Investment Monthly

Starting the next phase of the recovery

June 2021

Key Takeaways

- The recovery remains on track and we believe the next phase will be driven by the services sector. This should be positive for equities over the coming 3-6 months.
- To invest into this next phase, we prefer consumer discretionary companies, particularly in the US, UK, Singapore and China.
- However, markets may experience volatility from concerns around inflation and Covid-19, meaning portfolio diversification is critical.

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Asset class	Short-term view (3-6 months)		Long-term view (>12 months)	
Global equities	▲	We are still pro-risk with a cyclical stance as economic recovery gathers momentum, while services rather than manufacturing PMIs will lead the second half of 2021.	▲	Long term global economic outlook is upbeat, with promising vaccine progress, a record strong corporate earnings season in recent times and ultra-accommodative central banks plus plenty of fiscal ammunition.
Government bonds	▼	We estimate a negative bond risk premium for major DM government bonds, for example, German bunds, Japanese Government Bonds and UK gilts hence we are underweight.	▼	Investors are being penalised for holding bonds rather than cash. Although bond prices are unlikely to be volatile and treasury yields have picked up, prospective returns are still low.
Investment grade corporate bonds	▲	Although yields are relatively low, on a volatile road to recovery we view global IG bonds, in particular Asian IG credit, a defensive way to diversify portfolios.	▼	Spreads have come down materially and are likely to remain tight due to a strong economic outlook and ongoing central bank purchases. Outlook for longer-duration IG bonds are poor.
High yield corporate bonds	▲	As interest rates remain at record low levels globally and investors prefer higher yielding instruments, we continue to like high yield credit but advocate being selective on issuers.	▶	We are neutral as there are uncertainties on default outlook and market pricing has compressed spreads recently. We continue to prefer Asia credits to DM although the Fed and ECB are very accommodative.
Gold	▶	Although gold prices regained strength lately it has limited upside in a 'risk-on' environment where global recovery gathers momentum and bond yields are moving higher.	▶	Gold is an effective traditional inflation hedge but currently sees limited diversification benefits in a multi-asset context as economies recover and bond yields rise.

Note: Short-term view (3-6 months): a relatively short-term tactical view on asset classes. Long-term view (> 12 months): a relatively long-term strategic view on asset classes.
▲ "Overweight" implies a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▼ "Underweight" implies a negative tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▶ "Neutral" implies neither a particularly negative nor a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
Icons: ↑ View on this asset class has been upgraded; ↓ View on this asset class has been downgraded.

Talking points

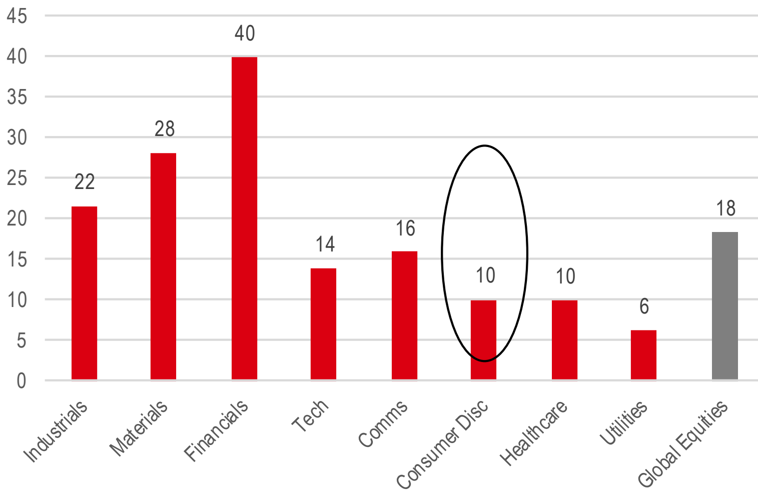
Each month, we discuss 3 key issues facing investors

1. What will drive the next phase of the recovery?

- **We remain cyclical but selective** as vaccination progress takes shape in most parts of the world. The re-opening process lifts confidence in the services sector, best explored through **consumer discretionary stocks**, which have underperformed. Financial stocks are another cyclical sector to play into the recovery and also act as an inflation hedge.
- **Technology and growth stocks** may underperform with bond yields now higher. Hence, we have turned slightly more cautious. However, there is a strong case for maintaining a structural position for the long term.
- We are focused on **US, UK and Asian equities,** which are markets that have arguably navigated the pandemic better than others, and are better positioned to return to normality.

Chart 1: Global Consumer Discretionary Sector has lagged

% Performance since Covid-19 Vaccine Announcement on 8 Nov 2020

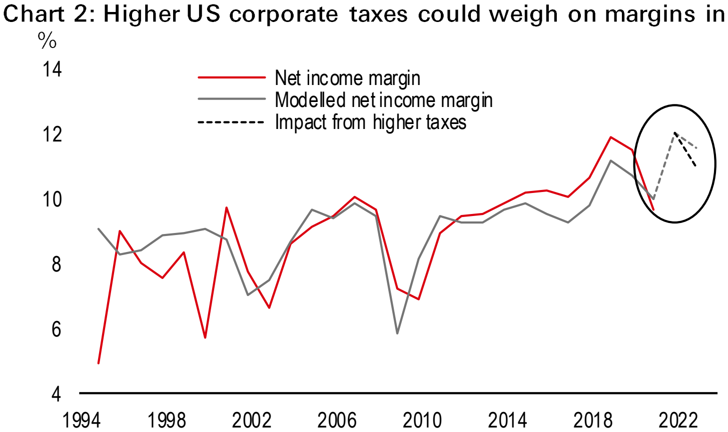


Source: Refinitiv Datastream, data as of 24 May 2021. commencing 8 Nov 2020. Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

2. What is the impact of higher taxes in the US?

- **The USD1.9trn American Rescue Plan and USD2trn American Jobs Plan** stipulate infrastructure spend over 8 years, 50% of which will be financed by higher corporate and capital gains taxes.
- **Higher equities volatility and a negative earnings impact on the S&P500 for 2022 is possible.** This is because higher taxes may deter spending.
- **We believe the annual impact is manageable** as this will be absorbed over 8 years.

Chart 2: Higher US corporate taxes could weigh on margins in 2022



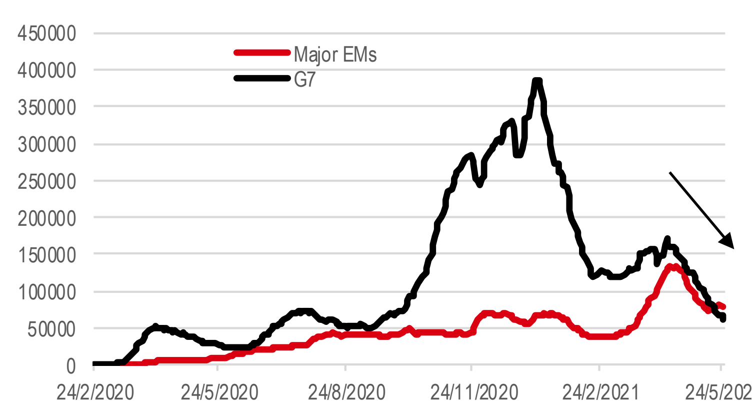
Source: Bloomberg, Federal Reserve, data as of 20 May 2021. Forecasts are subject to change. Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

3. Should investors be concerned about new waves of Covid-19?

- **New waves of Covid-19 have arisen in some markets,** raising concerns around the recovery.
- **India, Taiwan and Singapore are examples of markets seeing new waves of the virus.** Taiwan's stock market, which has been a strong performer since the start of the year is down about 5% over the past month. Singapore is also down about 2% over the same period.
- **Our base case is still for the recovery to gather pace, with the next phase driven by the services sector.** However, the pandemic is not over and investors need to be **appropriately diversified** to guard against surprises.

Chart 3: New Covid-19 cases are trending downwards

Number of new cases (seven-day moving averages)



Source: Refinitiv Datastream, data as of 24 May 2021. Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

House views

Our latest short-term (3-6 months) and long-term (>12 months) views on various asset classes

Asset class	Short-term view	Long-term view	Comment
Global equities			
Global	▲	▲	Our risk-on approach and cyclical stance benefit from the outperformance of global equities. The recent earnings season has been one of the strongest in history and the global economy generally surprised positively. Cyclical and value stocks can outperform, even if bond yields were to increase if volatility spikes.
United States	▲	▶	In the short run we remain on the back of strong vaccine progress, solid corporate earnings and ample fiscal stimulus. In the long run we are more cautious as US inflation could lead to the earlier tapering of bond purchases and a hawkish Fed that could push US bond yields higher.
United Kingdom	▲	▲	Retail sales jumped 9.2% year-on-year in April on the back of successful vaccination roll-out and strong re-opening progress. Stronger-than-expected Q2 economic momentum has led us to upgrade our 2021 UK GDP growth forecast to 6.8% from 5.8%.
Eurozone	▶	▲	Eurozone PMIs hit 39-month high and it benefits from a dovish ECB and exposure to cyclical and value stocks.
Japan	▶	▶	GDP contracted sequentially again, Covid cases are not contained, vaccination is slow, BoJ has little policy room.
Emerging Markets (EM)	▶	▲	Still underperforming DMs, the key risks are slower vaccine and higher US bond yields causing capital outflows. ASEAN EMs is preferred to LatAm due to a higher growth trajectory and lower policy risks.
Central & Eastern Europe, Latin America	▼	▶	Macro challenges remain with constrained policy and low virus containment. Higher commodity prices can be beneficial but new virus variants, lagging vaccine progress and political uncertainty are major headwinds.
Asian equities			
Asian ex-Japan	▲	▲	Asia is seeing an uneven path of recovery as India and parts of ASEAN struggle to contain the virus while North Asia benefits from the tech and manufacturing trade. Near-term challenges may be brought on by a stronger USD and higher US yields but we still have a preference for China and Singapore on the back of robust growth.
China	▲	▲	China's focus on quality growth, domestic consumption and technological upgrade under their dual circulation strategy provides a platform for short and long-term structural opportunities. Anti-trust measures on the broader tech sector and policy normalisation could pose as headwinds.
India	▶	▶	Economic challenges presented by high Covid cases, inflation pressures, renewed lockdowns and high valuations.
Hong Kong	▶	▲	Hong Kong equities are one of the outperformers in Asia as it provides access as a listing hub for primary and secondary deals, while its cyclical and financial sectors exposures benefit from the current 'risk-on' sentiment.
Singapore	▲	▲	Higher domestic growth, potential travel bubbles and a global rotation into cyclical sectors benefit Singapore.
South Korea	▶	▶	Korea stands to benefit from the electrical vehicles and semiconductor but impaired by slow vaccine.
Taiwan	▶	▶	The tech plays still benefit from margin uplift and strong digital demand but we are neutral on its high valuation.
Government bonds			
Developed markets (DM)	▼	▼	Despite recent pick-up in US Treasury yields, we do not have a positive view on this asset class as negative bond yields remain an unattractive feature for major government bonds including Japan, German and UK instruments.
United States	▶	▼	The US government's historically large-scale fiscal stimulus along with dovish monetary policy could result in inflation upside surprise which may drive up US yields again, resulting in the loss of capital.
United Kingdom	▶↓	▼	The successful reopening of the UK economy resulted in robust retail sales (+9.2% YoY) and strong inflation (+1.5% in April). With a hawkish BoE, yields of gilts are likely to rise (between 0.4-0.9%), hence we downgraded.
Eurozone	▼	▼	New levels of debt issuance and unattractive valuations warrant an underweight in the short and long run.
Japan	▼	▼	Overvalued with a negative bond risk premium, Japanese government bonds are unattractive.
Emerging Markets (Local currency)	▲	▲	We still believe EM currencies are undervalued. Real rates are higher and potential returns look attractive. Being selective in a low yield world is more important than ever.
Emerging Markets (Hard currency)	▲	▼	The USD may maintain its status quo in the near term. The higher return profile of Emerging Markets (USD) credit should be supported by the search for carry and yield. We are positive in the short term but not in the long term.
Corporate bonds			
Global investment grade (IG)	▲	▼	Spreads are likely to remain tight as central banks' bond buyback programs continue. We have a preference for Asia IG and short-dated IG bond, which are more attractively priced.
USD investment grade (IG)	▲	▼	Longer-duration USD IG bond valuations are unattractive despite strong US corporate fundamentals.
EUR and GBP investment grade (IG)	▶	▼	Europe and UK economies are recovering after lagging US and China, but spreads and returns are unattractive. Meanwhile we keep a close watch on corporate fundamentals.
Asia investment grade (IG)	▲	▲	Asian IGs may outperform due to a positive outlook on corporates and economies. A weak or directionless USD is positive for Asian corporates with USD-denominated debt, while a valuation gap still exists between Asia and DM.
Global high-yield (HY)	▲	▶	Accelerating economic recovery, improving corporate fundamentals and higher yields form the base case for our overweight on high yield credit in all the regions.
US high-yield (HY)	▲	▶	There are limited default risks as the US economy is expected to outperform a number of DM counterparts. The Fed is supportive and there are more upgrades to come.
European high-yield ex UK (HY)	▲	▶	The EU has lagged the US and the UK on vaccination programs but is quickly catching up. Monetary policy is ultra-accommodative and we are relatively upbeat on this asset class.
Asia high-yield (HY)	▲	▲	Spreads look attractive and default rates should remain low relative to global peers. Asian HY can benefit from robust macro trends. We keep a close watch on the Chinese Government's deleveraging efforts on HY bonds.
Commodities			
Gold	▶	▶	Although gold prices regained strength lately it has limited upside in a 'risk-on' environment where global recovery gathers momentum and bond yields are moving higher.
Oil	▶	▶	Oil demand remains soft until travel resumes but OPEC+'s supply discipline, plus Iran sanctions, is positive for oil.

Sector Views

Global and regional sector views based on a 3-6 month horizon

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▲	▲	As economic re-opening continues, consumer spending accelerates on the back of record high savings, lower debt levels and robust demand. We remain overweight as further upside is likely in the auto and luxury segments. Although we are not fully 'risk-on' in the leisure and travel segments, the developed market hospitality industry is likely to rebound steadily in 2H.
Financials	▲	▲	▲	▶	Improved economic outlook with the stimulus packages in the US and Europe should offset the impact of lower interest rates and potentially high taxes in the US. Low valuations, high trading revenues and M&A activity provide further support. Companies earnings were upbeat on higher trading volumes and lower loan provisions in the US.
Industrials	▲	▶↓	▲	▲	While we are positive in other regions we downgraded US industrials due to limited further upside and high valuations. The sector is up 30% YTD as companies need to rebuild inventories and demand picks up in infrastructure projects. Capex expectations continue to improve, and investment is picking up in particular automation. 2021 forecasts are upgraded.
Information Technology	▲	▲	▶↓	▲	Digitalisation trends support the tech story and long-term fundamentals remain structurally sound. Semiconductors supply causes short-term challenges but should drive long-overdue supply chain reassessment. We reduced our weighting in some regions due to the valuation premium.
Communication Services	▲	▲	▶	▲	The sector benefits from steady cash flows and growth from increased data usage as more activity shifted online and business digitalised. Media companies continue to benefit from pent-up consumer demand. The 5G roll-out is positive for telecom equipment provider but slightly negative initially for service providers.
Materials	▲	▶↓	▲	▲	We reduced our US material sector exposure to take profit as prices may have peaked in the near term. An upbeat global recovery and supply chain disruptions have driven commodity prices to record levels. Sector support comes from Infrastructure-focused fiscal stimulus plans (big consumer of base metals) and increased activity in China (consumes most of the world's commodities).
Real Estate	▶	▶	▶↑	▲	We upgraded European real estate as faster vaccine progress improves sentiment. Private residential is supported by high savings and low interest rates, while commercial real estate suffers low demand. The high dividend yield provides attraction in a low yield environment.
Consumer Staples	▼	▼	▼	▼	Consumer staples is a defensive sector that underperforms in a 'risk-on' environment. Further, a tougher year-on-year comparison after 2020's panic buying and accumulation of consumer essentials warrants an underweight position in our view.
Energy	▶	▶	▶	▶	Supply control is beneficial to energy prices. A nuclear weapons deal with Iran, a major oil producer, could put pressure on oil prices. We expect geo-politics continue to affect the volatility of energy prices in the foreseeable future.
Healthcare	▶	▶	▶	▶	After the ongoing roll-out of mass vaccination programs, tougher regulations may resurface in relation to drug pricing brought on by the Biden administration. Healthcare spending should remain a priority for households and governments as large backlogs in elective surgical procedures should drive strong growth in 2021.
Utilities	▼	▼	▼↓	▼	We downgraded European utilities as the growth potential of renewable energy investments are now fully priced in by the markets. Despite relatively attractive valuations, the global sector is likely to underperform as we continue to pivot deeper into the cyclical recovery.

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