Onward to a Rosy 2018

On the back of global economic growth in 2017 comes a question: Will 2018 see more of the same?

Our expert panellists share their views on 2018's outlook, risk, and the rise of cryptocurrencies like Bitcoin.

There were multiple global occurrences which seem to have driven the activities of investors in 2017. What are your views on 2018's outlook?

Kian Soon: I am optimistic about the 2018 macroeconomic and geopolitical outlook. The IMF's projections for economic growth in 2017 have been revised upwards to 3.6%. 2018's is projected to be 3.7%. The upward trend is supported by synchronised global economic growth. Key central banks will also continue the gradual departure from super-easy monetary policy, led by the US and Europe.

The US has seen solid economic growth in 2017, with unemployment going below 4%. China will continue to drive economic reform in 2018. China's economic growth will likely be slower than 2017's, but I still expect China to achieve GDP growth of at least 6.5% for 2018, with more emphasis on deleveraging, environmental protection, and tightening measures for the housing market.

With such positive expectations for key global economies, it is likely that stock markets will continue rallying in the first half of 2018.

Geoff: To determine the potential strength of growth in 2018, investors can study the momentum of growth drivers in 2017. These include government or consumer expenditure, various PMI segments, international trade and net exports, sector benchmarks or company earnings.

With these information, investors can then ascertain where 2017's primary growth drivers have been. They can also assess their momentum and potential effect on other segments, and whether the economy is at the different junctures of broad-based growth or growth driven by specific sectors.

Indeed, growth strengthened in 2017 with the recent Fed Minutes stating that US economic activity has been 'rising at a solid rate' and foreign economic activity has continued to 'expand at a solid pace'. The IMF has attributed the global recovery to pickups in investment, trade, and industrial production, coupled with strengthening business and consumer confidence. This growth may continue into 2018.

Janice: All boats rise with the tide. Synchronised global recovery will continue to drive economic growth in Asia, which Singapore has benefited from since end-2016. We believe this turn is powerful and will continue to drive more sustainable earnings growth.

Singapore's economic improvement will broaden from the manufacturing sector to the rest of the economy next year. The services sector, which accounts for two-thirds of GDP, is gaining strength. We have revised up Singapore's GDP growth to 3% for 2018. This will translate into stronger corporate earnings growth of 8-9% for 2018/2019, which will be a key driver for equity markets' performance.

Singapore remains one of the few regional markets where the STI is still trading below its all-time high of 3,831 achieved on Oct 31, 2007. Among the ASEAN countries, Singapore is the destination of choice that offers the strongest combination of earnings growth (8.4%), lowest valuation (14 times) and highest dividend yield (3.2%). Our STI year-end objective is 3,688 and we do not rule out a re-rating catalyst pushing up STI's target valuation to 3,800.

What risks should investors be mindful of in 2018? Is diversification the best option?

Kian Soon: The global macroeconomic outlook is rosy. With stock markets soaring, the key challenge for investors in 2018 is where to invest their money to optimise returns and risk.

US stocks have set many new records in 2017, but I think they are relatively expensive as compared to Asian stocks in terms of Price-to-Earnings (P/E) and Price-to-Book (P/B) ratios. When diversifying across markets, investors should look into investing more in Asian markets in 2018, especially in Singapore and Hong Kong, where there are many good companies trading at attractive valuations, and with solid earnings growth.

Risk-wise, inflation is another cause for concern. Inflation has been disappointing in recent years, but if it picks up momentum, bond investors will see their gains eroded.

There is also the risk posed by geopolitical events such as conflicts and cyber-attacks. They will undoubtedly persist in 2018 and cause their share of market volatility. However, unless an all-out war breaks out, these events are unlikely to have prolonged or significant effects.

Geoff: Investors should always be mindful that in any market, prices can move against their anticipations and past market behaviour is no guarantee of future outcomes. Ongoing macro risk themes in 2018 include global geopolitical tensions, more inward-looking policies in advanced economies, potential economic slowdowns in developing countries, and unexpected policy changes by the G7 Central Banks.

Diversification is a compromise between doing nothing and taking a concentrated exposure in one stock or market. Modern portfolio diversification can spread risk over different asset classes, in addition to stocks of different sectors with local and alternative country exposures. In recent years, investors have also chosen to spread market risk over time, dollar-cost averaging exposures in STI ETFs and STI stocks, rather than engage in lump-sum investing.

Janice: The market is still largely optimistic at this moment. However, risk exists regardless of the market condition; therefore, it is essential for investors to keep an eye for such risks. Interest rates could rise faster than expected due to inflationary pressures as global recovery drives up commodity prices. CPI could also rise beyond the comfortable 2% level that may pressure the FED to hike more than three times. A faster than expected hike in interest rates will be negative for companies with high debt levels.

Which sector(s) is/are likely to outperform in 2018?

Geoff: Any sector could outperform in 2018. In 2017 it was IT (worldwide). In 2016 it was Consumer Staples (Singapore), and in 2015 it was Healthcare (Singapore).

All sectors have their unique drivers. IT is a cyclical sector that saw large growth due to multiple instances of earnings growth, higher worldwide semiconductor sales, and higher demand for consumer electronics. Both upstream and downstream technology companies benefited from the cyclical upswing.

For instance, upstream high precision manufacturers UMS Holdings and Micro-Mechanics Holdings gained 120% and 155% respectively, whilst the more downstream Venture Corp and Valuetronics Holdings gained 113% and 101% respectively. Venture Corp is now the largest capitalised stock on the STI Reserve List.

The 95% average gains of the largest IT stocks did not happen overnight. The above moves and drivers coincided with the SIPMM Singapore Purchasing Managers' Index Electronics Cluster recording 16 months of consecutive expansion through to November 2017. Institutional fund flow into the sector amounted to net buying of S$194 million, comparatively high given the sector ended 2016 with a market capitalisation of S$10 billion.

Investors should keep abreast of changes to the drivers that can impact sector outlooks. Let the sector tell you its chances for outperformance.

Janice: We favour banks, property, consumer goods, and offshore & marine sectors to ride the broad-based recovery as well as rising oil prices in 2018.

Singapore banks are good proxies to ride on the economic growth momentum, and loan growth is expected to sustain at 7% this year. A sustained rise in SIBOR will lead to NIM improvement. Lower credit costs can be expected as the bulk of oil & gas exposures have been settled. Long term revenue growth still hinges on wealth management business and regional agenda. The index heavyweight bank stocks should continue to underpin the STI with mid-teens EPS growth of 14.8% in 2018.

Developers in the property sector will continue to re-rate on the back of improving property fundamentals. We will continue to see higher transaction volume and prices for the Singapore property market in 2018. Strong project sell-through rates in 2018 is a key re-rating catalyst and successful land-banking activities will result in RNAV upside for developers. We suggest picking residential-focused players like City Developments, Frasers Centrepoint Ltd and UOL Group.

We are turning more optimistic on Singapore consumer companies' outlook in 2018. We project earnings growth to accelerate from 4% in FY2017 to 12% in FY2018, on the back of rising consumer demand from both Singapore and this region. The upturn in Singapore retail sales coupled with stronger economic growth and stimulus in this region will boost consumption. This will benefit companies with regional exposure. Our stock picks are Thai Beverage and BreadTalk.

The offshore and marine sector will benefit from higher Brent crude prices in 2018. This will drive oil majors' capex and stimulation of offshore activities. Stronger order flow ahead will be a strong catalyst for shipyards. Asset owners could see more significant upswing towards 2H18 as the capex effect filters through. Preferred stock picks – Keppel Corp, Sembcorp Marine and Yangzijiang.

What's your take on the rise of interest in Bitcoin?

Kian Soon: Blockchain technology was reported widely this year as a key enabler for Bitcoin and other cryptocurrencies. Undeniably, this technology has great potential. However, cryptocurrencies are risky.

Bitcoin has dominated headlines in 2017, largely due to the stellar increase of its price in a single year. Currently priced at about USD 13,000, Bitcoin has already surpassed the famous 17th-Century Tulip Mania bubble.

Prices are highly volatile and regulations from the global central banks are still vague. Liquidity is limited: it is easier to buy Bitcoin than to sell it. Bitcoin is also vulnerable to cyber-theft. Greed, the fear of losing out, and curiosity are the primary drivers behind Bitcoin's price movement.

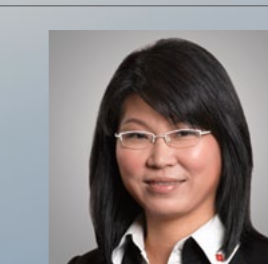
Financial mania typically doesn't end well, so this is my take on Bitcoin: caveat emptor.

Geoff: Cryptocurrency swings in 2017 were highly speculative. There are currently no regulatory safeguards for investments in cryptocurrencies, and they don't hold fiat status.

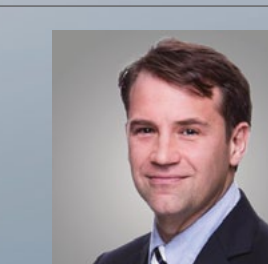
Many of us are excited by the automation and efficiencies associated with new financial technologies. However, it would be wise to act with extreme caution when investing one's hard-earned money in highly speculative developments that have no safeguards.

PANELLISTS

Lee Kian Soon
CEO,
Astral Asset Management



Janice Chua
Head of Equity Research,
DBS Bank



Geoff Howie
Market Strategist,
Singapore Exchange