In collaboration with:

J.P.Morgan Asset Management

UOB Investment Insights
Market PowerBar

OCTOBER 2020

Key events at a glance

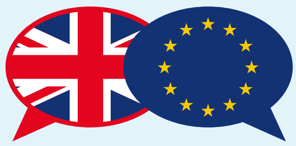
Market recap

Suga elected as Japan's new Prime Minister

Suga to continue key policies to revive Japan's economy

- On 16 September 2020, Yoshihide Suga was nominated as the new Prime Minister of Japan after winning the Liberal Democrat Party's (LDP) leadership vote by a wide margin.
- Suga is expected to serve out the outgoing Prime Minister Abe's term as party leader through September 2021.
- While Suga's leadership represents policy continuity, we remain negative on Japan due to its high dependence on global trade and relatively unattractive valuations.

Brexit negotiations are set to continue in October 2020



Brexit uncertainties back to the forefront

- The UK government's controversial Internal Market Bill unsettled the European Union (EU) as it overrides parts of the previously-agreed Withdrawal Agreement concerning provisions on state aid and export declarations.
- The EU has consequently commenced legal action against the UK and gave a deadline for the UK to withdraw clauses in the Bill which the EU claimed were in breach of international law.
- As negotiations continue, volatility in the British Pound Sterling (GBP) could rise as uncertainties regarding a Brexit deal increase.

A look at this month

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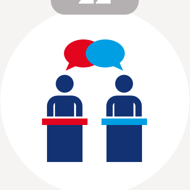

US presidential debate
The second debate between Trump and Biden scheduled originally for 15 October has been cancelled. Both candidates will participate in the final debate which will be held on 22 October 2020.

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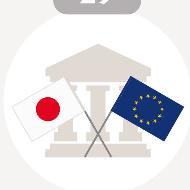


Bank of Japan & European Central Bank meetings
Both central banks are expected to maintain dovish monetary policies to support the economy.

Topic 1:

Uncertainties in Q4 2020 could lead to volatile markets

Despite improvement in economic activity leading to economic data surprises in recent months, the global economy is likely to see slower improvement in the months ahead. As investors digest the recent economic and political developments, markets are likely to be volatile in Q4 2020.

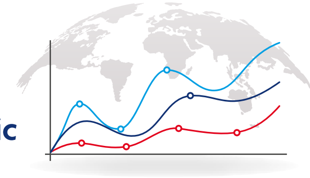


Figure 1a. Recent economic data has significantly exceeded expectations, resulting in a jump in the economic surprise* indices

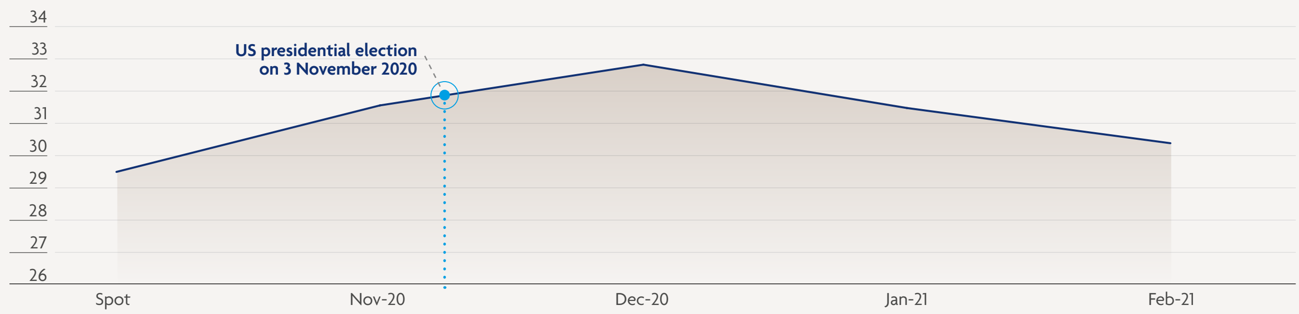
Source: Citigroup, Bloomberg L.P. Finance, J.P. Morgan Asset Management. Data as of 30 September 2020.
* Economic surprises are positive when actual economic data beats forecasts and negative when data comes in below expectations.

Major developed economies have experienced a sharp rebound in activity in recent months, with actual data significantly exceeding expectations (Figure 1a). Following this, improvement in activity is likely to slow in coming months.

For many economies, the path to recovery remains uneven as authorities deal with resurgence of cases. China is an exception, where incoming data shows a broadening recovery across sectors.

Despite these improvements, equity markets are likely to exhibit more volatility in Q4 2020 (Figure 1b), especially ahead of the US presidential election in November 2020 as seen in the Volatility Index (VIX) below.

Figure 1b. Volatility is expected to rise in equity markets till the US presidential election



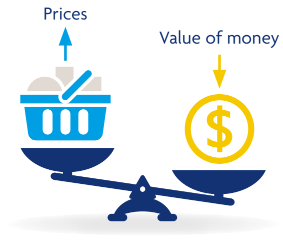
Source: Bloomberg L.P. Finance, J.P. Morgan Asset Management. Data and estimates as of 30 September 2020.

Views & Implications:

- While markets are focused on economic recovery and updates on vaccines, the uncertainty surrounding the election outcome weighs on investors. This can be seen in the chart above, where the VIX term structure is indicating that volatility is expected to increase in November.
- A Biden victory could see renewable energy industries emerging as winners, while a Trump victory could mean more tax credits for American companies that are reshoring their operations.
- Therefore, investors are encouraged to remain prudent and not speculate on the exact outcome. They should remain diversified across asset classes to weather potential volatility.

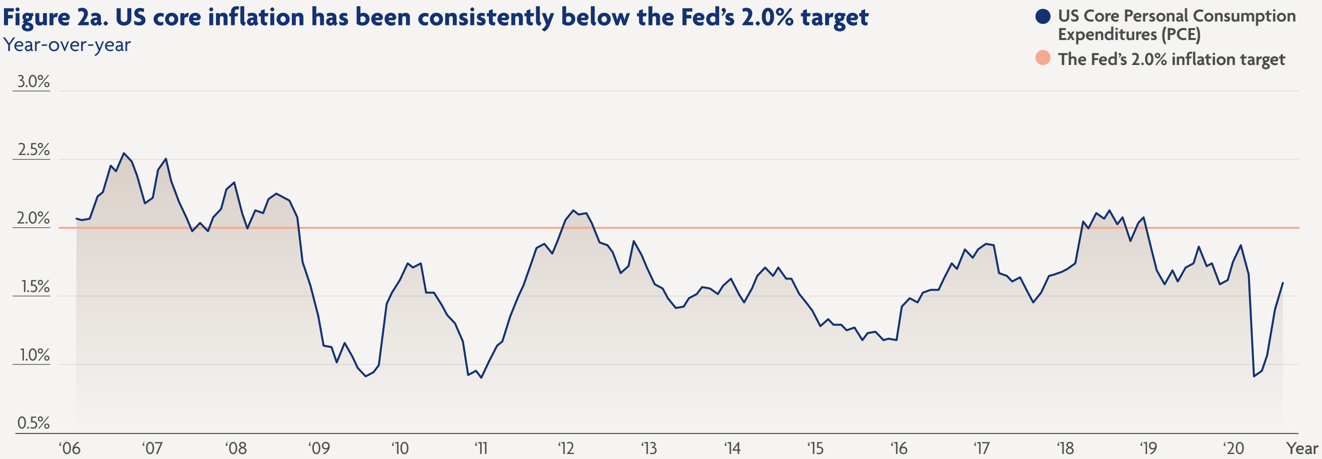
Topic 2:

The Fed rolls out new inflation-targeting framework



The US Federal Reserve (Fed) announced a move towards a flexible 'average inflation targeting' (AIT) framework, which signifies a paradigm shift in the US monetary policy. A dovish Fed is likely to be positive for asset prices and negative for the US dollar.

Figure 2a. US core inflation has been consistently below the Fed's 2.0% target
Year-over-year



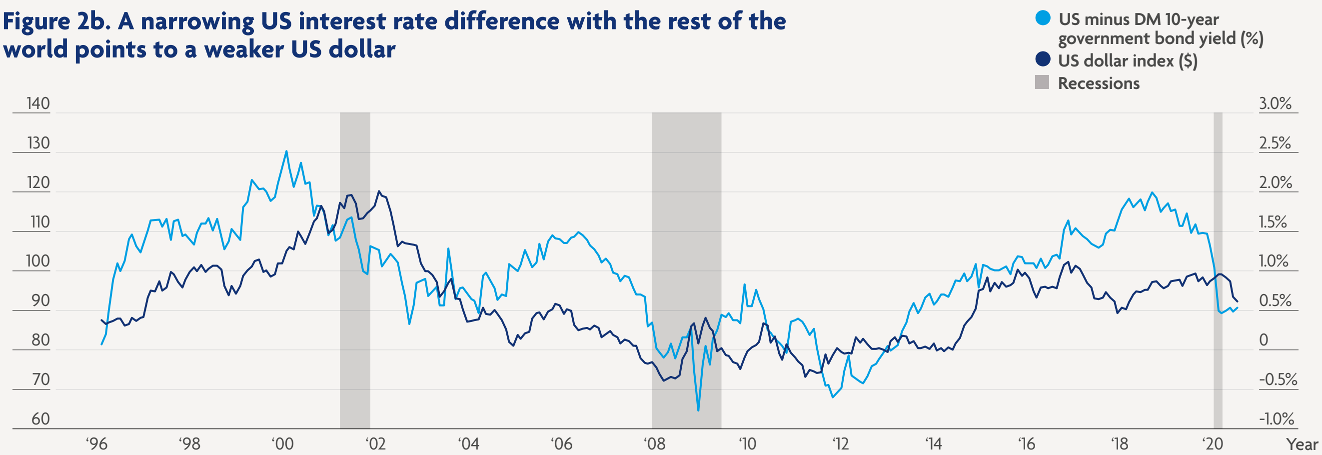
Source: Bloomberg L.P. Finance, J.P. Morgan Asset Management. Data as of 30 September 2020.

The Fed has previously adopted a fixed inflation target, and will tighten the monetary policy if inflation is higher than the target.

With the new 'AIT' framework, the Fed will tolerate inflation going above the targeted 2.0% for an extended period, to make up for inflation running below target in the past (Figure 2a) – hence the term 'average'.

This implies that the Fed will tolerate higher inflation to the upside and keep rates low potentially till end 2023, as indicated in the recent September FOMC meeting. The US economy is thus likely to have lower interest rate differentials relative to other economies for a longer period of time.

Figure 2b. A narrowing US interest rate difference with the rest of the world points to a weaker US dollar



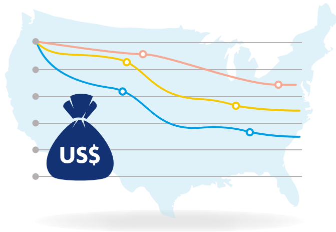
Source: FactSet, OECD, Tullet Prebon, WM/Reuters, J.P. Morgan Asset Management. DM refers to developed markets – Australia, Canada, France, Germany, Italy, Japan, Switzerland and the UK. Data as of 30 September 2020.

Views & Implications:

- The lower-for-longer interest rates are likely to be positive for assets such as equities and corporate bonds.
- As interest rate differentials between the US and the rest of the world narrows, the USD will tend to weaken as well (Figure 2b). A weaker USD will support Emerging Market and Asia ex-Japan equities moving forward.

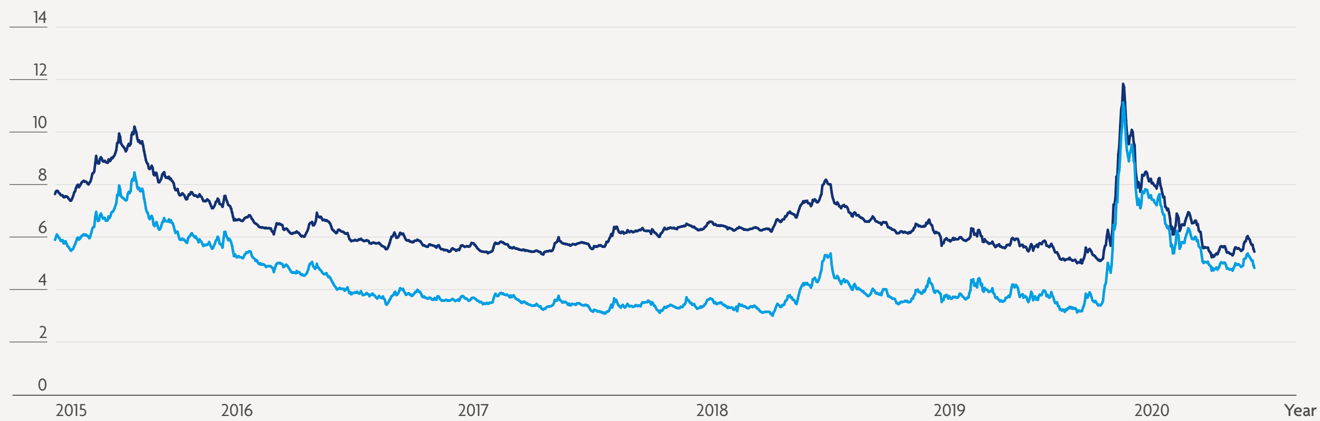
Topic 3:

US high yield bonds are less attractive



Yields and spreads of the US high yield bonds have fallen, resulting in higher valuations and making them less attractive. As a result, we are removing the US high yield bonds from our High-Conviction Tactical Calls.

Figure 3. Yields of US high yield bonds have fallen due to narrower credit spreads, making them less attractive



Source: Bloomberg. Data as of 6 October 2020.

We initiated a High-Conviction Tactical Call on US high yield bonds on 1 June 2020. The segment has since posted a 5.8% gain (as of 2 October 2020).

However, the prices of high yield bonds have risen and yields have fallen from 7.0% to 5.5%. Credit spreads have also fallen to 480 bps (Figure 3).

While a gradual economic recovery alongside the Federal Reserve's stimulus programmes are likely to continue supporting the segment, we are no longer positive on US high yield bonds given the rise in valuations and an expected lower potential upside.

In addition, if economic conditions weaken, defaults may rise which could dent market sentiments and cause a rise in credit spreads.

Investors can consider diversifying to global multi-asset funds, or consider fixed income alternatives (such as investment-grade bonds) that may potentially offer stable returns. Alternatively, investors with higher risk appetites may consider other tactical calls such as Asia ex-Japan equities.

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