CIO Perspectives

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Key points

- Fed adopts hawkish stance in FOMC meeting by refusing to rule out aggressive rate hikes while emphasising on the need to stay "nimble" on inflation; But this will not herald the start of a bear market
- Historically, the prevailing combination of rising bond yields and positive growth momentum has generated strong average annual returns for the S&P 500
- Beyond the current bout of market correction, risk assets will resume their uptrend, underpinned by (a) Earnings resilience, (b) Attractive equity risk premium, and (c) Persistence of negative real interest rates
- The outlook on corporate earnings remains upbeat, particularly in on the Technology front; Global Technology leaders have demonstrated their ability to produce superior earnings and recent announcements by Intel, Microsoft, and IBM attest to this view
- Never "waste" a market correction; Investors should make use of this selldown to build strategic positions on secular themes in our CIO Barbell Strategy as well as gain exposure to quality plays and gold

Asset Allocation

Not the start of a bear market

Hawkish Fed – But this will not herald the start of a bear market. Federal Reserve Chair Powell has in the Federal Open Market Committee meeting maintained the end of quantitative easing in March and signalled the imminence of policy rate hikes in coming months – no surprises here. However, Powell's stance on being "nimble" on inflation as well as his refusal to rule out more aggressive rate hikes was widely seen as a sign of hawkishness – driving sharp overnight spikes in US Treasury yields.

Will this herald the start of a bear market? We think not.

Global risk assets have, without question, undergone substantial correction since the start of the year as investors grapple with the ramifications of imminent monetary tightening after years of central bank largesse. But our stance on this remains unchanged: the Fed hiking policy rates on the back of an improving economy will not derail the equity markets and our analysis of historical data validates this view.

Rising Bond Yields + Rising Growth Momentum: Historically generated highest average returns on S&P 500. To analyse how bond yields and growth conditions can impact the trajectory of the S&P 500, we look at annual data stretching back to 1963. Using the ISM Manufacturing as proxy for "growth momentum", our analysis drew the following conclusions:

- The prevailing combination of rising bond yields and growth momentum has historically generated the highest average annual returns of c.15% for the S&P 500
- Regardless of rising/falling growth momentum, falling bond yields have, in general, been positive for risk assets with returns averaging at c.8-10% for S&P 500
- The combination of rising bond yields and weakening growth momentum has historically generated the worst returns for S&P 500

Based on consensus forecast, US growth domestic product and corporate earnings are poised to grow 3.8% and 19.7%, respectively, in 2022. Clearly, the market is currently in the "rising bond yields and rising growth momentum" category and this is constructive for the outlook of risk assets. Beyond the current phase of market correction, we believe that risk assets will resume their uptrend, underpinned by:

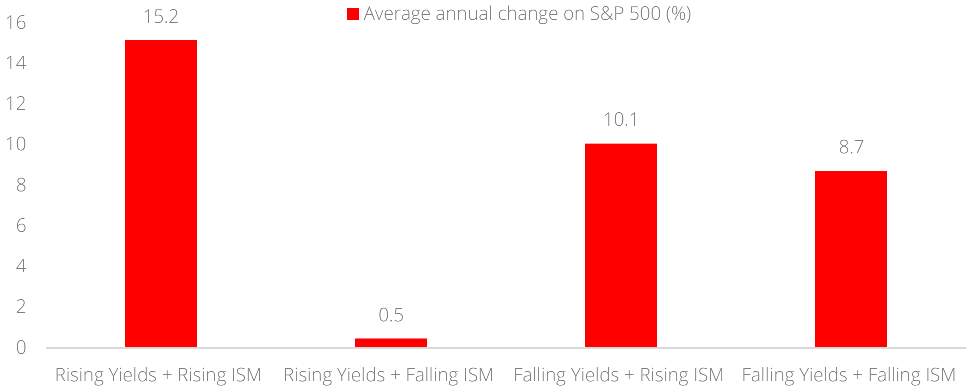
1. Resilient corporate earnings, particularly in the Technology-related space
2. Attractive equity risk premium
3. Persistence of negative real interest rates

Table 1: Rising yields and improving growth momentum is positive for the outlook of equity markets

	Average annual change in bond yields (%)	Average annual change in ISM Manufacturing	Average annual change on S&P 500 (%)
Rising Bond Yields & Rising Growth Momentum	+1.0	+9.5	+15.2
Rising Bond Yields & Falling Growth Momentum	+0.6	-7.7	+0.5
Falling Bond Yields & Rising Growth Momentum	-1.1	+5.0	+10.1
Falling Bond Yields & Falling Growth Momentum	-1.0	-7.0	+8.7

Source: DBS

Figure 1: Historical returns of S&P 500 amid different macro dynamics



Source: Bloomberg, DBS

Look beyond the Fed and focus on corporate fundamentals instead. The market's ongoing obsession with Fed monetary tightening will eventually fade to the back burner as expectations get increasingly "priced in". Instead, investors will divert their attention to corporate earnings and on this front, we are particularly upbeat on the Technology-related space. Global technology leaders have demonstrated their ability to produce superior earnings relative to the broader industry. This is evident from the current earnings season which saw the likes of Apple, Intel, Microsoft, and IBM reporting both earnings beat and providing optimistic corporate guidance.

Table 2: Corporate outlook remains upbeat

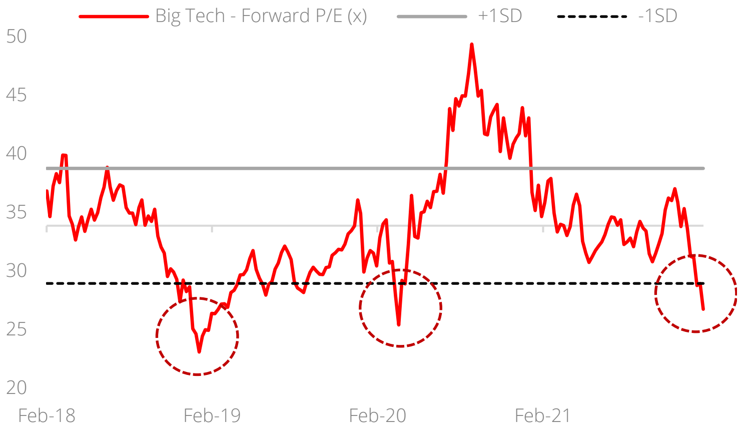
Company	Revenue	Earnings	Guidance
Apple	4Q21: Beat	4Q21: Beat	Optimistic
IBM	4Q21: Beat	4Q21: Beat	Optimistic
Intel	4Q21: Beat	4Q21: Beat	Optimistic
Microsoft	4Q21: Beat	4Q21: Beat	Optimistic
Netflix	4Q21: In line	4Q21: Beat	Cautious
Samsung	4Q21: Beat	4Q21: Miss	Optimistic
TSMC	4Q21: Beat	4Q21: Beat	Optimistic

Source: Corporate announcements

Never "waste" a market correction – Apt time to adopt longer-term view and build strategic positions in secular themes. Expect volatility to stay elevated as markets navigate through the initial phase of Fed monetary tightening. But never "waste" a market correction. We advise investors to maintain rationality and see this policy tightening phase as a necessary transition as economies return to normalcy. Our portfolio recommendations are:

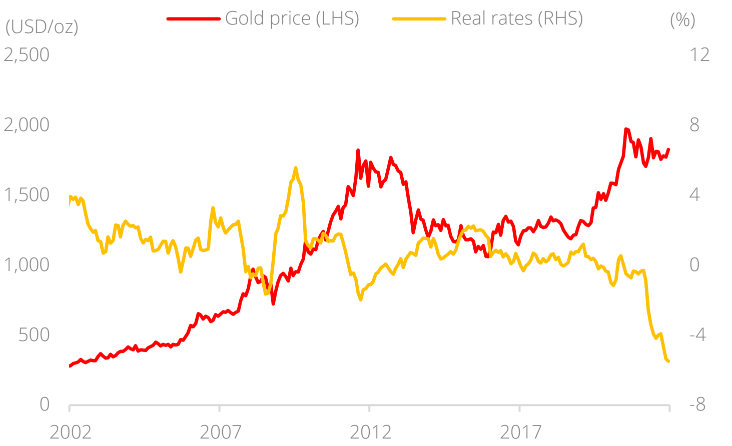
- Gain exposure to secular themes in CIO Barbell Strategy: In the CIO Barbell Strategy, Big Tech companies are our top conviction picks. The recent market selloff has driven forward earnings multiples for Big Tech to hit the -1 standard deviation mark and historically, this space will stage a substantial rebound from this level.
- The haves and the have nots – Quality plays to outperform: A distinct feature evident in the current selldown is the outperformance of quality companies over their weaker peers. A clear case in point is the Technology space which saw vast outperformance of Big Tech over "Emerging Tech". We expect this divergence in performance to persist as investors get more discriminating in a rising rates environment.
- Gold displaying resilience in a storm: Gold has served its purpose as a risk diversifier in the current bout of volatility and stayed resilient. As a hard asset, gold has long been considered as a hedge for inflation. Sticky inflation will result in real rates staying negative for longer and this is supportive of gold prices. We recommend investors to continue to hold gold as a risk diversifier in a barbell portfolio.

Figure 2: Big Tech's valuation looking compelling



Source: Bloomberg, DBS

Figure 3: Negative real rates are positive for gold



Source: Bloomberg, DBS

DBS