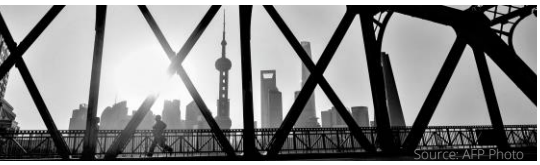

Source: AFP Photo

CIO Weekly

11 November 2020

Key Points

- **Equities:** Uptrend in S&P 500 to resume as election uncertainties fade; divided government historically positive for US equities
- **Credit:** Fading of trade tension risks may see compression in the Asia High Yield premium
- **FX:** DXY rebound supported by 10 bps spike in US 10-year treasury yield
- **Rates:** Sharp US yield curve steepening amid positive development on COVID-19 vaccine
- **Thematics:** China's refining sector comes roaring back
- **The Week Ahead:** Keep a lookout for US change in initial jobless claims; Japan GDP numbers

Global cross assets

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	29,157.97	2.9%	2.2%
S&P 500	3,550.50	1.2%	9.9%
NASDAQ	11,713.78	-1.5%	30.6%
Stoxx Europe 600	380.99	4.0%	-8.4%
DAX	13,095.97	4.9%	-1.2%
CAC 40	5,336.32	7.6%	-10.7%
FTSE 100	6,186.29	4.7%	-18.0%
MSCI AxJ	781.89	0.8%	13.6%
Nikkei 225	24,839.84	2.1%	5.0%
SHCOMP	3,373.73	1.9%	10.6%
Hang Seng	26,016.17	1.2%	-7.7%
MSCI EM	1,192.37	1.4%	7.0%
UST 10-yr yield*	0.92	12.8%	-99.4
JGB 10-yr yield*	0.02	0.0%	3.6
Bund 10-yr yield*	-0.51	-17.7%	-32.3
US HY spread*	4.01	-9.3%	65.0
EM spread*	344.58	-6.0%	67.2
WTI (USD)	40.29	8.5%	-34.0%
LMEX	3,122.50	-0.2%	9.8%
Gold (USD)	1,863.04	-4.5%	22.8%

Source: Bloomberg
* Changes in basis points

Equities: Uptrend in S&P 500 to resume as election uncertainties fade

The end of election uncertainties. Democrat Joe Biden was elected as the 46th president of the United States after a projected victory at key battleground state Pennsylvania gave him the minimal threshold of 270 electoral votes needed to win the election.

Republican Donald Trump has yet to concede defeat, citing unsubstantiated claims of electoral "fraud". But such claims will do little to change the outcome as Biden is also leading in states such as Georgia and Arizona. With Biden on course for a resounding victory, the likelihood of a contested election has diminished substantially and this is positive for risk sentiments.

A divided government and its impact on risk assets. In this election, the Democrats have won the presidency while the Senate race remains undecided. With the Republicans still holding a majority in the Senate, the sharp ideological divide between the two parties suggests little chance of bipartisanship in congress and decisions will likely be made along party lines.

Contrary to expectations, a divided US government need not be negative for US equities:

1. Biden will take steps to reset US foreign policy, putting diplomacy and "American Leadership" back on the table. Healing the rancorous relationship with China should top his agenda and we expect the US-China trade tension to taper.
2. A Republican Senate will ensure that Trump's pro-business policies remain while Biden's tax hikes plan is put to the back burner.

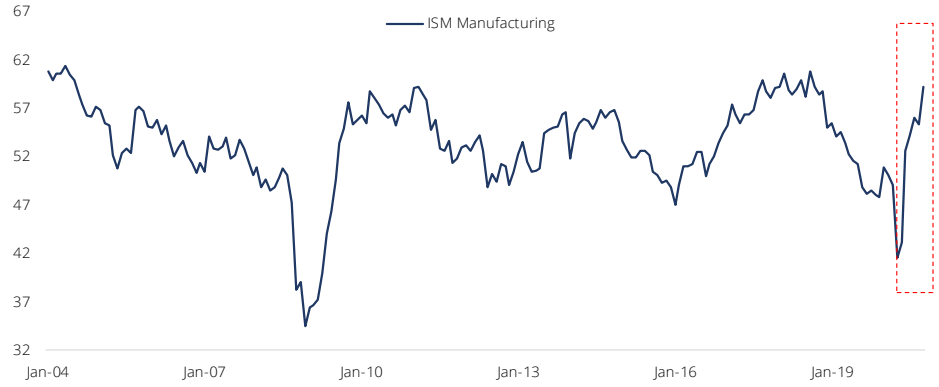
Based on our research, the S&P 500 Index has on average registered gains of 66% during periods of a divided US government (since 1968). This time will be no different.

Factors underpinning the uptrend in the S&P 500. Moving beyond the uncertainties of elections, we believe the following factors will underpin US equities in the coming months:

- Monetary accommodation from the US Federal Reserve: Given uncertainties on the fiscal front, we believe that the Fed will continue to maintain monetary accommodative in order to support the nascent economic recovery.
- Rebounding of macro and corporate momentum: Recent data point to a sustained recovery in macro and corporate momentum. Barring another full-scale economic lockdown in the US, we expect this recovery to persist.

Dylan Cheang | Strategist

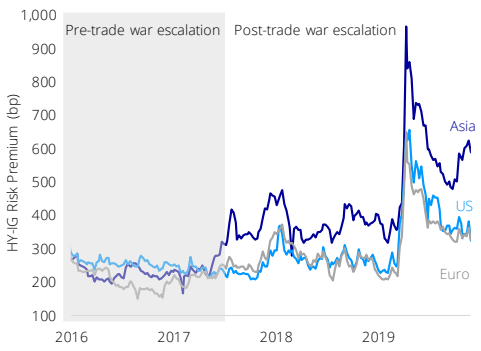
Figure 1: US economy on the rebound and this underpins the S&P 500



Source: Bloomberg, DBS

Credit: Fading of trade tension risks may see compression in the Asia High Yield premium

Figure 2: Fading of trade tension risks may see compression in the Asia HY premium



Source: Bloomberg, DBS

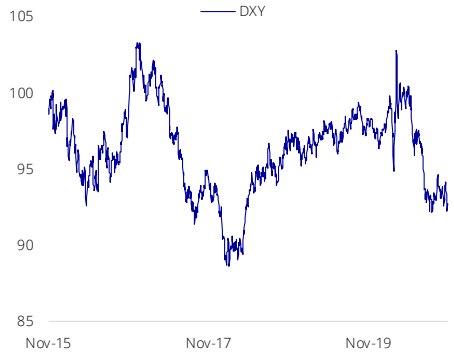
In almost any other year, the US elections would be the likeliest event of major volatility. But for 2020 – which had already endured a virus crisis and oil price shock – the elections came more as a relief that there is now one less event to test asset price gains for the year. The electoral victory of now President-elect Joe Biden over the incumbent Donald Trump is none more than welcome for Asian economies, in anticipating the diminution of trade war rhetoric that has led to much uncertainty among the export economies in the region.

One clear trend since the onset of the trade tensions was the rise in the Asia risk premium, mainly characterised by the spread between Asia High Yield (HY) and Investment Grade (IG) bonds. This Asia HY-IG premium saw no meaningful difference compared to US and Europe before mid-2018 but widened considerably post-trade war escalation. We believe a reversion towards Obama-era policies (his "pivot to Asia") sees room for compression of this Asia premium to previous norms; with Asia HY the likeliest beneficiary. We like China HY property bonds in particular (please refer to "The stars align for China property bonds", 26 Oct 2020), given the more insulated domestic demand drivers as well as structural improvement from government-led deleveraging policies.

Daryl Ho | Strategist

FX: USD supported by vaccine-led recovery

Figure 3: DXY supported by spike in UST



Source: Bloomberg, DBS

The USD Index (DXY) rebounded by 0.7% to 92.8, supported by a 10 bps spike in the US 10-year treasury yield to 0.92%. Vaccine hopes had relegated the importance of the stalled US fiscal spending bill currently holds ransom to the inconclusive Senate elections. As the greenback regained its composure, gold lost its lustre and plunged by 4.5% to USD1863/oz. In the short term, the market has associated a vaccine-led recovery as positive for USD and one led by increased fiscal spending as negative. This differentiation was also reflected by steeper losses in US tech stocks, which in turn should temper some of the recent Biden-led optimism in Emerging Asian currencies.

Notably, USD's rebound was strongest against JPY, CHF, and EUR. First, these are the DXY components with negative interest rates that are vulnerable to a higher and steeper US treasury yield curve. Second, policymakers in these countries are vigilant against excessive strength in their exchange rates. CHF and JPY have weakened back above 0.90 and 104 per USD, respectively, from last week's (ended 6 November) election-led rally. The Swiss National Bank threatened, if needed, to drive rates deeper into negative territory and intervene in the forex market. The Bank of Japan has pledged to ease monetary policy without hesitation on heightened economic uncertainties and destabilising market forces. That said, **CHF and JPY may need to digest some of yesterday's (9 November) steep losses** if equities turn sideways with a downside bias.

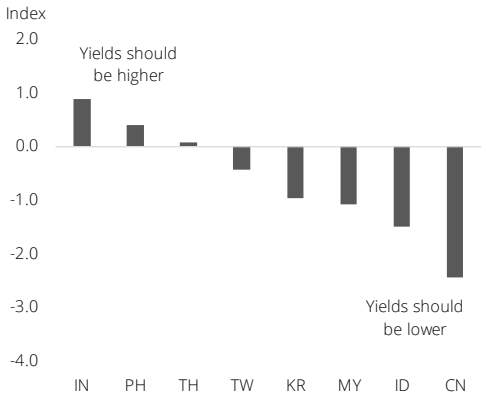
The European Central Bank (ECB) has given notice for more stimulus at its next meeting on 10 December. The dampened European Union economic outlook for 4Q is likely to be reinforced by a fall in today's ZEW Survey to 43.3 in November from 52.3 a month earlier. The Sentix Investor Confidence released yesterday fell a second month to -10.0 in November, its first negative double-digit print in three months. ECB Executive Board Member Yves Mersch remarked yesterday that the central bank still has negative rates at its disposal. Hence, **caution is likely to run high ahead of the ECB Forum on 11-12 November.** The ECB has been clear that, amid negative inflation and rising joblessness, a stronger EUR would be counterproductive to its mandate. **EUR/USD is likely to fluctuate with a downside bias around the 1.18** level, which it fell to yesterday after it failed to extend its election rally above 1.19.

NZD could return lower into its 0.66-0.68 range. The Reserve Bank of New Zealand meeting on 11 November is expected to pave the ground for negative rates via an announcement on its Funding for Lending Program. Most economists in New Zealand expect the cash rate to turn negative by April 2021 and drop from the present 0.25% to minus 0.50% next year.

Philip Wee | FX Strategist

Rates: USD and Asia rates adjusting to vaccine prospects

Figure 4: Asia – Gap to ARVI indicator



Source: Bloomberg, DBS

US yield curve steepened sharply overnight as a COVID-19 vaccine under trial by Pfizer showed considerable promise. 10Y yields rose above 0.95% (the previous high registered when the market was pricing in a Blue Sweep) and closed at 0.92%, erasing the gains made when the market adjusted to the prospect of a mixed House and diminished fiscal stimulus prospects. Implied volatility in USD rates did pop but is still far from the elevated levels seen in the leadup to the US elections earlier this month. In short, the market has priced out election risks and is starting to price in the transition to a more conventional economic crisis, away from the pandemic. While it will be at least several more quarters before any vaccine(s) gets disseminated widely, the possibility of a complete economic recovery in 2H21 should keep longer-term USD rates buoyant. **We remain in the on dips camp, noting that our 0.95% end-2020 forecast has already been reached. Our model suggests that 10Y yield should be closer to 1.3%, a level that we think can be reached in 2H21.**

In Asia, rates performance will be nuanced. There could be some optimism for tourist hubs where asset price recovery has lagged. The challenge lies with whether Asia rates can hold up well amid higher USD rates. Our sense is yes; there are a few sovereigns that stand out. Within the low yielders, South Korea and Thailand government bonds have underperformed through the pandemic and should hold up relatively well amid a moderate rise in USD rates. While not a laggard, Singapore Government Securities should also do well once the market starts to price in the recovery of the tourism sector, driving further SGD rates outperformance versus US Treasuries. Within the higher yielders, both Indonesia and India government bonds appear to be under-owned by foreign investors. We suspect that a likely kneejerk selloff (on the back of sharply higher USD rates) today (10 November) would be met with investor interest. In terms of valuation, **our Asia Rates Valuation Indicator (ARVI) suggest that China, Indonesia, South Korea, and Malaysia govvies look cheap.**

Eugene Leow | Rates Strategist

Thematics: China's refining sector comes roaring back

- Domestic demand for most refined oil products is already back or even above pre-pandemic levels
- Low rates of local infections enabled domestic mobility trends to normalise and economy to recover
- Domestic refining margins continued to improve in 3Q20
- Anticipate refining margins to steadily trend higher from here on
- Divergence in economic activity/ mobility levels is positive for Chinese refineries

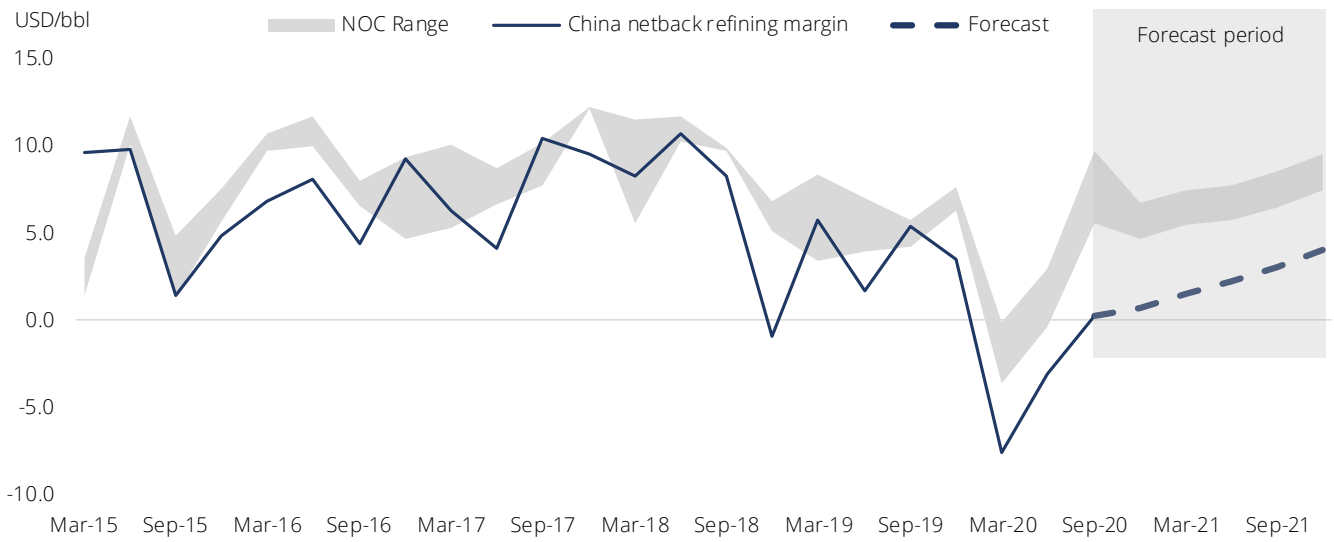
Domestic demand for refined oil products has largely reverted to pre-COVID-19 levels. Demand for most refined oil products is already back or even above pre-pandemic levels, underpinned by China's "first in and first out" of COVID-19, which has enabled domestic mobility trends to normalise, and economic growth to swiftly revert to positive territory. DBS Group Research expects demand to continue trending higher on the back of economic recovery in both domestic and key regional markets, and as mobility continues to normalise with more people returning to work/resuming leisure activities.

Refining margins to continue improving. Domestic refining margins continued to improve in 3Q20 as record refinery throughput in 2020 was more than offset by subdued feedstock costs. Refining margins should stay stable in 4Q20 and continue widening in the near term on improving sector fundamentals. However, a full-fledged recovery to 2017-2018 levels appears implausible at least for a few years, due to chronic oversupply in the sector.

Chinese downstream players set to benefit. The divergence in economic activity/mobility levels between China and the rest of the world is positive for Chinese refineries such as Sinopec Corporation (386 HK) and Sinopec Shanghai Petrochemical Company (338 HK). This is because crude oil prices should remain conducive to refining margins if global demand (excluding China) stays subdued, while domestic refined oil product prices will be supported by resilient local demand.

Pei Hwa HO | Analyst
Suvro SARKAR | Analyst
Jason SUM | Analyst

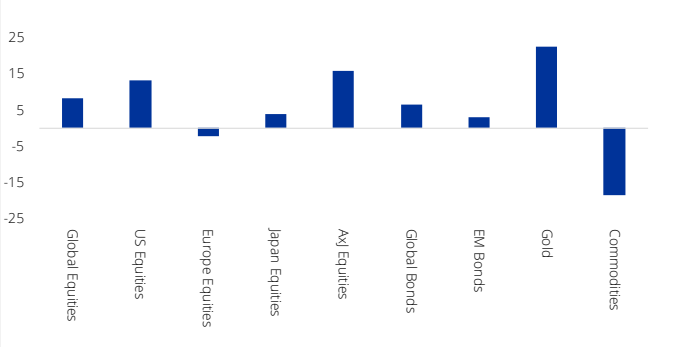
Figure 5: Historical and projected domestic refining margins



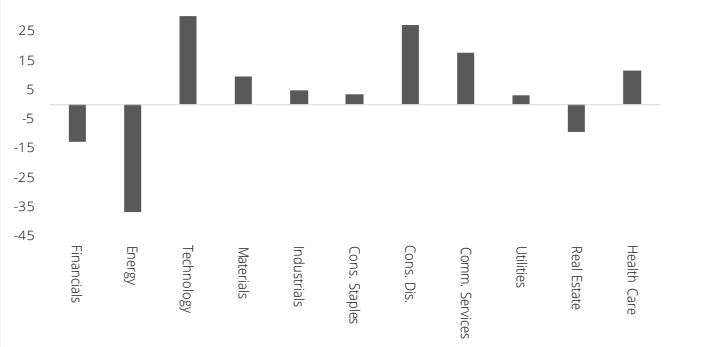
Source: Bloomberg, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

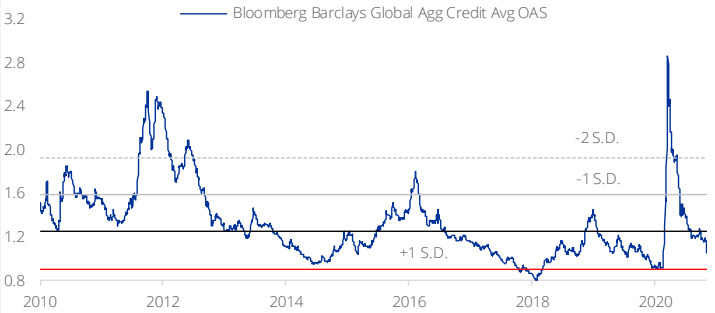


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



Index Returns

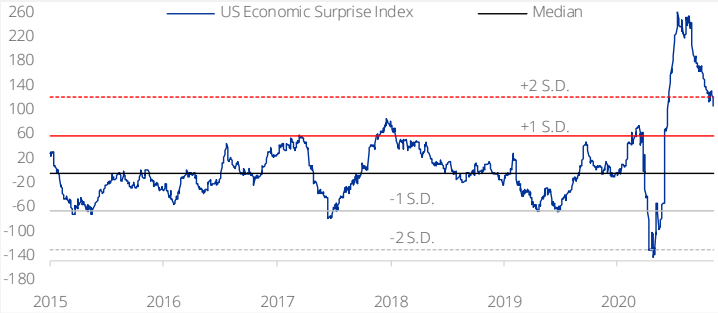
	1 week	MTD	QTD	YTD
Equities				
S&P 500	7.3%	8.6%	5.6%	9.9%
NASDAQ	6.9%	7.4%	4.9%	30.6%
Russell 2000	8.7%	10.8%	13.1%	2.2%
Stoxx Europe 600	9.5%	11.3%	5.5%	-8.4%
Nikkei-225	6.6%	8.1%	7.1%	5.0%
MSCI WORLD	7.7%	9.1%	5.7%	6.1%
MSCI ACWI	7.6%	9.0%	6.3%	6.2%
MSCI Asia ex-Japan	5.7%	6.8%	9.7%	13.6%
MSCI EM	7.0%	8.1%	10.2%	7.0%
HSCEI	7.0%	8.9%	13.1%	-4.8%
SHCOMP	4.6%	4.6%	4.8%	10.6%
Hang Seng	6.4%	7.9%	10.9%	-7.7%
STI Index	6.8%	7.7%	5.8%	-19.0%
Fixed Income				
Barclays Global Aggregate	0.6%	0.6%	0.7%	6.5%
Barclays US Aggregate	-0.1%	0.0%	-0.4%	6.3%
Barclays US High Yield	3.0%	3.2%	3.7%	4.4%
Barclays Euro Aggregate	-0.4%	-0.4%	0.4%	3.2%
Barclays Euro High Yield	2.4%	2.4%	2.7%	-0.7%
JPM EMBI Global	2.9%	2.9%	2.8%	3.2%
JPM EMBI Global Diversified	2.3%	2.3%	2.1%	2.6%

Prices & Spreads

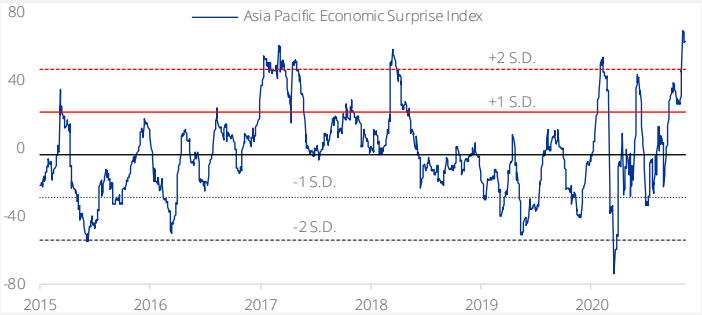
	Spot	2Q20	1Q20	4Q19
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	0.92	0.69	0.66	0.67
Japanese Govt Bond 10-yr	0.02	0.01	0.02	0.01
German Bunds 10-yr	-0.51	-0.52	-0.46	-0.47
Spreads				
US Agg Corporate Spread	1.10	1.36	1.50	2.72
US Corporate HY Spread	4.01	5.17	6.26	8.80
Euro Agg Corporate Spread	1.05	1.23	1.53	2.41
EM USD Agg Spread	2.96	3.34	3.93	6.19
Currencies				
US Dollar Index (DXY)	92.7	93.9	97.4	99.0
EUR/USD	1.18	1.17	1.12	1.10
USD/JPY	105.4	105.5	107.9	107.5
USD/CNY	6.6	6.8	7.1	7.1
Commodities				
WTI Oil	40	40	39	20
London Metal Exchange (LMEX)	3123	2968	2682	2335
TR/CC CRB Commodity	151	149	138	122
Gold	1863	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)	12-Nov	Nov	732k	751k
CPI MoM (US)	12-Nov	Oct	0.10%	0.20%
U. of Mich. Sentiment (US)	13-Nov	Nov	82	81.8
GDP SA QoQ (EU)	13-Nov	3Q	12.70%	12.70%
MBA Mortgage Applications (US)	11-Nov	Nov	--	3.80%
PPI Final Demand MoM (US)	13-Nov	Oct	0.20%	0.40%
Empire Manufacturing (US)	16-Nov	Nov	13.8	10.5
CPI Ex Food and Energy MoM (US)	12-Nov	Oct	0.20%	0.20%

Macro Calendar

	Date	Period	Survey	Prior
Asia				
Industrial Production MoM (JP)	15-Nov	Sep	--	4.00%
GDP SA QoQ (JP)	15-Nov	3Q	4.40%	-7.90%
Core Machine Orders MoM (JP)	11-Nov	Sep	-1.00%	0.20%
PPI YoY (JP)	11-Nov	Oct	-2.00%	-0.80%
Tertiary Industry Index MoM (JP)	11-Nov	Sep	1.20%	0.80%
Industrial Production YoY (CN)	15-Nov	Oct	6.70%	6.90%
Money Supply M2 YoY (CN)	15-Nov	Oct	10.90%	10.90%
Retail Sales YoY (CN)	15-Nov	Oct	5.00%	3.30%