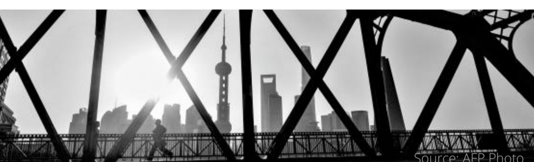


CIO Weekly

20 September 2022

Key Points

- **Equities:** Industrial metals to benefit from favourable demand-supply balances
- **Credit:** Liquid+ Strategy – The importance of yield and liquidity in an age of volatility
- **FX:** USD bulls positioning for hawkish FOMC meeting; markets fear the Fed wants rates to be more restrictive above 4%
- **Rates:** Recession risks unlikely to fade in the near term; 2Y/10Y and 2Y/30Y to be inverted for an extended period
- **Thematics:** China/HK's key F&B operators well-poised to record decent sales and higher margins in 2H22

GLOBAL CROSS ASSETS

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	31,020	0.6%	-14.6%
S&P 500	3,900	0.7%	-18.2%
NASDAQ	11,535	0.8%	-26.3%
Stoxx Europe 600	408	-0.1%	-16.4%
DAX	12,803	0.5%	-19.4%
CAC 40	6,062	-0.3%	-15.3%
FTSE 100	7,237	0.0%	-2.0%
MSCI AxJ	602	-0.6%	-23.8%
Nikkei 225	27,568	0.0%	-4.3%
SHCOMP	3,116	-0.3%	-14.4%
Hang Seng	18,566	-1.0%	-20.7%
MSCI EM	939	-0.6%	-23.8%
UST10-yr yield*	3.49	411.0%	198.0
JGB 10-yr yield*	0.25	0.0%	18.5
Bund 10-yr yield*	1.80	480.0%	198.4
US HY spread*	4.81	-600.0%	198.0
EM spread*	422.29	-210.0%	92.0
WTI (USD)	85.73	0.7%	14.0%
LMEX	3,679.00	-0.3%	-18.3%
Gold (USD)	1,675.84	0.0%	-8.4%

Source: Bloomberg

* Changes in basis points

Equities: Favourable demand-supply balances support long-term metal pricing

On the back of favourable demand-supply balances, the DBS Chief Investment Office maintains a long-term constructive outlook on industrial metals. Declining metal inventories worldwide and energy cuts in China and Europe are constraining supply in the short term. Meanwhile, decarbonisation and the energy transition (boosted by the Inflation Reduction Act) continue to underpin long-run demand.

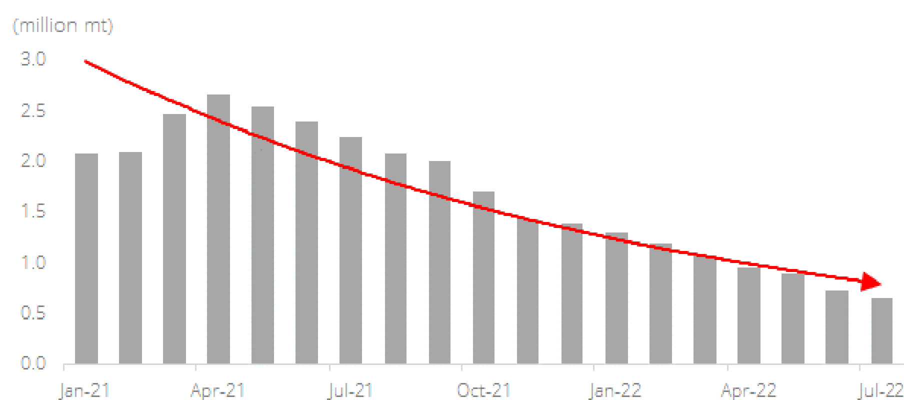
The London Metal Exchange list of warehouses registered just 649,830 tonnes at the end of July (Figure 1), which represents a halving of inventory levels since the beginning of the year and a 75% decline vis-à-vis April 2021 levels. On the energy front, extreme heat-wave conditions in China have caused increasing power outages while Russia continues to turn down gas supplies to Europe. This will negatively impact metals production and further contribute to an already tight physical market.

On the demand side, industrial metals continue to be a beneficiary of the energy transition as they are critical inputs in building up the low-carbon infrastructure of tomorrow. And this demand is set to receive a further boost from the recently passed Inflation Reduction Act in the US, which will see USD369b channelled into climate change action, of which USD177b, or nearly half the entire stimulus package, will be used to fund metals-intensive decarbonisation/clean energy initiatives.

Accordingly, companies along the industrial metals value chain are poised to be long-term beneficiaries of the above-mentioned tailwinds. Investors can therefore look to express this investment thesis in their portfolios via direct equity holdings in diversified upstream/mining companies for the added benefit of risk diversification and additional alpha generation during commodity upcycles. For investors who wish for a more diversified approach, sectoral ETFs and thematic funds can achieve similar results while reducing concentration risk on individual names.

Goh Jun Yong | Analyst

Figure 1: Depleting metals stockpile

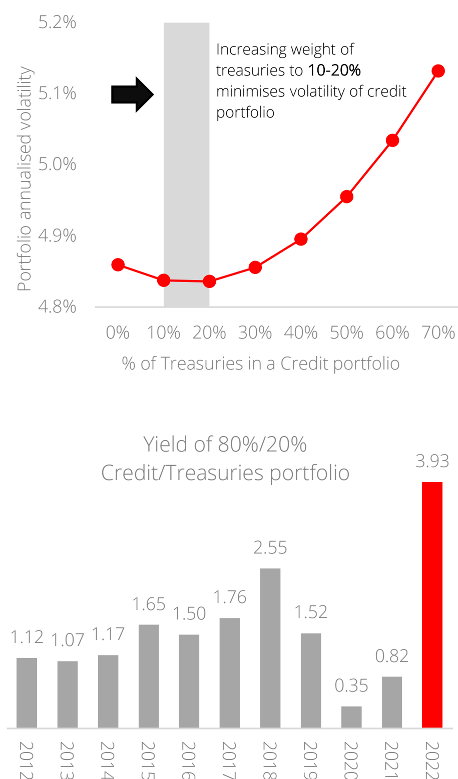


Source: London Metals Exchange, DBS

DBS

Credit: The importance of yield and liquidity in an age of volatility

Figure 2: A balanced mix of lower risk and higher returns



Source: Bloomberg, DBS

In an environment fraught with uncertainty, it is natural for risk-averse investors to seek first the safety of cash. However, the highest inflation in 40 years now threatens to erode the real returns of cash, beckoning risk-averse investors to seek a better strategy for capital and liquidity preservation. To this end, we advocate a Liquid+ Strategy – a portfolio construct comprising short-duration (1-3Y) Investment Grade (IG) credit and risk-free Government Treasuries that provides a worthy alternative in terms of safety and liquidity, but with returns that could stand a chance against inflation.

A mix of IG corporate credit and risk-free Treasuries is greater than the sum of its parts. As illustrated in Figure 2, our analysis of the risk/return spectrum of a portfolio of IG credit and Treasuries shows that adding 10-20% of Treasuries to a credit portfolio minimises the overall volatility of the portfolio, giving investors the best of both worlds in terms of capital stability and income generation. Moreover, the Treasury allocation positions the portfolio to benefit from flight-to-safety flows under unexpected downturns, while its deep market provides liquidity for the portfolio. The cherry on top is that with the hawkish pivot of global central banks in 2022, investors are now well-compensated for taking less risk. The yield on an 80/20 Credit/Treasury portfolio is now close to 4%, dwarfing the returns of the same portfolio mix over the last 10 years.

Amid today's volatility, a Liquid+ Strategy allows investors to stay nimble to seize opportunities as they present themselves, while income-generation is an added plus. We outline more on this in our CIO Perspectives report.

Daryl Ho | Strategist

FX: USD bulls position for hawkish Fed

Figure 3: Trending South

Source: Bloomberg, DBS

USD bulls are positioning for a hawkish Federal Open Market Committee (FOMC) meeting on 21 September. DXY appreciated 0.7% to 109.76 last week (ended 16 September), its highest weekly close since June 2002. After the stronger-than-expected US Consumer Price Index (CPI) in August, we see the Fed Funds Rate rising a third time by 75 bps to 3.25%, turning restrictive above its estimated 2-3% neutral range. Following the last FOMC in July, the US Treasury 2Y yield has risen from 2.86% to 3.40% at Jackson Hole in August to 3.87% last Friday. Markets fear the Fed wants rates to be more restrictive above 4% before it pauses in 2023. All eyes will be on the Summary of Economic Projections and Fed Chair Jerome Powell's post-FOMC press conference.

The USD's strength poses a challenge to the rest of the world. Other central banks see depreciation in their currencies adding to price pressures. The European Central Bank (ECB) and the Bank of Canada (BOC) have responded with 75 bps hikes this month to cushion their currencies, not so much against the greenback but on an effective exchange rate basis. EUR/USD is weak around parity. The ECB sees several more hikes for European Union rates to be neutral. This is not good considering that US rates will be above neutral this Wednesday (21 September). Although the BOC's policy moves have (more or less) paralleled the Fed's, the USD's strength still drove USD/CAD above its price channel to 1.3264, its highest close since October 2020.

We expect the Swiss National Bank (SNB) to also deliver a 75 bps hike to 0.50% on 22 September. However, SNB's jumbo hike will only end negative rates in Switzerland on Thursday, one day after US rates turn restrictive. USD/CHF has bounced off its firm support level at 0.94 to 0.9650 and is eyeing the highs around 0.98 this quarter.

GBP could end 2022 on UK's weak fundamentals. GBP closed last week at 1.1420, its cheapest level since March 1985. Thoughts are on 1.0520, the pound's all-time low in February 1985. As per CFTC data, speculators racked up the largest short GBP positions since late April. On 22 September, the Bank of England's (BOE) second 50 bps hike will pale compared to the Fed's third 75 bps hike a day earlier. Even if the BOE surprises with a 75 bps hike, it is unlikely to help the pound. Markets are convinced the UK economy will enter recession from 4Q22 into 2023, one quarter after the US economy exits its technical recession.

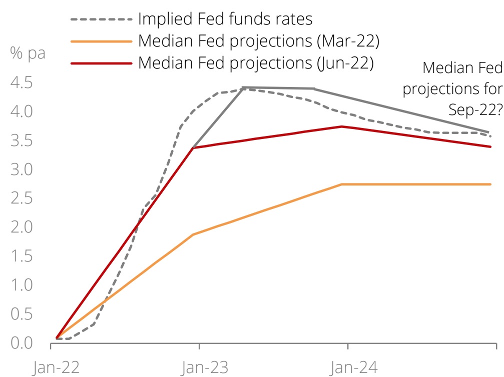
Since the last BOE meeting on 4 August, the 10Y Gilt yield has surged to 3.14% from 1.89% on fiscal worries. Chancellor Kwasi Kwarteng will present the mini-budget one day after the BOE meeting. He will announce GBP30b of tax cuts to ease the cost-of-living crisis and to support economic growth, one week after Prime Minister Liz Truss declared energy price caps. However, the market will be more interested to understand how the Truss government intends to fund the wider fiscal deficit.

Philip Wee | FX Strategist

Rates: Maximum fear heading into FOMC meeting

There has been significant angst across assets as market participants re-assess the Fed's rate hike path after a grim inflation print last month. This week (ending 24 September) might be particularly challenging as stresses build into the Federal Open Market Committee (FOMC) meeting (the outcome is due 22 September, 2am SGT). The market is pricing in a significant chance of a 100 bps hike. We do not sit in this camp and still see the Fed hiking by 75 bps, taking policy settings into restrictive territory. With labour market data (including NFP, jobless claims) and Consumer Price Index (CPI) still scorching (8.3% y/y in August), there are no fundamental reasons why the Fed should sound dovish. Lastly, while financial conditions have deteriorated, they are probably not dire enough for the Fed to back off. It would probably require a further drop in the stock market and /or a widening of credit spreads to generate sufficient negative feedback (similar to June) to drive yields lower.

Figure 4: Fed and market views



Source: Bloomberg, Federal Reserve

Economic projections will be closely scrutinised. Unfortunately, even as the market has clearly become data dependent, the immediate path of the Fed will still be dictated by what the Fed puts in the dot plot. We think that the Fed might put a terminal rate of 4.5% in 2023 with cuts only featuring in 2024. The longer-term neutral might get pushed up to 3% (up from 2.5% currently). We think 2025 will mark a return to the long-term neutral. The unemployment rate needed to generate a fall in inflation back towards 2% and the time to get there will also be important.

While the terminal rate is a moving target, the Fed has to choose between two paths — frontload very aggressively or downshift and extend the cycle somewhat. While a resilient economy and hot inflation argues for more frontloading, we think that holds insofar as policy settings are loose, but perhaps less convincing when implied real yields are already firmly tight (2Y implied real yields have climbed rapidly and are close to our target of 1.5%). At this point, we are not convinced that the pace of rate hikes should be sped up even more. Tactically, receiving 2M, 3M rates might make sense. We would also fade the cuts in 2023 relative to peak pricing in 2Q23. We currently think a slightly gentler glide path makes the most sense.

We think there will be some upside to USD rates with the FOMC a key risk event. Timing wise, a local peak in fear could be hit around FOMC day. However, we do note that the 30Y (implied real 1% yield) is proving to be sticky around 3.50% (around our forecasts). In so far as the market does not see the Fed losing control of inflation, upside might be limited, even if the Fed does hint of MBS sales.

Curve wise, we think the 2Y/10Y and 2Y/30Y can be inverted for an extended period. Recession risks are unlikely to fade in the near term. The more aggressive the Fed goes, and the higher the terminal rate, the larger the degree of plausible inversion. Under the current assumption of 4% peak Fed funds rate, we think the 2Y/10Y should not invert much more than 45 bps. However, if this shifts to 4.5%, -60 bps might become the new floor.

Lastly, receiving 2Y/5Y/10Y fly on recession fears looks more interesting again. The upshot? Conditions are not ripe yet for a Fed downshift. While CPI inflation has peaked, it is grinding down very slowly amid a firm labour market. Steepening plays (5Y/30Y) might be a tad premature. It might be better to await clearer signs, perhaps in 1Q23, that the Fed will be able to downshift.

Eugene Leow | Rates Strategist

Duncan Tan | Rates Strategist

Thematics: China/HK Food & Beverage – A more lucrative 2H22

- Premium sales to sustain strong momentum
- Most commodity prices peaked out by 2Q22 to minimise cost pressures
- More efficient Covid measures in China should also reduce business disruption
- Key F&B operators are well-poised to record decent sales and higher margins in 2H22

The worst could be over. The Omicron outbreak in March 2022 took China by surprise and triggered the country's toughest city lockdowns and supply chain disruptions. Coupled with high global raw material prices and weaker consumer sentiment, 2Q22 performance across F&B operators was hammered substantially, seeing double-digit y/y volume declines in selected segments. The Chinese government has since learnt from experience and is now adopting more effective Covid measures to stabilise daily supplies. New rounds of subsidies are also revitalising consumer sentiment as seen from the around 3% retail sales rebound since June 2022, signalling a better outlook.

Multiple catalysts in 2H22. Premium sales and product-mix upgrades, rising demand for quality and trendy products, as well as tighter supplies in certain segments (e.g. pork) should continue to support higher average selling prices and margin growth. Increasing health awareness also favours the sale of dairy products that help to boost nutrition and immunity. Meanwhile, lower raw material prices and packaging expenses should alleviate cost pressures in 2H22. A gradual recovery of on-trade channels could also lead to higher premium sales while an exceptionally hot weather this summer will further benefit beverage plays.

Cream of the crop. On the back of improving performance, especially for beverage operators, stronger brands are in sound positions to ignite more advertising and promotional campaigns, and gain better sales traction. DBS Group Research prefers leading players in breweries, non-alcoholic drinks, and dairies.

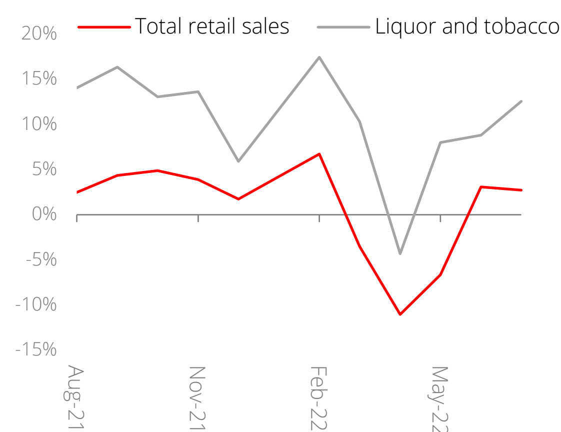
Clement Xu | Analyst

Alison Fok | Analyst

Mavis Hui | Analyst

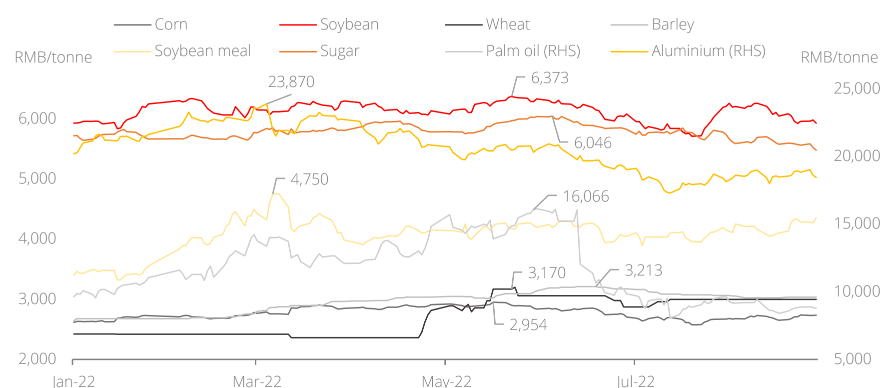
Alice Hui | Analyst

Figure 5: China retail sales trends (% y/y)



Source: NBS, DBS HK

Figure 6: Commodity price trends

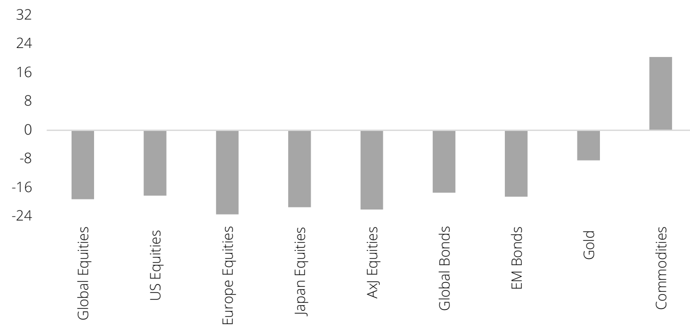


*Data labels represent YTD peaks

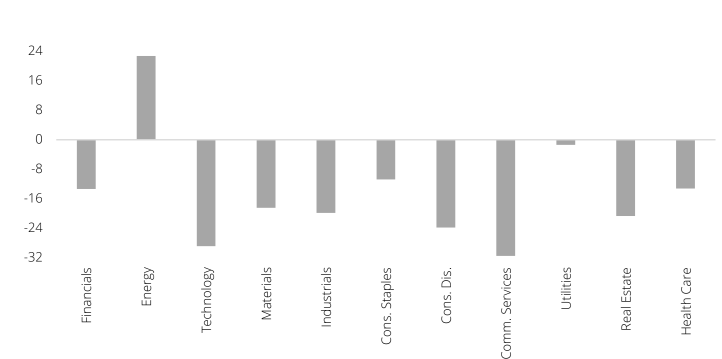
Source: CME, CEIC, Bloomberg Finance L.P., DBS HK

CIO Markets Watch

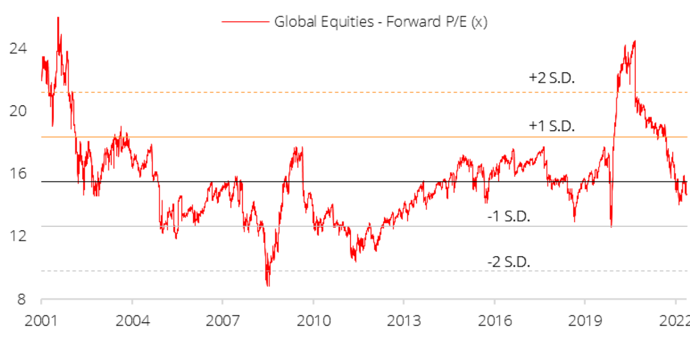
Global Cross Assets YTD Returns



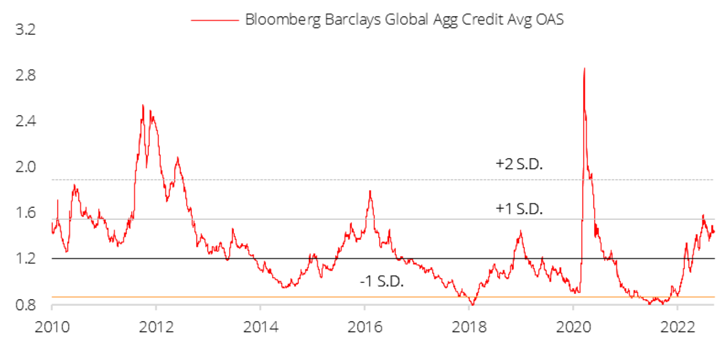
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



INDEX RETURNS

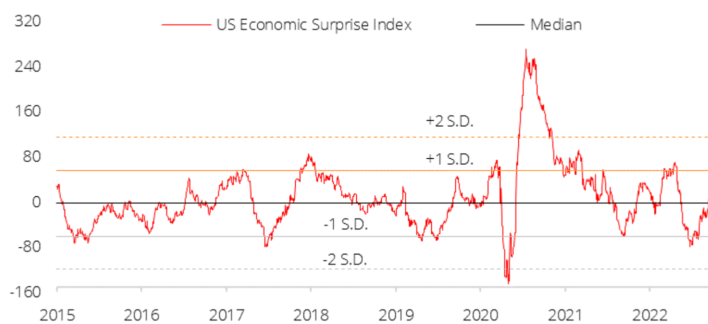
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-5.1%	-1.4%	3.0%	-18.2%
NASDAQ	-6.0%	-2.4%	4.6%	-26.3%
Russell 2000	-4.9%	-1.7%	6.1%	-19.3%
Euro Stoxx 600	-4.6%	-1.7%	0.2%	-16.4%
Nikkei-225	-3.4%	-1.9%	4.5%	-4.3%
MSCI WORLD	-5.1%	-1.8%	1.3%	-20.1%
MSCI ACWI	-5.0%	-2.2%	0.5%	-20.6%
MSCI Asia ex-Japan	-3.9%	-6.1%	-7.9%	-23.8%
MSCI EM	-4.1%	-5.6%	-6.2%	-23.8%
HSCEI	-4.4%	-7.7%	-17.3%	-23.0%
SHCOMP	-4.5%	-2.7%	-8.3%	-14.4%
Hang Seng	-4.1%	-7.0%	-15.1%	-20.7%
STI Index	-0.6%	1.1%	5.0%	4.2%
Fixed Income				
Barclays Global Aggregate	-1.4%	-2.2%	-4.0%	-17.4%
Barclays US Aggregate	-1.0%	-2.0%	-2.4%	-12.5%
Barclays US High Yield	-2.2%	-0.8%	2.6%	-11.9%
Barclays Euro Aggregate	-0.9%	-1.2%	-2.1%	-14.0%
Barclays Euro High Yield	-1.2%	-0.9%	2.6%	-12.1%
JPM EMBI Global	-1.9%	-1.5%	0.4%	-18.5%
JPM EMBI Global Diversified	-1.6%	-1.4%	0.3%	-20.9%

PRICES & SPREADS

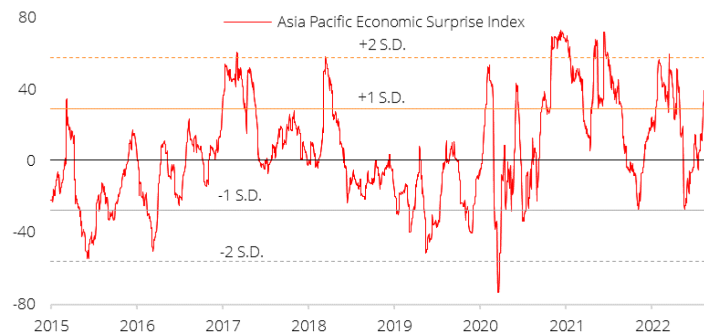
	Spot	2Q22	1Q22	4Q21
Rates				
Fed Funds Target	2.50	1.75	0.50	0.25
ECB Main Refinancing Rate	1.25	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	3.49	3.02	2.34	1.51
Japanese Govt. Bond 10-yr	0.25	0.23	0.21	0.07
German Bunds 10-yr	1.80	1.33	0.55	-0.18
Spreads				
US Agg Corporate Spread	1.42	1.55	1.16	0.92
US Corporate HY Spead	4.81	5.69	3.25	2.83
Euro Agg Corporate Spread	2.00	2.15	1.31	0.97
EM USD Agg Spread	3.63	4.04	3.13	2.85
Currencies				
US Dollar Index (DXY)	109.7	104.7	98.3	95.7
EUR/USD	1.00	1.05	1.11	1.14
USD/JPY	143.2	135.7	121.7	115.1
USD/CNY	7.0	6.7	6.3	6.4
Commodities				
WTI Oil	86	106	100	75
London Metal Exchange (LMEX)	3679	3879	5174	4502
TR/CC CRB Commodity	280	291	295	232
Gold	1676	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)	22-Sep	17-Sep	217k	213k
FOMC Rate Decision (Upper Bound) (US)	21-Sep	21-Sep	0.0325	0.025
MBA Mortgage Applications (US)	21-Sep	16-Sep	--	-0.012
S&P Global Eurozone Manufacturing PMI (EU)	23-Sep	Sep	48.7	49.6
S&P Global US Manufacturing PMI (US)	23-Sep	Sep	51	51.5
Housing Starts (US)	20-Sep	Aug	1450k	1446k
Existing Home Sales (US)	21-Sep	Aug	4.69m	4.81m
Leading Index (US)	22-Sep	Aug	-0.001	-0.004

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
CPI y/y (SG)	23-Sep	Aug	7.20%	7.00%
Jibun Bank Japan PMI Mfg (JP)	25-Sep	Sep	--	51.5
Industrial Production y/y (SG)	26-Sep	Aug	--	0.60%
BOJ Policy Balance Rate (JP)	21-Sep	22-Sep	-0.10%	-0.10%
Jibun Bank Japan PMI Services (JP)	25-Sep	Sep	--	49.5
Jibun Bank Japan PMI Composite	25-Sep	Sep	--	49.4
Automobile COE Open Bid Cat A (SG)	21-Sep	Sep	--	86000
Automobile COE Open Bid Cat B (SG)	21-Sep	Sep	--	113000

Disclaimers and Important Notes

This information herein is published by DBS Bank Ltd. ("DBS Bank") and is for information only. This publication is intended for DBS Bank and its subsidiaries or affiliates (collectively "DBS") and clients to whom it has been delivered and may not be reproduced, transmitted or communicated to any other person without the prior written permission of DBS Bank.

This publication is not and does not constitute or form part of any offer, recommendation, invitation or solicitation to you to subscribe to or to enter into any transaction as described, nor is it calculated to invite or permit the making of offers to the public to subscribe to or enter into any transaction for cash or other consideration and should not be viewed as such.

The information herein may be incomplete or condensed and it may not include a number of terms and provisions nor does it identify or define all or any of the risks associated to any actual transaction. Any terms, conditions and opinions contained herein may have been obtained from various sources and neither DBS nor any of their respective directors or employees (collectively the "DBS Group") make any warranty, expressed or implied, as to its accuracy or completeness and thus assume no responsibility of it. The information herein may be subject to further revision, verification and updating and DBS Group undertakes no responsibility thereof.

All figures and amounts stated are for illustration purposes only and shall not bind DBS Group. This publication does not have regard to the specific investment objectives, financial situation or particular needs of any specific person. Before entering into any transaction to purchase any product mentioned in this publication, you should take steps to ensure that you understand the transaction and has made an independent assessment of the appropriateness of the transaction in light of your own objectives and circumstances. In particular, you should read all the relevant documentation pertaining to the product and may wish to seek advice from a financial or other professional adviser or make such independent investigations as you consider necessary or appropriate for such purposes. If you choose not to do so, you should consider carefully whether any product mentioned in this publication is suitable for you. DBS Group does not act as an adviser and assumes no fiduciary responsibility or liability for any consequences, financial or otherwise, arising from any arrangement or entrance into any transaction in reliance on the information contained herein. In order to build your own independent analysis of any transaction and its consequences, you should consult your own independent financial, accounting, tax, legal or other competent professional advisors as you deem appropriate to ensure that any assessment you make is suitable for you in light of your own financial, accounting, tax, and legal constraints and objectives without relying in any way on DBS Group or any position which DBS Group might have expressed in this document or orally to you in the discussion.

Any information relating to past performance, or any future forecast based on past performance or other assumptions, is not necessarily a reliable indicator of future results.

If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of the Information, which may arise as a result of electronic transmission. If verification is required, please request for a hard-copy version.

This publication is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation.

If you have received this communication by email, please do not distribute or copy this email. If you believe that you have received this e-mail in error, please inform the sender or contact us immediately. DBS Group reserves the right to monitor and record electronic and telephone communications made by or to its personnel for regulatory or operational purposes. The security, accuracy and timeliness of electronic communications cannot be assured.

Dubai International Financial Centre: This communication is provided to you as a Professional Client or Market Counterparty as defined in the DFSA Rulebook Conduct of Business Module (the "COB Module"), and should not be relied upon or acted on by any person which does not meet the criteria to be classified as a Professional Client or Market Counterparty under the DFSA rules.

This communication is from the branch of DBS Bank Ltd operating in the Dubai International Financial Centre (the "DIFC") under the trading name "DBS Bank Ltd. (DIFC Branch)" ("DBS DIFC"), registered with the DIFC Registrar of Companies under number 156 and having its registered office at units 608 - 610, 6th Floor, Gate Precinct Building 5, PO Box 506538, DIFC, Dubai, United Arab Emirates.

DBS DIFC is regulated by the Dubai Financial Services Authority (the "DFSA") with a DFSA reference number F000164. For more information on DBS DIFC and its affiliates, please see http://www.dbs.com/ae/our--network/default.page.

Where this communication contains a research report, this research report is prepared by the entity referred to therein, which may be DBS Bank Ltd or a third party, and is provided to you by DBS DIFC. The research report has not been reviewed or authorised by the DFSA. Such research report is distributed on the express understanding that, whilst the information contained within is believed to be reliable, the information has not been independently verified by DBS DIFC.

Unless otherwise indicated, this communication does not constitute an "Offer of Securities to the Public" as defined under Article 12 of the Markets Law (DIFC Law No.1 of 2012) or an "Offer of a Unit of a Fund" as defined under Article 19(2) of the Collective Investment Law (DIFC Law No.2 of 2010).

The DFSA has no responsibility for reviewing or verifying this communication or any associated documents in connection with this investment and it is not subject to any form of regulation or approval by the DFSA. Accordingly, the DFSA has not approved this communication or any other associated documents in connection with this investment nor taken any steps to verify the information set out in this communication or any associated documents, and has no responsibility for them. The DFSA has not assessed the suitability of any investments to which the communication relates and, in respect of any Islamic investments (or other investments identified to be Shari'a compliant), neither we nor the DFSA has determined whether they are Shari'a compliant in any way.

Any investments which this communication relates to may be illiquid and/or subject to restrictions on their resale. Prospective purchasers should conduct their own due diligence on any investments. If you do not understand the contents of this document you should consult an authorised financial adviser.

Hong Kong: This publication is distributed by DBS Bank (Hong Kong) Limited (CE Number: AAL664) ("DBSHK") which is regulated by the Hong Kong Monetary Authority (the "HKMA") and the Securities and Futures Commission. In Hong Kong, DBS Private Bank is the private banking division of DBS Bank (Hong Kong) Limited.

DBSHK is not the issuer of the research report unless otherwise stated therein. Such research report is distributed on the express understanding that, whilst the information contained within is believed to be reliable, the information has not been independently verified by DBSHK.

DBSHK is not the issuer of the research report unless otherwise stated therein. Such research report is distributed on the express understanding that, whilst the information contained within is believed to be reliable, the information has not been independently verified by DBSHK.

Singapore: This publication is distributed by DBS Bank Ltd (Company Regn. No. 196800306E) ("DBS") which is an Exempt Financial Adviser as defined in the Financial Advisers Act and regulated by the Monetary Authority of Singapore (the "MAS").

Thailand: This publication is distributed by DBS Vickers Securities (Thailand) Co., Ltd. ("DBSVT").

United Kingdom: This communication is from DBS Bank Ltd., London Branch located at 9th Floor, One London Wall, London EC2Y 5EA. DBS Bank Ltd. is regulated by the Monetary Authority of Singapore and is authorised and regulated by the Prudential Regulation Authority. DBS Bank Ltd. is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of DBS Bank Ltd., London Branch's regulation by the Prudential Regulation Authority are available upon request.

DBS

Funds

DBS