CIO Weekly

15 June 2022

Key Points

- **Equities:** Technology firms remain committed to rolling out new capital expenditure to expand capacity and address supply chain constraints
- **Credit:** IG yields compensate for inflation
- **FX:** Investors sought safety in the greenback; JPY crosses fell against commodity currencies on risk aversion
- **Rates:** Sharp repricing of USD rates curve after Friday's CPI release; Market sees at least one 75 bps move this year and a terminal Fed funds rate of 4%.
- **Thematics:** Data Centre S-REITs – An attractive buy
- **The WeekAhead:** 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	30,516.74	-2.8%	-16.0%
S&P 500	3,749.63	-3.9%	-21.3%
NASDAQ	10,809.23	-4.7%	-30.9%
Stoxx Europe 600	412.52	-2.4%	-15.4%
DAX	13,427.03	-2.4%	-15.5%
CAC 40	6,022.32	-2.7%	-15.8%
FTSE 100	7,205.81	-1.5%	-2.4%
MSCI AxJ	658.20	-3.4%	-16.6%
Nikkei 225	26,987.44	-3.0%	-6.3%
SHCOMP	3,255.55	-0.9%	-10.6%
Hang Seng	21,067.58	-3.4%	-10.0%
MSCI EM	1,016.46	-3.6%	-17.5%
UST 10-yr yield*	3.36	6.5%	185.0
JGB 10-yr yield*	0.25	1.6%	18.6
Bund 10-yr yield*	1.63	7.6%	181.1
US HY spread*	4.80	9.6%	197.0
EM spread*	412.96	3.3%	82.7
WTI (USD)	120.93	0.2%	60.8%
LMEX	4,353.70	-2.4%	-3.3%
Gold (USD)	1,819.26	-2.8%	-0.5%

Source: Bloomberg
* Changes in basis points

Equities: Global Semicon – Strong Capex Trends

The CIO Office remains constructive on the broader technology sector, including the bellwether semiconductor sub-sector.

The broader technology supply chains have been overstretched over the past few years even prior to occurrence of the pandemic, where IC design, foundry, electronics, components, and assembly firms were caught unprepared to address the surge in digital expansion and strong end demand. The thriving demand backdrop has sustained industry players operating on near full utilisation rates in recent quarters and will remain high over the coming quarters.

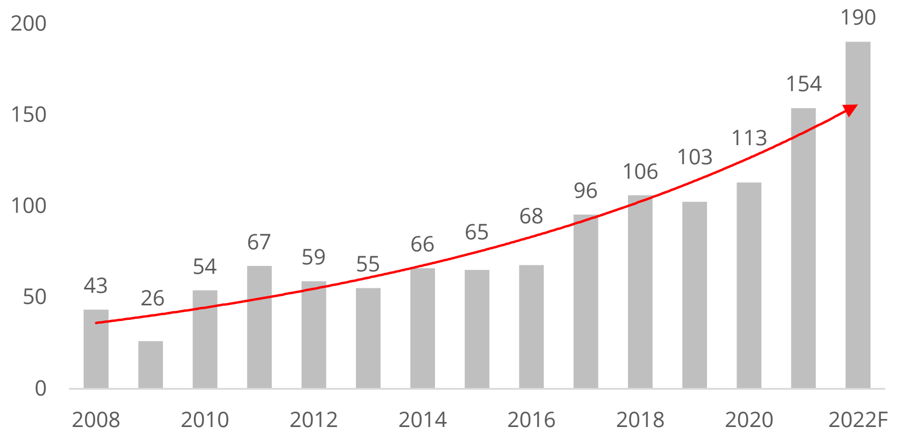
Further to our earlier report on the global capex outlook, there is new evidence showing further strength in semiconductor industry capex spending. After a whopping 36% jump in 2021, the industry's capex is projected to surge 24% in 2022 to another new high of USD190b, which marks the third consecutive year of capex scoring new highs and doubling the amount in 2017. Importantly, the combined five-year capex between 2018 – 2022 have likewise doubled that in the prior five years between 2013-2017 (Figure 1).

Besides the commitment from the world's leading memory makers like Samsung, SK Hynix, and Micron, and logic foundries TSMC, UMC, and Global Foundry, a new wave of capex commitment has been initiated by analog IC design firms as they ramp up new product developments to cater for the demand of more sophisticated communication and processor chips.

The strong capex outlook is an indication that end demand remains healthy where leading industry players remain dedicated to rolling out more capacity. The focus will be on advanced node and a diverse range of chipsets driven by the ongoing advancement in technology devices, embedding of logic, memory, power management IC into a wide range of equipment and systems, and more importantly, the world's rising reliance on technology-led processes and solutions.

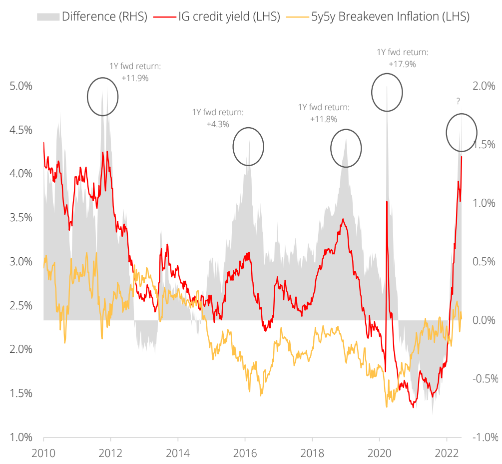
Yeang Cheng Ling | Strategist

Figure 1: Surging semiconductor annual capex (USDb)



Source: IC Insights, DBS

Figure 2: IG yields exceed inflation expectations



Source: Bloomberg, DBS

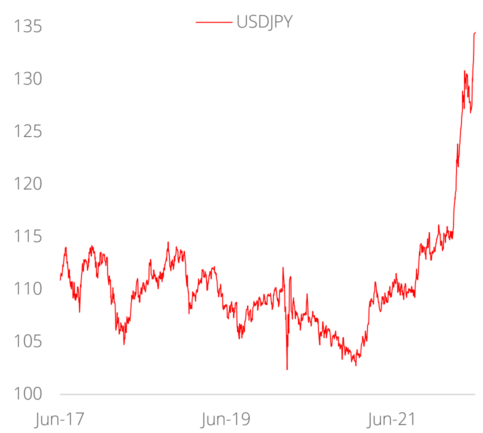
Credit: IG Yields Compensate for Inflation

2022 has practically left investors with mouths agape, watching inflation prints continue to defy belief with each subsequent print overwhelming the last, despite being at levels not seen in 40 years since the Volcker era. The latest May headline Consumer Price Index figure of +8.6% y/y once again jolted both bond and equity markets with expectations that the Fed would need to act even more hawkishly to quell inflation expectations.

While spot inflation prints may surprise with volatility, it is worthwhile to consider longer-term measures of inflation expectations – such as the five year forward five year breakeven inflation (5Y5Y breakeven) – to ascertain where markets expect inflation to approximate five years into the future. Notably, this figure stands at 2.3%, which is not meaningfully higher than the 10Y average of c.2.2%. Yet global (Investment Grade) IG credit yields have spiked far higher to c.4.5%, opening a more than 2.2 %pt gap to long run inflation expectations. Over the last 10 years, the one year forward returns of IG credit have been strongly positive whenever this gap had widened beyond 1.5%. We believe this is once again an opportunity for investors to scale into quality credit, to take advantage of higher yields for safe income generation.

Daryl Ho, CFA | Strategist

Figure 3: Capped



Source: Bloomberg, DBS

FX: Some Correction is Likely After the Selloff

Investors sought safety in the greenback. DXY appreciated 0.9% to 105.08, its strongest level since December 2002. After last Friday's stronger-than-expected US Consumer Price Index inflation, markets swung from expecting a slower 25 bps Fed hike in September to calling for a 75 bps hike at tomorrow's Federal Open Market Committee (FOMC) meeting. The US Treasury (UST) yield curve (10Y vs 2Y) flattened to 0.6 bps on Monday (13 June) from 9.3 bps last Friday. The 2Y yield rose 29.1 bps, faster than the 20.4 bps increase in the 10Y yield. JPY crosses fell on risk aversion, especially against the commodity currencies. AUD and NZD depreciated most by 0.9% and 1.8% respectively.

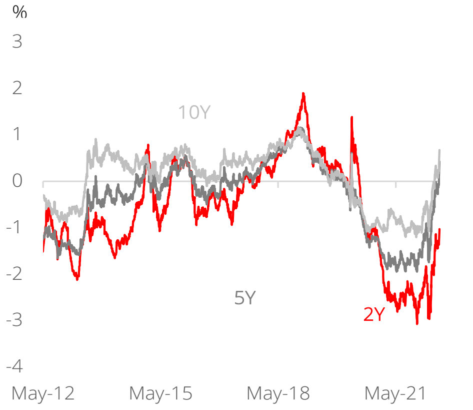
Japan's policymakers capped USD/JPY at 135with a clear message that the JPY's rapid depreciation was bad for the Japanese economy. The same view was expressed earlier on 9 June by some 75% of respondents in a Japan Association of Corporate Executives survey. For the first time on 10 June, the Ministry of Finance (MOF), the Bank of Japan (BOJ) and the Financial Services Agency (FSA) issued a joint statement expressing "concern" about the recent rapid decline in the JPY. Meanwhile, the National CPI ex Food has risen to 2.1% y/y in April, above the 2% target. The 10Y JGB yield is above 0.25% or the ceiling under the BOJ's yield curve control framework. The other central banks with negative yields – the European Central Bank (ECB) and the Swiss National Bank (SNB) – have signalled their desire to join their peers in normalising policy. Apart from not ruling out interventions in USD/JPY at 135, markets will pay close attention to the BOJ meeting for any hints of joining its peers (ECB and SNB) with negative yields in normalising policy.

Today, some correction is likely after three days of aggressive selling. Most currencies – EUR, CHF, AUD, NZD, HKD, KRW, TWD, SGD, and IDR – have returned near their weakest levels a month ago. Currencies that fell to a new year's low included the JPY, GBP, MYR, THB, PHP, and INR. The more resilient currencies were the CAD and CNY. Although the UST 10Y yield hit the highest level since 2010, it did pull back from a high of 3.44% to end Monday lower at 3.36%. Despite traders looking for a 4% terminal rate, consensus did not budge in expecting a 50 bps hike at tomorrow's FOMC meeting. The Fed will also present its summary of economic projections which is likely to revise down GDP growth and revise up the unemployment rate. Tweaks to its PCE inflation forecasts might not be as large as the latest CPI data suggested. Apart from the post-FOMC press conference, Fed Chair Jerome Powell is scheduled to deliver his semi-annual monetary policy testimony before the Senate Banking Committee on 22 June.

Philip Wee | FX Strategist

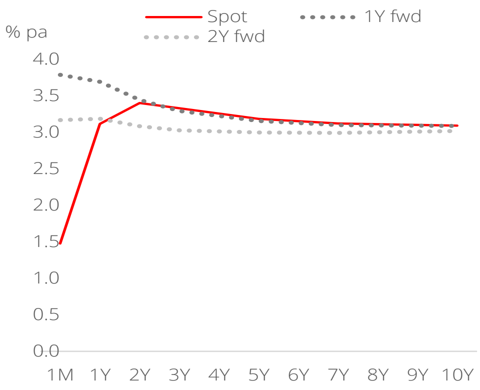
Rates: How Much More to Go?

Figure 4: UST implied real yields



Source: Bloomberg, DBS

Figure 5: SOFR OIS Curve – Pricing in Fed hikes



Source: Bloomberg, DBS

The repricing across the USD rates curve since Friday's (10 June) Consumer Price Index (CPI) release was one for the ages. The entire US Treasury (UST) curve (2Y and above) is now above 3%, the market now sees at least one 75 bps move for this year (which might get delivered this week, although we still think odds are in favour of 50 bps) and expects a terminal Fed funds rate of 4%. Prior to the CPI beat, the market was content with a few 50 bps moves before a downshift later this year and saw the Fed funds rate peaking in the 3-3.25% region. Having broken the 3.2% top (also a key resistance level) seen in early May, 10Y yields closed at 3.36%, close to our forecast of 3.5%. The upshot is that nobody is keen to hold duration risks into the Federal Open Market Committee (FOMC) meeting where Fed Chair Powell will almost certainly have to sound hawkish.

We are watching to see when and where the upshift in USD rates will stabilise. The CPI print and survey-based inflation expectations suggest that the Fed should move. However, with a significant amount of tightening suddenly factored in, there should be a dampening impact on growth and inflation. Much like how stresses in the market in early May marked an interim top in rates, we might be able to get some respite post FOMC meeting. It might not be that easy to beat the hawkish hurdle already set by the market as USTs continue to sell off. We would also note that 10Y implied real yields are now close to 0.68%, in the restrictive zone (which we tag to be in the 0.5-1.0% range) and 10Y breakevens have fallen close to 2.68%, suggesting confidence that the Fed can get a grip on inflation.

We see upside risks to our shorter-term USD rates forecasts, noting that inflation is proving stickier than we had anticipated. While the Fed may not ultimately deliver all the hikes priced, persistent inflation worries are likely to keep rates buoyant for some time. We are also cognizant that growth worries could be revisited later this year. Curve wise, flattening is now taking place at an accelerated pace (quicker than our forecast suggests). We have always subscribed to flattening in the 2Y/10Y and to receive the 2Y/5Y/10Y fly. We think that both strategies have room to play out. Flattish / inverted curves in the 2Y/10Y, 5Y/30Y and 2Y/30Y are very likely in the coming few quarters as the market grapples with a hawkish Fed / growth worries.

Eugene Leow | Rates Strategist

Thematics: Data Centre-Focused REITs – Fuel for the Digital World

- Data centre (DC) S-REITs' recent correction presents opportunities to buy growth at attractive prices
- Pipelines are crucial for REITs to tap into, as returns remain compressed due to high competition

The case for data centre-focused S-REITs. DBS Group Research believes that data centre (DC)-focused S-REITs will remain a key part of investors' portfolios going forward. We remain convinced that DCs remain the "oil" for the digital world post-Covid, with demand exceeding supply, which translates into a continuously tight transaction market with improving operating metrics.

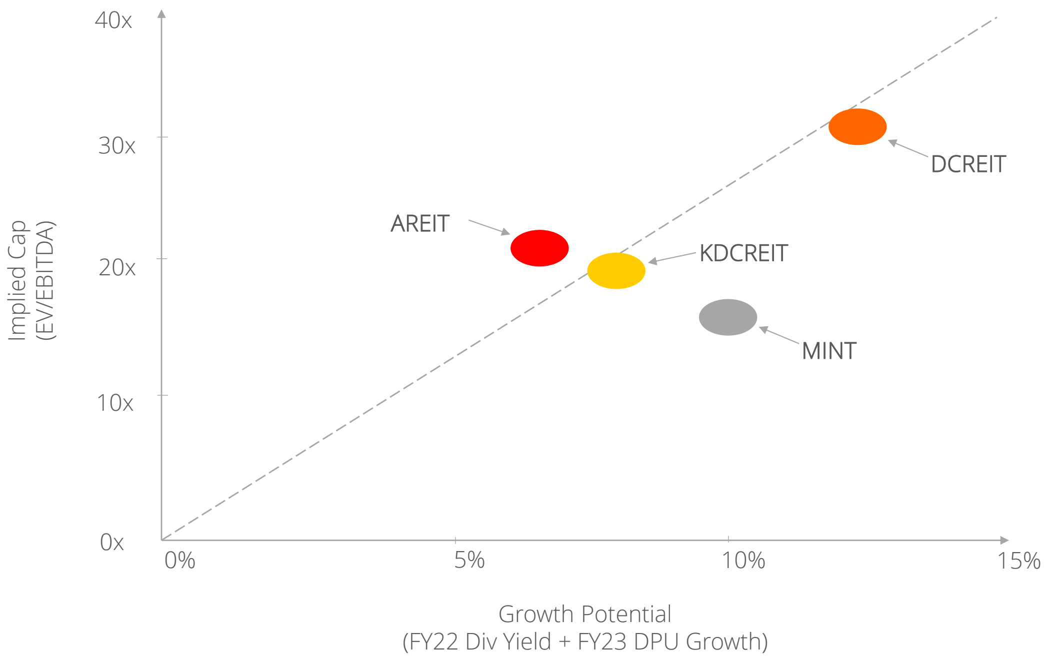
Data centre-focused S-REITs' price correction provides opportunity to buy growth at attractive prices. With the recent share price correction, yields for the four DC-focused S-REITs have expanded to >5.0% on average, and we see attractive re-entry points at the current levels. The market appears to have "discounted" the superior growth that DC-focused S-REITs offer to investors, especially when selected S-REITs have significant pipelines that can be acquired from their respective sponsors over time.

Comparing DC-focused S-REITs. We compare the DC-focused S-REITs over seven holistic metrics covering (i) concentration risk, (ii) geographical exposure, (iii) DC type, (iv) acquisition pipeline, (v) debt headroom, (vi) valuations, and (vii) growth. Among the metrics, we believe that having sponsors that are both owners and operators will lead to REITs acquiring operational data centres (co-location), which we believe translates into more sticky tenants and drive stronger earnings growth.

Dale Lai | Analyst   Derek Tan | Analyst

Click here to read the full report

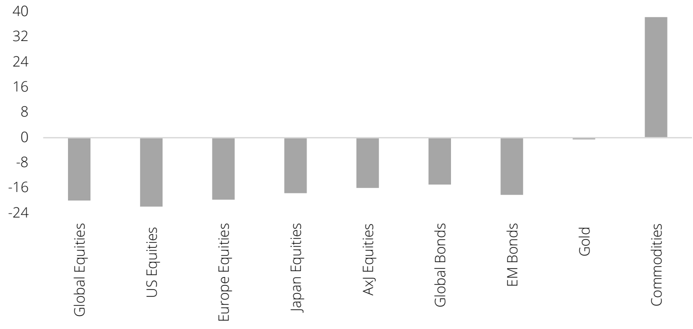
Figure 6: Valuation vs growth of S-REITs with data centre exposure



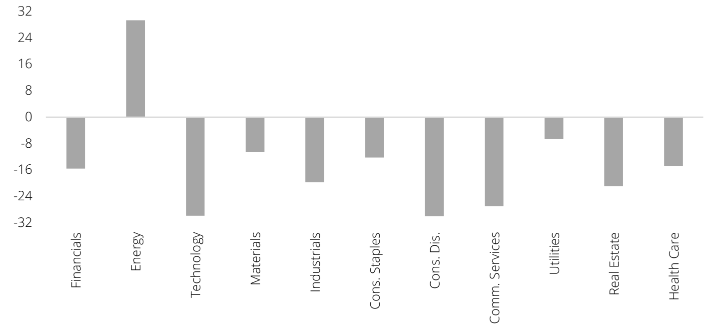
Source: DBS

CIO Markets Watch

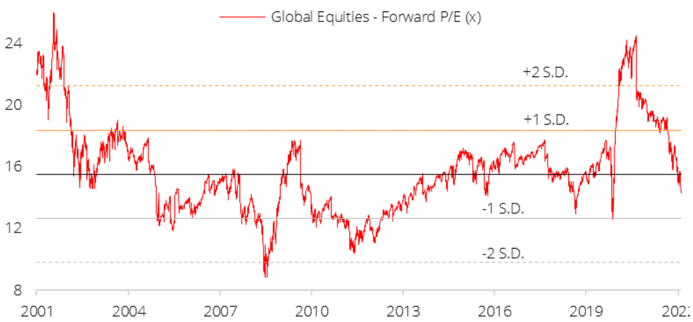
Global Cross Assets YTD Returns



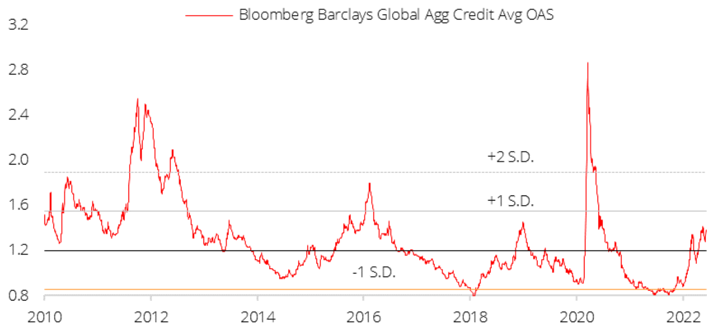
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



INDEX RETURNS

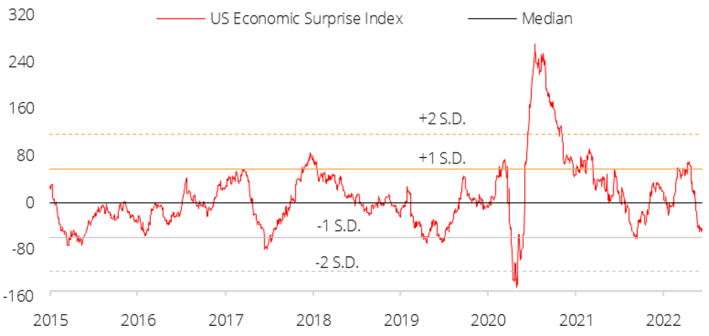
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-9.0%	-9.3%	-17.2%	-21.3%
NASDAQ	-10.4%	-10.5%	-24.0%	-30.9%
Russell 2000	-9.3%	-8.0%	-17.2%	-23.6%
Stoxx Europe 600	-7.1%	-7.0%	-9.5%	-15.4%
Nikkei-225	-3.3%	-1.1%	-3.0%	-6.3%
MSCI WORLD	-8.8%	-8.8%	-16.6%	-21.2%
MSCI ACWI	-8.4%	-8.5%	-16.0%	-20.8%
MSCI Asia ex-Japan	-4.1%	-4.3%	-9.1%	-16.6%
MSCI EM	-5.1%	-5.7%	-11.0%	-17.5%
HSCEI	-2.1%	-1.0%	-2.5%	-10.9%
SHCOMP	0.6%	2.2%	0.1%	-10.6%
Hang Seng	-2.7%	-1.6%	-4.2%	-10.0%
STI Index	-2.7%	-2.9%	-7.9%	0.5%
Fixed Income				
Barclays Global Aggregate	-3.3%	-4.4%	-9.4%	-15.0%
Barclays US Aggregate	-2.5%	-3.5%	-6.6%	-12.1%
Barclays US High Yield	-4.7%	-5.3%	-8.4%	-12.8%
Barclays Euro Aggregate	-2.7%	-4.1%	-8.7%	-13.7%
Barclays Euro High Yield	-3.0%	-3.1%	-7.1%	-10.9%
JPM EMBI Global	-4.1%	-4.8%	-9.9%	-18.2%
JPM EMBI Global Diversified	-2.4%	-3.0%	-8.2%	-18.2%

PRICES & SPREADS

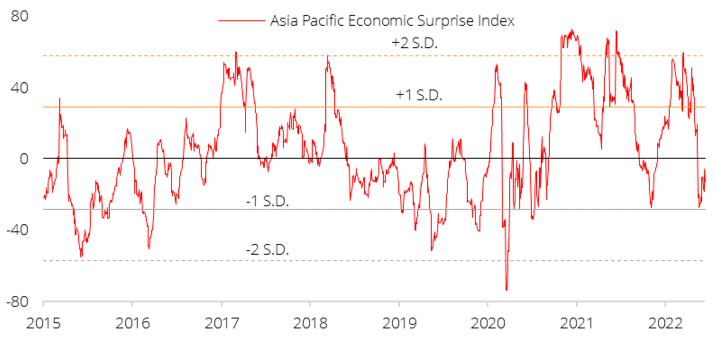
	Spot	1Q22	4Q21	3Q21
Rates				
Fed Funds Target	1.00	0.50	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	3.37	2.34	1.51	1.49
Japanese Govt Bond 10-yr	0.25	0.21	0.07	0.07
German Bunds 10-yr	1.63	0.55	-0.18	-0.20
Spreads				
US Agg Corporate Spread	1.41	1.16	0.92	0.84
US Corporate HY Spread	4.80	3.25	2.83	2.89
Euro Agg Corporate Spread	1.80	1.31	0.97	0.87
EM USD Agg Spread	3.51	3.13	2.85	2.87
Currencies				
US Dollar Index (DXY)	105.1	98.3	95.7	94.2
EUR/USD	1.04	1.11	1.14	1.16
USD/JPY	134.4	121.7	115.1	111.3
USD/CNY	6.8	6.3	6.4	6.4
Commodities				
WTI Oil	121	100	75	75
London Metal Exchange (LMEX)	4354	5174	4502	4161
TR/CC CRB Commodity	321	295	232	229
Gold	1819	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)	16-Jun	11-Jun	218k	229k
FOMC Rate Decision (Upper Bound) (US)	15-Jun	15-Jun	1.50%	1.00%
CPI y/y (EU)	17-Jun	May	8.10%	7.40%
Retail Sales Advance m/m (US)	15-Jun	May	0.10%	0.90%
Industrial Production m/m (US)	17-Jun	May	0.40%	1.10%
MBA Mortgage Applications (US)	15-Jun	10-Jun	--	-6.50%
Housing Starts (US)	16-Jun	May	1700k	1724k
PPI Final Demand m/m (US)	14-Jun	May	0.80%	0.50%

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	14-Jun	Apr	--	-1.30%
Non-oil Domestic Exports y/y (SG)	16-Jun	May	7.50%	6.40%
Core Machine Orders m/m (JP)	14-Jun	Apr	-1.30%	7.10%
Tertiary Industry Index m/m (JP)	15-Jun	Apr	0.80%	1.30%
Industrial Production y/y (CN)	14-Jun	May	-0.90%	-2.90%
Retail Sales y/y (CN)	14-Jun	May	-7.10%	-11.10%
BOJ Policy Balance Rate (JP)	16-Jun	17-Jun	-0.10%	-0.10%
Capacity Utilisation m/m (JP)	14-Jun	Apr	--	-1.60%

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