DBS Focus

ETF Strategy — Singapore offers plenty of diversification

DBS Group Research

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- *SGX-listed ETFs bring suite of multi-asset investment opportunities in Singapore*
- *Singapore equities and bonds will likely continue to be supported over the next 10 years with relatively low but stable, high quality growth and low inflation*
- *Herd instinct and emotions are "investment hazards" — A regular savings plan set up with ETFs provides many benefits of diversification as well as dollar cost averaging*
- *Investing using Straits Times Index and Singapore government bond ETFs will provide the exposure; yield seeking investors can opt for S-REITS and Singapore Investment Grade Corporate Bond ETFs*

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Introduction

With the introduction of ETFs which are exposed to a range of asset classes, multi-asset diversification for Singapore investors can be achieved. This is essential today when policy uncertainties have made investing more difficult.

Rising costs of living and longer life spans have made retirement planning more challenging. With structurally lower bond yields, an allocation away from bonds towards other higher-yielding products may be warranted. What's even more interesting is how individual assets can be combined to provide specific exposure to compensated forms of risk.

This report serves to explore the different asset classes in Singapore, which have now become investible for individual retail investors through the use of ETFs listed in Singapore.

Case for investing in Singapore

Singapore is one of the few triple A-rated economies, thanks to its sound monetary and fiscal policies. It maintains an exchange-rate based monetary policy regime. The Singapore dollar has proven to be less volatile in times of global financial crisis. An open financial system and capital markets backed by strong reserves can boost investor confidence and draw investment flows into the country.

Singapore's economy is heavily dependent on exports of goods and services, as well as tourism. Government policies are steering towards a more broad-based economy with the services sector to complement the manufacturing-based economy. Efforts in promoting sectors such as tourism, financials, legal and litigations, ASEAN integration, and population policy are strongly in place to transform the economy.

Singapore in 2030: BAU, reinvention, or decline

Singapore's economic performance over the past several decades has been exceptional, and the country now sits at the income frontier. However, recent GDP growth rates are markedly lower than in the past few decades. This is consistent with the experience of small advanced economies that are close to the income frontier.

In a research note looking into Singapore 2030, DBS economists note that a series of structural dynamics will impact on the outlook for Singapore. For example, factors such as medium-term demographic and productivity trends, the impact of technology and regional integration, and the international trading system.

Taking into consideration productivity and demographic trends and ongoing structural reforms, a baseline of ~2-2.5% GDP growth on average over the period to 2030 is a reasonable starting point: 1.5% labour productivity growth plus 0.5-1.0% labour force growth. This is low by Singapore standards, but is healthy compared to other countries at the income frontier.

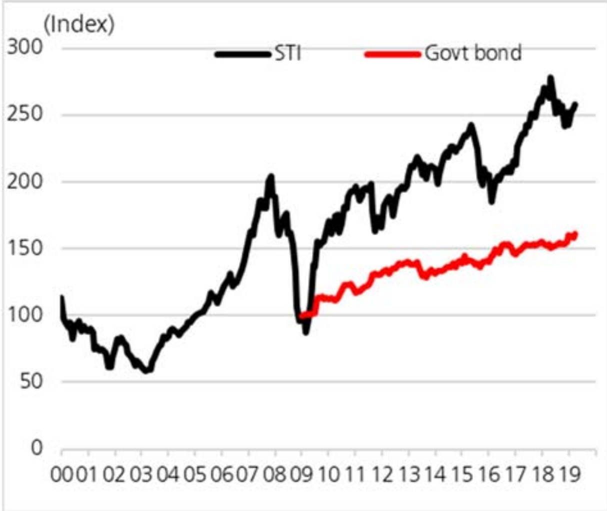
(For details, refer to ***Singapore in 2030: BAU, reinvention, or decline?****, Taimur BAIG, Irvin SEAH, David SKILLING, 17 July 2018)*

What about investment returns in the longer run?

Based on returns over the past 20 years, average return of Singapore equities ranges from -1.7% to 10.3%, depending on the investment horizon. However, over the past 10 years since the global financial crisis ("GFC"), volatility has been high. Notably, STI equities returned an annualised 10.3% during this period, but at the same time featured negative returns in some years. Singapore bonds have provided steady returns of 2.4%–5%, depending on the investment period, which have acted as a portfolio diversifier.

The implication is that investors will need time and diversification to realise investment goals, and a disciplined approach would be needed.

Singapore equities and bond performance, total return in SGD, rebased to 100 on 1/1/09



Annualised return	Singapore Equities	Singapore Govt. bond	Average Return
20-year	5.3%	NA	5.3%
15-year	7.4%	NA	7.4%
10-year	10.3%	4.8%	7.5%
5-year	3.9%	3.9%	3.9%
3-year	8.8%	2.4%	5.6%
1-year	-1.7%	5.0%	1.7%

Source: Thomson Reuters, DBS. NA not available

Investment hazards derail long term investment goals

Herd instincts and emotions are investment factors which commonly control investors' risk appetite. Few amateur investors can put Warren Buffett's investment advice — *"Be fearful when others are greedy, be greedy when others are fearful"* — into practice.

A disciplined strategy with a regular savings programme set-up will have the benefit of dollar cost averaging – more units being bought when market is down, and fewer units bought when the market is up. Investments into underlying products such as an ETF would have the diversification benefit of investing into a basket of securities over time.

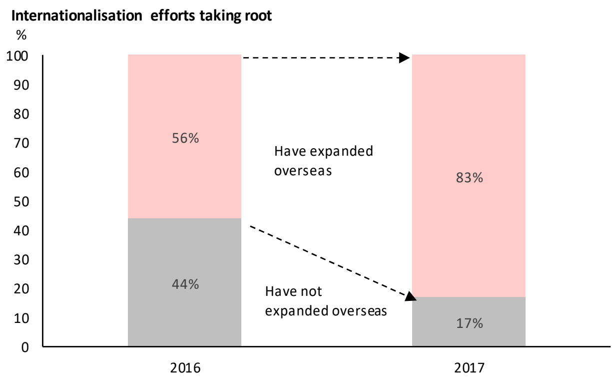
The following section explains the Straits Times index, Singapore government bonds, Singapore REITS and Singapore Corporate Bonds, which are the underlying instruments used in Nikko AM suite of ETFs listed in the Singapore stock exchange. Investors can use these ETFs as the underlying investment in a regular savings programme.

Singapore Straits Time Index — Blue chip exposure

The Singapore market blue chip Straits Times index is represented by 30 stocks which are exposed to the domestic Singapore economy as well as China, ASEAN and the global economy. Our calculations show that about 18% of the revenues are derived from Singapore and the is from outside Singapore.

Hence gaining exposure to the STI would lead one to gaining exposure in line with Singapore's economic structure, which is open and cyclical. In the aforementioned ***Singapore 2030 report***, the authors discuss regional integration as one of the structural dynamics that provide opportunities for Singapore companies and is a win-win for Singapore. There is evidence to suggest that Singaporean companies are increasingly encouraged to internationalise and Singapore's blue chip companies are definitely in the forefront of the trend.

Singapore Business Federation (SBF) – survey of companies in their internalisation efforts



Source: National Business Survey, Singapore Business Federation

Near-term outlook for the STI

Singapore is one of the cheapest markets in Asia. Trading at 12.7x 12-month forward PE and 6.2% earnings growth, we believe it is one of the more attractive market compared to other Asia markets. And compared to its history, it is also trading below its 10-year average valuation levels.

We like the market's resilience, high yields and good governance, which are all important considerations to protect from downside risks.

Our index target for the near term is 3250, while a bull-case scenario of a constructive US-China trade deal and Fed rate cuts could bring the index towards 3500 by year-end, representing about 6% return. The Index pays about 4.0% dividend yield, which is the highest in the region.

The Nikko AM STI ETF tracks the STI index closely with a low price-tracking error of 2.35%. It pays out the dividends distributed by the underlying STI component stocks on a half-yearly basis.

Singapore Straits Times Index 12-month forward PE valuations

Source: Thomson Reuters, DBS

Singapore REITs: Bond babies

With 42 listed REITs in Singapore, and yielding 6.2% on average, the Singapore REIT (S-REIT) sector has been an asset class of its own drawing interests of yield-seeking investors. The sector provides exposure to the rental yield market in Singapore in the office, hotel, warehouse, retail, and factory space. Some REITs have exposure to overseas properties.

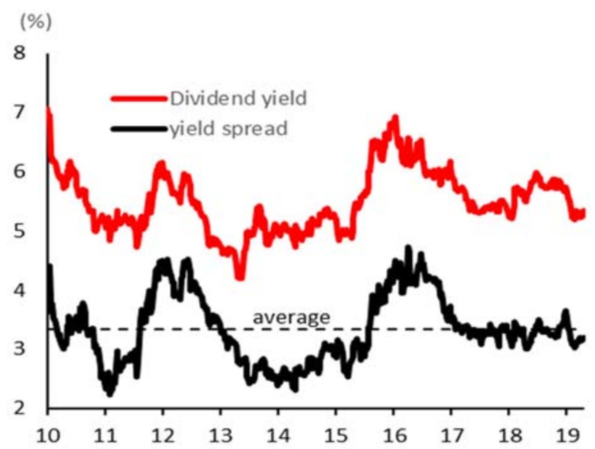
Investors who put their money in REITs can expect a constant stream of payouts. However, as REITS are listed equities, they are also subject to the volatility of the stock market and to the ebbs and flows of investor appetite.

Near term outlook for Singapore REITS

Despite strong return in the S-REITS sector YTD, we see more prospects for higher prices, driven by conducive macro conditions as the Fed has turned more dovish with low risk of hikes in the medium term between 2019 and early 2020. Riding on positive property fundamentals in Singapore, we continue to see improving prospects for most subsectors where landlords are able to raise rents as supply tapers.

The Nikko AM Asia ex-J REITS ETF tracks the FTSE EPRA/NAREIT Asia ex-Japan REITS Index and has 25 REITs altogether, with 15 from Singapore, 5 from Hong Kong, 3 from Malaysia and 1 from Thailand. 71.2% of the ETF is represented by Singapore REITS. It pays out the dividends distributed by the underlying component stocks on a quarterly basis.

Singapore REIT sector — historical dividend yield and yield spread vs Singapore 10-year bonds



Source: Thomson Reuters, DBS

Singapore Government Bonds: Stable yields

The Singapore government bond market was previously available for institutional investors and for retail investors in big tranches. For retail investors, the Singapore government bond ETF has been around since 2005. Retail investors can participate in the Singapore government market by buying into the ETF consisting of a basket of Singapore government bonds.

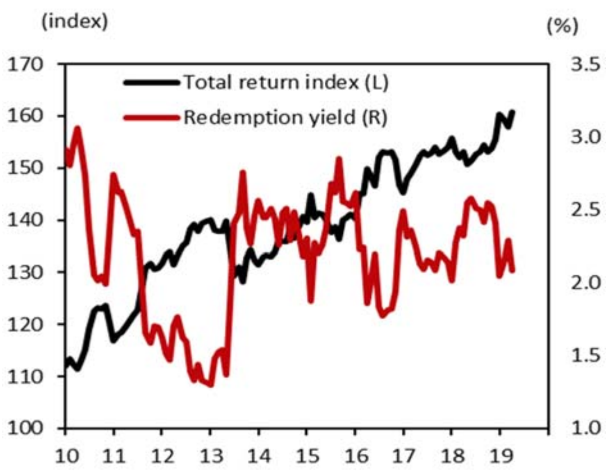
Investors must note that throughout the investment period of a bond, the price of Singapore government bond is in inverse relationship with interest rates, i.e. when interest rates fall, bond prices go up; and when interest rates rise, bond prices fall. Hence, investors should be aware that if a bond is sold before maturity, its price may fall below par.

In bond investing, we recommend bond ladder strategy. A bond ladder is an investment strategy whereby an investor staggers the maturity of the bonds in his/her portfolio so that the bond proceeds mature and can be reinvested at regular intervals. This strategy is implemented effectively on an ETF of bonds.

Near-term outlook for SGS

We expect Singapore government securities (SGS) yields to hold up well this year, but not higher. It is difficult to envisage much upside if global growth challenges remain, inflationary pressures are generally muted, and the Fed is done with the hiking cycle as we expect. Our base case is for the Fed to stay on hold through 2020.

Singapore government bonds: Total return index and redemption yield



Source: Thomson Reuters, DBS

Singapore investment grade corporate bonds

The Nikko AM SGD Investment Grade Corporate Bond ETF (the "Fund") is the first to offer investors easy access to Singapore Dollar-denominated, investment-grade corporate bonds in affordable units. The Fund aims to replicate the performance of the iBoxx SGD Non-Sovereigns Large Cap Investment Grade Index (the "Index"), allowing investors to diversify their portfolios with corporate bonds from high-quality issuers.

The ETF is for investors who want to invest in an ETF with corporate bond holdings that are of investment-grade rating. An investment-grade rating shows that the bond has a relatively low risk of default. A diversified portfolio of securities can also help to reduce credit risk. Some of the top issuers include Singapore Banks, Singapore Airlines, Singapore Land and Transport Authority etc.

Near-term outlook for Singapore IG Corporate Bonds

Credit market moves earlier in the year have been aggressive, in our opinion. While the move was largely rates driven and even though spreads are still wider than what we have seen in the past (e.g. early 2018), absolute yields have turned less appealing in our view. As such, we recommend being selective in adding risk at this point. That said, we see the Singapore credit market being well supported, given the strength of market technicals.

Singapore Investment grade Corporate Bond index

Source: Bloomberg Finance L.P., DBS

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