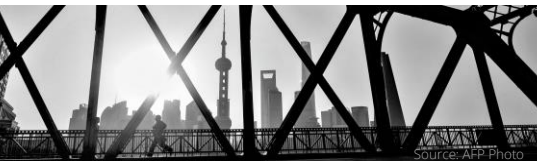


CIO Weekly

23 November 2021

Equities: EV theme surging ahead; major growth contributor for our I.D.E.A. investment framework

Key Points

- **Equities:** EV theme surging ahead; major contributor for I.D.E.A. framework
- **Credit:** ESG framework augments credit portfolios
- **FX:** DXY appreciated 0.5% to 96.5 on Powell's re-nomination; EUR found support level near 1.12
- **Rates:** Re-nomination of Powell for second term as Fed Chair drove UST yields higher as uncertainties are lifted
- **Thematics:** Pricing power in China F&B
- **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	35,619.25	0.0%	16.4%
S&P 500	4,682.94	-0.3%	24.7%
NASDAQ	15,854.76	-1.3%	23.0%
Stoxx Europe 600	485.46	-0.1%	21.7%
DAX	16,115.69	-0.3%	17.5%
CAC 40	7,105.00	-0.1%	28.0%
FTSE 100	7,255.46	0.4%	12.3%
MSCI AxJ	816.57	-0.1%	-3.1%
Nikkei 225	29,774.11	0.1%	8.5%
SHCOMP	3,582.08	0.6%	3.1%
Hang Seng	24,951.34	-0.4%	-8.4%
MSCI EM	1,261.56	-0.6%	-2.3%
UST 10-yr yield*	1.62	5.0%	71.0
JGB 10-yr yield*	0.07	-5.3%	5.4
Bund 10-yr yield*	-0.30	-11.9%	26.9
US HY spread*	2.95	-2.0%	-65.0
EM spread*	322.28	-1.1%	-0.7
WTI (USD)	76.75	0.9%	58.2%
LMEX	4,444.10	1.0%	30.2%
Gold (USD)	1,804.65	-2.2%	-4.9%

Source: Bloomberg
* Changes in basis points

Biggest year for EVs yet as demand surges. The DBS Chief Investment Office introduced Electric Vehicles (EVs) as a new investment theme in June 2021 and the call has panned out as expected. According to EV volumes, global EV sales in the first 6 months of 2021 are up 168% y/y, with Europe, China, and the US leading the way (+157%, +197%, and +166% respectively). 2021 is set to be a record year for the industry as the strong momentum continues and industry sales is estimated at 6.4m units (this constitutes a 98% y/y increase).

The future of the automobile industry is electric – investors' appetites for EV companies are skyrocketing. Every automaker has announced plans to launch electric models, with some even setting timelines on when they would go full electric. For instance, in October 2021, car rental giant Hertz (HTZ US) jumped in the EV game with an order of 100,000 Tesla (TSLA US) to join their fleet. More recently, in November 2021, EV maker Rivian (RIVN US) listed at USD70b valuation after having delivered 156 cars (mostly to employees). In contrast, Tesla's initial public offering in 2010 was merely USD1.7b, despite delivering 1,500 cars. This suggests that market appetite for the EV space has grown massively over the decade and investors are willing to assign higher valuation multiples for EV companies.

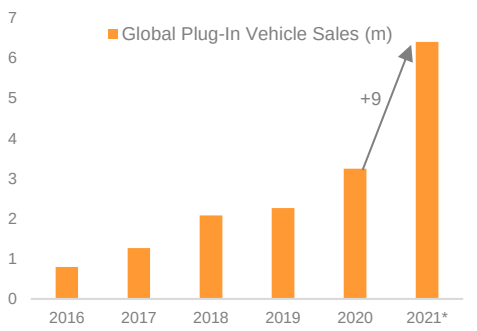
Changing consumer preferences – EVs becoming the preferred choice. In late August, AlixPartners launched a worldwide survey which concluded that 1 in 4 respondents are "Very Likely" to buy an EV as their next car. This represents a doubling of the number of respondents that are likely to buy an EV over the past 2 years. Meanwhile, policymakers are cognisant of this change and are adapting policy to match the demand.

In the US, for instance, President Joe Biden has signed a USD1t Infrastructure bill that would focus on fixing issues in transportation, broadband, and utilities. Included in the bill is USD7.5b allocated to build EV charging infrastructure, and another USD7.5b to be spent on zero-emission buses and ferries.

Robust demand for EVs translating to outperformance EV-related equities. Since our initiation of the EV theme, the Bloomberg Electric Vehicle Index has outperformed the S&P 500 Index by 14%pts. The EV theme sits within our I.D.E.A. framework (Innovators, Disruptors, Enablers, and Adapters), with most EV-related companies falling within the Disruptors and Adapters categories.

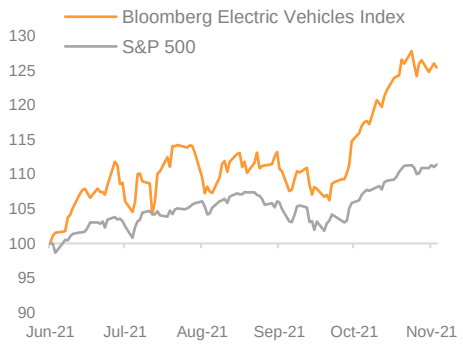
Benjamin Goh | Analyst

Figure 1: Record breaking year for EV sales



Source: EV Volumes, DBS

Figure 2: Strong outperformance for EV

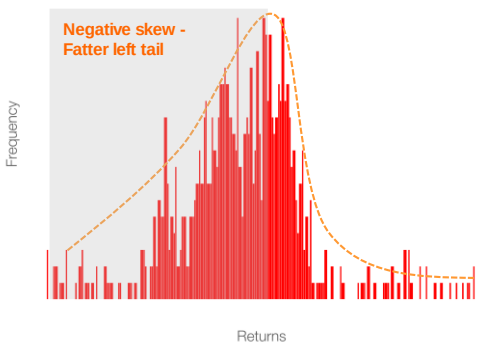


Source: Bloomberg, DBS

DBS

Credit: ESG framework augments credit portfolios

Figure 2: Skew of credit returns begets robust risk analysis



Source: Bloomberg, DBS

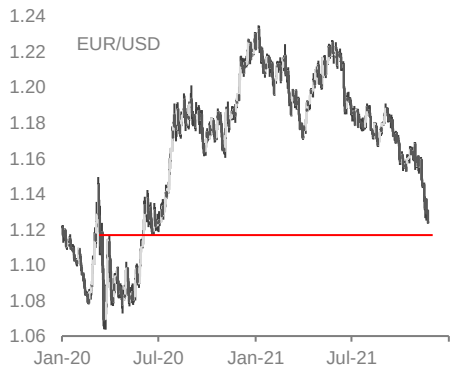
The demand for income-generating assets sees a reach for higher risk in credit as risk-free assets around the world give mediocre, and in some cases, negative returns. However, therein lies a catch. Unlike equities, which generally sees returns follow a normal distribution, credit return distributions have a negative skew – resulting in a fatter left tail (Figure 2). Intuitively, this is because of an asymmetrical likelihood of outcomes, investors holding bonds to maturity face downgrade/default risk, which sees larger swings on the downside, but they are capped by the coupon yield and thus limited on the upside. In other words, a credit investor is better off avoiding losers than picking winners.

This negative skew begets a more multi-dimensional risk analysis framework that extends beyond credit fundamentals. This is why environmental, social, and governance (ESG) integration makes sense for credit portfolios. ESG metrics by nature are designed to measure unconventional risk exposure in companies (environmental irresponsibility, unsafe workplace practices, product impact, social capital risk etc.), which serves to mitigate exposure to the left tail scenarios that can be detrimental to credit returns. We believe that the adoption of ESG integration into credit analysis would as such prove to be a long-term benefit to credit portfolio Sharpe ratios, and investors would do well to incorporate the theme of sustainability into their future investment decisions.

Daryl Ho | Strategist

FX: "Powell rally" in DXY might be fleeting

Figure 3: EUR has a support level near 1.12



Source: Bloomberg, DBS

DXY appreciated 0.5% to 96.5 on US President Joe Biden's long-awaited decision to renominate Jerome Powell as the Federal Reserve Chair. Lael Brainard, who was considered more dovish, was appointed as Fed Vice Chair instead. Overall, the announcements sent US 10-year treasury yields up 7.7 bps to 1.624% and the S&P 500 Index and Nasdaq Composite Index down by 0.3% and 1.3% respectively for one simple reason. Last week ended with Fed Vice Chair Richard Clarida expecting more discussions on whether step up the pace of tapering asset purchases at the Federal Open Market Committee (FOMC) meeting on 15 December.

However, Brainard will replace Clarida when his term ends on 31 January 2022. Powell's comments that the Fed has met the criteria for the taper and not rate hike are likely to show up in tomorrow's FOMC minutes. **The Fed's favourite inflation gauge might disappoint tomorrow**. Consensus expects the PCE deflator to rise to 5.1% y/y in October from 4.4% in September, like CPI inflation did to 6.2% from 5.4%. However, the PCE deflator has not risen as quickly as CPI since May. Today, President Biden will also follow up with discussions on the US economy and his priority to contain inflation. **A decision to release oil from the Strategic Petroleum Reserves is possible** before Biden heads to Nantucket, Massachusetts, for the Thanksgiving weekend.

Hence, **we remain wary of profit-taking ahead of the long weekend**, especially after a move of 3 big figures (i.e., from 93.5 to 96.5) in the DXY within a short period of time. While the resurgence of Covid infections in Europe lifted USD via a weaker EUR, it also dampened risk appetite in stock markets. After having depreciated almost 4% to 1.1237 in the past three weeks, EUR will be running up against an important support level around 1.1170.

Philip Wee | FX Strategist

Rates: Powell re-nominated for second term as Fed Chair

Figure 4: Uptrend intact

Source: Bloomberg, DBS

President Biden re-nominated Jerome Powell for a second term as Fed Chair, resolving one of the lingering uncertainties for the year. Market participants were dealing with uncertainties amid speculation that Lael Brainard could take the position. Brainard has instead been selected for the Vice Chair. The market reaction to this news was along expected lines. US Treasury yields rose as uncertainties got lifted. More Fed hikes also got priced into the belly of the curve as the market removed the possibility of an even more dovish Fed. Close to three hikes are now being factored into 2022. However, the equities space was mixed as the sharp spike in yields caused a tumble in the Nasdaq.

The key theme over the coming quarters would be policy normalisation and there is arguably greater clarity under Powell. He turned incrementally hawkish since June's FOMC meeting and kicked off taper in November. Upcoming minutes would likely show that policy flexibility has been kept, providing leeway for accelerated taper if needed. Moreover, we think that there is a reasonable chance that the Fed would allow the balance sheet to shrink shortly after taper ends. As a gauge, the Fed funds rate upper bound was at 1.75% pre-crisis. While growth and inflation have surged, the employment mandate has not quite been met. Accordingly, the market is only factoring in partial normalisation out to 2023 (Fed funds rate upper bound of 1.5%). We expect 10Y yields to climb towards 2% in 2022. Our overall rates outlook for 2022 can be found on DBS Insights Direct.

Eugene Leow | Rates Strategist

Thematics: China F&B Sector – which brands have pricing power?

- Margin pressure lingers for China's F&B sector, yet this could ease for most sub-segments by mid-2022
- Based on our sensitivity analysis, noodles and dairies should see manageable impact from material cost fluctuations
- We favour picks with ability to pass on costs to consumers

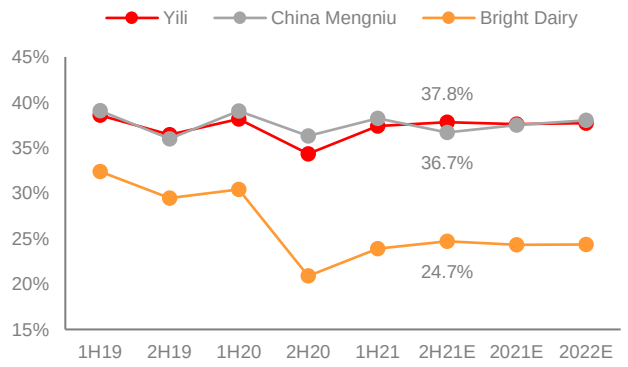
Commodity cost pressure to lessen starting mid-2022. We believe the rise in agricultural commodity prices in China should begin to moderate by mid-2022, after seeing double-digit growth in 2021F driven by demand-based inflation. The rate of inflation in G-20 countries should subside with supply constraints expected to gradually fade, while wage increases should moderate. The DBS house view is that inflation should stay benign at 2.5% p.a. in FY21-22F. We project raw milk prices to grow at slower pace in FY22F, live hog prices to recover on a m-o-m basis, and we think palm oil price pressure could fade in 2H22. Meanwhile, concerns about adverse weather changes and additional Covid outbreaks remain.

Our sensitivity analysis shows selected companies' earnings are more resilient under cost pressure. Despite cost hike concerns, we found that prices of dairies, instant noodles, and condiments have been adjusted in the face of increases in raw material prices year-to-date. These segments managed to pass on costs to customers, with dairy makers still expanding their operating margins. We conducted a sensitivity analysis to assess the potential impact that rising costs of key commodity items would have on the companies we cover. Within the dairy supply chain, margin impact on the downstream players will be less severe than that on the upstream players.

Prefer segments with better ability to pass on costs. DBS Group Research is positive on companies that have higher pricing power, as well as sectors with higher market concentration. Within the dairy sector, companies like China Mengniu (2319 HK) and Yili (600887 CH) can partly offset the impact of higher material prices through product mix adjustment. Tingyi (322 HK) also has room to raise pricing due to boosted demand from Covid-19 resurgence.

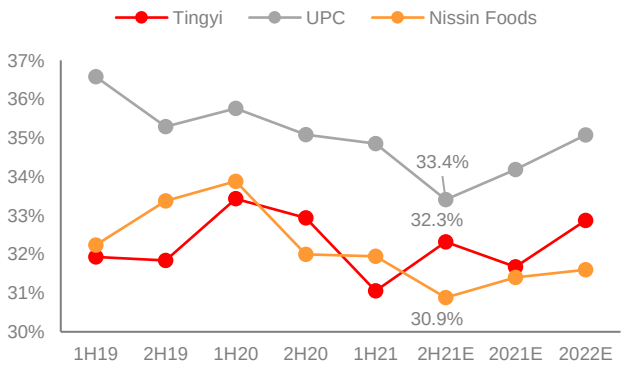
Alison FOK | Analyst Alice HUI | Analyst
Mavis HUI | Analyst

Figure 5: Dairy – Gross profit margin stabilising into 2022E



Source: Company, DBS HK estimates

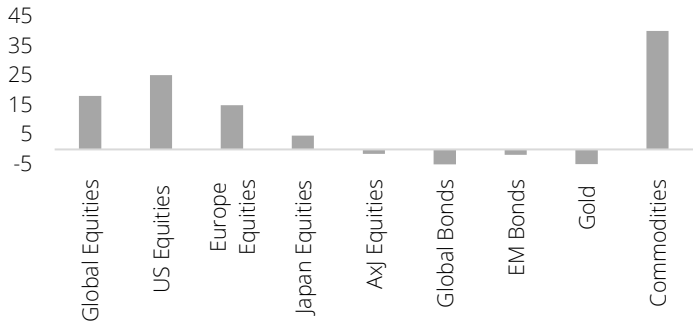
Figure 6: Packaged foods – Gross profit margin to bottom out in 2H21



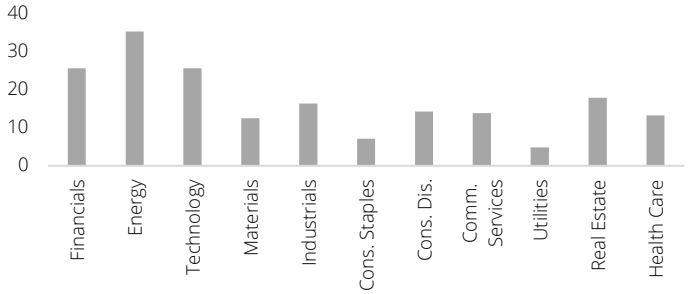
Source: Company, DBS HK estimates

CIO Markets Watch

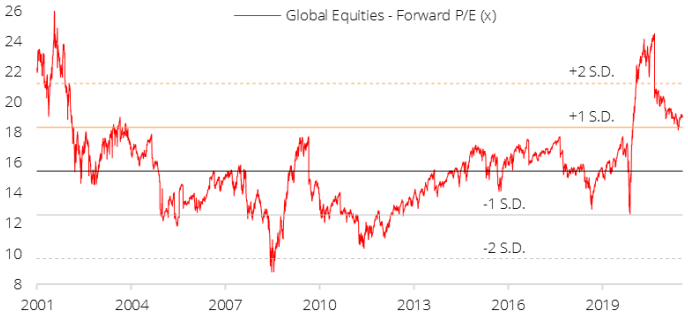
Global Cross Assets YTD Returns



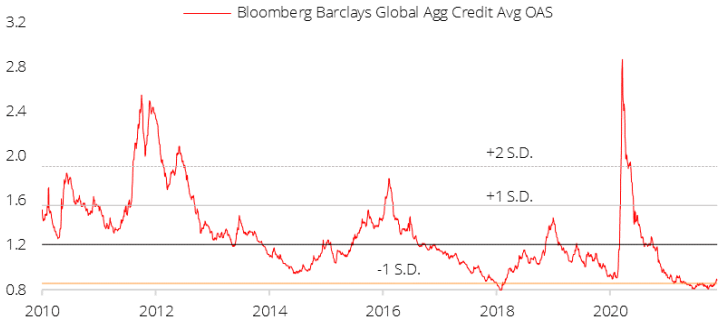
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



INDEX RETURNS

	1 week	MTD	QTD	YTD
Equities				
S&P 500	0.0%	1.7%	8.7%	24.7%
NASDAQ	0.0%	2.3%	9.7%	23.0%
Russell 2000	-2.9%	1.5%	5.8%	18.1%
Stoxx Europe 600	-0.6%	2.1%	6.7%	21.7%
Nikkei-225	0.0%	3.1%	1.1%	8.5%
MSCI WORLD	-0.8%	0.8%	6.5%	19.0%
MSCI ACWI	-0.9%	0.7%	5.8%	16.1%
MSCI Asia ex-Japan	-1.0%	0.6%	1.9%	-3.1%
MSCI EM	-2.0%	-0.3%	0.7%	-2.3%
HSCEI	-1.7%	-0.4%	2.3%	-16.8%
SHCOMP	1.4%	1.0%	0.4%	3.1%
Hang Seng	-1.7%	-1.7%	1.5%	-8.4%
STI Index	-0.1%	1.2%	4.9%	13.8%
Fixed Income				
Barclays Global Aggregate	-0.5%	-0.8%	-1.1%	-5.1%
Barclays US Aggregate	0.0%	-0.5%	-0.5%	-2.0%
Barclays US High Yield	-0.3%	-0.1%	-0.3%	4.2%
Barclays Euro Aggregate	0.2%	1.2%	0.5%	-1.7%
Barclays Euro High Yield	0.1%	0.4%	0.0%	4.2%
JPM EMBI Global	-0.5%	-0.4%	-0.3%	-1.9%
JPM EMBI Global Diversified	-0.4%	-0.2%	-0.2%	-2.2%

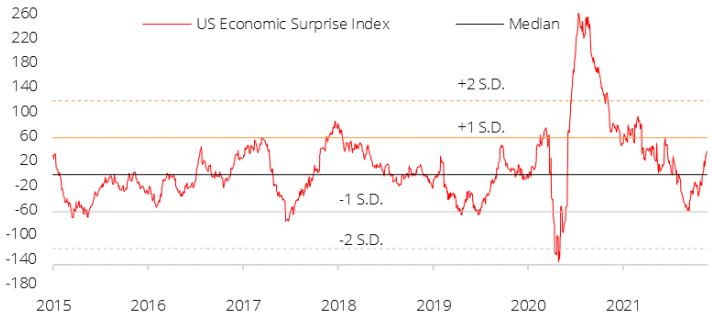
PRICES & SPREADS

	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	1.63	1.49	1.47	0.92
Japanese Govt Bond 10-yr	0.07	0.07	0.05	0.02
German Bunds 10-yr	-0.30	-0.20	-0.21	-0.57
Spreads				
US Agg Corporate Spread	0.91	0.84	0.80	0.96
US Corporate HY Spread	2.95	2.89	2.68	3.60
Euro Agg Corporate Spread	0.99	0.87	0.86	0.95
EM USD Agg Spread	2.92	2.87	2.57	2.68
Currencies				
US Dollar Index (DXY)	96.5	94.2	92.4	89.9
EUR/USD	1.12	1.16	1.19	1.22
USD/JPY	114.9	111.3	111.1	103.3
USD/CNY	6.4	6.4	6.5	6.5
Commodities				
WTI Oil	77	75	73	49
London Metal Exchange (LMEX)	4444	4161	4152	3415
TR/CC CRB Commodity	235	229	213	168
Gold	1805	1757	1770	1898

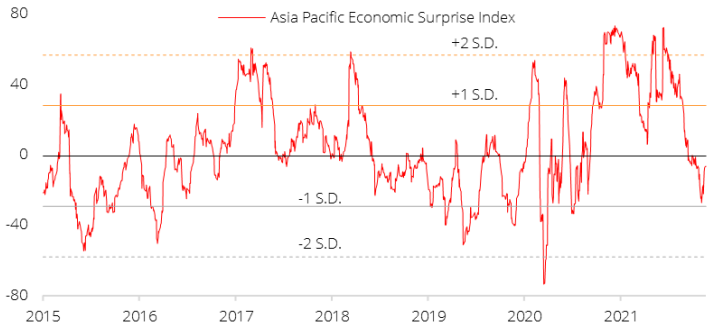
DBS

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)	24-Nov	20-Nov	260k	268k
GDP Annualized q/q (US)	24-Nov	3Q	2.20%	2.00%
U. of Mich. Sentiment (US)	24-Nov	Nov	66.9	66.8
MBA Mortgage Applications (US)	24-Nov	19-Nov	--	-2.80%
Durable Goods Orders (US)	24-Nov	Oct	0.20%	-0.30%
New Home Sales (US)	24-Nov	Oct	800k	800k
Markit Eurozone Manufacturing PMI (EU)	23-Nov	Nov	57.4	58.3
Markit US Manufacturing PMI (US)	23-Nov	Nov	59.1	58.4

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	29-Nov	Oct	--	-5.40%
Jobless Rate (JP)	29-Nov	Oct	--	2.80%
CPI y/y (SG)	23-Nov	Oct	2.80%	2.50%
Manufacturing PMI (CN)	29-Nov	Nov	--	49.2
Tokyo CPI Ex-Fresh Food y/y (JP)	25-Nov	Nov	0.30%	0.10%
GDP y/y (SG)	23-Nov	3Q	6.50%	6.50%
Jibun Bank Japan PMI Mfg (JP)	23-Nov	Nov	--	53.2
Job-To-Applicant Ratio (JP)	29-Nov	Oct	--	1.16

DBS