Interview on 2014 Singapore Stock Market Outlook

By: **Dr Tee (Ein55)**, Investing Educator, www.ein55.com
Date: 18th Dec 2013 Email: ein55.tee@gmail.com

Below are my questions for my 2014 outlook story for local stock market:

Q1) What are the major events, such as Fed's tapering of QE and debt ceiling issue, that will affect the performance of the local stock market?

Singapore is a "penny stock market" from a global perspective, weightage is less than 1%, therefore any major event, especially from the world No 1 economy (US) and No 2 economy (China), will have significant impact on the local stock market performance. Due to globalization of businesses, as well as easy flow of liquidity from one investment market to another one without international border, local stock market generally will follow the trend of major regional stock markets.

For Fed QE3, here are the potential impacts to local markets:

1) Significant reduction in liquidity of global market (from US$85B to $0 per month, tapering over a period) which will also implicate Singapore, as there will be less foreign investment funds (eg. from US and other regions) flowing in to local stock market. However, this likely will be just a correction (<20% downside), not a major trend reversal from bull to bear market (>40% downside) as in a global financial crisis.

2) If the Fed could make the QE3 tapering more gradual, eg. $10B/month or lesser reduction, the effect will be less intense, stock market could take the impact easily because the shortage of liquidity may be filled in by new funds from everyone's pocket when more jobs are created, resulting in higher spending and investing activities. However, if US$85B/month is terminated abruptly to $0 within 1 month, this will be a shock to the stock market, reducing short-term confidence of investors, leading to significant correction to global and local stock markets.

3) US government bond yield will increase when the asset purchase by the Fed is reduced due to lower bond prices, resulting in higher borrowing cost. Singapore government bond yield will also increase gradually, following similar footsteps of US government bond. When bond price is reduced, the fund from bond market will partially flow to stock market, aiming at quicker and higher return of investment. For short term, both global and local stock market will suffer due to lack of confidence, but once the strength of global and local economy is demonstrated, it will support stock market in longer term, attracting more funds to exit from bond market, injecting into stock market. For Singapore, since the property market is at much higher state of % Optimism, the downside is more than the upside, therefore short-term and mid-term investors may be in favour of stock market over property market.

4) US dollar index will increase but the exchange rate of USD/SGD will increase more gradually, partially due to appreciation of SGD to fight the inflation. For local stock market with counters traded in US$, they could benefit from rises of both stock market and also USD/SGD exchange rate in longer term.

US debt limit crisis is just a political show, unlikely to cause major impact to both global and local stock market, but it could result in some correction due to fear of investors. From practical point of view, it is nearly impossible for US government to "commit suicide" to default in payment of sovereign debt (eg. US government Treasury bonds) because this is the main source of cheap loans (was 2% for 10 year bond) from global investors (who balance their investing portfolio with some safer components) which help the accelerate the growth of US economy at lower cost. If US government loses its credibility, other countries (China, Japan, Singapore, etc) who invest over trillion of US$, unlikely to increase its stake, then the US government bond price may collapse, resulting in higher bond yield (higher cost of loan). Based on the latest "show", the US Congress has compromised to agree on a budget, to ensure the operation of US government over the next 2 years. This US debt crisis has become less concern now to global and local investors.

Q2) The local penny stocks had a good run-up this year until they were hit by the saga brought about by Blumont, Liongold and Asiason which are not exactly penny stocks themselves during the year before the price crash. Do you think investors sentiments will recover and year 2014 will see the price of penny stocks picking up again? Why?

These 3 penny stocks have a common trait, i.e. the stock prices went up from penny range to dollar range, over 10+ times within the last 1-3 years. This is clearly due to speculation (buy high sell higher) by some invisible hands, stock prices usually are not sustainable at high % Optimism level, any correction in the stock market, could trigger the investors of these "dollar stocks" to quickly take the profit (following by some who may cut loss and some who short-sell to profit), resulting in a snowball effect rolling from the peak (dollars) to the valley (cents), back to status of penny stocks again. Due to the 10+ times of potential, the falling of price is very severe, over 90%, correction (reasonable price before speculation) to form its mega support, then another speculation will start, hope to buy low sell high. Therefore, the status of "dollar stocks itself does not mean their traits of penny stocks are removed. An investor should analyze the history and growth rate of a particular dollar stock, when it went up in a parabolic way, likely it will come down in a similar inversed parabolic way if the rise could be justified by its fundamental (eg. business performance).

The overall penny stock market can be reflected by FTSE Fledgling Index and Small Cap Index, both are showing relatively stable trends in 2013 with correction of 10%-15%, aligned well with the trend of STI (blue chips). This implies the 3 problematic penny stocks do not significantly implicate the entire penny stock market. An investor should consider some penny stocks, especially those with strong fundamental, in their overall stock portfolio. From TA (Technical Analysis), we could not be very sure that penny stock market will recover significantly in 2014, but the blue chips have to recover first, following by the lagging penny stocks (exact duration required will depend on market sentiment), as long as the mega market remains bullish. However, an investor should buy undervalued penny stocks (price is much cheaper than its value), using holding power to wait for its appreciation in future. This investing strategy is much safer compared to trading approach of buy high (when penny stocks have risen >20% in prices), hoping to sell higher (same tragedy may repeat due to the greedy emotion). At second phase of bull market, most of the blue chips have limited upside (around 20%) but penny stocks are usually lagging, they could potentially have >50% to 100% upside. In the last market cycle, the speculation factor or max/min price of blue chips is 2.5X, while the Small Cap Index is 4X, implying penny stocks have much higher upside.

Q3) Are there any sectors that investors should take note of in the year to come? Are there any sectors or stocks that ride on the US economic recovery?

1) US economy recovery:

- Banking & finance sector will benefit, especially US interest rate is likely to increase in 2015, Singapore banks will follow gradually, the earning is expected to increase. Look for stocks with lower price / NAV (Net Asset Value): an undervalued US stock, Citigroup has >50% upside based on this criteria, one could try to accumulate this stock closer to US$45/share if it could not break the US$55 mega resistance (once broken, next limit will be US$70). Singapore banks generally will benefit but upside will not be as high.

2) China economy recovery

- S-chips (China related stocks) is at low % optimism, the share price likely will recover, following the China SSEC trend, those S-chips with strong fundamentals but undervalued may be considered. Alternatively, buy UETF A50 ETF to indirectly invest in China SSEC Index (2000 points is a strong mega support zone, good entry point if close to it). When China market releases more positive economic news in 2014, likely China stock market will recover significantly, leading S-chips in Singapore stock market to rebound together.

3) Global economy recovery (including US, Europe, China, Japan, etc):

- Commodity related stocks will increase in price due to higher demand for commodity with stronger economy. Price of Wilmar is over-corrected due to declining oil palm price in the past few years which affected its earning. Price/share near to $3 was considered a good buy 1 year ago, new investor could try to accumulate when the price is approaching $3 again.

- Maritime/shipping related stocks will have higher potential (use Baltic Dry Index to reflect rising shipping cost) because it is currently at around 25% Optimism, downside is very limited, growing global economy will bring more businesses to this sector. NOL has poor business performance but its share price has over-compensated, price/share near to $1 is a good buy if an investor has holding power of a few years, min 50% upside can be expected. YangZiJiang is in this sector (shipbuilding), as well as a fundamentally strong S-chip, golden entry price of $0.80/share may not be possible in mid-term, next possible buying target is around $1/share.

Q4) STI has remained flat throughout the year, what does this imply for the investors? For investors who are thinking of capturing the opportunities that may arise due to a possible rally in year 2014, what should they take note of when it comes to stock picking for: a) STI component stocks; b) reits and business trust; & c) the other stocks

Among the major regional stock markets (US, Germany, UK, Japan, Hong Kong, China, Singapore), STI has the worst performance (nearly zero) in the past 1 year. This is partly due to appreciation of SGD, discouraging foreign investing fund, as well as penny stock market nature (lagging market) of STI, which usually rises the most during the initial recovery phase from the valley of bear market (eg in year 2009) and also the euphoric stage, about 6 months before end of bull market.

In my opinion, having a long-term sideway or lagging stock market (but not long-term declining trends like China market in the past 4 years or Japan market over the past 2 decades) is a blessing in disguise for STI. Usually for an index which is traded within a tight range (eg. 3000 - 3200 points), it is storing the "spring energy" through the accumulation phase (by some big players), when the time is right (eg. aligned with a major positive global financial news - eg QE3 or US debt limit is no longer a threat), it will have a much higher growth potential >20%. Investing in STI requires great patience as it has been sleeping around 3000 points +/- 10% in the past 4 years, while other major leading stock markets have gone up consistently. Usually the worst performance market can be the best performance market in the following year due to lower baseline for comparison. Japan Nikkei Index is a good example: bad performance in 2012 but after the Japan QE, it becomes the best performance stock market in the world in 2013.

STI is projected to have ultimate upside of 4800 points (before reaching the peak of market cycle), about 50% from the current level, when the global economy reaches its peak a few years later (estimated to be year 2017 or later). For year 2014, due to disturbance of QE3, the upside is estimated to be about 10+% for STI (target is 3500 points), but individual local stocks (especially the lagging penny stocks with strong fundamental) could have as high as 50% upside, especially after major correction (QE3 tapering can be a good crisis and opportunity).

For STI components, choose stocks which have similar trend as STI, i.e. lagging or undervalued in nature, as the growth potential will be higher. If there is limited capital, one may consider to buy STI ETF (acceptable by CPF investment fund), indirectly diversify the investment portfolio with 30 STI components. Buy STI while it is bearish, closer to 3000 points for mid-term (if global market is stable) and below 3000 points, around 2800 points if QE3 tapering becomes a major issue. After more than 50% appreciation for REITS sector in 2013, the last correction of 15% has brought another good buying opportunity, especially for those stocks with price much lower than its Net Asset Value (NAV). However, REITS will have limited upside for capital gain, it is more suitable as defensive stock for value investors, therefore buying low after correction is a must to ensure higher % dividend. The interest rate hike (estimated in 2015) will continue to give earning pressure to property market and REITS sector, but the recovery of global economy may balance it out eventually.

The main investing strategy recommended is to buy undervalued stocks with strong fundamental, accumulating after each major correction (>10+%), then hold until the ultimate upside (>75% Optimism) is reached, this could potentially give >50% return. Following the trend to buy high and sell higher is more suitable for trading in mid-term (3-12 months) but the average gain of a portfolio likely will be less than 20% due to unpredictable mid-term crises.