CIO Weekly

27 October 2020

Equities: ASEAN markets prefer a blue wave

Key Points

- **Equities:** S-REITs are resilient to the US elections outcome. China+1 strategy serves ASEAN well in the long run
- **Credit:** Credit bests equity dividend yields among High Yield China developers
- **FX:** USD found support on risk aversion; EUR/USD under pressure to break below 1.18 on coronavirus resurgence
- **Rates:** Bear steepening in USD rates space a sign of crowded positioning?
- **Thematics:** Restaurants and caterers preparing for a new normal
- **The Week Ahead:** Keep a lookout for US change in initial jobless claims; Japan industrial production numbers

ASEAN markets are sensitive to global risks due to their high leverage on global growth and capital flows. US elections next week (ending 6 November) are driving investors to take risks off the table, given the uncertainties on whether there will be a change for the better in US policies. The dire global COVID situation and the ongoing tussle in US-China relationship drive investors to hope for a breakthrough.

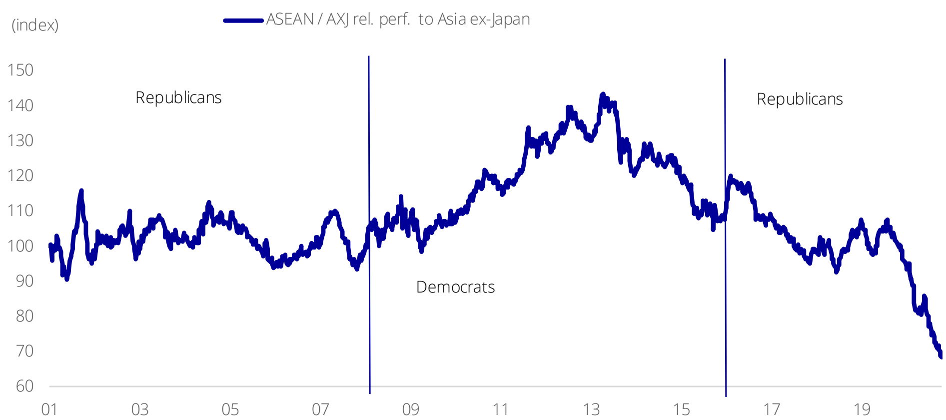
The three most probable scenarios appear to be 1) A Biden win with Democrats retaking the Senate (blue wave); 2) A Biden win with Republicans retaining the Senate, and 3) A Trump re-election with Republicans retaining the Senate (status quo). In our view, a blue wave scenario will be the most positive for ASEAN markets, associating with a bigger US stimulus bill, easing US-China tensions, and a weaker dollar can be expected. These factors should increase the probability of a stronger global recovery thus capital flows returning to the region. Cyclical markets such as Singapore and Thailand should outperform in this scenario as global recovery gains traction, and Indonesia will benefit from a weak dollar and lower US bond yields as equity risk premium compresses.

Should the situation remain status quo, we believe ASEAN markets will likely continue to underperform global markets in a challenging global environment, but recovery is probably delayed, not derailed. Solid macro fundamentals, the advancement of reforms, and strong external positions have put the region in a better place to meet these challenges. Additionally, during Trump's first term many international companies, including Chinese companies, have built the China+1 strategy due to the US-China trade war – a strategy that includes ASEAN as an alternative hub for manufacturing and services sectors. This should serve ASEAN well in the long run, as it is widely expected that US's tough policy towards China is unlikely to go away under either administration, though there could be softening of the rhetoric and some variations in method and style under Democrats.

We remain invested in S-REITs which we believe will be resilient to the elections outcome. A low interest rate environment, China+1 strategy, and accelerated digitalisation trend should continue to benefit the sector.

Joanne Goh | Strategist

Figure 1: ASEAN markets performed well during a Democrat presidency



Source: Bloomberg, DBS

Global cross assets

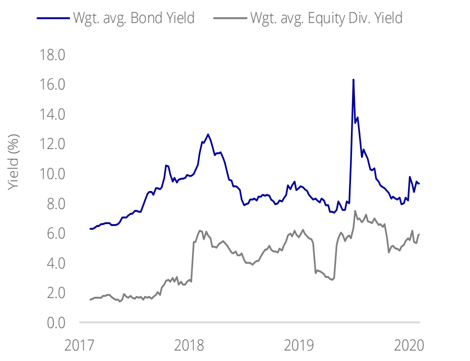
Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	27,685.38	-2.3%	-3.0%
S&P 500	3,400.97	-1.9%	5.3%
NASDAQ	11,358.94	-1.6%	26.6%
Stoxx Europe 600	355.95	-1.8%	-14.4%
DAX	12,177.18	-3.7%	-8.1%
CAC 40	4,816.12	-1.9%	-19.4%
FTSE 100	5,792.01	-1.2%	-23.2%
MSCI AxJ	745.59	-0.3%	8.3%
Nikkei 225	23,494.34	-0.1%	-0.7%
SHCOMP	3,251.12	-0.8%	6.6%
Hang Seng	24,918.78	0.0%	-11.6%
MSCI EM	1,130.65	-0.5%	1.4%
UST 10-yr yield*	0.80	-5.0%	-111.7
JGB 10-yr yield*	0.03	-16.7%	5.0
Bund 10-yr yield*	-0.58	0.9%	-39.3
US HY spread*	4.83	3.2%	147.0
EM spread*	385.90	1.1%	108.5
WTI (USD)	38.56	-3.2%	-36.8%
LMEX	3,052.40	-1.1%	7.4%
Gold (USD)	1,902.08	0.0%	25.4%

Source: Bloomberg
* Changes in basis points

Credit: Credit bests equity dividend yields among High-Yield (HY) China developers

Figure 2: Credit bests equity dividend yields among HY China developers



Source: Bloomberg, DBS

Earlier this month, policymakers in Beijing drafted what state-run media are now calling the "Three Red Lines" – balance sheet metrics that China's developers need to meet in order to increase indebtedness. While this is likely to inflict some short-term pain for the sector, we believe that this is ultimately beneficial through tampering bubble formation and systemic risk. Such government-led deleveraging makes an interesting proposition for China Property credit (please see "The stars align for China property bonds", 26 Oct 2020); a higher-yielding asset class now guided by a government directive to improve issuer credit quality – and hence investor's risk exposure – over the longer term

Investors thus have the opportunity to gain credit exposure in a sector that will benefit from deleveraging policies through (a) spread compression under improving credit profiles, and (b) lower expected growth in net bond issuance over the next few years. In our view, the HY developer credits offer the most value, seeing as average yields in these bonds exceed even equity dividend yields. This presents an unusual opportunity to move up the capital structure and still capture higher yields for income-generation.

Daryl Ho | Strategist

FX: Risk aversion returns

Figure 3: EUR/USD under pressure

Source: Bloomberg, DBS

USD found support on risk aversion. The USD Index (DXY) is back at 93 for the first time since 20 October. The Dow Jones Industrial Average shed 650 points or 2.3% on Monday (26 October), its largest one-day drop since early September. Focus has returned to the coronavirus resurgence amidst diminished prospects for a stimulus bill before the US elections. Optimism for a Blue Wave on 3 November have subsided. The race to control the Senate remains too close to call. Fears of a contested outcome for the presidency have not gone away. US President Donald Trump and Democratic candidate Joe Biden have been campaigning hard in the swing states of Arizona, Michigan, North Carolina, Pennsylvania, Wisconsin, and especially Florida.

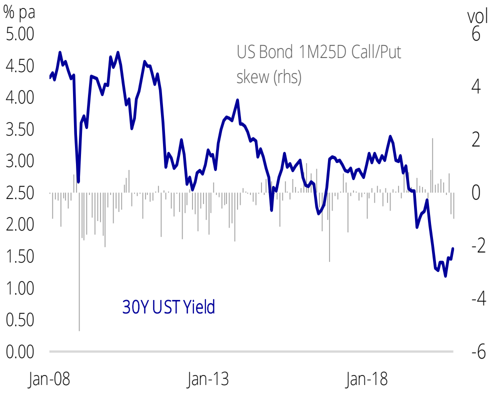
EUR/USD is under pressure to break below 1.18 on the coronavirus resurgence. The Euro Stoxx 50 plunged by 2.9% to 3105, its lowest close since the start of June. French President Emmanuel Macron will decide on Tuesday-Wednesday new tightening measures to slow the rapid spread of the virus. Spain had announced a new state of emergency on Sunday. Italy is facing protests from businesses to the latest restrictions to curb the escalating infections. Purchasing Manager Indexes in October highlighted the risk of a relapse in the pandemic-hit Eurozone economy. The European Central Bank is expected to pause, at its governing council meeting on 29 October, pave the way for more stimulus in December.

GBP/USD to fall to 1.2930 first, and 1.2860 next, if the support at 1.30 fails. GBP bounced sharply to 1.3177 from 1.2948 on 21 October on the resumption of EU-UK Brexit talks. Since then, the pound has been returning its gains each day. With the transition period set to end on 31 December, time is running out. Both sides have yet to resolve their differences in fishing rights, the settlement of disputes and the level-playing field. The Bank of England is expected to increase its asset purchases programme at the its next meeting on 5 November. Short sterling futures have not abandoned the prospect of negative rates in late 2021.

CNY depreciated above 6.70 per USD for the first time since mid-October. USD/CNY bottomed with the DXY at 6.65 on 21 October. The market is sensitive to news of new infections. China reported the highest number of asymptomatic cases in almost seven months in Xinjiang. Meanwhile, the Chinese Communist Party is deliberating its next five-year plan this week. China is expected to pivot away its export- and investment-led model towards more economic self-reliance. Financial risks will be managed with the goal of discouraging excessive speculation and mitigating financial bubbles. Pushing new financial innovation will need to be balanced by stronger regulation.

Philip Wee | FX Strategist

Figure 4: Yields and Call / Put Skew



Source: Bloomberg, DBS

Rates: How are USD rates positioned?

The bear steepening in the USD rates space has left market participants wondering if the position is getting crowded. The reality is more nuanced. Looking at the net non-commercial speculative futures positions, the overall market is slightly net short on a normalised basis. However, a breakdown into the different tenors suggest that while market participants are negative on the 2Y, 5Y, and 30Y tenors, net longs in the 10Y tenor stand out. In short, bets on steepening are concentrated in the 3M/5Y and the 10Y/30Y segments. In the options space, we take a look at UST 1M25D call / put skew to get a gauge to see if the market wants greater protection for bond downside. To be sure, this figure has drifted sharply lower over the past few months and is relatively low compared to recent years. However, a longer-term perspective (over the past decade) is probably more instructive. While, downside protection for UST is certainly on the expensive side, puts can persistently stay expensive, especially after a major economic shock and the market looks to a recovery.

The upshot is that USD rates space has turned more cautious on longer-dated bonds in terms of net positions as well as call/put skew. This makes sense from perceived reduction of uncertainties as Biden sets up a sizable lead over Trump in the polls. In the near term, it may not make much sense to chase longer-term USD rates high given lingering election and fiscal uncertainties. However, these issues (and that of the COVID-19 vaccine) could be resolved by the end of the year, setting up a bias for higher longer-term rates over the medium term.

Eugene Leow | Rates Strategist

Thematics: Restaurants and caterers preparing for a new normal

- We interviewed 16 major restaurant groups that operate a total of 20,000+ eateries across Asia
- Our worst-case scenario sees new waves of infections reducing 2020 sales by 16-32% across the region
- Government support policies may protect selected operators from spilling red ink…
- … While leading players could gain market share as consolidation accelerates
- Prefer the more resilient, mass- to mid-end restaurant chains

China rebounded the fastest. The restaurant and catering industry are among those that have been substantially affected by the pandemic, especially when cities are locked down and tourists are not visiting. What's more, any new wave of COVID-19 infections could worsen market conditions and dampen restaurant sales. So far, the pandemic is well-controlled in China, with the Ministry of Commerce citing 4.9% y/y growth in daily sales among key retail and restaurant enterprises during its latest National Day Golden Week Holiday (1-8 Oct 2020). Overall, China is recovering faster than other regions, followed by Thailand, Singapore and Hong Kong.

Entering a new norm. In 3Q20, DBS Group Research spoke to 16 major players in the industry that run a total of over 20,000 eateries across Asia to find out how the restaurant & catering industry in Asia will transform following the virus outbreak. Over 60% of restaurant operators believe that a full COVID-19 recovery may be achieved sometime in 2021, while 6% expect this to happen in 2022. Key areas companies are working on: (1) Food safety and hygiene, (2) online food deliveries, (3) store model & operating efficiencies, (4) product innovation, (5) store expansion, (6) live streaming, cloud kitchens and robotics, etc., to optimise their operations under a new normal.

Worst-case scenario. Our worst-case scenario sees new waves of COVID-19 infections reducing 2020 restaurant sales by 16-32% across Asia. While our projections suggest that any sales decline of more than 10% in Hong Kong, Singapore, and Indonesia could see most restaurant operators running a loss this year, various government subsidies and support policies thus far should mitigate such losses to a large extent, in our view. Leading players could also gain market share as consolidation accelerates. As such, the more resilient, mass- to mid-end restaurant chains that cater to a higher proportion of food delivery and takeaway sales like Café de Coral (341 HK), Koufu (KOUFU SP), and YUM China (YUMC US) may have an edge over their peers .

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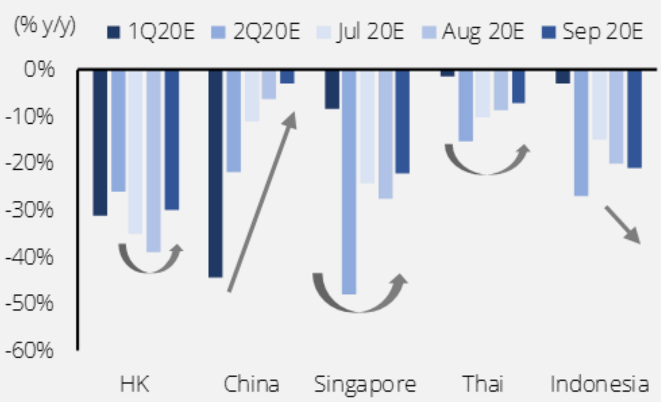
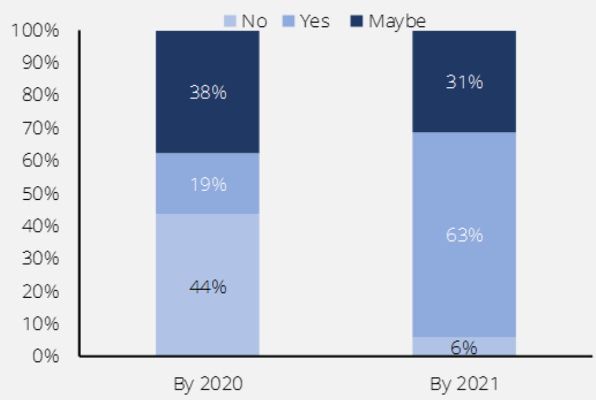
Figure 5: Estimated sales trend



Source: Restaurant industry data (China National Bureau of Statistics, HK Census & Statistics Dept., Singstat, BOT), Survey responses, DBS

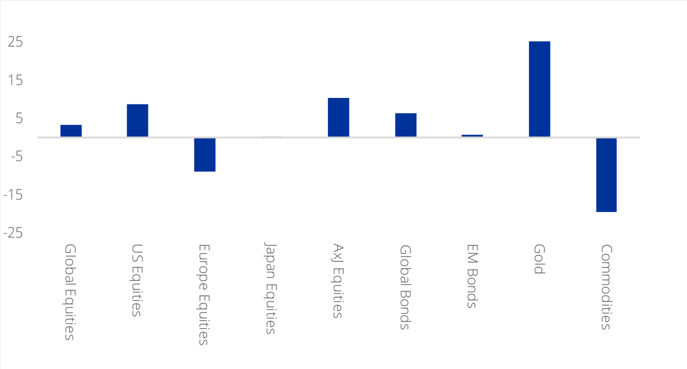
Figure 6: Management expectations on when will a full recovery emerge?



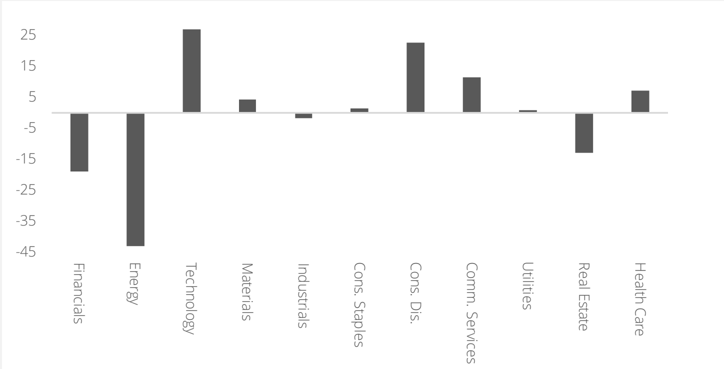
Source: DBS

CIO Markets Watch

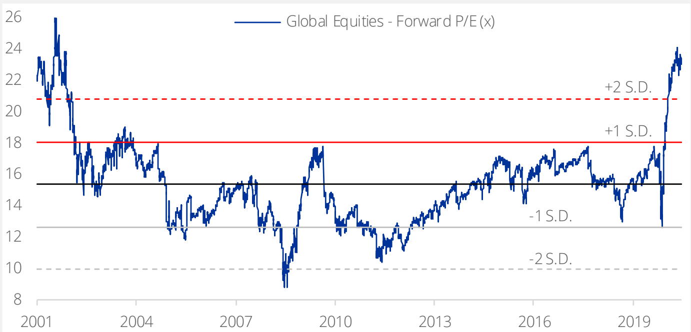
Global Cross Assets YTD Returns



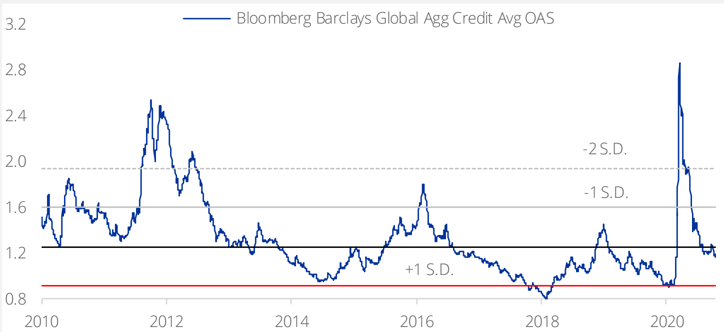
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Index Returns

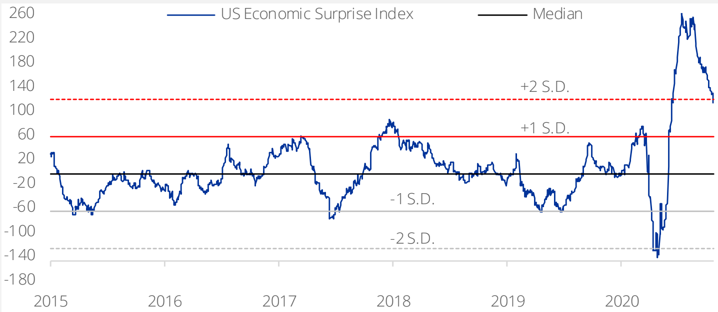
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-0.8%	1.1%	1.1%	5.3%
NASDAQ	-1.0%	1.7%	1.7%	26.6%
Russell 2000	-0.5%	6.5%	6.5%	-3.8%
Stoxx Europe 600	-3.0%	-1.4%	-1.4%	-14.4%
Nikkei-225	-0.7%	1.3%	1.3%	-0.7%
MSCI WORLD	-1.1%	1.0%	1.0%	1.3%
MSCI ACWI	-1.0%	1.4%	1.4%	1.4%
MSCI Asia ex-Japan	0.2%	4.6%	4.6%	8.3%
MSCI EM	0.3%	4.5%	4.5%	1.4%
HSCEI	1.5%	7.7%	7.7%	-9.3%
SHCOMP	-1.9%	1.0%	1.0%	6.6%
Hang Seng	1.5%	6.2%	6.2%	-11.6%
Straits Times	-0.8%	2.3%	2.3%	-21.7%
Fixed Income				
Barclays Global Aggregate	0.0%	0.6%	0.6%	6.3%
Barclays US Aggregate	-0.2%	-0.2%	-0.2%	6.6%
Barclays US High Yield	-0.2%	1.3%	1.3%	2.0%
Barclays Euro Aggregate	-0.3%	0.6%	0.6%	3.3%
Barclays Euro High Yield	0.1%	1.1%	1.1%	-2.3%
JPM EMBI Global	-0.9%	0.5%	0.5%	0.8%
JPM EMBI Global Diversified	-1.3%	0.3%	0.3%	0.9%

Prices & Spreads

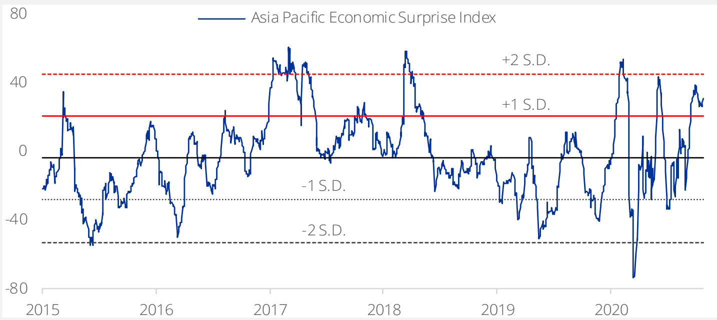
	Spot	2Q20	1Q20	4Q19
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	0.80	0.69	0.66	0.67
Japanese Govt Bond 10-yr	0.03	0.01	0.02	0.01
German Bunds 10-yr	-0.58	-0.52	-0.46	-0.47
Spreads				
US Agg Corporate Spread	1.23	1.36	1.50	2.72
US Corporate HY Spread	4.83	5.17	6.26	8.80
Euro Agg Corporate Spread	1.15	1.23	1.53	2.41
EM USD Agg Spread	3.21	3.34	3.93	6.19
Currencies				
US Dollar Index (DXY)	93.0	93.9	97.4	99.0
EUR/USD	1.18	1.17	1.12	1.10
USD/JPY	104.8	105.5	107.9	107.5
USD/CNY	6.7	6.8	7.1	7.1
Commodities				
WTI Oil	39	40	39	20
London Metal Exchange (LMEX)	3052	2968	2682	2335
TR/CC CRB Commodity	149	149	138	122
Gold	1902	1886	1781	1577

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)	29-Oct	Oct	775k	787k
ECB Main Refinancing Rate (EU)	29-Oct	Oct	0.00%	0.00%
GDP Annualized q/q (US)	29-Oct	3Q	32.00%	-31.40%
ISM Manufacturing (US)	02-Nov	Oct	55.6	55.4
Uni of Mich Sentiment (US)	30-Oct	Oct	81.2	81.2
Conf. Board Consumer Confidence	27-Oct	Oct	102	101.8
Durable Goods Orders (US)	27-Oct	Sep	0.50%	0.50%
GDP SA q/q (EU)	30-Oct	3Q	9.60%	-11.80%

Macro Calendar

	Date	Period	Survey	Prior
Asia				
Industrial Production MoM (JP)	29-Oct	Sep	3.00%	1.00%
Jobless Rate (JP)	29-Oct	Sep	3.10%	3.00%
Manufacturing PMI (CN)	30-Oct	Oct	51.3	51.5
Tokyo CPI Ex-Fresh Food y/y (JP)	29-Oct	Oct	-0.50%	-0.20%
Caixin China PMI Mfg (CN)	01-Nov	Oct	52.8	53
Jibun Bank Japan PMI Mfg (JP)	01-Nov	Oct	--	48
Job-To-Applicant Ratio (JP)	29-Oct	Sep	1.03	1.04
BOJ Policy Balance Rate (JP)	28-Oct	Oct	-0.10%	-0.10%

Live more,
Bank less