Global Market Outlook

This reflects the views of the Wealth Management Group
November 2013

Standard Chartered
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Contents

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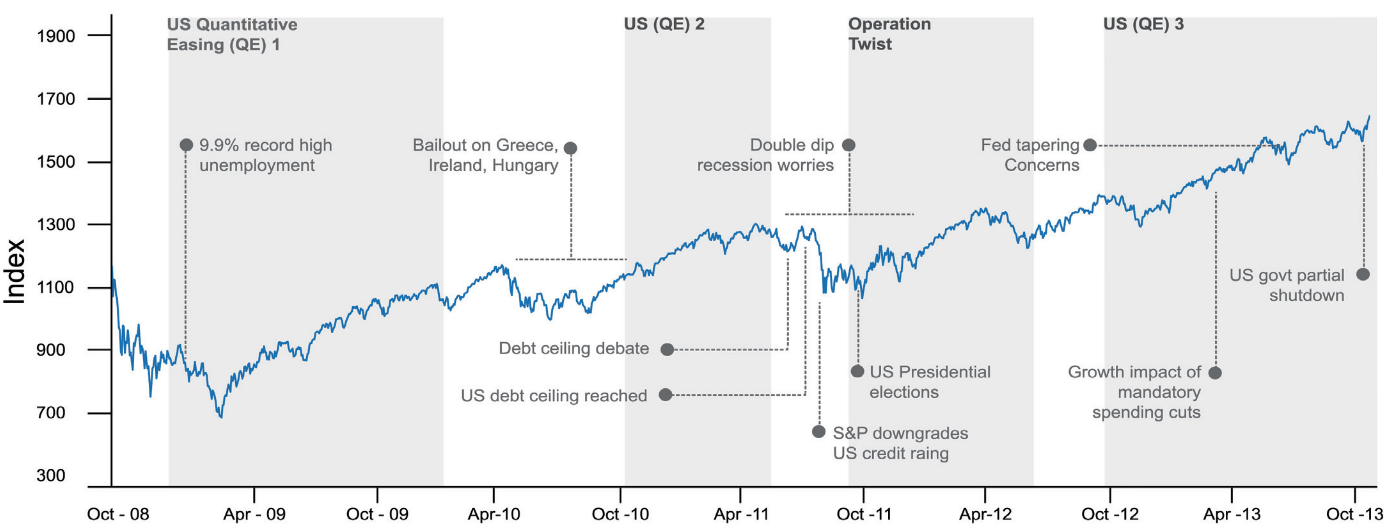
Climbing the 'wall of worry'

- **Global equities continue to climb the wall of worry.** It is normal for equity markets to start rallying even when there are a lot of fears in the market. Indeed, many believe this is when returns are strongest. This period of strong returns in the face of persistent fears is sometimes referred to as 'climbing the wall of worry'.
- **US equities have been climbing the wall of worry for some time.** We went overweight US equities in April 2012. At the time, there were many excuses to ignore our views (see chart below). The deferment of the latest excuses, debt ceiling fears and the government shutdown, pushed the US market to a new all-time high within 24 hours. (1)
- **While we remain bullish on US equities, we believe Europe has greater scope to continue climbing the wall of worry in the coming 12 months.** Investors are far from convinced the recent economic recovery will prove sustainable, for instance citing record unemployment levels. Meanwhile, banking sector stress tests are another reason to worry, as is the reducing popularity of the Euro project in some of the core countries, although notably not in Germany.
- **Positives are being downplayed.** The fact that the periphery countries have made substantial progress in addressing both fiscal and current account deficits has been lost on many. As has the fact that equity markets should do well from high unemployment levels as accelerating growth can occur with no concern about inflationary pressures.
- **We expect strongly positive returns from European equities in the coming 12 months** as investors start to accept the economic recovery is likely to be sustained, earnings are likely to accelerate and the political commitment to the single currency project remains strong.

1. US equities are still climbing the 'wall of worry'



Source: Bloomberg, Standard Chartered

This commentary reflects the views of the Wealth Management Group of Standard Chartered Bank

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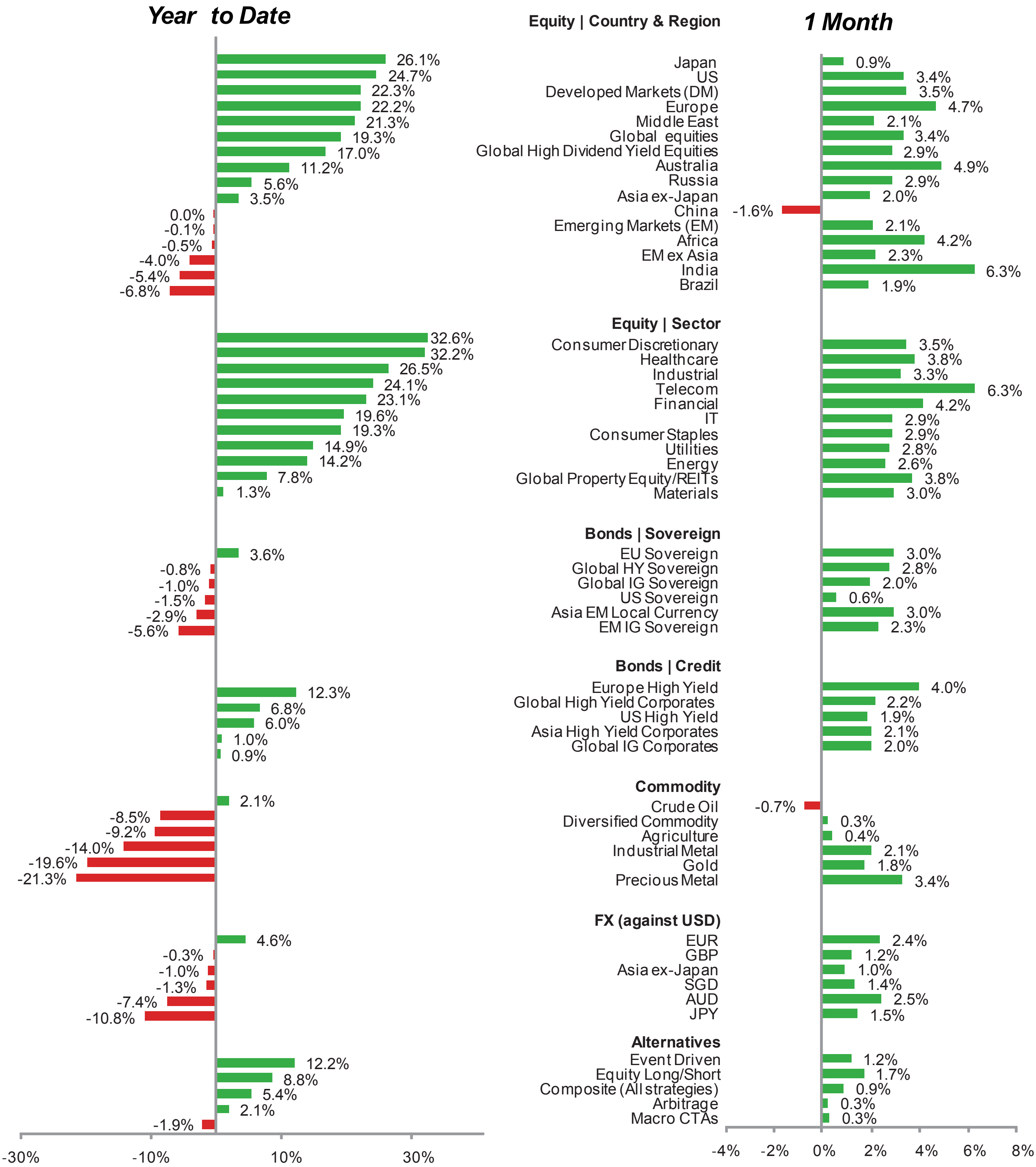
2. Market Performance Summary (Year to date & 1 Month)*



** All performance shown in USD terms unless otherwise stated.*
**YTD performance data from 31 Dec 2012 – 24 Oct 2013 and 1 Month performance from 24 Sep – 24 Oct 2013*
Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

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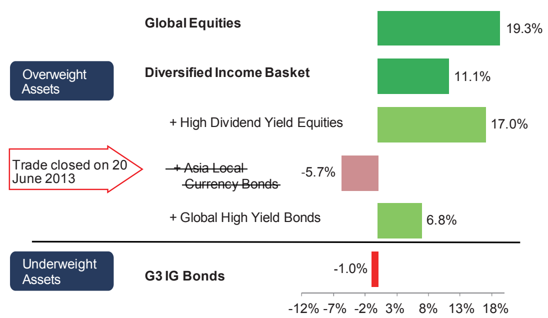
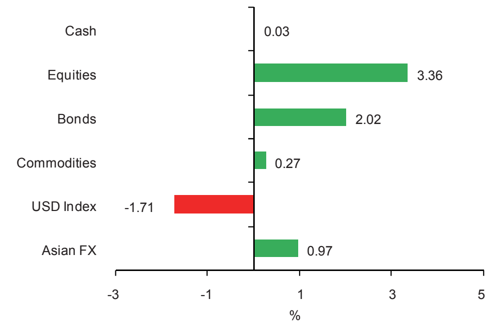
3. B.R.I.D.G.E. themes performing well so far

*B.R.I.D.G.E. performance YTD (USD)**



** For the period 31 Dec 2012 to 24 Oct 2013*
Source: Bloomberg, Standard Chartered
** Income basket is equally weighted performance of global high dividend yielding equities (MSCI ACWI High Dividend Yield USD),Global HY bonds (BarCap Global HY TR USD) and Asian local curr bonds (BarCap Asia Local Net TR USD, until 20 June)*

4. Asset Performance (USD)*



** For the period 24 Sept to 24 Oct 2013*
Source: Bloomberg, Standard Chartered
Indices are JP Morgan US 3M Cash Index, MSCI AC World TR Net, CITI World BIG, DJ-UBS Commodities, DXY and ADXY

Investment Strategy: 'Risk on' extended

Over the next 12 months, we expect:

- **equity markets to perform well, led by Developed markets (DM). Asia ex-Japan expected to generate positive returns**
- **the recent strong performance of investment grade bonds to reverse and generate negative returns**
- **US and Europe high yield to generate positive returns** (3, 4)

Paradoxically, the recent government shutdown/debt ceiling debacle should prove positive for global equities. With economic data likely to be weak near term, the Fed may further delay the tapering of asset purchases. This is supportive for global equities and may lead to short term out-performance of Emerging market (EM) equity markets while offering an opportunity to reduce Asian local currency bond exposures.

However, we continue to have a preference for DM equity markets on a 6-12 month basis. We expect liquidity conditions in Europe and Japan to continue easing and even when tapering begins in the US, we believe this will have a limited impact on the US equity market. However, eventually liquidity conditions in EM may become less supportive - we have already had a taste of what tapering could mean for currencies and liquidity in the region. Additionally, China is proactively trying to control credit creation.

Under-performance relative to DM, but still positive performance. We expect EM/Asia ex-Japan (AXJ) equities to under-perform DM over the next 6-12 months. That said, we believe AXJ markets will generate positive returns given still-reasonable earnings growth, cheap valuations and a 2.6% dividend yield. Therefore, we prefer a diversified global equity exposure, tilted towards DM equities, but certainly not exclusively DM-focused.

USD-denominated investment grade bonds expected to generate negative returns over the next 12 months. We believe recent positive returns are likely to reverse as the uptrend in yields resumes once economic data rebounds. Thus, we prefer to focus on high yield credit in the US and Europe where we expect low, but positive, returns over the next 12 months.

We still see DM equities as the favoured asset class on a 12 month view. EM equities could outperform in the short term, and are likely to generate positive returns over the next 12 months.

5. Asset allocation summary*

Asset Class	Relative Outlook	Start Date
Cash	UW	Feb-12
Fixed Income	UW	Jan-11
Equity	OW	Aug-12
Commodities	UW	Jun-13
Alternatives	OW	Jun-13

	Sub-asset Class	Relative Outlook	Start Date
Cash		UW	Feb-13
Fixed Income	DM Investment Grade	UW	Jan-11
	EM Investment Grade	N	Oct-12
	DM High Yield	OW	Sep-11
	EM High Yield	N	Sep-12
Equity	US	OW	Apr-12
	Europe	OW	Jul-13
	Japan	N	Apr-13
	Asia ex-Japan	UW	Jun-13
	Other EM	UW	Aug-12
Commodities		UW	Jun-13
Alternatives		OW	Jun-13

Legend

Start Date - Date at which this tactical stance was initiated

OW - Overweight **N** - Neutral **UW** - Underweight

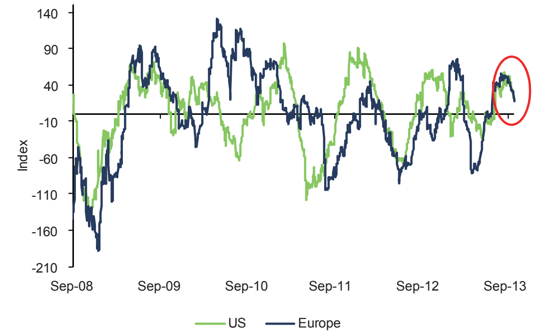
DM - Developed Markets

EM - Emerging Markets

*Source: Standard Chartered, *'start date' reflects the date at which this tactical stance was initiated*

6. Positive economic surprises starting to wane

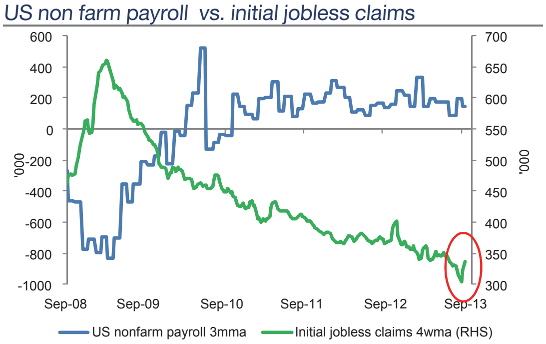
Economic surprise indices – US & Europe



Source: Citigroup, Bloomberg, Standard Chartered

7. US labour market data weakens slightly

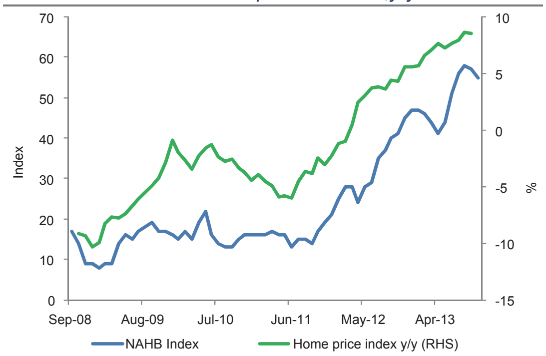
US non farm payroll vs. initial jobless claims



Source: Bloomberg, Standard Chartered

8. US housing market is still on an uptrend

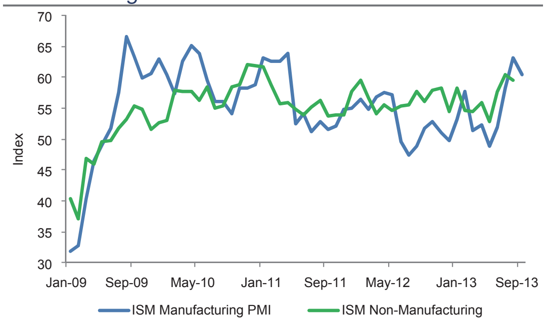
NAHB index and US home price index %,y/y



Source: Bloomberg, Standard Chartered

9. US forward-looking indicators still strong

US ISM new orders – Manufacturing and non-manufacturing



Source: Bloomberg, Standard Chartered

Economic and policy outlook

Data becoming more mixed. (6)

- In the **US**, data has become more mixed. New orders sentiment remains consistent with strong growth going forward while housing data has stabilised. However, employment data has continued to soften.
- In **Europe** and **Japan**, the data continues to point to a sustained recovery with business confidence remaining firm.
- In **Asia**, the economy has stabilised, but we continue to believe the Chinese authorities do not want too strong an economic rebound. This view is reinforced by recent interest rate moves and policy statements.

US: Still on recovery path

While data may soften in the near term, the recovery remains on track. The government shutdown and last minute deal to avoid a breach of the debt ceiling is likely to have negatively impacted sentiment and the economy. This likely pushes Fed tapering into 2014.

- **Labour market data weakens.** The employment report has been weak for three consecutive months. More recently, initial benefit claims have risen. (7) While the latter has been caused by temporary factors, it is adding to concerns the recent slowdown in job creation will extend.
- **Housing market data mixed.** After a period of weakness, the situation is stabilising. Construction activity is starting to increase and house prices are still rising, reducing the number of home-owners that are in negative equity. (8)
- **Business confidence remains robust.** Business confidence indices for both the manufacturing and service sectors remain well above the 50 level which separates expansion and contraction. (9) Meanwhile, the new orders indices are the strongest areas of both surveys.

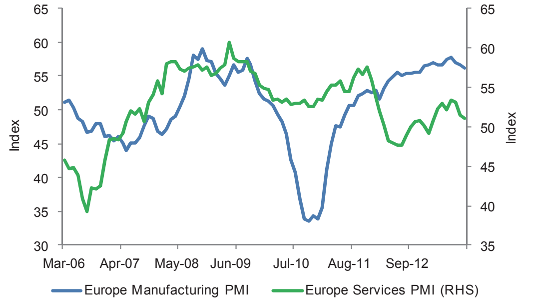
Government indecision has three implications:

- **Growth:** Near term data releases may disappoint as the effects of the government shutdown and uncertainty surrounding the debt ceiling talks undermine activity.
- **Tapering:** This backdrop is likely to persuade FOMC members to hold off on tapering its asset purchases this year. We now expect the Fed to taper only in Q1, with a bias to this happening later rather than earlier. It would require strong upside data surprises to bring tapering to December, in our opinion. It is important to note, however, that the composition of FOMC voting members becomes more hawkish in 2014.
- **Chances of a long term fiscal deal have increased:** Both political parties and the President have seen dissatisfaction ratings rise. We believe this increases the incentive to get a deal done before we run into the debt ceiling again in Q1/Q2 of next year. The key is whether the politics within the Republican Party allow for this to happen.

Europe: Recovery continues

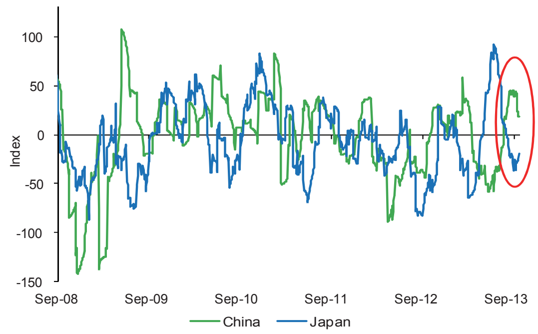
- **Euro area business confidence data remains firm.** Business confidence data continues to point to an expansion in both the manufacturing and service sectors. While we saw a marginal decline in the latest surveys, they remained well above the 50 level – which

10. Europe manufacturing sector likely to strengthen
Euro area – Manufacturing and services PMI



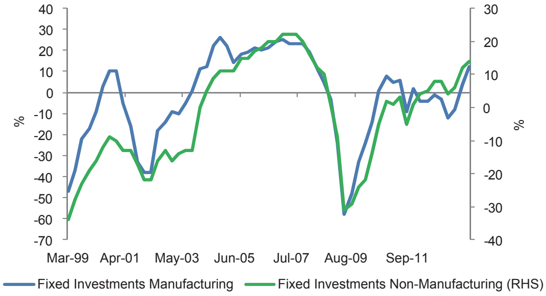
Source: Bloomberg, Standard Chartered

11. Economic surprises between China and Japan starting to converge
Economic surprises indices – China & Japan



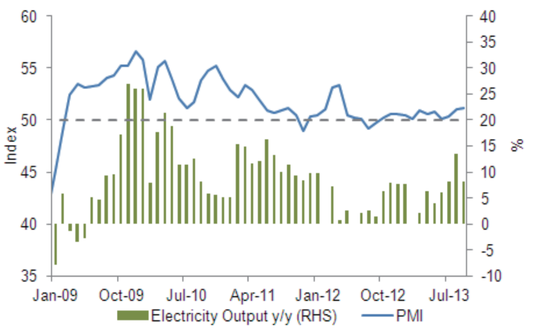
Source: Citigroup, Bloomberg, Standard Chartered

12. Japanese companies accelerate investment spending
Japan Tankan business conditions, Manufacturing and Non-manufacturing



Source: Bloomberg, Standard Chartered

13. China recovery remains relatively tepid
China manufacturing PMI and power production, % y/y



Source: Bloomberg, Standard Chartered

separates sector expansion from contraction – and was likely affected by short term political uncertainty in both the US and Germany. (10)

- **Economy sweet spot to extend.** Inflation remains low and falling. High levels of unemployment mean wage pressures are unlikely to increase for many months, and possibly years, to come. This view is reinforced by the continually dovish stance taken by European Central Bank officials with a potential interest rate cut and another liquidity injection still being discussed.
- **Banking sector stress tests important.** The ECB is due to start examining the health of Euro area banks in November. This will be key as it may encourage banks to boost capital ratios – either by constraining lending or raise capital – as well as raising provisions. This is a potential source of risk.

Asia: Japan recovering, positive surprises in Asia ex-Japan wane (11)

Japan

- **Signs on capital spending positive.** The Bank of Japan's quarterly survey of Japanese companies showed that business investment plans are accelerating. (12) It seems business leaders are becoming increasingly optimistic that 'Abenomics' will work. This optimism could prove self-reinforcing, especially if wages start to accelerate.
- **Increase in consumption tax mitigated by the stimulus package.** The government has confirmed its plan to hike the consumption tax in April 2014. However, the government has announced a stimulus package to support the economy through the transition. Consensus 2014 growth forecasts have been stable since the announcement suggesting analysts are willing to give the government the benefit of the doubt and are projecting the recovery to extend into 2014.

China

- **Data may be taking a pause.** There are signs the Chinese economic recovery, following the government's mini-stimulus, may be pausing. Retail sales and industrial production data decelerated marginally while power production fell. However, new loans accelerated, suggesting the economy is unlikely to slump significantly in the coming months. (13)
- **Policy:** We expect the authorities to keep a tight leash on credit creation as they try to balance off the need for growth and the need to avoid a credit bubble. This view is reinforced by a central bank adviser saying policy will be tightened slightly following the recent increase in inflation.

Rest of Asia:

- **Growth still relatively tepid.** The wider Asian region appears to be seeing the initial benefits of the recent pick-up in the global economy. Growth is expected to pick up as we move into 2014.

EM policy: The likelihood that the Fed may not taper until Q1 2014 is likely to alleviate some of the short term pressure on EM currencies, reducing the need to tighten liquidity. However, many countries in the EM world are entering their electoral cycles with significant current account deficits. Therefore, we expect liquidity to generally tighten over the next 6-12 months.

Overall, the economic data is consistent with the 'Transition to Stronger Growth' theme. However, we still foresee some speed bumps, especially for some of the Emerging markets, along the way.

Fixed Income – Underweight

We remain Underweight G3 government bonds. Rise in Treasury yields is likely delayed, but is still expected as we move into 2014.

Developed market, both the US and Europe, high yield are our preferred exposure within corporate credit.

We close our CNH bond Overweight on rising credit concerns.

The current rebound offers an opportunity to reduce Asia local currency bond exposure at better levels. (14)

G3 sovereign bonds:

- **Long-term path for US Treasury yields remains to the upside, but short-term outlook is now likely more subdued.** A higher likelihood of a delay to Fed QE tapering is likely to delay a rise in US Treasury yields. While much of the delay is now likely in the price, yields are likely to remain largely around current levels until the tapering conversation returns to the table. We maintain our view that 10-year Treasury yields are likely to remain within a 2.4-3.0% range for now. (15)
- Longer-term, however, this does not change our view that Treasury yields are likely to trend higher. Tapering of Fed QE purchases is only delayed, not indefinitely postponed, in our view. We continue to believe a short maturity profile is appropriate on a 12-month investment horizon.

Corporate credit (USD):

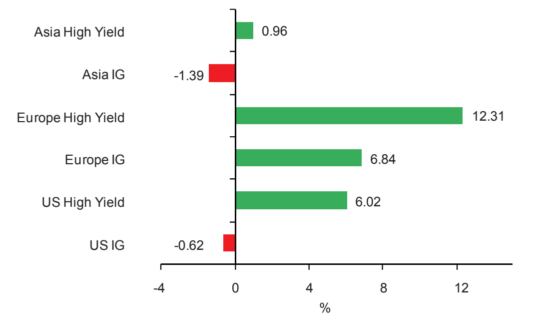
- **We remain comfortable with Developed market high yield credit.** Our case for US HY remains unchanged – lending conditions remain comfortable, the all-in yield remains reasonably attractive and default rates remain low. There are a number of similarities with European HY. Valuations are largely in a similar place to US HY (see Chart 16) and an improving economic outlook arguably reduces forward-looking default risks. While we believe risks for the HY asset class are gradually rising, we believe Developed market HY (i.e. the US and Europe) offer the most attractive relative value within corporate credit. As before, however, we recognise total returns are likely to be moderate.

Local currency bonds:

- **Take profits on CNH bonds.** 'Dim Sum' bonds have performed reasonably well since we went Overweight, but we believe this is the right time to take profits. We have noted before that the rising number of ratings downgrades relative to upgrades is one piece of evidence suggesting credit risks in Asia may be rising. Given the large number of corporates (including unrated corporates) in the CNH universe, we believe it makes sense to use the current rally to take profits.
- **Use rebound to reduce exposure to Asia local currency bonds.** A resumption in Fed tapering expectations is ultimately likely to lead to renewed Asian FX weakness, similar to that witnessed in Q3. We see the current rebound in this asset class as an opportunity for investors who have not yet reduced exposure, as we suggested earlier, to do so. (17)

Conclusion: Overweight Developed market HY. Continue to favour corporates over sovereigns. Use current rebound to reduce exposure to Asia local currency bonds, including taking profit on CNH bonds. Stay Underweight G3 sovereigns.

14. Performance of Fixed income YTD* (USD)

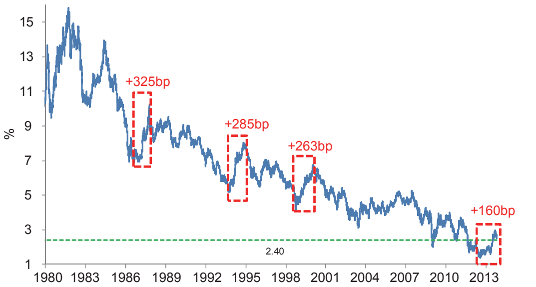


* For the period 31 December 2012 to 24 October 2013

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

15. Key support remains at 2.4% for US 10-year Treasury yields

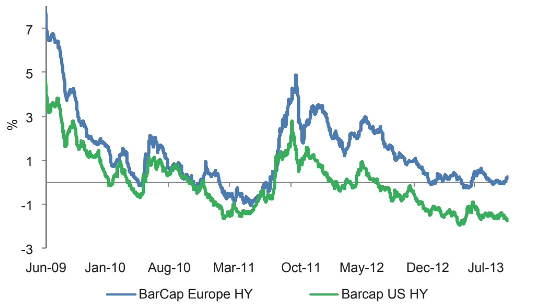
US treasury 10y yields trough to peak



Source: Bloomberg, Standard Chartered

16. European HY arguably offers slightly greater value relative to US HY

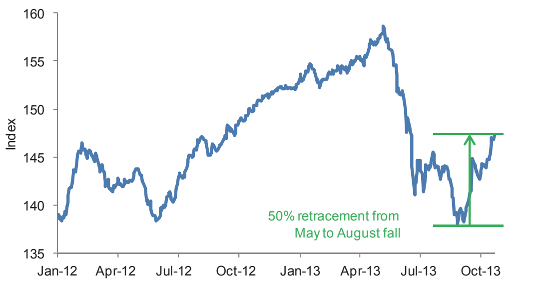
US, Europe HY spreads, deviation from median



Source: Barcap, Bloomberg, Standard Chartered

17. Asian FX rebound likely offers an opportunity to reduce Asia local currency bond exposure

BarCap EM Asia local currency, total returns index



Source: Barcap, Bloomberg, Standard Chartered

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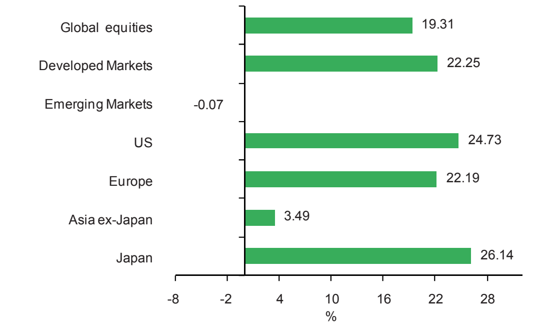
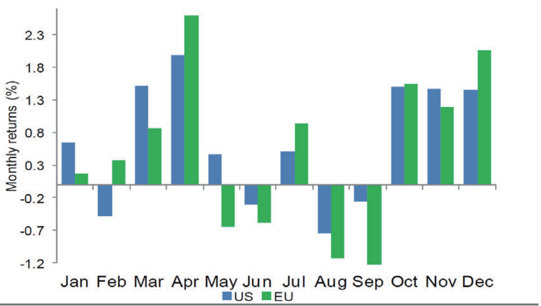
18. Performance of Equity markets YTD* (USD)



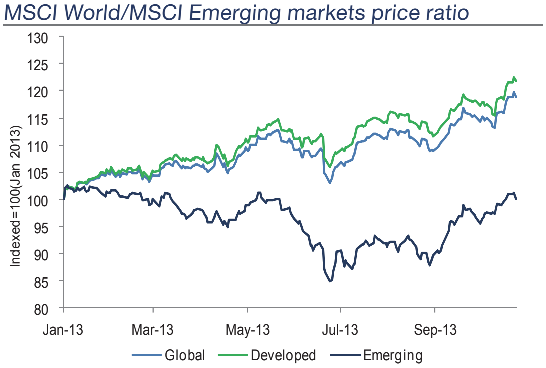
** For the period 31 December 2012 to 24 October 2013*
Source: Bloomberg, Standard Chartered. Indices are MSCI World TR, MSCI Emerging Markets TR, MSCI USA TR, MSCI Europe TR USD, MSCI Asia ex-Japan TR USD, MSCI Japan TR USD

19. US and EU entering a period of seasonal strength
US and Europe equity market – average monthly returns from 1993



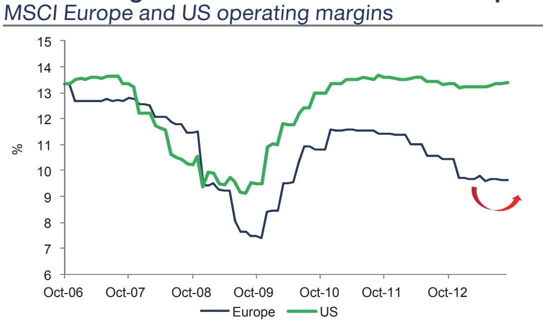
Source: MSCI, Bloomberg, Standard Chartered

20. DM has significantly outperformed since YTD
MSCI World/MSCI Emerging markets price ratio



Source: Bloomberg, Standard Chartered

21. EU margins have fallen and room to improve
MSCI Europe and US operating margins



Source: Bloomberg, Standard Chartered

Equity – Overweight

Given a gradually improving macro backdrop, benign inflation and still loose G3 monetary policy settings, we believe equities will continue to outperform other asset classes and end the year higher – particularly in the case of Europe. Our view is supported by the fact that we are entering what is typically a strong seasonal period for equities. (18, 19)

While constructive, we are the first to acknowledge that risks remain and investors need to be cognisant that a) equities have had a strong run year-to-date and b) that it remains a very policy-driven environment.

We maintain our preference for the Developed markets (DM) over Emerging markets (EM) on a 6-12 month basis. However, as we noted last month, the decision by the Fed not to taper has been supportive to EM equities and they continued to marginally outperform this month due to the US debt ceiling and Federal budget discussions being pushed out. We see this EM rally possibly continuing a little further into year end, at least until the fears over tapering come back to haunt the market. With this is mind, we would continue to advocate that investors that are relatively OW EM, consider to shift some of this exposure into the Developed markets, with a particular preference for Europe. (20)

We stick with our preference for DM longer term on the basis of:

- **Economic Momentum:** The growth differential keeps narrowing. While the macro outlook is improving in DM, the reverse is increasingly the case for EM, with growth expectations being revised down.
- **Earnings expectations:** While EM valuations are relatively cheap, earnings continue to be revised down and the weaker macro outlook may remain a headwind on the longer term. In parts of DM such as Europe, there is scope, albeit on the longer term, for significant improvement in earnings, due to operational leverage and margin improvement.
- **Liquidity and stronger USD:** Fed tapering has, in our view, only been postponed and the eventual tightening will likely be negative for EM in relative terms.

Key region/country views:

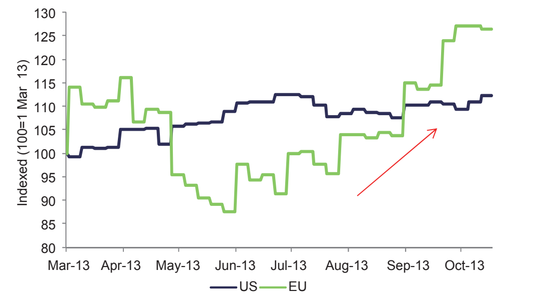
Europe (OW): Since going OW in July the market has outperformed and we expect further upside.

- Underlying economic data has continued to show improvement.
- Although very early in the earnings season, companies are beating earnings expectations and this may be a reflection of margins stabilising/improving, in line with our expectations. Margins have been beaten down over the past years and there is upside potential here. (21)
- While valuations have largely reverted back to their 10yr mean, the improvement in margins and outlook will likely be reflected in an improvement in earnings revisions (we are already starting to see this). (22)

Since investor sentiment improved in July, we have seen the more cyclical parts of the market outperform, particularly the previously sold down areas. This is in line with our preference for 'defensive & early cyclicals' and we find the best opportunities in the Industrials sector and particularly those areas of the market that are more domestically focussed.

22. Expectations for EU earnings showing an improving trend

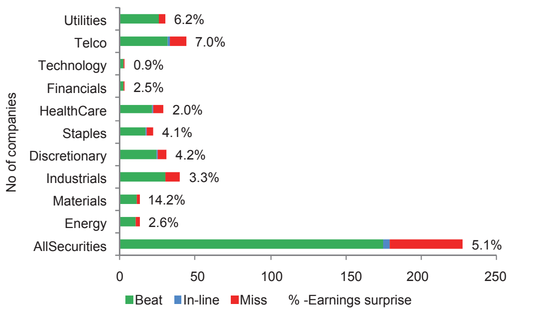
12m forward EPS% (indexed=100, 1 March 2013)



Source: Datastream, Standard Chartered

23. Earnings beating expectations in US

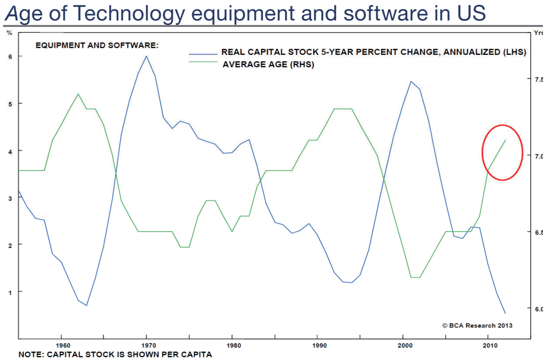
S&P 500 3Q earnings surprise



Source: Bloomberg, Standard Chartered

24. Average age of Tech equipment reaching historical peaks

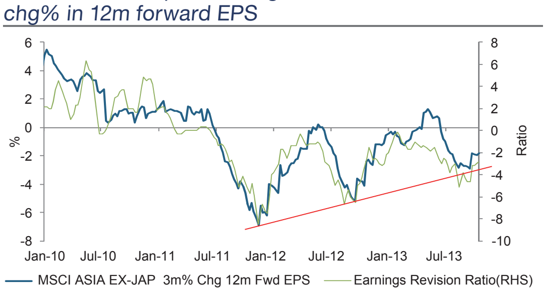
Age of Technology equipment and software in US



Source: Bank Credit Analyst Research, Standard Chartered

25. Asia ex-Japan earnings revisions still negative but trend improving

MSCI Asia ex-Japan earnings revisions ratio and 3m chg% in 12m forward EPS



Source: Datastream, Standard Chartered
*Earnings revision ratio=Net upgrades/(Upgrades+Downgrades)*100*

US (OW): While Europe is preferred, the US should still offer further upside.

- Earnings are so far coming in ahead of expectations – of the companies that have reported, the earnings surprise has been 5.1%, with earnings growth coming in at over 6%. (23)
- With the Fed still very supportive, underlying inflation remaining low, the housing market improving, economic growth likely to pick up and companies doing share buybacks, the equity market should be well supported.
- We believe valuations will eventually overshoot into overvalued territory.
- The best opportunity in the US, in our opinion, is the Technology sector. It offers great value, higher than average returns on capital invested and should benefit from an eventual improvement in technology capex. (24)

Japan (N): BoJ actions still supportive.

- We still have a preference for taking hedged exposure to Japan (expecting the Yen to weaken further) and to the exporters.

Asia ex-Japan (UW):

Asian equity markets still expected to generate positive returns.

- Valuations vary substantially across the region, but overall they remain cheap relative to history – on both price-to-book and price-earnings perspectives – and cheap relative to bonds.
- Earnings growth is expected to remain relatively robust – the consensus is for over 12% earnings growth. While this may prove slightly optimistic, we believe earnings growth will remain significantly positive. Add in the c.2.6% dividend yield and it would take a significant decline in valuations to generate negative returns over the next 12 months. (25)

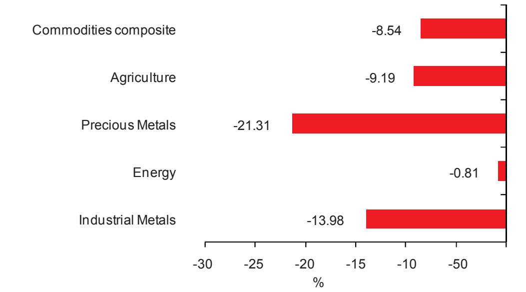
Preferred themes:

- **High dividend & high quality:** With cash and sovereign bonds offering so little yield, or income, investors are likely to still favour equities for their high dividend yield. The European market for example still offers a yield of c.3.5%.
- **'Defensive & early cyclicals':** This theme is particularly relevant to the US and EU. In the US, we have a key preference for Technology while in Europe we favour the more domestic focussed players and Industrials.

Risk to our view. Equities have continued to climb the wall of worry. EM equities have rallied as fears of a hard landing in China and tapering eased. In DM, the markets continue to get unprecedented support from central banks in the form of QE and low interest rates. Kicking the 'debt ceiling can' down the road has also been supportive. Should underlying economic growth disappoint, however, and/or monetary policy unexpectedly tighten, equities may start to underperform. With this in mind, we advocate investors consider having a balanced approach, maintaining diversity and a focus on stock specific drivers, rather than just chasing the momentum.

Conclusion: We continue to prefer equities to bonds and would suggest underweight investors consider averaging into equities, with a focus on Developed markets.

26. Performance of Commodities YTD* (USD)

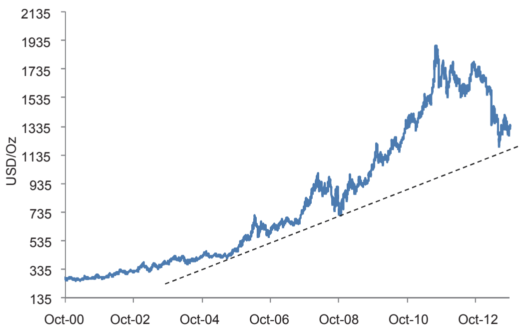


For the period 31 December 2012 to 25 October 2013
Source: DJUBS, Bloomberg, Standard Chartered

DJUBS, DJUBS Agri, DJUBS Precious metals, DJUBS Energy, DJUBS Industrial metals

27. Break below long-term trendline would be very negative for gold

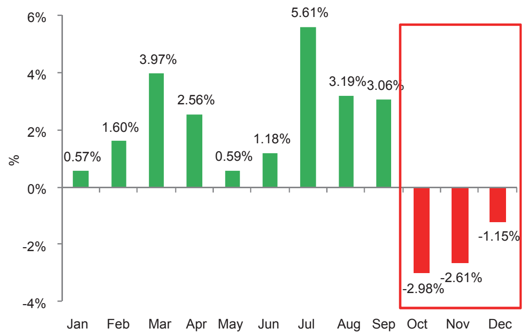
Gold spot (USD/Oz)



Source: Bloomberg, Standard Chartered

28. We are entering a seasonally weak period for oil prices

Average monthly performance of crude oil from 1988



Source: Bloomberg, Standard Chartered

Commodity – Underweight

We remain Underweight commodities. A potential delay in Fed tapering may be a short term positive for select commodities, but gold's disappointing performance during the US debt ceiling debate, in particular, raises doubts on the extent of any potential strength in commodities. Oil may fail to support the broader asset class due to seasonal weakness. Continued uncertainty in China remains an overhang. (26)

We remain Underweight gold. There is a risk prices may strengthen somewhat in the short term as a weaker US Dollar and a likely delay in Fed QE tapering support the metal. However, a large part of this move may have already occurred, suggesting further upside may be limited to key resistance at USD 1360 or, at the most, USD 1420. A break below the long-term trend-line (see Chart 27) would be, technically, a very bearish outcome for gold.

Longer term, we maintain our Underweight and bearish view on gold:

- The inflation-adjusted price of gold remains very high, inconsistent with the low level of US inflation
- Rising equity returns and bond yields over the longer term will likely continue to raise the opportunity cost of holding gold
- Geopolitical concerns have, thus far, provided little support. Gold's disappointing performance over the course of the US debt ceiling, in particular, suggesting risk aversion may not be a significant source of support.
- Long-term US dollar strength would also work against the metal

We remain Neutral on industrial metals. Still high inventory levels and the lack of any significant turnaround in final demand remain key risks. A delay in Fed tapering may prove to be supportive in the short term, but this impact alone is likely to be only temporary.

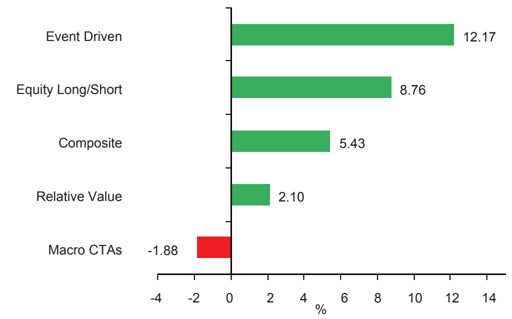
We remain Overweight oil, but expect prices to remain largely within their 3-year range. Demand and supply data remain well-matched for now. A delay in Fed tapering would likely be temporarily positive for oil, but keep in mind we are entering a seasonally weak period for oil prices (see Chart 28). Together, they point to a fairly balanced outlook for oil.

We remain Neutral agricultural commodities. Smaller-than-expected planting intentions in the US (i.e. smaller acreage than expected) proved to be initially supportive for most agricultural commodity prices. Indonesia's intentions to redirect some crude palm oil output towards domestic biodiesel may place upward pressure on palm oil prices. Total demand, however, remains subdued which, in turn, is likely to keep a lid on agri prices.

Conclusion: A delay in Fed tapering is positive for commodity prices in the short term, but still high inventories (metals), seasonal weakness (oil) and very high inflation-adjusted prices (gold) are likely to continue weighing on commodities over a longer time horizon.

Standard Chartered
Here for good

29. Performance of Alternative Strategies YTD* (USD)



** For the period 31 December 2012 to 24 October 2013*
Source: HFRX, Bloomberg, Standard Chartered

HFRX global hedge, HFRX equity hedge, HFRX event driven, HFRX relative value, HFRX macro/CTA

Medium term
refers to a time horizon of 6 to12 months

Short term
refers to a horizon of the less 3 months

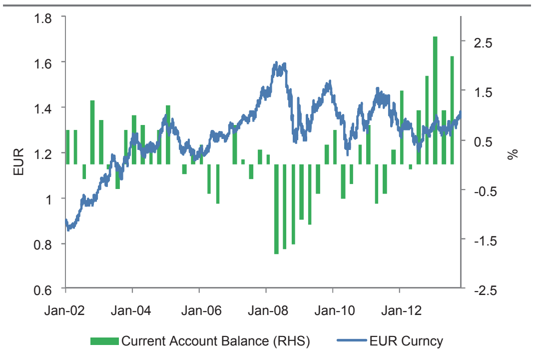
30. USD likely to remain within long-term sideways range

DXY Index

Source: Bloomberg, Standard Chartered

31. Current account surpluses have been a key source of support for EUR

EUR currency and Euro area current account balance(%)



Source: Bloomberg, Standard Chartered

Alternative Strategies – Overweight

We remain Overweight Alternative Strategies, based on our view that the asset class offers exposure to our preferred asset classes, but with the possibility of lower volatility. A diversified approach offers attractive exposure by itself, but equity long/short offers an alternative way of gaining exposure to equities, our preferred asset class. (29)

Diversified exposure to Alternative strategies remains attractive, in our view. A basket of alternative strategies offers the potential of a lower level of volatility (relative to equities) and somewhat limited sensitivity to rising interest rates. We view both these characteristics as attractive in an environment where interest rates may continue trending higher over the long term and the outlook for some regional equity markets remains uncertain. Equity long-short and event-driven strategies remained the top-performing strategies both year-to-date and for the full month of September.

We see equity long/short strategies as attractive for investors uncomfortable with accepting the volatility associated with long-only exposure. These strategies can be interesting for investors wanting to raise equity exposure to benefit from what we view to be an attractive long-term trend, but are uncomfortable with the inescapable volatility associated with a long-only position.

Conclusion: Maintain Alternative Strategies Overweight. Favour diversified exposure and equity long-short strategies both as portfolio diversifiers and for lower volatility relative to long-only equities.

Foreign Exchange

USD – We are moderately bullish on the USD in the medium term

We remain moderately bullish on the USD, but acknowledge the currency may remain weak in the short term. The economic impact from the temporary US government closure and relatively disappointing recent economic data is likely to mean Fed tapering is delayed. While the USD may have already largely priced this in, we are conscious that negative momentum poses the risk of further weakness in the short term. (30) Beyond that, however, we continue to believe tapering of QE purchases is still likely in 2014. This, together with our expectation for gradually higher Treasury yields, causes us to maintain our medium term bullish view.

EUR – We are moderately bearish in the medium term

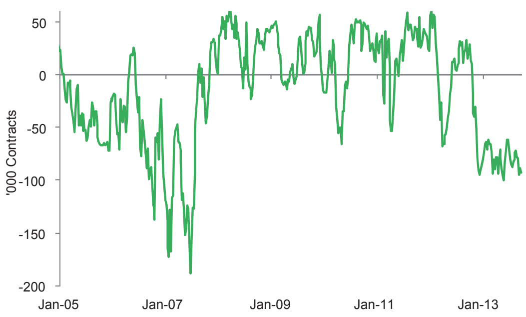
EUR strength may persist largely due to USD weakness in the short term. A strong current account balance and rising Bund yields countries have also supported to the currency. (31) However, we continue to believe an eventual resumption of Fed tapering expectation and likely European policymakers preference to keep lower rates for longer than the are likely to weigh on the currency. We therefore maintain our medium term bearish view on the Euro.

GBP – We are medium-term bearish

Inexpensive valuations and USD weakness are likely to offer some short-term support to the currency. However, we continue to believe continued monetary stimulus is likely needed to meet unemployment goals, which is medium-term bearish for the currency. Elevated inflation remains a key risk.

32. Market positioning strongly net short the JPY

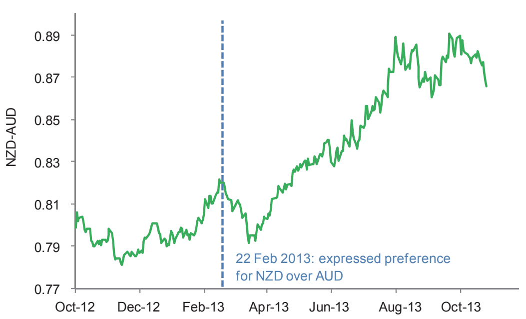
JPY non-commerical future positions



Source: Bloomberg, Standard Chartered

33. NZD outperformance over AUD has likely run its course

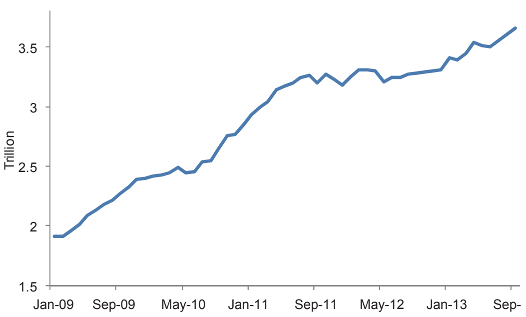
NZD-AUD pair



Source: Bloomberg, Standard Chartered

34. Rising China FX reserves suggest appreciation pressure remains in place

China foreign exchange reserves



Source: Bloomberg, Standard Chartered

JPY – We are medium-term bearish

Extreme net short market positioning and Japan's decision to raise the consumption tax poses the risk of short-term Yen strength. (32) However, we continue to believe the Bank of Japan is likely to act to defend its inflation goal if growth suffers. We, therefore, remain comfortable with a long-term bearish view on the currency.

AUD – We are medium-term bearish

Extreme market positioning has largely corrected following the currency's recent bounce. While we believe the RBA is likely to continue favouring a weaker currency, the risk of renewed inflation pressure may hold the central bank back from being able to lower rates further. Lacklustre commodity prices are also not a support. **We believe current levels offer an opportunity to reduce exposure to the AUD.**

We have favoured the NZD over the AUD since late February this year, a trade that has performed well so far. However, given Australia's higher inflation outlook, is is likely the yield premium offered by NZD rates over AUD rates has now peaked. (33) We prefer to close this idea at this time.

CNY – We are medium-term neutral

We believe Chinese authorities are likely to maintain a stable Renminbi in the midst of ongoing policy reforms and development of the offshore Renminbi market. It remains our preferred regional currency. (34)

SGD – We are medium-term neutral

The policy decision to maintain 'modest and gradual appreciation' of the currency is in line with our view that the currency is likely to offer relative stability in the region. We maintain a neutral medium-term view on the SGD.

We are medium-term bearish on other Asia ex-Japan currencies

Asia ex-Japan currencies are likely to be one of the key short-term beneficiaries of any potential delay in Fed QE tapering. However, we are reluctant to chase any rally as a large part of these expectations appear to be in the price now following the currencies' recent rally.

Longer-term, we remain concerned about continued external imbalances and debt levels in select countries. An eventual Fed tapering decision poses the risk of renewed volatility amongst the countries facing the largest risks. We, therefore, remain medium-term bearish.

Conclusion: We remain medium-term bullish on the USD and bearish on AUD and Asian currencies.

The likely delay in Fed tapering may lead to further, but temporary, USD weakness. However, a likely eventual resumption of the Fed QE tapering conversation causes us to maintain our medium-term views, even if paths diverge in the short term.

Conclusion

The likely delay in Fed tapering is providing further support for global equities. It is also encouraging investors to continue looking at investments that generate significant income. EM equities may outperform short term on the back of a likely delay in Fed tapering. However, over the longer term, we expect DM equities to outperform as Fed tapering comes back on the agenda. As such, we retain our Overweight on Europe and US equities.

Disclosure Appendix

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