iFAST

SECTOR REVIEW

MONTHLY MORNING MEETING OCTOBER 2017. PRESENTED BY iFAST CAPITAL SDN BHD ©

REGIONAL MARKETS UPDATE

EUROPE (2.5 STARS – NEUTRAL)

EUROZONE AGGREGATE

- Advance reading of Eurozone PMI composite at 56.7 in Sep 17, as compared to a finalised 55.7 in Aug 17
- Advance Consumer Confidence at -1.2 in Sep 17, up from a finalised -1.5 reading in Aug 17
- Retail sales rose 2.6% y-o-y in Jul 17, down from an upward-revised 3.3% y-o-y gain in Jun 17
- ZEW survey (expectations) at 31.7 in Sep 17, up from 29.3 in Aug 17
- Sentix Investor Confidence came in at 28.2 in Sep 17, down from 27.7 in Aug 17

GERMANY

- Advance composite PMI at 57.8 in Sep 17, up from a finalised 55.8 in Aug 17
- Factory orders rose 5.0% y-o-y in Jul 17, after a 5.1% rise in Jun 17
- ZEW readings rose for both the current situation and expectations survey in Aug 17
- IFO surveys saw a slight decrease in business climate, current assessment and expectations surveys in Sep 17

FRANCE

- Preliminary PMI composite at 57.2 in Sep 17, up from a finalised 55.2 in Aug 17
- Industrial production rose 3.7% y-o-y in Jul 17, up from a downward-revised 2.4% rise in Jun 17
- Bank of France business sentiment at 104 in Aug 17, INSEE business confidence at 109 in Sep 17

UNITED KINGDOM

- Preliminary PMI Composite at 54.0 in Aug 17, as compared to 54.1 in Jul 17
- Retail sales ex auto fuel rose 2.8 % y-o-y in Aug 17, up from an upward-revised 1.7% rise in Jul 17
- Retail sales ex auto fuel rose 1.0% m-o-m in Aug 17, up from an upward-revised 0.6% gain in Jul 17

MARKET OUTLOOK

European companies on aggregate (as represented by the benchmark Stoxx 600 index) saw minor upgrades to their earnings estimates over the month of September, with 2017's earnings shifted 0.7% higher while 2018's earnings were upgraded by 0.6% (as of 25 September 2017). 2019's earnings estimates also saw an upgrade (by 0.5%). Year-to-date, 2017's and 2018's earnings estimates have been lowered -1.4% and -2.7% respectively. On a sector basis, retail, insurers and financial services related companies saw slight earnings upgrades over the month. The travel and leisure industry saw the largest upgrades in earnings estimates for both 2017 and 2018 (by 6.5% and 6.3% respectively). On the other hand, the basic resources industry saw earnings estimates being lowered for both 2017 and 2018, and European oil and gas firms also saw slight earnings downgrades as a whole over the month. Should growth on the continent and in emerging markets come in stronger than expected, we could see some aggregate earnings upgrades moving forward.

In terms of economic data, the trend in the labour markets across Europe remain constructive, with continued job gains and unemployment generally improving (with the periphery seeing a faster rate of recovery than the core). The Eurozone aggregate's industrial production came in at 3.2% year-on-year in July, up from a prior upward-revised 2.8% year-on-year increase, with capacity utilisation rates also improving. In terms of leading indicators, composite PMIs of Germany, France, Spain and Italy continued to remain firmly in expansionary territory, pointing to expansion and growth on the continent. Consumer confidence has also continued to improve, lending support to the outlook for domestic consumption.

In their latest monetary policy update, the European Central Bank (ECB) announced that no changes would be made to benchmark policy rates and its asset purchases at this juncture, but that it will soon decide on the extent of its stimulus programme for 2018. ECB President Mario Draghi reiterated that a "substantial degree of monetary accommodation to secure a sustained return of inflation" is still required as inflation data continues to linger below target. He also mentioned that the ECB's new projections showed that economic growth remains broad-based, with private consumption supported by higher employment and household wealth while investment is benefiting from easy financing and improved corporate profitability. The ECB also noted on the EUR's recent appreciation, commenting that it remains "a source of uncertainty which requires monitoring with regard to its possible implications for medium-term outlook for price stability." While speculation on the ECB's 'tapering' is rising, we reiterate that European policy-makers are still maintaining a data-dependent approach in normalising monetary policy, and that any potential adjustments to the current programme remains to be seen. Across the English Channel, the Bank of England (BOE) left its benchmark policy rate and stimulus programme unchanged, but added that "some withdrawal of monetary stimulus is likely to be appropriate over the coming months in order to return inflation sustainably to target". This hawkish statement from the British central bank caught markets by surprise, sending the Sterling (GBP) up 1.4% against the USD and yields on the Gilt market higher post-announcement. The BOE acknowledged that inflation has risen and "is now expected to rise above 3% in October", while commenting that "recent developments suggest that remaining spare capacity in the economy is being absorbed a little more rapidly than expected at the time of the August Report." While policymakers have turned hawkish in recent times, we opine that a further tightening stance, if continued, may complicate the economic outlook caused by the dampening impact and uncertainties surrounding the ongoing divorce settlements with the European Union (EU). Thus, it remains to be seen how far the BOE will tighten policy moving forward.

Over the month of September, the benchmark Stoxx 600 Index rose 2.5% in EUR price terms (2.0% in SGD terms) as of 25 September 2017. The European equity market thus trades at 15.9X and 14.7X 2017's and 2018's estimated earnings respectively, as compared to its fair PE ratio of 13.5X, indicating that valuations are currently premium to where we deem it fair. European companies are projected to see their earnings grow by 9.9% this year and by 8.5% in 2018, which is achievable and reasonable given that various indicators and data points suggest that the ongoing recovery is increasingly entrenched (barring any unforeseen adverse political developments). **We maintain a 2.5 Stars "Neutral" rating for Europe, and advocate investors to remain an underweight exposure to European equities in their portfolios.**

RECOMMENDED FUNDS:
TA EUROPEAN EQUITY FUND

Europe (2.5 Stars – Neutral)

Why we like it

1. International Companies Are Sound
   - MNC giants such as BMW, Siemens, Adidas, Carrefour and other well-known large caps are in good financial health and possess strong balance sheets
   - MNCs have exposure to overseas markets, benefiting from the pickup in growth momentum in other developed and emerging markets

2. Domestic Demand Recovering, European Central Bank (ECB) Policy's Attempt To Spur Lending
   - Data continues to suggest that domestic demand and corporate investment remain supported; growth momentum picking up
   - Composite PMIs are firmly in expansionary territory and at cyclical highs
   - The ECB has continued to maintain an accommodative monetary policy, helping to spur lending and supporting credit growth in the Eurozone

Why we don't like it

1. Existing And New Reforms Need To Be Implemented
   - Not all countries have implemented all the reforms previously promised
   - Some countries, e.g. Italy and France, need to implement reforms to restructure their industries and work force and improve their efficiency and competitiveness

2. Valuations Not The Most Attractive
   - Valuations remain at premium relative to our estimated fair value
   - Against an estimated fair PE ratio of 13.5X earnings, 2017's estimated PE of 15.9X is above fair value, 2018's estimated PE ratio is 14.7X (as of 25 September 2017)
   - Projected returns are one of the lowest among the markets we cover – an estimated annualised 3.7% by end-2019

3. Political Uncertainty In The European Union (EU)
   - Brexit talks are now underway, with a cloud of uncertainty hanging over Britain's commercial fate. Being the second largest economy in the EU, the likely eventual departure of the UK could hurt the EU as well
   - Although pro-EU centrist politicians have prevailed in elections in core EU countries thus far, there remains the risk of unexpected political changes that could weigh on investment sentiment and corporate decision-making, affecting overall growth on the continent