UOB Investment Insights

Monthly Market Views

November 2019

3 reasons why you should invest in the consumer staples sector

Amid a slowing global economy, the consumer staples sector has held strong – making it a sound investment option in turbulent times.

Summary:

- The consumer staples sector has turned in a solid performance this year due to its non-cyclical nature.
- Given the recent Fed easing, dividend stocks have become more attractive; consumer staples stocks offer above-market dividend yields.
- The consumer staples sector has seen strong capital inflows in the last three months.

Although the global economy is slowing, the consumer staples sector has stayed on solid footing. Year-to-date, stalwarts such as Procter & Gamble (+39.3%), Hershey (+39.4%), Pepsi (+26.9%) and Walmart (+27.9%) have all turned in solid performances for the year, due in large part to their relative resilience when growth is soft.

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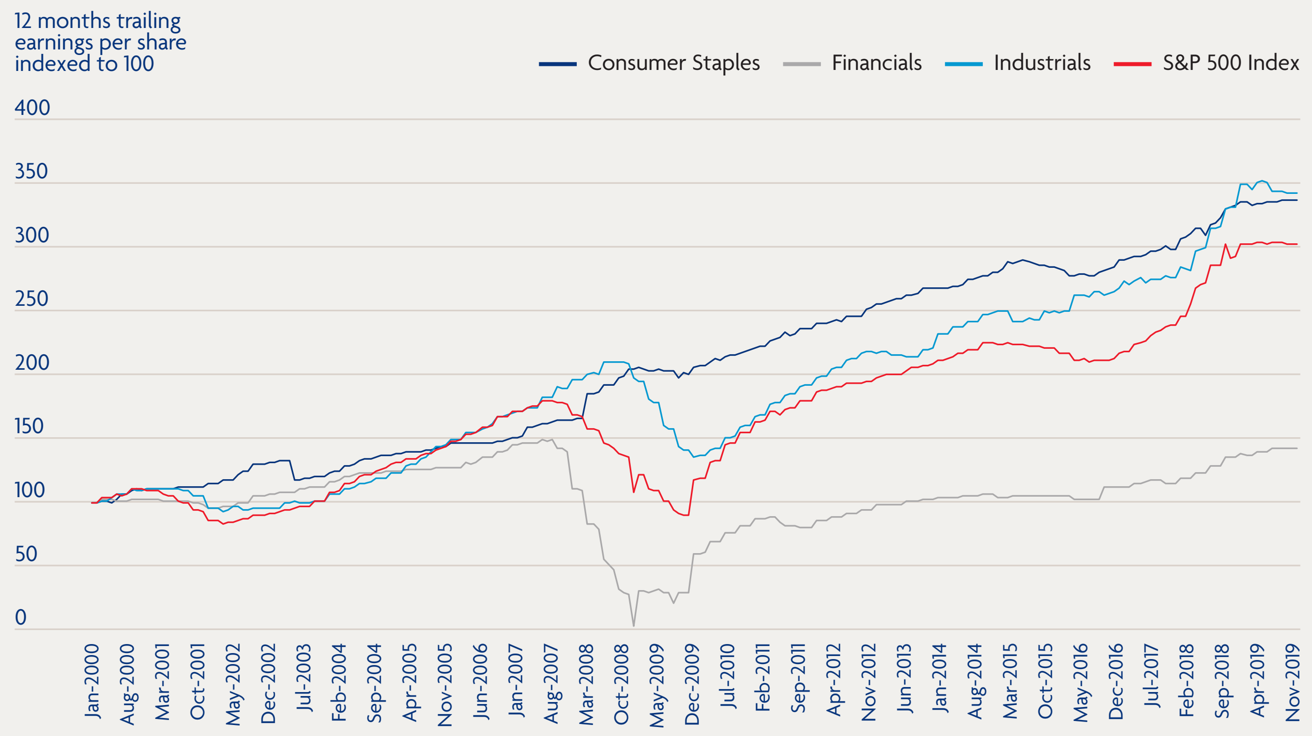
1. US consumer staples are relatively resilient

The reason for this is that companies in the consumer staples sector generally produce goods which are considered everyday necessities. These include beverages; food products; household products; personal products and tobacco – products which most consumers will continue to purchase even in an economic downturn.

As a result, the consumer staples sector enjoys relatively low volatility, enabling it to perform robustly despite weaker overall growth. During the last three recessionary periods, the consumer staples sector has consistently outperformed the S&P 500.

Figure 1: Earnings of Consumer Staples have been relatively resilient during economic weakness



Source: Bloomberg, 31 October 2019

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2. Consumer staples stocks perform decently during Fed rate cuts

Historically, the consumer staples sector has performed decently during easing cycles. This year was no exception. The US Federal Reserve (Fed) has cut interest rates three times this year, with the latest cut seeing the Federal Open Market Committee lowering its benchmark funds rate by 25 basis points to 1.5%-1.75%. Despite the Fed pausing rate cuts for the moment, the bar for the Fed to hike rates is very high. This suggests that interest rates are likely to stay low at where they are currently.

Low interest rate environments make dividend stocks an attractive option for income-seeking investors, as they offer higher returns relative to bond yields. Within the equity market, consumer staples stocks tend to offer relatively higher and stable dividends compared to sectors like industrials and financials as their earnings are less cyclically-exposed. As of 31 October 2019, the sector had an estimated dividend yield of 2.7%, which is 80 basis points higher than the S&P 500 Index's 1.9%.

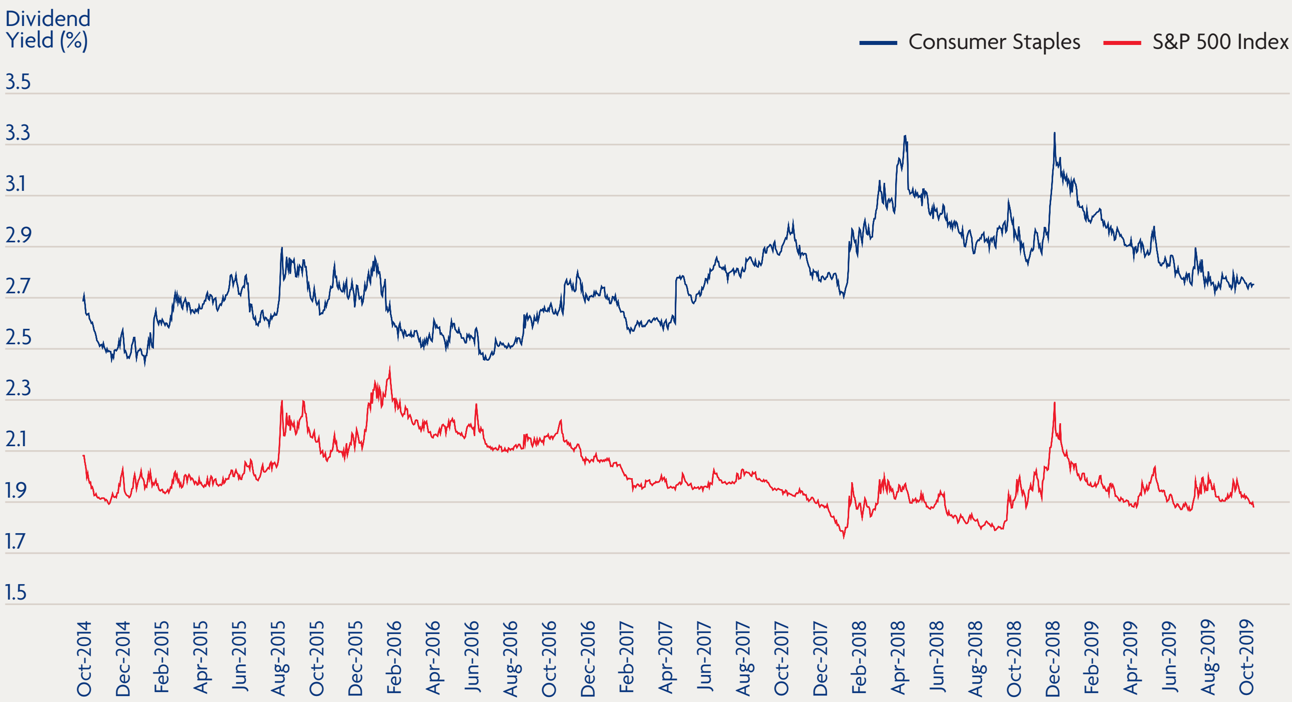
Figure 2: Consumer Staples stocks did well during the previous Fed easing cycles

	1984	1987	1989	1995	1998	2001	2007	Med.	% pos
S&P 500 return	14%	14%	17%	23%	23%	(12%)	(18%)	14%	71%
Sector excess return (pp)									
Health Care	15	(4)	9	15	(26)	3	9	**9**	71%
Consumer Staples	8	6	13	4	(16)	12	25	**8**	86%
Industrials	0	(1)	1	19	2	6	(1)	**1**	57%
Energy	(7)	1	6	1	(11)	3	7	**1**	71%
Consumer Discretionary	0	12	(6)	(8)	3	13	(1)	**(0)**	43%
Financials	4	(1)	(12)	6	(13)	1	(22)	**(1)**	43%
Materials	(2)	6	(9)	(21)	(9)	18	10	**(2)**	43%
Utilities	9	(2)	(2)	(12)	(28)	(12)	5	**(2)**	29%
Comm Services	8	(2)	2	(7)	13	(3)	(7)	**(2)**	43%
Info Technology	(14)	(17)	(8)	(13)	48	(14)	0	**(13)**	29%

Gains Losses

Source: Goldman Sachs Investment Research, 6 June 2019.

Figure 3: Consumer Staples stocks offer higher dividend yields than the broad market



Source: Bloomberg, 31 October 2019

3. Capital inflows support consumer staples

With the slowing global economy, investors have flocked towards defensive sectors such as real estate, utilities and consumer staples. Over the last three months, the consumer staples sector has seen an influx of USD 1,497 million – ahead of all sectors except for real estate. Capital inflows are likely to continue given the demand for yield and stability, which keeps equity prices supported.

Figure 4: Sector ETF fund flows over the past three months

	Trailing 3-month ($mn)
Real Estate	2,006
Consumer Staples	1,497
Utilities	815
Technology	462
Communications	356
Consumer Discretionary	-47
Industrials	-530
Materials	-626
Energy	-647
Health Care	-2,433
Financials	-2,982

Positive Negative

Source: Bloomberg, State Street Global Advisor, 25 October 2019.

The outlook for consumer staples

Although the consumer staples sector has historically outperformed during periods of economic uncertainty – attracting investors with its relative stability – current valuations are not cheap. The sector also faces risks, whether in the form of regulatory risks or technological disruption.

However, the consumer staples sector is seeing supportive factors which outweigh the negatives. Fund inflows are supporting the sector given the sector's attractive dividend yields. Competitive pressures within the sector have led to a change in business models and cost-cutting measures which could support the sector's growth.

In general, investing in the consumer staples sector would be a sensible option for those looking for some resilience in their investment portfolios.

Value	Trend	Activity	Risk
The sector currently trades at a PE ratio of 20.4X, as compared to the 5-year average of 20.0X.	The index price has been on a stable uptrend. Significant fund inflows year-to-date, which will likely stay high amid uncertainty and market volatility.	Consumer staples are bond proxies and have an inverse relationship with government bonds. Bond yields have fallen while consumer staples prices have yet to catch up. Many consumer staples companies are embracing new business models and/or distribution channels to cope with the disruption caused by e-commerce and new players.	Certain sectors, such as beverages and tobacco, could face regulatory risk which reflect the change in social norms and acceptable practices. Technological disruption could result in companies which fail to keep up falling behind the competition.

● Positive ● Neutral ● Negative

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Economic Drivers and Risks

Economic drivers

Global growth

While growth momentum has been slowing, with the IMF acknowledging it by **lowering 2019's GDP forecast to 3.0%***, from previous forecast of 3.2%*, a recession is still not expected in 2019.

Inflation and Central Banks

Central banks have maintained **accommodative policies**. The Fed **cut policy rates by 25bps** in its October meeting. We expect the Fed to pause in the December meeting, and **implement the next cut in Q1 2020**. The ECB and BOJ are on an easing trajectory.

Corporate earnings

In 2019, strong personal consumption supported by a healthy jobs market should continue to drive the **positive trend** in corporate profits. Global earnings growth is expected to rise around **11% in 2019 and 10% in 2020**.

Risks

US Policy Uncertainties

The US continues to engage many countries in **trade disputes**, such as China, and the European Union, thus creating a drag on global growth. Meanwhile, it remains actively **entangled in geopolitical tensions** with North Korea and the Middle East. The upcoming **2020 Presidential and Congressional elections** add to the uncertainty as political parties continue to vie for power.

Global Growth Slowdown

After 10 years of economic expansion, the global economy is entering a **late-stage expansion cycle**. Despite "insurance cuts" from the Fed and the ECB, global economic growth will remain positive but likely face a further slowdown.

China Policy Missteps

Markets are expecting China to stimulate its economy through **(i) currency controls**, **(ii) monetary stimulus and (iii) fiscal stimulus**. China is one of the few major economies that still has the ability to conduct fiscal stimulus, which the broader Asian region is relying upon. If China enacts the wrong policies, it could have a profound negative impact on Asia as a whole.

* World Economic Outlook, IMF, October 2019

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Asset Class Views

Asset Class	Subclass	View	VTAR framework	Rationales/Drivers
Equities	US	N		Valuations are expensive, but price momentum stays strong. Prolonged trade negotiations could hurt consumer and business sentiment.
	Europe	–		Valuations are attractive relative to the US, but growth is slowing and volatility is expected to remain high due to political uncertainties.
	Japan	N		Valuations have risen though not yet expensive. Economic data remain mixed. Global trade tensions are weighing on business sentiment.
	Asia (ex-Japan)	+		Valuations are cheaper than DM. Price trend starts to improve. Despite possible partial trade deal between the US and China, trade tensions remain heightened.
	EM (ex-Asia)	+		Valuations are cheaper than DM. Price trend starts to rise. Easy DM monetary policies and range-bound oil prices are likely to sustain equity returns.
Fixed Income	DM Sovereigns	N		Fed, ECB and BoJ are all expected to remain dovish going into 2020. However, valuations are high after YTD rally and the Fed is likely to pause for the year.
	DM IG	N		IG yield spreads have narrowed year-to-date as investors preferred quality assets to ride through equity market volatility.
	HY	–		HY offers a relatively better yield pick-up but market volatility is likely to remain high, which will likely result in a high risk-low reward trade-off.
	EMD USD	N		Spreads have narrowed after the YTD rally. Easing by global central banks lends support to EMD USD. Prefer Asian investment-grade bonds.
	EMD LCY	N		EM sentiment is likely to improve if the Fed remains supportive of growth. However, EM currencies, led by CNY, could weaken against the USD.
Commodities	Gold	+		The Fed's potential rate cuts are positive for Gold. China's reallocation of reserves into Gold will provide a support level. Target USD 1,650/oz by Q2 2020.
	Oil	N		Oil will likely remain range-bound between USD 60 and 70/bbl as resumption of Saudi Arabian supply is offset by concerns over slower global growth.
Currencies	USD	N		The USD is expected to weaken against EUR and JPY, but is expected to strengthen against EM currencies.

– – Negative   – Slightly Negative   N Neutral   + Slightly Positive   + + Positive

V=Value   **T**=Trends   **A**=Activity   **R**=Risk

● Positive   ● Neutral   ● Negative

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High-conviction Strategies

Conviction	VTAR framework	Proposition	Risk
Global Quality Equities		Global quality equities tend to outperform broad equity markets over longer investment cycles.	Relatively expensive valuations could increase the probability of short-term corrections. However, the quality companies tend to better weather the economic slowdown, limiting the likelihood of large corrections in quality stocks.
US Consumer Staples		US Consumer Staples is a sector that offers a more defensive positioning than many other US equity sectors, and thus is less likely to experience the same level of drawdowns in a risk-off scenario.	Certain sectors, such as Beverages and Tobacco, could face regulatory risk to reflect the change in social norms and acceptable practices. Technological disruption could cause companies that fail to keep up to fall behind the competition.
EM Equities		Broad EM equities are supported by stronger fundamentals and attractive valuations.	An unexpected surge in USD strength could cause a retreat from EM equities, as seen in the Turkey situation last year. A worsening of US-China trade tensions could also lead to higher market volatility. Another escalation, such as the recent increase in tariffs by both sides, can cause near-term pullbacks.
Unconstrained Bond Strategy		A dovish stance from major central banks will keep key global interest rates low. An unconstrained bond strategy tends to enhance the return over the broad fixed income market.	An inflation overshoot will send bond yields higher, which will be the major risk to fixed income in general. However, inflation-linked securities such as TIPS will be less affected in such an event.

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● Positive ● Neutral ● Negative

Megatrends

Conviction	VTAR framework	Proposition	Risk
Global Healthcare		Healthcare is a structural growth story driven by long-term growth in an ageing global population. In the medium-term, we expect drug approvals and an increase in M&A activity to be catalysts for a sector re-rating.	Policy uncertainty could weigh on sentiment for the sector. The Medicare-for-all proposed by Democrat Presidential candidate Bernie Sanders could lead to volatility, but the probability for the programme to pass is low at the present time. This risk will likely be mitigated in the long-term as a growing silver segment should contribute to stronger increase in demand.
Chinese Equities		Chinese equities are underowned by global investors, and provide a good risk-reward and diversification benefits.	A US-China trade war remains a key risk in the near term and is likely to negatively impact China's economic growth. Financial deleveraging could continue to put pressure on growth and lead to higher risks of policy missteps.
AI & Innovation		Artificial Intelligence (AI) has the ability to drive multi-fold increases in productivity by utilising big data and powerful computing hardware to accurately and reliably solve real-world problems with little human input.	Policy and regulatory uncertainty is a key risk to watch for. As AI permeates more and more into people's daily lives, questions about safeguarding individual privacy and appropriate use of such tools will surface. Regulators may step up efforts to curb the uses and applications, while differing standards from various countries can create barriers to universal adoption.

V=Value **T**=Trends **A**=Activity **R**=Risk
● Positive ● Neutral ● Negative ● NIL

Rates and FX Forecasts

Key Currencies					Key Rates (%)				
	4Q19F	1Q20F	2Q20F	3Q20F		4Q19F	1Q20F	2Q20F	3Q20F
USD/SGD	1.40	1.41	1.42	1.42	**US**	1.75	1.50	1.50	1.50
EUR/SGD	1.54	1.55	1.59	1.62	**EU**	0.00	0.00	0.00	0.00
GBP/SGD	1.79	1.82	1.85	1.85	**UK**	0.75	0.75	0.75	0.75
AUD/SGD	0.97	0.97	0.99	1.01	**AU**	0.75	0.75	0.75	0.75
JPY/SGD x 100	1.30	1.32	1.33	1.34	**JP**	-0.10	-0.20	-0.20	-0.20
NZD/SGD	0.90	0.90	0.92	0.94	**NZ**	1.00	1.00	1.00	1.00
SGD/CNY	5.14	5.14	5.14	5.14	**CN**	3.90	3.65	3.65	3.65
					SG	1.60	1.45	1.35	1.35

Source: UOB Global Economics & Markets Research, 1 November 2019

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