Global Macro Asset Strategy - Update

Nibbling in opportunities present themselves

By Joshua Tan & Ng Weiwen
Products: ETF | CFD | Unit Trusts

8 July 2013
Phillip Securities Research Pte Ltd

Revised table summary of Asset Strategy (Pg.8), with ETF and CFD instruments to trade the outlook (Pg.9). Tactical trading without front-load sales charge is available with a Phillip UT WRAP account.

OW = Overweight; NW = Neutralweight; UW = Underweight
Note: Neutralweight is equivalent to our previous rating of Marketweight

In GMAS 12th April we warned of the prospect of a correction in 2q13 as we had a p/e expansion rally despite a slowing global economy. Markets have indeed finished a wave of correction. While we maintain our view that the bull-run is not over yet and that the sell-off is largely technical in nature, we do not rule out another leg down before resumption of the uptrend. As the global economy is likely to rebound in the 2H after a lackluster 1H, the possibility of a resumption of the equities uptrend is likely.

Present levels in equity markets offer nibbling opportunities – it is after all tough to time bottoms, in the event there is no 2nd leg down, we wouldn't want to waste what is still a good entry point. Our OWs are the US (pick up in economy), JP (Yen depreciation will boost earnings) and ASEAN economies such as ID, TH and SG (resilient domestic demand).

We recently downgraded Philippines from OW to NW on 5th June Morning Note. Although the macro outlook for the Philippines remains positive, the equity index has vastly outperformed this year and valuations are still expensive at 19x trailing. Simply put, it needs to digest the run-up which it has had.

We also reluctantly downgraded Greater China (5th July China Strategy) from OW to UW just for the *short-medium term* due to continued uncertainty concerning the economy, the solvency of the banking sector, and the fact that bank earnings will be under pressure. But, from a long-term perspective Greater China is very much an OW, valuations are yet again too cheap to ignore especially if you consider that the government is resolute to walk the correct path of structural reform.

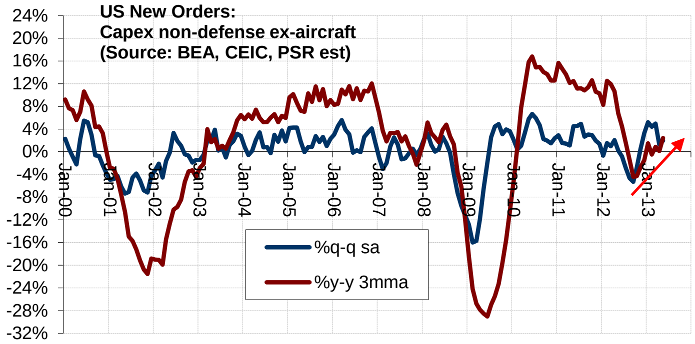
Fed tapering QE3 was what precipitated this correction. Our base case is gradual tapering in Dec, though there is a significant possibility of it happening earlier in Sept FOMC. Before then – we see a tug of war between investors who see tapering as a sign of a strengthening economy (good! Buy!) and those who have seen the last 4 years as a liquidity driven rally (it was all just liquidity! Sell!). We believe the former will win out, because the last 4 years has NOT just been about liquidity.

No change to our broad asset allocation of OW equities, NW fixed income, NW commodities and UW gold.

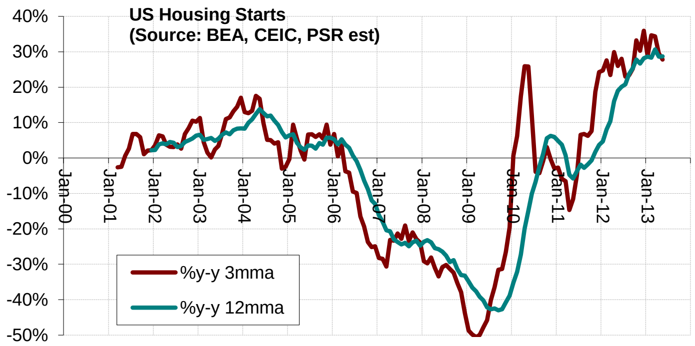
THE GLOBAL ECONOMY:-

We reckon that we will likely see a rebound in global economic activity in 2H13, though the rebound will be more pronounced in DMs rather than EMs. US key forward indicators investment spending and housing remain firmly in expansionary territory, the EZ's growth outlook is getting less bad with tail risks receding (or rather the perception of tail risks on the EZ front), JP's economy is rebounding on animal spirits fuelled by Abenomics. The only wild card that remains is CHINA – which in its determination to wean itself off short term stimulus in favour of structural reform, is chancing a cyclical hard-landing in the absence of policy support for the economy.

US core capital goods new orders picking up



US housing starts moving swimmingly along



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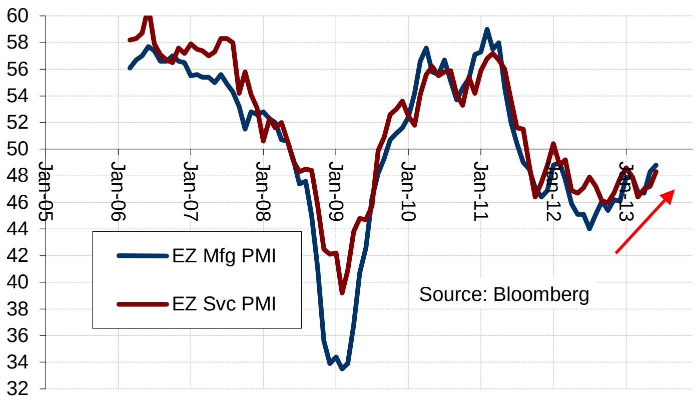
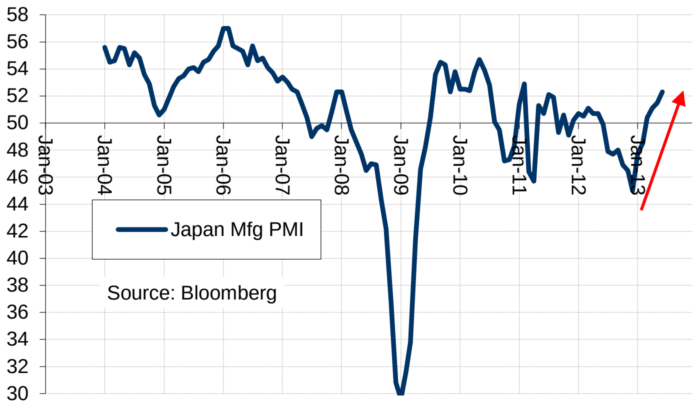
EZ contractions easing off

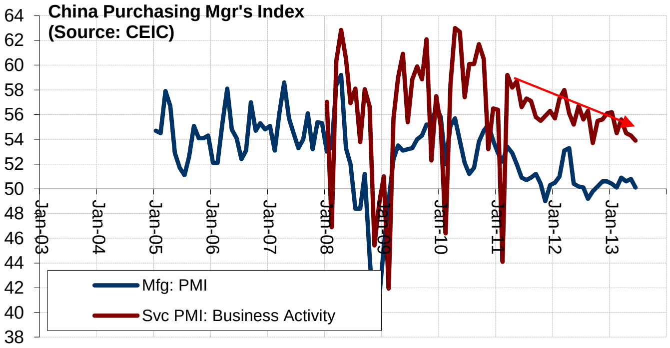


Japan – confidence is coming back!

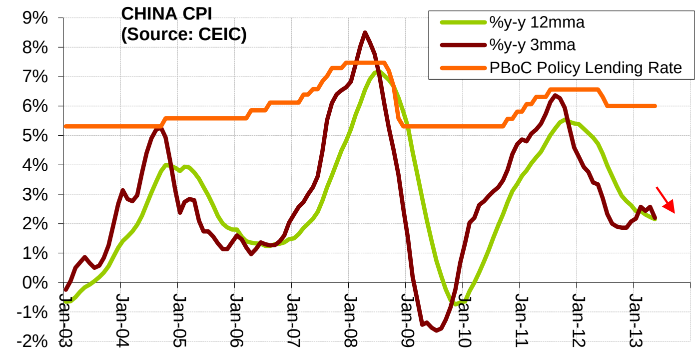


The present wild card in terms of growth is China: prospects of a hard landing are real. Economic activity from industrial output to retail sales to exports has been sluggish at best (see 5th July China Strategy), and the CPI has been weak, indicating poor demand.

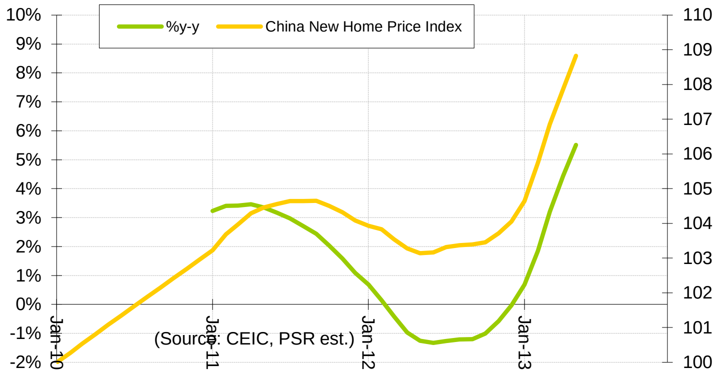
China's weak economy best summarised by the PMIs



China's weak CPI reflects weak demand…



Yet the ability to ease will be hampered by still rising housing market



3 THEMES TO WATCH THIS 2H13:-

(1) Sep 13: US monetary AND fiscal policy! Tapering of LSAPs (Large Scale Asset Purchases) by the Fed, and the debt ceiling issue may rear its ugly head.

Employment numbers may start to outperform as June's 195k jobs added was way above expectations. As we have a bullish view of US growth 2H13, this may just happen.

The question at the back of everyone's minds (as well as the key source of uncertainty) is when will the Fed start to taper its LSAPs?

Our base case is that the Fed will begin gradually tapering its purchase of assets in 4q13, specifically Dec, though there is a significant possibility of it happening in Sep if employment numbers continue to outperform. (Tapering aside, we are pencilling the first rate hike by end 2014.)

We reckon that chatters of gradual tapering of LSAPs might gain momentum in Sept once the Fed has a full 3q13 of jobs data. Furthermore, Bernanke will be able to manage market's expectations during the quarterly press conference in Sep13.

Simultaneously, **unresolved fiscal uncertainties** in the US persist. US stayed just a tad below the debt ceiling by undertaking an emergency measure, suspending investments in federal worker retirement funds. So the US has earned a reprieve till possibly early Sept though there is a significant risk that fiscal consolidation remains absent even after emergency measures are exhausted.

So watch out for a confluence of major event risks in Sept.

(2) Data point to data point: China cyclical hard landing? While Premier Li Keqiang has resolutely steered the nation thru the narrow gate of structural reform, totally shunning cyclical monetary/fiscal stimulus unlike his US, EZ and JP counterparts, he is taking the chance of a cyclical hard landing of the economy. Although a hard landing scenario (growth for 2013 <7%) is not our base case nor the consensus base case, we keep in view that it is now a tail risk event. Markets and ourselves will be hanging onto every data point that comes out of China to assess whether or not the nation is headed in that direction. A China hard landing could easily induce an Asian bear market.

China's chosen path of structural reform will pay dividends in the future. The following reforms will prove expansionary but will take time to implement and have an effect on the economy, they include: hukou reform, cutting red tape, social spending, strengthened land rights, VAT reform, and private rail investment. Other reforms, necessary to make the economy more efficient, could nonetheless be contractionary in the medium term: natural resource tax, higher utility prices, liberalisation of the exchange rate, liberalisation of the interest rate, and property tax.

Through this retrofit of the economy, hard landing fears will abound – the important thing to realise and take comfort from is that China's hard landing risk is self-induced. This by itself is encouragement to stay positive on China because the first rule of a crisis is denial – this Premier Li and his team clearly are not, instead being fully aware and determined to tackle economic imbalances the hard way.

(3) Jul 13: Japan – the world awaits the 3rd arrow. We have caught a glimpse of Abe's 3rd arrow (special economic zones, etc) but essentially we need DETAILS! For Japan to have a structural effect on the global economy, Abe must provide specific (as opposed to sketchy) plans and implement his "3rd arrow" in Abenomics. Specifically, he needs to push through supply-side reforms to reinvigorate the economy. And an overhaul of the corporate tax will be warmly welcomed by markets. Abe's commitment to the Trans-Pacific Partnership free-trade negotiations is a good start. Right now the risk is that Abe might shy away from other difficult – and politically unpopular – reforms ahead of parliamentary upper house elections in July. If he veered from structural reforms towards constitutional reforms instead in July, that would be a disappointment for the global economy.

ASSET STRATEGY:

We are still OW equities as:

(i) Global economic activity has not really fallen over the cliff, and is likely to improve China notwithstanding

(ii) Abenomics 3rd Arrow would be catalytic. But even if it doesn't happen will not derail the global economy.

(iii) Tail risks have receded particularly on the EZ front (as reflected by the decline in 10yr yields of peripheral EZ sovereigns). Tail risk from China are rising, but we reckon the Chinese leadership would still be pragmatic enough to tweak policy in view of a cyclical threat.

(iv) Fed tapering may further induce a sell-off in both stocks and bonds, but ultimately tapering itself means the economy is getting better which is far more positive for stocks than it will be for bonds. Thus as much as a sell-off may occur, so will a swift rally as money out of bonds will go into stocks. One word here: VOLATILITY.

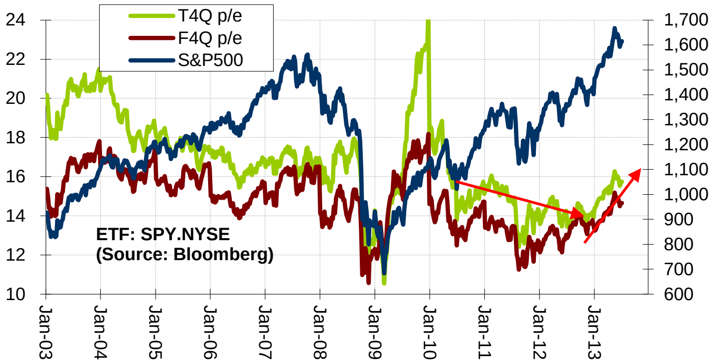
No change to our broad asset allocation of OW equities, NW fixed income, NW commodities and UW gold.

EQUITIES (OW):-

US (OW)

The US remains an OW for us due to the 2H13 pickup we talked about. Fed tapering we see as a mere pause before another leg higher – why? Because (1) this bull market has only been a liquidity driven event in the last 6 months where it was all multiples expansion (chart below), the 3.5yrs before that was an earnings driven rally as valuations progressively fell, (2) an improving economy ultimately means higher earnings – hence it will be about earnings again.

US equity bull has only been about liquidity these last 6 months (arrow pointing up), it will be about earnings again.



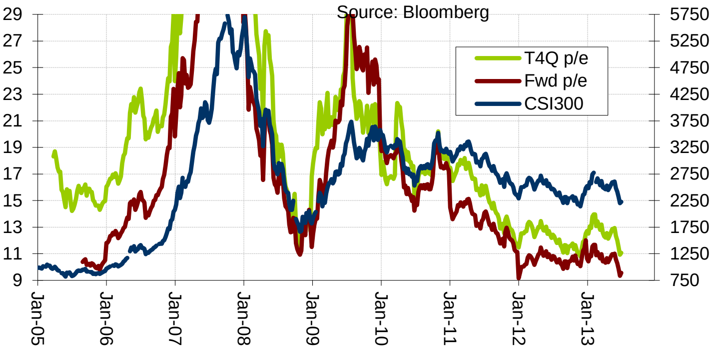
CHINA (UW if short-medium term; OW if long term)

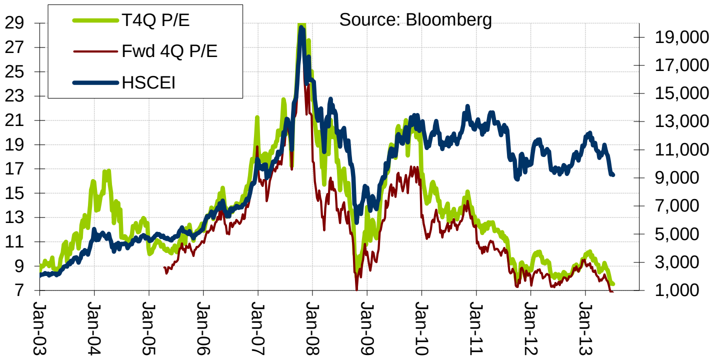
How you trade China will totally depend on the type of market player you are.

Traders will welcome what we see as range bound volatility, investors will welcome ultra-cheap valuations and think about how they will laugh all the way to the bank years from now. Everyone else in between should stay out.

We might have yet to see the last of the bears in the Chinese market. Near term wise, news flow on the banking sector will likely drive negative sentiment: tighter short term financing from the PBoC (to discourage shadow financing), will reduce loan growth. In addition, net interest margins are likely to narrow on greater interest rate liberalisation on the loan and deposit rates (to encourage competition and force banks to explore new customers outside of the SOEs). All this means poorer banking earnings which will have a negative effect on the indices given their greater weightage. But eventually lower interest earnings for banks means greater earnings for non-banks, again, short term pain for long term gain – hence UW in the short-medium term, OW for the long term.

Nonetheless, we wish to highlight that Chinese equities still offer compelling valuations.



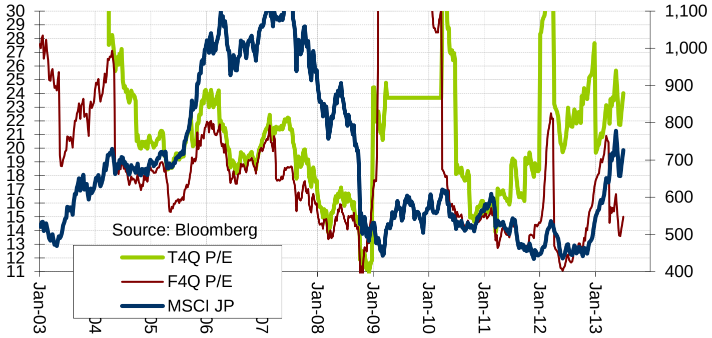


JAPAN (OW)

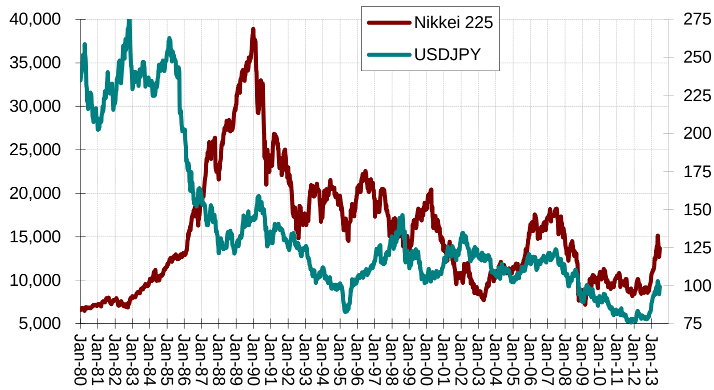
Prior to this GMAS report, we held onto the belief that JP must undertake structural reform in order for the Nikkei to rally higher but this is not a necessary condition. If JP does undertake structural reform of course this would be good for both the Nikkei and the Rest of the World's equity bull.

But if it does not, the Nikkei can still actually rally some more. If you think about it, the Yen is going to depreciate powerfully – while the US is on a tightening path, JP is on a loosening path – there is therefore only one way for the Yen to go – down some more! Exporters are therefore going to have a field day for earnings due to Yen depreciation, as Japanese goods re-known for quality suddenly become much cheaper.

MSCI JP forward p/e is 15.6x versus trailing p/e of 23.5x, that's a lot of eps growth (~60%!) analysts are expecting!



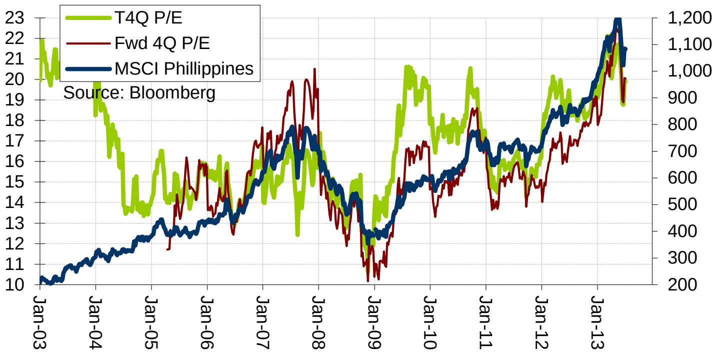
Yen has depreciated over 30% already, its full effect on FY13 earnings is not yet felt, at the same time it could depreciate further from the 100 level to 120 easily.



ASEAN:-

PHILIPPINES (NW)

Notwithstanding its still positive macro outlook, we downgraded Philippines to NW from OW on 5th June.



This takes into account the following:

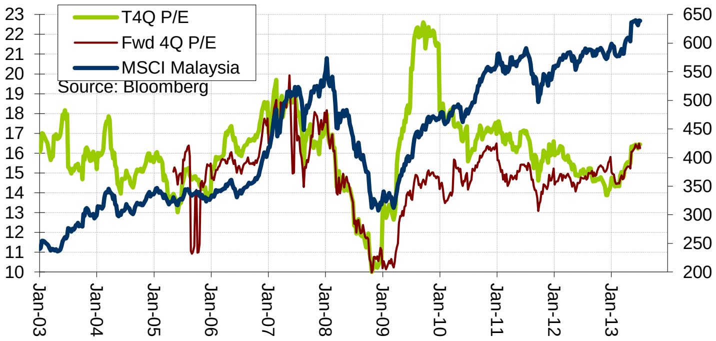
(i) The index has vastly outperformed this year and (P/E) valuation multiples are expensive compared to an absolute and relative to peers basis.

(ii) Post upgrade to investment grade, there is a lack of visibility of catalysts. While 1Q13 growth (7.8% y-y) surprised to the upside and it received its second investment grade rating from S&P (after Fitch's upgrade), most of the upside has already been priced in. Specifically, we raised the possibility of Philippines achieving investment grade as early as last year in our ASEAN macro strategy report. Since then, Philippines equities have already rallied quite a fair bit and government bond yields have fallen below many other investment grade sovereigns (with dubious credit quality).

(iii) Asset bubble bubbling. In the near term, Philippines could see larger capital inflows as the upgrade opens up a pool of potential investors. But Philippines will be confronted with challenges such as managing a stronger peso as well as risks of an asset bubble if not managed prudently

Indeed the central bank (BSP) is cognisant of this, standing pat in April, maintaining the key policy rate while cutting the rate on its special deposit account (SDA) by 50 bps, likely in an attempt to temper the appreciation of the Philippine peso, rather than stimulating growth per se. Looking ahead, the BSP is likely to adopt an interest rate corridor framework with the lower bound being the SDA rate (2%) which is below the reverse repo rate (3.5%).

MALAYSIA (NW)



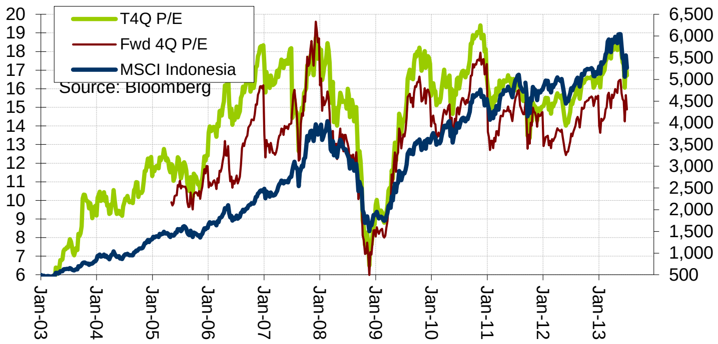
There are upsides to our NW rating on Malaysia**,** especially when all signs suggest that Najib will unlikely face a leadership challenge within UMNO. Note we were previously worried that Najib might be confronted with a leadership challenge after failing to garner a strong mandate (or even improve on 2008 dismal performance) despite massive social handouts as well as economic building and reforms. A challenge to the leadership would translate to headwinds for the Economic Transformation Program and Government Transformation Program – major pillars of the domestic demand story. A return of political uncertainties might also delay Petronas's planned RM300 billion capital expenditure over the next five years in the oil and gas sector.

But while Malaysian markets might be due for a re-rating, fiscal consolidation (via GST to broaden the tax base as well as food and fuel subsidy cuts) – after massive cash handouts and pre-election pump priming in the months preceding 13th GE – will be the key priority for the administration post-elections.

INDONESIA (OW)

In Indonesia, the long overdue fuel price hike was finally implemented after several false alarms earlier.

While the fuel price hikes of 44% for retail gasoline and 22% for diesel will likely weigh on the purchasing power of the low-income households, the Indonesian government is also cognizant of this and has announced an assistance package to help poor families directly. Rationally, it makes more sense to transfer cash to the poor directly as a subsidy, than to blanket subsidy the entire population, rich included, via the fuel subsidy. This move is significant as it means the budget going forward will have more capacity for the things that matter to future growth – education, health, infrastructure.



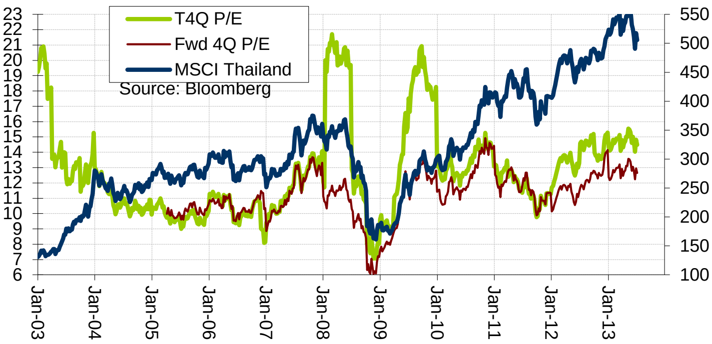
That said, the fuel hike will have negative consequences to inflation and growth. Inflation accelerated to 5.9% y-y in June, faster than the 5.5% registered in the preceding month. Expect July inflation to come in much higher as the effects of the fuel price hike filter through and demand rises during Ramadan. We reiterate that we expect headline inflation to rise to around 8% y-y in 2H13 (peaking in Sept-Oct). Growth could be shaved off around 0.4%-pts.

However, we take comfort from Bank Indonesia's pro-active management thus far, especially in its recent bid to anchor inflation expectations before the fuel price hike. Recall the central bank Bank Indonesia hiked its key rate by 25bps to 6% after raising the FASBI deposit rate (off-cycle) by 25bps to 4.25%. We do not rule out the possibility of another 50bps of FASBI rate hike to 4.75% by year end and another 25bps hike in key policy rate to 6.25%.

Going forward then we expect the Rupiah to have appreciation pressure – the fuel price hike will help reduce the twin deficits of the current account and the budget, and there will be upward pressure on the interest rate to anchor inflation expectations. At the same time the improved budget would mean greater investment in public goods. Thus we maintain OW on appreciating Rupiah and continued investment demand.

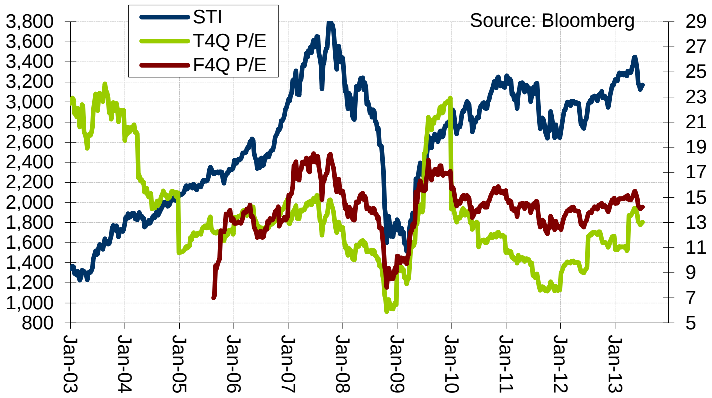
THAILAND (OW)

In 2H13, Thailand is expected to commence its THB2.2trn infrastructure plan after more than a decade of neglect of public goods. Within the next 3 years it is estimated two-thirds of the amount would have been disbursed, or 4.3% of nominal GDP per year. This is huge and guards downside risks to growth, we expect investors to take note of this and pay a premium for growth resilience.



SINGAPORE (OW)

We are still OW Singapore as we expect the country to benefit along with our sanguine outlook for the global economy in the 2nd half.



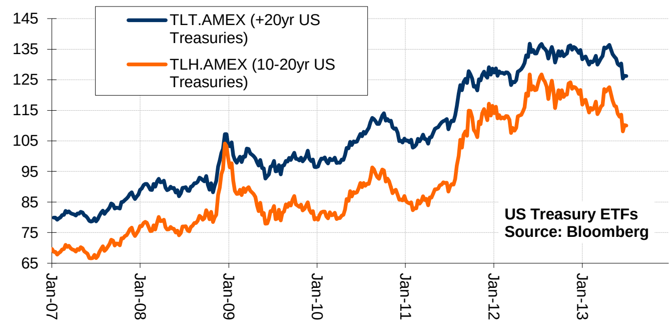
ASEAN rates table:-

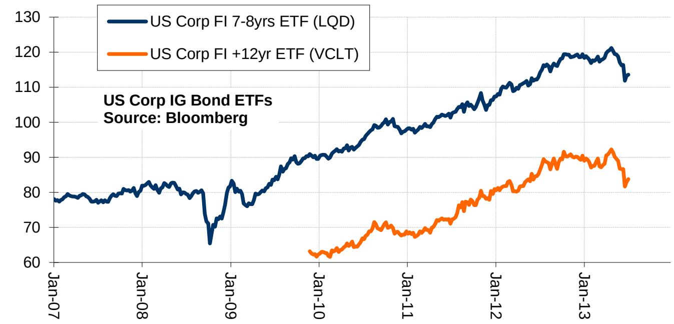
Country	Policy Rate	Current	Last Change
Singapore	SGD NEER	maintain modest and gradual appreciation of S$NEER	increase slope of policy band, restore narrower policy band (Apr 2012)
Malaysia	O/N Policy Rate	3.00%	+25bp (5 May 2011)
Thailand	1-Day Repo	2.50%	-25bp (29 May 2013)
Indonesia	O/N Rate	6.00%	+25bp (13 June 2013)
Philippines	O/N Reverse Repo	3.50%	-25bp (25 Oct 2012)

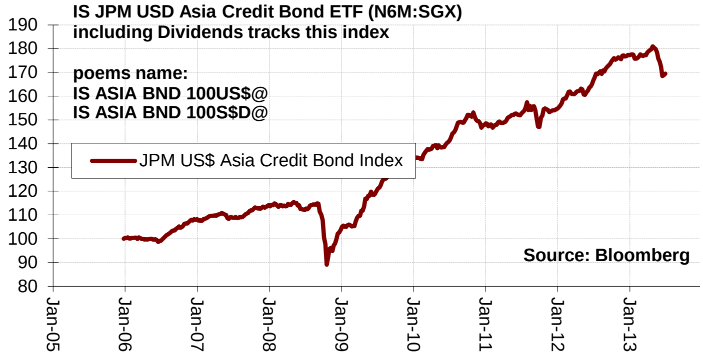
FIXED INCOME (NW):-

Our fixed income calls have been exemplary, as our call at the start of the year to downgrade the entire fixed income asset class from OW to NW has proved accurate. Given our sanguine view of the US economy, which will call for tighter monetary policy, will continue to put the long end of the curve and safe haven issues as the most vulnerable to a selloff. We maintain this view, and our calls below.

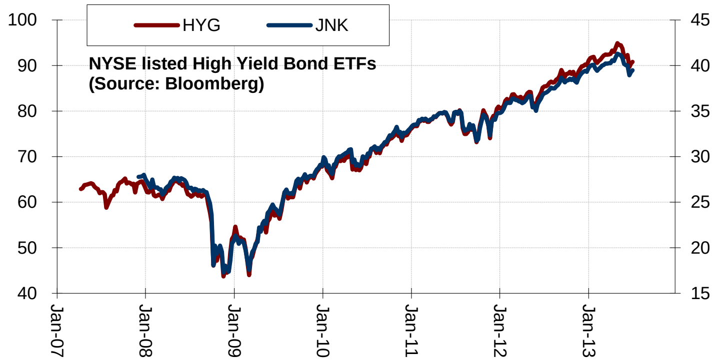
Maintain UW: US Treasuries, US$ Investment Grade Corporate Debt, and EM-Asia US$ IG

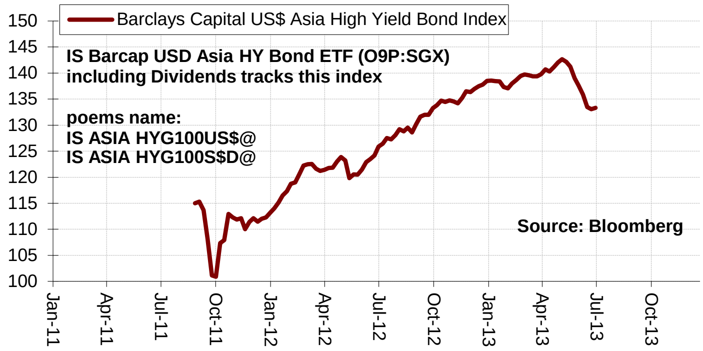


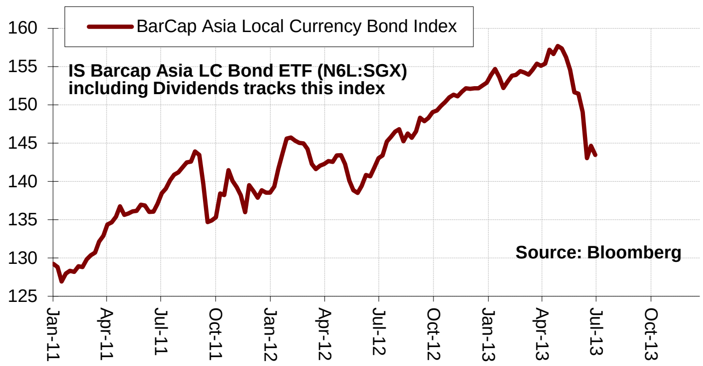




Maintain NW for High Yields and EM-Asia LC:

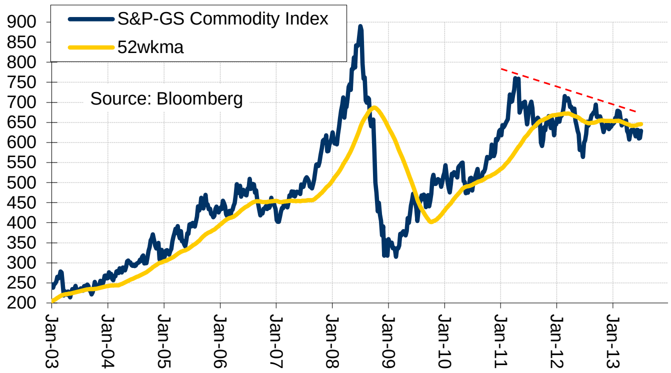






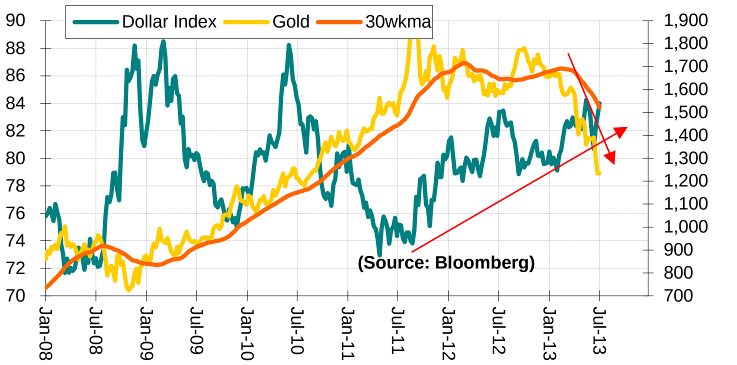
COMMODITIES (NW)

Ytd, the performance of commodities has vindicated our NW rating on this asset class. We continue to prefer to express our views of an improving global economy with an OW on Equities than an OW on commodities, given China's slowdown.



GOLD (UW)

One of best calls has been to UW Gold since 25th Oct 12 (GMAS – Is gold losing its glitter?). We continue to UW Gold on a positive outlook for the US$ vs major currencies, premised on: tapering of QE, an improved US trade balance on the shale energy boom, an improved US economy which increases expectations of tighter monetary policy even as the EZ, JP, UK run loose monetary policy.



Phillip Securities Research: Asset Allocation Strategy

Returns incl. Yield	2012	2012 total return		2013	2013 total return	
Bonds						
US Treasuries	OW to UW 9th Oct	7.0%	correct	UW	-6.6%	correct
US MBS	OW	4.6%	wrong	OW to UW 23rd Jan	-2.3%	correct
US Corp IG	OW to MW 9th Oct	16.5%	correct	UW	-6.0%	correct
US Corp HY	OW	20.0%	correct	OW to NW 18th Feb	-0.1%	correct
EM-Asia US$ IG	OW	19.6%	correct	OW to UW 23rd Jan	-7.2%	correct
EM-Asia LC IG	OW	13.3%	correct	OW to NW 23rd Jan	-5.7%	correct
EM-Asia HY	OW	30.7%	correct	OW to NW 18th Feb	-6.0%	correct
simple average:	OW	15.9%	correct	NW	-4.8%	CORRECT
Equities						
World	NW	15.4%	correct	OW	9.4%	CORRECT
US	UW to NW 21 Dec	13.8%	shld have MW in Jun not Dec!	NW to OW 18 Mar	14.4%	better late than never
EZ	UW	17.8%	wrong	UW	4.3%	wrong
JP	-			NW to OW 7 Jul	38.2%	OW short term correct. Now LT!
Korea	NW	12.8%	correct	NW	-9.6%	wrong, should be UW
Taiwan	NW	12.2%	correct	NW	2.6%	correct
China-A	OW 22 Oct	7.8%	timely!	OW (LT only)	-6.2%	UW short term
China-H	OW 22 Oct	17.8%	caught 2nd move	OW (LT only)	-13.1%	UW short term
HK	OW 8 Oct	26.1%	caught 2nd move	OW (LT only)	-2.2%	UW short term
SG	OW	23.5%	correct	OW	-0.1%	maintain
MY	NW	13.4%	correct	NW	8.9%	wrong
TH	OW	29.6%	correct	OW	-0.1%	maintain
ID	NW	11.3%	correct	NW to OW 11 Apr	3.1%	maintain
PH	OW	36.8%	correct	OW to NW 5 Jun	14.2%	correct
India	UW	29.3%	wrong	UW	-0.3%	correct
Commodities	UW	-3.4%	correct	NW	-4.4%	CORRECT
Gold	UW 25th Oct	-2.9%	correct	UW	-25.0%	CORRECT

OW = Overweight | NW = Neutralweight | UW = Underweight (Souce: PSR, Bloomberg)

Global Macro, Asset Strategy Team, Phillip Securities Research

OW = Overweight ; MW = Neutralweight ; UW = Underweight

Broad Asset	Sub-Asset	ETF		Phillip CFD
Bonds (MW)	US Treasuries	TLH.AMEX / TLT.AMEX		
	US Mortgage Backed	VMBS.AMEX / MBG.AMEX		
	US Corp	VCLT.AMEX / LQD.AMEX		
	US Corp High Yield	HYG.AMEX / JNK.AMEX		
	EM US$ Govt	EMB.AMEX		
	EM LC Govt	LEMB.AMEX		
	EM US$ HY Corp & Govt	EMHY.AMEX		
	Asian US$ Govt & Corp	N6M.SGX		
	Asian LC Govt & Corp	N6L.SGX		
	Asian US$ Corp HY	O9P.SGX		
Equities (OW)	US	SPDR S&P 500 (SPY:AMEX)		US SP 500 Index USD5 CFD (S&P500) / Wall Street Index USD1 CFD (DJIA)/ US Tech 100 Index USD5 CFD
	Europe	SPDR Stoxx 50 (FEU:AMEX)		
	Australia	iShares MSCI Australia (IOZ:ASX)		
	Japan	Lyxor Japan TOPIX (CW4:SGX)		Japan 225 Index JPY100 CFD (Nikkei 225) / Tokyo Index JPY1000 CFD (Topix)
	S.Korea	DBXT - MSCI Korea (IH2:SGX)		
	Taiwan	DBXT - MSCI Taiwan (HD7:SGX)		Taiwan Index USD20 CFD (MSCI Taiwan)
	China A shares	CSI300 (83188.HK) / SSE 50 (JK8.SGX)		FTSE China A50 Index USD1 CFD
	China H shares	HKCEI (2828.HK)		H Shares Index HKD5 CFD (HSCEI)
	HK	Hang Seng (2800.HK)		Hong Kong 40 Index HKD5 CFD (Hang Seng)
	Singapore	SPDR STI (ES3:SGX)	**CIMB ASEAN40 ETF (QS0:SGX for S$ or M62:SGX for US$)**	STI SGD5 CFD / S'pore Index SGD20 CFD (SMSCI)
	Malaysia	DBXT - MSCI Malaysia (LG6:SGX)		FBM KLCI MYR10 CFD
	Thailand	DBXT - MSCI Thailand TRN (LG7:SGX)		
	Indonesia	DBXT - MSCI Indonesia (KJ7:SGX)		Indonesia Index USD1 CFD (MSCI Indon)
	Phillippines	DBXT - MSCI Philippines (N2E:SGX)		
	Vietnam	DBXT - FTSE Vietnam (HD9:SGX)		
	India	iShares MSCI India (I98:SGX)		India50 Index USD1 CFD (S&P CNX Nifty)
Commodities		Lyxor Commodity 10$US (A0W:SGX)		
Gold		SPDR Gold ETF (O87:SGX or GLD:AMEX)		

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