US Macro Asset Strategy - Update

Upgrade US equities to OW as the US macroeconomy likely reached an inflection point

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Products: ETF | CFD | Unit Trusts

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Phillip Securities Research Pte Ltd

Revised table summary of Asset Performance (Pg5) and Strategy (Pg6), with ETF and CFD instruments to trade the outlook. Tactical trading without front-load sales charge is available with a Phillip UT WRAP account.

In this note, we update our views on US.

(i) **Upgrade US equities from MW to OW in view of improving macro fundamentals (esp with consumption holding up) as well as robust momentum (rather than value) in equities.**
However, we caution that this rally has been driven by multiples expansion (rather than earnings) as well as the Fed's near zero interest rate policy (ZIRP) and large scale asset purchases (LSAPs).
Furthermore, fiscal uncertainties persist, though lawmakers are making some efforts to put their act together and reach a bipartisan compromise.

(ii) **Maintain Long USD against EUR, JPY. The USD is undergoing a structural shift. Looking ahead, the USD is likely to relinquish its status as a funding currency to the JPY and instead continue to outperform along with risky assets.**

(iii) **Low Conviction on Treasuries and US Investment Grade Corporate Debt -maintain UW for both of them- on account of poor reward to risk ratio.**

In terms of our global macro asset strategy, no change to our broad call of OW equities, MW bonds, MW commodities and UW gold. Equities are still likely to rally in a risk-on mood, punctured by intermittent episodes of pull-back in prices which offer an attractive opportunity to accumulate our OWs in US (albeit a small OW), CN,HK (on compelling valuations), PH, TH (resilient domestic demand) and SG (construction boom, attractive dividend yield).

Upgrade US equities to OW from MW

Notwithstanding a possible pull back in the near term, the US macroeconomy is at an inflection point with all cyclinders (employment, consumption, investment, housing and trade) firing ahead. And that could continue to lend support to US equities risk rally.

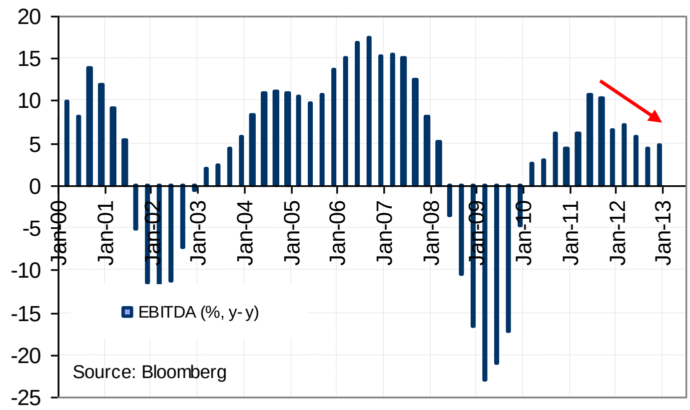
The fact that S&P and DJIA merely slipped –rather than correct sharply- in view of the latest Cyprus bailout suggest that the US equities market is still very much a healthy one.

In our recent GMAS (dated 4th March), we have been MW US and highlighted there are upsides to our call. The green light to upgrade US equities to OW was flashed on account of the recent release of stronger-than-expected Feb retail sales which suggest that consumers shrug off the drag from payroll tax hikes at the turn of this year as well as higher gasoline prices. This recent encouraging data portend further upsides for consumption spending and consequently GDP growth in 1Q13.

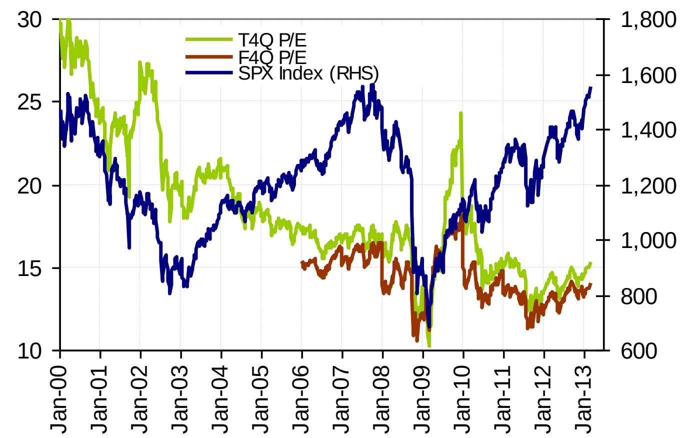
In this note, we formally upgrade US to OW on account of (i) strong *momentum* rather than *value* in equities, (ii) improving macroeconomic fundamentals.

But this OW assigned is a small one on account of headwinds such as the persistent fiscal uncertainties.

In recent sessions, the DJIA has inched up higher to fresh highs, with the S&P 500 a whisker away from its record high. But we reckon that **this recent rally has not been driven by earnings**



Instead, this looks more like a multiples expansion rally and valuations are rich (with little upside to earnings)



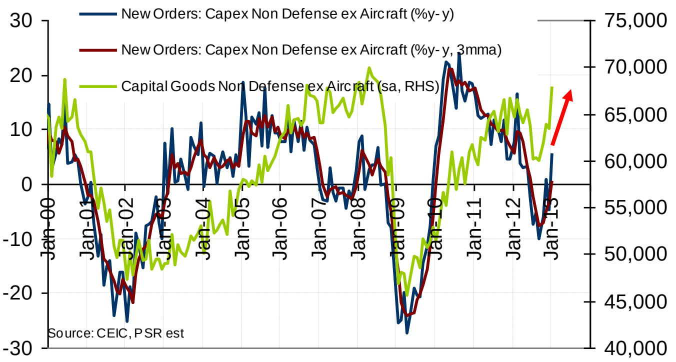
Other factors that bode well for US equities include:

(i) Still-accommodative monetary conditions,

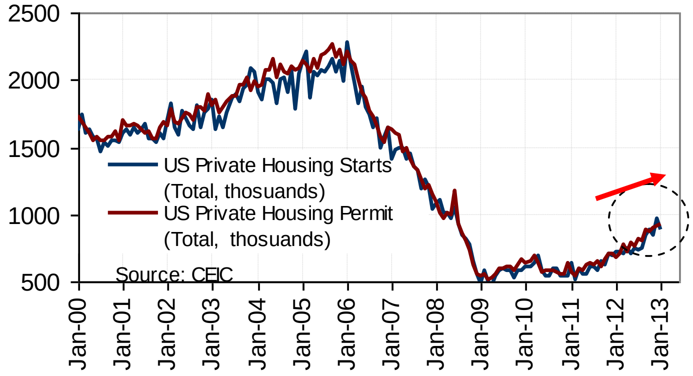
(ii) Shale gas and oil boom which will stimulate a revival of US manufacturing and reduce US reliance on costly energy imports

(iii) Positive spillovers from EU-US free trade agreement (deal scheduled by end 2014 and expected to add 0.2ppts to US GDP)

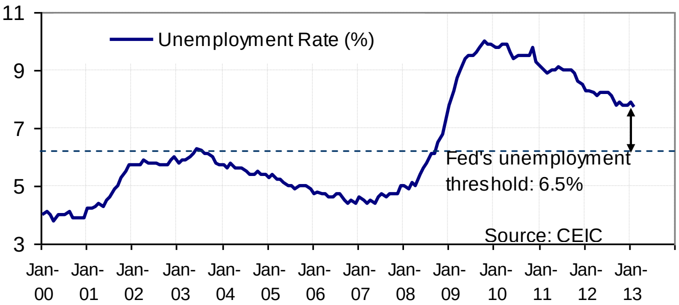
Capex rebounded strongly as businesses ramp up investments after the fiscal compromise at the turn of this year



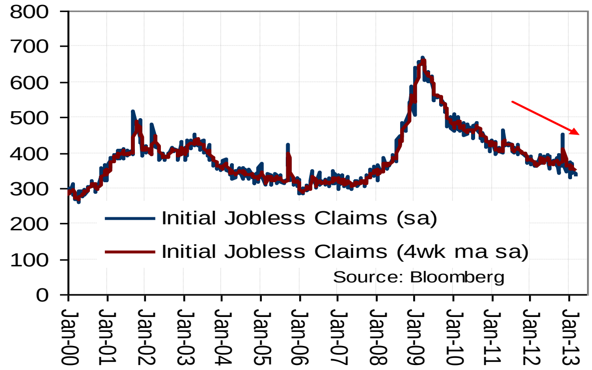
Housing market recovery continue to hum along



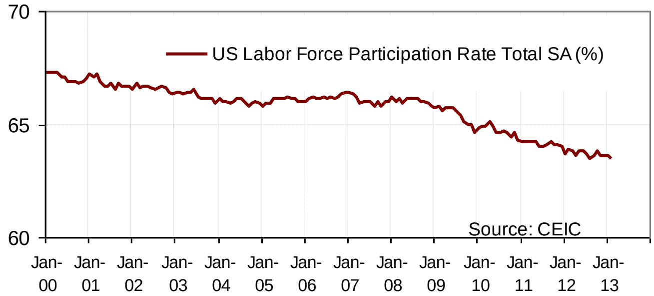
Labour market improved with unemployment rate declining to a 4year low…



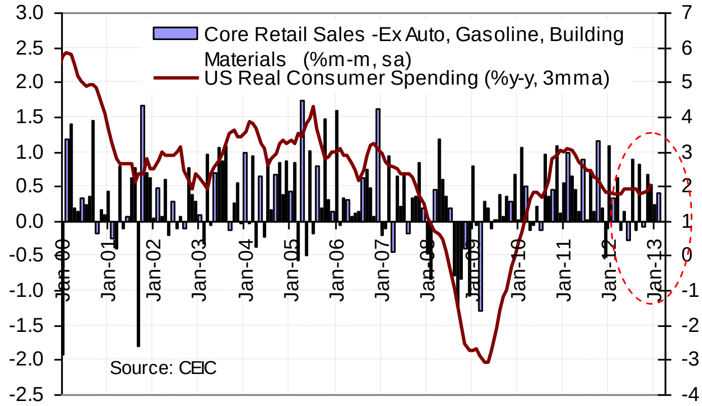
… and initial jobless claims declining to almost a 5-yr low



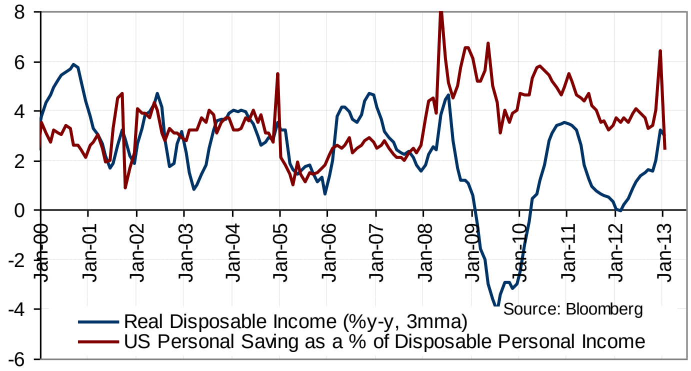
But labour force participation rate worsened suggesting that the labour market recovery is still fragile at best.



Some bright spots in consumption. Core retail sales -ex auto, gas and building materials-gained 0.4% m-m in Feb, following a 0.3% increase the preceding month.



But personal disposable income needs to hold up, otherwise the strong consumption spending in the 1Q13 will likely fizzle out as there is a limit to how much households can dig into their savings.



Notwithstanding these encouraging data on the macro front, the "sequester" –automatic and across-the-board budget cuts- during the remainder of FY13 (March through Sept) - will still likely weigh growth on 2H13 and shave off around 0.6%pt from calendar year 2013 economic growth.

Still we are cautiously optimistic that Congress might dampen the fiscal drag to some extent possibly via legislative changes as well as emergency appropriations. Thus, on balance, we revised downwards (GMAS 4th Mar) our real GDP growth for the US by 0.5%-pt to 1.7% for the whole of 2013. Downside risk to our US 2013 GDP forecast is a sharper-than-expected fiscal drag. On the other hand, a strong-than-expected capex rebound would pose some upsides for growth.

Apart from the sequestration, there is likely a lagged adverse effect of the payroll tax hikes on household consumption. While recent macro data suggests US consumers -in the face of the payroll tax hike- saved less to keep spending up, the question is whether consumers will continue to dig into savings? Households could have saved quite a fair bit of early dividend payouts distributed last Dec, indicating a possible one-off payback effect. **But Jan-Feb retail sales have proved to be resilient thus far. Though that means either consumers continue to dig into their savings to finance consumption or personal income was higher than expected.**

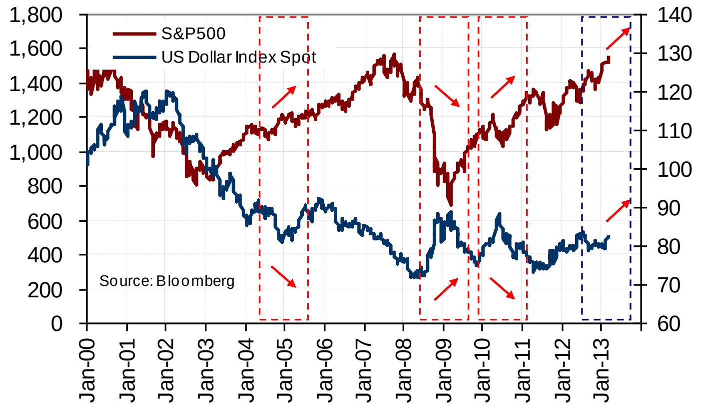
Furthermore, fiscal uncertainties persist: (i) the need to pass a bill by 27th March to extend routine government funding for federal program/agencies to avoid a possible partial government shutdown, (ii) the need to raise its US$16.4tn debt limit after 18th May, as well as (iii) the absence of a medium-term deficit reduction deal.

Maintain Long USD against EUR, JPY

Our prognosis at the start of this year (GMAS dated 4th Jan) was for the USD to gain ground against the EUR as well as the JPY. And indeed we have been correct thus far with the EURUSD dipping below the key 1.30 level while the USDJPY has blazed through the 95 strong resistance level.

Looking ahead, the USD is likely to relinquish its status as a funding currency to the JPY and instead continue to outperform along with risky assets.

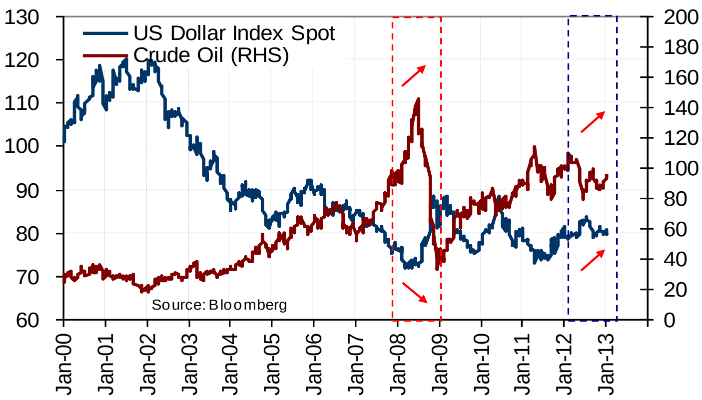
A structural shift in the USD –positive correlation with risk asset



The shale gas revolution will result in gradually energy independence for the US and correspondingly reduces its reliance on oil (a relatively more expensive energy source). This will translate to an improved current account balance, consequently lending support to the USD.

The shale gas boom also portends a weaker correlation between crude oil and the USD, thereby easing the inflation-growth trade-off in the US. This will increase the attractiveness of US assets, barring a disorderly exit from the large-scale asset purchases.

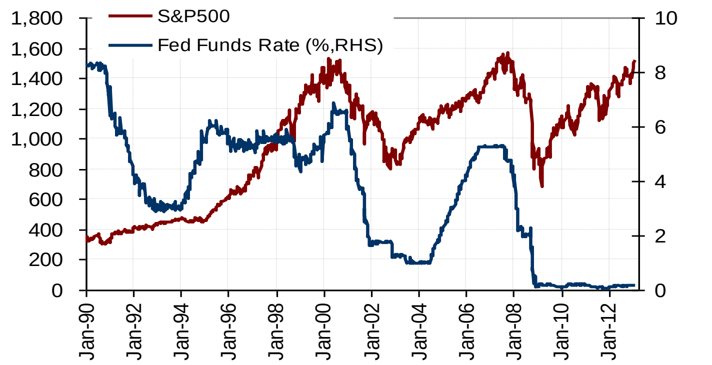
Has the USD decoupled from oil? Incipient signs of a structural break in the negative relationship between the oil-USD relationship which has previously resulted in undesired volatility in the business cycle.



Low Conviction on Treasuries and US Investment Grade Corporate Debt -maintain UW for both of them- on account of poor reward to risk ratio.

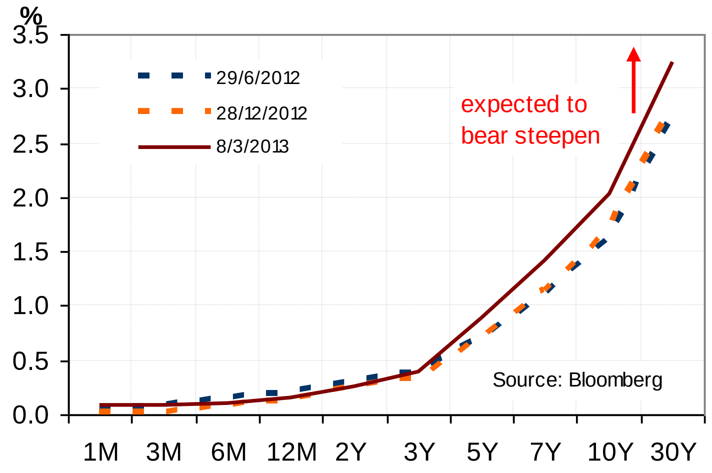
In view of encouraging (albeit tepid) signs of a global cyclical upturn and resilient domestic demand, the inevitable question will be: When will the Fed pull away the QE punchbowl and what happens after that? To be sure, an exit from the LSAP should signal a strengthening economy, in which case equities would rally even more (as a selloff in bonds under Fed withdrawal and a strengthening economy would entail a cycle out of bonds into stocks). But if the exit is too early, or judged by the market to be too early, both the economy could slow and equity risk-on be halted, as was the case in 1994. Recall that in 1994 the S&P500 bull run stalled that year as the Fed Funds rate soared 400bp between Jan94 to Feb95. Do note in this premature exit from loosening scenario, equity risk-on only stalled and resumed its climb in 1995 as the economy withstood the tightening. The end of LSAP therefore could cut either way, and depends much on the skill of the Fed's timing and reading of the underlying economy.

Note the sharp rise in interest rates from Jan94 to Feb95 merely stalled the bull run for a year as the exit from loose policy did not result in a weak economy. Will the Fed this time read the economy as well as in 1994?

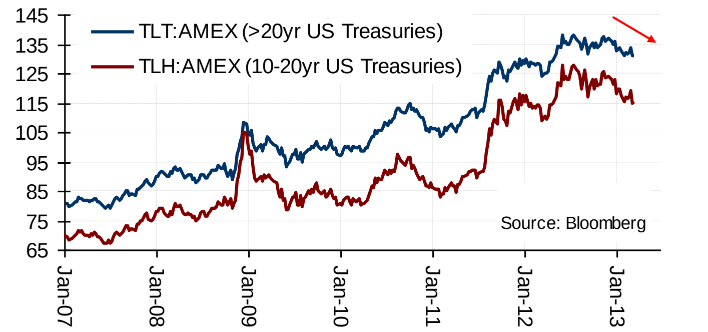


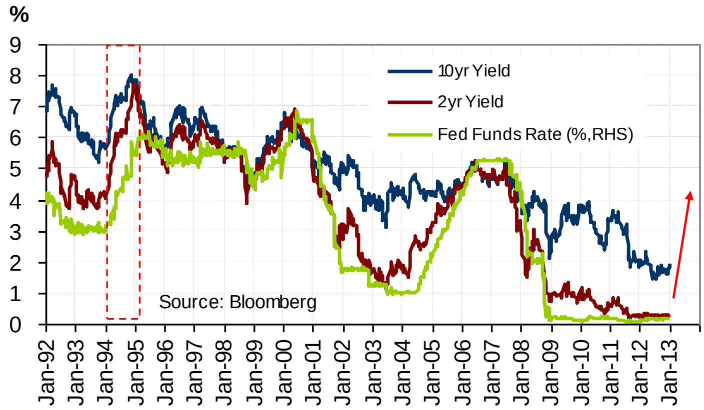
The effect is that we expect the US Treasury yield curve to continue to bear steepen (consistent with our 21st Dec US Macro Strategy), with long-term bond yields rising faster due to improving sentiment on the US economy following the cyclical upturn, while yields at the short end remain anchored. Furthermore, rates at the long-end of the yield curve could go even higher, especially if the sequester is watered down and Congress reach a bipartisan medium-term deficit reduction plan. **As US investment grade corporate debt tends to track US treasuries, we maintained UWs for both of them**.

US Treasury yield curve have continued to bear steepen, with long-term bond yields rising faster



Little upside to US Treasuries as they are highly sensitive to interest rate hikes





Total Return	2012	2013	2013 rtn (ytd)	
Bonds				
US Treasuries	OW to UW 9th Oct	UW	-3.3%	correct
US MBS	OW	OW to UW 23rd Jan	-0.4%	correct
US Corp IG	OW to MW 9th Oct	UW	-1.0%	correct
US Corp HY	OW	OW to MW 18th Feb	1.8%	correct
EM-Asia US$ IG	OW	OW to UW 23rd Jan	-1.0%	correct
EM-Asia LC IG	OW	OW to MW 23rd Jan	0.8%	correct
EM-Asia HY	OW	OW to MW 18th Feb	1.0%	correct
simple average:	OW	MW	-0.3%	correct
Equities				
World	MW	OW	7.4%	correct
US	UW to MW 21st Dec	MW to OW 14th March	9.5%	<=upgrade
EZ	UW	UW	6.0%	<= too pessimistic again?
Japan	-	MW	20.2%	Possible Upside to MW call
Korea	MW	MW	-0.5%	Under Review- Downgrade UW
Taiwan	MW	MW	4.0%	correct
China (A)	OW 22nd Oct	OW	4.5%	Near-term weakness on property curbs
China (H)	OW 22nd Oct	OW	-3.2%	Near-term weakness on property curbs
HK	OW 8th Oct	OW	4.2%	correct
SG	OW	OW	3.6%	correct
MY	MW	MW	-1.3%	<= reassess after elections
TH	OW	OW	6.7%	correct
ID	MW	MW	13.0%	Under Review- Upgrade OW
PH	OW	OW	16.3%	correct
India	UW	UW	-0.9%	correct
Commodities	UW	MW	-0.4%	correct
Gold	UW	UW	-5.3%	correct

OW = Overweight | MW = Marketweight | UW = Underweight

Source: PSR, Bloomberg (14 Mar 2013)

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OW = Overweight ; MW = Neutralweight ; UW = Underweight

Broad Asset	Sub-Asset	Rating	ETF		Phillip CFD
Bonds (MW)	US Treasuries	UW	TLH.AMEX / TLT.AMEX		
	US Mortgage Backed	UW	VMBS.AMEX / MBG.AMEX		
	US Corp	UW	VCLT.AMEX / LQD.AMEX		
	US Corp High Yield	MW	HYG.AMEX / JNK.AMEX		
	EM US$ Govt	UW	EMB.AMEX		
	EM LC Govt	MW	LEMB.AMEX		
	EM US$ HY Corp & Govt	MW	EMHY.AMEX		
	Asian US$ Govt & Corp	UW	N6M.SGX		
	Asian LC Govt & Corp	MW	N6L.SGX		
	Asian US$ Corp HY	MW	O9P.SGX		
Equities (OW)	US	OW	SPDR S&P 500 (SPY:AMEX)		US SP 500 Index USD5 CFD (S&P500) / Wall Street Index USD1 CFD (DJIA)/ US Tech 100 Index USD5 CFD
	Europe	UW	SPDR Stoxx 50 (FEU:AMEX)		
	Australia	-	iShares MSCI Australia (IOZ:ASX)		
	Japan	MW	Nomura Nikkei 225 (1321.JP)		Japan 225 Index JPY100 CFD (Nikkei 225) / Tokyo Index JPY1000 CFD (Topix)
	S.Korea	MW	DBXT - MSCI Korea (IH2:SGX)		
	Taiwan	MW	DBXT - MSCI Taiwan (HD7:SGX)		Taiwan Index USD20 CFD (MSCI Taiwan)
	China A shares	OW	CSI300 (83188.HK) / SSE 50 (JK8.SGX)		FTSE China A50 Index USD1 CFD
	China H shares	OW	HKCEI (2828.HK)		H Shares Index HKD5 CFD (HSCEI)
	HK	OW	Hang Seng (2800.HK)		Hong Kong 40 Index HKD5 CFD (Hang Seng)
	Singapore	OW	SPDR STI (ES3:SGX)	**CIMB ASEAN40 ETF (QS0:SGX for S$ or M62:SGX for US$)**	STI SGD5 CFD / S'pore Index SGD20 CFD (SMSCI)
	Malaysia	MW	DBXT - MSCI Malaysia (LG6:SGX)		FBM KLCI MYR10 CFD
	Thailand	OW	DBXT - MSCI Thailand TRN (LG7:SGX)		
	Indonesia	MW	DBXT - MSCI Indonesia (KJ7:SGX)		Indonesia Index USD1 CFD (MSCI Indon)
	Phillippines	OW	DBXT - MSCI Philippines (N2E:SGX)		
	Vietnam	MW	DBXT - FTSE Vietnam (HD9:SGX)		
	India	UW	iShares MSCI India (I98:SGX)		India50 Index USD1 CFD (S&P CNX Nifty)
Commodities		MW	Lyxor Commodity 10$US (A0W:SGX)		
Gold		UW	SPDR Gold ETF (O87:SGX or GLD:AMEX)		

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