CIO Weekly

5 October 2021

Key Points

- **Equities:** Europe oil majors in a sweet spot between fossils and ESG investing
- **Credit:** Only Asia HY beats inflation
- **FX:** Expect the greenback to stay strong for rest of the year; CNY has scope to depreciate to 6.60 per USD in 4Q21
- **Rates:** Longer-term US rates depicting fundamentals (decent growth, elevated inflation with some Fed tightening); Reiterate 1.60% forecast for end-2021 and see fair value at 1.64%
- **Thematics:** Entering peak hotpot season in China and Hong Kong
- **The Week Ahead:** Keep a lookout for US change in nonfarm payrolls; Japan BOP Current Account balance

GLOBAL CROSS ASSETS
Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	34,002.92	-0.9%	11.1%
S&P 500	4,300.46	-1.3%	14.5%
NASDAQ	14,255.48	-2.1%	10.6%
Stoxx Europe 600	450.77	-0.5%	13.0%
DAX	15,036.55	-0.8%	9.6%
CAC 40	6,477.66	-0.6%	16.7%
FTSE 100	7,011.01	-0.2%	8.5%
MSCI AxJ	788.57	-0.8%	-6.4%
Nikkei 225	28,444.89	-1.1%	3.6%
SHCOMP	3,568.17	0.0%	2.7%
Hang Seng	24,036.37	-2.2%	-11.7%
MSCI EM	1,236.41	-0.8%	-4.2%
UST 10-yr yield*	1.48	1.2%	56.6
JGB 10-yr yield*	0.05	-11.1%	3.1
Bund 10-yr yield*	-0.22	-4.9%	35.7
US HY spread*	2.93	0.0%	-67.0
EM spread*	330.18	0.1%	7.2
WTI (USD)	77.62	2.3%	60.0%
LMEX	4,267.30	1.4%	25.0%
Gold (USD)	1,769.57	0.5%	-6.8%

Source: Bloomberg
* Changes in basis points

Equities: Europe oil majors in a sweet spot between fossils and ESG investing

Investment takeaways from the global energy crisis. The current energy crisis has highlighted the delicate trade-off between the urgent need to adjust to climate change and yet meet global energy demand for a sustainable recovery. We believe the current energy crisis is largely led by a strong post-pandemic recovery driving up pent-up demand, under-investment during the pandemic leading to supply disruption, reduced capex in fossils which could have a longer-term impact on demand-supply balance, and climate changes which are happening faster than usual. As we raise our oil price forecasts for the next few quarters, key investment takeaways from the related risks and opportunities arising from the crisis are as follow:

Expect higher oil prices to stay for the longer term. This is due to the under-investment in oil fields as a result of green initiatives and the notion that fossils are not ESG (environmental, social, and governance) friendly, leading to the oil balance tilting towards greater demand than supply in the long run.

Stay invested in Europe oil majors. Due to a hydrocarbons backlash and hostility towards the sector, price performance of Europe oil majors has not mirrored the oil price rally this year. The sector is so "unloved" as suggested by its cheap valuation trading at near its all-time high FCF yield of 9.9x. We believe the investment tone should turn more bullish towards the sector as the energy crisis could linger on through the cold winter. Investors can look forward to strong 3Q earnings and robust merger and acquisition activities, as well as next month's global climate talks and the Organization of the Petroleum Exporting Countries's move which are likely to reinforce a higher oil price outlook.

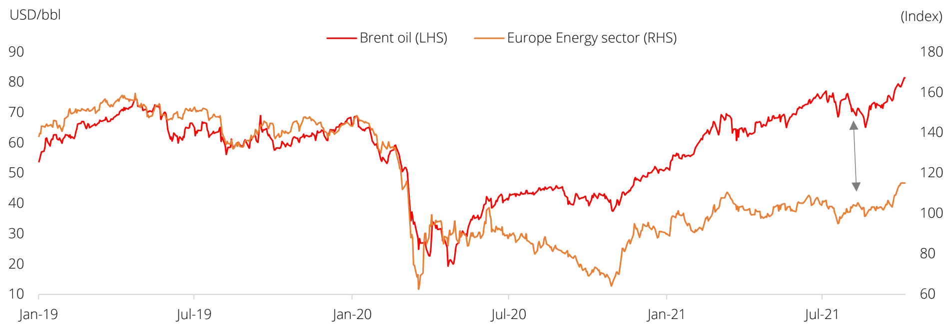
Meanwhile, on the green transition, these companies remain committed to ESG. A strategy of building out an integrated portfolio of low carbon technologies, including renewables, bioenergy, electric mobility, and early positions in innovative energy solutions such as hydrogen and carbon capture technologies, are targeted.

Capex in diversified energy sources to ramp up. There is a lack of investment in energy sources and this has to be sped up in the coming years. In particular, we see potentially more investments in nuclear power and gas pipelines, as well as green initiatives such as the electric vehicle supply chain and infrastructure.

Higher inflation on watch with central banks' tightening policies. With higher oil prices comes inflation. The debate over whether high inflation is transient will likely dominate headlines and central banks' policy decision making. With the threat of quantitative easing taper coming as soon as next month, we believe markets are set up for risk-off should rate hike talks arrive earlier than expected.

Joanne Goh | Strategist

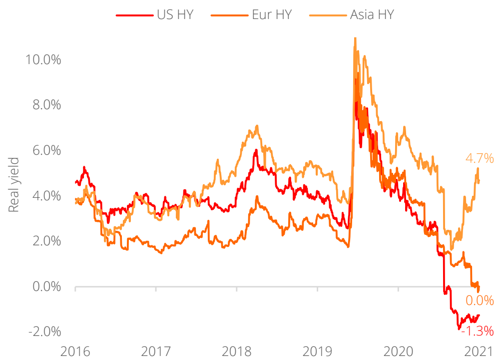
Figure 1: Europe energy sector performance to catch up with oil price rally



Source: Bloomberg, DBS

Credit: Only Asia HY beats inflation

Figure 2: Only Asia HY beats inflation



Source: Bloomberg, DBS

Supply-demand imbalances are increasingly evident with the persistence of bottlenecks across the global supply chain. The acute supply shortage is particularly observable in energy prices, currently seeing a strong surge across crude and natural gas due to a "perfect storm" of inter-related factors including (a) years of under-investment due to a prolonged bear-market cycle, (b) the push for (environmental, social, and governance) ESG-focused investment curtailing production capacity, (c) strong electrical demand leading into the cold winter months, (d) the Organization of the Petroleum Exporting Countries+ maintaining a gradual supply hike despite the shortages, and (e) world demand continuing to increase on a gradual reopening. As headline inflation is closely linked to energy prices, the continuous upside surprises to inflation prints may prove less transitory than the market expects in the months to come.

When it comes to inflation and bonds, it is imperative to pay attention to gaps in valuations that are not in line with near-term risks. At present, despite High Yield (HY) credit being almost synonymous with larger risk exposure, the yield on DM HY bonds in the US and Europe are insufficient to compensate for upside surprises in their respective regional headline CPI, leading to an unprecedented situation of negative real yields on HY credit (Figure 2). Asia HY on the other hand, remains in positive territory, which remains our basis for holding in this segment as value has emerged despite onshore regulatory tightening in China. A diversified portfolio across BBB/BB names would provide downside protection, and most importantly, defend against upside surprises in inflation that can erode the real value of an investor's portfolio.

Daryl Ho | Strategist

FX: US-China in focus, as are RBA and RBNZ

Figure 3: Scope to depreciate

Source: Bloomberg, DBS

CNY has scope to depreciate to 6.60 per USD in 4Q21. On the final day of 3Q21, China's State Administration of Foreign Exchange (SAFE) warned companies in China to hedge their foreign exchange exposures. CNY averaged 6.47 inside a 6.35-6.58 trading range this year. As of last Friday, CNY appreciated 1.3% year-to-date despite broad-based USD strength this year. In the first half of this year, the capital and financial accounts deficit was four times larger than the trade surplus from the clampdowns in its private sector. Sentiment in the third quarter has been dragged by the ongoing Evergrande debt crisis, a spike in infections in the Fujian province, and power shortages that shut factories. After an 18.3% y/y peak in 1Q21, real gross domestic product growth slowed to 7.9% in 2Q, with consensus looking for more deceleration to 5.3% in 3Q and 4.5% in 4Q.

We expect the greenback to stay strong for the rest of the year. Expectations are high for the Fed to start tapering asset purchases at its FOMC meeting on 3 November. At a panel discussion today, St Louis Fed President James Bullard is likely to support completing the taper by mid-2022 and bringing forward the rate hike into late 2022. Tomorrow, European Central Bank (ECB) President Christine Lagarde might reaffirm the market expectations for the ECB to hike after the Fed in 1H23. On Thursday, Cleveland Fed President Loretta Mester and ECB chief economist Philip Lane will discuss why high inflation is stickier in the US compared to the Eurozone. Not surprisingly, Commodity Futures Trading Commission data for the week ended 28 September showed that speculators accumulated more net long USD positions and gave up almost all net long EUR positions despite the big miss in US nonfarm payrolls a month ago. This Friday, consensus expects payrolls to increase from 235k in August to 470k in September.

Pay close attention to US-China tensions. Today, US Trade Representative Katherine Tai will unveil the Biden administration's "top-to-bottom review" of its trade strategy with China, who will be away for the Golden Week holiday until Thursday.

According to CNBC, Tai will take China to task for falling short of its commitment under the Phase 1 trade deal that expires at the end of 2021. In May, Tai told Congress that the US needed new tools (eg., updating the US's old trade laws) to head off competition from China, eg. the latter's state subsidies for its high-tech sector. Tai had pledged to level the playing field if China did not adapt to international rules and norms.

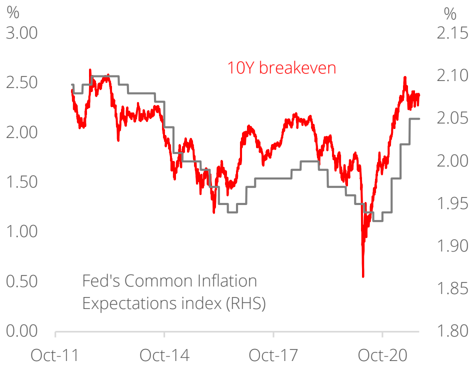
AUD has appreciated from its 0.7170 low last Thursday but 0.73 remains a significant hurdle. Last Friday, Prime Minister Scott Morrison announced that Australians would be allowed to travel overseas from November after an 18-month ban. At its monetary policy meeting tomorrow, the Reserve Bank of Australia (RBA) will likely maintain its "cup half full" outlook for the Australian economy but refrain from rate hikes until 2024. According to a Reuters poll, the RBA will also lag the Fed in ending its bond buying programme in September next year.

NZD to hold below 0.70. At its meeting on 6 October, the Reserve Bank of New Zealand (RBNZ) is expected to lift its official cash rate by 25 bps to 0.50%, the hike that did not materialize in August. However, the RBNZ is not expected to follow through with a second hike in November. Today, Prime Minister Jacinda Ardern is likely to keep Auckland under a Covid-19 level 3 alert after the Waikato region was returned to level 3 on Sunday. Ardern pledged to end lockdowns only after 90% of the population were vaccinated. As of 30 September, 67.8% received at least one dose of the vaccine.

Philip Wee | FX Strategist

Rates: No panic on inflation… yet

Figure 4: Survey vs market-based inflation expectations



Source: Bloomberg, DBS

Longer-term US rates are depicting fundamentals (decent growth, elevated inflation with some Fed tightening), judging by market-based indicators, including inflation expectations. Inflation expectations are generally captured in two ways – inflation breakevens and surveys. We note that 10Y inflation breakeven (at 2.39%) is still below the 2.6% peak registered earlier this year. By contrast, the Federal Reserve's common inflation expectations index (which takes into account survey-based indicators) have pushed above 2%, reaching levels not seen since 2014. We think that breakevens will continue to lead survey-based measures. This has been the case for large periods over the past ten years. As long as breakevens stay around recent levels, it would indicate that while inflation is likely to be elevated, expectations have not come unanchored.

The market's pricing of term premium and Fed tightening is probably just a paring of the summer doldrums where the rates space got too pessimistic. The overall growth outlook for the global economy is decent with some downside risks from China. Meanwhile, the inflation outlook appears to be broadly stable, with some risks that expectations could come unhinged (possible if energy prices keep climbing). Our overall strategy for USD rates has not changed. We remain in the pay-on-dips camp, seeing a clear upward bias for rates. We reiterate our 1.60% end-2021 forecast and see fair value at 1.64%. Risks are slightly tilted to the upside as we await how the Chinese economy and global inflation pressures play out.

Eugene Leow | Rates Strategist

Thematics: Entering peak hotpot season in China & HK

- We see room for China and Hong Kong hotpot operators' table turnover to catch up to normal levels seen in 2019
- Rising vaccination rates and upcoming peak season could enable better same-store performance
- We see more reasonable valuations emerging in the sector

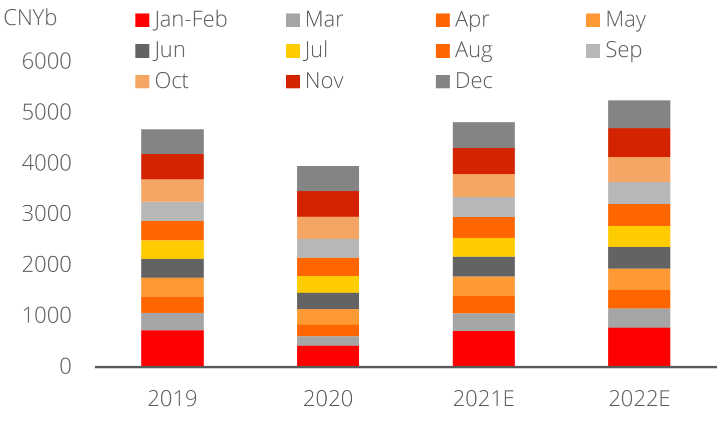
Improving table turnover and overall operations. China and Hong Kong hotpot operators' table turnover remains impacted by the Covid-19 resurgence in Mainland China, and remains below 2019 levels. But rising vaccination rates plus the upcoming peak season, where five to six months in 2H account for the bulk of earnings, should beef up performance. We expect XiabuXiabu (XBXB) (520 HK) and Haidilao (6862 HK) to deliver store unit expansion of 3% and 17% in 2020-22E, to 1,271 units and 2,098 units, respectively.

Room for margin enhancement. Following the disappointing 1H21 results, the market significantly revised down expectations, especially on store counts and near-term operations. Cost management would likely be tightened further to carefully raise store productivity and overall profitability. We expect the operating margin for major players to expand by around 1-2 %pts in 2021-2022E.

Opportunity to dip in. With share prices retreating by 60-70% since the peak in February 2021, DBS Group Research believes the current share price presents an opportunity to gain exposure to the hotpot operators like Haidilao and XBXB, particularly amid the peak seasonality in 2H21. Current valuation has become under-rated, with Haidilao now trading at 50x, which is more than 1 standard deviation (SD) below its average since listing, and XBXB at 15x, equivalent to 1.5SD below its four-year average.

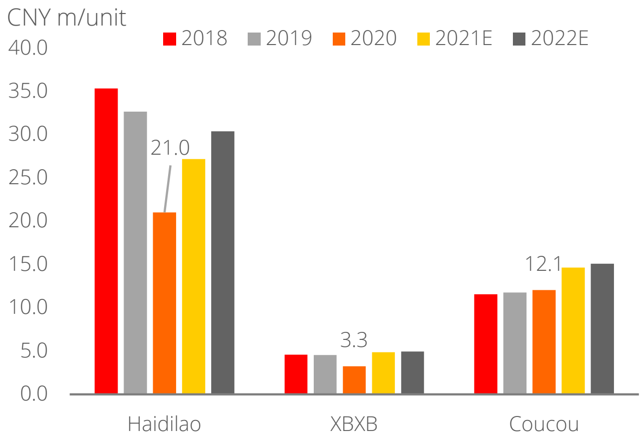
Alison Fok | Analyst
Mavis Hui | Analyst
Alice Hui | Analyst

Figure 5: China catering sales



Source: CEIC, DBS

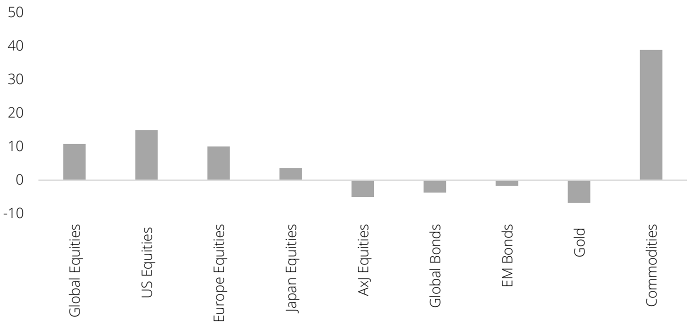
Figure 6: Sales per unit to reflect gradual recovery



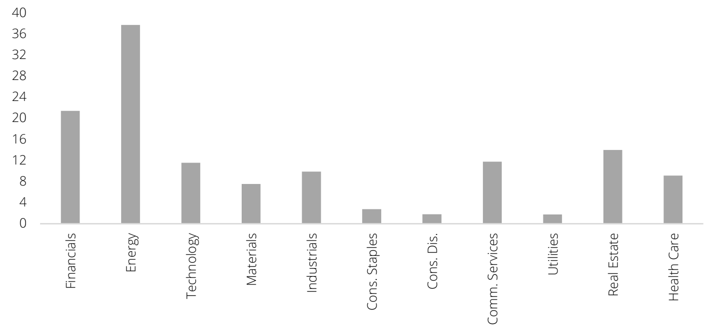
Source: Company data, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

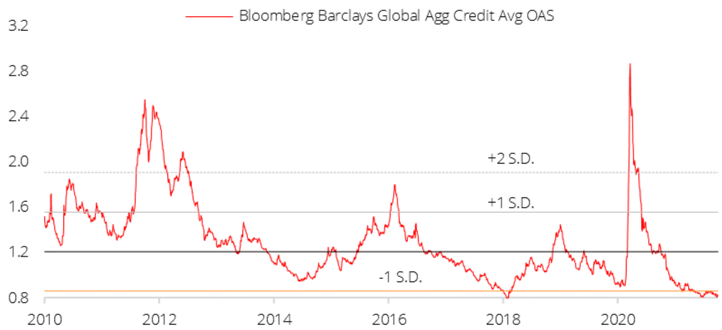


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

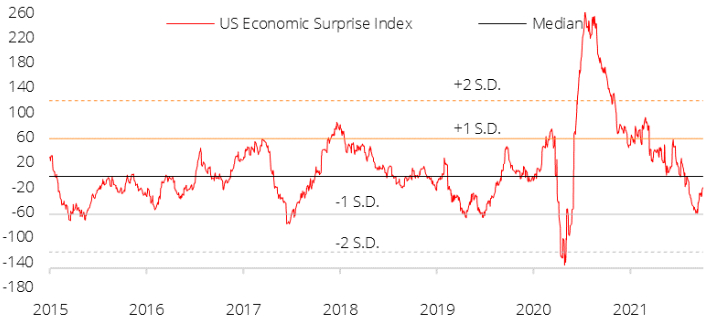
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-3.2%	-0.2%	-0.2%	14.5%
NASDAQ	-4.8%	-1.3%	-1.3%	10.6%
Russell 2000	-2.8%	0.6%	0.6%	12.3%
Stoxx Europe 600	-2.5%	-0.9%	-0.9%	13.0%
Nikkei-225	-5.9%	-3.4%	-3.4%	3.6%
MSCI WORLD	-3.3%	-0.5%	-0.5%	11.3%
MSCI ACWI	-3.2%	-0.6%	-0.6%	9.2%
MSCI Asia ex-Japan	-2.6%	-1.6%	-1.6%	-6.4%
MSCI EM	-2.4%	-1.3%	-1.3%	-4.2%
HSCEI	-0.7%	-2.4%	-2.4%	-20.6%
SHCOMP	-0.4%	0.0%	0.0%	2.7%
Hang Seng	-0.7%	-2.2%	-2.2%	-11.7%
STI Index	-0.3%	0.1%	0.1%	8.6%
Fixed Income				
Barclays Global Aggregate	-0.3%	0.4%	0.4%	-3.7%
Barclays US Aggregate	-0.1%	0.2%	0.2%	-1.4%
Barclays US High Yield	-0.3%	-0.1%	-0.1%	4.5%
Barclays Euro Aggregate	-0.1%	0.1%	0.1%	-2.2%
Barclays Euro High Yield	-0.4%	0.0%	0.0%	4.2%
JPM EMBI Global	-0.7%	-0.2%	-0.2%	-1.7%
JPM EMBI Global Diversified	-1.0%	-0.1%	-0.1%	-2.1%

PRICES & SPREADS

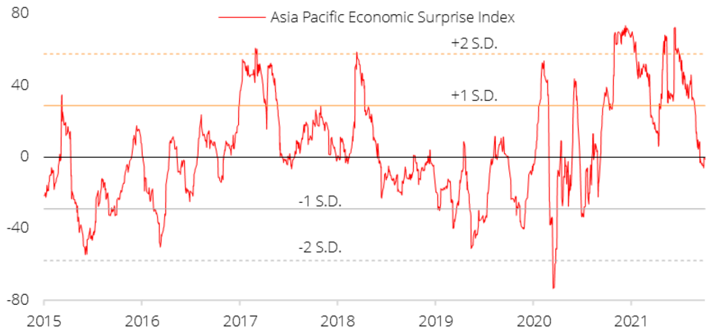
	Spot	2Q21	1Q21	4Q20
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	1.48	1.47	1.74	0.92
Japanese Govt Bond 10-yr	0.05	0.05	0.09	0.02
German Bunds 10-yr	-0.22	-0.21	-0.29	-0.57
Spreads				
US Agg Corporate Spread	0.85	0.80	0.91	0.96
US Corporate HY Spread	2.93	2.68	3.10	3.60
Euro Agg Corporate Spread	0.88	0.86	0.94	0.95
EM USD Agg Spread	2.84	2.57	2.67	2.68
Currencies				
US Dollar Index (DXY)	93.8	92.4	93.2	89.9
EUR/USD	1.16	1.19	1.17	1.22
USD/JPY	110.9	111.1	110.7	103.3
USD/CNY	6.4	6.5	6.6	6.5
Commodities				
WTI Oil	78	73	59	49
London Metal Exchange (LMEX)	4267	4152	3787	3415
TR/CC CRB Commodity	233	213	185	168
Gold	1770	1770	1708	1898

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-Oct	Sep	488k	235k
Initial Jobless Claims (US)	07-Oct	02-Oct	349k	362k
MBA Mortgage Applications (US)	06-Oct	01-Oct	--	-1.10%
Unemployment Rate (US)	08-Oct	Sep	5.10%	5.20%
ADP Employment Change (US)	06-Oct	Sep	430k	374k
Trade Balance (US)	05-Oct	Aug	-$70.8b	-$70.1b
Wholesale Inventories m/m (US)	08-Oct	Aug	1.20%	1.20%
ISM Services Index (US)	05-Oct	Sep	59.9	61.7

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
BoP Current Account Balance (JP)	07-Oct	Aug	¥1473.6b	¥1910.8b
PPI y/y (JP)	11-Oct	Sep	--	5.50%
GDP y/y (SG)	06-Oct	3Q	6.70%	14.70%
Retail Sales y/y (SG)	05-Oct	Aug	-0.10%	0.20%
Money Supply M2 y/y (CN)	08-Oct	Sep	8.20%	8.20%
New Yuan Loans CNY (CN)	08-Oct	Sep	1800.0b	1220.0b
Machine Tool Orders y/y (JP)	11-Oct	Sep	--	85.20%
Caixin China PMI Services (CN)	07-Oct	Sep	49.2	46.7