Phillip 2Q24 Singapore Strategy

Drifting sideways

1 April 2024

SINGAPORE | STRATEGY

Review: Singapore's equity market rose a modest 0.5% in 1Q24. Most sectors were down during the quarter except banks (Figure 1) and telecommunications. With their attractive yields and expectations of rate cuts extended, banks recovered strongly, especially in March. The consumer sector was a drag with high cost of living and weak economic growth (Figure 3). REITs suffered as expectations in the number of interest rate cuts by the Federal Reserve were lowered and delayed (Figure 4).

Outlook: Economic indicators point to a US economy that is flatlining. Retail spending, PMI, industrial production, employment, and capital expenditure are sluggish (Figures 6 and 7). This is despite aggressive fiscal deficits to prop up the economy (Figure 8). The Congressional Budget Office forecasts another US$1.56tr (5.6% of GDP) deficit stimulus to the US economy in 2024. The huge deficit spending will cap the downside to economic growth. Apart from the government, consumer spending is holding up despite weakening disposal income (Figure 9). We believe higher borrowings (Figure 10) and wealth effect (housing and equity) are supporting consumption spending. The lagged impact of higher interest rates, diminishing pandemic savings, and repayment of student loans will persist as a drag on the economy. On interest rates, inflation is becoming stickier than expected (Figure 11). The deflation in goods prices has started to stall, and services are not turning down quickly enough. Inflation becomes a challenge in 2H24 as base effects will cap the downside. Another worry is creeping oil prices from supply cuts. Our base case of two rate cuts in 2H24 is unchanged.

The Singapore economy is similarly drifting sideways. Exports are recovering but against a collapse in 2023 (Figure 12). Retail sales are stable, supported by rising wages and the availability of jobs. The key strength of Singapore equities is the dividend yield of 5.6% (Figure 13), and it is a steadfast currency. The Singapore dollar is supported by its rising foreign reserves (Figure 14), persistent current account surplus (Figure 15), and only AAA-rated sovereign in Asia.

Recommendation: The lack of economic momentum and unclear path to rate cuts, keeps us cautious on Singapore equities. Dividends will again be the primary source of return for investors. REITs suffered this quarter as interest rate expectations climbed by 90bps since December (Figure 16). Markets are now rolling back their expectations towards two rate cuts in 2024. Despite interest rate cuts, REITs will still face sluggish dividends this year. Interest rate pressure will persist due to the unwinding of interest rate hedges. The domestic sectors with momentum are construction and tourism. Construction will ride on record-high and stable construction contracts. Tourism is surging again after the lull in 4Q23. Arrivals are up 50% in the first two months of this year. We replaced OCBC with DBS in our model portfolio for its dividend visibility. DBS surprised the market with aggressive dividend plans and a committed yield for 2024 of 6.7%, paid quarterly. The debate will be about DBS's ability to sustain earnings as interest rates peak. Net interest margins will be supported by the higher proportion of fixed deposits, rolling over their fixed rate assets at higher yield and increasing the duration of their book. Other earnings drivers will be fee income as risk appetite in wealth management returns and modest loan growth. DBS is also well capitalised with the recapitalisation for new Basel rules plus management overlay in general provisions. Another stock we added was Cromwell European REIT. The REIT trades at an attractive yield of 10%. The portfolio occupancy has been stable, rental reversions of 6% and managed to dispose assets at a 15% premium. We still expect dividends to soften this year but remain attractive. An added positive is the prospect of a rate cut by the European Central Bank ahead of the Fed. Cromwell will replace Fraser's Centrepoint Trust, which has already rallied with the inclusion into the Straits Times Index to replace Emperador. The weakest names in our model portfolio were CapitaLand Investment (CIL) and ThaiBev. CLI is building a valuable fund management franchise with the intention of double the fund size in five years. For ThaiBev, we expect the economy to revive, led by a US$14bn cash handout and export recovery.

1Q24 performance

Figure 1: Attractive yields paid by banks

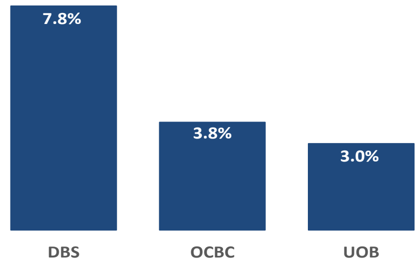


Figure 2: Cyclical bets returning

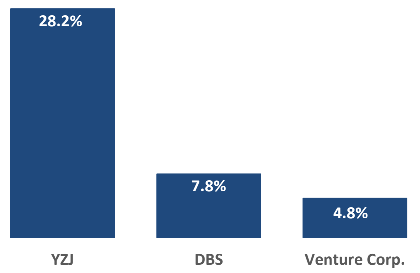


Figure 3: Consumer stocks a drag

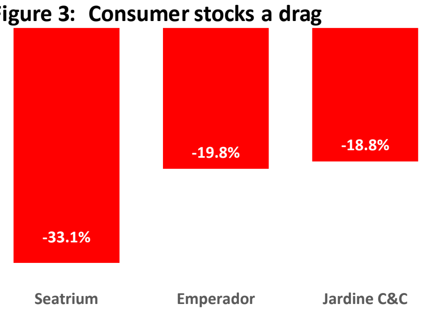
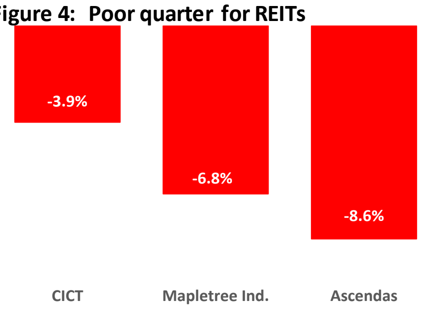


Figure 4: Poor quarter for REITs



Source (Fig 1-4): PSR, Bloomberg, 29Mar24

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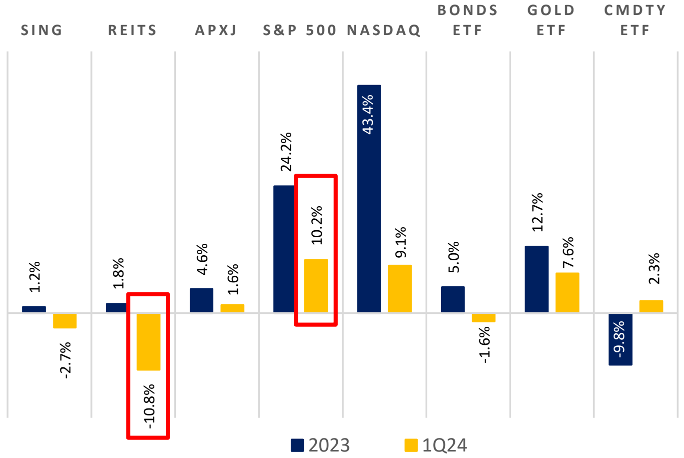
Figure 5: Interest-sensitive assets lose out to US equities

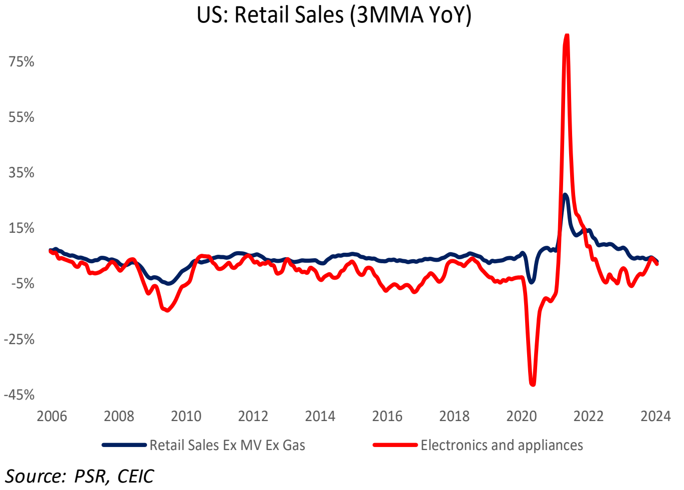


Source: PSR, Bloomberg

Figure 6: Corporates are not spending

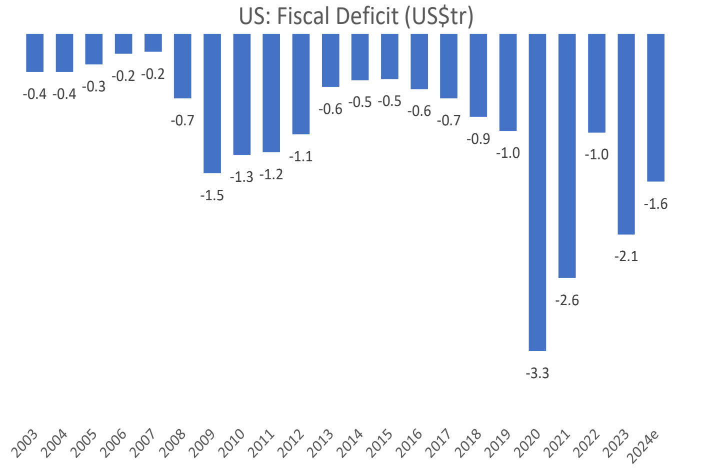
Source: PSR, CEIC

Figure 7: Retail sales moving sideways



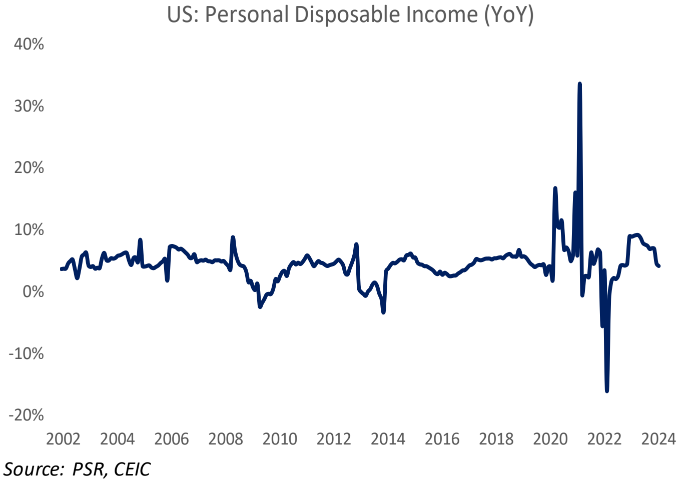
Source: PSR, CEIC

Figure 8: Major US$1.6tr or 5.6% of GDP stimulus underway



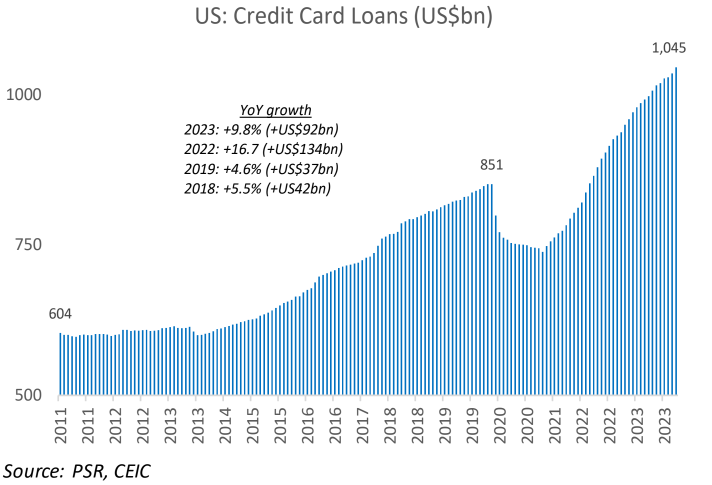
Source: PSR, CEIC

Figure 9: Income levels are slowing back down



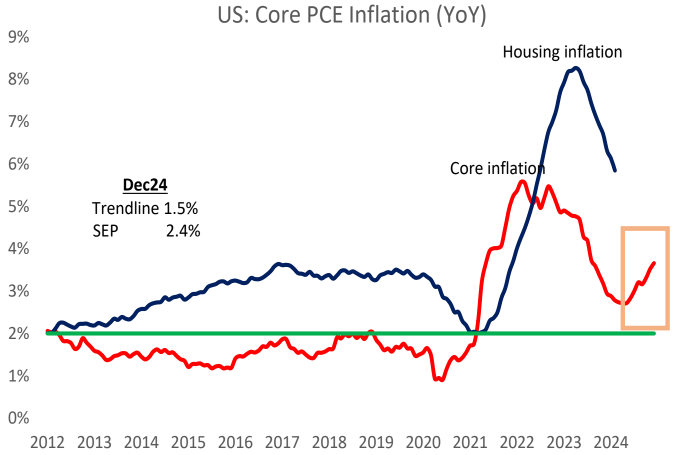
Source: PSR, CEIC

Figure 10: Households relying more on expensive credit card loans



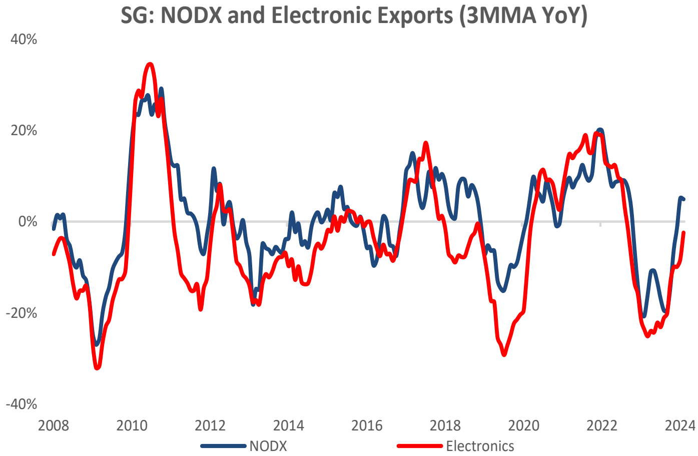
Source: PSR, CEIC

Figure 11: Inflation turning stickier than expected



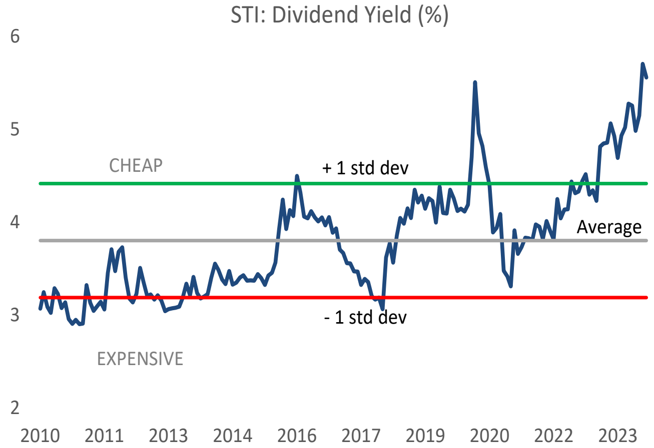
Source: PSR, CEIC

Figure 12: Export bump due to the collapse last year



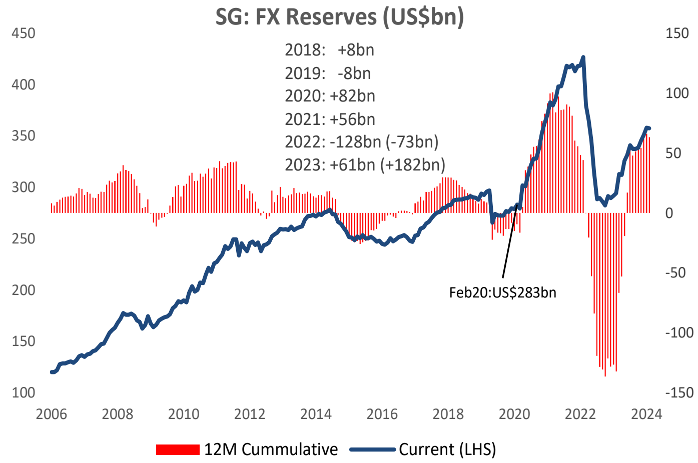
Source: PSR, CEIC

Figure 13: Rising back to record yields



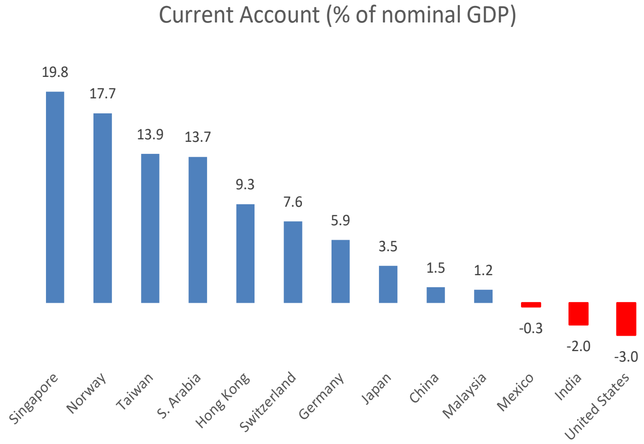
Source: PSR, Bloomberg

Figure 14: US$253bn flowed in since the pandemic



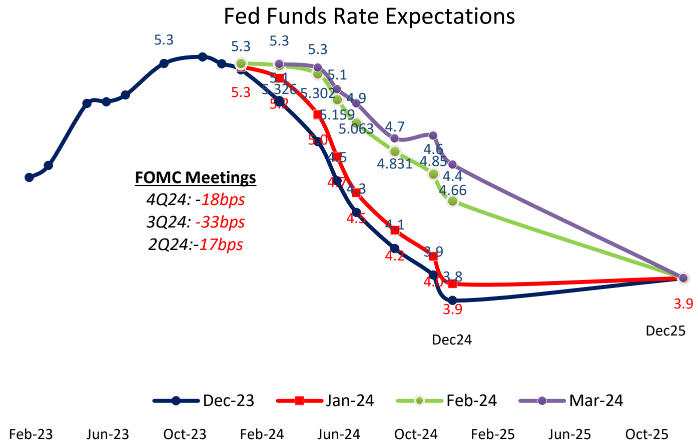
Source: PSR, CEIC

Figure 15: Highest surplus amongst developed countries



Source: PSR, CEIC

Figure 16: Fed rates expectations climbed 90bps from December 2023



Source: PSR, Bloomberg

Phillip Absolute 10

Our model portfolio was down -1.1% YoY during the quarter. Property and consumer names suffered the largest losses. CapitaLand's earnings declined due to renminbi weakness, a decrease in event-driven fees, revaluation losses, and negative rental reversion in China. ThaiBev's beer operations in Thailand and Vietnam continue to contract. The best performers were Keppel Ltd, ST Engineering, and China Aviation.

3Q23 - Add: Thai Beverage; **Remove:** DBS
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

Strategy commentary: With a lacklustre economic backdrop, our portfolio is focused on attractive dividend and earnings visibility. We generally underweight cyclical unless there is the visibility of earnings growth such as China Aviation, Valuetronics and ComfortDelgro.

Changes to model: We removed Frasers Centrepoint Trust and OCBC. Cromwell pays a higher dividend yield and a portfolio of assets starting to stabilise in valuations and occupancy. DBS enjoys a higher dividend yield and higher earnings stability in an environment of peak interest rates.

Figure 17: Monthly movements

	Absolute 10	SING
Jan24	-0.9%	-2.7%
Feb24	-0.9%	-0.4%
Mar24	0.7%	2.6%
Apr24		
May24		
Jun24		
Jul24		
Aug24		
Sep24		
Oct24		
Nov24		
Dec24		
YTD	-1.1%	-0.5%
Out/(Under)perf.		-0.7%

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

Stock commentaries

Company	Comments
1. Cromwell REIT (New)	Divestment and redevelopment strategies in place to drive organic growth while keeping capital management in check. We expect a forward dividend yield of c.10%.
2. DBS (New)	FY23 DPS was raised 28% YoY to S$1.92. With quarterly dividends of 54 cents, we expect FY24e dividend yield of 6.7% (post bonus share issue). Recovery in loans growth and fee income will sustain earnings momentum.
3. China Aviation	We expect margin expansion in the trading operations from higher end-to-end sales directly to airline customers. Shanghai airport volumes have room to grow, with China international flights at 37% below pre-Covid levels
4. ST Engineering	Defence and public security remain key earnings drivers in FY24e, underpinned by digital solutions, AI-enabled command and control, and cybersecurity. Transcore will deliver its first full year of positive contribution from FY24e.
5. ThaiBev.	We expect a consumption rebound in Thailand led by macro improvement from aggressive fiscal expansion plans. The next phase will be beer recovery in Vietnam, which is dependent on export growth returning to the country.
6. Valuetronics	Valuations are attractive, as the company trades at 90% of net cash. The company also pays a 6% dividend yield and a share buyback plan of around 58mn shares. Growth is returning with 4 new customers.
7. CapitaLand Inv.	Leasing and lodging operations will be used to recover from the re-opening and recovery in China. Recurring fund management fees continue to grow (+9.3% in FY23). Target to double funds under management to S$200bn in five years.
8. ComfortDelGro	FY24e is another year of growth due to lagged pricing in domestic rail, a rising taxi fleet in China, new Zig platform fees, higher taxi commissions in Singapore, and repricing of UK bus fees.
9. Singtel	Multiple share price catalysts include higher mobile prices (in India, Thailand, Australia, and Indonesia), plans to reduce costs by S$600mn over 3 years, and $4bn of assets to monetize (real estate, data centres, and regional associates).
10. Keppel Ltd	The near-term share price catalyst would be asset monetisation. Keppel targets to monetise a further S$5-7bn of assets by 2026, after a slow FY23 (S$0.9bn). It has S$12.6bn worth of assets on its balance sheet that can be disposed.

Figure 18: Phillip Absolute 10 for 2Q24

Company	1M	3M	YTD	Rating	Target Px (S$)	Share Px (S$)	Upside	Mkt Cap (US$m)	Dvd. Yield
Yield									
CromwellREIT-EUR (New)	-3.5%	-2.8%	-2.8%	**Buy**	**1.91**	1.38	38%	837	11.4%
DBS (New)	8.1%	7.8%	7.8%	**Buy**	**38.90**	36.03	8%	69,039	5.3%
Dividend / Earnings Growth									
China Aviation	-3.7%	3.4%	3.4%	**Buy**	**1.05**	0.91	16%	577	5.6%
ST Engineering	1.0%	3.3%	3.3%	**Accumulate**	**4.50**	4.02	12%	9,295	5.0%
Thai Beverage	-3.0%	-6.7%	-6.7%	**Buy**	**0.67**	0.490	37%	9,125	4.5%
Valuetronics	-0.9%	-3.4%	-3.4%	**Buy**	**0.70**	0.575	22%	174	4.2%
Re-rating Plays									
CapitaLand Investment	-3.6%	-15.2%	-15.2%	**Buy**	**3.38**	2.68	26%	10,086	4.5%
ComfortDelGro	3.7%	0.0%	0.0%	**Buy**	**1.63**	1.40	16%	2,247	4.8%
Singtel	7.7%	2.4%	2.4%	**Buy**	**2.80**	2.53	11%	30,945	3.9%
Keppel Ltd	1.4%	3.8%	3.8%	**Accumulate**	**7.98**	7.34	9%	9,654	4.6%
Average	0.72%	-0.7%	-0.7%				19%		5.4%

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

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