UOB HOUSE VIEW

4Q2022

GLOBAL MACRO

Expectations of moderating growth has now morphed into a more ominous global outlook. The main driving force for the pessimistic change is the aggressive pace of monetary policy tightening led by the US Federal Reserve to tame an inflation trajectory that is at multi-decade highs in developed economies. Global central banks have made it clear that their priority is taming inflation and they are willing to risk a recession to do so.

ASSET ALLOCATION

We have decided to tactically maintain the neutral allocation to equities as elevated fears of an aggressive Fed have led to sharp declines in asset prices. Whilst recent data suggest that inflation may be stickier than expected, we believe that inflation may have peaked and will begin the process of moderating.

EQUITIES

With expectations of grim growth prospects for developed markets in the year ahead, equities look very likely to continue facing headwinds in the near term. Global equities have been de-rated aggressively this year and further de-rating is still possible, the only question in investors' minds is – how much more? We note that across stock cycles, forward P/E ratios and equity prices usually bottom before forward earnings.

FIXED INCOME

The risk-reward is most attractive at the short to intermediate maturities given the repricing on the front-end rates amid the Fed's policy tightening. Longer dated investment-grade credits could be attractive as long-end rates price in weakening economic conditions. The credit allocation should continue to favour investment grade over high yield given rising risk of a recession in the coming year.

COMMODITIES

Given the sharp pullback in crude oil and gold across 3Q22, have prices corrected too much? We stay positive on gold, but lower the point forecasts to USD 1,700 / oz for 4Q22, USD 1,800/ oz for 1Q23 and USD 1,900 / oz for 2Q23 and 3Q23. We also revised our crude Brent point forecasts to USD 90 / bbl for 4Q22 and 1Q23, followed by USD 100 / bbl for 2Q23 and 3Q23.

FX & INTEREST RATES

With the Federal Funds Target Rate (FFTR) estimated to reach its terminal level of 4.75% in the upper bound by 1Q23, this would portend that a peak in the DXY will likely be around that time frame too but that the path to a DXY's eventual peak is fraught with uncertainties. On the back of our higher Fed Funds Target Rate (FFTR) forecast update, we expect yield top for longer maturities might come in early 2023. Until then, upside spikes are still possible, but the pace of gains in yield should slow going forward.

GLOBAL MACRO & MARKETS STRATEGY

Global Outlook Darkens
"*We have got to get inflation behind us. I wish there were a painless way to do that…There isn't.*" – Fed Chair Jerome Powell (Post-FOMC press conference on 21 Jun 2022).

Expectations of moderating growth has now morphed into a more ominous global outlook. The main driving force for the pessimistic change is the aggressive pace of monetary policy tightening led by the US Federal Reserve to tame an inflation trajectory that is at multi-decade highs in developed economies. Global central banks have made it clear that their priority is taming inflation and they are willing to risk a recession to do so.

In Europe, the situation feels even more dire as sky-high inflation is coupled with a potential winter energy crisis, As for the UK, it may already be in a recession in 3Q (2022) but its latest risky fiscal gamble already imposed a very heavy punishment via a plunging GBP and surging Gilt yields. As for China, its problems are already well-telegraphed, with a potential silver lining of a potential surge in pent-up demand if and when the authorities relax the zero-COVID policy. Overall, we are now forecasting a recession for UK and Eurozone in 2023 amidst a softer contraction for the US economy.

With the **Federal Funds Target Rate (FFTR) estimated to reach its terminal level of 4.75% in the upper bound by 1Q23,** this would portend that a peak in the DXY will likely be around that time frame too but be warned that the path to a DXY's eventual peak is fraught with uncertainties if the string of recent policy surprises is any indication. Needless to say, both EUR an GBP will weaken further before they recover. In the meantime, Asia FX will likely stay weaker for longer as the CNY softens further.

As for our rates outlook, overall, we expect yield top for longer maturities might come in early 2023. Until then, upside spikes are still possible, but the pace of gains in yields should slow going forward. Finally, in the commodities space, given the sharp pullback in crude oil and gold across 3Q22, have prices corrected too much?

MAS Monetary Policy Preview – Expecting A Steeper Slope In Oct With A Chance Of Re-Centring: Our core view has not changed. We anticipate the Monetary Authority of Singapore (MAS) to tighten monetary policy further in the upcoming Oct meeting (which we estimate to be between 10 and 14 Oct), via steepening of the S$NEER (the Singapore dollar Nominal Effective Exchange Rate) gradient. We estimate the current slope of the S$NEER to be 1.5% appreciation per annum and our expectation is for the slope to be raised to 2% in Oct.

There is a risk of another double-tightening via an added re-centring of the policy mid-point as the S$NEER is already trading at 1.8% (near the projected top end of the band as of 27 Sep) and an even steeper slope (say, 2.5%) also cannot be ruled out, especially as core inflation has accelerated above 5% in Aug.

Our expectation for the Oct announcement is premised on inflation remaining elevated beyond 3Q 2022, likely into early 2023 even as our GDP growth projection has turned significantly weaker next year. Singapore inflation has continued to trend higher, with the increase in core inflation and upward pressures on services inflation particularly concerning. The changing MAS expectations on core inflation developments further affirm our view that core inflation may stay elevated for longer. We maintain our forecasts for headline inflation to average 6.0% and core inflation to average 4.2% in 2022. Importantly, while our headline forecast is at the top end of the official forecast range (5.0-6.0%), our core inflation forecast exceeds the official estimates (3.0-4.0%). We believe that official forecasts will soon be revised higher by the authorities.

FX STRATEGY – USD Strength Intensifies With Peak Unlikely This Year: Underpinned by aggressive Fed rate hike expectations, the US Dollar Index (DXY) rose for a fifth straight quarter in 3Q22 and touched the highest levels in over two decades. As to when the DXY will peak, it's important to note that Fed rate hike expectations have been a key driver for the DXY in this cycle. With the Federal Funds Target Rate (FFTR) estimated to reach its terminal level of 4.75% in the upper bound by 1Q23, this would portend that a peak in the DXY will likely be around that time frame too. That said, the path to a DXY's eventual peak is fraught with uncertainties if the string of recent policy surprises is any indication.

Major FX Outlook: Likely To Get Worse for EUR and GBP. At the moment of writing, GBP crashed to the lowest historic level and threatens parity to the USD, after the UK government announced sweeping tax cuts in its "mini budget" that led to questions about the sustainability of UK finances. And in Europe, the EUR was sold off deeper into sub-parity territory after the far right won Italy's General Election, raising concerns yet again on the sustainability of the large debt pile of Eurozone's third largest economy. In short, we expect more pain for both the GBP and EUR before things get better.

Asia FX Strategy: Extended Weakness Alongside CNY Slide. Like their developed markets peers, Asia FX weakened further in 3Q22 and the Asia Dollar Index (ADXY) fell to the lowest level in 19 years. The prospect of further portfolio outflows as the Fed continues its aggressive front-loading of rate hikes while Asia central banks normalize monetary policies on a more gradual basis keeps Asia FX on the defensive. Renewed weakness in the CNY past its psychological level of 7.0 against the USD has exacerbated pressure on Asia FX. Overall, we continue to expect Asia FX to stay weak through 3Q23. Specifically, we forecast USD/CNY rising to 7.25 by 2Q23, lifting USD/THB, USD/MYR, USD/IDR higher to 38.40, 4.69, 15,400 respectively. Further anticipated tightening of monetary policy by the Monetary Authority of Singapore (MAS) come mid-October will limit excessive SGD losses, but USD/SGD is still expected to climb in tandem to 1.45 by 2Q23 as well. Please refer to our latest 4Q 2022 FX Strategy for more details of our currencies outlook.

RATES STRATEGY - Early Stages Of Better Value In Bonds: Following the third hawkish 75 bps hike from the FOMC, our baseline on peak Fed funds has been revised higher to 4.75% by 1Q 2023. Needless to say, bonds are priced for this new hawkish baseline, with the scale tipping towards room for recession premium to grow. It follows from our view that we are gradually turning less bearish on longer maturity bonds going forward, especially with the 10Y UST yield setting new highs across September and therefore offering a much better value proposition for asset allocation compared to the low yielding days where "there is no alternative" (TINA). The big question is, when will be the optimal time to position for a turn in the monetary policy cycle and lower yields?

Overall, we expect yield top for longer maturities to come in early 2023. Until then, upside spikes are still possible, but the pace of gains in yields should slow going forward. We have refitted our yield curves to our new (higher) Fed funds baseline and now see 10Y UST and SGS at 4.30% and 3.80% respectively by the end of 2022. Thereafter, we expect to see bond yields drifting lower across 2023, based on our expectation that Fed funds peak in 1Q 2023 as well as accounting for our view that the balance of risk will increasingly tilt in favor of slowing economic growth going forward.

Should our abovementioned base case become untenable, then we see the alternative scenario as one that carries higher yields across the curve with it. Conditions for the alternative to prevail will rest on two main factors: specifically, a much higher than anticipated peak in Fed funds, possibly into the 5% region as well as an unwinding of safe-haven premiums should economic growth turn out to be better than expected. Please refer to our latest 4Q 2022 Rates Strategy for more details of our rates outlook.

COMMODITIES STRATEGY - Is The Heavy Sell-Off In Brent Crude Oil And Gold Prices Overdone?
Gold: The aggressive front loading of interest rate hikes by the US Federal Reserve continued unabated. And this has added to further strength in USD and further rise in interest rates, both of which are key negative drivers which weighed down on gold. Both negative drivers have gotten worse over the past quarter. As a result, gold had nowhere to go but to head south. Most recently, the tentative recovery to USD 1,800 / oz in Aug failed and gold subsequently fell back below the psychological support of USD 1,700 / oz. Nonetheless, we maintain the view that once these negative drivers dissipate, gold will recover in line with on-going safe haven demand as well as the return of physical jewellery demand. Unfortunately, this recovery is likely to be delayed till after 1Q next year, when the Fed hikes are expected to peak. In the meantime, we stay positive on gold, but lower the point forecasts to USD 1,700 / oz for 4Q22, USD 1,800/ oz for 1Q23 and USD 1,900 / oz for 2Q23 and 3Q23.

Brent crude oil had a disappointing performance across 3Q22. Instead of being driven higher by rising geopolitical risk, prices were instead significantly depressed by widespread recession fears. This rising recession fear was a key trigger in the sharp pullback in Brent crude oil prices from the USD 110 / bbl handle at the start of 3Q22 to its subsequent sell-off towards USD 85 / bbl in late September after the disastrous release of the UK "Growth Plan" under the Liz Truss government. Nonetheless, it is difficult to ignore the potential looming supply issues. Overall, there is a risk that crude oil price may have fallen too much too soon. We revise our point forecasts to USD 90 / bbl for 4Q22 and 1Q23, followed by USD 100 / bbl for 2Q23 and 3Q23.

Copper: After consolidating largely around USD 7,500 to USD 8,000 / MT, LME Copper prices took a renewed dip to the low USD 7,000 / MT level after worries of a global recession intensified. However, it is worth noting key positive drivers for downside price support, including lower mining production, lower on-exchange inventory as well as potential short squeeze from financing woes of intermediaries. Overall, we maintain our forecast that LME Copper price will continue its consolidation, in the coming four quarters, but at a lower level of USD 7,000 / MT. And warn of potential short-term volatility in prices amidst the temporary short squeeze. Kindly refer to our latest 4Q 2022 Commodities Strategy for more details of our crude oil, copper and gold outlook.

ASSET ALLOCATION

We have decided to tactically maintain the neutral allocation to equities as elevated fears of an aggressive US Federal Reserve have led to sharp declines in asset prices. Whilst recent data suggest that inflation may be stickier than expected, we believe that inflation may have peaked and will begin the process of moderating.

This also implies that incoming economic data will reveal a material slowdown ahead. Against this backdrop, the appropriate strategy continues to be a balanced portfolio of defensives and quality growth stocks; the latter has less cyclical earnings profile and would generally benefit from peaking interest rates.

Fixed income yields including government and investment grade bonds are now attractive given rich front-end rates. In a recession, these assets' value will hold up well and could be an effective hedge against the riskier sleeve in an investor's portfolio.

Global Asset Allocation For 4Q 2022

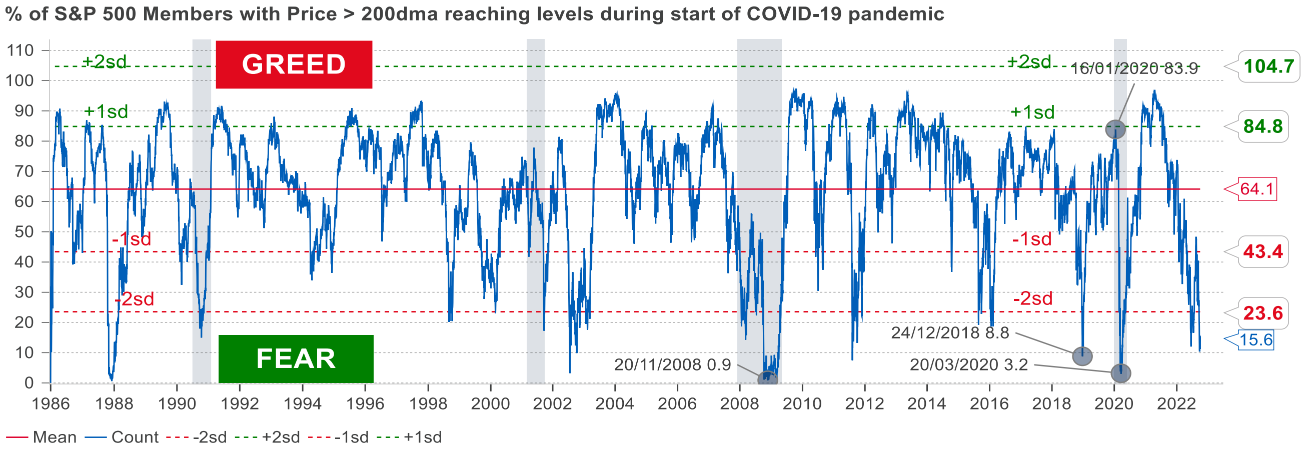
	Underweight	Neutral	Overweight
Equities		•	
Fixed Income			•
Commodities		•	
Alternatives (hedged strategies)		•	
Cash	•		

EQUITIES

With expectations of grim growth prospects for developed markets in the year ahead, equities look very likely to continue facing headwinds in the near term. **Global equities have been de-rated aggressively this year and further de-rating is still possible, the only question in investors' minds is – how much more?** We note that across stock cycles, forward P/E ratios and equity prices usually bottom before forward earnings.

Although it is possible that further equity de-rating is possible, stocks are already oversold. Using the S&P 500 as an example, the following shows that only 15.6% of the constituents are trading with a price above their 200-day moving average. For the majority of them, they have been sold off aggressively. The last straw that broke the camel's back towards end-Sep was the 75bps interest rate hike from the Fed, which saw the S&P 500 drawing down another 8%, bringing US equities deeper into the bear territory.

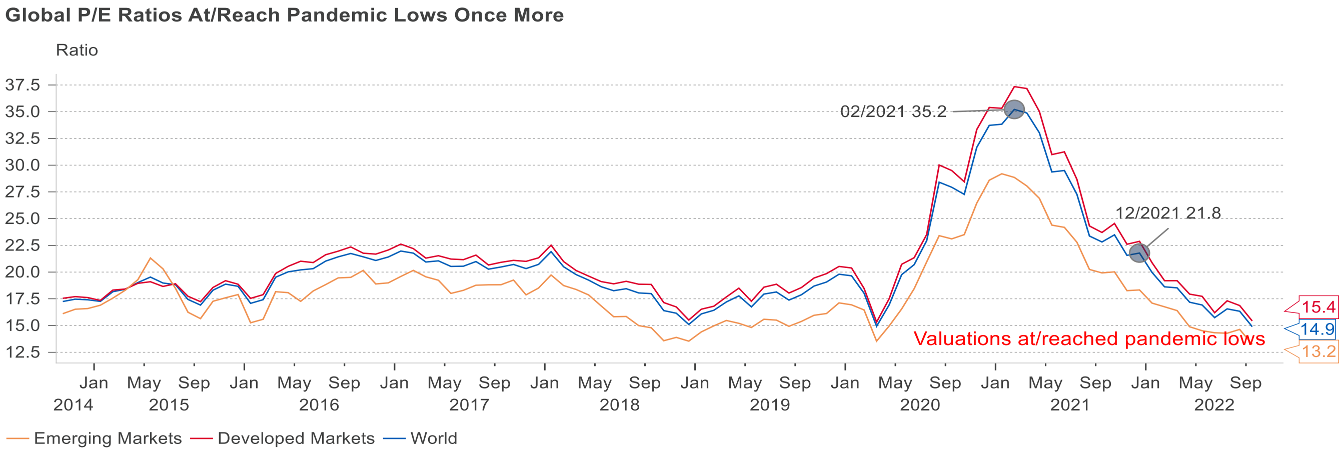
% Share of S&P 500 Members With Price > 200dma Reaching Levels During Start Of COVID-19 Pandemic



Source: Macrobond, UOB Private Bank

In our previous 3Q 2022 report, we noted that global equity valuations are already hovering around pandemic lows. One quarter later, they are still trading around the same valuations. Valuations at this level already discount a materially weaker global economy. However, with the major central banks holding on to their hawkish policies to tame inflation (which we believe to have peaked but will take some time to trend towards the magic 2% mark), there is little prospect of a reversal of equity market fortunes. We need to see the first signs of "dovishness" coming from the major central banks.

Global P/E Ratios At/Reach Pandemic Lows Once More

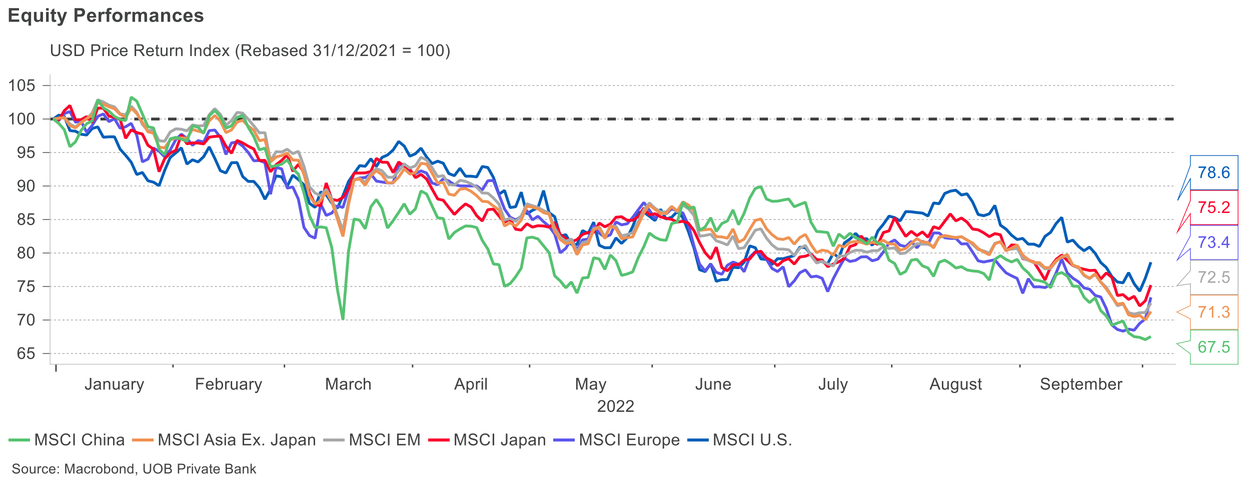


Source: Macrobond, UOB Private Bank

For now, with the Fed still in a restrictive mode and till we see a material decline in inflation rates, we are expecting a cyclical US economic recession with the usual peak-to-trough drawdown of 30-35% in the S&P 500, from the peak of 4,796 reached on 3 Jan 2022. **This means the S&P 500 index's fair value could reach 3,200 at cyclical lows.** Huge price gyrations can reasonably be expected amid rising odds of a Fed policy overkill.

For now, **we have decided to tactically maintain the neutral allocation to equities** as elevated fears of an aggressive Fed has already led to sharp declines in asset prices. In the near term, regional equity positioning should be focused on protecting capital as much as on seeking opportunities.

Equity Performance



FIXED INCOME

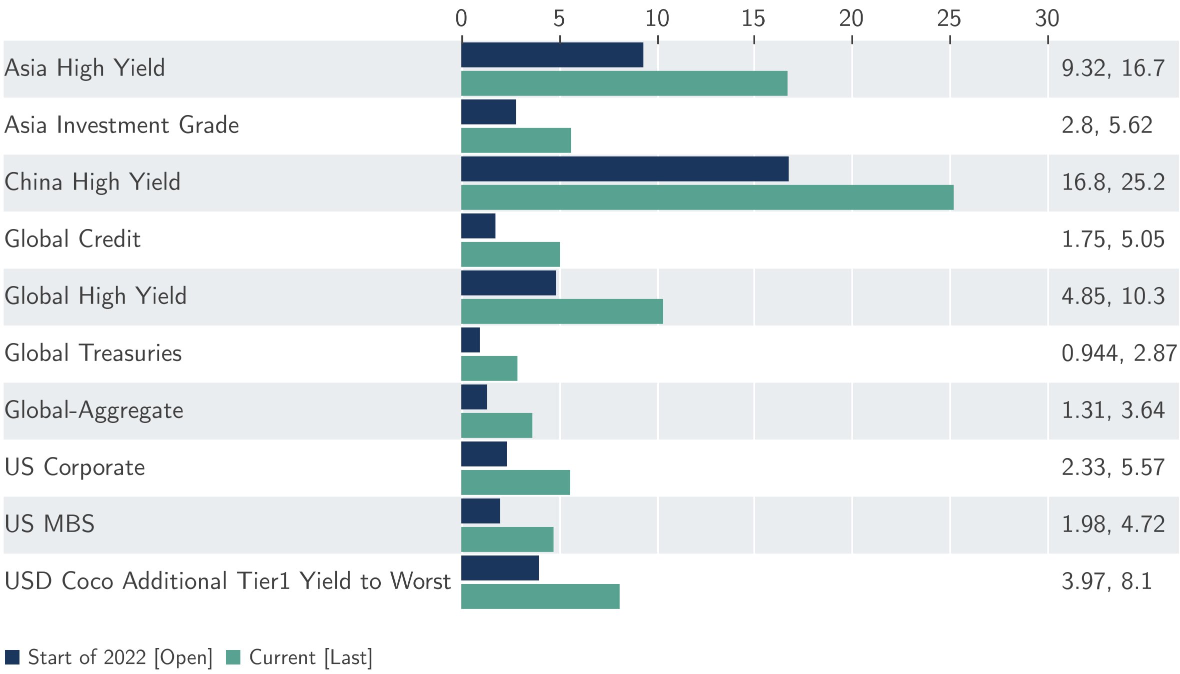
USD fixed income largely traded weaker on more aggressive forward guidance by the US Federal Reserve. The dot-plot from the Sep FOMC meeting points to a peak funds rate closer to 4.5-4.75% range. Moreover, the earlier Jackson Hole speech by Fed Chair Powell has ruled out the prospect of a near-term pause despite softening economic conditions and sharply lower asset prices.

Despite weakening economic conditions and cost pressures, **overall US corporate credit fundamentals remained healthy**. Net upgrade-to-downgrades improved in Sep for sectors like financials, healthcare, energy and technology. The number of issuers with a negative outlook by the rating agencies stayed resilient while instances of fallen angel (i.e. downgrade from investment grade to high yield) stayed low.

The risk-reward is most attractive at the short to intermediate maturities given the repricing on the front-end rates amid the Fed's policy tightening. Longer dated investment-grade credits could be attractive as long-end rates price in weakening economic conditions. **The credit allocation should continue to favour investment grade over high yield** given rising risk of a recession in the coming year.

Year to date, return on investment-grade Asia credits was largely in line with global benchmarks despite acute liquidity stresses in China. Having said that, Asia high yield was significantly weaker as real estate contagion in China continues to percolate through the system. The figure below shows elevated Asian and China high yields, reflecting high risks of default especially for the weaker issuers. Despite more supportive measures to alleviate the liquidity strain and to boost demand, contract pre-sales continued to be anemic given the moribund economy and weak employment resulting from the COVID-zero policy. While a lot of risks have been priced in, the lack of a sector-wide meaningful restructuring among distressed issuers will limit the upside potential.

Yields Changes Since Start Of 2022



UOB Private Bank, Bloomberg, Macrobond

.

FX, INTEREST RATE & COMMODITIES FORECASTS

FX, Interest Rates & Commodities Forecast

Global Economics & Markets Research

FX	26 Sep 22	4Q22F	1Q23F	2Q23F	3Q23F
USD/JPY	144	145	145	142	139
EUR/USD	0.96	0.95	0.95	0.98	1.00
GBP/USD	1.08	1.05	1.05	1.08	1.12
AUD/USD	0.65	0.64	0.63	0.65	0.68
NZD/USD	0.57	0.56	0.55	0.57	0.60
DXY	113.68	114.3	114.5	111.0	108.7
USD/CNY	7.16	7.20	7.23	7.25	7.25
USD/HKD	7.85	7.85	7.85	7.85	7.85
USD/TWD	31.84	32.0	32.2	32.4	32.4
USD/KRW	1,428	1,440	1,450	1,460	1,460
USD/PHP	58.99	59.2	59.4	59.6	59.8
USD/MYR	4.61	4.63	4.67	4.69	4.69
USD/IDR	15,153	15,200	15,300	15,400	15,400
USD/THB	37.95	38.0	38.2	38.4	38.4
USD/VND	23,731	24,000	24,100	24,200	24,300
USD/INR	81.39	82.0	82.5	83.0	83.5
USD/SGD	1.44	1.44	1.45	1.45	1.45
EUR/SGD	1.38	1.37	1.38	1.42	1.45
GBP/SGD	1.55	1.51	1.52	1.57	1.62
AUD/SGD	0.93	0.92	0.91	0.94	0.99
SGD/MYR	3.21	3.22	3.22	3.23	3.23
SGD/CNY	4.99	5.00	4.99	5.00	5.00
JPY/SGDx100	0.99	0.99	1.00	1.02	1.04

INTEREST RATES	26 Sep 22	4Q22F	1Q23F	2Q23F	3Q23F
US Fed Funds Rate	3.25	4.50	4.75	4.75	4.75
USD 3M SOFR (compounded)	2.07	3.66	4.47	4.63	4.66
USD 3M LIBOR	3.63	4.60	4.85	4.85	
10Y US Treasuries Yield	3.87	4.30	4.00	3.80	3.80
JPY Policy Rate	-0.10	-0.10	-0.10	-0.10	-0.10
EUR Refinancing Rate	1.25	1.75	1.75	1.75	1.75
GBP Repo Rate	2.25	4.25	5.25	5.25	5.25
AUD Official Cash Rate	2.35	2.75	3.10	3.10	3.10
NZD Official Cash Rate	3.00	4.00	4.00	4.00	4.00
CNY 1Y Loan Prime Rate	3.65	3.55	3.55	3.55	3.70
HKD Base Rate	3.50	4.75	5.00	5.00	5.00
TWD Official Discount Rate	1.63	1.75	1.88	1.88	1.88
KRW Base Rate	2.50	3.00	3.00	3.00	3.00
PHP O/N Reverse Repo	4.25	5.00	5.00	5.00	5.00
SGD 3M SORA (compounded)	1.92	2.97	3.62	3.71	3.86
SGD 3M SIBOR	3.03	3.75	3.80	3.80	3.85
SGD 3M SOR	3.04	3.80	3.85	3.85	
SGD 10Y SGS	3.36	3.80	3.55	3.40	3.40
MYR O/N Policy Rate	2.50	2.50	2.75	3.00	3.00
IDR 7D Reverse Repo	4.25	5.00	5.25	5.50	5.50
THB 1D Repo	0.75	1.00	1.25	1.50	1.50
VND Refinancing Rate	5.00	5.50	6.00	6.00	6.00
INR Repo Rate	5.40	5.90	5.90	5.90	5.90

COMMODITIES	26 Sep 22	4Q22F	1Q23F	2Q23F	3Q23F
Gold (USD/oz)	1,631	1,700	1,800	1,900	1,900
Brent Crude Oil (USD/bbl)	85	90	90	100	100
Copper (USD/mt)	7,342	7,000	7,000	7,000	7,000

USD 3M LIBOR and SGD 3M SOR will be ceased by end-June 2023

Updated as of Tuesday, 27 September 2022

Source: UOB Global Economics & Markets Research

THE TEAM

Global Economics & Markets Research
Private Bank

All chart data from Bloomberg unless otherwise specified.

Singapore Company Reg No. 193500026Z