Singapore 2Q 2022 Strategy

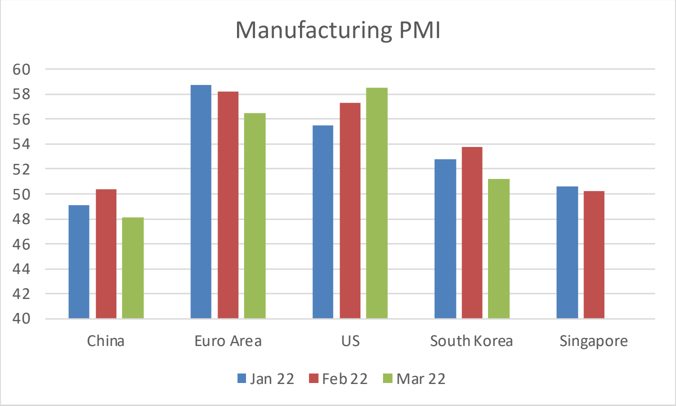
Reopening positioning propelled the Singapore market (+9.1% YTD) to the ranks of top regional performers in Q1. A relaxation of rules for travel and social gatherings would fuel consumption spending. However, global uncertainties are setting in. The war in Ukraine, higher energy and commodity costs and supply-chain constraints are clouding the economic outlook. We think the STI has priced in reopening gains but not the costs inflicted by the war, and a possible slowdown in Europe and China in 2022. We expect an earnings downgrade for 1H2022 if the war prolongs or escalates beyond April.

Decline in business confidence

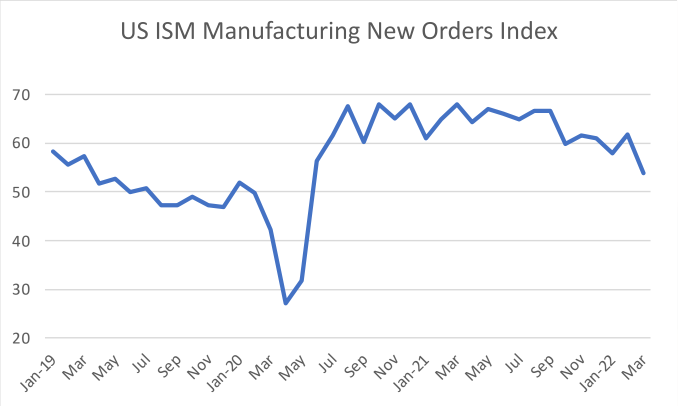
Business confidence has weakened in major economies. Germany's IFO Business Climate indicator slipped to a 14-month low of 90.8 in March (Feb: 98.9). South Korea's Business Survey Index on business conditions in the manufacturing sector fell to 83 in March (Feb: 91). The index that measures the outlook for April also ceded 8 points to 85.

The euro zone's March manufacturing PMI retreated 1.7 points to 56.5. South Korea's fell 2.6 points to 51.2. China's PMI turned contractionary by -2.3 points to 48.1, as strict COVID rules and regulatory oversight of the property, internet, tuition, gaming and entertainment sectors led to lay-offs and dented consumer confidence.

Though US PMI shows an uptrend, March ISM Manufacturing New Orders Index fell 7.9 points to 53.8, reflecting weakening demand. Similarly, Singapore's PMI is expected to slow.



Trading economics



Institute for Supply Management

Inflation

The escalation of the Russia/Ukraine conflict has added significant stress to an inflationary environment. Though Asia has limited direct trade with Russia, the ramifications are high.

The most direct link between Russia and Asia is energy. A potential loss of Russian oil and gas trades has sent prices higher. Costlier energy would have a larger negative impact on Thailand, Korea and Taiwan, where energy trade balances are -4.6%, -4.5% and -4.2% of GDP respectively. These countries are key exporters of tech hardware and equipment, a sector that is slow to pass on higher costs. Lockdowns in Shenzhen and Shanghai have dealt a double whammy to the tech sector. Singapore manufacturers also face a 30% YTD rise in energy costs.

Auto and auto component makers are most susceptible to higher commodity prices. Smartphone makers such as Apple, Vivo and Oppo are, at the same time, cutting output due to sales disruptions in Russia and a demand slowdown in China. We think energy, materials and transport have more than priced in the upside. If sanctions on Russia last through Q3, the peak manufacturing season, hardware tech and consumer durables might face an earnings downgrade. Our preferred stock is Grand Venture, which should be well-positioned in the life science and medical diagnostics equipment sectors.

It is not just **commodity prices that are rising;** commodities are also becoming scarcer. The loss of volume, in particular of food, is worse than a price hike. A price hike could be due to inefficiencies in the supply chain, which can be resolved or substituted. But food crop harvests are seasonal, and volume is lost with a missed planting season.

Food forms a bigger proportion of the CPI basket in Asia. Higher food costs will force households to cut back on spending on discretionary items. Food processors and F&B players are traditionally able to pass on the higher costs and should, hence, be less affected. Japfa is our preferred stock in the sector. Though higher corn prices might hit its feed margins, better hog prices in Vietnam and the spin-off of its Chinese dairy business on the Hong Kong exchange is expected to bring Japfa's share price closer to our SOTP value of S$1.00.

That said, we believe high commodity prices are not sustainable for long. This is because of: 1) weaker economies, triggered by high inflation; 2) demand destruction from an expected slowdown in Europe and China; 3) potential increased output from other countries in South America; and 4) continued imports by China and India of Russian goods. Although the world will take time to adjust, trade flows will rebalance over time and prices will adjust accordingly. Food prices, however, are likely to stay high for longer, as Ukrainian farmers miss the coming planting season in April.

Reopening beneficiaries

The reopening of Singapore's borders, especially with Malaysia, could help to arrest wage cost inflation through a return of foreign workers. The MAS is also expected to strengthen the trade-weighted S$ to ringfence core inflation within its target range of 2-3% for 2022.

On the other hand, a strong S$ might deter a quick return of tourists. This could slightly deflate the expected recovery in tourism and hospitality. Still, F&B players, retail and recreation, and outbound tourism should be the biggest winners of border reopening. UnUsUaL, MM2 Asia and GHY Culture will ride a return of large-scale events and concerts, which draw crowds from the region.

Mergers, spin-offs and privatisation

Spin-offs and mergers will likely dominate in Q2. Besides Japfa, Yangzijiang will list and distribute in specie the shares of its financial arm, Yangzijiang Financial Holdings. Our SOTP value for Yangzijiang is S$1.90. Details of the merger between Keppel Offshore and Marine and Sembcorp Marine are expected to be announced at end-April. We estimate the merger will take several months to complete as it will require regulatory approval from other countries such as Brazil and China.

SPH will be privatised and delisted by mid-May. If the Cuscaden consortium secures more than 30% of SPH REIT, it will need to launch a GO at S$0.964 per unit. SPH REIT's retail assets could potentially be absorbed into CICT. We see the merger trend continuing for REITs, to give leverage for acquisitions, aid tenant acquisitions and secure better borrowing terms.

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