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Singapore's high-yield stocks bolster returns

BY **PATHMA SUBRAMANIAM**

Despite a global environment of slowing growth and an expected drop in corporate earnings, there are still opportunities for investors to augment their returns through Singapore-listed dividend stocks.

Lai Yeu Huan, senior portfolio manager at Nikko Asset Management Asia, who manages the Singapore Dividend Equity Fund, believes dividends are important in a moderate growth environment.

Near-zero interest rates in the last five years have forced investors to search globally for high-yield investments. This sentiment has propped up stocks that offer steady dividend yields. Listed companies in Singapore have been some of the most generous in the region when it comes to distributing dividends.

"When growth is tepid, capital appreciation [on equities] might not be strong. This makes it very important to look towards dividends to bolster returns. As far as Singapore is concerned, dividends are an important source of returns," says Lai.

"In the last five years, if you had invested in its stock market, your capital returns would not have been very high. But you would have boosted your returns by almost 20% by reinvesting the dividends over five years. This is reasonable because the dividend yield in Singapore is above 4% — the highest in Asia."

This is attributed to the fact that its economy is more mature than its Southeast Asian counterparts, says Lai. "More mature means the companies have invested what they need to in order to build up their businesses. For example, technology-based firms may have invested in machines they need and telecommunications giants have already invested in 3G and 4G. The incremental cost for tech companies is not as much as it used to be because technology is improving while equipment cost is falling," he points out.

"As these companies become more mature, there will be a relatively less need to maintain the same level of investment every year to derive a certain level of earnings or cash flow. As less cash is used for capital investment, they will have more available for dividend payments."

Lai's sanguine outlook is backed by the fact that the companies in the island republic have a strong track record when it comes to dividend payouts.

The Monetary Authority of Singapore said on April 27 that the slow growth environment is expected to have an impact on city state's economy as global factors put a dampener on economic growth. The central bank also said the economy is expected to grow between 1% and 3% for the full year.

Lai says the forecast was within expectations. "I think this year, everybody has a slightly above 2% sort of average, and that is pretty much within expectations. So, it doesn't change the way we manage the fund in any great way.

"If you look at the dividend payout ratios [of Singapore-listed companies] over the past 10 years, they have hovered between 40% and 60%. In other words, for every dollar of earnings these companies make, they will pay out a dividend of 40 to 60 Singapore cents. This has been very consistent."

Lai favours the telecommunications sector and real estate investment trusts (REITs). "We have a strong REIT sector. For example, REITs can give you a dividend yield of 6.5%. A good REIT sector gives you the opportunity to get a little more in terms of dividend yields," he points out.

The Singapore Dividend Equity Fund also has exposure to the manufacturing sector, albeit underweighted. "We have invested in a very typical tech company, which does precision components. One might think such a company may be facing some challenges because [operational] costs in Singapore are not low and so a major part of its activities may have migrated overseas. But we invested in this company because it has found a second driver [for its business] — it now produces precision components for automotive parts, also known as automotive sensors," says Lai.

"This is the reason we can still invest in a high-cost environment because it promises quality, which the automotive sector is very sensitive about as everything that you put into a car is very important in terms of safety. Customers look for quality suppliers and you will find that Singapore has this niche."

Singapore Dividend Equity Fund's performance

RETURNS (%) AS AT MARCH 31	3 MONTHS	6 MONTHS	1 YEAR	3 YEARS	5 YEARS	SINCE INCEPTION
NAV-NAV (net of fees)	-1.67	1.10	-12.61	-2.01	5.41	3.29
NAV-NAV (net of fees and charges*)	-6.58	-3.96	-16.98	-3.67	4.34	2.97
Benchmark	-1.45	1.79	-17.58	-4.95	-1.77	1.62

SOURCE: MORNINGSTAR, NIKKO ASSET MANAGEMENT ASIA LTD
*TAKES INTO ACCOUNT OF MAXIMUM INITIAL SALES CHARGE AND A REALISATION CHARGE WHERE APPLICABLE.

Lai's key targets, however, are companies that he considers to be part of the "new Singapore". "The country, like many other economies, is undergoing a restructuring. We think the new Singapore will revolve around services such as logistics — either in terms of goods or people," he says.

Companies in the air transport sector include those that provide airport services. "We like airports throughout the region. But in Singapore, the airport is not listed," he jokes.

"So, the next best thing is airport services companies. It is an important idea because Asians are travelling more, especially tourists from China, and we find that it is a resilient sector even in a slower growth environment," he says.

"In the last six months, tourist arrivals in Singapore have seen a recovery. Changi Airport's volumes have grown consistently, by about 10% annually. This is an important part of Singapore's future as an air hub."

Another concept Lai is banking on is connectivity, with the advent of multi-nation trade policies, such as the Asean Economic Community and Trans-Pacific Partnership (TPP), which are aimed at promoting freer movement of trade and capital in the region.

"Agreements such as the TPP never move in a straight line, but they will come through because the trend of becoming a globalised world is irrefutable. People are demanding more efficiencies in goods and services — it is as simple as that," he says.

"The future Singapore will see a greater degree of financial intermediation. Financial services will be provided in the region and across Asia. Nikko, for example, is in Kuala Lumpur selling a fund that is managed out of Singapore." Nikko holds a 30% stake in Affin Hwang Asset Management.

Corporate restructuring among Singapore-based companies is another investing theme Lai is betting on. This comes as domestic challenges encourage local firms to focus on capital efficiencies and returns.

"They restructure to trim the fat and enhance returns. We saw this in the early 2000s, when growth was slow and oil prices were low. These are the things we can look for in a slower growth environment," he says.

While the fund invests mostly in Singapore equities, it has an allowance of up to 20% to invest in stocks outside of the country. "We are not fully exploiting the allowance just yet. As of today, we hold less than 10% in Hong Kong because we think the dividend yields in Singapore are attractive. It is a good dividend-paying market, but not necessarily in the traditional way of asset allocation. We invest 70% to 80% of the fund in high-dividend-paying stocks and 20% to 30% in dividend growers," says Lai.

As at March 31, the fund's top holdings included banks such as DBS Group Holdings Ltd, Oversea-Chinese Banking Corp and United Overseas Bank Ltd; telecoms giant Singapore Telecommunications Ltd; defence and aerospace company ST Engineering; Singapore Airport Terminal Services; and local bourse the Singapore Exchange. The stocks it zeros in on outside of the city state are similar to those it looks at in Singapore, such as technology and REIT counters.

Underpinning Lai's outlook is his bottom-up stock-picking methodology. Having an experienced management team, sustainable earnings and the ability to service debts during a downturn are crucial elements when picking companies, he says.

"We select business models that can survive the competition. We believe companies that adhere to superior environmental, social and governance (ESG) factors will deliver superior yields. We subscribe to the United Nations-supported Principles for Responsible Investment initiative, and ESG is an important component," he adds.

"So, we will not hesitate to sell off a stock because it has gone wrong on ESG, no matter how positive the potential returns can be. For example, we invested in this company and the management told us that it would achieve a certain amount of growth, but the growth was disappointing at the net earnings announcement.

"Another example was when a company guided a capital expenditure of S$5 billion for a project, but the capital expansion doubled to S$10 billion. This is a very suspicious situation. We need to ask why the company is doubling its expenditure, whether it is justifiable. Why has the guidance been so poor? Are the returns going to be the same? In such a situation, we have no qualms about selling off such stocks.

"In such a situation, ESG is 100% of our decision-making — at that point, nothing else matters. We have sold stocks based only on ESG," Lai says, adding that a sustainable business model and positive fundamental change are key in the decision-making process.

"We don't necessarily focus on value. While 70% to 80% of our portfolio is in high-dividend stocks, there is another 20% to 30% reserved for dividend growers. These stocks do not have high enough dividends yet, but exhibit good potential for growth and could give you high dividends in two to three years."

The straightforward strategy of investing in Singapore-listed dividend-paying companies with a sustainable payout policy has worked well for the fund house. The Singapore Dividend Equity Fund bagged two awards at *The Edge*-Lipper Singapore Fund Awards 2016 in March — best Equity Singapore fund in the three and five-year categories.

According to Nikko, the fund saw cumulative returns of 7% and 28% over three and five years respectively as at Dec 31, 2015. The fund paid out about 5% in dividends last year.

The Singapore Dividend Equity Fund is distributed in Malaysia by Affin Hwang Asset Management Bhd. The fund — one of the first few to be approved as a qualifying collective investment scheme (CIS) under the Asean CIS framework — was introduced to local investors in March as the Nikko AM Shenton Horizon Investment Funds — Singapore Dividend Equity Fund.

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HARRIS HASSAN/THE EDGE