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PIAS INVESTMENT OUTLOOK Q3 2019

Global markets began the first half of 2019 positively, with nearly all asset classes proved to be exceptional (Chart A), mostly exceeding our expectations. Against this backdrop of slowing global economic growth, second quarter continued first quarter bullish sentiments as risk assets such as stocks and credits rallied along with traditional safe haven assets, such as developed market government bonds, gold and the yen. Reversing the weakness in risk assets in May, June's strong performance has made it a good quarter and certainly a good start to the year.

Although markets have rebounded impressively so far this year, recession risk are certainly higher than they were at the start of the year as the U.S. yield curve inversion would suggest. The 2019 plunge in key interest rates is now mainly telegraphing a dire assessment of the world economy. Bond markets are expressing a view that has been developing since late 2018 that the neutral policy rate in key currency areas is lower than previously thought. It is possible the bond market has over-reacted to trade-war fears and weakness in trade data. With current domestic demand relatively good in most economies and spending continuing to be bolstered by the strong labor market, risk of contraction over the near term is relatively contained and we will take the inversion much more seriously if it persists for a couple more months.

Global growth prospects have softened, as earlier signals of a modest rebound led by China have fallen victim to protracted uncertainties about global trade relations. Thus far, the future path of trade policy is likely to be a key catalyst for financial markets and remains the primary risk to the global expansion. It is nearly impossible in predicting the path it will head with any degree of conviction, making investors ponder from the knock-on effects on global supply chains. Up till march, global freight volumes have seen to be stabilized. Elsewhere, financial markets are more sensitive than the wider economy to trade uncertainty as this would hinder the central banks latitude to adjust monetary conditions. Aggressive trade disruption could also result to policy errors which may threaten economic growth.

We think US equities are overvalued in our central scenario of escalation of US-China trade tensions. Growth of economic activity has slowed from its solid rate in the

fourth quarter 2018. U.S. manufacturing cycle slowed abruptly at the end of 2018 (Chart B) and remains weak at mid-year 2019 with recent indicators point to slower growth of household spending and decline in inflation. To be clear, we are not in a recession, but the disconcerting dynamics sends a warning signal. Elsewhere in Europe, we expect low-single-digit upside for the remainder of 2019. Valuations are not excessive but we expect EPS growth to be subdued. The region remains under-owned, so any reduction in geopolitical and macro risks could help unlock latent demand. EM Asia economic backdrop remains encouraging and valuation remains cheap relative to the developed markets. Near-term resilience in China should support emerging market assets, with China's earnings growth expectations seem to have bottomed out. Q1 GDP growth beat market expectations as China economic reforms and stimulus efforts (Chart B) cushioned the economy. It is noteworthy that China has ample ammunition to further stimulate its economy should the trade tensions fuel.

Amid risks to growth and muted inflation, short rates are likely to move lower as major DM central banks ease. Long-term yields have an asymmetric profile, with room for larger rallies on markets pricing for "lower for longer," while contained inflation makes a material sell-off unlikely. While we are not convinced with cylical growth sensitive EM assets like equities but expect EM debt to do well, upgrading our view to slight positive. We prefer local-currency over hard-currency markets where the dovish shift in U.S. policy could further support local-currency markets.

The second half of the year promises to be very eventful, with central banks on the move, uncertainty on trade negotiations, and many bond and stock markets at the year's highs. Few assets strike us as compellingly cheap; investors will need to be nimble to eke out returns. At a time of elevated macro uncertainty, we argue for a portfolio that builds in some protection, with the changes made within our model portfolio asset allocation reflects this cautious tone.

It is our hope that this publication assists you, our clients, in your investment process for the rest of 2019.

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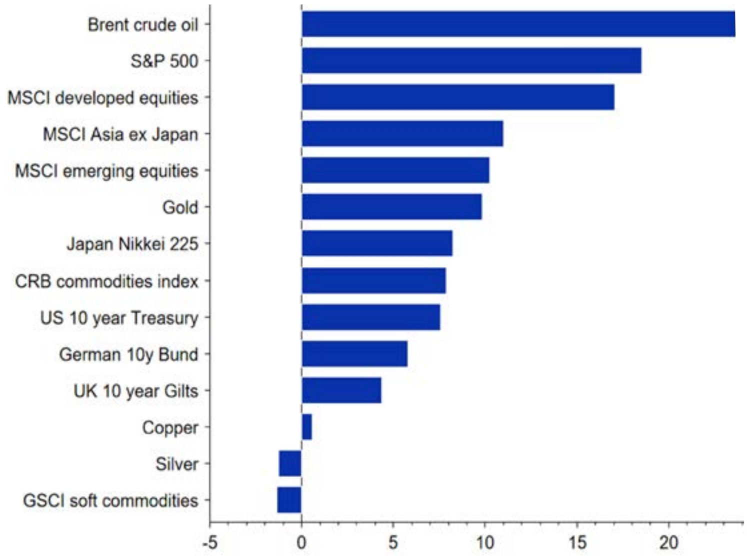
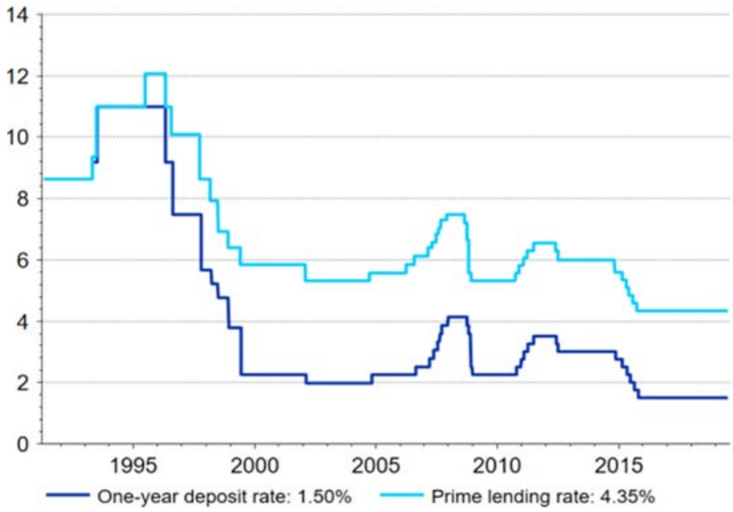
Source | Figures extracted from Thomson Reuters Datastream

Asset Returns in 2019 (Chart A)
Per cent



China Policy Rates (Chart B)
Per cent



Source: Thomson Reuters, Datastream, data as at 1 July 2019

QUALITY, RESILIENT SINGAPORE STOCKS TO SHINE DESPITE A CHALLENGING MILLIEU

Summary

In our view, the macro backdrop for Singapore is likely to be challenging in the near term with possible economic downgrades and slower corporate earnings growth. Yet, our bottom-up view on stock selection remains constructive. We continue to be positive on innovative 'New Singapore' stocks, selected industrial counters and quality dividend stocks, all of which should offer resilience in an environment of slower economic growth.

Weighing the Positives and Negatives

Being finicky has its merits especially when it comes to stock selection in Singapore, which is facing a challenging macroeconomic backdrop. Without doubts, fears of a steep slowdown in the global economy and the possibility of a flare-up in the unresolved US-China trade feud will likely dominate as key investor concerns in the coming quarters. And we expect these uncertainties to translate into slower economic and corporate earnings growth in Singapore for the rest of 2019.

While we are cautious on the rising macro headwinds, our bottom-up views on stock selection continue to be constructive. We see good opportunities in stocks with quality value, sustainable growth and strong structural ideas, especially those that are reinventing their business models. We are also positive on Singapore dividend stocks, whose dividends are supported by healthy and structural earnings growth. In short, our focus will be on delivering stock selection returns by picking quality companies, which are resilient amid an increasingly volatile but slower growth environment.

On a more positive note, after a fleeting market downturn in May 2019, global risk appetite has started to improve of late after the Fed signalled its intention to cut rates to prevent the US-China trade war from stalling economic growth. The increasingly dovish tilt of major central banks as well as the resumption of US-China trade talks in late June had also lifted market sentiment at the end of 2Q 2019.

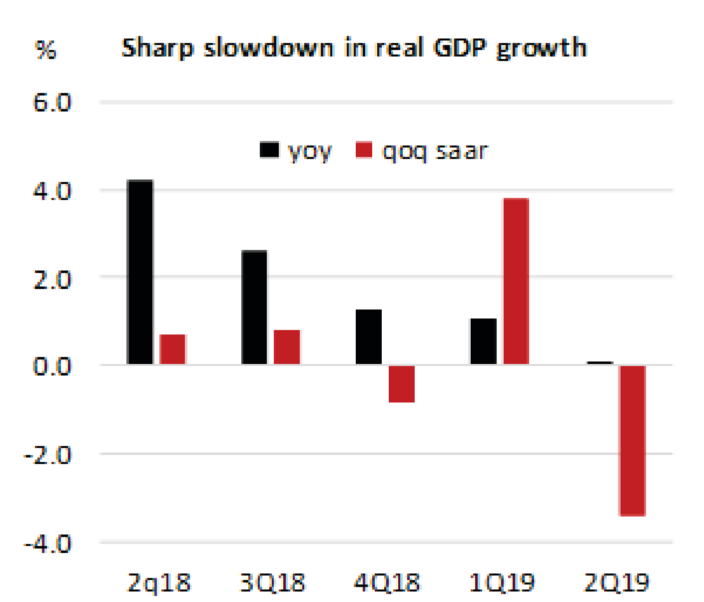
Moreover, equity markets have already begun to price in growth concerns and earnings risks. At the same time, valuations of Singapore equities are looking inexpensive relative to their historical averages, with price-to-book multiples still nearing the trough levels that were last seen in 2011 and 2015. All things considered, we believe these positive and negative factors are setting up an interesting backdrop for Singapore equities, which will continue to be a good hunting ground for the discerning, active and bottom-up stock pickers.

Bleak Economic Outlook for Singapore

The Singapore economy saw 1.2% growth year-on-year (YoY) in 1Q 2019, the lowest growth rate in close to 10 years. And recent flash estimates by the Singapore Ministry of Trade and Industry (MTI) pinpointed to an even slower YoY growth of 0.1% (or -3.4% on a quarter-on-quarter basis) in 2Q 2019. A technical recession—defined as two consecutive quarters of negative economic growth—occurring in Singapore in 2H 2019 is now a real possibility, especially with the worsening of global trade of late.

Notably, contraction in manufacturing sector growth is the main driver of the slowdown. But other segments of the Singapore economy, such as wholesale and retail sales, are also not performing well. It is likely that MTI will again lower its full-year economic growth forecast for Singapore. In May 2019, it downgraded Singapore's 2019 GDP growth to 1.5-2.5% from an earlier range of 1.5-3.5%.

Illustration 1: Singapore Economic Growth at a Glance



Source: Ministry of Trade and Industry, Singapore, DBS, July 2019
2Q19 data are advanced estimates. The acronyms 'qoq saar' denote quarter-on-quarter on a seasonally adjusted annual rate. Any forecast on the economy, markets or performance of the market is not necessarily indicative of the future or likely performance, and is subject to change without notice.

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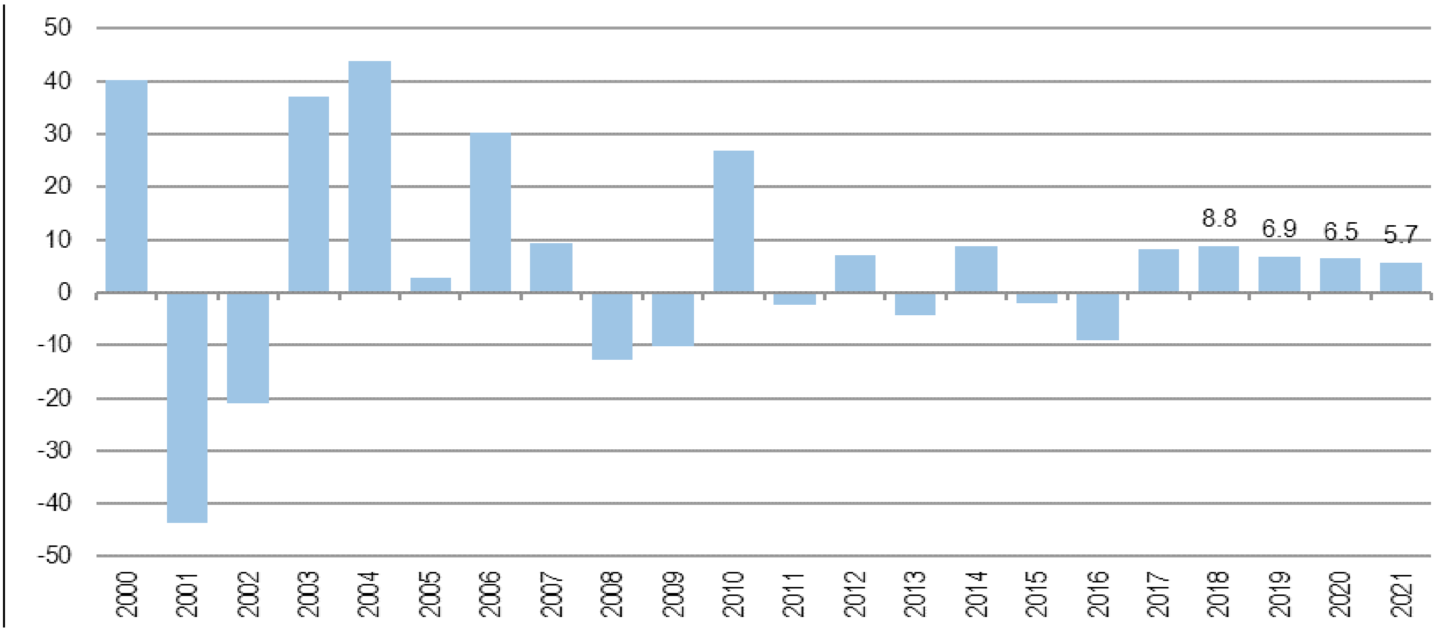
To be sure, the macro risks are beginning to bite for the open and trade-dependent economy of Singapore and we now think that Singapore's GDP growth for 2019 will come in at around 1%. Nonetheless, we continue to see no serious excesses in the global economy, where growth remains supported by the dovish stance of the Fed and other major central banks, as well as targeted support measures by the Chinese government.

In Singapore, weak economic growth often translate into deteriorating earnings for companies, and earnings downgrades in the city-state could be on the rise. Against this backdrop, it is likely that earnings expectations will continue to be cut, with downside risk to our current expectation of 3-5% growth. Still, earnings growth trajectory in Singapore is increasingly bifurcated and dispersed. In 2019, we have witnessed much wider sector and company dispersion in terms of earnings growth. This tends to bode well for us as bottom-up stock selectors.

Illustration 2: Slower Earnings Growth Expected in Singapore MSCI SG EPS growth (%)



Source: Datastream, IBES, July 2019. Any forecast on the economy, markets or performance of the market is not necessarily indicative of the future or likely performance, and is subject to change without notice.on the economy, markets or performance of the market is not necessarily indicative of the future or likely performance, and is subject to change without notice.

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Sanguine on 'New Singapore' Stocks and Industrials

Beyond the economic doom and gloom, Singapore stocks that offer sustainable earnings growth and decent dividends, which are backed by strong free cash flows, will continue to shine in our view. In an environment where economic growth and corporate earnings are deteriorating, resilient stocks with structural growth drivers will remain highly sought-after by investors.

One group of equities that we are positive on are the "New Singapore" stocks, which represent the future economy of Singapore, embodying innovation, integration and sustainability. These are companies that are reinventing or reorganising their business models to succeed and be more relevant in the future economic landscape. In particular, we like corporate restructuring candidates.

In our view, corporate restructuring will continue to be one of the key drivers of Singapore equity returns as locally-listed companies look to exploit inorganic growth opportunities. 'New Singapore' companies tend to be in sectors such as technology, data centres, healthcare, logistics, tourism and consumer services, most of which focus on the service eco-system.

(see Illustration 3 for examples)

Illustration 3: Focusing on the Service Eco-System of the 'New Singapore'

Source: Bloomberg and Nikko AM Asia Limited, June 2019.
Any references to particular sectors are for illustrative purposes only. This is not a recommendation in relation to any named sectors and no warranty or guarantee is provided.

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Elsewhere, we continue to favour industrials and consumer staples sectors. Industrials are offering a combination of good value, earnings resilience (see Illustration 4) and decent growth, all of which should provide some upside as US-China trade tensions ease. In addition, industrials are typically beneficiaries in the latter part of the economic cycle where capital expenditure begins to accelerate. Likewise, defensive consumer staples, whose revenues are linked to basic needs and are less economically sensitive, tend to offer resilience in an environment of slower economic growth.

Illustration 4: Singapore Industrials and Consumer Staples Offer Earnings Resilience

EPS Growth (concensus)	CY19E	CY20E	CY21E
Banks, Diversified Financials & Insurance	9%	3%	5%
Consumer Discretionary	(3%)	1%	1%
Consumer Staples	8%	13%	8%
Industrials (Conglomerates)	5%	7%	12%
Industrials (Offshore Marine)	13%	19%	3%
Industrials (Transport)	0%	13%	(2%)
Real Estate Developers	(2%)	6%	8%
Real Estate Investment Trusts	2%	5%	1%
Technology	6%	6%	7%
Telecommunications	(7%)	(2%)	2%
Healthcare, Utilities & Others	40%	24%	19%
TOTAL	**5%**	**6%**	**8%**

Source: Citigroup, July 2019. Any forecast on the economy, markets or performance of the market is not necessarily indicative of the future or likely performance, and is subject to change without notice.

The Dividend Advantage

Lastly, we remain convinced about the long-term merits of investing in Singapore dividend stocks, especially those with dividends that are supported by healthy and structural earnings growth. In the current low interest-rate environment, where decent yields are hard to come by, stocks that pay an attractive and predictable dividend yield will continue to be in strong demand with yield-hungry investors.

Dividend expectations for Singapore corporates continue to remain much more resilient than earnings estimates. That's a testament to the quality of their underlying earnings, cash flows and balance sheets. Forward dividend yields of Singapore stocks also remain one of the most attractive in the Asian region, highlighting the importance of dividends as part of the total return equation for investing in locally-listed stocks. Since 2010, reinvested dividends had offered additional alpha and enhanced the returns for the STI by more than 40% as shown in Illustration 5 (annualised returns of the STI over 10 years up to April 2019 is 6.60%).

Illustration 5: Reinvested Dividends Enhanced STI Returns by 40.6% Since 2010 (annualised returns 6.60%)

Source: Bloomberg, April 2019. Past performance is not necessarily indicative of future performance.

In general, we invest in two groups of dividend stocks, namely dividend anchors and dividend growers. In short, dividend anchors are companies with low gearing, strong cashflow streams, consistent profitability and a strong track record of dividend payouts.. Whereas dividend growers are those with decent earnings growth, free cash flow growth and exhibit an increasing payout ratio.

Illustration 6: Singapore Dividend Yield at an Attractive Level

Source: Bloomberg, April 2019. Past performance is not necessarily indicative of future performance.

To conclude, despite the challenging macro backdrop for Singapore, exacerbated by a slowing global economy and the yet-to-be-resolved US-China trade feud, we continue to find ample opportunities in Singapore to deliver decent gains and generate alpha with judicious stock selections.

Important Information

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