

CIO Weekly

11 January 2022

Key Points

- **Equities:** Health care sector offers investors attractive returns, driven by consistent earnings growth and compelling valuations
- **Credit:** Focus on sectoral winners of inflation
- **FX:** Rising bond yields drove selloff in commodity and European currencies as investors sought safety in JPY and the greenback
- **Rates:** Accelerated taper, rate hikes, and potential quantitative tightening driving USD rates higher
- **Thematics:** Singapore REITs – Reopening theme remains in focus
- **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	36,068.87	-0.4%	-0.7%
S&P 500	4,670.29	-0.1%	-2.0%
NASDAQ	14,942.83	0.0%	-4.5%
Stoxx Europe 600	479.04	-1.5%	-1.8%
DAX	15,768.27	-1.1%	-0.7%
CAC 40	7,115.77	-1.4%	-0.5%
FTSE 100	7,445.25	-0.5%	0.8%
MSCI Axj	789.73	0.6%	0.1%
Nikkei 225	28,478.56	0.0%	-1.1%
SHCOMP	3,593.52	0.4%	-1.3%
Hang Seng	23,746.54	1.1%	1.5%
MSCI EM	1,232.27	0.5%	0.0%
UST 10-yr yield*	1.76	-0.1%	25.0
JGB 10-yr yield*	0.14	0.0%	7.1
Bund 10-yr yield*	-0.04	-20.0%	14.6
US HY spread*	3.02	1.3%	19.0
EM spread*	336.92	1.8%	6.7
WTI (USD)	78.23	-0.8%	4.0%
LMEX	4,524.00	0.0%	0.5%
Gold (USD)	1,801.68	0.3%	-1.5%

Source: Bloomberg

* Changes in basis points

Equities: Health Care – resilient earnings quality

As the saying goes, health is wealth. With ageing populations across the world, this is only becoming more relevant. The health care sector, which accounts for 11-12% of the global benchmark, demonstrates stable and secular growth characteristics. Covid-19 has certainly shone a spotlight on this sector. Thanks to the gargantuan efforts of pharmaceutical companies, governments, and benefactors worldwide, vaccines were successfully developed at an unprecedented pace.

With its strong long-term fundamentals, the sector has delivered solid earnings and share price performance since the start of the last decade. At the same time, the sector exhibits defensive qualities.

Structural tailwinds behind the sector include:

1. Ageing populations and longer lifespan giving rise to increasing needs for medical products and services.
2. Rising disposable income and greater spending on medical expenditure.
3. Continuous R&D leading to medical & technological advances that expands the total addressable market (TAM) for new and existing diseases.

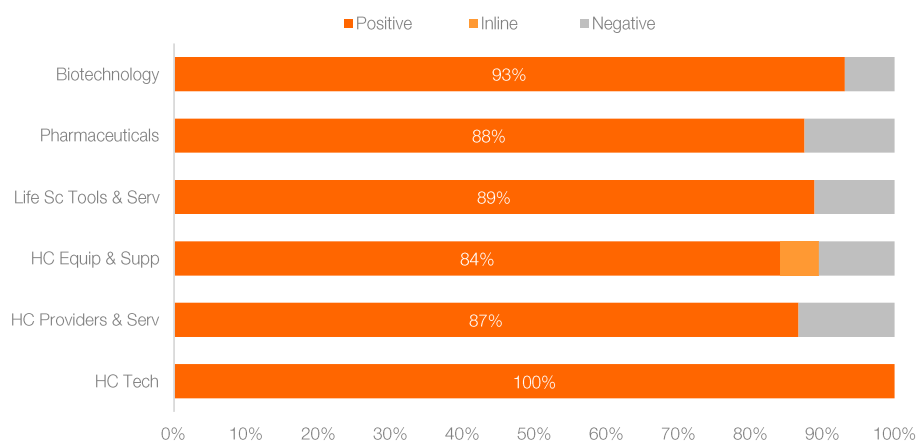
Fundamental drivers for the investment catalysts in this important industry include rising demand for medical procedures, new drug launches, awareness of service-based solutions, and the emergence of diagnostic services.

Biotech and pharmaceutical firms are seeing strong pipelines in drug development. The successes in rolling out drugs to the market with attractive monetisation prospects literally give health care firms streams of stable and recurrent revenue and pricing power. In the latest quarterly earnings results, more than 85% of the firms delivered positive earnings surprises. This is in line with the trend since 2013, where consistently, more than 70% of the sector has delivered positive earnings surprises.

Health care is among the core themes in the CIO Barbell and I.D.E.A. strategies. We are constructive on this sector and expect it to continue rewarding investors with attractive returns driven by stable earnings growth on compelling valuations. Within health care, the sub-sectors we like include pharmaceuticals, life science services, and medical devices.

Yeang Cheng Ling | Strategist

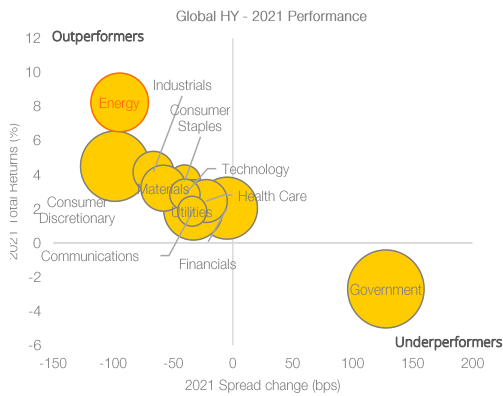
Figure 1: A sector that delivers positive earnings surprises (latest quarter)



Source: Bloomberg, DBS

Credit: Focus on sectoral winners of inflation

Figure 2: Inflation-sensitive sectors outperformed in 2021



Source: Bloomberg, DBS

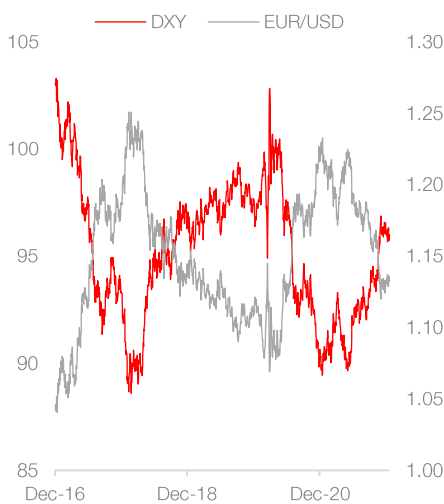
With inflation prints in recent months hitting decade-high levels, it appears that inflation is stickier than initially anticipated. In the current inflationary climate, we recommend that investors engage with credit market strategies to mitigate the effects of higher inflation to prevent the erosion of purchasing power. One such strategy is to select sectors that benefit from the inflationary environment to mitigate its negative effect on fixed-coupon instruments.

For example, Energy and other commodity-related industries have been key beneficiaries of inflation, given that their revenue growth exceeds potentially higher costs of production. This would serve to improve overall corporate profit margins and support credit spread stability for such sectors. The chart also illustrates other sectors such as Consumer Discretionary, Industrials, and Materials which have also outperformed under the current inflationary conditions. We outline these and other inflation-shielding credit strategies in our 1Q22 CIO Quarterly Insights.

Daryl Ho | Strategist

FX: Wary of animal spirits

Figure 3: Contrasting fortunes



Source: Bloomberg, DBS

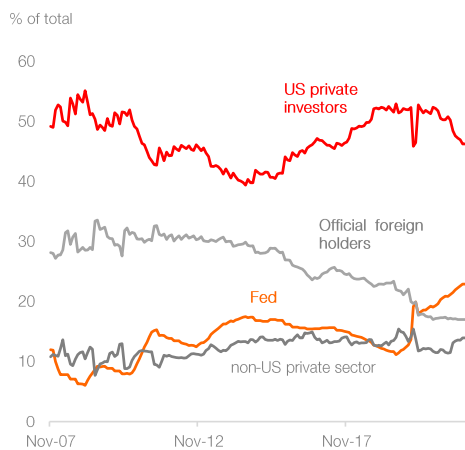
Monday (10 January) was a telling session regarding fears of an aggressive Fed tightening to rein in US inflation. The US 10Y Treasury yield hit a high of 1.806% before ending the session lower at 1.748%. The 10Y UST yield is still significantly above its end-2021 level of 1.51%. Commodity and European currencies bore the brunt of the selloff and investors sought safety in JPY and the greenback. All said, DXY and EUR are still consolidating in the same ranges seen over the past month. The same can be said for many exchange rates too.

According to prepared remarks for his confirmation hearing today, Federal Reserve Chair Jerome Powell will tell the Senate Banking Committee that the Fed would “prevent higher inflation from becoming entrenched”. Powell’s remarks come ahead of what may be the highest Consumer Price Index (CPI) reading since the early 1980s tomorrow. Consensus expects CPI inflation to rise to 7.0% y/y in December from 6.8% in November. With asset purchases set to end in spring (March to May), a few Fed officials reckoned rate hikes could start early at the Federal Open Market Committee (FOMC) meeting in March. Some private sector forecasters discounted four hikes this year (more than the three signalled at the FOMC meeting in December) and reckoned the Fed might even start shrinking its balance sheet (quantitative tightening) this year.

On Thursday, Lael Brainard will also weigh in on the debate during her confirmation hearing as Fed vice chair. Brainard is considered more dovish and is likely to be more measured in her comments. We remain wary that markets might have gotten ahead of itself over their Fed tightening expectations to the point of believing that the Fed has lost control of inflation. Looking back, the Fed started quantitative tightening in 2018 after five hikes from 2015 to 2017. All said, the S&P 500 did rebound from its 100-day moving average yesterday. So did the Nasdaq Composite after it shed more than 10% from its late November peak. With the Fed believing the US economy is strong enough to pull back its pandemic stimulus, it is difficult to see the Fed agreeing with markets that its actions will result in recession at this early stage.

Philip Wee | FX Strategist

Figure 4: Holders of US Treasuries



Source: Bloomberg, DBS

Rates: How to think about QT?

Accelerated taper, rate hikes, and possibly quantitative tightening (QT) – policies that reduce the Federal Reserve’s balance sheet – have brought USD rates sharply higher since the start of the year. While taper and rate hikes are well understood, the impact from QT is less clear. There is some consternation among investors that there could be significant market impact. In the previous cycle, QT was done by setting a cap on the runoff pace. Initially, this was set at USD10b per month in 2017 (when the Fed funds rate was above 1%) and was gradually increased to a peak of USD50b per month in 2019. In this cycle, with the Fed’s balance sheet much more bloated at USD8.8t, there appears to be more urgency to bring the size down. Building policy space (both on the rates and balance sheet fronts) might well be a key consideration. The Fed could kick QT off in the middle of the year, shortly after the rate hike cycle begins.

The impact on the market should be split into two components – the liquidity impact and the duration impact. First, we do not think that the liquidity impact would be significant for many quarters. The Fed’s reverse repo facility is the last resort for excess funds to be parked. If we assume that the Fed runs down the balance sheet at a pace of USD100b per month, it would still take over a year before this facility gets drained. Note that even if that happens, there are still excess reserves in the system. Moreover, a standing facility has also been put in place to add liquidity. In short, a repeat of excess tightness experienced in 2019 (leading to repo market issues) is unlikely to be seen.

The impact on duration is negative, all else equal, but there is a time component. If the Fed reinvests its holdings to keep the balance sheet constant, the Fed still buys assets every month, lending support to US Treasuries (UST). However, if holdings are allowed to mature, this reinvestment stops/slows depending on the cap that the Fed sets. For example, there are chunky maturities months with the largest at USD166b in February. Clearly, there will be some smoothing needed, with the Fed likely to set the run-off rate cap at about USD80-100b. A simpler way to think about it would be to see Fed holdings of UST running down from the current 22% of total outstanding at a faster pace than if the balance sheet was kept constant. As reference, at the start of 2020, the Fed held less than 14% of UST outstanding. That said, the Fed is only one factor impacting rates. We should also consider the improving US fiscal position, likely reduced fiscal stimulus from Biden’s social spending plan, economic conditions, and how the other major players in the market would react. In short, some term premium has to be factored in as a price insensitive buyer of UST fades.

Eugene Leow | Rates Strategist

Thematics: Singapore REITs – Reopening theme remains in focus

- Reopening plays a key theme as S-REITs held firm in December 2021
- Hospitality S-REITs rebound as Omicron fears subside
- More optimistic outlook come 1Q22 results to drive further upside
- Retail sales and office operational metrics may spring a surprise as workers return to office
- Reopening trade to remain a dominant theme for S-REITs

Reopening plays a key theme. The reopening theme continues to see favour ahead of the Chinese New Year, despite initial hiccups, as the impact of the Covid-19 omicron variant has proven to be milder than that of delta. We anticipate a strong retail sales performance in 4Q21 to propel domestic festivity spending for the retail REITs as overseas travel was once again jeopardised by the onset of omicron. The hospitality sector continued to see strong domestic demand across the December holidays even as Vaccinated Travel Lane ticket sales were halted till 20 January 2022. The office sector sees brighter skies ahead as more corporates set clearer instructions on staff return to office in 2022.

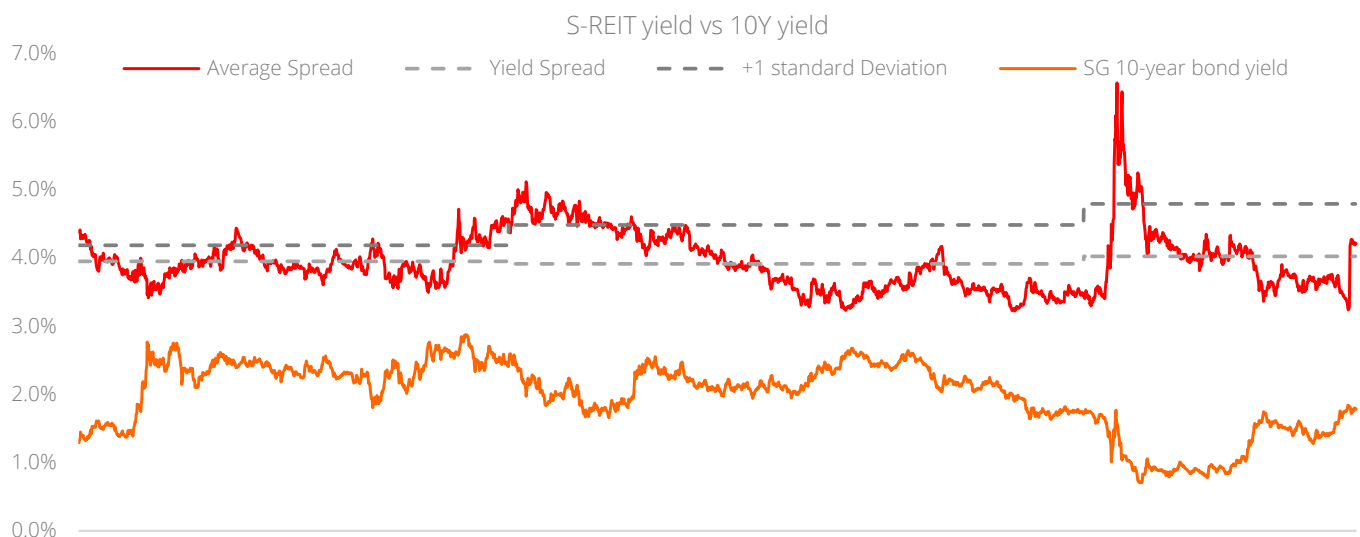
What to look out for in 1Q22. With inflation and rate hikes at the top of investors' minds, DBS Group Research believes the rotational interest happening with the reopening trades (retail, office, and hospitality) will outperform industrial subsectors given (i) cheaper relative valuations and (ii) stronger growth on a relative basis. Upcoming results season will see a brighter outlook especially with the Singapore economy showing strength.

Upbeat on retail and office S-REITs. We see stronger domestic retail sales driving a 5-6% rise in distributions per unit for retail and selected commercial S-REITs like Frasers Centrepoint Trust (FCT SP), Lendlease Global REIT (LREIT SP), CapitaLand Integrated Commercial Trust (C38U SP), and Suntec Real Estate Investment Trust (T82U SP). Meanwhile, construction delays have pushed office supply completions to 2023/24, implying that rentals are likely to remain firm. We think hospitality players with globally diversified portfolios like Ascott Residence Trust (ART SP) will lead peers in a recovery. Within the industrial space, Mapletree Industrial Trust (ME8U SP) and Frasers Logistics and Commercial Trust (BUOU SP) stand out for their relative stronger dividend growth profiles.

Geraldine WONG | Analyst
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Derek TAN | Analyst
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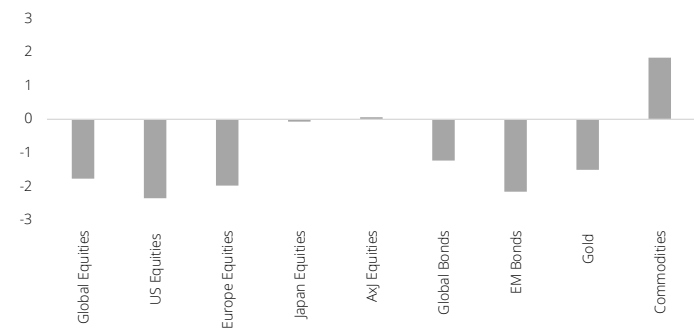
Figure 5: S-REIT yield and yield spreads



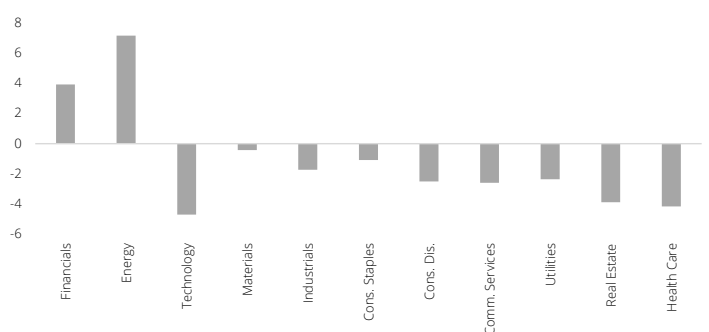
Source: Bloomberg, DBS

CIO Markets Watch

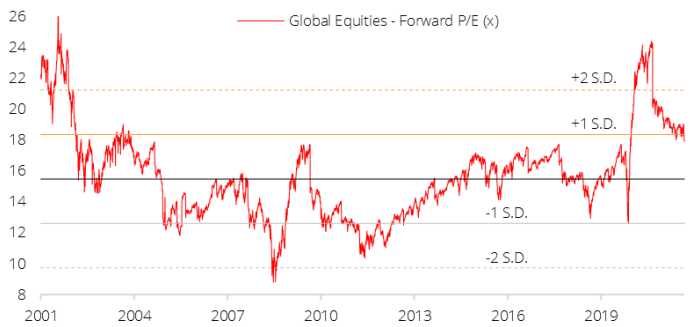
Global Cross Assets YTD Returns



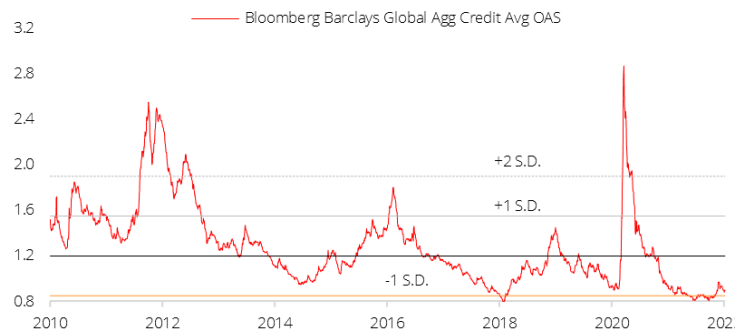
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



INDEX RETURNS

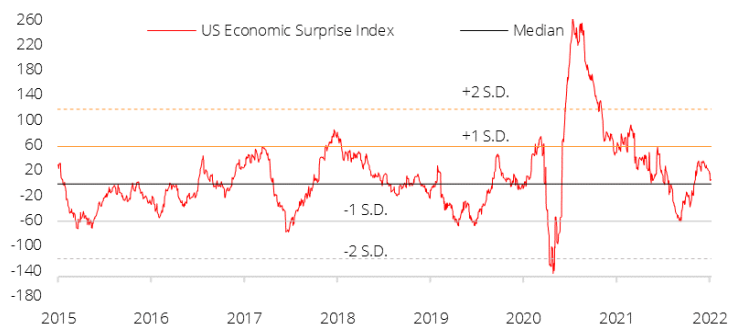
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-2.6%	-2.0%	-2.0%	-2.0%
NASDAQ	-5.6%	-4.5%	-4.5%	-4.5%
Russell 2000	-4.5%	-3.3%	-3.3%	-3.3%
Stoxx Europe 600	-2.2%	-1.8%	-1.8%	-1.8%
Nikkei 225	-1.1%	-1.1%	-1.1%	-1.1%
MSCI WORLD	-2.3%	-2.0%	-2.0%	-2.0%
MSCI ACWI	-2.1%	-1.8%	-1.8%	-1.8%
MSCI Asia ex-Japan	-0.1%	0.1%	0.1%	0.1%
MSCI EM	-0.1%	0.0%	0.0%	0.0%
HSCEI	2.2%	1.6%	1.6%	1.6%
SHCOMP	-1.3%	-1.3%	-1.3%	-1.3%
Hang Seng	2.0%	1.5%	1.5%	1.5%
STI Index	3.0%	3.3%	3.3%	3.3%
Fixed Income				
Barclays Global Aggregate	-0.6%	-1.2%	-1.2%	-1.2%
Barclays US Aggregate	-0.8%	-1.6%	-1.6%	-1.6%
Barclays US High Yield	-1.1%	-1.2%	-1.2%	-1.2%
Barclays Euro Aggregate	-0.4%	-0.6%	-0.6%	-0.6%
Barclays Euro High Yield	0.1%	0.1%	0.1%	0.1%
JPM EMBI Global	-1.9%	-2.2%	-2.2%	-2.2%
JPM EMBI Global Diversified	-1.7%	-1.7%	-1.7%	-1.7%

PRICES & SPREADS

	Spot	4Q21	3Q21	2Q21
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	1.76	1.51	1.49	1.47
Japanese Govt Bond 10-yr	0.14	0.07	0.07	0.05
German Bunds 10-yr	-0.04	-0.18	-0.20	-0.21
Spreads				
US Agg Corporate Spread	0.94	0.92	0.84	0.80
US Corporate HY Spread	3.02	2.83	2.89	2.68
Euro Agg Corporate Spread	0.97	0.97	0.87	0.86
EM USD Agg Spread	2.86	2.85	2.87	2.57
Currencies				
US Dollar Index (DXY)	96.0	95.7	94.2	92.4
EUR/USD	1.13	1.14	1.16	1.19
USD/JPY	115.2	115.1	111.3	111.1
USD/CNY	6.4	6.4	6.4	6.5
Commodities				
WTI Oil	78	75	75	73
London Metal Exchange (LMEX)	4524	4502	4161	4152
TR/CC CRB Commodity	237	232	229	213
Gold	1802	1829	1757	1770

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)	13-Jan	08-Jan	200k	207k
CPI MoM (US)	12-Jan	Dec	0.40%	0.80%
U. of Mich. Sentiment (US)	14-Jan	Jan	70	70.6
Retail Sales Advance m/m (US)	14-Jan	Dec	0.00%	0.30%
Industrial Production m/m (US)	14-Jan	Dec	0.20%	0.50%
MBA Mortgage Applications (US)	12-Jan	07-Jan	--	-5.60%
PPI Final Demand m/m (US)	13-Jan	Dec	0.40%	0.80%
CPI Ex Food and Energy m/m (US)	12-Jan	Dec	0.50%	0.50%

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	17-Jan	Nov	--	7.20%
CPI y/y (CN)	11-Jan	Dec	1.70%	2.30%
GDP y/y (CN)	16-Jan	4Q	3.60%	4.90%
BoP Current Account Balance (JP)	11-Jan	Nov	¥589.8b	¥1180.1b
Non-oil Domestic Exports y/y (SG)	16-Jan	Dec	--	24.20%
Core Machine Orders m/m (JP)	16-Jan	Nov	--	3.80%
PPI y/y (JP)	13-Jan	Dec	8.80%	9.00%
Tertiary Industry Index m/m (JP)	16-Jan	Nov	--	1.50%

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