CIO Weekly G L O B A L M U L T I - A S S E T

22 May 2023

Key Points

- **Equities:** US equities traded higher amid rising optimism that debt ceiling agreement could be reached
- **Credit:** Should rates revise lower, bonds to see capital gains while deposits would face reinvestment risks
- **FX:** EUR/USD retreated on the back of ECB downshift; USD/CNY consolidation on the cards amid regulatory warnings on FX speculation
- **Rates**: USD rates rose considerably with 10Y yields breaking above banking crisis range; Expect 4.30-4.50% to be resistance area for 2Y yields while 4% will be a hard cap for 10Y yields
- **The Week Ahead**: Keep a lookout for US Initial Jobless Claims; Singapore CPI numbers

GLOBAL MULTI-ASSET RETURNS

Index	Close	Overnight	YTD
DJIA	33,427	-0.3%	0.8%
S&P 500	4,192	-0.1%	9.2%
NASDAQ	12,658	-0.2%	20.9%
Stoxx Europe 600	469	0.7%	10.3%
DAX	16,275	0.7%	16.9%
CAC 40	7,492	0.6%	15.7%
FTSE 100	7,757	0.2%	4.1%
MSCI AxJ	628	-0.1%	1.5%
Nikkei 225	30,808	0.8%	18.1%
SHCOMP	3,284	-0.4%	6.3%
Hang Seng	19,451	-1.4%	-1.7%
MSCI EM	977	-0.1%	2.2%
UST10-yr yield*	3.67	2.7	-20.2
JGB 10-yr yield*	0.39	1.5	-2.1
Bund 10-yr yield*	2.43	-1.9	-14.0
US HY spread*	4.77	-4.0	8.0
EM spread*	403.31	-2.1	29.1
WTI (USD)	71.55	-0.4%	-10.9%
LMEX	3,722.00	0.9%	-6.6%
Gold (USD)	1,977.81	1.0%	8.4%

Source: Bloomberg
* Changes in basis points

Equities: Debt ceiling negotiation drove market volatility

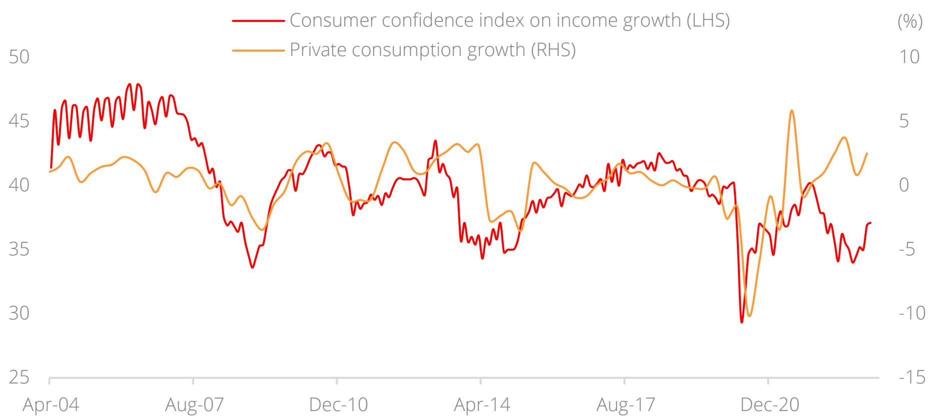
Global equities traded higher amid shift in expectation surrounding debt ceiling negotiation. Markets posted notable gains last week (ended 19 May), with a significant portion coming from Thursday's (18 May) surge which was driven by rising optimism that a debt ceiling agreement could be reached. Global equities were up 1.1% for the week, with Developed Markets and Emerging Markets gaining 1.2% and 0.4% respectively.

US equities dipped on Friday (19 May) after GOP designated negotiators suspended the discussion on debt ceiling, fuelling pessimism among investors that a deal could not be reached. Despite Friday's performance, the S&P 500, Dow Jones, and NASDAQ notched gains of 1.6%, 0.4%, and 3.0%, respectively, for the week. Europe rose on the back of investors' confidence on peaking interest rates; the Stoxx 600 gained 0.7% while the FTSE 100 remained flat. China equities bucked the trend as macroeconomic data such as industrial production, retail sales, and fixed asset investment came in weaker-than-expected; the HSI and HSCEI fell 0.9% and 1.0% respectively.

Topic in focus: Rising optimism in Japan. Japan stocks have surged to their highest level since 1990, sparking optimism that the upward trend in TOPIX may have long-term sustainability. The reopening of China, accommodative monetary policies, and market reforms offer opportunities for the Japanese market. Compared to the US market, Japan is perceived as a cheaper option and could serve to diversify risks stemming from a potential US slowdown and future disruptions in the supply chain, given the escalating tensions between the US and China.

Japanese workers received their largest wage increment in 26 years since April, boosting discretionary spending power and consumer confidence in the economy. Furthermore, the implementation of reflationary policies aimed at achieving sustainable inflation above the targeted 2%, spearheaded by the new Prime Minister Kishida and Bank of Japan (BOJ) Governor Ueda, is likely to yield positive outcomes in terms of the newly introduced reform policies. Alongside the rise in inbound tourism and the release of pent-up demand, we anticipate a revival in consumption, which will have a positive impact on the retail and food and beverage sectors.

Figure 1: Better confidence in wage growth to drive consumption



Source: Refinitiv Datastream

Credit: Quality credit outperforms cash once hiking cycle is over

Lock in generous yields by moving cash to high quality IG credit. On the back of financial stability concerns, moderating inflation, and a slowing economy, the end could soon be in sight for the Fed's rate hiking cycle. Given the prospects of a Fed pause, the days of fleetingly attractive yields on cash deposits are numbered. On the other hand, those who invest in investment grade (IG) credit during this window for higher yields would enjoy dual benefits of locking in generous yields for a longer duration, while also enjoying the safety of high-quality credit exposure given IG credit's stellar track record.

Quality credit outperforms cash once hiking cycle is over. Looking back into notable episodes of Fed rate hike pauses since 1987, history illustrates the phenomenon of credit outperforming cash. In the six instances (Table 1), cash rates saw a mean peak-to-trough yield decline of 3.5% over 2.4 years on average following a pause in the rate hike cycle – usually due to the emergence of some form of economic stress – implying that reinvestment risk runs high once the hiking cycle is over. IG credit, on the other hand, saw tailwinds take over as it enjoyed capital gains from the lower rates environment, averaging an annualised yield of 10.6% in the same period.

The window to lock in higher yields is soon closing. With systemic stresses in financial markets remaining at the fore, the opportunity is soon closing to lock in higher yields. We continue to recommend that investors capitalise on this narrowing window for higher yields by shifting excess cash towards high quality credit – in what we term the Liquid + Strategy – to capture yields while stocks last.

Table 1: Quality credit outperforms cash after the Fed takes a pause

Rate Hike Pause	Emerging Concern	Subsequent Peak to Trough Change in Cash Rates	Time Till Cash Rate Trough (years)	Annualised US IG Credit Returns in Same Period
Feb-1989	Savings and loans crisis	-6.1%	2.9	12.6%
Feb-1995	Receding Inflation	-0.9%	1.0	14.3%
Mar-1997	Asian Currency Crisis	-0.8%	1.8	11.5%
May-2000	Dot-com Bust	-5.6%	2.8	11.4%
Jun-2006	Housing Market Slowdown	-4.9%	3.0	4.5%
Dec-2018	US-China Trade Tensions	-2.7%	2.6	9.4%
Average		-3.5%	2.4	10.6%

Source: Bloomberg, DBS

FX: DXY vs EUR at the mid of this year's ranges

DXY appreciated a second week by 0.5% to 103.2 last Friday, alongside a 28 bps rise in the US Treasury 2Y yield to 4.27%. DXY and the 2Y yield bottomed at 101 and 3.65%, respectively, on 4 May, a day after the Fed lifted the Fed Funds rate (FFR) by 25 bps to 5-5.25%. DXY is near support at 102.9, or its 100-day moving average. To extend its upside, DXY needs to close above 103.5, the level it ended last year.

Figure 2: Consolidation mode?

Source: Bloomberg, DBS

Over the past fortnight, many Fed officials did not close the door on more hikes to return inflation to its 2% target. The Fed could always lift this year's FFR target in its June Summary of Economic Projections if inflation's slowdown starts to become bumpy in a labour market that is not cool enough. On Friday (26 May), Bloomberg consensus expects the US PCE deflator to firm to 0.3% m/m (4.3% y/y) in April from 0.1% m/m (4.2%) in March and sees the PCE core deflator unchanged at 0.3% m/m and 4.6% y/y.

However, Fed Chair Jerome Powell kept the door open for a pause at the FOMC meeting on 14 June. US Treasury Secretary Janet Yellen reiterated that the US government could stop paying its bills as early as 1 June (next Thursday) if Congress fails to raise the debt ceiling. Yellen doubted the Treasury could stretch the X-date to 15 June when more tax payments are due. US President Joe Biden will resume negotiations with House Speaker

Kevin McCarthy on Monday. However, markets do not expect a compromise to break the deadlock and are bracing for more volatility.

EUR/USD retreated to 1.0805 last week, around the mid-point of this year's trading range between 1.0484 and 1.1095. EUR's latest slide started on 4 May, the day the European Central Bank (ECB) downsized hikes to 25 bps, the same as the Fed a day earlier (3 May). After raising the main refi rate from 0% to 3.75% since July, some ECB officials see the central bank 1-2 hikes from a pause. Like the Fed, the ECB wants to keep rates at restrictive levels for some time to get inflation back to its 2% target. EUR did not break above 1.11 in the past month because the Fed's and ECB's policy paths may not be as divergent as markets believe.

GBP/USD could push below 1.24 or its 50-day MA. Following the Bank of England's (BOE) 25 bps hike to 4.50% on 11 May, GBP retreated from the year's peak of 1.2680 to 1.2445 last Friday. On 24 May, consensus expects UK CPI inflation to decline to a 13-month low of 8.2% y/y in April after seven months of double-digit readings. If so, this is consistent with the BOE's expectation for inflation to fall sharply from April on base effects.

USD/CNY may consolidate after rallying more than 3% in the past month. Last Friday (19 May), USD/CNY hit a high of 7.06 before retreating to 7.01. China's regulators issued a statement, warning that the People's Bank of China and the State Administration of Foreign Exchange would curb speculation in the FX market when necessary, targeting pro-cyclical and one-way bets. At the end of the G7 Summit on Sunday (21 May), US President Joe Biden raised expectations for US-China tensions to ease. Last week, US National Security Adviser Jake Sullivan met China's top diplomat Wang Yi. This week (ending 26 May), US Commerce Secretary Gina Raimondo and US Trade Representative Katherine Tai will meet China's Commerce Minister Wang Wentao. In June, US Defense Secretary Lloyd Austin is seeking to meet with Chinese Defense Minister Li Shangfu.

Rates: Level watching amidst optimism

Figure 3: Key resistance at 4.30- 4.50%

Source: Bloomberg, DBS

USD rates have risen considerably over the past few weeks with 10Y yields decisively breaking above their banking crisis range (3.3-3.6%). Meanwhile, 2Y yields are just about at the ceiling of their recent range (3.8-4.3%). There are two key developments that drove this optimism. First, an imminent banking crisis appears to have been averted and incoming US data seems strong. Accordingly, rate cuts pricing should be pared. Second, there seems to be a lot of optimism on a debt ceiling deal. 10Y yields briefly touched 3.70%, undoing a lot of the pessimism over the past two months. 3.70% is at levels consistent with a relatively firm economy with limited stresses. We are a tad concerned that a fair amount of good news might already be factored in, especially on the debt ceiling.

This week, there will likely be more wrangling on the debt negotiations. Data wise, we would get a PCE deflator reading on 26 May. Fed minutes will also be released on 25 May (2am SGT). We suspect that there might be considerable debate over when to pause the current hike cycle given uncertainties over the impact of policy lags and increased credit tightening. In level terms, we think that 4.30-4.50% would prove to be a key resistance area for 2Y yields. For 10Y yields, we see 4% as a hard cap. If the debt ceiling gets lifted, we suspect that 10Y yields would be in the 3.70-3.80% region. This would also be broadly consistent with levels seen before the bank failures hit in March. From here on, we see yield spikes as opportunities to receive.

Thematics: China Banking Sector – Are TLAC capital replenishment needs a cause for worry?

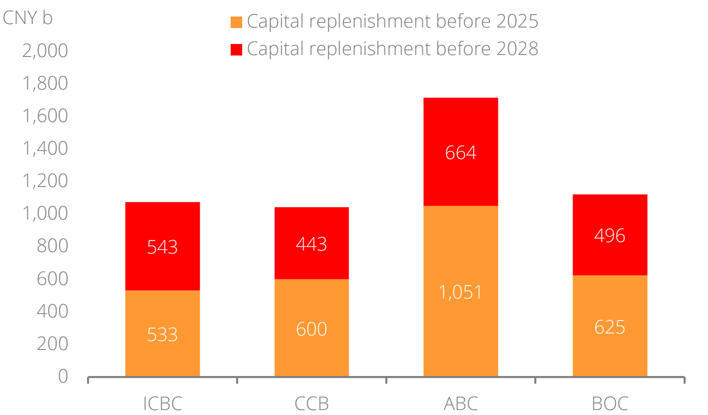
- Big Four banks will need to replenish over CNY2.8t of capital before 2025 to meet TLAC requirement
- Offshore issuance of TLAC debt incurs higher costs but has a broader investor base
- Issuance of TLAC debt might be negative to funding costs and ROE but impact limited

China's Big Four banks need around CNY2.8t of additional capital. As Global Systematically Important Banks (G-SIBs), China's Big Four banks will have to meet the Total Loss Absorbing Capability (TLAC) requirement by the beginning of 2025. The Capital Adequacy Ratio (CAR) and TLAC ratio requirement will increase by 8%pts accordingly to 19.5-20% and leverage ratio requirement will increase from 4.5% to 6%. To meet the TLAC requirement, DBS expects China's Big Four banks to need around CNY2.8t of additional capital by the end of 2024.

Offshore vs onshore issuance. Based on the experience from US major banks, we estimate that China's Big Four banks may bear an interest rate of >5.7% if issuing USD bonds in the offshore market, while onshore issuance cost is likely to be <4.5%. However, given the large size of potential TLAC bond issuances, the offshore market offers a broader investor base, compared with a higher portion of inter-bank holdings in the onshore Financial Institution (FI) bond market. As such, we expect China banks to undertake some level of TLAC offshore bond issuances as well. We expect 2-3 bps of negative impact in funding costs.

Challenges and opportunities for China banks. Fulfilling the TLAC requirement lowers systematic risks for China's banking sector. It could also help to meet the liquidity gap in balance sheets, but may have some negative impact on return on equity and funding costs. Among the Big Four, we prefer names that are less negatively impacted by the TLAC requirements.

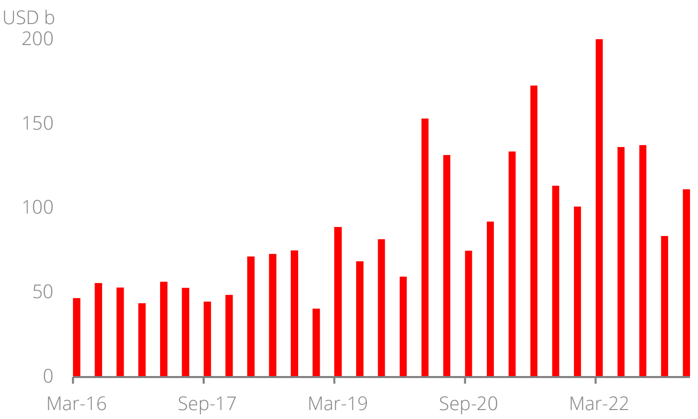
Figure 4: Estimated capital replenishment requirement for Big Four Banks



Source: Companies, DBS

*Not taking Deposit Insurance Fund as part of TLAC instruments

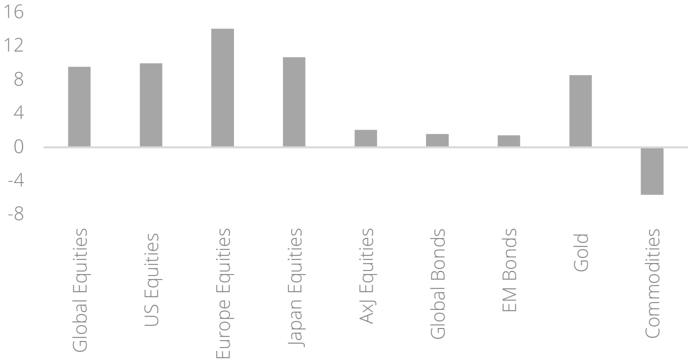
Figure 5: Quarterly issuance of TLAC instruments



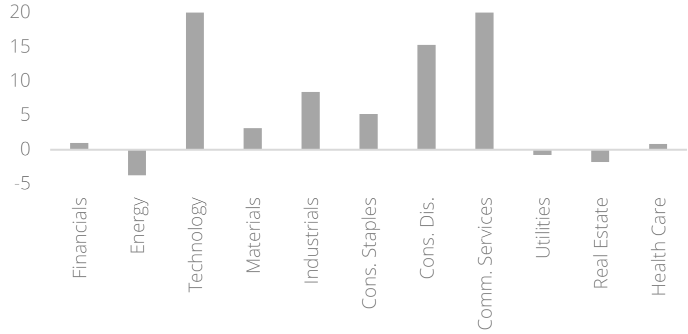
Source: Bloomberg, DBS

CIO Markets Watch

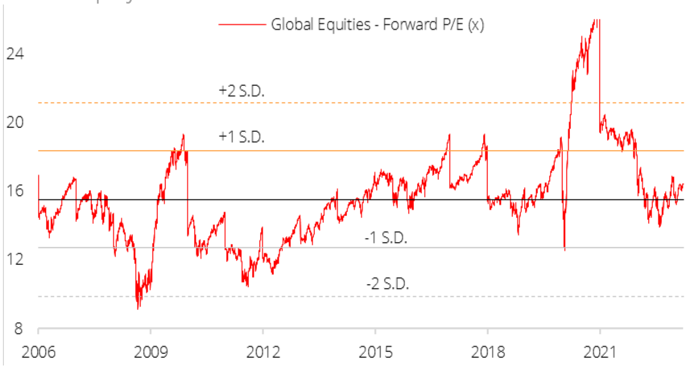
Global Cross Assets YTD Returns



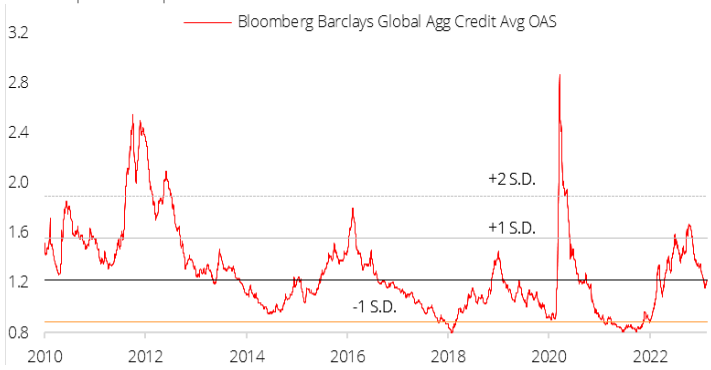
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Source: Bloomberg, DBS

INDEX RETURNS

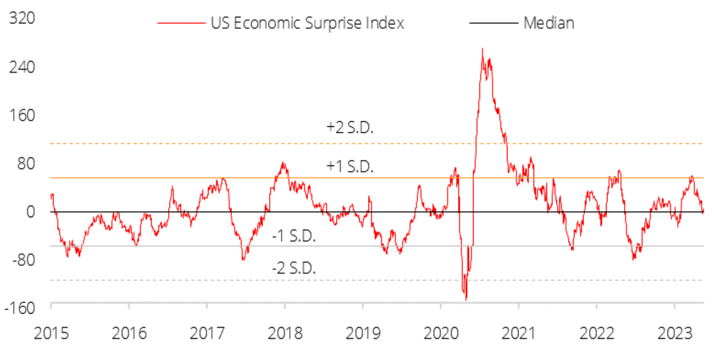
	1 week	MTD	QTD	YTD
Equities				
S&P 500	1.6%	0.5%	2.0%	9.2%
NASDAQ	3.0%	3.5%	3.6%	20.9%
Russell 2000	1.9%	0.3%	-1.6%	0.7%
Euro Stoxx 600	0.7%	0.5%	2.4%	10.3%
Nikkei-225	4.8%	6.8%	9.9%	18.1%
MSCI WORLD	1.2%	0.2%	1.8%	9.2%
MSCI ACWI	1.1%	0.2%	1.5%	8.4%
MSCI Asia ex-Japan	0.6%	-0.3%	-2.5%	1.5%
MSCI EM	0.4%	0.0%	-1.3%	2.2%
HSCEI	-1.0%	-1.6%	-5.4%	-1.7%
SHCOMP	0.3%	-1.2%	0.3%	6.3%
Hang Seng	-0.9%	-2.2%	-4.7%	-1.7%
STI Index	-0.2%	-2.1%	-1.7%	-1.5%
Fixed Income				
Barclays Global Aggregate	-1.5%	-1.8%	-1.4%	1.6%
Barclays US Aggregate	-1.4%	-1.7%	-1.1%	1.9%
Barclays US High Yield	-0.4%	-0.9%	0.1%	3.7%
Barclays Euro Aggregate	-0.9%	-0.7%	-0.5%	1.6%
Barclays Euro High Yield	0.4%	0.8%	1.3%	4.2%
JPM EMBI Global	-1.4%	-1.3%	-0.8%	1.4%
JPM EMBI Global Diversified	-1.3%	-1.1%	-0.3%	1.6%

PRICES & SPREADS

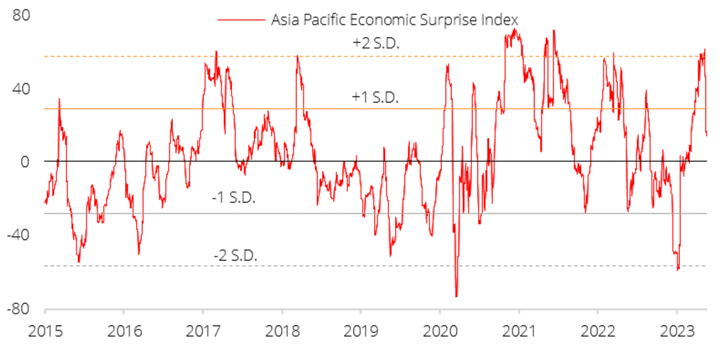
	Spot	1Q23	4Q22	3Q22
Rates				
Fed Funds Target	5.25	5.00	4.50	3.25
ECB Main Refinancing Rate	3.75	3.50	2.50	1.25
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10Y	3.68	3.47	3.88	3.83
Japanese Govt. Bond 10Y	0.39	0.33	0.41	0.24
German Bunds 10Y	2.43	2.29	2.57	2.11
Spreads				
US Agg Corporate Spread	1.43	1.38	1.30	1.59
US Corporate HY Spread	4.77	4.55	4.69	5.52
Euro Agg Corporate Spread	1.70	1.72	1.70	2.25
EM USD Agg Spread	3.51	3.52	3.32	4.03
Currencies				
US Dollar Index (DXY)	103.2	102.5	103.5	112.1
EUR/USD	1.08	1.08	1.07	0.98
USD/JPY	138.0	132.9	131.1	144.7
USD/CNY	7.0	6.9	6.9	7.1
Commodities				
WTI Oil	72	76	80	79
London Metal Exchange (LMEX)	3722	4038	3984	3541
TR/CC CRB Commodity	262	268	278	268
Gold	1978	1969	1824	1661

CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



Source: Bloomberg, DBS

MACRO CALENDAR

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims (US)	25-May	20-May	248k	242k
GDP Annualised q/q (US)	25-May	1Q	1.10%	1.10%
U. of Mich. Sentiment (US)	26-May	May	58	57.7
Durable Goods Orders (US)	26-May	Apr	-1.00%	3.20%
MBA Mortgage Applications (US)	24-May	19-May	--	-5.70%
S&P Global US Manufacturing PMI (US)	23-May	May	50	50.2
HCOB Eurozone Mfg PMI (EU)	23-May	May	46	45.8
New Home Sales (US)	23-May	Apr	663k	683k

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
CPI y/y (SG)	23-May	Apr	5.50%	5.50%
Core Machine Orders m/m (JP)	22-May	Mar	0.40%	-4.50%
Tokyo CPI Ex-Fresh Food y/y (JP)	26-May	May	3.40%	3.50%
Jibun Bank Japan PMI Mfg (JP)	23-May	May	--	49.5
GDP y/y (SG)	25-May	1Q	0.20%	0.10%
Industrial Production y/y (SG)	26-May	Apr	-4.80%	-4.20%
Industrial Production SA m/m (SG)	26-May	Apr	-0.40%	9.30%
Jibun Bank Japan PMI Services (JP)	23-May	May	--	55.4

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