



CIO Weekly

8 September 2020

Key Points

- **Equities:** China equities now account for a significantly larger weight in global and EM equity indices.
- **FX:** EU and commodity currencies grind lower as short-term momentum favours the USD.
- **Rates:** Tweaks in the Fed's mandate translate to higher future inflation risk and these uncertainties should be reflected in a steeper UST curve.
- **Thematics:** Tide is turning for Singapore REITs.
- **The Week Ahead:** US jobs data and Japan industrial production in focus.

Equities: China – rising representation in indices

Best performing index year-to-date. China equities have benefited from rising equity allocation among portfolio managers. The ChiNext Index was the best performing index year-to-date among all major and minor indices globally in USD terms, driven by investment optimism on the emergence of China technology and new economy companies. The ChiNext surged 50%, ahead of the second-best performing index Nasdaq Composite Index by over 10 %pts.

Among the major indices, Shenzhen A-shares took the pole position as the best performing market globally with a gain of more than 30% in USD terms. In general, investing in China onshore equities enables investors to participate in the growth trajectory of the world's second largest economy, which is increasingly skewing towards domestic consumption and local self-sufficiency.

Government pro-market policy initiatives. Over past months, policies have been introduced by the government to attract investors and expand access for global investors. Some examples include:

1. The People's Bank of China and State Administration of Foreign Exchange (SAFE) abolished the investment quota restrictions for Qualified Foreign Institutional Investors (QFII) and Renminbi QFII.
2. The inclusion of STAR board constituents into Northbound Stock Connect and STAR board companies into the Shanghai Composite Index.
3. The approval of Hang Seng Technology Index ETF.
4. The approval of two exchange-traded funds under the Hong Kong and Mainland Exchange Traded Fund cross-linking schemes.

Rising representation in indices. Over the past decade, the representation of China equities in highly followed equity indices has expanded consistently. China equities now account for close to 5.0% in the global equity index, up more than three times from 2009, while its weight in the Emerging Markets (EM) index has doubled to some 35%. This reflects the continuous share price appreciation and inclusion of new index constituents during this period.

Global cross assets

Returns of cross assets around the world

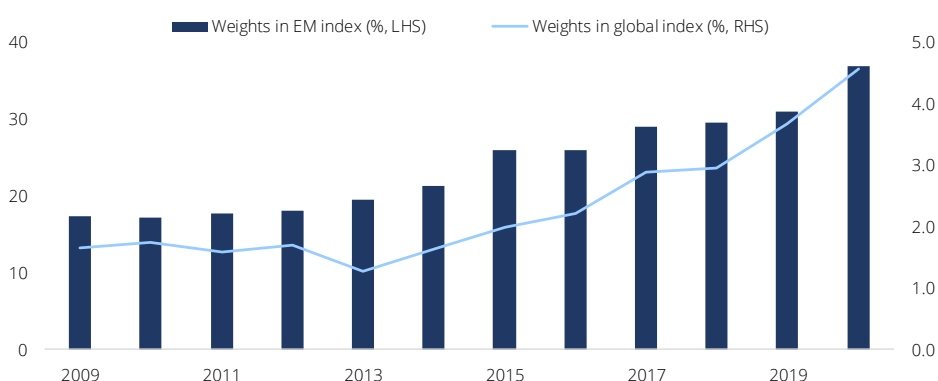
Index	Close	Overnight	YTD
DJIA	28,133.31	0.0%	-1.4%
S&P 500	3,426.96	0.0%	6.1%
NASDAQ	11,313.13	0.0%	26.1%
Stoxx Europe 600	367.97	1.7%	-11.5%
DAX	13,100.28	2.0%	-1.1%
CAC 40	5,053.72	1.8%	-15.5%
FTSE 100	5,937.40	2.4%	-21.3%
MSCI AxJ	717.86	-0.4%	4.3%
Nikkei 225	23,089.95	-0.5%	-2.4%
SHCOMP	3,292.59	-1.9%	7.9%
Hang Seng	24,589.65	-0.4%	-12.8%
MSCI EM	1,094.56	-0.4%	-1.8%
UST 10-yr yield*	0.72	0.0	-120.0
JGB 10-yr yield*	0.04	0.5	6.1
Bund 10-yr yield*	-0.46	1.1	-27.5
US HY spread*	4.88	0.0	152.0
EM spread*	374.79	0.0	97.4
WTI (USD)	39.77	0.0%	-34.9%
LMEX	3,043.70	0.8%	7.0%
Gold (USD)	1,933.64	0.0%	27.4%

Source: Bloomberg

* Changes in basis points

Yeang Cheng Ling | Strategist

Figure 1: China's weight in global equity indices



Source: Bloomberg, DBS CIO Office

Figure 2: Downwards pressure



Source: Bloomberg, DBS

FX: EU and commodity currencies grind lower

Short-term momentum favours the USD. Bearishness is, as per our momentum scorecard, higher for the European currencies than the commodity currencies. **GBP takes the spotlight from renewed prospects for a disorderly Brexit** after the transition period ends on 31 December. Prime Minister Boris Johnson has set 15 October as the deadline for the UK to walk away without a deal with the European Union (EU). GBP/USD ended Monday (7 September) at 1.3166, its first daily close below 1.32 since 25 August, with a downside bias towards 1.30.

EUR/USD edged lower towards 1.18 on Monday ahead of the European Central Bank (ECB) meeting this Thursday. ECB President Christine Lagarde is expected to echo chief economist Philip Lane's warning that EUR's strength mattered to the slow and uneven EU recovery tainted by deflation risks and rising joblessness. This was evident in the headline Sentix for September where the positive 20.7 reading for expectations was not supported by the negative 33.0 print in current assessment. A lower support awaits EUR/USD around 1.1650 once it breaks 1.18.

USD/CHF edged closer to the top of its 0.90-0.92 range seen since late July. Swiss National Bank (SNB) President Thomas Jordan warned that interventions and negative rates would be needed to prevent deflation from a strong CHF. Consumer Price Index inflation has been negative in y/y terms since February. As a gauge of interventions, the amount of cash that commercial banks parked with the SNB has increased by CHF1.4b last week (ended 4 September); USD/CHF tested its key psychological support at 0.90 on 31 August and 1 September.

AUD/USD has held below 0.73 since 3 September with a downside bias. The Aussie dollar did not get a lift from China's better-than-expected export data on Monday. The Morrison administration has conceded that Australia's economic recovery in 3Q would be lacklustre due to the coronavirus resurgence and extended lockdown in Victoria. Treasurer Josh Frydenberg has extended the insolvency and bankruptcy protections by another three months to end-December. More government spending and tax cuts are expected at the October Budget announcement. Breaking below 0.7230 would open the door to the next support at 0.7130 or its 50-day moving average.

US stock markets return today from the long Labour Day weekend. Investors have woken up to the risk of a contested outcome at the US elections scheduled for 3 November. The US 10-year Treasury yield and the CBOE Volatility Index have bounced off the year's lows to above 0.70% and 30, respectively. The long bond yield bottomed around 0.50% and the equity volatility gauge at 21.35 in August. Gold prices continued to languish around USD1,930/oz after a failed attempt to trade above USD2,000 on the first day of the September. **The US Dollar Index (DXY) still needs to close above its 25-day moving average just below 93 to extend its upside to 94.0-94.2**, between the ceiling of its range in August and its 50-day moving average.

Philip Wee | Strategist

Figure 3: Steepening yields curve on the charts?



Source: Bloomberg, DBS

Rates: Heavy auction calendar ahead

Market participants are still grappling with evolving news on the economic front. While the US Treasuries (UST) curve bull flattened aggressively for the most part of last week (ended 4 September), these gains were largely erased after labour market data was released on Friday (4 September). The tweaks in the Federal Reserve's mandate is a source of volatility. The key takeaway is that the hurdle for rate hikes is set higher. However, in our opinion, low rates do not lead to higher inflation. Instead, with the Fed more tolerant of inflation, the risks of inflation down the line is therefore higher. Accordingly, these uncertainties should be reflected in a steeper UST curve.

In any case, cyclical dynamics matter. USD rates have been ignoring improving US data for some time. This has happened before as market participants assume that the Fed will run ultra-accommodative monetary policy for an extended period. Last Friday's unemployment and payrolls numbers clearly show that the labour market is improving. The unemployment rate fell to 8.4%, ahead of consensus estimates of 9.8%. Payrolls registered close to consensus, at 1,371k. While this is a slowdown the previous month and private payrolls disappointed, it does not change the fact that the US economy is on the mend.

This week, a heavy issuance calendar looms, with USD50b, USD35b, and USD23b of 3-year, 10-year, and 30-year auctions scheduled. We will be watching to see if interest in USTs will be sustained.

Eugene Leow | Strategist

Duncan Tan | Strategist

Thematics: Tide is turning for Singapore REITs

- Time to venture out of safe industrials S-REITs as valuation disparity stretches beyond 1SD.
- Channel checks and macro datapoints signal broadening recovery across various sectors.
- Financial metrics for S-REITs pass the litmus test; downside risk dissipating.
- Yield disparity attractive except for Industrial and Health Care S-REITs.

Valuation discount for "COVID-19-impacted" sectors too wide to ignore. We maintain our stance that we expect the S-REIT rally to broaden out in 2H20. While investors have been rewarded for sticking with the large cap industrial S-REITs year-to-date, the valuation disparity between these and COVID-19 impacted sectors (retail, office, and hospitality) has widened to more +1 standard deviation (SD) since the pandemic struck. We believe this warrants a relook and switch.

Laggards set to catch up. Supported by positive datapoints in DBS Group Research's recent channel checks, coupled with expected gradual upturn in economic metrics, these sectors should play catch up. We believe that office and retail will outperform but there is value from taking a rotational strategy in the industrial space. Hospitality will take time to recover but given minimal (or no) expectations, there are some stocks in this space that offers good value.

Financial metrics stable; book value deterioration lesser than expected. We see risk abating as financial metrics remain stable despite one of the worst quarters in S-REITs' history. Supported by government incentives, managers' proactive cash preservation strategy, and access to capital markets have enabled S-REITs' balance sheets to pass the litmus test. Strong liquidity and low interest rates have kept the decline in book valuations at a marginal 1.5-3.0%.

Yield disparity attractive at -1SD to mean except for Industrial and Health Care. Our overall FY20F distribution per unit (DPU) estimates are -1% to +2% of FY19 DPU, led by industrial (excluding potential acquisitions) and retail (+1% to +2%), followed by office ex-hospitality (+0.5% to +1%) supported by contributions from new assets. As such, the yield disparity is attractive at -1SD of the mean except for Industrial and Health Care, which are trading close to above +1SD.

Derek TAN | Analyst
Dale LAI | Analyst

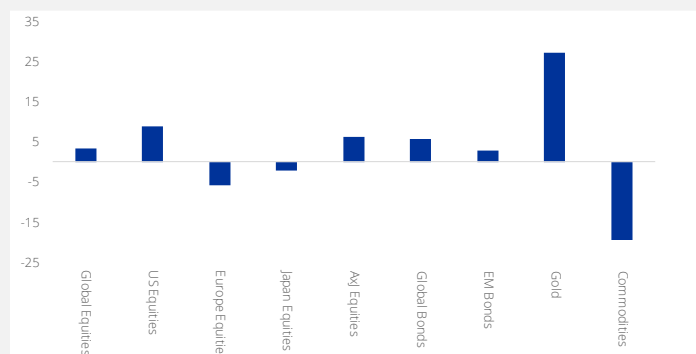
Figure 4: Relative underperformance of retail, hospitality, and office



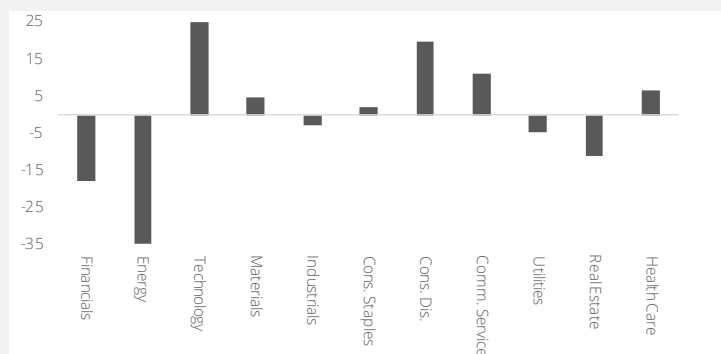
Source: Bloomberg, DBS

CIO Markets Watch

Global Cross Assets YTD Returns



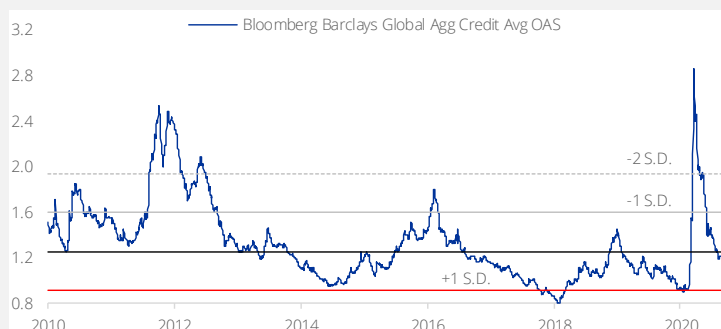
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Index Returns

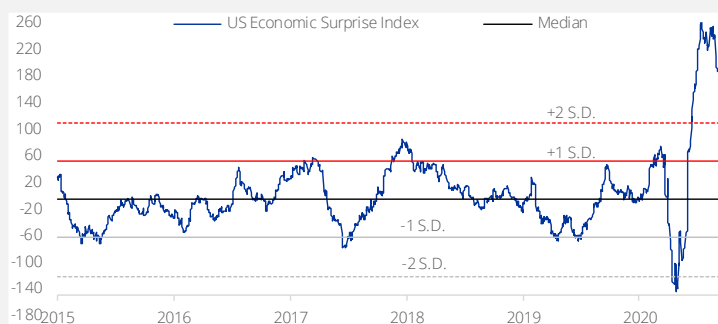
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-2.1%	-2.1%	10.5%	6.1%
NASDAQ	-3.9%	-3.9%	12.5%	26.1%
Stoxx Europe 600	-1.7%	-1.7%	6.5%	-8.0%
DAX	0.4%	0.4%	2.1%	-11.5%
Nikkei 225	-0.2%	-0.2%	3.6%	-2.4%
MSCI WORLD	-1.9%	-1.9%	9.4%	2.1%
MSCI ACWI	-1.8%	-1.8%	9.4%	1.6%
MSCI Asia ex-Japan	-0.9%	-0.9%	10.6%	4.3%
MSCI EM	-0.6%	-0.6%	10.0%	-1.8%
HSCEI	-2.3%	-2.3%	0.1%	-12.6%
SHCOMP	-3.0%	-3.0%	10.3%	7.9%
Hang Seng	-2.3%	-2.3%	0.7%	-12.8%
Straits Times	-0.8%	-0.8%	-3.0%	-22.1%
Fixed Income				
Barclays Global Aggregate	-0.3%	-0.3%	2.7%	5.8%
Barclays US Aggregate	-0.1%	-0.1%	0.6%	6.8%
Barclays US High Yield	-0.1%	-0.1%	5.6%	1.6%
Barclays Euro Aggregate	0.4%	0.4%	0.9%	2.1%
Barclays Euro High Yield	0.3%	0.3%	3.7%	-2.4%
JPM EMBI Global	0.8%	0.8%	4.9%	2.9%
JPM EMBI Global Diversified	1.2%	1.2%	5.5%	3.4%

Prices & Spreads

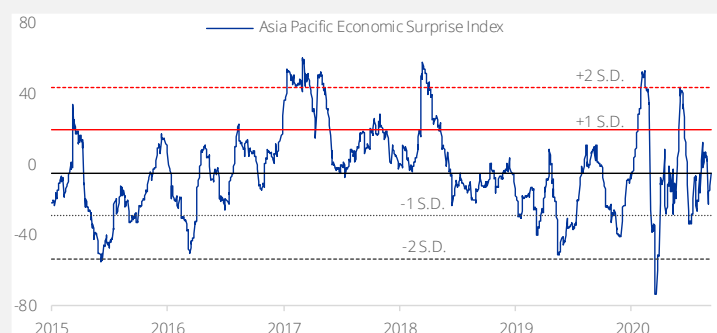
	Spot	2Q20	1Q20	4Q19
Rates				
Fed Funds Target	0.25	0.25	0.25	1.75
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	0.72	0.66	0.67	1.92
Japanese Govt Bond 10-yr	0.04	0.02	0.01	-0.02
German Bunds 10-yr	-0.46	-0.46	-0.47	-0.19
Spreads				
US Agg Corporate Spread	1.29	1.50	2.72	0.93
US Corporate HY Spread	4.88	6.26	8.80	3.36
Euro Agg Corporate Spread	1.19	1.53	2.41	0.98
EM USD Agg Spread	3.31	3.93	6.19	2.87
Currencies				
US Dollar Index (DXY)	92.7	97.4	99.0	96.4
EUR/USD	1.18	1.12	1.10	1.12
USD/JPY	106.3	107.9	107.5	108.6
USD/CNY	6.8	7.1	7.1	7.0
Commodities				
WTI Oil	40	39	20	61
London Metal Exchange (LMEX)	3044	2682	2335	2843
TR/CC CRB Commodity	150	138	122	186
Gold	1934	1781	1577	1517

CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



Macro Calendar

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims (US)	10-Sep	Sep	845k	881k
ECB Main Refinancing Rate (EU)	10-Sep	Sep	0.00%	0.00%
CPI m/m (US)	11-Sep	Aug	0.30%	0.60%
MBA Mortgage Applications (US)	09-Sep	Sep	--	-2.00%
GDP SA y/y (EU)	08-Sep	2Q	-15.00%	-15.00%
PPI Final Demand m/m (US)	10-Sep	Aug	0.20%	0.60%
ECB Deposit Facility Rate (EU)	10-Sep	Sep	-0.50%	-0.50%
Wholesale Inventories m/m (US)	10-Sep	Jul	-0.10%	-0.10%

Macro Calendar

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	14-Sep	Jul	--	8.00%
CPI y/y (CN)	08-Sep	Aug	2.40%	2.70%
Core Machine Orders m/m (JP)	09-Sep	Jul	2.00%	-7.60%
PPI y/y (JP)	10-Sep	Aug	-0.50%	-0.90%
Tertiary Industry Index m/m (JP)	14-Sep	July	--	7.90%
PPI y/y (CN)	08-Sep	Aug	-1.90%	-2.40%
Industrial Production y/y (CN)	14-Sep	Aug	5.20%	4.80%
Money Supply M2 y/y (CN)	09-Sep	Aug	10.70%	10.70%

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