In collaboration with: J.P.Morgan Asset Management

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UOB Investment Insights

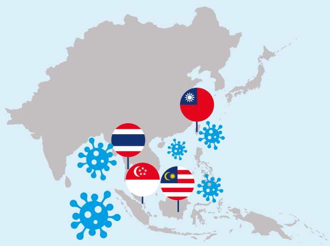
Market PowerBar

JUNE 2021

Key events at a glance

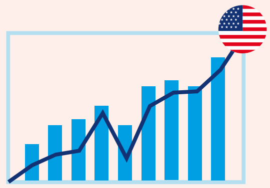
Market recap

Asia sees new wave of COVID-19 infections



- A series of outbreaks across Asian markets such as Taiwan, Thailand, Malaysia and Singapore has led to the tightening of movement restrictions by local governments.
- Although this could temporarily weigh on economic growth for 2Q2021, an eventual economic recovery is unlikely to be completely derailed.
- Major economies like China and the US are seeing a gradual economic recovery, and this is likely to support Asia's economic rebound moving forward.

Equity markets likely to be supported by ongoing corporate earnings recovery



- Q1 earnings season in the US reported a spike in corporate earnings, with 86% of S&P 500 companies beating their earnings targets.
- More companies have expressed stronger confidence in the future and expect better sales in the second half of 2021. In addition, earnings estimates have been upgraded since the start of April 2021.
- Share prices are likely to be supported by the ongoing corporate earnings recovery worldwide. We remain positive on equities, and expect prices to gradually grind higher.

A look at this month

JUN 10 — ECB

European Central Bank Policy Meeting
European policymakers are expected to keep monetary policy unchanged. Investors will be on the lookout for cues on any potential scaling back of asset purchases.

JUN 16 — FED

US Federal Reserve (Fed) Policy Meeting
While no changes are expected to be made to policy, markets will be paying attention to guidance from the Fed on growth forecasts as well as communication on recent inflation data.

JUN 24 — BOE

Bank of England Policy Meeting
UK policymakers are expected to keep monetary policy unchanged.

Topic 1:

Inflation expected to be transitory

Inflation has become one of investors' top concerns. April's inflation numbers jumped above expectations, casting doubts on corporate profit margins and the Fed's policy outlook. For now, we see these higher inflation data as being transitory, and remain positive on equities.

Figure 1:

Change in US inflation data

Year-on-year

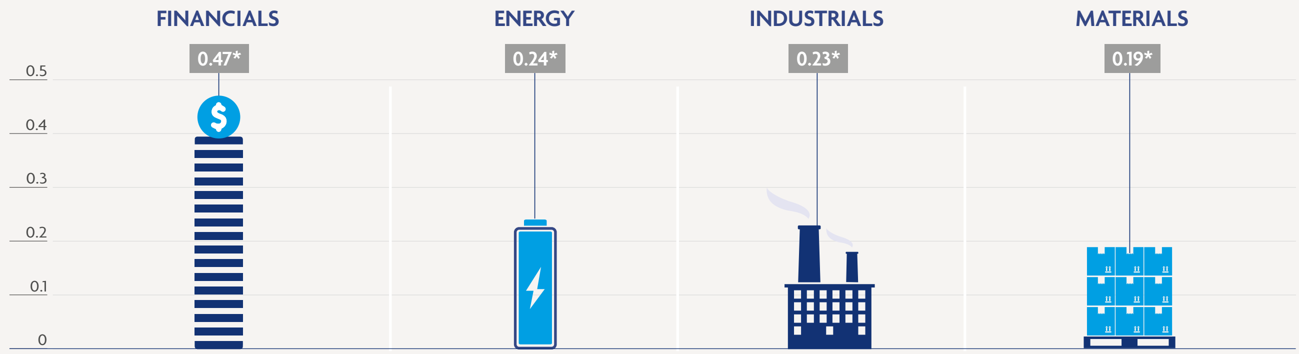
Source: Bureau of Economic Analysis, FactSet, U.S. Department of Labor, J.P. Morgan Asset Management. Data as of 31 May 2021.

- Both US Consumer Price Index (CPI) and Producer Price Index (PPI) recorded a sharp year-on-year jump – by 9.4% and 4.1% respectively – in April 2021, as shown in Figure 1. Given higher commodity prices, a low base effect and the gradual reopening of the US economy, inflation data is expected to remain strong over the next few months.
- For equity investors, this raises concerns on two levels. First, many companies may face potential margin pressure given the difficulties of passing on rising costs to the consumers. Second, strong inflation data may prove less transitory than the Fed expects, thereby necessitating the Fed to hike interest rates earlier than expected. US Treasury bond yields may also move higher.
- Historically, as US Treasury bond yields move higher, some cyclical sectors tend to outperform the market as shown in Figure 2 – The higher the correlation, the better the sector had performed to the gradual rise in yields.

Figure 2:

Correlation of cyclical sectors' performance to US 10-year Treasury yield

Correlation over the last 10 years



* Numbers indicated are relative to a perfect correlation score of 1.

Source: FactSet, U.S. Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management. Returns are based on price index only and do not include dividends. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2021.

Views & Implications:

- Inflation numbers may remain elevated over the coming months, but this is likely to be transitory and will recede as supply constraints ease.
- We remain positive on equities, in particular the cyclicals sectors, as they have historically outperformed the market amid rising US Treasury bond yields and will likely benefit from the continued reflation backdrop.

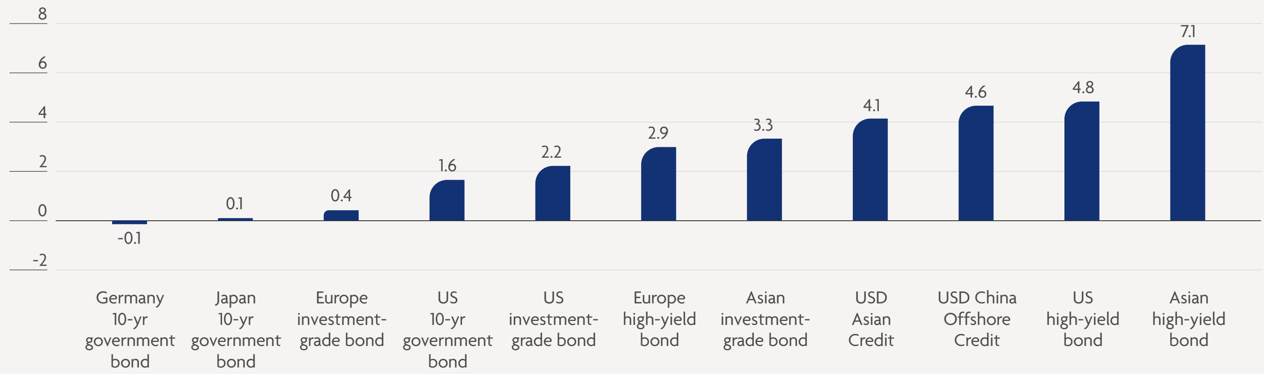
Topic 2:

Higher inflation does not mean bad news for Asian bonds

Higher inflation risks and rising US Treasury bond yields have caused some investors to shy away from fixed income. However, it's not all doom and gloom. After the recent sell-off, we are seeing a few potential opportunities arise in Asian credit. Additionally, China onshore bonds remain an attractive source of yield and avenue for diversification of risk.

Figure 3:

Fixed income yields (%)

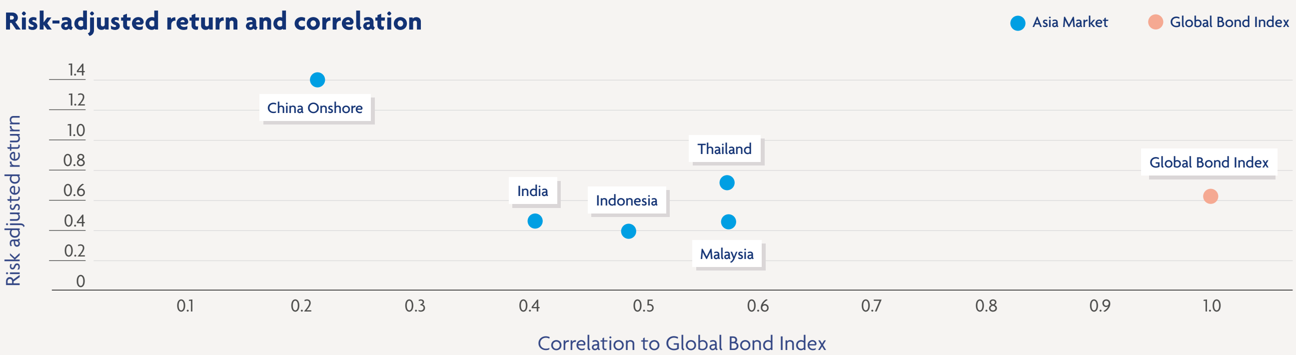


Source: Barclays, Bloomberg Finance L.P., FactSet, ICE BofA Merrill Lynch, J.P. Morgan Economic Research, J.P. Morgan Asset Management. Based on Bloomberg Barclays U.S. Aggregate Credit – Corporate Investment Grade Index (U.S. IG), Bloomberg Barclays Euro Aggregate Credit – Corporate (Europe IG), J.P. Morgan Asia Credit Investment Grade Index (Asia IG), Bloomberg Barclays U.S. Aggregate Credit – Corporate High Yield Index (U.S. HY), Bloomberg Barclays Pan European High Yield (Europe HY), J.P. Morgan Asia Credit Index (JACI) (USD Asia Credit), J.P. Morgan Asia Credit China Index (USD China Offshore Credit). Positive yield does not imply positive return. Past performance is not a reliable indicator of current and future results. Data as of 31 May 2021.

- Higher inflation risks and rising US Treasury bond yields may pose headwinds to Asian bonds, but we expect the Asian credit market to remain relatively stable given their lower sensitivity to higher US yields and higher quality rating. Additionally, their yields remain relatively high, as shown in Figure 3 above.
- The recent sell-off in the Asian credit market could be attributed to the uncertainty over China Huarong, which will likely see government support due to its systemic importance. We expect the Chinese fixed income market to recover as market sentiment gradually improves. As shown in Figure 4 below, Chinese onshore bonds in particular potentially offer higher risk-adjusted returns and can provide diversification to a bond portfolio, due to its low correlations to global bonds.

Figure 4:

Risk-adjusted return and correlation



Source: Bloomberg Finance L.P., J.P. Morgan Asset Management. Risk-adjusted return is annualized returns from 31 December 2004 to 31 May 2021, correlation data uses returns over the same period. Data as of 31 May 2021.

Views & Implications:

- Against a backdrop of rising inflation and US Treasury yields, the Asian bond space is likely to hold up better and can offer more attractive yields for income-seeking investors.

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