CIO Weekly

19 July 2022

Key Points

- Equities: Recession worries driving commodity prices lower juxtapose the medium-term undersupply situation; stay constructive on energy and mining sectors
- Credit: Performance of DM IG validates our call to focus on short-duration quality credit since 2Q22
- FX: Monetary divergence driving USD/JPY higher may run out of steam; EUR's weakness on recession risks not ironclad
- Rates: All eyes on ECB and BOJ (8301 JP) policy meeting on 21 July; ECB poised to lift policy rates by 25bps while the odds of a BOJ pivot remain low
- Thematics: China/HK Biotech Sector – time to bottom fish
- 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	31,072.6	-0.7%	-14.5%
S&P 500	3,830.9	-0.8%	-19.6%
NASDAQ	11,360.1	-0.8%	-27.4%
Stoxx Europe 600	417.6	0.9%	-14.4%
DAX	12,959.8	0.7%	-18.4%
CAC 40	6,091.9	0.9%	-14.8%
FTSE 100	7,223.2	0.9%	-2.2%
MSCI AxJ	640.6	1.9%	-18.8%
Nikkei 225	26,788.5	0.0%	-7.0%
SHCOMP	3,278.1	1.6%	-9.9%
Hang Seng	20,846.2	2.7%	-10.9%
MSCI EM	980.5	1.9%	-20.4%
UST10-yr yield*	3.0	2.4%	147.5
JGB 10-yr yield*	0.2	0.0%	16.4
Bund 10-yr yield*	1.2	7.3%	139.3
US HY spread*	5.2	-2.6%	232.0
EM spread*	485.0	-2.2%	154.8
WTI (USD)	102.6	5.1%	36.4%
LMEX	3,613.0	3.4%	-19.7%
Gold (USD)	1,709.2	0.1%	-6.6%

Source: Bloomberg

* Changes in basis points

Equities: Tight supply situation to persist

Near-term recession fears and a strong USD have clouded the outlook for commodity demand and prices. We believe recession fears are overstated, which undermine the undersupply in commodities in the medium term. With China still in semi-lockdowns, the peak in demand is yet to come. We remain constructive on the outlook for oil, selected base metals, and gold.

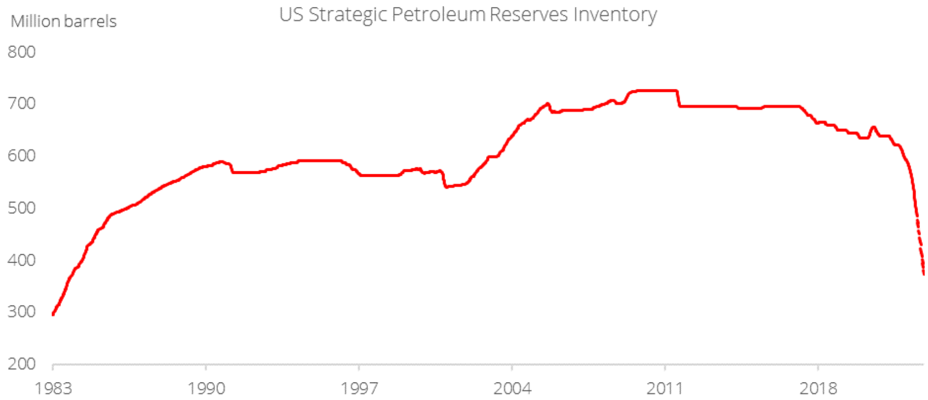
Oil is the commodity sector with the worst supply disruption. However, we do not think there is a war premium built in at prices of USD90-100. There is thus upside risk if the conflict drags on and Russian energy supplies continue to be disrupted. Furthermore, bearing in mind that the US Strategic Petroleum Reserve's release of 1 million barrels of oil per day to ease prices will not be available after October, the drawdown in reserves will need to be replenished. Unincentivised upstream producers, due to environmental, social, and governmental issues, as well as government regulations, investor pressure, and lack of access to financing have restricted growth in upstream exploration activities, contributing to further undersupply in the medium-term.

The energy transition towards reaching net zero emission by 2050 is supportive of demand for copper, which is used in electrification, and battery materials such as lithium, nickel, and cobalt which are used for electric vehicles. Given our view that prices have yet to reach an optimum level to incentivise capital investment, either a rise in spot prices rise or delays in production will lead to undersupply and drive up prices.

Spikes in gold prices have a history of being their own worst enemy. Since April, gold exchange-traded funds investors took profit with net outflows of 4.6m troy as rising interest rates and USD hurt investment appetite towards gold, leading to a USD270 drop in gold price. The longer-term prospects for gold as a store of value is intact as prices have proven to be relatively resilient in a volatile environment. At current levels, gold prices should find some relief as we believe that the dollar and US bond yields have topped out in the near term. A decline in these two variables should drive gold prices higher.

Joanne Goh | Strategist

Figure 1: Reserves dip to a 40Y low, replenishment needed

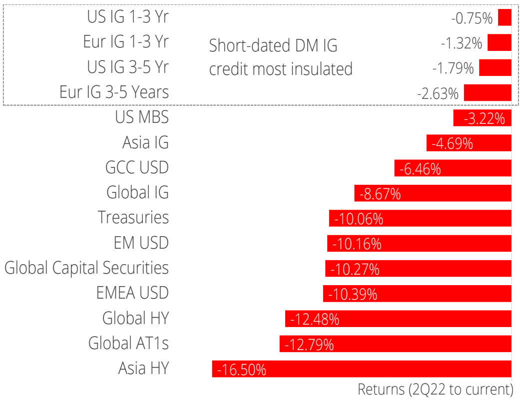


Source: Bloomberg, DBS

Note: Dotted portion refers to forecast

Credit: Performance of DM IG validates our call to focus on short-duration quality credit

Figure 2: Shorter-dated DM IG continues to outperform



Source: Bloomberg, DBS
(Returns are from 31 March to 15 July 2022)

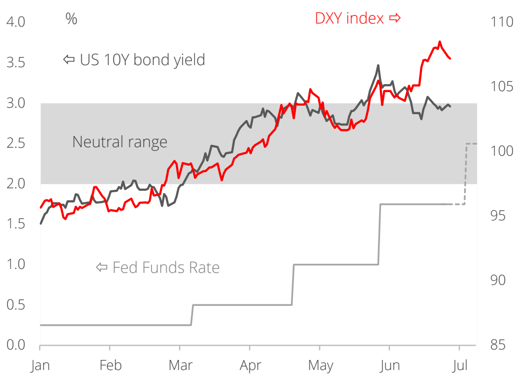
The latest string of inflation prints continue to soar at multi-decade highs, despite central banks' hawkishness over the past months. While they have had limited success in quelling the current persistent inflation thus far, these aggressive monetary policies have posed significant headwinds to economic growth, with markets decidedly turning risk-off since the turn of the second quarter, increasingly threatening to tip world economies into recession and further complicating an environment that has been watershed for most risk assets.

Amid the selloff in global markets, the performance of bond markets continues to validate our call to focus on short-dated quality credit highlighted in our 2Q22 Global Credit outlook. Since then, our call has played out and short-dated developing markets investment grade (IG) has indeed provided investors the best protection (Figure 2). With IG credit now offering record-high yields above 4%, investors are well compensated for staying with quality – coupons provide stable income generation even as most other risk assets grapple with volatility, while high quality credit stands to benefit from flight-to-quality sentiment should rates reprice higher against a backdrop of growth concerns. We outline this and other benefits of switching from cash to quality credit in our 3Q22 Global Credit outlook.

Daryl Ho | Strategist

FX: Inconsistencies in G3 currencies

Figure 3: Should DXY be near 110 or below 105?



Source: Bloomberg, DBS

The US Federal Reserve is in a blackout period ahead of the Federal Open Market Committee (FOMC) meeting on 27 July. Many Fed officials favour a back-to-back 75 bps hike to 2.50% after another strong Consumer Price Index inflation print. After the better-than-expected US jobs report, they also pushed back against the US recession talk. A small minority in the market thinks the Fed could surprise with a 100 bps increase like the Bank of Canada last week. However, the inverted US Treasury yield curve (10Y-2Y differential) was the deepest since the global financial crisis. So was the near-20% YTD fall in the S&P 500.

The greenback's appreciation may stall next week after the Fed Funds Rate returns into the 2-3% neutral range. The market's reluctance to stomach more jumbo moves was evident in the inclination of the 10Y bond yield to stay neutral below 3%. Another sign was the DXY diverging from the 10Y yield after the 75 bps hike in June. Based on the 14-day, 14-week, and 14-month relative strength indices, USD is profoundly overbought, and EUR and JPY extremely oversold.

On 21 July, the Bank of Japan (BOJ) and the European Central Bank (ECB) will meet to decide on monetary policy. They are the remaining central banks with negative policy rates. As of mid-July, the JPY depreciated 17% YTD to become the worst performing Developed Market currency. The EUR was not far behind with an 11.4 loss. However, JPY might be near a major resistance at 140 per USD, a level not seen since 1998. EUR also tried and failed several times to break below parity last week.

The monetary divergences story driving USD/JPY higher may run out of steam. Besides the BOJ capping the 10Y JGB yield at 0.25% under its yield curve control framework, rising US bond yields also drove USD/JPY higher. Apart from questions over the sustainability of outsized hikes by the Fed and other central banks, Japan may start to review or correct Abenomics. With voters delivering a strong mandate to the Liberal Democratic Party at the Upper House elections, Prime Minister Fumio Kishida has an opportunity to push his "new capitalism" agenda. Signs of change will be evident when Kishida elevates more people from his faction in a cabinet reshuffle expected in August or September. Many expect Kishida to emphasize fiscal discipline (vs stimulus under Abenomics) while maintaining spending, and will pay close attention to who will replace

BOJ Governor Haruhiko Kuroda when his term ends in April 2023. After raising the economic assessment for seven out of the nine regions in Japan last week, the BOJ is set to lift its inflation forecast above 2% this week. Finally, the Kishida government has not eased the sense of urgency over the JPY's weakness and its negative impact on consumers and corporates.

Likewise, the ECB has recognised the weak EUR's threat to its price stability goal. But first, the ECB is scheduled to deliver its first hike in 11 years via a 25 bps increase in the deposit facility rate to -0.25%. With other central banks stepping up their fight against inflation, and the EUR feeble just above parity, the ECB may bring forward the 50 bps hike expected in September into this Thursday's governing council meeting.

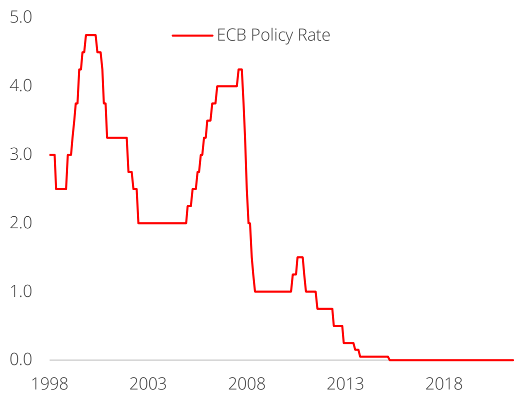
Given the bad experiences of the EU sovereign debt crisis that followed the last hikes in 2011, the ECB will introduce its anti-fragmentation tool to avert a sudden widening in the spreads of the peripheral EU nations. For now, there is no imminent sign of another crisis. The 10Y bond yield spread between Italy and the EU has widened according to the US rate cycle. Unlike 2011, Italy's yields were not tearing above the US and EU policy rates. Lastly, the EU crisis was a confidence crisis that started with accounting inconsistencies in Greece.

EUR's weakness on recession risks is not ironclad. The European Commission's (EC) latest downgrade for EU GDP growth was mild for 2022 and positive for 2023. Recession risks are reflected more in the inverted US yield curve compared to the EU curve. Hence, it was ironic that EUR tracked the US yield curve lower. More so when the EC's higher inflation outlook reflects ECB's view for inflation to stay above the 2% target through 2024.

Philip Wee | FX Strategist

Rates: Three different speeds, three different curves

Figure 4: Behind the curve



Source: Bloomberg, DBS

Fed policy takes a backseat this week as attention shifts towards the European Central Bank (ECB) and Bank of Japan (BOJ) policy meeting on 21 July. The ECB is poised to lift policy rates by 25 bps (first time in this cycle). Note that the ECB is widely seen to be even further behind the curve than the Fed. With headline CPI expected to run even hotter in June (consensus: 8.6% y/y, May figure: 8.1%), it is very difficult to justify interest rates are so low. To put things into perspective, US CPI is comparable to the Eurozone, but the Fed has already hiked by a cumulative 150 bps this year and is on track to deliver another 75 bps later this month. To be sure, the Eurozone faces considerable challenges including its ongoing energy woes and fragmentation worries. Market participants will be closely watching to see if a tool will be unveiled as the ECB hikes. 10Y BTP-Bund spreads have tightened from wides and are trading around 200 bps. But if the tool falls short of expectations, it might be difficult for the ECB to manage inflation expectations (tighten) without peripheral spreads blowing out. Considerations are also particularly dicey amid political uncertainties in Italy.

Meanwhile, the odds of a BOJ pivot still seem low. Pressure did build in the lead up to the previous BOJ meeting. These include a rapidly weakening JPY, acute selling pressures on JGB futures, and 10Y JGB yields hitting the top of the yield target (0.25%). We believe that inflation expectations and realised inflation may be more important in driving the BOJ. These might feed into the policy calculus, but we doubt that that market pressure will be able to prompt a BOJ pivot. We think that the curves will evolve according to where they are on their monetary policy cycles. The US, which is the most advance, would have a flattish govvie curve. At this point, we think that the rate cut pricing in 2023 might be premature. The German curve should flatten as rate hikes get factored in and delivered. If Eurozone's CPI (due today), surprised on the upside, short-tenor govvies should bear the brunt of the adjustment. Lastly, if the BOJ eventually tightens, the JGB curve should see steepening pressures.

Eugene Leow | Rates Strategist

Thematics: China/HK Biotech Sector – Time to bottom fish

- Biotech stocks listed in Hong Kong sink 58% in one year, close to historical trough
- Stocks dual listed in the US dropped even more
- We believe it is time to bottom fish
- We favour stocks which can make inroads into the US market

Negatives largely priced in. The Hang Seng Hong Kong-Listed Biotech Index dropped 58% in the last 12 months, which is steeper than the 36% decline in the Nasdaq Biotechnology Index, due to price cuts and tightened clinical trial procedures in China, rejected launch of Chinese drugs in the US, and the possible delisting of selected stocks in the US. Trading at an enterprise value (EV, mkt cap +net debt or –net cash) to FY22 sales that is 84% below the global average, negatives are largely priced in, and it is now time to bottom fish.

Buy stocks that can make inroads into the US market. While many countries have been lowering drug prices, drug prices in the US have been rising by 4-10% per annum. during 2016-20. Thus, entry into the US is crucial for sales growth. Since the US authorities rejected launch of two innovative drugs from two Chinese players in 1H22, the market is concerned that Chinese players cannot make inroads into the US. We note that the reason for the rejection was the absence of US patients in their clinical trials. Hence, running clinical trials in the US with sizeable numbers of US patients participating is crucial.

Despite market concerns, DBS Group Research believes selected Chinese stocks will keep their listed status in the US. The US has identified 150 US-listed Chinese companies as potential targets for delisting as the US thinks their financial reports are unable to be inspected. However, there are three companies who have changed their principal auditor to a US firm, adopting similar practices of US firms with businesses in China. As the auditor is in the US, the authorities are able to inspect their financials. This puts them at a low risk of being delisted.

Mark Kong | Analyst   Nico Chen | Analyst

Figure 5: Hang Seng Hong Kong-Listed Biotech Index

Source: Bloomberg

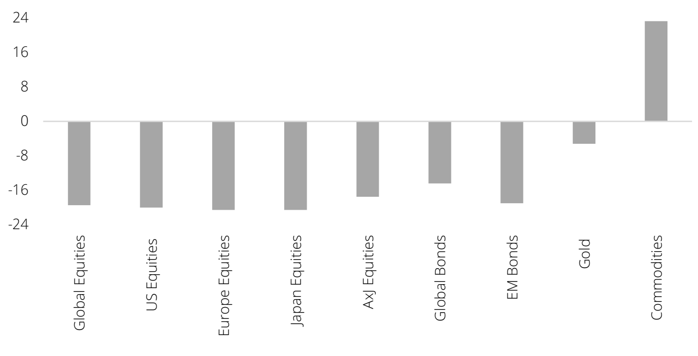
Figure 6: Bio & pharm sector valuation: Enterprise value / FY22F sales

Location of stock exchange(s)	No. of company	EV / Best 22F sales (mkt cap weighted)	EV / Best 22F sales (simple average)	Location of stock exchange(s)
Hong Kong	55	24	24	Hong Kong
Mainland China	103	11	8	Mainland China
U.S.	457	47	150	U.S.
South Korea	31	17	5	South Korea
India	38	5	3	India
Taiwan	8	8	9	Taiwan
Japan	48	5	23	Japan
Western Europe	165	7	13	Western Europe
Australia	23	13	17	Australia
Average		15	28	Average
Hong Kong's discount to average		62%	-15%	Hong Kong's discount to average

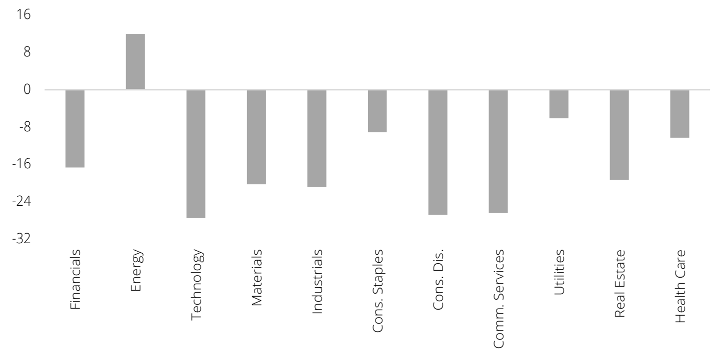
Source: Bloomberg
Updated as of 8 July 2022

CIO Markets Watch

Global Cross Assets YTD Returns

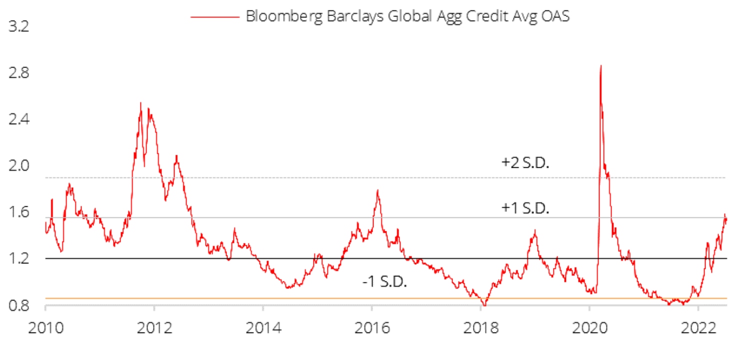


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

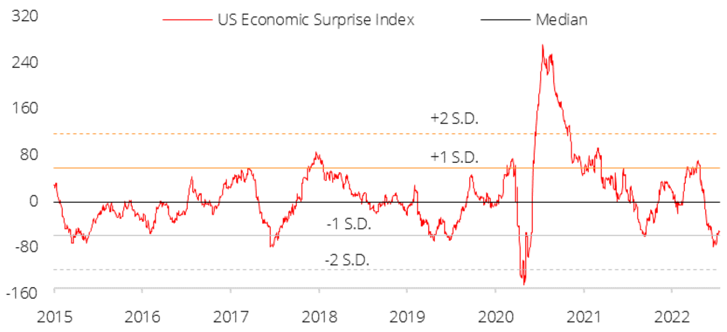
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-0.6%	1.2%	1.2%	-19.6%
NASDAQ	-0.1%	3.0%	3.0%	-27.4%
Russell 2000	0.4%	1.8%	1.8%	-22.6%
Euro Stoxx 600	0.6%	2.6%	2.6%	-14.4%
Nikkei-225	-0.1%	1.5%	1.5%	-7.0%
MSCI WORLD	-0.2%	0.8%	0.8%	-20.5%
MSCI ACWI	-0.2%	0.5%	0.5%	-20.5%
MSCI Asia ex-Japan	-0.1%	-1.9%	-1.9%	-18.8%
MSCI EM	-0.1%	-2.0%	-2.0%	-20.4%
HSCEI	-2.1%	-6.5%	-6.5%	-13.0%
SHCOMP	-1.1%	-3.5%	-3.5%	-9.9%
Hang Seng	-1.3%	-4.6%	-4.6%	-10.9%
STI Index	-0.3%	0.6%	0.6%	-0.1%
Fixed Income				
Barclays Global Aggregate	0.2%	-0.6%	-0.6%	-14.4%
Barclays US Aggregate	0.4%	0.6%	0.6%	-9.8%
Barclays US High Yield	0.1%	1.8%	1.8%	-12.7%
Barclays Euro Aggregate	0.1%	1.3%	1.3%	-11.0%
Barclays Euro High Yield	0.2%	1.6%	1.6%	-12.9%
JPM EMBI Global	-1.1%	-1.3%	-1.3%	-19.9%
JPM EMBI Global Diversified	-2.1%	-2.1%	-2.1%	-22.8%

PRICES & SPREADS

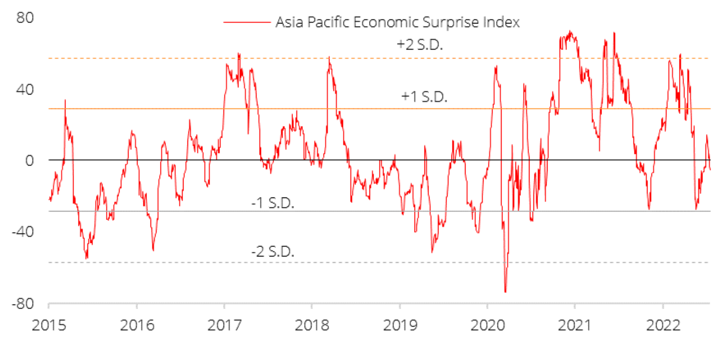
	Spot	2Q22	1Q22	4Q21
Rates				
Fed Funds Target	1.75	1.75	0.50	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	2.99	3.02	2.34	1.51
Japanese Govt. Bond 10-yr	0.23	0.23	0.21	0.07
German Bunds 10-yr	1.21	1.33	0.55	-0.18
Spreads				
US Agg Corporate Spread	1.50	1.55	1.16	0.92
US Corporate HY Spead	5.29	5.69	3.25	2.83
Euro Agg Corporate Spread	2.05	2.15	1.31	0.97
EM USD Agg Spread	4.32	4.04	3.13	2.85
Currencies				
US Dollar Index (DXY)	107.4	104.7	98.3	95.7
EUR/USD	1.01	1.05	1.11	1.14
USD/JPY	138.1	135.7	121.7	115.1
USD/CNY	6.7	6.7	6.3	6.4
Commodities				
WTI Oil	103	106	100	75
London Metal Exchange (LMEX)	3613	3879	5174	4502
TR/CC CRB Commodity	287	291	295	232
Gold	1709	1807	1937	1829

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)	21-Jul	16-Jul	240k	244k
ECB Main Refinancing Rate (EU)	21-Jul	21-Jul	0.0025	0
CPI y/y (EU)	19-Jul	Jun	8.60%	8.10%
MBA Mortgage Applications (US)	20-Jul	15-Jul	--	-1.70%
S&P Global Eurozone Manufacturing PMIe (EU)	22-Jul	Jul	51	52.1
S&P Global US Manufacturing PMI (US)	22-Jul	Jul	52	52.7
Housing Starts (US)	19-Jul	Jun	1580k	1549k
ECB Deposit Facility Ratee (EU)	21-Jul	21-Jul	-0.25%	-0.50%

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
CPI y/y (SG)	25-Jul	Jun	--	5.60%
Jibun Bank Japan PMI Mfg (JP)	22-Jul	Jul	--	52.7
Natl CPI y/y (JP)	22-Jul	Jun	2.40%	2.50%
BOJ Policy Balance Rate (JP)	21-Jul	21-Jul	-0.10%	-0.10%
Natl CPI Ex Fresh Food y/y (JP)	22-Jul	Jun	2.20%	2.10%
Jibun Bank Japan PMI Services (JP)	22-Jul	Jul	--	54
Jibun Bank Japan PMI Composite (JP)	22-Jul	Jul	--	53
Machine Tool Orders y/y (JP)	21-Jul	Jun	--	17.10%

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