DBS Live more, Bank less

CIO Insights 1Q21

A New Hope

Light at the end of the tunnel
Positive vaccine developments have given hope the world economy can return to normal. We see recovery in corporate earnings in 2021, as the stop-start cycle of lockdowns and re-openings can be avoided.

Rotation to Value signals sustainable rally
The equity market has entered a healthy, broad-based uptrend as Value/laggard sectors played catch-up to Growth. Stay invested through a Barbell portfolio comprising Growth equities on one end and Income assets on the other.

I.D.E.A. for Growth
On Growth equities, Overweight Innovators, Disruptors, Enablers, and Adapters. At the same time, add "Vaccine Winners" for a tactical rebound. These include travel-related companies, Asian property, global banks, and energy stocks.

Credit for Income
Fed's inclusion of corporate bonds into their QE policy toolkit infer credit is the "safe play" as an income-generating asset. The sweet spot in terms of yield/default rate ratio is BBB/BB-rated credits in Asia and Europe. Maintain average portfolio duration of 5 years.

Source: Carole Lum

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Note: Unless otherwise stated, views are as of 10 December 2020.

Foreword

Source: Carole Lum

Dear valued clients,

2020 has taken all of us by surprise, but we are heartened that the bond between us has weathered the storms. We have seen strong demand for wealth management services, and this is thanks to your continued support and trust in us.

Globally, we are starting to see some early signs of economic recovery from COVID-19. Closer to home, recent developments such as the Regional Comprehensive Economic Partnership has reinvigorated the region's trade and investment outlook. In Singapore, the latest economic figures seem to show that we have turned a corner, with a path to recovery in sight.

Nonetheless, we remain cognisant of the fact that markets could continue facing volatility amid resurgences of the virus.

Against this backdrop, I present to you 1Q21's CIO Insights, a guide to navigate the investment landscape of this brave new world. Continue with the DBS Barbell Strategy in portfolios – an approach favouring income-generating assets, as well as an overweight in secular growth themes.

Sustainable investing remains in the spotlight. We have partnered with the Community Chest in Singapore on an initiative to enable our wealth clients to raise funds for vulnerable communities. This complements our ongoing initiatives aimed at supporting clients in creating positive impact, and aligns with our ethos of being People of Purpose.

As a fun way for you to participate in these two threads, join in our "Topple the Barbell" challenge where you can pit your investing wits and acumen against the DBS CIO portfolio. The winner can choose to benefit a charitable organisation/social enterprise of their choice. Do speak to your RMs on how to sign up.

Amid this new normal, markets can be jittery; emotions and fatigue can come into play. But I hope you can take comfort in knowing we take a transparent, rigorous, and disciplined approach in managing your portfolios, particularly in unsettling times.

Through our Intelligent Banking capabilities, we have been laser-focused on delivering timely, relevant, and actionable insights that guide you to make more informed financial and investment decisions.

Once again, thank you for your continued support and trust in DBS as your preferred wealth management partner. We look forward to serving you better in the new year.

Sim S. Lim
Group Head
Consumer Banking &
Wealth Management


Source: Carole Lum

Executive Summary

Dear valued clients,

2020 is surely a year without precedence. A once-in-a-century pandemic crisis, followed by global economies locking down and air travel coming to a halt, were unparalleled.

Led by the Federal Reserve's QE Infinity policy, we saw a sharp turnaround from a 35% peak-to-trough fall to end the year with a 14% gain (as of 10 December) in the global equity index. At the same time, corporate bond prices soared, leading to all-time low credit spreads.

Where do we go from here?

Positive developments on vaccines triggered a rotation back into Value and laggard sectors of the equity market. For example, travel-related plays like hotels and airlines, as well as banks and energy stocks rebounded strongly. More importantly, this rotation resulted in a "broadening" of the market – no longer one that is led by Big Tech only. To us, this is a healthy dynamic which will lead to a sustainable uptrend.

We advocate that you stay invested through a Barbell Strategy. It means to hold Overweight exposures in Growth equities on one end, and Income assets on the other. Our Barbell portfolio recorded a gain of 17%, outperforming the underlying benchmark index comprising 50% global equities and 50% global bonds by 6% (as of 10 December).

On the growth side, buy into I.D.E.A. companies – the Innovators, Disruptors, Enablers, and Adapters. These companies would thrive in a world that is fast transforming into a digital economy. We also add "Vaccine Winners", companies that were hit hard by the pandemic. On the income side, stay with BBB/BB-rated bonds and dividend-yielding stocks including Singapore REITs.

This quarter, we feature opportunities in I.D.E.A. as well as innovations within Biotechnology.

Enjoy the read and I wish you all success investing in 2021!

Hou Wey Fook, CFA
Chief Investment Officer

DBS Live more, Bank less

Asset Allocation | 1Q21

A new bull

Macro Outlook

Monetary Policy
Fed policy accommodation is expected through mid-2021 until economic recovery gains a firmer footing. Concern over Fed taper is premature for now.

Economic Growth
Uncertainty over new US fiscal stimulus will be mitigated by accommodative monetary policy. Confidence from vaccine developments will support consumption.

Geopolitics
How US-China relations will evolve under the Biden administration will be closely watched. Low likelihood of further escalation in the trade war.

Inflation
Inflationary pressure to gather pace towards late 2021 as economies normalise. US and China inflation expected at 1.7% and 2.5%, respectively.

Fiscal Policy
US fiscal stimulus remains in focus as monetary easing has reached its limits. The prospect of a large US stimulus bill hinges on the Senate runoff in Georgia.

Market Outlook

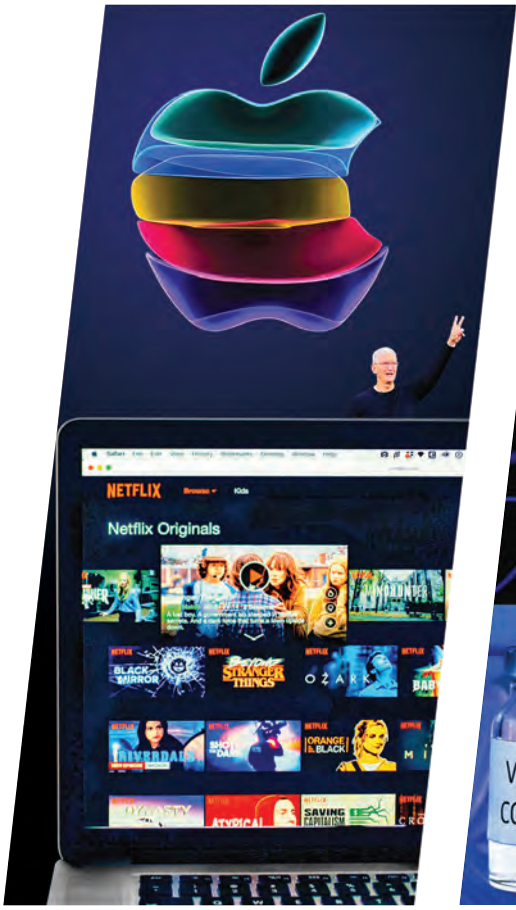
Equities
Rally in equities to be underpinned by negative real bond yields, attractive equity risk premium, and corporate earnings recovery.

Currencies
USD depreciation to moderate amid steepening UST curve and uncertainties over US stimulus bill. Measured CNY gains expected in 2021.

Rates
Policy accommodation to persist through 1Q21. But less easy policy is expected as recovery gains firmer footing in 2H21. Ten-year UST yield to target 1.3%.

Credit
Favour Asia credit for fundamentals and valuations. Easing US-China trade tension to translate to compression of Asia HY-IG risk premium.

Thematics
Gain exposure to Innovators, Disruptors, Enablers, and Adapters (I.D.E.A.) – winners of the new digital world. Outlook for biotechnology looks promising.



New Theme: I.D.E.A.

The pace of digital change is faster than ever in our ever-evolving world. Looking ahead is critical to success. DBS CIO's I.D.E.A. focuses on technology trends that help investors select sectors and companies to be ahead of the pack. Companies which have the characteristics of Innovators, Disruptors, Enablers, and Adapters have seen their stock prices surge, and we expect this trend to continue.

CIO Expert Series: Biotechnology

These are exciting times for Health Care, in particular for biotechnology. There are several secular growth themes impacting the industry with favourable long-term ramifications for health care spending and drug development (including broad demographic trends and major advancements in medical science). Longer term, the tremendous amount of innovation in development of new drugs augurs well for the outlook.

Special Feature: The War on Big Tech

The war against Big Tech has begun; this came in the wake of the rising dominance of US tech companies. But are US antitrust laws still relevant today, given that they focus predominantly on pricing? Despite the headwinds, investors should stay calm as spinning-off a business division in Big Tech can result in value creation. Moreover, the emergence of a "Digital Iron Curtain" between the US and China suggests that policymakers will adopt a "centrist approach" to this issue.

Asset Allocation

Hou Wey Fook, CFA | Chief Investment Officer
Dylan Cheang | Strategist

A New Bull

The COVID-19 pandemic brought the 11-year bull market to an end in March 2020, and during this period the S&P 500 Index rallied 401% – the second highest gain in history. The only other bull market which registered stronger gains was the rally from October 1990 to March 2000 that saw US equities gaining 417%.

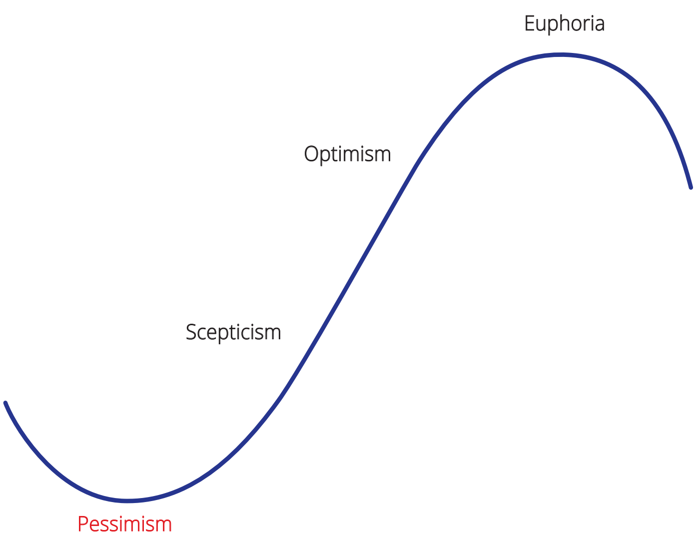
By definition, a bull market occurs when equity prices increase by 20% or more. Conversely, a bear market takes place when prices fall by the same magnitude (or more). So based on this convention, the acute 33.9% peak-to-trough selldown during February to March 2020 signified a bear market and the subsequent high-octane rebound since 23 March marked the start of a new bull market.

No doubt, sceptics will bemoan such an "optimistic" view. After all, how can a bull market possibly commence when unemployment rate remains high while the service-related industries remain challenging? But as the old adage goes: "Bull markets are born on pessimism, grown on scepticism, mature on optimism, and die on euphoria" (Figure 1).

So where are we in the cycle?

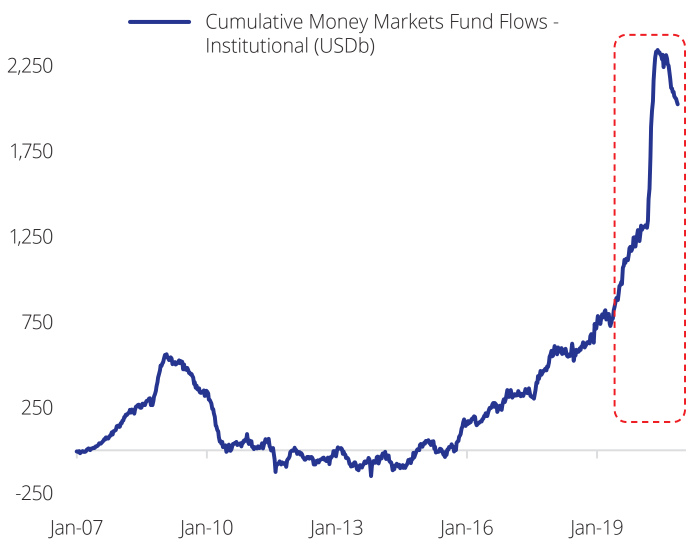
Given the huge mountain of funds parked in money markets (Figure 2), we are clearly in the pessimism stage, and this is where bull markets have historically been born. As US elections uncertainties come to an end, and with the discovery of a vaccine for COVID-19, we believe that the stage is set for stronger equity markets in 2021.

Figure 1: Bull markets are historically born in the pessimism stage, and this is where we are now



Source: DBS

Figure 2: Where is the euphoria? Huge mountain of funds remained parked in money markets



Source: EPFR Global, DBS

We see several similarities between the start of previous bull markets and current conditions:

- Sharp plunge in bond yields: The typical playbook for central bankers is to cut policy rates during times of macro distress and this explains the plunge in government bond yields when risk assets were in correction mode.

  During the dot-com crisis, the UST 10-year yield fell 307 bps over 32 months until the S&P 500 troughed in September 2002. Similarly, bond yields fell 212 bps over 32 months during the Subprime Crisis. In the COVID-19 pandemic, bond yields have fallen 247 bps over a short span of 17 months (Figure 3).

  Such acute plunges in bond yields are historically associated with the end of a bear market (and the start of a new bull market).

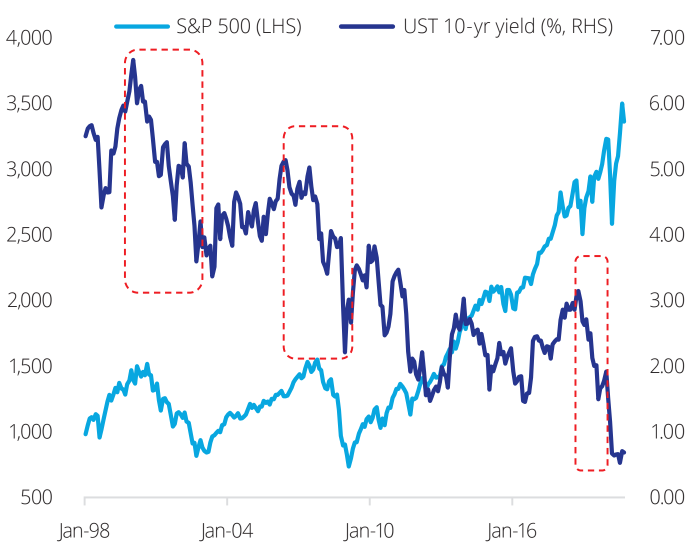
- Reversal in macro momentum: During times of market dislocation, risk assets tend to trade in line with the "delta" of macro indicators when the latter hits an extreme. In other words, so long as macro conditions are not becoming increasingly worse, the selldown will hit an inflexion point and change course. Such a trading pattern is evident in past crisis:

  » At the end of the dot-com bubble in 2002, the S&P 500 took off even though ISM Manufacturing had just started to reverse (but remained in contractionary mode nonetheless).

  » Post-Subprime Crisis, US equities were up 34% during March to July 2009 despite ISM Manufacturing remaining below the 50-mark.

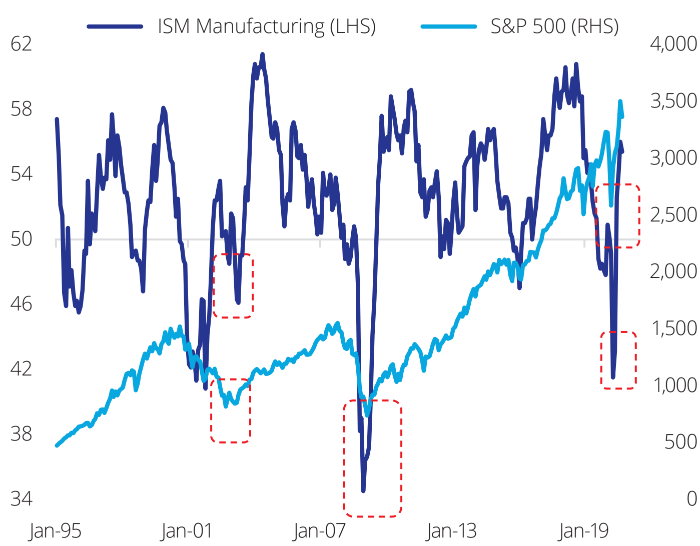
In the COVID-19 pandemic, the same trading behaviour is evident with US equities rallying 18% during April and May 2020 even though ISM Manufacturing was stuck in contractionary territory (Figure 4). This signalled that sentiments have hit a trough and the rebound heralded the start of a new bull market.

Figure 3: The end of a bear market was historically characterised by sharp declines in bond yields



Source: Bloomberg, DBS

Figure 4: The start of new bull market was historically marked by acute reversal of macro momentum



Source: Bloomberg, DBS

Three conditions underpinning the rally

Given the fiscal headwinds and low mortality rate, we believe that governments around the world will have little appetite for prolonged shutdowns of their economies again. The very most policymakers will do is to impose restriction orders to flatten the curve in the event of a resurgence. Recent comments from the incoming Biden administration attest to this view.

Since the high-octane rally which started in late March, institutional investors who missed out on the rebound would bemoan the "disconnect" between risk assets and fundamentals. We understand that. Indeed, there is no denying that the global economy is looking fragile after the damage done by COVID-19.

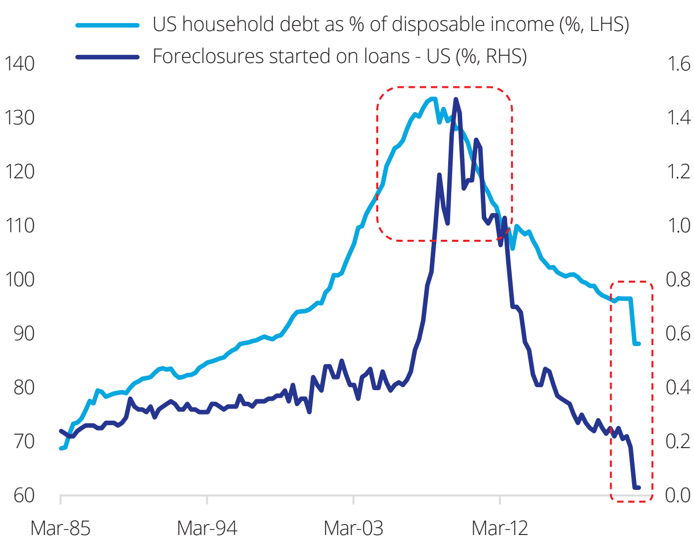
But the pertinent question is: Is this economic weakness caused by structural imbalances or exogeneous shocks? We are firmly in the camp that the prevailing macro challenges are caused by exogenous factors that are transitory and have no bearing on the long-term structural outlook of the economy.

Back in 2008, US household debt to disposable income hit a high of 133.6% while foreclosures on all loans also peaked at 1.4% just prior to the onslaught of the Subprime Crisis. But none of these imbalances are prevalent today (Figure 5). With the exception of some industries that will face sustained challenges (e.g. airlines), we believe that the broader economy will undergo a broad-based recovery as business normalcy resumes while financial conditions ease (Figure 6).

2021 will herald a year of recovery as companies gradually emerge from the ashes of the pandemic – stronger and nimbler. As we navigate the new year, the following themes will dominate the narratives:

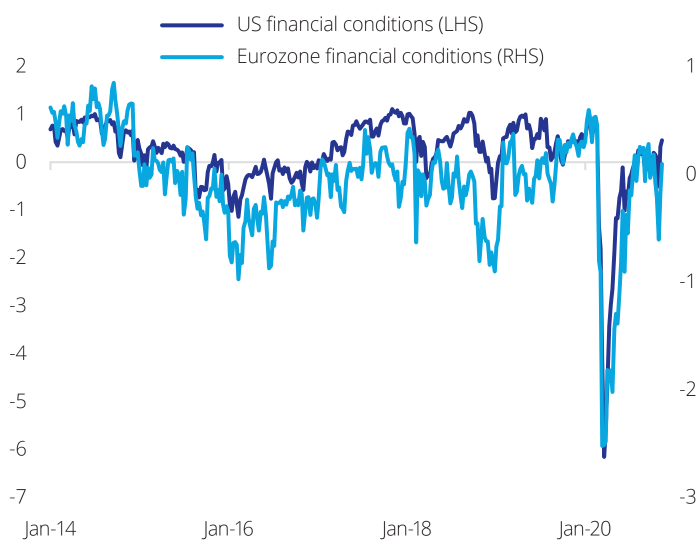
1) Negative real bond yields
2) Attractive equity risk premium
3) Corporate earnings recovery

Figure 5: Structural imbalances seen prior to Subprime Crisis are not evident today



Source: Bloomberg, DBS

Figure 6: Easing financial conditions in the US and Eurozone

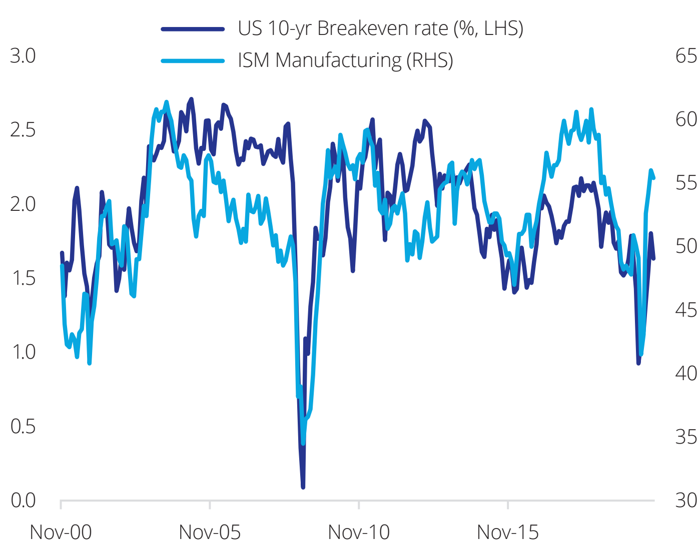


Source: Bloomberg, DBS

Negative real bond yields to underpin risk assets. Real bond yields – which refer to nominal bond yields minus inflation – is negative. The prevalence of low nominal bonds yields is understandable given the aggressive monetary easing by the US Federal Reserve since the start of the pandemic. Moreover, the subsequent pledge to allow inflation to overshoot while keeping policy rates low exerted further downward pressure on nominal yields.

But paradoxically, low nominal yields are commonly associated with economic weakness. And if this is the case, what is currently causing the sharp rebound in the US 10-year breakeven rate – a market-based measure of inflation expectations? We believe that rising inflation expectations reflects rising confidence of a recovery in the real economy and this is evident from Figure 7, which shows ISM Manufacturing rebounding with the US 10-year breakeven rate (a proxy for inflation expectations).

Figure 7: US inflation expectations rebounding in tandem with macro momentum



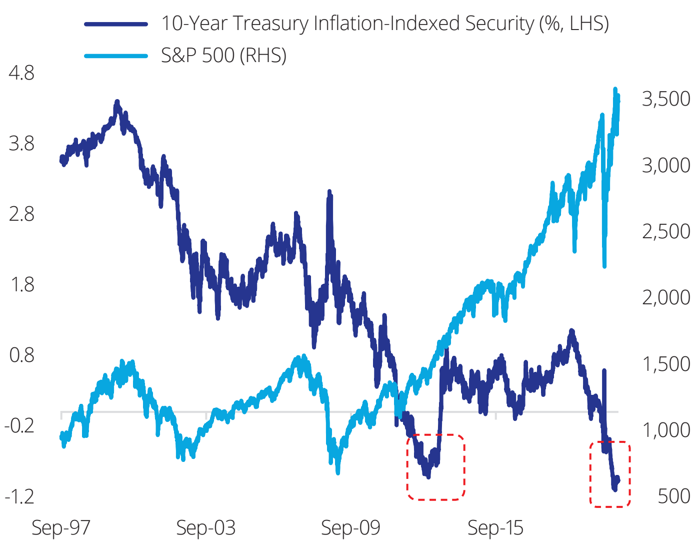
Source: Bloomberg, DBS

We believe that the combination of: a) The Fed anchoring nominal yields to the lows through yield curve control and (b) Rebounding inflation expectations as the recovery gather pace would result in sustained negative real interest rates in the course of 2021, and this will spur investors to seek higher returns in riskier assets like equities and corporate bonds (Figure 8).

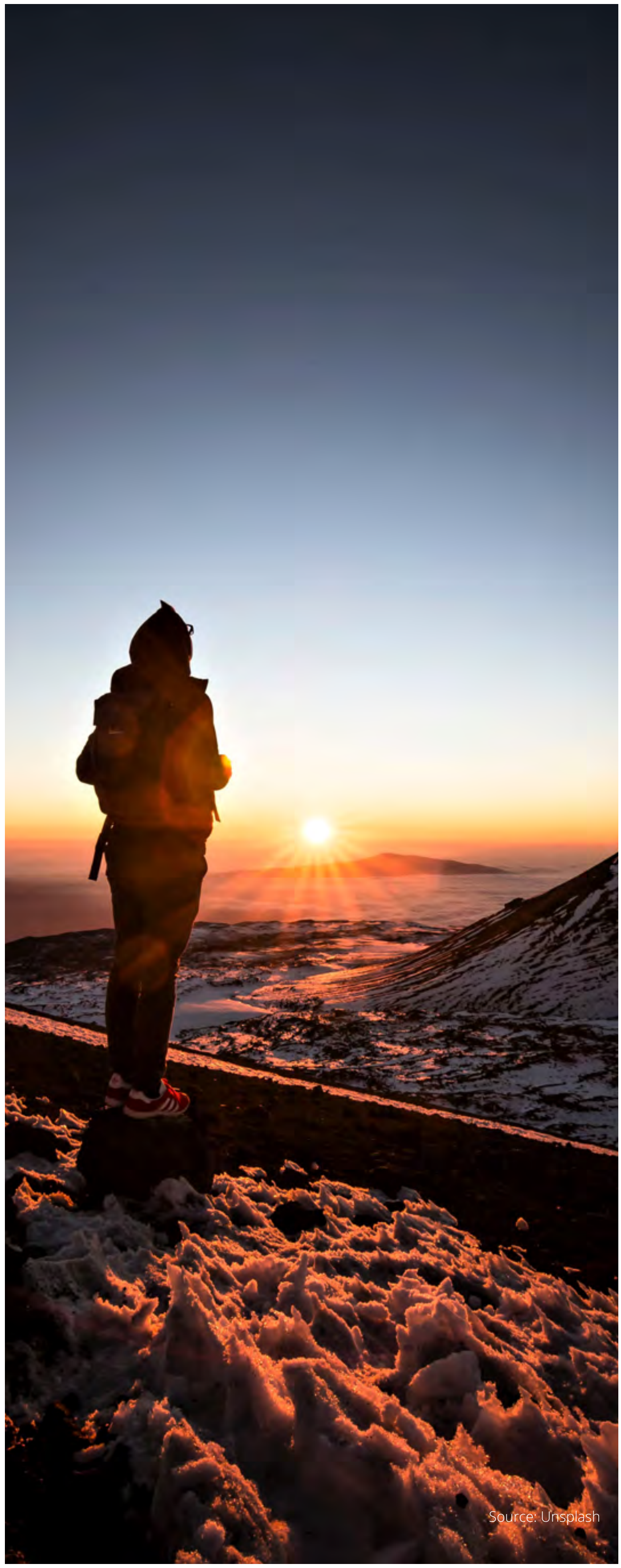
Prevailing equity risk premium to trigger funds inflow to equities. A common pushback among clients on the sustainability of this equity rally is that valuation is currently "looking rich". Sure, on an absolute basis, the forward P/E of global equities stands at 25.8x and this is above its long-term average.

But one needs to be mindful that such relative valuation matrices are not static as the ratio consists of two moving parts: (a) Price and (b) Earnings forecast. As global economic momentum gather pace in coming quarters, corporate earnings will normalise, and this translates to downward pressure on valuations.

Figure 8: Negative real bond yield will spur the flow of funds into risk assets

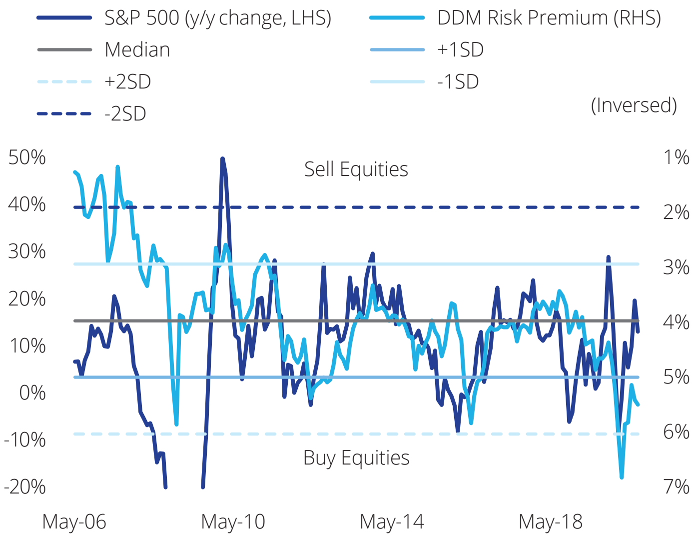


Source: Bloomberg, DBS



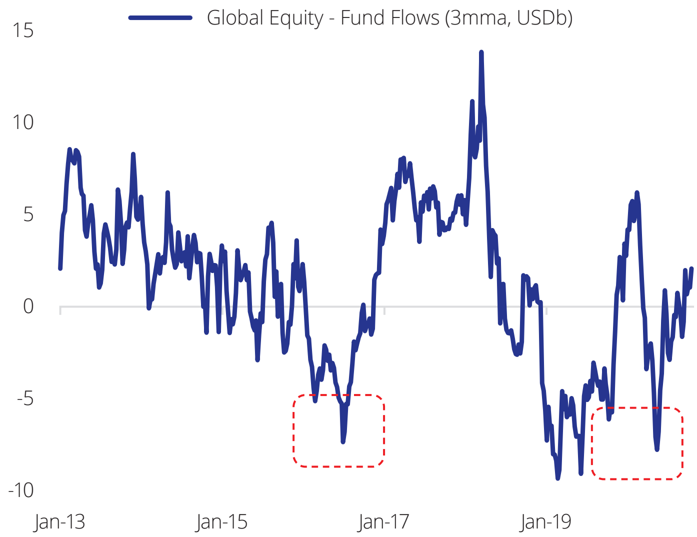
Source: Unsplash

Figure 9: Current ERP implies that equities are more attractive than bonds



Source: Bloomberg, DBS

Figure 10: A high ERP will accelerate the flow of funds into the asset class



Source: EPFR Global, DBS

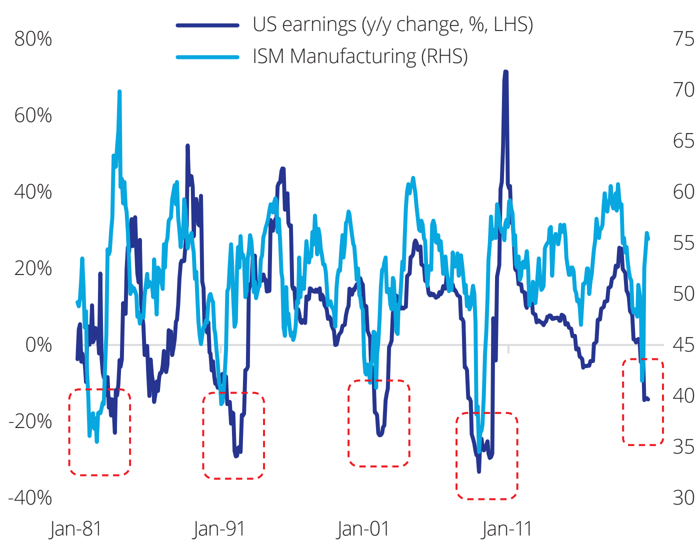
A bigger factor determining the trajectory of equity markets, in our view, is the equity risk premium (ERP) – which measures the excess returns expected by investors for holding on to equities (as opposed to a risk-free asset). In our two-stage dividend discount risk premium model (Gordon Growth Model), we assumed a terminal growth of 4.6%, and the implied ERP stands at 5.5% currently (vs a long-term median of 4.0%) (Figure 9).

Our analysis of fund flow data suggests that a high ERP may not necessarily herald the start of a bond-to-equity rotation and this has much to do with the overall prevalence of risk aversion in financial markets. Instead, a high ERP has historically marked the start of funds inflow into the equity asset class and we have seen that in 2016 as ERP hit a high of 5.8% (Figure 10).

Corporate earnings set to rebound as business normalcy resumes. Corporate earnings fell into the red as the pandemic lockdown literally led to a cessation of activities. Businesses that require face-to-face human interactions, particularly those related to tourism, were hard hit. But 2Q20 marked the trough for corporate earnings, which we expect to undergo sequential rebound in subsequent quarters.

As Table 1 shows, ISM Manufacturing has historically been a leading indicator for corporate earnings. During recessions triggered by the Iran/Energy crisis (1981-82), Gulf War (1990-91), and September-11 (2001), the trough for ISM Manufacturing has, on average, preceded that of corporate earnings by 10 months. ISM Manufacturing troughed in April 2020, and judging from historical patterns, we expect to see subsequent troughing of corporate earnings (Figure 11).

Figure 11: US ISM Manufacturing suggests earnings rebound on the cards



Source: Bloomberg, DBS

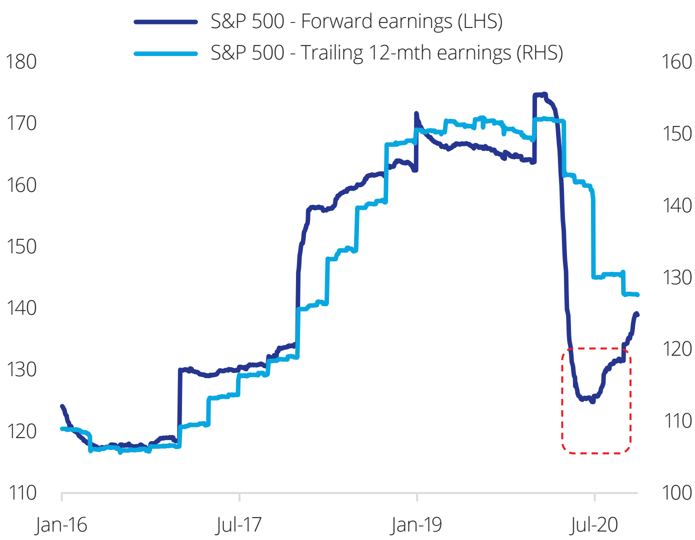
Table 1: Historical relationship between ISM Manufacturing and US earnings

Name of Recession	ISM Manufacturing trough	US earnings trough	Difference
Iran/Energy Crisis Recession	May 1982	August 1983	15 months
Gulf War Recession	January 1991	January 1992	12 months
September-11 Recession	October 2001	January 2002	3 months
Subprime Crisis Recession	December 2008	December 2008	-
COVID-19 Recession	April 2020	-	-
Average			10 months

Source: DBS

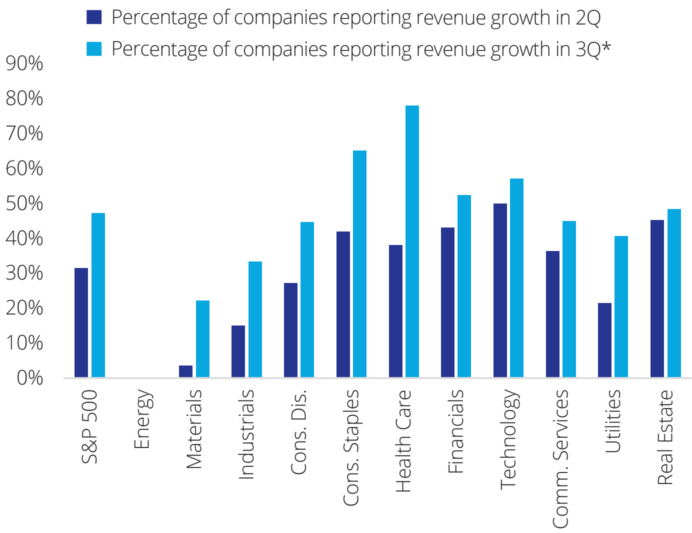
The sequential rebound seen in US third quarter earnings confirmed that corporate momentum is on the mend. To get a clearer picture of the prevailing situation, we looked at revenue instead of earnings given that the latter could be inflated by share buybacks.

Figure 12: US forecasted earnings has undergone upward revision



Source: Bloomberg, DBS

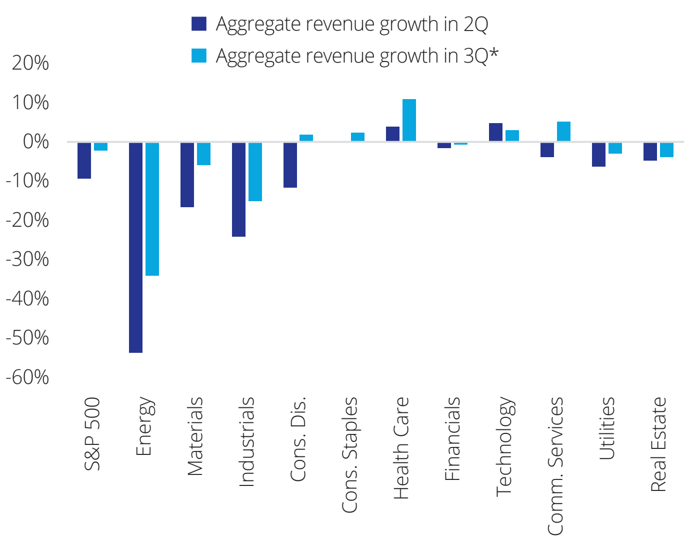
Figure 13: Corporate momentum on the mend – more companies reporting revenue growth



Source: Bloomberg, DBS
* as of 15 November 2020

Figure 13 shows that 47% of the companies on S&P 500 reported revenue growth in 3Q20 (based on data as of 15 November), an improvement from 32% in 2Q20. On an aggregated basis, the decline in total revenue for S&P 500 has also improved from -9.4% in 2Q20 to -2.2% in 3Q20. In fact, the aggregate revenue growth for sectors like Health Care, Communications Services, and Technology are among the highest during the quarter (Figure 14).

Figure 14: Aggregate revenue growth on the mend



Source: Bloomberg, DBS
* as of 15 November 2020

Vaccine Discovery: Rotation into Value signals a broadening rally

A vaccine jointly developed by Pfizer and BioNTech attained 95% effective rate in preventing COVID-19 based on Phase 3 trial results. Similarly, a vaccine developed by Moderna was also said to achieve 94.1% effective rate in a late stage trial. These announcements signify critical milestones reached in the global race to find a vaccine as the pandemic rages on.

Vaccine news triggered outperformance of Value stocks. Recent vaccine news has unleashed a powerful rotation into Value stocks. Since the start of the pandemic, Value counters have been particularly hard hit as economic lockdowns and looming macro challenges triggered the switch out of economic sensitive sectors in the Value space.

The promise of a vaccine for COVID-19 changed the narrative. An effective vaccine will allow economic activities to return to normalcy. But in our view, this does not herald the start of a major portfolio shift from Growth to Value (Figure 15).

Figure 15: Recent Value outperformance does not mark the start of a Value-to-Growth rotation

Source: Bloomberg, DBS

Tactical rotation into Value signals broadening market rally. There is a perception in the market that Value stocks consist of "hidden gems" with catalysts that investors are not aware of. In reality, most Value stocks that we see today are economic sensitive companies that were sold down during the pandemic and have failed to rebound since.

Given that these Value stocks are simply "laggard plays", their recent outperformance over Growth will, therefore, not mark the start of a new cycle. Instead, the outperformance of Value signals a broadening of the market rally as portfolio allocators switch into laggard Value plays after the strong run in Growth.

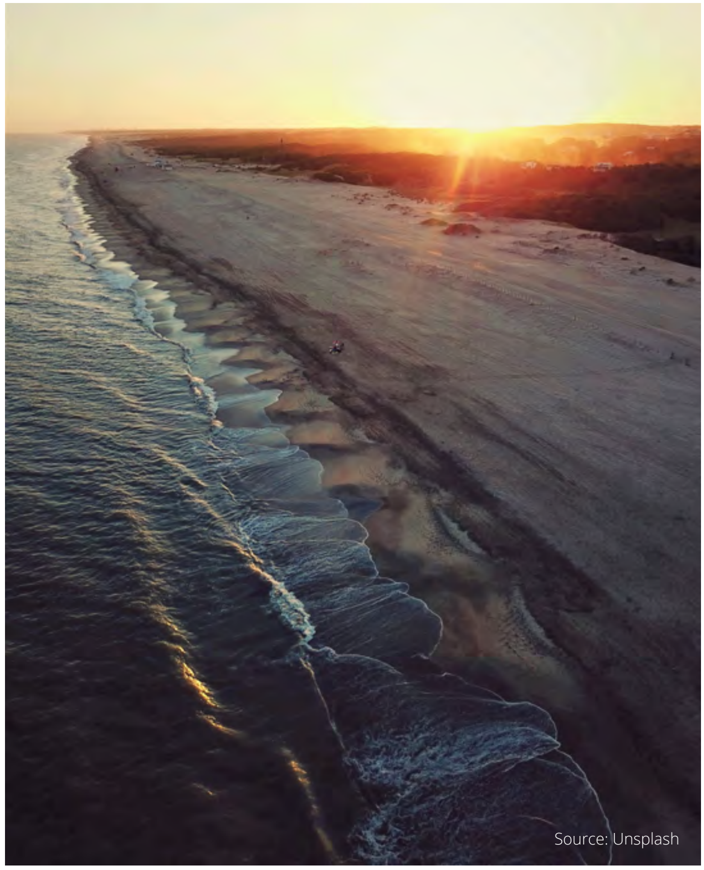
Our analysis of past market cycles show that the outperformance of Value over Growth tends to take place in a rising market:

» During 2H12 to 1H13, US Value outperformed US Growth by 7%, while the S&P 500 rallied 18%.

» In 2016, US Value outperformed US Growth by 9%, while the S&P 500 rose 10%.

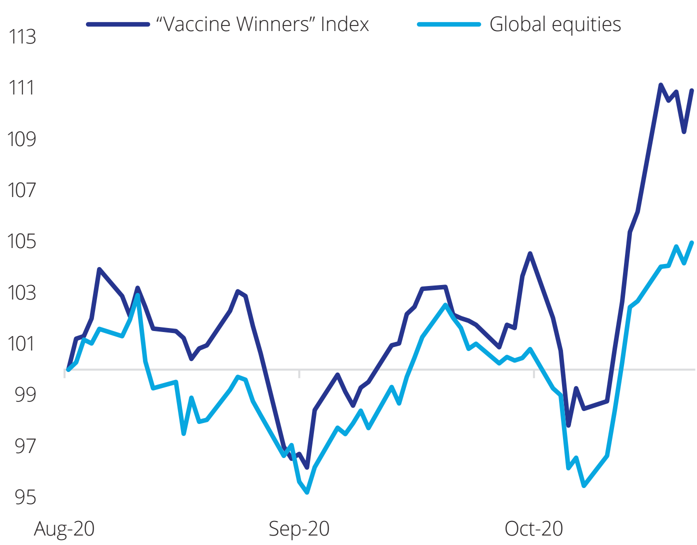
» During 2H19, US Value outperformed US Growth by 3%, while the S&P 500 rose 10%.

Maintain Barbell approach; gain tactical exposure to Value while maintaining strategic longs on Growth. We continue to advocate the Barbell Strategy to portfolio construction. On the Growth end of the portfolio, maintain exposure to the Technology sector. Riding on the positive vaccine news, investors should also gain tactical exposure to Value via "Vaccine Winners" in the restaurants, hotels, leisure, and casino space (Figure 16). Industries that require face-to-face interactions are poised to rebound strongly in the event of a vaccine discovery.



Source: Unsplash

Figure 16: Gain tactical exposure to Value plays via "Vaccine Winners"



Source: Bloomberg, DBS
Note: The "Vaccine Winners" Index consists of (1) MSCI World Hotel, Restaurants & Leisure Index and (2) S&P Global 1200 Casinos & Gaming Index

1Q21 Asset Allocation – The return to normalcy

Table 2: 1Q21 CIO Asset Allocation (CAA) Framework

Categories	Indicators	Score Range	Equities				Bonds		
			US	Europe	Japan	AxJ	DM Govt	DM Corp	EM Bonds
Fundamentals	PMI	-1 to +1	0	0	0	1	0	0	1
	Economic surprise	-1 to +1	-1	-1	0	1	0	0	1
	Inflation	-1 to +1	0	0	0	0	0	0	0
	Monetary policies	-1 to +1	0	0	0	0	1	1	0
	Forecasted EPS growth	-2 to +2	2	-1	1	1	-	1	1
	Earnings surprise	-2 to +2	1	-1	0	1	-	0	1
Valuation	Forward P/E	-2 to +2	-1	-1	0	0	-	-	-
	P/B vs ROE	-2 to +2	0	-1	0	1	-	-	-
	Earnings yield - 10-yr yield	-2 to +2	1	1	1	1	-2	-1	0
	Free Cashflow yield	-2 to +2	1	-1	0	0	-	-	-
	Credit spread	-2 to +2	-	-	-	-	-	0	1
Momentum	Fund flows	-2 to +2	1	0	0	0	0	-1	0
	Volatility	-1 to +1	0	0	0	0	0	-	-
	Catalysts	-2 to +2	1	1	1	1	0	0	1
Raw Score			5	-4	3	7	-1	0	6
Adjusted Score*			**0.24**	**-0.19**	**0.14**	**0.33**	**-0.09**	**0.00**	**0.38**

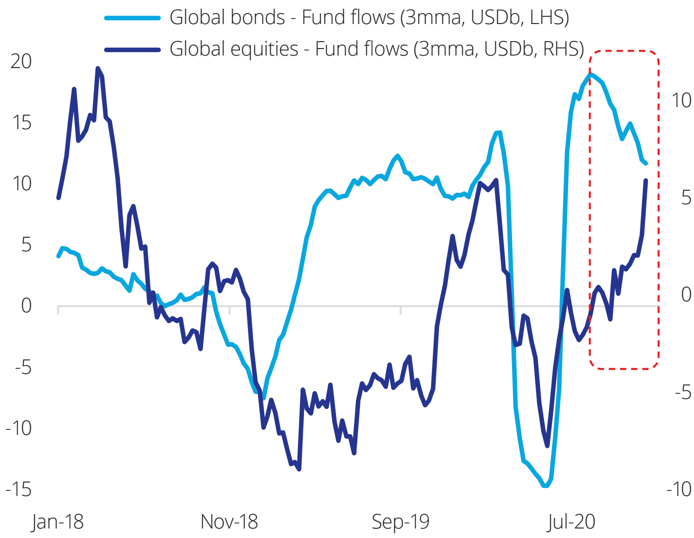
*Note: The "Adjusted Score" is calculated using the "Raw Score" divided by the maximum attainable score for each category. Source: DBS

Cross Assets: Vaccine discovery and the end of election uncertainties will drive outperformance of equities over bonds. From a cross-assets perspective, we keep our preference for equities over bonds. In our CAA Framework, equities garnered a higher composite score of 0.13, as compared to 0.09 for bonds.

Fundamentals: The latest data suggest that macro momentum has troughed in 2Q20. This is evident from the ISM Manufacturing index, which surged from a low of 41.5 in April (contractionary territory) to 57.5 in November (expansionary territory). The US economic surprise index has also rebounded from -144.6 in end-April to 75.8 currently. Stronger economic momentum has, in turn, buoyed corporate earnings. For the 3Q20 US earnings season, 72% of the companies have reported positive sales surprise while the proportion of companies with positive earnings surprise came in at 84%.

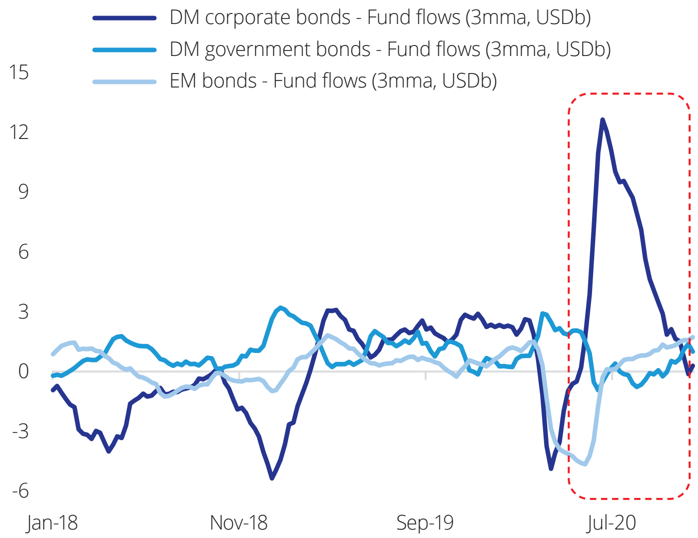
With a Republican-controlled Senate and a divided government in the US, the likelihood for a robust fiscal programme gaining passage is low. However, this will be offset by ongoing monetary support from the US Federal Reserve as well as potential vaccine discovery for COVID-19. The latter will allow the service-related industries (such as tourism) to return to normalcy, underpinning macro momentum in the new year.

Figure 17: Cross-asset flows suggests rising enthusiasm for equities over bonds



Source: EPFR Global, DBS

Figure 18: Fund flows to DM corporate bonds have fallen substantially



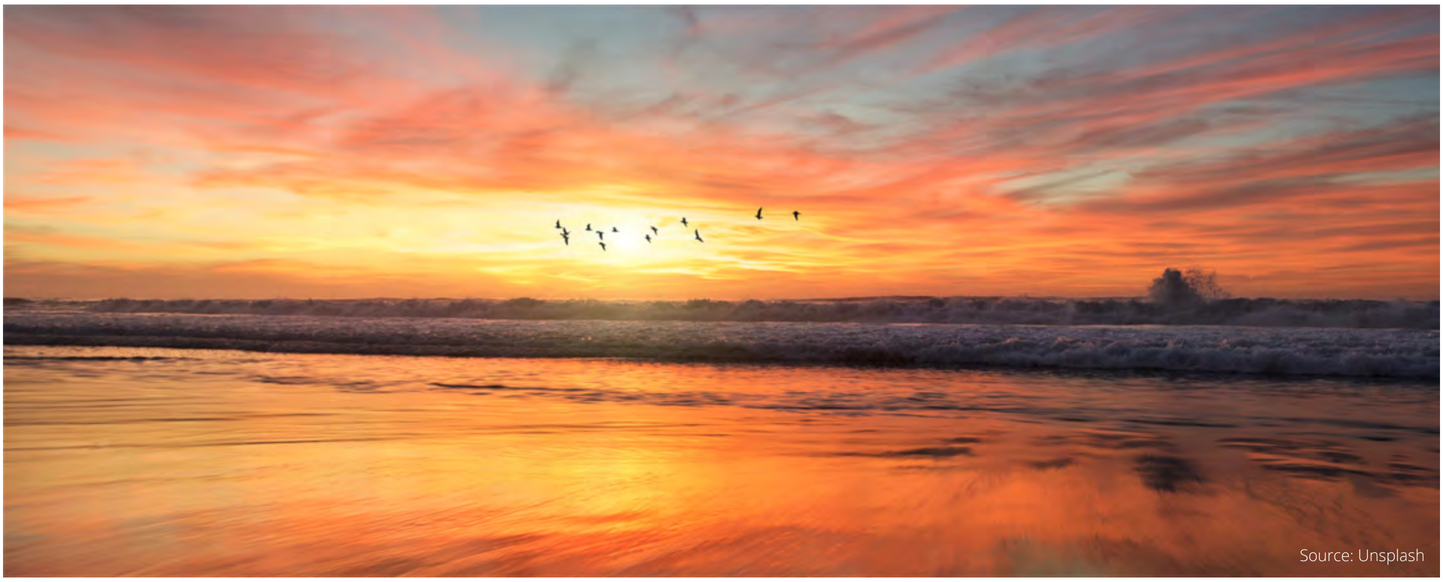
Source: EPFR Global, DBS

Valuation: On a cross-asset basis, the 2.66% gap between earnings yields and Treasury yields suggest that equities, as an asset class, remains more attractive than bonds.

Momentum: On cross-asset flows, USD18.4b exited from global equities while USD250.4b surged into bond funds during 9M20. But the momentum is starting to shift. Since October 2020, equities saw cumulative inflows of USD63.6b while inflows to bonds were broadly similar at USD73.5b. This suggests rising allocation of funds for equities over bonds and we expect this trend to persist in the coming months (Figure 17).

The tapering of enthusiasm in the bonds space was particularly due to DM corporate bonds. On a 9M20 basis, DM corporate bonds saw inflows of USD131.4b while EM bonds saw outflows of USD22.5b. But since the beginning of 4Q20, the momentum has shifted. DM corporate bonds registered only inflows of USD8.3b while flows to EM bonds were marginally higher at USD11.8b (Figure 18).

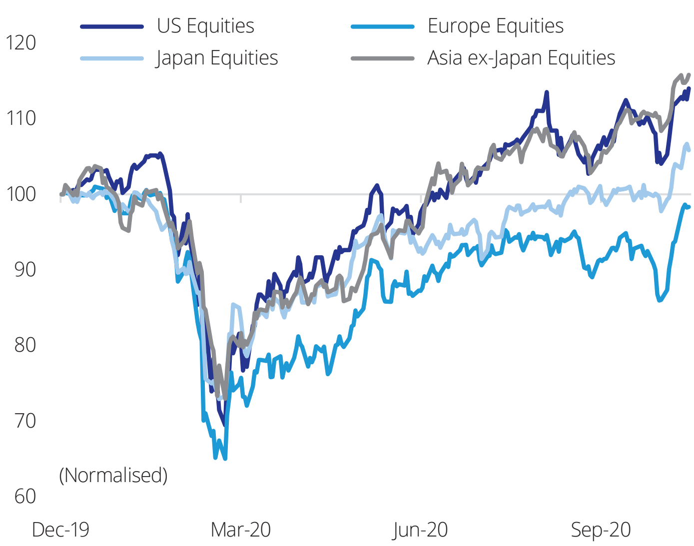
Source: Unsplash



<u>Equities</u>: Our regional allocation call for equities panning out as expected; no change in strategy. Our Overweight calls on the US and Asia ex-Japan has panned out as expected. On a YTD basis, US was up 14.0%, outperforming Europe and Japan by 15.7 %pts and 8.2 %pts, respectively, within the DM space (Figure 19). The strong outperformance in the US was predominantly due to robust gains in technology sectors and we expect this trend to persist in 2021.

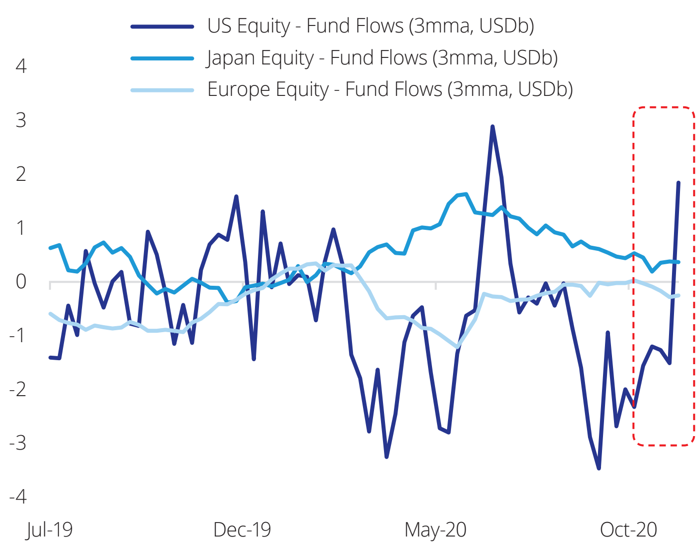
Recent fund flows data also suggests that investors are gaining enthusiasm for the US market. On 9M20 basis, US equities registered the highest outflow of USD40.5b, compared with inflows of USD33.2b for Japan. However, the momentum has shifted. Since October, US equities have seen inflows of USD30.2b (vs +USD2.3b for Japan and -USD3.5b for Europe) (as of 11 November) (Figure 20).

Figure 19: US and Asia ex-Japan have outperformed this year



Source: Bloomberg, DBS

Figure 20: Rising fund flows into US equities

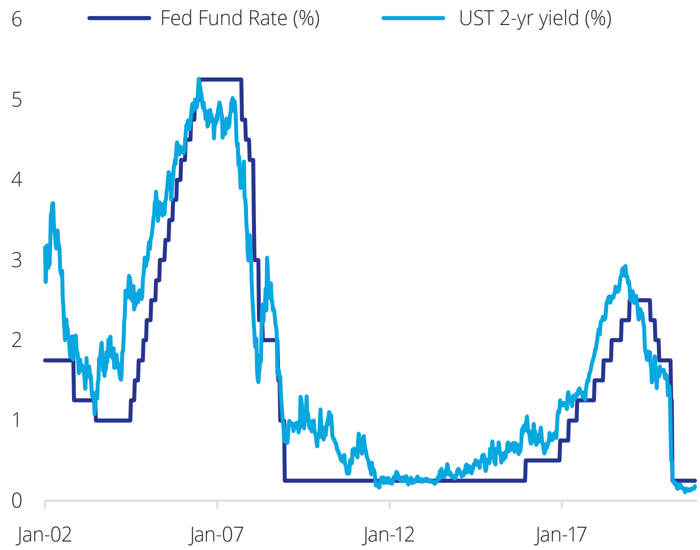


Source: EPFR Global, DBS

Bonds: HY bonds looking more attractive than IG under new Fed framework. To address persistent undershooting of inflation, the US Federal Reserve has introduced a "flexible" form of average inflation targeting in future. Under the new framework, the Fed will allow inflation and employment rate to run above its target in order to compensate for periods of momentary weakness.

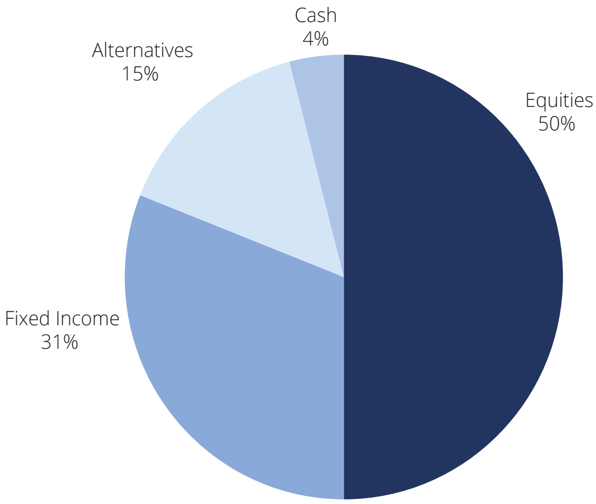
The combination of anchored short-term rates (Figure 21) and upward drifting longer-term rates result in curve steepening. In such environment, we favour HY over IG given that the former has shorter average duration and hence, encapsulates lower risks.

Figure 21: New Fed framework anchored short-term rates to the lows, favouring HY bonds



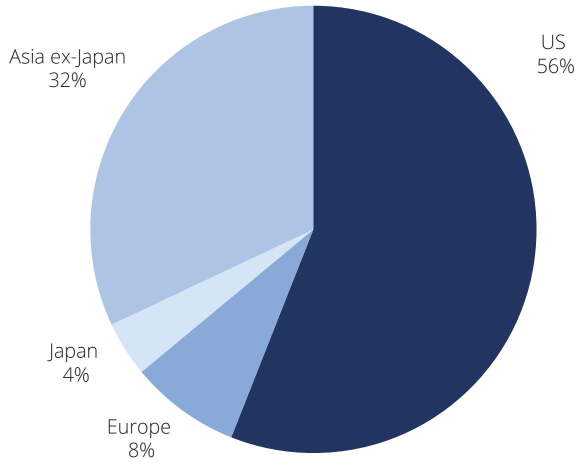
Source: Bloomberg, DBS

Figure 22: TAA breakdown by asset class (Balanced Profile)



Source: DBS

Figure 23: TAA breakdown by geography within equities (Balanced Profile)



Source: DBS

Table 3: 1Q21 Global Tactical Asset Allocation (TAA)

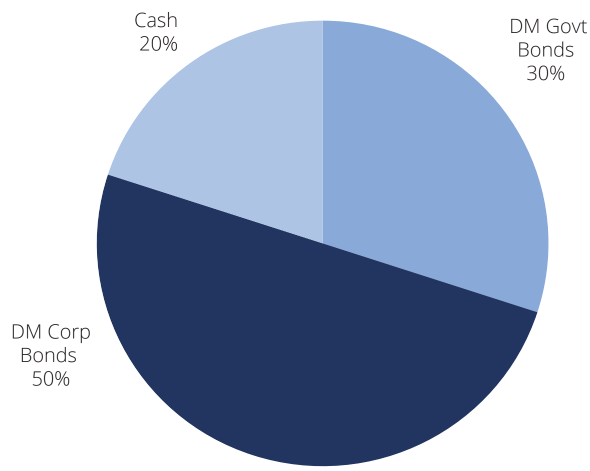
Asset Class		
	3-Month Basis	12-Month Basis
Equities	**Neutral**	**Neutral**
US Equities	Overweight	Overweight
Europe Equities	Underweight	Underweight
Japan Equities	Underweight	Underweight
Asia ex-Japan Equities	Overweight	Overweight
Fixed Income	**Underweight**	**Underweight**
Developed Markets (DM)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

Source: DBS

Conservative

	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 (DM)	80.0%	80.0%	
DM Government Bonds	30.0%	30.0%	
DM Corporate Bonds	50.0%	50.0%	
Emerging Markets (EM)	0.0%	0.0%	
Alternatives	0.0%	0.0%	
Gold	0.0%	0.0%	
Hedge Funds*	0.0%	0.0%	
Cash	20.0%	20.0%	

*Only P4 risk rated UCITs Alternatives

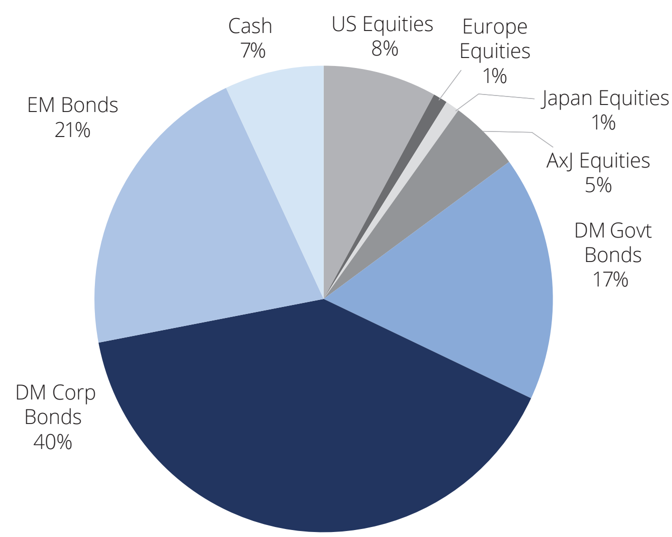


Source: DBS

Moderate

	TAA	SAA	Active
Equities	15.0%	15.0%	
US	8.0%	6.0%	2.0%
Europe	1.0%	4.0%	-3.0%
Japan	1.0%	2.0%	-1.0%
Asia ex-Japan	5.0%	3.0%	2.0%
Fixed Income	78.0%	80.0%	-2.0%
Developed Markets (DM)	57.0%	60.0%	-3.0%
DM Government Bonds	17.0%	20.0%	-3.0%
DM Corporate Bonds	40.0%	40.0%	
Emerging Markets (EM)	21.0%	20.0%	1.0%
Alternatives	0.0%	0.0%	
Gold	0.0%	0.0%	
Hedge Funds*	0.0%	0.0%	
Cash	7.0%	5.0%	2.0%

*Only P4 risk rated UCITs Alternatives

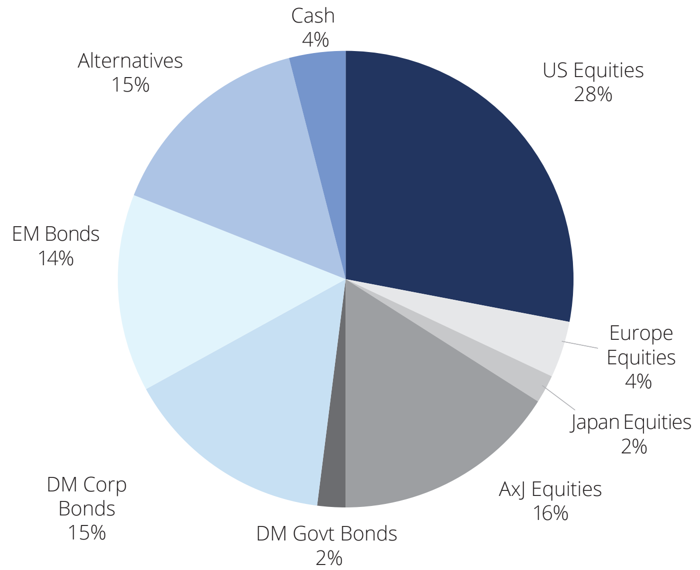


Source: DBS

Balanced

	TAA	SAA	Active
Equities	50.0%	50.0%	
US	28.0%	25.0%	3.0%
Europe	4.0%	10.0%	-6.0%
Japan	2.0%	5.0%	-3.0%
Asia ex-Japan	16.0%	10.0%	6.0%
Fixed Income	31.0%	35.0%	-4.0%
Developed Markets (DM)	17.0%	25.0%	-8.0%
DM Government Bonds	2.0%	10.0%	-8.0%
DM Corporate Bonds	15.0%	15.0%	
Emerging Markets (EM)	14.0%	10.0%	4.0%
Alternatives	15.0%	10.0%	5.0%
Gold	8.0%	5.0%	3.0%
Hedge Funds*	7.0%	5.0%	2.0%
Cash	4.0%	5.0%	-1.0%

*Only P4 risk rated UCITs Alternatives

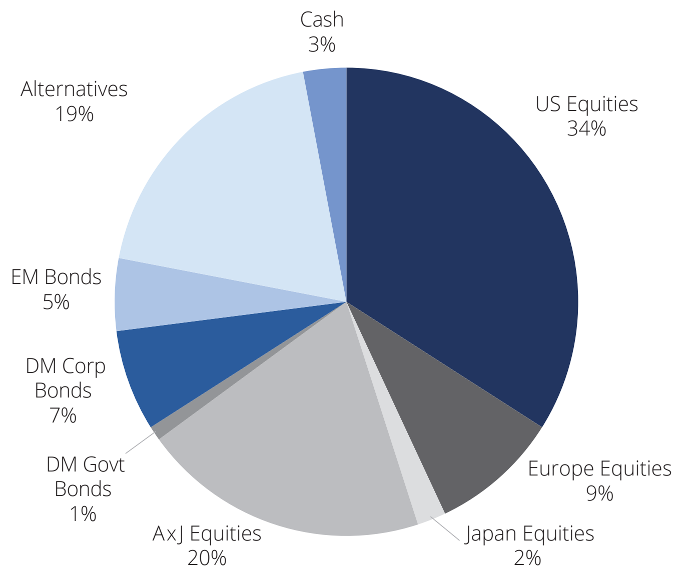


Source: DBS

Aggressive

	TAA	SAA	Active
Equities	65.0%	65.0%	
US	34.0%	30.0%	4.0%
Europe	9.0%	15.0%	-6.0%
Japan	2.0%	5.0%	-3.0%
Asia ex-Japan	20.0%	15.0%	5.0%
Fixed Income	13.0%	15.0%	-2.0%
Developed Markets (DM)	8.0%	11.0%	-3.0%
DM Government Bonds	1.0%	4.0%	-3.0%
DM Corporate Bonds	7.0%	7.0%	
Emerging Markets (EM)	5.0%	4.0%	1.0%
Alternatives	19.0%	15.0%	4.0%
Gold	7.0%	5.0%	2.0%
Hedge Funds*	12.0%	10.0%	2.0%
Cash	3.0%	5.0%	-2.0%

*Only P4 risk rated UCITs Alternatives



Source: DBS

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. Based on the SAA model, the Aggressive model has the highest risk, followed by Balanced, Moderate, and Conservative, with Conservative being the least risky.
5. 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.

Macroeconomics | 1Q21

Divergence

Global Macroeconomics

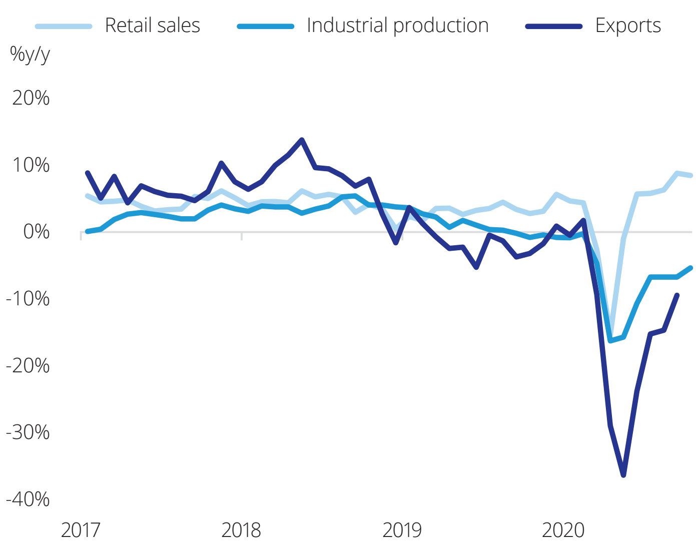
Taimur Baig, Ph.D. | Chief Economist
Radhika Rao | Economist
Ma Tieying | Economist
Suvro Sarkar | Analyst

US: Macro and electoral divergences

In a year characterised by a once-in-a-century pandemic, sharp economic contraction, and historically large policy support response, its final stretch is characterised by vigorous financial markets and economic rebound, and yet, lingering uncertainties about outbreaks.

Aided by generous stimulus measures, US consumers have gone back to shopping despite considerable uncertainty about livelihood and COVID-19 infection rates which remain high. Retail sales have gone from strength to strength lately, benefitting from public sector support, low interest rates, and low inflation.

Figure 1: Weak production and exports, strong consumption



Source: CEIC, DBS

The strong consumption picture is unsurprising. The CARES Act, enacted in late March, put cash in the hands of unemployed Americans, provided paycheck support to those who were on the payroll, and extended a range of credit facilities to businesses. As a result, businesses which lost out on foot traffic continued to earn revenue; consumers who did not have jobs continued to have their purchasing capacities largely intact. This pushed up the rate of savings during stringent lockdowns, which have supported consumption since the lockdowns eased. Additionally, exceptionally low interest rates have supported demand for housing and home renovation. There is some question about the sustainability of consumption if new stimulus support does not come and the pandemic intensifies, but even then, accommodative monetary policy and confidence from vaccine developments ought to keep the consumption train moving.

The picture is less bright on the production side. US exports recovery has been slow, with goods exports contracting 13% y/y in 3Q20. In contrast, during the same period, China's exports were up by 9%. Industrial production has begun to recover, but at a far slower pace than consumption. Putting these data together, we see the US real GDP contracting by 3.5% in 2020.

The contrast between strong consumption and weak production is showing up in trade data, with declining exports and recovering imports combining to create USD260b in trade deficit outturns in 3Q. The foundation of the US economy remains firmly set on consumption, despite all the sound and fury to reviving manufacturing and promoting exports.

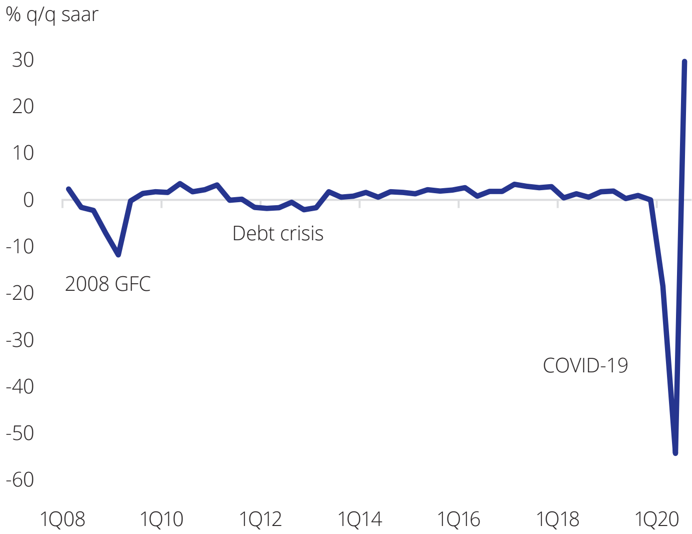
Just like the consumption-production divergence, the November election results underscore the electoral divide in the US. Joe Biden will be next president of the United States, but his effectiveness will be constrained by a slim party majority in the House of Representatives and no margin for comfort in the Senate. The pandemic, however, is undeterred by the fog of the political process. After a summer lull, as businesses reopened and travel picked up, people lowered their guard. Infections began to rise. Now that winter beckons, the risk of airborne infection among those huddled indoors will rise, as has been the case in past pandemics.

Medical researchers have made heroic efforts to develop and trial a range of vaccines this year, and expectations are that one or two will be cleared to be in production soon. We hope that 2021 will be the year of mass vaccination worldwide. However, remain wary about its safety, efficacy, availability, and distribution at a scale like never before.

By the time vaccination reaches a level wide enough to make a difference, it will be the second half of next year or the following year. In the meantime, use of therapeutics to treat the ill and dedicated adherence to mask and social distancing for the healthy would be warranted. Unfortunately, it seems that the population in the US is losing its patience with stringent restrictions on mobility and social behaviour. US government officials would need to adhere to science, transparent reporting, and inspirational leadership to keep the fight against COVID-19 going.

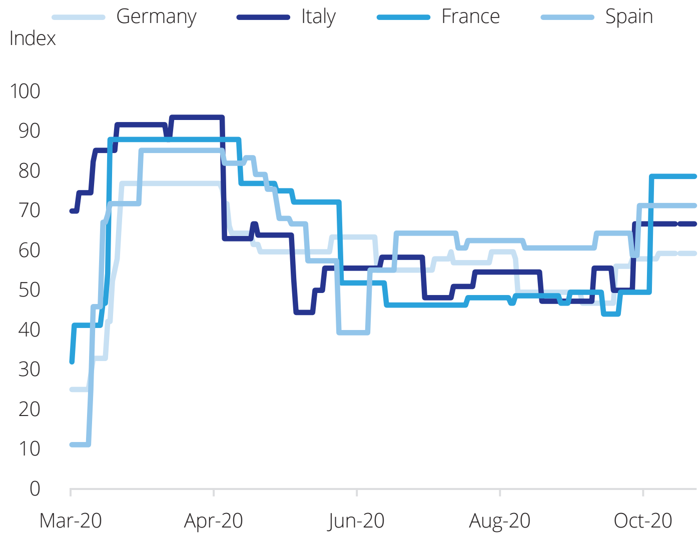
Source: Unsplash

Figure 2: GDP growth rebounded in 3Q



Sources: CEIC, DBS

Figure 3: Pandemic/stringency index



Sources: Blavatnik School of Government, University of Oxford, DBS

Eurozone

The Eurozone economy's growth trajectory will be dictated to a great extent by how the pandemic evolves and the efficacy and availability of vaccines. Tapering of the first wave of infections into August convinced authorities to lift lockdowns and ease movement restrictions. This led output to rebound 12.6% q/q (-4.4% y/y vs 2Q's -14.8%) in 3Q20, shaking off the pandemic-led recession.

This proved to be short-lived due to the onset of a ferocious second wave of the pandemic, with the daily count reaching record highs in some instances (more so in the economically key core-4 countries). Premature easing in social curbs and poor communication were named as a few of the shortfalls. In light of the significant economic impact from earlier lockdowns, authorities initially resisted the option to reinstate lockdowns, but have since re-imposed strict curbs in France, Germany, Greece, Ireland, Belgium, etc, to gain an upper hand on the infection curve.

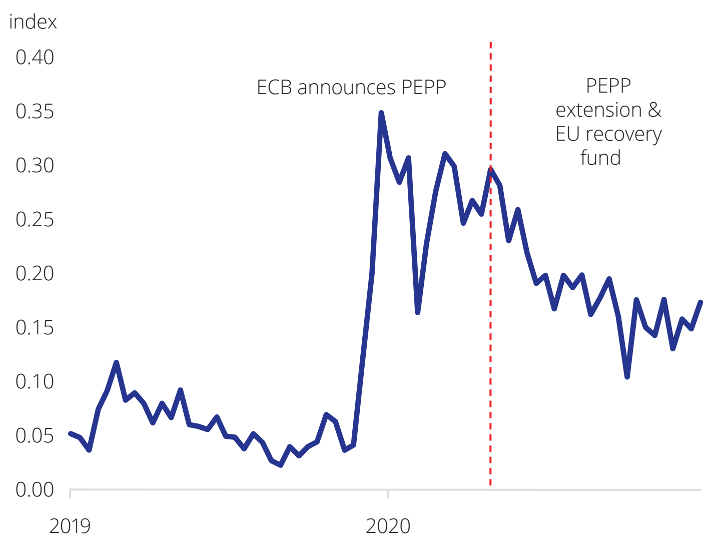
Restrictions vary across countries and are not as stringent as back in April-May. Nonetheless, this is likely to impinge on 4Q20 growth as well as 2021 prospects, leaving recovery as more of a "W" shaped rather than "V". 4Q20 GDP is poised to slip back into negative q/q (and y/y) growth and remain in red into early 2021. 2020 GDP growth is seen at -8.0% y/y, followed by a shallow bounce to 4% y/y in 2021.

Beyond the deep scarring economic impact, repercussions of weaker fiscal health and the jump in public debt levels will reverberate for a longer time, if 2012-13 debt crisis is any indication. At an aggregate level, Eurozone debt to GDP ratio is expected to surpass 100% of GDP this year and stay elevated next year. National fiscal stimulus spending is underway, however, optimism from the EU-wide recovery plan has temporarily hit a hurdle by legal reservations raised by Warsaw and Budapest.

As monetary policy support runs its course, the ball will fall back in the national governments' court, worryingly, causing a vicious cycle of higher spending, debt, and monetisation as growth stays sub-potential. The ECB is set to continue with its pandemic-driven asset purchase programme, raising the size from EUR1.35t by another EUR500b, alongside conducting another round of TLTROs. This is likely to keep a lid on the financial system stress indicator, which retreated from highs since the PEPP was announced earlier in the year.

Concurrently, the future trading linkage between the UK and the EU remains uncertain beyond December 2020, when the Brexit transition period ends. Passage of the Brexit deadline without a bilateral treaty will impose onerous tariff limitations on both parties, given the large weight of intra-trade and investment between the UK and EU. This could potentially compound the fallout from the pandemic and resultant recession.

Figure 4: Eurozone – financial system systemic stress indicator stabilises



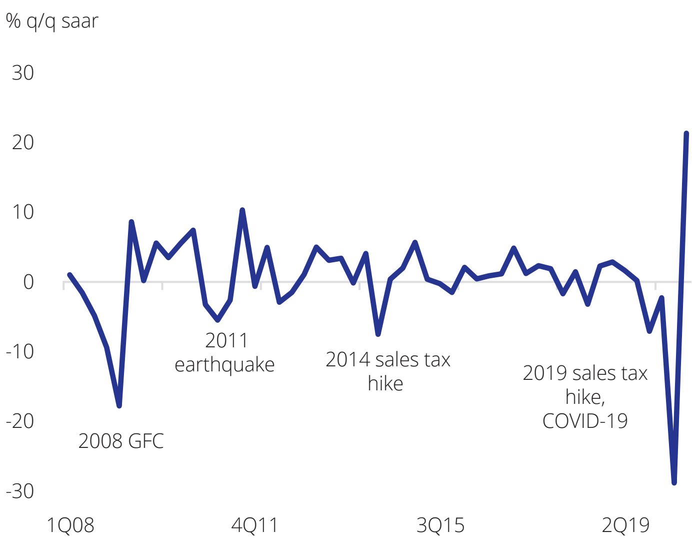
Sources: ECB, Bloomberg, DBS

Japan

Japan's economy has made a strong turnaround, expanding 21.4% q/q saar in 3Q after contracting 28.8% in 2Q. Exports and private consumption both rose strongly, thanks to the easing of COVID-19 lockdowns at home and abroad. The level of aggregate output, however, remained about 4% below the level before the COVID-19 outbreak in 4Q19, and 6% below the level prior to the consumption tax hike in 3Q19.

Looking ahead, we expect the economy to continue recovering in 2021, but at a slower pace. Exports are expected to lead the recovery, thanks to the restoration in Japan's manufacturing supply chain and the revival in global durable goods demand.

Figure 5: GDP growth made a strong turnaround in 3Q

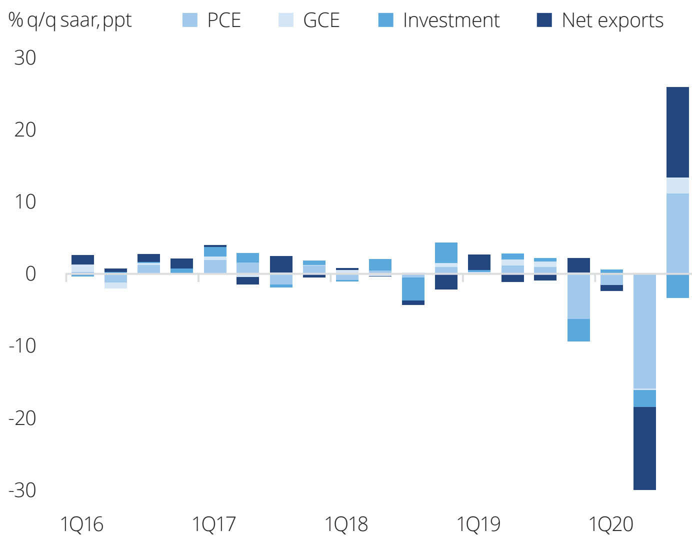


Sources: CEIC, DBS

Consumption growth is likely to moderate, however, after the release of pent up demand in 3Q. We maintain the full-year GDP forecasts at -5% for 2020 and 2.8% for 2021, which imply that aggregate output will return to the pre-pandemic level in the first half of 2022.

Monetary and fiscal policies will remain supportive into next year. Prime Minister Yoshihide Suga is set to submit a supplementary budget to the National Diet in January 2021, the first in his tenure (which started in September 2020). The budget will likely be used to extend the "Go To Travel" subsidy campaign to support the domestic tourism sector, alleviate pressure in the labour market, and promote investment in the digital sector among others.

Figure 6: Rebound led by consumption and exports

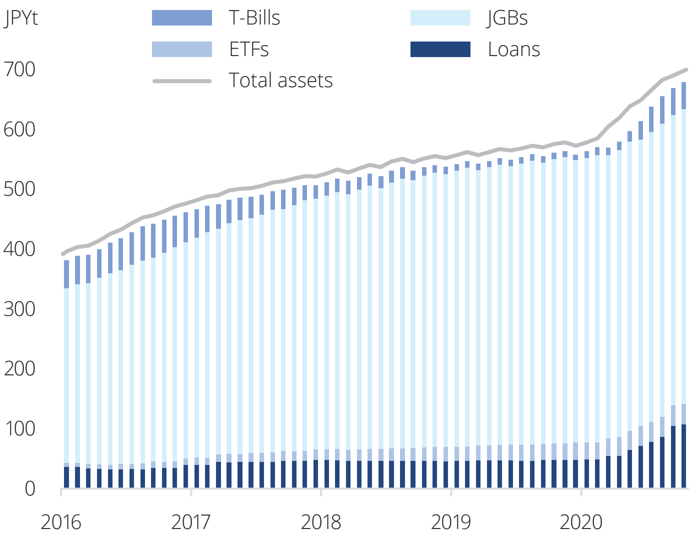


Sources: CEIC, DBS

The BOJ is expected to coordinate on monetary policy. At the least, the BOJ will likely extend its funding support measures related to COVID-19, which are scheduled to expire in March 2021. These include the special lending programme to encourage banks to provide interest-free unsecured loans to small companies, and the outright purchase of commercial paper and corporate bonds by the BOJ to support large companies.

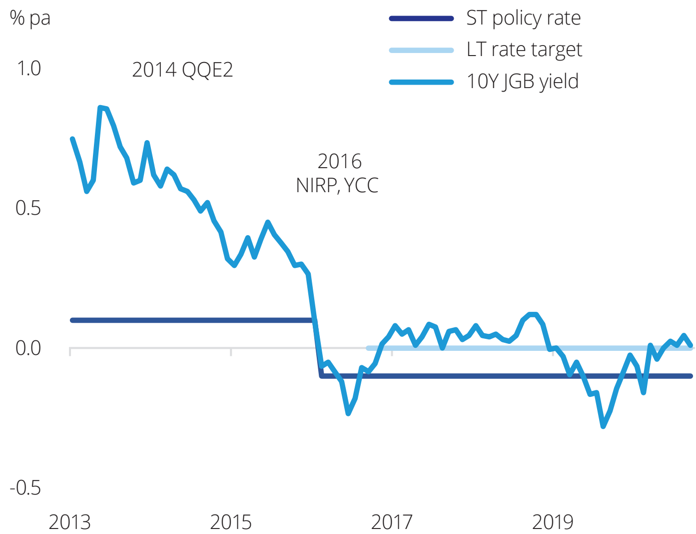
On long-term policies, Suga has pledged to restructure and reinvigorate Japan's economy after the pandemic. Specifically, he has proposed to create a new government agency to upgrade digital capability, promote competition in the telecom sector, facilitate consolidation among SMEs, revitalise regional economies, as well as diversify the supply chain of essential goods like PPE and medical equipment.

Figure 7: BOJ has expanded its balance sheet by 20% since the COVID-19 outbreak



Sources: CEIC, DBS

Figure 8: Yield curve control remains in place



Sources: CEIC, DBS

An important question, however, is how long Suga will stay in office to carry out these reforms, which require efforts to tackle vested interests. The country's next general election is scheduled to be held before October 2021. Although the ruling Liberal Democratic Party is very likely to win the election, the size of victory would have significant impact on the duration of Suga's tenure. Whether Suga will implement the pledged reforms, and how well he will do so, remains to be witnessed during his term.

Source: Unsplash

Asia: RCEP is a big deal

It took eight years, 46 negotiating meetings, and 19 ministerial meetings to get the agreement done. The Regional Comprehensive Economic Partnership (RCEP) was finally signed by 15 Asian nations on 15 November.

RCEP includes all 10 members of ASEAN, along with Australia, China, Japan, New Zealand, and South Korea. This marks the second major multilateral trade deal in recent years. After US President Donald Trump pulled the US out of the Trans-Pacific Partnership in 2017, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP, or TPP minus the US) was agreed upon in 2018. Seven of the 15 RCEP members belong to the CPTPP.

Accounting for nearly a third of the world's population and GDP, and comprising USD12.4t in trade, the 15-country RCEP is easily the world's largest trade agreement. The agreement includes 20 chapters of rules covering trade in goods, investment and e-Commerce, intellectual property, and government procurement. The goal is to increase rules-based economic interaction among members.

Goods tariffs are not high in the region, and many Asian economies already have existing bilateral free trade agreements in place. While the agreement will not lead to large cuts in overall tariffs, it would harmonise rates and standards, which would take the region closer toward a coherent trading zone like the EU or North America. This would be beneficial for supply chain efficiency, market access, and investments. Implementation will be challenging, as member countries have highly diverse levels of development and institutional capabilities. Still, experience from other regional trade agreement suggests that net benefits would accrue, nonetheless.

As the region prepares to move on from Trump's isolationist and protectionist policies, for the US, a large trade agreement that includes China but excludes itself underscores the reality

Table 1: RECP and CPTPP; who's in and who's out?

	RCEP	CPTPP
Australia	√	√
Brunei	√	√
Cambodia	√	x
China	√	x
India	x	x
Indonesia	√	x
Japan	√	√
Laos	√	x
Malaysia	√	√
Myanmar	√	x
New Zealand	√	√
Philippines	√	x
Singapore	√	√
South Korea	√	x
Taiwan	x	x
Thailand	√	x
Vietnam	√	√

Source: ASEAN Secretariat, DBS

that trade can progress without the world's foremost economic powerhouse. We do not think Joe Biden will have ease erasing Trump's trade legacy, but we do not expect the present level of antagonism toward a rule-based trading system to sustain. Even without being a member of the RCEP, US firms ought to find the agreement beneficial for their investment plans.

For China, RCEP is a major positive. It had viewed TPP as a pushback against its burgeoning trade-related prowess, while the RCEP cements it. Beijing hopes the RCEP will also add tailwind to other deals currently in the works, including a China-EU investment treaty and a China-Japan-South Korea free trade agreement.

The RCEP noticeably excludes India, which dropped out of the discussions in late 2019. India's key concerns were that competition from China would affect its domestic textiles, agriculture, and dairy sectors, although these sectors are presently characterised by low productivity. Both the ruling and opposition parties are united in their opposition to the deal, reflecting a strong distrust of China and growing inward focus on development strategy. Most RCEP members nonetheless will likely see their trade ties grow with India in the coming years, and we expect some of the benefits of the agreement to spill over to India.

Taiwan is not part of the RCEP as China does not recognise it, but 70% of trade between Taiwan and RCEP countries is already tariff-free. Taiwan is more likely to join the CPTPP.

After several years of trade wars and growing mistrust on trade benefits, RCEP signifies lingering promises of free and fair trade. We hope that this marks the beginning of a new chapter in regional cooperation, which begins with trade and commerce, and ends with enduring peace and prosperity.


Source: Unsplash

Table 1: Quarterly average oil price forecast 2020-21– DBS base case view

USD per barrel	1Q20A	2Q20A	3Q20A	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Average Brent crude oil price	51.0	33.5	43.5	47.5	44.5	50.0	56.5	56.0
Average WTI crude oil price	46.0	28.0	41.0	44.5	41.5	47.0	53.5	53.0

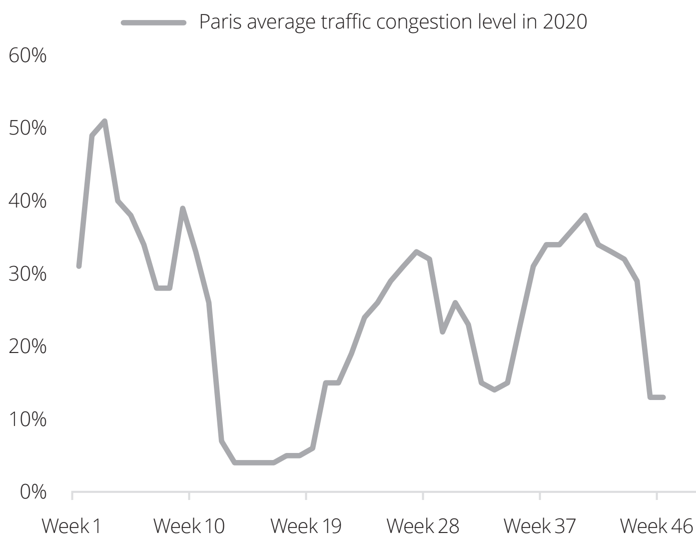
Source: DBS

Oil markets buoyed by vaccine lifeline

Vaccine news flow leads to return of positive sentiment. Brent crude oil prices are currently rallying towards USD50/bbl, despite the rise in "second wave" cases of COVID-19 in Europe and the US since November, which has dampened the near-term demand outlook. We have seen oil prices respond positively to announcements of promising vaccine progress, although it remains to be seen whether the rally can sustain or if it will take a breather before resuming momentum. It is important to note that even after possible fast track approvals, these vaccines would not be immediately available to most of the world population owing to manufacturing, supply, and logistics limitations. In the meantime, oil demand trends in 4Q20 and 1Q21 could be slightly weaker than earlier expected, owing to increased travel restrictions in certain geographies. Hence, we expect oil prices to correct in early-2021 before a more sustained recovery from 2Q21 onwards.

Taking into account "second wave" impact in Europe and the US, we conservatively cut our 2020 oil demand forecast again, now expecting global oil demand to decline by 9.0 mmbpd on average in 2020 (from 8.0 mmbpd decline estimate earlier), before recovering by around 5.0 mmbpd in 2021, which is still some way off pre-COVID demand levels even after assuming vaccine rollouts start in 2H21. Pre-COVID oil demand levels may only be reached by 2022/23 in our view, as the aviation sector and jet fuel demand will be a structural drag. Supply side discipline from OPEC+ and others will thus be critical in ensuring oil price stability for a while.

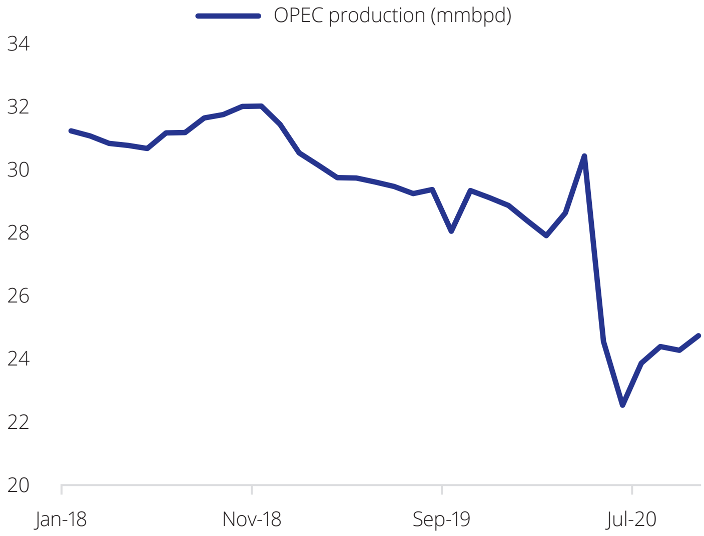
Figure 9: Falling traffic congestion levels in Europe bad news for near-term oil demand



Source: TomTom Traffic Data, DBS

Sustained oil price recovery likely to take place from 2H21. We project Brent crude oil prices to average around USD47.5/bbl in 4Q20 as market sentiment has improved. Keeping in mind the possibility of improvement in economic and transport activity post vaccine deployment success from 2H21, we maintain our 2021 Brent crude average forecast at USD50-55/bbl (18-30% higher y/y). As highlighted earlier, we expect some retracement in oil prices in 1Q21 but from 2Q21 onwards and into 2H21, we expect oil prices to show a more sustainable recovery trend above USD50/bbl.

Figure 10: OPEC cannot afford to ease production cuts too much in the near term



Source: Bloomberg, DBS

Figure 11: OECD inventories still at elevated levels, overhang on oil price recovery

Source: International Energy Agency, DBS

OPEC+ reaches a conclusion eventually, with minor upward production adjustment from January 2021. After a few days of increased dissent within the group related to the viability of continuation of production cuts in 2021 and postponements of meetings, the OPEC+ meeting finally concluded in early December, with a slight adjustment to the production cuts from January 2021. Instead of increasing production by 2.0 mmbpd from January 2021 as per the existing agreement (from 7.7 mmbpd cuts to 5.7 mmbpd cuts), the cartel proposed to return the additional 2.0 mmbpd supply more gradually to the market, starting with 0.5 mmbpd upward adjustment in January 2021 production (from 7.7 mmbpd cut to 7.2 mmbpd cut). Beyond that, there will be monthly ministerial meetings of OPEC and non-OPEC allies to monitor market conditions and decide on further adjustments for following months, subject to the condition that each monthly adjustment is no larger than 0.5 mmbpd.

Oil markets relieved that the discussions have not fallen apart like earlier in 2020. While consensus had hoped for no production increase from OPEC+ for the next three to six months, the fact that the full 2.0 mmbpd scheduled to come online early next year will not hit the market at once is somewhat of a comfort. There is thus unlikely to be another spike in supply or oil glut like we saw in March-April 2020, when Russia and Saudi Arabia fell apart over production quotas. The eventual cooperation by all members is welcome, though dissent among the group has been growing, given impact of prolonged low oil prices on member nations' economies. The direction of the new US administration under President-elect Joe Biden with regards to Iran sanctions throws further uncertainty into the mix, though it is unlikely that any decision on Iranian oil export curbs will be taken in the first six months or so.

Table 2: GDP growth and CPI inflation forecasts

	GDP growth, % y/y					CPI inflation, % y/y, ave				
	2018A	2019A	2020F	2021F	2022F	2018A	2019A	2020F	2021F	2022F
Mainland China	6.7	6.1	2.0	7.0	5.5	2.1	2.9	2.3	2.5	2.5
Hong Kong	2.8	-1.2	-7.0	4.0	2.3	2.4	2.9	0.7	2.0	2.5
India	6.8	4.9	-7.4	7.6	4.3	4.0	3.7	6.7	4.2	4.0
India (FY basis)*	6.2	4.2	-8.0	7.7	4.5	3.4	4.8	6.3	4.3	4.0
Indonesia	5.2	5.0	-2.0	4.0	4.5	3.2	2.8	2.0	2.2	2.8
Malaysia	4.7	4.3	-6.8	6.0	4.8	1.0	0.7	-1.1	1.4	2.0
Philippines**	6.2	5.9	-9.5	7.0	6.0	5.2	2.5	2.4	3.0	2.8
Singapore	3.1	0.7	-6.0	5.5	3.2	0.4	0.6	-0.2	0.9	1.5
South Korea	2.9	2.0	-1.1	2.9	2.8	1.5	0.4	0.2	0.5	1.0
Taiwan	2.8	3.0	1.8	4.2	2.8	1.3	0.6	0.1	0.5	1.0
Thailand	4.2	2.4	-6.3	3.5	2.2	1.1	0.7	-1.0	1.0	1.3
Vietnam	7.1	7.0	2.7	6.7	6.8	3.5	2.8	3.7	3.3	3.6
Eurozone	1.9	0.9	-8.0	4.0	3.5	1.8	1.2	0.3	1.0	1.2
Japan	0.3	0.7	-5.0	2.8	1.5	1.0	0.5	-0.1	0.0	0.5
United States***	2.9	2.3	-3.5	5.0	2.2	1.9	2.3	1.3	1.7	2.2

* refers to fiscal years, i.e. 2020 represents FY21 - year ending March 2021. ** new CPI series. *** eop for CPI inflation. Source: CEIC, DBS

Table 3: Policy interest rates forecasts, eop

	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22
Mainland China*	3.85	3.85	3.85	3.85	3.85	3.85	3.85	4.05
India	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Indonesia	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Malaysia	1.75	1.75	2.00	2.00	2.25	2.50	2.50	2.50
Philippines	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Singapore**	0.12	0.12	0.12	0.12	0.12	0.12	0.12	0.12
South Korea	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75
Taiwan	1.13	1.13	1.13	1.13	1.13	1.13	1.13	1.25
Thailand	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Vietnam***	4.00	4.50	5.00	5.00	5.00	5.00	5.00	5.00
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States***	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

* 1-yr Loan Prime Rate; ** 3M SOR ; *** prime rate. Source: CEIC, DBS

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Source: Unsplash

US Equities | 1Q21

Beyond vaccines and elections

US Equities

Dylan Cheang | Strategist

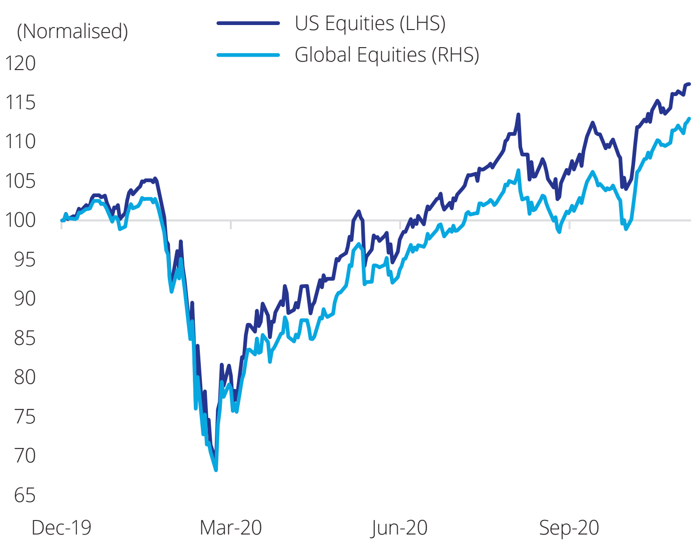
Beyond vaccines and elections

Our conviction call on US equities paid off yet again in 2020 as the market outperformed global equities by 4.4 %pts on a YTD basis (as of 3 December 2020) (Figure 1). The stellar outperformance transpired despite substantial headwinds facing the market, from US elections uncertainties to the difficulties faced by US policymakers in controlling the COVID-19 pandemic.

At the time of writing, COVID-19 cases in the US have hit record highs while ongoing refusal by incumbent Donald Trump to concede the presidential election race continues to impede a smooth transition to the Biden administration. But none of these headwinds have deterred investors from raising their conviction on the market, and this underlines the long-term resilience of Corporate America.

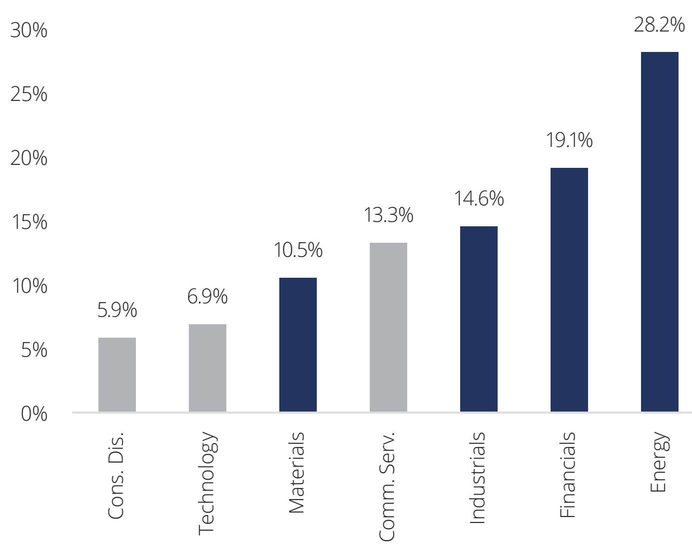
Value stocks rallying on asset reflation hopes. In the early days of the rebound from March's trough, the rally in US equities was led predominantly by Growth sectors in the technology-related space. In fact, the gains for the Technology sector were particularly outsized as the pandemic accentuated the importance of online activities, such as e-Commerce and e-Sports. "Traditional" industries in the Financials and Industrials space were sold down given the economic sensitive nature of their businesses.

Figure 1: US equities powered ahead in 2020



Source: Bloomberg, DBS

Figure 2: Musical Chairs – Positive vaccine news triggered strong bounce in reflation trades during 4Q



Source: Bloomberg, DBS
Note: This consists of QTD performance in 4Q (as of 3 December 2020)

But the arrival of positive news from Pfizer Inc and Moderna Inc has changed the narrative. Overnight, the plausibility of a vaccine bringing some form of normalcy back to everyday life triggered strong portfolio rotation into the embattled Value plays. Sectors like Financials, Industrials, Materials, and Energy sprung back to life in 4Q20, gaining 18.1% on average (as of 3 December 2020), compared to average gains of 8.7% registered by Technology, Consumer Discretionary, and Communications Services (Figure 2).

Rotation to Value not the start of a new trend. Despite the recent strong performance of Value stocks, we believe that this does not mark the start of a sustained trend in Growth-to-Value rotation. As Figure 3 shows, Value has been underperforming Growth for more than a decade and this underperformance is not about to turn around anytime soon. Why is that so?

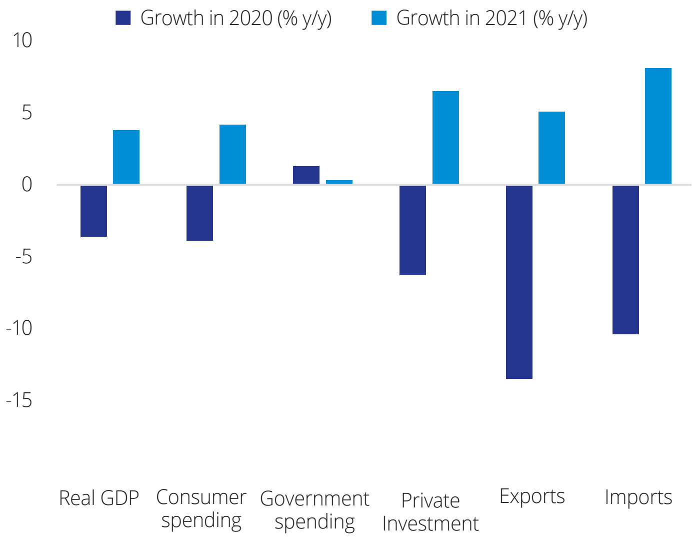
Since 2009, the rush into Growth sectors was accelerated by the decline in government bond yields as the US Federal Reserve unleashed QE to support the economy post-Subprime Crisis. A low rates and low growth environment accentuated the attractiveness of Growth sectors like Technology, and with the Fed committing to anchor rates to the lows, we believe that the outperformance of Growth sectors will resume after the current rotational phase.

Figure 3: The outperformance of Growth to Value is set to persist

Source: Bloomberg, DBS

Source: Unsplash

Figure 4: Broad-based macro recovery expected for the US in 2021



Source: Bloomberg, DBS

Figure 5: Robust revenue and earnings growth expected for the S&P 500

Source: Bloomberg, DBS

Don't look back in anger; 2021 will be a year of recovery. Ravaged by economic lockdowns and plunging business confidence, 2020 saw macro and corporate earnings momentum collapsing across the board. Based on consensus forecast, US real GDP fell 3.6% y/y during the year, led by weakness in consumer spending, private investment, and exports (Figure 4). Macro weakness in turn weighed on US corporate earnings, which is expected to fall 1.6% in 2020 (although the magnitude of the decline is significantly lower than during the Subprime Crisis years.

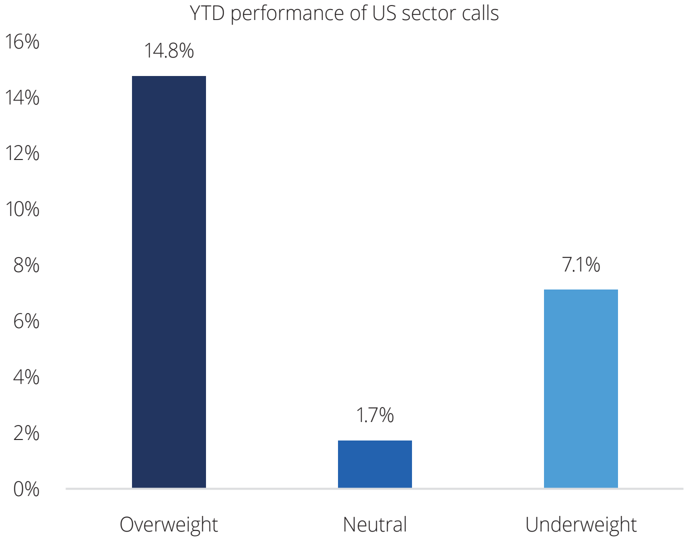
Come 2021, market consensus is penning in a 3.8% y/y growth in real GDP, led by strong rebound in consumer spending (+4.2% y/y) and private investment (+6.5% y/y). US exports, which plunged 13.5% y/y amid the US-China trade tension and weak external demand, is also expected to rebound by 5.1% y/y. On the corporate front, top-line revenue growth is expected at 7.5% while margin expansion will see earnings expanding by 13.9% (Figure 5).

1Q21 US Sector Strategy

Stay the course – Maintaining Growth bias in our Overweight calls. Our US sectoral strategy of emphasising on Growth sectors in our Overweight calls has reaped dividends in 2020. On a YTD basis, they have gained 14.8% on average, outperforming the Neutral and Underweight calls by 13.0 %pts and 7.6 %pts, respectively (as of 3 December 2020, Figure 6). The stellar performance was due to robust gains in Technology (+37.6%), Consumer Discretionary (+30.6%), and Communications Services (+23.0%). Collectively, these are the top three performers on the S&P 500 (Figure 7).

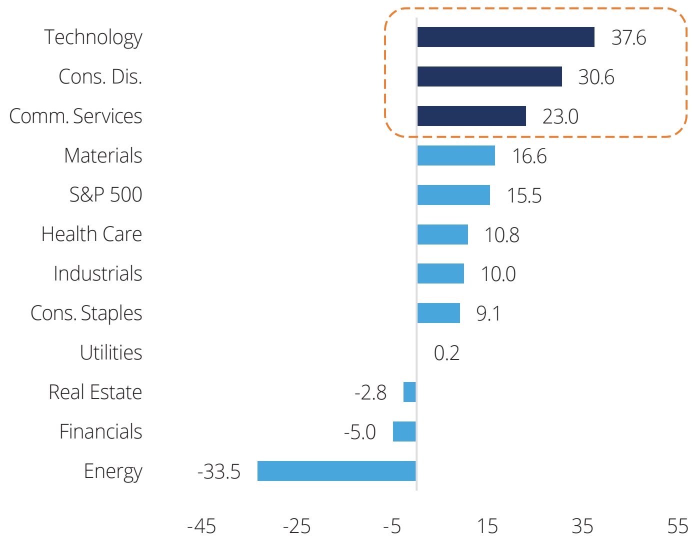
For 1Q21, we are making no changes to our US sector allocation. On the Growth side of our Overweight basket, we remain positive on Technology and Health Care. These sectors are underpinned by long-term secular trends and we expect the positive momentum to continue. On the Value side, segments that may benefit from potential vaccine discovery will include Energy as well as the tourism-related industries within Consumer Discretionary.

Figure 6: Our Overweight sectoral calls have outperformed the Neutral and Underweight calls



Source: Bloomberg, DBS
* Performance as at 3 December 2020

Figure 7: Technology, Consumer Discretionary, and Communications Services have led the S&P 500



Source: Bloomberg, DBS
* Performance as at 3 December 2020

Source: Unsplash

Table 1: 1Q21 US sector allocation

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

* Note: This refers only to integrated oil majors.

Source: DBS

Table 2: US sector key financial ratios

	YTD Total Returns (%)	Forward P/E (x)	P/B (x)	EV/EBITDA (x)	ROE (%)	ROA (%)	OPM (%)
S&P 500 Index	15.5	26.0	4.0	18.0	11.2	2.2	10.3
S&P 500 Financials	-5.0	17.7	1.3	9.3	8.0	0.9	16.3
S&P 500 Energy	-33.5	-	1.3	-	-17.9	-7.7	-14.8
S&P 500 Technology	37.6	28.3	10.1	22.3	29.1	10.2	21.7
S&P 500 Materials	16.6	26.6	3.0	18.2	3.9	1.5	6.9
S&P 500 Industrials	10.0	41.1	5.2	20.0	10.7	2.5	6.9
S&P 500 Cons. Staples	9.1	21.9	6.5	16.4	25.5	7.0	9.0
S&P 500 Cons. Discretionary	30.6	42.2	10.8	21.5	20.1	3.7	6.2
S&P 500 Comm. Services	23.0	25.6	4.0	14.3	12.3	4.7	17.5
S&P 500 Utilities	0.2	19.0	2.1	13.5	9.3	2.4	19.5
S&P 500 Real Estate	-2.8	49.0	3.4	23.0	7.6	2.9	20.2
S&P 500 Health Care	10.8	17.7	4.6	16.2	17.3	5.9	9.1

Source: Bloomberg
*Data as at 2 December 2020.

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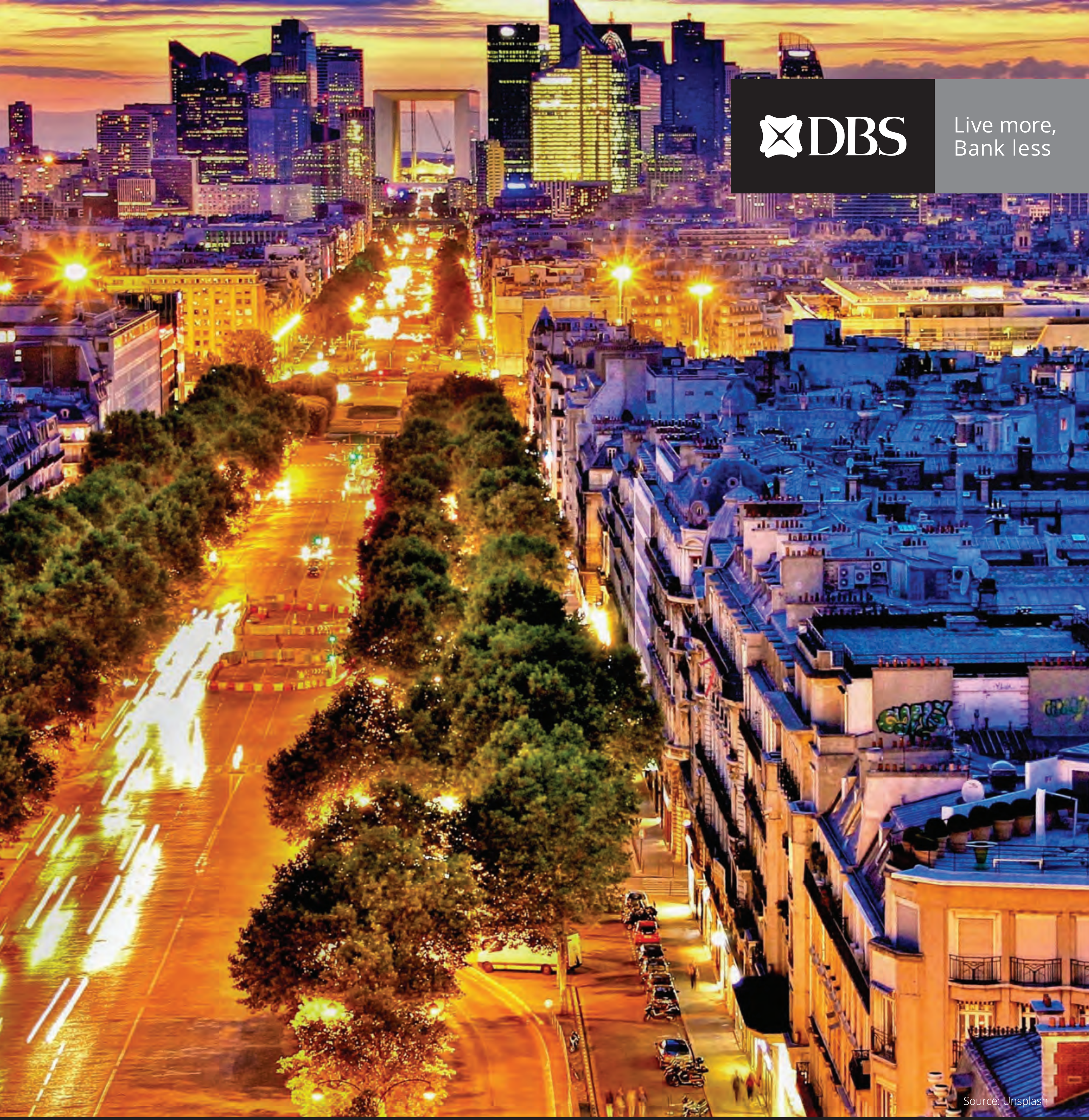

Source: Unsplash

Europe Equities | 1Q21

Value in play

Europe Equities

Joanne Goh | Strategist

In line with other global regions, Europe markets have made a strong comeback since November after a projected victory by Democrat Joe Biden in the US presidential election and encouraging progress in a COVID-19 vaccine. Investors look beyond the resurgence of virus cases towards a recovery next year by positioning in laggard sectors, driving Europe markets up by c.15% in the last quarter of 2020. Economic sensitive sectors such as Banks and Energy outperformed as vaccine hopes triggered optimism that the pandemic will end soon, and global economies will return to pre-crisis levels by the end of next year.

However, our economist believes that this is quite unlikely for Europe given the onset of a ferocious second wave and lockdowns being reinstated. Brexit uncertainties over movements of trade, companies, and people could compound the fallout. 2020 GDP growth is seen at -8.0% y/y, followed by a shallow bounce to 4% y/y in 2021.

Key events to watch in 1Q to extend the recovery. With the strong performance in 4Q, we believe Europe markets have priced in a lot of positives in the near term. Further sentiment and growth boosters will come from the following events:

1. Amid spiralling new infections, should a quick vaccination programme occur – widely expected to be possible in December – it will be highly positive.

2. Two seats for US Senate will be up for grabs in early January, which could swing the majority in the Senate. A larger US fiscal stimulus to aid with the recovery and a less political pandemonium can be expected if it is indeed a Blue Wave. A positive US sentiment will lift Europe stocks as well.

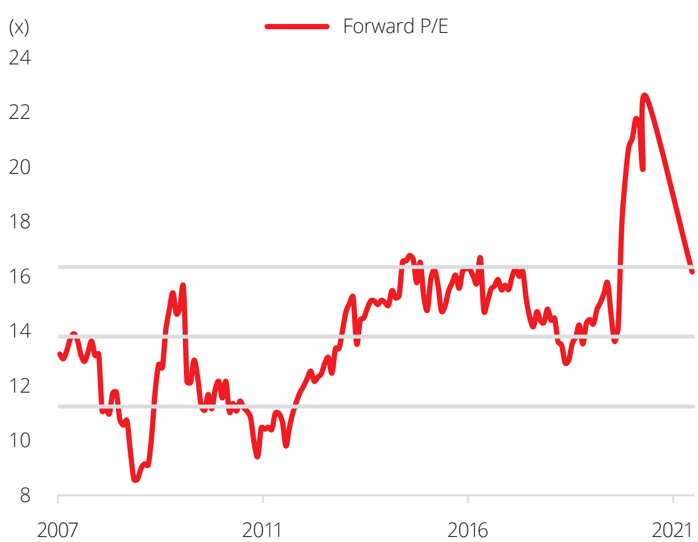
3. The US and China find ways to start talking soon enough and look for trade deals to strike.

4. Further fiscal stimulus support by individual EU countries as most countries are preparing budget for 2021.

5. A chaotic end to Brexit is a big risk now for the region if there is no deal. On the other hand, the overhang would be gone as at least there is visibility. Investors could start to look at the UK and the region seriously again.

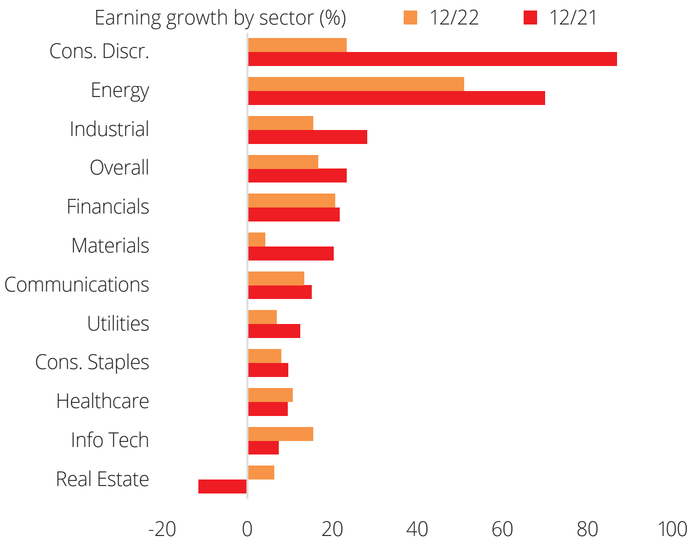
Weakened earnings but strong rebound for next year. Earnings deteriorated further in 3Q20, but the pace of slowdown is more gradual. Consensus is forecasting earnings to grow 22% next year. But this will only bring 12-month forward P/E valuation from +3σ to +1σ (Figure 1). Hence, unless earnings keep on surprising on the upside, the current rally of chasing up laggards may have to pause for a while.

Figure 1: Earnings must grow even stronger to bring valuations down



Source: Bloomberg, DBS.
Bands are average and ±1 SD bands

Figure 2: Earnings forecast by sector



Source: Bloomberg, DBS

Figure 3: Affluent China consumers support the EU Consumer Discretionary sectors

Source: Bloomberg, DBS

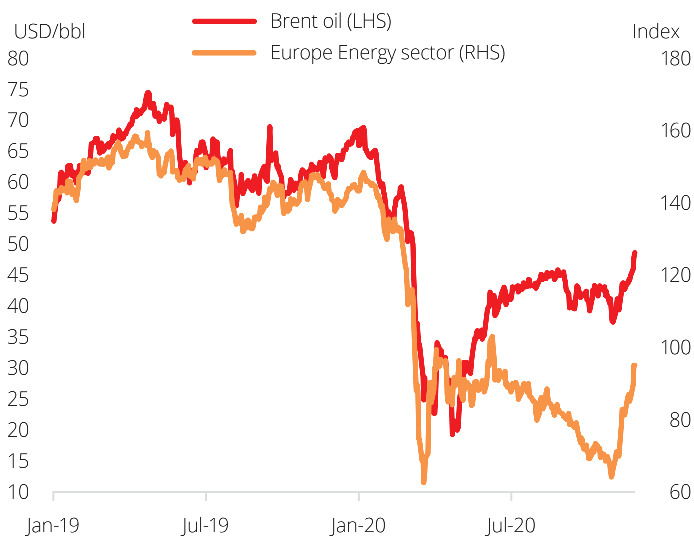
Cyclical uptick favours the quality laggards. Consumer Discretionary, Energy, and Industrials will lead earnings growth next year, unsurprising due to their cyclicality (Figure 2) .

The Consumer Discretionary sector in Europe is a pandemic winner due to its resilience. This is especially valid when top-line revenue is supported by the secular trend of Millennials' consumption behaviour, such as spending on active wear, gadgets, and dining out. Millennials are also spending more time online for entertainment and shopping.

The sector consists of many EU brand titans – companies which have strong bands with pricing power and superior brand portfolios. Earnings are supported by their global reach, such as to China, a country that has tackled the virus effectively and may have more confident consumers.

The oil sector is a strong vaccine discovery play. Should a vaccine transpire in the coming months, it will provide an uplift for risk assets in general, including oil and energy stocks, as confidence in a global recovery starts to pick up. One could also assume that the biggest "victims" of this pandemic will conversely be the largest beneficiaries of a vaccine, and this includes **Europe's oil supermajors**. We should see sequential improvement in the earnings as oil prices gradually recover from the lows.

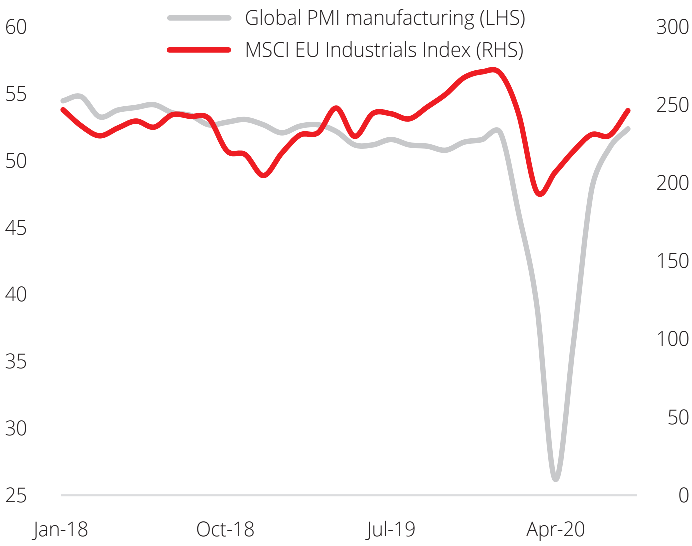
Figure 4: Energy sector to catch up with oil prices



Source: Bloomberg, DBS

A cyclical pick up in 2021 should also benefit the **Industrials capital goods sector**. The sanguine recovery outlook mainly hinges on its cyclicality that corporate investment will return as the global economy recovers from COVID-19. China's broad recovery offers some relief to the sector. The group is also a key recipient of state aids to maintain jobs and cash liquidity during the shutdowns.

Figure 5: China's broad recovery offers some relief to the sector



Source: Bloomberg, DBS

There are reasons to stay positive that investment should return, driven by the following factors:

1. Supply chain disruption due to US-China trade spats and the travel lockdown have driven companies to rethink how to bring key supply chains closer to home.

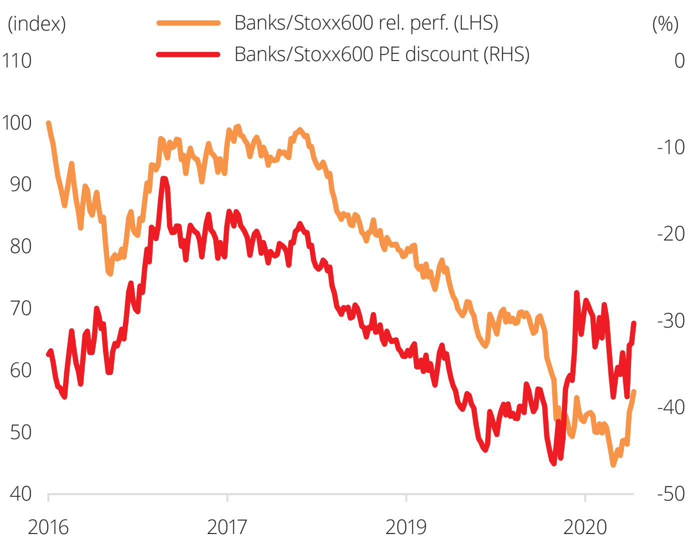
2. The adoption of automated and AI as social distancing and stay home measures become new norms. In order to reduce pandemic risks in the future, manufacturing and work processes will have to be redesigned.

3. Separately, individual European countries and the EU are devising fiscal plans to boost the economy. Germany's chancellor has taken the chance to associate the rescue package with reforms, industry upgrades, and state controls to revolutionise the country's economy with "a view to the future". EUR100b will be set aside to groom home champions in the area of AI, battery cells, and clean energy. It also includes measures to protect companies against foreign competition as well as to reduce dependence on overseas supply chains. Further, spending is being set aside for infrastructure projects on digitalisation, security, defence, 5G data networks, railway upgrades, and the doubling of electric vehicles incentives. We believe Europe's Industrials and Technology sectors could be revived with these initiatives.

Source: Unsplash

Banks. A combination of improving consensus momentum, yield curve steepening, resumption of dividends, and M&A should improve sentiment on European banks in 2021. A rotation into cyclical and Value stocks may benefit the sector as a laggard play; it has underperformed the overall market for the past five years and trades at a deep discount to the market.

Figure 6: European banks as a Value laggard play



Source: Bloomberg, DBS

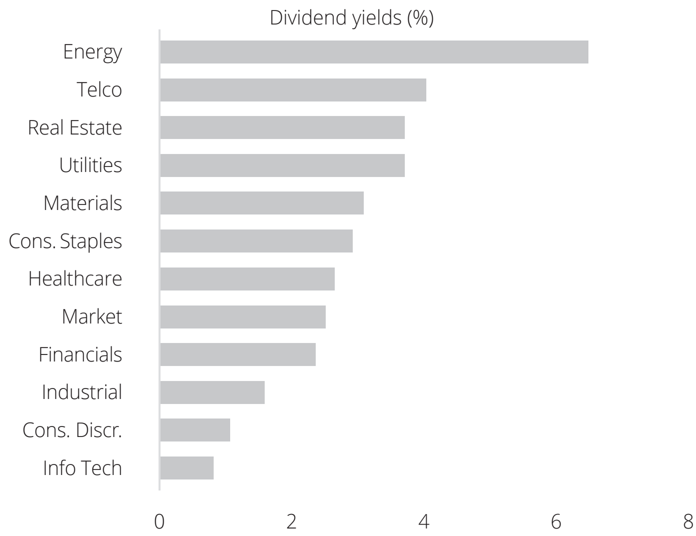
Earnings risk, however, remains high in our view, as many banks are still struggling with bad debt, restructuring, and revenue pain. It would be critical to monitor for a shift in policymakers' outlook, plans for interest rate changes, and QE for a relief in these pressure points.

A key performance differentiator will be the various banks' capacity to pay out dividends and for buybacks.

Dividends to resume. Despite the cuts in dividends, Europe is still one of the regions with the highest dividend yields. Valuation in terms of yield gaps stand out in the region vs a negative bond yield of -0.4%.

Thus, we will continue to be on the lookout for dividend-yielding stocks in Europe which have already disclosed their dividends. An acceleration in restructuring plans by way of cost cutting, deleveraging, asset sales, or M&A activities should see stronger balance sheets for these companies going forward.

Figure 7: Hunt for yield will support some of these sectors paying sustainable yields

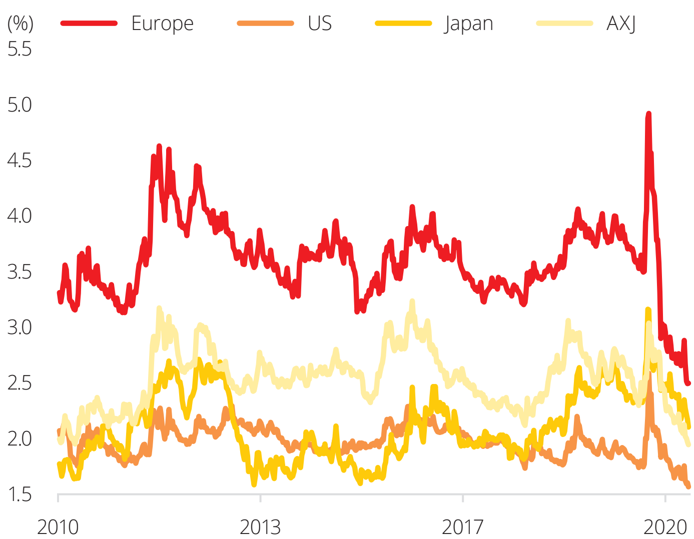


Source: Bloomberg, DBS

We believe the Energy and Utilities sectors can pay sustainable dividends. Selective banks can start to pay dividends due to regulatory changes going forward, while an uptick in earnings for the cyclicals would have their dividends revised up as well. The capacity to pay will help to support their share prices.

Alternative income plays in Europe would include banks' AT1s and high yield bonds.

Figure 8. Europe dividend yields still highest among the regions



Source: Bloomberg, DBS

Source: Unsplash

DBS Live more, Bank less

Japan Equities | 1Q21

Rising sun

Japan Equities

Joanne Goh | Strategist
Glenn Ng, CFA | Equities

Japan equities rose sharply in 4Q20 thanks to improved sentiments as a result of a change in Japan's leadership, the discovery of vaccines, and the US elections. We expect US policies to be more predictable, COVID-19 to cause less economic pain, and that Japan structural reforms would take place more earnestly. A recovery in global equities could thus become more broad-based, Japan equities should join in the rebound. A combination of cyclical forces, value rotation, earnings upgrade, and structural secular trends and reform efforts should see the Japan market ripe for cherry picking in the new reset.

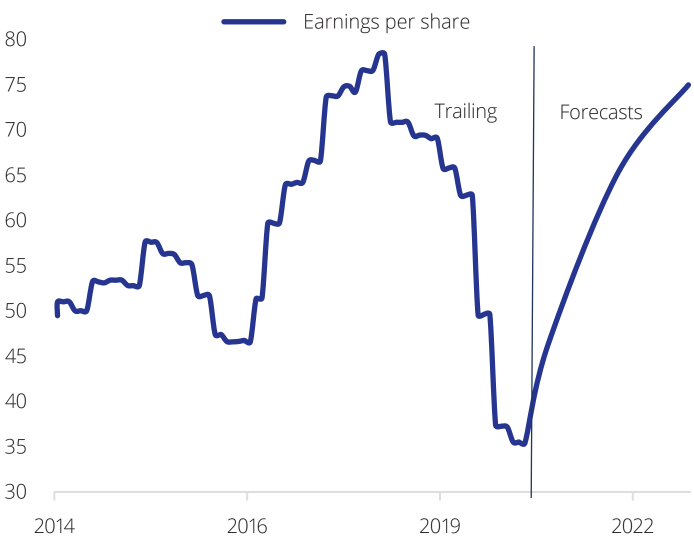
Japan equities are also faring better than their European counterparts due to a steadier macroeconomic environment, a stable political decision-making process, and a milder impact from the pandemic in terms of the scale of infection and fatality rates. It is also getting a lift from the expansion of the Chinese economy.

We thus stay constructive on Japan equities moving into 2021.

Earnings and economic bottoming in 2Q20. The Japan economy is gradually improving from the deep rout and has made a strong turnaround, expanding 21.4% q/q saar in 3Q20. Looking ahead, we expect the economy to continue to recover into 2021, but at a slower pace. Exports are expected to lead the recovery, thanks to the restoration in Japan's manufacturing supply chain and the revival in global durable goods demand. Consumption growth is likely to moderate, however, after the release of pent up demand in 3Q. We maintain the full-year GDP forecasts at -5% for 2020 and 2.8% for 2021, which implies that aggregate output will return to the pre-pandemic level in the first half of 2022.

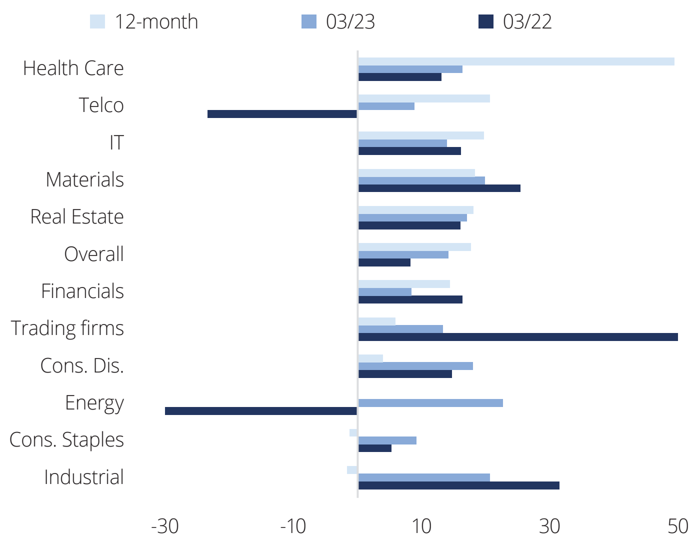
Likewise, earnings improvement from the previous quarter was seen. Earnings will be returning to pre-crisis levels by first half of 2022. Earnings recovery is expected to be broad-based in FY3/22, except for telcos and the Energy sector. Continuous improvement in the earnings revision ratio and positive vaccine development could bring upside surprise for both the economy and earnings recovery in FY3/22, especially for cyclical sectors.

Figure 1: Japan corporate earnings to return to pre-crisis levels by the end of 2021



Source: Bloomberg, DBS

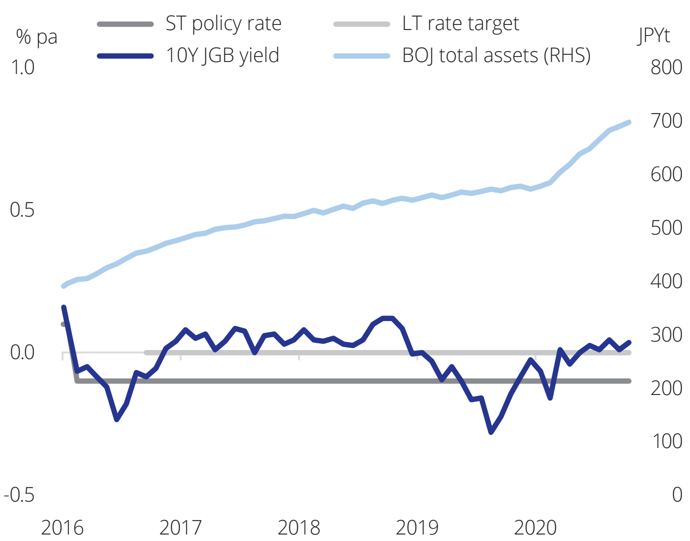
Figure 2: Earnings recovery is broad-based (earnings growth by sector, %)



Source: Bloomberg, DBS

Monetary and fiscal policies to remain supportive. We expect monetary and fiscal policies to remain supportive into next year. Prime Minister Yoshihide Suga is set to submit a supplementary budget to the National Diet in January 2021, the first during his tenure, which started in September 2020. The budget will likely be used to extend the "Go To Travel" subsidy campaign to support the domestic tourism sector, alleviate pressure on the labour market, and promote investment in the digital sector, among others. Assistance schemes for different sectors such as banks, airlines, loan support, and direct bond buying for big and small companies are also being discussed. On monetary policies, the BOJ's bond buying and yield curve control are likely to be maintained.

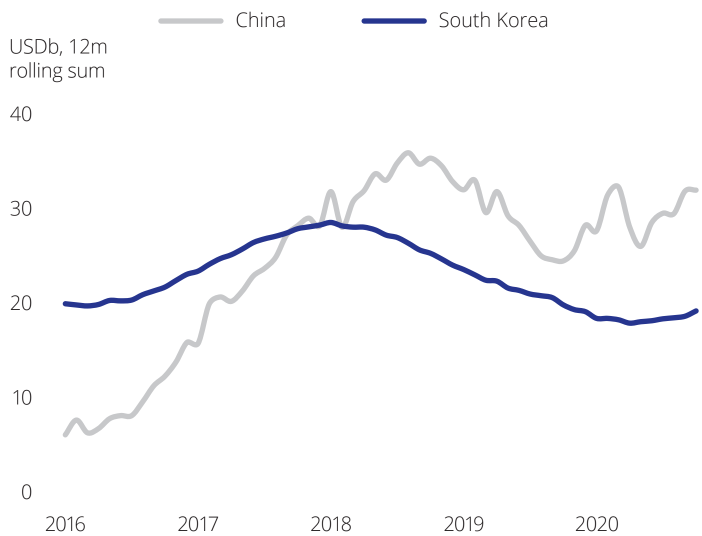
Figure 3: BOJ to remain supportive with existing monetary tools



Source: Bloomberg, DBS

Biggest beneficiary in RCEP. The Regional Comprehensive Economic Partnership (RCEP) Agreement was signed by 15 countries on 15 November 2020, including the 10 member states of ASEAN. As far as the export boosting effect of RCEP is concerned, Japan will be a major beneficiary as it enjoys large trade surplus with South Korea and China, and has comparative advantage over them in sectors such as transportation equipment, chemicals, plastics, rubber, as well as metals.

Figure 4: Japan's trade surplus with China and South Korea reaps benefits from the RCEP



Source: Bloomberg, DBS

Less fearful US elections results. With the US elections uncertainty out of the way, we believe investors can more readily focus on strong earnings and economic recovery. The more fearful scenario of tax cuts, health care reform, and tighter financial regulations are unlikely in the near term as the focus for the new US administration will be on combating the virus. Besides, the appointment of Janet Yellen as the new Treasury Secretary should give confidence to the market that sound economics will prevail, and hopes for a large fiscal stimulus could be fulfilled. Last but not the least, US-China tensions ought to ease, which should bode well for Japan to work with China on the recovery process.

Suga's reform policies. Prime Minister Yoshihide Suga has pledged to restructure and reinvigorate the Japanese economy. More meaningful measures that may present opportunities for investors are the opening of the financial sector, an upgrade of the nation's digital capability, new industrial revolution for Japan Inc, consolidation of the banking sector, the promotion of competition in the telecom sector, and facilitation of consolidation among SMEs. Suga is also committed to the Olympics, which if held smoothly, could lead to a major re-rating for the market.

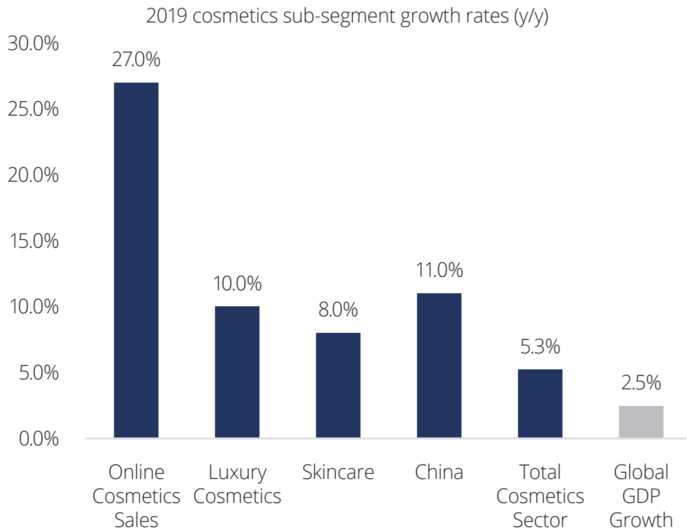
We have identified below the key themes which should play out well in 2021.

Vaccine beneficiaries – Cosmetics and P&C Insurance. As COVID-19 vaccines become available and swathes of the global population are vaccinated in 2021, the re-opening theme will remain a central one. Cyclicals and Value stocks will be the main beneficiaries of the re-opening. However, bearing in mind our view that the underperformance of the Value vs Growth trade is likely to persist in the long term, we would caution against over-investing in low growth cyclicals for the sake of capturing a near-term bounce.

For Japan, one alternative is to go for sectors that have been beaten down in the near-term due to COVID-19, yet possess long-term secular growth prospects; we think the Cosmetics sector fits the bill. Another alternative for investors seeking income generation is to go for defensive sectors which may not have strong growth prospects, but are unlikely to see a decline in earnings over the long term, and have good shareholder return policies; we think the Property & Casualty (P&C) Insurance sector fits the bill.

The Cosmetics sector took a hit from the pandemic, as travel retail volumes plummeted, unemployment ticked up, and stay-at-home reduced the demand for cosmetics. However, pre-pandemic, the sector had been growing steadily at about twice the global GDP growth, owing to a rising middle class and a broadening of product suites. In particular, the luxury, skincare, online, and China sub-segments of the cosmetics market had been experiencing above-average growth rates. Japan's cosmetics companies are well positioned in these sub-segments, owing to their tilt towards premium brands and positive impression among Chinese consumers who deem Japanese products as high in quality.

Figure 5: Japanese cosmetics sector should ride on the sector's growth rate due to "premiumisation"

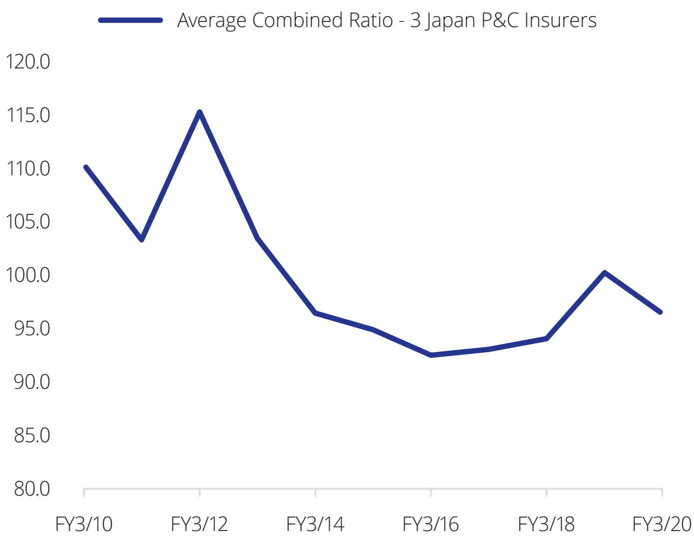


Source: World Bank, L'Oreal, CosmeticdesignAsia.com

Source: Unsplash

The P&C Insurance sector has been hit by the pandemic due to worries over rising Business Interruption claims, event cancellations, and lower auto sales. However, these worries should fade as the economy re-opens. The long-term outlook remains sanguine in our view, owing to favourable industry dynamics, where consolidation over the years has resulted in the top three P&C insurers now accounting for over 80% of domestic premiums, which reduces pricing pressure. This has helped them reduce combined ratios, generate positive free cashflow, and increase profitability. In turn, total shareholder returns (dividends plus buybacks) as a percentage of market capitalisation have roughly doubled over the last five years to about 7% currently, which is almost twice the average total shareholder return for the Topix Index of 3.6%. Low sensitivity to interest rates (unlike other Financials sub-sectors) is also a positive from a volatility perspective.

Figure 6: Consolidation among P&C insurers have reduced pricing pressure and increased profitability



Combined Ratio = Claims Ratio + Expense Ratio

Source: Bloomberg

The new era of Suganomics. Yoshihide Suga became Japan's new Prime Minister in September 2020 after Shinzo Abe's surprise resignation due to health reasons. As a long-time Abe supporter, last serving as Abe's Chief Cabinet Secretary, Suga has pledged to retain the core direction of Abenomics, which has been a positive for markets due to the higher visibility afforded by policy continuity. However, there will inevitably be some changes and nuances under new leadership. While Suga has yet to unveil detailed reforms and policies, we highlight some of the sectors likely to be winners and losers.

Likely losers: During his time in the Abe cabinet, Suga was a strong advocate of lower drug and telecommunications prices. It is expected that he will continue to pursue these agendas, making pharmaceutical and telecommunications companies the key losers under his administration.

Likely winners: IT systems integrators should be a key beneficiary of Suga's push to accelerate the digitalisation of government agencies; he has set up a digital agency to oversee this. This comes on the back of Japan scoring poorly in assessments of its government's digital capabilities, with many tasks still handled manually and via paper forms. IT systems integrators could benefit if they win government projects.

The tourism sector should also be a winner, on the tailwinds of continued government support, as Suga has said he will maintain Japan's target of 60m visitors by 2030, compared to 31.9m in 2019.

Recent moves by Suga highlight his pro-hospitality sector views. While the pandemic has put Japan's foreign visitor goals on the backburner, he has meanwhile been backing Japan's "Go To Travel" campaign, which aims to boost domestic tourism despite the virus which remains uncontained. Suga has also said he would not allow hotels and inns to go bankrupt.

DBS

Live more,
Bank less

Source: Unsplash

Asia ex-Japan Equities | 1Q21

New dawn

Asia ex-Japan Equities

Yeang Cheng Ling | Strategist
Joanne Goh | Strategist

Asia equities had a strong year in 2020 driven mainly by North Asia markets. China equities rose more than 25% while overall North Asia equities gained more than 20% on the back of robust corporate activities and domestic demand.

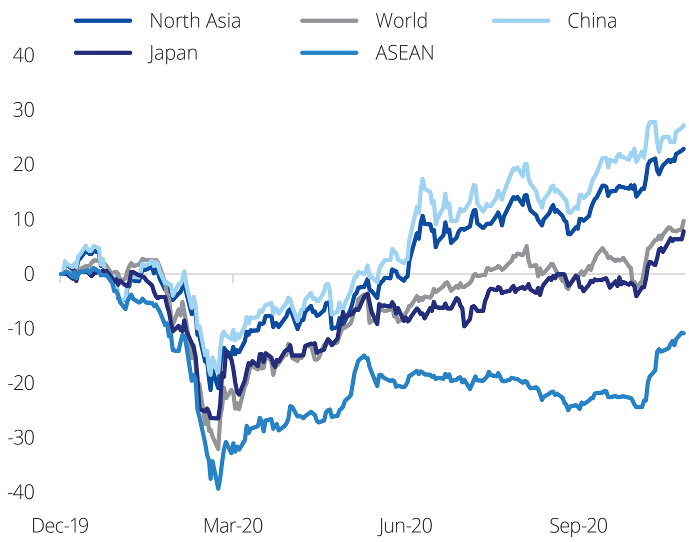
The outperformance of North Asia markets was due to success in stopping the spread of the pandemic swiftly and stamping out sporadic resurgences while most of the world still struggled with containing COVID-19. China's management of the disease allowed it to re-open its domestic economy and resume production quickly. As a result, its 2Q and 3Q GDP grew 3.2% and 4.9%, respectively, after a plunge of 6.8% in 1Q during the height of the pandemic.

In contrast, Southeast Asia lost c.15% as the region was hit by multiple headwinds. Moreover, it did not take part in the global rally of pandemic winners due to its lack of Technology sector exposure.

Sentiments turned better towards the end of the year. The US presidential election results were well greeted by Asia investors in expectation that the bilateral policies between the world's two largest economies would turn less confrontational under the new Biden administration.

Investors were also cheered by the discovery of vaccines, unwinding the underperformance of cyclical sectors such as energy, tourism, and consumer stocks.

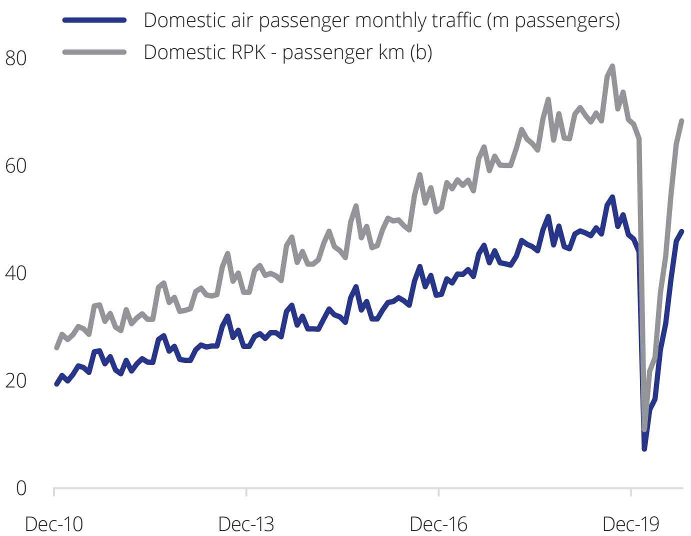
Figure 1: 2020 Asia equities performance (%)



Source: Bloomberg, DBS

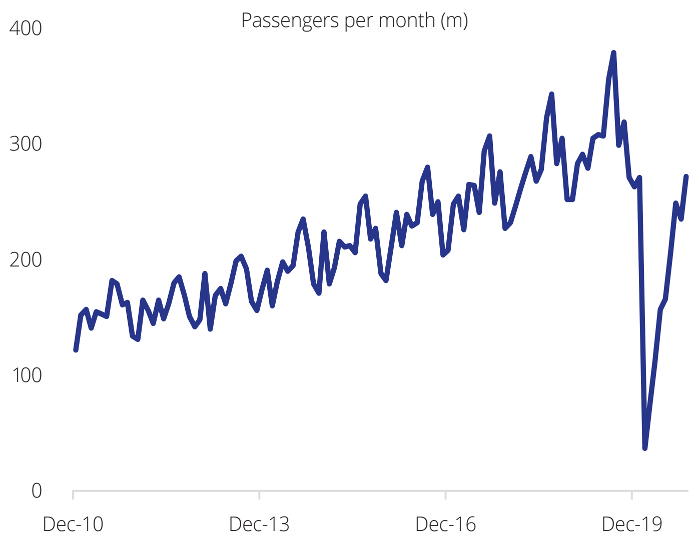
Going into 2021, we expect a broad rally to benefit Asia as a whole as risk appetite improves from vaccine discoveries and new US political leadership. Value and cyclical sector rotation should favour ASEAN in 1Q, and accelerating digitalisation should continue to benefit Tech-related sectors. China remains our most preferred market as we see fresh impetus from domestic re-rating drivers to lift the market to new heights. The Asia Tech sector should still stay in focus.

Figure 2: Rebound in domestic air traffic and RPK



Source: Bloomberg, DBS

Figure 3: Railway passenger volume bounced back to normal



Source: Bloomberg, DBS

China maintaining lead in the recovery

China's GDP is projected to maintain positive economic growth at >5% in 2021 as recovery momentum picks up pace.

China cemented its pole position as the world's leading manufacturer and trading partner as shown in the high frequency data and steady recovery. The quick re-opening of manufacturing plants spinning out large volume of products – ranging from hazmat suits, face masks, to technology components and work-from-home devices – enabled China to capture a larger market share of global exports.

The data also underscored its resilience against the perceived relocation of long existing manufacturing chains to neighbouring countries.

China domestic activities resuming

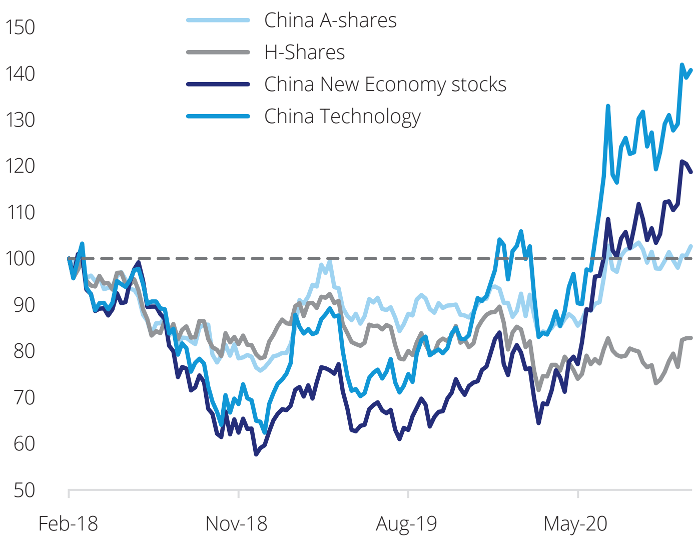
The scene of crowded tourist attractions seemed remote throughout the first half of 2020. However, domestic tourism sprung back to life during the Golden Week holiday in October 2020. Domestic air passenger traffic reached 39m in July while revenue passenger kilometre (RPK) rose to CNY55b, equivalent to 70% of the peak level seen a year ago (Figure 2). Railway monthly passenger numbers improved to 250m (Figure 3).

Domestic policies to reign in China. Having experienced negative US policies over the past few years and adverse trade conditions, China's government has adjusted its development framework around the headwinds.

Taking technology and its massive manufacturing sectors as examples, China decided to develop local capability for upstream capacity and increase the depth of its IC design competence.

Since 2018, China has expedited the reform of its domestic socio-economic structure and further decoupled from relying too heavily on external markets. In particular, China will continue to reduce emphasis on low end, labour intensive, which was embarked on four to five years ago. China will stay the course on developing its domestic economy and supply chain, shifting to higher levels of self-sufficiency and self-reliance. As such, this will increase the depth and breadth of technology supply chains and build up the resilience of its domestic economy.

Figure 4: China equities performance since the start of the trade war (February 2018=100)



Source: Bloomberg, DBS

Figure 5: Improving earnings outlook

Source: Bloomberg, DBS

New Economy stocks climb unabated, Old Economy sectors benefit from policies. Almost three years on since the US imposed trade tariffs on China products in 1Q18, China's equity markets have not only regained their lost ground – some sectors have soared to much higher levels thanks to the robust fundamentals of China's equity markets (Figure 4).

Within the China equities universe, the New Economy sector – which comprises mainly Internet, e-Commerce, and digital economy stocks – grew more than 20% during this period while the broader China Technology sector delivered gains of c.40%.

The earnings recovery among China's industrial enterprises with strong output bodes well for their earnings outlook in the coming quarters (Figure 5), paving the way for an upward revision of earnings forecast. Similarly, retail sales, the barometer for domestic conditions, also revealed encouraging signs of a stable recovery (Figure 6).

Figure 6: Convincing rebound in retail sales

Source: Bloomberg, DBS

The domestic focused A-shares index (Shanghai Composite Index), which has significantly large exposure to Old Economy sectors, recovered remarkably to levels when the trade war first started, boosted by domestic end demand. We are confident that financial markets in North Asia will keep up their stellar performance backed by their earnings, fundamentals, and robust outlook.

China A-shares opening in the works. Onshore equities continued to attract investors' participation as the domestic economy recovery remained on course and more activities resumed. The combined market value of onshore equities rose above USD7t, compared with USD6t at the end of 2019 (Figure 7), demonstrating resilience against the backdrop of the COVID-19 pandemic and external headwinds. Valuations remain supportive, trading at slight discount to historical mean even after the recent increase, as firms' balance sheet quality has largely stayed stable (Figure 8).

Notably, China firms derived a large majority of their revenue from the domestic economy, which has proven to be robust. As the world's second largest economy sustains its decent growth trajectory, local companies will benefit.

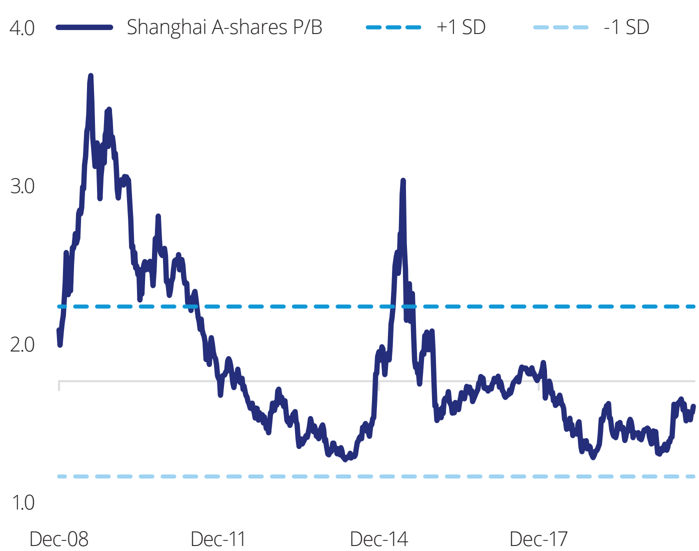
We are constructive on sectors which generate their revenue domestically, namely the e-Commerce ecosystems, New Economy sectors, technology components, large banks, and Vaccine Winners. The compelling investment fundamentals are demonstrated in their stellar YTD performance, and we expect their attractive investment fundamentals to remain.

The revenue mix of the 15 largest constituents among China indices clearly show they earn between 70% and 95% of their revenue from local operations (Figure 9). This will remain a core catalyst for the share prices to continue rising.

Figure 7: A-shares market value above USD7t

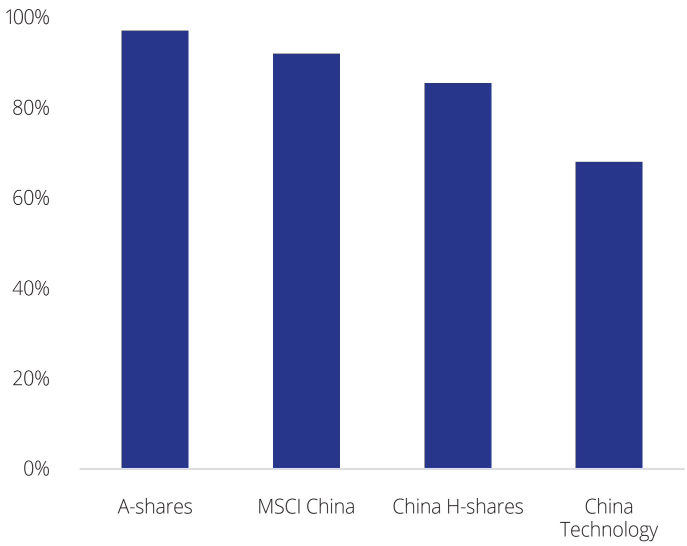
Source: Bloomberg, DBS

Figure 8: Valuations are supportive



Source: Bloomberg, DBS

Figure 9: Percentage of revenue derived locally among 15 largest China index constituents



Source: Bloomberg, DBS

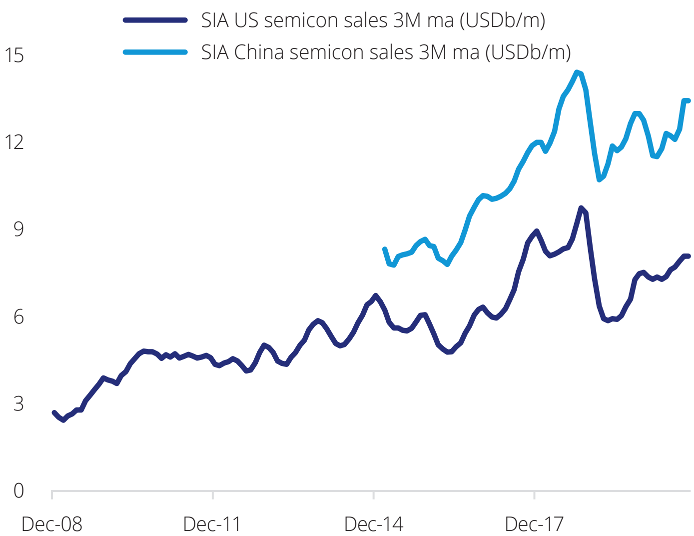
Asia Technology – unscathed. The adoption of digitalisation, cloud-based services, and long distance connectivity have increased. The COVID-19 pandemic has compelled more industries and businesses to migrate their operations to be cloud based with remote access, and ensuing efficiency.

The corporate sector's willingness to incur capital expenditure to sustain productivity enables them to capture the stronger-than-expected end demand in order to restore normalcy. Global demand has remained strong for smart devices, cloud services, IOT, and semiconductor IC as technological innovation progresses. This will continue to benefit global technology industries and North Asia, namely component makers, IC design firms, and wafer foundries.

China remained the main consumer of semiconductor components and integrated chipsets (Figure 10). We expect this trend to continue in the coming years while it develops capability in upstream technology and inches towards self-sufficiency over the long term.

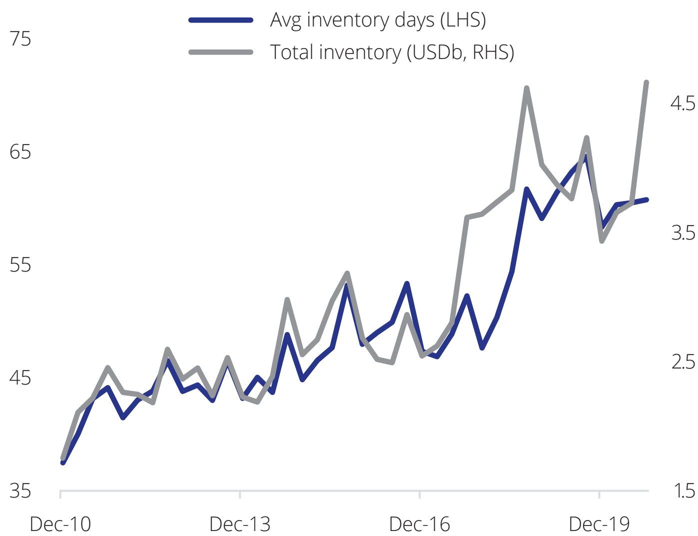
Source: Unsplash

Figure 10: China remained a big buyer of semiconductor products



Source: Bloomberg, DBS

Figure 11: Inventory conditions in Asia's technology supply chain



Source: Bloomberg, DBS

Another encouraging sign is the inventory clearance in the North Asia supply chain. Inventory days were kept at around 60 days and total inventory value has declined to more manageable levels (Figure 11).

The amplification of cloud, automation, work-from-home, and advanced connectivity will drive the next big wave in global technology towards artificial intelligence know-how for machine learning, IOT, data processing, and analytics. This new development will be another driving force behind the global technology cycle, including North Asia.

Concerns over technology exports are overblown. China exports of mechanical and electrical products accounted for 60% of total exports in 2019, amounting to CNY10.1t (USD1.5t). The export value of data processing machines and related components was USD176b, making it an export giant for technology products including computers, smartphones, electronics devices, and transport equipment.

It took more than 20 years for the technology supply chain to be comprehensive in China, making it the least costly and most convenient location to manufacture. It is likely to take as long to shift part of the manufacturing elsewhere; currently, no country can replace what China has to offer.

At the same time, some companies are adopting the approach of separating their supply chain into China-based for China, and outside of China for the rest of the world. This has led to the sale of businesses from Taiwanese technology companies to China companies. Counterintuitively, it will boost the revenue of China technology companies in the long run. This means that current non-China competitors are likely to sell their assets and businesses rather than shutting down. China companies will benefit from the contribution of newly acquired business. For example, Taiwan iPhone supplier Wistron sold its two plants in China to China-listed company Luxshare.


Source: Unsplash

Stars aligned for ASEAN

ASEAN markets made a strong comeback since November as vaccine discoveries cleared the clouds for a more visible recovery in 2021. The region has yet to fully recoup the steep losses in 2020 but is halfway there. ASEAN markets should benefit as risk appetite picks up and the rally broadens. Rotation into value and cyclical sectors should lift ASEAN markets in the near term, and an economic recovery scenario for 2H21 should see the rally extending into next year.

The key drivers for ASEAN in 2021 are:

1. Lower valuations leave room for re-rating. Trading at a historically low range, ASEAN is at a discount to the Asia ex-Japan region, which is rare. We see deep value in ASEAN.

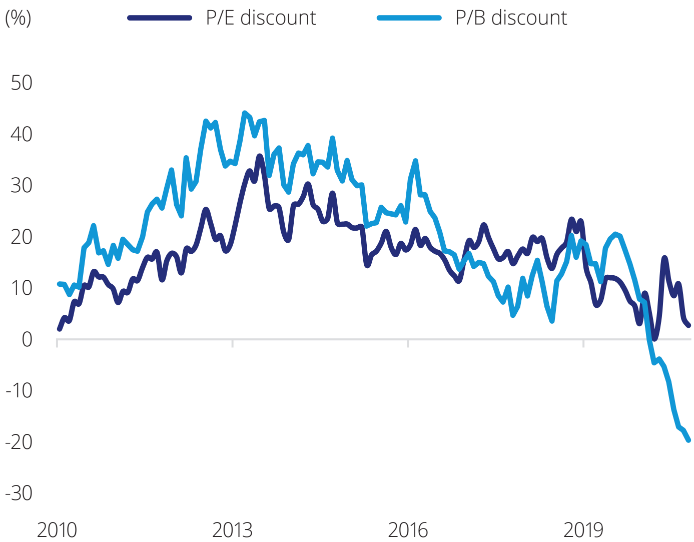
2. Vaccine discovery should benefit ASEAN the most as the region suffered multiple whammies from loss in tourism receipts, exports decline, domestic consumption pause, and foreign investment outflows as a result of the pandemic. We expect these headwinds to unwind gradually.

3. RCEP boosts exports and improves ease of doing business. This should entrench ASEAN's role in the "China+1 Strategy" and regional supply chain, thereby attracting FDI, which generate jobs and help with the recovery.

4. Change in the US's political leadership bodes well for ASEAN as trade and geopolitical tensions are expected to ease. ASEAN has been mired in a diplomatic dilemma as tensions rise between China and the US.

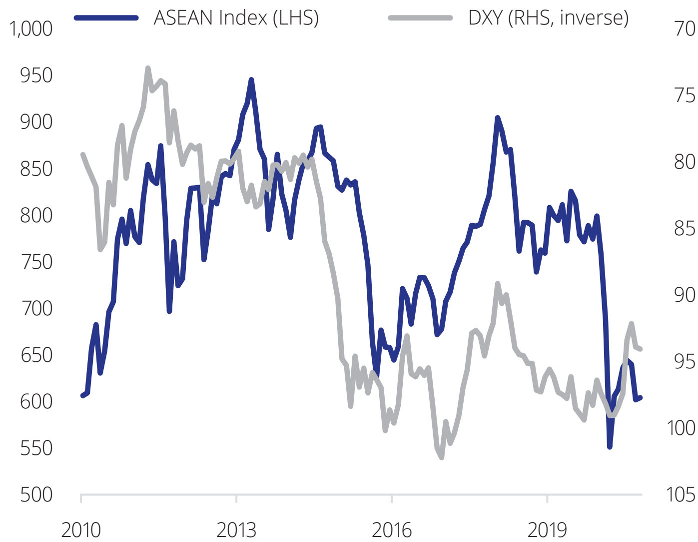
5. Return of flows to ASEAN assets. With the improvement in risk appetite for ASEAN assets, we can expect a powerful cycle of bond flows driving currency and equity gains. Yield spreads are attractive and ASEAN assets are under-owned. Foreign investors have net sold USD18.6b till November and flows have only started to return. We believe this is only just the beginning.

Figure 12: ASEAN is cheap when compared to the rest of the region



Source: Bloomberg, DBS

Figure 13: ASEAN markets perform well in a weak USD environment



Source: Bloomberg, DBS

6. We expect USD to stay weak in 2021. This should be positive for ASEAN's export-oriented economies. The outlook for equities should be positive on a dollar return basis.

7. US infrastructure spending and a global recovery scenario are supportive of commodity and material prices on demand boost and structural underinvestment. Thailand and Indonesia are main beneficiaries.

8. ASEAN is getting a strong lift from China's recovery, as the region is now China's biggest trading partner, even outranking other major economies such as the US and the EU.

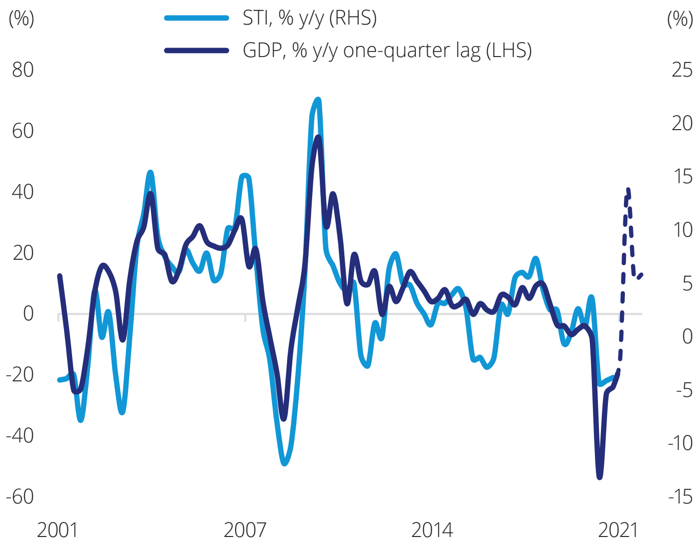
We look for a broad-based recovery among ASEAN markets to leverage on the global recovery into 2021. In particular, we prefer Singapore and Indonesia as prime beneficiaries of the value cyclical trade.

Singapore

The Singapore market should benefit the most from the cyclical recovery. The key drivers are:

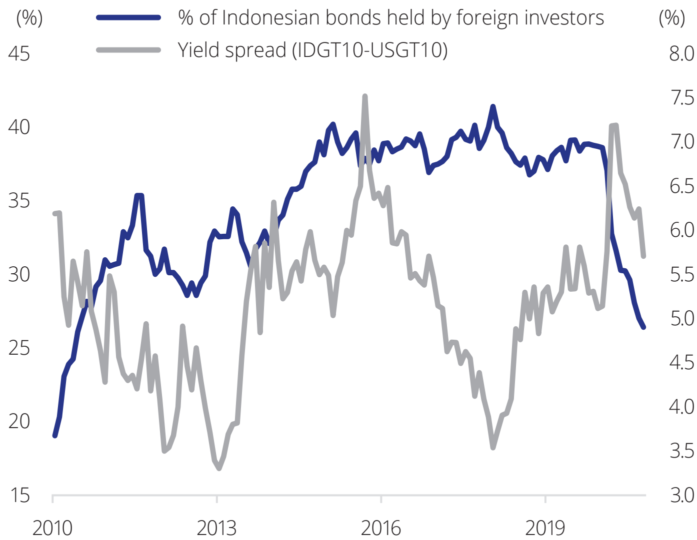
1. Singapore is the cheapest market among ASEAN, trading at less than -1 SD on P/B, leaving ample room for re-rating.
2. Besides it is the most cyclical market with stocks leveraged to tourism and domestic consumption – which should benefit greatly from a vaccine recovery – such as retail and hospitality REITs, airlines, airports, and transport operators.
3. An economic recovery should bode well for loan growth to recover and credit costs to ease, reducing the drag from low interest margin for the banks.
4. Government plans to maintain a budget deficit until at least 1H21 to help with the recovery. RCEP should boost trade flows and FDI in the region, where Singapore is a prime beneficiary as a regional hub. The economy is set to rebound to 5.5% next year, expanding up to 99% of pre-COVID level.

Figure 14: Recovery in GDP portends recovery in STI



Source: Bloomberg, DBS

Figure 15: A combination of attractive yield spread and low foreign ownership are conducive for bond funds to return to Indonesia



Source: Bloomberg, DBS

Indonesia

Being the largest consumer market in ASEAN, a vaccine discovery will help kickstart another consumption boom as social restrictions ease and travel restarts. Meanwhile the government is providing unprecedented support with bond purchases and temporary raising of the regulatory budget deficit limit, as well as structural reform to attract investments. The unique drivers that make Indonesia stand out from other ASEAN countries are:

1. Indonesia will be the first ASEAN country to receive inoculations as soon as end December 2020. Domestic sentiments should improve significantly once this exercise is implemented and demonstrates success.
2. The market typically enjoys a virtuous cycle of bond flows leading to FX gains and resulting in more equity flows. Indonesia government bonds is still under-owned by foreign investors and yield spreads (vs the US) are close to their longer-term averages. Foreign portfolio flows should return to the bond and equity markets, and the rupiah should strengthen as vaccine hopes spur demand for undervalued risk assets.
3. Approval for Omnibus Law by parliament in 2H20 as policy reform catalyst to boost FDI and transform Indonesia into Asia's next manufacturing hub.
4. Large consumer base, which are attractive to investors hoping to gain access to the market.

Table 1: Summary of key Asia investment themes

Themes	Beneficiaries
Digitalisation, 5G	Semiconductors, IC Design, Cloud Computing
e-Sports	Gaming platforms
Ageing population	Insurance
Dividend plays	Singapore REITs
	Singapore banks
	China large banks
Asia domestic consumption	China e-Commerce
Government stimulus	China banks
	Indonesia consumption
Market reform	China A-shares
	Vietnam
Vaccine discovery	Tourism
	Gaming
	Indonesia

Source: DBS

Global Rates | 1Q21

A return to normal

Global Rates

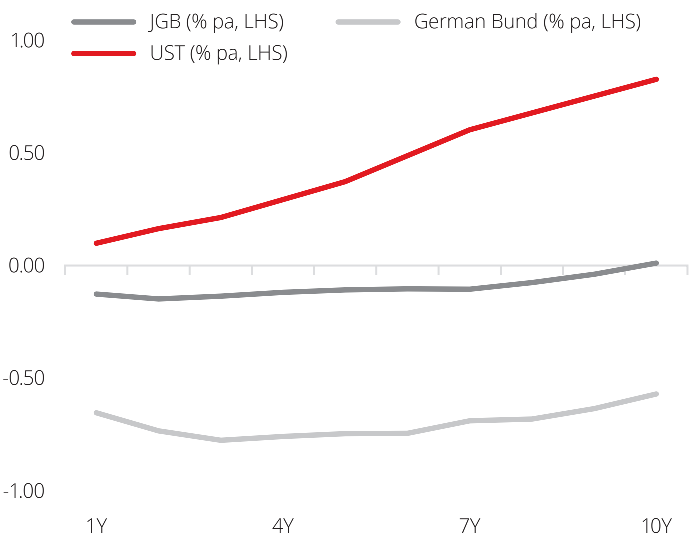
Eugene Leow | Strategist
Duncan Tan | Strategist

2021 should mark a return to normalcy after a tumultuous 2020 gripped by COVID-19 fears and uncertainties over the US elections. Defining what normal is for the economy is arguably easier than defining what normal is for global interest rates. Moreover, the speed of recovery of the market (which can be split into different asset classes) and the real economy can differ. Our key point was that without vaccines, the initial V-shaped recovery would slow as selected industries (tourism-linked) cannot normalise. However, that changed when Pfizer Inc, Moderna, and Oxford reported encouraging preliminary vaccine results. Vaccine approvals could set the stage for a more complete global economic recovery in 2H21 when vaccines become widely distributed.

The market will be ahead of the real economy. DM curve steepening took place in earnest in 4Q20 as the market gained clarity on US elections, fiscal spending, and a potential COVID-19 vaccine. With the pandemic crisis having an expiry date and about to transition to a more conventional economic crisis, there no longer is any need to place a sizable COVID-19 premium on longer-term USTs. Our regression model suggests that neutral 10Y US yields should be closer to 1.3%.

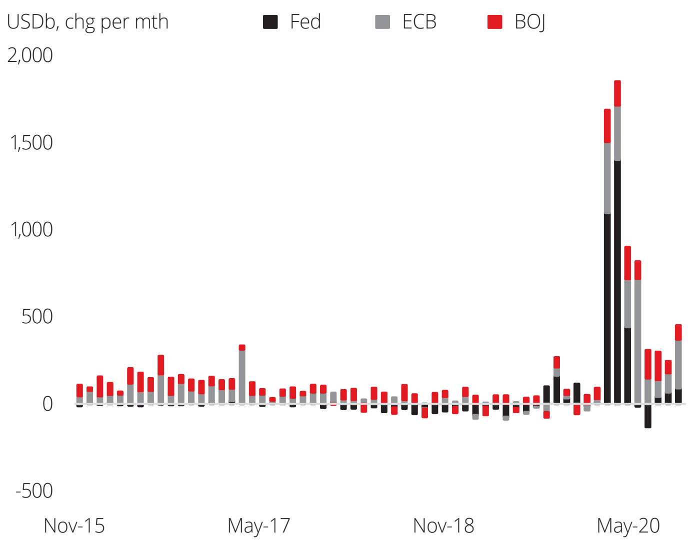
Stances of the authorities will probably be accommodative into the first quarter of 2021. However, there will be rumblings of support pullback (fiscal and monetary) sometime in mid-2021 when the recovery is on firmer footing. For rates, there will be nuances amongst DM central banks. In general, we believe that monetary easing will largely be done in 2020 with the ECB possibly firing the last bullet (more QE and possibly deeper negative rates) in December. The Federal Reserve and BOJ have been on pause for several months. Speculation of Fed taper is probably premature, but this could get contentious as we get into late 2021. The US unemployment rate is already below 7%. Under the old regime, the Fed would probably be thinking about reducing asset purchases. Similarly, while the dot plot indicated no hikes through 2023, risks of earlier tightening should not be underestimated. Steepening in the 2Y/10Y and 2Y/30Y segments may give way to steepening in the 1Y/5Y segment in 2H21. We expect German and Japanese government bond curves to steepen in tandem, but to a smaller extent given a dovish stance from the ECB and BOJ.

Figure 1: G-3 curves to steepen



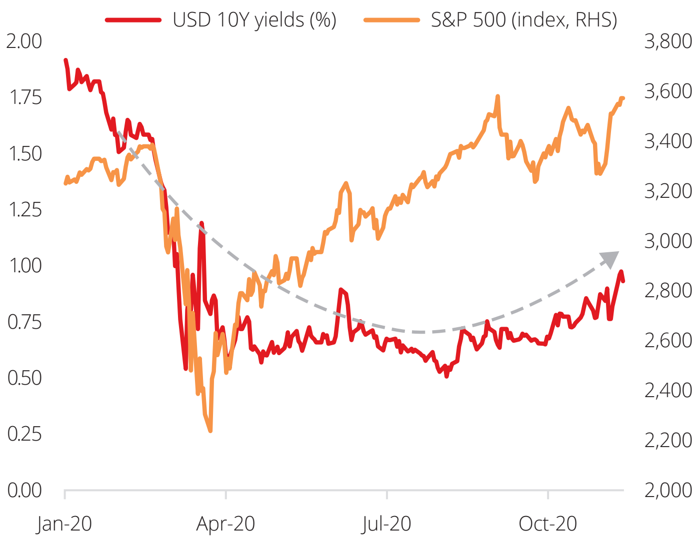
Source: Bloomberg, DBS

Figure 2: Taper is not an imminent concern



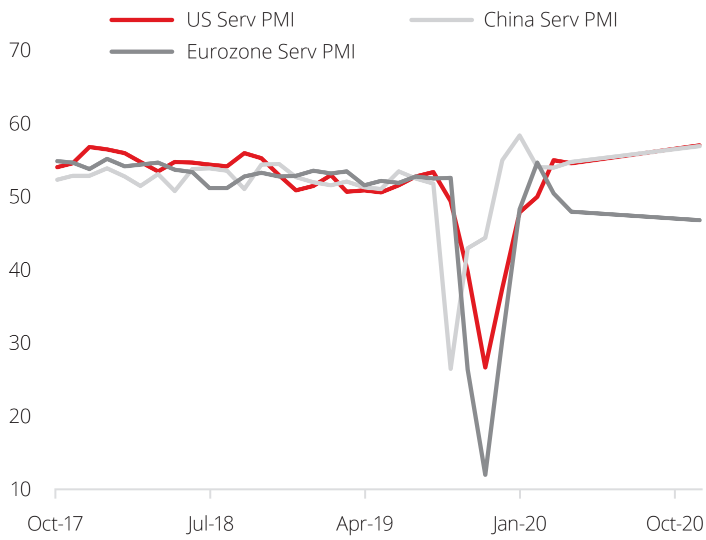
Source: Bloomberg, DBS

Figure 3: US 10-year yields lagging equities



Source: Bloomberg, DBS

Figure 4: Awaiting a broad-based recovery



Source: Bloomberg, DBS

Source: Unsplash

Asia Rates

CNY rates: Neutral with a hint of tightness

China government bond (CGB) yields will probably grind modestly higher through 2021. The PBOC has been the fastest to normalise policy, driving onshore short- and long-term rates back to pre-pandemic levels. We think CGB will outperform DM govvies in general given that CGB yields are already high. While it can be argued that China's economy may overheat, we think that is an unlikely development for 2021 (we see chance of tightening in 2022). If the PBOC sticks to neutral (with a hint of tightness), 10Y yields should hover around 3.4%, with the curve generally flattish. At 3.2%, 10Y CGB holds a 230 bps (still wide by historical standards) cushion over UST. This should more than cushion an expected rise in DM/US yields when they normalise higher in 2021, in tandem with a recovering global economy.

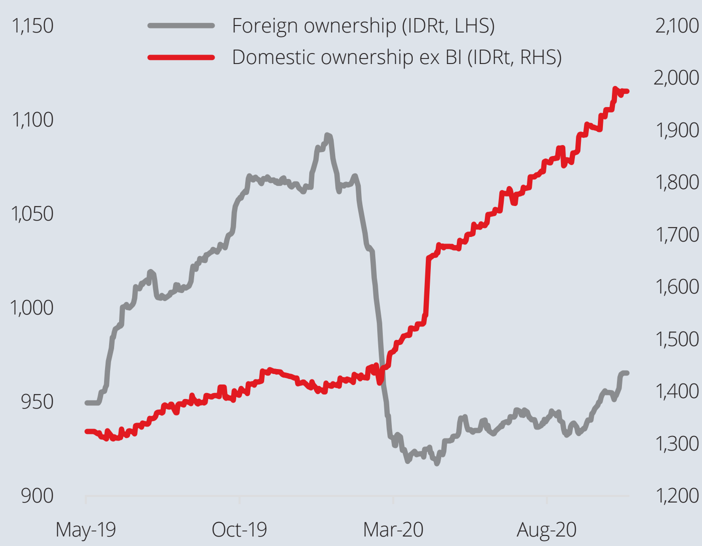
Figure 5: CGB has considerable yield cushion

Source: Bloomberg, DBS

IDR rates: Two halves

Indonesia government bonds are likely to hold up very well in the first half of 2021. However, conditions could get more challenging in 2H21. In the near term, we think that policy setting will likely stay accommodative as the rupiah stays firm. Moreover, foreign investors, who have been underweight IndoGBs, might play catch up. On a spread basis (over 10Y USTs, IndoGBs are about neutral, close to their multi-year average. On balance, we think that 10Y yield around 6.5% offers some margin of safety for investors when conditions stay benign in the coming few months. Beyond that, better economic growth and inflation prospects in Indonesia could stoke higher IDR interest rates, posing headwinds to govvies.

Figure 6: Foreign investors are warming up

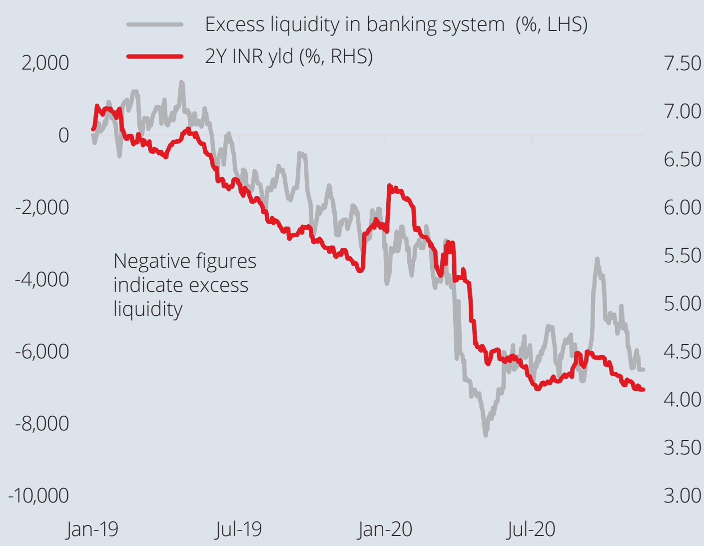


Source: Bloomberg, DBS

INR rates: Liquidity will stay flush for a while

The India government bond curve is impacted by a variety of factors including flush liquidity, implicit efforts from the RBI to cap longer-term yields, as well as the trajectory of monetary policy. Taken together, we think that favourable Current Account dynamics are likely to be in place for a couple more quarters as growth remains slow. With the RBI appearing to be more tolerant of INR weakness, we would assume that liquidity would stay flush in the coming few months, anchoring the front of the IGB curve even if rate cuts are no longer as forthcoming (given persistently high inflation). We suspect that these dynamics will be in play in the first half of 2021, with positive spillover into the intermediate tenors. Beyond that, a recovery in India's economy could lead to deterioration in the current account. If USD rates are also materially higher by then, INR rates should face upward pressures.

Figure 7: Flush liquidity anchors the front of the curve

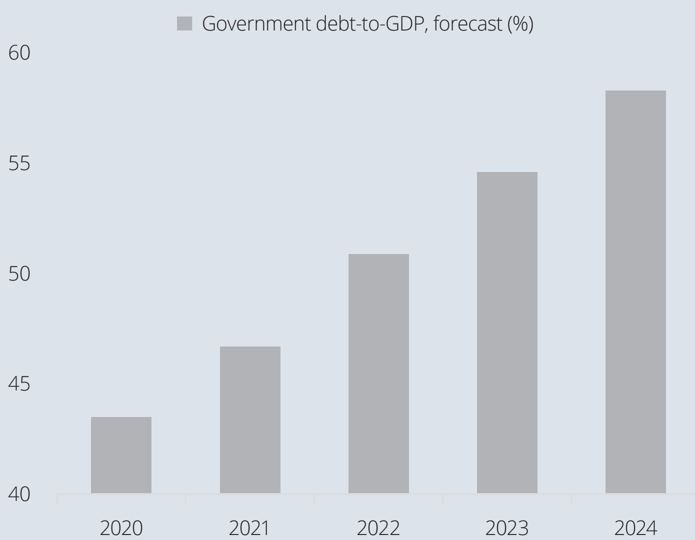


Source: Bloomberg, DBS

KRW rates: Bond supply concerns

Fiscal policy is expected to be expansionary for the next few years – deficits are projected to remain wide in a 5.4 to 6.0% of GDP range, and government debt to rise quite quickly from 37.1% in 2019 to 58.3% of GDP in 2024. The recent volatility and underperformance of longer-tenor KTB yields are a clear reflection of the bond market's supply concerns. In response, the BOK has announced rounds of KTB purchases, likely to total KRW11t in 2020. The BOK has also announced that it would start to issue 2Y KTBs and pare back on 10Y/20Y/30Y issuances, in a move to reduce duration supply. In our view, these support measures are rather limited in size and impact, and it is not clear if the BOK would step up its support in 2021. Therefore, we see limited scope for 10Y KTB yields to decline.

Figure 8: Government debt to keep climbing in South Korea

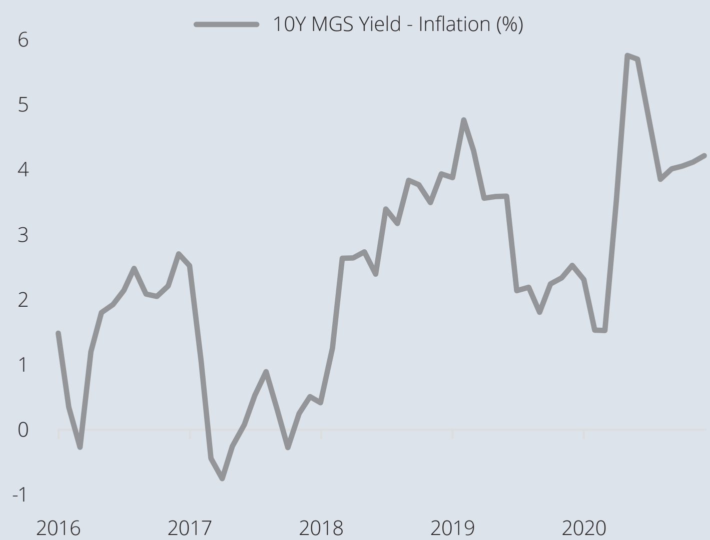


Source: Ministry of Economy and Finance, South Korea

MYR rates: Demand to drop off

From a valuation perspective, we can see how bond investors would find Malaysia Government Bonds (MGS/GII) to be attractive – Locals drawn in by the high real yields and foreigners attracted to the high nominal yields and high sovereign credit rating (S&P: A-). Looking ahead, we think technicals are going to be less supportive and the risks are skewed towards higher yields. For 2021, we are projecting gross bond issuances to stay elevated at MYR152b. However, demand is expected to drop off. Banks' statutory deposits with the central bank are now very low at c.MYR2-3b and thus, their capacity to support fiscal financing would be much lower in 2021. Net contributions to the Employee Provident Fund, another key buyer of MGS/GII, are expected to remain weak due to recently announced measures to lower minimum contribution rates and allow voluntary withdrawals for the unemployed.

Figure 9: Real bond yields in Malaysia remain elevated

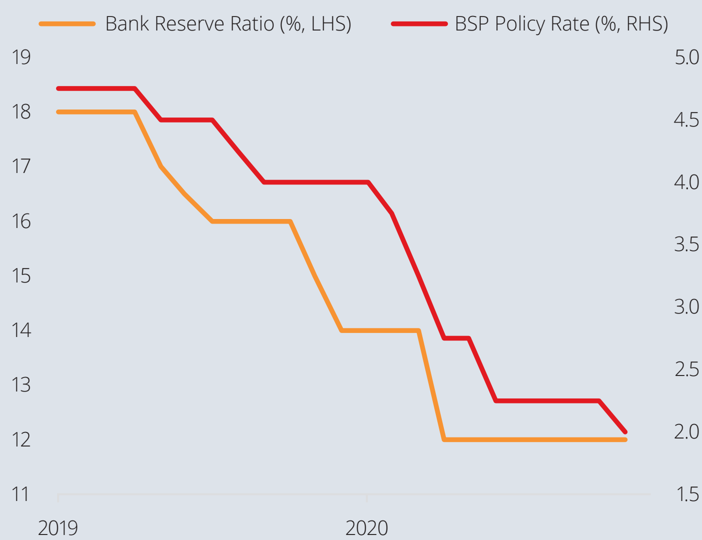


Source: Bloomberg, DBS

PHP rates: Standout performer no more

In total return terms, RPGB have been the region's top performer for both 2019 and 2020. Large declines in RPGB yields, led by compression of inflation risk premium and the BSP's deep rate cuts, had driven much of the outperformance. Looking ahead, the room for yields to fall further has narrowed substantially and forward RPGB performance will likely be more in line with regional bonds. With the policy rate negative in real terms, BSP is likely near to or already at the end of this cut cycle. For 2021, we expect 2Y RPGB yields to remain well anchored by stable policy rates and flush onshore liquidity, and thus be stable around 2.00-2.25%. We also see scope for some curve flattening with 10Y RPGB yields possibly falling a modest 20-30 bps. Total domestic borrowing is projected to stay elevated at PHP2.5t in 2021, but we expect the BSP to continue to play a prominent support role.

Figure 10: Policy rates may have bottomed in Philippines

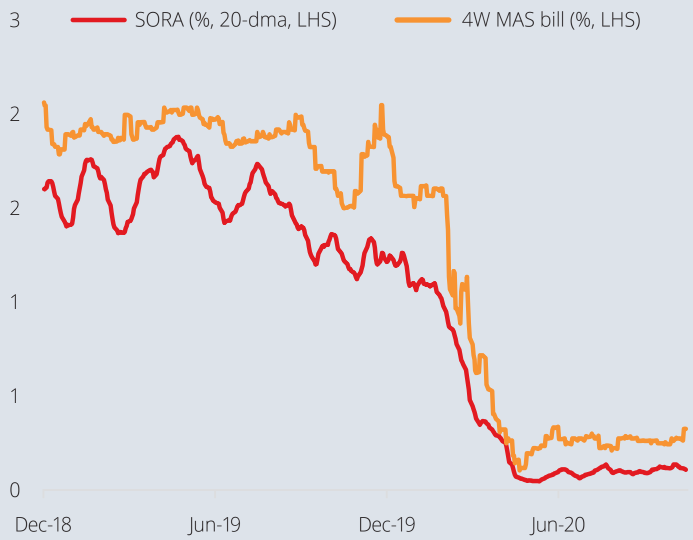


Source: Bloomberg, DBS

SGD Rates: Transition to SORA

Our research on SGD rates will increasingly focus on SORA and SORA OIS, reflecting the transition away from SOR and SIBOR as benchmark interest rates. Given that SORA is a cash-driven rate, it trades much more closely to T-bills, rather than to the FX-implied SOR. We would also note that SORA does not have a term component and being an overnight rate, it tends to be volatile. We will be focusing on the 3M OIS, which should smooth the numbers. The outlook for the SORA is relatively benign. With the Fed unlikely to hike rates through 2022 (our forecast horizon), the 3M SORA OIS is likely to stay anchored. Meanwhile, some steepening pressures on the SORA OIS curve could take place as the global economy recovers. However, these increases will likely be more muted than that seen for the SOFR OIS curve.

Figure 11: SORA will be anchored through 2022

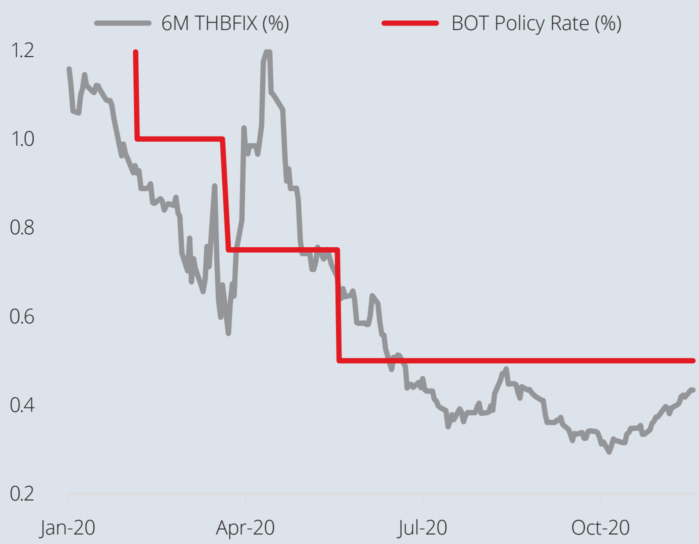


Source: Bloomberg, DBS

THB rates: Market-friendly issuance strategy

In 2021, we expect 6M THBFIX to trade slightly higher in a 0.5-0.6% range, as the BOT continues to gradually normalise onshore liquidity in line with the domestic recovery. There have already been some signs of normalisation by the BOT in recent months, whether it is through rebuilding of FX forward book, issuance of more BOT bills, or reduction of repos with banks. We like long duration Thai Government Bond (ThaiGB) because of relatively favourable supply dynamics. At a time when regional governments are raising gross bond issuances by 50-75% to fund fiscal support measures, Thailand has employed a much more market-friendly issuance strategy. The Public Debt Management Office has, quite early on, chosen to raise significant funds via alternative instruments such as Treasury bills and promissory notes, to manage the amount of ThaiGB supply that the market has to absorb. As a result, gross issuance of ThaiGB totalled only THB841b in FY2020, a mere 15% increase over FY2019.

Figure 12: 6M THBFIX to grind higher to 0.5-0.6% range



Source: Bloomberg, DBS

Table 1: Rates forecasts

		2021				2022			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
US	3M SOFR OIS	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
	2Y	0.20	0.20	0.23	0.25	0.30	0.35	0.40	0.45
	10Y	1.05	1.15	1.25	1.30	1.40	1.50	1.60	1.70
	10Y-2Y	85	95	102	105	110	115	120	125
Japan	3M Tibor	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
	2Y	-0.13	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
	10Y	0.05	0.05	0.08	0.10	0.10	0.10	0.10	0.10
	10Y-2Y	18	15	18	20	20	20	20	20
Eurozone	3M Euribor	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
	2Y	-0.80	-0.70	-0.65	-0.60	-0.60	-0.60	-0.60	-0.60
	10Y	-0.55	-0.50	-0.45	-0.40	-0.35	-0.30	-0.30	-0.30
	10Y-2Y	25	20	20	20	25	30	30	30
Indonesia	3M Jibor	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25
	2Y	4.50	4.55	4.65	4.80	4.90	5.00	5.00	5.00
	10Y	6.00	6.20	6.40	6.60	6.80	6.90	7.00	7.00
	10Y-2Y	150	165	175	180	190	190	200	200
Malaysia	3M Klibor	1.95	1.95	2.20	2.20	2.45	2.70	2.70	2.70
	3Y	1.80	1.80	2.10	2.10	2.40	2.60	2.60	2.60
	10Y	2.75	2.85	3.05	3.10	3.30	3.40	3.40	3.40
	10Y-3Y	95	105	95	100	90	80	80	80
Philippines	3M PHP ref rate	1.75	1.75	1.75	1.75	1.85	1.95	2.05	2.15
	2Y	2.00	2.00	2.00	2.00	2.05	2.10	2.15	2.20
	10Y	3.00	3.00	2.90	2.90	2.80	2.90	3.00	3.10
	10Y-2Y	100	100	90	90	75	80	85	90
Singapore	3M SORA OIS	0.12	0.12	0.12	0.12	0.12	0.12	0.12	0.12
	2Y	0.25	0.25	0.25	0.25	0.27	0.30	0.35	0.40
	10Y	1.00	1.05	1.10	1.10	1.15	1.20	1.30	1.35
	10Y-2Y	75	80	85	85	88	90	95	95
Thailand	3M Bibor	0.62	0.62	0.62	0.62	0.62	0.62	0.62	0.62
	2Y	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
	10Y	1.55	1.65	1.70	1.75	1.80	1.90	1.95	2.05
	10Y-2Y	105	115	120	125	130	140	145	155
Mainland China	1Y Lending rate	3.85	3.85	3.85	3.85	3.85	3.85	3.85	4.05
	3Y	3.05	3.10	3.15	3.20	3.20	3.20	3.20	3.20
	10Y	3.25	3.30	3.35	3.40	3.40	3.40	3.40	3.40
	10Y-3Y	20	20	20	20	20	20	20	20
Hong Kong	3M Hibor	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
	2Y	0.20	0.20	0.23	0.25	0.30	0.35	0.40	0.45
	10Y	0.70	0.80	0.85	0.90	1.00	1.10	1.20	1.30
	10Y-2Y	50	60	62	65	70	75	80	85

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

Source: CEIC, Bloomberg, DBS

		2021				2022			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
South Korea	3M CD	0.65	0.65	0.65	0.65	0.65	0.65	0.90	0.90
	3Y	1.05	1.10	1.15	1.20	1.30	1.40	1.50	1.50
	10Y	1.70	1.75	1.85	1.90	2.00	2.10	2.20	2.30
	10Y-3Y	65	65	70	70	70	70	70	80
India	3M Mibor	3.75	3.75	3.85	3.95	4.05	4.15	4.25	4.25
	2Y	4.40	4.50	4.50	4.50	4.50	4.60	4.70	4.80
	10Y	5.90	6.00	6.10	6.20	6.30	6.40	6.50	6.50
	10Y-2Y	150	150	160	170	180	180	180	170

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

Source: CEIC, Bloomberg, DBS

DBS Live more, Bank less

Global Credit | 1Q21

The new safe play

Global Credit

Daryl Ho, CFA | Strategist

The watershed year of watershed events. One would not find in recent history a comparable period to accurately reflect the tumultuous year that marked the end of the decade of the 2010s. The upending of economic, financial, social, legislative, and geopolitical norms in 2020 alone (just to name a few) has beckoned the overhauling of conventional "wisdoms" that have been entrenched in various facets of our very lives.

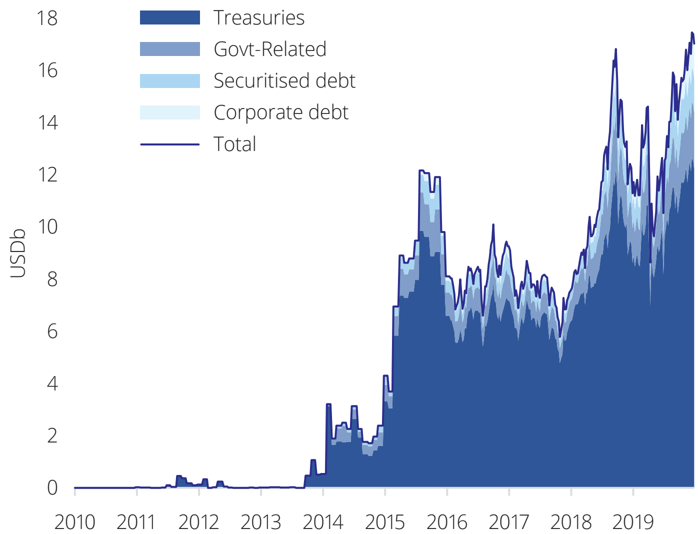
Traditional truisms then, when it comes to investment formulation, would certainly be no less unscathed; some of which warrants earnest re-evaluation.

Rethinking the effectiveness of "risk-free" bonds in diversifying returns. One multi-decade mainstay of investment strategy was the use of risk-free government treasuries as a balancing allocation to a portfolio of equities. The thesis was simple – treasury bonds provided a bedrock of consistent income generation through coupon payments, and capital preservation through the unparalleled safety in government risk – providing an investor a defensive foundation while pursuing riskier returns with better growth prospects through stocks.

Government treasuries are a shadow of their former selves. The premise for such bonds, however, has changed drastically following the wake of the COVID-19 crisis as central banks slashed rates and restarted open-ended bond purchase programmes to support the economy.

Functioning as buyers of ***first*** resort, yields are now pushed so low that they no longer provide any worthwhile coupon income, while prices are pushed so high that a record amount of bonds are now trading at negative yields (Figure 1). Rather than capital preservation, holders of such bonds to maturity are instead facing nothing but guaranteed capital loss.

Figure 1: Market value of negative yielding bonds at record highs

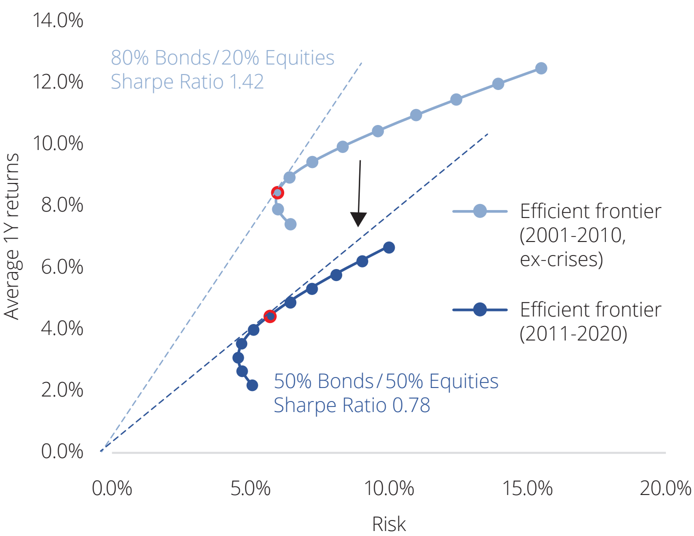


Source: Bloomberg, DBS

What about the multi-decade treasury bull market? In defence of the viability of risk-free treasuries, some might point to the fact that yields have been in structural decline since the 1980s and price performance may yet still lie ahead; why should the 2020s be the decade that bucks the trend? While we do not deny that structural forces are at work (ageing population demographics, large fiscal debt burdens, etc.) in causing the progressive decline in yields, we are at the same time conscious of not committing the investing faux pas of extrapolating historical trends alone to determine future performance.

Using Modern Portfolio Theory (MPT), we note that the gradual collapse in yields has inevitably shifted the composition of the optimal portfolio against bonds. By constructing the portfolio efficient frontiers over two sequential decades – between 2001-2010 (ex-crises) and 2011-2020 – we compared the characteristics of the optimal portfolios (lying at the tangency point of the capital market line

Figure 2: The optimal portfolio suggests a diminishing allocation to treasury bonds



Source: Bloomberg, DBS

to the respective efficient frontiers) of each decade – deriving clearer evidence that risk-free bonds have progressively waned in prominence.

Bonds are mathematically falling out of favour. In the decade of the 2000s, the optimal portfolio comprised of an 80% weight in bonds and 20% in equities. The underweight in equities was likely due to its "lost decade"; having to deal with both a bursting Tech-bubble and a GFC in the same period, resulting in paltry returns. The following decade of the 2010s saw the optimal portfolio shift significantly out of bonds – dropping to a 50% weight – yet not without a downside; the portfolio Sharpe ratio was greatly diminished from 1.42 to 0.78.

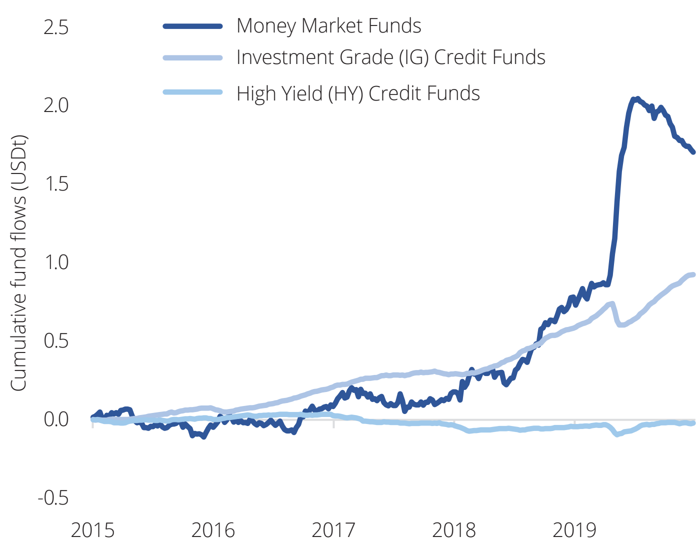
While optimal portfolios have an element of hindsight in derivation, it is their evolution that partly bestows the gift of foresight. Ten-year US treasuries began the 2000s at 6.44%, resulting in an 80% optimal weight. It began the 2010s at 3.29%, which saw the optimal weight decline to 50%. With the same yields now languishing below 1%, it is not difficult to imagine optimal allocations to risk-free bonds being slashed much further for the decade of the 2020s.

Finding other baskets to put one's eggs. Reducing allocations to treasuries alone would be insufficient in improving a portfolio's Sharpe ratio – as MPT instructs. Investors would eventually have to search for assets that can replace government bonds, assets that (a) maintain low correlations of returns with equities, (b) present respectable income generation, and (c) provide investors with confidence of capital preservation in order to be a substitute – albeit an imperfect one – for the role that risk-free bonds played in the past.

It takes no stretch of the imagination to see that global credit checks all the right boxes. As the world increasingly searches for alternatives to "risk-free returns" – or more aptly termed "return-free risk" – we postulate that global credit will be the most immediate beneficiary at the precipice of such a shift.

Hard to teach an old dog new tricks. Despite the insignificant returns in holding cash-like instruments such as treasuries, the time-conditioned "flight-to-safety" response remains for funds to flow into such cash proxies when risks are at bay. Even now, as economic data have sustained their positive momentum since the virus crisis and progress on vaccines continue to inspire a return to normalcy, money market fund inflows remain at cumulative peaks (Figure 3).

Figure 3: The rotation from cash-like instruments to credit still has room to run



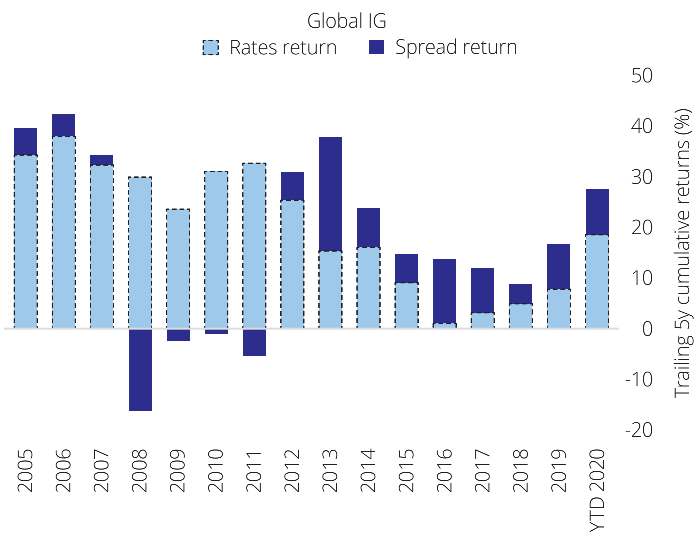
Source: EPFR Global, DBS.

Investors are reluctant to exit the paradigm that "cash is king" in the preservation of capital, even if it means suffering capital erosion in real terms. While taking credit risk is not the obvious alternative, investors may perhaps be unaware that certain extraordinary developments in credit have actually augmented the security of the asset class.

Global IG credit is becoming more characteristically similar to risk-free treasuries. It is no secret that IG credit is an asset that trades with a high beta to treasury bonds, making it at least characteristically similar as a substitute. In that regard, should the treasury market still see yields in structural decline, investors would still be partial beneficiaries through IG credit exposure.

Spreading risk by taking spread risk. Looking at Figure 4, we note that this was in fact the case – especially between 2005-2012 where the main contribution of IG credit returns was from the rates component. More than that however, since 2013, IG credit has seen a larger component of annual returns through spread compression – a trend that is likely to continue with yields so near the zero bound. We expect that investors would increasingly seek high grade spread products as alternatives to return-free risk.

Figure 4: IG spread compression has compensated declining returns on rates



Source: Bloomberg, DBS.

Source: Unsplash

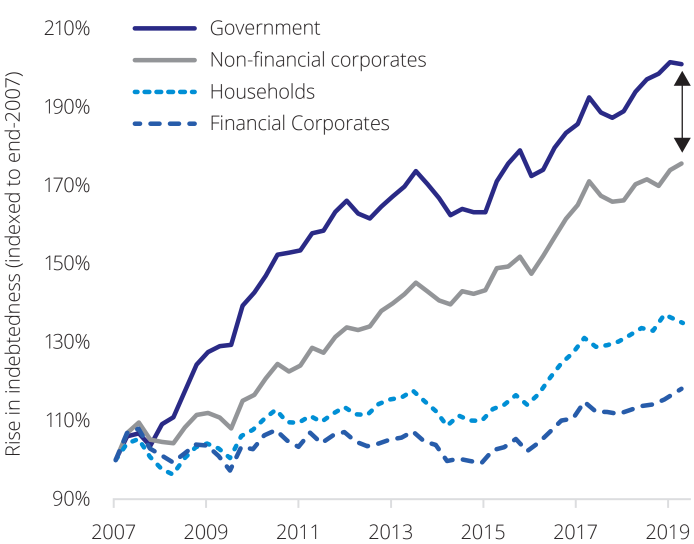
Corporate credit is now a major "government-backed" asset class. What has changed in 2020 is that these additional spread returns now have the crucial element of government support. In March this year, the Federal Reserve joined its compatriots in the ECB and BOJ in purchasing IG corporate credit as an official policy lever. Capital preservation and liquidity therefore improved in substantial degree, with the three largest central banks functioning as buyers of last resort.

Although some of these central bank credit facilities have limited terms to expiry, we believe that the market now has expectations baked in for implicit support from central banks for future emergencies, seeing how effective these facilities were in stemming a full-fledged liquidity crisis. Moreover, it is also not a high hurdle to restart the programmes if required, as precedents have already been set. As Milton Friedman famously said – "Nothing is so permanent as a temporary government program".

Governments are ironically becoming less responsible borrowers. Moreover, exposure to IG corporate credit does not necessarily translate to intolerably larger risk than government bonds. With a rising penchant for fiscal imprudence and debt monetisation, it is ironically the latter that has more dramatically increased its rate of indebtedness since the GFC (Figure 5).

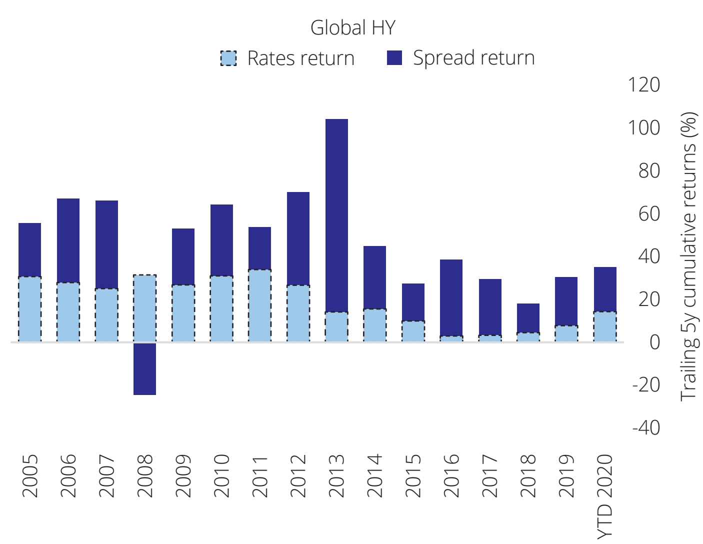
Global HY credit may assume some upside responsibility from equities. Admittedly, credit would never fully replicate the kind of upside that investors stand to achieve with growth equities. Yet there are undeniably positive catalysts for global HY in the near term, with (a) search-for-yield motives continuing to dominate in a prolonged era of low rates, (b) policy tools by global central banks already dipping into HY credit, and (c) evidence that we may be migrating into a structurally lower default world, as we had highlighted in 2Q 2020. This grants HY credit the attractiveness of both high income generation and potential price appreciation in the years to come.

Figure 5: Governments have increased indebtedness faster than corporates since the GFC



Source: IIF, BIS, Haver, National Sources, DBS.

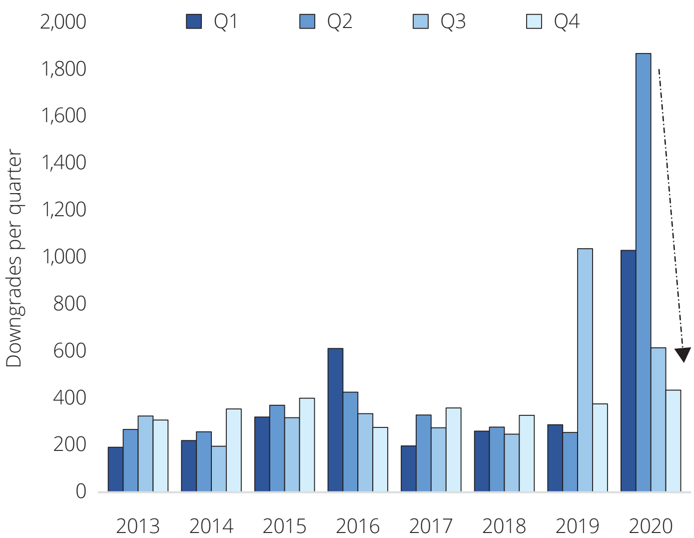
Figure 6: HY spread compression will remain a key driver for excess returns in a low-rates world



Source: Bloomberg, DBS.

Angels have stopped falling. Naturally, the shift into high spread products warrants additional concern for the incremental credit risk borne by investors – mainly with downgrade/default risks. Credit fundamentals, however, have already begun to improve. Monitoring the actions of ratings agencies, we note that there has been a sharp decline in corporate downgrades since the peak in 2Q20, signifying that the post-crisis spread compression is at least justifiable by a diminution of assessed credit risk. With recovery being well on the cards, we believe that further spread compression remains the path of least resistance for credit going forward.

Figure 7: Slowing pace of downgrades signals that credit recovery is on track



Source: S&P, Bloomberg, DBS. Downgrades span across the major regions of the Americas, Europe, Asia ex-Japan, and Middle East & Africa.

Low correlations strengthen diversification benefits. The four asset correlation matrix (Figure 8) similarly conveys little objection in increasing allocations to credit, seeing as the Rates → IG credit shift still maintains low correlations with equities, and the Equity → HY credit shift similarly maintains low correlations with rates. The portfolio as a whole would still carry the benefits of greater diversification.

Got to catch EM all. By natural extension, the favourable characteristics of spread products imply substantial spillover flows into EM debt as well, as risk-taking incentives push investors beyond the frontiers of DM and IG in search of both positive real returns and diversification benefits.

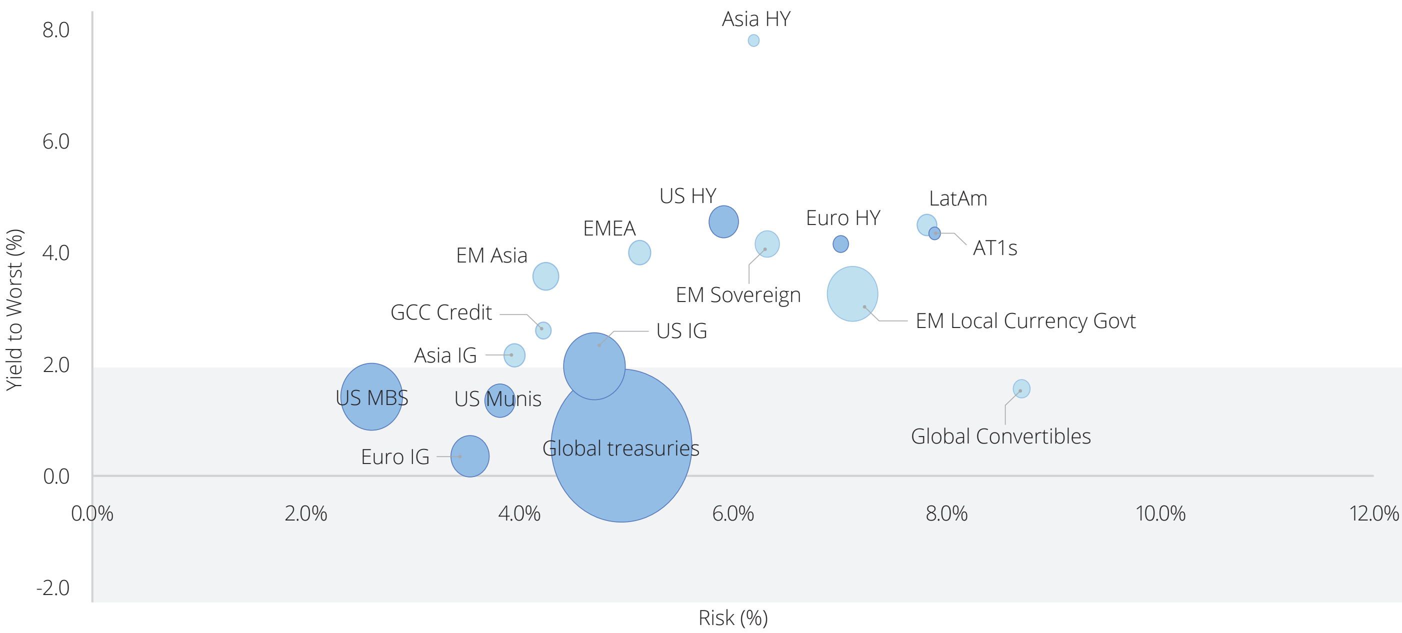
Source: Unsplash

Figure 8: Credit offers strong diversification benefits due to low correlations

	Global rates	Global IG	Global HY	World equities
Global rates	1.000			
Global IG	0.736	1.000		
Global HY	0.303	0.774	1.000	
World equities	-0.010	0.467	0.743	1.000

Source: Bloomberg, DBS. Correlations are of one-year returns over the last two decades.

Figure 9: Most DM bond yields do not exceed a 2% inflation target – more likely positive real returns in EM



Source: Bloomberg, DBS. Relative market size indicated by circle area. DM predominance is represented by a darker shade, while EM predominance is represented by a lighter shade.

That said, investors would be more discerning about credit fundamentals with broader EM bonds, as higher risk premiums invariably require greater due diligence to harvest rewards. In this regard, we think that Asia credit continues to stand out with its decent fundamentals and inexpensive valuations.

In sifting through EM risk, the spotlight remains on Asia HY. Looking at Figure 9, it appears almost anomalous that Asia HY is trading at much wider yields compared to the rest of the credit markets, given that (a) Asia has most effectively handled the virus crisis and is continuing to make progress on re-opening, and (b) ratings agencies having projected much lower default rates in Asia vs US and European HY. While idiosyncratic risks remain with pockets of highly leveraged issuers in Asia, we believe that there is little basis for the broad cheapening of the entire sector to remain for a protracted period.

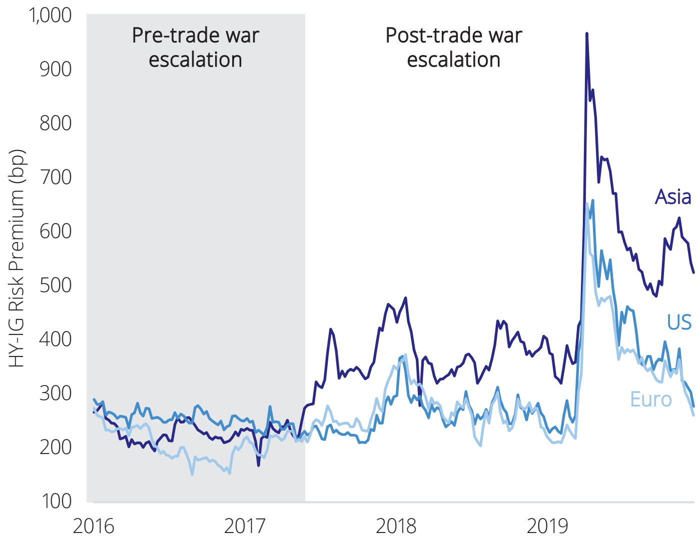
Potential positive catalyst with fading trade tension risks. With a Biden administration at the helm of US policy in 2021, we believe a reversion towards Obama-era policies (his famed "pivot to Asia") would end the overtly aggressive rhetoric around trade policy that has been a hallmark of the Trump administration since mid-2018. This would serve as a tailwind to risky assets in Asia, with Asia HY a clear recipient of subsequent inflows due to competitive valuations.

This sets the stage for the potential compression of the Asia HY-IG risk-premium – which only started to see meaningful widening compared to US and Europe premiums after the trade war escalations (Figure 10) – as American foreign policy reverts to more familiar domains.

All things considered, we maintain our stance that both Asia and European HY would be key beneficiaries of search-for-yield motives and have potential tailwinds from the afore-mentioned Biden foreign policy shift. The BBB/BB segment remains the segment of choice, with a preference for the 5-7 years maturity tenor.

We conclude that more than ever, credit deserves an increasing relevance in investor portfolios. With risk-free treasury yields lingering just above all-time lows, investors are asymmetrically disadvantaged should a post-virus recovery rise in yields erode the prices of such bonds – risk-free is not always loss-free. IG markets offer an additional spread buffer for still low risk, while HY markets are prime avenues for more diversified sources of alpha – setting the stage for credit to excel as the prime return diversifier as we enter the decade of the 2020s.

Figure 10: Fading of trade tension risks may see compression in the Asia HY premium



Source: Bloomberg, DBS

Live more,
Bank less

Source: Unsplash

Global Currencies | 1Q21

Softer US dollar

Global Currencies

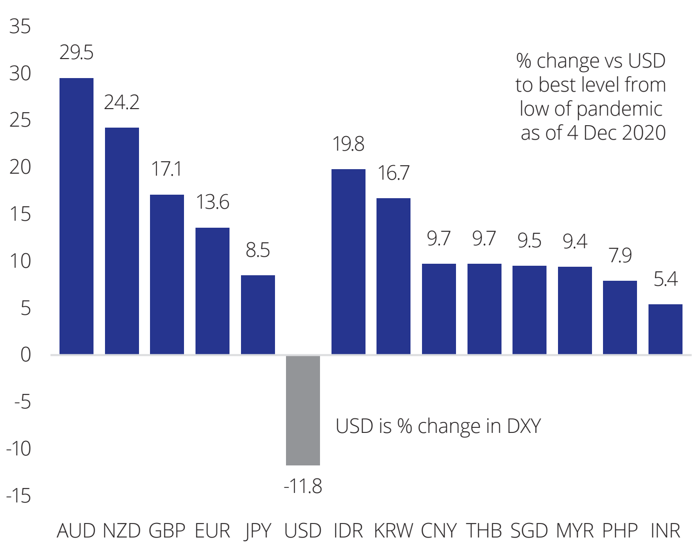
Philip Wee | Strategist

Global non-USD currencies staged a strong comeback in 2020 after the COVID-19 selloff in March. Risk appetite has been supported by the "pandemic put", or the assumption that populist fiscal spending and expansive monetary policy will keep getting expanded and extended to underwrite economies, and insulate them from self-induced recessions and new waves of infections. Investors have not taken issues with the ample liquidity from central banks to fund government packages aimed at providing safety nets to mitigate job losses and corporate bankruptcies. Monetary policy has also steered towards supporting the recovery of labour markets amidst increased flexibility to achieve inflation targets.

Looking ahead, the depreciation pace of USD is likely to slow. The DXY has depreciated 12% since March. Major USD depreciations since the GFC were 15-18% over 9-13 months. The US elections and vaccine rally in November may stall into 1Q21 as the global economy slows on coronavirus resurgences in the US and Europe. US President-elect Joe Biden has a task force and a plan to address the pandemic but will only assume office on 20 January. The prospect of a large US stimulus bill hinges on the Senate runoff in Georgia on 5 January. There is no assurance that extended UK-EU talks can avert a no-deal Brexit at the end of the transition period on 31 December. Beyond that, our rates strategists expect the global recovery in 2021 to be accompanied by a steeper US Treasury curve. A preview of the vaccine rally suggests more rotation plays into unloved sectors and assets, and could eventually include USD.

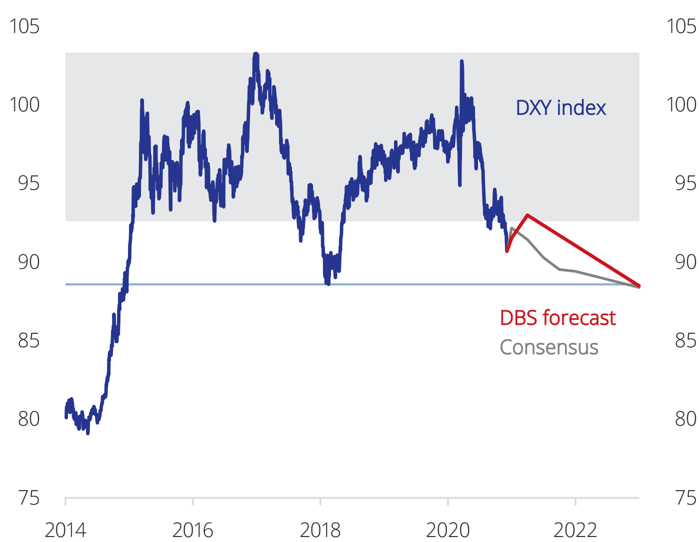
EUR/USD is forecast to trade in a higher but flatter 1.17-1.23 range in 2021. The Eurozone's fundamentals have weakened relative to the US's. The new lockdowns and restrictions from the coronavirus resurgence have threatened to tip the Eurozone economy back into a services-led recession in 4Q20. Given that monetary conditions have tightened on deflation and a stronger euro amidst rising joblessness, the ECB paved the ground to deliver more stimulus at its meeting on 10 December. Consensus expects the ECB to add another EUR500b to its EUR1.35t asset purchases plan, which will

Figure 1: Non-USD currencies have exceeded expectations



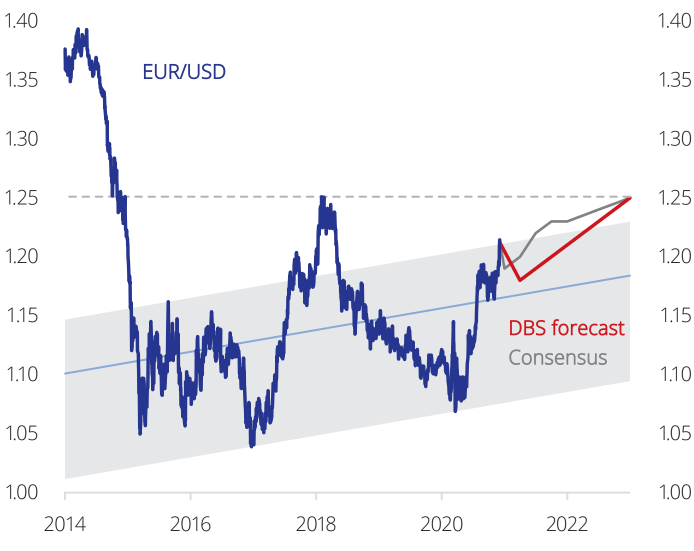
Source: Bloomberg, DBS

Figure 2: The US dollar will fall at a slower pace in 2021



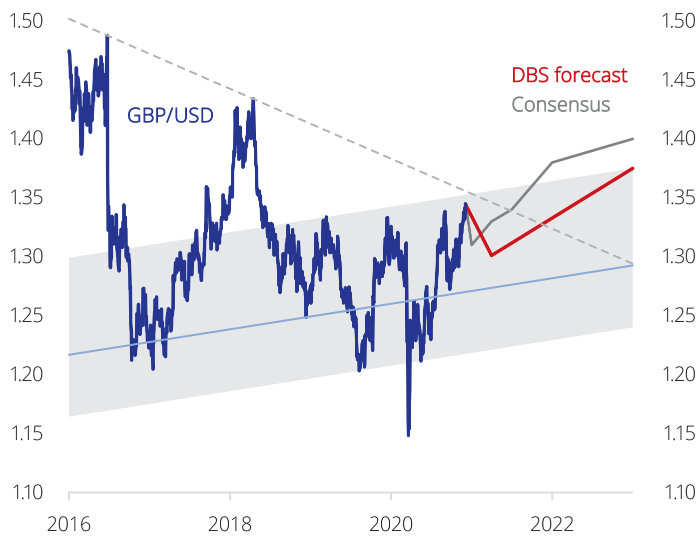
Source: Bloomberg, DBS

Figure 3: Euro is strong relative to its weakened fundamentals



Source: Bloomberg, DBS

Figure 4: British pound



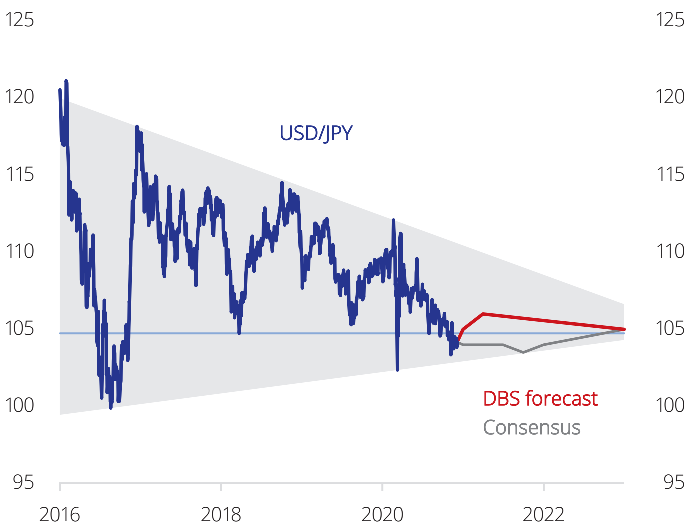
Source: Bloomberg, DBS

probably be extended to end 2021. This should keep the ECB's balance sheet increasing at a significantly faster pace than the Federal Reserve's balance sheet and render the euro sensitive to a steeper US yield curve. That said, EUR is well positioned for a vaccine-led recovery later next year assuming no major surprises from Brexit on 31 December, the EU recovery fund and the German elections in September.

GBP/USD is forecast to hold a 1.27-1.34 range during the recovery from UK's worst recession in 300 years. The Office of Budget Responsibility (OBR) forecasts 5.5% growth in 2021 after a 11.3% contraction in 2020. But first, the BOE expects the UK economy to contract by 3.0% q/q in 4Q20 from the new lockdown to curb the second round of coronavirus infections, and for the unemployment rate to peak in 2Q21. To support the economy, the BOE has boosted asset purchases by another GBP150b to GBP875b while the Treasury forecasted a record borrowing of GBP94b or 19% of GDP. The OBR projected underlying debt to increase to 97.5% of GDP in 2025-26 from 91.9% this year. Our forecasts have not factored in a no-deal Brexit which is an event risk that could depreciate GBP by 5%. At the time of writing, the UK and EU have yet to find middle ground on reaching an agreement on their future relationship before the transition period ends on 31 December.

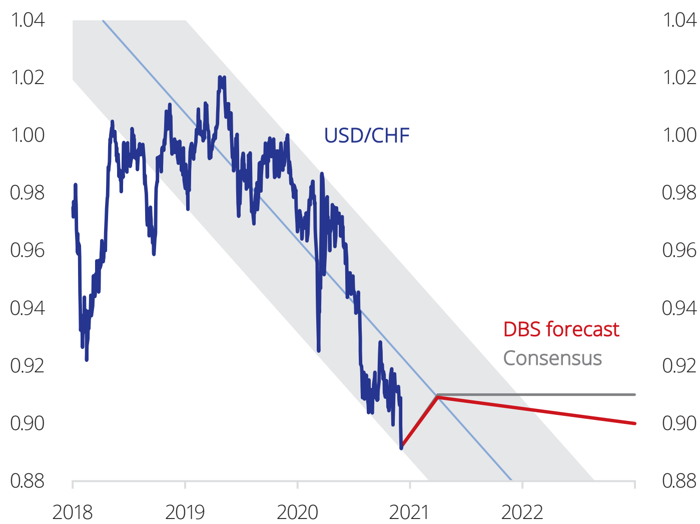
Source: Unsplash

Figure 5: Japanese yen will not ignore a steeper US yield curve



Source: Bloomberg, DBS

Figure 6: Swiss franc is not expected to deviate far from 0.90

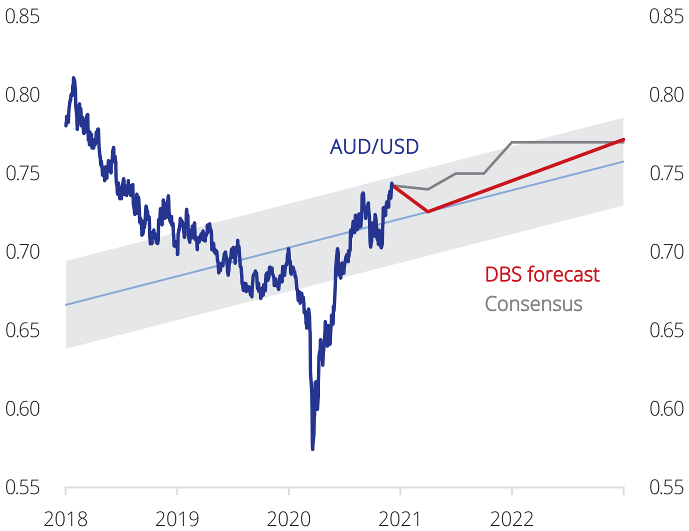


Source: Bloomberg, DBS

USD/JPY's trading range has continued to narrow and pivot around 105. Prime Minister Yoshihide Suga's top priority is to revitalise the pandemic-hit Japanese economy before the general election, which must be held by 22 October 2021. The government is planning a third fiscal 2020 supplementary budget to stimulate the economy. A stronger JPY after the US elections has, however, become a challenge to its economic and inflation goals. Having put on hold a deeper debate on how to achieve its 2% inflation target, the BOJ reckoned the benefits of prolonged easing to combat the virus would outweigh the costs. The BOJ is likely to expand and extend its pandemic relief measures that expire in March 2021. The central bank has not ruled out pushing deeper negative rates with future measures more focused on the entire shape of the yield curve. Moving beyond the strain of ultra-low rates on bank profits, the BOJ is steering towards incentive to encourage financial institutions, especially the regional banks, to raise profitability or improve operations through mergers.

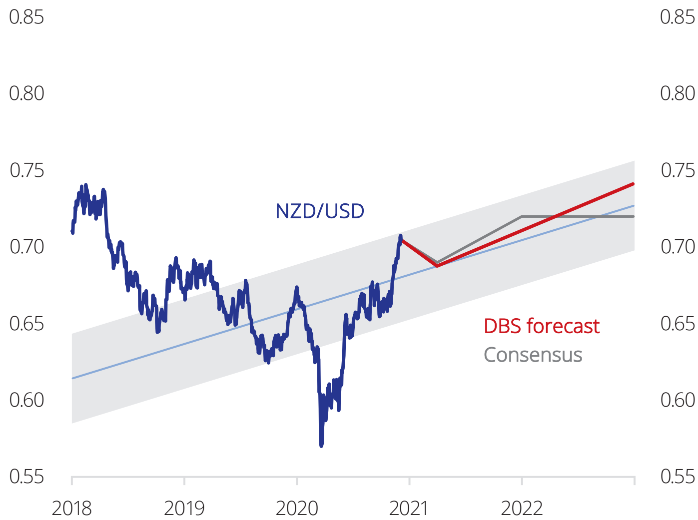
USD/CHF is forecast to keep trading around 0.90-0.93. Switzerland has not been spared by the coronavirus resurgence in Europe, but unlike its neighbours, the country is resisting a second lockdown. According to a UBS Group AG survey of 325 companies, nominal wages are expected to increase by 0.3% in 2021, its slowest since 1999. The SNB will continue to pursue an expansive monetary policy to combat the negative effects of the COVID-19 pandemic. Negative interest rates and currency interventions have been key to offset the disinflationary pressures from a strong exchange rate. The SNB is not deterred by fears of being labelled a currency manipulator by the US and does not consider its massive balance sheet a constraint to its ability to intervene. In fact, the central bank reported a profit of CHF14.3b in 3Q20 from its massive holdings of foreign currency investments.

Figure 7: Australian dollar is on a flatter appreciation path



Source: Bloomberg, DBS

Figure 8: New Zealand dollar is on a flatter appreciation path too



Source: Bloomberg, DBS

AUD is forecast to stay on a flattened recovery path between 0.70 and 0.75 in 2021. The economic recovery from the coronavirus resurgence in Victoria and New South Wales is likely to be gradual and uneven amid a deterioration in bilateral relations with China. The government has advised exporters to seek out new markets and reduce their reliance on China, and scrapped plans for foreign students to return in 2021. Speculators have, as per CFTC data, started to trim their long AUD positions since mid-October, around the time the 10Y Australia-US bond differential turned flat to negative. The RBA on 3 November lowered its targets for the cash rate and 3Y government bonds by 15 bps to a record low of 0.10%. The RBA also extended bond purchases beyond three years with a commitment to buy AUD100b of 5Y to 10Y bond over six months. The Treasury has unleashed a budget deficit of 11% of GDP for the fiscal year ending June 2021.

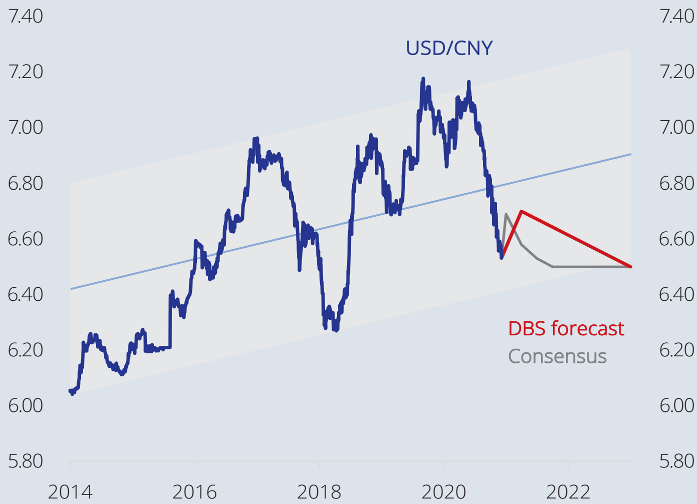
NZD/USD is forecast to stay firm in a narrower 0.66-0.73 range in 2021. New Zealand is considered one of the most resilient economies to the pandemic. Growth is expected to rebound to 4.5% in 2021 after -5.0% recession this year. Prime Minister Jacinda Ardern was re-elected in a landslide victory at the general election October with a majority government for the first time since 1996. The prospect for negative interest rates in 2021 has diminished after the RBNZ agreed to work with the government to cool the hot housing market. Barring another round of infections and lockdowns, the RBNZ's measures – a low cash rate at 0.25%, Large Scale Asset Purchase program at NZD100b, and the latest Funding for Lending Program – are considered enough to support the recovery. All said, stay alert to market volatility from a fragile global recovery and a steeper US yield curve next year.

Asia Currencies

CNY

Gains in CNY are likely to be more measured in 2021. After a strong 9.7% appreciation vs USD between late May and early December, the CFETS RMB Index has returned to levels seen after the start of the US-China trade war in 2Q18. In late October, the PBOC phased out the countercyclical factor used to determine the mid-point of USD/CNY. This followed an earlier decision before mid-October to lower the reserve requirement ratio for some FX forwards to 0% from the 20% imposed in 2018. The above measures are consistent with the policy goal to keep the exchange rate at basically stable at a reasonable and balanced level. China's new Five-Year Plan has moved away from targeting medium-to-high growth towards a more self-sufficient economy that boosts domestic demand and promotes self-reliance in technology. US policy to contain China as a rival is unlikely to change under Biden, but bilateral relations are likely to be less turbulent and become more predictable.

Figure 9: Chinese yuan is unlikely to repeat its stellar performance in 2020

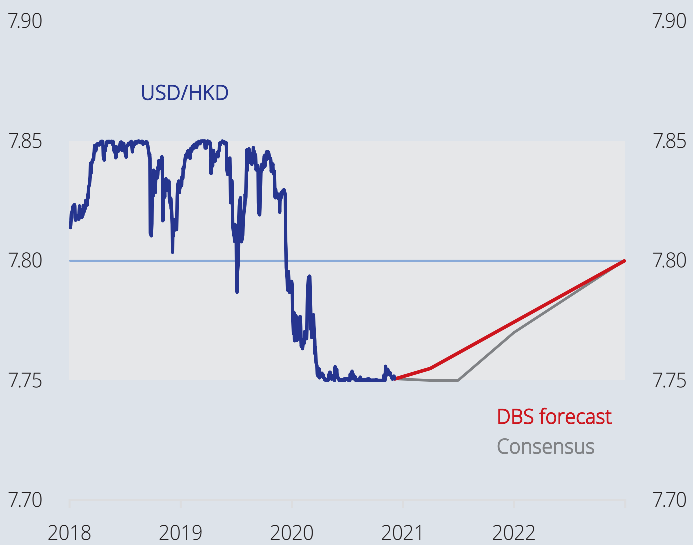


Source: Bloomberg, DBS

HKD

USD/HKD is forecast to rise modestly from the floor of its 7.75-7.85 convertibility band in 2021. The global recovery next year is likely to be accompanied by a steepening in the US yield curve. The HKMA's commitment to the HKD peg to USD was reflected by its multiple interventions to hold the 7.75 floor of its band this year. HKD was also immune to China's national security law in the territory and the US President's Executive Order on Hong Kong normalisation. This was reflected by its tight range between 7.75 and 7.7560 since April. Despite the above status changes and suspension of Ant Group's IPO, Hong Kong has not diminished as the fundraising gateway for Chinese companies. Hong Kong's exit from recession will turn focus on the Guangdong-Hong Kong-Macao Greater Bay Area, especially the cross-border pilot schemes Wealth Management Connect and Bond Connect.

Figure 10: Hong Kong dollar will start weaning off 7.75

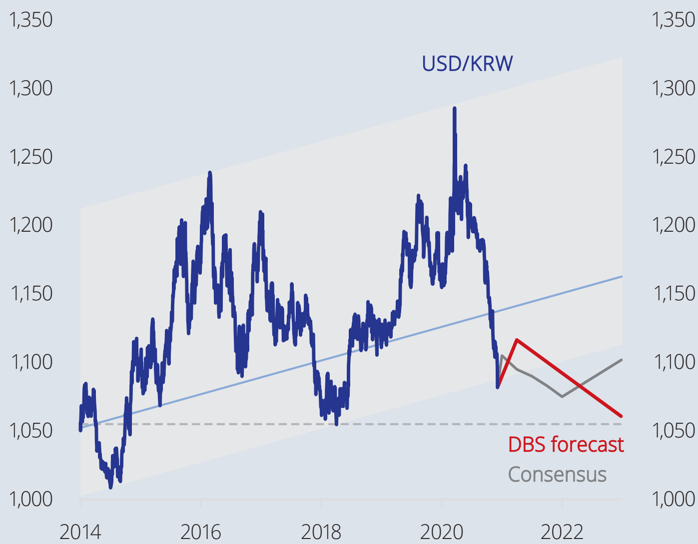


Source: Bloomberg, DBS

KRW

KRW is forecast to trade in a narrower range of 1,090-1,150 per USD in 2021 after its stellar 14% rebound (as of mid-November) from its pandemic low in March. KRW has also largely corrected its underperformance against the major USD indices experienced during the 2018-19 trade war. The currency's appreciation in 2020 has been attributed to an export-led recovery where South Korea has benefitted more than the rest of the world from China's rebound. While the global economy may slow in 4Q20 from the coronavirus resurgence in the US and Europe, global demand recovery is seen in 2021. Unlike 2020, pressures on USD from the global recovery in 2021 are likely to be tempered by a steepening in the US yield curve. A return to stronger US multilateralism under President-elect Joe Biden will be welcome. Although defence ties with the US could improve, there will be national security concerns related to North Korea.

Figure 11: South Korean won is close to starting a consolidation

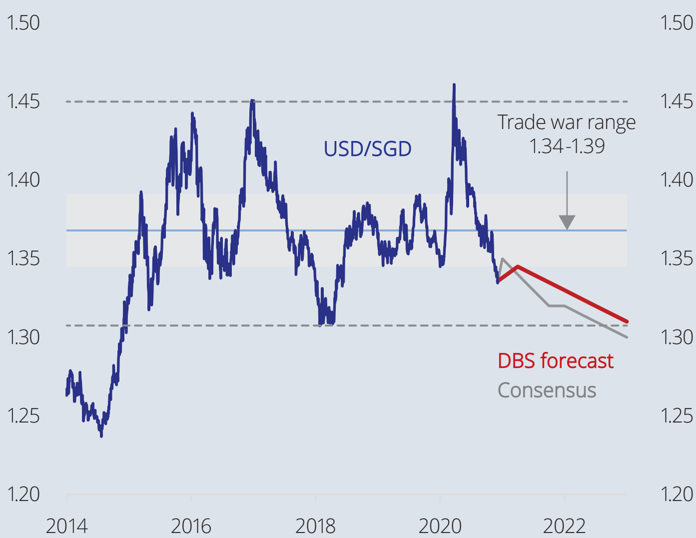


Source: Bloomberg, DBS

SGD

USD/SGD has scope to pause around 1.33-1.37 or its trade war range after its sharp 9.5% fall from 1.46. The weak USD story has run against slower global growth in 4Q20 on the coronavirus resurgence in the US and the EU, and later, a steeper US yield curve with the global recovery in 2021. USD/SGD has also aligned with the major USD indices. Unless EUR and CNY appreciate to 1.25 and 6.30, respectively, USD/SGD will not fall towards 1.31. Despite its strength against USD, SGD has been stable on a trade-weighted basis. The SGD NEER has held close to the mid-point of its policy band after 30 March when the central bank re-centred the band lower and set it on a zero appreciation path. There is no hurry to return the band to a gradual and modest appreciation path. Although the economy has turned around in 3Q20 from an unparalleled contraction in 2Q20, the recovery from the pandemic will be slower and more uneven compared to past recessions.

Figure 12: Singapore dollar will take its cue from USD

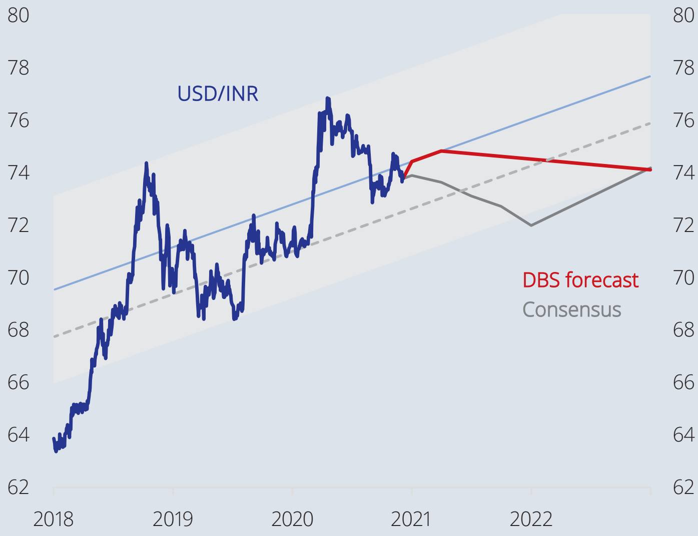


Source: Bloomberg, DBS

INR

The outlook for INR has improved since the last quarterly update. At the time of writing, daily infection cases dropped to their lowest since mid-July. India has the second highest number of COVID-19 cases in the world. The Bombay Sensex Index has, from 5 November, turned positive for the year on an Asia-friendly US elections outcome and vaccine hopes. The balance of payments is supported by a solid Current Account surplus of USD19.8b in the April-June quarter and record foreign reserves of USD561bn in October. Although CPI inflation has yet to return into its official 2-6% target, the 10-year bond yield has been stable within 5.75-6.20% after the last RBI rate cuts in May. This should offset some of the concerns from Moody's debt rating downgrade in June. A global slowdown in 4Q20 from the coronavirus resurgence in the EU and US, and a strong CNY, should continue to keep INR steady into 1Q21 before a modest appreciation bias sets in for the global recovery.

Figure 13: Indian rupee was not left out of the pandemic recovery



Source: Bloomberg, DBS

IDR

USD/IDR is forecast to be hold around 14,000-15,000 in 2021. IDR has a track record of settling into range during the recovery from a global recession. Externally, there is no threat of rising US interest rates next year; the Fed has pledged to keep rates low into 2023. That said, stay alert to volatility from a steeper US yield curve when the US recovery gains traction. Domestically, there are no imminent signs of macroeconomic imbalances. CPI inflation is below the official 2-4% target range. Economists have continued to rein in their Current Account deficit forecasts since mid-year. Finance Minister Sri Mulyani was named Finance Minister of the Year for East Asia Pacific by the Global Markets magazine for steering the economy through the pandemic. This should assuage concerns over a larger budget deficit above the previous legal limit of 3% of GDP, and BI's role to buy bonds directly from the government to help fund the fiscal stimulus.

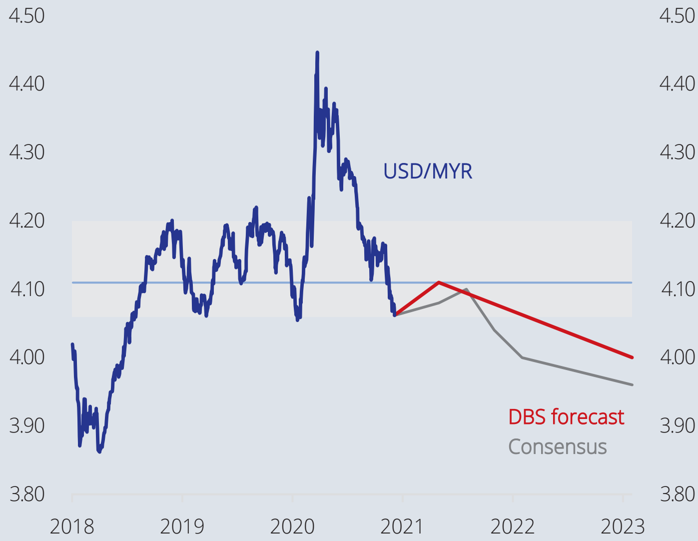
Figure 14: Indonesian rupiah has stabilised after its stellar rebound

Source: Bloomberg, DBS

MYR

Barring unforeseen circumstances, MYR is forecast to trade 2021 between 4.02 and 4.12 per USD, the lower half of its 2018-19 trade war range. Malaysia's markets have been resilient to domestic political uncertainty. The FBM KLCI Index and USD/MYR have, by mid-November, returned to their start-of-the-year levels. The government has forecast economic growth to recover to 6.5-7.5% in 2021 from a projected 4.5% contraction in 2020, on the continued implementation of large infrastructure projects and investment intention in the commodity, electrical, and electronics sectors. The rebound in 2021 is supported by the expansionary Budget 2021 which was passed on 25 November. The budget vote was also considered a vote of confidence on the coalition government which has a razor thin majority of 113 out of 222 seats. BNM expects the budget deficit to consolidate from 6% of GDP in 2020 to 5.4% in 2021 and average 4.5% in the following three years. However, this did not prevent Fitch from downgrading Malaysia's debt rating by a notch to BBB+ on 4 December.

Figure 15: Malaysian ringgit has defied sceptics with its appreciation



Source: Bloomberg, DBS

THB

THB has been mostly within 30-36 per USD after the 2008-09 GFC. That range has halved into 30-33 after the 2017-18 global reflation trade. Barring a global economic relapse, this narrowed band is likely to stay intact into 2021. Before the post-US elections and vaccine stock rally in November, Thailand's pandemic-hit economy and domestic protests were better reflected by its weak stock market than its exchange rate. The currency remains underpinned by its positive interest rate differentials against its US counterpart. The key 30 level is closely watched because of the hit to trade and tourism from the pandemic. With GDP growth having rebounded to +6.5% q/q sa in 3Q from -9.9% in 2Q, the BOT will resist rate cuts and continue to rely on tools that encourage capital outflows to alleviate appreciation pressures. In the short-term, THB could get some respite if investors turn attention to the infection spread that has weighed on the US and EU economies.

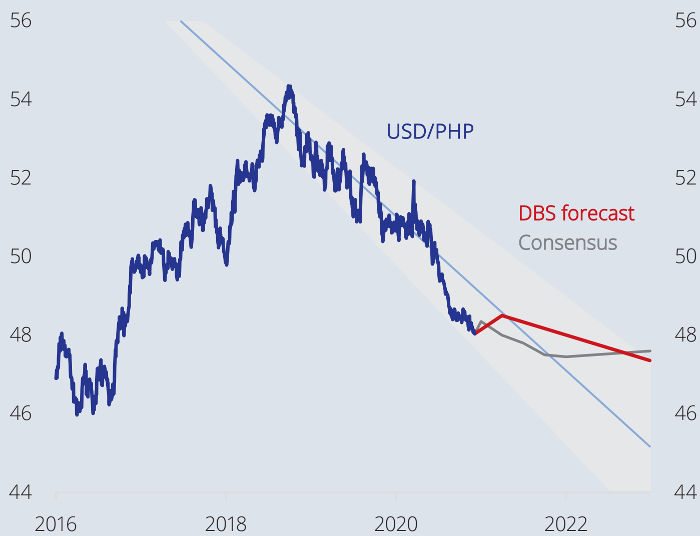
Figure 16: Thai baht is resistant to further strength below 30 per USD

Source: Bloomberg, DBS

PHP

PHP has scope to flatten around 47-49 per USD after strong gains this year. The PHP has appreciated 8% between late March and early December. USD/PHP traded below 50 from mid-2020 for the first time since 2017. This was an amazing feat given PHP's poor track record with wide fiscal deficits. Rating agencies have recognised the government's macroeconomic management credentials which has provided the room for a fiscal response to the pandemic with a medium-term consolidation plan. The budget deficit in 2020 is likely to come in around 7-8% of GDP in 2020, below the government's 11% target. The Current Account is set to turn into a modest surplus in 2020 for the first time since 2016. Overseas foreign worker remittances contracted 1.4% in the first nine months, significantly less than the initial estimate of a full year hit of -5%. Finally, CPI inflation has been benign within the central bank's 2-4% target in 2020.

Figure 17: Philippine peso may ascend at a slower pace

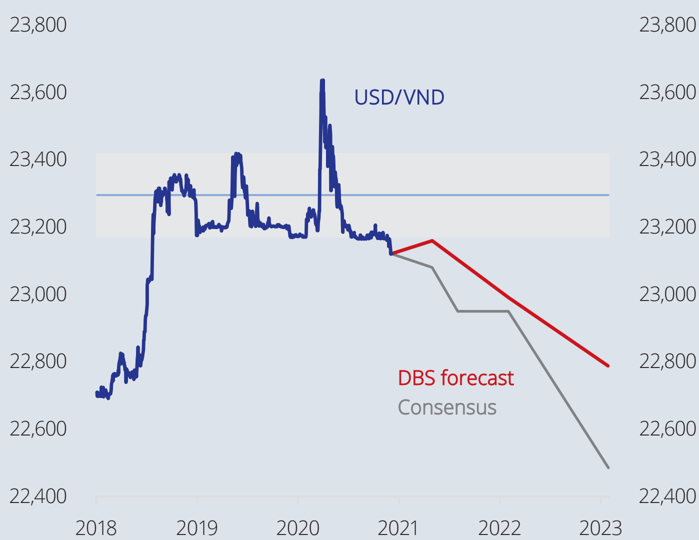


Source: Bloomberg, DBS

VND

USD/VND is projected to appreciate by less than 1% a year in 2021. Vietnam will face more competition from other Southeast Asian countries to attract foreign direct investments from manufacturers seeking to diversify their supply chain from China. For 2021, the National Assembly is targeting a 6% growth rate and a 4% inflation rate. Real GDP growth averaged 2.1% in the first three quarters of this year. In the next five years, the government is targeting an average fiscal deficit of 3.7% of GDP to achieve its average growth target of 6.5-7.0%. Meanwhile, the US Treasury Department has determined in August that VND was undervalued in 2019 by some 4.7% vs USD from government intervention. The US government in October launched an investigation into possible currency manipulation by Vietnam. In November, the US Department of Commerce cited an undervalued currency as a reason for a preliminary anti-subsidy tariff on car and truck tires from Vietnam.

Figure 18: Vietnamese dong may have started a modest appreciation



Source: Bloomberg, DBS

Table 1: DBS currency forecasts

Exchange rates, eop										
	04-Dec	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22
Mainland China	6.5315	6.57	6.70	6.67	6.64	6.61	6.59	6.56	6.53	6.50
Hong Kong	7.7507	7.75	7.76	7.76	7.77	7.77	7.78	7.79	7.79	7.80
India	73.789	74.4	74.8	74.7	74.6	74.5	74.4	74.3	74.2	74.1
Indonesia	14,105	14,200	14,500	14,430	14,360	14,290	14,210	14,140	14,070	14,000
Malaysia	4.0620	4.07	4.11	4.09	4.08	4.06	4.05	4.03	4.02	4.00
The Philippines	48.035	48.1	48.5	48.3	48.2	48.0	47.8	47.7	47.5	47.3
Singapore	1.3358	1.34	1.35	1.34	1.34	1.33	1.33	1.32	1.32	1.31
South Korea	1,082	1,090	1,115	1,110	1,100	1,090	1,085	1,075	1,070	1,060
Thailand	30.191	30.4	31.0	30.8	30.6	30.4	30.2	30.0	29.8	29.6
Vietnam	23,121	23,130	23,160	23,100	23,050	22,990	22,940	22,890	22,840	22,780
Australia	0.7425	0.74	0.73	0.73	0.74	0.75	0.75	0.76	0.77	0.77
Eurozone	1.2121	1.20	1.18	1.19	1.20	1.21	1.22	1.23	1.24	1.25
Japan	104.17	105	106	106	106	106	105	105	105	105
New Zealand	0.7048	0.70	0.69	0.70	0.70	0.71	0.72	0.73	0.73	0.74
Switzerland	0.8922	0.90	0.91	0.91	0.91	0.91	0.90	0.90	0.90	0.90
United Kingdom	1.3441	1.33	1.30	1.31	1.32	1.33	1.34	1.35	1.36	1.37
DXY	90.701	91.5	93.0	92.4	91.7	91.1	90.4	89.8	89.1	88.5

Australia, Eurozone, and United Kingdom are direct quotes.

Source: Bloomberg, DBS

Source: Unsplash

Alternatives: Gold | 1Q21

Romancing gold

Alternatives: Gold

Joanne Goh | Strategist

Gold price consolidated in 4Q20 after hitting a record high in 3Q20 as its lustre was overshadowed by the US elections and news of a vaccine discovery for COVID-19. Tailwinds turned against its favour as USD consolidated after a sharp depreciation in the third quarter and yields started to steepen on vaccine-led recovery hopes.

Notwithstanding 4Q's volatility, we believe the gold rally could continue into 2021 as we examine the demand and supply dynamics and the drivers behind past rallies. In the near term, risks are still lurking. The uncertainties over US policies under a new post-Trump era, a split Senate, and escalating COVID-19 cases should lend good support for gold.

Gold's increasing relevance in asset allocation in a QE world heralds demand

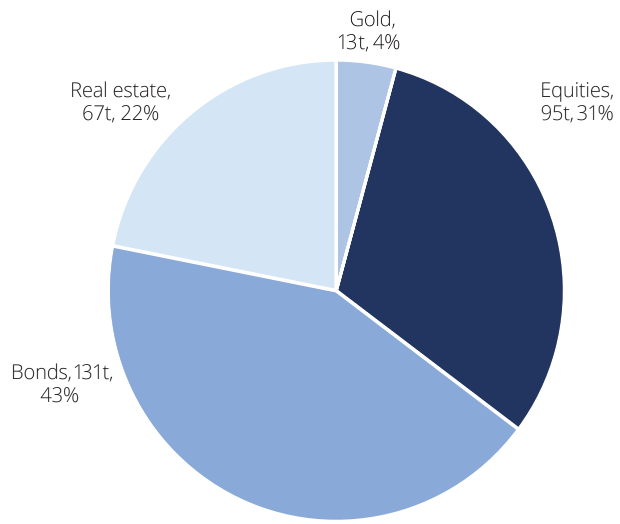
Much has been said about the positive impact of QE on gold prices. The transmission mechanism of its impact is more profound than it seems. Most directly, QE creates liquidity and is inflationary, but indirectly tempers treasury yields and weakens the US dollar.

As such, gold as a store of wealth and a hedge against systemic risk, currency devaluation, and inflation can become more relevant in broad-based portfolios such as pension funds and personal private wealth. Therefore, allocation towards gold should increase, driving the strategic demand for gold.

However, the fact is that the supply of gold is limited. Based on estimates by World Gold Council, the estimated amount of gold mined in history is about 200,000 tonnes, and worth around USD13t using the current gold price of c.USD1,800. Compared with the total global investment in stocks, bonds, and real estate, this number is small (Figure 1).

Calculations show that increasing gold allocation by one percentage point would require USD3t or a third of the current total investable value of gold, or 48,000 tonnes of gold (based on USD1,800 per ounce). However, only about 3,000 tonnes of gold are produced every year in the past 10 years. It is thus physically impossible to meet the growing demand for gold, unless gold prices rise sharply!

Figure 1: Gold is a drop in the bucket among investable assets

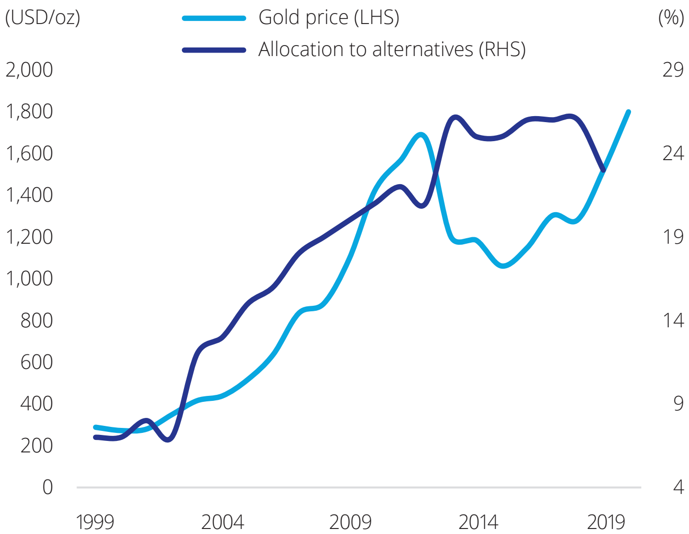


Source: Bloomberg, BIS, LaSalle, World Gold Council, DBS

Allocation is thus limited by supply, but not by the price of gold. Moreover, unlike oil and property prices, gold is not inflationary and does not hinder economic recovery. Hence, higher gold prices are unlikely to trigger monetary response.

Indeed, gold prices have been rising in line with the increases in asset allocation towards alternatives (which includes gold). In a world where fiat currencies are looking less reliable and politics and financial markets less stable, haven assets such as gold stand a very good chance of attracting more allocation. In recent surveys, central banks and sovereign funds have indicated intentions to make changes to gold allocations over the next 12 months, citing gold's potential as a replacement for negative-yielding debt, its low correlation to other central bank assets, and liquidity.

Figure 2: A combination of greed and fear – both rising risk and rising gold price could send more allocation towards gold



Note: Allocation includes alternatives

Source: World Gold Council, Willis Towers Watson, Bloomberg, DBS.

Uncorrelated with equities

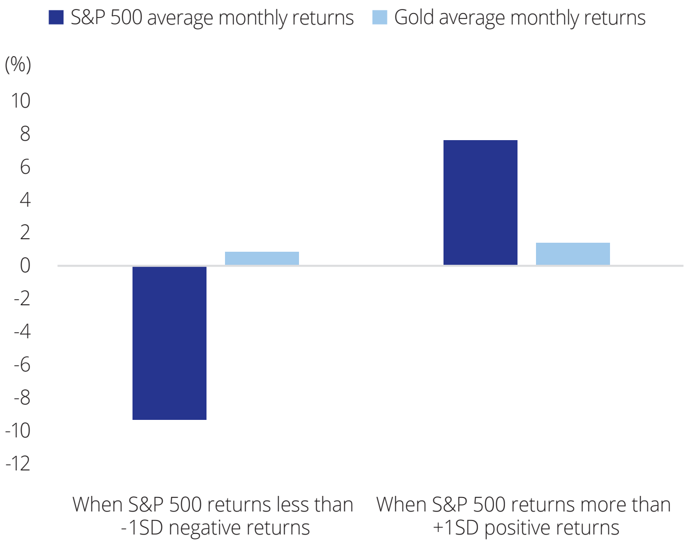
Investors should like the uncorrelated characteristics of gold with risk. In the long run, the correlation between gold and equities is almost zero. This is because the relevance of gold is not only useful for investors in turbulent times. It can also be positively correlated with stocks and other risk assets in positive markets.

This dual benefit stems from the dual nature of gold as an investment and a luxury good. 50% of gold demand comes from jewellery. The latest reaction of gold price to vaccine discovery is an illustration of this uncorrelated benefit.

On one hand, it may be true that vaccine discovery is not great for gold price, as there are concerns that a stronger recovery may drive higher inflation and yields higher, and that additional fiscal stimulus measures may not be required and QE tapering may begin soon. However, gold has also been

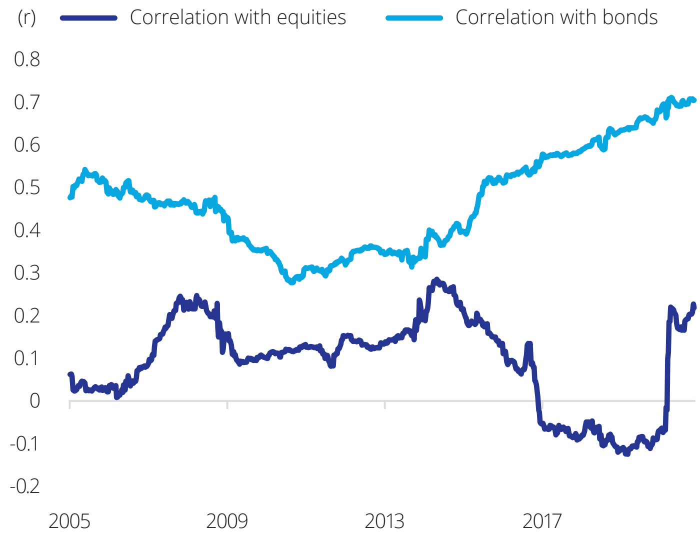
Source: Unsplash

Figure 3: Gold's dual benefit – negative correlation in negative markets, positive correlation in positive markets



Source: Bloomberg, DBS

Figure 4: Correlation* with bond prices is high; gold should be preferred in this low interest rate environment



*Calculated using rolling five-year weekly returns

Source: Bloomberg, DBS

found to be negatively correlated with real rates and is a good inflation hedge. Intuitively, a stronger economic recovery will drive discretionary spending on gold for jewellery, and it is seen as a good store of value in an inflationary environment.

The 2008-2009 GFC is an example of on how gold can effectively mitigate losses during periods of market pressure. The value of stocks and other risk assets plummeted, as did hedge funds, real estate, and most commodities that have long been effective diversifiers. The S&P 500 Index fell 50% from December 2007 to February 2009; in contrast, gold rose 14% over the same period.

In March 2020, gold acted as a liquidity provider during periods of stress and recovered faster than other asset classes as it benefited from "flight-to-quality" inflows.

Strong correlation with bonds

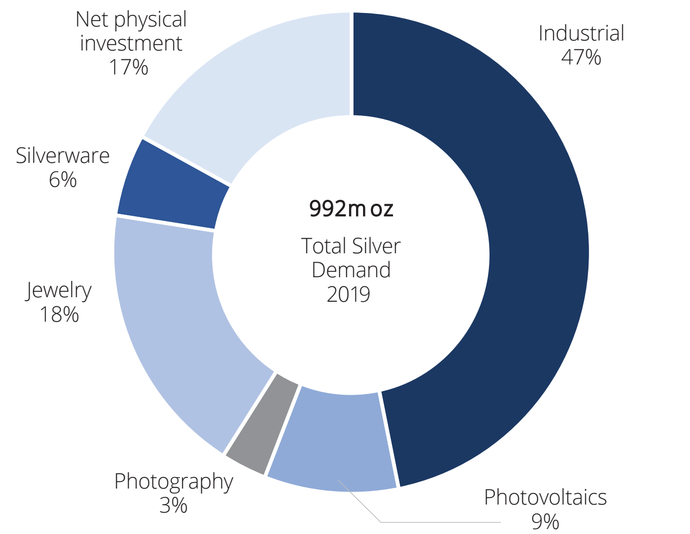
While the correlation between gold and equities is low and sometimes negative, the correlation with bond prices is high, and it is also rising. Unlike the past when cash deposit rates were high, there is minimal opportunity cost in holding gold today, given the ultra-low level of rates. We advocate to stay overweight gold while underweighting bonds in an overall portfolio construct.

Silver to outperform gold in a recovery

In all previous gold rallies, silver has outperformed gold, and sometimes has its own rallies. Like gold, it will continue to provide security in volatile financial markets. But unlike gold, demand for silver is dominated by industrial use. With a recovery scenario into 2021, we believe this aspect of demand dynamics should drive its outperformance over gold.

The number one use of silver in industry is in the electronics field. Silver has unparalleled thermal and electrical conductivity among metals, which means it is not easily replaceable with less expensive materials. Its photosensitivity has given it a place in film photography. Silver is a key ingredient in solar energy because of its high reflectivity.

Figure 5: Demand breakdown of uses of silver



Source: Silver Institute

Gold miners

The quarterly price gains in gold should bode well for the miners. Gold price has been rising USD300 above the 2Q20 average, so if it just sits there for the next 12 months, most gold miners will report an unbroken string of jaw-dropping comparisons for another year.

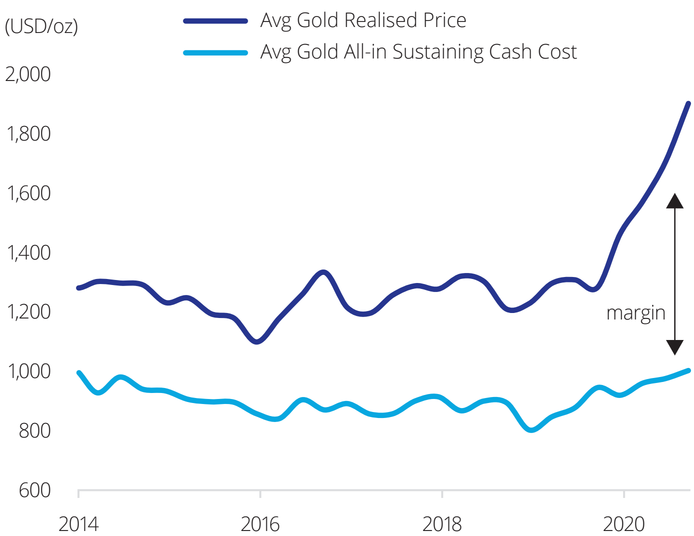
The idea that a rising gold price is good for gold miners is intuitive. To understand how good, refer to the operating leverage chart (Figure 6), which shows you the potential even if gold prices stay flat at current levels.

Consider the latest quarterly results of a gold stock – a sector that Warren Buffet would never consider investing in according to his previous belief that gold does nothing – which he eventually bought this year.

A snapshot of the stock's 3Q20 results shows amazing earnings improvement largely due to higher gold prices. Production has been disrupted due to the pandemic, but it is expected to return to normal next year. As a result, sales were down, but revenue was greatly compensated by higher gold prices.

Source: AFP

Figure 6: Global senior gold producers' sector operating leverage



Source: Bloomberg, DBS

Then, the magic of operating leverage kicked in. Revenue rose by 32%, operating earnings grew 57%, and net earnings more than doubled. Free cashflow – the ultimate point of the whole exercise – rose by 161%.

Barrick Gold's results is a typical snapshot of companies in the sector. Screening criteria among the stocks would generally include the amount of reserves, the quality of mines, the ability to control costs, as well as generate high free cashflow, debt levels, acquisition record, and how managers are paying attention to ESG.

The likely result is that investing in gold and silver mining stocks will start to gain attention of anyone tracking earnings, especially in this low growth environment.

The NYSE Arca Gold Miners Index (GDM) is currently consolidating in line with gold prices but maintains its lead over gold price this year. Indeed, as a leveraged play, it has outperformed the gold price in every gold price rally. Investor demand is derived from equity fund managers who cannot invest directly in commodities, and from multi-asset managers who wanted higher beta. Since the gold mining sector is quite an obscure sector relative to potential capital flows, the outperformance is likely to continue.

Table 1: Barrick Gold 3Q20 production and earnings snapshot

	3Q20	3Q19	% Change
Gold price production ('000s oz)	1,155	1,306	-11.6
Gold sales ('000s oz)	1,249	1,318	-5.2
Avg realised price (USD/oz)	1,926	1,476	30.5
Avg gold cash cost (USD/oz)	696	710	-2.0
Avg gold cash margin (USD/oz)	1,230	766	60.6
Avg gold all-in sustaining cash cost (USD/oz)	966	984	-1.8
Revenue (USDm)	3,419	2,599	31.6
Operating income (USDm)	1,477	938	57.5
Net income	592	278	112.9
Free cashflow (USDm)	1,311	502	161.2

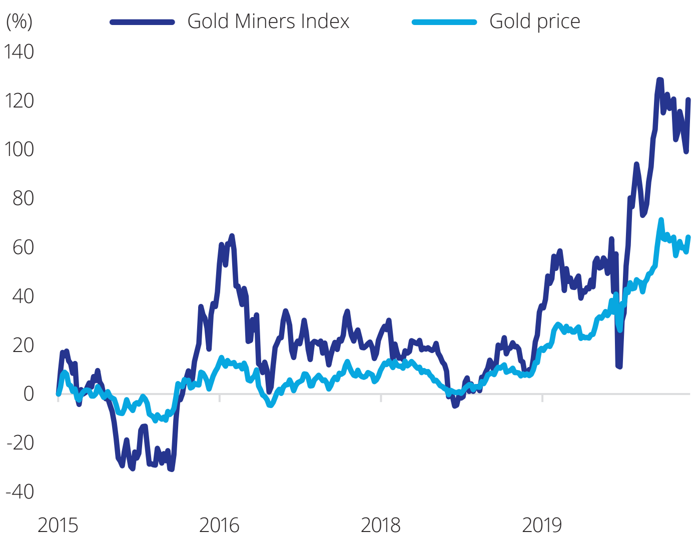
Source: Bloomberg, DBS

Table 2: Gold price sensitivity ratio (USD per ounce)

		DXY				
		80	85	90	95	100
UST 10-year bond yield (%)	0.6	2,503	2,402	2,301	2,201	2,100
	0.8	2,477	2,377	2,276	2,176	2,075
	1	2,452	2,352	2,251	2,151	2,050
	1.2	2,427	2,327	2,226	2,126	2,025
	1.4	2,402	2,301	2,201	2,100	2,000
	1.6	2,377	2,276	2,176	2,075	1,975

Source: DBS

Figure 7: Gold miners sector has outperformed in every gold price rally



Source: Bloomberg, DBS

Gold price forecast

Based on our proprietary gold price model, which includes DXY and 10-year bond yields as key drivers, gold can trade above USD2,000 next year given our dollar depreciation view. We maintain our 12-month price forecasts of USD2,300 for gold and USD35 per ounce for silver.

DBS Live more, Bank less

Thematic Strategy | 1Q21

I.D.E.A.

Source: AFP, Unsplash

Theme: I.D.E.A.

Hou Wey Fook, CFA | Chief Investment Officer
Yeang Cheng Ling | Strategist
Joanne Goh | Strategist

I.D.E.A.: Champions of the new world

We have continually advocated a Barbell approach to investing. To reiterate, our Barbell Portfolio construct comprises taking on outsized exposures in two areas. On one end, take on income-generating assets such as corporate bonds and dividend-yielding equities, given the ultra-low interest rate environment we are in. On the other end of the portfolio, take on secular growth equities that ride on long-term, irreversible growth trends. We are most excited about the trend of the world becoming a digital economy.

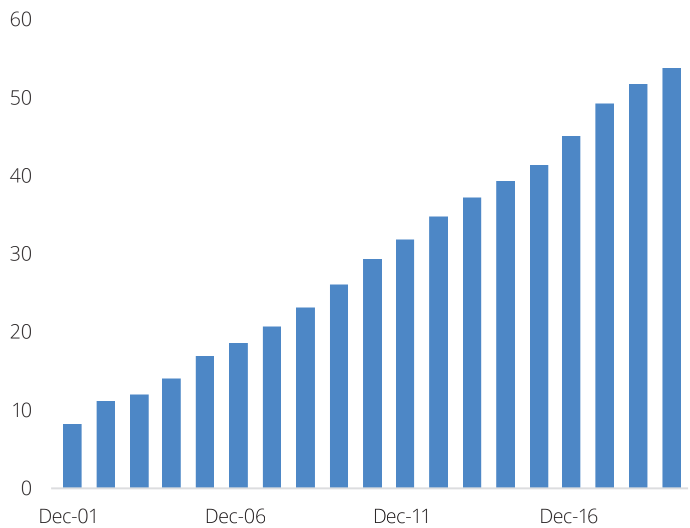
You may ask, "What are the companies that are riding this trend?"

At the DBS Chief Investment Office (CIO), we have coined the acronym I.D.E.A. to encapsulate the types of companies that will be winners of this new digital world. The acronym represents:

I	INNOVATORS	Constantly doing things differently to challenge the status quo
D	DISRUPTORS	Create new products and services which displace mainstream leaders
E	ENABLERS	Empowers innovation and disruption to be successful
A	ADAPTERS	Traditional companies that successfully adapt and transform their business models

In 1990, the World Wide Web came into being and set in motion the widespread use of the Internet. Today, the number of end systems connected to the Internet has risen to 300b. Globally, 55 out of every 100 persons have Internet access (Figure 1). We have witnessed the exponential growth of activities conducted on the Internet. Common day-to-day activities include online shopping, education, social media activities such as messaging and video streaming, banking transactions, and stock market trading.

Figure 1: Rising Internet penetration boosting the digital economy and innovation (%)



Source: Bloomberg, DBS

In Switzerland, citizens are even voting in elections on the Internet.

Digital innovation has truly engendered a huge and very promising opportunity set.

Digital ecosystems

New retail

Marketplace

Digital finance/ payments

Logistics/ speed delivery

Content/ streaming

Advertising

e-Sports

Health care

Social media

Cloud computing

Data analytics

Artificial intelligence

Innovators

Constantly challenge the norm by inventing new ways to improve on current methods

Disruptors

Create a new normal that drastically changes the industries they operate in

Tencent

Enablers

Empower innovation and disruption, aid disruptive ideas, making them possible

Adapters

Traditional businesses that successfully adapt and transform their business models, turning adversity into advantage

Disney VISA Walmart

e-Commerce: the digital economy pulses at a different beat

e-Commerce is not simply retail sales on B2C and C2C platforms; it forms the heart of the digital economy, just as how general commerce embodies the core of economic growth. It is everything that involves buying, selling, and transacting online.

The exponential growth of e-Commerce has challenged the traditional ways businesses are conducted. Operating in a "borderless" world, it enables businesses to reach millions of customers beyond their domestic markets. e-Commerce also encompasses transactions on B2B and P2P portals. B2B online transactions are expected to increase at a CAGR of 17.5%, hitting USD20.9t by 2027.

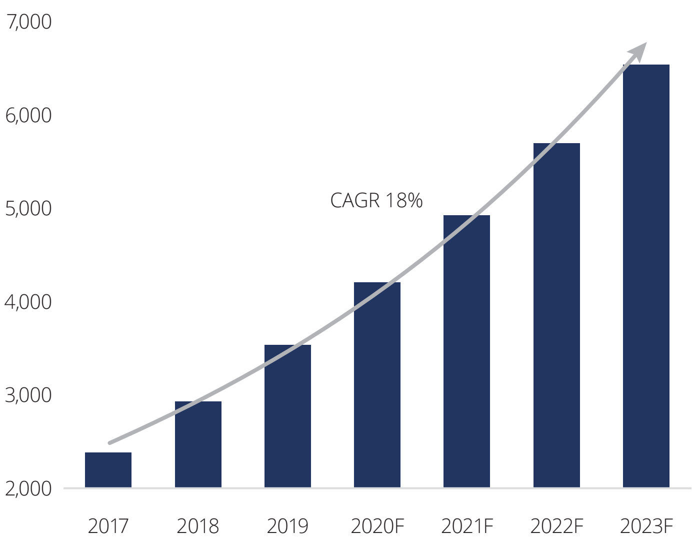
Beyond consumer goods, e-Commerce has expanded to solutions and services such as loans, insurance, and investment products. Other segments include cloud storage, online education, software applications, telemedicine, online gaming services, and consultancy services.

Despite the exponential growth in e-Commerce in the last decade, the reality is that we are in the early innings of this secular growth trend. There is a long runway ahead.

This is encapsulated in the current low penetration of e-Commerce within total global retail sales. Standing at 14% currently, annual retail e-Commerce spending is forecasted to reach USD6.5t (Figure 2), or 22% of global retail sales by 2023.

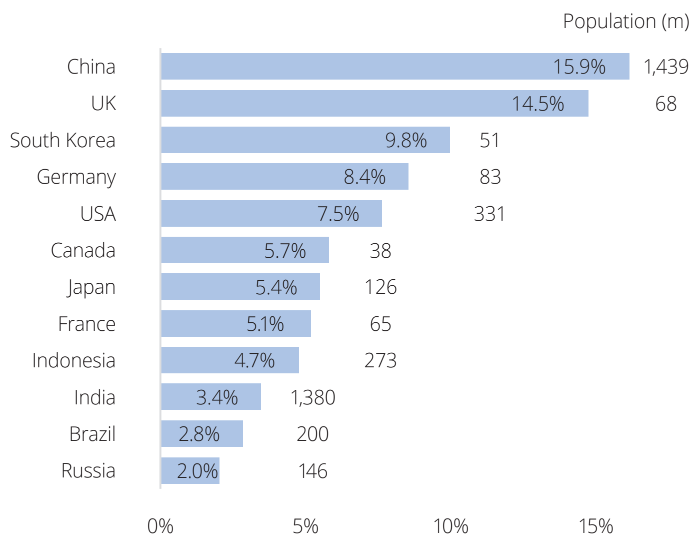
Geographically, penetration rates are highest in China at 16%, and below 10% in other major economies. This is particularly marked in populous nations such as the US, Japan, Indonesia, Brazil, and Russia (Figure 3).

Figure 2: Global retail e-Commerce sales to grow exponentially (USDb)



Source: Bloomberg, DBS

Figure 3: Global retail e-Commerce penetration rate (% of retail sales)



Source: Matthews Asia, Advisor Perspectives, livemint.com, DBS

<u>INNOVATORS</u> impact the way we live, work, and play through inventions that lead to new trends.

"When Henry Ford made cheap, reliable cars, people said, 'Nah, what's wrong with a horse?' That was a huge bet he made, and it worked."

– Elon Musk

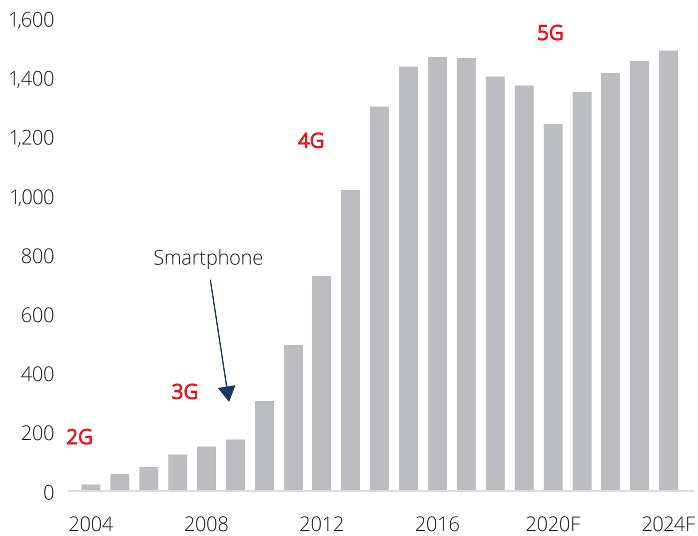
The most impactful innovation in recent years, in our view, has to be the smartphone. The introduction of Apple Inc's iPhone more than a decade ago created a whole new era of communication and information access.

Smartphones today are embedded with advanced applications, baseband processors, large memory storage, battery density, brighter display, and multiple cameras. Owning a smartphone has become a necessity in the modern world.

These features have contributed to the success of digitalisation of commerce as the ability to shop, connect to social media, and execute payments from anywhere can all be done easily on the smartphone.

With 3.2b smartphone users worldwide, the smartphone penetration level reached 41.5% in 2019 (Statista.com). Since 2015, an average of 1.4b units of smartphones have been sold every year (Figure 4). The 5G wireless communication standard will further boost global smartphone penetration, expediting the digitalisation wave and its monetisation potential.

Figure 4: Global smartphone annual sales (m units)



Source: Bloomberg, DBS

Source: Unsplash

DISRUPTORS upend the existing industry structure with their new products or methods, rendering conventional models obsolete.

"Disruption is a critical element of the evolution of technology – from the positive and negative aspects of disruption a typical pattern emerges, as new technologies come to market and subsequently take hold."

– Steven Sinofsky

e-Commerce platforms are disruptors to physical retail storefronts. Over the past decade, e-Commerce with its marketplaces and surrounding ecosystems have swept across the globe at whirlwind speed. Such disruption by digital commerce has led to a long trail of conventional store closures and bankruptcies.

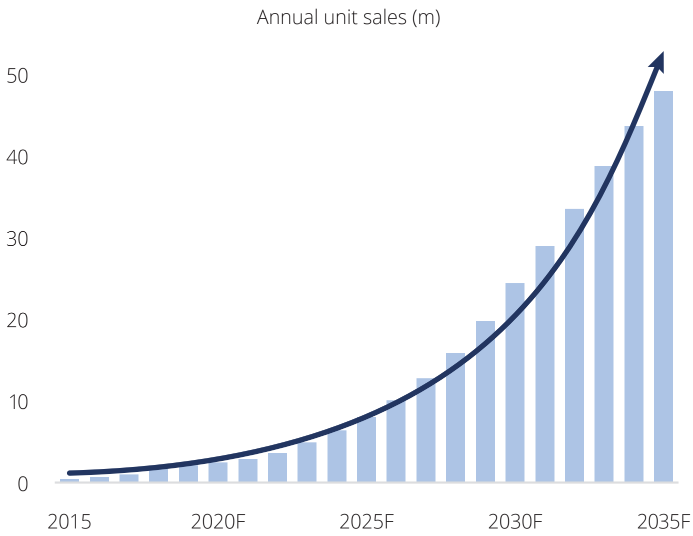
In consumer finance, we see mobile banking apps being challenged by digital wallets as consumers' first choice for making payments – disintermediating banks from their retail customers, and placing 30% of major bank revenues at the risk of disruption.

Fintech and payment systems like Amazon Pay, Alipay, GrabPay, and WeChat Pay disrupt conventional banking and physical payment modes.

Electric vehicles (EV) are another disruptor in the making. They are becoming increasingly popular, leading to the cannibalisation of traditional vehicles sales. As a result, we are going to see consequential changes in the supply side of the automobile industry.

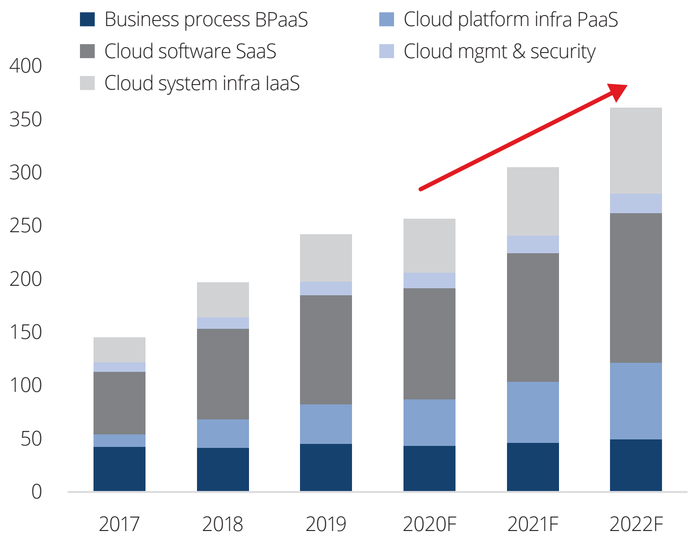
EV benefits from the secular trend of the world moving towards greener and cleaner energy sources, and away from fossil fuels. This shift disrupts the vast automobile industry manufacturing chain, leading to new research and development, as well as supply chain partnerships.

Figure 5: Global EV sales to accelerate



Source: Bloomberg, DBS

Figure 6: Global public cloud TAM to reach USD362b in 2022



Source: Gartner, DBS

Against the backdrop of rising environmental awareness among consumers and arrival of commercially viable technology, EV sales are projected to rise significantly, potentially becoming a new normal (Figure 5).

ENABLERS facilitate effective digital and technological transformation. Companies which integrate technology, social media, mobile, data, and cloud give rise to next-generation applications and new business opportunities.

A key success factor among enablers is the ability to integrate a wide range of technology applications into interfaces that are agile, scalable, robust, and business-centric to support sustainable monetisation.

"Design, in its broadest sense, is the enabler of the digital era - it's a process that creates order out of chaos, that renders technology usable to business."

- Clement Mok

The emergence of cloud services has brought businesses and customers closer, where users can access information and databases **anytime, anywhere, on any device.**

The annual growth rate for the public cloud industry is anticipated to resume at 20% in 2021 and 2022, after slowing to 6% in 2020 due to a temporary cut back in corporate Internet technology cloud capex spending. Cloud software and Platform and Infrastructure as a Service companies have a projected TAM of USD362b in 2022 (Figure 6).

Here are some examples of successful enablers:

1. Cloud and data centres enable reliable and efficient information access and data analytics. The global leaders include Amazon Web Services and Microsoft Azure.
2. Cybersecurity ensures the reliability of the cloud network and credibility of data safety.
3. Development of application specific IC, advanced NODE semiconductor chipsets, and 5G enable stronger processing power. These have benefited the IC design firms and semiconductor foundries.
4. Online payment methods foster fast progression of the digital economy.

5. Augmented reality integrates physical and digital realms, creating better user experience.

6. 5G and advanced graphic processors facilitate gamers with low latency when engaging in the highly competitive online gaming arena, thus offering extraordinary gaming experiences like never before.

ADAPTERS transform and adjust old business models to suit ever-changing trends.

"In today's era of volatility, there is no other way but to re-invent. The only sustainable advantage you can have over others is agility, that's it. Because nothing else is sustainable, everything else you create, somebody else will replicate. "

- Jeff Bezos

Source: Unsplash

As technology evolves, so does the world. Ongoing digital transformation is a good litmus test through which companies that adapt should emerge as the winners of tomorrow.

The Walt Disney Company is a great example of an adapter. It created its streaming services in 2015, later named Disney+. This initiative allowed the Old Economy media conglomerate Disney to enter the new digital world and transform its business model to embrace the benefits of digital connectivity.

Now, Disney+ brings entertainment to many households, and its TAM has increased immensely. The best testimony is that the revenue from "direct-to-consumer and Internet" segment rose to nearly one-third of Disney's consolidated revenue in June 2020, from less than 10% in 2018.

Other exemplary adaptors include the following:

1. Walmart Inc's transformation to embrace e-Commerce allowed it to continue to grow swiftly, including introducing marketplaces and building a robust logistic network for quick delivery. Grocery has emerged as the strategic cornerstone of its business adaption.

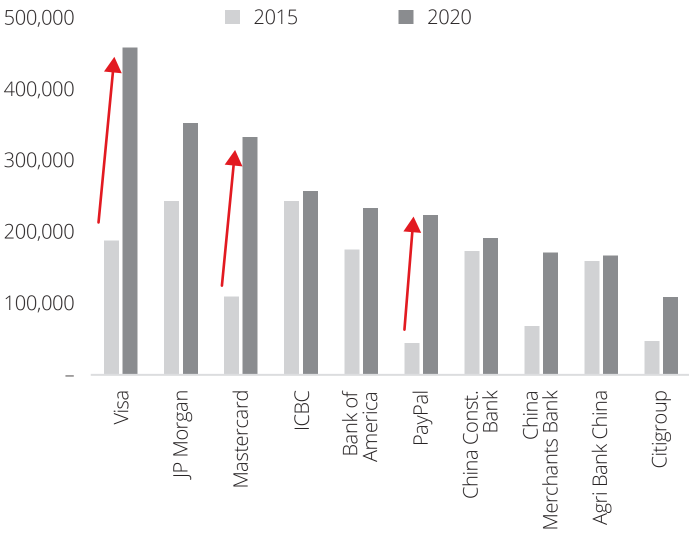
2. As part of the 4th Industrial Revolution, industrial automation to adapt and transform conventional manufacturing to a programmable smart factory, facilitated by IOT and Industrial IOT architecture. Common names include Fanuc, Keyence, ABB, and Rockwell Automation Inc.

3. Credit card companies capturing the business of fast rising digital commerce by providing borderless online payment methods. Visa Inc and Mastercard Incorporated are among these payment providers.

The payment sector benefits greatly as online spending flourishes and brick-and-mortar shops with storefront presence are increasingly establishing online platforms to better serve their customers. Credit card and payment companies which adapted their businesses to facilitate fast growing digital consumption have seen their income and market value surge.

The combined market capitalisation of Visa, Mastercard, and PayPal reached nearly USD1t, equal to the market value of the world's five largest banks combined. Notably, Visa is now more valuable than any commercial bank, while Mastercard is worth more than any Chinese bank (Figure 7). Intriguingly, some of these large banks have been in business for more than a century.

Figure 7: Strong performance of payment adapters (market cap USDm)



Source: Bloomberg, DBS

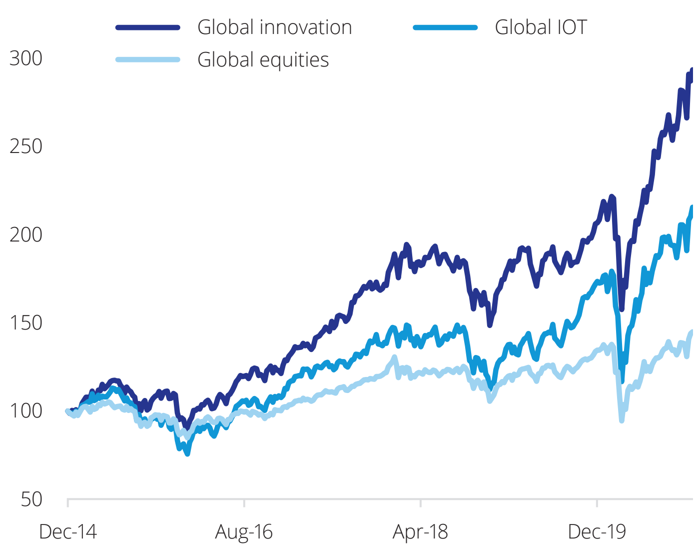
Investment Conclusion

The pace of digital change is faster than ever in our ever-evolving complex and fast moving world. Looking ahead is critical to success.

DBS CIO's I.D.E.A. focuses on technology trends that will help investors select sectors and companies to be ahead of the pack (Table 1).

Companies which have the characteristics of Innovators, Disruptors, Enablers, and Adapters have seen their stock prices surge, and we expect this trend to continue (Figure 8). These companies are featured heavily on the growth end of our Barbell portfolio construct.

Figure 8: Glaring outperformances of Innovation and New Economy sectors (2014 = 100)



Source: Bloomberg, DBS

Table 1: Investment themes relating to IDEA

	Innovator	Disruptor	Enabler	Adapter
5G	√		√	
Artificial Intelligence	√	√		
Cloud, Data Centre	√		√	
Cyber Security			√	
e-Commerce		√		√
Electric & Autonomous Vehicles	√	√		
e-Sports	√		√	
IC Design, Semiconductor	√		√	
Industrial Automation	√			√
Online Payment			√	√
Smartphone	√		√	

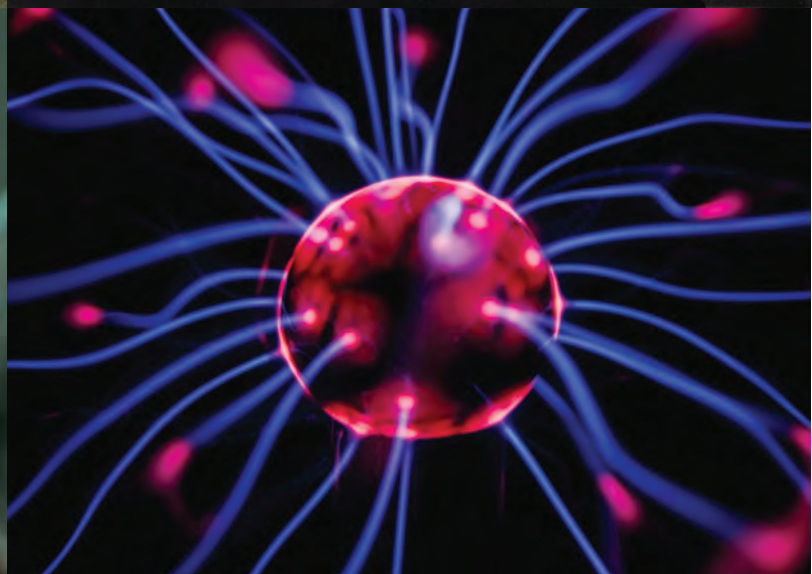
Source: DBS

2021 investment themes

	Growth	Income
Ongoing themes	I.D.E.A. Work from Home 5G Cloud Computing Industrial Automation Semiconductor, IC Design e-Commerce Millennials: e-Sports Millennials: Athleisure Global Health Care China A-shares Vaccine Winners	Global Infrastructure BBB/BB-USD Corporate Bonds Singapore REITs China Large Banks Europe Integrated Oil Majors Europe Bank Additional Tier-1 Capital

DBS

Live more,
Bank less



CIO Expert Series | 1Q21

Biotechnology

Source: Unsplash

CIO Expert Series: Biotechnology

Franklin Templeton

In the present environment, we are very excited to be investing in Health Care – to be more specific, biotechnology. We see several secular growth themes impacting the industry with favourable long-term ramifications for health care spending and drug development, including broad demographic trends and major advancements in medical science. Over the longer term, we are optimistic about the tremendous amount of innovation in the development of new drugs.

Demographic Shifts

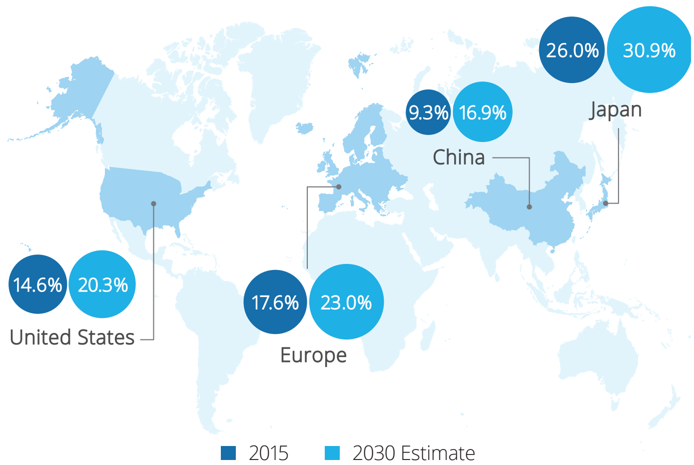
We believe the ageing global population will continue to drive health care demand. As the world's population ages, the elderly as a group will continue to spend more on drugs and medical services than younger generations. Across the globe, the proportion of the population over 65 is expected to grow rapidly, and we have seen a continued increase in annual prescription drug expenditures over the past four decades (Figure 1). This demographic shift is also fuelling strong growth in the biotechnology industry, which in turn helps fund increased R&D spending (Figure 2 and 3). We expect this upward trend to likely continue.

A Wave of Innovation

In addition to these demographic trends, we believe as a society, we are finally beginning to reap the benefits of the many scientific and medical advancements made in the past 10-15 years, all of which have led to the recent surge in novel drugs. The past several years have consistently seen large numbers of new therapies approved, and 2020 looks to be another strong year (Figure 4). Recent advances in genomics, proteomics, as well as in DNA sequencing technologies have enabled a more informed and targeted approach to designing drugs.

Figure 1: Ageing population continues to drive health care demand

A significant portion of the population will be
OVER 65 WITHIN 20 YEARS…



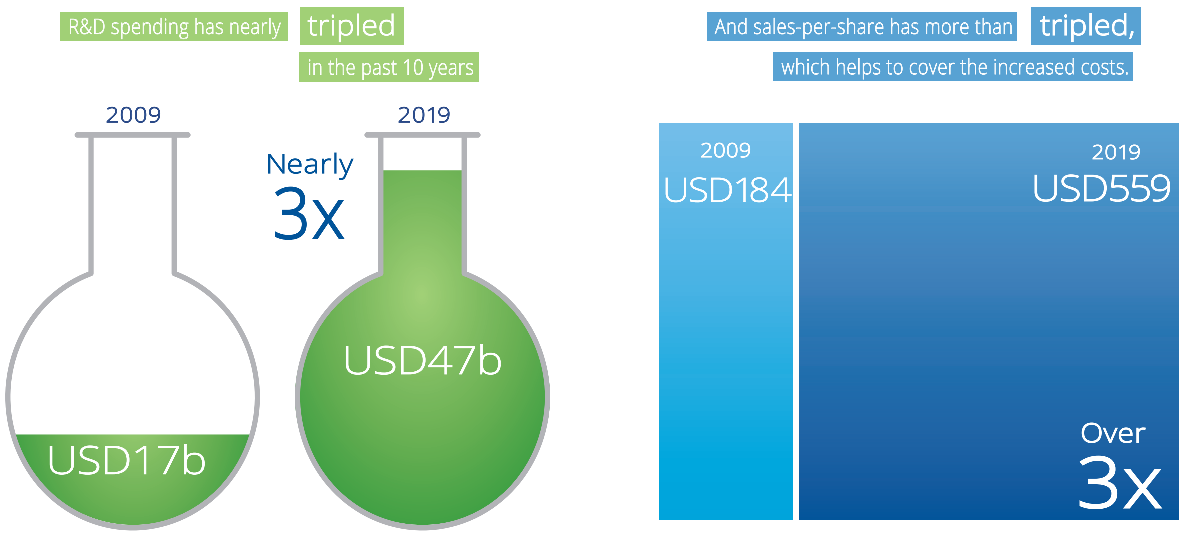
…and people spend more on health care as they age

Percentage of total annual expenditures

Under 25	25–34	35–44	45–54	55–64	65+
3.8%	5.4%	6.1%	6.8%	8.7%	13.4%

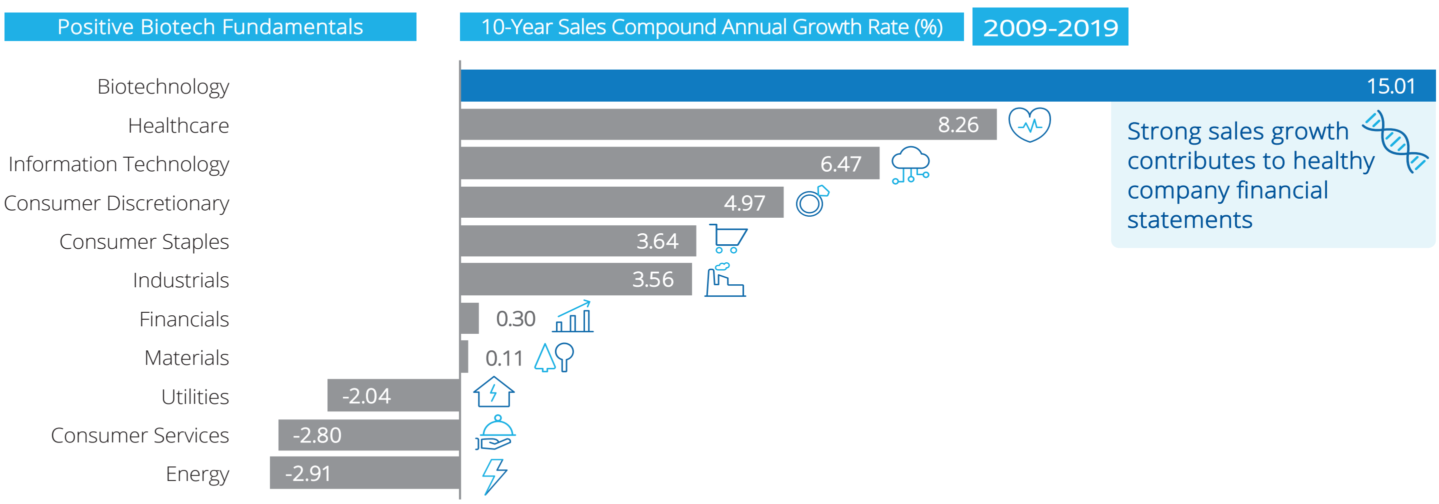
Source: United Nations, Department of Economic and Social Affairs, Population Division, World Population Prospects: The 2019 Edition. Most recent data available. There is no assurance that any projection, estimate or forecast will be realised.

Figure 2: Biotech offers attractive fundamentals



Source: Bloomberg LP. As of 31 December 2019. Updated annually. Based on holdings in the NASDAQ Biotechnology Index from 2009 through 2019

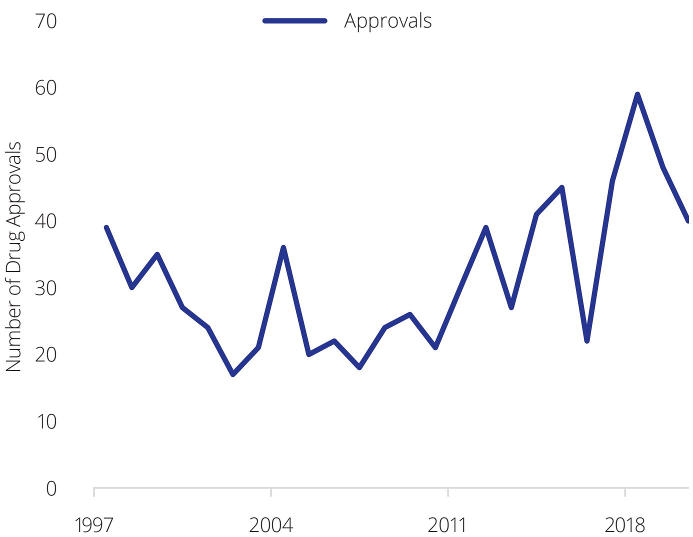
Figure 3: Biotech sales growth outpaced other sectors



Source: FactSet. As of 31 December 2019. Updated annually. The CAGR is the rate at which something (e.g. revenue, savings, population) grows over a period of years, taking into account the effect of annual compounding. Sectors shown are represented by the corresponding S&P 500 sector index, each which is comprised of those companies in the S&P 500 Index that are classified as members of the appropriate GICS® sector. S&P® and S&P 500® are registered trademarks of Standard & Poor's Financial Services LLC. S&P does not sponsor, endorse, sell or promote any S&P index-based product. Indices are unmanaged and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges. Important data provider notices and terms available at www.franklintempletondatasources.com.

While witnessing a wave of innovation across all therapeutic areas within the biotechnology sector, we are particularly enthusiastic about the recent advancements made in the areas of immuno-oncology, precision oncology, and gene therapy.

Figure 4: FDA annual drug approvals 1997 to 2020 (September)



Source: US Food and Drug Administration, CDER New Drug Review: 2020 Update. FDA approvals from 1997-2011 were found via the CDER New Drug Review: 2012 Update. 2012 and subsequent years may be found via the FDA website by searching "development and approval process" and the year.

Advancements in Oncology

One area where we have seen a major paradigm shift is in oncology, where advancements in both immuno-oncology and precision oncology have opened up new pathways for treating patients.

Immuno-oncology (IO) is a therapeutic approach that harnesses the power of a patient's own immune system to fight cancer. This is based on the knowledge that the immune system continuously scans the body for pre-cancerous and cancerous cells and destroys them when necessary. But this natural immunosurveillance mechanism sometimes fails. IO therapies aim to activate the body's natural immune response to recognise and destroy cancer cells that it may have missed. IO treatments are used alone or in combination with other drugs (e.g. chemotherapy) to drive long-lasting remissions.

Several IO approaches have already transformed the treatment landscape. A few examples include:

- Immune checkpoint inhibitors: Drugs designed to block immune checkpoints ("taking the brakes off") so that the immune system can respond more strongly to cancer.
- Adoptive cell therapy: This involves the use of immune cells to recognise and destroy tumors. These cells are usually collected from the patient and genetically modified and/or expanded before being infused back into the patient.
- Bispecific T-cell engagers: These antibody constructs form a bridge between tumor cells and cytotoxic T-cells so that those T cells can recognise and destroy the tumour.

Precision oncology (also known as targeted oncology) is another promising area. Precision oncology drugs are designed to target specific mutations known to drive cancerous growth. This allows for a more precise killing effect with fewer side effects than non-targeted drugs like chemotherapy, which do not differentiate between healthy and cancerous cells.

To determine eligibility for a targeted therapy, a patient's tumour tissue is tested for the presence of a specific mutation. If an applicable mutation is detected, a patient can receive targeted therapy if it is available.

While precision oncology is not a new concept, we have seen a recent resurgence in the area. Recent advancements in the space include:

- New mutations and targets: There has been an explosion in the number of new actionable targets, driven to recent advances in large-scale molecular profiling of different cancers.
- Structure-based drug design: New bioinformatics approaches to model 3D structures of proteins have enabled smarter drug design.
- Overcoming drug resistance: New drugs that target mutations that confer resistance to first generation targeted therapies.
- Novel diagnostics: Liquid biopsy offers a minimally invasive option.

Gene Therapy

Gene therapy is a decades-old idea that is finally becoming medically feasible, due to recent advancements that have made it safer and more effective. Gene therapy involves the viral delivery of genetic material into a patient's cells to correct a missing or defective disease causing gene in the body. The advantage of gene therapy is that it is designed to be a one-time treatment that would ideally cure a patient for life, rather than chronically treating their symptoms.

We have now seen several successful examples across a variety of rare genetic disorders, such as spinal muscular atrophy (SMA). SMA is a rare genetic neurodegenerative disorder characterised by the loss of motor neurons and progressive muscle wasting. In 2019, the FDA approved the first gene therapy product for SMA patients who are two years or younger. Within a little over a year on the market, this has already transformed the treatment of SMA.

Innovation in Drug and Vaccine Development for COVID-19

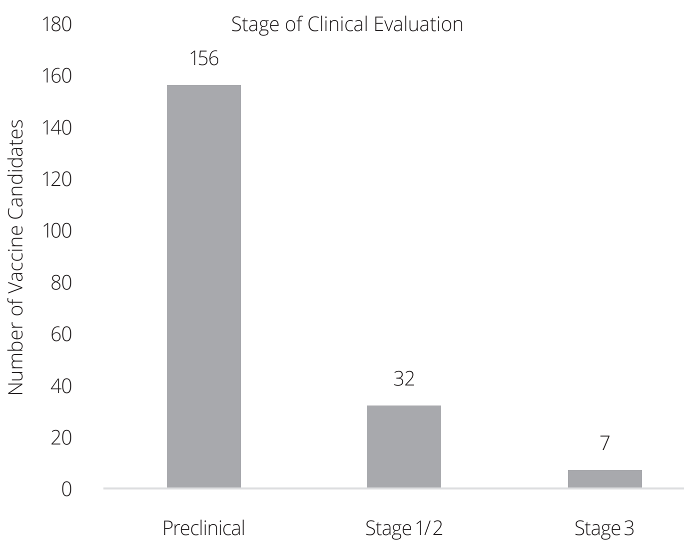
We believe a perfect example of how innovation is driving rapid drug development is the biopharma industry's response to the COVID-19 pandemic. The entire industry mobilised almost immediately in response to this global emergency, and companies around the world have managed to leverage their innovative drug/vaccine discovery platforms and move candidates into human testing at an unprecedented pace. Remarkably, drug developers have managed to condense the development timelines for these drugs and vaccines to a matter of months, whereas under normal circumstances it would typically take several years from start to finish.

In the following discussion, we will divide the COVID-19 therapeutics landscape into three categories.

1. **Antivirals**
   Antiviral drugs are designed to reduce viral load by preventing the virus from replicating. Thus far, one antiviral, remdesivir, has been shown to be effective in randomised studies. In these studies, treatment with remdesivir reduced the time to recovery as well as mortality in moderately severe patients, and for this reason it has quickly become the standard of care for severe COVID-19 cases.

   In addition to conventional antiviral drugs, monoclonal antibodies from companies including Regeneron and Lilly have shown promising activity in reducing viral load and accelerating time to recovery in clinical trials. We believe these antibody treatments could be effective in a subset of patients.

Figure 5: COVID-19 vaccines by stage in development as of 15 October 2020



Source: World Health Organization

2. **Supportive care**
   Aside from antivirals, there are multiple drugs in development to address the symptoms associated with COVID-19 infection. These drugs will likely be used in combination with antivirals. Examples include anti-inflammatory drugs (e.g. dexamethasone, anti-IL-6 antibodies) for treating the overactive immune response (cytokine storm) triggered by a COVID-19 infection. The recent introduction of these supportive care drugs has dramatically improved patient outcomes; however, we continue to believe that the best way to address the pandemic is to prevent future infections through vaccination.

3. **Vaccines**
   We believe an effective vaccine is the key to preventing future infections and generating herd immunity. The COVID-19 vaccine pipeline is evolving and expanding at an unprecedented pace (Figure 5). Currently, there are over 180 vaccine candidates in various stages of development, most are in early stage going through pre-clinical development. Many of these candidates are based on novel technologies (e.g. mRNA vaccines) that have not been clinically validated in humans. That said, several vaccines based on the more tried-and-true technologies are already in or about to enter human trials.

In the past few months, several companies have reported initial results from early clinical studies. These candidates have shown promising activity, in the form of neutralising antibodies and T-cell responses. While these companies still need to complete their Phase 3 studies to confirm efficacy, we are hopeful that these early results will translate to protection from infection.

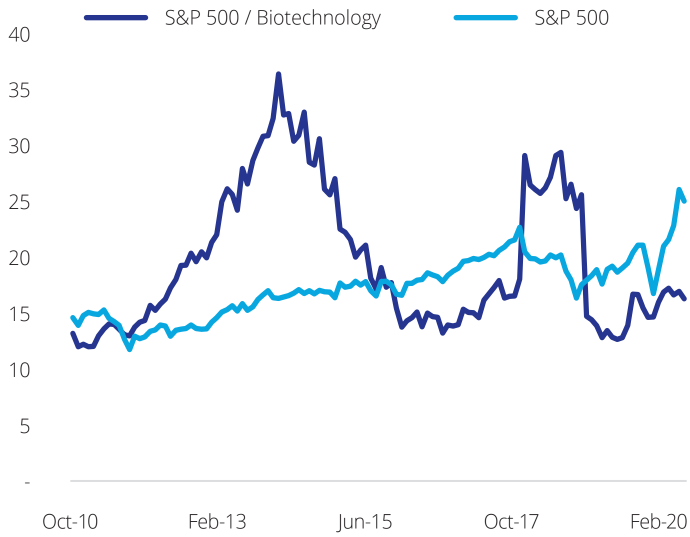
Looking Forward

We continue to believe the commercial side of the biopharma business will prove relatively resilient to the economic disruption caused by COVID-19, whereas the development side saw some disruption earlier on as the pandemic started. While it has been more challenging to initiate clinical trials or maintain the pace of enrolment in existing trials, these activities began to resume this summer or are scheduled to resume shortly. Further, we have been checking with companies held by the fund to ensure there is minimal disruption to their manufacturing and supply chains, or to any clinical or regulatory timelines.

While we believe it will take months, if not longer, for our global economy to return to "normal", we are optimistic that we will find a solution to the pandemic. Some regions have been successful at slowing the spread of the virus through social distancing, mask wearing, and other measures. The standard of care for COVID-19 has also improved, which in turn has reduced mortality rates. We believe that within the next year, the biopharma industry will deliver at least one if not more vaccines that will be effective at preventing the spread of the virus. For this reason, our positive long-term view of the sector remains unchanged as we see this disruption as temporary.

In addition to the fundamental drivers discussed, biotechnology stocks offer other compelling attributes. First, because they are driven by individual company factors like R&D success, drug approvals, and sales, they tend to have lower correlation to other broad sections of the market. Additionally, biotechnology stocks look compelling compared to the broader US market.

Figure 6: Monthly P/E ratio S&P 500 Biotech Index vs S&P 500 Index, 10 years ending September 2020



Source: Morningstar

Table 1: Correlation report – 10-year period ending 30 September 2020

Fund / Indices	S&P 500 Sub/ Biotechnology TR	FTSE EPRA Nareit Developed TR USD	MSCI World/ Financials GR USD	MSCI World/ Energy GR USD	MSCI World/ Utilities GR USD	MSCI World/ Telecom Services Ig GR USD	MSCI World/ Information Tech GR USD	MSCI World/ Consumer Disc GR USD	MSCI World GR USD	S&P 500 TR USD
S&P 500 Sub/ Biotechnology TR	1.00									
FTSE EPRA Nareit Developed TR USD	0.34	1.00								
MSCI World/ Financials GR USD	0.50	0.70	1.00							
MSCI World/ Energy GR USD	0.33	0.72	0.79	1.00						
MSCI World/ Utilities GR USD	-0.01	0.73	0.38	0.45	1.00					
MSCI World/ Comm Services GR USD	0.38	0.75	0.69	0.72	0.63	1.00				
MSCI World/ Information Tech GR USD	0.45	0.60	0.73	0.59	0.42	0.69	1.00			
MSCI World/ Consumer Disc GR USD	0.52	0.72	0.84	0.74	0.45	0.82	0.89	1.00		
MSCI World GR USD	0.55	0.79	0.90	0.81	0.54	0.84	0.89	0.96	1.00	
S&P 500 TR USD	0.56	0.76	0.87	0.79	0.51	0.84	0.90	0.95	0.98	1.00

Source: S&P 500, FactSet

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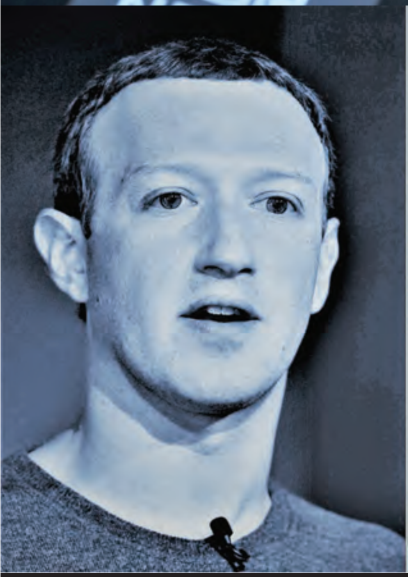


Special Feature | 1Q21

The War on Big Tech

Source: AFP, Unsplash

Special Feature: The War on Big Tech

Dylan Cheang | Strategist
Benjamin Goh | Analyst

Overview: The start of Big Tech regulation. After nearly two decades of unfettered growth, Big Tech companies like Amazon, Apple, Facebook, and Google are facing renewed waves of scrutiny by competition watchdogs and antitrust probes. Both Democrats and Republicans have expressed the need to keep Big Tech's expanding reach in check. And indeed, after years of procrastination over how Big Tech should to be restrained, words have finally translated into action.

The US Department of Justice (DOJ) has recently filed an antitrust case against Google, claiming that the company has made its search engine the "default" choice in electronic devices and this impedes the abilities of other search platforms to compete. And in a rare show of bipartisanship, this lawsuit has received support from both sides of the political aisle.

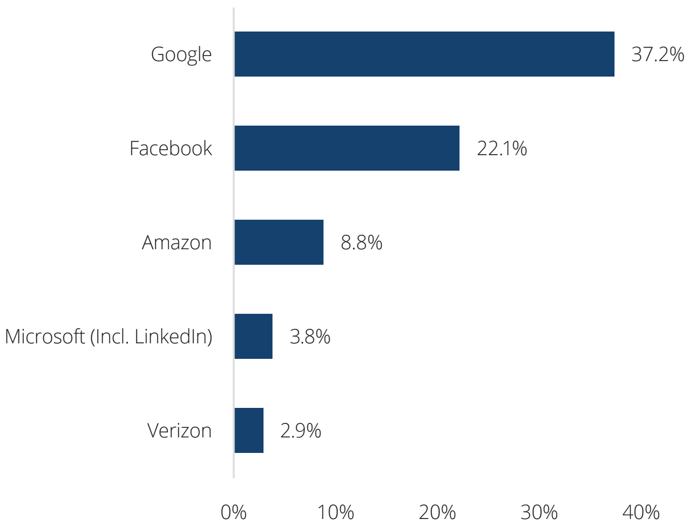
The landmark lawsuit filed against Google is just the tip of the iceberg. Table 1 shows the upcoming policies aimed at regulating Big Tech and we believe this could herald the start of changing power dynamics between governments and corporates in the years to come.

Table 1: Upcoming policies regulating Big Tech

Policy	Companies Impacted	Impact	Probability (%)	Timing
Expensing of R&D	Apple, Google, Samsung, Intel, Microsoft, Amazon.com, etc	Positive	70	1-2 Years
Journalism Competition and Preservation Act	Amazon.com, Apple, Facebook, Google	Negative	65	2-4 Years
Data Privacy Legislation	Amazon.com, Facebook, Google, Twitter	Negative	60	2-4 Years
FTC Penalty and Rulemaking Authority	Amazon.com, Facebook, Google, Twitter	Negative	60	2-4 Years
Journalism Competition and Preservation Act	Amazon.com, Apple, Facebook, Google	Negative	60	2-4 Years
Competition on Internet platforms	Amazon.com, Apple, Facebook, Google, Microsoft	Negative	40	2-4 Years
Digital Services Tax	Apple, Google, Facebook, Amazon.com, Netflix	Negative	40	1-2 Years
FTC Penalty and Rulemaking Authority	Amazon.com, Facebook, Google, Twitter	Negative	40	2-4 Years
Patent Box	Apple, Google, Microsoft, etc	Positive	40	2-4 Years
State Digital Taxes	Amazon.com, Walmart, Wayfair, NewEgg	Positive	35	2-4 Years
Section 230 Liability Shield	Amazon.com, Facebook, Google, Twitter	Negative	15	2-4 Years

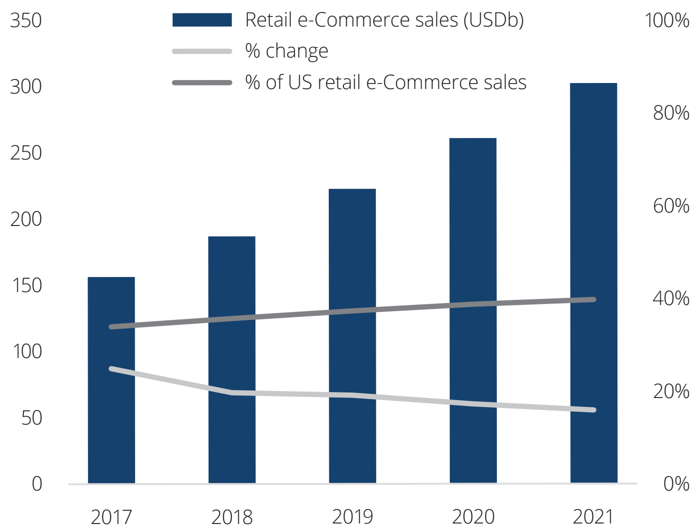
Source: Bloomberg, DBS

Figure 1: Big Tech dominates US digital ad spending



Source: eMarketer, DBS

Figure 2: Amazon accounts for 37% of US retail e-Commerce sales



Source: eMarketer, DBS

Why is Big Tech regulation deemed necessary? The antitrust lawsuit filed by the DOJ will be a complex and long-drawn affair with no easy solution. But to begin with, why is the regulation of Big Tech deemed necessary? And is Big Tech really so dominant?

The numbers below suggest so. Today:

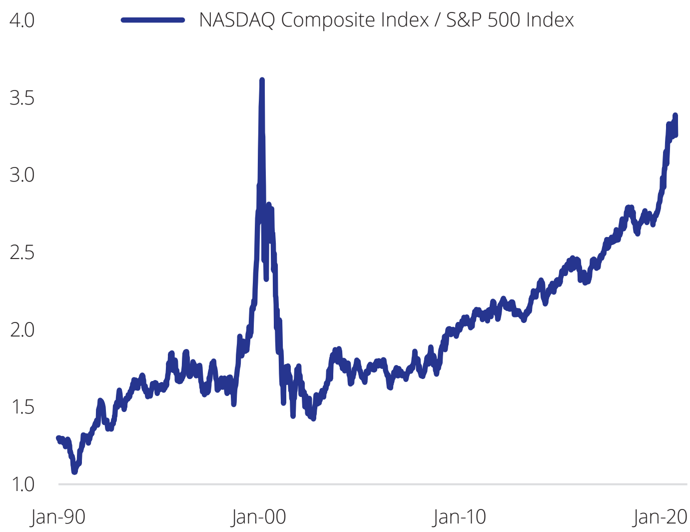
- Google commands 92% share of global Internet search engine.
- Facebook controls 75% of global social media usage.
- Amazon accounts for 37 cents of every dollar US consumers spend online.

Source: AFP

The dominant industry positioning of Big Tech has, in turn, translated to strong dominance in the US equity market:

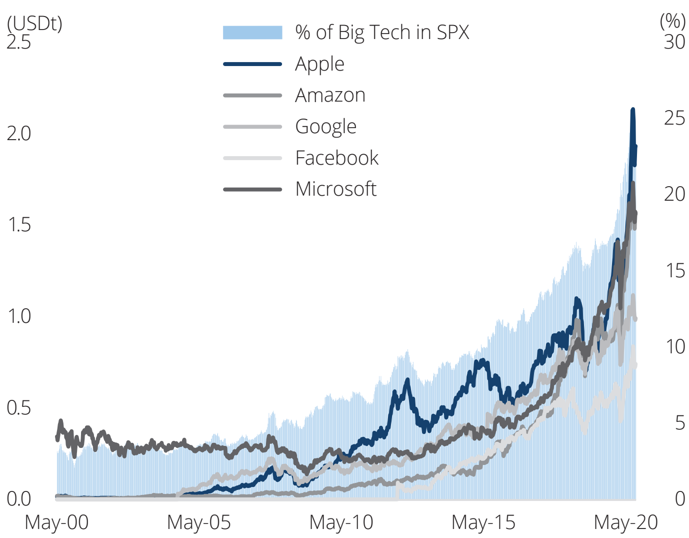
- The combined market cap of Apple, Amazon, Facebook, Google, and Microsoft combined has reached USD6.8t in 2020 – 23.4% of the S&P 500 Index.
- The ratio for the Nasdaq Composite Index to the S&P 500 is surging back to its 2000s peak and this signals dot-com era concentrations in technology companies.
- The S&P 500 has outperformed the S&P 500 Equal Weighted Index since 2019 due to higher exposure to technology stocks.

Figure 4: NASDAQ to S&P 500 ratio hitting dot-com era highs



Source: Bloomberg, DBS

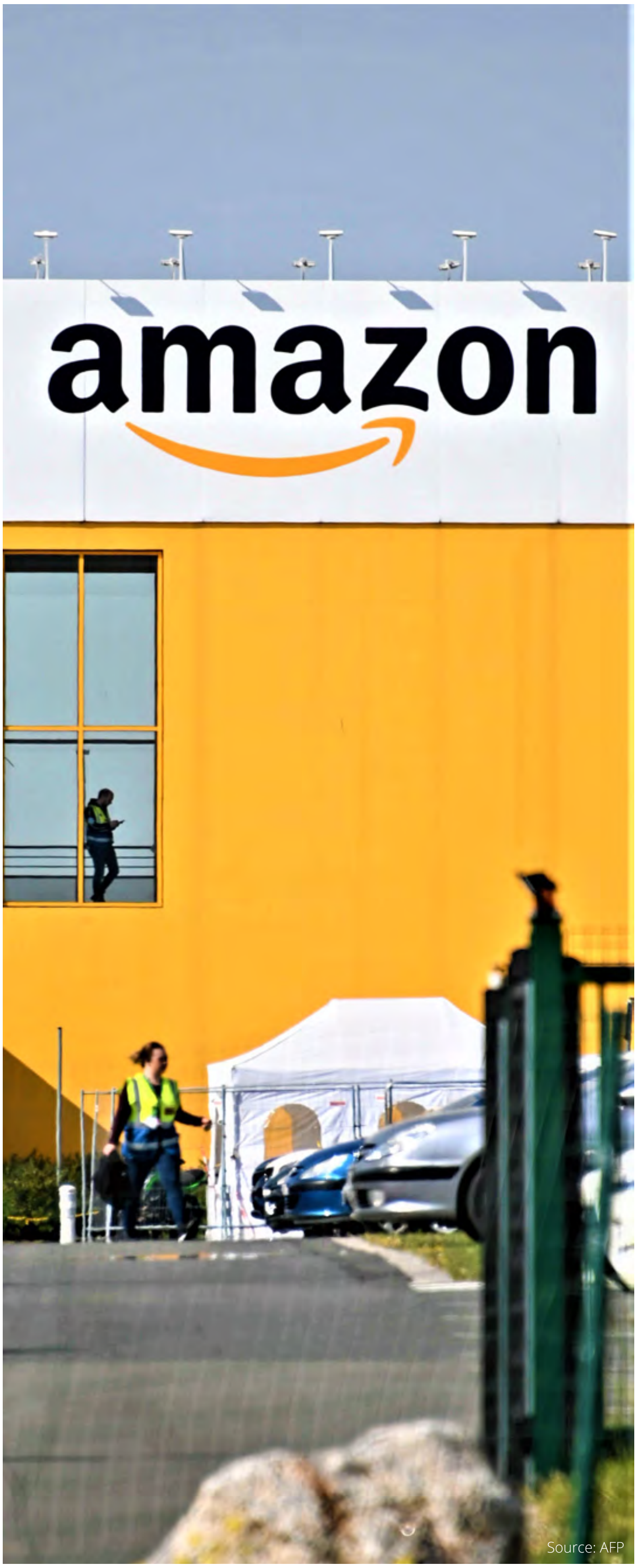
Figure 3: Big Tech makes up 23.4% of entire S&P 500 Index



Source: Bloomberg, DBS

Figure 5: Higher weightage in tech stocks propelled S&P 500's outperformance over S&P 500 Equal Weighted Index

Source: Bloomberg, DBS



Source: AFP

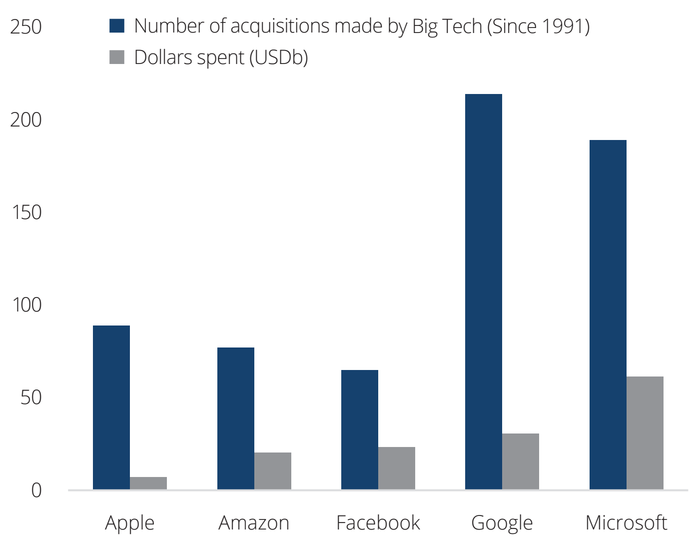
"Kill Zone" – Strategies employed by Big Tech to limit competition. Big Tech has been known for its "Buy and Kill" strategy. This entails acquiring competitors that pose the biggest threats to their operations and shutting them down before they gain further momentum. No doubt, the common push back given by Big Tech is that they are merely creating synergies by combining the best features from their competitors' products with their own suite of offerings.

But research from The University of Chicago Booth School of Business suggests otherwise. Their work shows that whenever Big Tech acquires a start-up, it creates a "Kill Zone" – a situation whereby the market segment becomes over-concentrated and as a consequence, this stifles venture capital (VC) funding for new start-ups.

Big Tech companies like Alphabet, Amazon, Apple, Facebook, and Microsoft have made nearly 500 acquisitions in the last decade worth USD161b (Figure 6). And according to Chicago Booth, whenever a start-up is acquired by Google or Facebook, VC investments in the same space dropped by 46% in subsequent three years while the number of deals also fell by 42%.

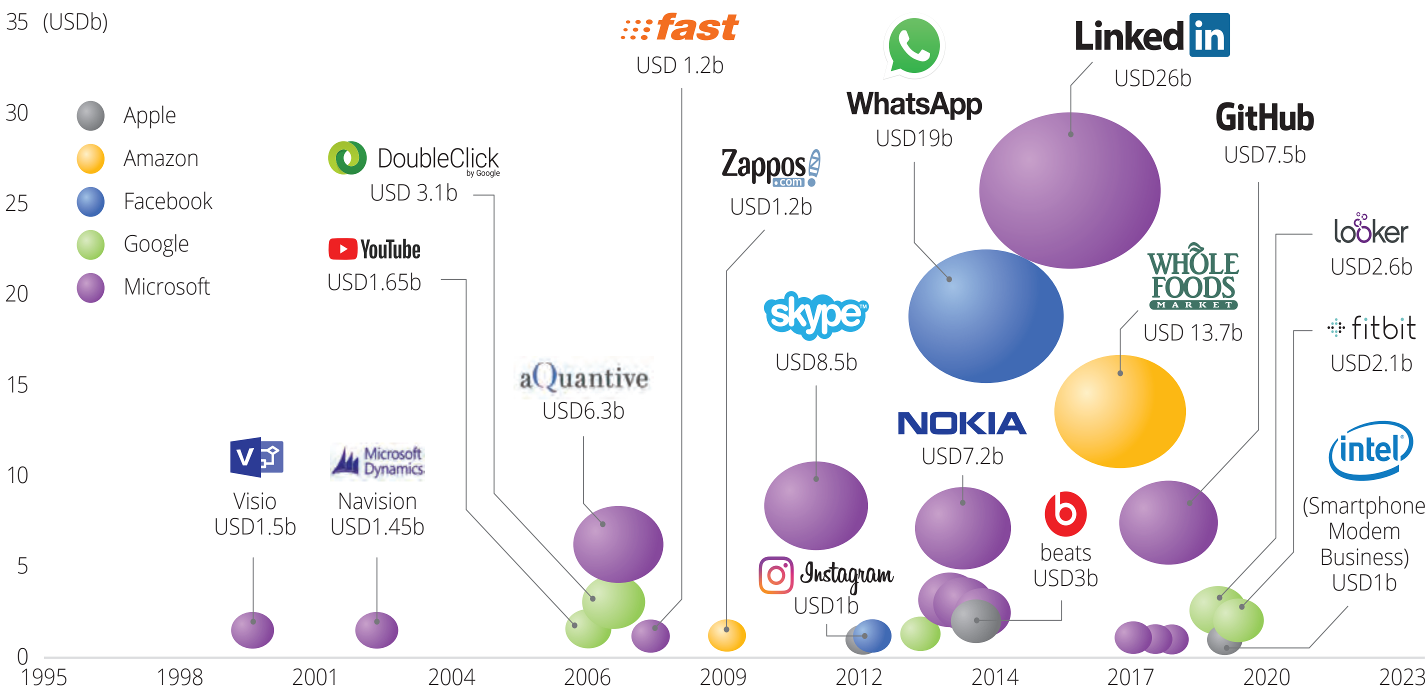
This suggests that Big Tech acquisitions not only deter investments in the same space, it also stifles innovation.

Figure 6: Number of acquisitions made by Big Tech



Source: Bloomberg, DBS

Figure 7: Big Tech's acquisitions over the last 20 years (above USD1b)



Source: Bloomberg, DBS

Source: Unsplash

Antitrust Laws: Still relevant?

How did antitrust laws come about and what is the purpose? The first antitrust law came about in the late-1800s when businesses grouped together to form large umbrella companies called "Trusts". During that era, large railroad and oil companies were essentially unregulated monopolies, charging exorbitantly high prices to keep competitors out of the market. Their purported "abuse of power" resulted in mounting pressure on the government to introduce legislations and keep these monopolies in check.

The US Antitrust Law consists predominantly of three legislations and they are:

1. Sherman Antitrust Act (1890): This was the first antitrust law passed by Congress and the key aim was "preserving free and unfettered competition as the rules of the trade".

2. Clayton Antitrust Act (1914): This was a follow-up to the Sherman Act and the new legislation sought to address specific practices not clearly prohibited under the Sherman Act. For instance, it prohibits M&As that would lessen competition and lead to the creation of a monopoly.

3. Federal Trade Commission Act (1914): This legislation bans unfair methods of competition as well as unfair or deceptive acts or practices.

Relaxation of antitrust laws during Reagan's era. In the 1980s, the Reagan administration started adopting the stance of "self-correcting markets, composed of rational, self-interested market participants" with regards to antitrust laws. Under his presidency, the US DOJ revised the interpretation of the antitrust laws, weakening enforcement as well as allowing more consolidation to take place. This planted the seeds of the takeover boom seen during the 1980s.

Since then, US antitrust laws are based on the "consumer welfare" standard. This means that large companies are now deemed acceptable, so long as consumer welfare is not affected. The revision in law led to a sharp decline in antitrust prosecutions over the next decades.

Notable antitrust cases: Standard Oil & Microsoft. There were several high profile antitrust cases through the years and the most notable ones were:

- United States vs Standard Oil: Standard Oil, at its peak in 1904, controlled 91% of the oil production and 85% of final sales in the US. But as public sentiments towards these large corporate trusts deteriorated, an antitrust case was filed against Standard Oil, alleging that the company uses its monopolistic power to raise prices and keep competition out of the industry. At the end of the case, Standard Oil was eventually broken up into 34 separate entities in 1911 and its market share fell to 64%.

- United States vs Microsoft: In 1998, the US DOJ filed antitrust charges against Microsoft, which at that time controlled around 90% of the market for PC operating systems. Microsoft was alleged to have violated parts of the Sherman Antitrust Act of 1890 and was ordered by the judge to split. But Microsoft successfully appealed the judgement and reached a settlement with the DOJ in 2001.

The Counterpunch: Are 20th century antitrust laws still relevant today? Since Reagan's era, US antitrust laws are based on the "consumer welfare" standard which means that big companies are acceptable so long as consumer's welfare is not negatively affected. And broadly speaking, the price of goods sold essentially constitutes the key component of "consumer welfare".

But in the modern world, the narrative has changed. Today, Big Tech gives away most of their services for free. Facebook, for instance, does not charge consumers for using its services such as Instagram and WhatsApp. Similarly, Google does not charge for the usage of its Google Maps, Gmail, and YouTube apps.

Big Tech, instead, generates revenue through the monetisation of user data by targeted advertisements. So, the counterargument is that regulators should no longer be fixated on how M&A would reduce competition so long prices remain unchanged and "consumer welfare" is not negatively affected.

In fact, Big Tech could potentially benefit consumers and small business via the following means:

- **Provision of free services with significant monetary value:** One of the counter arguments for Big Tech regulation is that consumers actually benefit from Big Tech. A study conducted by the National Bureau of Economic Research attempts to value the services which Big Tech offers to consumers for free by asking the respondents the following question: How much compensation would they require if they were to stop using each service for a year.

  The results are interesting. As Table 2 shows, consumers would expect to be compensated USD17,530 if they were to stop using Internet search engines for a year. Similarly, the refrain from using email for a year would require a compensation of USD8,414 in the eyes of consumers.

  Clearly, the results of this study show that Big Tech companies are actually offering services that are of immense value to consumers, and this serves as a strong counterargument against the assertion that Big Tech is reducing "consumer welfare".

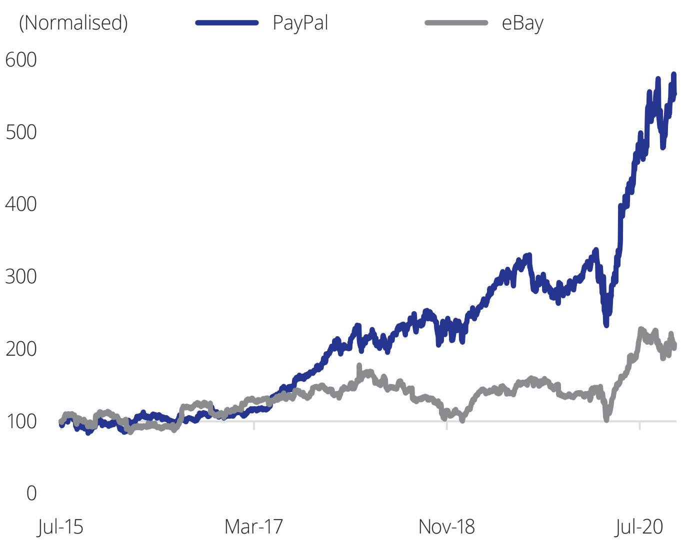
Source: Unsplash

Table 2: Free services provided by Big Tech connote great monetary value

	Compensation required by respondents for forgoing their usage of the following items offered freely by Big Tech for a year (USD)
Search engines	17,530
Email	8,414
Digital maps	3,648
Video streaming services	1,173
e-Commerce	842
Social Media	322
Music	168
Instant Messaging	155

Source: National Bureau of Economic Research, DBS

Figure 8: PayPal has sharply outperformed eBay after spin-off



Source: Bloomberg, DBS

Figure 9: PayPal trading at 222% valuation premium to eBay

Source: Bloomberg, DBS

- **Provision of lower prices and platform access:** As discussed, the enforcement of antitrust laws is contingent on whether consumer welfare is negatively affected. In the case of Big Tech, these companies sought to maintain their dominant position either by offering products at the lowest prices possible (Amazon) or providing their best services for free (Facebook and Google). Moreover, Big Tech also provides a platform for small companies as well as individual sellers to reach a global audience which they would otherwise not have access to. From this perspective, the breaking up of Big Tech could actually impact consumer welfare negatively.

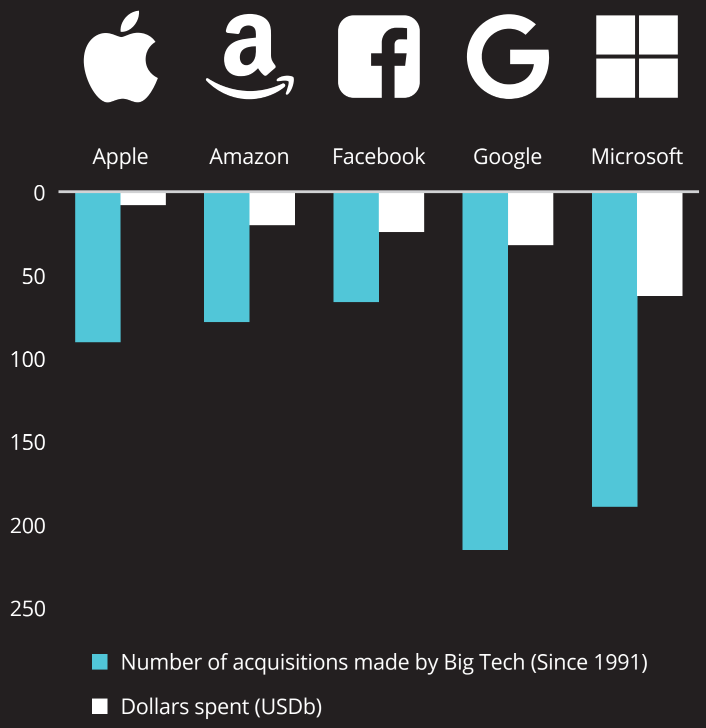
Investment Implications: Stay calm and maintain rationality as a "centrist approach" to Big Tech regulation will likely be the eventual outcome. Given the high octane rally in US Technology stocks this year, the prospects of rising regulation in the US Technology space has unnerved investors. We understand that.

But at the same time, we urge calm and rationality in addressing this topic. For two reasons:

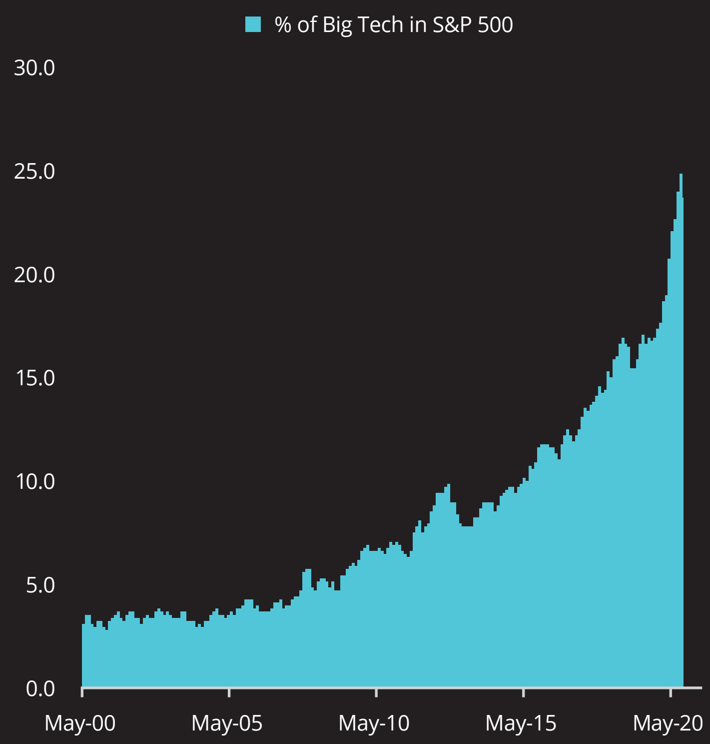
- Rationale 1: The spinning off of a business division in Big Tech may result in value creation for the investor.
- Rationale 2: Prevailing geopolitical realities suggest that policymakers may not be too draconian in their pursuit to regulate Big Tech.

Rationale 1: Value accretion arising from spin-offs: Scott Galloway from New York University has been making the case for the breaking up of Big Tech, arguing that large companies tend to be less innovative and value creating for shareholders as compared to smaller ones.

There are indeed strong merits to this view and one needs to look no further than the share price performance of PayPal after it was spun off from eBay. As Figure 8 shows, PayPal has outperformed eBay by 346% since 6 July 2015 and currently, the company trades at 49.2x forward P/E (a 222% premium to eBay) (Figure 9).



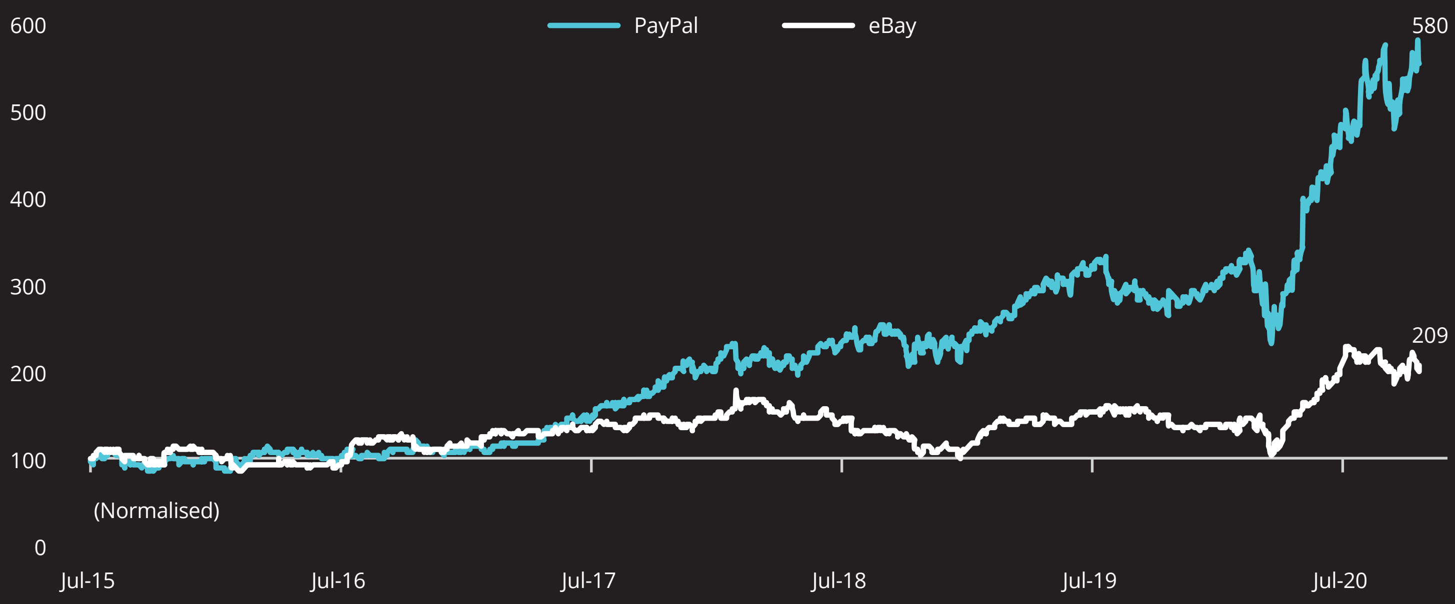
“Big Tech” (Apple, Amazon, Facebook, Google, & Microsoft) accounts for 23% of the entire S&P 500 index



“Kill Zone” Strategies – Whenever a startup is acquired by Big Tech, VC investments in the same space dropped by 46%

WAR ON BIG.Tech

Breakup of Big Tech could be beneficial to shareholders (PayPal has outperformed eBay by 346% since its spinoff)



We believe that the global bifurcation wave, which sees traditional industries getting disrupted by technology companies, will persist in coming years. So even in the event that Big Tech is forced to break up, there are still strong merits in staying invested in its spun-off subsidiaries.

Case study: Valuing Google by using sum-of-the-parts methodology. To take our analysis one step further, we look at how much additional shareholder value could be generated from the breakup of Big Tech using sum-of-the-parts methodology, taking Google for an example.

The two biggest revenue generators of Google are (1) Google Search and (2) YouTube. In our back-of-the-envelope analysis, we look at the price-to-sales (P/Sales) valuation multiples which investors are willing to assign to companies operating in similar segments. From there, we assign the same valuation multiples to the key business segments of Google to obtain basic sanity checks on the company's valuation.

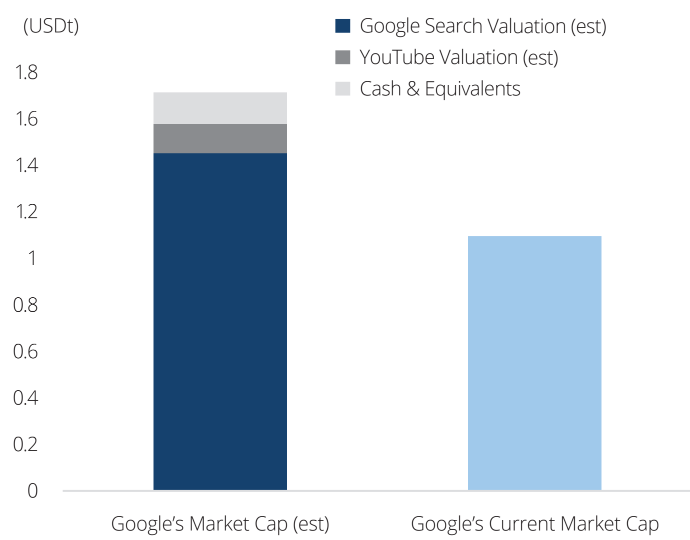
- Google Search vs Facebook: Google's closest rival in the online advertising space is Facebook, which is estimated to generate USD83b in sales for 2020. Facebook's market cap of USD749.4b translates to a P/Sales ratio of 9.0x. Google Search generated USD160.7b sales in 2019. Applying Facebook's P/Sales ratio to this revenue figure will translate to a valuation of USD1.45t for Google Search.

- YouTube vs Netflix: There is no direct comparison for YouTube as it operates on an advertising model while Netflix operates on a subscription model. The subscription-based revenue of YouTube is classified under "Google other revenue" and Google does not provide a granular breakdown for this segment. But despite the difference in revenue model, Netflix is nonetheless closest to YouTube in terms of size and hence it can be a useful gauge for YouTube's valuation.

Netflix is estimated to generate USD25b in sales for 2020. Given its market cap of USD210b, the P/Sales multiple for Netflix stands at 8.4x. Applying Netflix's P/Sales multiple to YouTube's 2019 advertising revenue of USD15.1b results in a valuation of USD127b. To compensate for YouTube's advertising model as compared to Netflix's subscription model (the latter usually connotes a higher valuation given the recurring nature of its revenue), we assign a 10% discount to YouTube and the resulting valuation is USD115b.

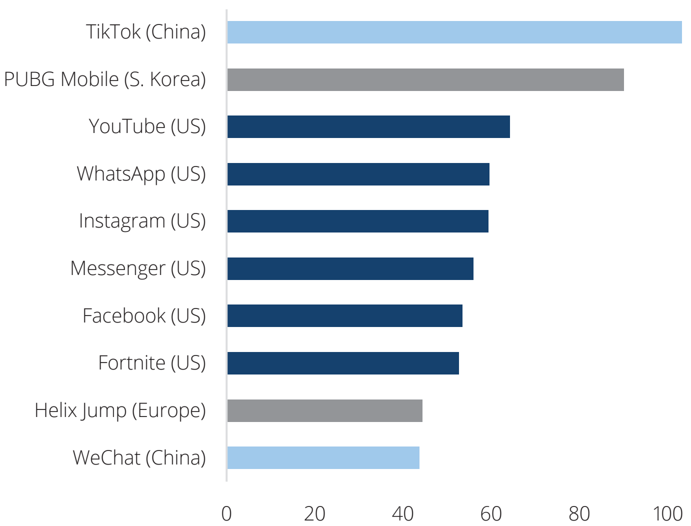
Based on our analysis, the combination of (a) Google Search, (b) YouTube, and (c) Net cash will already translate to a valuation of USD1.5t (vs current market cap of USD1.1t) and this figure has yet to encapsulate revenues from other business segments like Google Cloud and Google Other. The result suggests that the sum of parts might be worth more if the company is spun off into separate entities.

Figure 10: Google's sum of parts is worth more than its current valuation



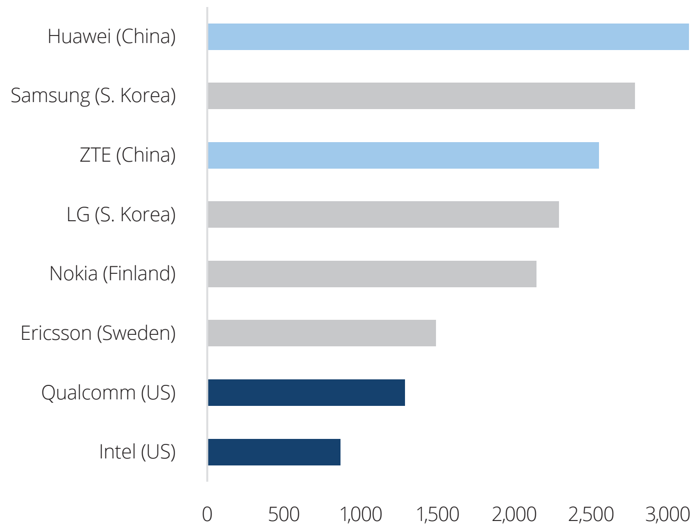
Source: Bloomberg, DBS
*as of 30 October 2020

Figure 11: The rise of China Tech – Worldwide downloads



Source: CNBC, DBS
*Note: this is as of 1H18

Figure 12: The rise of China Tech – 5G patents



Source: ZDnet, DBS
*Note: This consists of declared, filed, and granted patents

Rationale 2: Emergence of the "Digital Iron Curtain" between the US and China: What that started off as a trade war between the US and China has clearly morphed into the fight for global technological dominance. This development is inevitable given rapid advancements made by Chinese technology companies in recent years (Figure 11 and 12) and judging from the steps the US has taken against Huawei, the fight will only intensify in coming years regardless of the US elections outcome.

Coincidentally, just when the US is taking steps to regulate Big Tech, China is also doing the same to their domestic tech giants. Indeed, China's State Administration for Market Regulation has recently announced new regulations to curb monopolistic practices in the Internet industry. These new rules will be built on China's Anti-Monopoly Law which was announced earlier in January 2020.

Caught between a rock and a hard place – Why a centrist approach will prevail. The desire to rein in Big Tech and prevent monopolistic behaviour is not surprising given the dominance of tech companies. But in view of the ongoing fight for global tech dominance between the US and China, we believe that it is not in either countries' strategic interest to undertake excessively draconian steps to break up their tech champions. Instead, we believe that strategic rationality will prevail.

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Glossary of Terms:

Acronym	Definition	Acronym	Definition
ASEAN	Association of Southeast Asian Nations	GDP	gross domestic product
AxJ	Asia ex-Japan	GFC	Global Financial Crisis
B2B	business to business	HIBOR	Hong Kong Interbank Offered Rate
B2C	business to consumer	HKMA	Hong Kong Monetary Authority
bbl	barrel	HY	high yield
BI	Bank Indonesia	IC	integrated circuit
BNM	Bank Negara Malaysia	IG	investment grade
BOE	Bank of England	IOT	Internet of Things
BOJ	Bank of Japan	IPO	initial public offering
BOK	Bank of Korea	ISM	Institute for Supply Management
BOT	Bank of Thailand	IT	Information Technology
bpd	barrels per day	JGB	Japanese Government Bond
BSP	Bangko Sentral ng Pilipinas	KTB	Korea Treasury Bonds
C2C	consumer to consumer	M&A	merger and acquisition
CAGR	compound annual growth rate	MAS	Monetary Authority of Singapore
CFTC	Commodity Futures Trading Commission	MGS/GII	Malaysia Government Securities
CPI	consumer price index	mmbpd	million barrels per day
DM	Developed Markets	NEER	nominal effective exchange rate
DXY	US Dollar Index	OECD	Organisation for Economic Co-operation and Development
EBITDA	earnings before interest, tax, depreciation, and amortisation	OIS	overnight indexed swap
EC	European Commission	OPEC	Organization of the Petroleum Exporting Countries
ECB	European Central Bank	OPM	operating margin
EM	Emerging Markets	P/B	price-to-book
eop	end of period	P/E	price-to-earnings
EPFR	Emerging Portfolio Fund Research	P2P	peer to peer
EPS	earnings per share	PBOC	People's Bank of China
ESG	Environmental, Social, and Governance	PEPP	Pandemic Emergency Purchase Programme
e-Sports	electronic sports	PM	portfolio manager
ETF	exchange-traded fund	PMI	purchasing managers' index
EU	European Union	PPE	Personal Protective Equipment
FCF	free cashflow	QE	quantitative easing
FDA	Food and Drug Administration	R&D	research and development
FDI	foreign direct investment	RBA	Reserve Bank of Australia
FX	foreign exchange	RBI	Reserve Bank of India

Acronym	Definition
RBNZ	Reserve Bank of New Zealand
RCEP	Regional Comprehensive Economic Partnership
RCEP	Regional Comprehensive Economic Partnership
REIT	real estate investment trust
RM	relationship manager
ROA	return on asset
ROE	return on equity
RPGB	Philippine Treasury Bonds
SAA	Strategic Asset Allocation
saar	seasonally adjusted annual rate
SBV	State Bank of Vietnam
SD	standard deviation
SGS	Singapore Government Securities
SIBOR	Singapore Interbank Offered Rate

Acronym	Definition
SME	Small and medium enterprises
SNB	Swiss National Bank
SOR	swap offer rate
SORA	Singapore Overnight Rate Average
TAA	Tactical Asset Allocation
TAM	Total Addressable Market
THBFIX	Thai Baht Interest Rate Fixing
TLTRO	Targeted longer-term refinancing operations
UCITS	Undertakings for Collective Investment in Transferable Securities
UST	US Treasury
WFH	work from home
WTI	West Texas Intermediate
YTD	year-to-date
YTW	yield to worst

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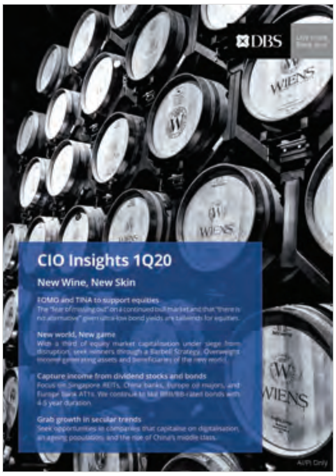

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