DBS Live more, Bank less

CIO Insights 4Q20

On The Mend

Moving to Recovery Phase

Following a sharp recession, we are now beginning to see signs of economic recovery. Further easing of movement restrictions, boost in fiscal spending globally, and zero interest rates will ensure a gradual normalisation in growth trajectory.

Stay Invested through Barbell

The Barbell Strategy has demonstrated resilience and scored well even in this most uncertain period. Stay invested in secular growth equities, income-generating assets, and gold in this new digital world, amid an ultra-low interest rate environment.

Winners from Vaccine Discovery

Given the positive developments in the race to discover a vaccine, add "pandemic victims" like hotels, restaurants, integrated resorts, and beauty industry equities for potential reversion to mean.

Favour Asia, European Credits

BBB/BB-rated credits in Asia and Europe are expected to outperform. In a world where central banks have anchored rates at zero, credit yield spreads would continue to narrow. Maintain average portfolio duration of 5 years.

Source: Unsplash


Source: Unsplash

Contents

Note: Unless otherwise stated, views are as of 17 September 2020.


Source: Unsplash

Executive Summary

Dear valued clients,

We reaffirm our call to stay engaged with risk assets of equities and corporate bonds, in spite of the current global battle against COVID-19.

Since last year, we have been advocating for your portfolio to employ the Barbell Strategy – comprising secular-growth and income-generating investments – that would take advantage of a world transitioning into a digital economy, amid an ultra-low rate environment.

I am pleased to inform you our Barbell portfolio has returned in the high single digits so far in 2020 (as at 19 September), highlighting the efficacy of this strategy.

In this publication titled "On the Mend", we recognise the world is now moving forward from the pandemic. Although the infection rate is not yet falling, we note lower fatality rates as well as favourable outcomes in "flattening the curve" – which lead to health care systems not being overloaded.

Hence, we see a low likelihood of another blanket lockdown. Together with further easing of restrictions on people movement, risk assets are expected to be well bid. Unprecedented stimulus policies, which had put a floor to risk assets in 2Q, are now translating into economic recovery. This is reflected in the expansion of the global manufacturing sector with new orders at its steepest since mid-2018. Improvement in the labour market, however, will take longer as traditional business models will be undergoing restructuring, in response to the world's new normal.

In this quarterly edition, we weigh the market impact from various outcomes of the US presidential election, as well as identify winning investment themes post a vaccine discovery.

I wish you success, and a strong finish to your investing, as we approach the end of this most unusual year.

Hou Wey Fook, CFA
Chief Investment Officer

Live more,
Bank less

Asset Allocation | 4Q20

Rationality,
not blind faith

Macro Outlook

Monetary Policy
G-3 central banks to take a back seat amid limited room for further rate cuts while the pace of asset purchases is reduced as financial conditions normalise.

Economic Growth
Global economy staged a meaningful recovery amid easing of lockdowns. But further gains may prove elusive until a vaccine is made widely available.

Geopolitics
Geopolitical tension between the US and China, which has expanded beyond trade, remains a concern. The November US elections will be closely watched.

Inflation
Inflation expectations on the rebound amid pandemic-related supply crunch and massive stimulus measures. This is in turn driving real interest rates lower.

Fiscal Policy
Fiscal policies to remain loose given resurgent infection waves and moribund macro recovery in the G-7.

Market Outlook

Equities
US outperformance over Japan and Europe to persist. Dollar weakness positive for cyclical sectors, including Technology, Consumer Discretionary, and Asia.

Currencies
DXY to consolidate at current levels on the back of US growth rebound in 2H and yield curve steepening. USD/CNY to range around the 7.00 critical level.

Rates
G-3 yields to move ahead of real economy and to narrow COVID-19 price premium embedded in government bonds. Steepening G-3 curves on the cards.

Credit
Asia credit provides good value to investors on fundamental and valuation grounds. Positive catalysts emerging for European HY.

Highlights
Upcoming US elections to be the most pivotal event impacting markets in 4Q. Outlook for US Health Care and Infrastructure sectors will be closely watched.

Source: Unsplash


Source: Unsplash


Source: Unsplash

Special Feature: US Elections

The upcoming US presidential election will be the single most pivotal event affecting financial markets in the final months of 2020. The outcome of this election will be significant. On the international front, it will determine whether the confrontative state of US-China relationship will persist for another four years, or, will this be replaced by something more predictable and collaborative. Domestically, this election will also determine the trajectory of taxation policy, infrastructure, and health care spending.

Ongoing Theme: Semiconductors

Semiconductors have massively changed our world. An effective angle to ride the digitalisation wave is to invest in upstream semiconductor ecosystems. As the backbone of digitalisation, upstream technology's future is bright, driven by the rising use of AI, IOT, and 5G.

Ongoing Theme: Beyond Pandemic

The COVID-19 pandemic has changed the way we live, work and play completely. Major post-pandemic trends like the diversification of supply chains, rise in alternative meats, more individuals adopting the work-from-home approach, as well as the accentuation of e-Commerce and e-Sports will be the key drivers of growth in the future as consumers and companies adapt to the new normal.

Asset Allocation

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

Rationality, not blind faith

This has to be one of the most unloved rallies in recent years. The scepticism is evident from investors' positioning, which shows institutional money having missed out a large part of the high-octane market rebound since late-March. The fund flows numbers from EPFR Global say it all:

- On a 3-month moving average basis, retail investor sentiment troughed on 25 March (Figure 1) and this coincided nicely with the trough for the S&P 500 on 23 March.
- Sentiment for institutional investors troughed only on 20 May and the S&P 500 had already rallied 33% by then.
- Retail investor sentiment eventually peaked on 24 June after a 36% rebound on the S&P 500. Institutional money, on the other hand, continued to play "catch-up".
- While global risk assets were rallying, institutional investors were parking their funds in money markets (Figure 2).

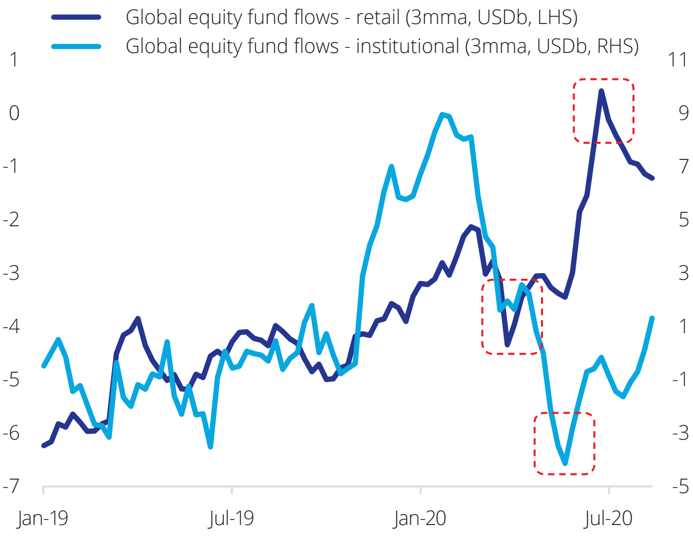
So why have institutional investors not entered the market earlier? The two commonly cited pushbacks are:

a. Fundamentals remain weak and hence the rally is "not sustainable".

b. The rally is led predominantly by retail money and hence, is "not sustainable".

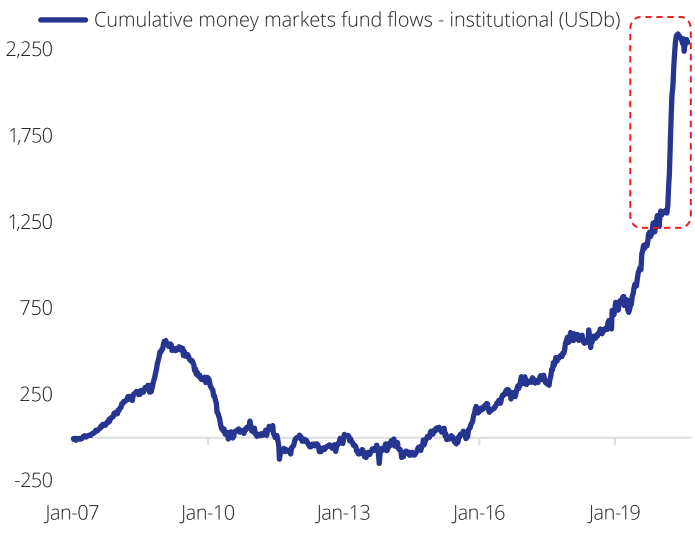
And indeed, sustainable rallies necessitate supportive macro fundamentals. We understand that. But one has to be more discerning in analysing the nature of this selldown compared to previous episodes. In the past, market corrections were

Figure 1: Retail investors correctly timed the market trough; institutional investors late by almost two months



Source: EPFR Global, DBS

Figure 2: "Institutional Angst": smart money investors parked their funds in money markets while risk assets rallied



Source: EPFR Global, DBS

triggered by factors such as irrational exuberance (dot-com bubble) or over-leverage (Subprime Crisis).

This time round, none of those are prevailing.

Instead, the correction was triggered by an exogenous event (a viral infection) which has no bearing on the structure of the economy. So long as the infection curves flatten, economic activities will return to normalcy eventually. This explains why risk assets were correlating more closely with mobility data than official economic numbers during the initial stage of the rebound.

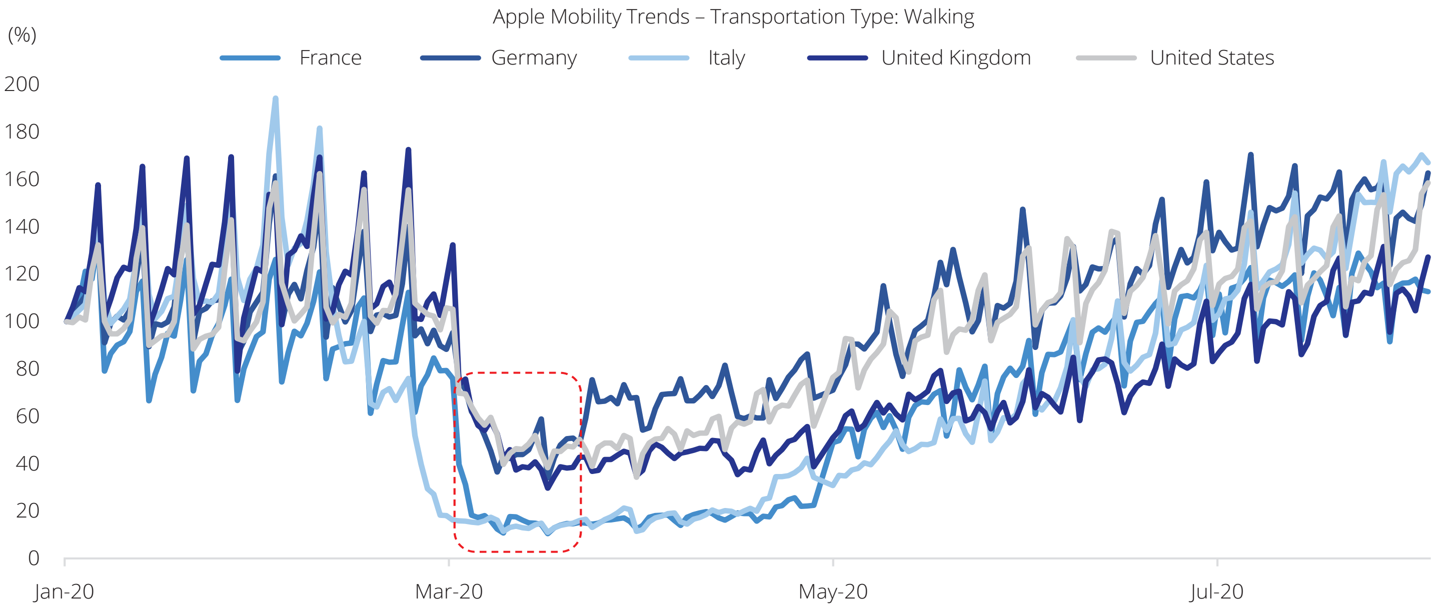
Retail investors caught this trend. But the institutional "smart money" missed the rebound.

The "catch-up" trade; looking beyond the horizon. With macro momentum rebounding and second quarter earnings turning out not as dire as feared, analysts started to do the next obvious thing – revising up their forecasts. As evident from Figure 4, the year-end target as well as forward earnings estimates for the S&P 500 were revised up by 6% and 4% from their respective troughs. Expect more to come.

In the meantime, we maintain a constructive stance on risks assets despite the economic damage caused by the pandemic. The bigger, and more sustained, determinants of market trajectory for the coming quarters, in our view, are:

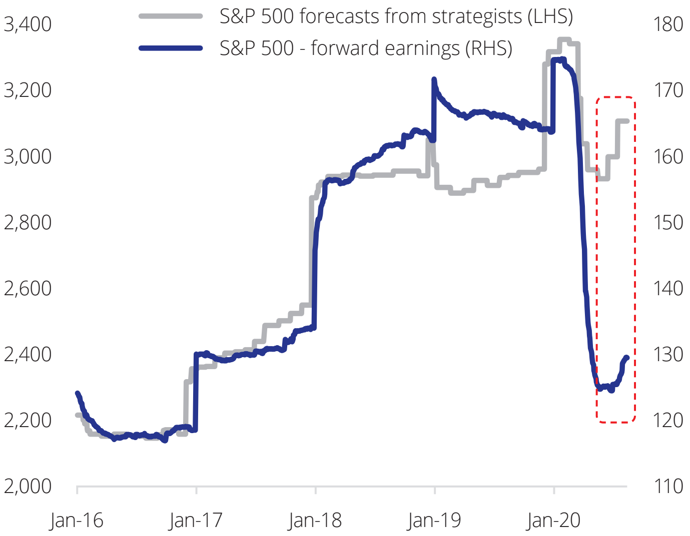
- Excess liquidity
- Structural superiority of Technology

Figure 3: Apple mobility data signalled the trough of market selldown; retail investors rode the upturn



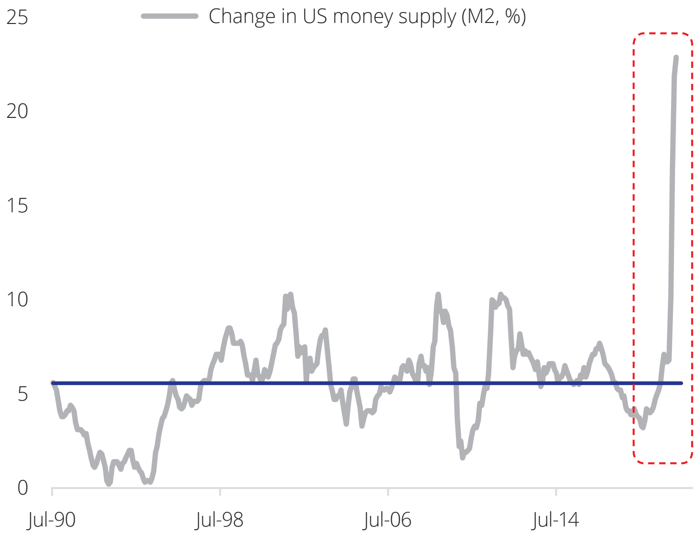
Source: Apple. Mobile Trends Report.
Available from https://www.apple.com/covid19/mobility

Figure 4: Better Late Than Never – upward revisions have started as analysts reassess the nature of this selldown



Source: Bloomberg, DBS

Figure 5: Money supply surged as the Fed eased monetary policy in the wake of the COVID-19 pandemic



Source: Bloomberg, DBS

Excess liquidity (Marshallian K) and risk assets

Let us first touch on the topic of "excess liquidity". Since the start of the COVID-19 pandemic, the US Federal Reserve has unleashed an unprecedented bout of QE. Based on Bloomberg Economics, the current QE is estimated at USD3.3t and this is almost equivalent to the total amount spent for QE1, QE2, and QE3 combined. Given the speed and magnitude of the latest monetary easing, M2 money supply growth surged to a high of 22.9% y/y in June, as compared to the long-term average of 5.6% y/y (Figure 5).

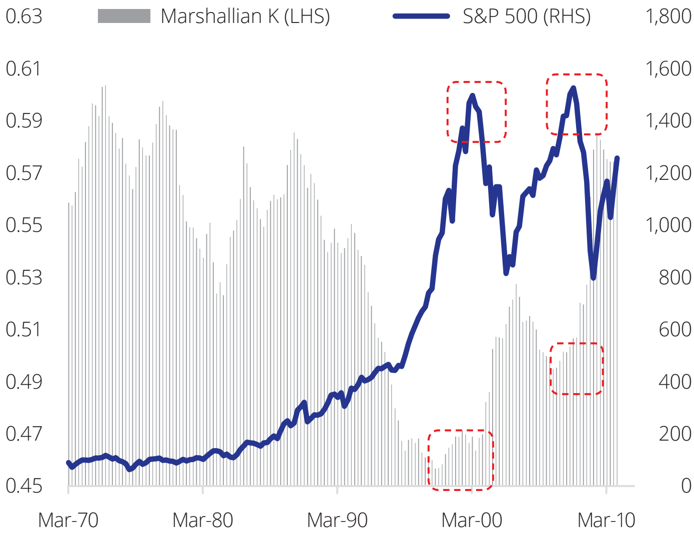
The sharp gains in money supply, meanwhile, is translating to rising excess liquidity – which is defined as the ratio of money supply over nominal GDP (the "Marshallian K"). This theory assumes that money aggregates that are not utilised in the real economy will be channelled into financial assets. Figure 6 shows that the Marshallian K ratio has broadly trended in tandem with US equities since the 1990s.

Source: Unsplash

Figure 6: Broad-based correlation between Marshallian K and US equities over the years

Source: Bloomberg, DBS

Figure 7: The fall in excess liquidity has previously sown the seeds for previous market corrections



Source: Bloomberg, DBS

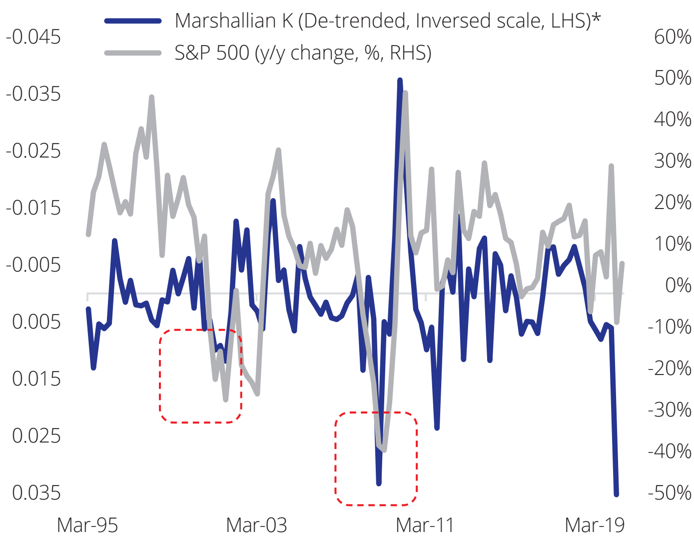
Further analysis of the Marshallian K ratio unveiled the following points:

- Sustained declines in excess liquidity contributed to previous market corrections
- The peak in excess liquidity signals an equity market trough

The robust equity rally seen in the 1970s and 1980s coincided with strong excess liquidity in the system (Figure 7). For instance, by the time the dot-com bubble burst in 2000, the Marshallian K ratio had already hit a low of 0.47. The same situation happened in the run-up to the Subprime Crisis as excess liquidity started to pull back since late-2003 and remained subdued until the crisis struck. In this regard, the current high level of excess liquidity in the system suggests that the ongoing rally is well supported.

For greater granularity, we detrended the dataset and compared it with the y/y change for the S&P 500. It is evident that the peak for excess liquidity in the system has historically coincided with the trough of the US equity market (see Figure 8). Again, the current toppish level for the Marshallian K ratio may also imply that the worst of the pandemic is behind us.

Figure 8: Historically, the peak of excess liquidity coincides with an equity market trough



Source: Bloomberg, DBS
* The Marshallian K chart is truncated in this figure

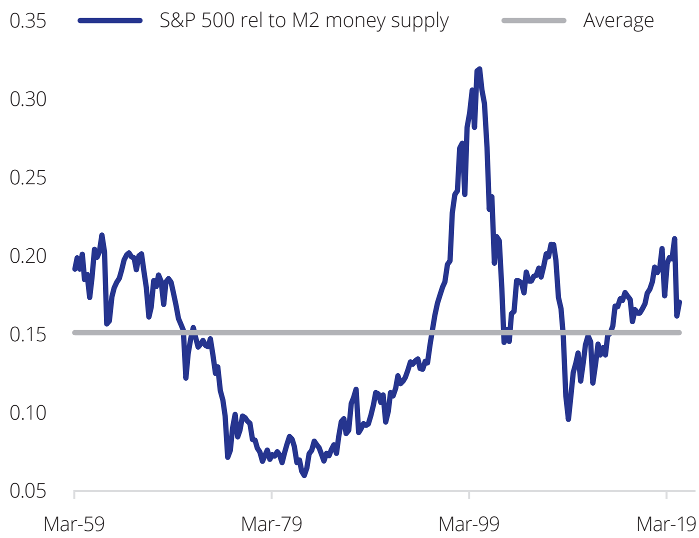
Given the strong market rally since late-March, a natural question will be "Is the rebound excessive"?

Indeed, there are concerns surrounding the sustainability of this rebound given the fragile economic backdrop. But past market cycles show that fundamentals are only one of the factors driving equity markets. Liquidity matters too. Figure 9 shows that the S&P 500 as a proportion of M2 money supply is currently broadly in line with its long-term average.

Resilience and dynamism of Technology sector

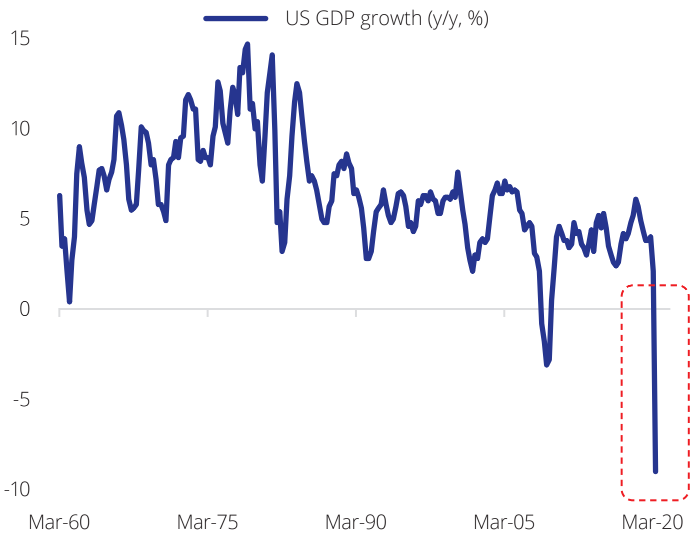
We touched on the topic of global bifurcation in the 3Q20 CIO Insights. Back then, we argued that the COVID-19 pandemic will accelerate paradigm shifts in business models around the world and the technology space will be a geared beneficiary of this development.

Figure 9: The US equity market as a proportion of money supply is currently not looking excessive



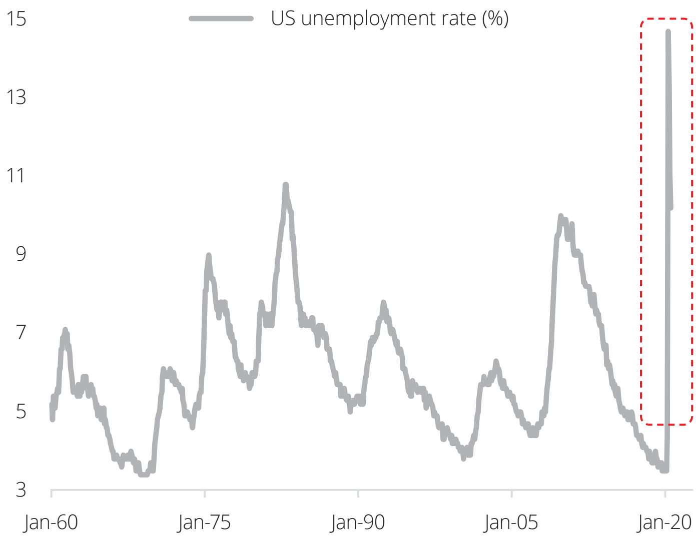
Source: Bloomberg, DBS

Figure 10: US GDP growth plunged amid economic lockdowns and stoppages of business activities



Source: Bloomberg, DBS

Figure 11: US unemployment rate surged to an all-time high



Source: Bloomberg, DBS

Taking this argument one step further, it is also evident that global bifurcation, and by extension, the rise of technology companies, are the very reasons why the current rally is so resilient. The apparent dynamism of technology companies during the pandemic reinforced this view.

To recap, the second quarter of 2020 represented the "worst of times" for the US economy. This is a quarter that saw:

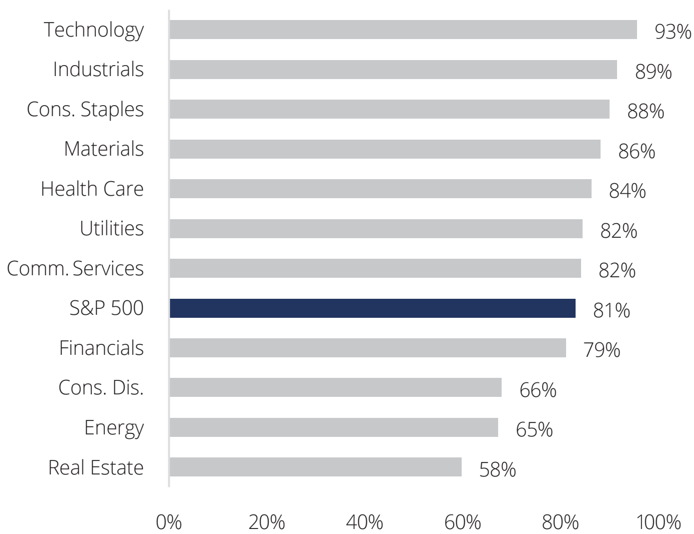
- US GDP contracting by 9.0% y/y (in 2Q20)
- ISM Manufacturing plunging to a low of 41.5 (in April)
- Unemployment rate surging to 14.7% (in April)

A natural assumption would be for 2Q20 corporate earnings to be equally downbeat. But surprisingly, Corporate America has proved to be much more resilient than expected.

In the 2Q20 reporting season, 80% of companies managed to report positive earnings surprise and robust momentum was seen in Technology (at 93%); granted that the aggressive downgrades in earnings forecast during the pandemic (which inevitably "set the bar lower") was one of the factors behind the robust showing. However, this does not tell the complete picture.

Investors should instead focus on the fact that 44% of companies still managed to deliver actual earnings growth despite dismal business conditions during the economic lockdown. This level is not significantly far from the 50% rate reported in the previous quarter and it underlines the overall resilience of Corporate America.

Figure 12: Technology registered the highest proportion of positive earnings surprise



Source: Bloomberg, DBS

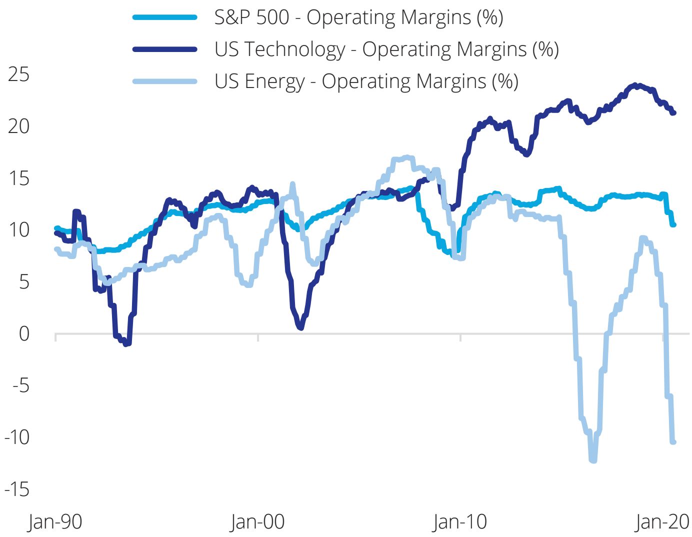
A breakdown of the list of companies that reported positive earnings growth unveiled one interesting fact: while the companies (ex-Technology) registered earnings growth of 44% on average, the growth for tech companies came in higher at 50%. This suggests that tech companies are resilient even in the worst of times.

An analysis of the underlying operational matrix for Technology provides an explanation for this phenomenon:

- Robust Operating Margins: Back in December 2004, the OPM for the S&P 500, Technology, and a traditional industry like Energy were similar in the 13% range. That was the pre-bifurcation era. By 2009, things started to evolve.

  The OPM for Technology trended higher from 12% in May 2009 to 21% currently (+9%pts). On the other hand, OPM for the broader market only rose moderately from 8% to 11% (+3%pts). At the other extreme, the OPM for Energy, a disrupted sector, plunged 23%pts (Figure 13).

Figure 13: Rising OPM for Tech companies suggests improving pricing power and operational cost control

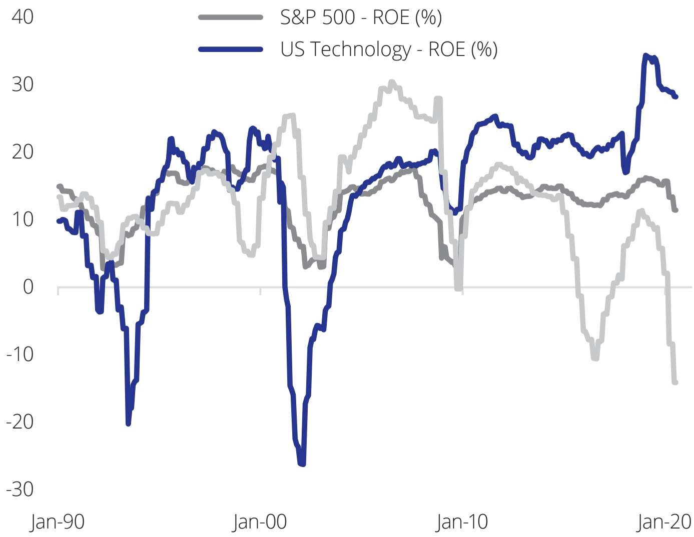


Source: Bloomberg, DBS

- Attractive ROE: The ROE for the S&P 500, Technology, and Energy were in the 11-17% range back in May 2004. Again, things started to diverge markedly after the Subprime Crisis. From April 2009, ROE for Energy plunged 25%pts while the broader market registered gains of 7%pts. ROE for Technology, however, surged 16%pts (Figure 14).

  A rising ROE suggests that Technology companies are utilising their equity capital efficiently. Using DuPont analysis, we conclude that the ROE gains came on the back of rising earnings margin and equity multiplier.

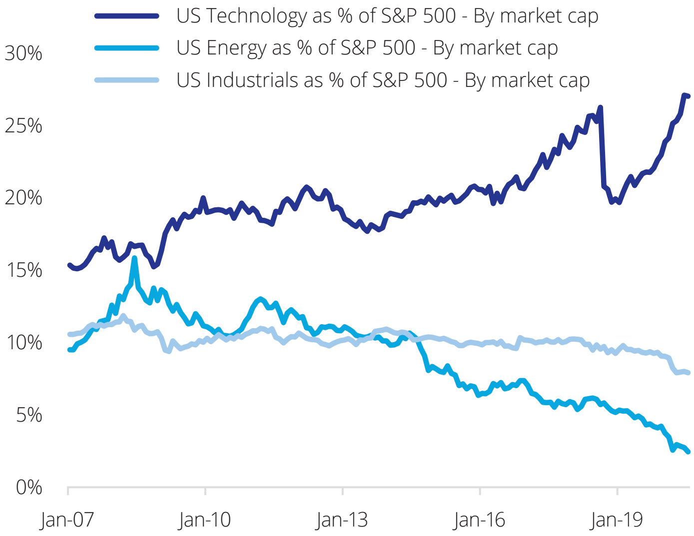
Figure 14: Rising ROE for tech stemmed from rising earnings margin and equity multiplier



Source: Bloomberg, DBS

The exceptional investment merits of US Technology augur well for the outlook of the S&P 500 given rising significance of the sector within the index. On a market cap basis, US Technology accounts for 27% of the S&P 500 today (vs 15% in December 2008). On the other hand, a traditional sector like Energy accounts for only 2% of the index (vs 13% in December 2008) (Figure 15).

Figure 15: Technology accounting for a rising proportion of S&P 500



Source: Bloomberg, DBS

Rising significance of Technology explains why US equities managed to grind higher despite weak macro data (which is likely have a greater impact on traditional sectors like Industrials, Energy, and Materials). Technology companies possess the ability to maintain their profitability even when business conditions deteriorate, underpinning the sector's resilience through the cycles.

Source: Unsplash

Pivotal events in the fourth quarter: US presidential election and COVID-19 vaccine

As we move into the final quarter of 2020, there are two developments which investors should keep an eye on: (a) the US presidential election and (b) a vaccine discovery.

US presidential election: The US presidential election is scheduled to be held on 3 November 2020 in conjunction with the Senate and the House of Representatives elections. Based on an opinion poll by FiveThirtyEight, Democrat Joe Biden currently has a 52%pts spread over incumbent Republican Donald Trump in the national poll (76% vs. 24%) (as of 15 September 2020). But as we have seen in past elections, the situation remains dynamic and anything can happen on polling day. From a financial markets' perspective, we believe that the November elections will be largely neutral for risk assets due to the following reasons:

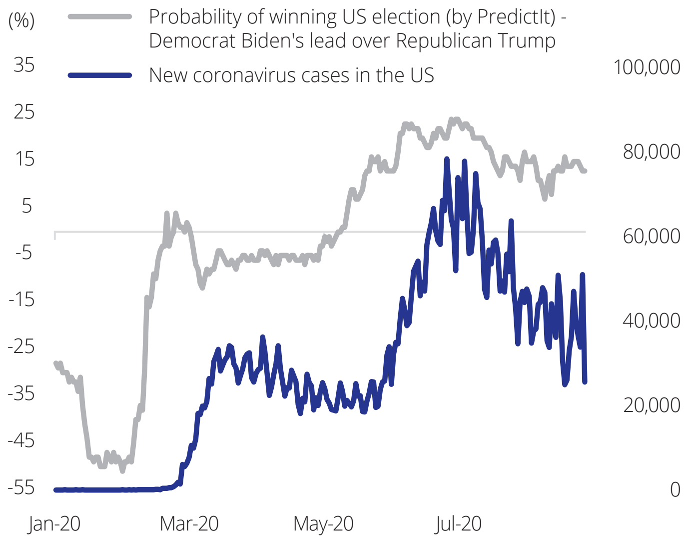
- A Republican victory in the presidential election will mean status quo for financial markets. While risk assets may get a lift from further taxation cuts, Republican Trump's combative style in foreign policy will weigh on overall sentiments.

- A Democrats victory in the presidential election does not spell disaster either as risks assets have historically undergone strong rallies during a Democratic presidency over 6-, 12-, and 24-month periods.

  In fact, market's concerns over the Democratic Party's left-leaning tendencies were largely dispelled given Democrat Biden's choice of Kamala Harris as running mate (as opposed to Elizabeth Warren, for instance).

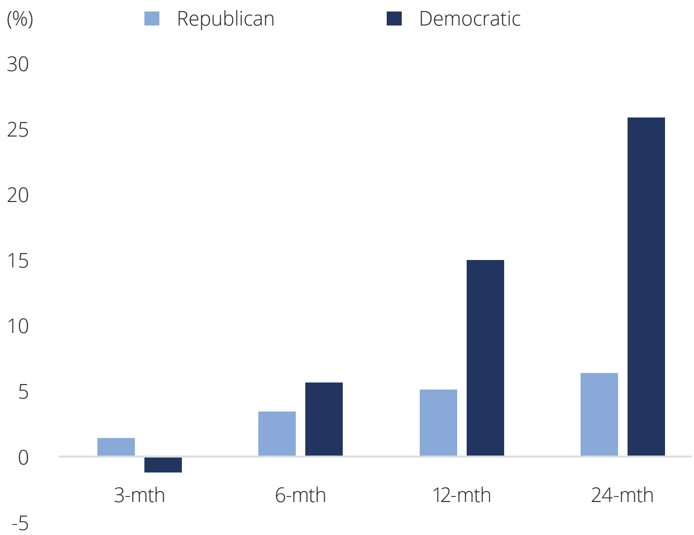
The best outcome for risk assets will entail the following scenarios: (a) Democrats win the presidential election and (b) Republicans keep the Senate. This outcome will ensure that the proposed tax hikes will not be passed in the Senate (hence limiting the impact on corporate earnings). On the other hand, a Biden Administration will likely maintain a firm but less unpredictable stance towards China and this is positive for risk sentiments.

Figure 16: Situation remains fluid and anything can happen on polling day



Source: Bloomberg, DBS

Figure 17: The S&P 500 has historically registered stronger gains during a Democrats presidency



Source: Bloomberg, DBS

Vaccine discovery. Based on recent news flow, the race to develop a vaccine for the coronavirus is bearing fruit. Russia, for instance, announced that it has granted regulatory approval to a COVID-19 vaccine while a vaccine jointly developed by Moderna Inc and the US National Institute of Health could also be ready by November.

In other words, the plausibility of a COVID-19 vaccine is no longer a matter of if, but when. Based on forecasts by Good Judgement, the probability of broad-based treatment by a FDA-approved COVID-19 vaccine in the US (by 4Q20-1Q21) stood at only 5% on 1 May. The probability has shot up to 61% (as of 16 September 2020).

Indeed, should a vaccine be approved in coming months, it will provide an uplift for risk assets in general. But the positive impact will not be uniform as some industries will benefit more than the others:

- Restaurants, hotels, casinos, and leisure – poised for strong rebounds: Given the highly contagious nature of the coronavirus, industries that require face-to-face human interactions were among the hardest hit during the pandemic. The main casualties include companies operating in the restaurants and casinos space. But with the plausibility of a vaccine by year-end, we believe that this segment could undergo a substantial rebound.

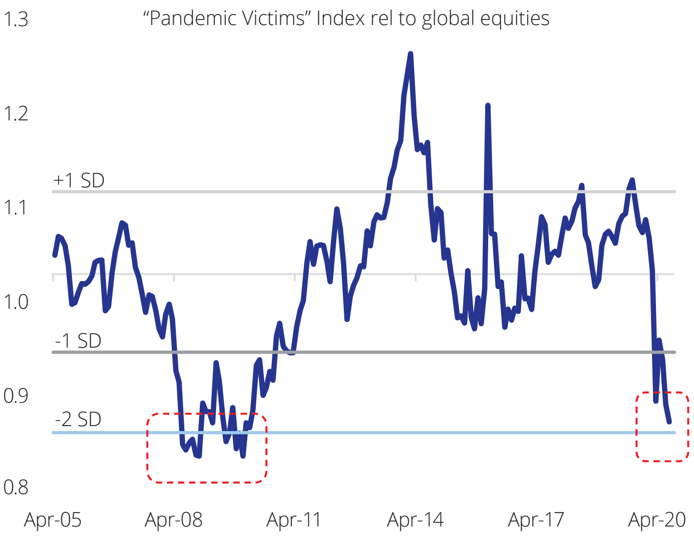
  As Figure 18 shows, the "Pandemic Victims" Index (which consists of companies in the hotels, restaurants, casinos, and leisure space) has markedly underperformed global equities since the start of 2020. The underperformance is approaching the -2SD mark – a level last breached after the subprime crisis in 2009. With a vaccine on the way, a reversion to the mean is highly likely.

- Airlines – more structural pains ahead: The coronavirus has caused air travel demand to collapse across the board with airline companies grounding the bulk of their fleets. But even with a vaccine round the corner, we believe that the pandemic has already caused structural damages to air travel, in particularly business travel.

  The pandemic has demonstrated that online meetings are equally effective and this reduces the necessity of business travel in future. Besides, should business travel resume, the demand for "business class" seats (which is the main revenue generating segment for airlines) will likely be muted given the state of the global economy.

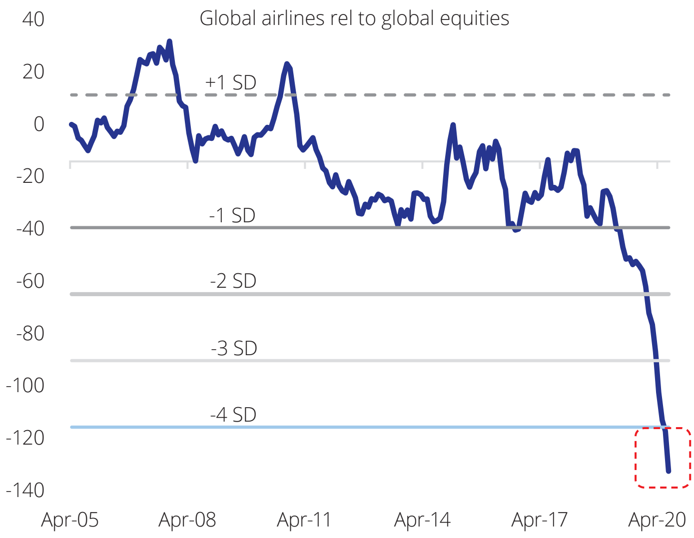
  Figure 19 shows that the relative price performance of global airlines relative to global equities has collapsed beyond the -4SD level. This suggests that investors are pricing-in potential structural changes to the industry. A cautious stance is warranted.

Figure 18: Companies in the hotels, restaurants, casinos, and leisure segments are poised to rebound if a vaccine comes along



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

Figure 19: The global airline industry is facing structural damages caused by the pandemic



Source: Bloomberg, DBS

4Q20 Asset Allocation – Broadening rally

Table 1: CIO Asset Allocation (CAA) Framework – 4Q20

Categories	Indicators	Score Range	Equities				Bonds		
			US	Europe	Japan	AxJ	DM Govt	DM Corp	EM Bonds
Fundamentals	PMI	-1 to +1	-1	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	0	0
	Forecasted EPS growth	-2 to +2	0	0	0	0	-	-1	-1
	Earnings surprise	-2 to +2	1	0	0	0	-	0	0
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	1	0	1	1
	Volatility	-1 to +1	0	0	0	0	0	-	-
	Catalysts	-2 to +2	1	1	1	1	0	0	0
Raw Score			2	0	2	6	-1	-1	3
Adjusted Score*			**0.10**	**0.00**	**0.10**	**0.29**	**-0.09**	**-0.06**	**0.19**

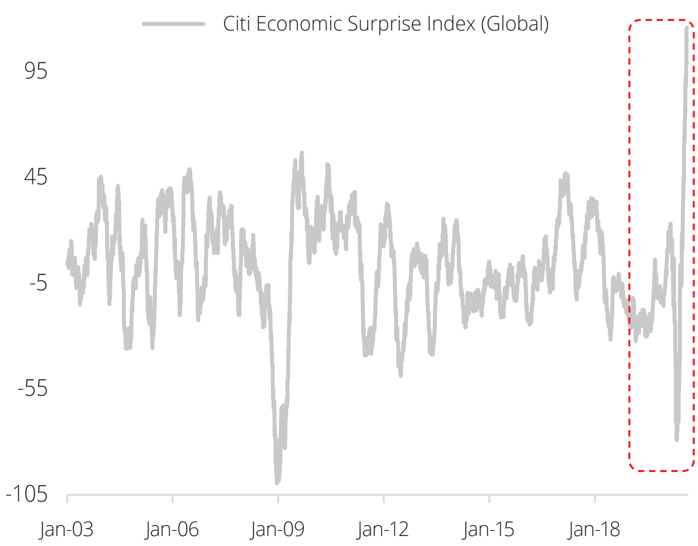
*Note: The "Adjusted Score" is calculated using the "Raw Score" divided by the maximum attainable score for each category. Source: DBS

Cross Assets – equities remains as the "only game in town" in a low-yielding world. From a cross-assets perspective, we keep our preference for equities over bonds. In our CAA Framework, equities garnered a higher composite score of 0.12, as compared to 0.01 for bonds.

Fundamentals: As the virus infection curve continues to flatten while economic reopening gathers pace globally, we expect overall macro momentum to improve at the margins. The potential discovery of a vaccine will provide a much-needed boost for industries that require "face-to-face" human interactions, such as the restaurants, hotels, casinos, and leisure space.

The second quarter of 2020 was clearly the trough for global economic momentum. We expect a sequential rebound in the remaining months of the year as business activities return to normalcy. The Citi Economic Surprise Index (Global) currently stands at 115.9 and this is the highest level attained since the series started back in 2003 (Figure 20).

Figure 20: Global economic surprises have surged ahead



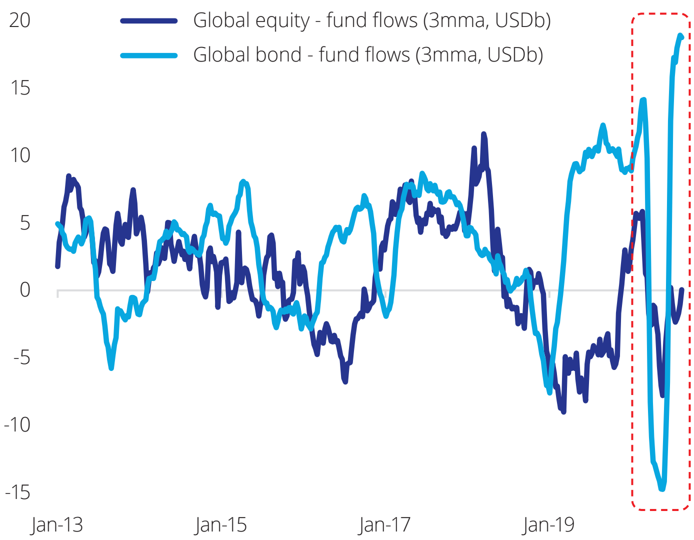
Source: Bloomberg, DBS

Valuation: On a cross-asset basis, the 3.1% gap between earnings yields and Treasury yields suggest that equities, as an asset class, remains more attractive than bonds.

Momentum: On cross-asset flows, USD31b exited from global equities this year (as of 12 August) while USD172b entered the bonds space. But looking at these flow data on a YTD basis does not tell the full picture. Instead, we have to analyse them from two different time frames: (1) Market selldown (January-March) and (2) Market rebound (April till present).

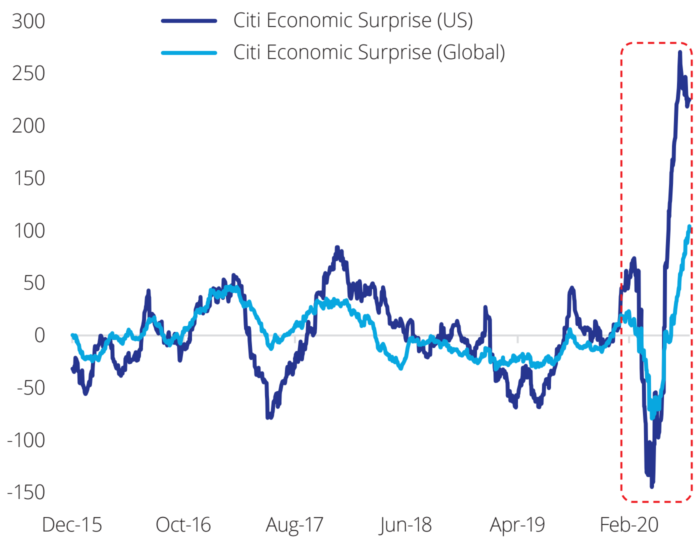
The bulk of the outflows for equities took place during January-March (at USD34b). But since April, equities has seen net inflows of USD2b. This suggests that market sentiment is at an inflexion point. Instead, the bonds space has seen a huge inflow of USD279b since April, vastly superseding the USD107b outflows registered during January-March. With interest rates anchored to the lows, investors' search for yield via bonds persists.

Figure 21: Investors have poured more funds into bonds than equities since the market troughed in March



Source: EPFR Global, DBS

Figure 22: US economic momentum has rebounded sharply



Source: Bloomberg, DBS

Equities: US equities to maintain cyclical leadership. The 2Q20 earnings reporting season was a watershed moment. It was a quarter which divided the haves from the have-nots. A quarter which separated the strong companies from the weak ones. Technology, clearly, emerged to be the standout performer during the quarter and one need not look further than the robust performance by industry bellwethers like Amazon.com Inc and Apple Inc. The post-pandemic landscape of social distancing and heightened online activities accentuated the dominance of these companies.

From a relative geographical perspective, we maintain our conviction view on US equities given:

- High exposure to Technology: We believe portfolio allocators will continue to build long-term positions in US Technology companies to prepare for the post-pandemic world of rising online activities. Outside of Technology, it will take some time before business investments and consumer demand return to normalcy and this will weigh on traditional sectors like Materials and Utilities.
- Stronger macro momentum: US macro momentum has undergone a sharp rebound and this is evident from Figure 22. The plausibility of a vaccine discovery for COVID-19, coupled with the US government's effort in securing supply for themselves, augurs well for the outlook of business activities resuming in the country.

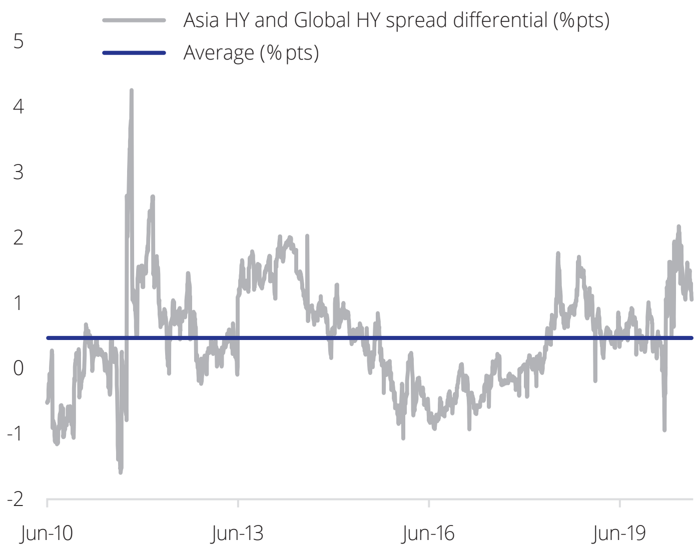
Bonds: The search for yield continues; prefer European HY over US HY. Despite the broad-based rebound in the US economy, we believe that the US Federal Reserve will err on the side of caution and maintain monetary accommodation amid muted inflation and lingering uncertainties from the pandemic. With long-term bond yields staying anchored to the lows, the global search for yield will persist in coming quarters.

On the credit front, we maintain a preference for Europe in the DM HY space given the region's stimulus agreement and flattening virus curve. Asia HY, meanwhile, stays attractive as the current spread of 6.6% is still implying default rates that are wider than projected. Moreover, the spread differential of 1.1%pts between Asia and Global HY remains above the long-term average (Figure 24).

Figure 23: Sharp rebound in US momentum is translating to outperformance in the equity markets

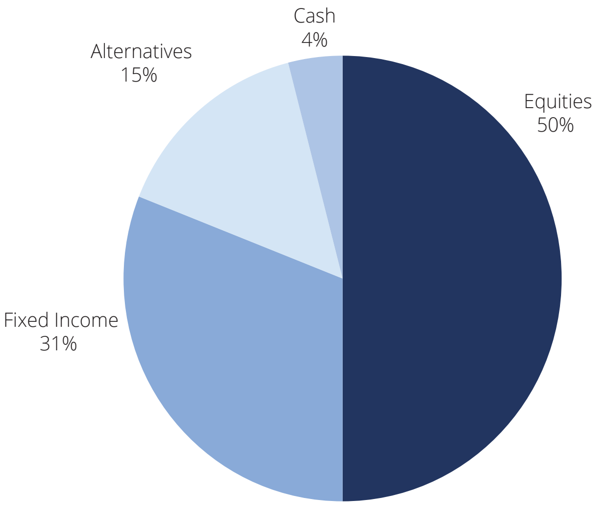
Source: Bloomberg, DBS

Figure 24: Asia HY maintains an attractive spread differential over Global HY



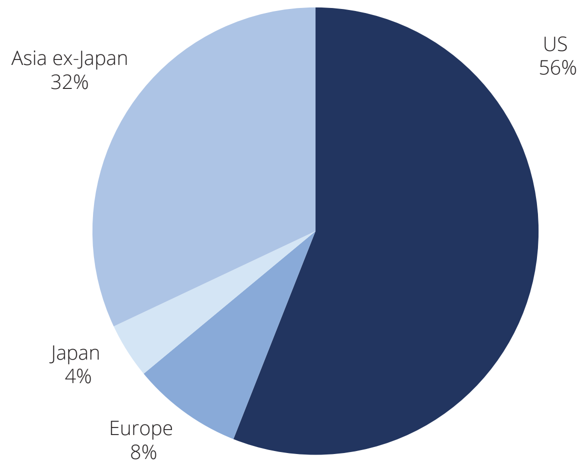
Source: Bloomberg, DBS

Figure 25: TAA breakdown by asset class (Balanced Profile)



Source: DBS

Figure 26: TAA breakdown by geography within equities (Balanced Profile)



Source: DBS

Table 2: 4Q20 Global Tactical Asset Allocation (TAA)

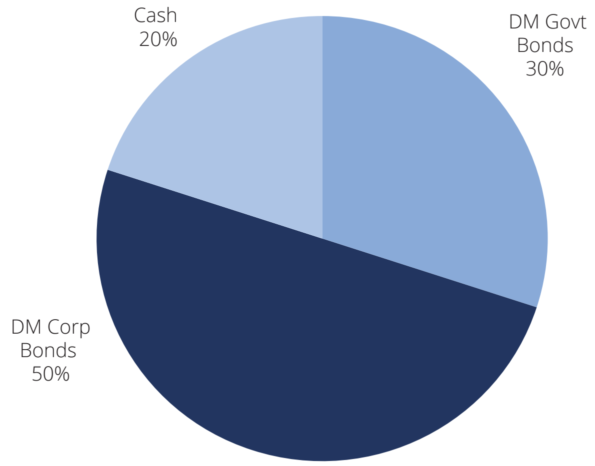
Asset Class		
	3-Month Basis	12-Month Basis
Equities	**Neutral**	**Neutral**
US Equities	Overweight	Overweight
Europe Equities	Underweight	Underweight
Japan Equities	Underweight	Underweight
Asia ex-Japan Equities	Overweight	Overweight
Fixed Income	**Underweight**	**Underweight**
Developed Markets (DM) 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

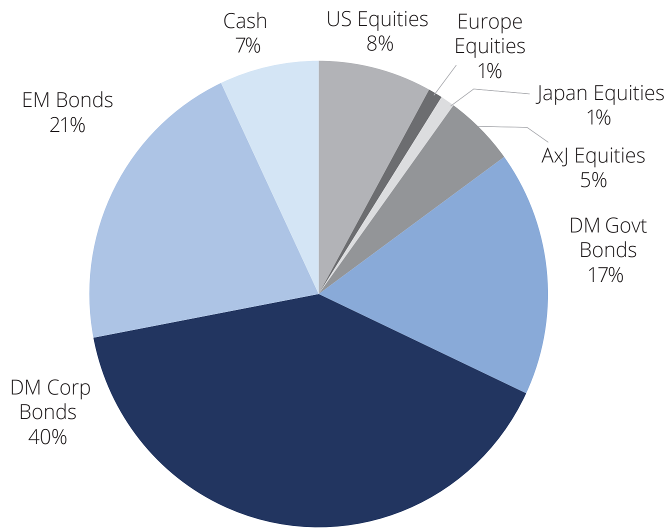


Source: DBS

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

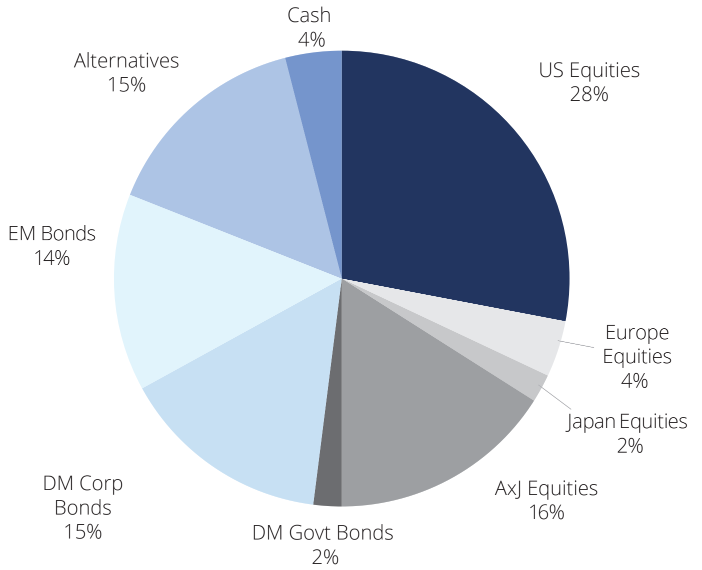


Source: DBS

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

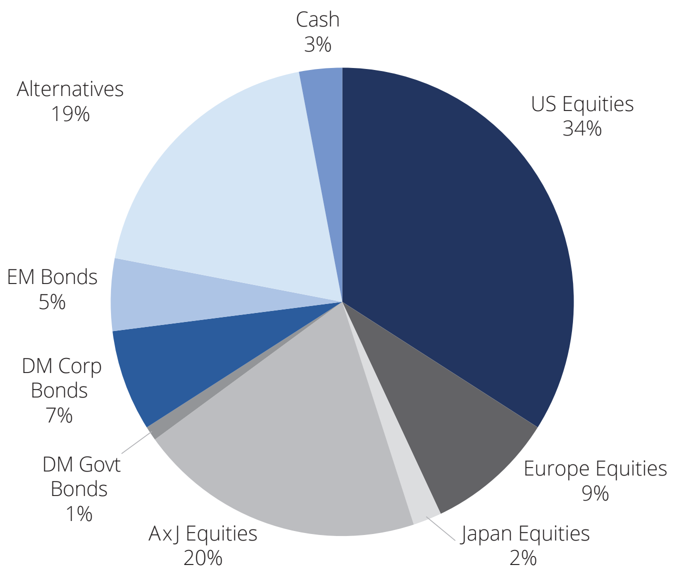


Source: DBS

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 | 4Q20

Inflation at inflexion

Global Macroeconomics

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

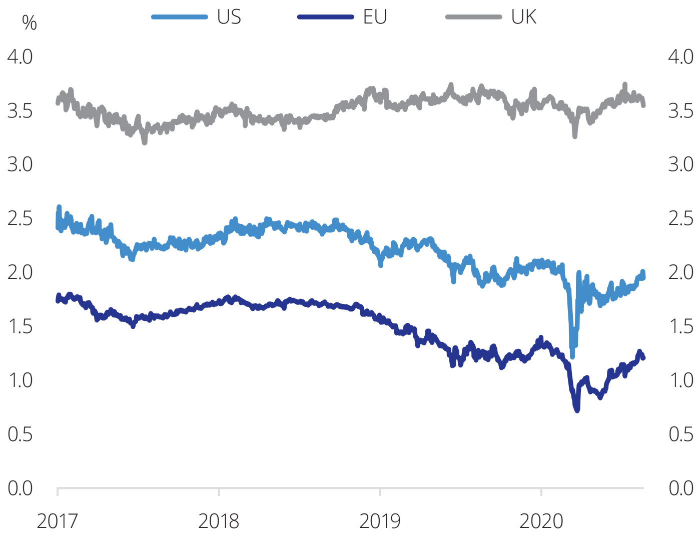
United States: "Good" vs "bad" inflation

A pandemic-related supply crunch and massive monetary and fiscal stimulus measures have had only a modest impact on inflation expectations so far, but things could be changing. US five-year forward five-year inflation swap rate, a measure of expected inflation (on average) over the five-year period that begins five years as of late-August, hit 2.0% recently. This is quite a turnaround from the bottom of 1.2% reached in March, when global markets were under considerable stress with the COVID-19 pandemic spreading swiftly. Inflation expectations in the UK and Euro Area have also displayed similar trajectory in recent months.

The upshot of a rise in inflation expectation is a concomitant decline in real interest rates. The US 10-year government bond has seen a decline in nominal terms in recent months; combine that with a rise in inflation expectations, real 10-year yield is now hovering around a low of -1%. Despite all the lingering uncertainties about the outlook, such low rates have helped the market for residential mortgages, improved corporate sector debt service capacity, pushed down the USD, and eased overall financial conditions.

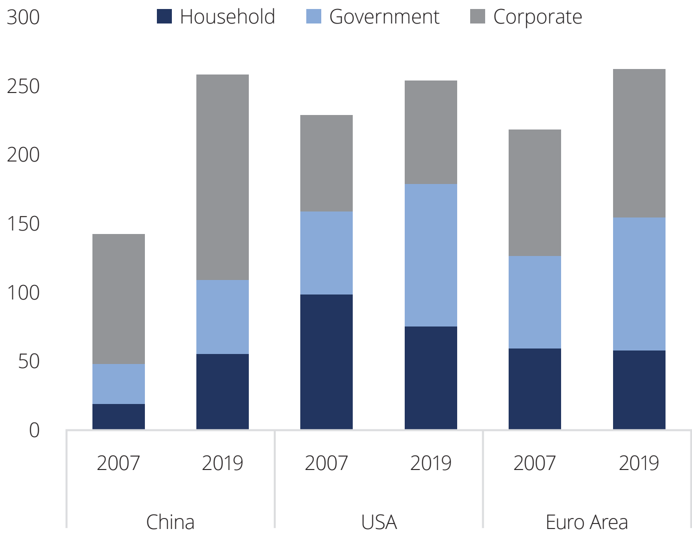
A world beset with low growth and high debt burdens could do with a healthy dose of inflation. The thrust of G-3 monetary policy over the past dozen years has been to mitigate deflationary risks. After pricing in a resurgence of such risks in March, markets have responded favourably to the seismic easing measures put in place since then. So, could some inflation be around the corner?

Figure 1: G-3 inflation expectations have bottomed



Source: Bloomberg, DBS
Note: Market-based expectations of long-term inflation based on 5Y forward 5Y inflation swaps

Figure 2: Debt/GDP ratio in China, EU, and US, by sector

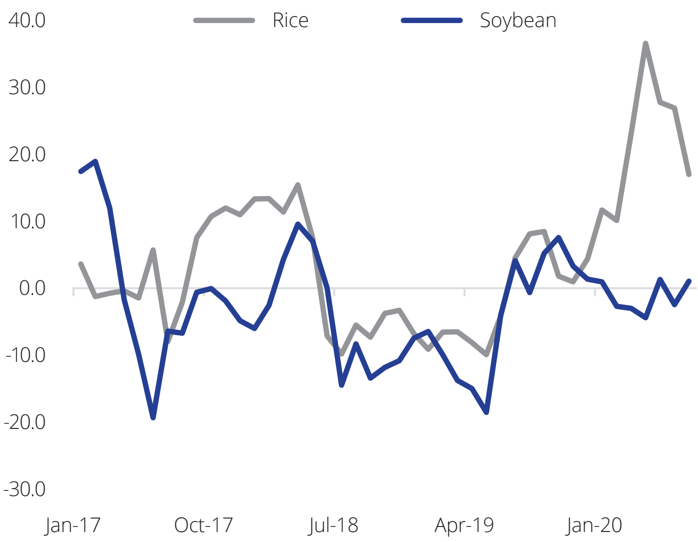


Source: IMF, DBS

Not all inflation is the same – there is "good" and "bad" inflation. Good inflation could come from successful monetary policy action. If interest rate cuts and liquidity injections push up bond prices, it would signal demand for debt. That could perk up the credit channel. As the higher borrowing translates into an increase in consumption and investments, there ought to be a rise in prices.

Good inflation can also come from successful public investment. Properly targeted investment in infrastructure, jobs training, and technology promotion can boost employment and productivity, which in turn push up returns on capital, workers' wages, and consumer demand. If some of the large-scale public sector deficits being run presently by the fiscal authorities worldwide are directed towards green initiatives and filling investment gaps in transportation, communication, health, and education, some good quality growth and inflation would be on the horizon.

Figure 3: Rice prices firmed around supply crunch earlier this year (%, y/y)

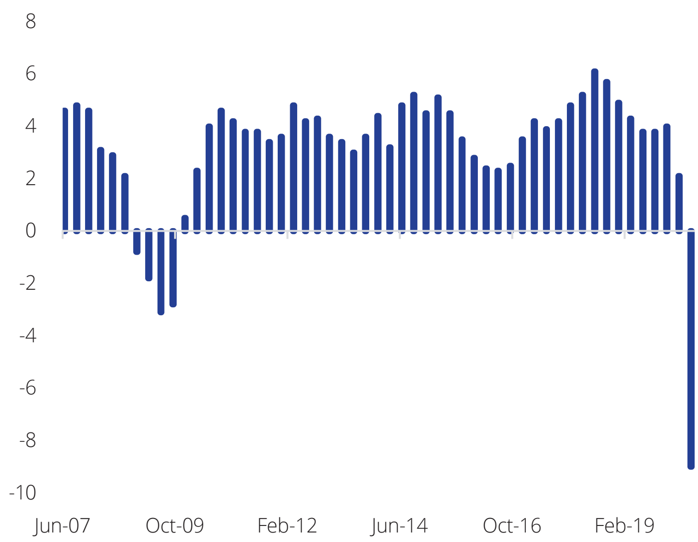


Source: IMF, DBS

In contrast, bad inflation can come from supply shocks. Lately, prices of some products (such as processed foods, cleaning material, and protective gear) have jumped owing to a pandemic-led demand spurt and supply shortages. Bad inflation can also stem from poor policy, ranging from protectionism to nationalism, that reduces competition and introduces a wide range of distortions in the production process and supply chain.

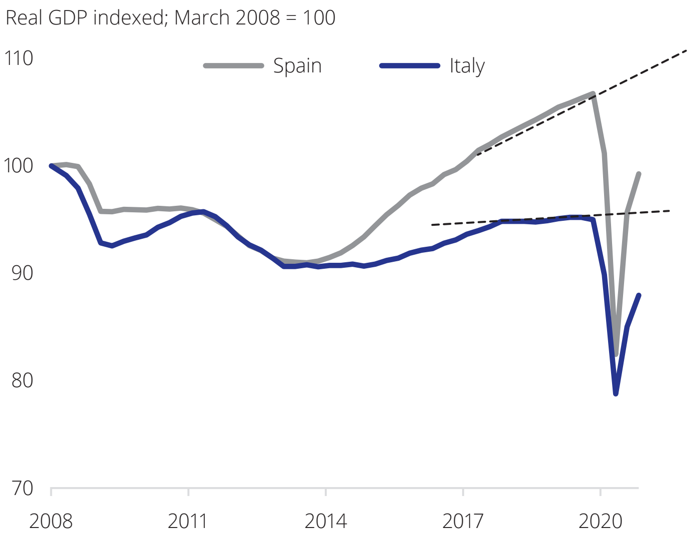
Markets are pricing in a slight rise in inflation expectations, but is it the good or bad sort? We are afraid there is not much in the pipeline that makes us optimistic about better growth, demand, and higher wages, which could in turn cause good inflation. There are however, plenty of drivers of bad inflation. If the world has to live with physical distancing while using protective gear for years to come, prices of restaurant meals, hotel stays, and air travel are bound to go up. This would take place amid massive liquidity injection and frothy asset prices, adding fuel to the dynamic that sees prices go up. Several years of the pandemic will also cause bankruptcies, constraining supply. Pessimistic investors could hold off investments, further scaling back capacity. Watch out for such markers.

Figure 4: US nominal GDP (%, y/y)



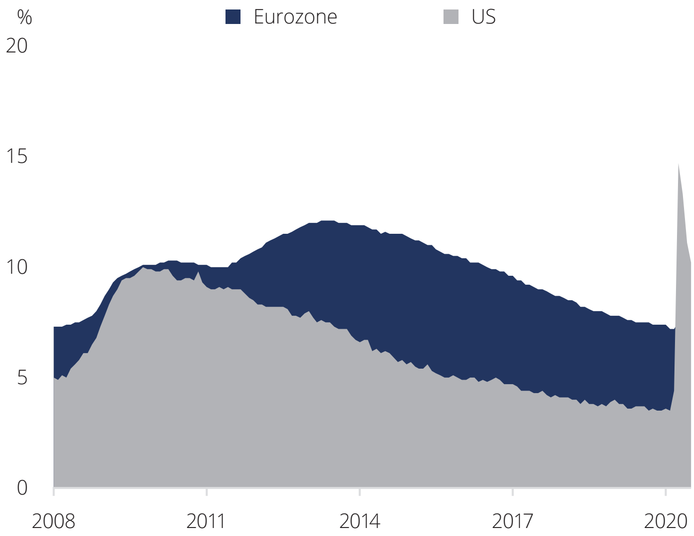
Source: IMF, DBS

Figure 5: Trend and cycle growth disrupted



Source: Bloomberg, DBS

Figure 6: Unemployment rate – US & Eurozone



Source: CEIC, DBS

Eurozone: Trend and cycle of growth to weaken

The Eurozone economy is on course to register a full-year contraction this year owing to the pandemic. It is set to be deeper than the debt crisis in 2012-13 and the 2008-09 GFC. 1H GDP growth averaged -9% y/y, covering the period when a steep infection curve necessitated not only stringent movement restrictions but also nationwide lockdowns. Momentum was diverse among member countries, ranging from Germany's -7% to Spain's -13%, among the core four. The bloc's cyclical and trend growth have been disrupted, with a return to pre-COVID-19 levels likely to take at least two to three years.

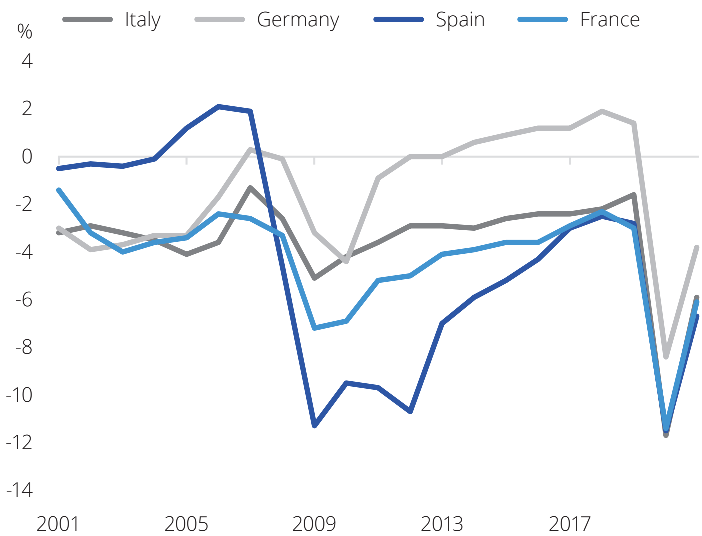
Assuming a gradual improvement in 2H, we peg our 2020 forecast at -8.0%, and expect a bounce (much due to low base effects) to 4.5% in 2021. Risks, nonetheless, need to be monitored. Mobility indicators were off lows when the first wave of the infection was brought under control. However, a resurgence in July-August threatens to put a spanner on recovery expectations. Concurrently, despite the limited fallout on the Eurozone labour markets thus far – unemployment rate is up marginally by 0.6% to 7.8% in June – which would stay elevated through 2021 as job and wage support schemes expire. This will impinge on consumption anew, capping purchasing power, thereby making it crucial to keep fiscal policies loose.

Source: Unsplash

Early fiscal response to the pandemic was piecemeal and led by individual member countries. Measures were a combination of above- and below-the-line support, including wage support, tax deferrals, funds for health care systems, credit guarantees etc. Public debt levels are expected to surge – for instance, Italy's from 135% of GDP to over 145%, and Spain's to 115% of GDP by end-2020, and to stay high next year. The removal of EU restrictions on national budgets, until 2022 at least, will provide more elbow room.

Marking a significant step towards a unified response, an EU-wide initiative was agreed upon in late-July, which included a EUR750b European recovery fund. While this will be an important support pillar for indebted member countries, timely implementation will be key to materially backstop spending plans.

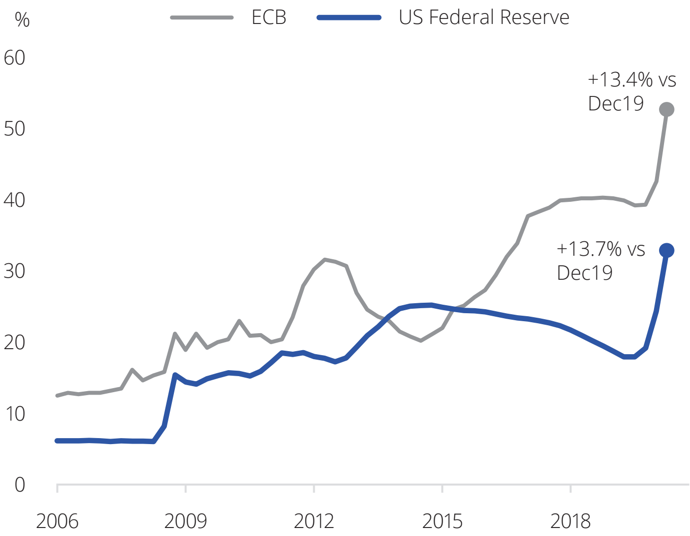
Figure 7: Fiscal deficits likely to balloon



Source: IMF, Bloomberg, DBS

Strong fiscal response is accompanied by supportive monetary policy. With rates at zero-bound, the ECB continues to lean on asset purchases and cheap financing programmes to ensure the financial system remains well lubricated and rates stay low. Apart from raising the asset purchase programme by EUR120b, an increase in the threshold for the new Pandemic Emergency Purchasing Programme (PEPP) now stands at EUR1.35t. While purchases are restricted to investment grade papers, Fallen Angels might be added to the pool if financial conditions unexpectedly tighten and growth stumbles. We expect more burden to be now borne by government support, while the ECB follows the drawn-out roadmap to continue asset purchases.

Figure 8: Central banks on the defensive

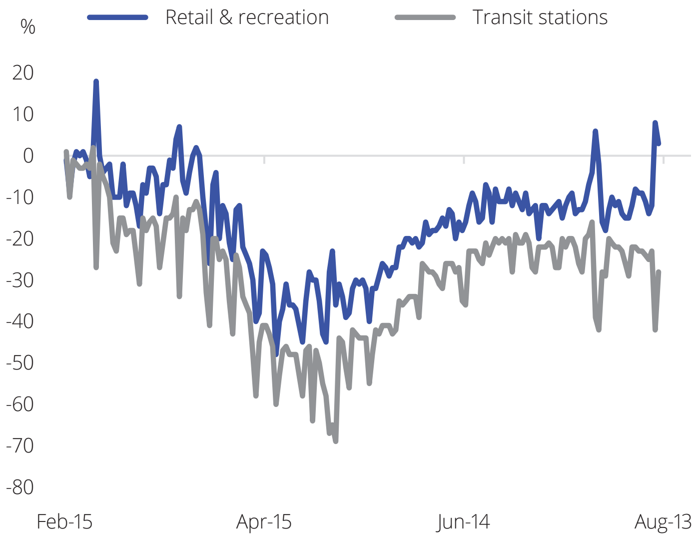


Source: Bloomberg, CEIC, DBS

Japan: A fragile recovery ahead

COVID-19 has driven Japan into a deep recession. Real GDP plunged by -27.8% q/q saar in 2Q20, far worse than the -17.8% seen during the GFC in 1Q09. Negative growth is expected to turn around in 2H20, thanks to the easing of lockdowns and reopening of the economy. But the risk of the recovery turning into a W cannot be ruled out.

Figure 9: Consumption bottoming out



Source: Google LLC "Google COVID-19 Community Mobility Reports". https://www.google.com/covid19/mobility/ Accessed: 11 August 2020; DBS.

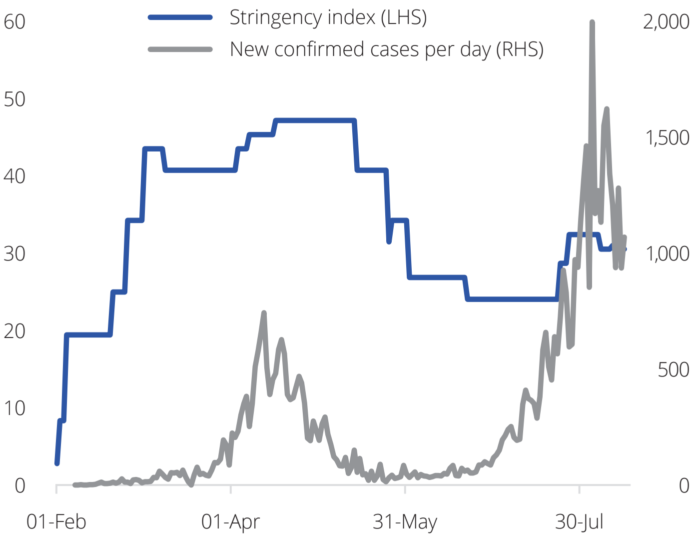
The Japanese government fully lifted the nationwide state of emergency in late May and domestic consumption bounced back. Retail and recreation activities notably rose from their bottoms, with the gaps in the normal levels narrowing to -11% in July, from -14% in June and -30% in May.

But Japan has been hit by a second wave of infections. The total number of new confirmed cases has surged to about 1,000 per day since late July, more than double the peak levels in April. The Okinawa region declared a state of emergency on 31 July and asked its people to stay at home for two weeks. Tokyo's governor also warned that a state of emergency could be declared in the capital if the situation deteriorated further.

We have further revised down our full-year GDP forecast to -5.0% from -3.0%. The embedded assumption is a strong 17% q/q saar growth rebound in 3Q20 and 10% in 4Q20. In the event of a W-shaped recovery in 2H20, full-year GDP would contract more sharply by more than -5.5%.

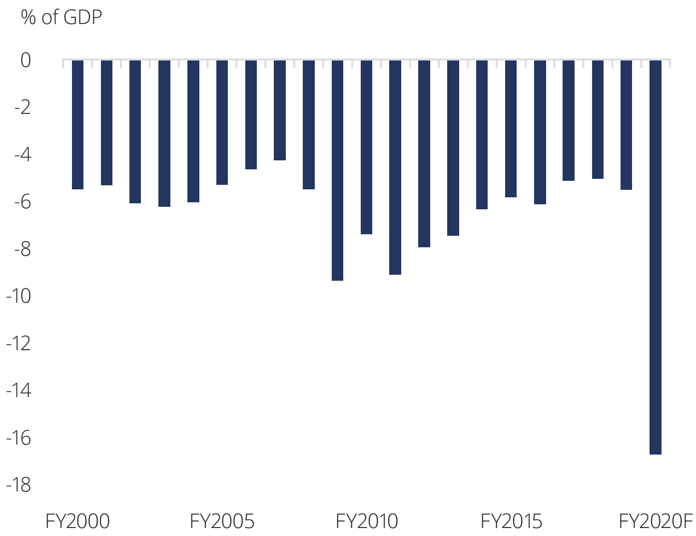
On the policy front, the pressure for the Japanese authorities to mitigate the impact of COVID-19 and support public

Figure 10: A second wave of infections



Source: Oxford, CEIC, DBS

Figure 11: Fiscal deficit widening sharply

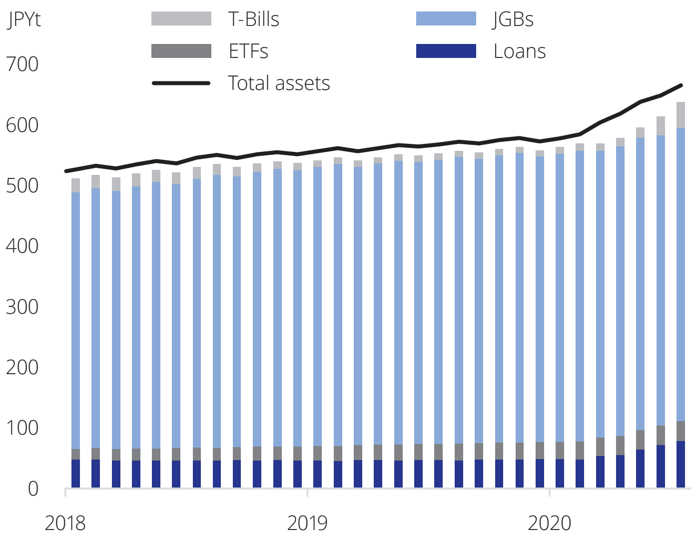


Source: Bloomberg, CEIC, DBS

livelihood will likely remain high in the near term. Prime Minister Shinzo Abe's government has approved two stimulus packages totalling JPY234t or 40% of GDP. They include two supplementary budgets worth a total of JPY57.6t (11% of GDP). We expect a third stimulus package, which will be smaller than the earlier two, within this year. Possible measures would include additional financial assistance to the SMEs and regional financial institutions, a relief on personal income tax, and a temporary reduction in consumption tax rate.

The BOJ has further eased monetary policy this year, including 1) pledging unlimited government bond purchases, 2) increasing the buying of risky assets like ETFs, REITs, corporate bonds, and commercial papers, and 3) expanding the special loan programme. The BOJ's balance sheet has increased by JPY80t (15% of GDP) since March, which matched the rise in fiscal deficit from the government's two stimulus packages. There is a good chance for the BOJ to further expand some of the existing asset purchase and lending programmes in the remainder of this year as part of its efforts to coordinate with looser fiscal policy.

Figure 12: BOJ's balance sheet expansion quickened since March

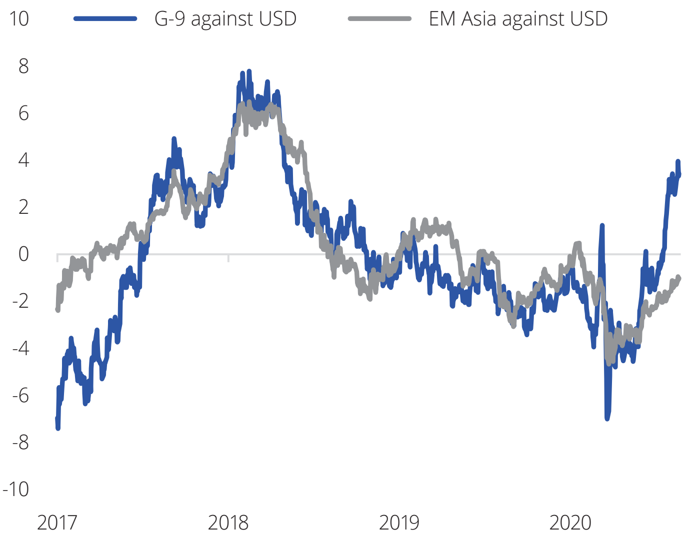


Source: CEIC, DBS

Asia: USD weakness a double-edged sword

DXY, the commonly followed index for the US dollar, has weakened 7% since April, giving rise to discussion about the turn in the strong dollar cycle. From Asia's perspective, the movement has been less pronounced (DXY tracks USD's movement against DM currencies); the corresponding figure for ADXY, which tracks Asian EM currencies, is about 4%.

Figure 13: USD against DM and EM Asian FX (base: Jan 2019)



Source: Bloomberg, DBS

What is going on? First, the Fed hitting the zero bound has eliminated a considerable amount of short-term yield (nominal and real) differentiation between the major currencies, taking away the interest rate driven support for USD. Second, the muscular commitment to a EUR1.8t fiscal package by the EU, formalised on 21 July, has added considerable tailwind to the euro.

If the present trend persists, and USD continues to weaken, it may cause inflation expectations to rise somewhat (although the cause and effect are not particularly clear at a time of weak demand). It could also add upward pressure on US interest rates eventually. At the same time, this would add some degree of competitiveness to US exporters (again, not a given in present circumstances). A weaker dollar will drive the additional following mitigating dynamics in the non-USD world:

- Those with USD payables and local currency receivables will find debt service cheaper. With a surge in dollar debt issuance by emerging market sovereigns and corporates in the past decade, this would be a relief.
- In USD terms, investment in non-USD assets will provide better returns, catalysing capital flows for non-USD assets. EMs, having experienced considerable capital flow volatility this year, would welcome that.
- As most global trade is denominated in USD, most companies and economies will find imports cheaper in local currency terms. This is particularly beneficial to commodity importers, and most Asian economies fall in that category. Other than the lower cost of imports, this also lowers the risk of exchange rate pass-through driven inflation risks (which is moderate in any case).
- A weak dollar improves the purchasing capacity of consumers in non-USD jurisdictions, providing them with extra motivation to purchase more goods and go out travelling (as most tourism related activities, especially flights and hotels, are linked to the USD), boosting global tourism. This could be particularly critical in the post-pandemic environment.

Finally, for those economies under pressure from the US government on matters of trade imbalance and currency manipulation, a weaker dollar would reduce geopolitical pressure, much needed in a strife-ridden world.

Oil market delicately balanced

Demand supply balance achieved but its sustainability is in question. After an extremely volatile first few months of the year amid price wars and the COVID-19 pandemic, Brent crude oil prices have rather uncharacteristically stabilised in the USD40-45/bbl range since mid-June 2020 as the supply cut has been able to match the demand decline. How long will this so-called "normalcy" hold though? There is a rather delicate balance of positive and negative factors at this point of time, and hard to determine with certainty.

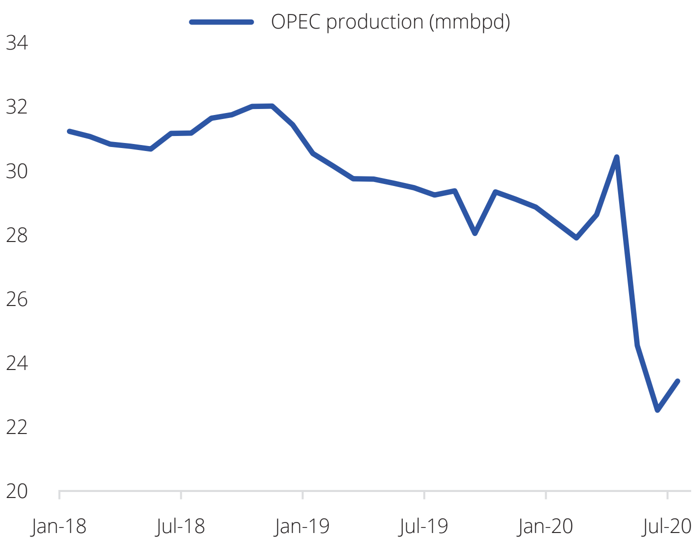
Positive drivers from here on:

1) The demand destruction in 2Q20 was slightly less than we earlier expected, and demand recovery in 3Q20 has been on track, with China and parts of Europe leading the way and the US picking up as well.
2) The OPEC+ cartel has been very disciplined with the level of supply cuts since May 2020, with close to 100% compliance, and there has been no change in plans to continue supply cuts for the rest of 2020 and into 2021.
3) US shale oil supplies saw a sharp falloff in May 2020.
4) Second wave concerns have waned to an extent, and strict lockdowns will likely not be re-imposed in most countries even if infections pick up in autumn-winter owing to the economic costs and rise of herd immunity
5) Several vaccine candidates under development show promise.

Negative drivers to watch out for:

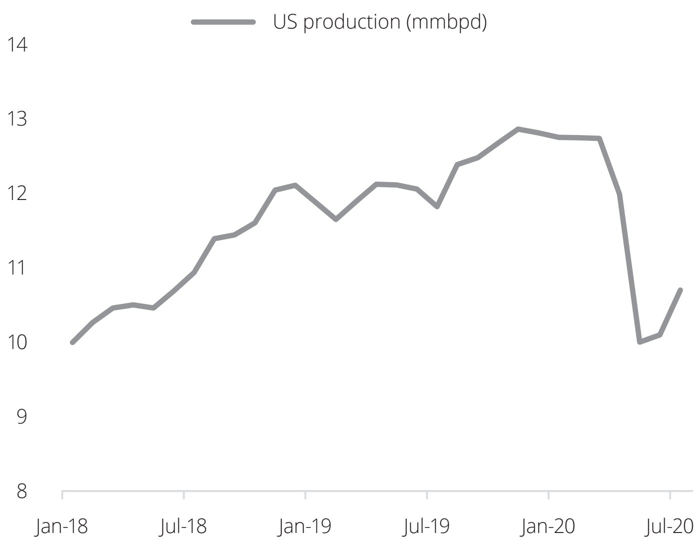
1) We estimate global oil demand will still be around 5mmbpd off 2019 levels by end-2020 and on average, still around 3mmbpd off 2019 levels in 2021, owing to slow recovery from the aviation sector, in particular.
2) The US-China trade war could intensify as China's purchases of US goods are behind schedule.
3) Global oil inventory levels are close to record high levels.
4) OPEC surplus capacity is more than 10mmbpd currently, and as more member countries face fiscal stress, maintaining output discipline in 2021 may prove to be a bigger challenge.
5) As WTI oil prices hold above USD40/bbl, US shale production has started showing signs of increased activity.

Figure 14: OPEC compliance to supply cuts instrumental to oil price stability



Source: Bloomberg, DBS

Figure 15: US production starts to rise as WTI stabilises above USD40/bbl



Source: Bloomberg, DBS

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

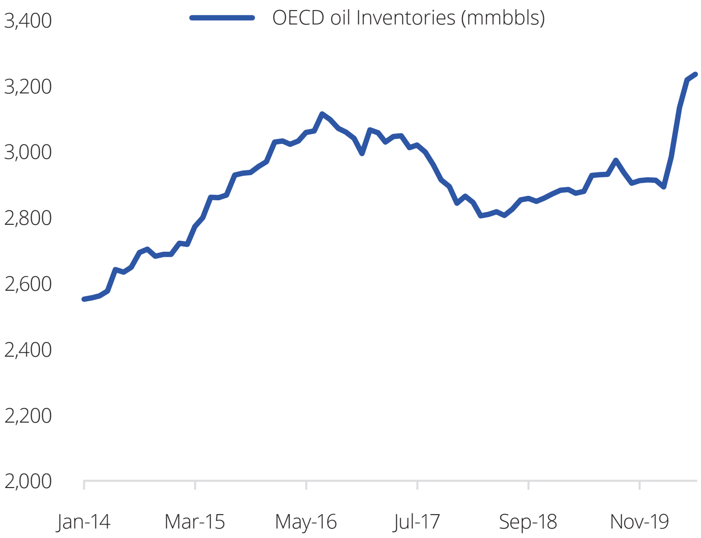
USD per barrel	1Q20A	2Q20A	3Q20F	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Average Brent crude oil price	51.0	33.5	44.5	52.0	49.5	50.0	51.0	51.5
Average WTI crude oil price	46.0	28.0	41.5	48.0	45.5	46.0	47.0	47.5

Source: DBS

Oil prices could struggle to break out beyond USD50/bbl levels. We now project global oil demand to decline by around 8.0mmbpd in 2020, and then recover by around 5.0mmbpd in 2021, while supplies are expected to fall by around 7.0mmbpd in 2020, before adding some 4.0mmbpd in 2021.

We continue to project Brent crude oil prices to average between USD42-47/bbl in 2020 with recovery all through 2H20 but we lower our 2021 average to between USD50-55/bbl (from USD55-60/bbl), as we expect the recovery to stall owing to inventory overhang and less supply discipline in 2021.

Figure 16: OECD inventories at record levels, big overhang on oil price recovery



Source: International Energy Agency, DBS

Table 2: GDP growth and CPI inflation forecasts

	GDP growth, % y/y				CPI inflation, % y/y, ave			
	2018A	2019A	2020F	2021F	2018A	2019A	2020F	2021F
Mainland China	6.7	6.1	2.0	5.6	2.1	2.9	2.3	2.5
Hong Kong	2.8	-1.2	-7.0	0.5	2.4	2.9	1.1	2.0
India	6.8	4.9	-9.0	6.5	4.0	3.7	6.0	4.2
India (FY basis)*	6.2	4.2	-10.5	7.5	3.4	4.8	5.5	4.4
Indonesia	5.2	5.0	-1.0	3.5	3.2	2.8	2.0	1.6
Malaysia	4.7	4.3	-5.5	6.0	1.0	0.7	-1.5	1.8
Philippines**	6.2	5.9	-6.2	5.0	5.2	2.5	2.4	3.0
Singapore	3.1	0.7	-6.5	5.5	0.4	0.6	-0.7	1.5
South Korea	2.9	2.0	-1.1	2.9	1.5	0.4	0.2	0.5
Taiwan	2.7	2.7	0	2.9	1.3	0.6	0.1	0.5
Thailand	4.2	2.4	-7.5	3.0	1.1	0.7	-1.2	1.0
Vietnam	7.1	7.0	3.2	6.2	3.5	2.8	3.4	3.0
Eurozone	1.9	0.9	-8.0	4.0	1.8	1.2	0.5	1.1
Japan	0.3	0.7	-5.0	2.8	1.0	0.5	-0.1	0.0
United States***	2.9	2.3	-5.0	5.0	1.9	2.3	1.3	1.5

* 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

	1Q20A	2Q20A	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
Mainland China*	4.05	3.85	3.70	3.55	3.55	3.55	3.55	3.55
India	4.40	4.00	4.00	4.00	3.75	3.75	3.75	3.75
Indonesia	4.50	4.25	4.00	4.00	4.00	4.00	4.00	4.00
Malaysia	2.50	2.00	1.75	1.50	1.50	1.50	1.75	1.75
Philippines	3.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
Singapore**	0.85	0.40	0.40	0.40	0.40	0.40	0.40	0.40
South Korea	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.75
Taiwan	1.13	1.13	1.13	1.13	1.13	1.13	1.13	1.13
Thailand	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Vietnam***	5.00	4.50	4.50	4.00	4.00	4.50	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

US Equities | 4Q20

Staying constructive

US Equities

Dylan Cheang | Strategist

Since March's trough, the S&P 500 Index notched gains of 51.2% and at 3383.54, the index has already superseded its previous peak. The run-up seen on the technology-heavy Nasdaq Composite Index was even more acute, with the index rallying 61.2% (Figure 1). Clearly, unprecedented monetary easing by the US Federal Reserve has played major role in driving US equities higher. But it is more than that. The strong market momentum is also a reflection of two other major factors:

a) Transitory nature of pandemic

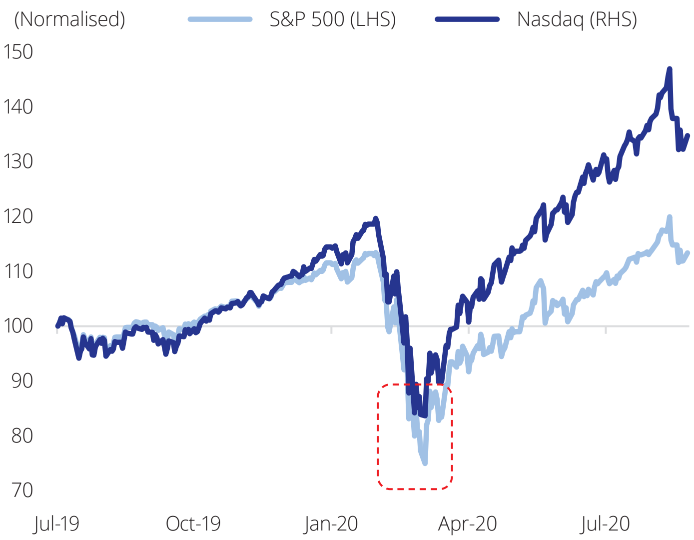
b) Falling risk-free rate

The first point has panned out in line with our expectations. We have, since the start of the pandemic, maintained that the latter is a transitory event which has no bearing on the structural outlook of the economy. Things will return to normalcy when infection curves flatten and a vaccine comes along.

Recent news flow suggests that both scenarios are materialising, which explains why analysts are starting to temper their pandemic angst and revising up earnings forecasts.

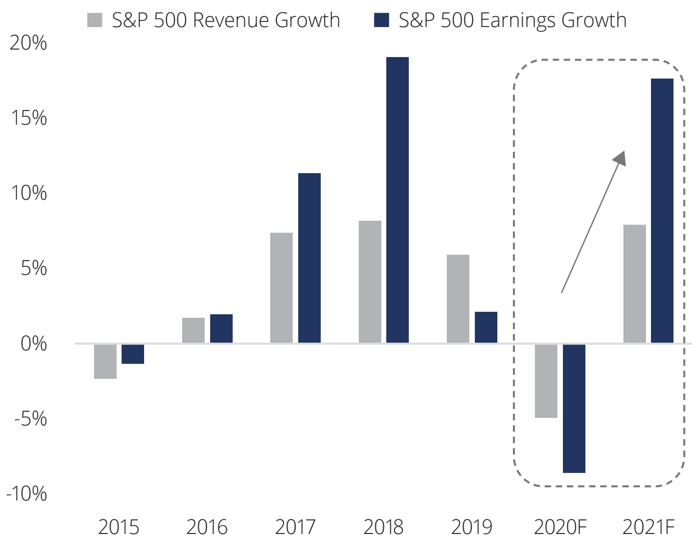
Based on current estimates, an 18% surge in US corporate earnings growth is expected for 2021 – the second highest

Figure 1: Comeback kid – US equities have powered to new highs after hitting a trough in March



Source: Bloomberg, DBS

Figure 2: Sunshine after the rain – strong US corporate earnings growth expected for 2021

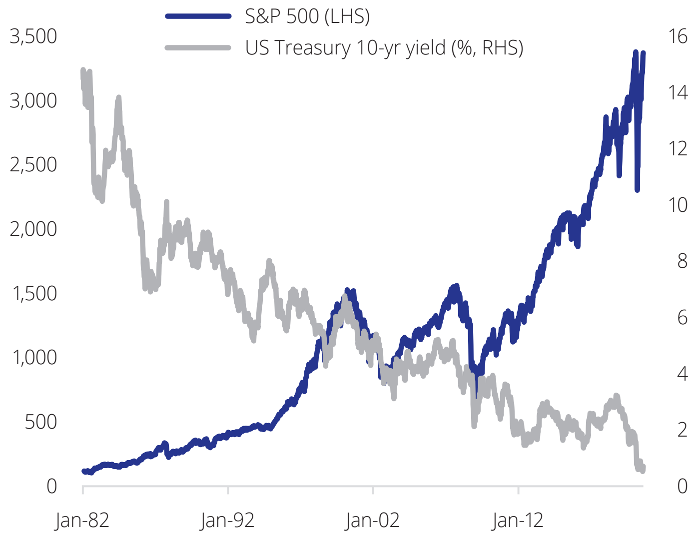


Source: Bloomberg, DBS

over the last ten years (Figure 2). This will be driven by a combination of top-line revenue growth (+8%) and margin expansion (EBITDA margin +1.7%pts).

The other factor underpinning the equity rally is the falling cost of capital. The UST 10-year yield has collapsed this year, and in discounted cashflow (DCF) modelling, a lower risk-free rate (the UST 10-year yield) translates to higher implied valuation. Figure 3 shows that since 1982, there is a clear inverse relationship between the US equity market and bond yield.

Figure 3: A falling risk-free rate has traditionally been positive for risk assets



Source: Bloomberg, DBS

Source: Unsplash

Dollar weakness: A timely catalyst. The DXY has corrected 3.6% this year amid fundamental and valuation concerns. On a component basis within DXY, the US dollar has depreciated 5.3% against the euro (Figure 4) and this broadly reflects two things:

a. Stronger pace of macroeconomic rebound in Europe as the region has managed better than the US in putting the pandemic under control. Since 15 May, the Economic Surprise Index for the Eurozone has surged 484 pts, as compared to 348 pts for the US (Figure 5).

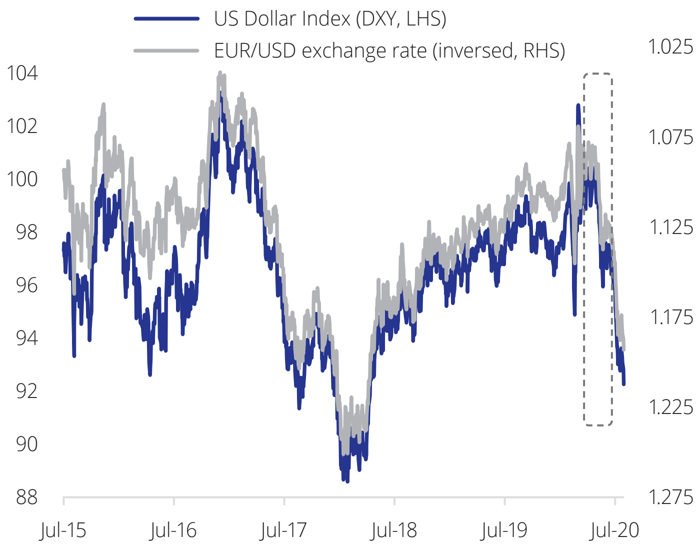
b. The deterioration of US's debt-to-GDP relative to Europe.

On balance, the US Federal Reserve's commitment to an open-ended QE, coupled with the US's fiscal positioning, suggests that more downside awaits the greenback.

From a historical perspective, dollar weakness is positive for companies that derive a large proportion of their revenue from overseas markets (the exporters).

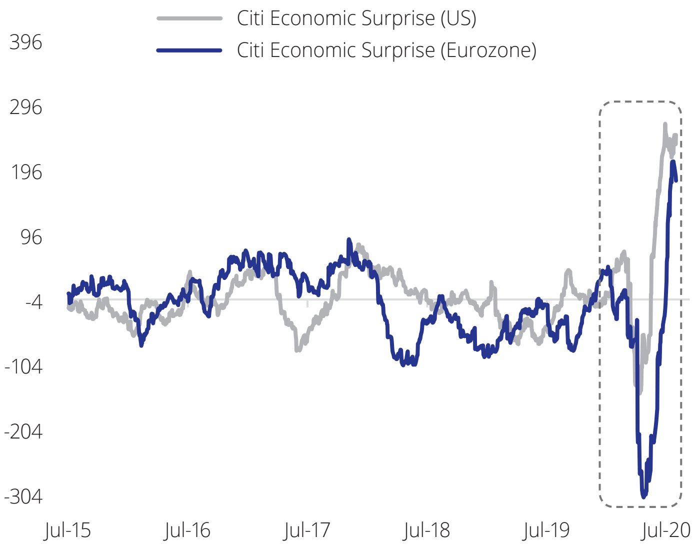
In our analysis to gauge the historical impact of dollar weakness for the S&P 500, we look at: (a) Data stretching back to January 2005, (b) Tabulating months where DXY fell by 3.0% or more, (c) Tracking the performance of S&P 500 sectors during those months. Our analysis unveiled the following:

Figure 4: Sharp pullback in DXY was partly due to euro strength



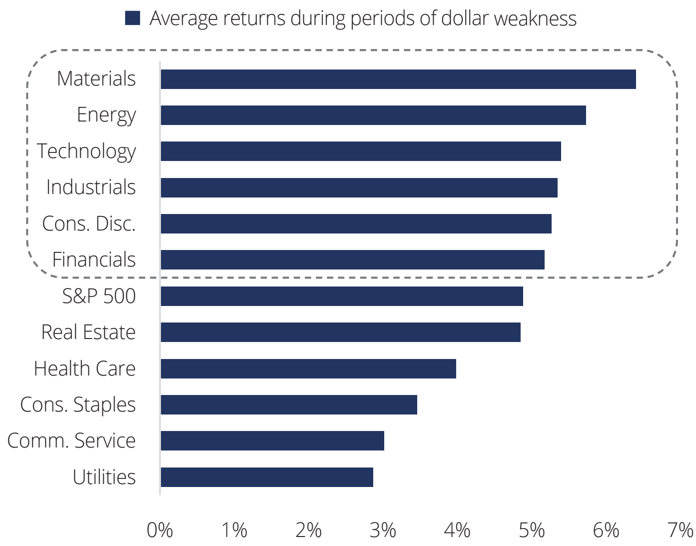
Source: Bloomberg, DBS

Figure 5: Europe's stronger macro rebound reflects the region's better control of the pandemic crisis



Source: Bloomberg, DBS

Figure 6: Dollar weakness has predominantly benefitted global cyclical sectors



Source: Bloomberg, DBS

- Since January 2005, there are a total of 12 months where DXY declined 3.0% or more.
- During those months, the average decline for DXY was 4.4% while the S&P 500 rose 4.9% on average.
- Six sectors managed to register higher average monthly gains than the S&P 500: Financials (+5.2%), Consumer Discretionary (+5.3%), Industrials (+5.4%), Technology (+5.4%), Energy (+5.7%), and Materials (+6.4%).

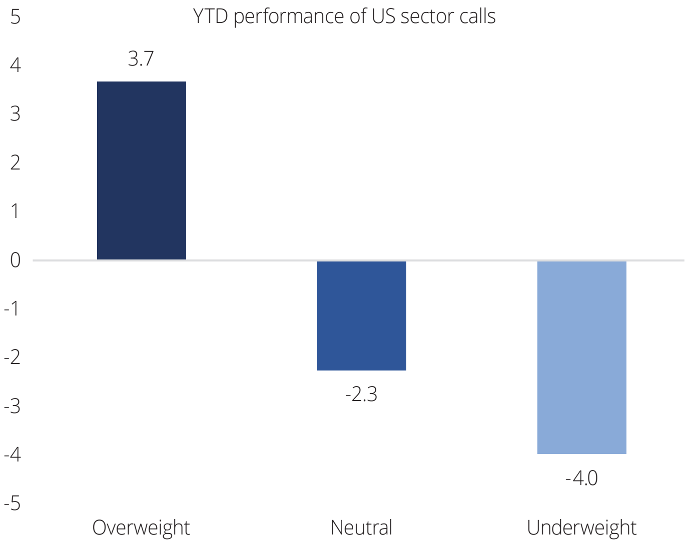
Our findings validate the view that global cyclicals will be geared beneficiaries of a weak dollar environment (Figure 6). Out of the six sectors that outperformed the markets, three of them are rated Overweight in our sector allocation: Technology, Consumer Discretionary, and Energy.

4Q20 US Sector Strategy

Positive view on Technology is paying off. We have been positive on US Technology-related sectors since 2018 and the rise in global bifurcation (as result of the pandemic) has accentuated the attractiveness of this segment. Rising social distancing is increasingly driving business and leisure activities online and the geared beneficiaries of this trend include the e-Commerce, video conferencing, as well as software/hardware companies within the Technology space.

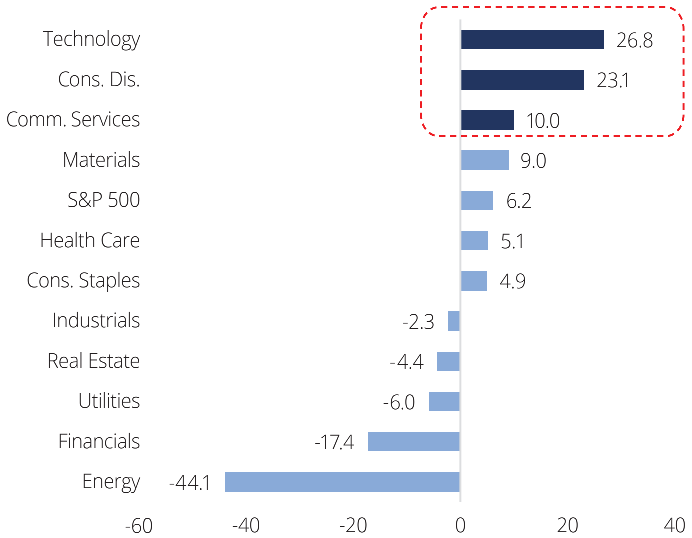
On a YTD basis, our Overweight calls have garnered 3.7% total return (as of 14 September), outperforming our Neutral and Underweight calls by 5.9%pts and 7.6%pts, respectively (Figure 7). Our bullish stance on Technology, Consumer Discretionary (particularly e-Commerce), Communication Services (particularly social media), and Health Care has reaped dividends as these are the top performing sectors

Figure 7: Our Overweight sectoral calls have vastly outperformed the Neutral and Underweight calls this year



Source: Bloomberg, DBS
* Performance as at 14 September 2020.

Figure 8: Technology and Consumer Discretionary have led the market this year (%)



Source: Bloomberg, DBS
* Performance as at 14 September 2020.

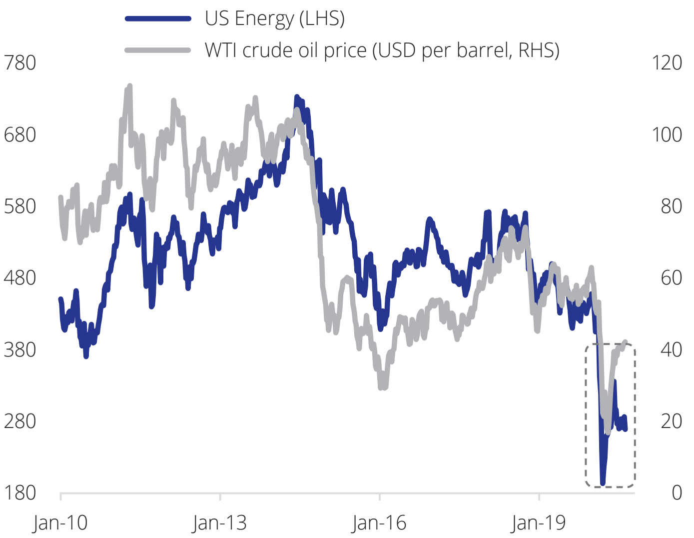
this year (Figure 8). But our call on Energy, however, has underperformed amid lacklustre oil prices.

As we head into the final quarter of 2020, we are keeping our US sector allocation. As discussed, a weak dollar environment has historically favoured Financials, Consumer Discretionary, Industrials, Technology, Energy, and Materials. Within this group, our preferred global cyclical exposure to play the dollar weakness theme is via Technology, Consumer Discretionary, and Energy.

We maintain a constructive stance on Energy as we believe negative news flow surrounding the sector (from demand-supply imbalances to the rise of clean energy) has already been sufficiently priced in. Our regression analysis suggests that at the current level, the Energy sector is pricing in WTI crude oil price of USD38.00 per barrel (vs our forecast of USD47.50 per barrel by 4Q21) and this is overly pessimistic given gradual rebound in global economic momentum.

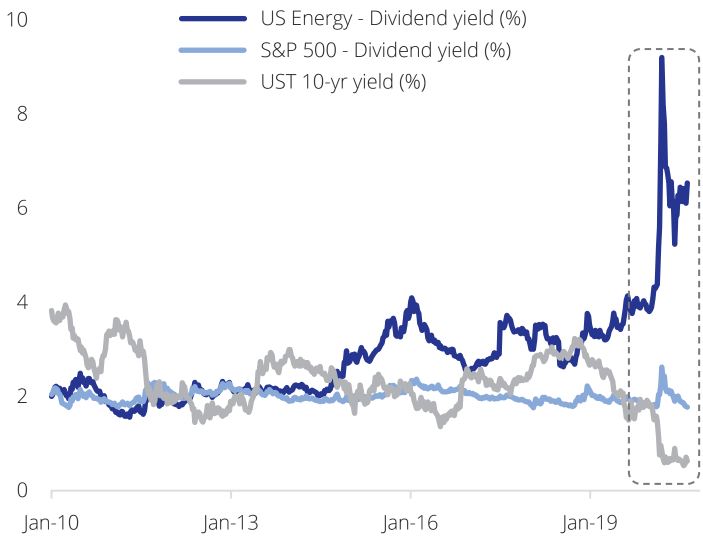
Energy companies are expected to benefit from the weak dollar environment, and we advocate investors to stay engaged in the sector (particularly in the integrated oil majors) from a portfolio perspective. Concerns on the rising likelihood of dividend cuts is mitigated by the substantial buffer in dividend yields between the Energy sector and the broader market (Figure 10).

Figure 9: US Energy has momentarily delinked from crude oil prices



Source: Bloomberg, DBS

Figure 10: Substantial buffer between the dividend yields of US Energy sector and broader market



Source: Bloomberg, DBS

Table 1: 4Q20 US sector allocation

	Overweight	Neutral	Underweight
US Sectors	Technology	Utilities	Financials
	Communication Services	Consumer Staples	Materials
	Consumer 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	6.2	25.8	3.8	16.2	11.5	2.3	10.5
S&P 500 Financials	-17.4	17.2	1.2	8.4	7.8	0.8	15.9
S&P 500 Energy	-44.1	-	1.1	90.0	-15.7	-6.9	-11.8
S&P 500 Technology	26.8	28.4	9.5	20.8	28.9	10.1	21.4
S&P 500 Materials	9.0	26.9	2.8	15.6	5.4	2.1	8.2
S&P 500 Industrials	-2.3	38.5	4.8	14.6	13.5	3.2	9.0
S&P 500 Cons. Staples	4.9	21.9	6.5	16.2	24.2	6.5	8.6
S&P 500 Cons. Discretionary	23.1	48.6	10.8	19.7	21.2	3.8	6.1
S&P 500 Comm. Services	10.0	24.2	3.6	13.0	12.4	4.7	17.8
S&P 500 Utilities	-6.0	18.8	2.1	12.5	9.9	2.6	20.5
S&P 500 Real Estate	-4.4	45.4	3.4	20.8	9.0	3.4	21.1
S&P 500 Health Care	5.1	17.7	4.5	15.6	17.8	6.0	9.4

Source: Bloomberg
* Data as at 14 September 2020.

DBS Live more, Bank less

Source: Unsplash

Europe Equities | 4Q20

Rebuilding

Europe Equities

Joanne Goh | Strategist

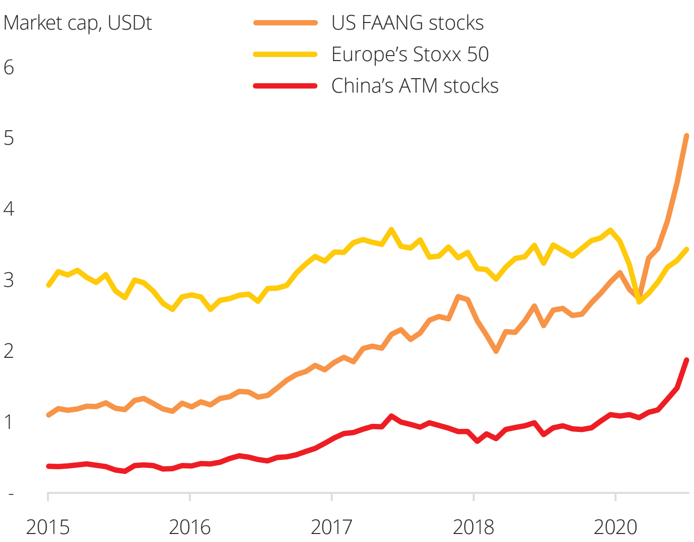
European markets recovered in 3Q amid optimism on the EU recovery fund, that sent the euro gaining 5.5% and the MSCI Europe Index up by 2.5%. The recovery fund of EUR750b, both in loans and grants, should be able to lift the region out of recession by 2021 and relieve the weaker economies such as Spain and Italy from further economic downshift. The IMF sees the region recording the worst economic growth globally, with most countries except Germany posting double-digit contractions this year. These economies are unlikely to reach pre-COVID-19 levels of activity by end-2021.

With both unprecedented fiscal and monetary stimulus, we believe Europe can thus focus on the recovery process and its stock markets can be lifted in line with the global markets. However, the region will likely lag the rest of the global markets mainly because the Technology sector is a small representation in the index, thus missing out on the benefits from accelerated digitalisation in the aftermath of COVID-19.

To put into perspective the size of Tech sector in Europe, today, the market capitalisation of the five FAANG stocks in the US is bigger than the Euro STOXX 50 Index! China's three ATM stocks (Alibaba, Tencent, and Meituan) are now about half of the Euro STOXX 50. In the world of digitalisation and technological innovation, our concern is that the European region, without having enough of technology stocks, may be marginalised.

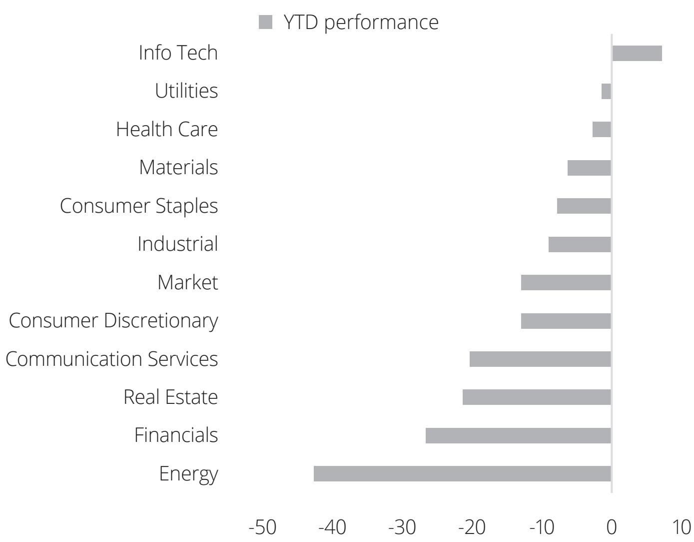
Indeed, the only sector which had positive performance in Europe on a year-to-date basis is the Tech sector, while all other sectors have registered negative returns.

Figure 1: The US's FAANG stocks is now bigger than Euro STOXX 50



Source: Bloomberg, DBS

Figure 2: Tech is the only bright spot in Europe



Source: Bloomberg, DBS

Earnings, not multiple expansion needed to drive upside

Driven by a continuous downgrade in earnings, the 12-month forward P/E valuation has now extended to +3 SD. Even taking into account next year's earnings growth, valuation will still be +1 SD away, leaving no room for P/E expansion. Hence, we believe earnings are essential in order to drive share prices going forward.

We are of the view European markets have fully priced in the impact from the EU recovery fund after rallying c.30% from the bottom in March. With 1H earnings and GDP already out, earnings downgrades should find some floor for now. Consensus is now expecting c.20% growth next year, driven by earnings recovery in Health Care, Consumer Discretionary, and Industrials. We believe earnings can beat expectations in these three sectors from our analysis. Banks, however, may continue to face stress from negative yields and uncertainty in provisions.

Globally competitive businesses

Many European companies have globally competitive businesses, with some among the best in areas such as automation, pharmaceuticals, technology and IT services, and global luxury brands.

We believe there is a strong case for the laggards from these sectors to play catch up as global economies look to reopen and earnings for some of these sectors are expected to register a V-shaped recovery next year. The recovery in global PMIs bodes well for this scenario to pan out.

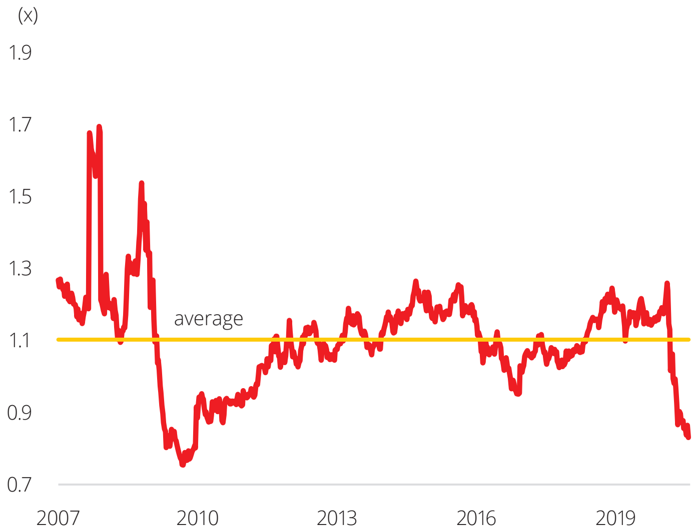
Defensive Health Care

Health Care remains well-positioned as a defensive sector. Historically, the sector trades at a premium to the overall market, but it is currently at a discount. As a key beneficiary

Figure 3: The earnings multiple continues to stay high despite embedded recovery

Source: Bloomberg, DBS

Figure 4: The Health Care sector deserves a higher P/E premium



Source: Bloomberg, DBS

from long-term secular trend of ageing population and the COVID outbreak amid economic uncertainty, we believe the discount is unjustified. The sector should rerate after facing threats from the delay in drug approvals, strong euro, and disruption to supply chains. The market is looking for a strong earnings recovery in the next 12 months. Health Care stands out with a stronger earnings trend and a lower valuation vs the MSCI Europe Index.

Consumer Discretionary: a pandemic winner

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

Figure 5: Rebound in China's discretionary spending should bode well for Europe's Consumer Discretionary sector

Source: Bloomberg, DBS

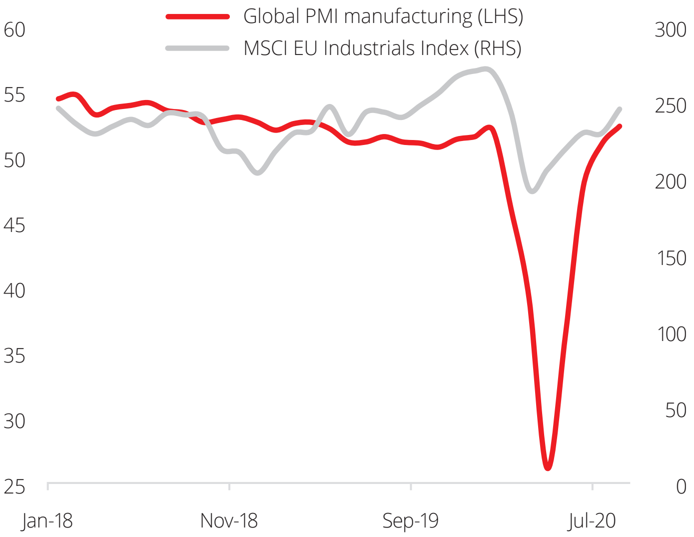
The higher income group, supposedly less affected by the pandemic, are also supporting discretionary spending in luxury goods items. European companies with global exposure are likely to recover with strong pent-up demand anticipated post pandemic in countries, such as China, that have tackled the virus most effectively and may have more confident consumers.

The outlook for the industrial sector is mixed

A sanguine recovery outlook mainly hinges on the sector's cyclicality that corporate investment will return as the global economy recovers from COVID-19. We believe there are reasons to stay positive as the disruption brought about by the pandemic calls for adaption and innovation. Key drivers brought about by: 1) Supply chain disruption due to US-China trade spats and the travel lockdown have driven companies

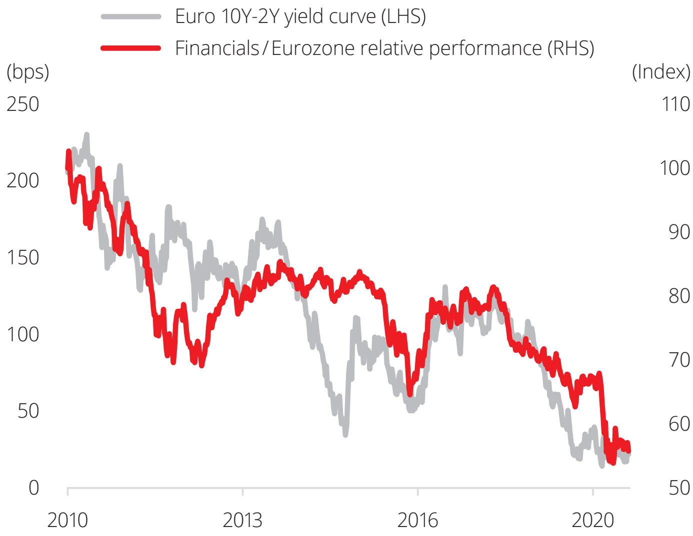
Source: Unsplash

Figure 6: European Industrials sector should see a sustainable rebound following recovery in global PMI data



Source: Bloomberg, DBS

Figure 7: Yield curve needs to steepen for banks to perform



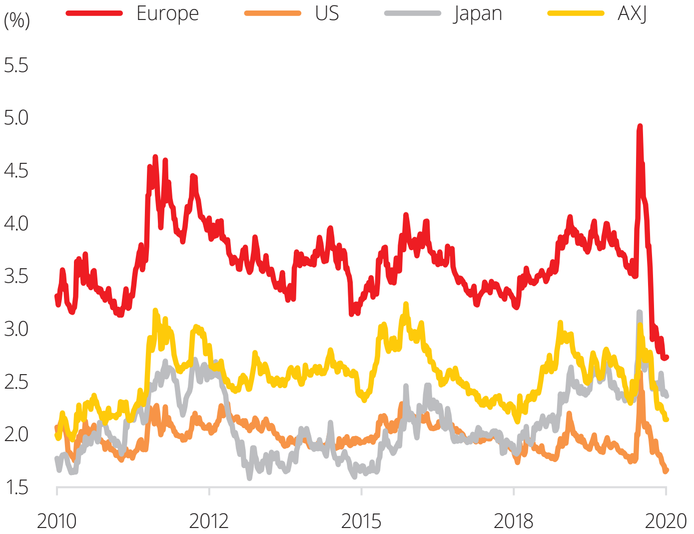
Source: Bloomberg, DBS

to consider bringing key supply lines nearer to home; 2) The adoption of automation and AI as social distancing and stay home measures become new norms, and in order to reduce pandemic risks in the future, manufacturing, and work processes will have to be redesigned; and 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 Germany's 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, including measures to protect companies against foreign competition as well as to reduce dependence on overseas supply chains. Spending is also being set aside for infrastructure projects on digital, security, defence, 5G data networks, railway upgrades, and the doubling of electric vehicles incentives. We believe Europe's Industrial and Technology sectors could be revived with these initiatives.

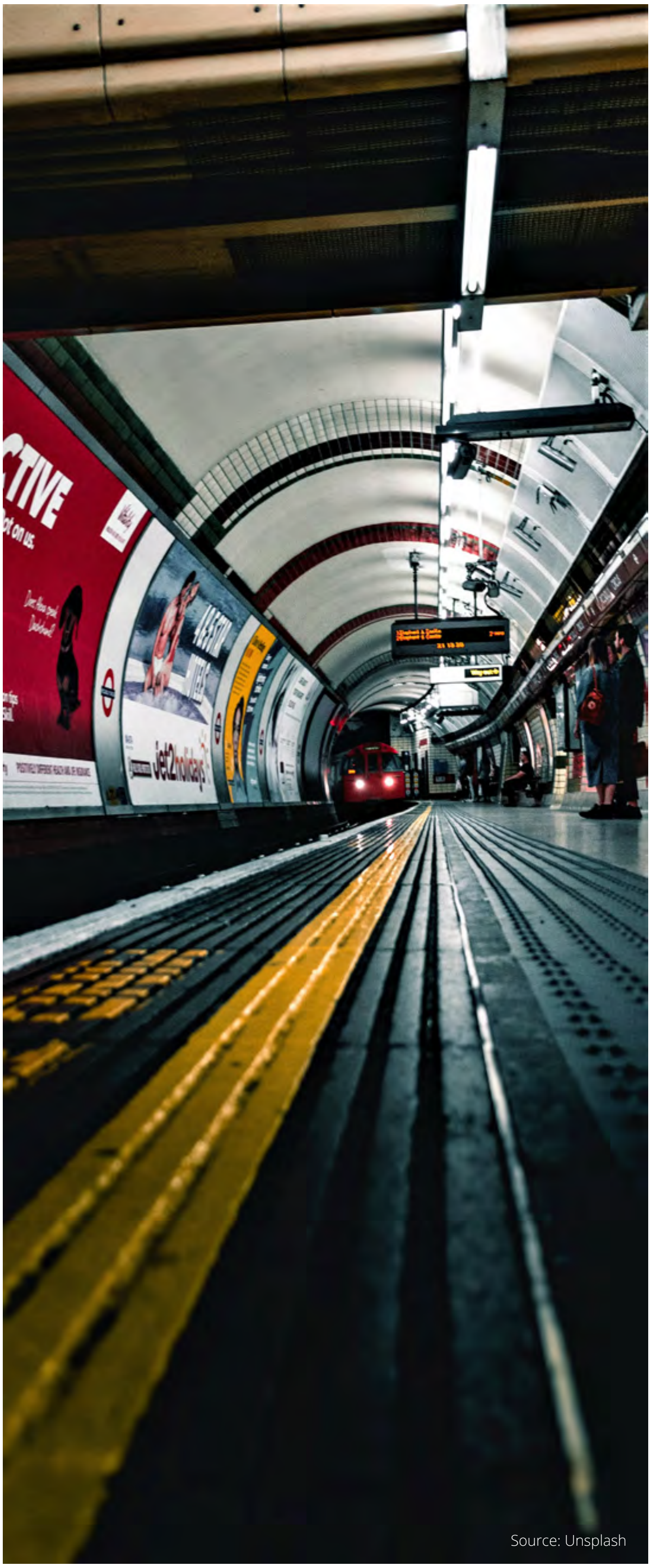
Cautious on banks

We continue to stay cautious on European banks as we expect that yields will stay negative and inverted. Although there are some signs of recovery as reflected in global PMI data, ECB is likely to be more worried about downside risks and maintain the accommodative policy for some time. In Europe, inflation is still negative, unemployment rates may start to rise once job support measures are removed, and the rise in euro is complicating a recovery in the exports-driven region. A further rise in yields may prove elusive after some pick-up recently.

Figure 8: Europe dividend yields still highest among the regions



Source: Bloomberg, DBS

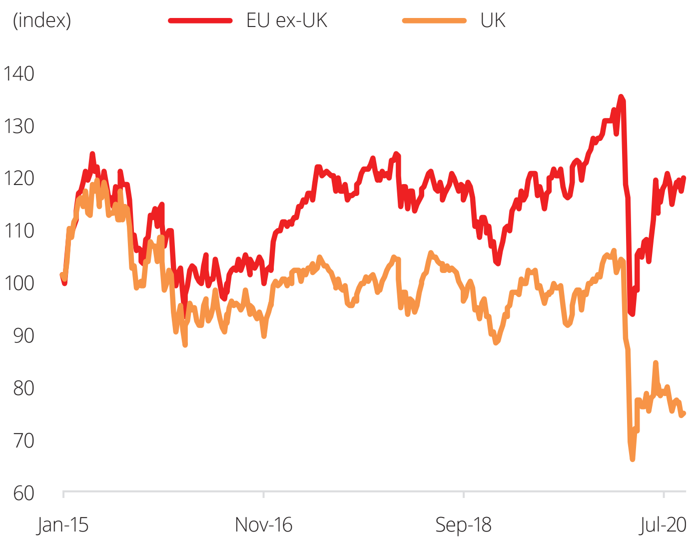


Source: Unsplash

A region to consider for income

Despite the cuts in dividends, Europe is still one of the regions with the highest dividend yields and is still considered attractive when compared to a negative bond yield of -0.4%. Thus, we will continue to be on the lookout for dividend-yielding stocks in Europe from firms that have already disclosed their dividend plans in 1H. 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. We believe European oil majors remain attractive dividend plays as the oil price gradually recovers towards USD40/bbl. Bank dividends, however, are impacted as they are hamstrung by government policies. For the bank sector, our preferred play is through AT1s, as we believe they will not be impacted by government regulations. We also like European HY bonds.

Figure 9: UK equities – rangebound since Brexit talks started and time is out



Source: Bloomberg, DBS

Brexit: Higher tariffs for both EU and the UK

As the UK prepares to exit the EU by year-end, negotiators from both sides are trying to come to an agreement for a Brexit deal by mid-October for it to be ratified in time, before the hard deadline. To us, deal or no deal, UK's depart from the EU will mean more restricted trade and services between the two, and tariffs will rise on both sides. The negotiation right now is to determine new tariff rates and the list of goods and services either subject to the tariffs or barred to do business.

Between the two, Britain is far more dependent on its trade with the EU. For the past five years, the EU accounted for average 46% of UK's total exports. It is also UK's biggest source of imports. Conversely, EU exports to UK is only about 4% of its total exports. Coupled with the uncertainties surrounding other factors including freedom of movements, services, transportation, data, IP, energy, fishing, governance, foreign policy, security, and defence, we believe there is too much for UK to digest. While Boris Johnson promised a "golden age"

Source: Unsplash

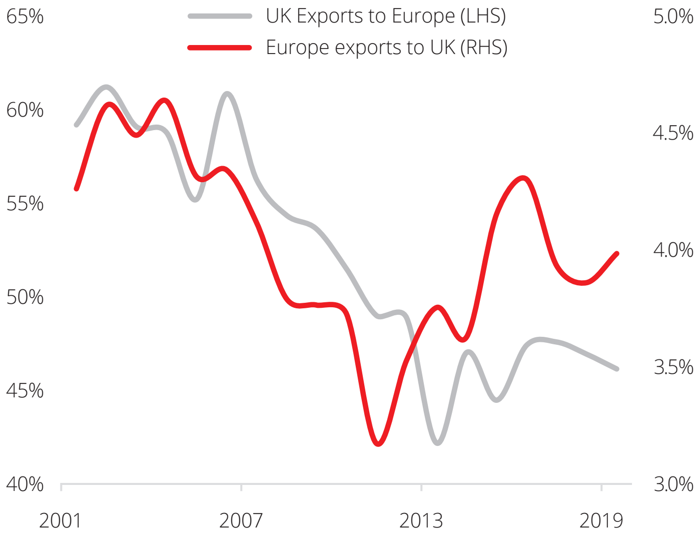
for the UK, it remains to be seen if most promises can come through given a parliamentary government and an intractable EU.

We are thus negative on UK at the end of the transition period, preferring EU to UK. Risks and opportunities surrounding the event include: 1) Germany's current outperformance may not be sustainable as its exports are the most affected by the new tariffs among EU countries; 2) UK may pursue a currency depreciation policy to make its exports more competitive; 3) UK still has room for QE expansion and to cut rates considering the interest rate differential with the EU.

A stock picker's region

The European region is a classic example of a stock picker's market where bottom-up research can help to uncover bright spots – exciting businesses that are globally competitive and are well-positioned for the new normal, with some paying good yields. We stay Underweight Europe and selective for stocks from companies which can adapt and innovate.

Figure 10: UK's exports are much more dependent on Europe



Source: Bloomberg, DBS


Source: Unsplash

Japan Equities | 4Q20

Post-Abe opportunities

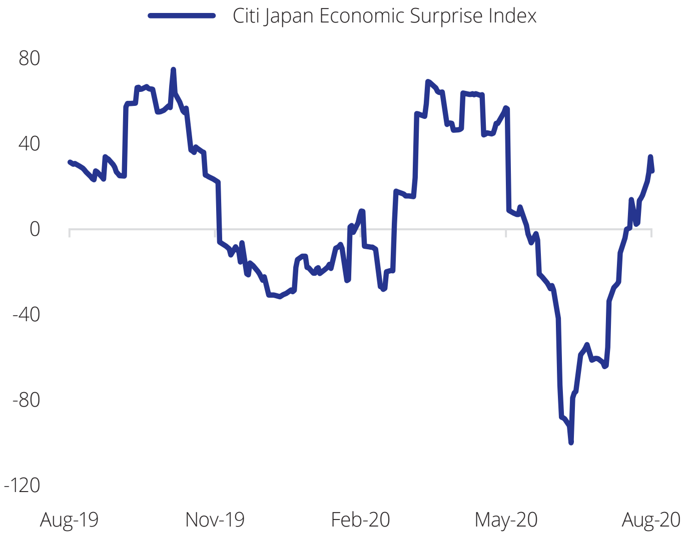
Japan Equities

Joanne Goh | Strategist
Glenn Ng, CFA | Equities

Japan's Topix Index continued its recovery from March's trough. From March to end-3Q, the index gained c.20%, with the third quarter alone seeing a c.4% rise. The market has so far demonstrated resilience, in spite of the deep recession in Japan. The economy shrunk further in 2Q after two prior quarters of contraction. Growth is expected in 3Q but could fall short of expectations as Japan continues to grapple with rising virus cases.

We expect the Japan market to trade cautiously in 4Q as political uncertainties in the US and Japan are likely to take centre stage and could pose policy uncertainties. The 2Q GDP outcome was also below expectations and weakness was widespread in all aspects of the economy including private consumption, business investment, housing investment, government spending, and exports, posing a threat to the recovery.

Figure 1: Negative economic surprise has dragged till August



Source: Bloomberg, DBS

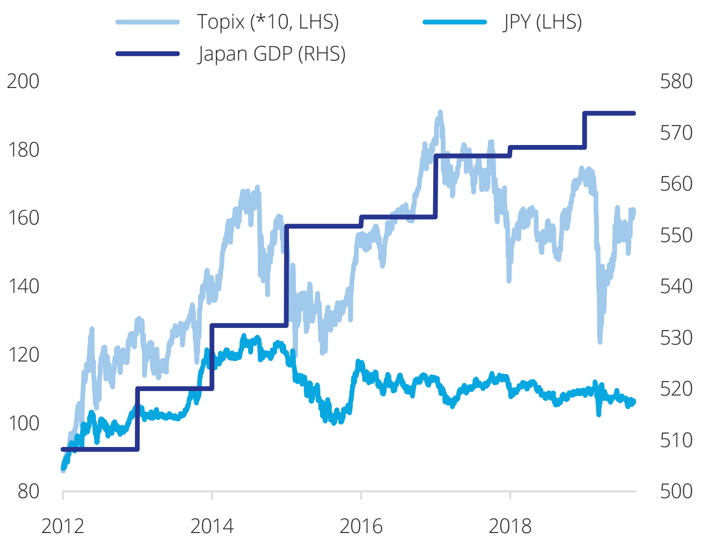
Massive stimulus and relief measures from the government and the BOJ have fended off surges in bankruptcies and unemployment but are insufficient to offset the economic downswing. The fear is that the economy may fail to recover once public support expires and rising virus cases are not arrested.

We have further revised down our full-year GDP forecast to -5.0% from -3.0% with an embedded assumption of a strong rebound of 17% in 3Q20 and 10% in 4Q20. In the event of a W-shaped recovery in 2H20, full-year GDP would contract more sharply by more than -5.5%.

Bye, Abe!

Shinzo Abe's planned early retirement as prime minister will be a source of uncertainty for financial markets. At stake is the continuation of "Abenomics". In 2013, Abe, together with BOJ governor Haruhiko Kuroda, worked together on plans to jolt the economy and revive Japan after two decades of deflation with the "three arrows" of fiscal expansion, monetary easing, and structural reform.

Figure 2: Abenomics characterised by a rising nominal GDP, weak yen, and a rising stock market



Source: Bloomberg, DBS

Abenomics has indeed served Japan well as GDP during Abe's tenure was above the years preceding him. Reviews for the success of Abenomics, however, have been mixed as the targeted inflation of 2% was not hit at all; inflation continues to stay around 0%. But exports, employment, and productivity have risen, and GDP has grown uninterrupted since 2013 (except for 2020) in nominal terms.

The stock market has benefitted from Abenomics as the Topix doubled from 2013 to 2018. The stability brought about by Abenomics arises from the presence of a plan, the accompanying depreciation in JPY, and the BOJ's buying of the stock market. These have helped to support sentiments and exports.

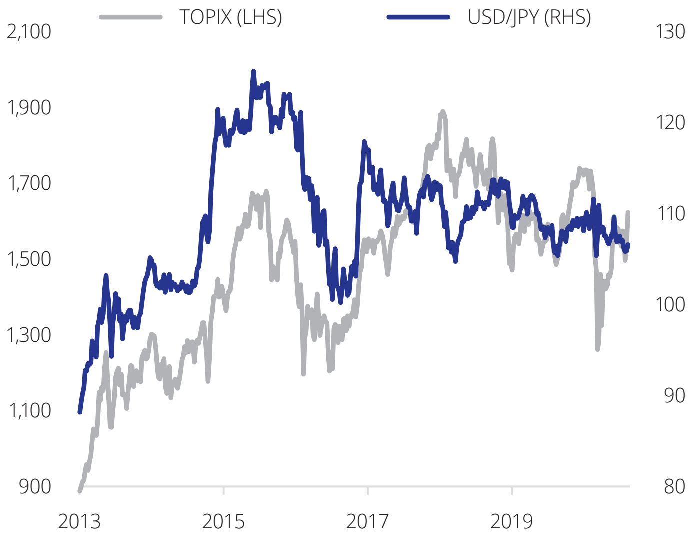
Much to the market's relief, Abe's right-hand man, Yoshihide Suga was appointed as Abe's successor. With Finance Minister Taro Aso and BOJ governor Kuroda remaining in their jobs as well, this should ensure the continuation of monetary policies, which is biased towards a "lower for longer bond yields" and the current weak yen. Suga is also focused on reform, the "third arrow" in Abenomics. Initial readings are that he is committed to the Olympics for next year, and is focused on pushing forward administrative reform and digitalisation.

Nonetheless, Suga's position as prime minister will have to be re-confirmed by an election in the next 12 months. In the interim, domestic economic recovery and the easing of the COVID situation are instrumental to watch, as they will have bearing on Suga's performance in the general elections. Uncertainties also lie in foreign policy relations with China, South Korea, and the US.

Broad market moves muted

Other than Abe's early retirement, the market is also grappling with many other issues. Besides domestic politics, uncertainties over the US's post-election policies will have a bearing on US-Japan relations and Japanese companies with business in the US. On the COVID-19 front, multiple experts on contagious diseases have predicted that the fall season will likely bring with it a re-emergence of the virus, assuming that the current second virus wave is brought under control prior to that. There is also the decision to be made if the postponed 2020 Tokyo Olympics will be permanently cancelled. Hence, until a vaccine is discovered, we believe that broad market moves will be quite muted in Japan.

Figure 3: Topix performs well in a weak yen environment



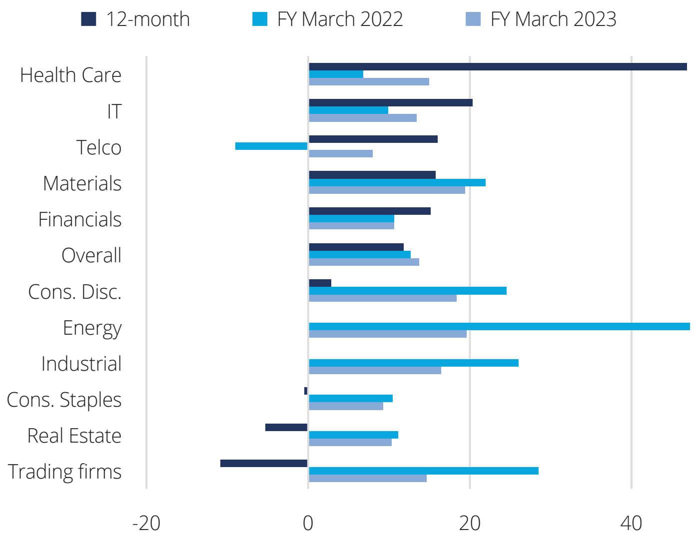
Source: Bloomberg, DBS

Tech, Health Care, and vaccine

Without its own catalyst, the Japan market is likely to mirror peer moves in the US, especially in the Technology and Health Care sector. These two high growth sectors will likely continue to attract buying interest and support the broad market.

Meanwhile, the race for a vaccine has intensified as governments, corporates, and academics accelerate their efforts especially as economies, politics, and lives are at stake. As such, stocks which are likely to do well are those which can leverage off a vaccine discovery.

Figure 4: Earnings growth by sector (%)



Source: Bloomberg, DBS

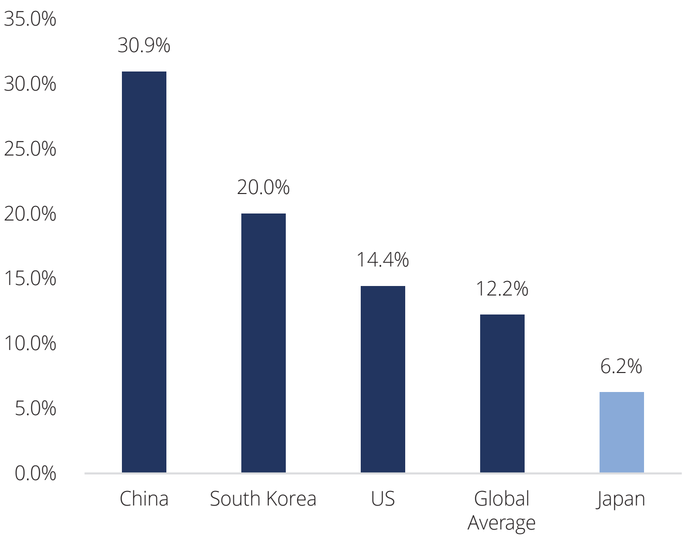
The results from the current earnings season and company guidance have provided a clue of the impact from COVID-19 and a peek into the outlook for the next 12 months. The earnings outlook for FY March 2022 is highly uncertain, let alone FY March 2023. Investors anticipate a second straight year of profit increases in the Health Care, IT, and Materials sectors, and a V-shaped recovery in the other cyclical sectors such as Energy, Consumer Discretionary, and Industrials, after profit declines in FY March 2021. Another sector bound for a V-shaped recovery is Trading Firms, where Warren Buffet recently made acquisitions.

Given the dynamics, Japan is a classic example of a stock picker's market in which bottom-up research can help to uncover bright spots – exciting businesses that are globally competitive and well-positioned for the new normal.

We summarise the major leading themes and investment ideas in Table 1.

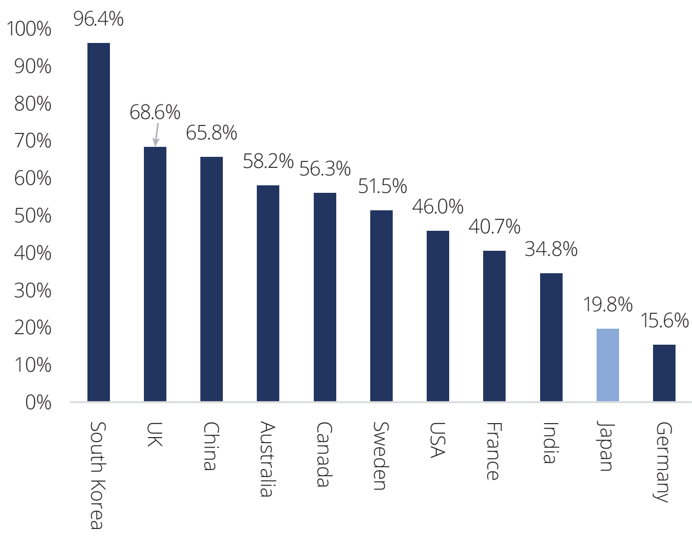
Source: Unsplash

Figure 5: 2018 e-Commerce as a % of total retail sales



Source: Japan Ministry of Economy Trade and Industry, emarketer.com, digitalcommerce360

Figure 6: Demand for digital payment solutions to accelerate given low cashless payment ratio



Source: BIS, SuMi TRUST. As of 2016.

Table 1: Summary of key themes in Japan

Sector/Theme	Rationale/Investment idea
Technology	The Technology sector is a winner benefitting from long-term secular growth trends, which include shifts in demographics (ageing population and labour shortages), the global transition in Millennials lifestyles (changes in consumption patterns, the rise of gaming culture, different set of leisure activities), and the rise of IOT (e-Commerce, cloud computing, automation). This crisis has also clearly accelerated digitalisation and the use of technologies in all areas including working, schooling, shopping, medical and entertainment, creating demand for 5G, cloud computing, and IT solutions. Japan's Tech sector may lag the US's in terms of innovation and scale, but it has its own niche adapted to its own culture. Companies that have strategies to adapt to these secular trends will be long-term winners.
IT services	Japan's IT Services sector is driven by several factors including: (i) the ageing population resulting in an acute labour shortage; (ii) work-style reforms; and (iii) the rise in next-generation IT technologies including cloud, big data, and AI. Demand for IT services will also become more urgent due to the crisis as WFH trends start to emerge, resulting in greater demand for B2B and communication tools, such as web-conferencing, business chat, virtual desktop infrastructure (VDI), digital banking, authentication security, and products that can help reduce paper-based documents and improve productivity. We believe opportunities for IT services in Japan abound post-COVID as behavioural patterns change.

Sector/Theme	Rationale/Investment idea
Digital payments	Japan has a low cashless payment ratio of c.20%, based on a study done in 2017 by the Bank of International Settlements (BIS). This has historically been driven by prudence and a lack of necessity as crime rates are low in Japan and near-zero interest rates do not incentivise people to convert their cash to deposits or other "digital" assets. This could change quickly post COVID-19 as contactless and social distancing regulations change ways cash is being handled. The government is pushing for the ratio to double to around 40% by 2025 and has begun offering rebates on cashless payments since October 2019.
e-Commerce	The potential growth in e-Commerce demand in Japan over the next decade should be higher than other developed economies. Japan's e-Commerce adoption rate remains low at just over 6% of retail sales (vs a global average of 12%, and higher in developed countries) which implies a long growth runway ahead. Strong demand for e-Commerce due to the stay-at-home trend has been witnessed globally, including in Japan. We believe it could be transformational in Japan because as an Internet savvy nation, a behavioural attitude change towards digital payments could be the linchpin, accelerated by the new normal of WFH.
Logistics J-REITs	Despite having rebounded sharply after the March selloff, we like the larger-cap Logistics J-REITs for their defensive portfolios. The larger J-REITs, with their newer and higher quality assets due to reputable sponsors, have tended to outperform the logistics market. Occupancy levels for the sector have remained stable at the 98-100% level even during the 2008 GFC, owing to strong demand for logistics assets. Thanks to strong demand for e-Commerce due to the stay-at-home trend, the big logistics landlords have commented that these 3PL tenants have reported flat-to-increased volumes during the COVID-19 period, which has offset areas of weakness such as apparel and exports.
Health Care	Drug sales and health care services may be punctuated during the pandemic at its worst time, but essential health care services will have to resume regardless. The sector will be driven by the pursuit for vaccines and cures, promotion of good health, safe quality of life, and an ageing population – a secular trend which is very pronounced in Japan. The Japan Health Care sector holds pharmaceutical companies with many patents, and medical device companies which are leaders in global market share. Some companies are also expanding their online opportunities as well as expanding overseas.
Do-everything-from-home trend	Spending more time and having entertainment at home will also mean a pickup in the home video games industry, as well as in a range of digital consumer electronics such as laptops, printers, and air conditioners. Companies which can seize business opportunities in the form of the shift to digital technologies and bolster online sales and digital marketing will be key winners.

Sector/Theme	Rationale/Investment idea
Industrials	The sector has underperformed the overall market and investors looking for beneficiaries of the post-pandemic recovery can look for value here. Industrials is an eclectic mix of companies and opportunities are in those which can benefit from the secular growth trends and the new normal. The five trading firms – in which Warren Buffet made recent acquisitions – are in a diverse mix of industries from energy and commodities, to hospitals and selling tires, as well as in growth sectors including IT, health care, and even space. They will be good recovery plays from the damage caused by the pandemic and the US-China trade war.
Automation	Japanese corporates excel in areas such as automation, mechatronics, and precision manufacturing. The country's growing prowess in automation technologies, in particular, has been driven by an acute need to combat the negative effects of a shrinking and ageing population. In the aftermath of COVID-19, the need to minimise contact and an unprecedented drop in economic activity should drive the growth of factory automation and accelerate digital innovation for productivity growth.
Tourism	The Tourism sector is the hardest hit sector by the pandemic and its recovery will probably take time; it may take even longer if the Olympics were to be cancelled. As part of fiscal stimulus, the "Go to Travel" campaign is a Japanese government subsidy encouraging domestic travel to help boost the economy. There may be some reprieve for the sector in the near term where valuation could normalise, but the sector still faces lots of uncertainty pending the discovery of a vaccine. Selective positioning for those which have a strategy to survive, transform, and gain market share post COVID-19 is warranted.
Uncertainty from the US elections	Companies with US business operations face uncertainty if Democratic nominee Joe Biden wins in the election, which could result in an increase in corporate tax rates and income tax hikes being mulled. The auto sector is most exposed to this risk.
Japan's leadership transition	The yen could strengthen when Abe leaves office as the continuation of Abenomics is currently being questioned. A strong yen is unfavourable to the exports sector and overall market. Regulatory risk also portends for the Telcos sector.
Survivors of COVID-19 with strong balance sheets	One unique characteristic of the Japan equity market is the large number of companies with net cash balance sheets, with the average Topix Index company now around 0x net debt/equity. This is the result of a generally risk-averse mindset among corporate managers who prefer not to employ significant leverage, coupled with a rise in corporate profits over the Abenomics era. Companies in Japan that have been heavily impacted by COVID-19 could be quality laggards to invest in, if they have (i) positive long-term growth outlooks, and (ii) the balance sheet strength to survive this period of weakness. Examples include companies in the cosmetics and recruitment sectors.

DBS
Live more,
Bank less

Source: Unsplash

Asia ex-Japan Equities | 4Q20

Reopening

Asia ex-Japan Equities

Yeang Cheng Ling | Strategist
Joanne Goh | Strategist

After the trough in March, overshadowed by the outbreak of COVID-19, global equities and financial markets rebounded impressively as investors looked past the social and economic impact of the pandemic, while confidence was boosted by governments' monetary support and stimulus measures.

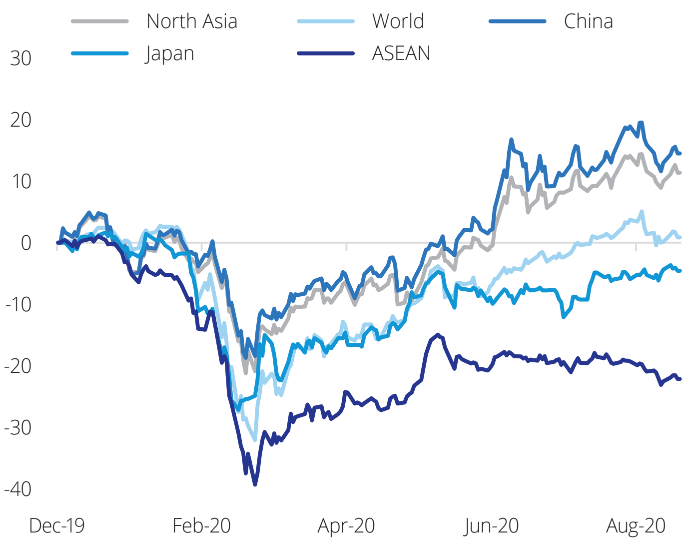
Among the major Asian markets, Mainland China equities remained sturdy relative to their regional peers. In USD terms, China and North Asia equities gained more than 10% (Figure 1). In contrast, Japan and ASEAN equities remained in negative territory, down some 5% and near 20%, respectively.

During this period, North Asia corporate earnings forecasts exhibited resilience by staying stable since May (Figure 2). North Asian economies have emerged from the COVID-19 ordeal earlier than the rest of the world.

The unexpected and unwanted outbreak of COVID-19 has massively dislocated economic growth, business operations, and daily activities of people from all walks of life globally, so much so that even the reopening of higher education institutions has been deferred. Nonetheless, the relentless commitment and concerted efforts of policymakers are providing much-needed lifelines to domestic economies.

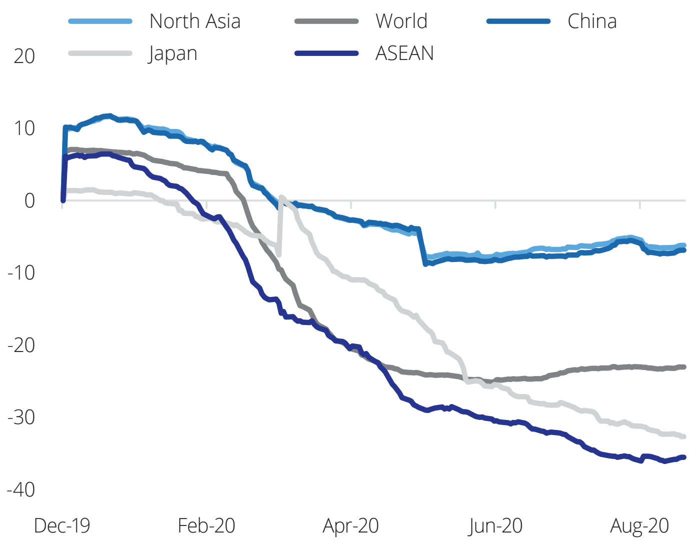
Within Asia ex-Japan, selected sectors displayed their ability to come out better off and capture the trends favoured by the CIO Office, namely digitalisation, semiconductors, 5G, e-Commerce, domestic consumption, e-Sports, and health care (Figure 3). Corporate earnings outlook in these sectors are not only unscathed, but may be brighter than last year's as the businesses they engage in benefit from the pandemic-induced changes.

Figure 1: Asian equities YTD performance



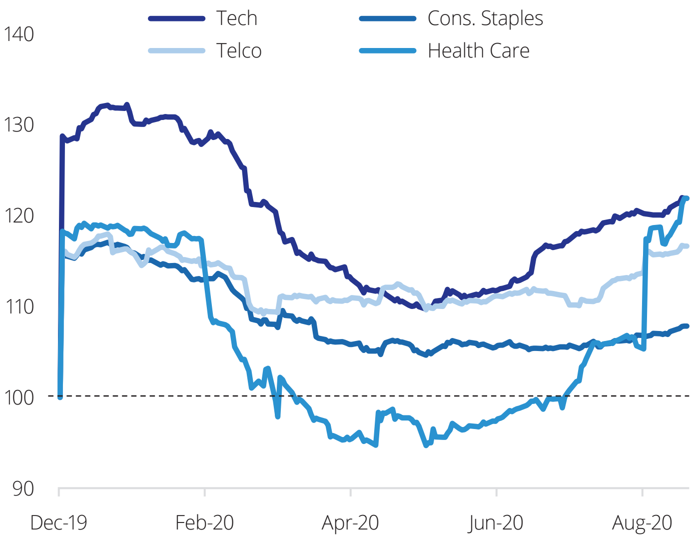
Source: Bloomberg, DBS

Figure 2: Bifurcation in earnings outlook by region



Source: Bloomberg, DBS

Figure 3: Sectors with stronger earnings outlook in Asia ex-Japan



Source: Bloomberg, DBS

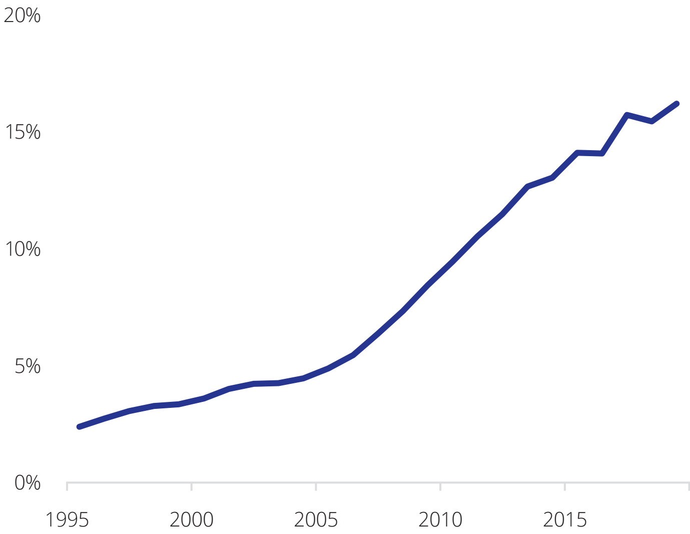
Notably, China's economy as a percentage of the world rose to 16% in 2019; a respectable achievement over the period of two Chinese zodiac cycles (Figure 4), thanks to the continuous reform which has transformed the country and moved industries up the value chain.

China was affected less than expected by the trade tensions owing to the rising proportion of domestic consumption in its economy. It has also demonstrated resilience during the pandemic.

The IMF projects the world's second-largest economy to grow 1% in 2020, compared to a decline of 4.9% in the global economy. The recovery in industrial production and 2Q GDP are evidence of its effective policy implementation (Figure 5) and the resilience of its local economy.

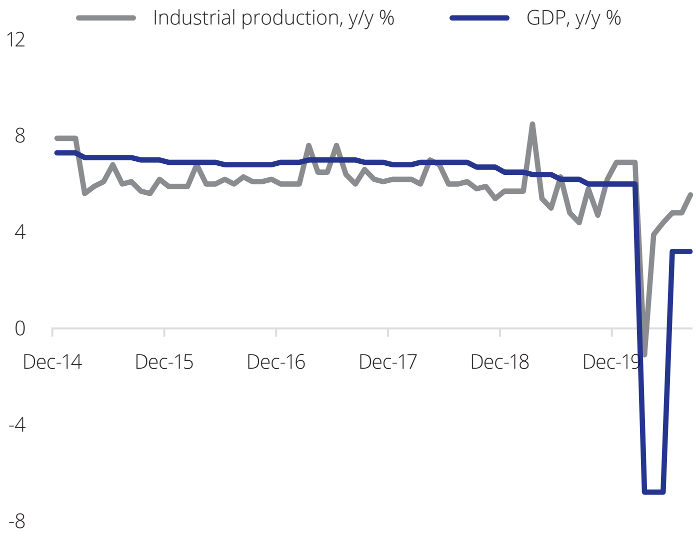
Source: Unsplash

Figure 4: China GDP as a percentage of world GDP (1995-2019)



Source: Bloomberg, DBS

Figure 5: Industrial production leading the recovery



Source: Bloomberg, DBS

Asia semiconductors: Riding the digitalisation trend

Global demand for smart devices, cloud, IOT, and semiconductors has stayed firm as technology innovation charges on. This bodes well for North Asia and global technology industries, namely equipment makers, IC design firms, and wafer foundries. China continues to be the largest buyer of semiconductor components and integrated chips, as measured by the number of chips imported on a per person basis (Figure 6). This steady uptrend over the past 15 years has been buoyed by China's mammoth supply chain churning out a rising number of devices and more importantly, the country's ability to move up the value chain towards locally made advanced gadgets.

Asia's technology sector is well-positioned to ride the global secular digitalisation and cyber-connectivity trends, with their long-existing presence in the technology supply chain. Asian technology players standout in areas including wafer foundries, logic IC design, memory (DRAM, NAND), and semiconductor backend packaging and testing; as well as the downstream works of component assembly, printed circuit board, metal casing, display panel, acoustic, touch sensor, smartphone camera, and other passive components.

Evidently, Japan's monthly wafer export to China, South Korea, and Taiwan remained robust as the supply chain sprung back into operation (Figure 7) since the second quarter this year.

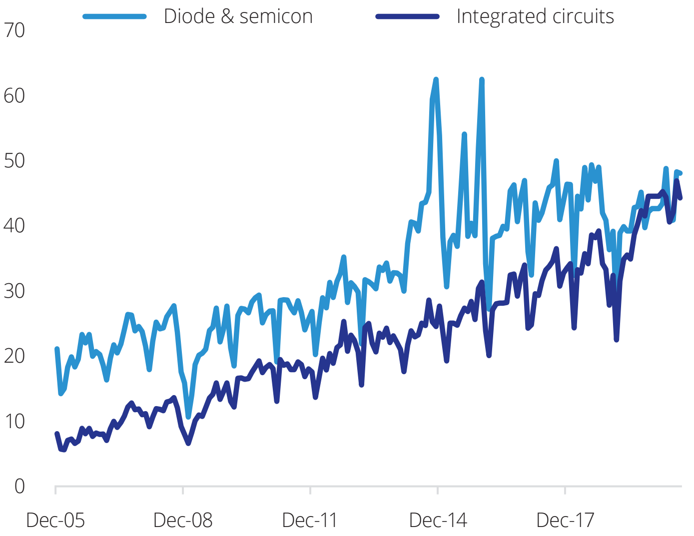
The Asia semiconductor sector, which encompasses firms in the segments of IC design, equipment, wafer foundry, backend assembly testing and memory, has proved its ability to deliver steady earnings with average EBITDA margins around 27% since 2005. It is noteworthy that profit margins have stayed at or above the historical average since 2013 (Figure 8).

Technology advancement, initiatives to increase self-sufficiency in the manufacturing sector, and widening of end markets are factors supporting the progression of the semiconductor and related sectors in the Greater China region.

The next big race in global upstream technology will shift towards artificial intelligence IC for more sophisticated processing and self-learning capability. The Asia supply chain will no doubt be part of this new trend.

We prefer upstream semiconductor and IC design firms for their roles in leading the technology development, strong pricing power, and hence better profitability. For example, the operating margin among Asia's leading wafer foundries has consistently been around 35% in the past eight years thanks to the emergence of new devices (eg smartphones, cloud computing, high performance computing, and IOT). In contrast, profitability in the downstream component supply chain remained trapped at low single digits.

Figure 6: Rising semiconductor imports, December 2005 – July 2020 (unit per person)



Source: Bloomberg, DBS

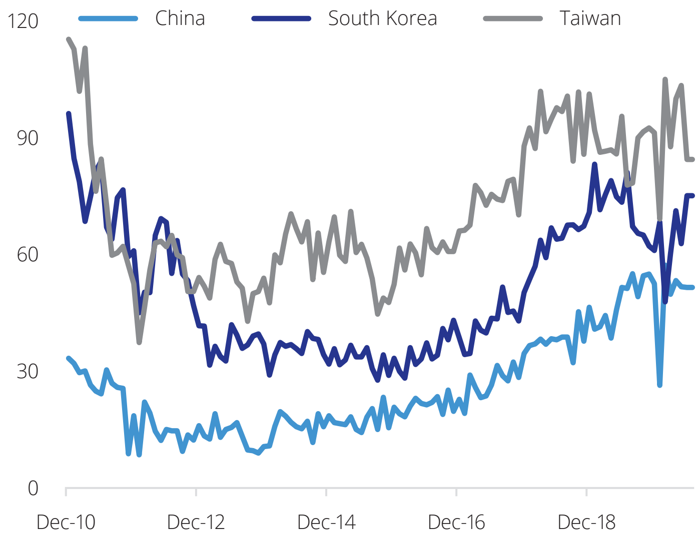
China equities: Rising representation

China equities continue to attract fund inflows due to their unique investment propositions. Besides serving global and regional portfolio managers for the purpose of allocation diversification, China equities have the following investment angles:

1. Faster recovery of its domestic economy
2. Higher revenue mix from local demand
3. Government stepping up stimulus measures
4. Prudent policy adjustment
5. Access to China's new economy sectors

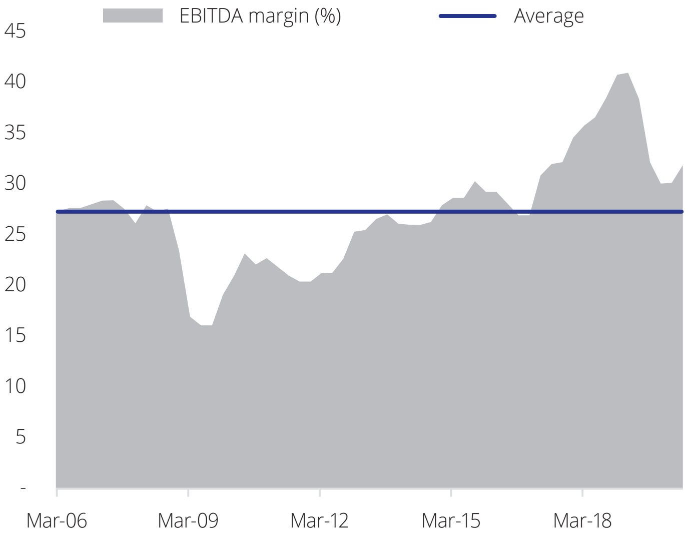
The representation of China equities among global benchmark indices has consistently risen. In the EM universe, China equities now account for about 35% in weighting, doubling their representation a decade ago. In the global context, the representation has nearly tripled to 4.5-4.7% (Figure 9). These prove the rising importance of China equities in global index representation.

Figure 7: Japan semiconductor wafer exports by market, December 2005 – July 2020 (USDm per month)



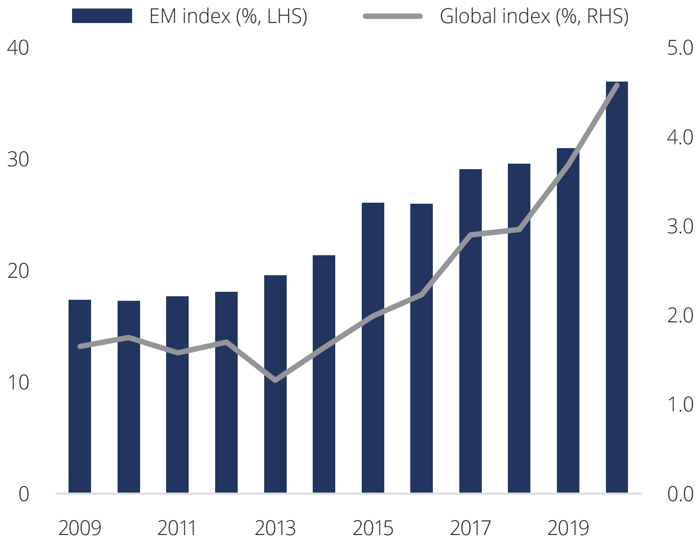
Source: Bloomberg, DBS

Figure 8: Asia technology sector – solid profitability, December 2006 – June 2020



Source: Bloomberg, DBS

Figure 9: Rising China equities weighting in global indices, December 2009 – August 2020



Source: Bloomberg, DBS

We are constructive on the outlook of China equities as they offer investors attractive returns and compelling valuations (Figure 10) on long-term robust corporate earnings growth, driven by ongoing transformation, rising domestic consumption, and pro-market reforms to include new economy sectors.

Figure 10: Valuations are not excessive

Source: Bloomberg, DBS

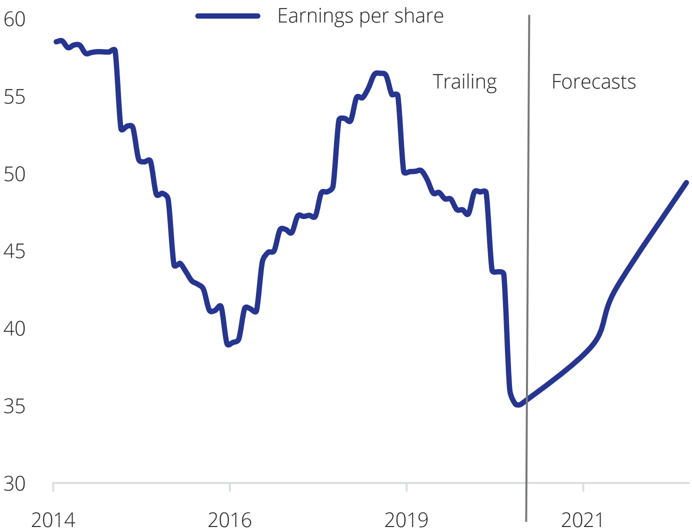
ASEAN as a recovery play

Investors' confidence in ASEAN was frail in 3Q as disappointments around macroeconomics and earnings took toll on markets. Even if poor results were expected generally, confirmation is needed to assess the downside and if a recovery in the second half of the year can be safely presumed. Working on a base assumption that economies will gradually reopen, we believe the worst is over for ASEAN economies and markets. However, confidence is lacking in the speed of the economic recovery.

ASEAN sees the world's worst performing markets including Singapore, Thailand, Indonesia, and the Philippines. With fortunes tied to the external economy for tourism, foreign fund flows, and exports, the region has been severely affected by the pandemic. However, we believe once global risk appetite returns, USD weakens, and a global hunt for value drives investors to look into EM, the region will be poised to recover strongly.

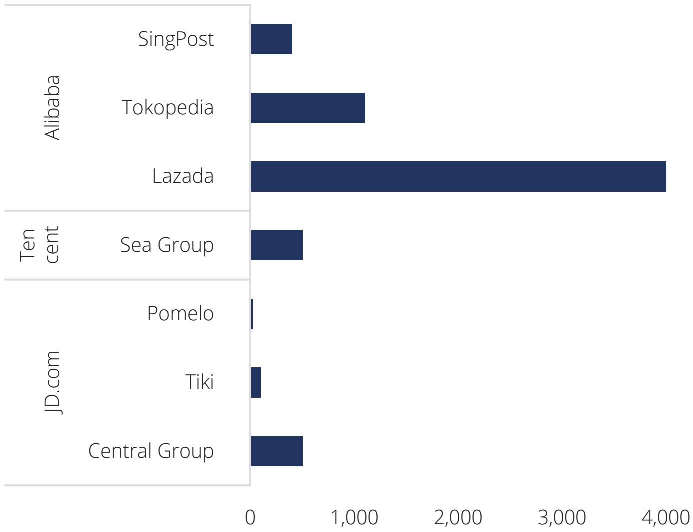
Earnings for the region are forecast to return to 2014 levels but estimates are crawling back. One of the main reasons for the region in trailing global estimates is in its lack of technology stocks and hence it did not participate in the global Tech rally.

Figure 11: ASEAN earnings set to recover next year



Source: Bloomberg, DBS

Figure 12: Investments by the tech giants in ASEAN e-Commerce (USDm)



Source: TLG Commerce, DBS Bank report "E-commerce: Can Asean be the China of this decade?, 12 Jun 2020"

Some smaller Tech and Health Care stocks actually performed well; and gloves stocks in Malaysia returned c.330% YTD, joining the list of pandemic winners globally.

Notwithstanding the pandemic, we believe investment prospects in the region are promising with improvements in the investment environment, strong economic growth, big populations and consumer markets, a growing middle class, and advancements in regional integration. The region should see the return of FDI post pandemic and continue to prosper. Several industries, such as mining, should attract investments given:

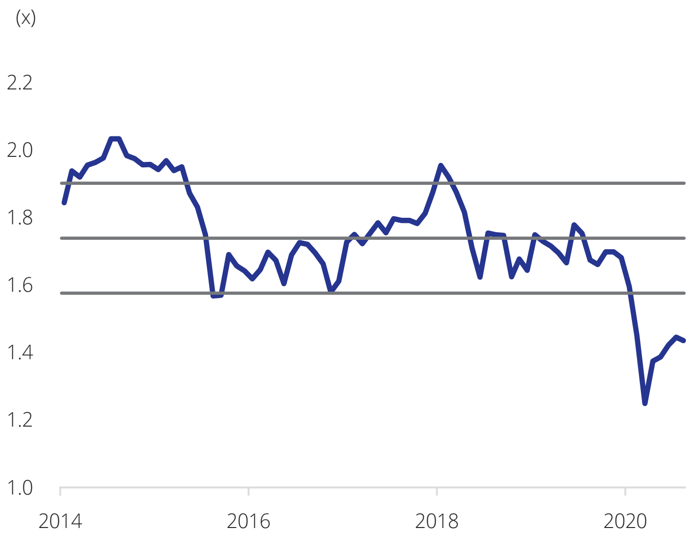
1. Rising commodity prices
2. Infrastructure development in the region given the steady economic and industrial growth
3. The competitiveness of the region for manufacturing and services as a supply chain diversification strategy

In addition, emerging investment opportunities in the digital economy will push more global digital firms to adopt regional strategies to benefit from network effects and scalability in a captive market.

The region's stock market is undervalued from a P/B perspective. We see opportunities in Thailand, Indonesia, and Singapore for recovery into next year.

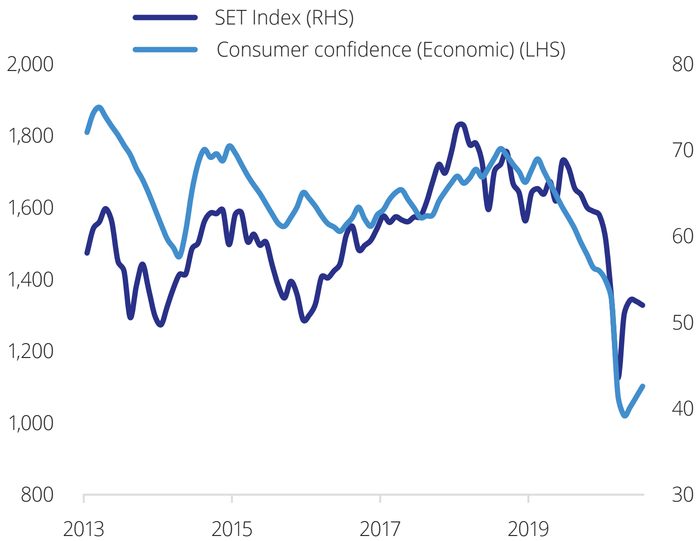
Source: Unsplash

Figure 13: ASEAN P/B valuation is near its low



Bands are average and +/- 1 SD. Source: Bloomberg, DBS

Figure 14: Thai consumer confidence index has bottomed



Source: Bloomberg, DBS

Thailand. As a country which is heavily dependent on tourism, the performance of the market will depend on how soon global travel can resume. The tourism industry makes up about 15-20% (direct and indirect) of the country's GDP. Currently, the BOT forecasts tourist arrivals will drop from 40m people in 2019 to 8m people in 2020 and 16m people in 2021. Even though the number is expected to double in 2021, it would just be 40% of the pre-COVID level. The tourism sector should see improving sentiment and operations. However, we believe the sector's operating revenue needs to be at minimum 30-40% to break even at the EBITDA level, and higher to break even at the bottom-line level.

For recovery plays into next year, we prefer to look into other cyclicals such as the Energy, Commerce, Food, and Health Care sectors. They should see earnings recover strongly next year.

Indonesia. The recovery in Indonesia resumed in 3Q, driven by gradual reopening of the economy and fiscal stimulus plan, and a weak dollar. We expect the Indonesia equity market to continue recovering as a result of the government's efforts to bring the economy back to normal with strong fiscal and monetary stimulus. Being the largest consumer market in ASEAN, we expect Indonesia's economy to be relatively resilient. Although consumption and investment have shrunk, some changes in consumption patterns can be witnessed post-COVID which can uncover new investment trends and opportunities.

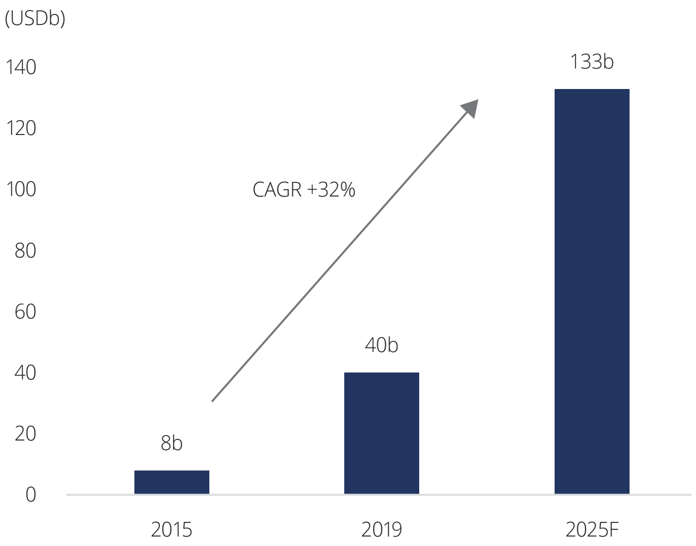
An online survey was conducted recently to gather insights into consumer behaviour, and the key findings are:

1. There was a large tilt towards consumers perception of health and hygiene.
2. Consumption of home meals surged to 69% vs 42% before COVID-19.
3. The home has become the new place of entertainment as more people seem to relish their private time and space at home.
4. e-Commerce adoption with a shift to online shopping accelerated as this channel provided consumers (who stayed home) access to product needs.

5. Traditional grocery channels losing market share due to limited access to fresh products in wet markets during the PSBB (large-scale social restrictions) and higher awareness of safety and hygiene.

These findings are re-enforcing our belief on accelerated digitalisation post-COVID. For Indonesia, this trend can benefit many sectors, such as Banks, Telcos, and e-Commerce platforms, which are enablers in the process. Companies that can adapt to the new normal through sales channel and geographical diversification, execute online or B2C sales channels supported by leveraging on third party platforms, as well as enhance their own online platforms are likely to be post-COVID winners.

Figure 15: Indonesia's Internet economy poised to increase at a CAGR of 32% between 2015 and 2025



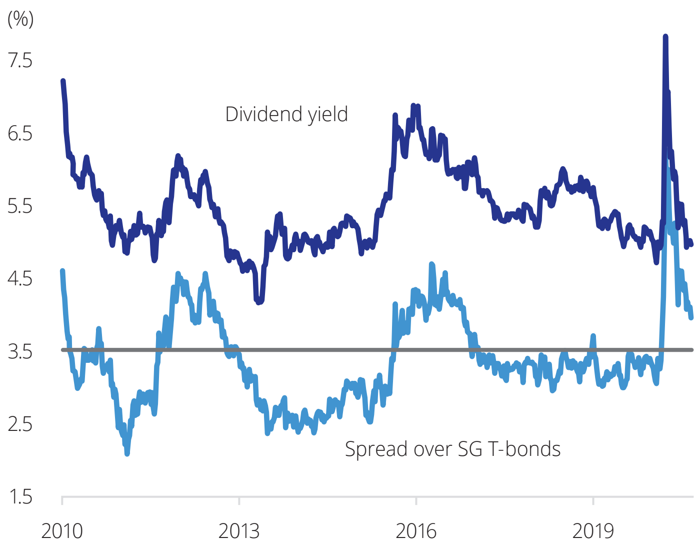
Source: Google, Temasek, and Bain "e-Conomy SEA 2019" report

Singapore. As a cyclical market, the Singapore benchmark index did not recover as well as the other countries mainly because of its index composition which has almost no Technology and Health Care exposure, and hence the Straits Times Index (STI) did not participate in the Tech rally. Some smaller Tech names, health care stocks, and logistics companies actually did well. Overall earnings are projected to grow at 19% next year after sliding 24% this year. The outlook for cyclical stocks could get some earnings and valuation uplift.

2Q GDP growth was at its worst, but lagging indicators such as unemployment numbers are likely to rise and more companies may go under after the government's interim support measures. According to a survey by Singapore Business Federation, 20% of companies surveyed expect headcount reductions over the next 12 months. Thus, bank provisions may still go up. However, most banks have announced dividend cuts upon the guidance from the MAS and the sector should have stabilised for now, supported by dividend yields.

Although we believe a lot of negatives are already in the price, the STI will need a broad-based return in global risk appetite and flows before it starts to unleash its value fully. The sector we like for stability and recovery play is REITs. The industrial and logistics REITs are less affected by the pandemic. In fact, they benefitted from the post-pandemic new normal where e-Commerce activities accelerated. For office, retail, and hospitality REITs, as most of them have cut their dividends. We believe yields are attractive at current levels and REITs will be good recovery plays for next year.

Figure 16: Singapore REITs yield



Source: Bloomberg, DBS

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
	Indonesia banks
	Indonesia telcos
Government stimulus	China banks
	Indonesia consumption
Market reform	China A-shares
	Vietnam

Source: DBS

Live more, Bank less

Global Rates | 4Q20

Steepening in play

Global Rates

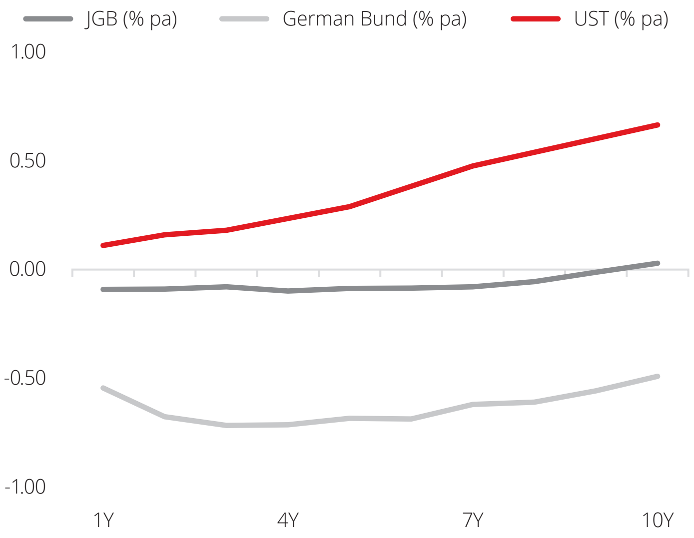
Eugene Leow | Strategist
Duncan Tan | Strategist

G-3 central banks are generally taking a backseat after doing a lot of heavy lifting in the initial part of the COVID-19 crisis. Room for further rate cuts has now been exhausted while the pace of asset purchases has been reduced as financial conditions normalise. The Federal Reserve, ECB, and BOJ are now generally playing supportive roles (to fiscal policy) to ensure that financing costs do not become too onerous for their respective governments. Put another way, G-3 central banks are taking away a chunk of the government bond supply that the private sector would otherwise have to absorb.

Conditions have not aligned for G-3 central banks to remove accommodation. Consensus expects fiscal deficits for the G-3 economies to remain wide in 2021 (10%, 4.6%, and 6.8% of GDP for US, Eurozone, and Japan respectively). Moreover, we suspect that central banks will want to see the unemployment rates drift much lower (even if GDP growth rebounds strongly in 2021) before considering reducing the pace of asset purchases. Inflation is not likely to be a priority. While inflation break-evens have normalised to a large extent, central banks are likely to be more worried about downside risks to the economy and prefer to allow inflation to overshoot for a period. We think that tapering of asset purchases could take place in mid-2021 the earliest and may well be delayed into late 2021.

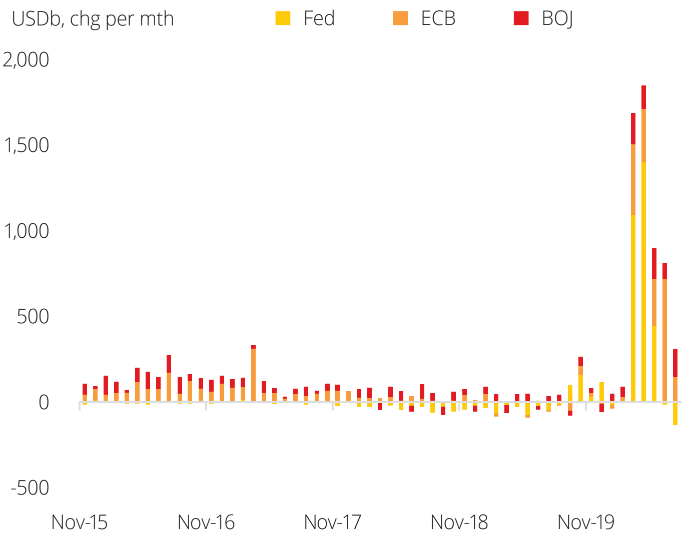
That said, the market is unlikely to ignore the fact that the global economy has staged a meaningful recovery over the past few months as lockdowns ease. This can clearly be seen from the bounce in PMI numbers and Google Mobility Trends. To be sure, these are the early gains from reduced mobility restrictions. Further gains may prove elusive as long as vaccines are not widely made available. On this front, we think that there is cause for optimism. There are several candidates that are already in phase three trials and a couple could get approval by the end of the year. Once the vaccine becomes widely circulated, a second leg of recovery could take place by mid-2021. We suspect that the G-3 rates space will be ahead of the real economy and would remove the COVID-19 price premium embedded in G-3 government bonds, steepening G-3 curves in the coming months.

Figure 1: Flat G-3 curves awaiting vaccine cues



Source: Bloomberg, DBS

Figure 2: G-3 central banks slow QE

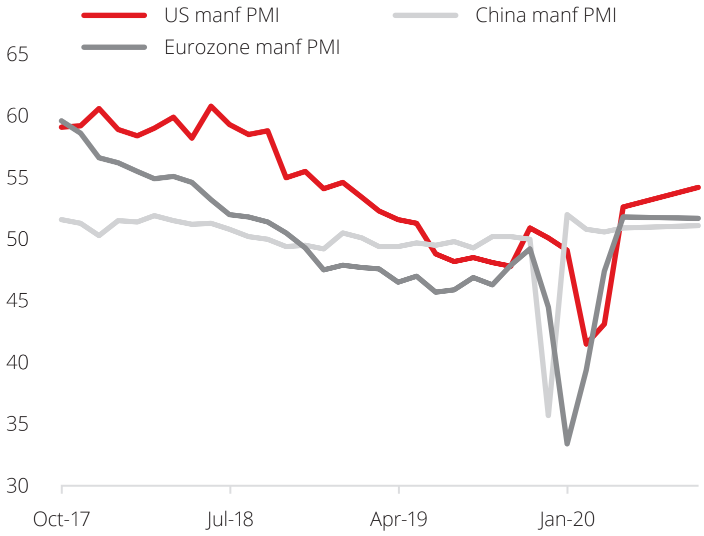


Source: Bloomberg, DBS

Figure 3: US 10-year yields can rise modestly in 4Q20

Source: Bloomberg, DBS

Figure 4: A global recovery is underway



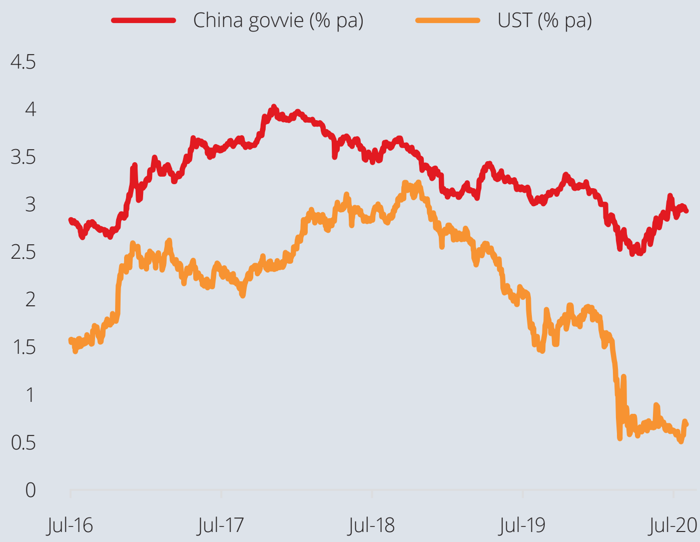
Source: Bloomberg, DBS

Asia Rates

CNY rates: Normalised policy

There are not many alternatives to China government bonds (CGB) in the low-yielding global environment. While there are domestic headwinds as the authorities seek to frontload government bond issuances, foreign investors will probably look past this issue. Note that the PBOC is probably the first major central bank to normalise monetary policy. It is easier to see the PBOC's policy stance by the amount of liquidity injected into the market and observe the reactions in the 7-day repo rate and the 10-year CGB yield. In both cases, rates have recovered close to pre COVID-19 levels (2-2.5% for the 7-day repo and close to 3% for 10-year yields). At around 230 bps premium over 10-year USTs, 10-year CGB yields look very attractive compared to DM peers. The key risk is if the PBOC opts for tight monetary policy, instead of maintaining a neutral stance as it is doing currently. However, we think the risk of tight policy is low given still significant challenges to the Chinese economy.

Figure 5: PBOC normalises policy, Fed stays dovish

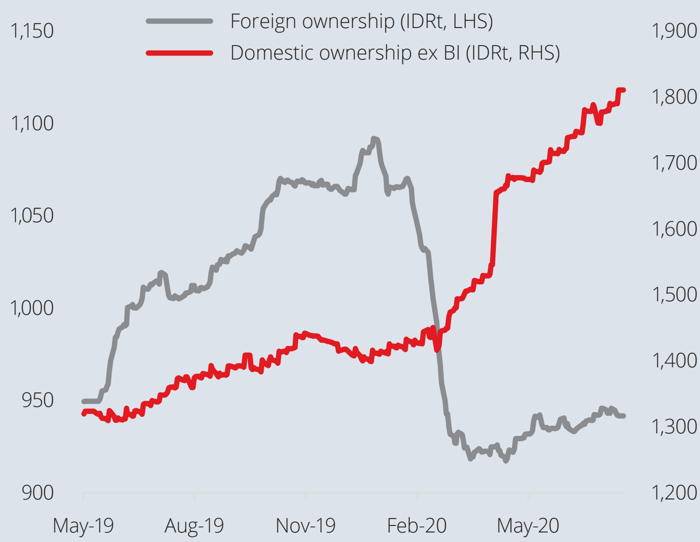


Source: Bloomberg, DBS

IDR rates: Grinding lower

IndoGB have done relatively well over the past few months, driving 10Y yields below 7%. The rally in Indonesia government bonds (IndoGB) can be viewed from several angles. First, BI has kept policy setting accommodative, cutting the policy rate to 4%. Second, fiscal and monetary coordination is at play with BI's burden sharing scheme set to take off close to IDR400t of bond supply off the market. With gross issuances hitting around 55% of target as of 12 August, we think that the fall off in supply in the coming months will be felt by the market. To be sure, the rally has largely been driven by domestic players, with BI acting as a major tailwind. Foreign investors are more reticent as shown by recent action participation. Foreign ownership of IndoGB has fallen below 30%, from close to 40% pre COVID-19 crisis. There are still lingering concerns on the IDR, but we think that foreign interest will return (especially those who are more opportunistic). Short-term volatility aside, we think 10-year yields can grind towards 6.5% when COVID-19 risks dissipate.

Figure 6: Foreign investors are still reticent

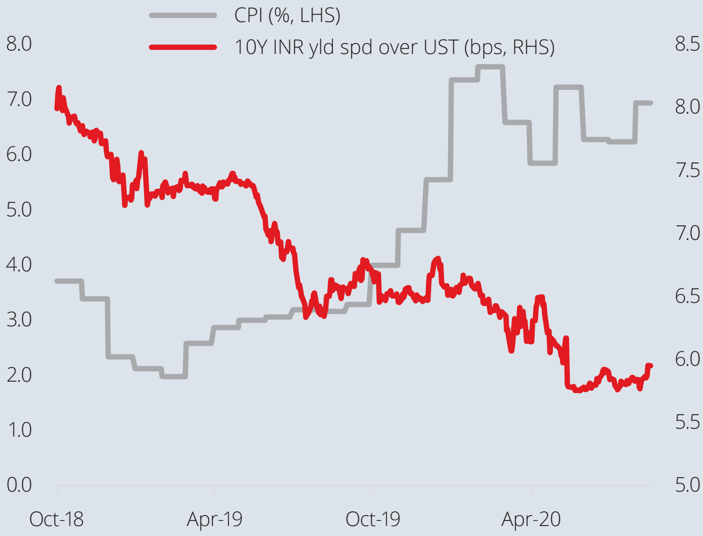


Source: Bloomberg, DBS

INR rates: Still neutral

Market participants have front-runned anticipated RBI easing (rate cuts as well as government bond support). This rendered rates/yields susceptible (to the upside) from any perceived disappointment on the policy front. Notably, the RBI refrained from cutting rates in August (against consensus expectations of a 25 bps cut) and has thus far not given much hint on either Operation Twist or QE. Recent comments also suggest that the RBI is watching inflation risks as headline CPI ticked close to an uncomfortably high 7% y/y in July. That said, we still think INR rates will stay anchored/rangebound in the short term. Inflation is likely to prove transitionary and we expect another 25 bps cut later this year. If longer-end yields drift significantly higher, the RBI is also likely to step up support for government bonds. Beyond the short term, we think that the curve would steepen into 2021 as the global economic recovery takes hold.

Figure 7: A tad worried about India's inflation

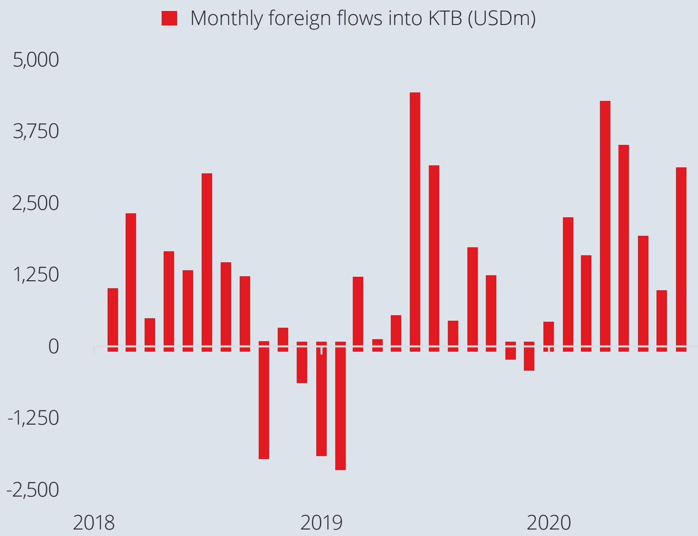


Source: Bloomberg, DBS

KRW rates: Extended stability

South Korean interest rates have generally been slow to normalise post the global deleveraging of March. 10-year bond yields remain high relative to peer Asia low-yielders, likely due to higher duration supply pressures in 2020 (70% projected increase in gross issuances) and prospects of more expansionary fiscal policy in 2021 and beyond. Our outlook is for policy, swap, and bond rates to be stable ahead. The policy rate at 0.5%, is close to the BOK's effective lower bound, and thus likely to be kept unchanged. The BOK also appears to be reluctant to conduct large outright purchase transactions of KTB, unless volatility rises, or the yield curve steepens excessively. Through August, foreign inflows into KTBs, in both cash and futures markets, have been outsized relative to historical. Global bond investors should continue to be attracted to the hedge properties (against US-China tension) and yield-enhancing opportunities (FX-hedged to USD) of KTBs.

Figure 8: Foreigners have bought a lot of KTBs in 2020

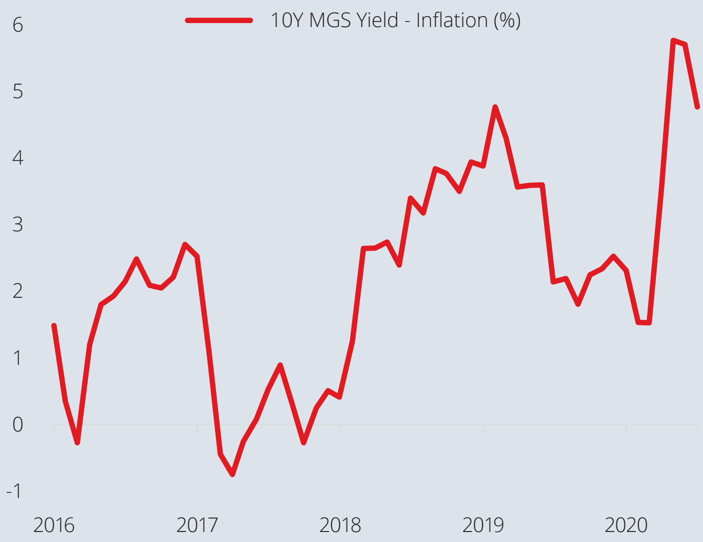


Source: Bloomberg, DBS

MYR rates: Quick normalisation post March

Relative to Asian peers, Malaysia interest rates have been one of the quickest to recover from March's selloff. In terms of flows, it is the first government bond market to show a clear return of foreign capital. Inflows of USD2.5b in June and USD1.8b in July are large vs historical and have almost fully reversed the USD4.7b of combined outflows seen in February and March. In terms of price, interest rates levels have recovered from March's spread widening and rallied more – 10-year MGS yields are now 20 bps lower than pre COVID-19 levels. We attribute the strong rally primarily to BNM's 125 bps of rate cuts (YTD) and persistent domestic deflation. Looking ahead, considering that MGSs have normalised much faster than regional bonds, we think that the scope for further outperformance is likely to be capped.

Figure 9: Real bond yields in Malaysia are elevated

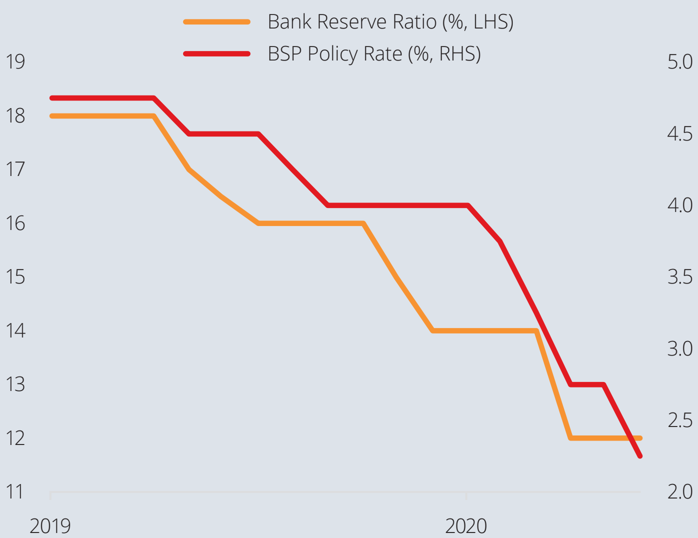


Source: Bloomberg, DBS

PHP rates: Standout performer

Year to date, the Philippine local government bond, RPGB, has been Asia' standout performer. 10-year RPGB yields have declined by almost 170 bps. The PHP has strengthened 2-4% against a broadly weaker Asia FX complex. Looking ahead, the scope for incremental returns is likely to be much more limited – the BSP is expected to slow the pace of easing (policy rate cuts and RRR reductions) to allow earlier policy measures to work through the financial system. This, however, does not mean that RPGB yields are about to rebound. Flush onshore liquidity acts as a dampener against upward pressures on bond yields. We also expect the BSP to continue to be a key anchor of bond yields via their purchase transactions. Through July, they have already bought PHP800b of government securities, equivalent to 45% of the government's domestic borrowings.

Figure 10: Philippines's pace of monetary easing to slow ahead

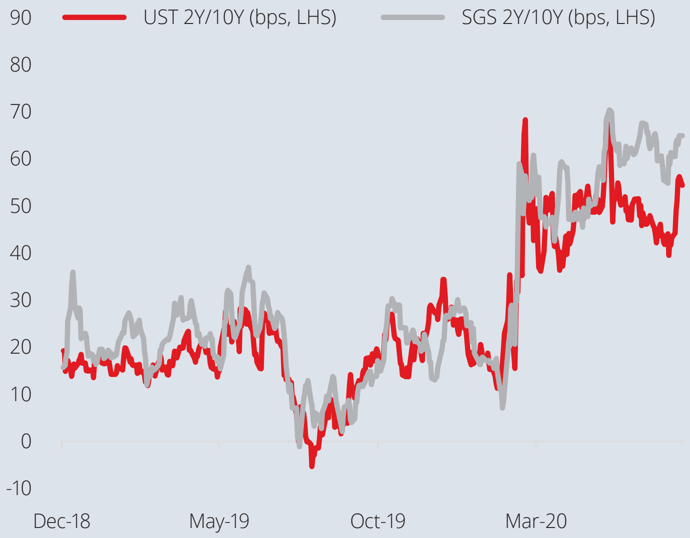


Source: Bloomberg, DBS

SGD Rates: Steeper with the US

While short-term SGD rates are likely to be anchored for an extended period (assuming that the Fed holds rates through 2022), there may be more gyrations in the longer tenors. Longer-term USD rates are low by historical standards and we suspect that market participants may have to recalibrate to a steeper curve when credible COVID-19 vaccines get approved towards the end of the year. Accordingly, we would expect steepening pressures to materialise in the SGS and SGD swap curve (2Y/10Y segment). That said, we think that the 5Y to 15Y SGS still trade at a significant yield premium over comparable US Treasuries. This premium should cushion SGS from the worst of the bear steepening that could take place in the coming months. In any case, the SGS curve is inverted in the 15Y/30Y and 20Y/30Y and flattish in the 10Y/30Y segment. By this measure, the 5Y to 15Y SGS should hold up well given better relative valuation to other tenors.

Figure 11: SGS curve faces steepening pressures

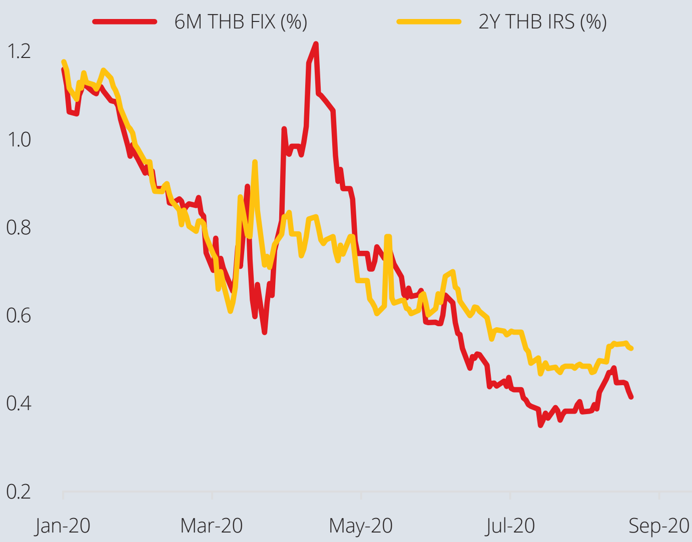


Source: Bloomberg, DBS

THB rates: More downside to 6M THB FIX

Looking across the various drivers of the 6M THB FIX, we are convinced that the balance of risks is skewed towards more downside ahead. The BOT is expected to keep the policy rate low for an extended period, to support the economic recovery. In terms of the BOT's liquidity stance, we note a slight pullback in recent months, after the large liquidity expansions of March-May. However, we believe the BOT will maintain liquidity at highly accommodative levels. Year to date, onshore THB liquidity has already been greatly boosted by large declines in outstanding BOT bills/bonds and expansion of the BOT's repo operations. The BOT has also allowed its FX Forward book to roll off, representing a more direct downward force on the THB FIX. Therefore, we are projecting the 6M THB FIX to decline to 20-25 bps range by year end. Front-end THB IRS rates appear too high relative to our projected THB FIX trajectory, and thus offer good value to receive.

Figure 12: 6M THB FIX to decline to 20-25 bps range



Source: Bloomberg, DBS

Table 1: Rates forecasts

		2020				2021			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
US	3M Libor	1.45	0.30	0.30	0.30	0.30	0.30	0.30	0.30
	2Y	0.25	0.15	0.20	0.20	0.20	0.20	0.25	0.30
	10Y	0.67	0.66	0.80	0.95	1.05	1.15	1.25	1.30
	10Y-2Y	42	51	60	75	85	95	100	100
Japan	3M Tibor	0.07	0.07	0.05	0.05	0.05	0.05	0.05	0.05
	2Y	-0.14	-0.13	-0.15	-0.13	-0.13	-0.10	-0.10	-0.10
	10Y	0.02	0.03	0.05	0.05	0.05	0.05	0.08	0.10
	10Y-2Y	16	16	20	18	18	15	18	20
Eurozone	3M Euribor	-0.36	-0.42	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45
	2Y	-0.69	-0.69	-0.70	-0.65	-0.60	-0.55	-0.55	-0.55
	10Y	-0.47	-0.45	-0.45	-0.40	-0.35	-0.30	-0.25	-0.20
	10Y-2Y	22	23	25	25	25	25	30	35
Indonesia	3M Jibor	4.88	4.66	4.50	4.50	4.50	4.50	4.50	4.50
	2Y	6.24	5.47	5.00	5.00	5.00	5.00	5.10	5.20
	10Y	7.91	7.21	6.90	6.80	6.60	6.60	6.60	6.80
	10Y-2Y	167	174	190	180	160	160	150	160
Malaysia	3M Klibor	2.80	2.28	1.75	1.75	1.75	1.75	2.00	2.00
	3Y	2.76	2.25	1.75	1.75	1.75	1.75	2.00	2.00
	10Y	3.36	2.86	2.65	2.70	2.75	2.85	3.10	3.15
	10Y-3Y	60	61	90	95	100	110	110	115
Philippines	3M PHP ref rate	3.95	1.94	2.15	2.15	2.10	2.10	2.05	2.05
	2Y	4.46	2.17	2.20	2.20	2.15	2.15	2.10	2.10
	10Y	4.86	2.80	2.65	2.65	2.70	2.70	2.75	2.75
	10Y-2Y	40	63	45	45	55	55	65	65
Singapore	3M Sibor	1.00	0.56	0.40	0.40	0.40	0.40	0.40	0.40
	2Y	0.73	0.29	0.25	0.20	0.20	0.20	0.25	0.30
	10Y	1.29	0.90	0.95	1.05	1.10	1.15	1.20	1.20
	10Y-2Y	56	62	70	85	90	95	95	90
Thailand	3M Bibor	0.87	0.63	0.62	0.62	0.62	0.62	0.62	0.62
	2Y	0.81	0.43	0.50	0.50	0.50	0.50	0.50	0.50
	10Y	1.40	1.19	1.40	1.55	1.60	1.70	1.75	1.80
	10Y-2Y	58	76	90	105	110	120	125	130
Mainland China	1Y Lending rate	4.05	3.85	3.70	3.55	3.55	3.55	3.55	3.55
	3Y	2.06	2.36	2.45	2.45	2.45	2.45	2.45	2.45
	10Y	2.59	2.85	3.00	3.00	3.00	3.00	3.00	3.00
	10Y-3Y	52	49	55	55	55	55	55	55
Hong Kong	3M Hibor	1.93	0.78	0.55	0.55	0.55	0.55	0.55	0.55
	2Y	0.67	0.28	0.25	0.25	0.25	0.25	0.30	0.35
	10Y	0.72	0.62	0.60	0.75	0.85	0.95	1.05	1.10
	10Y-2Y	5	34	35	50	60	70	75	75

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

Source: CEIC, Bloomberg, DBS

		2020				2021			
		1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
South Korea	3M CD	1.10	0.79	0.65	0.65	0.65	0.65	0.65	0.90
	3Y	1.07	0.85	0.80	0.80	0.75	0.75	0.70	0.95
	10Y	1.55	1.39	1.50	1.60	1.65	1.70	1.75	1.95
	10Y-3Y	48	54	70	80	90	95	105	100
India	3M Mibor	5.93	4.69	4.45	4.45	4.45	4.45	4.45	4.45
	2Y	5.27	4.21	4.20	4.30	4.40	4.50	4.50	4.50
	10Y	6.14	5.89	5.70	5.70	5.90	6.10	6.10	6.10
	10Y-2Y	87	168	150	140	150	160	160	160

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

Source: CEIC, Bloomberg, DBS

Global Credit | 4Q20

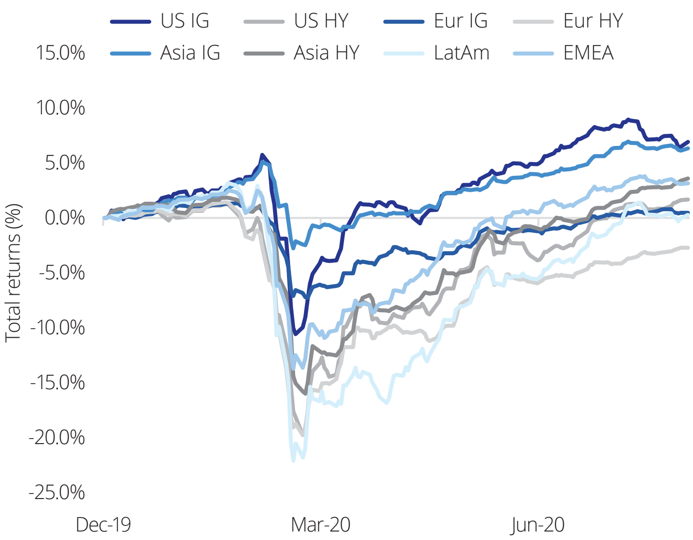
New dawn for European HY

Global Credit

Daryl Ho, CFA | Strategist

Time in the markets beats timing the markets; an axiom none more true than for the credit markets. With the volatility that has encapsulated much of 2020, a clairvoyant trader could have come up with positive returns by repeatedly selling at tops and buying at bottoms with perfect foresight, making pretty handsome gains in the process. For the rest of us normal human beings however, there was thankfully another simpler way of coming out unscathed through the crisis – staying invested.

Figure 1: Most credit markets had registered YTD gains by August



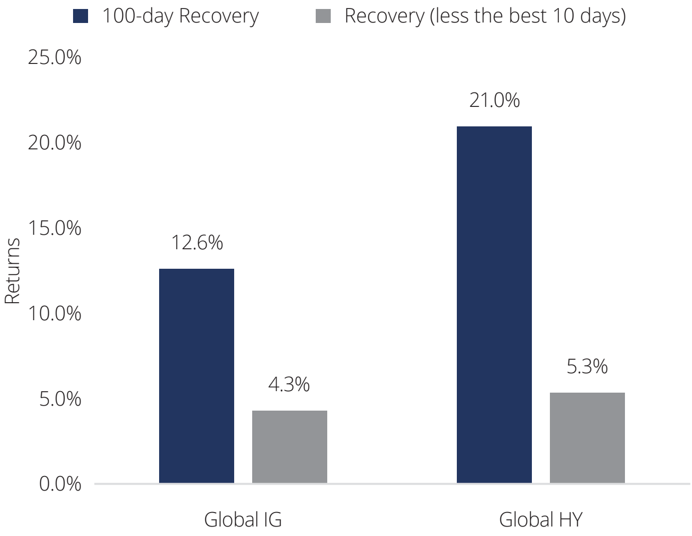
Source: Bloomberg, DBS

Investment performance is impeded more by bad decisions than bad investments. As legendary investor Peter Lynch once famously said, "*Far more money has been lost by investors trying to anticipate corrections, than lost in the corrections themselves*." As tempting as it was to anticipate further correction amid talk of recession and poor economic data, investors would have done themselves a disservice by succumbing to the news-driven fear back in March.

No two crises are exactly alike – it pays to differentiate. This crisis originated in the real economy, and not the financial sector (like in 2008), which required its own set of novel solutions. It was crucial for credit to flow to businesses which have cashflows impeded by economic lockdowns around the globe. Policymakers showed keen understanding of the crux of the problem by unleashing unprecedented amounts of stimulus – even directly participating in corporate credit purchases and Main Street lending – to ensure that the flow of credit was not impeded. This catalysed a rebound in bonds that was possibly more remarkable than the initial selloff, which was severely punitive to market timers who were left stranded on the sidelines.

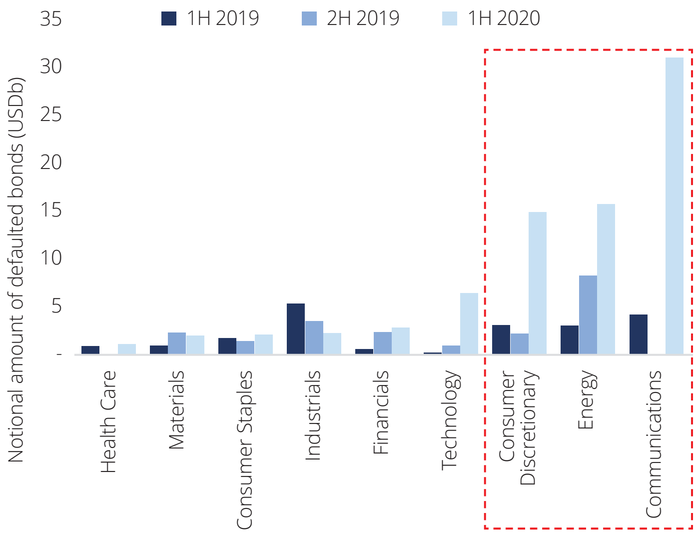
Timing credit markets requires impossibly perfect precision. The uneven path of recovery itself made the timing of re-entry into credit markets even more complicated. We categorised the 100-day rebound as the period between the bottom of the market on 23 March and the end of 2Q on 30 June and took note of the daily returns in this period. Significantly, missing out on the best 10 days out of 100 – or being out of the market for just the wrong 10% of the time – meant an 8.3% difference in IG returns and a 15.7% difference in HY returns in the recovery. Note that this does not even factor in the wide bid-ask spreads of more than 100 bps that would have had an additional penalty on trading returns in the thick of uncertainty.

Figure 2: Missing just the best 10 days of the recovery greatly detracted from performance



Source: Bloomberg, DBS

Figure 3: Unprecedented policy support in 2020 did not stem the rising wave of defaults in distressed sectors



Source: Bloomberg, DBS

Looking back in order to look forward. While the road to recovery remains clouded by viral containment uncertainty and geopolitical noise, investors can still learn from three revelations of the crisis so far in order to optimise credit portfolio positioning and stay invested.

1. **Credit markets must function at all costs** – If the flow of credit is the key to preventing a full-blown recession, then policymakers can and will do whatever it takes to be the liquidity providers of last resort.

2. **Policymakers have skin in the game** – Having established aggressive measures of rate cuts, QE, direct investments in credit markets, and Main Street lending, central banks are deeply committed in a way that discourages the premature reversal of support measures that risks unravelling the recovery.

3. **Defaults are still expected to rise** – Central banks can backstop liquidity, but they cannot prevent defaults. Policy support is not a free pass for investors to buy the riskiest debt, and we would be cautious on the B/CCC ratings buckets.

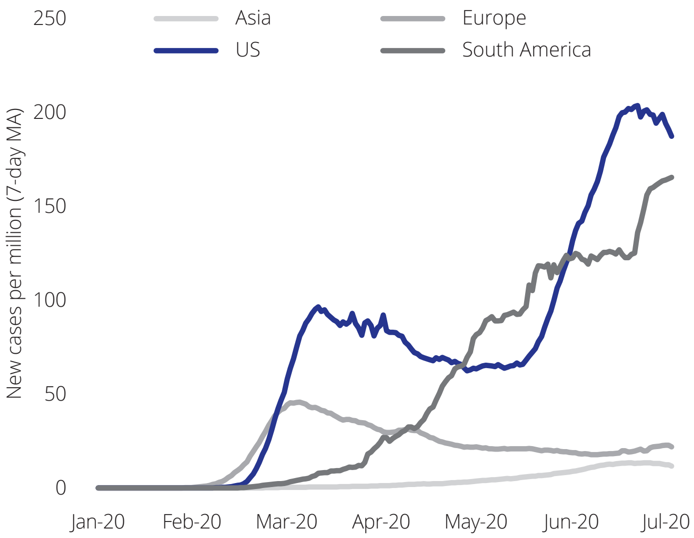
Implications for credit portfolios. Given the three revelations above, there are also three implications – (a) With the Federal Reserve providing the backstop of emergency lending facilities, it is improbable that credit as a whole will see a repeat of the same magnitude of drawdown in March, (b) credit spreads are likely to grind tighter in a low rates environment – it is also in the interest of policymakers for credit to perform so that yields are stably low and financial conditions remain easy through the recovery, and (c) credit analysis and loss avoidance are key as defaults are not preventable by liquidity-supporting measures.

The BBB/BB segment remains the risk bucket of choice in this regard, given the comparatively generous credit spreads, lower expected default risk, and importantly, being direct beneficiaries of central bank support.

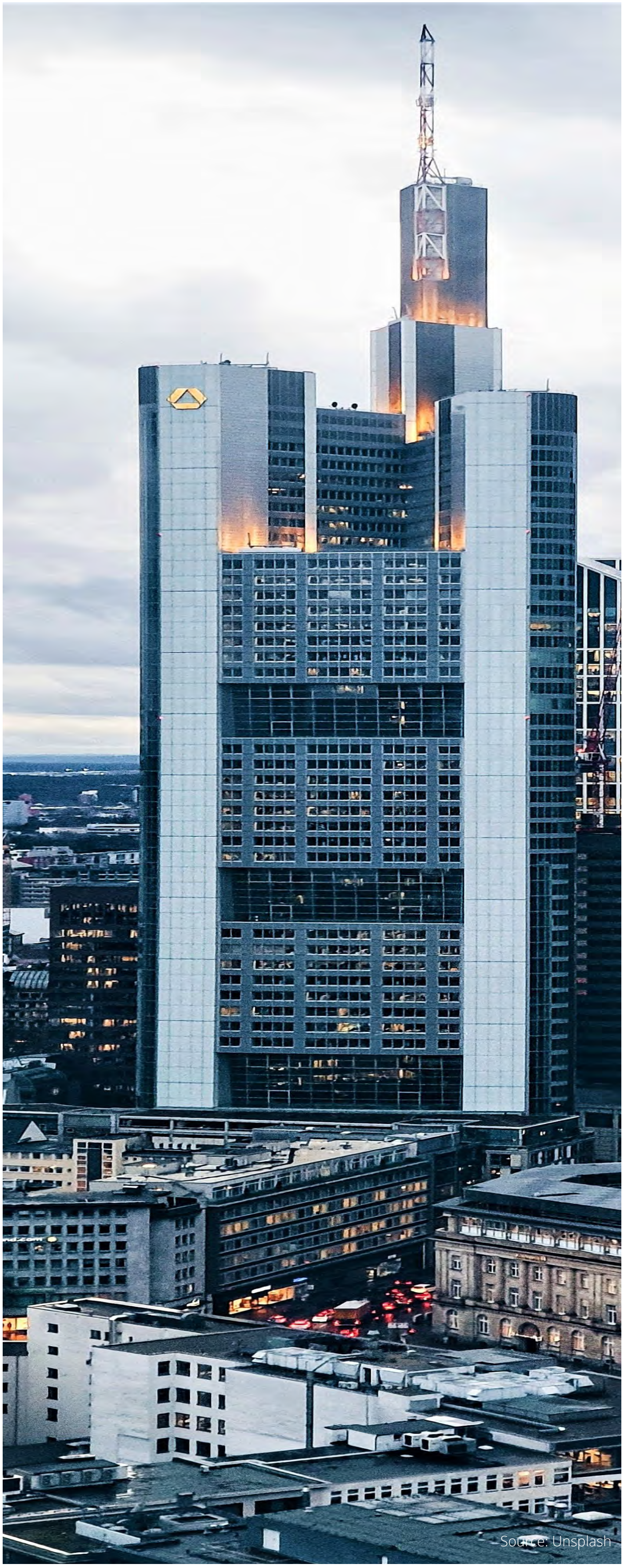
Which credit markets provide value for investors? We have been consistent in our view that Asia credit continues to provide value to investors from a fundamental and valuation perspective, and the supportive factors remain intact. Looking across global credit markets, we are now also seeing positive catalysts for European HY, and believe that there is a decent probability that the market will catch up with other credit peers.

Crossing a political Rubicon. The new stimulus agreed by the EU to be funded by common borrowing is a landmark deal; a step towards fiscal integration to complement the monetary union (and partial banking union) that already exists in the region. The breaking of new ground in fiscal policy coordination shifts outcomes away from the extreme left tail risks concerning the dissolution of the EU, frequently championed by Eurosceptic left- and right-wing populists of member nations. Diminishing risks of splintering from weaker states give consumer and commercial confidence a much needed sentiment boost for the region's recovery.

Figure 4: Europe has demonstrated effective virus management in flattening the curve

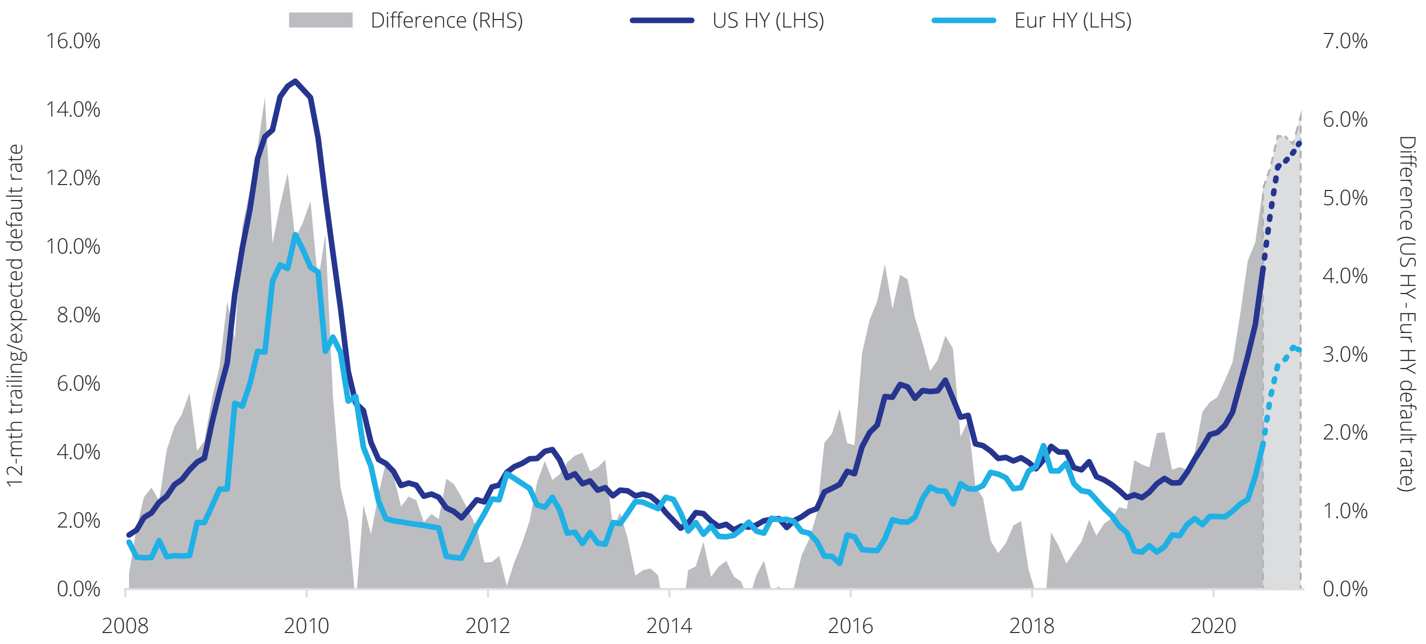


Source: ourworldindata.org, DBS



Source: Unsplash

Figure 5: European HY default rate more muted compared to US HY



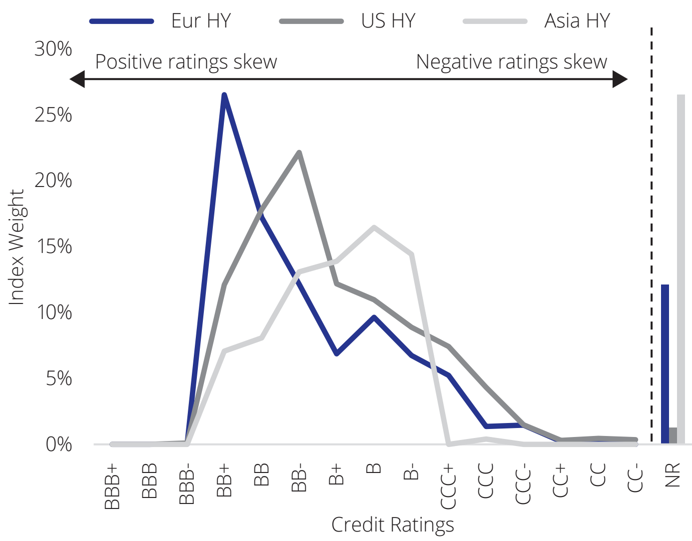
Source: Moody's Investors Service, DBS

The virtuous cycle of viral containment. On the medical front, new cases remain low despite the continued reopening of various European economies. This inspires confidence for further normative reversion, and prolonged success could lead to the formation of intra-Europe travel bubbles which would further expand economic activity. Notably, the Markit Eurozone PMI had swung back into expansionary territory by August with a print of 51.9, reflecting the positive change in business sentiment.

European HY default risks comparatively benign. Default rate forecasts for European HY are also distinctively lower compared to their DM counterpart across the Atlantic in US HY. While credit spread tightening between 2Q-3Q has eroded much of the additional returns that investors are traditionally compensated for HY default risk, investors are better off positioning for loss-avoidance at this juncture – a more defensive posture that European HY gives for reasons we shall explore in detail below.

Positive ratings skew. Firstly, European HY appears structurally more defensive vis-à-vis their HY peers, given the ratings skew towards the BB segment – the risk bucket closest to Investment Grade.

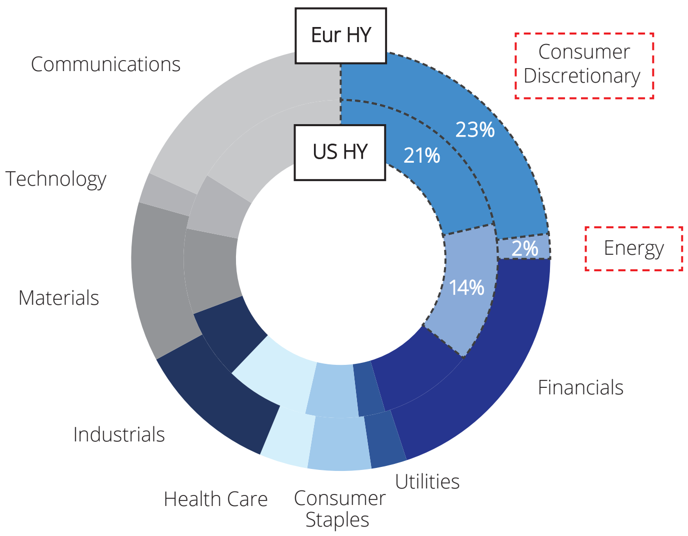
Figure 6: European HY is structurally weighted towards the BB segment



Source: Bloomberg, DBS

Favourable sector weighting in European HY. Drawing comparison with US HY, European HY also has a comparatively lower weight in sectors under distress. Pertinent to the current environment, it is well documented that the Energy and Consumer Discretionary sectors are seeing the highest downgrades/defaults due to the strong sectoral discrimination by the oil-virus crisis.

Figure 7a: Distressed sector weighting more favourable for European HY compared to US HY



Source: Bloomberg, DBS

Most noticeably, while Energy accounts for more than 14% of US HY, it only accounts for less than 2% of European HY. Moreover, while the Consumer Discretionary sector appears comparable in overall weight on the surface, taking a deeper look into the industry sub-groupings provides a clearer picture of risk differentiation.

US HY is comparably overweight on industry subgroups such as Retail & Restaurants and Travel-related industries, segments that continue to face headwinds from viral non-suppression and international travel constraints – issues that are unlikely to abate in the near term. European HY however, is weighted heavily towards Auto manufacturing. The surprising upside is that Euro Area car registrations and vehicle production saw a sharp rebound in 2Q; anecdotally this may be fuelled by COVID-driven demand as social distancing measures may have skewed preferences for private over public transportation. While this may be transitory, car purchases may take a more non-discretionary than discretionary nature while the virus threat remains.

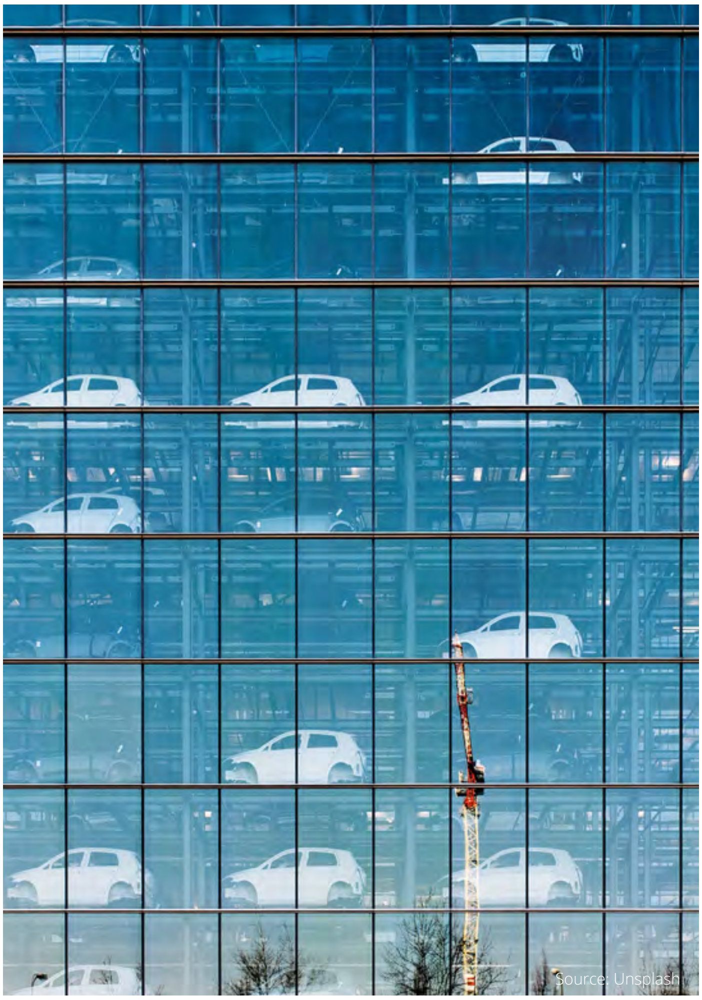
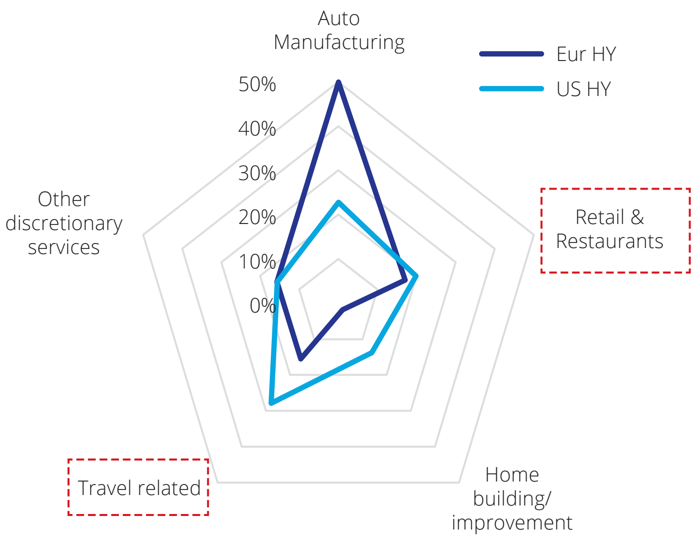
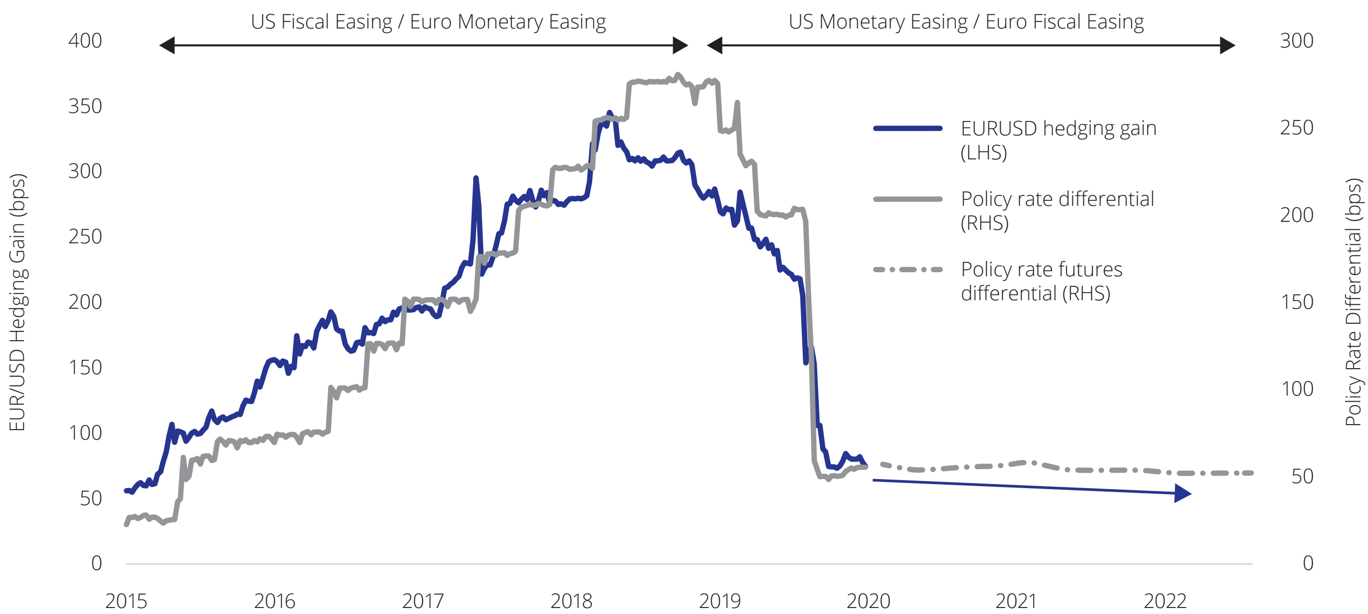


Figure 7b: Consumer Discretionary subgroups favour European HY at the margin



Source: Bloomberg, DBS

Figure 8: EUR/USD hedging gains remain positive; although likely to be eroded over the medium term



Source: Bloomberg, DBS

Hedging gains provides an avenue for higher yields in USD terms. The hedging of EUR assets into USD currently provides an additional yield pick-up, depending on the costs of execution. While this pick-up is not as sizeable as the nearly 350 bps at the end of 2018, the likely trend is a continued erosion of hedging gains in the medium term.

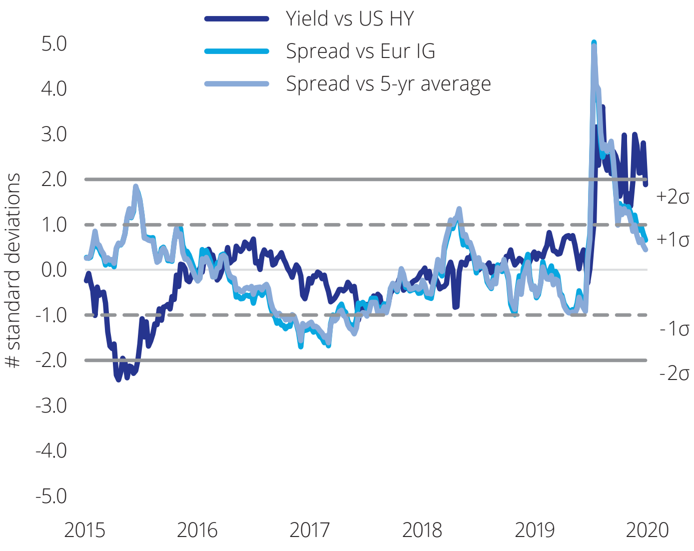
Note that the hedging gains are closely correlated to the policy rate differential (proxied as the Fed Funds rate – EONIA), which is a feature of the Interest Rate Parity argument. Prior to end-2018, US fiscal policy was doing the economic heavy lifting (namely with large tax cuts), which allowed US rates to drift higher under hawkish monetary policy. European economies on the contrary, were still reeling from the aftershocks of a sovereign debt crisis which prevented a hasty exit from negative rates.

Since the COVID-19 crisis, however, the reverse has happened. The US has relied on aggressive monetary policy by slashing rates to the zero bound and restarting QE. The EU, as highlighted earlier, has conversely taken steps towards stronger fiscal coordination which shifts the burden away from monetary policy to mitigate the downturn. As such, the policy rate differential, and equivalently hedging gains, are likely to diminish over time (a trend being priced by rates futures).

While the pick-up remains positive, we consider this beneficial to investors who hedge their EUR assets to USD under currency swaps/rolling hedges.

European HY valuations are reasonable by multiple measures. Measuring relative value against historical averages reveals that European HY remains comparatively inexpensive.

Figure 9: European HY valuations still above historical means on several measures



Source: Bloomberg, DBS

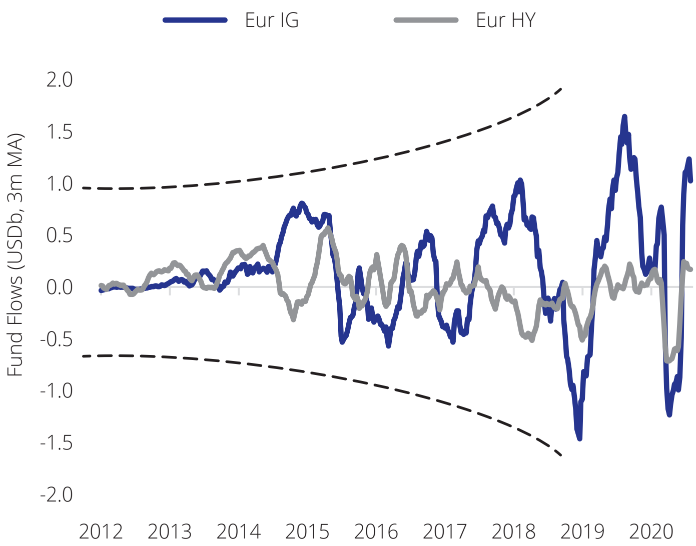
- **Yield vs US HY** – The stark divergence in performance between US and European HY this year can be attributable to one pivotal factor: central bank support. While the Fed had explicitly intervened in US HY credit, the ECB has yet to take that bold step, only loosening collateral requirements to allow the acceptance of "fallen angels" from banks to maintain access to liquidity. As the Fed had been the forerunner in this regard, it would no longer be a high bar for the ECB to follow in their footsteps should the need arise in future.

- **Spread vs Euro IG** – Central bank support means all the difference once again, as the ECB's bond purchase programmes explicitly provide for European IG but not HY.

- **Spread vs 5-yr average** – While US credit spreads are already close to their 5-yr means, European HY spreads are still trading wide to those averages.

Rising waves of extremities in European credit fund flows. One unfavourable trend, however, is that European credit has seen flows become increasingly extreme in the last five years. Investors must be able to take the volatility that comes with flows, in order to stay the course and reap the benefits of strong income generation. As the year 2020 has proven, there are fewer means that investors can prove their worth better than by sticking with their deepest convictions through the unnerving volatility. As they say – smooth seas do not make good sailors.

Figure 10: European credit in/outflows are increasingly extreme



Source: EPFR Global, DBS

In summary, we think that European HY has seen a rising list of supportive factors and consider them an increasingly strong asset class for income generation, along with our long-standing positive view on Asia credit. While the low rates environment beckons investors to search for yield, a challenging economic recovery also accelerates default risk and requires a stance of loss avoidance. European HY offers a decent mix of attractive valuations and structural defensiveness – allowing investors the stability of income generation while also providing some degree of insulation against prevailing macro risks in our world today.

The US elections and credit markets. There is little doubt that the US elections will be at the forefront of investor focus come 4Q20. While the polls currently favour the Democratic Party nominee Joe Biden over the incumbent Donald Trump, it does pay to envision what a Biden presidency might mean for credit markets in general.

1. **Tax proposals** – Generally less punitive to credit markets. Biden's proposals to raise corporate taxes may dampen earnings on equities, but credit fundamental measurements often use pre-tax earnings to measure metrics such as interest coverage. Higher proposed capital gains taxes are also less punitive on credit investments which are mostly held for coupon income.

2. **Climate change** – Biden's proposals to raise carbon taxes and end oil & gas drilling leases are clearly negative for the energy sector, a sector not already without its challenges. European credit may benefit from a tailwind of flows due to (a) a structural underweight in energy, and (b) greater support for green investments; the EU continues to lead the globe in identifying best practices and frameworks for sustainable investing.

3. **Foreign policy** – It is no secret that a Biden presidency would unlikely see a marked improvement in US-China relations. However, in line with Obama's playbook, a Biden administration is likely to rely on bilateral relationships with long-standing allies to further America's interests. Europe once again features well in this regard, while ASEAN may also benefit from a renegotiation of the Trans-Pacific Partnership.

Source: Unsplash

DBS Live more, Bank less

Global Currencies | 4Q20

The recovery flattens

Global Currencies

Philip Wee | Strategist

The DXY has scope to stabilise after its 10% selloff in March-August. Speculation that the USD would lose its reserve status has been inconsistent with ultra-low UST yields and the market's dependence on the Federal Reserve's swap facilities to alleviate USD liquidity shortages. The Nasdaq Composite and S&P 500 indices achieved new record highs despite the coronavirus resurgence, racial protests, and the rapid deterioration in US-China relations. On a relative basis, the US economy did not contract as much as its DM peers in 2Q. In fact, US data have surprised on the upside into the expiry of the jobless payment benefit on 31 July and the bipartisan stalemate over the new stimulus bill. A US growth rebound in 2H, especially if accompanied by an unemployment rate below 10%, should pave the way for a steeper yield curve via higher long bond yields and provide some support for USD.

Investors are also wary of volatility from a triple sweep by the Democrats at the US elections on 3 November. Coincidentally, the DXY this year has mirrored the 1980 and 1992 elections when a US president was not re-elected. Democratic nominee Joe Biden has a wide lead over President Donald Trump and has pledged to roll back the latter's tax cuts if elected. A repeat of 1980 and 1992 could see a USD recovery in 4Q. Even so, the DXY is expected to resume its downtrend in 2021 when the global recovery gains traction amid hope for a vaccine.

EUR to consolidate within 1.15-1.20 after its stellar 13% rally in March-August. EUR/USD met stiff resistance from the ECB at 1.20 in early-September. The ECB warned that the euro's strength has not only dampened the inflation outlook but also diluted the growth efficacy its policies. The ECB's discomfort with the high level of the EUR has been reflected in its assumption for EUR/USD to trade at 1.14 this year and 1.18 in 2021 and 2022. The ECB expected inflation to stay negative in the coming months. No interest rates hikes were expected based on its trajectory for the Harmonised Index of Consumer Prices (HICP) to remain well below its 2% inflation target up to 2022. This optimistic growth outlook has been premised on a

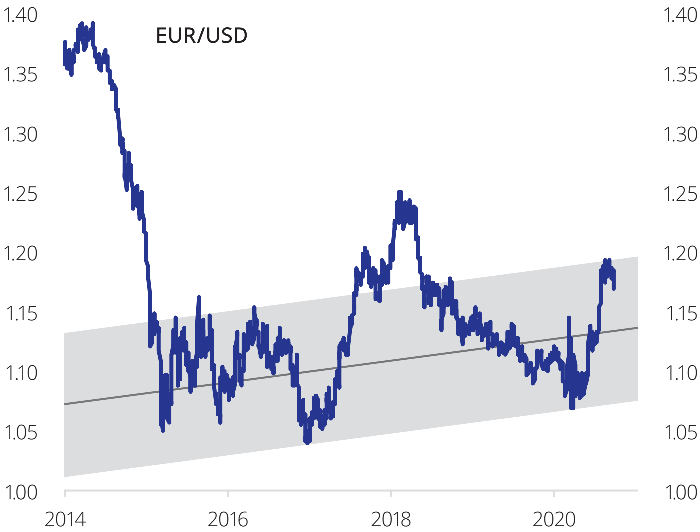
Figure 1: US dollar to stabilise

Source: Bloomberg, DBS

Figure 2: DXY and US presidential elections

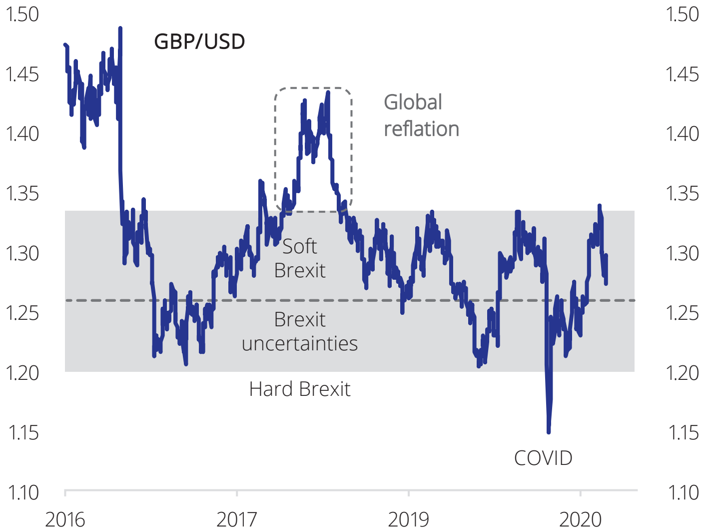
Source: Bloomberg, DBS

Figure 3: The euro to consolidate amid a crowded trade



Source: Bloomberg, DBS

Figure 4: GBP undermined by weakened fundamentals



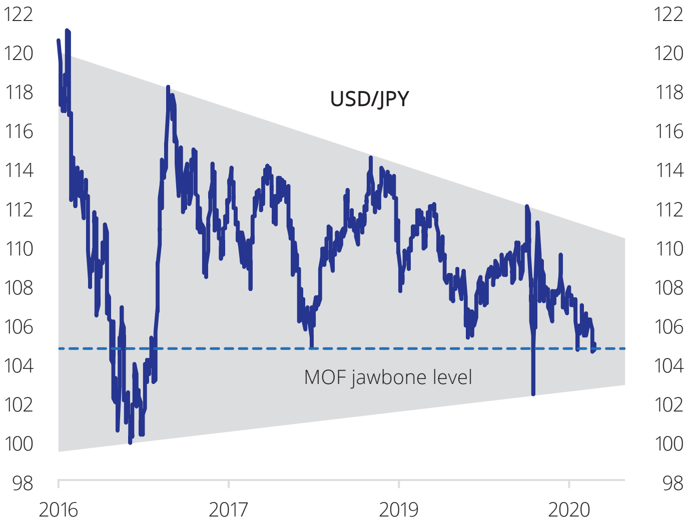
Source: Bloomberg, DBS

positive outcome for Brexit talks, a scenario that is at risk from the UK-EU standoff over Brexit talks and more restrictions to rein in the rapid spread of the coronavirus across Europe. Not surprisingly, speculators have, as per Commodity Futures Trading Commission data, started to reduce some of their record-long euro positions.

It should not come as a surprise that GBP stumbled below 1.30 again. GBP/USD has appreciated 16% during its recovery from the coronavirus outbreak, mostly on a weaker USD and a stronger EUR. Even so, it did not break out of the 1.20-1.34 range set between the global reflation in 2017-18 and the pandemic this year. Barring a global USD shock, GBP is unlikely to revisit 1.45 because of the UK's weakened fundamentals. As the worst hit of all G-7 nations, the economy is in no state to withstand a disorderly Brexit when the transition period ends on 31 December. Brussels wants the UK to remove the Internal Market Bill, which violates international rules by overriding parts of Withdrawal Agreement, by end September. The UK and EU have until October to work out a deal. The BOE has placed negative interest rates in its toolbox as a last resort. Prime Minister Boris Johnson's approval rating has weakened over his mishandling of the coronavirus, rising unemployment, and Scotland pushing for an independence referendum. The odds of other rating agencies joining Fitch in downgrading the UK's sovereign debt rating cannot be ruled out.

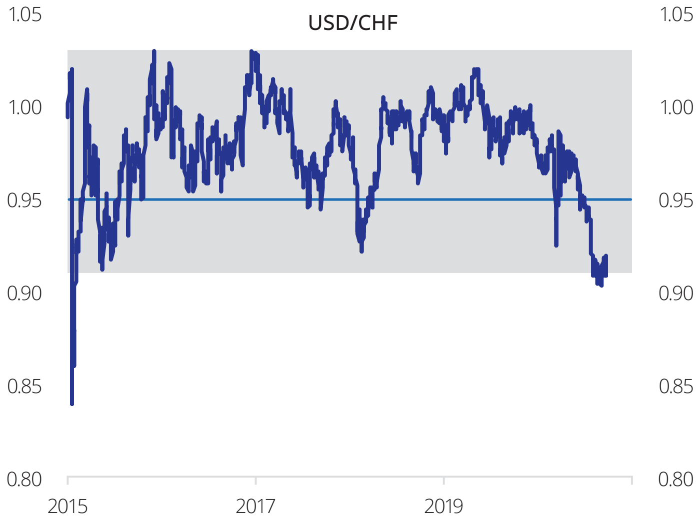
Source: Unsplash

Figure 5: JPY to hold a stable range



Source: Bloomberg, DBS

Figure 6: USD/CHF to hold steady

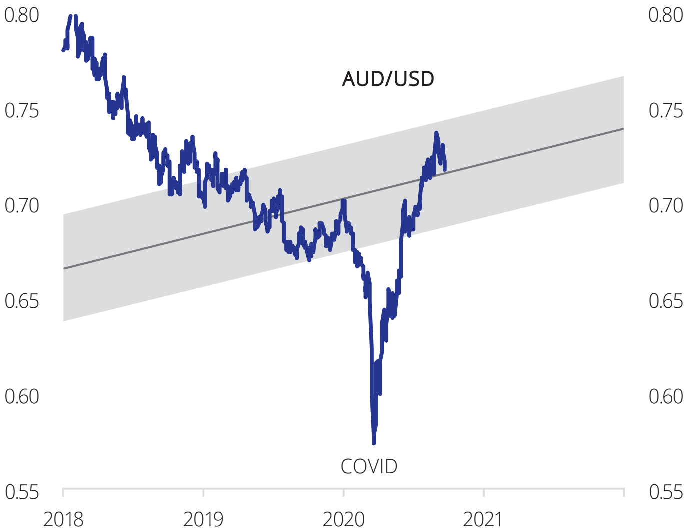


Source: Bloomberg, DBS

JPY is projected to hold 102-110 per dollar for the rest of 2020. JPY was sought as a safe haven during the COVID-19 outbreak; USD/JPY hit a low of 101 on 9 March. It bounced to almost 112 on 24 March on a scramble for USD liquidity that was subsequently quenched by the Federal Reserve's swap facilities. USD/JPY traded below 104 in 3Q20, first on the USD's weakness in July, and again, on a leadership change in September. Shinzo Abe announced on 28 August his resignation as prime minister citing health reasons. He was succeeded by former chief cabinet secretary Yoshihide Suga in mid-September, whose priorities will be to end the coronavirus pandemic and revive the economy. A snap election is likely to be called and held before the next general elections due in October 2021, possibly before the Tokyo Olympics in July 2021. As for 4Q20, JPY is likely to be caught between stock market volatility and a stronger USD into the US elections in November. The Finance Ministry is expected to be vigilant against excessive JPY strength below 100 per dollar.

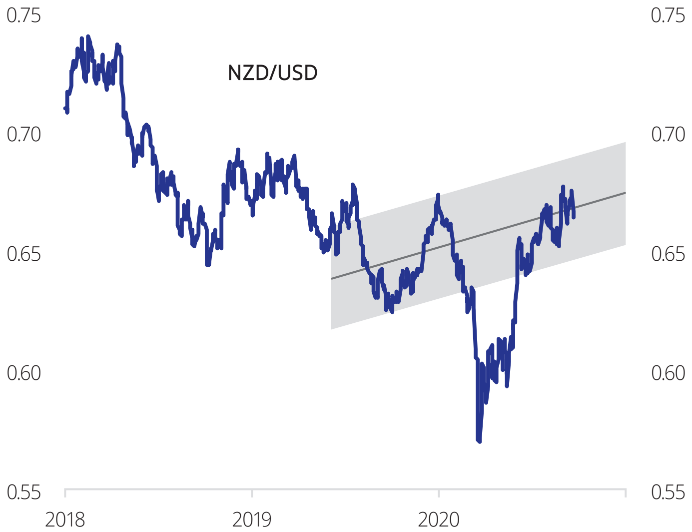
CHF has tightened its correlation with EUR on the coronavirus. Several observations were made during the pandemic this year. CHF's safe-haven allure during the trade war has weakened under the pandemic. Given its inverse relationship with global stock markets, USD is now considered a better safe-haven currency. Despite denials by the SNB, the market has perceived EUR/CHF at 1.05 as the new informal limit for currency interventions to curb the currency's strength. The SNB confirmed in June that it intervened; EUR/CHF was just above 1.05 while USD/CHF hovered around 0.96 in May. The central bank did not repeat its threat when USD/CHF fell towards 0.90 in July-August; EUR/CHF was higher around 1.08. If this relationship holds, USD/CHF could break below 0.90 if EUR/USD pushes above 1.20. But this is not our baseline scenario. If we are correct about a EUR/USD consolidation between 1.15 and 1.19, USD/CHF should also hold steady around 0.91-0.95.

Figure 7: AUD's recovery to moderate



Source: Bloomberg, DBS

Figure 8: NZD's appreciation path to flatten



Source: Bloomberg, DBS

AUD's recovery from the coronavirus outbreak has exceeded our expectations. The Aussie has not only recouped its pandemic losses but also appreciated for the year. Barring further shocks, the appreciation is likely to continue but at a gradual and more sustainable pace, and along a more bidirectional path. The pandemic crisis is different from the dot.com recession and the GFC. First, Australia will not be hiking rates before the US. Instead, the RBA has joined the Fed in keeping monetary policy ultra-loose into 2022. Second, Australia is no longer riding on the emergence of China. Instead, its relations with China have become increasingly strained after Canberra supported an inquiry into the origins of the coronavirus. Third, Standard and Poor's and Fitch have put the country's sovereign debt rating on negative watch. Australia could lose its AAA rating if the coronavirus and its resurgences lead to higher debt levels and a more sluggish economy.

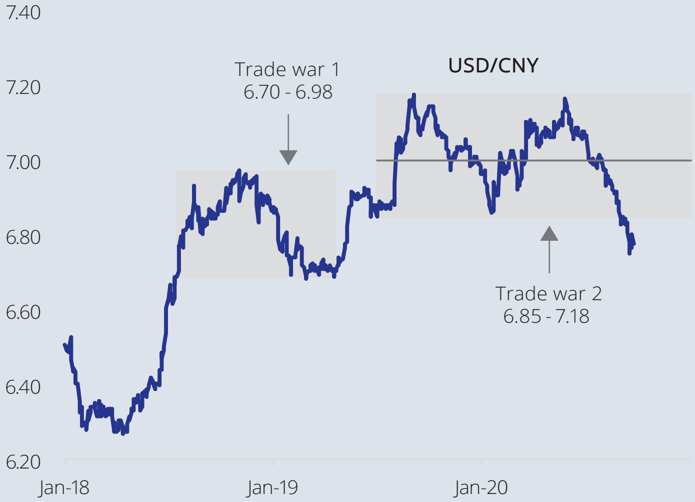
NZD appreciation path to flatten after a V-shaped rebound. New Zealand was not spared from a coronavirus resurgence, namely in Auckland, which led Prime Minister Jacinda Ardern to postpone the general election to 17 October from 19 September. The RBNZ has been more aggressive than its Australian counterpart in delivering stimulus to counter the pandemic recession. On 12 August, its Large Scale Asset Purchases programme was expanded to NZD100b from NZD60b. The RBNZ also left the door open for more stimulus measures such as a negative Official Cash Rate and the option to buy foreign assets. The central bank has told banks to be operationally ready for negative interest rates by the end of the year. Fiscal spending to cushion the economy from the pandemic is projected to increase Crown debt to 53% of GDP in 2022-23 from 19% just before the outbreak.

Asia Currencies

CNY

USD/CNY has and is expected to remain in a ±2% range around its critical 7.00 level. The coronavirus outbreak did not take USD/CNY out of its second tariff war range between 6.85 and 7.18. Although relations with the US have deteriorated, China has remained committed to the Phase 1 trade deal which rejects competitive devaluation i.e. a weaker CNY well above 7.00. America's bilateral trade deficit with China has narrowed by 21% in 1H20. As witnessed during the GFC, China may prefer a stable exchange rate to weather the pandemic too. Today, this would probably be synonymous with a range instead of a level. This year's trading range for USD/CNY has, as of 28 August, narrowed to just below 5% compared to 8-12% in the past four years. Looking ahead, China's (q/q) growth will slow after the V-shaped rebound in 2Q. Given its high growth correlation with growth this year, CNY is expected to do likewise.

Figure 9: USD/CNY is expected to remain around its critical 7.00 level

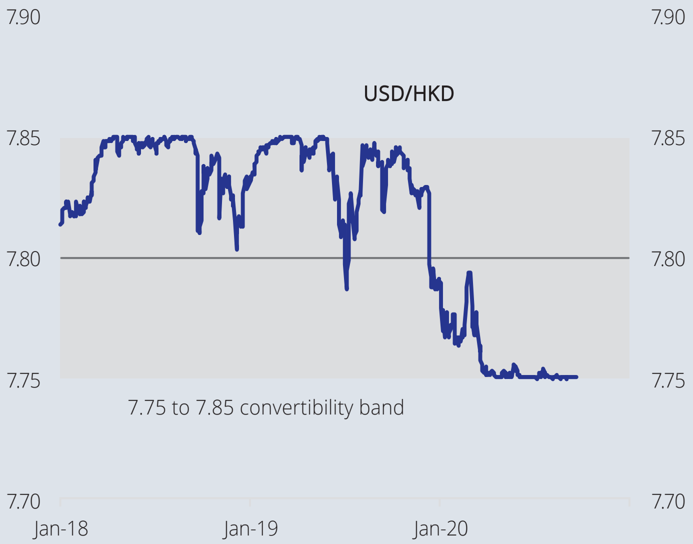


Source: Bloomberg, DBS

HKD

The HKD peg to USD is intact despite the passing of the Hong Kong National Security Law on 30 June and the US's decision to end the preferential treatment for Hong Kong a fortnight later. The US cannot "unilaterally revoke" the HKD peg. The Linked Exchange Rate System was introduced in October 1983 by Hong Kong based on its own considerations for financial and monetary stability. HKD remains freely convertible on the capital account under the Basic Law for the HKD peg. In this regard, Hong Kong will continue to be important to Chinese finance regardless of US actions. America's decision to remove Hong Kong's trade privileges could, however, lead China-based trade to flow through mainland options like the Shanghai Free Trade Zone. Finally, HKD has been firm after the coronavirus outbreak from positive rate differentials against the US. This has led the Hong Kong Monetary Authority, for the first time in four years, to intervene in April to defend the stronger limit of the 7.75-7.85 band.

Figure 10: The HKD peg to USD is intact

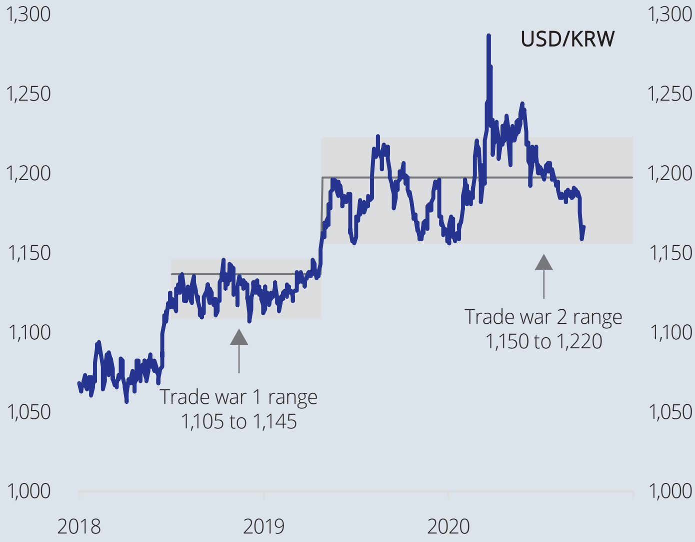


Source: Bloomberg, DBS

KRW

South Korea's recovery from the COVID-19 pandemic was better reflected by its stock market than its exchange rate. At their worst points during the coronavirus outbreak on 19 March, the Kospi Index plunged by 33.8% YTD while KRW depreciated by 10.7% YTD to almost 1,300 per USD. As of 12 August, the Kospi has turned positive for the year at +11.8% YTD but KRW was still weaker by 2.4% YTD against the greenback. The pandemic did not hit the South Korean economy as hard as many of its Asian peers. Thanks to years of budget surpluses, the country could afford a budget deficit of 4.3% of GDP to combat the pandemic. The Current Account surplus is not expected to slip below 3% of GDP in the coming years. Overall, USD/KRW has returned into the 1,150-1,220 trading range seen during the second US-China tariff war in 2019. We expect this range to remain intact for the rest of the year.

Figure 11: USD/KRW has returned into the 1,150-1,220 trading range

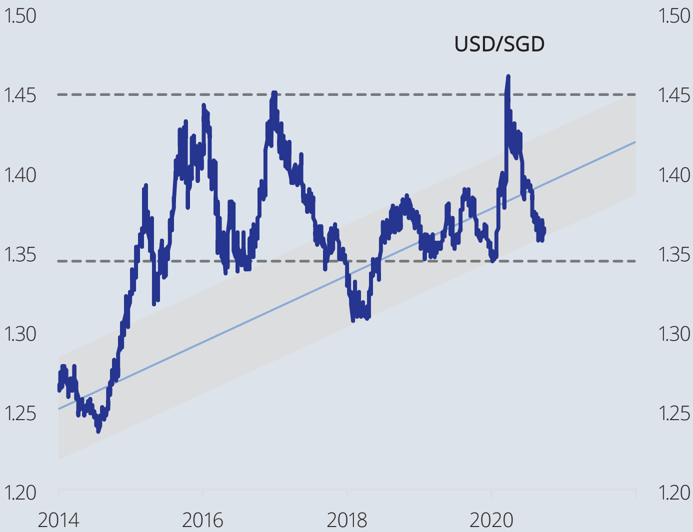


Source: Bloomberg, DBS

SGD

The SGD NEER policy was eased on 30 March to combat the coronavirus. The MAS mildly re-centred the policy band which was also set on a zero-appreciation path. Since then, the SGD NEER has been holding close to the mid-point of its 4%-wide policy band, consistent with the economy's weak and uneven recovery prospects. Hence, USD/SGD's return into its trade war range between 1.3440 and 1.3940 has been driven mainly by a weaker USD against the currencies of its major trading partners. The USD60b swap facility that the MAS established with the US Federal Reserve in April has been extended into March 2021. The government has narrowed its 2020 growth target to 5-7% from 4-7%, consistent with its expectation for a weak and uneven recovery from the pandemic.

Figure 12: Dollar weakness drives USD/SGD back to 2018 range

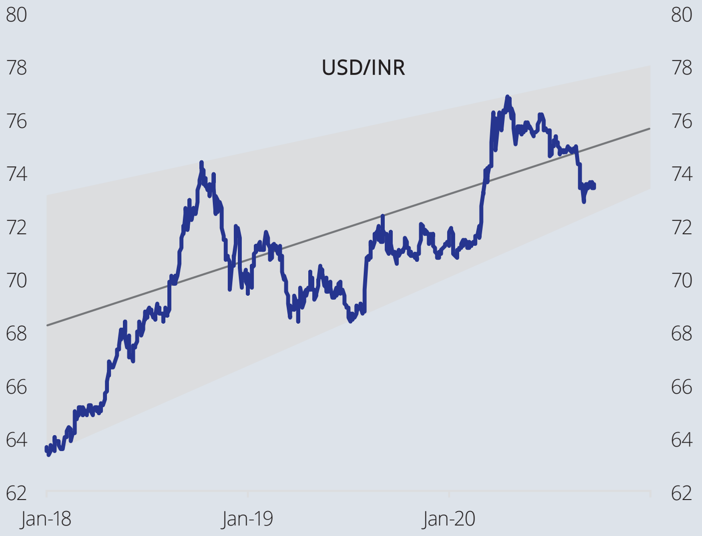


Source: Bloomberg, DBS

INR

INR did not buck the Asian currency appreciation after the pandemic selloff in March. Its recovery was, however, the slowest. As at 28 August, the INR (-2.8% YTD) was the region's third worst currency after THB (-3.8%) and IDR (-5.2%). USD/INR did not return into its 68.4-74.4 trade war range. Based on the USD77b surge in foreign reserves to a record high of USD534b, INR's slow recovery since April was possibly a policy preference rather than a drag from weakened fundamentals. In fact, a Current Account surplus was reported for 1Q20 and a trade surplus in June. Even so, there is little room for complacency. On 1 June, Moody's downgraded India's sovereign debt rating by one notch to Baa3. Another downgrade by any of the three international agencies would lead India's debt rating back into junk.

Figure 13: Slow depreciation for the Indian rupee



Source: Bloomberg, DBS

IDR

IDR was the worst-hit (-18% YTD on 2 April) Asian currency during the coronavirus outbreak. Thanks to the USD60b repo facility between BI and the US Federal Reserve in April, IDR recovered the year's losses by early June. Since then, IDR has bucked USD's weakness and depreciated again to -4.6% YTD on 28 August. Two developments weighed on IDR in July. First, Indonesia reported the most infections in Southeast Asia, a title it has relinquished to the Philippines in early August. Second, and more importantly, consensus no longer sees the country averting a full-year recession in 2020. On a positive note, international debt rating agencies have not taken issues with the government's decision to suspend its self-imposed deficit ceiling of 3% of GDP for the next three years. Despite the burden sharing scheme between BI and the government, foreign reserves have increased to support external resilience and maintain macro prudential and financial system stability. For now, USD/IDR may consolidate within a 14,000-15,000 range.

Figure 14: IDR to consolidate

Source: Bloomberg, DBS

MYR

MYR bottomed around 4.45 per USD (-8% YTD) on 23 March during the pandemic outbreak. USD/MYR's subsequent fall has been stepwise, first supported at 4.30 in April-May, and next at 4.25 in June-July. This was attributed to domestic political uncertainties and the negative outlook on its sovereign debt rating placed by Fitch in April and Standard & Poor's in June. This, however, did prevent the MYR from appreciating below 4.20 per USD in August on the dollar's weakness. The overnight policy rate is still at high at 1.75% and even more attractive in real terms; Malaysia has been in deflation since March. A record trade surplus was achieved in June after a mild deficit in April. With the surplus driven by an export rebound to China and the US, this has partly assuaged concerns regarding the negative spill over from deteriorating US-China relations. Barring a USD rebound or another growth shock, USD/MYR is likely to settle back into its previous trade war range between 4.05 and 4.20.

Figure 15: USD/MYR likely to settle back into its trade war range

Source: Bloomberg, DBS

THB

Unlike 2018 and 2019, THB is no longer the top performing Emerging Asian currency this year. At its worst point during the coronavirus outbreak, THB depreciated by 8.8% YTD on 1 April. Despite the recovery, THB was still down by 5% YTD as of 21 August and was the third worst performer. Thailand's healthy Current Account surplus, which boosted THB in 2018-19, has turned into a deficit in 2Q20 for the first time since 3Q14. Our economists expect Thailand to be the worst hit economy (-7.5% growth) in Southeast Asia this year with a lacklustre rebound (3.0%) in 2021. The state of emergency has been extended to 30 September to avoid a second pandemic wave. The emergency in three southern provinces – Narathiwat, Yali, and Pattani – was on 16 September extended by another three months. Authorities have indicated that borders will remain closed to international tourism until February-March 2021. Amid the economic hardship, political uncertainties have also returned. Overall, there will be resistance to THB strength below 31 per USD.

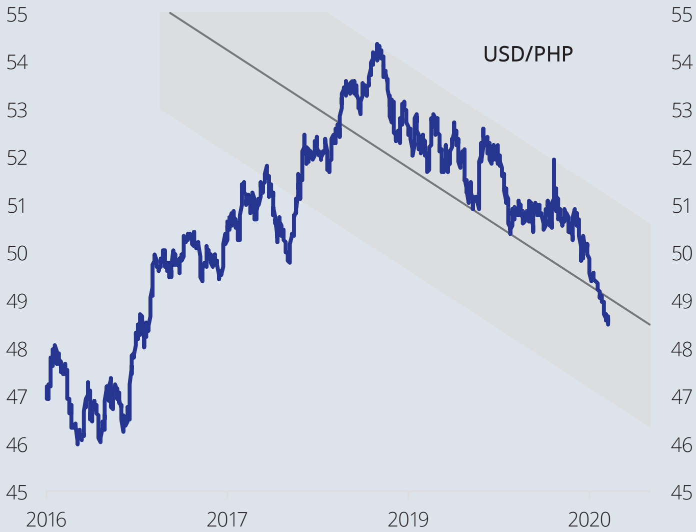
Figure 16: Appreciation in THB to moderate

Source: Bloomberg, DBS

PHP

PHP has, as of 28 August, appreciated 4.7% YTD to become the strongest currency in Asia. Ironically, the Philippines has the worst coronavirus outbreak in the region. Given the heavy toll on the economy, PHP's appreciation may be limited to 46-47 per USD, the low seen in 2016. Real GDP contracted by 16.5% q/q sa in 2Q amid a record unemployment rate of 17.1% in April. The budget deficit has widened more than tenfold to PHP560b in 1H vs PHP42.6b the same period a year ago. While a mild Current Account surplus was posted in 2Q, overseas foreign worker remittances, which accounts for 10% of GDP, has shrunk 10% y/y in 2Q. CPI inflation has risen to 2.7% y/y in July from the year's low of 2.1% in May despite the total 175 bps of rate cuts this year to 2.25%. As witnessed in 2018, a CPI inflation above its official 2-4% target band could easily hurt PHP again.

Figure 17: PHP's appreciation may be limited



Source: Bloomberg, DBS

VND

VND has, by July, recovered its 2% depreciation incurred during the coronavirus outbreak in July. Having returned to the floor of its trade war range between 23,170 and 23,420, USD/VND is expected to hold steady around 23,200 into 2021. After the GFC, VND has never posted a full-year appreciation of more than 1%. Unlike the ASEAN-5 economies, Vietnam will avoid reporting a full-year recession in 2020. Still, growth will be below 5% for the first time since the Asian Financial Crisis. With CPI inflation falling to 3.4% y/y from 6.4% in the first seven months, the central bank has started to cushion its economy with rate cuts. The factors that hurt VND are absent. There is no double-digit inflation and the Current Account is in surplus. Barring a resurgent USD, CNY, and other Asian currencies are seen moving towards a stable-to-firmer path during the recovery.

Figure 18: USD/VND is expected to hold steady into 2021

Source: Bloomberg, DBS

Table 1: DBS currency forecasts

Exchange rates, eop							
	28-Aug	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
Mainland China	6.8655	6.93	6.97	6.93	6.91	6.89	6.87
Hong Kong	7.7504	7.75	7.75	7.76	7.76	7.77	7.77
India	73.400	75.0	75.4	75.8	76.2	76.6	77.0
Indonesia	14,632	14,710	14,570	14,430	14,290	14,140	14,000
Malaysia	4.1640	4.18	4.20	4.18	4.16	4.14	4.12
The Philippines	48.468	49.1	49.6	49.2	48.7	48.3	47.9
Singapore	1.3581	1.37	1.38	1.37	1.36	1.35	1.34
South Korea	1,185	1,185	1,195	1,185	1,180	1,170	1,165
Thailand	31.097	31.5	32.0	31.8	31.6	31.4	31.2
Vietnam	23,166	23,200	23,200	23,200	23,200	23,200	23,200
Australia	0.7365	0.72	0.71	0.72	0.72	0.73	0.73
Eurozone	1.1903	1.17	1.15	1.17	1.18	1.19	1.20
Japan	105.37	107	107	107	106	106	106
New Zealand	0.6743	0.66	0.66	0.67	0.67	0.68	0.69
Switzerland	0.9042	0.92	0.93	0.92	0.91	0.91	0.90
United Kingdom	1.3353	1.30	1.28	1.29	1.30	1.31	1.32

Australia, Eurozone, and United Kingdom are direct quotes.

Source: Bloomberg, DBS

Alternatives: Gold | 4Q20

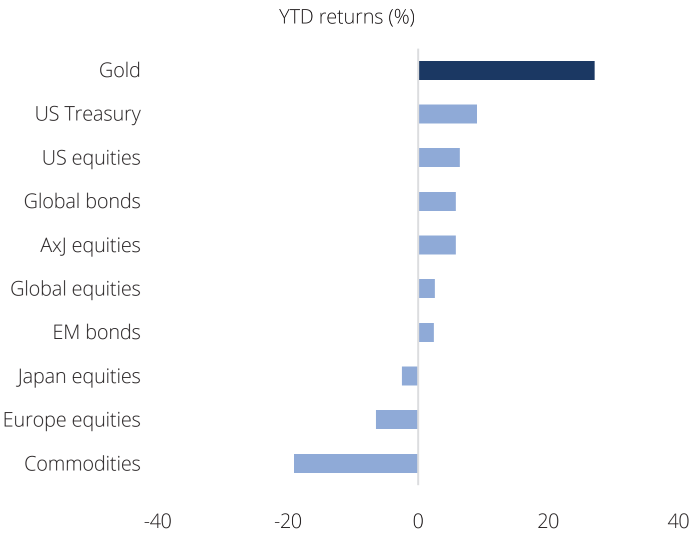
Go Gold!

Alternatives: Gold

Joanne Goh | Strategist

Gold outperformed all asset classes in 3Q20, with a return of c.10% during the quarter and c.30% YTD. We believe this is attributable to the weaker dollar, falling UST yields, and uncertainties arising from subsequent waves of COVID-19 cases. As these tailwinds for gold persist, we continue to see gold being supported at current levels.

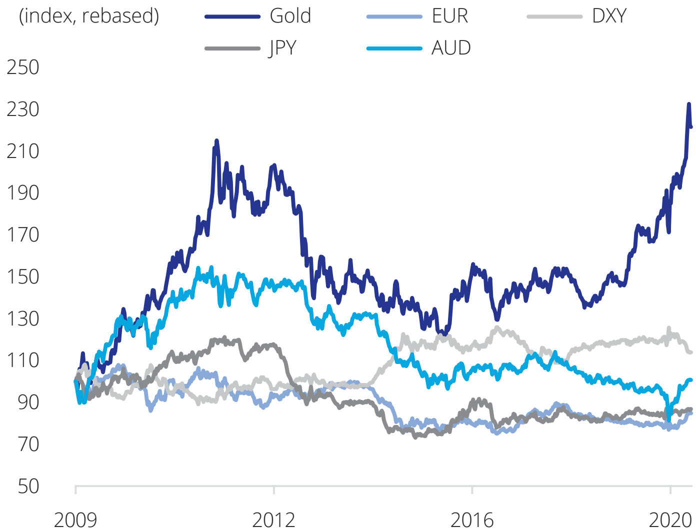
Figure 1: Gold has outperformed major asset classes with one of the least drawdowns YTD



Source: Bloomberg, DBS

The new normal: above USD2,000 per ounce. Our sensitivity analysis on gold price and its key drivers shows that based on the current bond yield of 0.65% and the DXY at 92, fair value for gold is above USD2,000. We are of the view that as long as global central banks have not weaned off QE, and that US yields have yet to go to zero, debate over these two variables will continue to drive uncertainties and demand for hedges. Gold as a risk diversifier has proven itself to be an effective hedge outperforming most currencies, including the dollar, in the past 10 years. Fears of a potential return of inflation is another reason to consider safe havens, such as gold, which have performed well in an inflationary environment.

Figure 2: Gold prices have appreciated more than major currencies* since 2019



*Excludes compound interest.

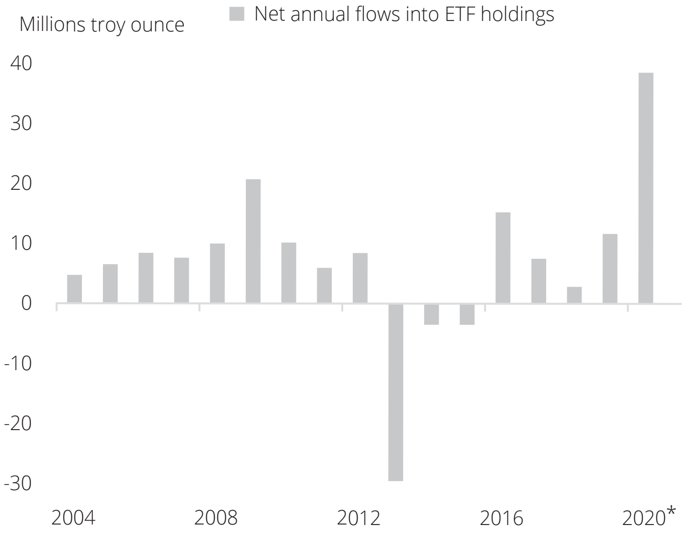
Source: Bloomberg, DBS

Demand for gold is accelerating. Investment demand for gold has accelerated, as evidenced from the net inflows into gold ETF holdings. Net inflows into ETF holdings has been positive every month this year except during the market turmoil in March. This year has also been the strongest year on record since data become available.

It is not all about retail money; central banks are expanding their gold reserves. While retail investors are chasing after gold ETFs, central banks are also expanding their gold reserves slowly as seen in Figure 4. Gold reserves as a percentage of total reserves had stood roughly flattish, but there are indications that this allocation is likely to rise.

In a 2020 survey conducted by Invesco for central banks and sovereign funds, 18% of central banks and 23% of sovereign funds surveyed have indicated intentions to make changes to gold allocations over the next 12 months.

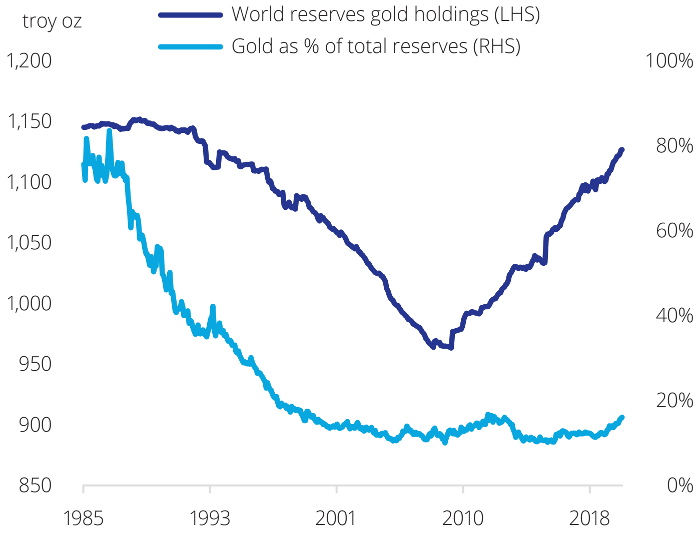
Figure 3: Record net inflows into ETF this year



*Annualised using data till August.

Source: Bloomberg, DBS

Figure 4: Net purchase by central banks has been a steady source of new gold demand. % of reserves held in gold still has room to rise



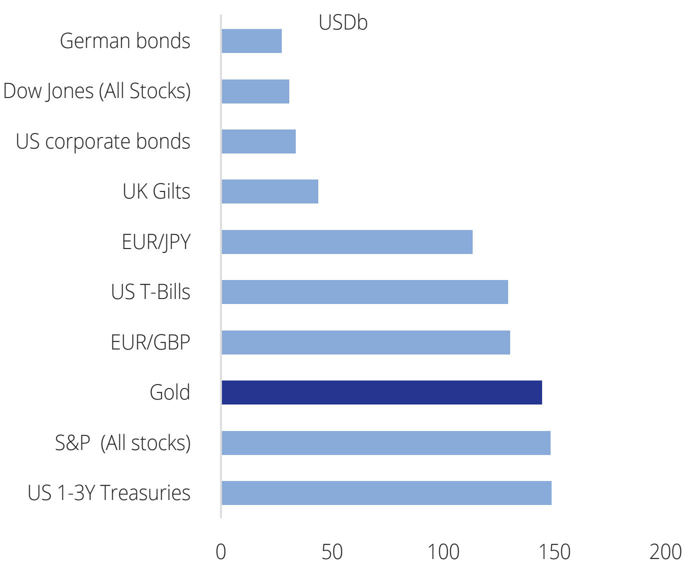
Source: IMF, Bloomberg

Gold is not illiquid. The survey cited that central banks are particularly attracted by gold's potential as a replacement for negative-yielding debt, its low correlation to other central bank assets, and liquidity. They bought into physical gold, ETFs, as well as gold swaps and futures.

Surprisingly, while gold is thought to be bulky, and needs to be physically stored and transported, its liquidity aspect is considered to be attractive. Indeed, according to World Gold Council data, trading in gold is as liquid as in US stocks and Treasuries, and much better than other bond markets.

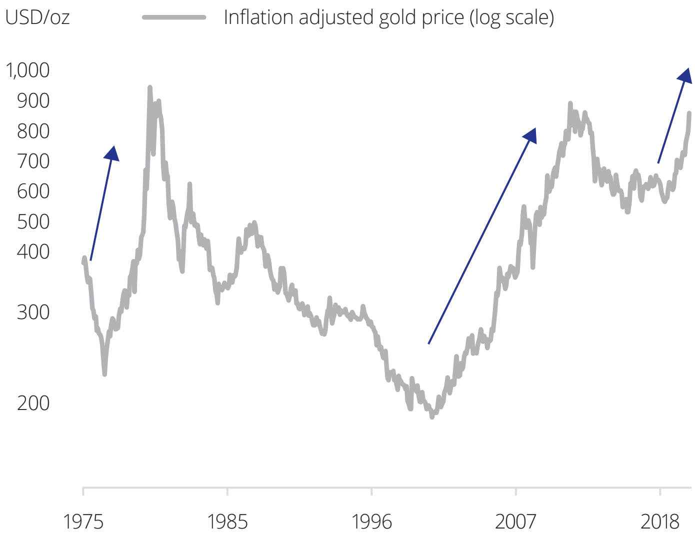
We believe the proliferation of gold ETFs and financial instruments should continue to enhance liquidity of gold and a deserving stake in individual's as well as institution's portfolio allocation. Our study has suggested that adding gold to a 50/50 portfolio of equities and bonds improves the risk- adjusted return of the overall portfolio. A hedge against tail risks, while opportunity costs are almost zero, further enhanced the appeal of gold. Moreover, swaps and leverage

Figure 5: Major asset classes average daily trading volume



Source: World Gold Council

Figure 6: Is this the start of the third great gold rally?



Source: Bloomberg, DBS

are readily accepted by banks and financial institutions which could transform gold into leverage assets in this low interest rate environment. From a speculative angle, investing in gold should have much more appeal than investing in cryptocurrencies.

Considering the limited supply of gold compared to other asset classes, a small increase in allocation could see considerable demand for gold and increase in prices.

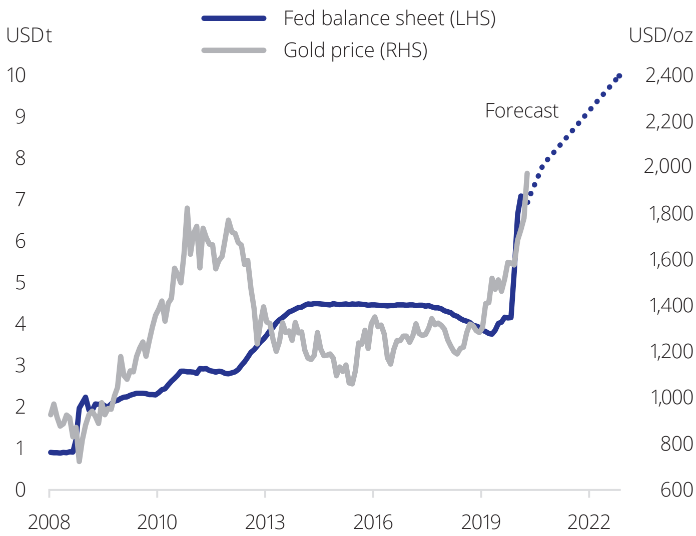
The start of an enduring liquidity-driven rally. Gold has hit USD2,000/oz earlier than expected. We believe the main contributing factor is the monetary expansion brought about by Federal Reserve's QE programme. With the view that the Fed will continue to expand QE to fund the wide fiscal budget

deficit needed to support the economic recovery, we see conditions at the moment are highly supportive of gold and now could be the start of an enduring gold rally.

Back in 2008, liquidity has been an important driver for gold when the Fed's QE involved purchasing close to USD3.5t of bonds. Total Fed assets had jumped from USD1t to USD4.5t in early-2015. During the period, gold rose by 150% from its low to its peak.

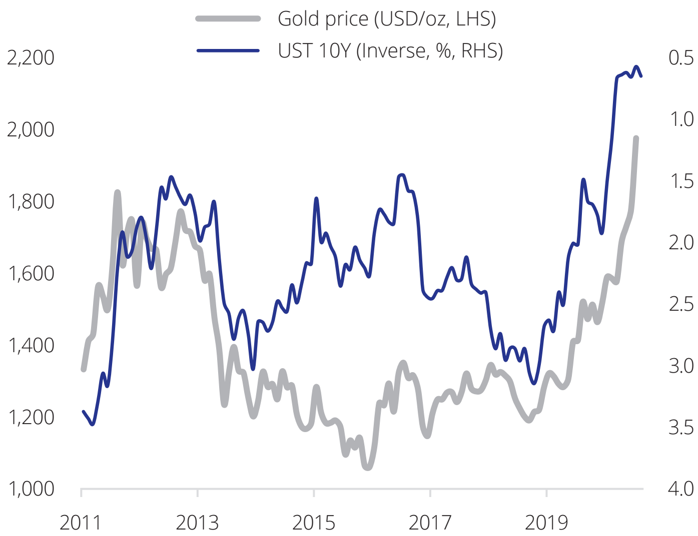
Current liquidity conditions are indeed more flushed than before. Since March, the Fed's total assets have skyrocketed from just over USD4t to around USD7t currently, and the amount is expected to rise to USD10t. With the amount almost double that of 2008, a similar performance for gold to back then cannot be ruled out.

Figure 7: Gold price could overshoot on Fed's balance sheet expansion



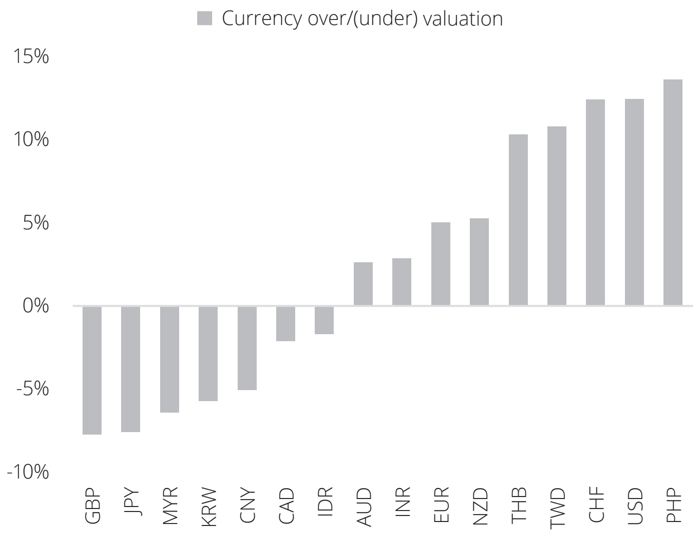
Source: Bloomberg, DBS

Figure 8: Bond yields vs gold price



Source: Bloomberg, DBS

Figure 9: DEER currency model suggests both USD and EUR are overvalued while JPY and CNY are undervalued



Source: Bloomberg, DBS

Current gold rally still has legs

While one would argue that liquidity money is pure speculation, we would believe that the rise in gold price, unlike oil price and property prices, is not inflationary and does not stand in the way of economic recovery. Hence it is unlikely to invite any monetary actions.

Indeed, looking at the past two gold rallies, monetary actions prompted their demise. During the 1980s, gold price collapsed when there was high inflation due to high oil prices followed by aggressive interest rate hikes up to 20%. In 2012, talks of the end of QE (which finally ended in 2015) had left gold investors nervous. We believe these conditions will take a long time before they appear.

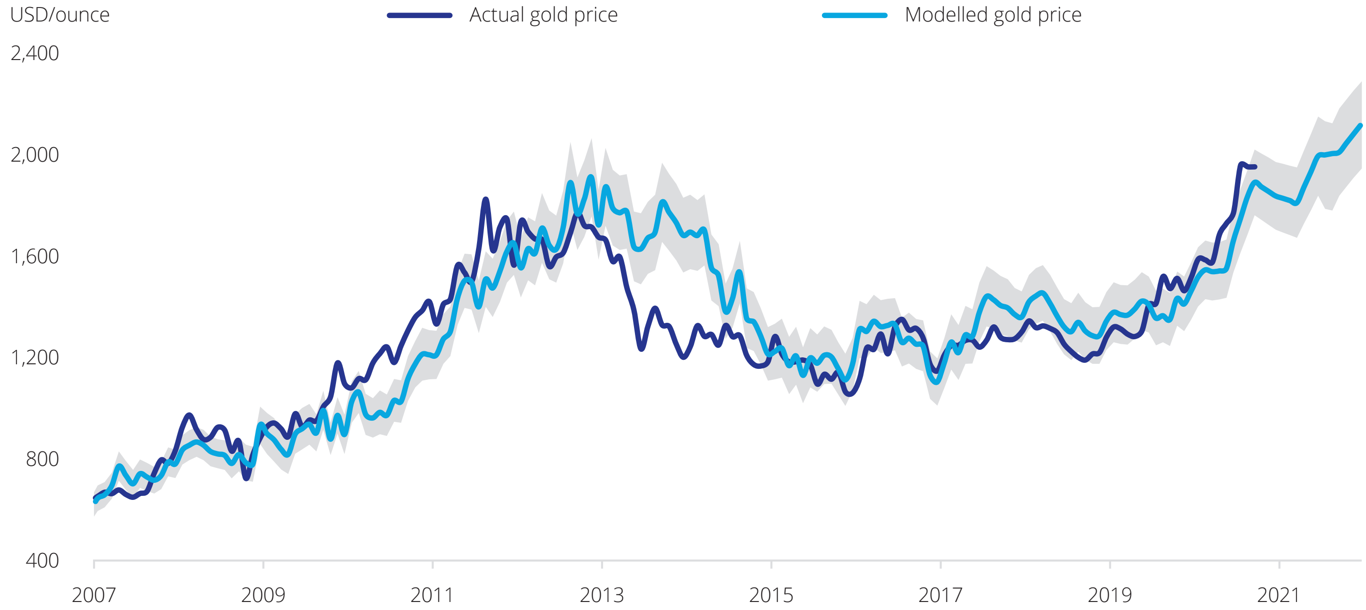
While talks of reflation could hurt the current rally, we believe that the short-end policy interest rates are unlikely to rise in the near term, in view of the recessionary global economy which may need years to return to normal. As long as nominal rates do not rise while inflation picks up, real yields will be dragged down further to the negative territory which is positive for gold.

Bond yields on the other hand, is unlikely to move a lot higher and will probably be stuck at 0.6-1.3% range given the low policy rates. This is still a far cry from the high yields in the 1980's where gold as a non-interest-bearing asset will find it hard to compete.

Drivers playing out to support further gold price increases in the longer term

Our pricing model for gold suggests the three most important drivers for gold price are bond yields (negative correlation), the DXY (negative correlation), and recession risk (positive correlation).

Figure 10: Gold price model (Δ Gold Price = f(-ΔBond Yields, -ΔDXY, Recession Probability)



Bands are +/- 0.5 SD.

Source: DBS

The biggest uncertainty to us is the dollar. According to our DEER (DBS Equilibrium Exchange Rate) currency model which looks at long-term fundamentals of a country's currency, the dollar is overvalued by 11%. Hence it is a matter of time that the dollar will converge, in our view. However, without a corresponding relative strengthening in other countries' fundamentals, the timing may be difficult to call for. With regards to other components in the DXY, EUR is overvalued, but not as much as the dollar while JPY and CNY are undervalued. In our base case, we believe the DXY should consolidate at current levels and not ready to break below 90, after having weakened from 97 to 92 in 3Q20. DXY should however resume its weakness post US elections.

Gold forecast to hit USD2,300 in the next 12 months, silver at USD35

Given the conditions at the moment being highly supportive of gold, we believe prices could hit the upper end of our forecast range. We are thus upgrading our 12-month gold price forecast to USD2,300.

For silver, we believe the gold/silver ratio could return to average of 65 given the bullishness around precious metals. The 12-month target for silver is adjusted up to USD35.

Thematic Strategy

Source: Unsplash

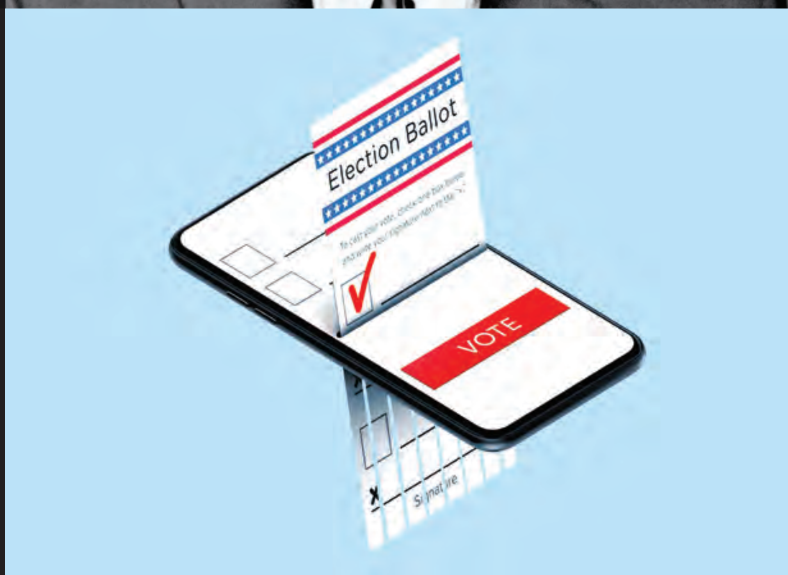
Investment themes initiated by the DBS Chief Investment Office, as of 4Q20

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

DBS Live more, Bank less

Special Feature | 4Q20

US Elections



Source: Unsplash

Theme I: US Elections

Dylan Cheang | Strategist
Benjamin Goh | Analyst

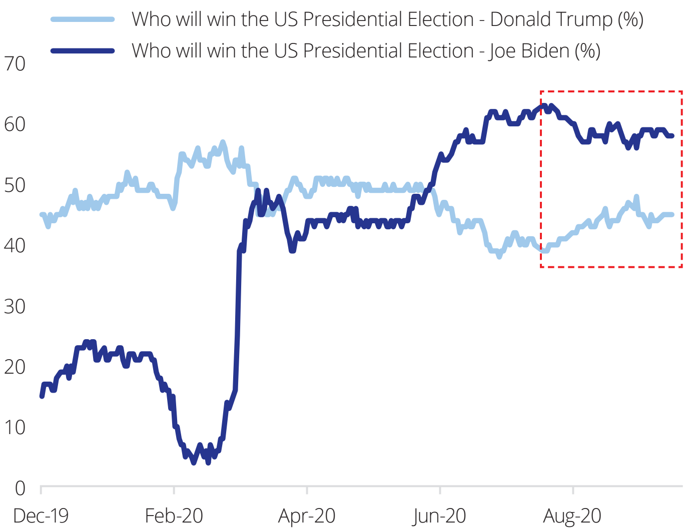
Opportunities in US Health Care & Infrastructure from election outcomes

US presidential election: Going down to the wire. The upcoming US presidential election will be the single most pivotal event affecting financial markets in the final months of 2020 – a bittersweet year which has seen risk assets collapsing on pandemic fears followed by a high octane rebound underpinned by unprecedented central banks' largesse, no less.

The outcome of this election will be significant. First and foremost, on the international front, it will determine whether the confrontative state of US-China relations will persist for another four years, or if this be replaced by something more predictable and collaborative. On the domestic front, the outcome of this election will also determine the trajectory of tax policy, infrastructure, and health care spending.

Without question, the stakes are high.

Figure 1: Prediction on who will win the US presidency in November



Source: PredictIt.org, Bloomberg, DBS*as of 15 September 2020.

We have, in our CIO Perspectives report "Our views on the US presidential election" (20 July 2020), covered some of the areas which will be of concern to investors. These are the key highlights from the report:

- Election outcome remains fluid. Based on an opinion poll by FiveThirtyEight, Democrat Joe Biden currently has a 52 percentage points spread over incumbent Republican Donald Trump in the national poll (76% vs. 24%) (as of 15 September 2020). In fact, predictions by PredictIt.org suggest that the Democrats are slated to make a clean sweep in this election. But as history shows, anything can happen on polling day and a good case in point is the experience of Democrat Hillary Clinton in the 2016 election.

- State of the economy matters too. Our analysis of past elections shows that the state of the economy has significant impact on election outcomes. Voters are more likely to vote against the incumbent party during periods of economic hardship, and that took place in 1980 and 2008. The US has dipped into a recession this year due to the pandemic and this does not augur well for the incumbent.

- Democrats vs Republicans: which party is more positive for US equities? Based on conventional wisdom, a Republican victory is deemed as more "market friendly" given the party's association with pro-growth business policies. But our analysis suggests otherwise. On a shorter-term basis, a Republican presidency may be a boon for US equities. But over a longer term, historical data show that a Democrat victory is actually more positive over a 6-, 12-, and 24-month period.

In this follow-up report on the US election, we turn our attention to focus on how this election will impact the following key sectors in the US:

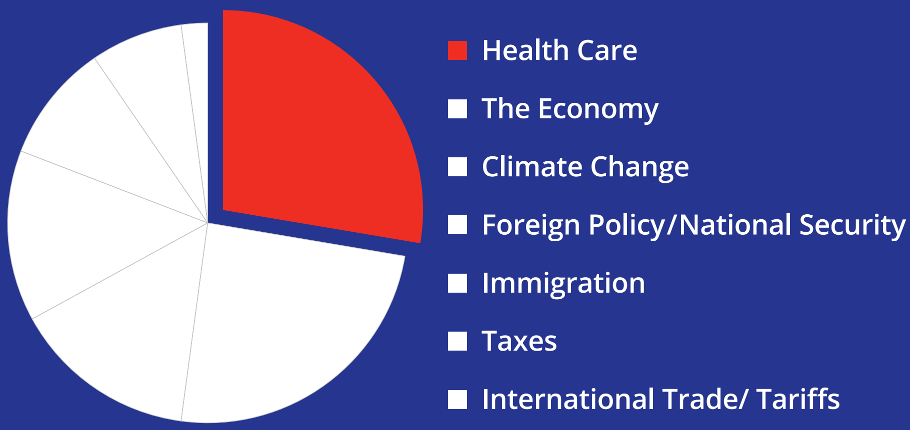
- Health Care
- Infrastructure

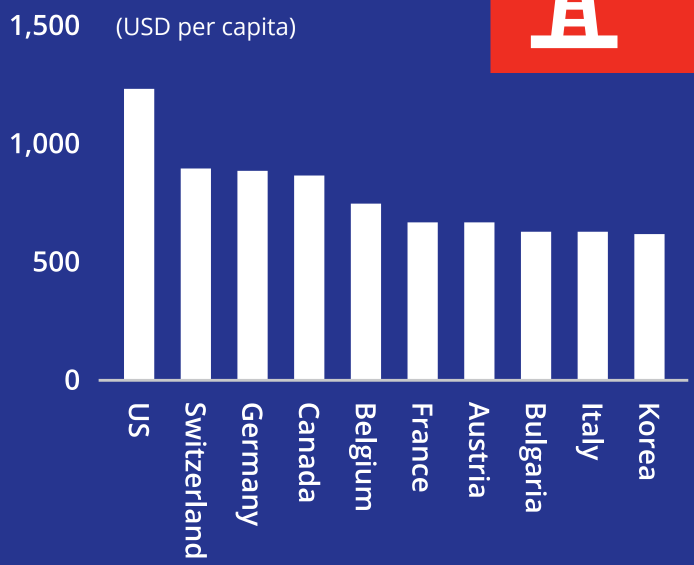
★ US ELECTION ★

Health care is the most important issue for voters

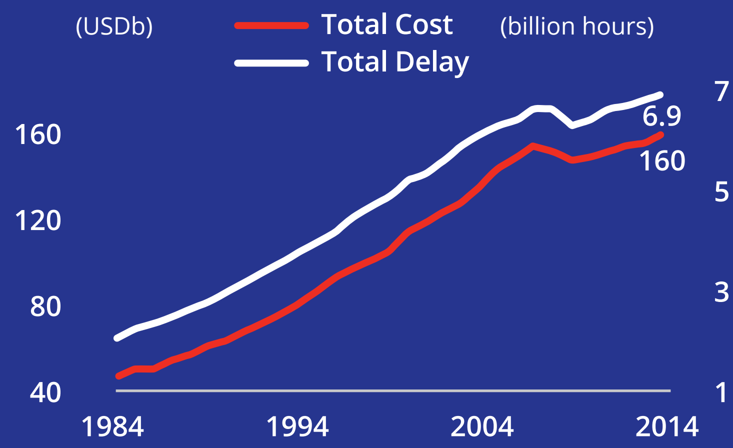
★★★★★

Globally, the US spends the most on health care (per capita)



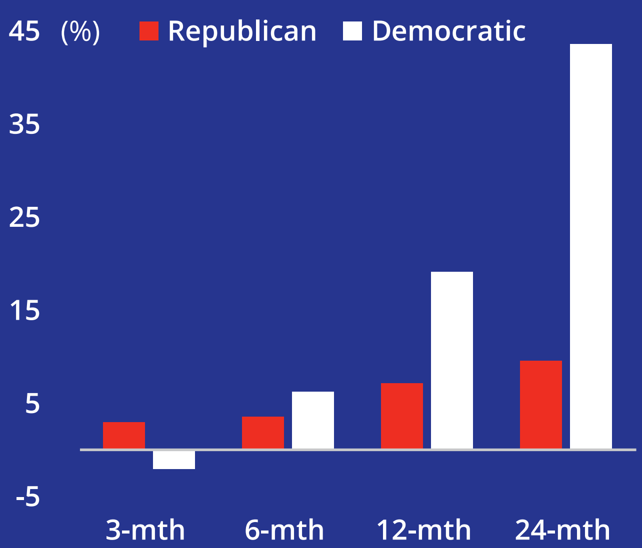


Poor infrastructure costs the US economy over USD160b and 6.9b hrs of delays annually



Historically, a Democratic victory would result in better market returns over the longer-term (12-and 24-month period)

Health Care performance



Infrastructure performance

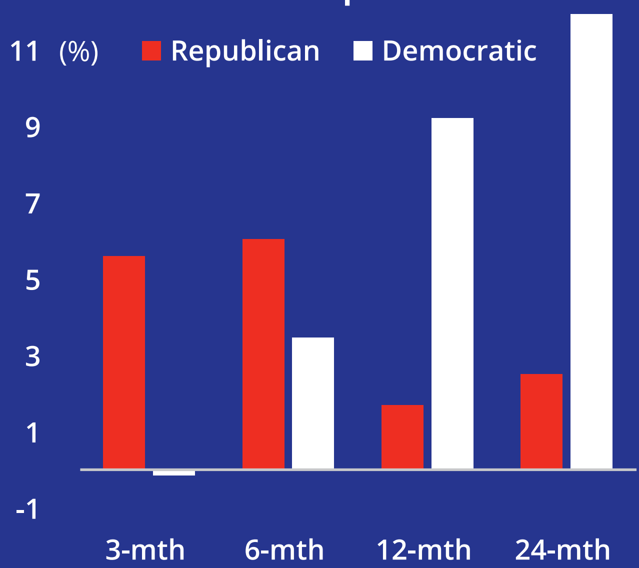
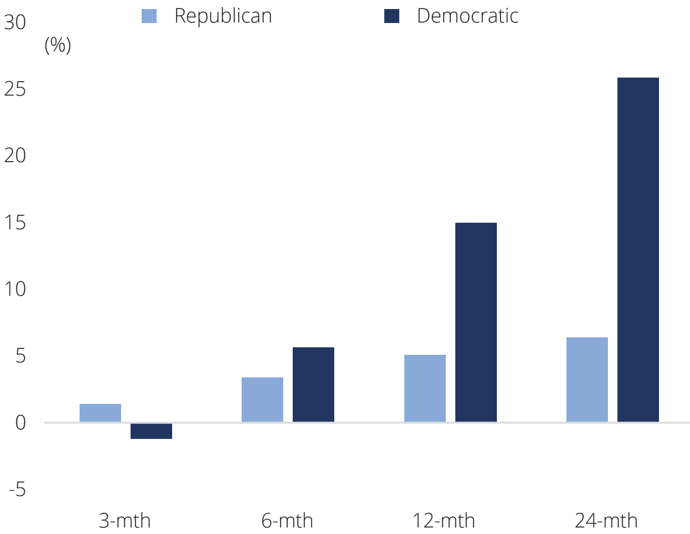


Figure 2: Average returns on the S&P 500 Index after election victory since 1972



Source: Bloomberg, DBS

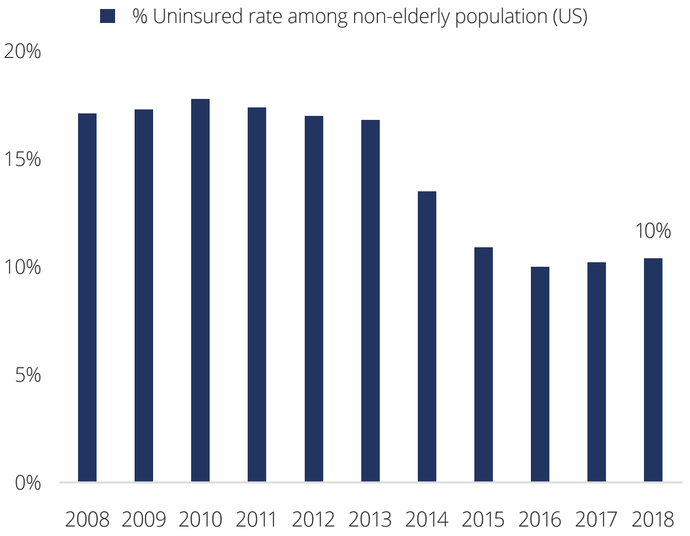
Election focus: US health care

Overview: The US health care system. The US health care system affects the very basics of American lives and it is an enormous complex totalling USD3.6t (as of 2018). According to Brookings Institution, the US health care sector is significant on several fronts: (a) It accounts for 24% of government spending; (b) It employs 11% of the US workforce; and (c) It accounts for the largest proportion of consumer expenditure. But unlike other developed countries, the US does not provide universal health coverage. Instead, it operates on a "hybrid" system made up of both private and government-run programmes.

Government programmes meant for low income families, the elderly, and people with disabilities are provided with options such as "Medicare" and "Medicaid". Those who fall outside of these groups, however, will have to opt for private programmes either on their own or via their employers. The number of uninsured Americans is historically high and to address this problem, the Affordable Care Act ("Obamacare") was established in 2010.

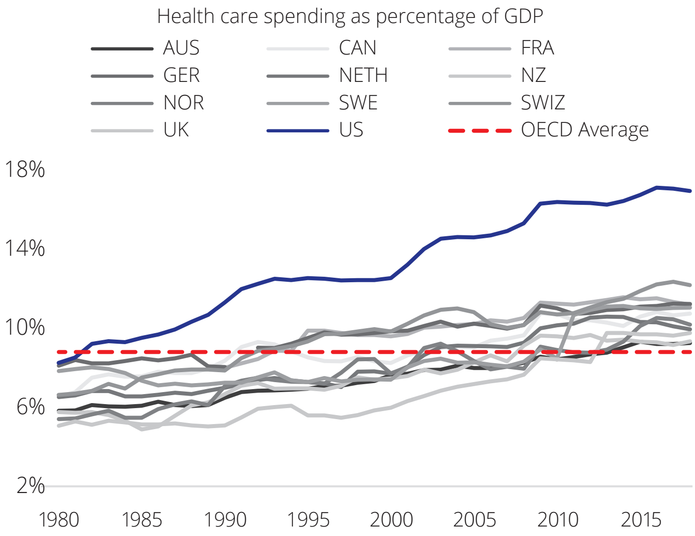
Source: Unsplash

Figure 3: 10% of non-elderly Americans are uninsured (as of 2018)



Source: KFF.org, DBS

Figure 4: The US spends more on health care than other developed countries

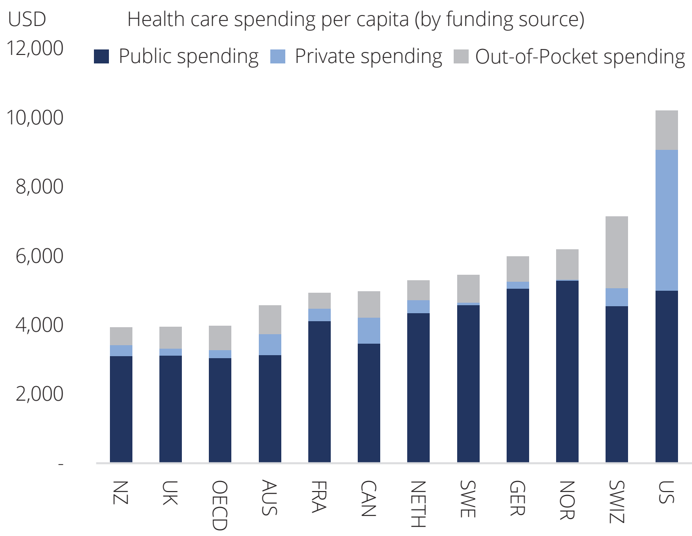


Source: OECD Health Statistics, DBS

The Affordable Care Act aims to extend health insurance coverage via various means, such as expanding the eligibility of Medicaid as well as preventing insurance companies from denying coverage to applicants as a result of pre-existing conditions. But while the Act managed to extend health coverage to an additional 20-24m Americans (as of 2016), 10.4% of Americans remain uninsured (as of 2018).

Higher cost + poorer outcomes: Why health care is a contentious issue in the US. Health care cost is on the rise in America. According to research by the Peterson Foundation, medical cost in the US has increased by 3.5% per annum over the past 20 years and this far outstrips the 2.1% inflation rate. Data from the World Health Organization (WHO) show that the US spent USD10,224 on health care per capita in 2018. This constitutes 16.9% of its GDP and it is nearly twice as much as the OECD average of 8.8%. Despite the huge expenditure, the US consistently ranks lower in many health-related measures compared to other developed economies, such as in life expectancy and infant mortality rates.

Figure 5: The US has the highest health care spending on a per capita basis



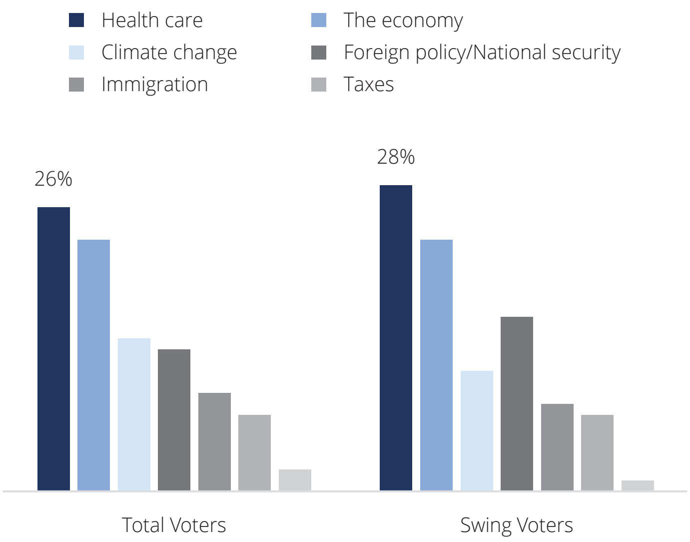
Source: OECD Health Statistics, DBS

The average life expectancy for Americans is 78.6 years and the US is ranked 42 out of 224 on this. But among industrialised OECD countries, the US fares poorly as it is ranked 22 out of 35. The same can be said for infant mortality. According to the America's Health Ranking Annual Report, infant mortality rate in the US is 5.9 deaths per 1,000 live births, and this is substantially higher than the 3.9 deaths per 1,000 births for other OECD countries. In fact, the US is ranked 33 out of 36 on infant mortality by the OECD.

So, the question is: why does the US have worse life expectancy and infant mortality rates despite spending so much on health care? The reasons are as follows:

- System complexity translating to higher administrative cost
    - » The US health care system is highly complex with several types of plans and coverage in place. For instance, Medicare has different types of coverage while Medicaid varies from state to state. Employers, meanwhile, can also customise their own insurance programmes for their workers.
    - » Such apparent lack of uniformity has a major downside – it incurs huge administrative costs. According to the Journal of American Medical Association, administrative costs account for 8% of total health care spending in the US, compared to 1-3% in other countries.
- Labour supply shortages translating to higher staff cost
    - » Studying for a medical degree in the US is a huge financial commitment. In fact, the situation has worsened over the years. According to the National Centre for Education Statistics, the average medical school debt for the class of 2000 was USD127,500. But by 2016, the sum had almost doubled to USD251,600.
    - » The astronomical medical school fees, coupled with low intake rates, have inevitably reduced the supply of new doctors and consequentially, salaries have skyrocketed. According to a study by Medscape, American doctors have the highest annual salaries of USD313,000 and this is 92% higher than Germany.
- Higher drug costs
    - » According to OECD Health Statistics, Americans spend about USD1,229 per capita on prescription medicine and this is the highest globally. Switzerland, which comes in second, spends USD894 and this is 27% lower than the US.
    - » The high drug cost in the US is mainly because the country does not have a government agency tasked with negotiating drug prices with pharmaceutical companies. Instead, the negotiations are done at the individual insurance company level which inevitably leads to lower bargaining power from the perspective of the buyers. Medicare, the federal health insurance programme, is prohibited by law from negotiating drug prices.
    - » The overall fragmented nature of the industry translates to higher drug costs in the country.

Figure 6: Health Care is the single most important issue for voters



Source: KFF.org, DBS

Figure 7: Americans have the highest expenditure on prescription drugs globally

Source: OECD Health Statistics, DBS

How do Democrats and Republicans differ on key issues in US health care? Faced with an ageing population and spiralling medical costs, health care is, undoubtedly, a major issue among voters in the upcoming election. A survey conducted by KFF shows that 26% of the voters consider health care as the single most important issue for them, compared to 23% for the economy and 14% for climate change (Figure 6).

In the run-up to the election, the key discussions on health care will be centred around the following topics:

- Affordable Care Act (ACA)
  - » Democrat Biden has pledged to: (a) Expand the ACA, (b) Propose over USD2t worth of new health care spending over 10 years.
  - » Republican Trump has promised to replace the ACA since his 2016 campaign.
- Medicare/Medicaid
  - » Democrat Biden has proposed lowering the eligibility age for Medicare to 60 (from 65), a move which could potentially increase Medicare coverage to another 20m Americans.
  - » Republican Trump, on the other hand, is proposing various steps to limit the public's access to Medicaid, such as: (a) Reducing the eligibility to Medicaid by imposing work requirements and other limitations, (b) Blocking grants and placing caps on spending growth for Medicaid. These moves will result in fewer people being covered by the scheme.
- Drug prices
  - » Democrat Biden supported a bill that would permit Medicare to start negotiating drug prices like private insurance companies. Secondly, he also supports international price indexing which would result in lower drug costs in the US.
  - » Republican Trump has proposed restructuring the prescription drug market by allowing imports of cheaper drugs from overseas.

Post-election US Health Care sector performance: Any difference between a Democrat and Republican victory?
In our inaugural report on this topic, we analysed the post-presidential election performance of the S&P 500 index. Despite the Republicans being widely perceived as a "market friendly" party that is more pro-business, our research shows that the stock market has actually performed better after a Democrat victory on a 6-, 12-, and 24-month basis.

Surprisingly, extending this analysis to the US Health Care sector yielded the same outcome. Based on data stretching back to 1992, a Democrat presidential victory translates to strong Health Care sector performance over a 6-, 12-, and 24-month period. This, in our view, will help allay concerns on whether a Democrat victory in the November election will trigger a selloff in US health care stocks.

Source: Unsplash

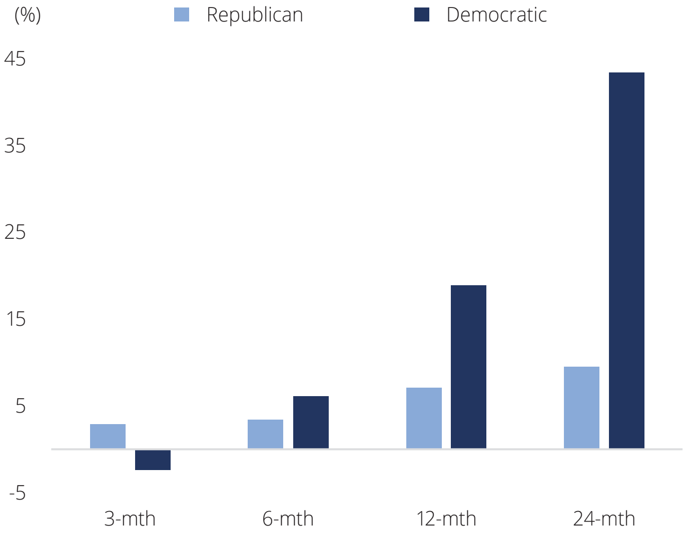
- 3-month returns: Since 1992, a Republican victory in the US election sees the US Health Care sector rallying 2.9% on average while a Democrat victory precedes a 2.4% loss on average.

- 6-month returns: On a 6-month basis, the tables turn as the average return for a Republican victory is 3.4% while the average return for a Democrat victory is 6.1%.

- 12-month returns: On a 12-month basis, the picture is vastly different as the average return for a Republican victory is only 7.1% while the average return for a Democrat victory is 18.9%.

- 24-month returns: Lastly, on a 24-month basis, the average return for a Republican victory is only 9.5% while the average return for a Democrat victory is 43.4%.

Figure 8: Average returns on US the Health Care sector after election victory since 1992



Source: Bloomberg, DBS

Source: Unsplash

Impact on Health Care sector: Scenario analysis for presidential and senate elections. In this section, we provide an analysis on how the US Health Care sector will be affected under the following three scenarios: (a) Status quo – Split congress, (b) Democrats clean sweep, and (c) A Democrat presidency and a Republican senate.

- Status quo – Split congress
    - » The Republicans will continue in their attempt to repeal the ACA.
    - » Republican Trump's attempt to lower drug costs through overseas imports will put downward pressure on pharmaceutical companies' top-line margins.

- Democrats clean sweep
    - » Democrat Biden's plans to (a) Expand the ACA, (b) Extend Medicare coverage to more Americans, and (c) Add a public option to private plans sold on ACA's public exchanges will translate to higher competition and by extension, lower profitability for health insurers.

   » Democrat Biden's plan to lower drug prices via (a) Adoption of international reference pricing and (b) Allowing Medicare to negotiate pricing like private insurers, would put downward pressure on the pricing power of pharmaceutical companies.

- A Democrat presidential victory and a Republican senate

   » Significant health care reform would be unlikely in this scenario. The only reform that will likely gain passage will be those aimed at lowering drug prices.

Election focus: US infrastructure

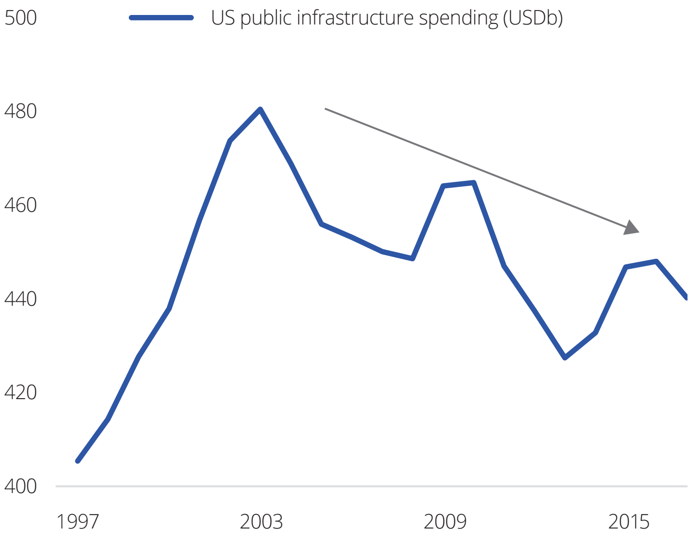
US infrastructure – in dire straits. It is a well-known fact that US infrastructure is in a state of decay. And this is not surprising. The majority of America's infrastructure was built after the second world war and since the 1970s, most of the funding was spent on maintenance work as opposed to new developments. Data from the Congressional Budget Office (CBO) show that US infrastructure spending peaked at USD480.8b in 2003 and since then, it is on a general decline, last reaching USD440.5b in 2017.

The American Society of Civil Engineers', in a 2017 Infrastructure Report Card, gave US infrastructure a "D+" grading (the same grading it received back in 2013) and it is advocating a USD2t increase in infrastructure spending. Internationally, the US is also falling down the pecking order. According to the 2019 World Economic Forum's Global Competitiveness Report, the US is ranked 13th in infrastructure quality, down eight notches from a 5th place positioning in 2002.

Politically in the US, there is broad-based consensus in Washington that massive investment in infrastructure is necessary and this is particularly so from an economic perspective:

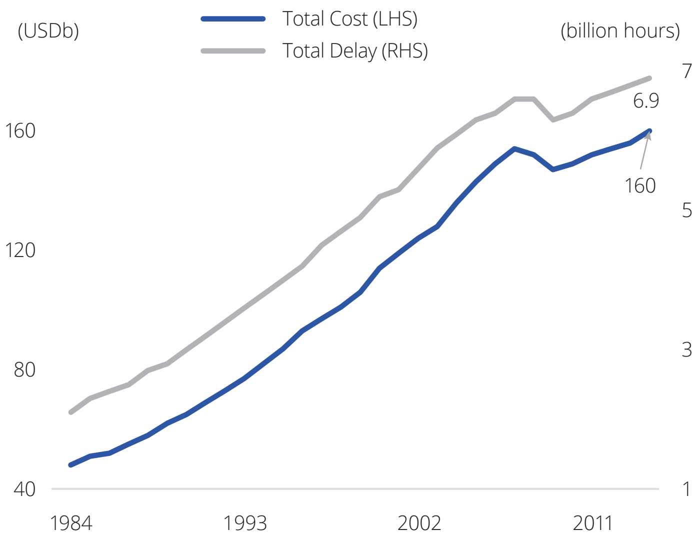
- Based on estimates by the American Society of Civil Engineers, the dire state of infrastructure in the US is costing the economy USD160b per year as well as 6.9b hours of delays.
- A study by the University of Maryland in 2014 concluded that for every dollar spent, infrastructure investments can add up to USD3 to GDP growth.
- According to McKinsey, an increase in infrastructure investment by 1% of GDP will result in the creation of 1.5m jobs.

Figure 9: US infrastructure spending has been declining



Source: Congressional Budget Office (CBO), DBS

Figure 10: Cost incurred by poor infrastructure

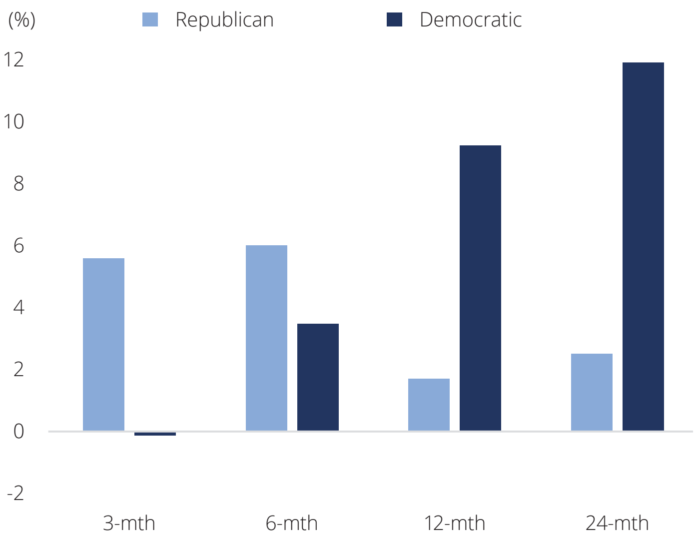


Source: Infrastructurereportcard.org, DBS

Post-election US Infrastructure sector performance: any difference between a Democrat or Republican victory? The post-Presidential election performance for the US infrastructure sector is mixed. On a near-term basis (3-6 months), a Republican victory has historically resulted in stronger equity market performance. But longer term (12-24 months), a Democrat victory has historically resulted in stronger outperformance.

- **3-month returns:** Since 1992, a Republican victory in the US election sees the US Infrastructure sector rallying 5.6% on average while a Democratic victory precedes a 0.1% loss on average.
- **6-month returns:** On a 6-month basis, a Republican victory sees US Infrastructure rallying 6% on average while a Democratic victory returns only 3.5% on average.
- **12-month returns:** On a 12-month basis, the picture is vastly different as the average return for a Republican victory is only 1.7% while the average return for a Democratic victory is 9.2%.
- **24-month returns:** Lastly, on a 24-month basis, the average return for a Republican victory is only 2.5% while the average return for a Democrat victory is 11.9%.

Figure 11: Average returns on US Infrastructure after election victory since 1992



Source: Bloomberg, DBS
* Note: This is performance is calculated based on a "proxy" index for US Infrastructure consisting of (a) S&P 500 Utilities and (b) S&P 500 Oil Gas and Consumable Fuels

Scenario analysis for presidential and senate elections – impact on the Infrastructure sector. In this section, we provide an analysis on how the US infrastructure sector will be affected under the following three scenarios: (a) Status quo – Split congress (b) Democrats clean sweep and (c) A Democrat Presidential victory and a Republican senate.

- Status quo – Split congress
  - » Should Trump retain the presidency, he will proceed with his USD1t plan that covers traditional infrastructure work as well as 5G wireless infrastructure and rural broadband spending.
- Democrats clean sweep
  - » The Biden campaign has proposed an infrastructure plan totalling USD1.3t that will be spent over 10 years and fully funded via higher taxation.
  - » Democrat Biden's proposal of "green infrastructure" suggests significant investment in the clean energy transportation space.
- A Democrat presidency and a Republican senate
  - » Both Democrats and Republicans are in consensus on the need for greater infrastructure spending in the US. However, they would need to reach common ground on how to go about financing these projects.

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Glossary of Terms:

Acronym	Definition
3PL	third party logistics
ASEAN	Association of Southeast Asian Nations
AUM	assets under management
AxJ	Asia ex-Japan
B2B	business to business
B2C	business to consumer
bbl	barrel
BI	Bank Indonesia
BNM	Bank Negara Malaysia
BOE	Bank of England
BOJ	Bank of Japan
BOK	Bank of Korea
BOT	Bank of Thailand
bpd	barrels per day
BSP	Bangko Sentral ng Pilipinas
CAGR	compound annual growth rate
CAR	capital adequacy ratio
CET1	common equity tier 1
CPI	conusmer price index
DM	Developed Markets
DXY	US Dollar Index
EBITDA	earnings before interest, tax, depreciation, and amortisation
EC	European Commission
ECB	European Central Bank
EM	Emerging Markets
eop	end of period
EPFR	Emerging Portfolio Fund Research
EPS	earnings per share
ESG	Environmental, Social, and Governance
e-Sports	electronic sports
ETF	exchange-traded fund
EU	European Union
FCF	free cashflow
FDI	foreign direct investment

Acronym	Definition
FX	foreign exchange
GDP	gross domestic product
GFC	Global Financial Crisis
HIBOR	Hong Kong Interbank Offered Rate
HY	high yield
IC	integrated circuit
IG	investment grade
IMF	International Monetary Fund
IOT	Internet of Things
IP	intellectual property
ISM	Institute for Supply Management
IT	Information Technology
JGB	Japanese Government Bond
KTB	Korea Treasury Bonds
M&A	merger and acquisition
MAS	Monetary Authority of Singapore
MGS	Malaysia Government Securities
mmbpd	million barrels per day
NEER	nominal effective exchange rate
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
OPM	operating margin
P/B	price-to-book
P/E	price-to-earnings
PBOC	People's Bank of China
PM	portfolio manager
PMI	purchasing managers' index
QE	quantitative easing
RBA	Reserve Bank of Australia
RBI	Reserve Bank of India
RBNZ	Reserve Bank of New Zealand
REIT	real estate investment trust
RM	relationship manager
ROA	return on asset

Acronym	Definition
ROE	return on equity
RPGB	Philippine local government bonds
RRR	reserve requirement ratio
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
SNB	Swiss National Bank
SOR	swap offer rate
TAA	Tactical Asset Allocation
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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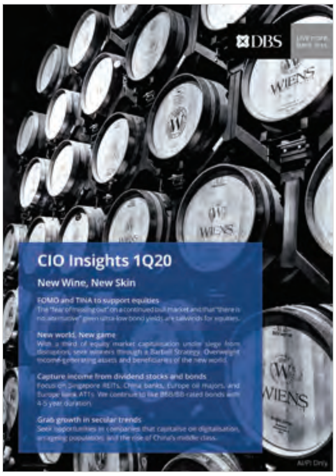

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