In collaboration with: J.P.Morgan ASSET MANAGEMENT

UOB

UOB Investment Insights

Market PowerBar

MAY 2023

A LOOK AT THIS MONTH

Key Topics	What Investors Should Know
1 What recession indicators are telling us	**There are early signs that higher interest rates are placing pressure on the United States economy, and growth is expected to slow further this year.** ▶ Yields on long-duration US Treasury bonds have fallen below shorter-duration ones. This unusual phenomenon, called an inverted yield curve, sometimes precedes a recession. ▶ US bank lending standards have tightened significantly and are expected to tighten further due to recent banking sector troubles. This tends to happen before the onset of a recession.
2 Frequently released economic indicators offer timely clues about the economy	**Investors can look at different indicators to gauge a country's economic health. Economic data with frequent releases are preferred because they offer timely updates.** ▶ Some economic indicators are showing warning signs, but the service sector, job market and consumer confidence are still healthy. ▶ Data from key cyclical sectors also do not look worrisome at the moment, supporting our view that any recession would be mild.
3 Investors can consider positioning for the next market upcycle	**The economic cycle is always moving through peaks and troughs. Investors should be prepared for both.** ▶ Bull market periods can last a long time, while bear market periods are usually shorter. Even though current markets reflect slow growth and poor performance, market sentiment can turn positive quickly. ▶ Certain asset classes may be favoured at different points of the economic cycle. Investors with risk appetite can prepare for the recovery phase, as the contraction period will not last forever.
Upcoming Event	
MAY 3 **Federal Open Market Committee (FOMC) policy meeting**	Keep an eye on whether the Federal Reserve announces a 25 basis point (bps) rate hike or holds interest rates at the current level.

Speak to your UOB Advisor today to find out more.

Topic 1

What recession indicators are telling us

With recent troubles in the banking sector and higher interest rates placing pressure on the United States economy, there appears to be a greater possibility of the US entering a recession. We look at what some indicators are telling us.

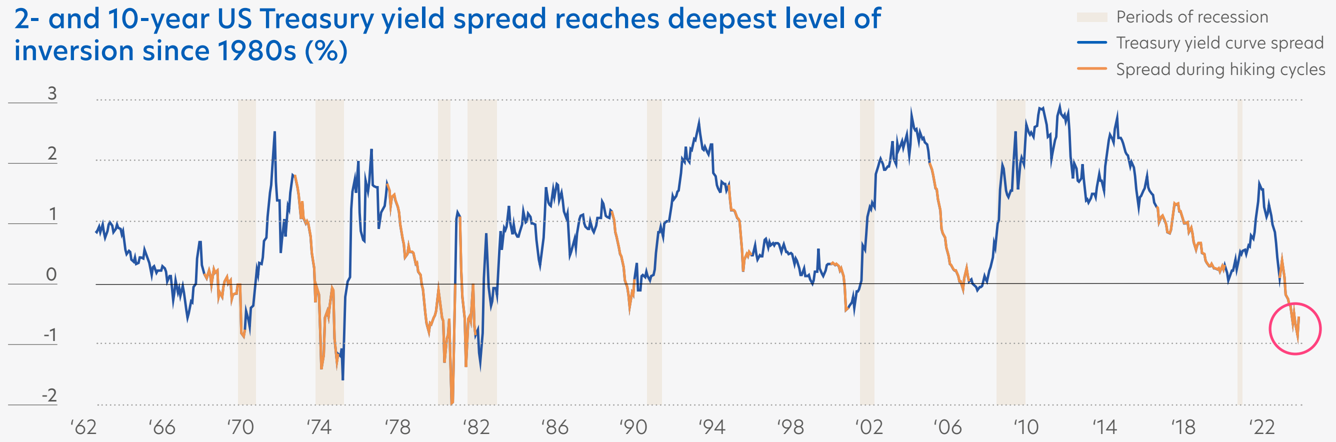
1. Investors are usually rewarded with higher yields when holding bonds with longer maturities, resulting in an upward sloping yield curve. This is because longer-duration bonds factor in the risk of inflation and default over time. When yields on long-maturity bonds fall below those of shorter maturities, it results in an inverted yield curve. An inverted yield curve indicates that markets are not optimistic about the future and sometimes precedes a recession.

2. As shown in Figure 1A, when the yield curve inverts, a recession tends to follow after some time. However, investors should keep in mind that this is not always the case. There have been situations when the curve inverted but no recession occurred. Nonetheless, the current level of inversion has reached the deepest level since the 1980s, signalling the risk of a recession ahead.

3. Various sentiment surveys show how expectations are changing. One of them is bank lending standards. When lending standards are tightened, it is harder to borrow money. This tends to happen before the onset of a recession. As shown in Figure 1B, lending conditions have tightened meaningfully since the second quarter of 2022, and we expect them to tighten further due to recent troubles in the banking sector.

Figure 1A

2- and 10-year US Treasury yield spread reaches deepest level of inversion since 1980s (%)



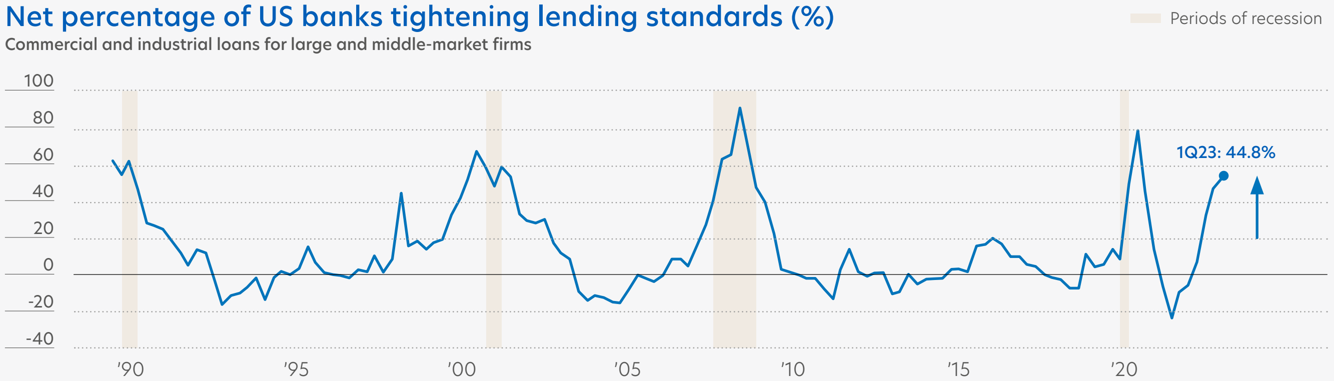
*Yield curve is inverted when yield spread falls below 0%

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

Figure 1B

Net percentage of US banks tightening lending standards (%)

Commercial and industrial loans for large and middle-market firms



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

Topic 2

Frequently released economic indicators offer timely clues about the economy

There are many economic indicators that investors can look at to gauge if an economy is in a recession. Economic data that have frequent releases offer a more up-to-date reflection of the current environment.

1. The technical definition of a recession is two consecutive quarters of negative GDP growth. In the US, the National Bureau of Economic Research (NBER) officially determines whether the country is in recession based on several economic indicators. The problem is that by the time an announcement is made, the actual start date of the recession has long passed.

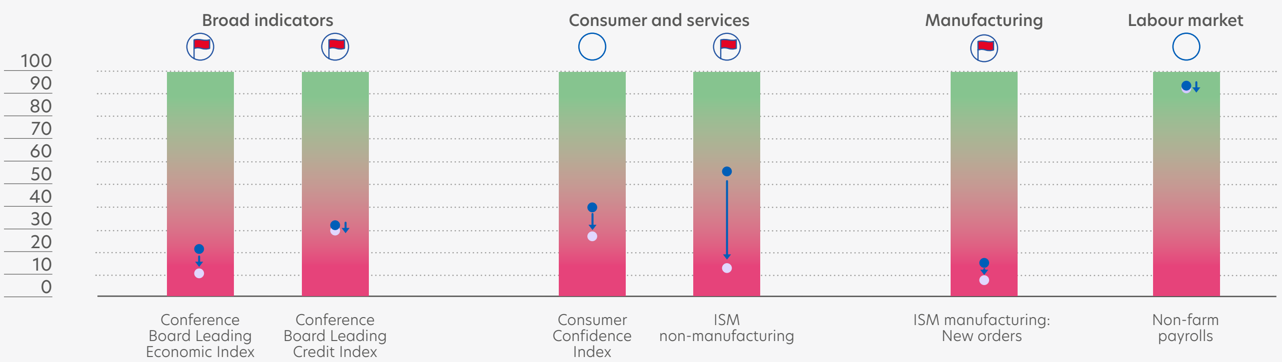
2. Investors can also look at other data to gauge a country's economic health. Economic data with frequent releases are preferred for timeliness. In Figure 2A, which lists several important economic indicators, a red flag means the indicator is signalling a higher recession risk. Although the Conference Board Leading Economic Index* and ISM Manufacturing New Orders are flashing warning signs (red flag), consumer and labour markets appear to be in good shape for now.

3. Another way to assess the health of the US economy is by looking at key cyclical sectors. Residential investment and business fixed investment levels, light vehicle sales and the business inventory-to-sales ratio can show overheating or economic bubbles. For the time being, none of these look worrisome, supporting our view that any recession would be a mild one. The only sector that looks troubled is residential investment. Figure 2B shows that US residential investment (as of 4Q2022) has fallen sharply to 4% of GDP, below the long-term average of 4.4%. This is mainly due to higher mortgage rates.

*Conference Board Leading Economic Index comprises forward-looking indicators from different areas of economic activity to provide a broad-based view of the health of the economy.

Figure 2A

Some economic indicators have triggered a "red flag"



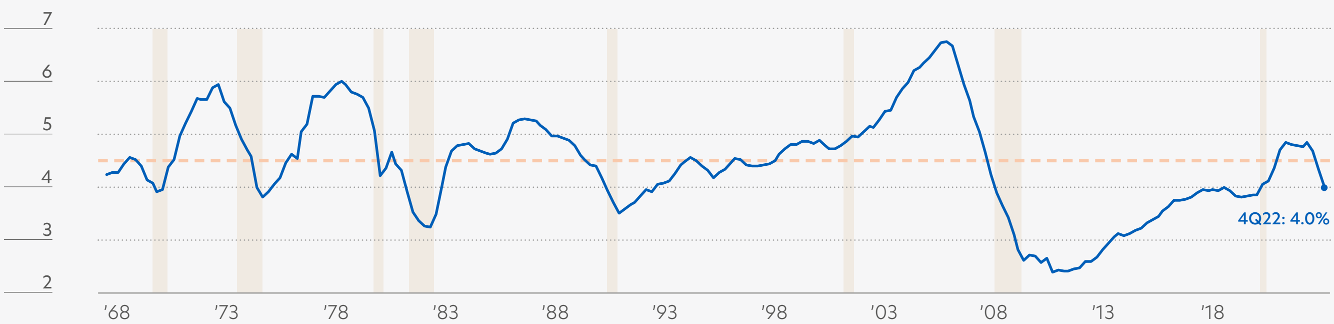
Source: Bloomberg Finance L.P., FactSet, J.P. Morgan Asset Management.

Figure 2B

Residential investment (as a % of GDP) falls below long-term average (%)

Quarterly, seasonally adjusted

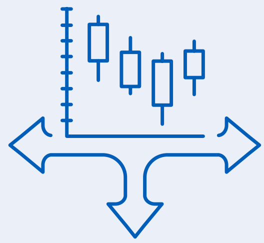
Long-term quarterly average



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

Topic 3

Investors can consider positioning for the next market upcycle



Even though recession risks are rising, investors need not panic. Keep in mind that the economic cycle is always moving through peaks and troughs, and we should be prepared for both.

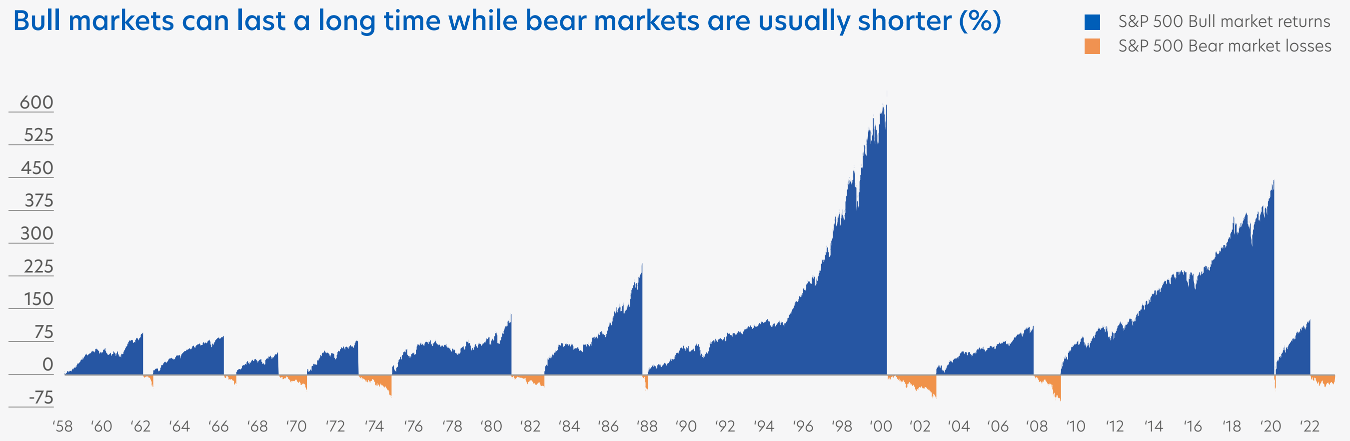
1. As shown in Figure 3A, investors should note that bull markets can last a long time while bear markets are usually shorter. The worst-performing days of a market often occur quite close to its best-performing days as the market rallies. Even though current markets reflect slow growth and poor performance, market sentiment can turn positive quickly.

2. Even though certain asset classes may be favoured at different points of the economic cycle, stay diversified to protect yourselves from large losses which may result from overexposure in any area. The economic cycle in Figure 3B shows the overall state of the economy as it goes through four stages in a cyclical pattern: recovery, expansion, slowdown, and contraction. Investors with the appropriate risk appetite can gradually increase allocation to stocks after the downturn to benefit from the next upcycle. Economic slowdowns or contractions typically do not last forever.

3. At this point in time, increase allocation to bonds over stocks given the rising probability of a recession later in the year. Although neither the US nor developed markets are in recession yet, investors who have a higher risk appetite can start thinking about positioning for recovery once the impending contraction is over.

Figure 3A

Bull markets can last a long time while bear markets are usually shorter (%)

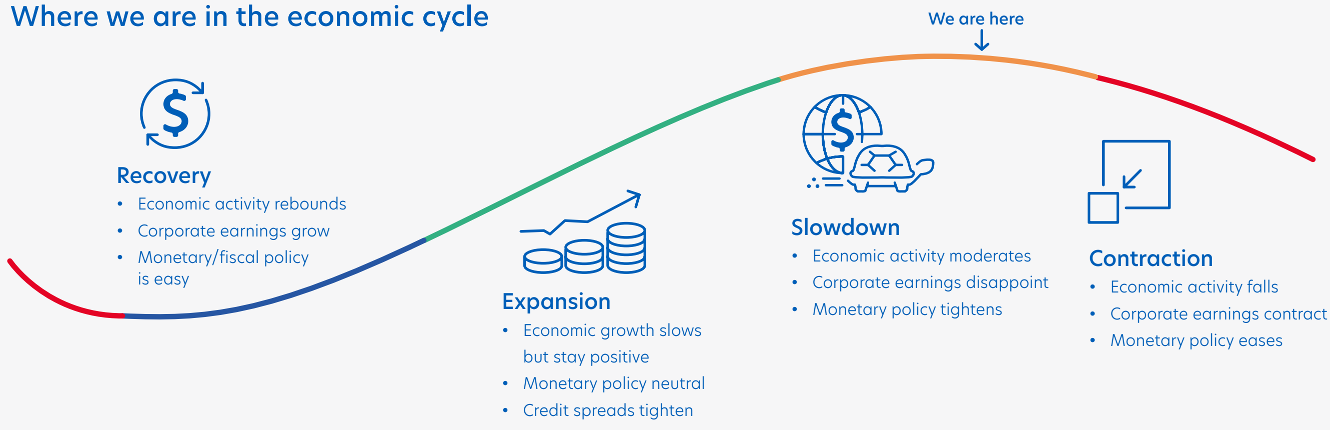


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

A bear market represents a 20% or more decline from the previous market high; a bull market represents a 20% increase from a market trough. Charts and labels refer to price return. Past performance is not a reliable indicator of current and future results.

Figure 3B

Where we are in the economic cycle



Right By You