CIO Perspectives

Second Quarter 2022

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Key points

- Focus in 2Q22 will be on the Fed's rate hikes concerns being priced in and the impact of the Russia-Ukraine crisis
- We look to corporate fundamentals again, as opposed to policies and geopolitics
- The US Energy sector sets to gain given rising energy prices, as a result of the Russia-Ukraine conflict
- Stay the course and remain Overweight on the US Tech sector; the selldown will bottom as investors price in Fed rate hikes
- Earnings forecast for the sector remains upbeat with consensus expecting 19% earnings growth in 2022

EQUITY STRATEGY

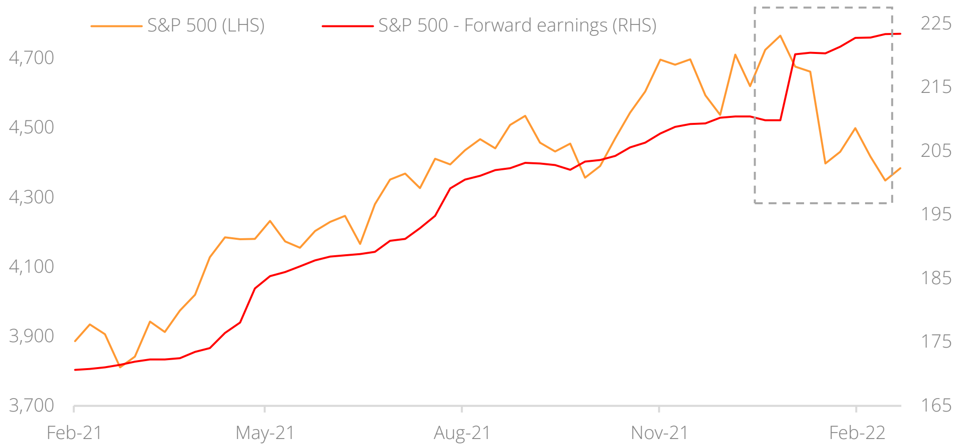
US Equities 2022: Beyond policies and geopolitics

Major disconnect emerging between equity prices and earnings forecasts. US equities started 2022 on a weak footing as concerns over Federal Reserve policy tightening drove "long duration" equities (like select Technology plays) and rates sensitive equities (like Real Estate) lower. On the flipside, the Russia-Ukraine conflict and surging energy prices propelled US Energy sharply higher as the sector is perceived as both "value" and "dividend" play.

With the acute market correction this year, a significant disconnect between equity prices and corporate earnings estimates is emerging. While the S&P 500 is down 8.0%, forward earnings estimates have been revised up by 6.5%. This suggests two things: (1) Global investors are overly pessimistic, or (2) Analysts and corporate CEOs are overly sanguine. We believe that the answer lies somewhere in between.

As we head into 2Q22, we believe that the headwinds weighing on market sentiment during the first quarter will falter and instead, the following narratives will increasingly transpire: (a) Fed rate hiking concerns are mostly priced in and (b) the Russia-Ukraine conflict has little impact on the global economy. If our view is right, then the focus will switch to corporate fundamentals again (as opposed to policies and geopolitics).

Figure 1: Disconnect between share prices and earnings



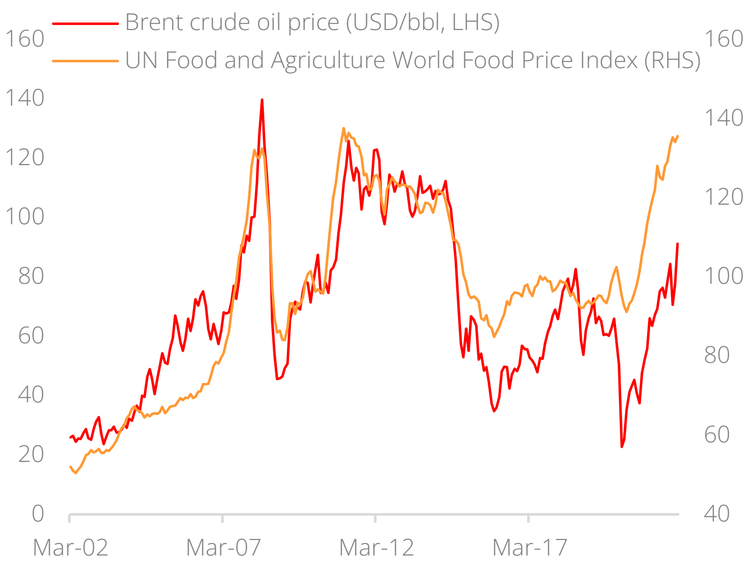
Source: Bloomberg, DBS

Navigating elevated energy and food prices. The Russia-Ukraine crisis could be a long-drawn affair with no clear resolution in sight. Geopolitical uncertainties, coupled with the imposition of sanctions on Russia, suggest that energy and food prices will stay elevated in the foreseeable months.

A clear winner in such an environment is the US Energy sector given that rising energy prices will boost the profitability of US oil majors and enable these companies to pay higher dividends or conduct shares buyback. Shell, for instance, has announced shares buyback of USD8.5b in the first half of this year after reporting robust earnings.

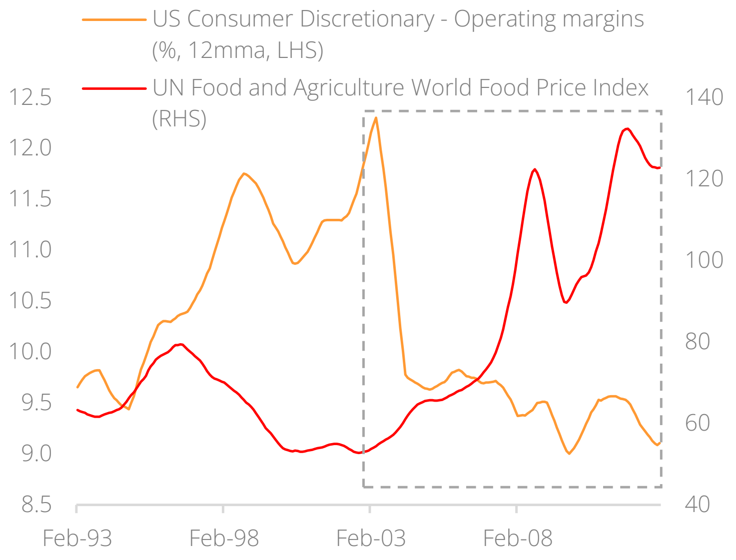
On the flipside, surging food prices will be negative for US Consumer Staples companies that fail to pass on the rising input cost. Since June 2020, the UN Food and Agriculture World Food Price Index has surged 48.8% and historical data show that food prices possess a broad inverse relationship with the operating margins of consumer staples companies. Case in point: Between May 2003 and November 2012, food prices increased 126% and it resulted in a 3.2 %pts operating margin contraction for the Consumer Staples sector.

Figure 2: Energy and food prices on the rise



Source: Bloomberg, DBS

Figure 3: Rising food prices weigh on the margins of consumer staples companies



Source: Bloomberg, DBS

2Q22 US Sector Strategy – Stay the course

Our long-term conviction call on Technology-related plays did not pan out as anticipated in 1Q22 as the rise in bond yields triggered the switch away from sectors perceived as "long duration". But as investors increasingly "price in" the trajectory of Fed rate hiking, we believe that the selldown in Technology will bottom during 2Q. Our optimism is two-fold:

1. The Technology space operates in a digital borderless world and unlike "traditional" sectors, it is less impacted by rising energy and commodity prices.
2. Earnings forecast for the sector remains upbeat with consensus expecting 19% earnings growth this year and this underlines the sector's resilience.

The huge run-up in energy prices, meanwhile, could take a breather by 2Q and henceforth, the Energy sector is maintained at Neutral as most of the upside has likely been priced in.

Table 1: 2Q22 US Sector Allocation

	Overweight	Neutral	Underweight
US Sectors	Technology	Materials	Utilities
	Comm. Services	Real Estate	Cons. Staples
	Cons. Dis.	Energy	Industrials
	Health Care		
	Financials		

Source: DBS

Table 2: US sector key financial ratios

	Forward P/E (x)	P/B (X)	EV/EBITDA (X)	ROE (%)	ROA (%)	OPM (%)
S&P 500 Index	19.6	4.4	14.7	20.7	4.1	16.1
S&P 500 Financials	14.6	1.6	7.2	15.5	1.6	31.0
S&P 500 Energy	12.4	2.3	9.4	13.9	6.0	9.2
S&P 500 Technology	24.9	10.3	20.1	36.1	13.6	26.2
S&P 500 Materials	15.3	3.1	10.8	18.5	7.7	16.0
S&P 500 Industrials	20.2	5.2	14.9	19.8	5.1	12.3
S&P 500 Cons. Staples	21.6	6.8	16.3	27.0	7.8	9.5
S&P 500 Con. Discretionary	26.2	10.1	17.8	36.9	8.1	9.7
S&P 500 Comm. Services	17.7	3.8	12.1	20.0	7.7	21.9
S&P 500 Utilities	19.7	2.2	14.5	8.6	2.2	15.0
S&P 500 Real Estate	42.5	3.9	24.7	10.8	4.1	22.7
S&P 500 Health Care	15.7	4.9	14.8	22.8	8.0	10.5

*Data as at 2 March 2022

Source: Bloomberg

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