CIO Weekly

GLOBAL MULTI-ASSET

22 July 2024

Key Points

- Equities: Global equities declined as the market rotated away from tech giants and toward value and small-cap stocks
- Credit: Credit investors have a unique opportunity to lock in high yields and benefit from price gains as the market anticipates Fed easing and a steepening yield curve
- FX: DXY's outlook becoming less predictable given low visibility on Fed's policy timing and Trump Trade; possibility of MAS slightly easing the slope of SGD NEER policy band
- Rates: Caution needed as USTs sell off with stocks; more market volatility appears inevitable as US elections draw near
- The Week Ahead: Keep a lookout for US Change in Initial Jobless Claims; Singapore Inflation

Equities: Volatile week for global equities

Volatility and uncertainty drive global equity weekly declines. In the US market, there has been a notable shift in market dynamics for the week, characterized by a pronounced rotation out of technology megacaps and into cyclical and small-cap stocks. This led to the S&P 500's largest weekly drop since April, with the index shedding around 2%. The tech-heavy Nasdaq 100 bore the brunt of the sell-off, plummeting nearly 4% while the Russell 2000 small-cap index outperformed, gaining 1.7% for the week. This divergence underscores the market's evolving sentiment and the potential for a broadening rally beyond the leadership of megacap tech stocks.

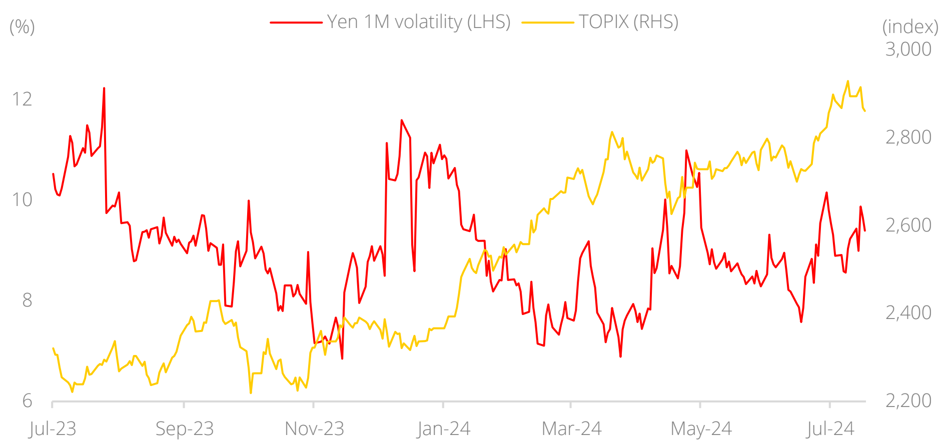
Adding to the volatility were concerns over a global cyber outage that disrupted multiple industries. The Europe Stoxx 600 Tech Index ended the week 2.7% lower, and Japan's Nikkei 225 fell 2.7% due to concerns over tighter US restrictions on semiconductor exports to China. During China's third plenum, the Hang Seng Index retreated 0.5% for the week due to a lack of clarity on the execution of initiatives, alongside a concerning downside surprise in 2Q GDP.

Topic in focus: Japan equities – Benefits and challenges of a weak yen. The yen's depreciation to a 38-year low against the dollar has made Japan an attractive destination for overseas travellers. The tourism industry is expected to become Japan's second-largest export sector in 2024, trailing only the automotive industry and surpassing electronic components. While a weaker yen boosts export revenues, corporate profits, and wage growth, several issues persist.

Export volumes remain stagnant and real wages are declining. Additionally, the weaker yen accelerates imported inflation, complicating the Bank of Japan's efforts to normalise monetary policy. Both core and wholesale inflation had risen in June, keeping alive market expectations of a near-term interest rate hike, while both business and consumer sentiments remain weak. The country is also facing an "overtourism" crisis with crowded trails and excessive littering at popular tourist spots. It also puts pressure on Prime Minister Kishida's government, as declining purchasing power weakens domestic sentiment. The Japanese government has reduced its growth forecast for this year to 0.9% as rising import costs – arising from the weak yen – have impacted consumption, highlighting the patchy nature of Japan's economic recovery.

Yen volatility, driven by extensive carry trades and intervention risks, has unsettled Japan's equity markets. Previously fuelled by "Kishidanomics," the market is likely to pause and shift towards themes that generate alpha, such as AI beneficiaries and the financial sector.

Figure 1: Topix performs well when yen volatility is declining



Source: LSEG Datastream, DBS

GLOBAL MULTI-ASSET RETURNS

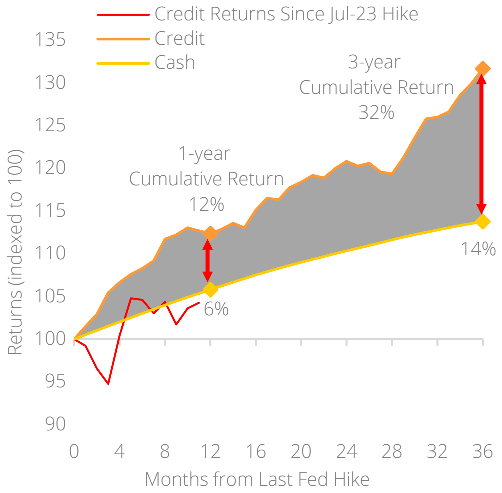
Index	Close	Overnight	YTD
DJIA	40,288	-0.9%	6.9%
S&P 500	5,505	-0.7%	15.4%
NASDAQ	17,727	-0.8%	18.1%
Stoxx Europe 600	510	-0.8%	6.5%
DAX	18,172	-1.0%	8.5%
CAC 40	7,535	-0.7%	-0.1%
FTSE 100	8,156	-0.6%	5.5%
MSCI AxJ	696	-1.8%	8.5%
Nikkei 225	40,064	-0.2%	19.7%
SHCOMP	2,982	0.2%	0.2%
Hang Seng	17,418	-2.0%	2.2%
MSCI EM	1,090	-1.5%	6.4%
UST 10Y yield*	4.24	3.7	36.0
JGB 10Y yield*	1.04	0.1	42.7
Bund 10Y yield*	2.47	3.6	44.5
US HY spread*	3.03	0.0	-20.0
EM spread*	345.86	-0.9	26.9
WTI (USD)	80.13	-3.2%	11.8%
LMEX	3,987.80	-1.0%	6.0%
Gold (USD)	2,400.83	-1.8%	16.4%

Source: Bloomberg
* Changes in basis points

DBS

Credit: Time to favour credit over cash

Figure 2: Credit outperforms cash following the end of hiking cycles



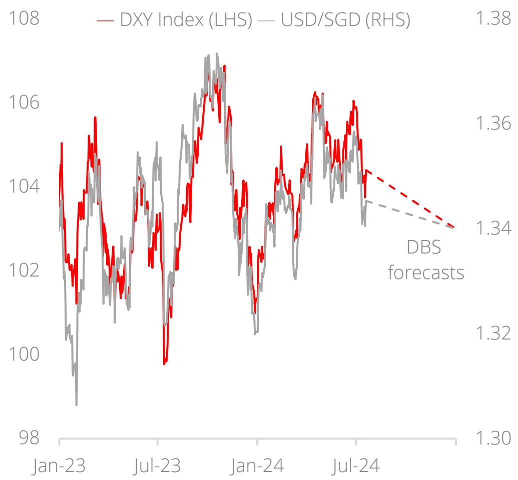
Source: Bloomberg, DBS

Market participants are leaning deeper into bets of Fed easing. Following the latest Consumer Price Index (CPI) data, markets have aggressively priced in 2.5 rate cuts before year-end. Easing premium is now reflected at the front-end of the US Treasury (UST) yield curve, with 2Y yields falling below 4.50%. Although longer-term yields have also declined slightly, they are expected to remain elevated due to structural concerns about the US fiscal deficit. This combination of factors has manifested in a steepening yield curve. At a time where high rates are on the precipice of falling, this presents a unique window of opportunity for credit investors to lock in high coupon yields and benefits from price gains when rate cuts materialise – a privilege that eludes those who remain in cash.

To illustrate this, we compared credit returns against cash returns at the tail-end of policy cycles since 1984. As shown in Figure 2, the cumulative returns of credit (following the last hike in the cycle) far exceed that of cash on average. Credit returns from the current "Fed pause" appear lackadaisical at the start, presumably due to initial market fears of a "higher for longer" narrative. With rate cuts now in sight, credit returns are projected to outperform cash returns before year-end. Returns aside, an astute investor would also recognise the magnified reinvestment risk in cash when rate cuts begin. We believe the window is now open for the forward-looking investor to capture returns from credit in this once-in-a-decade opportunity.

FX: Awaiting the Fed's timing on rates and clarity on the Trump Trade

Figure 3: USD/SGD is a price-taker that closely tracks the DXY Index



Source: Bloomberg, DBS

The DXY's outlook has become less predictable after its aggressive sell-off in the first half of July. Despite its intention to lower interest rates this year, the Fed lacks the confidence to provide time-based guidance. With the Fed in a blackout period this week, pay attention to Thursday's US advance GDP and Friday's PCE deflators to affirm the futures market's bet for a Fed cut in September.

Given the relatively weaker high-frequency US data in April-June vs the previous three months, we cannot rule out GDP missing the consensus for growth to improve to an annualised 1.9% q/q saar in 2Q24 from 1.4% in 1Q24. The Fed will likely consider the PCE headline and core inflation as very good if June repeats the 0% m/m and 0.1% readings in May. However, the Fed appears more ready to cut rates if the labour market weakens unexpectedly i.e., if the unemployment rate rises to 4.1% in June. Unfortunately, the US monthly jobs report will only be out on 2 Aug, after the FOMC meeting on 30-31 Jul.

The market is also grappling with how a Trump victory in the US Presidential election in November will influence the USD. Those who favour a stronger USD argue that Trump's trade tariffs on China and tax cut plans will fuel inflation and higher interest rates in America. However, the UK mini-budget crisis in Sep-Oct 2022 demonstrated how an unsustainable fiscal situation could hurt a currency. Although Trump's running mate, JD Vance, called China the biggest threat to the US, Trump would welcome China to build cars in the US and does not like the USD's strength, especially against the JPY and CNY.

On Friday, we do not rule out that the Monetary Authority of Singapore (MAS) will slightly ease the slope of its SGD NEER policy band. We see tomorrow's MAS Core inflation slowing to 3% y/y in June after holding at 3.1% for three months. If so, core inflation would fall to 3.1% in 2Q24 from 3.3% in 1Q24. CPI and core inflation have been within this year's official forecast range of 2.5-3.5% since March. According to our model, the SGD NEER has eased from the upper quartile towards the mid-point of its policy band, consistent with the MAS's comment about core inflation staying on its disinflation path and easing more significantly in 4Q24 before reaching 2% in 2025.

Despite this, USD/SGD is significantly correlated with the DXY Index. In the first half of July, USD/SGD's fall from 1.36 to 1.34 mirrored the DXY's drop from 106 to 103.5. To push lower, USD/SGD and the DXY will need the Fed to become more confident about rate cuts.

Rates: Caution needed as USTs sell off with stocks

Figure 4: Caution needed

Source: Bloomberg, DBS

Sentiment has deteriorated somewhat over the past few trading days and judging from the price action of US Treasuries and equities, some caution is probably warranted. The US stock market has been strong this year as tech stocks powered higher. However, as earnings loom, some profit-taking appears to be taking place. We would reasonably expect some of this to translate into a bid for Treasuries but that has not happened. Instead, as the stock market corrected, US yields have risen. 2Y yields appear to have found a base at 4.40%. Similarly, 10Y yields bounced off 4.15%. The most reasonable explanation is that there is a limit to the rally in USTs even if the Fed has communicated that calibrated cuts are in the offing. Accordingly, there may not be a need to frontload more than 2.5 cuts into 2024 or to add a lot more cuts into 2025. From a rates perspective, there is no need to deviate from Goldilocks yet.

That said, with the US elections upcoming, market volatility appears inevitable. Both parties are likely to be hawkish on China. Moreover, it is widely expected that Trump would apply tariffs across US imports, putting more disruptions to global trade. A re-pricing across assets to take into account potential shifts would probably result in few winners. Typically, we would expect USTs to benefit if sentiment goes awry. However, this comes with some caveats. First, yields need to be sufficiently high to entice investors. Second, investors may be concerned with an even quicker deterioration of the US's fiscal position if Trump returns. Lastly, watch for market reactions as Biden drops out of the race.

Thematics: Singapore Retail & Retail REITs – More fad than trend?

- Opening of Rapid Train System (RTS) in end-2026 to cut travel time to as low as 15 minutes – a gamechanger for Singaporeans
- With F&B and services up to 50% cheaper in JB, we estimate potential leakage in the medium term could increase by SGD1.5-2.1bn, about 3-4% of 2023 retail spend in Singapore
- Sustainability of "spending leakage" will depend on Singapore and Johor Bahru maintaining this "value gap". Singapore landlords with good exposure in the North could dial up tenant and product mix, and leverage on higher traffic
- Supermarket sales likely resilient, contrary to market expectations

Shorter travel time to Johor Bahru could boost more outbound travel among Singaporeans. Parallels have been drawn between rising northbound travel from Hong Kong to Shenzhen and that of Singapore (SG) to Johor Bahru (JB). With the weak MYR-SGD rate, JB is a popular weekend destination for many Singaporeans (around 530k peak daily travellers over long weekends) due to its "value for money" offerings. Post the completion of RTS, travel time will see a potential cut from more than one hour to only around 15-30 minutes. Day trippers to JB could potentially rise to as high as 700k across peak periods, around a 32% rise from the 2024 peak. That said, the higher day-tripper count will likely depend on the continuation of price differentials in goods and services between SG and JB, which can be as wide a savings as 50%, depending on the type of consumption basket.

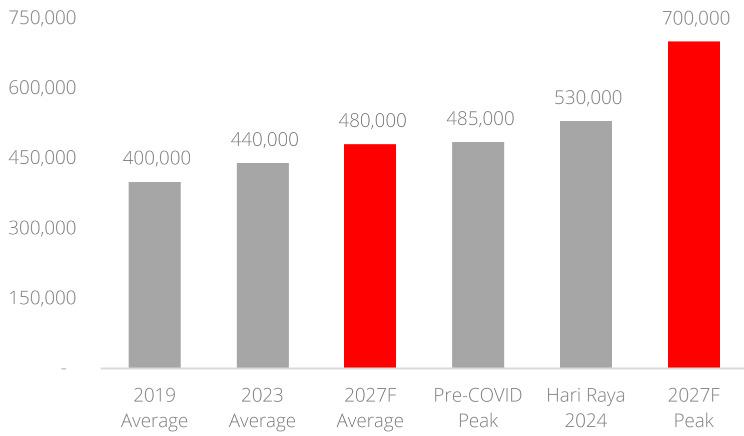
Projected retail sales leakage could be 3-4% of 2023; impact to be felt more in F&B and service trades. In our channel checks during a visit to JB, we had the first-hand experience of "stretching our SGD". Cost savings we tracked came in the range of around 30-50% for F&B consumption and services (i.e., haircuts, massages, facials, etc.). Assuming retail spend of SGD100-141 per pax per day (based on Malaysia Tourism Board numbers) and a 40k increase in daily travellers post RTS opening, DBS estimates an incremental annual retail leakage to JB of SGD1.5-2.1bn in the medium term. Amongst the trade categories, we expect the "substitution effect" to be greater in the F&B and service trades. Contrary to expectations, we hold a non-consensus view that the supermarket trade should remain resilient, given the inconvenience of lugging heavy items across the border and low absolute savings.

More fad than trend? The impact to retail sales will come from two sources: proximity and the trade sectors. We see retail malls in the north of Singapore feeling the most heat with a higher need to adapt. Amongst trade sectors, services and F&B are the most impacted, totalling to around 38% of total exposure for malls.

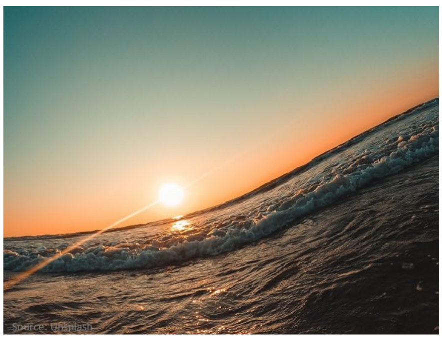
Figure 5: SGD appreciated >17% at its peak against MYR since 19 Jan

Source: Bloomberg, DBS

Figure 6: Average daily travellers could jump by ~10% and >46% during peak periods with RTS

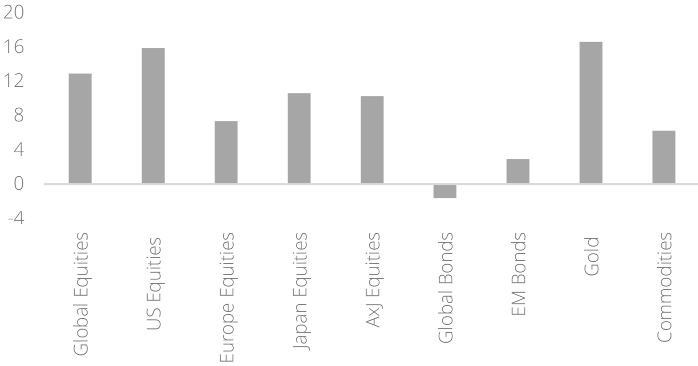


Source: ICA, DBS

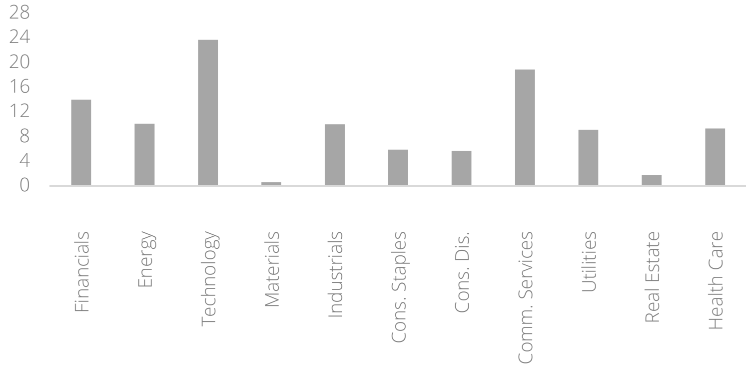


CIO Markets Watch

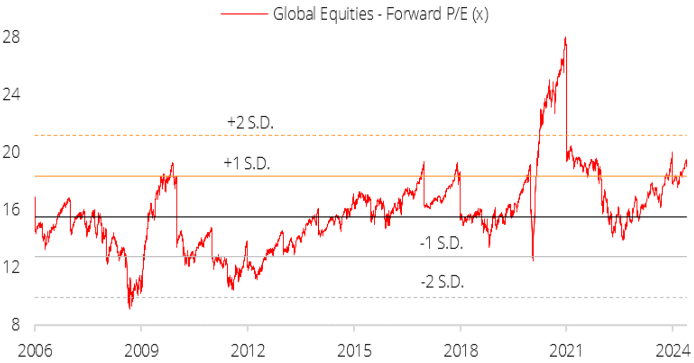
Global Cross Assets YTD Returns



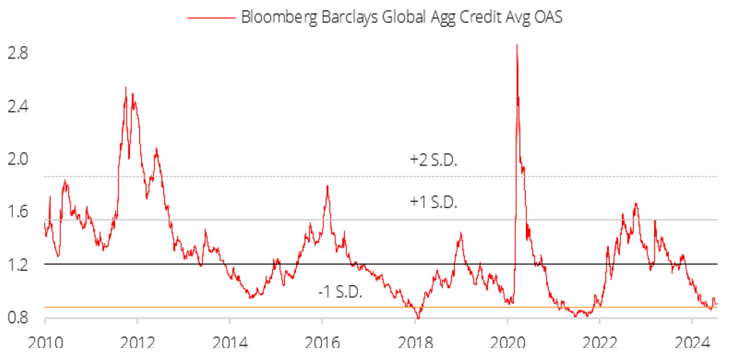
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



Source: Bloomberg, DBS

INDEX RETURNS

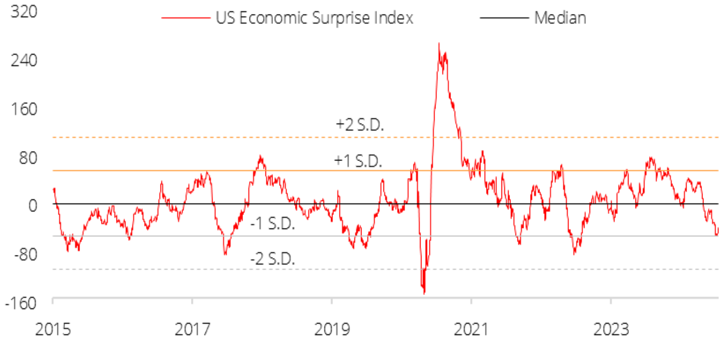
	1 week	MTD	QTD	YTD
Equities				
S&P 500	-2.0%	4.3%	4.8%	15.4%
NASDAQ	-3.6%	5.9%	8.2%	18.1%
Russell 2000	1.7%	5.5%	2.8%	7.8%
Euro Stoxx 600	-2.7%	-1.6%	-0.5%	6.5%
Nikkei-225	-2.7%	4.1%	-0.8%	19.7%
MSCI WORLD	-2.0%	3.2%	3.4%	12.1%
MSCI ACWI	-2.1%	3.2%	3.5%	11.5%
MSCI Asia ex-Japan	-3.5%	3.8%	6.3%	8.5%
MSCI EM	-3.0%	3.9%	4.4%	6.4%
HSCEI	-5.6%	-3.6%	6.1%	6.9%
SHCOMP	0.4%	-3.4%	-1.9%	0.2%
Hang Seng	-4.8%	-3.7%	5.3%	2.2%
STI Index	-1.4%	3.3%	6.9%	6.4%
Fixed Income				
Barclays Global Aggregate	-0.2%	1.7%	0.5%	-1.6%
Barclays US Aggregate	-0.3%	2.2%	1.3%	0.5%
Barclays US High Yield	0.3%	2.3%	2.5%	4.0%
Barclays Euro Aggregate	0.3%	1.4%	0.2%	-0.1%
Barclays Euro High Yield	0.1%	1.3%	2.2%	4.1%
JPM EMBI Global	-0.5%	1.8%	1.6%	3.0%
JPM EMBI Global Diversified	-0.2%	2.1%	1.7%	3.2%

PRICES & SPREADS

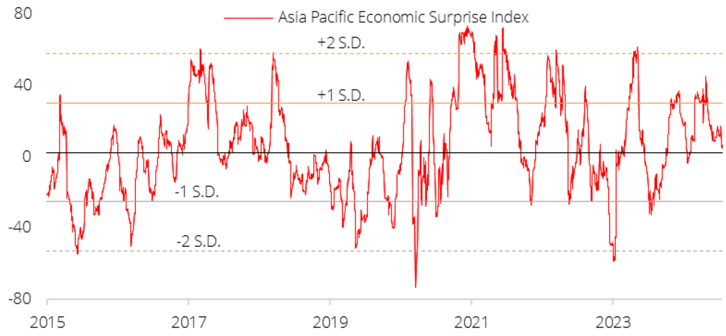
	Spot	2Q24	1Q24	4Q23
Rates				
Fed Funds Target	5.50	5.50	5.50	5.50
ECB Main Refinancing Rate	4.25	4.25	4.50	4.50
BOJ Policy Balance Rate	0.10	0.10	0.10	-0.10
US Treasury 10Y	4.24	4.40	4.20	3.88
Japanese Govt. Bond 10Y	1.04	1.05	0.72	0.61
German Bunds 10Y	2.47	2.50	2.30	2.02
Spreads				
US Agg Corporate Spread	0.91	0.94	0.90	0.99
US Corporate HY Spread	3.03	3.09	2.99	3.23
Euro Agg Corporate Spread	1.10	1.19	1.14	1.37
EM USD Agg Spread	2.58	2.58	2.60	2.94
Currencies				
US Dollar Index (DXY)	104.4	105.9	104.5	101.3
EUR/USD	1.09	1.07	1.08	1.10
USD/JPY	157.5	160.9	151.4	141.0
USD/CNY	7.3	7.3	7.2	7.1
Commodities				
WTI Oil	80	82	83	72
London Metal Exchange (LMEX)	3988	4164	3811	3762
TR/CC CRB Commodity	280	290	290	264
Gold	2401	2327	2230	2063

CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



Source: Bloomberg, DBS

MACRO CALENDAR

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims	25-Jul	20-Jul	238k	243k
GDP Annualized q/q	25-Jul	2Q	1.90%	1.40%
U. of Mich. Sentiment	26-Jul	Jul	66.4	66
Durable Goods Orders	25-Jul	Jun	0.50%	0.10%
S&P Global US Manufacturing PMI	24-Jul	Jul	51.7	51.6
HCOB Eurozone Manufacturing PMI	24-Jul	Jul	46.1	45.8
MBA Mortgage Applications	24-Jul	19-Jul	--	3.90%
New Home Sales	24-Jul	Jun	640k	619k

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
CPI y/y (SG)	23-Jul	Jun	2.70%	3.10%
Tokyo CPI Ex-Fresh Food y/y (JP)	25-Jul	Jul	2.20%	2.10%
Jibun Bank Japan PMI Mfg (JP)	23-Jul	Jul	--	50
Industrial Production y/y (SG)	26-Jul	Jun	0.00%	2.90%
Tokyo CPI y/y (JP)	25-Jul	Jul	2.30%	2.30%
Jibun Bank Japan PMI Composite (JP)	23-Jul	Jul	--	49.7
Jibun Bank Japan PMI Services (JP)	23-Jul	Jul	--	49.4
Machine Tool Orders y/y (JP)	23-Jul	Jun	--	9.70%

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