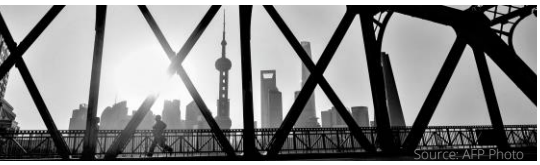


CIO Weekly

21 June 2022

Key Points

- **Equities:** Elevated oil prices on the back of Russia-Ukraine crisis and new regulations fuelling EV adoption; EVs to account for 22% of total car sales by 2030
- **Credit:** Quality credit offers shelter amid the storm, at record high yields
- **FX:** USD could come off its high like in the 1994 Fed hike cycle but the process will be slow as markets need confidence in picking up DXY components from depressed levels
- **Rates:** Markets struggle between inflation and recession risks, 3M/10Y segment of US Treasury curve can provide signals of impending recession
- **Thematics:** Hospitality S-REITs – Sun is shining again
- **The Week Ahead:** Keep a lookout for US Change in Initial Jobless Claims; Singapore Inflation Numbers

GLOBAL CROSS ASSETS
Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	29,888.78	0.0%	-17.7%
S&P 500	3,674.84	0.0%	-22.9%
NASDAQ	10,798.35	0.0%	-31.0%
Stoxx Europe 600	407.14	1.0%	-16.5%
DAX	13,265.60	1.1%	-16.5%
CAC 40	5,920.09	0.6%	-17.2%
FTSE 100	7,121.81	1.5%	-3.6%
MSCI AxJ	648.88	-0.2%	-17.8%
Nikkei 225	25,771.22	-0.7%	-10.5%
SHCOMP	3,315.43	0.0%	-8.9%
Hang Seng	21,163.91	0.4%	-9.5%
MSCI EM	1,000.42	-0.4%	-18.8%
UST 10-yr yield*	3.23	0.0%	171.6
JGB 10-yr yield*	0.23	4.9%	16.9
Bund 10-yr yield*	1.75	5.3%	192.7
US HY spread*	5.02	0.0%	219.0
EM spread*	426.23	0.0%	96.0
WTI (USD)	109.56	0.0%	45.7%
LMEX	4,213.10	0.3%	-6.4%
Gold (USD)	1,838.74	0.0%	0.5%

Source: Bloomberg
* Changes in basis points

Equities: High oil prices fuelling EV adoption

Rising oil prices – Beyond geopolitical tension. After languishing at 20Y lows in the depth of the pandemic, oil prices have since surged to recent highs as the Russia-Ukraine crisis rages on. While the disruption in Russian oil exports plays a major role in driving prices higher, oil prices have, in fact, been rising steadily since the signing of the Paris accords in 2016. Indeed, from the start of the Paris agreement till the Russia-Ukraine conflict, Brent crude oil price has risen by 152%. On the other hand, the prevailing Russia-Ukraine crisis has only pushed prices higher by 27%.

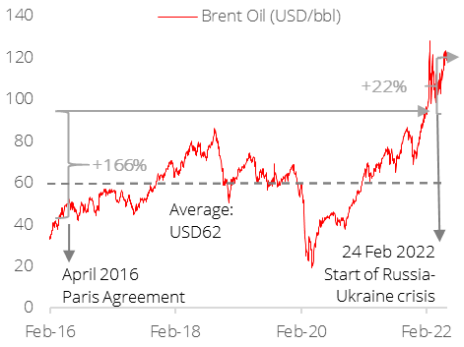
With most major economies pledging to reach carbon neutral by 2050, new regulations and policies are targeting the energy sector which produces about three quarter of global greenhouse gas emissions, while the US, EU, and China make up c.76%. Faced with onerous regulations from governments and shareholder pressure for more aggressive corporate climate targets, oil majors like BP (BP/ LN) and Shell (SHEL LN) have pledged to cut future oil production and invest in renewables instead.

Elevated oil price driving the shift to EVs. With energy prices staying elevated, the percentage of consumers surveyed planning to switch to Electric Vehicles (EVs) has doubled from 4% in 2019 to 11% in 2022. In another survey conducted, 25% of the respondents mentioned that they would change their vehicle if fuel price soar higher. Taken together, it is evident that consumers are starting to reassess their options and becoming more receptive towards EVs as costs continue to fall while charging infrastructure becomes more developed.

We have highlighted in CIO Vantage Point: Electric Vehicles (16 June 2021) our positive view on the industry and our view stays. According to the International Energy Agency, EV sales are forecasted to grow at a compound annual growth rate of 25% from 3m units in 2020 to 28m units by 2030. EVs are also projected to represent 22% of total car sales in 2030 from a mere 4% in 2020.

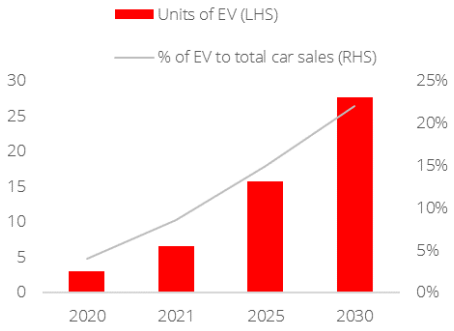
Benjamin Goh | Analyst **Daryl Lim** | Analyst

Figure 1: Rising price of oil



Source: IEA, DBS

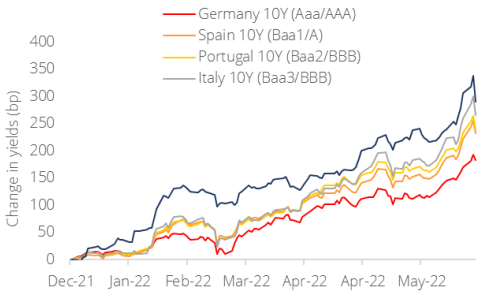
Figure 2: EV Sales Forecast



Source: IEA, DBS

Credit: Quality Credit offers shelter amid the storm at record high yields

Figure 3: Performance divergence of quality credit amongst European sovereign bonds



Source: Bloomberg, DBS

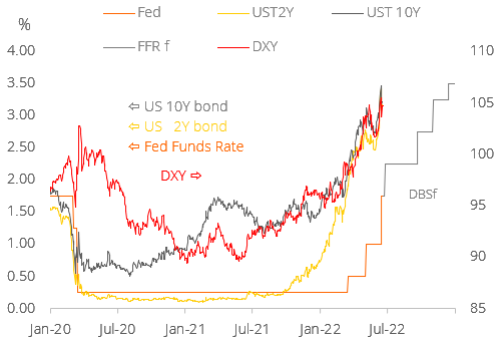
Faced with dual headwinds of tightening monetary policy and modest growth outlook at the start of the second quarter, we highlighted a preference to focus on quality to reduce portfolio volatility in our 2Q22 Global Credit outlook, noting that rate hike headwinds would result in flattening yield curves which would be unfavourable for riskier HY and EM names. Since then, markets have decidedly turned risk-off. While most bonds were not spared losses over the last few months, it was indeed the higher quality credit that proved to be a relative shelter amid the storm ravaging the financial markets.

Looking at the following chart (Figure 3) on European sovereign yields, we see a clear picture of the performance divergence of quality credit. Where AAA German sovereign 10Y bonds rose 182 bps YTD, weaker regions such as Greece saw their bonds rise by 290 bps. We believe that our call to stay with quality remains relevant, noting that yields on safe, investment grade credit have now exceeded 4% - providing good income generation while the broader markets face uncertainty. Risk-averse investors with cash to deploy should bear in mind that this could be a golden opportunity to switch into high grade credit and capitalise on record high yields.

Daryl Ho, CFA | Strategist

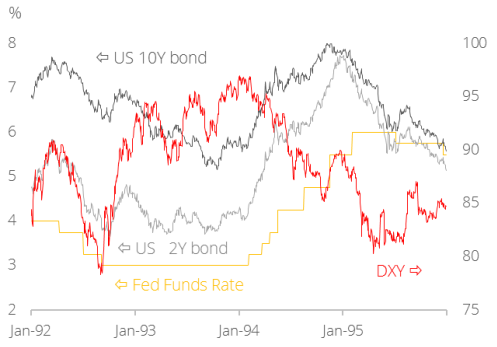
FX: USD should be coming off its peak like in 1994

Figure 4: More Fed hikes to ratify forward guidance



Source: Bloomberg, DBS

Figure 5: USD depreciated during the 1994 Fed hike cycle



Source: Bloomberg, DBS

US equity and bond markets were closed for a holiday. Investors are still pondering if the US economy would survive outsized Fed hikes. Let us pay attention to St Louis Fed President James Bullard, who has been right about the Fed's 50 bps hike in May and the 75 bps increase to 1.75% last week. Bullard expects the Fed to follow through on hikes to ratify the earlier forward guidance that lifted US bond yields to 3-3.5%, above the Fed's collective neutral range of 2-3%. During his semi-annual congressional testimonies on 23-24 June, Fed Chair Jerome Powell will tell US lawmakers to expect a 50 bps or 75 bps hike at the next Federal Open Market Committee meeting on 27 July. Fed Governor Christopher Waller has signaled his bias for a second 75 bps hike.

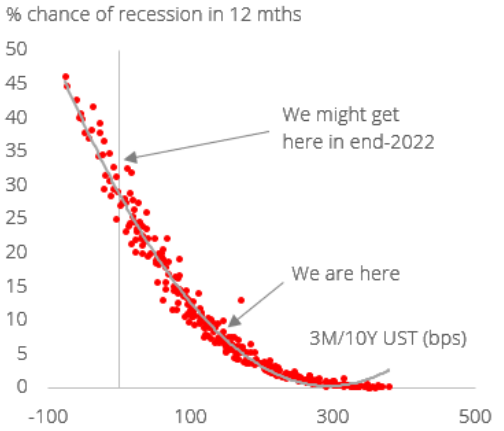
Bullard argued that strong actions were needed to prevent inflation expectations from becoming unhinged. He expects the US economy to keep expanding through 2022 amidst a robust labour market. However, last Friday, the New York Fed's economic model predicted an 80% chance of a hard landing like the 1990 recession. The model forecasted a 0.6% contraction on elevated inflation in 2022 and a 0.5% decline with waning inflation in 2023. However, the New York Fed clarified that this was not the official central bank's forecast. Nonetheless, the US Treasury yield curve is flat enough for markets to ponder rate cuts next year. Our chief economist expects three more 50 bps hikes in July, September, and November, and one final 25 bps rise in December, taking Fed Funds Rate to 3.50% this year.

Bullard hoped the US economy could soft-land as it did during the 1994 Fed hike cycle (which also delivered 50 bps and 75 bps hikes). Back then, the Fed Funds Rate and the US yield curve were above and not below US inflation like today. Everyone applauded Fed Chair Alan Greenspan for pre-empting inflation in 1994. Conversely, many former policymakers criticized the Fed for falling behind the curve and wrong about inflation being transitory. Not surprisingly, Bullard acknowledged that "the current economic situation was straining the Fed's credibility concerning its inflation target. The University of Michigan reported that 5Y inflation expectations rose from 3% in May to 3.3% in June - its highest level since 2008. 1Y inflation expectations held at 5.3-5.4% for four straight months. Against this background, one cannot help but wonder if USD should be coming off its high like in 1994. However, this is likely to be a slow process because the markets still need to have more confidence in picking up the DXY components – EUR, JPY, GBP, CHF, SEK, and CAD – from their depressed levels.

Philip Wee | FX Strategist

Rates: Inflation Versus Recession Risks

Figure 6: US recession probabilities & 3M/10Y UST curve



Source: Bloomberg, NY Fed, DBS

Markets continue to struggle between inflation and recession risks, making a poor backdrop for risk taking, but the narrative on these two issues can shift quickly. Back in early May, the market was worried about central banks tightening and drove 10Y US yields to an interim top of 3.2%. Subsequently, there was a pullback towards 2.7% when recession worries hit. This was followed by a rebound in yields to 3.5% (our current forecasts for 2Q/3Q). A quick resolution to this issue is unlikely. For markets to be comfortable that price pressures will cool, it would probably require a few Consumer Price Index (CPI) prints that show that sequential inflation is falling. This would allow the Fed to downshift to normal 25 bps hikes and ease duration fears somewhat. On the other hand, we are also watching to see if economic momentum stalls. There are some early indications from rising jobless claims and weak housing data. These are unlikely to change the Fed's tightening stance just yet but could become more meaningful towards the end of the year.

The 3M/10Y segment of the US Treasury curve can provide signals of impending recession. Currently, the curve is still steep (about 160 bps) and that translates into a recession probability of <10% over the coming 12 months. However, if the Fed continues with Jumbo hikes, the curve could well be flattish / slightly inverted by the end of the year. This would put the odds of recession into the 30% area, elevated by any measure. Clearly, the information captured here is an interplay of the CPI path, the economic growth path, and the Fed's actions. The ideal scenario would be one where CPI heads lower before economic momentum stalls / reverses. Unfortunately, the odds of CPI staying sticky as growth slows is also significant. Clarity would likely only be seen after a few more months of data. The Fed's reaction function is also important. Recession risks are already being closely monitored by market participants. It is not a given that Fed would have to hike to 4% in 1H23 (risking a sharp slowdown), only to cut back down in 2H23. A more balanced path to tackle inflation (a chunk of which is supply side driven) amidst growth headwinds may well be a more palatable way to navigate cross currents.

Eugene Leow | Rates Strategist

Thematics: Hospitality S-REITs – Sun is shining again

- A summer surge in travel demand on the cards
- Hoteliers have pricing power in their hands, expect 2022 performance to exceed pre-pandemic levels
- Selected S-REITs expected to report robust operating metrics in US come 1H22 results

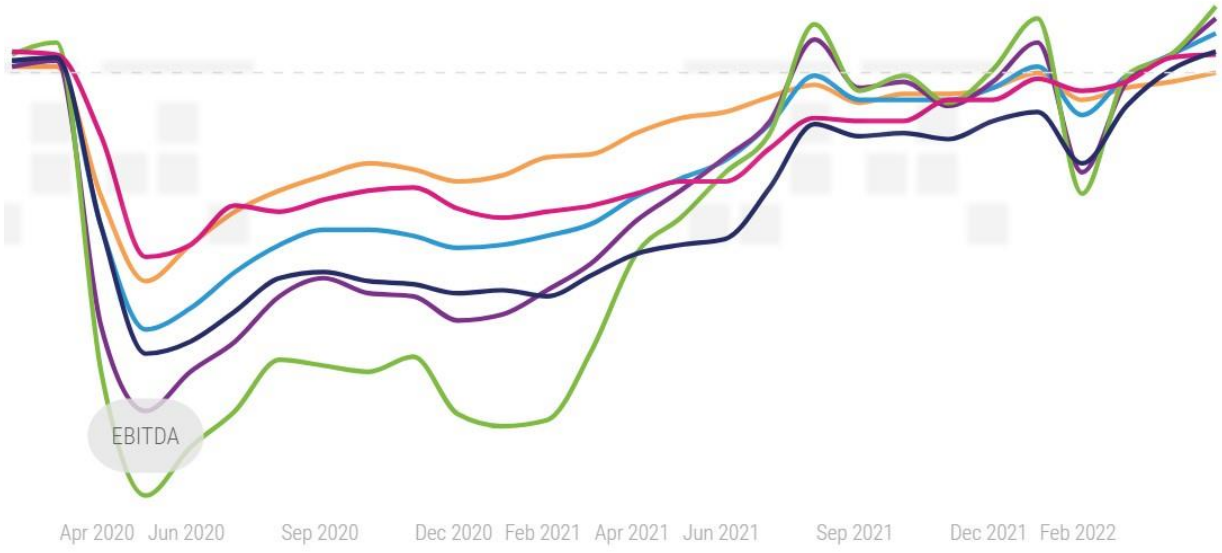
A summer travel surge on the cards as vacationers flock to holiday destinations. We are excited about the prospects of a rebound in operating metrics observed in the US, starting from 2Q22, which is the peak travel season. We see a variety of positive indicators starting from (i) major US airlines raising guidance on higher-than-expected ticket prices and capacity yields, (ii) cruise spending now just 10% shy of full recovery, and (iii) strong forward booking trends on travel websites. These encouraging signs point towards the ability of hospitality S-REITs with US exposures to post strong operating metrics come 1H22 results.

Hoteliers upping prices as pricing power returns in the US. Recent forward outlook statements from major hotel groups (Marriott (MAR US), Hyatt (H US), and Hilton (HLT US)) are also turning more promising, with most hoteliers expecting to see a leap in revenue per available room (RevPAR) in 2Q-3Q22, on the back of robust domestic travel demand for both leisure and corporate travel segments. With pricing power back in the hoteliers' hands, we also note that hospitality analytics firm STR and Tourism Economics recently upgraded their recovery timeline forecast for US hotel RevPAR to surpass 2019 (or pre-Covid-19) levels by 2022). We note that these revisions are inflation-adjusted, implying that the pent-up demand for travel will likely be sustained, despite high inflation rates in the US.

Close correlation between RevPAR and share price not fully reflected in valuations. With RevPAR-led recovery underway with further strength boosting upside potential, we remain confident that a re-rating in share prices of selected hospitality S-REITs with US exposure can be sustained. DBS Group Research remains vested in the multi-year growth story that the hospitality sector offers.

Geraldine WONG | Analyst
Tabitha FOO | Analyst
Derek TAN | Analyst

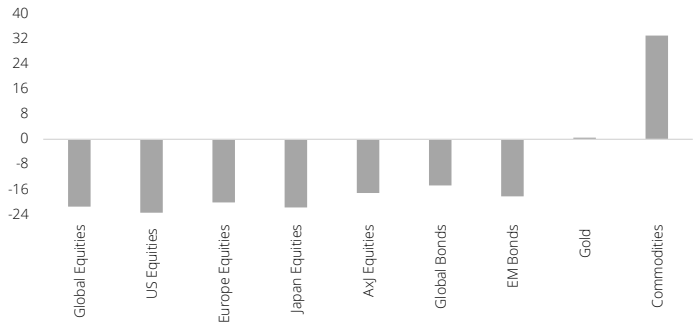
Figure 7: Estimated US hotel revenues, profits, and metrics indexed to 2019



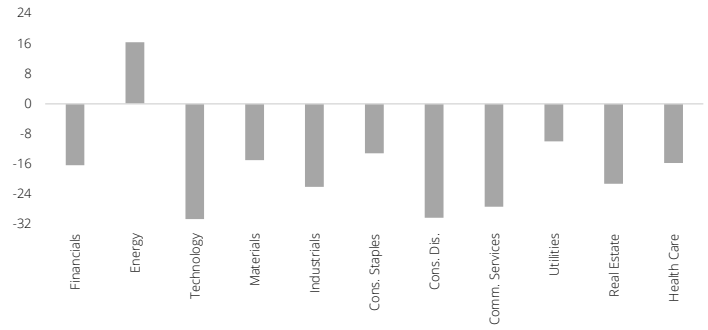
Source: DBS

CIO Markets Watch

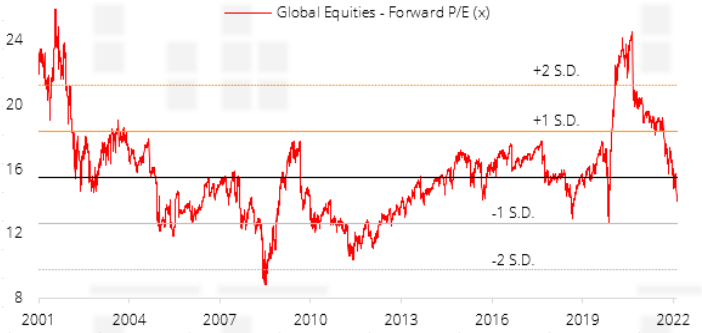
Global Cross Assets YTD Returns



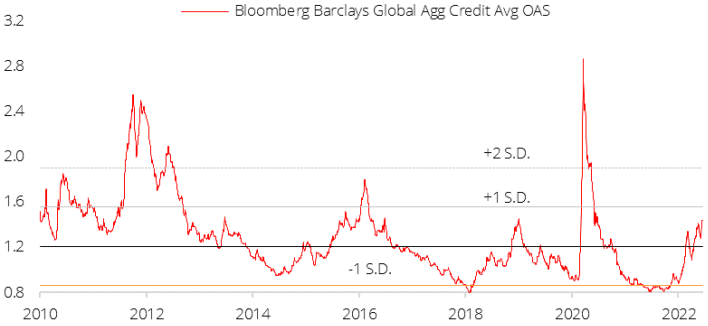
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



INDEX RETURNS

	1 week	MTD	QTD	YTD
Equities				
S&P 500	-2.0%	-11.1%	-18.9%	-22.9%
NASDAQ	-0.1%	-10.6%	-24.1%	-31.0%
Russell 2000	-2.9%	-10.6%	-19.5%	-25.8%
Euro Stoxx 600	-1.3%	-8.2%	-10.7%	-16.5%
Nikkei-225	-4.5%	-5.5%	-7.4%	-10.5%
MSCI WORLD	-2.0%	-10.6%	-18.3%	-22.8%
MSCI ACWI	-1.9%	-10.2%	-17.6%	-22.3%
MSCI Asia ex-Japan	-1.4%	-5.7%	-10.4%	-17.8%
MSCI EM	-1.6%	-7.2%	-12.4%	-18.8%
HSCEI	0.8%	-0.2%	-1.7%	-10.2%
SHCOMP	1.8%	4.0%	1.9%	-8.9%
Hang Seng	0.5%	-1.2%	-3.8%	-9.5%
STI Index	-1.4%	-4.2%	-9.2%	-0.9%
Fixed Income				
Barclays Global Aggregate	0.3%	-4.1%	-9.1%	-14.7%
Barclays US Aggregate	0.7%	-2.8%	-5.9%	-11.5%
Barclays US High Yield	-0.3%	-5.5%	-8.7%	-13.1%
Barclays Euro Aggregate	-0.3%	-4.4%	-9.0%	-13.9%
Barclays Euro High Yield	-1.6%	-4.6%	-8.6%	-12.3%
JPM EMBI Global	0.0%	-4.8%	-9.8%	-18.2%
JPM EMBI Global Diversified	-2.4%	-5.4%	-10.4%	-20.2%

PRICES & SPREADS

	Spot	1Q22	4Q21	3Q21
Rates				
Fed Funds Target	1.75	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	3.23	2.34	1.51	1.49
Japanese Govt. Bond 10-yr	0.23	0.21	0.07	0.07
German Bunds 10-yr	1.75	0.55	-0.18	-0.20
Spreads				
US Agg Corporate Spread	1.44	1.16	0.92	0.84
US Corporate HY Spead	5.02	3.25	2.83	2.89
Euro Agg Corporate Spread	1.95	1.31	0.97	0.87
EM USD Agg Spread	3.69	3.13	2.85	2.87
Currencies				
US Dollar Index (DXY)	104.7	98.3	95.7	94.2
EUR/USD	1.05	1.11	1.14	1.16
USD/JPY	135.1	121.7	115.1	111.3
USD/CNY	6.7	6.3	6.4	6.4
Commodities				
WTI Oil	110	100	75	75
London Metal Exchange (LMEX)	4213	5174	4502	4161
TR/CC CRB Commodity	309	295	232	229
Gold	1839	1937	1829	1757

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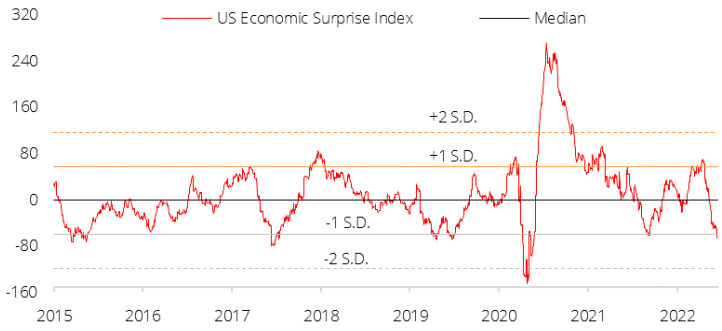
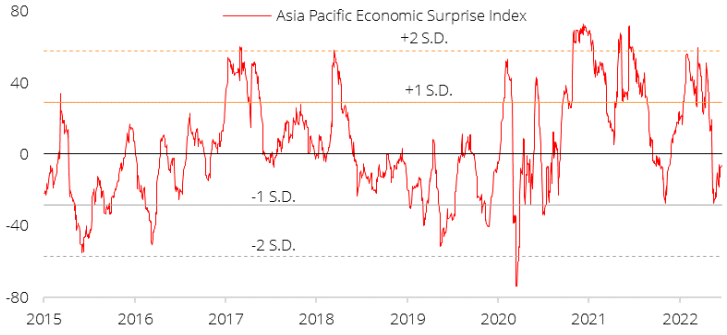
CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



MACRO CALENDAR

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims (US)	23-Jun	18-Jun	225k	229k
U. of Mich. Sentiment (US)	24-Jun	Jun	50.2	50.2
Durable Goods Orders (US)	27-Jun	May	0.50%	0.50%
MBA Mortgage Applications (US)	22-Jun	17-Jun	--	6.60%
New Home Sales (US)	24-Jun	May	592k	591k
S&P Global Eurozone Manufacturing	23-Jun	Jun	53.8	54.6
S&P Global US Manufacturing PMI	23-Jun	Jun	56	57
Existing Home Sales (US)	21-Jun	May	5.40m	5.61m

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
CPI YoY (SG)	23-Jun	May	5.50%	5.40%
Jibun Bank Japan PMI Mfg (JP)	22-Jun	Jun	--	53.3
Industrial Production YoY (SG)	24-Jun	May	5.50%	6.20%
Natl CPI YoY (JP)	23-Jun	May	2.50%	2.50%
Jibun Bank Japan PMI Composite (JP)	22-Jun	Jun	--	52.3
Jibun Bank Japan PMI Services (JP)	22-Jun	Jun	--	52.6
Machine Tool Orders YoY (JP)	22-Jun	May	--	23.70%
Leading Index CI (JP)	27-Jun	Apr	--	102.9

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