

CIO Weekly

5 January 2021

Equities: Corporate earnings growth to underpin US equities in 2021

Key Points

- **Equities:** Corporate earnings growth to underpin US equities in 2021
- **Credit:** Bullish signal for HY credit to start the year
- **FX:** Commodity currencies weakened after a false start; IDR and CNY led the new year rally in Asia
- **Rates:** USD rates appropriately priced for now; Moderation in optimism on real economy could weigh on US yields in the short term
- **Thematics:** China's data centre sector set for strong growth
- **The Week Ahead:** Keep a lookout for US change in nonfarm payrolls; China inflation numbers

2020 – a year of valuation expansion. The S&P 500 Index ended 2020 with a 16.3% gain, and this marks the fourth highest annual return during the decade. The stellar performance is particularly remarkable considering the acute challenges that confronted the market last year, from the devastating COVID-19 pandemic to the divisive US presidential election. Indeed, the pandemic and subsequent lockdowns have taken a significant toll on the US domestic economy and by extension, corporate earnings. With forward earnings slashed 15.2%, the rally in 2020 was driven entirely by a massive 37.1% expansion in valuation multiples.

2021 – a year of earnings recovery. While the trajectory of US equities was dominated by valuation expansion in 2020, this year, corporate earnings recovery will drive the momentum instead. We believe that economic activities will gradually return to normalcy as mass vaccination takes place over the course of 2021 and sectors/industries which were hardest hit by the pandemic will in turn be the geared beneficiaries this time. Based on consensus forecast, real gross domestic product growth for the US is expected at 3.9% in 2021 (vs -3.5% in 2020) while earnings growth for S&P 500 is expected at 30% (vs -17.5% in 2020).

Interestingly, the expectation of strong earnings recovery this year is not merely a function of low “base effects”. For 2022, the street is also expecting US earnings to grow by a robust 17.2% and this underlines the strong conviction that Corporate America will eventually recover and rebound to the pre-pandemic days.

Sectoral Winners – Geared beneficiaries of a recovering US economy. On a sectoral basis, the arrival of mass vaccination, coupled with the plausibility of further fiscal easing, has prompted analysts to revised up their earnings forecasts across the board. With the exception of Utilities, the remaining sectors on S&P 500 are all on track for substantial earnings growth. The Energy space, in particular, is expected to register positive earnings in 2021 after dipping into the red last year amid plunging oil prices. The other four sectors that are expected to register stronger earnings growth than the broader US market are Consumer Discretionary (+66.5%), Industrials (+51.2%), Materials (+41.5%), and Health Care (+39.1%).

Global cross assets

Returns of cross assets around the world

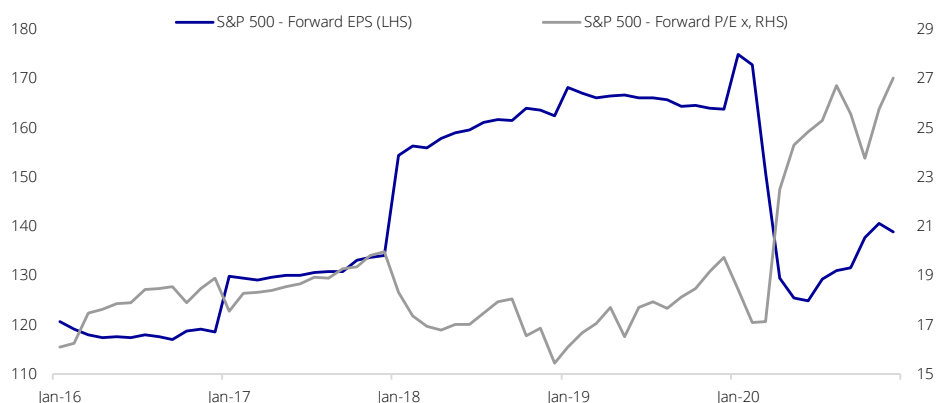
Index	Close	Overnight	YTD
DJIA	30223.89	-1.25%	-1.25%
S&P 500	3700.65	-1.48%	-1.48%
NASDAQ	12698.45	-1.47%	-1.47%
Stoxx Europe 600	401.69	0.67%	0.67%
DAX	13726.74	0.06%	0.06%
CAC 40	5588.96	0.68%	0.68%
FTSE 100	6571.88	1.72%	1.72%
MSCI AxJ	852.81	1.13%	1.17%
Nikkei 225	27258.38	-0.68%	-0.68%
SHCOMP	3502.96	0.86%	0.86%
Hang Seng	27472.81	0.89%	0.89%
MSCI EM	14902.03	1.15%	1.15%
UST 10-yr yield*	2944.45	2.47%	2.47%
JGB 10-yr yield*	6104.90	2.10%	2.10%
Bund 10-yr yield*	1602.57	-1.51%	-1.51%
US HY spread*	2858.90	0.53%	0.53%
EM spread*	48176.80	0.64%	0.89%
WTI (USD)	1304.43	0.98%	1.02%
LMEX	30223.89	-1.25%	-1.25%
Gold (USD)	3700.65	-1.48%	-1.48%

Source: Bloomberg

* Changes in basis points

Dylan Cheang | Strategist

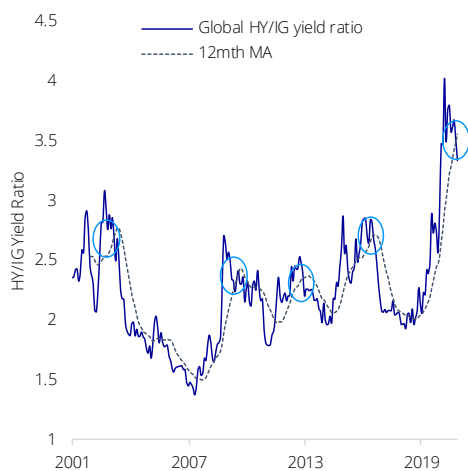
Figure 1: US equities to start 2021 on a firm footing



Source: Bloomberg, DBS

Credit: Bullish signal for HY credit to start the year

Figure 2: Longer-term bullish signal for HY credit



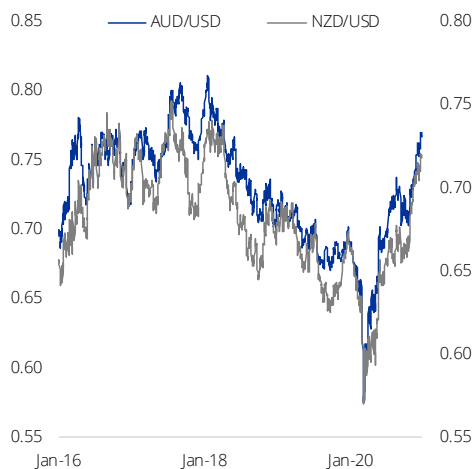
Source: Bloomberg, DBS

The post-virus bull market saw no sign of taking a Christmas break in December with positive news around the passage of a new USD900b stimulus package through the United States Congress, as well as the Christmas Eve agreement on a trade deal between the United Kingdom and the European Union; averting the no-deal Brexit scenario that the markets had generally feared. The positive turn of events saw markets trade close to all-time highs at the turn of the decade.

While most asset markets may not have begun the year at cheap levels, global High Yield (HY) credit appears to still have undemanding valuations. Measured against yields of global Investment Grade (IG) bonds, HY credit yields trade at a 3.3x multiple to IG yields – close to a 20-year high. This HY/IG yield ratio had also recently crossed below its 12-month moving average, a positive setup for HY to perform as observed in trends over the last two decades. We believe that this could be a technical validation of several other fundamental supportive factors for HY credit for the year ahead (Please refer to Global Credit 1Q21: The new safe play, 18 Dec 2020).

Daryl Ho | Strategist

Figure 3: Retreating lower



Source: Bloomberg, DBS

FX: Soft start

Commodity currencies weakened after a false start. NZD fell most by 0.4%, followed by AUD and CAD at 0.3% and 0.2%, respectively. AUD and NZD targeted their end-2020 highs around 0.7740 and 0.7240, respectively, before they retreated lower to 0.7665 and 0.7176, accordingly. West Texas Intermediate crude oil prices fell 2.5% to USD47.30/bbl but gold rose 2.3% to USD1943/oz. Between the two, the antipodean currencies were clearly more concerned about the short-term growth slowdown than the weaker USD. The Reserve Bank of Australia monetary policy committee will not be meeting in January and will return on 2 February. The support levels for AUD and NZD are located around 0.76 or 0.7120, respectively.

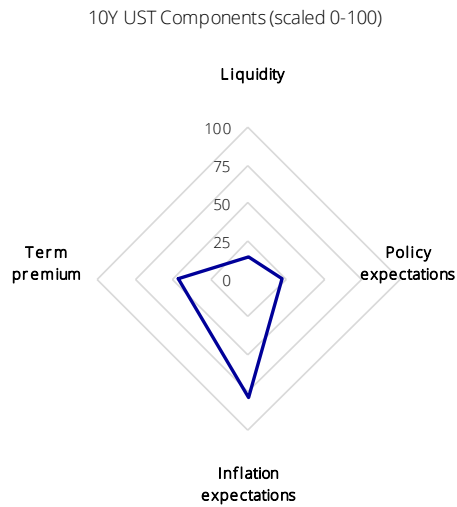
IDR and CNY led the new year rally in Asia with 1.1% and 1.0% gains, respectively. IDR firmed below 14,000 per USD for the first time since June 2020. Despite a weaker fixing to 6.54 on Monday (4 January), CNY ended stronger below 6.50 per USD for the first time since June 2018. Indonesian stocks performed better at 2.1% vs 1.0% in Chinese equities. December's purchasing managers' index (PMI) manufacturing strengthened in Indonesia but softened in China. On the other hand, PMI services surprised in China with a higher reading. Indonesia's CPI inflation firmed to 1.69% y/y in December but held below its official 2-4% target for a seventh straight month. Firmer manufacturing PMIs in December also buoyed other Asian currencies which firmed below key levels against USD.

Still, there could be some payback for Asian currencies after the overnight selloff in Wall Street. The US Dollar Index (DXY) has returned closer to 90 after a failed attempt to break below 89.50. Another bout of risk aversion could support USD if tonight's Institute of Supply Management (ISM) manufacturing disappoints; consensus expects the index to slow to 56.7 in December from 57.5 in the previous month. Given the focus on a weak US jobs reports this Friday (8 January), another slide in the ISM employment sub-index would not be welcome. The resistance at 90.40 for the DXY commensurate with the support levels for EUR and GBP (its major components) at 1.22 and 1.3490, respectively.

Philip Wee | FX Strategist

Rates: Where things stand

Figure 4: Breakdown on 10Y UST by components



Source: Bloomberg, DBS

2020 ended on a reasonably optimistic note as uncertainties over US elections, COVID-19 vaccines, and US fiscal stimulus got resolved. 2021 got off to a slightly rough start as US equities took a tumble overnight. Ten-year US yields are still hovering above 0.90% as **vaccine rollouts kept yields buoyant despite the virus resurgence across many parts of the world**. With some luck, this might be the last big virus wave before herd immunity gets established and economic activity can fully normalise. As things stand, we think that USD rates are about appropriately priced for now. Breaking down the moves in the 10Y tenor, we note that USD liquidity conditions are very flushed, rate hike expectations are muted, while term premium is about close to average. **The only thing that stands out is that inflation expectations (as measured by the 10Y breakeven) is high. Inflation could well be the tail risk for the year if loose fiscal and monetary conditions persist into 2H21.**

In the near term, market participants will be watching for the Georgia Senate runoffs. If the Democrats manage to win both races (leading to a delayed Blue Wave), it would improve the odds of additional fiscal spending, providing another jolt to USD rates. Broadly speaking, we think that a lot of good news have already been reflected in the markets. **A moderation in optimism as the real economy catches up in the next few months could keep a lid on US yields in the short term.** However, we think that USD rates will push higher in the coming few quarters as vaccines become more widely disseminated. **We reiterate our projection 10Y yields to touch 1.30% by end-2021.** Most of this will probably be driven by an increase in term premium when the market contemplates Fed taper sometime in late 2021.

Eugene Leow | Rates Strategist

Thematics: China's data centre sector set for strong growth

- Expect data centre market demand to grow by 20%+ per annum in 2021-2022
- Estimate 420k standard cabinets net-adds per annum in 2021-2022 from cloud service providers and new emerging wholesale customers, representing c.25% of utilised cabinets in 2020
- Leading data centre operators accelerating capacity expansion to meet the rising demand

Expect 20%+ data centre demand growth. We expect the data centre market to grow at 20%+ per annum in China in 2021-2022, supported by strong demand from cloud service providers and new emerging wholesale customers. DBS Group Research estimates 260k standard cabinets net-adds from cloud service providers, such as Alibaba (9988 HK), Tencent (700 HK), and Baidu (BIDU US), and 160k standard cabinets net-adds from new emerging wholesale customers such as ByteDance and Pinduoduo (PDD US). These represent a total of 420k standard cabinets net-adds per annum in 2021-2022 and 25% of utilised standard cabinets in 2020.

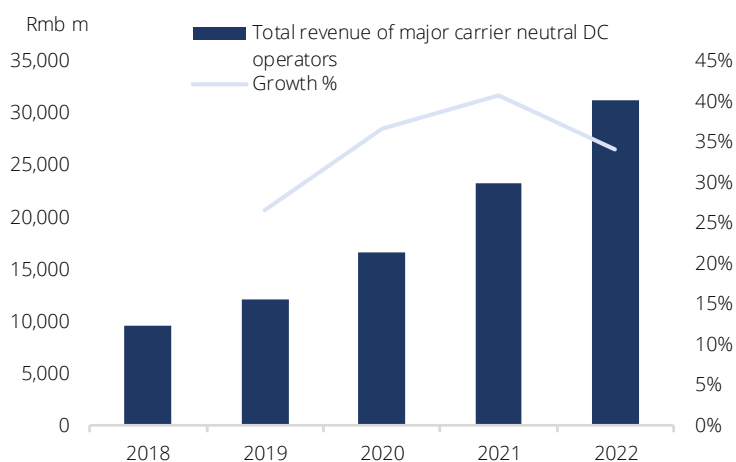
Acceleration of capacity expansion plan to support growth. To meet the rising demand, leading data centre operators raised capital to accelerate capacity expansion plans in 2020 to support strong revenue growth. For example, 21Vianet (VNET US

) raised its capacity net-adds target from 17k cabinets in 2020 to 25k in 2021. We estimate the seven leading carrier-neutral data centre operators' revenue growth in China to be 37% in 2020 and 41% in 2021 (vs 27% in 2019).

Carrier-neutral wholesale data centre operators to gain market share. We believe carrier-neutral data centre operators that enable customers to connect with all the telecommunications networks and respond to customers' needs in an agile manner will continue to gain market share. In addition, telecom operators also operate cloud business which compete with cloud service providers. We reckon that cloud service providers prefer to use carrier-neutral data centres. As demand is mainly driven by cloud service providers and large internet companies that require customised data centre specifications, we expect wholesale data centre operators to gain market share.

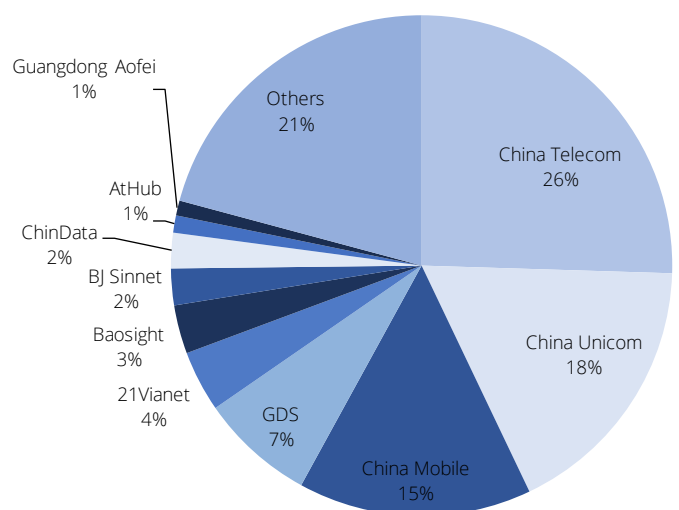
Chris KO | Analyst
Tsz-Wang TAM | Analyst

Figure 5: Total revenue of major carrier-neutral DC operators



Source: MIIT, DBS HK

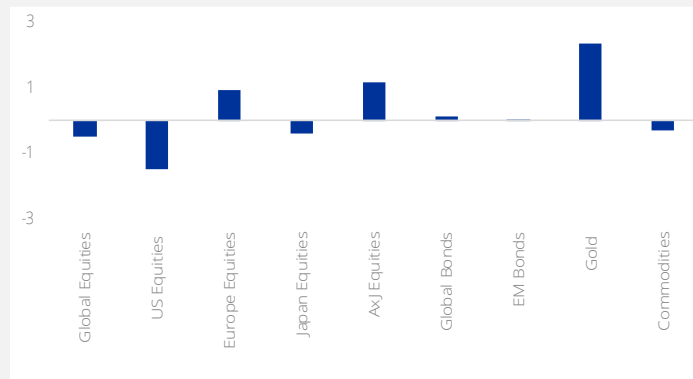
Figure 6: Market share of major data centre operators (2020)



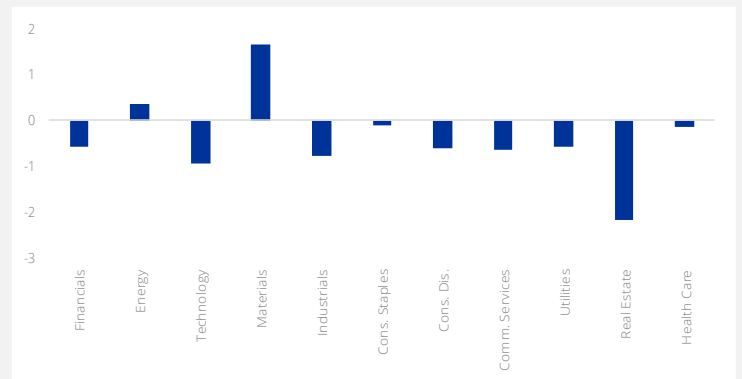
Source: IDC Quan, Companies, Bloomberg Finance L.P., DBS HK

CIO Markets Watch

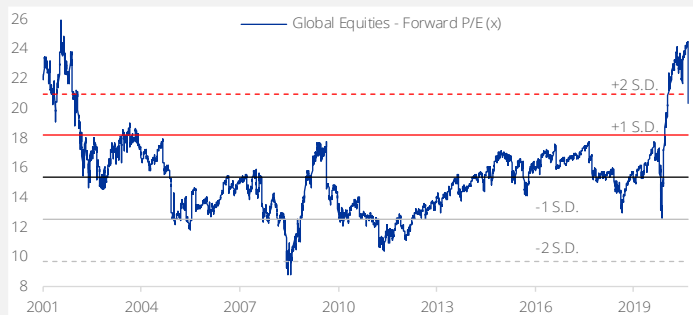
Global Cross Assets YTD Returns



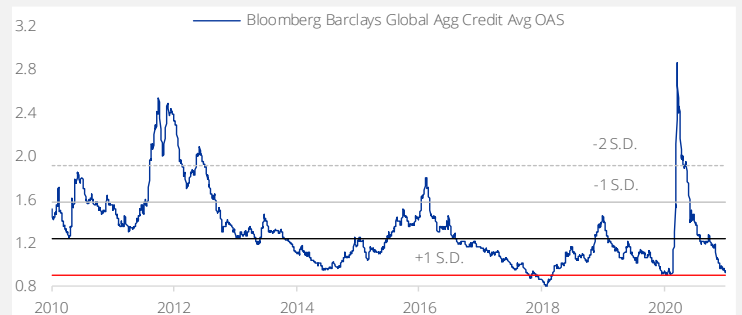
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Index Returns

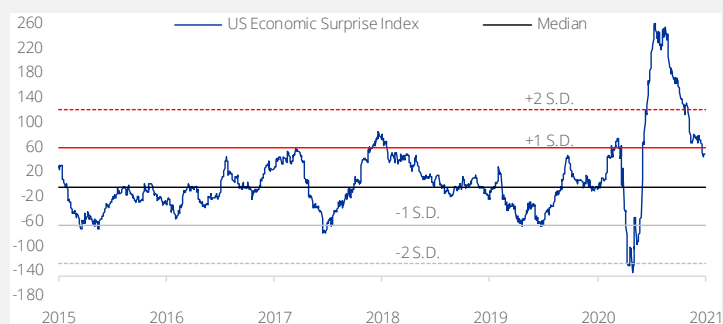
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-0.9%	-1.5%	-1.5%	-1.5%
NASDAQ	-1.6%	-1.5%	-1.5%	-1.5%
Russell 2000	-2.5%	-1.5%	-1.5%	-1.5%
Stoxx Europe 600	0.8%	0.7%	0.7%	0.7%
Nikkei-225	1.5%	-0.7%	-0.7%	-0.7%
MSCI WORLD	-0.3%	-0.7%	-0.7%	-0.7%
MSCI ACWI	0.3%	-0.5%	-0.5%	-0.5%
MSCI Asia ex-Japan	4.6%	1.2%	1.2%	1.2%
MSCI EM	4.2%	1.0%	1.0%	1.0%
HSCEI	4.0%	-0.1%	-0.1%	-0.1%
SHCOMP	3.1%	0.9%	0.9%	0.9%
Hang Seng	4.4%	0.9%	0.9%	0.9%
STI Index	0.7%	0.5%	0.5%	0.5%
Fixed Income				
Barclays Global Aggregate	0.7%	0.2%	0.2%	0.2%
Barclays US Aggregate	0.1%	-0.1%	-0.1%	-0.1%
Barclays US High Yield	0.1%	0.0%	0.0%	0.0%
Barclays Euro Aggregate	0.4%	0.1%	0.1%	0.1%
Barclays Euro High Yield	0.3%	0.1%	0.1%	0.1%
JPM EMBI Global	0.3%	0.0%	0.0%	0.0%
JPM EMBI Global Diversified	0.3%	0.0%	0.0%	0.0%

Prices & Spreads

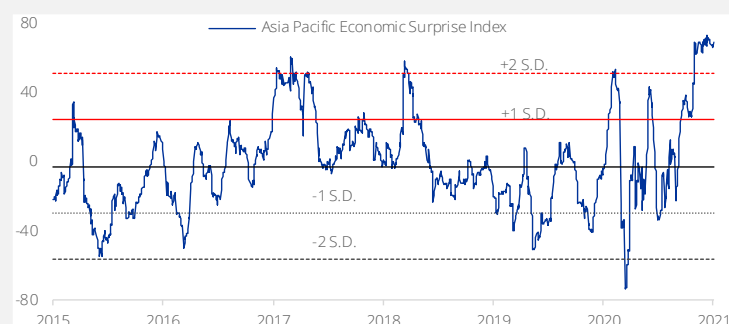
	Spot	4Q20	3Q20	2Q20
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	0.91	0.92	0.69	0.66
Japanese Govt Bond 10-yr	0.02	0.02	0.01	0.02
German Bunds 10-yr	-0.61	-0.57	-0.52	-0.46
Spreads				
US Agg Corporate Spread	0.98	0.96	1.36	1.50
US Corporate HY Spread	3.65	3.60	5.17	6.26
Euro Agg Corporate Spread	0.93	0.95	1.23	1.53
EM USD Agg Spread	2.67	2.68	3.34	3.93
Currencies				
US Dollar Index (DXY)	89.9	89.9	93.9	97.4
EUR/USD	1.22	1.22	1.17	1.12
USD/JPY	103.1	103.3	105.5	107.9
USD/CNY	6.5	6.5	6.8	7.1
Commodities				
WTI Oil	48	49	40	39
London Metal Exchange (LMEX)	3481	3415	2968	2682
TR/CC CRB Commodity	167	168	149	138
Gold	1943	1898	1886	1781

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)	08-Jan	Dec	50k	245k
Initial Jobless Claims (US)	07-Jan	Jan	803k	787k
ISM Manufacturing (US)	05-Jan	Dec	56.7	57.5
Durable Goods Orders (US)	06-Jan	Nov	0.90%	0.90%
MBA Mortgage Applications (US)	06-Jan	Jan	--	0.80%
Unemployment Rate (US)	08-Jan	Dec	6.80%	6.70%
M3 Money Supply y/y (EU)	05-Jan	Nov	10.60%	10.50%
ADP Employment Change (US)	06-Jan	Dec	50k	307k

Macro Calendar

	Date	Period	Survey	Prior
Asia				
CPI y/y (CN)	10-Jan	Dec	-0.10%	-0.50%
BoP Current Account Balance (JP)	11-Jan	Nov	--	¥2144.7b
PPI y/y (CN)	10-Jan	Dec	-1.10%	-1.50%
Money Supply M2 y/y (CN)	08-Jan	Dec	10.60%	10.70%
Retail Sales y/y (SG)	05-Jan	Nov	-8.10%	-8.60%
New Yuan Loans CNY (CN)	08-Jan	Dec	1227.5	1430.0b
Caixin China PMI Services (CN)	05-Jan	Dec	57.9	57.8
Caixin China PMI Composite (CN)	05-Jan	Dec	--	57.5

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