ATRAM

Investment Outlook

GLOBAL ECONOMY AND MARKETS

Pundits who were of the view that the worst was over were deeply disappointed. Their early optimism was dashed with a short-lived risk-on rally. Global inflation figures consistently surprised to the upside even against decelerating energy prices in 3Q22. High inflation validated the commitment of the Federal Reserve to maintain a hawkish stance until next year. With the Federal Reserve in an inflation-fighting mode, central banks continue to hike their respective rates to manage economic contraction amidst a resilient US economy and persistent supply disruptions.

Going into the last quarter, our deployment of capital will revolve around three key themes. First, we slightly adjust our central view that the "Fed will hike until something breaks" to "the Fed will hike until something American breaks." While seemingly rhetorical, the change carries significant ramifications, specifically, that the Federal Reserve is not stopping its hiking phase even if other central banks are inclined to slow down their respective policy rate hikes to avoid potential liquidity crises.

Second, the US dollar wrecking ball will continue to inflict damage to global economic growth and partly export inflation, particularly to countries that are running trade deficits and net importers of energy and food.

Lastly, we are increasingly positive about the US energy sector due to structural reasons of capital underspending, resilient demand, and most importantly, the growing divide between the OPEC+ oil cartel and the US.

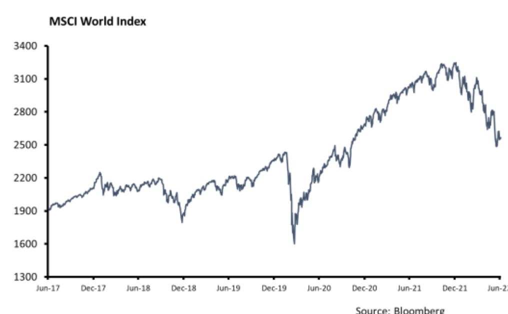
Our global strategy going into 4Q 2022 is to remain in the defensive where we keep an overweight cash position to take advantage of rising yields. The strategy is also to be tactical and flexible in order to be ready to be gradually deployed to markets with great risk-reward propositions such as the US energy sector theme. Even against negative and short-term cyclical factors, we expect the defensive strategy to sustain outperformance and positive returns within the foreseeable horizon.

Developed Market (DM) Equities

We attribute the deep correction in US equities to the rise of the risk-free rate. As cashflows get discounted by the higher rate, valuations are expected to be reduced with our base case that they do remain lower for the end of the year. On broad indices, our base case for the S&P500 is 3,300 by year-end.

The next leg down for the US and the rest of DM equities will come from negative earnings revisions. We believe we are still in the initial stages of the revisions cycle, which means the big downgrades are still ahead of us.

While we remain defensive but we are increasingly overweight the US versus other developed countries due to our preference for the energy sector. Given the cyclical nature of energy prices, we foresee more volatility for this sector, but we view this as an opportunity to allocate more capital at fair prices.



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Emerging Market (EM) Equities

We are far more cautious on EM equities relative to DM given persistent US dollar strength. One area of interest has been the resilience of Latin American equities led by Brazilian equities. This is due to early and aggressive central bank hikes combined with commodity exports that had blunted the impact of the USD's strength. Despite this, we expect broad EM equities to be weak as long as the US Fed keeps on raising rates and siphoning liquidity from across the world creating a double negative impact of lower global economic growth and weaker EM currencies.

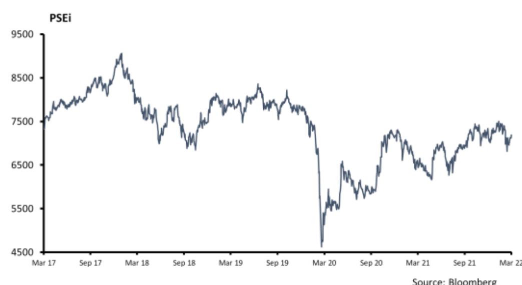
Asia ex-Japan Equities

Given that China has been doubling down on its Zero COVID policy, we remain cautious about the Asia-Pacific region's markets despite the attractive valuations. We are looking for Chinese policymakers to initiate and be a more aggressive on-demand stimulus to support household consumption before adding to A-shares. On the tech side, we are wary given the escalating technology war between US and China. Given the strategic importance of technology to both countries, this will increase tensions in the region..

Philippines Equities

Where we are less apprehensive is in Philippine equities. The market may continue to be weighed down by global risk-off sentiment towards equities and foreign currency depreciation. While volatility in the fourth quarter of 2022 may still be high, we are looking forward to relative improvements in 2023 just like what we are seeing in 2022.

We are entering the corporate earnings season for the 3Q print, we expect the results to show the sustained earnings momentum from the reopening but tempered by margin pressures from the recent rounds of raw material price increases. We continue to have low tactical cash levels on the portfolio as we capitalize on the improving risk-reward proposition of the market, which we believe in the medium- to long-term looks attractive.



Source: Bloomberg

Commodities

It is only one of two asset classes that have positive returns this year. Particularly for energy and despite the volatility surrounding the asset class, we see an opportunity in both the medium and long term due to structural demand and supply factors.

A significant seasonal consideration will be the weather conditions heading into the winter. A colder-than-expected winter will speed up the European gas storage depletion which could be bullish for natural gas early next year when the demand for replenishment rises.

This will have the knock-on effect of pushing up fertilizer prices which threatens future harvests and creates a tailwind for the prices of demand-inelastic agricultural commodities. As a US recession becomes more of a reality and the Fed begins to signal a pause in hiking, we believe that energy and agricultural commodities have tremendous upside.

Taking all of this into consideration, we remain neutral on commodities with a tilt towards becoming overweight depending on how the weather develops over the coming weeks in conjunction with further economic data.

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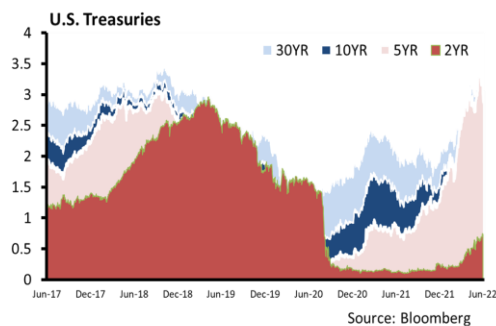
Global Market Bonds

Developed market bonds continued to remain fragile over the third quarter as the global monetary tightening lingers on while hawkish forward guidance continues to send yields further higher. The US Federal Reserve has hiked its policy rate by 150 basis points (bps), bringing the rate to 3.25%. As a result, developed market central banks were forced to respond - raising interest rates to retain their currency's relative purchasing power and positive carry against the USD.

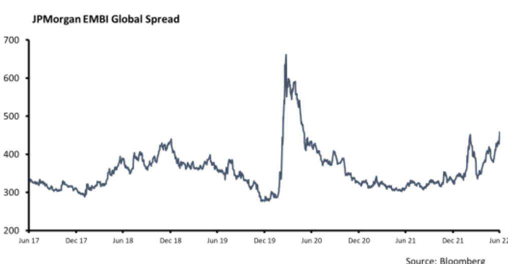


Volatility also came from Europe. A sharp sell-off was seen towards the end of September as European pension funds faced margin calls from the knockoff effect of the new fiscal program in the UK thereby creating a snowball effect of rising rates and weakening local currency.

We anticipate any significant slowdown in inflation in the latter half of 4Q 2022 could support a less aggressive pace in policy hikes. As we started to see value in absolute yields given the wide spreads and elevated rates, we started to tactically go overweight on the duration for our portfolios.

Emerging Market (EM) Bonds

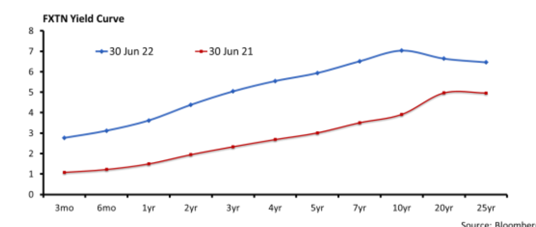
Emerging market (EM) bond valuations have continued to weaken over the third quarter as the US Federal Reserve (US Fed) intensifies its battle against inflation through aggressive policy rate hikes and hawkish forward guidance. The greenback has strengthened against all other currencies, placing pressure on emerging market central banks to match monetary policy responses in defense of their local currencies.



Further to this, with continued weakness in China owing to its strict policy on COVID-zero and still fragile property markets, investors have scaled back in purchasing EM credits until they see sustained evidence that the broad macroeconomic and monetary policy environment will improve. We have turned constructive on the asset class going into the fourth quarter as we see significantly weak valuations on rates and credit spreads thereby paving the way to take advantage of opportunities to deploy at attractive levels.

Philippine Bonds

Philippine bond yields continued to trend upward as the Bangko Sentral ng Pilipinas (BSP) hiked interest rates to slow inflation and cushion the PHP volatility as a result of the strength of the USD. Domestic inflation failed to peak over the quarter, reaching a high of 6.9% from heightened food and fuel costs. Short to medium-term yields rose by 100-150 bps as the BSP increased their key rate to 4.25% (+175 bps).



Going into the fourth quarter, we expect the BSP to remain hawkish until inflation has shown a clear sign of peaking. Given this, we retain an underweight position to protect against further spikes in inflation and look to add duration when opportunities present themselves.

Currencies

The Philippine peso followed the movement of other global currencies that weakened with the USD strength. The local currency continued to weaken and record new lows. In the background, the peso's low was reflected by a deterioration of the gross international reserves to US$95bil as of August from a peak in the past 12 months as well as in the current account deficit, which is now more than 6% of GDP.

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Currencies (continued)

Our analysis points to a year-end value of the peso-dollar exchange rate from anywhere between PHP59:USD to PHP65:USD. This wider range of outcomes points to the high level of uncertainty around what we believe are now the key drivers for our currency – Fed/BSP monetary policy and rate outlook.

Some support may be expected in 4Q22 with seasonal flows from OFW remittances and a pick-up in tourism arrivals with mobility restrictions now barely existent. However, any significant reprieve on the Peso from elevated weakness in the case of global monetary tightening tapers off in 2023 seems unlikely in the near-term. The twin deficits – deficits on our fiscal and current accounts -- will remain persistent in the medium-term. Other concerns such as potential supply shocks in rice and sugar and elevated oil prices will continue to put pressure on our import bill and the twin deficits.

Source: Bloomberg

Index/Currency	Price as of Sep 30	Percent Change		
		QoQ	YTD	YoY
MSCI World Index	2,378.65	-6.58%	-26.40%	-20.89%
MSCI AC Asia ex Japan Index	557.95	-14.57%	-29.31%	-30.36%
MSCI EMEA Index	181.95	-6.26%	-34.00%	-35.91%
PSEi	5,741.07	-6.73%	-19.40%	-17.43%
USD / PHP	58.63	6.64%	14.95%	14.95%
USD / JPY	144.74	6.65%	25.77%	30.06%
EUR / USD	0.98	-6.51%	-13.79%	-15.35%

Source: Bloomberg

Security	Yield as of Sep 30	Change in Yield (bps)		
		QoQ	YTD	YoY
US Treasuries 2YR	4.28	133	355	400
US Treasuries 5YR	4.09	105	283	313
US Treasuries 10YR	3.83	82	232	234
US Treasuries 30YR	3.78	59	187	173
PHIL. FXTN 2YR	5.22	83	254	311
PHIL. FXTN 5YR	6.29	35	209	305
PHIL. FXTN 10YR	7.04	0	222	254
PHIL. FXTN 20YR	7.40	76	231	200

Source: Bloomberg

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