

CIO Weekly

1 September 2020

Key Points

- **Equities:** With rising policy uncertainty, we stay Underweight on Japan and are stock selective in Tech and Health Care sectors.
- **Credit:** New Fed framework favours HY over IG.
- **FX:** Further AUD strength in doubt amid moderation in domestic economic momentum and potential easing by the RBA.
- **Rates:** Implied volatility in USTs and swaps suggests prevalence of sanguine view on US rates; eventual vaccine approval for COVID-19 could change things.
- **Thematics:** COVID-19 is changing consumer behaviour in Indonesia.
- **The Week Ahead:** Keep a lookout for US change in nonfarm payrolls and initial jobless claims; Japan GDP numbers.

Equities: "Abenomics" policy continuation is key to stability in Japan's financial markets

Shinzo Abe's planned early retirement will be a source of uncertainty to financial markets. At stake is the continuation of "Abenomics". In 2013, Abe, together with Bank of Japan (BOJ) governor Haruhiko Kuroda, worked together on plans to jolt the economy with the "three arrows" of fiscal expansion, monetary easing, and structural reform to revive Japan after two decades of deflation. Abenomics has indeed served Japan well as gross domestic product (GDP) during Abe's tenure is above that in the years preceding him. Reviews on the success of Abenomics, however, have been mixed as the targeted inflation of 2% was not hit at all; inflation continues to stay around 0%. But exports, employment, and productivity have risen, and GDP has grown uninterrupted since 2013 (except for 2020) in nominal terms.

The stock market has benefitted from Abenomics as the Topix doubled from 2013 to 2018. The stability brought about by Abenomics arises from the presence of a plan, the accompanying depreciation in JPY, and the BOJ's buying of the stock market which has helped to support sentiments and exports.

In the next 12 months, we can expect the appointment of Abe's successor in September, a potential early election, a new prime minister, and a cabinet reshuffle. Investors would like to see Finance Minister Taro Aso and BOJ governor Kuroda stay in their jobs for the continuation of policies. But that would very much depend on whether the new prime minister would be as dovish as Abe. Uncertainties also lie in foreign policy relations with China, South Korea, and the US.

We continue to stay Underweight on Japan and are stock selective in Tech and Health Care. Without its own catalyst, the Japan market is likely to mirror moves in the US, especially in these two high growth sectors which will continue to attract buying interest in supporting the broad market. Uncertainty in the yen will pose risks to the exports sector, especially the auto sector which also faces US election risks.

Joanne Goh | Strategist

Global cross assets

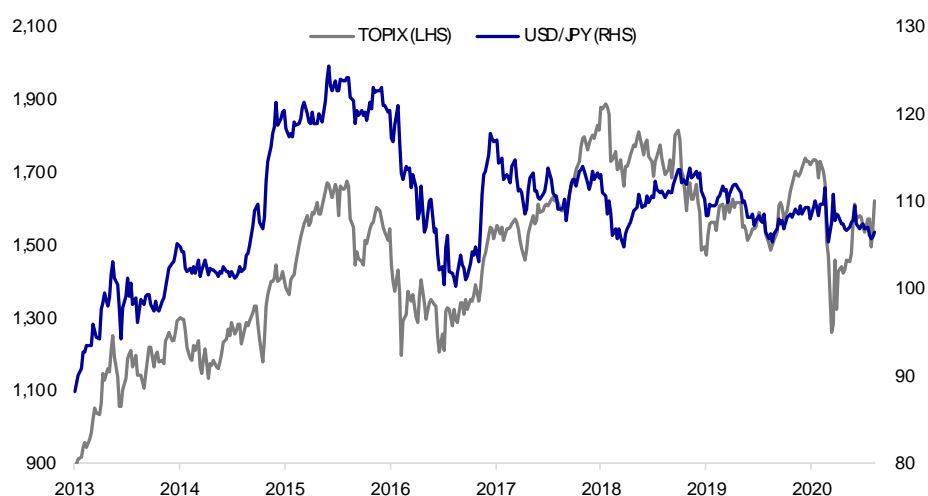
Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	28,430.05	-0.8%	-0.4%
S&P 500	3,500.31	-0.2%	8.3%
NASDAQ	11,775.46	0.7%	31.2%
Stoxx Europe 600	366.51	-0.6%	-11.9%
DAX	12,945.38	-0.7%	-2.3%
CAC 40	4,947.22	-1.1%	-17.2%
FTSE 100	5,963.57	0.0%	-20.9%
MSCI AxJ	724.66	-1.5%	5.3%
Nikkei 225	23,139.76	1.1%	-2.2%
SHCOMP	3,395.68	-0.2%	11.3%
Hang Seng	25,177.05	-1.0%	-10.7%
MSCI EM	1,101.50	-1.8%	-1.2%
UST 10-yr yield*	0.70	-1.6	-121.3
JGB 10-yr yield*	0.05	-0.7	6.7
Bund 10-yr yield*	-0.40	1.2	-21.0
US HY spread*	4.77	2.0	141.0
EM spread*	385.35	2.8	108.0
WTI (USD)	42.61	-0.8%	-30.2%
LMEX	3,017.30	0.0%	6.1%
Gold (USD)	1,967.80	0.2%	29.7%

Source: Bloomberg

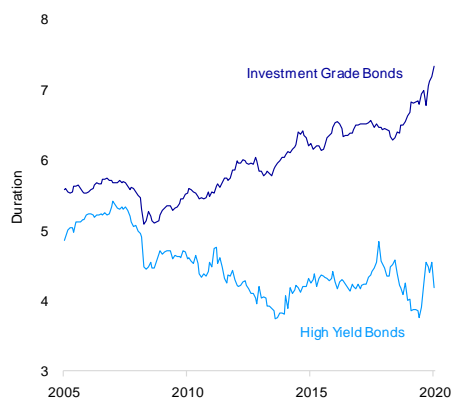
* Changes in basis points

Figure 1: Topix tends to perform well in a weak yen environment



Source: Bloomberg, DBS

Figure 2: Average duration of IG and HY bonds have shown clear divergence



Source: Bloomberg, DBS

Credit: New Fed framework favours HY over IG

The US Federal Reserve revealed a new approach for setting monetary policy, following a framework review since early 2019. The new strategy aims to address the persistent undershooting of the 2% inflation objective by letting both inflation and employment run above target following a period of economic weakness, in order to “make up” for those periods of underperformance. This “flexible” form of average inflation targeting will see rates lower for longer, although the curve will likely see steepening as the long end adjusts for higher inflation expectations and uncertainty.

Under this outcome, longer duration credits are likely to face price weakness. Curiously, duration risk is the one area that High Yield (HY) bonds fare better than Investment Grade (IG). IG issuers have continued to tap the markets for bonds with higher maturities to lock in low funding costs for the long run; average duration of IG bonds from c.5 years after the Global Financial Crisis to more than 7 years today. HY credits have conversely seen average duration decline, in part due to issuers structuring call options to take advantage of earlier redemption for possible lower coupon refinancing. In this regard, the new Fed framework and possibly steeper UST curve would impact IG credit more negatively than HY credit at the margin (please refer to “Credit: New Fed framework favours HY over IG”, 31 August 2020).

Daryl Ho | Strategist

Figure 3: Facing resistance



Source: Bloomberg, DBS

FX: Will AUD rise for a sixth month?

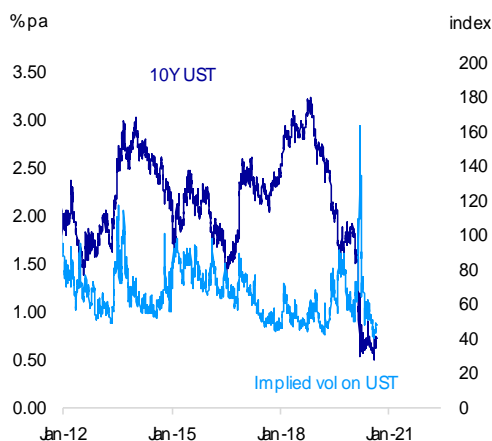
AUD/USD tested 0.74 for the first time since August 2018 but did not break above a March-June **trendline resistance at 0.7390**. That said, there is also a June-August **trendline support around 0.7320**. Looking beyond the gains in recent days, **AUD’s uptrend has been difficult in recent months**. Speculative long and short positions have, as per Commodity Futures Trading Commission data, risen together, and ironically, on a modest net short position. This should not come as a surprise. AUD has rallied sharply by some 28% appreciation since March in defiance of Australia’s first recession and weak outlook. The question now is whether AUD will score a sixth straight month of appreciation in September.

Consensus expects a contraction of -6.0% q/q for Australia’s seasonally adjusted real gross domestic product (GDP) in 2Q (to be released on 2 September), significantly worse than the -0.3% decline in the first quarter. The **Reserve Bank of Australia (RBA) has warned of a delay to the economic recovery from the coronavirus resurgence** in Victoria and has **flagged falling property prices**. This morning’s Australian Industry Group Performance of Manufacturing Index slipped below 50 again (contracted) in August from 53.5 in the previous month. Melbourne dragged the CoreLogic home value index lower by a fourth straight month in August. Hence, the RBA may, at today’s policy meeting, signal discomfort over AUD’s strength and keep the door open for more monetary easing if needed. AUD bulls are hoping for the RBA to disappoint here like they did at its July meeting.

As a barometer of global risk appetite, **AUD will become vulnerable if global stocks turn volatile**. This morning’s headlines have heralded the Dow and S&P 500 for having reported their best August since 1984 and 1986, respectively. With the US elections two months away, history suggests that US stocks may turn volatile in September and October. We remain mindful that USD was also weak and surprised on the upside in 1980 and 1992, the years that American voters did not re-elect their president. Like it or not, the US 10-year bond yield has bounced off its low around 0.50% in early August. Despite some retracement on Monday (31 August), the US long bond yield is still holding firm above 0.70%. The US yield curve has a steepening bias in anticipation of the US recovery ahead. Consensus expects US real GDP growth, on a seasonally adjusted annualised basis, to rebound to +21% q/q in 3Q from its worst 31.7% contraction in 2Q.

Philip Wee | Strategist

Figure 4: COVID-19 premiums still embedded in UST



Source: Bloomberg, DBS

Rates: USD rates and implied volatility on rates are too low

Judging from implied volatility in US Treasuries as well as swaps, market participants still have a sanguine view of US rates. While the USD curve did steepen post Jackson Hole, implied interest rates volatility did not budge much and are still very low by historical standards.

Comparatively, the CBOE Volatility Index (VIX) is still elevated even as equity markets continue to rally. We suspect that dovish forward guidance from the Fed may largely be to blame for limited rates volatility. The low rates environment appears to be entrenched with the market unwilling to bring 10Y yields above 1% even as inflation expectations (judging from 5Y and 10Y breakevens) have soared. Note that 10Y yields were hovering north of 1.5% before the COVID-19 crisis hit. Even during the period of complacency in 2012, 10Y yields did not dip below 1%.

We still think that the rates space is embedding a COVID-19 premium that has been weighing on yields. An eventual vaccine approval and/or better treatment of COVID-19 could change things. Implied 10Y real yields of -1% is still unattractive, in our view. While it is likely that dovish Fed policy would keep short-term real rates (out to the 3Y tenor) negative, longer tenors do not face the same level of distortion. We suspect that the **real 10Y yields have room to climb in the coming quarters.**

Eugene Leow | Strategist

Thematics: COVID-19 is changing consumer behaviour in Indonesia

- We conducted a survey with Indonesian consumers about 10 weeks from the start of lockdown.
- Survey shows change in consumer behaviour is accelerating since the onset on the COVID-19 pandemic.
- On a macro level, we expect spending to shift towards food, away from non-food.
- Consumer companies are coping well; concern over uncertain future, need for diversification.
- Investment outlook likely to remain tepid in the near term; we prefer staple F&B counters.

A viral impact on consumer behaviour and basket spending. The repercussions from the current COVID-19 pandemic have been far reaching. Our consumer survey conducted in June/July with Indonesian consumers (c.10 weeks from the start of lockdowns) shows five key trends emerging: (i) health, (ii) home-ward focused, (iii) home-cooking, (iv) accelerated e-Commerce, and (v) no more traditional grocery shopping. Though it is still early days, these trends are worth noting even though the current situation remains fluid.

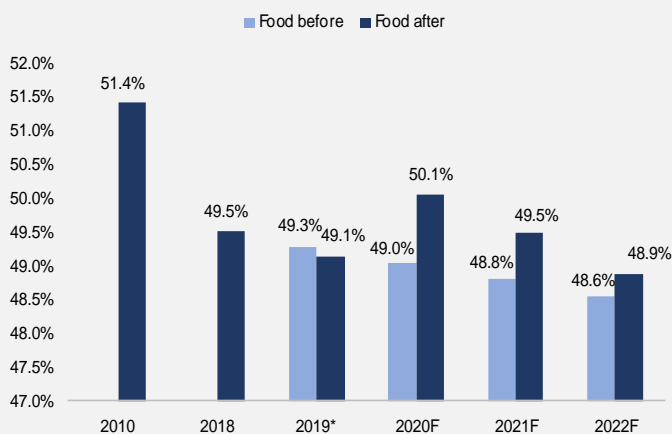
Pivot back towards food basket in 2020. On the macro front, with the slowdown in the economy and personal income, we expect personal household consumption to shift back towards staple foods and necessities, and away from discretionary items and activities such as eating out, leisure activities, etc. For 2020, we expect to see consumers pivot towards spending more on food vs non-food – a reversal of a notable trend in the past decade, driven in large by rising incomes.

Consumer companies are coping well. Interviews with companies have shown that most, if not all, are reacting quickly to the changes. The pandemic has forced many to rethink their product, marketing, and channel strategies, among others. There is a high level of uncertainty on the pace of recovery, but the common message among Indonesian consumer companies is diversification – sales channels, products, geography, supply chains, etc.

Preference for staples and value. Synthesising the various factors, from consumer surveys, macro as well as company-level interviews, the immediate outlook is likely to remain murky while consumer sentiment remains tepid. Our preference is on consumer F&B staple plays. For household and personal care products, demand is likely to stay relatively resilient though valuations are not attractive vis-à-vis growth. We would avoid retail and food service for the time being, given the challenges in the immediate term.

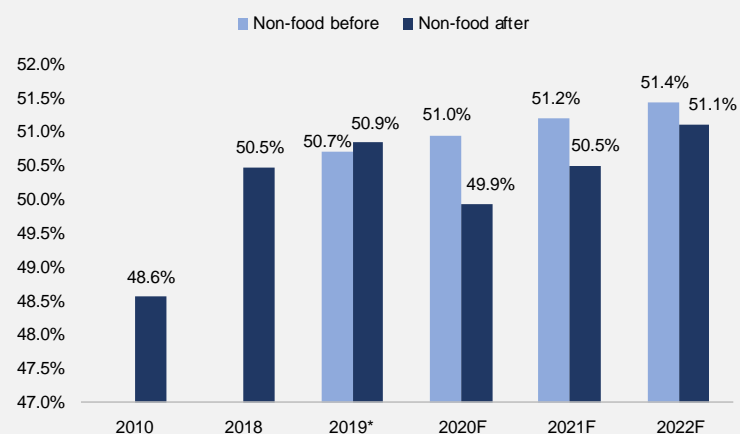
Cheria Christi WIDJAJA | Analyst
Andy SIM | Analyst

Figure 5: Food as % of consumption basket; before vs after COVID-19



Source: BPS, DBSVI, DBS Bank estimates
*2019: our previous forecasts (before) vs actual numbers (after)

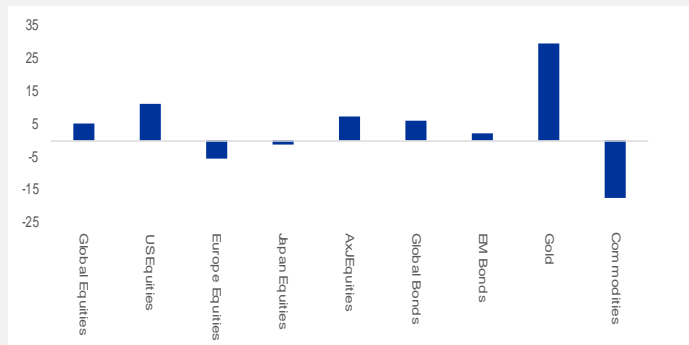
Figure 6: Non-food as % of consumption basket; before vs after COVID-19



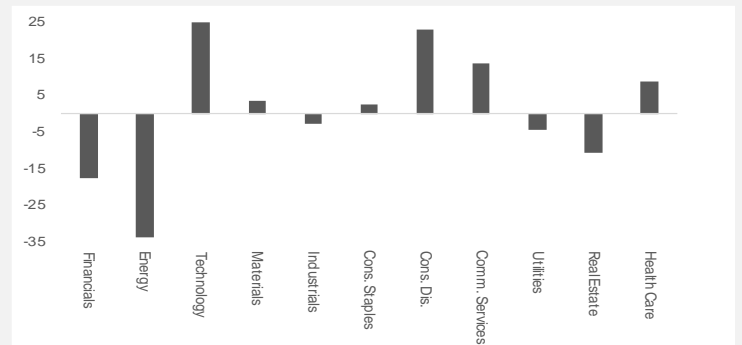
Source: BPS, DBSVI, DBS Bank estimates
*2019: our previous forecasts (before) vs actual numbers (after)

CIO Markets Watch

Global Cross Assets YTD Returns



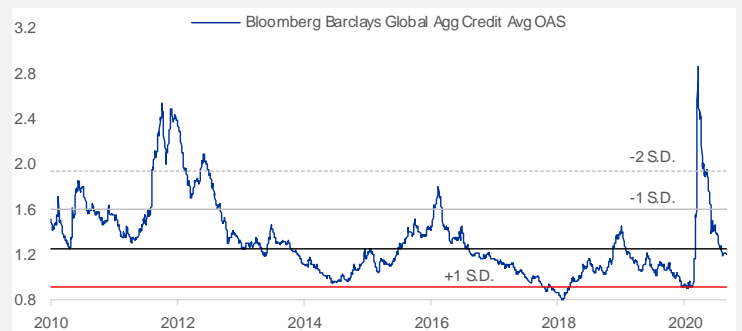
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Index Returns

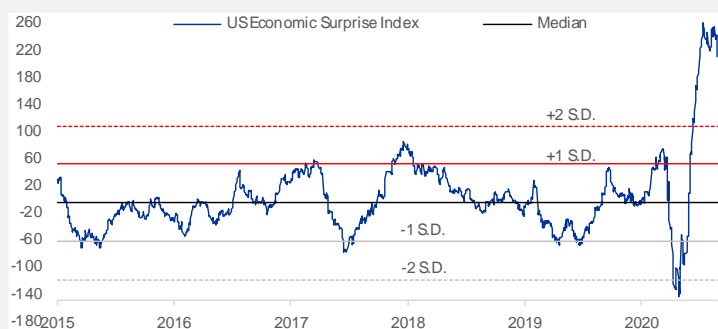
	1 week	MTD	QTD	YTD
Equities				
S&P 500	2.0%	7.0%	12.9%	8.3%
NASDAQ	3.5%	9.6%	17.1%	31.2%
Stoxx Europe 600	-0.4%	5.5%	8.4%	-6.4%
DAX	-1.2%	2.9%	1.7%	-11.9%
Nikkei 225	0.7%	6.6%	3.8%	-2.2%
MSCI WORLD	1.6%	6.5%	11.5%	4.1%
MSCI ACWI	1.3%	6.0%	11.4%	3.5%
MSCI Asia ex-Japan	-0.2%	3.4%	11.7%	5.3%
MSCI EM	-0.6%	2.1%	10.7%	-1.2%
HSCEI	-3.3%	-0.5%	2.4%	-10.5%
SHCOMP	0.3%	2.6%	13.8%	11.3%
Hang Seng	-1.5%	2.4%	3.1%	-10.7%
Straits Times	-0.2%	0.1%	-2.2%	-21.4%
Fixed Income				
Barclays Global Aggregate	0.2%	-0.2%	3.0%	6.1%
Barclays US Aggregate	-0.3%	-0.8%	0.7%	6.9%
Barclays US High Yield	0.6%	1.0%	5.7%	1.7%
Barclays Euro Aggregate	-0.7%	-0.5%	0.5%	1.7%
Barclays Euro High Yield	0.4%	1.5%	3.3%	-2.7%
JPM EMBI Global	-0.5%	0.3%	4.0%	2.1%
JPM EMBI Global Diversified	-0.7%	0.1%	4.2%	2.2%

Prices & Spreads

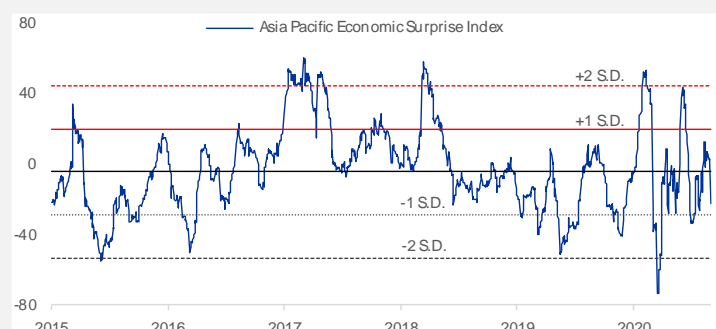
	Spot	2Q20	1Q20	4Q19
Rates				
Fed Funds Target	0.25	0.25	0.25	1.75
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	0.71	0.66	0.67	1.92
Japanese Govt Bond 10-yr	0.05	0.02	0.01	-0.02
German Bunds 10-yr	-0.40	-0.46	-0.47	-0.19
Spreads				
US Agg Corporate Spread	1.29	1.50	2.72	0.93
US Corporate HY Spread	4.77	6.26	8.80	3.36
Euro Agg Corporate Spread	1.19	1.53	2.41	0.98
EM USD Agg Spread	3.35	3.93	6.19	2.87
Currencies				
US Dollar Index (DXY)	92.1	97.4	99.0	96.4
EUR/USD	1.19	1.12	1.10	1.12
USD/JPY	105.9	107.9	107.5	108.6
USD/CNY	6.8	7.1	7.1	7.0
Commodities				
WTI Oil	43	39	20	61
London Metal Exchange (LMEX)	3017	2682	2335	2843
TR/CC CRB Commodity	153	138	122	186
Gold	1968	1781	1577	1517

CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



Macro Calendar

	Date	Period	Survey	Prior
United States & Eurozone				
Change in Nonfarm Payrolls (US)	04-Sep	August	1370k	1763k
Initial Jobless Claims (US)	03-Sep	August	950k	1006k
ISM Manufacturing (US)	01-Sep	August	54.8	54.2
Durable Goods Orders (US)	02-Sep	July	11.20%	11.20%
MBA Mortgage Applications (US)	02-Sep	August	--	-6.50%
Markit Eurozone Manufacturing	01-Sep	August	51.7	51.7
Markit US Manufacturing PMI (US)	01-Sep	August	53.6	53.6
Unemployment Rate (US)	04-Sep	August	9.80%	10.20%

Macro Calendar

	Date	Period	Survey	Prior
Asia				
GDP SA q/q (JP)	07-Sep	2Q	--	-7.80%
BoP Current Account Balance (JP)	07-Sep	July	--	¥167.5b
GDP Deflator y/y (JP)	07-Sep	2Q	--	1.50%
Trade Balance (CN)	06-Sep	August	\$45.80b	\$62.33b
Retail Sales y/y (SG)	04-Sep	July	-15.00%	-27.80%
Monetary Base YoY (JP)	01-Sep	August	--	9.80%
Exports y/y (CN)	06-Sep	August	3.50%	7.20%
Imports y/y (CN)	06-Sep	August	-0.10%	-1.40%

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Bank less