Global Market Outlook

1 September 2016

Pivoting towards EM

Markets have enjoyed a post-Brexit relief rally, but we remain cautious. Equity markets have rallied strongly as fears surrounding the global implications of the Brexit decision faded and oil prices rebounded. We remain cautious in the coming 2-3 months given the risk of rising US interest rate expectations and US political risks. On a 12-month view, we prefer to be a bit defensive as we believe the risks of a rollover in US growth are likely to rise over time and it remains unclear how successful China will be in managing its deleveraging cycle.

Pivot towards Emerging Market assets. We continue to gradually increase allocations to EM assets. Last month, we increased our recommended allocation to EM Investment Grade (IG) sovereign bonds. This month, we have become more constructive on the medium-term outlook for Asia ex-Japan equities given an improving earnings outlook and a pick-up in net inflows to the region, which we believe are sustainable given our expectation that the USD will remain relatively stable. That said, a global equity market pullback is a short-term risk.

Scenario-based approach argues for balanced investment allocations. The recent performance of equities has highlighted the importance of maintaining an allocation to this asset class. However, it is more risky to have a strong conviction in the macroeconomic outlook. This argues for a balanced approach to investing. We continue to believe an approach to investing tilted/biased towards multi-asset income makes sense, but argue a multi-asset macro strategy allocation is a reasonably inexpensive way to hedge the downside risks.

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Asia and Emerging Markets still dependent on China, which is transitioning towards consumer-led growth. Oil prices also key

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Transition to late cycle likely to lead to higher volatility

Pivoting towards EM

- Global equity and bond markets were well supported over the past month by positive technicals, an intensified search for yield and robust inflows into Emerging Markets (EM). These tailwinds could easily support markets for another month or more.
- However, a positive short-term outlook does not alter long-term risks. A continued muddle-through scenario appears most likely, but the risks of an inflationary or deflationary shock should not be ignored.
- This is consistent with our view to favour multi-income assets, but balance with multi-asset macro. Within this, our views on EM assets continue to incrementally improve.

Consider the scenarios

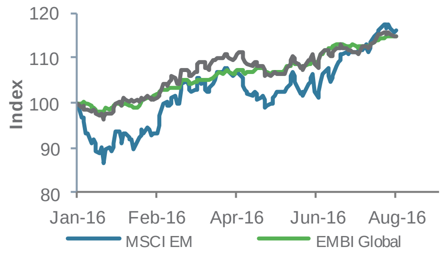
Most asset classes performed well over the past month, and momentum, the yield chase and EM inflows argue this could continue. However, we continue to be mindful of (1) our view that we are late in the US economic cycle, (2) the risks posed by extended positioning and (3) the fact that volatility is close to post-2009 lows.

We continue to believe that an appropriate approach late in the cycle is to consider a range of possible scenarios (an approach we first laid out in our H2 2016 Investment Outlook). In our view, a continuation of the current muddle-through environment remains most likely. This implies positive, albeit tepid, growth in most regions, accompanied by supportive monetary policies – an environment in which income assets should continue to do well.

However, we continue to believe there are significant risks of a much more challenging scenario. This could be a result of an inflation shock in the US, an outcome in which both equities and bonds suffer, but real assets such as gold do well. This could equally be a result of a deflationary outcome, good for bonds but negative for equities. In our view, the likelihood of a continued muddle-through environment is only slightly higher than the downside scenarios (around 45% likelihood versus a 35% chance).

Figure 1: EM equities and bonds have done well

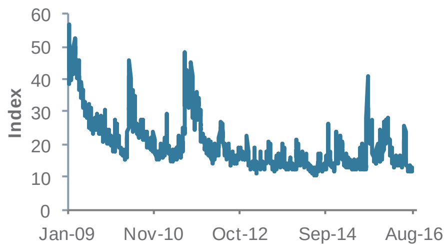
MSCI EM, EMBI Global, GBI-EM index returns YTD



Source: Bloomberg, Standard Chartered

Figure 2: Volatility is approaching range lows

S&P500 implied volatility (VIX) index



Source: Standard Chartered

Investment strategy

Continuity in investment themes, albeit with tweaks

From an investment perspective, our outlook on the range of scenarios makes a case for continuity of our asset-class views, albeit with a few tweaks. We believe our preference for maintaining exposure to multi-asset income strategies, but balance it out with the insurance characteristics of multi-asset macro strategies, remains valid. A muddle-through scenario is supportive of income assets, and risky assets could continue to 'climb the wall of worry'.

We have not needed to use the insurance characteristics of multi-asset macro strategies thus far, and we hope we will not need to. However, the sizeable probability we assign to ending up in either of the downside scenarios means we cannot ignore the need to own protection against drawdown risks. History illustrates the value multi-asset macro strategies have provided during periods of volatility, both for short bouts and more extended drawdowns.

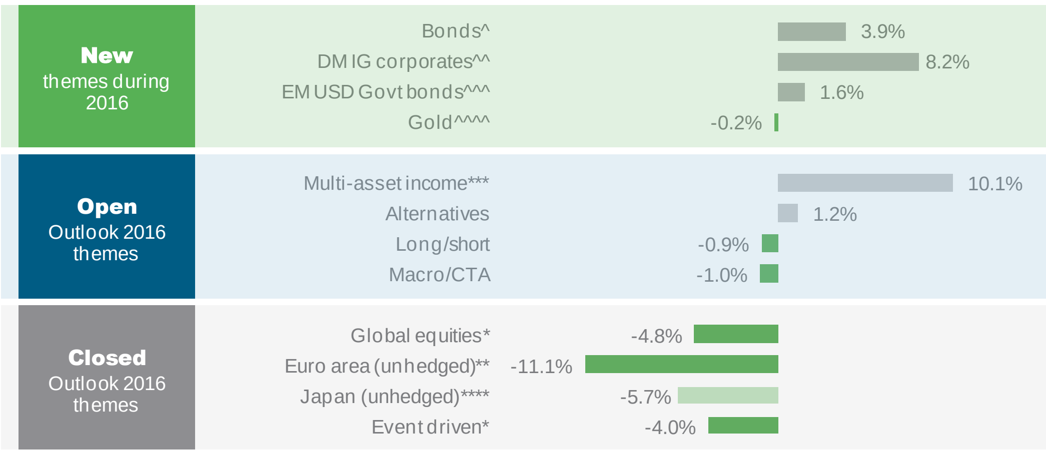
Favour USD government bonds in EMs

We continue to become incrementally more constructive is in EM given supportive commodity prices, strong inflows and select bright growth spots. However, we continue to believe it will pay to be selective on the asset class through which to increase EM exposure. We believe EM USD government bonds still offer the most rewarding route to EM exposure because of attractive yields, valuations and the fact that they are denominated in USD, reducing short-term currency risks. However, a rise in our medium term preference for Asia ex-Japan equities means that, within a selective equities allocation, we would look for opportunities to partially rotate away from Developed Markets (DM) to EM over the next 2-3 months. Asia ex-Japan equities and US equities are now our two most preferred markets.

While it is tempting to increase exposure also to local currency bond markets given reduced EM currency volatility, we prefer a more selective approach (see page 15).

Figure 3: Income theme once again the strong performer

Performance of A.D.A.P.T. themes since Outlook 2016***
'Themes during 2016' consist of sub-asset classes where we are OW or N the main asset class and OW the sub-asset class



* Closed on 25 February 2016
**FX-hedge removed as of 25 February 2016. Theme closed on 27 June 2016.
*** For the period 11 December 2015 to 25 August 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, and revised in the Global Market Outlook, 28 March 2016;
**** Closed on 25 March 2016
^ Returns from 25 May 2016 to 25 August 2016; ^^ Returns from 25 February 2016 to 25 August 2016; ^^^ Returns from 21 July 2016 to 25 August 2016
^^^^ Returns from 27 June 2016 to 25 August 2016
Source: Bloomberg, Standard Chartered

Investment strategy

Figure 4: Our Tactical Asset Allocation views (12m) USD

Asset class	Sub-asset class	Relative outlook	Rationale
Multi-Asset Strategies	Multi-Asset Income	↑	Low policy rates, negative yields remain a support
	Multi-Asset Macro	↑	Insurance policy against a surge in yield or an end of the cycle
Equities ↓	US	↑	Earnings growth expected; valuations not cheap; US elections a risk
	Euro area	↓	Earnings visibility poor; valuations reasonable; Brexit impact a concern
	UK	↔	Brexit vote clouds earnings outlook; high valuations, weak GBP helps
	Japan	↔	Inexpensive valuations; risk of extreme outcomes is high
	Asia ex-Japan	↑	Earnings/dividends uptick positive; valuations reasonable; flows supportive
	Non-Asia EM	↔	Commodities key to earnings; valuations high; flows supportive
Bonds ↑	DM Govt	↓	Low yields; high valuations; Fed policy and inflation are risks
	EM Govt (USD)	↑	Attractive yields (~5.0%); inexpensive valuations; supportive flows
	DM IG corporate	↑	Reasonable yields; valuations fair; preferred route to IG bond exposure
	DM HY corporate	↔	Attractive yields (~6.6%); valuations fair; tighter US credit standards a risk
	Asian corporate	↔	Reasonable yields; valuations fair; demand/supply favourable, but prefer IG
	EM (LCY)	↔	Reasonable yields; reduced currency risk; prefer selective exposure
Currencies	USD	↔	Rate differentials stabilising; markets complacent on a rate-hike possibility
	EUR	↔	Rate differentials stabilising; Fed likely the key driver
	JPY	↔	Risk of extreme outcomes is elevated; BoJ efforts key
	GBP	↓	Rate differential falling on BoE easing; current account, political stress risks
	AUD	↔	Rate premium reduced; China stability positive, but metal prices a risk
	Asia ex-Japan	↔	Rate premium over G3 currencies; central banks may limit gains

Legend: ↑ Overweight ↔ Neutral ↓ Underweight

Source: Standard Chartered

Perspectives on key client questions

Do you agree with 'lower for longer' US interest rate outlook?

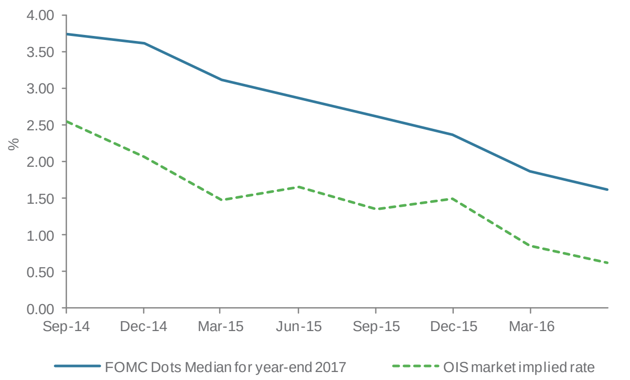
Generally, we do. This does not preclude the possibility the Fed could hike rates once more this year in December – indeed we believe the market may be slightly under-estimating the probability of a 2016 rate hike as we believe modest inflationary pressures are building.

However, this would still mean a very low interest rate relative to estimates of its long-term 'neutral' level. Potential economic growth has likely fallen in recent years due to reduced productivity and slower labour market growth. This means the neutral level of interest rates – the level consistent with neither accelerating nor decelerating economic growth – has likely declined significantly in recent years. The Fed currently estimates the neutral rate is around 3%, but it is possible this estimate will continue to fall.

Against this backdrop and with still-high debt levels (globally and in the US), we believe the Fed is likely to be more tolerant of rising inflation than it has been historically. Thus, absent a sharp increase in inflation, we believe any hiking cycle will be limited and, as a consequence, retain our preference for multi-asset income investing, as investors continue their 'search for yield'.

Figure 5: Fed and market expectations for Fed rates at end of 2017 have continuously been revised lower

Median of Fed FOMC rate expectations ('dot plot' median), Overnight Index Swap market implied interest rate, both for end-2017



Source: Bloomberg, Standard Chartered

Are you getting more constructive on the outlook for equity markets?

The rebound in equity markets has been impressive following the UK's decision to leave the EU, likely reflecting both the extent of cash waiting for an entry point and the realisation that the challenges created by the Brexit vote will take time to play out. Of course, there are still risks out there. As highlighted above, we may see a short-term upward adjustment in US interest rate expectations. Meanwhile, we are entering a critical period with regards to the US Presidential election (see pages 11-12).

With Developed Market (DM) equities generally quite expensive, this suggests an equity market drawdown at some point in the coming 2-3 months is a risk. However, with the worst of the US corporate earnings recession likely behind us, the downside may be limited to 5-10%.

Within equities, we are becoming more constructive on the outlook for Asia ex-Japan equities. We believe the improved outlook for corporate earnings, after 2-3 years of disappointments, a gradual rise in the dividend payout ratio and strong flows into Emerging Market (EM) assets should help support potential outperformance in the coming 12 months. Asia ex-Japan and US are now our preferred regions from an equity market perspective.

Figure 6: We are becoming more constructive on Emerging Market equities, especially in Asia ex-Japan

Indicators	Signal	Remarks
Earnings growth	Green	Improving
Corporate margins	Green	Improving
USD	Green	Weaker
Techncials	Green	Improving
Market Valuations	Amber	Elevated
Flows	Amber	Stabilised, after YTD decline

Source: Standard Chartered

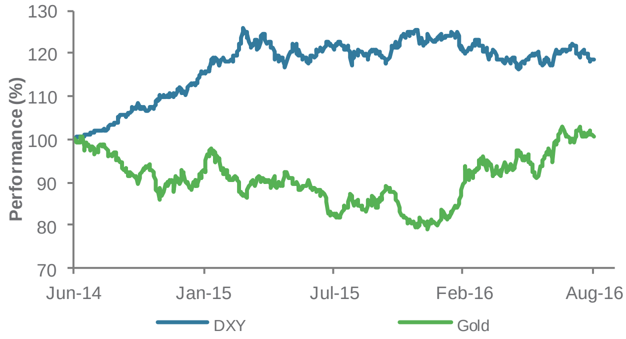
Will the USD rebound and what are the implications for gold prices?

Rising US interest rate expectations may support the USD in the near term, which could be a headwind for gold. However, given our view for a modest pace of rate hikes, we do not expect the USD to hit new highs on a trade-weighted basis. Therefore, we remain bullish on gold on a 6-12 month view and believe USD 1,400/oz is likely to be tested again and possibly broken.

It is important not to have an excessive allocation to any asset class, including gold. Historically, an allocation of 2-4% has generally been seen as optimal. Against the backdrop of negative bond yields in many parts of the world, it could be argued this range should be adjusted slightly higher. Including gold equities, we believe the combined allocation should not exceed 5-8%.

Figure 7: USD unlikely to hit new highs, but gold is expected to at least retest USD 1,400/oz in the next 6-12 months

USD (DXY) index and the gold price (USD per ounce)



Source: Bloomberg, Standard Chartered

Do you prefer EM bonds or equities?

While we have become more constructive on the outlook for EM equities, we still prefer EM USD bonds from a risk-return perspective. While we expect EM equities to generate higher returns under our core scenario, the risks to this view are much greater than to our view that EM bonds will generate positive returns.

Meanwhile, EM bond yields are relatively attractive in a yield-starved world, which should keep demand relatively supported whether one looks at EM USD sovereign bonds or Asia ex-Japan Investment Grade (IG) corporate bonds.

Macro overview

The Fed is likely to remain cautious

The ECB and BoE may be on hold for now; Japan needs more fiscal and monetary easing

China is likely to maintain targeted policy easing

IMPLICATIONS FOR INVESTORS

More muddle-through

- **Global growth** remains subdued, but stable, with the exception of Japan. Brexit appears to have had little impact on the Euro area and the UK so far. China remains stable, providing a floor under Asia and other Emerging Markets (EM). The probability of a US recession in the next 12 months may have receded slightly to around 30%.
- **Inflation** remains below central bank targets across most major economies, enabling policymakers to remain highly accommodative.
- **Policy –** We expect the Fed to raise rates once this year, possibly after the elections, but maintain a gradual pace of hikes thereafter. The ECB and BoE are likely to assess Brexit risks before easing further. Japan needs fiscal and monetary stimulus to revive the economy. China is likely to rely on fiscal stimulus to support growth.

Slow, but steady growth

Recent weeks have seen a convergence in growth expectations for the US, the Euro area and the UK, with consensus forecasts projecting 1.5% growth in 2016 for each. The main surprise so far has been the resilience of Euro area and UK growth following the Brexit vote. However, we believe Euro area growth may have peaked, given political uncertainties. The US, Asia and non-Asia EM could provide upside growth surprises on the back of a strong US job market, stability in China and a recovery in commodity prices.

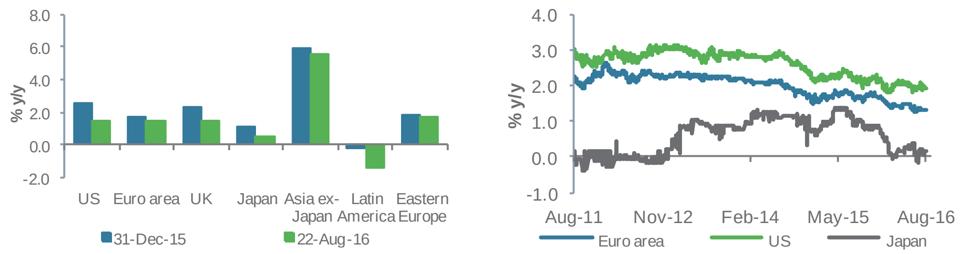
Inflation remains subdued, allowing central banks to maintain accommodative monetary policies. There are signs fiscal policies may be relaxed worldwide.

Given this, we see the following policy implications:

- The Fed is likely to raise rates later this year, but maintain a gradual pace of hikes.
- The BoE and ECB are likely hold off on policy easing for now, pending further data.
- Japan needs fiscal and monetary easing; China is likely to maintain targeted easing.

Figure 8: Global growth forecasts have been downgraded through the year, but Asia ex-Japan growth continues to outperform; long-term inflation expectations remain subdued, especially in Japan

Consensus GDP growth forecasts of major economies for 2016 – now versus December 2015, %, y/y; long-term inflation expectations (based on 5-year-on-5-year forward inflation swap rates) for major economies, %, y/y



Source: Bloomberg, Standard Chartered

Macro overview

Fed preparing for a rate hike by December

US economic data have been mixed over the past month, with job creation and housing markets remaining robust and consumption growth slowing after its peak in April. The rebound in oil and resource prices and a weaker USD since the start of the year have helped energy, materials and the broader manufacturing sector recover in recent months.

The robust job market has encouraged some Fed policymakers to call for a rate hike this year (futures markets assign a 54% probability of a hike this year). We believe a hike is more likely in December, than in September, given the Fed's data dependency and uncertainties ahead of the Presidential elections. However, a benign inflation outlook argues for a very gradual pace of hikes thereafter. A wage-driven inflation surge is a key risk to this benign outlook.

Euro area remains resilient after Brexit vote

Euro area data have belied initial concerns about the likely fallout of the UK's vote to leave the EU. Business confidence and growth indicators have remained resilient. There are also signs that fiscal austerity is being gradually relaxed (authorities withheld imposing penalties on Spain and Portugal for exceeding their fiscal deficit targets).

Economic resilience following the UK's Brexit vote relieves some pressure on the ECB. However, Euro area inflation remains close to 0%, sustaining deflation risks, while the refugee influx and security issues have heightened political risks. We remain watchful about their impact on growth. The Italian referendum in October is the next stress point.

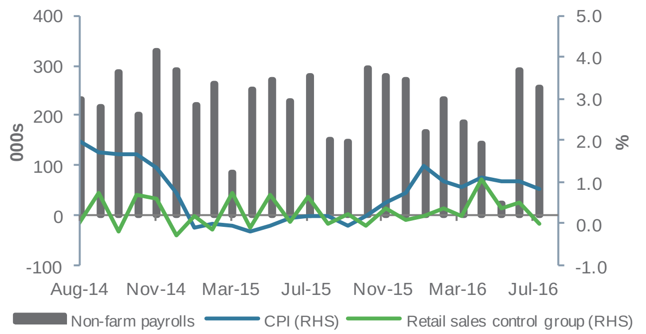
UK data show little sign of Brexit damage

The early batch of hard data following the Brexit vote indicate the UK economy remains resilient, although initial surveys showed a sharp deterioration in business confidence. The job market and consumption appear to be holding up.

The BoE's rate cut and renewed bond-buying are likely to support confidence, while the weaker GBP boosts export orders. Although inflation is likely to rise due to the weaker GBP, the BoE could look through the temporary gains.

Figure 9: US job creation remains robust, but inflation remains subdued while consumption has slowed in recent months

US non-farm payrolls, '000s; CPI, %, y/y; retail sales (control group), %, m/m



Source: Bloomberg, Standard Chartered

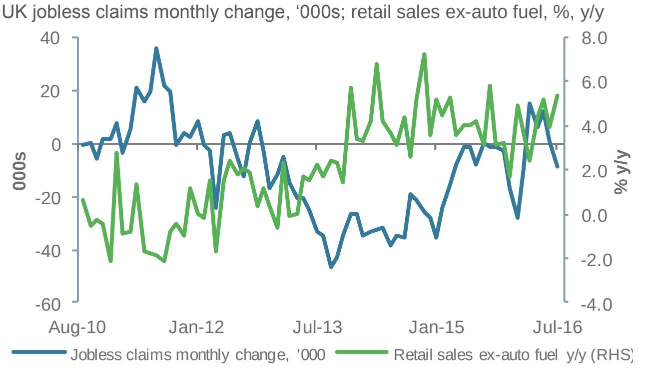
Figure 10: Euro area growth expectations have recovered after a post-Brexit vote slump, but inflation remains well below the ECB target

Euro area ZEW survey expectations index; Euro area CPI, %, y/y

Source: Bloomberg, Standard Chartered

Figure 11: The UK's job market and consumption trends have remained resilient after the Brexit vote

UK jobless claims monthly change, '000s; retail sales ex-auto fuel, %, y/y



Source: Bloomberg, Standard Chartered

Macro overview

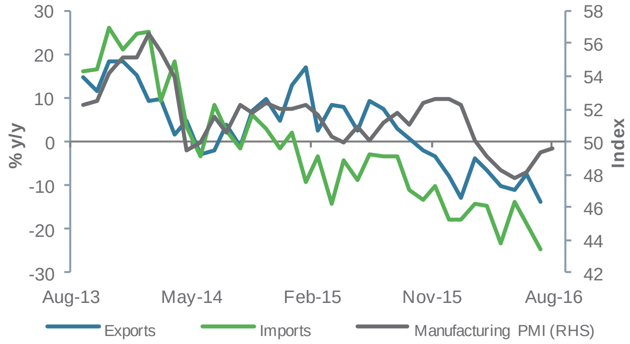
BoJ under pressure to ease as data weaken

Japan's economy has continued to weaken, buffeted by a strong JPY that has hurt exports. Business spending contracted for the second straight quarter in Q2, while domestic consumption slowed, resulting in the economy barely growing during the quarter.

Prime Minister Abe's new fiscal package to revive growth and inflation fell short of expectations. With long-term inflation expectations remaining well below target, the BoJ's review of its monetary policy and its effectiveness – due in September – will be closely watched. A coordinated fiscal and monetary stimulus may be needed to weaken the JPY and reignite inflationary pressures.

Figure 12: Japan's external and domestic indicators have continued to deteriorate

Japan's exports and imports, % y/y; Nikkei Manufacturing PMI



Source: Bloomberg, Standard Chartered

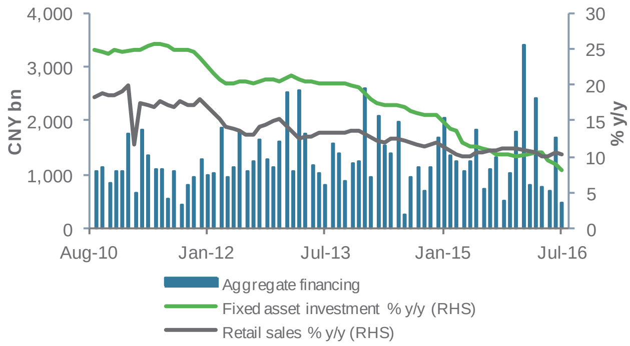
China remains stable as investment slows

China's economy has been relatively stable after successive bouts of monetary and fiscal stimulus and a weaker CNY. The economic drivers continue to shift towards domestic consumption, which remains robust, and away from fixed investments. The authorities also appear to have curbed some of the credit stimulus in recent months.

With capital outflows and the CNY stabilising since July, the focus turns to restructuring of industries battling excess capacities (eg, steel and cement) and addressing bad loans in the banking sector. We believe the authorities are likely to continue with fiscal stimulus and targeted monetary easing to achieve their 6.5% growth target for the economy.

Figure 13: China's investments have slowed along with cutbacks in lending in recent months, but consumption growth remains robust

China's aggregate financing, CNY bn; Fixed asset investment YTD, %, y/y; Retail sales, %, y/y



Source: Bloomberg, Standard Chartered

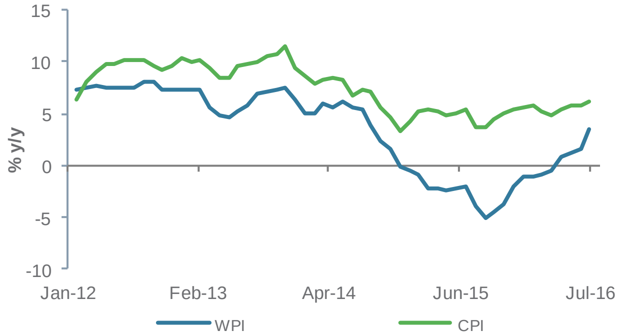
Low Asian inflation to keep policy easy

Asia's domestic-focussed economies in South and Southeast Asia continued to outperform other EMs in terms of growth. However, weak exports remain a drag on trade-oriented economies such as South Korea, Taiwan and Singapore.

Inflation remains well below central bank targets across the region, which should allow policy to remain accommodative. Indonesia has a scope to cut rates further, given low inflation and a strong IDR. We would watch India's inflation closely, though, for signs of a further pick-up. We expect the new RBI governor to maintain rates until inflation subsides.

Figure 14: India's inflation has been on an uptrend in recent months

India's wholesale and consumer price inflation, %, y/y



Source: Bloomberg, Standard Chartered

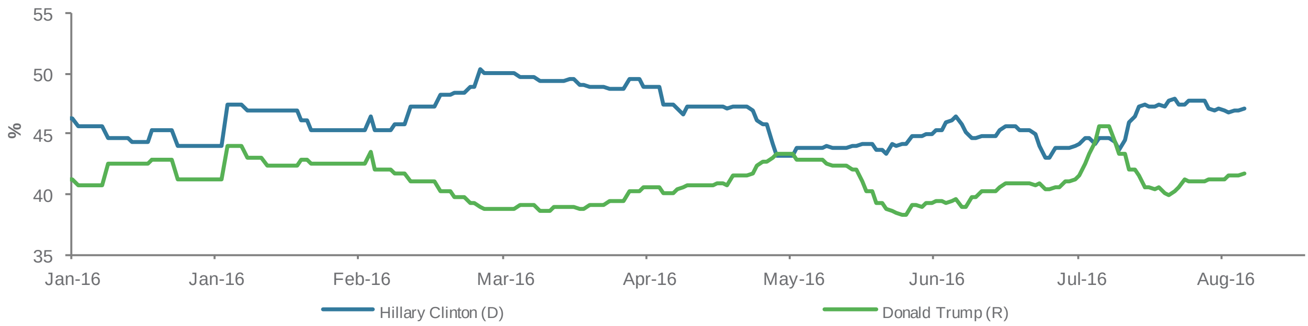
Macro overview

US Presidential election

Democratic candidate Hillary Clinton has opened a significant lead in the polls (Fig. 15), and even this may understate her true advantage based on a 'swing-state' analysis. However, Republican Donald Trump has clawed back such leads before. Here, we outline the potential implications of each candidate's win from a policy and asset market perspective. Investors should note: 1) policy guidance may change before or after the election and 2) the possible implications are based on policy announcements alone and are not standalone recommendations. Other factors may receive a greater weight in our investment views.

Figure 15: Clinton once again pulls into a healthy lead, but Trump has closed similar gaps before

National Presidential Election Poll showing support for the two candidates, %



Source: Real Clear Politics, Bloomberg, Standard Chartered

Figure 16: Potential policy and financial market implications of the two US Presidential candidates

	Trump	Clinton
Policies		
Fiscal spending	• Big fiscal stimulus, including infrastructure spending plan (USD 500bn); • Increased military spending	• Focus on infrastructure and jobs. Comments suggest spending could total up to USD 500bn over five years
Taxation	• Cut, simplify corporate and personal tax rates • Introduce tax on foreign business income • Impose repatriation tax on accumulated income of foreign subsidiaries	• Impose tax on 'tax-inversion' mergers • Remove tax incentives on fossil fuel production • Maintain the current top personal tax rate and add a surcharge and limit exclusions on high-income earners
Minimum wage	• Let states decide on raising minimum wages	• Raise federal minimum wage to USD 12/hr (USD 7.25)
Global trade	• Withdraw from WTO, TPP (even if in place) • Renegotiate trade pacts with China, Mexico • Retaliation against currency 'manipulators'	• Unlikely to push TPP if not concluded already • Renegotiate NAFTA; tougher on Russia and China • Oppose WTO's 'market economy' status for China
Healthcare	• Repeal the Affordable Care Act (Obamacare), expand medical insurance for the uninsured; lower drug prices, including through imports	• Increase 'Obamacare' subsidies; allow people 55 years and older to buy into Medicare; negotiate lower drug prices and allow imports
Immigration	• Tough on immigration (especially versus Mexico): likely to be pursued through enforcement	• Immigration reform, includes citizenship path for illegal immigrants already in the US

Macro overview

	Trump	Clinton
Energy	• Ease oil sector rules, allow the Keystone pipeline	• Ban offshore drilling, tighten fracking rules
Financial services	• Repeal Dodd-Frank, reinstate Glass-Steagall	• Tax, capital boost for big banks, hi-frequency trading
Federal Reserve	• Yellen may be replaced when her term ends	• Reform of regional Fed governance
Potentially positive for		
	• Oil, Gas and Coal	• Solar and Wind Energy
	• Materials	• Materials
	• Aerospace and Defence	• Aerospace and Defence
	• Consumer Discretionary	• Consumer Staples
	• Gold (due to policy uncertainty)/TIPS	• TIPS (due to inflation)
	• Financials	• Healthcare facilities and services
		• Technology and Telecom services
Potentially negative for		
	• US Treasuries, if reflation policies work	• US Treasuries, if reflation policies work
	• Corporate earnings, due to higher taxes	• Corporate earnings, due to higher taxes
	• Housing	• Consumer Discretionary, Retail
	• REITs (less attractive as interest rates rise)	• Oil, Gas and Coal
	• Consumer Staples	• Big banks
	• Healthcare facilities	• Pharma/Biotech
	• China and Mexico (due to trade barriers)	• China (due to trade barriers)

Source: Standard Chartered

Bonds

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Favourable winds for EM debt

- We continue to favour bonds over other asset classes. Despite the strong rally over the past month, and the exceptional rally this year, we believe fixed income remains a valuable source of income and relative stability in a 'lower for longer' world.
- Emerging Market (EM) USD government bonds are now our most favoured sub-asset class (and our most preferred route to raise EM exposure) followed by US Investment Grade (IG) corporate bonds.
- We are comfortable in maintaining Asian corporate bonds, Developed Market (DM) High Yield (HY) bonds and EM local currency bonds as core holdings. An intense search for yield could continue to tilt the balance in support of returns in these assets.

Government bonds – Developed Market

The strong rally in G3 government bonds continues to defy laws of gravity. However, the rally has also pushed overall yields close to multi-decade lows. As we have highlighted before, this leaves very little buffer for investors – even a small uptick in yields, either due to a rise in inflation, a Fed rate hike or a fiscal stimulus, could lead to a price decline greater than the coupon on offer.

Since the start of the year, we have held a preference for US Treasuries over Bunds and JGBs due to the higher yield on offer. However, after accounting for the cost of hedging currency risks, this case has weakened, causing us to close this view. Additionally, there is the risk that the market is under-pricing Fed rate hikes, and a readjustment in expectations could lead to lower US Treasury prices. We also believe a view of a range-bound USD means it is worth removing our currency hedge, but in light of the recent USD weakness, we would await a better opportunity to do so.

We would choose to gain exposure to safe and high-quality bonds through IG corporate bonds. On balance, we continue to prefer maintaining a 5-7 year maturity profile for USD-denominated government bonds.

We favour EM USD government bonds and US IG corporate bonds

Maintain exposure to HY bonds to generate income

Take EM exposure through USD-denominated bonds

IMPLICATIONS FOR INVESTORS

Figure 17: Our preferred areas within bonds

Bond Asset Class	Preference	Yield	Value	FX
USD government bonds in Emerging Markets (EM)	Preferred	Green	Green	Amber
Investment Grade (IG) corporate bonds in Developed Markets (DM)	Preferred (US over Europe)	Amber	Amber	Amber
USD corporate bonds in Asia	Core holding	Amber	Amber	Amber
High Yield corporate bonds in DMs	Core holding (US over Europe)	Green	Amber	Amber
Local currency government bonds in Ems	Core holding	Green	Amber	Amber
IG government bonds in DMs	Least preferred	Red	Red	Amber

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

Bonds

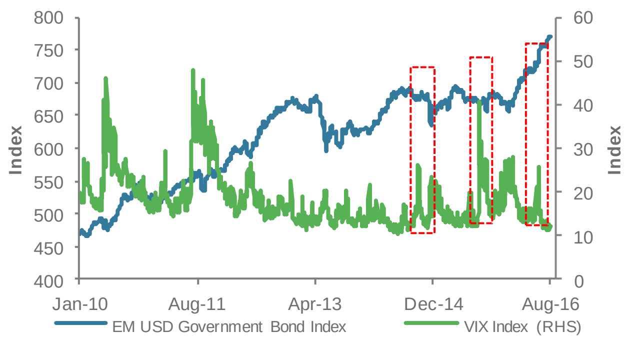
BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Government bonds – EM USD government bonds

The continuation of supportive tailwinds for EM in terms of easy G3 monetary policies, a rebound in commodity prices and the search for yield make us more positive on EM. We especially like EM USD government bonds, which are now our most favoured choice within bonds, with an attractive yield of around 5.0%.

Figure 18: EM USD sovereign bonds have held up well during volatile periods due to their sensitivity to US Treasury yields

EMBI Index vs. VIX, 1-Jan-2010 onwards, circling periods when VIX has risen

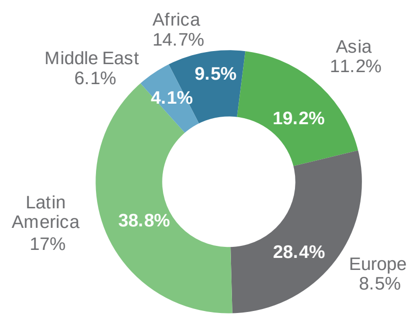


Source: Bloomberg, Standard Chartered

In addition to EM credit risk, US Treasuries are a big driver of returns for EM USD government bonds. This may help offer some stability during periods of volatility.

Figure 19: Latin America and Asia have led YTD positive returns

EMBI Global diversified regional weights (inside) and YTD returns (outside)



Source: EPFR, Standard Chartered

Latin America and Asia have been strong performers on the back of higher commodity prices and strong inflows. However, a sharp decline in commodity prices, fund outflows or faster-than-expected Fed rate hikes remain key risks. We prefer to maintain a diversified exposure within EM USD government bonds.

Corporate bonds – DM IG corporate bonds

US IG corporate bonds remain one of our preferred areas. As mentioned earlier, we choose to take the high quality exposure through corporate bonds compared to government bonds.

The bonds have performed well since the start of the year, resulting in a much lower yield premium on offer. While this has resulted in a reduction in their attractiveness to some extent, we continue to like the exposure they offer. Having said that, we continue to believe a US 10-year Treasury yield break above 1.60% (from the current yield of 1.55%) would offer a much better entry point for new investors.

Figure 20: Strong performance in US IG corporate bonds this year has led to lower yields

US IG corporate bond index yield

Source: Barclays, Bloomberg, Standard Chartered

Corporate bonds – DM HY corporate bonds

US HY corporate bonds remain a core holding within a diversified fixed income allocation, in our view, given an attractive yield of around 6.3%. While they have performed well year-to-date, we are monitoring two risks in particular.

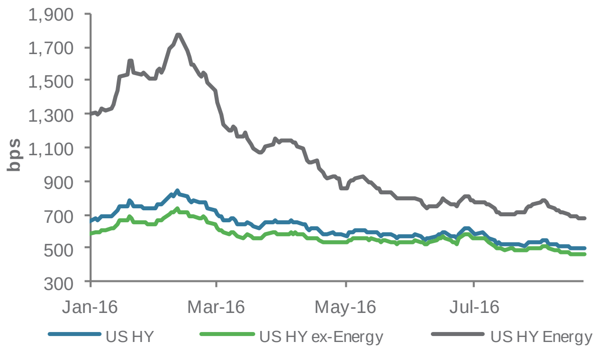
Bonds

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

First, US lending standards have become more stringent over the past few months, and such a trend has historically preceded a rise in HY default rates. Second, the significant rally in energy sector bonds has helped overall YTD returns and thus a pullback in oil prices remains a key risk. To balance the attractive yield and the risks, we maintain a benchmark exposure to US HY bonds (see page 26).

Figure 21: Energy sector bond spreads have rallied sharply

US HY, US HY ex-Energy and US HY Energy sector spreads



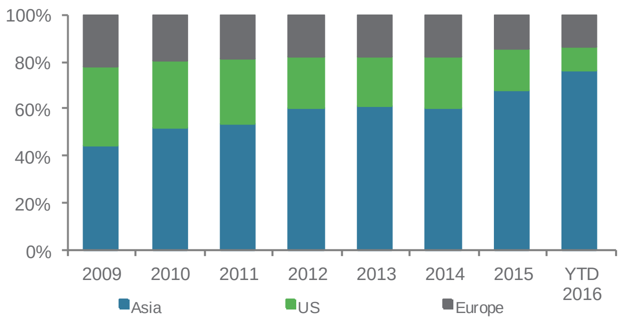
Source: Barclays, Bloomberg, Standard Chartered

Corporate bonds – Asian credit

Asian corporate bond yields continue to grind lower as they benefit from inflows into EM bonds, strong regional demand and lower volatility. In our opinion, the strong in-region demand differentiates Asian credit from other EM corporate bond markets.

Figure 22: Asian credit anchored by a strong regional buyer base

Asian credit new issuance allocation by geography



Source: Bloomberg, Barclays, Standard Chartered

In recent years, Asian investors – especially China's investors – have become prominent investors in the Asian USD corporate bond space. This trend could continue as yields in China's onshore bond market trend lower and CNY maintains a weakening bias against USD.

However, aggregate credit quality is on a gradual decline. Thus, overall credit spreads are likely to remain range-bound, in our view. We continue to favour the IG component over HY bonds.

EM local currency bonds

Within bonds, we suggest taking EM exposure through USD-denominated government bonds compared to local currency bonds. Admittedly, the recent improvements in commodity prices and the search for yield have eased the pressure on EM currencies (see page 25). Nevertheless, currency fluctuations remain a key driver of local currency bond returns as well as a source of volatility and the appetite for local currency risk is at higher levels.

Figure 23: Local currency bonds offer attractive yields for most local investors

Country	Current 10y yield	Currency view*	Investor flows**
Indonesia	7.00%	green	green
India	7.16%	green	red
Malaysia	3.53%	red	green
Philippines	3.02%	yellow	green
S. Korea	1.41%	yellow	green
Thailand	2.06%	yellow	green

*Standard Chartered Wealth Management currency views. **Bloomberg Foreign Portfolio flows, greater than USD 100mn over 1month.

Traffic light signal refers to whether the factor is positive, neutral or negative for each country.

Source: Bloomberg, Standard Chartered

The search for yield and the rebound in commodity prices lead us to believe that Asia, Latin America, Europe and Middle East local currency bonds have a similar risk/reward. We continue to look for attractive country-specific opportunities and at present we retain our preference for IDR bonds within Asia.

Equities

The big switch

- Global equities have risen 5% year-to-date, with Emerging Markets (EM) outperforming Developed Markets (DM) by almost 10%.
- A key equity market trend in recent months has been investors switching into EM equities and in particular non-Asia EMs. The recovery in commodity prices, a weaker dollar and higher DM equity valuations are encouraging investors to favour EMs.
- We are observing diminishing conviction levels among our individual equity views, which may reflect the drop in market volatility. Nevertheless, Asia ex-Japan stands out as the region we are most positive on currently, overtaking the US, which previously held the top spot.
- A delay in the US earnings recovery to the Q4 period from Q3 is a concern, but the fundamental drivers of the recovery – stable to higher oil prices and a flat to weaker dollar – remain on track.
- Japan is experiencing an unusual pattern of JPY strength not leading to weakness in the Nikkei 225. This breakdown may reflect expectations of a more aggressive fiscal and monetary policy stimulus, which investors believe may be supportive of equities.

Five factors driving the DM to EM pivot

1) Increase in the EM/DM growth differential (see chart below)
2) Recovery in commodity prices
3) Weaker USD contributing to an increase in fund inflows
4) Attractive EM relative valuations
5) Investor positioning – significantly underweight EM and overweight DM

We are cautious on global equities

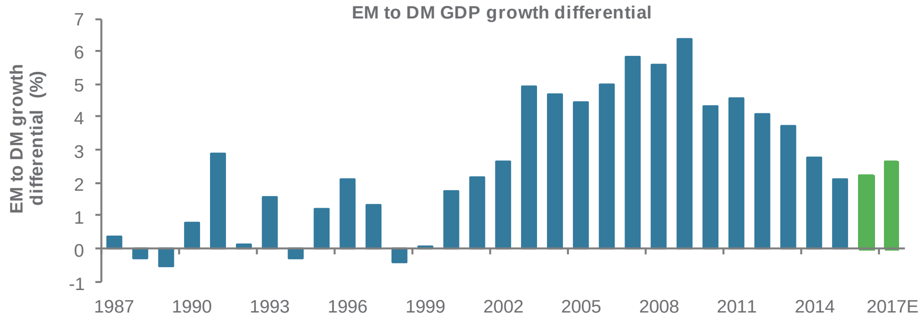
Individual equity market conviction levels are diminishing

US earnings recovery is delayed, buy not derailed

IMPLICATIONS FOR INVESTORS

Figure 24: The differential between EM and DM growth in 2016 is expected to widen in favour of EM for the first time since 2011

Differential between EM and DM GDP growth



Source: IMF, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

US – temporary delay in earnings recovery

Within equities, the US remains a preferred market on a relative basis over the next 12 months. The S&P500 has repeatedly hit new highs over the past month. The ability of the market to reach new highs, despite the weakness in headline earnings which shrank for the fourth consecutive quarter in Q2, reflects optimism about earnings prospects.

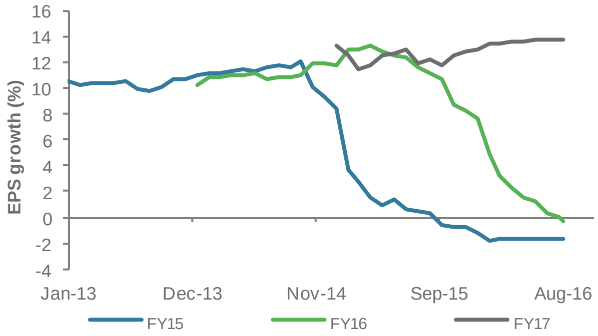
A recovery in commodity prices and a weaker USD are supporting the consensus forecast of a recovery in energy and technology sector earnings. The recovery in energy sector consensus earnings has been delayed by a quarter to Q4 2016 because of the weakness in oil prices in July. Nevertheless, with the Brent crude oil price sitting in the middle of our USD 45-55 per barrel range, we are confident the recovery will materialise, providing support to the market.

A key risk we have identified to a continued rally in the US market is sharply faster-than-expected rate increases by the Fed. We are sanguine on this risk as we believe the Fed is willing to overlook a modest uptick in inflation to secure the foundations of the current recovery.

Corporate margins and valuations are also risks to the US market, in our view. Non-financial margins peaked in 2015 and have dropped almost a point to 8.3% currently. The US S&P500 index is currently trading on 17x 12-month forward forecast earnings, which is high, but not overvalued given current inflation and future earnings growth prospects.

Figure 25: S&P500 earnings growth in 2017 is a key market support

S&P500 2015-17 earnings growth



Source: FactSet, Standard Chartered

Euro area – banks remain a concern

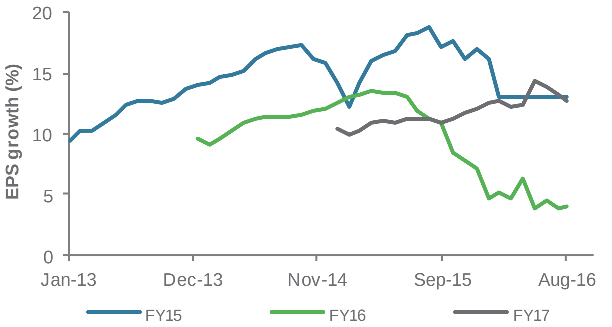
We are cautious on Euro area equities. While the fallout from the Brexit vote has not been as bad as investors had feared, the outlook for Euro area banks remains as bad as they had feared. Italy grabbed the headlines when one bank was found insolvent in the recent European stress tests. The test also revealed weaknesses in Irish banks.

The consensus among analysts is for a recovery in Euro area corporate earnings in 2017. However, we would differentiate between the recovery forecast in the US and that in the Euro area. While we can identify the catalysts in the US, the catalysts for a recovery in the Euro area are more general: a pick-up in GDP growth, a recovery in consumption and an improvement in overseas earnings. Aside from the last, the factors driving the recovery in earnings are underwhelming and EUR strength could easily undermine all three.

One area that is starting to get attention and could act as a boost to earnings is talk of an easier fiscal policy. While investors are familiar with the medicine of easier monetary policy, the effects to date in the Euro area have been modest. Fiscal policy has been mostly contractionary, but there are growing expectations that this could reverse. The impact of an easier fiscal policy on the market would depend on the form it takes – eg, cash transfers/tax cuts for households or infrastructure spending.

Figure 26: Euro area earnings growth for 2017 appears optimistic given EUR strength

Euro area 2015-17 earnings growth



Source: FactSet, Standard Chartered

Equities

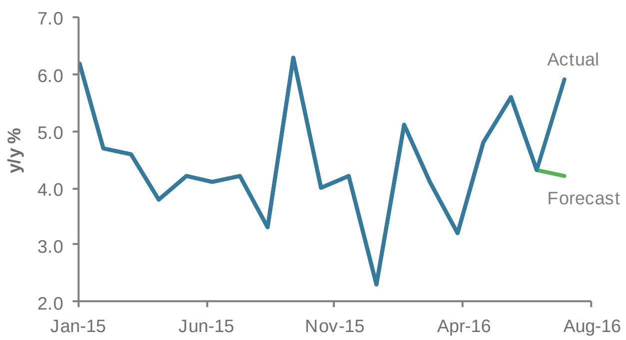
BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

UK – first bulls emerge

We are cautiously optimistic on the outlook for the UK market. Two months have passed since the Brexit vote and we note that some research houses have started to turn positive on the UK equity market and the GBP. The recovery in commodity prices and economic data that has not been as bad as feared have been cited as positives. The energy and materials sectors have a combined weight of 20% in the FTSE100 index, highlighting the importance of commodities and the GBP in the outlook for the index.

Figure 27: UK retail sales have performed better than expected after the Brexit vote

UK retail sales trend – July forecast and out-turn



Source: FactSet, Standard Chartered

Non-Asia EMs – valuations and growth expectations turn

We are cautiously optimistic on the outlook for non-Asia EMs. The recovery in commodity prices is an important driver of this view. Nevertheless, the search for yield, current underweight positioning and the improvement in the DM/EM growth differential are important fundamental supports for the turn in sentiment towards non-Asia EMs.

The turn in sentiment is reflected in the dramatic improvement in equity flows into non-Asia EM: year-to-date net flows amount to +USD 26bn. This compares with net flows of -USD 8bn from Asia ex-Japan – although, we note, these outflows have since started to reverse.

While the commodity recovery theme is well known and an increased risk appetite has led investors to look for high yield opportunities in EM equity markets, the forecast of widening in the growth differential is new. As highlighted in Figure 24, 2016 will be the first year since 2011 when EM growth has increased relative to DM. While this includes all EMs, as growth in China is forecast to remain subdued, the widening in the growth differential will likely be led by non-Asia EMs.

Attractive relative valuations are another important support for non-Asia EMs. While low relative valuations are not a recent development – and low valuations alone are not a sufficient condition for near-term outperformance – what has changed is the emergence of a catalyst, the recovery in commodity prices. This has helped boost earnings expectations and has created a virtuous circle of optimism towards non-Asia EM equity markets.

That said, we acknowledge that a reversal in the oil and iron ore recovery could lead to a similar reversal in optimism towards non-Asia EMs. Nevertheless, the recovery in oil prices is built on a reduction in supply and a continued increase in demand, which we believe will keep oil prices supported going forward. We are less convinced in the fundamental basis for rising iron ore prices.

Figure 28: Non-Asia EM's relatively attractive valuations compared with DM are starting to be recognised

Non-Asia EM relative to DM P/E valuations

Source: MSCI, Bloomberg, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Japan – expectations change

We are cautious on the outlook for Japan, focusing on the recent JPY strength and the potential negative impact this could have on earnings. Additionally, we are concerned about the delay in additional meaningful fiscal/monetary policy easing.

Balancing this caution is the recent price action in the market following the decline in USD/JPY from the 20 July high of 107. Typically, a stronger JPY results in a weaker equity market in the short term. However, following the 7% appreciation of the JPY since 20 July, the Nikkei 225 has been flat, as reflected in the chart below.

We interpret the resilience in the equity market and the concurrent weakness in the bond market as reflecting expectations of a more aggressive monetary and fiscal policy response ahead. As these expectations have not been fulfilled in the past, we are cautious in ascribing too much weight to them, preferring to invest in regions where we have greater confidence that a recovery is underway.

Following the improvement in Japan's earnings growth forecasts in 2015, we have witnessed a sharp roll-over. Consensus earnings growth expectations for 2016 have weakened as analysts have focused on the potential damage to corporate profits caused by a stronger JPY. Valuations in the market remain attractive, but we are missing a re-rating catalyst at this juncture.

Figure 29: Recent JPY strength has not acted as a drag on equity market performance as has been the case in the past

USD/JPY and Nikkei 225 trend YTD

Source: FactSet, MSCI, Standard Chartered

Asia ex-Japan – the search for yield attracts attention

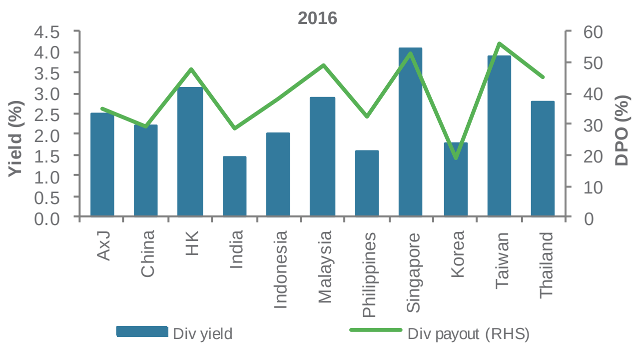
Asia ex-Japan equities now rank as the market that we are most positive on across the globe. On a relative basis, it ranks slightly above the US. We are, however, observing diminished conviction levels among our individual equity views, which may reflect the drop in market volatility. Nevertheless, there are clear drivers of Asia's 'most preferred' status, in our opinion.

Earnings revisions have started to recover in Asia as analysts have become more positive on the outlook for domestic demand following the easing of monetary policies across many markets in the region. With valuations now more attractive than earlier compared to DMs and non-Asia EMs, we expect a recovery in portfolio flows leading to performance in Asia ex-Japan playing catch up with that in non-Asia EMs.

Selected markets in Asia ex-Japan have always attracted yield-orientated investors, in particular Taiwan and Singapore. Fund managers we speak with have highlighted that the search for yield in Asia is broadening beyond these countries, as they are searching for yield in markets such as Hong Kong and Thailand.

Figure 30: Hong Kong and Thailand are gaining attractive-yield-orientated investor interest, along with Taiwan and Singapore

Asian dividend yields and dividend payout ratios by market



Source: MSCI, Standard Chartered

Commodities

BONDS EQUITIES **COMMODITIES** ALTERNATIVE STRATEGIES FX MULTI-ASSET

Resilient, but limited upside

- We expect gold prices to trade between USD 1,250/oz and USD 1,400/oz in the short term (three months) amid lower interest rates globally.
- We believe oil prices have bottomed, and may trade around USD 45-55/bbl in the short term, before eventually moving higher.

Retain preference for gold in the commodities space

We expect commodity prices to continue to consolidate in the months ahead, as some major headwinds, including China growth risks, significant overcapacity and a stronger USD, have abated somewhat. Within commodities, we expect gold and energy prices to outperform industrial metals.

We are more constructive on gold, given depressed yields globally, its role as a hedge late in the current economic cycle and against unforeseen negative economic and political developments. The main downside risk to our outlook on gold is a significantly steeper Fed rate hiking path than what markets currently expect and a quick resolution of post-Brexit concerns.

In energy, while inventories remain high, we expect the process of rebalancing to continue. Given the current rates of US production declines, we believe prices are likely to gradually move higher in H2 16, but remain capped around USD 60-65/bbl this year. In contrast, persistent supply declines have not been forthcoming in the industrial metals space as margins remain attractive and spare capacity plentiful.

Key upside risks to our commodity outlook are stronger-than-expected producer cutbacks and a weaker USD. Downside risks include deterioration in China's growth outlook, more aggressive Fed hikes and increased market volatility amid political uncertainty in Europe.

Oil likely to trade in the USD 45-55/bbl range short term

Gold could see further upside to USD 1,400/oz in the short term

Expect a pull-back in base metals short term

IMPLICATIONS FOR INVESTORS

Figure 31: China's growth outlook remains paramount to the broad commodity outlook

China's Leading Economic Index and Bloomberg Commodity Index

Source: Bloomberg, Standard Chartered

Commodities

BONDS EQUITIES **COMMODITIES** ALTERNATIVE STRATEGIES FX MULTI-ASSET

Crude oil – gradually moving higher

We expect crude prices to gradually recover through the year, but remain capped at USD 60-65/bbl. The recent pull-back was expected and was likely the result of the extreme short-term rally earlier. A weakening USD, unforeseen production disruptions and speculation of OPEC action to curtail prices, may have pushed oil higher than justified by current fundamentals. Nonetheless, the rebalancing process continues with further evidence of US oil production declines. Inventory stocks, too, have begun to decline, albeit from a high level. Longer-term indicators of supply, including capital expenditure, have declined more dramatically, pointing to potential headwinds to production medium-to-long term.

Oil demand has continued to show resilience in the face of modest economic growth. A slowdown in demand in the US, Europe and Japan has been compensated by more resilient demand from China, India and other markets.

Gold – more constructive

Gold is expected to trade in the USD 1,250-USD 1,400/oz range over the next three months; hence, a short-term rally is likely from current levels. We expect lower interest rates (outside the US), moderately higher US inflation and political risks in Europe to be supportive of gold. Scenarios in which gold could breach the upper band of this range could include a reversal in the Fed rate-hiking cycle, greater-than-expected political stress in Europe or concerns regarding financial stability. Similarly, downside scenarios for gold include greater-than-expected pick-up in global growth and a steeper Fed rate-hike cycle.

Industrial metals – rally unsustainable

We expect any broad upside in industrial metals to remain limited. Economic data from China, particularly with respect to fixed asset investment and the property market, have shown signs of softness, which we believe is likely to ultimately reflect in the industrial metals space. Moreover, speculative positioning, particularly in iron ore, is considerably net-long, which could reinforce a sell-off. Adding to this, inventory build-up, more so for iron ore and copper, is likely to dampen price momentum.

Figure 32: Outlook for key commodities

Commodity	Summary of key views
Crude Oil	Upside likely capped at USD 60-65/bbl
Gold	Bullish, USD 1,250-USD 1,400/oz range in the short term
Industrial Metals	Expected to underperform energy and precious metals; expect aluminium, zinc, nickel to outperform copper and iron ore

Source: Standard Chartered

Figure 33: What has changed – Oil

Factor	Recent moves
Supply	Production declines in non-OPEC regions have accelerated, less so in OPEC
Demand	Demand remains resilient particularly from Emerging Markets
USD outlook	USD remains in consolidation mode

Source: Standard Chartered

Figure 34: What has changed – Gold

Factor	Recent moves
Interest rate expectations	Market-implied probability of a 2016 Fed rate hike remains at around 50%
Inflation expectations	Continue to decline outside the US
USD outlook	USD remains in consolidation mode

Source: Standard Chartered

Figure 35: Gold has rebounded this year amid falling inflation adjusted bond yields

US 5year TIPS yields (inverted) and gold prices

Source: Bloomberg, Standard Chartered

Able diversifier

- Alternative strategies remain one of our most preferred asset classes. Positive returns over the past month were led by equity market gains as equity long/short strategies, one of our preferred approaches, rose alongside global equities.
- Global macro strategies underperformed slightly. Systematic (CTA) strategies fared slightly better than discretionary, but both were still able to deliver positive returns.
- We continue to like equity long/short and multi-asset macro strategies.

A month for the equity substitutes

Gains in alternative strategies' over the past month were led by equity-correlated asset classes. While absolute returns were somewhat lower than simple long-only exposure, we have highlighted before that this lower volatility relative to long-only exposure is one key reason why we like equity long/short strategies late in the economic cycle; while it does result in relative underperformance during periods of strong equity market gains, we believe it should lead to outperformance during periods of volatility.

While event-driven strategies were also a beneficiary of positive equity market correlation, we continue to favour equity long/short strategies as a substitute for long-only exposure.

Systematic outperforms discretionary macro strategies

Both discretionary and systematic (CTA) macro strategies offset gains in late July with losses in early August. This is not surprising as it may be simply a breather following positive returns in the aftermath of Brexit woes amid continued falls in volatility.

However, we maintain our strong preference for multi-asset macro strategies. As we lay out in the strategy section, volatility is close to post-2009 lows, raising the risk of a surge in coming months. We believe holding protection against volatility remains key, and believe multi-asset macro strategies offer an attractive way to do this.

Global macro strategy offers diversification

Equity long/short a substitute for long-only

Managing volatility is a key focus

IMPLICATIONS FOR INVESTORS

Figure 36: Our preferences within alternative strategies

Sub-strategy	Our view
Equity long/short	**Positive:** Attractive substitute to long-only equities in volatile markets
Relative value	**Neutral:** Volatility has increased opportunities, but liquidity challenging
Event-driven	**Neutral:** M&A activity a positive, but vulnerable to broad market volatility
Credit	**Neutral:** Volatility/sector-stress positive for long/short, but defaults are a risk
Global macro	**Positive:** Most preferred sub-strategy as it offers diversification amid volatility.
Commodities	**Neutral:** Rising oil prices may be supportive
Insurance-linked	**Negative:** Insurance losses below average in 2015, which could reverse

Source: Standard Chartered

FX

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

EUR to remain largely within the 1.10-1.15 range

Prefer to reduce short GBP exposure tactically

AUD range bound, but close to short-term top

IMPLICATIONS FOR INVESTORS

Themes are more tactical

- We expect the USD to remain largely range-bound as the Fed continues to follow a very gradual rate-hiking path. The EUR is likely to remain in the 1.10-1.15 range versus the USD, while downside risks to the GBP may have been priced-in short term. We believe, the risk-reward in the JPY does not warrant a directional stance.
- We expect the AUD and the NZD to remain resilient, though we do not believe their respective rallies can extend in a significant way. In general, we expect the USD to maintain 2016 ranges against Asia ex-Japan currencies, though the CNY and the SGD may weaken against the USD.

USD to continue trading sideways

- We expect the USD to remain broadly stable over a 12-month horizon, trading within its 2016 range (92-100 on the DXY). The USD has been stable this year as interest rate differentials have not changed much owing to a fairly correlated fall in yields across Developed Markets (DM).
- Going forward, we would need to see at least two major changes to turn more constructive on the USD. First, the Fed would need to turn more hawkish and follow a significantly steeper rate-hiking path than what the markets expect currently. Second, a substantial negative growth surprise in China, resulting in significant Emerging Market (EM) underperformance, could increase demand for the USD.
- Similarly, we would need to see two major changes to make us turn bearish on the USD. First, a shift in monetary policies of other major central banks such as the BoJ and the ECB towards withdrawal of stimulus. Second, a significant slowdown in the US prompting the Fed to move towards policy stimulus.
- Both these scenarios are unlikely for now, in our view. Therefore, we would continue to expect sideways moves in the USD.

Figure 37: US interest rate differentials have not risen significantly, keeping USD gains in check

USD index weighted interest rate differentials and USD index (DXY)

Source: Bloomberg, Standard Chartered

FX

EUR – likely to maintain its range

The EUR is expected to largely trade in the 1.10-1.15 range over the next three months. We believe two factors would have to change for the EUR to break-out of its range. First, the Fed would need to change its policy course. A steeper rate hiking scenario could result in EUR weakness, whereas a shift in stance towards easing may allow the EUR to rise beyond its current range. Second, greater-than-expected political stress in the Euro area, reviving concerns regarding the stability of the currency bloc, would be a clear negative for the EUR. However, with risks largely balanced, a sideways movement looks like the most plausible scenario.

JPY – warrants caution

Though we expect the JPY to likely trade in a relatively tight range in the short term, risks of a large move in either direction have increased. On the upside, any move towards abandoning the current BoJ 2% inflation target, as some have speculated, could drive another round of JPY strength. On the downside, a significant policy easing package, especially one involving more unconventional measures, could help drive near-term JPY weakness. Hence, the risk-reward does not favour a strong directional view at this time because of the risk of a big move either way.

GBP – immediate risks likely priced-in

Following the UK's decision to leave the EU, and the ensuing decline in the GBP, economic data have not been as bad as largely expected. In fact, economic data surprises have been positive since Brexit so far. Against this backdrop, one can see room for consolidation and range-bound movement until more clarity on the state of the economy and policy can be ascertained. Nonetheless, this does not take away the significant longer-term risks that continue to exist for the GBP. A large current account funding gap, the current low interest rate differentials and considerable uncertainty regarding the UK's relationship with the EU are clearly negatives for the GBP.

Figure 38: What has changed – G3 currencies

Factor	Recent moves
Interest rate differentials	Rate differentials have moved slightly in favour of the USD, with a modest pick-up in US yields coupled with flat-to-slightly lower Euro area and Japan yields
Economic differentials	Economic surprises in the US have moderated, but those in the UK have picked up. Those in the Euro area and Japan have been flat
Speculator positioning	USD positioning remains neutral; the JPY still remains excessively net-long

Source: Bloomberg, Standard Chartered

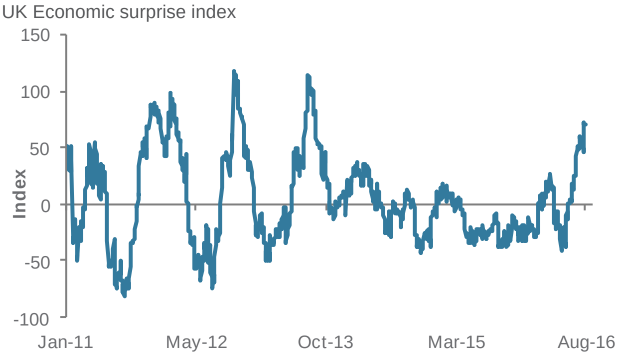
Figure 39: The real (net of inflation) interest rate differential has been the main factor driving USD/JPY lower; higher Japan inflation or significantly lower JGB yields needed to reverse course

US-Japan real interest rate differentials and USD/JPY

Source: Bloomberg, Standard Chartered

Figure 40: UK economic data have not been as bad as initial expectations

UK Economic surprise index



Source: Bloomberg, Standard Chartered

FX

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

AUD – resilient, to a point

We expect the AUD to continue to trade largely range-bound, but believe a pull-back is possible from current levels, which are close to the top of the range. We believe three factors continue to be the dominant drivers of the AUD; rate differentials with the US, iron ore prices and global financial market volatility. While rate cuts in Australia have narrowed rate differentials, the other two factors have been strongly supportive. Going forward, we doubt iron ore prices (see commodities section) can extend their rally significantly, although in the absence of a hard landing in China, downside may also be limited. Volatility, in general, may also remain low as major central banks ease and the Fed continues to follow a gradual rate-hike path. Given the confluence of the above factors, we would expect the AUD to trade within its 2016 ranges.

Asia ex-Japan – policy to restrict upside

We continue to see Asia ex-Japan currencies largely trading in a range, along with the broad USD. Though higher capital flows and lower rates globally are supportive of appreciation in regional currencies, we believe central banks are likely to limit significant gains owing to the still-lacklustre regional growth picture.

We expect USD/SGD to trade largely within its 2016 range. With the pair trading near the lower end of this range, there is a good possibility of some gains from here. Increasing risks of a further MAS policy easing (ie, downward adjustment of the policy band) could be a near-term catalyst. While this has historically only happened in recessions, continued appreciation in the trade-weighted SGD since initiation of policy easing might compel authorities to take more drastic measures. We believe there is likely to be further weakness in the CNY as China weakens its currency against those of its trade partners to ease domestic monetary conditions.

Currencies with lower exposure to external risks, namely the INR, IDR and PHP, are likely to be more resilient, given markets focus on domestic growth fundamentals. However, we believe policymakers' interventions may limit any significant rally in these currencies.

Figure 41: AUD remains strongly correlated with iron ore prices

Iron ore prices and AUD/USD

Source: Bloomberg, Standard Chartered

Figure 42: What has changed in Asia ex-Japan currencies

Factor	Recent moves
USD outlook	USD remains within 2016 ranges, but has now moved closer to the bottom of this range
China risks	Recent China data have been slightly disappointing; the property market appears to be cooling
Capital flows	Capital flows to the region have begun to pick up strongly, particularly into equities.

Source: Standard Chartered

Figure 43: Equity capital inflows to Asia-ex-Japan-ex-China have increased significantly more than in other EMs

AXJ (Korea, Taiwan, India, Indonesia, Thailand, Philippines) and other EM (Brazil, South Africa, Turkey) equity inflows

Source: Bloomberg, Standard Chartered

Market performance summary *

Equity	Year to date		1 month	
Global Equities	6.4%	↑	1.8%	↑
Global High Dividend Yield Equities	10.8%	↑	1.2%	↑
Developed Markets (DM)	5.4%	↑	1.6%	↑
Emerging Markets (EM)	15.1%	↑	3.5%	↑
By country				
US	7.2%	↑	0.4%	↑
Western Europe (Local)	0.9%	↑	1.2%	↑
Western Europe (USD)	-0.1%	↓	3.3%	↑
Japan (Local)	-15.0%	↓	-1.1%	↓
Japan (USD)	1.7%	↑	4.4%	↑
Australia	11.5%	↑	2.8%	↑
Asia ex-Japan	10.7%	↑	3.5%	↑
Africa	19.5%	↑	0.3%	↑
Eastern Europe	19.5%	↑	2.5%	↑
Latam	34.5%	↑	2.5%	↑
Middle East	-0.8%	↓	-2.4%	↓
China	5.1%	↑	5.5%	↑
India	6.1%	↑	0.2%	↑
South Korea	13.7%	↑	5.1%	↑
Taiwan	19.0%	↑	3.7%	↑
By sector				
Consumer Discretionary	2.6%	↑	1.9%	↑
Consumer Staples	10.3%	↑	0.2%	↑
Energy	19.9%	↑	2.4%	↑
Financial	2.2%	↑	3.7%	↑
Healthcare	-0.6%	↓	-2.4%	↓
Industrial	10.4%	↑	3.0%	↑
IT	10.1%	↑	4.1%	↑
Materials	19.3%	↑	4.4%	↑
Telecom	11.4%	↑	-0.5%	↓
Utilities	10.8%	↑	-3.1%	↓
Global Property Equity/REITS	12.8%	↑	0.0%	↑

Bonds	Year to date		1 month	
Sovereign				
Global IG Sovereign	11.2%	↑	2.5%	↑
US Sovereign	5.3%	↑	0.2%	↑
EU Sovereign	11.0%	↑	2.9%	↑
EM Sovereign Hard Currency	14.3%	↑	1.6%	↑
EM Sovereign Local Currency	13.8%	↑	2.5%	↑
Asia EM Local Currency	12.9%	↑	1.5%	↑
Credit				
Global IG Corporates	9.3%	↑	1.6%	↑
Global HY Corporates	12.9%	↑	2.0%	↑
US High Yield	14.2%	↑	1.6%	↑
Europe High Yield	8.7%	↑	4.2%	↑
Asia High Yield Corporates	11.1%	↑	0.9%	↑

Commodity	Year to date		1 month	
Diversified Commodity	8.5%	↑	1.4%	↑
Agriculture	3.5%	↑	-0.7%	↓
Energy	5.4%	↑	7.6%	↑
Industrial Metal	7.9%	↑	-2.6%	↓
Precious Metal	26.5%	↑	-1.9%	↓
Crude Oil	15.1%	↑	10.1%	↑
Gold	24.5%	↑	0.5%	↑

FX (against USD)	Year to date		1 month	
Asia ex- Japan	0.7%	↑	0.7%	↑
AUD	4.6%	↑	2.0%	↑
EUR	3.9%	↑	2.6%	↑
GBP	-10.5%	↓	0.4%	↑
JPY	19.6%	↑	5.3%	↑
SGD	4.8%	↑	0.6%	↑

Alternatives	Year to date		1 month	
Composite (All strategies)	0.9%	↑	0.4%	↑
Relative Value	-0.8%	↓	-0.1%	↓
Event Driven	6.9%	↑	1.2%	↑
Equity Long/Short	-1.7%	↓	0.8%	↑
Macro CTAs	-0.7%	↓	-0.3%	↓

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

*YTD performance data from 31 December 2015 to 25 August 2016 and 1-month performance from 25 July 2016 to 25 August 2016

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

H2 Events calendar

Jul

18-21 US Republican Party National Convention

21 ECB Policy Meeting

25-28 US Democratic Party National Convention

26-27 US Federal Reserve Policy Meeting

28-29 Bank of Japan Policy Meeting

Aug

Brazil – Congress convenes; impeachment proceedings start against former President Dilma Rousseff

25-27 Fed's Jackson Hole meet

Sep

04-05 G20 Summit in Hangzhou, China

08 ECB Policy Meeting

21 US Federal Reserve Policy Meeting

20-21 Bank of Japan Policy Meeting

India New RBI Governor Urjit Patel takes charge

Oct

20 ECB Policy Meeting

31 Oct-01 Nov Bank of Japan Policy Meeting

Italy Constitutional Referendum

Nov

02 US Federal Reserve Policy Meeting

08 US Presidential Elections

30 Australia Parliamentary Elections

APEC Annual APEC Summit, Peru

Dec

08 ECB Policy Meeting

14 US Federal Reserve Policy Meeting

19-20 Bank of Japan Policy Meeting

11 WTO – China expects to gain "market economy" status

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