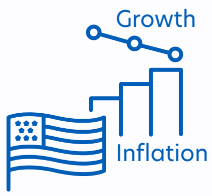
In collaboration with: J.P.Morgan ASSET MANAGEMENT

UOB Investment Insights

Market PowerBar

NOVEMBER 2022

A LOOK AT THIS MONTH

Key Topics		What investors should know
1 	The possibility of the United States entering a recession is rising amid high inflation and interest rates.	**Despite the challenges the US economy faces, we think any recession would likely be mild.** ▶ Nonetheless, any slowdown or recession in the US will weigh on the global economy. ▶ In such a scenario, we recommend staying invested but prefer lower-volatility asset classes such as high-quality bonds and dividend-paying stocks.
2 	Inflation may trend lower as we move towards the end of 2022 and into 2023 but will likely remain at elevated levels.	**Persistently high inflation means holding cash will reduce your purchasing power and erode your wealth over time.** ▶ Unlike holding cash, investing in US high-quality bonds and high-dividend stocks could provide attractive income opportunities now. ▶ Quality stocks and bonds also offer the potential of capital gains when the economy and markets recover.
3 	Chinese stocks have been weighed down by zero-COVID policies, an ailing property market and geopolitical risks.	**Earnings growth expectations for Chinese stocks have been depressed by negative news.** ▶ Earnings growth expectations in 2023 are relatively low compared to historical levels. ▶ Earnings could potentially be boosted as economic development remains China's top priority.

Upcoming Events		
	US Mid-term Elections	Look out for the results of the US mid-term elections, which will decide which party controls the Congress and determine the future of President Joe Biden's agenda.

Speak to your UOB Advisor today to find out more.

Topic 1

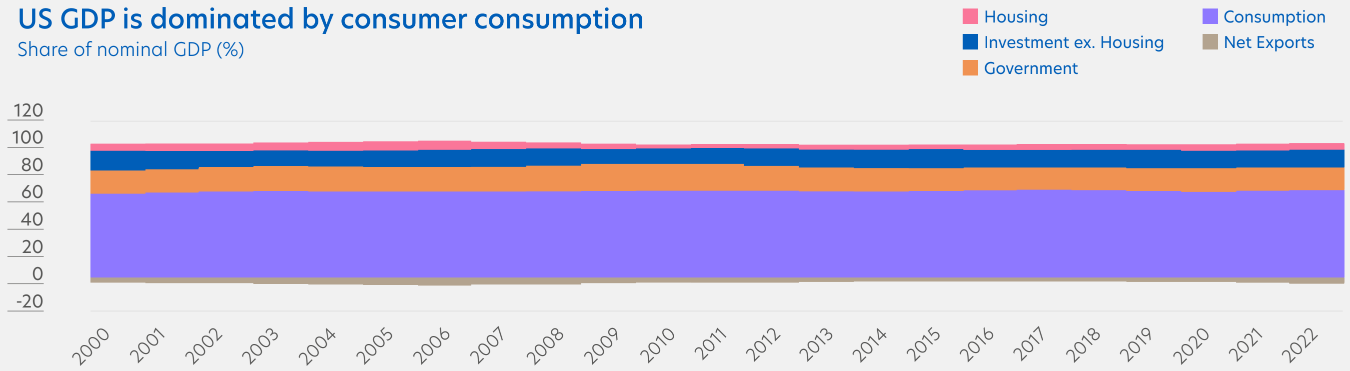
The risk of a United States recession

Across developed markets, positive effects from the post-pandemic re-opening appear to have faded. Now, a surge in costs of living and rising interest rates are expected to weaken growth prospects, and the probability of a recession in the US within the next year are higher. Investors should prepare themselves for a downturn in both economic activity and market performance.

Figure 1A

US GDP is dominated by consumer consumption

Share of nominal GDP (%)



Source: Bureau of Economic Analysis, FactSet, J.P. Morgan Asset Management. Data reflect most recently available as 30 September 2022.

Key takeaways

1. Recent economic data show worrying signs of a slowdown in the US. Interest rates are rising, causing businesses to hold back their investment and capital expenditure. Meanwhile, mortgage rates have climbed higher, putting pressure on the housing market. In addition, the strong US dollar is slowing down exports.
2. Despite these challenges the economy faces, we think any recession would likely be mild, given that household and corporate asset levels remain high and the US is not facing a shock like the financial crisis in 2008.
3. US GDP is driven significantly by consumer spending, which has stayed resilient (Figure 1A). The strong and healthy labour market as seen in Figure 1B also implies any recession should be a relatively mild one for the US.

Figure 1B

Healthy US labour market continues to support the economy

Job openings ratio*

Source: FactSet, US Bureau of Labor Statistics, J.P. Morgan Asset Management.
* Job openings ratio = Job openings / Number of persons unemployed.

In summary

- Any slowdown or recession in the US will have a negative impact on the global economy, and investors need to be prepared for further volatility in equity markets.
- However, this is not the time to sit on the sidelines. While interest rates and bond yields have continued creeping upwards, we believe there is a limit to how high yields can go. If the economy tips into a recession and inflation falls under control, central banks will be less aggressive in raising rates.
- In such a scenario, we recommend staying invested but prefer lower-volatility investment instruments such as quality bonds and dividend-paying stocks.

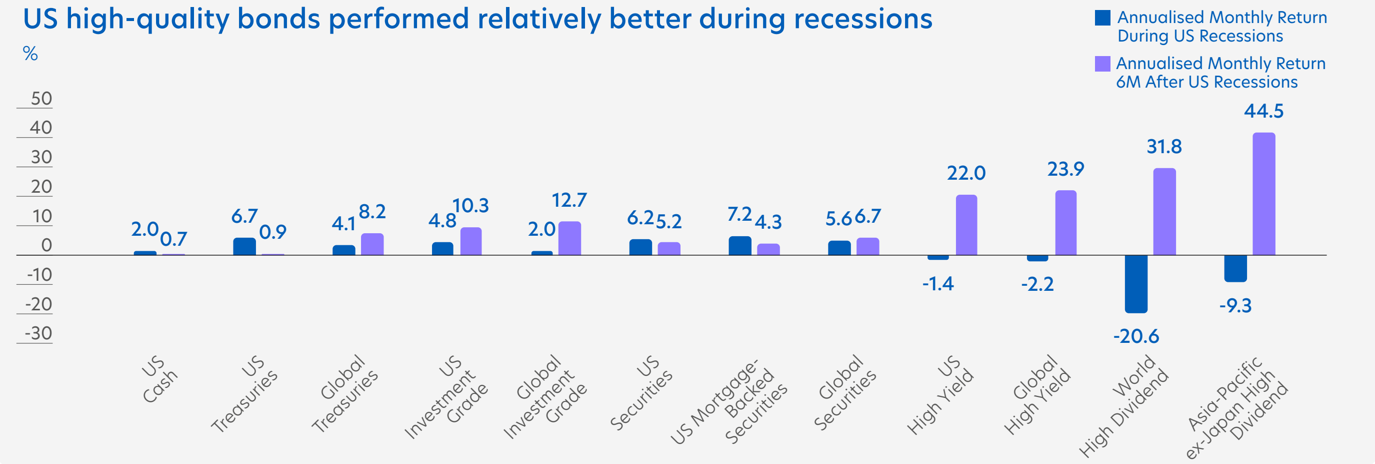
Topic 2

Investment options amid stubbornly high inflation

Inflation may trend lower as we move towards the end of 2022 and into 2023, but it is still likely to remain at elevated levels. Persistently high inflation means holding cash will result in the value of your money getting eroded. High-quality bonds and high-dividend stocks are options to consider in this environment.

Figure 2A

US high-quality bonds performed relatively better during recessions



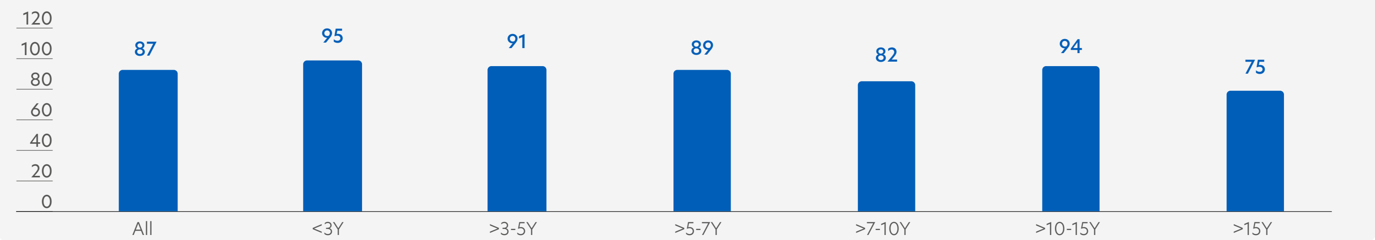
Source: Bloomberg, NBER. Annualised monthly returns during time period: 31 October 2000 – 31 October 2022. Data reflects most recently available as of 31 October 2022.

Key takeaways

1. How much the US Federal Reserve continues to hike rates will be highly influenced by how long inflation continues to stay elevated.
2. Because inflation is likely to remain stubbornly high, the opportunity cost of holding cash is high as your real purchasing power will get eroded over time.
3. US high-quality bonds such as Treasuries, investment grade bonds (IG) and securitised assets tend to do historically well during recessions (Figure 2A). While high-dividend-yielding stocks do not protect against capital losses, they tend to rebound strongly after recessions.

Figure 2B

US investment grade bonds traded below par value* across different maturity buckets currently



Source: Bloomberg. Data reflects most recently available as of 31 October 2022.
* Par value for bond is often denominated in 100 cents and bond investors are expected to receive 100 cents when bond matures.

In summary

- Increasing your exposure to US high-quality bonds and high dividend yielding stocks at this juncture could provide attractive income opportunities now and potential capital gains after the economy recovers from any potential recession.
- With fixed deposits currently at around 3%, investors may not see the point of taking on more risk in US IG bonds for an additional 1-2% yield. However, the quoted yield in US IG bonds is only indicative of what an investor would earn when bonds mature at par value. The chart above shows that on average, the IG universe trades at 87 cents on the dollar (Figure 2B). Today's bond yield therefore does not consider potential capital appreciation when economic growth deteriorates and inflation falls to a point where Fed rate hikes can be less aggressive.

Topic 3

Spotlight on China's corporate earnings

2022 continues to be a tough year for China, which faces multiple challenges including zero-COVID policies, an ailing property market and geopolitical risks. As a result, stock valuations have fallen significantly to below 15-year-average levels.

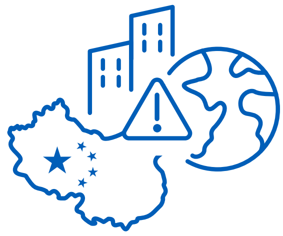
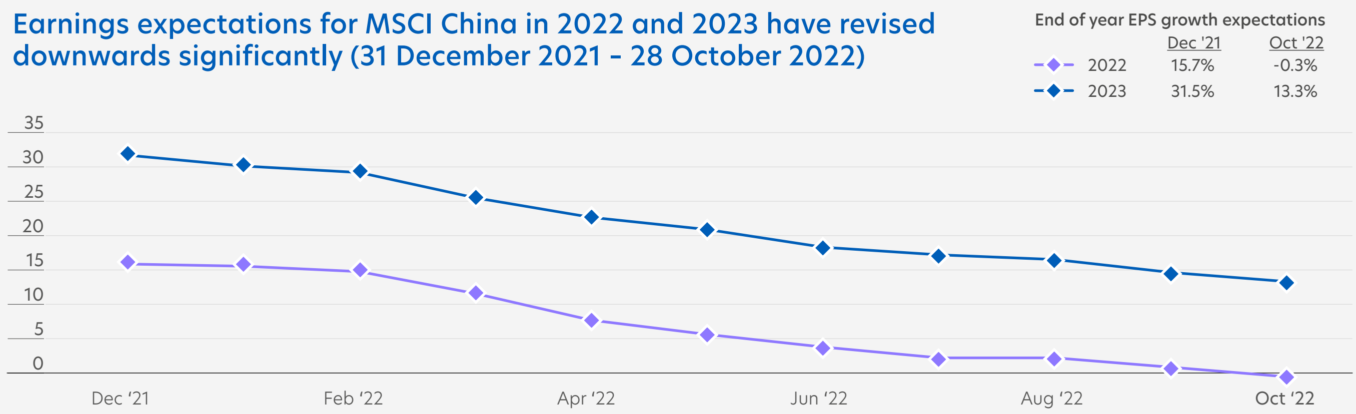


Figure 3A

Earnings expectations for MSCI China in 2022 and 2023 have revised downwards significantly (31 December 2021 - 28 October 2022)



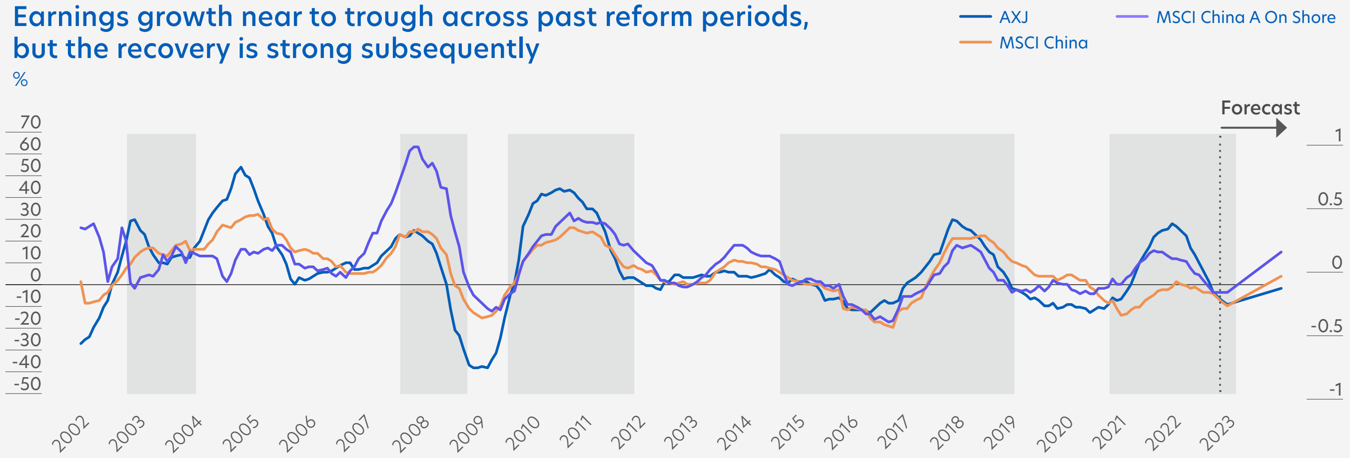
Source: FactSet, MSCI, J.P. Morgan Asset Management.
Data reflects most recently available as of 28 October 2022.

Key takeaways

1. Besides stock valuations falling to historically low levels, the China equities market has also witnessed earnings growth expectations for both 2022 and 2023 tumbling from 16% and 32% respectively to -0.3% and 13.3% respectively (Figure 3A).
2. In our view, most of the challenges China faces have already been priced into current depressed stock valuations. We believe there could be a renewed focus on economic recovery, since economic development remains China's top priority.

Figure 3B

Earnings growth near to trough across past reform periods, but the recovery is strong subsequently



Source: FactSet. Data reflect most recently available as of 31 October 2022. Gray bars = reform periods.

In summary

- Historical data during past periods of China's regulatory reforms show that earnings growth tends to bottom out one year after reform periods start. This is consistent with the current market consensus that earnings growth is bottoming out, based on the MSCI AXJ and MSCI China indices (Figure 3B).
- On top of that, 2023 earnings growth expectations are also low compared to previous recovery periods. We think markets are continuing to price in uncertainty for big technology and consumer discretionary companies that were subject to regulatory crackdown in 2021. We think that is reasonable but reflects a relatively negative view, considering potential recovery in profit margins across these industries.

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