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FINANCIAL

KGI SECURITIES (SINGAPORE) PTE. LTD.

2020 OUTLOOK:

10 CONVERSATIONS FOR 2020

9 JANUARY 2020
KGI SECURITIES (SINGAPORE) OUTLOOK 2020

" IT WAS THE BEST OF TIMES,
IT WAS THE WORST OF TIMES,
IT WAS THE AGE OF WISDOM,
IT WAS THE AGE OF FOOLISHNESS,
IT WAS THE EPOCH OF BELIEF,
IT WAS THE EPOCH OF INCREDULITY,
IT WAS THE SEASON OF LIGHT,
IT WAS THE SEASON OF DARKNESS,
IT WAS THE SPRING OF HOPE,
IT WAS THE WINTER OF DESPAIR. "
- CHARLES DICKENS

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WATCHLIST:

Mapletree Commercial Trust
(MCT SP)

Mapletree Logistics Trust
(MLT SP)

Sembcorp Industries
(SCI SP)

Jardine Cycle & Carriage
(JCNC SP)

OCBC
(OCBC SP)

WHAT HAPPENED IN 2019 AND WHAT'S NEXT?

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Equity markets closed out the year with one of the best performances in the decade despite the slowest global economic expansion since the financial crisis in 2009, defying consensus forecasts that were expecting the bull market to finally be upended by the US-China trade war.

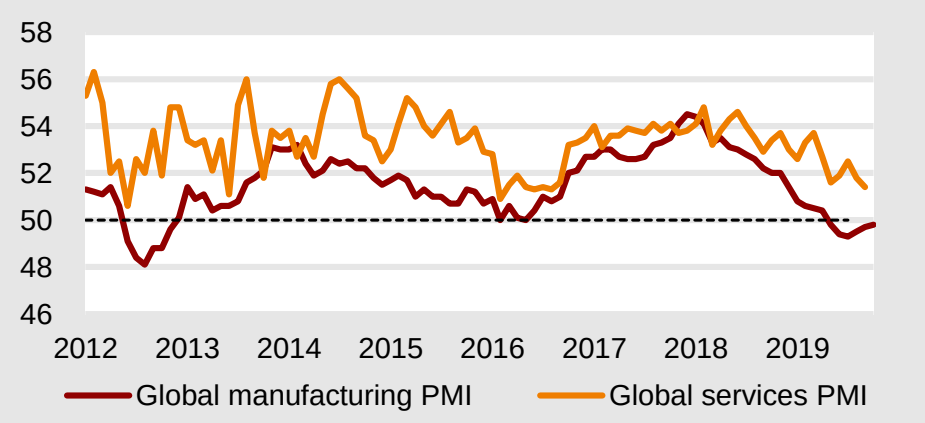
However, the fundamental picture looks mixed and continues to look mixed as we enter 2020.

For one, the *global economy diverged significantly* as the manufacturing sector experienced the weakest growth in the last decade, while the service sector portrayed a completely different picture of robust growth.

Second, the trade tensions and political movements such as Brexit, was a reflection of the populist backlash against globalisation, and likely signals the start of *de-coupling* between countries.

Finally, technology advancement will continue at an accelerated pace, bringing with it not only winners but significant *disruption* to companies and the existing global system, thus exacerbating the de-coupling trend of slowing cross-border flows of trade and capital.

Figure 1: Divergence between the global manufacturing and service sector



Source: Bloomberg, KGI Research

A great year for global equity markets

The major equity indices had one of the best years over the last decade, although the journey over the past year was punctuated by two corrections in May and August. US Indices finished the year up between 27% and 38% (inclusive of dividends reinvested back) as hopes that the combination of lower interest rates and easing trade tensions will help sustain the longest bull market in US history. Technology, a key theme which we touch on in this report, was the best performing sector. Apple and Microsoft, the two largest S&P 500 components, drove most of the outperformance. In Asia, equities most exposed to international trade underperformed; Hong Kong's shares still managed to eke out a 15% gain despite months of protests, outperforming both the South Korean and Singapore markets.

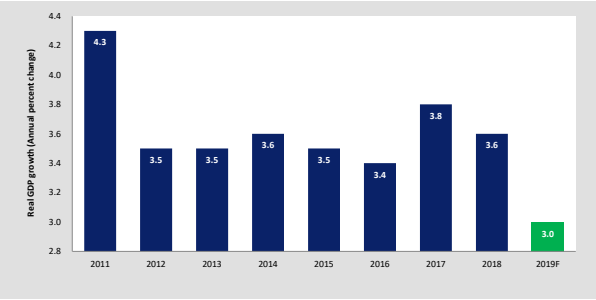
In 2020, our focus will be on Emerging Markets (EM) (click here), especially China (click here), precious metals (click here) as a hedge against the increasing geopolitical risks (trade war and US-Iran tensions), and technology (click here), which continues to ride on the long-term structural changes in the global economy. All of this will not matter if the world literally burns down, hence a 5-page section on ESG (click here).

Figure 2: Global equity benchmarks- 1 year, 5 year and 10 year total annualised returns

Bloomberg Ticker	Index	Div Yield (%)	PE Forward (%)	1-Year Total Return (%)	5-year Annualised Return (%)	10-year Annualised Return (%)
	AMERICAS					
INDU Index	DOW JONES INDUS. AVG	2.24	16.8	27.3	12.5	13.3
SPX Index	S&P 500 INDEX	1.82	18.0	33.0	11.5	13.5
CCMP Index	NASDAQ COMPOSITE INDEX	1.12	23.4	38.3	14.9	16.4
SPTSX Index	S&P/TSX COMPOSITE INDEX	3.13	14.7	24.5	6.4	7.1
IBOV Index	BRAZIL IBOVESPA INDEX	2.79	13.6	32.6	18.4	4.9
	EURO					
SX5E Index	EURO STOXX 50 PR	3.27	14.5	31.3	7.5	6.8
UKX Index	FTSE 100 INDEX	4.47	13.4	18.7	7.4	7.4
CAC Index	CAC 40 INDEX	3.12	14.9	33.2	10.8	8.5
DAX Index	DAX INDEX	2.91	14.1	26.3	6.3	8.8
	ASIA					
NKY Index	NIKKEI 225	1.90	17.0	20.9	8.4	12.0
HSI Index	HANG SENG INDEX	3.63	10.7	15.4	7.7	5.9
SHSZ300 Index	CSI 300 INDEX	2.33	11.9	38.3	5.5	3.3
AS51 Index	S&P/ASX 200 INDEX	4.04	17.4	27.0	10.9	10.4
KOSPI Index	KOSPI INDEX	2.08	11.8	8.5	4.5	4.8
NIFTY Index	NIFTY 50	1.46	17.6	14.4	9.7	10.9
TWSE Index	TAIWAN TAIEX INDEX	3.73	16.3	29.8	9.7	8.2
JCI Index	JAKARTA COMPOSITE INDEX	2.18	14.6	4.4	6.0	12.0
FBMKLCI Index	FTSE BURSA MALAYSIA KLCI	3.41	15.9	-1.3	1.4	5.5
STI Index	STRAITS TIMES INDEX STI	4.13	12.6	10.0	2.8	4.8
PCOMP Index	PSEI - PHILIPPINE SE IDX	1.65	15.3	6.5	3.3	12.3

Source: Bloomberg, KGI Research

Figure 3: Global GDP growth



Source: Bloomberg, KGI Research

Slowest global growth since 2009

The global economy is expected to grow at 3.0% in 2019, the slowest since the global financial crisis in 2009. Economic data in 4Q 2019 are showing signs of a bottom in economic growth, and consensus is forecasting a rebound this year.

However, views of the recovery is widely dispersed, with **2020 global GDP growth forecasts coming in as low as 1.2% to as high as 3.7%**. As such, we believe we are not totally out of the woods yet in 2020. Even though the manufacturing sector only represents 15% of global GDP, it could still pose a threat to global growth if it were to weaken and pull down the service sector, a sector that has provided a much-needed support to the global economy in the midst of geopolitical and economic challenges.

Figure 4: Best and worst - STI components performance in 2019

BBG TICKER	COMPANY NAME	PRICE	MKT CAP (SGD mn)	EPS (PREV Y) FY18A	EPS (Y) FY19E	EPS (Y+1) FY20E	EPS (Y+2) FY21E	GROWTH (Y)	GROWTH (Y+1)	RELATIVE PERFORMANCE YTD TO STI (%)
MCT SP Equity	Mapletree Commercial Trust	2.39	7,903	0.091	0.084	0.104	0.097	-7.9%	23.8%	38.4
THBEV SP Equity	Thai Beverage PCL	0.89	22,351	0.938	1.062	1.142	1.236	13.3%	7.5%	38.9
MLT SP Equity	Mapletree Logistics Trust	1.74	6,607	0.079	0.075	0.080	0.081	-5.6%	6.7%	31.5
CIT SP Equity	City Developments	10.95	9,931	0.599	0.586	0.635	0.709	-2.2%	8.4%	30.1
UOL SP Equity	UOL Group Ltd	8.32	7,018	0.515	0.412	0.484	0.408	-20.0%	17.5%	28.0
WIL SP Equity	Wilmar International Ltd	4.12	26,124	0.178	0.185	0.207	0.229	3.9%	11.9%	25.7
SGX SP Equity	Singapore Exchange Ltd	8.86	9,489	0.365	0.368	0.409	0.418	0.8%	11.1%	18.0
CAPL SP Equity	CapitaLand Ltd	3.75	18,909	0.185	0.218	0.275	0.290	17.6%	26.1%	14.8
AREIT SP Equity	Ascendas Real Estate Investment Trust	2.97	10,730	0.157	0.171	0.169	0.176	8.7%	-1.2%	12.1
VMS SP Equity	Venture Corporation Ltd	16.20	4,673	-	1.228	1.275	1.329	-	3.8%	10.6
ST SP Equity	Singapore Telecommunications Ltd	3.37	55,029	0.173	0.172	0.190	0.202	-0.6%	10.5%	9.5
CCT SP Equity	CapitaLand Commercial Trust	1.99	7,677	-	0.087	0.085	0.089	-	-2.3%	8.3
KEP SP Equity	Keppel Corp Ltd	6.77	12,297	0.520	0.456	0.537	0.589	-12.3%	17.8%	9.1
STE SP Equity	Singapore Technologies Engineering Ltd	3.94	12,276	0.159	0.184	0.208	0.224	16.1%	13.0%	7.5
DBS SP Equity	DBS Group Holdings Ltd	25.88	66,101	2.146	2.465	2.468	2.603	14.9%	0.1%	4.0
CD SP Equity	ComfortDelGro Corp Ltd	2.38	5,155	0.140	0.138	0.143	0.148	-1.5%	3.6%	5.4
CT SP Equity	CapitaLand Mall Trust	2.46	9,074	0.115	0.122	0.133	0.133	6.1%	9.0%	3.6
SATS SP Equity	SATS Ltd	5.06	5,658	-	0.218	0.234	0.250	-	7.3%	3.4
UOB SP Equity	United Overseas Bank Ltd	26.41	44,061	2.406	2.564	2.553	2.687	6.6%	-0.4%	3.1
OCBC SP Equity	Oversea-Chinese Banking Corp Ltd	10.98	48,323	1.064	1.108	1.109	1.156	4.1%	0.1%	(7.1)
SIA SP Equity	Singapore Airlines Ltd	9.04	10,714	0.577	0.581	0.634	0.622	0.7%	9.1%	(8.6)
GENS SP Equity	Genting Singapore PLC	0.92	11,093	0.062	0.058	0.056	0.058	-6.9%	-3.4%	(10.2)
SPH SP Equity	Singapore Press Holdings Ltd	2.18	3,476	0.140	0.106	0.110	0.111	-24.1%	3.8%	(11.3)
HKL SP Equity	Hongkong Land Holdings Ltd	5.75	13,529	0.442	0.450	0.476	0.498	1.7%	5.8%	(13.1)
YZJSGD SP Equity	Yangzijiang Shipbuilding Holdings Ltd	1.12	4,389	0.913	0.837	0.778	0.722	-8.4%	-7.0%	(14.7)
SCI SP Equity	Sembcorp Industries Ltd	2.29	4,089	0.170	0.207	0.253	0.277	21.8%	22.2%	(14.2)
JCNC SP Equity	Jardine Cycle & Carriage Ltd	30.10	11,897	2.255	2.270	2.460	2.637	0.7%	8.4%	(18.9)
JS SP Equity	Jardine Strategic Holdings Ltd	30.65	33,964	3.139	3.013	3.333	3.633	-4.0%	10.6%	(20.5)
JM SP Equity	Jardine Matheson Holdings Ltd	55.60	41,034	4.530	4.545	4.743	5.063	0.3%	4.4%	(23.9)
DFI SP Equity	Dairy Farm International Holdings	5.71	7,724	0.314	0.263	0.296	0.344	-16.2%	12.5%	(39.9)

Source: Bloomberg, KGI Research

What to expect for the STI in 2020. We think that 1H 2020 will likely be positive for the STI before softening in the second half. Against the backdrop of improving economic growth, accommodative monetary policies and easing trade tensions, investors will mostly likely favour cyclical companies that have lagged the index in 2019, including **Sembcorp Industries (SCI SP), Jardine Cycle & Carriage (JCNC SP)** and **OCBC (OCBC SP)**. There are still opportunities among the REITs (click here), especially for those with low debt limits, including **Mapletree Commercial Trust (MCT SP)** and **Mapletree Logistics Trust (MLT SP)**. However, going into 2H 2020, uncertainty surrounding the US Presidential Elections in November could weigh on investors' sentiment.

2019 STI Review

It was a mixed bag for companies in the STI even as Singapore's main equity benchmark gained 5% (excluding dividends) in 2019.

The REIT sector was among the best performing in 2019. Two out of the three best performing stocks in the STI were REITs: Mapletree Commercial Trust and Mapletree Logistics Trust.

Property developers also performed well last year, managing to recoup most of the losses recorded in 2018. City Development, UOL Group and CapitaLand managed to outperform the STI by 15-30% points.

The banks' performance were mixed with DBS and UOB only slightly outperforming the benchmark, while OCBC lagged the index by as much as 7% points.

Underperformers were predominantly those companies linked to the Jardine Group, including Hongkong Land and Dairy Farm International. These five companies underperformed the STI by 13-40% points.

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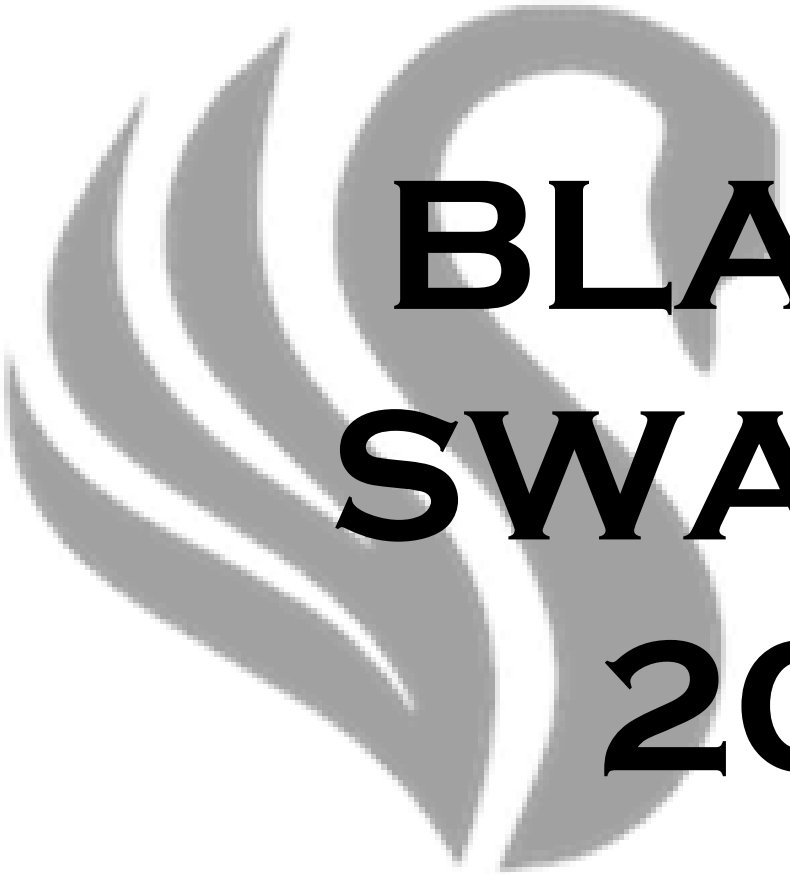


BLACK SWANS 2020

BREXIT GREXIT ITALEAVE AND DONEGARY?

It has taken a while, but we finally have some concrete decisions - the UK, barring another improbable yet not impossible delay, will leave the EU on 31 January 2020. Boris Johnson and the Conservative party will then have to draft a trade deal by 1 July 2020, or ask for *yet* another 1 or 2 year extension for the transition period. Except this time, Boris Johnson has tried to make this extension illegal through UK domestic laws, signalling his intention to get it done and over with. The end of this transition period is dated at 31 December 2020. Most don't believe that it will be done by then; LinkedIn highlighted Brexit as a big topic even in 2021 (click here).

While the alignment of UK under Boris Johnson has mostly ruled out a disorganized Brexit, there remains a multitude of hoops to jump through. Given that this is the first member state leaving the EU, deal terms are unlikely to skew towards UK's favour, to set an example for other disgruntled states. Additionally, although Grexit has left the lips of most naysayers, eurosceptical extremists continue to pay lip service to Italeave, Donegary (Hungary) and other potential EU exits.

Meanwhile, we have Scotland & Northern Ireland that don't see eye to eye with Boris Johnson's plans for Brexit, which threatens the stability of the whole UK constitution. And nobody currently has the stomach to discuss the potential changes in trade relationships between what remains of UK and the rest of the world. All we know is this: geopolitics continue to dominate headlines of the new decade, and it forces a re-examination of international trade relationships.

It was messy, is messy, and will continue to be messy.

Modern Monetary Theory – the Missing Money Treatment or Magic Money Tree?

The crux of Modern Monetary Theory (MMT) is the belief that budget deficits don't matter in any country that has their own currency, unless too much inflation occurs. Governments should thus create money and spend as they deem necessary to maximize the economy's production, and use tax as a tool to combat inflation rather than taxing to finance government spending.

Opponents of MMT cite multiple problems with it: the past failures of emerging economies to print their way out of economic difficulty; the lack of consideration of foreign demand of the economy's currency, which will impact exchange rates and lead to increased inflation of the local economy; executive difficulties due to misalignment of fiscal control (government) and monetary control (Federal Reserve/central banks), etc.

Nonetheless, the theory has gained traction over the past few years, as developed economies such as US, EU and Japan waddle in deeper budget deficits without hitting inflationary targets. According to MMT, this gives the countries more headroom to spend. But to base global economic policies on *ad ignorantiam* could be unwise, especially when the saving grace of tax increments requires strong political will.

Should central banks adopt MMT at the risk of hyperinflation? In our near-zero interest rate environment, it seems like an inevitability, albeit in slightly altered forms that all involve money creation. Only time will tell whether MMT is a game changer, or a black swan disguised as a Magic Money Tree.

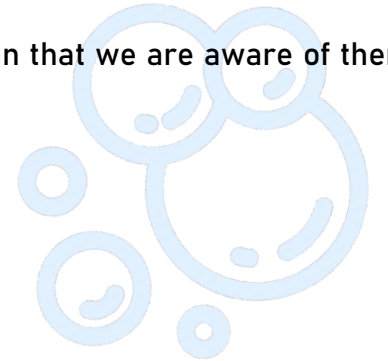
ETF BUBBLE POP

Last year, the contest between passive and active funds reached one of the biggest milestones as assets in US index-based equity and mutual funds and ETFs overtook those in active stock funds. Not that it wasn't expected given that 78% of big equity mutual fund managers and 73% of institutional accounts have underperformed the S&P 500 index over 10 years prior to 2019, according to S&P Global.

Michael Burry of The Big Short recently caused some commotion by saying that index funds are a massive bubble, likening them to the collateralised debt obligations (CDO) that he shorted before the global financial crisis in 2008. Burry said that index funds are currently distorting prices for stocks and bonds in a similar way that CDO did for subprime mortgages, as price-setting in the market is not done by fundamental security-level analysis, but by massive capital flows.

How this bubble could potentially burst is one of liquidity, where billions of dollars are linked to lower-traded stocks in the index. Burry believes flows will reverse at some point and it will be "ugly" when they do, as everyone exits through the same door at the same time. Exacerbating the problem will be the impossibility of unwinding derivatives linked to the underlying stocks in the index.

As of now, we can possibly consider the risk to the ETF industry as a "Known Unknown", in that we are aware of them but do not understand them, as the industry has yet to undergo its first major test in a bear market.



WORLD WAR THREE (WWIII)

World War 3 (WW3) was the top searched term in Singapore on 3 January 2020, garnering five times more searches than the next two most searched terms (Second: "FA Cup"; Third: "Australia fire"). On that day, the US assassinated the commander of Iran's Quds Force, General Qassem Soleimani, one of the most influential figures in the Middle East.

The immediate impact has been the surge in oil prices and the standard flight to safe-haven assets such as gold. But in general, the general perception is still one of relative calm. Both sides have stated they are not interested in war. Therefore, for the escalation to become a real threat, both sides will have to *seriously miscalculate each other's intentions*.

World War 1 can be considered a black swan event, in that while tensions were already brewing prior to the start of the war, no one deemed a war of such magnitude involving all the major powers in Europe to have ever been possible. As Mark Twain said, "It ain't what you don't know that gets you in trouble. It's what you know for sure that just ain't so."

Iran has already started the ball rolling by announcing that it will no longer abide by the limits contained in the 2015 nuclear deal, which could eventually bring the country closer to developing an atomic bomb. Such actions is highly likely to lead to a nuclear arms race in the region.

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IS THE SINO-US TRADE WAR OVER?

Unfortunately, no.

The trade war has not officially ended since tariffs are still being levied. For now, both parties are simply at a fragile truce – vulnerable to the execution of the Phase One Trade Deal.

Meanwhile, the Phase Two Trade negotiations will be much tougher. Trade tensions have spilled over into the technology sector, and it's going to be a long and bumpy road.

Besides, we think that the next battle field could be the finance sector as China is opening up its capital market in 2020.

Trade tensions have been subdued since China and the US reached a long-awaited Phase One Trade Deal on 13 December 2019, despite it only implying a truce (somewhat…) since tariffs of 25% on US$250bn and 7.5% on US$120bn Chinese goods have not been lifted.

Furthermore, China's ability to fulfil the quota to purchase agricultural products from the US is doubtful given that the total amount required substantially exceeds historical levels of its past purchases.

While the Phase Two Trade deal is under negotiation, it's not really about trade anymore; it could involve China's economic and political structural reform, including intellectual property protection, state-owned enterprise (SOE) subsidies, and opening up key state-controlled sectors, and so on.

Basically, it could get much uglier.

PHASE ONE TRADE DEAL
AGREED ON, NOT SIGNED; FINALISED, NOT FULFILLED

Both parties have seemed to reach an agreement on the Phase One Trade Deal but only agricultural trade details have been disclosed.

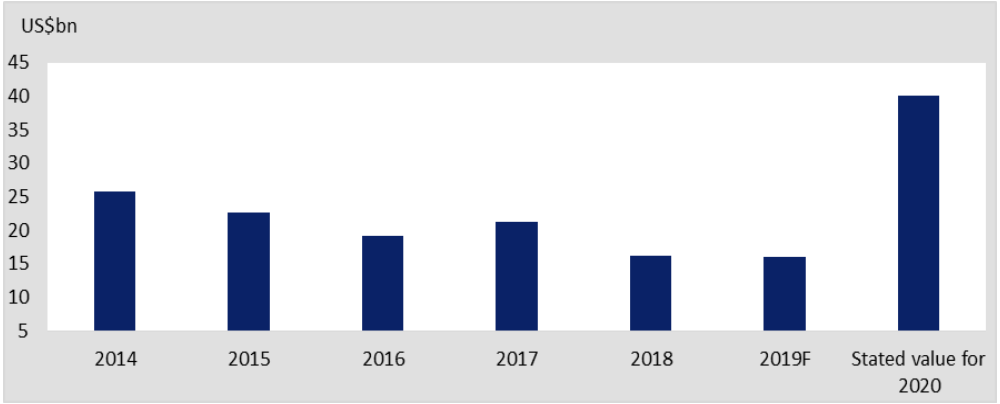
According to the official announcements, China is agreeing to purchase over US$40bn of US agricultural products every year in exchange for a roll-back on the scheduled 10% tariff on US$160bn of consumable goods (mainly electronic gadgets), and a 50% cut on the existing 15% tariffs on US$120bn of goods.

However, China has only spent a maximum of US$25bn on agricultural products per year in the last five years, the import values of which have been driven further downward due to the fall in commodity prices. Assuming China purchases the maximum amount in each main category, the total value is estimated at a mere US$17.3bn to US$19bn, based on the current prices.

This would imply that China needs to substantially reduce imports from other South American countries such as Brazil, Mexico, and Argentina in order to meet the requirements of the trade deal. However, by doing so, China may potentially have to break previous trade agreements, hurting existing bilateral ties with them.

Yet, if China fails to uphold its end of the deal with the US, the latter may decide to resume and impose all proposed tariffs.

Figure 5: US agricultural products exported to China



Source: USAD, FAS, KGI Research

Figure 6: Main US agricultural products exported to China over the last 5 years

('000 tonnes)	2014	2015	2016	2017	2018	2019F	Peak
Beef and related prodcuts	154.7	120.9	112.8	133.7	130.0	100.6	154.7
Coarse Grain (exl corn)	6,374.8	9,098.1	5,374.1	4,603.9	2,660.4	628.5	9,098.1
Corn	333.4	713.0	243.5	843.2	324.3	343.3	843.2
Cotton	529.4	490.8	309.8	533.2	194.1	346.5	533.2
Pork and related products	336.4	343.0	544.6	495.5	352.6	546.7	544.6
Soybean	30,828.6	27,259.6	36,051.7	31,689.8	8,237.0	15,843.2	36,051.7
Soybean Meal	28.9	21.2	35.6	28.3	39.3	18.1	39.3
Soybean Oil	156.7	18.2	144.1	36.4	1.1	0.6	156.7
Wheat	579.1	553.5	905.7	1,520.6	401.7	108.9	1,520.6
Total estimated value (US$ bn)							17.3 to 19

Source: USAD, FAS, KGI Research

BATTLE KICKED OFF IN TECH… WHAT'S NEXT?

In April 2018, the US initiated sanctions on ZTE, the second largest telecommunication equipment and system provider in China. The ban on ZTE from purchasing accessories from US companies was lifted eventually on the condition of a US$1.4bn fine.

A year later, the same sanction was imposed on Huawei, China's tech giant.

Yet this time, not only has Google barred Huawei from updates of the Android operating system and its popular applications (Google Play Store, Gmail and YouTube), the US government has also tried to keep its allies from using Huawei as their 5G equipment and service provider.

Crippling Huawei is an effective strategy for the US since China could gain the upper hand in technology, given that Huawei has taken the lead on 5G. Currently, Huawei is still under the 90-day extension permit for doing business with US companies.

Then, in November 2019, the US introduced a new bill to ban federal pension funds from investing in China.

China in response is encouraging Chinese US-listed tech firms to return to China or Hong Kong (Alibaba has recently re-listed in Hong Kong – it now is dual-listed), in addition to loosening restrictions on foreign direct investments. It also has plans to integrate more than 100 securities companies to create a state-owned flagship investment bank (IB) in order to compete with foreign IBs.

Though these moves have not triggered a full-blown war, they represent tidings that the tit-for-tat battleground has shifted to the capital markets.

PHASE TWO WILL NOT BE A DRIVE-THROUGH

In hindsight, when China launched the "Made-in-China 2025" plan in 2015, it seemed to have rubbed the US off the wrong way – it was then that the US began initiating its slew of tariffs and sanctions against specific Chinese goods and companies in its attempt to retard China's growth and global expansion.

China's rapid development could be attributed to its top-down approach – the Chinese government plays a critical role in directing economic and industrial development. It drives the competitiveness of different sectors and the overall economy by introducing supportive policies and making full use of national resources. Of the 119 Chinese and Hong Kong firms on the Fortune 500 list, 80.2% are SOEs in 2019, up from 76.3% in 2018.

The IMF currently projects that China's GDP will exceed 70% of US's GDP by 2021 – a challenge that the US is intent on 'Trump-ing'.

Therefore, we expect the Phase Two deal negotiations to involve restrictions on subsidies and favourable financing options to Chinese SOEs; restrictions on technology transfers, prohibitions on intellectual property theft; and relinquishing state-controlled sectors such as energy, internet, telecommunication, and banking. Consequently, for China, these terms will push the limits of what it will be willing to accept and compromise on, especially with respect to its policy formations and planning for the direction of its economy – terms that will not be solved by just purchasing more goods.

And since China will not, without the shadow of a doubt, back down and let itself be controlled by the US, expect the Phase Two deal negotiations to be nothing less than chaotic.

IS CHINA APPROACHING STAGFLATION?

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Yes.

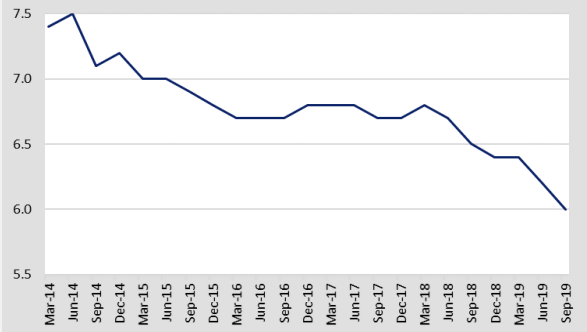
China's GDP growth has been on a downswing, demand is shrinking (narrowing industrial profit margins) while inflation (due to the shortage of pork) and unemployment are soaring.

The economic landscape and financial markets changed in 2019. On the economic front, China confronted trade tensions and stagflation, and its financial markets saw an influx of foreign capital.

In recent years, fiscal policies have focused primarily on the development of its regional economy while accommodative monetary policies opened up the financial markets.

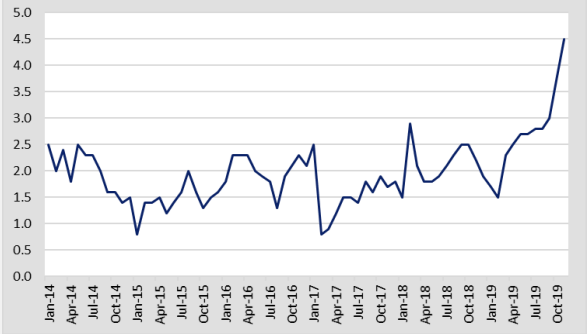
In 2020, we see China overcoming stagflation with opportunities arising from 5G and the technology, healthcare, infrastructure, and consumer sectors, despite the brevity of its trade truce with the US.

Figure 7: Declining China GDP growth (%)



Source: Bloomberg, KGI Research

Figure 8: Surge in CPI growth (%) in 2019



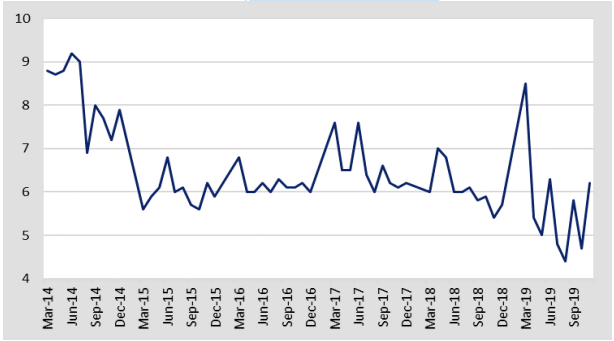
Source: Bloomberg, KGI Research

China had a rough 2019.

On the external front, the US tariffs, technology sanctions, and interference in internal affairs (human rights in Hong Kong and Xinjiang) dragged China's economic growth which was already slowing down. Concerns of decoupling between the two countries affected market confidence, especially so for companies heavily exposed to the US.

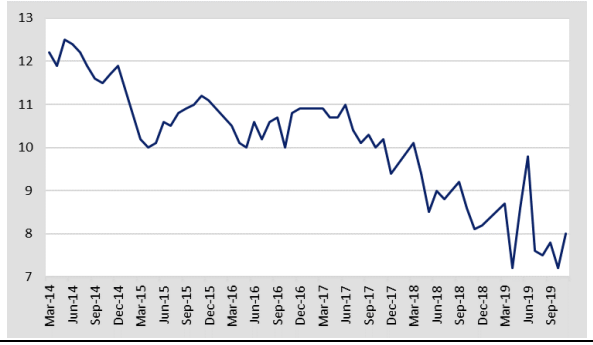
Internally, inflation surged mainly due to pork prices skyrocketing as a result of the African swine flu outbreak. Simultaneously, industrial profit margins were shrinking due to falling demand. At the end of 2019, The State Council of PRC issued an opinion document regarding stabilizing the job market, which could possibly indicate that officially reported unemployment levels are more optimistic that it seems.

Figure 9: Lowest value added of industry growth (%)



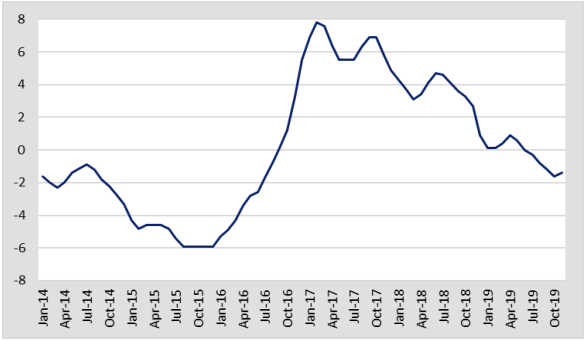
Source: Bloomberg, KGI Research

Figure 10: Retail sales value growth (%) on a downtrend



Source: Bloomberg, KGI Research

Figure 11: PPI growth (%) dipped into the negative

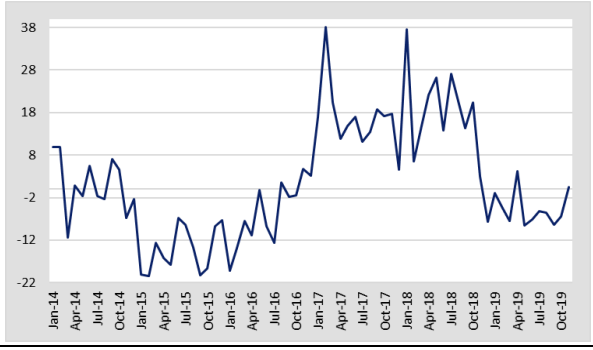


Source: Bloomberg, KGI Research

Figure 12: Declining China import growth (%)

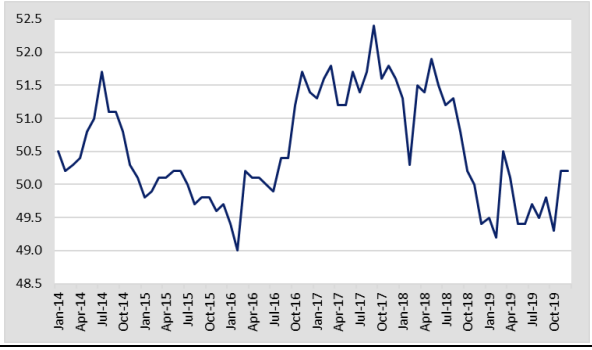
Source: Bloomberg, KGI Research

Figure 13: Shrinking export growth (%)



Source: Bloomberg, KGI Research

Figure 14: Manufacturing PMI mostly below 50



Source: Bloomberg, KGI Research

However, the financial markets portrayed a 180.

The Shenzhen Component Index delivered 44.1% return, followed by ChiNext's 43.8% and Shanghai Composite Index's 22.3% in 2019. The recovery was mainly due to the influx of funds via Shanghai-Hong Kong connect and Shenzhen-Hong Kong connect, worth RMB352.9bn (US$50.4bn). Meanwhile, MSCI increased the weighting of China A shares in certain indices by raising the inclusion factor from 5% to 20% across three phases in 2019. In other words, China's equity market has largely been driven by foreign capital, similarly for China's debt market since its net purchase of domestic bonds reached close to RMB1tn (US$142.8bn), more than 10% of the total capitalisation of debt under management.

In 2019, the RMB also broke the psychological level of 7.0 against USD for the first time in the last nine years. The depreciation of RMB (-1.2% YoY), deemed as a buffer to the tariffs imposed by the US, have turned from a peak of close to 7.2 back to below 7.0 currently. Apart from the PBOC intervention, acceleration of capital inflows in the equity markets in 4Q19 have helped stabilised the exchange rate.

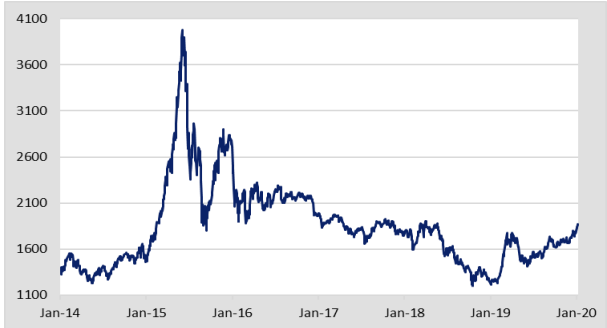
Figure 15: Shanghai composite index

Source: Bloomberg, KGI Research

Figure 16: Shenzhen Component index

Source: Bloomberg, KGI Research

Figure 17: ChiNext index



Source: Bloomberg, KGI Research

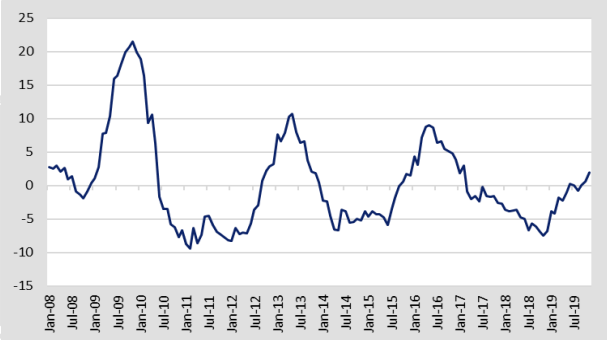
Figure 18: Bloomberg Barclays China Aggregate index

Source: Bloomberg, KGI Research

Figure 19: USD/RMB

Source: Bloomberg, KGI Research

Figure 20: China credit impulse YoY change (%)



Source: Bloomberg, KGI Research

Understanding China's fiscal and monetary policies is crucial

China's central government plays a pivotal role in both economic and financial market developments; hence, it is important to understand their fiscal and monetary policies.

Generally, fiscal policies issued by the State Council highlight the industries or sectors that China aims to develop. Provincial or municipal governments will develop details and launch the specific rules or regulations based on the local situation accordingly. More importantly, both state-owned (SOE) and private-owned enterprises (POE) will leverage the favourable policies to explore and develop business in the new areas.

In recent years, the authorities have focused on the development of the regional economy. Besides liquidity control, China's monetary policies also aims to gradually open up the financial markets and speed up China's pace in catching up with international finance standards. In recent years, PBOC has focused on strengthening the market mechanism and exploring new finance technologies such as blockchain and cryptocurrency.

Date	Fiscal Policies	Remark
26-Sep	Guideline to establish a fiscal relationship between the central and local governments built upon clearly defined powers and responsibilities, appropriate financial resource allocation and greater balance between regions.	Maintain the equal split of value-added tax (VAT) revenues between the central and local governments to stabilize expectations and encourage local governments to develop competitive industries and expand tax sources
17-Jun	Guiding opinions of the state council on promoting revitalization of rural industries	The implementation of the rural revitalization strategy shall be regarded as the object, the supply-side structural reform of agriculture shall be regarded as the theme, the integrated development of the primary, secondary, and tertiary industries in rural areas shall be brought into focus
16-May	Outline for the digital countrysid	Accelerate the construction of rural information infrastructure to promote the rejuvenation of the countryside and agricultural modernization
1-Apr	Work plan for payment services in reducing social insurance premium rates	Employers' contribution rates are higher than 16%, such rates may be reduced to 16%; and in provinces where such rates are lower than 16%, transitional measures shall be put forward upon deliberation
18-Feb	Outline development plan for the Guangdong-Hong Kong-Macao Greater Bay Area	A vibrant world-class city cluster; a globally influential international innovation and technology hub; an important support pillar for the Belt and Road Initiative; a showcase for in-depth cooperation between the Mainland China, Hong Kong and Macao; and a quality living circle for living, working and travelling

Date	Monetary Policies	Remark
28-Dec	Use of loan prime rate as benchmark for floating-rate loans	Starting from 1 March 2020 financial institutions should engage in negotiations with existing floating-rate loan clients to change the pricing benchmark, and shift from the original contractually stipulated pricing method to use of the LPR as the pricing benchmark
12-Oct	Rules for the recognition of standardised debt-based assets	Provide clear recognition standards for standardised debt-based assets and raise the inclusion and accommodation of the bond market
6-Sep	Fintech Development Plan (2019-2021)	Outline "guidance ideology, basic principles, development targets, key missions and guarantee mechanisms" for fintech work over the upcoming three years
16-Aug	Decision to reform and improve the formation mechanism of loan prime rate (LPR)	LPR will be determined based on open mar-ket operating rates, and the medium-term lending rate in particular;The LPR will also be expanded from a single one-year rate to two rates- a one-year rate and a five-year rate
15-Jan, 25-Jan, and 16-Sep	Cut required reserve ratio by 50bps	Inject liquidity; Balance the grwoth of in the scale of currency loans and total social financing and economic growth

Time for space: embracing challenges and opportunities

After the Phase One Trade Deal is reached, China's external pressure from the US will relatively abate. Despite remaining as a highly unpopular US president amongst polls, a favourable economy usually favours an incumbent president. Thus, there is no sign that Trump is in urgent need to reach a phase two deal before the election date in order to guarantee his re-election. This gives Trump additional ammunition to pressure China.

However, in this short period between Phase One and the potential Phase Two trade deal, China now has some breathing room to settle domestic issues. Back in 2018, the Chinese central government proposed "six stabilities" in the areas of employment, finance, foreign trade, foreign investment, domestic investment, and development targets. Stability has been emphasised quite a few times in 2019, not only in economic fields but also in social affairs.

Re-election of US presidents and existence of an economic recession

	Recession prior to reelection	Reelection results
Wilson	No	Yes
Hoover	Yes	No
Roosevelt	No	Yes
Truman	No	Yes
Eisenhower	No	Yes
Kennedy-Johnson	No	Yes
Nixon-Ford	No	Yes
Carter	Yes	No
Reagan	No	Yes
Bush	No	No
Clinton	No	Yes
Bush	No	Yes
Obama	No	Yes

In 2020, we believe it remains the main theme of the development plan. 2020, the final year of its 13th Five-Year plan, is the year that China aims to achieve its goal (set in 1976) of a moderately prosperous society. Hurdles such as poverty alleviation, high unemployment, aging population, increasing defaults of corporate and municipal debts, and SOE crowding out POE need to be mitigated or solved. Nonetheless, the acceleration of foreign capital inflows demonstrates investors' continued confidence in China. ***We see China overcoming stagflation with opportunities arising from 5G and the technology, healthcare, infrastructure, and consumer sectors.***

KGI CHINA DEVELOPMENT FINANCIAL

SHOULD WE REALLY LOOK AT EMs?

Yes.

While Emerging Markets (EM) markets severely underperformed Developed Markets' (DM) equity benchmarks by as much as 18% points in 2019, we believe the trend in 2020 will likely be very different.

During the early phase of an economic recovery, EMs stand to benefit more due to their greater exposure to external demand.

Against the backdrop of a mild global economic recovery and a weaker US Dollar in 2020, we thus recommend to go long on EM, with emerging Asia as our top pick within this segment.

1. The typical pattern of EMs recovering ahead of DM remains in place despite weaker global economic momentum. The strength of EMs' recovery and duration will depend on two key factors: China and commodities.

2. While we believe the weaker US dollar in 2020 will favour EMs, we note that EM's are more subject to the Chinese economy than to the US economy. Specifically, China's factory orders can be seen as a leading indicator of EM earnings. EMs are also greatly affected by changes in commodity prices, especially that of industrial metals.

3. Recently, both factory orders and industrial metal prices in China have come out of the doldrums that began in 2018, which are positive news for EMs.

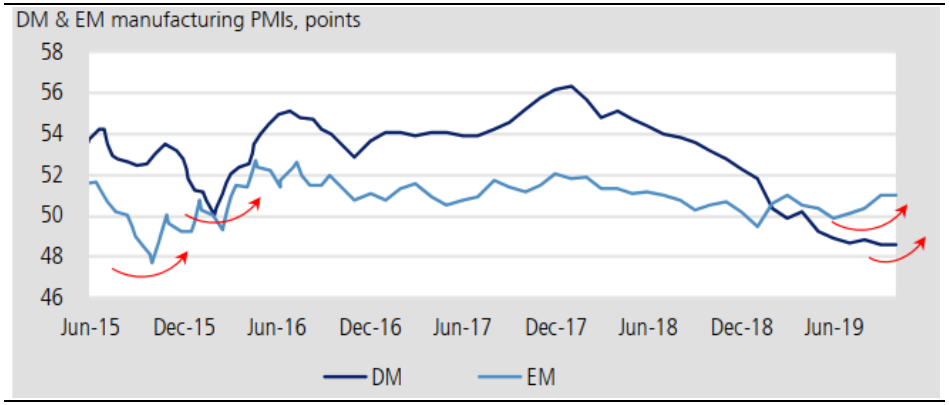
WATCHLIST:

iShares MSCI Emerging Markets ETF (EEM US)

iShares MSCI Taiwan ETF (EWT US)

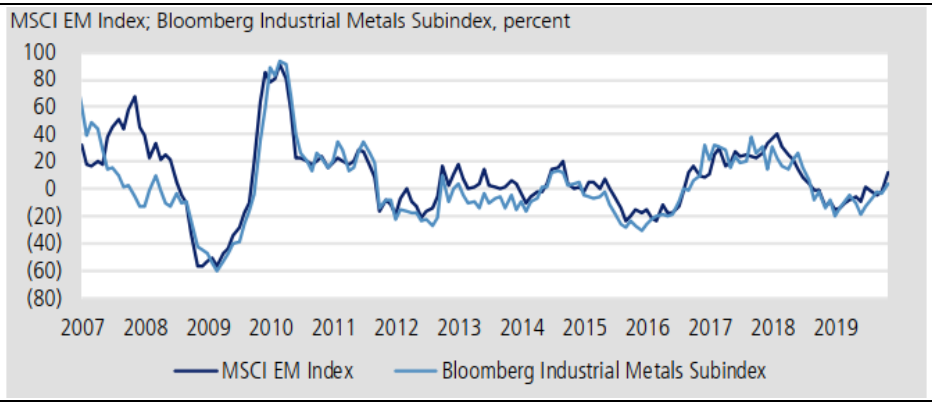
iShares MSCI South Korea ETF (EWY US)

Figure 21: EMs typically recover ahead of DMs



Source: IHS Markit, KGI Research

Figure 22: Rebound in industrial metals are positive for EM stocks



Source: Bloomberg, KGI Research

EMs vs DMs

DMs, in particular the US markets, have gained between 17-30% in 2019.

This significant rally in 2019 was driven primarily by valuation gains following interest rate cuts, rather than by corporate profit growth. In fact, we saw downward earnings revisions in 2019 as aggregate corporate earnings fell in 2H 2019.

US stock valuations appear stretched; in terms of P/E and P/B multiples, the S&P 500 composite valuation indicator is trading at near +1 standard deviation to the long-term historical averages (25 years), which is a potential risk in the event that valuations were to contract or if earnings were to disappoint.

Therefore, EMs present a much more favourable risk-reward dynamic over DMs in our view.

Figure 23: Market performance

		Local currency				
		Past 1 month	Past 3 months	YTD 2019	2018	2017
Equity markets	**Developed markets**					
	S&P 500	1.71%	5.61%	25.49%	-6.24%	19.42%
	STOXX 600	0.48%	5.22%	20.64%	-13.24%	7.68%
	Nikkei 225	-0.16%	10.16%	16.69%	-12.08%	19.10%
	Emerging markets					
	MSCI Emerging Markets Index	-1.49%	4.07%	8.61%	-16.63%	34.35%

Source: Bloomberg, KGI Research

We are positive on EM, with emerging Asia as our top pick.

EMs are riding on three key themes in 2020.

First, the monetary easing by global central banks should provide a foundation for global growth to recover mildly in 2020.

Thanks to the accommodative monetary conditions, the current economic growth cycle has outlived expectations without showing critical signs of an imminent recession.

The US has remained the strongest economy in the developed world, while the Eurozone and EMs are showing signs of improvement.

The trade tensions - although still not fully resolved even with the mini-deal - will be less of a drag on global growth and investor sentiment in 2020 than it was in 2019 given the significant change in attitudes from both sides in order to avoid further escalations.

Second, the US dollar which reflects shifting dynamics as a "counter-cyclical currency", has started to weaken in 2H 2019.

We continue to expect the US Dollar to depreciate as the global economy picks up in 2020, and as the US Federal Reserve resumes buying Treasury notes.

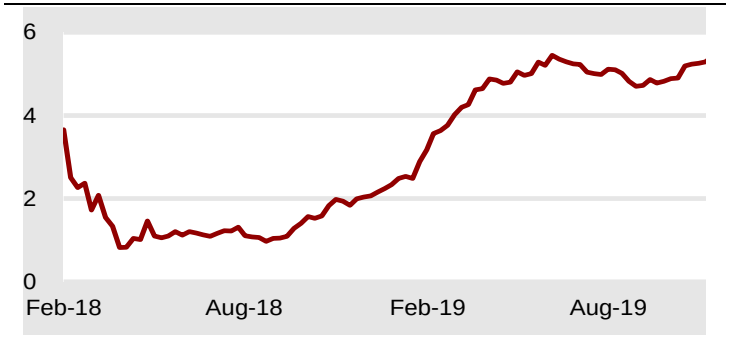
Ever since the 180-degree turn of the US Federal Reserve following the spike in overnight lending rate in September 2019 (i.e., repo blow-up), the US has now joined the rest of the world with dovish monetary policies and is in fact injecting more liquidity (by buying Treasury notes) than the other major central banks at this point, thus increasing the liquidity of the US Dollar.

Finally, valuations of EM markets are not high, but there are differences in region and sectors.

We particularly like emerging Asia, given that IBES estimates corporate earnings to grow around 15% YoY in 2020 (Figure 3).

Furthermore, we expect fund flows to favour Emerging Asia on MSCI weighting expansion. And given the significant underperformance of EMs against DMs over the past two years, and where valuations of DMs are now relatively more expensive, we see investors' interest eventually returning.

Figure 24: Emerging Asia 2020F corporate earnings growth (%), YoY



Source: Refinitiv, KGI Research

Among EMs, we are the most positive on Taiwan given its exposure to the critical semiconductor sector. South Korea and India are also likely to pick up after a challenging 2019.

China has the highest weighting in the MSCI EM Index at 33%; please see our China section outlook for details.

South Korea (13.02% weight in MSCI EM)

- South Korea is on pace to deliver another 2.0% growth in 2019, a drop from the original estimates of 2.6% at the beginning of last year, according to the country's central bank, and the slowest pace since the global financial crisis 10 years ago.
- The economy has been battered by declining exports (-10.3% YoY) due to the trade tensions between the US and China, China's slowdown and a cyclical downturn in the memory chip market. Exports accounted for 45% of South Korea's GDP and China represents around 25% of the country's outbound shipments.
- However, the country may finally see a turnaround in 2020 ***as it embarks on its largest stimulus since 2009***, and as global technology demand heats up and companies resume investments.

Taiwan (11.35% weight in MSCI EM)

- We are positive on Taiwan equities as ***5G will trigger a smartphone replacement boom*** and supporting tech stock earnings.
- Taiwan defied the global contraction in manufacturing, benefitting from many China-based Taiwanese companies relocating their supply chain back to Taiwan. Taiwan is the second largest beneficiary of this flow, after only Vietnam.
- The semiconductor industry played a critical part in Taiwan's stronger-than-expected economy in 2019, owing a great deal mainly to TSMC (2330 TT), which revised its capex and operational guidance upwards.
- The upgrade from 3G to 4G in 2012-2014 saw Taiwanese tech stocks' (ex-TSMC) P/E valuations rise from 15x to 18x. We expect the ongoing upgrade from 4G to 5G to also provide a similar re-rating for Taiwanes tech stocks.

India (9.16% weight in MSCI EM)

- India's slowdown has been deeper and more persistent in 2019 as financial-sector stress, production cuts due to increase in inventory and weak consumption weighed on the overall economy. India's central bank also surprised markets with a decision not to reduce rates in December 2019 due to rising headline inflation, which has softened the impact of the previous rate cuts.
- However, India is well-positioned going into 2020 as growth recovers on the back of structural reforms over the past several years, as well as the ***lagged impact from accommodative monetary and fiscal stimlus***. Lending rates have already started to drop while bank loan growth has began to stabilise, which should be supportive of economic recovery this year.

KGI CHINA DEVELOPMENT FINANCIAL

STRICTLY SPEAKING, NO, THIS IS NOT A TECH BUBBLE.

Despite the NASDAQ Composite Index rising by ~35% in 2019, tech and semiconductor companies still remain within +2 S.D. of their 5 or 10 year PE valuation averages.

In comparison, the Dotcom bubble had the NASDAQ reach 200x PE, and had a 1-year gain of 111% till its peak. Additionally, tech continues to see new and legitimate growth drivers beyond peak smartphone, with cloud computing the next big thing.

HOWEVER, IT IS STILL AN OVERVALUATION, RELATIVE TO HISTORICAL LEVELS.

Financial asset inflation, aided by excess liquidity, has slowly taken place over the past 10 years. The Buffett indicator (total market cap / total GDP) for the US market is now at a level similar to when it was during the Dotcom stock market, fuelled both by excess liquidity and optimism.

At this stage, we highly recommend investors to tread lightly, and to invest selectively, as risk-to-reward ratios are well elevated.

Tech's stellar performance was driven not only by the usual software suspects, but also the recovery of confidence in the semiconductor industry.

While 2019 was supposed to be a bust year, expectations of an industry-wide recovery in 2020 has pushed up the PHLX Semiconductor Sector Index (SOX) by 60% for 2019.

AI, 5G and Internet-of-Things will serve as the next drivers for tech, with cloud computing the unifying support infrastructure.

Amidst high valuations, we will still be highlighting several names across global tech that see promise in this new decade.

WATCHLIST:

AEM Holdings Limited (AEM SP)

Broadcom (AVGO US)

Tencent Holdings Limited (700 HK)

ARE WE IN ANOTHER TECH BUBBLE?

Big Tech averaged ~50% gain in 2019, led by Apple (>80%), Microsoft (>50%) and Facebook (>50%).

Improvement in investor sentiment, evident of the consistent increase in PE valuations, created most of the gains. Only Amazon had figures that were contrary to this, with falling PE. Yet, Amazon's PE was never below 70x in the past 5 years, so confidence is high across all of Big Tech.

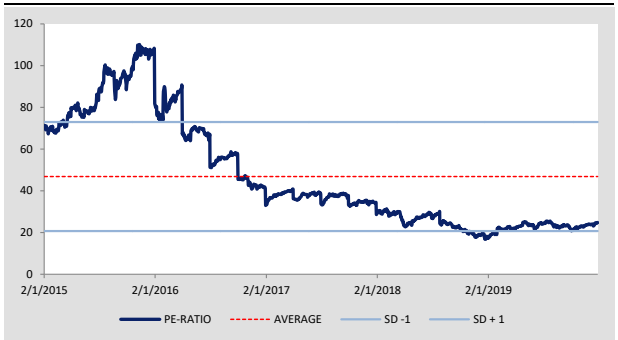
The pivot towards software and services has aided the sustenance of earnings growth, which is eminent in this post-computer, peak smartphone era. This thematic is not new, and also prevalent in other forms of 'hardware' such as cars (click here). Each Big Tech player continues to build their ecosystem of products and solutions, sometimes with loss leader strategies, in order to gain market share and eventually draw more users into their ecosystem. Smart speakers' aggressive Black Friday pricing was one of such cases.

While legislation for Big Tech continues to remain a key risk, we believe that investors have largely discounted the impact in 2019, despite the increasing public attention and scrutiny over Big Tech's influence. The upcoming US elections now serve as a critical point, as regulators continue to brainstorm over ways to control Big Tech without stifling innovation. Additionally, while France's Big Tech tax received much publicity due to US's wine tariff retaliation, digital tax plans (click here) are now high on many other governments' to-do lists. This will help to level the playing field between the digital and retail sale channels, and serves as a secondary headwind on tech firms in the medium term.

Given the recent share price run-ups and growing dormant risks of US Big Tech, **we prefer Chinese Big Tech** (Baidu, Alibaba and Tencent, or BAT), as they continue to see favourable tailwinds from: 1) the Chinese government, whom are providing corporate tax relief in order to "foster innovation, attract foreign capital and grow its services industry" (click here); and 2) the Chinese consumer, whom are less concerned about privacy than Western consumers, thus leading to domestic business environments that are easier to manage.

Global demand for **Alibaba**'s goods and **Tencent**'s games will also stay strong, and we think US-China relationships will not dismantle the ecosystems that either company has built for themselves over the years.

Figure 25: Facebook 5-year PE chart

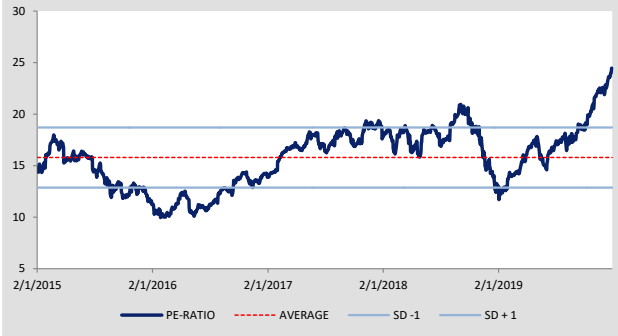


Source: Bloomberg, KGI Research

Figure 26: Microsoft 5-year PE chart

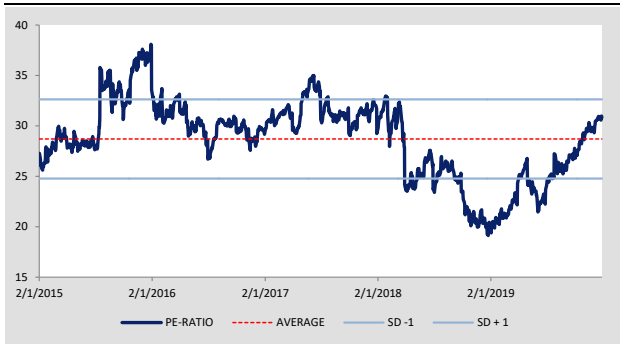
Source: Bloomberg, KGI Research

Figure 27: Apple 5-year PE chart



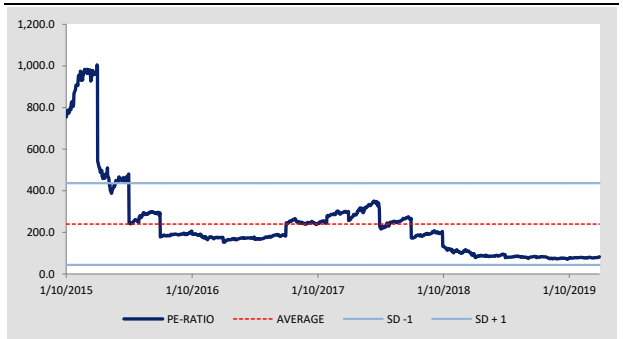
Source: Bloomberg, KGI Research

Figure 28: Alphabet 5-year PE chart



Source: Bloomberg, KGI Research

Figure 29: Amazon 5-year PE chart



Source: Bloomberg, KGI Research

Semiconductor industry – chip off the old block, ship off the old stock.

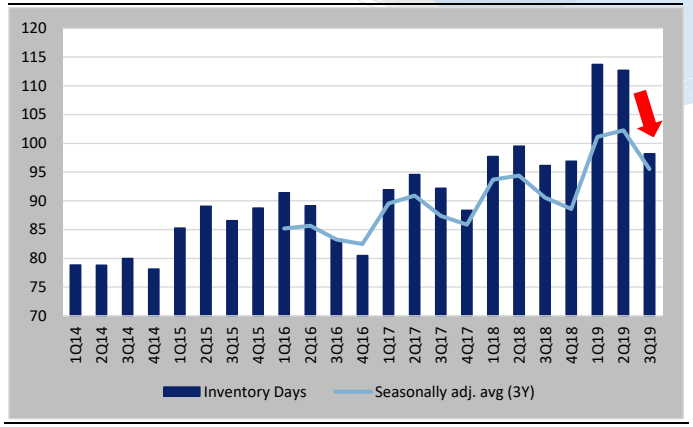
Performance of the semiconductor industry outpaced the tech sector, with SOX returning ~60% for 2019. The rally was most fervent in 1Q19, when the SOX bottomed out after earnings estimate cuts, and in 3Q19 after tariffs from US on Chinese goods were delayed as part of trade talks.

1Q19 and 2Q19 saw a substantial spike in inventory days across Semi and Semi capital equipment, largely due to memory players. While inventory days for capital equipment makers are in line with averages, the steady increase in inventory days for semi players could mean that **scale will become increasingly important, as companies have to hold on to inventory for extended periods of time.** The inventory clearance in 3Q19, coupled with positive performance across most semiconductor players, signals a recovery across the sector. We expect further inventory clearance in 4Q19F, in line with 4Q16 and 4Q17. However, there will still be weakness in automotive semiconductor subsector given peak car conditions (click here) and lingering trade tensions.

5G, AI and IoT serve as current drivers of innovation in the industry. At least 13 companies are looking to design their own AI-focused chips; 5G's adoption rate is likely to be faster than 4G LTE given industry readiness; IoT continues to make good traction with smart speakers and eventually autos driving growth. ***We see cloud computing infrastructure supporting all drivers, which are in turn supported by data centre build-outs.***

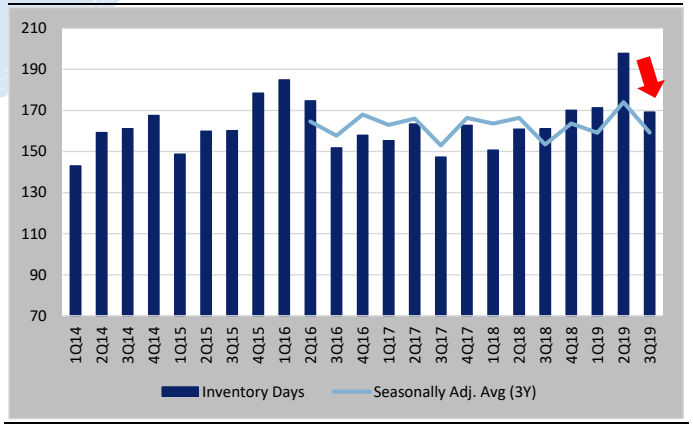
Semiconductor companies' inventory cycles

Figure 30: IDM+Fabless+Foundry



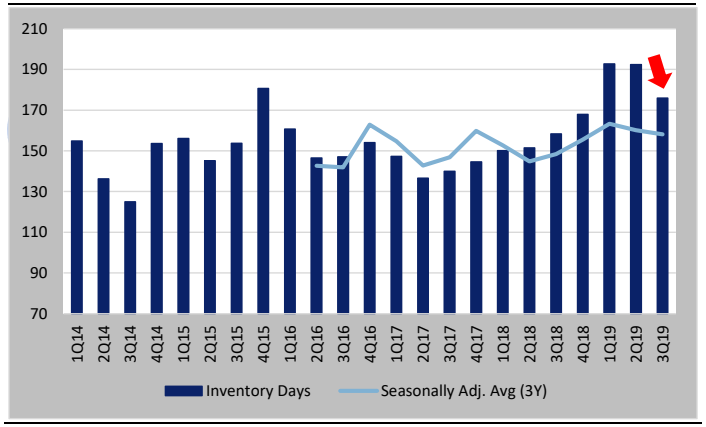
Source: Bloomberg, KGI Research

Figure 31: Front End Capital Equipment



Source: Bloomberg, KGI Research

Figure 32: Back End + APC Capital Equipment



Source: Bloomberg, KGI Research

[IDM+Fabless+Foundry] is formed from [16+13+3] of the largest semiconductor players, and excludes Samsung.
[Front End] is formed from 9 capital equipment makers.
[Back End + APC] is formed from 15 capital equipment makers.

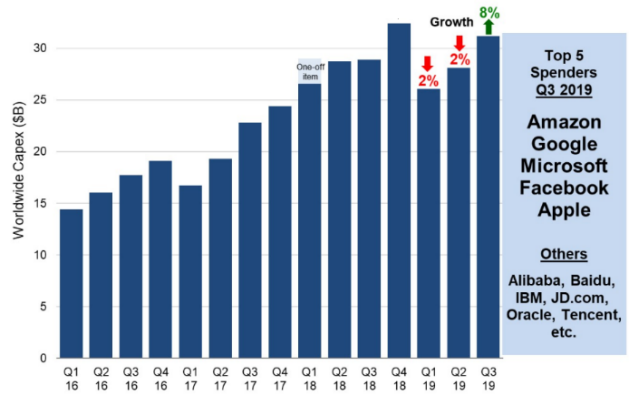
Data centres – return to growth, with much to show.

Hyperscale data centres continue to be constructed at high rates, with Synergy Research reporting 504 data centres in operation at the end of 3Q19. This is much in line with Cisco's Global Cloud Index White Paper estimate of 509 data centres at the end of 2019. The demand for co-location data centres has led to higher new build rates in Europe and Asia Pacific, as US already accounts for more than 1/3 of current hyperscale data centres. At present, another 151 are known to be under construction, thus data centre growth remains highly intact.

3Q19 saw a recovery in the data centre business: Data centre chip businesses saw QoQ revenue growth with Intel up 28%, AMD up 50%, Nvidia up 11% and Xilinx up 96%. Hyperscalers had a corresponding recovery in Capex levels, with an 8% YoY gain in 3Q19. Growth rates will remain in double digit territory, in alignment with growth from cloud computing services. We observe a tale of two halves for storage vs servers: while both hardware plays suffer from falling YoY sales in 2019, beliefs of a turnaround in storage plays are seemingly higher, as we observe for a divergence in share price momentum.

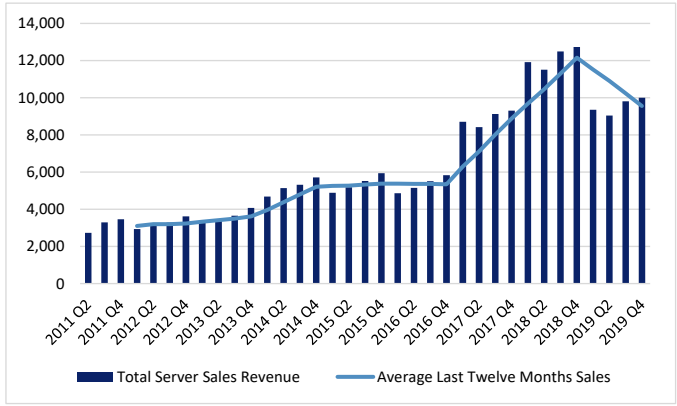
For the rest of our tech picks, we like **Broadcom (AVGO US)** for 1) their exposure to Apple as a supplier, 2) exposure to data centres with PCIE switches and 3) an acceptable valuation level relative to past valuation averages, which warrants entry. Amongst capital equipment plays, we like **ASM International (ASM NA)** and **ASML (ASML NA)** for having strong market position in deposition and lithography respectively. Back in Singapore, we continue to like **AEM Holdings (AEM SP; OUTPERFORM S$1.80)** for their disruptive potential in the test equipment space. We also see **Avi-tech (AVIT SP)** as having potential when automotive semi eventually recovers, with some investors already pricing in this recovery early on. It is also worth to keep an eye on data centre landlords **Keppel DC Reit (KDCREIT SP; OUTPERFORM S$2.11)** and **Mapletree Industrial Trust (MINT SP)**, when prices turn more attractive for entry. Lastly, we think **Procurri (PROC SP)** is a unique ancillary play on data centres, and will see stronger growth as more companies take their first steps to shift towards public cloud infrastructures.

Figure 33: Hyperscale Operator Capex



Source: Synergy Research, KGI Research

Figure 34: Total Server Sales



Source: Bloomberg, KGI Research

Figure 35: Share price momentum of server vs storage

Source: Bloomberg, KGI Research

WILL GOLD & SILVER CONTINUE TO SHINE?

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Yes.

We believe that gold and silver will still perform well in 2020, as a low yield environment and *increasing geopolitical risks support the demand for gold*.

Our target price for GOLD and SILVER is US$1,700/oz and US$25/oz respectively.

Escalating geopolitical risks (e.g. Sino-US trade tensions, recent developments in the Iran-US conflict, Brexit, North Korea nuclear issues), unexpected turn of Fed monetary policies (rate cut, treasuries purchase, and repo operation), and global low yield debt concerns (negative yielding sovereign bonds) have propelled gold and silver to deliver 18% and 15% returns.

Furthermore, the probability that the US economy will weaken in mid-2020 is expected to be the highest since 2008, and we expect that the US dollar will weaken accordingly.

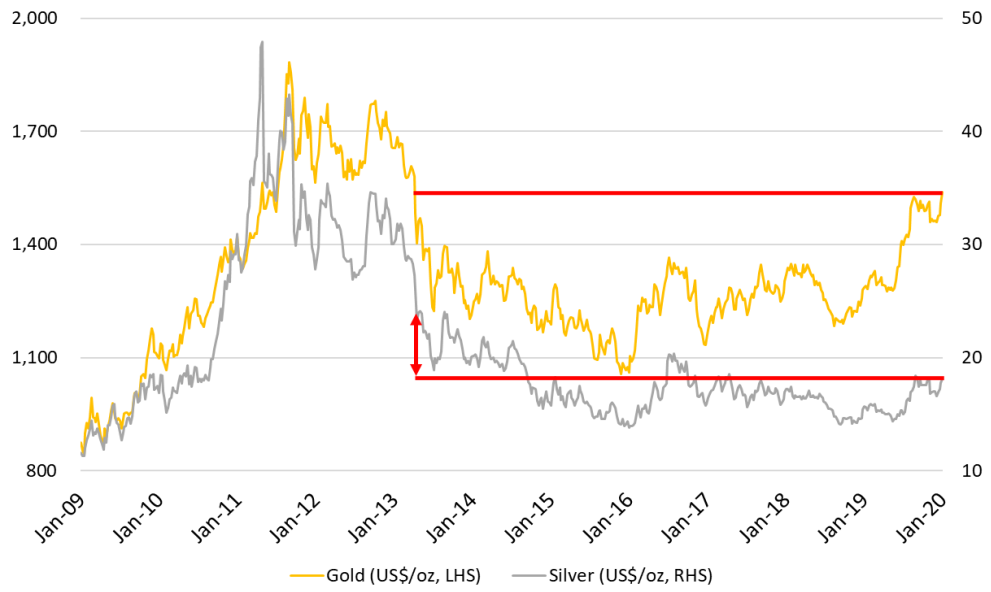
Therefore, we think that sluggish growth, low inflation, and low yields will extend into 2020, making a case for precious metals such as gold and silver.

Figure 36: Historical returns on asset classes

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
US HY Bond	-25%	16%	3%	-1%	4%	-1%	-4%	-10%	7%	1%	-7%	8%
US IG Bond	-3%	2%	4%	5%	6%	-6%	5%	-5%	3%	4%	-7%	13%
US MBS	3%	1%	0%	2%	0%	-3%	5%	-1%	-1%	0%	-2%	3%
EM Bond	-7%	9%	5%	2%	12%	-12%	1%	-4%	4%	5%	-10%	10%
US Large cap	-38%	22%	11%	0%	13%	29%	11%	0%	9%	20%	-6%	29%
US Small cap	-37%	38%	26%	-4%	16%	36%	6%	-5%	18%	16%	-11%	25%
EM Equity	-50%	66%	15%	-20%	17%	-6%	-6%	-18%	9%	35%	-17%	15%
Gold	5%	24%	29%	10%	7%	-28%	-2%	-11%	8%	13%	-2%	18%
Gold mines	-26%	36%	33%	-16%	-10%	-54%	-13%	-25%	52%	11%	-9%	39%
Silver	-24%	48%	82%	-11%	9%	-36%	-20%	-12%	15%	6%	-9%	15%
Siver mines	N/A	N/A	N/A	-22%	7%	-51%	-17%	-33%	73%	2%	-23%	35%

Source: Bloomberg, KGI Research

Figure 37: Gold (LHA) and silver (RHA) price movements



Source: Bloomberg, KGI Research

Gold and silver were the second best performing assets, following US equities.

Gold prices broke its six-year high (US$1,433/oz) in July 2019 and closed at US1,520/oz at the end of 2019.

However, silver lagged behind, closing at about US$3/oz shy from its last high (US$21/oz) in July 2016.

Given gold's and silver's 18% and 15% full year gain, corresponding mining stocks which have equity and precious metal components further benefited from the bull run of both metals, delivering 39% YoY and 35% YoY respectively.

It is counter-intuitive that gold and silver as safe haven assets rallied together with risk assets.

Multiple factors including escalating geopolitical risks, the Fed's monetary policies, and the global low yield debt concerns necessitate that gold be a key asset allocation.

It is also worth noting that several central banks like Central Bank of Russia and People's Bank of China have been increasing the demand for bullions, which strengthens the perception of the fragility of the modern currency system, especially the US dollar.

TAILWINDS FOR GOLD

1. Sino-US trade tensions have resulted in market concerns of further global economic slowdown or even a recession. Gold's substantial upward movements were in line with President Trump's sudden tweets announcing tariffs imposition and news of sanctions on Huawei and other Chinese tech companies. The ongoing hostile US policies against China plagued **sentiments of a decoupling** of the two biggest countries in the world throughout 2019. Even though the Phase One Trade Deal was reached in December, the lack of details and doubts of full and proper execution, as well as the retention of tariffs on a big chunk of Chinese goods, leave room for the de-escalation to be reversed, not to mention the already unfavourable outlook of the Phase Two Trade negotiation.

2. Irrational exuberance has resumed, increasing the hedging demand for gold. According to Factset, the respective S&P 500 quarterly earning's growth in the first three quarters in 2019 was -0.3% YoY, -0.4% YoY, and -2.2% YoY, and the expected growth for 4Q19 is -1.5% YoY. Yet the index delivered an exceptional 30.4% YoY return in full year 2019. Therefore, the **market's performance have not been a representation of fundamentals** such as corporate profitability – but why? The US Federal Reserve – three times of Fed Fund rate cuts totalling 75 bps, US$60bn/month purchase of Treasury bills beginning October, and the year-end repo operation with US$500bn of inflated prices in all asset classes. The higher the price of risk assets (without rationale), the more hedging positions the market requires. Therefore, we think that gold will hardly be abandoned when the market is flooded with easy money.

3. Gold without any yields is becoming more attractive when low-risk assets barely generate yields, or even worse, negative yields. 2019 was also the year of serious quantitative easing. On the backdrop of trade tensions, central banks initiated the reverse-cycle operation by launching expansionary monetary policies. More than 30 economies cut policy rates in 2019. Furthermore, earlier than the Fed, the ECB announced in September its €20bn/month (US$22.2bn/month) QE that started in November. The PBOC also engaged in mid-term lending facility operations totalling RMB3.69tn (US$529bn) in 2019. What is more worrisome though, is the **surge of negative yield debts** – mainly sovereign debts. At about US$11tn, despite already being lower than its peak of US$17tn in July, the enormous debt only strengthens our case for gold.

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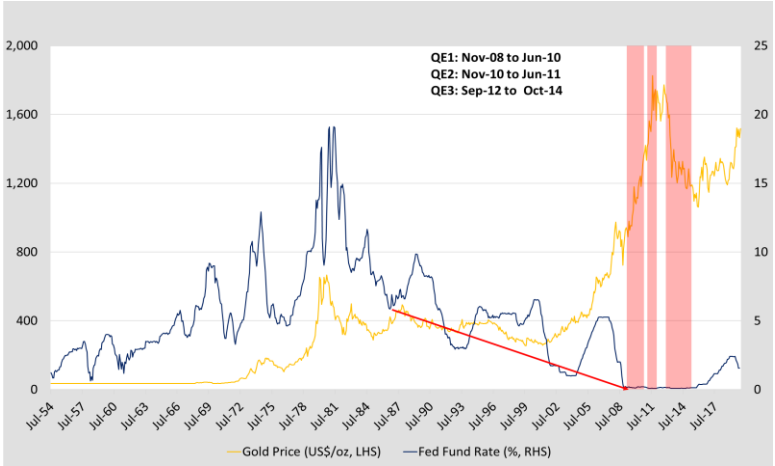
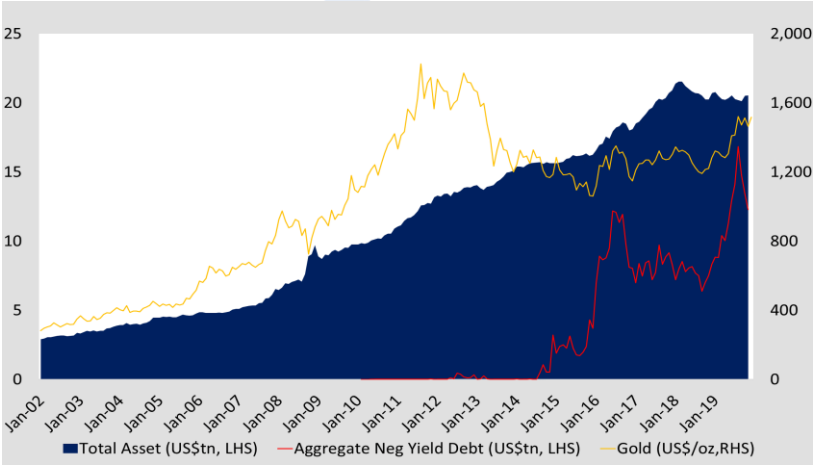
Figure 38: Gold performance during QE and rate cut cycles



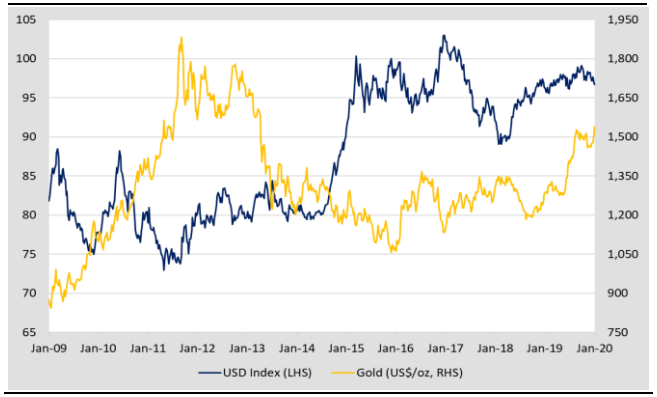
Source: Bloomberg, KGI Research

Figure 39: Major central bank balance sheets & global negative yield debt



Central banks include the Fed, ECB, PBOC, BOJ, and SNB

Figure 40: US Dollar and Gold correlation

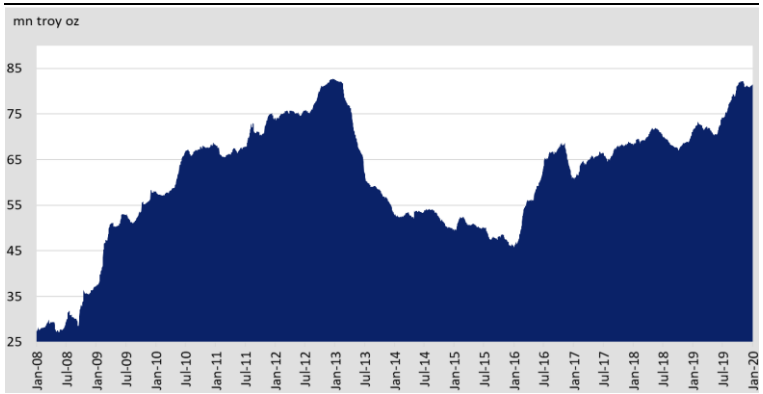


Source: Bloomberg, KGI Research

Figure 41: Gold/silver ratio

Source: Bloomberg, KGI Research

Figure 42: Increasing ETF holdings of gold



Source: Bloomberg, KGI Research

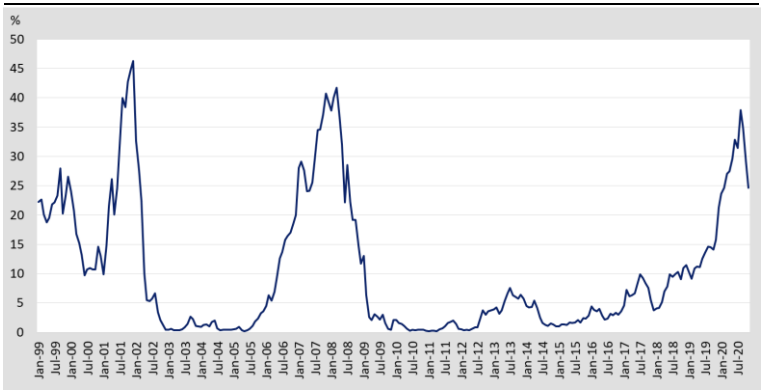
Investments in precious metals, gold and silver, has no doubt been a cliché, but it is infallible in a long-term investment horizon. We believe 2019 marked the start of a gold bull cycle after the downturn post-2011 when gold hit its historical high of US$1,900/oz.

Against the odds of impending risks and ongoing tensions between countries, we believe that the need for safe-haven assets will remain throughout 2020. Should the US economy weaken in 2020, the Fed will be forced to further cut rates, weakening the US Dollar and driving gold's performance. At the mercy of geopolitical risks, black swan events could unexpectedly tremble economies, further propelling demand for gold.

Given that the gold/silver ratio is currently already relatively high (Jan 2019: c. 85) in comparison to its past ten-year performance (Average: c. 69), we believe that silver will be playing catch-up in 2020 as well.

Our target price for gold and silver is US$1,700/oz and US$25/oz respectively.

Figure 43: Probability of recession in mid-2020



Source: Bloomberg, KGI Research

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WHAT ARE THE IMPLICATIONS OF PEAK OIL?

Saudi Aramco, the world's newly listed and most valuable public company expects peak oil within the next 20 years. However, peak oil now has a completely new meaning compared to a decade ago; *peak oil now represents peak oil demand as global concerns on climate change propel a shift to lower carbon-intensity sources.*

Meanwhile, in the short term, we expect Brent oil prices to remain range bound again in 2020 at between US$60 and US$70 per barrel, similar to what we had forecasted for 2019, but with a **positive upward bias**. Driving this more positive view is the global economic recovery, particularly among Emerging Market (EM) countries, and the OPEC+ production cuts. A weaker US Dollar is also positive for industrial commodities.

WATCHLIST:

Our baseline Brent oil price forecast for 2020:

Adjusted upwards to **US$65-75/barrel** based on a conservative US$5/barrel risk premium;

US$80/barrel based on a US$10/barrel premium.

One final bull run in oil markets.

Global oil demand has historically increased by around 1-2% per year, bringing total global oil consumption to 101 million barrels per day in 2019. However, forecasts for when peak oil demand will occur has continually been revised to earlier dates, ranging to as soon as the mid-2020s, to further out such as Saudi Aramco's 2040 estimate.

The wide range of projected peak oil forecasts mainly centres on the adoption speed of Electric Vehicles (EVs), as around 40-45% of oil is used for transportation. The rate at which the cost of renewables and batteries decline will eventually determine whether the use of oil for transport falls in an accelerated scenario. Even in a scenario of rapid EV adoption, capex to replace depleting oil fields will still be required to meet the demand from the aviation, industrial and petrochemical sectors.

Therefore, we still expect opportunities to invest in oil & gas companies, but note that there is a need to be selective.

2020 IS SETTING UP TO BE A BETTER YEAR FOR OIL MARKETS THAN 2019

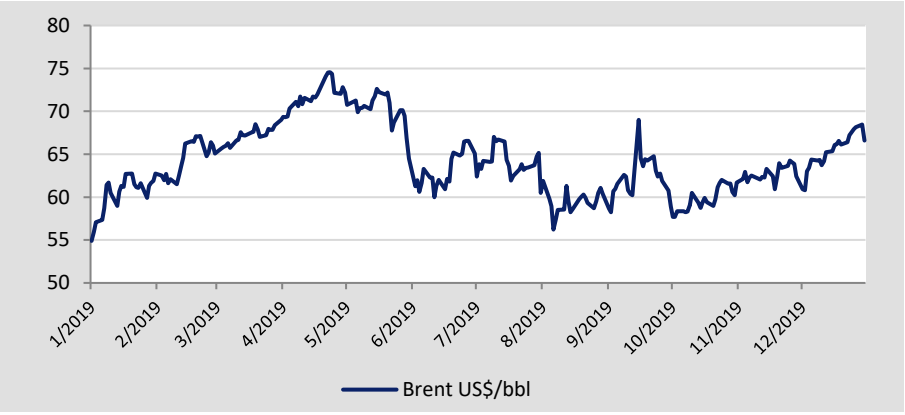
Brent oil prices averaged US$64/barrel in 2019, down from the average of US$71/barrel in 2018. However, 2019 is still an improvement over the average prices of US$52, US$44 and US$54 in 2015, 2016 and 2017.

A key reason for the drop in average oil prices in 2019 was due to lower demand growth and resilient production from key producers, specifically US shale production as it defied talks of a slowdown. Even with the supply disruptions caused by the attacks on oil tankers and processing facilities in the Middle East, oil markets continue to be beset by oversupply, a problem that has been ongoing since 2014.

However, with supply and demand to be tighter in 2020 than it was in 2018 and 2019, we believe that Brent oil prices may surprise on the upside of our target range of US$60-70/barrel.

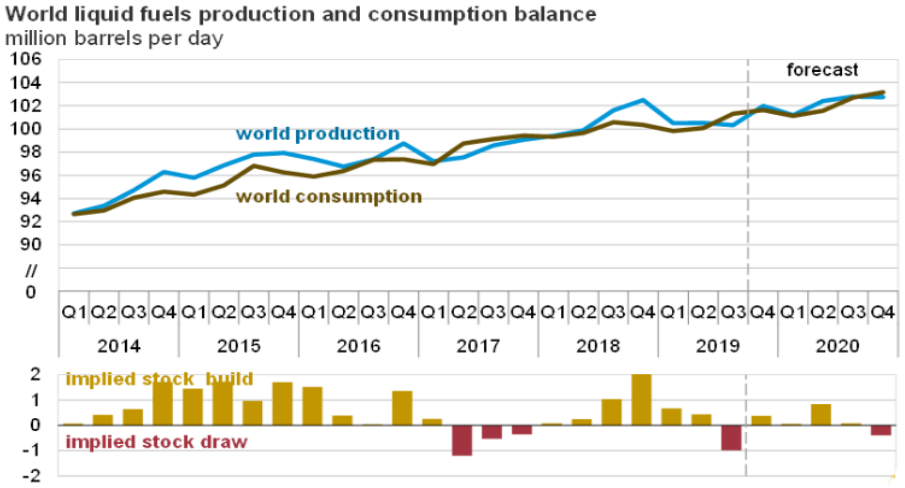
1. OPEC+'s December 2019 meeting showed a strong interest to protect the price gains achieved so far in oil markets.
2. The headwinds over global economic growth has abated as both China and the US now seek to de-escalate trade tensions.
3. US shale growth may finally cool down this year as banks begin to tighten lending to small shale companies. Energy companies made up more than 90% of defaults of corporate debt in 3Q19, according to Moody's Investors Service.
4. Geopolitical risks, such as the recent airstrike in Iraq that killed Iran's General Qassim Soleimani, will likely keep markets worried about a renewed war in the Middle East.

Figure 44: Brent Oil Prices – One Year. Oil price was weaker in 2019 due to slower demand growth and resilient US oil production.



Source: Bloomberg, KGI Research

Figure 45: Global oil supply and demand. More balanced in 2020 than in 2018 and 2019.



Source: US EIA, KGI Research

Oil price risk premium has returned

Geopolitics is once again at the forefront of the oil markets in 2020 as the first risk-off event of the year has the potential to spill over into the wider economy.

The fallout from the assassination of one of Iran's most powerful and respected generals sent oil prices surging by as much as 4% on 3 January 2020.

Figure 46: Capital Economics' risk premium/discount for Brent oil prices (US$/barrel)

Source: Capital Economics, KGI Research

For most of 2019, oil prices had traded at a risk discount to what should normally be a risk premium (i.e., oil prices should be higher to account for risks of potential disruption), according to a study done by Capital Economics (CE). A key possible reason for the risk discount was that market participants were instead focused on concerns about global economic growth due to the trade war. CE's models noted a risk discount of around US$7/barrel in 3Q 2019 (figure 46 above).

However, with the global economy avoiding a recession in 2019 and with the rise in geopolitical tensions in the Middle East, a region which produces a third of global oil production, we are of the view that the risk premium in oil prices should finally return in 2020. We also believe that the *risk premium will be more persistent this time around* (as compared to last year's attack on Saudi's facilities) as Iran will now be under pressure to retaliate, not directly at the US or its citizens, but against the US' allies who are key oil producers in the Middle East. US Platts Analytics forecasts a US$5-10/barrel price premium due to the tensions in the Middle East.

Implications. Our baseline Brent oil price forecast of US$60-70/barrel for 2020 will have to be adjusted upwards to US$65-75/barrel based on a conservative US$5/barrel risk premium, and to as high as US$80/barrel based on a US$10/barrel premium.

DO I REALLY NEED TO CONSIDER ESG NOW?

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The short answer? Yes, if you want to stay ahead of the game.

The long answer? Sustainability in itself takes more than a few years to prove, that we're making an impact and our actions indeed make a difference – but despite shorter term costs needed to really implement and incorporate sustainability into an organisation's decision making processes, ESG adoption and reporting has been shown to positively affect a company's market performance.

But why? Because it is only logical that an organisation that adopts best practices, are considerate of the environment and society around them, and continuously promotes innovation and improvement in the way they operate – generates a competitive advantage that is comparable to none. And ICYMI, ESG metrics have now become an important signal of future earnings risk and volatility for some investors.

Basically, ***progress on ESG isn't just a nice-to-have anymore***; ESG is in demand because shareholders believe that it's going to help drive growth, market share, and profitability. As a result, companies are becoming increasingly scrutinised for their sustainability practices, and so for any company keen to attract capital, ESG must become a priority. Specifically, irreversible environmental changes will, with time and scientific certainty, put a growing premium on good environmental stewardship.

Clients are increasingly more aware of where their money is being invested, and what impacts their investments are creating - socially and environmentally. The term 'investments' in this case, refers not only to equity or bond market investments, but also the everyday consumer expenditure - including ethically sourced coffee beans or zero-waste grocery stores, or even choosing public transport over personal cars. In a 2018 UBS Investor Watch global survey, 81% of respondents had expressed wanting to align their consumer spending patterns with their values.

In other words, individuals are now learning that every dollar spent or invested, is an opportunity to vote for sustainability.

WATCHLIST:

Sunpower Group (SPWG SP)

Sembcorp Industries (SCI SP)

Keppel Corporation (KEP SP)

Mapletree Logistics Trust (MLT SP)

In recent years, the focus on sustainable investments has accelerated considerably; as of June 2019, more than 2450 investment companies with US$82 trillion in assets under management (AUM) have signed commitments to incorporating ESG issues into their investment decisions under the UN-backed Principles for Responsible Investing (UN-PRI).

While many institutional investors were initially reluctant to embrace sustainability as a criteria in investment decisions, arguing that their duty was limited to the maximization of shareholder profits irrespective of environmental or social impacts, or even broader governance issues such as corruption, time has proven that *ESG issues do indeed have financial implications.*

Walmart became a more palatable choice for socially minded investors after it announced in September that it would restrict the types of firearm ammunition that it sells, according to S&P Global Intelligence. Nielsen also found in a recent study, 66% of all global consumers and 73% of millennial consumers are willing to pay more for a sustainable brand - not all because of environmental and socially-conscious considerations but also because **sustainability has also become a way for companies to show consumers that they care for more than just profits, are thoughtful about their customers, and how their business practices impact the communities in which they operate.**

Sustainability is becoming cheaper for those who align themselves accordingly…

Keppel Corporation

Keppel Corporation (KEP SP/KPLM.SI) was included as an index constituent of the FTSE4Good Index Series in August 2019, which "identifies companies demonstrating strong environmental, social and governance (ESG) policies and practices". Since the end of 2018, Keppel's office at Keppel Bay Tower has been fully powered by clean energy. ***Cumulatively, the group has saved over three million GJ of energy over the past five years, which works out to about S$188 million in cost savings, and an avoidance of over 360,000 tonnes of carbon dioxide emissions over the same period.***

mapletree logistics

Mapletree Logistics Trust (MLT SP/MAPL.SI) obtained the first S$200m sustainability-linked loan from OCBC Bank in Nov 2019. The six-year committed revolving credit facility is designed with reference to MLT's rooftop solar installation programme for its logistics properties in Asia-Pacific. ***Under the facility, MLT will report its progress on an annual basis, and will be eligible for a discount on the interest rate charged on the loan if it meets its renewable energy generation target.***

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WHAT IS ESG?

The term and scope of "ESG", despite having been around for over a decade, has unfortunately not been clearly defined, and "Sustainable Investing" withal.

But generally, ESG refers to the consideration of environmental and social impacts an organization has in the communities in which they operate, and its governance structures that are in place to ensure effective execution of business decisions.

E - An organisation's effect on the **environment**, directly and indirectly. It refers everything from carbon emissions, air and water pollution, energy efficiency, to waste management.

S - The relationships that an organisation fosters with all the **society** in which it operates. This could refer to labour standards, diversity and equality, employee health and safety, privacy and data security, to corporate social responsibility efforts.

G - The internal system of practices, controls, and procedures a company adopts in order to govern itself. It relates to corporate **governance** - from compensation and oversight of CEOs and top executives, transparency and reporting, to cyber risk mitigation.

WHAT IS SUSTAINABLE INVESTING?

Sustainable investing is often applied to a range of investment strategies including ESG-integration, thematic investing, impact investing, and norms-based or negative screenings.

ESG INTEGRATION

Investing in companies based on ESG scores/rating systems
e.g. Using optimized ESG benchmarks, and overweighting strong ESG performers.

In ESG integration, ESG scores are tools to guide investment decisions. ESG scores are usually the result of a blended rating of several key inputs for each E, S and G factor – and they can differ rather vastly across different data providers.

THEMATIC INVESTING

Focusing particularly on one or several E, S or G issues.
e.g. Low carbon, renewable energy

IMPACT INVESTING

Investing in companies whose products or services have a positive ESG impact.
e.g. Projects that provide affordable housing or clean water

NEGATIVE SCREENING

Removing specific companies or industries associated with objectionable activities
e.g. Screening out weapon producers, coal-fired power plants, tobacco

… and those who aren't are going to start paying a premium.

Banks across the globe have pledged to stop funding new coal-fired power plants… and we know that this is just the tip of the iceberg.

"It's part of our fiduciary duty to our clients, and we are convinced that an ESG-compliant company is better equipped to outperform in the long run."
- Amundi

"The biggest challenge in the coming decade is to reduce the greenhouse gases, like CO_2, or methane… The risk of stranded assets is real. Ask any coal-fired power-plant owner in the US, and now increasingly, in India."
- Ho Ching, CEO, Temasek Holdings

"We aim to future-proof our business as we work towards delivering long-term value for our stakeholders, and our achievement of interest savings as a result of our sustainability efforts shows that we can also do well when we do good and do right."
- Lynette Leong, Chief Sustainability Officer, CapitaLand Group

"Purpose unifies management, employees, and communities. It drives ethical behaviour and creates an essential check on actions that go against the best interests of stakeholders.

"Purpose guides culture, provides a framework for consistent decision-making, and, ultimately, helps sustain long-term financial returns for the shareholders of your company."

- Larry Fink, CEO and Founder,

*However, one of the major barriers has irrefutably been the **lack of data recorded and disclosed**, and the necessary tools to dissect, analyse and understand whatever data that is available.*

Every company, every institution, every fund, and every individual, would have different frameworks by which they value ESG based on their individual needs, industry and geography.

Earlier in December, the European Union (EU) outlined the world's first comprehensive green-financing rules, seeking to regulate claims made by the finance industry in the burgeoning area of environmentally sustainable investment products, amid surging demand for sustainable investment.

The rules will apply only in the EU but could have a global impact due to Europe's large financial markets and leadership in the sector. EU regulators must, however, define the details of the green-investments framework, a tall order that will still take some time. The commission will solidify its rules on climate-related aspects of sustainable finance by the end of 2020, and environmental regulations by the end of 2021. Industries will then have a year to implement each measure, presumably by the end of 2022.

Although only a draft has been drawn, or more details on what might count as green and what doesn't, or what standard companies might have to start adhering to, click here to read this Financial Times' article: "How will the EU's system for classifying green investments work?", December 19, 2019 (*only available to FT subscribers).

The **Singapore Exchange Regulation (SGX RegCo)** is looking to make ESG data in mandatory sustainability reports more useful for investors in 1H20 by providing more guidance for companies, as the current regulatory framework has proven to be insufficient since it allows companies to choose material matters to report on, making data less comparable for investors.

For example, the review also noted that more can be done on the climate change front given that it has been a hot button issue recently. Currently, a mere 6.5 per cent of companies acknowledged climate change as a material factor.

CURRENT GUIDELINES

In recent years, the ***Global Reporting Initiative (GRI)*** has provided some guidance to corporate disclosure on sustainability reporting, along with other initiatives such as the ***Global Impact Investing Network (GIIN)*** (including IRIS+ and GIIRS), and the ***Sustainable Accounting Standards Board (SASB)***.

Institutional investors in addition may choose to be a signatory to the ***UN Principles of Responsible Investing (UNPRI)***, a set of principles that offer possible actions for incorporating ESG issues into investment practice:
Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
Principle 6: We will each report on our activities and progress towards implementing the Principles.

The 17 ***United Nations' Sustainable Development Goals (UN SDGs)***; a part of the ***2030 Agenda for Sustainable Development***.

Sustainability issues will inevitably impact all businesses and investment decisions. If not today, then tomorrow…

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Investing in sustainability has not always been the most profitable (for now…), but it also hasn't made the biggest losses. Therefore, we believe that sustainable choices aren't a question of 'why?', ***but rather 'why not?'***.

Investors now have the opportunity to catch the worm – to invest in firms who are boldly and bravely the first movers, the ones with an irrefutable competitive advantage, before global funds and indices recognise their true value.

'Sustainability' has been gaining momentum in 2018 and 2019 and we believe that 2020 will be the year it finally, and fully, catches on. And when it does, there will be winners, and there will be losers. *Which side will you be on?*

OUR SUSTAINABILITY NOMINEE: SUNPOWER GROUP (SPWG SP/SUNP.SI)

Rating: **OUTPERFORM**; Target price: SGD $0.91

Sunpower Group (Sunpower) is an environmental protection and energy-saving solutions provider, mainly engaged in two business segments, Green Investment (GI) and Manufacturing & Services (M&S).

Sunpower's environmentally-friendly "Combined Heat and Power" (CHP) plants in its growth driver and value creator GI segment, can help reduce the number of small-scale environmentally hazardous plants run by industries to generate steam or power by centralising the supply of steam and power. CHP also reduces the consumption of coal through better efficiencies hence providing an energy-saving solution.

Sunpower's M&S segment on the other hand, is able to provide its GI projects with more energy-efficient facilities and cutting-edge solutions to reduce heat loss in order to improve margins.

CHP plants have emerged as the backbone of China's environmental agenda. Facing increasingly severe air pollution, it has been aggressively devoting resources to implement stringent policies and regulations to improve air quality.

Click here to read more about Sunpower Group in Guangzhi's initiation report.

OUR SUSTAINABILITY NOMINEE: SEMBCORP INDUSTRIES (SCI SP/SCIL.SI)

Rating: **NOT RATED**

Sembcorp Industries (SCI) is Singapore's largest home-grown international renewable energy player, being one of the largest wind energy developers in India, and one of the largest battery-based energy storage players in Europe. SCI currently provides a total operating power capacity of over 12,200MW globally comprising thermal power, renewable power, energy-from-waste and battery storage.

With the push for sustainability, SCI has set aggressive targets for itself in order to be aligned with the IEA 450 Scenario (2°C scenario):

1. To reduce GHG emissions intensity –
    a. by approx. 22% to 0.42 tCO_2e/MWh by 2022 (from 2017)
    b. by more than 26% to <0.40 tCO_2e/MWH by 2030 (from 2017)
2. To double its renewables capacity to ~4,000 MW (equiv. to ~50% of total power capacity) by 2022.
    a. As of 3Q19, a further 360 MW of renewable power and battery storage are under development.
3. To spend at least 80% of its R&D budget on green business lines and new business models, products and services.

The International Energy Agency (IEA) 450 Scenario (click here) describes an energy pathway consistent with the goal of limiting the average global temperature increase to 2°C. In a "450 Stabilisation Case" according to the IEA, the concentration of greenhouse gases in the atmosphere are stabilised at around 450 parts per million; and exceptionally quick and vigorous policy action by all countries, and unprecedented technological advances, entailing substantial costs, would be needed to make this case a reality.

By tapping on immense growth opportunities in Australia and New Zealand as well as in Europe, we see great potential for SCI to become one of the region's leading independent renewable energy players.

Click here to read more about Sembcorp Industries' Climate Change Strategy.

WATCHLIST:

EC World REIT
TP: SGD $0.84
FY20F Div Yield: 8.40%

Manulife US REIT
TP: USD $1.03
FY20F Div Yield: 6.80%

Keppel DC REIT
TP: SGD $2.11
FY20F Div Yield: 5.04%

CAN I STILL BUY REITS?

KGI CHINA DEVELOPMENT FINANCIAL

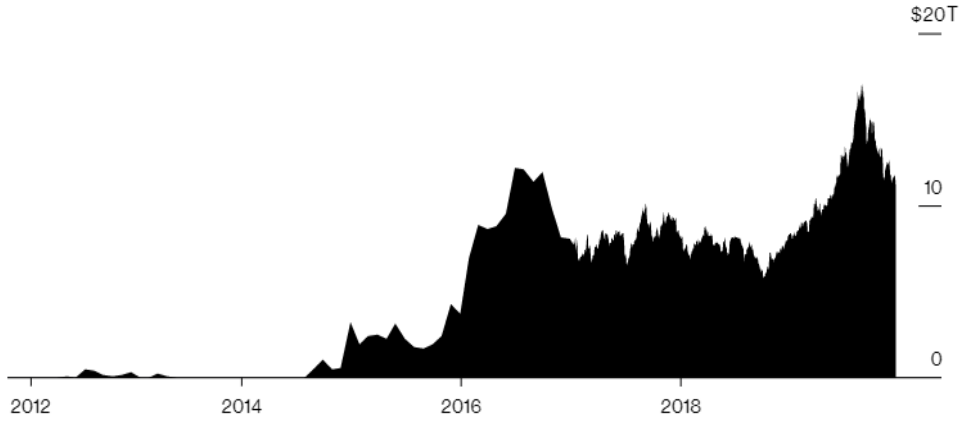
Yes. At least some of them.

2019 can be summarised as a year of the hunt for yield. In Singapore's market, the REIT sector outperformed the overall market as investors sought stable income producing assets. This flight to yield was mainly a reflection of the collapse in bond yields as investors sought out a safe place amid economic and geopolitical risks.

Nothing encapsulates this trend better than negative yielding bonds.

Globally, the total amount of negative yielding bonds rose to a peak of US$17 trillion in 2019 but has since fallen to around US$11 trillion in December 2019 as signs of further progress in trade negotiations between China and the US lifted investor optimism.

Figure 47: Market value of negative-yielding bonds in the Bloomberg Barclays Global-Aggregate Index



Source: Bloomberg

IT WAS A GREAT YEAR FOR REITS AS THE FTSE ST REIT INDEX RECORDED A TOTAL RETURN (INCL DIV) OF 26% IN 2019 COMPARED TO THE STI'S 9%.

Figure 48: Key STI sector indices

BBG Ticker	Company Name	Price	6 Months Performance (%)	Total Return 1 Year (%)	Total Annualized Return 3 yrs (%)	Total Annualized Return 5 yrs (%)
STI INDEX	**Straits Times Index STI**	3,222.8	(1.0)	9.4	7.7	2.8
FSTTG INDEX	**FTSE ST Technology**	261.0	4.7	27.0	11.7	(4.5)
FSTREI INDEX	**FTSE ST REIT**	923.3	3.3	25.5	15.8	9.9
FSTREH INDEX	**FTSE ST Real Estate**	820.4	2.5	15.3	8.0	4.5
FSTCS INDEX	**FTSE ST Consumer Svcs**	612.8	(5.7)	(3.7)	(2.6)	(2.8)
FSTCG INDEX	**FTSE ST Consumer Goods**	505.3	4.6	28.3	1.7	3.2
FSTUT INDEX	**FTSE ST Utilities**	269.5	4.8	4.0	(5.8)	(7.7)
FSTTC INDEX	**FTSE ST Telecom**	844.4	1.2	19.6	2.2	1.1
FSTIN INDEX	**FTSE ST Industrials**	667.3	(9.9)	(6.8)	0.4	(0.9)
FSTFN INDEX	**FTSE ST Financials**	1,020.3	2.4	15.5	14.0	7.2
FSTBM INDEX	**FTSE ST Basic Materials**	35.2	(8.8)	(14.2)	(26.9)	(20.8)
FSTRE INDEX	**FTSE ST Real Estate Index**	877.7	3.0	21.9	12.9	7.8
FSTOG INDEX	**FTSE ST Oil & Gas Index**	336.7	1.0	14.3	3.2	(7.2)
FSTM INDEX	**FTSE ST Mid Cap Index**	758.4	0.2	16.0	8.5	4.8
FSTAM INDEX	**FTSE ST Maritime Index**	219.2	(24.1)	(6.7)	11.4	1.2
FSTLM INDEX	**FTSE ST Large & Mid Index**	1,149.4	(0.2)	11.1	8.4	3.5
FSTHC INDEX	**FTSE ST Healthcare Index**	1,184.8	(3.5)	(4.9)	(4.4)	2.2
FSTF INDEX	**FTSE ST Fledgling Index**	742.1	5.6	7.9	4.0	1.1
FSTC INDEX	**FTSE ST China Index**	208.2	(0.5)	10.2	4.2	2.1
FSTICA INDEX	**FTSE ST Catalist Index**	272.4	(0.8)	(10.7)	(13.9)	(17.1)

Source: Bloomberg, KGI Research

Those shaded green under the Gearing column indicate gearing less than 35%.

Although trailing just behind the Technology and Consumer Goods Indices in 2019, the REIT sector takes the crown as the best performing sector based on a 3 and 5 year total annualised return. The FTSE ST REIT Index recorded a 10% total annualised return over the last 5 years, outperforming the STI's 3% total annualised return.

It was also a record year for REITs and property trusts as they raised a record of S$6 billion in capital through the secondary market (e.g., placements and rights issuance).

Figure 49: Singapore REITs dividend yield and gearing

BB ticker	Company Name	Last Price (local $)	Currency Adj. Market Cap (S$ m)	Forward Dividend Yield (%)	Gearing (%)
PREIT SP	PARKWAYLIFE REAL ESTATE	SGD 3.36	2,033	4.0	37.5
KDCREIT SP	KEPPEL DC REIT	SGD 2.18	3,559	4.1	32.4
MCT SP	MAPLETREE COMMERCIAL TRUST	SGD 2.39	7,903	4.1	33.7
CCT SP	CAPITALAND COMMERCIAL TRUST	SGD 2.03	7,831	4.4	27.4
KREIT SP	KEPPEL REIT	SGD 1.23	4,141	4.7	30.0
MLT SP	MAPLETREE LOGISTICS TRUST	SGD 1.73	6,569	4.8	39.1
FCT SP	FRASERS CENTREPOINT TRUST	SGD 2.77	3,096	4.9	29.6
MINT SP	MAPLETREE INDUSTRIAL TRUST	SGD 2.66	5,854	5.0	31.4
CT SP	CAPITALAND MALL TRUST	SGD 2.46	9,074	5.2	32.8
SUN SP	SUNTEC REIT	SGD 1.84	5,154	5.3	37.7
FEHT SP	FAR EAST HOSPITALITY TRUST	SGD 0.75	1,457	5.5	38.4
AREIT SP	ASCENDAS REAL ESTATE INV TRT	SGD 3.02	10,910	5.5	37.1
SPHREIT SP	SPH REIT	SGD 1.08	2,976	5.6	28.2
ART SP	ASCOTT TRUST	SGD 1.36	4,193	5.6	37.8
CDREIT SP	CDL HOSPITALITY TRUSTS	SGD 1.63	1,977	5.7	35.3
AIT SP	ASCENDAS INDIA TRUST	SGD 1.57	1,795	5.8	38.9
FLT SP	FRASERS LOGISTICS & INDUSTRI	SGD 1.21	2,733	5.9	34.5
FCOT SP	FRASERS COMMERCIAL TRUST	SGD 1.65	1,510	6.1	30.4
OUECT SP	OUE COMMERCIAL REAL ESTATE I	SGD 0.56	3,016	6.1	39.4
MUST SP	MANULIFE US REAL ESTATE INV	USD 0.99	2,093	6.3	34.4
MAGIC SP	MAPLETREE NORTH ASIA COMMERC	SGD 1.16	3,705	6.3	38.5
SSREIT SP	SABANA SHARIAH COMP IND REIT	SGD 0.46	484	6.3	37.4
CRCT SP	CAPITALAND RETAIL CHINA TRUS	SGD 1.60	1,935	6.4	39.8
FHT SP	FRASERS HOSPITALITY TRUST	SGD 0.72	1,365	6.4	36.5
SGREIT SP	STARHILL GLOBAL REIT	SGD 0.73	1,594	6.4	37.0
PRIME SP	PRIME US REIT	USD 0.97	1,203	7.0	36.6
CERT SP	CROMWELL EUROPEAN REIT	EUR 0.55	2,094	7.3	34.6
AAREIT SP	AIMS APAC REIT	SGD 1.46	1,025	7.4	34.9
SASSR SP	SASSEUR REAL ESTATE INVESTME	SGD 0.89	1,065	7.8	31.5
ARAUS SP	ARA US HOSPITALITY TRUST	USD 0.86	657	7.9	34.0
CACHE SP	CACHE LOGISTICS TRUST	SGD 0.72	778	8.1	36.6
EREIT SP	ESR-REIT	SGD 0.55	1,901	8.1	43.7
KORE SP	KEPPEL PACIFIC OAK US REIT	USD 0.78	982	8.1	36.1
DASIN SP	DASIN RETAIL TRUST	SGD 0.85	547	8.3	39.2
FIRT SP	FIRST REAL ESTATE INVT TRUST	SGD 1.00	798	8.7	36.4
ECWREIT SP	EC WORLD REIT	SGD 0.74	593	8.8	40.8
SBREIT SP	SOILBUILD BUSINESS SPACE REI	SGD 0.53	662	9.0	38.8
EAGLEHT SP	EAGLE HOSPITALITY TRUST	USD 0.54	628	12.0	39.8

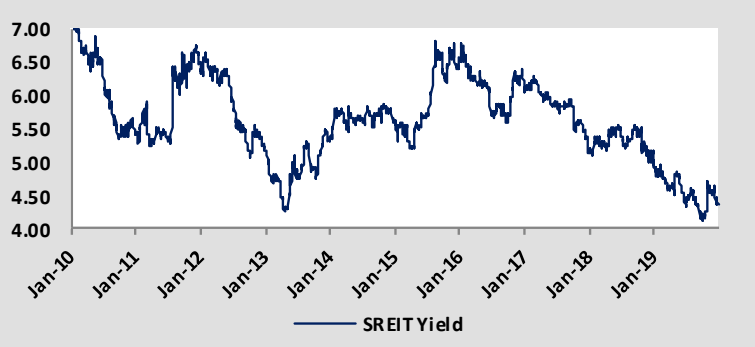
Source: Bloomberg, KGI Research

Those shaded green under the Gearing column indicate gearing less than 35%.

REITs are learning to limbo

Dividend yield for the overall FTSE ST REIT Index has compressed from 6% and higher in 2016 to 5% and lower in 2019. However, there is a wide variance among the REITs, with yield compression heavily weighted towards those with established sponsors, such as Keppel, Mapletree, CapitaLand and Frasers.

Figure 50: FTSE ST REIT Index Dividend Yield



Source: Bloomberg, KGI Research

More M&A with the potential increase in leverage limits

The Monetary Authority of Singapore (MAS) is currently reviewing plans to allow REITs' leverage ratio to exceed 45% but not more than 50% if the REIT is able to meet a minimum interest coverage requirement (ICR) of 2.5x, after taking into account the interest payments from the new debt. A higher debt level would definitely be positive for REITs such as Keppel DC REIT, Mapletree Commercial Trust, CapitaLand Commercial Trust, Keppel REIT, Frasers Centrepoint Trust and other REITS highlighted in the table on the left.

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Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon
Not Rated (NR)	The stock is not rated by KGI Securities.
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