CIO Weekly

28 June 2022

Key Points

- Equities: S&P 500 attractive on a 12-month perspective; Sell-down in Technology reaching a tail-end
- Credit: Flight-to-quality provides tailwinds for quality credit
- FX: USD to depreciate in 2H22 after the surge in 1H22; USD/JPY to end 2022 below 130
- Rates: US recession potentially a massive headwind for Asia bonds as investors grapple with dollar strength and widening of risk and term premiums
- Thematics: Regional Oil & Gas prefer upstream oil players to downstream
- The Week Ahead: Keep a lookout for US Change in Initial Jobless Claims; Japan Industrial Production Numbers

GLOBAL CROSS ASSETS
Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	31,438.26	-0.2%	-13.5%
S&P 500	3,900.11	-0.3%	-18.2%
NASDAQ	11,524.55	-0.7%	-26.3%
Stoxx Europe 600	415.09	0.5%	-14.9%
DAX	13,186.07	0.5%	-17.0%
CAC 40	6,047.31	-0.4%	-15.5%
FTSE 100	7,258.32	0.7%	-1.7%
MSCI AxJ	669.86	1.6%	-15.1%
Nikkei 225	26,871.27	1.4%	-6.7%
SHCOMP	3,379.19	0.9%	-7.2%
Hang Seng	22,229.52	2.4%	-5.0%
MSCI EM	1,027.55	1.6%	-16.6%
UST 10-yr yield*	3.20	2.2%	169.0
JGB 10-yr yield*	0.24	5.3%	17.2
Bund 10-yr yield*	1.54	7.4%	172.6
US HY spread*	5.02	-1.0%	219.0
EM spread*	427.34	-0.6%	97.1
WTI (USD)	109.57	1.8%	45.7%
LMEX	3,967.70	1.2%	-11.9%
Gold (USD)	1,822.85	-0.2%	-0.3%

Source: Bloomberg
* Changes in basis points

Equities: Positive 12-month view for S&P 500

US corporate earnings remain resilient despite rising rhetoric on recession. US equities have suffered an acute selloff since the start of the year amid rising bond yields and geopolitical uncertainties. Adding on to the proverbial wall of worries are rising recession concerns as elevated inflationary pressure weighs on the outlook for investments and domestic consumption. Indeed, US domestic consumers are essentially stuck between a rock and a hard place today given falling assets prices and rising cost of living.

Despite the domestic headwinds, the earnings outlook for US companies remains resilient. According to Bloomberg consensus, corporate earnings growth (based on calendar year) is still expected at 17.8% in 2022 and 9.1% in 2023. While such a growth trajectory is not what one would typically consider as "spectacular", however, they are also not as dire as what the prevailing rhetoric on recession is suggesting.

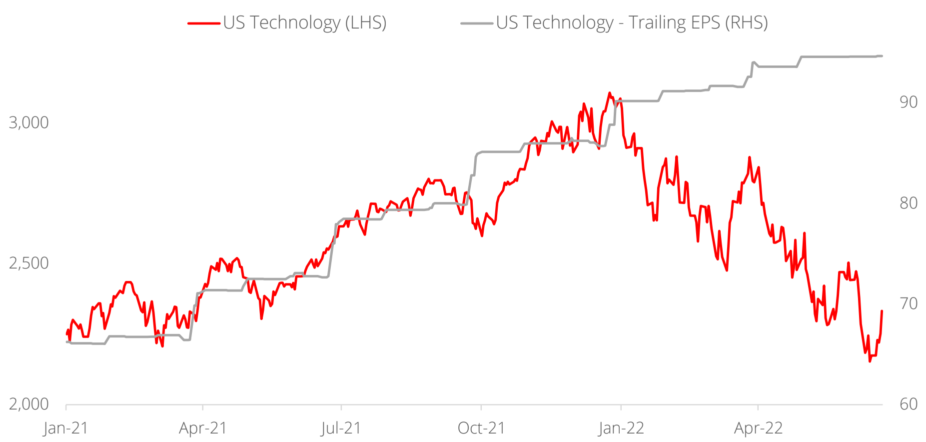
The resilience of US corporate profitability can be attributed to two factors: a) Globally diversified nature of US companies' revenue base and 2) Strong market positioning and ability of US companies in protecting their profit margins.

S&P 500 attractive on a 12-month perspective; Focus on Quality Plays. We have previously analysed how the S&P 500 tends to trade in subsequent 12-months after an acute correction at the start of the year. Our research concludes that US equities have historically rallied 20% on average, with positive returns occurring on four out of five occasions. Such findings underpin our view that the risk-reward of gaining exposure to the US market is looking increasingly attractive. We advise investors to focus on Quality Plays – companies that possess strong pricing power and market positioning.

Selldown in Technology reaching a tail-end. From a sectoral perspective, we do not advocate switching out of Technology as we believe the selldown (as a result of rising bond yields) is reaching a tail-end. At the end of the day, the Technology space is backed by resilient earnings and rising bond yields have limited impact on their long-term fundamentals.

Dylan Cheang | Strategist

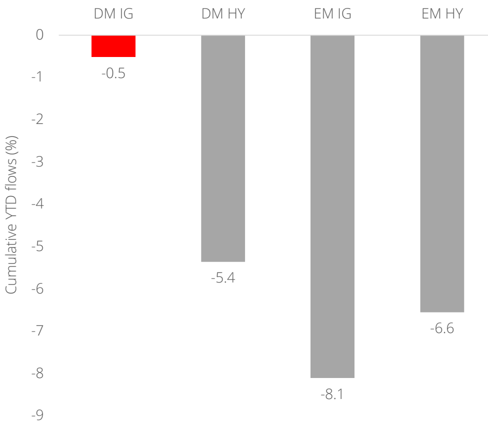
Figure 1: US Technology earnings stay resilient



Source: Bloomberg, DBS

Credit: Flight-to-quality provides tailwinds for quality credit

Figure 2: DM IG has faced minimal outflows YTD



Source: EPFR Global, DBS (data as at 8 June 2022

As we conclude the first half of 2022 faced with markets that have decidedly turned risk-off, we reiterate our preference to focus on quality. Under hawkish guidance by the Fed, the 2-10Y yield curve has flattened aggressively over the past months, even dipping into negative territory at the end of 1Q22, an inversion that has preceded every recession since 1957. Given growth concerns, investors seeking additional returns by taking on credit risk should seek the safety of quality and avoid taking on undue default risk amid the mid-to-late credit cycle dynamics.

Fund flows into high quality credit echo this flight-to-quality sentiment. As shown in Figure 2, flows into Developing Markets (DM) Investment Grade (IG) have been resilient in 2022 despite weakness across most risk markets. Where most higher risk EM or HY credit markets have experienced more than 5% in cumulative outflows year-to-date, DM IG credit has only seen a minute 0.5% reduction. Further flight-to-quality sentiment may present a tailwind for this space in the second half of 2022 as rates reprice higher against a backdrop of slowing growth concerns. We outline this and other benefits of switching from cash to quality credit in our 3Q22 Global Credit outlook.

Daryl Ho, CFA | Strategist

FX: A game of two halves

Figure 3: Heading south

Source: Bloomberg, DBS

We maintain that the USD will depreciate in 2H22 after its surge in 1H22. Although the Fed stepped up rate hikes from 25 bps in March to 50 bps in May and 75 bps in June, we forecast three 50 bps hikes in July, September, and November, and one final 25 bps hike in December. Our currency forecasts reflect that US bond yields have discounted the Fed Funds Rate rising above its 2.50% neutral rate to 3.50% this year.

Fed Chair Jerome Powell did not rule out a US recession from the frontloading of Fed hikes to restore price stability. St Louis Fed President James Bullard played down recession fears, citing the strong US labour market and healthy household savings. But the University of Michigan's consumer sentiment index fell to a record low of 50 in June. On 28 June, the Conference Board's consumer confidence index is also likely to head south to 100 (consensus) in June from 106.4. The Fed is committed to lifting rates until inflation eases. Thursday's Personal Consumption Expenditures (PCE) deflators will influence the Fed's decision to hike by 50 bps or 75 bps at the Federal Open Market Committee (FOMC) meeting on 27 July. Consensus expects PCE core inflation to ease to 4.8% y/y in May from 4.9% in April. However, the Fed is paying more attention to the monthly changes which consensus expects will rise to 0.4% m/m from 0.3%. As mentioned above, the bond market has priced in this year's hikes.

At a central bank panel discussion on 29 June, the European Central Bank (ECB), Fed, Bank of England (BOE), and Bank for International Settlements (BIS) are likely to agree on preventing a wage-price spiral and averting 1970s-style stagflation. The Fed and the BIS will favour frontloading hikes to restore price stability. The ECB and BOE will probably favour 25 bps hikes but keep the door open for larger moves if inflation stays persistently high. However, inflation is also becoming a cost-of-living crisis, especially in the UK. Consumers and voters are unhappy and looking for someone to blame. Opposition political parties blamed monetary and fiscal stimulus measures but incumbent governments attributed the higher prices to supply-side disruptions and Russia's invasion of Ukraine.

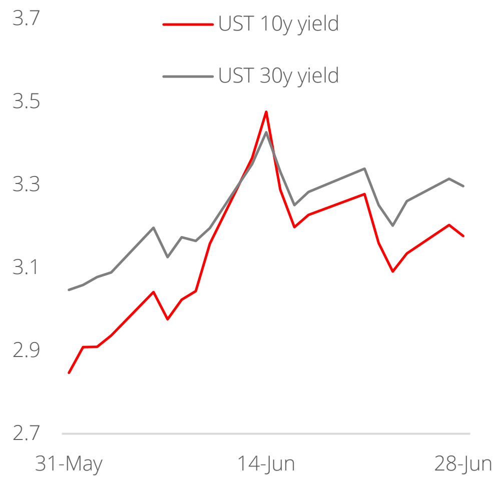
EUR has been in the 1.04 to 1.06 range since 10 June. The ECB is committed to hiking the deposit facility rate by 25 bps to -0.25% at its meeting 21 July and ending negative rates in 3Q22. The ECB should lean towards a 50 bps hike on 8 September if Friday's Eurozone Consumer Price Index increases to 8.5% y/y in June from 8.1% in May, with core inflation rising to 3.9% from 3.8%. ECB hawks are vigilant against second-round effects from wage demands and want rates to reach neutral or 1-2% this year. To facilitate this, the ECB should unveil the details of its antifragmentation tool at the July meeting.

USD/JPY fell back to 135.23 last Friday (24 June) after hitting a high of 136.71 on 22 June. The 10Y JGB yield held below 0.25% after the Bank of Japan reaffirmed its commitment to its yield curve control policy. However, it was also evident that the USD/JPY could not extend its uptrend when US bond yields fell on US recession fears and, to a lesser extent, a unified view from policymakers that a weak JPY was bad for Japan's economy. According to CFTC data, speculators trimmed their net long USD/JPY positions to 58,454 contracts last week, below 60K for the first week since 11 March. Risk reversals for the next six months also fell to March levels. We forecast USD/JPY ending 2022 below 130 this year.

Philip Wee | FX Strategist

Rates: June feels different from May

Figure 4: Pulling back



Source: Bloomberg, NY Fed, DBS

US rates have pulled back post the June Federal Open Market Committee. We have seen a similar-sized pullback in May where 5Y USD IRS also retracted around 40 bps lower and USD OIS/Fed fund futures also priced out close to 2 Fed hikes (50 bps). However, from the perspective of Asia rates and bonds, June's pullback in US rates feels quite different from the May experience. In both episodes, Asia swap rates and bond yields declined alongside US rates. The difference has been that Asia bonds' total returns were better supported in May, but in June, total returns are down even with the gains on duration/price.

Of late, we think that financial markets have repriced to low levels with regards to the likelihood that Asia central banks could surprise hawkish to the same extent as Developing Markets central banks. As a result, June's pullback in US rates have not lifted bond total returns like in May. Based our economists' forecasts, except for India and Indonesia, we face the prospect that all other Asia policy rates would be lower than the US come year-end. Another contributing factor for June's decline in Asia bond total returns, despite the fall in US rates, could also be the increased market expectations for a US recession, especially after Fed Chair Powell recently described a soft landing as "very challenging". From the perspective of Asia bonds, a US recession would be a massive headwind – US rates would fall but investors would likely have to confront a stronger US dollar and widening of risk and term premiums in Asia bonds.

As has usually been the case in recent months, the direction of China rates has gone against the regional trend over the past two weeks. 5Y CNY NDIRS have risen around 20 bps as there are some signs of improvement in the economic recovery, any prospects of rates cuts (to 7D reverse repo, 1Y MLF) are being priced out and accommodative funding rates seem to have hit a bottom.

Duncan Tan | Rates Strategist

Thematics: Regional Oil & Gas – Prefer upstream oil players to downstream

- Oil prices could spike again during upcoming peak demand season.
- Unfavourable regulatory policies in the region could cap refining margin upside though.
- Thus, we prefer upstream players to downstream, betting on Chinese oil majors.

Oil prices could potentially spike again in 3Q. The European Union officially announced its partial ban on Russian crude imports at the end of May, which skews the tight supply demand balance further. As we approach peak summer demand in the coming months, we could see oil prices potentially spiking beyond USD130/bbl again in the near term, in case of oil supply shortages. We are raising our average Brent crude oil price assumptions to USD102-107/bbl (from USD97-102/bbl) for 2022 and maintain USD90-95/bbl for 2023, significantly higher than USD71/bbl in 2021. Demand destruction concerns on the back of stagflation trends, Fed rate hikes, and Covid-related lockdowns in China have put a lid on the bullishness recently, but with China relaxing restrictions, oil demand could perk up again in 3Q.

Regional refiners hitting roadblock though. Global refiners (excluding China) have enjoyed rising crack spreads in the past two to three quarters. In China, refining margins have always been regulated with a robust pricing mechanism that imposes product retail price ceilings when oil price is above USD130/bbl, to control inflation. Meanwhile, for the first time, Thailand's Ministry of Energy is exploring policies to temporarily cap the refining crack spread, bringing about an overhang on potential government intervention risks. This might also raise concerns whether other governments in the region would follow suit to tame inflation.

Prefer upstream players to downstream. On the back of our positive stance on oil prices, DBS Group Research favours upstream players that will see another year of record profit and good dividend yield – in particular, Chinese oil majors.

Suvro SAKAR | Analyst

Pei Hwa HO | Analyst

Duladeth BIK | Analyst

William SIMADIPUTRA | Analyst

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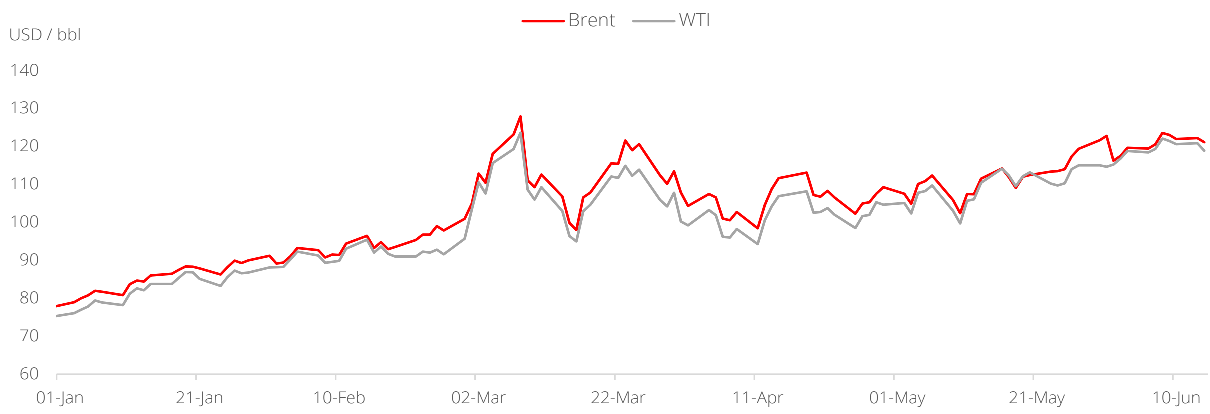
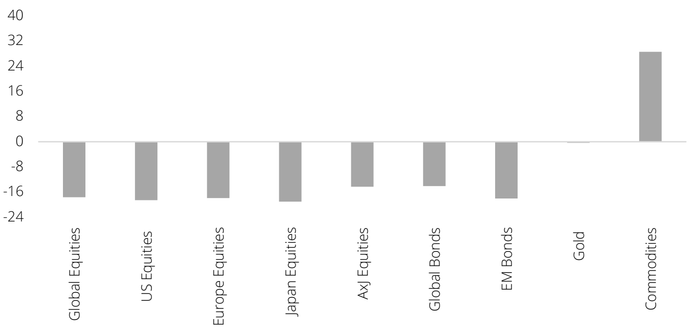
Figure 5: Oil looking to break out of the USD100-120/bbl range



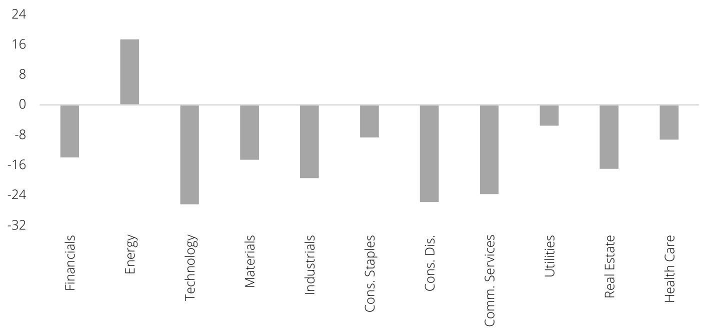
Source: Bloomberg, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

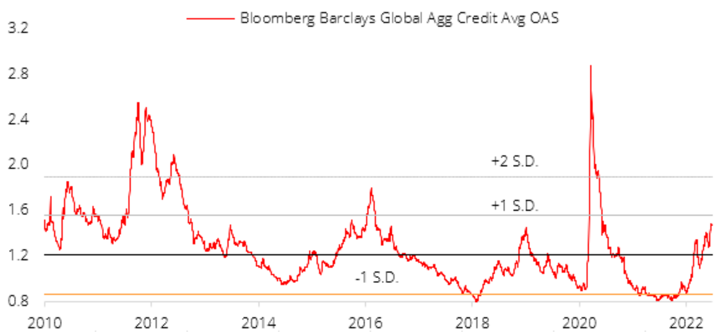


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

	1 week	MTD	QTD	YTD
Equities				
S&P 500	6.1%	-5.6%	-13.9%	-18.2%
NASDAQ	6.7%	-4.6%	-19.0%	-26.3%
Russell 2000	6.4%	-5.0%	-14.4%	-21.1%
Euro Stoxx 600	2.0%	-6.4%	-8.9%	-14.9%
Nikkei-225	4.3%	-1.5%	-3.4%	-6.7%
MSCI WORLD	5.1%	-6.0%	-14.1%	-18.8%
MSCI ACWI	4.9%	-5.9%	-13.6%	-18.6%
MSCI Asia ex-Japan	3.2%	-2.6%	-7.5%	-15.1%
MSCI EM	2.7%	-4.7%	-10.0%	-16.6%
HSCEI	5.6%	5.4%	3.9%	-5.1%
SHCOMP	1.9%	6.0%	3.9%	-7.2%
Hang Seng	5.0%	3.8%	1.1%	-5.0%
STI Index	1.3%	-2.9%	-8.0%	0.4%
Fixed Income				
Barclays Global Aggregate	0.7%	-3.5%	-8.5%	-14.1%
Barclays US Aggregate	0.3%	-2.6%	-5.7%	-11.3%
Barclays US High Yield	0.6%	-5.0%	-8.1%	-12.6%
Barclays Euro Aggregate	1.3%	-3.1%	-7.9%	-12.9%
Barclays Euro High Yield	-0.5%	-5.1%	-9.0%	-12.7%
JPM EMBI Global	0.2%	-4.6%	-9.7%	-18.0%
JPM EMBI Global Diversified	0.4%	-5.0%	-10.1%	-19.9%

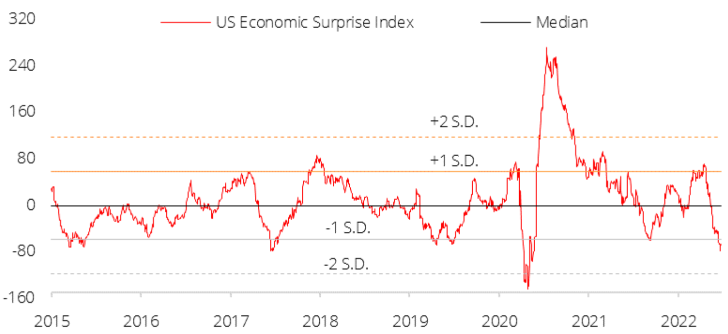
PRICES & SPREADS

	Spot	4Q21	3Q21	2Q21
Rates				
Fed Funds Target	1.75	0.50	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	3.20	2.34	1.51	1.49
Japanese Govt Bond 10-yr	0.24	0.21	0.07	0.07
German Bunds 10-yr	1.54	0.55	-0.18	-0.20
Spreads				
US Agg Corporate Spread	1.48	1.16	0.92	0.84
US Corporate HY Spread	5.02	3.25	2.83	2.89
Euro Agg Corporate Spread	1.98	1.31	0.97	0.87
EM USD Agg Spread	3.76	3.13	2.85	2.87
Currencies				
US Dollar Index (DXY)	103.9	98.3	95.7	94.2
EUR/USD	1.06	1.11	1.14	1.16
USD/JPY	135.5	121.7	115.1	111.3
USD/CNY	6.7	6.3	6.4	6.4
Commodities				
WTI Oil	110	100	75	75
London Metal Exchange (LMEX)	3968	5174	4502	4161
TR/CC CRB Commodity	299	295	232	229
Gold	1823	1937	1829	1757

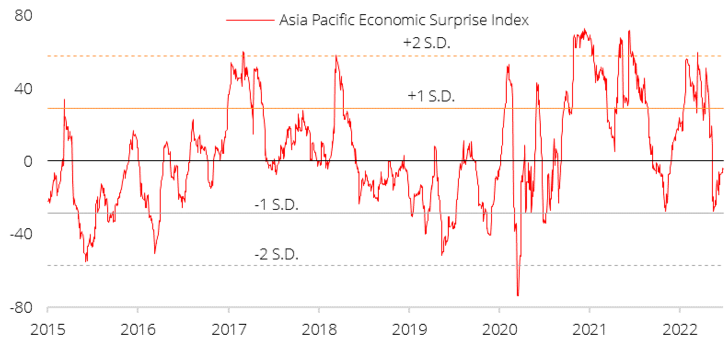
DBS

CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



MACRO CALENDAR

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims (US)	30-Jun	25-Jun	229k	229k
GDP Annualised q/q (US)	09-Jun	1Q	-1.50%	-1.50%
ISM Manufacturing (US)	01-Jul	Jun	54.5	56.1
Conf. Board Consumer Confidence (US)	28-Jun	Jun	100	106.4
MBA Mortgage Applications (US)	29-Jun	24-Jun	--	4.20%
S&P Global Eurozone Manufacturing PMI (EU)	01-Jul	Jun	52	52
S&P Global US Manufacturing PMI (US)	01-Jul	Jun	52.4	52.4
Personal Income (US)	30-Jun	May	0.50%	0.40%

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	29-Jun	May	-0.30%	-1.50%
Jobless Rate (JP)	30-Jun	May	2.50%	2.50%
Manufacturing PMI (CN)	29-Jun	Jun	50.5	49.6
Caixin China PMI Mfg (CN)	30-Jun	Jun	50.2	48.1
Tokyo CPI Ex-Fresh Food y/y (JP)	30-Jun	Jun	2.10%	1.90%
Jibun Bank Japan PMI Mfg (JP)	30-Jun	Jun	--	52.7
Tankan Large Mfg Index (JP)	30-Jun	2Q	13	14
Job-To-Applicant Ratio (JP)	30-Jun	May	1.24	1.23

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