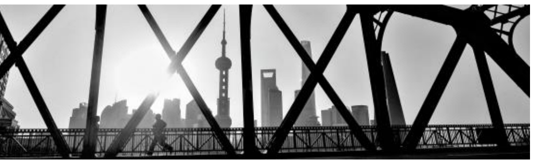


CIO Weekly

22 November 2022

Key Points

- Equities: EM outperforms DM as Fed reiterates hawkish stance despite slowing inflation
- Credit: IG credit offers the best of both worlds
- FX: USD index (DXY) to consolidate amid thin trading activities; NZD to consolidate in a 0.60-0.62 range after its 10% rally from October's lows
- Rates: Fed tightening dampens inflation worries, fall in inflation expectations sharpened lowering of US Treasury yields
- Thematics: Singapore home buyers are likely to turn cautious given rising interest rates and economic uncertainty
- The Week Ahead: Keep a lookout for US Initial Jobless Claims; Japan Jobless Rate

GLOBAL CROSS ASSETS

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	33,700	-0.1%	-7.3%
S&P 500	3,950	-0.4%	-17.1%
NASDAQ	11,025	-1.1%	-29.5%
Stoxx Europe 600	433	-0.1%	-11.2%
DAX	14,380	-0.4%	-9.5%
CAC 40	6,634	-0.2%	-7.2%
FTSE 100	7,377	-0.1%	-0.1%
MSCI AxJ	593	-1.4%	-24.9%
Nikkei 225	27,945	0.2%	-2.9%
SHCOMP	3,085	-0.4%	-15.2%
Hang Seng	17,656	-1.9%	-24.5%
MSCI EM	931	-1.3%	-24.4%
UST10-yr yield*	3.83	-0.2	231.7
JGB 10-yr yield*	0.24	-0.3	17.7
Bund 10-yr yield*	1.99	-2.1	217.1
US HY spread*	4.49	-1.0	166.0
EM spread*	407.51	1.3	77.2
WTI (USD)	79.73	-0.4%	6.0%
LMEX	3,735.20	-2.7%	-17.0%
Gold (USD)	1,738.05	-0.7%	-5.0%

Source: Bloomberg

* Changes in basis points

Equities: Fed tightening rhetoric divides market

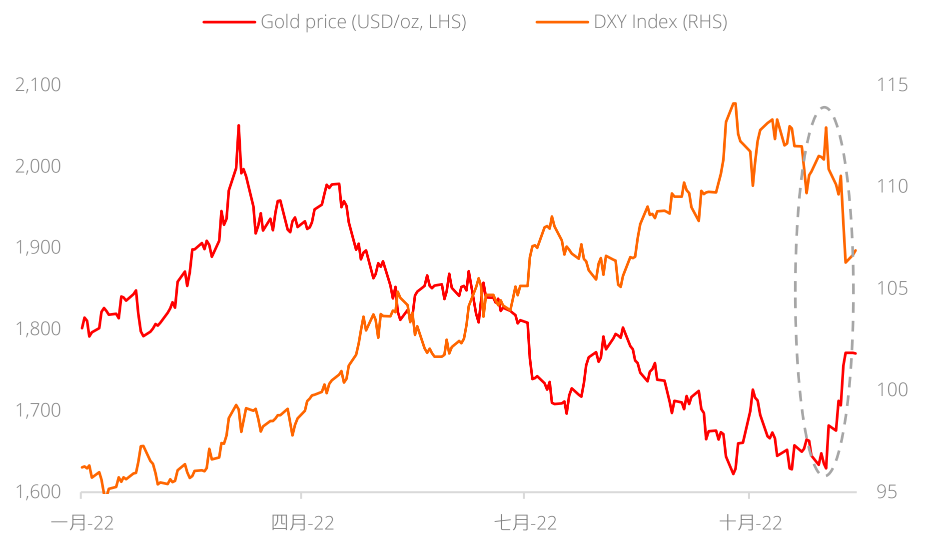
Global equities mixed as investors digest tough language from Fed. Global equities pared some gains from previous sessions as the Fed reiterated its hawkish stance amid speculation that it would slow its aggressive pace of hiking. Global equities were down 0.4% for the week, with Developed Markets and Emerging Markets registering -0.6% and +0.8% respectively.

In US, equity indices posted losses for the week despite signs of easing inflation (WTI tumbled 10%); the S&P 500, Nasdaq and Dow Jones were down 0.7%, 1.6% and 0.0% respectively. Europe markets closed higher on the back of UK's newly announced fiscal austerity measures amid debt sustainability concerns; the Stoxx 600 and FTSE 100 rose 0.2% and 0.9% for the week. Asian equities saw bifurcated performance with the Nikkei ceding 1.3% on rising inflation (core inflation hit a 40-year high); HSCEI and Hang Seng gained 4.4% and 3.8% respectively as investor sentiment on China improves following the gradual easing of Covid restrictions, and policy announcements to salvage the property sector.

Topic in focus: Upside for gold ETFs and equities amid slowing consumer price index (CPI). Gold gained 5.3% for the week ending 11 November on the back of lower-than-expected US CPI data and a weakening dollar (the DXY index ceded 4.1% in the same period). Gold's YTD performance of -4.6% firmly establishes it as one of the top-performing asset classes for the year thus far.

While there is no certainty on the timing of a Fed pivot yet, inflation data is trending in the right direction, and the CIO Office believes a turning point (whether a pause or a full-on pivot), is on the horizon in 2023. This would further normalise the dollar and drive a positive re-rating for gold. Elevated levels of geopolitical uncertainty and strong central bank buying also continue to act as tailwinds for gold. We also remain constructive on gold as a portfolio risk diversifier due to its low correlation with equities and bonds. Investors can express gold in their portfolios through mutual funds, ETFs, and gold-related equities such as miner stocks.

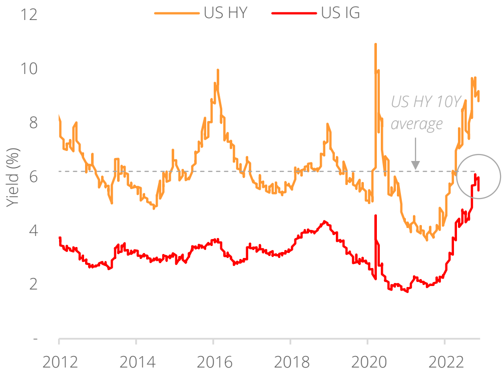
Figure 1: Gold rallies on slowing CPI data



Source: Bloomberg, DBS

Credit: IG credit offers the best of both worlds

Figure 2: US IG yields now close to the 10Y average for HY



Source: Bloomberg, DBS

In the face of persistent inflation and central banks determined to subdue it, rates and spreads have risen in tandem, leading to what is shaping up to be what could go down as the most challenging year on record for bonds. Yet not all is doom and gloom in the road ahead. A silver lining is that these movements have brought about the most generous yields seen by the safest of bond markets, with quality credit now offering the best of both worlds. As illustrated in Figure 2, US Investment Grade (IG) yields now soar at their highest levels compared to their historical performance over the past decade and are now yielding close to the 10Y average levels of US HY, providing investors with an attractive entry point into bond markets.

Moreover, the safety of US IG with its stellar track record of low defaults presents a compelling proposition, considering expectations of a worsening economic backdrop in the road ahead. Although US economic activity appears resilient thus far, we are cognisant of lagging indicators and that we are in the thick of the Fed's most aggressive tightening in decades. With very quickly tightened financial conditions potentially triggering a slowdown and rising defaults, we continue to emphasise quality credit since loss avoidance is key for outperformance in credit. Furthermore, an eventual slowdown would necessitate moderation in the Fed's hawkishness, spelling a brighter road ahead for bond markets.

FX: DM sideways, China in focus

Figure 3: Consolidating

Source: Bloomberg, DBS

Trading activities will likely thin due to the FIFA World Cup in Qatar and the long Thanksgiving weekend. Expect the USD index (DXY) and its components to consolidate for a second week. Last week (ended 18 November), EUR/USD consolidated in a 1.02-1.05 range, GBP/USD between 1.17 and 1.20, and USD/JPY mostly inside 139-141.

On 23 November, the Federal Open Market Committee (FOMC) minutes will affirm that the pace of future increases will assess "the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments." Although the Fed is leaning towards a smaller 50 bps hike in December, Fed officials are divided over whether rates should peak and pause at 4.75-5% or 5-5.25% next year. Hence, the Fed will want the US Treasury 10Y yield, to rise from below 4% towards 5%. Between now and the FOMC meeting on 14 December, Fed officials will likely push back against any market pivot.

Eventually, Fed hikes should pause before US Treasury Department runs out of funds by June 2023. After regaining control of the House of Representatives at the mid-term elections, Republicans will push for spending cuts and entitlement reforms as conditions for lifting the USD31.4t debt ceiling. Given President Joe Biden's opposition to entitlement reforms, expect a bitter fight to avoid a government shutdown and the risk of a debt default, factors that will weigh on the USD next year.

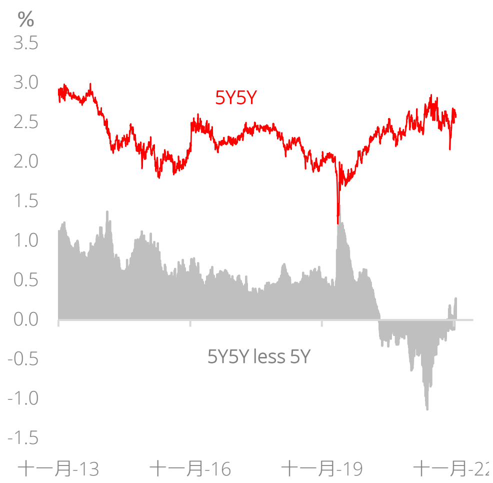
With the Western economies slowing from ongoing rate hikes, global investors are turning optimistic about China. The CNY and the Shanghai Composite Index bottomed on 31 October, one week after President Xi Jinping secured an unprecedented third term. This month, the CNY and stock index have rebounded 2.6% and 7%, respectively, from the government refining its Covid-Zero policies and 16-point plan to rescue the property sector. People's Bank of China (PBOC) advisor Liu Shijin expects China to target a 5% growth in 2023. The central bank also issued new regulations, which will take effect in 2023, to enhance the attractiveness of China's bond market to foreign institutional investors.

The Xi-Biden meeting at the G20 Summit in Bali was considered positive. Both leaders agreed to improve dialogue and avoid conflict to resolve issues, starting with a visit to Beijing by State Secretary Antony Blinken early next year. President Biden did not believe China would invade Taiwan, and both leaders opposed the use of nuclear weapons in Ukraine. At the G20 Summit, European Council President Charles Michel also affirmed that the EU would seek to engage China more "to develop a better mutual understanding." Investors viewed the meeting between President Xi and Australian Prime Minister Anthony Albanese as a first step to thawing relations.

NZD to consolidate in a 0.60-0.62 range after its 10% rally from October's lows. Many expect the Reserve Bank of New Zealand (RBNZ) to deliver a larger 75 bps hike to 4.25% because the monetary policy committee will return three months after its meeting on Wednesday. However, the RBNZ might hike by 50 bps for a fifth time, in line with the slower hikes in Australia and Canada.

USD Rates: Positive breakeven curve

Figure 4: US Breakevens



Source: Bloomberg, DBS

The fall in inflation expectations (as represented by breakevens) was one of the key drivers behind sharply lower US Treasury yields over the past week. This seems to be triggered by the weaker-than-expected CPI print and a decline in Brent oil prices below USD 90/bbl. That said, the overall size of the moves in breakevens (BE) and nominal yields look outsized and can probably be attributed to stretched positioning shifts amidst poor liquidity.

10Y BE has fallen to 2.26%, close to the lower part of the range that has been largely in place since early 2021. Assuming that neutral is close to 2.5% or slightly higher longer term, this estimate of inflation looks a tad low. We can further break these expectations into the shorter-term (5Y) as well as the medium term (5Y5Y). Notably 5Y5Y inflation swaps are trading at 2.50%, close to the middle of this year's range, but probably still a tad low given structural shifts to a more volatile world. However, the more interesting part is the sharp decline in 5Y BEs (down to 2.30%) in both the past week and compared to the start of the year. Clearly, Fed tightening is having an impact dampening inflation worries, at least in the markets. Another recent development is that the difference between 5Y5Y and 5Y BEs have turned positive. Markets are pretty convinced at this point that inflation is not going to be an issue in the near term (five years or so). Note that for the most part of the last decade, 5Y5Y BE tends to be higher than 5Y BE. It was only during the pandemic that these two rates flipped.

While there are too many moving parts, in isolation, the upward sloping BE suggest that a steeper curve is forthcoming. The key reason why curves are inverting is probably due to continued Fed hawkishness which is keeping implied real yield elevated in the shorter tenors. Against this backdrop, there is increasing pessimism on how the US/global economy is going to fare in 2023. Another down from the Fed towards a pause by late 1Q23 might be sufficient to do the trick and trigger curve steepening.

- Property prices to moderate amid higher interest rates and tighter lending limits but a significant drop is unlikely
- Higher interest rates to rein in affordability as mortgage rates cross 4%
- Limited risks to banks' mortgage book
- Unemployment is a bigger driver of declining property prices and mortgage non-performing loans

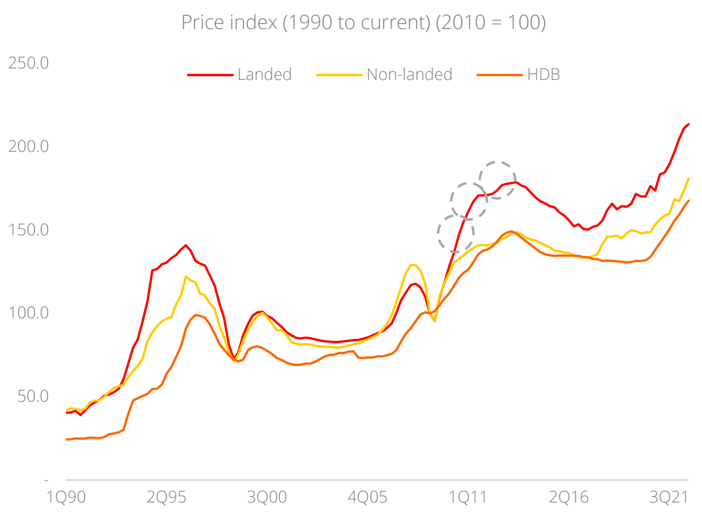
Property prices to moderate amid higher interest rates and tighter lending limits but a significant drop is unlikely. We see a slowdown in prices of the Singapore property market to a tune of +1% to -3% in 2023. Given rising interest rates and economic uncertainty, home buyers are likely to turn cautious with Singapore's strong household balance sheet preventing a significant drop in property prices. That said, developers have sold well but are trading at "recessionary levels" at -2 standard deviations price-to-book basis.

Higher interest rates rein in affordability as mortgage rates cross 4%. Based on our estimates, every 1% rise in interest rates on an SGD1m loan (30-year tenure) will see about 14% (SGD500) rise in monthly mortgage obligation. We expect the Singapore Overnight Rate Average (SORA) to increase to around 3.5% in 2023. This implies that households could potentially face a higher mortgage payment of SGD1,000 per month once loans are refinanced. Buyers intending to purchase or refinance their loans may consider a fixed-rate mortgage to improve visibility on expenses.

Households to tighten their belts to cope with higher mortgage repayments; limited risks to banks' mortgage book on rising interest rates. We believe households are likely to tighten expenses amid rising inflation to cope with heftier mortgage repayments. Many of the new sales in recent years originate from personal stay and/or upgrading demand. Banks' mortgage books have strong buffers with loan-to-values averaging 50-60% in the event of nonrepayments.

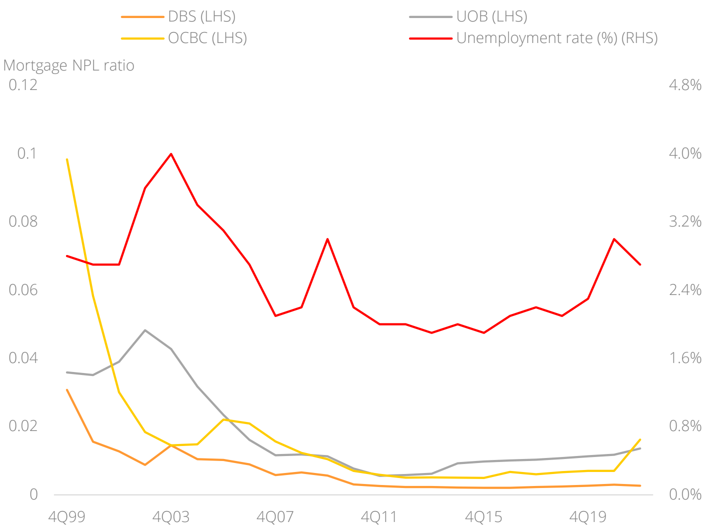
Unemployment is a bigger driver of declining property prices and mortgage non-performing loans (NPLs). Higher interest rates aside, we believe the mortgage system is stronger with stringent credit underwriting practices and cooling measures in place. Unemployment is a bigger driver of declining property prices, as seen in mortgage NPLs in previous cycles. In a bear case scenario, DBS does not rule out a possible 10%-15% retreat in the property price index (PPI). We believe valuations will continue to draw support from good provisions' buffer built up during the pandemic.

Figure 5: Property price index



Source: MAS, URA, DBS

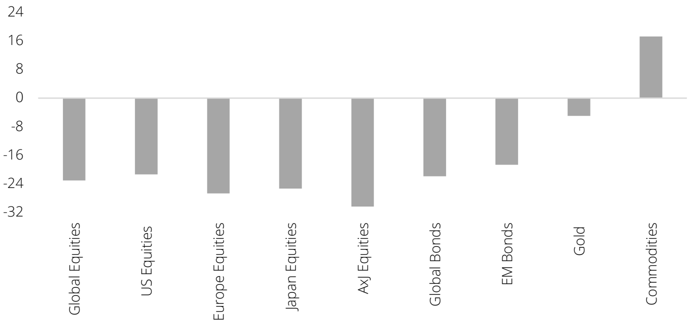
Figure 6: Singapore banks - Mortgage NPL ratio



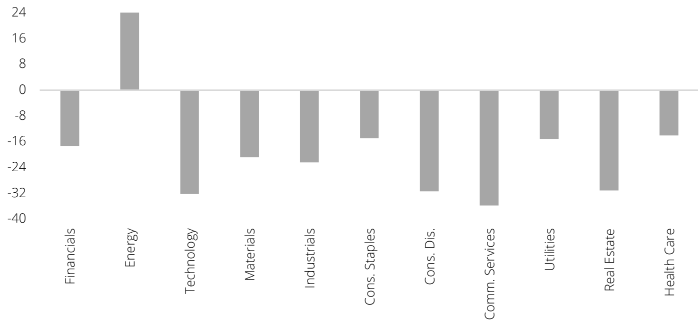
Source: MAS, companies, DBS

CIO Markets Watch

Global Cross Assets YTD Returns

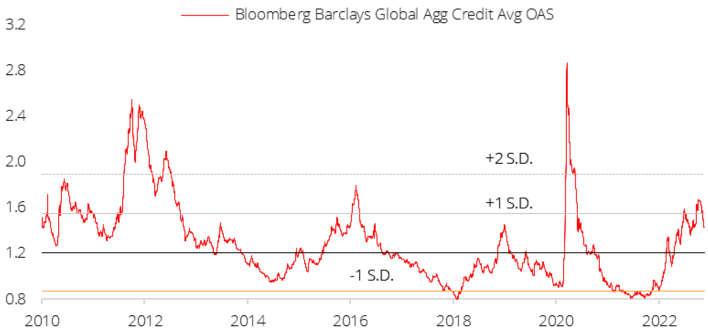


Global Sector YTD Returns



Global Equity Valuation

US Corporate Spreads



INDEX RETURNS

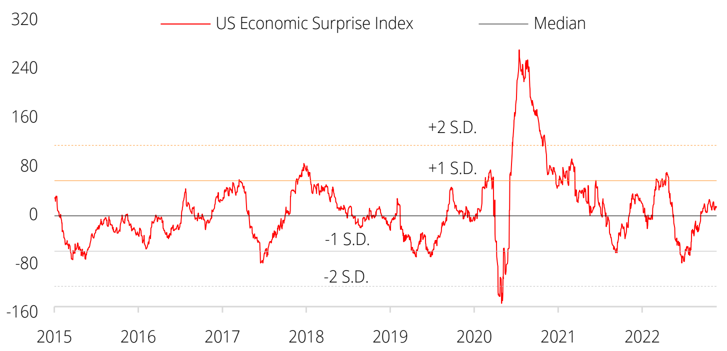
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-0.2%	2.0%	10.2%	-17.1%
NASDAQ	-1.5%	0.3%	4.2%	-29.5%
Russell 2000	-1.2%	-0.4%	10.5%	-18.1%
Euro Stoxx 600	0.0%	5.1%	11.7%	-11.2%
Nikkei-225	-0.1%	1.3%	7.7%	-2.9%
MSCI WORLD	-0.5%	3.6%	11.0%	-18.3%
MSCI ACWI	-0.6%	4.3%	10.5%	-19.0%
MSCI Asia ex-Japan	-0.4%	13.3%	6.3%	-24.9%
MSCI EM	-0.9%	9.8%	6.3%	-24.4%
HSCEI	0.4%	21.5%	1.5%	-27.1%
SHCOMP	0.1%	6.6%	2.0%	-15.2%
Hang Seng	0.2%	20.2%	2.5%	-24.5%
STI Index	-0.3%	5.1%	3.8%	4.1%
Fixed Income				
Barclays Global Aggregate	0.2%	3.5%	2.8%	-17.6%
Barclays US Aggregate	0.7%	2.4%	1.1%	-13.7%
Barclays US High Yield	0.3%	1.2%	3.8%	-11.5%
Barclays Euro Aggregate	1.3%	1.8%	1.9%	-14.5%
Barclays Euro High Yield	0.2%	2.4%	4.5%	-11.3%
JPM EMBI Global	0.4%	4.5%	4.6%	-18.7%
JPM EMBI Global Diversified	1.7%	4.4%	4.9%	-21.2%

PRICES & SPREADS

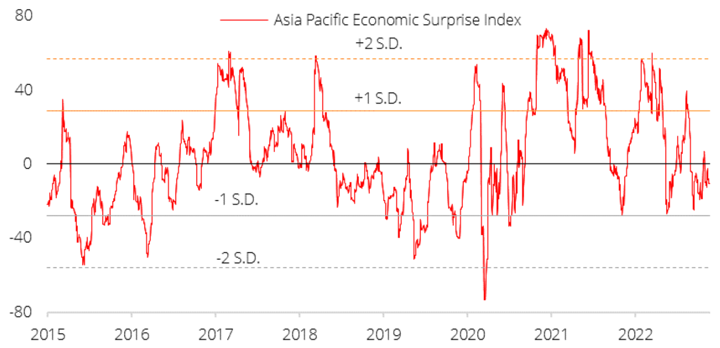
	Spot	3Q22	2Q22	1Q22
Rates				
Fed Funds Target	4.00	3.25	1.75	0.50
ECB Main Refinancing Rate	2.00	1.25	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	3.83	3.83	3.02	2.34
Japanese Govt. Bond 10-yr	0.24	0.24	0.23	0.21
German Bunds 10-yr	1.99	2.11	1.33	0.55
Spreads				
US Agg Corporate Spread	1.34	1.59	1.55	1.16
US Corporate HY Spead	4.49	5.52	5.69	3.25
Euro Agg Corporate Spread	1.92	2.25	2.15	1.31
EM USD Agg Spread	3.71	4.03	4.04	3.13
Currencies				
US Dollar Index (DXY)	107.8	112.1	104.7	98.3
EUR/USD	1.02	0.98	1.05	1.11
USD/JPY	142.1	144.7	135.7	121.7
USD/CNY	7.2	7.1	6.7	6.3
Commodities				
WTI Oil	80	79	106	100
London Metal Exchange (LMEX)	3735	3541	3879	5174
TR/CC CRB Commodity	277	268	291	295
Gold	1738	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)	23-Nov	19-Nov	225k	222k
U. of Mich. Sentiment (US)	23-Nov	Nov	55	54.7
Durable Goods Orders (US)	23-Nov	Oct	0.40%	0.40%
New Home Sales (US)	23-Nov	Oct	570k	603k
S&P Global US Manufacturing PMI (US)	23-Nov	Nov	50	50.4
MBA Mortgage Applications (US)	23-Nov	18-Nov	--	2.70%
S&P Global Eurozone Manufacturing PMI (EU)	23-Nov	Nov	46	46.4
M3 Money Supply y/y (EU)	28-Nov	Oct	--	6.30%

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Jobless Rate (JP)	28-Nov	Oct	--	2.60%
CPI y/y (SG)	23-Nov	Oct	7.00%	7.50%
Tokyo CPI Ex-Fresh Food y/y (JP)	24-Nov	Nov	3.50%	3.40%
Jibun Bank Japan PMI Mfg (JP)	23-Nov	Nov	--	50.7
GDP y/y (SG)	22-Nov	3Q	4.30%	4.40%
Job-To-Applicant Ratio (JP)	28-Nov	Oct	--	1.34
Industrial Production y/y (SG)	25-Nov	Oct	-1.70%	0.90%
Retail Sales y/y (JP)	28-Nov	Oct	--	4.50%

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