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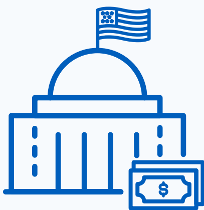
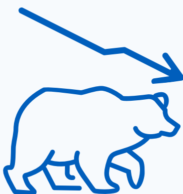
J.P.Morgan ASSET MANAGEMENT

UOB Investment Insights

Market PowerBar

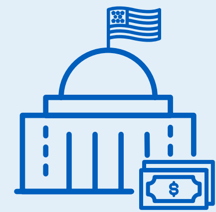
NOVEMBER 2023

A LOOK AT THIS MONTH

Key Topics	What Investors Should Know
1  United States government shutdown is looming, but impact may be limited	**US government could shut down if Congress does not pass a longer-term funding bill by 17 November.** ▶ A shutdown means that the government would be unable to pay federal workers, leading to certain federal agencies having to stop operations. ▶ Historically, US government shutdowns have not had a significant or lasting impact on markets.
2  Bear steepening of yield curve is a concern for investors	**The recent surge in long-term bond yields has resulted in "bear steepening" of the yield curve. Investors see this as negative.** ▶ Yields on longer-term bonds are rising due to expectations for interest rates to stay higher for longer. ▶ Investors can take advantage of higher yields now by locking them in investment grade bonds. As the rate hike cycle is near its end, moving into longer duration bonds can also benefit portfolios.
3 Conflict in the Middle East sparks concern over global oil supply	**The Israel-Hamas conflict caused a spike in oil prices as markets worry about possible energy supply issues.** ▶ Higher oil prices from the conflict could lead to the cost of fertilisers and transportation moving up, contributing to higher headline inflation globally. ▶ As potentially higher oil prices may lead to broader market volatility, it is important to include defensive investments such investment grade bonds and high-quality stocks in your portfolio.

Speak to your UOB Advisor today to find out more.

United States government shutdown is looming, but impact may be limited

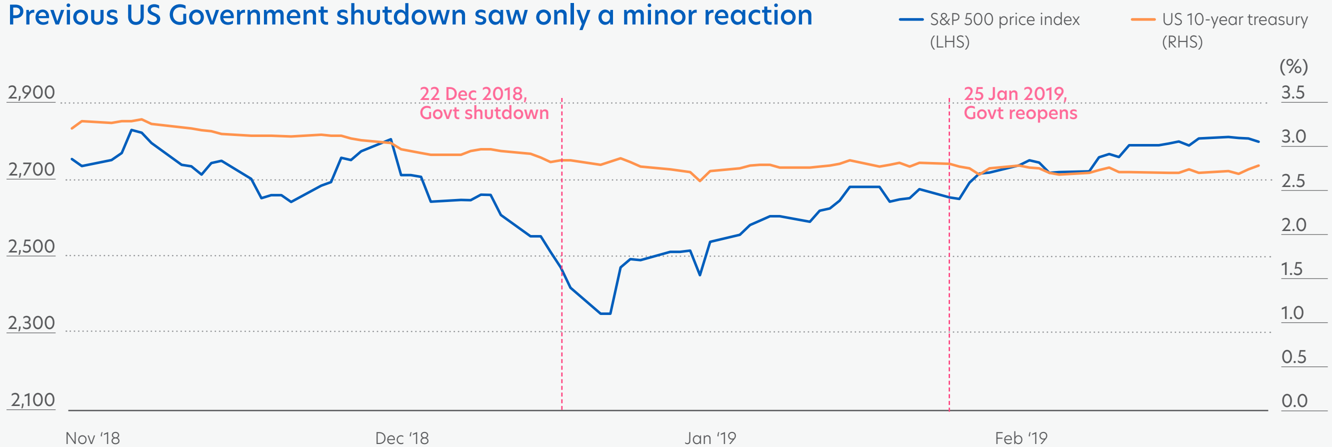


The US Congress passed a short-term funding bill on 30 September 2023 to avert a government shutdown. This agreement temporarily funds government spending till 17 November 2023.

1. The US Congress passed a short-term deal on 30 September just before the new fiscal year started on 1 October to avoid a government shutdown. The current agreement on funding lasts 45 days and the government could shut down if Congress does not pass a longer-term funding bill.
2. A full shutdown means that the government would be unable to pay federal workers, leading to some federal agencies having to stop operations. However, it is likely to be temporary, as political and market pressures should push for a funding deal to be made eventually.
3. Historically, US government shutdowns have not had lasting impact on markets (Figure 1A). Initial reactions might be negative, but they tend to fade quickly.
4. In the longer run, issues related to government spending and unsustainable debt are concerning for the US economy. Greater problems may arise when tax revenues fall short of interest payments and spending, but this could still be several years from now (Figure 1B).
5. In the meantime, markets are expected to be volatile as the issue of a potential government shutdown resurfaces this month. This is especially true as little is known about the policy stance of the newly elected speaker of the House, Mike Johnson. Focus on your long-term financial objectives by staying invested and diversified.

Figure 1A

Previous US Government shutdown saw only a minor reaction

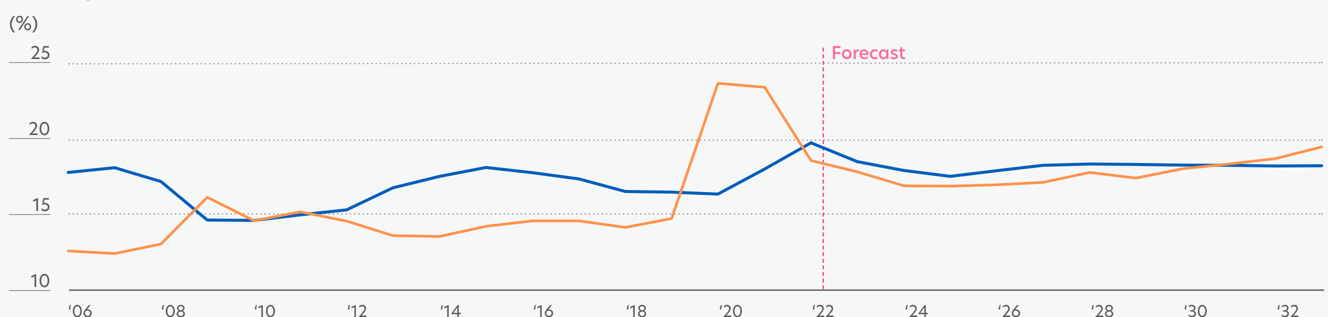


Source: FactSet, S&P Global, J.P. Morgan Asset Management.

Figure 1B

US tax revenues may fall short of outlays* at some point in the future

US outlays vs revenue forecast



*Mandatory outlays refer to spending such as social security and healthcare programs.

Source: Congressional Budget Office, FactSet, J.P. Morgan Asset Management.

Topic 2

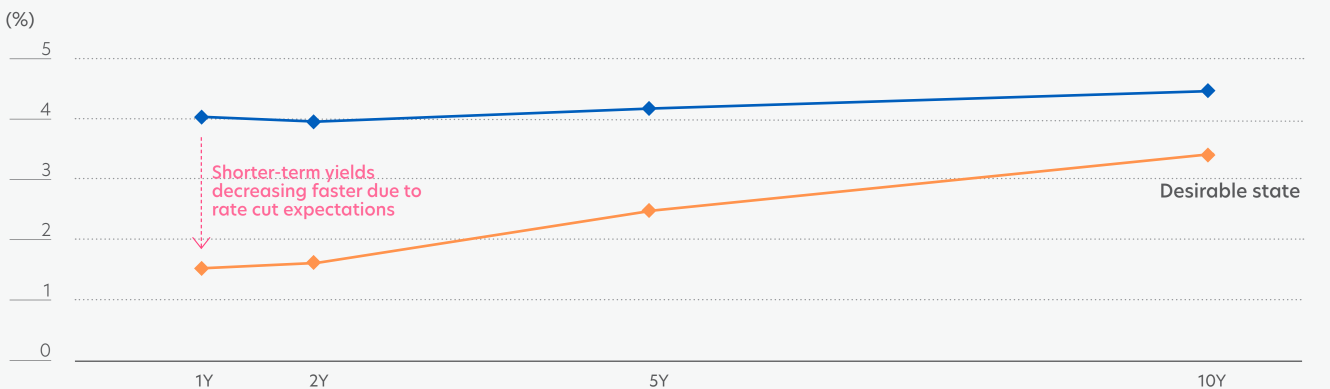
Bear steepening of yield curve is a concern for investors

The recent surge in long-term bond yields has resulted in "bear steepening" of the yield curve. Investors see this as negative.

1. "Bear steepening" of the yield curve occurs when long-term bond yields increase faster than those of short-term bonds.
2. One might think that this could be good news since an inverted yield curve, where long-term bond yields are lower than short-term bond yields, is usually seen as a sign of an impending recession. After all, the yield curve is now un-inverting and normalising.
3. Instead, what would be positive is "bull steepening" of the yield curve. In this scenario, the yield curve steepens when short-term yields fall more that long-term yields. This usually happens when rate cuts are expected (Figure 2A).
4. In the current "bear steepening" curve, yields of longer-term bonds are rising due to expectations for interest rates to stay higher for longer (Figure 2B).
5. This is a concern to investors as it suggests that inflationary expectations remain high, leading to central banks raising interest rates further or holding rates higher for longer. Tighter financial conditions general do not bode well for markets.
6. Investors can take advantage of higher yields now by locking them in investment grade bonds. As the rate hike cycle is near its end, moving into longer duration bonds can also benefit portfolios.

Figure 2A

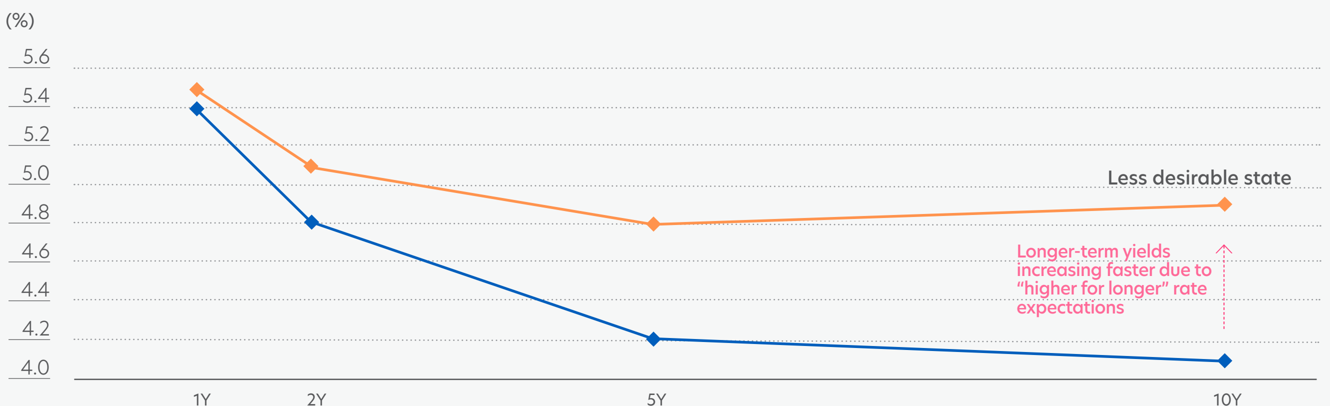
Bull steepening curve is driven by short-term rates falling faster than long-term rates



Source: FactSet, US Federal Reserve.

Figure 2B

Bear steepening curve is driven by long-term rates increasing faster than short-term rates



Source: FactSet, US Federal Reserve.

Topic 3

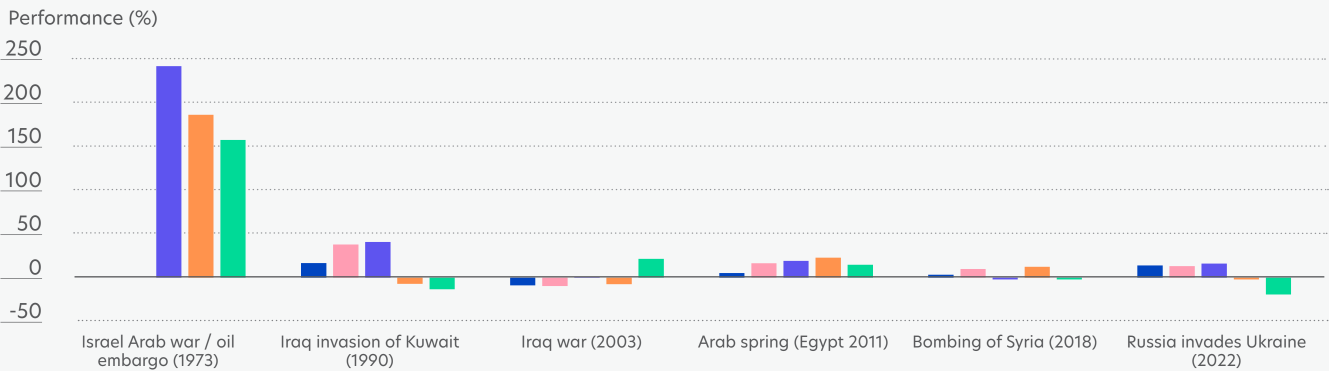
Conflict in the Middle East sparks concern over global oil supply

The Israel-Hamas conflict caused a spike in oil prices as markets worry about possible energy supply issues. Prolonged conflict could impact global economic activity and inflation outlook.

1. Geopolitics have had direct impact on oil prices. The Russia-Ukraine conflict and recent troubles in the Middle East both saw immediate reaction in oil prices, reminding us that oil remains a highly volatile commodity vulnerable to sudden shocks from world events.
2. In the Israel-Hamas conflict, potential risks include the involvement of other Middle East nations leading to disruption of oil supply from the region and potential higher oil prices in the near-term (Figure 3A).
3. There are two possible scenarios oil supply from the Middle East could be disrupted. First, sanctions on crude oil from Iran could be more strongly enforced. Second is a disruption of oil shipments through the Strait of Hormuz, an important shipping route. It is crucial to keep an eye on how the ongoing conflict plays out even though the risk of the above two scenarios is low.
4. In the near term, higher oil prices from the conflict could lead to the cost of fertilisers and transportation moving up. This could eventually make food more expensive, contributing to higher headline inflation globally (Figure 3B).
5. If the conflict persists for longer than expected, high oil prices could negatively impact consumer spending as well as the profit margins of sectors heavily reliant on oil.
6. In light of potentially higher oil prices leading to broader market volatility, it is important to include defensive investments such investment grade bonds and high-quality stocks in your portfolio.

Figure 3A

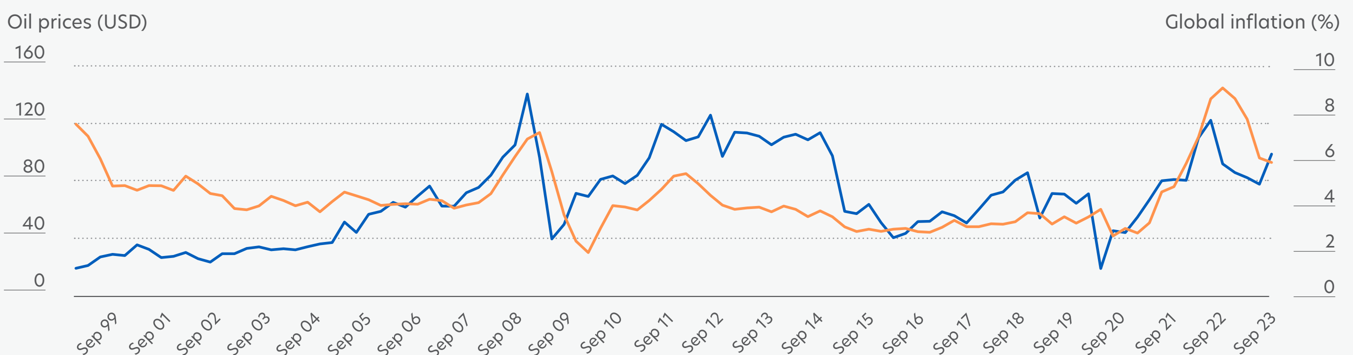
Oil prices may see a short-term spike after geopolitical tensions



Source: FactSet, J.P. Morgan Asset Management.

Figure 3B

Higher oil prices could contribute to higher headline inflation



Source: FactSet, J.P. Morgan Asset Management.

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