

# CIO Weekly

5 December 2022

## Key Points

- Equities: Constructive on China equities on attractive risk-reward and conducive policy directions
- Credit: Bond yields have bounced back to decade highs
- FX: Emerging Asia to outperform DM economies in 2023; Investors should prefer currencies in Emerging Asia
- Rates: Current stagflation backdrop to give way to slower economic activity/lower inflation; The yield curve inversion of 2022 set to reverse as market moves away from stagflation pricing
- Thematics: China online travel industry benefits from increased spending among Gen-Z; Expect 13% per annum growth during 2024F-2032F
- The Week Ahead: Keep a lookout for US Change in Initial Jobless Claims; China Inflation Numbers

## Equities: Global equities gain despite strong jobs data

Fed slowdown hopes remain amid tight labour market. Global equities continued their winning streak despite labour market resilience in the US. Nonfarm payrolls for November increased by 263,000, beating consensus of 200,000. Global equities were up 1.3% for the week, with DM and EM gaining 1.1% and 3.5% respectively.

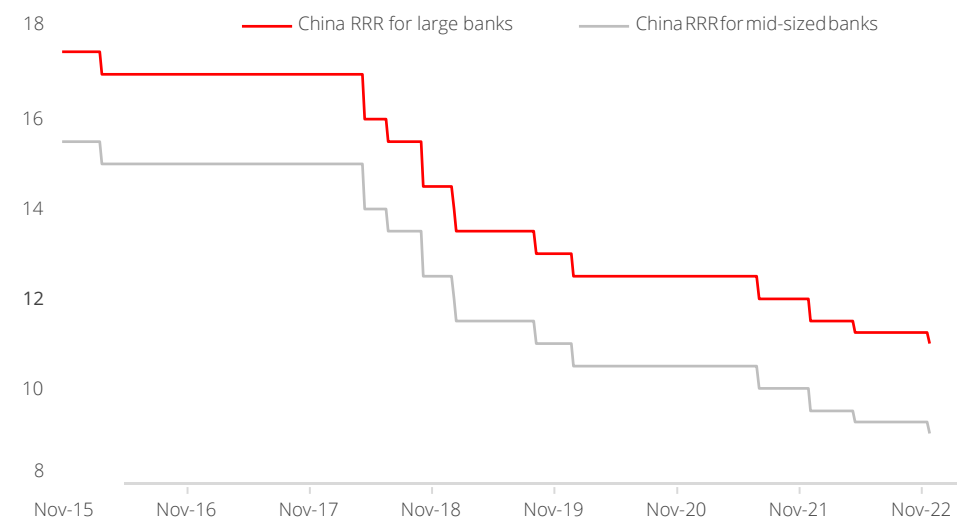
US ended another week in green and logged its first back-to-back monthly gain since 2021. The S&P 500, Nasdaq, and Dow Jones closed 1.1%, 2.1%, and 0.2% higher for the week and 8.3%, 8.9%, and 7.1% higher for the month. Europe markets rose for the week too; the Stoxx 600 and FTSE 100 registered gains of 0.6% and 0.9% for the week. Asian equities rose for the week as investors speculate on the outcome of China's reopening plans following the lockdown protests; HSCEI and Hang Seng were up 6.7% and 6.3% respectively.

**Topic in focus:** China equities – policy easing and RRR reduction. The recent policy adjustments on Covid-19 and moves taken to address the impending issues faced by real estate developers have been largely welcomed by the market, which saw equity prices rebound by nearly 30% from end October. The government has further adjusted the Covid-19 measures by easing lockdown restrictions in areas like Guangzhou and surrounding towns, shortening the quarantine period, while softening its Covid-zero rhetoric. Other adjustments include home isolation for close Covid-19 contacts rather than quarantine at centralised facilities.

In addition, the People's Bank of China has announced a 25 bps reduction in reserve requirement ratio (RRR) among large and mid-sized banks, taking effect on 5 December (Figure 1). This would take the level of RRR to 11% and 9% respectively. This move will free up some CNY500b of liquidity into the financial system. This marked the second RRR reduction in 2022 to conclude an otherwise challenging year for China stocks.

We expect more policy clarity and implementation to be announced in the coming months as Chinese authorities work toward opening its door to the rest of the world. We maintain our constructive stance on domestic oriented sectors, i.e.: A-shares, new economy sectors, local consumer brands, and financials.

Figure 1: China banking sector reserve requirement ratios (RRR)



## GLOBAL CROSSASSETS

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	34430	0.1%	-5.3%
S&P 500	4072	-0.1%	-14.6%
NASDAQ	11462	-0.2%	-26.7%
Stoxx Europe 600	443	-0.2%	-9.1%
DAX	14529	0.3%	-8.5%
CAC 40	6742	-0.2%	-5.7%
FTSE 100	7556	0.0%	2.3%
MSCI AxJ	625	-0.5%	-20.8%
Nikkei 225	27778	-1.6%	-3.5%
SHCOMP	3156	-0.3%	-13.3%
Hang Seng	18675	-0.3%	-20.2%
MSCI EM	974	-0.5%	-21.0%
UST10-yr yield*	3.49	-1.9	197.6
JGB 10-yr yield*	0.25	0.2	18.5
Bund 10-yr yield*	1.85	4.1	203.3
US HY spread*	4.38	1.0	155.0
EM spread*	387.17	-0.2	56.9
WTI (USD)	79.98	-1.5%	6.3%
LMEX	4033.9	1.8%	-10.4%
Gold (USD)	1797.63	-0.3%	-1.7%

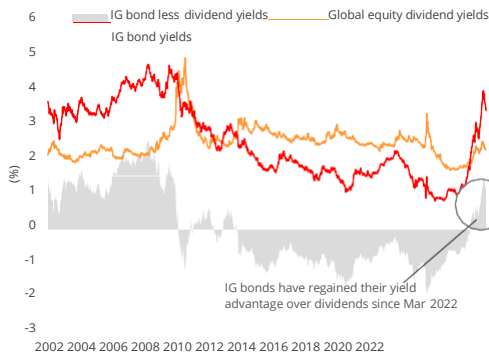
Source: Bloomberg

\* Changes in basis points

Source: Bloomberg, DBS

## Credit: Bond yields have bounced back to decade highs

Figure 2: Global IG bonds regain yield advantage over equities



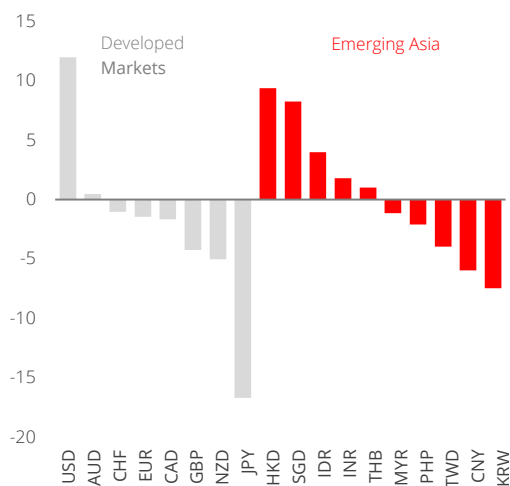
Source: Bloomberg, DBS

After years of a low or even negative-yielding environments, 2022 has brought bond yields back. Sequential outsized rate hikes by major central banks this year targeted at reining in inflation have brought bond yields to their most attractive levels over the past decade. As Figure 2 demonstrates, no longer do yield-seeking investors need to turn to equity dividends to scavage for income, as the yield advantage of global IG bonds has widened considerably vis-à-vis equity dividends since the start of 2022. This suggests attractive income generation even amongst low-risk bond markets, with the added benefit of certainty and stability of returns given bond issuers' contractual obligation to service periodic interest and principal repayments.

While the above illustrates the renewed appeal of bonds, we are cognisant of rising default risks as tightened monetary conditions work their way through the economic system as the Fed remains committed to "stay the course until the job is done" in its fight against inflation. As such, within fixed income markets, we continue to emphasise the safety of high-quality IG, as loss avoidance remains key to outperformance in credit.

## FX: Returning to relative value

Figure 3: BIS REER, % change in 2022



Source: BIS, DBS

Our outlook for currencies to recover in 2023 hinges heavily on Fed hikes pausing and the world economy averting a hard landing without a financial crisis. However, every driver knows that inputting the destination into the vehicle's GPS does not guarantee a smooth journey devoid of road works, detours, and other unforeseen traffic conditions.

By October 2022, it was evident that the USD was very expensive relative to its peers. In November, the USD Index (DXY) plunged 5% after the Fed telegraphed a smaller 50 bps hike to 4.25-4.5% in December. Effectively, the market was removing the risk premium that propelled the DXY to a 20-year high from the four "jumbo" 75 bps Fed hikes in June – November. Assuming US inflation becomes less elevated, we see the Fed Funds Rate peaking at 4.75-5% via two 25 bps increases in 1Q23. The odds of Fed hikes pushing into 2Q23 are unlikely because of an imminent fight between the White House and Republican lawmakers to lift the federal debt ceiling before the US Treasury Department runs out of funds by June.

Developed Markets economies will slow much with the EU and UK in recession. Other major central banks will likely pause their hikes with or soon after the Fed. America will end up with the highest policy rate vs its DXY peers, i.e., EU, UK, Japan, Canada, Sweden, and Switzerland. A broad-based pause should also relegate monetary policy as a major theme and return the focus to relative value.

Investors should prefer currencies in Emerging Asia, the region providing critical support for world growth. There will be fewer countries with weaker current account and fiscal balances. However, the external outlook is weak and central banks will want to replenish the foreign reserves depleted in 2022 to defend their currencies. In 2H23, assuming the global economy turns the corner amidst inflation cooling from elevated levels, currencies could benefit from the traditional pick-up in exports led by festive demand. It will be a bonus if China relaxes its Covid-zero policy and starts reopening its borders by mid-year.

## Rates: Shift away from stagflation

Figure 4: Reversal?



Source: Bloomberg, DBS

The current stagflation backdrop will give way into a period of slower economic activity/lower inflation (recession) with an outside chance growth would prove more resilient. Curve flattening was probably the single biggest shift for 2022. Note that the 2Y/10Y bear flattened from around 80 bps at the start of 2022 to an inversion of around 75 bps in November, levels not seen since the early 1980s. This could start to reverse as the market moves away from stagflation pricing.

We suspect that the combination of a hawkish Fed, aggressive hikes, and very high inflation prints would fade in late 1Q/2Q. The Fed has already indicated that it is poised to downshift in December. By 1Q, we think that the terminal rate of 5% would be hit. At that point, the vantage point should be different, and a pause would be needed to assess the impact to the economy. Across the DM, we might well find that many central banks would probably be close to the tail end of their respective tightening cycles.

In the Eurozone, recession risks are particularly acute, and the European Central Bank (ECB) might well find itself having to cut rates in late 2023. Japan is the notable exception. There are lingering risks that the Bank of Japan (BOJ) might opt to ease up on yield curve control in April 2023 when BOJ Governor Kuroda is set to step down. In any case, a shift from stagflation into recession/Goldilocks points to lower yields (especially for belly tenors).

The impact on DM curves depends on whether the pricing lurches into recession or Goldilocks or both through 2023. The US economy has so far surprised on the upside, staying resilient despite bouts of financial stress and much higher rates. While there are reports of layoffs (especially in the tech sector), these have not impacted jobless claims or payrolls yet. Moreover, external factors such as China reopening (plausible around mid-2023) also have considerable impact on global growth. Our suspicion is that stagflation would give way to recession pricing first and potentially Goldilocks thereafter if the global economy holds up better than expected in 2H23.

Steepening could play out in the 5Y/30Y, 5/10Y segments, and eventually the 2Y/10Y (in that order). We also like holding on to receiving 2Y/5Y/10Y fly. The key motivation is that this economic cycle is slowing, and rate cuts should feature in the 2Y to 5Y tenors. However, if inflation is now structurally higher than the pre-pandemic era, longer term rates should be more buoyant. We should also be keeping an eye on mortgage-backed securities sales in 2023. The extent of steepening in the German Bund curve would probably be more limited. This is a function of the curve being less inverted and the fact that the ECB is likely to deliver cumulatively less hikes than the Fed. Meanwhile, our base case is for the Japanese Government Bond curve to stay flat with an outside chance of steepening if Kuroda's successor changes tack.



### DBS CIO LIQUID<sup>+</sup> 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: China Online Travel - Gen-Z fuelling online travel agencies' growth

- Online travel industry benefits from rising travel spending in lower tier cities and among Gen-Z
- Structural shift away from group tours to individual travel, and favouring online travel agencies
- Expect 13% per annum growth during 2024F-2032F, even after 24% CAGR rebound from Covid during 2021-2024F

Expect 13% per annum growth post-COVID recovery. DBS analysis concluded that the China online travel market will sustain a compound annual growth rate (CAGR) of 13% per annum from 2024F-2032F, even after a 24% per annum recovery during 2021-2024F due to the lifting of travel restrictions post-Covid. The sector benefits from (1) continuous expansion of domestic travel spending, (2) structural increase in online travel penetration, and (3) expansion of product offerings and advertising.

OTAs are key beneficiaries. 60%+ of online bookings are via online travel agency (OTA) platforms. Gen-Z is also an emerging force with 70% of them travelling two to three times a year. Travellers are also favouring independent travel and thus OTAs, thanks to (1) the preference to travel with a smaller family size rather than in a group tour, as well as (2) increasing sophistication in travel to include African safaris, diving, skiing, or photography trips.

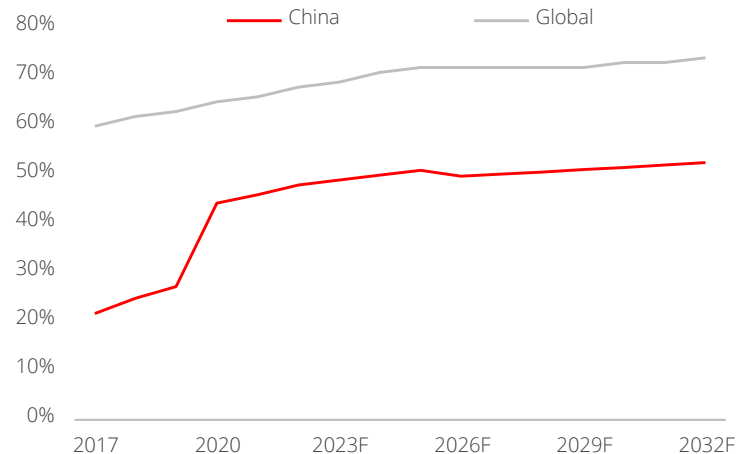
Expect online travel market to outgrow offline. China's online travel industry grew at a three-year CAGR of 26% to RMB18b in 2019, outpacing 12% of the overall travel market. China's online travel bookings revenue were made up 46% of total travel bookings revenue in 2021, below the globe's 66% in 2021, according to Statista.

Figure 5: Domestic revenue of tourism industry in China



Source: MCT Gov, CEIC, DBS HK

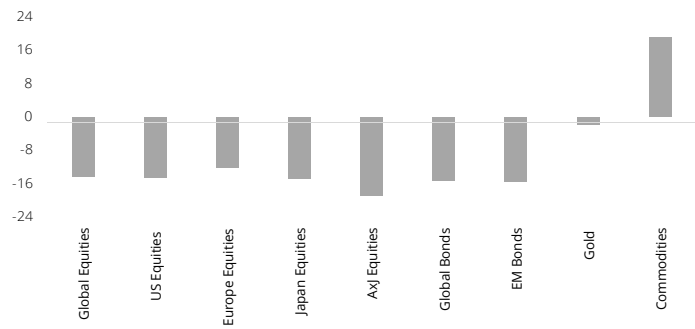
Figure 6: China's online travel penetration rate vs. global



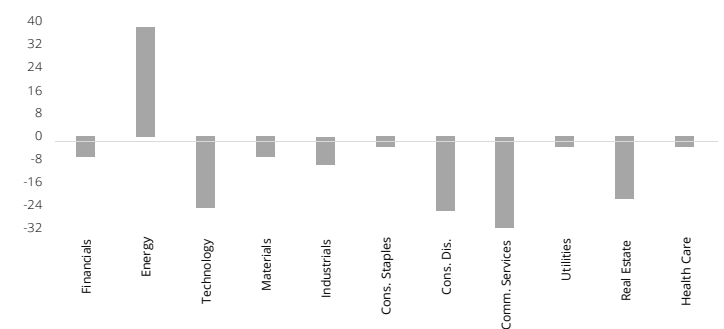
Source: Statistics, DBS HK

# CIO Markets Watch

Global Cross Assets YTD Returns



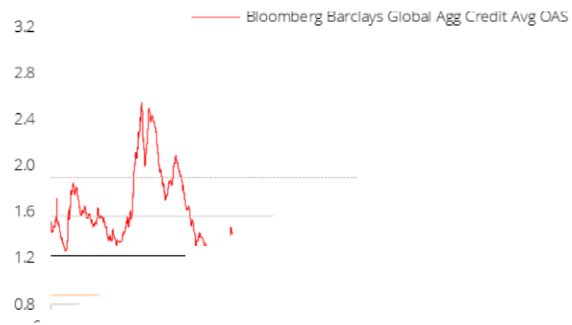
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



## INDEX RETURNS

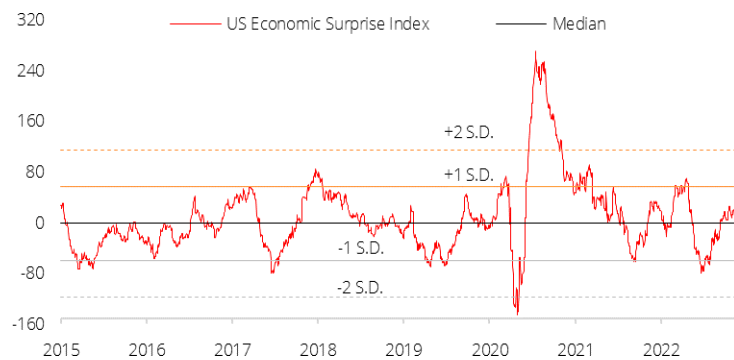
	1 week	MTD	QTD	YTD
<b>Equities</b>				
S&P 500	1.1%	-0.2%	13.6%	-14.6%
NASDAQ	2.1%	-0.1%	8.4%	-26.7%
Russell 2000	1.3%	0.3%	13.7%	-15.7%
Euro Stoxx 600	0.6%	0.7%	14.3%	-9.1%
Nikkei-225	-1.8%	-0.7%	7.1%	-3.5%
MSCI WORLD	1.1%	0.4%	14.9%	-15.4%
MSCI ACWI	1.3%	0.4%	14.5%	-16.1%
MSCI Asia ex-Japan	4.4%	0.6%	12.1%	-20.8%
MSCI EM	3.5%	0.2%	11.2%	-21.0%
HSCEI	6.7%	-0.1%	7.7%	-22.7%
SHCOMP	1.8%	0.2%	4.4%	-13.3%
Hang Seng	6.3%	0.4%	8.4%	-20.2%
STI Index	0.4%	-1.0%	4.1%	4.3%
<b>Fixed Income</b>				
Barclays Global Aggregate	1.6%	1.9%	5.9%	-15.1%
Barclays US Aggregate	1.5%	1.3%	3.7%	-11.4%
Barclays US High Yield	0.9%	0.9%	5.8%	-9.8%
Barclays Euro Aggregate	0.9%	0.6%	3.2%	-13.5%
Barclays Euro High Yield	0.4%	0.5%	6.2%	-9.9%
JPM EMBI Global	2.2%	1.5%	8.6%	-15.5%
JPM EMBI Global Diversified	2.3%	1.5%	9.0%	-18.0%

## PRICES & SPREADS

	Spot	3Q22	2Q22	1Q22
<b>Rates</b>				
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	3.49	3.83	3.02	2.34
Japanese Govt. Bond 10-yr	0.25	0.24	0.23	0.21
German Bunds 10-yr	1.85	2.11	1.33	0.55
<b>Spreads</b>				
US Agg Corporate Spread	1.30	1.59	1.55	1.16
US Corporate HY Spread	4.38	5.52	5.69	3.25
Euro Agg Corporate Spread	1.79	2.25	2.15	1.31
EM USD Agg Spread	3.49	4.03	4.04	3.13
<b>Currencies</b>				
US Dollar Index (DXY)	104.5	112.1	104.7	98.3
EUR/USD	1.05	0.98	1.05	1.11
USD/JPY	134.3	144.7	135.7	121.7
USD/CNY	7.1	7.1	6.7	6.3
<b>Commodities</b>				
WTI Oil	80	79	106	100
London Metal Exchange (LMEX)	4034	3541	3879	5174
TR/CC CRB Commodity	277	268	291	295
Gold	1798	1661	1807	1937

# CIO Economics Watch

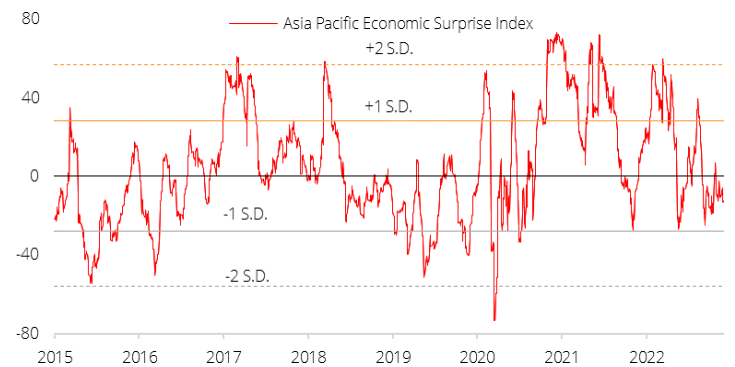
US Economic Surprise Index



MACRO CALENDAR

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims (US)	8-Dec	3-Dec	230k	225k
U. of Mich. Sentiment (US)	9-Dec	Dec	56.8	56.8
GDP SA q/q (EU)	7-Dec	3Q	0.20%	0.20%
Durable Goods Orders (US)	5-Dec	Oct	1.00%	1.00%
MBA Mortgage Applications (US)	7-Dec	2-Dec	--	-0.80%
PPI Final Demand m/m (US)	9-Dec	Nov	0.20%	0.20%
Factory Orders (US)	5-Dec	Oct	0.70%	0.30%
Trade Balance (US)	6-Dec	Oct	-\$80.0b	-\$73.3b

Asia Pacific Economic Surprise Index



MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
CPI y/y (CN)	8-Dec	Nov	1.60%	2.10%
GDP Annualised SA q/q (JP)	7-Dec	3Q	-1.00%	-1.20%
BoP Current Account Balance (JP)	7-Dec	Oct	¥621.7b	¥909.3b
PPI y/y (CN)	8-Dec	Nov	-1.50%	-1.30%
Money Supply M2 y/y (CN)	8-Dec	Nov	11.70%	11.80%
Retail Sales y/y (SG)	5-Dec	Oct	10.40%	11.20%
Trade Balance (CN)	6-Dec	Nov	\$78.10b	\$85.15b
Exports y/y (CN)	6-Dec	Nov	-4.30%	-0.30%

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