Quarterly Market Update

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3Q 2022

Five Key themes over the 3rd Quarter, 2022

US inflation stays elevated

US inflation saw hotter than expected numbers, particularly in August. Headline inflation dropped to 8.3%, which was less than the market's forecast of 8.1%. The largest contributors of this surprise were from rent, food and healthcare, which were up 6.2%,13.5%, and 5.6% respectively, on a year-over-year (YoY) basis. More importantly, core CPI surprised to the upside, rising 0.6% month-over-month (MoM) to 6.3% YoY. The volatile components of core CPI, such as used cars, are up 7.8% YoY and transportation +11.4% YoY. Recent research highlighted that core CPI could potentially hit a new peak even as headline CPI declines. With core CPI spiking up again, will this push the Fed to become more hawkish in the next FOMC meeting?

Asian Inflation reversing

Asian inflation has been mostly driven by food and energy cost, but their contributions are seemingly stabilizing and poised to moderate as commodities prices fall. The rise in core goods inflation was driven by transient excess spending on goods and supply-chain disruptions, both of which are also reversing. Labour markets are not that tight and wage growth are still below pre-Covid trend for 92% of the region. The exception is in Singapore, where wage growth is currently at 8%, a reflection of some sort of normalization in wages following a public sector wage freeze during the pandemic.

China's housing market

Despite recent rate cuts and property loan facilities, China's housing sales have been sluggish in recent months. Consequently, weaker sales could force more disruptive deleveraging among developers and liquidity stress spillover to suppliers. Interestingly, parallels have been drawn to Japan's housing bubble burst in the 1980s, where there was a similar drive-up in property prices and land prices prior to the bubble bursting. Generally, housing has been gradually declining in its contribution to GDP as China continues its deleveraging journey while pivoting to a consumption driven economy. Even with more stimulus expected, GDP growth will remain challenged as lockdowns and China's zero-Covid policy hamper efforts to boost the economy. For example, mobility indicators like subway passenger volume and intercity highway mobility declined sharply in August and beginning of September.

Revisiting the 'value' vs 'growth' debate

Valuations (and its wide dispersion) imply that Value will outperform in the coming years. When the valuation spread between the most and least expensive stocks is wide, Value stocks tend to outperform. Historically, a wide spread in the valuations of the cheapest vs. most expensive stocks has some predictive power for value outperformance over a 3-year time horizon. For Growth, expectations today – even if proven accurate – do not appear to justify current stock multiples. Even on growth-adjusted earnings multiple, Growth stocks trade at a historically elevated premium vs. Value stocks. Another interesting fact is that Value stocks have managed to outperform on average after the final hike of the most recent six tightening cycles. Nevertheless, based on recent research, the recent relationship between the Growth vs. Value trade and interest rates suggests that Growth may outperform during the next 12 months if real interest rates fall by 25 bp or more, which could be likely if/when economic growth weakens, and the Fed turns dovish to support growth.

Source: Eastspring Investments.

US Dollar Strength

The significant strength in the US Dollar is likely to continue for the rest of this year as the US Fed continues to spearhead the hiking cycle and the interest rate differentials of US yields to the rest of world continue to rise. Especially against the Euro, we think the USD will appreciate as the ECB is lagging behind the curve on its hiking cycle, faces immense pressure on its external balance amid gas supply shortages, and greater growth concerns compared to the US. Asian currencies have also depreciated against the USD and many markets have seen their 10y yield differential to the US narrow fast and significantly. This would lead to fewer portfolio inflows into local currency bonds in Asia, and although we have not reached there yet, the potential for concerns around external balances deteriorating if USD liquidity dries up.

Source: Eastspring Investments.

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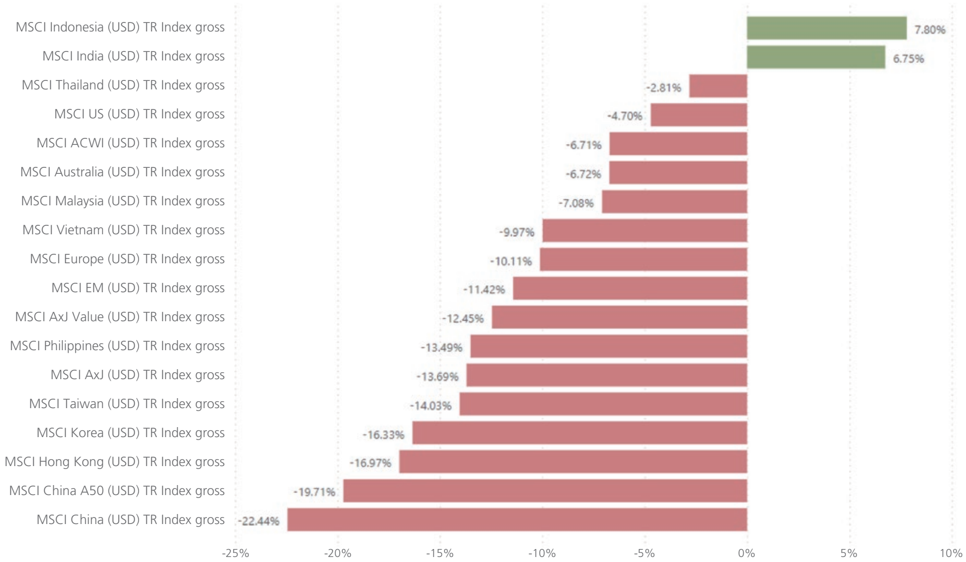
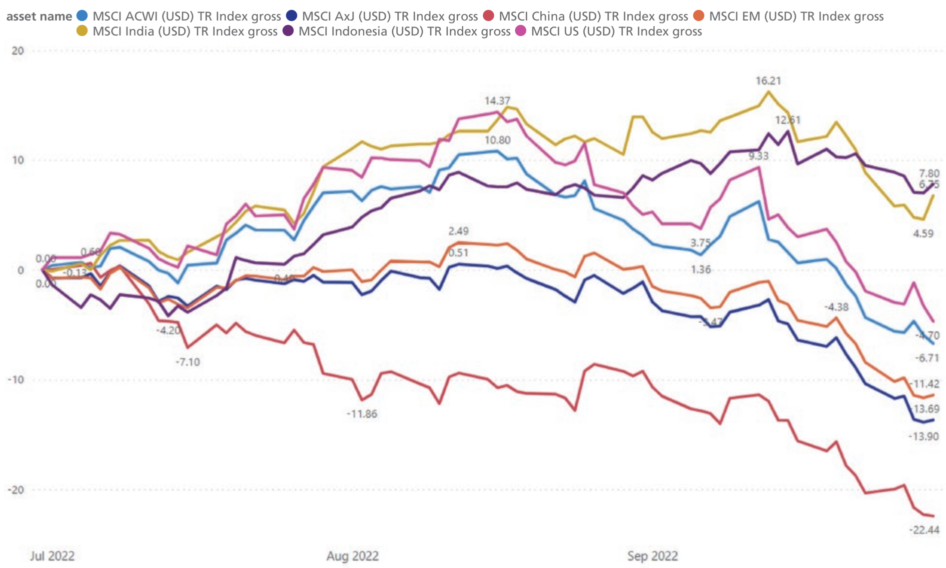
Equities

- US markets plunged on the last day of the 3rd quarter seeing the steepest decline in two decades, skidding across the finish line of a tumultuous quarter fraught with historically hot inflation, rising interest rates and recession fears. European stocks while finishing higher on Friday still saw sharp losses during the quarter with tumbling risk sentiment from the region keeping investors on edge. Asian markets also saw widespread quarterly declines.
- MSCI Indonesia and MSCI India were the outliers ending in positive territory for 3Q of 2022, rising 7.8% and 6.8% respectively. The broader markets represented by MSCI ACWI (-6.7%), MSCI EM (-11.4%), MSCI Europe (-10.1%) and MSCI Asia ex Japan (-13.7%) all finished the quarter in negative territory. MSCI Hong Kong finished the quarter also in the red, down -17.0%.

Asset Performance Custom (30 Jun 22 till 30 Sep 22)



Asset Performance 30 Jun 22 till 30 Sep 22



Source: Eastspring Investments.

Fixed Income

- As central banks continue to raise rates significantly, most notably with the US Fed's hike of 75bps recently, Fixed Income markets had a challenging 3rd quarter. Returns across the various segments of the bond markets were in negative territory. The Bloomberg Barclays Global Aggregate index finished the quarter lower by -6.9%. The JACI Index finished lower by -3.5%. The JP Morgan EMBI Global Diversified index (-4.6%), JACI non-investment grade index (-6.0%), ICE BofA Current 30-Year Treasury Index (-11.2%) in the 3rd quarter. 30 Year Bunds were again one of the laggards in a generally 'down' market, giving up another -12.3% for the quarter ending in September.

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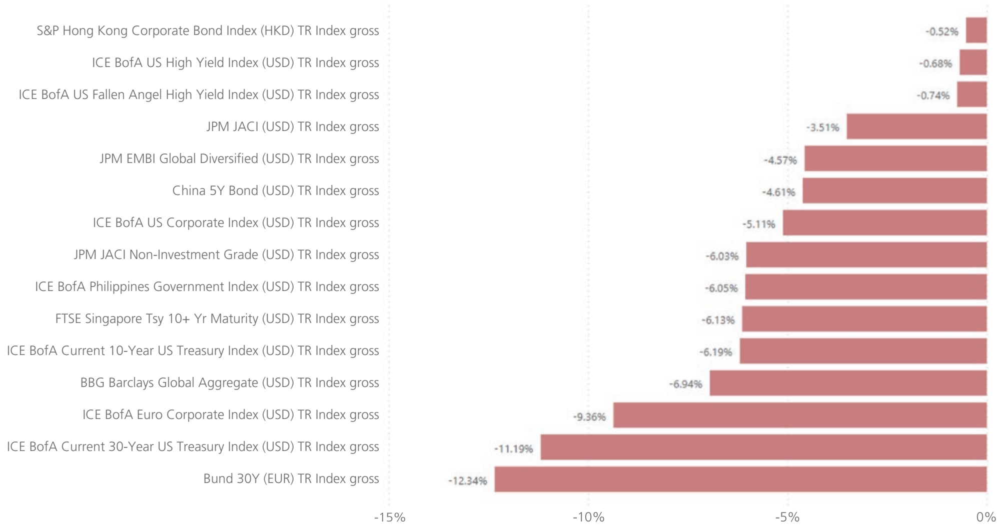

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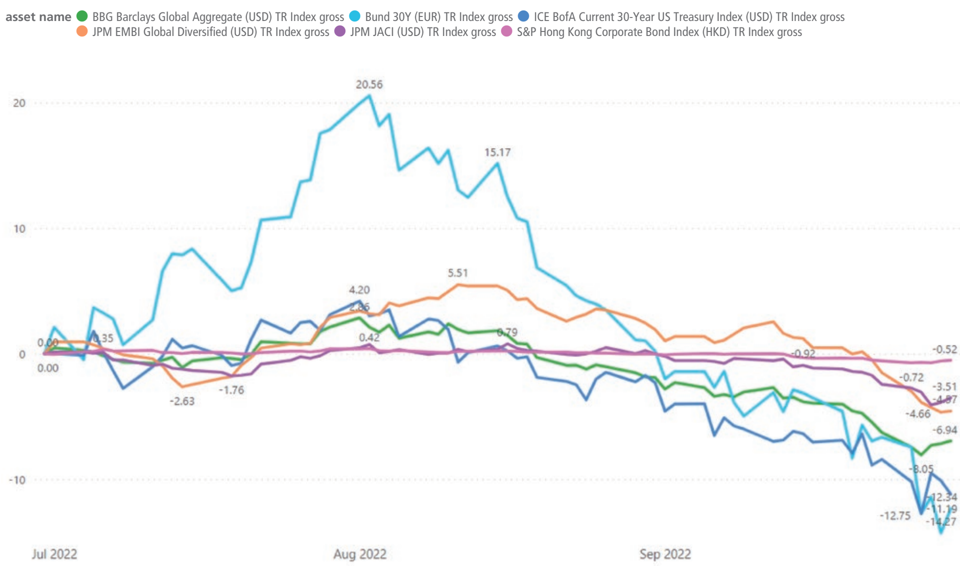

Source: Eastspring Investments.

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Currencies

- The US Dollar continued its broad strength in the quarter moving upwards, with the DXY index rising a further 7.1% in the third quarter of 2022. The Korean Won particularly struggled against the US Dollar with the greenback rising 11.5%. The Dollar posted strong returns relative to the British Pound (9.1%), Thai Baht (6.7%), and the Japanese Yen (6.6%).
- The Taiwan Dollar (-6.6%), Yuan (-5.6%), Singapore Dollar (-3.2%), and the Indian Rupee (-3.1%) all moved lower relative to the dollar over the quarter.

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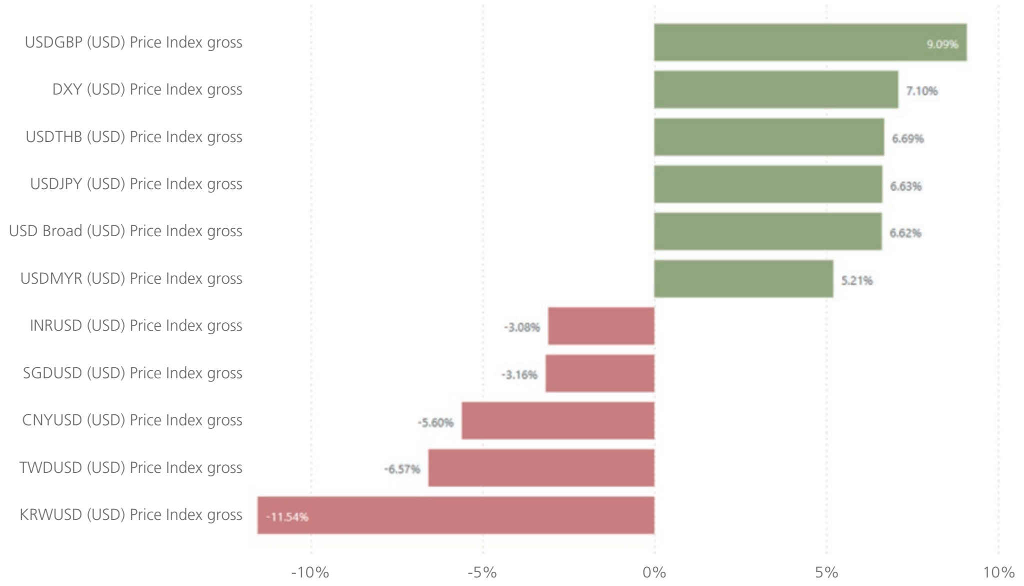

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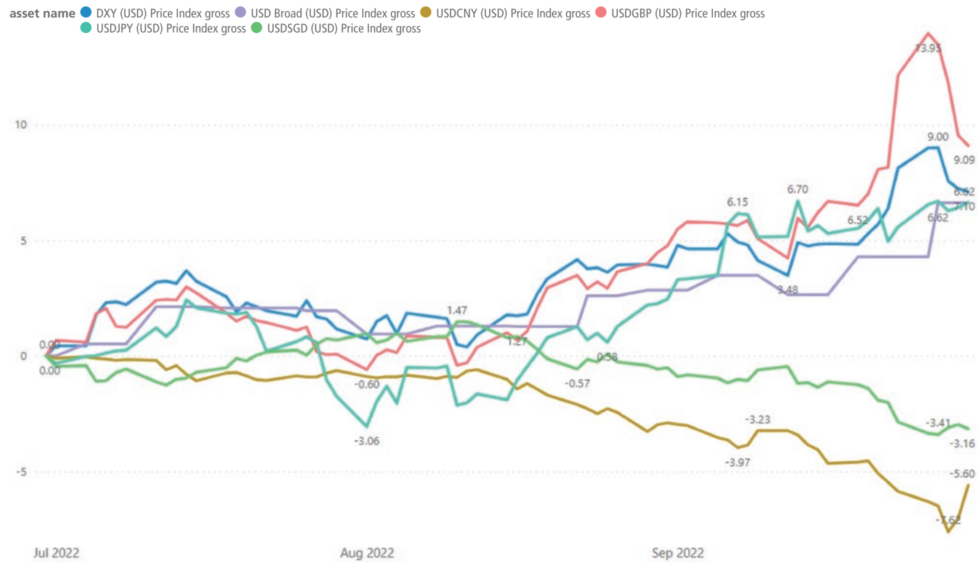

Source: Eastspring Investments.

Economics

- With the Fed still taking a hard stance on inflation, bond yields have remained at relatively high levels while several economies are facing various macro risks from a war in Ukraine, a gas supply shortage in Europe, a slowdown in China and Covid-19 outbreaks. That said, investors may not have a large sense of impending doom as the labour market in the US has been incredibly resilient. Payroll numbers still show a healthy pace of hiring with positive job growth in different sectors. The oil futures market is also in steep backwardation which suggest the market is pricing the future oil price to be meaningfully lower.
- As mentioned by the Fed Chairman, reducing inflation will likely require a sustained period of below-trend expansion. If the central bank delivers on its promise to continue tightening in the months ahead, there is a high probability inflation will decelerate. Yet business activity could slow and earnings growth in 2H22 may not show up as strong as the previous year. IMFs latest projections saw further downward revisions in global growth slowing to 3.2% in 2022 and 2.9% in 2023.

Source: Eastspring Investments.

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