Sell in May?

- Global equities have rebounded almost 15% from their February lows. As we head into the northern hemisphere summer, we are concerned that the rally may be coming close to its end. In line with our A.D.A.P.T. framework we would suggest trimming exposure to global equities.
- Two of our key themes that complement each other in a blended allocation are alternative strategies and multi-asset income. We would be increasing our allocation towards the former, particularly to global macro strategies, ahead of the summer months.
- We continue to prefer Developed Market equities, despite their recent underperformance. We are becoming more constructive on Emerging Market sovereign bonds but would wait before increasing allocations. We retain a preference for credit.

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04 Market performance summary
05 Investment strategy
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Global Investment Council Perspectives

Our GIC met last week. The below summarises our discussion on some of the key issues affecting financial markets.

1 Global equities have rallied almost 15% from their February lows. Should we chase this rally?

In February, we emphasised global equities were oversold and a technical rebound was likely. Since then, we have also seen support from stronger oil prices, easing US financial conditions (a weaker USD and reduced US interest rate hike expectations) and a rebound in US/China economic indicators.

We are cautious about extrapolating these trends too far: fundamentals have not kept pace with the rebound in prices; the Federal Reserve (Fed) is becoming more balanced in its language, risking a firmer USD; and China is showing signs of trying to cool its Q1 credit boom. (see pages 14-19).

Therefore, we would continue to use the rally as an opportunity to trim our equity exposure and rebalance into corporate bonds and alternative strategies.

2 Does this mean 'sell in May and go away'?

There has been some validity to this way of thinking, especially in recent years. With some major equity markets approaching key technical resistance levels, markets may be vulnerable to weakness over the summer months (see page 4).

Potential catalysts for such weakness include rising US interest rate expectations, political concerns in Europe (Brexit, Grexit, Spanish elections) and China policy changes (the CNY continues to weaken on a trade-weighted basis).

3 Emerging Market assets have outperformed strongly. Is this something you expect to continue?

Emerging Market (EM) equity outperformance has largely been driven by an improved external environment and the recent 'old style' China stimulus rather than a dramatic improvement in domestic fundamentals. Given our cautious attitude to risk, we would not be chasing the EM equity market rally.

We are becoming more constructive on EM USD bonds. For local currency bonds, we believe domestic returns are likely to be positive as we see the bias for easier policies to remain. However, international investors need to take into account FX risks that may rise if the Fed shifts towards a less dovish stance.

4 Income assets have generally performed well. Is this something you expect to continue?

All the asset classes in our preferred income allocation have delivered positive total returns since our Outlook 2016 report. While the income theme remains valid, we have become increasingly focused on managing drawdown risks by increasing our allocation to corporate bonds at the expense of equities. We would also look to increase our allocation to multi-asset macro strategies (see pages 5-6).

5 What is your outlook for the US dollar?

The US dollar is currently close to a key support at a time when the Fed may shift to a less dovish stance amid improving domestic/international data. We believe the USD may rebound a little from here, but we doubt it will break to new highs. Gains are likely to be capped at 5-6% from here (pages 23-26).

The team

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Global Investment Council Perspectives (cont'd)

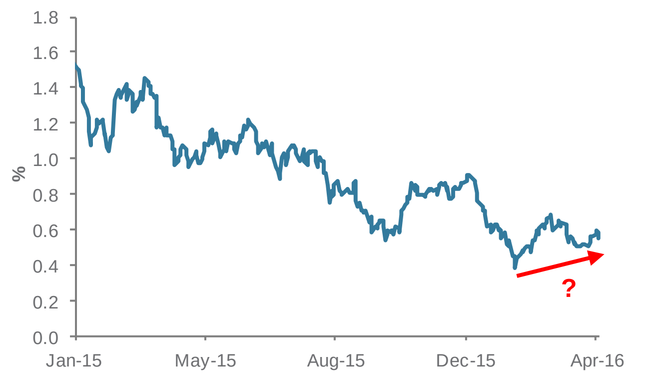
Sell in May?

Are we about to see a period of weakness?

Source: Bloomberg, Standard Chartered

Fed guidance likely to be less of a tailwind

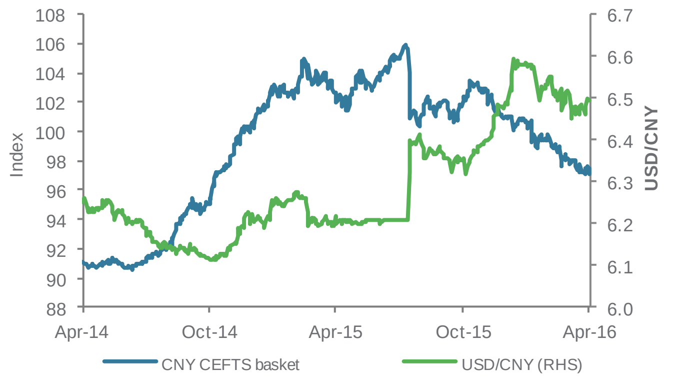
Market expectations for end-2016 Fed Funds rate



Source: Bloomberg, Standard Chartered

CNY risks may increase if the USD stabilises/appreciates

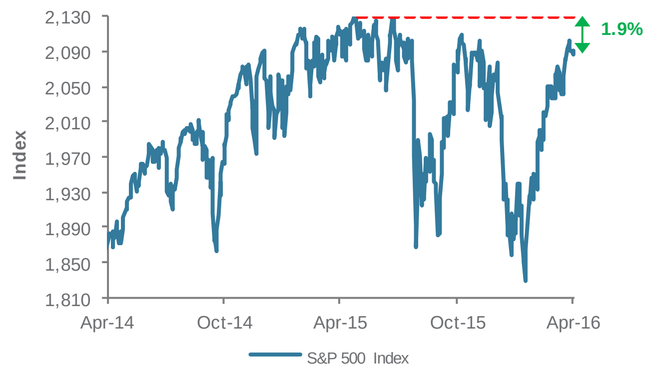
CNY CFETS index and USD/CNY (inverted)



Source: Bloomberg, Standard Chartered

US equity market very close to all-time highs

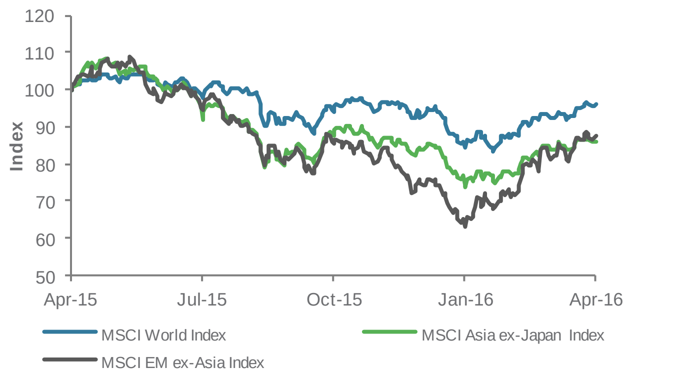
Standard and Poor's 500 equity index



Source: Bloomberg, Standard Chartered

DM equities preferred despite recent underperformance

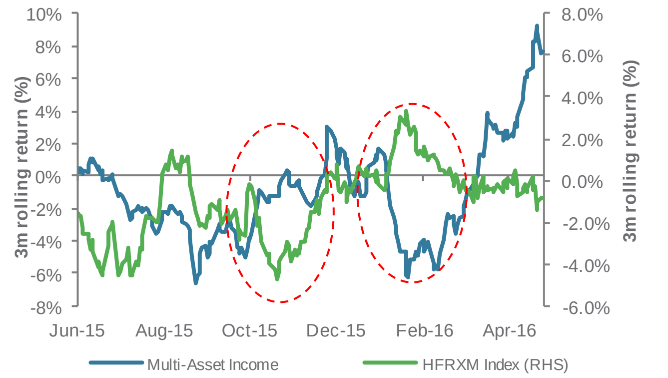
Recent performance of DM, Asia, non-Asia EM markets



Source: Bloomberg, Standard Chartered

Low correlation between multi-asset income and multi-asset macro strategies support blended approach

Multi-asset income allocation performance versus HRFX global macro strategy index, % 3mth rolling return



Source: Bloomberg, Standard Chartered

Standard Chartered

Market performance summary*

Equity	Year to date		1 month	
Global Equities	2.1%	↑	3.4%	↑
Global High Dividend Yield Equities	6.6%	↑	4.2%	↑
Developed Markets (DM)	1.6%	↑	3.3%	↑
Emerging Markets (EM)	6.8%	↑	4.0%	↑
By country				
US	1.8%	↑	2.2%	↑
Western Europe (Local)	-1.6%	↓	4.4%	↑
Western Europe (USD)	0.8%	↑	5.7%	↑
Japan (Local)	-13.0%	↓	-2.1%	↓
Japan (USD)	-3.6%	↓	2.1%	↑
Australia	4.3%	↑	3.9%	↑
Asia ex- Japan	1.7%	↑	2.4%	↑
Africa	16.7%	↑	10.9%	↑
Eastern Europe	19.2%	↑	7.7%	↑
Latam	25.8%	↑	7.7%	↑
Middle East	3.6%	↑	7.8%	↑
China	-4.0%	↓	3.6%	↑
India	-2.2%	↓	2.2%	↑
South Korea	5.3%	↑	3.0%	↑
Taiwan	3.3%	↑	-1.7%	↓
By sector				
Consumer Discretionary	-0.7%	↓	1.5%	↑
Consumer Staples	5.4%	↑	1.8%	↑
Energy	16.5%	↑	10.2%	↑
Financial	-0.6%	↓	5.6%	↑
Healthcare	-2.6%	↓	5.5%	↑
Industrial	5.7%	↑	3.4%	↑
IT	-1.9%	↓	-1.3%	↓
Materials	13.6%	↑	8.9%	↑
Telecom	7.7%	↑	2.0%	↑
Utilities	7.7%	↑	1.2%	↑
Global Property Equity/REITS	5.6%	↑	3.1%	↑

Bonds	Year to date		1 month	
Sovereign				
Global IG Sovereign	7.2%	↑	1.5%	↑
Global HY Sovereign	6.5%	↑	2.9%	↑
EM IG Sovereign	7.0%	↑	2.0%	↑
US Sovereign	2.9%	↑	0.3%	↑
EU Sovereign	7.2%	↑	0.7%	↑
Asia EM Local Currency	9.7%	↑	2.6%	↑
Credit				
Global IG Corporates	5.6%	↑	1.9%	↑
Global HY Corporates	7.3%	↑	4.0%	↑
US High Yield	7.4%	↑	4.4%	↑
Europe High Yield	6.9%	↑	3.7%	↑
Asia High Yield Corporates	5.1%	↑	2.2%	↑

Commodity	Year to date		1 month	
Diversified Commodity	8.1%	↑	6.8%	↑
Agriculture	7.0%	↑	4.7%	↑
Energy	2.7%	↑	11.9%	↑
Industrial Metal	7.7%	↑	4.8%	↑
Precious Metal	21.4%	↑	6.8%	↑
Crude Oil	19.6%	↑	17.8%	↑
Gold	19.3%	↑	3.6%	↑

FX (against USD)	Year to date		1 month	
Asia ex- Japan	1.9%	↑	0.9%	↑
AUD	4.7%	↑	1.1%	↑
EUR	4.5%	↑	1.4%	↑
GBP	-0.9%	↓	2.5%	↑
JPY	11.2%	↑	4.9%	↑
SGD	5.5%	↑	1.8%	↑

Alternatives	Year to date		1 month	
Composite (All strategies)	-1.2%	↓	1.1%	↑
Arbitrage	-2.0%	↓	1.0%	↑
Event Driven	-0.3%	↓	1.4%	↑
Equity Long/Short	-2.3%	↓	1.4%	↑
Macro CTAs	0.4%	↑	0.4%	↑

*All performance shown in USD terms, unless otherwise stated.

*YTD performance data from 31 December 2015 to 28 April 2016 and 1-month performance from 28 March to 28 April 2016

Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

Investment strategy

- Equities and High Yield (HY) bonds continued to rebound strongly over the past month. Our multi-asset income allocation remains the top performer among our A.D.A.P.T. themes.
- As we head into the summer months, we are worried that markets investors are becoming complacent. We would look to rebalance into absolute return strategies and corporate bonds, particularly multi-asset macro strategies and US investment grade (IG) bonds.
- The recent Emerging Market (EM) equity outperformance may be coming closer to the end. We are becoming gradually more constructive on EM USD bonds. Asian local currency bonds are still attractive for local investors but less so for international investors, given currency risks.

Sell in May?

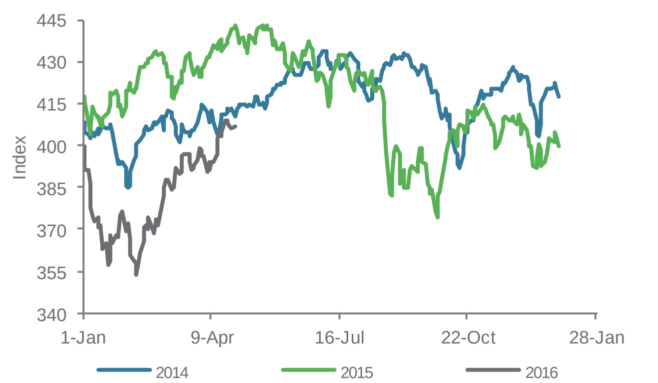
Global equities have risen 2.1% over the past month and are down 4.8% since our Outlook 2016 publication. The rally has been supported by easing financial conditions in the US, reduced hard-landing concerns in both the US and China and a rally in commodity prices. We are not confident in extrapolating these factors too far into the future.

Meanwhile, another adage – 'sell in May and go away' – gives us pause for thought. As the chart below shows, we have seen significant weakness in global equity markets at some point over the summer months in recent years.

Of course, it is difficult to judge when markets will peak and it is quite possible that the rally will extend over the short term. But with US earnings under pressure – due to slow economic/revenue growth and gradually increasing costs – elevated valuations may be difficult to justify. Thus, we have become more worried about the three-month outlook for equities (see chart).

Sell in May?

Seasonality has been challenging during the summer

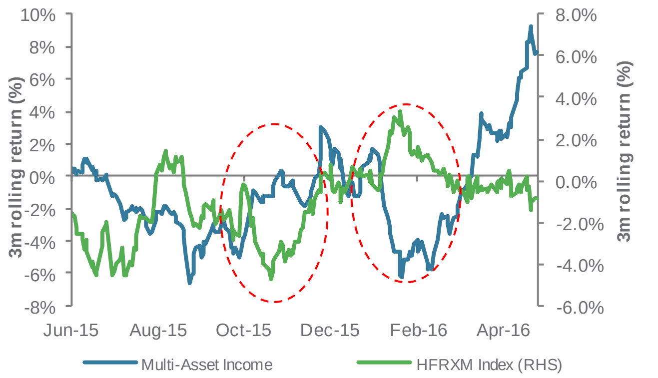


Data as of 26-Apr-2016
Source: Bloomberg, Standard Chartered

Potential catalysts for equity market weakness include a less dovish Fed; increased political risk in Europe as we head towards the UK's EU membership referendum, Greece's negotiations for another deal with the IMF and Spain second attempt at electing a government; and the risk of the CNY coming under renewed pressures as the USD stabilises. Against this backdrop, we would continue to use the rally in global equities to trim equity allocation and allocate more to alternative strategies and corporate bonds.

Low correlation between multi-asset income and global macro strategies suggest blended approach beneficial

multi-asset income allocation* performance versus HRFX global macro strategy index, % 3mth rolling return



Data as of 26-Apr-2016
Source: Standard Chartered * See Global Market Outlook, Looking to Rebalance

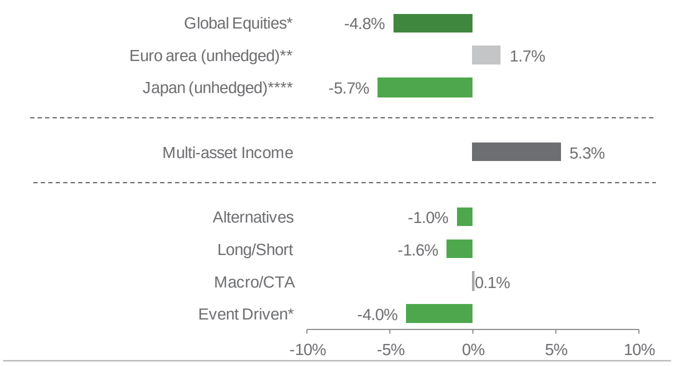
Multi-asset income & alternative strategies

As the chart above shows, a sizeable discrepancy exists between the performances of two of our main three themes for 2016. Multi-asset income (MAI) has been the top performer YTD, while diversified alternative strategies have generally disappointed. We go into our views on alternatives in more detail on page 22, but we believe a blended approach between these two areas makes sense. Indeed, we would consider adding to multi-asset macro strategies now as these can benefit most from significant equity market weakness (see chart).

Regarding MAI strategies, all asset classes in our model income allocation have generated positive total returns since our 2016 Outlook. Our cautious nature makes us concerned that we may see this model allocation give up some of its gains over the summer months, even though we believe that the income theme is valid. Of course, we have tried to mitigate drawdown risks by increasing our allocation to more defensive areas of the income spectrum. A different approach would be to complement MAI with multi-asset macro strategies

Multi-income remains a strong performer

Performance of A.D.A.P.T. since Outlook 2016***



* Closed on 25-Feb-2016; **FX-hedge removed as of 25-Feb-2016

*** For the period 11 December 2015 to 28 April 2016. Income basket is as described in the Outlook 2016: A year to A.D.A.P.T. to a changing landscape, Figure 38 on page 60; **** Closed on 25 March 2016

Source: Bloomberg, Standard Chartered; Data as of 28-Apr-2016

Implications for investors

- **Multi-asset macro strategies – opportunity to add.** These have underperformed in the recent rebound, but they outperformed and delivered positive returns early in the year during the risk-off environment. Should we see equity market weakness in the summer, we would expect a similar performance.
- **Multi-asset income – cautious near term, bullish long term.** We see a risk of multi-asset income strategies giving up some of their recent gains in the short term. We would 1) manage drawdown risks by allocating more to absolute return strategies and/or corporate bonds at the expense of equities and 2) refraining from adding to this strategy at the moment.
- **EM bonds may have turned the corner.** We are becoming more constructive on EM government bonds, particularly in the USD space. Asian investors can also consider increasing allocation to their own local currency bond markets as we expect monetary policies to remain loose or loosen further. International investors may prefer to wait for better entry points from an exchange-rate perspective.
- **Japanese equities – risk of extreme outcomes high.** While expected return for Japanese equities suggests this should remain a favoured market, the dispersion around the average outcome, based on different scenarios, is extremely high, leaving us neutral Japanese equities today. Therefore, it is too risky to have a sizeable direct exposure, in our opinion.

Asset class	Sub-asset class	Relative outlook	Start date*
Cash		Underweight	Feb 2012
Fixed Income	Developed Markets Investment Grade government bonds	Underweight	Jan 2011
	Developed Markets Investment Grade corporate bonds	Overweight	Dec 2015
	Developed Market High Yield corporate bonds	Neutral ↓	April 2016
	Emerging Markets USD government bonds	Neutral	Dec 2015
	Emerging Markets local currency government bonds	Underweight	Dec 2015
	Asia USD corporate bonds	Neutral	Feb 2016
Equity	US	Neutral	Feb 2015
	Euro area	Overweight	Jul 2013
	UK	Neutral ↑	April 2016
	Japan	Neutral	March 2016
	Asia ex-Japan	Neutral	Jul 2015
	Other EMs	Underweight	Aug 2012
Commodities		Neutral	March 2016
Alternatives		Overweight	Jun 2013

*Start Date - Date at which this tactical stance was initiated
Source: Standard Chartered

Economic and policy outlook

- The global economic outlook has stabilised over the past month, with signs of an old-style policy-driven recovery in China. However, growth estimates for the US and Japan continue to be downgraded, while excess capacity keeps inflation well below major central bank targets.
- Our Global Investment Council debated the risks. We do not expect China to experience a hard landing and believe commodity prices may have bottomed, helping Emerging Markets (EMs) stabilise. However, we are more cautious than before about the outlook, seeing growing risks of a US recession in the next 12 months.
- Given this backdrop, the Fed may struggle to raise rates more than once this year. The European Central Bank's (ECB's) added stimulus should help sustain the recovery in the Euro area. Japan needs fiscal and monetary stimulus to ward off deflation, while a weaker USD provides EMs the scope to ease policy to revive growth.

We have turned more cautious about the global growth outlook

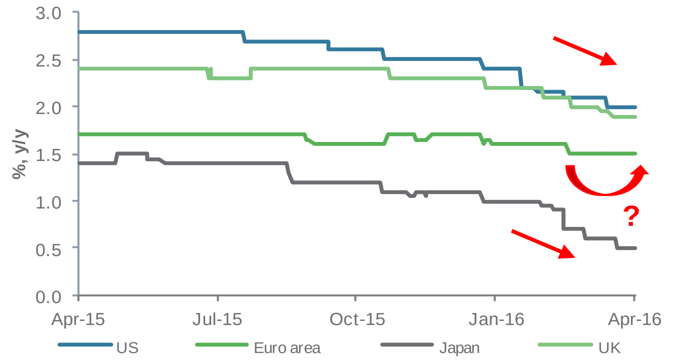
China imparts stability to global growth. China's economic data showed signs of stabilisation in March, easing concerns about a hard landing, boosted commodity prices and the outlook for EMs. However, growth estimates in the US and Japan continue to be downgraded. Moreover, China may not be able sustain its range of stimulus measures for long as the measures could create financial stability risks. This leaves us cautious about the global growth outlook.

Commodity recovery, USD weakness ease deflation pressures. Our Global Investment Council debated the key growth drivers, as well as risks to the global growth outlook. We believe oil and metal prices may have bottomed, while the USD may have peaked – this combination is likely to help ease deflation pressures in the developed economies over the coming months. It is also a positive catalyst for an EM recovery.

Monetary policy to remain accommodative. We see slightly increased risks of a US recession in the next 12 months. As a result, the Federal Reserve (Fed) may struggle to raise rates more than once this year. The ECB and the Bank of Japan (BoJ) may need to ease further as inflation remains well below target. In addition, Japan would likely need more fiscal stimulus to revive growth and inflation. China may resort to more targeted measures to sustain its recovery, having achieved the initial goal of stabilising growth. A weaker USD and subdued inflation mean EM central banks can ease further to revive growth.

Consensus growth forecasts have continued to be downgraded for the US, UK and Japan in the past month

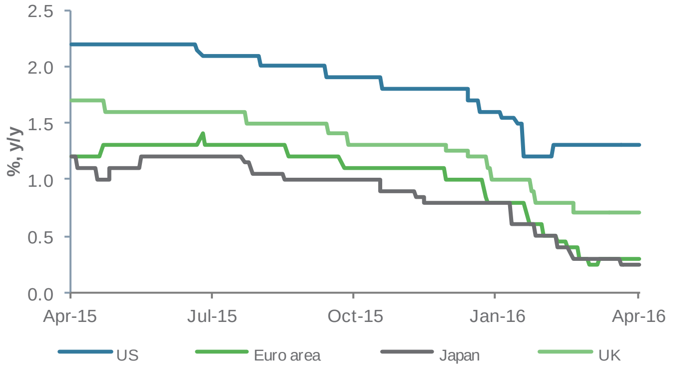
Consensus GDP growth forecasts for 2016 (%, y/y)



Source: Bloomberg, Standard Chartered

While inflation forecasts have stabilised across DMs in the past month, they remain well below central bank targets

Consensus consumer inflation forecasts for 2016 (%, y/y)



Source: Bloomberg, Standard Chartered

US: Manufacturing out of the woods?

- **Weaker US auto sales boost inventory, offsetting manufacturing turnaround.** US auto sales fell to a one-year low in March, raising concerns about the outlook for US consumer spending. Meanwhile, the US business inventory-to-sales ratio has climbed to its highest level since 2009, suggesting the manufacturing sector, which was in the midst of a turnaround, may have to curtail output if consumption fails to revive. However, housing sales, another key economic driver, remain on an uptrend.
- **Strong job market, subdued wages prolong the 'goldilocks' economy.** US job creation continued at a robust pace, without triggering a sharp acceleration in wage growth, as more people re-entered the labour market. The labour force participation rate – the number of workers divided by the total working-age population – has risen for the fourth month, indicating slackness in the labour market, which could restrain inflation for some time.
- **Fed upbeat on consumption, but cautious on rates.** The Fed noted the upbeat consumer sentiment amid a resilient job market as an indication that consumption is likely to rebound in the coming quarters. However, with global growth headwinds persisting and domestic wage pressures subdued, we believe the Fed may struggle to raise rates more than once this year.

US inventory-to-sales ratio has continued to surge, suggesting the recent pick up in manufacturing may stall

ISM Manufacturing index; US total inventory-to-sales ratio for manufacturing and trade sectors (RHS)

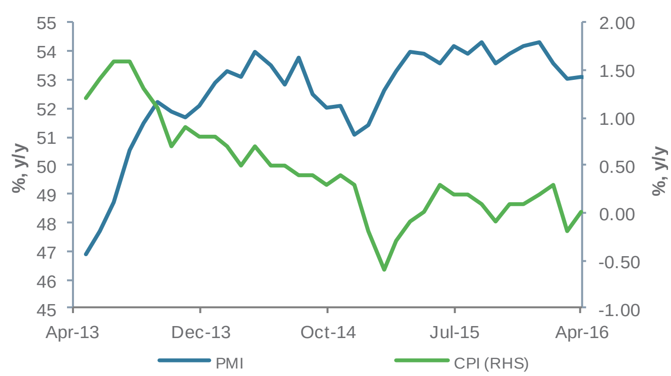
Source: Bloomberg, Standard Chartered

Euro area: Growth holds up, but disinflation pressures remain

- **Euro area business confidence resilient.** Euro area growth forecasts have remained more resilient than other major economies (see chart on page 8), with a declining jobless rate helping sustain domestic demand. Business confidence in Germany and Spain remains robust, while confidence in France recovered to expansion territory in April. However, Italy's business confidence continued to falter as undercapitalised banks crimped lending.
- **Inflation continues to fall short of expectations.** Consumer prices were unchanged in March from a year earlier after falling in the previous month, while producer prices decelerated to a 4.2% decline in February.
- **ECB easing likely to sustain growth.** We expect the ECB's policy easing in March – including a cut in interest rates deeper into negative territory and increased bond purchases, including buying of corporate bonds – to have a positive impact in the coming months. The steps, which include incentives for banks to boost lending, are likely to stimulate domestic demand and help offset the impact on the economy from weakening global growth.

Euro area manufacturing and services sector confidence indicators continue to hold up well, with recent gains witnessed in France, although inflation remains well below ECB's 2% target

Euro area PMI; consumer inflation (%, y/y) (RHS)



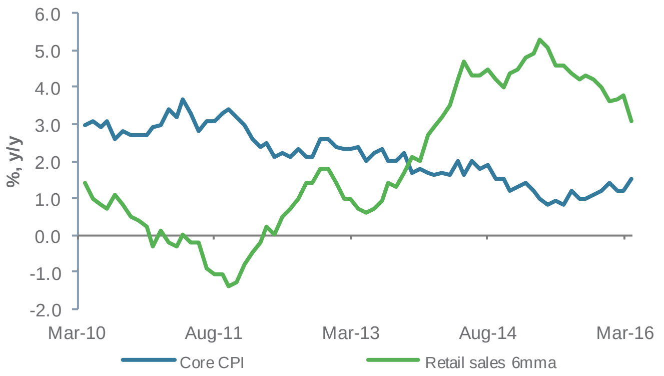
Source: Bloomberg, Standard Chartered

UK: 'Brexit' uncertainty continues to dampen outlook

- **The UK economy loses momentum amid Brexit uncertainty.** Domestic consumption and job creation have both slowed, while industrial output has contracted in recent months amid growing uncertainty about the outcome of the 23 June referendum, which will determine whether the UK will leave the European Union or not. Brexit risks have declined lately (market estimates point to a 20-30% probability of an exit vote), with most opinion polls suggesting voters want the UK to stay in the union.
- **Downgrades to growth outlook could delay a BoE rate hike.** Although UK inflation has been rising since it bottomed in mid-2015, consensus growth estimates have continued to be downgraded amid the Brexit uncertainty. Cabinet ministers and Bank of England (BoE) Governor Carney have highlighted the risks to the UK's economy and financial stability from a vote to leave the EU. Given the uncertainty, we do not expect a BoE rate hike in the coming months. Carney has said a rate cut is possible if the economy deteriorates as a result of the uncertainty.

UK retail sales have taken a hit from Brexit uncertainty, although inflation has picked up in recent months

UK retail sales, ex-auto fuel (%, y/y, 6mma); core consumer inflation (%, y/y) (RHS)



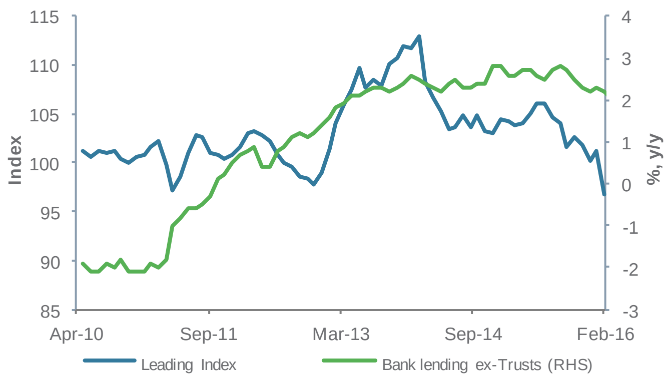
Source: Bloomberg, Standard Chartered

Japan: Further fiscal and monetary easing likely as data weakens further

- **Japan's economic data weakens further.** Japan's business confidence fell deeper into negative territory in April as exports and industrial production continued to contract, while a quarterly (Tankan) survey of large companies showed a weak outlook for investment. Meanwhile, bank lending growth has softened since peaking in mid-2015, suggesting weakening demand for loans, despite cuts to some of the BoJ's key rates to negative. Annual wage negotiations for the manufacturing sector have resulted in lower wage gains than last year, dampening the outlook for domestic consumption, although in inflation-adjusted terms the picture is less bleak.
- **BoJ refrains from further policy stimulus; sales tax delay likely.** The BoJ maintained its monetary policy despite cutting growth and inflation forecasts. Given the recent deterioration in economic activity, we believe more policy easing may be needed to turnaround the economy, including more fiscal spending. The damage to southern Japan from recent earthquakes could provide the government an opportunity to further delay the proposed sales tax increase (to 10% from 8%), slated for April next year.

Japan's leading indicator shows the broad-based decline in economic activity in recent months; slowdown in bank lending highlights the weakening outlook

Japan's leading index; Bank lending ex-Trusts (%, y/y) (RHS)



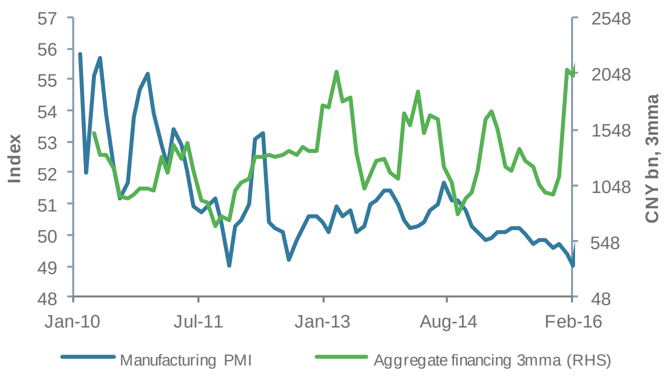
Source: Bloomberg, Standard Chartered

China: Signs of policy-induced stabilisation

- **Broad-based stabilisation in China data.** China's manufacturing business confidence returned to expansion territory for the first time in eight months, exports rose for the first time in nine months, while fixed-asset investment accelerated for the second straight month after more than a year of slowdown. The stabilisation in growth has been driven by successive cuts in benchmark interest rates and bank reserve requirements, as well as a pick-up in fiscal spending, and more recently, a lending boost.
- **Further policy easing likely to be more targeted as hard landing avoided, for now.** The recent stabilisation in data as well as reduced capital outflows and the rebound in major property markets are likely to enable policymakers to hold off from more broad-based policy easing measures in the coming months. Moreover, sustained broad-based stimulus measures could increase financial stability risks in the long run. As a result, we believe policymakers are likely to target easing measures mainly towards priority sectors in the coming months, helping China avoid a hard landing and achieve its 6.5-7.0% growth target for 2016.

China's manufacturing sector confidence has returned to expansion territory, while policy stimulus has led to a surge in lending

China's manufacturing sector purchasing managers index; aggregate financing (CNY bn, 3mma) (RHS)



Source: Bloomberg, Standard Chartered

Other EM: More policy easing likely in Asia; Brazil's inflation may have peaked

- **Asia's exports contract, low inflation points to further policy easing.** With the exception of China and Malaysia, Asian exports continued to contract. Meanwhile, inflation remained below central banks' targets across the region, with Singapore experiencing continued deflation. While stabilisation in China's data is likely to support a recovery in Asia, the challenging external outlook suggests there may be scope for further policy easing across the region. The Monetary Authority of Singapore's surprise policy easing to 2008 crisis settings and the Reserve Bank of India's rate cut over the past month reflect the dovish outlook.
- **Brazil's inflation may have peaked, creating scope for rate cuts.** The economy is showing signs of stabilisation after two years of sharp slowdown and recession. Inflation, after peaking at 10.8% in February, has slowed in the past couple of months. The rebound in commodity prices is helping reduce the current account deficit and a slump in domestic consumption and business confidence is showing signs of bottoming. Although Brazil faces some challenging months ahead, with the start of impeachment proceedings against President Rousseff, the decline in inflation is likely to create space for the central bank to start cutting rates (currently at a 10-year high of 14.25%).

Asia's policymakers have scope to cut rates further as inflation remains subdued and the USD stabilises

Asia's benchmark policy rates, including last changes to the rates (%, y/y)

				Last change	
	Benchmark	Policy rate	Next meeting	Date	Action, bps
China	1-year deposit rate	1.50	No schedule	21-Oct-15	-25
India	Repo rate	6.50	07-Jun-16	05-Apr-16	-25
Indonesia	BI rate	6.75	19-May-16	17-Mar-16	-25
Malaysia	Overnight rate	3.25	19-May-16	10-Jul-14	25
Pakistan	SBP target rate	6.00	28-May-16	12-Sep-15	-50
Philippines	Reverse repo rate	4.00	12-May-16	11-Sep-14	25
South Korea	Base rate	1.50	13-May-16	11-Jun-15	-25
Taiwan	Re-discount rate	1.50	30-Jun-16	24-Mar-16	-13
Thailand	1-Day repo rate	1.50	11-May-16	29-Apr-15	-25
Vietnam	Refinance rate	6.50	No schedule	18-Mar-14	-50

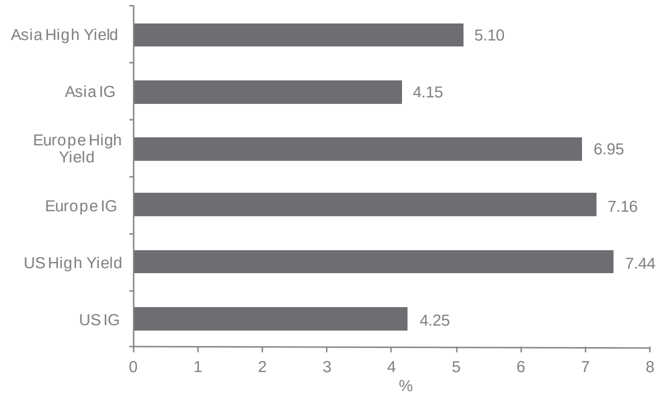
Source: Bloomberg, Standard Chartered

Bonds

- With our reduced preference for risk assets, we continue to prefer bonds over equities within balanced portfolios. We favour corporate bonds over government bonds. US Investment Grade (IG) bonds remain our top pick.
- In Emerging Markets, USD-denominated government bonds are expected to deliver positive returns. We expect Asian local currency bond markets to generate positive returns for local investors.

We prefer corporate bonds, particularly US Investment Grade corporate bonds

Performance of fixed income YTD* (USD)



For the period 31 December 2015 to 28 April 2016.

Source: Barclays Capital, JPMorgan, Bloomberg, Standard Chartered. Indices are Barclays Capital US Agg, US High Yield, Euro Agg, Pan-Euro High Yield, JPMorgan Asia Credit Index

G3 and EM (USD) sovereign bonds

- **Reduced preference for risk supports G3 government bonds.** The recent increase in yields across the G3 government bonds can partially be attributed to higher inflation expectations helped by the bounce in oil prices. However, despite the recent uptick, yields are still below the levels witnessed at the end of 2015. We believe easy central bank monetary policies and the broad demand for bonds should keep yields capped.

  Within G3 bonds, we retain our preference for US Treasuries over German Bunds and Japanese Government bonds as the low absolute (and often negative) yields in the latter two distort the risk/reward. We retain our preference for a 5-7 year maturity profile across USD-denominated government bonds. **EM USD government bonds – strong performance continues.** With over 6% returns this year, EM USD government bonds have delivered better-than-expected returns. The recent performance notwithstanding, they remain our most preferred choice within the government bond space.

  The stellar returns since the start of the year has largely been driven by price increase due to a combination of lower US Treasury yields and a reduction in the yield premium. As a number of EM countries are commodity exporters, the recovery in commodity prices, as well as a reduction in Fed rate hike expectations, has been positive. However, the recent positive developments are not enough to mitigate deteriorating credit quality. Hence, while we expect EM USD government bonds to deliver positive returns, we prefer to maintain a defensive stance with a preference for investment grade sovereigns.

Evolution of key factors since end-2015

Factor		What has changed since December 2015
Fed rate outlook	↑	Reduced rate hike expectations positive for USD-denominated IG bonds from G3 governments, corporates and EM countries
USD strength	↑	Softer USD positive for G3 and less negative for EM local currency bonds
Credit quality	↓	Worsening credit quality a rising risk for EM USD and DM corporate bonds. Deterioration relatively limited in Asian USD corporate bonds
Valuations	↓	Valuations have become more expensive across DM corporate, Asia corporate and EM sovereign (USD) bonds
Absolute yield	↓	Declined due to lower government bond yields and lower corporate bond yields
Commodity prices	↑	Stabilisation in price outlook is a positive for EM USD and DM HY corporate bonds

Note: Arrows indicate impact of the factor on potential bond returns.

Source: Standard Chartered

Corporate credit (USD)

- **Investment Grade (IG) corporates offer best risk-adjusted return.** We retain our preference for corporate bonds over government bonds. Within corporate bonds, US IG corporate bonds are our top picks, ahead of EUR-denominated corporate bonds.

  Undoubtedly, the ECB's corporate bond buying programme is supportive for EUR-denominated corporate bonds. However, European IG corporate bonds have rallied since the initial announcement and we believe a lot of good news is in the price. As shown in the chart alongside, European corporate bonds offer a considerably lower yield than US IG corporate bonds. We prefer the substantially higher yield on offer in US over the potential for moderate price appreciation in European bonds.

  For US IG bonds, the recent changes to tax rules on inversions and earnings stripping could dampen M&A activity. The ECB's bond buying programme, could lead to marginally lower-than-expected supply, which would be supportive for bond prices. Thus, the substantially higher yield and a supportive technical picture lead us to favour US IG corporate bonds.

- **US High Yield (HY) corporates – exhausted after the sizeable rally.** US HY corporate bonds have returned over 12% since their lows in February. While they still offer an attractive yield of approximately 7.60%, we believe their valuations are less compelling following the sizeable rally. Meanwhile, the fundamental picture continues to deteriorate. Default rates have crept higher, although we take comfort from the relatively stable aggregate credit metrics and the recent decline in correlation with oil prices. Hence, while we continue to like US HY bonds, we would prefer to wait for a better entry point.

- **Asian credit remains a defensive play.** Asian corporate credit has continued to deliver steady returns in 2016. While the yields on offer are lower than corporate credit in other Emerging Markets (EMs), we continue to like the defensive nature, which is substantiated by lower volatility. The recent rebound in Chinese economic data is supportive for Asian credit, given the large percentage of Chinese issuers. Additionally, lower supply compared to last year, increased fund flows into USD-denominated EM bonds and strong in-region demand remain supportive. Within Asian credit, we prefer the quality of IG bonds over bonds from HY issuers.

Bond spreads versus relevant benchmark*

	Current	52wk High	52wk Low	Long-term Average*
US IG	1.73	2.33	1.45	1.98
US HY	5.86	8.39	4.23	5.78
Europe IG	1.22	1.67	0.94	1.35
Europe HY	4.17	5.81	3.42	6.25
Asia IG**	2.25	2.60	1.94	2.53
Asia HY**	5.83	6.97	5.05	6.79

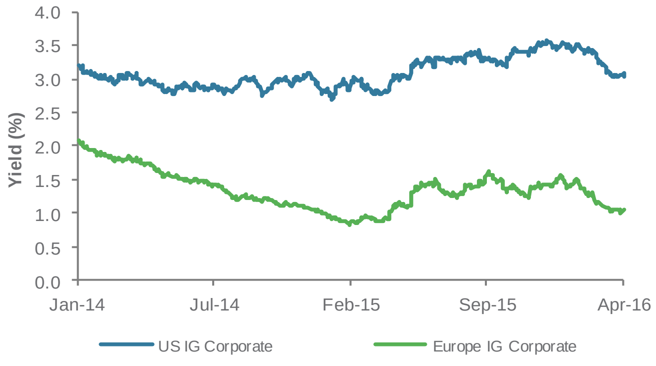
*Relevant benchmark for US and Asia is US Treasuries, Europe is bunds

** Long-term spread average from 2001 onwards. **Long-term spread average from 2006 onwards.

Source: JP Morgan, Barclays, Bloomberg, Standard Chartered

US IG corporates offer a higher yield than European IG corporates

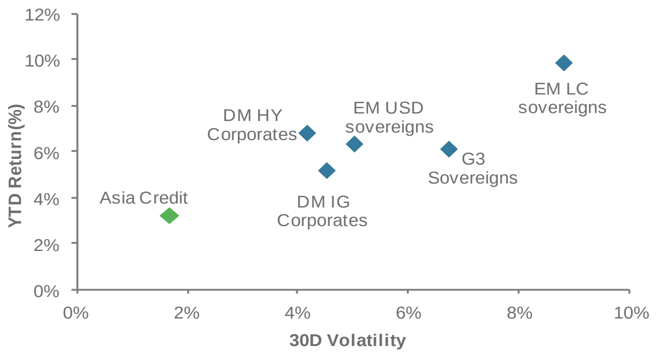
US IG corporate and European IG corporate bond yields



Source: Barclays, Bloomberg, Standard Chartered

Asian credit has offered stable returns

Year-to-date returns versus the 30-day volatility in each bond asset class



Source: Bloomberg, Standard Chartered

Asian local currency bonds

- **Dovish Fed and higher commodity prices provide a tailwind.** The lowering of expectations for the pace of Fed rate hikes have translated into a weaker USD, which has in turn benefitted Asian currencies. The recent stability has given central banks in Asian countries more room to ease and has led to high investor inflows, which have benefitted the bonds.

  For local investors, we believe local currency government bonds broadly offer an attractive carry and the scope for capital appreciation through further monetary easing. For international investors, currency remains an important driver of returns and we prefer INR bonds over bonds from other Asian countries.

- **Retain preference for INR bonds.** Within the Asian local currency bond space, we continue to like INR bonds. Following the positive budget announcement, where the government reiterated its commitment to fiscal prudence, the Reserve Bank of India cut the policy rate by 25bps in early April. While we are likely closer to the end of the rate cutting cycle, we continue to like the carry-on offer and remain comfortable with our INR exposure.

Local currency bonds offer an attractive carry

Country	Current 10-yr yield	Currency View*	Investor flows**
India	7.44%	🟢	🟢
Indonesia	7.54%	🟡	🟢
Malaysia	3.88%	🟡	🟢
Philippines	3.76%	🟡	🟡
S. Korea	1.80%	🔴	🟢
Thailand	1.76%	🟡	🟢

*Standard Chartered Wealth Management currency views. **Bloomberg Foreign Portfolio flows, greater than USD 100mn.

Traffic light signal refers to whether the factor is positive, neutral or negative for each country Source: Bloomberg, Standard Chartered

INR bond yields have declined in 2016

10-year Indian Government bond yields

Source: Bloomberg, Standard Chartered

Equity

- Earnings weakness and high valuations in Developed Markets (DMs) make us cautious on equity market prospects as we head into the summer months.
- We would use the rally in equities to trim exposure here and allocate elsewhere. We would not be chasing the rally in non-Asia Emerging Markets (EMs) at this juncture.
- Confidence over our positive view on US banks continues to wane, but we reiterate our positive view on US-listed technology companies.

Cautious on equity markets as we head into the summer

Estimated potential market returns using different approaches

	Consensus Return Estimates[1]	Consensus Return Estimates[2]	Option Implied Return Estimates[3]	Average of Three Return Estimates
US	9%	6%	7%	8%
Japan	18%	14%	9%	14%
Euro area	10%	7%	9%	9%
UK	7%	3%	8%	6%
Asia ex-Japan	14%	6%	10%	10%
Emerging Markets	12%	15%	9%	12%
Developed Markets	9%	8%	8%	8%

1. Consensus estimates based on analyst bottom-up price forecasts

2 Estimates using consensus earnings and the estimated price-earnings ratio expansion/contraction

3 Option potential return estimates are based on selling a 12-month Put at current levels and expressing the potential return using the premium earned as a % of the current level.

The estimates should be considered a best case with a probability of <50%.

FXI China ETF used as Asia ex-Japan proxy

Source: Bloomberg, FactSet, Standard Chartered

Key market drivers and recent trends

Factor		What has changed YTD and MTD
Earnings growth	↑	**YTD:** 2016 earnings growth is forecast to be the highest in Japan (13%), followed by Euro area (4%), US (2%) and Asia ex-Japan (2%). **MTD:** US earnings are beating expectations, but we note that earnings are still expected to contract 8% in Q1 or 4% ex-energy.
DM market valuations	↓	**YTD:** Valuations in the US and Euro area are viewed as fully valued, Japan is undervalued. **MTD:** Price-to-earnings multiples continue to rise given the market rally over the past 30 days.
EM market valuations	↑	**YTD:** EM valuations are viewed as undervalued, Asia ex-Japan fairly valued. **MTD:** Valuations in EM have climbed over the past 30 days. However, as earnings forecasts have also been revised up after the recovery in commodity prices, the rise in valuations has been capped.
Corporate margins	↓	**YTD:** Corporate margins are under downward pressure as costs, including labour expenses, rise. **MTD:** Margins in the Euro area are showing some signs of a recovery, but remain significantly below US levels.
Oil prices	↑	**YTD:** Oil prices are rebounding as the forecast surplus of supply over demand declines as US shale output dips. **MTD:** Oil prices remain above USD 40 per barrel, despite the absence of a production deal between the OPEC and Russia. We view the price reaction to the absence of a deal as positive.
USD	↑	**YTD:** The USD has been on a weakening trend, based on a basket of DM currencies. **MTD:** The USD has weakened against the GBP as investors see a lower likelihood of Brexit. The greenback has also weakened against the yen, with negative implications for Japanese equities.

Source: Standard Chartered

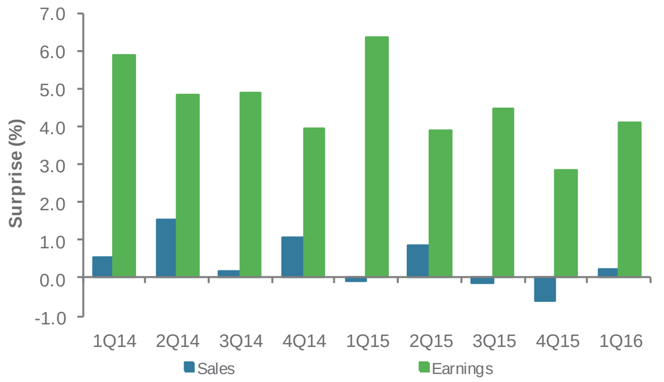
Note: Arrows indicate whether factor is improving or deteriorating YTD

US: Cautious, Q1 positively surprising, full-year remains weak

- We are cautious on the US equity market outlook, but acknowledge the recent recovery in the market driven by Q1 earnings surprises. Headline earnings growth in the Q1 period is forecast to shrink 7% (-4% ex-energy); however, investors are focusing on the 4% positive surprise in earnings among companies that have reported Q1 earnings.
- While the positive surprise in earnings is welcome, it can be partially attributed to management guiding expectations lower in the prior quarter. Moreover, there remains a significant contraction in earnings during the quarter. In the absence of a turnaround in headline sales, it is difficult to build a very bullish picture for US equities: full-year earnings are forecast to increase only 2%, following zero growth in 2015; margins are in decline; and valuations are elevated at 18 times 2016 earnings forecasts.
- While positives do exist, including the recovery in commodity prices and signs of a peak in the USD, these may be insufficient on their own to act as new growth drivers. What would make us more constructive towards US equities include an increase in wages matched by productivity gains, implying inflation remains subdued, enabling the Fed to continue its policy of very gradual rate hikes, while consumers return to the malls and start a new virtuous consumption cycle.

Q1 earnings are surprising on the upside

Percentage surprise in quarterly earnings and sales



Source: Bloomberg, Standard Chartered

	April 2014	April 2015	April 2016
Global GDP revisions	Flat (3.6%)	Down (3.5%)	Down (3%)
MSCI World Earnings trend	Down (10.4%)	Down (5.2%)	Up (7.4%)
MSCI World Earnings revisions trend	Up (-0.2)	Up (-.2)	Up (-.4)
DM High Yield Credit spreads	Down (2.4%)	Down (3.9%)	Down (5.7%)
USD index	Flat (80)	Down (95)	Down (94)
Oil prices	Flat (USD 100)	Up (USD 60)	Up (USD 45)
Fed rate expectations	Flat (0.175%)	Up (0.175%)	Flat (0.375%)
Investor Sentiment (global equity flows)	Up (USD 50bn)	Down (USD -1bn)	Down (USD -59bn)
Market risk (VIX)	Falling (14)	Rising (15)	Falling (15)
Risks	Euro area bank stress tests	Bank capital raising	Fed outlook
	Russian invasion of Crimea	Grexit	Brexit
	EM corporate debt risk	China slowdown	Reversal of China easing

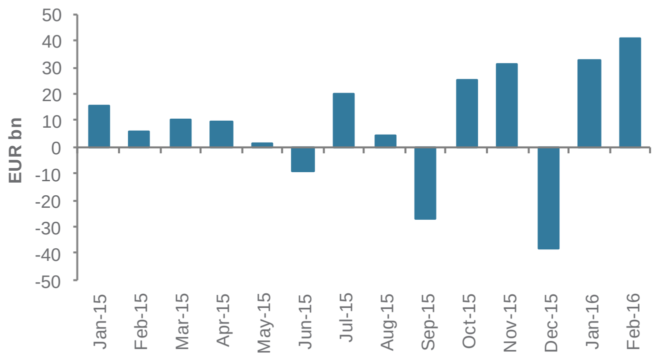
Note:
Earnings and earnings revisions refer to 12 month forward consensus forecasts
DM high yield credit spreads refer to Barclays US corporate 10 Year
Up/Down/Flat arrows refer to change relative to the prior month

Europe: Positive on Euro area, negative on the UK

- We are positive on Euro area equities, noting the 4% consensus earnings growth forecast for 2016 compared to 2% in the US. Drivers of the better outlook for Euro area equities include the continued improvement in credit growth, which was up 20% q/q in Q1 as banks leveraged the ECB's very attractive lending package.
- We expect cyclical sectors to outperform defensives in the Euro area in 2016 as the recovery broadens beyond the export-orientated manufacturing sectors. We view this transition as crucial given the recent strength in the euro could undermine the profits in the manufacturing sector, if the pace of appreciation were to continue.
- The risks surrounding the UK's vote on whether or not to leave the EU have diminished based on surveys of individual betting-market intentions. The probability of remaining in the EU is estimated to be 70% with Brexit at 30% (source: oddschecker.com). The 'Remain' camp received a major boost following President Obama's visit, where he highlighted that the UK would go to "the back of the queue" when it came to negotiating a new trade deal, which would be necessary in the event of a Brexit.
- While risks of Brexit may be diminishing, the impact on the economy and the corporate sector are already negative. Hiring intentions in recent purchasing manager surveys have deteriorated and the uncertainty is holding back investments. A vote to remain could release pent-up demand; however, the risk of damage to the economy in the intervening period could be significant. A number of high-street companies have recently entered administration as a combination of softer consumer demand, high rents and uncertainty over Brexit has undermined retail sales.

Euro area credit is growing rapidly

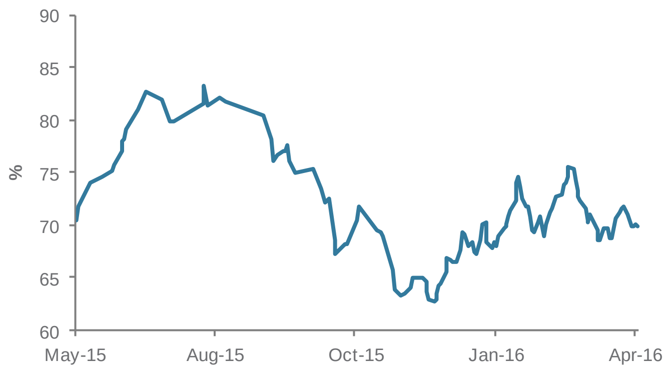
Euro area credit flows



Source: ECB, Standard Chartered

Betting markets indicate 70% probability of the UK remaining in the EU

Probability of Brexit vote outcome



Source: Oddschecker, Standard Chartered

Japan: Caution driven by yen strength

- We continue to adopt an increasingly cautious stance on the outlook for Japan. We are concerned about the after effects of the BoJ policy error at its January meeting when it adopted a negative interest rate policy. Japanese banks have been the biggest losers in the policy flip-flop, declining 24% year-to-date, compared to a 10% decline in the Nikkei.
- Japanese corporate earnings are forecast to increase 13% in 2016, the second-best growth rate of all markets in MSCI World (Ireland comes first with 28% growth). While positive, the growth reflects prior yen weakness. As the market is forward looking, current yen strength, if sustained, would undermine 2017 earnings growth and investors are focused on this as opposed to 2016 data, which was discounted in H1 2015.
- Estimated returns for the Japanese equity market are 14%, the highest among the regions/countries highlighted on page 14. We square our cautious view despite this bullish returns estimate by highlighting the risk of earnings cuts in Japan due to yen strength and a diminishing impact from quantitative easing and Prime Minister Shinzō Abe's reforms. Japanese earnings have been revised sharply downwards in recent months, which will drag down headline earnings forecasts, in our view.

Japanese equity market performance and the JPY are closely correlated

Nikkei 225 and the JPY

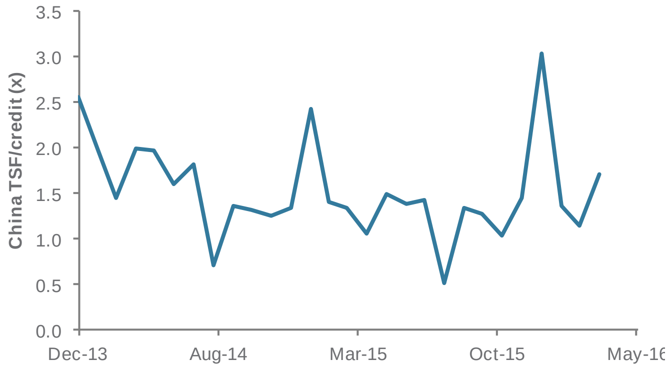
Source: Bloomberg, Standard Chartered

Asia ex-Japan: Remain positive on China and Taiwan, India looking better

- Asia equity markets have gained 2% over the past month, lagging the 3% return for Developed Markets (DMs). However, within Asia, China and Hong Kong stand out as solid performers, rising 4% and 5%, respectively, over the same period.
- China maintained an easing policy stance, with bank credit rising CNY 2.3tn in March from CNY 780bn in February. Smoothing out some of the monthly fluctuations, we note that "total social financing" (a measure of total credit creation) has increased 40% q/q. This has directly contributed to a reflation of the real estate and steel sectors, with some provinces reporting a shortage of long steel products used in construction.
- Singapore stands as our least preferred market in Asia ex-Japan, although the market has posted a healthy 2% gain over the past month as investor interest in the REIT sector has been renewed. Falling government bond yields has contributed to a re-rating of the sector as investors discount a lower-for-longer view. However, we believe that US bond yields, which Singapore yields track, are likely to rise to a range of 2-2.25% with one rate hike by the Fed this year our central scenario. If correct, this implies renewed selling of REITs in the months ahead.
- Among the large Emerging Markets (EMs), India stands out as a preferred market for us. The recent budget highlighted renewed efforts by the government to restructure non-performing loans and inject capital into state-owned banks. There are also signs that the opposition Congress Party may be ready to seek a compromise on the Goods and Services Tax (GST) bill during the current session of parliament.
- Asia continues to rank in the middle in terms of our regional/country preferences, close to the US, but above non-Asia EMs, the UK and Japan. Within Asia, we prefer MSCI Taiwan and MSCI China. For the latter, we emphasise our preference for new-economy sectors, including technology and consumer services. One of the best ways to leverage this view is to focus on MSCI China as opposed to the more widely known, but financials sector heavy, H Share Index.

Chinese lending surges 40% q/q in Q1 2016

Total social financing/credit creation



Source: Bloomberg, Standard Chartered

Singapore REIT's rally as bond yields decline

Singapore REIT's and 10-year bond yields (inverted)

Source: Bloomberg, Standard Chartered

Non-Asia EMs: Rising commodity prices boosting performance

- We remain cautious on non-Asia Emerging Markets (EMs), despite the recent solid performance. An improvement in commodity prices is primarily responsible for the rally in these markets, including Brazil and Russia, which are up 6.5% and 5%, respectively, over the past 30 days and approximately double that in USD terms.
- Iron ore prices have risen 12% over the past 30 days and 44% year-to-date. The rally in iron ore started when news of China's credit easing emerged in late January. However, Chinese policy makers have recently started to slow the supply of credit, including imposing a 30-day halt on referrals by Shanghai mortgage brokers to banks for mortgages. Reduced availability of credit could slow real estate activity in China, which would put pressure on iron ore prices.
- Australia's largest iron ore producer expects prices to decline due to increased supply, including the new 55m tonne per annum Roy Hill mine in Pilbara. As iron ore prices are a key driver of EMs, including Brazil, we remain cautious on the outlook for Non-Asia EMs.
- We are more constructive on oil prices, believing that prices have bottomed. This is good news in the near term for markets dependent on oil exports, including Russia.

Iron ore prices have surged YTD

Price of iron ore 62% Fe for delivery to Qingdao

Source: Bloomberg, Standard Chartered

Conclusion

We are cautious on the outlook for equity markets with our conviction levels declining further over the past 30 days. Trimming our exposure ahead of the summer months could be an effective strategy to side step the three risks for markets we have identified: a shift in US monetary policy rhetoric, increased European political risks and rising concerns over China's FX policy. The recent market rebound, we believe, is driven by technical as opposed to fundamental factors. We base this view on the oversold nature of markets in February and the absence of a meaningful recovery in earnings forecasts since then. While Q1 earnings in the S&P500 are surprising positively, we note they are still forecast to shrink 7%, or 4% ex-energy. In line with our ADAPT framework, it is possible that we may change these views if developments evolve differently to our central scenario.

Ranking of our key country preferences

No. 1	Euro area	**Most Preferred**
No. 2	US	
No. 3	Asia ex-Japan	
No. 4	UK	
No. 5	Japan	
No. 6	Non-Asia Emerging Markets	**Least Preferred**

Source: Standard Chartered

Commodities

- We believe the recent rally in commodity prices has run ahead of fundamentals and would be caution against adding exposure in the short term.
- However, on a 12-month basis, we expect commodity prices to be stable or slightly higher.
- We believe the recent rally in oil has not been matched by any change in the supply-demand balance. Hence, we are cautious.

Evolution of key factors since end-2015

Factor	What has changed since December 2015
Demand	Oil demand likely tempered recently amid downward revision to GDP growth. Demand for gold has surprised slightly to the upside, while improved China data has been supportive for base metals
Supply	Oil and metals oversupply outlook unchanged, but US oil production cuts have accelerated. Iran continues to expand production. Inventories remain elevated
Sentiment	Speculative sentiment on commodities has risen significantly in the recent past from excessively negative earlier
USD	Softer USD a marginal support across the board

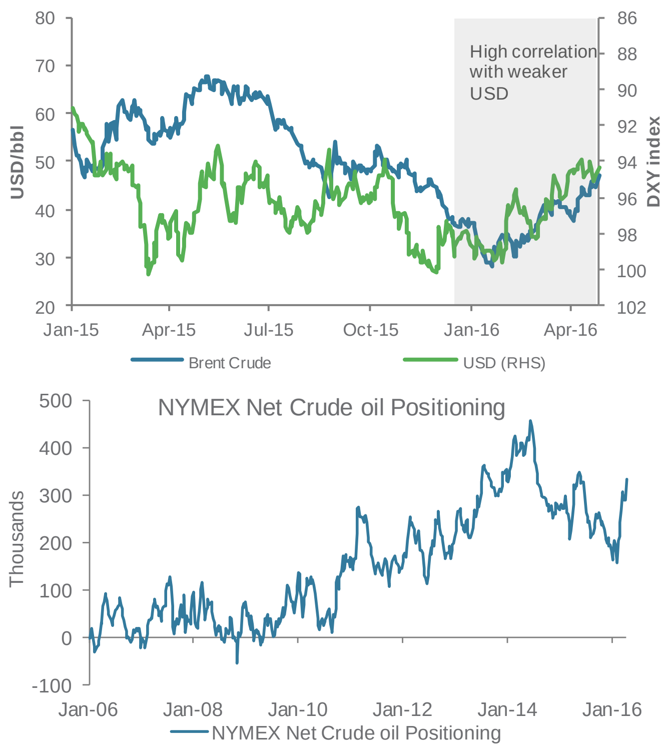
Source: Bloomberg, Standard Chartered

Oil

- **Recent rally might have run ahead of fundamentals.** As the chart alongside shows, the recent rally in oil prices has been aided by a weaker USD. While we believe that oil prices have likely bottomed, they appear to have run ahead of the fundamental demand-supply picture and the recent rally may have a speculative element to it.
- While we continue to expect oil markets to re-balance closer to the end of the year, the world currently has excess supply. Oil prices have continued to climb despite this and the disappointment in the recent talks in Doha, where hopes were for an agreement to cap oil production. In our opinion, producer cutbacks are the largest possible source of a price increase. However, with the failure of the Doha talks, this looks unlikely. Hence, in the near term, we believe that the downside risks to oil prices outweigh the upside risks, and would not rule out a pullback in prices.
- Over the long term, we continue to believe oil prices will bottom out as the gap between demand and supply narrows and returns into deficit in 2017. However, oil stocks remain massively above long-term highs and we believe that they would need to be cleared before oil prices can move sustainably higher. We acknowledge that unplanned oil production outages pose upside risks to oil prices given that many producers are already producing at, or close to, full capacity.

Weaker USD and higher speculative positioning have aided oil prices

Brent crude price and DXY index (inverted)



Source: Bloomberg, Standard Chartered

Standard Chartered

Gold

- **Gold prices likely to remain range-bound.** Gold prices are positively correlated to inflation expectations and negatively correlated to the USD. While we do not expect broad-based strength in the USD, we have a bias for slight strength in the near term, which would be a mildly negative factor for gold.
- Meanwhile, the recent rally in gold has been accompanied by a sharp jump in speculative positions, potentially as gold's lack of a yield becomes less concerning as interest rates go negative in many countries. Net speculative positions are now at their highest since 2013.
- However, there are signs that inflation expectations, at least in the US, may be bottoming on the back of higher oil prices and a gradual acceleration in wage growth.
- Given the balanced factors outlined above, we believe gold prices are likely to remain range-bound in the near term, perhaps with a slight downside bias.

Recent increase in gold prices has been accompanied by an increase in speculative positioning

Gold prices and net non-commercial futures positioning

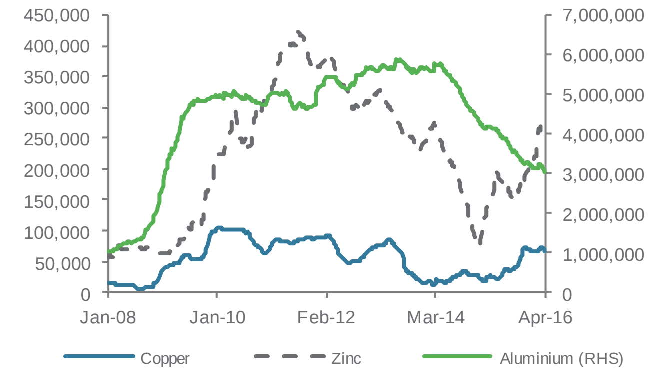
Source: Bloomberg, Standard Chartered

Industrial metals

- **Fundamentals remain challenged despite China-driven rebound.** The recent pick-up in economic data in China and the weaker USD have led industrial metal prices higher over the past month. However, we would be cautious in chasing the rally further.
- Major supply and demand indicators warrant some caution, in our opinion. Apart from the production cutback in zinc last year, we are yet to see similar action in other metals. Additionally, apart from aluminium, the inventories for other metals are on an increasing trend.
- Hence, if data from China continues to improve, it could lead to greater demand for metals; the negative fundamentals and the risk of slight USD strength balance the risk/reward, in our opinion.

Industrial metal inventories are generally on an upward trend

Inventories for copper, zinc and aluminium



Source: Bloomberg, Standard Chartered

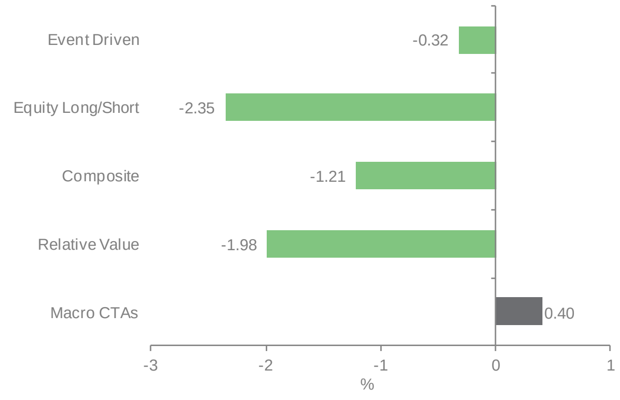
Alternative strategies

- Alternative strategies remain our preferred asset class. While they suffered during the recent rebound, rising volatility, market dispersion and continued policy divergence remain supportive factors. Global macro strategies are our preferred sub-asset class ahead of the summer.
- Equity long-short strategies may suffer somewhat should equity markets weaken significantly over the summer months.

The baton appears to be shifting towards macro strategies

Macro strategies outperformed early in the year; they may deliver again in the coming months

Performance of HFRX sub-strategy indices, (%, YTD)



For the period 31 December 2015 to 28 April 2016.
Source: Bloomberg, Standard Chartered

A return of risk appetite means strategies such as equity long/short outperformed, while macro strategies took a pause. Alternative strategies as an asset class gained over the past month as equity-focussed strategies gained amid the rebound in equity markets.

Key drivers largely unchanged. Volatility has declined, consistent with the rebound in risky assets, but we expect this to be temporary as volatility spikes become more frequent. The Fed's forecast for fewer interest rate hikes in 2016 arguably scales back the magnitude of likely policy divergence between global central banks, but the Fed and other major central banks remain on diverging rate paths and there are signs that the Fed is becoming less dovish. Other drivers (market dispersion and trending markets) remain in place.

Summer volatility would increase attractiveness of global macro strategies. We have been highlighting for the last two months that a temporary underperformance of alternative strategies was likely as equity markets rebounded from technically oversold levels. This has played out. However, we believe we are heading towards a period of greater market volatility, which may support the performance of global macro strategies, similar to what happened earlier in the year.

Equity long/short strategies tend to offer a much more attractive risk/reward proposition as they offer exposure to equities, but generally with lower levels of volatility. However, their high correlation with equities means they may still deliver negative returns over the summer period.

Our views on the main sub-strategies

Sub-strategy	Our view
Equity long/short	**Positive:** Exposure to equities, but likely with lower volatility relative to long-only
Relative value	**Neutral:** Volatility has improved opportunity set, but liquidity is likely to be a challenge
Event driven	**Neutral:** M&A activity is a positive, but strategy vulnerable to broader market volatility
Credit	**Neutral:** Volatility/sector stress positive for credit long/short strategies; defaults a risk
Macro	**Positive:** Outperformance during recent volatility reinforces diversification value
Commodities	**Neutral:** Commodity prices are a risk, although an eventual rise in oil prices may support
Insurance linked	**Negative:** Insurance losses below average in 2015, which could reverse in 2016

Source: Standard Chartered

Foreign exchange

- Expect the USD to trade broadly sideways, with a slight upside bias, and the EUR to remain within the 1.05-1.15 range. Gains in the JPY are likely to be limited as well
- Do not chase the AUD higher from here; IDR to outperform other Asian currencies, but SGD and CNY could underperform

Limited Fed rate hikes are likely to keep USD gains in check. The EUR and JPY are unlikely to gain significantly given continued pressure to maintain an easing bias. We believe it is too early to call for a bottom in the GBP amid uncertainty ahead of the June referendum. Asia-ex-Japan currencies are unlikely to extend the rally given the lack of key fundamental drivers. CNY weakness remains a key concern.

Fed and China growth key factors guiding currency markets

Short term: Refers to a horizon of less than 3 months

Medium term: Refers to a time horizon of 6 to12 months

USD: Not too hot, not too cold

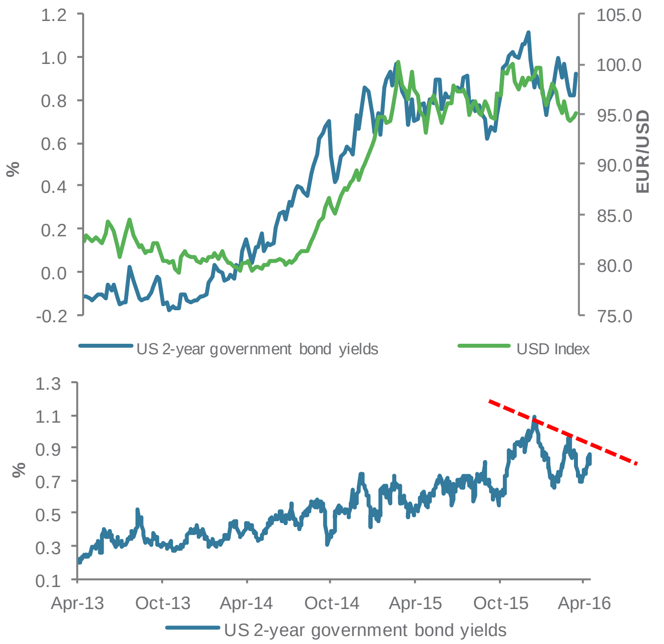
We expect the USD to broadly remain range-bound, defined by its highs and lows since the rally stalled in March 2015. Rebounds are likely to be limited, while buying interest may emerge on declines.

We believe significant USD strength is unlikely in the medium term for two reasons. First, the Fed is likely to hike interest rates cautiously and gradually, being particularly sensitive to USD strength. Concerns on tightening of US financial conditions are key considerations in this regard. Second, with the narrowing of US growth differentials over its peers, the allure of US assets has been tempered.

Similarly, we do not expect substantial USD weakness. First, while diminished, the monetary policy divergence theme remains in place. The US is still likely to modestly hike interest rates, while most other central banks are more likely to add to stimulus measures. Second, fund flows to non-USD assets are likely to be limited without strong growth pick-up in Emerging Markets (EMs).

US front-end rates remain capped, keeping the USD largely range-bound

USD Index-weighted interest rate differentials vs. the USD Index and 2-year US treasury yields (below chart)



Source: Bloomberg, Standard Chartered

EUR: ECB can still limit upside

We expect to the EUR to broadly trade within the 1.05-1.15 range, implying some weakness from current levels. In our view, the monetary divergence theme has diminished following the Fed's softening of its rate hike forecasts. However, we believe the theme remains valid as the Fed still expects to hike rates (even as the ECB keeps policy very easy), albeit at a slower pace than previously expected.

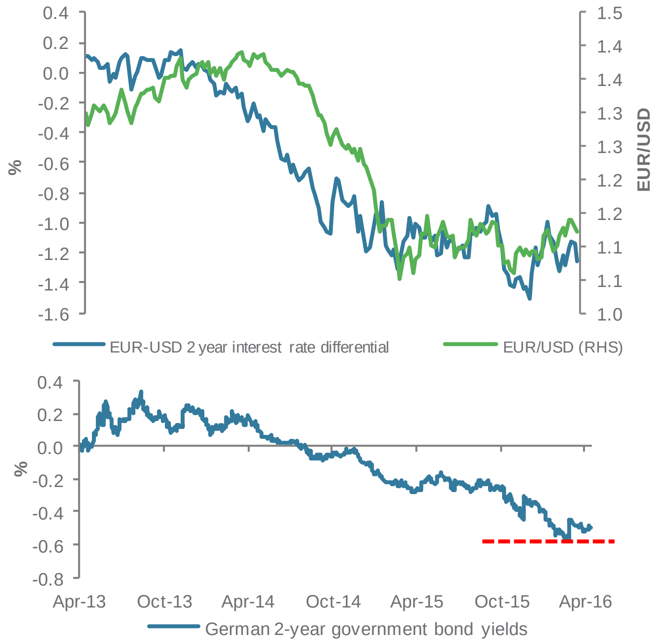
Political issues are likely to result in some volatility in the EUR over the summer. First and foremost, Brexit remains a risk in the short term, although we do not see it as a significant, sustained negative factor on its own. Greece's debt negotiations may come to the forefront yet again. Spanish general elections are also likely to be closely watched.

We also note some factors in the Euro area have become more EUR supportive. Euro area growth remains resilient (see page 9), while the current account surplus swells further. Against this backdrop, EUR remains cheap from a valuation perspective.

Risks to our range-bound EUR outlook are still tilted to the downside, with a pick-up in US inflation and a more hawkish Fed as possible catalysts.

Limited downside in core Euro area yields have kept the EUR range-bound

EUR-USD vs. EUR-USD 2-year government bond yield differential and 2-year German Bund yields (below chart)



Source: Bloomberg, Standard Chartered

JPY: BoJ last resort

We do not expect recent gains in the JPY to result in a sustained rally over the medium term.

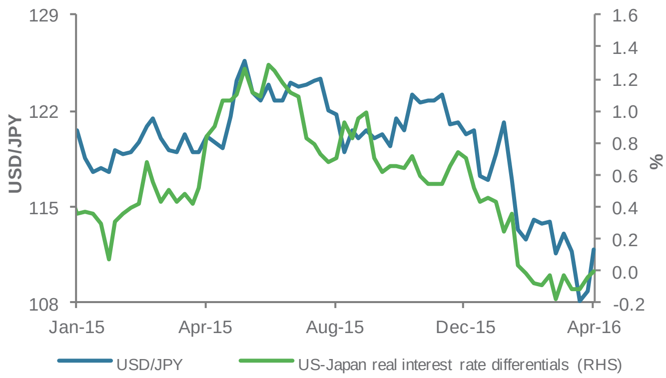
Gradual Fed rate hikes and a constant risk of accelerated policy easing by the BoJ are the main factors capping JPY strength, in our view. The recent JPY rally has coincided with a fall in US-Japan real (net of inflation) interest rate differentials, as inflation expectations in Japan have collapsed, although we believe these have likely bottomed given the rally in oil prices.

However, we contend the BoJ's potential to significantly weaken the JPY through additional quantitative easing (QE) and further negative rates is limited. One possible reason is that long-term fundamentals, namely deep currency undervaluation and a large current account surplus, are JPY supportive. Therefore, it may require a much bolder, rather than incremental, approach to easing for the JPY to weaken materially.

While the possibility of a direct currency intervention to weaken the JPY remains, it is unlikely since such action in the past has coincided with much steeper JPY weakness over a limited time period.

USD/JPY has been following real interest rate differentials recently

Japan 10-year real interest rate differentials and USD/JPY



Source: Bloomberg, Standard Chartered

GBP: Not out of the woods yet

We expect the GBP to remain volatile ahead of the June Brexit referendum. Recently, short technical indicators have picked up for the GBP and the three-month volatility has fallen.

Nevertheless, we believe it is too early to take a firm directional view. Should the UK decide to remain within the Euro area, our central scenario, we may see a limited rebound in the GBP, given markets appear to have incorporated this probability to some extent. A vote in favour of Brexit may see further sharp GBP losses in the short term, although these may eventually reverse.

The risks of a Brexit stem from the UK's record current account deficit, which may encounter funding issues should capital inflows dry up. Elsewhere, the fundamental situation is somewhat better than for the UK's peers. Domestic manufacturing and services appear to be performing marginally better than in Europe and the US. Markets too remain overly pessimistic on the UK rates outlook, expecting the first BoE rate hike in no less than two years, against our own expectation of late 2016 or early 2017. The BoE has highlighted the next interest rate move is likely to be higher but has not ruled out rate cuts should conditions warrant.

Brexit concerns appeared to have eased recently with GBP rally and fall in volatility

GBP/USD and 3-month implied volatility

Source: Bloomberg, Standard Chartered

AUD and NZD: AUD has likely bottomed, prefer AUD to NZD

We believe risks to the AUD have reduced, with any weakness likely to be limited to this year's lows. We view the following reasons for our slightly more constructive outlook.

First, commodity prices may have troughed, barring any major negative growth surprise from China. Second, relatively higher yielding bonds may be attractive to international investors. Third, an improvement in Australia's domestic growth and labour market is likely to keep the RBA on the sidelines. A key risk, however, is if inflation pressures continue to ease.

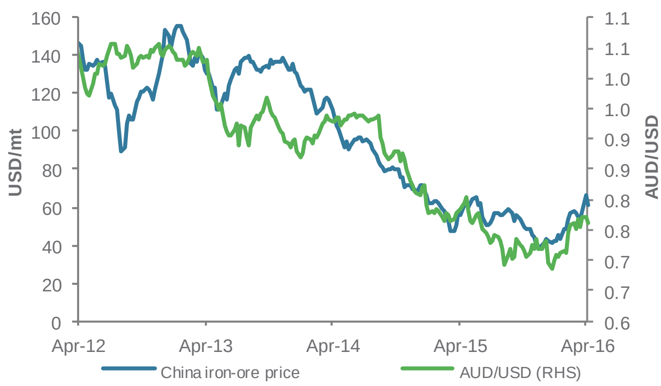
However, the upside in the AUD is likely to be capped for two reasons. First, until China and Emerging Market growth picks up in a big way, medium-term risks are likely to persist. Second, continued AUD strengthening could also eventually push the RBA towards further easing.

Recent NZD strength has been largely due to improving sentiment towards high-yielding currencies and USD weakness. However, we believe risks are still firmly tilted to the downside with dairy prices remaining depressed and rate cuts still firmly on the table.

Based on our diverging views on the AUD and the NZD, we expect the AUD/NZD pair to rally further.

AUD continues to follow iron ore prices, which may have bottomed

AUD/USD and China iron ore prices



Source: Bloomberg, Standard Chartered

Asia ex-Japan: Don't chase the rally

We believe the worst is behind us for Asian currencies. However, we do not believe a significant rally is likely as Asian central banks may push back against significant strength until we see a considerable improvement in the region's growth prospects.

The CNY has continued to weaken against a basket of currencies, contrary to our expectations. Helped by a weaker USD, authorities may be guiding the currency lower against the currency basket in order to support domestic financial conditions. However, we still see little probability of a one-time major devaluation, which may be counterproductive and could hurt market confidence. A weakening CNY basket has, thus far at least, had little impact on the USD/CNY pair, which has remained broadly stable amid USD weakness. Consequently, we maintain our modestly bearish view on the CNY against the USD amid some pick-up in USD strength.

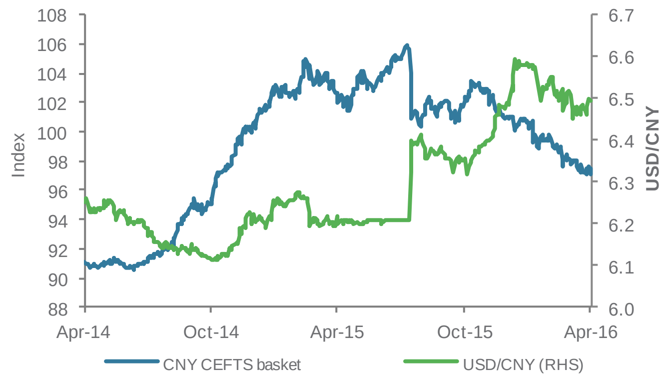
The SGD failed to weaken even as the MAS shifted to a neutral policy stance, one which it has adopted in the past only during recessions. We believe concurrent weakness in the USD is largely to blame for this. As long as Asian currencies continue to strengthen, the SGD may continue to strengthen against the USD. However, we now believe USD weakness against Asian currencies is reaching its limits. On the nominal effective exchange rate policy band, the SGD trades within the upper half, suggesting that the currency remains too strong compared with its peers. We expect the SGD to modestly weaken against the USD from here.

Among the regional currency pairs, we are most positive on the IDR. The return of optimism regarding growth following recent reforms and additional policy easing are likely to underpin the exchange rate. On the MYR, we believe most of the positives have been priced in, and, hence, expect more of a range-bound movement. However, we continue to expect the MYR outperform the SGD.

On the INR, we believe most of the recent weakness is behind us and expect USD/INR to trade broadly range-bound. We believe the Reserve Bank of India will remain cautious in lowering interest rates while focusing on building FX reserves, thus essentially capping any INR upside.

CNY basket weakens even as USD/CNY remains stable

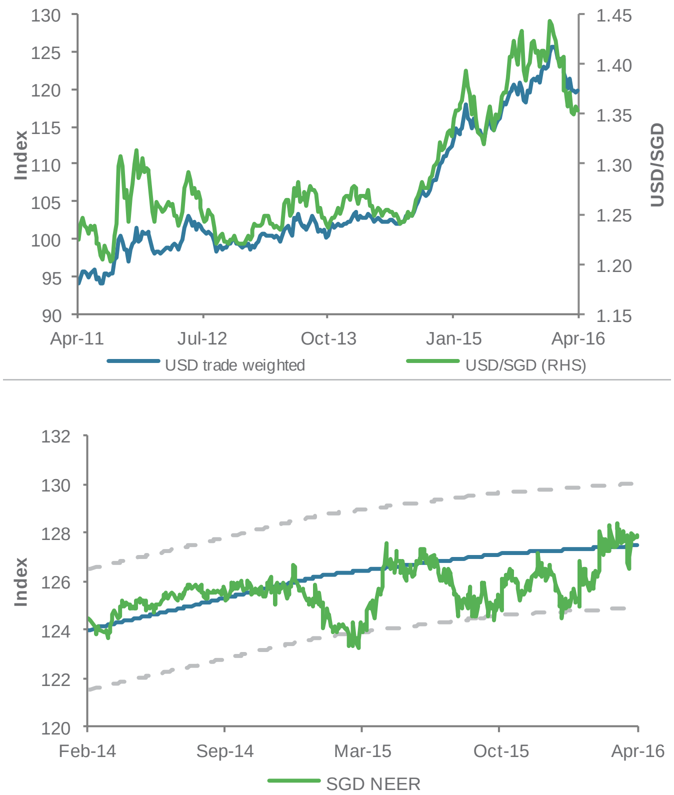
CEFTS CNY basket and USD/CNY



Source: Bloomberg, Standard Chartered

The SGD has been closely following the broad USD weakness recently; has not been as affected by monetary policy

USD broad trade-weighted index vs. USD/SGD and SGD NEER policy band (Standard Chartered estimate)



Source: Bloomberg, Standard Chartered

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