ASEAN Equity Strategy

Buying value worked in 2016. 'It's rates, silly.' What to do now

Equity Strategy

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As a style, value worked in 2016, eventually

In our 4 January 2016 report "For 15 years, growth has outperformed value; why it could be about to change", we discussed the possibility of value stocks outperforming growth. The rationale was simply that the premium the market was paying for growth was historically high, and that as interest rates started to normalise, history suggested that this premium would reduce. Initially, this recommendation did not work. In fact the premium for the growth screen widened further to 4.3x in January, and then again in July. However, since then, it has corrected sharply and the premium has since declined to 3.6x. Still high, but significantly below where we were six months ago.

'It's rates, silly'

What changed? Commodity prices (especially oil) rose strongly from February 2016, immediate concerns over Chinese growth eased, and the incoming US president has promised to boost growth and invest heavily in infrastructure. In H216, these factors were reflected in rising bond yields. In looking at the past 15 years, we have found an 80% correlation between 1) the relative premium for growth based on our sample screens and 2) benchmark 10-year US Treasury yields. As rates rose, the premium for growth started to reduce.

Do we see value continuing to outperform growth in 2017?

Much will depend on whether the market is correct to expect a rise in inflationary pressures, and whether market interest rates continue to rise accordingly. For the next 12 months, we have some reservations on this. Yes, UBS is forecasting oil prices to average US$60/barrel in 2017 and US$70/barrel in 2018. And we are expecting both US growth and global growth to accelerate. We also note rising wage pressure in the US. We believe that inflation will rise because of higher commodity prices and against the low base in 2016, especially in H116. However, growth in Europe continues to be relatively weak and the world still struggles with excess capacity. In short, yes, deflationary pressures appear to have receded for now, but we still do not feel that we are on the verge of sustained higher inflation either.

We suggest three alternative strategies for 2017

Assuming we are correct that 10-year US Treasuries do not rise substantially over the next 12 months, then we would not expect value stocks to deliver the same outperformance we witnessed in H216. And, we would resist the urge to chase stocks that have already risen sharply, in some cases by between 50% and 100% over the past 52 weeks. So, what should we do? Three strategies for 2017: 1) favour laggards (Bank Rakyat, BEC World, CapitaLand, Comfortdelgro, Glow, IJM, Keppel Corp, LT Group, Maybank, Megaworld, Public Bank, Siam City Cement, Singapore Telecom., Tenaga, TMB Bank, Vista Land and YTL Power); 2) buy those few stocks that, even if they outperformed in 2016, still offer at least 20% upside (Genting Berhad, Metro Bank, Supalai and TISCO); and 3) revisit selected growth stocks (Astra International, Ciputra Development, Metro Pacific Investments, Mitra Keluarga, Puregold, Robinsons Retail and Sino Thai Engineering).

In our 4 January 2016 report "For 15 years, growth has outperformed value; why it could be about to change", we discussed the possibility of value stocks outperforming growth. The rationale was simply that the premium the market was paying for growth was historically high, and that as interest rates started to normalise, history suggested that this premium would reduce.

In January 2016, we put forward a rationale for value to outperform growth. One year on, we re-visit this thesis

We looked at all publicly traded companies in ASEAN with a market capitalisation above US$1bn. At the time of writing, there were in excess of 300 such companies. From these, we created two screens, one with the characteristics of value and the other of growth.

- The value screen had a median forward PE of 11.2x, a P/BV of 0.9x and a dividend yield of 4.5%. Based on then-consensus estimates, the constituents were trading at an average 40% discount to their intrinsic value and the five-year market-implied growth rate is minus 5%.
- The growth screen had a median forward PE of 27.4x, a P/BV of 3.8x and a dividend yield of 1.5%. Based on then-consensus estimates, the constituents were trading at an average 20% premium to their intrinsic value, and the five-year market-implied growth rate is plus 14%.

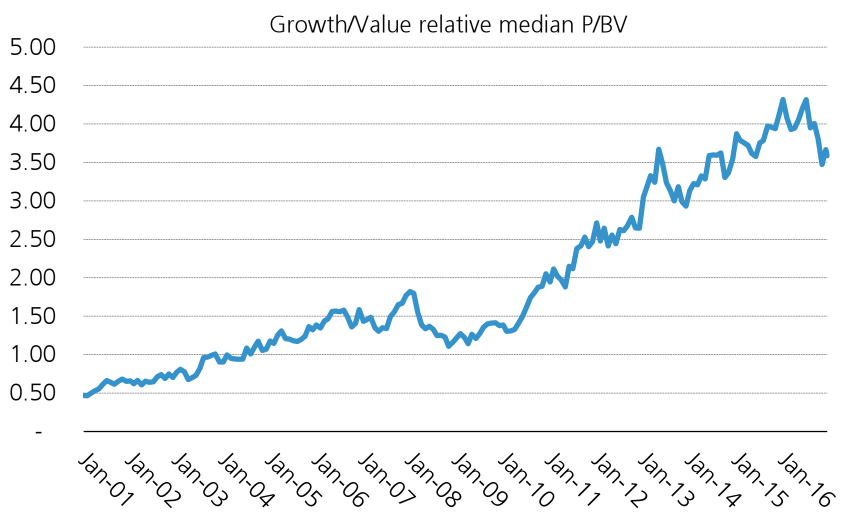
We analysed the trailing P/BV for the two screens since January 2001. Between then and January 2016, the premium for our growth screen had increased from 0.5x to 4.2x. Based on monthly data this was a historical high. Whilst there were a number of factors that justified the re-rating of growth screen, we felt that the premium being paid for growth was too high.

Our argument was based on the premium for growth being historically high

Initially this recommendation did not work. In fact the premium for the growth screen widened further to 4.3x in January, and then again in July. However, since then, it has corrected sharply and the premium has since declined to 3.6x. Still high, but significantly below where we were six months ago.

After initially not working, the value screen significantly outperformed growth in H216

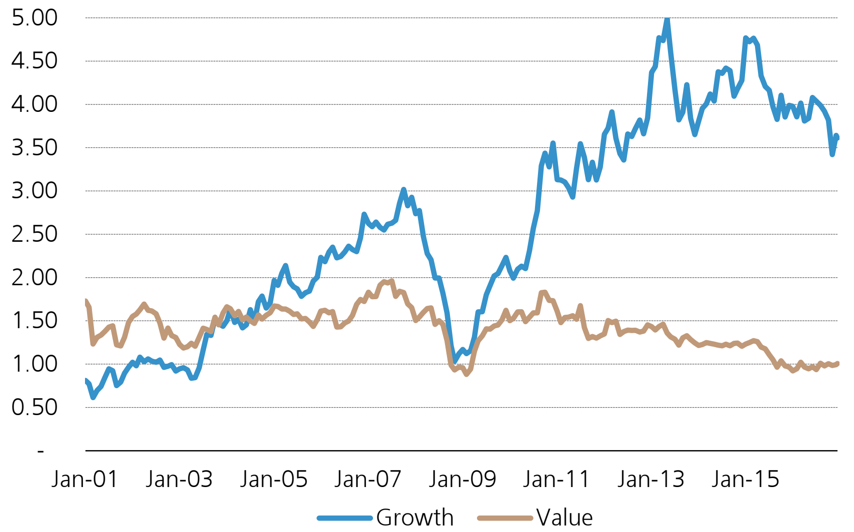
Figure 1: Premium of growth median P/BV vs value median P/BV 2001-2017 (x)



Source: Thomson Reuters Datastream, UBS

Over the past 12 months, two things have changed. The median P/BV for value stocks stopped declining, and the median P/BV for growth fell; actually to the levels of four or five years ago.

Figure 2: Growth and value median P/BV 2001-2017 (x)



Source: Thomson Reuters Datastream, UBS

The value constituents were heavily weighted in banks and property. They also included large-cap energy stocks

The composition of the two screens is set our below. By number of companies, approximately two-thirds of the value screen was banks and property. Conversely, there were no consumer discretionary companies or healthcare. Financials clearly benefitted from the 'reflation trade' in H216.

Figure 3: Composition of the value screen, by GICS industry and sector

	ID	MY	PH	SG	TH	Total
Banks	7%	9%	2%	5%	9%	**32%**
Other financials	0%	0%	0%	0%	0%	**0%**
Consumer discretionary	0%	0%	0%	0%	0%	**0%**
Consumer staples	2%	0%	0%	2%	2%	**5%**
Energy	0%	0%	0%	0%	5%	**5%**
Healthcare	0%	0%	0%	0%	0%	**0%**
Industrials	2%	0%	0%	7%	0%	**9%**
Materials	0%	0%	0%	0%	2%	**2%**
Real estate	0%	5%	2%	23%	4%	**34%**
Information technology	0%	0%	0%	2%	0%	**2%**
Telecoms	0%	0%	0%	0%	0%	**0%**
Utilities	2%	4%	2%	0%	4%	**11%**
Total	**13%**	**18%**	**5%**	**39%**	**25%**	**100%**

Source: Thomson Reuters, Datastream, UBS

Figure 4: Composition of the growth screen, by GICS industry and sector

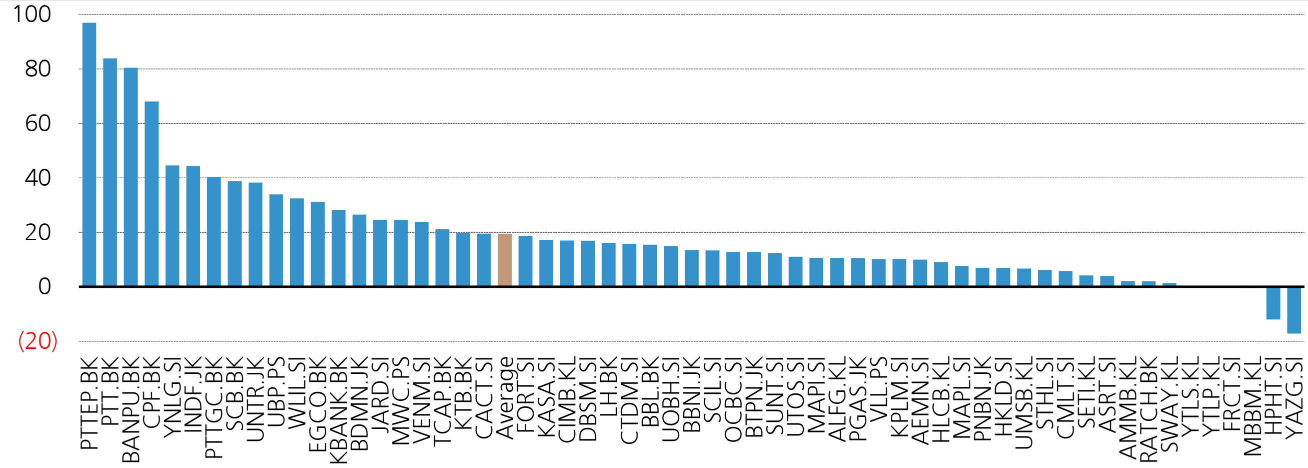
	ID	MY	PH	SG	TH	Total
Banks	2%	0%	0%	0%	0%	**2%**
Other financials	0%	0%	3%	0%	7%	**10%**
Consumer discretionary	8%	0%	2%	2%	5%	**17%**
Consumer staples	7%	2%	5%	0%	5%	**19%**
Energy	0%	0%	0%	0%	2%	**2%**
Healthcare	2%	2%	0%	2%	3%	**8%**
Industrials	7%	3%	10%	2%	3%	**25%**
Materials	0%	0%	0%	0%	0%	**0%**
Real estate	3%	0%	5%	0%	2%	**10%**
Information technology	0%	3%	0%	0%	0%	**3%**
Telecoms	2%	0%	0%	0%	0%	**2%**
Utilities	0%	0%	0%	2%	0%	**2%**
Total	**31%**	**10%**	**25%**	**7%**	**27%**	**100%**

Source: Thomson Reuters, Datastream, UBS

In terms of share-price change, all but four of the stocks in our value screen rose over the past 52 weeks, and the average absolute gain was 19%. The best performers were three Thai energy companies: PTT Exploration, PTT Public and Banpu. Also doing very well were CP Foods and Indofood.

The average 52-week gain for the value constituents has been 19%, and only four failed to rise in price

Figure 5: Share-price change over the past 52 weeks for our value screen

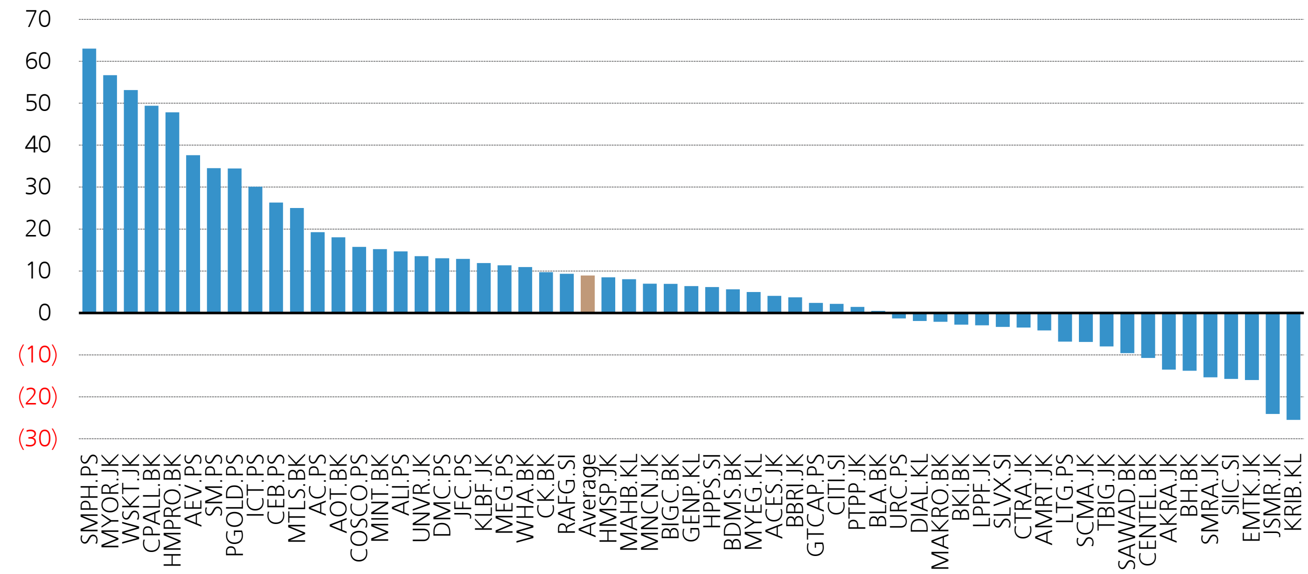


Source: Thomson Reuters Datastream

Conversely, for the companies in our growth universe, one-third of the constituents have declined over the past 52 weeks and the average gain for the whole universe was 9%; less than half that for our value screen.

This compares with average gains of 9% for the growth constituents

Figure 6: Share-price change over the past 52 weeks for our growth screen



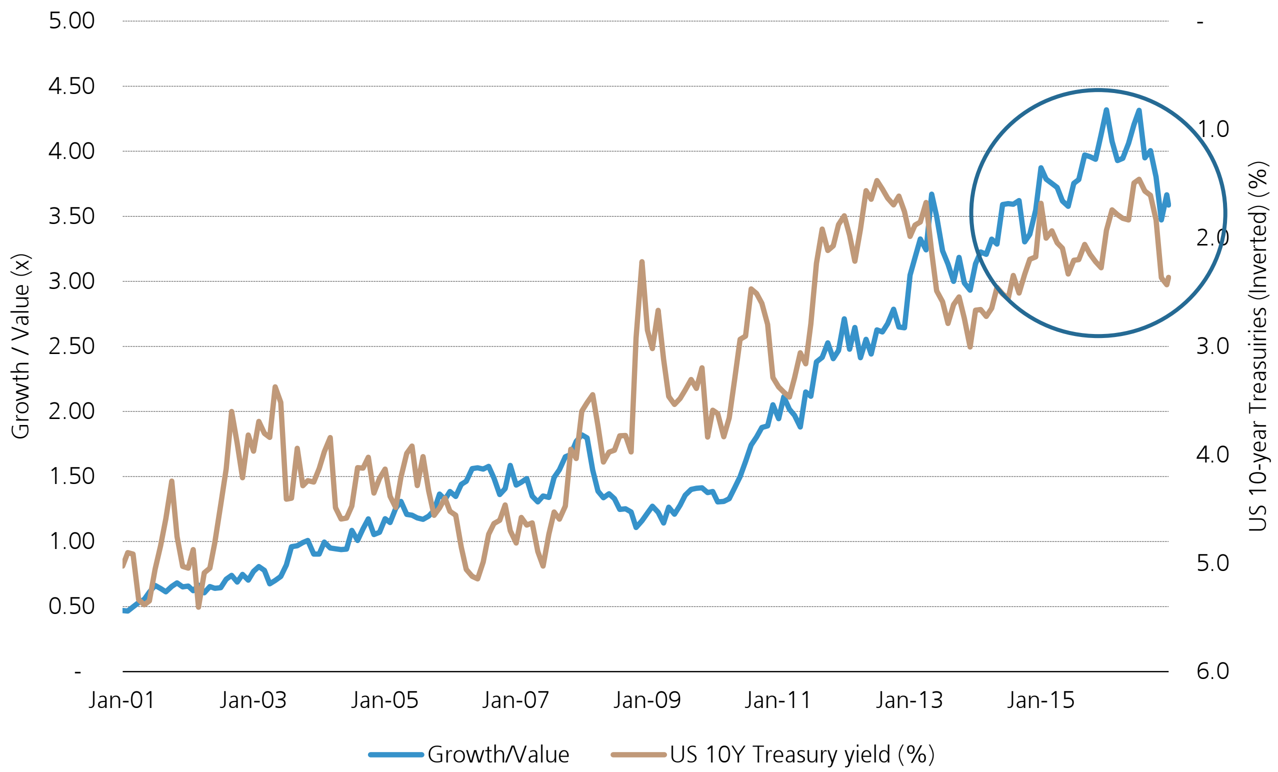
Source: Thomson Reuters Datastream

What changed? We mentioned the 'reflation trade' above. Commodity prices (especially oil) rose strongly from February, immediate concerns over Chinese growth eased and the incoming US president promised to boost growth and invest heavily in infrastructure.

What changed was receding fear of deflation and rising global benchmark rates

In H216, these factors were reflected in rising global interest rates. In looking at the period from 2001, we found an 80% correlation between 1) the relative premium for growth based on our sample screens and 2) benchmark 10-year US Treasury yields. As rates rose, the premium for growth started to reduce.

Figure 7: Growth relative to value median P/BV (x) vs. 10-year US Treasury yield (%) (Inverted)



Source: Thomson Reuters Datastream, UBS

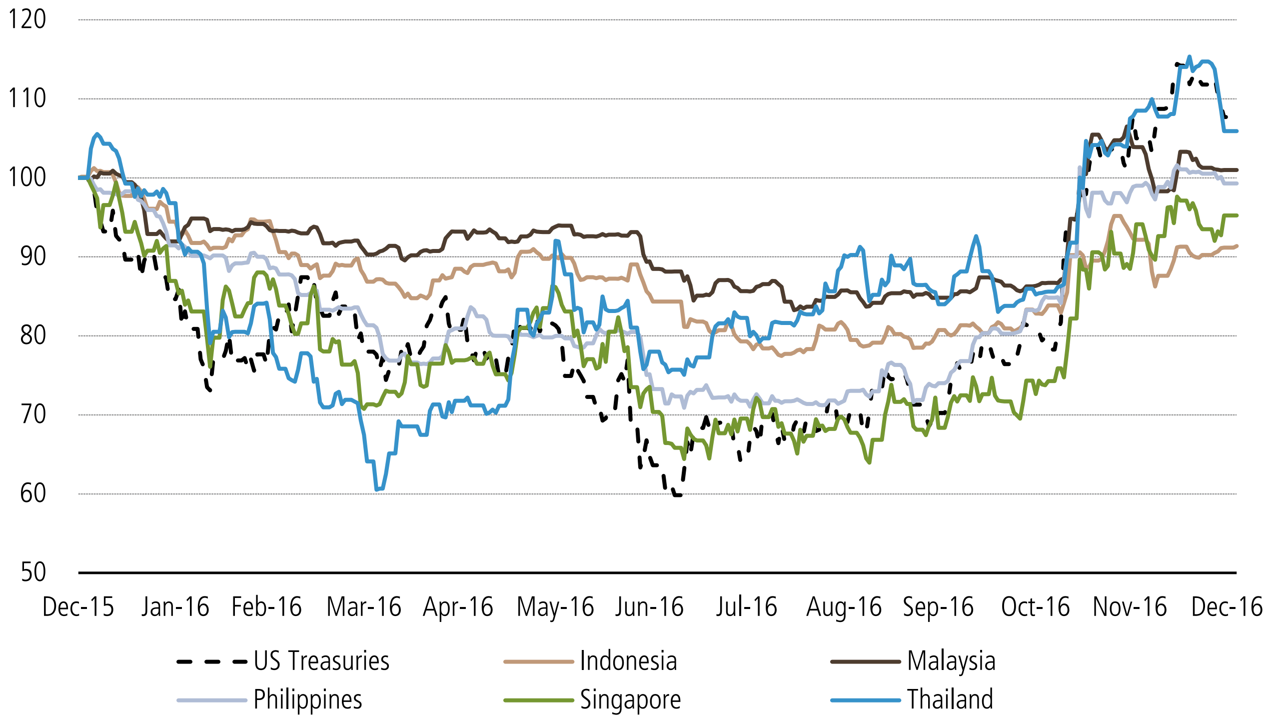
UBS is not forecasting benchmark rates to rise substantially from current levels in 2017

Do we see value continuing to outperform growth in 2017? Top-down, a lot will depend on whether the market is correct to expect a rise in inflationary pressures, and whether market interest rates continue to rise accordingly. Over the next 12 months, we have some reservations on this.

Yes, UBS is forecasting oil prices to average US$60/barrel in 2017 and US$70/barrel in 2018. And we are expecting both US growth and global growth to accelerate. We also note rising wage pressure in the US. We believe that inflation will rise because of higher commodity prices and against the low base in 2016, especially in H116. However, growth in Europe continues to be weak and the world still struggles with excess capacity. In short, yes, deflationary pressures appear to have receded for now, but we still do not feel on the verge of sustained higher inflation either.

UBS is expecting the US Federal Reserve to hike policy rates two more times in 2017. However, the sharp move in US Treasuries over the past three months is such that we are not expecting 10-year Treasuries to rise substantially from here; our forecast for the end of 2017 is 2.5%, an increase of only approximately 10 basis points from here.

Figure 8: US Treasuries 10-year yield vs ASEAN



Source: Bloomberg

If we are correct, then we should not expect value stocks to deliver the same outperformance we witnessed in H216

Assuming we are correct, and benchmark 10-year interest rates do not rise substantially over the next 12 months, then we do not expect value stocks to deliver the same outperformance we witnessed in H216. And, we would resist the urge to chase stocks that have already risen sharply, in some cases by between 50-100%.

So, what should we do? Three strategies for 2017: 1) favour laggards; 2) buy the few deep-value names left; and 3) return to selected growth

So what do we favour? The stocks fall into three buckets:

(1) Value stocks that lagged the median gain for ASEAN mid and large caps over the past 52 weeks. (Value stocks are those trading at a discount to intrinsic value. The average gain for ASEAN stocks with a current market capitalisation above US$1bn over the past 52 weeks is 13%.)

(2) Value stocks that may have outperformed over the past 52 weeks but for which there is still 20% or more upside to UBS price target.

(3) Growth stocks – because remember we think the performance should be more balanced in 2017 – that UBS rates as Buy and which feature amongst the most-preferred lists of ASEAN country strategists.

The three buckets are set out below:

Figure 9: Value stocks that have lagged over the past 52 weeks (vs. the MEAN change of +13%)

	IBES rating (1-5)	Price/ Intr. val (x)	Earnings Trailing CAGR (%)	Market implied CAGR (%)	PE NTM (x)	P/BV (x)	RoE FY1 (%)	Div Yld FY1 (%)	Price Mo'tum (100-1)	Analyst Revisions (100-1)	Relative Value (100-1)	Price chg -52W (%)
Bank Rakyat	2.17	0.8	17%	-1%	10.2	2.1	20%	2.4%	72	74	79	4
BEC World	3.47	1.0	-2%	-7%	20.5	5.4	17%	3.4%	1	8	69	(37)
CapitaLand	1.90	0.6	-6%	4%	16.3	0.8	5%	2.9%	36	34	42	1
Comfortdelgro	2.00	0.9	5%	5%	15.9	2.3	13%	3.9%	9	55	74	(13)
Glow Energy	2.77	0.8	8%	-2%	13.6	2.4	17%	6.8%	35	58	80	3
IJM Corporation	2.00	1.0	14%	2%	17.1	1.3	7%	2.5%	17	41	53	1
Keppel Corp.	3.11	0.8	0%	-11%	11.6	1.0	8%	3.5%	29	7	60	10
LT Group	3.00	0.6	28%	10%	14.4	1.0	7%	1.1%	31	55	42	(7)
Malayan Banking	2.86	0.8	3%	-6%	12.3	1.3	10%	5.9%	12	62	88	(0)
Megaworld Corp	2.42	0.6	10%	3%	10.1	1.0	10%	1.6%	29	39	80	11
Public Bank	2.57	0.9	9%	3%	14.8	2.4	15%	2.9%	82	48	70	10
Siam City Cement	2.57	0.8	11%	-3%	14.7	3.0	17%	4.5%	38	52	69	(2)
Singapore Tel.	2.32	0.9	0%	3%	na	2.4	15%	4.5%	55	16	50	7
Tenaga	2.09	0.8	49%	-3%	10.3	1.5	14%	3.3%	65	66	88	6
TMB Bank	2.73	na	23%	na	11.1	1.2	10%	2.6%	11	43	83	0
Vista Land	1.75	0.5	12%	-5%	7.7	0.8	11%	1.9%	71	9	79	10
YTL Power Intl	2.79	na	-5%	na	na	0.9	7%	5.7%	70	48	85	0

Source: Thomson Reuters Datastream, UBS

Figure 10: Value stocks that outperformed over the past 52 weeks, but where there is still more than 20% upside to UBS price targets

	IBES rating (1-5)	Price/ Intr. val (x)	Earnings Trailing CAGR (%)	Market implied CAGR (%)	PE NTM (x)	P/BV (x)	RoE FY1 (%)	Div Yld FY1 (%)	Price Mo'tum (100-1)	Analyst Revisions (100-1)	Relative Value (100-1)	Price chg -52W (%)
Genting	2.18	0.7	-9%	2%	15.4	0.8	5%	0.5%	7	84	69	13
Metro. Bank	1.80	0.7	12%	3%	12.1	1.3	9%	1.2%	30	33	72	16
Supalai	1.91	0.6	11%	-3%	8.3	2.0	23%	4.2%	73	84	88	36
TISCO	2.39	0.5	7%	-1%	9.1	1.7	17%	4.0%	90	100	90	54

Source: Thomson Reuters Datastream, UBS

Figure 11: Most preferred growth stocks of UBS ASEAN country strategists

	IBES rating (1-5)	Price/ Intr. val (x)	Earnings Trailing cagr (%)	Market implied cagr (%)	PE NTM (x)	P/BV (x)	RoE FY1 (%)	Div Yld FY1 (%)	Price Mo'tum (100-1)	Analyst Revisions (100-1)	Relative Value (100-1)	Price chg -52W (%)
Astra Intl	2.33	1.1	0%	6%	17.2	3.1	14%	2.3%	92	69	54	38
Ciputra Dev.	2.00	1.1	38%	2%	16.7	2.3	10%	1.1%	56	27	50	(3)
Metro Pacific Inv.	1.78	1.1	19%	8%	17.2	1.5	9%	1.1%	91	70	55	40
Mitra Keluarga	2.00	2.5	-5%	28%	46.2	10.8	21%	0.9%	70	33	16	13
Puregold	2.44	1.2	35%	10%	18.4	2.7	13%	0.8%	49	30	46	34
Robinsons Retail	2.08	1.2	11%	12%	19.8	2.3	10%	0.7%	37	72	46	22
Sino Thai Eng.	1.80	1.5	28%	15%	29.4	4.3	10%	1.0%	75	78	47	13

Source: Thomson Reuters Datastream, UBS

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12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	45%	29%
Neutral	FSR is between -6% and 6% of the MRA.	39%	27%
Sell	FSR is > 6% below the MRA.	15%	16%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Astra International	ASII.JK	Buy	N/A	Rp8,200	10 Jan 2017
Bank Rakyat Indonesia[7]	BBRI.JK	Buy	N/A	Rp11,800	10 Jan 2017
BEC World	BEC.BK	Buy	N/A	Bt18.70	10 Jan 2017
CapitaLand Ltd.	CATL.SI	Buy	N/A	S$3.14	10 Jan 2017
Ciputra Development	CTRA.JK	Buy	N/A	Rp1,300	10 Jan 2017
ComfortDelGro	CMDG.SI	Buy	N/A	S$2.54	10 Jan 2017
Genting	GENT.KL	Buy	N/A	RM8.21	10 Jan 2017
Glow Energy PCL	GLOW.BK	Buy	N/A	Bt79.50	10 Jan 2017
IJM Corporation	IJMS.KL	Buy	N/A	RM3.39	10 Jan 2017
Keppel Corporation	KPLM.SI	Buy	N/A	S$6.10	10 Jan 2017
LT Group	LTG.PS	Buy	N/A	P12.80	10 Jan 2017
Malayan Banking[4, 6a, 6b, 7]	MBBM.KL	Neutral	N/A	RM8.28	10 Jan 2017
Megaworld Corporation	MEG.PS	Buy	N/A	P3.92	10 Jan 2017
Metro Pacific Investments Corporation	MPI.PS	Buy	N/A	P7.10	10 Jan 2017
Metrobank[7]	MBT.PS	Buy	N/A	P80.15	10 Jan 2017
Mitra Keluarga Karyasehat[4]	MIKA.JK	Buy	N/A	Rp2,500	10 Jan 2017
Public Bank[7]	PUBM.KL	Buy	N/A	RM20.02	10 Jan 2017
Puregold Price Club	PGOLD.PS	Buy	N/A	P40.90	10 Jan 2017
Robinsons Retail Holdings	RRHI.PS	Buy	N/A	P77.00	10 Jan 2017
Siam City Cement	SCCC.BK	Buy	N/A	Bt282.00	10 Jan 2017
Singapore Telecom[12]	STEL.SI	Buy	N/A	S$3.77	10 Jan 2017
Sino-Thai Engineering & Construction PCL	STEC.BK	Buy	N/A	Bt26.75	10 Jan 2017
Supalai PCL	SPALI.BK	Buy	N/A	Bt25.75	10 Jan 2017
Tenaga Nasional[4]	TENA.KL	Buy	N/A	RM13.80	10 Jan 2017
TISCO Financial Group	TISCO.BK	Buy	N/A	Bt63.00	10 Jan 2017
TMB Bank[7]	TMB.BK	Buy	N/A	Bt2.28	10 Jan 2017
Vista Land and Lifescapes	VLL.PS	Buy	N/A	P5.09	10 Jan 2017
YTL Power International	YTLP.KL	Buy	N/A	RM1.45	10 Jan 2017

Source: UBS. All prices as of local market close.
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