CIO Insights 4Q22

Fed in Focus.

Rising Recession Risk

Fed Funds rate to rise towards 4.5% before a temporary pause for the Fed to assess impact on labour market and inflation. Investors need a better inflation hedge than cash.

Neutral Weight Equities

Stay with quality and dividend-yielding equities. This includes sectors with resilient demand despite Fed-induced recession risks, such as healthcare.

IG for Income

Investment Grade bonds, rated A/BBB with yields exceeding 5%, represent a stable source of income in our barbell strategy.

Dollar-cost Average

After years of zero rates and QE, swift policy normalisation has shaken risk assets, including safe-haven Treasuries. Dollar-cost average to add high quality bonds and equities.

DBS

Content

Executive Summary

Dear valued clients,

Markets saw no relief last quarter with increasing concerns of a global recession. After five rate hikes by the Fed totalling 300 bps since March, Treasury bond yields have more than tripled while equities have fallen 25%.

We see the Fed Funds rate rising towards 4.5% before taking a temporary pause for the Fed to assess the full impact of these hikes on the labour market and inflation.

The big question remains – have the markets sufficiently priced-in these headwinds?

Beyond the near-term market volatility, we see value emerging. We continue to advocate for portfolios to hold high quality bonds and stocks. For those with high cash levels, adopt a "dollar-cost average" approach to add A/BBB-rated bonds that are currently trading north of 5% as income generators in our barbell portfolio strategy. For secular growth equities, I.D.E.A. companies (Innovators, Disruptors, Enablers, Adapters) currently offer valuation buffers.

This quarter, we also highlight the investment themes of Luxury and Healthcare as beneficiaries of new lifestyle choices and demographic changes.

Do enjoy the read.

Hou Wey Fook, CFA
Chief Investment Officer

Hawkish Fed & Rising Recession Risks

ASSET ALLOCATION 4Q22

The world continues to grapple with geopolitical uncertainties and elevated inflation. With the recent 25% fall in equities, we believe equities now offer valuation buffers. We also continue to advocate high grade bonds and diversification with alternatives.

Source: Unsplash

Investment Summary 4Q22

Macro Policy

Fed's hawkish stance to drive down inflation suggests persistence of restrictive monetary policy.

Economic Outlook

Global consumption outlook impacted by monetary and fiscal policy tightening. China's timeline to ease zero Covid measures remains open-ended.

Equities

Topping out of bond yields will benefit growth stocks including Technology. Overweight ASEAN and Japan while maintaining Europe Underweight.

Credit

Sweet spot remains in A/BBB rated DM IG corporates. Maintain duration of 2-4 years where the roll down of the credit curve is the steepest.

Currencies

No let-up in USD strength as the Fed remains relentless in controlling inflation at the expense of growth. Monetary policy divergences weigh on both CNY and JPY.

Rates

Higher for longer USD rates as economy stays resilient. EUR curve to flatten as ECB tightens. Risks of BOJ adjustments begin to build.

Alternatives

Maintain Overweight in alternatives. The end of easy money warrants a more selective stance for private markets. Gold remains an important risk diversifier.

Commodities

Inflation Reduction Act and energy transition are bright spots for industrial metals amid dollar strength and weak demand from China and Europe.

Thematics

Structural changes in lifestyle and demographics make luxury and healthcare themes resilient.

Theme I: Luxury Never Goes Out of Fashion

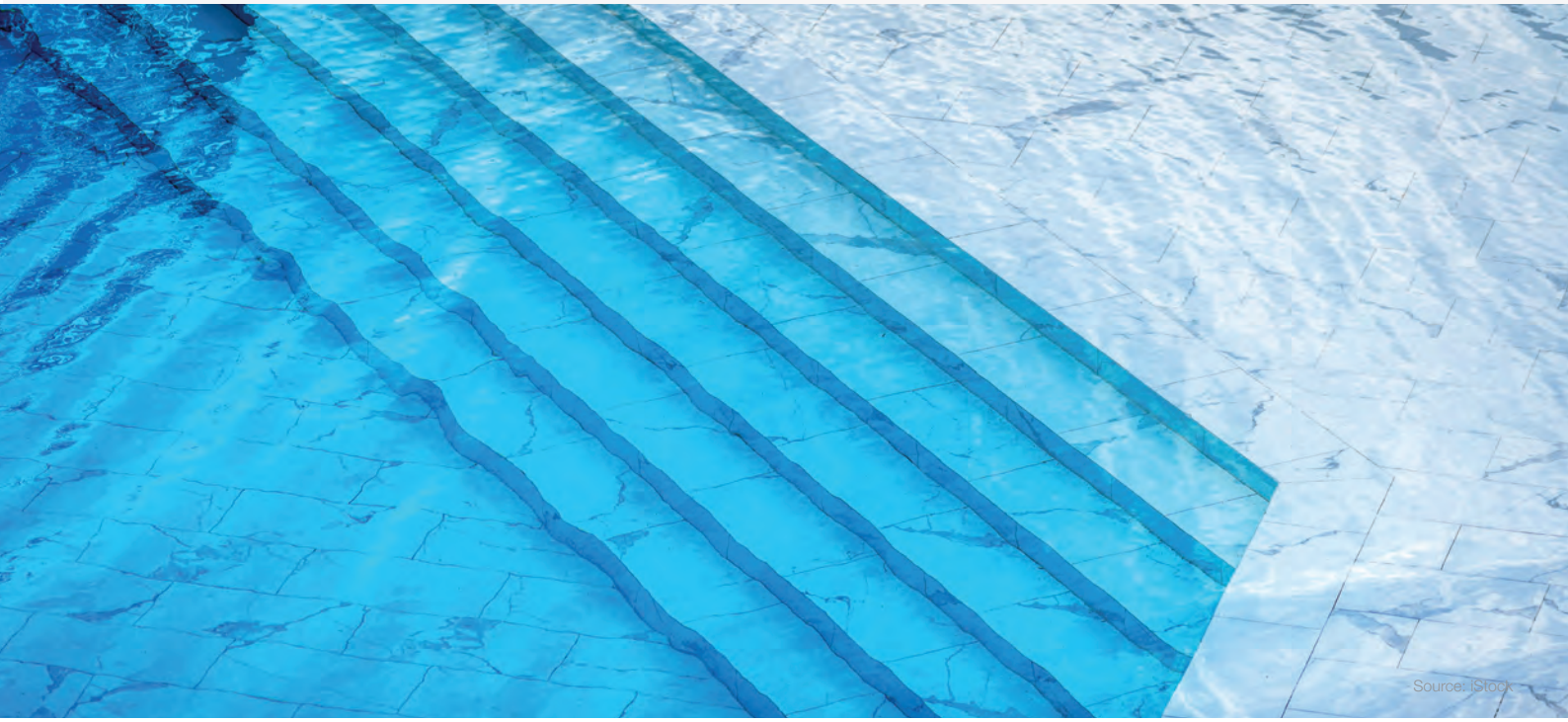
Despite a dampening consumption outlook, the luxury sector is set to remain in vogue, underpinned by (1) Digital lifestyles, (2) Millennial spending and (3) China's consumption.

The resilience of the sector, layered with the agility of successful players to pivot with the times, presents opportunities for investors to benefit from growth in global wealth.

Theme II: Healthcare - Positive Prognosis

The healthcare sector represents a significant 10% of total market capitalisation. Medical devices, in particular, is a strong area of growth with its Total Addressable Market stipulated to expand to USD800b by 2030.

Structural tailwinds underpinning sectoral dynamics include: (1) Growing demand for innovative devices and services, (2) Ageing population, (3) Prevalence of diseases.



01. Asset Allocation.

Hou Wey Fook, CFA
Chief Investment Officer

Dylan Cheang
Strategist

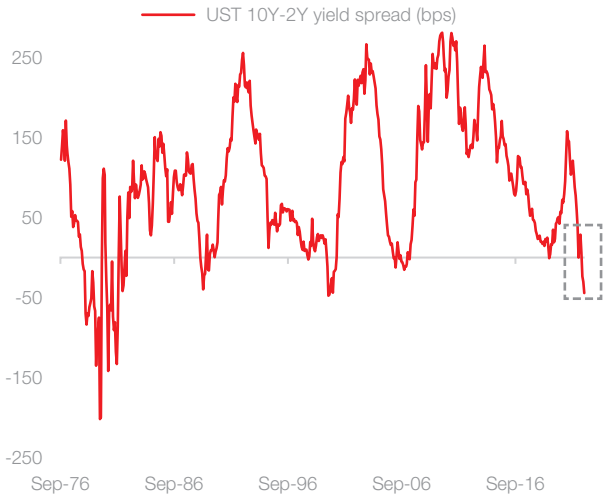
Recession concerns have dominated investor sentiment this year and this is unsurprising given acute macro headwinds globally. In the US, the Federal Reserve runs the risk of derailing the robust post-pandemic recovery in its zeal to play catch-up and control inflation through aggressive monetary tightening. And while the central bank hopes to engineer a "soft landing", this scenario is not necessarily a given.

Across the Atlantic in Europe, the region continues to grapple with the fallout from the Russia-Ukraine crisis and elevated energy prices. Over in Asia, uncertainties surrounding China's Covid policies remain a drag on consumer/business confidence and the country's growth prospects. The untimely convergence of these headwinds suggests that economic moderation is on the cards.

Probability of a Fed-induced recession on the rise. The FOMC has, in a widely expected move, hiked the Fed Funds rates by 75 bps to 3.25% in the September policy meeting. Based on the Summary of Economic Projections (SEP) table, the committee now expects the Fed Funds rate to peak at 4.6% by end-2023 (up from 3.8% in the June SEP estimates) and 3.9% by end-2024 (up from 3.4% in the June SEP).

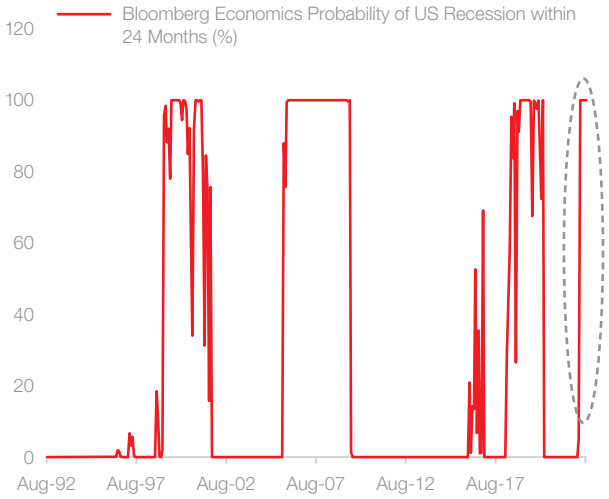
Fed Chair Jerome Powell made it clear that bringing inflation back down to 2% remains paramount as the central bank seeks to restore price stability to the economy. He also cautioned that the likelihood of a "soft landing" for the American economy has diminished as restrictive monetary policy persists for longer.

Yield curve inversion suggests rising recession risk



Source: Bloomberg, DBS

Probability of recession within the next 24 months is 100%



Source: Bloomberg, DBS

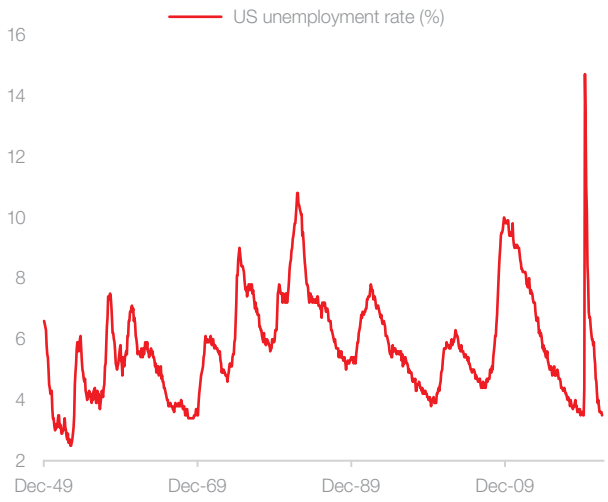
The acute shift in monetary policy stance suggests that the risk of a Fed-induced recession has increased materially. After all, bringing inflation down to 2% necessitates substantial demand destruction which will, in turn, bring significant pain to the economy. Market indicators are already suggesting that a recession is imminent:

- The US Treasury 2Y/10Y yield curve is deeply inverted and this, historically, is a harbinger for impending recessions.
- According to Bloomberg Economics, the probability of a recession in the US within the next 24 months is now 100%.

Most likely scenario: A mild recession. In any case, should a recession eventually transpire, we believe it will likely be mild and our view is premised on the following factors:

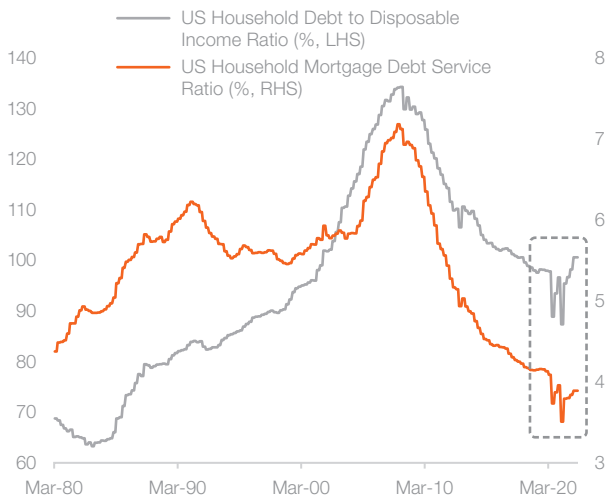
- Absence of systemic imbalances: Since the peak of the GFC in 2008, American consumers have undergone substantial deleveraging and today, household debt as percentage of disposable income stands at 101%, down from 134% in May 2008. Households' exposure to the property market has declined as well with mortgage debt service ratio falling from 7.2% in Feb 2008 to 3.9% currently.
- Prevalence of strong labour market: The post-pandemic rebound in the US labour market continues; unemployment rate fell to a low of 3.5%, pushing wage growth higher along the way. The persistence of a strong labour market augurs well for domestic consumption resilience in the US.

US unemployment rate near historical lows



Source: Bloomberg, DBS

US households' leverage on the decline since 2007-08 Global Financial Crisis

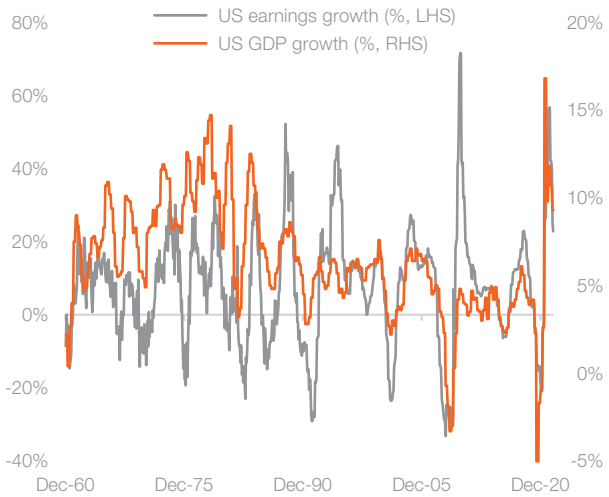


Source: Bloomberg, DBS

Recession impact on corporate earnings. Given rising recession risks, it is therefore imperative to analyse what impact an economic downturn will have on corporate profitability. Using the US as a proxy, we looked at data stretching back to the 1980s and analysed the recession impact on earnings and valuations. Listed below are the key findings:

- US recessions last an average of 11 months and the average change in GDP growth during those periods is -4.7%pts.
- While corporate earnings fall by an average of 11.6%, it is however, partly offset by substantial valuation multiple expansion (trailing P/E ratio expands by 7.2% on average).

Relationship between GDP growth and corporate earnings



Source: Bloomberg, DBS
* Note: Chart is truncated

Recession impact on corporate earnings since 1980

Period	Recession	Number of months	Change in US GDP (%pts)	Change in earnings (%)	Change in P/E (%)
Jan 1980 to Jul 1980	Energy Crisis and Inflation Recession	7	-2.0	7.1	5.3
Jul 1981 to Nov 1982	Double-Dip Recession	17	-9.9	-2.6	8.4
Jul 1990 to Mar 1991	Savings & Loans Crisis and Gulf War Recession	9	-3.4	-8.2	14.1
Mar 2001 to Nov 2001	Dot-Com Crash and September-11 Recession	9	-2.7	-17.5	11.4
Dec 2007 to Jun 2009	The Great Recession	19	-8.3	-42.8	8.5
Feb 2020 to Apr 2020	COVID-19 Recession	3	-1.9	-5.6	-4.4
Average		**11**	**-4.7**	**-11.6**	**7.2**

Source: Bloomberg, DBS

Impact of a mild recession on corporate earnings since 1980

Period	Recession	Number of months	Change in US GDP (%points)	Change in earnings (%)	Change in P/E (%)
Jan 1980 to Jul 1980	Energy Crisis and Inflation Recesssion	7	-2.0	7.1	5.3
Jul 1990 to Mar 1991	Savings & Loans Crisis and Gulf War Recession	9	-3.4	-8.2	14.1
Mar 2001 to Nov 2001	Dot-Com Crash and September-11 Recession	9	-2.7	-17.5	11.4
Feb 2020 to Apr 2020	Covid-19 Recession	3	-1.9	-5.6	-4.4
Average		**7**	**-2.5**	**-6.0**	**6.6**

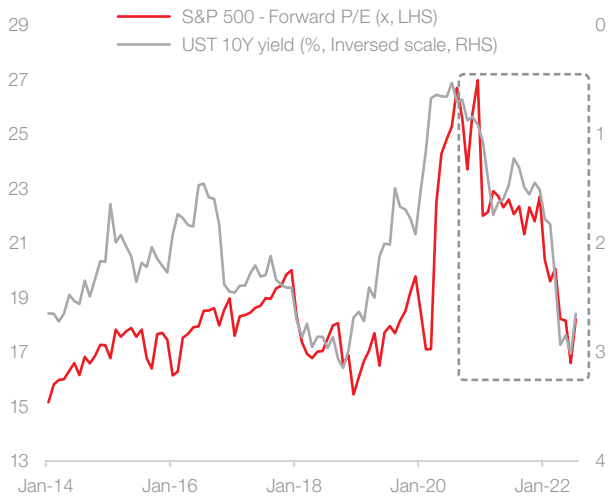
Source: Bloomberg, DBS

Taking our analysis one step further, we studied how earnings will be affected in the event of a mild recession. For this purpose, we stripped out periods where GDP growth moderated sharply (during the early-80s recession and the GFC). Below, our findings:

- On average, mild US recessions last seven months and the change in GDP growth is -2.5%pts.
- Average decline in corporate earnings is 6.0% and this is offset by valuation expansion of 6.6%.

We believe the assumption of a mild recession and a 6% corporate earnings decline is most reflective of the current situation. Moreover, a valuation multiple expansion of 6.6% should not come as a surprise given that most of the valuation contraction (on the back of rising bond yields) has already taken place this year.

US valuations have undergone substantial contraction amid rising yields concerns



Source: Bloomberg, DBS

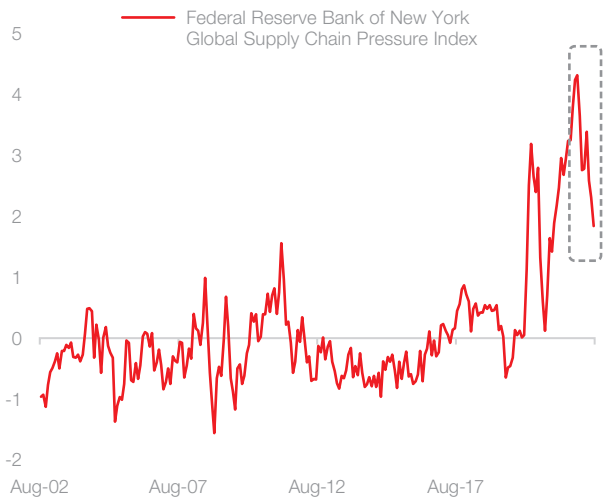
Glass half full: The case for peak inflation

Forward indicators point to the imminence of peak inflation. Despite an increasingly hawkish Fed rhetoric and backward-looking economic data suggesting the persistence of heightened inflation, we believe peak inflation is round the corner and our view is premised on the following factors:

- Easing supply chain bottlenecks: Supply chain bottlenecks as a result of the Covid-19 pandemic are showing sustained signs of easing as economies return to normalcy. According to the Federal Reserve Bank of New York Global Supply Chain Pressure Index, supply chain stress has evidently peaked in Dec 2021 and is currently on a sharp decline, falling 66% this year. We expect this trend to persist.

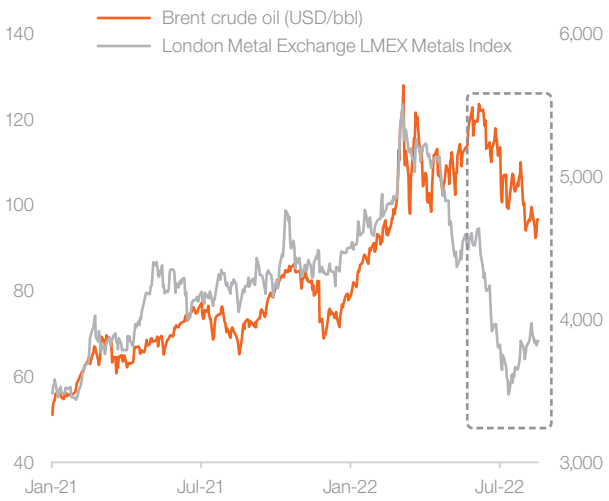
- Falling commodity prices: Global commodity prices are declining sharply on the back of recession fears and potential growth moderation. The Bloomberg Commodity Index was down 8% since end May and on a segmental basis, crude oil and industrial metals lost 23% and 17% respectively.

Global supply chain stress on the mend



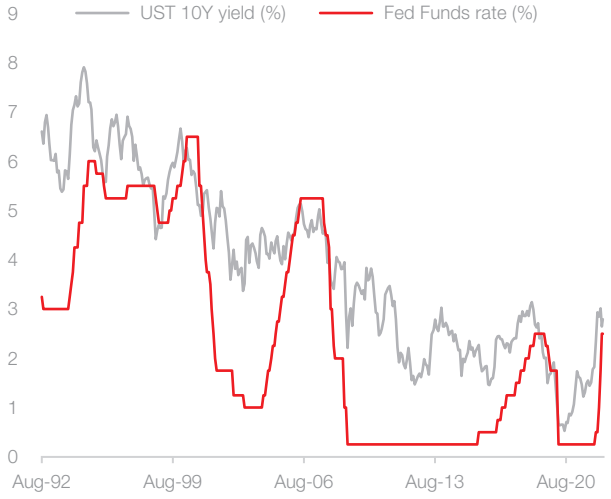
Source: Bloomberg, DBS

Crude oil and base metal prices on the retreat amid rising recession fears



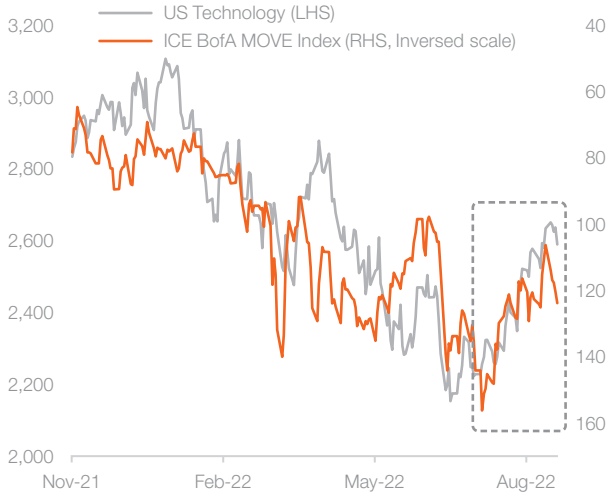
Source: Bloomberg, DBS

The peaking of US policy rate has historically coincided with falling bond yields in subsequent months



Source: Bloomberg, DBS

US Technology stocks rebound amid easing rates volatility



Source: Bloomberg, DBS

Peaking policy rate and retracing bond yields – A historical perspective. History has taught us one thing. The bond market does not require the Fed to start cutting rates before yields trade lower. As long as signs of a peak in Fed policy rates is imminent, bond yields would historically start trending lower as investors price forward. We believe this will also be the case in 2023.

Based on our economic forecast, the Fed Funds rate is expected to peak at 5.0% by 1Q23 and maintain at this level for the rest of the year. Below, highlights of how bond yields traded previously when Fed policy rate peaked:

- In the 1999-2000 policy tightening cycle, the Fed Funds rate peaked at 6.5% in May 2000 and the UST 10Y yield fell 2.9%pts in the subsequent 36 months.
- In the 2004-2006 policy tightening cycle, the Fed Funds rate peaked at 5.25% in June 2006 and the UST 10Y yield fell 2.9%pts in the subsequent 30 months.
- In the 2015-2018 policy tightening cycle, the Fed Funds rate peaked at 2.5% in December 2018 and the UST 10Y yield fell 2.2%pts in the subsequent 19 months.

Growth Equities: Endure short-term volatility to position for long-term upside. The Fed's resolve in containing inflation through hawkish rate hikes is negative for the outlook of growth equities as rising cost of capital weighs on valuations. Since the start of the year, valuations have indeed undergone substantial contraction. But at current levels, we believe many of the headwinds have been substantially priced-in. While the segment may stay volatile in coming months, the risk-reward looks fair from a 12-month perspective.

Position for peak bond yields through Technology plays. Technology stocks bore the brunt of the selldown on yield concerns this year. But as the inflationary environment and bond yields eventually turn the corner in the coming months, we expect the Technology space to lead the pack in terms of market returns.

Our optimism on Technology is premised on the view that the digital disruption wave is secular, and while short-term macroeconomic factors (such as rising bond yields) may derail its trajectory momentarily, the long-term trend remains. Above all, fundamentals for Technology have remained robust despite prevailing economic headwinds. For instance:

» The sector is forecasted to register earnings growth of 21% in 2022 and 10% 2023 respectively (vs 10% and 6% respectively for global equities).

» In the recent 2Q22 earning season, Technology accounted for robust earnings surprise of 82.9%.

» In terms of profitability, Technology's operating margin is currently 11% wider than the broader US market (vs 9% in Dec 2019).

Cross Assets – Stay the course as macro headwinds intensify. Our CAA framework suggests that equities as an asset class remains marginally more attractive than bonds (composite score of 0.05 vs. 0.03).

Fundamentals: The sharp spike in Fed hawkishness and strong resolve in taming inflation will only mean one thing: The central bank is more than willing to drastically cool down the US labour market and domestic economic momentum if this is what it takes to control prices. Expect growth to moderate and joblessness to increase.

Over in Asia, the economic outlook for China remains challenging amid pandemic restrictions and property sector concerns. The domestic challenges are, however, partly mitigated by robust external demand as post-pandemic business activities return to normalcy.

On corporate earnings, the 2Q US reporting season saw an earnings surprise of 75%, led by strength in Energy, Real Estate, and Technology. Given rising prices, companies/sectors that fail to pass on costs to consumers would face margin pressure in the coming months.

4Q22 Asset Allocation – Stay the course as macro headwinds intensify

Categories	Indicators	Score Range	Equities				Bonds		
			US	Europe	Japan	AxJ	DM Govt	DM Corp	EM Bonds
Fundamentals	PMI	-1 to +1	-1	-1	0	1	1	1	0
	Economic surprise	-1 to +1	-1	-1	0	1	1	1	0
	Inflation	-1 to +1	0	-1	0	-1	0	0	-1
	Monetary policies	-1 to +1	0	0	0	-1	0	0	-1
	Forecasted EPS growth	-2 to +2	2	-1	0	0	-	0	0
	Earnings surprise	-2 to +2	1	-1	1	1	-	0	0
Valuation	Forward P/E	-2 to +2	0	0	0	1	-	-	-
	P/B vs ROE	-2 to +2	0	0	-1	1	-	-	-
	Earnings yield - 10-yr yield	-2 to +2	1	0	1	1	0	0	0
	Free Cashflow yield	-2 to +2	1	0	1	0	-	-	-
	Credit spread	-2 to +2	-	-	-	-	-	0	-1
Momentum	Fund flows	-2 to +2	1	-1	0	0	1	0	-1
	Volatility	-1 to +1	0	0	0	0	0	-	-
	Catalysts	-2 to +2	0	0	0	0	0	0	-1
Raw Score			4	-6	2	4	3	2	-5
Adjusted Score*			**0.19**	**-0.29**	**0.10**	**0.19**	**0.27**	**0.13**	**-0.31**

*Note: The "Adjusted Score" is calculated using the "Raw Score" divided by the maximum attainable score for each category. Source: DBS

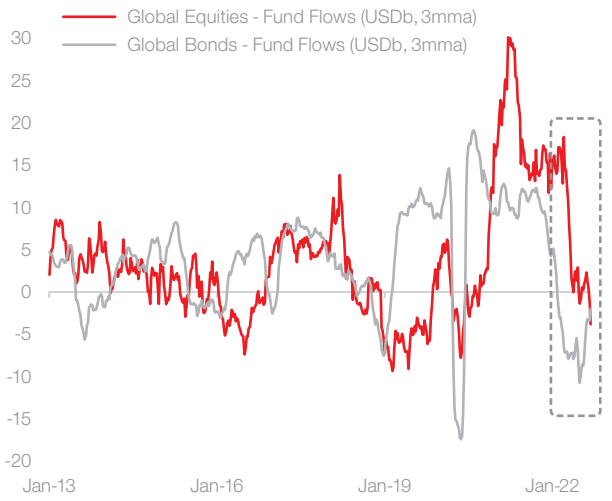
Valuation: The gap between US earnings yields and Treasury yields contracted in 3Q. But at 1.8% (as of 13 September), equities as an asset class still remains more attractive than bonds.

Momentum: Global equities registered outflows of USD23.2b in 3Q22 (as of 7 Sep), while bonds saw inflows of USD16.5b as investor appetite for government bonds surged during the quarter. Cross-asset flows suggest an ongoing flight to safety among portfolio allocators.

Equities: US equities lead the pack again as appetite for growth returns. US equities suffered a torrid first half as investors' concerns on rising bond yields triggered a rotation from cyclicals to non-cyclicals. US equities, given their huge exposure to cyclical sectors like Technology, bore the brunt of the selldown with a 21.1% loss on a total returns basis. However, given toppish bond yields and rising recession concerns, the search for growth is back in the current quarter as portfolio allocators adopt a longer-term view and position in this space. On a quarter-to-date basis, US equities gained 4.6% (as of 13 September) and vastly outperformed Japan (-0.1%), Europe (-0.9%), and Asia ex-Japan (-2.7%).

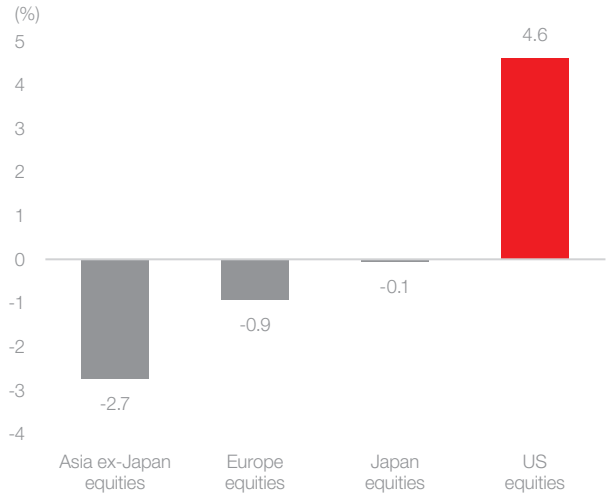
We expect the sectoral shift from non-cyclicals to cyclicals to persist in 4Q22 and this will, in turn, support the momentum for US equities. Fund flow data from EPFR Global underpin our constructive view. On a quarter-to-date basis, US equities garnered slight inflows of USD8.6b (as of 7 Sep) and this marked a stark contrast to the outflows seen in other markets: Europe (-USD14.3b), Japan (-USD4.7b), and Asia ex-Japan (-USD4.6b). Europe registered the strongest outflow during the quarter as asset allocators continued to de-risk their portfolios

Fund flows turning the corner



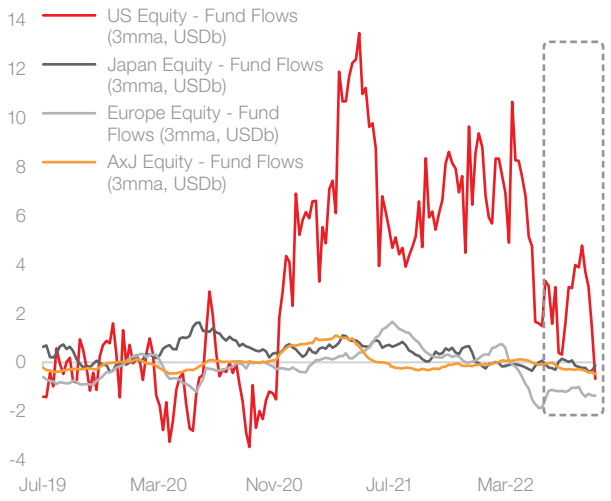
Source: EPFR Global, DBS

US equities led the pack in 3Q22



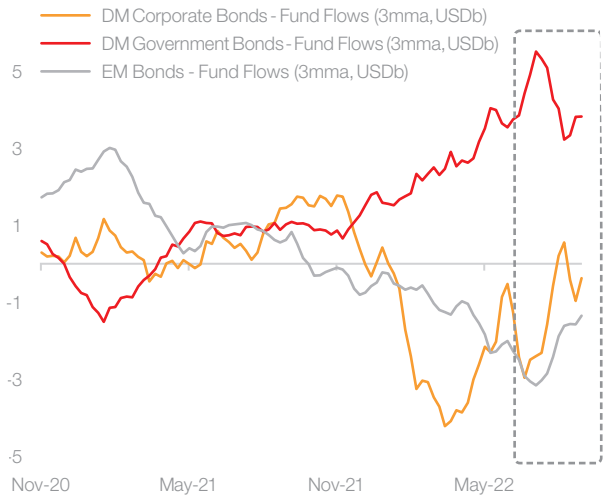
Source: Bloomberg, DBS
Note: Performance as of 13 September 2022.

Fund flows for key equity markets



Source: EPFR Global, DBS

Strong flows into DM government bonds



Source: EPFR Global, DBS

in the wake of lingering geopolitical tensions and spiralling inflation in the region. We stay Underweight on Europe.

Bonds: Stick to quality plays in DM corporate bonds. We turned positive on US Treasuries (under DM Government Bonds) in 3Q22 as Fed hawkishness has been sufficiently priced-in and peak bond yields are around the corner. Moreover, US Treasuries will also benefit from the flight-to-safety as portfolio allocators prepare for the plausibility of an impending recession. Fund flow data from EPFR Global broadly reflects this shift in investors' positioning as DM Government Bonds registered inflows of US38.4b (as of 7 Sep), compared to inflows of USD9.7b for DM corporate bonds and outflows of USD10.5b for EM bonds.

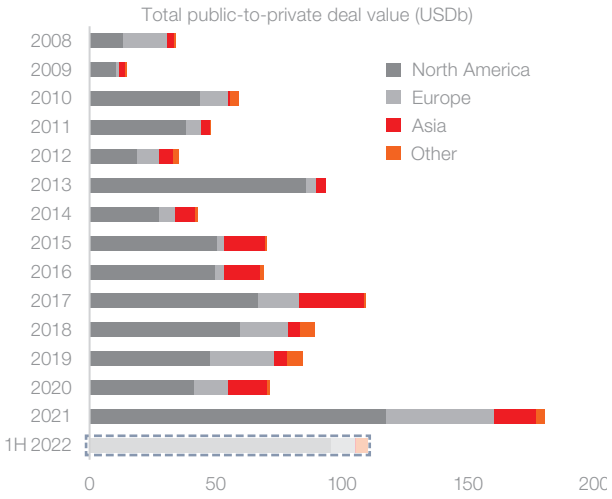
In the credit space, we maintain a preference for quality DM IG bonds as we head into 4Q22. With the Fed maintaining a tightening bias during the quarter, quality bonds will be best positioned to withstand the rising rates given (a) stronger credit fundamentals and cash flow generation and (b) lower refinancing risks. We favour DM IG bonds in the A/BBB rating bucket at 2-4 years duration while on a sectoral basis, we favour Energy, Materials, and Technology.

Alternatives: Seeking private asset opportunities in a rising rates environment. Prior years of easy money have pushed private assets valuation to historical highs. But clearly, those days are over and with the Fed embarking on monetary tightening, certain segments of the private assets space will face headwinds in the coming quarters. That said, with challenges come opportunities. While the rise in the cost of capital inflicts pain on highly leveraged companies, it also presents new opportunities for investors with dry powder, for instance:

- Private Equity: Valuations have fallen as a result of rising rates and this translates to a sharp increase in public-to-private deals with more than USD110b done during the first half of this year (as compared to USD181b for the whole of 2021). From a debt servicing perspective, rising rates will no doubt be a strain on the cash flow of deals that are highly leveraged. Henceforth, investments with low leverage in the venture and growth capital space are preferred.

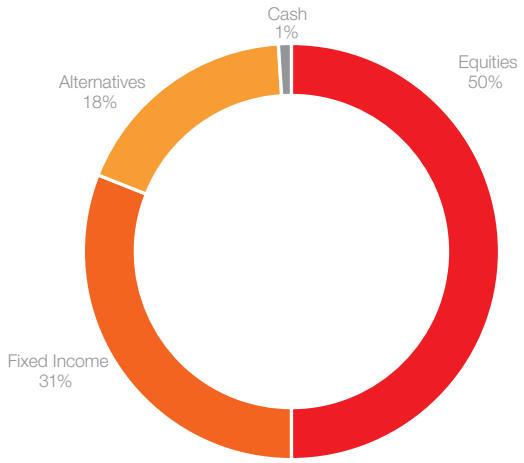
- Private Debt: In the Private Debt space, Direct Lending will be a geared beneficiary of rising bond yields as loans are made based on floating rates and a rising bond yield environment will translate to higher interest income for the lenders. Meanwhile, tightening financial conditions may, at some point, also surface new opportunities in the Special Situations/Distressed Debt space as companies struggle to refinance their debt and manage operating costs.

Public-to-private transactions



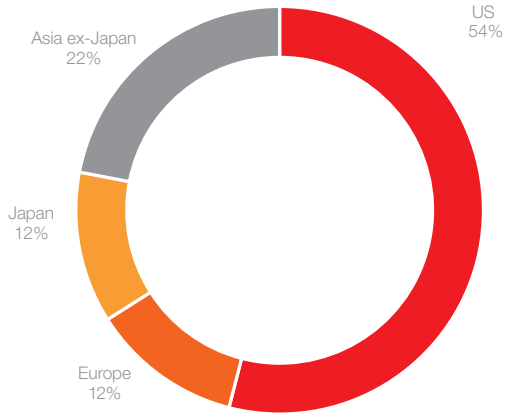
Source: Preqin, DBS

TAA breakdown by asset class (Balanced Profile)



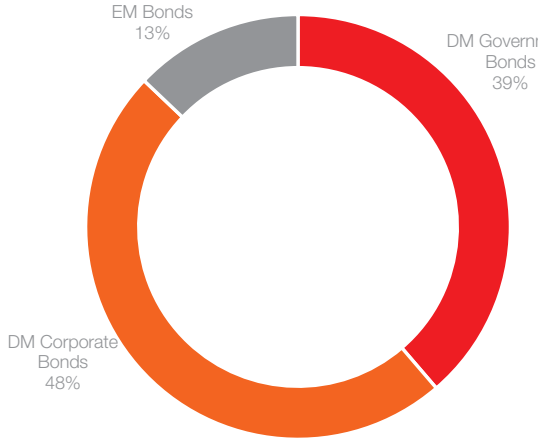
Source: DBS

TAA breakdown by geography within equities (Balanced Profile)



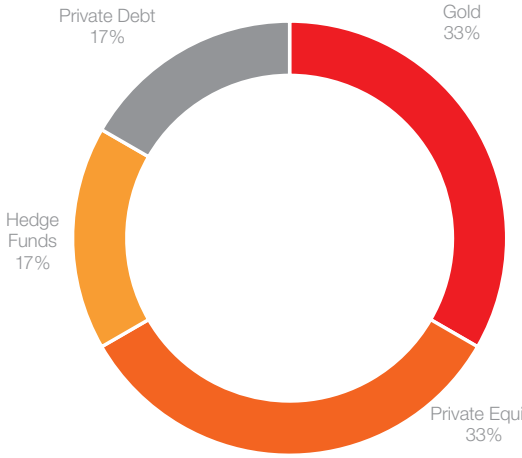
Source: DBS

TAA breakdown by bond types within fixed income (Balanced Profile)



Source: DBS

TAA breakdown by segments within Alternatives (Balanced Profile)

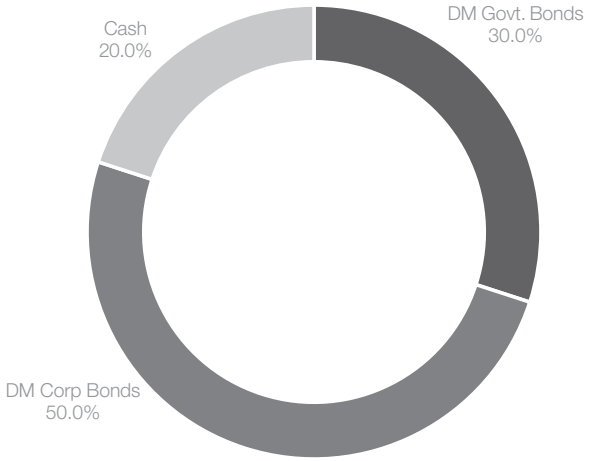


Source: DBS

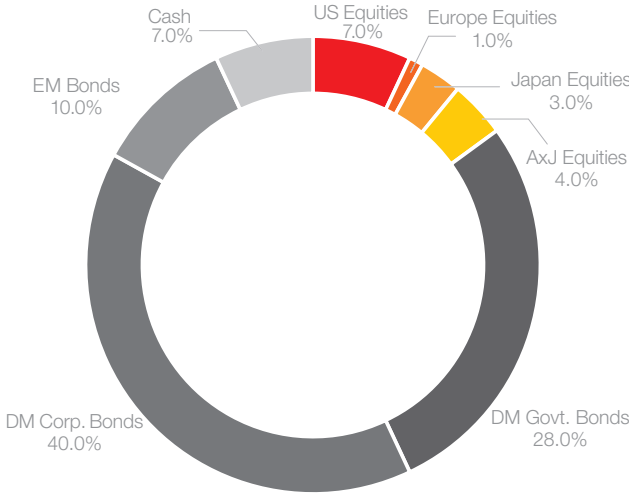
4Q22 Global Tactical Asset Allocation

	3-Month Basis	12-Month Basis
Equities	**Neutral**	**Neutral**
US Equities	Overweight	Overweight
Europe Equities	Underweight	Underweight
Japan Equities	Overweight	Underweight
Asia ex-Japan Equities	Overweight	Overweight
Fixed Income	**Underweight**	**Underweight**
Developed Markets (DM) Government Bonds	Overweight	Underweight
Developed Markets (DM) Corporate Bonds	Neutral	Neutral
Emerging Markets (EM) Bonds	Underweight	Neutral
Alternatives	**Overweight**	**Overweight**
Gold	Overweight	Overweight
Private Assets & Hedge Funds	Overweight	Overweight
Cash	**Underweight**	**Neutral**

Source: DBS



Source: DBS



Source: DBS

CONSERVATIVE

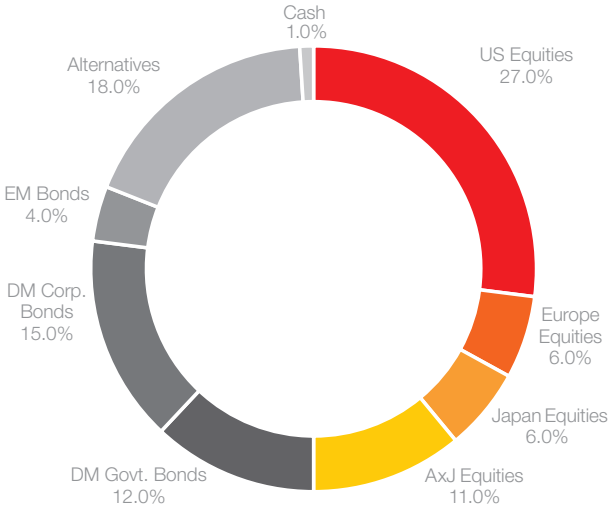
	TAA	SAA	Active
Equities	**0.0%**	**0.0%**	
US	0.0%	0.0%	
Europe	0.0%	0.0%	
Japan	0.0%	0.0%	
Asia ex-Japan	0.0%	0.0%	
Fixed Income	**80.0%**	**80.0%**	
Developed Markets - Government	30.0%	30.0%	
Developed Markets - Corporate	50.0%	50.0%	
Emerging Markets	0.0%	0.0%	
Alternatives	**0.0%**	**0.0%**	
Gold	0.0%	0.0%	
Private Assets & Hedge Funds	0.0%	0.0%	
Private Equity	0.0%	0.0%	
Hedge Funds*	0.0%	0.0%	
Private Debt	0.0%	0.0%	
Cash	**20.0%**	**20.0%**	

*Only P4 risk rated UCITs Alternatives

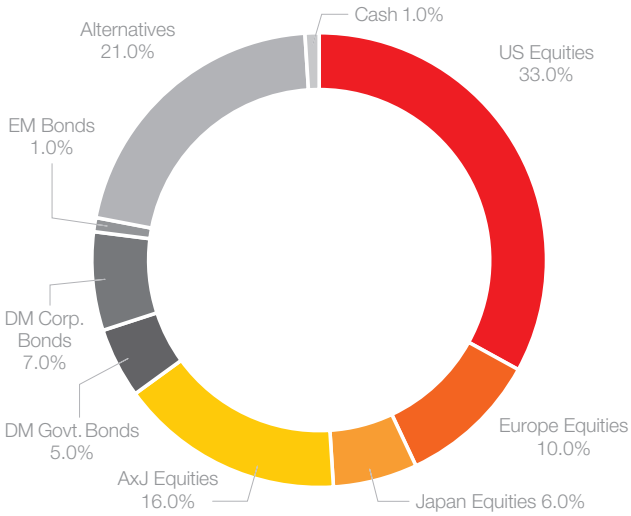
MODERATE

	TAA	SAA	Active
Equities	**15.0%**	**15.0%**	
US	7.0%	6.0%	1.0%
Europe	1.0%	4.0%	-3.0%
Japan	3.0%	2.0%	1.0%
Asia ex-Japan	4.0%	3.0%	1.0%
Fixed Income	**78.0%**	**80.0%**	**-2.0%**
Developed Markets - Government	28.0%	20.0%	8.0%
Developed Markets - Corporate	40.0%	40.0%	
Emerging Markets	10.0%	20.0%	-10.0%
Alternatives	**0.0%**	**0.0%**	
Gold	0.0%	0.0%	
Private Assets & Hedge Funds	0.0%	0.0%	
Private Equity	0.0%	0.0%	
Hedge Funds*	0.0%	0.0%	
Private Debt	0.0%	0.0%	
Cash	**7.0%**	**5.0%**	**2.0%**

*Only P4 risk rated UCITs Alternatives



Source: DBS



Source: DBS

BALANCED

	TAA	SAA	Active
Equities	**50.0%**	**50.0%**	
US	27.0%	25.0%	2.0%
Europe	6.0%	10.0%	-4.0%
Japan	6.0%	5.0%	1.0%
Asia ex-Japan	11.0%	10.0%	1.0%
Fixed Income	**31.0%**	**35.0%**	**-4.0%**
Developed Markets - Government	12.0%	10.0%	2.0%
Developed Markets - Corporate	15.0%	15.0%	
Emerging Markets	4.0%	10.0%	-6.0%
Alternatives	**18.0%**	**10.0%**	**8.0%**
Gold	6.0%	5.0%	1.0%
Private Assets & Hedge Funds	12.0%	5.0%	7.0%
Private Equity	6.0%	2.4%	3.6%
Hedge Funds*	3.0%	2.0%	1.0%
Private Debt	3.0%	0.5%	2.5%
Cash	**1.0%**	**5.0%**	**-4.0%**

*Only P4 risk rated UCITs Alternatives

AGGRESSIVE

	TAA	SAA	Active
Equities	**65.0%**	**65.0%**	
US	33.0%	30.0%	3.0%
Europe	10.0%	15.0%	-5.0%
Japan	6.0%	5.0%	1.0%
Asia ex-Japan	16.0%	15.0%	1.0%
Fixed Income	**13.0%**	**15.0%**	**-2.0%**
Developed Markets - Government	5.0%	4.0%	1.0%
Developed Markets - Corporate	7.0%	7.0%	
Emerging Markets	1.0%	4.0%	-3.0%
Alternatives	**21.0%**	**15.0%**	**6.0%**
Gold	6.0%	5.0%	1.0%
Private Assets & Hedge Funds	15.0%	10.0%	5.0%
Private Equity	7.0%	4.9%	2.1%
Hedge Funds*	5.0%	4.0%	1.0%
Private Debt	3.0%	1.1%	1.9%
Cash	**1.0%**	**5.0%**	**-4.0%**

*Only P4 risk rated UCITs Alternatives

Notes:
1. The above are based on three-month views.
2. Asset allocation does not ensure a profit or protect against market loss.
3. "TAA' refers to "Tactical Asset Allocation". "SAA" refers to "Strategic Asset Allocation".
4. Based on the SAA model, the Aggressive model has the highest risk, followed by Balanced, Moderate, and Conservative, with Conservative being the least risky.
5. The investor type classification for the portfolio has no direct relationship with the Financial Needs Analysis customer risk profile types and the portfolios are not assigned any product risk rating based on the bank's proprietary risk rating methodology.

Inflation Stays Elevated

MACROECONOMICS 4Q22

The Fed has ratcheted up its hawkishness and we see the Fed Funds rate at 4.5% by end-2022. Exogenous shocks continue to pose the biggest risk to the Eurozone's economic outlook. Asia remains steady despite global headwinds, with resilient export earnings.

Source: Unsplash

02. Macroeconomics.

Taimur Baig, Ph.D.
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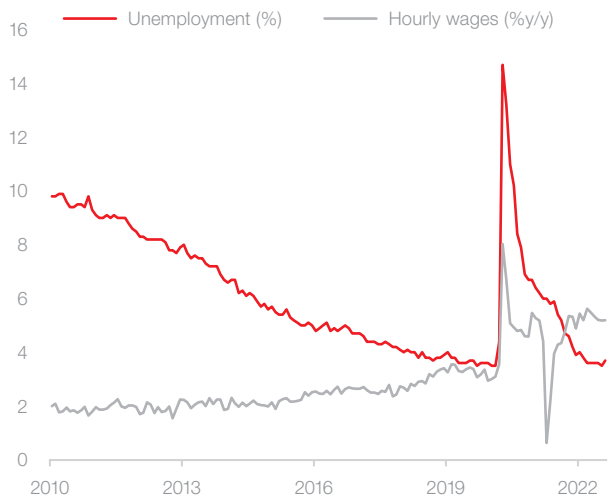
US

The key message from the Fed's September FOMC meeting was not the widely-expected, unanimously-voted, 75 bps rate hike, taking the top end of the target rate to 3.25%. Instead, it was the extraordinary ratcheting up of hawkishness. US Federal Reserve officials have raised their policy rate forecasts by 100 bps between June and September this year. This shift, as indicated by the "dot-plot" of their projections, puts a terminal rate of around 5% in play, something that was unthinkable by most. This is especially the case since growth projections worldwide have been revised down in recent months, commodity and shipping prices have corrected considerably, and interest rates are already above what is widely considered to be the neutral rate.

But in their frustration with sticky core inflation, the focus of the Fed officials has shifted decidedly towards wages and shelter, which, by extension, makes the rate of unemployment the key outcome to watch. The prevailing rate (3.7%) is considered way too low, and if a recession or near-recession like conditions are warranted to push it above 4%, Fed officials are willing to entertain that. We gleaned that message from Chair Powell's press conference remarks after the FOMC meeting.

As we discuss the Fed Funds rate going from 3% to 4% and beyond, some perspective is warranted about the profound shift in the monetary policy landscape. Just a year ago at this time, the Fed was signalling that rates might stay near zero for another year, and it was purchasing Treasury and mortgage securities to provide additional stimulus. Now 75 bps hikes have become near-routine, along with substantial and steady withdrawal of liquidity from the markets.

US wages and unemployment



Source: Bloomberg, DBS

We now expect another 75 bps rate hike in the next meeting (2 November), followed by a 50 bps rise (14 December), taking the end-2022 Fed Funds rate to 4.5%. It is conceivable that both economic and financial conditions will have tightened sufficiently by then to warrant a lengthy pause thereafter, but given the Fed officials' eagerness to cool down the labour market, they may remain on the path of some additional tightening in 1Q23 as well. We are therefore pencilling in 50 bps of further rate hikes between the February and March meetings, but only with even odds.

Implications for growth and inflation are clear; this type of tightening will soften hiring and activities, with core PCE inflation easing through 2023 to below 3% towards the end of the next year. Growth will be 1% or lower, and joblessness will rise. Will a million and a half Americans have to lose their jobs (pushing up unemployment towards 4.5%) to bring inflation down to comfortable levels? We fear so.

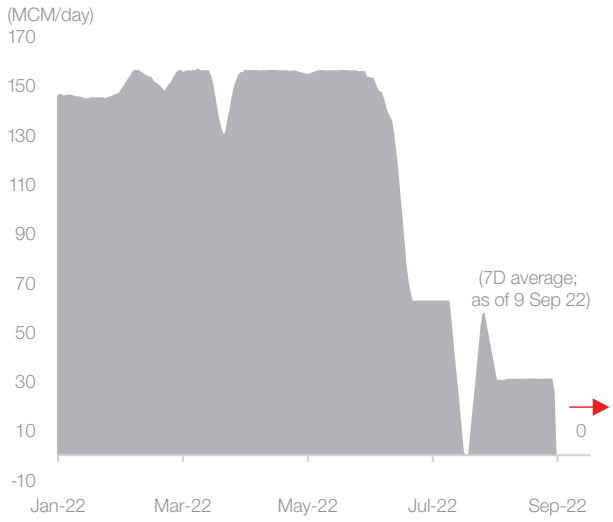
What are the global risks? We are looking at the markers for liquidity tightness and currency volatility as quantitative tightening continues and DXY soars. That would imply pain for hard currency debt issuers and those looking to raise capital. With risk-free rates heading to 4% and beyond, a massive repricing of asset valuation is on the cards. There is no near-term silver lining, we're afraid.

Eurozone

Exogenous shocks continue to pose the biggest risk to Eurozone's economic outlook, and its intensity has risen since the second half of the year. Significant cuts in Russian gas supply to the continent, soaring inflation, and an adverse impact on purchasing power are likely to be the areas in focus. A sobering Eurozone outlook also coincides with a dour view on China's growth expectations as well as a rising likelihood that high inflation and a hawkish Fed might slow the US economy next year.

The gas crisis has intensified since 3Q22. Russia's supply through the Nord Stream pipeline was initially cut to 40%, with the flow thinning further to 20% on return from a maintenance shutdown,

Nordstream gas flows at Griefswald



Source: Bloomberg, DBS

before drawing a full stop in August. High energy demand during the heatwave last month and weak supplies have compounded concerns over Berlin's ability to meet the required gas reserve thresholds by November, ahead of the winter months. As gas storage sites continue to be filled up, member countries are also tapping oil or coal as alternatives, besides stepping up LNG imports. The populace and businesses have also been asked to rationa power consumption, while also exploring alternative supply sources.

Emergency intervention in the Euro Area energy markets has become essential in light of the sharp increase in gas prices and ripple effects on businesses and households. Potential steps include: i) rationing of electricity demand during peak times, binding or otherwise; ii) imposition of windfall taxes on energy companies to fund relief measures

Soaring gas and energy prices will adversely impact inflation, while growth faces downside risks. Confidence surveys have captured the fall in sentiments, with manufacturing firms' confidence on selling prices softening, likely in anticipation of a slowdown in demand. Previously resilient business surveys have also given way, as reflected in the fall in the IFO's business expectation survey. Retail sales – value and volume terms – have moderated, alongside PMIs slipping below the neutral 50 level, impacted by a rise in input prices and uncertain demand outlook.

Germany's IFO Business survey

Source: CEIC, DBS

Resilience in 2Q22 growth, base effects, and revisions to past data necessitate a mechanical revision in 2022 numbers to 2.5% y/y (even as we assume growth grinds to a halt in 4Q). We assign a 40% probability to the risk that the bloc slips into recession in late-2022-early 1Q23 before returning to black. Fallout of the gas crisis and related uncertainty, besides base effects, might be more apparent in 1H 2023 and we temper full-year growth to 1.0% from 1.8% earlier. Inflation has been rising, which together with the more than 10% YTD depreciation in the euro vs the dollar, could drive the headline to a double-digit increase in early 4Q22. Our inflation forecast for 2022 stands 7.8% y/y.

The ECB delivered a large 75 bps rate hike in September, taking the main refinance rate to 1.25% and deposit facility rate to 0.75%, marking the single largest hike on record for the bloc. Policy guidance was hawkish as inflation risks were seen as becoming broad-based, and the ECB sees the need to hike interest rates "several times" in the coming months. This rate hike cycle is likely to settle at the higher end of the 1.5-2.0% range (with upside risks of 50-100 bps), rather that 1.0-1.5% we assumed earlier. With the inflation target at 2%, the terminal rate will still be far below restrictive levels. Impending slowdown in the Eurozone growth in late-2022 and early-2023 will depend more on geopolitics and the impending energy crisis rather than the tightening cycle.

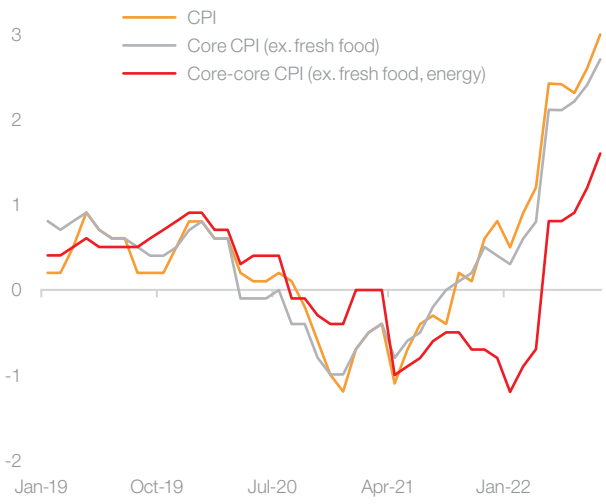
Japan

Policy divergence between the BOJ and its G10 counterparts continues to widen. The BOJ has an explicit 2% inflation goal under its current Yield Curve Control (YCC) policy framework. It pledges to continue expanding its monetary base until CPI growth "exceeds 2% and stays above the target in a stable manner". This strong commitment is aimed at addressing the long-standing deflation mindset in Japan and creates a virtuous cycle of rising prices and rising demand. At present, most indicators, including CPI, GDP deflator, output gap, inflation expectations, and wage growth still show that underlying inflation is below the BOJ's 2% target.

Under our central case scenario, we think the BOJ will maintain the YCC policy framework for the rest of this year. Substantial policy adjustments will require convincing signs of a virtuous economic recovery, or a review of the BOJ's 2% inflation goal and policy mandate. This may only happen after the BOJ's leadership change in mid-2023, at the earliest.

Under the stress case scenarios, excessive yen weakness or massive foreign selling of JGBs may trigger a BOJ policy change, such as shifting the yield target from the 10Y to 5Y segment, raising the 10Y yield target, or abandoning the YCC. The probability of stress scenarios is now on the rise, but still modest. Foreign investors hold only 8% of the total outstanding JGBs. Furthermore, the yen needs to depreciate sharply every year to generate 2% inflation on a sustainable basis. Overshoot in CPI numbers, if mainly driven by exchange rate movements, could be seen as a temporary phenomenon by the BOJ.

Headline CPI rising faster than underlying CPI

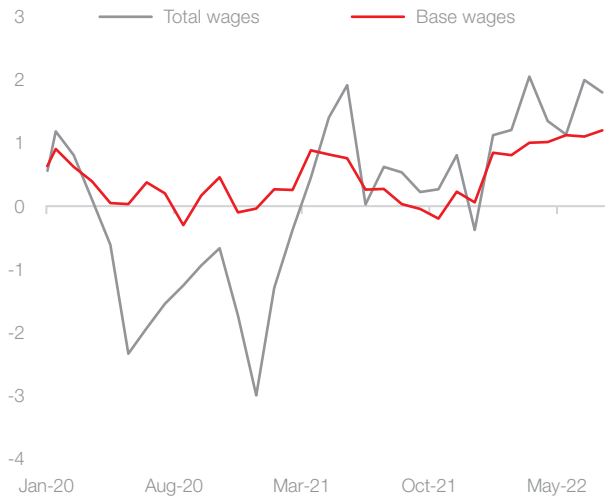


Source: CEIC, DBS

To counteract the adverse impact of a weak yen, the government will likely further expand fiscal measures to alleviate the pressure on household living costs. Prime Minister Fumio Kishida's cabinet approved a JPY2.7t supplementary budget in May to provide

Source: Unsplash

Wage growth insufficient to drive 2% inflation



Source: CEIC, DBS

subsidies for oil wholesalers and give cash handouts to low-income families. More recently, he announced an extension of the existing fuel price subsidies and offered another JPY50,000 in financial support for low-income families. His cabinet is likely to unveil a more comprehensive stimulus package in October, and submit a second supplementary budget for parliamentary approval before the year ends.

Meanwhile, the authorities will likely accelerate the pace of post-Covid border reopening to boost the number of tourist arrivals, expedite the recovery in services exports, and alleviate the pressure on the yen. From 7 September, Japan has started to allow the entry of non-guided foreign package tours, and raise the daily arrival cap to 50,000 from 20,000. The authorities are expected to announce further reopening measures by October, including lifting the ban on foreign individual tourists and scrapping the daily arrival limit.

Asia

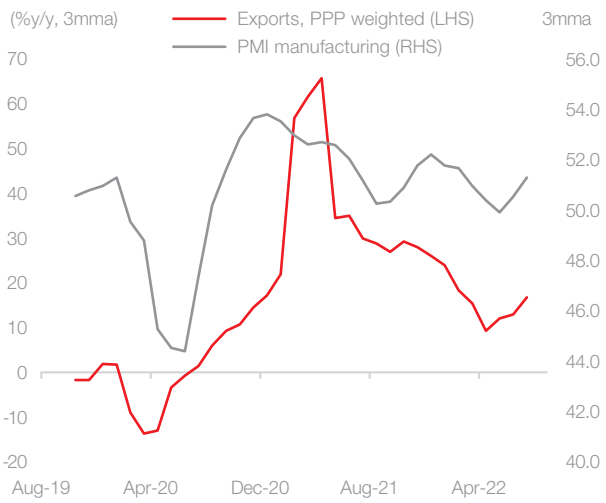
Given the inflationary and rising interest rate environment, Asia's goods exports, a bellwether for global demand, should be softening by now. As consumers worldwide pay more for food and fuel, some correction in discretionary demand should be unsurprising. Similarly, as interest rates go up across countries, the rising cost of financing should have a dampening impact on consumer and business spending, affecting the demand for goods produced in Asia.

But so far, so good. Our measure of aggregate exports out of the region was up 16.8%y/y through June. The figure is almost as promising for Asia ex-China (+16.5% y/y). On a chart, this may come across as a part of a broad softening trend, but this outturn should be seen in the context of rather adverse base effects. At this time last year, on the back of a post-lockdown rebound, Asia's exports were up 45% y/y, so a double-digit growth at the current juncture is indicative of sustained strength of the exports cycle. PMI manufacturing has stayed well above 51 lately, another source of comfort, despite the global headwinds.

China

China's domestic economy is facing multiple headwinds, including pandemic management struggles and a deepening property sector crisis, but through all this, the country's factories have been humming, allowing the exporters to keep their operations going. The cost of shipping a container from Shanghai to Los Angeles has declined by over 50% since 4Q last year, suggesting that some of the supply side frictions related to ports have eased considerably, helping trade. China's still-strong

Asian exports and PMI



Source: CEIC, DBS

exports also reflect resilient demand from its largest importer, the US. With jobs and wages showing continued strength, American consumers have so far shrugged off the challenges posed by the high cost of fuel and food, keeping retail sales growth in high single digits.

With domestic-demand related imports running weak, China's trade surplus in July crossed USD100b, the first such occurrence in its history. Much has been made about the July manufacturing PMI falling below 50, but we note that beyond the figure published by the China Federation of Logistics and Purchasing, another widely-followed manufacturing PMI published by Caixin remains above 50, edging up to 50.5 in August. There is no denying the risks facing China's domestic economy, but it gives us some comfort to note external demand and exports-related production remain robust.

India

While China is running record trade surpluses, India's trade deficit keeps widening (July deficit went past USD31b). Export demand has softened lately, while the high cost of energy imports has kept the import bill elevated. A recent contraction in the export of refined fuel may be attributed to the government's levy of windfall tax on oil exports, which is being calibrated and the impact may turn out to be temporary. PMI surveys post a favourable picture, with manufacturers holding their own despite rising costs and RBI rate hikes.

South Korea

With signs of electronics and auto demand peaking, South Korea's August exports slowed somewhat, up 6.6% y/y. Auto exports had recovered robustly after last year's chip-shortage led disruptions, but now could be heading in the other direction. Semiconductor demand has begun to weaken, just as supply has caught up.

Considering that exports were growing by 30% y/y twelve months ago, the outturn is particularly impressive for this export giant. The manufaturing PMI edged below 50 in August, suggesting risks ahead.

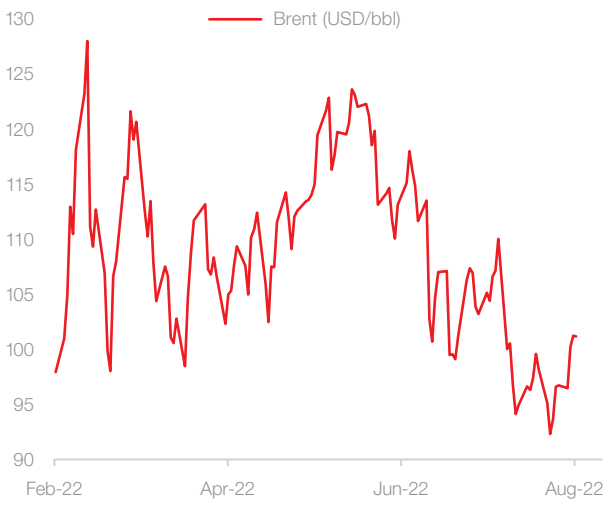
Asia's exports begun the second half of the year still in good shape. Chances are the going may get tough as demand in the US, EU, and China soften further, but it is heartening to see that export earnings have not yet been hit as much as we had feared given the plethora of outstanding headwinds.

Oil: Supply constraints top demand concerns

Lowering forecasts for 2H22, raising forecasts for 2023. Oil prices have been pulled down of late by demand-side concerns, but it is the risk of further push factors that is probably more worrying for the world, as inflationary risks get heightened. Oil prices have fallen by about 15% since the beginning of July and is currently hovering around USD100/bbl, a level we could get used to for some time to come. Despite the Russia-Ukraine crisis dragging on and supply concerns still very much on the anvil, the pullback has come on the back of heightened global recession concerns, reversion of fund flows driven by Fed rate hikes, slowdown in China economic activity leading to lower-than-expected oil demand in the third quarter of 2022, and the renewed possibility of an Iran nuclear deal resolution.

The increase in the US dollar index to fresh highs is also putting pressure on oil prices. Russian production and supplies have also not been affected to the extent earlier envisaged, with only an estimated 1.0 mmbpd decline likely on average in 2022. We have lowered our demand growth assumptions further for 2022 to 2.0 mmbpd, down from 2.5 mmbpd, and now expect 2H22 Brent crude oil price to average around USD100/bbl, down from our earlier expectations of around USD110/bbl. However, we expect the market to get tighter by the end of the year, as support from the release of strategic petroleum reserves (SPR) tapers down after October 2022, and the EU ban on Russian oil imports comes into effect towards the end of the year. With Saudi and OPEC signalling that they would cut production in case the Iran sanctions are lifted, we think it is likely that we could see oil price spikes again towards end 2022 / early 2023 and we envisage higher oil prices in 1H23 compared to 2H22. Our full year Brent crude oil price average forecast for 2023 is thus revised to USD100-105/bbl, up from USD90-95/bbl.

Brent crude oil price has lost some ground since July but shows signs of perking up again



Source: Bloomberg, DBS

Watch out for Chinese demand. The IMF has revised world GDP growth projections downward from 3.6% to 3.2% (0.4 %pts) for 2022F, and from 3.6% to 2.9% (0.7 %pts) for 2023F. This is driven by the prolonged geopolitical conflict between Russia and Ukraine, high inflation levels worldwide, and the situation in China. Over in China – the world's second-largest economy and oil consumer – the manufacturing PMI fell to 49.0 in July 2022, down from 50.2 the month before, marking the lowest reading in three months. China's zero-Covid policy, supply chain bottlenecks, and energy crisis is leading to slower growth and cuts in forward growth estimates. Further downward revisions of Chinese economic growth estimates could have a material impact on oil demand and oil prices.

Impact on Russian supplies has been moderate so far, but that could change. We have seen limited decline in Russian oil production so far and expect that to continue in 2H22 after Russia diversifies its export volumes to China, India, Turkey, and Bangladesh,

Quarterly average oil price forecast 2022/23 – DBS base case view

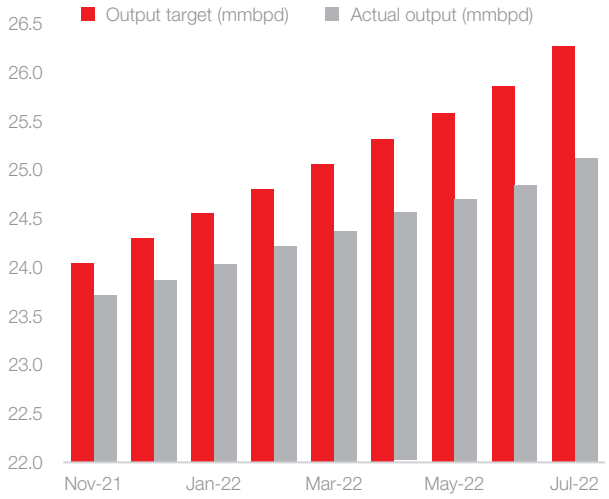
(USD per barrel)	1Q22A	2Q22A	3Q22F	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F
Average Brent crude oil price	98.0	112.0	102.5	103.5	112.5	111.0	99.5	87.0
Average WTI crude oil price	95.0	108.5	97.5	100.5	109.5	108.0	96.5	84.0

Source: DBS

among others— albeit accepting steep discounts on its oil. But in addition to the EU ban taking effect more strongly by year-end (EU imported around 2.5 mmbpd of Russian oil last year), G7 countries are also exploring a price cap on Russian oil exports. If such a move comes to fruition, Russia may retaliate by lowering oil exports – a plausible outcome given that it has already lowered natural gas flows to Europe. In such a scenario (bear case for global macroeconomics but bull case for oil), Russia could lower exports by 1 mmbpd or so to retaliate, which could drive oil prices towards the USD140-150/bbl range, instead of the USD100-110/bbl range we envisage in the near term as per our base case assumptions.

Overall, supplies will stay tight as SPR support tapers off, OPEC+ struggles to meet production targets, and structural underinvestment trends persist. OPEC spare capacity will have dwindled from around 6.2 mmbpd in 1Q21 to around 2.5 mmbpd by 4Q22, limiting the ability to increase production from current levels. OPEC+ agreed to raise production by a paltry 0.1 mmbpd in September 2022 despite US pressure to increase production. In its latest general meeting in early August 2022, OPEC members highlighted the severely limited availability of excess capacity and chronic underinvestment in the oil sector value chain that could impact the world's ability to meet oil demand beyond 2023. The US SPR release is also slated to end by October 2022 and given that it is currently at a 37-year low, the US President's hands may be tied in terms of further attempts to lower domestic gasoline prices. Thus, in our view, oil prices will remain elevated for years to come, especially as the Russia-Ukraine conflict shapes up to be a multi-year conflict. The Iran nuclear deal may be considered a wild card, but it will likely have a knee-jerk reaction on oil price rather than a sustained one. OPEC, led by Saudi, has signalled a likely cut in production to undermine the deal if it happens, and increasingly, it looks like OPEC is comfortable with a USD100/bbl oil price scenario.

OPEC's failure to meet output targets symptomatic of systemic underinvestment



Source: Bloomberg, DBS

GDP growth and CPI inflation forecasts

	2020	2021	2022F	2023F	2020	2021	2022F	2023F
China	2.2	8.1	3.5	5.0	2.5	1.0	2.5	2.2
Hong Kong SAR	-6.1	6.4	1.0	3.8	0.3	1.6	2.2	2.0
India	-6.7	9.0	6.2	5.8	6.6	5.1	6.8	5.5
India (FY basis)*	-6.6	8.7	7.0	6.0	6.2	5.5	6.8	5.2
Indonesia	-2.1	3.7	5.2	4.8	2.0	1.6	5.0	4.0
Malaysia	-5.6	3.1	7.2	4.4	-1.1	2.5	3.0	2.5
Philippines	-9.6	5.7	7.0	6.3	2.4	3.9	5.5	4.0
Singapore	-5.4	7.6	3.5	3.0	-0.2	2.3	5.7	4.5
South Korea	-0.9	4.0	2.8	2.0	0.5	2.5	5.3	2.8
Taiwan	3.4	6.4	2.9	2.3	-0.2	2.0	3.0	1.8
Thailand	-6.2	1.5	3.2	4.2	-0.8	1.2	6.5	2.5
Vietnam	2.9	2.6	7.0	6.8	3.2	1.8	3.6	3.4
Eurozone	-6.5	5.5	2.5	1.0	0.3	2.6	7.8	4.0
Japan	-4.5	1.7	1.6	1.8	0.0	-0.2	2.1	1.4
United States	-3.5	5.7	2.0	1.3	1.3	4.7	8.1	3.6

* refers to fiscal years, i.e. 2020 represents FY21 - year ending March 2021.

Source: CEIC, DBS

** new CPI series. *** eop for CPI inflation.

Policy interest rates forecasts, eop

	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
Mainland China*	3.70	3.70	3.55	3.45	3.45	3.45	3.55	3.70
India	4.00	4.90	5.40	6.00	6.00	6.00	6.00	6.00
Indonesia	3.50	3.50	4.25	5.00	5.00	5.00	5.00	5.00
Malaysia	1.75	2.00	2.50	2.75	3.00	3.00	3.00	3.00
Philippines	2.00	2.50	4.25	4.50	4.50	4.50	4.50	4.50
Singapore**	0.65	1.75	2.90	3.28	3.58	3.58	3.58	3.58
South Korea	1.25	1.75	2.50	3.00	3.25	3.25	3.25	3.25
Taiwan	1.38	1.50	1.63	1.75	1.88	1.88	1.88	1.88
Thailand	0.50	0.50	1.00	1.25	1.50	1.75	2.00	2.00
Vietnam***	4.00	4.00	4.50	5.00	5.00	5.50	5.50	6.00
Eurozone	0.00	0.00	1.25	2.00	2.00	2.00	2.00	2.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	0.50	1.75	3.25	4.50	5.00	5.00	5.00	5.00

* 1-yr Loan Prime Rate; ** 3M SOR ; *** prime rate.

Source: CEIC, DBS

Fed Tightening Fears Present Opportunities

US EQUITIES 4Q22

US growth equities selloff in the wake of hawkish Fed rhetoric offers opportunities for long-term investors. Growth equities, especially Technology-related ones, have registered sharp valuation contraction as investors have priced-in tightening of financial conditions.

Source: Unsplash

03. US Equities.

Dylan Cheang
Strategist

Post-Jackson Hole Tech selloff persists as Fed reiterates restrictive stance in September FOMC. What a difference a day makes. Prior to the Jackson Hole Symposium, the market was swiftly pricing in the plausibility of a dovish Fed pivot as recession fears mounted. Expectations of lower bond yields resulted in the outperformance of US growth equities over value equities. Indeed, from the start of 3Q up till the day before Fed Chair Powell's speech, US Consumer Discretionary and Technology were up 21.2% and 15.1% respectively, vastly outperforming the 11.2% gain registered by the broader market.

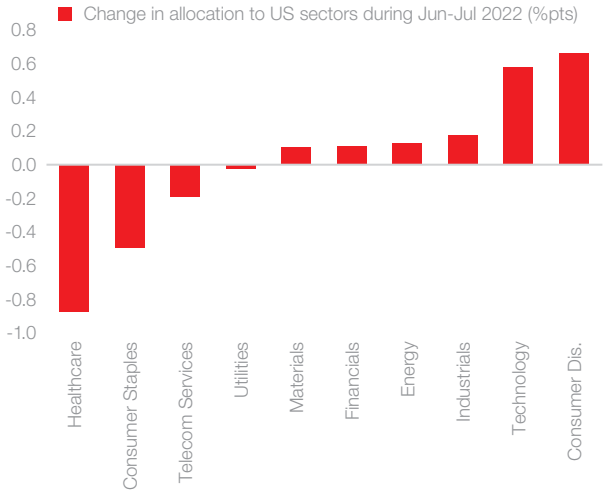
But Powell's speech changed the narrative. The insistence of "maintaining a restrictive policy stance for some time" underlines the Fed's resolve in tackling inflation. This view was reiterated in the September FOMC with Powell making it clear that bringing inflation down to 2% remains paramount and above all, the likelihood of a "soft landing" for the American economy diminishes should restrictive monetary policy persists.

Growth equities, especially Technology-related ones, have undergone acute selloff as investors reassess the outlook on bond yields and financial conditions. We believe the latest bout of volatility presents opportunities for investors on a 12-month perspective. The valuation for global technology, for instance, has already contracted by 31.4% since the start of the year as investors have priced-in impending tightening of financial conditions

Investors' positioning: Shift towards cyclicals underway. Data from EPFR Global show that global investors' appetite for US equities remains healthy as the market saw inflows of USD8.6b (as of 7 Sep) on a quarter-to-date basis, as compared to outflows of USD14.3b and USD4.7b seen in Europe and Japan respectively.

On a sectoral basis, it is evident that a rotational shift towards cyclical equities within the US market is underway. A breakdown of US sector allocation data unveiled the following:

Rotational shift to US cyclicals in play



Source: EPFR Global, DBS

- Between June and July this year, cyclical sectors registered net increase of 1.4%pts in portfolio allocation in aggregate. The largest increases were seen in Consumer Discretionary (+0.7%pts) and Technology (+0.6%pts).

- On the other hand, defensive sectors saw net decline of 1.3%pts in allocation, with the largest pullbacks seen in Healthcare (-0.9%pts) and Consumer Staples (-0.5%pts). Energy, however, managed to buck the trend and registered 0.1%pts increase in allocation.

We believe the rotational shift from defensives to cyclicals will persist and our view is premised on the following factors:

1. Toppish bond yields: Despite hawkish Fed rhetoric, US policy rate is expected to peak by 1Q23. Historically, bond yields would start to trend lower when signs of peak policy rate are round the corner. US cyclicals (in particular, Technology-related ones) have seen substantial selldown on the back of yield concerns in 1H22. But should bond yields top out and start to retrace, this segment will be a geared beneficiary.

2. Attractive valuation: On balance, the average valuation for cyclicals have contracted by 41% since end-2020 and the risk-reward looks attractive at current levels.

US cyclicals see attractive risk-reward

Source: Bloomberg, DBS

4Q22 US Sector Strategy – Technology-related sectors back in the game

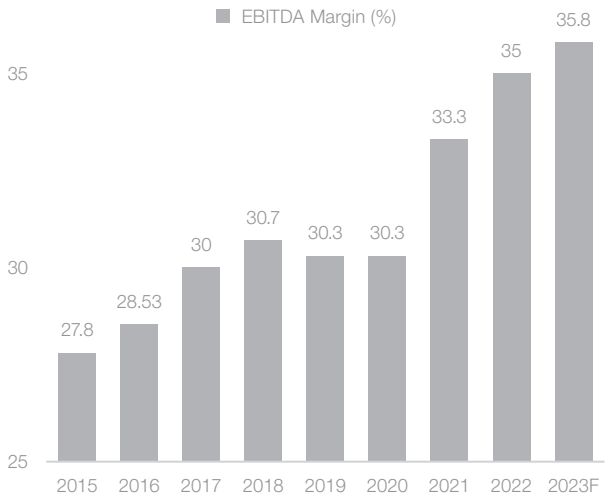
We maintain a constructive view on US Technology stocks as the impact of rising bond yields has already been sufficiently priced-in by the sector. Despite investors' concerns of a slowdown in growth, the Technology sector continues to display strong resilience:

- In the recent reporting season, earnings surprise for Technology stood at 83% — substantially higher than the broader market (75%). On a segmental basis, the momentum was robust across the board within Technology: Software & Services (84%), Technology Hardware & Equipment (79%), and Semiconductors & Semiconductor Equipment (84%).

- Based on consensus forecast, the EBITDA margin for Technology is slated to increase from 33.3% in 2021 to 35.0% in 2022 and this underlines the sector's ability to sustain its margin despite rising inflationary pressure.

Maintain exposure to US Technology to ride the tailwinds of toppish bond yields.

EBITDA margin for S&P 500 on the rise



Source: Bloomberg, DBS

US Sector Allocation – 4Q22

	Overweight	Neutral	Underweight
US Sectors	Technology	Materials	Utilities
	Comm. Services	Real Estate	Consumer Staples
	Consumer Discretionary	Energy	Industrials
	Healthcare		
	Financials		

Source: DBS

US sector key financial ratios

	Forward P/E (x)	P/Book (x)	EV/EBITDA (x)	ROE (%)	ROA (%)	OPM (%)
S&P 500 Index	17.4	4.0	13.2	19.8	3.9	15.2
S&P 500 Financials	13.1	1.5	9.1	11.8	1.2	23.3
S&P 500 Energy	7.7	2.4	6.5	24.3	10.9	14.2
S&P 500 Technology	21.5	8.3	16.8	34.6	13.4	26.0
S&P 500 Materials	12.8	2.8	9.4	18.8	7.8	16.5
S&P 500 Industrials	18.6	4.9	13.9	20.0	5.1	11.7
S&P 500 Con. Staples	20.7	6.3	15.3	26.7	8.0	9.4
S&P 500 Con. Discretionary	27.9	9.3	16.5	28.5	6.1	9.1
S&P 500 Comm. Services	15.3	2.9	9.7	18.1	7.0	20.6
S&P 500 Utilities	21.7	2.5	15.2	9.0	2.3	14.9
S&P 500 Real Estate	34.7	3.4	21.9	10.7	4.2	23.2
S&P 500 Health Care	15.6	4.7	13.7	22.7	8.0	10.7

Source: Bloomberg
*Data as at 13 September 2022.

Bracing for the Cold

EUROPE EQUITIES 4Q22

We remain cautious on Europe equities amid inflation challenges from energy prices and supply chain disruptions. Stay close to selective opportunities in Oil majors, Luxury, Healthcare, and Technology as sound company fundamentals and low valuations prevail.

Source: iStock

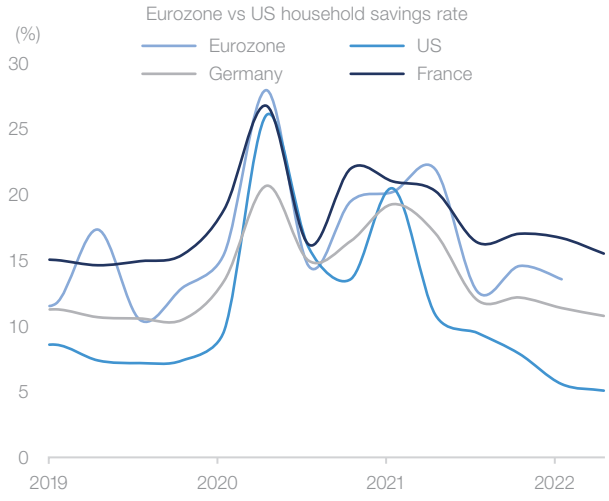
04. Europe Equities.

Joanne Goh
Strategist

Sentiment towards investing in Europe remains weak as the Russia-Ukraine crisis drags on and the euro drops below parity. Markets are also spooked by global tightening fears as the Fed's hawkish message intensified, erasing hopes of an early pause or a U-turn on the path of interest rates. Meanwhile, global slowdown fears gain traction as PMI and exports numbers start rolling over.

Europe's resilience in the earlier part of the year has begun to falter, but we believe recession is not on the cards. Various EU supportive programmes implemented during the pandemic are still in disbursement mode. Two other programmes – REPowerEU and TPI – were newly introduced to help support households, companies, and sovereigns to deal with high energy prices and bond market volatility. Re-activation of fiscal rules has also been delayed by one additional year to late 2023.

Economic resilience supported by consumers' high savings rate



Source: Eurostat

It is worth noting that the labour market is strong and nominal disposable income is quickening as wage growth catches up amid supportive government policies. Household savings remain high; together with various government relief packages, these should remain sources of support for consumers to ride through the inflation peak.

Among the four core economies in the Eurozone, impact will be most pronounced in Germany due to the fallout in manufacturing activity and high dependence on Russian energy supplies. On the other hand, tourism-dependent Spain and France are likely to fare better. Being the weakest among the core four and faced with political challenges, there are also concerns on Italy's ability to service its debts.

Germany's recovery delayed but not derailed

Germany's economic growth is expected to slow sharply to 1.2% in 2022 and 0.8% in 2023, owing to elevated energy import prices and weak consumer confidence. Supply bottlenecks and delayed pass through of wholesale to retail gas prices are expected to persist. However, it is no coincidence that Germany is the fourth biggest economy globally and the strongest in Eurozone. Its economy has shown strong resilience throughout the pandemic – flexible fiscal policies stand ready to provide more relief support to vulnerable households and liquidity to firms if the headwinds worsen. The government has also taken significant steps to boost energy security, leading a green public investment push to build a cleaner economy.

As the Eurozone's bellwether exporter, Germany is sensitive to global bond yields and the global economic cycle. German bond yields have spiked this year from 0% to 1.5%, and there is little to no benefit from the weak euro as high energy costs offset any positive impact. Corporate earnings are likely to face pressure from slower revenue growth and rising costs. Nonetheless, there remains strong companies with sound fundamentals. We look for selected opportunities in the autos and oil and gas industries, where earnings will be resilient against recession due to stock specific drivers.

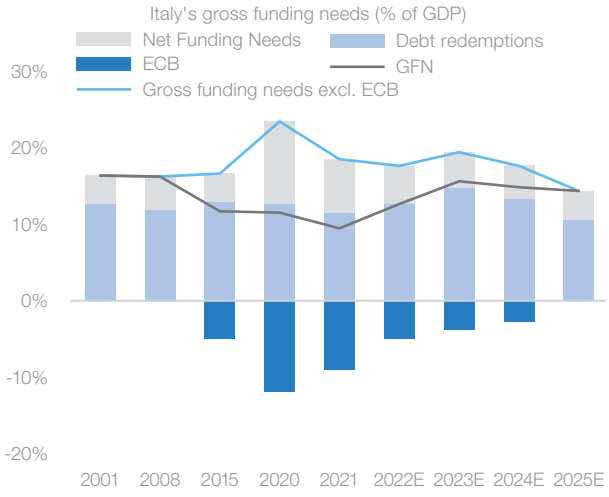
Sound fundamentals among corporates

Source: Bloomberg, DBS

Italy's debt sustainability

Rising bond yields in Italy highlight the issue of its debt sustainability. Thanks to the ECB's QE policy and various funding programmes (NGEU funds, PEPP, REPowerEU, and Transmission Protection Instrument), vulnerabilities to its gross funding needs should be limited in the short and medium term, even in 2025 when the ECB's reinvestment programme ends. Increases in bond yields also do not have an immediate impact on actual borrowing costs. Over the longer term, boosting productivity may be key to maintaining debt stability. Italian stocks do not stand out in our screening for global equities that will benefit from accelerated digitalisation, millennial spending, and an ageing population.

Debt levels can be sustained



Source: SocGen, DBS

Cyclicals rebounded in 3Q but it is unlikely to last

Europe equities saw some relief in 3Q as cyclicals rebounded after an abysmal performance in the first half of the year. The outperformers were Energy, Info Tech, and Consumer Discretionary while the laggards were Telcos, Healthcare, and Real Estate. The rotation between cyclical and defensive sectors was evident in a year of uncertainty.

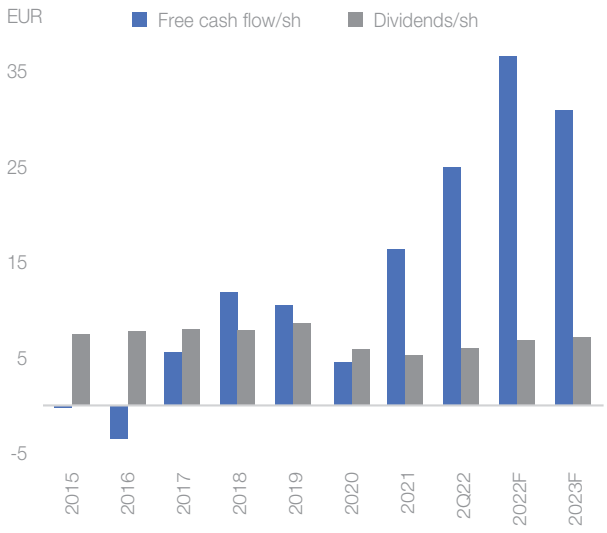
Amid sound company fundamentals, prevalent long-term structural demand, and low valuations, challenged by inflation from energy prices and supply chain disruptions, we remain cautious on European equities. Selective opportunities are in Oil majors, Luxury, Healthcare, and Tech where companies in these sectors are weathering the challenges better.

Our main macro views supporting the longer-term outlook for these sectors are:

1. Our oil price forecast remains at about USD100 for the next four quarters as supply constraints would top demand concerns. Overall, supplies will stay tight as support from the Strategic Petroleum Reserve tapers off, as OPEC+ struggles to meet production targets, and structural underinvestment trends persist. Oil prices will remain elevated for some years to come, especially as the Ukraine situation shapes up to be a multi-year conflict. Increasingly, it looks like the OPEC is comfortable with a USD100/bbl oil price scenario.

   We favour integrated oil majors as both upstream and downstream businesses should enable them to ride through the oil cycle given their strong cash flow. The absolute dividend of this sector has stayed relatively stable over market cycles with their commitment to dividend distribution. We expect dividend payouts to creep up from the current 4-6% annually.

Higher dividends can be expected from high free cash flow



Source: Bloomberg, DBS

2. The ongoing tech downturn is a typical cyclical adjustment in the sector, and is largely driven by the downstream consumer electronics segment, and to a lesser extent, upstream semiconductors. Semiconductor plays in Europe are mainly in upstream businesses such as semiconductor manufacturing equipment and chips design, where capex remains stable.

   The US Chips and Science Act recently signed into law in the US will provide over USD52b for semiconductor research, development, and manufacturing, and also offers a 25% investment tax credit for capital expenses. The bill will enable many companies to accelerate investments in manufacturing and boost the outlook for capex spending in the semiconductor sector.

3. European households are likely to be resilient in the high inflation environment largely due to a strong labour market. Job retention schemes at the start of the pandemic helped to keep jobs; economic pick-up supported strong job creation and complete job recovery by 3Q21.

   The tight labour market helped avoid a spike in household debt, which we believe will underpin the resilient consumption trends in Europe. In tackling the energy crisis, governments have come up with relief plans to help millions of households struggling with soaring prices amid Europe's harshest energy crunch in decades. For example, Germany's coalition government has agreed on a EUR65b package to provide relief to citizens.

Tight labour market underpinned stable consumption trends

Source: Bloomberg, DBS

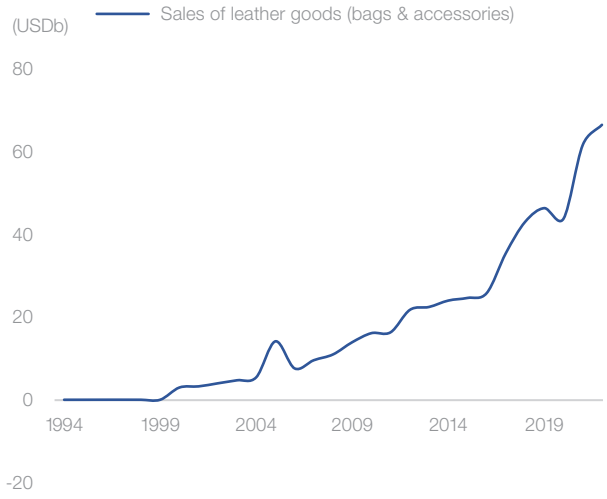
A beneficiary of the strong consumption trend is the Europe luxury sector. European luxury brands have demonstrated solid fundamentals in the latest quarterly earnings results despite concerns on higher inflation and slowing consumer spending. The demand-led recovery in the luxury resale scene was led by rising millennial and Gen Z demand against a backdrop of post-pandemic "revenge spending" and resumption in global travel and experiences. Leading brands are able to leverage on strong consumer appetite to spend on luxury goods with new designs, collaborations with top artists and e-sports platforms, high quality portfolio of brands, widespread geographical exposure, expansion of online stores, and the rejuvenation of retail stores globally. Sales reached the highest for the quarter despite China's continued on-off lockdowns. Hence, the outlook is for sales to climb higher when China fully reopens.

The pricing power of such luxury brands is difficult to match. As operating costs such as wages and rentals start to pick up due to higher inflation, brands are able to raise prices regularly without sales volume being adversely impacted. Disruption in global supply chains drives demand for highly sought-after products, allowing brand owners to maintain profit margins at a time when most other industries are facing margin pressure.

Millennials today have a heightened awareness of sustainability and demand greener products and greater accountability. This has pushed brands to commit to reducing carbon emissions. Initiatives such as the shift to fur-free products and research into innovations to reduce packaging and transportation carbon emissions communicate clear values and could reap several lasting benefits. Luxury customers are willing to pay more for such products and develop loyalty to such brands.

With its strong pricing power, the sector is a beneficiary of the post-pandemic global reopening and an inflation winner. Its global business stands out as a resilient sector in a weak European outlook. Currently trading at below pre-pandemic levels, the sector should resume its rerating as it benefits from the secular millennial consumption trend. With its adaptability, we see long-term potential.

Luxury bags sales unfazed by inflation and a slower economy



Source: Bloomberg, DBS

Benefiting from a Weak Yen

Source: iStock

JAPAN EQUITIES 4Q22

Albeit at a sluggish pace, Japan's economy is showing signs of recovery, with the weak yen offsetting some effects of cyclical slowdown. Our approach is to select quality companies that ride on sectoral and thematic tailwinds.

05. Japan Equities.

Joanne Goh
Strategist

Japan equities continue to perform well amid a weak yen environment in 3Q22. The economy is gradually recovering, albeit at a sluggish pace, from 0% in 1Q to 0.5% in 2Q. With the global economy normalising from pandemic disruption, coupled with pent-up post-Covid demand, we expect a more normalised level of 1.6% GDP growth for Japan in 2022.

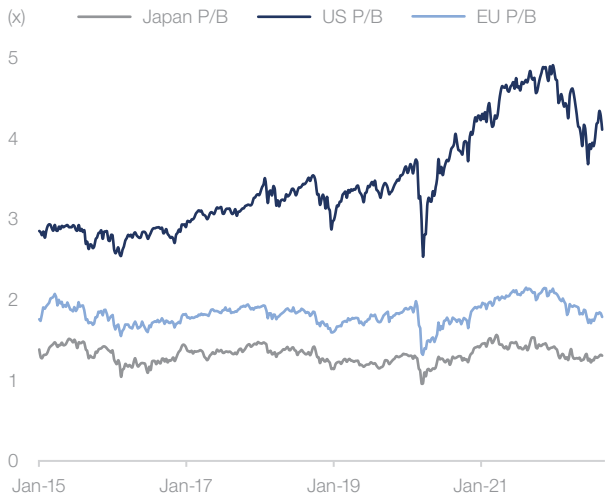
Growth normalising to low growth volatility

Source: Bloomberg, DBS

The spike in global inflation, faster-than-expected global central bank tightening, and the protracted Russia-Ukraine crisis are key risks for the economy. Having said that, for an economy which has yet to return to potential, we believe Japan is likely to take the pace of normalisation in its stride, as evidenced by the BOJ maintaining its monetary policy against a backdrop of global bank tightening. Moreover, inflation has eluded Japan in the past two decades. With the move from deflation to modest inflation, wage hikes and government subsidies to offset inflationary pressure, and implementation of growth-oriented policies and reform – a meaningful structural change on attitudes towards consumption and investment could happen.

We believe there is compelling value in Japanese companies that currently trade at price-to-book ratio of 1.2x, as compared to 1.7x in Europe and 4x in the US. Our approach to engage Japan is to select quality companies that ride on sectoral and thematic tailwinds. Tax breaks on spin-offs have been proposed, encouraging businesses to review portfolios with the view of realising underlying value and improving capital efficiency. Meanwhile, P/E ratios at 12.7x appear attractive when compared to 15.7x for world equities. With bond yields stuck at 0.25%, a dividend yield of 2.6% is attractive by comparison for domestic investors.

Value in the books



Source: Bloomberg, DBS

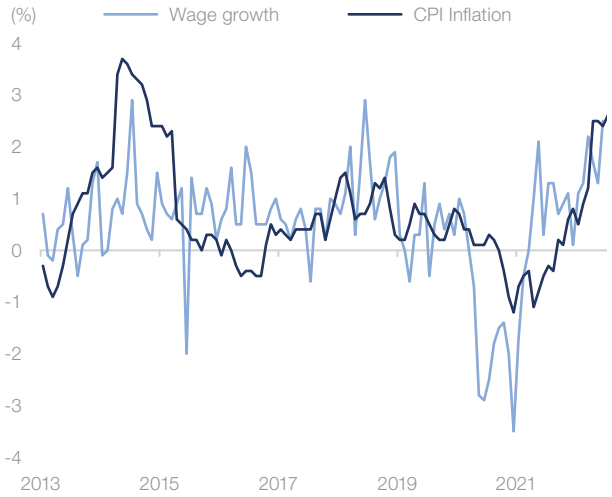
Earnings surprise on the upside

In FY1Q, all sectors except for Communications (due to Softbank) reported positive earnings surprise. We believe this is due to a lowering of expectations as macro volatility is high and gradual reopening of the economy has seen a pick-up in economic activities. Going forward, stocks which benefit from the easing of travel restrictions, domestic demand revival due to a rise in wages and relief budget spending, cheaper yen, and strong pricing power should continue to register positive earnings momentum. We also continue to recommend gaining long-term exposure to Japan's 'sumotoris' – economic heavyweight companies with a durable global competitive advantage.

Domestic demand revival amid easing of travel restrictions

The government is expected to expand fiscal measures to support public livelihood across the rest of this year. This includes measures such as the provision of more subsidies to cushion the impact of inflation. Separately, further incentives were introduced to encourage companies to raise wages. Growth of total wages has picked up to 2% y/y. Although it is still insufficient to offset consumer price inflation, we think it is significant given that Japan's economy has eluded inflation thus far. A 2% inflation rate still remains a policy target.

Wage growth rising in line with inflation could sustain the expectant 2% target



Source: Bloomberg, DBS

Japan plans to gradually ease border controls to allow more visitors into the country. From a high of 31.9m visitors in 2019 to just over 500,000 in the first six months this year, the tourism industry has been badly hit by the pandemic.

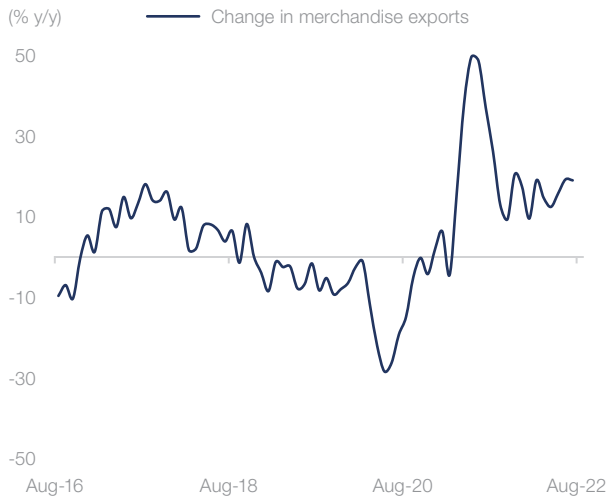
We thus believe that domestic demand will pick up upon the easing of border controls and inbound travel restarts, supported by government subsidies and rising wages. Amid the reopening, we expect earnings to recover in hotels, restaurants, travel, and consumer spending-related operations. These will also include companies that manage IT solutions for the sector. These solutions will support productivity and ease the sector's labour crunch which is exacerbated by Japan's ageing population.

Weak yen offsets cyclical slowdown

While Japanese exporters may be vulnerable to a global cyclical slowdown and rising inflation, they should fare better than their global peers. As a result of a weaker yen, overseas profits are higher when brought back to Japan while a cheaper yen translates to improved market positioning. As reported in the latest results season, many companies had assumptions of around USD/JPY 120 made in the beginning of the fiscal year when currency fluctuations and future prospects were still relatively unclear. With the yen averaging around 126 YTD, we believe there is upside to earnings. BOJ governor Kuroda has pledged for a loose monetary policy to continue, implying that a weak yen environment could persist.

Output indices have started to recover from the supply-side disruption caused by the Shanghai lockdown in 2Q. The long-term outlook for Japan's 'sumotoris' should remain intact owing to a more forceful China stimulus, structural demand for EVs and chips needed for the upscaling of equipment powered by millennium consumption, and the green energy transition. In the near term, supported by a weaker yen, we believe they will maintain a competitive edge.

Japan exports growth stabilising at higher levels



Source: Bloomberg, DBS


麻雀
Tax Free
Welcome
熱烈歓迎
환영합니다
錦糸町北口
くすりの福太郎
駄菓子とおかしのみせ
三間堂
SANGENDOU
磯丸水産
24時間営業中
アエラス
錦糸町店
6F
リーチ麻雀
雀吉
お部屋探し
アパート・マンション
4F
MAST
有限会社 寺村不動産
錦糸町店
寺村不動産
炭火焼肉
ホルモン
Ticket
STORE
Source: iStock

Promising outlook for Japan machinery

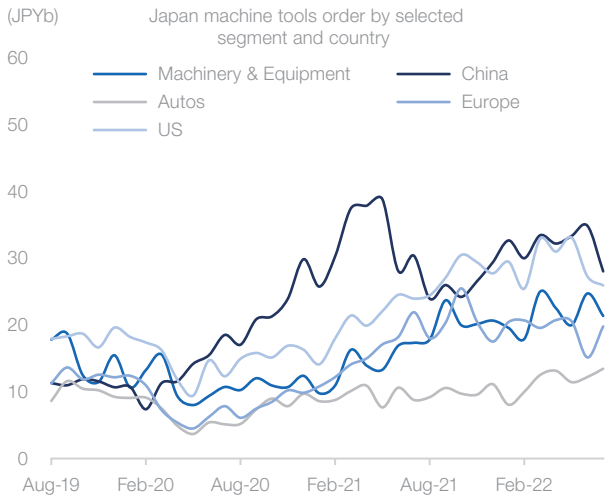
Japan is positioned upstream in the capital goods sector. Japanese corporates excel in areas such as automation, mechatronics, and precision manufacturing. The outlook for the sector continues to look promising. Machine tool orders have surpassed pre-pandemic levels due to the tailwinds of global capex spending driven by supply shortages, higher demand for electric vehicles, an overall push to localise the semiconductor supply chain, and outsized stimulus packages disbursed during the pandemic. Orders from the autos and semiconductor industries are bright spots as supply chain bottlenecks ease and companies work through growing orders of backlogs and resume plans for the build of EV and battery plants.

The US Chips and Science Act recently signed into law will provide over USD52b for American semiconductor research, development, and manufacturing, and also offer a 25% investment tax credit for capital expenses. The bill will enable many companies to accelerate investments in manufacturing.

Auto stocks gain from weak yen

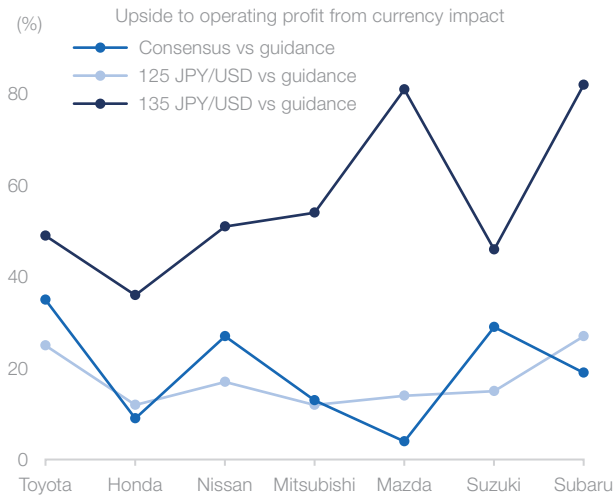
Japanese autos stand to benefit from a weakening yen due to its high global exports. According to calculations performed by Bloomberg Intelligence, the yen at 125 to the dollar could lift operating profit forecasts by 12-27% for FY2023 (ending March), rising to 36-82% at 135. With the yen trading near 140, we believe there will be upside earnings

Machinery tool orders surpass pre-pandemic levels



Source: Bloomberg, DBS

Japan autos' currency impact



Source: Bloomberg, DBS

Source: Unsplash

surprise in this sector. Consensus estimates appear to factor in JPY125 to the dollar while companies assume around 115-123 to the dollar in FY2023. A peaking-out of material prices and easing of supply chain bottlenecks may also help in companies beating earnings expectations. The impact on Japan carmakers will vary according to export sales and local production ratios.

Cosmetics

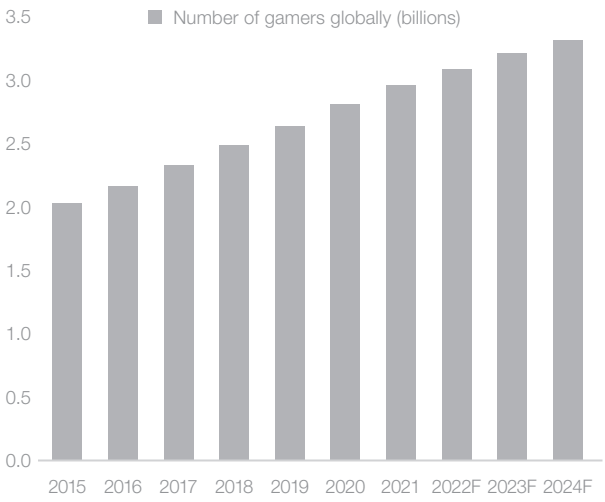
The Japan cosmetics and skincare industry has a large following in Asia and is expanding its global reach to include Europe and North America. Japanese cosmetics brands are diversified and global in nature and are segmented by product type (personal care/cosmetics), category (premium/mass), and distribution channels. Industry innovation can be evidenced on two fronts. First, through product innovations responding to consumer demand; this includes the use of recyclable natural ingredients that feed into the circular economy for plastics packaging. Second, through marketing efforts to reach consumers globally. The sector has a premium revenue mix and strong margins with a high ability to pass on costs. We expect to see higher growth as workers return to the office amid pick up in socialisation and travel. The sector will benefit as soon as Japan opens its doors to tourists.

Video gaming sector

Despite the video gaming sector being proclaimed as a winning pandemic stay-at-home play, performance has softened recently due to the resumption of economic activities globally, amid structural tailwinds such as improving economic productivity and growing disposable income. With improved productivity contributing to less hours spent in the office, the global gaming population continues to grow.

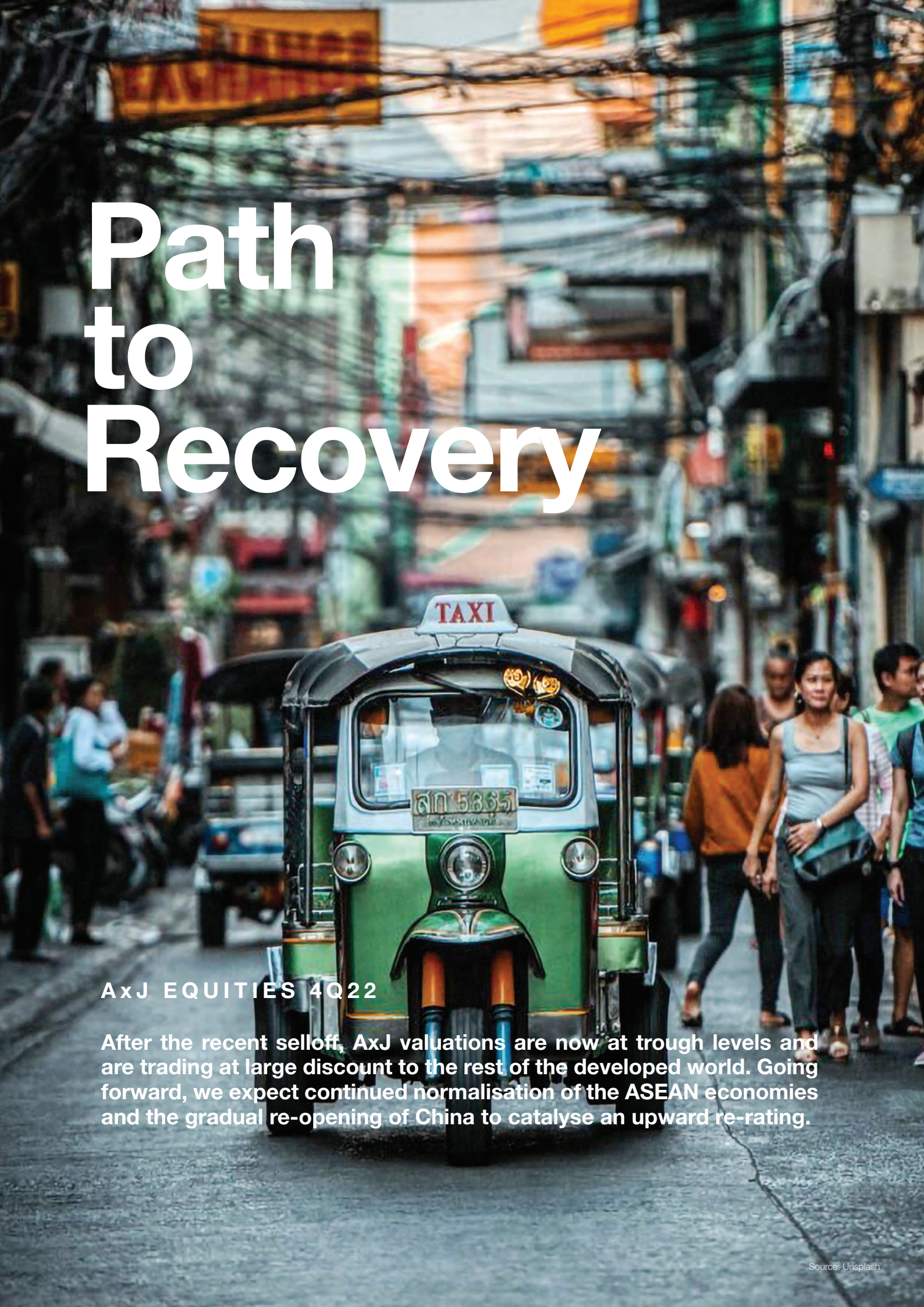
In general, we have seen much of the strong demand from the peak of Covid in 2020 carry through till 2022. Pipelines for major Japanese gaming companies for 2H22 have a better outlook, as the semiconductor shortage due to global supply chain disruption improves and the pivot towards digital sales channel for the industry gains traction. We deem sector players Adapters (in our I.D.E.A. framework) as they have embraced the shift towards more effective monetisation methods such as Free-to-Play and in-game purchases, as well as digital purchases (CD sales are still relatively popular in Japan), which are positive for margins.

Gamers make up more than one-third of the world population



Source: Bloomberg, DBS

Path to Recovery



AxJ EQUITIES 4Q22

After the recent selloff, AxJ valuations are now at trough levels and are trading at large discount to the rest of the developed world. Going forward, we expect continued normalisation of the ASEAN economies and the gradual re-opening of China to catalyse an upward re-rating.

Source: Unsplash

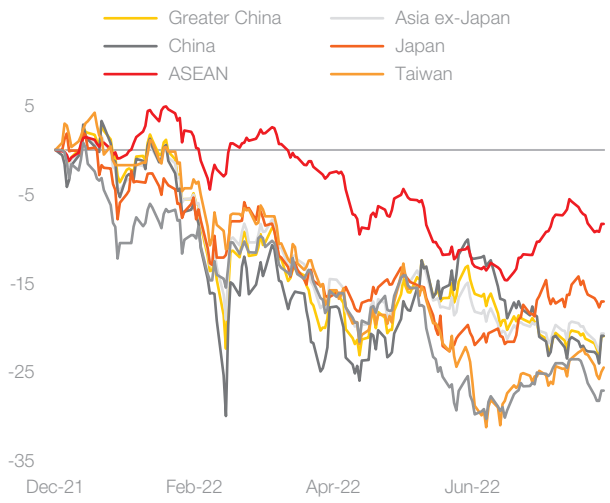
06. Asia ex-Japan Equities.

Yeang Cheng Ling
Strategist

Joanne Goh
Strategist

Strict Covid measures have undoubtedly dampened the growth outlook for North Asia, while the reopening of ASEAN nations has created outperformance over the markets of Greater China.

YTD performance of Asia equities

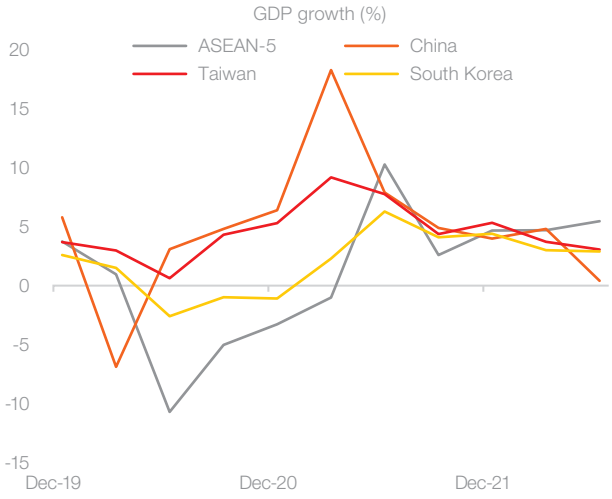


Source: Bloomberg, DBS

After registering weak GDP during the early phases of Covid, ASEAN-5 delivered a convincing recovery in growth momentum; the latest quarterly GDP stands at +4.7% in contrast to an average growth of 1.4% for North Asia.

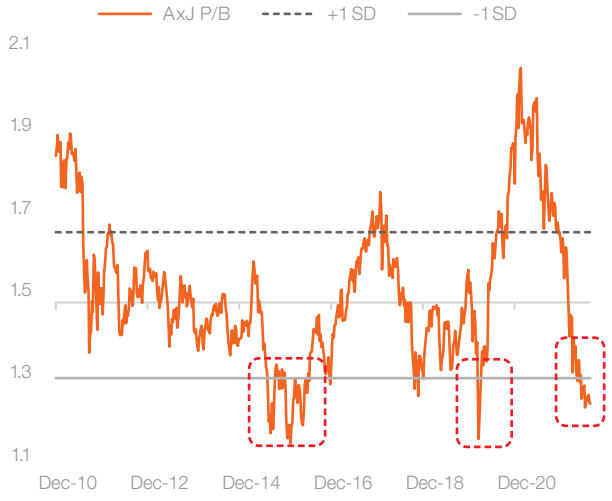
After the recent selloff, AxJ valuations are now at trough levels and are trading at large discount to the rest of the developed world. Going forward, we expect continued normalisation of the ASEAN economies and the gradual re-opening of China to catalyse an upward re-rating.

GDP growth of ASEAN-5, China, Taiwan, and South Korea (%)



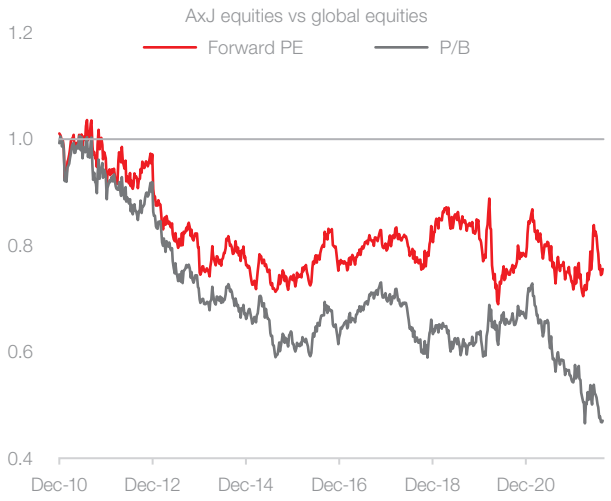
Source: Bloomberg, DBS

AxJ valuations at trough levels



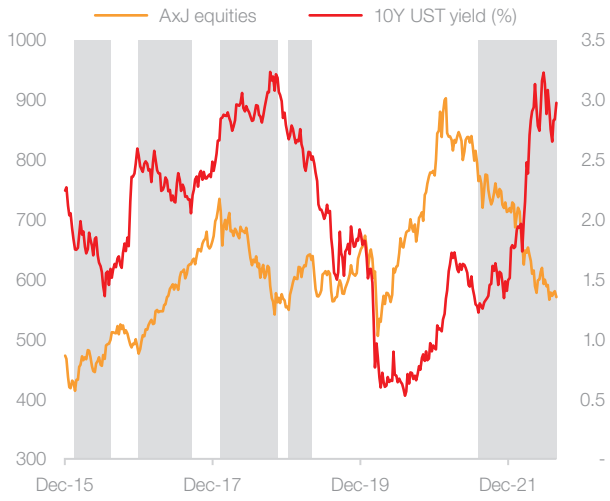
Source: Bloomberg, DBS

Steep valuation discount to limit downside



Source: Bloomberg, DBS

Inverse relationship between AxJ equities and 10Y UST yield



Source: Bloomberg, DBS

We also observe the strong inverse relationship between US Treasury yields and AxJ equities. Based on the expectation that the trajectory of rate hikes will slow going forward, there is potential for AxJ to recover lost ground in the coming quarters.

At 0.4% in 2Q22, China's GDP growth remained nearly flat from a year ago as Covid Zero measures hampered domestic consumption and corporate activities, as shown in data for consumption, manufacturing, and logistics.

A series of domestic headwinds in China has weighed on the North Asia equity market, including rising geopolitical tensions, slowing corporate earnings, and issues surrounding China's real estate sector. These headwinds have contributed to weaker than expected growth readings in China (+0.4%), Taiwan (+3.1%), and South Korea (+0.7%).

In view of this recent weakness, consensus has revised down China's 2022 GDP forecast. From 5.2% at the start of the year, China's GDP is now projected to expand at a slower pace of 3.8%, before recovering to above 5% in the following year. Similarly, corporate earnings are only expected to recover in 2023 when government stimulus measures start to take effect.

In a bid to address these domestic issues, China authorities are making funding costs cheaper and considering special purpose loans to support the completion of stalled development projects to avoid a slump in the real estate industry, and to prevent a cash crunch among developers.

Meanwhile, regulators have made headway to maintain the listing of more than 200 China ADRs by availing audit working papers to be reviewed by US officials, in compliance with US listing rules. While pending further details, should an agreement be reached for China ADR counters to remain listed on the New York Stock Exchange, this will serve as an additional tailwind for the rerating of China technology stocks and the broader market as a whole.

In view of the government's policy response and considering the level of valuation that has largely priced in currently challenging economic conditions, we maintain our overweight on China and AxJ equities.

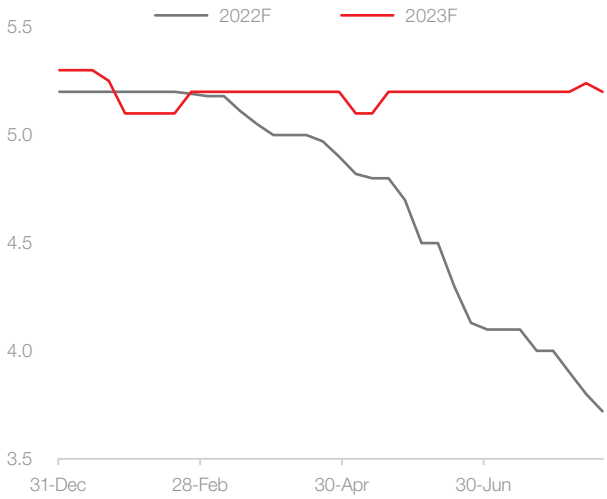
This quarter, we reiterate our conviction on China's large banks in view of their supportive dividend yields. Share prices of China banks have experienced volatility in recent months amid news flow on homebuyers' refusal to service their mortgage obligations on unfinished residential projects, as some construction works were suspended, and deliveries were delayed by a number of cash-strapped developers.

While headline news have painted a bleak picture of the impact to real estate and its related sectors, the direct real estate sector (excluding other indirect and related industries) as a percentage of GDP has been stable at 6-7%.

We maintain that the gridlock will ultimately be resolved, given the wide range of stakeholders involved – local government bodies, commercial banks, building contractors, construction firms, material suppliers, real estate developers and their employees, and homebuyers. It is important to note that homebuyers are incentivised to resume the servicing of their mortgages so as not to impact their personal credit ratings.

As such, China's large banks should not be adversely impacted by the real estate issues in the long run. For example, sector NPL ratio has stayed at 1.7% over the past five years and is likely to stay within a manageable range as banks have taken prudent steps to maintain asset quality. The four largest banks in China have set aside loan loss provisions of

China GDP consensus forecast for 2022 and 2023



Source: Bloomberg, DBS

Real estate as percentage of GDP (1995 – 2021)

Source: Bloomberg, DBS

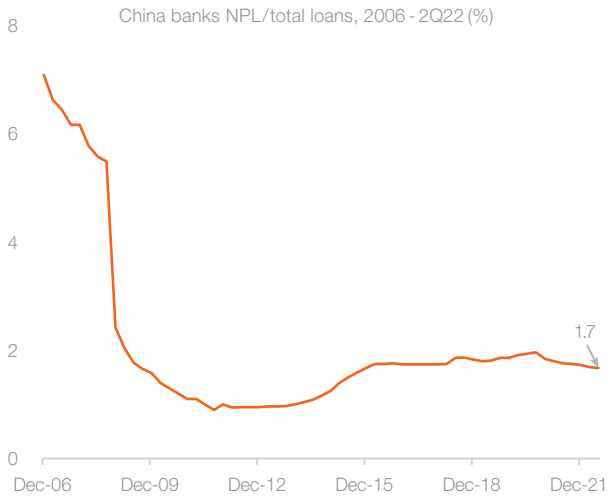
250% as at the end of March 2022, which collectively amounts to CNY2.8t. This will play a pivotal role in banks maintaining stable balance sheet quality while cushioning the impact of economic volatility.

Within the financial sector, our preference remains with state-owned large banks given their strong balance sheets with higher loan loss provisions and lower NPL ratios compared to industry average. Large banks may also tap into cheaper funding from their larger Current Account Saving Account (CASA) deposit base, have a more diversified loan book composition, and lower percentage of exposure to real estate mortgages.

Against this backdrop, we reaffirm our constructive view on large China banks for their dividend yield play, which averages close to 8%.

We expect China's government to maintain moderate stimulus support for the rest of this year and expand efforts next year to drive more meaningful recovery. Recent initiatives implemented include cuts in the medium-term lending facility rate and loan prime rate in a bid to reduce funding costs in order to support domestic demand and the easing of restrictions imposed on home purchases.

China banking sector NPL ratio manageable (Dec 2006 – June 2022)



Source: Bloomberg, DBS

Attractive dividend yield of 8%

Source: Bloomberg, DBS

Source: Unsplash

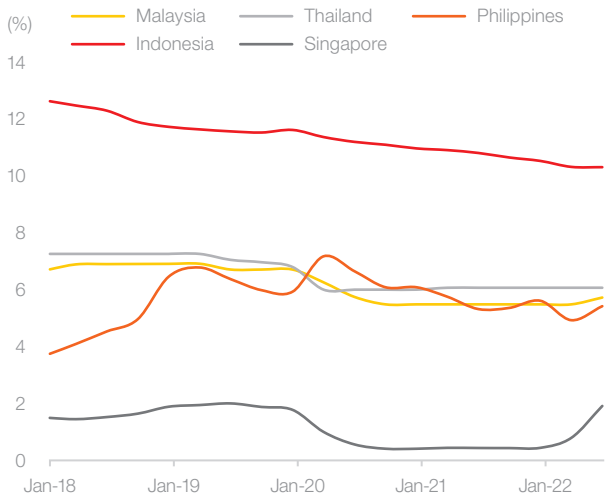
ASEAN remains resilient against inflation and rate hikes

ASEAN markets have withstood external macro volatility surprisingly well, with Singapore and Indonesia among the best performing markets in Asia. Concerns on Fed hikes and inflation did not derail the positive momentum in ASEAN amid reopening optimism. Key themes of rising interest rates benefitting the banks, re-opening beneficiaries and higher commodity prices should continue to support its outperformance. In the near term, governments are walking a tight rope between controlling inflation and rate hikes, compounding risks of external flows, and weakening finances. That said, as we expect the trajectory of Fed rate hikes to slow going forward, investors may focus on healthy large capitalisation stocks in ASEAN for their outperformance.

Banks are key beneficiaries of rate hikes

The banking sector presents interesting opportunities in a rising interest rate and inflationary environment. Rising rates boost income for banks as they profit from the spread between rates on deposits and loans; credit card and transactional fees should also increase along with higher nominal GDP growth. ASEAN banks have hiked rates this year between 25 bps to 175 bps, giving rise to higher lending rates. Net interest margin should continue to expand as the effects of loans repricing come through the following months.

Lending rates poised to rise in ASEAN



Note: Various commercials banks lending rate; 3M interbank rate for Singapore

Source: Bloomberg, DBS

Long runway for reopening plays

ASEAN's services sectors such as hospitality, food and beverages, aviation, healthcare, and tourism related services industries have started to recover strongly on the back of resumption in global travel. IATA International forecasts air travel to return to pre-pandemic levels by the end of 2024, after China and Japan both open their borders. Hence, there is still a long runway for recovery to persist and broaden out. Singapore REITs in the retail and hospitality sectors and airport operators are key beneficiaries.

Beneficiaries of commodity boom

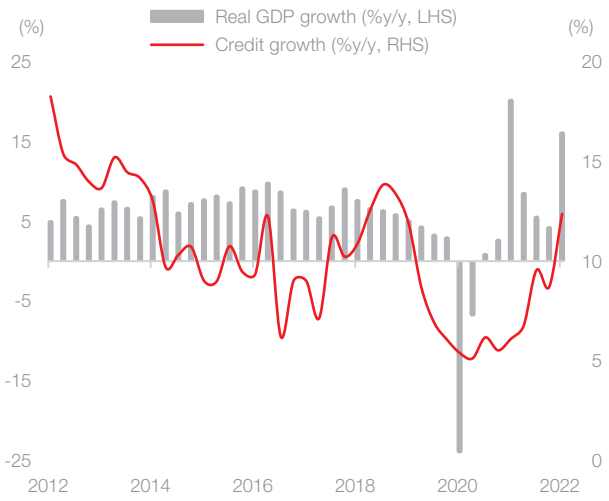
As an economy with rich natural resources, Indonesia stands to benefit from the current commodity boom. The energy transition towards reaching net zero emission goals by 2050 is supportive of demand for battery materials such as lithium, nickel, and cobalt for electric vehicles. Foreign direct investments into metals mining and battery production are rising in Indonesia. It is also rich in coal and natural gas, which is a relevant alternative energy source today; Indonesia holds about 1-2% of the world's total known reserves. Beneficiaries would include coal, energy, and metals stocks in Indonesia, Thai energy, and Singapore palm oil stocks.

Remain neutral in India

Attracted by a weak rupee and its position as an outlier in Asia's growth outlook, foreign investors were net buyers in India equities in 3Q22, reversing the weak trend observed in 1H22. However, macro risks are by no means fading – particularly from high oil and food prices and potentially further rate hikes. As such, the market is vulnerable to a turn in risk appetite due to its high valuation.

We remain Neutral in the market with preference for selected opportunities in banks and consumer discretionary sectors and FMCG stocks, driven by resilient domestic demand. Urban consumption remains strong as a result of post pandemic recovery; decent monsoon rains and higher agricultural prices are tailwinds for the rural income recovery.

India's credit growth supports recovery



Source: CEIC, DBS

Still Too Hot

GLOBAL RATES 4Q22

Inflation is proving stickier than what policymakers had anticipated. With no clear signs of a slowdown just yet, jumbo hikes in the DM space (excluding Japan) have become the norm. A downshift in the inflation fighting rhetoric from policymakers has been delayed.

Source: iStock

07. Global Rates.

Eugene Leow
Strategist

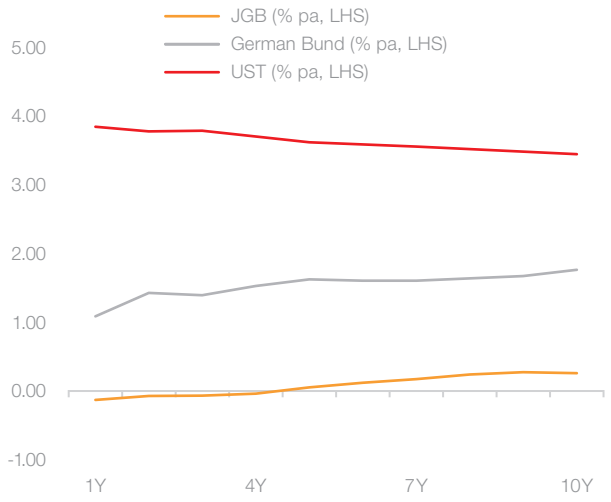
Duncan Tan
Strategist

The backdrop for interest rates remains challenging as markets struggle to digest persistently high inflation, hawkish central banks and resilience in economic activity. While headline inflation has likely already peaked in the US, we have become more worried about inflation being sticky. In the US, headline CPI did dip to 8.3% y/y in August (from a peak of 9.1% in June), however, this was a much milder drop than expected given the easing of supply chain disruptions, decline of commodity prices (including oil and food) and market-based inflation expectations. Moreover, the breakdown is worrying with signs of broadening out in price pressures that go beyond energy and food. With high frequency indicators pointing to a bounce in economic activity and the labour market still firm. We would expect the Fed to maintain its hawkish stance through 2023, marking a terminal rate of 5.0%. Risk of an extended hike cycle and a higher terminal rate should not be dismissed. We would expect USD rates to be reasonably buoyant in the immediate few months. Higher for longer will be the key theme as the Fed tried to curb inflation. This will likely keep the UST curve inverted for much of 2023. We also do not subscribe to the Fed cutting rates in 2023.

Meanwhile, the ECB will probably take the Refi rate to 2.0% by the end of the year. There is a reasonable risk that the hiking cycle gets extended or turns out to be more aggressive. The ECB is further behind the curve than the Fed even as the inflation figures are just as elevated (August CPI printed 9.1% y/y). Arguably, the runway for tightening is slightly longer as we the ECB started later and will probably want to get to at least neutral in this cycle. With the ECB getting serious with a 75bps hike next month, we think that there is further scope for the 2Y/10Y segment of the German Bund curve to flatten towards par.

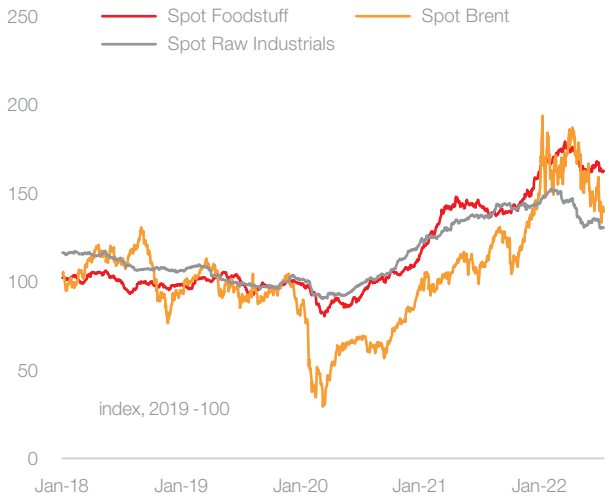
Lastly, there are no clear signs that a shift in BOJ's yield curve control (YCC) is imminent. It is difficult for the market to push the BOJ into shifting policy. Market participants did try in mid-year, pushing 10Y yields to the top of the trading band (0.25%) and selling JGB futures. However, the final decision still lies with the authority. Note that even with headline CPI breaching 2% in recent months and the yen weakening sharply, 10Y breakevens are still trading below 1%, suggesting that inflation expectations are anchored. It probably also helps that commodity prices have corrected somewhat. There are some signs that the authority might be concerned about yen weakness, but that might not be a sufficient trigger for a relaxation of YCC. We see 10Y JGB yields hugging near the ceiling of 0.25% for the foreseeable future.

G-3 curves likely to stay flat



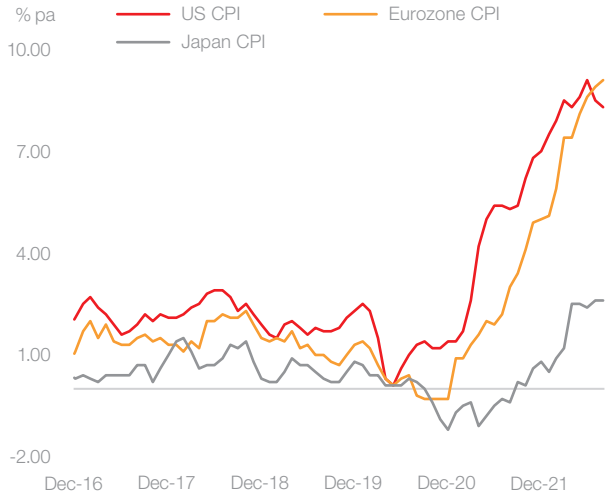
Source: Bloomberg, DBS

Commodity prices are easing off



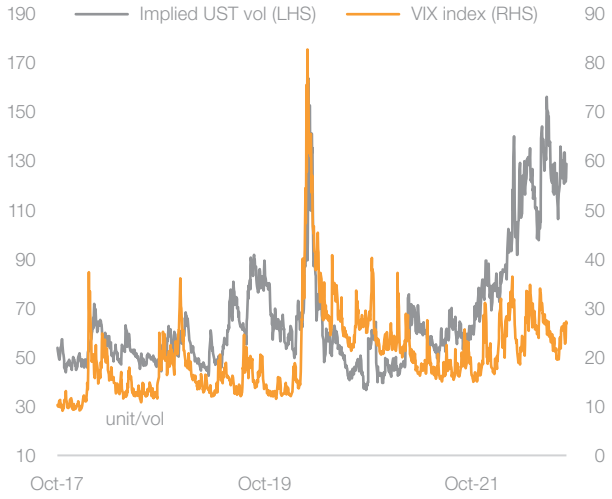
Source: Bloomberg, DBS

Inflation is peaking, but sticky, across the DM



Source: Bloomberg ,DBS

Rates volatility still elevated



Source: Bloomberg ,DBS

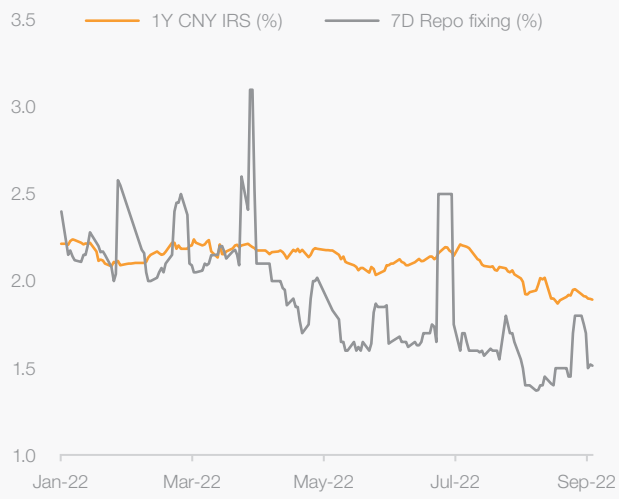
Source: iStock

Asia Rates

CNY rates: Slow and bumpy recovery

With significant uncertainty over China's Covid policy and possible spill overs from property sector risks, it has become increasingly clear that China's economic recovery would be slow and bumpy. Therefore, we expect monetary support to be in place for some time, rather than being unwound rapidly. CNY rates and CGB yields are likely to stay low in 4Q — the rebound in rates and yields that we had been expecting has been pushed further out now. Liquidity should stay very supportive in the near term until the recovery appears to be on a stronger footing. Market participants are likely to discount the possibility of rate hikes in the near term and would also expect the 7D repo fixing to stay low for an extended period of time. Positioning is likely already heavy, but there should still be strong interest to receive 1Y and 2Y CNY IRS/NDIRS to monetise the associated carry against low fixings.

Swap fixings to stay low in China

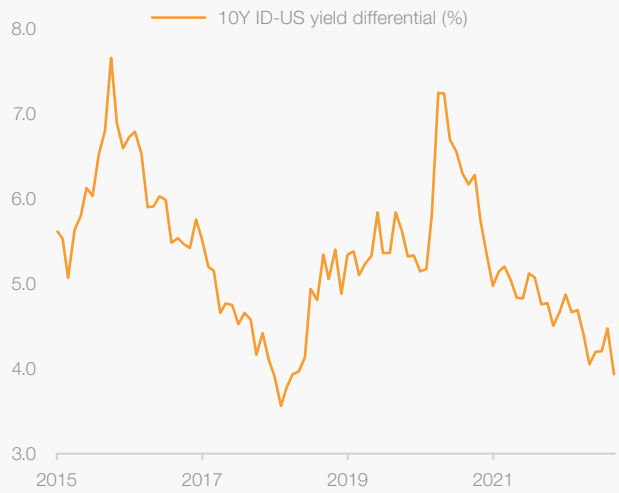


Source: Bloomberg, DBS

IDR rates: Liquidity normalisation drives flattening bias

We maintain a neutral stance on IndoGB as the global macro backdrop of tightening financial conditions, growth slowdown worries, and heightened geopolitical risks are not conducive for higher-beta and more risk-sensitive bonds to outperform. IndoGB's yield differentials over core and EM bonds also remain low relative to historical ranges, suggesting that risk-reward proposition may not be particularly attractive yet. 10Y IndoGB-UST yield differentials above 500 bps would be our trigger levels to reassess and consider turning bullish. In 4Q, total returns could be weighed down by bond and equity outflows, while the trade and Current Account surpluses could narrow if commodity export prices decline further. After the reserve requirement ratio for banks was raised to 9% in September, onshore liquidity is expected to normalise further with higher credit growth and continued bond sales (maturities of five years and below) by BI. As a result, the IndoGB curve is likely to flatten.

IndoGB's yield differentials remain low relative to historical



Source: Bloomberg, DBS

INR rates: Sensitive to declining oil prices

As the RBI gets closer to the end of its hike cycle (we forecast terminal policy repo rate at 6.00%), it could be interesting to look at OIS curve-steepening ideas to position for an eventual RBI pause and the pricing out of further rate hikes. Bond supply is also expected to stay heavy for the rest of the financial year, which could pass through to steepening pressures on the OIS curve, especially if market participants pay longer-tenor OIS to hedge duration risks of their bond portfolios. In 4Q, we favour a slight bullish stance on India GSec and think that GSec could outperform within the region. Besides the expected near completion of the RBI's hike cycle, crude oil prices could decline lower on global growth worries and disproportionately benefit GSecs. We could also begin to see stronger inflows on the back of FX liberalisation measures announced back in July, thereby bringing about better support for India's balance of payment dynamics.

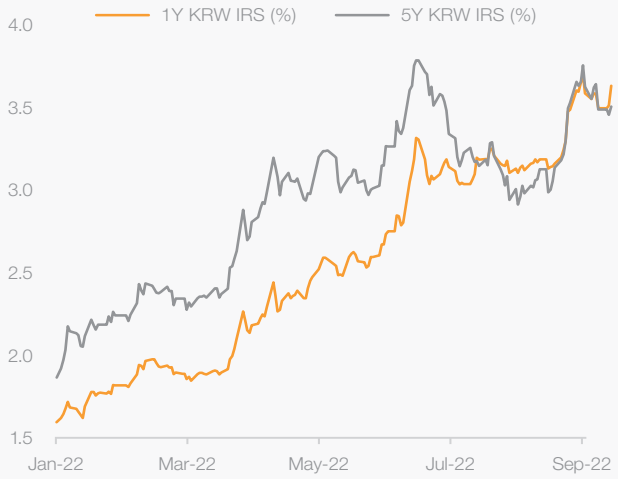
Favour steepeners as we approach end of RBI hike cycle

Source: Bloomberg, DBS

KRW rates: Scope for dovish pivot

In 3Q, there was strong upward momentum in KRW rates as markets, encouraged by the Bank of Korea (BOK)'s hawkish stance, priced for a more extended hike cycle. Instead of taking a directional view, we think the better opportunity is in IRS steepeners to fade the current extreme flatness of the curve. The outlook for external demand is expected to stay soft, and as a result, there is scope for the BOK to under-deliver on rate hikes in 4Q and markets could also start to project a dovish pivot. That could turn out to be the trigger for the IRS curve to re-steepen from very flat levels. Certainly, the slope of the US rates curve would also be a key factor on re-steepening potential. We also think that receiving KRW vs pay USD swaps could be an attractive relative value idea, as we see Korean terminal policy rates at a lower level relative to the US.

Favour steepeners to fade the flatness of KRW IRS curve

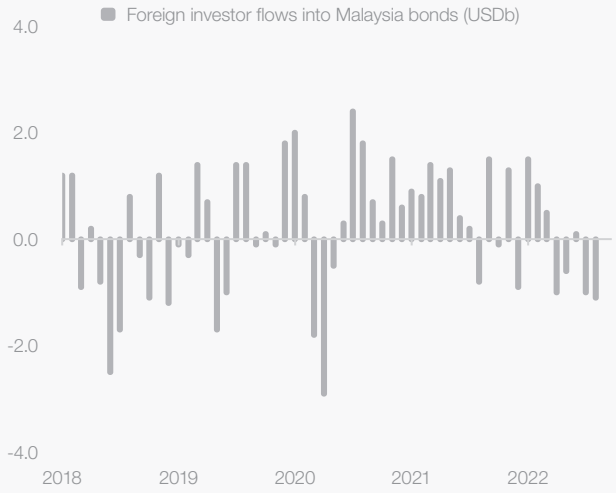


Source: Bloomberg, DBS

MYR rates: Less pressure for aggressive hikes

We like a receive on spikes strategy for MYR rates and also favour relative-value ideas involving receive MYR rates against pay other regional rates. BN is evidently under lesser pressures to hike rates in an aggressive manner. Inflation risks are relatively restrained as some of the fiscal tailwinds from higher commodity export prices are helping the government to maintain price subsidies aimed at keeping the cost of living manageable. Over the course of the pandemic, BN also stood out for not employing quantitative easing/bond-buying measures. Therefore, unlike some of its regional peers, the extent of required liquidity adjustment and balance sheet reduction is smaller and would not pose significant upward risks to MYR rates and bond yields. Foreign bond inflows could however be relatively muted in the near term due to the upcoming general election and the attendant policy uncertainty. However, we expect bond demand from local players, especially pension funds, to step up.

Foreign buying of Malaysia bonds could be muted in 4Q

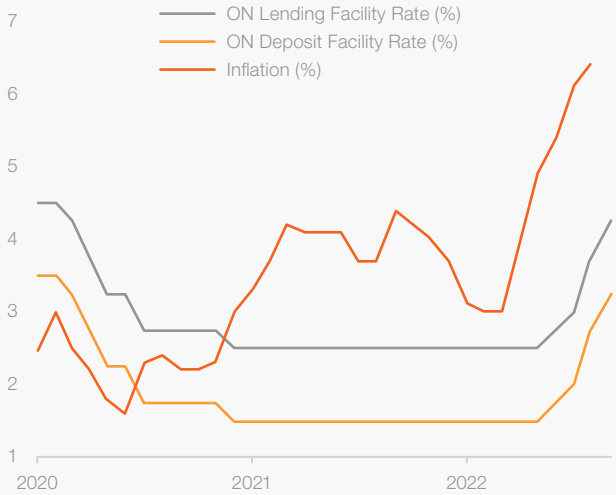


Source: Bloomberg, DBS

PHP rates: Larger rate hikes to compress inflation risk premium

The Philippine Treasury Bond curve is biased to continue flattening as BSP keeps up on rate hikes to anchor inflation expectations and bring inflation prints lower and towards its target. Recently in July, the BSP hiked policy rates by an outsized 75 bps. That was, at the time, the largest hike any Asia central bank had done. Further rate hikes in 4Q, likely of smaller sizes, are expected to push up the front-end of the bond curve, while the backend could be more anchored on compression of inflation risk premium. We are not overly worried on the Philippines' wide trade deficits as we think that the aggressive rate hikes would provide an offset via higher carry and also help to impart a dampening effect on domestic demand and capital imports. Being lower beta, and with limited exposures to China recovery risks, we think Philippines bonds can outperform.

Larger rate hikes in Philippines to anchor inflation expectations

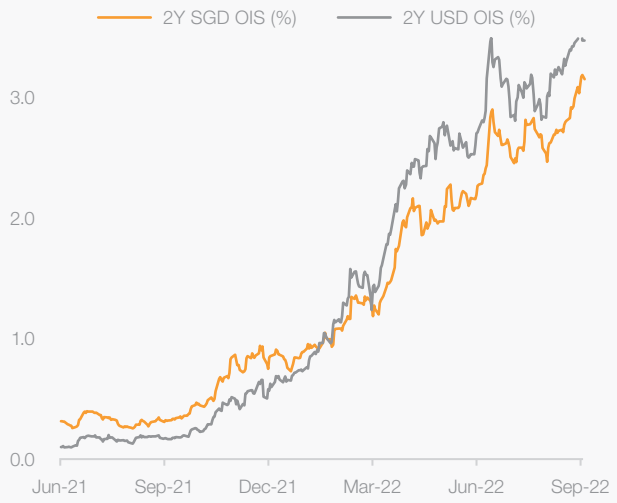


Source: Bloomberg, DBS

SGD Rates: Keeping policy tight

For this tightening cycle, the MAS has already done two rounds of recentring and three rounds of slope steepening. With core inflation not yet showing clear signs of moderation, we think that another round of tightening appears likely. Note that this hawkish bias is likely to remain even as growth risks could be tilted to the downside for Singapore due to global uncertainties. Accordingly, we expect SGD rates to outperform versus USD rates in this twin tightening backdrop (Fed and MAS). From the USD leg perspective, the Fed might also be forced to hike more aggressive to deal headline CPI that is stubbornly hovering around 8%.

Expect outperformance theme for SGD rates to extend



Source: Bloomberg, DBS

THB rates: Sooner than expected turn in Current Account

The BOT has signalled that its policy normalisation process would be gradual and measured, as the economy is still operating below pre-pandemic levels and recent high inflation prints were more supply than demand-driven. As a result, THB OIS rates and bond yields are expected to stay relatively low within the region, as the pace of BOT's rate hikes lags regional peers. The THB OIS curve could stay relatively steep, as a slower rate hike trajectory could mean that the BOT takes longer to reach terminal policy rates. Thai bond yields are substantially below comparable-maturity US Treasuries and are one of the lowest in the EM bond universe. However, Thai bonds could still deliver better total returns in 4Q. An acceleration in tourism arrivals closer to the high season, if accompanied by a further decline in oil prices on global growth worries, could see Thailand's Current Account turn into a surplus sooner than expected.

Thailand's tourism recovery could accelerate in 4Q

Source: Bloomberg, DBS

Rates forecasts

		2022				2023			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
US	3M SOFR OIS	0.67	2.10	3.50	4.38	4.88	4.88	4.88	4.88
	2Y	2.33	2.95	4.30	4.70	4.60	4.40	4.30	4.20
	10Y	2.34	3.01	3.70	3.90	3.80	3.70	3.60	3.60
	10Y-2Y	0	6	-60	-80	-80	-70	-70	-60
Japan	3M TIBOR	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
	2Y	-0.03	-0.06	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05
	10Y	0.22	0.23	0.25	0.25	0.25	0.25	0.25	0.25
	10Y-2Y	25	29	30	30	30	30	30	30
Eurozone	3M EURIBOR	-0.46	-0.20	0.95	1.70	1.70	1.70	1.70	1.70
	2Y	-0.07	0.65	1.45	1.80	1.80	1.80	1.80	1.80
	10Y	0.55	1.34	1.70	1.80	1.80	1.80	1.80	1.80
	10Y-2Y	62	69	25	0	0	0	0	0
Indonesia	3M JIBOR	3.65	3.65	4.00	4.55	4.80	4.80	4.80	4.80
	2Y	4.42	5.14	5.95	6.00	5.90	5.80	5.70	5.70
	10Y	6.74	7.22	7.45	7.60	7.70	7.65	7.55	7.45
	10Y-2Y	232	208	150	160	180	185	185	175
Malaysia	3M KLIBOR	1.97	2.38	2.75	3.00	3.25	3.25	3.25	3.25
	3Y	3.18	3.49	3.60	3.50	3.40	3.35	3.30	3.30
	10Y	3.87	4.24	4.40	4.45	4.45	4.40	4.35	4.30
	10Y-3Y	69	75	80	95	105	105	105	100
Philippines	3M PHP ref rate	3.09	2.85	4.25	4.60	4.60	4.60	4.60	4.60
	2Y	3.35	4.44	4.95	5.30	5.30	5.20	5.20	5.20
	10Y	5.83	7.02	6.80	6.95	7.00	7.00	6.95	6.90
	10Y-2Y	248	258	185	165	170	180	175	170
Singapore	3M SORA OIS	0.65	1.75	2.90	3.28	3.58	3.58	3.58	3.58
	2Y	1.86	2.68	3.40	3.60	3.40	3.30	3.20	3.10
	10Y	2.34	2.98	3.35	3.50	3.40	3.30	3.20	3.20
	10Y-2Y	48	29	-5	-10	0	0	0	10

%, eop, govt bond yield for 2-year and 10-year, spread bps.

Source: CEIC, Bloomberg, DBS

		2022				2023			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Thailand	3M BIBOR	0.63	0.73	1.12	1.37	1.62	1.87	2.12	2.12
	2Y	1.07	1.80	1.70	1.80	1.90	2.00	2.00	2.00
	10Y	2.26	2.82	2.65	2.65	2.75	2.75	2.75	2.80
	10Y-2Y	119	102	95	85	85	75	75	80
Mainland China	1Y LPR	3.70	3.70	3.55	3.45	3.45	3.45	3.55	3.70
	2Y	2.29	2.25	2.05	2.20	2.35	2.50	2.60	2.60
	10Y	2.79	2.82	2.60	2.70	2.80	2.90	2.95	3.00
	10Y-2Y	50	57	55	50	45	40	35	40
Hong Kong	3M HIBOR	0.55	1.75	3.20	3.98	4.48	4.48	4.48	4.48
	2Y	2.19	3.11	4.45	4.85	4.75	4.55	4.45	4.35
	10Y	2.40	3.26	3.90	4.10	4.00	3.90	3.80	3.80
	10Y-2Y	21	15	-55	-75	-75	-65	-65	-55
South Korea	3M CD	1.51	2.04	2.75	3.25	3.50	3.50	3.50	3.50
	3Y	2.66	3.55	3.75	3.85	3.85	3.75	3.65	3.55
	10Y	2.97	3.62	3.85	3.90	3.95	3.90	3.85	3.80
	10Y-3Y	30	7	10	5	10	15	20	25
India	3M MIBOR	4.24	5.18	5.60	6.10	6.10	6.10	6.10	6.10
	2Y	5.00	6.53	6.40	6.50	6.50	6.50	6.50	6.50
	10Y	6.84	7.45	7.55	7.60	7.60	7.40	7.30	7.30
	10Y-2Y	184	92	115	110	110	90	80	80

%, eop, govt bond yield for 2-year and 10-year, spread bps.

Source: CEIC, Bloomberg, DBS

Quality is King

GLOBAL CREDIT 4Q22

We anticipate that the slower but steadfast drift towards higher rates still necessitates an up-in-quality stance for credit. DM IG corporates remain in the best position to weather an environment of higher rates. In addition, longer term investors with a stronger risk appetite may pick points in DM HY for higher yields.

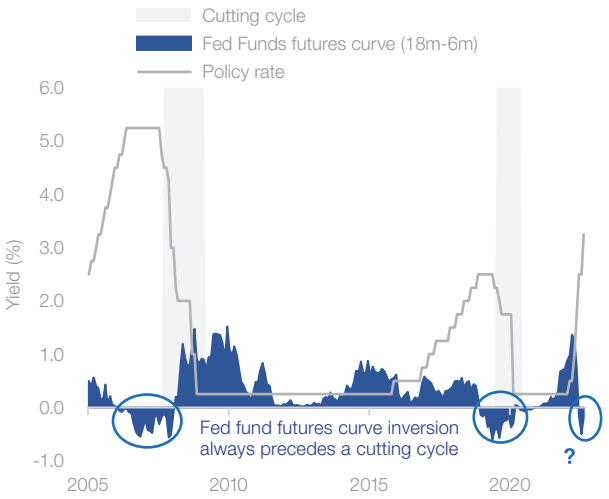
Source: Unsplash

08. Global Credit.

Daryl Ho, CFA
Strategist

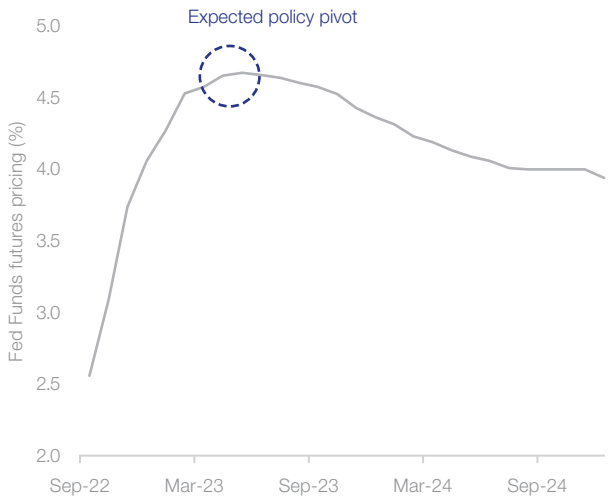
Back to the futures. For a year that has been fraught with volatility, it appears that all hope for a recovery in financial assets remain pinned on the sole prospect of a "Fed pivot" given softer economic conditions and the peaking of inflation expectations. In no other domain is this "pivot" more explicit than in the Fed funds futures curve, where the markets are now pricing that rates will peak in May 2023, and—rather remarkably—enter a cutting cycle that will last all the way into 2024. As incredulous as it sounds, the markets are suggesting that all the fears of runaway inflation, supply chain bottlenecks, and tight labour markets in the real economy would swiftly dissipate, resulting in a complete policy shift for the US Federal Reserve just six months down the road.

Markets leading the Fed



Source: Bloomberg, DBS

Hikes expected to give way to cuts



Source: Bloomberg, DBS

Futures market predicting the future. Investors might be derided for their naivete in believing that the futures market bestows some form of supernatural clairvoyance, if not for the fact that it has been unusually reliable in forecasting a turn in the policy cycle. In the last 20 years, an inversion in the futures curve—represented by the difference in yield between the 18-month forward and six-month forward Fed funds futures contracts—has preceded both the 2008 cutting cycle following the GFC, as well as the 2019 cutting cycle that was eventually extended through the Covid-19 crisis.

With this futures curve inverting again since June in the midst of an aggressive hiking cycle, investors may be enthused to think that easier monetary policy is just around the corner, allowing themselves a resurgence of risk-taking behaviour in the hope of reversing their fortunes for the remainder of 2022.

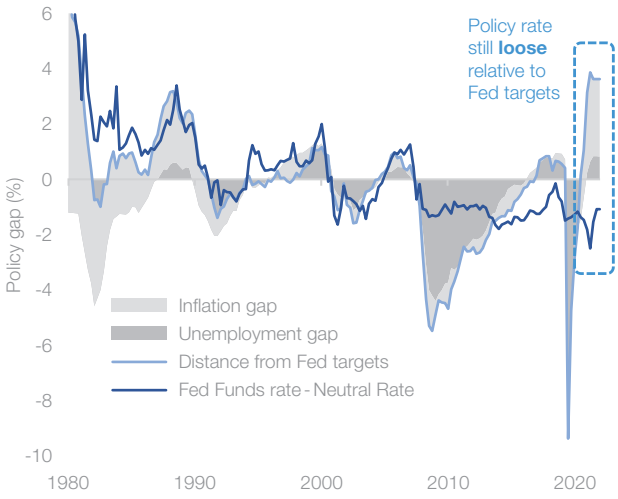
False dawns can lead to false hopes. We would, however, remain cautious with excessive risk-taking based purely on the expectation of expeditious rate cuts. In essence, none of the FOMC members have articulated a policy shift; rather, now that the Fed funds rate has been brought to a level that is commensurate with their expectations of the long-run neutral rate, any rate hikes that proceed henceforth would be dependent on data rather than on forward guidance.

The data itself does not encourage a change of heart. While economic activity has shown a moderation in its rate of change, one must be mindful that in absolute terms, the Fed is still further from their dual mandate of stable prices and maximum employment than they have ever been in the last 40 years, measured by both core PCE inflation (in excess of 2%) as well as the unemployment gap.

Theory suggests that the policy rate would still have to rise meaningfully above the neutral rate to rein in both inflation and unemployment from present excesses. As such, the time for unbridled risk-taking may be premature, given that either (a) the Fed would still need to push rates further above neutral, or that (b) inflation numbers somehow drop quickly/ unemployment numbers rise sharply enough, which often occurs during an economic hard landing.

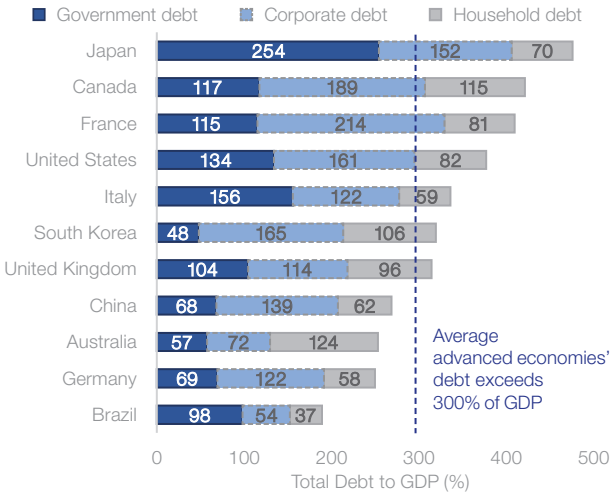
Anything worth doing is worth doing slowly. Where we are sympathetic with the market's expectations, is the fact that the Fed would eventually have to slow down its pace of hikes come 2023. After all, the impact of interest rate rises above neutral is amplified by the level of indebtedness observed around the globe — global debt to GDP in the post-virus binge is now in excess of 300% across most advanced economies.

Central bank targets are the furthest in 40 years



Source: Bloomberg, DBS

The world and all its liabilities



Source: IMF, DBS

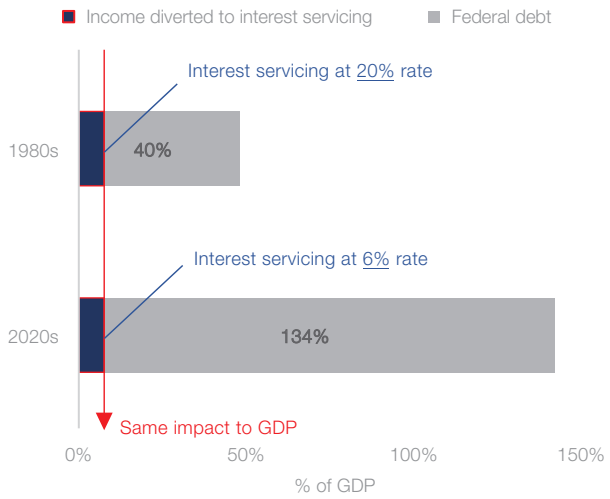
Source: Unsplash

How does indebtedness affect the level of interest rates? Fed Chair Paul Volcker had to famously raise the policy rate to 20% to reign in spiralling inflation in the early 1980s. However, given that Federal debt/GDP was c.40% at the time, this implied that a diversion of 8% (40% x 20%) of GDP to servicing interest was sufficient to bring down aggregate prices. Today, with Federal debt/GDP at c.134% in the US, the same tightening effect of 8% of GDP would be had with just a peak policy rate of c.6%. This number is arguably an overestimate, given that (a) current inflation is far from the peaks of the late 1970s, and (b) corporate debt has also risen dramatically since Volcker's time; the private sector would experience an equal if not greater degree of contraction with the same magnitude of hikes. We therefore expect that peak rates in this hiking cycle would end up far lower than 6% by the time the central banks are done.

When insolvency threatens the government. Another consideration for why rates cannot shift aggressively higher is that US tax revenues, after accounting for obligatory spending (such as entitlements and defence), is presently only just enough to cover debt interest expenses. While it could be argued that the Fed could always print the difference, the government would risk a vicious ever-growing debt-interest spiral should tax revenues continue to diminish relative to what is needed to service their liabilities. Notably, such "interest coverage" ratios of 1x are more typical of junk-rated companies — one could hardly fathom that the most advanced economy in the world would fall in the same creditworthiness camp as many distressed businesses.

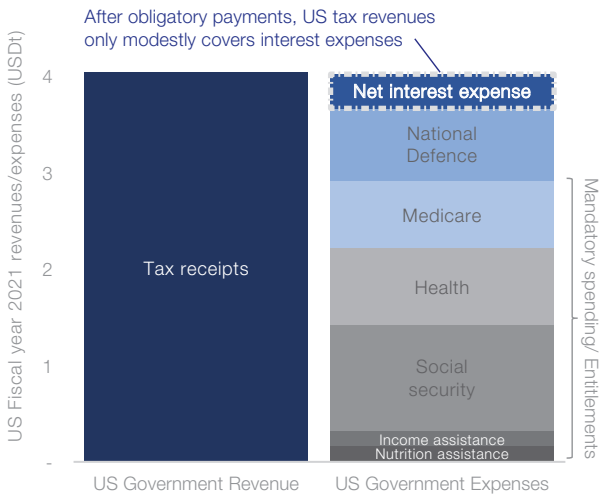
Minding risks in corporate credit. Given the macro setup of (a) interest rates still having to rise

Same detraction from GDP at much lower rates



Source: IMF, DBS

US tax revenues can hardly cover interest payments



Source: Datalab, USAspending.gov, DBS

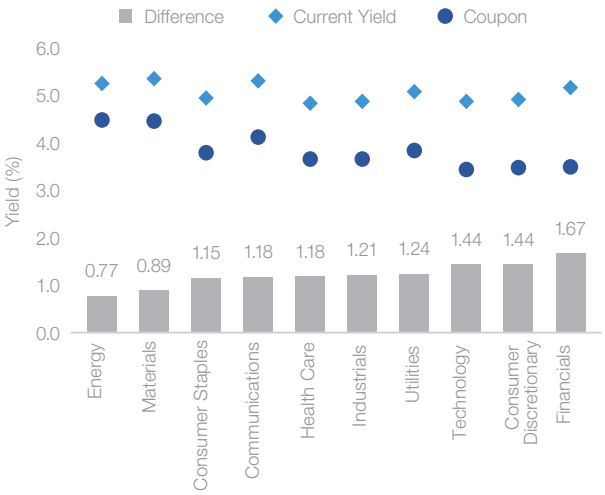
above neutral to slow inflation, coupled with (b) the amplified impact of higher rates on growth due to soaring indebtedness worldwide, credit risks would likely first emanate from the most leveraged corners of the economy. It would therefore be prudent for credit investors to conduct a sectoral risk assessment to reveal the areas of greatest risk, given that loss avoidance is key for outperformance in a credit portfolio.

We illustrate this sectoral analysis using companies across the US IG universe, covering both credit risks and fundamental data to rank the sectors that are most exposed to a higher rates environment. We then replicate the analysis across other key global credit markets to come up with an overview of where pockets of weaknesses may surface as rates continue their upward trajectory.

Refinancing risk – how much it costs to extend maturing debt. The first concern in a higher rates environment for corporates is how much more it will cost to refinance existing debt. Here, we compare existing coupon yields against prevailing bond yields across the various sectors of the US Investment Grade (IG) universe, as this approximates the difference in cost between current and future debt. Notably, the Consumer Discretionary and Financials segments are seeing the highest refinancing costs, while the Energy sector is hardly registering a difference.

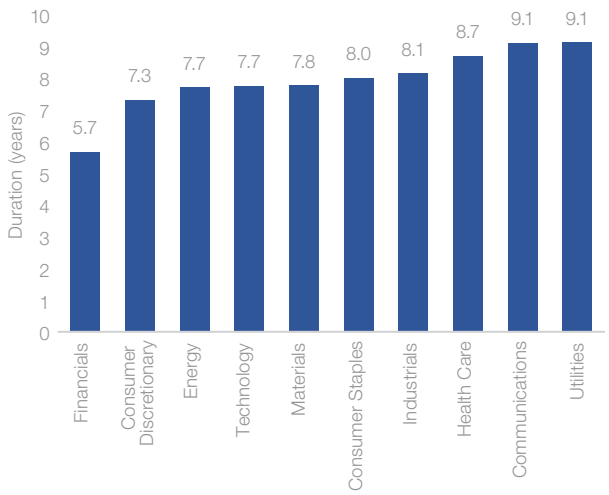
Duration risk — how long interest rates are locked in. Related to the risks of refinancing is the average term of debt across the various sectors. A higher average duration of bonds in the sector implies that companies have locked in prior lower rates for longer periods, therefore insulating themselves against rising rates as debt may not be maturing in the near term. Here, we observe that once again the Financials and Consumer Discretionary sectors have debt with the shortest maturities. It is noteworthy

Refinancing risk across sectors in US IG



Source: Bloomberg, DBS

Debt duration across sectors in US IG



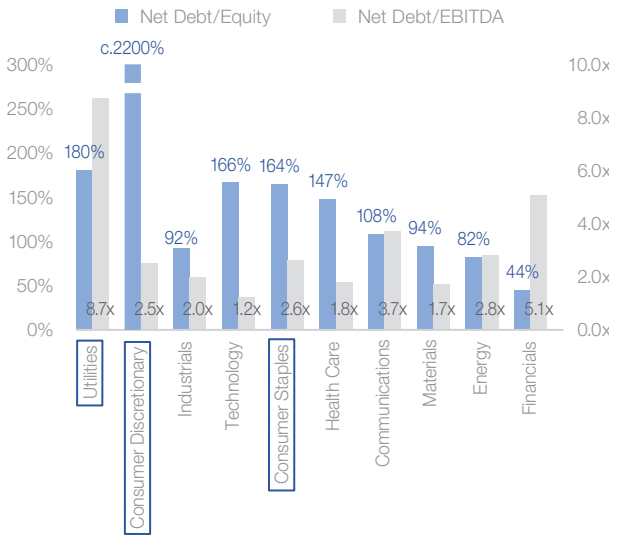
Source: Bloomberg, DBS

however, that overall duration is still upwards of five years, which is commendable — most companies in the US had seized the opportunity during the extraordinarily low rates of 2020 to term out their borrowings.

Leverage — how much absolute debt a company has relative to assets and earnings. Next, we look at company balance sheet fundamentals — particularly gearing (net debt/equity) and earnings coverage (net debt/EBITDA). The former represents a measure of financial leverage (how encumbered a company is with debt) while the latter is an estimate of how long it might take for the company to pay back its debt, assuming consistency in earnings. We are cognisant that the benchmark for financial health can vary across sectors — e.g. some sectors such as Utilities can remain fundamentally strong with higher leverage due to good earnings visibility. However, for this analysis, we highlight a more straightforward comparison of aggregate leverage in the system for the sake of simplicity. Here, apart from Utilities, it is both the Consumer Staples and Consumer Discretionary sectors that are showing elevated levels of leverage.

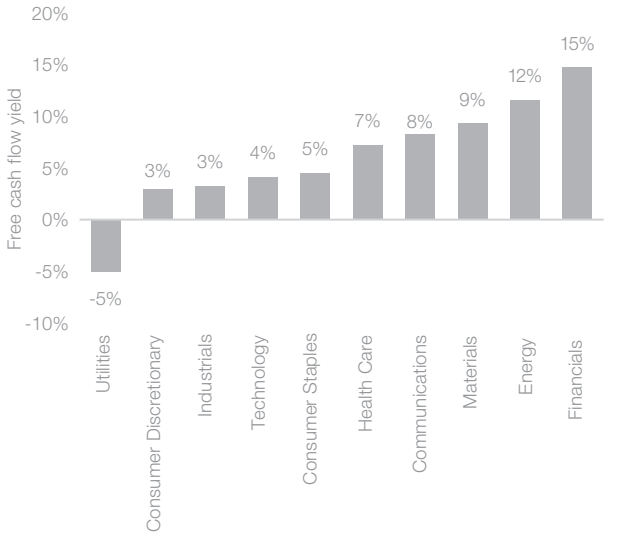
Free cash flow — the lifeblood of companies. Finally, we include a measure of financial performance — looking at the free cash flow yields of various sectors. This is cash that a company retains after paying for operating expenses and capital expenditures — cash that allows for flexibility in a slowing growth environment. Here it is the Utilities, Industrials, and Consumer Discretionary sectors that are showing mediocre performances, while Energy, Financials, and Materials have shown excellence — not a surprise given that elevated commodity prices and higher interest rates directly add to their bottom lines.

Leverage risks across sectors in US IG



Source: Bloomberg, DBS

Free cash flow yields across sectors in US IG



Source: Bloomberg, DBS

Source: Unsplash

Rising rate risk scores for key credit markets

Sector	US IG	US HY	EUR IG	EUR HY	EM USD	Asia USD
Energy	13.8	29.4	12.0	19.6	16.8	12.4
Materials	12.6	40.4	22.0	44.6	19.6	37.2
Technology	22.8	45.0	20.0	34.2	15.0	14.6
Health Care	18.0	48.0	22.4	39.6	37.2	
Communications	17.2	40.8	19.8	37.8	18.4	19.6
Industrials	18.8	43.4	25.0	44.0	31.4	34.4
Financials	20.4	43.0	30.8	37.8	35.4	40.8
Consumer Discretionary	30.0	51.0	19.4	39.6	30.0	23.4
Consumer Staples	23.4	46.6	26.0	50.0	31.6	38.2
Utilities	32.4	35.0	31.4	39.8	35.6	42.2

Source: Bloomberg, DBS

Summarising sectoral risks in a rising rate environment. Using this framework, we formulated a scoring system to determine the composite exposure of risk to rising rates based on the above factors, and extended the analysis across sectors in the US IG/HY, Europe IG/HY, EM USD, and Asia USD credit markets.

IG credit scores best, while Energy, Materials, and Technology sectors are expected to remain strong. Utilities and Consumer-related sectors will face pressure. Unsurprisingly, the IG corporates are expected to best weather an environment of higher rates. In terms of sectoral comparison, the Energy, Materials, and Technology companies have the best risk scores, while the Utilities and Consumer-related segments have the poorest. This makes intuitive sense. Utility companies are likely to face margin pressure, given (a) the higher input costs of raw materials and labour due to inflation, while (b) revenues cannot quickly adjust as prices are often heavily regulated due to political pressure. The consumer segments would also likely face headwinds, as the effect of inflating costs and rising mortgage rates would reduce the real value of disposable income, diminishing every individual's propensity to consume.

Returns adjusted for higher rates risk. To complete the analysis, we use the risk scores that we had derived as a denominator to adjust sectoral credit spreads — to obtain a measure of risk-adjusted returns.

Risk-adjusted spread scores for key credit markets

Sector	US IG	US HY	EUR IG	EUR HY	EM USD	Asia USD
Energy	11.7	13.1	17.3	31.0	18.3	14.3
Materials	13.7	11.2	8.3	12.2	15.8	9.1
Communications	10.0	11.0	8.4	14.3	14.2	10.9
Technology	5.5	10.0	6.7	16.7	11.5	11.9
Health Care	6.7	9.8	6.5	12.5	8.9	
Industrials	6.6	10.0	6.3	11.2	7.8	5.2
Financials	7.4	11.7	7.5	16.7	6.5	6.1
Consumer Staples	5.7	9.5	5.9	16.7	9.0	4.9
Consumer Discretionary	4.3	9.2	9.4	15.1	14.8	17.3
Utilities	4.5	9.0	6.8	11.7	6.6	4.8

Source: Bloomberg, DBS

Once again, the Energy and Materials sectors come out on top. Interestingly, DM HY bonds are also surfacing value, given that spreads have widened since 2Q this year. Longer-term investors may find select opportunities to obtain good risk-adjusted returns over an extended time horizon with DM HY, but this would not immunise them from volatility in the near term as the rate hike cycle is still underway.

In summary, we anticipate that the slower but steadfast drift towards higher rates still necessitates an up-in-quality stance for credit. The cycle may turn sooner or later, but it certainly does not look like it would come all at once. DM IG corporates remain in the best position to weather an environment of higher rates, given lower refinancing risk, stronger credit fundamentals, and greater cash flow generation. In terms of sectors, the same factors are favourable for the Energy, Materials, and Technology space, while the Utilities and Consumer-related segments are likely to face pressure. Longer term investors with a stronger risk appetite may pick points in DM HY for higher yields, at the same time being mindful that volatility is not expected to dissipate anytime soon. The sweet spot remains with DM IG in the A/BBB rating bucket, with the 2-4 year duration segment as the steepest point of the credit curve.

Hope & Caution

GLOBAL CURRENCIES 4Q22

The Fed wants more rate hikes which should keep the USD strong for the rest of 2022. Next year, a peak and pause in the Fed hike cycle could cool the USD, barring financial stress and a hard landing.

Source: Unsplash

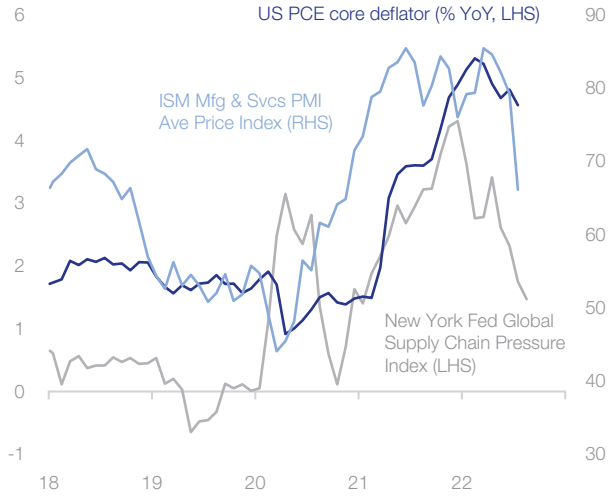
09. Global Currencies.

Philip Wee
Strategist

We see USD extending its rally for the rest of the year before pulling back in 2023. After the Jackson Hole Symposium in August, the Fed sees more rate hikes to 4.4% this year and 4.6% next year to control inflation. The US economy is set to exit its technical recession in 3Q22. Conversely, EU's growth is expected to turn negative in 4Q22 from Russia turning off the gas this winter. UK is projected to enter a recession from 4Q22. With China cutting rates to cushion its struggling economy, the CNY is pressured, like the JPY, by monetary policy divergences. However, some major central banks, like the European Central Bank and the Bank of Canada, have joined the Fed in delivering outsized hikes to cushion their currencies against the USD's strength. USD could rise further as a haven if the concerted tightening tips the world economy into a recession or a financial crisis. However, this will be brief because of the need for policy to support growth or financial markets. Assuming a soft-landing next year, we expect the USD to peak when the Fed stops jumbo hikes and returns to normal increases before an eventual pause.

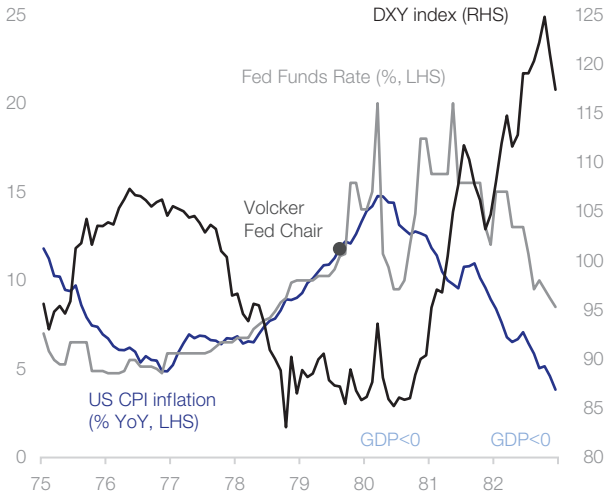
Emerging Asian (EA) currencies were less resilient to the greenback's strength in 3Q22. INR, MYR, PHP, and VND depreciated to lifetime lows. TWD, KRW, and THB plunged to the weakest levels since 2019, 2009 and 2006 respectively. INR and IDR tested psychological support levels at 80 and 15,000 per USD respectively. HKD held close to the weaker limit of its convertibility band. Like JPY, CNY came under pressure from monetary policy divergences. The outlook for the export-led region was weighed down by weaknesses in the world's largest economies. China's economy continued to struggle with its Covid-Zero policy and property woes. Europe faces recession risks from a cost-of-living crisis, Russia cutting off energy supplies, and a prolonged war in Ukraine. In the US, the Fed is committed to controlling elevated inflation at the expense of growth. With more Western central banks joining the Fed in delivering large hikes, more Asian central banks also raised rates to support their currencies and fight inflation. Although EA currencies can expect relief when Fed hikes pause, there is little room for complacency given the gloomier outlook for 2023 on higher borrowing costs worldwide.

US inflation still elevated despite nascent signs of peaking



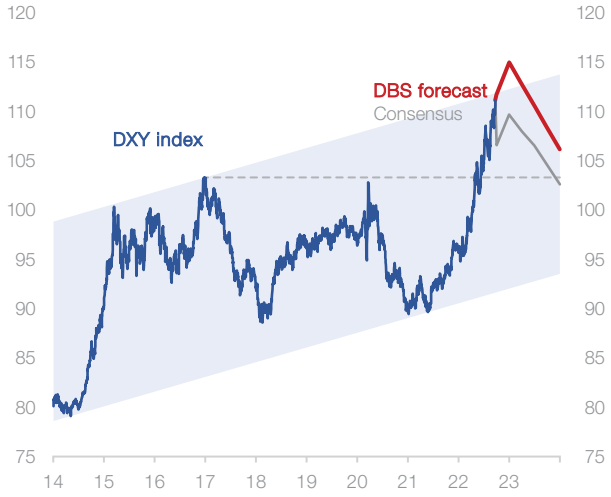
Source: Bloomberg DBS

Volcker pushed inflation lower with high rates, a strong USD, and a double-dip recession



Source: Bloomberg DBS

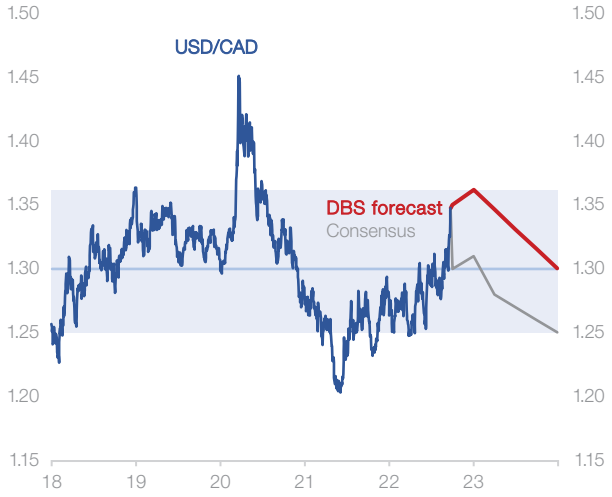
USD Index firm until Fed hikes pause in 2023 amidst soft landing



Source: Bloomberg DBS

We see USD extending its uptrend into 4Q22 before consolidating in 2023. In September, the Fed forecasted rates ending the year higher at 4.4% instead of 3.4% previously and flattening at 4.6% in 2023. The projections suggest that USD stays strong ahead of a possible fourth 75 bps hike in November. The US economy will fare relatively better than its troubled peers in Europe and China in 2H22. However, the projections also suggest smaller hikes in the subsequent FOMC meetings that will be less hawkish and less supportive of the greenback. More so, given that other central banks such as the ECB and the BOE are also stepping up hikes into the neutral and restrictive territory to fight inflation. The Fed's pledge to reduce inflation with a sustained period of below-trend growth, a softer labor market, and some pain to households and businesses are unlikely to sit well with US lawmakers running at the mid-term elections on 8 November. As this year's aggressive tightening works through the economy, inflation should show more evidence of slowing. US hike cycles ended after the New York Fed's underlying inflation gauge fell back to 3% in the past three hike cycles.

CAD resilient but not immune to USD's strength



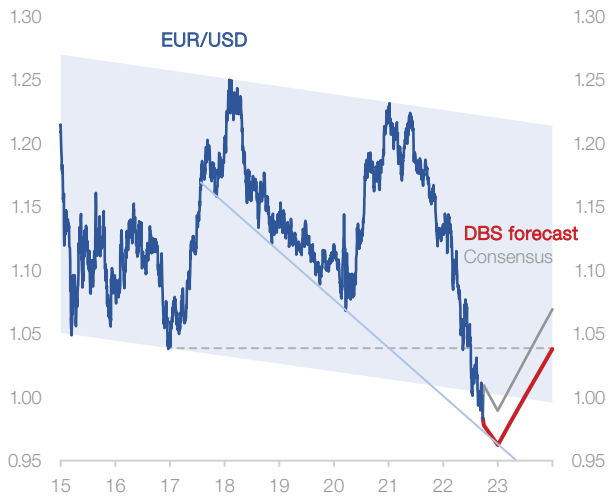
Source: Bloomberg DBS

CAD depreciated into a weaker 1.30-1.40 per USD range. In the first eight months of this year, CAD was the most resilient currency in the DXY basket, keeping to a 1.25-1.31 range. The central bank (BOC) strove as best as possible to synchronise rate hikes with the Fed at every meeting. After the Fed's Jackson Hole Symposium in late August, the CAD was not immune to the USD's strength from the Fed's resolve to control inflation at the expense of growth. Weak demand fears weighed heavily on commodities and the currencies that rely on them. As CAD extended its depreciation from 1.30 to 1.35, CAD became the second most resilient DXY currency after CHF. Although we expect the BOC to parallel Fed hikes to 4.5%, CAD will stabilise only after the Fed shifts towards smaller hikes, possibly with a 50 bps hike in December and two 25 bps rises in 1Q23. The Canadian economy is better positioned than the US to achieve a soft landing. Unlike the wide twin deficits in the US, consensus expects Canada to post current account surpluses of 0-1% of GDP over the next two years and narrower fiscal deficits of less than 2.5% of GDP.

EUR to stay pressured in 4Q22 before stabilising. Although the central bank (ECB) joined the Fed in delivering a 75 bps hike in September, consensus sees the Eurozone economy contracting in 4Q22, one quarter after the US economy exits its technical recession. Russia shut down Europe's gas supplies via the Nord Stream 1 pipeline and would not resume production until the West lifted sanctions. The ECB is prepared to sacrifice growth to control inflation which it now sees firmer at 5.5% in 2023 instead of 3.5%. Its pledge to keep hiking over the next several meetings was accompanied by a significant downgrade in the 2023 growth forecast to 0.9% from 2.1% previously and its refusal to define a neutral rate. In bringing its stance closer to the Fed's, the ECB addresses the additional inflationary pressures from a weak EUR. The ECB is not looking to reverse EUR's decline against USD but to uphold it on a nominal effective exchanger rate basis. To achieve its goals without disruption, the ECB introduced the Transmission Protection Instrument in July to address fragmentation risks. Hence, the EUR's stabilisation hinges heavily on the Fed hikes slowing and entering a pause in the coming quarters.

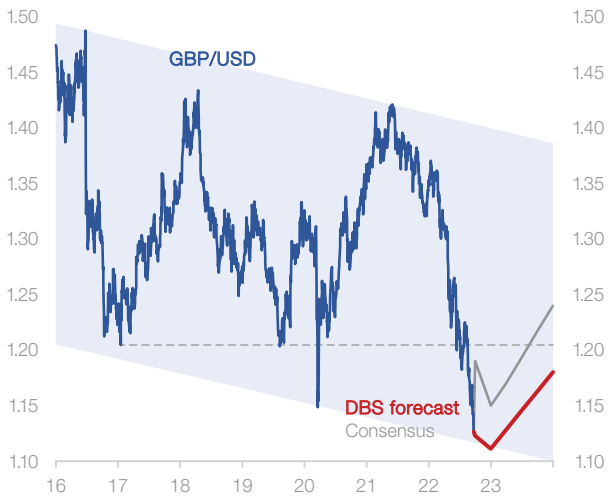
GBP remains under pressure from UK's fragile economy, a cost-of-living crisis, and political-policy uncertainties. GBP plunged 16.8% YTD to 1.1263, its fastest decline since the 2016 Brexit Referendum. Hitting its lowest level since March 1985, GBP was near its lifetime low of 1.0520 in February 1985. Although the central bank (BOE) started tightening earlier last December, its policy rate differential against the US turned negative in June and widened on the Fed's jumbo 75 bps hikes. The BOE has refrained from matching the Fed's pace because of UK recession risks. However, markets considered the BOE's 50 bps hike inadequate to rein in double-digit inflation. On 6 September, Liz Truss became the fourth Prime Minister since 2016, two days before the Queen's passing. Despite support for the energy price cap to ease the cost-of-living crisis, investors consider her tax cut plan to support growth as inflationary, putting the national debt on an unsustainable upward trajectory. Between the two BOE meetings on 4 August and 22 September, the 2Y Gilt yield surged to 3.53% from 1.85%. According to an article by The Guardian, Tory MPs worry her policies might hurt the Conservative Party at the next general election.

EUR still seeking a bottom until Fed hike cycle pauses



Source: Bloomberg, DBS

With UK's weakened fundamentals, GBP keeps below 1.20

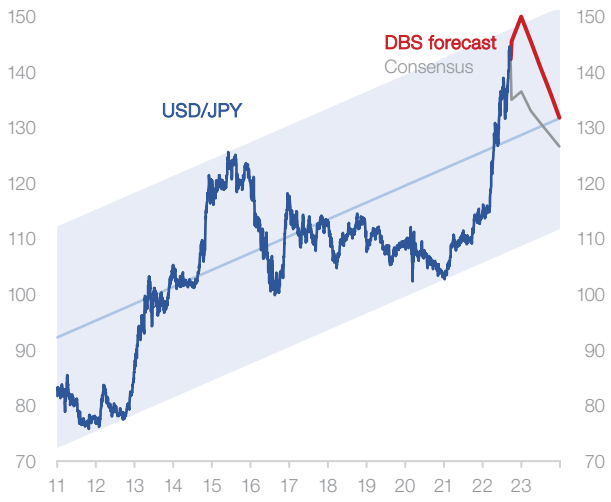


Source: Bloomberg, DBS

JPY is weak in a 140-150 range on monetary policy divergences. At its worst point in September, JPY depreciated 20% YTD to 145 per USD, a 24-year low. The last time the JPY fell this badly was in 1982, when the Fed sought to control inflation with aggressive hikes and a stronger USD. Doubts persist that direct interventions, like the one on 22 September, can halt the one-sided selling pressures on the JPY. Past experiences in the early 1980s and the interventions in 1998 suggested that financial stress or a US hard landing were better at lifting the JPY via Fed cuts. However, the Fed plans to lift rates to 4.6% this year, up from the 3.4% projected in June. Other major central banks also stepped up rate hikes to mirror the Fed to support their currencies on an effective exchange rate basis. Conversely, the central bank (BOJ) firmly stands by its yield curve control policy to keep monetary policy loose until Governor Kuroda's term ends in April 2023. Although Japan's CPI inflation rose to 3% y/y in August, core prices (excluding food and energy) held below the 2% target at 1.6%. To complicate matters, Japan reported its worst trade deficit in nine years.

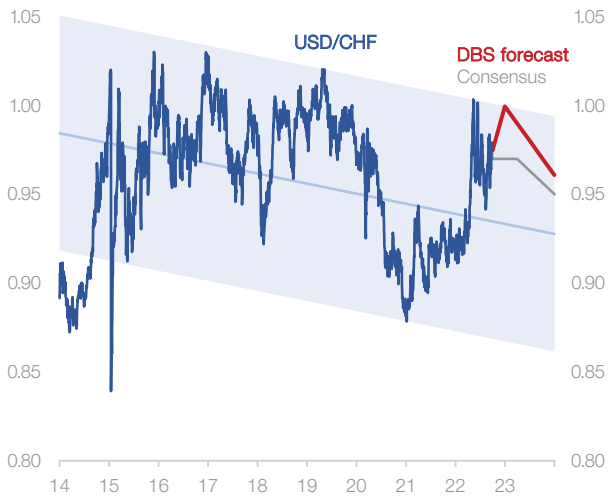
We expect CHF to fluctuate between 0.93 and 1.00 per USD, the upper half of its descending price channel. Shortly after USD/CHF hit parity a second time in mid-June, the SNB joined the global tightening cycle with a surprise 50 bps hike to -0.25%, its largest in 15 years. SNB considers positive interest rates and a stronger exchange rate desirable in cooling inflation from three-decade highs. We believe consensus might be too conservative in expecting rates to peak at 0.75% this year. SNB joined the ECB in delivering a 75 bps hike in September and left the door open for more tightening. SNB's Thomas Jordan warned that it was premature to call a top in inflation because of the European energy crisis. He also sees a strong exchange rate contributing to price stability, especially in nominal and real effective exchange rate terms. Compared to the Eurozone and the UK, Switzerland is better positioned to tighten monetary policy, thanks to a healthy current account surplus of some 7% of GDP, a balanced fiscal position, and a low public debt ratio of around 40% of GDP. Hence, CHF is well-positioned to recover next year, assuming the Fed hikes slow and peaks in the coming quarters.

JPY continues to struggle against monetary policy divergences



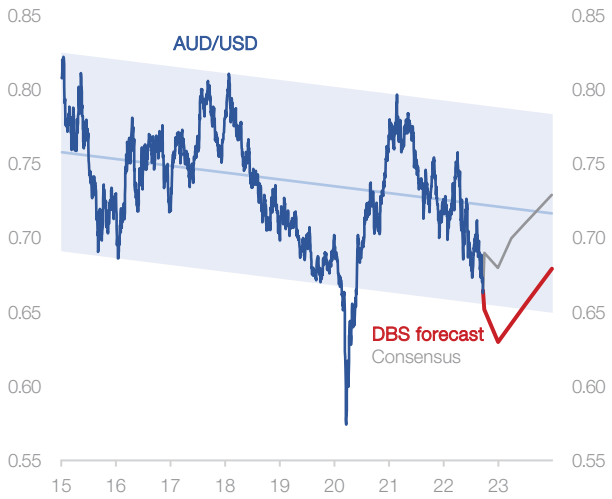
Source: Bloomberg, DBS

CHF to fluctuate in the weaker half of its descending price channel



Source: Bloomberg DBS

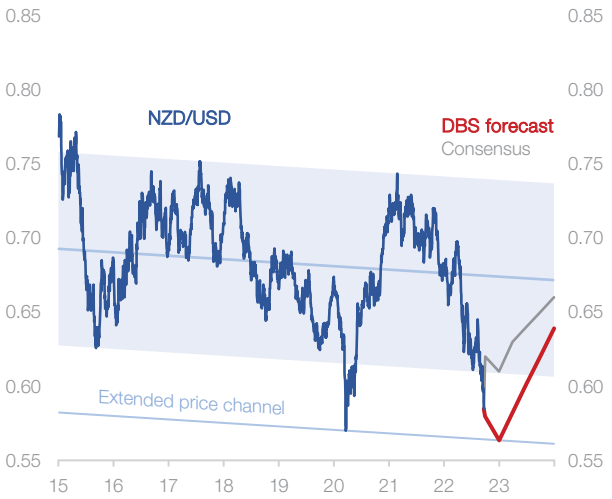
AUD depreciated into the weaker half of its price channel



Source: Bloomberg, DBS

AUD to break below its price channel. AUD was not immune to USD's strength worldwide and fell into the lower half of a price channel. The central bank's (RBA) 225 bps hikes to 2.35% in May-September could not match the Fed's 300 bps hikes to 3.25% in March-September. Consensus expects RBA rates to peak at 3% this year, less than the Fed's projected 4.6% level in 2023. Australia's inflation surged to a three-decade high of 6.1% y/y in 2Q22. Treasurer Jim Chalmers predicted inflation peaking at 7.75% in December and staying high at 5.5% in mid-2023. Australia will join its developed peers in reporting inflation monthly instead of quarterly. Chalmers did not expect a recession and forecast a 3% growth in FY2022-23 and 2% in FY2023-24. In Asia, Australia's largest export destination, currency weakness added more pressure on the Oz in 3Q22. Global growth worries from a struggling Chinese economy and synchronised monetary tightening worldwide hurt commodity demand. AUD was more resilient than NZD. As of 22 September, AUD depreciated 8.5% YTD, less than the kiwi's 14.3% decline. Although the DXY hit a 20-year high, AUD's 0.6630 low was well above 0.55, the Covid-19 low in 2020.

NZD to trade below its price channel before recovering in 2023



Source: Bloomberg, DBS

We see NZD holding below 0.60 before recovering next year. Although the central bank (RBNZ) was ahead and more aggressive in hiking rates, NZD was the weakest commodity-led currency. As of 22 September, NZD depreciated 14.3% YTD, more than the 8.5% and 6.2% declines in AUD and CAD respectively. It has also retraced 90% of its post-Covid 19 gains. RBNZ Governor Adrian Orr apologised for the role of monetary policy in inflation and pledged to tighten monetary conditions further to cool the tight labour market, wage pressures, and housing market. Prime Minister Jacinda Ardern has eased her Covid-Zero policy and reopened borders to tourism to shore up her low approval ratings ahead of next year's elections. To ease the cost-of-living crisis, Treasury extended in July the reductions in fuel excise duty, road user charges, and public transport fares until the end of January 2023. Despite 275 bps of hikes to 3% from October to August, the RBNZ was "absolutely resolute" about bringing rates to at least 4% by 1Q23, a level it deemed unambiguously above neutral. RBNZ expects inflation to return from a 32-year high of 7.3% y/y in 2Q22 to its 1-3% target by mid-2024 without a recession.

Source: iStock

Asia Currencies

CNY

We see CNY weaker above 7.00 per USD on monetary divergences. CNY's 21-month appreciation halted at 6.30 shortly after Russia invaded Ukraine in February. Two factors lifted USD/CNY into a 6.65-6.80 range between May and August. First, China's economy missed its official 5.5% growth target this year because of its Covid Zero Policy lockdowns and property crisis. Second, the Fed quickly moved to deliver jumbo hikes that eroded the resilience of the Asian currencies to USD's strength. Monetary policy divergences started to pressure the CNY after the central bank (PBOC) began cutting rates in mid-August, just before a more hawkish Fed projected US rates peaking higher at 4.6% next year. USD/CNY duly entered a higher trading range above 7 in September. However, we see scope for USD/CNY to stabilise between 7 and 7.20 on a Fed pause and a US slowdown. Our economist also projects China's growth recovering from 3.5% this year to 5% in 2023 and rate hikes in 2H23. We expect President Xi Jinping to secure a precedent-breaking third term at a party congress later this year. No one expects US-China relations to improve from Xi's meeting with US President Biden at the G20 Summit in November.

CNY under pressure from monetary policy divergence

Source: Bloomberg, DBS

HKD

In 2023, HKD could return to 7.80, the mid-point of its convertibility band, assuming Fed slows the pace of hikes and pause in the coming quarters. Our economists expect Hong Kong's GDP growth to recover to 3.8% in 2023 from 1% this year, and US growth to slow to 1.3% from 2%. However, slow growth has a silver lining. Hong Kong has been spared from the high inflation plaguing many countries. Monthly composite inflation held below 2% y/y in the first eight months. We do not doubt the de facto central bank's (HKMA) commitment to the linked exchange rate system. First, Hong Kong's short-term rates marched in lockstep with the aggressive US rate increases. Second, HKMA intervened to defend HKD's peg to the USD at the ceiling of convertibility range. Foreign reserves decreased 13% YTD to USD431bn in August, to levels at the start of Covid-19. The peg is also supported by healthy current account surpluses of 8% of GDP in 2022 and 7% in 2023. The fiscal deficit of 1.9% this year is also one of the narrowest in the region. Hong Kong could also benefit from more dual primary listings of Chinese companies in the territory.

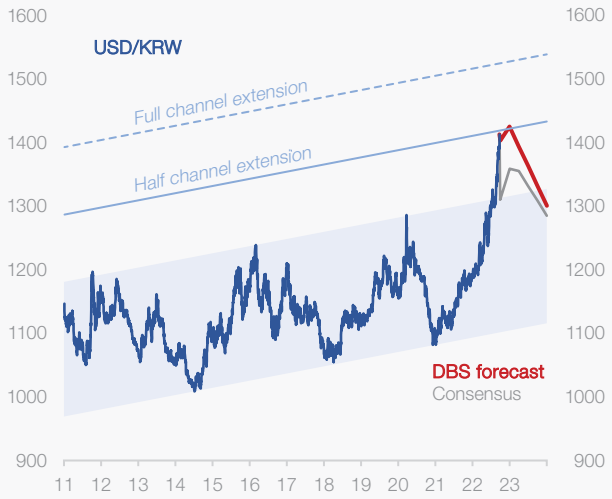
HKD to hold at 7.85 before recovering next year

Source: Bloomberg, DBS

KRW

We see more upside for USD/KRW above its multi-year price channel. KRW is the second-worst performing Asian currency after the JPY. On 22 September, the KRW depreciated 15.7% YTD to 1413 per USD, its worst close since 2009. The KRW was not immune to its weak Northeast Asian peers – JPY, CNY, and TWD. The trade deficit totalled USD24.7b in the first eight months from slowing exports, a sharp reversal of the USD20.7b surplus in the same period last year. However, the current account surplus is forecast to widen to 3.4% of GDP next year from 1.6%. South Korea's rate differentials against the US turned negative from jumbo hikes in the US. Our economist sees BOK hikes peaking at 3.25% in 1Q23, less than the Fed's 4.6% forecast for US rates in 2023. She expects rates to hold at this level from GDP growth slowing from 2.8% this year to 2% in 2023, and inflation doing likewise from 5.3% to 2.8%. Policymakers and banks are mindful of the challenge of higher borrowing costs on record household debt (2Q: 108.5% of GDP). Although external debt also hit a record USD662bn in 2Q22, foreign reserves (August: USD436b) were comfortably above short-term external debt (2Q: USD184b).

KRW extended its weakness above the price channel

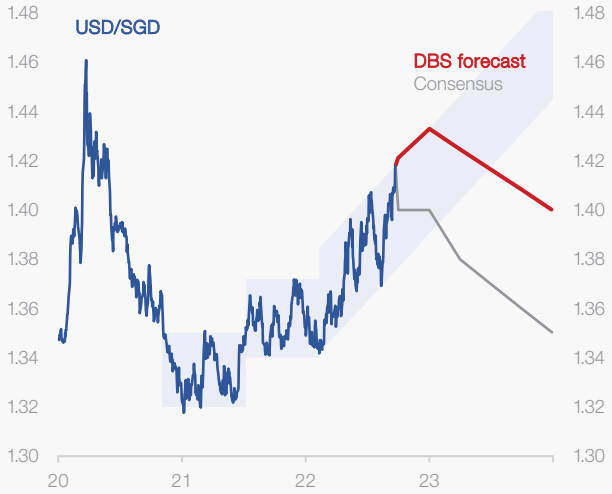


Source: Bloomberg, DBS

SGD

USD/SGD above 1.40 reflects USD strength, not SGD weakness. Thanks to its appreciating SGD NEER policy, SGD is amongst the most resilient currencies to aggressive Fed hikes this year. As of 21 September, SGD depreciated 4.8% YTD against USD, less than half the average 10% depreciation in the Emerging Asian and Developed Market currencies we cover. SGD could be an alternate haven for investors with weaker exchange rates. This year, SGD achieved lifetime highs against the EUR, GBP, INR, MYR, and PHP. We see the MAS tightening policy again in October by re-centering the SGD NEER policy band higher a third time. Although the Ministry of Trade and Industry narrowed the 2022 growth forecast to 3-4% from 3-5%, it did not expect the Singapore economy to enter a technical recession. Deputy Prime Minister Lawrence Wong sees inflation peaking in the 4Q22 after CPI inflation surged to 7% y/y in July, above the official 5-6% forecast for 2022. Next year, we expect exchange rate markets to stabilise when Fed hikes become normal and pause eventually. If a global recession or a financial crisis materialises, expect USD/SGD to rise further towards 1.50.

Resilient SGD not immune to higher US interest rates this year

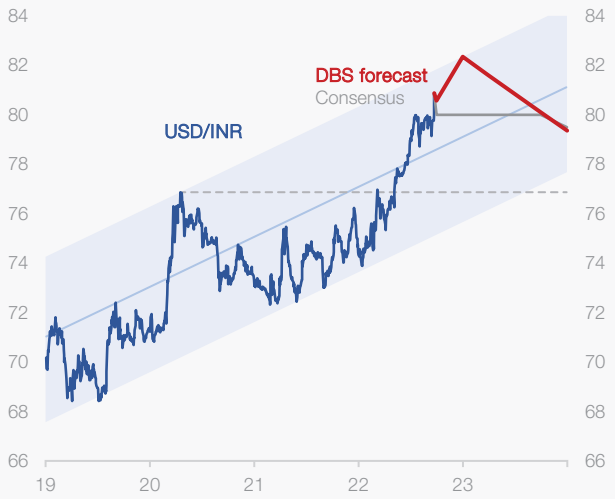


Source: Bloomberg, DBS

INR

INR to push into a weaker 80-82 per USD range in 4Q22. Although the INR hit a new record low of around 80 per USD, its depreciation has been mild compared to most Asian currencies. As of 21 September, INR depreciated 6.8% YTD, significantly less than 44% and 26% plunges in the LKR and PKR, respectively, and the average 8.1% and 12.2% declines in the ASEAN 5 and three Northeast currencies (CNY, TWD, and KRW) respectively. However, there is little room for complacency. Many Asian currencies have buckled on the Fed's aggressive stance to control inflation with higher rates at the expense of growth. India's trade deficit widened 95% y/y to USD85b in the first eight months from weaker exports and elevated import growth. Our economist sees the current account deficit deteriorating to 3.9% of GDP in FY22 before narrowing to 2.7% in FY23. To bring inflation back into its 2-6% target, the central bank (RBI) will lift rates to 6% by December after three back-to-back hikes totalling 140 bps to 5.40%. To counter the cost-of-living crisis, India sought to control food prices by curbing rice, wheat, and sugar exports. Hence, there is a limit to interventions to support the INR at the psychological 80 level.

INR depreciated into the weaker half of a price channel



Source: Bloomberg, DBS

IDR

IDR to stay weak past 15000 per USD in 4Q22 before recovering next year. Historically, IDR does not respond well to rate hikes and CNY weakness. The central bank (BI) delivered back-to-back hikes in August and September, lifting the policy rate by a total 75 bps to 4.25%. CPI inflation has been above the 2-4% target since June. Following President Jokowi's decision to cut fuel subsidies and raise fuel prices by 30% in early September, our economist sees the policy rate reaching 5% this year. Foreign reserves fell USD12.78b or 8.8% in the first eight months to USD132b in August. Even so, we consider the IDR a resilient currency. The government is committed to reducing the fiscal deficit to 3% of GDP in 2020. The share of foreigners holding Indonesian bonds fell below 15% in early September from 39% at the start of 2020. Unlike weak US stocks, the Jakarta Composite Index has rallied almost 10%. Investors are attracted to Indonesia's relatively high growth and sound fundamentals. International debt rating agencies were comfortable with the country's investment-grade sovereign debt ratings. Next year, IDR is well-positioned to recover when Fed hikes pause and take the pressure off Asia's currencies.

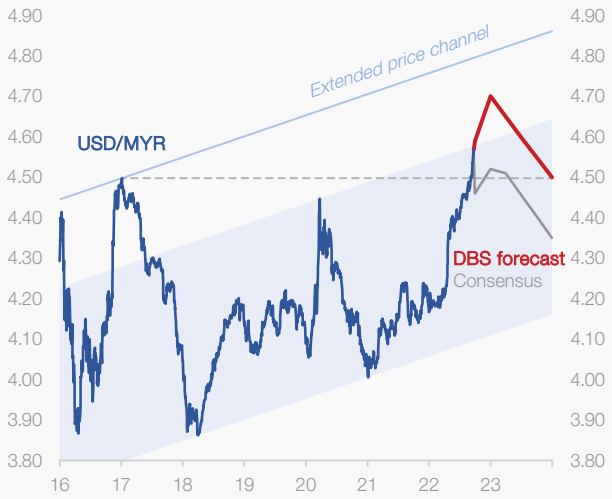
IDR has held up better than its peers to Fed hikes this year

Source: Bloomberg, DBS

MYR

USD/MYR to hold above 4.50 into 2023. Despite Malaysia's stellar 8.9% y/y GDP growth in 2Q22, MYR did not buck the USD's strength and depreciated 8.8% YTD to 4.57 per USD on 22 September. Malaysia's interest rate differential against the US turned negative in September, with the differential set to widen. In 1Q23, our economists see rate hikes peaking at 3% in Malaysia and 5% in the US. The government is optimistic about achieving this year's official growth target of 5.3% to 6.3% on strong consumption and the reopening of the economy. However, it sees a challenging global landscape in 2023 from China's struggles with its Covid-Zero policy and property woes, and the aggressive monetary tightening in Western economies. Meanwhile, policymakers were criticised for not doing enough to control inflation. After holding steady at 2.2% to 2.3% y/y in the first four months, CPI inflation accelerated from 2.8% in May to 3.4% in June and 4.4% in August. Given the prospect of slower growth and higher inflation next year, the government might bring forward the general elections from September 2023 into this year. Our economist expects the fiscal deficit to stay wide at 6% of GDP this year.

MYR can depreciate more in the weaker half of its price channel

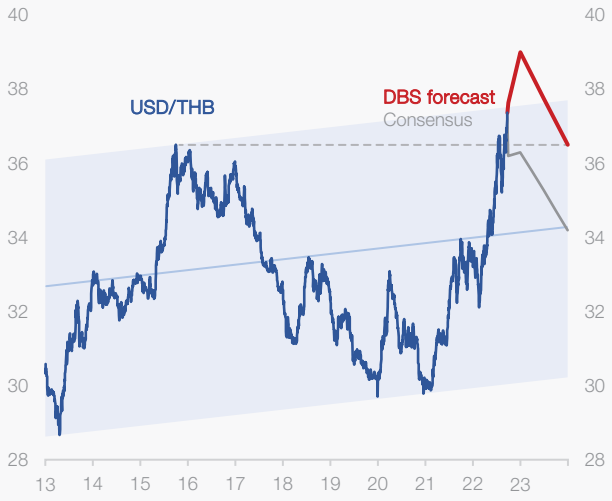


Source: Bloomberg, DBS

THB

USD/THB to hold above 36, above its multi-year price channel. On 22 September, the THB depreciated 10.6% YTD to 37.4 per USD, its weakest level since 2006. The central bank (BOT) was late in hiking rates on 10 August. Although CPI inflation exceeded 7% y/y for four straight months into August, it acted only after core inflation breached the 1-3% target. With a low policy rate of 0.75%, Thailand's negative rate differential against the US will widen for the rest of the year on the Fed's new and higher 4.4% target for 2022. After seven years of surpluses, this year's trade deficit will be the widest since 2013. Falling foreign reserves are also set to converge with rising external debt at around USD200-210b. Fitch maintained Thailand's BBB+ rating with a stable outlook in June, citing the government's record of fiscal prudence, a deep capital market, and a public debt mainly funded by THB. The currency's recovery next year hinges heavily on a tourism rebound lifting economic growth, attracting inflows into equities, and returning the current account deficit into a surplus. We also see the rate differential narrowing next year from a Fed pause (also viewed as USD negative) amidst more tightening by the BOT.

THB enters the weakest quartile of its price channel

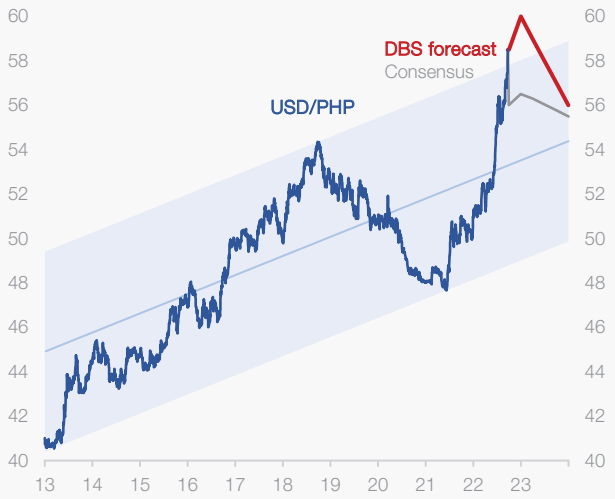


Source: Bloomberg, DBS

PHP

PHP is the weakest Southeast Asian currency looking for bottom. As of 21 September, PHP depreciated 12% YTD to a record low of 58 per USD. The currency did not benefit from the Philippine economy expanding above 7% y/y for five quarters into 2Q22. In the first seven months, the trade deficit widened 67% y/y to a record USD35.7b on weak exports, well above USD18.3b of overseas foreign worker (OFW) remittances. Our economist sees the current account deficit widening to 5.3% of GDP in 2022 from 1.8% last year, and the fiscal deficit narrowing and staying wide at 7.5% from 8.6% for the corresponding years. Between May and August, the central bank (BSP) delivered four rate hikes totalling 175 bps to 3.75%. However, the PHP could not overcome USD's strength from the Fed's jumbo hikes to control inflation. Philippine CPI inflation averaged 4.9% in the first eight months, above the official 2-4% target. BSP forecasts inflation to average 5.4% this year before slowing to 4% in 2023 and 3.2% in 2024. Our economist sees the BSP hikes peaking at 4.50% by December. Foreign reserves fell 10.4% YTD to USD97.4b in August while external debt rose to USD109.8b in 2Q22 from USD106.4b at the end of 2021.

PHP hit an all-time low against the USD in September



Source: Bloomberg, DBS

VND

VND to end the year weaker at 23880 per USD before consolidating in 2023. Although the VND was resilient to the hawkish Fed pivot in 2021, it surrendered to aggressive Fed hikes hammering Emerging Asian currencies in 2022. China is Vietnam's largest trading partner. Its top foreign direct investors are South Korea, Japan, Singapore, and Taiwan. Despite this, Vietnam benefits from China's economic uncertainties, offering itself as an attractive alternative investment destination with robust growth (2Q22 GDP was 7.7% y/y), relatively stable inflation, and the second-most resilient exchange rate in the region after the HKD. As of 21 September, VND depreciated 3.7% YTD, with a less than average 8.1% fall in the ASEAN-5 currencies and an average 12.2% plunge in the Northeast Asian currencies (CNY, TWD, and KRW). Despite the challenging global environment, Vietnam has maintained macroeconomic stability. The country reported trade surpluses in the past five out of six months. Unlike many countries, Vietnam's inflation will be modest at 3.6% this year and 3.4% in 2023. Our economist sees the central bank (SBV) hiking the refinancing rate from 4% to 5% this year and 6% next year. Finally, Fitch also ranked Vietnam fifth out of 35 Asian countries in terms of economic openness.

VND hit an all-time low in 2022, to consolidate in a weaker range in 2023

Source: Bloomberg, DBS

DBS currency forecasts

Exchange rates, eop	21-Sep	4Q22	1Q23	2Q23	3Q23	4Q23
China	7.0501	**7.25**	7.20	7.15	7.10	**7.05**
Hong Kong	7.8500	**7.85**	7.84	7.83	7.82	**7.81**
India	79.979	**82.3**	81.6	80.9	80.1	**79.4**
Indonesia	14997	**15300**	15120	14930	14750	**14560**
Malaysia	4.5535	**4.70**	4.65	4.60	4.55	**4.50**
Philippines	57.997	**60.0**	59.0	58.0	57.0	**56.0**
Singapore	1.4173	**1.43**	1.42	1.42	1.41	**1.40**
South Korea	1396	**1430**	1390	1360	1330	**1300**
Thailand	37.185	**39.0**	38.4	37.8	37.1	**36.5**
Vietnam	23688	**23880**	23820	23760	23700	**23640**
Australia	0.6630	**0.63**	0.64	0.66	0.67	**0.68**
Canada	1.3463	**1.36**	1.35	1.33	1.32	**1.30**
Eurozone	0.9837	**0.96**	0.98	1.00	1.02	**1.04**
Japan	144.06	**150**	145	141	136	**132**
New Zealand	0.5853	**0.56**	0.58	0.60	0.62	**0.64**
Switzerland	0.9664	**1.00**	0.99	0.98	0.97	**0.96**
United Kingdom	1.1270	**1.11**	1.13	1.15	1.16	**1.18**
United States (DXY)	110.642	**115.0**	112.8	110.6	108.4	**106.2**

Australia, Eurozone, and United Kingdom are direct quotes.

Source: Bloomberg DBS

Awaiting Catalyst

ALTERNATIVES: GOLD 4Q22

Gold's appeal may have weakened amid rising interest rates, but its sensitivity to USD suggests that its place as an alternative currency could be validated when the dollar weakens. Our 3m/6m/12m outlook for gold stays at USD1,850/1,900/1,950.

Source: Unsplash

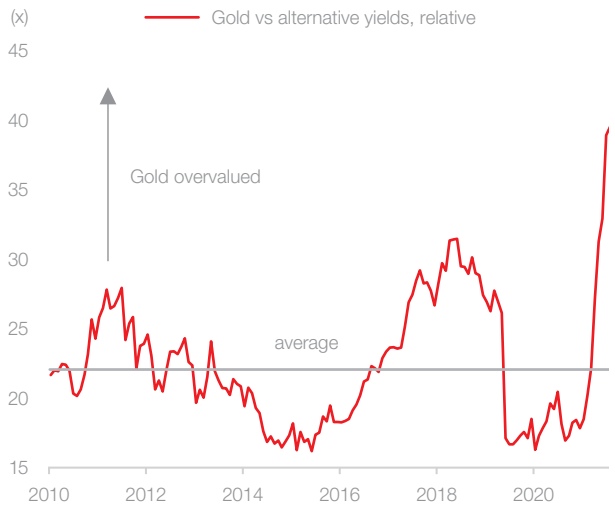
10. Alternatives: Gold.

Joanne Goh
Strategist

Gold's appeal has weakened on the back of rising interest rates and bond yields. As a non-interest bearing asset, gold's relative value has also declined, especially when compared to cash deposits, bonds, and dividend yields from equities. With the duo likelihood of the US Fed hiking rates to 4.5% by the end of this year and bond yields hovering around 4%, the attractiveness of gold will be challenged. Thus, we see limited upside for gold in the near term.

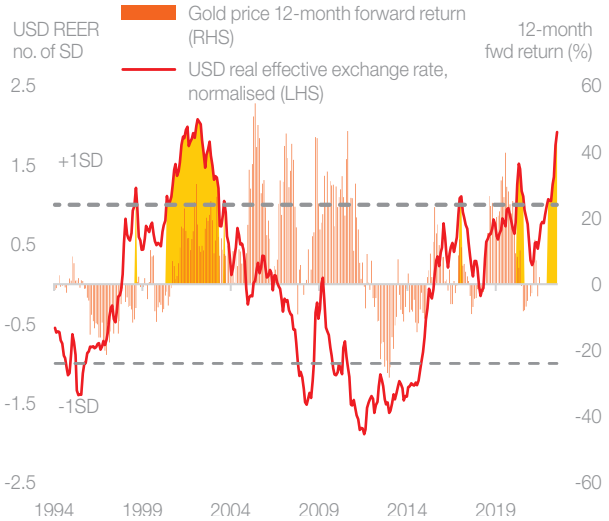
Notwithstanding the muted outlook, gold's sensitivity to the US dollar suggests that its place as an alternative currency could be validated once the dollar starts to weaken. We believe dollar strength should fade after trading at extreme high levels in anticipation of rising US recession risk and the Fed pivoting from restrictive monetary policy.

Opportunity cost of holding gold grows as yields rise



Note: Yields are average of Fed funds rate, 10-year GT10, and dividend yield
Source: Bloomberg, DBS

USD REER reverses from extreme high levels; strong performance for gold 12 months ahead

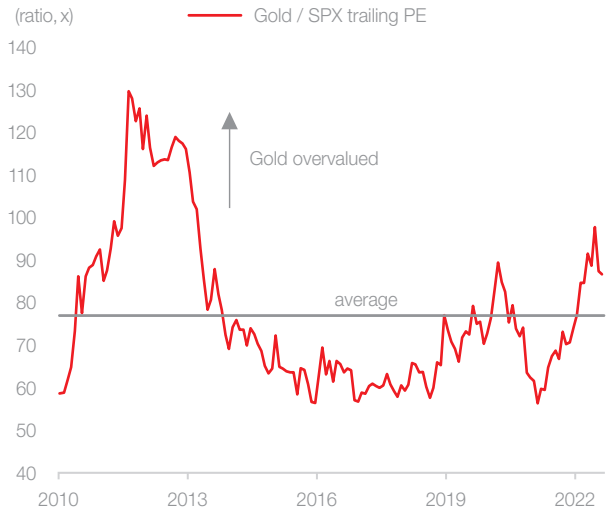


Source: Bloomberg, DBS

Gold is overvalued vs the S&P 500 and undervalued vs inflation. The value of gold as an alternative asset class to equities has become less compelling, given that equity valuations have improved with the 20% market correction since the start of the year.

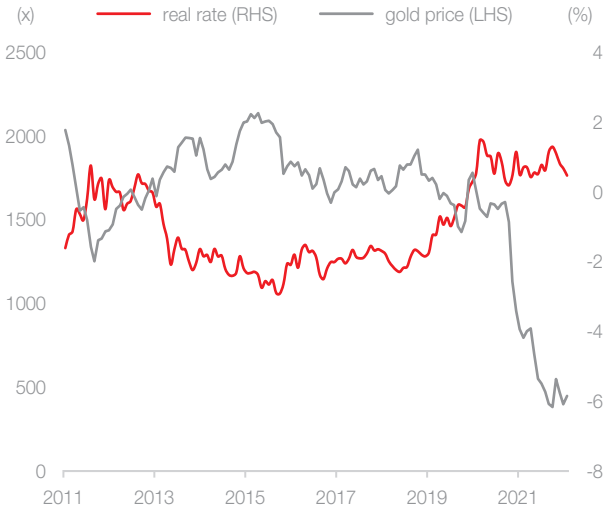
However, when compared to real rates and other commodities, gold has potential as an inflation hedge. To put it simply, the ratio of gold relative to real rates and other commodities, points to severe underperformance. As the global economy transitions to a new regime of structurally higher inflation, the longer-term impact on hard assets such as gold will be felt; gold has historically performed well in high inflation environments.

Gold as an alternative asset is more expensive than equities



Source: Bloomberg, DBS

Gold, vs real rates, is undervalued as an inflation hedge



Source: Bloomberg, DBS

Fundamental demand remains stable. During the first half of the year, fundamental demand for gold remained stable. Despite higher interest rates and weaker domestic currencies, jewellery demand equalled to last year's. We believe a normalisation of economic activities helped with the resumption of jewellery demand, mainly for festive seasons and weddings in the world's two largest gold consumption markets of India and China.

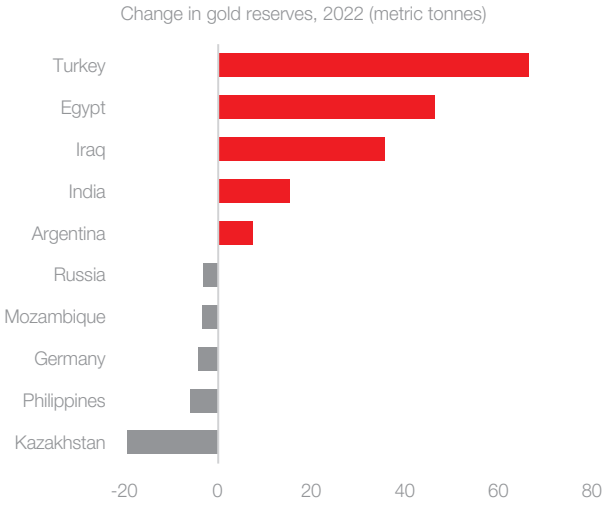
Central banks accumulate gold as a currency diversifier. We saw evidence of central banks accumulating more gold in 1H22 when geopolitical risks returned to the fore, particularly from EM countries. Still, these countries have what is considered low (<5%) gold holdings in their reserves.

Source: Unsplash

In the latest annual central bank survey by the World Gold Council, gold continues to be viewed favourably by central banks as a reserve asset, with 25% of respondents saying they have plans to increase their gold reserves, up from 21% last year, and none have plans to sell.

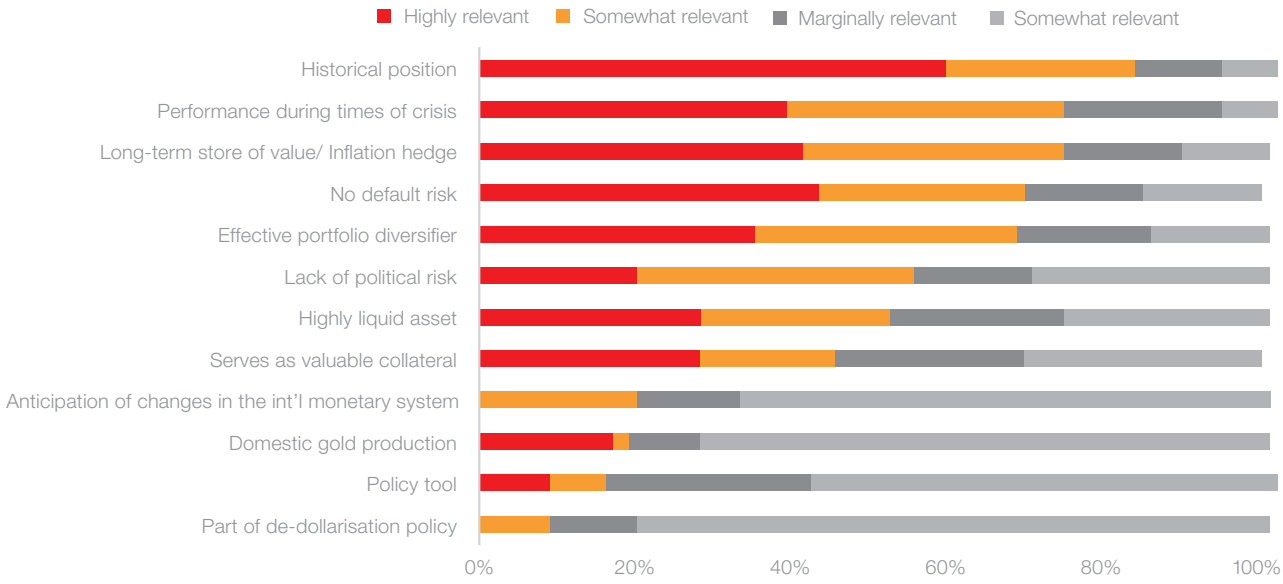
Another observation from the survey was how gold was held for its "performance during times of crisis". This is a likely reflection of gold's resilience during the pandemic. Other attributes, including "long-term store of value / inflation hedge", "no default risk", "effective portfolio diversifier", are indeed relevant in today's environment, and gold should have a place in one's portfolio. It is worth noting that "de-dollarisation policy" is not a relevant consideration for holding gold, according to the survey.

Top and bottom net purchasers (sellers) of gold in 2022



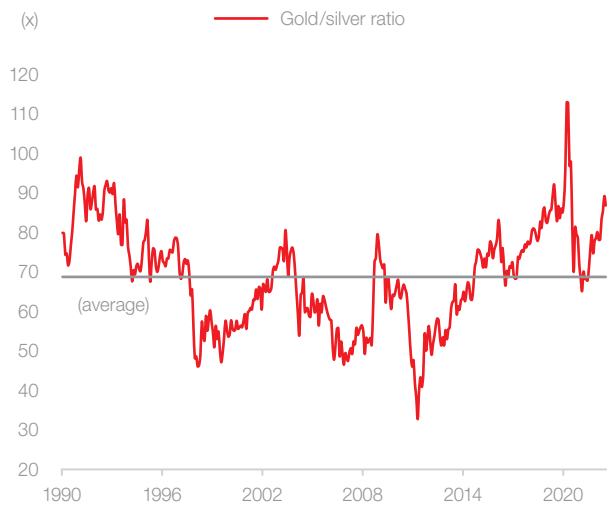
Source: World Gold Council

Central Banks' reasons for holding gold



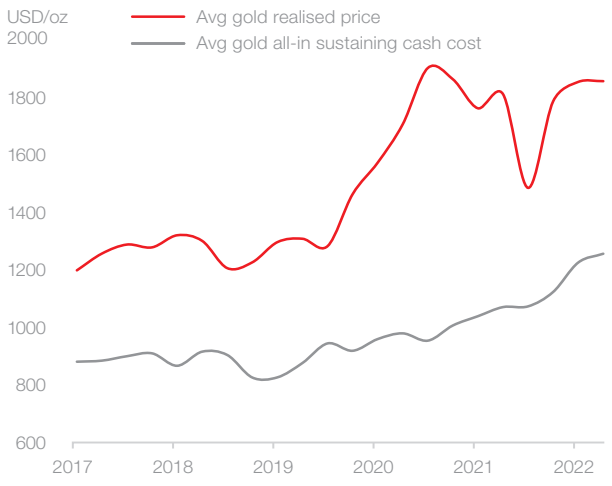
Source: World Gold Council

Silver is undervalued vs gold



Source: Bloomberg, DBS

Senior gold producers' margin pressured with rising costs



Source: Bloomberg, DBS

Silver undervalued relative to gold. The gold-to-silver ratio is near 90, compared to a 30-year average of 68, which suggests silver is undervalued relative to gold. However, in the current rising yield environment, this gap in its undervaluation vis-à-vis gold may take a while yet to close.

Margin compression for gold miners. All-in-sustaining costs for gold miners rose to a record again in 2Q22, but these were offset by the strength in gold price, resulting in a slight expansion in their cash margins. Going forward, higher wages and energy bills are likely to compress margins against a flattish outlook for gold prices. Larger miners should be more resilient with room for M&A to boost growth. We reduce the sector to Neutral in view of the foreseeable margin compression, with selected senior miners being favoured.

Gold forecast. We reduce our price outlook for gold. A higher interest rate regime for the next 12 months reduces the attractiveness for holding gold. In the longer term, gold will continue to be supported by fundamental demand, and the upside catalyst will come from the dollar weakening. Our 3m/6m/12m outlook for gold stays at USD1,850/1,900/1,950. The base case assumption is for Fed to end its rate hike cycle by the end of this year.

Gold's sensitivity to DXY and US bond yields

	DXY				
Yield (%)	**95**	**100**	**105**	**110**	**115**
2.50	1,957	1,914	1,871	1,828	1,785
3.00	1,906	1,863	1,820	1,777	1,734
3.50	1,855	1,812	1,769	1,726	1,683
4.00	1,804	1,761	1,718	1,675	1,632
4.50	1,753	1,710	1,667	1,624	1,581

Source: DBS. Forecast range in shaded cells

Forecast table

	3m/6m/12m forecast
Gold (USD/oz)	1,850/1,900/1,950
Silver (USD/oz)	21/22/24

Source: DBS

Call for Calibration

ALTERNATIVES: PRIVATE ASSETS 4Q22

The rising tide of interest rates may not lift all boats. The changing macro-environment warrants greater selectiveness. Work with best-in-class managers to invest in value-adding private businesses.

Source: iStock

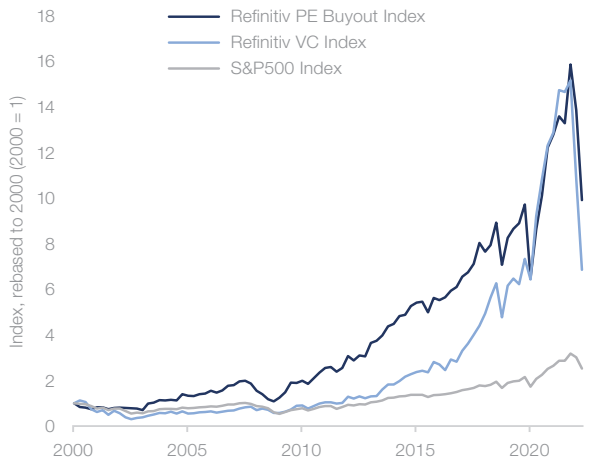
11. Alternatives: Private Assets

Beatrice Tan
Analyst

When the stars align for a bull market. Private markets were on a tear over recent decades, relishing in a combination of cheap debt and rising valuations. Amid years of monetary accommodation, interest rates declined to record lows, pushing investors to seek returns in alternatives – resulting in record capital raised by the private markets year after year. Low rates have also given leveraged strategies access to cheap funding and refinancing, allowing them to amplify returns at low cost. During this period, equity valuations rallied to historic highs, providing a rising tide for attractive exits, triggering a 'virtuous cycle' that further attracted investors to the private markets.

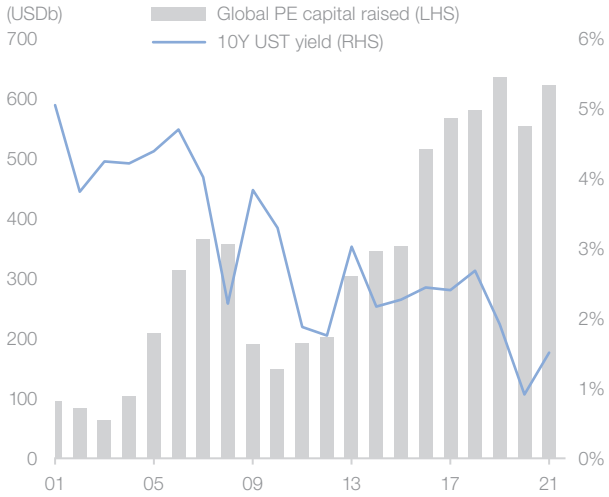
Do private markets feel public market fears? However, with the Fed determined to curtail the highest inflation in decades with the most aggressive slew of rate hikes not seen since the 1990s, what does this spell for private markets, which do not typically gyrate with the volatility of tradable securities? Faced with what could be the end of an era of easy money as central banks step away from markets, we examine key parts of the alternatives markets for key opportunities and risks that a rising rate environment could bring for this asset class.

Stellar performance of private market strategies over past decades



Source: Bloomberg, DBS

Record fundraising for private equity over years of declining yields



Source: Bloomberg, Preqin, DBS

Private equity

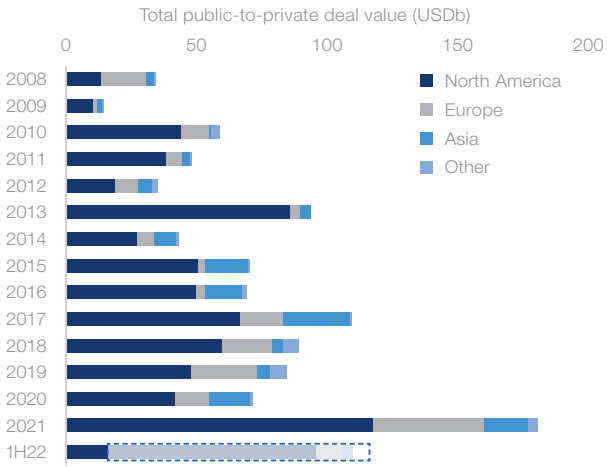
The first half of 2022 has already seen private equity moderate against the exuberance of the year before. While private business valuations tend to experience a lag in responding to changing market conditions, higher rates will nonetheless affect private equity investments on various fronts.

- *Asset valuations*

  From a cash flow discounting perspective, rising rates inadvertently lead to lower company valuations. Consequently, private equity deal valuation multiples have already started to move lower in response to the selloff in public markets, according to Preqin. On the flip side, this raises the supply of attractive acquisition targets for general partners. Given falling valuations, the first half of 2022 alone saw a significant increase in public-to-private deals, with more than USD110b worth of deals done—compared to USD181b in the whole of 2021—as managers with dry powder took advantage of the seemingly lower valuations to deploy cash.

  On the other hand, funds in their harvesting stages, especially vintages which entered the market during past elevated valuations, would face challenges in exiting investments. This need not spell disaster since managers typically have the flexibility to extend the investment horizon and await market recovery, although this would detract from returns in internal rate of return terms. Noting that many such transactions often employ leverage, it is also important that private equity managers successfully negotiate loan extensions to match the extended investment holding periods.

Values of public-to-private transactions



Source: Preqin, DBS

- *Interest and debt servicing of leveraged investments*

  Leverage has been an established means of amplifying returns in private equity buyout strategies. Capitalising cheap costs of borrowings, debt for sponsor-backed loans was six times of earnings on average in 2021, and at its highest over the past two decades. Looking ahead, deals that had taken on significant leverage using floating rate loans would experience a cash flow strain from interest servicing. Should portfolio companies' operating cash flows fall short of loan servicing requirements, this could pose a risk to fund returns. It is in such challenging scenarios that disparity between fund managers becomes clear, and what sets managers apart is their

network and bargaining power to negotiate funding, robust modelling, stress testing of investment scenarios, and most importantly, the ability to pivot in changing market conditions.

On the other end of the spectrum, investments with little to no leverage, typically found in venture and growth capital, would be relatively insulated from any direct impact of interest rate movements. Key risks, especially to early stage and VC-backed companies could instead come from challenges in securing subsequent funding to support business expansion as capital becomes scarce. Nonetheless, these strategies are likely to continue offering opportunities for longer term growth, since neither central banks' monetary tightening nor equity bear markets are likely to outlast the structural growth trends that underpin businesses in the frontiers of technology — which include domains such as artificial intelligence and energy transition.

Private debt

- *Direct lending*

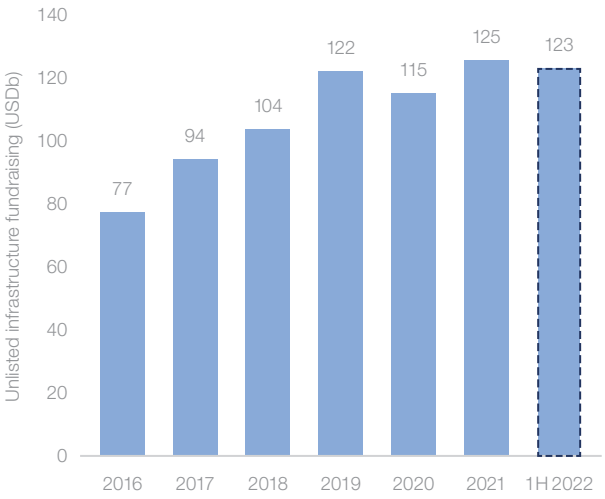
  Direct lending is poised to be a key beneficiary of rising rates given that loans predominantly employ floating rate structures. As rates rise, lenders benefit from higher interest income. However, this may come as a double-edged sword, as heavier interest servicing burdens can lead to a higher likelihood of default. Mitigants of this risk are careful credit selection, debt structuring, and protective covenants. It is worth noting that direct lending funds have had high recovery rates due to their structural seniority and tight covenants. Nonetheless, we note that the resilience of the direct lending market remains to be tested, given that the growth of direct loans occurred in the wake of the GFC in a decade characterised by sustained low rates.

- *Special situations and distressed debt*

  The distressed debt and special situations space has been relatively muted in past years, given that (a) the abundance of liquidity provided by central banks and (b) government-led low interest loans and subsidies had allowed poorly performing companies to remain as going concerns for far longer than they normally could. With conditions now tightening, this could soon become a fertile hunting ground for opportunistic investors, as such "zombie companies"—unproductive companies that survive by barely servicing their overheads and refinancing their debt—may soon be exposed.

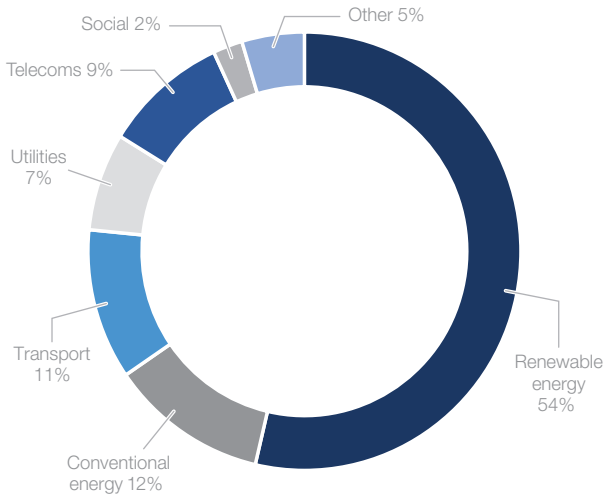
  Should inflation, dislocations in the global economy, and the end of monetary stimulus result in rising corporate distress, this would provide rising deal flow for distressed debt and special situations investors on two fronts. Firstly, companies barely able to service their interest will find it increasingly difficult to do so. Secondly, diminished investor confidence in junk bond markets would make it even more challenging for such companies to secure refinancing. As such, the current climate may increase the opportunity set for funds specialised in reviving struggling but salvageable businesses. This may be an attractive area for investors seeking counter-cyclical returns.

Capital has flooded into unlisted infrastructure since the start of the year



Source: Preqin, DBS

Number of unlisted infrastructure deals by sector



Source: Preqin, DBS

Unlisted infrastructure

Capital has flooded into infrastructure in 1H22, with the first half of 2022 seeing the market attract more capital than one would record over an entire year. This strong interest stems from investors seeking inflation protection, amid soaring oil prices, energy shortages, and the Russia-Ukraine crisis.

Given the strong interest in this asset class's inflation-hedging properties, it is noteworthy that Preqin analysis has found that inflation protection is not ubiquitous across all infrastructure investments. As such, investors accessing unlisted infrastructure should take note of the underlying industry, business model, and investment structure, to have a firm grasp of the risk characteristics of their investment. Furthermore, the most stable projects, especially in energy or social infrastructure, tend to exhibit high leverage (sometimes up to 90%) to boost equity returns. In this regard, infrastructure projects employing long-term fixed-rate debt facilities with low rates locked-in would delay any impact of rising rates on interest servicing or refinancing.

Hedge funds

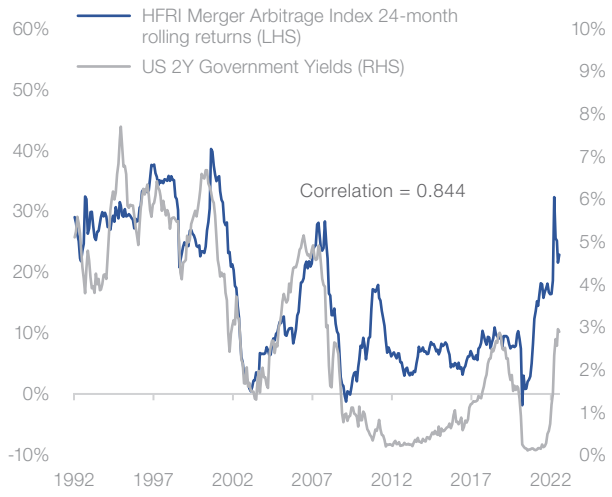
Rising rates directly impact certain hedge fund strategies. Because of their flexibility and agility, hedge funds can benefit from dislocations, and are poised to navigate a changing rates environment. Here we briefly draw attention to examples of hedge fund strategies that stand to benefit from rising rates.

- *Event driven strategies – Merger arbitrage*

  Based on historical returns, merger arbitrage strategies have displayed a close positive

correlation to interest rates. With rising rates, spreads on merger and corporate restructuring deals could increase, providing opportunities for these strategies.

Merger arbitrage strategies' performance correlated with interest rate movements



Source: Bloomberg, DBS

- *Relative value strategies – Fixed income arbitrage*

  With shifting rates, fixed income arbitrage strategies may act on rising volatility and market dislocations. While providing liquidity to illiquid fixed income securities, managers generate alpha by hedging both interest and credit spread risks.

- *Macro strategies*

  Macro hedge fund strategies profit from their view of market movements caused by events affecting global financial markets. Current spikes in volatility triggered by the actions of major central banks provide such strategies the opportunities to take directional bets tied to market volatility not just in rate movements but also in currencies and commodities.

While present conditions may prove challenging for traditional portfolios, they create opportunities for some hedge fund strategies. Hedge funds have demonstrated the ability to navigate economic challenges, policy changes, and benefit from market dislocations. This underscores the critical and defensive value of hedge funds in providing diversification, especially when portfolios are faced with challenging public markets. Nonetheless, investors should be mindful of risks associated with hedge fund investing in a rising rates environment as in a changing landscape, divergence from historical norms increases the complexity of estimating values and correlations.

The rising tide of interest rates may not lift all boats. To conclude, the various types of private assets respond differently to changes in the macro environment. Understanding the nuances of each strategy will be beneficial for investors in diversifying their portfolios. It would also be prudent for investors to take note of investment structures as private market investments are sometimes held through layers of funds, which could conceal risks within the structure.

A higher rate environment may unearth risks relating to strategies and structures involving high leverage considering more onerous interest servicing. On the other hand, rising rates benefit floating rate private debt, so long as the underlying borrowers remain able to service the loans. Assets with inflation pass-through mechanisms, such as infrastructure, could also be well positioned to deliver positive risk-adjusted returns. While highly levered strategies face the greatest risk, still other pockets of private equity remain largely insulated and continue to offer investors exposure to emerging trends and technologies.

Ultimately the best hedge for uncertain times is to invest in companies with genuine value-adding businesses. While some caution is necessary as the private markets face a new era away from the liquidity punchbowl, we continue to look to private asset exposure for diversification benefits and emphasise working with experienced investment managers equipped to navigate the road ahead.

	Opportunities/Benefits	Risks
Private Equity	• Growth strategies with minimal leverage which have demonstrated profitability.	• Impact of rising interest costs on leverage buyouts. • Funds in harvesting stages may face challenges. • Early stage / VC-backed companies may have reduced access to capital.
Private Debt	• Higher interest income from floating rate loans, subject to borrowers' ability to repay. • Deal flow for distressed and special situation strategies.	• Heightened default risks should borrowers be unable to support rising interest costs.
Unlisted Infrastructure	• Stable real cash flow streams.	• Leverage, if based on floating rates or short financing tenors.
Hedge Funds	• Market dislocations and high volatility provide trading opportunities.	• Changing environment adds complexity to estimating correlations.

A Tale of Two Halves

COMMODITIES 4Q22

In a world where returns from equities and bonds are becoming increasingly correlated, commodities as an asset class, including industrial metals, soft commodities, and precious metals, has an important role as a risk diversifier in our overall barbell portfolio.

Source: iStock

12. Commodities.

Goh Jun Yong
Analyst

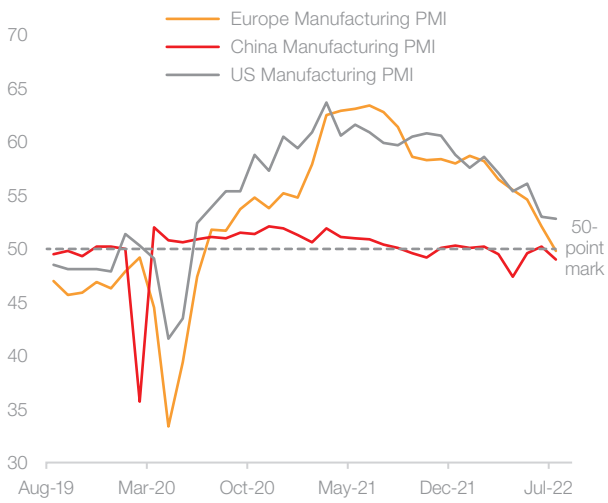
2022 has been a tale of two halves for commodities. 1Q saw a unanimous spike in prices across the commodities complex on the back of supply chain disruptions from the Russia-Ukraine war. Moving into 2Q and 3Q however, prices started to correct as slowing growth and recession fears among the major economies started to raise demand concerns. Among the sub-asset classes, industrial metals experienced the most significant pullback, followed by soft commodities; energy remained resilient due to ongoing supply concerns around Russian gas. Notwithstanding the short-term performance of metals and soft commodities, we believe these two sub-asset classes continue to warrant investor attention as they are underpinned by long-term secular tailwinds.

Industrial Metals

A mixed bag for metals. Since reaching multi-year highs in March on the back of war-driven supply fears, metal prices have cooled. As of August, the London Metal Exchange (LME) index was down -14.5% on a YTD basis, underperforming broad commodities (represented by the Bloomberg Commodities Index), which returned +22.7% over the same period. This retreat was driven largely by weakened demand from China and Europe, although surprises on the supply side (e.g., strong short-term copper mine supply growth in Indonesia) also contributed to the price weakness at the margin. Despite these headwinds, there are potential catalysts for a recovery, namely elevated energy prices, dwindling inventory levels, and a fiscal boost from the US in the form of the recently passed Inflation Reduction Act.

Weak demand from China and Europe. Consumption of virtually all metals is dominated by the world's major economies, and in particular China, which accounts for c.60%, c.55%, and c.52% of the world's aluminium, copper, and crude steel consumption respectively. It therefore comes as no surprise that metal prices have retreated in recent quarters as Covid lockdowns and property sector woes continue to weigh down China's growth outlook. Notably, China's manufacturing PMI slipped backed into contractionary territory, registering 49.4 in August. This is a worrying sign as more than half of the available PMI data for 2022 have been below the 50-point mark, which separates growth from contraction. Weak data also emerged from Europe, further compounding demand woes for metals.

US remains sole bright spot



Source: Bloomberg, DBS

Recession fears, high inflation, and a curtailing of natural gas supply by Russia have collectively driven the manufacturing PMI in Europe down to 49.6 in August, its worst reading since June 2020. Among the developed economies, US remains the sole bright spot as its manufacturing PMI came in at 52.8 in August.

US Inflation Reduction Act to boost demand for metals. US consumption of metals is set to see a boost following the passing of the Inflation Reduction Act of 2022 by the US congress in August. The Act will see approximately USD370b channelled into climate change initiatives via a combination of tax credits, grants, and loan programmes. This is positive for metals as clean energy and decarbonisation initiatives, both of which are metals-intensive, form a large part of climate change action. As can be seen from the table below, a total of USD177b, or just under half the entire stimulus package, will be used to incentivise corporates and consumers to adopt a smaller carbon footprint. Notwithstanding implementation details and timeline for the Act that have yet to be disclosed, this represents a bright spot for metals, which in recent quarters, have been weighed down by weak demand from China and Europe.

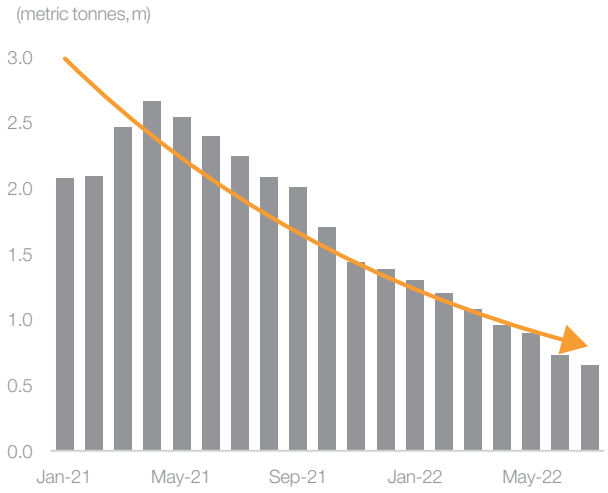
US Inflation Reduction Act to boost metals demand through clean energy and decarbonisation initiatives

Initiative	Amount (USDb)
Production tax credits to accelerate US manufacturing of solar panels, wind turbines, batteries, and critical minerals processing	30
Investment tax credits to build clean technology manufacturing facilities (EV, wind turbines, solar panels)	10
Loans to build new clean vehicle manufacturing facilities	20
Targeted grant and loan programmes for states and electric utilities to accelerate transition to clean electricity	30
Clean energy accelerator to support deployment of technologies to reduce emissions	27
Environmental justice priorities to drive investments into disadvantaged communities, including grants for zero-emissions technology and vehicles	60
Total	**177**

Source: Announcements, DBS

Supply squeeze from diminishing metal stocks. In addition to the boost from the Inflation Reduction Act, supply-side factors offer a potential catalyst for metal prices, chief among which are diminishing inventories worldwide. The LME list of warehouses had just 649,830 tonnes at the end of July. This represents a halving since the start of the year, and more than a 75% decline from April 2021 levels. And even at its current historical low level, the downward trend looks set to continue as 306,000 tonnes out of the existing stock were already awaiting physical load-out. And while there has been an increase in LME shadow stocks, the rebuild has been almost negligible at just 4,600 tonnes YTD. This extreme tightness in the physical market is incongruous with the plummeting spot prices of metals and suggests that an upward price correction is due to take place.

Depleting LME metals stockpile

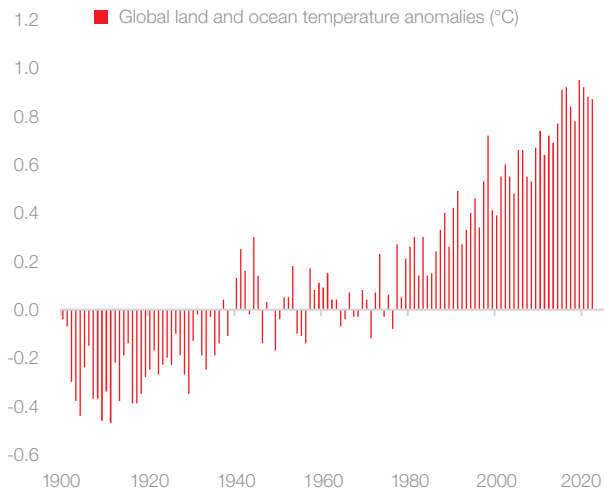


Source: London Metals Exchange, DBS

Soft Commodities

Entrenched challenges support long-term price performance. While soft commodities have not matched the superlative performance of oil and gas, it is still an outperformer relative to other asset classes, returning +13.8% YTD as of August. We believe there is investment potential in soft commodities, and in particular food commodities, on the basis that demand is stable and growing but supply looks increasingly constrained moving forward. It is worth noting that many of the trends that are shaping the soft commodities space such as global warming and shrinking arable land supply, are fundamental and deep-rooted, with no easy solution in sight. It is therefore not a matter of if but when scarcity will drive food prices to its next historical high.

Temperature surprises have been on the upside since 1980

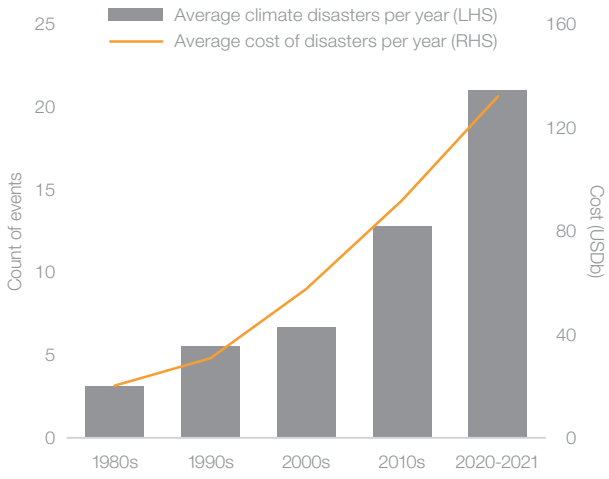


Source: NOAA National Centers for Environmental Information

Warming up for the challenge ahead. "Climate change" has been the buzzword among investors for the past decade and it has played a key role in inspiring the current ESG-focused paradigm. And when assessing the impact of climate change, nowhere are its effects more clearly seen than in the soft commodities sector – erratic weather patterns and rising temperatures worldwide are affecting crop and livestock yields on a scale that has been hitherto unseen. Based on the National Oceanic and Atmospheric Administration (NOAA), the earth's temperature has risen by 0.08°C per decade since 1880, but the rate of warming since 1981 has jumped more than twice to 0.18°C per decade. Global land and ocean temperature anomalies have been, without exception, on the positive side since 1980. This rise in global temperatures could reduce yields of crops that require cooler growing temperatures. In addition to rising global temperatures, increasing frequency and severity of major weather disasters are further compounding supply side woes for agricultural commodities.

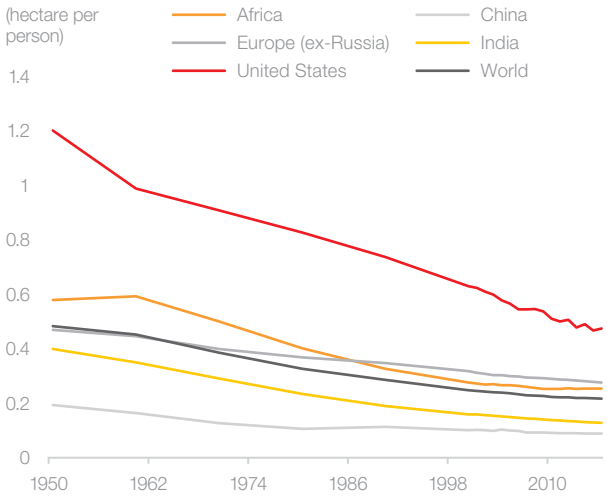
Declining agricultural land per capita. Land is a crucial input for agricultural commodity production, and of all habitable land on earth, half is used for agriculture (crops and livestock). It is therefore concerning that global availability of cropland has been dropping on a per capita basis since 1960. Over the past 60 years, cropland per capital dropped by 54% from 0.48 hectares/person to just 0.22 hectares/person. With a growing number of mouths to feed and finite usable land, the demand-supply balance looks set to tighten moving forward.

Extreme weather events are increasing in frequency and severity



Source: NOAA National Centers for Environmental Information

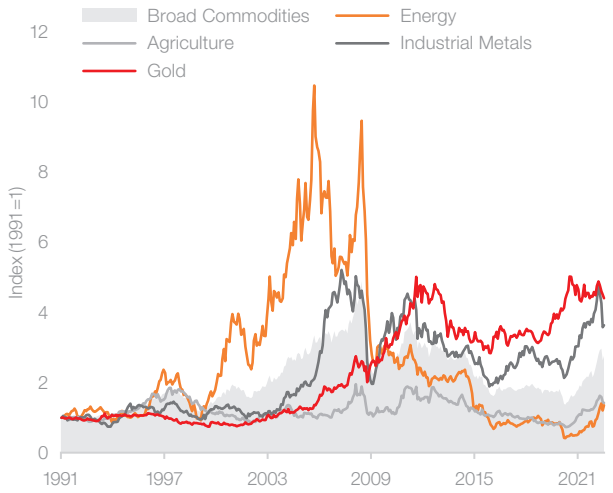
Global available cropland per capita



Source: Our World In Data

Commodities as a portfolio risk diversifier. In conclusion, both industrial metals and soft commodities are underpinned by long-term tailwinds and present investment opportunities. In a world where returns from equities and bonds are becoming increasingly correlated, commodities as an asset class, including gold, has an important role as a risk diversifier in our overall barbell portfolio construct. Exposure to commodities can be achieved through investment in diversified commodity funds, which give investors direct exposure to various commodity prices. Alternatively, investors can gain more selective and indirect exposure to commodities through equities/ETFs of commodity-related companies/sectors across the value chain.

Performance of commodity sub-indices over the past 30 years



Source: Bloomberg, JPM, Refinitiv, LME, Euronext Amsterdam, Food and Agricultural Organisation of the United Nations

Commodities have low correlation with other major asset classes

Security	Global Equities	Global IG Bonds	US High Yield Bonds	EM Bonds	Sovereign IG Bonds	Broad Commodities	Crude Oil	Industrial Metals	Soft Commodities	Food Commodities	Gold
Global Equities	1.00	0.32	0.64	0.58	0.48	0.45	0.23	0.58	0.39	0.20	0.09
Global IG Bonds	0.32	1.00	0.30	0.38	0.89	0.21	0.09	0.27	0.32	0.09	0.40
US High Yield Bonds	0.64	0.30	1.00	0.60	0.55	0.40	0.22	0.46	0.41	0.21	0.06
EM Bonds	0.58	0.38	0.60	1.00	0.83	0.29	0.22	0.37	0.40	0.12	0.28
Sovereign IG Bonds	0.48	0.89	0.55	0.83	1.00	0.30	0.22	0.31	0.40	0.19	0.43
Broad Commodities	0.45	0.21	0.40	0.29	0.30	1.00	0.84	0.62	0.70	0.42	0.29
Crude Oil	0.23	0.09	0.22	0.22	0.22	0.84	1.00	0.44	0.45	0.22	0.18
Industrial Metals	0.58	0.27	0.46	0.37	0.31	0.62	0.44	1.00	0.57	0.40	0.31
Soft Commodities	0.39	0.32	0.41	0.40	0.40	0.70	0.45	0.57	1.00	0.53	0.35
Food Commodities	0.20	0.09	0.21	0.12	0.19	0.42	0.22	0.40	0.53	1.00	0.19
Gold	0.09	0.40	0.06	0.28	0.43	0.29	0.18	0.31	0.35	0.19	1.00

Source: Bloomberg, JPM, Refinitiv, LME, Euronext Amsterdam, Food and Agricultural Organisation of the United Nations

Luxury Never Goes Out of Fashion

THEMATIC STRATEGY - LUXURY

By evolving with changes in lifestyles and demographics, we believe that the enduring appeal of top luxury brands to a new generation of consumers will allow them to maintain premium valuations, providing sectoral exposure that will not go out of vogue.

Source: Unsplash

13. Luxury in Vogue.

Joanne Goh
Strategist

Beatrice Tan
Analyst

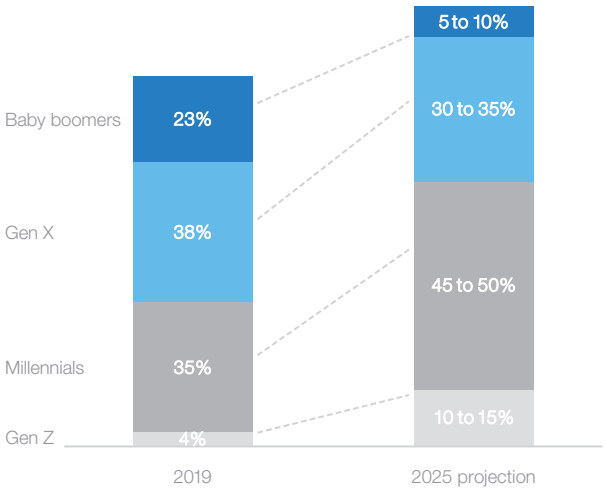
As consumers become more affluent, they consume luxury goods to express their individuality, social status, and aspirations. Luxury products are expensive, of high quality, and limited in distribution. But beyond premium price tags and intricate workmanship, it forms part of a bespoke experience and is held as a signifier of success. Unsurprisingly, top brands that have orchestrated these elements to a T have become synonymous with opulence. Mention the word "luxury" and labels such as Louis Vuitton, Hermes, and Gucci come quickly to mind.

With the power vested by their brand names, the Goliaths of the luxury world enjoy enviably strong pricing power and are well-placed to pass on the costs to their fans. While entry-level luxury brands may feel the squeeze from current headwinds of rising input costs and dampening consumption growth, brands at the top echelons face a lower risk of a demand downturn. Although a downturn could cause wealthy consumers to become more selective, it could also prove to be an opportunity for labels with a strong brand identity as a downturn would phase out smaller entrants.

Beyond their enduring success of the past, we believe that the powerhouses that own top-end brands are here to stay. Strong business fundamentals have been built through their tried and tested pricing models, diversified exposure to geographies and products, and tight control over supply chains. Looking ahead, by evolving with changes in lifestyles and demographics, we believe that their enduring appeal to a new generation of consumers will allow them to maintain premium valuations, providing sectoral exposure that will not go out of vogue.

Millennial spending: A new generation of luxury. Thierry Hermes first set up his workshop in Paris in 1837 which was patronised by European royalty, while Coco Chanel designed her first bag in 1929. While a rich heritage of the past may have created years of intangible value, the future of luxury lies in capturing the hearts of each new generation of spenders. Millennials are now in their prime spending years and are set to form the bulk of the luxury market by 2025. This generation of consumers is the driving force behind the evolving concept of luxury, and the industry is well in step with this evolution.

Millennials are set to make up the bulk of the luxury market by 2025



Source: BCG, Altagamma, DBS

The evolving concept of luxury

	Old luxury	New luxury
Symbolises	Status and achievement	Self-expression
Goods viewed as	Property	Investment asset
Adoption	Pure luxury	Blurring of lines between luxury and street
Social praise	Branding	Cultural credibility and backstory
Engagement	Passive shoppers	Critics and co-creators
Consumption style	Conspicuous	Conscious
Digital channels	Side project	Driving force

Source: Luxe Digital, DBS

Luxury goes street. While the classic Hermes Birkins and Goyard travel bags continue to hail as fashionable items of the rich and famous, millennials define luxury differently from their parents' generations and those before. Think Travis Scott, the Biebers, the Kardashian/Jenners or BTS, whose fans mainly comprise a younger demographic, shaping latest streetwear trends with their bold styles and irreverent attitude. Casualisation is transforming global luxury with the boom of streetwear. Infused with skate, surf, and hip-hop subcultures, streetwear is now the status symbol of millennials.

To appeal to this new generation of consumers, today's notion of luxury has reinvented itself by infusing street culture, blurring the lines between fashion concepts. Take for example the collaborations between such luxury titans as Louis Vuitton and Christian Dior, with top sportswear players like Nike or adidas. Or consider the emergence of cult skate brand Supreme as the darling of limited edition, sellout high fashion collaborations, with new collections selling out in seconds.

We shine the spotlight on some of the top collaborations of this year:

Brand collaborations	Collaborative outcomes
Louis Vuitton x Nike Air Force 1	The late Off-White designer Virgil Abloh took the world by storm with the debut of the Louis Vuitton x Nike Air Force 1 collection. Combining the best of Nike's classic sneaker with Louis Vuitton's fine quality leather and iconic insignia, the top bid for a pair of LV x NIKE AF1 sneakers fetched a whopping USD352,000 when the collection debuted at Sotheby's.
adidas x Gucci	This collaboration merges adidas' iconic three stripes with Gucci's classic red and green colour palette, and comprises apparel, shoes, accessories, and lifestyle pieces. After debuting at Gucci's Fall 2022 runway show, the collection was released for purchase in June, retailing from around USD200 to USD4,200.
Disney x Givenchy	As part of its long-term collaboration with Disney, Givenchy unveiled a capsule collection of characters from Disney's 101 Dalmatians, adding a fashionable spin to the beloved household animated film.
Burberry x Supreme	Not the first to don Supreme's signature bright red and certainly not the last, Burberry teamed with the streetwear label to elevate Burberry's plaid print with Supreme's casual aesthetic.
Barbie x Balmain	Balmain creative director Olivier Roustening gave Barbie a new look by teaming with Mattel to create a collection spanning T-shirts to couture gowns. The partnership also included an NFT auction offering three Barbie avatars styled in digital renditions of physical pieces.
Loewe x Studio Ghibli	Loewe collaborated with Studio Ghibli to create a capsule "wearable movie" collection featuring the adorable characters from Ghibli's award-winning film Spirited Away. The collection sold out on Loewe's website within a week of its release.
Yeezy Gap Engineered by Balenciaga	Kayne West and Gap levelled up their collaboration by bringing in Balenciaga creative director Demna Gvasalia, creating a collection of apparel including a denim jacket, jeans, logo T-shirts, hoodies, and puffer jackets.
adidas for Prada Re-Nylon	The third collection co-created by these two brands, adidas for Prada Re-Nylon reimagines the adidas Originals Forum sneaker, and includes tracksuits, sweaters, and bucket hats.

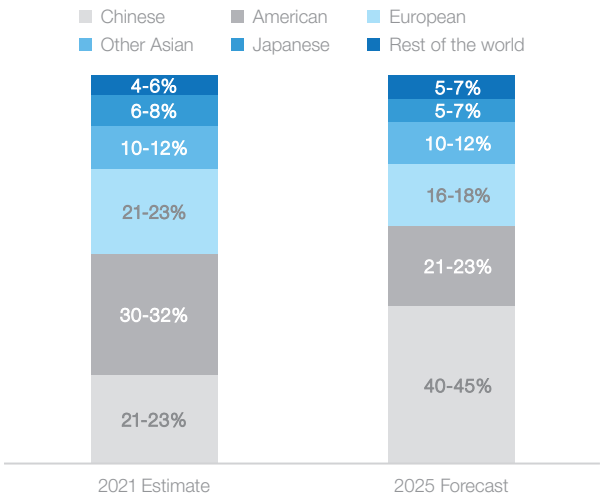
Source: Womens Wear Daily, brand websites, DBS

If you didn't post about it, did it really happen? Social media today is the channel through which many both envy and flaunt a luxurious lifestyle. A myriad of social media platforms has made falling in love with luxury accessible, with nearly 70% of millennials following luxury fashion brands on social media channels. Consumers are now exposed to and identify with luxury brands at a younger age than previous generations, giving them more runway to spend. Just think of the social influence of personalities such as Kylie Jenner (@kyliejenner) who was the first woman to attain 300 million followers on Instagram, with her sister Kim Kardashian (@kimkardashian) not far behind. Through courting these personalities, brands can tap into their loyal follower bases and attract digital eyeballs. After all, luxury is meant to be flaunted.

Conscious consumption. Having spent a large part of their lives in an age of extreme environmental concern, millennials are conscious consumers, and expect much from brands regarding their commitments to the environment and society. Millennials often opt to interact with brands with values that resonate with their own beliefs. These consumers are increasingly conscious of the impact of their purchases on the planet. Ernst & Young's Future Consumer Index study found over half of respondents surveyed paid increasing attention to the environmental and social impact of their purchases.

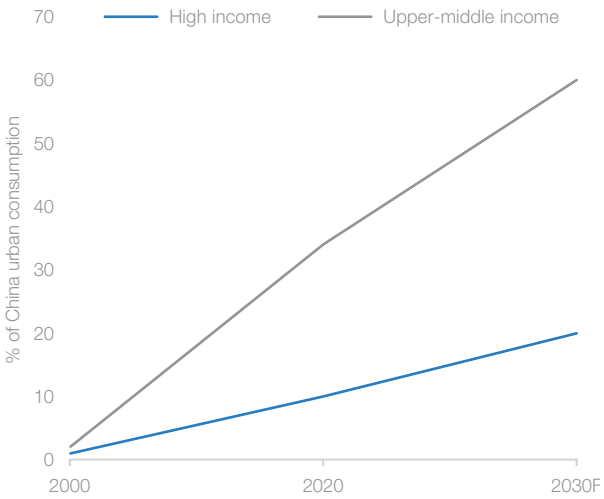
In line with consumer behaviour, brands too are increasingly focused on making not just their businesses but also their wider ecosystems

Growing share of Chinese consumption in the global personal luxury goods market



Source: Bain & Company, DBS

Rising affluence: High and upper-middle income households expected to constitute 80% of China's urban consumption by 2030



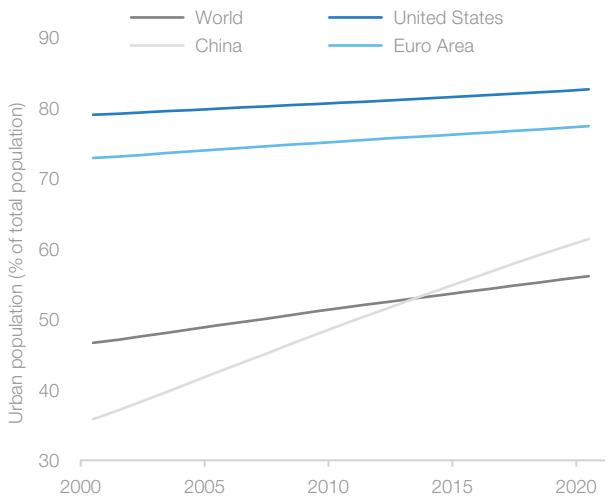
Source: McKinsey & Company, DBS

sustainable. Take the Aura Blockchain Consortium founded by LVMH, Prada Group and Cartier, targeted at developing blockchain applications to raise the standards of luxury. Environmental sustainability is a key value of the consortium and it seeks to leverage technology to provide traceability of materials through the production process, from raw materials to finished goods.

Rising China: The world's consumption engine. China offers a trove of youthful luxury demand as the average age of luxury buyers in China is just 28 years old, about a decade younger than the global average age. Home to the world's largest population and a steadily rising upper-middle class, China contributes an outsized demand for aspirational products, both in terms of the sheer number of consumers as well as their willingness to spend. China is expected to generate more than a quarter of global consumption growth as its population climbs up the income pyramid.

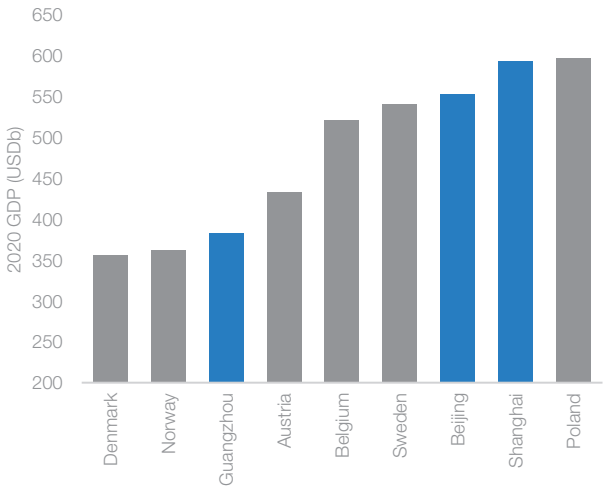
However, there exists considerable headwinds to China's consumption today. These include a common prosperity push to address the nation's persistent wealth divide, intermittent lockdowns driven by China's strict stance against Covid, and the "guochao" movement of Chinese consumers favouring domestic brands, and nationalistic activist boycotts of Western brands. Nonetheless, we believe that China's longer-term luxury consumption prospects are likely to move in parallel with the meteoric rise of urbanisation into its megacities. Today, China's megacities hold more economic power than entire countries in terms of GDP. In other words, China's role as the world's consumption engine is here to stay.

China's meteoric urbanisation over the past two decades



Source: World Bank, DBS

China's megacities generate more economic activity than entire European nations



Source: Bloomberg, World Bank, DBS

Source: Unsplash

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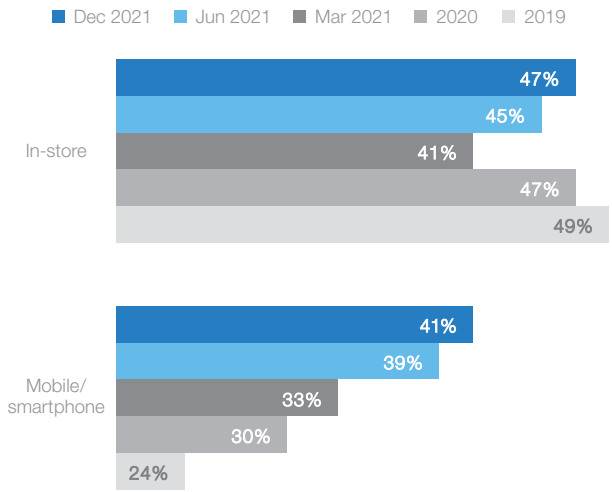
Digital lifestyles: A recipe for multi-touchpoint engagement. The migration of consumers to the digital realm creates new opportunities that drive luxury consumption. While this was already in force pre-Covid, the pandemic catalysed a wider shift toward digital behaviour across demographics and geographies. With the melding of consumers' digital and physical personas, luxury brands are likewise going "phygital", tapping on any opportunity to meet consumers.

For years, luxury retailers were sceptical that digital experiences could evoke the same emotional response as in-person luxury experience. However, store closures and movement restrictions during the pandemic provided impetus for many to go digital. Luxury players have astutely navigated a merger of physical and digital branding, using digital tools to augment physical experiences in unique ways. Take for example Gucci's augmented reality feature on its smartphone; it allows fans to try virtually try their styles of choice by simply pointing their smartphone camera at their own feet. Then there's Dior's virtual beauty consultations that enable consumers to enjoy real-time consultations with experts, right from the comfort of home. By offering personalised experiences beyond mere e-Commerce fare, brands are able to extend the luxury experience across the digital sphere. Digital strategies will continue to widen the playing field for luxury, allowing brands to deepen customer engagement via multi-channel and real-time touchpoints.

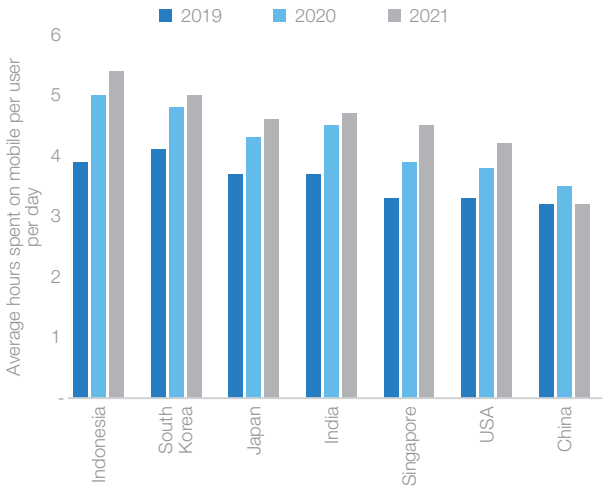
This digital shift— especially as more digital platforms emerge—is likely to provide long-run opportunities for luxury brands to penetrate geographies where they are not physically present. Looking ahead, the Metaverse presents the next digital frontier for luxury, and top brands have been early movers in engaging customers in this realm, for example, by curating flagship branded digital worlds, or providing digital fashion for consumers to channel their individuality through their avatars.

The pandemic introduced many to online consumption, with smartphone shopping seeing increasing adoption



Source: PwC, DBS
(Survey responses to question: In the last 12 months, how often have you bought non-grocery products using the following channels?)

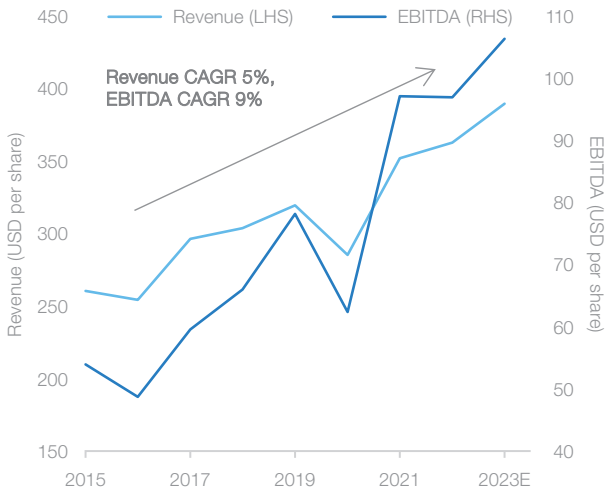
Consumers now spend more than a third of their waking hours on mobile devices



Source: data.ai, DBS

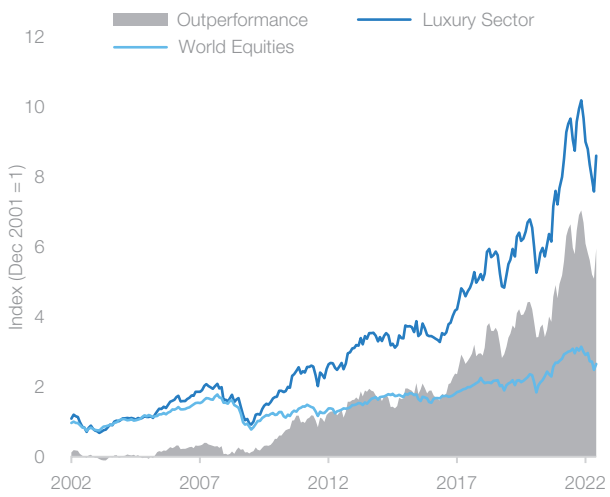
The performance of the luxury sector demonstrates society's hunger to consume. By its proactiveness in embracing the above lifestyle changes and shifts in consumption, the sector has outpaced the broader global equities market over the long term. Strong valuations come on the back of earnings that evidence robust consumer demand. Indeed, after a blip in 2020 caused by the pandemic, earnings in the luxury sector quickly bounced back to pre-pandemic levels. Such resilience, layered with the agility of successful players to pivot with the times and embrace structural shifts, makes the luxury sector a means for investors to benefit from growth in global wealth, consumption, and consumer trends, providing sectoral exposure that will not go out of vogue.

The luxury sector displays resilient earnings



Source: Bloomberg, DBS
(as at 19 Aug 2022)

Luxury has outpaced global equities over the past two decades



Source: Bloomberg, DBS
(as at 19 Aug 2022)

Top players in luxury

Source: Bloomberg, DBS
(as at 16 Sep 2022)

Business of cool – Fashion brand rankings by HYPEBEAST

Rank	Brand	Description
1	Nike	Nike has grown beyond being the largest sportswear company globally. Its widely recognised Swoosh label now defines not just athleisure, but also streetwear and music, including frequent mentions of the brand in rap and hip hop, starting in 2003 when American rapper Nelly's song "Air Force Ones" made it to number 3 on the US Billboard Hot 100.
2	adidas	After investing extensively in revamping its brand and products in the mid-2010s, adidas now channels the energies and attitudes of sports to influence fashion. The sportswear brand's popular collaborations include Stella McCartney, Kanye West, and actress Jung HoYeon of Squid Game fame.
3	New Balance	Similar to many successful streetwear labels, New Balance's surge in popularity stems from collaborations with stars to add a breath of fresh air to the unaltered design of its classic sneaker. Fans include A-listers such as Chris Pine, Timothee Chalamet, and Jaden Smith.
4	Gap	After losing its way as a struggling retailer, Gap is staging a comeback. Its recent adoption by Gen Z TikTok users has made the ubiquitous casual clothing retailer hip again. Furthermore, Gap's latest partnership with Yeezy, albeit short lived, has raised eyebrows and brought it into the spotlight.
5	Supreme	It might have started as a skatewear label, but Supreme has since amassed a cult following with each of the brand's limited edition collections fast selling out. Supreme is known for its extensive track record of collaborations. These include Louis Vuitton, Balenciaga, Gucci, Nike, Vans, The North Face, and Comme des Garcons.
6	Off White	Founded by the late DJ and designer Virgil Abloh, Off White is known for its trademark stripes and embossing, featuring a "gangster chic" aesthetic, ironic quotation marks, and the iconography of American cities.
7	Yeezy	Yeezy is known for its sneakers' unique silhouette. Initially created by Kanye West in collaboration with Nike and later adidas, Kanye West has since announced his intention to produce the label independently of corporate partners.
8	Reebok	With the reinvigoration of 80s flashback fashion, Reebok's classic white leather sneakers continue to remain cool, having been donned by a bevy of celebrities including Gigi Hadid, Jonah Hill, and Meghan Markle.
9	Gucci	Reinvigorated by Tom Ford during the 1990s, Gucci is now known for its eclectic styles, gender fluidity, and youthful appeal.
10	Nike ACG	A Nike line producing sports gear for all climates, Nike ACG enjoys a cult following with its bold colour schemes and silhouettes, making it a sneakerhead favourite.
11	Louis Vuitton	One of the world's leading fashion houses, LV's monogram is an iconic stamp of luxury and needs no further introduction.
12	PUMA	PUMA has recently expanded from its traditional sportswear to fashion and lifestyle, collaborating with the likes of Alexander McQueen, Rihanna, and Kylie Jenner.
13	Uniqlo	A casualwear company known for its everyday staples, Uniqlo boasts collaborations with the likes of Jil Sander, Pharrell Williams, Helmut Lang, and Theory.
14	Jordan Brand	Line of basketball shoes and clothing by Nike. The first Air Jordan shoe was produced for Michael Jordan in 1984 and this model began retailing in the following year.
15	Audemars Piguet	Considered to be one of the most prestigious watchmakers, the brand's most coveted models include the Royal Oak which was first introduced in 1972.
16	Crocs	Known for their patented EVA foam clogs, these chunky shoes have transcended their use as medical footwear to become a fashion icon, with collaborations ranging from MCM to Balenciaga, Justin Bieber, and even General Mills breakfast cereal.
17	Patagonia	Retailer of outdoor clothing and gear. The company recently made headlines after its billionaire founder Yvon Chouinard gave away the company to fight climate change.
18	Carhartt WIP	Founded in the 1880s as a manufacturer of durable apparel for blue-collared workers and hunters, the label has become a fashion staple since the hip-hop music industry embraced the workwear style in the late 1980s to 90s.
19	Patta	Dutch streetwear savants Patta began as a platform retailing exclusive items. Patta now collaborates with sneaker powerhouses such as Nike, adidas, Reebok among other brands.
20	Helmut Lang	Designer Helmut Lang's eponymous fashion house is known for his minimalist yet severe designs, evident in his slim monochromatic suits and denim collections.

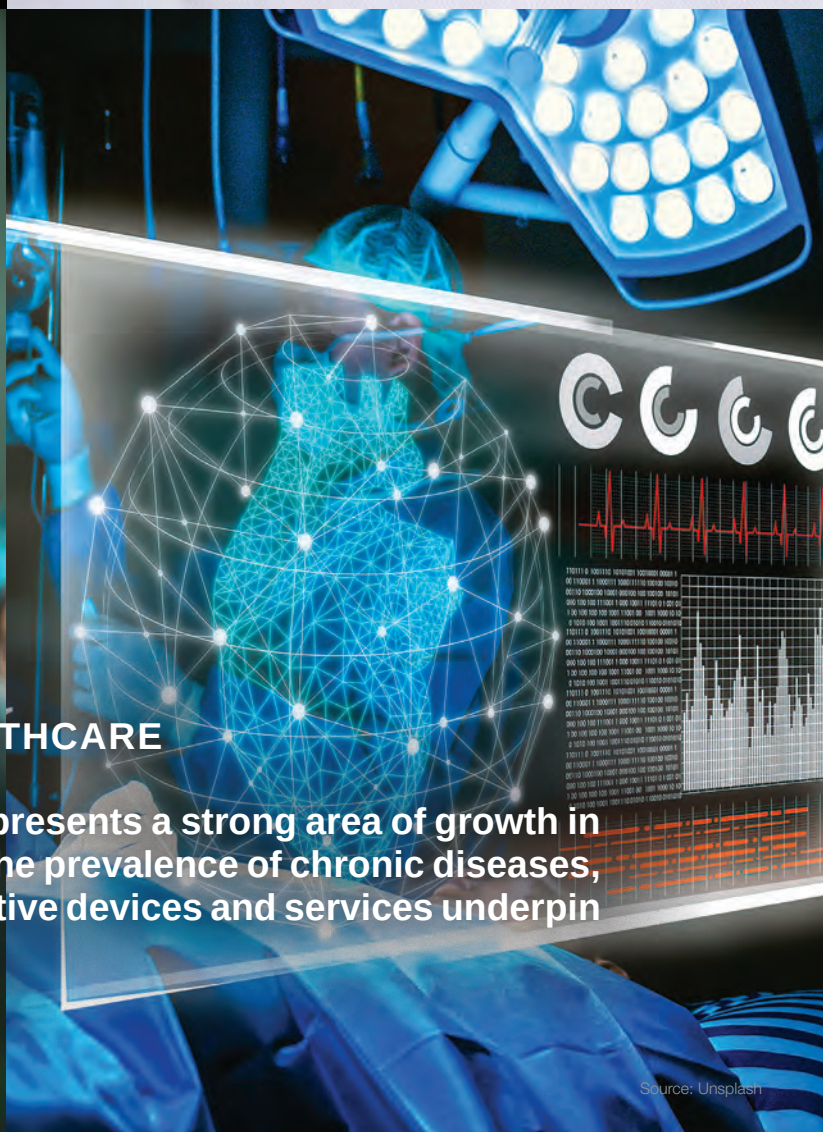
Source: HYPEBEAST, DBS (Based on listing as at 16 Sep 2022)

Source: Unsplash

Source: Unsplash

Healthcare: Positive Prognosis

Source: Unsplash



Source: Unsplash

THEMATIC STRATEGY – HEALTHCARE

The medical equipment sector represents a strong area of growth in healthcare. Ageing populations, the prevalence of chronic diseases, and a growing demand for innovative devices and services underpin the sector's expansion potential.

14. Medical Devices Poised for Growth.

Yeang Cheng Ling
Strategist

Goh Jun Yong
Analyst

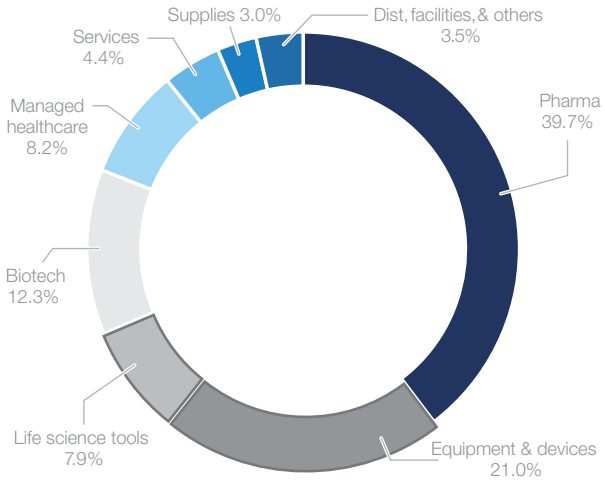
Healthcare, with its wide variety of sub-sectors such as pharmaceuticals and health insurance, is a significant sector that makes up 14% of the world's equity market capitalisation. The diversity and earnings capability of these sub-sectors make healthcare a unique sector with 'defensive growth' characteristics. In this report, we focus on medical devices and equipment that enable medical prevention, diagnosis, and care; these include biomedical apparatus, diagnostic instruments and more.

Despite some near-term headwinds posed by material shortages due to supply chain disruptions and new Covid variants, we believe that the medical equipment sector represents a strong area of growth for healthcare. Long-term secular trends such as growing demand for innovative devices (e.g., wearables) and services (e.g., health data analytics), ageing populations, and the prevalence of diseases such as diabetes underpin the expansion potential for the sector.

"We are in the midst of one of the most challenging times in healthcare history, facing growing and ageing populations, the rise of chronic diseases, global resource constraints, and the transition to value-based care."

Jeroen Tas,
Chief Innovation and Strategy Officer,
Philips Healthcare

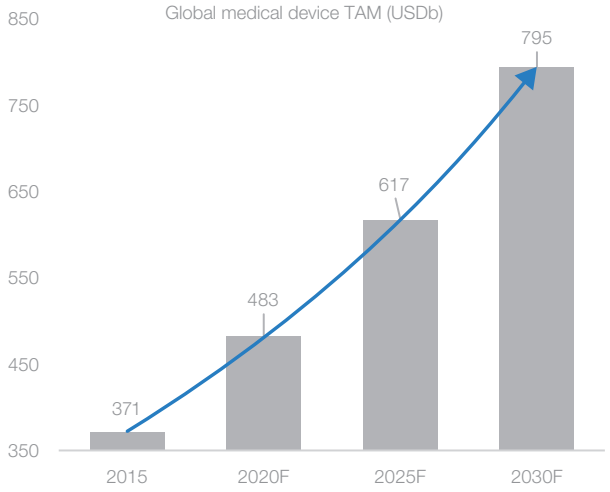
Devices and equipment constitute one-third of the healthcare sector



Source: Bloomberg, DBS

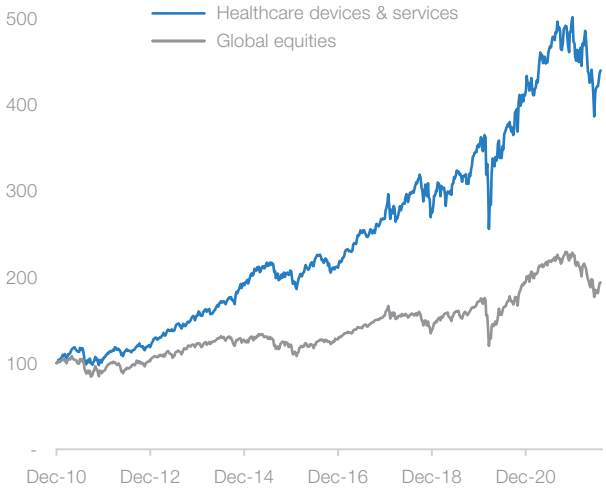
Growing TAM and strong returns. By 2030, the global Total Addressable Market (TAM) of medical devices will reach USD800b, with some USD300b in the US and USD200b in China. The sector has delivered consistently strong returns over the long term, especially in the second half of the past decade. We expect this upward momentum to persist over the next decade as TAM expands amid rising end demand and emergence of new devices.

Steady sales growth of global medical devices (USDb)



Source: KPMG, DBS

Medical device companies – strong growth momentum

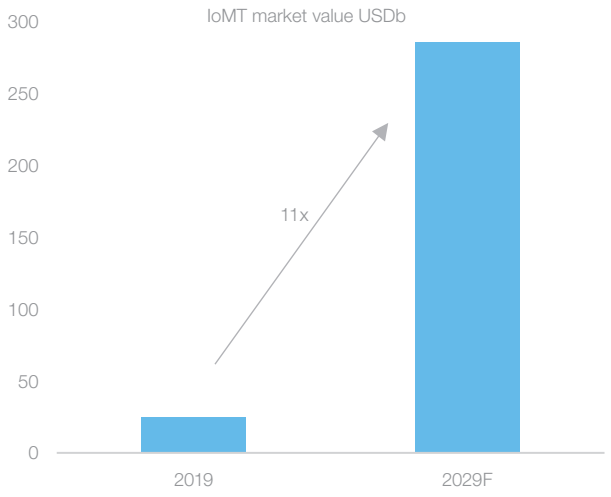


Source: Bloomberg, DBS

Examples of lifestyle illnesses, types of medical devices, and medical device suppliers:

Lifestyle illnesses	Medical devices	Suppliers
Type-2 diabetes	Diagnostic ultrasound scanners	Medtronics
Stroke	Scalpels	Thermo Fisher
Heart diseases	Patient monitors	Agilent
Hypertension	Defibrillators	GE Healthcare
Arteriosclerosis	Surgical tables & devices	Qualcomm Life
Swimmers' ear	Hospital beds	Stanley Healthcare
Chronic obstructive pulmonary disease	Disposables	Microsoft
Cirrhosis	Infusion pumps	Honeywell Care Solutions
Obesity	Oxygen generators	Edward Lifesciences
	Microneedles	
	Endoscopic coronary stents	
	Heart valves	
	Pacemakers	
	Orthopaedic implants	
	Lung ventilators	
	Biopsy devices	
	Mammography equipment	
	MRI machines	

IoMT – connected healthcare



Source: GlobeNewswire, DBS

IoMT to grow exponentially. The market of Internet of Medical Things (IoMT) was valued at USD24b in 2019 and projected to rise steeply by 11x to USD285b by the end of this decade. This is driven by rising validation, adoption, and commercialisation of these services. For instance, Big Tech firms such as Amazon, Microsoft, and Apple have established partnerships with precision-focused medical device makers to create integrated healthcare services on a single platform.

Healthcare services blending in digital transformation

Future of healthcare lies in IT connectivity. The industry is undergoing rapid digital transformation to enhance its offerings. Product makers are incorporating smart functions into integrated devices, connected through cloud for real-time monitoring of patient data. For example, smart watches are used to detect cardiac arrhythmia conditions, which signal risks of stroke. The adoption of digital connectivity allows for uninterrupted monitoring of patients to identify preventive measures ahead of life-threatening situations.

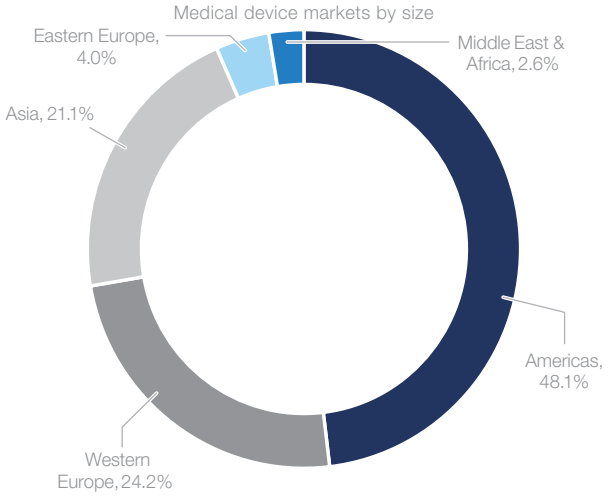
With digital innovation, healthcare providers gain access to new perspectives:

1	On-demand healthcare services	Consumers to decide on timing to suit their own convenience
2	IoMT	Based on predictions by Intel, the worldwide TAM for internet of things (IOT) will reach USD6.2t annually by 2025, of which 30% will be related to healthcare
3	Big data collection and analytics	To reduce medical errors, identify, and track common needs
4	Remote medical services	Virtual interaction between doctors and patients, as some parts of medical services are moving to homes of end users
5	Use of wearable devices to monitor health data 24/7	Examples include heart rate trackers and oximeters to monitor blood oxygen levels
6	AI-enabled medical facilities	Examples include nursing robots to replenish medical supplies and chatbots. AI may also be used in drug discovery, genomics analysis, and pattern recognition

Source: Digitalauthority.me, DBS

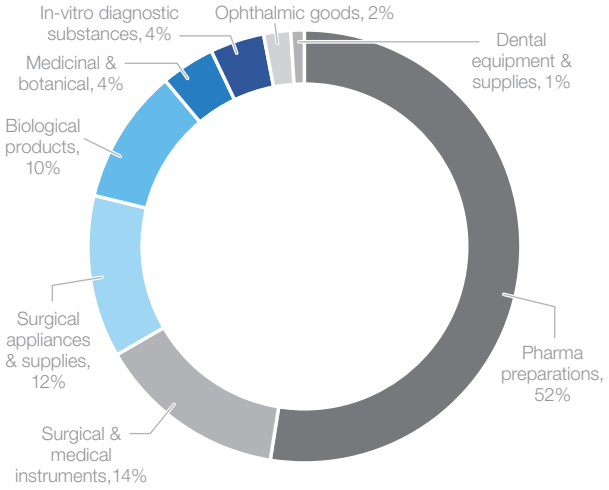
US leads the world in MedTech spending. In terms of spending across the various medical device and equipment sub-segments in the US, pharmaceutical preparations have been dominant—commanding more than half of total expenditure—followed by surgical and medical instruments at 14%, and surgical appliances at 12%.

North America dominated close to half the market share for medical devices, followed by Europe and Asia



Source: Khidi, DBS

US medical device spending



Source: US Census Bureau 2018, PMMI, DBS

Asia Pacific – a new horizon for medical devices

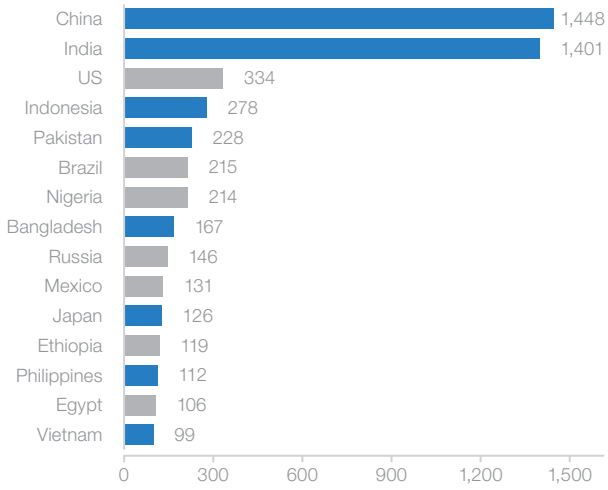
Ample growth headroom in Asia. While North America has long been the core market for medical equipment owing to its developed healthcare system and longstanding industry leaders, Asia is projected to be the fastest growing market over the coming decades due to its vast population and underinvestment in medical facilities. To modernise its healthcare systems, Asia will expand its medical services capacity and readiness.

Eight of the 15 most populous countries are in Asia, which comprises 3.8b people, making up nearly half of the world's population (based on 2020 data). This sheer size, combined with fast-growing spending power of the middle-income group, ageing demographics, and demand for improved medical care brings great prospects for healthcare and its sub-sectors, which includes medical devices and equipment.

Health insurance a spending catalyst. This growth trajectory is further steepened by increasing health insurance coverage, which is a tailwind for overall healthcare spending. Based on a recent survey by Emergo, global medical device makers are optimistic on the demand outlook for US, Europe, and Asia markets.

Along with age, health commonly deteriorates. Ageing populations will drive demand for medical equipment and facilities. Furthermore, governments around the world are spending more on healthcare. From 2000 to 2019, as a percentage of GDP, domestic general government healthcare expenditure rose from 5.5% to 8.5% in the US, and from 1% to 3% in China. Importantly, growing healthcare expenditure was allocated based on ever-growing GDP over the years. To put things into perspective, the US government spent nearly USD1.8t on healthcare, a three-fold increase from 2000, in 2019 (in absolute terms). In China, the government's healthcare expenditure surged 35 times to USD430b over the same period. We expect both the share of GDP and absolute amount allocation on healthcare spending across the world to sustain the spending uptrend, with priority on healthcare devices and capacity.

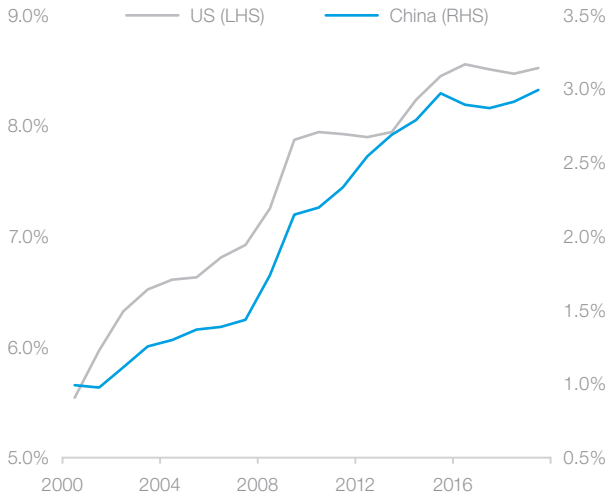
Majority of the world's most populous nations are in Asia (million population, 2020)



Source: Worldometers, DBS

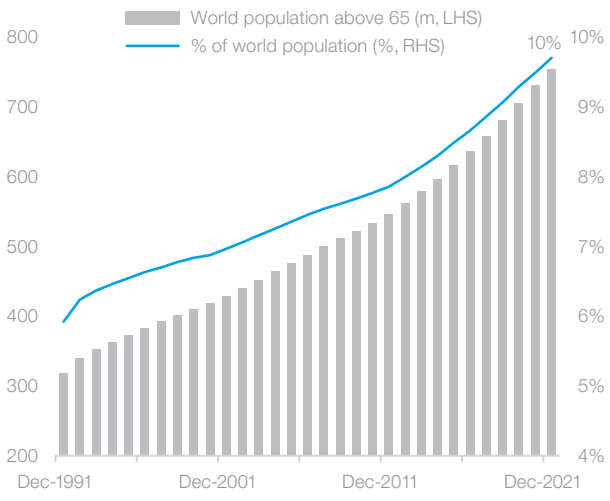
Asia still in MedTech infancy and primed for growth. It is projected that in 2023, the availability of hospital beds in Asia will be at alarmingly low levels; less than 5 per 1,000 population in countries such as China, Australia, Thailand, Malaysia, and India. The shortage of trained healthcare personnel will also linger. This will create a perennial expenditure cycle where both public and private healthcare systems channel more financial resources and policy commitments to their upgrade.

Government healthcare expenditure, as % of GDP



Source: WHO, DBS

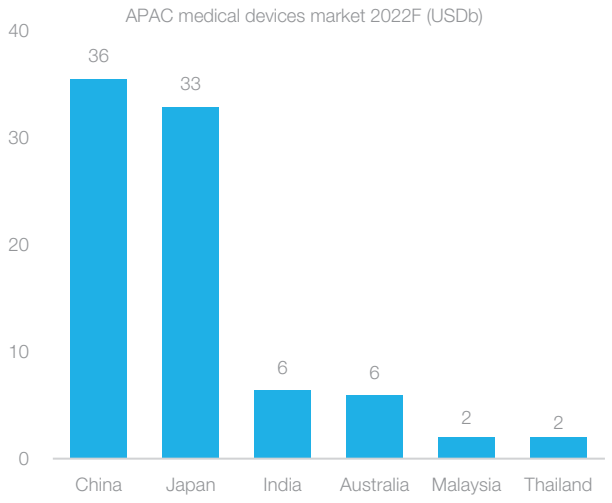
Ageing population



Source: Bloomberg, DBS

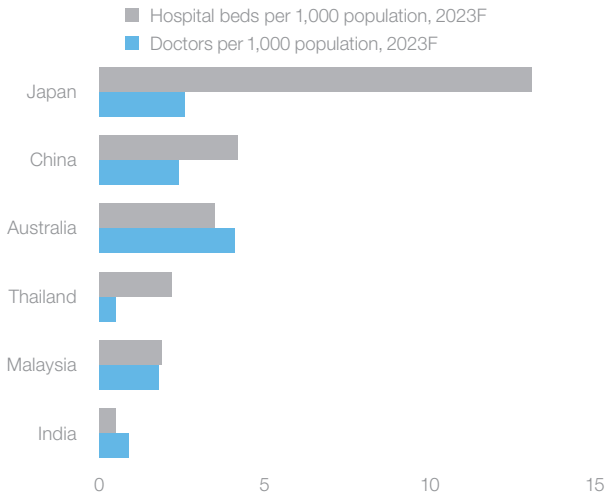
Chronic/lifestyle diseases a key driver in device adoption. Based on analysis by the International Diabetes Federation in 2019, some 460m of adults aged between 20-79 are diabetic, and this number is projected to rise to 700m by 2045 – this is equivalent to nearly 10% of the current global population. Along with diabetes, the long list of medical conditions forms a huge market for equipment and devices used to manage patient conditions.

Asia's increasing healthcare preparedness



Source: KPMG, DBS

Ample room for Asia's medical service capacity to grow



Source: KPMG, DBS

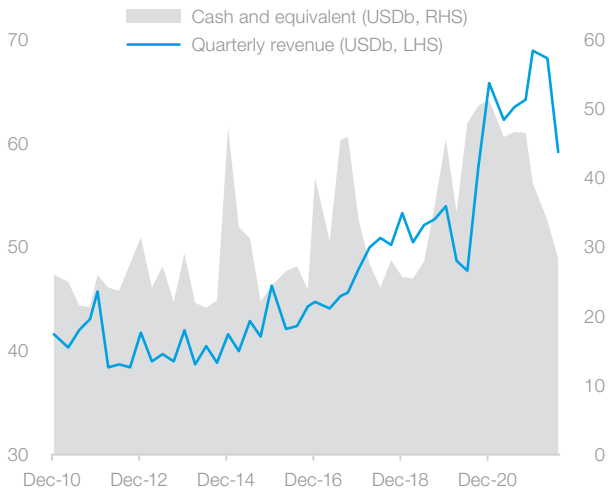
Solid financials to drive M&A and capex

Mergers and acquisitions (M&A) mainstay. The healthcare sector has been and will continue to be one of the biggest contributors to M&A activity. In 2021, it ranked fourth with a total transaction volume of USD436.5b, lagging only financials, real estate, and IT.

Cash and innovation are major catalysts. The 15 leading medical device firms globally generated more than USD60b of quarterly revenue at the end of 2021, and collectively have USD50b of cash which may be used to fund M&A activities. Industry leaders continuously seek to acquire niche players to enhance innovation, product pipeline, and market position. Furthermore, the long-term prospect of this sector is reinforced by its strong cash generating ability, which is driven by rising end demand, pricing power, and operating scalability.

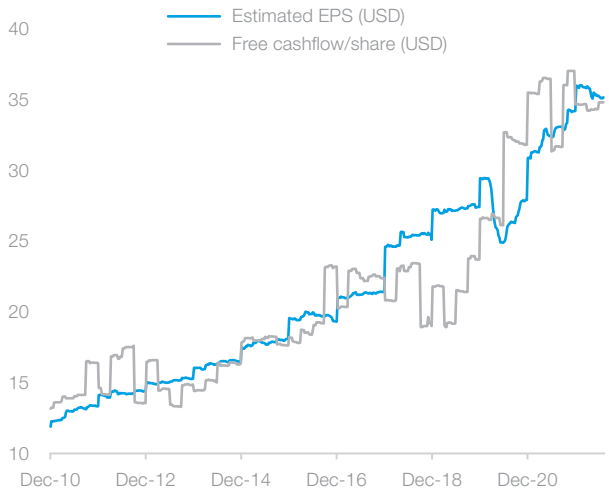
Commitment to Capex. The thriving healthcare devices industry came at the heels of its commitment to capital expenditure. Industry players commit increasing capital and resources to holistically meet ever-changing medical needs through the development of new high-precision solutions and equipment.

Balance sheet strength to drive acquisition



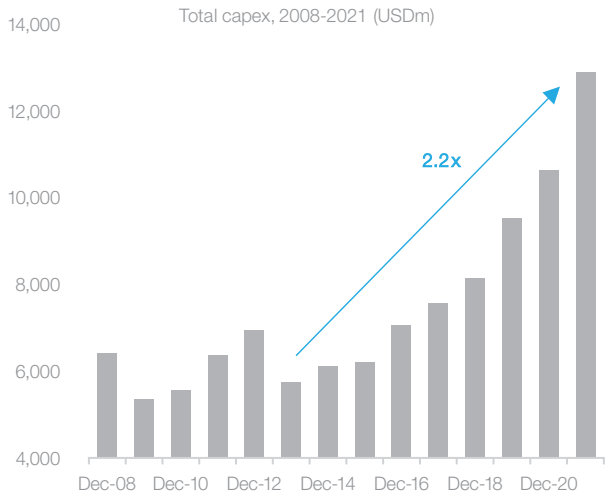
Source: Bloomberg, DBS

Strong profits and cash generating ability



Source: Bloomberg, DBS

Capex of 15 industry leaders (2008-2021)



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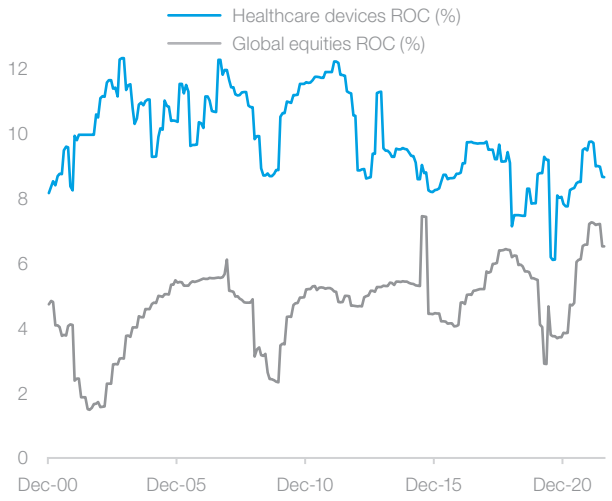
Higher ROC

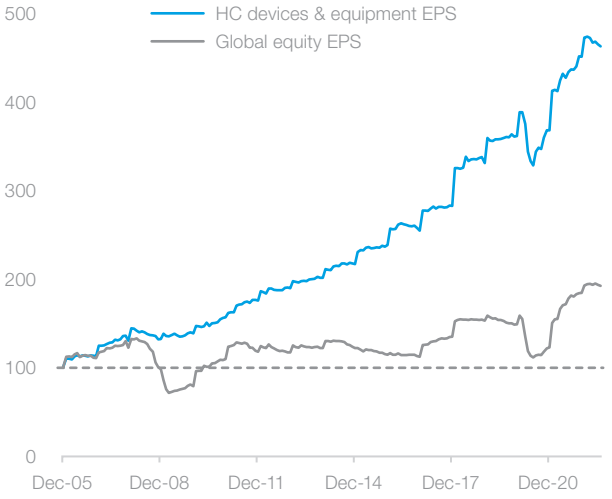


Source: Bloomberg, DBS

A pathway to higher returns. More importantly, the broader capital spending and M&A activity in the listed healthcare devices sector have consistently yielded higher returns than global equities. Since 2000, the listed fraternity delivered return-on-capital (ROC) in the range of 7%-12%; the average ROC of 10% is an impressive double that of global equities. This demonstrates the sector's strong ability to generate remarkable yield from capital invested, rewarding shareholders handsomely in return.

Strong earnings resilience. The sector demonstrates clear earnings resilience – it was largely unscathed in periods of market volatility thanks to its robust end demand and growing use of advanced devices and solutions. Since 2005, earnings among healthcare device stocks have multiplied nearly fivefold, well ahead of global equities. This substantiates the defensive-growth nature of the broader healthcare sector and sub-sectors.

Healthcare device earnings to overtake global equities earnings (2005 = 100)



Source: Bloomberg, DBS

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Glossary.

Acronym	Definition
ADR	American depositary receipt
ASEAN	Association of Southeast Asian Nations
AUM	Assets under management
AxJ	Asia ex-Japan
bbl	barrel
BI	Bank Indonesia
BNM	Bank Negara Malaysia
BOC	Bank of Canada
BOE	Bank of England
BOJ	Bank of Japan
BOK	Bank of Korea
BOT	Bank of Thailand
bpd	barrels per day
BSP	Bangko Sentral ng Pilipinas
CAA	CIO Asset Allocation
CGB	China Government Bonds
CPI	consumer price index
DM	Developed Markets
DXY	US Dollar Index
EBITDA	earnings before interest, tax, depreciation, and amortisation
EC	European Commission
ECB	European Central Bank
EM	Emerging Markets
eop	end of period
EPFR	Emerging Portfolio Fund Research
EPS	earnings per share
ERP	equity risk premium
ESG	Environmental, Social, and Governance

Acronym	Definition
e-Sports	electronic sports
ETF	exchange-traded fund
EU	European Union
EV	electric vehicle
FOMC	Federal Open Market Committee
FX	foreign exchange
GDP	gross domestic product
GFC	Global Financial Crisis
HIBOR	Hong Kong Interbank Offered Rate
HKMA	Hong Kong Monetary Authority
HY	high yield
IC	integrated circuit
IG	investment grade
IMF	International Monetary Fund
IPO	initial public offering
IRS	interest rate swap
ISM	Institute for Supply Management
IT	Information Technology
JGB	Japanese Government Bond
KTB	Korea Treasury Bonds
LATAM	Latin America
M&A	Mergers and acquisitions
MAS	Monetary Authority of Singapore
mmbpd	million barrels per day
NATO	North Atlantic Treaty Organisation
NAV	net asset value
NDIRS	non-deliverable interest rate swaps
NEER	Nominal Effective Exchange Rate

Acronym	Definition
NFIB	National Federation of Independent Business
NGL	Natural gas liquids
NIM	net interest margin
NPL	nonperforming loan
OECD	Organisation for Economic Co-operation and Development
OIS	overnight indexed swap
OPEC	Organization of the Petroleum Exporting Countries
OPM	operating profit margin
P/B	price-to-book
P/E	price-to-earnings
PBOC	People's Bank of China
PCE	personal consumption expenditure
PE	Private Equity
PMI	purchasing managers' index
PPI	producer price index
PRR	price-to-research ratio
QE	quantitative easing
R&D	research and development
RBA	Reserve Bank of Australia
RBI	Reserve Bank of India
RBNZ	Reserve Bank of New Zealand
REIT	real estate investment trust
RM	relationship manager
ROA	return on asset
ROE	return on equity
RRR	reserve requirement ratio
SAA	Strategic Asset Allocation
SBV	State Bank of Vietnam
SD	standard deviation
SNB	Swiss National Bank
SOE	state-owned enterprises
SOFR	Secured Overnight Financing Rate
SORA	Singapore Overnight Rate Average
SPR	Strategic Petroleum Reserve
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TAA	Tactical Asset Allocation
TAM	total addressable market
UCITS	Undertakings for Collective Investment in Transferable Securities
UN	United Nations
US FDA	United States Food and Drug Administration
UST	US Treasury
VC	Venture Capital
WTI	West Texas Intermediate
WWF	World Wildlife Fund
YTD	year-to-date
YTW	yield to worst

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