iFAST financial

M3

SECTOR REVIEW

MONTHLY MORNING MEETING APRIL 2018. PRESENTED BY iFAST FINANCIAL PTE LTD ©

REGIONAL MARKETS UPDATE

US MARKET (2.0 STARS – UNATTRACTIVE)

- ISM Manufacturing PMI came in at 60.8 in Feb 18, up from 59.1 in Jan 18
- ISM Non-Manufacturing came in at 59.5 in Feb 18, down from 59.9 in Jan 18
- Nonfarm payrolls rose 313,000 in Feb 18, after an upward-revised 239,000 gain in Jan 18
- Private payrolls rose 287,000 in Feb 18, after an upward-revised 238,000 increase in Jan 18
- Unemployment rate unchanged at 4.1% in Feb 18
- Factory orders fell -1.4% m-o-m in Jan 18, after an upward-revised 1.8% gain in Dec 17
- Advance retail sales fell -0.1% m-o-m in Feb 18, after an upward-revised -0.1% m-o-m drop in Jan 18
- Excluding autos and gas, retail sales rose 0.3% m-o-m in Feb 18, after an upward-revised -0.1% m-o-m drop in Jan 18
- Industrial production rose 1.1% m-o-m in Feb 18, after a downward-revised -0.3% m-o-m decline in Jan 18
- Leading index posted a 0.6% m-o-m increase in Feb 18, after a downward-revised 0.8% gain in Jan 18
- Housing starts registered a 1.236 million annual rate in Feb 18, after an upward-revised 1.329 million annual rate in Jan 18
- Building permits registered a 1.298 million annual rate in Feb 18, after a downward-revised 1.377 million rate in Jan 18
- Existing home sales rose 3.0% m-o-m in Feb 18 to a 5.54 million annual rate, after a -3.2% m-o-m fall in Jan 18
- Consumer confidence index at 127.7 in Mar 18, down from a downward-revised 130.0 reading in Feb 18
- Based on the S&P/Case-Shiller Composite 20, US home prices rose 6.40% y-o-y in Jan 18, after an upward-revised 6.31% gain in Dec 17
- Fed Funds Rate: 1.50% – 1.75%

MARKET OUTLOOK

Earnings estimates of American corporations (as represented by the S&P 500 Index) on aggregate saw little changes over the month of March (as of 26 March 2018). 2018's earnings estimates were revised -0.2%, while 2019's earnings estimates were revised by -0.1% over the month. Year-to-date, 2018's and 2019's earnings estimates have been raised 7.2% and 7.0% respectively, with the bulk of the upgrades made back in January as sell-side analysts grew more confident of stronger corporate earnings prospects stemming from the recent change in the tax code. The energy sector bore the brunt of earnings downgrades over the month, as the sector saw aggregate earnings for 2018 lowered by -1.7% (2019's earnings estimates were unchanged). Estimates for the technology and health care sector as a whole were almost unchanged, while the materials and industrials sector saw 2018's aggregate earnings upgraded 0.6% and 0.2% respectively month-to-date. On a year-to-date basis, the energy, consumer discretionary and financials sectors has seen the strongest upgrades, which is consistent with the current global macroeconomic backdrop.

With regards to recently-released economic data from the US, leading indicators such as the ISM manufacturing PMI came in at 60.8 in February, up from a prior 59.1 and beating consensus estimates. While new orders fell slightly, new export orders, backlogs and employment all rose. Additionally, the prices paid index rose once more (to 74.2) to a level the highest since June 2011, indicating that input price increases have been sustained, which could lead to inflationary pressures working through value chains into consumer inflation in the near future. On the other hand, the services (non-manufacturing) PMI declined slightly to 59.5 from a prior 59.9, but still above consensus forecasts. The employment component fell in February, but readings on new orders, new export orders and backlogs rose, suggesting strong demand. As a whole, the ISM surveys suggests that momentum in services and manufacturing in the US remains supported, boding well for the outlook for growth in 2018. In terms of employment numbers, February's nonfarm payrolls came in at 313,000, increasing from a prior upward-revised 239,000 and smashing consensus estimates for 205,000. The unemployment rate remained at 4.1%, while wages rose 2.6% year-on-year, lower than the prior downward-revised 2.8% year-on-year gain (wages rose 0.1% month-on-month). We maintain our view that the pace of job growth in the US will moderate to a lower pace, as the US enters the later stages of its business cycle.

In the Federal Open Market Committee's (FOMC) March's meeting, policy-makers raised the benchmark Fed Funds rate by 25 basis points to a range of 1.50% – 1.75%, a move which was by and large expected by the consensus. The Fed also raised its projections for GDP, with 2018's GDP forecast upgraded by 20 basis points to 2.7% and 2019's GDP raised 30 basis points to 2.4%. Inflation projections (represented by the Core PCE forecast) for 2018 were left unchanged but 2019's was raised by 10 basis points to 2.1%. More crucially, the updated 'Dot Plot' suggests that there remains a possibility of 3 more hikes this year. In his first press conference, new Fed chair Jerome Powell struck a balance between being data-dependent and the need for policy-making to be effective in the current economic backdrop. We believe that the pace of policy normalisation will continue to be the gradual moving forward.

Jitters over potential regulation of new tech giants like Facebook and trade tensions caused a return of volatility once again in March, and US equity markets tumbled -4.6% before making a month-to-date loss of -2.0% (-3.0% in SGD terms) as of 26 March 2018. Year-to-date, the US equity market has returned -0.6% in USD price terms. Despite an increasingly protectionist Trump administration, we do not think that a full-blown trade war would result, as the outcome of the tariffs and potential negotiations are not set in stone yet. With the recent sell-off, valuations have become slightly more attractive than before. At this juncture, American equities trade at 17.8X and 16.0X 2018's and 2019's estimated earnings as compared to its fair PE ratio of 15.0X. **We acknowledge the near-term benefits of the fiscal package, but are cognisant of relatively stretched valuations that limit the potential upside to any long term investor. We maintain our rating of 2.0 Stars "Unattractive" for the US equity market.**

RECOMMENDED FUNDS:
FIDELITY FUNDS - AMERICA FUND
BLACKROCK US SMALL AND MIDCAP OPP A2 USD (SMALL CAP EXPOSURE)

REGIONAL STAR RATINGS

US (2.0 Stars – Unattractive)

Why we like it

1. Economic Fundamentals Robust, Lending Support To Corporate Earnings Growth
   - Economic momentum remains robust, manufacturing has picked up since 3Q 16 while consumption is expected to be the key driver for GDP, supported by a robust labour market and still relatively subdued energy costs
   - In an environment of positive economic growth, earnings are forecasted by consensus to grow by a 8.7% annualised rate by end-2020 (as of 26 Mar 18)

2. Strong Brands, Global Reach And Importance
   - Many US companies possess strong branding power; 9 out of the 10 most valuable brands of the world are US companies (according to Forbes' 2016 study)
   - A large proportion of the largest US companies derive significant proportions of revenue from overseas, allowing such companies to benefit from global growth rather than being fully dependent on the domestic economy
   - Leading US companies still remain global leaders in various fields like technology (Apple, Google, IBM), finance (JP Morgan, Citigroup), energy (Exxon Mobil, Chevron), consumer-orientated (P&G, Coca Cola, Amazon, Walt Disney) and even healthcare (Johnson & Johnson, CVS Health)

3. Domestic Growth Drivers And Trends
   - Other than a normalisation of the residential housing market, unparalleled access to cheaper energy prices – via the shale energy revolution – should provide a competitive advantage for US manufacturing and companies
   - The Trump administration has rolled out a fiscal stimulus package via a lowering of statutory tax rates, boosting domestic growth
   - The US remains a key player in the global innovation scene, leading the way in digitisation

What we don't like

1. Valuations Remain Elevated, Resulting In Lower Potential Returns
   - On several valuation metrics, valuations of the US equity market remain stretched at this current juncture. The forecasted annualised return of US equities by end-2019 is the lowest among the markets we cover

2. Earnings Growth Vulnerable To A Contraction Of Corporate Profit Margins
   - Profit margins of US companies remain high relative to historical averages (approximately 6.0%); may contract if labour costs increase and the Fed continues on its monetary tightening stance as the US economy enters the later stages of the business cycle
   - Earnings growth prospects will be affected if margins decline and sales growth do not increase

3. Selected Areas Of "Excesses" And "Frothiness"
   - Signs of over-optimism have manifested in selected areas of the market – the recent IPOs of new technology companies with no profits calls to mind the more "bubbly" period of the stock market in the late 1990s
   - Relatively-stretched valuations in some areas in small caps, certain technology sub-sectors and the defensive sectors (healthcare, utilities) are also areas of concern

4. Increasing Tendency Towards Protectionism
   - The Trump Administration has continuously threatened the US' trading partners over its trade deficit, and started leveraging its executive power to impose trade tariffs on various sorts of imports
   - An escalation of tensions could lead to a trade war, which could hurt certain segments of the economy and put upward pressure on domestic inflation