QUARTERLY INVESTMENT STRATEGY
FIRST QUARTER 2022

Slowing Growth In A Mid-Cycle Expansion

UOB Asset Management

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Introduction

While 2021 was a year of recovery, we would characterise 2022 as a year of mid-cycle expansion. In the first quarter, markets are expected to be in a transition mood with investors on the lookout for sweet spots amid this phase of ongoing expansion but slowing momentum.

We think the current environment is following a classic investment cycle pattern, which is something we have not seen for more than a decade.

The current cycle is following the pattern that leads us to believe that global economies in 2022 will be in a mid-cycle expansion. This would imply continued growth and economic expansion, growing earnings, rising inflation, rising rates, this would imply continued growth and economic expansion, leading to growing earnings, rising inflation and rising rates. In this environment, cyclical equity sectors, real assets like property/REITS, and commodities, and alpha generators like alternatives, tend to outperform. On the other hand, fixed income is likely to face headwinds.

This is a straightforward takeaway from the current cycle and a fairly consensus view. But since investors have not seen a classic cycle in over a decade, we suspect there is a lack of conviction in this view. In the cycle from 2008 to 2019, the growth and inflation environment was very subdued, and it took many years for interest rates to rise and the overall cycle was not in line with classic cycle theory. We suspect this has led many investors to not trust the classic investment cycle and the corresponding investment implications, just as the cycle is looking more classical than it has in a long time. We think investors should have conviction in the investment outlook and not get shaken out by risk on/risk off behaviour that has prevailed in the past decade.

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Global Outlook and Strategy

A mid-cycle expansion has clear implications for most asset classes. Growth assets benefit from continued economic growth. Real assets do well in a period of rising inflation. While rising rates are a headwind for fixed income.

Sector Allocation	View	Notes
Equities	+	**Rationale:** Equities should be a key asset to depend on during a mid-cycle expansion. Equity gains may be more modest than during the rapid recovery stage but should benefit from continued expansion and perform better than most asset classes. **Risks:** Slowing growth momentum, hawkish Fed policy, China's slowing growth and inflation are all meaningful risks to global equities.
Fixed Income	–	**Rationale:** We expect bond yields to continually rise through the expansion at a modest pace. Bond yields already rose significantly in 2021 and we think the pace of further rises will continue and the UST 10yr should climb above 2 percent by the middle of 2022. Fed rate hikes and bond yield rises will be a headwind for fixed income markets. **Risks:** Inflation could be a downside risk for fixed income. On the other hand, geopolitical risks could trigger a rally in safe haven assets like bonds and thus "wrong-foot" the fixed income underweight.
Commodities	+	**Rationale:** Most commodities should benefit from continued global economic expansion. Structurally, many of the metal commodities are facing strong demand in their uses in green energy solutions. Gold should still be a good hedge against inflation but if inflation moderates and the Fed turns hawkish, then gold returns would be lacklustre. **Risks:** Fed hawkishness could drag down both growth-related commodities and the gold outlook.
Alternatives	+	**Rationale:** Broad market upside is more limited after a strong rally but opportunities remain in stock and sector picks that also implies lots of stock picking alpha opportunities. This tends to be a healthy environment for alternative assets including market neutral hedge fund strategies, hence our overweight alternatives. **Risks:** The rotations in assets have proved unpredictable and investment strategies may get wrongfooted.
Cash	–	**Rationale:** There are several attractive sectors to overweight in this period of healthy growth and expansion. Cash suffers from relatively low yields that remain negative in real terms. **Risks:** As central banks withdraw policy support, markets could become more volatile and larger cash positions could help buffer this volatility and thus make the underweight in cash regrettable.

++: Very Positive   +: Positive   N: Neutral   –: Negative   – –: Very Negative

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Here come the rate hikes

Markets usually get nervous around the first rate hike by the US central bank, but the first rate hike in a cycle has never been the end of the economic cycle.

Instead, it usually signals confidence in the economy and thus ends up supporting growth assets for several more years. The global economy is now at the stage where it has fully recovered from the recession and is now continuing with healthy growth that will bring on inflation and interest rate hikes.

Over the next several years, we should expect a steady stream of rate hikes that will start to flatten the yield curve. In the next two to three years, short-term rates will match the level of long-term rates, causing the yield curve to flatten and possibly even invert. Global investors will also likely shift towards being on guard for the end of the cycle. But for now, these are all classic mid-cycle expansion patterns by bringing in consistent performance in growth assets and headwinds to yield-sensitive assets.

Pandemic resilience

We expect the pandemic to fade as being a key driver for markets, and markets have already proven exceptionally resilient to the pandemic.

While global life has been enormously disrupted, corporations have proven to be very adaptive. The invisible hand of capitalism proved to be more efficient than most could have imagined at the start of the pandemic when observers were pontificating the potential impact of large supply chain disruptions.

Yet within a year, the S&P 500 earnings surpassed pre-crisis earnings and the market was on to making new all-time highs. At this stage in the pandemic, each new variant is affecting the markets less and less even as the variants continue to disrupt daily life. As we start the new year, we think Omicron is likely to cause concerns in the near-term over rising hospital admissions that threaten the health care systems of many countries. But after the initial wave, we think concerns over Omicron are likely to start to fade. So far, Omicron is proving to be much more transmissible but less severe and appears to continue to create a degree of natural immunity.

Between vaccines that have proved very effective, two years of natural spread and the incredible spread of Omicron, we think it is fair to say that many of the world's populations are much better protected against Covid. Covid is increasingly likely to shift to an endemic state that is less disruptive to markets.

Maturing expansion

Many characteristics of a mid-cycle expansion are evident in the current expansion and will become clearer as the first quarter of 2022 unfolds.

Most major economies have seen overall economic activity recover from the recession in 2020 and are now above pre-crisis levels. As major economies continue their expansion at above-trend growth rates, typical characteristics of an expansion would be rising inflation, rising interest rates, and rising prices of real assets like properties and commodities.

We expect this scenario to become increasingly apparent. Global GDP growth forecasts for 2022 stand at 4.4 percent which is a good level above what we would call trend growth levels of about 3.5 percent. Inflation is rising in the US and Europe, and real assets like property and commodities have been rising. Typically, as economies go through a mid-cycle expansion, growth assets like equities outperform safe assets like bonds. Corporate earnings have

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benefited from the above-trend growth levels, supporting equity prices. But rising inflation is leading to interest rate hikes which has become a headwind for bonds.

Multi-year cycle

The mid-cycle expansion also leads to questions about how long the cycle could last. In the past 50 years, the average cycle has been about seven years.

The current recovery and expansion only started in the middle of 2020. If the current cycle is only 1.5 years so far, that should imply that there are likely to be at least several more years of an expansionary environment even if this cycle is shorter than average. However, rising inflation could imply that the cycle may end prematurely.

Overall, we recommend investing confidently in growth assets in 2022, but to start looking for potential signs of a shorter-than-expected cycle by the end of 2023. The cycle is likely to have several more years of expansion, but the downturn triggered by the pandemic has had different characteristics than downturns in other cycles and thus it would be fair to watch for different patterns in the expansion in the coming year.

Short-term inflationary pressures

As always, there remain significant market risks. Among the foremost of these risks is inflation.

Already at the start of 2022, core inflation in the US has risen to 5.5 percent and in Europe to 2.9 percent. Inflation in major regions such as China and Japan remain low, but we think even these regions will see more pricing pressures over the coming year.

While most of the current inflationary pressures are due to issues that should dissipate over the coming year, there are important structural drivers that are building that have the potential to lead to greater inflation risks in the years ahead. In the current high inflation numbers, the vast majority of the inflation rise is due to issues relating to the pandemic and in particular, due to supply chain bottlenecks. Travel prices of airlines, hotels and rental cars have all shot up as the world struggles to get supply back and available as travel resumes. Chip shortages have caused auto manufacturing delays that have driven up the price of autos in the major regions.

Longer-term inflationary pressures

While most of the current pressures will not continue to be major issues in the years to come, there are structural risks in housing and wages.

These are not currently big drivers of inflation but have the risk to become so over the coming years. Underbuilding in US housing is causing prices to go up. And for various reasons, labour is in shortage in the US and real wages there appear set to grow for the first time in decades – which is both a big positive but also an inflation risk.

Other key risks include geopolitics that appear fragile. US and China tensions remain high while at the same time tensions with Russia are high in Europe over Ukraine. And mundane risks such as slowing growth momentum as interest rates rise remain a key market risk.

Overall, we think we should position for a continued but slowing expansion. We target to overweight equities with an overweight in the US and Asia. We are underweight fixed income but have shifted our fixed income focus more squarely on investment grade credits.

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Global Equities (Regional Strategy)

Sector Allocation	View	Notes
US 	+	**Rationale:** US equities have some of the most dynamic companies to invest in and in an environment of growth but heightened uncertainties, US equities tend to be the most resilient. **Risks:** The US Fed has turned much more hawkish than any central bank in any other major region. Valuations are high and could face deratings.
Europe 	N	**Rationale:** Europe's economic progress has been steadily improving just as the US and China data appear to have peeked. European GDP forecasts have been steady and valuations are better than other regions. **Risks:** European earnings growth forecasts are lower than other major regions. Europe has struggled to maintain periods of better performance in the past and may disappoint again in 2022.
Japan 	N	**Rationale:** Japan's economic data has lagged the other major regions but its 2022 earnings growth outlook is solid with expectations of 10 percent growth. Japan has managed the pandemic well and has achieved good vaccination levels. **Risks:** Even in a world of rising inflation, Japan has not been able to shrug off deflation. Deflation contributes to weak investment and stagnant growth.
Asia ex Japan 	+	**Rationale:** Accommodative monetary policies should help counter any economic weaknesses while corporate earnings should remain healthy despite higher prices of raw materials given better operating leverage. **Risks:** More lockdowns stemming from Covid resurgence could delay the region's economic recovery. Much anticipated policy relaxations in China especially relating to the property sector may fail to materialise.

++: Very Positive +: Positive N: Neutral -: Negative --: Very Negative

Earnings and consumption-driven recovery

The US has been a steady outperformer over the years and still has among the strongest earnings growth prospects for the coming year.

Europe is enjoying a healthy recovery and most parts of the continent have managed the pandemic reasonably well. We expect European corporate earnings to grow at healthy rates in the coming quarters.

Japan should benefit from the export recovery, but its domestic consumption recovery appears to be recovering more slowly than other regions.

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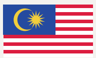
Asian Equities (Country Strategy)

Country Allocation	View	Notes
Mainland China 	-	**Rationale:** Anticipate further earnings downgrade on Chinese corporates in the near term as government policy preferences shift towards addressing balance sheet overhangs and growth imbalances. **Risks:** Stronger-than-expected government credit impulse, or earlier-than-expected recovery in domestic real estate sector.
Hong Kong 	-	**Rationale:** Domestic consumption remains weak against a subdued GDP growth and moderating exports/investments backdrop. **Risks:** Earlier-than-expected borders reopening, improved China-HK political relations.
India 	N	**Rationale:** Earnings revision upcycle likely has peaked and valuation remains unattractive. **Risks:** Corporate earnings outlook weakens, sustained rebound in oil price.
Indonesia 	+	**Rationale:** GDP growth accelerating amid domestic reopening. Best hedge against stagflation risk as a net commodity exporter. **Risks:** Spikes in infections, collapse in commodity prices, weak Rupiah.
Malaysia 	N	**Rationale:** Limited upside to corporate earnings as fiscal stimulus largely discounted. Political environment has turned less conducive. **Risks:** Slower-than-expected domestic economy recovery, sharp drop in oil prices could weaken MYR.
Philippines 	-	**Rationale:** Negative earnings revision narrowing but pace of domestic economy recovery from reopening likely to trail regional peers. **Risks:** Faster-than-expected recovery in tourism, Earlier-than -expected normalisation in economic activities.
Singapore 	N	**Rationale:** Beneficiary of global trade exports and global reopening but valuations have turned less attractive. **Risks:** Sharper-than-expected growth slowdown in China/major trading partners.
South Korea 	-	**Rationale:** Semiconductor downcycle appears largely discounted, but recovery in domestic stock market partly hinges on current memory/DRAM cycle bottoming. **Risks:** Exports are susceptible to US-China trade friction especially in tech supply chains. Lockdowns from resurgent virus waves.

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Country Allocation	View	Notes
Taiwan	+	**Rationale:** Continued robust corporate earnings upgrade should support valuations. Secular demand for tech hardware remains intact given digitalisation/automation. **Risks:** Worse than feared disruption to tech hardware supply chain and/or end demand, Worsening cross-straits relationship.
Thailand	N	**Rationale:** Valuations are unattractive against a lacklustre earnings recovery near term as fiscal stimulus is tempered by a weak tourism sector. **Risks:** Meaningful revival in tourism sector, Resurgence in political unrests.

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Subdued growth in North Asia

The macro backdrop for Asian equity markets is supportive but we maintain our negative views on North Asia with the exception of Taiwan.

Moderating but still above-trend global growth will continue to support Asia's exports. Despite the recent rise in underlying core inflation in Asia, it remains benign at the lower end of range since the global financial crisis. Pass-through due to demand-pull pressures and higher input costs is likely manageable as Asian economies, notably ASEAN, are yet to close the negative output gap.

As global recovery matures and policy support fades, we expect growth to broaden out from front-runners to laggards, and from exports to domestic demand. This lends support to our continued tilt towards South Asia over North Asia, given the latter is more export oriented.

China's growth is likely subdued in the near term due to further earnings downgrade risk for Chinese corporates as government policy preferences shift towards addressing balance sheet overhangs and growth imbalances. We expect a muted outlook for **Hong Kong** as domestic consumption remains weak against a backdrop of lackluster GDP growth and moderating exports/investments.

Korea remains an underweight. Semiconductor downcycle appears largely discounted, but recovery in domestic equities market partly hinges on current memory/DRAM cycle bottoming. In contrast, we upgrade **Taiwan** from neutral to overweight as continued robust corporates earnings uptrend should support valuations. Secular demand for tech hardware supply chain remains intact given digitalisation/automation. We maintain neutral on **India** as earnings revision upcycle likely has peaked.

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ASEAN's domestic demand recovery

The setup for ASEAN markets heading into 2022 is favourable and we expect the region to witness a bigger rebound in growth

ASEAN-based company earnings are expected to be strong amid a strong domestic demand recovery relative to the export-oriented North Asian markets. We upgrade Indonesia from neutral to positive as GDP growth is accelerating, and the market offers an inflation hedge against stagflation concerns from supply-side constraints as a net commodity exporter country.

We have downgraded Singapore and Malaysia from positive to neutral. **Singapore** is a beneficiary of global trade exports and global reopening. However, valuations have turned less attractive. **Malaysia's** fiscal stimulus is largely discounted and likely to cap earnings upside for corporates, whilst the political environment has turned less conducive. We remain neutral on **Thailand** as valuations are uncompelling against a muted near-term earnings recovery as fiscal stimulus is tempered by a weak tourism sector. **The Philippines** remains an underweight as the pace of domestic economy recovery from reopening is likely to trail regional peers.

Key risks to our cautiously optimistic positioning include Covid-variant concerns, greater-than-expected inflationary pressures and a faster taper by central banks. Earlier-than-expected stability in the domestic policy shift in China also represent downside risks to our view.

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Global Fixed Income (Sector Strategy)

Sector Allocation	View	Notes
Developed Markets (DM)	N	**Rationale:** While growth is likely to remain at healthy levels, normalisation may prevail in the near future, and we cannot afford to take our eyes off rising short-end rates. **Risks:** The Omicron variant could easily delay any potential rate hikes.
DM Government	N	**Rationale:** While rising short-end rates appear to be inevitable, we are comforted by how the long end has stayed relatively anchored due to flattening dynamics. **Risks:** The long end could see another strong sell-off should the Fed choose to reduce the duration of their current holdings in the upcoming balance sheet unwind.
DM Credit	+	**Rationale:** Credit spreads, while low, could provide a buffer against any rates sell-off. **Risks:** Should we see extended risk-off behaviour, it is not inconceivable that investment grade spreads will widen too.
Emerging Markets (EM)	N	**Rationale:** While we are still positive on growth differentials in EM vs DM, should Omicron turn out to be worse than expected, it would inevitably lead to a sell-off in EM markets. **Risks:** A lower vaccination rate in EM means that the threat of Omicron cannot be discounted.
EM Government	N	**Rationale:** Selection is key here, with different EM economies at different stages of any hiking/easing cycle. **Risks:** EM inflation has been relatively contained but should it blow up, we would start downgrading our view on EM government bonds.
EM Corporate	+	**Rationale:** Again, we are selective in our positive and negative views and believe sector selection is paramount, we note that EM credits are undervalued from the recent sell-off. **Risks:** Certain industries could be at risk again given that the resurgent virus waves and emergence of new variants.
EM Local Currency	–	**Rationale:** USD strength is prevalent and we would prefer to err on the side of caution when it comes to non-Asia EM currencies. **Risks:** High nominal yields might still attract idle money on the sidelines.

++: Very Positive +: Positive N: Neutral -: Negative --: Very Negative

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Sector Allocation	View	Notes
Duration	N	**Rationale:** While short-end yields may go higher, a rapidly flattening curve means that the long end is likely to stay anchored. We strike a balance by going for the belly. **Risks:** Poor employment numbers could mean the Fed is delaying the rate hike cycle.
Yield Curve	-	**Rationale:** The yield curve is well and truly flattening with yield movements reminiscent of mid cycle dynamics. **Risks:** The yield curve could steepen yet again should the Fed elect not to raise rates in 2022.

++: Very Positive +: Positive N: Neutral -: Negative --: Very Negative

Rising rates

While market participants expect the Fed to hike rates soon, they do not expect the cycle to be prolonged and long-end yields have stayed anchored.

With increasingly hawkish comments from Fed officials, it appears to be inevitable that the rate hike cycle will start in 2022. While we might see an earlier start to normalisation, we note how the long end has stayed anchored and that further flattening is inevitable unless the Fed holds off due to the Omicron variant.

As for other non-US economies, we see a wide dispersion between individual regions/countries. Japan and Europe are not likely to hike rates anytime soon, while China is well and truly on an easing cycle.

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Global Fixed Income (Regional Strategy)

Regional Allocation	View	Notes
Latin America	+	**Rationale:** Political risk is still high going into 2022. The trend of a voter shift away from the centrist parties will continue to raise concerns over fiscal profligacy, though this is mostly discounted by the market. Valuations are attractive in both investment grade (IG) and high yield (HY) after the detraction in 2021. **Risks:** We remain watchful over weaker oil and commodity prices. Also, lower per capita income could raise voter discontent over income inequality and social mobility.
CIS/EE*	N	**Rationale:** IG bonds look rich on valuations, we prefer HY credits, albeit these have high idiosyncratic risks. **Risks:** Idiosyncratic risks playing out beyond our expectations.
Middle East (ME)	+	**Rationale:** Despite some weakness over 4Q21, oil prices have held up impressively through the year which resulted in smaller fiscal deficits in most ME countries. **Risks:** A reassessment of travel following the Omicron variant could result in oil prices plunging.
Africa	N	**Rationale:** Region with the most attractive valuations given better supply to vaccines. But this is balanced by a weak external backdrop of lower oil prices, China growth slowdown, Fed rate hikes, and the emergence of Omicron, especially in the southern region. **Risks:** Further correction in commodity prices, low vaccine efficacy rates to Omicron and low bond supply in 2022.
Asia	+	**Rationale:** IG credits should remain stable vis-à-vis other regions, while frontier credits with IMF support should anchor valuations. **Risks:** Further regulatory tightening in China that could worsen the economic slowdown.
Singapore	+	**Rationale:** SGD NEER appears set for further normalisation in Q4, which should boost demand for SGD rates. **Risks:** Plans to build a Covid-resilient economy could be thrown into disarray should Omicron become prevalent.

++: Very Positive +: Positive N: Neutral -: Negative --: Very Negative

* Commonwealth of Independent States and Central and Eastern Europe

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Currencies

FX Allocation	View	Notes
US Dollar (USD) **US$**	N	**Rationale:** While USD strength appears to be inevitable against the other DMs due to differentiation in short-end rates, Asian currencies should perform relatively better. **Risks:** Should the Fed hike in clips of more than 25bps, the USD could spike higher.
Euro (EUR) **€**	–	**Rationale:** There is a significant difference between short-end rates between the US and EU due to different normalisation paths which is unlikely to dissipate anytime soon. **Risks:** Should inflation in EU continue on an upward trajectory in 2022, raising rates will be inevitable.
Japanese Yen (JPY) **¥**	–	**Rationale:** Likewise, Japan is not likely to raise rates anytime soon, and this should lead to USD outperformance. **Risks:** Another flight to quality due to Omicron could result in JPY strength.
Singapore Dollar (SGD) **S$**	+	**Rationale:** With inflation numbers at eight-year highs, we expect the SGD NEER slope to be steepened again next year. **Risks:** Omicron could throw a spanner into the works when it comes to a full reopening.
China Renminbi (CNY) **CNY**	+	**Rationale:** A healthy current account balance and index inclusion means that we are unlikely to see any steep falls in the CNY. **Risks:** Should China's Central Bank signal that they will embark on an extended easing cycle, CNY will likely trend lower.

++: Very Positive +: Positive N: Neutral –: Negative ––: Very Negative

Currency strength for selected Asian currencies

With the US set to embark on a rate hike cycle in 2022, the difference in short-end rates when compared to the likes of Europe and Japan is increasingly stark.

The latter two would not be able to raise rates anytime soon, which should contribute to near-term **USD** strength. However, we do not expect it to be the case against certain Asian countries, which means that Asian local currencies should perform relatively better against the USD. However, once again, differentiation is key, as we favour currencies with higher real yields like the **IDR** vs others which are more dependent on reopening plans like the **THB**.

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Commodities

Sector Allocation	View	Notes
Commodities	+	**Rationale:** We like commodities on a cyclical and a structural basis. Cyclically commodities perform well in a mid-cycle expansion. Structurally, many commodities such as base metals are seeing increased demand as they are increasingly used as part of the solution to shift away from carbon based energy. **Risks:** If the US FED overtightens that it could both slow growth and raise real rates which would be negative for both the cyclical commodities and the safe-haven metals.
Gold	N	**Rationale:** Gold will retain its role as a valuable hedge if inflation re-emerges as a threat. But in the near term, it appears that real rates are rising and provides a near-term headwind for gold prices. **Risks:** In the last cycle, gold started to underperform when the US Fed announced the tapering of its monetary policy support. We think the Fed has turned very hawkish in 2022.
Base Metals	+	**Rationale:** Industrial metals have performed well over the past year with many key metals reaching all-time highs. We think the multi- year outlook will be strong as new technologies and green technologies create high demand for many of the metal commodities such as copper. **Risks:** Most base metals are very sensitive to global demand and any unexpected slowdown will weaken the outlook.
Energy	N	**Rationale:** While we continue to see oil as a strong beneficiary of the global recovery, we ultimately think as oil prices rise, supply from shale and other sources will grow and eventually cap the upside in oil. **Risks:** A setback in the pandemic, or the rise of troubling new variants would undermine the reopening of the global economy and oil prices would be negatively affected.
Others	N	**Rationale:** Demand for other broad commodities such as agriculture and bulk commodities looks relatively stable for 2022. **Risks:** As always, supply disruptions remain a key risk to the strengths and weakness of many commodities.

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Continued demand

We expect most of the major commodities to benefit in a mid-cycle expansion in 2022.

As growth continues and overall global demand expands then global supply of many of the major resources will come under pressure again and prices should be well supported.

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Alternatives

Sector Allocation	View	Notes
Hedge Funds	+	**Rationale:** Stretched valuations and volatile market support limiting beta exposure and investors are seeking returns from alpha. **Risks:** Continued bull market performance would cause hedged strategies to relatively underperform.
Private Equity (PE)	N	**Rationale:** Ability to access companies with superior growth and that can benefit from disruptions in areas such as technology and healthcare. **Risks:** Valuations are less attractive and selectivity is required.

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Value amid slower growth

Alternatives continue to be an attractive asset class for investors looking to diversify beyond traditional investible classes which exhibit high correlation during times of market stress.

It can also add value to a portfolio in the current environment of low fixed income yields, risk of interest rate appreciation and volatile equity markets. Private equity can provide excess returns during a low interest rate environment with less volatility while providing access to new opportunities not available in listed markets.

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