In collaboration with:

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UOB

UOB Investment Insights

Market PowerBar

JUNE 2022

A LOOK AT THIS MONTH

Key developments to watch	What investors should know
1 The recent lockdowns in China's tier-one cities have raised market concerns.	**Stringent measures have resulted in a drop in new COVID cases.** ▶ A drop in new infections will allow China to reopen and resume economic activity progressively. ▶ Valuations in Chinese equities are attractive, especially with earnings expected to grow 7% this year.
2 The US dollar has strengthened on the back of the United States' economic recovery and the Federal Reserve's tough stance on inflation.	**US dollar strength could negatively affect certain investment returns.** ▶ A strong USD will be a drag on US companies' revenue and earnings and also tends to be negative for Asian equities. ▶ USD is expected to weaken in the long run, and non-US equities such as those in Asia will be more attractive in comparison.
3 Equity markets have endured significant volatility in the past month.	**Diversification into fixed income could provide a buffer against volatility.** ▶ Investment grade (IG) bonds can shelter investors against slowing economic growth and offer a steady income stream. ▶ Attractive valuations, healthy corporate fundamentals and low expected default rates are additional reasons to consider IG bonds for your portfolio.

Upcoming Event	
JUNE 14 – 15 US Federal Reserve (Fed) Meeting	Look out for any changes in the Fed's rate hike trajectory.

Speak to your UOB Advisor today to find out more.

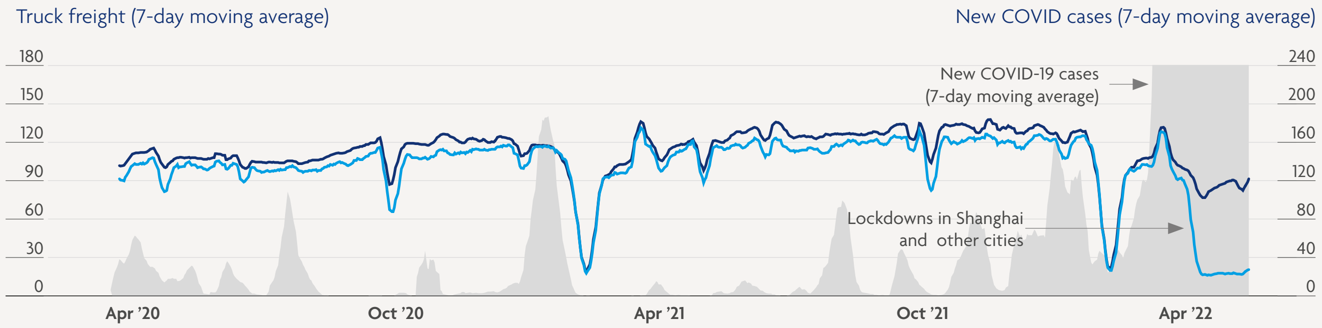
Topic 1:

Stringent measures have reduced new COVID cases, presenting opportunities in Chinese equities

Recent lockdowns in China's tier-one cities have concerned markets. However, the stringent measures have largely helped contain the COVID outbreak, with new cases falling rapidly after peaking on 13 April.

Figure 1A:

Truck freight traffic in China has decreased sharply amid strict COVID lockdown measures



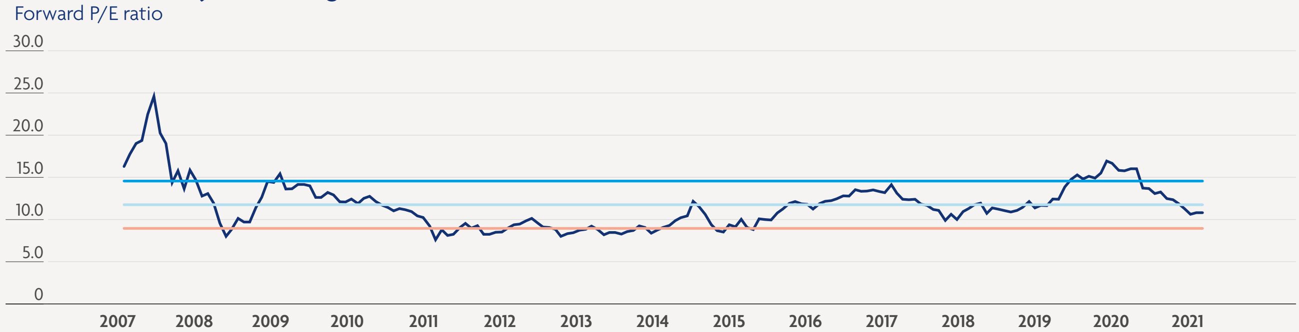
Source: China Ministry of Transport; J.P. Morgan Asset Management (Left) Wind; (Right) CEIC. The raw data for transportation index is collected by G7 internet of things platform, covering truck flow, freight hub and freight throughput. *COVID-19 cases incorporates both domestic confirmed and asymptomatic cases. Confirmed cases are infections with imagological changes to the patients' lungs. Asymptomatic cases are patients with positive PCR testing results and/or mild symptoms, while without imagological changes in lungs. Secondary axis on left chart has been cut to maintain reasonable scale. Data reflect most recently available as of 5 May 2022.

Key takeaways

1. Stringent controls adopted by local governments have hindered truck flow (Figure 1A). On the bright side, China's Ministry of Transport has instructed local governments to facilitate transportation, putting economic activity back on recovery.
2. The strict measures have reduced infections in the community outside of hospitals, quarantine centres and locked buildings. This should also help China resume economic activity at a faster pace.
3. However, Chinese equities have dipped significantly as growth fears persist among investors. Valuations are now significantly below their 15-year historical average (Figure 1B).

Figure 1B:

Valuations for the broad China market have fallen below their 15-year average



Source: Factset, J.P. Morgan Asset Management.
Data reflect most recently available as of 30 May 2022.

In summary

- Consensus earnings growth expectations for 2022 have been revised downwards to 7%. The sectors which have experienced the bulk of the regulatory pressure like Consumer Discretionary and Communication Services have also seen substantial downward revisions to earnings expectations.
- However, we believe the worst may have passed for these sectors and opportunities are emerging in the Chinese market for the long term.

Topic 2:

US dollar strength could negatively affect certain investment returns

The US dollar (USD) has appreciated significantly this year. Historically, a strengthening USD has had a negative impact on investors' portfolio returns. This does not mean investors should panic, but they should be aware of the reasons behind USD strength and where we expect it to move from here.

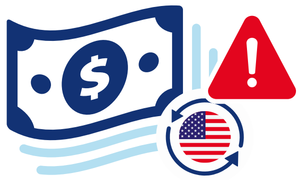


Figure 2A:

The USD has strengthened on the back of the US's strong recovery, Fed hawkishness and safe haven play

US dollar index

Source: FactSet, WM/Reuters, J.P. Morgan Asset Management. *The US dollar index shown here is a nominal trade-weighted index of major trading partners' currencies. Major currencies are the British pound, Canadian dollar, euro, Japanese yen, Swedish kroner and Swiss franc.

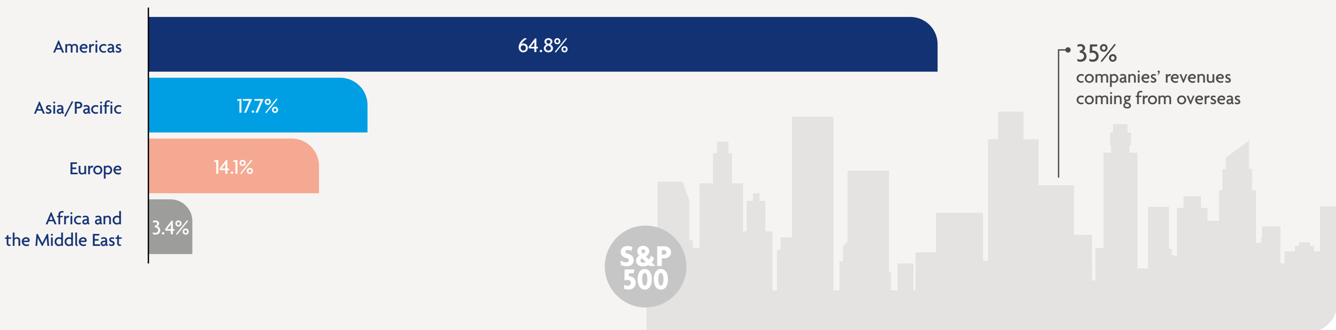
Key takeaways

1. The USD, as represented by the Dollar Index, has climbed has climbed 6.0% in the first five months of this year (Figure 2A). The main drivers of this include the US economy seeing a relatively strong recovery and the Federal Reserve being seen as increasingly hawkish. Global events have also pushed the idea of the USD as a safe haven, causing more inflows to the dollar.
2. A strong USD hurts US corporate earnings, with around 35% of S&P500 companies' revenues coming from overseas (Figure 2B). In the 1Q22 earnings season, the appreciating USD was partly the cause of lacklustre earnings. Even if the USD were to not move from current levels this quarter, it would still apply a significant drag on revenue and earnings for 2Q22.

Figure 2B:

A strong USD could hurt the 35% of S&P 500 revenues that come from overseas

S&P 500 revenue breakdown



Source: FactSet.

In summary

- The direction of the dollar is always hard to predict. In the long run, we think the pace of US economic growth will slow against other major economies, the Fed will become less aggressive and the US trade deficit will increase, putting downward pressure on the USD.
- A stronger dollar can mean higher borrowing costs, higher interest payments and lower foreign inflows for US companies. This makes non-US equities such as those in Asia more attractive in comparison. This, combined with significantly lower valuations overseas, adds to the case for increasing diversification through international stock allocations.

Topic 3:

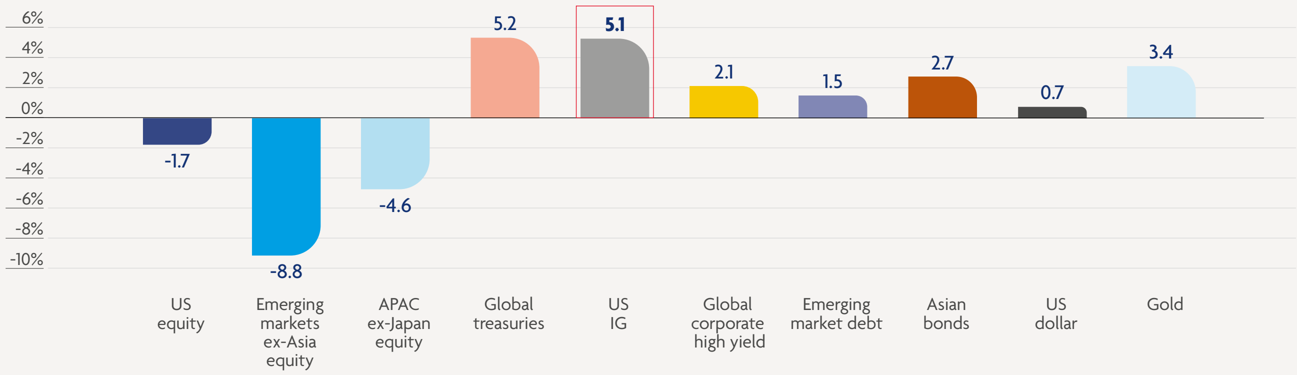
Diversification into fixed income could provide a buffer against volatility

Equity markets endured a particularly significant bout of volatility over the past month, with concerns over rising inflation, a potential policy misstep by central banks and slowing growth. The sell-off in stocks should remind investors about the need to diversify their holdings and protect against market risks with defensive holdings.

Figure 3A:

Investment grade bonds have historically performed strongly when the economy is still growing but appears to be slowing down

Annualised asset class performance during cooling periods



Source: Bloomberg Finance L.P., FactSet, IHS Markit, J.P. Morgan Economic Research, MSCI, Standard & Poor's, J.P. Morgan Asset Management. Based on S&P 500 (US equities), MSCI EM ex-Asia Index (EM ex-Asia), MSCI AC Asia Pacific ex-Japan (APAC ex-JP), Bloomberg Barclays Global Treasury (Government bonds), Bloomberg Barclays US Aggregate Credit – Corporate Investment Grade Index (Investment grade bonds), Bloomberg Barclays Global Corporate High Yield Index (High yield bonds), J.P. Morgan EMBIG Index (EM debt), J.P. Morgan Asia Credit Index (Asian bonds), DXY index (US dollar), Gold USD/ozt (Gold). All data represent total return in US dollar terms and are calculated from 31 January 1998 except for high yield bonds (31 December 2000) and Asia bonds (31 October 2005) due to data availability.

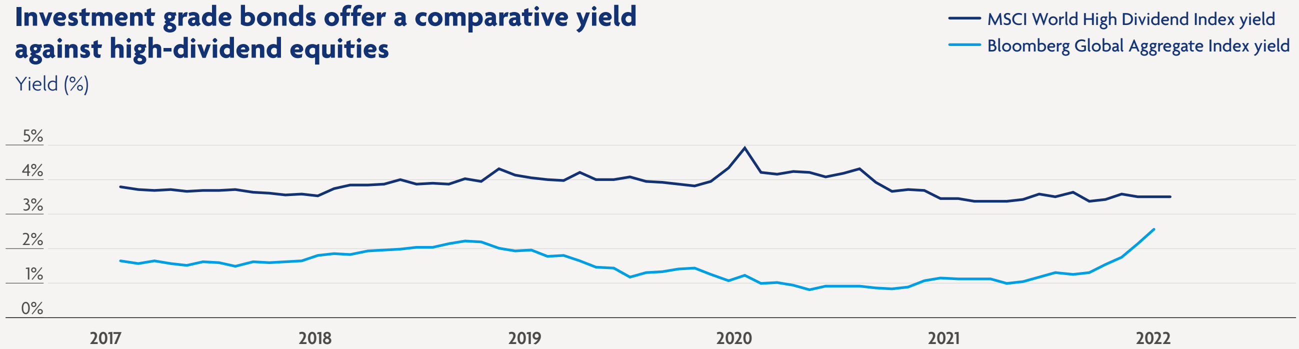
Key takeaways

1. During later parts of the business cycle when the economy is still growing but appears to be slowing down – which we believe to be the current situation – investment grade bonds have historically been a strong performer (Figure 3A).
2. While we still believe equities will deliver solid returns this year, we also believe fixed income is important given its ability to reduce portfolio volatility. The appeal of fixed income is still relatively attractive for income-oriented investors, as the yield for investment grade bonds is comparable to that offered by high-dividend equities (Figure 3B).

Figure 3B:

Investment grade bonds offer a comparative yield against high-dividend equities

Yield (%)



Source: MSCI, FactSet, JP Morgan Asset Management.

In summary

- Investment grade bonds offer a good balance of risk, return and income generation in our current uncertain environment.
- Higher corporate bond yields make the asset class more attractive. Corporate fundamentals remain healthy and corporate default rates are expected to remain low throughout this year. Investment grade bonds provide downside protection to slowing growth momentum while offering investors a steady income stream.

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