Economics & Strategy Weekly

Trades to carry through the market fog

DBS Group Research

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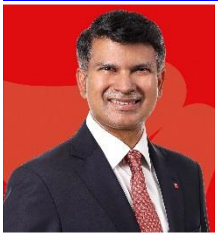

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- *Markets have swung from despair to cautious optimism lately, soothed by Fed guidance and expectations of a thaw in trade wars.*
- *Sensitivities remain high—a swing back to negative sentiments will remain on the cards.*
- *Investment strategies would have to guard against such possibilities*
- *Our favourite trades in this environment across asset classes include betting on steepeners in the US and India and flattener in China (rates); long the USD against AUD, CNY, and SGD (FX); favourable toward investment grade credit and China BBs (credit); and long Indonesia ETF and S-REITs (equities)*
- *Risk to these trades include a sharp slowing of global growth momentum and liquidity squeeze during the course of the year*

Our favourite trades

From utter despair to widespread optimism, it hasn't taken much for the markets to turn around so far this year. All it took was a few dovish words from Fed officials and some news that China-US trade talks were proceeding. We will take this development with a grain of salt, as the threshold for falling back into risk aversion does not seem particularly high. This is a sharp contrast from the global growth dynamic a year ago, when sentiment was so strong that concerns about trade wars or China slowdown were regularly shrugged off.

Recognizing that the market fog can reappear readily, we have some high conviction trades in mind to get going with the year:

Rates: We think that the US fixed income market has overreacted to slowdown concerns, and a steepener is on the cards. Given the wage-jobs dynamic and widening fiscal deficit, the 10-year yield should be considerably higher. We also think that long-term rates in India will rise on fiscal concerns, and support a similar trade. In contrast, a China flattener is in order, given the ongoing economic slowdown and pipeline policy support.

FX: We are not as bullish the USD now as we were last year, but still see it gain modestly against the AUD, CNY, and SGD. As the US economic cycle matures, there will a moment to go dollar bearish, but the moment is not now.

Credit: The migration to higher grade credit has been on for a while, and will continue this year, in our view. We like BBBs, especially out of China and India, and BBs in China for carry.

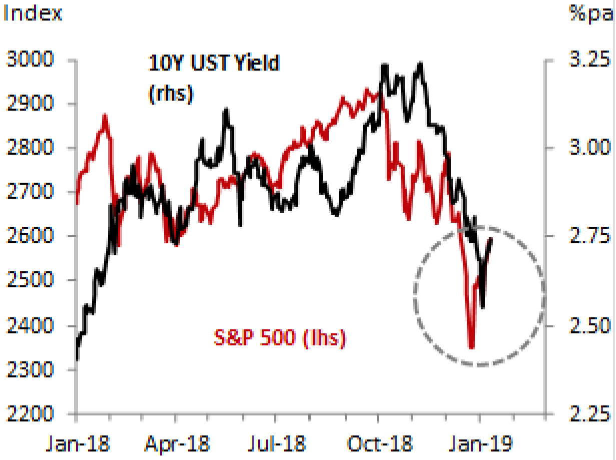
Equities: After a torrid 2018, we see reasons to be constructive Indonesian equities as prospects of a market-favourable election outcome rise and oil strikes a sweet spot of helping commodities in general without causing inflation concerns. As a defensive play, we consider S-REITs in the retail and industrial subsegments.

Taimur Baig

Rates: Cautious optimism

Wobbles from the start of the year aside, risk sentiment has held up well over the past week. In terms of timing, the stock market bottomed first (on 24th Dec) followed by USD rates (on 3rd Jan). The S&P 500 is now 10% off its trough while Fed funds futures are no longer pricing in a rate cut for 2019. Similarly, 10Y UST yields are back at 2.73%, more than recouping the plunge at the start of the year that saw yields touch 2.55%. Finally, **the VIX index dipped below 20, suggesting that the overblown fears about the global economy is finally receding.**

USD assets fading the excessive pessimism



Source: Bloomberg

We have been tactically bullish on emerging markets / Asia since the start of the week (see Macro Strategy, 7th Jan), noting that it makes sense to **fade the excessive pessimism**. Some of this has played out and we think that there may be room for some cautious optimism, allowing risky assets to run a bit further in the short term. News narrative has turned less negative (a more patient Fed, China increasing stimuli, a sense that China-US trade relations may have stopped deteriorating). Arguably, the largest concern may be the US government shutdown at this point.

We reiterate the rate ideas put forth – short Dec-2019 Fed funds futures and long short-dated / 3Y Indonesia government bonds (3rd Jan) – to take advantage of the respite in the markets.

Eugene Leow

FX: USD's uptrend to turn gentler

The sentiment pendulum has swung from US recession fears to optimism for a dovish Fed and positive US-China trade talks. After the aggressive sell-off in 4Q18, stocks have rebounded strongly after the flash crash in the Japanese yen and the near-convergence of the US 10Y bond yield and the Fed Funds Rate on 3 January. The return of risk appetite, in turn, has pressured the US dollar lower.

This is may well turn out to be a relief rally. The upside risks for the global outlook is currently viewed as an easing of the downside risks, namely from a hawkish Fed hike stance and deteriorating US-China trade relations. The Fed's latest shift towards patience is not the dovish stance taken by his predecessor, Janet Yellen, in 2017. Amongst the world's largest economies, the US economy is holding up better than the Eurozone, China and Japan. The recovery from a US-China tariff war in 2H18, which has started to hurt the manufacturing/export data, will be more challenging than one from a currency war.

On a positive note, the Fed is now market-sensitive and not just data dependent. We believe that the Fed still wants to hike rates and we see two more lifting the Fed Funds Rate to 3% in 3Q19. On trade talks, both US and China negotiators have been keen to showcase progress but the verdict is still pending if a deal can be achieved to end the tariff war. China's latest policy announcements should also be viewed as measures to cushion its economy against slowdown, and not as growth stimulus. China's GDP data to be released on 21 January is likely to show growth falling below 6.5% for the first time since 2009.

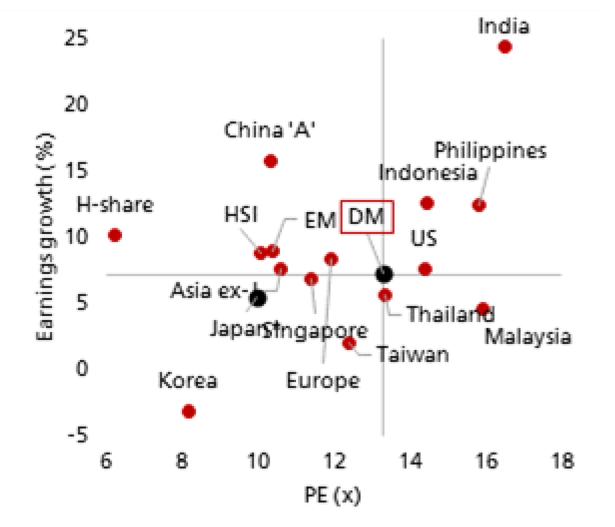
On balance, we view the latest US dollar fall as a correction in its uptrend. The Fed Funds Rate is no longer accommodative but neutral, and more importantly, positive in real terms. In line with the a more patient Fed, the USD dollar's rise will become gentler. On the other hand, inflation has followed growth lower in the Eurozone, Japan and China. The central banks in EU and Japan are likely to push out their monetary policy normalization plans into 2020.

Philip Wee

Equities: Asia's relative growth and valuation vs developed markets are appealing

Asia's growth has outperformed G3's growth over the years and save for analysing valuation and sentiment, the case for investing in Asia is always present. Last year, it was not because Asia's growth was weak but the US was strong. In the next two years, US will slow down and the growth differential will re-establish itself as the main driver for Asia's outperformance.

Moreover, a stronger dollar has historically proven to be a harbinger of turmoil on Emerging Markets (EM). Last year EM have been highly driven by US dollar and US interest rates, international relations and trade. External funding concerns for EM have become more acute, most obviously for Turkey and Argentina, coming under pressure due to external funding requirements, given local current accruing deficits. However, as can be seen, if we look more broadly across EM, the picture is healthier with more robust currency reserves and robust current accounts, especially in Asia with differentiated growth and policy outlooks.



Joanne Goh

Credit: Momentum change

Such was the change in sentiment over the last week, that the Asian credit market resembled the buoyant start of 2018. Our observation last week that market performance in the near term would be constrained by the same issues of last year (e.g. new issues repricing secondary curves) was proven misplaced. While several new issues in the Chinese high yield space were indeed announced wider than secondary levels, they were well subscribed (even up to 9x in the case of Road King) and performed well in the secondary market. The recovery in oil-related credits and tender exercises (Sritex, Road King) were other positive developments during the week.

Meanwhile, as new Chinese high yield deals continue to hit the market regularly, the Wall Street Journal reported that a HY deal in the US on 10 January broke a dry spell of 40 days (the last HY issuance in the US being in November, reflecting investor sentiment towards year-end). This is the longest stretch without a US HY issuance since 1995, said the report quoting Dealogic.

Pick up in Asian Tier 2 issuance: The week saw the announcement of three Tier 2 capital issuances from Asian banks. Dah Sing Bank priced a USD225mn 10NC5 Tier 2 bond at a yield of around 5.1% (T+255bp). The spread on the bond is much lower than the 375bp that the bank paid on its USD225mn 5.25% T2 bond issued in 2014, indicating that credit spreads, despite the widening seen in 2018, are still on the tighter side compared to historical levels. Malaysia's Maybank is also in the market exploring a Tier 2 issuance. The bank has an outstanding 3.905% 2026 issue currently indicated at a yield of around 4.2%. Subordinated debt of high grade issuers is an area where we see some value although the Tier 1 space is where we see better value. Outside the region, Turkey's Yapi bank issued USD650mn of AT1 bonds, which we see as a very significant change in risk appetite towards Turkey. Just a few months back, even a senior issuance from Turkey was seen to be challenging.

We believe in the strategy of not fighting momentum for now. However, we maintain our longer-term recommendation of positioning defensively and see market rallies as opportunities to exit or reduce exposure to weaker credits.

Neel Gopalakrishnan

Highlights of the week:

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018f	2019f	2020f	2017	2018f	2019f	2020f
China	6.9	6.6	6.2	6.0	1.6	2.1	2.3	2.3
Hong Kong	3.8	3.3	2.5	2.0	1.5	2.5	2.7	2.5
India*	7.1	6.7	7.1	7.4	4.5	3.6	4.0	4.2
Indonesia	5.1	5.1	5.2	5.1	3.8	3.2	3.8	3.6
Malaysia	5.9	4.7	4.5	4.2	3.8	1.1	2.5	1.6
Philippines**	6.7	6.3	6.5	6.4	2.9	5.3	4.7	3.8
Singapore	3.6	3.4	3.0	2.8	0.6	0.7	1.8	1.5
South Korea	3.1	2.7	2.6	2.4	1.9	1.5	1.7	1.6
Taiwan	3.1	2.7	2.2	1.8	0.6	1.4	1.0	1.0
Thailand	3.3	4.1	3.8	4.0	0.7	1.1	1.4	1.5
Vietnam	6.8	6.9	6.6	6.3	3.5	3.6	3.8	3.4
Eurozone	2.5	1.9	1.8	1.8	1.5	1.8	1.4	1.4
Japan	1.9	1.0	1.0	0.5	0.5	1.0	1.1	1.6
United States***	2.3	3.0	2.5	1.5	2.1	2.6	2.5	2.5

* refers to year ending March ** new CPI series *** eop for CPI inflation

	Policy interest rates, eop							
	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
Indonesia	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Malaysia	3.25	3.25	3.25	3.25	3.25	3.25	3.00	3.00
Philippines	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
Singapore**	1.80	2.05	2.30	2.30	2.30	2.30	2.30	2.30
South Korea	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Vietnam***	6.25	6.25	6.25	6.25	6.00	5.75	5.75	5.75
Eurozone	0.00	0.00	0.00	0.00	0.25	0.25	0.50	0.50
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	0.00
United States	2.50	2.75	3.00	3.00	3.00	3.00	3.00	3.00

* 1-yr lending rate; ** 3M SOR ; *** prime rate

	Exchange rates, eop							
	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
China	7.10	7.20	7.15	7.10	7.05	7.00	6.95	6.90
Hong Kong	7.85	7.85	7.84	7.83	7.82	7.81	7.80	7.79
India	74.0	75.0	76.0	77.0	76.5	76.0	75.5	75.0
Indonesia	15000	15200	15400	15600	15500	15400	15300	15200
Malaysia	4.25	4.30	4.28	4.25	4.23	4.20	4.18	4.15
Philippines	53.5	54.0	54.5	55.0	54.8	54.5	54.3	54.0
Singapore	1.42	1.44	1.43	1.42	1.41	1.40	1.39	1.38
South Korea	1180	1200	1190	1180	1170	1160	1150	1140
Thailand	33.5	34.0	33.8	33.5	33.3	33.0	32.8	32.5
Vietnam	23500	23600	23550	23500	23470	23440	23410	23380
Australia	0.68	0.66	0.67	0.68	0.69	0.70	0.71	0.72
Eurozone	1.10	1.08	1.09	1.10	1.11	1.12	1.13	1.14
Japan	116	118	117	116	115	114	113	112
United Kingdom	1.26	1.24	1.23	1.22	1.23	1.24	1.25	1.26

Australia, Eurozone and United Kingdom are direct quotes

Rates forecasts

		2019 Q1	2019 Q2	2019 Q3	**2019 Q4**	2020 Q1	2020 Q2	2020 Q3	**2020 Q4**
US	3m Libor	2.70	2.95	3.20	**3.20**	3.20	3.20	3.20	**3.20**
	2Y	2.70	2.85	3.00	**3.00**	3.00	3.00	3.00	**2.90**
	10Y	2.80	2.90	3.00	**3.00**	3.00	3.00	3.00	**2.90**
	10Y-2Y	10	5	0	**0**	0	0	0	**0**
Japan	3m Tibor	0.05	0.05	0.05	**0.05**	0.05	0.05	0.10	**0.10**
	2Y	-0.08	-0.05	-0.03	**0.00**	0.02	0.04	0.05	**0.05**
	10Y	0.14	0.16	0.18	**0.20**	0.20	0.20	0.22	**0.22**
	10Y-2Y	22	21	21	**20**	18	16	17	**17**
Eurozone	3m Euribor	-0.30	-0.30	-0.30	**-0.30**	-0.05	0.20	0.20	**0.20**
	2Y	-0.55	-0.40	-0.25	**-0.10**	0.05	0.15	0.15	**0.15**
	10Y	0.50	0.60	0.70	**0.80**	0.80	0.80	0.70	**0.70**
	10Y-2Y	105	100	95	**90**	75	65	55	**55**
Indonesia	3m Jibor	7.60	7.70	7.70	**7.70**	7.70	7.70	7.70	**7.70**
	2Y	7.60	7.70	7.70	**7.70**	7.70	7.70	7.70	**7.70**
	10Y	8.40	8.60	8.80	**8.80**	8.80	8.80	8.60	**8.40**
	10Y-2Y	80	90	110	**110**	110	110	90	**70**
Malaysia	3m Klibor	3.65	3.65	3.65	**3.65**	3.65	3.65	3.40	**3.40**
	3Y	3.75	3.75	3.75	**3.75**	3.75	3.75	3.60	**3.60**
	10Y	4.15	4.20	4.25	**4.30**	4.35	4.35	4.30	**4.25**
	10Y-3Y	40	45	50	**55**	60	60	70	**65**
Philippines	3m PHP ref rate	5.65	5.80	5.80	**5.80**	5.80	5.80	5.80	**5.80**
	2Y	6.85	6.90	6.90	**6.90**	6.90	6.90	6.90	**6.90**
	10Y	7.85	7.90	7.90	**7.90**	7.90	7.90	7.80	**7.70**
	10Y-2Y	100	100	100	**100**	100	100	90	**80**
Singapore	3m Sibor	1.80	2.05	2.30	**2.30**	2.30	2.30	2.30	**2.30**
	2Y	1.90	2.05	2.20	**2.20**	2.20	2.20	2.20	**2.10**
	10Y	2.15	2.25	2.35	**2.35**	2.35	2.35	2.35	**2.25**
	10Y-2Y	25	20	15	**15**	15	15	15	**15**
Thailand	3m Bibor	1.85	1.85	1.85	**1.85**	1.85	1.85	1.85	**1.85**
	2Y	1.80	1.80	1.80	**1.80**	1.80	1.80	1.80	**1.80**
	10Y	2.40	2.40	2.50	**2.60**	2.60	2.60	2.60	**2.50**
	10Y-2Y	60	60	70	**80**	80	80	80	**70**
China	1 yr Lending rate	4.35	4.35	4.35	**4.35**	4.35	4.35	4.35	**4.35**
	3Y	2.90	2.80	2.80	**2.80**	2.80	2.80	2.80	**2.80**
	10Y	3.30	3.20	3.25	**3.30**	3.40	3.50	3.40	**3.30**
	10Y-3Y	40	40	45	**50**	60	70	60	**50**
Hong Kong	3m Hibor	2.40	2.65	2.70	**2.70**	2.70	2.70	2.70	**2.70**
	2Y	2.10	2.30	2.40	**2.40**	2.40	2.40	2.40	**2.30**
	10Y	2.25	2.35	2.45	**2.45**	2.45	2.45	2.45	**2.35**
	10Y-2Y	15	5	5	**5**	5	5	5	**5**
Korea	3m CD	1.90	1.90	1.90	**1.90**	1.90	1.90	1.90	**1.90**
	3Y	2.10	2.15	2.20	**2.20**	2.20	2.20	2.15	**2.10**
	10Y	2.30	2.40	2.50	**2.50**	2.50	2.50	2.40	**2.30**
	10Y-3Y	20	25	30	**30**	30	30	25	**20**
India	3m Mibor	7.30	7.20	7.10	**7.10**	7.10	7.10	7.10	**7.10**
	2Y	6.80	6.65	6.50	**6.50**	6.50	6.50	6.50	**6.50**
	10Y	7.30	7.40	7.50	**7.50**	7.50	7.50	7.50	**7.50**
	10Y-2Y	50	75	100	**100**	100	100	100	**100**

%, eop, govt bond yield for 2Y and 10Y, spread bps

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).