CIO Perspectives

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Key points

- Inflation is here to stay as hope for a swift resolution to the Russia-Ukraine crisis and China's Covid-19 situation fades
- Time to think about how entrenched inflation will impact your cash holdings; To avoid an erosion of spending power, one should stay invested in income assets
- In Fixed Income, gain exposure to IG Credit; With global IG yields at c.3.8%, investors reap asymmetric benefits when switching from cash to IG
- Should the Fed fail to hike as aggressively, IG credit still stands to see capital gains amid yields on short-term bonds repricing lower
- Risk-reward advantageous for investors to deploy cash into high quality credit with 3-5 year duration, capitalising on the certainty of income generation
- In Equities, gain exposure to S-REITs given the consistency of dividend distribution and its ability to benefit from Singapore's re-opening
- S-REITs are a good inflation hedge given that rental and property values tend to rise in tandem; Provides strong total returns in a rising rates environment given sustainability in dividend payment
- Recommend investors to allocate 80% of the exposure to IG Credit and 20% to S-REITs

ASSET ALLOCATION

CASH+ investing to mitigate inflation

Adopt income strategy to tackle entrenched inflation. 2022 has proven to be a sobering experience for investors as this is one of those unique times where both equities and bonds have fallen in tandem. Clearly, the commonly held view of inflation peaking in the first half is off the mark by now as inflationary pressure rages on, fueled no less by the Russia-Ukraine conflict and Covid-19 situation in China.

Prevailing narratives suggest that the hope for a swift resolution to these headwinds is fading by the day and for portfolio allocators, now is perhaps the time to start thinking about how entrenched inflation will impact your cash holdings. To tackle the challenge of rising prices and avoid an erosion of spending power, one would need to stay invested in income assets and listed below are our recommendations:

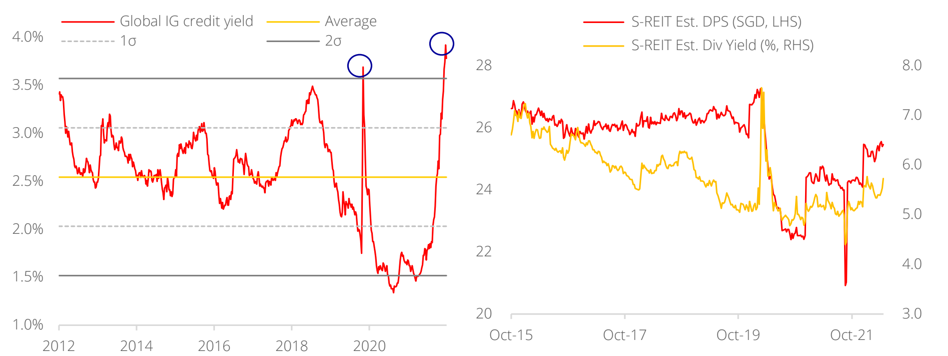
Inflation Winner in Fixed Income: Investment Grade (IG) Credit. The prospect of facing the highest inflation in 40 years leaves it difficult to imagine that cash would register positive real returns in the medium term. Yet the price for income certainty has scarcely been as reasonable as now, with global IG yields at c.3.8% - a level not seen in the last 10 years. Investors switching from cash to IG credit stand to reap asymmetric benefits. The key investment merits are:

- Should rate hikes proceed as anticipated, investors would still obtain a return on IG credit exceeding the anticipated higher deposit rates. With the aggressive Fed rhetoric, the Federal Open Market Committee (FOMC) median peak rate is at 2.75%, while the Fed funds futures peak pricing is at c.3%, both lower than the yield on IG credit.
- Even if the US Federal Reserve were unable to hike as aggressively as expected, IG credit would stand to see capital gains amid yields on short-term bonds repricing lower.
- We view this risk-reward advantageous for investors to deploy cash into short-dated (3-5 year duration), high quality credit – capitalising on the certainty of income generation while most other risk assets grapple with volatility.

Inflation Winner in Equities: Singapore REITs. We have in our publication *CIO Vantage Point – Inflation Chronicles* (April 2022) ascertained that Real Estate has historically outperformed during periods of heightened inflation given the ability of the sector to pass on rising costs to consumers. This view ties in with our positive stance on Singapore REITs (S-REITs). And indeed, S-REITs has delivered strong total returns given consistent dividend distribution and it is poised to benefit from the re-opening of the Singapore economy. The key investment merits are:

- Proxy to the real estate sector and good hedge for inflation as rental and property values rise in tandem. Provides strong total returns in a rising rates environment as the ability to sustain dividend payment is not affected.
- Strong position for rental increase in the office and industrial space given favourable demand-supply backdrop.

Figure 1: Global IG and S-REITs looking compelling



Source: Bloomberg, DBS

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