CIO Insights 1Q24

Shifting Currents.

Peaked US Rates

Slower economic growth and inflation rate point to a peak in US rates. 2024 is the time to put cash to work in multi-asset portfolios. Expect rate cuts to start on further signs of cooling.

Overweight Bonds

Fed Funds rate at a 15-year high has made the asset class of Fixed Income attractive again. Favour Investment Grade corporates for the best risk-reward and include a measured exposure to Private Credit funds.

US Growth, Asia Value in Play

Favour US Tech for quality growth and Asia Equities for deep value. Downgrade dividend-paying stocks as the yield gap has shifted in favour of Bonds. On asset allocation, shift Equities to underweight, stay overweight Bonds and Private Assets.

Upgrade Gold

Resilience in Gold underpinned by peaking rates and dollar amid heightened geopolitical risk. Persistent central bank buying to provide long-term support. Maintain Gold as a portfolio risk diversifier.

Source: iStock

DBS

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Foreword

Dear valued clients,

Kayakers don't look around. Their focus is forward. On the water, they keep time to the rhythm of the paddle, thrusting the vessel forward each time the paddle slices the water. Left. Right. Left. Right. Pushing against tide, currents, wind, waves. It is mental prowess and physical poetry in motion, buoyed by a clear sense of purpose.

At DBS, we are anchored by our purpose to be the best bank for a better world. Like kayakers at sea, we paddled past the turbulence of 2023 and look upon 2024 as a year where we navigate – as the title of our 1Q24 CIO Insights publication suggests – shifting currents.

The banking tumult across both sides of the Atlantic, coupled with market volatility, has shifted the centre of gravity of global wealth towards Asia. Within this evolving landscape, we have solidified our standing, not just as a bank, but as a trusted partner in wealth management. Our clients, like yourself, have witnessed the unparalleled commitment we bring to the table — one rooted in our robust capital base, disciplined cost management, investment expertise, and the distinction of being Asia's safest bank.

In a marriage of safety and innovation, DBS Trustee Limited emerged as one of the pioneering trust companies in Asia to offer our private banking clients the opportunity to trade digital assets on the DBS Digital Exchange and custodise them securely.

In mid-2023, we were also the world's first private bank to launch a Multi Family Office structuring proposition, leveraging Singapore's Variable Capital Company (VCC) regime. The DBS Foundry Multi Family Office VCC is established as an umbrella VCC with multiple underlying sub-funds, offering a range of customisable investment strategies for UHNW families. This solution not only represents a milestone in our family office proposition but also exemplifies our commitment to continuous reinvention.

Beyond banking, we recognise our role in creating impact and fostering positive change in the communities we operate in. In August 2023, we made known our intention to commit up to SGD 1 billion over the next decade to improve the lives and livelihoods of the low-income and underprivileged. As we enter the new year, we invite you to walk this journey with us.

With this, I wish you a year of bold beginnings and boundless success.

Shee Tse Koon

Group Head, Consumer Banking & Wealth Management

Executive Summary

Dear valued clients,

We had made a bold call since the start of 2023 for investors to put cash to work with “The Return of 60/40”.

Our call has paid off. Despite headwinds from geopolitical uncertainties and recession risks, our Barbell Strategy, comprising outsized exposures to income-generating Bonds on one end and secular-growth Equities on the other, recorded 10.7% of gains for 2023 (as of 1 Dec).

From the time the Fed started policy tightening, a total of 525 bps of hikes was done over 16 months, one of the fastest in its history. Interest rates, being the discount factor for valuing future cash flows, have always been the key determinant for financial asset performance, thus explaining the challenging conditions for Equities and Bonds in periods of heightened rates.

Now, we see a peaking of US rates as economic data on growth and inflation point to a softening. As a result, we believe 2024 will be a supportive environment for risk assets.

The sharp divergence between US Big Tech stocks or the “Magnificent 7” versus the broad market index over 2023 has propelled strong outperformance of our Barbell Portfolio over underlying benchmarks.

We expect this to continue. Elevated bond yields today pose a high bar for Equities to clear. Apart from quality Consumer Discretionary and Technology-related companies, earnings growth of most companies in the other sectors will be challenged by > 6% yields that Bonds can offer.

Hence, it will be no surprise that growth stocks will continue outperforming value stocks, thus reinforcing the efficacy of our Barbell Strategy into 2024.

In this publication, we also highlight the theme of next generation infrastructure and luxury, along with the opportunities that abound in these sectors.

I wish you a prosperous year of investing.

Hou Wey Fook, CFA

Chief Investment Officer

Turning Points

Asset Allocation 1Q24

Three major turning points will converge – rising disinflation and peak Fed, negative Equity-Bond yield gap, and the dis-inversion of the US Treasury yield curve. Overweight IG Bonds, Private Assets, and Gold. We downgrade Equities to underweight, maintaining preference for quality growth plays.

Investment Summary 1Q24

Macro Policy

Fed and ECB to start rate cuts amid slowdown in economic growth and inflation. BOJ to normalise its ultra-loose monetary policy. Less room for rate cuts in Asia as growth stabilises.

Economic Outlook

Soft landing in US growth to 1.2% amid a slowing Japan and stagnating Eurozone. Electronics exports to be a key driver for Asia growth.

Equities

Favour quality growth in Technology and Consumer Discretionary, and Asia for deep value. Downgrade dividend yielding Equities.

Credit

Sweet spot remains with A/BBB Credit in 3-5Y duration. Bright spots in AT1 bank capital instruments, quality EM Credit, and local currency Bonds that would benefit from moderating USD strength.

Rates

US and Eurozone short-end yields to fall on signs of cooling inflation and growth. Cautious on the long-end of the yield curve given supply risks to fund deficits. Less room for Asia ex-China to cut rates due to inflation risks.

Currencies

Yen to benefit most against a weaker dollar as US rates peak, followed by the Euro. Export recovery in Asia led by electronics to be supportive of Asian currencies.

Alternatives

Geopolitical risks and peak Fed rates are tailwinds for Gold. Private Equity secondaries and Private Credit distressed debt are attractive in the current environment.

Commodities

Weakening global growth to weigh on demand for Commodities. Downside risk for oil price given lack of additional cuts from OPEC+.

Thematics

The evolution of consumer mindsets is redefining the Luxury sector. Structural changes are set to drive demand for new Infrastructure spend.

Theme: Luxury, Redefined

In a post-pandemic world where conscious consumerism is a key focus, businesses are prompted to differentiate themselves with fresh strategies. Within the Luxury sector, 'Quiet Luxury' has been creeping to the fore, fuelled by the desire for exclusivity and emergence of 'uneasy affluence', a growing caution against ostentatious displays of wealth.

Theme: Next Generation Infrastructure

Next generation infrastructure enjoys persistent demand as the world struggles to keep ahead of 21st century challenges such as climate crises, demographic shifts, cyberattacks, and supply chain upheavals.

01.
Asset Allocation.

Hou Wey Fook, CFA
Chief Investment Officer

Dylan Cheang
Strategist

Another year, another forecast. Making year-end predictions can be tricky. With innate optimism bias wired into the human brain, there is a tendency for one to assume the upcoming year will be better than the last. We are no different. After the shocks and disappointment of 2022's sell-off, followed by the broad-based recovery in 2023, it is certainly tempting to assume that 2024 will be a friendlier year for risk assets.

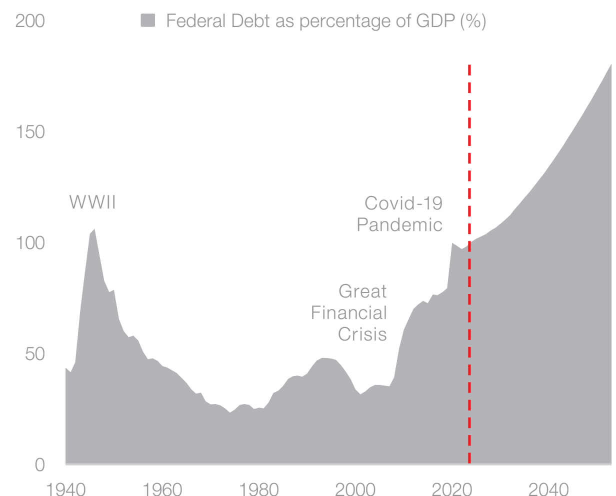
So, why wouldn't it be? After all, the Fed is widely expected to put monetary tightening on hold as disinflation seeps in while the likelihood of rate cuts, however remote, should be a matter of when, not if. But history tells us that when the Fed exits from monetary tightening and pivots to policy easing, the journey for risk assets is, often times, a volatile one.

And this makes sense. Historically, major monetary easing cycles foreshadowed recessions. It happened in 1989, 2000, and 2007. While the Fed may aspire to engineer a "soft landing" for the economy, in truth, aspiration and reality are separated by a fine line. Things could swing the other way. Policy errors are not uncommon, especially given the Fed's chequered history in policy making.

One of the key uncertainties facing financial markets today is the Fed's insistence on using a data-dependent policy approach with little forward-looking components in it. This can be dangerous. It exposes the central bank to the unintended risk of overtightening. US data is already showing early signs of weakness and the homebuilding space is a case in point.

Adding to the proverbial wall of worries are rising concerns on US indebtedness and its untenable fiscal situation. Years of fiscal largesse, coupled with rapid rate hikes, have put the US in an unenviable position of servicing a mountain of debt. According to the Congressional Budget Office, federal debt as percentage of GDP will hit 98% this year and this is not far from the post-WWII peak of 106% in 1946.

US indebtedness nearing WWII level



Source: Congressional Budget Office, DBS

With the existence of pandemic excess savings (albeit declining) and rise in real wages, a US economic "soft landing" remains our base case scenario. But this will not preclude risk assets from undergoing substantial volatility ahead given the convergence of three major turning points in financial markets:

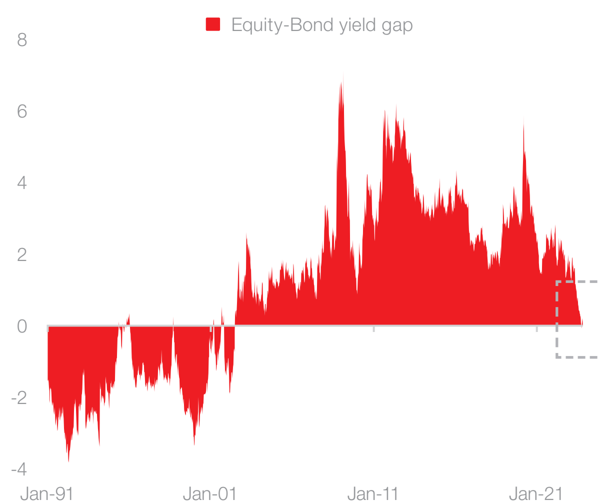
- Rising disinflation and peak Fed
- Negative Equity-Bond yield gap
- Dis-inversion of US Treasury yield curve

Indeed, our analysis of past market cycles conclude one thing: When the factors above converge, the outlook for risk assets can be a sobering one. The negative Equity-Bond yield gap in particular, is a major cause for concern. For equity valuations to stay elevated despite obvious headwinds, it is clear investors are not quite ready to accept the new reality that the days of easy money are over.

Given the prevalence of these turning points, navigating financial markets in 2024 will require extreme pragmatism and certainly, without dogma. The key tactical asset allocation calls which we are making for the upcoming quarter are:

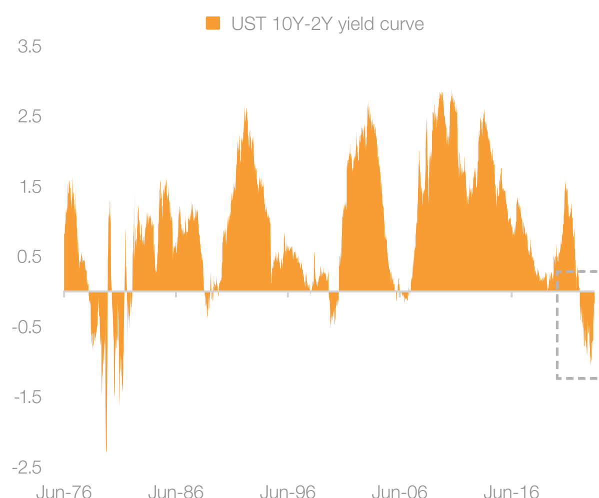
- Downgrade dividend yielding Equities to underweight while staying with outsized exposure to quality growth plays riding on secular themes
- Upgrade US Equities to overweight within DM
- Upgrade Gold to overweight
- Maintain overweight on IG Bonds and Private Assets

Turning Point I: Negative Equity-Bond yield gap



Source: Bloomberg, DBS

Turning Point II: Dis-inversion of UST 10Y-2Y yield curve

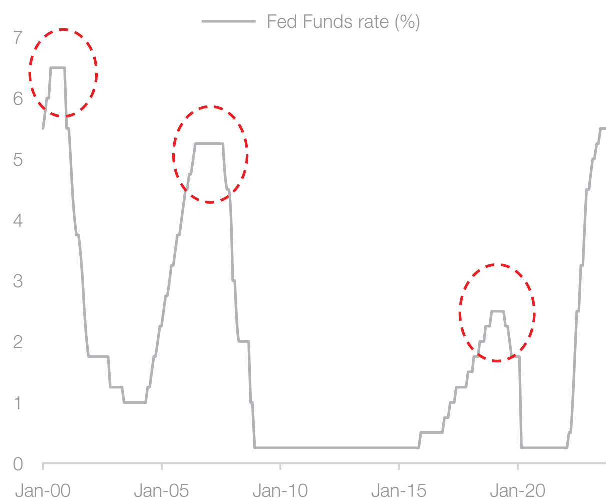


Source: Bloomberg, DBS

Rising disinflation and peak Fed. The past few years have been punctuated by episodes of Fed indecisions. Just as consumer prices were surging post-pandemic when economies reopened, the Fed declared the phenomenon as “transitory inflation”. Now, just as inflation has fallen substantially from its peak, the central bank is calling for “higher for longer”. Time will tell if the latest Fed narrative holds true.

From the 1970s oil crisis to the dot-com bubble and the subsequent subprime crisis, the Fed has undertaken monetary policy decisions that took markets by surprise. Looking back at the past two decades, the central bank has on average, maintained peak rates for only 10 months after a series of hikes. We are currently at month 6 since policy rates peaked in the latest hiking cycle.

Previous episodes of peak Fed did not last long



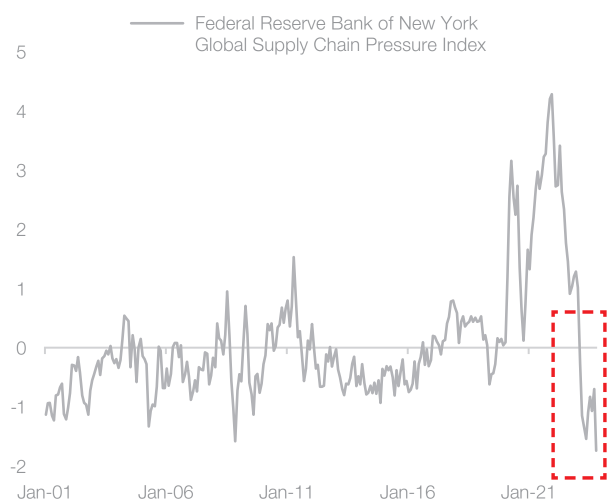
Source: Bloomberg, DBS

The more pertinent question for investors in 2024 will be: Where is inflation heading?

To recap, the initial surge in inflation was largely due to supply shocks arising from acute disruptions to supply chains globally when economies reopened. Based on Fed data, the differential between “supply-driven” and “demand-driven” headline inflation hit a peak in Nov 2020 and this coincided with rising supply chain pressure globally. But since 2021, the latter has begun to trend south and eventually hitting a trough in May 2023. Easing supply chain pressure translated to broad-based disinflation, with US headline CPI falling from a peak of 9.1% in Jun 2022 to 3.7% currently.

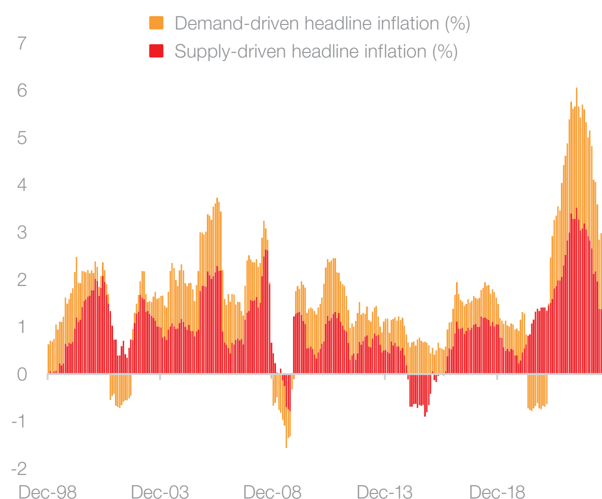
Research from Roosevelt Institute suggests that the current disinflationary wave is the result of supply expansion as opposed to demand contraction. In fact, the speed of decline in inflation is no longer in sync with the Phillips Curve. Their findings tie in with Fed data, which shows supply-driven headline inflation increasing by a mere 0.1% pts during Dec 2020 till Sep 2023, as compared to a significantly larger increase of 2.2% pts for demand-driven inflation.

Bottoming of supply chain pressure



Source: Bloomberg, DBS

Inflationary pressure: Supply-driven vs Demand-driven

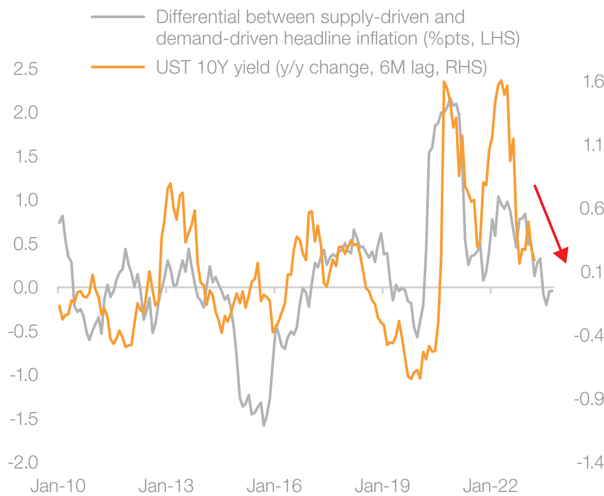


Source: Bloomberg, DBS

If the above analysis is correct, then it will have a major impact on the Fed's policy trajectory in 2024. When economies first reopened and drove inflation higher, the Fed reacted with aggressive monetary tightening, rising its policy rates by 525 bps in 17 months. However, dealing supply shocks (and by extension, supply-driven inflation) with conventional monetary tightening was widely deemed to be ineffectual. Indeed, can rising policy rates solve supply chain constraints caused by the Russia-Ukraine conflict or industrial lockdowns in China during the pandemic days? Surely not.

Now that supply-driven inflationary pressure has receded sharply, the narrative on the efficacy of the Fed rate hike will change. With US Treasury 10Y yield at c.4.2%, aggregate demand will undergo contraction and drive headline inflation lower over the course of the year. This underpins our view that peak Fed is on the horizon. Historically, as the impact of supply-driven inflation fades relative to demand-driven, the y/y change for US Treasury yields will tend to fade as well. The sharp drawdown in long duration US Treasuries also suggests that investors' pessimism has hit an extreme.

Inflation dynamics suggests lower bond yields ahead



Source: Bloomberg, DBS

Sharp drawdown in long duration US Treasuries: Investors' pessimism at an extreme

Source: Bloomberg, DBS

That said, we believe discussions surrounding whether the Fed will stay "higher for longer" or embark on rate cuts are moot since the central bank adopts a data-dependent policy approach. Trajectory of Fed policy will continue to be subjected to the volatility of high frequency economic data and how "assured" Powell and team want to be before pivoting to a new policy direction without reigniting inflationary pressure on the economy.

Negative Yield Gap: Implications on the trajectory of Equities. The differential between Equity earnings yield and US Treasury 10Y bond yield (simplistically referred to as "yield gap") turned negative in Oct 2023. This means that one is no longer compensated to take on equity risk (as opposed to holding Bonds). So why are investors willing to settle for such poor risk reward? Recency effects – the cognitive bias to place greater emphasis on recent events – could be at play here.

Since the subprime crisis, Equity markets have been on a tear. Apart from the pandemic-related momentary sell-down (which was followed by an acute V-shaped recovery), Equity markets have

been notching handsome gains in most years. Not surprisingly, complacency crept in. Equity valuations have remained elevated despite an acute rise in the cost of capital and rising geopolitical uncertainties. Clearly, investors are not quite ready to embrace the fact that the environment has evolved.

In the past 95 years (since 1928), the phenomenon of negative yield gap has occurred only 29 times, which explains why the prevailing situation warrants further analysis. For starters, the yield gap was generally positive between the 1920s-1960s as high earnings yield (low P/E) vastly superseded bond yields. But this started to change during the late-1960s and up till the early noughties, which saw significant periods where higher bond yields superseded earnings yield.

Based on conventional thinking, the yield gap is negative when investors are anticipating strong economic/earnings growth (and hence assigning higher equity valuation) in a rising yield environment. Conversely, a positive yield gap assumes that investors are anticipating weak earnings growth (and hence assigning lower equity valuation) in a low bond yields environment. Our analysis of past data suggests that such an assumption is valid:

- Aggregating the earnings growth for years with positive yield gap, the median annual growth is 3.6%

- However, for years with negative yield gap, the median earnings growth is meaningfully higher at 7.6%

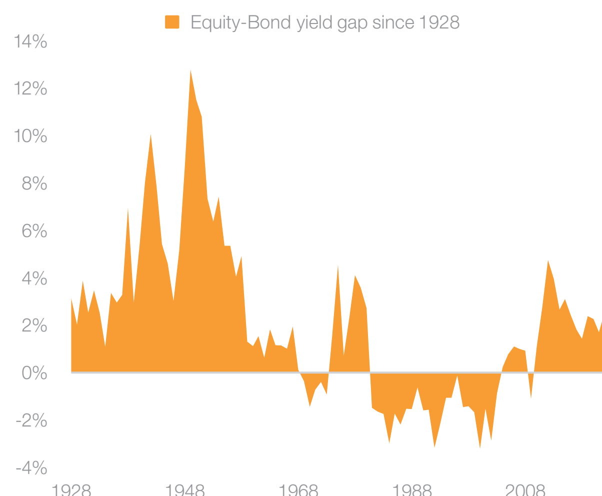
However, higher earnings trajectory does not necessarily translate to stronger equity returns:

- During years where the yield gap is positive, median annual returns is 7.6%

- Conversely, during periods where the yield gap is negative, the median annual returns is lower at 4.9%

The overall weakness in equity returns during periods of negative yield gap suggests portfolio allocators should taper their enthusiasm for the asset class in the forthcoming year. Instead of taking a blanket view on Equities in totality, a selective approach focusing on secular trends and quality plays will be more appropriate in an environment of elevated bond yields.

Since 1928, a negative Equity-Bond yield gap has occurred on 29 occasions



Source: Bloomberg, DBS

Fed pause amid dis-inversion of yield curve: Implications for Equities and Bonds. The US Treasury 10Y-2Y yield curve, historically a harbinger of impending recessions, is showing signs of dis-inversion as the 10Y yield surged amid rising expectations of a US "soft landing". But while a steepening yield curve (dis-inversion) typically augurs well for the macro outlook, historical data suggests that this may not necessarily be the case for risk assets.

Looking at data going all the back to 1976, we observed that the turning points for the yield curve, as it pivots from inversion to dis-inversion, will usually coincide with (or is close to) a Fed peak. This happened on three occasions: 1989, 2000, and 2007. Listed below are performance of risk assets during such turning points:

- 1989 Fed Peak cycle: During this cycle, the Fed peaked from Feb till May 1989 while the inverted yield curve turned positive in Oct 1989. Equities (as proxied by the S&P 500) dipped 2.8% six months after the yield curve turning point and corrected 10.7% 12 months after. Bonds (as proxied by US Corporate IG) fared better, dipping 1.1% in the subsequent six months and gaining 4.3% over a 12M period.

- 2000 Fed Peak cycle: At the turn of the millennium, the Fed peaked from May till Dec 2000 and the yield curve turned positive in December. Equities performed poorly from both a 6M and 12M perspective, declining by 7.3% and 13.0% respectively. Bonds, on the other hand, notched respective gains of 5.5% and 10.3%.

- 2006-07 Fed Peak cycle: Prior to the subprime crisis, the Fed was on hold from Jun 2006 till Aug 2007 and during this period, the yield curve turned positive in Jun 2007. Performance for Equities was dismal in the subsequent 6- and 12-months, correcting 2.3% and 14.9% respectively. Bonds, however, managed to notch up gains of 3.8% and 3.0% respectively.

On balance, it is evident that equity performance tends to be dismal when (a) the yield curve dis-inverts and (b) the Fed starts cutting its policy rate. The latter has historically taken place near impending US recessions:

- The 1989 rate cut cycle preceded the 1990s recession, which came on the back of aggressive Fed monetary tightening, sharp oil spike (+142% during Jul-Oct 1990), and plunge in consumer confidence.

- The 2001 rate cut cycle preceded the Mar-Nov 2001 recession which came in the aftermath of the dot-com bubble collapse.

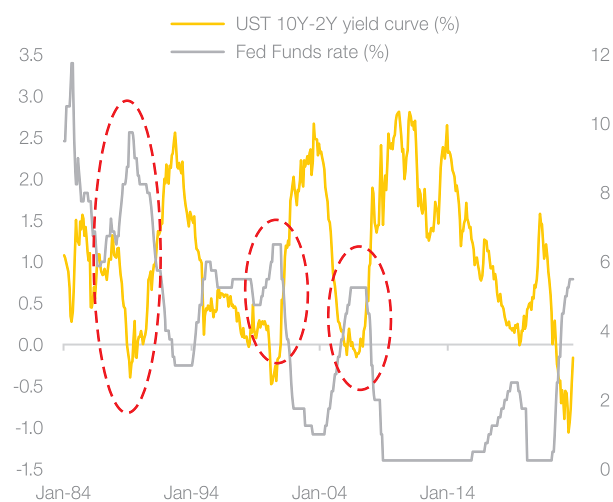
- Lastly, the Fed rate cut in 2007 took place prior to the start of the Great Recession (Dec 2007 till Jun 2009) which came on the back of the US subprime crisis.

Impact of past Fed peak and yield curve dis-inversion on financial markets

	Fed Peak	Start of US recession	Inverted yield curve turning positive	US Equities performance 6M after yield curve turned positive	US Equities performance 12M after yield curve turned positive	US Bonds performance 6M after yield curve turned positive	US Bonds performance 12M after yield curve turned positive
1	Feb-89 till May-89	Jul-90	Oct-89	-2.8%	-10.7%	-1.1%	4.3%
2	May-00 till Dec-00	Mar-01	Dec-00	-7.3%	-13.0%	5.5%	10.3%
3	Jun-06 till Aug-07	Dec-07	Jun-07	-2.3%	-14.9%	3.8%	3.0%
Average				**-4.1%**	**-12.9%**	**2.7%**	**5.8%**

Source: DBS

Turning points for yield curve coincide with Fed peak



Source: Bloomberg, DBS

In the current cycle, given the absence of structural imbalances amongst households and companies, we believe the likelihood of a soft landing for the US economy is high and this will mitigate downside pressure for Equity performance on 6- and 12-months perspectives.

1Q24 Asset Allocation – Bonds assuming leadership

Categories	Indicators	Score Range	Equities				Bonds		
			US	Europe	Japan	AxJ	DM Govt	DM Corp	EM Bonds
Fundamentals	PMI	-1 to +1	-1	-1	0	1	1	1	0
	Economic surprise	-1 to +1	-1	0	0	1	0	0	0
	Inflation	-1 to +1	0	0	0	0	0	0	1
	Monetary policies	-1 to +1	0	0	-1	0	0	0	0
	Forecasted EPS growth	-2 to +2	1	-1	-1	2	-	0	0
	Earnings surprise	-2 to +2	1	0	1	-1	-	0	0
Valuation	Forward P/E	-2 to +2	0	1	0	1	-	-	-
	P/B vs ROE	-2 to +2	0	0	-1	0	-	-	-
	Earnings yield - 10Y yield	-2 to +2	-1	0	0	1	2	2	1
	Free Cashflow yield	-2 to +2	0	-1	1	0	-	-	-
	Credit spread	-2 to +2	-	-	-	-	-	0	0
Momentum	Fund flows	-2 to +2	1	0	0	0	1	0	0
	Volatility	-1 to +1	0	0	0	0	0	-	-
	Catalysts	-2 to +2	-1	0	-1	-1	-1	-1	0
Raw Score			-1	-2	-2	4	3	2	2
Adjusted Score*			**-0.05**	**-0.10**	**-0.10**	**0.19**	**0.27**	**0.13**	**0.13**

*Note: The "Adjusted Score" is calculated using the "Raw Score" divided by the maximum attainable score for each category.

Source: DBS

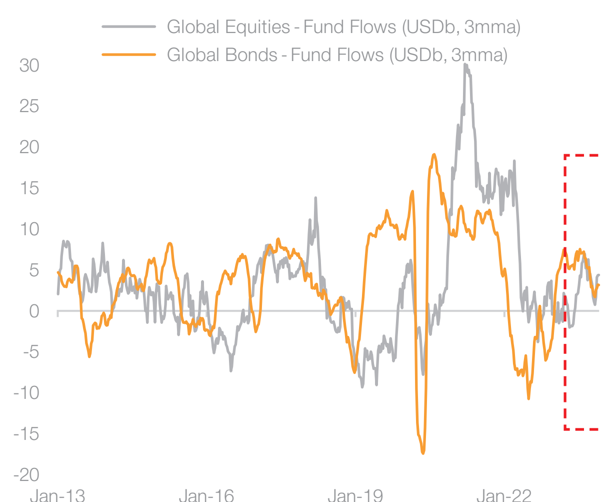
Cross Assets – Prefer Bonds over Equities. The latest scoring on our CAA framework suggests a preference for Bonds over Equities.

Fundamentals: US domestic consumption has remained resilient in part due to pandemic excess savings. But the stock is declining and with heightened interest rates working its way through the economy, aggregate demand is expected to weaken over the course of the year. This will have a knock-on impact on corporate profitability as top line demand and margins come under pressure. Heavily indebted companies with weak balance sheets will face an additional headwind of higher interest expense.

Valuation: The gap between US earnings yield and US 10Y Treasury yield stood at 0.4% in 4Q23 (as of 5 Dec) and this underlines the relative attractiveness of Bonds over Equities at this juncture.

Momentum: Global Bonds registered net inflows of USD34.2b in 4Q23 (as of 29 Nov) and this brought total flows to +USD273.9b YTD. Evidently, investors expected the Fed monetary tightening cycle to end in 2023 with potential cuts in 2024. The momentum for Equities was equally upbeat during the quarter as peak Fed expectations drove USD32.4b into the asset class. On a YTD basis, Equities registered inflows of USD142.2b.

Bonds seeing marginally better fund flows momentum than Equities



Source: EPFR Global, DBS

Equities: Curb your enthusiasm on dividend stocks; Upgrading US to overweight in DM. After a dismal 3Q23 which saw Global Equities losing 3.3% on total returns basis, the asset class staged a slight rebound in 4Q23 with a 5.8% gain (as of 5 Dec). In DM, US Equities led with a 7.0% gain as the Technology sector rallied 12.2% on the back of moderating bond yields and expectations that the Fed's monetary tightening cycle had peaked. The performance for Japan and Asia ex-Japan were lacklustre at +2.7% and +0.9% respectively. Weakness in China (-6.3%) and ASEAN (-0.7%) was a significant drag for the latter.

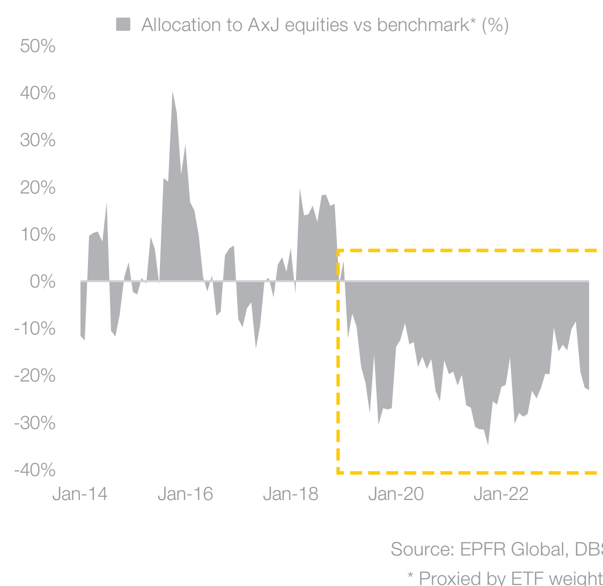
For 1Q24, we are downgrading Equities as an asset class to underweight in view of the negative yield gap (which makes Bonds more attractive on a relative basis). But within the Equities space, we are upgrading our view on US to overweight while maintaining underweight on Europe and neutral on Japan. Our rationale is:

- Stronger earnings outlook: Based on consensus forecast, US Equities is expected to register 9.4% earnings growth in 2024 and this is substantially higher than the 0.5% and 1.7% growth expected for Europe and Japan respectively. We believe that room for earnings upside in the US market is high given the strong momentum in Tech-related plays. In the 3Q earnings season, Technology and Communications Services registered positive earnings surprise of c.88.9% and c.84.2% respectively.

- Beneficiary of peak Fed: Given the plausibility of Fed rate cuts over the course of 2024, a geared beneficiary will be "long duration" plays like Technology. A lower risk-free rate (and hence lower discount rate) translates to higher valuation for Tech-related plays. Within DM, US has the largest exposure to this segment and this will underpin its outperformance over Japan and Europe.

Our call on AxJ has not panned out as expected given the subdued performance of China Equities. But with the region trading at 14.5x forward P/E (vs 18.5x for DM), we see AxJ as a deep value play in 2024. Based on data from EPFR Global, global investors are 23% underweight on AxJ and this suggests that expectations on the region is extremely low. Earnings growth outlook, however, remains upbeat at 20.2% for 2024 (vs 6.7% for DM). Maintain overweight.

Global investors are sharply Underweight on AxJ Equities

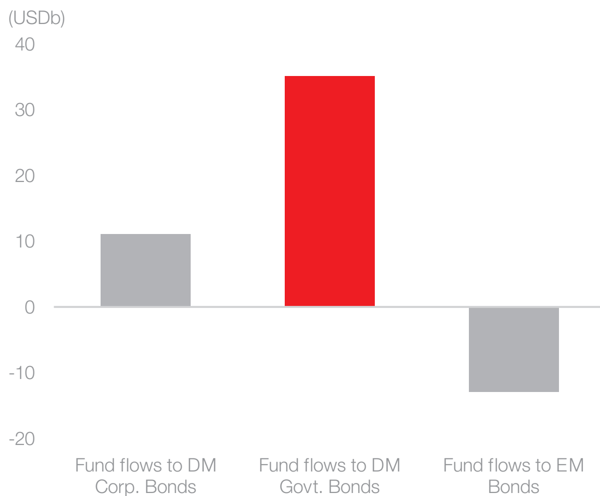


Source: EPFR Global, DBS
* Proxied by ETF weights

Bonds: HY Credit to see higher defaults; Stay with IG Credit in 3-5Y duration segment. With the recent inflation print coming in weaker than expectations, investors are quick to pivot and embrace the view that Fed policy tightening has finally come to an end with potential rate cuts on the table in 2024. This is a fair assumption. Given growing concerns on US's rising debt burden, any further surge in bond yields would only aggravate the country's fiscal outlook as interest expenses mount.

In such an environment, we continue to advocate quality plays in IG Bonds. At this stage of the economic cycle, elevated bond yields will eventually work its way into the broader economy and weigh on aggregate demand. This is when HY Credit will see higher defaults while the IG space remains sheltered. Moody's is projecting for HY defaults to hit 4.9% in 1Q24. Sweet spot for IG Credit lies in the 3-5Y duration segment.

Strong flows into DM government Bonds amid rising expectations of policy peak



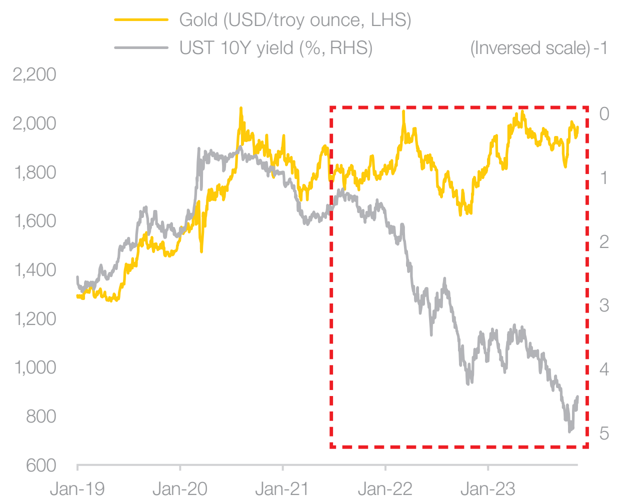
Source: EPFR Global, DBS

On fund flows, data from EPFR Global reinforces the view that peak Fed is on the cards as DM government Bonds registered inflows of USD35.2b in 4Q23 (as of 29 Nov) while outflows from EM Bonds persisted at USD12.9b. This marks a continuation of the trend seen this year with DM government Bonds netting strong inflows of USD153.6b while USD32.6b exited EM.

<u>Alternatives</u>: Gold in a sweet spot; Upgrade to Overweight. On the surface, Gold's resilience was broadly attributed to geopolitical uncertainties as investors sought refuge in the safety of the precious metal. But this is just a side show. The bigger driver underpinning the resilience is the overarching expectation that the Fed monetary tightening cycle has peaked. The combination of peak Fed and geopolitical uncertainties represent a sweet spot for Gold, and we see room for upside ahead. Broader concerns over the US's debt burden and fiscal sustainability will only add to Gold's attractiveness as concerns of de-dollarisation gain traction. Upgrade to overweight.

In Private Assets, we see bright spots in the distressed debt space as aggressive monetary tightening in recent quarters translates to acute funding pressure for the weakest corporate borrowers. This presents opportunities for distressed debt investors looking for undervalued debt of bankrupt (or soon to be bankrupt) companies. The US Treasury 10Y-2Y yield curve has undergone dis-inversion and historically, this served as a harbinger of impending peak in corporate defaults. Gain selective exposure to hedge against portfolio downside risks.

Gold remained resilient despite rising bond yields



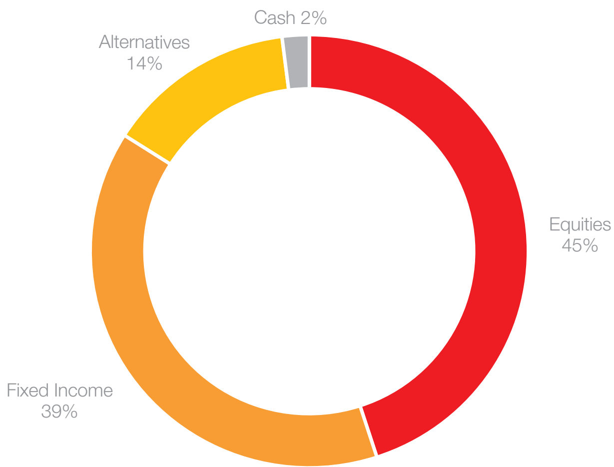
Source: Bloomberg, DBS

1Q24 Global Tactical Asset Allocation

	3-Month Basis	12-Month Basis
Equities	**Underweight**	**Neutral**
US Equities	Overweight	Overweight
Europe Equities	Underweight	Underweight
Japan Equities	Neutral	Underweight
Asia ex-Japan Equities	Overweight	Overweight
Fixed Income	**Overweight**	**Underweight**
Developed Markets (DM) Government Bonds	Overweight	Underweight
Developed Markets (DM) Corporate Bonds	Overweight	Neutral
Emerging Markets (EM) Bonds	Underweight	Neutral
Alternatives	**Overweight**	**Overweight**
Gold	Overweight	Overweight
Private Assets & Hedge Funds	Overweight	Overweight
Cash	**Underweight**	**Neutral**

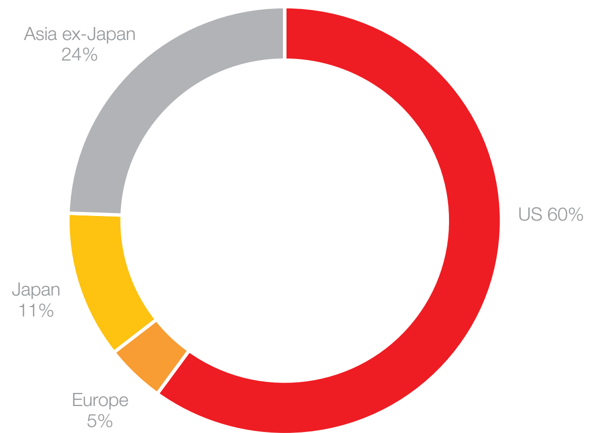
Source: DBS

TAA breakdown by asset class (Medium Risk)



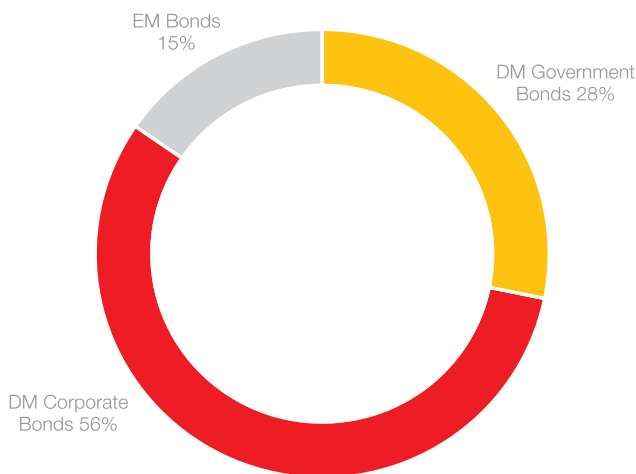
Source: DBS

TAA breakdown by geography within Equities (Medium Risk)



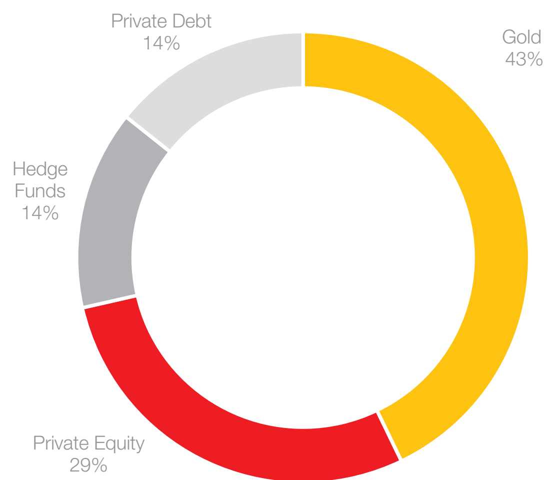
Source: DBS

TAA breakdown by bond types within Fixed Income (Medium Risk)

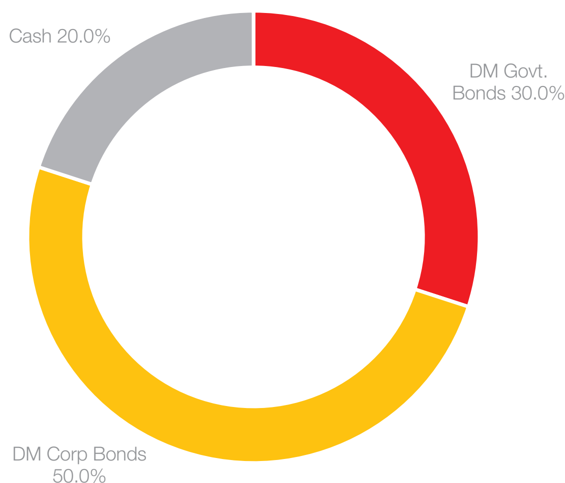


Source: DBS

TAA breakdown by segments within Alternatives (Medium Risk)



Source: DBS



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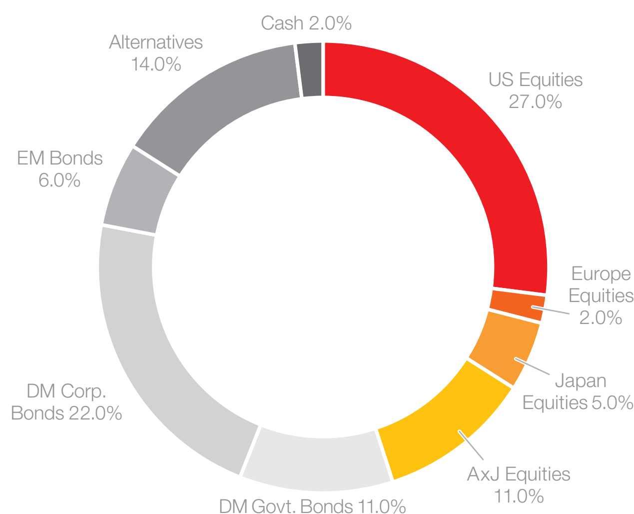


Source: DBS

Low Risk

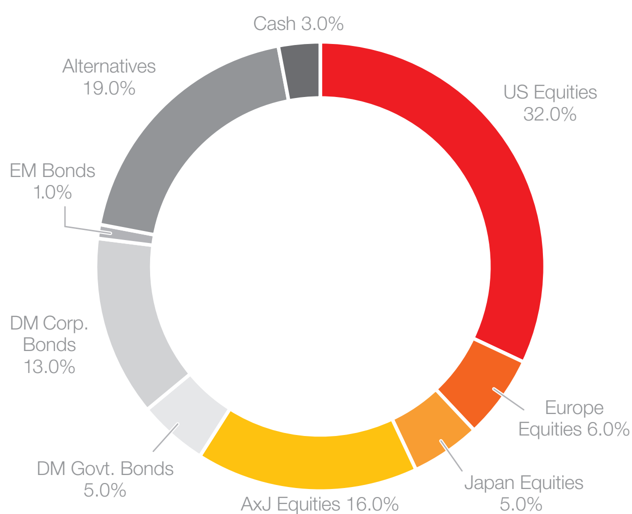
	TAA	SAA	Active
Equities	**0.0%**	**0.0%**	
US	0.0%	0.0%	
Europe	0.0%	0.0%	
Japan	0.0%	0.0%	
Asia ex-Japan	0.0%	0.0%	
Fixed Income	**80.0%**	**80.0%**	
Developed Markets - Government	30.0%	30.0%	
Developed Markets - Corporate	50.0%	50.0%	
Emerging Markets	0.0%	0.0%	
Alternatives	**0.0%**	**0.0%**	
Gold	0.0%	0.0%	
Private Assets & Hedge Funds*	0.0%	0.0%	
Private Equity	0.0%	0.0%	
Hedge Funds	0.0%	0.0%	
Private Debt	0.0%	0.0%	
Cash	**20.0%**	**20.0%**	

*Only P4 risk rated UCITs Alternatives

Medium Risk

	TAA	SAA	Active
Equities	**45.0%**	**50.0%**	**-5.0%**
US	27.0%	25.0%	2.0%
Europe	2.0%	10.0%	-8.0%
Japan	5.0%	5.0%	
Asia ex-Japan	11.0%	10.0%	1.0%
Fixed Income	**39.0%**	**35.0%**	**4.0%**
Developed Markets - Government	11.0%	10.0%	1.0%
Developed Markets - Corporate	22.0%	15.0%	7.0%
Emerging Markets	6.0%	10.0%	-4.0%
Alternatives	**14.0%**	**10.0%**	**4.0%**
Gold	6.0%	5.0%	1.0%
Private Assets & Hedge Funds*	8.0%	5.0%	3.0%
Private Equity	4.0%	2.4%	1.6%
Hedge Funds	2.0%	2.0%	
Private Debt	2.0%	0.5%	1.5%
Cash	**2.0%**	**5.0%**	**-3.0%**

*Only P4 risk rated UCITs Alternatives



Source: DBS

High Risk

	TAA	SAA	Active
Equities	**59.0%**	**65.0%**	**-6.0%**
US	32.0%	30.0%	2.0%
Europe	6.0%	15.0%	-9.0%
Japan	5.0%	5.0%	
Asia ex-Japan	16.0%	15.0%	1.0%
Fixed Income	**19.0%**	**15.0%**	**4.0%**
Developed Markets - Government	5.0%	4.0%	1.0%
Developed Markets - Corporate	13.0%	7.0%	6.0%
Emerging Markets	1.0%	4.0%	-3.0%
Alternatives	**19.0%**	**15.0%**	**4.0%**
Gold	6.0%	5.0%	1.0%
Private Assets & Hedge Funds*	13.0%	10.0%	3.0%
Private Equity	7.0%	4.9%	2.1%
Hedge Funds	4.0%	4.0%	
Private Debt	2.0%	1.1%	0.9%
Cash	**3.0%**	**5.0%**	**-2.0%**

*Only P4 risk rated UCITs Alternatives

Notes:
1. The above are based on three-month views.
2. Asset allocation does not ensure a profit or protect against market loss.
3. "TAA' refers to "Tactical Asset Allocation". "SAA" refers to "Strategic Asset Allocation".
4. The investor type classification for the portfolio has no direct relationship with the Financial Needs Analysis customer risk profile types and the portfolios are not assigned any product risk rating based on the bank's proprietary risk rating methodology.

Moderating Growth Ahead

Macroeconomics 1Q24

Economic growth is set to lose momentum in 2024. The focus will turn to Fed easing, with rate cuts in 2H24. The Bank of Japan is likely to contemplate monetary policy normalisation, given early indications of reflation success. China is due for a soft rebound, with AI-driven demand driving North Asia's recovery.

02. Macroeconomics.

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US

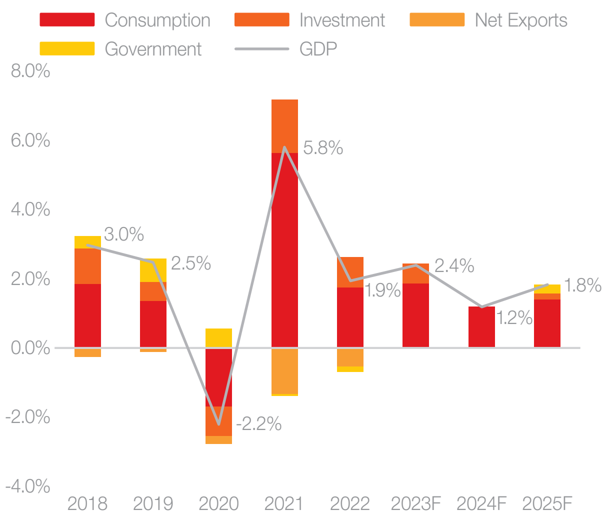
Growth and inflation slowdown beckons in the coming year. The US economy gets more than a passing grade for 2023. It will likely grow by nearly 2.5%, defying consensus expectations from a year ago by a large margin. High interest rates and lingering inflation were expected to cause a downturn in consumption, property market, and investments, along with possible financial instability for institutions and investors exposed to tightening monetary and financial market conditions. When a number of regional banks faced difficulties in 1Q23 with fixed income duration mismatch on their balance sheets and large mark-to-market losses on bond holdings, it seemed like 2023 was going to be a rough ride.

US consumers and investors shrugged off the financial market wobble in no time. Retail sales grew steadily, while the property market slowdown was modest. Despite sizeable borrowing needs and scrutiny of ratings agencies, US debt issuance and servicing continued in a stable manner. Government shutdown-related machinations dominated headlines from time to time, but never lasted long enough to materially impede the fiscal stance or economic growth. A rise in the cost of capital did not make its way into credit marker distress, nor did consumer loan delinquencies rise sharply. Finally, despite consumer sentiment reflecting discontent with the high level of prices and tight monetary policy conditions, there was no evidence of major consumer distress. Consumer loan delinquencies rose only modestly.

How did this happen? Let's consider the three major mitigants to what is surely an adverse policy cycle that ought to reduce growth momentum. First, a year and a half of QE notwithstanding, the Fed's balance sheet remains massive, amounting to 30% of GDP. The stock of bank reserves or central bank supported liquidity is still ample, which helps address market liquidity, payments, and settlements. Second, energy inflation, a major source of uncertainty and concern in 2022 around the Russia-Ukraine crisis, largely disappeared in 2023 as the supply side caught up and demand from China moderated. Third, public sector industrial policy providing major impetus for green transition and high tech-related investments added tailwinds to job creation and capital investment. An industry-wide push toward AI adoption added to the momentum.

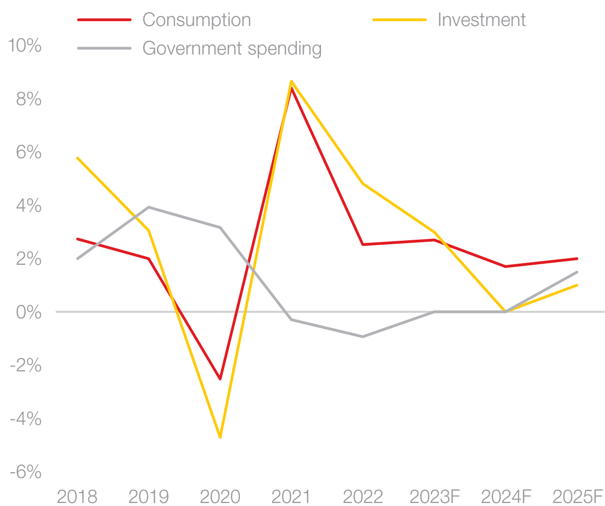
What beckons in 2024? We think it is unreasonable to expect more of the same. Continued QT, steadily removing liquidity, is bound to weigh down the financial sector. Cost of borrowing, high in both nominal and real terms, will begin to hurt consumption and investment, and by extension, hiring. Inflation may ease to below 3%, but the cumulative price increases of the past three years will keep hurting purchasing capacity, especially as wage and jobs growth lose momentum. In addition, financial stability conditions may worsen if asset markets turn volatile and new corners of fragility appear among bank and non-bank financial institutions.

US GDP growth and contribution from key components



Source: CEIC, DBS

Drivers of US GDP



Source: CEIC, DBS
Note: y/y real growth rates

Our expectation of a growth slowdown is not a majorly bearish call. We see a low 1% growth year somewhat inevitable after the recent outburst of inflation and activities. A protracted recession is unlikely, in our view, especially as corporate balance sheets are strong. Slowing growth and inflation would likely pave the way for rate cuts in 2H24, perhaps by about 100 bps from July onwards. But a soft landing scenario will also likely leave real rates at levels that may not be particularly supportive for markets.

No free lunch

Large fiscal needs have manifested in bloated central bank balance sheets, underscoring a critical fiscal-monetary linkage. Despite steady QT, the balance sheets of the two largest central banks in the world remain enormous. The Fed's balance sheet currently stands at nearly USD8t (30% of GDP), while the corresponding figure for the ECB is 50% of GDP, despite an accelerated QT program relative to that of the Fed. QE has become a key part of the monetary policy toolbox of major central banks in this century. It is clear that with their power to print money and purchase assets, central banks are capable of boosting asset prices, resolving liquidity crises, and reducing deflation risks.

But bloated central bank balance sheets, built through purchasing financial assets and injecting bank reserves, come with their share of complications and costs. Research by BIS and Fed officials have shown that they lead to a financial system where banks are over-reliant on central banks for funding. That in turn could distort banks' incentives to manage liquidity and portfolio risks. QE has also been associated with exacerbating inequality as such monetary operations favour those with significant ownership of financial assets and property, leaving the rest behind.

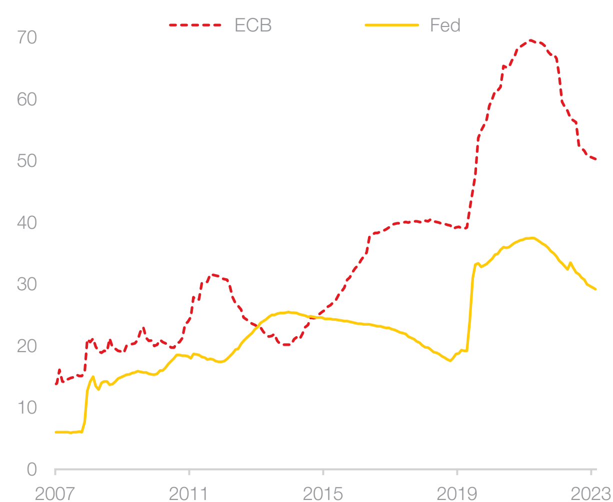
At the other end of the operational spectrum, shrinking the balance sheet, which in theory is welcome as it signals normalisation of economic conditions, comes with its share of risks. As rates rise, central banks take on capital losses on their holding of Fixed Income assets. Additionally, central banks stepping away from bond buying or holdings while there are large fiscal funding needs could end up destabilising the government debt market. Case in point is the US, where there has been a marked rise in volatility in treasury markets, even as recent easing of long-term interest rates has given the markets some relief.

G2 central bank balance sheets need to continue to shrink for months and years as the level of balance sheet sufficient for the market's liquidity needs is several trillions lower, in our view. For instance, the Fed's current monthly rate of balance sheet reduction will take it from the present level of USD7.8t to around USD6.5t by the end of 2024, still more than ample by historical standards, necessitating further consolidation through 2025 and beyond.

But complications abound. As growth slows in 2024 and rate cuts are warranted, could this continue alongside QT? That would require the Fed to differentiate between the impact of balance sheet operation from interest rate policy. This tough choice lies ahead for the Fed and ECB.

The QE vs QT dilemma. Coming back to the critical matter of US debt and deficit, how would they pan out if QT sustains all through 2024 and 2025? Can QT continue if bond yields turn volatile or soar? We think that a truly disorderly bond market could undermine the entire soft landing plus balance sheet

Fed and ECB balance sheet, % of GDP



Source: IMF, DBS

normalisation narrative. While we do not assign more than 20% probability to such a scenario, we will expect to see the Fed suspend QT in such an eventuality. If even that does not safeguard the debt markets, the last resort would be a resumption of QE, which would come at considerable cost to Fed credibility.

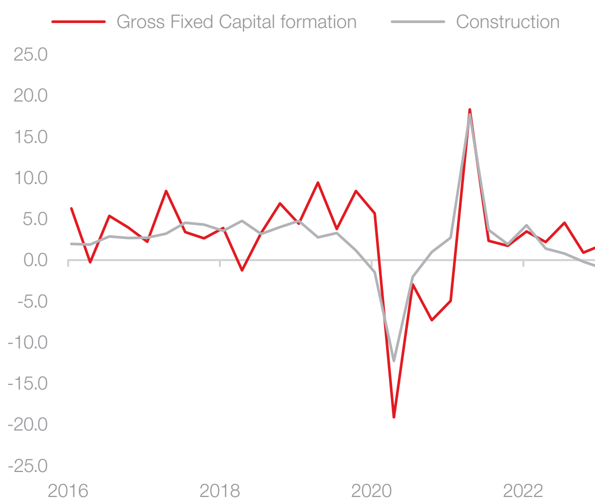
Hence US debt markets' shadow looms large both on the treasury and Fed. The authorities would hope that strong private sector interest on the demand side, together with no further fiscal slippage on the supply side, would keep the market stable in the coming years. We believe that the US debt market has a lot going in its favour, and therefore temper our concerns. But vigilance is warranted; there is no free lunch for debt issuers.

Eurozone

Growth to lose momentum in 2024. The Eurozone economy expanded 0.6% y/y in 1Q-3Q23, with the sequential momentum grinding to a halt in 2H23. The benefits of higher real incomes, a tight labour market, and lower energy are being countered by the lagged impact of a tight monetary policy, difficult geopolitical backdrop, energy supply disruptions, and high above-target inflation. Germany is stuck in a phase of stagnation, with its preliminary 3Q growth declining on the quarter, dragged by weaker consumption, slowing exports to China, energy uncertainties, and higher rates. This outlook belies the slight improvement in the recent Ifo index, as activity settles at a weak part of the curve.

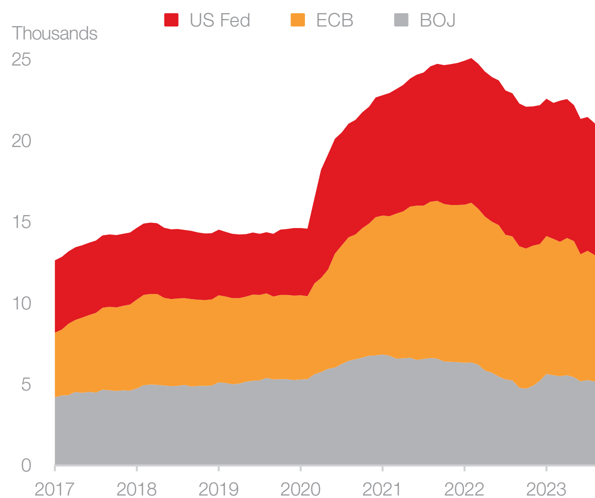
Retail sales contracted -0.6% in Jul-Aug 2023, slowing sharply from a 7% rise at the start of the year. Manufacturing PMIs across the core-four countries extended their decline into 4Q, with the Eurozone-wide reading in contractionary territory, hovering below 45.0. ECB's bank lending survey in Oct 2023 captured further tightening in credit standards across all loan categories. This was accompanied by a deceleration in demand for loans by non-financial corporations' -0.9% in 3Q23 (4.4% in 1Q) and households 0.3% (vs 3% in 1Q). Slowing final demand might persuade firms to hold back on further investments, with capital formation slowing to 0.5% in 1H23 vs 4% growth last year, besides lower growth in construction activity. With the ECB signalling higher-for-longer rates (making up for the delayed fiscal consolidation plans) and above target inflation for 2023 and 2024, GDP growth is expected to slow from 0.4% y/y in 2023 to 0.2% y/y in 2024.

Tight financial conditions and uncertain demand take a bite



Source: CEIC, DBS

QT likely to continue over the next few years



Source: CEIC, DBS

Price pressures have abated, with the import price and producer price indices in red for the past seven and five months, respectively. Headline HICP inflation slowed sharply to 2.9% y/y in Oct 2023, slipping below the core at 4.2%, owing to a high base. We expect inflation to average 5.6% in 2023 before easing to an average 2.3% in 2024, with energy prices and the fallout of unexpected weather conditions as key risks to the outlook.

Weaker growth and the need to contain long-end bond yields is likely to see the ECB pause at the main refinance rate at 4.5% in 1H24, before starting to gradually lower rates. We also expect reinvestments in the pandemic-bond purchase program to cease within 1H24. Either way, the ongoing QT exercise has months and years to go before it returns to pre-pandemic levels and materially impacts domestic liquidity.

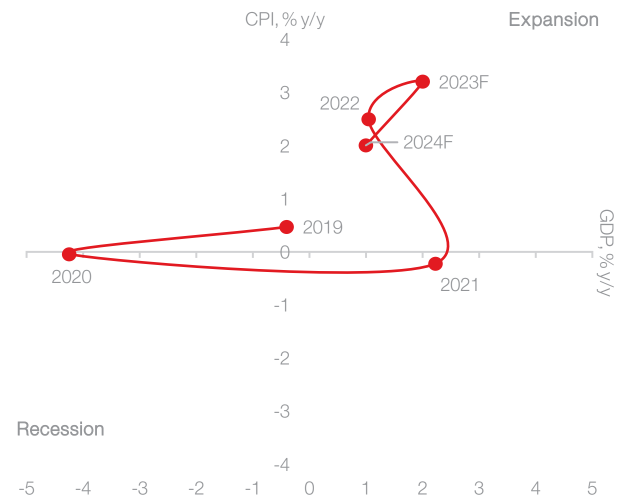
Budgetary plans from member countries suggest that consolidation plans have yet to get back on track. A deal over the revised EU fiscal rules is under close watch, as member countries will be required to table national debt reduction plans to achieve deficit targets and reforms that might have to be undertaken to gain additional time to implement these plans. If agreed upon, the new rules are set to apply in 2025, with 2024 likely to be a bridge year due to a less adverse fiscal stance for the bloc. Countries with over 3% of GDP deficit will still be subject to the previous rules in the interim.

Japan

The Japanese economy is set to normalise in 2024 following a robust upswing in 2023 driven by its post-Covid reopening. With early indications of reflation success, conditions have tentatively aligned for the BOJ to contemplate monetary policy normalisation in the year ahead.

GDP growth to slow to 1.0% from 2.0%. Anticipated GDP growth is 1.0%, a slowdown from 2023's 2.0%, mirroring the diminishing demand from Japan's reopening. Nonetheless, favourable labour market conditions are likely to support consumption growth. Rengo, the largest labour organisation, targets "5% or higher" in the upcoming Shunto

A moderate economic expansion anticipated for 2024



Source: CEIC, DBS

negotiations in spring 2024, signalling a more ambitious goal than their demand for an "around 5%" pay raise at the end of 2022. Rengo's 2022 target resulted in a 3.7% increase in total wages during 2023's Shunto, suggesting the potential for a 4% overall wage increase in 2024.

Fiscal policy is expected to sustain support for consumption growth in 2024. Prime Minister Fumio Kishida's government unveiled a JPY17t economic stimulus package, featuring one-time cuts to income and residential taxes, cash payments to low-income households, and extension of subsidies on gasoline, electricity, and gas prices. Similar measures to bolster household incomes and alleviate cost burdens are likely in the coming year, considering the Liberal Democratic Party leadership election and a potential lower house election in 2024.

Inflation to ease to 2.0% from 3.2%. CPI inflation is projected to ease to 2.0% in 2024, down from 3.2% in 2023. The cost-push inflation from the yen depreciation is expected to gradually subside. Assuming 100 bps rate cuts from the US Fed in 2H24, USD/JPY has the potential to decline towards 135 by the end of the year, owing to improved interest rate differentials. Conversely, demand-pull inflation is likely to persist, driven by rising inflation expectations and wage growth. According to the consumer confidence survey, over 90% of Japanese consumers anticipate price increases in the coming year, while the Tankan survey indicates that Japanese enterprises expect the inflation rate to remain above 2%.

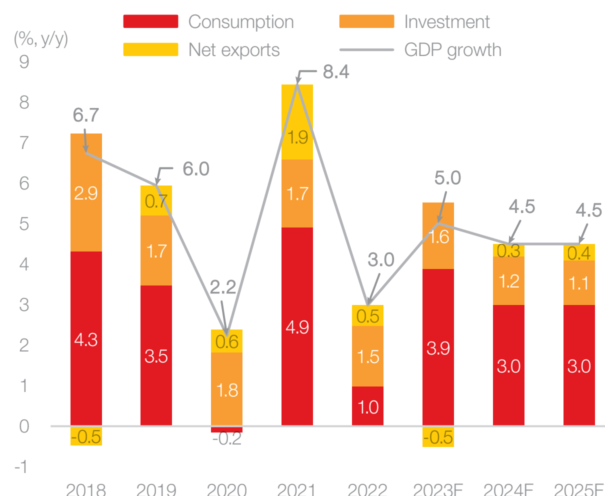
Policy-balance rate to rise to 0% from -0.1%. The BOJ is expected to raise the policy-balance rate to 0% from -0.1% in 2024. Having already increased YCC flexibility in 2023, tolerating the 10Y JGB yield at around 1% without a hard cap, the BOJ's next step is to consider terminating YCC and the NIRP. The latter could be managed relatively effectively. Currently, deposits held at the BOJ earn interest under a "three-tier structure," with the -0.1% interest rate applied to only a portion of BOJ's current account deposit balances. Raising the policy-balance rate from -0.1% to 0% does not necessarily translate to a 10 bps rise in short-term effective interest rates, and adjustments to the "three-tier structure" could be made to mitigate potential impacts.

China

Rebound ahead. After three years of deleveraging, a soft rebound is on the cards for China's property sector, but not yet normalisation. Unfinished homes, local government debts, and geopolitical risks still pose as risks; albeit softer risks in 2024 than in 2023.

Government stimulus to boost property sector. Unlike other housing crises in modern financial history, China can avoid a property hard landing as their deleveraging

Contribution to China GDP growth



Source: CEIC, DBS

is not taking place across all sector participants. In fact, home buyers are leveraging up. Stimulus policies such as mortgage rate and downpayment ratio cuts will continue to help homebuyers, while fiscal stimulus through infrastructure investment will offset the shortfall of property investment. Case in point, the recently approved CNY1t in special government bonds for infrastructure investments is equivalent to 0.8% of China's GDP in 2022. Half of it has been allocated to 2023, with the other half expected to be issued in 2024.

As the risk of a hard landing abates due to policy mitigants in place, improvement in the economic environment is likely to follow. The recent pick-up in retail sales offers emerging evidence in that regard. Policies such as increases in tax allowances, will provide some support to consumption sentiment. However, a sustained recovery will hinge on labour market conditions; wage growth has been moderating with modest new employment expansion.

RMB1.6t worth of unfinished homes remains a key risk. Developers are now scaling back investment to complete these existing projects. Property investment fell by 9.3% y/y YTD in 2023, with floor space slumping 23.6%. This will trickle down to the deteriorating local government debt situation. Already, total local government debt, including LGFVs, has soared from 53.8% of GDP in 2017 to 81.5% in 2022 according to our estimation. 12 provinces are presently restricted from issuing new government debts, underscoring the fragility of local government finances.

Subdued land sales will further weigh on the already stressed situation. Land sales revenue of local government has fallen by 20.5% y/y YTD, while total local government revenue plunged from 44.3% in 2020 to just 24.6% as of Oct 2023.

North Asia

AI driving North Asia recovery. The trade cycle has shown signs of bottoming and is expected to continue improving in 2024. The electronics sector, following inventory clearance in global smartphone and PC segments coupled with AI-driven demand, is on a modest upswing. South Korea and Taiwan's semiconductor exports, which experienced a sharp downturn over the past one year, have narrowed to single-digit declines since 4Q23. Manufacturing capacity utilisation rates in South Korea – currently at 70% – are approaching pre-Covid levels of 75%. We expect South Korea and Taiwan to benefit from the ongoing recovery in trade throughout 2024.

ASEAN

A mild recovery ahead. 2023 has been somewhat of an underwhelming year for Asean. Protracted weakness in the electronics cycle, which began in early 2022, hovered over the export-oriented economies of the region for much of the year. We estimate that Asean-6 economies will grow by 4.3% in real terms in 2023. This compares quite unfavourably with 2022's 5.7% growth. Malaysia, Singapore, and Vietnam were hit the hardest, with growth rates falling by 50-75%.

The weakness in the electronics cycle was a legacy of the pandemic. After soaring purchases of electronics products in 2020 and 2021, customers and businesses worldwide took a breather in 2022-23, as the WFH demand spike eased and company inventories soared. Looking at industry inventory data and consumer surveys, we believe that the cycle has troughed at long last, and Asia's electronics exporters would step into the new year with some upside.

It was not just exports of electronics that underwhelmed. Commodity prices, which were substantially buoyant in 2021/22, softened in 2023 around strong supply side response on the energy side. For the likes of Malaysia and Indonesia, this became a drag to growth. Soft demand in China also played into the region's traders and tourist operators.

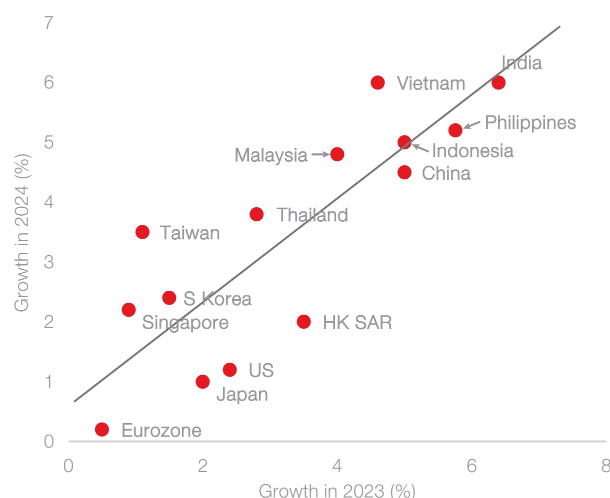
The outlook for 2024 would depend on the extent to which these drags dissipate. We are somewhat optimistic that 2024 would be a better year for the region, forecasting a 30 bps pickup in the annual real GDP growth rate of Asean-6. We see three key drivers for this modest projected turnaround. First, the much-awaited revival of electronics demand. PMI surveys already indicate that advanced orders are picking up for a wide variety of electronics products. A chip cycle is underway as well, reflecting soaring interest in AI-driven products and services. One risk to the outlook is the projected slowdown in the US economy, although we believe that the chip-related cycle can continue even if the overall demand environment turns out to be on the weak side.

The second driver is regional travel and tourism. While economies in the West are three years into their post-pandemic reopening, 2024 would mark the first full year for Asia. China's lockdown ended in 2022, 2023 was fraught with roadbumps that included flight, passport, and package tour availability, as well as high ticket prices from tight demand. In our view, the coming year would mark the normalisation of these drags. The region's hotel operators, event organisers, and restaurant owners should be looking forward to 2024 optimistically.

China is the final factor that could make or break Asean's 2024 outlook. A 4%+ growth outturn with a broadly stable regulatory environment and bottoming property market would be a major source of solace for the region's exporters and businesses. As Chinese tourists return to the region in large numbers and commodity exports to China stabilise, the makings of some growth upside would materialise.

2024 would see plenty of headwinds, ranging from geopolitics to a likely slowdown in the US. Asia's openness to trade is its strength during good times and drag during tough times. While not much can be done about partner country demand, we expect Asian policy makers to keep monetary policy easy and be ready to cut rates when the Fed does so. We also expect to see strong regional competition for investments as Chinese, North Asia, Europe, and US investments are deployed as part of supply chain realignment.

GDP growth in 2023 and 2024



Source: CEIC, DBS

Oil prices set for moderation despite OPEC+ efforts

2024 forecasts revised down. Our 2024 average Brent crude oil forecasts are revised down to USD75-80/bbl from USD80-85/bbl earlier. This is in light of the high prevailing global crude inventory levels arising from weaker demand-supply trends, tapering down of major geopolitical risks, and limited options on the OPEC+ front to shore up prices. As US production reaches record levels and the US government takes a more lenient view on sanctions ahead of election year, we believe oil prices will hover below USD80/bbl on average in 1H24, before some recovery in 2H24, assuming rate cuts kick in. We also introduce 2025 average Brent crude oil price forecasts at USD77-82/bbl, a tad higher than 2024 average on the back of improving macroeconomic conditions.

As 2H23 rally fizzles out. After the strong rally in Sep/Oct 2023, oil prices lost steam and Brent is down around 15% from the recent peak of USD95/bbl to around USD80/bbl levels, as of writing. This is in line with our earlier view that oil would peak out sometime in 2H23 before moderating in 2024/25. Wider geopolitical risks may seem abated for now as the Gaza conflict has not evolved into a full-blown Middle East crisis, and with the recent ceasefire between Israel and the Hamas. US sanctions on Iranian oil have not been tightened either as feared, while US sanctions on Venezuelan oil exports have been partially lifted to ensure US pump prices remain in check. Meanwhile, demand-supply fundamentals continue to be challenged by uncertainties around global economic outlook and China's recovery in 2024. In addition, the rise in non-OPEC supplies, especially the US, where production is back to peaks above 13.0mmbpd much sooner than we expected, which has negated the voluntary production cuts from Saudi/Russia to a great extent. Rising US crude oil inventories over the last few weeks and a still hawkish Fed have added to the drag on oil sentiment, as net long positions on Brent and WTI have declined sharply in recent weeks.

OPEC+ attempts to stabilise markets in latest meeting not impactful. In our view, the latest OPEC+ ministerial meeting held in end-Nov 2023 flattered to deceive in terms of outcomes. While the headline announcement was that several OPEC+ countries announced additional voluntary cuts amounting to 2.2mmbpd, the crux lies in the details. Based on our calculations, the latest OPEC+ deal is mostly a continuation of existing supply cuts, and additional cuts could only amount to a mere 0.2mmbpd in 1Q24

Quarterly average oil price forecast 2023/24 – DBS base case view

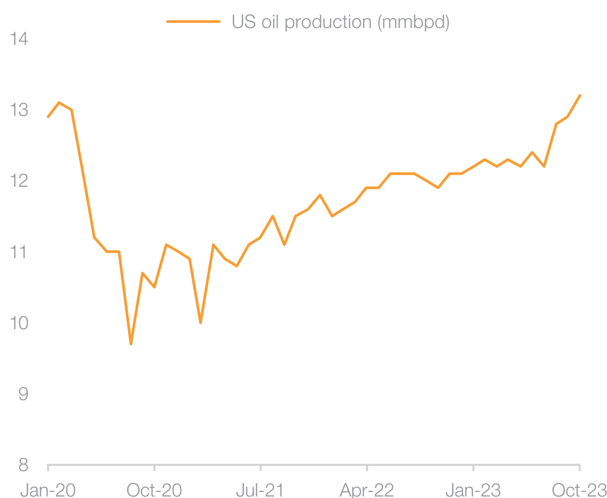
(USD per barrel)	1Q24	2Q24F	3Q24F	4Q24F	1Q24F	2Q25F	3Q25F	4Q25F
Average Brent crude oil price	77.5	76.0	79.0	80.5	79.5	78.5	80.0	78.5
Average WTI crude oil price	73.5	72.0	76.0	77.5	76.5	75.5	77.0	75.5

Source: DBS

Brent crude oil price has likely seen a near-term peak in 3Q23

Source: Bloomberg, DBS

Non-OPEC supplies, led by US, have been on an uptrend in 2023

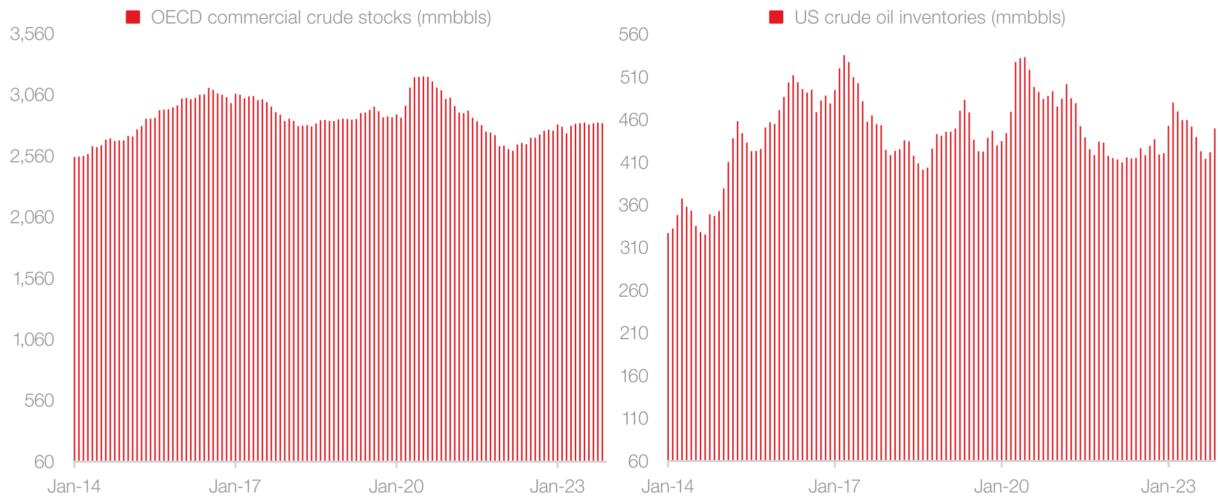


Source: Bloomberg, DBS

by our estimates. In addition, OPEC member Angola had voiced dissent to its revised production target and could look to exceed if possible. Notably, these cuts are all "voluntary" cuts by individual member countries, and not part of a group cut as was the norm previously. This also implies that convincing OPEC+ members to keep cutting production as a group to maintain oil prices above a certain level is not going to be easy going forward, as surplus capacity keeps increasing and OPEC+ members keep losing market share to non-OPEC+ participants. The second thing to note is that the cuts starting on 1 Jan 2024 are only for three months till the end of 1Q24, and these voluntary cuts will gradually return afterwards, subject to market conditions. Thus, these cuts may help counter the seasonal demand weakness in 1Q to an extent. Uncertainty, however, remains beyond that, especially given that oil demand will normalise in 2024 after a couple of years of above-trend growth driven by post-pandemic recovery.

Higher inventory levels going into 2024 will continue to put pressure on prices. With the rise in non-OPEC supplies in 2023, even the voluntary cuts by Saudi in 2H23 could not meaningfully alter the global crude inventory picture. OECD inventories remain stubbornly high throughout 2H23, unlike the drawdowns we saw for much of 2021 which kept inventory levels tight in 2022 as well, supporting oil price recovery in 2021/22. US inventory levels, as reported by the EIA, have also shown an unexpectedly sharp rise in crude inventories in Oct/Nov 2023, which is atypical for that time of year.

Lack of inventory drawdowns a drag on oil price momentum going into 2024



Source: Bloomberg, DBS

GDP growth and CPI inflation forecasts

	GDP growth, % y/y					CPI inflation, % y/y, ave				
	2021	2022	2023F	2024F	2025F	2021	2022	2023F	2024F	2025F
China	8.1	3.0	5.0	4.5	4.5	0.9	2.2	1.0	1.6	2.0
Hong Kong SAR	6.3	-3.5	3.5	2.0	2.5	1.6	1.9	2.0	2.0	2.2
India	8.9	6.7	6.9	6.0	5.8	5.1	6.7	5.6	4.4	4.0
India (FY basis)*	9.1	7.2	6.8	6.2	6.0	5.5	6.7	5.3	4.5	4.0
Indonesia	3.7	5.3	5.0	5.0	5.2	1.6	4.2	3.7	2.8	2.5
Malaysia	3.1	8.7	4.0	4.8	4.8	2.5	3.4	2.5	2.9	2.5
Philippines	5.7	7.6	5.8	5.3	5.4	3.9	5.8	6.0	3.3	3.0
Singapore	8.9	3.6	0.9	2.2	2.5	2.3	6.1	4.7	3.5	2.4
South Korea	4.1	2.6	1.5	2.4	2.2	2.5	5.1	3.6	2.4	2.3
Taiwan	6.5	2.4	1.1	3.5	2.6	2.0	2.9	2.3	1.7	1.7
Thailand	1.5	2.6	2.3	3.3	3.0	1.2	6.1	1.3	1.7	2.0
Vietnam	2.6	8.0	4.6	6.0	6.8	1.8	3.2	3.2	3.5	3.5
Eurozone	5.3	3.5	0.5	0.2	1.0	2.6	8.4	5.6	2.4	2.2
Japan	2.2	1.0	2.0	1.0	0.9	-0.2	2.5	3.2	2.0	1.3
United States	5.9	2.1	2.4	1.2	1.8	4.7	8.0	4.2	3.0	2.5

* refers to fiscal years, i.e. 2020 represents FY21 - year ending March 2021.

** new CPI series. *** eop for CPI inflation.

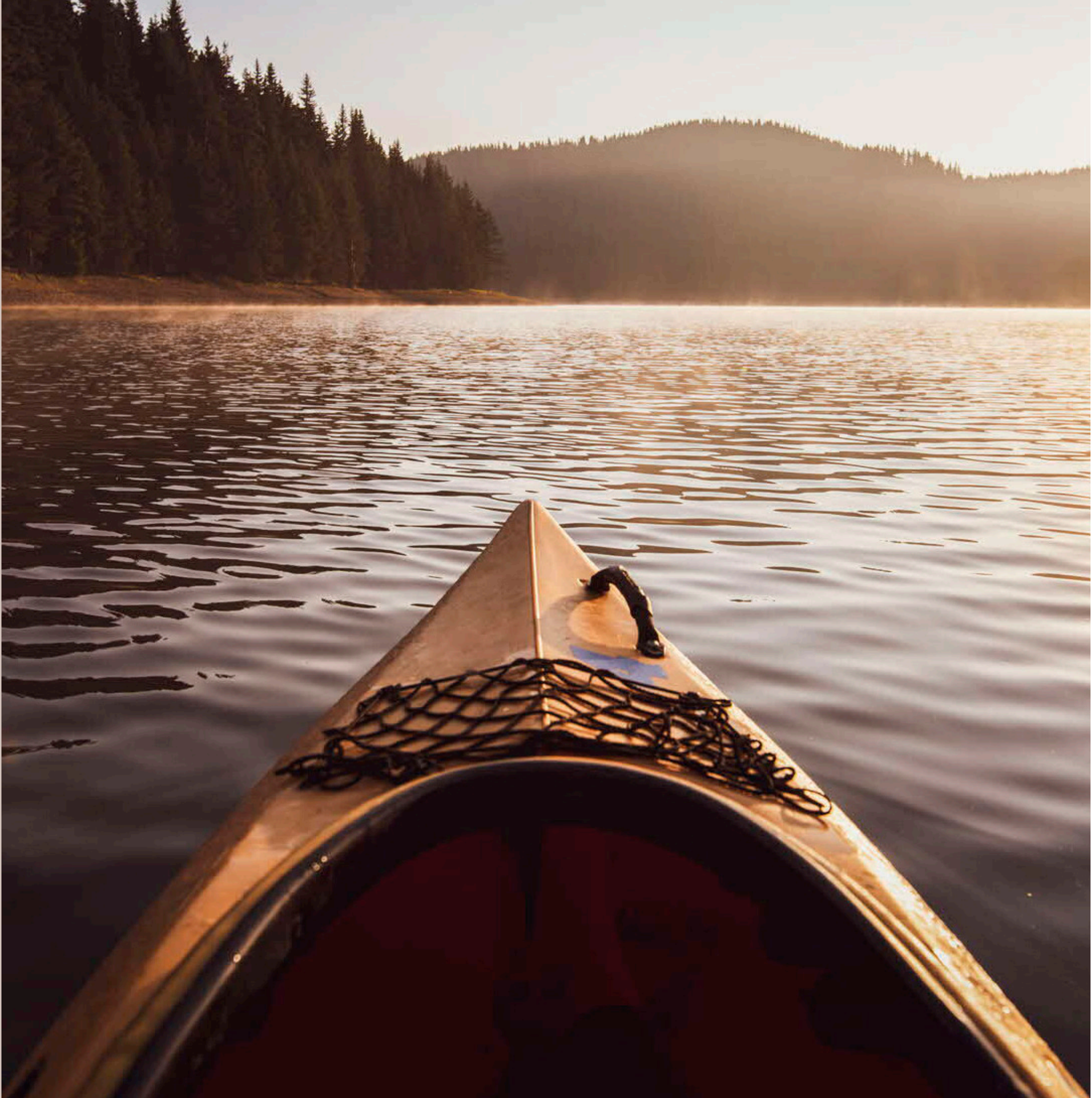
Source: CEIC, DBS

Policy interest rates forecasts, eop

	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
Mainland China*	3.45	3.45	3.45	3.35	3.25	3.15	3.15	3.15
India	6.50	6.50	6.00	5.50	5.00	5.00	5.00	5.00
Indonesia	6.00	6.00	5.50	5.00	4.50	4.50	4.50	4.50
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Philippines	6.50	6.50	6.00	5.50	5.00	5.00	5.00	5.00
Singapore**	3.60	3.52	3.25	3.08	2.78	2.58	2.58	2.58
South Korea	3.50	3.25	3.00	2.75	2.50	2.50	2.50	2.50
Taiwan	1.88	1.88	1.88	1.88	1.88	1.88	1.88	1.88
Thailand	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
Vietnam***	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Eurozone	4.50	4.50	4.00	3.50	3.00	3.00	3.00	3.00
Japan	-0.10	0.00	0.00	0.00	0.00	0.10	0.10	0.10
United States	5.50	5.50	5.00	4.50	4.00	3.50	3.50	3.50

* 1-yr Loan Prime Rate; ** 3M SOR ; *** prime rate.

Source: CEIC, DBS



Earnings Recovery In Sight

US Equities
1Q24

Favour US Equities over other Developed Markets given its strong earnings momentum and the likely trajectory of lower rates. Stay with quality growth in Consumer Discretionary and Tech-related companies.

03.
US Equities.

Dylan Cheang
Strategist

It's all relative: Upgrading US Equities to 3-month overweight. We downgraded Equities as an asset class in our 1Q24 asset allocation as the yield gap between Equities and Bonds suggests better risk-reward for the latter. This is particularly so for the income segment. With US 10Y Treasury yielding 4.4%, Bonds certainly look more attractive than dividend stocks yielding at 2.7% at this juncture.

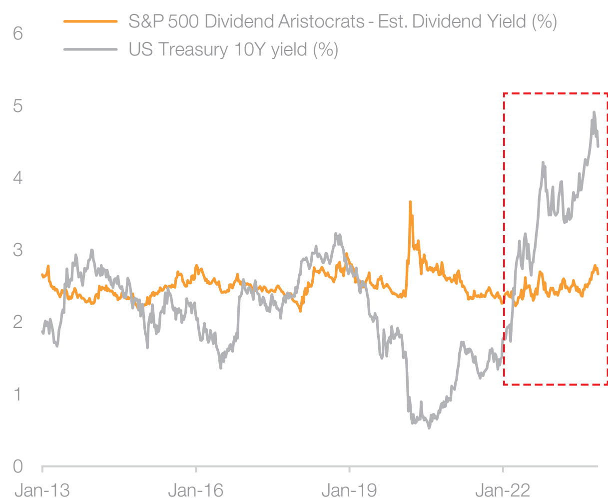
On a comparative basis, unlike Bonds, Income Equities have the additional advantage of potential "growth" upside. However, from a portfolio construction standpoint, our preference is always for investors to seek growth opportunities via Growth Equities as opposed to income plays. This underpins our decision to overweight Bonds over Income Equities.

But in asset allocation, nuance matters. Despite our overall cautious stance on Equities, we are upgrading the US market to 3-month overweight for the upcoming quarter. We expect US to outperform its peers in the DM space given:

- Strong earnings momentum: DM ex-US possessed vastly stronger forward earnings momentum than the US during 1H23. But the relative earnings strength for DM ex-US started to fade during the second half while US forward earnings remained resilient.

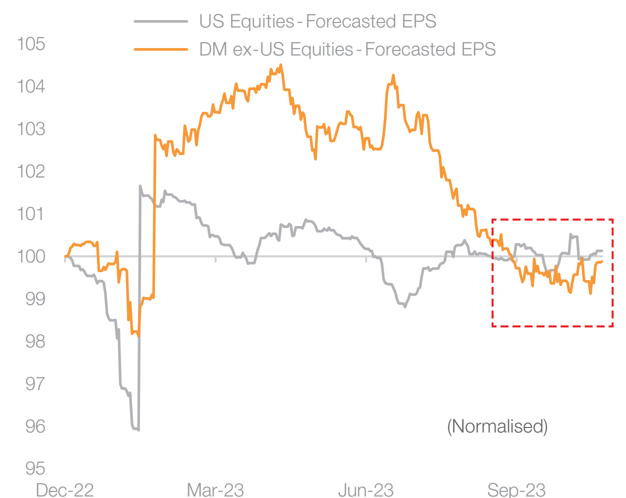
  Historically, US earnings display close correlation with the change in ISM Manufacturing. The latter has clearly bottomed and a reversal of this downtrend will augur well for the outlook of US earnings. Based on consensus forecast, the US is expected to register earnings growth of 10.0% in 2024 and this is substantially higher than the 2.1% growth expected for DM ex-US.

Bonds looking more attractive than income Equities at this juncture



Source: Bloomberg, DBS

Forward earnings momentum for DM ex-US has sharply weakened

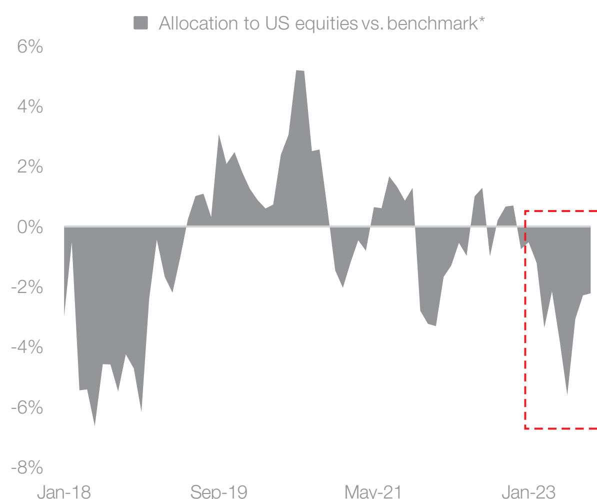


Source: Bloomberg, DBS

A bottoming ISM Manufacturing augurs well for US earnings trajectory

Source: Bloomberg, DBS

Global Equity investors are currently Underweight on US Equities



Source: EPFR Global, DBS
* Proxied by ETF weights

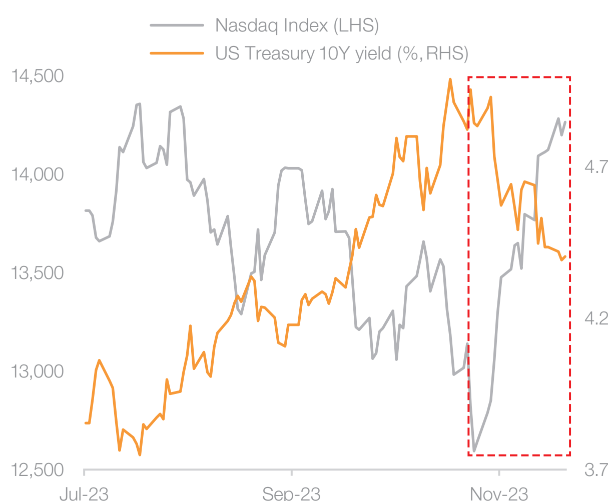
- Low US Equities ownership: Based on data from EPFR Global, global equity funds are moderately underweight on US Equities. The same subdued momentum is evident from flow data with USD6b entering the market this year (as of 1 Nov), compared to inflows of USD15.3b to Japan.

  The combination of low ownership and subdued flows suggests that investors' expectations for the market is not undemanding at this juncture as concerns on Fed policy uncertainties linger. But as earnings recovery gains momentum over the course of the year, investors will be compelled to, at the very least, lift their US market exposure back to benchmark levels.

Peak Fed: Positive for Technology-related plays. As highlighted in the asset allocation chapter, we believe peak Fed is on the horizon. Recent inflation numbers are showing signs of easing as prior policy rate hikes work its way through the broader economy. Indeed, the recent CPI print of 3.2% in October, which was below market expectation of 3.3%, already triggered a sharp rally in Technology plays.

Propelled by tailwinds from rising interest in artificial intelligence, we believe tech-related industries will remain on an upward trajectory should incoming inflation data remain benign. This, in turn, will underpin the outperformance of US Equities over Europe and Japan given its larger exposure to the tech-related segment.

Tech undergoing a sharp rally as bond yields ease



Source: Bloomberg, DBS

1Q24 US Sector Strategy – Stay the course and ride secular trends

CIO's overweight calls garnered strong performance in 4Q23. Our overweight calls registered average total returns of 6.4% in 4Q23 (as of 6 Dec), outperforming our Neutral calls by 3.6 %pts and underweight calls by 1.3 %pts. Within the overweight basket, Technology registered the largest gains of 11.4%, followed by Financials at +7.90%. Essentially, Technology stocks rallied during the quarter amid rising expectations of peak Fed as US inflation data eased.

In our neutral basket, Energy was the standout underperformer as the sector registered losses of 10.0%. The weaker performers within our underweight calls include Consumer Staples (+2.2%) and Materials (+3.3%).

Stay with secular plays: Tech and Healthcare. The Fed's insistence on a data-dependent approach in policy making will only mean one thing: One can never have near-term visibility of the central bank's policy intent. A sudden surprise pivot in incoming data, for instance, could potentially result in a drastic reversal in the Fed's rhetoric. In such an environment, it is instructive for investors to conduct sector allocation in the US not based on macro assumptions, but rather, based on long-term secular trends.

Digitalisation and ageing demographics are long-term secular trends that will persist regardless of business cycles and central bank policies. Stay invested in these themes to ride the momentum. In the tech-related space, seek opportunities in "adapter" companies that are adopting the usage of AI to enhance their business operations.

US Sector Allocation – 1Q24

	Overweight	Neutral	Underweight
US Sectors	Technology	Real Estate	Utilities
	Comm. Services	Energy	Cons. Staples
	Healthcare	Cons. Discretionary	Industrials
	Financials		Materials

Source: DBS

US sector key financial ratios

	YTD Total Returns (%)	Forward P/E (x)	P/Book (x)	EV/EBITDA (x)	ROE (%)	ROA (%)
S&P 500 Index	6.4	21.0	4.3	13.4	17.9	3.8
S&P 500 Financials	7.9	14.6	1.9	-	12.4	1.4
S&P 500 Energy	-10.0	10.9	2.2	6.6	21.5	10.4
S&P 500 Technology	11.4	31.4	10.7	20.8	29.8	12.6
S&P 500 Materials	3.3	19.0	2.8	11.8	13.6	5.8
S&P 500 Industrials	7.1	20.1	5.2	14.2	24.4	6.5
S&P 500 Con. Staples	2.2	19.9	5.9	16.9	23.6	6.9
S&P 500 Con. Discretionary	7.1	25.0	8.7	14.7	29.6	7.0
S&P 500 Comm. Services	3.9	19.4	3.8	12.5	13.3	5.3
S&P 500 Utilities	8.1	16.8	1.9	12.1	8.9	2.3
S&P 500 Real Estate	11.3	34.8	2.7	18.5	7.2	3.0
S&P 500 Health Care	2.5	20.2	4.6	15.8	18.3	6.4

Source: Bloomberg
* Data as at 6 December 2023

Growth Unease Abounds

Europe Equities 1Q24

Structural concerns surrounding high energy import dependency and fiscal constraints to put a lid on economic growth. Stay with quality names in Luxury, Healthcare, and Technology, as they remain resilient in an environment of sluggish growth.

04. Europe Equities.

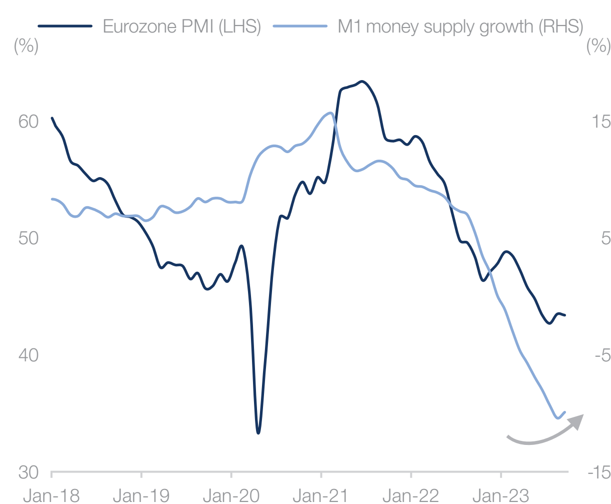
Joanne Goh
Strategist

Awaiting pivotal factors. The outlook for Europe Equities in 1Q24 is showing hopes of stabilisation as investors anticipate pivotal factors for potential upward revaluation. Despite some optimism, markets face a growing likelihood of macro tail risks driven by the region's vulnerability to fluctuations in energy prices, fiscal consolidation, and geopolitical tension.

Stay with resilient sectors which benefit from structural demand trends. Our stance on Europe remains cautious as market rotations are expected to be steered by shifts in yields. Maintain selective exposure in high-quality stocks within the European Luxury, Healthcare, and Technology sectors. These sectors benefit from enduring structural demand trends, making them resilient in the long term. Companies with longer-term growth potential are well-positioned to thrive amid an environment of lower interest rates and lukewarm growth.

Diminishing headwinds from easing inflation, monetary policy pause, and recovery in manufacturing. The region's economic landscape faced significant challenges in the past year with soaring gas prices, the ECB's tightening measures, and sluggish global growth, particularly in China. These resulted in significant underperformance in the Euro Area, compared to the US. In recent months, core inflation has subsided more than initially expected, improving real household income, and providing room for rate cuts. Looking ahead, we anticipate the economy to grind lower, projecting a 0.2% growth in GDP for 2024 after a lacklustre 0.5% in 2023. The economy should show

Manufacturing sector poised for recovery amid improving macro conditions

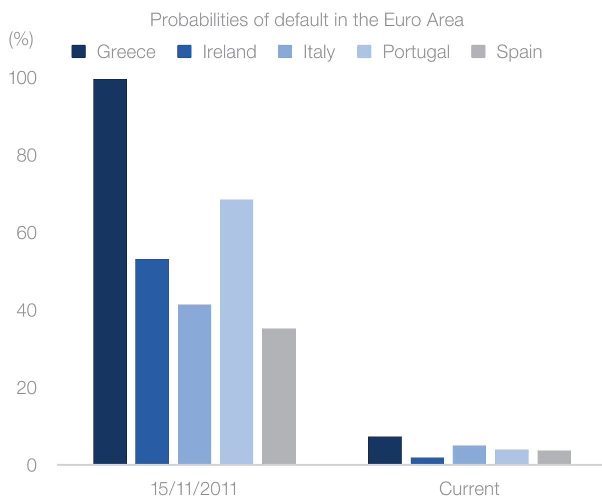


Source: LSEG Datastream, DBS

signs of stabilisation by 2H24, buoyed by abating inflationary pressures, a more accommodative ECB, and a cyclical recovery in the manufacturing sector supported by steady growth in China.

Fiscal dilemma and budgetary concerns remain. However, challenges may surface from Europe's fiscal policies. For instance, as governments phase out their energy support initiatives and progress towards normalising post-pandemic funding early next year, slowdown in growth in some sectors may ensue. At time of writing, a deal over the revised EU fiscal rules is under close watch. If agreed upon, the new rules are set to apply in 2025, with 2024 likely a bridge year with less adverse fiscal stance for the bloc.

Fiscal pressure has abated, for now

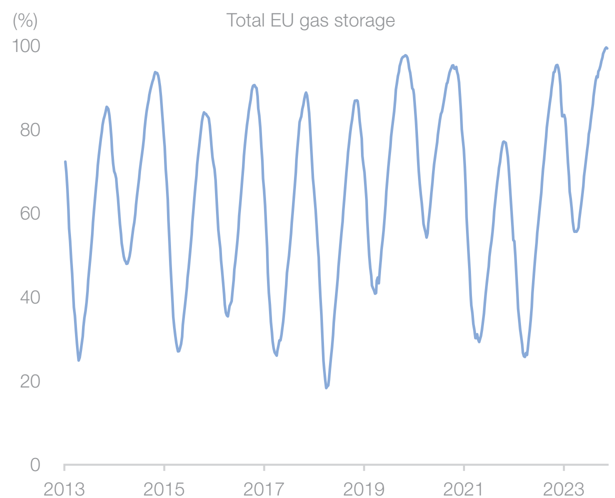


Source: LSEG Datastream, DBS
Note: Market-implied probabilities of default within next five years based upon CDS spreads

In particular, budgetary concerns are in focus, with Italy standing out as one of the more vulnerable countries grappling with elevated budget deficits. While we expect fiscal strains to remain under control thanks to support from a favourable EU institutional framework, we remain watchful of the longer-term fiscal challenges facing the region. These fiscal uncertainties could exert pressure on overall regional growth, as tightening financial conditions may trigger further budgetary consolidation.

Energy initiatives present opportunities. The risk of another surge in natural gas prices in view of a harsh winter or escalating geopolitical tension remains a concern. It could exert renewed upward pressure on headline inflation, impeding the recovery of real household incomes. However, given already subdued demand, elevated energy costs, and ample inventory, the impact on inflation is likely to be limited. In contrast to the US, which is more self-reliant for energy, Europe's reliance on external sources amplifies its economic vulnerability. It is worth noting that Europe is actively working to alleviate this through initiatives to improve energy security and independence. These include greater diversification of energy sources as well as investments in renewable energy and greater energy efficiency. Recognising these concerted efforts, we believe that improved energy infrastructure in the region will be a key driver of future economic growth.

Ample storage reduces risk from price spike



Source: LSEG Datastream, DBS

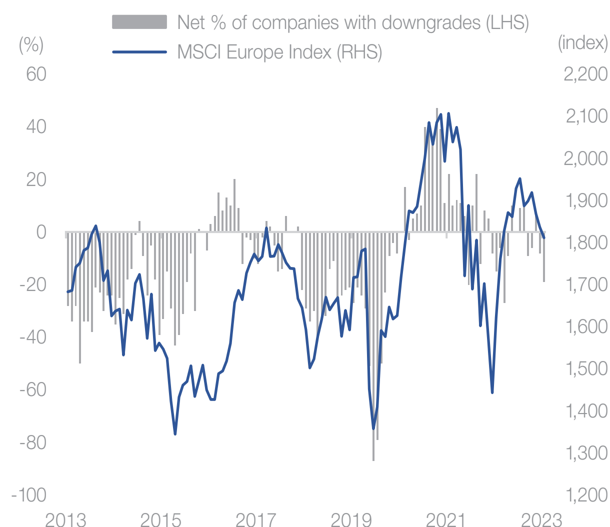
Subpar earnings prospects. The 3Q23 earnings season for Europe Equities turned out lacklustre, with c.30% of companies having their earnings forecasts revised downward in the past two months. The Europe index has been on a downward trajectory after reaching its peak in April 2023, responding to the prevailing weak macroeconomic conditions. This re-iterates the headwinds faced by Europe Equities, as they continue to grapple with a complex backdrop marked by sector-specific performance disparities. Forward guidance provided by companies was also uninspiring, with consensus estimate for the coming year anticipating a 7% growth in earnings. However, it is important to note that this forecast is contingent on significant improvements in earnings for the Materials, Energy, and Communications sectors.

Mixed sector opportunities. 4Q23 marked several trend reversals. With bond yields peaking at around 3% towards the end of the year, Technology stocks staged a comeback. We stay overweight on the Tech sector and especially favour the semiconductor industry for its sustained demand from digitalisation propelled by the AI boom.

The interest rate-sensitive Real Estate sector faced headwinds in 4Q23 from peaking rates, with profitability expectations and investor confidence dipping. While we stay underweight on Europe Real Estate, we maintain specific interest in logistics, datacentres, and student housing.

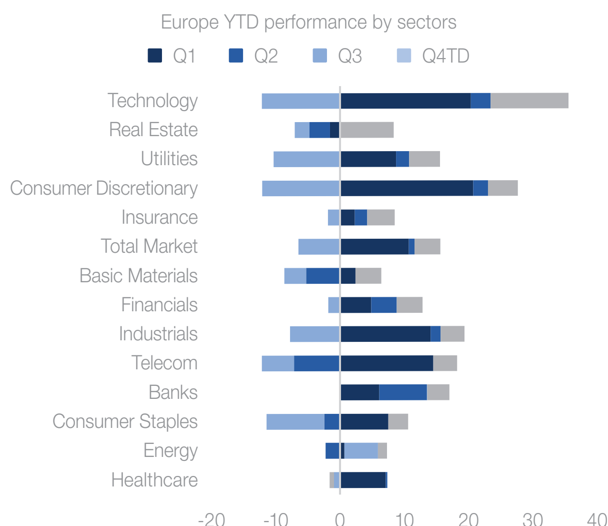
The Utilities sector also saw a positive turnaround in 4Q23 after a lacklustre performance through 2023. Europe's strategic focus on improving its energy infrastructure resilience should bode well for the sector. Furthermore, progress in technology

Net downgrade in earnings for 2 consecutive months



Source: LSEG Datastream, DBS

Disparate performance across sectors



Source: LSEG Datastream, DBS

and shifts in consumer mindsets have blurred lines between conventional and new energy sectors, welcoming new players and energy sources in the sector. We favour engagement through Private Asset funds which have a focus on new generation utility infrastructure.

The Consumer Discretionary sector which includes Luxury, Autos, and Airlines is sensitive to household income levels, and will thus benefit from rising real income as inflation continues to fall. We prefer the Luxury sector as it benefits from improving global demand, structural growth from a rise in millennial spending, and evolving e-Commerce trends.

International travel, especially between Europe and Asia, remains robust. The demand for premium travel offerings is expected to stay strong, driven by a growing consumer inclination for indulgent travel experiences. We expect Europe's carriers to outperform North America's airlines in passenger yields given the solid demand, acute staff, aircraft shortages, and effective fuel hedging strategies.

European Autos are lagging in the EV transition. EVs in Europe generally cost about 33% more than traditional cars. Apprehension surrounding the lack of charging infrastructure, battery life fears, and price are delaying purchases. We would prefer manufacturers with the right price point and demand in the luxury segment.

Although Banks performed consistently in 2023, a backdrop of slowing growth, widening credit spreads, and topping yields could adversely impact the sector in 2024. Instead, favourable bottom-up dynamics such as cost-cutting and consolidation may present stock-picking opportunities.

Lastly, earnings for the Healthcare sector should remain resilient through economic downturns. We look to selective opportunities in life sciences, particularly in medicines for diseases such as diabetes, obesity, and heart disease as they are poised for a steady climb in global demand.

Luxury remains in vogue

Source: LSEG Datastream, DBS

Hindered Optimism

Japan Equities
1Q24

Investor optimism moderated amid rising bond yield and lack of progress in restoring P/B multiples. Prefer upstream semiconductor supply chain given strong government support.

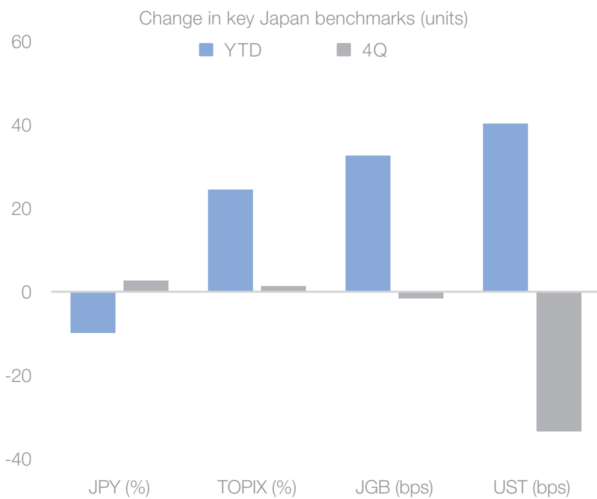
05.
Japan Equities.

Joanne Goh
Strategist

Stagnant stock performance. Japan Equities deteriorated in 4Q23 as investor optimism moderated amid rising long-term interest rates in both Japan and the US, and as geopolitical tension in the Middle East escalated. 10Y US Treasuries hit 5% for the first time since 2007; equivalent JGBs neared 1% as the BOJ lifted the "soft" 1% cap in the October monetary meeting. JPY hovered around, then broke through the 150 psychological resistance level. Foreign investors net sold through November in 4Q23 but maintained their net buying position firmly with a cumulative inflow of USD26t YTD.

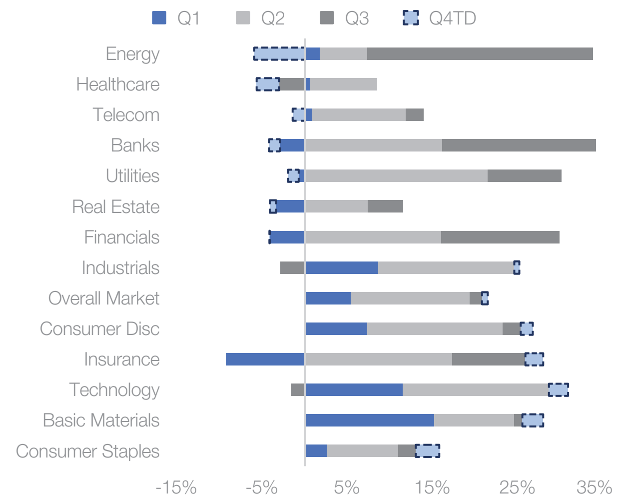
Tech and Industrials taking the lead. On a sectoral basis, the Energy and Banking sectors reversed their strong performance in 4Q23 as oil prices and bond yields show signs of peaking in the near term. Meanwhile, investors continue to pursue economically important sectors such as Tech and Industrials. On the other hand, defensive sectors including Healthcare and Telecommunications registered weak performance despite low investor risk appetite, while Consumer Discretionary and Staples both fared well. In the Basic Materials sector, chemicals outperformed.

4Q characterised by big moves in UST



Source: LSEG Datastream, DBS
* as of 12 December

Sector performance YTD



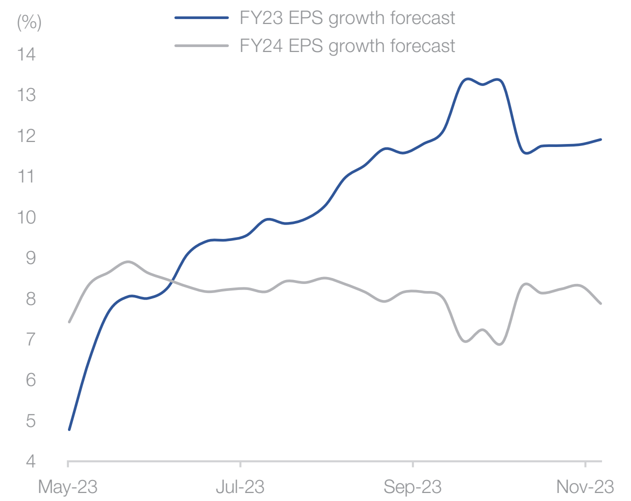
Source: LSEG Datastream, DBS

Less compelling earnings trends and valuations. Companies started to release 3Q23 results in late October, where most beat expectations for sales and EPS. Forward guidance, however, was lowered due to weaker-than-expected recovery in China for export stocks. Yen assumptions stood at 135.75, approximately 10% stronger than current levels – this could provide some degree of buffer from translation gains. Meanwhile, domestic demand stocks could see some uplift from steep price increases. For example, the base price of the Japan Rail (JR) pass has barely changed in decades. However, with the yen's decline, inflation of energy and maintenance costs, Japan Railways has deemed a price increase from 1 October 2023 necessary, with the largest being 77% for the 7-day Green pass.

For the TOPIX, EPS growth forecasts have started to trend south, currently at +12% y/y for FY23, followed by +8% in FY24. 12-month forward PE is now at +1SD above average, rendering the market less attractive despite strong earnings growth and low JGB yields. In contrast, based on P/B ratios where we see room for further upside, returns are forecast to be positive. The Tokyo Stock Exchange (TSE) in March asked companies with P/B ratios below 1x to disclose specific policies and initiatives to lift their value as it sought to raise management awareness of capital costs and stock prices. The directive, although not binding, is also seen as a message to draw more interest from overseas investors.

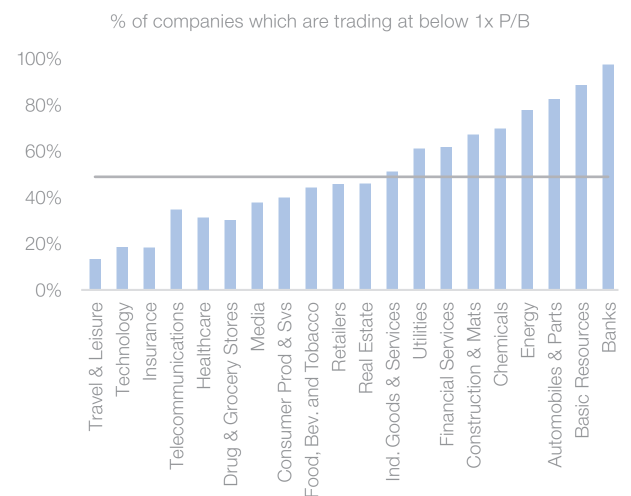
Progress has been limited – currently, 48% of companies listed on the TOPIX are still trading below 1x, with most coming from Banks, Basic Resources, Autos, Energy Chemicals, and Utilities. Interestingly, these companies are 'old economy'

Earnings trend starting to normalise after a strong start to the year



Source: LSEG Datastream, DBS

"Old economy" sectors with low P/B



Source: LSEG Datastream, DBS

stocks which have de-rated over the years due to poor ROE performance and the BOJ's negative interest rate policy. Although there appears to be room for restoring P/B multiples through share buybacks and increased dividends, gains in these stocks are unlikely to be sustainable unless there are concerted efforts to expand profits and restructure businesses.

Equities dis-associated from YCC policy. The BOJ further increased its YCC flexibility during the October 2023 meeting. Instead of strictly capping the 10Y JGB yield at 1% through fixed-rate operations, the BOJ will now consider the 1% level as a reference in its market operations. This signifies that the BOJ is willing to allow the 10Y JGB yield to exceed 1%. However, it remains unclear to what extent the BOJ will tolerate a yield above 1%, as well as whether markets will chase yields or USD/JPY higher.

BOJ to remain cautious on monetary policy. To be sure, Japan is the only country to maintain a negative interest rate policy (NIRP) whereas central banks around the world have raised rates aggressively to rein in inflation. Having maintained the policy for more than 20 years, moving away from negative interest rates would have far-reaching effects on Japan's economy, from corporate investment to household savings. We thus believe the BOJ will be very cautious before changing its monetary policy.

For now, we anticipate that movements in Japanese yields will align with those of the US. Consequently, Japan's equity market will be influenced by global risk sentiment, particularly in response to changes in US bond yields. This implies that the correlation between Japan Equities and US Equities should have increased. We observe US bond yields trading in the 4.5-5% range, but it is crucial to monitor fiscal constraints and the outcomes of debt auctions for potential spikes in bond yields.

TOPIX correlation with S&P 500 rising from low

Calculated from 52W rolling correlation of weekly returns

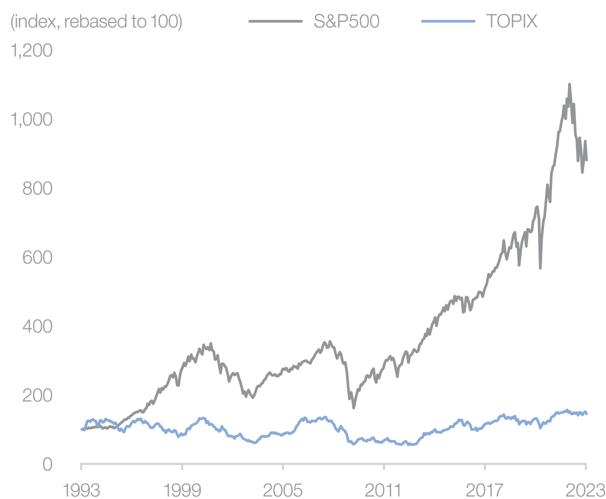
Source: LSEG Datastream, DBS

Focus on quality. Given a mixed bag of uncertain central bank policy as well as weak earnings trends and valuations, we emphasise the need to stay with quality names. We remain selective on Japan Equities, with a focus on companies which are:

1. pushing for profit expansion and rationalising of businesses
2. reaping sustainably high ROEs
3. Sumotoris – economically important sectors such as semiconductors
4. Tech stocks exposed to AI-related demand
5. exposed to next-generation infrastructure such as cloud networks, energy transition, and logistics

In the longer term, the question lingers about Japan's ability to surpass the US and overcome its lost decades.

Japan Equities underperformed US in the past 30 years



Source: LSEG Datastream, DBS

Structural challenges ahead. Despite a vibrant history of technological innovation, Japan is often perceived to face challenges in keeping pace with innovation compared to some other economies. Deep-rooted traditions such as that in Japan's corporate culture is a contributing factor – where stability and incremental progress are often valued over rapid yet potentially transformational bouts of innovation. While this approach has enabled the continuance of high-quality products, it may have hindered breakthrough advancements. Japan's demographics (such as an ageing population) and a general reluctance to embrace startups and entrepreneurship which are crucial drivers of innovation have also set the economy back.

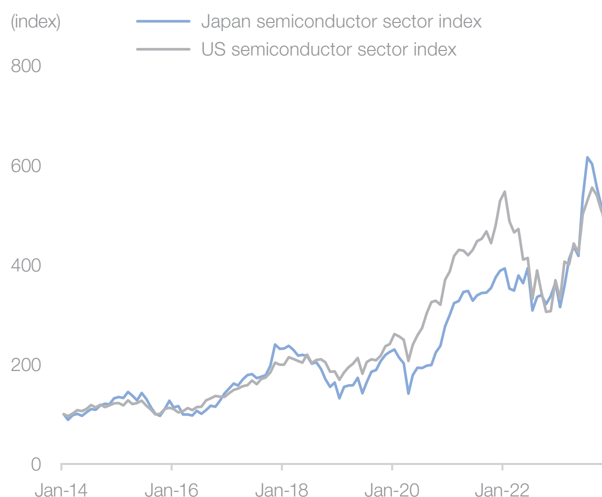
Reforms underway to maintain competitiveness. It is important to acknowledge varying perceptions, but Japan remains a significant player in various technological sectors today. For example, Japan maintains international competitiveness in specific semiconductor device types. However, as acknowledged by the Japanese government, the ongoing chip promotion effort may signify the country's "last chance" to establish a robust position in the global chip marketplace. Initiatives in AI, robotics, and semiconductor technology are underway to foster innovation. Reforms, including an emphasis on international collaborations, represent a significant shift for the country, which had previously pursued a policy of achieving self-sufficiency.

Key sector recommendation: Japan's semiconductor prowess

Strong government support to drive sectoral growth. The semiconductor sector is one where there is strong will by the Japanese government to stake out a dominant position in the global chip marketplace. The core strategy has been set which includes the formation of a partnership with the US through the consortium Rapidus, which involves Japanese firms collaborating with IBM and Europe's IMEC for next-gen chip development. Besides, the country aims to create chip manufacturing bases for legacy devices, partnering with foreign players, such as Taiwan's TSMC, to establish Japan Advanced Semiconductor Manufacturing. The Japanese government plans to subsidise domestic and foreign manufacturers, covering one-third of capital costs, to produce specific semiconductor devices, materials, and equipment, with a 10-year domestic production requirement.

Japan holds unrivalled best-in-class competencies. As it is, Japan has a strong chip infrastructure and global industry leaders are reportedly coming to view Japan as an alternative chip production hub to China. Japan has extraordinary competencies in the tools and materials necessary for the most advanced forms of chipmaking, with Japanese suppliers often best-in-class in their areas of specialisation. For example, for the EUV lithography equipment, which is essential for advanced chipmaking, Tokyo Electron (TEL) leads with near 100% market share in in-line coaters/developers, and Japanese firms JEOL and NuFlare hold a 91% share of the global market for mask-making. Japan is the largest maker of semiconductor materials in the world – a status it has held for decades – holding over a 50% share of 14 of the most critical materials needed for chipmaking, including photomasks, photoresist, and silicon wafers.

Japan plays a key role in the semiconductor sector



Source: LSEG Datastream, DBS

Time For Rerating

Asia ex-Japan Equities 1Q24

Confluence of low valuations, peak US rates, and double-digit earnings growth bode well for Asia ex-Japan. 2024 should see stable growth across the region with greater policy rollouts in China and a narrowing of discount in Asia ex-Japan Equities to Global Equities.

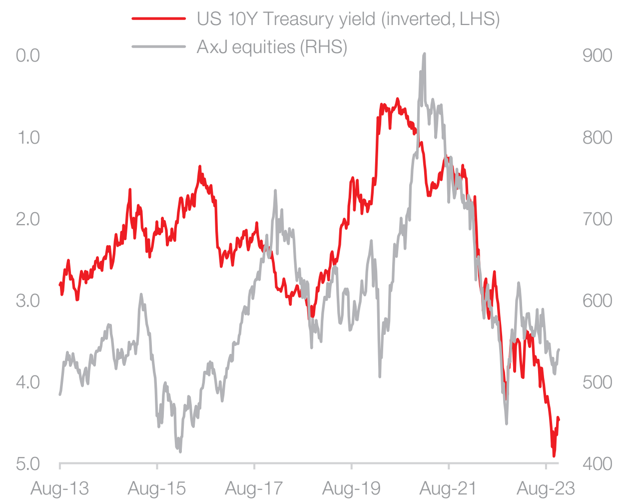
06. Asia ex-Japan Equities.

Yeang Cheng Ling
Strategist

Joanne Goh
Strategist

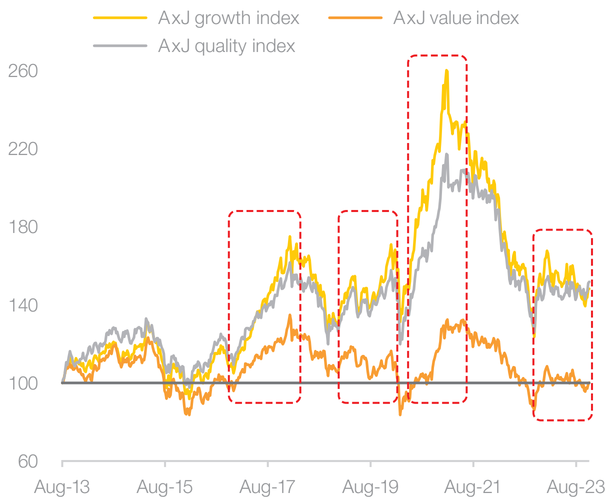
A challenging 2023. AxJ Equities were down c.6% as at end-Nov 2023, extending the 21% decline from the previous year as sentiment continued to be muted due to a combination of headwinds. China's weaker-than-expected post-Covid recovery, deterioration in domestic consumption across Asia, inter-regional tensions, as well as higher-for-longer US Fed policy rates have largely weighed on the performance of AxJ Equities. The unexpected war in the Middle East further added to the contrasting returns between AxJ and DM Equities, as investors shunned EM. Within the region, North Asia and Southeast Asia markets have lost 7% and 9% respectively, compared with nearly 10% returns delivered by Global Equities.

Inverse correlation between US rates and AxJ Equities



Source: Bloomberg, DBS

Quality growth vs value, a bifurcated region



Source: Bloomberg, DBS

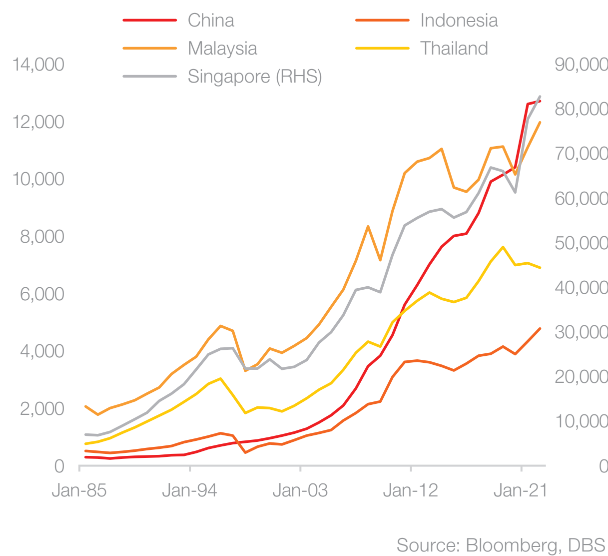
Asia – a region known for growth potential. 2024 should see stronger growth across the region as greater policy rollouts in China would drive improvement in corporate earnings. Over the past decade, the quality-growth investing approach we advocate has noticeably yielded better returns than value investing. We remain convinced that investors who invest in quality growth companies will be well rewarded over time.

Peak US rates' positive effect. With the Fed deciding to keep the Fed Funds rate stable over two consecutive meetings, the Fed pause has become the mainstream narrative. Regional markets can now breathe a sigh of relief. The ECB, BOE, HKMA, and central banks across Southeast Asia have similarly kept their policy rates unchanged as inflation readings continued to decline.

Expectations of flattening US rates and an eventual decline around mid-2024 (based on the present Fed Fund Futures) should further support a turnaround in AxJ Equities. The peaking of rates will have a bottoming effect on markets across this region thanks to the historical inverse correlation between AxJ Equities and US rates.

Another constructive structural tailwind for AxJ is the momentum in GDP per capita, which is on an upward trajectory and a solid foundation for domestic consumption resilience.

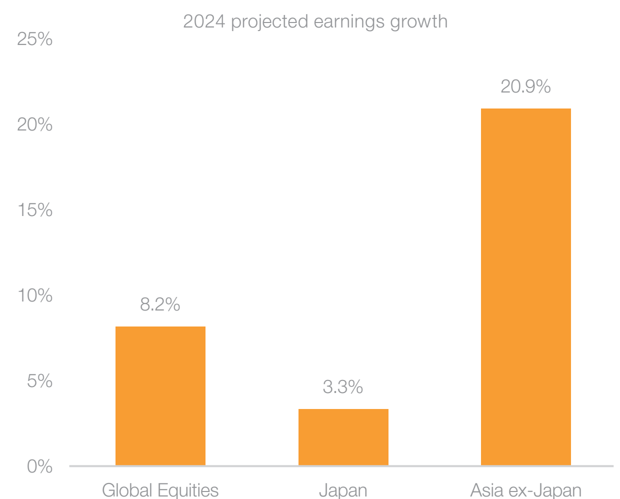
Asia's nominal GDP per capita – a formidable force (USD)



Source: Bloomberg, DBS

Notably, compared to global peers, AxJ corporates are projected to deliver more attractive earnings growth in excess of 20% and 15% in 2024 and 2025, respectively. This is a sharp recovery from the preceding year and a factor for AxJ to reverse its dismal performance over the last two years.

Asia earnings growth – a factor that cannot be disregarded



Source: Bloomberg, DBS

Hence, we find compelling fundamental reasons to stay overweight in AxJ and invest in selective secular themes. On the growth side, our preference remains with semiconductors, Internet platforms, and diversified financials. The Fed's higher-for-longer narrative has led to share price corrections among the region's dividend stocks like Singapore REITs, but the sustainable yields appear attractive and investors should maintain exposure as global interest rates have peaked. Against this backdrop, we will look to add further weights once tangible signs indicate that global rates are declining, and sentiment recovery picks up pace.

China

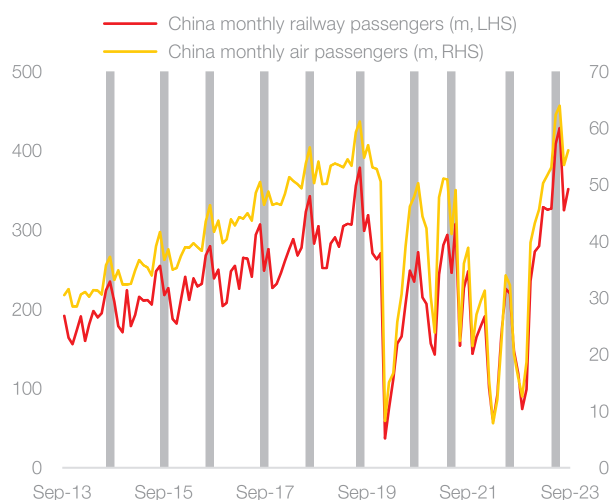
China concluded 2023 as one of the worst performing major markets. As at end-Nov 2023, China Equities dropped 8% in USD terms, with more than half of the decline attributable to foreign exchange effect. However, better-than-expected 4.9% GDP growth in 3Q23 indicated a bottoming of consumption and spending, making the official growth target of 5% within year-end's reach.

Consumption back on trend. Holiday travel has finally recovered. During the 2023 summer holidays, often viewed as a barometer of domestic spending, both airlines and railways recorded more than 60m and 400m monthly passengers respectively, surpassing pre-pandemic highs. Consumption recovery remains on track as travel and leisure activities are reliable indicators for domestic sentiment.

Overall consumption recovery should continue to gather momentum in 2024 as services activities rebound and consumer confidence improves from multi-year lows. Household confidence has been deeply affected by the negative wealth effect from declining property and stock markets, which triggered an increase in overall household savings. As authorities continue to introduce stimulus measures – some aiming to address the real estate developer issues – consumer confidence should gradually recover and release some excess savings, although timing remains questionable.

Another area of focus is the revival of youth employment availability. Last available data as of June 2023 was 21.3%, but this can be gradually improved when private sectors renew their business investments and jumpstart hiring.

Recovery in domestic travel



Source: Bloomberg, DBS

Household savings a strong pillar to sustain the economy

Source: Bloomberg, DBS

Tailwinds from government stimulus. Policy steps announced thus far include monetary easing, measures to spur spending on big ticket items and home sales, and reduction of personal income tax. The rollout of RMB1t in special central government bonds should ease local fiscal difficulties and support related public investment. 2024 will be a year of policy implementations to boost economic momentum. Specifically, support to improve real estate demand in lower-tier cities and the completion of stalled projects are likely to be on the drawing board in order to accomplish a 'L-shape' stabilisation outcome.

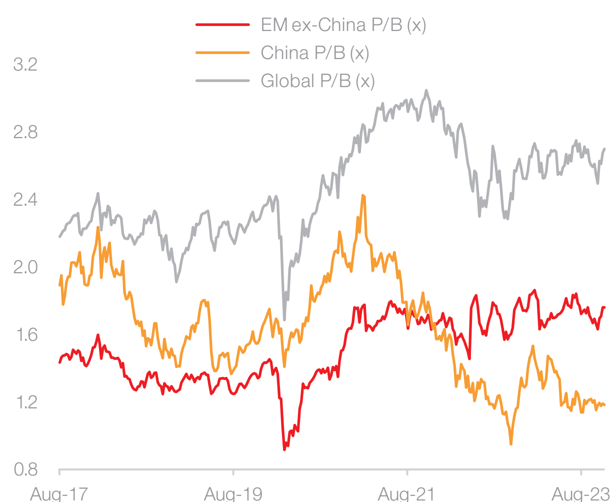
We believe the negative developments surrounding China have been largely factored in by investors, as evidenced by beaten down valuations and signs of rebound on the back of government-announced measures to address domestic issues.

The sharp underperformance of China Equities relative to global and EM peers should reverse based on the following rationale:

1. Valuation: China Equities now trade at P/B of 1.2x, a steep valuation discount to both global and EM peers trading at 2.7x and 1.7x respectively
2. Earnings: China firms are projected to deliver appealing forward earnings growth of 15% in 2024
3. The peaking of US rates

We remain constructive on the broader outlook as market participants look forward to policy implementations; focus on themes and industries that stand to benefit from government expenditure and stimulus. New IPO entrants indicate easing in government policy while a potential de-escalation of US-China tensions could also materialise. Beneficiaries include platform companies, AI technology developers, technology services, and diversified financials on the growth side. On the income side, large state banks stand to benefit as the eventual decline in global rates should once again attract the interests of yield hunters.

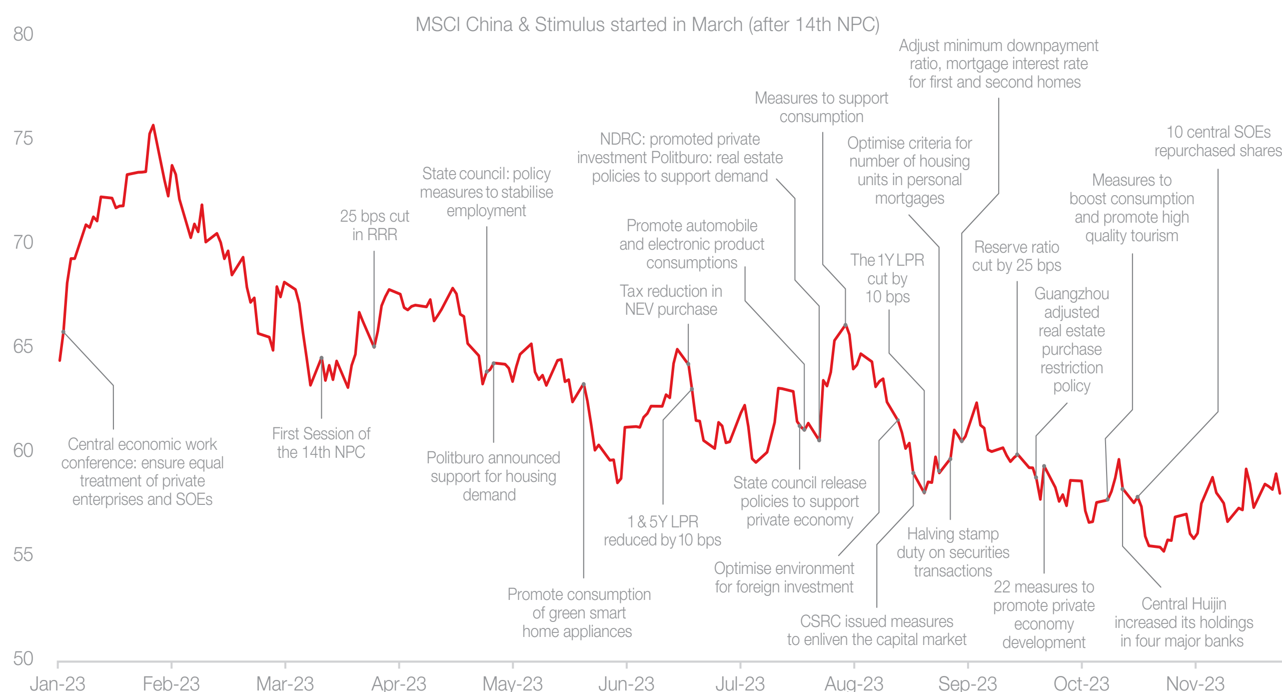
Wide valuation discount



Source: Bloomberg, DBS

The following chart demonstrates how stimulus measures restore stability and resolve hitches overshadowing real estate and consumption.

China government policy initiatives at a glance



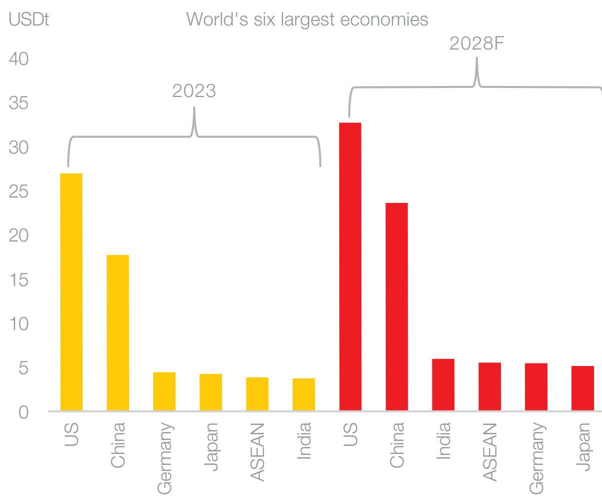
Source: Bloomberg, DBS

Fed pause bodes well for ASEAN and India markets

We expect improved sentiment in ASEAN as we foresee a less hawkish Fed, USD weakness, and lower yields in 2024. Economic growth is forecast to be stronger with exports and investment recovery being the key drivers, while consumption heals from high inflation and interest rates. Growth should stabilise after the past few years of volatility from the pandemic, soaring commodity prices, high interest rates, and disruption from geopolitics.

The region has consistently outpaced global economic growth, providing fertile ground for businesses to expand. ASEAN is projected to be the fourth largest economic region in the world with a nominal GDP exceeding USD4t by 2030. ASEAN and ASEAN member countries have demonstrated resilience in the face of global economic challenges thanks to structural tailwinds, favourable demographics, and increased regional integration.

ASEAN and India will join China in the next five years



Source: IMF, DBS

With China's growth stabilising and supportive policies in force, it is a favourable time to reconsider investments in sectors tied to Chinese growth and recovery. China's projected 2024 GDP growth of 4.5% is seen as a stabilising factor amid global growth slowdown, with government stimulus and regulatory shifts offering potential policy reassurance. Three key areas within ASEAN which stand to benefit from China's growth and are less exposed to policy risk are:

1. Commodities, particularly steel and coal, as a result of China's infrastructure-led recovery

2. Companies involved in the China+1 strategy, benefitting from reconfiguration in global supply chains

3. Critical infrastructure providers, such as real estate, utilities, and infrastructure, aligning with the China+1 strategy

Near-term investable themes include:

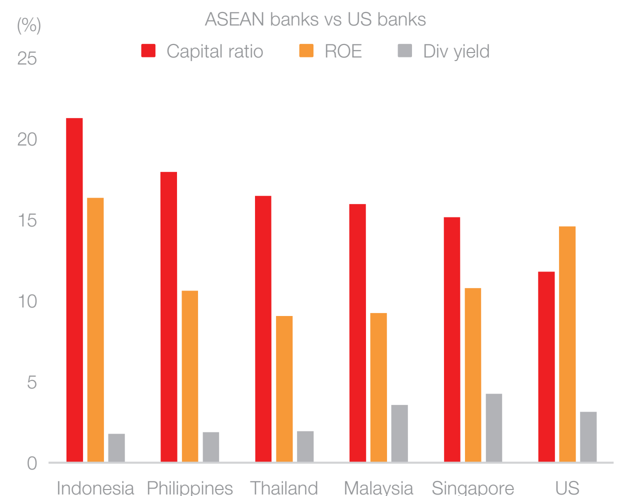
1. Indonesia elections where consumers and telcos will benefit from the pickup in election activities

2. Thai tourism revenue boosted by temporary visa waivers

3. Industrial names in Singapore benefitting from broad based recovery and capex spending in global travel and oil services activities

The higher-for-longer narrative should also continue to support banks' earnings in the region, given the positive economic outlook. Although banks may guide for slightly lower NIMs and higher provisions into 2024, those with strong balance sheets and franchises should still benefit from a better growth environment. Wealth management, financial inclusion, digital transformation, and cross-border trade and investment are key growth areas for the sector.

Favour Indonesia banks for ROE, Singapore banks for yields



Source: LSEG Datastream, DBS

India's macroeconomic backdrop remains favourable, with GDP growth expected to average 6-6.5% y/y in FY24. The economy has maintained good momentum, despite challenges such as below average rainfall, high oil prices, and uneven private sector investments. The nation has been one of the fastest-growing major economies globally and opportunities in Equities are often linked to this success. Key sectors contributing to this growth include technology, consumer goods, and services.

India's financial sector, including banks and non-banking financial institutions, play a crucial role in supporting economic activities. We see bright spots in well-established financial institutions as well as fintech companies innovating in the sector.

India has a robust IT sector that includes software services, IT consulting, and business process outsourcing (BPO). In this digital transformation era, companies involved in engineering and research and development (ER&D), as well as those benefitting from AI and digital tech spend should perform well.

A rising middle class and increasing urbanisation trends in India contribute to the growth of the consumer goods and services sector. This includes companies involved in FMCG, retail, and e-commerce. Recent trends in widening income inequality present opportunities for premiumisation in sectors like autos, beverages, food, apparel, tourism, and luxury retail.

Soft Landing

Global Rates
1Q24

A slowdown in US and Eurozone remains our core scenario. Expect rate cuts by both the Fed and European Central Bank in 2H24. There is a reasonable chance the Bank of Japan will abandon yield curve control, putting upward pressure on long-end yields. Less rate-cut prospects in Asia.

07.
Global Rates.

Eugene Leow
Strategist

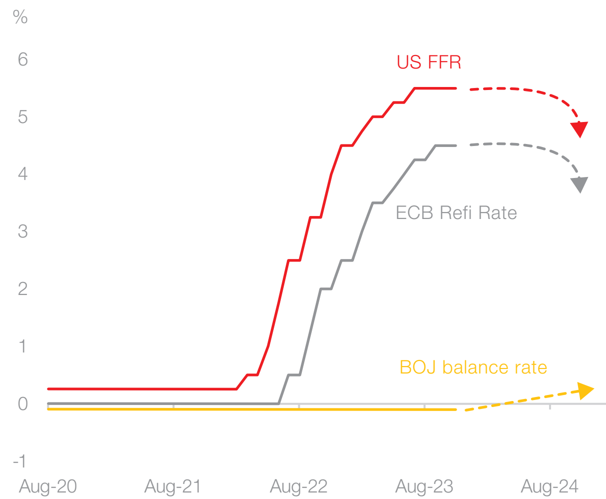
Across the G3, 2024 rates and curve direction will be contingent on the state of the global economy and stances of respective central banks. In a poly-crisis world, shocks tend to be more frequent. As such, considerable nimbleness and volatility in the market is to be expected. As things stand, we believe the Fed is done hiking. A cyclical recovery on electronics, manufacturing, and/or the Chinese economy may well provide a tailwind even as the services sector starts to cool. In the Eurozone, stresses are more acute and the ECB arguably faces greater pressure to loosen policy in 2024. Lastly, the BOJ remains by far the laggard in terms of normalising monetary policy. In level terms, aside from JPY rates, USD and EUR rates can be considered high. Where do we go from here?

A slowdown in 2024 (especially for US and Eurozone) remains our core scenario. Expect cuts by both the Fed and ECB in 2H24. We believe risks are balanced. Logically speaking, a moderate to severe recession would prompt sizable Fed cuts, inordinately benefitting shorter tenors (around 2Y). However, in the case of a soft landing, or if the economy achieves near-term reacceleration, Fed cuts may yet be delayed. Conversely, a sharp worsening of financial conditions could also prompt imminent Fed cuts. All three conditions were at play at different times in 2023. With this in mind, the 5Y tenor (which has risen significantly) may provide a better hedge against recession (Fed cuts) risks especially if the US proves resilient for much longer than anticipated. Conversely, while the 10Y and 30Y would likewise perform, we are a tad more cautious given unfavourable US fiscal dynamic.

Aside from US fiscal headwinds, the BOJ might potentially axe the YCC. Under current circumstances, it is difficult to gauge the overall liquidity adjustments from the BOJ's actions. Between defending the yield cap (currently at 1%), slowing the ascent in JGB yields, and defending the yen, shorter-term moves are not predictable. Instead, we emphasise that there is a reasonable chance the YCC will be abandoned in 2024. If that happens, 10Y JGB yields may settle into the 1-1.5% range, putting upward pressures on long-end DM yields. Lastly, there is also the added complication that the BOJ may hike rates even before the YCC gets dismantled - but we believe this will have limited spillover beyond intermediate-tenor JPY rates.

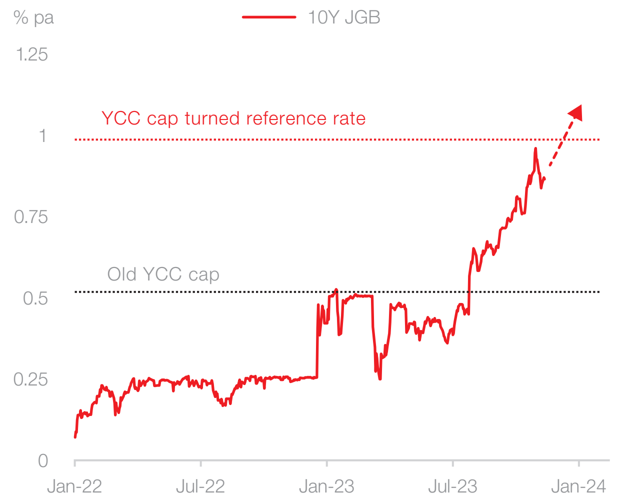
We maintain our steepening call for USD and EUR curves. Steepening may be delayed if the global economy holds up and delays cuts in late 2024 or beyond. The speed and extent of steepening is contingent on how hard of a downturn the market expects. Lastly, JPY rates across all tenors will likely be buoyant in 2024.

Divergence in G3 policy rates



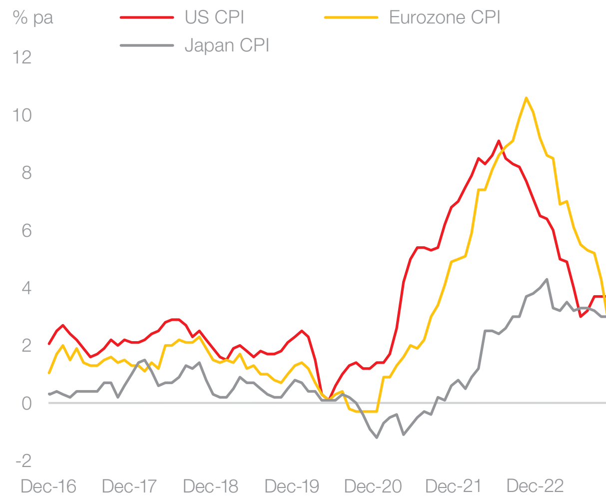
Source: Bloomberg, DBS

BOJ likely to continue normalising in 2024



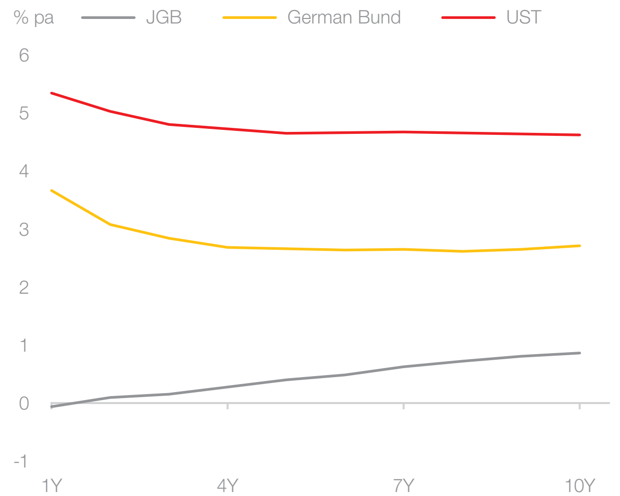
Source: Bloomberg, DBS

Inflation settling at higher than pre-pandemic levels



Source: Bloomberg ,DBS

Soft landing should drive curves another leg steeper in 2024



Source: Bloomberg ,DBS

Asia Rates

CNY rates: Funding conditions could stay tight

We hold a neutral stance on CNY Rates. At the front-end of the curve, money-market rates and 1-2Y swap rates appear too high relative to the policy rate (PBOC 7D Reverse Repo) and seem out of line with the subdued strength of economic recovery. However, policymakers could keep funding conditions tight for some time to support the currency and lower capital outflow risks. Therefore, while we expect the front-end of the curve to be lower, it is challenging to forecast the timing of such a potential move. Policymakers also appear keen to support the economy with more fiscal stimulus; this could mean that 2024 fiscal deficit and net bond issuances could be larger than currently expected. If policy rates are also cut in 2024, the curve is biased to steepen. Having seen the peak of the Fed hike cycle, China-US rate differentials are expected to widen further.

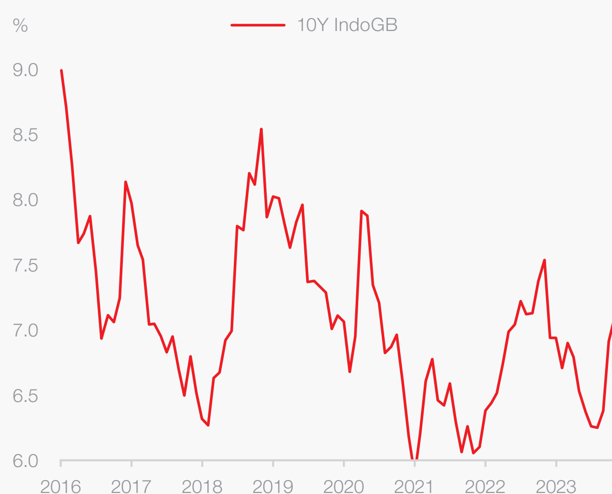
1Y China swap rates appear too high

Source: Bloomberg, DBS

IDR rates: External environment to turn more benign

The external environment is likely to turn more benign for IndoGB in 2024. Fed rates are expected to have peaked and the next Fed cut cycle could commence in 3Q, leading to strong foreign demand for high-beta EM Bonds, such as IndoGBs. Potential easing in external financial conditions could also mean that the rupiah would be more stable, giving BI the flexibility to cut policy rates in 2H and allow IndoGB yields to fall meaningfully. Indonesia's macro fundamentals remain solid, with domestic inflation well-anchored and fiscal position strong. Current account could stay in a small deficit position, but we expect portfolio inflows to be more than sufficient to offset the deficit. The one risk we see for IndoGBs is that some investors could rebalance their portfolios in favour of buying more IGB Bonds, which could be at the expense of their IndoGB holdings.

10Y IndoGBs could rally on a more benign external environment

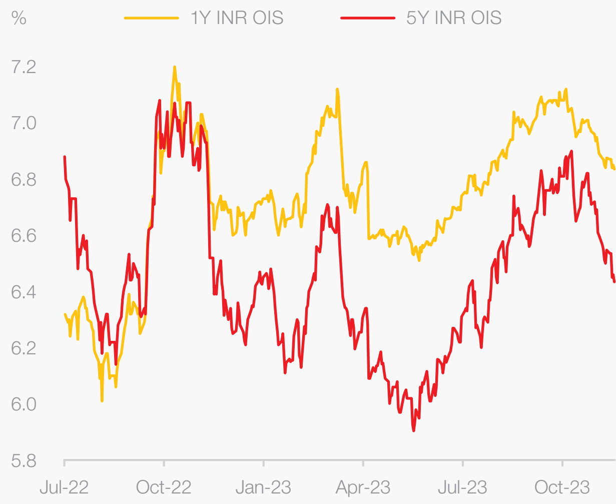


Source: Bloomberg, DBS

INR rates: Bullish around bond index inclusion

We hold a receive bias on INR swaps and bullish stance on IGBs. The worst of domestic inflation worries are likely behind us. Assuming no renewed supply shocks, forward inflation prints are expected to remain low on favourable base effects. Real rates are therefore expected to rise and drive expectations for the next RBI cut cycle, which we expect to commence in 3Q24. At this point, we believe that swap markets are under-pricing the extent of rate cuts for the next cut cycle. We are also bullish on IGBs on account of the JP Morgan GBI-EM Global Diversified inclusion process beginning in Jun 2024, which will bring substantial foreign inflows and support bond sentiments. Within the region, IGBs offer high yields at relatively low yield and currency volatilities, making it an attractive investment. Index inflows could be larger than predicted as we expect investors to favour going overweight.

Next RBI cut cycle is still under-priced

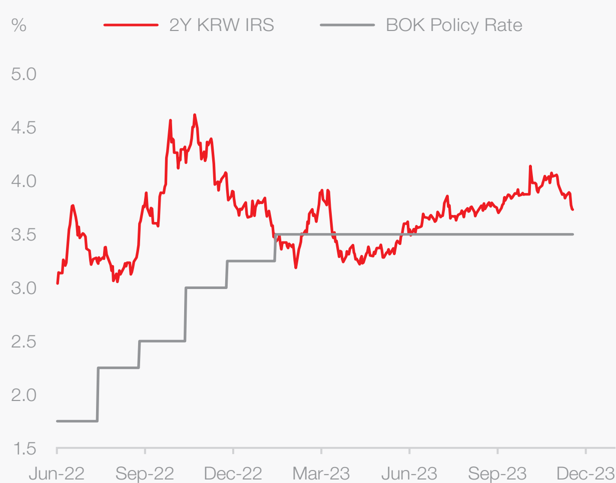


Source: Bloomberg, DBS

KRW rates: First to cut policy rates

We are bullish on KRW swaps, but timing the rally is challenging owing to KRW rates' typically-high beta vis-à-vis US and global rates. Back in 2021, BOK was one of the first to begin normalising rates in the region. We expect the next BOK cut cycle to commence in 2Q24, earlier than its peers. Besides rate cuts, another bullish trigger stems from the potential inclusion of KTBs into FTSE Russell's WGBI Index, which could drive repricing for lower long-term KTB yields. Fiscal policy continues to be conducted prudently and we expect bond supply pressures to be benign. As household leverage continues to rise at a rapid pace, there is a chance that the BOK will hike rates further in order to dampen domestic demand and rein in financial stability risks.

Next BOK cut cycle is also under-priced

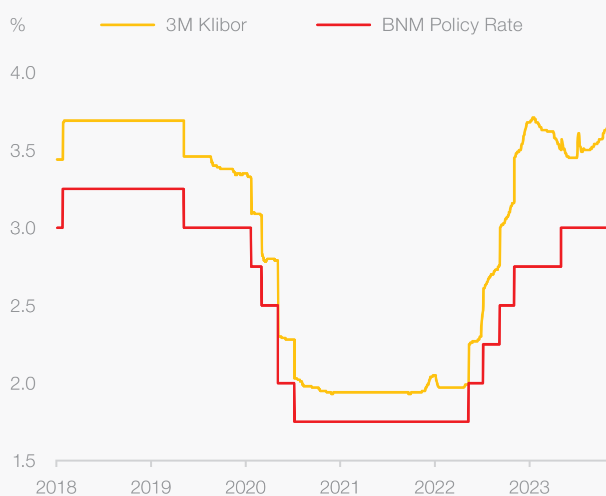


Source: Bloomberg, DBS

MYR rates: Risks around subsidy rationalisation

We hold a neutral stance on MYR Rates. The 2024 Budget showed a larger than expected consolidation on the fiscal front, which was a slight positive surprise for the bond supply outlook. However, a better fiscal picture was achieved partly on the back of delayed subsidy rationalisation, which could create possible inflationary impulses and prevent BNM from cutting rates alongside the rest of the region. If ringgit weakness also carries over into 2024, that would require BNM to maintain interest rate defences and further reduce the scope to cut rates. Our forecast is for BNM to hold the policy rate at 3.00% through the whole of this year even though the majority of regional central banks are expected to cut rates. The lack of rate cuts will likely mean that there is relatively less potential for MYR rates to rally.

Klibor-policy rate spread is wide in Malaysia

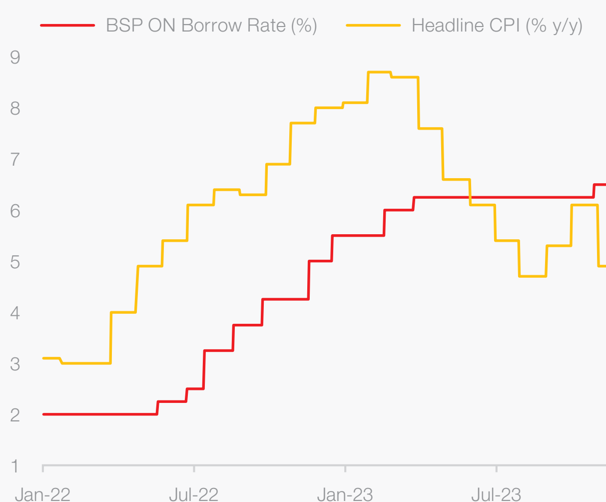


Source: Bloomberg, DBS

PHP rates: Likely to underperform

We hold a neutral stance on RPGB. Our forecast is for policy rates to peak and BSP would begin cutting rates in 3Q. The key worry is that upside inflation risks carry over into 2024, forcing BSP to continue with rate hikes. Higher duration supply in 2024 is also a concern and it is unclear if Bond demand would sufficiently step up to absorb the larger supply. RPGBs are also likely to underperform regional bonds due to traditionally low correlations to US rates (which is expected to fall in 2024).

Inflation in Philippines stickier than expected

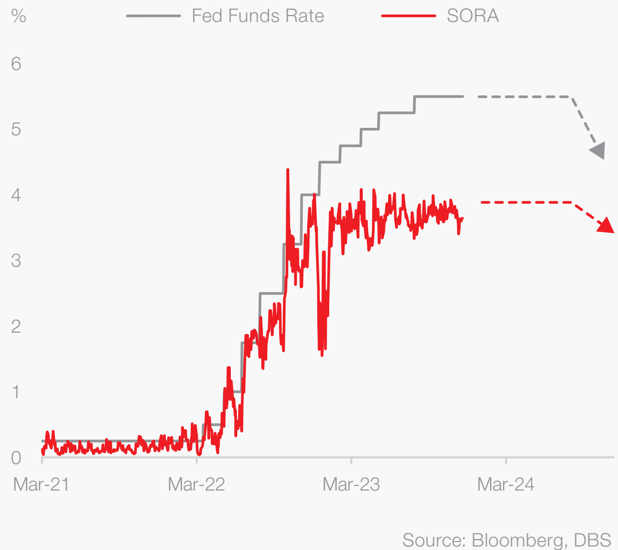


Source: Bloomberg, DBS

SGD Rates: Uneven path lower

The trajectory of SGD rates largely depends on how the global economy will adjust to high levels of interest rates across the developed world. We think that a soft landing is still the most likely scenario with the US economy's resilience through 1H24 before cooling inflation allows the Fed to start measured cuts. If global inflation cools, Singapore's price pressures will also ease. The MAS expects core inflation at 2.5-3.5% in 2024. Excluding the impact of the GST hike in Jan, this will be in the 1.5-2.5% area. If this plays out, MAS's version of higher-for-longer may see no shifts in the SGDNEER band for some time, with any easing closely linked to the Fed's cycle. To this end, SORA has likely peaked and will be rangebound before a more meaningful decline in 2H24 as the Fed cuts. However, the passthrough from Fed cuts into lower SORA is likely less than 100%. The effect will likely be the reverse of the hike cycle we have seen - where SORA did not track SOFR all the way above 5%. Instead, the discount in SORA can be attributed to SGDNEER appreciation expectations and more flush SGD liquidity conditions. This discount in SORA will likely narrow when economic conditions turn more challenging, and when the market speculates on a flatter NEER slope.

SORA will drift lower in 2H24

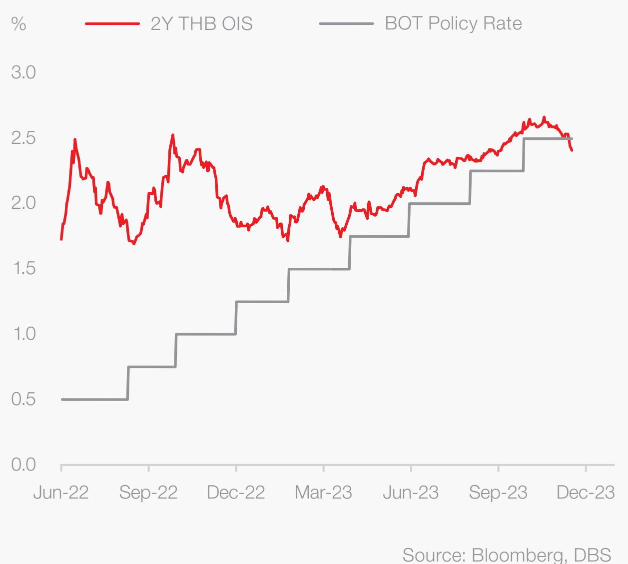


Source: Bloomberg, DBS

THB rates: Less scope to rally

Within the region, we are relatively bearish on THB swaps and ThaiGBs in 2024. The starting level of THB rates are very low compared to other regional rate markets, implying that THB rates would rally by a lesser degree during the next global rates downcycle. Bond investors appear to be concerned with the size of government spending in the 2024 Budget, especially with regards to cash handouts which could negatively impact public debt levels, size of bond issuances, and the ratings outlook. BOT could also stay hawkish for an extended period of time as the associated increase in consumption could spur greater inflation risks. So far, the post-pandemic recovery in tourism has been weaker than expected, mainly due to the slow normalisation of Chinese tourist arrivals. If oil prices rise in 2024, current account could come under pressure again and weigh on the total returns of ThaiGBs.

Relatively less scope for Thai swaps to rally



Source: Bloomberg, DBS

Rates forecasts

		2024				2025			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
US	3M SOFR OIS	5.38	5.25	4.75	4.38	3.88	3.38	3.38	3.38
	2Y	4.85	4.70	4.50	4.20	3.70	3.60	3.60	3.60
	10Y	4.70	4.50	4.30	4.10	4.00	4.00	4.00	4.00
	10Y-2Y	-15	-20	-20	-10	30	40	40	40
Japan	3M TIBOR	0.12	0.20	0.20	0.20	0.20	0.20	0.30	0.30
	2Y	0.15	0.20	0.25	0.30	0.40	0.40	0.40	0.40
	10Y	1.20	1.20	1.20	1.20	1.10	1.00	1.00	1.00
	10Y-2Y	105	100	95	90	70	60	60	60
Eurozone	3M EURIBOR	4.00	3.85	3.35	2.90	2.50	2.50	2.50	2.50
	2Y	3.20	3.10	2.95	2.70	2.50	2.50	2.50	2.50
	10Y	2.70	2.60	2.55	2.50	2.50	2.50	2.50	2.50
	10Y-2Y	-50	-50	-40	-20	0	0	0	0
Indonesia	3M JIBOR	6.95	6.70	6.20	5.70	5.40	5.40	5.40	5.40
	2Y	6.90	6.60	6.00	5.50	5.30	5.30	5.30	5.30
	10Y	6.90	6.60	6.40	6.30	6.20	6.20	6.20	6.20
	10Y-2Y	0	0	40	80	90	90	90	90
Malaysia	3M KLIBOR	3.65	3.40	3.40	3.40	3.40	3.40	3.40	3.40
	3Y	3.50	3.40	3.35	3.35	3.35	3.35	3.35	3.35
	10Y	3.85	3.80	3.75	3.65	3.65	3.50	3.50	3.50
	10Y-3Y	35	40	40	30	30	15	15	15
Philippines	3M PHP ref rate	6.50	6.50	6.00	5.50	4.90	4.80	4.80	4.80
	2Y	6.20	6.00	5.85	5.30	4.80	4.70	4.70	4.70
	10Y	6.60	6.35	6.10	5.90	5.45	5.35	5.35	5.35
	10Y-2Y	40	35	25	60	65	65	65	65
Singapore	3M SORA OIS	3.60	3.52	3.25	3.08	2.78	2.58	2.58	2.58
	2Y	3.40	3.35	3.25	3.15	2.80	2.70	2.70	2.70
	10Y	3.20	3.00	2.80	2.70	2.70	2.70	2.70	2.70
	10Y-2Y	-20	-35	-45	-45	-10	0	0	0

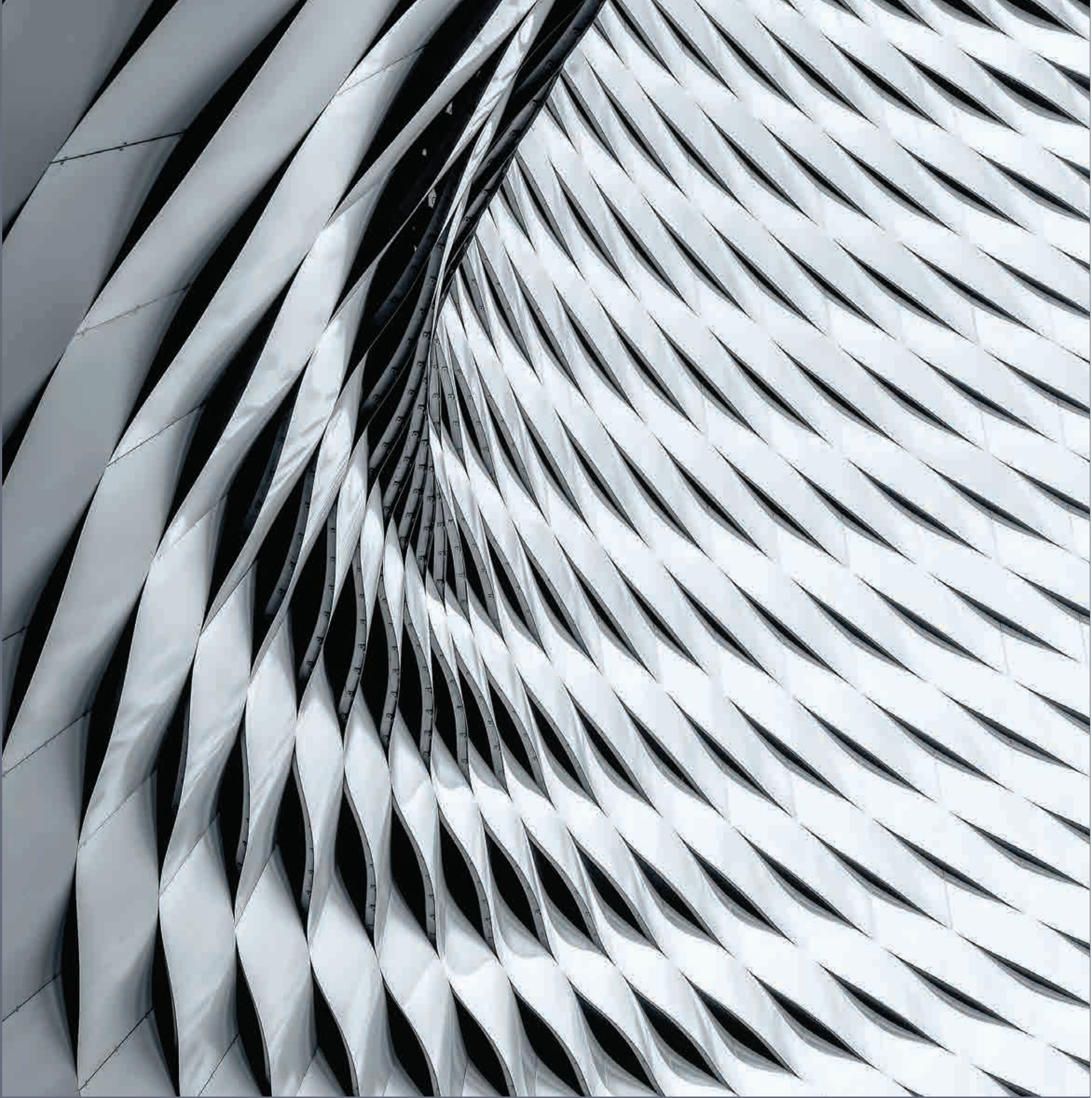
%, eop, govt bond yield for 2-year and 10-year, spread bps.

Source: CEIC, Bloomberg, DBS

		2024				2025			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Thailand	3M BIBOR	2.65	2.65	2.65	2.65	2.65	2.65	2.65	2.65
	2Y	2.60	2.60	2.50	2.50	2.50	2.50	2.50	2.50
	10Y	3.30	3.25	3.10	3.10	2.90	2.90	2.90	2.90
	10Y-2Y	70	65	60	60	40	40	40	40
Mainland China	1Y LPR	3.45	3.45	3.45	3.35	3.25	3.15	3.15	3.15
	2Y	2.40	2.40	2.45	2.45	2.50	2.50	2.60	2.60
	10Y	2.60	2.60	2.65	2.65	2.70	2.70	2.80	2.80
	10Y-2Y	20	20	20	20	20	20	20	20
Hong Kong, SAR	3M HIBOR	5.28	5.20	4.70	4.33	3.83	3.33	3.33	3.33
	2Y*	4.65	4.50	4.30	4.10	3.60	3.50	3.50	3.50
	10Y*	4.60	4.40	4.20	4.00	3.90	3.90	3.90	3.90
	10Y-2Y	-5	-10	-10	-10	30	40	40	40
Korea	3M CD	3.75	3.45	3.20	2.95	2.70	2.70	2.70	2.70
	3Y	3.70	3.30	3.00	2.80	2.75	2.75	2.75	2.75
	10Y	3.90	3.75	3.60	3.40	3.30	3.30	3.30	3.30
	10Y-3Y	20	45	60	60	55	55	55	55
India	3M MIBOR	7.15	7.10	6.60	6.10	5.60	5.60	5.60	5.60
	2Y	7.15	6.70	6.10	5.60	5.60	5.60	5.60	5.60
	10Y	7.35	7.30	7.20	7.10	7.00	7.00	7.00	7.00
	10Y-2Y	20	60	110	150	140	140	140	140

%, eop, govt bond yield for 2Y and 10Y, spread bps. *swap rates.

Source: CEIC, Bloomberg, DBS



Pause Means Play

Global Credit
1Q24

Bonds outperform Cash after a rate pause. Continue to favour Investment Grade Bonds over High Yield; sweet spot remains with A/BBB Credit in the 3-5Y duration segment. Opportunities lie within bank capital instruments, high quality Emerging Market Credit, and Local Currency Bonds.

08. Global Credit.

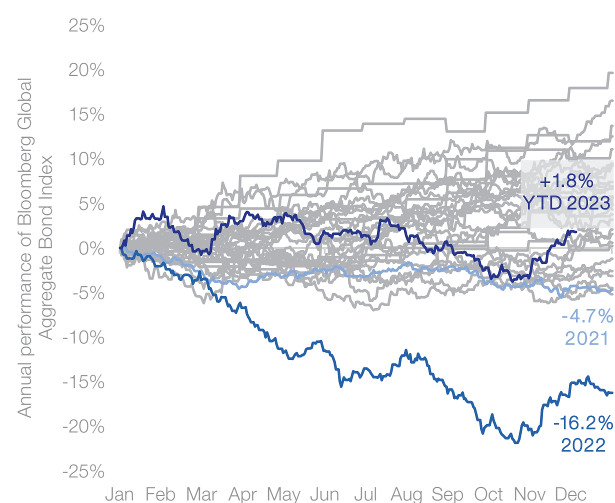
Daryl Ho, CFA
Strategist

Goh Jun Yong
Analyst

It was supposed to be the year for Bonds. Investors entered 2023 with no shortage of reasons to be risk-averse, with (a) the US Federal Reserve maintaining its hawkish push even after a 50 bps hike in Dec 2022, (b) early signs of cracks in the financial system with UK pension funds and US mid-sized banks nursing deep paper losses on their balance sheet yield-assets, and (c) no signs of an end to the Russia-Ukraine conflict. Since then, not only did the Fed raise rates by another 100 bps, several banks on both sides of the Atlantic failed, and a new front of war developed in the Middle East. Moreover, recessionary expectations in 2023 rose to the highest levels since the onset of the Covid pandemic. Just on these developments alone, one would have thought that Bonds would have been the standout performer for the year.

Expectations far from reality. Yet in stark contrast to market expectations, it was risk markets that performed incredibly. The US S&P and NASDAQ indices – led by the performances of the large-cap "Magnificent Seven" stocks – saw expectation-defying gains. HY Bonds not only paid huge coupons; spreads had on aggregate tightened back in line with their 5Y averages. Even Bitcoin, the infamously volatile cryptocurrency, saw a c.150% increase YTD in defiance of regulatory risk. On the flipside, "safer" Fixed Income instruments – represented by the Bloomberg Global Aggregate Bond Index – faced a YTD gain of c.1.8%, underperforming Cash. Considering that the index already suffered declines of -4.7% in 2021 and -16.2% in 2022, mean reversion hardly came to the rescue for Fixed Income investors in 2023.

Third time was hardly the charm for Bonds



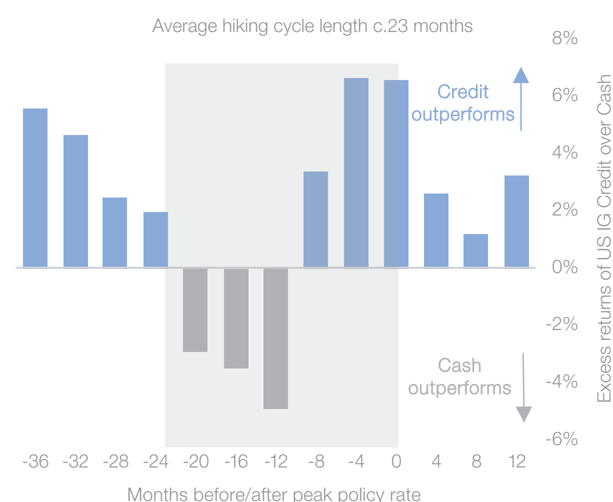
Source: Bloomberg, DBS. Data since 1990

Duration was the danger. Peeling back the layers of performance attribution showed that a lot of the decline was contributed by duration-related losses, especially during the sharp steepening in the yield curve at the turn of 2H23. We had highlighted this risk in the 2023 3Q and 4Q Global Credit outlook pieces, and had advocated a short-duration, high quality credit portfolio termed the Liquid+ Strategy for the whole of the year in view of these concerns we had acknowledged. Despite generally tepid performances in Fixed Income in 2023, the strategy did ultimately offer investors good risk-adjusted positive returns for the year.

Where do we go from here? We believe that the dearth of demand for Bonds was amplified not so much by the gains had on Equities, but because of the allure of Cash. After all, for income-generating allocations, it is difficult to imagine why one would move out of the certainty offered by Cash – into Bonds – when yield differentials are insignificant. Now while that may have been true for the years 2022-2023, we believe more serious considerations for Bonds need to be had in 2024 now that the long-awaited Fed policy pause is coming into effect.

Cash has already had its day. We looked at performance data since 1984 comparing the 1Y forward excess returns of US IG Credit over Cash both before and after the policy rate peaks. What we noticed is that Cash is the better bet early in the hiking cycle – 12 to 20 months before the pause. However, investors need not wait for rates to peak before Credit starts to outperform. This is because markets usually move in advance of the policy cycle; funds flow before the end of the policy cycle in order to lock in higher yields for longer. Our analysis shows that Credit outperformance can even begin as early as four to eight months before the cycle ends. Having seen cash returns surpass Credit in 2022-2023, following a typical cycle implies that outperformance in Credit is no longer difficult to achieve from 2024 onwards.

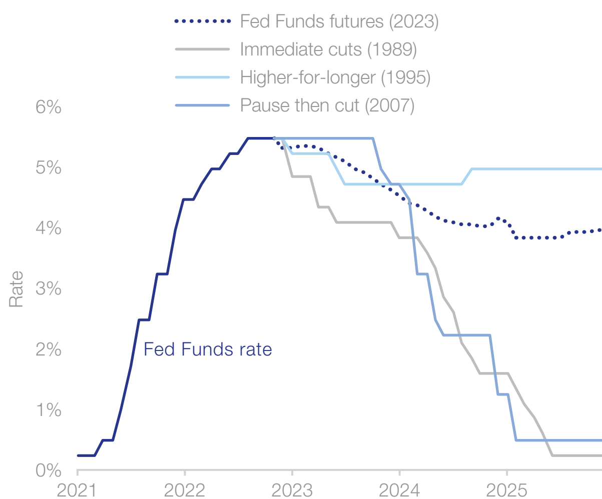
Credit starts to outperform Cash before the cycle ends



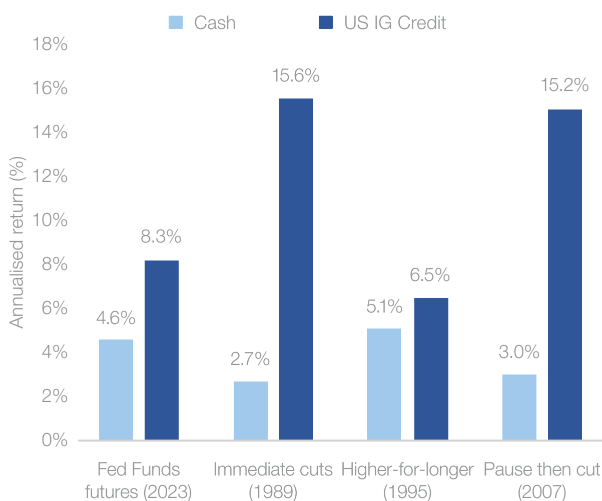
Source: Bloomberg, DBS
Note: Data since Dec-1984. Hiking cycles commence from the first hike in the cycle and ends when it reaches peak policy rate for the cycle.

Performing a scenario analysis with various rate trajectories. No doubt, the choruses of "higher-for-longer" raise the notion that yields on Cash may still offer a compelling alternative to Bonds for a long while to come. As such, to anticipate the performance of Credit vs Cash in the years ahead, we projected the possible pathways of the Fed Funds rate over the next three years under four scenarios mimicking historical episodes, including the pathways of (a) immediate cuts – following the 1989 pause, (b) higher-for-longer rates – mimicking the 1995 pathway, (c) pause then cut – such as in 2007, as well as (d) using the current Fed Funds futures projections. We then compared the expected annualised returns of Credit vs Cash based on the anticipated yield movements.

Under various historical pathways for the Fed Funds rate…



…IG Credit shows a high likelihood of outperformance over Cash



Source: Bloomberg, DBS

Assumptions: (a) Fed Funds rate upper bound does not drop below 0.25%, (b) US IG performance proxied by the Bloomberg US Corporate IG Index, (c) parallel shifts in the yield curve only, (d) credit spreads remain unchanged.

Credit outperforms Cash over various scenarios. Notably, Credit outperforms across all these various precedent scenarios after a pause as illustrated above. It is remarkable to consider that even in the higher-for-longer scenario following the 1990s pathway, Credit still ekes out marginal gains over Cash.

Credit also performs well under stress testing. With much uncertainty around the investment climate, investors may still feel that taking neither duration nor credit risks in Cash is preferred, given that return of capital is now a greater priority than return on capital. However, given that starting yields on broad swathes of the short-duration high-quality credit markets are now yielding close to 6%, it would take very extreme cases of rate rises and/or spread widening for an investor to end up with losses over a one-year horizon.

By our estimates, interest rates need to rise by more than 200 bps, and credit spreads concurrently widen more than 80 bps, for short-duration IG Credit to run into losses over a one-year timeframe. This in itself is an unlikely scenario. Typically, widening spreads are symptomatic of a weakening economy, which negates the need for higher rates. Conversely, if rates do push higher because of strong growth, credit spreads should remain well-behaved. It would be abnormal to see a prolonged period of both higher rates and wider spreads.

Credit faces losses only under extreme scenarios

Interest rate change (columns); Credit spread change (rows)

	-100bp	-50bp	0bp	+50bp	+100bp	+150bp	+200bp	+250bp
-60bp	8.7%	7.8%	6.8%	5.8%	4.9%	3.9%	3.0%	2.0%
-40bp	8.3%	7.4%	6.4%	5.5%	4.5%	3.6%	2.6%	1.6%
-20bp	8.0%	7.0%	6.0%	5.1%	4.1%	3.2%	2.2%	1.3%
0bp	7.6%	6.6%	5.7%	4.7%	3.7%	2.8%	1.8%	0.9%
+20bp	7.2%	6.2%	5.3%	4.3%	3.4%	2.4%	1.4%	0.5%
+40bp	6.8%	5.8%	4.9%	3.9%	3.0%	2.0%	1.1%	0.1%
+60bp	6.4%	5.5%	4.5%	3.6%	2.6%	1.6%	0.7%	-0.3%
+80bp	6.0%	5.1%	4.1%	3.2%	2.2%	1.3%	0.3%	-0.7%
+100bp	5.7%	4.7%	3.7%	2.8%	1.8%	0.9%	-0.1%	-1.0%
+120bp	5.3%	4.3%	3.4%	2.4%	1.4%	0.5%	-0.5%	-1.4%

Source: Bloomberg, DBS

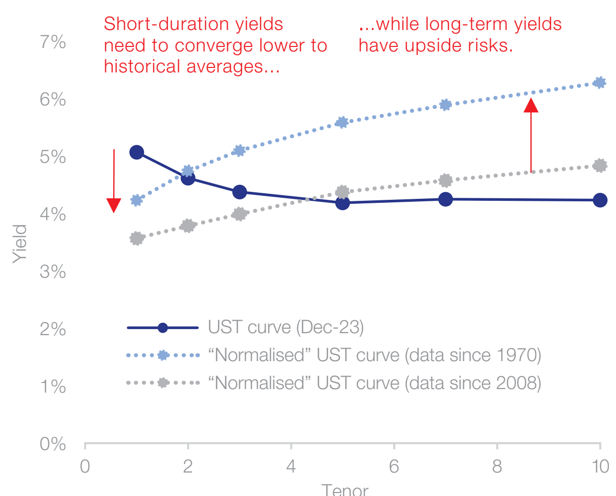
Bonds give more optionality after a rate pause. Most importantly, Bonds now offer more optionality than Cash after a rate pause as reinvestment risk now exceeds duration risk. A policy pause implies that the future direction of interest rates is more likely to be flat/down than up. So, if rates (a) stay higher-for-longer, short-duration IG Credit would earn a higher spread than Cash, while (b) a rate-cutting cycle would see potential for capital gains in Bonds – optionality that is not present in Cash.

Why not then just lock in long-term Bonds for this optionality? The issue becomes more complicated when one considers not whether to lock in duration, but how far to take duration risk before it eclipses potential returns. This brings us to consider what a "normalised" yield curve should look like under more typical conditions where (a) the curve is upward sloping, (b) policy rates are close to neutral, and (c) inflation expectations are well-anchored. Approximating the shape of this "normalised" yield curve allows us to appreciate the risks within each duration bucket.

How does one estimate a "fair value" for yield? At every point on the yield curve, the nominal yield of a t-year bond could be represented by a summation of the (i) real neutral rate of interest, (ii) inflation expectations over period t and (iii) a term premium that approximates the risk of carrying Bonds for term t. Markets understand that at some level, the post-pandemic environment of zero rates is an anomaly, and some reversion to historical levels had to eventually occur. We therefore used long-term averages of each of these three components using both (1) data since 1970 (for long-term comparisons) and (2) data since 2008 (should the post-GFC secular stagnation environment prevail in the years ahead) to observe where mean reversion could take us.

Under both instances, the "normalised" yield curves are upward sloping, and it is interesting to note that front-end yields are still much higher than historical

Front-end yields have the greatest premium to historical averages

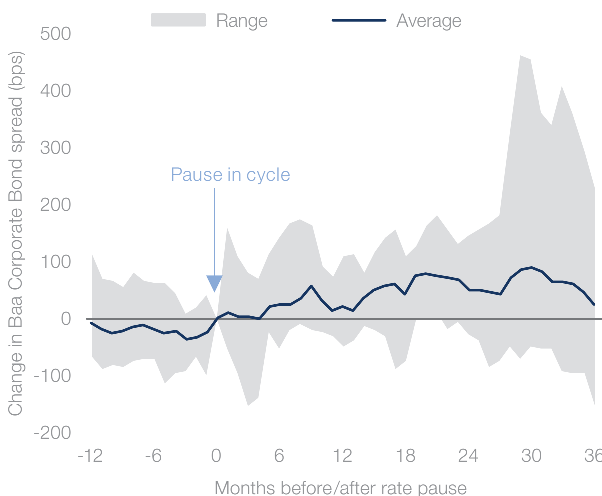


Source: Bloomberg, DBS

averages, while longer-term yields could see more upside risk should mean reversion occur. The sweet spot for duration seems to remain in the 3-5Y segment of the curve.

Take caution on credit risks. Investors should also remain cautious with credit risks following a rate pause. While it is intuitive to think that headwinds should abate after a pause in the cycle, the data seems to suggest that credit risks can accumulate beneath the surface even after a peak in rates. Looking at aggregate spread data since 1972, we note that credit spreads on average continue to widen after the pause, likely due to stresses in companies adjusting to higher funding costs and tighter lending conditions. This leads us to continue to favour IG over HY for 2024, with the A/BBB segment remaining the sweet spot for Credit.

Credit spreads widen after a rate pause



Source: Moody's Investors Service, St. Louis Fed, DBS
Note: Data since 1972

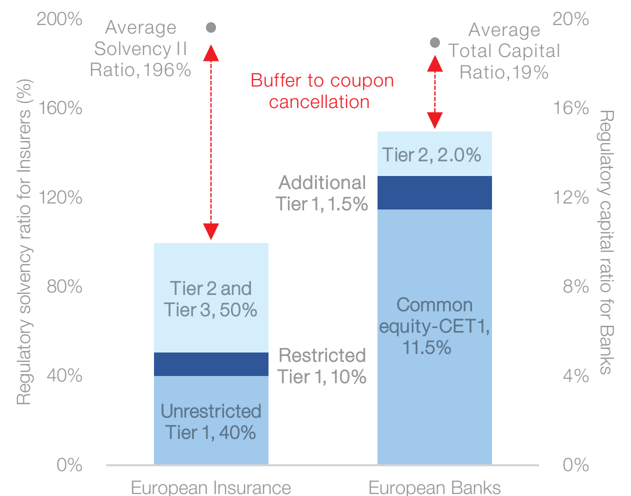
Bright spots in Credit. At this juncture, there are a couple of bright spots in Credit worth highlighting:

A. AT1 Bank Capital instruments

Sentiment around bank capital paper took a huge hit earlier in 2023 from the fallout of high-profile bank collapses in both the US and Switzerland, with investors starting to believe that subordinated AT1 instruments should be more Equity- than Bond-like given the risks involved. While there is truth to this, we also believe that since such bank collapses did not lead to worldwide financial dysfunction, such capital instruments did serve their purpose of preventing idiosyncratic risks from becoming systemic.

At present, financial contingent capital instruments

European insurers have large capital buffers



Source: Bloomberg, DBS

are still yielding close to 9%, with valuations still wide of corporate equivalents; implying that there could be value in this space. Fundamentally, many European banks are still maintaining adequate capital buffers against regulatory requirements, which means that the sector remains in good health. We would however, maintain a preference for quality IG issuers even for financials, given that we could be late in the credit cycle.

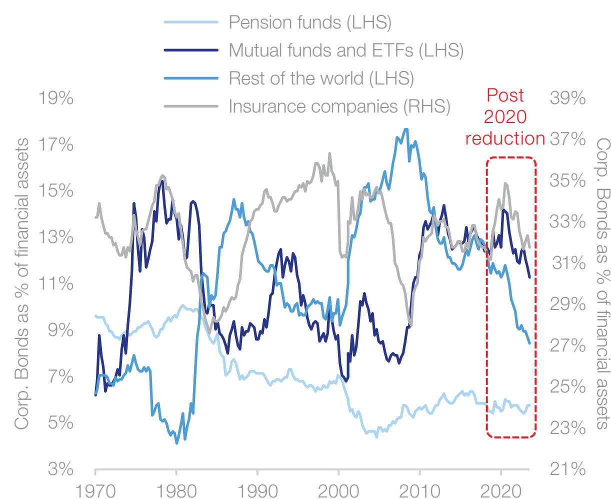
B. EM Credit and Local Currency Bonds

A Fed pause also usually marks the end of sustained USD strength. As such, green shoots are likely to emerge in local currency EM Bonds, as USD funding tightness abates while potential alpha comes in the form of FX gains on top of their high yields. In Hard Currency Credit, we also believe that there are opportunities in high quality EM Bonds in Asia, as well as IG commodity exporters in the Middle East/ LatAm that will continue to benefit from stable global demand for materials and energy.

Bond allocations could turn favourable in 2024. Finally, a structural tailwind for Credit could come in the form of revised portfolio allocations from real money accounts around the world. We note that asset managers have been reducing portfolio allocations to Bonds in the low-yielding post-pandemic years. The sharp rise in yields post hiking-cycle could see higher allocations and overweight calls return for Fixed Income, resulting in a tailwind of fund flows in support of Bonds at the turn of the year.

In summary, we believe that the coming Fed pause gives confidence to deploy Cash into Bonds. Investors should continue to take the opportunity to switch from Cash to short-term Credit; the sweet spot remaining with A/BBB Credit in the 3-5Y duration segment. Certain bright spots in Credit also remain with (a) bank capital instruments that still trade fairly wide, and (b) high quality EM Credit and Local Currency Bonds that could benefit under diminishing USD strength.

Reversion of portfolio allocations to Bonds could be on the cards



Source: Federal Reserve Board, DBS

A Year Of Normalisation

Global Currencies 1Q24

US to lose momentum over the course of the year as central banks normalise monetary policies. Export recovery in Asia favours Asian currencies, moderating depreciation pressure on the JPY and CNY.

09. Global Currencies.

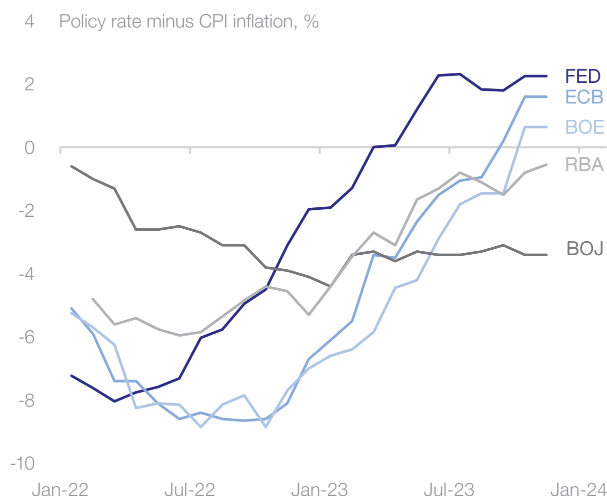
Philip Wee
Strategist

Chang Wei Liang
Strategist

Developed Market currencies could keep consolidating in 2024 with a downside bias for the USD. Monetary policies across the global central banks have largely aligned. They believe that inflation will remain sticky amid a highly uncertain economic outlook into early 2024. Until they are convinced that inflation is on a sustained path to target, central banks want rates to stay elevated for an extended period and will keep countering the market's impatience in bringing rate cuts forward. Over the course of the year, we expect the USD to lose momentum from central banks normalising policy. Japan will probably start in 2Q by abandoning its negative interest rate policy and YCC framework. Conversely, when other central banks are ready to declare victory on inflation, the Fed should lead the way in reducing real interest rates. Unfortunately, 2024 is fraught with uncertainties and risks. The IMF highlighted three challenges for the economic landscape – tougher global financial conditions, rising geopolitical fragmentation, and costly climate changes. The ongoing war between Ukraine-Russia and Israel-Hamas may collide with the presidential elections in Ukraine (Mar), Russia (Mar), and the US (Nov).

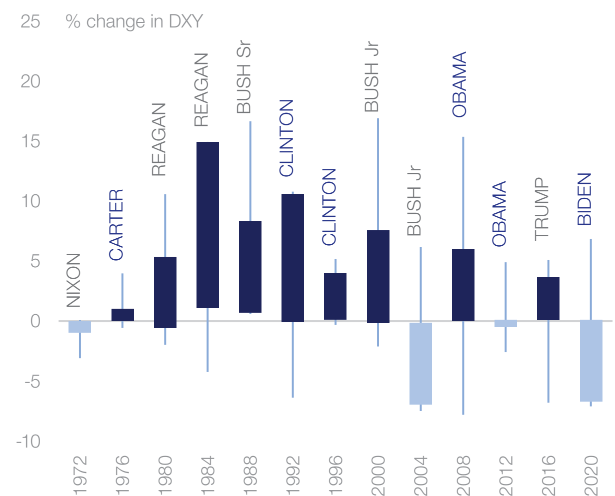
Asian currencies could start 2024 with some volatility from China doubling down on threats ahead of Taiwan's presidential and parliamentary elections in Jan. For now, we assume no miscalculations that could reverse efforts by Washington and Beijing to prevent competition from turning into conflict. However, North Korea remains an ongoing threat in the Korean peninsula with its artillery, nuclear, cyberattack, and spy satellite capabilities. Barring any geopolitical mishaps in Northeast Asia, the second half of 2024 could favour Asian currencies on an export recovery amid rate cuts by the Fed and global central banks ending depreciation pressure on the JPY and the CNY. Southeast Asia should stand out with resilient domestic demand amid the drag on G7 economies from past hikes. Favourable outcomes at the Indonesian and Indian elections would encourage foreign investors to proceed with their "China Plus One" strategies in these countries. Newly elected leaders in the Philippines, Malaysia, and Thailand are also keen to attract foreign direct investments into their countries. Towards the end of the year, risk appetite could subside if uncertainties increase into the US Presidential Elections in Nov.

Fed, ECB, and BOE can afford to pause on positive real rates with RBA and BOJ lagging



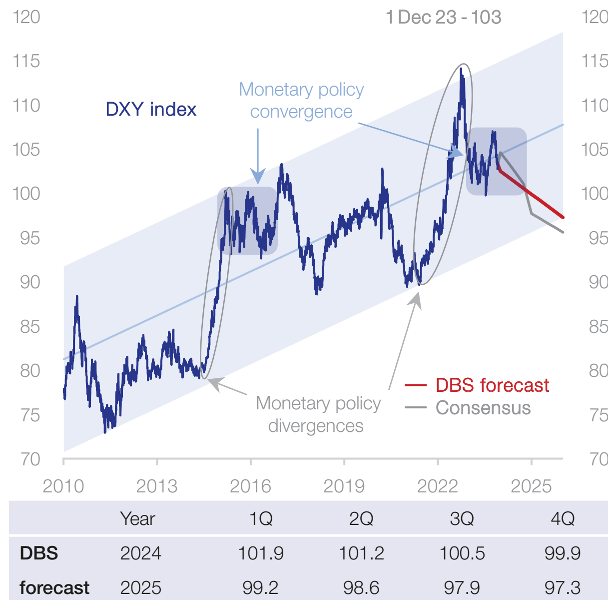
Source: Bloomberg DBS

Two-way USD risks witnessed in the previous two US Presidential election years



Source: Bloomberg DBS

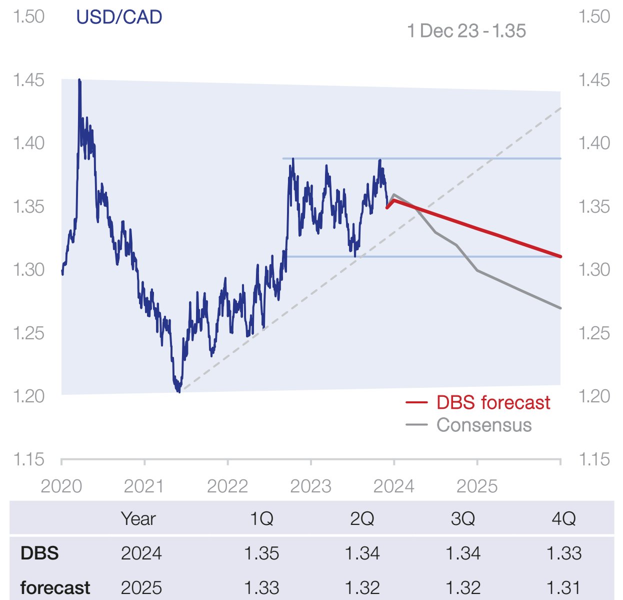
USD Index has been consolidating on monetary policy converges in the G10



	Year	1Q	2Q	3Q	4Q
DBS	2024	101.9	101.2	100.5	99.9
forecast	2025	99.2	98.6	97.9	97.3

Source: Bloomberg DBS

Canadian Dollar has been in a 1.31-1.39 range since Sep 2023



	Year	1Q	2Q	3Q	4Q
DBS	2024	1.35	1.34	1.34	1.33
forecast	2025	1.33	1.32	1.32	1.31

Source: Bloomberg DBS

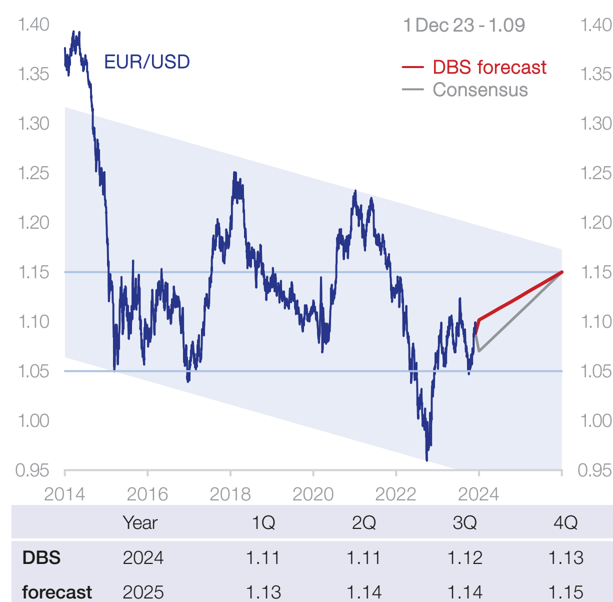
USD to lose momentum when Fed confirms end of hiking cycle. DXY failed to break out of its 101-106 range set in the first half of 2023. The assault at the floor on disinflation hopes (Jun: 3% y/y) evaporated at 99.6 in mid-Jul. The subsequent push above the ceiling on strong GDP growth (3Q23: 4.9% q/q saar) was aborted at 107.3 in October. Throughout 2023, the US Federal Reserve countered the market's push to discount rate cuts with its higher-for-longer mantra. Expect both parties to keep moving forward and backward on the same issues into the first half of 2024. By mid-year, inflation's path towards the 2% target should gain traction amid a soft landing for the US economy. If so, we expect the Fed to normalise monetary policy by reducing real interests, starting with a 100 bps of cuts in 2H24 to bring the Fed Funds rate off its high, currently at 5.25-5.50%. We cannot rule out a stronger USD; the greenback will reprise its haven role if the Fed cuts rates aggressively on any shocks to the global economy/financial market, or if inflation keeps rising to push rates higher.

In 2024, we expect USD/CAD to keep consolidating between 1.31 and 1.39. This range was established after USD/CAD peaked at 1.40 in Oct 2022. As of 24 Nov, the CAD depreciated 1% YTD vs USD, significantly less than the 4.7% and 3.7% declines in the NZD and the AUD, respectively. Barring unforeseen shocks, USD/CAD is unlikely to spike to 1.45 like it did during the currency war in 2015 or the Covid outbreak of 2020. During the previous US tightening cycle, USD/CAD was range-bound with a downside bias after the Fed's last hike in Dec 2018 and during its subsequent three cuts in Jul-Oct 2019. In 2024, consensus expects the BOC to match the Fed in lowering rates by 100 bps on CPI inflation declining back into the 1-3% target from 2Q24. Until this materialises, the CAD is at risk to the troubled housing sector. The IMF singled Australia and Canada as the top countries facing the greatest risk of defaults from steeper mortgage payments. BOC said that 60% of fixed-rate mortgage holders must renew their mortgages by end-2026. Homeowners could also face more pressure as weak economic growth persists and increase the unemployment rate at a pace that exceeds expectations.

EUR should consolidate again in 2024. EUR/USD spent the first 11 months of 2023 fluctuating between 1.04 and 1.13 from monetary policies converging in the Euro Area and US. With inflation off their highs, the ECB and US Federal Reserve paused their hiking cycles after slowing the hiking pace to 25 bps. However, inflation remained too high above target for them to declare victory. As things stand, both believed that by keeping rates elevated for an extended period, they can lower inflation to the 2% target in a timely manner. In 2H24, we see central banks normalising rates with the ECB matching the Fed in lowering the policy rate by 100 bps. Given the pessimism over the outlook for the Eurozone economy, especially Germany, EUR will probably be less enthusiastic about the ECB resuming rate hikes. The ECB wants assurances from EU nations that their fiscal policies are aligned with its inflation-fighting goal. Brussels has also started pushing member states to begin de-risking from China. In spring 2024, geopolitical tensions could haunt the EUR again when NATO holds its joint command exercise around the Russian presidential elections.

GBP lacks strong drivers to embark on a sustainable uptrend or downtrend. GBP/USD had difficulties staying above 1.30 or holding below 1.20 in 2023. With Prime Minister Rishi Sunak delivering on his promise to halve inflation in 2023, the BOE paused its hiking cycle in Sep. Unfortunately, the lower inflation also reflected the stagnant UK economy which the IMF declared as the weakest economy of the G7 nations. The IMF predicted mild growth rates of 0.5% and 0.6% for 2023 and 2024, respectively. Despite the "largest ever tax cut for workers" in the Autumn Statement, the OBR's growth forecast for 2024 was only marginally higher at 0.7%. To complicate matters, inflation was still too high above target for the BOE to declare victory, leaving it little choice but to join the ECB and the Fed in pushing for higher-for-longer rates. OBR sees inflation falling to 2.8% by the end of 2024 before hitting the 2% target in 2025. Even so, consensus also expects the UK and US policy rates to converge at 4.50% from rate cuts in 2024. Monetary and fiscal policies should continue to be torn between supporting growth and addressing inflation, keeping GBP/USD volatile.

Euro is holding the 1.05-1.15 range as per 2015-2016



	Year	1Q	2Q	3Q	4Q
DBS	2024	1.11	1.11	1.12	1.13
forecast	2025	1.13	1.14	1.14	1.15

Source: Bloomberg, DBS

British Pound is oscillating in one of its post-Brexit referendum ranges

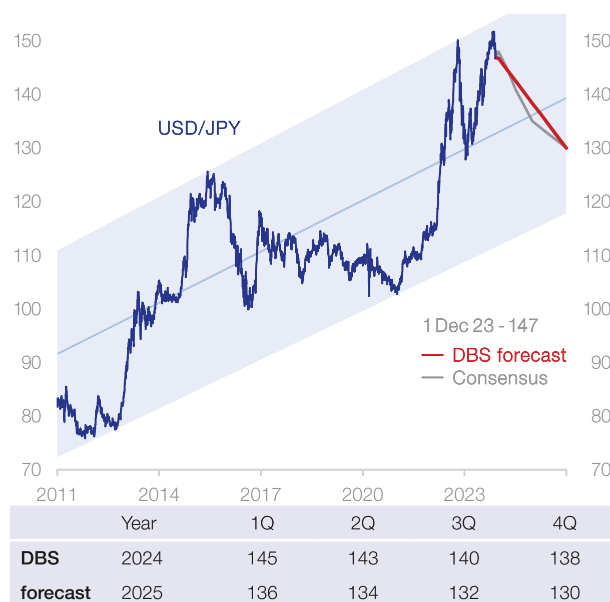
	Year	1Q	2Q	3Q	4Q
DBS	2024	1.28	1.29	1.29	1.30
forecast	2025	1.31	1.32	1.32	1.33

Source: Bloomberg, DBS

JPY should finally reverse from 2023's extreme weakness, as we expect US-Japan yield differentials to narrow over 2024. US rates have likely passed its peak, with the Fed now set to be on pause in early 2024 and its Jul 2023 rate hike possibly being the last for this cycle. Meanwhile, we expect the BOJ to reverse from its NIRP in 1H24, after allowing even more flexibility to YCC in Oct 2023, switching the 1% upper bound on 10Y JGB yield from a hard cap to a mere reference level. Indeed, we believe such YCC flexibility will be helpful to create space for an eventual policy normalisation, as it limits spillovers to global bond markets when it is time to finally call an end to YCC, perhaps in 2H24. Higher Japanese short-term and 10Y rates, coupled with Fed rate cuts, could create conditions for USD/JPY to fall as sharply as it had risen in 2023. The JPY is highly undervalued, and Japanese insurers, pension funds, and banks may well rebalance their foreign asset holdings towards JPY assets if the foreign yield advantage turns less attractive.

For 2024, USD/CHF is anticipated to maintain its stability within the 0.86-0.92 range established in 2Q23. The SNB executed its final rate increase, reaching 1.75% in Jun. Despite the policy rate being below the neutral rate of 2%, Switzerland has successfully kept its CPI and core inflation within the target range of 0-2% since Jul. In Sep, the SNB projected inflation to average around 2.2% for both 2023 and 2024, before decreasing to 1.9% in 2025, assuming the policy rate remains steady at 1.75% during this period. Economic growth forecasts, however, are less optimistic following a 2.7% growth in 2022. Consensus sees sluggish 0.8% growth in 2023 and a slight improvement to 1.1% in 2024. Consequently, the SNB does not need further appreciation of the CHF to control imported inflation, nor face significant political barriers to doing so. In Nov, the US Treasury Department removed Switzerland from its currency monitoring list. Between Mar 2022 and Nov 2023, the CHF saw a notable appreciation of 10.4% against the USD, outperforming the 5.8% rise in the EUR and the largely stable GBP. Hence, USD/CHF can afford to remain steady amidst a broader weakening of the USD against major currencies.

Japanese Yen is bracing for BOJ to end its NIRP and YCC policies



	Year	1Q	2Q	3Q	4Q
DBS	2024	145	143	140	138
forecast	2025	136	134	132	130

Source: Bloomberg, DBS

Swiss Franc is overvalued and poised for a consolidation

	Year	1Q	2Q	3Q	4Q
DBS	2024	0.88	0.88	0.89	0.89
forecast	2025	0.89	0.89	0.90	0.90

Source: Bloomberg DBS

Australian Dollar has a consolidative 0.62-0.72 range

	Year	1Q	2Q	3Q	4Q
DBS	2024	0.67	0.68	0.68	0.69
forecast	2025	0.69	0.70	0.70	0.71

Source: Bloomberg, DBS

New Zealand Dollar could consolidate after a challenging year

	Year	1Q	2Q	3Q	4Q
DBS	2024	0.62	0.62	0.62	0.63
forecast	2025	0.63	0.63	0.63	0.64

Source: Bloomberg, DBS

We look for AUD/USD to hold between 0.62 and 0.72 after a tough year. Barring unforeseen shocks, the factors undermining the Oz against the greenback should reverse in 2024. First, we expect the policy rate differential to narrow in 2024 in Australia's favour. The RBA may hike again after raising the cash rate target by 25 bps to 4.35% in Nov following four rate pauses. The RBA believes the unemployment rate needs to rise to 4.5% from 3.7% in Oct to get inflation back to the 1-3% target range from 5.6% in 3Q23 amid concerns about housing prices returning to record-high levels. However, the RBA will likely cut rates by a smaller 50 bps when the Fed normalises monetary policy with 100 bps of rate cuts in 2H24. Second, the US economy will go from outperforming to underperforming the Australian economy. We expect US GDP growth to halve to 1.2% in 2024 from 2.4% in 2023 vs the consensus for Australia's growth to slow to 1.5% from 1.8%. Australia's economy is cushioned by relatively higher growth in Asia, its largest trade market, amid better relations between Beijing and Canberra under the Albanese government, balancing China's slower growth in 2024.

We see NZD/USD consolidating in a 0.58-0.65 range after a year of depreciation. The NZ and US rate hike cycles peaked at the same 5.50% level in 2023. Consensus expects the RBNZ to lower rates to 4.75% in 2024 on confidence that CPI inflation will reach its 1-3% target by the final quarter. An RBNZ quarterly survey in 4Q23 reported one-year inflation expectations declining to 3.6% from 4.2% three months earlier. The rate cuts should help address the deteriorating asset quality from the higher borrowing costs weighing on households. In 2H24, the USD will likely depreciate from 100 bps of Fed cuts to 4.50% amid uncertainties into November's US presidential elections. Prospects for the NZ economy should improve if Asia's export recession turns the corner with a more stable economy and property sector in China. However, some uncertainties await the NZD too. The National Party, which leads a coalition government with ACT New Zealand and New Zealand First, wants to subject the RBNZ to an external review, fulfilling one of its pledges at the elections held on 14 Oct. All three parties want to cut government spending, return government accounts to surplus, and reduce taxes.

Asia Currencies

CNY

CNY depreciation pressures will likely reverse as markets finally concede to the PBOC's desire for CNY stability — a position we strongly advocated against consensus. The Biden-Xi Nov 2023 summit had been a critical catalyst for a CNY recovery, surprising investors on the upside after President Biden said that the US wants better ties to help China's economy. This suggests that US administration actions in 2024 are less likely to be adversarial, even if politics are always risky in an election year. US investors could be encouraged by Biden's rhetoric to increase allocation to Chinese assets, which they had been quite underweight on since 2022. Of course, China's real estate sector still lingers in distress and will pose significant tailwinds for growth into 2024. But there is reason to hope that an external demand pickup, expected Fed rate cuts, and an uneventful Taiwanese Presidential election could sooth nerves enough to catalyse a return of capital inflows. Furthermore, a 0.8% of GDP rise in China's fiscal deficit will be felt from 4Q23 to 1H24, cushioning China's growth to an extent. CNY sentiment is thus likely to be well supported, though far from exuberant.

Chinese Yuan may have seen its worst level in 2023

	Year	1Q	2Q	3Q	4Q
DBS	2024	7.08	7.04	7.00	6.96
forecast	2025	6.92	6.88	6.84	6.80

Source: Bloomberg, DBS

HKD

USD/HKD has eased back to the mid-point of its convertibility band, with HKD supported by rising HIBOR rates that are close to, and sometimes exceeding, USD rates of the same tenor. Hong Kong's aggregate balance has stopped declining and is stabilising at around USD45b (or 1.5% of GDP) since 2Q23. Tightening HKD liquidity has resulted in the 12M HIBOR climbing to around 5.65% in Nov, nearing highs last seen in late 2022. Higher HKD rates could continue to weigh on USD/HKD below the 7.80 mid-point alongside a softer USD. Hong Kong's FX reserves should also stabilise at around USD416b after almost two years of declines since the start of 2022. On 17 Oct 2023, the 40th anniversary of the USD/HKD peg, HKMA's Chief Executive Eddie Yue wrote that there was no intention nor need to change the Linked Exchange Rate System (LERS). He hailed the LERS as a sound system that forms the cornerstone of monetary and financial stability in Hong Kong, with a high degree of credibility built up gradually over the years. We uphold our conviction that the USD/HKD peg is a compelling policy choice for Hong Kong, with little risk of a near-term change.

Hong Kong Dollar transitions into the lower half of its convertibility band

	Year	1Q	2Q	3Q	4Q
DBS	2024	7.79	7.79	7.78	7.78
forecast	2025	7.77	7.77	7.76	7.76

Source: Bloomberg, DBS

KRW

KRW is likely to firm amid a recovery in exports and industrial production, deferred expectations of BOK rate cuts, and tailwinds from some strengthening in the JPY and CNY. Korean exports have exited a soft patch in 4Q23 as the electronics cycle bottomed out and could soon rise at its fastest y/y pace since mid-2022. Chinese external demand remains a drag for now, but Korea's higher dependence on the US and enhanced role in US supply chains provide a counterweight. Industrial production is also picking up on the back of stronger manufacturing activity, while inflation is proving to be more persistent, resulting in the BOK raising its 2024 core CPI forecast to 2.3% from 2.1%. The upshot is that the BOK will likely hold rates longer than markets expect, supporting further KRW gains. After three consecutive months of foreign portfolio outflows from Aug to Oct, inflows may return as a more positive outlook for Korean exports offset concerns over high Korean household debt and a slowdown in consumption demand. The JPY is also likely to pose fewer trade competitiveness concerns in 2024, paving the way for a gradual strengthening of the KRW.

South Korean Won should return into its long-term price channel

	Year	1Q	2Q	3Q	4Q
DBS	2024	1,280	1,270	1,260	1,240
forecast	2025	1,230	1,220	1,210	1,200

Source: Bloomberg, DBS

SGD

In 2024, we expect USD/SGD to keep oscillating inside the same 1.30-1.38 range as in 2023. Over the year, the USD should lose momentum from global central banks normalising monetary policies. We forecast the MAS reducing the steepness of the SGD NEER policy band's slope in Jul 2024 per our expectations for Fed rate cuts of 100 bps in 2H24. A slightly flatter slope sits better with a Singapore economy expanding around the 2-3% trend growth amid a slightly negative output gap in 2024. The MAS sees 'CPI - All Items' inflation slowing to 3-4% in 2024 from 5% in 2023 and core inflation cooling to 2.5-3.5% from 4%. Stripping out the impact of the 1% GST hike coming on 1 Jan 2024, the forecasts for CPI and core inflation will be lower at 2.5-3.5% and 1.5-2.5%, respectively. Alas, 2024 is fraught with uncertainties and risks, underscored by the MAS's decision to hold four instead of two policy reviews in 2024. Worst-case scenarios include: a) a hard landing in the world economy from high interest rates feeding through the G7 economies, b) continued disappointment over China's economy and property sector, and c) geopolitical miscalculations around US-China relations, Taiwan, North Korea, and the South China Sea.

Singapore Dollar's resilience has not gone unnoticed

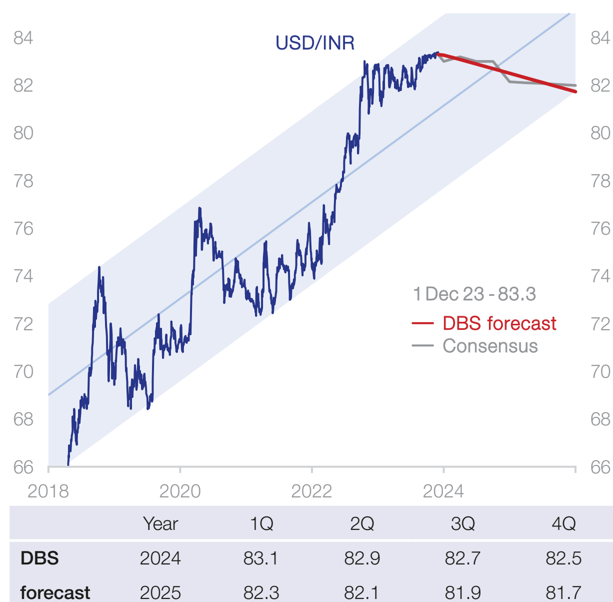
	Year	1Q	2Q	3Q	4Q
DBS	2024	1.33	1.33	1.32	1.32
forecast	2025	1.32	1.32	1.31	1.31

Source: Bloomberg, DBS

INR

In 2024, USD/INR will continue its exceptional stability with a downside bias. The 3.2%-wide trading range between 80.9 and 83.5 was significantly narrower than the 13% registered in 2022 and the smallest since 1999. USD/INR's new record high of 83.475 in Nov 2023 was only 0.2% higher than the 83.3 peak in Oct 2022. Several factors contributed to the INR's remarkable stability. First, the RBI intervened when the USD strengthened in the region. Second, India Equities hit lifetime highs on reaccelerating GDP growth after the RBI's final hike in Feb. Third, India's interest rate differentials stayed positive and wide against their US counterparts. Investors will pay close attention to the general elections in Apr-May 2024. The opposition parties have formed a united front to bolster their chances of denying the Bharatiya Janata Party (BJP) a third victory as the ruling political party. The trading ranges for USD/INR were wider between 6% and 14% in the previous four election years. In 2H24, we expect the RBI to match the Fed in lowering interest rates by 100 bps. India's relatively higher growth and a globally weaker USD should keep a downward bias on USD/INR in the latter half of 2024.

Indian Rupee has been resilient within a narrow 81-84 range



	Year	1Q	2Q	3Q	4Q
DBS	2024	83.1	82.9	82.7	82.5
forecast	2025	82.3	82.1	81.9	81.7

Source: Bloomberg, DBS

IDR

For 2024, we look for USD/IDR to keep consolidating between 14,500 and 16,000, the range it has held since mid-2022. Our expectations align with BI's forecast for USD/IDR to average 15,510 in 2024. Despite a slight increase in the peak of 15,970 in Oct 2023, compared to 15,770 in Dec 2022, the average rate for the first 11 months of 2023 was 15,215. In Oct, BI raised interest rates again for the first time in nine months to cushion the exchange rate from the USD's resurgence. For 2024, we expect the Indonesian economy to expand at a steady 5%, mirroring its 2023 performance. Investment decisions will hinge on the outcome of the Presidential and Legislative Elections in Feb 2024, as foreign investors evaluate Indonesia's potential in the "China Plus One" strategy. With inflation holding inside the 2-4% target for a second year, BI will likely mirror the Fed's 100 bps cuts in 2H24. USD/IDR fell when this happened in 2H19 on a soft landing in the global economy. If the outlook is worse than expected, USD/IDR could spike as it did during the Covid outbreak in 1Q20.

Indonesian Rupiah is also resilient within a wider 14,500-16,000 range

	Year	1Q	2Q	3Q	4Q
DBS	2024	15,310	15,220	15,130	15,040
forecast	2025	14,950	14,860	14,770	14,680

Source: Bloomberg, DBS

MYR

Maintaining perspective on the MYR's weak performance in the first 11 months of 2023 is essential. Several factors were responsible for the record high of 4.80 for USD/MYR in Oct 2023: the US 10Y bond yield surpassing Malaysia's during the USD's resurgence from Jul to Oct, the depreciation of the JPY and CNY affecting Asian currencies broadly, and a slowdown in Malaysia's GDP growth that contrasted with the US's rebound in 3Q23. Despite the increased currency market volatility, the 4.22-4.80 trading range in 2023 was only modestly wider than the 4.17-4.75 range in 2022. Historically, USD/MYR has a track record of pulling back from the highs of its price channel. Looking forward, we see Malaysia's GDP growth improving to 4.8% in 2024 vs 4% in 2023 amid a US slowdown and the BNM keeping rates steady at 3% against a 100 bps of rate cuts by the Fed anticipated in 2H24. The Ministry of Finance's modestly higher CPI inflation of 2.1-3.6% in 2024 vs 2.5-3% in 2023 is not a major concern because it is part of the government's fiscal strategy, which includes higher taxes and lower subsidies, aimed at enhancing Malaysia's appeal to foreign investors in the medium term.

THB

THB was more resilient than many Asian currencies in 2023. Despite the political uncertainties that followed the general elections in May, USD/THB did not surpass the peak posted in 2022 during the USD's resurgence in Jul-Oct. The trading range also narrowed to 32.5-37.3 (14.3%-wide) in 2023 from 32.0-38.5 (19.8%-wide) in 2022. First, the BOT delivered the most (five) rate increases in Asia; its real policy rate also exceeded the US. Second, Thailand was on track to post a current account surplus in 2023 after two years of deficits. While not spared from the export recession across the region, the economy benefitted from a revival in tourism receipts from reopening its borders. The World Bank expects foreign tourist arrivals to exceed its pre-pandemic levels in 2024. Thailand should also benefit from an export recovery in 2H24, during which we see the Fed cutting rates by 100 bps. Conversely, we expect the BOT to keep rates unchanged throughout 2024 as GDP growth accelerates to 3.3% in 2024 from 2.3% in 2023, buoying inflation to 1.7% from 1.3%. On a cautious note, we will monitor the BOT and rating agencies on their concerns regarding the government's spending ambitions on fiscal sustainability.

Malaysian Ringgit can recover quickly when the tide turns against the USD

	Year	1Q	2Q	3Q	4Q
DBS	2024	4.60	4.55	4.50	4.50
forecast	2025	4.45	4.40	4.35	4.30

Source: Bloomberg, DBS

Thai Baht has yet to break out of its long-term range

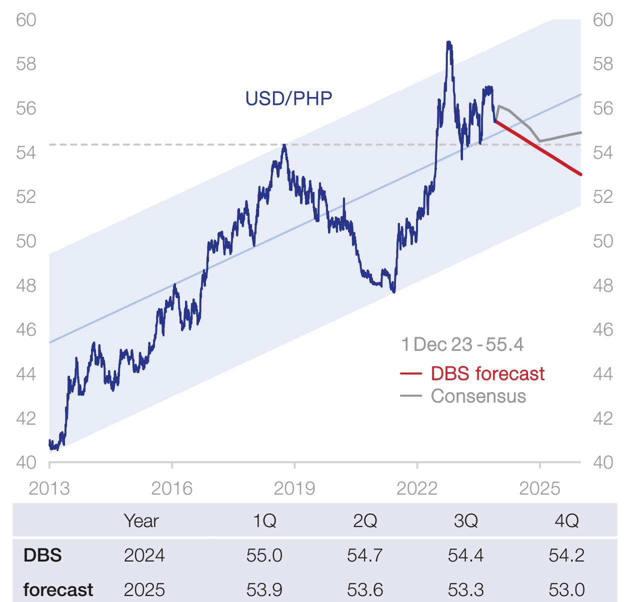
	Year	1Q	2Q	3Q	4Q
DBS	2024	34.4	34.1	33.8	33.6
forecast	2025	33.3	33.0	32.8	32.5

Source: Bloomberg, DBS

PHP

Our analysis suggests that USD/PHP will remain in the 53-57 range with a downside bias, aligning with the Philippine government's expectations. In 2023, USD/PHP stayed within the official forecast range of 54-57, averaging 55.7 for the first 11 months, in stark contrast to the more volatile range of 51-59 in 2022. In Jul-Oct, the BSP played a crucial role in stabilising the PHP against the resurgent USD on rising US long bond yields. The BSP delivered an unexpected rate hike on 26 Oct 2023, setting its policy rate at 100 bps above that of the US. Looking ahead to 2024, the BSP will maintain the same differential by mirroring the Fed's 100 bps rate cuts in 2H24. We see inflation improving significantly from 6% to 3.3%, aligning with the 2-4% target range. Despite expectations for GDP growth to slow to 5.2% in 2024 from 5.8% in 2023, the Philippine economy will shine vs US GDP growth halving to 1.2%, especially if the former's export recovery gains traction. Defying downgrade predictions, rating agencies affirmed the country's investment-grade debt ratings on confidence in the country's macroeconomic management and fundamentals. However, the deteriorating relationship between Manila and Beijing will be critical for investors to watch.

Philippine Peso has an official forecast range of 53-57



	Year	1Q	2Q	3Q	4Q
DBS	2024	55.0	54.7	54.4	54.2
forecast	2025	53.9	53.6	53.3	53.0

Source: Bloomberg, DBS

VND

We forecast USD/VND returning to 23,500, the lows of 2023, over the next two years. We see Vietnam reclaiming its position as Southeast Asia's fastest-growing economy in 2024. Our forecast for GDP growth to accelerate from 4.6% in 2023 to 6% in 2024 is at the low end of the official 6-6.5% target. With inflation rising from 3% to 3.5%, the SBV will likely keep rates unchanged at 4.50% throughout 2024. Assuming we are correct about the Fed lowering rates by 100 bps in 2H24, the US policy rate should converge with the SBV rate. With export growth turning positive in Sep and Oct, the odds favour the current account deficit reversing into a surplus in 2024. Regarding the struggling property sector, rating agencies such as S&P Global see limited risk of a massive contagion, noting that Vietnam did not share the acute problems of oversupply and speculation in China. The sector accounted for 25% of total loans in the banking sector, while corporate bond holdings made up only about 3% of total loans. Vietnam also faces increased competition from other ASEAN countries in attracting foreign investments from global companies looking to de-risk from China.

Vietnamese Dong is keeping to its long-term price channel

	Year	1Q	2Q	3Q	4Q
DBS	2024	24,100	24,000	23,900	23,800
forecast	2025	23,700	23,600	23,500	23,400

Source: Bloomberg, DBS

DBS currency forecasts

Exchange rates, eop	1 Dec	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
China	7.1285	7.08	7.04	7.00	6.96	6.92	6.88	6.84	6.80
Hong Kong	7.8144	7.79	7.79	7.78	7.78	7.77	7.77	7.76	7.76
India	83.295	83.1	82.9	82.7	82.5	82.3	82.1	81.9	81.7
Indonesia	15,485	15,310	15,220	15,130	15,040	14,950	14,860	14,770	14,680
Malaysia	4.6735	4.60	4.55	4.50	4.50	4.45	4.40	4.35	4.30
Philippines	55.405	55.0	54.7	54.4	54.2	53.9	53.6	53.3	53.0
Singapore	1.3335	1.33	1.33	1.32	1.32	1.32	1.32	1.31	1.31
South Korea	1306	1280	1270	1260	1240	1230	1220	1210	1200
Thailand	34.243	34.4	34.1	33.8	33.6	33.3	33.0	32.8	32.5
Vietnam	24,287	24,100	24,000	23,900	23,800	23,700	23,600	23,500	23,400
Australia	0.6675	0.67	0.68	0.68	0.69	0.69	0.70	0.70	0.71
Canada	0.6209	1.35	1.34	1.34	1.33	1.33	1.32	1.32	1.31
Eurozone	1.0884	1.11	1.11	1.12	1.13	1.13	1.14	1.14	1.15
Japan	146.82	145	143	140	138	136	134	132	130
New Zealand	0.6209	0.62	0.62	0.62	0.63	0.63	0.63	0.63	0.64
Switzerland	0.8692	0.88	0.88	0.89	0.89	0.89	0.89	0.90	0.90
United Kingdom	1.2710	1.28	1.29	1.29	1.30	1.31	1.32	1.32	1.33
United States	103.27	101.9	101.2	100.5	99.9	99.2	98.6	97.9	97.3

Australia, Eurozone, New Zealand and United Kingdom are direct quotes.

Status Quo Persists

Commodities
1Q24

Commodities are currently trading at multi-year lows vs Equities, however we recommend staying cautious until there are more definitive signs of recovery in the global economy.

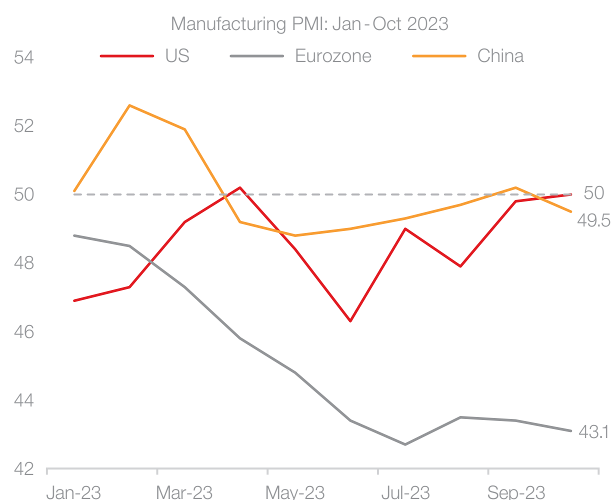
10. Commodities.

Goh Jun Yong
Analyst

Geopolitical risk at play. In the current quarter, a noteworthy development in the commodities space is the emergence of geopolitical risk from the Middle East conflict. This has several implications. Firstly, it introduces additional upside risk to oil prices, particularly if the conflict were to escalate and extend regionally. Factors such as possible sanctions on Iran crude and potential disruptions to trade routes could contribute to a substantial increase in oil prices (>USD100/bbl). Secondly, precious metals (especially Gold), are poised to benefit from the heightened volatility. Although the risk premium has already begun to recede, the sustained conflict in the region is likely to keep prices moderately supported. Needless to say, there remains a risk of further increases if the conflict were to escalate and widen regionally. That, however, is not our base case, given that the US has put in considerable effort into ringfencing the conflict (e.g., back-channel talks with Iran and diplomatic action calling for less intrusive action on Israel's part).

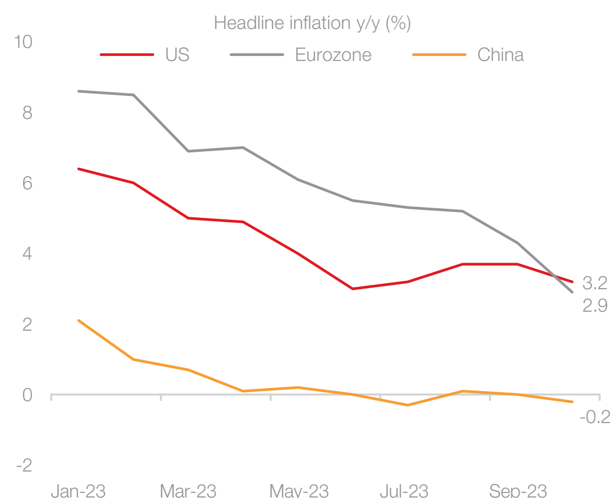
Macro backdrop remains tepid. Conflict aside, the macro backdrop underscoring the asset class continues to be tepid. Economic growth, and in particular manufacturing activity, which drives industrial metal and energy demand, continues to be weak. For the month of Oct 2023, manufacturing PMI for the US came in flat at 50.0 while Europe and China remained in contractionary territory (43.1 and 49.5 respectively). Inflation in developed markets, although sticky above central bank targets, have come down significantly from earlier highs of this year, indicating that monetary policy has successfully cooled their economies. October saw headline inflation come in at 3.2% y/y, while Europe registered a 2.9% y/y increase in prices. In China,

PMI remains subdued



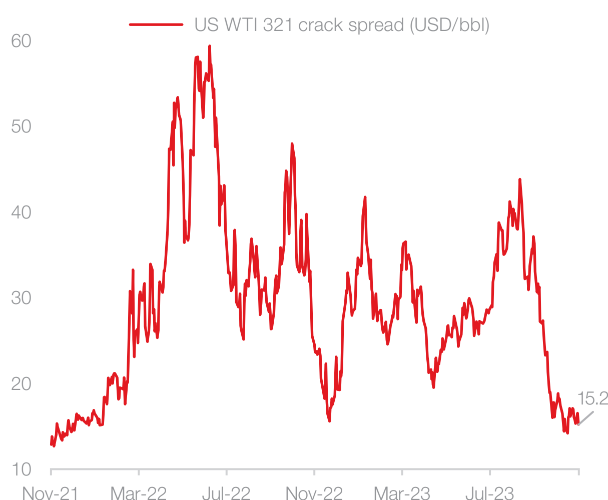
Source: Bloomberg, DBS

Moderating inflation



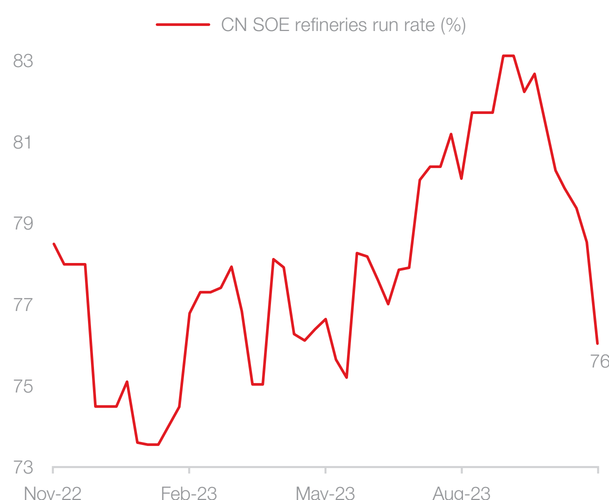
Source: Bloomberg, DBS

US WTI 321 crack spread near 2Y lows



Source: Bloomberg, DBS

China SOE refineries run rate has declined sharply since September



Source: Bloomberg, DBS

consumer prices swung lower, with October CPI falling 0.2% y/y. These further confirm a lacklustre economic recovery despite a pro-growth policy stance and announcements of further stimulus. This is in line with moderating commodity prices; on a YTD basis, the Bloomberg Commodity Total Return Index fell 4.1% (as at 14 Nov).

Energy – Tight supply meets shaky demand. Barring the effects of the Middle East conflict, the fundamentals of the energy market remain largely unchanged; the major forces at play are still: i) supply side constraints from the voluntary production cuts by Saudi Arabia and OPEC+; and ii) demand side concerns from 'higher for longer' rates and a faltering economic recovery in China. On the demand side, it is worth noting that refining spreads have fallen significantly, indicating that crude demand will likely wane for December and early 2024. US WTI 321 crack spread, which measures the difference between the purchase price of crude oil and the selling price of finished products such as gasoline and diesel, are at an almost two-year low. Similarly, China's independent refiners have also turned negative in late October for the first time since early January, and this is reflected in the lowering run rates by state-owned refineries, which has fallen to c.76% in November. Furthermore, there is typically a seasonal drop in gasoline and diesel consumption towards the year end, which will further dampen demand for energy. Given the tight supply but also shaky demand, we foresee an average Brent price of USD85/bbl for the remainder of 2023, and some further moderation to the USD80-85/bbl in 2024.

Industrial metals – manufacturing and construction woes. As mentioned, manufacturing activity has been lacklustre for much of the year across the world's major economies. This will continue to weigh on the demand for industrial metals. China is no exception even though it is running a loose monetary policy (in contrast with much of the western world); manufacturing activity remains mildly contractionary, and construction is still being plagued by defaults in the property space. Our view on industrial metals remains unchanged: we remain overall cautious due to the weak macro backdrop, with a selective preference for copper due to its exposure to the electrification megatrend.

- **Copper** – Favour copper on growing demand and sales of electric vehicles (EVs) and burgeoning energy grid storage capacity to benefit long-term copper demand. Case in point, BYD (1211 HK) posted >200% y/y increase in 1H23 profits. Similarly, Li Auto (2015 HK) posted a 271% y/y increase in 1H23 revenues.

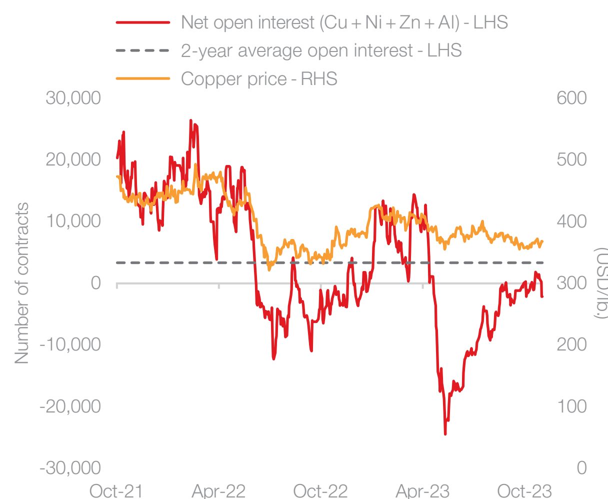
- **Aluminium** – Neutral on aluminium because while a good portion of end demand is attributable to the transport sector, c.25% is still being used for construction and the property sector.

- **Steel and iron ore** – Bearish on steel despite price strength this year because in addition to weak demand from China's property sector, we will likely see rising supply due to i) improved seaborne supply; ii) improved scrap availability domestically in China; and iii) reduced Chinese steel exports, which will boost local supply.

China steel imports remain at multi-year lows

Source: Bloomberg, DBS

Industrial metal positioning recovering but below 2-year trend

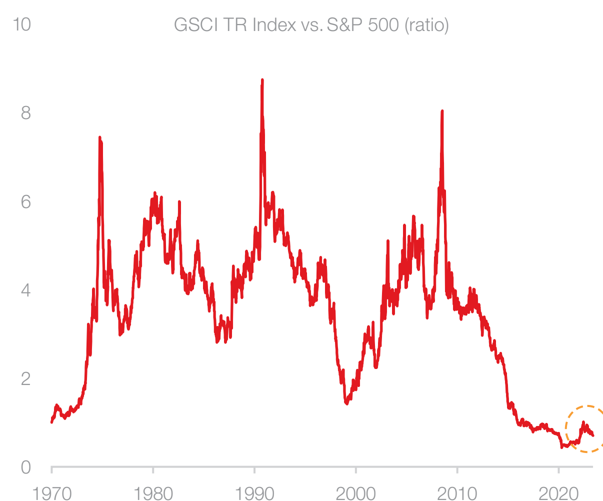


Source: Bloomberg, DBS

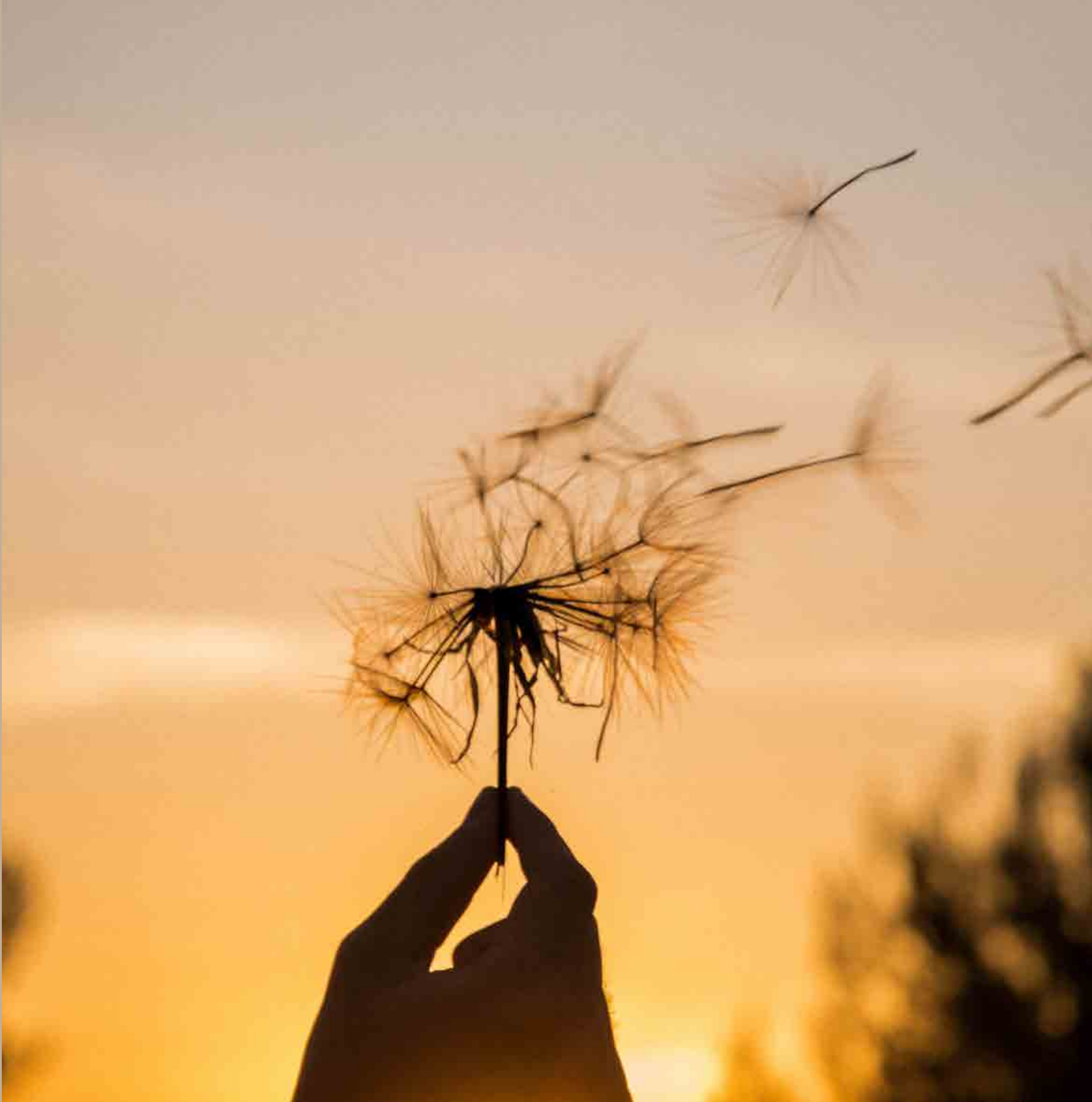
Agricultural commodities – Resilient supply despite volatile weather. Wheat prices are finding support from heightened Chinese import demand. However, this is being offset by robust output from Russia and the US. Ukraine, amidst its ongoing conflict with Russia, continues to export wheat and corn through the temporary grain corridor. This resilience suggests that global grain supplies remain reasonably diversified and resilient, placing a cap on price increases. The story with soybean is similar as Brazil continues to expand crop acreage; exports in October amounted to 8.4m metric tonnes, a 25% increase y/y. Regarding agricultural commodities in general, climate change has been linked to shifts in weather patterns, notably the intensification of El Nino and La Nina events, leading to increased rainfall variability that impacts crop production. Despite these challenges, the diversified nature of global supply chains, coupled with proactive measures in producing countries to counteract weather shifts, has allowed supply to keep pace with disruptions in the past few years.

Continue to watch for turn in commodity cycle amid geopolitical risk overlay. The Middle East conflict provides a favourable overlay for commodities as supply disruptions could spell upside price risk, especially for energy and precious metals. Idiosyncratic risk aside, the backdrop for the asset class remains weak, driven by a restrictive monetary environment in the west and slow growth momentum in the east. Supply tightness could drive rallies, as we have seen in the energy markets, but such rallies have proven to be largely fleeting. Valuations remain at multi-year lows, but in the absence of further catalysts and a more supportive macro backdrop, commodities could remain cheap for time to come. We remain cautious on the asset class, watching for more definitive signs of a global economic recovery.

Valuations attractive but catalysts needed for breakout



Source: Bloomberg, DBS



Tailwinds Gain Momentum

Alternatives:
Gold
1Q24

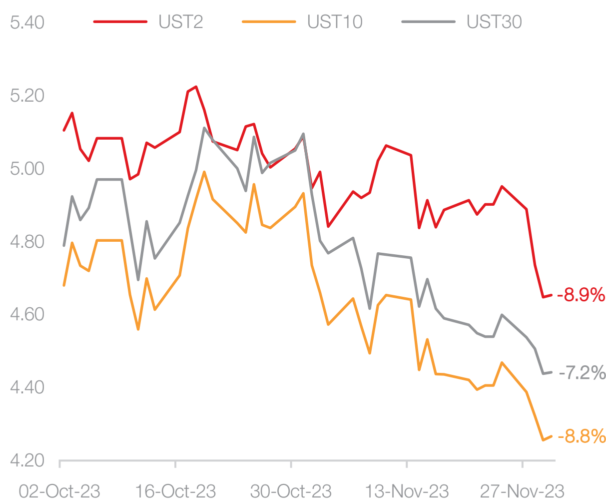
Signs of peaking rates and dollar strength propelled Gold to historic highs. Together with tailwinds from geopolitical risks, persistent central bank buying, and potential ETF infows, we see further upside for Gold.

11. Alternatives: Gold.

Goh Jun Yong
Analyst

Peaking rates see Gold surge to historical high. Since the start of the Fed's rate hiking cycle in March last year, interest rates and the dollar have been the primary headwind for Gold; this makes sense as treasury yields represent the (risk-free) opportunity cost of holding non-interest-bearing Gold. However, tides have recently started to shift with US treasury yields seeming like they may have peaked. Since the start of October, yields across the treasury curve have declined significantly; the 2-year, 10-year and 30-year US treasury yield declined 8.9%, 8.8% and 7.2% respectively (as at 30 Nov). Accordingly, Gold prices have rallied substantially, reaching an intraday high of USD2,110/oz. on 4 Dec before giving up some gains.

Rates slide across the curve as Fed pause bets gain momentum

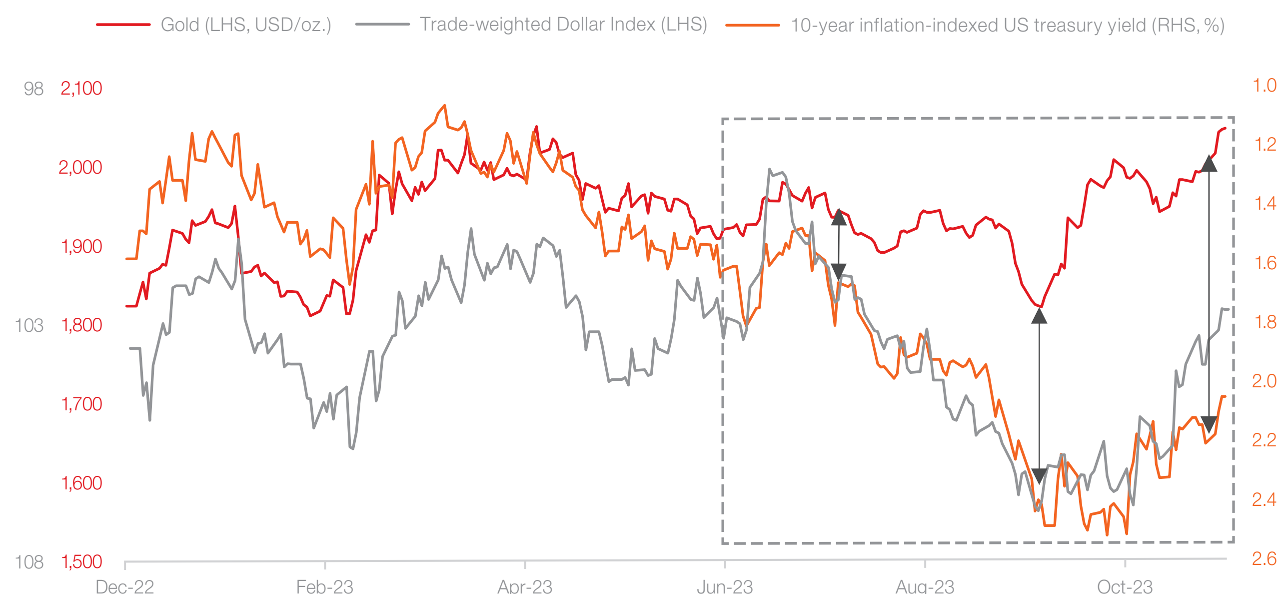


Source: Bloomberg, DBS

Increasing downside resilience to rise in real rates and the dollar. But even before the most recent rate-driven rally, it is worth noting that Gold has been displaying a diminished downside sensitivity to rises in real rates since the start of 2H23; from 1 Jun to 30 Nov, the 10-year inflation-indexed US treasury (GTII10) yield, which is seen as a proxy for real rates, increased 43.2%, while Gold rose 3.5%. Even if we disregard the supportive effect of the recent reversal in rates and the Israel-Hamas conflict on Gold prices, the point on reduced downside sensitivity remains valid – between 1 Jun to 6 Oct 2023 (just before the escalation in tensions in the Middle East), the GTII10 yield increased 73.6%, while Gold fell 7.3%. Whether or not rates and the dollar remain as tailwinds for Gold will depend on whether inflation stays under control in the US, which will determine if the Fed is done hiking rates.

Further hikes constrained by growing US indebtedness. While further rate hikes are possible, we believe that they will be constrained by the high level of indebtedness of the US government. To understand just how much US indebtedness has ballooned, it is useful to look at the recent trajectory of interest payable on US sovereign debt; gross interest payments have risen c.50% to c.USD970b within a year of the Fed's first 25 bps hike in in 2022. Additionally, net interest payments are projected by the Congressional Budget Office (CBO) to reach USD835b by 2025 (the deadline for the debt ceiling suspension), which ceteris paribus, would make this non-productive area of spending a larger component than other mandatory categories such as National Defense and Medicare. All this to

Real rates and the dollar soared since June but Gold stayed resilient

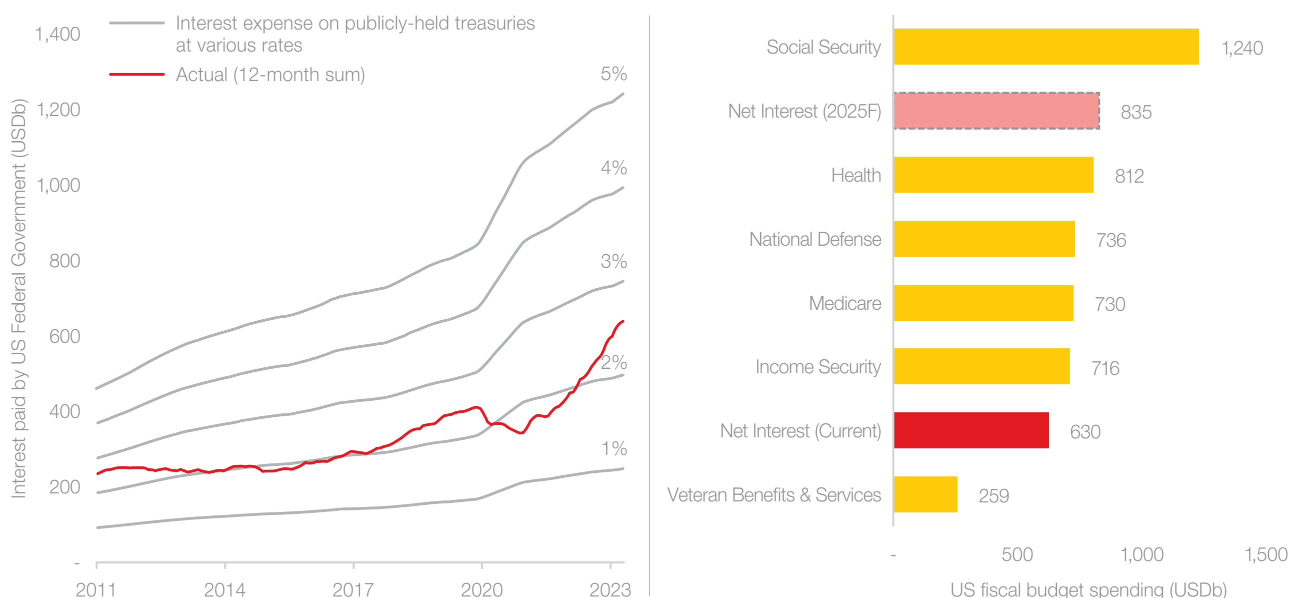


Source: Bloomberg, DBS

say that the Fed has limited headroom to hike rates further without exacerbating the US government's already massive fiscal deficit of USD1.7t, which is the largest deficit recorded with the exception of the Covid-fuelled USD2.8t in 2021. We cover in greater detail the implications of higher rates on US interest payments in our CIO Perspectives publication titled 'Credit: How Policy Rates Affect Deficits'(published on 29 Sep 2023). The inference for Gold is that further rate-driven downside, while possible, is likely to be limited.

Geopolitical risk still at play. It is almost a foregone conclusion that Gold benefits during tumultuous times given its status as a haven asset. Unsurprisingly, the recent escalation of Israel-Hamas tension boosted Gold significantly, lifting spot prices 6.8% for the month of Oct 2023. What remains uncertain at this point is where prices will go from here. To a large extent, this would depend on how the conflict plays out – if it remains contained, then it is likely that the bulk of the rally is behind us. We analysed past risk-off incidents to see their effects on Gold price and found that, such episodes resulted in Gold rallies that lasted an average of 15 days and resulted in an average increase in price of c.8.0%, and the latest Middle East conflict corresponds neatly with this analysis; the rally lasted 15 days and prices rose 9.5% trough to peak. Nonetheless, we believe that upside risk from the conflict remains; should there be signs of escalation and regional spread, we will likely see Gold rally again in short bursts. Given diplomatic efforts by the US and its allies to contain the conflict, which include back-channel talks with Iran to warn against escalation as well as the maintenance of a safe corridor between Israel and north Gaza, we do not believe that further escalation is the base case, though the possibility remains.

Net interest payments expected to rise to become a large component of fiscal spending



Source: Department of Treasury, Bureau of Fiscal Service, CBO, DBS

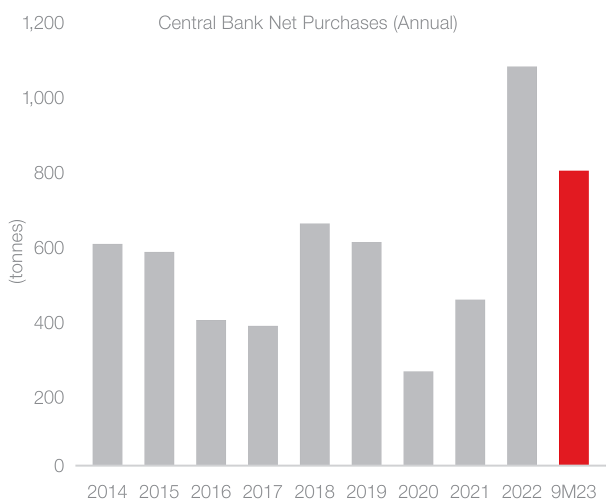
Duration and magnitude of Gold rallies from past risk-off episodes

Event	Start Date	Δ% (from trough to peak)	Duration of rally (days)
Russia-Ukraine war	24 Feb 2022	8.0%	14
SVB, Silvergate, Signature Bank, and Credit Suisse collapse	8, 10, 12 and 15 Mar 2023, respectively	12.5%	26
First Republic Bank collapse	1 May 2023	3.4%	4
	Average	**8.0%**	**15**

Source: Bloomberg, various news outlets, DBS

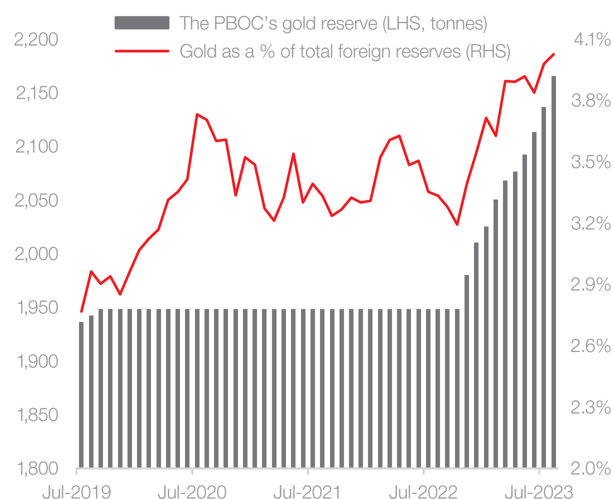
Persistent central bank buying. Additional tailwinds for Gold can be found in central bank buying, which turned from net negative in April and May, to net positive in June, July, and August. After setting a first half record in 1H23, central bank buying maintained its momentum and in July and August, taking 9M23 cumulative purchases to 800 tonnes. The largest buyers remained the usual suspects: China, Poland, and Turkey, with Qatar, Singapore and Czech Republic rounding out the buyer group for July. The PBOC, in particular, has been extremely active in adding to its Gold reserves, with its latest purchase of 23 tonnes in Oct stretching its buying spree to 12 consecutive months and a total purchase amount of 266 tonnes since Nov 2022. This continued strength in central bank buying, we believe, is part of a wider geopolitical trend that involves countries wanting to diversify their foreign exchange reserves and increase their holdings in neutral hard assets. This trend should prove supportive of Gold prices over the long run.

Central bank buying continues after record first half: 9M23 cumulative buying reaches 800 tonnes



Source: Metal Focus, Bloomberg, DBS

China's Gold reserves have steadily increased since Nov 2022

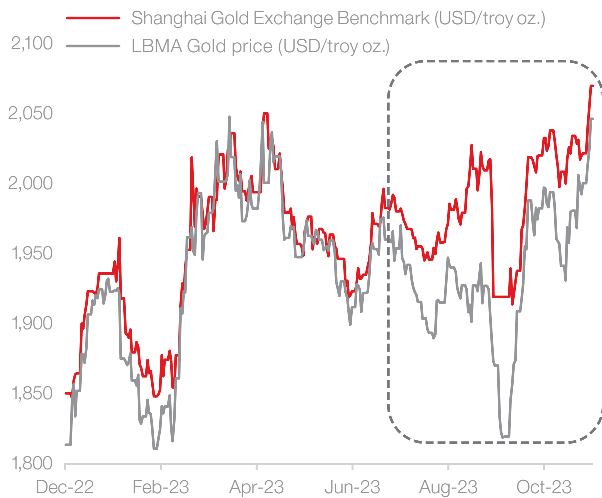


Source: PBOC, World Gold Council

Demand remains strong within the world's largest physical Gold market. Since July, the Shanghai Gold Exchange Benchmark has been trading at a premium over the London Bullion Market Association's Gold price. Though the premium has diminished from its peak of USD126/oz. in mid-Sep, it remains at a sizeable USD24/oz. This is despite the fact that China has since relaxed its import curbs on Gold, which it had earlier put in place to defend the RMB. This points to healthy demand for the precious metal within the Chinese market. Gold withdrawals (i.e. domestic Gold demand) dropped in October on a m/m basis but remained up y/y and above its 5-year average.

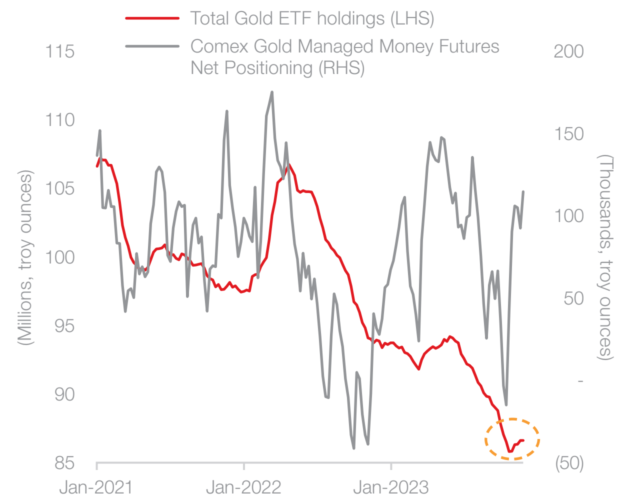
ETF flows remain at deeply depressed levels. On a more technical front, we also see that ETF flows have not yet recovered, which means that there is additional liquidity for Gold to rally further when the right factors are in place. Despite the Middle East conflict, total Gold ETF holdings have remained largely unchanged at ~87m troy ounces. That indicates

Shanghai Gold premium persists even after import curbs lifted



Source: Metal Focus, Bloomberg, DBS

ETF inflows have remained muted despite Middle East conflict



Source: Metal Focus, Bloomberg, DBS

strong real demand from institutions, consumers, and central banks. When Gold last visited the USD2,000/oz. level, ETF holdings were much higher at ~94m troy ounces, and this suggests that there is still further upside for Gold at current levels.

Policy rate dynamics, geopolitical risk, ETF flows, and central bank buying are tailwinds for Gold. With inflation seemingly under control and limited headroom for the Fed to continue hiking rates due to debt sustainability concerns, a case could be made that rates have peaked and will be heading lower from hereon. Coupled with the ongoing geopolitical risk premium, depressed ETF flows and persistent central bank buying, we believe that there is yet further upside for Gold moving forward. On that basis, we upgrade our 12M target price from USD2,050/oz., to USD2,250/oz. with possible rate-cuts in 2H24 and a weaker dollar as our main catalyst. Principally, we continue to advocate for investors to have holdings in Gold as a portfolio risk diversifier and blackswan hedge.

Peaking rates and geopolitical tensions will see gold break out of its 3-year range

Source: Bloomberg, DBS

Duration and magnitude of Gold rallies from past risk-off episodes

CPI @ 3%, 60% chance of recession

	DXY				
UST10 Yield (%)	90	95	100	105	110
2.00	2,552	2,448	2,344	2,240	2,136
2.50	2,509	2,405	2,301	2,197	2,093
3.00	2,466	2,362	2,258	2,154	2,050
3.50	2,423	2,319	2,215	2,111	2,008
4.00	2,380	2,277	2,173	2,069	1,965
4.50	2,338	2,234	2,130	2,026	1,922
5.00	2,295	2,191	2,087	1,983	1,879

Possible range

Current range

Source: DBS

A Whole New World

Alternatives: Private Assets 1Q24

After years of ‘cheap’ money, private markets must now contend with fresh challenges of elevated borrowing costs and a trying exit landscape. In this new world, leverage-intensive structures are most at risk, while dynamics favour secondary investing and distressed debt.

12. Alternatives: Private Assets.

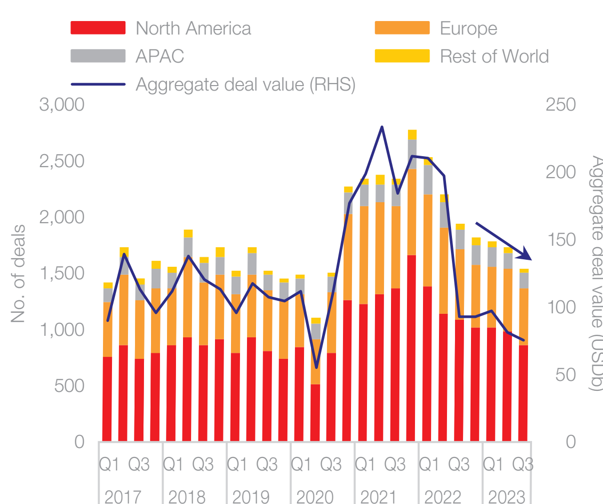
Beatrice Tan
Analyst

End of an era. The decades since the Global Financial Crisis were a golden era for private markets – against a landscape of zero-bound rates, institutional capital ploughed into private markets in pursuit of higher yields, lower volatility, and greater diversification, allowing private markets to relish in abundant capital. However, times have changed. Sharp interest rate increases in 2022/23 led to a drastic slowdown in global Private Equity deals. Slower growth, higher inflation, and structurally elevated capital costs pose fresh challenges. With riskless treasuries offering abundant yields, private market investments must grapple with (1) lower demand due to competition from less risky assets offering attractive yields, and (2) higher costs of capital weighing on businesses and investing structures relying on leverage to amplify returns. Despite these challenges, the dynamism of private markets over past decades suggests continued evolution as new sources of value creation emerge.

Private Equity: Redefining value creation

Current conditions pose multiple challenges for Private Equity, including tough fundraising, doubts about the viability of value creation models reliant on financial engineering due to borrowing costs, extended holding periods due to tepid exit prospects, and valuation concerns. As the industry evolves, it prompts a greater emphasis on value creation through operational improvements of portfolio companies. Despite market challenges, investing in secondaries remains attractive, and Private Equity remains a pathway to access innovative business models in high-growth markets and sectors.

Private Equity-backed buyout deal flow softens



Source: Preqin, DBS

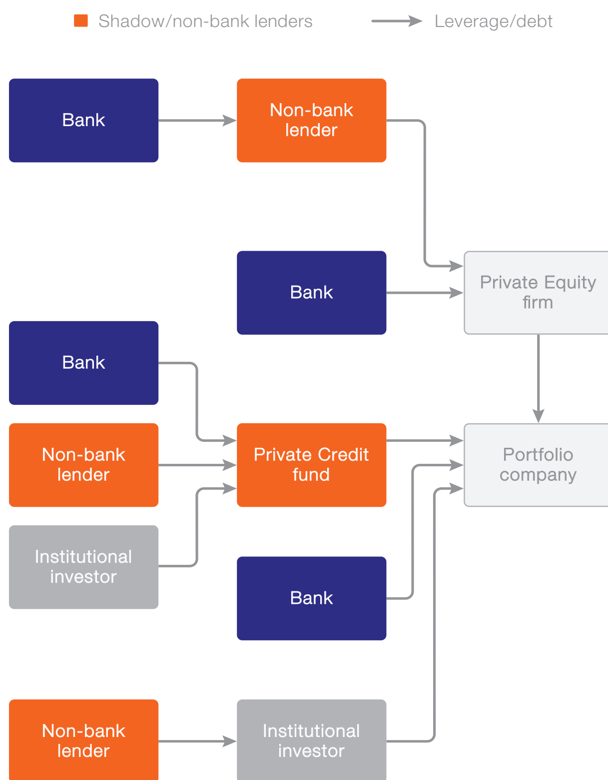
Key focus areas are:

1) High leverage in certain Private Equity structures at risk in a higher rates environment

Debt has traditionally been important in the business model of Private Equity firms, and an environment of higher borrowing costs and lower capital availability begets concerns about potential risks embedded in layers of leverage. No longer are investors able to take the availability of cheap and ample debt financing for granted. Entities across private market structures – including funds, managers, portfolio companies, and even investors

into the funds – have been availed leverage options from banks and, increasingly, non-bank/shadow lenders. The ease of obtaining debt over the past decade has enabled layering of leverage in Private Equity, which now poses a risk of strain across the entire ecosystem if burgeoning interest costs prove too prohibitive, or if creditors were to suddenly withdraw.

Layers of leverage: Opaque forms of credit have emerged across private markets



Source: Bloomberg, DBS

Leverage concerns could be intensified from extended holding periods, as sellers hold out for a better exit market. Already, the average holding period for buyout investments has risen to above 6 years, above the 3 to 5 years typical of Private Equity investments. For leverage buyout deals, holding period extensions would imply a need to also refinance or extend the corresponding acquisition loans, and anecdotal evidence suggests increasing prevalence of payment-in-kind loans (where borrowers can make interest payments in forms other than cash) for extensions and new loans, which could lead to a compounding of credit risks.

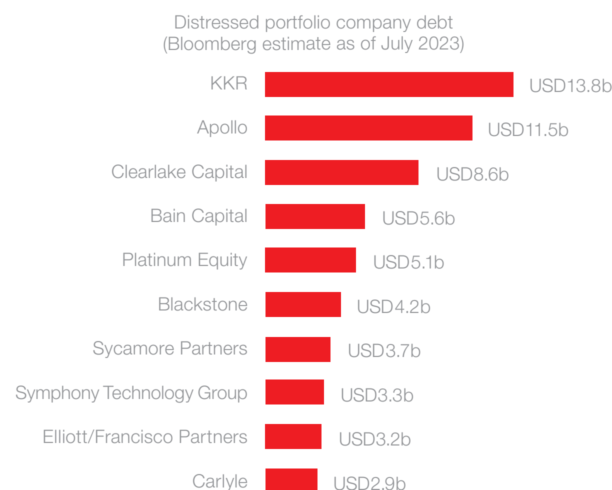
Yet some other lenders have already turned more conservative. Pitchbook's analysis suggests that lenders to Private Equity have also become more risk averse, evidenced by the average debt-to-EBITDA ratio for syndicated loans in 1Q23 of 4.7x adjusting lower from a peak of 5.3x in 2021. Lenders are demanding that Private Equity firms contribute more equity, as rising interest rates, risk-averse lenders, and existing covenants restrict the amount of debt they can tap.

2) Value creation through operational improvements key to sustainable advantages in Private Equity

A higher rates environment is prompting a re-examination in how Private Equity creates value. The unviability of financial engineering and over-leverage is cementing a shift in emphasis to value creation through real operational improvements. LPs seeking Private Equity investments with more sustainable value creation strategies would do well to understand the value creation methodology of the firms they invest with, as well as their available resources. Private Equity firms with sustainable advantages in improving operations of their portfolio

companies would need to be actively involved strategy and operations of their portfolio companies. This would entail access to in-house operations teams/industry specialists, and/or strategy and operations advisors to formulate and implement value-maximising improvements.

Private Equity-backed companies account for more than USD50b of distressed debt

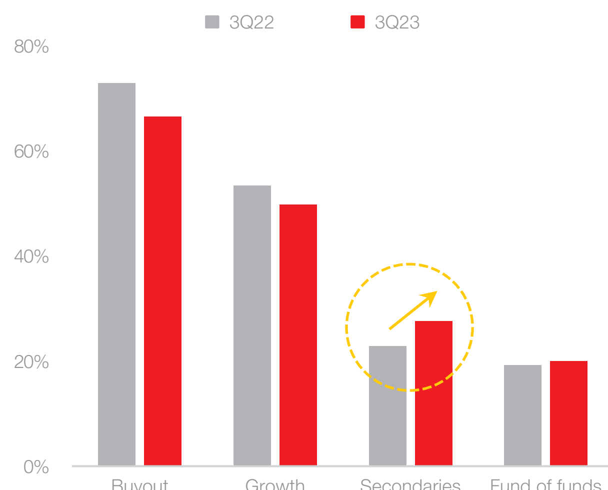


Source: Bloomberg, DBS
Note: Totals are Bloomberg estimates as of 7 July 2023.
Data does not include debt from the Private Credit industry.

3) Challenging exit environment and existing LPs' demand for liquidity favours secondaries investing

Private Equity secondaries remain attractive. LPs are increasingly turning to secondary markets for liquidity as funds take longer to return capital to investors while holding out for a better exit environment. The denominator effect also contributes to a rising number of institutional LPs looking to trim their allocations on the secondaries market. The resulting glut of investment opportunities in secondaries has made it a buyer's market, allowing secondary funds to purchase stakes at historically attractive discounts, which is set to translate to better expected returns for LPs in current vintages.

Strategies targeted by Private Equity investors: Growing interest in secondaries



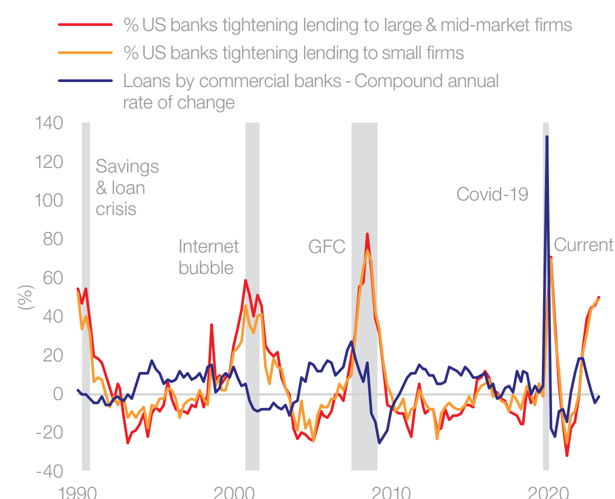
Source: Preqin, DBS

Although Private Equity secondaries investing is still in relatively nascent stages, with Preqin data demonstrating that secondary funds represent just c.3% of Private Equity funds in market and c.11% of capital raised (as of 3Q23), we expect more funds to launch secondaries strategies over the coming quarters, given favourable market conditions for secondaries.

4) Late-stage venture-backed investments could see greatest calibration in valuations

The challenging exit landscape has led to a recalibration in valuations, particularly for late-stage venture-backed companies like Instacart. Its September 2023 IPO valued the company at less than USD10b, a fraction of its peak valuation of USD39b in 2021 during the pandemic-induced grocery delivery craze. Earlier valuations likely reflected optimistic growth assumptions. This substantial down round resulted in significant losses for late-stage investors. On the positive side, it signals a potential normalisation in valuations, offering more reasonable entry points for under-allocated individual investors in private markets. While private markets remain a prime avenue for exposure to innovative businesses, caution is advised against inflated valuations driven by hype and overly aggressive growth forecasts.

Tightening of bank lending provides opportunities for Private Credit



Source: St Louis Fed, DBS
Data above for US Commercial & Industrial Loans

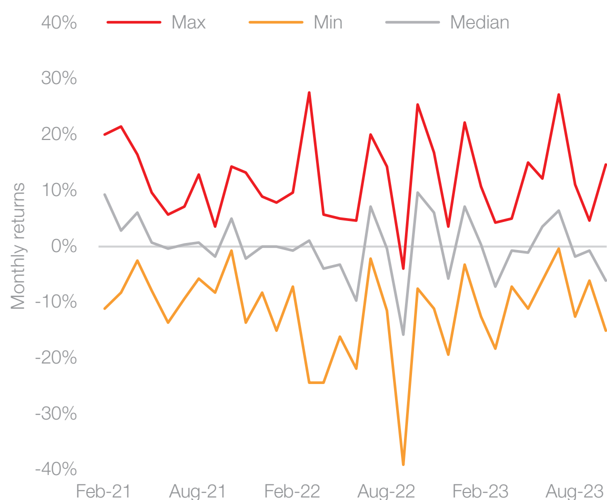
Private Credit: A balancing act

Our focus in Private Credit investing continues to be the balancing act amongst structural opportunities offered by bank disintermediation and attractive yields offered by floating rate structures in today's rate environment, against the extent to which the Private Credit industry is equipped to manage an environment of escalating credit risks and rising defaults.

Bank disintermediation tailwinds have significantly fuelled the growth of the global Private Credit market, expanding over 5 times to c.USD1.6b since the GFC. The Dodd-Frank Act played a pivotal role by accelerating the shift toward non-bank funding as banks steadily retreated from lending. In the current tightening cycle, alternative lenders, especially Private Credit funds, stand to benefit structurally by filling the lending gap left by banks. While the higher interest rate environment has favoured lenders with floating rate structures, it poses challenges for riskier businesses on the flipside, leading to substantially increased interest costs. As the impact of elevated rates begins to weigh on highly levered, floating rate borrowers, it remains to be seen how Private Credit will fare.

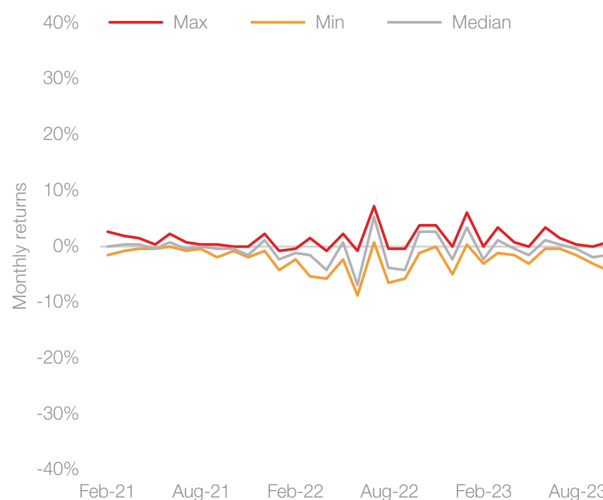
Signs of mounting credit stress are evident in leading indicators, with major rating agencies anticipating a rise in loan defaults in the coming months as companies grapple with interest servicing and refinancing challenges. It's crucial to note that the current size and structure of the Private Credit

Returns are highly dispersed across Private Credit*…



*Private Credit return dispersion proxied using returns of listed Business Development Companies (BDCs)

… relative to HY bond funds



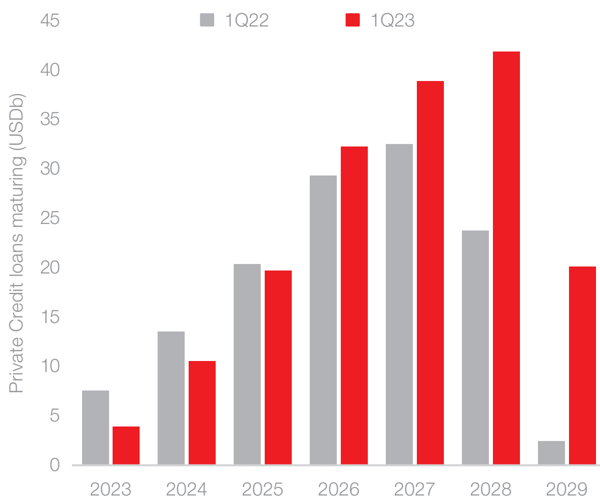
Source: Bloomberg, DBS

industry have not been tested by a major crisis. Given the pivotal role of credit evaluation, structuring, and monitoring in risk mitigation for Private Credit, the emphasis remains on manager selection and due diligence in investing, as we further note wide dispersion in returns.

Ample dry powder and propensity for lenders to work closely with stressed borrowers to avoid default, suggest that the burgeoning Private Credit market could serve as a potential cushion for the next default cycle. For example, despite overall tightening in financial conditions, S&P data suggests that Private Credit borrowers have pushed their maturity wall to later years, buying time for debt maturities. Notably, this also stands to contribute to sustained funding pressures in the coming years as interest rates remain higher for longer.

Risks on the Private Credit markets suggest it could be an opportune time for investors to allocate to distressed strategies. Across private debt strategies, distressed debt has notably seen largest uptick in fundraising activity in 2023 – in anticipation of rising defaults in the horizon. As funding pressures, higher rates, and slowing growth weigh

Kicking the can down the road: Maturity wall for Private Credit has been pushed to later years



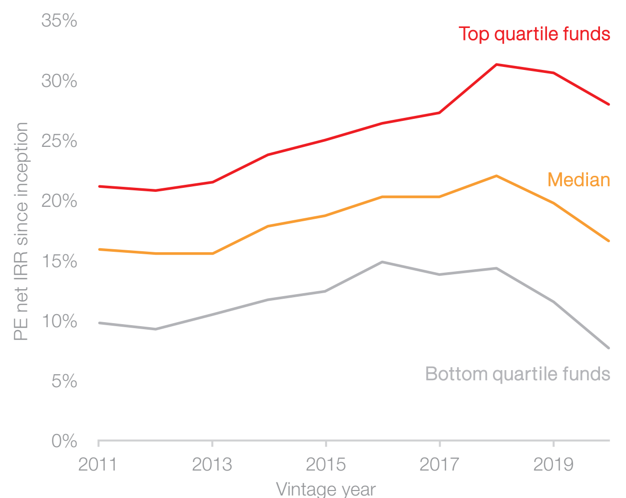
Source: S&P Global Ratings Credit Research & Insights, DBS
Based on fair value BDC holdings of Private Credit loans maturing by year

most heavily on the weakest borrowers, a silver lining amid this ominous outlook is opportunities from a surge in supply of heavily discounted, non-performing debt. Anticipating a fertile hunting ground, distressed managers expect compelling deal flow and have begun preparing to capture such opportunities by gathering dry powder. Accordingly, a record number of distressed debt managers are raising funds – more than 80 distressed funds are raising funds as at June 2023, a figure higher than at any point in the last decade. Similarly, more investors are also becoming convicted of opportunities in distressed debt, with 49% of respondents in Preqin's Investors Survey expecting this strategy to be the best performing Private Credit strategy over the next few months.

Conclusion

In conclusion, private markets, once buoyed by low interest rates and ample capital, now contend with fresh challenges. Heightened borrowing costs and prolonged holding periods introduce risks. Shifting the focus to operational improvements has become imperative for sustainable value creation, while secondaries investing gains prominence amid a challenging exit landscape. In Private Credit, the delicate balance between yields and rising defaults demands attention. Emerging signs of credit stress create unique opportunities for distressed strategies as funds prepare for a potential surge in discounted, non-performing debt. Significant performance dispersion among Private Asset funds underscores the paramount importance of manager selection and due diligence to navigate risks and seize opportunities in this new world for Private Assets.

Performance dispersion across Private Equity IRR returns



Source: Preqin, DBS

Quiet Luxury

Thematic Strategy 1Q24

Mindsets shift with a growing focus on sustainability and conscious consumerism. This has manifested in the growing popularity of understated opulence, better known as 'Quiet Luxury', where consumers partake in mindful choices that are timeless yet sophisticated.

13. Quiet Luxury.

DBS Chief Investment Office

Money talks, wealth whispers. In a time of global change, a growing focus on sustainability and conscious consumerism have made businesses eager to distinguish themselves with fresh strategies. Changes brought about by the pandemic have also inspired more discerning lifestyle choices prioritising values beyond the consumption of pure material goods. In the world of luxury, these changes manifest in the rise of subdued opulence, better known as quiet luxury, where mindful choices are aligned with all things timeless, sophisticated, and understated.

Though recently brought back into the spotlight by social media sensationalising Gwyneth Paltrow's courtroom outfits and popular HBO television drama Succession for its portrayal of luxurious yet minimalist lifestyles, quiet luxury's roots trace as far back as the 19th century's Gilded Age and France in the 1700s, as an antithetical reaction to boom periods when conspicuous wealth was all the rage. This was the case too, in the 1990s, when the minimalist aesthetic for practical dressing was made famous – and fashionable – by brands including Donna Karan and Miuccia Prada.

Beautiful things don't ask for attention. The term "quiet luxury" captures the very essence of what it exudes – a preference for subtlety over flashiness and obvious branding. Think well-fitted silhouettes from Isabel Marant and Vanessa Bruno, cashmere knitwear from Loro Piana and Brunello Cucinelli, long belted wool overcoats from Max Mara, and deconstructivist lines from Maison Margiela. Devoid of trendy logos and recognisable monograms, these staples of a capsule wardrobe are associated with the ultra-chic, and confidently nonchalant.

Breaking into the upper echelons of the luxury fashion sphere is a feat that few new brands achieve. From Hermès to Chanel, and Gucci to Louis Vuitton – the world of fashion has traditionally been dominated by heritage names patronised by big-name film stars and generations of royalty. Other notable brands that have stayed the course down a road less travelled include The Row, Jil Sander, Bottega Veneta, Khaite, and Savette. Their branding and designs reflect a commitment to exquisite craftsmanship and unparalleled attention to detail, each piece meticulously constructed by skilled artisans using the finest materials, culminating in garments and accessories that make a wardrobe feel luxurious, yet simple.

If you know, you know (#iykyk). Founded by the Olsen sisters, The Row quickly took centre stage in the world of understated luxury. In Jan and Feb this year, searches for the brand were up 185% versus the same period last year; meanwhile, the brand's Margaux tote continues to sell out within a week of listing on MatchesFashion.com. Notable for their lack of social media presence, the Olsen sisters' lives are shrouded in mystery, with their brief public appearances subject to much scrutiny and speculation. Regardless of media clamour, the Olsens remain unmoved by the ebbs and flows of the fashion industry – in a world dominated by 24/7 social media connectivity and branding, their stark disinterest in the scamper that surrounds them makes them all the more fascinating.

Quiet luxury is here to stay

Is quiet luxury a mere fad? To what extent does it reflect a lasting cultural shift that redefines consumer perspectives, purchasing decisions, and how they engage with brands and businesses? In this report, we look beneath the surface to unearth the following catalysts driving the redefinition of luxury:

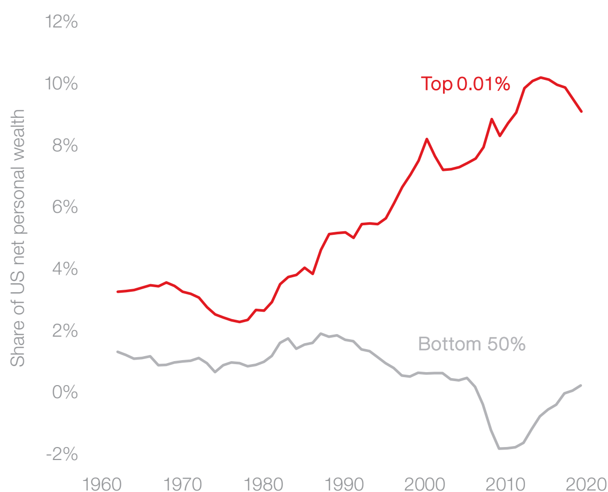
I. Emergence of uneasy affluence

II. Desire for exclusivity

III. Rise of conscious consumption

I: Emergence of uneasy affluence as wealth disparity widens. Social disparity has been thrust into the spotlight by the cost-of-living crisis. Escalating discontent towards a perceived hoarding of wealth by the ultra-elite has manifested in bouts of social upheaval. French workers, for instance, stormed luxury titan LVMH's Paris headquarters in Apr 2023 to protest against pension reforms just as the group celebrated its lead as Europe's most valuable company. Similarly, protests broke out in the UK against a rise in energy prices, as energy majors announced record profits at the expense of households hit by soaring oil and gas prices.

A widening social divide: Ever-increasing gap in wealth disparity since the 1970s



Source: World Inequality Database, DBS

Such collective backlash against widening social disparities has led the wealthy to avoid ostentatious displays of affluence, giving rise to stealth wealth. As a result, luxury brands have had to rethink their offerings and communications with their customers.

II: The desire for exclusivity amid democratisation of access to luxury. A second catalyst is the desire for exclusivity, a possible counter to forces - such as the rise of social media and the resale market - attempting to democratise access to luxury. The allure of luxury lies in its rarity and exclusivity; a signal of ability not just to afford, but to access items and experiences beyond the reach of others. Consequently, it makes sense for brands that appeal to the top echelons of consumers to limit the availability of their offerings.

Interestingly, the resale market has displayed the potential to democratise access to such luxury goods. The emergence of reputable resellers such as Vestiaire Collective and Farfetch has availed convenient consumption of luxury items, lowering the barriers to entry. The size of the global luxury resale market is on the rise and is expected to reach USD52b by 2026 (up from USD33b in 2021), constituting a CAGR of 9.5%.

Democratisation of luxury access: Global luxury resale market on the rise

Source: Statista, DBS

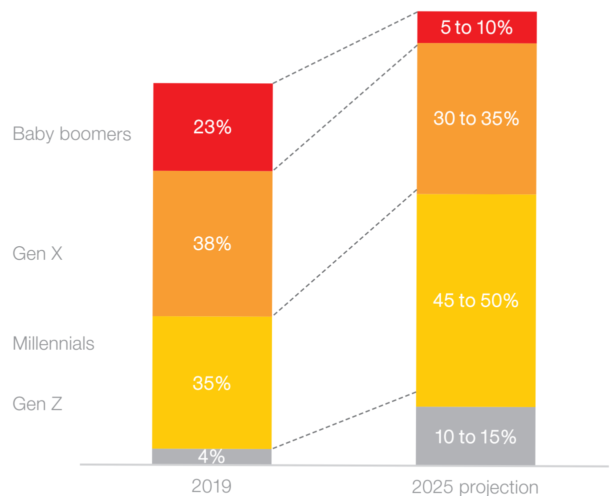
Therefore, the move toward stealth wealth is a telling response by the discerning elite to safeguard their exclusivity by distancing themselves from an overt display of wealth, and instead opting for muted elegance and focusing on quality, craftsmanship, and comfort.

III: The rise of conscious consumption driving consumers' preference for quality luxury goods. Millennials are set to form the bulk of the luxury market by 2025. Having spent a large part of their lives in an age of extreme environmental concern, millennials are conscious consumers, and expect much from brands regarding their commitments to the environment and society.

Millennials often opt to interact with brands that espouse values mirroring their own beliefs. These consumers are increasingly conscious of the impact of their purchases on the planet. Ernst & Young's Future Consumer Index study found over half of respondents surveyed paid increasing attention to the environmental and social impact of their purchases.

The rising embrace of conscious consumption, in turn, is driving consumers (in particularly millennials) towards quiet luxury brands that focus on quality and workmanship. Instead of chasing the latest fad with loud prints, environmentally conscious consumers today are embracing goods that emphasise quality and durability.

Millennials are set to form the bulk of the luxury market by 2025



Source: BCG, Altagamma, DBS

Fully immersed: The pursuit of unique experiences

This new age of luxury permeates a range of industries, reflecting a broader shift in consumer values and preferences. Consumer demand is no longer sated by an end-product; connection with the brand and the experience of revelling in one's luxury investment are what matter more. The price tag of something, while still important, is no longer the final arbiter of value – the artisanal spirit and exclusivity are just as important in determining the worth of an offering.

Listed below are a few examples of how consumers are moving beyond mainstream luxury brands and cottoning onto niche players that provide greater exclusivity:

Horology	Dubbed the holy trinity of luxury time pieces, Patek Philippe, Audemars Piguet, and Vacheron Constantin are well-known as the be-all and end-all of luxury time pieces. While they continue to hold immense value and status, some of the limelight has shifted to independent watch makers such as Philippe Dufour, F.P. Journe, and Roger W. Smith. This is in part due to increasing coverage from media publications such as Hodinkee, which tracks the latest trends in horology. In addition to exceptional craftsmanship, the main appeal behind these makers includes the exclusivity of their limited-production timepieces. For comparison, while brands such as Rolex churn out approximately one million watches per year, artisans such as Smith and Dufour routinely keep production to under 10 watches annually.
Perfumery	Another realm where artisans are overtaking big brands is perfumery. Niche fragrances, or fragrances crafted by independent perfumers or artisanal houses, have risen to prominence in recent times. In fact, it has become the norm for fragrance enthusiasts to equate fragrances from designer houses (e.g., Chanel, Christian Dior, Gucci) with mainstream tastes and niche fragrances with nuance and sophistication. Independent perfumers like Francis Kurkdjian, Roja Dove, and Frederic Malle made their name through offering ultra luxurious and expensive fragrances to a select crowd of connoisseurs. However, with the rise of quiet luxury, even they have recently gained some degree of mainstream notoriety, so to speak.
Gastronomy	Beyond Michelin stars, members-only restaurants are the new elite. Michelin stars used to be the definitive benchmark of success for chefs and restauranteurs. The culinary superstars the 1990s and early 2000s, including the likes of Joel Robuchon, Alain Ducasse, and Gordon Ramsey, were united by one commonality, and that is an abundance of Michelin accolades. However, the landscape of fine dining has since evolved drastically – once again aligned with the desire for exclusivity. Rather than chase mainstream accolades, today's top restaurants are actively shunning them. Notably, Sukiyabashi Jiro, once touted the world's best sushi restaurant and the subject of its eponymous documentary Jiro Dreams of Sushi, lost its three-Michelin-star rating when it became a members-only restaurant.

Soft boom: Quiet luxury market's growth potential

To be sure, industry data pertaining to quiet luxury is limited given the niche nature of the market. As such, to derive an overall view and assess the future growth potential of the quiet luxury market, we adopted a "bottom-up" approach with the following methodology:

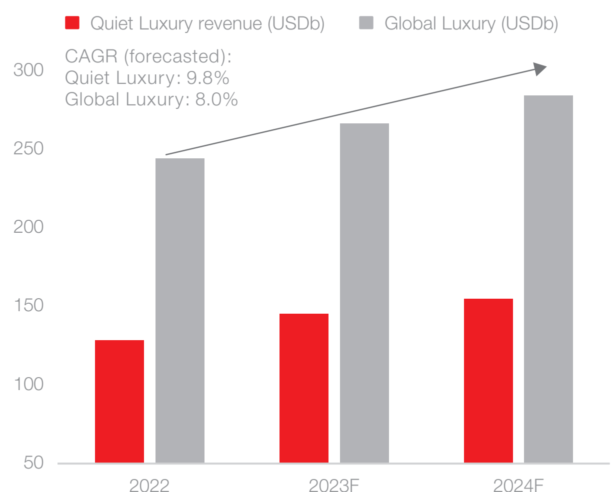
- The Bloomberg Global Luxury Goods Index is broken down into its constituents. Amongst the 30 companies in the index, we identify those that can be classified as quiet luxury.
- For a company to be classified as "quiet luxury", it must encapsulate the following qualities: (a) focus on understated elegance, with a strong heritage and unwavering commitment to quality, and (b) maintain exclusivity and scarcity in their offerings.
- Seven out of 30 companies in the index met the criteria above. They are: (1) Hermès, (2) Moncler, (3) LVMH Moët Hennessy Louis Vuitton, (4) Compagnie Financière Richemont, (5) Swatch Group, (6) Brunello Cucinelli, and (7) Ermenegildo Zegna.

Aggregating the forecasted revenue (based on Bloomberg estimates) of these companies for FY2023 and FY2024, we concluded that the combined revenue for quiet luxury companies is expected to register a CAGR of 9.8%. This supersedes the CAGR of 8.0% for the broader market.

Our analysis and findings suggest three key takeaways:

1. Quiet luxury companies possess some of the highest operating margins in the industry, surpassing even US Tech companies; the remarkable financial performance underscores their unique value proposition, combining aesthetic appeal with strong business models.
2. There is increasing consumer preference for sustainable luxury offerings that emphasise timeless elegance over traditional, more conspicuous luxury goods.
3. It is imperative for companies to pivot strategically and integrate quiet luxury offerings into their portfolio, so as to ride the evolving dynamics in the market.

Quiet luxury companies expected to register stronger growth



Source: Bloomberg, DBS

Eyes on the prize: Beneficiaries of quiet luxury

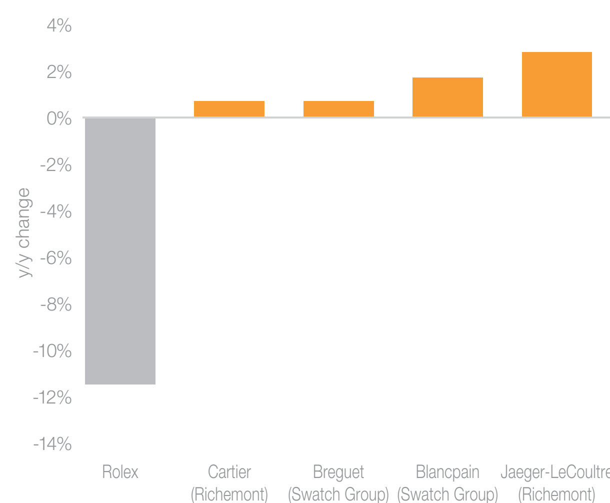
As consumers continue to gravitate towards brands which embody exclusivity masqueraded in exceptional craftsmanship and elegant finishes, we question what this means for the industry going forward, and what we, as investors, stand to gain. And if the luxury is truly "quiet", how do we then sieve out opportunities where our investment portfolios may benefit?

Spotlight on luxury's quiet beneficiaries. As the movement towards understated opulence gains prominence, a select group of companies and brands that have been pioneers in this space are set to benefit more than others. These brands, known for their subtle yet impactful approach to luxury, have laid the foundation for this trend with their emphasis on craftsmanship, quality, and discreet branding. They stand out for their ability to offer luxury experiences that are both sophisticated and subtle, in perfect alignment with the evolving preferences of today's discerning consumers.

For the purpose of identifying potential beneficiaries of this cultural/mindset shift, we classify companies into two distinct categories:

Soft Luxury Goods: Focus on understated elegance reaping dividends. In the realm of soft luxury, companies that epitomise the quiet luxury ethos, have shown remarkable performance this year. Their focus on elegance and timelessness has resonated with discerning consumers, contributing to their outperformance over louder, more ostentatious brands.

Less mainstream names registering superior outperformance



Source: WatchCharts,, DBS

With the quiet luxury movement underscoring growing consumer preference for subtlety and more sophistication in luxury consumption, we note a significant shift in the industry's dynamics.

Hard Luxury Goods: Rising embrace of quiet luxury trend. In the space of "hard luxury", the subtle influence of the quiet luxury trend is becoming increasingly evident. For instance, Rolex, a widely recognised brand traditionally known for its opulence, has observed a remarkable shift in its secondary market pricing dynamics. According to WatchCharts, Rolex witnessed a significant 11.5% y/y decrease in the prices of its watches in 3Q23.

In contrast, less mainstream names such as Breguet, Blancpain, Cartier, and Jaeger-LeCoultre, renowned for their sleek designs and mechanical excellence, achieved a subtle yet notable upturn in secondary market prices, registering an average increase of 1.5%.

Winners take all: The search for quiet luxury companies with "moat-like" qualities

At the heart of quiet luxury is a focus on the needs of the customer. In choosing to ignore trends, companies need to pursue wealthier consumers with understated tastes to match. Targeting this niche clientele requires an understanding of their lifestyles and preferences.

Brands that resonate with this ethos not only cater to a discerning clientele, but also demonstrate superior performance in an ever-evolving market. Their ability to appeal to values of consumers at the top echelons speaks to an ability to command premium margins, making these brands resilient against shifting socio and macroeconomic currents.

To maintain their competitive edge in the luxury space, brands are required to possess "moat-like" qualities that will enable them to differentiate themselves from the competition and protect their industry positioning. These qualities include:

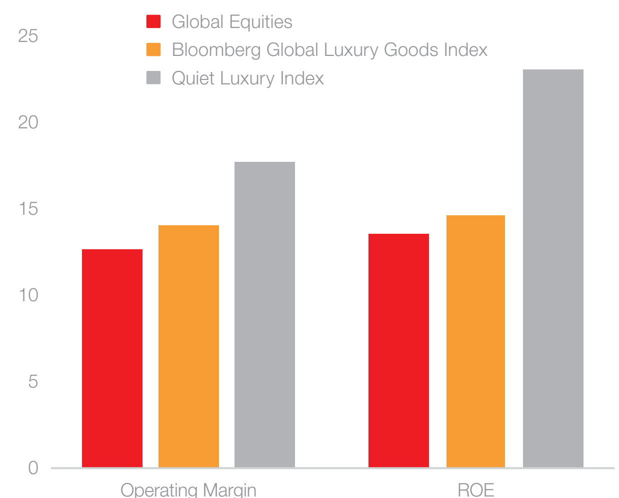
- Enduring brand heritage
- Allure of exclusivity
- Exceptional craftsmanship
- Deep-seated customer loyalty
- Continuous innovation

Unique industry positioning translating to superior financials. Each of the factors highlighted earlier play a vital role in creating a distinct and sustainable advantage, empowering companies to charge a higher price premium for their products. This premium, in turn, translates to stronger operating margin (OPM) and a higher return-on-equity (ROE). Our analysis suggests that quiet luxury companies excel on both fronts:

» Operating Margin: The global luxury space possesses a higher operating margin than Global Equities (14.1% vs. 12.8%). Delving deeper into the luxury space, our analysis suggests that the quiet luxury segment boasts an even more impressive OPM of 17.8%. This underscores the premium pricing quiet luxury companies are able to command.

» Return-on-Equity: A similar pattern is evident here, with the global luxury space possessing higher ROE than Global Equities (14.7% vs 13.7%). Within the realm of luxury, the quiet luxury segment once again outperforms with an ROE of 23.1%.

Premium margins for premium brands

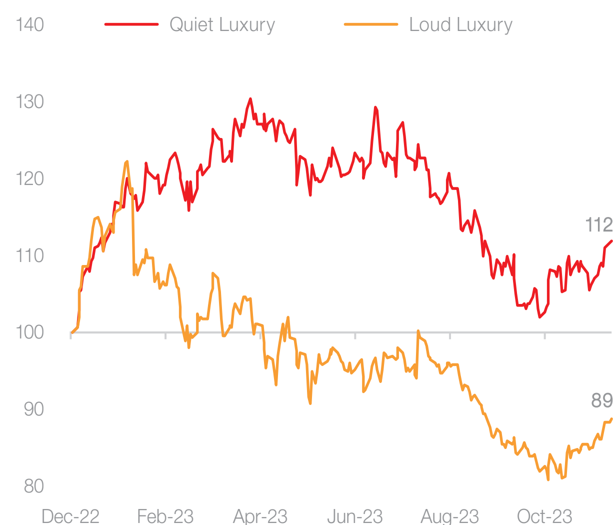


Source: Bloomberg, DBS

Superior financials translating to robust equity outperformance. In the realm of soft luxury, companies that epitomise the ethos of quiet luxury have shown remarkable performance this year. Their focus on understated elegance and timeless quality resonate with discerning consumers, contributing to their outperformance over louder, more ostentatious brands ("loud luxury") that emphasis bolder, more conspicuous branding and designs, often characterised by prominent logos and flashy aesthetics.

With the quiet luxury movement underscoring a growing consumer preference for subtlety and more sophistication in luxury consumption, we note a significant shift in the industry's dynamics. This shift has, in turn, translated to a robust outperformance of 23 %pts for quiet luxury brands over loud luxury brands. This bifurcation in performance is expected to stay.

Quiet luxury's outperformance over loud luxury



Source: Bloomberg, DBS

Conclusion

The allure of redefined luxury is unveiling a new age of quiet confidence and mindful consumption. As the evolution of consumer demand continues to chart new paths, it is the job of brands and businesses to keep up – growth comes from ideas and opportunities, and the way that brands embrace them.

The pace at which companies deploy those ideas into market is often the key determinant of success. In essence, industry players which continually adapt to fluid consumer preferences amid a changing socioeconomic backdrop – while maintaining connection beyond material satisfaction – will successfully capitalise on the redefinition of luxury, keeping people coming back for more.

Next Generation Infrastructure

Thematic Strategy 1Q24

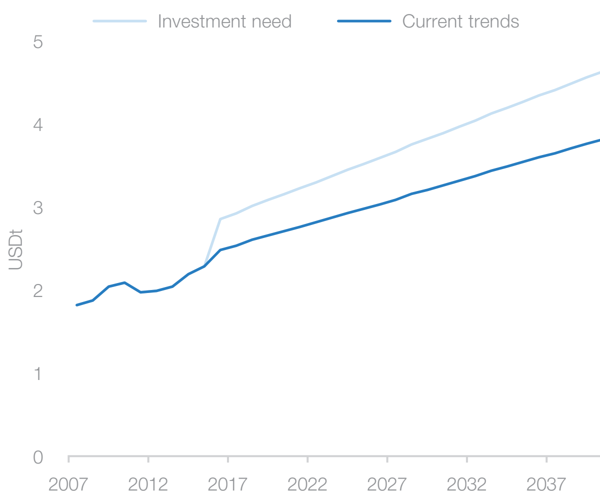
Demand for next generation infrastructure to persist as the world races to keep ahead of climate crises, demographic shifts, cyberattacks and supply chain upheaval. This presents attractive opportunities to deploy capital towards building future-proof infrastructure assets.

14. Next Generation Infrastructure.

DBS Chief Investment Office

Infrastructure as the backbone of society. From powering high speed connectivity, to distributing energy and managing waste, infrastructure systems, in all aspects, are essential for society to function. And yet, the world faces a worrying shortfall in infrastructure funding. According to the Global Infrastructure Hub, infrastructure investment needs will outstrip funding based on current trends by a cumulative USD15t from 2015 to 2040. As capital investment needs soar in the developing world, this chronic public underinvestment is expected to drive significant infrastructure deficit. In addition to an urgent need to replace existing ageing infrastructure, there is a growing demand for robust next-generation infrastructure. Climate crises, demographic shifts, urbanisation, cyberattacks, and supply chain upheaval all call for resilient and adaptable infrastructure to keep up with new 21st century challenges.

The world faces a cumulative USD15t infrastructure gap

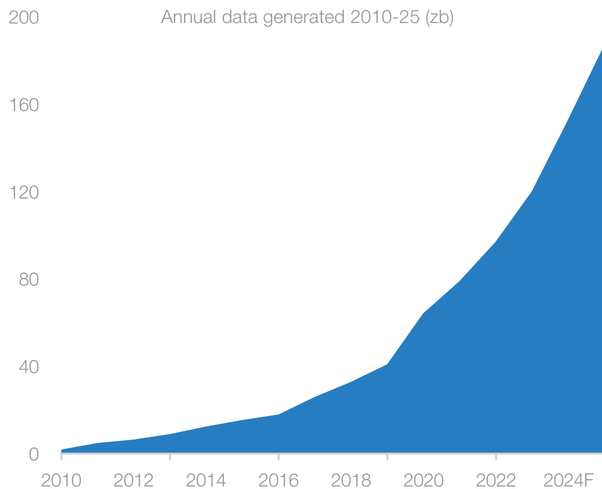


Source; Global Infrastructure Hub, DBS

Governments have already been heavily investing in infrastructure. Being acutely aware of a critical need to refresh ageing assets and build new ones, governments have been allocating considerable resources to this field. For example, the Biden administration's Bipartisan Infrastructure Law, Inflation Reduction Act, and CHIPS Act collectively promise c.USD2t in spending over the next decade. The EU's Global Gateway Strategy also targets about EUR300m in infrastructure investments by 2027. While significant, such public funding remains insufficient to meet burgeoning infrastructure needs. Challenges plaguing major governments have made public resources increasingly scarce; following the GFC, public financing institutions have been focusing on repairing their balance sheets. More recently, fiscal challenges brought by the pandemic (more social transfers, less tax revenues) have further strained developed economies' budgets.

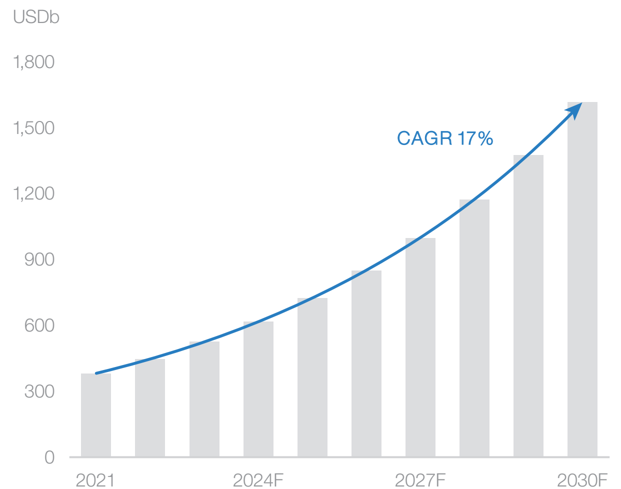
But private sector investments are severely needed to plug the gap. Acknowledging their limitations, governments have increasingly called for greater private sector involvement in infrastructure development, for example, through public-private partnerships. This has created lucrative opportunities for investors to gain exposure to the stable and attractive risk-adjusted returns of infrastructure assets. Furthermore, structural changes are set to drive steady demand for infrastructure spending. Opportunities for next-generation infrastructure are rampant across the following pillars, and we highlight several key trends driving this demand:

Constant increase in annual data generated globally



Source: Statista, Bernard Marr & Co, DBS

Rising cloud computing total addressable market



Source: Precedence Research, DBS

1. Cloud networks: The infrastructure of tomorrow

The emergence of cloud-based data centres has massively changed the way corporates and people work. The world is projected to generate 181 zettabytes or 181t gigabytes of data annually by 2025. The widespread adoption of cloud services will drive the demand for data centres, reliable cloud networks, and their surrounding ecosystems. This will support the evolution of cloud computing through data centres, cloud networks, data storage facilities, and cutting-edge infrastructure to seamlessly connect these components.

Leading cloud providers such as Amazon Web Services, Microsoft Azure, Google Compute Platform, and Alibaba Cloud have already heavily invested in this fast-growing business, anchoring the ubiquitous and utility-like nature of cloud capacity and networks. Nonetheless, an ever-growing amount of data being generated annually can only mean that further capacity will always be needed, additional capital will be required, and scores of other players will jump onto the bandwagon.

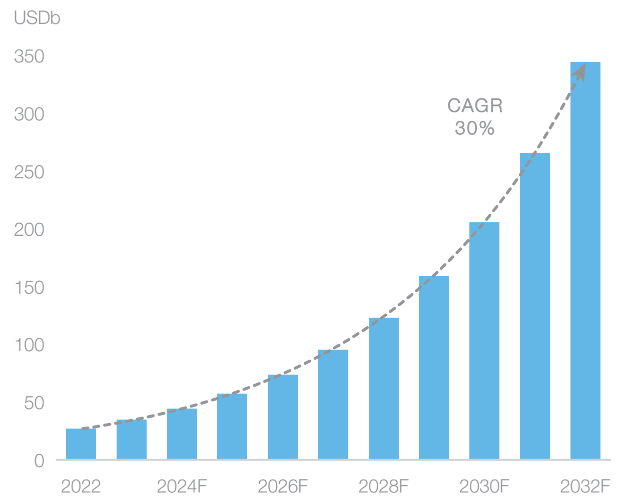
2. The energy transition: An electrifying future

The energy transition signifies a fundamental departure from traditional fossil fuels towards cleaner, more sustainable energy sources, encompassing various aspects of energy production, distribution, and consumption. A shift to cleaner and more secure energy sources is set to create significant opportunities to invest in renewable energy generation, grid networks for distribution, energy storage solutions, and new mobility.

For example, while renewable energy sources such as wind and solar energy are largely regarded as carbon-neutral, they come with inherent variability, unpredictability, and intermittency of energy supply. Energy storage systems are a solution to these limitations. The primary drivers of demand for these systems stem from the power generation and distribution grid sectors. Grid-scale energy storage is the dominant force in the market, given its considerable scale, especially when integrated with renewable energy generation facilities.

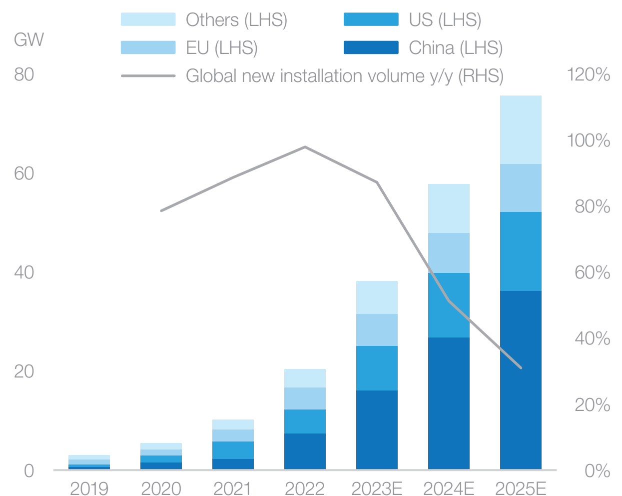
While energy storage systems play a crucial role as essential components in the pursuit of carbon neutrality, EVs are another prominent and transformative embodiment of the energy transition. The EV ecosystem includes companies engaged in the manufacturing and sale of electrification, automation, robotics, and motion products. Technological innovations in key areas like batteries, semiconductors, and charging infrastructure play pivotal roles in driving broader EV adoption. We expect to see a surge in demand for charging infrastructure as more consumers embrace EVs. Ongoing innovations in charging technologies that emphasise faster charging speeds and more user-friendly solutions are enhancing the attractiveness of EVs. Furthermore, governments are also incentivising and regulating the installation of charging stations, and private entities including utilities, charging network operators, and automakers, are investing towards expanding such infrastructure.

EV charging station market value



Source: Precedence Research, DBS

Global installation of new energy storage projects by region



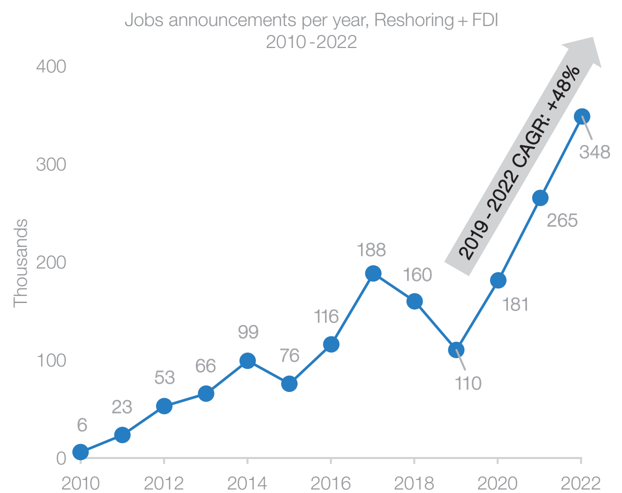
Source: CNESA, Wood Mackenzie, EASE, DBS

3. Transport and logistics: Building resilient supply chains

Post the dual shocks of Covid-19 and the Russia-Ukraine war, governments and businesses across the globe have woken up to the increasing need for not just supply chain efficiency, but also resilience. As a result, we are seeing a growing trend of reshoring; companies bringing manufacturing jobs back from overseas locations, and governments playing an active role in supporting and incentivising these activities. A crucial part of this reshoring push that is often overlooked is transport and logistics infrastructure – reshoring is not just about changing the location where goods are manufactured, it is a comprehensive process involving the relocation and re-routing of entire value chains of raw materials and finished products, ensuring that they are handled and warehoused appropriately at every step of the way. This seismic shift will see a sharp increase in demand for transport and logistics infrastructure moving forward.

Reshoring is a global phenomenon. We are witnessing this movement across a wide swathe of countries in both the developing and developed world. India is actively promoting its "Make in India" initiatives for electronics and pharmaceuticals, Germany and Italy are reshoring key manufacturing activities such as automobile and textile manufacturing, while the US, through its Inflation Reduction Act and CHIPS Act, is seeking to bring semiconductor and EV/battery-related manufacturing activities onshore. To illustrate the scale of the reshoring movement in the US, job announcements because of reshoring and FDI rose at a staggering CAGR of 46.8% between 2019 and 2022. This will inevitably see the increasing need for transport and logistics infrastructure.

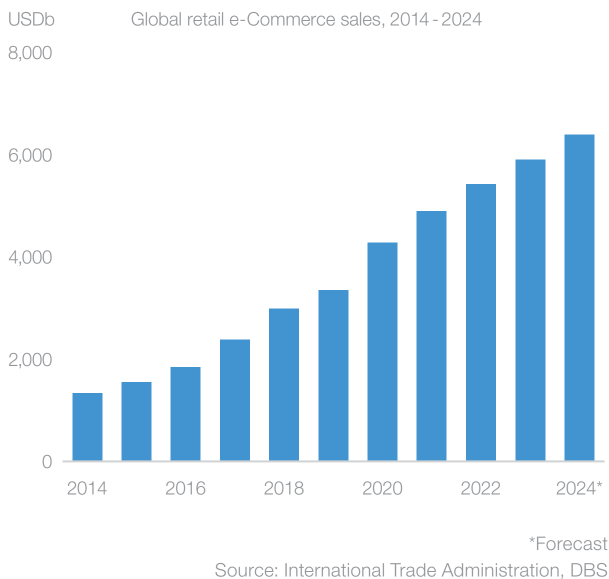
Reshoring and FDI-driven jobs in the US have spiked since 2019



Source: The Reshoring Initiative, DBS

e-Commerce: a secular tailwind. Another secular trend bolstering the need for transport and logistics infrastructure is the rise of e-Commerce. Transport and logistics are the operational backbone of modern e-Commerce. With e-Commerce sales set to boom further to USD6.4t by 2024, there will be a significant increase in demand for next-generation smart warehouses to overcome labour-related challenges and logistics complexities, as well as further optimise inventory movement. The current lack of strong logistics infrastructure as well as the structural tailwinds present numerous investment opportunities.

Global retail e-Commerce sales to reach USD6.4t by 2024



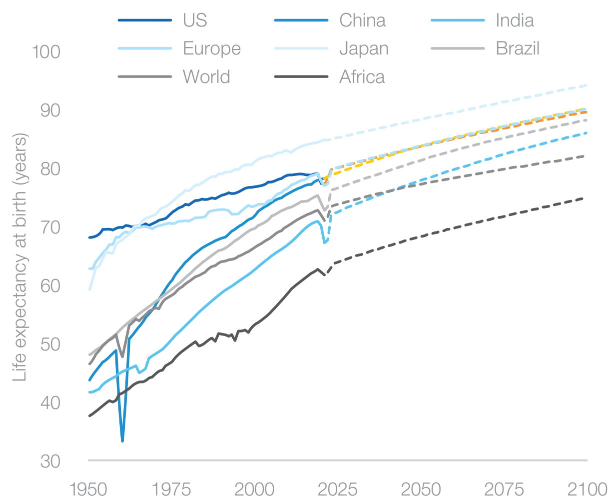
*Forecast
Source: International Trade Administration, DBS

4. Social infrastructure: Transforming cities into communities

Recent events such as the Covid-19 pandemic have exposed social vulnerabilities, underscoring the vital role of social infrastructure in sustaining communities. Social infrastructure assets include schools, hospitals, prisons, and community housing. Although reliable education, health, housing, security, and recreational facilities are indisputably essential, their benefits are hard to quantify. Nonetheless, economists note their substantial contribution to economic growth and employment, and social scientists also stress links between social capital formation and community welfare. Additionally, evolving social and demographic changes threaten the adequacy of existing infrastructure, necessitating ongoing investment in this pillar to maintain essential urban functioning. Such structural changes include:

- Ageing populations shaping infrastructure needs – As life expectancy increases, an ageing population, particularly in developed economies, will intensify pressure on infrastructure in elderly and healthcare sectors. This offers opportunities to private operators, particularly in community housing and long-term care facilities.

Ageing people across the globe



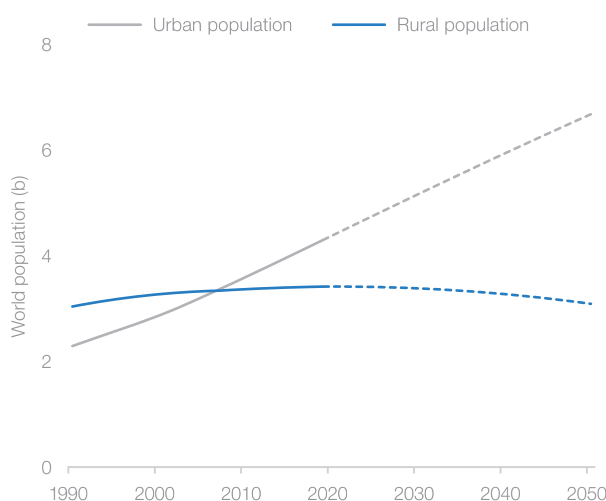
Source: OurWorldInData, United Nations, World Population Prospects (2022), DBS
Note: Dotted line represents projections

- Rapid urbanisation heightening demand for urban infrastructure – Rising urban density can challenge healthcare systems during crises as the pandemic has shown. This emphasises the importance of adequate infrastructure to relieve strain on existing facilities.

- Digitisation redefining the social infrastructure landscape – An increased need for smart infrastructure to serve public spaces could open new challenges and opportunities for investors.

Source: iStock

More than half the world's population live in urban areas



Source: OurWorldInData based on UN World Urbanization Prospects (2018), DBS
Note: Dotted line represents projections

These tailwinds underscore the necessity of social infrastructure investing and point to capacity for more private capital participation in this pillar. Given the inherent "public good" nature and positive externalities of social infrastructure, the public sector is likely to remain a key provider. Funding models are expected to rely on public payments, ensuring a consistent cash flow to investors.

Infrastructure investment strategies. Recognising reliable, compelling risk-adjusted returns offered by infrastructure investing over a long time horizon, the private sector has been eager to be involved in infrastructure investment. Infrastructure investments can generally be bucketed into different strategies, distinguished by the characteristics of the underlying asset targeted, level of risk exposure, and types of returns. These strategies are broadly summarised as follows:

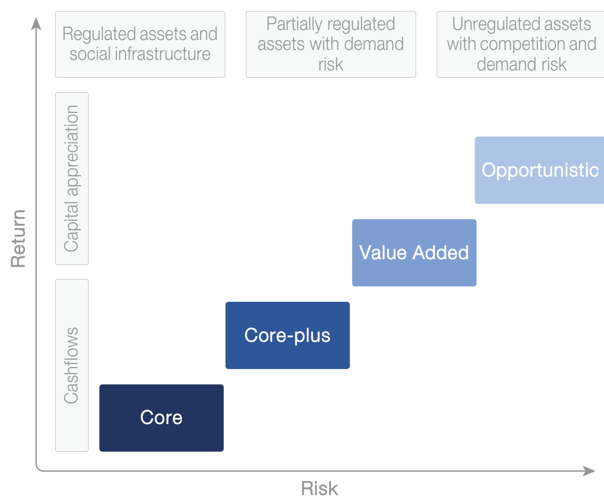
Key characteristics of infrastructure strategies

	Characteristics of assets	Source of returns
Core	Return-generating, essential assets usually in geographies with transparent regulatory and political environments	Stable, highly predictable cash flows
Core-plus	Completed assets, usually in less developed markets. Assets could face demand fluctuations, but include risk-mitigation features (e.g. long term contracts, regulatory support)	Cash flows that might be exposed to some demand fluctuations
Value-Added	Assets in need of a greater degree of enhancement, potentially through operational improvements and/or strategic repositioning	Adding value by repositioning, growing demand, enhancing efficiency and/or increasing scale
Opportunistic	Assets need to be developed/constructed	Capital growth of underlying asset

Source: Preqin, DBS

Investing to enable the digital, decarbonised world of the future. Investments in infrastructure are generally long-term commitments, backed by real assets, and generally offer protection against inflation; investors seeking exposure to infrastructure would do well to understand the nuances of different infrastructure strategies. Assets with more core-like characteristics offer persistent demand and stable cash flows across economic cycles. On the other hand, exposure to value-added or opportunistic-type infrastructure assets face more significant competition as well as construction and demand risk, while providing potential capital appreciation. Across various strategies, the key trends highlighted in next-generation infrastructure offer clear and present opportunities for discerning investors to deploy capital toward future-proof infrastructure both now, and in the decades to come.

Risk and return profile of infrastructure strategies



Source: Preqin, DBS

Vestas

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Glossary.

Acronym	Definition
AI	artificial intelligence
ASEAN	Association of Southeast Asian Nations
ASP	average selling price
AT1	additional tier 1
AUM	Assets under management
AxJ	Asia ex-Japan
bbl	barrel
BI	Bank Indonesia
BNM	Bank Negara Malaysia
BOC	Bank of Canada
BOE	Bank of England
BOJ	Bank of Japan
BOK	Bank of Korea
BOT	Bank of Thailand
BSP	Bangko Sentral ng Pilipinas
bpd	barrels per day
bps	basis points
CAA	CIO Asset Allocation
CAGR	compound annual growth rate
CBO	Congressional Budget Office
CET1	Common Equity Tier 1
CIPS	Chartered Institute of Procurement & Supply
CPI	consumer price index
DM	Developed Markets
dma	day moving average
DPU	distribution per unit
DXY	US Dollar Index
EBIT	earnings before interest and taxes
EBITDA	earnings before interest, tax, depreciation, and amortisation
EC	European Commission
ECA	European Chips Act
ECB	European Central Bank
EGB	European Government Bonds
EIA	Energy Information Administration
EM	Emerging Markets

Acronym	Definition
eop	end of period
EPFR	Emerging Portfolio Fund Research
EPS	earnings per share
ESG	Environmental, Social, and Governance
ETF	exchange-traded fund
EU	European Union
EUV	extreme ultraviolet
EV	electric vehicle
FOMC	Federal Open Market Committee
FDI	foreign direct investment
FX	foreign exchange
G2	Group of Two
G3	Group of Three
G7	Group of Seven
G10	Group of Ten
GDP	gross domestic product
GFC	Global Financial Crisis
GST	goods & services tax
HIBOR	Hong Kong Interbank Offered Rate
HICP	Harmonised Index of Consumer Prices
HKMA	Hong Kong Monetary Authority
HY	high yield
IEA	International Energy Agency
IndoGB	Indonesian Government Bonds
IG	investment grade
IGB	India Government Bonds
IMF	International Monetary Fund
IPO	initial public offering
IRS	interest rate swap
ISM	Institute for Supply Management
IT	Information Technology
JGB	Japanese Government Bond
KLIBOR	Kuala Lumpur Interbank Offered Rate
KTB	Korea Treasury Bonds
LERS	Linked Exchange Rate System

Acronym	Definition
LGB	local government bonds (China)
LGFV	local government financing vehicle
LP	limited partner
LPR	loan prime rate
LSTA	Loan Syndications and Trading Association
LVMH	Moët Hennessy Louis Vuitton
MAS	Monetary Authority of Singapore
MBS	Mortgage-backed securities
MLF	medium-term lending facility
mmbpd	million barrels per day
MNC	multinational corporation
NATO	North Atlantic Treaty Organisation
NEER	nominal effective exchange rate
NIM	net interest margin
NIRP	negative interest rate policy
NPL	nonperforming loan
OBR	Office for Budget Responsibility (UK)
OECD	Organisation for Economic Co-operation and Development
OIS	overnight indexed swap
OMO	Open Market Operations
OPEC+	Organisation of the Petroleum Exporting Countries
OPM	operating profit margin
OTC	over the counter
P/B	price-to-book
P/E	price-to-earnings
PBOC	People's Bank of China
PC	personal computer
PCE	personal consumption expenditure
PE	Private Equity
PER	price-to-earnings ratio
PMI	purchasing managers' index
PPI	producer price index
QE	quantitative easing

Acronym	Definition
QT	quantitative tightening
RBA	Reserve Bank of Australia
RBI	Reserve Bank of India
RBNZ	Reserve Bank of New Zealand
REER	Real Effective Exchange Rate
REIT	real estate investment trust
RPGB	Philippine Government Bonds
ROA	return on asset
ROE	return on equity
RRR	required rate of return
SAA	Strategic Asset Allocation
SBV	State Bank of Vietnam
SD	standard deviation
SGS	Singapore Government Securities
SNB	Swiss National Bank
SOE	state owned enterprise
SOFR	Secured Overnight Financing Rate
SORA	Singapore Overnight Rate Average
TAA	Tactical Asset Allocation
ThaiGBs	Thailand Government Bonds
TOPIX	Tokyo Stock Price Index
TP	target price
TPI	tax and price index
TSE	Tokyo Stock Exchange
UCITS	Undertakings for Collective Investment in Transferable Securities
UHNW	ultra high net worth
UST	US Treasury
WFH	work from home
WTI	West Texas Intermediate
YCC	Yield control curve
YTD	year-to-date
ZIRP	Zero Interest-Rate Policy

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September 2023

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March 2023

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December 2022

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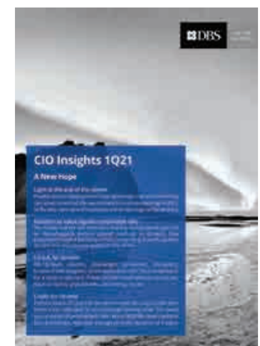

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