2H Market Outlook

Volatile Times, Opportune Time

Dear Investors,

2Q the worst quarter since 2015

Regional markets just ended their worst quarter since 2015. Stocks, currencies, bonds fell amid a looming global trade war and rising interest rates. From 6 July, the world's two largest economies, China and the US, will begin charging higher tariffs on each other's goods. With the EU, Mexico and Canada joining the fray, world trade will face testing times.

Effects already felt

China's manufacturing PMI slowed down to 51.5 in June from 51.9 in May. Its sub-index of new export orders fell to 49.8 from 51.2 - anything less than 50 indicates contractions. South Korea also reported a 0.1% decline in its June exports. It is a key producer of semiconductors and electronic components, which are shipped to China as intermediate goods.

But we don't see a meltdown

Market performance will depend on how the trade war evolves. That said, we do not expect a repeat of the 1997 Asian Financial Crisis. At that time, regional countries ran current account deficits and were saddled with huge foreign-currency debts. When their currencies tumbled, their debts soared in local currencies. Repayment became onerous, if not impossible. Today, most have current account surpluses, except for Indonesia and the Philippines. Their external debts denominated in foreign currencies have also been capped at less than 40% of GDP.

Pockets of opportunities

In these volatile times, we see pockets of investment opportunities across the region:

1) Potential diversion of manufacturing outsourcing or sourcing of raw materials to this part of the world. This could benefit countries such as Vietnam, Indonesia, Thailand and Malaysia.

2) Creeping interest rates – led by good GDP, low unemployment and inflation – may be bad for the highly-leveraged but should be good for asset prices in the long run. Expect higher rental reversions, especially for commercial and office space. CapitaLand Commercial Trust recently sold an office building on Anson Road at low 2.7% yields.

3) Upcoming elections in the region: India (2019), Indonesia (2019), Thailand (2019) and Cambodia (2018). These could be wild cards. But at election time, it is typical to see the introduction of measures that hurt foreign investors and benefit local consumers. In April this year, Indonesia's Ministry of Energy and Mineral Resources indicated that the country might issue rules allowing the government to regulate fuel prices. Consumer stocks are defensive and less exposed to currency risks.

4) Tech innovations to sustain growth. Tech companies that cater to driverless vehicles, the internet of things and smart devices should do well. Our only concern is over-bullish demand forecasts, potentially leading to component overstocking.

5) Record en-bloc property sales in Singapore. This is creating new wealth for private property owners and a potential pool of property hunters from 4Q18. Redevelopment of en-bloc projects should rejuvenate the construction sector in 2019. But we expect higher construction costs as the government is pushing for the adoption of PPVC or prefabricated prefinished volumetric construction to cut labour content. These will eat into developers' margins. And construction companies without PPVC capability could fall out of competition.

6) Finance-sector bedrock. This sector should enjoy: a) rising interest margins from higher rates; b) stronger loans growth; c) lower loan-loss provisions; and d) burgeoning mortgage-loan demand.

Focus on track records

While equity prices and currencies will react to policy uncertainties, any selldown is an opportune time for investments. The last few years of benign interest rates have lifted the value of all asset classes. Current turbulence will likely sift out the outperformers. Companies with good earnings track records and strong financial muscles should emerge stronger and gain market shares.

Thank you for your support!

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2Q2018 Performance

Market Indices / Phillip SMART Portfolio	Percentage Change* April – June 2018
Phillip SMART - Income	0.61%
Phillip SMART - Income & Growth	1.29%
Phillip SMART - Growth	1.59%

**Note: Returns in Singapore Dollar Terms.*

Despite the fear of global trade war and quickening rate hike path, SMART Portfolio posted positive returns of between 0.61% and 1.59% in 2Q2018. We are cautiously positive on the long-term economic outlook as 2018 global growth forecasts remain largely intact.

Tactical Allocation in 3Q2018

1) Eurozone

The International Monetary Fund might lower its growth projections for Eurozone, to reflect higher potential risks that could arise from global trade war, Brexit and political instability. Thus, we are looking to trim our Euro exposure.

2) Commodity

Precious metals are mostly weaker in 2Q2018 due to continued strength in the USD and rising interest rate. Thus, our gold exposure has also been weighed down despite market uncertainty, which typically would have attracted investors to steer towards safe haven assets such as gold. We take the view that a broad-based commodity ETF may offer us a better opportunity to gain exposure to other commodities. Looking ahead, commodities such as crude oil are still expected to be supported by stronger demand.

Crude oil supply would also face short term curtailment if the US re-implement its sanctions on Iran in November. Canadian oil sands production is also set to be cut through July, further drawing down crude oil stockpiles, and political instability in some OPEC nations would all impact on oil production globally. These factors are expected to cause short to medium term increase in crude oil prices until alternative production sources step in to boost oil production.

3) Emerging Market

Emerging Market dragged down our performance in 2Q2018 as some investors steered clear of emerging markets that rely on Chinese exports. However, we view that the selling could be overdone as P/E ratio is now 13.2x compared to January peak’s 16.6x.

4) Asia Pacific

We reckon the Sino-US trade war tensions will worsen first before it gets better. When the impact is most felt, we are considering adding Asia Pacific ETF, or country specific ETF such as HSI and STI ETFs. Asian companies still provide good domestic growth driven by the rise of the middle-income. Asian countries also have relatively healthier balance sheets that could overcome the headwind from the Sino-US trade war.

Thank you for your support.

About the Manager

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Mr Ooi has been with Phillip Securities since 2010. Before joining Managed Account Department as a Portfolio Manager, he was a Customer Experience Specialist before becoming an equity dealer with our POEMS Dealing team, progressing to lead the dealing team at Phillip Investor Centre – Toa Payoh branch. Prior to joining Phillip Securities, he was a Futures Dealer in an investment bank.

He has been a regular market commentator for various media programmes, including Channel NewsAsia's Asia Business First, Channel 8's Money Week and Morning Express, Capital 95.8FM and 938Live Morning news programmes where he talks about current market trends.

He is a SGX Academy Professional Trainer and also conducts seminars on Financial Analysis and Technical Analysis. He holds a Bachelor of Business degree with double majors in Finance and Marketing from the University of Technology Sydney.

MA Service Coverage: SMART Portfolio

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