GLOBAL MARKETS

# Yielding to Inflation: The global bond rout and what it means for equities

DIGITAL ENGAGEMENT TEAM

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TRADING MATTERS SERIES: NEWS FOCUS

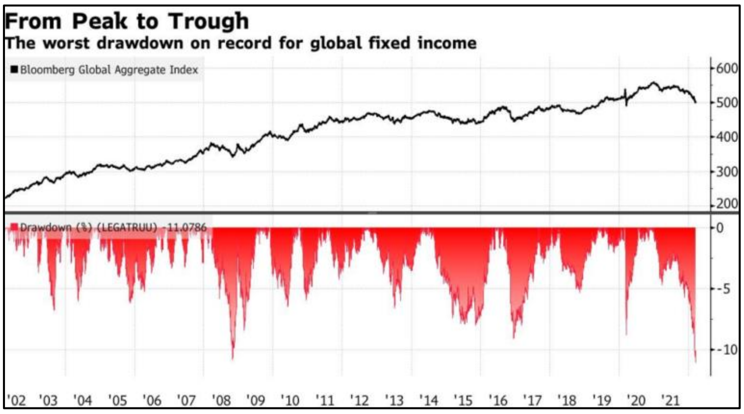
*The summary and impact of a major news event*

## What you need to know:

### Rising yields and inverting yield curves, what's that all about?

The global bond market is in trouble.

Global bond markets have now suffered record losses outweighing the peak of the 2008 financial crisis.[1] The Bloomberg Global Aggregate Index, a benchmark for government and corporate debt total returns, is down some US$2.6 trillion in market value, worse than the US$2 trillion in 2008.[1]



*Source: Bloomberg*

Bond yields, which move inversely to their prices and traditionally in lockstep with inflation expectations,[2] have spiked drastically over the past few weeks.[1] The US Treasury yield curve has been flattening.[3] Parts of it have even inverted, with short term yields higher than long term yields, a signal that traders are anticipating a slowing economy, rate cuts in the future, or even a recession.[3,4,5]

But how did we get here? And what does it mean for equities?

### 3 things to know about the global bond rout:

Changing monetary policy

The big concern is just how far will central banks have to tighten policy to control the worst inflation in decades.[1] Unpredictability of central banks in this hiking cycle is also partially to blame.[1,4] After all, just one year ago the US Fed was signalling no rate hikes until 2024.[6] Now, they've hiked once, pencilled in six more increases this year,[7] opened the door to double rate hikes if necessary, and conceded that the Fed had "widely underestimated" how long inflation would last.[8]

Rising recession risk

Weighing on markets is doubt in the US Federal Reserve's ability to engineer a "soft landing" for the economy as it hikes interest rates to fight inflation.[9] Expectations are that tighter policy will slow the economy and could even cause a recession.[3,4] The US Fed doesn't yet see an elevated probability of a recession in the next year,[10] but that hasn't stopped markets from pricing in a higher recession risk.[3,4]

Impact on equities

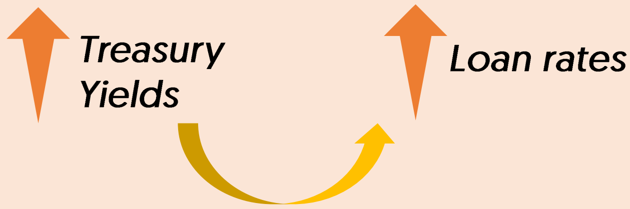
Yields affect a great many things in the financial markets, from margins to interest costs.[11] Even as bonds have suffered, funds flowing out of the reeling bond market have been finding its way into equities,[13] as investors find themselves with few alternatives to stocks[14] and look to equities as some ways to beat inflation.[15] In our previous News Focus in March 2021, we also covered the impact of rising yields on the stock market. See the next few pages for an update of that.

# 5 REASONS WHY TREASURY YIELDS ARE IMPORTANT TO THE STOCK MARKET

Going back nearly two decades, commodities prices have been rising together with yields and inflation expectations[16]

This will naturally raise the cost of goods and services, thereby affecting the profit margins of businesses

Loan rates are often pegged to treasury yields




Firms with loans on their books may therefore face higher debt servicing costs, which could prove to be a drag on their financial performance[17]

Rising treasury yields could result in asset reallocation for investors

Fund flows could shift between investing in bonds and equities, as investors look for alternative opportunities[13,18]

Rising yields may help to improve the profit margins from loans and interest-bearing products sold by financials-related companies[14]

This may have an impact on the financial performance of said companies, attracting investors to the financials sector[19]

Rising yields may be used as an indicator for the economic outlook and stock market

Central banks and the Federal Reserve may then look to adjust monetary policy for their respective economies. Yields that rise too high might be detrimental to economic growth and thereby earnings outlooks and equities[13]

# A Peek into the Financials Sector

Financials are one of the sectors most sensitive to changes in bond yields, as it directly impacts profitability.[19] Rising rates allow banks to earn higher net-interest margins, boosting earnings. However, rising rates could also cause bank assets to fall in value, and it could mean lower capital ratios.[20]

## United States

| Name | Market Cap (in USD) | Last Price | Analysts Fair Valuation (12 Month Target) | Upside/Downside from Analysts Consensus | Dividend Indicated Yield |
|---|---|---|---|---|---|
| Berkshire Hathaway – CL B (BRK/B US) | 793.24 Billion | 358.76 | 347.00 | -3.28% | N/A |
| JPMorgan Chase & Co (JPM US) | 419.06 Billion | 141.92 | 169.90 | 19.72% | 2.82% |
| Bank of America (BAC US) | 352.68 Billion | 43.73 | 51.00 | 16.62% | 1.92% |

## China/Hong Kong

| Name | Market Cap (in USD) | Last Price | Analysts Fair Valuation (12 Month Target) | Upside/Downside from Analysts Consensus | Dividend Indicated Yield |
|---|---|---|---|---|---|
| ICBC – H (1398 HK) | 250.52 Billion | 4.69 | 6.10 | 30.11% | 6.82% |
| CCB – H (939 HK) | 185.25 Billion | 5.73 | 8.00 | 39.53% | 6.83% |
| China Merchants Bank – H (3968 HK) | 181.06 Billion | 59.95 | 77.67 | 29.56% | 3.12% |

## Singapore

| Name | Market Cap (in USD) | Last Price | Analysts Fair Valuation (12 Month Target) | Upside/Downside from Analysts Consensus | Dividend Indicated Yield |
|---|---|---|---|---|---|
| DBS Group Holdings Ltd (DBS SP) | 68.39 Billion | 36.16 | 39.96 | 10.50% | 3.32% |
| Oversea-Chinese Banking Corp (OCBC SP) | 40.97 Billion | 12.41 | 14.20 | 14.39% | 4.27% |
| United Overseas Bank Ltd (UOB SP) | 39.79 Billion | 32.38 | 36.03 | 11.27% | 3.71% |

Stocks highlighted are the largest market cap stocks in the sector for their respective markets. Statistics for Market Cap, Last Price, Analysts Fair Valuation, Upside/Downside from Analysts Consensus, Dividend Indicated Yields are as of 28 March 2022, 6pm.

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