UOB House View 2Q 2023

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Global Economics & Markets Research
Private Bank

Global Macro

Due to the sudden crisis in the banking sector across Mar, various risk indicators have jumped but it is important to note that they are still far from 2008 Global Financial Crisis (GFC) highs. The authorities' swift, targeted and decisive response has defused significantly contagion and systemic risks and will go a long way in restoring confidence in the banking system. The Fed will most likely make one more 25 bps hike to 5.25% in May FOMC and thereafter stay on hold throughout the rest of 2023. China's economic recovery is one bright spark amidst the uncertainty.

Asset Allocation

From an asset allocation point of view, we advocate the following: 1) Tighter money will eventually bite, 2) Within risky assets, there are still opportunities in sectors and geographies with divergent cyclical profile, and 3) Increase allocation to Alternatives which have higher potential for manager's alpha.

Equities

We reiterate our focus on selected opportunities in defensive stocks as well as quality growth names. We recommend taking advantage of any volatility spikes via structured products. Overall, we remain Neutral on US equities, Underweight on European equities and stay Overweight on EM Asia equities.

Fixed Income

For Developed Markets High Yield (DM HY), we continue to advocate caution despite potential for further spread tightening. Given an anticipated rise in default rates, we stay Underweight on DM HY. For EM Asia USD Investment Grade (EM Asia IG), we reiterate our preference for selected credits in this space given better relative valuation and yield pick-up versus their DM IG peers. For EM Asia USD High Yield (EM Asia HY), we continue to advocate investors to stay highly selective and diversified, and we are Neutral on EM Asia HY.

Commodities

The banking sector crisis has triggered safe haven needs for gold and reinforced our positive view on gold. We raise our forecasts to USD 2,000 / oz in 2Q23 and 3Q23, thereafter USD 2,100 / oz in 4Q23 and 1Q24. However, the resultant downside global growth risks will weigh down on both Brent crude oil and LME Copper. We downgrade our Brent crude oil to USD 80 / bbl in 2Q23 and 3Q23, followed by USD 90 / bbl in 4Q23 and 1Q24. We also see LME Copper lower at USD 8,000 / MT in 2Q23 and 3Q23, followed by USD 7,000 / MT in 4Q23 and 1Q24.

FX & Interest Rates

Sharp repricing of US rates lower across Mar will inevitably weigh on USD, and we are more convinced of further USD weakness in the coming quarters. Markets are priced for imminent Fed rate cuts (to begin as early as Jun). We find this difficult to reconcile outside of a hard landing scenario, thus some upside yield calibration in the short term may be possible. From a medium-term holding period perspective; we prefer an opportunistic and positive stance on duration. We expect to see bond yields drift lower across 2023.

Global Macro & Markets Strategy
A Crisis of Confidence

" Every banker knows that if he has to prove that he is worthy of credit,
however good may be his arguments, in fact his credit is gone"

Walter Bagehot
in Lombard Street: A Description of the Money Market, 1873.

The Banking Sector Undergoes Its Very Own Confidence Crisis

Due to the sudden crisis in the banking sector across March, various risk indicators have jumped. Volatility in the rates space has also spiked to extreme levels. While the rise in the risk indicators is indeed worrying, it is important to note that they are still far from 2008 Global Financial Crisis (GFC) highs. So far, the Fed and various global central banks have been very proactive in various targeted policies to ring fence the crisis. To support US banks' elevated funding needs, the Fed has made available a new Bank Term Funding Program (BTFP) and dropped the lending rate at its existing discount facility. To ensure the orderly functioning of global foreign exchange market and pre-empt a USD funding crunch, the Fed has also vastly expanded its US Dollar liquidity swap lines with five other leading Developed Market (DM) central banks. The authorities' swift, targeted and decisive response has defused significantly contagion and systemic risks and will go a long way in restoring confidence in the banking system.

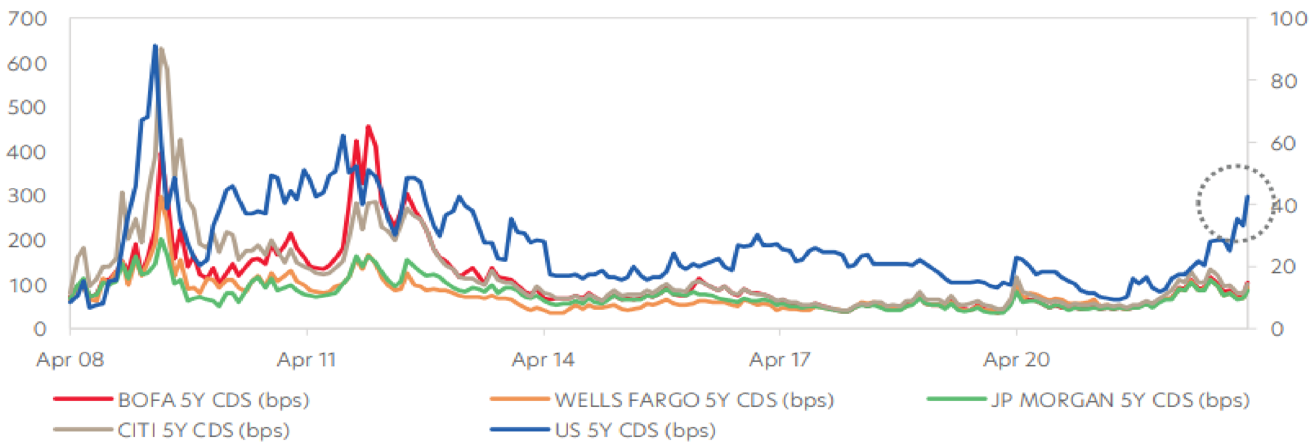
As widely expected, the Fed has hiked by 25 bps at the Mar 2023 FOMC and continued to highlight their concern about inflation. Our updated view is that the Fed will most likely make one more 25 bps hike to 5.25% at the subsequent May FOMC. That 5.25% level will likely be the terminal rate going forward and Fed will thereafter stay on hold throughout rest of 2023. Going forward, as long as the crisis in the banking sector is contained, our view is that the US economy is still relatively resilient amidst a robust job market that continues to emerge from Covid-19.

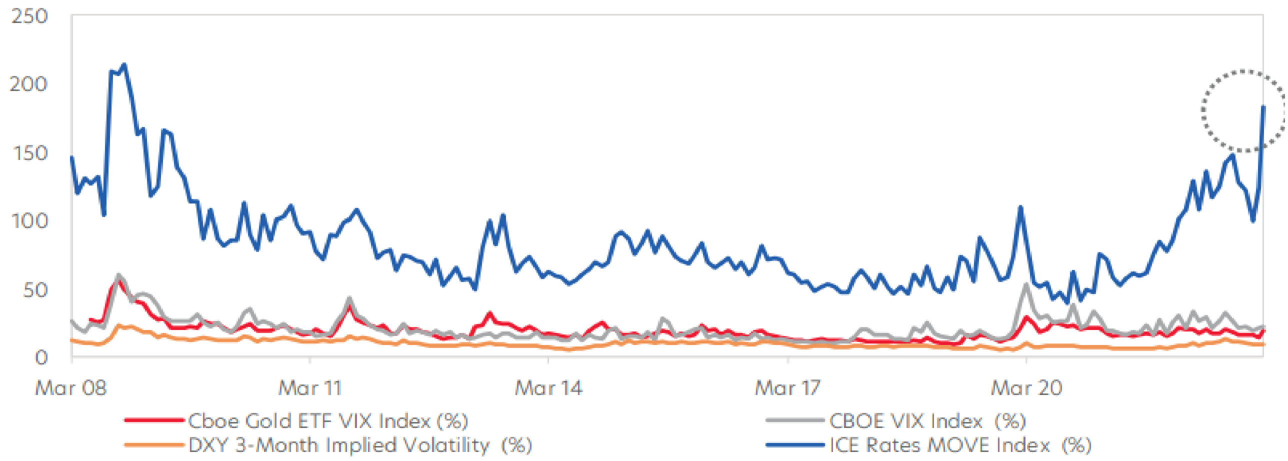
There is one relative bright spot amidst the uncertainty, i.e. China's economy is steadily emerging from its Covid-19 stasis and is gradually recovering. We are not forecasting an early 2021-style snap back in China's economy. Rather, the growth recovery this time round is likely to be more modest in nature. Our view remains that China's economy will register a growth of 5.2% y/y this year and it will be a stabilizing force to the uncertain economic path in both Eurozone and the US.

For more details, please see our 2Q 2023 Quarterly Global Outlook's Executive Summary.

US banking sector 5Y CDS and US Sovereign 5Y CDS Higher; Rates Volatility Have Jumped But Still Far From 2008 GFC Highs

Source: Bloomberg, UOB Global Economics & Markets Research





FX Strategy: Financial Stability Risks Introduce New Downside Risks For USD

The sharp repricing of US rates lower across March will inevitably weigh on the USD. In addition, the emergence of financial stability risks now challenges the “higher-for-longer” rhetoric and introduces new downside risks for our current Fed Funds rate and USD trajectory. As such, compared to the previous update of our FX forecasts (on 1 Mar), we are more convinced of the view of further USD weakness in the coming quarters. Now that the year-long US tightening cycle is almost over and with the intensifying market speculation of Fed rate cuts in 2H23, the USD is starting to lose its key interest rate support. Hence, we reiterate our view of a weaker USD against Major FX peers starting 2Q23. The US Dollar Index is expected to drift lower to 95.9 by 1Q24. Similarly, by 1Q24, we see EUR/USD, GBP/USD and AUD/USD rising to 1.16, 1.32 and 0.72 respectively. Concurrently, USD/JPY is expected to drop to 120 by 1Q24 as well.

Asia FX has appeared resilient in recent weeks even as other asset classes have gone into risk aversion mode after US financial stability risks suddenly surfaced. This was predominantly due to Fed rate cut expectations in 2H23 driving a weaker USD. Another reason for the resilient Asia FX performance is the fact that contagion risks of US banking sector woes to Asia appears low at this juncture. That said, now is probably not the time to throw caution to the wind and be overweight Asia FX, at least in the immediate quarter (2Q23). Previous episodes of risk aversion showed us that it is a matter of time before volatility catches up with the Asia FX space. Overall, we keep to the view of a modestly higher USD/Asia in 2Q23 before clearer signs of a sustained China economic recovery spur renewed weakness of USD/Asia in 2H23. With clearer signs of sustained China economic recovery in the second half of 2023, we see outright Asian FX strength thereafter. Consequently, by 1Q24, we see USD/CNY, USD/SGD, USD/MYR, USD/THB and USD/IDR dropping to 6.70, 1.28, 4.30, 32.0 and 14,800 respectively.

Rates Strategy: Looking Past Mar FOMC, Ahead To Apr MAS And Beyond

After accounting for the latest Mar FOMC, we look for the Fed funds to peak at 5.25% with no rate cuts taking place in 2023. From this US monetary policy baseline, our derived fair value for 10Y UST yield comes in at 3.80% for 2Q 23. From a medium-term holding period perspective, our framework remains that "something will break at the top", perhaps we are already witnessing this. We expect to see bond yields drift lower across 2023, based on our expectation that the Fed funds rate will peak in 2Q23 as well as accounting for our view that the balance of risk will increasingly tilt in favor of slowing economic growth and richer safe haven premiums consequentially.

Our base case sees room for the MAS to tighten monetary policy via another re-centering higher of the policy band. Indeed, based solely on the level core consumers price index (CPI) measure and an uptick in its latest rate of change, MAS tightening would be a consensus view. The SGD NEER performance gap versus last year's comparisons implies a meaningful amount of catch up should the consensus shift in favor of a MAS tightening scenario. In the rates markets, a stronger FX would be supportive of SG yield discount to US rates. If our base case was to come into fruition, then we could see the SG yield discount to US rates persist/deepen in the short term. However, the bigger macro picture suggests that a turn in the US monetary policy cycle is on the horizon.

Commodities Strategy: Gold Shines Brightly As Crude Oil Slumps Amidst Elevated Global Uncertainty

The first two months of 2023 were largely unexciting for commodities prices as investors were mostly sidelined while waiting for more clarity from the US Federal Reserve. Then volatility in financial markets, particularly in the fixed income space exploded in March after the sudden round of confidence crisis in global banking sector. The threat of a global growth slowdown amidst a credit crisis fueled the renewed volatility and has affected the commodities complex in very different ways.

Gold is the main beneficiary of this volatility and has rallied much higher and faster despite our existing positive outlook from last year. We reiterate our positive outlook for gold. The sharp drop in long-term yield is a key positive for gold going forward. On-going market uncertainty is the added fuel for further safe haven demand for gold. In short, gold appears poised to challenge the USD 2,000 / oz headline resistance yet again. We raise our point forecasts to USD 2,000 / oz in 2Q23 and 3Q23, thereafter USD 2,100 / oz in 4Q23 and 1Q24.

As for Brent crude oil, we need to acknowledge the increasing material risks to global growth. Having said that, the energy supply risk amidst Russia's on-going invasion of Ukraine meant that it may be premature to write off crude oil just yet. It is also true that supply issues are still prevalent in the background as global sanctions against Russian sea-borne crude oil start to bite. Overall, in line with higher risk of global growth slowdown, we downgrade our Brent crude oil point forecasts by USD 10 / bbl across the coming quarters. We now see Brent at USD 80 / bbl in 2Q23 and 3Q23, followed by USD 90 / bbl in 4Q23 and 1Q24.

Similarly, for LME Copper, prices have held up very well over the past month benefiting as a result from the optimism of China's post Covid reopening. However, LME Copper prices will likely see increasing downward pressure from global growth slowdown risks as well. We maintain our negative outlook and update our price forecasts to USD 8,000 / MT in 2Q23 and 3Q23, followed by USD 7,000 / MT in 4Q23 and 1Q24.

Asset Allocation

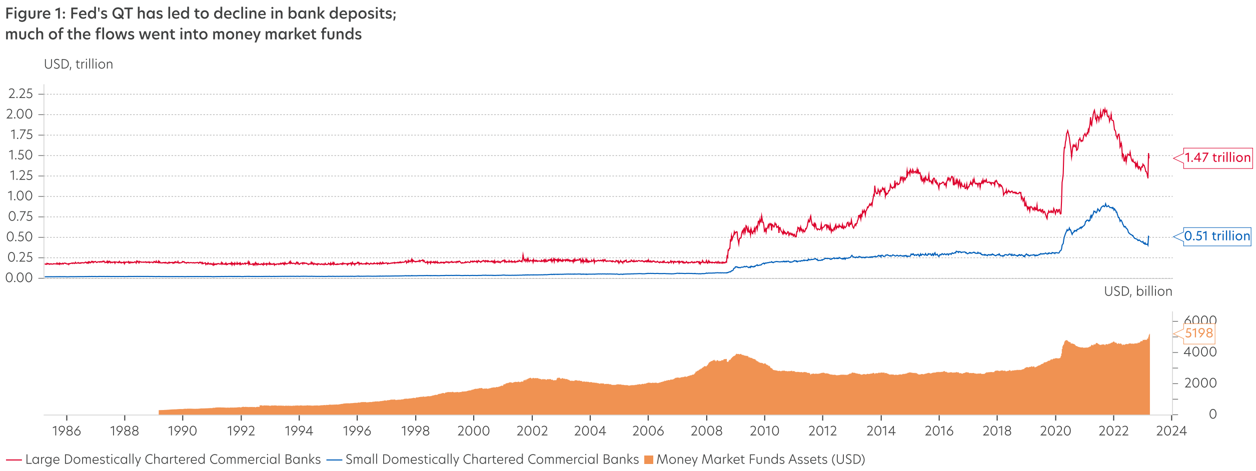
The key development in the past weeks centered around the spectacular collapse of Silicon Valley Bank (SVB). While the factors are dissimilar, the subsequent issues at a major Swiss bank, one of the 30 Global Systemically Important Banks (G-SIBs), saw it forced into a government-engineered merger under terms which broke market convention, leading to fears of a looming banking crisis. The nightmares of 2008 rapidly emerged and speculative funds started to short weaker banks, seeking to profit by identifying the next troubled entity.

As the dust settles, market participants have come to acknowledge that circumstances leading to the collapse of SVB are idiosyncratic, with no obvious read-through to the rest of the sector. However, it highlights that the post-2008 focus on building loss-absorption capital may not contain all the answers; a liquidity flight can sink an institution expeditiously.

The impact of Quantitative Tightening (QT) or unwinding of asset purchases by the Fed has led to a decline in bank deposits. Part of this trend is contributed by the migration to money market funds motivated by higher yields (Fig. 1).

Figure 1 – Fed's QT Has led To Decline In Bank Deposits; Much Of The Flows Went To Money Market Funds

Source: Macrobond, UOB Private Bank, Federal Reserve

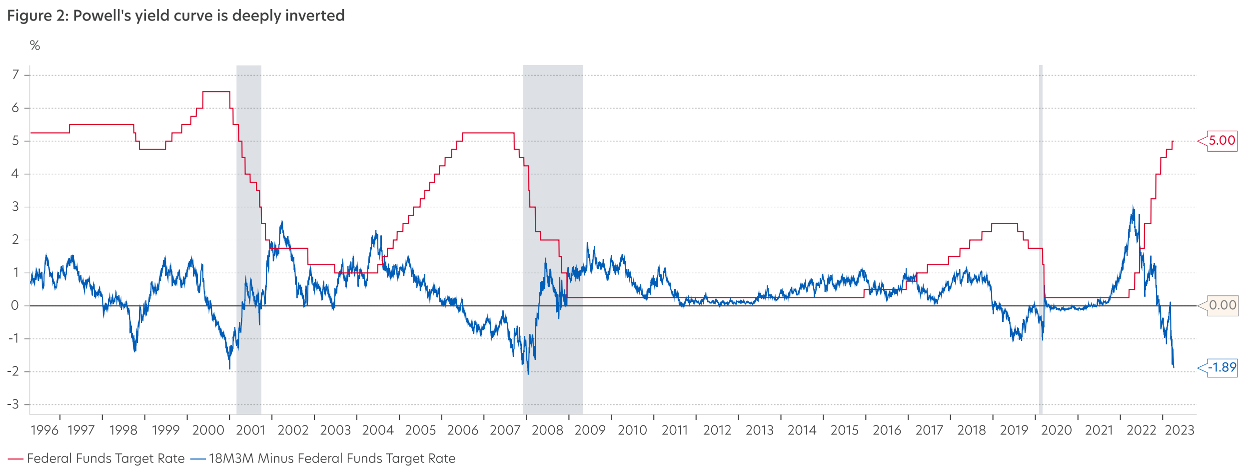


The need for higher liquidity is partly met by the usage of the Fed's discount window, which has risen to levels last seen during the financial crisis. Avoiding the fate of SVB will require banks to tighten lending standards and maintain more capital. To the extent that a systemic crisis is not at hand, the upshot of credit tightening is that it could lead to an earlier Fed pivot.

The trade-off of the Fed maintaining the terminal rate for longer is that the economy will gradually slip towards a deeper slowdown or a recession. The stylized reality of a recession is a risk-off market with a peak-to-trough correction of ~30% associated with earnings decline of ~20% on average. The so-called "Powell's yield curve", the 18-month forward 3-month rate less the Fed Funds target rate, is the most inverted in 20 years (Fig. 2).

Figure 2 – Powell's "Yield Curve" Is Deeply Inverted

Source: Macrobond, UOB Private Bank, Federal Reserve



However, there remains room for optimism that the global growth slowdown will be relatively mild. While the US faces a monetary-induced slowdown, growth in Asia is expected to be more resilient, augmented by China's recovery from a delayed reopening. Moreover, the technology sector has already experienced a severe contraction in 2022 due to the unwinding of excessive optimism from the pandemic-led demand surge in 2020. From an asset allocation point of view, we advocate the following:

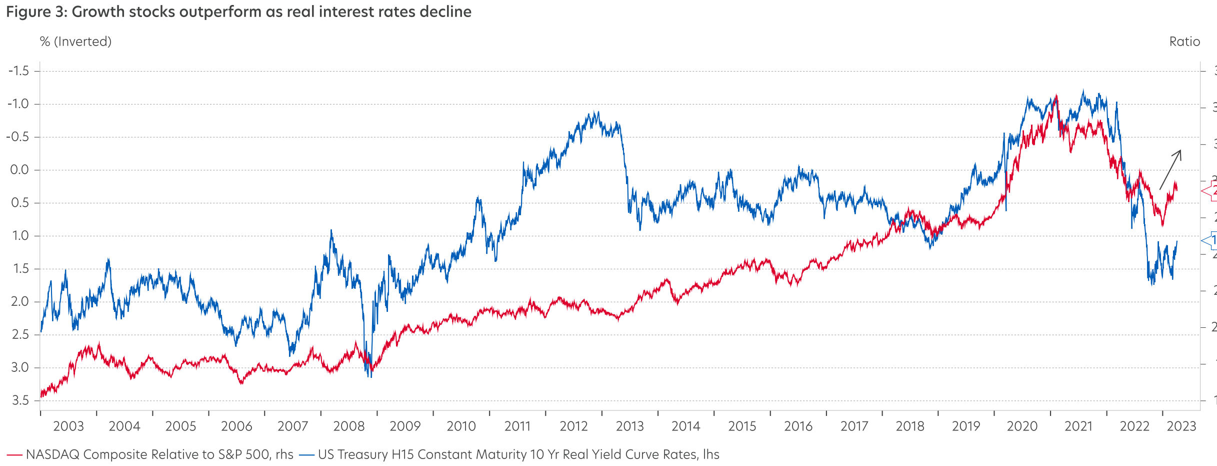
(1) Tighter Money Will Eventually Bite.

We will believe that a deeper slowdown is a matter of when, not if. The breakdown of SVB and the attending stress to the regional banks reinforce the notion that areas of weak links or excesses will eventually break. However, with backstop measures in place, this is unlikely to morph to a broader systemic banking crisis.

We continue to advocate a defensive posture in the US equities and have brought the allocation down slightly. Against a backdrop of rising interest rates, growth stocks are ahead of the market in the adjustment process; they could bottom out before the rest of the market (Fig. 3). Clients are also advised to focus more on high-quality bonds given the prospect of a broadening economic slowdown.

Figure 3 – Growth Stocks Outperform As Real Interest Rates Decline

Source: Macrobond, UOB Private Bank



(2) Within risky assets, there are still opportunities in sectors and geographies with divergent cyclical profile.

We continue to see growth stocks outperforming with large-cap growth as safe-havens during the earlier episode of banking stress. Since the start of the rate hike cycle in 2022 and over-investment from over-optimism of tech demand during the pandemic, the tech sector has undergone downward earnings revisions ahead of the broader market. Market devaluation and higher cost of capital also imposed cost discipline, as evidenced by news of large-scale layoffs by tech companies. Geographically, regions outside of the US appear to be lifting, with China exhibiting typical early-cycle recovery.

(3) Increase allocation to Alternatives which have higher potential for manager's alpha.

With the global economy facing significant uncertainty, investors should consider an allocation to alternative sources of returns. For this quarter, we are upgrading asset allocation to private markets. While private assets are subject to the same economic dynamics as public markets, the potential for manager's alpha is greater. These sources of returns are less correlated with public markets; they can provide enhanced portfolio resilience as we step into an uncertain environment. On commodities, Gold is likely to stay supported as real interest rates stabilize. Even though oil prices retreated on a weakening cyclical outlook, we continue to see the sector as under-supplied, and expect prices to stay firm amid OPEC+ proactive output management.

Asset Allocation Table

Asset Classes	Underweight	Neutral	Overweight
Equities	●	○	
United States		●	
Europe	●		
Japan			●
EM (Asia)			●
Fixed Income			●
DM IG			●
DM HY	●		
EM IG			●
EM HY		●	
Alternatives		○	●
Hedge Funds			●
Private Markets	○	●	
Crude Oil			●
Base Metals	●	○	
Precious Metals			●
Cash	●		

Equities

MSCI US (+7.3% year-to-date) has done relatively well, trailing just behind Europe (as of 31 Mar 2023). February saw some consolidation and profit-taking following a strong rally in January, while March was characterized by higher market volatility following a series of bank failures amid tightening liquidity.

We reiterate our focus on selected opportunities in defensive stocks as well as quality growth names. Investors will likely continue seeking shelter in recession-resilient companies, while quality growth stocks are expected to benefit from safe-haven demand. Notably, US Big Tech have re-rated meaningfully with capital markets front-running a Fed pivot. Looking ahead, investors can consider accumulating selected cyclicals (e.g., banks, retailers and semiconductors) for the next cycle. We recommend taking advantage of any volatility spikes via structured products. Overall, **we remain Neutral on US equities.**

MSCI Europe (+9.9% in USD terms) outperformed all its regional peers year-to-date (as of 31 Mar 2023). This can be primarily attributed to continued valuation re-rating amid light investor positioning from depressed levels seen in late-2022, and earnings resilience helped by falling natural gas prices. Recent declines in March were led by European financials in the wake of a complete Additional Tier-1 (AT1) write-down for a major Swiss bank, which is set for a government-engineer takeover by its rival. Having said that, markets have swiftly rebounded following a risk-off liquidation related to financial stress. We expect European equities to remain susceptible to the headline risks. **We remain Underweight on European equities.**

MSCI Asia ex-Japan (+4.1% in USD terms) saw a volatile start to the year, keying off MSCI China (+4.7% in USD terms) which saw a sharp rebound towards end of March (as of 31 Mar 2023). The drawdown in EM Asia/China equities since Feb 2023 can be viewed as a strong pullback following their dramatic surge through 4Q 2022 to Jan 2023. Importantly, recent news related to China's softening attitude towards private firms is a signal to investors that the tide has turned, as evidenced by a Chinese tech giant's overhaul. China's continued reopening and policy loosening is set to drive a strong rebound in its business cycle. Selected opportunities exist in China across sectors including Technology, Consumer Discretionary and Financials. We also like selected Singapore dividend plays. **We stay Overweight on EM Asia equities.**

Fixed Income

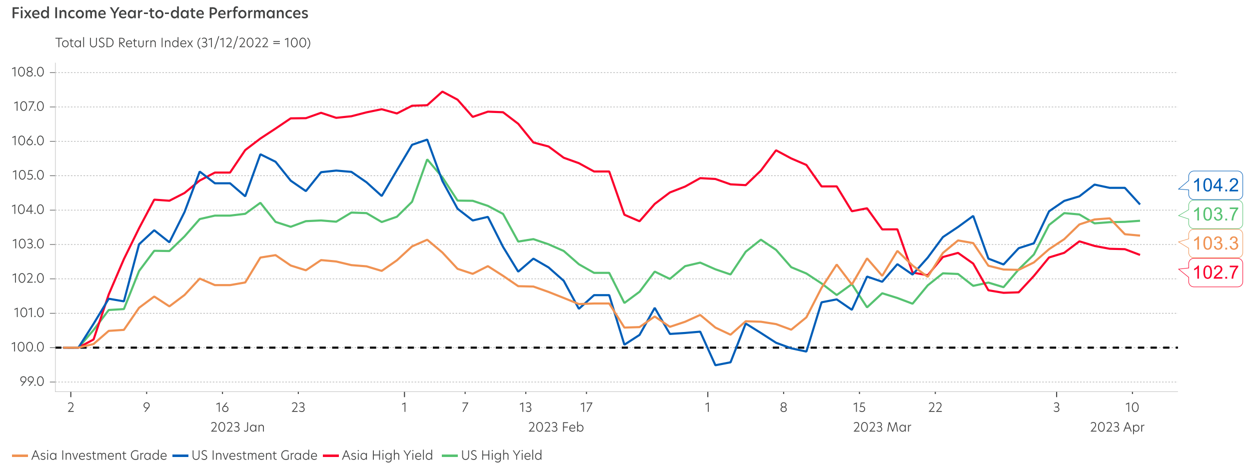
Developed Markets Investment Grade (DM IG):
Prefer quality credits, emphasize duration management

DM USD Investment Grade (IG) bonds saw +4.0% USD total returns year-to-date (as of 31 Mar 2023), outperforming all its peers. DM USD IG gains through the month of March came on the back of recent declines in US Treasury yields. We also saw a meaningful spread compression since mid-March amid the broad risk-on sentiment. Notably, Energy, Technology, Communications and Consumer Staples were the sectors leading the incremental spread tightening over the past few weeks. This trend could persist as investors flock to sectors with favourable developments and safe havens for recession resilience.

DM USD IG credits are backed by resilient fundamentals. The US tech giants still have strong balance sheets and robust operating cash flows despite macro headwinds. Going forward, we see potential near-term upside risks to Treasury yields following headline news on OPEC's surprise production cuts. This points to renewed inflationary pressures, especially given that China's continued reopening is set to drive oil demand higher. In addition, markets are already positioned for aggressive Fed rate cuts from 2H23. Against this backdrop, we emphasize duration management, while reiterating preference for quality DM IG credits amid a global growth slowdown. **We remain Overweight on DM IG.**

Fixed Income Year-To-Date Performances

Source: Macrobond, UOB Private Bank



Developed Markets High Yield (DM HY):
Remain cautious despite potential for further spread tightening

DM USD HY saw +3.6% USD total returns year-to-date (as of 31 Mar 2023), trailing just slightly behind DM USD IG. Previously, we advocated caution on DM USD HY which had a sizeable number of energy issuers; some of them have weak balance sheets as well as insufficient scale in oil production. This argument still holds. The credit spread tightening in late-March came on the back of risk-on sentiment and strong oil price recovery. Despite potential for further spread compression, we stay cautious given increasingly tight funding conditions in view of a potentially extended rate pause from the Fed and ECB, contrary to current market expectations. Given an anticipated rise in default rates, **we stay Underweight on DM HY.**

EM Asia USD Investment Grade (EM Asia IG):
Capture credit spreads in selected quality bonds

EM Asia IG saw +2.9% USD total returns year-to-date (as of 31 Mar 2023), outperforming its EM Asia HY peer. EM Asia IG credits have demonstrated great resilience against a challenging growth and rates backdrop. After a series of spread widening through most of March amid the broad risk-off sentiment, spreads have seemingly peaked in late-March. We reiterate our preference for credits in EM Asia IG space given better relative valuation and yield pick-up versus their DM IG peers. It is also worth noting that central banks in EM Asia generally do not raise interest rates as aggressively as their DM peers.

With the spread compression having taken some Asia IG bonds' cash prices above par, we recommend capturing alpha in credit spreads across selected Southeast-Asia champions, Asia quasi-sovereigns, strategic Chinese SOEs as well as China IT names. As with DM IG, we see potential near-term upside risks to long-term US Treasury yields following strong safe-haven bids. We continue to advocate duration risk management and a buy-on-dips stance to lock in higher yield carry. Overall, we emphasize a delicate balance between credit spreads capture and quality. **We stay Overweight on EM Asia IG**.

EM Asia USD High Yield (EM Asia HY):
Stay highly selective and diversified

EM Asia HY saw +2.6% USD total returns year-to-date (as of 31 Mar 2023), underperforming all its peers. For context, EM Asia HY's 1Q23 underperformance can primarily be attributed to a material pullback following its surge from Oct-2022. Looking ahead, further spread tightening will be contingent on China's growth recovery. Within China, we reiterate caution on property developers, especially given that much investor optimism has been priced in of late. While there have been green shoots in China's housing activity, selectivity in prioritizing issuer survivorship will be of utmost importance. Within this space, we prefer selected Indonesian property developers as well as Indian issuers in the commodities sector. Overall, we continue to advocate a diversified exposure. **We remain Neutral on EM Asia HY**.

FX, Interest Rate & Commodities Forecasts

FX	23 Mar	2Q23F	3Q23F	4Q23F	1Q24F
USD/JPY	130	128	125	122	120
EUR/USD	1.08	1.10	1.12	1.14	1.16
GBP/USD	1.23	1.25	1.28	1.30	1.32
AUD/USD	0.67	0.68	0.69	0.71	0.72
NZD/USD	0.62	0.64	0.65	0.66	0.67
DXY	102.64	100.9	99.0	97.4	95.9
USD/CNY	6.84	6.95	6.85	6.80	6.70
USD/HKD	7.85	7.82	7.80	7.80	7.80
USD/TWD	30.36	30.8	30.5	30.0	29.5
USD/KRW	1,290	1,350	1,300	1,280	1,260
USD/PHP	54.36	55.5	54.5	54.0	53.5
USD/MYR	4.43	4.48	4.45	4.35	4.30
USD/IDR	15,200	15,500	15,000	14,900	14,800
USD/THB	34.10	35.0	34.0	33.0	32.0
USD/VND	23,514	24,200	24,000	23,800	23,600
USD/INR	82.24	83.5	82.5	82.0	81.5
USD/SGD	1.33	1.34	1.32	1.30	1.28
EUR/SGD	1.44	1.47	1.48	1.48	1.48
GBP/SGD	1.63	1.68	1.69	1.69	1.69
AUD/SGD	0.89	0.91	0.91	0.92	0.92
SGD/MYR	3.33	3.34	3.37	3.35	3.36
SGD/CNY	5.15	5.19	5.19	5.23	5.23
JPY/SGDx100	1.02	1.05	1.06	1.07	1.07

POLICY RATES	05 Apr	2Q23F	3Q23F	4Q23F	1Q24F
US Fed Funds Rate	5.00	5.25	5.25	5.25	4.75
JPY Policy Rate	-0.10	-0.10	-0.10	-0.10	0.00
EUR Refinancing Rate	3.50	3.75	3.75	3.75	3.75
GBP Repo Rate	4.25	4.50	4.50	4.50	4.50
AUD Official Cash Rate*	3.60	3.60	3.60	3.60	3.60
NZD Official Cash Rate*	5.25	5.25	5.25	5.25	5.25
CNY 1Y Loan Prime Rate	3.65	3.65	3.65	3.65	3.65
HKD Base Rate	5.25	5.50	5.50	5.50	5.00
TWD Official Discount Rate	1.88	1.88	1.88	1.88	1.88
KRW Base Rate	3.50	3.50	3.50	3.50	3.50
PHP O/N Reverse Repo	6.25	6.75	6.75	6.75	6.25
MYR O/N Policy Rate	2.75	3.00	3.00	3.00	3.00
IDR 7D Reverse Repo	5.75	5.75	5.75	5.75	5.75
THB 1D Repo*	1.75	1.75	1.75	1.75	1.50
VND Refinancing Rate	5.50	5.00	5.00	5.00	5.00
INR Repo Rate*	6.50	6.50	6.50	6.50	6.50

INTEREST RATES	23 Mar	2Q23F	3Q23F	4Q23F	1Q24F
USD 3M SOFR (compounded)	4.46	4.80	5.05	5.05	4.83
SGD 3M SORA (compounded)	3.45	3.98	4.25	4.27	4.07
SGD 3M SIBOR	4.19	4.33	4.33	4.33	4.10
10Y US Treasuries Yield	3.39	4.30	3.95	3.60	3.40
SGD 10Y SGS	2.82	3.35	3.15	2.80	2.70

COMMODITIES	23 Mar	2Q23F	3Q23F	4Q23F	1Q24F
Gold (USD/oz)	1,992	2,000	2,000	2,100	2,100
Brent Crude Oil (USD/bbl)	76	80	80	90	90
Copper (USD/mt)	9,031	8,000	8,000	7,000	7,000

* Forecasts updated as of 06 Apr 2023
Source: UOB Global Economics & Markets Research

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