# Top-10 macro investment strategies for 1H2020

**Economics/Strategy/Rates/FX/Credit/Equities**

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*A year likely to be driven by non-economic factors presents many event-driven (trade deal, elections, geopolitics, civil unrest, armed conflict, cyber warfare) investment strategies, as already seen in the first few days of 2020. With that in mind, we support the following macro strategy themes for the first half of the year:*

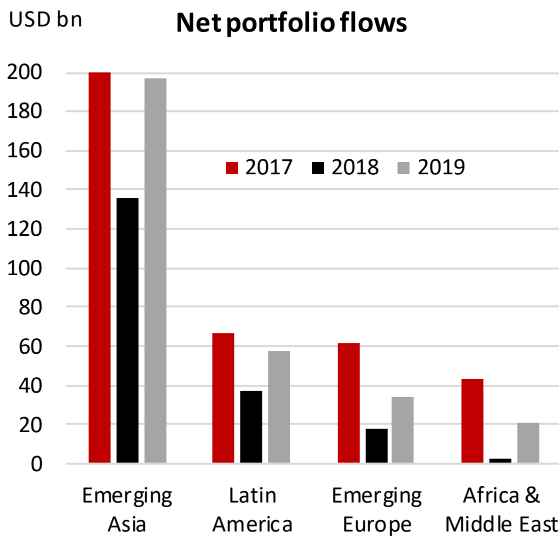
- *Theme 1: With no major economic catalysts in the pipeline, investors would look for value in emerging markets, reducing DM exposure*
- *Theme 2: Watch out for a US 2Y/10Y steepening trade once spreads compress to 15bps*
- *Theme 3: Short-term Indian govvies look cheap*
- *Theme 4: Ample liquidity to support SGD rates*
- *Theme 5: USD sell-off to lose steam*
- *Theme 6: CNY rally to phase out*
- *Theme 7: Holding back SGD optimism*
- *Theme 8: Stretch for duration in Chinese investment grade credit*
- *Theme 9: Oil downside limited at USD65*
- *Theme 10: Set for growth in gold investment*




Refer to important disclosures at the end of this report

## Theme 1: DM to EM and growth to value

US equity markets have reached exceptionally high valuation in recent months, with the S&P500 P/E ratio, on a cyclically adjusted basis, crossing 30, near all-time record territory. With US economic growth expected to be no stronger than 2%, investors would understandably find it reasonable to look for value elsewhere, in our view. EM Asia would likely draw capital away from Western markets as the global electronics cycle troughs and provides a basis for DM to EM rotation. Indeed, despite a poor year for exports, EM Asia saw a revival in capital inflows in 2019, a pattern we expect to persist through the course of 2020.



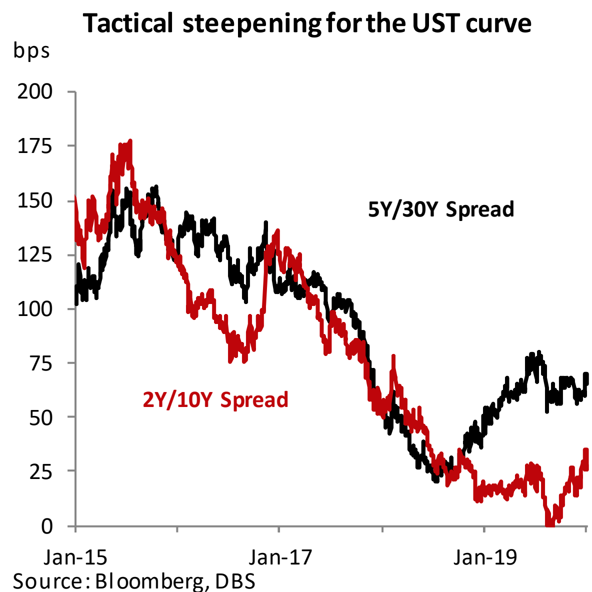
Source: IIF, DBS

Additionally, with the best-case scenario being no major deceleration in the key economies around the world, it is hard to make a case for growth, with investor interest likely to shift to value. From a messy geopolitical outlook to a pivotal US election, the desire to seek safe havens across asset classes may become engrained in the coming months, in our view. This can take place even in the middle of a mild normalisation narrative, in our view.

*Taimur Baig*

## Theme 2: Tactical steepening in US rates

We think that tactical steepening plays on the US Treasury curve will work out in 2020. Against a backdrop of a prolonged Fed pause (after three insurance cuts in 2019), the short end of the UST curve should stay anchored. However, there should be room for longer-term yields to rise, reflecting the cyclical turnaround in the global economy and still-resilient US domestic sector. Moreover, the risk of ultra-long tenor issuances should not be discounted.



Source: Bloomberg, DBS

The difficulty lies with picking the appropriate segments and levels given that some of this optimism has already been priced in. The 2Y/10Y spread was inverted in late-August but has since rebounded to 27bps. Assuming that the Fed stands pat, higher 10Y yields can only be driven by higher inflation expectations or term premium. This suggests that the 2Y/10Y spread may not breach 50bps under our core scenario for the year. Accordingly, we think that 2Y/10Y steepening is only attractive once the spread drops to 15bps.

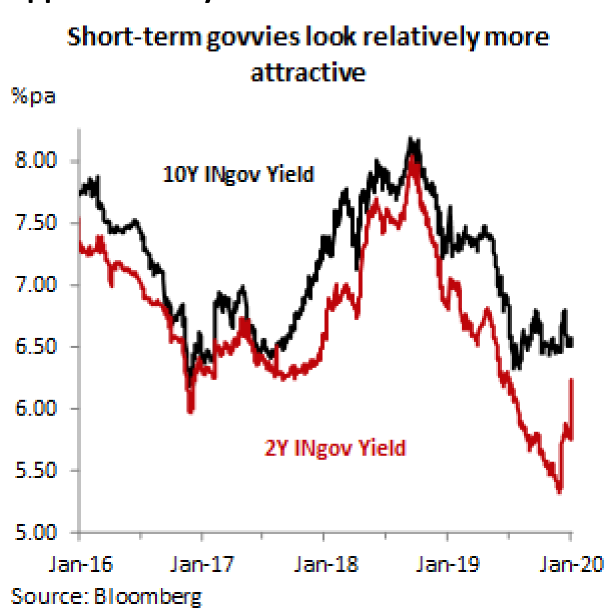
*Eugene Leow*

## Theme 3: Short-term Indian govvies look cheap

Considering the recent bear flattening in the India govvie curve, we view short-term INR rates (around 2Y tenor, Dec22) as relatively attractive given the limited yield pickup for extending duration. The Reserve Bank of India (RBI)'s decision to embark on Op-twist and avoid cutting policy rates (against consensus expectations) were the two key reasons why the rates space reacted accordingly. The RBI has announced three tranches of OMOs worth INR100bn each since December 2019, where shorter maturities have been sold in exchange for belly-to-10Y papers. Even with more such OMOs likely this year, 10Y yields are likely to stay supported around 6.5% (current paper).

Meanwhile, the market has unwound further easing expectations (previously up to two cuts) with 2Y yields up from lows. With liquidity still ample (and likely to sustain) and steady-rate-dovish-stance policy for the coming few quarters, further **upside to short-term yields appear unlikely.**

Short-term govvies look relatively more attractive




Source: Bloomberg

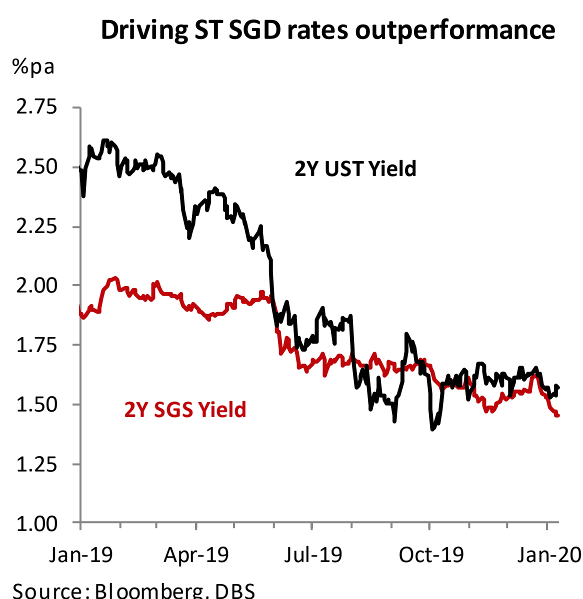
*Eugene Leow/ Radhika Rao*

## Theme 4: Ample liquidity in Singapore to keep rates low

SGD interest rates have benefited from the reflation trade from late last year as the global economy shows signs of bottoming out. We maintain this view, noting that Asia currencies also generally got a reprieve (indirectly strengthening the SGD, putting downward pressures on SGD rates in the process) when it was confirmed that the China-US phase 1 deal will be signed on January 15.

We reckon that another liquidity boost may come in the form of additional net investment income/returns contribution (NIRC) for 2020. Over the past few years, the amount of NIRC has been steadily increasing, from SGD 8.7bn in FY2014 (Apr-Mar) to an estimated SGD 17bn (3.4% of GDP) for FY2019. With elections upcoming and economic uncertainties still lingering, the case for more aggressive fiscal spending for the upcoming fiscal year is present. Accordingly, we would expect NIRC to be flat-to-higher.

Driving ST SGD rates outperformance




Source: Bloomberg, DBS

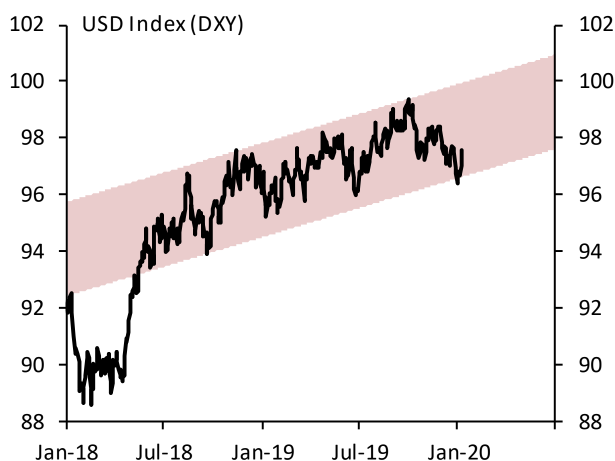
*Eugene Leow*

## Theme 5: USD sell-off to lose steam

Barring any further escalation in US tensions with China and Iran, **the USD Index (DXY) is expected to recover from the floor of its ascending price channel**. The two factors – receding hard Brexit fears and a China-US trade truce – that led the DXY lower in September-October have played out. After the signing of the Phase 1 trade deal and Brexit Day on mid- and end-January respectively, expect more difficult Phase 2 trade talks and negotiations over UK's future relationship with the EU.

As global recession fears give way to recovery hopes, **US growth is still holding up better than its developed market peers**. President Trump wants to improve his re-election odds with buoyant growth, jobs and stock markets. After synchronized easing last year, **monetary policy will slightly diverge in favour of the US again**. Fed is comfortable with a rate pause into 2020. The ECB is unlikely to abandon its asset purchase programme amidst negative yields, not with the EU and UK economy still weak and in need of fiscal/monetary stimulus.

**USD recovers from the floor of its ascending price channel**




Sources: DBS Research, Bloomberg data

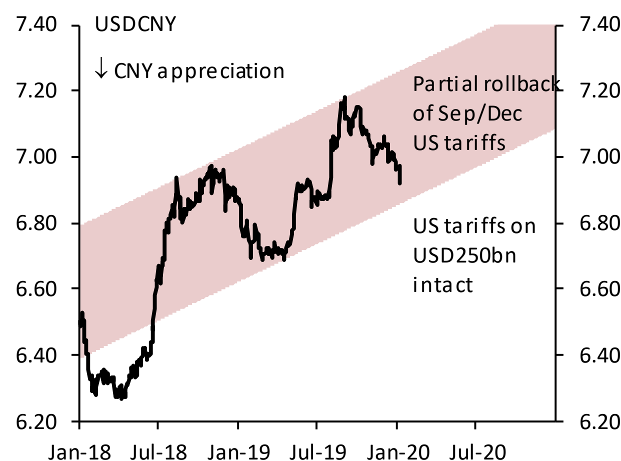
*Philip Wee*

## Theme 6: CNY rally to phase out

**The Chinese yuan's appreciation for the Phase 1 trade deal may be limited to around 6.90.** While the planned US tariffs in September and December have been partly rolled back for the Phase 1 deal on January 15, the 25% tariff on USD250bn (in place since May) will be intact without a Phase 2 deal. With US presidential candidates set to use China as a punching bag, a Phase 2 deal is not expected before the US elections on November 3. Instead, China will be under scrutiny over its commitment to scale up purchases of US goods in the Phase 1 deal.

**China will want to capitalize on the trade truce in 2020 to address its slowing economy and financial risks** such as bond defaults and regional bank failures. The PBOC has prioritised abundant liquidity for the banking system and shoring credit support this year. The reserve requirement ratio was cut by another 50bps on January 6. China will unveil its 2020 GDP growth target at the National People's Congress in March. Our economists have projected sub-6% growth in the next two years.

**Chinese yuan upside limited without Phase 2 trade deal**



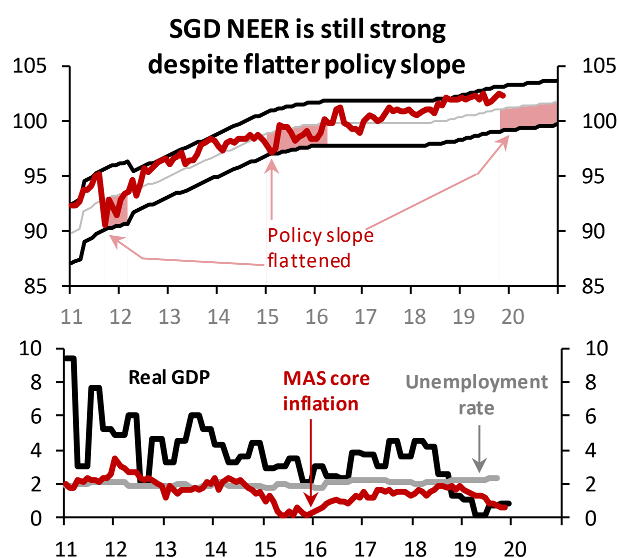

Sources: DBS Research, Bloomberg data

*Philip Wee*

## Theme 7: Holding back SGD optimism

Our USD and CNY views in Themes 5 and 6 suggest that the **SGD's 4-month appreciation against USD may have run its course around 1.34-1.35**. While better than the 0.7% in 2019, real GDP growth will remain below its 2.4% potential rate in 2020 and 2021. With China-US trade tensions eased but not evaporated, USDSGD should hold the 1.34-1.39 range set after the trade war broke out in 2H18. According to the MAS survey of professional forecasters, trade war remains the highest downside risk. Geopolitical risks, especially the Middle East, cannot be totally dismissed.

**The SGD NEER is strong relative to Singapore's weakened fundamentals.** When the SGD policy band was flattened in 2011 and 2015, the SGD NEER depreciated into its lower half. Conversely, the NEER has held firm near the band's ceiling after last October's flattening, despite weaker growth/inflation rates below the unemployment rate, underscored by a paltry 0.1-month year-end bonus for civil servants vs a 1-month payout a year ago.




Sources: DBS Research, Bloomberg data

*Philip Wee*

## Theme 8: Stretch for duration in Chinese IG credit

The recovery in Chinese USD credit in 2019 was helped by a decline in US treasury yields and robust spread compression, mostly in the first half of last year. Volatility in Chinese spreads had been high though, buffeted by a stream of US tariff threats. The good news is that a newly concluded Phase 1 trade deal should keep a lid on trade tensions going forward.

Yet, not all is well. China has seen an increased incidence of credit events. Onshore corporate bond defaults rose to a record in 2019, while the offshore market has just witnessed its largest bond failure since 1998—by a provincial government-owned commodities trader. This year, given a looming wall of Chinese bond maturities, we may yet see further pressure on stress points amidst tight liquidity.

This context is likely to result in increased credit differentiation for Chinese firms. We believe SOEs and less leveraged private firms are the best placed, while property credits should also be supported by sales holding up. Given that China deeply prizes stability, we see a high likelihood for state-owned firms to be able to rely on implicit backstops.

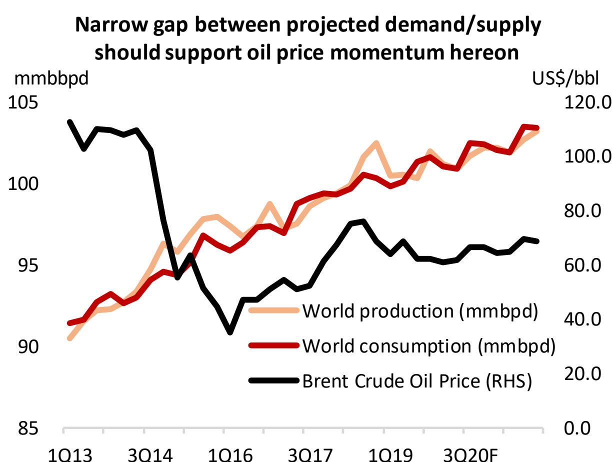
Despite the presence of credit risks, the search for yield due to accommodative policy and economic stabilization poses a conundrum. **One way out for investors is that instead of moving down the Chinese credit curve, they could move along the maturity spectrum to get extra yield.** Such a scenario should benefit longer-duration Chinese credit, which are typically of higher credit quality too.

*Chang Wei Liang*

## Theme 9: Oil downside limited at USD65

**Geopolitical risk premium made a comeback in early 2020**, with Brent crude oil prices briefly touching USD70/bb in the face of US – Iran hostilities. However, since we do not expect a full-fledged war, oil prices could only spike north of USD70/bbl for a few days in the case of any further conflict escalation in the Middle East. These gains should largely wear off and oil prices normalise around the USD65/bbl levels over the course of the year, with second half prospects slightly better than the first half.

**Downside is limited.** Downside remains limited as supply-demand situation is expected to remain relatively well balanced in 2020, and gradual inventory declines will offer support to oil price. The oil market is expected to be well supported by 1) tighter OPEC production cuts starting January 2020, 2) chances of global oil demand recovery after the thaw in US-China trade wars, 3) higher refinery runs due to IMO2020 marine fuels implementation and 4) expectations of slowdown in US shale oil production growth as rig counts fall sharply.



Source: DBS Research, EIA, Bloomberg data

*Suvro Sarkar*

## Theme 10: Set for growth in gold investment

Gold was the clear outperformer amongst all asset classes in 2019, rallying by 18%. The main drivers for the outperformance include: (i) dovish policy stance undertaken by the US Fed, which led to the lowering of interest rates across the world, (ii) enduring uncertainty in global macro economy, triggered by ongoing US-China trade tensions, (iii) de-dollarisation by some central banks, and (iv) strong fund inflows to safe haven, gold-related financial products. Specifically, investor holdings in gold-related ETFs reached an all-time high, growing by 14% over the year.

Gold's shimmer is set to retain in 2020, in our view. The attractiveness of investment should remain given persistently low interest rates, uncertainties surrounding the global macro economy and US-China trade tensions. Given its safe haven status, gold has historically outperformed all asset classes during periods of geopolitical tension. Another key driver adding to a bullish outlook for gold is inflation arising from oil price appreciation. In the near term, we expect gold prices to consolidate around USD1,600/oz in 1H20.

*Eun Young Lee*

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