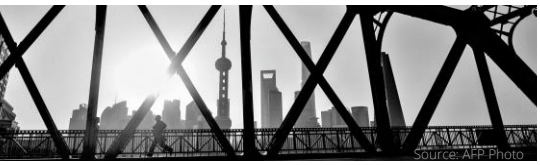

Source: AFP Photo

CIO Weekly

9 March 2021

Key Points

- **Equities:** Europe oil majors should ride on the global reflation trade and perform in line with oil prices
- **Credit:** Investors can benefit from steeper curves
- **FX:** GBP held up best among major currencies but this is about to change
- **Rates:** Short-term SGD rates appear elevated; looks attractive relative to USD rates
- **Thematics:** Positive earnings momentum for energy plays
- **The Week Ahead:** Keep a lookout for US Change in Initial Jobless Claims; Chinese inflation numbers

Equities: Rising oil prices to benefit Europe big oil

Markets have been on a risk-on mode since the end of November and have been re-pricing the potential for reflation. This can be seen in cross-asset performances where commodities have benefitted the most, with bond yields rising in anticipation of rising inflation. Energy is now the best performing asset year-to-date (YTD), with Brent and West Texas Intermediate Crude Oil rising in excess of 30%. Yet, Europe's big oil sector has well been lagging the rebound in oil prices. We believe it will catch up soon, driven by the following factors:

1. Demand outlook is improving as a result of faster-than-expected vaccine rollout. With global travel restrictions still in place, we expect the opening of economies and cross-border travel to take place in phases, which will drive higher oil demand.
2. Meanwhile, earnings have recovered from the lows in the second quarter of last year. However, downstream refinery margins have yet to recover. We expect recovery when the economy fully reopens.
3. The supply outlook has become clearer after the Organization of the Petroleum Exporting Countries+ (OPEC+) meeting in early March, indicating that it is more tolerant of current low levels of production in order to support oil price recovery.
4. Dividends cuts and deleveraging have been a drag on the sector's cashflow and appetite towards the sector. Near-term earnings can help to deleverage balance sheets more quickly, while providing cash flow for dividend hikes.
5. Environmental, social, and governance (ESG) concerns have also caused investors to leave the sector. Although ESG concerns for the Energy sector remain, the 'greening' of the sector is underway, as companies divest into clean energy projects and have announced support for new climate initiatives.

We believe earnings will soon track higher oil prices, leading to a re-rating of the sector.

Joanne Goh | Strategist

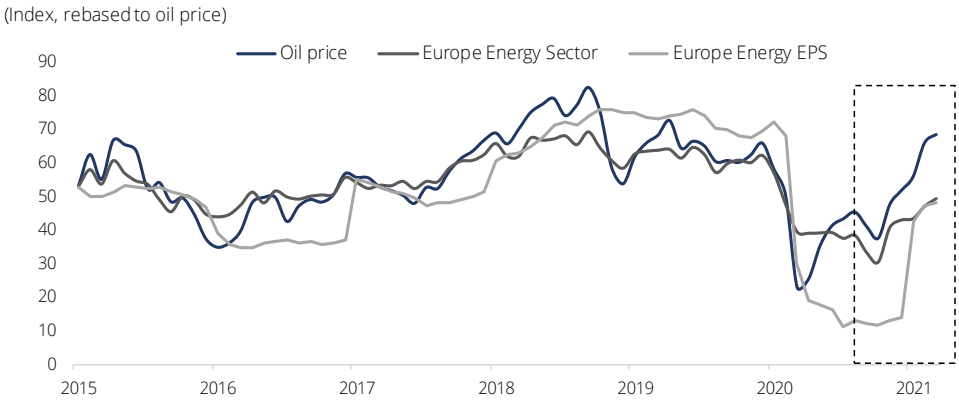
Global cross assets

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	31,802.44	1.0%	3.9%
S&P 500	3,821.35	-0.5%	1.7%
NASDAQ	12,609.16	-2.4%	-2.2%
Stoxx Europe 600	417.25	2.1%	4.6%
DAX	14,380.91	3.3%	4.8%
CAC 40	5,902.99	2.1%	6.3%
FTSE 100	6,719.13	1.3%	4.0%
MSCI AxJ	863.26	-2.4%	2.4%
Nikkei 225	28,743.25	-0.4%	4.7%
SHCOMP	3,421.41	-2.3%	-1.5%
Hang Seng	28,540.83	-1.9%	4.8%
MSCI EM	1,308.14	-2.3%	1.3%
UST 10-yr yield*	1.59	1.6%	67.8
JGB 10-yr yield*	0.12	34.1%	10.1
Bund 10-yr yield*	-0.28	-8.3%	29.4
US HY spread*	3.30	0.3%	-30.0
EM spread*	340.72	2.5%	17.8
WTI (USD)	65.05	-1.6%	34.1%
LMEX	3,816.10	0.6%	11.8%
Gold (USD)	1,683.54	-1.0%	-11.3%

Source: Bloomberg
* Changes in basis points

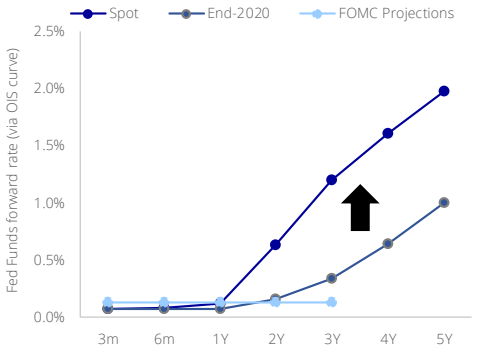
Figure 1: Europe Energy sector price and earnings should catch up with oil price and drive a re-rating for the sector



Source: Bloomberg, DBS

Credit: Investors can benefit from steeper curves

Figure 2: Rate hike expectations exceeding FOMC projections



Source: Bloomberg, DBS

There appears to be a battle of wills between the bond markets and the Federal Reserve – with the former believing that hikes are needed to come sooner to prevent economic overheating while the latter firmly resolute in their desire to see actual inflationary outcomes and a broader recovery before even thinking about acting. This has given rise to a pricing deviation in Fed Funds forward rates, with the overnight index swap curve pricing more than four hikes by end-2023 against none projected by the Fed.

In anticipating potential rate hikes, even the shorter-tenor 2Y/5Y UST yield spread has steepened by more than 40 bps since the start of the year. This presents an opportunity for investors to look at short duration credits (3-5Y) and benefit from steeper curve rolldown effects – a strategy that should outperform cash as front-end rates stay lower for longer than the market currently expects. Investors who have cash on the sidelines can progressively scale into short-end credit to take advantage of the higher yields while the market remains unduly bearish on bonds.

Daryl Ho | Strategist

FX: Tracking the rise in USD and its key levels

Figure 3: Euro weakness

Source: Bloomberg, DBS

USD index or **DXY appreciated a fourth session to 92.393**, its highest level since 23 November, supported by a higher US 10-year Treasury yield at 1.60%. US President Joe Biden's USD1.9t stimulus bill has been amended and approved by the Senate. The bill will head back to the House of Representatives for another vote as early as today before returning to the Senate and finally to the President for his signature before the unemployment benefits expire on 14 March. The stimulus and vaccinations are expected to lift US growth and inflation from pent-up consumer demand. If the US Consumer Price Index tomorrow affirms inflation worries by firming to 1.7% y/y in February from 1.4% a month, DXY will look to test its next resistance around 93.0.

Key levels	DXY	Levels	EUR/USD
US election	93.553	Peak	1.2349
200-dma	**92.954**	End 2020	1.2216
8-March	**92.393**	50-dma	1.2117
100-dma	91.249	100-dma	1.2041
50-dma	90.532	**8-March**	**1.1847**
End-2020	89.937	**200-dma**	**1.1829**
Low	89.209	US election	1.1715

EUR/USD fell a fourth straight session to 1.1845, down 3.2% YTD. Taking out its next support level at 1.1829 (200-day moving average (dma)) would open the door to give back its post-US election gains i.e. trade lower to 1.1715 seen on 3 November. EUR bears are betting on the European Central Bank to increase the pace of asset purchases at its meeting on 11 March.

Key levels	GBP/USD	Key levels	AUD/USD	NZD/USD
Peak	1.4237	Peak	0.8007	0.7465
8-March	**1.3836**	50-dma	0.7735	0.7216
50-dma	**1.3768**	End-2020	0.7694	0.7184
End-2020	1.3670	**8-March**	**0.7650**	**0.7129**
100-dma	1.3523	**100-dma**	**0.7544**	**0.7072**
US election	1.3059	US election	0.7164	0.6686

GBP has held up best among the major currencies, but this is about to change. Taking out its support at 1.3768 (50-dma) will also break its post-US election price channel. This would sour the appetite for GBP and increase its vulnerability to further EUR weakness or USD strength. **AUD and NZD have given up their gains for 2021** with their sights on their next support level marked by their 100-dma. These two commodity currencies have not bucked the weakness in metals, especially gold and copper.

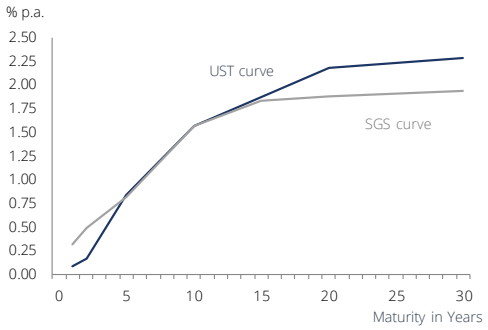
Key levels	USD/SGD	Key levels	USD/CNY	Key levels	USD/CNH
US election	1.3605	200-dma	6.7618	200-dma	6.7265
200-dma	**1.3560**	US election	6.6777	**US election**	**6.6829**
8-March	**1.3508**	**100-dma**	**6.5489**	**8-March**	**6.5515**
100-dma	1.3359	**End-2020**	**6.5272**	100-dma	6.5270
50-dma	1.3283	**8-March**	**6.5261**	End-2020	6.5028
End-2020	1.3221	50-dma	6.4808	50-dma	6.4689
Low	1.3171	Low	6.4283	Low	6.4009

As a price-taker, USD/SGD been highly correlated with the DXY. The currency pair ended above 1.35 for the first time since 5 November. Effectively, SGD has depreciated 2.1% YTD against the greenback. The next resistance is at 1.3560 (200-dma), close to the 1.3605 seen on US election day. **Export-led Asian currencies have not taken kindly to prospects of a more normalised global economy paved by vaccinations.** This was best reflected by the Nasdaq Composite Index, which has plummeted 12.5% from its peak in mid-February. **Onshore USD/CNY firmed to 6.5261, ready to test the level it ended last year** and the following resistance at 6.5489 (100-dma). Offshore USD/CNH has already surged above its 100-dma and is ahead of its onshore counterpart in retracing its post-US elections gains. CNY tracks a basket of currencies of its major trading partners and is not immune to global USD strength.

Philip Wee | FX Strategist

Rates: Catching relative value

Figure 4: SGS and UST curve



Source: Bloomberg, DBS

Short-term SGD rates appear elevated and look attractive relative to USD rates. From the USD perspective, liquidity is flush with 1M Libor drifting to 0.1% with the Fed funds rate at zero. With the Treasury Cash Balance set to run down in the coming few months as stimulus-led disbursements pick up, it is possible for short-term USD rates to crash towards zero in the absence of Fed intervention. We suspect that the Fed may have to eventually do open market operations (OMOs) (or stealth twist) to suck up excess liquidity and should put a floor on short-term USD rates in the coming few weeks.

Comparatively, SGD liquidity appears to be modestly tight. Short-term SGD rates including the Singapore overnight rate average and Monetary Authority of Singapore (MAS) bills have been drifting slightly higher. With foreign reserves and long futures/forward positions in foreign currency rising, it does appear that the current tightness in SGD liquidity is driven by the MAS's OMOs (that net withdraw liquidity). This has filtered out into the front of the Singapore government securities (SGS) curve, with yields displaying considerable premium over UST. By contrast, longer-term (10Y and 30Y) SGS yields are trading below their UST counterparts. **We see most relative value in the front of the SGS curve.** Meanwhile, there may be tentative signs of stability in the ultra-long tenors of the UST curve. This could translate into fewer worries for long-tenor SGSs ahead of the upcoming 10Y auction on 29 March. **We think that the setup for SGS outperformance (over UST) out to the 10Y tenor is also decent.**

Eugene Leow | Rates Strategist

Thematics: Upstream and integrated oil plays' earnings to surge up to 60% if oil crosses USD80

- Brent crude oil prices have already breached USD70/bbl and show little signs of fatigue
- Oil plays are looking at much improved earnings in FY21/22, but share prices are still below their 2020 highs despite the better outlook
- If oil price rally continues, earnings upgrades could range from 30-60% at oil price USD80 and even double at the USD100 mark

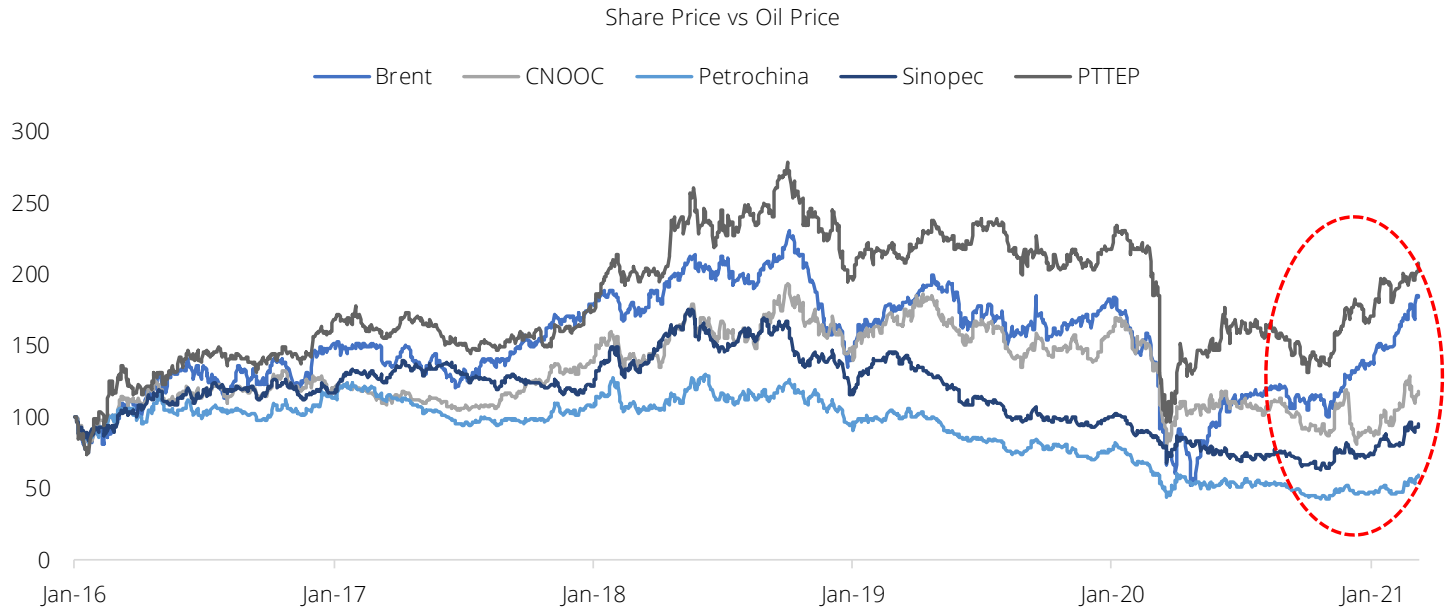
Forecasts revised up again. With a stronger-than-expected start to the year, DBS Group Research is raising its average 2021 Brent crude oil price forecast again to USD60-65/bbl. Demand recovery in 2021 (of around 5.5 mmbpd by our projections) should outpace supply growth significantly (increasing by only around 2.0 mmbpd by our projections, curtailed by OPEC+ cuts), leading to continued global inventory drawdowns, supporting oil prices. Our 2022 average Brent crude oil forecast stands at USD62-67/bbl on the assumption that air travel recovers closer to normal levels in 2022, OPEC+ discipline stays, and US shale production growth is contained. Looking further ahead, we believe there could be potential risk of oil price spikes towards USD80/bbl or higher in future, once demand has recovered to pre-COVID levels and OPEC spare capacity is down to normalised levels, as severe systemic underinvestment on the upstream side in recent years could have an impact on non-OPEC supply growth in future.

Oil proxies remain in favour. While oil and gas names have had a good run, stock prices are still lower than 2020 highs despite a rosier oil price outlook. China National Offshore Oil Corporation (CNOOC) (883 HK) was especially hard hit by a selloff on stocks in the US military blacklist. Oil proxies such as CNOOC, PTT Public Company Limited (PTT TB), and PT Medco Energi Internasional Tbk (MEDC IJ) are poised to ride the uptrend.

Significant upside if oil rally continues. We have raised our earnings forecasts and target prices for upstream names to factor in the higher oil price assumptions for 2021/22 and higher long-term oil price of USD60/bbl (vs USD55/bbl previously). Our sensitivity analysis suggests that in the event of oil price surging towards USD70-80/bbl, earnings upgrades of 30-60% could be possible and at USD100/bbl (unlikely), we could see pure upstream companies' earnings doubling from current estimates. This would then imply significant valuation upside from current levels.

Suvro SARKAR | Analyst
Pei Hwa HO | Analyst
Duladeth BIK | Analyst
William Simadiputra | Analyst

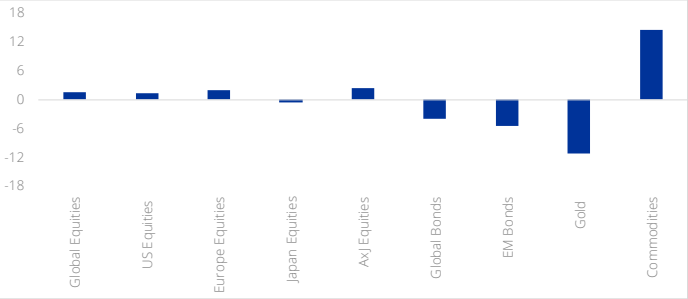
Figure 5: Share prices of upstream companies mostly still lagged oil price performance



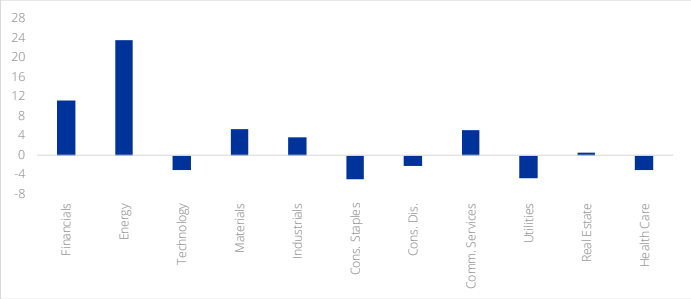
*Indexed to 1-Jan-2016 where oil price was ~USD37/bbl, near last cycle's trough oil price of USD27.88 on 20 Jan 2016
Source: Company, Bloomberg Finance L.P., DBS Bank

CIO Markets Watch

Global Cross Assets YTD Returns

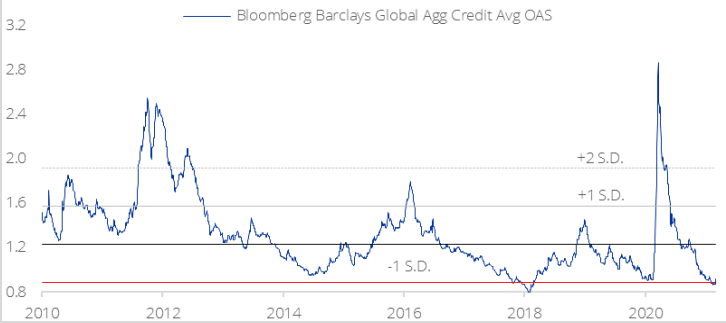


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



Index Returns

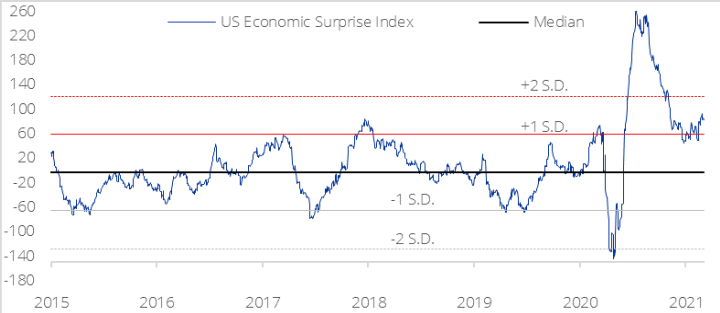
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-2.1%	0.3%	1.7%	1.7%
NASDAQ	-7.2%	-4.4%	-2.2%	-2.2%
Russell 2000	-3.2%	0.1%	11.6%	11.6%
Stoxx Europe 600	1.2%	3.0%	4.6%	4.6%
Nikkei-225	-3.1%	-0.8%	4.7%	4.7%
MSCI WORLD	-2.2%	-0.2%	1.2%	1.2%
MSCI ACWI	-2.4%	-0.5%	1.2%	1.2%
MSCI Asia ex-Japan	-4.3%	-2.7%	2.4%	2.4%
MSCI EM	-4.0%	-2.3%	1.3%	1.3%
HSCEI	-3.8%	-2.1%	2.6%	2.6%
SHCOMP	-3.7%	-2.5%	-1.5%	-1.5%
Hang Seng	-3.1%	-1.5%	4.8%	4.8%
STI Index	3.3%	4.1%	8.0%	8.0%
Fixed Income				
Barclays Global Aggregate	-1.4%	-1.4%	-4.0%	-4.0%
Barclays US Aggregate	-0.9%	-1.1%	-3.2%	-3.2%
Barclays US High Yield	-0.6%	-0.3%	0.4%	0.4%
Barclays Euro Aggregate	-0.5%	0.0%	-2.0%	-2.0%
Barclays Euro High Yield	-0.1%	0.1%	1.6%	1.6%
JPM EMBI Global	-2.2%	-1.7%	-5.4%	-5.4%
JPM EMBI Global Diversified	-0.9%	-0.9%	-5.1%	-5.1%

Prices & Spreads

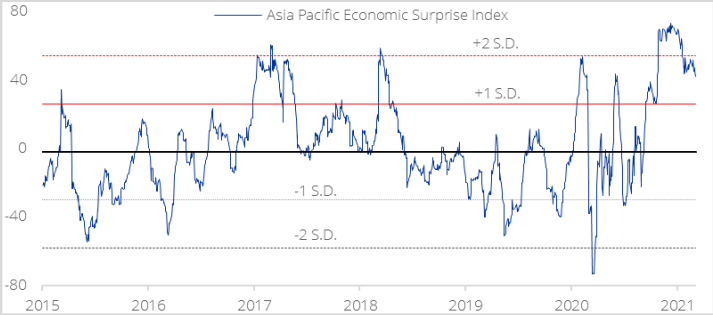
	Spot	4Q20	3Q20	2Q20
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	1.59	0.92	0.69	0.66
Japanese Govt Bond 10-yr	0.12	0.02	0.01	0.02
German Bunds 10-yr	-0.28	-0.57	-0.52	-0.46
Spreads				
US Agg Corporate Spread	0.98	0.96	1.36	1.50
US Corporate HY Spread	3.30	3.60	5.17	6.26
Euro Agg Corporate Spread	0.92	0.95	1.23	1.53
EM USD Agg Spread	2.69	2.68	3.34	3.93
Currencies				
US Dollar Index (DXY)	92.3	89.9	93.9	97.4
EUR/USD	1.18	1.22	1.17	1.12
USD/JPY	108.9	103.3	105.5	107.9
USD/CNY	6.5	6.5	6.8	7.1
Commodities				
WTI Oil	65	49	40	39
London Metal Exchange (LMEX)	3816	3415	2968	2682
TR/CC CRB Commodity	192	168	149	138
Gold	1684	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)	11-Mar	06-Mar	725k	745k
ECB Main Refinancing Rate (EU)	11-Mar	11-Mar	0.00%	0.00%
CPI m/m (US)	10-Mar	Feb	0.40%	0.30%
U. of Mich. Sentiment (US)	12-Mar	Mar	78.5	76.8
MBA Mortgage Applications (US)	10-Mar	05-Mar	--	0.50%
GDP SA y/y (EU)	09-Mar	4Q	-5.00%	-5.00%
PPI Final Demand m/m (US)	12-Mar	Feb	0.40%	1.30%
ECB Deposit Facility Rate (EU)	11-Mar	11-Mar	-0.50%	-0.50%

Macro Calendar

	Date	Period	Survey	Prior
Asia				
CPI y/y (CN)	09-Mar	Feb	-0.30%	-0.30%
Core Machine Orders m/m (JP)	14-Mar	Jan	--	5.20%
PPI y/y (JP)	10-Mar	Feb	-0.70%	-1.60%
Tertiary Industry Index m/m (JP)	15-Mar	Jan	--	-0.40%
PPI y/y (CN)	09-Mar	Feb	1.50%	0.30%
Money Supply M2 y/y (CN)	08-Mar	Feb	9.40%	9.40%
New Yuan Loans CNY (CN)	08-Mar	Feb	950.0b	3580.0b
Machine Tool Orders y/y (JP)	09-Mar	Feb	--	9.70%