



CIO Weekly

Key Points

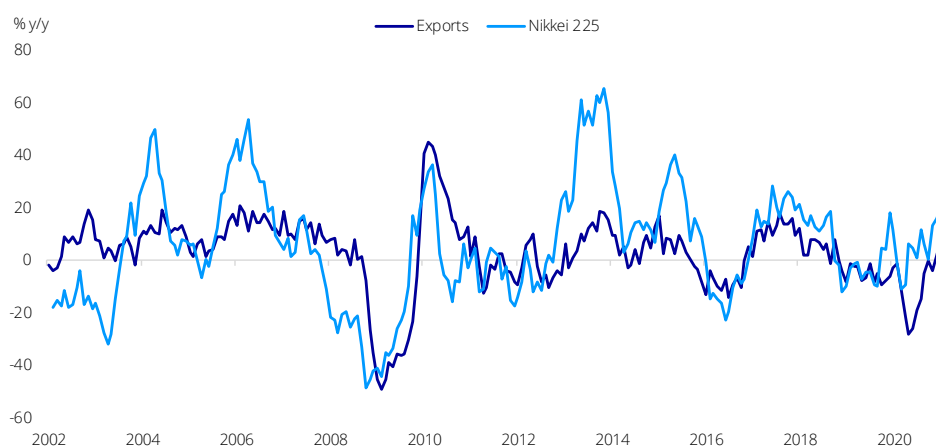
- **Equities:** Accommodative policies, rising tech exports, and Suga's restructuring plans bode well for the Nikkei 225
- **Credit:** Investors paid to take risks
- **FX:** Pandemic headwinds in UK could push GBP below 1.40 again if bulls book some profits
- **Rates:** Global gowie yield curves steepening persist, frontloading the optimism that the pandemic has an expiry date
- **Thematics:** Singapore REITs set to beat the odds
- **The Week Ahead:** Keep a lookout for US change in initial jobless claims; Japan industrial production numbers

Equities: Nikkei 225 reclaiming 30,000 beckons more to come

Fresh out from the global pandemic crisis, Japan is entering a recovery phase with many promises in store for an extended recovery. 4Q20's gross domestic product was better than expected, bringing the economy back to pre-pandemic levels on a quarterly basis, thus setting the stage for a full-fledged recovery this year despite the re-introduction of a state of emergency in January.

Accommodative monetary policies such as bond and equity purchases, negative zero interest rates, and yield targeting remain to aid the recovery. Vaccinations are starting this week (ending 26 February) and targeted towards the whole of Japan's population, with plans to produce AstraZeneca (AZN UK) vaccines in Japan. Japan's exports were rising due to China's swift recovery and accelerated digitalisation post-COVID, and is seen as sustainable due to Japan benefiting from Regional Comprehensive Economic Partnership, and its high tech production capabilities, such as those in the semiconductors and automation space. A major re-rating catalyst for the market would be the Olympics, which if held smoothly, could lead to a huge comeback for the tourism sector.

Figure 1: Recovery in Japan's export-oriented economy is a major driver for the Nikkei 225 Index



Source: Bloomberg, DBS

Global cross assets

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	31,521.69	0.1%	3.0%
S&P 500	3,876.50	-0.8%	3.2%
NASDAQ	13,533.05	-2.5%	5.0%
Stoxx Europe 600	413.06	-0.4%	3.5%
DAX	13,950.04	-0.3%	1.7%
CAC 40	5,767.44	-0.1%	3.9%
FTSE 100	6,612.24	-0.2%	2.3%
MSCI Axj	926.64	-2.0%	9.9%
Nikkei 225	30,156.03	0.5%	9.9%
SHCOMP	3,642.45	-1.5%	4.9%
Hang Seng	30,319.83	-1.1%	11.3%
MSCI EM	1,397.67	-2.3%	8.2%
UST 10-yr yield*	1.37	2.2%	45.2
JGB 10-yr yield*	0.12	14.3%	10.3
Bund 10-yr yield*	-0.34	10.7%	23.2
US HY spread*	3.19	0.0%	-41.0
EM spread*	319.04	1.5%	-3.9
WTI (USD)	61.49	3.8%	26.7%
LMEX	3,931.80	1.6%	15.2%
Gold (USD)	1,809.67	1.4%	-4.7%

Source: Bloomberg

* Changes in basis points

New prime minister Yoshihide Suga has pledged to restructure and reinvigorate the Japanese economy. More meaningful measures that may present opportunities for investors are the opening of the financial sector, an upgrade of the nation's digital capabilities, a new industrial revolution for Japan Inc, consolidation of the banking sector, the promotion of competition in the telecom sector, and the facilitation of consolidation among small and medium-sized enterprises.

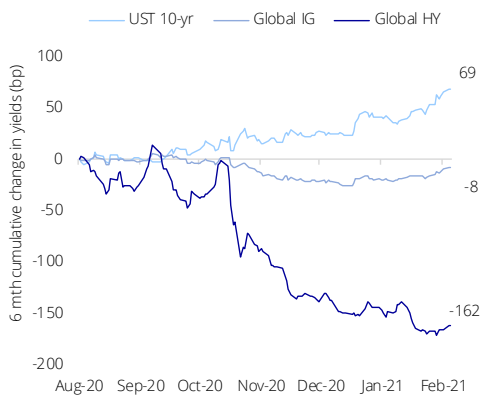
IT systems integrators should be a key beneficiary of Suga's push to accelerate the digitalisation of government agencies; he has set up a digital agency to oversee this. This comes on the back of Japan scoring poorly in assessments of its government's digital capabilities, with many tasks still being handled manually and via paper forms. IT systems integrators could benefit if they win government projects.

Japan's Nikkei 225 Index broke 30,000 for the first time since 1989. We believe there is a high probability that the index can climb towards its all-time high of 38,915 in the next two years.

Joanne Goh | Strategist

Credit: Investors were paid to take risks

Figure 2: Divergence of performances in fixed income markets



Source: Bloomberg, DBS

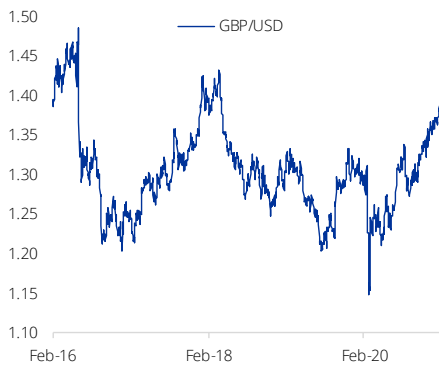
We had been bullish on risky credit markets since 4Q20, noting that the recovery was still in its early innings back then and that High Yield (HY) markets were the most poised to perform. Conversely, we also flagged caution on treasury markets – noting that yields below 1% were underpricing recovery and inflation risks that could come with a vaccine rollout – and that investors could do well by placing hedges on underlying interest rate risks (please refer to “How to deal with inflation uncertainty”, 12 Jan 2021) where possible.

With the dominant narrative in fixed income turning towards the relentless steepening of the yield curve, it is no surprise that the “riskless” treasury markets were where investors saw the most negative returns; yields have risen c.69 bps cumulatively in just six months (note that bond prices move inversely to yields). Global HY credit, however, seemed immune to higher rates – yields actually declined c.162 bps in the same period. We continue to think that a pro-risk approach to credit is favourable in a recovery, and HY spread compression should remain under a controlled ascent in rates.

Daryl Ho | Strategist

FX: Powell testimony, GBP overbought, PHP weak

Figure 3: Overbought at current levels



Source: Bloomberg, DBS

There is a fair amount of anxiety going into Federal Reserve Chairman Jerome Powell's semi-annual monetary policy testimony before the Senate Banking Committee tonight. **Wall Street continues to struggle with a steepening US yield curve positioning for a rebound in growth and inflation in the US.** Powell has and will continue to prioritise the labour market over inflation in carrying out the Fed's dual mandate during the recovery from the pandemic. Under the average inflation targeting framework introduced last September, the Fed will allow inflation to run above 2% for periods when inflation is below 2%. It was less than a fortnight ago when Powell told the Economic Club of New York that the US economy remains a long way from a strong labour market. His predecessor, US Treasury Secretary Janet Yellen, said yesterday (22 February) that the success of President Joe Biden's stimulus plan will be assessed by the speed at which unemployment returns to pre-pandemic levels.

GBP appreciated a third session to 1.4068 vs USD on Monday, its second close above 1.40. At this level, GBP appears overbought. Apart from a Relative Strength Index reading around 74, GBP is around the top of an ascending price channel established after the November US elections. GBP's rally has been driven by the country's rapid vaccine rollout and the Bank of England ruling out negative rates for now. While UK research showed that the vaccines sharply reduced hospitalisation and transmissions, Prime Minister Boris Johnson has decided to go slow on easing lockdowns which will be carried out in four stages between 8 March and 21 June. Meanwhile, Chancellor of the Exchequer Rishi Sunak will be presenting his budget on 3 March. He is reportedly looking to hike the corporate tax rate every year by a percentage point to 23% by the general elections on 2024 from its present 19%. **With the UK economy slow to emerge from the pandemic in 1H21, GBP could return below 1.40 again if the bulls decide to book some profits.**

PHP has become the weakest currency in February. The Philippine economy is set to miss its official 7.85-8.5% growth target for 2021 after its worst ever 9.5% contraction last year. The second most infected Southeast Asian country has yet to start mass vaccinations. National Economic and Development Authority (NEDA) expects gross domestic product (GDP) growth to turn negative (q/q) again in 1Q21 after two positive quarters. With inflation above its official 2-4% target range in January and likely to head higher, the central bank will refrain from easing interest rates. More fiscal spending is unlikely after the record PHP4.5t budget approved last December lifted this year's budget deficit ceiling to 8.9% of GDP from 7.6% last year. Consensus expects the current account surplus last year to return into deficit in 2021. Overseas foreign worker remittances, which accounted for 9.0% of GDP, have decreased by 9.5% in 2020.

Philip Wee | FX Strategist

Rates: Optimism and rates selloff

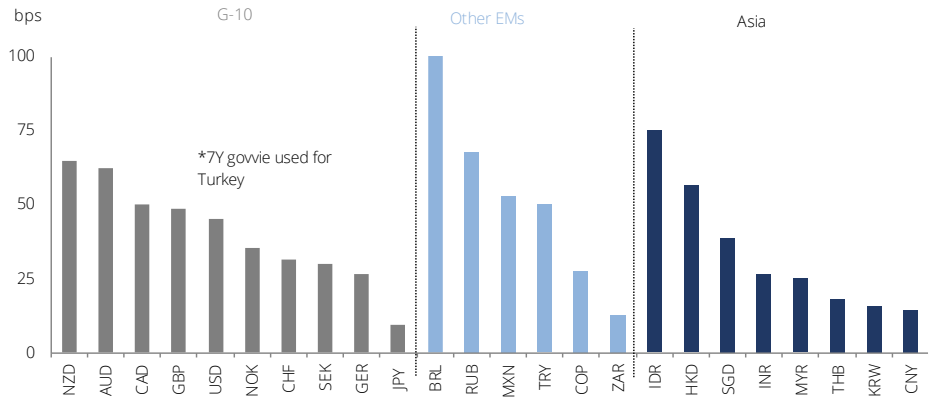
Figure 4: Asia: Gap to ARVI Indicator



Source: Bloomberg, DBS

Global gowie yield curves continue to steepen, frontloading the optimism that the pandemic crisis has an expiry date. We believe that recent moves in the market are validating our views the large parts of the developed world will achieve herd immunity in 2H21, allowing these economies to normalise. While rates were initially driven up by increased inflation expectations, more recently, there was also a significant reduction in term premium (most of it we view as the COVID-19 premium). Optimism is hurting the rates space with 10Y US yields quickly drifting towards our target of 1.5%. We would also emphasise that the pre-pandemic range is 1.5-2.0%.

Figure 5: Change in 10Y LCY Government Bond Yields since end-2020



Source: Bloomberg, DBS

Asia govies are also feeling the strain. Aside from rapidly rising USD rates, there is also the firmer USD to contend with. In the current round of tantrums, there has been varied performances across Asia. Using yield changes as a gauge of performance, China Government Bonds (CGB) stands out to be the best. This is unsurprising given that the CGB curve has normalised to a large extent and the debate really lies with when the People's Bank of China may want to consider tightening. Hong Kong, Singapore, and Indonesia bonds underperformed. **We revisit our Asia Rates Valuation Indicator (ARVI) to get a sense of how Asia rates are doing.** One point to note is that the ARVI captures relative value over comparable US Treasuries given a set of macro variables. CGBs are still the most attractive. Meanwhile, Indonesia Government Bonds screen as undervalued. Once the USD rates tantrum settles, investors will want to revisit the carry play.

Eugene Leow | Rates Strategist

Duncan Tan | Rates Strategist

Thematics: Singapore REITs set to beat the odds

- S-REITs underperformed the STI in 10 out of 12 periods when 10-year yields rose by 50 bps or more over a three to six-month period
- Weakness is an opportunity to accumulate – S-REITs generally turn outperformers in the subsequent six to 12 months after a pause in rising 10-year yields
- Higher than average yield spreads of 4.7% and a robust DPU growth profile to drive sector re-rating
- Focus on S-REITs with growth and potential to hit pre-pandemic DPU in 2021

Rising 10-year yields a bane for S-REITs. With increasing confidence and visibility of economic recovery on progress of vaccine distribution, 10-year US yields have climbed close to 40 bps since the low in November 2020. This has put upward pressure on Singapore interest rates, which have also risen in tandem. In the past 15 years, there were 12 periods when 10-year yields have risen by more than 50 bps and S-REITs had generally underperformed the Straits Times Index (STI) in 10 out of those 12 periods. While the current hikes in 10-year yields are likely near-term headwinds, we expect that the majority of the steepening has already happened.

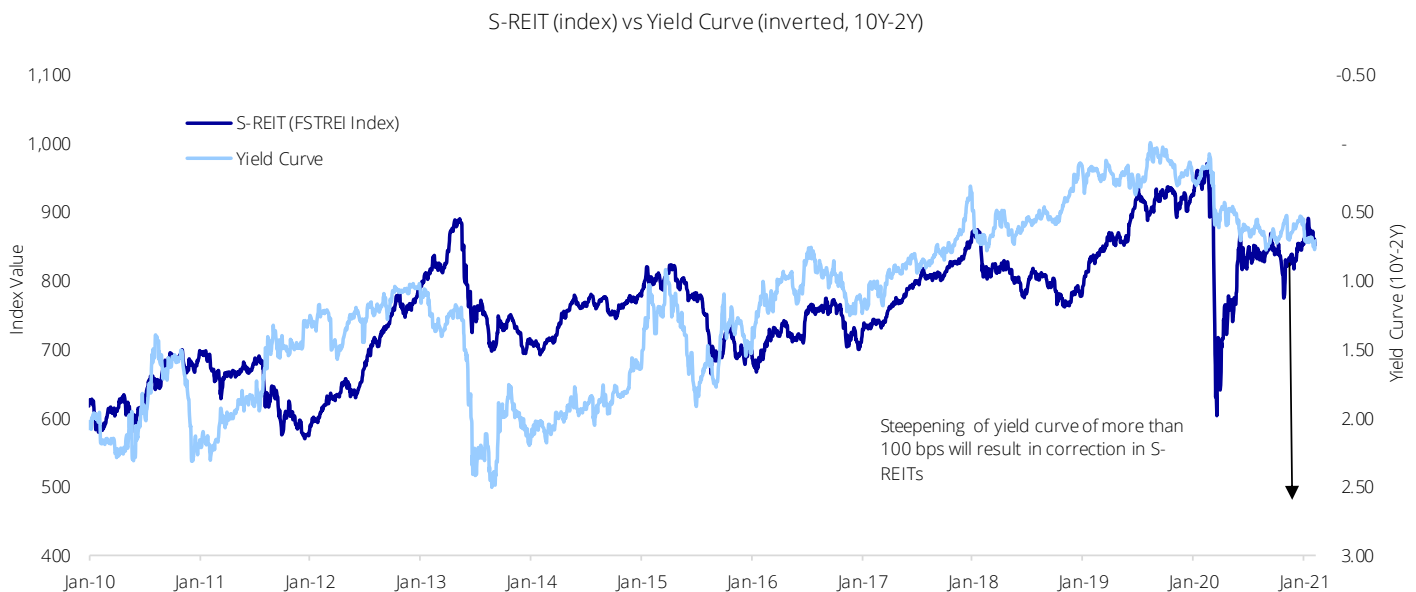
S-REITs consistently turned the tide in subsequent six to 12 months once rate hikes taper off. DBS Group Research's analysis also showed that S-REITs generally turned outperformers in the subsequent six to 12 months after a pause in hikes in the 10-year yields. Since 2013, S-REITs outperformed the STI once the 10-year yields stabilised. We believe this is due to the sector's increasing relevance in the Singapore market given (i) their larger market caps, (ii) strong and consistent growth profiles, and (iii) attractive relative spreads. The wider yield spreads (vs 10-year bonds) offered by the S-REITs of around 4.0% since 2013 (vs <2.0% from 2005-2010) has provided the sector with more buffer, which should maintain firm investor interest in the sector.

Buy S-REITs with growth potential. While S-REITs have lagged the STI year-to-date, we believe investors should accumulate selectively on weakness. We see support from (i) wider-than-average sector yield spreads (vs 10-year bonds) of around 4.9% (4.7% on forward basis), (ii) a strong rebound in distributions per unit (DPUs) of up to about 18% (around 13% ex-hospitality S-REITs) as re-rating catalysts. (See "Singapore REITs: Ride the winds of change", 11 Dec 2020). Our strategy is to take a balanced approach to select our top picks. Retail and office S-REITs such as MCT, FCT, CICT, and LREIT, and logistics players like MLT and FLT are poised to do well.

Derek TAN | Analyst
Dale LAI | Analyst

Rachel Tan | Analyst
Geraldine Wong | Analyst

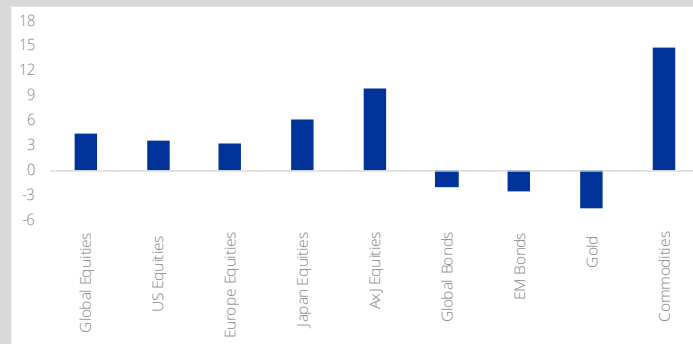
Figure 6: Yield curve and S-REITs share price



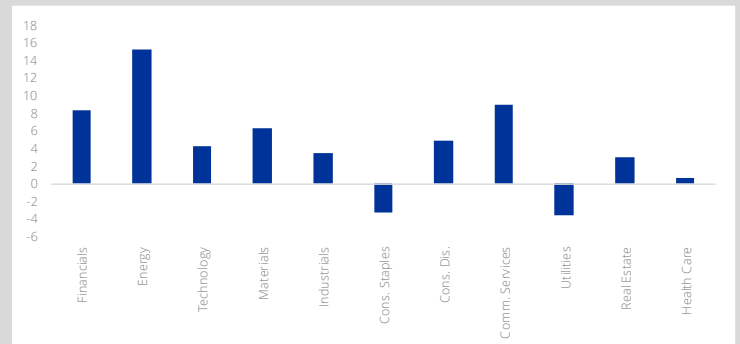
Source: Bloomberg, DBS

CIO Markets Watch

Global Cross Assets YTD Returns



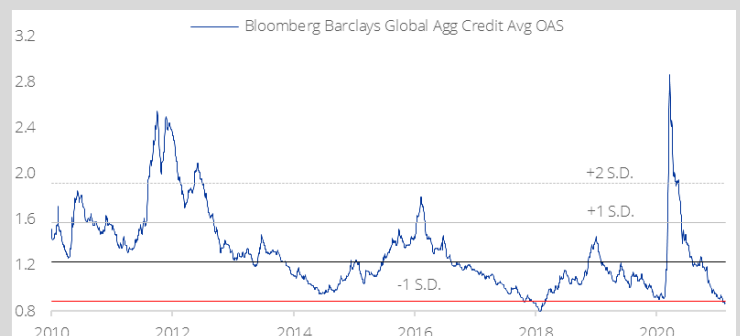
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Index Returns

	1 week	MTD	QTD	YTD
Equities				
S&P 500	-1.5%	4.4%	3.2%	3.2%
NASDAQ	-4.0%	3.5%	5.0%	5.0%
Russell 2000	-1.7%	8.6%	14.0%	14.0%
Stoxx Europe 600	-1.5%	4.3%	3.5%	3.5%
Nikkei-225	0.2%	9.0%	9.9%	9.9%
MSCI WORLD	-1.5%	4.7%	3.6%	3.6%
MSCI ACWI	-1.7%	4.8%	4.3%	4.3%
MSCI Asia ex-Japan	-2.3%	5.7%	9.9%	9.9%
MSCI EM	-2.8%	5.1%	8.2%	8.2%
HSCEI	0.1%	6.1%	10.8%	10.8%
SHCOMP	-0.3%	4.6%	4.9%	4.9%
Hang Seng	0.5%	7.2%	11.3%	11.3%
STI Index	-1.7%	-0.7%	1.3%	1.3%
Fixed Income				
Barclays Global Aggregate	-0.5%	-1.1%	-1.9%	-1.9%
Barclays US Aggregate	-0.8%	-1.3%	-2.0%	-2.0%
Barclays US High Yield	-0.1%	0.9%	1.2%	1.2%
Barclays Euro Aggregate	-0.3%	-1.0%	-1.4%	-1.4%
Barclays Euro High Yield	0.2%	1.3%	1.8%	1.8%
JPM EMBI Global	-1.7%	-1.4%	-2.6%	-2.6%
JPM EMBI Global Diversified	-1.3%	-1.2%	-2.4%	-2.4%

Prices & Spreads

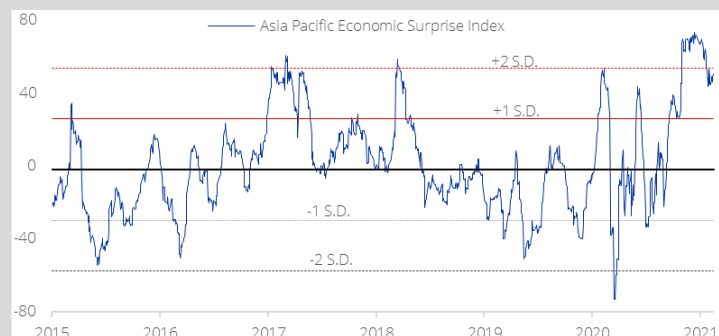
	Spot	4Q20	3Q20	2Q20
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	1.37	0.92	0.69	0.66
Japanese Govt Bond 10-yr	0.12	0.02	0.01	0.02
German Bunds 10-yr	-0.34	-0.57	-0.52	-0.46
Spreads				
US Agg Corporate Spread	0.91	0.96	1.36	1.50
US Corporate HY Spread	3.19	3.60	5.17	6.26
Euro Agg Corporate Spread	0.90	0.95	1.23	1.53
EM USD Agg Spread	2.55	2.68	3.34	3.93
Currencies				
US Dollar Index (DXY)	90.0	89.9	93.9	97.4
EUR/USD	1.22	1.22	1.17	1.12
USD/JPY	105.1	103.3	105.5	107.9
USD/CNY	6.5	6.5	6.8	7.1
Commodities				
WTI Oil	61	49	40	39
London Metal Exchange (LMEX)	3932	3415	2968	2682
TR/CC CRB Commodity	193	168	149	138
Gold	1810	1898	1886	1781

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)	25-Feb	20-Feb	830k	861k
GDP Annualized q/q (US)	25-Feb	4Q	4.20%	4.00%
ISM Manufacturing (US)	01-Mar	Feb	58.6	58.7
CPI y/y (EU)	23-Feb	Jan	0.90%	-0.30%
U. of Mich. Sentiment (US)	26-Feb	Feb	76.5	76.2
Conf. Board Consumer Confidence (US)	23-Feb	Feb	90	89.3
MBA Mortgage Applications (US)	24-Feb	19-Feb	--	-5.10%
Durable Goods Orders (US)	25-Feb	Jan	1.00%	0.50%

Macro Calendar

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m	25-Feb	Jan	3.80%	-1.00%
Jobless Rate	01-Mar	Jan	--	2.90%
CPI y/y	23-Feb	Jan	0.20%	0.00%
Manufacturing PMI	28-Feb	Feb	51.2	51.3
Tokyo CPI Ex-Fresh Food y/y	25-Feb	Feb	-0.40%	-0.40%
Caixin China PMI Mfg	28-Feb	Feb	51.5	51.5
Jibun Bank Japan PMI Mfg	28-Feb	Feb	--	50.6
Job-To-Applicant Ratio	01-Mar	Jan	--	1.06

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