from UK commercial assets, student dorms and private rented homes. |
| 9. ComfortDelgro | Earnings drivers from a reduction in taxi rental rebates, the introduction of platform fees for ride-hailing app (Zig) and a repricing of bus contracts in the UK. |
| 10. KeppelCorp | Embark on asset recycling and build an asset management platform to generate recurring income. Assets earmarked for sale are its landbank in China/Vietnam/Indonesia and legacy rig assets. The proceeds could be recycled into renewable energy and infrastructure assets to be co-owned by funds and managed by Keppel CapitaLand. |

**Figure 18: Phillip Absolute 10 for 3Q23**

| Company | 1M | 3M | YTD | Rating | Target Px (S$) | Share Px (S$) | Upside | Mkt Cap (US$m) | Dvd. Yield |
|---|---|---|---|---|---|---|---|---|---|
| **Yield** | | | | | | | | | |
| CapitaLand Ascott | 1.9% | 8.5% | 2.9% | **Buy** | **1.26** | 1.08 | 17% | 2,767 | 5.3% |
| FCT | 2.8% | -4.4% | 4.3% | **Accumulate** | **2.35** | 2.19 | 7% | 2,767 | 5.6% |
| SGX | 3.6% | 2.2% | 7.4% | **Buy** | **11.71** | 9.61 | 22% | 7,592 | 3.3% |
| **Dividend / Earnings Growth** | | | | | | | | | |
| OCBC | 0.1% | -0.7% | 0.8% | **Buy** | **14.96** | 12.28 | 22% | 40,831 | 5.5% |
| PropNex | -2.9% | 4.7% | 32.0% | **Buy** | **1.20** | 1.01 | 19% | 829 | 6.7% |
| ThaiBev (New) | 3.6% | -7.9% | -15.3% | **Buy** | **0.80** | 0.580 | 38% | 10,780 | 3.9% |
| **Re-rating Plays** | | | | | | | | | |
| CapitaLand Inv. | 0.0% | -8.6% | -9.1% | **Accumulate** | **4.12** | 3.31 | 24% | 12,541 | 3.6% |
| City Developments | -0.4% | -8.8% | -18.3% | **Accumulate** | **8.33** | 6.72 | 24% | 4,508 | 1.2% |
| ComfortDelgro | 5.5% | -1.7% | -5.7% | **Buy** | **1.57** | 1.16 | 35% | 1,858 | 4.0% |
| Keppel Corp. | 6.3% | 19.2% | 41.8% | **Accumulate** | **7.01** | 6.71 | 4% | 8,747 | 4.9% |
| Average | 2.1% | 0.3% | 4.1% | | | | 21% | | 4.4% |

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

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