Quarterly Market Update

1Q 2023

Five Key themes – Mar 2023

Quantitative Tightening and its effects on liquidity

While every other major DM central bank is starting on their tightening journey, there is one central bank that defied the global expectations – the Bank of Japan. They have expanded their balance sheet strongly since the start of Dec 2022, thereby supporting the overall market. In the US, because of the consistent hiking and tightening, for the first time since 1960, its M2 growth turned negative (-1.3% vs. a year ago) in Dec-22. In both the US and Europe, corporates' average quick ratios (i.e., liquidity) have been on a downward trend since mid-2021, showcasing rising liquidity concerns. Stocks with high receivables, despite high liquidity, could be more vulnerable to profitability risks during recession. This reinforces the importance of considering both quality and liquidity concurrently, particularly during economic slowdown. The weakening liquidity, along with widening credit spreads and slowing growth, could all come together to weigh on the equities market, especially as credit spreads now well below levels seen during past recessions. The recent US Senior Loan Officer (SLO) survey results point to a potential slowdown in consumption ahead as the banks tighten their lending standards, in lock-step with central banks' tightening.

The death of King Dollar is greatly exaggerated

Across all the developed markets central banks, there is a sense of easing already priced into rates. The highest rate of change can be seen in the US with the FOMC expected to ease significantly into 2025, while the BoJ is the only central bank expected to hike over the next 2 years. The recent swift repricing in US rates and market expectations for the Fed was due to the strong hawkish data, which halted the current dominant disinflation narrative and reignited rates volatility. In such situations where equities and rates both suffer a downdraft, the USD can still hold up. Rising rates expectations have certainly benefitted the USD, with strong flows coming in from both Hedge Funds and Real Money investors. No convincing signs of inflation slowing would also crater equities, especially as it means rates will continue to be higher for longer.

China's recovery on track

There have been some recent positive prints in China, pointing to signs of a recovery. China's weekly operated flights have started to pick up again after moderation in February. Hotel occupancy ratio have also rebounded in March after dipping in February. Weekly primary sales of properties across 28 cities have been flat since February but 4W moving average are still on the uptrend. There is also scope that housing sales may turn positive in 2Q and property capex will turn around in 4Q 23. The unemployment rate remains higher than pre-covid levels and industrial capacity utilization rate have been slow to recover. On the commodities front, cement shipments and rebar demand have moderated slightly. Inflation concerns remain low as excess capacity remains in the economy. Commodities prices have been closely tracking activity levels as well as property sales and further recovery are needed to offset global slowdown concerns. Notably, Chinese banks have been the safe haven among global financials as there are limited spillover to China. Chinese banks hold 98% domestics assets and their capital adequacy ratio is higher than the statutory 10.5%.

Source: Eastspring Investments.

The case for bullish oil prices

Since the start of the year, observable inventories have risen 1.1 mb/d, with oil supply seemingly well-stocked thus far. Global oil demand should be driven strongly by China, with the mobility statistics in China remaining well above year-ago levels. Aviation demand has also benefitted strongly from China's reopening; jet fuel demand could reach near to pre-COVID levels by the end of the year. Nonetheless, the recent voluntary cuts by OPEC/Russia counters this rise in supply, so net-net, supply forecasts are marginally lower than before. Most investors did not position well for the uptick in oil prices caused by the OPEC cuts, as fund managers slashed their combined positions in crude oil to just 222 million barrels from 445 million on March 7. MAPS team is currently bullish on China reopening themes, Oil and Energy related stocks.

All about the global flows

Despite most categories of institutional investors running low equity exposure at present, US households' allocation to equities remains high compared with long-term history based on the latest AAII asset allocation survey, which has been supporting the current market rally so far. If a recession indeed materialises, equities look vulnerable to more redemptions, given the very small outflows seen so far; flows typically lag performance, and they are looking elevated against equity price levels. In Asia, Chinese southbound inflows have been strong, hitting > USD5 billion over the past month. For context, stocks performed very well the last three times the US$5bn threshold was crossed in a down market (March '22, May '22 and Oct '22). In Korea and Taiwan, we see strong expansion of flows into the semiconductor and tech sectors, similar to other countries. Samsung & TSMC have been the biggest beneficiaries, with TSMC accounting for more than the inflows in Taiwan.

Source: Eastspring Investments.

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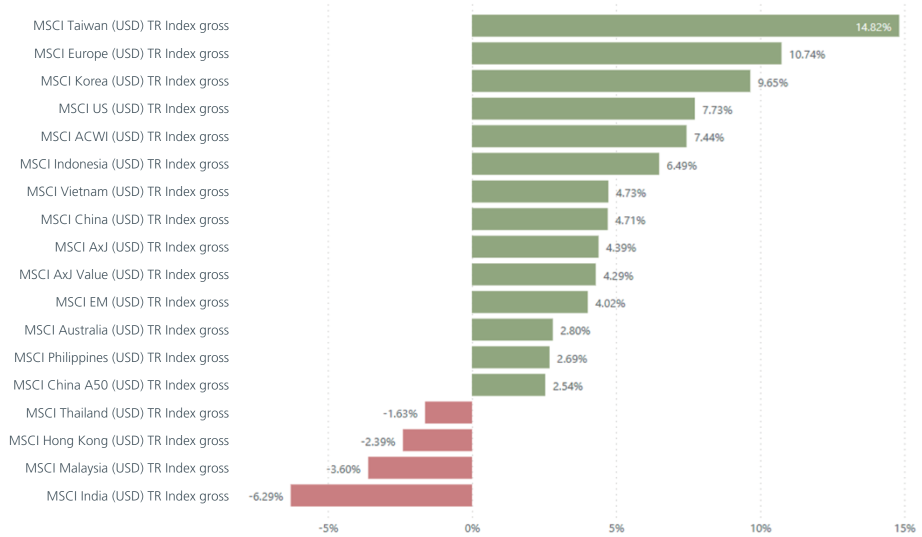
Equities

- Global equities rose over the quarter, although they took a step down in March after a strong rally in January. Global risk sentiment was initially supported by signs of taming inflation, strengthening market hopes for less restrictive policy from central banks going forward, and hopes of a strong recovery in China. Markets declined sharply in March, driven by risk-off sentiment following the collapse of Silicon Valley Bank – the second largest banking failure in US history – and the rescue of Credit Suisse by Swiss authorities through a sale to rival UBS. Markets recovered going into the end of the period, however, as the turmoil in the banking sector tempered expectations for further rate hikes by the US Federal Reserve ("Fed").

- MSCI Taiwan and MSCI Korea were strong performers for 1Q 2023, rising 14.8% and 9.7% respectively. Amongst the broader markets MSCI Europe (10.7%) topped the charts followed by MSCI ACWI (7.4%), MSCI Asia ex Japan (4.4%) and MSCI EM (4.0%), all finishing the quarter in positive territory. MSCI India (-6.3%), MSCI Malaysia (-3.6), MSCI Hong Kong (-2.4%) and MSCI Thailand (-1.6%) were all down over the quarter.

Asset Performance Custom (30 Dec 22 till 31 Mar 23)



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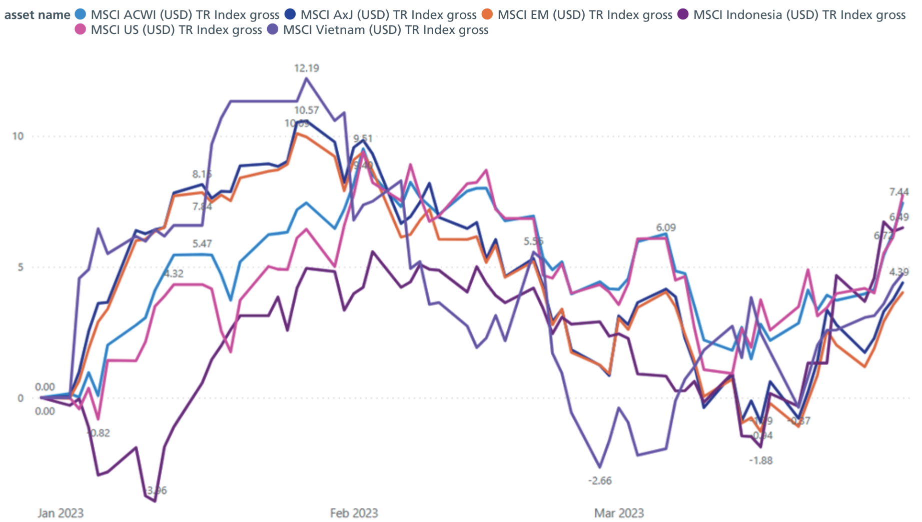

Source: Eastspring Investments.

Fixed Income

- Fixed income markets had an eventful month in March. The month started on a downbeat note as the collapse of Credit Suisse and several US banks dampened confidence. US Treasuries whipsawed amid higher market volatility as the US Treasury yield curve bull flattened as yields on two-year notes fell by 79 bps while yields on five and ten-year Treasury notes declined by 61 bps and 45 bps to 4.03%, 3.57% and 3.47% respectively.
- The Bloomberg Barclays Global Aggregate index finished the quarter up by 3.0%. The JACI Index finished higher by 2.5%. The JP Morgan EMBI Global Diversified index (1.9%), the JACI non-investment grade index (3.1%) along with Current 30-Year US Treasury Index (6.0%).

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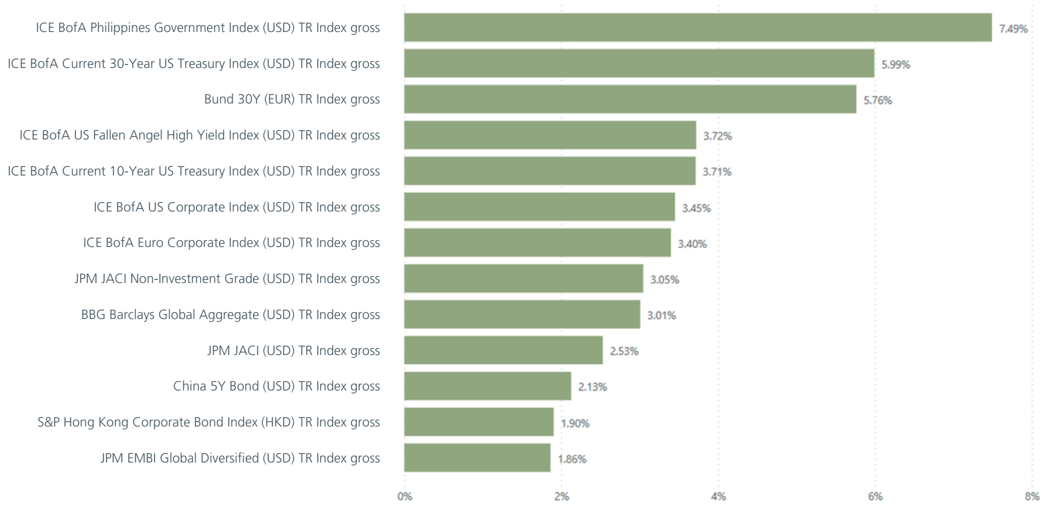

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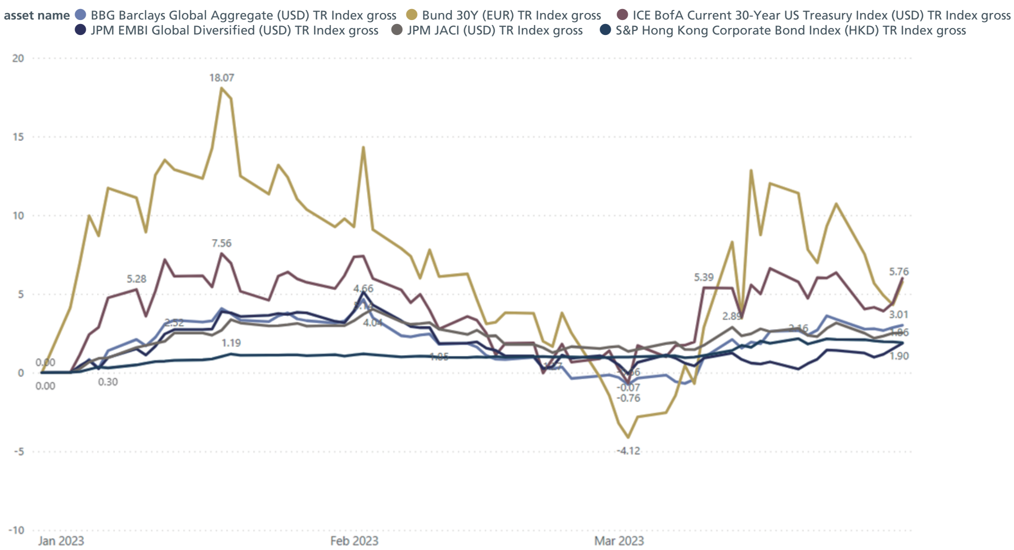

Source: Eastspring Investments.

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Currencies

- The US Dollar painted a mixed picture in the first quarter of 2023, though broadly easing, with KRW (3.5%) and JPY (1.1%) being notable exceptions. The DXY index fell -1.0% and gave up ground against the British Pound (-1.9%), Thai Bhat (-1.3%), CNY (-1.2%) the Singapore Dollar (-0.7%) and the Indian Rupee (-0.7%).

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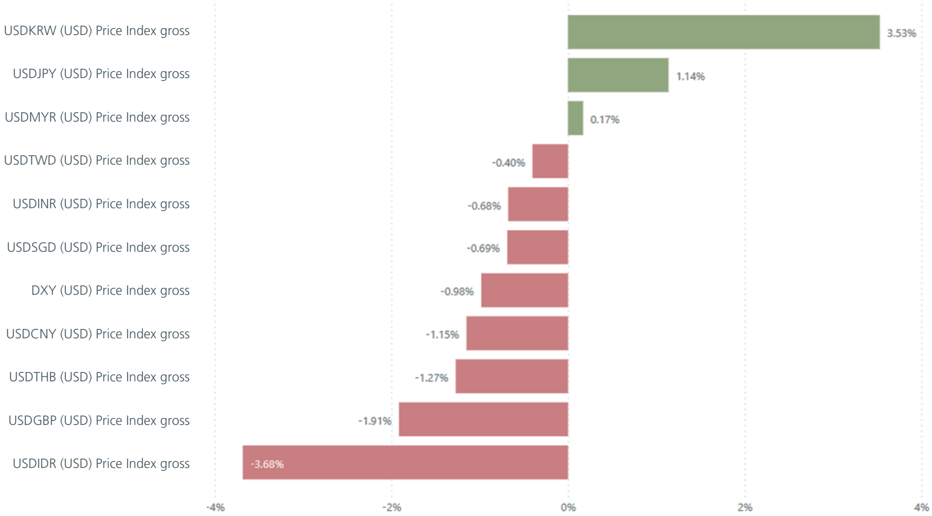

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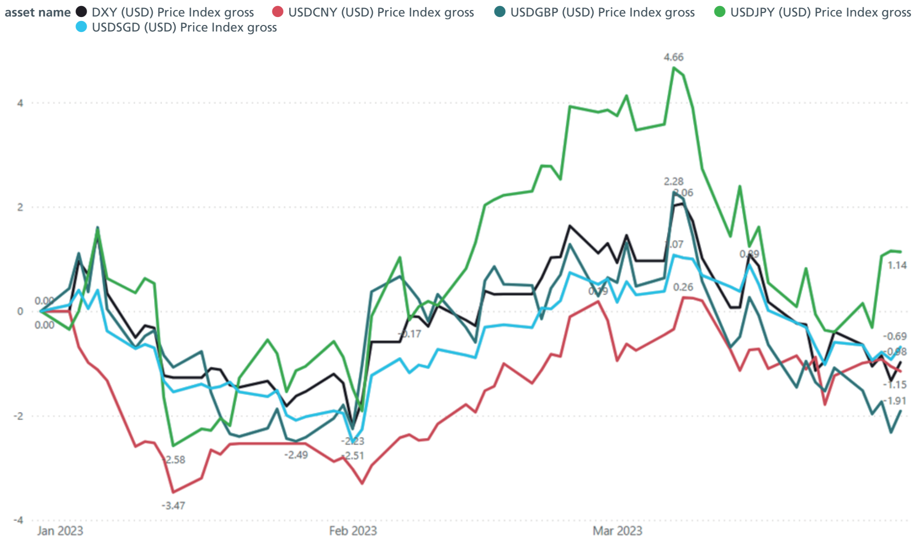

Source: Eastspring Investments.

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Economics

- Recent events in the US banking sector created financial stability concerns and raised the awareness of investment risks in lower tier instruments of a bank capital structure. History shows that banking problems can challenge investor's confidence in healthy banks and weaken the economy and as a result, regulators have quickly taken steps to ensure that the banking system is sound and there is ample liquidity for lenders to meet their funding requirements.
- With high interest rates and tight financial conditions, the pace of global economic growth is likely to moderate as central banks remain focused on controlling inflation. In most markets outside of China, prices are increasing at an elevated but slower rate although consumer spending is proving resilient as the labour market remains incredibly tight. With lower demand and softer economic activity underway, base effects suggest that the rate of inflation has probably past its peak although it will take time for prices to reach a more acceptable level.

Source: Eastspring Investments.

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