December 2018

Monthly Commentary

Singapore update

- Singapore equities rebound in November
- **CapitaLand** buys Shanghai towers at attractive price
- We initiate **Sembcorp Marine** on possible inflection in O&M cycle

Driven by discretionary stocks

Singapore equities shrugged off a host of worries to rise 5.5% month-on-month in November. Sharp gains in consumer discretionary, banking and real estate stocks offset losses among consumer staples, telecom and industrial counters.

In macroeconomic data, third-quarter economic growth fell short of economists' expectations as a result of moderating demand for electronics. In contrast, October exports surged 8.3%, thanks to an increase in non-electronic shipments that outweighed a continued decline in electronic exports. Manufacturing output data was similarly upbeat, growing 4.3% year-on-year in October which far exceeded forecasts.

Outlook

Trade and geopolitical worries will likely continue rattling markets for some time. Singapore's open economy means trade tensions between the US and its major trading partners, as well as the moderating outlook for China's economic growth, could dampen market sentiment.

On the domestic front, banks and real estate stocks will likely remain restrained by the property cooling measures introduced in July. We are positive on our Singapore bank holdings, which are benefiting from rising rates. Their fee incomes are also relatively stable, and asset quality, good.

Overall, the fall in share prices over the past few months has led to more attractive valuations. We are cautiously optimistic about the market, especially as earnings growth is still expected to be robust. Singapore also compares well with regional markets: it has the second highest yield in Asia excluding Japan, and its price-earnings ratio is the third-lowest, after Korea and China. Still, while we take advantage of depressed valuations to invest in stocks that present quality and value, we remain wary given the long shadow cast over markets by the trade war, even with the current ceasefire.

What we've been up to:

We initiated **Sembcorp Marine** (SMM) after a period of share-price weakness, as fundamentals indicate that the offshore and marine sector may be reaching an inflection point. Specifically, work inquiries for SMM have increased, and its orderbook for production equipment is at an all-time high. Operating leverage tends to be high in this sector, and since SMM has invested in its integrated yards during the downcycle, its balance sheet and cashflow profile should improve as the cycle turns upward.

Adding to the appeal of the investment case is SMM's ongoing development into a player in the natural gas supply chain. While still a relatively nascent venture, the dynamics of the natural gas sector are favourable over the long term and would further bolster and diversify SMM's business profile, if executed well.

Note: Any changes refer to those of our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations, so the comments may not apply to all portfolios.

Corporate news

Landing big

CapitaLand, through an investment fund, is partnering GIC to buy Shanghai's tallest twin towers for 12.8 billion yuan (about S$2.54 billion). The property, located on a 4.05-hectare site along Huangpu River in North Bund, comprises two 50-storey premium Grade A office towers linked by a seven-storey shopping podium. Currently under development, it will begin operations in phases from the second half of next year.

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Raffles City China Investment Partners III (RCCIP III), in which CapitaLand owns 41.7%, formed a joint venture with GIC for the acquisition. CapitaLand's effective stake stands at 20.85%, or 5.8 billion yuan (S$1.2 billion). The acquisition brings the total number of Raffles City projects to three in Shanghai and nine in China.

We believe the acquisition price is attractive for the prime location. CapitaLand's total asset under management will increase to S$95 billion after the acquisition, putting it on track to meet its target of S$100 billion by 2020, and will be a boost to its asset recycling strategy, if executed well.

Separately, CapitaLand's third-quarter profits rose 14% year-on-year to S$362.2 million, thanks to asset recycling gains as well as contributions from newly-acquired and -opened investment properties in Singapore, China and Germany.

We attended CapitaLand's Investor Day, where management reiterated that the group's return on equity remains a key focus. It will continue to actively recycle capital and divest S$3 billion in assets every year, potentially selling more retail properties in tier 3 Chinese cities and also the US multi-family offices into funds.

It also believes the property sector is entering a late-stage cycle, and hence is pursuing more brownfield opportunities for quicker turnover. It expects dividend payouts to continue to rise with its cash earnings despite the rising cost of debt.

CapitaLand will continue to tap technology to improve productivity and tenant activity across its mall, office and service apartment platforms. These include providing data analytics to its mall tenants, optimising energy usage in its office buildings, and setting up digital platforms to connect tenants and customers for its office and serviced apartments.

Deals by Singapore Reits

There was also plenty of activity in the Reits sector. **Keppel Reit** announced the divestment of a 20% stake in Ocean Financial Centre for S$537.7 million, or S$3,061 per square foot. While the sale is likely part of an asset-rationalisation strategy, the key question for us is how the capital will be recycled. We note that the company has been buying back shares from the market.

Meanwhile, **CDL Hospitality Trusts** (CDReit) acquired a 95% interest in Hotel Cerretani Florence in Italy for €40.6 million (S$63.3 million), to be funded by internal resources or euro-denominated debt. The freehold four-star hotel, which has 86 rooms, is located in the heart of Florence city centre and underwent a €5.3 million refurbishment in 2016. CDReit expects to stabilise occupancy at 80% compared with the current 60-70%. Total international visitor arrivals to Florence grew 2.2% on average annually for the past five years, while there is limited future hotel room supply in Florence due to new urban planning regulations prohibiting new hotel developments in the city centre.

IHH's shareholding change

Elsewhere, Malaysian sovereign wealth fund Khazanah Nasional sold a 16% stake in **IHH Healthcare** to Mitsui and Co for about RM8.42 billion (S$2.76 billion) in cash, as part of a portfolio restructuring under the new government. Mitsui's stake will increase to 32.9% after the deal, making it IHH's biggest shareholder, while Khazanah's stake will fall to about 26%.

Separately, the private hospital group posted a net loss of RM104.1 million for the third quarter, due to foreign exchange losses on a business unit's borrowings.

We hold the companies highlighted.

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