SAC CAPITAL

Singapore Strategy – 2H21

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A confluence of bullish economic data has rejuvenated the Singapore market. These include: 1) exceptionally strong GDP growth of 14.3% in 2Q21; 2) a drop in unemployment to 2.8% in May; 3) May retail sales growth of 80% yoy; and 4) the re-opening of the economy and travel resumption by year-end.

2Q's strong data were measured against a low base last year. Output was still 0.9% below 2Q19 levels and 2% below 1Q21. About 14,000 jobs, or +0.4%, were added. Of these, 70% were in community and social services and 22% in the infocomm sector. These jobs would taper off when vaccination rates are high enough to remove movement controls. The manufacturing sector, a key pillar of Singapore's economy, cut 37,900 jobs (-7.8%) in FY20 and a further 4,200 (-0.9%) in 1Q21. Corporates have turned to automation to cope with COVID restrictions.

May's retail sales were still 13% below 2019 levels. Only supermarket (+37%) and computer and telecommunication equipment (+36%) sales were higher. Department-store sales nearly halved (-49%). Meanwhile, online sales rose to 13.7% (Dec 2019: 6.8%) and 16.1% if motor vehicles were excluded, with supermarket (12.1%), computer & telecom equipment (54.4%) and furniture & household equipment (30.7%) sales all shifting online. These are the traditional anchor tenants at retail malls. Consumer spending might not return to pre-COVID levels, with the population declining, an absence of tourists and moderate wage increases.

This implies malls' vacancy rates might not improve (1Q21: Orchard 11.6%; outside Central 6.7%). We think tenants still have the upper hand in rental negotiations.

2H GDP growth is likely to soften, despite higher exports and a gradual resumption of construction activities. We expect the authorities to maintain its growth forecast of 4-6% for the full year. NODX gained 8.7% in the first five months, mainly supported by electronics (+13.2%). Singapore is growing its share in the semiconductor value chain. Chip shortages have hastened capex in the sector. This benefits the listed tech players that produce equipment and components for chip production. Companies include UMS, Grand Venture and Frencken. But we are also mindful of fresh virus infections in Japan and South Korea, the two key players in the semiconductor supply chain. That might drag down growth.

Construction. The construction sector will find its footing eventually. Underlying demand remains strong. Construction output is expected to range between S$24bn and S$27bn in 2021, up from S$19.5bn last year, according to construction consultant, Turner and Townsend. Construction margins, though, could succumb to higher manpower costs, lower productivity with adjustments to safe-distancing workflows and higher material costs.

BRC Asia and Pan-United, the dominant suppliers of steel and ready-mixed concrete, are better

positioned in a construction recovery, in our view, given their dominant market share of about 70% and 40% respectively.

The Jobs Support Scheme covered a portion of many Singapore companies' staff costs in 2020. These have tapered off, except for the tourism and aviation sectors. Banks' loan moratoriums also tapered off at end-March 2021. While 1H21 earnings reports due from July are likely to beat, thanks to a weak 2Q last year, 2H earnings face challenges from a virus resurgence and renewed lockdowns in neighbouring countries. The latter account for most of Singapore's production and supply chain.

Singapore's 10-year bond yields, at 1.52%, are still 50bps below their average in the last 10 years. With the rebound in the economy, inflation and interest rates are expected to trek higher. The risk/reward tilt in favour of price leaders which can raise prices to protect margins.

Banks. Banks are enjoying the biggest earnings upgrades. The market is looking beyond credit concerns to focus on income growth, under higher interest rates and stronger housing markets. The MAS is also expected to lift its 60% dividend cap on banks imposed in 2020. However, we do not expect the dividends that were held back last year to be paid out. At current equity prices, yields are 3-4%, back to pre-COVID level. We are neutral on banks.

REITs. Logistics and warehouses benefitted from stockpiling during the pandemic when border restrictions choked supply chains. Part of this demand has petered off. However, manufacturers are also building up inventories, pivoting from just-in-time to just-in-case strategies. We still prefer logistics and industrial REITs, although current yields of 5-6% might not be compressed to take into account shorter land tenures in Singapore. We prefer REITS in the following order: Logistics > Healthcare > Hospitality > Office > Retail.

Real estate. A record 8,012 private homes exchanged hands in 1Q21 (1Q20: 4,229). The strong demand could be traced to construction delays in HDB BTO projects, declines in the supply pipeline and an upsurge in HDB resale prices (2Q21: +10.8% yoy, +2.8% qoq). This trend benefits property agencies more than property developers. Developers have to replenish land banks at higher land costs. They also have to fork out higher construction costs. CDL is an opportunistic buy as we believe its share price has factored in its exposure to Sincere Property.

Offshore & marine. Crude prices have crossed US$70/bbl, raising optimism about a revival of the O&M industry. What's different this time is the difficulty of securing credit for fossil-fuel projects. Banks are reluctant to lend. Oil majors such as Exxon Mobil are facing pressure to step up renewable efforts and cut carbon footprints. Higher cost of funds is a disincentive to offshore drilling. Local O&M players have pivoted to providing transportation and engineering work for offshore wind and solar farms, a small but steady step towards shedding their reliance on the oil sector. Keppel and SembMarine are combining their O&M operations in a restructuring exercise that will take place at year-end.

OVERWEIGHT. We think 2Q earnings could surprise on the upside and expect positive market reactions. Our year-end STI target is 3,380, pegged to 15x FY21e P/E, the index's 10-year average. The Singapore market should remain attractive for its yields, though COVID remains the greatest risk. The virus situation in neighbouring countries could throw a spanner in the earnings recovery expected in 2H. Already, lockdowns and virus resurgence have affected Malaysia's glove makers and manufacturing plants.

We Overweight building materials, logistics REITs, F&B and consumer and Underweight aviation and transportation. We are Neutral on banks, healthcare and real estate.

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