Macro | FX Research and Strategy

Global

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FX Insight

Signposts for FX Risk Sentiment

Evaluating RMB Moves and Market Technicals

In this report, we take stock of the current episode of RMB decline and compare it to past periods of significant RMB depreciation in 2015, 2018, taking into account their respective underpinning drivers and macro-landscape. We then share our view if we have seen the worst of RMB weakening and if significant ASEAN FX-RMB co-movement remains intact. We then explore the behavioral and sentiment aspects of technical analysis to get a gauge on how stretched markets may be and to keep a look out for any potential contrarian bottoming signals.

Yuan's Capitulation Nearing its End?

China stuck to its zero-Covid strategy and CNY finally capitulated. We looked at a few notable lockdown episodes (Shenzhen, Shanghai, Beijing) and are more inclined to think that China has managed to control the recent spate of infections at home. Flow-wise, China has wider current account surplus now compared to past episodes of CNY declines in 2015 and 2018 which can act as a buffer (even if at risk of narrowing). In addition, continued pressure from Fed-PBoC divergence may be limited from here. That said, any escalation in geopolitical tensions could drag on yuan and drive capital outflows.

ASEAN FX/Yuan Co-movement Still Significant, But Moderated in 1H
Spillovers to ASEAN FX from recent shift in yuan narrative have been varied in extent. More idiosyncratic factors could be at play. Our regression analysis shows that ASEAN FX's sensitivity to yuan moves have moderated in recent months. MYR is the only exception, with drags likely amplified by its exposure to oil swings (which also reacted to China lockdown news). While yuan moves will likely remain a significant driver of ASEAN FX sentiments in 2H, the earlier stability imparted to ASEAN FX from yuan's consolidative phase has notably ebbed. In such an environment, "signposts" on turning points in market sentiments could be of greater relevance.

Technicals Still Paint a Story of Fear and Caution

On broader market sentiments, the fear-greed index, AAII investor sentiment survey and BofAML FMS cash balance data are painting a coherent story of fear and caution. Sentiment readings are approaching extreme levels and can potentially trigger contrarian signals. That said, any meaningful rebound still need a positive fundamental driver, which is lacking today.Looking at regional FX performance in past periods of S&P 500 sell-offs, KRW expectedly displayed high sensitivity (median ~11.8% decline), while among ASEAN FX, IDR (-7.2%) and MYR (-8.7%) appear more sensitive versus peers. Historically, average AxJ FX depreciation range between -3% and -11%, and AxJ FX drags in this episode (-3%) has been relatively modest in comparison. Reopening momentum in the region could be helping to mitigate externally-induced drags but caution could persist for a while more. A closer look at a subset of ASEAN FX, via implied market positioning, vols, portfolio flows, suggest that a more sustainable recovery in the ASEAN FX complex may not be forthcoming yet.

Analysts

Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Tan Yanxi
(65) 6320 1378
tanyx@maybank.com.sg

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Amongst many negatives including global growth concerns, fears of inflation expectations risk being de-anchored, tightening of financial conditions, protracted war in Ukraine, the RMB decline since Apr was also one of the key negative factors behind the depreciation in AXJ FX.

In particular, we take stock of the current episode of RMB decline and compare it to past periods of significant RMB depreciation (about 15% vs. USD) in 2015, 2018, taking into account their respective underpinning drivers and macro-landscape. We then share our view if we have seen the worst of RMB weakening and if significant ASEAN FX-RMB co-movement remains intact.

Moving from fundamentals, we also look at technical analysis to provide a more complete picture. We focus on the behavioral and sentiment aspects to get a gauge on how exuberant and stretched markets may be and to keep a look out for any potential contrarian bottoming signals.

We then wrap up the report with a recap of our trading strategies, final thoughts on RMB, USD and if there are more tactical opportunities.

I. China's Lockdowns - Will They Get Better?

The yuan finally reversed out its pandemic gains on a multitude of factors (the extended lockdown for Shanghai that weakened consumption and production considerably, the Russia-NATO conflict that fans price pressures higher, weaken global demand and potentially fuel West-China tensions).

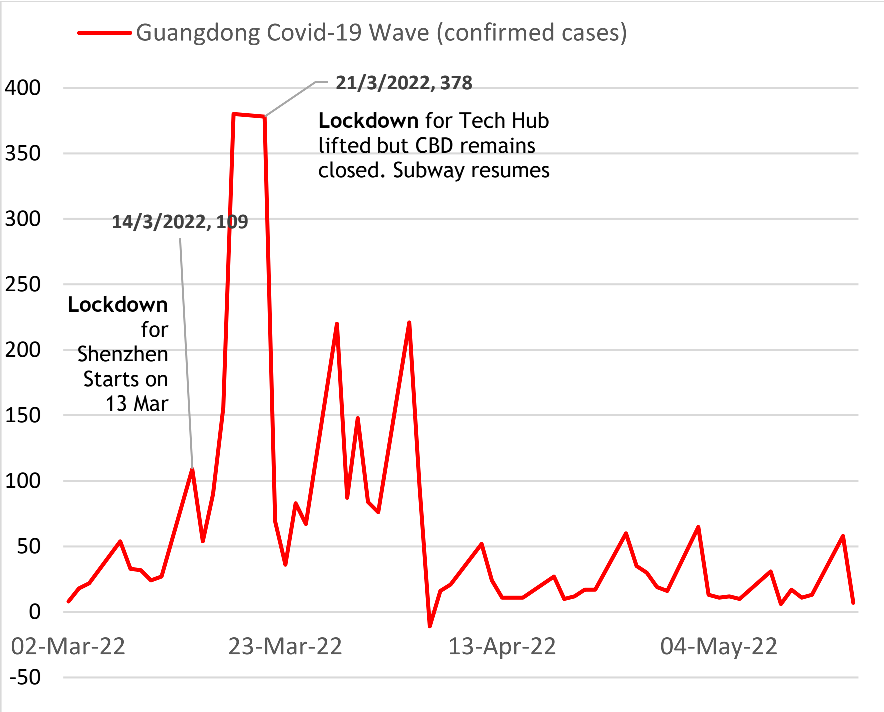
Key to the CNY direction is still arguably idiosyncratic with China's zero-covid strategy at the core and whether Shanghai alone has borne the brunt of the pandemic. A more optimistic view could be for other cities to continue to face sporadic lockdowns rather than a prolonged, city-wide lockdown that Shanghai has endured.

While most of the world moves towards living with Covid-19, China stuck to its zero-Covid strategy that has become synonymous with President Xi's leadership, exacerbating supply shocks and fanning inflation risks higher. The partial lockdown for the east of Huangpu River in Shanghai that started on 28 Mar extended to a city-wide lockdown and most residents still face varying extents of restrictions today (19 May). In this section, we looked through different lockdowns to see whether zero-Covid strategy is working for China and the likelihood for another Shanghai-like lockdown to happen. We also compared the different episodes of yuan depreciation over the past ten years for a gauge of yuan's vulnerability to further outflows.

Shenzhen Lockdown Worked

China has been using flash lockdowns to combat Covid-19. Back in Mar, a lockdown was imposed on Shenzhen when confirmed cases rose above 100. That lockdown lasted for around a week before the lockdown on tech hub was lifted and the subways were allowed to resume. Confirmed cases started to ease soon after.

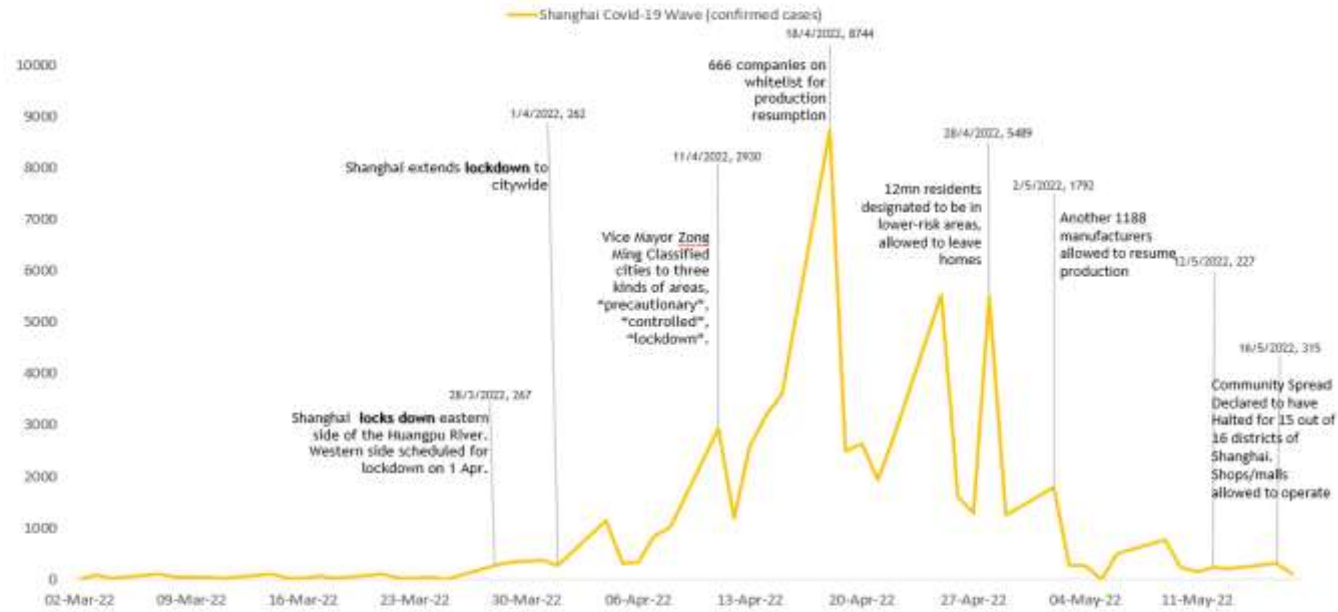
Figure 1 : Flash Lockdown of Shenzhen Worked



Source: 丁香医生, Bloomberg, Maybank FX Research & Strategy

Shanghai was placed on alert for outbreaks within the city as early as Mar. A lockdown for the city east of Huangpu river was then declared when confirmed cases reached 270 for Shanghai on 28 Mar. The lockdown was then extended on 1 Apr (4 days later) which was followed by a surge of infections in the city. **Localized lockdown that worked for Shenzhen** did not work for Shanghai and a city-wide shutdown had to be in place for prolonged period of time.

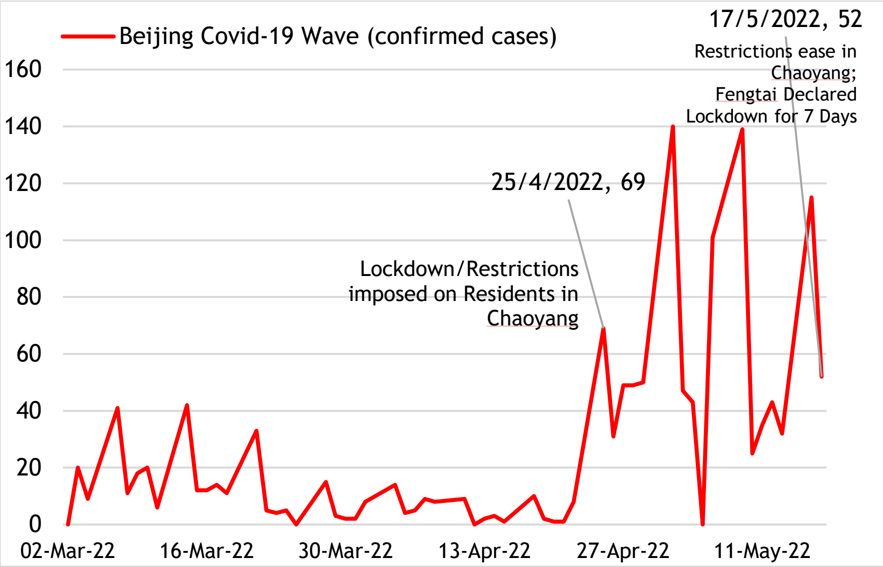
Figure 2: Flash Lockdown of Shanghai Did Not Work, Outbreak Worsened



Source: Bloomberg, Maybank FX Research & Strategy

During the lockdown of Shanghai, the world was peppered with horror stories of inadequate quarantine facilities, immense logistic issues for food delivery and the killing of pets. By day 7 of city-wide lockdown (8 Apr), daily confirmed cases crossed 1000. Fears of another city-wide lockdown prompted other governments to conduct mass testing. Some residents in Chaoyang (Beijing) were reportedly placed in lockdown (25 Apr) when the city reported just 69 confirmed cases of Covid-19, well under the number of cases reported by Guangdong (to trigger Shenzhen lockdown) as well as Shanghai. Early and localized lockdown seem to be effective thus far as confirmed cases remained well in *low hundreds* for the city of population >21mn and restrictions in Chaoyang were eased on 17 May while Fengtai in Beijing was declared to be under a 7-day lockdown from 18 May.

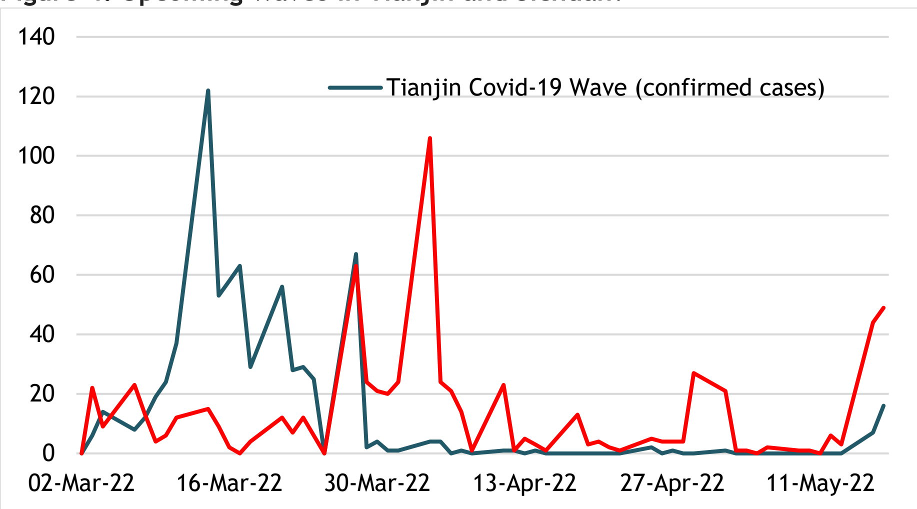
Figure 3: Earlier and Localised lockdowns working thus far for Beijing



Source: 丁香医生, Bloomberg, Maybank FX Research & Strategy

Despite some evidence that the combination of aggressive mass testing as well as localized lockdowns have worked thus far, news of further outbreaks in other cities that are critical to the manufacturing sector such as Tianjin and Sichuan could continue to keep investors cautious. In addition, newly discovered Omicron subvariants BA.4 and BA.5 are denoted as more infectious and the European Centre for Disease and Control has classified them as "variants of concerns" due to their rapid spread. More infectious variants could continue to test the resolve of China's zero-Covid strategy.

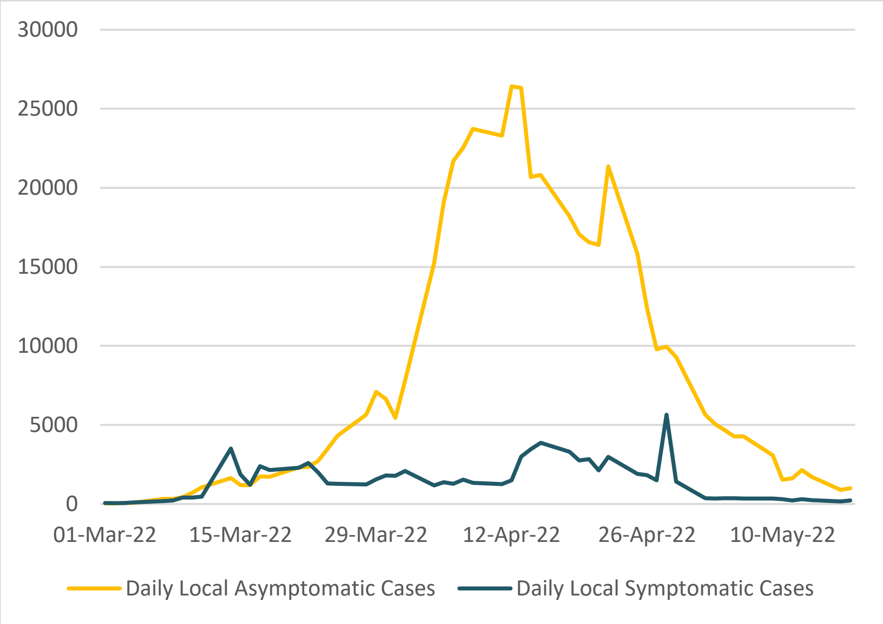
Figure 4: Upcoming Waves in Tianjin and Sichuan?



Source: 丁香医生, Bloomberg, Maybank FX Research & Strategy

Taking a look at the nationwide Covid figures, cases seem to have declined drastically, led by the fall in confirmed cases in Shanghai. The road to reopening for Shanghai is stll very cautious with authorities flagging 1 June to be start of a phased reopening that will eventually lead to a "normal life" by mid-late Jun.

Figure 5: Nationwide Data Suggests Infections Have Declined



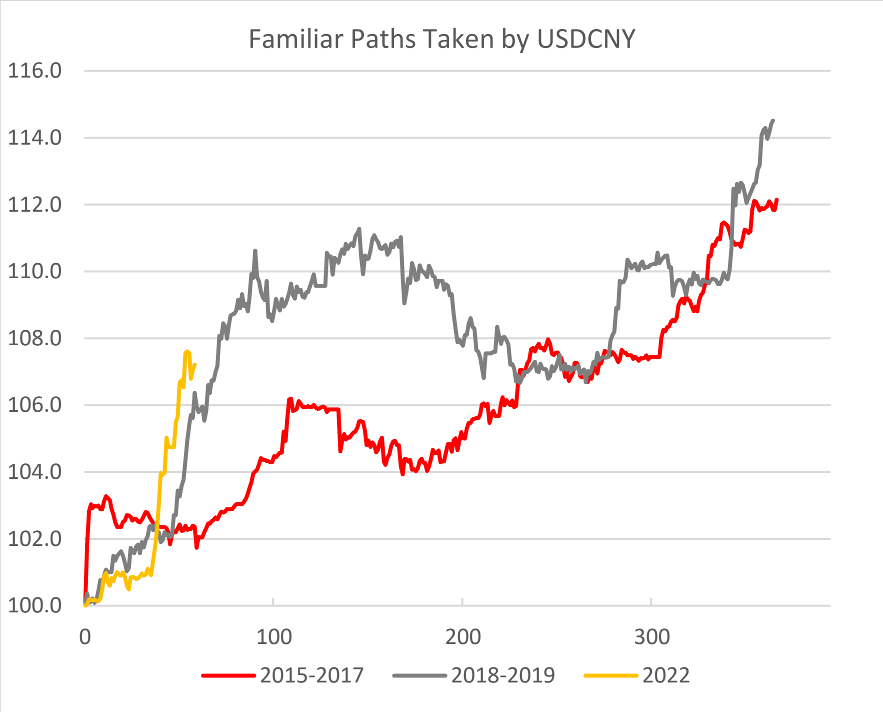
Source: 丁香医生, Bloomberg, Maybank FX Research & Strategy

Overall, we are more inclined to think that China has managed to control the recent spate of infections at home. The experience of residents in Shanghai and Chaoyang suggest that the authorities have somewhat found a definition of "societal zero" - three days of no community spread for easing of restrictions. Chaotic as the lockdowns have been for the residents at first, logistical kinks for food delivery, production seem to be ironed out with less anecdotal stories of residents being starved from Chaoyang compared to Shanghai (although they did have time to stock up their food larder) and Shanghai port resuming 90% of cargo-handling capacity as of 19 May. The Chinese authorities are likely to continue to use mass testing, early and localized lockdowns to achieve "societal zero" - aka a situation where there is no community spread and they could succeed, notwithstanding lingering risks.

Will the Yuan Continue to Weaken?

The breakout of yuan did not occur right at the start of the lockdown for Shanghai, significant as it was. USDCNY started to rise with more momentum around 19 Apr and broke out of the 6.30-6.40 range on 20 Apr after a sharply higher-than-expected USDCNY reference rate fix gave the spot more headroom. We noted that yuan sentiments actually turned noticeably more negative amid reports of record amount of bond outflows for Mar that was released around 18 Apr.

Figure 6: Recent Surge in USDCNY Seem to Mirror the Path of 2018 Decline at first glance



Note: index 100 = denotes peak of the CNY vs. the USD in respective episodes. X-axis denote days of CNY decline. Periods of CNY decline are taken from 11-Aug 2015 to 3 Jan 2017; 11 Apr 2018- 3 Sep 2019 and 28 Feb 2022. Apart from the event-triggered one-off devaluation on 11 Aug 2015, the start of each period is normally the peak of the CNY vs. the USD.

Source: Bloomberg, Maybank FX Research

The sharp CNY decline took market players back to previous episodes of yuan decline (2015 one-off devaluation post equity as well as the 2018-2019 trade war), fueling the upmove of the USDCNY. The chart above begs the question of whether there could be further yuan depreciation like what we have seen before and what are the key differences between yuan drivers (and underpinnings) for 2022 and before.

CNY Declines Happen in Economic Downturns, Equity Sell-Offs

All three episodes of yuan weakness occurred when China was experiencing a cyclical downturn and the OECD leading indicator for China flagged a peak in economic cycle months before. We note that in all three periods, the OECD leading indicator for the world also showed a downturn.

Table 1: Comparison with Past Episodes of RMB Decline

	2015-2017	2018-2019	2022
	China equity crash, one-off CNY	*US-China Trade War*	*China's Lockdowns*
CNY Decline (peak to trough)	12%	15%	8%
CNY TWI Decline	10%	6%	4%
Growth Condition of China (using OECD Leading Indicator) when CNY peak	Downturn, peak in May 2015	Downturn, peak in Jun 2017	Downturn, peak in Jan 2021
Curr. Acct ($bn/qtr)	$57bn/qtr on average	$9bn/qtr on average	**$89.5bn in 1Q 2022**
Estimated Net Capital Flows ($bn/mth)	-$38.1bn/mth	-$11.3bn/mth	-$9.9bn/mth
Debt Flows (worst month)	-$15.6bn (Jan 2016)	-$8.7bn (Nov 2018)	-$11.2bn (Mar 2022)
Equity flows (worst month)	-$6.8bn (Jul 2015)	-$11.0bn (May 2019)	-$6.6bn (Mar 2022)
Portfolio Flows (worst month)	**-$14.4bn (Jan 2016)**	**-$4.3bn (May 2019)**	**-$17.9bn (Mar 2022)**
Conse. Mths Port. Outflows	**4 months**	**2 months**	**2 months so far**
CSI 300	-40%	-29.60%	-25%
peak	May-15	Jan-18	Jan-21
trough	Feb-16	Dec-18	
Months between CSI 300 Peak and CNY peak	**3**	**3**	**13**
Months between CSI 300 trough to CNY trough	**11**	**9**	**--**
Fed Policy	Early stage of rate hike cycle	Late Stage of rate hike cycle	Early Stage of Rate Hike Cycle
	Gradual	Gradual	Steep
PBoC	Easing Cycle Well Underway	End of Rate Hike, Start of Easing	Cross-Cycle Policy Design
US-CH Yield Discount	narrowed >40bps	narrowed 20bps	closed completely and turned positive (~110bps)
Fed-PBoC Divergence	*Limited Divergence*	*Limited Divergence*	*Moderate Divergence*

Note: Periods of CNY decline are taken from 11-Aug 2015 to 3 Jan 2017; 11 Apr 2018- 3 Sep 2019 and 28 Feb 2022. Apart from the event-triggered one-off devaluation on 11 Aug 2015, the start of each period is normally the peak of the CNY vs. the USD.

Note 2: Debt and equity flows data are extracted from IIF and we looked at the worst months in respective periods of CNY decline. Net capital flows (including errors & omissions) are also estimated by IIF.

Source: Maybank FX Research, IIF, OECD.

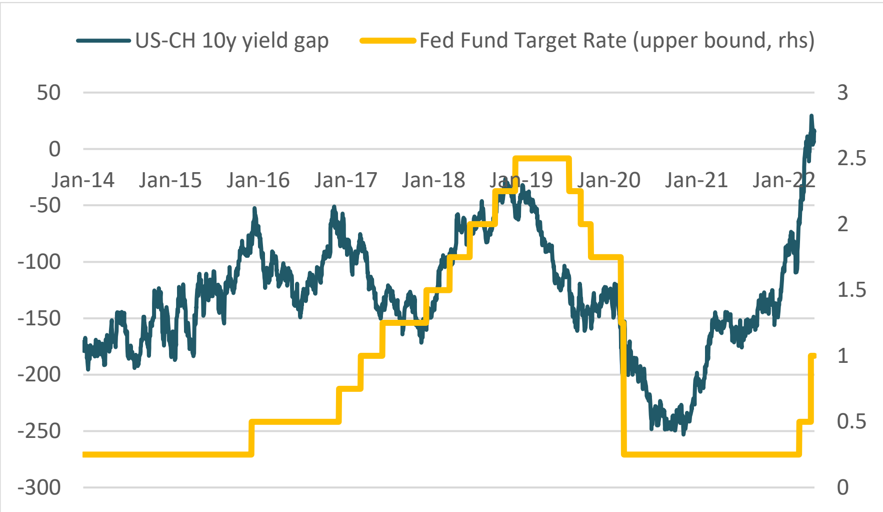
Solid Current Account Surplus Supported the CNY

In all three episodes, equity bourses such as the CSI 300 plunged at least three months before CNY. However, there are significant differences in the three episodes such as the solid current account balance for 2022. Current account surplus is at a robust $89.5bn for 1Q 2022 compared to an average of $9bn over the period of 2018-2019. Current account surplus was also rather healthy for China in 2015 at around $57bn/qtr. This could be a reason why the CNY had held up for around 13 months since the crash of local bourses last year.

Debt-driven Portfolio Outflows Undermine

Portfolio outflows had been significant in recent months for China but Russia's sales of RMB assets due to the embargo on the USD and EUR-denominated portion of its FX reserves could have contributed to the portfolio outflows. **As a result, IIF recorded $17.9bn of portfolio outflows (the largest ever on its record) for China.** The bulk of the portfolio outflows was driven by debt outflow. This is again *similar to the 2015 CNY decline*, debt outflows make up the bulk of outflows as the Fed and PBoC diverged on policy rate cycles from the Fed. We see history repeating for this year as debt outflows make up the bulk of the $17.9bn recorded of outflows for Mar again and recently released data from Chinabond suggests that foreign investors continue to de-risk on bonds for Apr as well. This underscores the significance of Fed-PBoC divergence as another key driver of yuan weakness against the USD as well as concerns on China's zero-covid strategy that could affect growth.

Figure 7: High Inflation likely frontloaded Pressure on USTs



Source: Bloomberg, Maybank FX Research & Strategy

There are again, noticeable difference. **In 2015, Fed was at the early stage of rate hike cycle and there was little inflation pressure then. For 2022, multi-decade high inflation headlines have driven UST yields to surge significantly even as we are at the start of the rate hike. This could mean significant frontloading of pressure on USTs compared to the 2015-2019 rate hike cycle.** At this point, Powell's mention of raising policy rates past neutral have increased fears of US recession and could keep the UST 10y yield from making further headway. Meanwhile, with China embarking on cross-cycle policy designs that encompass a mix of *fiscal spending* for infrastructure construction, easing of *macro-prudential measures* to support the flailing property markets as well as *targeted credit support* measures (various relending quota programs), broad monetary policy rate action is thus limited. The combinations of these factors could keep US-CH yield premium from making drastic widening from here and impetus for debt outflow may not intensify.

Taken together, we think there are reasons for us to be less negative on the yuan from this point given China's ability to achieve societal zero for Shanghai and possibly contain outbreaks elsewhere with localized and shorter lockdowns. Upgrades for China's growth prospect and CNY forecast may not happen in a jiffy given lingering threats of outbreaks and more infectious Omicron subvariants found recently but there seems to be a better chance of control by the Chinese government on the Covid narrative vs. 2018 trade war and the 2015 episode which was marked by a serious loss of confidence in China's financial system.

Robust current account remains a buffer for the yuan but could narrow. Fed-PBOC yield gap could also be at stretched level here and may not get much more impetus from either central bank which could translate to less upside pressure on the USDCNY as well.

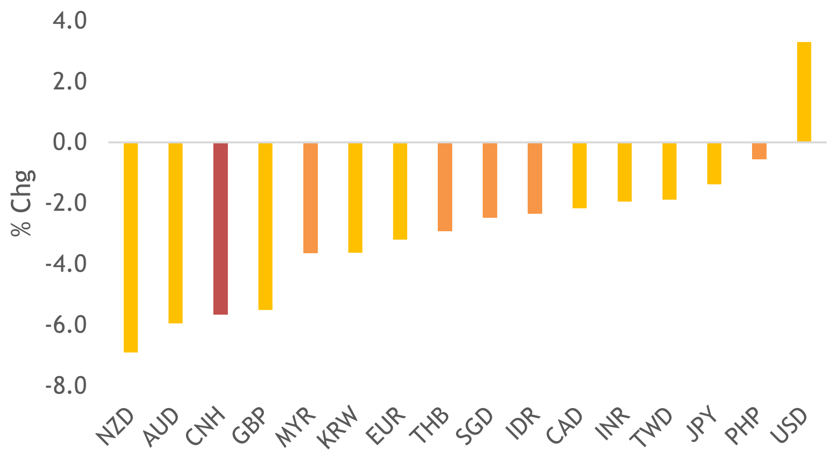
We are still wary of further net capital outflows though. Net capital outflows estimated by IIF (including errors & omissions) may still be relatively small at an average of $9.9bn for Feb-Mar 2022, compared to -$38.1bn/mth in 2015-2017 and $11.3bn/mth in 2018-2019. The outsized net capital outflows in 2015 could be due to China's severe equity crash and the government's interference to stem the rout both for CNY and equities could have hurt confidence in China's financial system then. For 2021-2022, there were not many measures imposed to close China's capital account thus far. President Xi repeatedly vows to keep markets open. That said, there have been geopolitical tensions between China and the West, not helped the least by the Russia-NATO conflict and sharp deterioration of that could worsen outflows and undermine yuan sentiments further and the path of USDCNY could then, mirror that of the 2018-trade war. We like to clarify that it is still more of a risk rather than our base case.

At this point, USDCNY is still susceptible to two-way trades but risks of persistent one way move beyond the 7-figure has reduced as China seems to have a fair chance of avoiding a Shanghai-like lockdown on another city. Recession fears for the US might keep the US-CH 10y yield premium from widening, thus also reducing another bullish impetus for USDCNY. Lingering risks that could keep USDCNY supported include the possibility that more infectious variants could lengthen the period of flash lockdowns or any escalation in geopolitical tensions.

II. ASEAN Currencies' Co-movement with RMB Still Significant, But Moderated in 1H 2022

The recent shift in yuan narrative has undoubtedly impacted regional FX sentiments, but spillovers to ASEAN FX have been varied in extent. More idiosyncratic, or economy-specific factors could be at play, given emerging differentiation in normalization pace in ASEAN monetary policies, economic drags from Covid-zero policies in China etc. Covid-linked disruption to growth and supply chains in China is also not the only major risk event in focus now, with global removal of monetary stimulus and intermittent escalation in European geopolitical tensions vying for market attention too.

Fig 8: % Changes in FX (vs. USD) from 15 Apr to 18 May 2022



Note: % change in USD refers to DXY moves. Orange bars refer to ASEAN FX.
Source: Bloomberg, Maybank FX Research & Strategy Estimates

To some extent, **we opine that the sensitivity of ASEAN currencies to yuan moves might have potentially moderated a tad this year**, and confirm this via a regression approach. We employ a simple workhorse model used by McCauley and Chang (Jun 2018, "*Recent RMB Policy and Currency Co-movements*"), a tool we have used before, to evaluate co-movements in yuan and regional FX.

The model takes the form:
ΔASEAN FX = C + $\beta 1 * \Delta$CNH + $\beta 2 * \Delta$EUR + $\beta 3 * \Delta$JPY + $\beta 4 * \Delta$VIX + ε,

where ΔASEAN FX is the daily percentage change in individual ASEAN currencies vis-à-vis the USD, and ΔCNH, ΔEUR and ΔJPY are the daily changes in, respectively, the yuan, euro and yen vis-à-vis the USD. Changes in VIX are included to control for shifts in global risk environment. The regression is estimated for each individual ASEAN FX. We examine β1—the co-movement coefficient between the RMB and the ASEAN FX in question—over two key phases:

(i) 23 Jan 2020 to Dec 2021: This period captures the onset of Covid-19 as well as subsequent recovery in activity and sentiments, where yuan and ASEAN FX moves were arguably reacting to similar broader shifts in global risk attitudes (e.g., simultaneous injections of monetary and fiscal support, emergence of vaccines, variants).

(ii) Jan 2022 to 17 May 2022: Differentiation in drivers impacting regional FX arguably came to the fore a tad more discernibly this year.

Table 2: β1—Co-movement Coefficient Between RMB and ASEAN FX

	SGD	MYR	IDR	THB	PHP
23 Jan 2020 to Dec 2021	0.43	0.21	0.85	0.48	0.27
Jan 2022 to 17 May 2022	0.28	0.42	0.17	0.38	0.15

Source: Maybank FX Research & Strategy Estimates

As we suspected, the results of our analysis suggests that with the exception of MYR, sensitivity of ASEAN FX to yuan moves have moderated in extent in 1H 2022.

Some key observations:

- SGD has seen greater resilience over this period, aided by its front-loading in monetary policy tightening (Oct 2021, off-cycle in Jan 2022, "double-tightening" via slope and re-centring in Apr 2022). SGD NEER is currently hovering near the middle of our expected +0.5% to +1.5% (above implied policy mid-point) range, reflecting modest strength on a relative basket basis.
- **MYR is the only FX to have seen its sensitivity to yuan amplified over the last few months. We postulate that exposure to oil price swings could have exacerbated drags on the currency**. I.e., news of China partial lockdowns led to concerns over slowing oil demand and bearish oil moves, which in turn led to second-round downswings in MYR.
- For THB, sensitivity to yuan came off a tad but remained high among peers, likely reflecting still-tight sentiment linkages via the tourism revenue channel. Tourism accounted for more than one-tenth of Thailand GDP pre-Covid, and China provided the largest share of such revenues at 28%.
- For IDR and PHP, timing of FX moves could be a tad decoupled from yuan shifts recently given more idiosyncratic domestic drivers. E.g., at various points in time, IDR reacted to shifts in export policy (e.g., earlier curb on coal exports and current curb on palm oil exports), while PHP likely saw some volatility tied to the recent president elections. The more domestic-oriented nature of both economies could have also mitigated the expected hit to economic activity from China partial lockdowns.

To be clear, China Covid developments and yuan moves will still be a significant driver of ASEAN FX sentiments in 2H 2022. But the earlier stability imparted to ASEAN FX from yuan's consolidative phase has notably ebbed.

In such an environment, "signposts" on turning points in market sentiments could be of greater relevance. We evaluate some of these in the next section of this report.

III. Signposts for Broad Market/ASEAN FX Risk Sentiments

In this section, we focus on the behavioral and sentiment aspects to get a gauge on how exuberant markets may be and to keep a look out for any potential contrarian signals. In particular, we draw insights from popular market measures of (1) fear-greed index; (2) AAII investor sentiment; (3) BofAML fund manager survey (FMS) cash balance and (4) a simple study on AXJ past performance during significant S&P500 sell-offs since GFC.

We also explore via (5) implied AXJ positioning for indication of any crowded bearish bets on AXJs; (6) a refresh of our ASEAN FX volatility model to get an indication on whether FX markets are over or under-pricing broader risk conditions; (7) taking stock of portfolio flows in the region if value could be seeping in.

What Market Technical Indicators Are Saying

(1) Fear and Greed Index – In the Zone of Peak Fear

The Fear and Greed Index is an amalgamation of 7 indicators (equally-weighted) that measures some aspects of investor behavior:

- Market momentum of S&P500 relative to 125DMA;
- Stock price strength tracking number of stocks in NYSE hitting 52w high vs 52w low;
- Market breadth via McClellan Summation Index (difference between number of advancing counters and declining counters in NYSE);
- CBOE put-call ratio (signs of investor nervousness when ratio is rising; above 1 reading is considered bearish);
- Market volatility – VIX relative to its 50DMA;
- Safe haven demand defined as difference between stock returns and UST returns over the past 20 days;
- Junk bond demand as a signal for greed, measured by yield spread between junk bonds and IG bonds (wider spread indicates caution).

Index score is between 0 and 100, where higher score indicates maximum greed while lower score indicates maximum fear. It gives a snapshot sense on the mood of the market at any point of time and if taken together with time series, it offers some insights on behavioral or sentiment shifts. To some extent, the extreme points of the index can also indicate inflection points and hence a contrarian signal.

Fig 9: Fear-Greed Reading at Extreme Fear

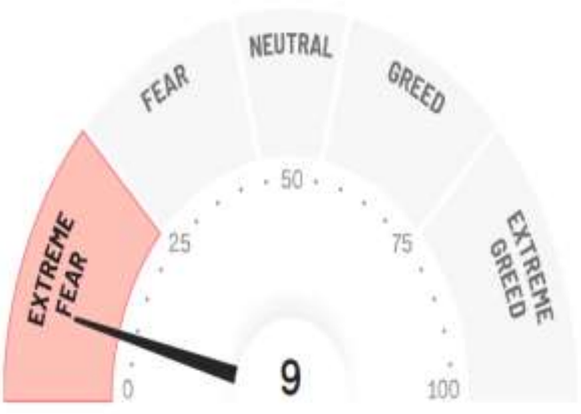
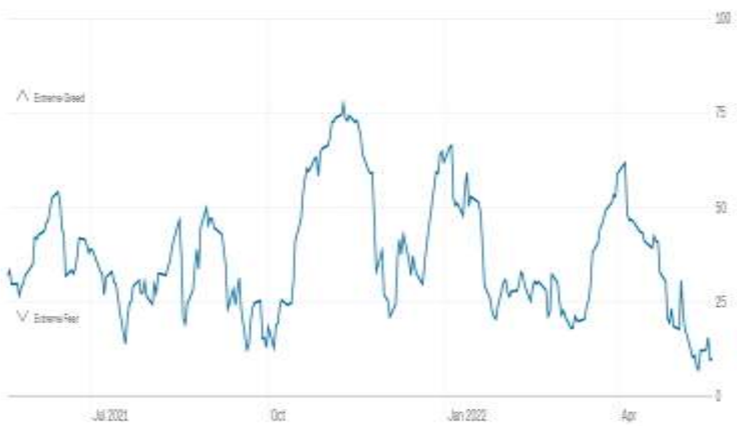


Fig 10: Fear-Greed Index Re-visiting Multi-Year Lows



Source: CNN Fear & Greed Index (as of 19 May 2022, Maybank FX Research & Strategy

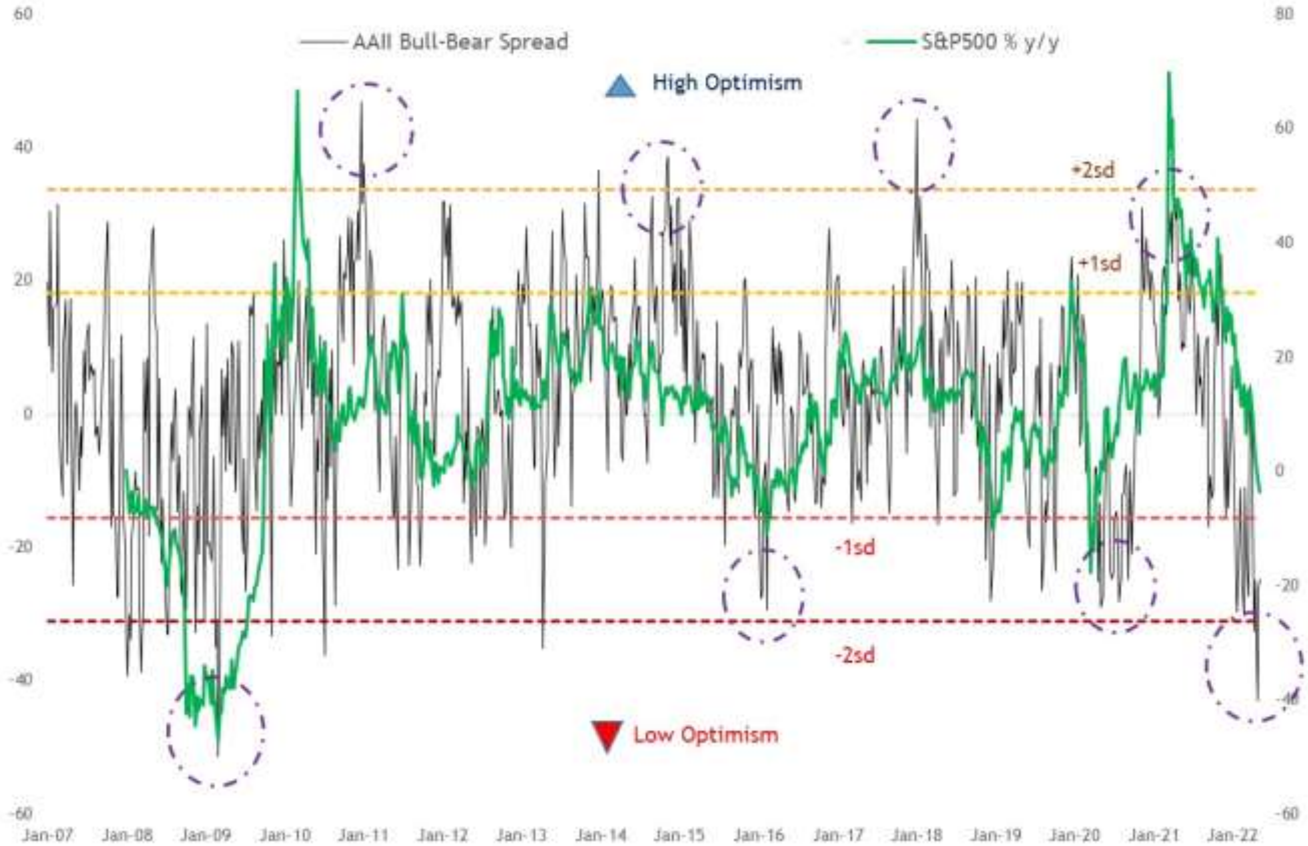
As of 19 May, the **fear and greed index of investor sentiment stood at 9 or 'extreme fear'.** Counterintuitively, this may signal that **a potential turnaround in sentiments could be on the horizon though from a valuation standpoint, some may argue that despite the near 20% sell-off in S&P500 YTD, the S&P500 is still trading around 20x PE ratio (a of 18 May) and is still "not cheap" relative to its historical average of 15x.**

We avoid jumping to conclusion based on 1 indicator alone. We next consider other sentiment measures – AAII investor sentiment and BofAML FMS – to see if there is a coherent pattern on stretched bias.

(2) AAII Investor Sentiment – Bears Out in Full Force

The AAII Investor Sentiment Survey is a regular weekly survey conducted by American Association of Individual Investors and aims to offer insights into the opinions of individual investors by asking them where the market is heading in the next 6 months.

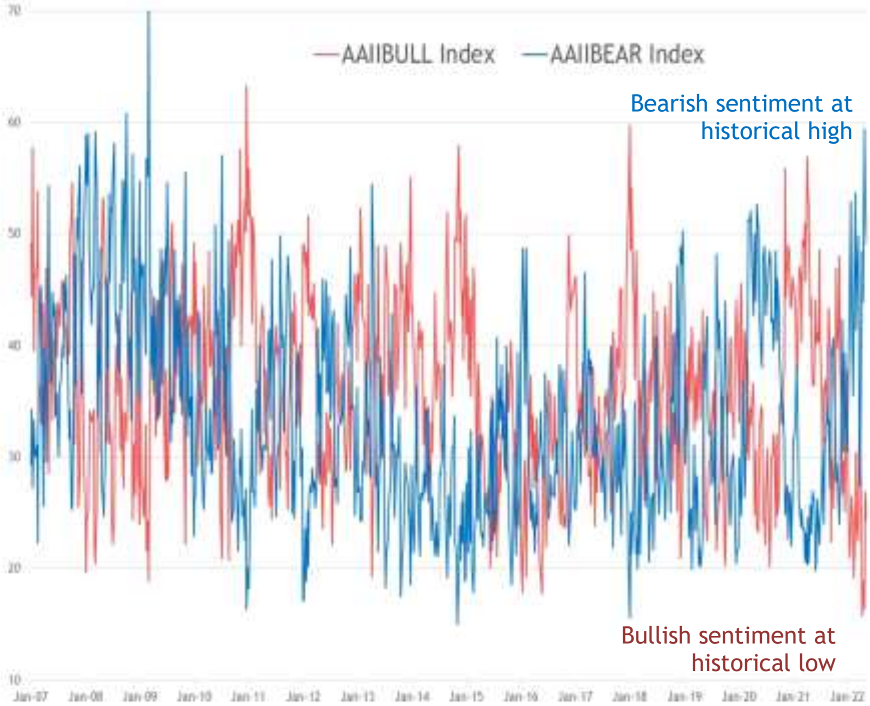
Fig 11 AAII Bull-Bear Spread Slumped to Decade-Low



Note: Circled indicates peak stretched levels hence triggering inflection points
Source: AAII Investor Sentiment, Bloomberg, Maybank FX Research & Strategy

AAII Bullish sentiment dipped slightly to 24.3% (as of 12 May). But the decline keeps optimism way below its historical average of 38% for the 25th straight week. Even though AAII Bearish sentiment dipped to 49%, this is the 24th out of 25 weeks that market pessimism is way above its historical average of 30.5%.

Fig 12: AAII Bullish Sentiment at Historical Lows; Bearish Sentiments at Historical Highs



Source: AAII Investor Sentiment, Bloomberg, Maybank FX Research & Strategy

On net, the **AAII Bull-Bear spread and bullish sentiment readings are at historical lows**, accompanied by **bearish sentiments at historical high**. The bearish take is justified given rising uncertainties owing to growth concerns, Fed tightening, protracted war in Ukraine, China's sporadic lockdowns due to zero covid policy, etc.

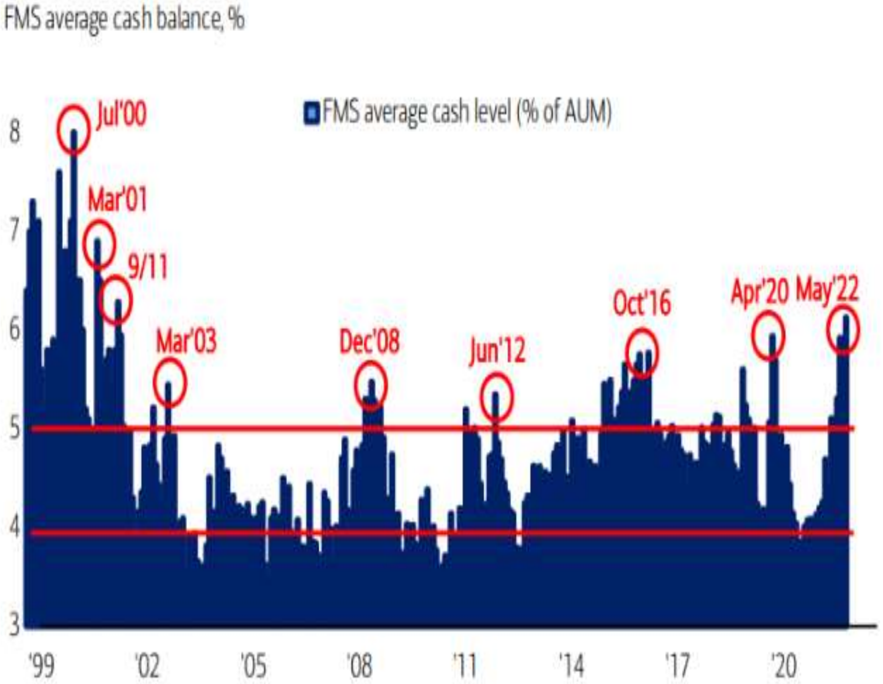
While caution is warranted, extreme bearish sentiments should not be overlooked and they can serve as inflection points for equity markets, and in this case, signaling a potential rebound. **AAII noted that unusually high bearish sentiment readings historically have been followed by above average and above-median 6-month returns in the S&P500**.

(3) BofAML FMS Cash Holdings - Investors are Extremely Bearish

The monthly survey by Bank of America gathers the views of 288 institutional, mutual and hedge fund managers from around the world. Collectively these investment professionals oversee assets of over $800bn for pension funds, insurance companies, asset managers and hedge funds.

Shifts into cash is a behavior of risk aversion and typically happens during periods of heightened volatility. But at the same time, extreme cash hoarding can trigger contrarian signals. According to BofAML FMS cash rule, when average cash balances rises above 4.5%, a buy signal is generated for equities and when cash balances fall below 3.5%, a contrarian sell signal is generated.

Fig 13: Cash Holdings at >10Y High Indicates How Bearish Investors Are
(BofAML's Global Fund Manager Survey)



Source: BofAML Global Fund Manager Survey, Bloomberg, Maybank FX Research & Strategy

The latest report published this week shows that cash balance surged to 6.1% on average across AUMs of global asset allocators. This is the highest level since Sep-2011 terrorist attacks in US and has inadvertently triggered a buy signal for equities. Nonetheless, nothing is stopping cash balances from advancing further – caution still warranted.

At this point, the fear-greed index, AAII investor sentiment survey and BofAML FMS cash balance are painting **a coherent story of fear and caution**. **Sentiment readings at extreme levels can trigger contrarian signals but a positive catalyst (i.e. growth slowdown fears dissipating, end to war in Ukraine, etc.) is still required to cause a meaningful snapback on pessimism.** Until then, we interpret the technical signs as indication of potential bottoming in bearish sentiments and that any meaningful rebound will still need a positive fundamental driver.

(4) A Walk Down Memory Lane – FX Implications during S&P500 Sell-Offs

Typically Asian FX positively correlates with sentiments and global growth momentum. It is no surprise that AXJ underperformed YTD, alongside the near-20% decline in S&P 500. Global growth slowing concerns, risks of inflationary expectations being de-anchored, fears of further tightening of financial conditions, and war in Ukraine were some of the factors driving risk aversion thematic.

We thought of re-visiting the past, looking at past episodes of S&P 500 sell-offs since Global financial crisis in 2007-09 and corresponding AXJ performance around those respective S&P500 downturns.

Table 3: FX Implications around Periods of Sharp S&P500 Sell-offs

Episode	% Decline in S&P500 (Peak to trough)	S&P500 Decline Duration (trading sessions)	AXJ % Decline vs USD Peak to Trough in Respective S&P500 Downturn									Average % Decline in AXJ FX vs. USD
			SGD	MYR	IDR	THB	PHP	CNY	KRW	TWD	INR	
3 Jan to 12 May 2022 (Fed tightening fears, Ukraine war, Shanghai lockdown, growth and inflation concerns)	-18	90	-1.84	-1.42	-1.04	-4.95	-2.80	-1.15	-4.47	-5.42	-4.33	-3.05
13 Feb - 23 Mar 2020 Covid Pandemic	-33.92	23	-7.89	-8.72	-18.92	-8.85	-2.71	-3.55	-8.67	-2.41	-8.10	-7.76
20 Sep -24 Dec 2018 (US-China trade war, Fed QT/rate hike picking up pace)	-19.78	65	-1.68	-2.17	-4.36	-3.02	-2.08	-2.49	-3.11	-2.09	-5.99	-3.00
18 May 2015 - Feb 2016 (Shanghai sell-off, slowing growth, plunge in oil prices, Greek default)	-14.1	186	-8.50	-20.19	-12.34	-8.96	-8.97	-8.65	-13.05	-9.65	-7.98	-10.92
Jul - Oct 2011 (Fears of contagion from European sovereign debt crisis, slowing US growth and downgrade of US credit rating)	-18.77	61	-8.98	-9.02	-7.20	-4.93	-4.66	-2.14	-12.12	-6.59	-11.94	-7.51
Apr - Jun 2010 (Global growth concerns)	-16	49	-4.09	-5.53	-5.90	-1.53	-6.15	-0.91	-11.81	-3.56	-7.16	-5.18
Oct 2007 - Mar 2009 (Global Financial Crisis)	-56.78	355	-13.29	-16.22	-27.72	-18.87	-19.55	-9.53	-43.04	-14.90	-24.45	-20.84
Mean	-25.34	118	-6.61	-9.04	-11.07	-7.30	-6.70	-4.06	-13.75	-6.37	-9.99	
Median	-18.77	65	-7.89	-8.72	-7.20	-4.95	-4.66	-2.49	-11.81	-5.42	-7.98	

Note: We consider sell-offs of above 14% magnitude (as significant) over the last 14 years; Cut-off date of current episode of S&P sell-off as of 12 May 2022; AXJ performance vs USD measured via AXJ peak to trough for periods around respective S&P500 sell-off episodes; Shaded cell intensity is episode-specific.
Source: Bloomberg, various sources, Maybank FX Research & Strategy

There are a few observations that we can draw on:

1. KRW still lived up to its status as a highly sensitive AxJ FX to market developments while in the ASEAN FX space, IDR and MYR are on average more sensitive than other ASEAN peers such as SGD and PHP during episodes of significant market sell-offs.

2. Extreme S&P500 sell-off (over 50% losses) during the GFC 2007-09 episode was accompanied by sharp AXJ FX sell-off (of about 20% vs USD on average) but there is no clear evidence to assume that sharp S&P500 sell-off is usually accompanied by sharp AXJ FX sell-off.

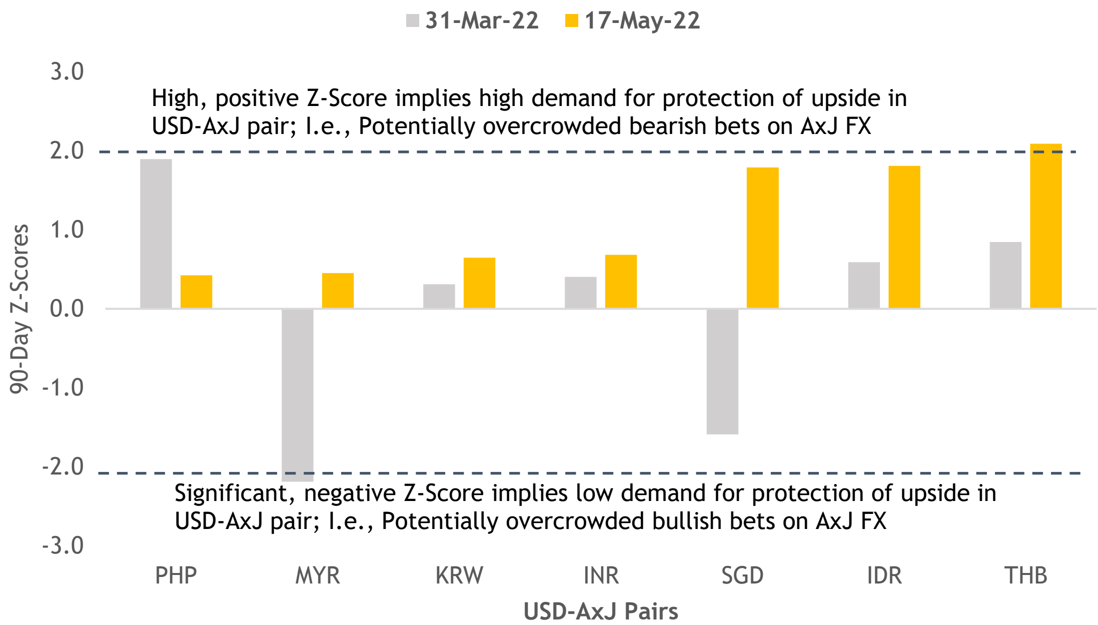
3. Looking back at 2015-2016 period, the S&P500 sell-off was considered relatively mild (at 14%) vs. other periods but yet the AXJ sell-off in 2015-16 was by far one of the largest (average loss of 11% vs. USD) since GFC 2007 – 09. Global growth concerns, Shanghai market sell-off (nearly 50% of value wiped), plunge in oil prices and the lead-up to first Fed rate hike (in Dec 2015) were some of the factors behind AXJ softness. In particular, MYR and IDR fell by 20% and 12.3%, respectively (vs. USD). These were net oil exporter proxy plays and the sharp plunge in oil prices compounded their woes then.

4. However the current episode of AXJ sell-off around the period of S&P500 sell-off appeared relatively mild with losses only averaging about 3% vs. USD. Historically AXJs depreciate between 3% and 11% on average during significant sell-off in S&P500 post-GFC. Potentially there may still be room for further AXJ decline if macro fundamentals weaken further, covid sub-variants turn more deadly or political uncertainties broaden..

(5) Implied AXJ positioning for indication of any crowded bearish bets on AXJs

Markets were hedging against AxJ FX underperformance but there are only pockets of potentially overcrowded bearish bets.

Fig 14: Markets Have Broadly Turned Bearish on AxJ FX against the USD, Versus end-1Q



Source: Bloomberg, Maybank FX Research & Strategy Estimates

The chart above reflects an attempt to gauge the positioning of Asian FX against the USD using volatility-adjusted risk reversals (i.e., the delta-neutral difference between call-option and put-option volatilities).

90-day Z-scores of the risk reversals are shown for easy interpretation, with any value near or larger than +2 implying potentially overcrowded bearish bets on AxJ FX and any value near or lower than -2 implying potentially overcrowded bullish bets.

Broadly, markets require significantly more protection against AxJ FX losses against USD, versus conditions as at end-1Q (i.e., yellow bars more positive versus grey bars). **This suggests that intermittent dollar upsides are seen as more likely now, and possibly also reflects a more cautious mood in Asia amid confluence of external risks (China Covid, Fed normalization, European geopolitics).**

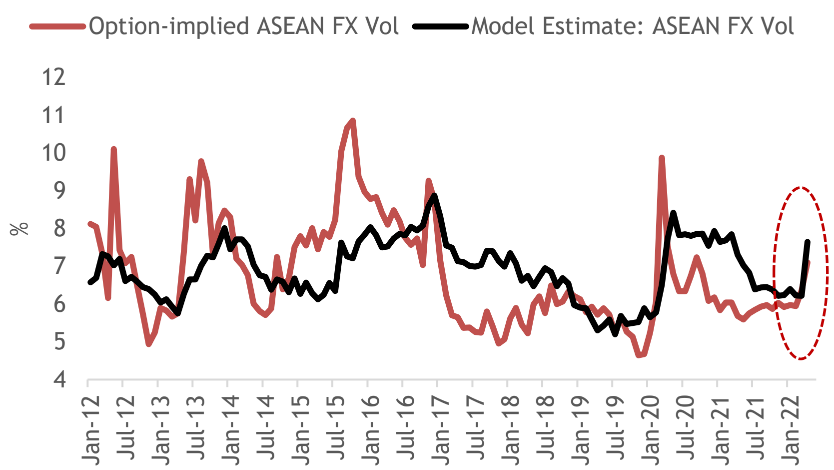
We note three points of interest:

- While positioning in PHP remains tilted towards bearish, demand for protection against USDPHP upswings has actually waned, as the dust has settled on Philippines elections in early May with a Marcos win.
- Positioning in MYR (versus USD) has turned from stretched bullish in March (likely on benign oil narrative then), to moderate bearish now, a significant swing in line with the underperformance of the MYR in recent weeks.
- A note of caution on SGD, IDR and THB shorts, with positioning estimates suggesting that bearish bets could be near to stretched conditions, barring new negative risk triggers.

(6) ASEAN FX volatility model to get a sense on whether FX markets are over or under-pricing broader risk conditions

We take the opportunity to refresh our ASEAN FX volatility model, as a check on whether regional FX markets are over-pricing or under-pricing broader risk conditions.

Fig 15: ASEAN FX Vols Broke Out from 2021 Slumber



Note: ASEAN FX Vol refers to average of 3M implied volatilities for USD-ASEAN FX pairs (i.e., USDSGD, USDMYR, USDIDR, USDTHB, USDPHP), in monthly data form.
Source: Bloomberg, Maybank FX Research & Strategy Estimates

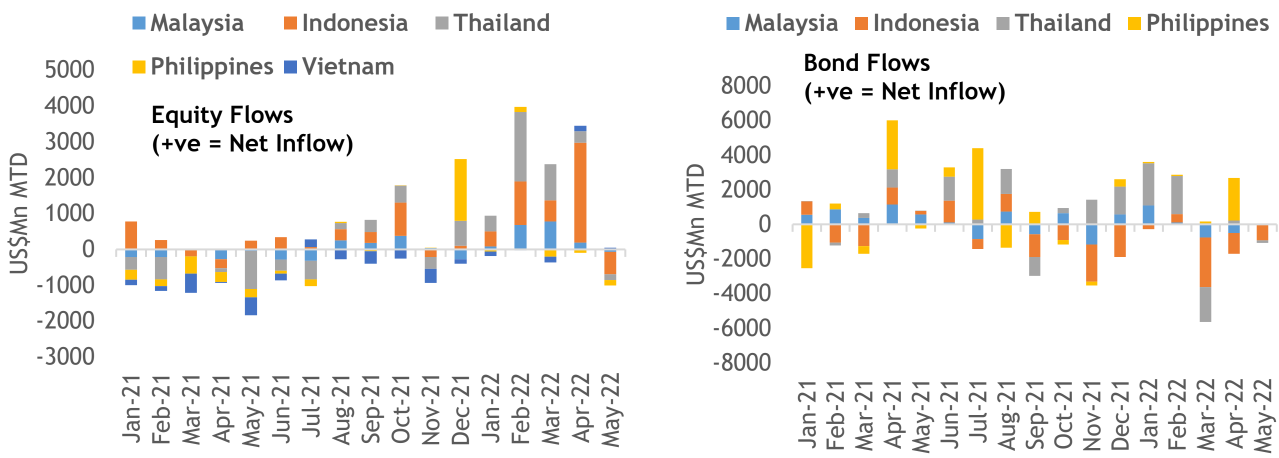
The model takes into account the following factors in monthly frequency (2007 to Apr 2022): (i) 3M10Y US term premiums, (ii) US-ASEAN interest rate volatility, (iii) USDCNY 3M implied Vol, (iv) US macro policy volatility (above and beyond Fed policy shifts). For a deeper dive into our model specification, please refer to our FX Insight report dated 9 Jul 2021 ("*Asia FX - How Insulated to Fed Tightening*").

The chart suggests that there may be some modest under-pricing of risks currently (i.e., ASEAN FX vols should be higher than actual given various conditions captured by explanatory variables), though the extent of "under-pricing" is likely not excessive at this point. **This could imply that while bouts of intermittent softness in ASEAN FX may be expected given the current risk landscape, this is less likely to manifest into a severe sell-off tantrum.**

(7) Taking stock of portfolio flows in the region

Regional bourses began to see more significant outflows in recent weeks, as regional equity indices slumped alongside US indices. Given that the magnitude of outflows MTD in May are still relatively modest compared to the accumulated inflows over the past 5 months, further adjustments in positioning could be expected near-term and some patience may be needed before a more sustainable turnaround sets in.

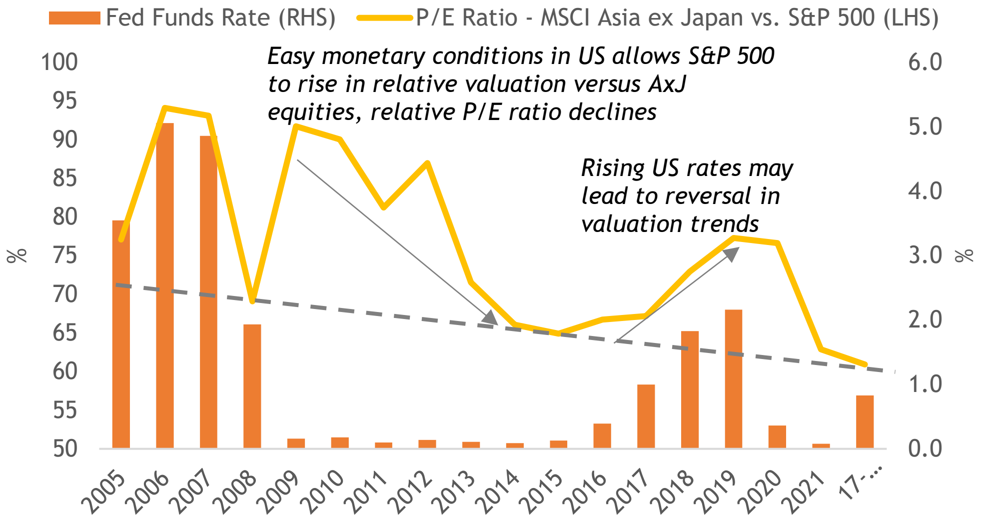
Fig 16: ASEAN Equity Flows Follow Bond Flows in Turning Negative in May



Note: MTD flow data as of 13 May. Malaysian and Philippines bond flows data for May are not available.
Source: Bloomberg, Maybank FX Research & Strategy Estimates

On bond flows, the incomplete picture in May given lag in MY and PH data makes it challenging to gauge the state of events, but recent bouts of softening in MYR and IDR and continued climb in domestic yields likely imply some ongoing drags on this front for both markets.

Fig 17: MSCI Asia ex-Japan Equities Reaching Relative Valuation Troughs (Vs. S&P 500)



Source: Bloomberg, Maybank FX Research & Strategy Estimates

But we note one factor which could help prevent ongoing portfolio outflows from turning into a rout and potentially support a recovery in inflows in subsequent quarters. Valuations for AxJ equities have reached relative lows versus US assets in May, and risk-reward dynamics could suggest Asian assets gaining some appeal. Historically, the last period of rising US rates did see an improvement in Asian risk asset valuations vis-à-vis US equities.

Conclusion

USDCNY is still susceptible to two-way trades but risks of persistent one way move beyond the 7-figure has reduced as China seems to have a fair chance of avoiding a Shanghai-like lockdown on another city. Recession fears for the US might keep the US-CH 10y yield premium from widening, thus also reducing another bullish impetus for USDCNY. Lingering risks that could keep USDCNY supported are potential for more infectious variants to lengthen the period of flash lockdowns or any escalation in geopolitical tensions.

<u>On broader market risk sentiments…</u>

At this point, the fear-greed index, AAII investor sentiment survey and BofAML FMS cash balance are painting a coherent story of fear and caution. Sentiment readings at extreme levels can trigger contrarian signals but a positive catalyst (i.e. growth slowdown fears dissipating, end to war in Ukraine, etc.) is still required to cause a meaningful snapback on pessimism. Until then, we interpret the technical as signs of potential bottoming in bearish sentiments but any meaningful rebound will still need a positive fundamental driver, which is lacking today.

<u>On ASEAN FX…</u>

Depreciation pressures thus far has actually been relatively contained versus historical global risk-off episodes, and caution could persist for a while more. Positioning/vols/flows indicators (our “signposts” above) suggest that a discernible/sustainable recovery in ASEAN FX may not be forthcoming at this point.

Even from trade-weighted perspective (both REER and NEER), current ASEAN TWI have been largely stable YTD, and since war in Ukraine started and since RMB depreciation. Idiosyncratic drivers (reopening/tightening monetary policies and ToT advantages) may have mitigated drags from external shocks (war in Ukraine, RMB depreciation, etc.).

Fig 18: ASEAN NEER Broadly Stable YTD

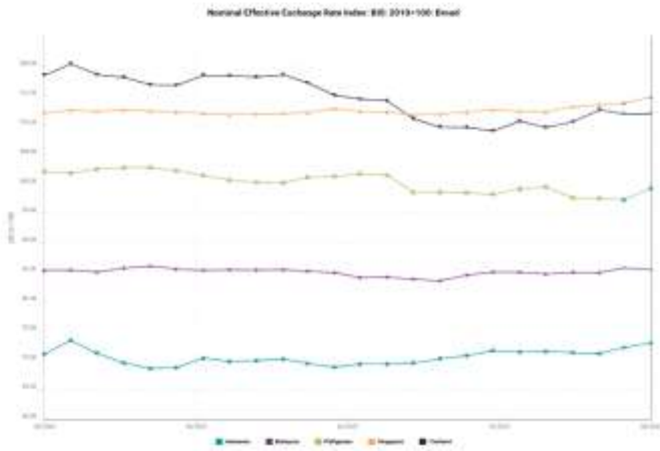
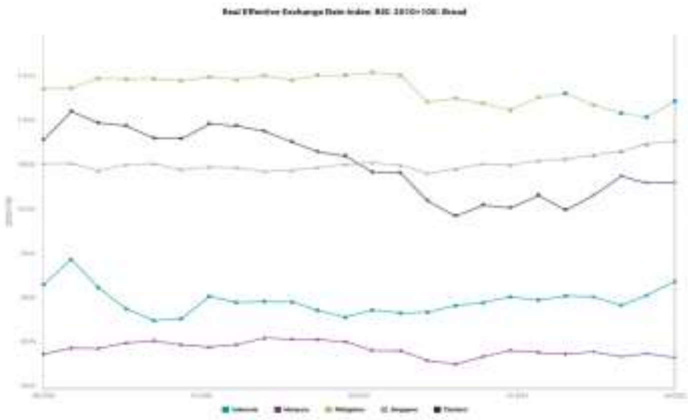


Fig 19: ASEAN REER Broadly Stable YTD



Source: BIS (broad), CEIC, Maybank FX Research & Strategy

Still, our ASEAN FX vols model indicates that any under-pricing in regional FX risks look to be relatively modest (i.e., large part of negative risk factors priced in) and there could be opportunities for near-term tactical plays in selected currencies.

For instance, we prefer to long SGD NEER on dips (support at +0.5% above par), or sell USDSGD towards 1.40, given potential stretched positioning, first mover in policy tightening. We also prefer to sell USDTHB nearer the 35-handle, given potentially overcrowded bearish THB bets, and a tentative bearish divergence signal playing out on the USDTHB daily chart.

<u>**On USD View…**</u>

Despite synchronous global policy normalization (excluding China) in the face of inflationary pressures, the protracted nature of the geo-political situation in Ukraine/Russia, continued expectations of additional hawkish Fed moves and global growth concerns suggest that markets may be mired in a risk-based cautious view based on the global economic backdrop. These factors are likely to lead to USD support and delay any further USD retracement towards end of the year at the earliest.

Table 4: Progress of Thematic Plays Outlined on 28 Jan

Themes	FX Strategies Recommended on 28 Jan	% Returns (28 Jan to 24 Mar)	% Returns (25 Mar to 19 May)
Covid-endemic, Reopening Play	Focus on Covid-endemic (less econ. drags) vs. zero-Covid policy stance in countries. Basket of equal-weighted long SGD, THB, KRW, vs. short TWD, CNH.	+1.2% [24 Mar Update: Stay long.]	+1.7%
G7-China Policy Divergence Play	Long CAD, AUD and NZD (potential rate hikes) vs. short CNH and JPY (easing spectrum).	+8.7% [24 Mar Update: Take partial profit.]	-1.1%
Benign Commodity Outlook	Long AUD, IDR, MYR, CAD vs. short net energy importer INR. Demand could broaden post 1Q Omicron drags; geopolitical events risk impacting energy supplies.	+3.7% [24 Mar Update: Take partial profit.]	-2.1%
Intra-ASEAN Policy Divergence Play	Tactical buy dips in SGD vs. short MYR, PHP. MAS first mover vs. slower normalization start for BNM, BSP. Buy dips preferred as S$NEER near top of policy band, long positioning near overcrowded.	+1.4% [24 Mar Update: Stay long.]	+0.0%
USD - the Long and Short of It	Tactical long USD in the lead-up to first Fed hike but get ready to turn short post first hike as DXY typically fall 2% - 4%.	+1.7% (long DXY from 28 Jan to FoMC on 17 Mar 2am); +0.2% (short DXY post-FoMC, as of 24 Mar) [24 Mar Update: Cautioned on near-	N.A.

		term USD haven demand.]	

Source: Maybank FX Research & Strategy

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Published by:

Malayan Banking Berhad
(Incorporated In Malaysia)

Foreign Exchange

Singapore

Saktiandi Supaat
Head, FX Research
saktiandi@maybank.com.sg
(+65) 6320 1379

Christopher Wong
Senior FX Strategist
Wongkl@maybank.com.sg
(+65) 6320 1347

Fiona Lim
Senior FX Strategist
Fionalim@maybank.com.sg
(+65) 6320 1374

Yanxi Tan
FX Strategist
tanyx@maybank.com.sg
(+65) 6320 1378

Indonesia

Juniman
Chief Economist, Indonesia
juniman@maybank.co.id
(+62) 21 2922 8888 ext 29682

Myrdal Gunarto
Industry Analyst
MGunarto@maybank.co.id
(+62) 21 2922 8888 ext 29695

Fixed Income

Malaysia

Winson Phoon Wai Kien
Fixed Income Analyst
winsonphoon@maybank-ke.com.sg
(+65) 6340 1079

Se Tho Mun Yi
Fixed Income Analyst
munyi.st@maybank-ib.com
(+60) 3 2074 7606

Sales

Malaysia

Azman Amiruddin Shah bin Mohamad Shah
Head, Sales-Malaysia, GB-Global Markets
azman.shah@maybank.com
(+60) 03-2173 4188

Singapore

Janice Loh Ai Lin
Head of Sales, Singapore
jloh@maybank.com.sg
(+65) 6536 1336

Indonesia

Endang Yulianti Rahayu
Head of Sales, Indonesia
EYRahayu@maybank.co.id
(+62) 21 29936318 or
(+62) 2922 8888 ext 29611

Shanghai

Joyce Ha
Treasury Sales Manager
Joyce.ha@maybank.com
(+86) 21 28932588

Hong Kong

Joanne Lam Sum Sum
Head of Corporate Sales Hong Kong
Joanne.lam@maybank.com
(852) 3518 8790