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Phillip 3Q22 Singapore Strategy

Demand destruction spiral

SINGAPORE | STRATEGY

4 July 2022

Review: The STI was down 9.1% in 2Q22. After reversing all the gains chalked up this year, the index was flat in 1H22. Its largest drags were banks (Figure 1), the consumer sector and industrial REITs (Figure 2). Despite rising rates that will benefit banks' interest margins, recession worries buffeted cyclicals, particularly the banks. Reopening proxies also suffered. These included Genting Singapore and SATS. The biggest gainers were helped largely by company-specific factors (Figure 3). Dividends in specie of its financial arm benefitted Yangzijiang Shipping. Stellar earnings at Astra International provided a tailwind for Jardine Cycle and Carriage. Sembcorp Industries rallied on higher spark spreads in India and Singapore.

Outlook: The global economy is facing a downward spiral of demand destruction, caused by a duet of higher inflation and interest rates. Higher inflation is outpacing income, shrinking household budgets and confidence levels. For corporates, costlier energy and materials eat into margins and force cutbacks in production. The negative spiral that ensues has workers demanding higher wages and corporates jacking up prices. Aggregate demand is further worsened by rising interest rates, triggering a deflationary shock for asset prices. We are in the middle of this downward spiral. It is hard to short-circuit rising inflation without demand destruction. There are silver bullets to lowering inflation but these are of low probability: an end to the Ukraine conflict, lowering of tariffs on goods going from China to the US and higher crude oil production following Biden's visit to Saudi Arabia. The most critical macro call this year will be inflation. We expect inflation to peak by 4Q22, though remaining stubborn. Supply chain conditions are easing (Figures 5, 6), commodity prices are rolling over (Figure 7) and capacity is responding to higher commodity prices, albeit cautiously (Figure 8). Any sustained rally in equities will also depend on the direction of the Federal Reserve's interest rates. Our base case is rates will rise to a neutral level of 3% by the September FOMC meeting. Thereafter, we expect the Fed to step down on its rate-hike cycle to 25 basis points or even pause. Firstly, higher interest rates work with a lag. We believe the Fed will pause to assess economic conditions before resorting to more aggressive moves. Secondly, inflation has largely been driven by supply chain constraints and disruptions. Monetary tools cannot resolve these bottlenecks. As for the threat of recession, leading indicators point to a weakening economy, raising the probability of a recession in the US. But computing probabilities is pointless. A probability of say, 60%, only means the predictors were not wrong, whatever the outcome. Economic conditions in Singapore remain resilient. Industrial growth is hovering at 9% this year. This is slower than last year's 14% but far stronger than the pre-pandemic level of 2% (Figure 9). Foreign direct investments into the country have recovered sharply. They are close to the record levels of 2019 (Figure 10). Employment is surging with record vacancies (Figure 11).

Recommendation: We remain positive on the banking sector. Banks benefit from higher rates through their excess liquidity or float and the repricing of variable loans. Benefits immediately flow through to the bottom line. Weaker macros and inflation will likely lead to modestly higher general provisioning. Staff costs will escalate due to a robust employment market. We prefer OCBC (OCBC SP, BUY, TP S$14.22) for its highest capital ratios, high CASA, exposure to a reopening of China and Hong King and dividend upside. Softer economic conditions will raise provisions but not significantly. For instance, the bank's loan growth has been toeing nominal GDP growth, unlike the 2008 and 2016 provisioning cycles when loans outpaced GDP by 2-5% points over two years (Figure 12). The margin call now is in crypto assets. Residential property prices have been climbing back, to double-digit levels not seen since end-2019 and 2011. New launches have sold more than 70% just over a weekend. A dearth of supply with unsold inventories of 14,000 is the lowest in more than a decade and only 1.2 years to sales (Figure 13). Rising prices work in the favour of developers with planned launches such as City Developments (CIT SP, BUY, TP S$9.19).

2Q22 performance

Figure 1: Banks the worst performers

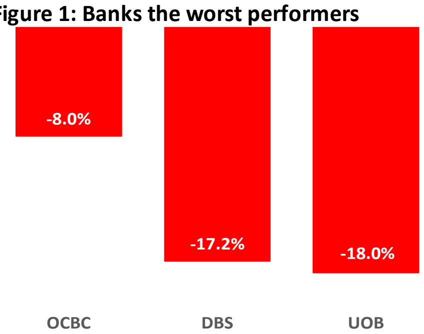


Figure 2: REITs remain under pressure

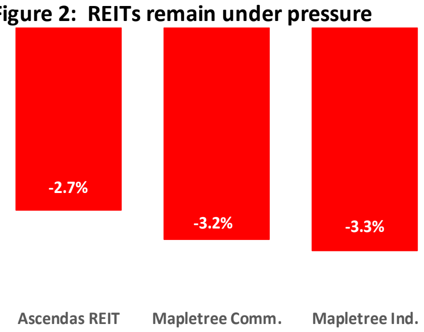
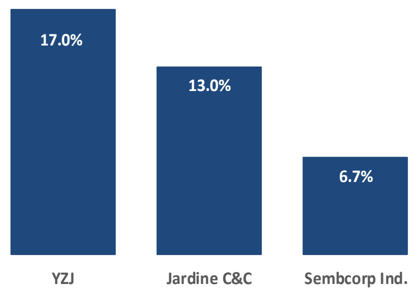


Figure 3: Top gainers during the quarter



Source (Fig 1-3): PSR, Bloomberg, 30 June 2022

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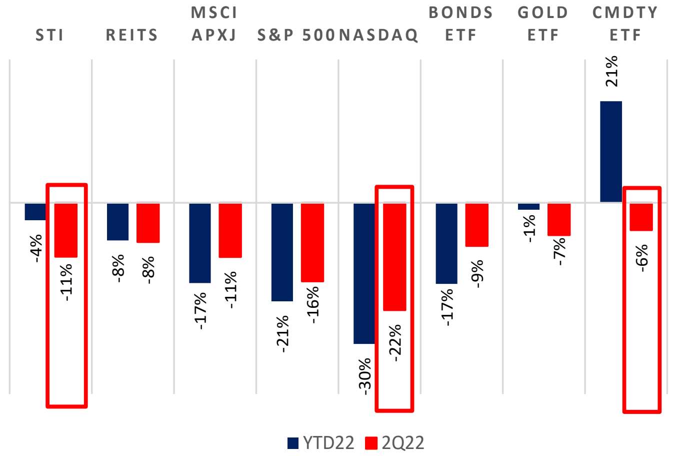
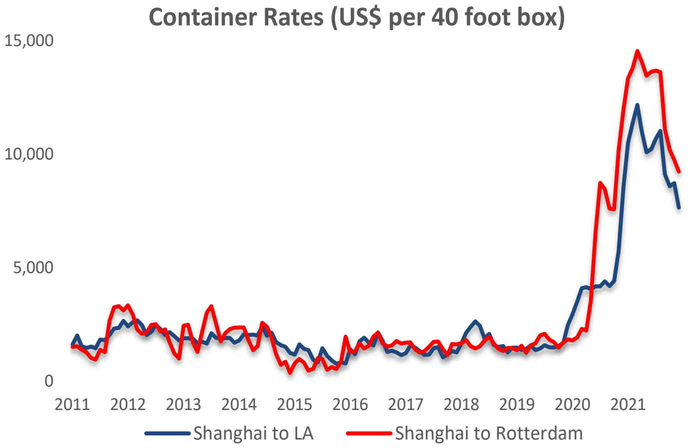
Figure 4: Sell-down on tech and commodity cyclicals



Source: PSR, Bloomberg

Figure 5: Container rates down 37% from the peak

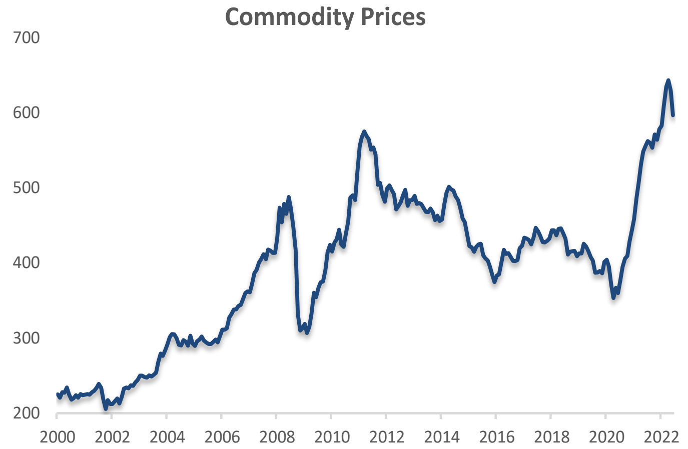


Source: PSR, CEIC

Figure 6: Global supply chain starting to ease

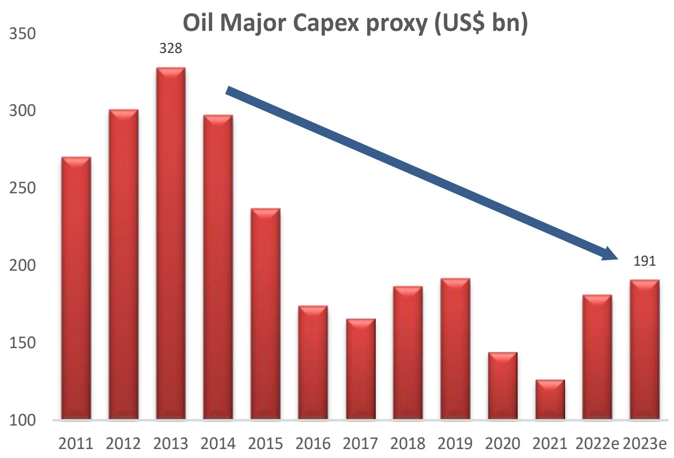
Source: PSR, Federal Reserve

Figure 7: Some signs commodities are rolling over



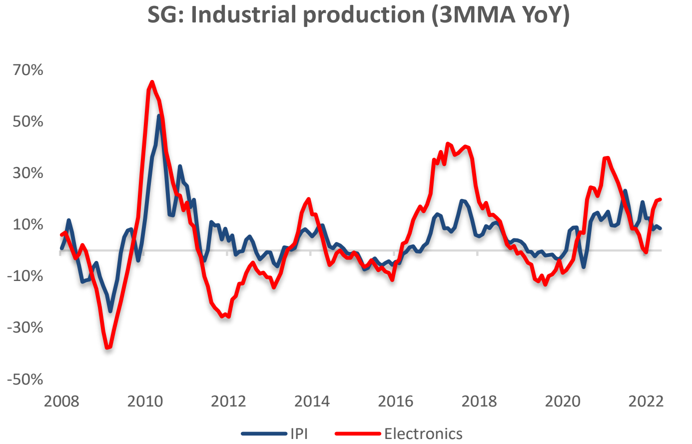
Source: PSR, CEIC, CRB

Figure 8: Oil CAPEX is 40% below peak despite the energy shock



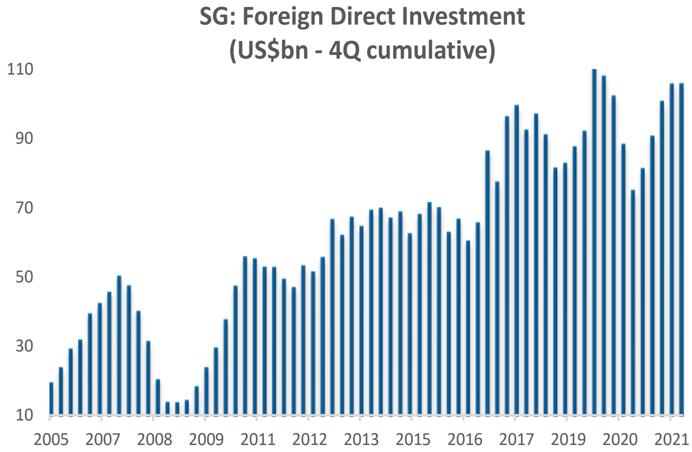
Source: PSR, CEIC

Figure 9: Manufacturing activity above pre-pandemic levels



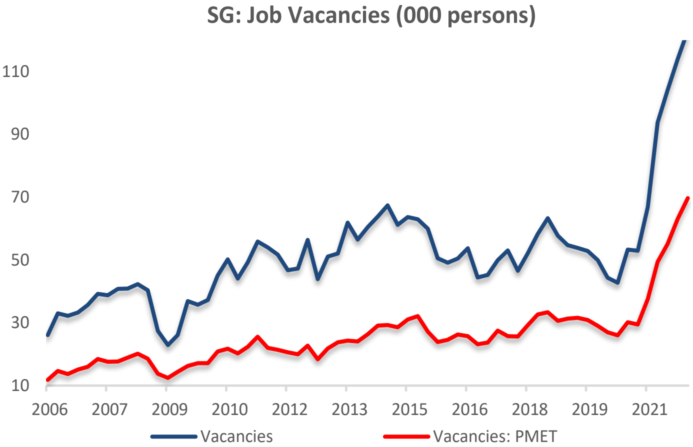
Source: PSR, CEIC

Figure 10: Singapore FDI have climbed back to record



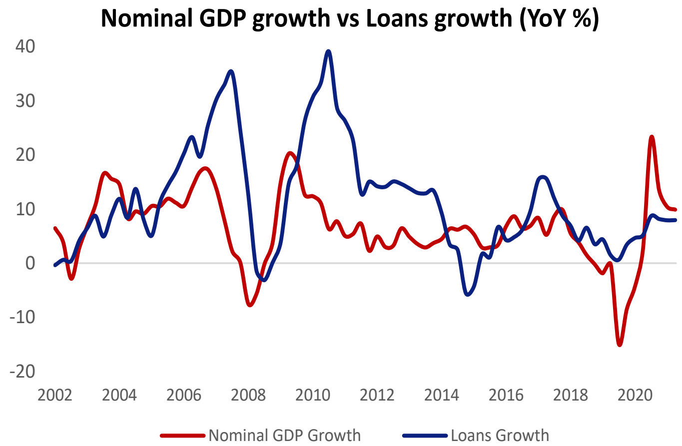
Source: PSR, CEIC

Figure 11: Spike in job vacancies



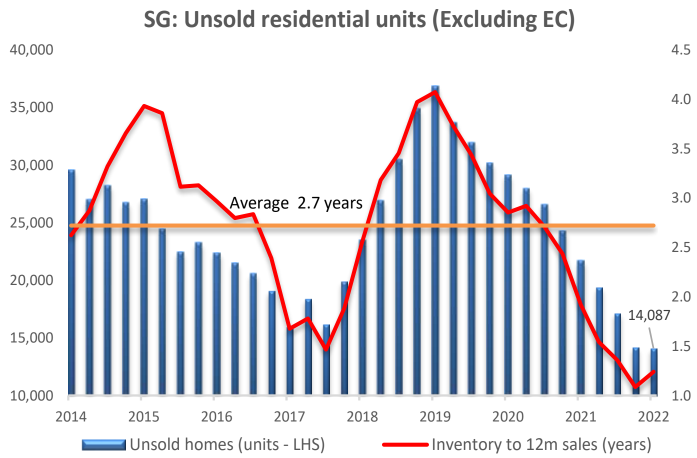
Source: PSR, CEIC

Figure 12: Loans growth not outpacing nominal GDP



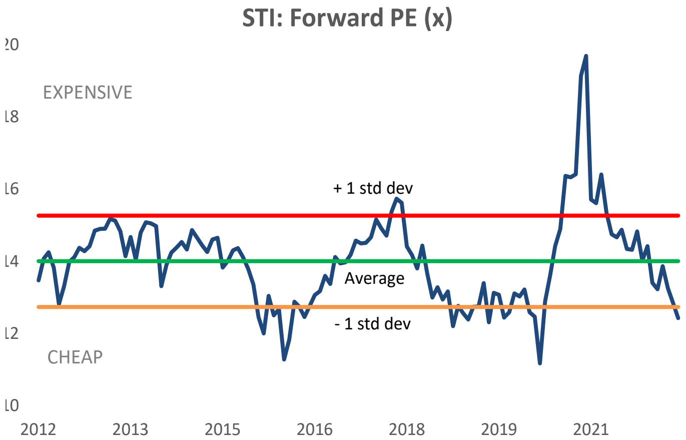
Source: PSR, CEIC

Figure 13: Decade lows in supply or unsold inventories



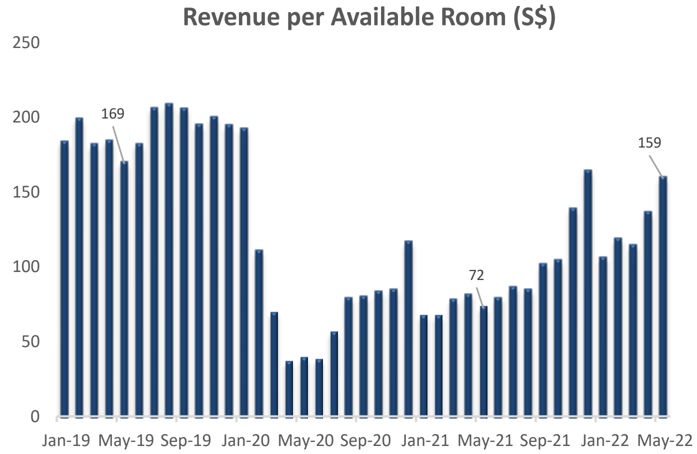
Source: PSR, CEIC

Figure 14: Singapore valuations at attractive levels



Source: PSR, Bloomberg

Figure 15: Sharp recovery in RevPAR, the re-opening theme is intact



Source: PSR, CEIC

Phillip Absolute 10

During the quarter our model portfolio was down 3.7% YoY. Banking stocks were the largest drag on the portfolio: DBS (-17%) and OCBC (-8%). Worries of a global slowdown and recession have punished cyclical stocks. Positive contributors to the portfolio were City Developments, Keppel Corp, Ascott Residence Trust and HRnetGroup. The rebound in property prices post-December 2021 cooling measure will drive up development margins. Keppel Corp rallied following the agreement to dispose of the marine business and uncompleted rigs. Ascott rides on recovery in international travel and RevPAR. HRnetGroup pays out a dividend yield of 5% and will benefit from the spike in job demand and vacancy rates.

4Q21 - Add: CDL, HRnetGroup; **Delete:** Ascendas REIT, CapitaLand Investment
1Q22 - Add: Del Monte Pacific; **Delete:** Thai Beverage
2Q22 - Add: OCBC; **Delete:** Q & M Dental
3Q22 - Add: Singtel; **Delete:** Frasers Centrepoint Trust

Strategy commentary: Rising interest rates make it harder to keep leveraged yield stocks such as REITs in the portfolio. Our strategy is to ride on rising interest rates through banks with their variable rate loans and excess deposits. Beneficiaries of the re-opening of borders and activities are Ascott Residence Trust, ComfortDelgro and SingTel. Our mid-cap growth names are Del Monte Pacific and HRnetGroup.

Deletions from our model: We removed Frasers Centrepoint Trust. We find the current dividend yields unattractive as interest rates climb up further. We added Singtel due to the return of roaming revenue as borders re-open, economic recovery in emerging markets and potential restructuring or monetization Bharti and Optus.

Figure 16: 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		
Aug22		
Sep22		
Oct22		
Nov22		
Dec22		
YTD	1.0%	-0.7%
Out/(Under)perf.	1.7%	

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 at an early stage of recovery. The first wave is leisure travellers, the next will be business travel and the final recovery phase is the re-opening of China borders.
2. Asian PayTV	Dividend yield of 8% is attractive and well supported by annual free cash flow of S$70-S$80mn vs $18mn payout.
3. DBS	With the highest CASA ratio, DBS is the major beneficiary of rising interest rates. We expect a benign provisioning cycle due to tepid lending and resilient real estate prices.
4. Del Monte	4Q22 earnings surged 38% YoY, helped by strong sales in the US. Revenue in the US jumped 25% on the back of new product sales, rising prices and households shifting consumption away from restaurants to home dining.
5. HRnetGroup	With 700 recruiters across the region, the company will benefit from the rise in volume and salary of hiring.
6. OCBC	OCBC is our preferred pick due to the upside in dividends and lower provisioning cycle.
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 to ride the resilient Singapore residential market. Another driver of earnings is the recovery in the hospitality sector. The stock trades at a 43% discount to RNAV.
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 its plan for the $500mn in cash it will receive from the SMM deal.

Figure 17: Phillip Absolute 10 for 3Q22

Company	1M	3M	YTD	Rating	Target Px (S$)	Share Px (S$)	Upside	Mkt Cap (US$m)	Dvd. Yield
Yield									
Ascott Residence Tr.	-1.7%	0.9%	10.7%	**Accumulate**	**1.23**	1.14	8%	2,683	3.8%
Asian PayTV	-5.3%	-7.5%	-7.5%	**Accumulate**	**0.15**	0.124	21%	160	8.1%
Dividend / Earnings Growth									
DBS	-4.1%	-17.2%	-9.1%	**Buy**	**41.60**	29.68	40%	54,688	4.0%
Del Monte Pacific	5.6%	-1.3%	-7.4%	**Buy**	**0.69**	0.38	84%	522	4.5%
HRnetGroup	6.9%	0.6%	-3.7%	**Buy**	**1.18**	0.78	52%	556	5.4%
OCBC	-3.7%	-8.0%	-0.1%	**Buy**	**14.22**	11.39	25%	36,651	4.7%
Singtel (New)	-2.3%	-4.2%	9.1%	**Accumulate**	**3.05**	2.53	21%	29,915	3.7%
Re-rating Plays									
City Developments	-1.3%	6.2%	22.8%	**Buy**	**9.19**	8.15	13%	5,292	1.0%
ComfortDelgro	-2.8%	-6.0%	0.0%	**Buy**	**1.80**	1.4	29%	2,172	3.0%
Keppel Corp.	-5.8%	1.1%	26.8%	**Buy**	**7.07**	6.49	9%	8,229	5.1%
Average	-1.5%	-3.5%	4.1%				30%		4.3%

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

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