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Nikko Asset Management

# 2023 Singapore equity outlook

**Navigating growth in uncertain times**

By the Asian Equity Team
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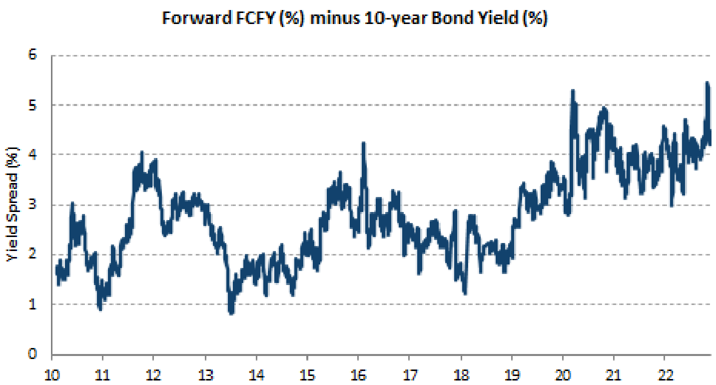
## A review of 2022

For investment assets globally, 2022 may be remembered as a watershed year as performance returns were some of the worst in decades. Positive returns were few and far between, but Singapore managed to become one of the few gainers in a sea of red. In 2022, the Straits Times Index Total Return (STITR) generated +8% year-to-date (as of end 21 November 2022). The positive performance in 2022 came on the back of earnings resilience, as EPS growth continued to accelerate despite the twin threats of tighter monetary policy conditions and higher inflation both domestically and abroad.

Singapore's outperformance against its global peers was supported by many factors. First, value came to be favoured against growth investing, which had been dominant in the prior years. The change in trend was caused by the sharp rise in bond yields. This in turn favoured the financial sectors such as banks, which are closely associated with value. Financials, which form a significant proportion of the Straits Times Index (50%), were well positioned to benefit from rising rates and the trend towards the return to value. This helped fuel overall corporate earnings growth approaching 20%[1] in Singapore as well as positive revisions in 2022 despite the rising pressure on costs on profit margins and slower overall macro growth.

Second, Singapore's dividend yield (measured by the Straits Times Index) remained attractive at above 4%, placing the domestic market as one of the highest dividend yield markets in the region. In 2022, Singapore corporates also continued to raise dividend pay-outs, supported by strong free cash flow generation from sectors such as financials, communication services and industrials. Rising free cash flows highlight Singapore's quality and cash flow resilience and remain supportive for future dividend yields and dividend growth.

### Chart 1: Singapore free cash flow (FCF) generation outpaces bond yields




Source: Factset, Jefferies Global Equity Strategy

[1] Based on Refinitiv data (as at 22 November 2022)

Third, Singapore's economy in 2022 benefitted from the post-COVID-19 re-opening. In a well calibrated re-opening strategy, the Singapore government managed to restore its economy quickly and benefitted from a swift recovery in tourism and other consumer-related services. Singapore was also well placed as a financial centre in terms of investment flows, benefitting from a sharp rise in business service formation and inflows of capital into the region. The attraction of Singapore as an investment centre was further supported by the Monetary Authority of Singapore's (MAS) steady messaging on policy and continued tightening stance to strengthen the Singapore dollar (SGD) against most of the country's trade partners. The MAS's monetary policy stance led to the strengthening of the Singapore dollar versus its trade-weighted basket and further helped anchor SGD flows into the region, supporting domestic equity returns.

## Constructive outlook for 2023

Looking forward, we remain moderately positive on the Singapore equity market, despite the strong outperformance the market already delivered in 2022. Singapore's economic resilience, tight monetary policy conditions and high inflation were highlighted in 2022. In 2023, a moderation of growth, a peak in inflation and a more accommodative monetary policy is expected. We see this as a positive for Singapore, as we believe a more accommodative policy backdrop will help support continued expansion in corporate earnings growth in 2023.

We see the prospect of economic growth moderating in Singapore from about 3% in 2022 to 1-3% in 2023. The growth moderation will likely be concentrated in the first half of 2023, when a slowdown in manufacturing and tighter credit conditions are likely to be more pertinent. Towards the second half of 2023, we do expect economic conditions to stabilise, with the prospect of some growth returning from a reopening of China and the moderation of global policy conditions in the end of 2023.

We expect interest rates to remain high for most of 2023, predicated on our view that global policy conditions will remain tight with global central banks including the MAS vigilant on quelling inflation. We expect inflation in Singapore to remain relatively elevated with core CPI ranging between 4-5% for 2023. The last MAS policy guidance in October 2022 saw a further steepening of the Singapore dollar's appreciation slope but no change in the mid-point of the currency's trading band. We expect policy conditions in Singapore to remain tight, and a higher terminal rate overall for interest rates in 2023. In such an economic environment, we favour quality and earnings resilience, with focus on companies with strong balance sheets and pricing power which we believe are better-placed to capture the opportunities in today's macro backdrop. We remain watchful, however, on the prospects of a faster deterioration of the economy which may see an earlier peak in interest rates. This will have broader implications on long duration assets including high dividend stocks and new economy sectors.

We continue to expect Singapore to outperform given its defensive characteristics and its ability to outperform on earnings resilience during times of risk aversion and volatility. The country is also well placed to benefit from China's reopening and a more accommodative policy backdrop should inflation moderate.

We believe valuations also bode well in Singapore. Corporate earnings growth looks set to improve by another 13%[2] in 2023, after rising 20%[3] in 2022. This brings overall market valuations to 11x[4] on a forward P/E basis and 1.1x[5] on a historical P/B basis, which is closer to the lower end of its historical range of valuations. The market also continues to offer a dividend yields of 4-5%, which keeps the Singapore equity proposition attractive.

## Pricing power, real assets, renewables: key narratives to counter inflation

2022 has witnessed a sharp rise in inflation, especially in services, as the Singapore economy reopened and COVID restrictions were relaxed. Business owners have struggled particularly in managing costs, especially those related to labour, and we expect such conditions to persist in 2023. Longer term, we also expect structural factors such as deglobalisation, domestic reshoring and demographic changes to keep inflation trends elevated.

As such, we believe outperformance in stock selection will come from companies which are able to deliver sustainable growth amid current high inflation and elevated cost pressures. From a stock picker's perspective, finding pricing power in stocks to counter inflation pressure will be key to alpha generation in 2023 as cost pressures will restrain

[2] Based on Refinitiv data (as at 22 November 2022)
[3] Based on Refinitiv data (as at 22 November 2022)
[4] Based on Refinitiv data (as at 22 November 2022)
[5] Based on Refinitiv data (as at 22 November 2022)

margins. We favour quality: that is, companies with strong balance sheets and those that can deliver sustainable returns in a post-pandemic Singapore.

We continue to favour industrials as a sector, focusing on key franchises with pricing power and the ability to pass through costs. The sector also offers a good proxy for energy transition and real asset infrastructure opportunities which represent growth in a time when energy security and self-sufficiency are key issues. Within industrials, we like utilities as we see rising energy prices as a boost to the sector; the continued push towards sustainability investment is also a growing theme. We also see utilities pursuing renewable opportunities actively, identifying positive future sustainable returns within their transition stories. These companies have demonstrated clear and aggressive plans to restructure and grow their renewable portfolios through decarbonisation initiatives, green financing and accelerated capital recycling for growth.

We also like the theme of real asset infrastructure within industrials, as we see compelling growth opportunities as the government and the private sector accelerate capital spending into restoring supply chain bottlenecks and investing in renewables as an alternative source of power. Electric vehicle infrastructure is particularly well positioned as Singapore transits away from traditional internal combustion engines (ICE) from 2030. Companies that are firmly engaged in the construction and management of the infrastructure supply chains and the operation of new infrastructure assets such as solar and hydrogen are poised to benefit most, in our view. We believe that companies involved in the maintenance, industrial automation and upgrading of networks critical to the infrastructure are also poised to benefit.

We also favour consumer food staples, given the importance of bio-food security and the tighter supply of key agriculture commodities. Improving food supply is a solution but this is complicated by biodiversity and emissions risks. We are positive on agri-food companies working towards providing solutions to solve these supply issues, e.g., food safety, recycling, clean water, crop yield improvement and biodiversity.

We also continue to favour financials.  Banks are expected to continue expanding their net interest margins amid a rising interest rate environment. With Singapore as a financial centre, banks are also well positioned to capitalise on supply chain reconfigurations in trade (re-shoring) and rising capital inflows into the ASEAN region. The sector's attractive dividend yield proposition of 4-5% is also likely to be sustained in 2023.

We are selective in technology as broad-based recession risks start to rise. We continue to favour companies which benefit from long-term trends such as digital disruption and those that are well placed from a trade diversion perspective as supply chains are reconfigured in Asia.

We are more cautious on sectors such as property, real estate investment trusts (REITs) and telecommunications given rising interest rates, limited growth options and their less attractive yield propositions compared to the other sectors.

## Summary

In summary, we are more constructive about Singapore as we approach 2023. We see Singapore offering back-to-back double-digit earnings growth in 2023, well supported by a steady domestic economy. The prospect of a more accommodative policy backdrop for 2H2023, attractive valuations and potential reopening tailwinds from China offer upside opportunities. A deeper global economic recession and longer and more aggressive global tightening represent key risks for the Singapore market.

We remain selective in stock selection, focusing on companies with pricing power and ability to sustain growth in times of economic growth moderation and elevated inflation pressures. We are most upbeat in industrials where we identify strong growth opportunities in capex and renewable and transition opportunities. We also favour financials and consumer staples within the Singapore backdrop. We remain more cautious on property, REITs and telecommunications due to their less attractive valuations and yield pressure from higher interest rates.

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