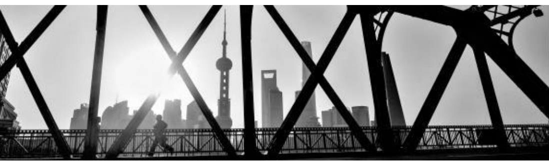


CIO Weekly

15 November 2022

Key Points

- Equities: Meaningful deceleration in CPI fuels market euphoria; US, Europe, and Asia all end week in green
- Credit: Opportunities amid the worst year on record for credit
- FX: DXY registered largest weekly decline on record; EUR appreciated on the back of improving outlook
- Rates: China's reopening unequivocally good for global growth; Less pessimism on growth to drive DM curves steeper
- Thematics: US Financials set to be key beneficiaries of Fed rate hikes
- The Week Ahead: Keep a lookout for US Initial Jobless Claims; Japan Core Machine Orders

GLOBAL CROSS ASSETS

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	33,537	-0.6%	-7.7%
S&P 500	3,957	-0.9%	-17.0%
NASDAQ	11,196	-1.1%	-28.4%
Stoxx Europe 600	433	0.1%	-11.3%
DAX	14,313	0.6%	-9.9%
CAC 40	6,609	0.2%	-7.6%
FTSE 100	7,385	0.9%	0.0%
MSCI AxJ	596	0.7%	-24.5%
Nikkei 225	27,963	-1.1%	-2.9%
SHCOMP	3,083	-0.1%	-15.3%
Hang Seng	17,620	1.7%	-24.7%
MSCI EM	940	0.4%	-23.7%
UST10-yr yield*	3.85	4.1	234.4
JGB 10-yr yield*	0.24	0.3	17.4
Bund 10-yr yield*	2.14	-1.4	232.5
US HY spread*	4.52	-16.0	169.0
EM spread*	404.67	-22.0	74.4
WTI (USD)	85.87	-3.5%	14.2%
LMEX	3,984.00	0.4%	-11.5%
Gold (USD)	1,771.40	0.0%	-3.2%

Source: Bloomberg

* Changes in basis points

Equities: CPI dip stokes global market rally

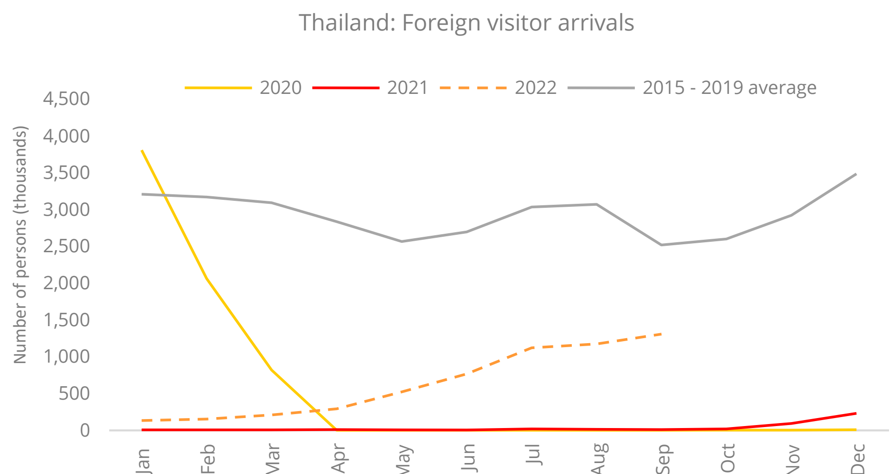
Bull run for global equities on lower-than-expected CPI reading. US Headline inflation for October beat consensus estimates (actual: +0.4% m/m, consensus: +0.6%; actual: +7.7% y/y, consensus: +7.9), triggering a broad-based market rally. Global equities rose 6.6% for the week, with Developed Markets and Emerging Markets registering +6.7% and +5.7% respectively.

In the US, all three major equity indices notched superlative one-day rallies on Thursday and an overall winning week; the S&P 500, Nasdaq, and Dow Jones were up 5.9%, 8.1%, and 4.1% respectively for the week ended 11 Nov. Europe also rallied on the positive US CPI reading as the Stoxx 600 and Stoxx 50 rose 3.7% and 4.9% for the week. Asian equities benefitted from increased risk appetites as China trims quarantine period for international travellers by two days; the Hang Seng, HSCEI, and SHCOMP added 7.2%, 7.0%, and 0.5% respectively.

Topic in focus: ASEAN's resilience underpinned by private consumption and tourism revivals. ASEAN markets had recently performed well on the back of positive sentiments from China. We believe ASEAN should continue to be resilient amid challenges from the global economic slowdown due to its recovery in private consumption along with tourism. With the re-opening of ASEAN economies since July, tourism in the region has picked up substantially. For example, in Thailand, tourist arrivals for 3Q had reached 37% of 2019 pre-Covid levels for the same period. In Singapore, 3Q passenger traffic in Changi Airport was 58% of 3Q 2019 levels. The strong momentum could extend to 2023, driven by the continuous relaxation of cross-border restrictions and a return to normalcy of global travel demand.

The potential relaxation of travel restrictions in China, thus encouraging outbound travels from China, should also assist with the momentum. Domestic plays in ASEAN such as banks, malls and hospitality REITs, hospitals catering for medical tourism and non-Covid treatments, as well as air and land transportation operators are key beneficiaries of private consumption and tourism revivals.

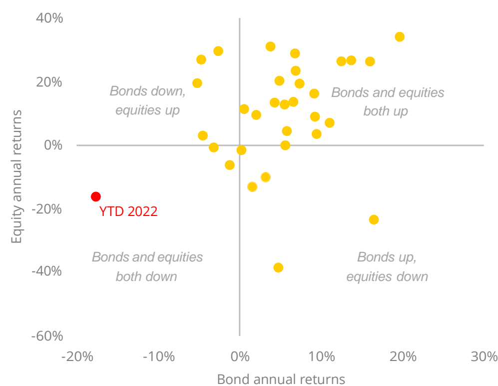
Figure 1: Tourist arrivals should reach pre-Covid levels by 2024



Source: CEIC, DBS

Credit: Opportunities amid the worst year on record

Figure 2: 2022 possibly worst year on record



Source: Bloomberg, DBS

This year looks to be possibly the worst year on record. Not only have global bonds lost a significant 18% year-to-date, but investors have also suffered the rare phenomenon of both bonds and equities falling in tandem. As illustrated in Figure 2, there have been very few years where bonds and equity returns experienced losses simultaneously. In environments of heightened risks that threaten growth, one would normally expect policymakers to lower interest rates to support the economy, and in doing so, drive up bond prices. However, today we are seeing inflation at levels unseen for the past four decades. This has warranted extraordinary measures by central banks, led by the Fed aggressively hiking interest rates to nip inflation in the bud, even at the risk of triggering an impending recession.

It is evident that 2022 will go down in history as an anomalous year for bond markets. After weathering months of sequential outsized rate hikes, bond yields across the board now soar above their historical averages. Nonetheless, factors such as the base effects of inflationary indicators, interest burdens of burgeoning fiscal debt, and looming recession fears, imply a possible cap on how high rates can rise. Already, last week's better-than-expected US CPI release gave battered investors hope that we may have already seen the worst of this spate of inflation, bringing yields down in the expectation of a more measured pace of rate hikes in the months to come. While we are cognisant of a possible overreaction by the markets and that inflation remains far from policy target levels, we anticipate an eventual normalisation, suggesting that the present offers a limited window to capitalise on generous yields offered by even the safest of bond markets. As the road ahead remains fraught with uncertainties, not least in relation to slowing growth, we continue to advocate an up-in-quality stance in fixed income.

FX: USD recovered some lost ground

Figure 3: Turning point?

Source: Bloomberg, DBS

USD recouped some of last week's losses on a Fed rethink and weaker risk appetite. DXY appreciated 0.6% to 106.88 in the overnight session, propped up by higher US bond yields and weaker stock markets. Fed Vice Chair Lael Brainard clarified that the guidance to move away from 75 bps hikes did not imply a weaker resolve at the Fed to control inflation. Fed Governor Christopher Waller said that rates would keep going up and stay high until inflation gets closer to its target. On 14 November, Philadelphia Fed President Patrick Harker considered a 50 bps hike as a significant move.

As the UST 10Y and 2Y yields rose to 3.85% and 4.39% respectively, Dow and S&P 500 fell 0.6% and 0.9% respectively. However, Nasdaq Composite fell harder by 1.1% from high-profile job cuts by Big Tech. The New York Times reported that Amazon (AMZN US) was considering culling 10,000 jobs. Facebook parent Meta (META US) announced 11,000 job cuts while Twitter (TWTR US) eliminated 3,700 jobs. Hence, investors will be looking for cracks in US consumer demand in this week's earnings reports by retailers Walmart (WMT US), Target (TGT US), and Home Depot (HD US), and 15 November's retail sales data by the Commerce Department.

USD/CNY fell a third session by 0.4% to 7.07, down sharply from the year's highest close of 7.3050 a fortnight ago. The meeting between Chinese President Xi Jinping and US President Joe Biden at the side of the G20 Summit cooled Cold War fears. Both leaders agreed to resume communications by senior officials, starting with a visit to China by Secretary of State Antony Blinken early next year. The fixing for USD/CNY plunged to 7.0899 from 7.1907 last Friday after Beijing refined the guidelines for its Covid Zero policy and announced comprehensive measures to support the property sector. The above positive developments and the greenback's retreat also led USD/HKD to retreat from 7.85, the ceiling of its convertibility band, to 7.8350. However, given the weaker market sentiment overnight, we expect the USD to consolidate against the CNY and HKD too.

Rates: China reopening hopes & adjusting inflation expectations

Figure 4: Buoyant

Source: Bloomberg, DBS

The past week marked two sizable adjustments across asset classes as market participants dealt with softer US CPI prints and news that China was taking steps to ease Covid Zero. We would analyse both events individually to see what this means for interest rates.

First, the weaker-than-expected CPI is a welcome relief for assets battered by unrelenting Fed hikes. While there are still data points in the coming weeks that could impact the Fed's decision, it does appear that the ingredients for a downshift are now in place. This would set the stage for smaller hikes going forward. The outsized reaction in USD rates can probably be attributed to a one-off position adjustment. We do not think that a single CPI print in the face of strong labour market data would change the Fed's decision to bring the terminal rate towards 5%. Moreover, we think it is probably still too early to factor in rate cuts in 2023, relative to the peak that the market expects to be hit in 2Q23.

We do think that the structural drivers of inflation have changed. We are not convinced that 10Y breakeven of 2.40% sufficiently captures inflation risks when supply chain diversification and geopolitical risks are elevated. With the Fed's QT likely to continue for several more quarters, UST issuances will increasingly be borne by the private sector. We think term premium could expand, keeping longer term (10Y and beyond) yields buoyant.

Second, China's shift in stance regarding Covid is also significant. This could be the clearest route to bolster the economy even if full relaxation of measures is probably still quite some time away, However, for markets starved of good news, this development is an important pivot moment. China's reopening is unequivocally good for global growth. However, on the inflation front, this is mixed. Supply chain constraints might be reduced, however, demand for commodities (and other items) might well go up as China's economy recovers. Less pessimism on global growth should drive Developed Market curves steeper, all else equal. For Asia, without persistent USD strength, there might be less of a push to hike rates. Domestic liquidity conditions may also improve.

Wrapping both events together, we think that rate cut pricing in 2023 should be faded relative to the peak seen in 2Q. We remain in the steepening camp (5/30Y more so than 2Y/10Y for now). 10Y US yields at 3.805 does seem a tad low if the Fed hikes to 5% and China's reopening provides a case of economic optimism.

DBS CIO LIQUID+ STRATEGY

How can you get a balance of yield and liquidity in today's uncertain market environment?

Scan the QR code to find out more.

Thematics: US Financials - Riding on higher and longer Fed rate hikes

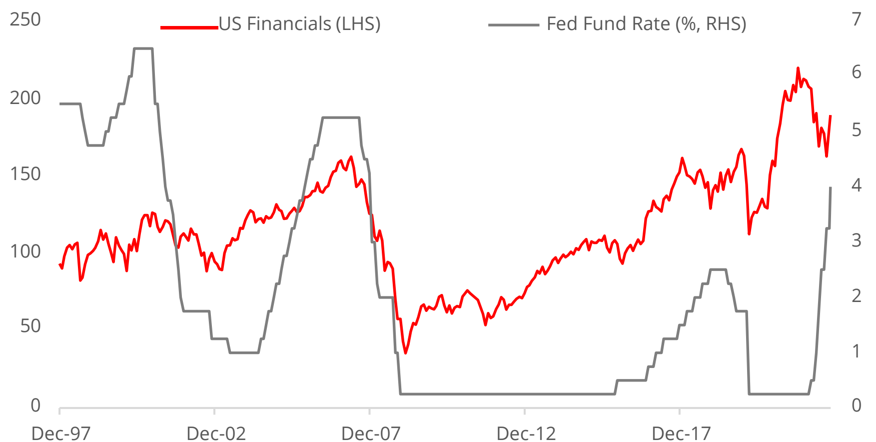
- Banks are key beneficiaries of rate hikes
- DBS expects terminal rates to reach 5.0% by 1Q23, with another 100 bps hikes in the months ahead
- US economy remains firm amid persistent inflation, which should support Fed's continued tightening

Banks tend to benefit during interest rate hike cycles. Historically, financials have performed well in a stable or rising interest rate environment. US Financials registered substantial gains during rising rates periods in 2004-2006 and 2016-2018. Banks could see increased interest income soon amid the currently high interest rates. Higher interest rates will drive net interest margin (NIM) expansion and raise loan interest income.

Terminal rate to reach a forecasted 5.0% by 1Q23. US economy is proving to be much more resilient than anticipated. Persistent inflation amid firm economic conditions could support continued Fed rate hikes. DBS forecasts the 2Y yield to reach 4.7%, with 10Y forecasts showing an upside above 4%. Fed rate hikes are positive for NIM, which should lead to earnings upside for banks going into 2023 as they reprice loans on higher benchmark rates.

Recent sell-off on financials a potential opportunity. Although higher yields typically translate to stronger share price performance for financials, i.e., a positive correlation, we are witnessing a divergence from the positive correlation relationship in the last six months. This is explained by a broad equity market sell-off as a result of the weak macro market sentiment and recessionary fears in the past few months, which has led to concerns about banks' loan growth and asset quality. The recent sell-off of financials has led to financials now trading at attractive valuations, with top US commercial banks trading below their four-year historical P/B average presently.

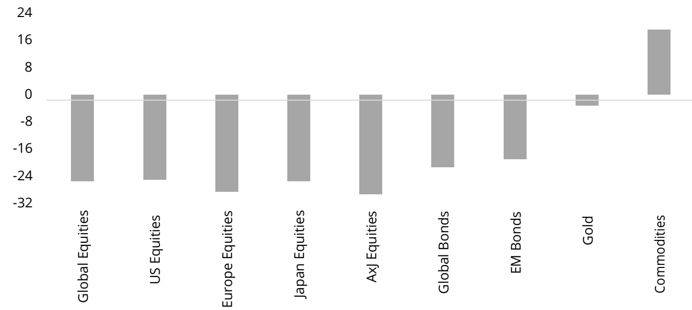
Figure 5: US Financials vs US policy rate



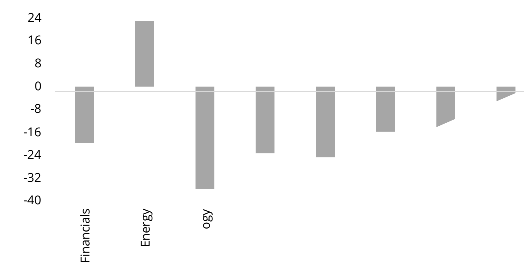
Source: Bloomberg, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

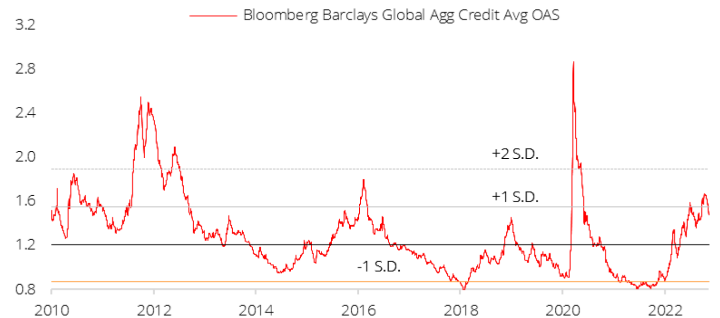


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

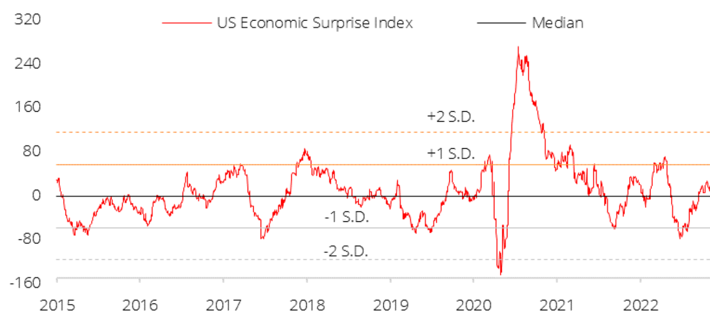
	1 week	MTD	QTD	YTD
Equities				
S&P 500	4.0%	2.2%	10.4%	-17.0%
NASDAQ	6.0%	1.9%	5.9%	-28.4%
Russell 2000	2.8%	0.8%	11.8%	-17.1%
Euro Stoxx 600	3.5%	5.0%	11.6%	-11.3%
Nikkei-225	1.6%	1.4%	7.8%	-2.9%
MSCI WORLD	4.7%	4.2%	11.6%	-17.9%
MSCI ACWI	4.7%	4.8%	11.1%	-18.6%
MSCI Asia ex-Japan	6.5%	13.7%	6.8%	-24.5%
MSCI EM	4.7%	10.8%	7.3%	-23.7%
HSCEI	6.1%	21.1%	1.1%	-27.4%
SHCOMP	0.2%	6.6%	2.0%	-15.3%
Hang Seng	6.2%	20.0%	2.3%	-24.7%
STI Index	3.8%	5.4%	4.2%	4.4%
Fixed Income				
Barclays Global Aggregate	3.4%	3.4%	2.7%	-17.8%
Barclays US Aggregate	2.4%	1.7%	0.4%	-14.3%
Barclays US High Yield	1.5%	0.9%	3.5%	-11.7%
Barclays Euro Aggregate	1.2%	0.5%	0.6%	-15.6%
Barclays Euro High Yield	1.9%	2.2%	4.3%	-11.5%
JPM EMBI Global	3.2%	4.1%	4.2%	-19.0%
JPM EMBI Global Diversified	2.8%	2.6%	3.1%	-22.5%

PRICES & SPREADS

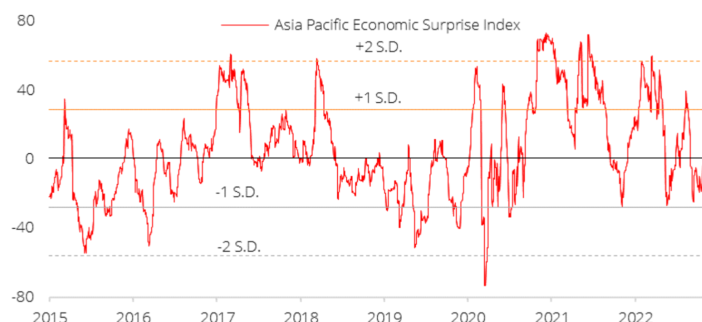
	Spot	3Q22	2Q22	1Q22
Rates				
Fed Funds Target	4.00	3.25	1.75	0.50
ECB Main Refinancing Rate	2.00	1.25	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	3.86	3.83	3.02	2.34
Japanese Govt. Bond 10-yr	0.24	0.24	0.23	0.21
German Bunds 10-yr	2.14	2.11	1.33	0.55
Spreads				
US Agg Corporate Spread	1.42	1.59	1.55	1.16
US Corporate HY Spread	4.52	5.52	5.69	3.25
Euro Agg Corporate Spread	1.97	2.25	2.15	1.31
EM USD Agg Spread	3.73	4.03	4.04	3.13
Currencies				
US Dollar Index (DXY)	106.7	112.1	104.7	98.3
EUR/USD	1.03	0.98	1.05	1.11
USD/JPY	139.9	144.7	135.7	121.7
USD/CNY	7.1	7.1	6.7	6.3
Commodities				
WTI Oil	86	79	106	100
London Metal Exchange (LMEX)	3984	3541	3879	5174
TR/CC CRB Commodity	282	268	291	295
Gold	1771	1661	1807	1937

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)	17-Nov	12-Nov	229k	225k
CPI y/y (EU)	17-Nov	Oct	10.70%	9.90%
Retail Sales Advance m/m (US)	16-Nov	Oct	1.00%	0.00%
GDP SA q/q	15-Nov	3Q	0.20%	0.20%
Industrial Production m/m (US)	16-Nov	Oct	0.10%	0.40%
MBA Mortgage Applications (US)	16-Nov	11-Nov	--	-0.10%
Housing Starts (US)	17-Nov	Oct	1411k	1439k
Existing Home Sales (US)	18-Nov	Oct	4.40m	4.71m

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Core Machine Orders m/m (JP)	15-Nov	Sep	0.70%	-5.80%
Non-oil Domestic Exports y/y (SG)	16-Nov	Oct	-1.70%	3.10%
Tertiary Industry Index m/m (JP)	15-Nov	Sep	0.60%	0.70%
GDP y/y (SG)	20-Nov	3Q	--	4.40%
Natl CPI y/y (JP)	17-Nov	Oct	3.60%	3.00%
Natl CPI Ex Fresh Food y/y (JP)	17-Nov	Oct	3.50%	3.00%
Trade Balance (JP)	16-Nov	Oct	-¥1620.0b	-¥2094.0b
Core Machine Orders y/y (JP)	15-Nov	Sep	8.00%	9.70%

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