CIO Vantage Point

Source: iStock

Inflation Chronicles

Taking lessons from history

Studying inflationary decades of the past, we look to glean insights from the 1910s – the decade that most closely resembles our current economic conditions.

Seeds of inflation have been sown

Key macro shifts including geopolitical uncertainties and the rising bargaining power of workers suggest we may be at the start of a new inflationary era.

Commonality among sectoral winners

Outperformers include upstream operators as well as downstream companies that are able to pass on rising costs to end consumers.

Beneficiaries of high inflation

In a rising inflation environment, Commodities, Energy Majors, and S-REITs are effective inflation hedges.

DBS

INTRODUCTION

The Great Inflation

Dear valued clients,

It is of no surprise that apart from the Russia-Ukraine conflict, inflation is the overriding concern among investors today. Key macro shifts such as global supply chain disruptions and central banks' decade-long quantitative easing policies suggest that inflation will continue to trend higher going forward.

The Federal Reserve has pivoted from a position of "transitory inflation", hence no urgency to normalise rates, to a "higher inflation for longer" and hence the urgency to hike rates. This has rocked financial markets, resulting in both bonds and equities registering negative returns this year.

In this CIO Vantage Point, we draw comparisons with past eras of peak inflation to guide us on what is likely to come. What appears as unusual inflation today has in fact occurred many times throughout history. After all, even though history doesn't repeat itself, it often rhymes.

We also highlight likely outperformers for our portfolios today. These are sectors that thrive on elevated inflation as well as companies that have the ability to pass on rising costs to end consumers.

I hope you enjoy the read.

Hou Wey Fook, CFA
Chief Investment Officer

The Chronicles of **Inflation**

Source: iStock

Inflation
Snapshot

Introduction

To determine sectoral outperformers amid rising inflation, we analysed US sectors during high inflationary periods starting from 1973. Energy, Real Estate, and Consumer Staples came out tops in terms of average real returns and frequency of positive returns. Energy registered the highest average real returns of 6.6%, followed by Real Estate at 4.3%, and Consumer Staples at 3.5%. On the other end of the spectrum, Telecom, Media & Technology, Utilities, and Consumer Discretionary registered the lowest gains.

Historical inflation peaks

We study three notable eras of high inflation – the 1910s through World War I, the 1940s through World War II, and the 1960s-70s "Great Inflation".

The present is reminiscent of the 1910s

Our present day and the 1910s share commonalities such as pandemic aftershocks, being close to periods of technological revolution, and central banks tightening policy.

Structural factors at play

History informs us that interest rates cannot rise as quickly to meet inflation under periods of high debt/GDP for fear that the debt may never be repaid.

Commodities an effective inflation hedge

Strong pent-up demand and the Russia-Ukraine conflict have driven up prices. Oil, base metals, and gold will outperform given the supply shortage and energy transition narratives.

Energy majors a key inflation beneficiary

This sector is able to maintain stable earnings through the cycles, underpinned by longer-term structural factors such as the underinvestment in fossil fuel capacity.

S-REITs a provider of stable dividend yield

S-REITs have delivered consistent returns over the last decade. The sector is also insulated from rising interest rates due to their reasonable gearing levels.

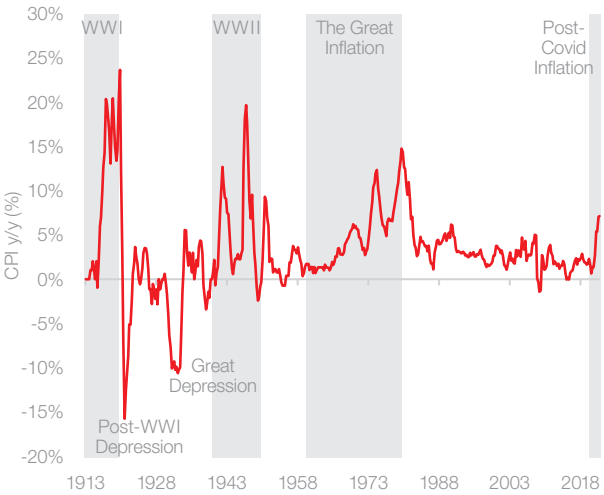
Inflation - Past, Present, and Beyond

DBS Chief Investment Office

A Brief History of Inflation

Lessons from history – the greatest teacher. Once called "taxation without legislation" by famed economist Milton Friedman, inflation has roared back at the turn of the decade of the 2020s, threatening to impose its illegitimate, invisible tariffs upon the man on the street purchasing essential goods and services. This surge in prices has come as the world is emerging from a pandemic, approaching levels not seen in 40 years. As the impact of higher prices has far-reaching consequences, it is instructive to take a brief look back on inflationary episodes over the last century to glean some insight as we approach the decade ahead of us – what appears as unusual inflation to us in the present has in fact occurred many times throughout history with observable reoccurring patterns.

Inflationary decades of the past



Source: Bloomberg, DBS

The costs of having too much money. A crude but well-acknowledged definition of inflation is the phenomenon of "too much money chasing too few goods". It is therefore no coincidence that periods which saw an increase in the broad money supply generally held the critical kindling for an inflationary ignition. Money supply, in turn, generally increases under two main conditions:

1. Higher private sector lending: Banks make more private loans and consequently create new deposits as a balancing accounting entry.

2. Larger public sector debt monetisation: Governments run large fiscal deficits while the central bank creates new reserves to finance the bonds issued in relation to those deficits.

Identifying historical inflation peaks. Looking across the 20th century, there are three notable eras where inflation has been exceptionally high (US CPI increments of >10% pa), starting with:

a. The 1910s inflation through World War I (WWI)

b. The 1940s inflation through World War II (WWII)

c. The 1960s-70s "Great Inflation"

We will go through each period to identify distinct events that resulted in either (a) an increase in broad money supply, or (b) a shortage of production of goods and services – factors that are well-known harbingers of inflationary cycles:

1910s through WWI

Inflation and its causes

- Soon after the outbreak of WWI in 1914, a large inflow of European gold to pay for US exports (munitions, food, etc) increased the money supply. The Federal Reserve was inexperienced (created in December 1913) and did not halt the resulting inflation.

- The US declared war on Germany in 1917, and federal spending surged as the military was mobilised, and the Treasury lent generously to US allies.

- As spending exceeded tax revenues, the Treasury issued "liberty loans" (war bonds) to raise funds. The Fed monetised those bonds by lending to member banks at low interest rates when the proceeds were used to (a) buy these war bonds, or (b) purchase Treasury certificates – short-term borrowings issued in anticipation of tax receipts.

- The Fed did not raise rates to combat inflation – as monetary policy was secondary to the needs of the Treasury – which prioritised spending needs for the war.

- Fed lending at low rates eased credit conditions, stimulating borrowing by businesses and households which increased broad money supply and fuelled inflation.

Post-WWI normalisation – Deflationary bust

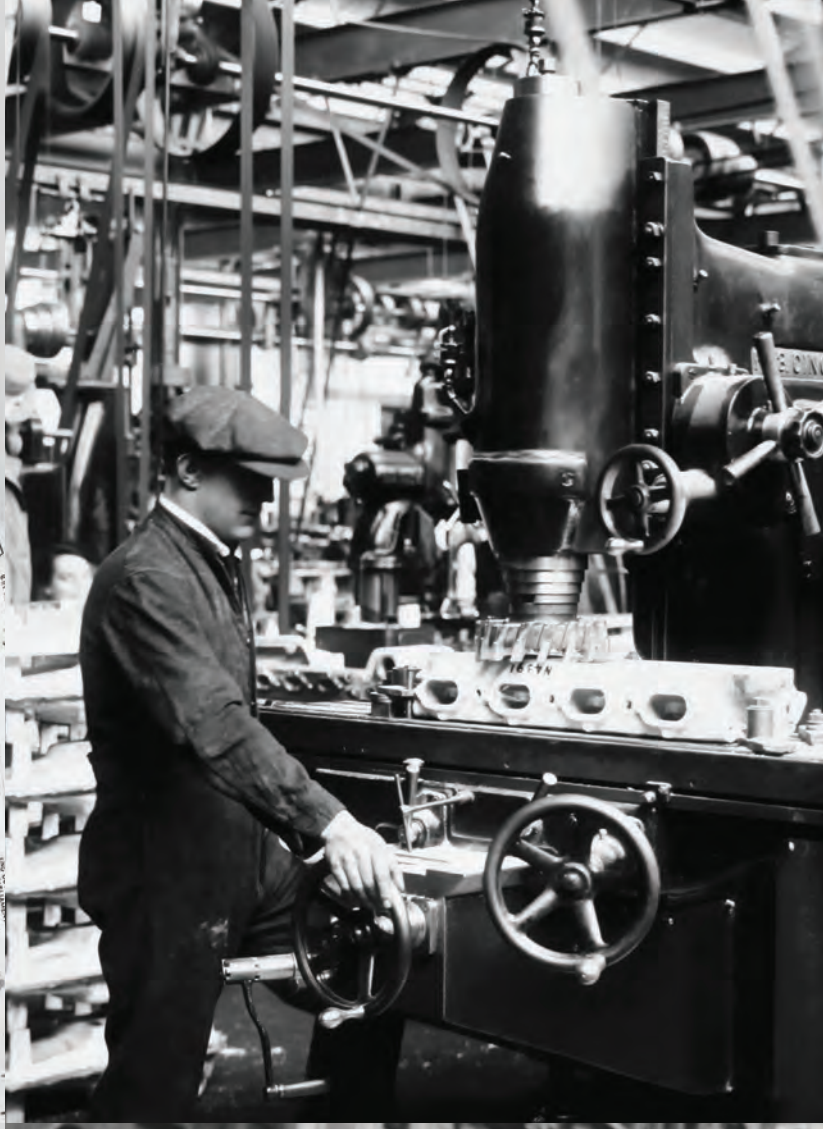
- Post-war boom after 1918 saw domestic demand rise and exports continued apace to supply war-torn Europe.

- After the war, the Fed asserted its independence from the Treasury and took measures to bring down inflation. In December 1919, the rate was raised from 4.75% to 5%. A month later it was raised to 6%, and in June 1920 it was raised to 7%.

- Returning troops caused a surge in the civilian labour force; the inability of the market to incorporate veterans resulted in sharply rising unemployment and wage stagnation.

- Factories focused on wartime production had to shut down or undergo retooling to adapt to peacetime – resulting in an economic slump.

- The US dollar (USD) was enhanced on the global stage. Huge military expenditures forced warring nations to abandon the gold standard, but USD maintained its link to gold. Financiers and traders turned to USD as a preferred medium of exchange.



Source:Unsplash

1940s through WWII

Inflation and its causes

- Wartime expenditures drastically increased fiscal deficits, despite a heavier reliance on taxation compared to WWI.

- Congress amended the Federal Reserve Act to (a) allow the Fed to purchase government securities directly from the Treasury, and (b) exempt war loan deposits from reserve requirements for the duration of the emergency.

- To keep the costs of the war low, the Fed essentially invoked yield curve control by pegging interest rates at low levels – Reserve Banks agreed to purchase Treasury bills at an interest rate of 0.375% pa and fixed long-term bond yields at 2.5% pa.

- This inevitably led to the purchase of a significant amount of government securities, expanding the system's balance sheet and increased the monetary base by 149% from August 1939 to August 1948, well after the conclusion of WWII.

- Gold inflows accelerated as Britain and other allies paid for war materials and other supplies produced domestically by shipping gold to the US – contributing to the expanding monetary base and money supply.

Post-WWII normalisation – Sustained but moderating inflation

- Wartime price and wage controls, along with food and goods rationing programmes were lifted following the war. Personal savings had increased in war time, and were quickly spent into the economy, causing prices to climb significantly.

- Supplies were running low or were exhausted entirely during the war. Families had trouble buying cars and household appliances because they were essentially unavailable. According to the US Bureau of Labor Statistics, "[by] 1943, many durable goods, such as refrigerators and radios, were also dropped from the [CPI] as their stocks were exhausted".

- Technology that was used for the war was repurposed for domestic use. Returning veterans were given educational benefits as part of the G.I. Bill, and utilised the benefits to complete college degrees or training programmes that encouraged long-term economic growth.

- Experience with WWI led to expectations that there would be high unemployment and recession following WWII. This led to the Fed's decision to continue to hold down Treasury financing costs, continuing the government bond support programme for much longer than what would be consistent with price stability.

- As such, the period after WWII did not experience the same deflationary bust as observed post-WWI. This inflationary episode only ended two years after the war as domestic and foreign supply chains normalised and consumer demand began to level off.

- Moderation of inflation was also supported by the (a) post-war productivity boom of the 1950s and (b) a global shift towards the Bretton Woods monetary system, which brought the world back to a quasi-gold standard, regulating the global money supply.

1960s-70s – The Great Inflation

Inflation and its causes

- Motivated by unprecedented high unemployment in the US during the Great Depression, Congress enacted policies to promote full employment after WWII, laying the groundwork for easy monetary policy through the 1950s and 1960s.

- There was a rapid increase in wages and bank lending, along with rising fiscal extravagance – "guns and butter" spending on (a) Vietnam war (guns) and Lyndon Johnson's "Great Society" spending on social initiatives (butter).

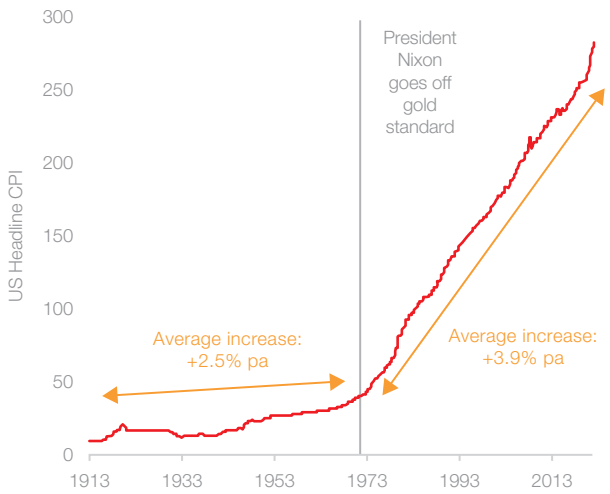
- Breakdown of the Bretton Woods system. Growth of global trade → Rise in demand for USD → US increased Balance of Payments shortfall → foreign central banks accumulated more USD reserves than US stock of gold. Nixon broke the gold link and the world moved to a fiat monetary system, essentially devaluing USD against gold.

- Energy crises with (a) the Arab oil embargo in 1973 [oil prices spiked c.2x from 1973-1975] and (b) another supply shock following the Iranian revolution in 1979 [oil prices spiked c.2.5x from 1979-1981].

- Policymakers initially maintained a dovish bias, stating that supply factors (such as oil embargoes) were beyond the control of monetary policy. Fed Chair Arthur Burns created the first iteration of the core CPI index (ex-Food and Energy) to strip out the effects of such external factors.

- The Nixon administration introduced wage and price controls between 1971-1974. Those controls only temporarily slowed the rise in prices while exacerbating shortages, particularly for food and energy.

Lifting the golden anchor



Source: Bloomberg, DBS

Lyndon Baines Johnson, the 36th President of the United States

Source: Unsplash

Johnson launched the "Great Society" initiative; a set of domestic programmes designed to improve the lives of Americans.

Nixon closed the convertibility of dollars to gold and moved the world into a fiat monetary system, setting global currencies on a perpetual path of devaluation against the precious metal.

Richard Milhous Nixon, the 37th President of the United States

Source: Unsplash

Post-Great Inflation normalisation – The Great Moderation

- Paul Volcker became Fed chair in 1979 and targeted monetary aggregates rather than the Fed funds rate as its policy instrument.

- As a result of the new focus and the restrictive targets set for the money supply, the Federal funds rate reached a record high of 20% in late 1980. Inflation peaked at 14.8% in March of the same year. Meanwhile, the economy entered a severe recession with high unemployment rates and businesses facing insolvencies.

- Volcker's conviction in the face of political pressure gained immense credibility for the Fed that laid the groundwork for the subsequent long period of sustained growth and low inflation, known as the Great Moderation.

Summary of economic data changes (by decade)

Decade Start	Average annual surplus (deficit) to GDP	Average debt to GDP	Change in Fed balance sheet (as % of GDP)	Absolute % change in oil prices	Absolute % change in gold prices
1900	-0.4%	4.3%	NA	-49%	0%
1910	-3.8%	7.5%	11%	403%	0%
1920	0.8%	23.6%	-1%	-61%	0%
1930	-2.9%	35.5%	17%	-14%	67%
1940	-8.9%	80.7%	13%	146%	1%
1950	-0.4%	68.6%	2%	15%	1%
1960	-0.7%	46.3%	4%	10%	0%
1970	-1.9%	34.5%	5%	462%	1,356%
1980	-3.8%	41.7%	4%	4%	-22%
1990	-2.1%	61.7%	5%	27%	-28%
2000	-2.3%	62.3%	12%	210%	281%
2010	-4.8%	101.4%	11%	-22%	38%
2020 (to date)	-13.5%	125.5%	22%	42%	28%

Source: Bloomberg, Centre for Financial Stability, Jordà-Schularick-Taylor Macrohistory Database, St Louis Fed, US Energy Information Administration, DBS

Disinflationary Productivity

Exceptions to the rule. While the growth in money supply had led most inflationary episodes, there have been periods where inflation remained subdued despite rising money supply, namely between (a) 1875-1910 and (b) 1990-2020, which warrants further exploration. These periods were characterised by a common theme of technological revolution that resulted in large productivity gains – as such, production of goods and services kept pace with (or even exceeded) the growth in money supply, resulting in little inflation.

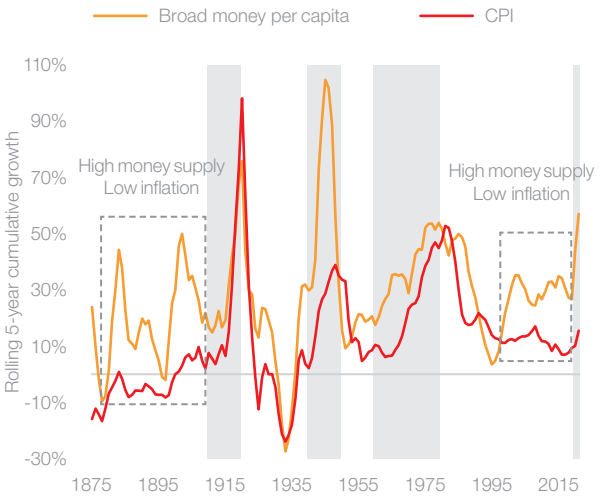
The Second Industrial Revolution (c.1870-1914)

- The US saw abundant land and population growth, along with an influx of cheap labour through immigration.
- The founding of Standard Oil in 1870 gave access to large energy reserves, through improvement in refining and transportation methods.
- The internal combustion engine was created in 1860, while the transcontinental railroad was completed in 1869, improving connectivity.
- Nikola Tesla and Thomas Edison made huge advancements in electrification.

Globalisation and Digitalisation (c.1991-2020)

- Expansion of free trade agreements gave developed markets access to cheaper labour in the developing world.
- Rise of automation displaced labour and limited wage growth.
- The US Shale Revolution upended oil markets in the mid-2010s and gave the world access to cheap energy.
- Creation of the personal computer, software tools, proliferation of the Internet, and smart phones led to the exponential rise in networking and productivity.

Productivity is disinflationary



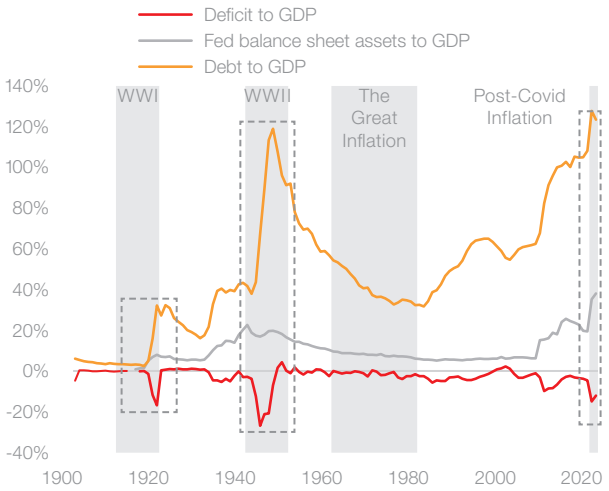
Source: Jordà-Schularick-Taylor Macrohistory Database, DBS

Comparing Past and Present

History doesn't repeat itself, but it often rhymes. The present post-Covid inflation – closely scrutinised – reveals shadows of a wartime past. Where large deficit spending was incurred at the time of the world wars to purchase munitions and tanks, the same was done during the pandemic through unemployment benefits and healthcare-related expenditures. Central banks kept interest rates low and expanded their balance sheets to keep debt burdens manageable. Supply chains, once disrupted by a world in conflict, are now disrupted by countries around the world undergoing desynchronised lockdowns. As such, we believe the current episode of inflation is more analogous to the decades of the 1910s and the 1940s, than to the Great Inflation of the 1970s.

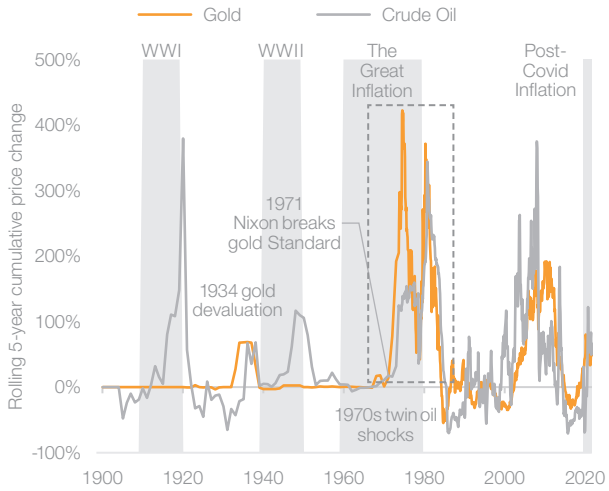
The 1970s' Great Inflation had unique commodity-related disruptions. Despite having extravagant fiscal spending and supportive central bank policies in the early 1970s, these still paled in extent to the decades of the 1910s, 1940s, and the 2020s. What was more unique, however, was the presence of multiple commodity price shocks, with (a) President Nixon suspending the dollar's convertibility with gold in 1971, and (b) the dual oil price shocks of 1973 and 1979. This reveals a very different underlying inflationary profile to those of its wartime predecessors, although there is some semblance to the 2020s with the climbing gold prices and oil price spike following the pandemic disruption and embargoes on Russian oil following the Russia-Ukraine conflict, respectively (although not to the same degree as the 1970s).

The 2020 war against an invisible enemy



Source: Bloomberg, Board of Governors of the Federal Reserve System, Centre for Financial Stability, St Louis Fed, World Bank, Jordà-Schularick-Taylor Macrohistory Database, areppim.com, DBS

Unique commodity shocks of the 1970s



Source: Bloomberg, Centre for Financial Stability, US Energy Information Administration, DBS

The most analogous era to the present. Noting the various inflationary drivers of the 20th century, we derive a simple checklist to compare the presence/absence of each factor across the four inflationary periods. While no two periods are exactly alike, we find that the present most closely resembles the decade of the 1910s. Aside from the inflationary factors that have already been mentioned, other close similarities include the fact that (a) the world had to suffer the aftershocks of a global pandemic (the Spanish Flu in 1918 and Covid-19 in 2020), (b) both periods being in close proximity to technological revolutions, and (c) the predisposition of central banks to quickly remove extraordinary policy accommodation to fight rising inflation.

As the 1910s inflation was followed by a deflationary bust, time will tell if the Fed's aggressive tightening in 2022 will result in the soft landing that they had optimistically projected for the decade ahead of us. On the upshot, the present decade continues to show strong economic growth and low unemployment unlike the post-WWI environment, which bodes well for the Fed's projections.

The present most closely resembles the decade of the 1910s

		WWI	WWII	The Great Inflation	Post-Covid Inflation
Inflationary	Deficit spending	✓	✓	✓	✓
	Central bank debt monetisation	✓	✓	X	✓
	Devaluation against gold	X	✓	✓	X
	Energy crisis	X	X	✓	✓
	Shortages of goods and services	✓	✓	X	✓
Disinflationary	Post-inflation policy tightening	✓	X	✓	✓
	Tech-driven productivity gains	✓	X	X	✓

Source: DBS

The Inflationary Future

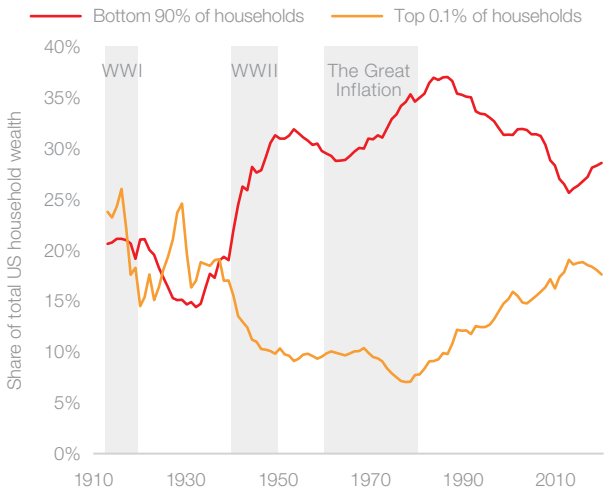
Seeds of inflation have been sown. Pertaining to the 2020s, there are several other key macro shifts that suggest that inflation could persistently average higher in this decade than in the last, shifts that investors should not ignore. These include:

1. Decelerating globalisation: Globalisation has unquestionably been a disinflationary force (for advanced economies), allowing production to be outsourced to external localities that reduce labour and other costs. However, the pandemic has taught governments and businesses that offshoring costs are now subordinate to the need to maintain a certain degree of onshore production capacity to mitigate future global disruptions; costs of such excess capacity would inevitably filter through to goods and services.

2. Higher fiscal activism: The effectiveness of the use of fiscal levers during the Covid-19 pandemic to mitigate the impact on livelihoods may have left policymakers more predisposed to employ such stimulative measures in future. Direct transfers to households now have a precedent, while infrastructure-related spending continues to receive bipartisan support. Such spending would serve to increase broad money supply in time to come.

3. Rising bargaining power of workers: Much has been said on the topic of "the Great Resignation", with scores of workers voluntarily quitting due to a recalibration of aspirations/disillusionment over the course of the pandemic. Adding to this the political shift towards tackling disproportionate wealth, sees a tendency towards a higher labour share of gross domestic product (GDP) in the coming future as policymakers seek to reverse the trends that have exacerbated inequality – pursuing policies that elevate fair employment and wage growth. These would also be inflationary by nature.

Inflation and wealth redistribution come hand in hand



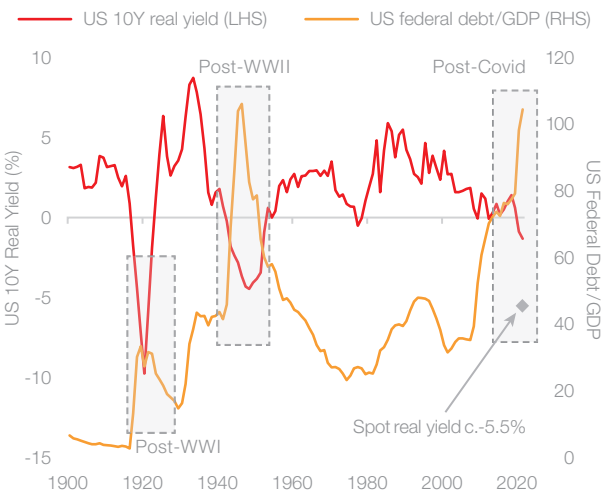
Source: Piketty, Saez and Zucman, DBS

4. Geopolitical uncertainties: The Russia-Ukraine conflict and resulting sanctions on Russia have translated to higher commodity prices given the world's reliance on Russia for hydrocarbons, metals, and grains. Disruptions in transport routes between Asia and Europe involving Eastern European ports have further aggravated global supply issues, adding to inflationary pressures. Beyond the current strife, this conflict may amplify risks of global fragmentation between democracies and autocracies, with longer-term ramifications on global trade uncertainty and commodity price risks adding to inflationary pressures in the coming years.

Debt is easier to inflate away than to repay. Another legacy of the Covid-19 pandemic is the steep rise in global indebtedness – where global debt/GDP had exceeded 350% at its peak. History once again informs us that interest rates cannot rise as quickly to meet inflation under periods of high debt/GDP for fear that the debt may never be repaid. There are three primary means of deleveraging from a high debt situation, namely (a) defaulting on debt obligations, (b) fiscal prudence – increasing taxes/ reducing spending, and (c) allowing inflation to reduce the debt load in real terms.

For the US in particular, it would be odd to default on USD-denominated debt, given the ability to print the world's reserve currency. The increasingly polarised political landscape also disinclines heads of state from pursuing fiscal austerity for fear of losing votes. That leaves inflation as the remaining savoury option, an option that finds the same historical precedents during the debt spikes in the two World Wars. Governments implemented financial repression, allowing inflation to run meaningfully above interest rates to bring down debt/GDP – resulting in deeply negative real yields.

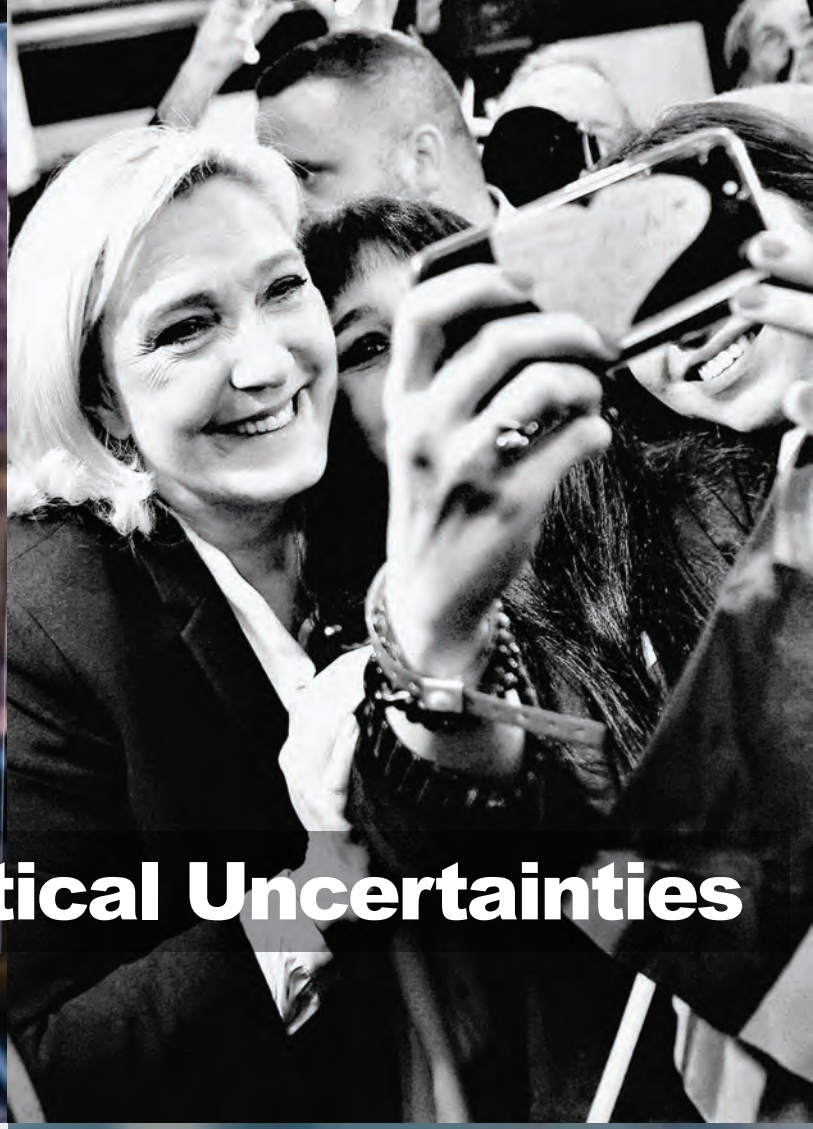
Higher debt, lower real yields



Source: CBO, NYU Stern, Federal Reserve Board, DBS

These structural shifts suggest that we may be standing at the start of a new inflationary era. Although the world is unlikely to experience a return to 1970s era stagflation, investors should be prepared that inflation in this decade would likely average higher than the decade prior – bucking the disinflationary trend that had characterised the Great Moderation.

Daryl Ho, CFA | Strategist
Beatrice Tan | Analyst



Geopolitical Uncertainties

Rising Labour Power

Source: AFP Photo, Unsplash

Decelerating Globalisation

Higher Fiscal Activism

Source: AFP Photo, Unsplash

Impact of rising inflation on equity markets – A historical perspective

Historically, inflation has been a doubled-edged sword for company earnings and equity markets. On one hand, rising inflation can translate to higher average selling prices (ASPs) for companies and lend a boost to nominal top-line revenue. Conversely, the boost to nominal revenue could also be offset by proportionately higher input costs (and leading to profit margin contraction) should companies be unable to pass them on to end consumers.

Since 1914, US inflation has averaged at 3.1% and our analysis suggests that the performance of US equities tends to be subdued during periods of elevated inflation. And indeed, since 1973, the monthly real returns for US equities averaged only 0.5% when inflation is high* (*defined as levels above the long-term average). Moreover, the frequency of US equities registering positive real returns is also subdued at 51.2%.

The lacklustre performance of equity markets during periods of elevated inflation could be broadly attributed to two key factors: (1) Rising inflation translates to monetary tightening and the increase in the cost of capital weighs on aggregate demand, and (2) From a discounted cashflow perspective, higher inflation (and by extension, higher interest rate) translates to lower net present value for risk assets like equities.

Sectoral outperformers during periods of elevated inflation. Taking our analysis one step further, we analyse the performance of US sectors during periods of high inflation since 1973 and our findings are:

- Average real returns: Energy registered the highest average real returns of 6.6%, followed by Real Estate at 4.3%, and Consumer Staples at 3.5%.

  On the other end of the spectrum, the TMT (Telecom, Media & Technology) space registered the lowest average real returns of -1.5%, followed by Utilities at -0.9%, and Consumer Discretionary at -0.8%.

- Frequency of positive returns: In terms of frequency of positive real returns, the Energy sector again came in tops at 65.5%, followed by Consumer Staples at 60.2%, and Real Estate at 59.8%.

  On the other end of the spectrum, Consumer Discretionary registered the lowest frequency of positive real returns at 42.2%, followed by TMT at 44.9%, and Technology at 46.5%.

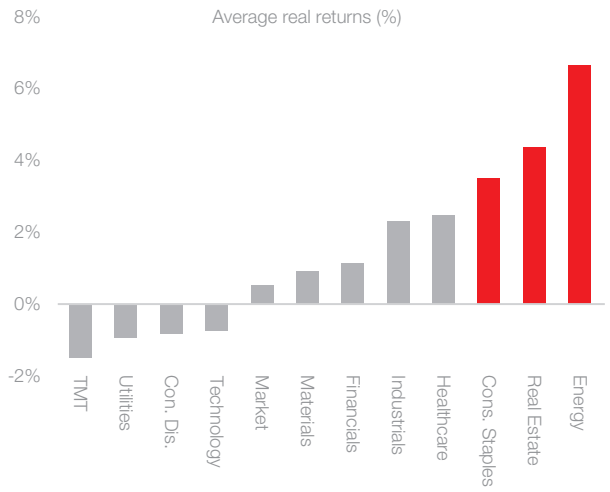
Clearly, the key sectoral outperformers during periods of high inflation are Energy, Real Estate, and Consumer Staples. A common factor underpinning the outperformance of these sectors lies on their ability to pass on rising cost to end consumers given that they operate in the "essentials" space, providing basic necessities like fuel, housing, and food.

Rising energy prices, for instance, can be easily passed on to consumers and this enhances the profitability of upstream energy producers. Similarly, rising inflation translates to higher property prices and rental charges, particularly in areas where housing is in short supply. Lastly, rising food prices benefits food producers, particularly those operating on the upstream.

By the same token, the sectors that have historically underperformed during periods of rising inflation are either those that (a) Operate in the non-essentials space or are (b) Constrained by regulations to increase prices. For the first point, a clear example is the Consumer Discretionary sector. Consumers typically cut back on discretionary spending and focus only on the essentials when prices are on the rise. In the case of Telecom (within the TMT sector) and Utilities, these sectors are usually constrained by regulations to pass on costs to consumers.

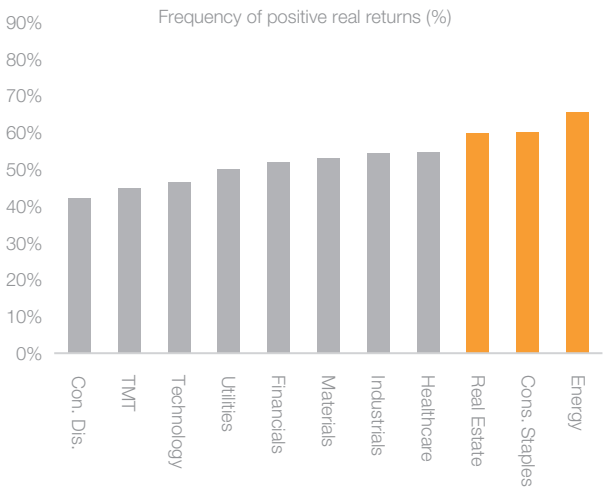
Dylan Cheang | Strategist
Benjamin Goh | Analyst

Average real returns during periods of elevated inflation



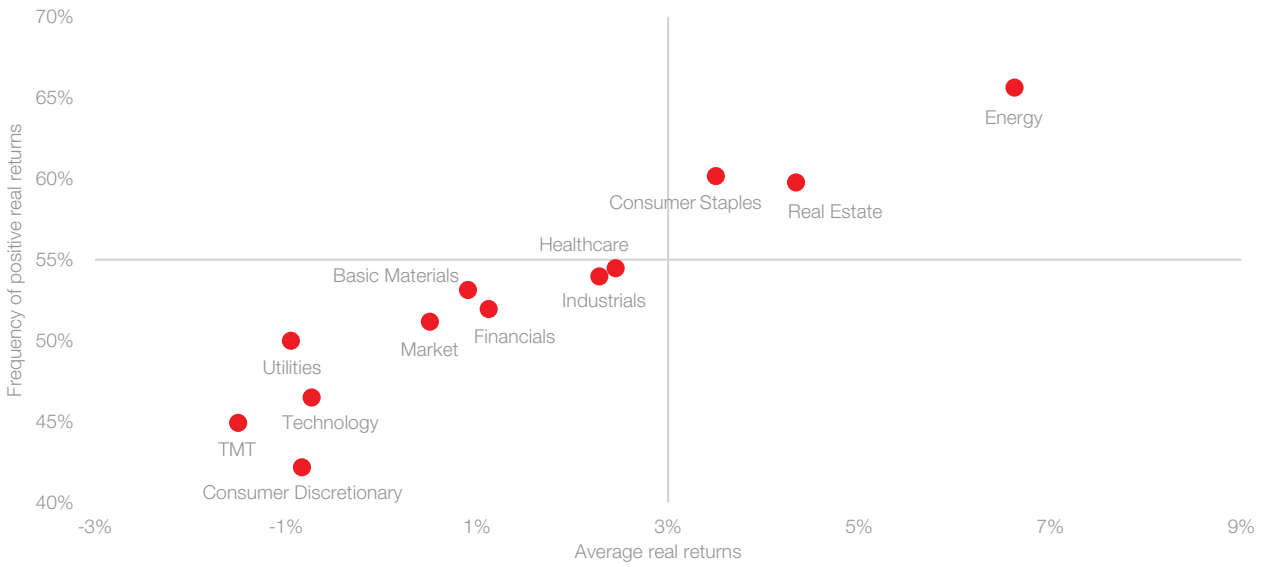
Source: Datastream, DBS

Frequency of positive real returns during periods of elevated inflation



Source: Datastream, DBS

Energy, Real Estate, and Consumer Staples tend to outperform when inflation is strong



Source: Datastream, DBS

Beneficiaries of high inflation

Listed below are some of the key beneficiaries of a rising inflation environment:

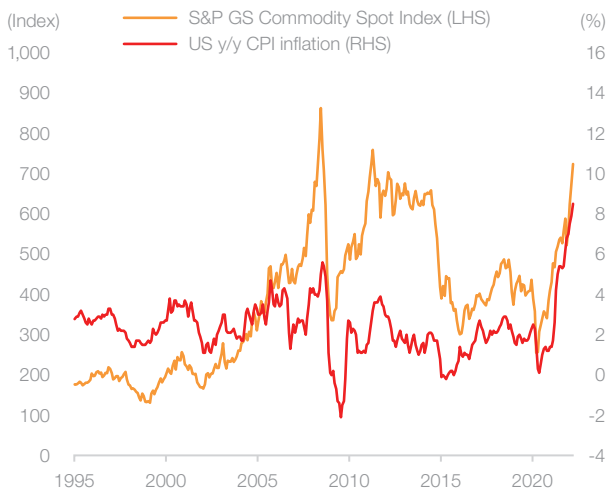
- Commodities
- Energy Majors
- Singapore Real Estate Investment Trusts (S-REITs)

Commodities

Commodity sector as an effective inflation hedge. Like inflation, commodity prices are affected by supply and demand dynamics. The prevailing global inflation is not caused by a single factor. Rather, it is the result of a combination of factors - from demand-pull to supply shortages and cost-push.

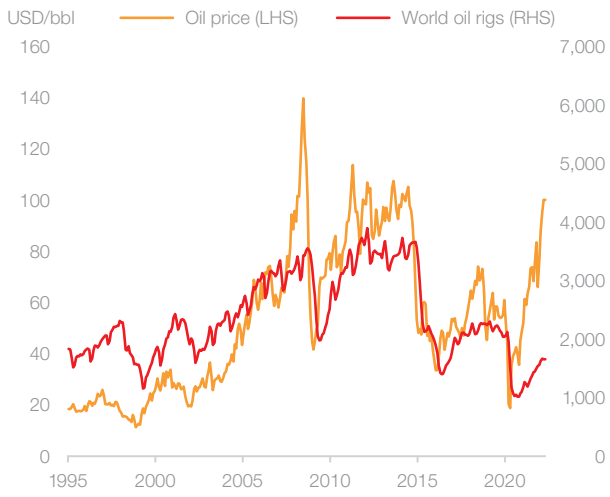
The combination of pandemic-related supply disruptions, strong pent-up demand, and the ongoing Russia-Ukraine conflict, have driven up prices higher across the commodity complex – from energy to base metals and agricultural produce. This, coupled with a tight labour market, has translated to the extreme cost-push inflation that we see today. To navigate these headwinds, one option is for investors to gain exposure to commodities.

Commodity prices are leading indicators for inflation



Source: Bloomberg, DBS

Oil price vs world oil rigs – tight supply to drive oil price higher



Source: Bloomberg, DBS

Outperformers in the commodity complex: Oil, Base Metals, and Gold. We believe oil, base metals, and gold will outperform given the supply shortage and energy transition narratives behind them. These factors will underpin prices in commodities.

- Oil

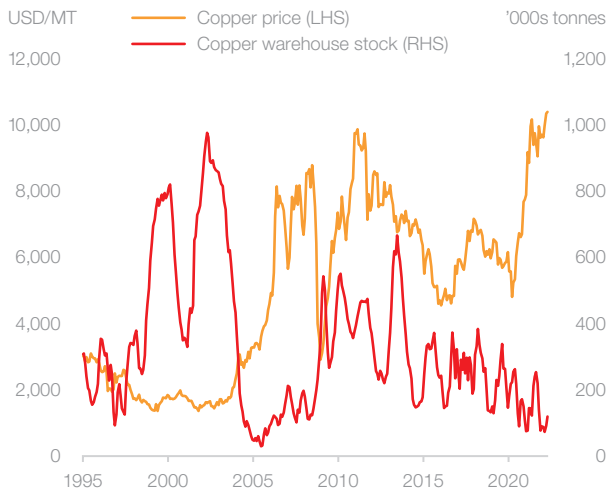
  Notwithstanding the current Russia-Ukraine crisis, we believe oil price will continue to be supported at USD95-100 per barrel due to the underinvestment in fossil fuels. Meanwhile, we expect oil demand to gradually increase as global economies reopen after two years of disruption. OPEC+ is expected to stick to its production plan in order to avoid another incident of negative oil prices (such as back in 2020).

- Base Metals

  Base metals are key raw materials for Tech products and the persistence of strong demand for the latter augers well for the price trajectory of base metals. Additionally, we believe that rising demand from the Green Energy transition will provide further support for this space, for instance:

  - Copper is used for the electrification of renewable energy sources (such as solar and wind power energy) and electric vehicles (EV).
  - Nickel and lithium are key raw materials used in EV batteries.

Tight supply to support prices



Source: Bloomberg, DBS

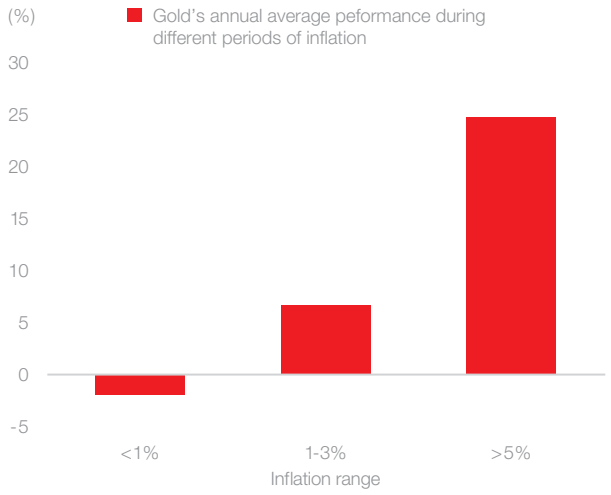
- Gold

  Gold has historically been perceived as an effective inflation hedge. This is not surprising. Data has shown that gold price rises during periods of inflation and protects purchasing power particularly well during periods of hyperinflation. The outlook for gold is underpinned by:

  - Strong demand – Gold possesses strong long-term demand from diversified segments, such as jewellery fabrication, bars and coins for investments, and central banks.
  - Limited supply – On the flipside, the supply for gold is limited. Production has consistently been falling short of demand and according to the World Gold Council, the known underground reserves of gold is only c.54,000 tonnes. Assuming annual demand of 4,000 tonnes, gold will run out of supply by 2050.

Beyond demand/supply dynamics, there is also a longer-term investment narrative for gold as an alternative to fiat currencies which are running the risk of devaluation as global debts pile up post-the Global Financial Crisis and Covid-19 pandemic.

Asymmetric gold price performance with higher inflation rate



Source: Bloomberg, DBS. Note: Annual data from 1971-2021 used in calculations.

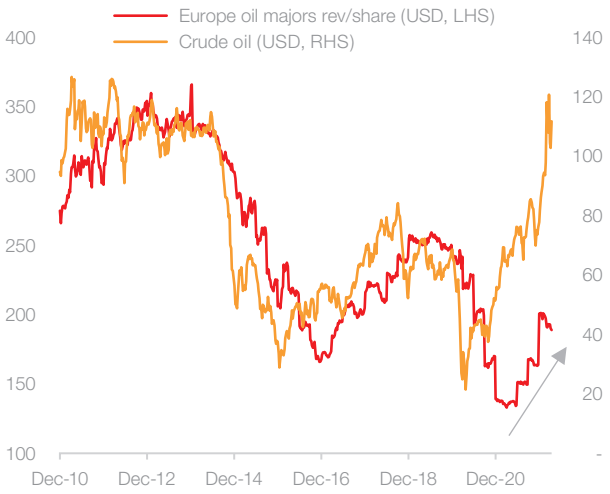
Energy Majors

Rising energy prices is one of the key factors contributing to the inflation surge that we see today. Not surprisingly, investors can hedge their portfolio against inflation by gaining exposure to energy majors – geared beneficiaries of high energy prices. Another reason to invest in this space is the sector's ability in maintaining stable earnings through the cycles, underpinned by longer-term structural factors (such as the underinvestment in fossil fuels capacity).

Over the years, the operations of energy majors have undergone vertical expansion and this strengthens their pricing power as well as overall profitability. In spite of the volatility in oil prices, sectoral dividend has remained stable through the cycles due to commitment on the part of these companies to maintain a stable dividend policy.

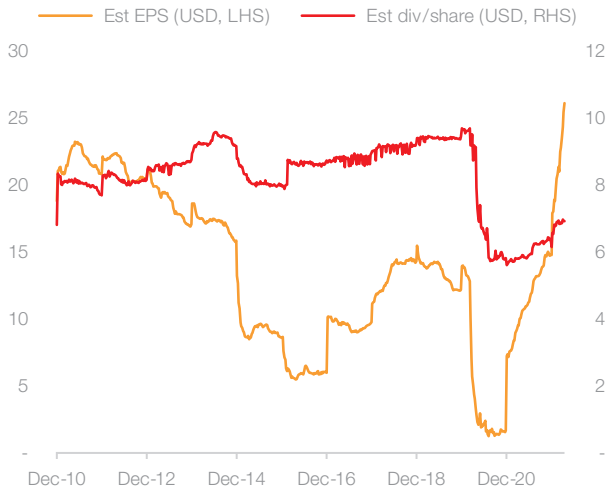
In the current energy up-cycle, sectoral earnings have risen to multi-year highs and this is expected to translate to higher dividend payouts, which will provide investors with stronger income buffer against rising inflation.

Oil price to give a boost to revenue, dividend trends



Source: Bloomberg, DBS

Dividends have yet to catch up with earnings recovery



Source: Bloomberg, DBS

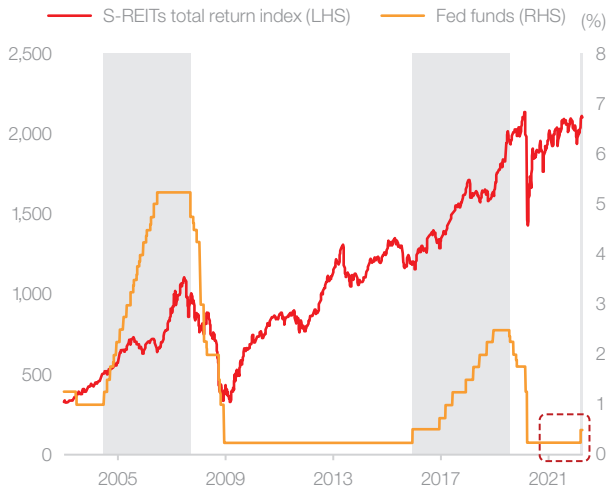
Singapore REITs

Singapore REITs (S-REITs) have provided stable dividend yield of 5%, and since the last decade, they have delivered strong returns, coming from consistent dividend payouts as well as capital gains. S-REITs serve as a good inflation hedge given that rental and property values tend to rise in tandem with rising inflation. Importantly, the ability of S-REITs in paying dividends is less impacted by rising interest rates due to their reasonable levels of gearing.

The outlook for the S-REITs space remains robust. Take the CBD Grade A office segment for instance. The current rental rates of SGD9.60 psf is above the 10-year average of SGD9.20 psf and according to JLL, rental growth of 25-30% is expected between now and 2025. Singapore will continue to be the preferred location for companies looking to set up regional headquarters and such a trend will underpin rental momentum across the retail and commercial segments within S-REITs.

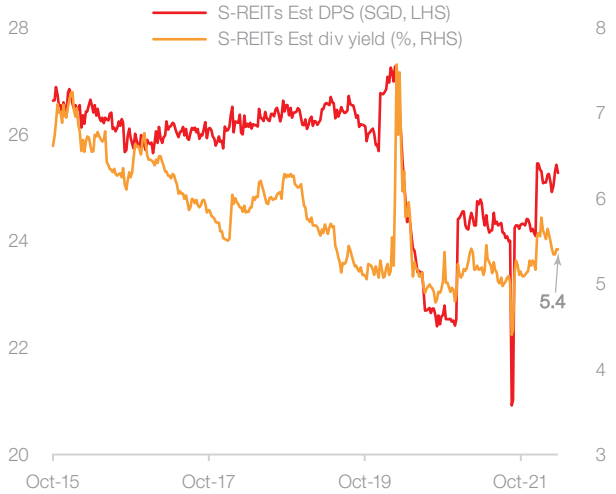
Joanne Goh | Strategist
Yeang Cheng Ling | Strategist

S-REITs outperform amid rising rates



Source: Bloomberg, DBS

S-REITs offer dividend yield of 5-6%



Source: Bloomberg, DBS

Source: Unsplash

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