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UOB Investment Insights

Market PowerBar

JUNE 2023

A LOOK AT THIS MONTH

Key Topics	What Investors Should Know
1 The Federal Reserve (Fed) may be close to ending its rate hikes	**At the May Federal Open Market Committee (FOMC) meeting, the Fed hinted at a pause in further rate hikes.** ▶ The Fed is unlikely to cut interest rates in 2023 as the labour market is tight and inflation remains high. ▶ As we are nearing the end of the rate hike cycle, investors can consider locking in higher yields in longer-duration bonds. Investors staying defensive with higher-quality bonds can also potentially benefit once the tightening cycle ends.
2 A resolution is in sight for the US debt ceiling standoff	**The US has reached its statutory limit on how much the government can borrow and faces the risk of defaulting on its debt in June 2023.** ▶ A tentative agreement has been reached to suspend the debt ceiling till next year. The next step is for lawmakers to pass the agreement. ▶ The likely outcome would be for the US Congress to eventually suspend the debt ceiling and avoid a default on its debt. Nonetheless, investors should not try to time the market and instead focus on investing to meet long-term financial goals.
3 Find opportunities arising from China's recovery amid the global growth slowdown	**China's post-COVID recovery has been uneven so far, but investors should pay attention to the longer-term evolution of its economy.** ▶ While China's manufacturing sector may be impacted by slowing global growth, China's GDP growth is also largely driven by the services sector. ▶ Tap into various trends unfolding in China through both its onshore and offshore stock markets.

Upcoming Event

JUN 13-14 **Federal Open Market Committee (FOMC) policy meeting**	Keep an eye on whether the Fed holds interest rates at the current level. The Fed's updated rate projections will also be key.

Speak to your UOB Advisor today to find out more.

Topic 1

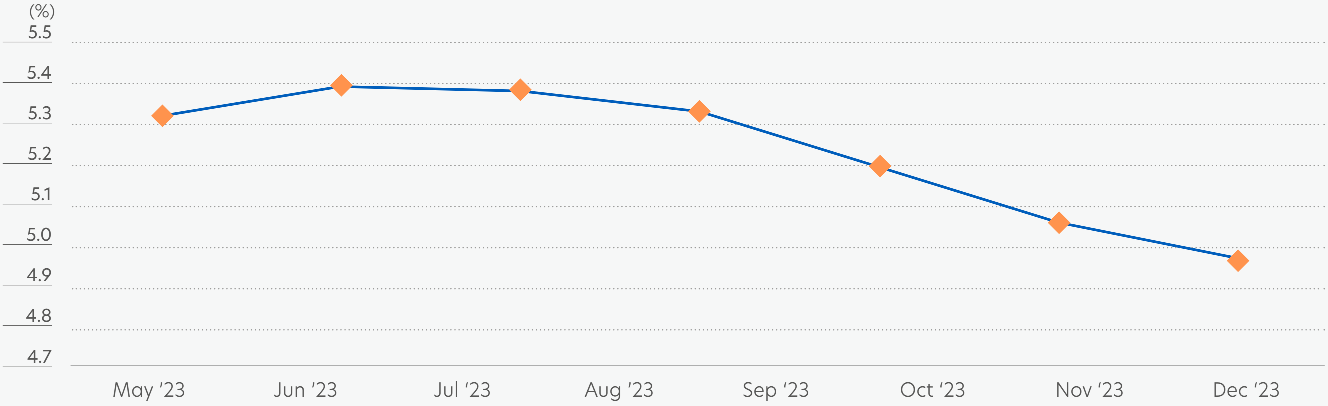
The Fed may be close to ending its rate hikes

At its most recent Federal Open Market Committee (FOMC) meeting in May, the United States Federal Reserve (Fed) raised interest rates by another 25 basis points (bps), as expected. What investors are paying closer attention to is the direction of future meetings and how they can position their portfolios for any change in the Fed's policy stance.

1. One of the most important takeaways from the May FOMC meeting was the adjustment to the Fed's forward guidance, with the change in language opening the possibility of a pause in rate hikes. However, the Fed emphasised that decisions will be made on a "meeting by meeting" basis, as the labour market is tight and inflation remains high.
2. A restrictive monetary policy will continue to put pressure on the economy as it reduces investment and spending. Rising yields have also contributed to recent turmoil among US regional banks.
3. If economic activity slows, the Fed may be forced to go beyond pausing rate hikes and move to cutting rates. The market anticipates 50 bps of rate cuts in the second half of this year (Figure 1A). This could be overly optimistic given the strength of the labour market and elevated inflation, but it reinforces the view that investors should be prepared for a policy shift when it comes.
4. If the rate hike cycle is indeed nearer to the end, investors should position for a decline in yields by locking in higher yields in longer-duration bonds. Figure 1B shows that investors staying defensive in higher-quality bonds can also benefit once the tightening cycle ends.

Figure 1A

Fed Futures are showing the market expects 50 bps of rate cuts in 2H 2023

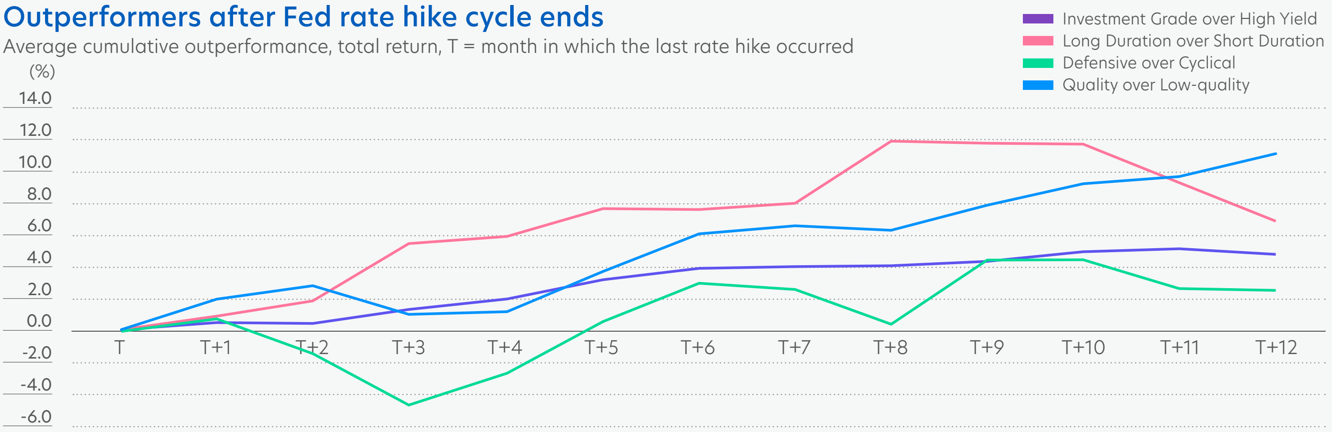


Source: Bloomberg, J.P. Morgan Asset Management.

Figure 1B

Outperformers after Fed rate hike cycle ends

Average cumulative outperformance, total return, T = month in which the last rate hike occurred



Source: Bloomberg, MSCI, Standard & Poor's, J.P. Morgan Asset Management. Investment Grade: Bloomberg US Corporate Bond Index, High Yield: Bloomberg US Corporate High Yield Bond Index, Long Duration: Bloomberg US Long Treasury Index, Short Duration: Bloomberg US Short Treasury Index, Defensive: MSCI Defensive Sectors Index, Cyclical: MSCI Cyclical Sectors Index, Quality: S&P 500 Quality Index, Low-quality: S&P 500 Quality - Lowest Quintile Index. Due to data availability, Investment Grade over High Yield averages outperformance from the past 6 rate hiking cycles, Duration over Short Duration averages outperformance from the past 5 rate hiking cycles, Quality over Low-quality averages outperformance from the past 4 rate hiking cycles, and Defensive over Cyclical averages outperformance from the past 3 rate hiking cycles. The calculations are based off of monthly returns, and begin at the month-end price for the month in which the last rate hike occurred. Data are as of May 3, 2023.

Topic 2

A resolution is in sight for the US debt ceiling standoff

The debt ceiling restricts the US government's ability to borrow from the public if its accumulated debt reaches a predetermined limit. This limit has either been suspended or raised multiple times since 1960 and the US Congress needs to come to an agreement once again to prevent a default on US Treasury debt.

1. The US reached its debt limit on 19 January 2023, and the Treasury Department has enacted "extraordinary measures" to allow the government to keep borrowing since then. However, the so-called "X Date", when the US government will be unable to fulfill its debt obligations, will likely come around June.

2. This is not the first time the US is facing this issue. It was more worrisome in 2011 when the debt ceiling was raised a mere two days before the "X Date". The Standard & Poor's credit rating agency then downgraded the credit rating of US sovereign debt from AAA to AA-, and markets reacted extremely negatively (Figure 2A).

   Another recent example in 2013 is more typical, with no significant market reaction to the debt ceiling stand-off even with a government shutdown (Figure 2B).

3. US President Joe Biden and House Speaker Kevin McCarthy have reached a tentative agreement to suspend the debt ceiling until next year. The next step is for lawmakers to pass the agreement.

4. The likely outcome would be for the US Congress to eventually suspend the debt ceiling and avoid a default on its debt. Nonetheless, investors should not try to time the market and instead focus on investing to meet long-term financial goals.

Figure 2A

In 2011, the S&P 500 index reacted negatively to the US credit rating downgrade, not to debt ceiling woes

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Figure 2B

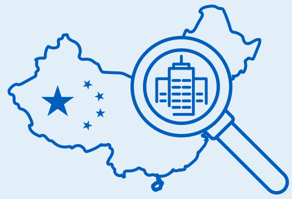
Limited reaction by S&P 500 index to 2013 debt ceiling crisis, even with a government shutdown

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Topic 3

Find opportunities arising from China's recovery amid the global growth slowdown

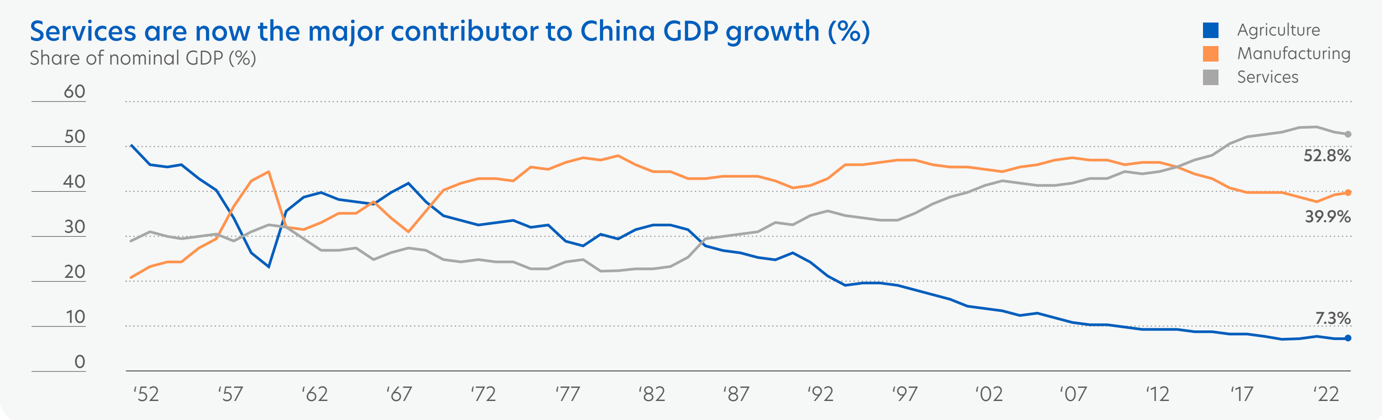
China's consumption levels are still recovering after exiting its zero-COVID policy. The April Purchasing Managers' Index (PMI)[1] data showed an uneven recovery, with manufacturing activity contracting and services still growing.



1. The recovery momentum in China's manufacturing sector may slow down due to weakening overseas demand as global growth slows, posing a challenge to the country's economy in the near term.
2. However, manufacturing has been contributing less to Chinese GDP growth in recent years (Figure 3A), even though it is still a significant part of growth. On the other hand, China's services sector is becoming a much more significant driver of its growth story and will be far more crucial to its economy going forward. More importantly, China is slowly shedding its image as just a manufacturing hub for the rest of the world.
3. A growing services sector also means increased attention will be given to domestic markets over time, with local consumption becoming a key factor driving recovery. As China's middle class grows, travel and leisure spending will increase along with greater demand.
4. China's onshore stock markets have greater representation of traditional sectors such as industrials, materials and consumer staples, while offshore stock markets consist of predominantly private sector names leading long-term growth trends in consumer discretionary and communication services. The vastly different sectoral compositions of onshore and offshore Chinese stocks allow investors to tap into various trends unfolding in China. More importantly, both onshore and offshore stocks are trading below their long-term average (Figure 3B).
5. Nonetheless, stock selection will be key in identifying potential outperformers from onshore and offshore markets.

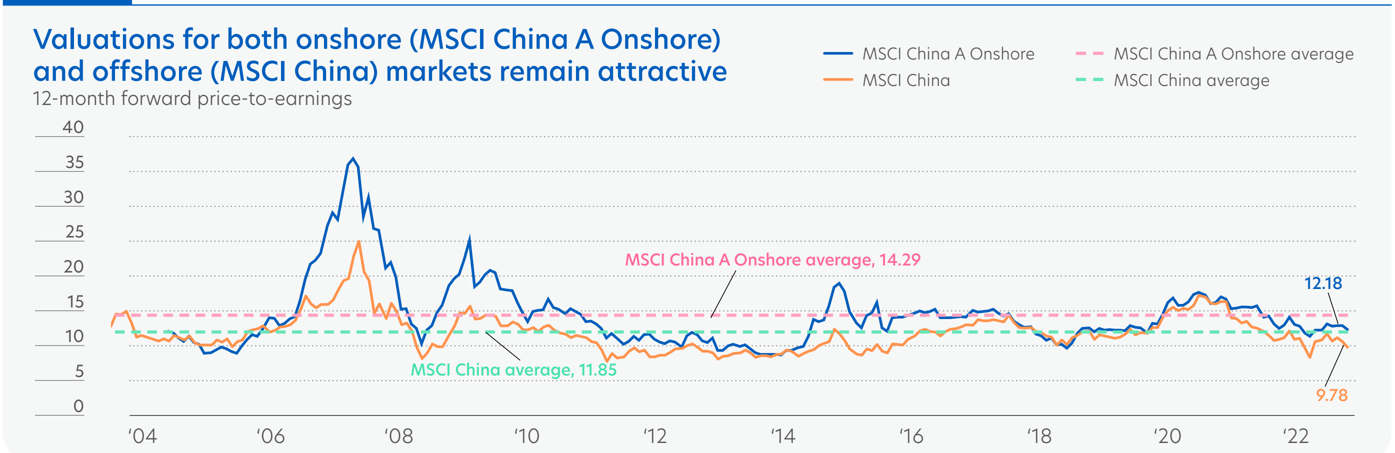
[1] Purchasing Managers' Index (PMI) data consist of economic indicators derived from monthly surveys of companies and provide an indication of current and future business conditions.

Figure 3A



Source: FactSet, J.P. Morgan Asset Management.

Figure 3B



Source: FactSet, J.P. Morgan Asset Management.

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