Phillip 2Q22 Singapore Strategy

A stagflation shelter

SINGAPORE | STRATEGY (Amended)

5 April 2022

Review: The STI was up 9.1% in 1Q22. This was its best performance since an 11.3% rally in 1Q21. Banks (Figure 1) and conglomerates (Figure 3) led the gainers. Rising interest rates was the dominant theme in the quarter. Banks rallied as higher interest rates will lift margins. On the flip side, REITs retreated (Figure 2) as higher rates can affect dividend growth and lower the attractiveness of their leveraged dividend yields. Conglomerates were the major outperformers from higher electricity spreads, increased dividends and aggressive share buybacks.

Outlook: The global economy is facing stagflation (i.e. high prices but lower incomes) shock. Inflation has been made worse by the Russia-Ukraine conflict, which has driven up crude oil prices to their highest in 13 years. Global growth is expected to decelerate as interest rates continue to climb. The yield curve has recently inverted, placing the market back on recession watch (Figure 5). The debate rages as to whether the Fed can orchestrate a soft landing for the economy. We are more upbeat. In the recent six rate-hiking cycles, two led to a soft landing (no recession) and three were followed by recessions that were not entirely triggered by the hiking cycle (Figure 6).

The Singapore market stands out as a shelter in the current stagflation environment. We will say this - it is an alpha generator in global equities. Almost every sector in the STI enjoys a tailwind: (i) Bank earnings will enjoy a huge lift as we enter an interest-rate cycle (Figure 7). A 100 basis point rise in rates can increase earnings by around 18%. We believe the three domestic banks have excess deposits or float totalling S$160bn that can immediately benefit from the rise in short-term rates. Banks are well represented, with a 45% weighting on the STI; (ii) The reopening of borders and relaxation of social restrictions will be a further boost for corporate earnings. Primary beneficiaries are transport, telecommunications, retail and hospitality. They make up a combined 20% of the STI (Figure 8). Tourism accounted for 5% of GDP in 2019 (Figure 9). So, it becomes a huge economic driver over the next 12-18 months. (iii) Singapore has not been dragged down by the current de-rating of tech stocks from stretched valuations, regulatory risks and supply-chain disruptions. Tech is only 2% of the STI; and (iv) Another 6% of the STI are rerating candidates due to share buybacks, restructuring and defence-related spending. Finally, the Singapore dollar is expected to stand firmer against regional currencies with the MAS tightening bias.

Recommendation: The Ukraine conflict has long-term implications for several sectors, most notably defence. An unfortunate arms race has developed due to this conflict. Germany kick-started the race with a one-off EUR100bn fund to upgrade its defence budget. It will be investing more than 2% of its GDP in defence. We worry every country will now look to outdo one another in military spending. The two stocks with defence-related revenue are ST Engineering (STE SP, Not Rated) and CIVMEC (CVL SP, Not Rated). Another repercussion is the diversification of energy sources away from Russian energy and the volatility (or unreliability) of renewable energy. Renewable is still dependent on the weather. Last year, renewable energy production in the UK fell 15% (Figure 10). A repricing of energy is underway after years of underinvestment in fossil fuels. Coal looks interesting, as even the German Chancellor mentioned the need to build a reserve for coal. In Singapore, we favour the financial, construction and reopening sectors. Financials will ride the rise in interest rates. The Fed funds rate is expected to rise by more than 2 percentage points this year (Figure 11), producing a two-year tailwind for the banks and exchanges. Construction, namely building materials, will gain from a return of foreign labour and construction activity. Following the government's relaxation of border controls and group activities (aka "Near Freedom Day") on 29 March, reopening stocks look attractive to us. Comfort Delgro (CD SP, BUY, TP S$1.80) is down 48% from pre-pandemic levels despite generating S$905mn of FCF over the past two pandemic years. Telcos are another reopening sector. Roaming is around 15% mobile revenue and almost pure profit. We estimate roaming is around 50% of Starhub's (STH SP, NEUTRAL, TP S$1.35) 2019 PATMI.

1Q22 performance

Figure 1: Great quarter for the banks

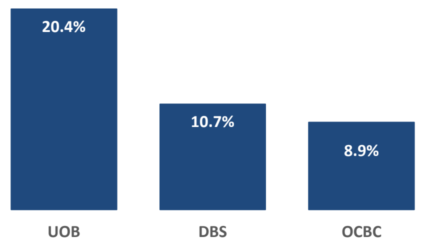


Figure 2: REITs under pressure

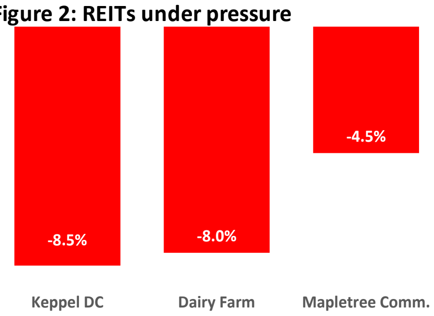
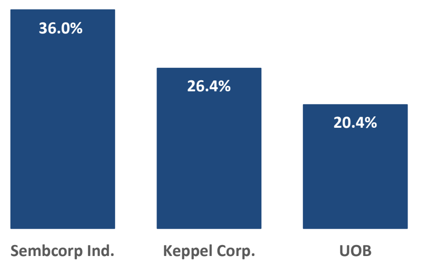


Figure 3: Major gains for utilities



Source (Fig 1-3): PSR, Bloomberg, 31 March 2022

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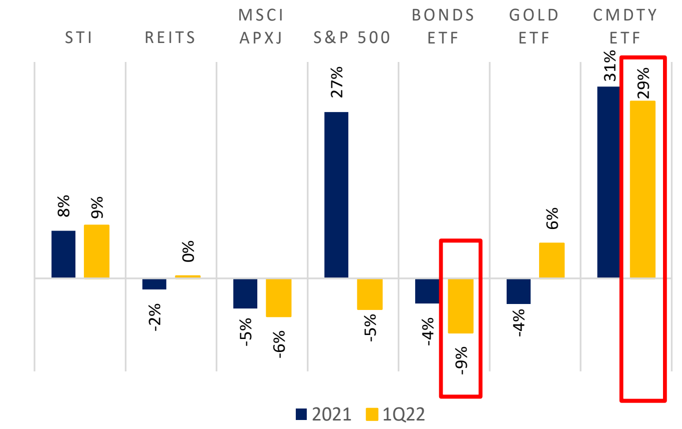
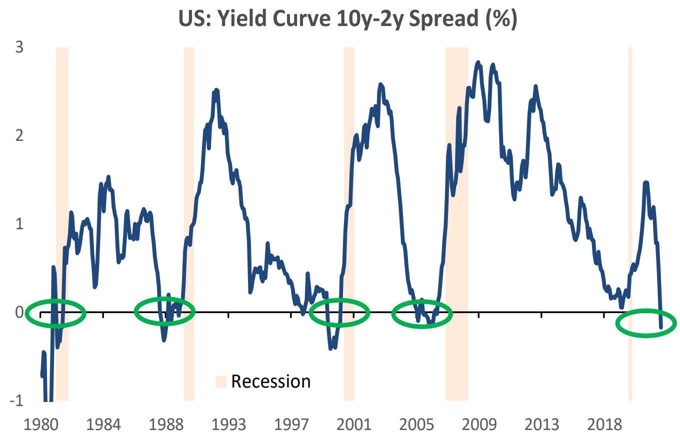
Figure 4: Commodities the best performer 1Q22, bonds worst



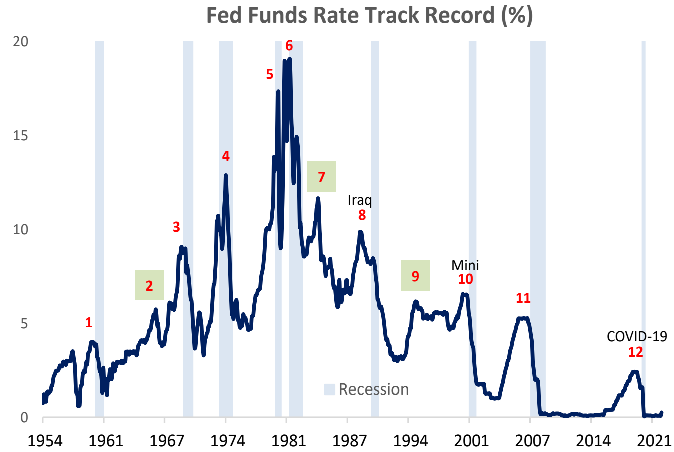
Source: PSR, CEIC

Figure 5: Back on recession watch



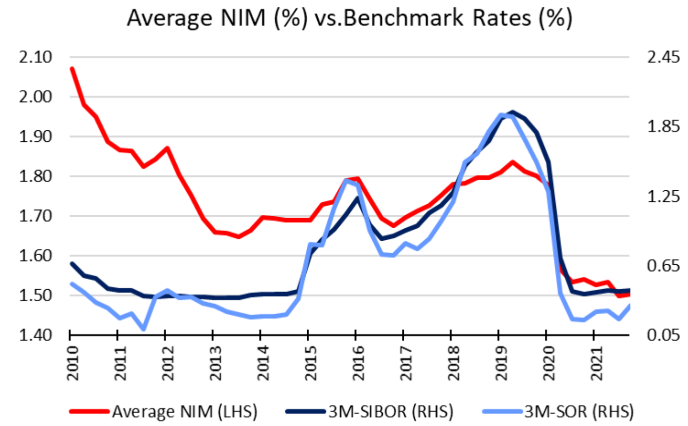
Source: PSR, CEIC

Figure 6: 5 of 6 hiking cycles not necessarily triggered a recession



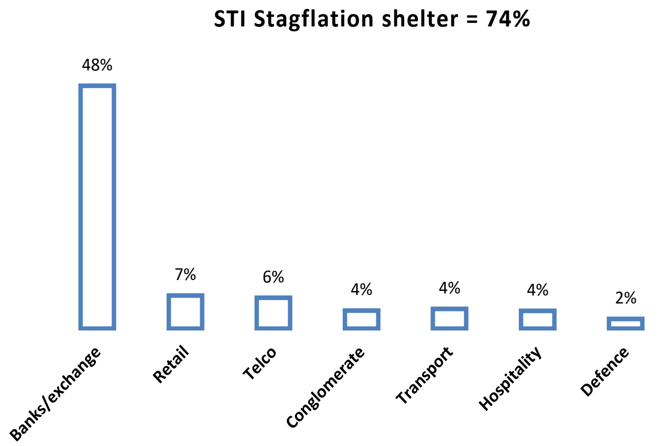
Source: PSR, CEIC

Figure 7: Higher interest rates mean higher interest margins



Source: PSR, Banks

Figure 8: Around 3/4 of the index enjoys a tailwind

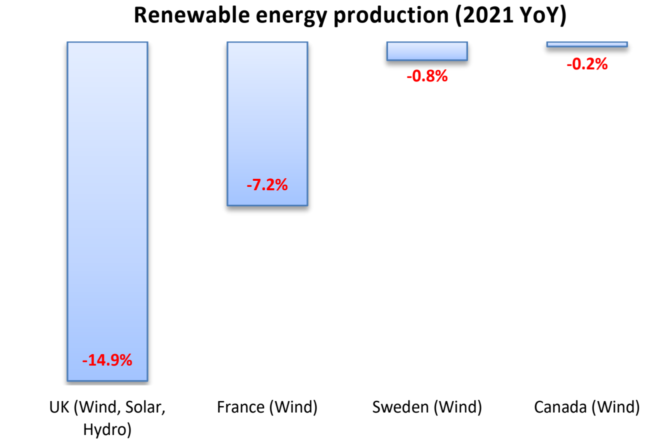


Source: PSR, CEIC

Figure 9: Tourism a missing part of GDP growth

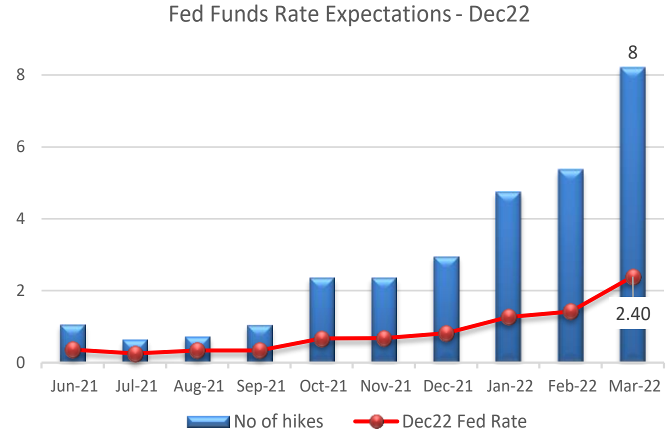
Source: PSR, CEIC

Figure 10: Renewable energy depends on the weather



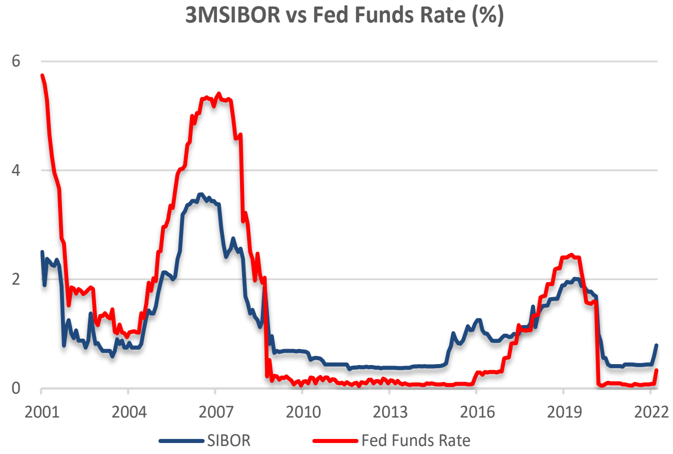
Source: PSR, CEIC

Figure 11: Rates expected to rise more than 200 bps by end Dec22



Source: PSR, CEIC

Figure 12: 93% correlation SIBOR and Fed rate since 2007

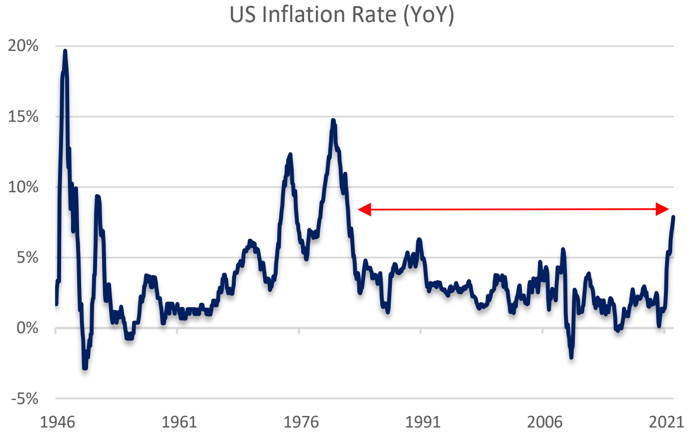


Source: PSR, CEIC

Figure 13: Europe starting to decelerate sharply

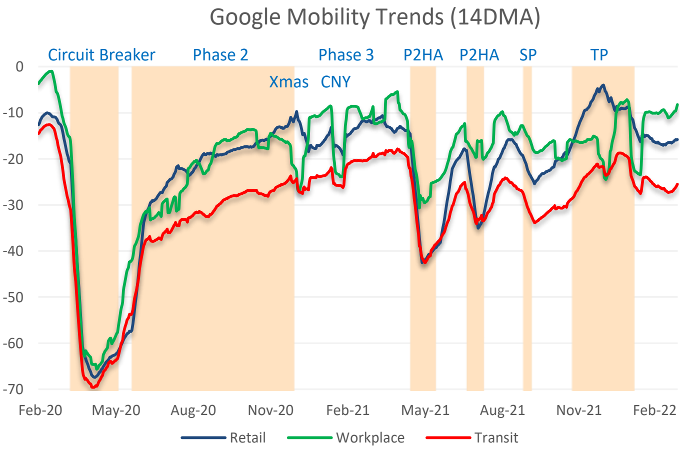
Source: PSR, Bloomberg

Figure 14: Inflation highest in 40 years, even before Ukraine



Source: PSR, CEIC

Figure 15: Retail and travel 20-30% below pre-pandemic



Source: PSR, CEIC, Google Mobility

Phillip Absolute 10

Mid-cap stocks were a drag on our 1Q22 performance. Softer margins in Del Monte 3Q22 results drove weakness in share price, down 6% during the quarter. We expect earnings to recover in 4Q22. Price increases in their products have a lagged impact on margins. HRnetGroup share price was down 4% during the quarter despite a 37% YoY surge in 2H21 earnings. The growth in hirings and expansion into overseas markets will be key earnings drivers in 2022. Q&M was the worst performer, down 12% during the quarter. Disappointing earnings in 4Q21 due to higher wages and reduced use of COVID-19 PCR tests hurt sentiment. We remain optimistic as the company's dental clinics in Singapore are expected to grow at least 16% CAGR till 2023.

3Q21 - Add: Ascendas REIT, DBS; **Delete:** Manulife US REIT, PropNex
4Q21 - Add: CDL, HRnetGroup; **Delete:** Ascendas REIT, Capitaland Investment (formerly CapitaLand)
1Q22 - Add: Del Monte Pacific; **Delete:** Thai Beverage
2Q22 - Add: OCBC; **Delete:** Q & M Dental

Strategy commentary: Our portfolio is leveraged on rising interest rates and the reopening theme. We expect upside in dividends and earnings surprises for DBS and OCBC. Our reopening beneficiaries are CDL, ComfortDelgro and Frasers Centrepoint Trust. Asian PayTV offers an attractive 7% yield with upside from sales of 5G backhaul to mobile operators. HRnetGroup can ride on growth in hiring volumes and salaries. Keppel Corp can benefit from the disposal of loss-making and other low return businesses.

Deletions from our model: We removed Q &M due to slower earnings momentum from the decline in COVID-19 PCR test revenue.

Figure 16: Monthly movements

	Absolute 10	STI
Jan22	0.0%	4.0%
Feb22	1.1%	-0.2%
Mar22	3.7%	5.1%
Apr22		
May22		
Jun22		
Jul22		
Aug22		
Sep22		
Oct22		
Nov22		
Dec22		
YTD	4.9%	9.1%
Out/(Under)perf.		-4.2%

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	Our proxy for the tourism recovery with added stability from a growing portfolio of extended-stay assets which currently accounts for 16% of AUM.
2. Asian PayTV	Current dividend yield of 7.5% or S$18mn is well-supported by the annual free cash flow of S$70mn to S$80mn.
3. DBS	Largest beneficiary of rising interest rates and improving economic conditions. Benign provisioning cycle with credit cost guidance of 12bps below pre-pandemic levels.
4. Del Monte	US subsidiary DMFI enjoys a market leader position, while DMPI holds dominant market shares in certain segments in the Philippines. Valuation is attractive at 8x P/E.
5. FCT	Necessity-driven purchases by surrounding households have kept tenant sales high throughout the pandemic, demonstrating the resilience of suburban malls. Rental reversions already turning positive.
6. HRnetGroup	One of the largest recruitment agencies in the region benefiting from a rise in hiring activities.
7. OCBC	OCBC is our preferred pick amongst the three banks due to attractive valuations, upside in dividend from the 15% CET 1 buffer and lower provisioning as Indonesia and Malaysia economies recover.
8. CDL	Healthy inventory of 3k units to capture the peak of the property cycle and beneficiary of a recovery in hospitality. UK commercial properties and hotel portfolios carry monetisation potential.
9. ComfortDelgro	Share price remains 37% below pre-pandemic levels despite the surge in cash flows over the past two years.
10. KeppelCorp	The re-rating catalyst is the disposal of its loss-making offshore & marine business and related assets and the successful disposal of its logistics business.

Figure 17: Phillip Absolute 10 for 2Q22

Company	1M	3M	YTD	Rating	Target Px (S$)	Share Px (S$)	Upside	Mkt Cap (US$m)	Dvd. Yield
Yield									
Ascott Residence Tr.	9.7%	9.7%	9.7%	**Accumulate**	**1.23**	1.13	9%	2,735	3.8%
Asian PayTV	-1.5%	0.0%	0.0%	**Accumulate**	**0.15**	0.134	12%	178	7.5%
Dividend / Earnings Growth									
DBS	5.9%	9.7%	9.7%	**Accumulate**	**41.60**	35.83	16%	67,977	3.3%
Del Monte Pacific	-5.0%	-6.2%	-6.2%	**Buy**	**0.63**	0.38	66%	545	3.2%
Frasers Centrepoint Tr.	8.0%	5.6%	5.6%	**Buy**	**2.64**	2.44	8%	3,060	5.0%
HRnetGroup	-0.6%	-4.3%	-4.3%	**Buy**	**1.18**	0.77	53%	570	3.2%
OCBC (New)	6.1%	8.6%	8.6%	**Buy**	**14.22**	12.38	15%	40,990	4.3%
Re-rating Plays									
City Developments	10.5%	15.6%	15.6%	**Buy**	**9.19**	7.87	17%	5,262	1.0%
ComfortDelgro	5.7%	6.4%	6.4%	**Buy**	**1.80**	1.49	21%	2,380	2.4%
Keppel Corp.	7.2%	25.4%	25.4%	**Buy**	**7.07**	6.42	10%	8,522	5.1%
Average	4.6%	7.1%	7.1%				23%		3.9%

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

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