

# Investment Monthly

## Keep your portfolios resilient

October 2021



### Key Takeaways

- ◆ The Fed kept policy rates unchanged at its September meeting, but opened the door to tapering which could start as early as November.
- ◆ We do not view the debt crisis in China's property sector as a systemic event. An orderly restructuring is more likely but markets may remain volatile short-term.
- ◆ We still like global equities, particularly US, UK, European and Asian equities. Large cap, high-quality, dividend-paying companies are our picks within this.



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Asset class	Short-term view (3-6 months)	Long-term view (>12 months)
Global equities	▲ Although the Delta Variant remains a risk, accommodative policies, a moderating inflation outlook and low rates should continue to support global equities.	▲ As we move into a slower mid-cycle growth phase, we prefer quality, large-cap, and income stocks with robust balance sheets and the ability to generate strong cash flows and pay-out dividends.
Government bonds	▼ Despite the US 10-year Treasury yield rising to the highest level since June 2021, developed markets government bond yields are unappealingly low, warranting an underweight view.	▼ Government bonds are not attractive due to low yields and low expected returns, although they still play a role as diversifiers within portfolios.
Investment grade (IG) corporate bonds	▶ We are neutral IG as yields remain unattractive and they have underperformed other credit instruments this year.	▼ Prospective returns are unattractive and spreads are at historically tight levels, especially for longer-duration credit.
High yield (HY) corporate bonds	▲ We remain selectively optimistic on Asian credit and China HY bonds despite heightened volatility in the Chinese property sector which is not viewed as a systemic crisis.	▼ High Yield bond valuations are amongst the highest in the credit universe and spreads are tightening. Asia bonds still present the most attractive opportunities.
Gold	▶ Gold prices are down almost 8% year-to-date on the back of higher risk-on sentiment. Real interest rates remain low, which is negatively correlated to gold price.	▶ There are a lack of catalysts to support gold prices and we believe the highest level of risks and volatility are largely behind us.

**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 does the latest FOMC meeting mean?

- ◆ **The Fed kept its policy rates unchanged** at its September FOMC meeting as expected. As we are still in the mid-cycle stage, policy normalisation will be gradual and this should support risky assets. We do not expect US policy rates to hike next year (our forecast is June 2023) but tapering could start in November.
- ◆ **Fed's well-managed communications**, along with above-trend growth (5.9% for 2021), **falling inflation** (projected to halve to 2.2% in 2022) and **a low interest rate environment** (0-0.25%) are positive for corporates to achieve healthy margins and earnings growth.
- ◆ We remain **overweight global and US equities with a pro-cyclical bias**. Consumer-related equities and interest rate sensitive sectors are more likely to outperform.

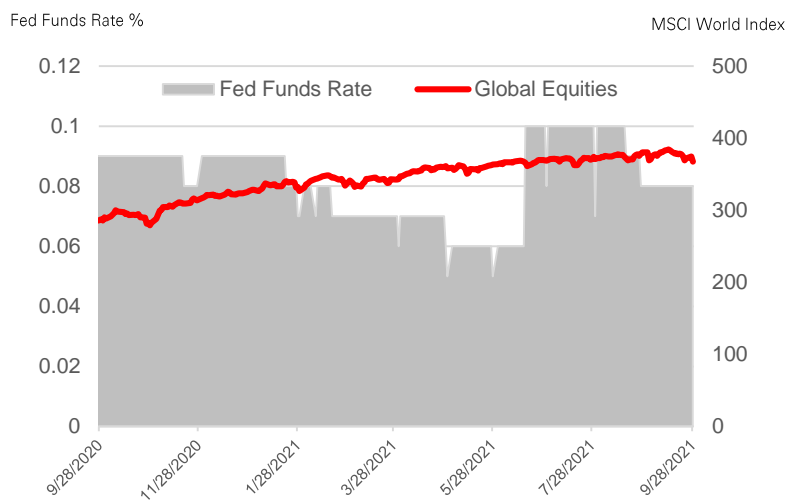
## 2. How to address recent market volatility?

- ◆ In addition to **uncertainties around Fed policy** and **Delta variant**, market concerns over the default risk of the **China's property sector** and its contagion effects have dominated the recent headlines, and weighed on global sentiment.
- ◆ Regarding concerns over the Chinese property sector, we expect to see **an orderly restructuring rather than a systemic crisis in China**. However, markets may remain volatile while events pan out. We are positive on Asian equities as a whole.
- ◆ Investors should not panic-sell but focus on portfolio resilience. This can be achieved through diversifying into **quality and large-cap equities (e.g. US, UK, Asian and European)**, and **selective high-quality bonds**.

## 3. What is the outlook for Europe?

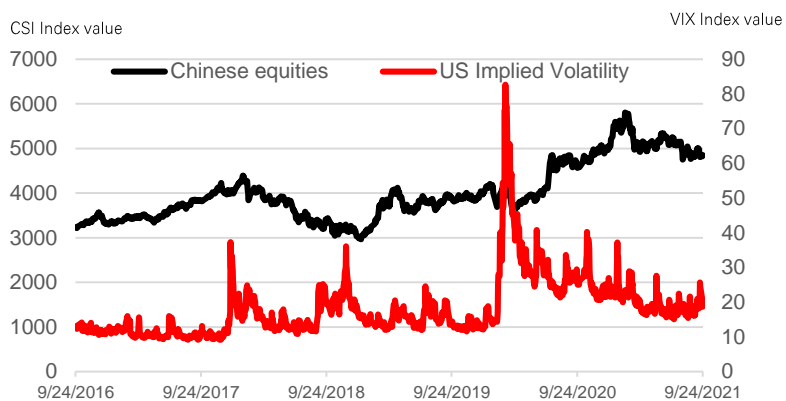
- ◆ European equities have performed well over the past few months. A number of catalysts have warranted our overweight position. First, the **relatively more dovish positioning of the European Central Bank (ECB)** is positive for businesses and asset prices. The ECB's commitment to stimulate the recovery and continue the bond purchases should support earnings.
- ◆ Second, there are long-term opportunities **from the EU's focus on green infrastructure**. We've upgraded the **region's utilities sector to Neutral** to capture the opportunities in renewable utilities. The upcoming Climate week and COP 26 will further boost the green theme.
- ◆ Finally, the **German Election result means a coalition government will be formed**, most likely involving the Social Democratic Party (SPD) and Green Party. Should this happen, we think this could lead to deeper Eurozone integration and a less conservative stance on fiscal spending. These should support European equities.

**Chart 1: The Fed's historic low rates support global equities rally**  
"Dot plot" projects first rate hike in 2022, while the Fed signals 2 hikes in 2023



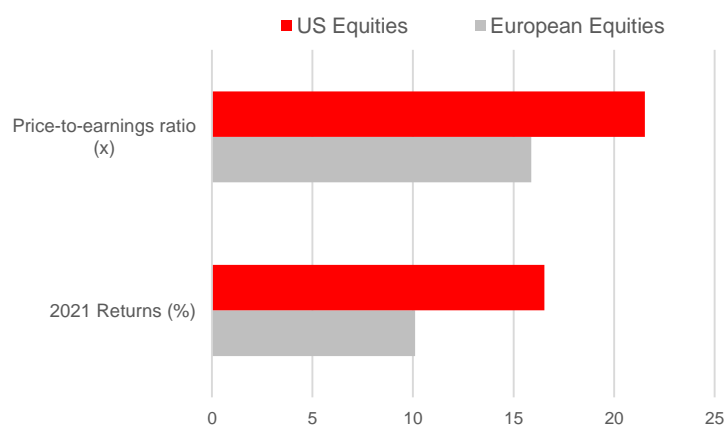
Source: Bloomberg, The Federal Reserve, data as of 29 September 2021.  
Indices: MSCI AC World Index (USD) and the Fed Funds Rate target.  
Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

**Chart 2: Volatility spiked temporarily amid Chinese property sector concerns**



Source: Refinitiv Datastream, Bloomberg, Data as of 29 September 2021.  
Indices: CSI300 in CNY for Chinese equities and VIX Index for US Implied Volatility, respectively.  
Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

**Chart 3: European equities have lagged the US and are trading on relatively attractive valuations**



Source: Refinitiv Datastream, Bloomberg, data as of 29 September 2021.  
Indices: S&P500 and EuroStoxx50 for US and European equities, respectively. 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
<b>Global equities</b>			
Global	▲	▲	Despite headwinds such as Covid variants, slowing earnings growth and regulatory risks, we remain risk-on thanks to accommodating policies, low interest rates and economic recovery. Market fundamentals continue to improve.
United States	▲	▶	While September has historically been a volatile month, more than half of the average annual return has been derived in Q4 over the past 25 years. We expect cash-rich companies to increase dividends, share buybacks and investment spending. Risks include slower growth, inflation concerns and higher corporate taxes.
United Kingdom	▲	▲	Economic activity slowed during the summer with high energy prices, labour shortages and a rise in taxes leading to higher-than-expected inflation but we still like the domestic economic story, attractive valuation and yield.
Eurozone	▲	▲	ECB is relatively more dovish than the Fed which should result in a weak EUR and is positive for European exporters.
Japan	▶	▲	Japan is accelerating its domestic vaccination while its manufacturing sector can benefit from global capex spending. We are positive on its long-term prospects in light of a new Prime Minister and LDP leadership with a sizable stimulus. We also like its leverage to the digital economy, technology leadership and quality factor.
Emerging Markets (EM)	▶	▶	EM performance is likely suppressed by policy constraints, with some central banks already tightening amid inflation and currency pressures, a strong US Dollar (+5% year-to-date as at 29 September) and Covid-related challenges.
Central & Eastern Europe, Latin America	▼	▶	EMs outside of Asia also face headwinds including political uncertainty, high number of Covid cases, low vaccination rates, high energy prices, and slow recovery in countries that rely on the tourism trade.
<b>Asian equities</b>			
Asian ex-Japan	▲	▶	Asian equity markets have shown mixed performance due to regulatory and credit risks in China. Rising Covid cases have led to disruptions in logistics networks. We remain positive on Asia's growth prospects and manufacturing.
China	▶	▶	Credit risks of the property sector have caused volatility and contagion fears to other sectors, but we do not view it as a systemic crisis. Although we have taken a neutral position because of ongoing regulatory risks, we think that Chinese equities should have a place in portfolios as a structural long-term investment.
India	▶	▶	The second wave of infections has receded and vaccination programme is picking up. Strong export demand and government capex are key drivers of growth. A new third wave and higher oil prices could slow recovery.
Hong Kong	▶	▲	Growth momentum will continue in Q4 with a revival in household consumption backed by the government's consumption vouchers and an improved labour market. The border restrictions will weigh on services trade though.
Singapore	▲	▲	Singapore equities continue to benefit from global recovery and improved Covid situation locally.
South Korea	▶	▶	Exports will face headwinds as global demand shifting to services with high inoculation rates. Weak private sector employment is not supportive of consumer spending.
Taiwan	▲	▶	Taiwan benefits from structural demand in 5G and semiconductors, with significant exposure to growth and tech sectors which are sensitive to US yields.
<b>Government bonds</b>			
Developed markets (DM)	▼	▼	Given unattractive yields and high valuations we remain underweight on developed markets government bonds.
United States	▶	▼	Risks to US Treasury yields are tilted to the upside amid robust global growth expansion, Fed policy normalisation and inflation uncertainties. We remain underweight in the long run.
United Kingdom	▶	▼	The BoE is not lifting rates in its recent monetary policy meeting but gilt yields are unattractive in the long term.
Eurozone	▼	▼	Prospective returns are negative and diversification benefits are limited but the ECB's bond-buying supports prices.
Japan	▼	▼	We continue to underweight Japanese government bonds due to unattractive yields and high valuation.
Emerging Markets (Local currency)	▲	▲	We have been overweight EM debt for some time due to more attractive bond yields and undervalued EM currencies. Overall, we think EM fixed income valuations are more attractive than EM equities.
Emerging Markets (Hard currency)	▲	▼	Bond yields are at historical lows. Diverging economic impacts from the spread of Covid along with different political regimes in the EM universe also mean that being selective is key.
<b>Corporate bonds</b>			
Global investment grade (IG)	▶	▼	Spreads are likely to remain tight on the back of accommodative monetary policy and the prospect of a strong economic growth recovery in 2021. We are more positive on shorter-duration bonds and Asia IG.
USD investment grade (IG)	▶	▼	Corporate fundamentals are sound, but valuations are unattractive in particular for longer-duration bonds.
EUR and GBP investment grade (IG)	▶	▼	The ECB is still engaged in substantial corporate bond purchases and European economies have scope for a strong cyclical rebound in 2021 given their underperformance last year and ongoing vaccine rollout.
Asia investment grade (IG)	▲	▲	Asian credit remains attractive on higher yields and strong fundamentals. Nonetheless, low spreads and some uncertainties on the default outlook mean that risks of capital losses in the short term remain.
Global high-yield (HY)	▲	▼	Positive in the short term on improved macro environment and earnings. Longer-term, we are more cautious because of tight credit spreads. Focus is on companies with stronger balance sheets and credit fundamentals like declining leverage. One risk is the uncertainty on the default outlook of USD HY bonds by China property developers.
US high-yield (HY)	▲	▼	US HY bonds should benefit short-term from the economic rebound, complemented by strong oil prices. Longer-term investors may wish to be more cautious about tight spreads and high valuations.
European high-yield ex UK (HY)	▲	▼	European monetary policy is ultra-accommodative, including ECB measures to support the market, which is positive short-term. The EU's vaccine rollout is accelerating, while HY default rates are on a downward trend thanks to better earnings outlook.
Asia high-yield (HY)	▲	▲	We remain selectively optimistic on Asia and Chinese credit and view the recent tightening measures on China's specific sectors such as tech, real estate and gaming as a positive move to improve market discipline in the long run.
<b>Commodities</b>			
Gold	▶	▶	Expectations of monetary tightening and the mild USD strength support our neutral view.
Oil	▶	▶	Brent oil prices almost touched US\$80/bbl on harsh weather conditions which disrupt global supply.

# Sector Views

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

Sector	Global	US	Europe	Asia	Comment
<b>Consumer Discretionary</b>	▲	▲	▲	▲	Seasonal demand and supply chain constraint should provide a strong pricing environment for the sector. Consumer sentiment is buoyed by rising wages, improved employment prospects, high levels of savings and lower debt levels, which support further upward earnings. Domestic travel and hospitality is picking up strongly in a number of countries.
<b>Financials</b>	▲	▲	▲	▶	The improving economic outlook with the stimulus packages in the US and Europe should support the sector to offset low interest rates and the potential for higher taxes in the US. Low valuations, higher trading revenues and M&A activity provide further support.
<b>Industrials</b>	▶	▶	▲	▶	The sector is appropriately valued for the anticipated economic recovery in the near term. Company specific risks associated with labour shortage, input cost inflation and supply chain issues may weigh on earnings. However rebuilding inventories from historically low levels should maintain demand and provide upside potential.
<b>Information Technology</b>	▲	▲	▶	▲	Long-term trends in digitalisation and new technologies should drive long-term above average growth. Semiconductors under supply causes short-term challenges while infrastructure spending should benefit digital infrastructure. The potential impact of regulatory actions continues to weigh on the sector but the focus has shifted from the US to Asian companies.
<b>Communication Services</b>	▲	▲	▶	▲	The sector benefits from steady cash flows and growth from increased data usage as more activities shifted on-line and business digitalised. Media companies are likely to see continued demand. The 5G roll-out is positive for telecom equipment provider but neutral/negative initially for service providers.
<b>Materials</b>	▶	▶	▶↓	▶	The economic outlook is constructive but this is somewhat reflected in valuations, so supports our downgrade in Europe. Metal prices have lost momentum in the short term as the Chinese authorities try to cool commodities prices. Infrastructure spending related to fiscal stimulus plans in Europe, Asia and the US will support demand in the medium term.
<b>Real Estate</b>	▶↓	▶↓	▶	▶↓	The demand for private residential real estate is supported by high savings and lower interest rates, but we've downgraded US and Asia real estate to neutral following a strong performance. Commercial real estate is suffering low demand as corporates look to reduce office space and retail moves online. The high dividend yield provides attraction in a low yield environment.
<b>Consumer Staples</b>	▼	▼	▼	▼	Valuations appear attractive relative to the cyclical sectors but staples tend to underperform in the current mildly risk-on environment. Slower growth is expected in 2021 on tougher comparison as 2020 benefited from pandemic fears that drove panic buying and stock piling of consumer essentials. Input cost rising and labour shortage may hurt margins in some industries.
<b>Energy</b>	▶	▶	▶	▶	Supply-demand imbalances continue to support prices with demand rebounding quickly to close to pre-pandemic levels as economies re-open. We expect to see volatility in energy prices and stocks on adverse weather conditions, ongoing geopolitics and OPEC+ supply discussions.
<b>Healthcare</b>	▶	▶	▶	▶	Healthcare spending should remain a priority with large backlogs in elective surgical procedures driving strong growth in 2021. Medical technology and biotechnology companies are likely to benefit. However, the sector is subject to regulatory and reforms risks such as pricing pressure in the US when Covid is contained.
<b>Utilities</b>	▼	▼	▶↑	▼	Valuations have eased to more reasonable levels after H1 rally, particularly in Europe where we upgraded the sector. Caution is still required as companies may not be able to pass on rising energy prices which may impact margins negatively.

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