Don't Leave Me This Way Jun 2016

We maintained the consistent message on the fallout of Brexit. The economic impact is limited to UK whist the impact to rest of world is immaterial and frankly hard to forecast given so many complexities in their negotiations with EU. (See "Mind the Gap", "Cheerios Good Mates" in Jun 2016). The financial impact is short-lived because the contagion impact on liquidity and solvency is well contained. We have seen Europe OIS Spread; an indicator of liquidity in the system, spiking from 11bps to high 14.5bps before retreating to 10.7 bps; back to pre-referendum level on Thursday. This is in contrast to back in 2011-2012 Europe existential crisis level of 60-100bps. Solvency risk has quickly receded as CDS Spread for Italy (apologises to our Italian readers for using Italy as a poster child) jumped from 135bps to high of 185 before receding back to 165bps currently versus the highs of 400-500bps during 2011-2012. There can be no solvency crisis if the liquidity tap continues to remain open. Simple analogy is a highly leveraged company can stay as ongoing concern as long as its credit lines are available. That is what is happening now. But to the last and most ominous risk of EU breaking up, we think is too early to opine its demise.

What we do know is the knock-on effect of Brexit will prolong the era of lower for longer interest rate environment globally and prompt central bankers to front load their QE experiment and for some like BOE, re-start its QE. For countries with less fractious politics, authorities will certainly want to implement fiscal stabilizers to counteract the uncertainty Brexit has induced. The hunt for yield will take on even greater animal instinct. Amidst all the chaos, there are opportunities to be made and we present several actionable ideas below. Please refer to our "Cheerios good mates" note on "Possible policy responses and actionable trades" for the rationale as much of our trade ideas are predicated on it.

Suggested Ideas	Ticker	Rationale
Fixed Income		
Long Investment grade credit	XDEP.GY, LQD.US	Twin drivers of low for longer policy rates and front loading of existing QE in Europe and Japan and possible restarting for UK. Spread compression for capital gains and yield pickup for income. XDEP coupon is 3% while LQD is 3.3%.
Long Capital strucuture credit		Alternative to investing in banking stock. Sub debt and Cocos provides yield pick up with stronger convenant over equities. Equity dividend will need to be cut before deferrment of coupon payment. Lese volatile than equities, esp sub debt.
	EJ688366 Corp	Deutsche Bank sub debt. Cpn 4.296%. YTM 5.32%. YTC 6.5%. Callable in 2023 @ 100. If not called coupon becomes variable, spread US 5y swap + 224bps. T2 paper, DB must pay coupon otherwise default. DB has omitted equity dividend payment last qtr.
	LW208887 Corp	HSBC Coco. Cpn 6.875%. YTM 6.88%. YTC 7.58%. Callable in 2021 @ 100. If not called coupon becomes variable, spread US ICE 5y swap + 551bps. AT1 paper. Cpn can be deferred and non-cumulative. However, HSBC has to pay coupon on Coco before dividend. Trigger level 7% CET1, conversion into equity @ USD 3.9479. Distance to trigger is 55B. Equity yield is 7.9% however subject to higher volatility and risk of dividend cuts
	JK585095 Corp	BNP Coco. Cpn 7.625%. YTM 7.45%. YTC 7.83%. Callable in 2021 @ 100. If not called coupon step up, spread US 5y swap + 631bps. AT1 paper. Cpn can be deferred and non-cumulative. Trigger level 5.125% (low) CET1, temporary write down. Distance to trigger is 37B. CET1 fully loaded is 11% currently. Equity yield is 6.26%.

Equities		
Global Dividend	RDSB, BATS, MSFT	**Shell** Dividend Yield: 7.4% vs peers: Total (1.2x), BP (1x), Exxon Mobil (2.2x), Chevron (1.3x). Current P/B 1x vs peers: Total (1.2x), BP (1x), Exxon Mobil (2.2x), Chevron (1.3x). EPS CAGR in '16 & '17: 6%. • Company's commitment to lowering gearing & capex ceiling US$30bn to 2020 in any oil price environment & below US$25bn in a low oil price environment. • Shell aims to generate US$20-25bn of FCF, more than covering the dividend. • Rooms to cut exploration capex & sell assets after BG acquisition as reserves replacement has not been a major concern.
		BATS: Dividend Yield: 3.6% vs European Staples: 2.7%. 5-year dividend growth: 6.2% p.a. EPS CAGR in '16 & '17: 7%. Forward PE '16: 19.5x vs European Staples: 21.1x. * Dynamic pricing power: price increment. • Rooms for cost savings & margin expansion. • Traction in the new products: Vype, iFUSE
		MSFT: Dividend Yield: 2.9%. 5-year dividend growth: 17.9% p.a. Forward PE '16: 19.5x with EPS CAGR of 18% in the next 2 years. Price has gone down 4.4% from the Brexit. • Strong growth in Cloud products: Azure, Office 365, data center. • Gaining market share in Intelligent Cloud business (Azure & Office 365). • New CEO – Satya Nadella with aggressive shift to cloud & social applications & away from declining businesses (feature phone, Nokia...)
Long Asia Dividend basket	JASIF.TB, DIF.TB, CD.SP, FUYU.SP, VALUE.SP, KDCREIT.SP, SSG.SP, SIDO.IJ.	Basket of stocks with dividend yielding >6%, 2 years EPS growth 10% or more, lowly geared companies and relative stable earnings predictability. Basket trades at reasonable 12 mths forward PE of 13x with average ROE of 20% and FCF Yield close to 8%. We will send a note on the individual companies separately.
Global Reits	1476 JP, IPRP NA	Positive on Japan Reits and Europe (ex UK) REITs. Both benefit from negative interest rates policies in the two regions. The spreads between the dividend yields and the respective government bonds yields are at three-year high. Japan REITs are backed by BoJ buying. 1476 JP is pure Japan REITs play with dividend yield of 3.2%. IPRP NA invests 50% in Europe(ex UK) REITs and 50% in developers, with a yield of 2.6%. In addition to the Asia REITs above of JASIF.TB, DIF.TB and KDCREIT.SP
FX		
Long GBP/USD		Tactical trade. GBP is undervalued to USD. Liquidity crisis overblown. Inter-government swap lines activated unlike GFC, where there was none.
Commodity		
Gold	GLD US	Gold displays low correlation to other major asset classes. It provideds very good hedge to geopolitcal uncertainties. In a world of negative interests, even after storage costs, the returns on gold are attractive.
Funds		
Partners Group Global Infrasture Fund	PGLIUSI LX - (Partners Group Listed Infra USD Insti)	Capitalise on the megatrend associated with infrastructure developments in both industralised and emerging countries. Sector with Stable Cashflows, Low Cyclicality, high dividend yield, broad diversification across regions and sectors. Current portfolio dividend yield of 3.2%, Firm depth in both Private and Public markets.
DB Global Dividend Equities	LU0507266574 (DB Top Dividend - USD Insti)	Targets potential growth and income from global dividend yielding quality equities, with a focus on quality and large/mega cap stocks. Flexibility to shift between Dividend Yield and Dividend Growth buckets. Stable Cashflows/payouts, dividend downside cushion. Focussed on buffering downside versus the World Index. Current portfolio dividend yield of 3.5% (3.6% distribution since inception), dividend growth of 9%. (1 year)

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