Global Market Outlook

21 October 2016

Do not miss the wood for the trees. Even as investment professionals, we can sometimes fall for the minutiae rather than the bigger picture. Stepping back, our tactical asset allocation model for a moderate risk profile (see page 31), incorporating the changes we have made through the year, has delivered a nominal 7.7% return since our 2016 Outlook publication. Over the past month, the return was 1.2%

Tug of war continues. Equity markets continue to face a tug of war between an event-risk-intensive fourth quarter (US elections, Italy's referendum and a potential US interest rate hike) and huge cash holdings (see pages 3-4). To us, this means the size of any equity market pullback in the coming three months is likely to be relatively limited, while the risk of a continued rally to new highs cannot be ruled out.

Diversify, diversify, diversify. Given the heightened uncertainties surrounding the economic and political outlook, we believe it is critical for investors to remain invested, but hedge against different scenarios. Against this backdrop, we maintain our longstanding preference for multi-asset income investments. We also note the outlook for global growth has improved modestly, which may continue to support equities, especially within Asia ex-Japan. However, there are significant downside risks to the global environment, which we believe warrant higher-than-normal allocations to USD investment grade bonds (both within Developed and Emerging Markets) and global multi-asset macro strategies.

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Advanced economies are at different stages of the economic cycle. US expansion mature, but consumer spending to drive growth in 2016

D

Deflationary pressures to abate in Developed Markets due to gradually tightening labour markets and bottoming oil prices

A

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

P

Policies of central banks to remain supportive of growth, notwithstanding Fed tightening

T

Transition to late cycle likely to lead to higher volatility

We will review this framework in our upcoming 2017 Outlook

Managing tensions

- Equity markets have been moderately weaker across regions (see page 27) amid higher government bond yields in major markets and a stronger USD, reflecting concerns about central banks becoming less supportive and higher US inflation.
- The tension between factors supporting a sharp equity market pullback and factors arguing for a continued equity rally remains high. We believe little has changed over the past month to challenge our balanced investment approach of retaining exposure to equities and equity-like assets, but balancing with drawdown protection.
- A relatively contained rise in yields thus far has not significantly impacted our multi-asset income theme, but we believe owning protection against a pullback is becoming increasingly important.

We expect yield increases to stay contained, but inflation is a risk

We disagree with market concerns last month that major central banks, outside of the US, will become less accommodative. The BoJ, for instance, still has more work to do to entrench inflation expectations and even a December Fed rate hike should hardly come as a surprise. Our view is that these factors should work to contain the rise in yields.

Higher-than-expected inflation is, of course, a risk, something last month's wage growth and headline CPI data reminded us. The unusually high correlation between stocks and bonds over the past month has also meant simple diversification has been of less help than usual in managing market weakness. Upcoming event risks, in the form of US elections, Italy's referendum and Brexit negotiations, remain on the table.

These risks notwithstanding, we remain confident on growth in Emerging Markets (EM) amid stable commodity prices, selectively strong domestic consumption and continued capital inflows. Putting these factors together leads us to two investment conclusions.

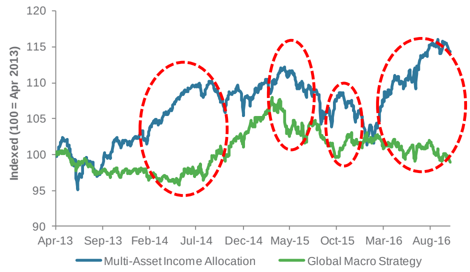
Figure 1: US inflation expectations are rising, but are not high

US market inflation expectations (US 10y TIPS breakevens) vs. 10y US Treasury yield

Source: Bloomberg, Standard Chartered

Figure 2: Income and macro strategies offer many periods of opposing performance

Our multi-asset income strategy vs. multi-asset macro strategies (April 2013=100)



Source: Bloomberg, Standard Chartered

Investment strategy

#1. Correction or not, stay balanced

Besides the yield and inflation risks already discussed, some major equity markets look weak on technical grounds and US and Asian credit valuations are close to post-2008 highs. The S&P500 index has now gone eight months without a 10%+ pullback, though it has extended longer before.

Despite our worries, though, fund manager surveys reflect extremely high cash levels and moderate equity market positioning. We are clearly not the only ones worried about a significant correction, which is often a contrarian signal and suggests markets could actually end up rallying instead.

We believe the opportunity cost of missing a continued equity and credit rally is as great as the cost of a potential correction. Therefore, a balanced approach remains the best way to manage this ongoing tension. Maintain diversified equity and corporate bond exposure, but protect with multi-asset macro and high-quality bonds.

#2. Protect gains in multi-asset income

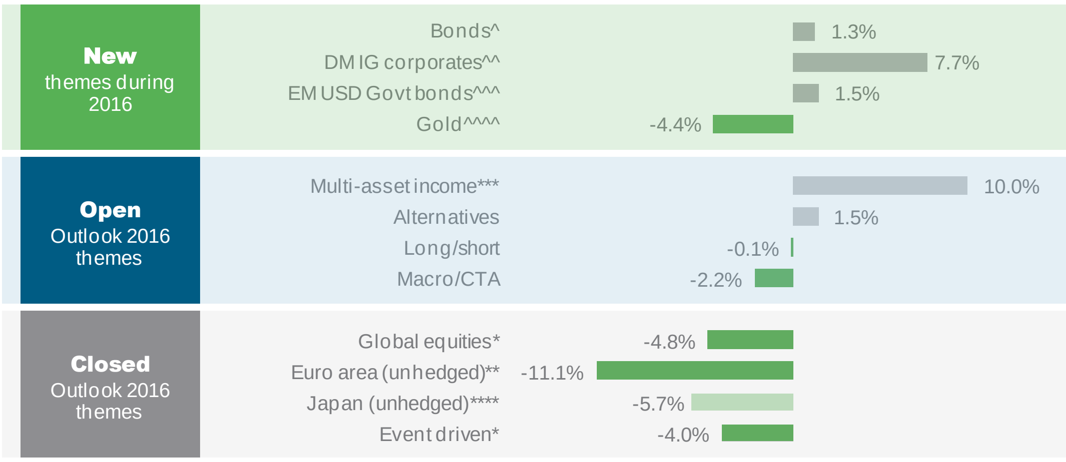
Given the significant YTD gains thus far, it is tempting to consider scaling back exposure with the aim of locking in profits. This may be a mistake, in our opinion.

Other than the risk of sharply higher inflation, we expect strenuous policy efforts to contain the increase in yields. This suggests the positive environment for income assets could continue. However, we believe it would be more prudent to protect gains using multi-asset macro strategies; this approach comes with less market-timing risk than exiting completely with an intention to re-enter.

A continued rally in equity markets and more entrenched inflation would also begin to question the relative attractiveness of income versus more balanced or outright growth assets. While it is something we are watching closely, it may simply be too early to consider such a move given weak global growth and earnings prospects and our view that we are quite late in the US economic cycle.

Figure 3: Learning to A.D.A.P.T. has been key to investing in 2016; this will be up for review as we start thinking about our outlook for 2017

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 20 October 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 20 October 2016; ^^ Returns from 25 February 2016 to 20 October 2016; ^^^ Returns from 21 July 2016 to 20 October 2016; ^^^^ Returns from 27 June 2016 to 20 October 2016.

Source: Bloomberg, Standard Chartered

Investment strategy

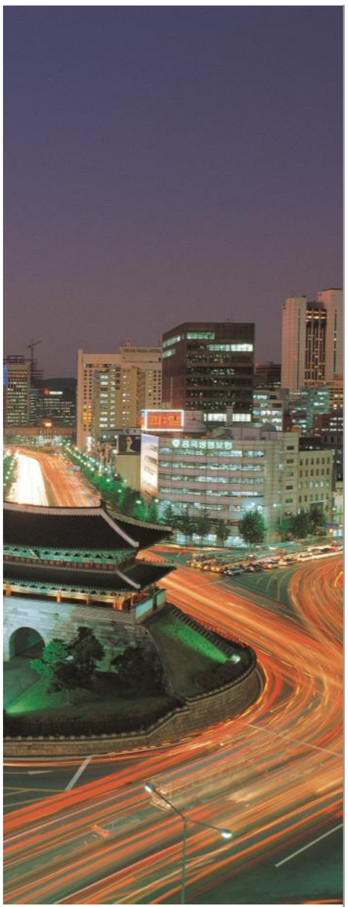
Figure 4: Our Tactical Asset Allocation views (12m) USD

Asset class	Sub-asset class	Relative outlook	Rationale
Multi-Asset Strategies	Multi-Asset Income	↑	Low policy rates, low/negative yields expected to remain a support
	Multi-Asset Macro	↑	Insurance-like asset against a surge in yields or an abrupt end of the US cycle
Equities ↓	US	↔	Earnings growth expected; full valuations; Fed rate hike a risk
	Euro area	↔	Earnings visibility poor; valuations elevated; European politics a concern
	UK	↔	Brexit vote clouds earnings outlook; full valuations; weak GBP helps
	Japan	↓	Inexpensive valuations; risk of extreme outcomes (up or down) is high
	Asia ex-Japan	↑	Earnings uptick positive; valuations reasonable; flows supportive
	Non-Asia EM	↔	Commodities key to earnings; valuations full; flows supportive
Bonds ↑	DM Govt	↓	Low yields; full valuations; Fed policy and inflation are risks
	EM Govt (USD)	↑	Attractive yields; reasonable valuations; supportive flows
	DM IG corporate	↑	Valuations full; good defensive characteristics
	DM HY corporate	↔	Attractive yields; valuations full; credit quality still deteriorating
	Asian corporate	↔	Valuations reasonable; demand/supply favourable; prefer IG
	EM (LCY)	↔	Reasonable yields; reduced currency risk; prefer selective exposure
Currencies	USD	↔	Rate differentials stabilising; US inflation the main risk factor
	EUR	↔	Rate differentials remain stable; Euro area politics the chief concern
	JPY	↔	More range-bound movement as JPY supportive factors likely priced-in
	GBP	↓	Rate differential falling on BoE easing; current account, politics key risks
	AUD	↔	Rate differentials and iron ore prices have stabilised, but strong rally unlikely
	Asia ex-Japan	↔	Rate premium over G3 currencies supportive; central banks may limit gains

Legend: ↑ Overweight ↔ Neutral ↓ Underweight

Source: Standard Chartered

Perspectives on key client questions



Q You have been talking about the short-term risks to equity markets for several months. Do you retain these concerns?

A Equity markets have weakened slightly over the past month, but remain only about 3% from recent highs. There is a tug of war between the probability of an event risk in Q4 and high levels of cash on the sidelines. Known event risks include US Presidential elections, European banking sector concerns (particularly in Germany and Italy), Italy's constitutional referendum and a potential US interest rate hike.

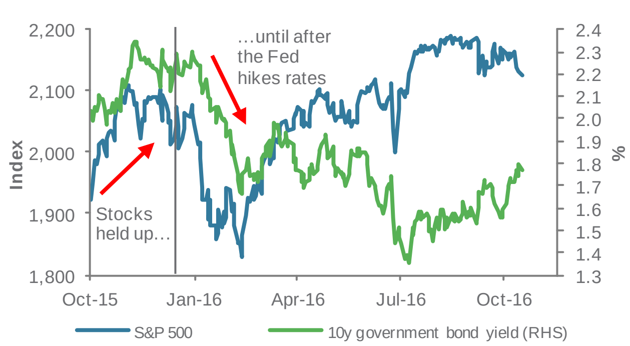
However, equity positioning is relatively light. Anecdotally, we see this from client behaviour, with clients very comfortable increasing their allocation to bonds. Fund managers are also significantly underweight equities and overweight cash. Historically, this has often been a good signal of a forthcoming equity market rally.

What does this mean for investors? A year ago, equities held up despite rising US interest rate expectations (see figure 5). This preceded an almost 15% pullback in global equities. However, we believe markets may be better supported this time. The two most likely scenarios are either 1) equities experience a pullback but this is relatively limited in size, or 2) equities break higher.

These two scenarios reinforce that clients should remain invested in equities, potentially looking for opportunities to add when appropriate in the coming months. However, an equity allocation should be supplemented by investments in other asset classes to manage the risk of short-term volatility (see the next question).

Figure 5: Some similarities between now and a year ago

Performance of the S&P500 index and the 10y US Treasury bond yield



Source: Bank Credit Analyst, Standard Chartered

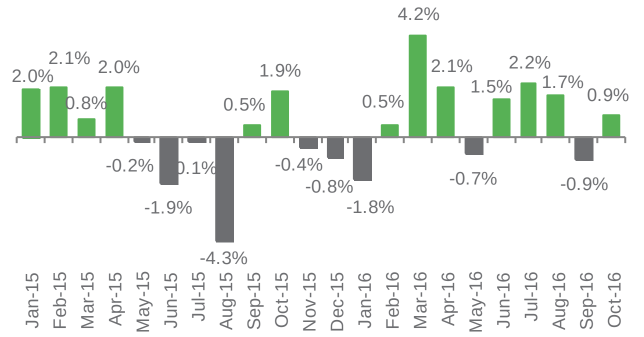
Q Multi-asset income investing has worked well. Do you see this strong performance extending?

A Our income allocation theme has continued to do well (up 10% since our Outlook 2016 publication). This begs the question whether we should reduce our allocation to this theme – via not reinvesting the income/profit generated or more actively reducing exposure – and become more pro-growth in our investment bias. This is especially pertinent with some global growth indicators, particularly in the Emerging Markets (EM), improving.

On a 12-month basis, we expect interest rates and yields to remain low globally. Therefore, we expect the income theme to continue to perform well. However, the risk of a short-term weakness cannot be ruled out (as discussed in the previous question). For now, we prefer to hedge against such risks with a significant allocation to global multi-asset macro strategies, which can take advantage of both increases and declines in different asset classes, and high-quality USD bonds. This allocation could come either from additional cash or via rebalancing accumulated income or capital gain. In either case, the effective yield is likely to drop, but we believe the benefits outweigh this cost.

Figure 6: Performance of our multi-asset income allocation has been strong and reasonably consistent so far this year

M/m performance of our proposed income allocation since our Outlook 2016*



Source: Bloomberg, Standard Chartered

* Please note the composition of this allocation has changed over time as outlined in our Global Market Outlook and Annual Outlook publications

Q Gold has fallen to the bottom of your forecast range. Would you buy here?

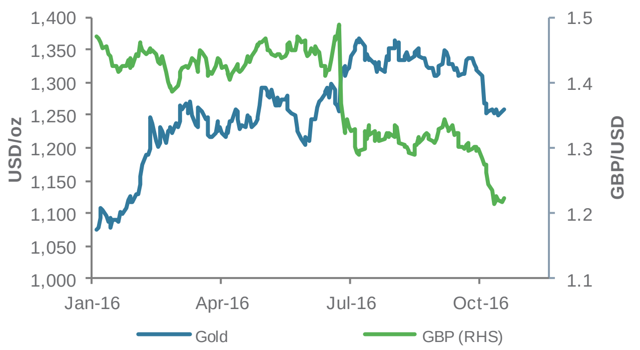
A We continue to like gold from an absolute return outlook perspective and as an asset class that helps diversify within a broader investment allocation.

The key short term concern is that speculative positions on gold futures remain net-long, which could risk a further short-term downside at a time when gold is sitting on a key technical support around USD 1,250/oz. A break of this level could significantly undermine the short-term outlook. Longer term, real yields are key to the outlook for gold in our opinion (see page 19).

In terms of potential allocation, even in a world of negative government and, in some cases, corporate bond yields, we would limit any combined allocation to gold and gold equities to 5-7%.

Figure 7: The GBP and gold have been under pressure recently

GBP/USD and gold (USD/oz)



Source: Bloomberg, Standard Chartered

Q The GBP has weakened sharply in recent times. Do you expect this to continue?

A The GBP has been under significant downward pressure since the Brexit vote, with a second 'flash crash' taking place on 7 October. How low the GBP fell is still under debate, but the fact that it went sub-1.20 appears clear (from 1.50 on the morning of the Brexit referendum results).

The GBP has fallen more than what nominal rate differentials would suggest and valuation is getting closer to 2008 lows. This suggests the GBP is significantly undervalued and, on a multi-year basis, appears to offer good value.

However, uncertainty around Brexit's implications (both from short-term economic and long-term competitiveness perspectives) and a weak UK balance of payments position mean further short-term GBP weakness cannot be ruled out.

A key near-term support is 1.21, while a key resistance is just below 1.30 (see FX Strategy, Looking to take profit on the USD, 17 October 2016, for more details)

Please see pages 3-5 for a summary of our key asset class views.

Standard Chartered

Macro overview

Still muddling through

- **Core scenario – '**Muddle through' remains our core economic scenario, with global growth chugging along below the pre-crisis trend and inflation staying benign, leaving policymakers accommodative.
- **Key risks –** Although inflation remains below target in the Euro area and Japan, there is an increasing risk of inflation rising in the US and the UK. China's producers have also emerged from five years of deflation, likely reviving global inflation expectations.
- **Policy implication –** Rising US inflation indicates a likely Fed rate hike in December. The BoJ could ease further, while the ECB and the PBoC keep policy loose. Expectations of fiscal stimulus have risen in the US, the UK and Japan, as authorities recognise the limitations of monetary stimulus. This would be growth-supportive.

Core scenario

Global growth has overcome a key hurdle this year, with Europe's economy staying resilient after the surprise Brexit vote and the UK economy avoiding a contraction. The US economy has recovered from last winter's slowdown on the back of still-robust consumer spending. Although Japan's growth remains lacklustre, the rest of Asia continues to drive global growth, with China meeting its 6.5-7.0% annual growth target for the third straight quarter, helped by significant fiscal and credit stimulus. With inflation remaining subdued, especially in the Euro area and Japan, monetary policies remain accommodative globally.

Our Global Investment Committee (GIC) attaches a 50% probability to this backdrop extending the current 'muddle through' economic expansion cycle, already one of longest on record, for a few more quarters. Recession risks appear to have receded at the margin, both in the Developed and Emerging Markets, with the latter benefitting from the gradual recovery in oil and commodity prices. Indeed, there is a rising expectation that policymakers in Japan, the US and the UK are likely to ease fiscal policy over the coming year, following the footsteps of China, as the effectiveness of more monetary policy stimulus is being questioned. Such a move could be a positive for growth.

Key risks

Rising inflation remains a key risk to this reasonably constructive macroeconomic scenario (other risks include a return to deflation or a return to the more constructive 'Goldilocks' environment of not-too-hot-not-too-cold economic activity). There is an increasing chance that a tightening US labour market may eventually boost wage pressures, while the GBP's sharp plunge raises imported inflation in the UK. Meanwhile, an end to China's prolonged producer price deflation is likely to add to global price pressures (see chart on page 10).

We expect the Fed to lift rates in December to pre-empt inflation, while maintaining a gradual pace of hikes thereafter. A faster inflation pick-up may lead to faster rate hikes.

Macro overview

US – rising expectations of a rate hike in Dec

Recovery intact: The economy appears to have recovered from last winter's slowdown, helped by a strong job market, which has supported consumption. Manufacturing and services sector confidence recovered in September after dipping sharply in July-August. However, inflation continues to rise, driven by rising rents and medical costs.

December rate hike: The market-based probability of a Fed rate hike in December has risen to more than 60%. Fed policymakers appear to support that expectation, with several members raising concerns about the risk of keeping monetary policy too loose. We see the continued uptrend in inflation giving further support to a rate hike in December. However, the pace of hikes thereafter could remain gradual, with the Fed tolerating inflation overshooting the target.

Euro area – ECB to keep policy loose for now

Resilient economy: The Euro area's economic growth and investor confidence have recovered from a post-Brexit slump, highlighting its resilience. Record-low borrowing costs continue to support lending to consumers and companies. However, German services sector confidence has faltered amid concerns about the local banking sector.

Loose policy: The ECB has reiterated its plan to keep monetary policy accommodative at least until March next year, with the possibility of extending it further, as inflation remains well below its 2% target. We expect policy to remain ultra-loose for a prolonged period as the economy reduces excess industrial capacity and high unemployment.

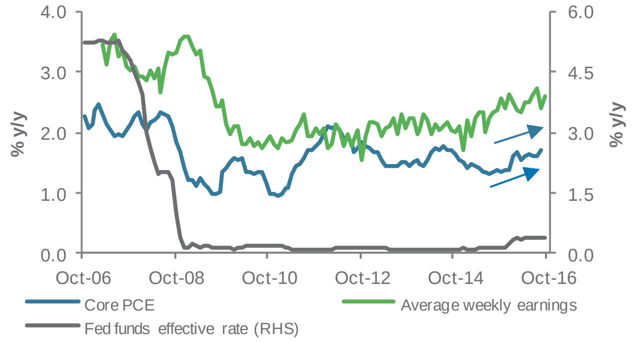
UK – BoE likely challenged by rising inflation

Inflation expectations surge: Although the UK economy appears to have avoided a contraction in Q3 following the surprise Brexit vote, the GBP's sharp plunge has boosted inflation expectations as import costs rise.

BoE's dilemma: We expect business spending to remain subdued in the coming quarters as the UK negotiates the terms of its EU exit. This is likely to hurt growth even as inflation rises, creating a dilemma for BoE policymakers.

Figure 8: US inflation pressures have increased over the past year, while rates have remained loose

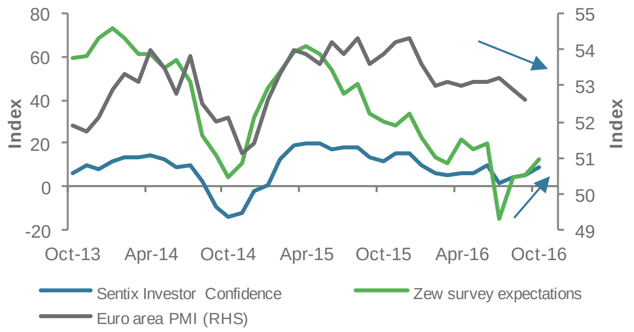
Core PCE and average weekly earnings, %, y/y; Fed funds effective rate, %



Source: Bloomberg, Standard Chartered

Figure 9: Euro area growth outlook and investor confidence have recovered, although services sector confidence has faltered

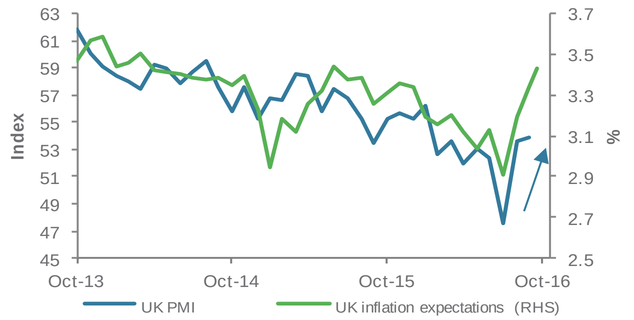
Euro area Sentix Investor Confidence and Zew survey expectations; PMI



Source: Bloomberg, Standard Chartered

Figure 10: The UK's business confidence has rebounded post-Brexit, but inflation expectations have risen too due to GBP slump

UK Composite PMI; UK long-term (5-year, 5-year) inflation expectations, %



Source: Bloomberg, Standard Chartered

Macro overview

Japan – more fiscal and monetary boost likely

Flagging inflation: Japan's economy continues to face headwinds from a strong JPY, which has exacerbated disinflationary pressures. Several bouts of monetary and fiscal stimulus have failed to revive inflation expectations, raising questions about the consistency and limitations of policy and highlighting the need for broader reforms.

Stronger stimulus: We believe the BoJ's recent decision to keep 10-year government bond yields anchored around 0% sets the stage for further easing of monetary policy. This could also open the path for the government to issue long-term bonds to boost public spending. However, much depends on implementation, leaving the outlook uncertain.

China – fiscal stimulus helps recovery

Stabilising economy: A combination of monetary, fiscal and credit stimulus in the past couple of years has helped China stabilise its economy, with growth staying within its 6.5-7.0% annual target in the first three quarters this year. The measures have lately benefitted the property sector, raising concerns about its medium-term financial stability.

Targeted policy: With the economy stabilising and inflation returning, we expect authorities to target policy easing towards priority sectors (eg, rural housing) while focusing on reforming old-economy sectors. China's key party congress, which will choose the next batch of leaders, will be held in H2 2017; this points to greater emphasis on economic stability.

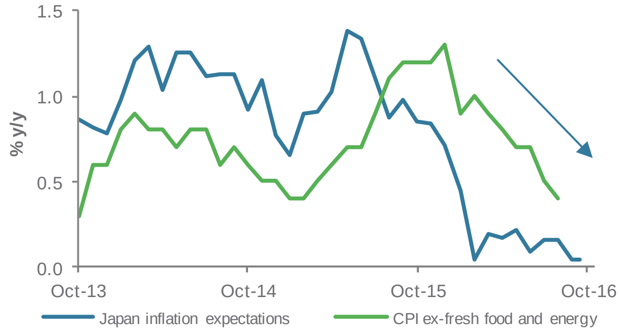
Emerging Markets – scope for policy easing

Asia outperforms: Asia's economic growth continued to outperform other Emerging Markets (EM) in Q3, aided by stabilisation in China and robust demand in consumer-driven economies such as India and Indonesia. Inflation remains subdued across the region, allowing central banks to cut rates further, notably in India, Indonesia and Malaysia.

Brazil: The economy is likely to return to growth next year. Inflation continues to decline from a 12-year high, enabling the central bank to start cutting rates this month. However, a high fiscal deficit is likely to constrain significant easing.

Figure 11: Japan's consumer inflation has continued to decline, while long-term inflation expectations remain near record lows

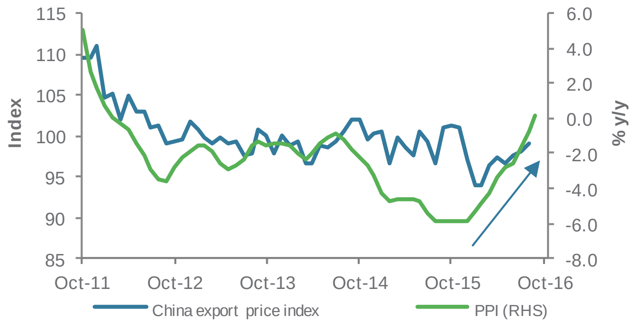
Core CPI; market-implied 5y inflation expectations starting in 2021; %, y/y



Source: Bloomberg, Standard Chartered

Figure 12: China's producers have likely emerged from five years of deflation; this could filter through to export prices and global inflation

China's producer price inflation, %, y/y; export price index



Source: Bloomberg, Standard Chartered

Figure 13: Asia's policymakers have room to cut rates further as inflation remains subdued

Asia's benchmark policy rates, %

	Benchmark	Policy rate	Next meeting	Last change: Date	Last change: Action, bps
China	1-year deposit rate	1.50	No schedule	21-Oct-15	-25
India	Repo rate	6.25	07-Dec-16	04-Oct-16	-25
Indonesia	7-day reverse repo rate	4.75	16-Nov-16	20-Oct-16	-25
Malaysia	Overnight rate	3.00	23-Nov-16	13-Jul-16	-25
Pakistan	SBP target rate	5.75	26-Nov-16	01-May-16	-25
Philippines	Reverse repo rate	3.00	10-Nov-16	16-May-16	-100
South Korea	Base rate	1.25	11-Nov-16	09-Jun-16	-25
Taiwan	Re-discount rate	1.38	30-Dec-16	30-Jun-16	-12
Thailand	1-day repo rate	1.50	09-Nov-16	29-Apr-15	-25
Vietnam	Refinance rate	6.50	No schedule	18-Mar-14	-50

Source: Bloomberg, Standard Chartered

We favour EM USD government bonds and US IG corporate bonds

HY still a core holding, but caution warranted given gains thus far

Senior loans offer an attractive alternative to HY bonds

IMPLICATIONS FOR INVESTORS

Valuations turn less attractive

- Bonds (excluding G3 government bonds) remain one of our preferred asset classes. We continue to like them both as a source of income and a hedge for downside protection. However, their strong performance in 2016 means valuations have turned less attractive for some bonds.
- We retain our preference for Emerging Market (EM) USD sovereign bonds as they offer attractive yields and historical average valuation levels. We prefer taking high-quality exposure with Developed Market (DM) Investment Grade (IG) corporate bonds.
- We maintain Asian corporate bonds, EM local currency government bonds and DM High Yield (HY) bonds as core holdings. We believe senior, floating-rate loans offer an attractive alternative to gaining DM HY exposure.

Figure 14: Our preferred areas within bonds

Bond Asset Class	Preference	Yield	Value	FX
USD government bonds in Emerging Markets (EM)	Preferred	Green	Amber	n/a
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	n/a
Local currency government bonds in EMs	Core holding	Green	Amber	Amber
High Yield corporate bonds in DMs	Core holding (US over Europe)	Green	Red	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

Government bonds – Developed Market

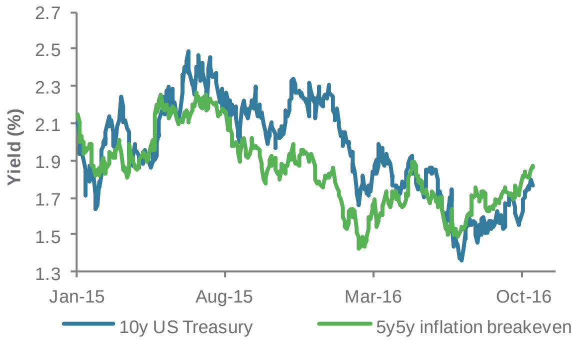
G3 government bond yields, especially in the US and Germany, rose notably over the past month. As discussed earlier (see page 8), we believe there is a potential risk of inflation surprising on the upside, with the US facing the greatest risk. Additionally, markets are assigning a high probability of a Fed rate hike in December. While the combination of these factors leads to an upward pressure on yields, the global scarcity of high-quality bonds is likely to prevent a lasting surge in US Treasury yields. We see a high likelihood of 10-year yields remaining range-bound (1.75-2.0%), over the next three months.

We favour gaining exposure to high-quality bonds through IG corporate bonds and have no objection gaining IG exposure through US mortgage-backed securities. Given the increasing risks of higher inflation and a faster pace of US Fed hikes, we believe a maturity profile centred around five years offers the best risk-reward. If inflation surprises to the upside, shorter maturity bonds (3-5 years) would provide better downside protection as they are likely to suffer lower price declines.

Bonds

Figure 15: Inflation expectations have led US Treasury yields higher

10y US Treasury yields and 5y5y inflation breakeven



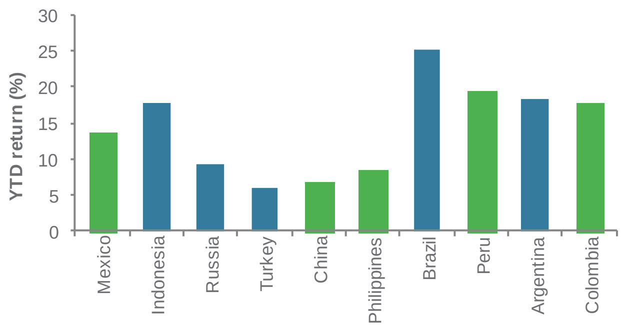
Source: Bloomberg, Standard Chartered

Government bonds – EM USD government bonds

EM USD government bonds remain our favourite bond sub-asset class, and we believe they are likely to deliver positive returns over the next 12 months. In spread terms, valuations are now close to their historical average but they continue to offer a relatively attractive yield of around 5%. The Fed policy and commodity price outlook are likely to be the key drivers, while a stronger USD and/or weaker commodity prices are the primary risks for EM bonds.

Figure 16: Idiosyncratic performance from Brazil, Argentina and Indonesia bonds led to the outperformance of the HY component

YTD returns of bonds of the 10 largest countries in the EMBI Global Diversified index. Green bars represent IG-rated and blue bars represent HY-rated countries



Source: JP Morgan, Standard Chartered

YTD, the HY component has outperformed the IG component. However, the strong performance was driven by bonds of few countries, such as Brazil and Argentina (see chart), which benefitted from idiosyncratic factors. It is difficult to predict a repeat of such factors and we prefer to have a diversified exposure in EM USD government bonds.

Corporate bonds – DM IG corporate bonds

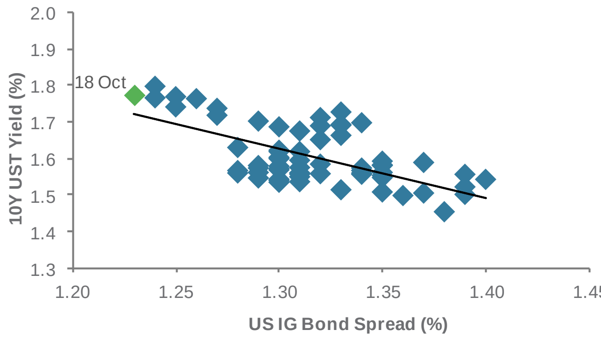
As we have highlighted earlier, we favour taking exposure to high-quality bonds through US IG corporate bonds.

US IG corporate bonds performed as expected in a rising yield environment. Over the past month, the decline in spreads partly offset the impact of rising US Treasury yields. However, the robust relative performance also means spreads are at one-year lows, reducing the room for spreads to compress further and limiting future upside potential.

Nonetheless, we continue to like US IG bonds for their defensive characteristics and view them as a hedge.

Figure 17: US IG spreads have partly offset the rise in yields

US IG corporate bond spreads and 10y US Treasury yields for past 3 months



Source: Barclays, Bloomberg, Standard Chartered

Corporate bonds – DM HY corporate bonds

DM and US HY bonds delivered a strong performance last month, buoyed by positive risk sentiment and the continued search for yield. The rebound in oil prices, following the OPEC agreement, was positive for US HY bonds. However, energy sector bonds have delivered a strong performance this year (>30% returns) and are at a risk of a pullback if concerns about oil prices resurface.

We continue to maintain US HY bonds as a core holding due to the still-attractive yield on offer, despite deteriorating fundamentals and slightly expensive valuations.

Bonds

In light of the above-mentioned concerns, we believe leveraged or senior, floating-rate loans offer an interesting alternative. They offer the benefit of gaining exposure to secured loans whose coupon is linked to Libor rates, and less volatility relative to simple HY bonds. Senior loans have lagged US HY's performance this year and we believe they now offer an attractive alternative to HY bonds.

Figure 18: Senior loans* offer less volatile HY-like exposure

YTD performance of US HY and senior floating rate loans*

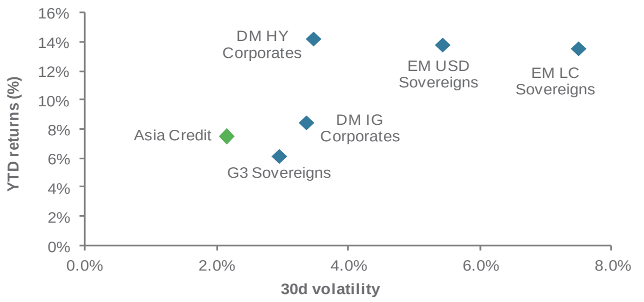
Source: Bloomberg, Standard Chartered
*Senior loans are secured loans made to HY companies and are based on floating rates

Corporate bonds – Asia credit

Asian corporate bonds posted small negative returns in October, largely driven by the rise in US Treasury yields. The recent surge in new supply may have also weighed on performance. We continue to view them as a core holding as they have offered low volatility and moderate returns.

Figure 19: Asia credit has offered stable returns

YTD returns versus the 30-day volatility in each bond asset class



Source: JP Morgan, Bloomberg, Standard Chartered

While Asia credit remains well supported by strong in-region demand, its credit fundamentals continue to deteriorate, especially in the HY segment. Hence, we prefer IG bonds over HY bonds, where we remain very selective.

EM local currency bonds

EM local currency government bonds generally offer attractive yields for domestic investors and could also offer a potential capital appreciation as the monetary policy easing bias could lead to further rate cuts. However, the recent USD strength has weighed on total returns for international investors and could be a short-term headwind as the Fed proceeds with its rate hike cycle.

Figure 20: Local currency government bonds offer attractive yields for most local investors

Country	Current 10y yield	Currency view*	Investor flows**
Indonesia	7.05%		
India	6.72%		
Malaysia	3.60%		
Philippines	3.80%		
S. Korea	1.58%		
Thailand	2.10%		

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

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

At a headline level, we believe EM local currency bonds warrant to be a core holding. Within local currency bonds, we prefer bonds from higher-yielding countries because of two reasons: (i) prevailing high interest rates give central banks more scope to cut rates, leading to potential price gains on these bonds and (ii) the high coupon offered by these bonds provides attractive income and a greater buffer against currency depreciation.

In Asia, we continue to like IDR-denominated bonds due to the attractive carry and a favourable currency view, though a bulk of rate cuts may be behind us. We believe IDR bonds are likely to deliver positive returns over the next three months.

Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

We remain cautious on global equities

Non-Asia EM is the best performer YTD

An earnings recovery in 2017 is reliant on the energy sector

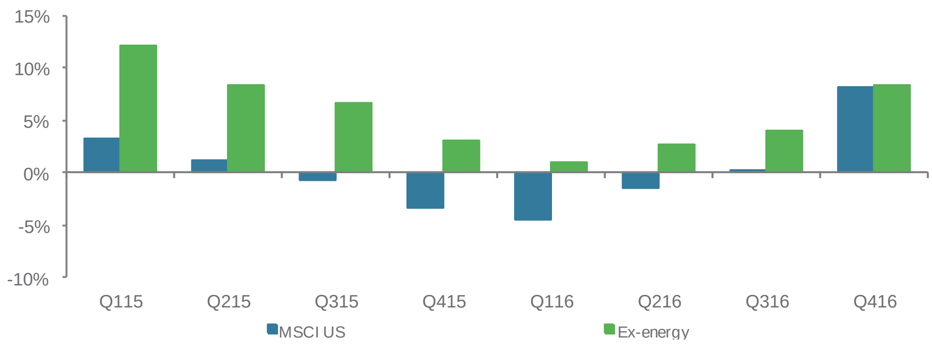
IMPLICATIONS FOR INVESTORS

Show me the earnings

- Global equities were little changed over the past 30 days with non-Asia Emerging Markets (EM) the top performer, rising just over 4%. YTD, global equities are up 5.6% with non-Asia EMs the top performer.
- We remain cautious on the outlook for global equities driven by the uncertainty over the 2017 earnings growth outlook. We believe that earnings should recover, but this is heavily reliant on the energy sector.
- Our central scenario is for global equity markets to remain within the range they have moved since the start of Q3 over the next 3 months. There are a number of key events on the horizon that are driving our caution, including US elections, Italy's referendum and a possible December rate hike by the Fed.
- The outcome of the US presidential elections on 8 November is likely to have the biggest effect on the US healthcare and technology sectors, regardless of the winner. We base this on the potential impact of the candidates' stated policies impacting these sectors.
- The GBP's depreciation has boosted share prices of companies listed in the UK but generating a majority of their earnings from overseas. We are concerned that this is a one-off re-rating and margin pressure will weigh on future performance.
- The Q3 earnings season has started in the US and the consensus among analysts is for flat growth. Investors are looking ahead to a recovery in Q4 earnings, driven by the energy sector. The concentration of recovery expectations in one sector is a risk in itself and is leading investors to a common refrain: show me the earnings. As earnings have been contracting for four consecutive quarters and market valuations are high, the risk of a correction in the absence of an earnings recovery is rising.

Figure 21: US corporate earnings ex-energy: bottomed in Q1 and recovered thereafter

MSCI US headline and ex-energy earnings trend



Source: MSCI, Bloomberg, Standard Chartered

Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Asia ex-Japan – high dividend yield equities in focus

We remain positive on equities in Asia ex-Japan, which rank as our preferred region. The region has performed in line with global equities over the past month as investors digest recent gains and fret over the impact of rising USD bond yields.

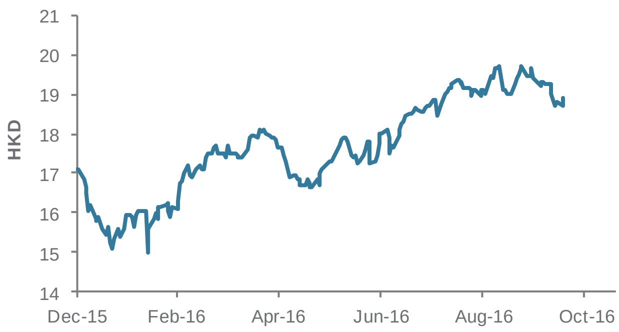
Similar to trends in the US, the recovery in Asia ex-Japan corporate earnings is driven by growth in the energy sector, particularly energy stocks in China. Consensus expectations are for 2017 earnings growth of 12%. Valuations are fair at 13x consensus estimates, in line with the average.

One of the top performing themes in Asian markets YTD has been high dividend yield equities. In Q1-Q3, high dividend yielding equities in Asia rose 14% compared with a 10% increase in the headline MSCI Asia ex-Japan index.

However, since the start of Q4, the Asian high dividend yield index has declined on concerns over the impact of rising US bond yields. Our central scenario for the coming three months is for 10-year bond yields in the 1.75-2.0% range. Such a range is not an obstacle for positive returns in the index. As such, we suggest using the current uncertainty as an opportunity to add to positions.

Figure 22: High dividend yield equities have come under pressure

Vanguard FTSE Asia ex-Japan high dividend yield ETF



Source: Vanguard, Bloomberg, Standard Chartered

Non-Asia EM – margin improvement underway

We continue to turn incrementally more constructive on the outlook for non-Asia EMs. Recent gains in commodity prices, led by oil but also including copper, have boosted sentiment and earnings expectations. An added positive factor is an easing of concerns about the outcome of the US elections and its effect on markets such as Mexico.

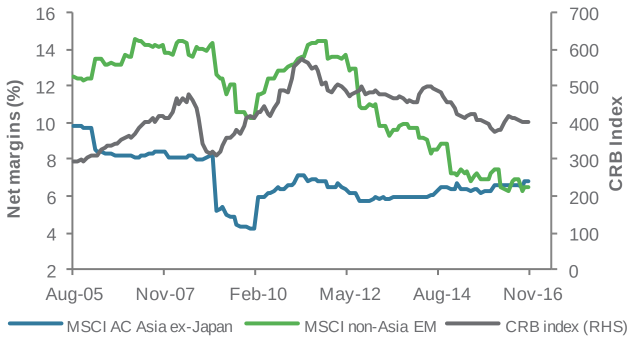
One of the big themes supporting non-Asia EMs is expectations of an improvement in corporate margins. Our central scenario is for an improvement in corporate margins in the coming 12 months relative to consensus expectations. This is driven in part by the increase in commodity prices and a recovery in EM currencies.

We expect 2017 corporate earnings to be in line with consensus expectations, which forecast a 16% increase led by the energy sector. Non-Asia EM valuations are at historically high levels, but the earnings recovery forecast makes us comfortable.

In line with the positive view on commodity prices, we expect Russia and Brazil to generate the highest total returns among large Non-Asia EM markets over the next 12 months. Investors should note that risk in the Russian market is significantly higher than that in other EMs and almost double that in the US. For context, a neutral allocation to Russia and Brazil in a global equity allocation is 0.5% and 1% respectively.

Figure 23: EM margins are showing signs of stabilising

MSCI EM non-financial corporate margins



Source: FactSet, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

US – election risk looms large in short term

We remain cautiously positive on US equities. YTD, the S&P500 has risen 5%, outperforming the 2% gain for global equities. The market's performance is solid given the USD's strength so far in H2. USD strength usually weighs on earnings of the technology sector, the largest in the index.

Consensus expectations are for flat growth in S&P500 earnings in Q3 and an 8% recovery in Q4. S&P500 P/E remains high at 17x 2017 forecasts.

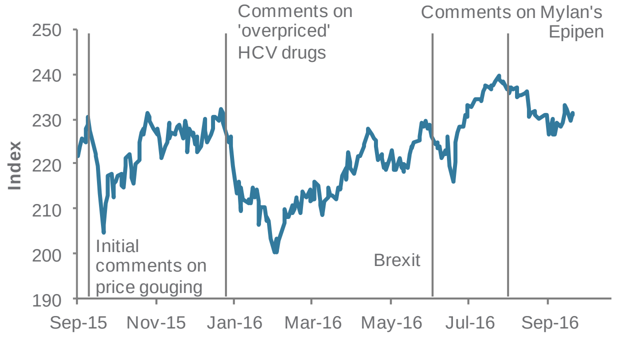
One of the biggest event risks for the US market in the short term is the outcome of the US elections on 8 November. Investors are focusing on the effect of the result on the healthcare and technology sectors as these are most at risk, based on the stated policies of candidates.

Healthcare is at risk due to the proposed repealing of the Affordable Care Act (ACA) by Republican nominee Donald Trump. Meanwhile, Democratic nominee Hillary Clinton has proposed regulating drug prices. Concerns over the implementation of either policy have already weighted on the healthcare sector's performance. Uncertainty is likely to remain until the presidential inauguration in January 2017.

The technology sector is at risk from both candidates' proposals to tax profits held overseas. Any move to tax profits of technology companies held overseas, in combination with limits to tax inversion deals, would likely weigh on the sector and in turn the market.

Figure 24: Impact of Clinton's comments on the healthcare sector

MSCI healthcare index and timeline of client comments



Source: MSCI, Bloomberg, Standard Chartered

Euro area – EUR weakness to lift profits

We remain cautious towards Euro area equities. The Euro Stoxx index has declined 7% YTD. The index has rallied 2% in October thus far as investors take comfort from exchange rate weakness, which should boost corporate profits.

The EUR has traded in a relatively tight range of 1.05-1.15 versus the USD since early 2015, following the huge slump in the exchange rate (EUR/USD) from 1.40 to 1.05 in 2014/15. The recent weakness in the exchange rate helped lift the performance of the export sensitive sectors, in combination with signs of stability in Chinese growth and expectations for further fiscal stimulus.

The European bank sector has been a huge drag on market performance in 2016, with the sector declining 23% YTD. The prospect of multi-billion dollar fines, which could account for up to 40% of European banks' profit in 2016, is the main drag on performance. Nevertheless, the fines are viewed as one-off legacy issues and bank earnings growth is forecast to rebound in 2017, rising by 18%.

Euro area valuations are high at 14x 2017 consensus earnings forecasts. Unlike the forecast recovery earnings of the US energy sector in 2017, we are not as confident that Euro area banks will post a recovery in earnings in H1 next year as consensus implies. Earnings disappointment and high valuations are not a good combination for a market.

Figure 25: Euro area equity valuations are high

MSCI Euro area P/E ratio

Source: FactSet, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

UK – GBP weakness may not boost margins

We remain cautious on the UK equity market outlook. Performance in local currency terms has been good YTD, with the FTSE100 rising 12%. However, in USD terms the market has declined 6% over the same period.

Reflecting the high export content of the FTSE100 index, companies' earnings forecasts have risen significantly owing to the positive translation effect of overseas revenue. Consensus expectations are for 20% earnings growth in 2017. Growth is forecast to be led by the energy sector, which accounts for almost half of forecast earnings growth.

Looking beyond the exchange rate-induced surge in corporate earnings in 2017, we note that corporate margins have been under pressure in the UK for some time.

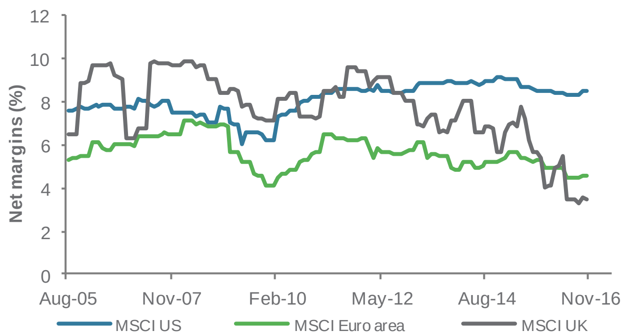
An analysis of prior periods of GBP weakness on exports indicates there is a relatively limited impact. This is primarily because services exports are almost half of total exports and these are dominated by financial and business services.

An analysis of these sectors highlights they are not very sensitive to price changes. Specifically, if a services company can reduce prices they charge foreign customers due to the positive effect of a weaker GBP, demand for those services may not respond.

The UK market is among the most expensive in terms of its historical valuations, reinforcing our cautious stance.

Figure 26: UK corporate margins have halved since 2012

Non-financial markets in the UK, US and Euro area



Source: MSCI, Bloomberg, Standard Chartered

Japan – JPY weakness supportive of earnings growth

We remain cautious on the outlook for Japanese equities. In the month since the BoJ announced its policy to hold 10-year bond yields below 0% or control yield curve, the yen has weakened modestly and the Nikkei 225 index has gained 1%, reversing some of the 10% YTD decline.

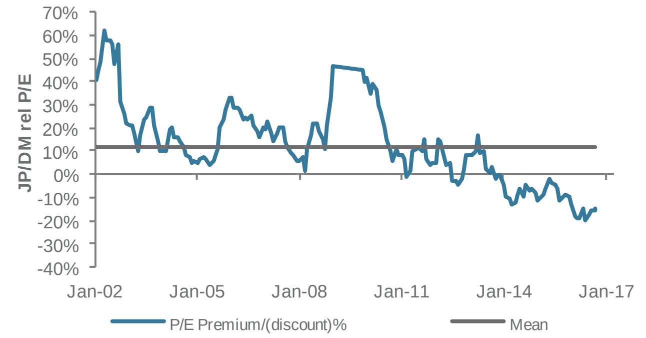
While credible on paper, there are doubts about the ability of the BoJ to deliver on its yield curve control policy, part of which centres on raising inflation expectations. This is leading investors to take a wait-and-see approach.

Consensus expectations for Japanese earnings growth in 2017 have remained sticky at 7% growth, the same rate of growth forecast for this year. A weaker JPY is good news for the export sensitive sectors, including industrials, which is forecast to grow 2017 earnings by 17% and is the sector making the largest contribution to forecast earnings growth.

One of the more compelling reasons for maintaining an allocation to Japanese equities is relative valuations. The Japanese market trades at a 13% discount to global equities. In part, this reflects the lacklustre growth in recent years. Nevertheless, if the yield curve control policy is successful, or if the BoJ were to embark on more aggressive policy measures, the market could undergo mean reversion, which would lead to a significant re-rating.

Figure 27: Japanese market valuations relative to MSCI World

MSCI Japan P/E relative to MSCI World



Source: FactSet, MSCI, Standard Chartered

Commodities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Steady as she goes

- We believe commodities could continue their modest uptrend in the medium term.
- We remain constructive on gold, viewing the recent correction as a good buying opportunity. We expect a USD 1,250-USD 1,400/oz trading range in the short term.
- We retain conviction in our medium-term positive view on oil, but highlight that the uptrend may not be smooth. We expect a USD 45-USD 55/bbl short-term range.

Pullbacks should be seen as selective buying opportunities

At the broad index level, commodity prices have continued their uptrend. We believe, monetary and fiscal policy easing in China has so far largely been successful in halting the downtrend in its growth outlook. While the supply-demand gap has begun to tighten earlier than expected in some cases, the size of inventory backlogs suggests significant upside pressure on prices might still take a while to come through.

Gold has undergone a sizeable pullback recently. We remain constructive longer-term as key fundamental drivers, including low bond yields, are supportive, in our opinion. Among our key scenarios, gold may perform well in our core muddle-through outlook, but an environment where real yields rose would likely be challenging for gold, in our opinion.

In energy, recent communication from key oil producing countries suggests greater willingness to cooperate to limit output increases. As a result, oil prices have remained resilient despite the uptick in the USD. This has reinforced our modestly bullish outlook for prices in the medium term, though short-term pullbacks cannot be ruled out.

The base metals group remains our lowest conviction segment within the commodities space, though we contend that supply increases have not been as robust as we expected earlier. However, only an inflationary or a Goldilocks scenario would be a clear positive, which is not yet our core scenario.

Modest uptrend to continue, USD 45-USD 55/bbl short term range

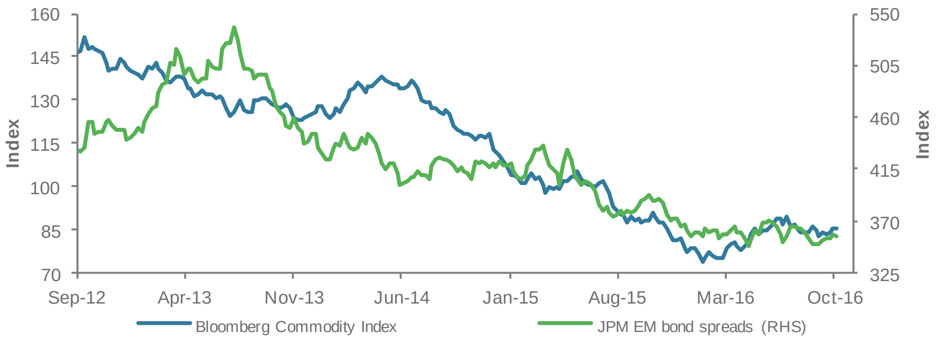
Current gold prices offer accumulation opportunities

Remain cautious on industrial metals

IMPLICATIONS FOR INVESTORS

Figure 28: Confidence in Emerging Markets (EM) key for a broader uptrend in commodities

J.P Morgan Emerging Market bond spreads and Bloomberg Commodity Index



Source: Bloomberg, Standard Chartered

Commodities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Crude oil – gradually moving higher

Recent indications of a deal among key producers have increased the possibility of curtailing production and supporting higher prices. Nonetheless, historical experience suggests implementation of production cuts is not easy.

In the short term, high inventories could be a headwind for oil prices and the process of rebalancing is unlikely to be smooth. Nonetheless, we still believe pullbacks are likely to be limited and could increase the attractiveness of selective investments associated with oil prices. In the short term, continued trading in the USD 45-USD 55/bbl range is likely.

Gold – increase allocation following pullback

Gold has come under some pressure recently on the back of rising US interest rate expectations and a stronger USD. Part of the reason for the pullback could be related to excessive net-long speculator positioning.

Over the medium term, we remain constructive on gold as we continue to expect accommodative central bank policies, with central banks more tolerant of a modest rise in inflation. As long as any rise in interest rates lags inflation expectations, real rates (a key driver of gold price) are likely to remain negative (see chart). Therefore, we would use the recent pullback to add gold. 1250 is technically key support for gold.

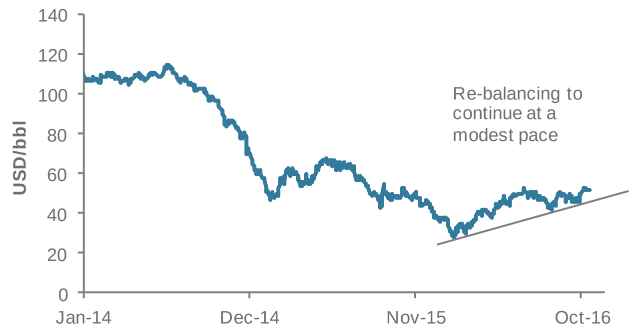
Industrial metals – slight improvement

Industrial metals have rallied strongly this year on the back of higher demand from China and other Emerging Markets (EM). In case of iron ore, for example, supply growth from Australia and Brazil has been offset by lower China production, while higher-than-expected steel demand has depleted inventories, increasing the possibility of a balance in markets by 2018.

Despite this, we are still some way from turning broadly constructive on base metals given varying degrees of demand supply gap and still lacklustre global growth. We will be watching this space closely should fundamentals turn faster than expected.

Figure 29: Modest uptrend in oil expected to continue

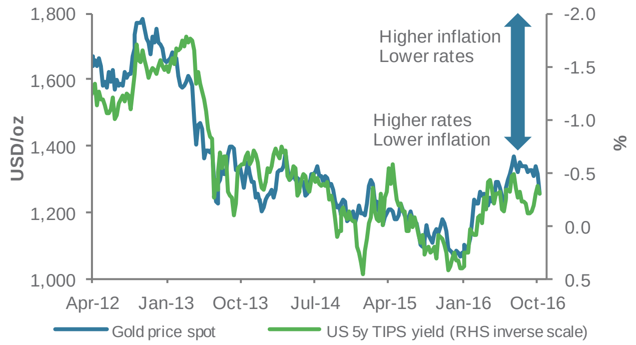
Brent crude oil prices



Source: Bloomberg, Standard Chartered

Figure 30: Rise in inflation outpacing interest rates positive for gold

US 5y TIPS yields (inverted) and gold prices



Source: Bloomberg, Standard Chartered

Figure 31: What has changed – Oil

Factor	Recent moves
Supply	Production declines in non-OPEC regions accelerated, but stabilised in the US
Demand	Demand remains resilient in EM, but US product inventories remain high
USD outlook	Recent uptick, but largely range-bound from a longer-term perspective

Source: Standard Chartered

Figure 32: What has changed – Gold

Factor	Recent moves
Interest rate expectations	Modest uptick yields globally, but 2016 Fed rate-hike expectations have picked up
Inflation expectations	Have picked up to varying degrees
USD outlook	Recent uptick, but largely range-bound from a longer-term perspective

Source: Standard Chartered

Higher correlations hurt

- Alternative strategies were weaker over the past month, with pullbacks witnessed across most sub-strategies. Higher cross-asset correlations may be one reason behind soft performance over the past month (see chart on page 25, for example), though year-to-date returns remain positive.
- Nevertheless, our preference for multi-asset macro and equity long/short strategies remains intact. We believe multi-asset macro's insurance-like characteristics, in particular, remain valuable as a counterbalance to risky asset exposure.

Global macro strategy offers diversification

Equity long/short a substitute for long-only

Managing volatility is a key focus

IMPLICATIONS FOR INVESTORS

A soft month

Correlation with equity markets ticked higher over the past month across most alternative sub-strategies. While we believe such phenomena should not be long-lasting, it explains the slightly weak performance over the past month in sub-strategies, such as equity long/short strategies. Encouragingly, multi-asset macro strategies' correlation with equities remains low (below 30%) relative to 2015, when it crept above 50%.

Maintain insurance-like asset class exposure

A soft month notwithstanding, we continue to believe the insurance-like characteristics of multi-asset macro strategies remains valuable at this time. As we discuss in the investment strategy section, we believe owning insurance against a pullback is a superior option relative to trying to implicitly time markets by withdrawing from risky assets altogether and looking for a lower entry point. This becomes all the more important when considering the risk that a significant pullback in equities and other risky asset classes does not occur.

Figure 33: 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

Remain bearish on GBP longer term

Expect continued AUD resilience

Do not expect further SGD downside

IMPLICATIONS FOR INVESTORS

Do not chase USD higher

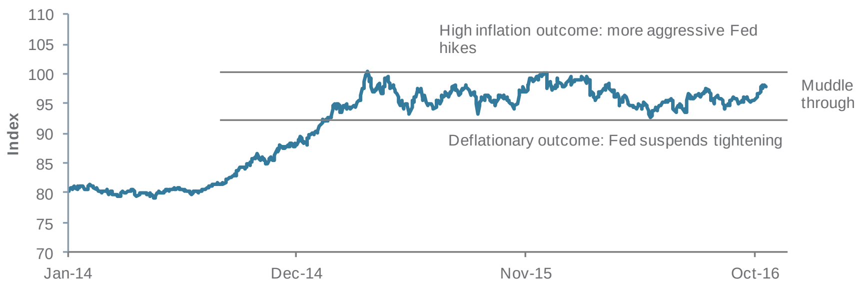
- We do not expect the recent EUR weakness to continue, and believe the 1.05-1.15 range will remain intact. We expect JPY to exhibit similar stability short-term.
- We are not comfortable with buying GBP at current levels.
- We believe there is limited downside in AUD and SGD from current levels, though we are not expecting a strong rally. We continue to expect modest CNY weakness. INR and IDR are likely to remain stable.

Case for a strong USD rally still not compelling

- The USD has rallied recently amid increasing market expectations of a December US rate hike. However, within the broader context, the USD still remains largely range-bound (see chart below). In our view, this broad sideways movement could continue in the medium term. The USD appears to have priced in a dovish Fed rate hiking scenario and additional easing measures by most major central banks.
- We believe only more aggressive Fed rate hikes and/or a strong probability of stimulus withdrawal can alter the USD's course.
- Idiosyncratic risks are rising. A Trump victory in elections, albeit looking unlikely at the time of writing, would likely increase the uncertainty for trade-oriented currencies in Asia ex-Japan and other Emerging Markets (EM). At the same time, high surplus currencies such as the EUR, JPY and CHF would likely rally given the uncertainty.
- A pick-up in US fiscal easing would likely be positive for the USD through the interest-rate channel. However, we should acknowledge that the US is not the only country considering a boost to government spending.
- Meanwhile, the European political environment remains fluid and the Italian constitutional referendum and EU-UK Brexit negotiations could impact currency sentiment significantly.

Figure 34: USD approaching upper-end of its range, we do not expect a breakout

USD index (DXY)



Source: Bloomberg, Standard Chartered

FX

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

EUR – significant downside unlikely

The EUR has recently weakened, though it continues to trade in a broad sideways range (1.05-1.15), as it has over the past 18 months. Most of this weakness was likely due to some narrowing of interest rate spreads with the US, amid the rising Fed rate hike probability. We continue to expect range-bound movement until a significant change in relative monetary policies or a huge increase in political concerns.

Key risks to our central scenarios are as follows. Indications from the ECB on reducing or withdrawing monetary stimulus could strengthen the EUR. On the downside, either a more aggressive Fed rate hiking trajectory or significant concerns regarding the stability of the Euro area could meaningfully weaken the EUR. In this regard, the Italian referendum seems to be the most obvious near-term risk event, should this lead to a significant rise in the probability of Italy leaving the Euro area.

JPY – more stability than trend

The JPY has stabilised recently following strong gains through most of 2016. We believe most of the supportive factors for the JPY have largely been priced in for now. We believe the likelihood of more extreme outcomes for the JPY has reduced. A more aggressive Fed rate hiking cycle or a much more accommodative BoJ is likely needed to significantly weaken the JPY. The biggest risk for a stronger JPY is a continued fall in inflation. This would increase real (net of inflation) interest rates further in Japan, which are an important driver of the JPY.

GBP – how much more downside?

The GBP fell sharply after the UK Prime Minister announced a time-line for post-Brexit negotiations. Medium-term risks to the UK economy remain considerable. The UK faces a record current account deficit at a time when there is an increasing risk of capital outflow. Foreigners, for example, continue to hold a large amount of UK government bonds relative to history. Therefore, we are not keen to buy the GBP on pullbacks. A more softening of respective stances on Brexit negotiations and/or continued capital flow towards UK assets is the main risk to our bearish outlook.

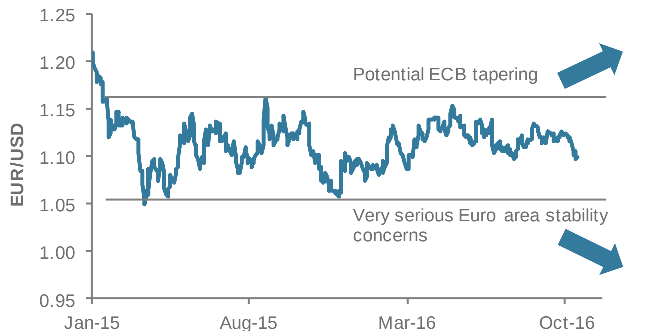
Figure 35: What has changed – G3 currencies

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	Recent US data have been weaker; UK surprises are beginning to moderate, while Euro area and Japan data are in line with expectations
Speculator positioning	USD positioning remains neutral; the JPY still remains excessively net-long

Source: Bloomberg, Standard Chartered

Figure 36: Likely to remain range-bound – barring an end to policy stimulus or rising Euro area break-up concerns

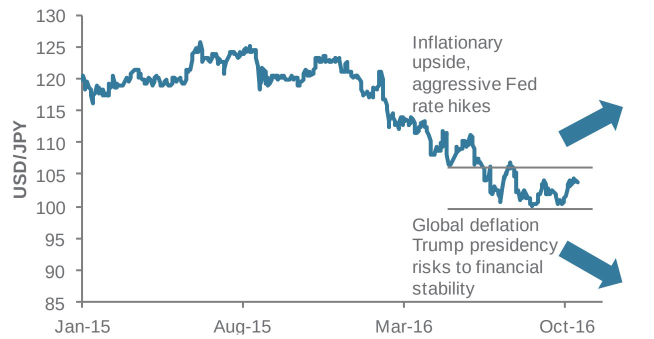
EUR/USD spot



Source: Bloomberg, Standard Chartered

Figure 37: JPY could stabilise for now; a significant alteration of inflation expectations could set the direction

USD/JPY spot



Source: Bloomberg, Standard Chartered

FX

AUD – China data remain the main anchor

The AUD has remained resilient to the recent bout of USD strength. We believe this is due to the fact that key drivers of the AUD, namely rate differentials with the US and iron ore prices, have remained supportive.

We do not expect the RBA to ease policy further this year, which is likely to limit further narrowing of Australia-US rate spreads. We also see a gradual rise in commodity prices over the medium term supported by a stabilisation in China growth (see commodities section).

Therefore, we are turning more constructive on the AUD, though we would not expect a sharp rally either. Only a more 'Goldilocks' type scenario (i.e. a strong growth rebound with moderate inflation) is likely to open room for a significant upside, which we believe is unlikely.

Asia ex-Japan – not too worried

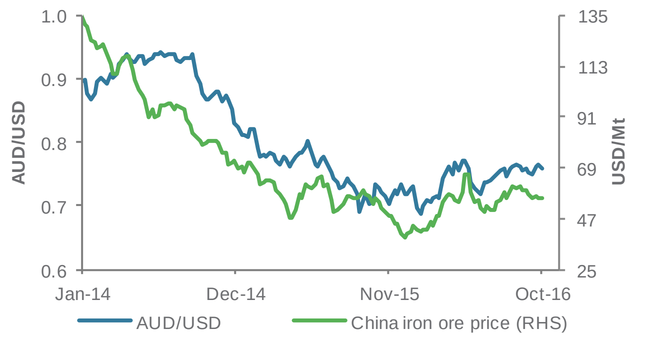
Asia ex-Japan currencies have weakened recently, in line with the stronger USD and rising chances of a December US rate hike. However, since this has now largely been priced in, our core muddle-through scenario does not expect the weakness to continue and sees Asia ex-Japan currencies remaining stable over the medium term. In our view, external macro factors – namely the broad USD and China risks – dominate the outlook for Asia ex-Japan currencies because of the importance of capital flows.

The USD/CNY pair recently made a new high, though we do not see this as particularly concerning. For one, markets have grown accustomed to China authorities gradually weakening the CNY. Second, the recent weakness has reflected USD strength, whereas the trade-weighted basket has largely remained stable. Having said this, a further modest CNY weakness can still be expected, as China maintains a broadly accommodative monetary policy.

We believe the recent SGD weakness has correctly priced in near-term fundamentals. Given that the SGD is managed against a basket of currencies, our outlook for the SGD is largely tied to our USD view. Therefore, we would continue to see a broad range-bound movement as oppose to a clear directional trend.

Figure 38: Iron ore prices have been supportive to AUD gains so far this year

Iron ore prices and AUD/USD



Source: Bloomberg, Standard Chartered

Figure 39: What has changed in Asia ex-Japan currencies

Factor	Recent moves
USD outlook	USD has ticked up recently, putting some pressure on Asia ex-Japan currencies
China risks	Recent strong China GDP numbers support our outlook for largely stable growth
Capital flows	Capital flows to the region have pulled back somewhat recently but remain healthy overall

Source: Standard Chartered

Figure 40: Asia ex-Japan currencies closely tied to broad USD movement; we do not expect a significant weakness in the regional currencies

Broad trade-weighted USD and Asia USD index (reverse scale)

Source: Bloomberg, Standard Chartered

Correlations in the spotlight

- Income assets have struggled recently given the rise in US interest rate expectations.
- Rising correlations make the strategy vulnerable to larger drawdowns.
- While we do not believe it is time to ring alarm bells, we are closely watching correlations to determine whether it is a temporary or structural phenomenon.
- The move in correlations reinforces the need for alternative strategies to manage risk.
- Protect gains in the income strategy using multi-asset macro strategies; this approach comes with less market-timing risk than exiting completely with an intention to re-enter

Rising correlations challenge diversification in the income strategy

Risk likely temporary but merits watching given the heavy event calendar in Q4 2016

Enhance yield with option strategies in specific sectors

IMPLICATIONS FOR INVESTORS

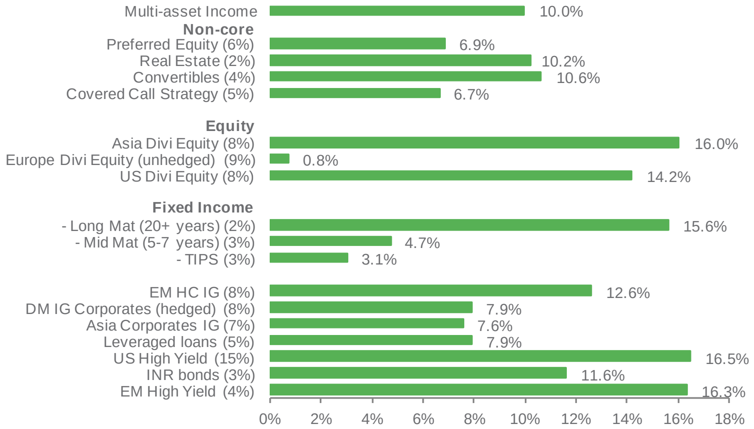
Income assets challenged over the past month

While multi-asset income continues to deliver strong performance as a strategy (up 10% since our Annual Outlook), the past month was a challenging one given the move in US interest rates. Income assets, including traditional fixed income and non-core income assets, such as REITs and convertible bonds, delivered negative return over the past month. Resilient among this pattern of negative returns were US High Yield (HY), leveraged loans, and local currency INR bonds, which recorded positive returns. These assets tend to exhibit less interest rate sensitivity. It is heartening to see them spared from the broadly rising correlation across asset classes (a topic we cover in the next section).

The bond-like characteristics of equity income meant they were not spared over the past month with all regions delivering negative returns. However, within equity income, our rebalancing out of European dividend equity into Asian dividend equity bore fruit, with the latter outperforming by 170bps over the past month.

Figure 41: Despite a challenging month for income assets, overall performance remains strong

Performance of our multi-income allocation since Outlook 2016 (as of 20 October, 2016)



Source: Barclays, Citi, CRISIL, JP Morgan, FTSE, S&P, MSCI, Bloomberg, Standard Chartered

Multi-asset

Rising correlations – here to stay?

As mentioned several times in our previous publications, the focus of our multi-income allocation has been on managing the risk of drawdown. Drawdown is an integral part of portfolio behaviour and cannot always be avoided. As long as there is sufficient diversification in the allocation, ie, not all assets are experiencing drawdowns at the same time, the overall risk of the allocation should remain reasonable.

However, when correlations between assets begin to rise, the impact of drawdowns in the allocation could be severe as the broad majority of the allocation might be affected in a risk-off scenario. Over the past month, we have seen correlations rise fairly significantly between various income assets. Of particular interest is the rise in correlation between safe assets (primarily government bonds and Investment Grade credit) and risky assets. Safe assets, which traditionally provide a degree of protection in times of stress, are moving in the same direction as risky assets.

While we do not believe it is time to ring alarm bells, we are closely watching correlations to determine if the trend is temporary or structural. An unanticipated rise in inflation followed by a strong Fed reaction to combat this surge could lead to a broad decline in the value of income assets given high correlations. While this is not our central macro scenario, an allocation to multi-asset global macro strategies could mitigate the impact of such a scenario.

Figure 42: Correlations rising between income sub-asset classes

Arrows show whether short-term (30-day) average correlations within and between income sub-asset classes have increased or decreased relative to their 2-year average. The size of the arrow denotes the relative magnitude of the change*

	High yielding bonds	'Safe-haven' bonds (Mid-low yielding)	Equity dividend	Non-core
High yielding bonds	▼			
'Safe-haven' bonds (Mid-low yielding)	▲	▲		
Equity dividend	▼	▲	▼	
Non-core	▼	▲	▼	▼

* High Yield (HY) bonds include INR, EM IG and HY, US HY and global leveraged loans. Mid-low yielding bonds include the rest of the bond universe as outlined in the performance chart on page 24

Source: MSCI, Bloomberg, Standard Chartered

Opportunities through equity options exist in specific sectors

The pick-up in global volatility over the past few weeks has been mild, with volatility remaining below the YTD average. Given that, all else equal, higher volatility means higher yields from selling equity options, extracting high yields from selling equity options has been challenging.

However, pockets of opportunities do exist. Chinese property developers are an interesting example, given the recent rise in volatility both in absolute terms and relative to other areas of the Hong Kong equity market.

We have been highlighting the deteriorating credit profile of the Chinese high-yield property names for some time. We would consider switching out of such HY bonds, which have rallied strongly in recent times. At the same time, investors could consider taking advantage of the rebound in equity volatility in the sector by selling equity options to generate attractive yields. We would focus on the higher-quality names in the sector.

Figure 43: Volatility of China property stock index has been rising

30-day historical volatility of China property index in both absolute terms and relative to the volatility of the Hang Seng index

Source: Bloomberg, Standard Chartered

Market performance summary *

Equity	Year to date		1 month	
Global Equities	5.6%	↑	0.4%	↑
Global High Dividend Yield Equities	8.8%	↑	-0.7%	↓
Developed Markets (DM)	4.3%	↑	0.2%	↑
Emerging Markets (EM)	17.3%	↑	1.7%	↑
By country				
US	5.9%	↑	0.1%	↑
Western Europe (Local)	3.2%	↑	2.3%	↑
Western Europe (USD)	-2.1%	↓	-0.8%	↓
Japan (Local)	-10.7%	↓	4.3%	↑
Japan (USD)	3.3%	↑	2.0%	↑
Australia	11.0%	↑	4.2%	↑
Asia ex-Japan	12.6%	↑	0.3%	↑
Africa	16.5%	↑	-1.8%	↓
Eastern Europe	21.6%	↑	1.8%	↑
Latam	44.0%	↑	10.6%	↑
Middle East	-3.3%	↓	-1.0%	↓
China	9.0%	↑	0.0%	↑
India	7.8%	↑	0.1%	↑
South Korea	13.3%	↑	0.8%	↑
Taiwan	23.4%	↑	1.8%	↑
By sector				
Consumer Discretionary	1.3%	↑	0.7%	↑
Consumer Staples	4.8%	↑	-2.0%	↓
Energy	24.1%	↑	7.1%	↑
Financial	4.3%	↑	2.2%	↑
Healthcare	-4.3%	↓	-3.4%	↓
Industrial	8.4%	↑	0.3%	↑
IT	12.4%	↑	0.9%	↑
Materials	19.2%	↑	2.9%	↑
Telecom	6.2%	↑	-1.7%	↓
Utilities	7.5%	↑	-2.3%	↓
Global Property Equity/REITS	6.9%	↑	-2.6%	↓

Bonds	Year to date		1 month	
Sovereign				
Global IG Sovereign	7.7%	↑	-1.7%	↓
US Sovereign	4.3%	↑	-0.2%	↓
EU Sovereign	6.8%	↑	-2.2%	↓
EM Sovereign Hard Currency	14.2%	↑	0.6%	↑
EM Sovereign Local Currency	14.4%	↑	0.9%	↑
Asia EM Local Currency	10.5%	↑	-0.9%	↓
Credit				
Global IG Corporates	7.5%	↑	-0.5%	↓
Global HY Corporates	13.8%	↑	1.3%	↑
US High Yield	16.4%	↑	2.2%	↑
Europe High Yield	5.3%	↑	-1.6%	↓
Asia High Yield Corporates	11.7%	↑	0.7%	↑

Commodity	Year to date		1 month	
Diversified Commodity	9.8%	↑	2.1%	↑
Agriculture	6.5%	↑	0.5%	↑
Energy	10.3%	↑	10.0%	↑
Industrial Metal	7.7%	↑	-1.2%	↓
Precious Metal	20.5%	↑	-5.4%	↓
Crude Oil	15.7%	↑	10.8%	↑
Gold	19.3%	↑	-3.7%	↓

FX (against USD)	Year to date		1 month	
Asia ex- Japan	-0.3%	↓	-0.8%	↓
AUD	4.7%	↑	0.9%	↑
EUR	0.6%	↑	-2.0%	↓
GBP	-16.8%	↓	-5.7%	↓
JPY	15.7%	↑	-2.2%	↓
SGD	1.9%	↑	-2.2%	↓

Alternatives	Year to date		1 month	
Composite (All strategies)	1.2%	↑	0.4%	↑
Relative Value	-0.1%	↓	0.9%	↑
Event Driven	7.2%	↑	-0.1%	↓
Equity Long/Short	-0.9%	↓	0.7%	↑
Macro CTAs	-1.9%	↓	0.1%	↑

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

*YTD performance data from 31 December 2015 to 20 October 2016 and 1-month performance from 20 September 2016 to 20 October 2016

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

Events calendar

Oct

20 ECB Policy Meeting

31 Oct-01 Nov Bank of Japan Policy Meeting

China Communist Party Sixth Plenum

Nov

02 US Federal Reserve Policy Meeting

08 US Presidential Elections

30 Australia Parliamentary Elections

20 Nov-04 Dec France Republican and Socialist primary elections

APEC Annual APEC Summit, Peru

Italy Constitutional Referendum

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

Jan

19 ECB Policy Meeting

20 US Presidential Inauguration Day

30-31 Bank of Japan Policy Meeting

Feb

01 Federal Reserve Policy Meeting

Mar

09 ECB Policy Meeting

15 US Federal Reserve Policy Meeting

15 Netherlands Parliamentary Elections

15-16 Bank of Japan Policy Meeting

The team

Alexis Calla*

Global Head, Investment Advisory and Strategy, Chair of the Global Investment Committee
Alexis.Calla@sc.com

Steve Brice*

Chief Investment Strategist
Steve.Brice@sc.com

Aditya Monappa*, CFA

Head, Asset Allocation and Portfolio Solutions
Aditya.Monappa@sc.com

Clive McDonnell*

Head, Equity Investment Strategy
Clive.McDonnell@sc.com

Audrey Goh, CFA

Director, Asset Allocation and Portfolio Solutions
Audrey.Goh@sc.com

Manpreet Gill*

Head, FICC Investment Strategy
Manpreet.Gill@sc.com

Rajat Bhattacharya

Investment Strategist
Rajat.Bhattacharya@sc.com

Arun Kelshiker, CFA

Executive Director Asset Allocation and Portfolio Solutions
Arun.Kelshiker@sc.com

TuVi Nguyen

Investment Strategist
TuVi.Nguyen@sc.com

Victor Teo, CFA

Investment Strategist
Victor.Teo@sc.com

Tariq Ali, CFA

Investment Strategist
Tariq.Ali@sc.com

Abhilash Narayan

Investment Strategist
Abhilash.Narayan@sc.com

Trang Nguyen

Analyst, Asset Allocation and Portfolio Solutions
Trang.Nguyen@sc.com

Our experience and expertise help you navigate the markets and provide actionable insights to reach your investment goals.

* Core Global Investment Committee voting members

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