CIO Weekly

18 May 2022

Key Points

- Equities: Energy majors are among our selections of beneficiaries in the rising inflation environment
- Credit: Switch from cash to IG credit for higher returns with less risk
- FX: USD too strong on a relative basis; AUD consolidation between 0.69 and 0.71
- Rates: US yields to stay buoyant amid elevated inflation and persisting Fed hawkishness
- Thematics: Hospitality S-REITs to ride the re-opening wave
- The Week Ahead: Keep a lookout for US change in initial jobless claims; Japan industrial production numbers

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	32,223.42	0.1%	-11.3%
S&P 500	4,008.01	-0.4%	-15.9%
NASDAQ	11,662.79	-1.2%	-25.5%
Stoxx Europe 600	433.67	0.0%	-11.1%
DAX	13,964.38	-0.5%	-12.1%
CAC 40	6,347.77	-0.2%	-11.3%
FTSE 100	7,464.80	0.6%	1.1%
MSCI AxJ	642.24	0.2%	-18.6%
Nikkei 225	26,547.05	0.5%	-7.8%
SHCOMP	3,073.75	-0.3%	-15.6%
Hang Seng	19,950.21	0.3%	-14.7%
MSCI EM	1,007.50	0.3%	-18.2%
UST 10-yr yield*	2.88	-1.2%	137.2
JGB 10-yr yield*	0.24	-0.4%	17.5
Bund 10-yr yield*	0.94	-1.0%	111.7
US HY spread*	4.59	1.5%	176.0
EM spread*	408.46	1.1%	78.2
WTI (USD)	114.20	3.4%	51.8%
LMEX	4,420.60	0.9%	-1.8%
Gold (USD)	1,824.14	0.7%	-0.3%

Source: Bloomberg
* Changes in basis points

Equities: EU energy majors as inflation beneficiaries

The DBS Chief Investment Office remains constructive on dividend yielding assets, focusing on the defensive income nature of these sectors, which include integrated energy majors. The soaring energy prices are among the reasons of this high inflation backdrop and have caught a lot of attention from the public, manufacturing sectors, transport providers, policymakers, and central banks.

Our investment thesis to stay invested in European energy majors is due to their ability to sustain stable income and earnings over economic and oil price cycles, as the upstream and downstream operations tend to neutralise the effect of input costs and output prices.

Underinvestment in fossil fuels capacity, coupled with higher-than-expected post-pandemic pent up demand and geopolitical conflicts have supported oil prices at elevated levels, thus boosting the revenue and profitability among oil majors (Figure 1).

Over the years, the idiosyncrasies among up-, mid-, and downstreams have blurred as energy majors expanded their operations vertically and horizontally along the supply chain, taking larger shares, and strengthening pricing power. Such developments have enhanced the income and earnings quality among the industry leaders.

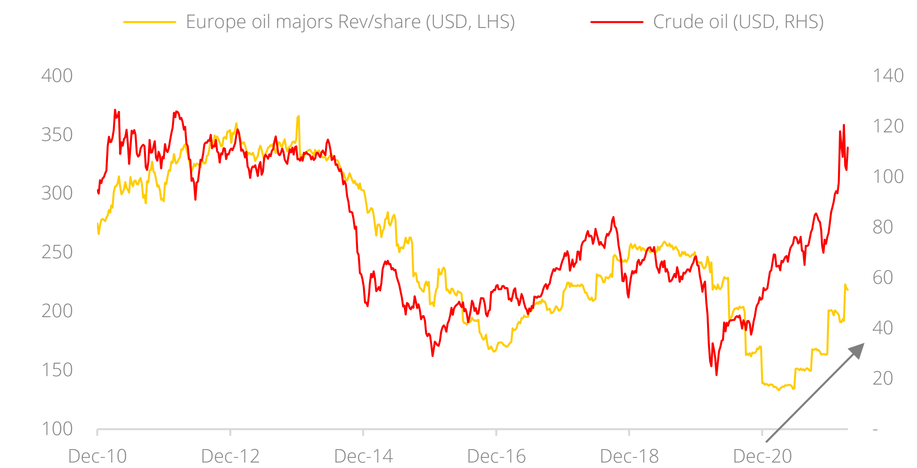
In spite of the fluctuations in oil prices and swing in earnings per share, the absolute dividend of the sector has stayed relatively stable over cycle as firms kept their distribution commitment and sustained the dividend yields in the range of 4-6% annually.

Remarkably, earnings of the sector have recovered to pre-Covid levels, but to multi-year highs. As such, the dividend distribution could potentially catch up to pre-Covid levels, giving investors regular income to buffer against inflation.

In essence, energy prices are among the elements contributing to elevated inflation, and investors can position their portfolios to hedge against it by having exposure in integrated energy firms which are beneficiaries of high energy prices.

Yeang Cheng Ling | Strategist

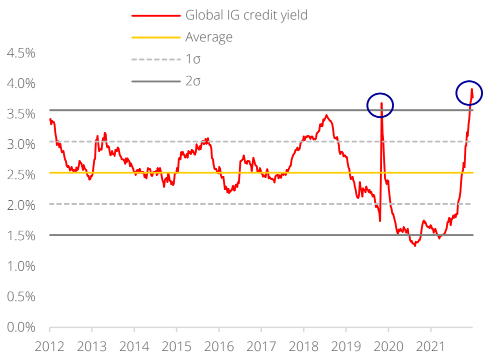
Figure 1: Operating leverage from oil prices



Source: Bloomberg, DBS

Credit: Switch from cash to IG credit for higher returns with less risk

Figure 2: IG yields exceed Covid crisis peak



Source: Bloomberg, DBS

The investment landscape remains challenging with markets experiencing the first 50 bps US Federal Reserve rate hike in 22 years, amid geopolitical tensions and commodity shocks causing widespread volatility around risk assets. With financial markets seeing sharp declines, it is natural for risk-averse investors to seek the safety of cash. Yet the prospect of facing the highest inflation in 40 years leaves it difficult to imagine that cash would register real returns in the medium term. Meanwhile the price for income certainty has scarcely been as reasonable as it has become, with global IG yields at c.3.8% - a level not seen in the last 10 years, exceeding even the peak of the Covid crisis (Figure 2).

Investors switching from cash to IG credit stand to reap asymmetric benefits, as we have outlined in our CIO Perspectives. Firstly, should rate hikes proceed as anticipated, investors would still obtain a return on IG credit exceeding the anticipated higher deposit rates. With the aggressive Fed rhetoric, the Federal Open Market Committee median peak rate is at 2.75%, while the Fed funds futures peak pricing is at c.3%, both lower than the yield on IG credit. Secondly, even if the Fed were unable to hike as aggressively as expected, IG credit would stand to see capital gains amid yields on short-term bonds repricing lower. We view this risk-reward advantageous for investors to deploy cash into short-dated (3-5Y duration), high quality credit – capitalising on the certainty of income-generation while most other risk assets grapple with volatility.

Daryl Ho, CFA | Strategist

FX: USD is too strong on a relative basis

Figure 3: Lower

Source: Bloomberg, DBS

DXY is correcting lower after hitting a 20Y high of 104.85 on 12 May. The US Treasury 10Y yield peaked at 3.127% on 6 May, two days after the US Federal Reserve delivered the first of the three 50 bps hikes telegraphed. The yield has returned below 3% since 10 May on doubts that the Fed can rein in elevated inflation with a soft landing. The US economy is one quarter away from a technical recession. Advanced gross domestic product (GDP) contracted by an annualised 1.4% q/q in 1Q22, weighed down by record trade deficits from the USD's strength. Not surprisingly, Fed Chair Jerome Powell conceded last week that factors outside the Fed's control, such as the global slowdown and geopolitical risks, could tip the US economy into recession.

GBP might have bottomed at a two-year low of 1.2202 on 12 May, the day UK GDP bested US GDP with a preliminary 0.8% q/q seasonally adjusted (sa) expansion in 1Q22 and eased UK recession worries raised at the Bank of England's (BOE) meeting a week earlier. Stagflation worries might wane again on the 18 May if CPI inflation comes in lower-than-expected in April (9% y/y consensus vs 7% in March) and plays down the BOE's double-digit inflation warning. We note GBP did not close below 1.20 after the Brexit referendum in June 2016 except for a week during the Covid outbreak in March 2020.

The factors responsible for the EUR sell-off have waned. EUR might have bottomed at 1.0350 on 13 May. The European Central Bank (ECB) no longer resists pressure to join the Fed and other central banks in normalising monetary policy to address elevated inflation. At its meeting on 9 June, the governing council will unanimously agree to end net asset purchase and start rate hikes in July to turn the -0.50% deposit facility rate positive by end-2022. Also, expect more officials to join ECB member Francois Villeroy de Galhau in warning that EUR weakness poses a challenge to its price stability goal. ECB President Christine Lagarde will be speaking today, followed by Vice President Luis de Guindos tomorrow.

Like the UK, consensus expects today's Eurozone GDP to beat US GDP by expanding in 1Q22 at the same 0.2% q/q sa (5% y/y) pace as 4Q21. Yesterday, the European

Commission did not forecast a recession on the Russia-Ukraine crisis; it downgraded this year's growth forecast to 2.7% from its previous 4% estimate in February. Last week, the EU sent out guidelines allowing economic operators to keep buying Russian oil and gas without breaching sanctions. As witnessed in 2015-2016, EUR parity can end up so near and yet so far, with EUR consolidating in a 1.05-1.15 range again.

AUD could consolidate between 0.69 and 0.71 after bottoming at 0.6830 on 12 May. On 18 May, consensus expects the wage price index to increase by 2.5% y/y in 1Q22 from 2.3% in 4Q21. More companies face pressure to offer higher wages to attract and retain staff. Although the International Monetary Fund downgraded its 2022 world growth forecast to 3.6% in April from its 4.4% estimate in January, it upgraded Australia's growth to 4.2% from 4.1% on higher commodity prices and the reopening of its economy. On 19 May, expect the unemployment rate to fall to 3.9% in April from 4% in March, with the Reserve Bank of Australia (RBA) expecting the jobless rate to remain in the "low threes" into June 2024. With CPI inflation holding above the 2% to 3% target next year, RBA will want rates to normalise at 2.50%.

Table 1: DBS Currency Forecasts

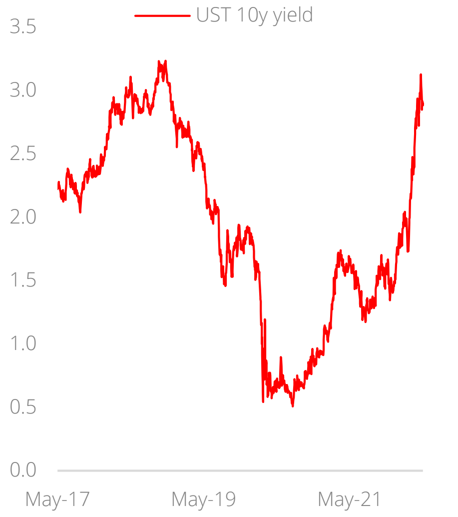
Ccy pair, eop	16 May	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
USDCNY	6.7862	6.3400	6.65	6.85	6.80	6.75	6.70	6.65	6.60
USDHKD	7.8499	7.8326	7.84	7.85	7.84	7.83	7.82	7.81	7.80
USDINR	77.829	75.789	76.2	76.7	76.3	75.8	75.4	75.0	74.5
USDIDR	14,697	14,363	14,630	14,900	14,760	14,620	14,480	14,340	14,200
USDMYR	4.3925	4.204	4.25	4.30	4.28	4.26	4.24	4.22	4.20
USDPHP	52.495	51.755	53.2	54.0	53.6	53.2	52.8	52.4	52.0
USDSGD	1.3918	1.3545	1.38	1.37	1.36	1.35	1.34	1.33	1.32
USDKRW	1,284	1,211.9	1,260	1,280	1,260	1,250	1,230	1,220	1,200
USDTHB	34.711	33.279	34.2	35.0	34.6	34.2	33.8	33.4	33.0
USDVND	23,085	22,837	22,690	22,640	22,590	22,530	22,480	22,430	22,380
AUDUSD	0.6971	0.7482	0.71	0.72	0.72	0.73	0.74	0.74	0.75
USDCAD	1.2846	1.2505	1.28	1.27	1.27	1.26	1.25	1.25	1.24
EURUSD	1.0434	1.1067	1.06	1.08	1.09	1.11	1.12	1.14	1.15
USDJPY	129.16	121.70	130	129	128	127	126	125	124
NZDUSD	0.6310	0.6947	0.65	0.66	0.67	0.68	0.68	0.69	0.70
USDCHF	1.0023	0.9225	0.99	0.98	0.98	0.97	0.96	0.96	0.95
GBPUSD	1.2319	1.3138	1.23	1.25	1.26	1.28	1.30	1.31	1.33
DXY Index	104.187	98.312	103.0	101.7	100.3	99.0	97.7	96.3	95.0

Philip Wee | FX Strategist

DBS

Rates: Unacceptable inflation, tolerable market pain

Figure 4: Buoyant



Source: Bloomberg, DBS

The US Federal Reserve made it clear that it is not going to be easily dissuaded from further hikes despite volatility in the market. The key issue facing policymakers is that inflation is still unacceptably high. Both CPI (8.3% y/y) and PPI (11% y/y) released last week point to further price pressures in the coming months. With considerable uncertainties on when supply-side woes (China's Covid-Zero strategy and the Russia-Ukraine conflict) would ease, there are risks that inflation expectations would become unanchored.

There are challenges as the Fed struggles to catch up with inflation. While the Fed had only hiked by 75 bps thus far this cycle, the amount of market stress is considerable. By our estimates, the current level of stresses in financial conditions have typically caused the Fed to pivot dovish over the past 30 years. This time, confronting a surge in inflation, we thought that the Fed would be much more tolerant of financial market pain. This view is holding up thus far. Over the past week, the biggest casualty was probably the crypto space, when prices across many coins tanked. The collapse of Terra's UST stable coin might well mark capitulation in what is arguably the frothiest market in the pandemic era.

We expect US yields to stay buoyant amid elevated inflation and likely continued hawkishness from the Fed. Macro data is likely to stay generally resilient, but we would note that the housing market could face a meaningful slowdown.

Eugene Leow | Rates Strategist

Duncan Tan | Rates Strategist

Thematics: Hospitality S-REITs – Seize the day

- Hospitality S-REITs to ride on the re-opening
- Green shoots in 1Q22 operating metrics
- RevPAR recovery in most markets to accelerate in 2H22
- Hotels in Singapore last transacted at SGD1.8m per key, more than double the implied value that listed peers trade at

Hospitality S-REITs to lead the race. DBS Group Research's expects rising revenue per available room (RevPAR) to fuel a c.25% CAGR in distributions per unit in FY22-24F. Pent-up leisure demand and the return of corporate travel demand is anticipated to drive RevPAR higher from 2H22 onwards. With a close correlation between RevPAR and P/NAV, we see hospitality S-REITs reaching new highs in this upcycle.

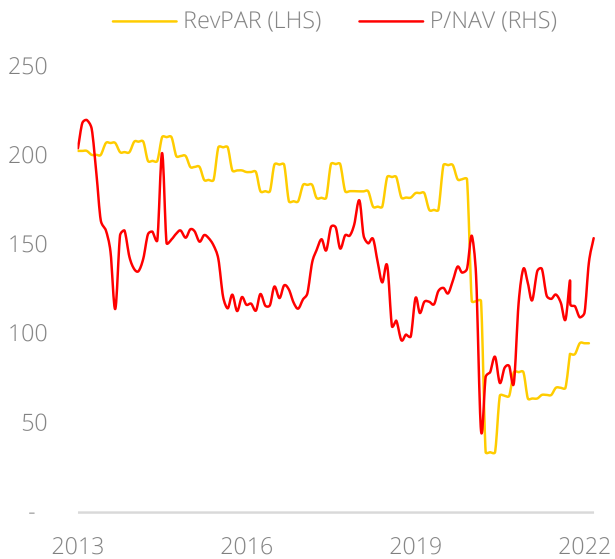
Easing of Covid-19 testing and quarantine requirements to fuel a meaningful upturn in demand. The return of leisure travel has led to hoteliers hiking room rates. Leisure demand is poised for a meaningful upturn come 2H22 as governments across the world ease Covid-19 testing and quarantine requirements for vaccinated travellers. We saw green shoots in 1Q22 with RevPARs rising by 1-34% in global travel markets despite Omicron remaining an overhang for most countries in the quarter. This short-term setback is unlikely to derail the recovery trajectory and we continue to expect more upside to RevPAR from 2Q22 onwards. Pace of forward booking has improved alongside higher visibility in forward room demand. Hospitality S-REITs' key markets like Singapore (c.40% of AUM exposure) have substantially opened its borders with a robust line-up of MICE events in 2H22, while staycation demand is still expected to remain robust. Meanwhile, Europe (c.15%) and Australia (14%) will likely shrug off the Omicron impact as international travel returns. In Asia, we await the reopening of Japan (c.13% of AUM exposure) and China, which are the next key catalysts to drive a further hike in RevPARs.

Hotel assets imply that owners getting below replacement costs. The recent transaction of So/ Singapore hotel located in the Central Business District at a valuation of SGD1.8m per key (or room) underlines the attraction of Singapore hotels as a store of value for global investors. Despite the rise in share prices, hospitality S-REITs are trading close to 0.9x P/NAV, or SGD700k–800k per key. Sponsors may choose to extract value from existing S-REIT assets through privatisation, in our view.

Geraldine WONG | Analyst

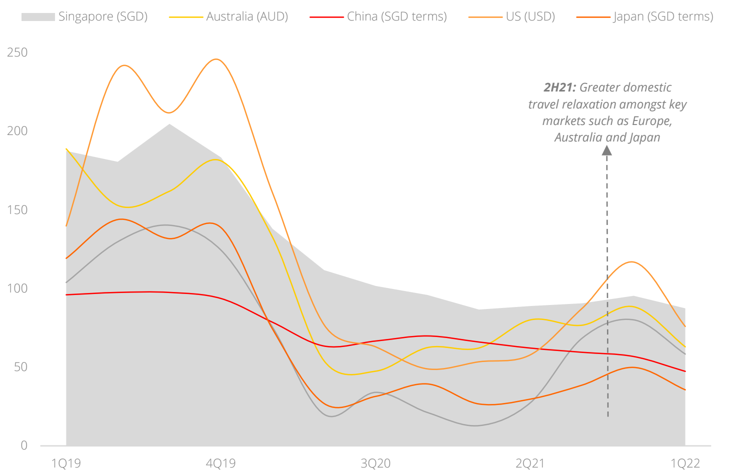
Derek TAN | Analyst

Figure 5: Hotel sector RevPAR vs P/NAV



Source: Bloomberg Finance L.P., DBS

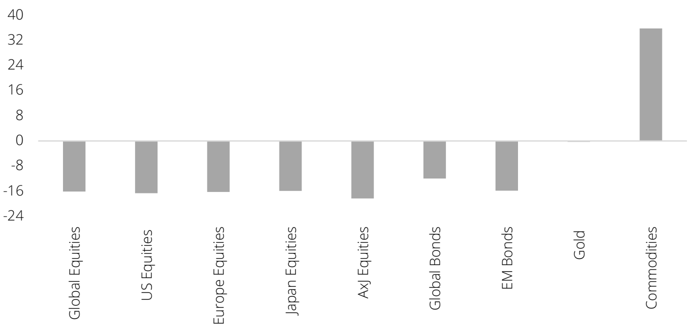
Figure 6: Quarterly hotel S-REITs RevPAR by key markets



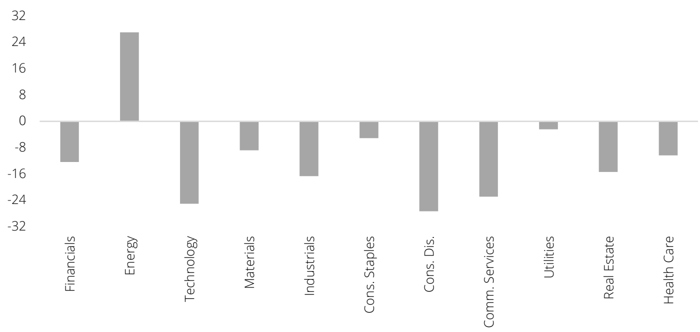
Source: Companies, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

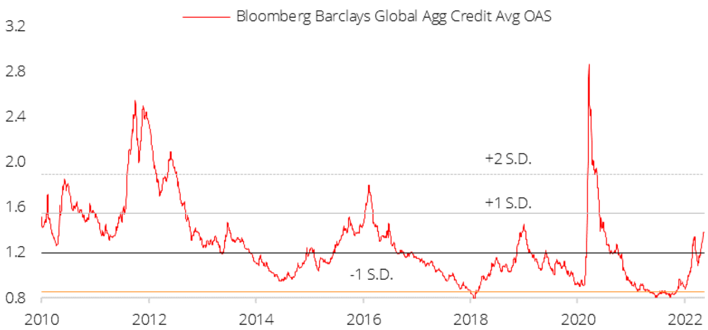


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

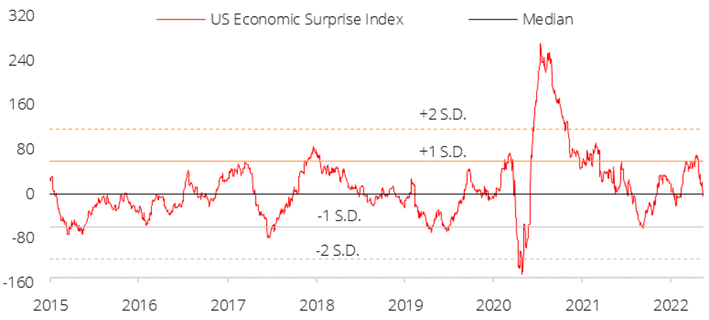
	1 week	MTD	QTD	YTD
Equities				
S&P 500	0.4%	-3.0%	-11.5%	-15.9%
NASDAQ	0.3%	-5.4%	-18.0%	-25.5%
Russell 2000	1.2%	-4.3%	-13.8%	-20.6%
Stoxx Europe 600	3.9%	-3.7%	-4.9%	-11.1%
Nikkei-225	0.9%	-1.1%	-4.6%	-7.8%
MSCI WORLD	0.8%	-3.6%	-11.8%	-16.6%
MSCI ACWI	0.7%	-3.9%	-11.8%	-16.8%
MSCI Asia ex-Japan	-0.8%	-6.5%	-11.3%	-18.6%
MSCI EM	-0.7%	-6.4%	-11.8%	-18.2%
HSCEI	0.2%	-6.5%	-9.3%	-17.1%
SHCOMP	2.3%	0.9%	-5.5%	-15.6%
Hang Seng	-0.3%	-5.4%	-9.3%	-14.7%
STI Index	-2.6%	-4.9%	-6.4%	2.2%
Fixed Income				
Barclays Global Aggregate	0.5%	-0.8%	-6.2%	-12.0%
Barclays US Aggregate	0.7%	0.0%	-3.8%	-9.5%
Barclays US High Yield	-0.4%	-2.4%	-5.9%	-10.4%
Barclays Euro Aggregate	1.3%	0.0%	-3.4%	-8.6%
Barclays Euro High Yield	1.2%	-1.5%	-4.2%	-8.2%
JPM EMBI Global	0.3%	-1.9%	-7.2%	-15.8%
JPM EMBI Global Diversified	-0.2%	-1.6%	-7.4%	-17.6%

PRICES & SPREADS

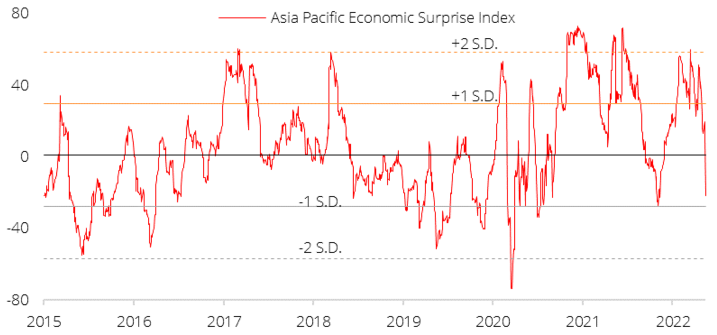
	Spot	1Q22	4Q21	3Q21
Rates				
Fed Funds Target	1.00	0.50	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	2.89	2.34	1.51	1.49
Japanese Govt Bond 10-yr	0.24	0.21	0.07	0.07
German Bunds 10-yr	0.94	0.55	-0.18	-0.20
Spreads				
US Agg Corporate Spread	1.43	1.16	0.92	0.84
US Corporate HY Spread	4.59	3.25	2.83	2.89
Euro Agg Corporate Spread	1.67	1.31	0.97	0.87
EM USD Agg Spread	3.65	3.13	2.85	2.87
Currencies				
US Dollar Index (DXY)	104.2	98.3	95.7	94.2
EUR/USD	1.04	1.11	1.14	1.16
USD/JPY	129.2	121.7	115.1	111.3
USD/CNY	6.8	6.3	6.4	6.4
Commodities				
WTI Oil	114	100	75	75
London Metal Exchange (LMEX)	4421	5174	4502	4161
TR/CC CRB Commodity	316	295	232	229
Gold	1824	1937	1829	1757

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)	19-May	14-May	200k	203k
CPI y/y (EU)	18-May	Apr	7.50%	7.40%
Retail Sales Advance m/m (US)	17-May	Apr	1.00%	0.50%
GDP SA q/q (EU)	17-May	1Q	0.20%	0.20%
Industrial Production m/m (US)	17-May	Apr	0.50%	0.90%
MBA Mortgage Applications (US)	18-May	13-May	--	2.00%
Housing Starts (US)	18-May	Apr	1759k	1793k
Existing Home Sales (US)	19-May	Apr	5.65m	5.77m

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	18-May	Mar	--	0.30%
GDP SA q/q (JP)	17-May	1Q	-0.40%	1.10%
CPI y/y (SG)	23-May	Apr	--	5.40%
Core Machine Orders m/m (JP)	18-May	Mar	3.90%	-9.80%
Tertiary Industry Index m/m (JP)	17-May	Mar	1.10%	-1.30%
GDP y/y (SG)	18-May	1Q	3.70%	3.40%
Jibun Bank Japan PMI Mfg (JP)	23-May	May	--	53.5
Natl CPI y/y (JP)	19-May	Apr	2.50%	1.20%

DBS

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