MA*Insights*

Treading an Unconventional Path

Dear Investors,

The September quarter was brutal as trade tensions from early July escalated. We believe the US tantrum will worsen as its mid-term elections in early November approach. Trade has been President Trump's trump card, holding up his approval ratings.

Asian markets appear to have factored in the worst, of a full-blown war affecting all exports from China into the US and causing severe disruptions to EU exports. Even though US importers are able to seek product waiver, many of the goods produced out of China are in fact shipped to other destinations such as Mexico and Canada, for final assembly before landing on US shores.

The focus will likely remain on an eventual outcome of the trade policies. If the remaining US$267bn of Chinese goods into the US were to be included in the tariff war, most basic consumer items such as smartphones would not be spared. That would have a far greater impact on US consumers. On the other hand, if tariffs are kept at 10%, the impact on Asia and EM markets is likely to be marginal, as manufacturers and vendors may opt to share the burden. At 25%, purchasers would be compelled to rescind contracts and source for alternatives.

Even without the trade uncertainties, global production in the US, Asia and EM is already easing from high levels achieved in the last two years. Only PMIs in the EU ticked up in July, to 55.1. The US market carries a higher risk of correction, as wage growth and higher interest rates raise the cost of doing business and investment. A possible cutback in consumption fuelled by inflation linked to the tariff war is another threat to profit growth. The Dow Jones and S&P 500 are trading at high price to book values of 4.1x and 3.3x, respectively (Singapore's is 1.1x).

Generally, we do not believe that the trade war is an all-out negative for Asian economies. US purchasing managers are likely to divert their manufacturing outsourcing to other Asian countries. Vietnam, Indonesia, Thailand and Malaysia stand to benefit from their shift in procurement for lower-end consumer goods.

That said, it might not happen for higher-end sectors such as auto parts and electronic devices. These are industries with large manufacturing support chains. Stringent plant qualification by brand owners also means that production cannot be easily relocated. On top of that, the US/Mexico settlement on the NAFTA agreement, albeit a diluted version, could ease some pressure for auto component makers, whose products are assembled in Mexico for the US market.

Chinese farmers, faced with higher tariffs on imported US agricultural products, could switch to Brazil and Argentina for their supplies. But to cope with its internal deficit, Argentina has raised its tax on soybean exports. This is expected to push up the prices of soybean oil and meal, which could lead to higher CPO prices. As Indonesia and Malaysia are the world's two biggest CPO producers, they should benefit. Climbing oil prices are also helping CPO as a biofuel alternative.

Our only concern is the rout on Asian currencies, partly caused by contagion from Turkey, Argentina and Venezuela. However, balance sheets in Asian countries are now stronger than during the Asian Financial Crisis. Except for Indonesia, all maintain current-account surpluses and have manageable foreign debts. The Philippine peso could be an exception, embattled by slowing foreign investments from China and damage wrought by Typhoon Mangkhut.

Indonesia and Thailand have elections in 2019. Policies are likely to skew towards favouring the locals at the expense of foreign investors, going by past experience. Indonesia has raised import tariffs for some goods to curb rupiah outflows. It has also imposed domestic-market obligations to put a check on coal exports so as to cut back on crude oil imports which strain foreign reserves. On top of that, infrastructure spending has been restrained to clip the rupiah's wings. Malaysia's new government is working hard to fix its fiscal deficit and debt problem. Its coming budget in October would be anything but expansionary.

Over in Singapore, the market is now trading at valuations similar to that at end 2015 (when oil price was diving below US$50 per barrel), only slightly higher than South Korea in Asia in terms of P/B, PE and yields. August's CPI, at 1.9%, was understated by rebates dished out to HDB dwellers to cover hikes in water bills. Actual inflation was likely to be nearer 2%. We therefore expect the S$ to strengthen as Singapore employs its exchange rate to manage inflation.

SG SIBOR and SOR have been running up, while deposit rates stay flat. Widening net interest margins are good for banks. Loan growth has risen above 5% yoy, driven mainly by loans to businesses. Cooling measures on properties are a dampener, though the impact so far has been flat mortgage demand rather than lower.

We are also becoming more upbeat about the construction and property sectors. About one-third of home sellers from S$15bn of successful en-bloc transactions have received cash payments; they are looking out for properties to buy or rent. At the same time, cooling measures have deterred new en-bloc transactions, especially the larger sites. This will limit growth in supply. Developers which have previously secured land sites should gain.

In real estate, commercial office space should enjoy the biggest boon from a dearth of new supply till 2020. NPI yields in recent transactions hit a low of 1.7%, suggesting possible upward revisions in capital values for office space. Business parks, whose rental rates typically track those of commercial office space, should also benefit.

Singapore is building a reputation as a location for data centres. Facebook has announced plans for a US$1.4bn data centre here in 2020. Google is talking about setting up a third one here. These should absorb industrial space available, leading to a possible rebound in industrial rentals and value.

We are holding a defensive stance, keeping more investments onshore in yield stocks. This also limits potential losses from regional currencies versus the S$.

A key risk to our assumptions is an erosion in consumer confidence. While our discussions with listed companies have not revealed any pull-back in customers' orders, we are cognizant that continual lower trade and economic production could curtail consumption demand.

Thank you for your support!

Peggy Mak
Head & Chief Investment Officer
peggymakbm@phillip.com.sg

Important Information

This newsletter is provided to you for general information only and does not constitute a recommendation or an offer or solicitation for any investment. The information contained in the newsletter has been obtained from public sources which Phillip Securities Pte. Ltd. ("PSPL") has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions contained in this newsletter are based on such information and are expressions of belief of the individual author or the indicated source (as applicable) only. PSPL makes no representation or warranty, express or implied, that such information is accurate, complete, appropriate or verified or should be relied upon as such. Past performance of any investment product or company referred to in this newsletter is not indicative of future results.

Any such information or opinion contained in this newsletter is subject to change, and PSPL shall not have any responsibility to maintain or update the information or opinions made available or to supply any corrections, updates or releases in connection therewith. In no event will PSPL or persons associated with or connected to PSPL, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this newsletter, (i) be liable in any manner whatsoever for any consequences (including but not limited to any special, direct, indirect, incidental or consequential losses, loss of profits and damages) of any reliance or usage of this newsletter or (ii) accept any legal responsibility from any person who receives this newsletter, even if it has been advised of the possibility of such damages. Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This newsletter does not constitute, and should not be used as a substitute for, tax, legal or investment advice. This newsletter should not be relied upon exclusively or as authoritative without further being subject to the recipient's own independent verification and exercise of judgment.

Recipients should be aware that many of the investment products which may be described in this newsletter involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such investment products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any investment product should not be considered to be a disclosure of all risks or a complete discussion of such risks. You should seek advice from a qualified financial advisor before relying on the information, analyses and opinions for any investment decisions.

Our representatives appointed under the Financial Advisers Act ("FAA") may be authorised to engage in non-FAA activities of marketing, client acquisition and client servicing of managed accounts services. Our representatives who are appointed under the Securities and Futures Act to conduct fund management activity ("FM Reps"), i.e. the Portfolio/Fund Managers, will be managing clients' money and investments, in addition to marketing, client acquisition and client servicing of managed accounts services.

PSPL is a member of the PhillipCapital Group of Companies. The PhillipCapital Group of Companies, their affiliates and/or their officers, directors and employees may own or have positions in any shares, units and other investments mentioned herein or any investment related thereto and may from time to time add to or dispose of any such investment. Any member of the PhillipCapital Group of Companies may have acted upon or used the information, analyses and opinions herein before they have been published.

This newsletter has been provided to you for personal use only and shall not be reproduced, distributed or published by you in whole or in part, for any purpose. If you have received this document by mistake, please delete or destroy it, and notify the sender immediately. PSPL shall not be liable for any direct or consequential loss arising from any use of material contained in this newsletter.

This newsletter is only for the purpose of distribution in Singapore. The information and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, availability or use would be contrary to the applicable law or regulation or which would subject PSPL to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Brought to you by Phillip Securities Pte Ltd (A member of PhillipCapital) Co. Reg No. 197501035Z

250 North Bridge Road
#06-00 Raffles City Tower
Singapore 179101
www.phillip.com.sg

PhillipCapital
Your Partner In Finance