CIO Weekly

17 November 2020

Equities: RCEP – a new milestone for Asia Pacific

Key Points

- Equities: The signing of RCEP paves the way for further rerating in Asia Pacific equities
- Credit: Slowing downgrades of "Fallen Angels" signals credit recovery is on track
- FX: AUD and NZD underpinned by global recovery hopes; but key resistances are near
- Rates: USD rates space priced in vaccine positives; period of consolidation likely after recent steepening
- Thematics: Improving outlook for China banks
- The Week Ahead: US retail sales and housing data in focus

RCEP, 15-countries regional trade deal. Over the weekend (14-15 November), 15 nations in the Asia Pacific region signed an agreement on Regional Comprehensive Economic Partnership (RCEP), effectively paving the way for better multilateral trade ties. This was achieved after eight years of negotiations, which first started in end 2012 among these China, Japan, South Korea, ASEAN-10, Australia, and New Zealand.

This is one of the world's largest trade pacts and is set to spur business prospects as the region emerges from the impact of the COVID-19 pandemic. The economic advantage of the bloc could be further enhanced should India decide to return to join this partnership. China, being the largest member by economic size and population, stands to benefit as the formation of this pan-Asia trade bloc will facilitate a more conducive regional trade.

Better trade treaty. In essence, the member countries can expect a reduction in tariffs, new trade arrangements, and investment partnerships to boost the region to catch up with the rest of the world. Effective implementation of this mega agreement in coming years may further see the decoupling of China and, to a lesser extent, the Asia Pacific region from the US.

The trade agreement facilitates more collaboration and technology transfer among member nations, especially those with existing technology knowhow and have prioritised the development of their domestic supply chain, like Japan, South Korea, and China. Other mutual benefits include an increase in trade volume.

New dawn for rerating. Both global and regional trade volumes came to halt during the height of the pandemic outbreak, during which corporate earnings outlook in the export-reliant Asia Pacific were adversely affected. However, as domestic economies gradually reopened starting in 3Q20, corporate capex spending picked up pace, China maintained the output of its vast manufacturing sectors, and the earnings outlook in Asia is showing early signs of a recovery (Figure 1); setting the foundation for further rerating in Asia equities.

Yeang Cheng Ling | Strategist

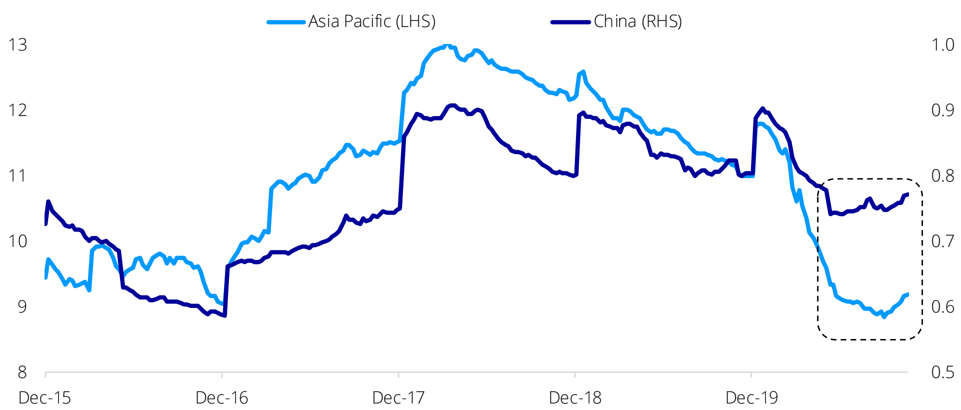
Global cross assets

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	29,950.44	1.6%	4.9%
S&P 500	3,626.91	1.2%	12.3%
NASDAQ	11,924.13	0.8%	32.9%
Stoxx Europe 600	389.74	1.2%	-6.3%
DAX	13,138.61	0.5%	-0.8%
CAC 40	5,471.48	1.7%	-8.5%
FTSE 100	6,421.29	1.7%	-14.9%
MSCI AxJ	790.78	1.1%	14.9%
Nikkei 225	25,906.93	2.1%	9.5%
SHCOMP	3,346.97	1.1%	9.7%
Hang Seng	26,381.67	0.9%	-6.4%
MSCI EM	1,203.04	1.2%	7.9%
UST 10-yr yield*	0.91	1.1%	-101.1
JGB 10-yr yield*	0.02	-10.0%	3.8
Bund 10-yr yield*	-0.55	-0.5%	-35.8
US HY spread*	4.27	-1.8%	91.0
EM spread*	345.15	-0.7%	67.8
WTI (USD)	41.34	3.0%	-32.3%
LMEX	3,160.90	0.0%	11.2%
Gold (USD)	1,888.95	0.0%	24.5%

Source: Bloomberg
* Changes in basis points

Figure 1: Forward EPS forming a base for recovery (USD)



Source: Bloomberg, DBS

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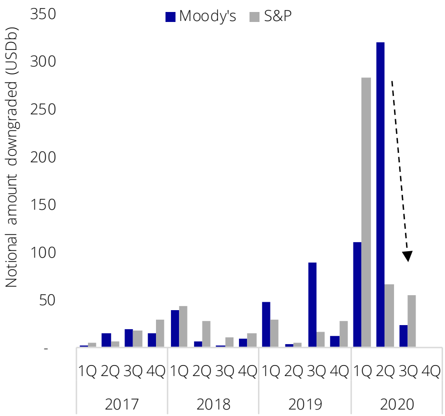
Credit: Slowing downgrades of "Fallen Angels" signals credit recovery is on track

Figure 2: Passing the peak of IG to HY downgrades in 3Q20



Source: Bloomberg, DBS

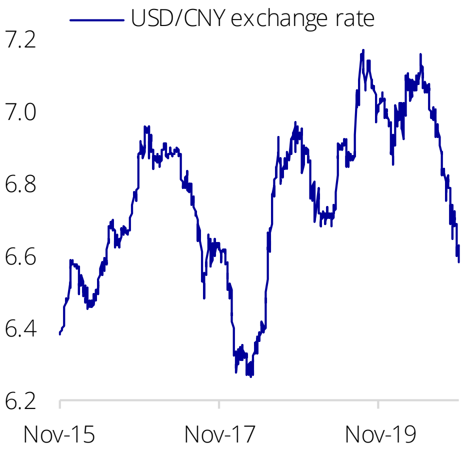
While risk markets have continued to cheer the positive upturn in economic data, recent promising results of vaccine trials from the Pfizer Inc (PFE US)/BioNTech SE (BNTX US) partnership gave an added boost of hope for a complete recovery across the battered world economies – anticipating that a sooner-than-expected return to normalcy could imbue the recovery with a second wind that possibly outpaces the already remarkable rebound that risk assets have seen since the lows in March.

In global credit, it is encouraging that fundamentals are catching up to asset valuations as well. While it cannot be argued that the unprecedented move by the US Federal Reserve into corporate credit was instrumental in preventing a full-blown credit crisis, the remarkable rally in credit spreads in the months after cannot be explained by central bank liquidity provision alone. Looking at the actions from ratings agencies in 3Q20, we note that there has been a sharp decline in corporate downgrades from Investment Grade (IG) to High Yield (HY), signifying that the spread compression is indeed supported by a diminution of assessed credit risk. With recovery being well on the cards, we believe that this spread compression remains the path of least resistance for credit going forward.

Daryl Ho | Strategist

FX: Optimism faces resistances

Figure 3: Near trendline support



Source: Bloomberg, DBS

In the immediate term, the US is struggling with record hospitalisations from record infections. While news on vaccine progress is welcome, vaccine availability and distribution matters more. **The US economy, like the European Union, is going to get worse before it gets better.** The US stimulus bill remains stalled. US President-elect Joe Biden has a task force and a plan to address the pandemic but he will not be in office until 20 January 2021.

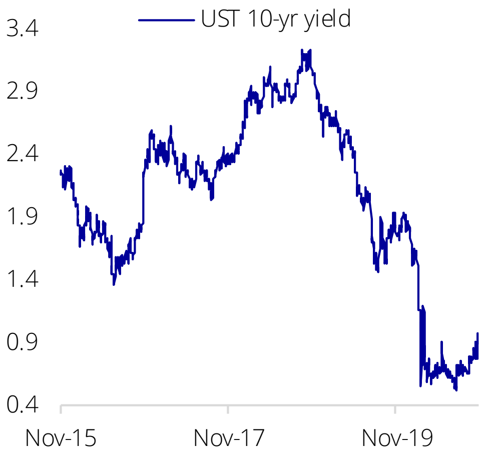
Earlier on Monday (16 November), **markets were lifted by the Regional Comprehensive Economic Partnership**, one of the largest trade deals signed by the 15 Asia Pacific Nations. They included the ASEAN+3 nations together with Australia and New Zealand. The plus three nations are China, Japan, and South Korea. Together, they account for a third of the global economy. The deal would have been larger if India had not withdrawn in 2019. Coincidentally, INR has the weakest momentum in Asia.

Three pairs of currencies have been underpinned by global recovery hopes, according to our momentum scorecard. They are AUD and NZD for commodity currencies, CNY and KRW in Northeast Asia, and THB and IDR in Southeast Asia. All said, **key resistances are also near**. AUD/USD is around 0.73, close to the top of its 0.670-0.74 range set since late July. NZD/USD is closing in on 0.6970, where its high in December 2018 meets a trendline resistance. USD/KRW is around the floor of the 1,105-1,145 range seen between June 2018 and April 2019. USD/CNY is near a trendline support around 6.56. Given the optimism, the risk for disappointment is high. **This morning's surprise drop in Singapore's non-oil domestic exports for October** (-3.1% y/y actual vs +5.1% consensus) **was a reminder that 4Q20 could be weak**.

Philip Wee | FX Strategist

Rates: The second shot of vaccine optimism

Figure 4: Further upside



Source: Bloomberg, DBS

The market got another shot of optimism overnight as Moderna (MRNA US) reported encouraging preliminary results for its vaccine. More importantly, storage requirements are reportedly less onerous than that of Pfizer's (PFE US). With this, we think that the USD rates space has largely priced in vaccine positives at this point. Notably, despite the rally in US equities, 10Y US Treasury (UST) yields barely notched up a few basis points, eventually closing at 0.91%. A period of consolidation is likely after the steepening seen over the past few months. The three big uncertainties (US elections, US fiscal spending, and COVID-19 vaccine developments) have largely been resolved and there does not appear to be any imminent development that could nudge USD rates sharply in either direction. Moreover, there are risks that the Federal Reserve would extend maturity of its purchases in December, dampening the rise in US yields. We expect 10Y yields to hover in the 0.80-1.00% range with further upside becoming more apparent as we draw closer to a firmer global economic recovery in 2021.

In Asia, vaccine optimism has resulted in spread tightening in govvies over comparable UST. Over the past month, 10Y US yields rose by 14 bps. Comparatively, yields in Asia generally rose by less. Indonesia stands out to be the outperformer with 10Y yields declining by 43 bps over the period. Note that there is another 4.2% kicker from a strengthening IDR. IndoGB was (and still is) under owned by foreign investors and appears to be playing catch up. Momentum suggests that there could be further downside to yields in the short term, with yield spreads just about close to their longer-term averages. KTB stands out as the worst performer as 10Y yields climb by 17 bps. While KTB yields are elevated due to issuance worries, losses have been more than offset by currency strength. On balance, the general picture for Asia govvies is one of outperformance in total return terms (including FX) and outperformance in relative terms vs UST.

Eugene Leow | Rates Strategist

Thematics: Light at the end of the tunnel for China's banking sector

- The recovery of China's economy would reduce banks' credit risk
- Increasing high yield loans and reducing high cost deposits to ease NIM pressure
- Highly positive correlation between A-shares transaction volume and banks' WMP-related fees
- Banks with strong retail banking arms offer better earnings outlook than peers

Robust loan credit to support economic recovery. China's economy is recovering on the back of lending support from banks. China banks have issued new loans of CNY16t in the first nine months of 2020, which is close to the level in FY19, mainly driven by SME financing, investment, and mortgage loans. With improving sentiment boosting the equity and bond markets, a portion of corporate funding demand could shift to the capital markets. As such, DBS Group Research expects China banks' loans to grow 12% y/y in FY21F, vs 13% in FY20F.

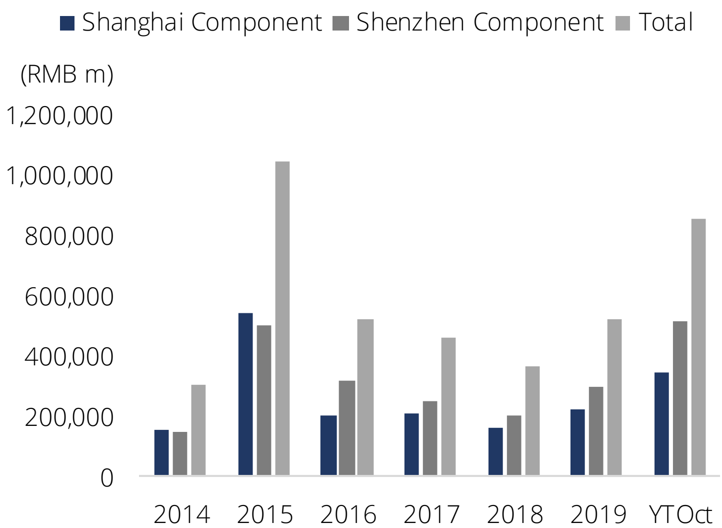
Unchanged LPR to lead to modest decline in NIM. The 1Y/5Y loan prime rate (LPR) has stayed at 3.85%/4.65% since April, and we expect this level to be maintained at the end of 2020. With a low interbank market rate and decline in high cost deposits, banks with better asset/liabilities allocation could face less pressure on net interest margin (NIM) even during this interest rate downcycle.

Strong A-shares performance leading to higher WMP-related fees. The A-share market has performed well this year in terms of index performance and transaction volume. China banks' wealth management products (WMP) and agency fees rose 9% y/y in 1H20 and contributed 34% of fee income (vs 31% in 2019). This seems to have a positive correlation (close to 1) with the A-share market's average daily transaction volume. With increasing investment demand, banks with strong retail banking arms, such as China Merchants Bank (3968 HK) and the Postal Savings Bank of China (1658 HK), would enjoy a higher contribution from WMP-related fees.

Provisions still a swing factor. China banks' 3Q20 non-performing loan (NPL) ratio was 2.06% (+12bps q/q) and coverage ratio was 177% (-5 %pts). We expect asset quality to continue to be under pressure until the expiry of relief measures in 1Q21. As long as China's economy continues to rebound, we expect the overall credit risks to be manageable with sufficient provisions to cover default risks. We see banks with better asset quality, risk management control, and higher coverage ratio to deliver better earnings performance in 2H20/2021.

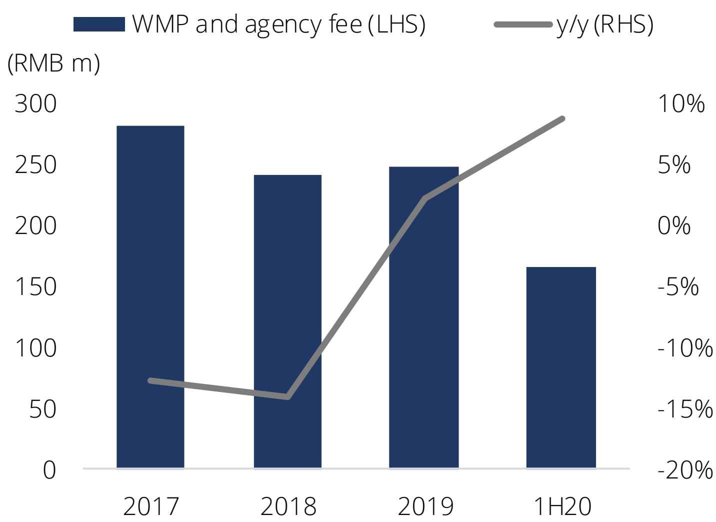
Cindy WANG | Analyst
Ken SHIH | Analyst
Ben WONG | Analyst

Figure 5: A-shares daily average transactions have surpassed 2019's levels



Source: WIND, DBS HK

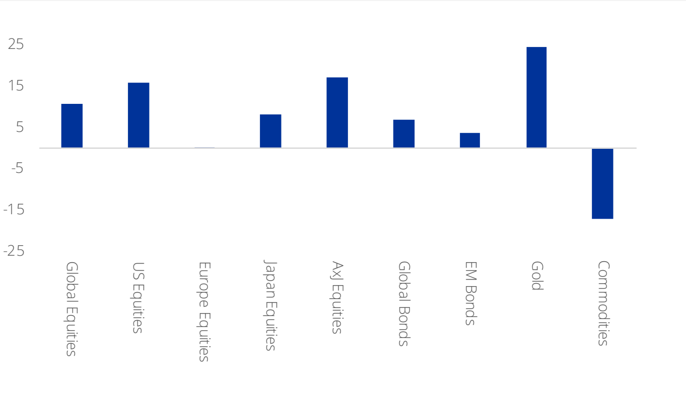
Figure 6: Banks' WMP and agency fees have positive correlation with market movement



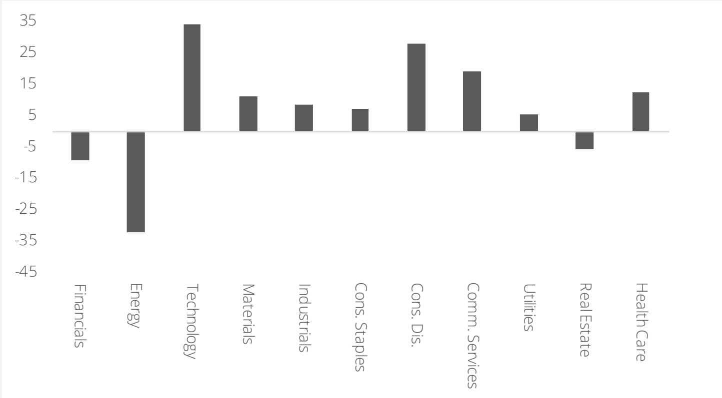
Source: Company data, DBS HK; data from China banks under DBS coverage

CIO Markets Watch

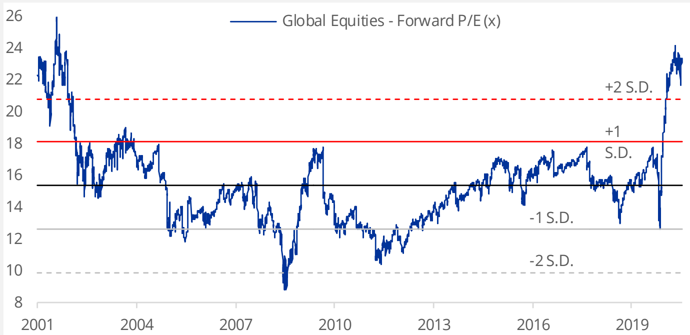
Global Cross Assets YTD Returns



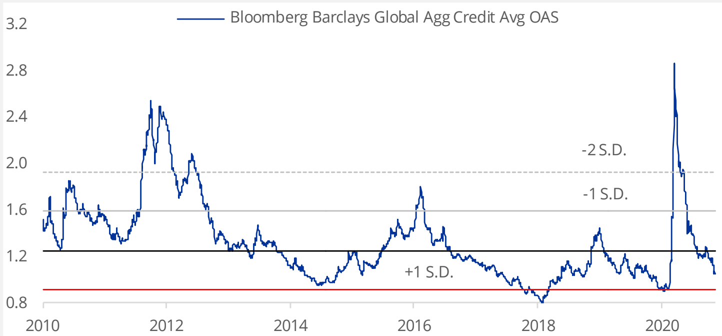
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Index Returns

	1 week	MTD	QTD	YTD
Equities				
S&P 500	2.2%	10.9%	7.8%	12.3%
NASDAQ	1.8%	9.3%	6.8%	32.9%
Russell 2000	4.7%	16.0%	18.4%	7.0%
Stoxx Europe 600	2.3%	13.8%	7.9%	-6.3%
Nikkei-225	4.3%	12.8%	11.7%	9.5%
MSCI WORLD	2.4%	11.7%	8.2%	8.6%
MSCI ACWI	2.2%	11.4%	8.6%	8.6%
MSCI Asia ex-Japan	1.1%	8.0%	11.0%	14.9%
MSCI EM	0.9%	9.0%	11.2%	7.9%
HSCEI	-0.5%	8.4%	12.6%	-5.3%
SHCOMP	-0.8%	3.8%	4.0%	9.7%
Hang Seng	1.4%	9.4%	12.5%	-6.4%
STI Index	5.3%	13.4%	11.4%	-14.7%
Fixed Income				
Barclays Global Aggregate	0.4%	1.0%	1.1%	6.9%
Barclays US Aggregate	0.4%	0.4%	-0.1%	6.7%
Barclays US High Yield	-0.3%	2.9%	3.4%	4.1%
Barclays Euro Aggregate	0.5%	0.1%	0.9%	3.7%
Barclays Euro High Yield	0.5%	2.9%	3.3%	-0.2%
JPM EMBI Global	0.5%	3.4%	3.3%	3.7%
JPM EMBI Global Diversified	0.9%	3.2%	3.0%	3.6%

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	0.91	0.69	0.66	0.67
Japanese Govt Bond 10-yr	0.02	0.01	0.02	0.01
German Bunds 10-yr	-0.55	-0.52	-0.46	-0.47
Spreads				
US Agg Corporate Spread	1.12	1.36	1.50	2.72
US Corporate HY Spread	4.27	5.17	6.26	8.80
Euro Agg Corporate Spread	1.02	1.23	1.53	2.41
EM USD Agg Spread	2.95	3.34	3.93	6.19
Currencies				
US Dollar Index (DXY)	92.6	93.9	97.4	99.0
EUR/USD	1.19	1.17	1.12	1.10
USD/JPY	104.6	105.5	107.9	107.5
USD/CNY	6.6	6.8	7.1	7.1
Commodities				
WTI Oil	41	40	39	20
London Metal Exchange (LMEX)	3208	2968	2682	2335
TR/CC CRB Commodity	154	149	138	122
Gold	1889	1886	1781	1577

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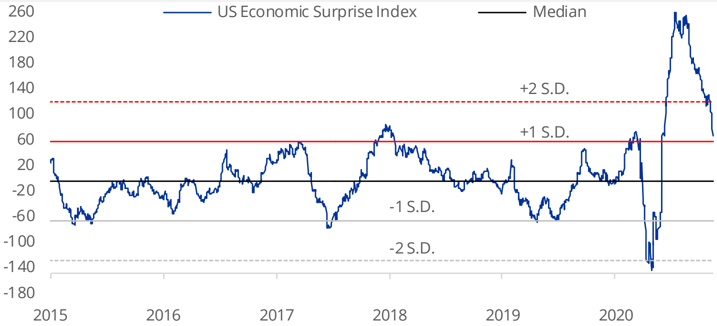
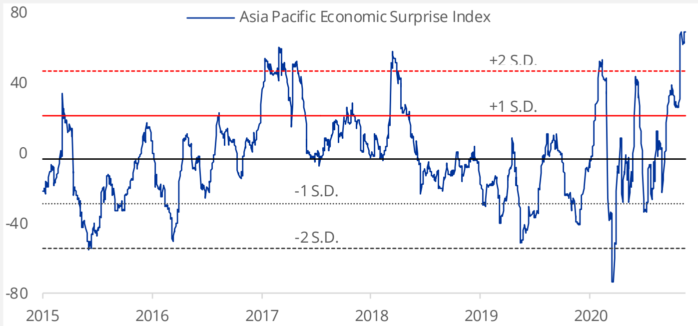
CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



Macro Calendar

	Date	Period	Survey	Prior
United States & Eurozone				
Retail Sales Advance m/m (US)	17-Nov	Oct	0.50%	1.90%
Industrial Production m/m (US)	18-Nov	Oct	1.00%	-0.60%
MBA Mortgage Applications (US)	18-Nov	13-Nov	--	-0.50%
Housing Starts (US)	18-Nov	Oct	1460k	1415k
CPI m/m (Eurozone)	18-Nov	Oct F	0.20%	0.20%
Initial Jobless Claims (US)	19-Nov	14-Nov	700k	709k
Existing Home Sales (US)	19-Nov	Oct	6.46m	6.54m
Consumer Confidence (Eurozone)	20-Nov	Nov A	-18	-15.5

Macro Calendar

	Date	Period	Survey	Prior
Asia				
National CPI y/y (Japan)	20-Nov	Oct	-0.40%	0.00%
Unemployment Rate SA (HK)	17-Nov	Oct	6.60%	6.40%
CPI Composite y/y (HK)	20-Nov	Oct	-2.00%	-2.20%
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-
-	-	-	-	-

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