CIO Weekly

6 September 2022

Key Points

- Equities: High inflation weighs on content subscription; ad-supported business models poised to benefit
- Credit: IG credit offers safe haven appeal at generous yields
- FX: Fed Funds Rate to peak at 4% this year. We expect the DXY to peak in 4Q22 before turning lower in 2023 on Fed pause
- Rates: Inflation and inflation fears have peaked. However, transition into peak Fed rhetoric and Fed downshift might have been delayed
- Thematics: Opportunities in ASEAN's consumer sector despite inflation
- The Week Ahead: Keep a lookout for US Change in Initial Jobless Claims; China Inflation Numbers

GLOBAL CROSS ASSETS

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	31,318	0.0%	-13.8%
S&P 500	3,924	0.0%	-17.7%
NASDAQ	11,631	0.0%	-25.7%
Stoxx Europe 600	413	-0.6%	-15.3%
DAX	12,761	-2.2%	-19.7%
CAC 40	6,093	-1.2%	-14.8%
FTSE 100	7,287	0.1%	-1.3%
MSCI AxJ	620	-0.6%	-21.4%
Nikkei 225	27,620	-0.1%	-4.1%
SHCOMP	3,200	0.4%	-12.1%
Hang Seng	19,226	-1.2%	-17.8%
MSCI EM	968	-0.4%	-21.4%
UST10-yr yield*	3.19	0.0	167.9
JGB 10-yr yield*	0.23	-0.4	16.6
Bund 10-yr yield*	1.56	3.9	174.2
US HY spread*	4.93	0.0	210.0
EM spread*	430.33	0.0	100.1
WTI (USD)	86.87	0.0%	15.5%
LMEX	3,638.10	0.8%	-19.2%
Gold (USD)	1,710.40	-0.1%	-6.5%

Source: Bloomberg

* Changes in basis points

Equities: High inflation weighs on content subscription

Paradigm shift for global inflation outlook. After four decades of weak inflation, the US Consumer Price Index hit a 40-year high of 9.1% in June 2022. The surge in prices can be attributed to a myriad of reasons: (1) Russia-Ukraine conflict affecting energy prices, (2) China's Zero-Covid policy impacting global supply chains, and (3) Central bankers signalling that the era of ultra-low inflation is unlikely to return.

Consumers adjust to the new normal and audit their expenses. Against this high inflationary backdrop, consumers see the need to exercise prudence on their spending. Consumer spending in real terms has dipped from 9.3 in June 2021 to 1.6 in June 2022. In another survey conducted by YouGov, 35% of consumers would consider cancelling their streaming subscriptions as a way of managing expenditures against rising costs of living. This is evident in Netflix's loss of 1.2m subscribers after a decade of unstoppable growth.

Advertising model—the modus vivendi. The shift to control spending amongst consumer will benefit ad-supported business models in the content streaming space. The biggest players, Disney (DIS US) and Netflix (NFLX US), have both announced plans to launch ad- supported tiers by the end of the year. We maintain our preference for streamers with advertising-based models over subscription-only models as customers are more willing to put up with ads if they can still consume their favourite content at a lower cost.

In CIO Vantage Point: Content is King (dated 30 June 2022), we highlighted our positive view on the industry and our view remains. According to Fortune Business Insights, the global video streaming market is projected to grow at a CAGR of 19.9%, from USD473b in 2022 to USD1,690b by 2029.

Benjamin Goh | Analyst

Daryl Lim | Analyst

Figure 1: Rising inflation weighs on consumer spending

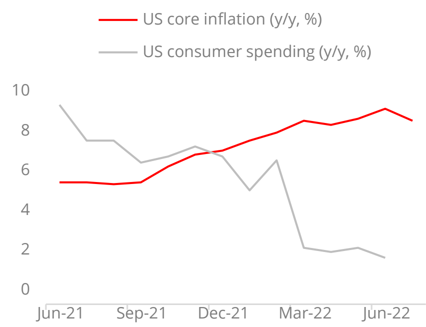
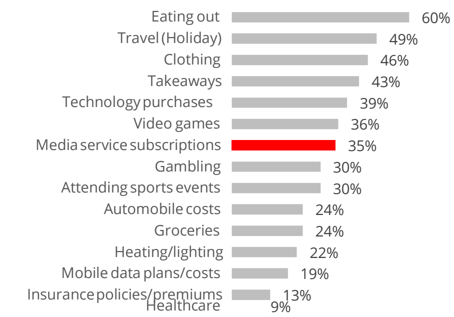


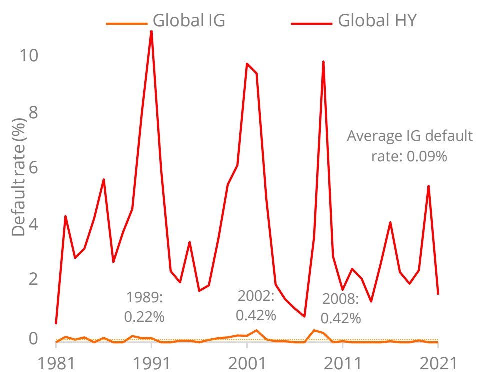
Figure 2: Consumer rankings of household cutbacks



Source: Bloomberg, YouGov, DBS

Credit: IG credit offers safe haven appeal at generous yields

Figure 3: Historical IG default rates consistently below 0.5% annually



Source: S&P Global Ratings Research, S&P Global Market Intelligence's CreditPro, DBS

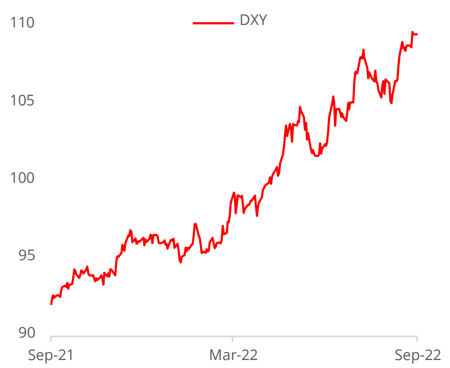
Rhetoric from Jackson Hole last month firmly reiterated the Fed's commitment to quelling red hot inflation through monetary tightening, even at the expense of economic growth. This may come as no surprise to markets, which had already priced in much of the Fed's highly anticipated hiking cycle on hawkish guidance since the start of the year. Nonetheless, the present uncertainty will inevitably present challenges for households and corporates alike, suggesting that investors should avoid taking on inordinate credit risk.

Given growth concerns and mid-to-late credit cycle dynamics, investors seeking additional returns through credit risk would do well to remain within the safety of quality. With global Investment Grade (IG) yields currently exceeding 4% – even higher than what was observed during the peak of the Covid crisis – investors would be generously rewarded for taking on modest default risk. Indeed, IG credit offers safety in an environment fraught with uncertainty. As shown in Figure 3, historical data over the past 40 years show global IG's stellar track record of an average annual default rate of less than 0.1%. Even during peak corporate default periods such as the Global Financial Crisis of 2008-2009, IG credit annual defaults remained within just 0.5%. This suggests that should macroeconomic headwinds prevail, flight-to-quality sentiment would further benefit this space.

Daryl Ho | Strategist

FX: Not fighting the Fed

Figure 4: To peak in 4Q22



Source: Bloomberg, DBS

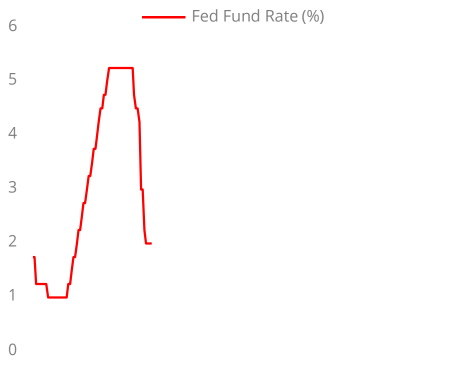
We have revised our outlook for Fed hikes and the USD. Our chief economist forecasts a third 75 bps hike to 3.25% at the Federal Open Market Committee meeting on 21 September. He sees the Fed Funds Rate peaking higher at 4.0% this year instead of 3.5% previously, and holding at 4.0% throughout 2023. Hence, assuming a soft landing for the US economy, we expect the DXY to peak in 4Q22 before turning lower in 2023 on the Fed pause.

On 7 September, the Fed's Beige Book and Fed Vice Chair Lael Brainard's speech should reinforce the Fed's hawkish message at the Jackson Hole Symposium. Last Friday's slower US nonfarm payrolls (315k actual vs 526k prior) and higher unemployment rate (3.7% actual vs 3.5% previous) in August will not stop the Fed from lifting rates above the 2-3% neutral range towards a restrictive level of 4% or above by early next year. On 6 September, prices paid in the ISM Services Purchasing Managers' Index will indicate whether Consumer Price Index inflation on 13 September will result in a third 75 bps hike on 21 September.

Philip Wee | FX Strategist

Rates: 4% terminal ahead

Figure 5: Heading to 4%



Source: Bloomberg, DBS

We have adjusted our USD, SGD, and HKD rates forecasts higher. Over the past week, we noted that US economic data were resilient despite the volatility generated by Fed tightening over the past few months. In accordance with payrolls registering 313k in August, we think that the Fed has sufficient runway to bring the Fed funds rate to 4% (up from 3.5% previously) by the end of the year.

The outlook is nuanced as data confirm the rates pushback against stagflation/recession risks. Aside from firm payrolls, we note that labour force participation has ticked up. This has brought back a welcome supply of labour and could cool off worries about a persistent surge in wages. We also note that forward-looking indicators of inflation (breakevens and commodity prices) point to moderation ahead. This sets up a better macro backdrop of falling inflation and a firm labour market. Accordingly, the 2Y/10Y segment of the curve has steepened accordingly and is now at -20 bps, vs -50 bps several weeks ago. This is in line with our assessment that hard-landing pricing should be faded.

We've tweaked our view of the three peaks. We maintain that inflation/inflation fears have peaked. However, the transition into peak Fed rhetoric and Fed downshift might have been delayed a tad. Overall, we still think that June marked peak duration fear. Note that the implied volatility in rates did not quite revisit the high seen in early July. Accordingly, while we did re-centre our USD rates forecasts higher, we kept the 10Y yield forecast just below the 3.5% peak seen in June. An economic slowdown and pause in Fed hikes should herald a subsequent grind in yields.

	2022F	2023F
US (% pa)		
3M SOFR OIS	3.88	3.88
2Y	3.70	3.40
10Y	3.45	3.30
10Y-2Y	-25	-10
Singapore (% pa)		
3M SOFR OIS	2.98	2.98
2Y	3.00	2.70
10Y	3.15	2.95
10Y-2Y	15	25
HK, SAR (% pa)		
3M HIBOR	3.63	3.63
2Y	3.50	3.20
10Y	3.35	3.20
10Y-2Y	-15	0

Source: DBS

Eugene Leow | Rates Strategist

- 2Q22 earnings saw surprises from retailers on reopening
- Staple companies saw margins under pressure, but mitigated partially by increasing prices since late 2021
- Inflation a common theme in outlook, poses uncertainty in companies' ability to pass it on
- Despite the challenges, we still see opportunities in ASEAN's consumer sector

2Q earnings: Retailers surprised, staples a mixed bag. In the 2Q22/1H22 earnings season, around 46% of our ASEAN consumer coverage reported results were within expectations, with the remainder evenly split above/below. Of note, reopening plays with exposure in Indonesia and Thailand pleasantly surprised us. Overall, sales revenues of consumer companies under our coverage were largely higher y/y, benefitting from higher sales and price increases passed through to counter cost inflation – though this only partially mitigated the effects due to gross margins softening. While commodity prices have retreated in recent months, we expect positive effects on margins to be seen only by 4Q22 or early 2023 given the lagged effect of pass through.

Outlook: Inflation vs sentiment and reopening. Looking ahead to 2H22, inflation will rank high in our focus given the potential impact on consumer spending and demand. Based on companies' commentaries on their respective outlook and expectations, there seems to be increasing apprehension on the ability and willingness of the market to absorb such price increases. As of the latest reading in July 22, Indonesia and Thailand core Consumer Price Index registered 2.9% and 3.0% y/y increases and could trend up further on the back of increases in subsidised fuel prices and raised utility tariffs respectively, dampening consumer purchasing power.

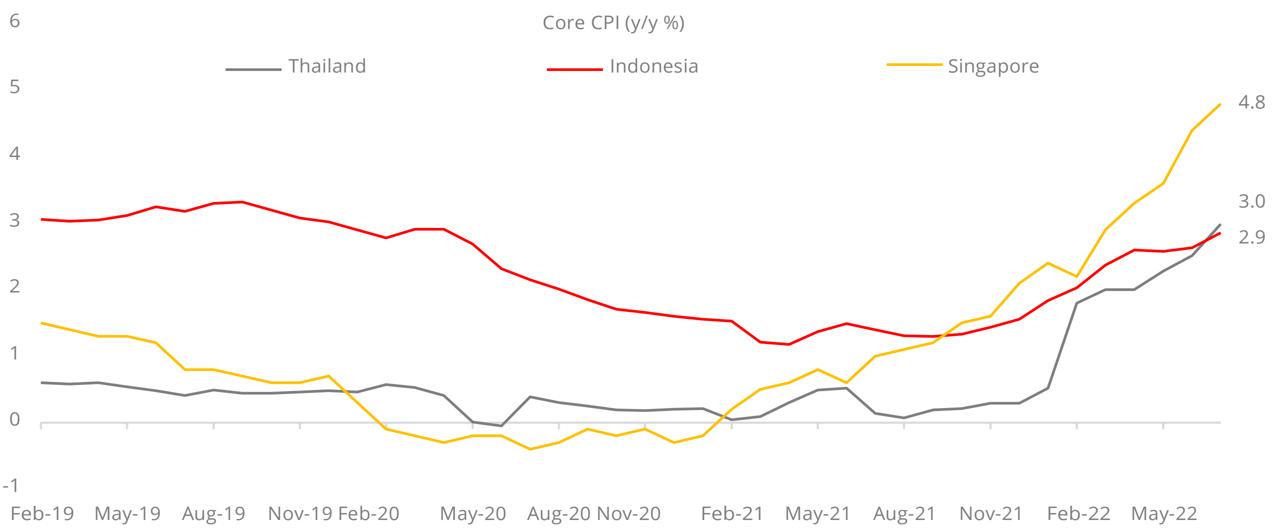
Strategy and picks. Taking into account reopening optimism, Fed tightening, and heightened fears of inflation impacting demand, DBS Group Research's picks rest on the following themes: (i) safer staple companies benefiting from inflation and/or its ability to pass on costs given its position; (ii) reopening and domestic recovery; and/or (iii) earnings upside surprises with valuations below its historical average.

Andy Sim | Analyst

Leena Phaerakkakit | Analyst

Cheria Christi Widjaja | Analyst

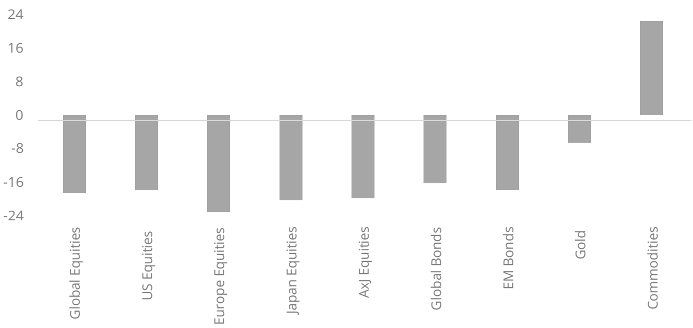
Figure 6: Core CPI trends a key focus in 2H22



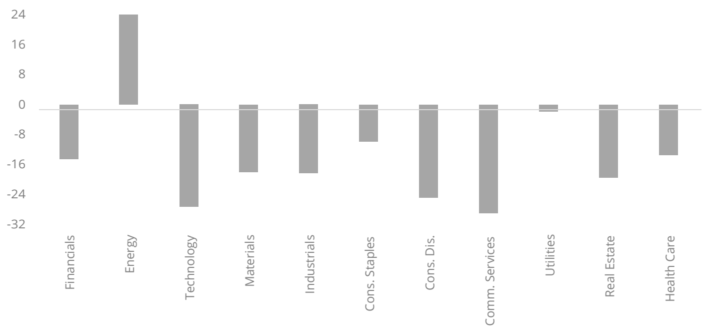
Source: Refinitive, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

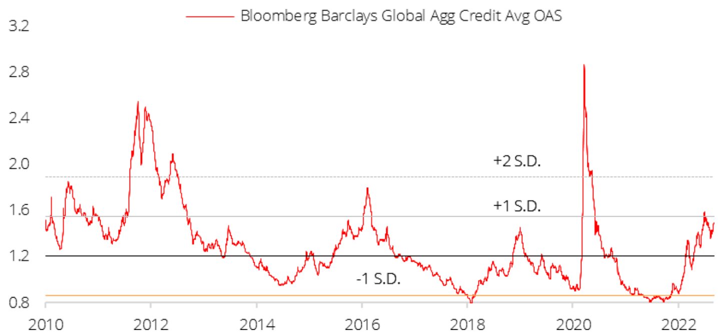


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

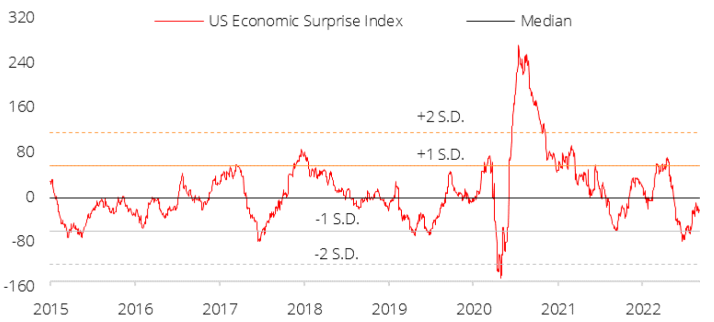
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-2.6%	-0.8%	3.7%	-17.7%
NASDAQ	-3.2%	-1.6%	5.5%	-25.7%
Russell 2000	-3.9%	-1.9%	6.0%	-19.4%
Euro Stoxx 600	-2.2%	-0.4%	1.5%	-15.3%
Nikkei-225	-0.9%	-1.7%	4.6%	-4.1%
MSCI WORLD	-2.7%	-1.2%	2.0%	-19.6%
MSCI ACWI	-2.7%	-1.3%	1.4%	-19.9%
MSCI Asia ex-Japan	-2.2%	-3.2%	-5.1%	-21.4%
MSCI EM	-2.4%	-2.6%	-3.3%	-21.4%
HSCEI	-4.3%	-4.2%	-14.2%	-20.1%
SHCOMP	-1.3%	-0.1%	-5.8%	-12.1%
Hang Seng	-4.0%	-3.7%	-12.0%	-17.8%
STI Index	-0.2%	-0.2%	3.7%	2.9%
Fixed Income				
Barclays Global Aggregate	-1.2%	-0.8%	-2.7%	-16.2%
Barclays US Aggregate	-0.6%	-0.2%	-0.7%	-10.9%
Barclays US High Yield	-1.3%	-0.2%	3.3%	-11.4%
Barclays Euro Aggregate	-1.3%	-0.3%	-1.2%	-13.2%
Barclays Euro High Yield	-2.2%	-0.9%	2.6%	-12.1%
JPM EMBI Global	-1.3%	-0.6%	1.4%	-17.7%
JPM EMBI Global Diversified	-1.9%	-0.6%	1.2%	-20.2%

PRICES & SPREADS

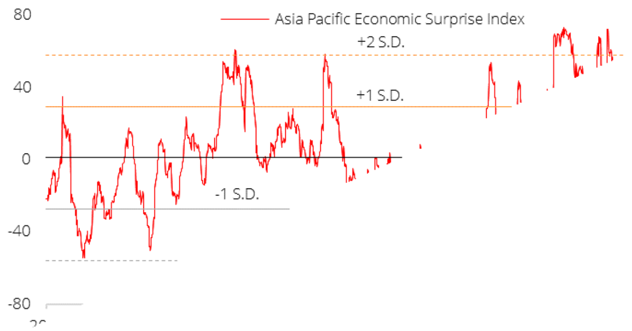
	Spot	2Q22	1Q22	4Q21
Rates				
Fed Funds Target	2.50	1.75	0.50	0.25
ECB Main Refinancing Rate	0.50	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	3.19	3.02	2.34	1.51
Japanese Govt. Bond 10-yr	0.23	0.23	0.21	0.07
German Bunds 10-yr	1.56	1.33	0.55	-0.18
Spreads				
US Agg Corporate Spread	1.45	1.55	1.16	0.92
US Corporate HY Spread	4.93	5.69	3.25	2.83
Euro Agg Corporate Spread	2.08	2.15	1.31	0.97
EM USD Agg Spread	3.69	4.04	3.13	2.85
Currencies				
US Dollar Index (DXY)	109.5	104.7	98.3	95.7
EUR/USD	0.99	1.05	1.11	1.14
USD/JPY	140.6	135.7	121.7	115.1
USD/CNY	6.9	6.7	6.3	6.4
Commodities				
WTI Oil	87	106	100	75
London Metal Exchange (LMEX)	3638	3879	5174	4502
TR/CC CRB Commodity	284	291	295	232
Gold	1710	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)	08-Sep	03-Sep	240k	232k
ECB Main Refinancing Rate	08-Sep	08-Sep	1.25%	0.50%
GDP SA q/q (EU)	07-Sep	2Q	0.60%	0.60%
MBA Mortgage Applications (US)	07-Sep	02-Sep	--	-3.70%
ECB Deposit Facility Rate (EU)	08-Sep	08-Sep	0.75%	0.00%
Trade Balance (US)	07-Sep	Jul	-$70.3b	-$79.6b
Wholesale Inventories m/m (US)	09-Sep	Jul	0.80%	0.80%
ISM Services Index (US)	06-Sep	Aug	55.4	56.7

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
CPI y/y (CN)	08-Sep	Aug	2.80%	2.70%
GDP Annualised SA q/q (JP)	07-Sep	2Q	2.90%	2.20%
BoP Current Account Balance (JP)	07-Sep	Jul	¥774.0b	-¥132.4b
PPI y/y (JP)	12-Sep	Aug	--	8.60%
PPI y/y (CN)	08-Sep	Aug	3.20%	4.20%
GDP Deflator y/y (JP)	07-Sep	2Q	-0.40%	-0.40%
Money Supply M2 y/y (CN)	08-Sep	Aug	12.20%	12.00%
Trade Balance (CN)	06-Sep	Aug	$92.40b	$101.26b

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