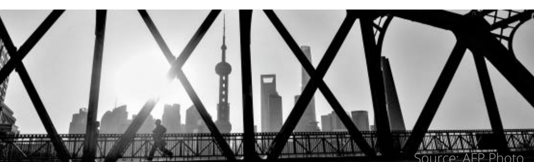


CIO Weekly

28 September 2021

Key Points

- Equities: Limited impact for S&P 500 on Evergrande fallout
- Credit: China property BBB/BB to ride out the storm
- FX: US Dollar Index (DXY) necessitates EUR weakness to move higher
- Rates: Short-dated SORA OIS rates look high relative to SOFR counterparts
- Thematics: Industrial S-REITs – Rediscovering their mojo
- The Week Ahead: Keep a lookout for US Change in Initial Jobless Claims; Japan Industrial Production Numbers

GLOBAL CROSS ASSETS
Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	34869.37	0.21%	13.93%
S&P 500	4443.11	-0.28%	18.29%
NASDAQ	14969.97	-0.52%	16.15%
Stoxx Europe 600	462.42	-0.19%	15.89%
DAX	15573.88	0.27%	13.52%
CAC 40	6650.91	0.19%	19.81%
FTSE 100	7063.40	0.17%	9.33%
MSCI AxJ	809.40	0.08%	-3.98%
Nikkei 225	30240.06	-0.03%	10.19%
SHCOMP	3582.83	-0.84%	3.16%
Hang Seng	24208.78	0.07%	-11.10%
MSCI EM	17313.77	0.31%	17.52%
UST 10-yr yield*	3133.64	0.27%	9.05%
JGB 10-yr yield*	6122.50	-0.36%	2.40%
Bund 10-yr yield*	1533.05	0.06%	-5.79%
US HY spread*	3100.30	1.27%	9.02%
EM spread*	60077.88	0.05%	25.81%
WTI (USD)	1267.36	0.18%	-1.85%
LMEX	34869.37	0.21%	13.93%
Gold (USD)	4443.11	-0.28%	18.29%

Source: Bloomberg
* Changes in basis points

Equities: Evergrande fallout – Limited impact for S&P 500

Fed taper – Much ado about nothing. The US Federal Reserve has, in the recent Federal Open Market Committee, given strong indication on the imminence of QE tapering. While the taper announcement could come as soon as November this year, the timeline for the Fed's rate hike, however, remains divided. Members were evenly split on the plausibility of a 2022 lift off – based on DBS's house view, a 2023 lift off is a more likely scenario. In any case, news surrounding the Fed's taper had limited impact on US equities as investors' attention was fixated on the potential fallout from China Evergrande instead.

Evergrande's (3333 HK) fallout – Limited impact on S&P 500. China Evergrande's debt concerns have triggered substantial volatility in financial markets given its "systemic importance" in the domestic Chinese economy. But, in our view, to compare this saga with the collapse of Lehman Brothers in 2008 will be too farfetched . Unlike Lehman Brothers (an investment bank with massive leveraged positions and counterparty risks), Evergrande is a highly geared property company with a far simpler operating structure. Therefore, its impact on global financial markets will be limited given:

a) The Real Estate sector accounts for c.25% of China's economy. Therefore, it is unlikely that the government will allow the sector to fall into a tailspin and cause material harm to the economy. Instead, in its pursuit of "common prosperity", the government will strike a fine balance between reducing moral hazard and maintaining overall financial stability.

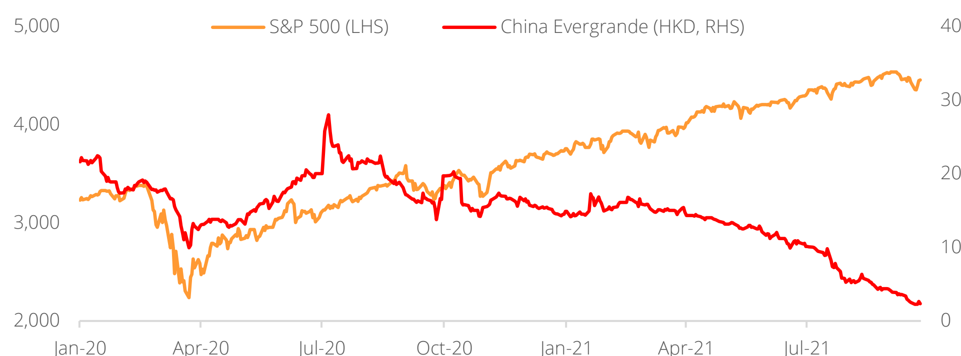
b) Despite the Evergrande concerns, physical property prices in China have yet to undergo any substantial decline. In fact, prices in Beijing and Shanghai have grown 7% YTD. Stability in physical prices will prevent the rise of contagion risks overspilling to the banking space.

c) From a portfolio perspective, global equity investors are currently 41% "Underweight" on China. This suggests global equity funds will unlikely suffer acute drawdowns should the Chinese real estate situation deteriorate further.

All eyes on 3Q21 earnings season. As we approach the month of October, investors are expected to divert their attention to the upcoming 3Q reporting season. Managements' forward guidance will be keenly watched as investors assess the impact on corporate earnings as macro momentum moderates.

Dylan Cheang | Strategist

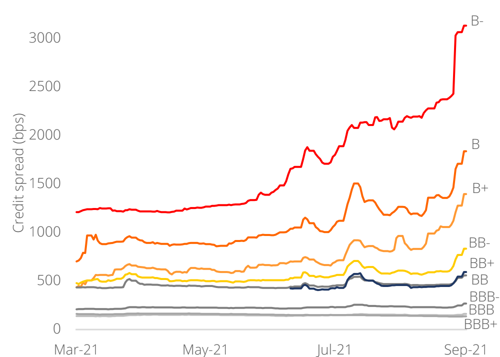
Figure 1: S&P 500 unfazed by Evergrande selldown



Source: Bloomberg, DBS

Credit: China property BBB/BB to ride out the storm

Figure 2: Stability in China property BBB/BBs over Bs



Source: Bloomberg, DBS

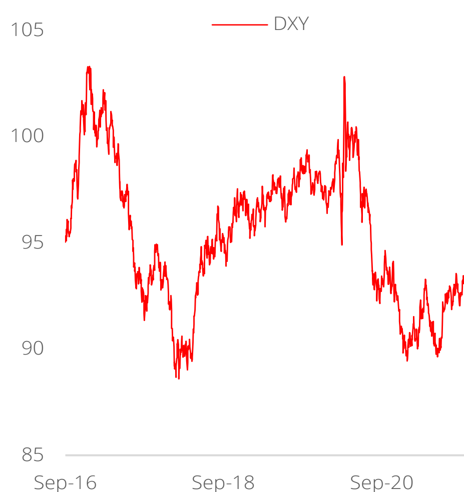
Asia credit markets have been spooked by the impending default of China Evergrande (3333 HK), one of China's most indebted property companies with more than USD300b in liabilities. Indeed, the Evergrande USD complex of bonds are trading at c.25%/15% of face value – pricing near recovery rates amid a restructuring scenario. Spreads in the China property space responded in sympathy, with broad widening to reflect the immense regulatory uncertainty in the onshore markets (Figure 2) as China seeks to address property-related social ills such as rising wealth inequality and declining birth rates (please refer to "Credit: Reasons for China property to avoid systemic fallout", 22 Sep 2021).

Certainly, these policy agenda warrant a more cautious view on China property. However, we reiterate that safety remains within the BBB/BB segments of the market, as we believe that a systemic default encompassing these higher-rated companies would amplify risks of social and financial instability – the very risks that the policymakers were trying to avoid with such curbs in the first place. We continue to see value in Asia credit, given that the risks appear more than adequately priced in by the markets. While China property lacks a catalyst for spread compression in the near term, investors can look to Asia ex-China credit markets in Indonesia/India/Thailand which have also widened in sympathy and offer value in the interim.

Daryl Ho | Strategist

FX: Guard against complacency

Figure 3: Indifference



Source: Bloomberg, DBS

DXY edged up to 93.4 from 93.3. USD should have appreciated more on weak stock market sentiment and higher US bond yields, but it did not. Appetite for the greenback was undermined by Senate Republicans who blocked the bill passed by House Democrats to avert a government shutdown on 1 October and a (possible but improbable) default on US government debt. Fed Chair Jerome Powell and US Treasury Secretary Janet Yellen, who will be testifying today on the pandemic responses before the Senate, are likely to push for bipartisan support (which is desired but not necessary) for the bill. Unlike past episodes, this does not appear to be a cliff-hanger. As a last resort, President Joe Biden and the Democrats could suspend the debt limit on their own.

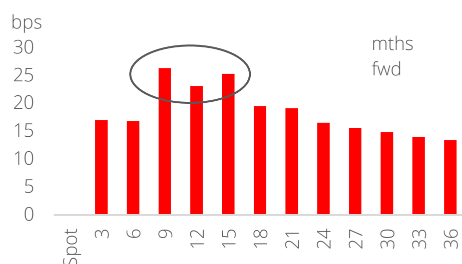
Investors are dealing with more negative factors ahead of October. The Dow rose 0.2% while S&P 500 and Nasdaq Composite fell 0.3% and 0.5%, respectively. Apart from the Evergrande crisis, China is now facing power shortages that have halted production in some factories, including suppliers to Apple and Tesla. US 10Y Treasury yield firmed to 1.487% from 1.451% after Fed Governor Lael Brainard and New York Fed President John Williams showed more support for the Fed to taper asset purchases by the end of this year. Brainard did not dismiss another miss in the September nonfarm payrolls which consensus expects will pick up to 513k from 235k in August. However, US inflation appears to be staying high for longer. WTI crude oil prices rose to USD75.45/bbl, its highest close since October 2018. Goldman Sachs increased its oil price target to USD90 after Hurricane Ida hurt offshore oil drilling capacity in the Gulf of Mexico.

DXY will need its largest component, EUR, to weaken to move higher. EUR closed below 1.17 on Monday for the third time in 5-6 weeks. Extending its fall today will break the past two times it recovered above 1.17 the following day. The European Central Bank (ECB) is more forceful than the Fed that inflation is temporary in the European Union, and insistent that its decision to slow down its pandemic emergency purchase programme is not a taper but a recalibration. The same messages are likely to be echoed by the many Fed and ECB officials speaking today. Hence, do not be complacent in expecting the DXY to repeat its indifference today.

Philip Wee | FX Strategist

Rates: Two ideas to navigate rising US yields

Figure 4: SORA premium



Source: Bloomberg, DBS

With USD rates rising (10Y UST yields closed just shy of 1.5%), SGD rates are also facing upward pressure. We think there are opportunities in SGD rates as investors navigate Fed taper (into eventual rate hikes), upcoming normalisation from the Monetary Authority of Singapore (MAS), and assumptions of fair value. Below, we outline a relative value play for SORA OIS and lay out a case for where fair value yield for the inaugural 30Y SINGA bond should be at.

We think that short-dated SORA OIS rates look high relative to their SOFR counterparts. Implied 3M SORA and SOFR suggest that SORA will maintain a meaningful premium over SOFR for the next few years. The spread of SORA over SOFR is priced to be widest (23-26 bps) 9-15 months forward before narrowing over an extended period. We are not convinced that would be the case. To be sure, there is about 10 bps premium embedded in SORA and that has been the case for the past several quarters. However, we reckon that as Fed hikes kick off, this SORA premium should get eroded, not exacerbated. Barring shocks that trigger Asia FX weakness, US hike cycles tend to coincide with a global recovery. Presumably, Fed hikes would start in early 2023 (or even late 2022), if taper concludes around mid-2022. Expectations are building that the MAS could well take a similar normalisation stance at the upcoming policy meeting in October. In which case, expectations of SGDNEER appreciation should on balance put downward pressure on SGD rates relative to USD rates. This phenomenon would likely be even more apparent in SOR IRS than SORA OIS. **We think paying short-dated SOFR (9M to 2Y) vs receive short-dated SORA is attractive.**

We think that 30Y SGS yields (at 1.89%) are close to fair value and we would reasonably assume that the 30Y SINGA auction (today) would see demand at around 1.92% (or a tad higher). Our reasoning is that 30Y US yields, (at 1.99%) are already very close to where we think short-term neutral should be at (2-2.25%). Under conditions of Fed and MAS normalisation in a global recovery (as laid out above), we should reasonably expect 30Y SGS yields to trade below 30Y UST yields. **At a 10 bps discount, we do not think that current SGS valuation is demanding.** With no more long-dated issuance for the year and strong auction results from the previous 20Y auction, we think that there will be demand especially as yields did take a meaningful leg higher over the past week. The biggest risk lies with uncertainties over the trajectory of 30Y US yields. However, we do see tentative signs that the back of the US curve is flattening out. Upward pressures are likely to be more acute for the bellies (3Y to 7Y) of the SGD and USD curves.

Eugene Leow | Rates Strategist

- Industrial S-REITs remain the choice sector given their multi-year pivot into new economy assets
- Close to 90% of AUM are now invested into new economy industrial asset classes that exhibit robust growth and capital upside
- Pipelines are even more important for REITs to gain access and grow
- Prefer large-cap and selected mid-cap industrial REITs

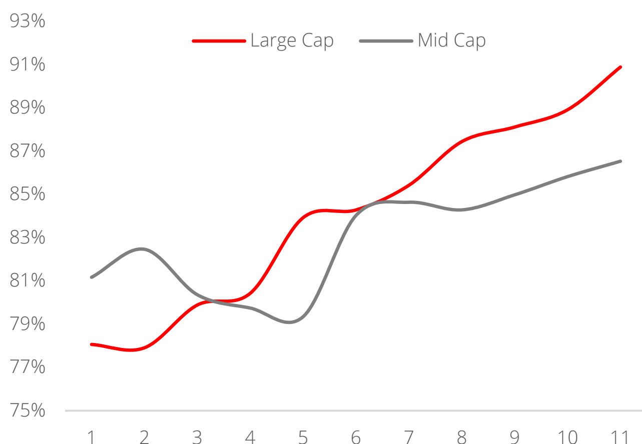
Industrial S-REITs are the "new economy" plays. Investors often balk at industrial S-REITs' tight yields of c.5.7% (4.5% for large caps), but DBS Group Research believes this premium is justified. With the sector's earnings resilience proven during the Covid-19 recession and as economies reopen, we believe the sector remains on firm footing to deliver decent growth of more than 3% CAGR over FY21-23F. Our preferred strategy would be to invest alongside structural growth trends within the new economy assets of logistics, data centres, and business parks, which we believe will deliver a potent mix of growth and capital upside.

Sponsors' role in shaping acquisition pipelines crucial in Industrial REITs' continued pivot to new economy assets. Industrial REITs have been actively growing their portfolios in recent years, with more than SGD6.7b in acquisitions announced and completed YTD. New economy assets now contribute close to 90% of AUM. However, with competition from funds, returns are increasingly looking compressed. Sponsors' pipelines and the ability to kickstart greenfield or brownfield developments, will therefore be an edge going forward. Among S-REITs, Mapletree Logistics Trust (MLT SP), Frasers Logistics and Commercial Trust (FLT SP), and Ascendas REIT (AREIT SP) remain the most attractive for their continued access to pipelines, which can potentially grow their AUM by 13-40%. Moreover, redevelopments to rejuvenate some of their ageing assets will offer added upside to net asset values. Selected mid-cap industrial REITs like ARA LOGOS Logistics Trust (ALLT SP), and ESR-REIT (1821 HK)are also set to benefit from their sponsors' pipelines.

Time for large-cap industrial S-REITs to reclaim their stage. Average yield spreads between large and mid-cap industrial S-REITs are converging to a 5-year average spread of c.2.1%, partly due to the latter's share price strength after news of the EPRA NAREIT indexation. Looking ahead, we believe investors will refocus on the S-REITs' ability to drive sustainable growth and expect large-cap names – especially those with pipelines – to see relative superior returns.

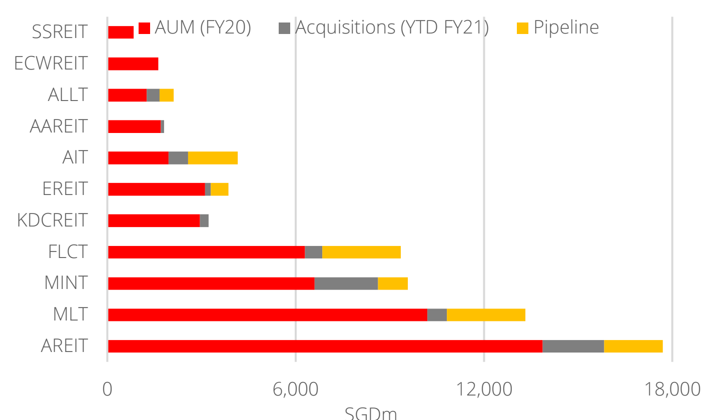
Dale Lai | Analyst
Derek Tan | Analyst

Figure 5: Industrial S-REITs exposure to new economy assets



Source: DBS

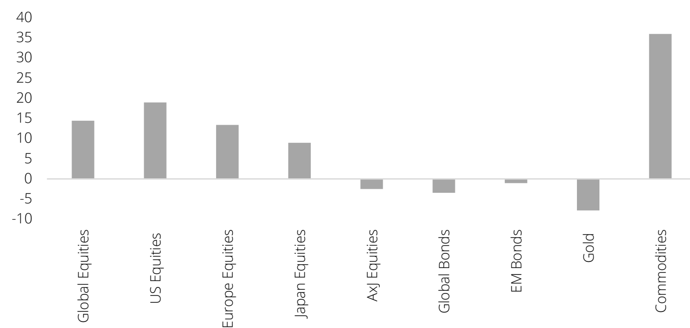
Figure 6: Estimated acquisition pipeline from sponsors



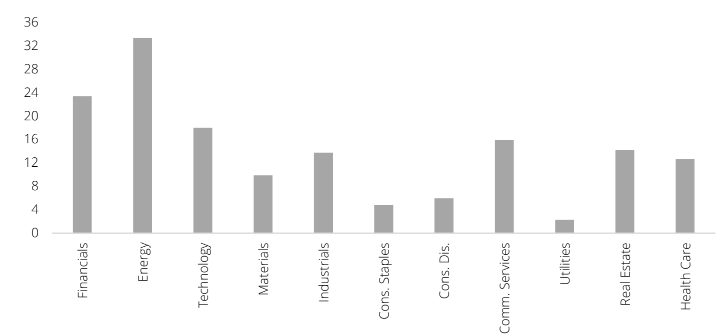
Source: DBS

CIO Markets Watch

Global Cross Assets YTD Returns

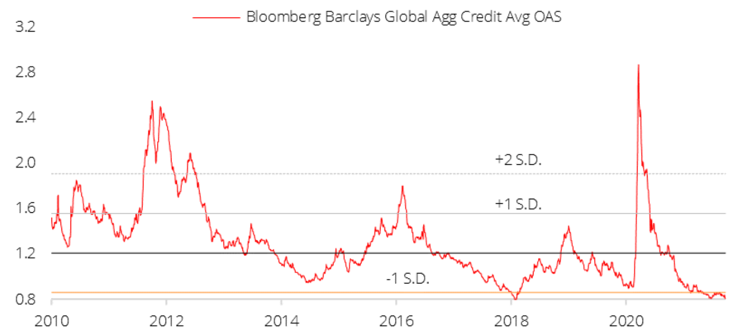


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

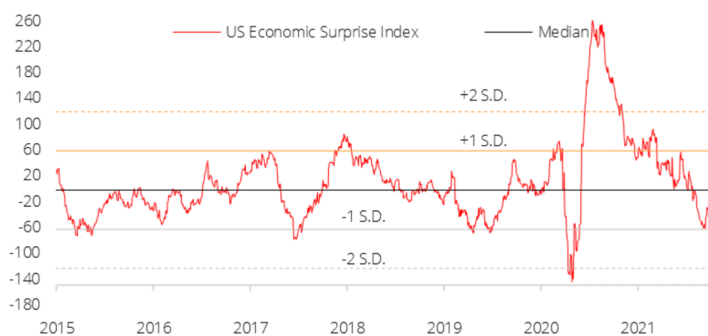
	1 week	MTD	QTD	YTD
Equities				
S&P 500	2.0%	-1.8%	3.4%	18.3%
NASDAQ	1.7%	-1.9%	3.2%	16.2%
Russell 2000	4.5%	0.3%	-1.3%	15.5%
Stoxx Europe 600	1.8%	-1.8%	2.1%	15.9%
Nikkei-225	-0.9%	7.7%	5.0%	10.2%
MSCI WORLD	1.6%	-1.5%	2.6%	15.1%
MSCI ACWI	1.5%	-1.7%	1.2%	12.8%
MSCI Asia ex-Japan	0.5%	-3.4%	-9.0%	-4.0%
MSCI EM	0.7%	-3.2%	-7.8%	-1.9%
HSCEI	-0.6%	-6.5%	-19.5%	-20.1%
SHCOMP	-0.9%	1.1%	-0.2%	3.2%
Hang Seng	0.5%	-6.5%	-16.0%	-11.1%
STI Index	1.9%	1.5%	-1.0%	9.0%
Fixed Income				
Barclays Global Aggregate	-0.8%	-1.1%	-0.2%	-3.4%
Barclays US Aggregate	-0.8%	-0.6%	0.3%	-1.3%
Barclays US High Yield	0.1%	0.3%	1.2%	4.8%
Barclays Euro Aggregate	-0.5%	-0.9%	0.2%	-2.1%
Barclays Euro High Yield	-0.1%	0.2%	0.9%	4.5%
JPM EMBI Global	-1.2%	-1.5%	0.0%	-1.0%
JPM EMBI Global Diversified	-1.3%	-1.4%	0.0%	-1.1%

PRICES & SPREADS

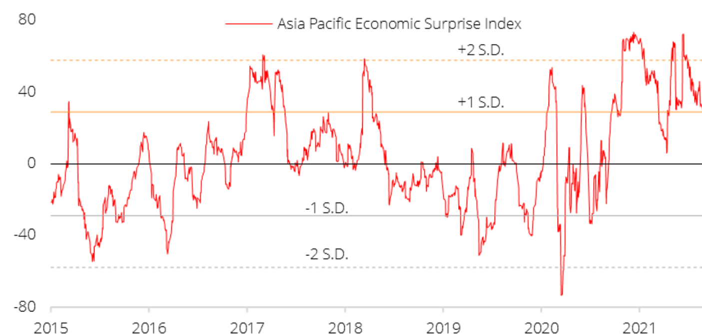
	Spot	2Q21	1Q21	4Q20
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	1.49	1.47	1.74	0.92
Japanese Govt Bond 10-yr	0.06	0.05	0.09	0.02
German Bunds 10-yr	-0.22	-0.21	-0.29	-0.57
Spreads				
US Agg Corporate Spread	0.82	0.80	0.91	0.96
US Corporate HY Spread	2.76	2.68	3.10	3.60
Euro Agg Corporate Spread	0.86	0.86	0.94	0.95
EM USD Agg Spread	2.82	2.57	2.67	2.68
Currencies				
US Dollar Index (DXY)	93.4	92.4	93.2	89.9
EUR/USD	1.17	1.19	1.17	1.22
USD/JPY	111.0	111.1	110.7	103.3
USD/CNY	6.5	6.5	6.6	6.5
Commodities				
WTI Oil	75	73	59	49
London Metal Exchange (LMEX)	4312	4152	3787	3415
TR/CC CRB Commodity	228	213	185	168
Gold	1750	1770	1708	1898

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)	30-Sep	25-Sep	330k	351k
GDP Annualised q/q (US)	30-Sep	2Q	6.60%	6.60%
ISM Manufacturing (US)	01-Oct	Sep	59.5	59.9
U. of Mich. Sentiment (US)	01-Oct	Sep	71	71
Conf. Board Consumer Confidence	28-Sep	Sep	115	113.8
MBA Mortgage Applications (US)	29-Sep	24-Sep	--	4.90%
Durable Goods Orders (US)	04-Oct	Aug	--	1.80%
Markit Eurozone Manufacturing PMI	01-Oct	Sep	58.7	58.7

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	29-Sep	Aug	-0.50%	-1.50%
Jobless Rate (JP)	30-Sep	Aug	2.90%	2.80%
Manufacturing PMI (CN)	29-Sep	Sep	50	50.1
Caixin China PMI Mfg (CN)	29-Sep	Sep	49.5	49.2
Tokyo CPI Ex-Fresh Food y/y (JP)	04-Oct	Sep	--	0.00%
Jibun Bank Japan PMI Mfg (JP)	30-Sep	Sep	--	51.2
Tankan Large Mfg Index (JP)	30-Sep	3Q	13	14
Job-To-Applicant Ratio (JP)	30-Sep	Aug	1.14	1.15

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