global **market outlook**

This reflects the views of the Wealth Management Group

macro strategy | March 2014

Still in recovery mode

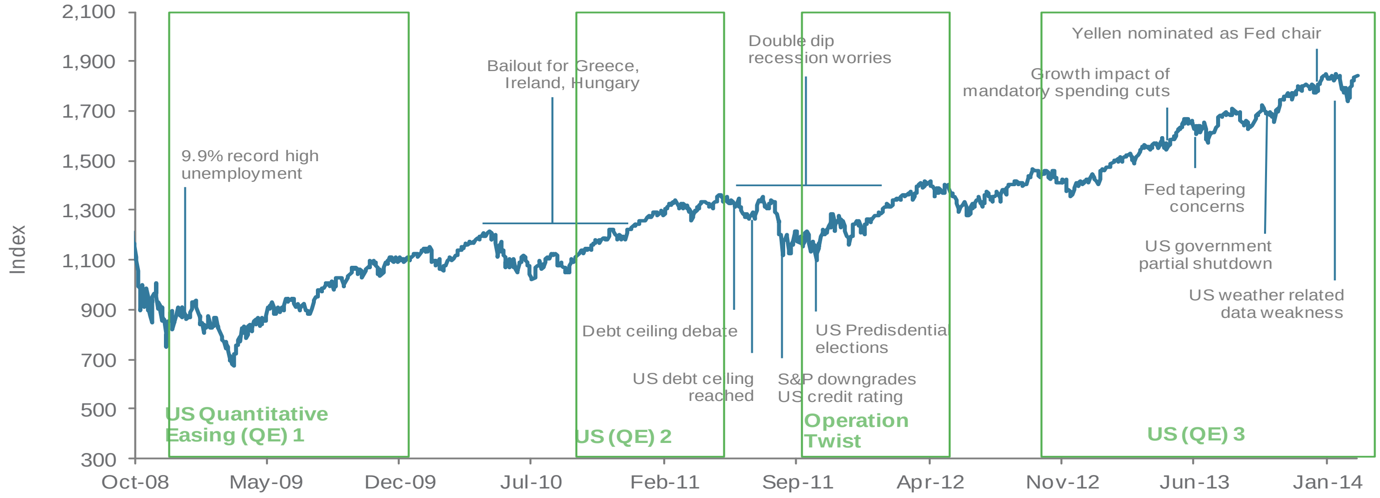
- **The world economy and global equities remain in recovery mode,** despite a disappointing start to the year.
- **US and China economic data has weakened,** the former due to poor weather conditions, the latter due to tight monetary policies. **DM equities took a breather** following a very strong performance at the end of 2013 (up 8% in Q4). **Emerging Market (EM) equities fell** due to fears of contagion from Turkey's deteriorating situation and concerns of a hard landing in China.
- **Despite this, the case for DM equities remains strong.** Growth is expected to accelerate, monetary policy remains accommodative and valuations are not stretched.
- **Our three key 2014 investment themes remain in place:**
  - **Global equities expected to perform well in 2014.** We labelled 2014 as the 'Time to Deliver' on earnings. Both the US and Europe have seen upside surprises in Q4 earnings.
  - **An income-focussed allocation can still generate positive total returns on a 12-month time horizon.**
  - **G3 USD Investment Grade (IG) bonds are expected to generate negative returns**, the strong performance so far this year notwithstanding.
- **Three changes this month** (in the spirit of being A.G.I.L.E.* and taking advantage of market movements)**:**
  - **Onshore Chinese CNY bonds** present a tactical opportunity. Onshore bonds offer a significant yield premium to offshore (CNH) bonds. A short-duration profile is preferred.
  - **We have raised Emerging Market IG bonds to Neutral** after spreads have stabilised.
  - We have raised our weight on **Taiwan** equities to Overweight (from Neutral), **Indonesia** to Neutral (from Underweight) and cut **Malaysia** to Underweight (from Overweight).

Contents

Steve Brice — *Chief Investment Strategist*
Rob Aspin, CFA — *Head, Equity Investment Strategy*
Manpreet Gill — *Head, FICC Investment Strategy*
Adi Monappa, CFA — *Head, Asset Allocation & Portfolio Construction*
Audrey Goh, CFA — *Investment Strategist*
Victor Teo, CFA — *Investment Strategist*
Tariq Ali, CFA — *Investment Strategist*

Bull market still in place

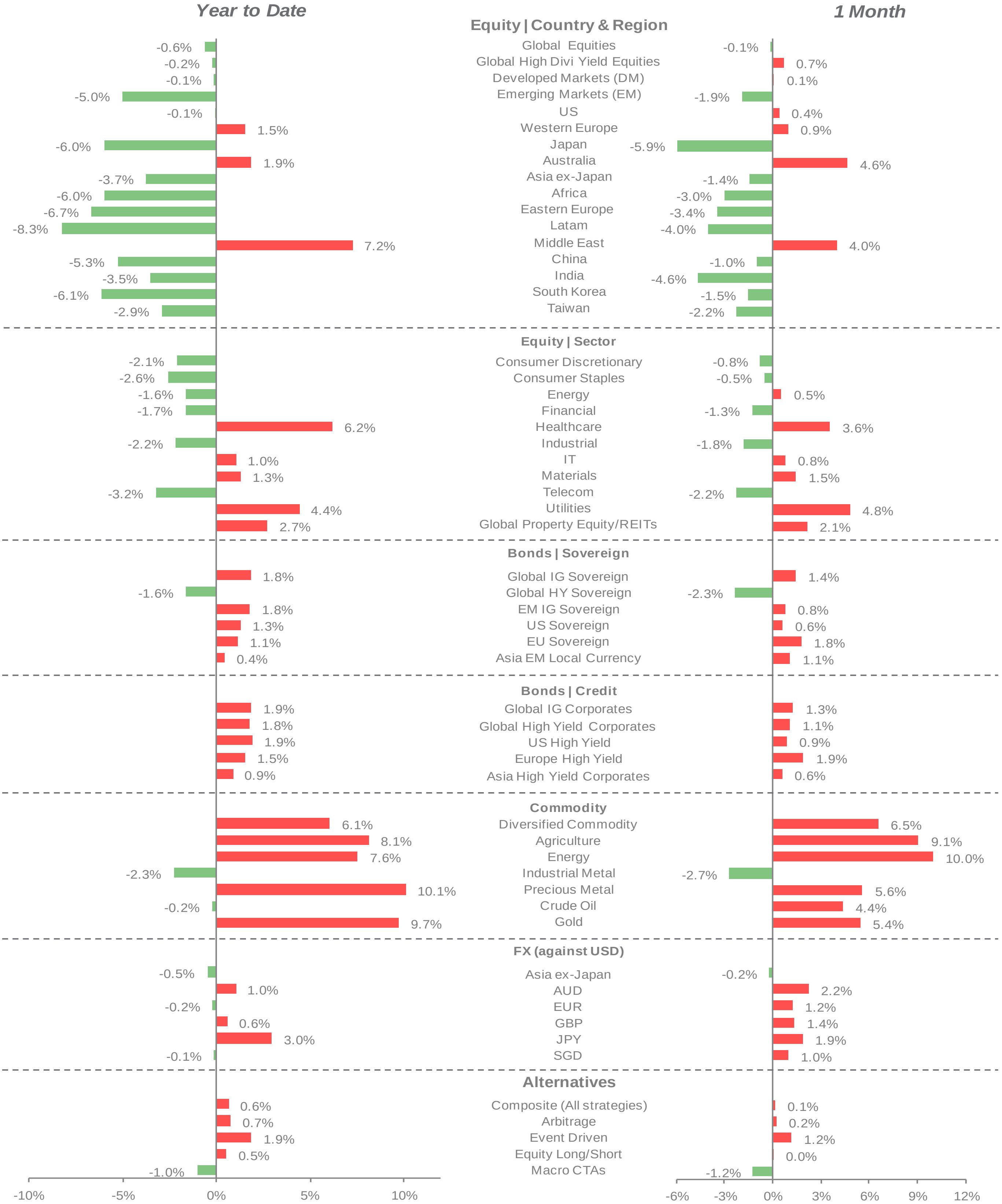
S&P 500



Source: Bloomberg, Standard Chartered

* See Outlook 2014: A Year to be A.G.I.L.E.

Market Performance Summary (Year to Date & 1 Month)*



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

**YTD performance data from 31 Dec 2013 to 20 Feb 2014 and 1-month performance from 20 Jan to 20 Feb 2014*

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

Investment strategy: Still on track

- Equity risk premium still elevated, suggesting **continued global equity market** outperformance relative to global bonds
- **Within equities**, we retain our preference for Developed Market (DM) equities given relative growth prospects and monetary policy divergence
- **Within bonds**, we favour DM High Yield (HY) over Investment Grade (IG). However, we have a strong preference for DM equities over HY bonds

Equity risk premium still elevated. Equity markets had a rough start to 2014, following a very strong performance in December. However, the gap between the equity earnings yield (earnings as a percentage of equity prices) and the US 10-year Treasury yield remains higher than normal. Thus, equities remain cheap relative to bonds. Given the prospect of accelerating global growth, led by the US economy, we believe this should support the outperformance of DM equities. The current DM earnings season, wherein earnings have surprised to the upside, reinforces this outlook.

We favour DM equities to DM HY. Within bonds, we continue to favour DM HY, which is expected to generate low-to-mid single-digit returns over the next 12 months, versus negative returns for the IG bond asset class as a whole. However, we acknowledge the HY bond asset class as a whole is expensive relative to equities. Therefore, we have a strong preference for DM equities relative to HY bonds.

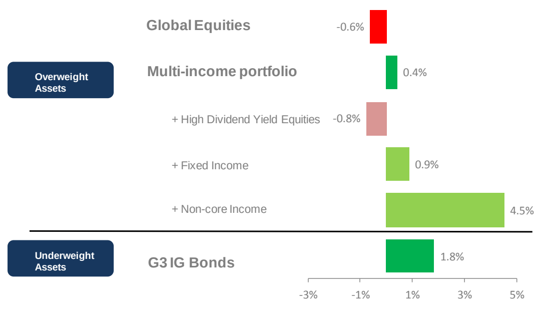
DM equities expected to continue outperforming EM equities. EM growth estimates are still being downgraded, which holds downside risks to earnings estimates. Meanwhile, while EM equity markets have cheapened significantly relative to DM equity markets, they are by no means at extreme levels. We continue to look for EM underperformance in the coming 6-12 months. For us to change our view, we would need to see a shift in relative growth patterns and earnings outlook. This does not look imminent.

Onshore CNY bonds look interesting. We closed our (offshore) CNH bond theme against the backdrop of rising credit risks. However, we have seen onshore yields rising significantly in recent months. We believe this is creating value and expect positive returns for this asset class on a 12-month basis, especially in USD terms. Given concerns around the potential for credit risk contagion, we prefer to focus on short-duration bonds.

We continue to see DM equities as the favoured asset class on a 12-month view. EM equity underperformance is expected to continue, with Turkey and China concerns to continue near term.

A.G.I.L.E. themes regain early losses

*AGILE performance year-to-date**



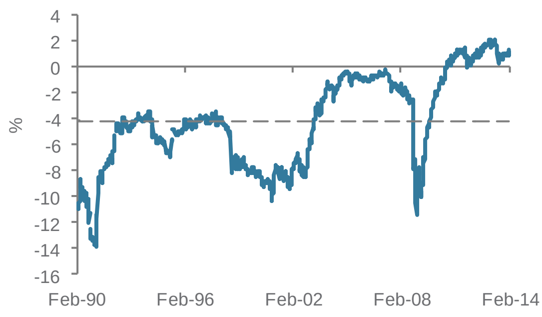
** For the period 31 Dec 2013 to 20 Feb 2014*

Source: Bloomberg, Standard Chartered

** Income basket is as described in the Outlook 2014: A Year to be A.G.I.L.E., Figure 53.*

DM HY bonds expensive relative to DM equities

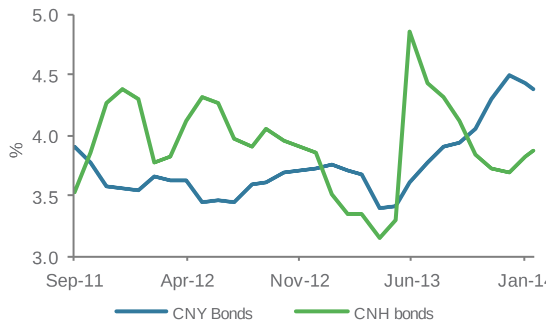
DM equity earnings yield minus DM HY yield



Source: MSCI, Barclays Capital, Bloomberg, Standard Chartered

Onshore China bonds more attractive than CNH bonds

China CNY (onshore) and CNH (offshore) bonds



Source: HSBC, Barclays Capital, Bloomberg, Standard Chartered

Asset Class	Relative Outlook	Start Date
Cash	UW	Feb-12
Fixed Income	UW	Jan-11
Equity	OW	Aug-12
Commodities	N	Nov-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

	Sub-asset Class	Relative Outlook	Start Date
Cash		UW	Feb-12
Fixed Income	DM IG	UW	Jan-11
	EM IG	N	Feb-14
	DM HY	OW	Sep-11
	EM HY	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		N	Nov-13
Alternatives		OW	Jun-13

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

Economic and policy outlook

Data still consistent with a US-led global recovery

- In the **US**, data has weakened a little in recent weeks, but we expect this to be temporary. A reduced fiscal drag – reinforced by the debt-ceiling deal – and a pickup in capital spending are expected to drive faster growth in 2014
- In **Europe** and **Japan**, data points to a sustained recovery, with business confidence remaining firm. However, we are watching bank lending conditions in Europe closely
- In **Asia**, we continue to believe the Chinese authorities do not want too strong a rebound. This is reinforced by the periodic spikes in short-term interest rates

US: Data disappoints, but recovery intact

Labour market data has weakened, but this is likely due to seasonal and weather-related distortions. Most economic data points to a continued recovery.

- **Economy hit by cold weather.** The last two employment reports and the latest manufacturing ISM survey have been disappointing, with the cold weather conditions taking their toll. However, the service sector survey remained robust and a small business survey suggests hiring intentions remain strong. Therefore, we retain our view that the US economic recovery will accelerate in 2014, supported by a strengthening labour market.

Two significant policy hurdles comfortably negotiated

- **The dreaded Fed 'tapering' of quantitative easing proceeded with little fanfare.** Markets had been prepared for the fact that tapering was inevitable. Fed chair Yellen's testimony to Congress highlighted that she favours a similar policy framework to her predecessor. We believe this means that, absent a severe and sustained slowdown in economic activity, the Fed will continue to taper QE at each meeting.
- **The second hurdle of extending the debt ceiling in the US was also cleared smoothly**, with the Republicans apparently deciding they had more to lose from any brinkmanship as we head into the mid-term elections in November.

Focus will shift to when short-term interest rates will rise

- **Focus will shift to when short-term interest rates will rise.** While Yellen is currently playing down this prospect, the outlook for wage inflation is key. We believe that structural factors – eg. retiring baby boomers – are largely responsible for the reduction in the level of labour market participation. This means there is less slack in the labour market than some believe.

  As such, **the risk of rising wage inflation is increasing.** This view is reinforced by a survey that shows small businesses are finding it difficult to fill vacancies and are planning to increase compensation as a result. This risks putting upward pressure on inflation later in 2014. Therefore, we have around a 50% probability the first rate hike will occur by June 2015.

Europe: Rising concerns, but recovery still intact

- **Business confidence remains robust.** Business and consumer confidence data remains consistent with a modest recovery. However, given the importance of the US recovery to economic prospects, the recovery may well weaken slightly in coming months.
- **Bank lending is key.** In our Outlook 2014 publication, we highlighted that while bank lending is still contracting, surveys indicate both the demand for and supply of loans is picking up.

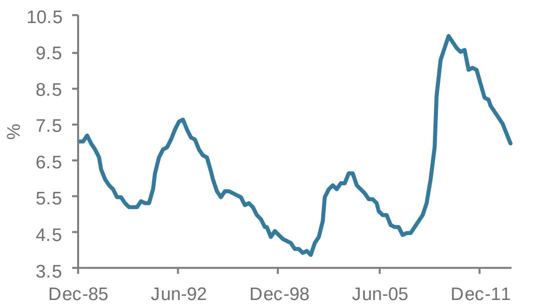
Economic surprises faltering for now
Economic surprise indices – US & Europe

Source: Citigroup, Bloomberg, Standard Chartered

Manufacturing confidence hit by severe weather conditions. Services sector remains robust
US ISM manufacturing and non-manufacturing indices

Source: Bloomberg, Standard Chartered

Spare capacity is falling rapidly
US unemployment rate



Source: Bloomberg, Standard Chartered

Wage pressures starting to increase
US NFIB (jobs hard to fill) & average hourly earnings

Source: Bloomberg, Standard Chartered

The latest bank lending data hints the worst may be behind us. We expect the key bank stress tests and Asset Quality Review to pass smoothly, but they are clearly something to keep an eye on.

- **Inflation likely to bottom soon.** The correlation between US and Europe inflation is high, and we therefore believe deflation fears will subside in the coming 3-6 months. In the meantime, the ECB will be increasingly under pressure to ease policy further. The March policy rate announcement and monthly bulletin will be closely watched for signs of potential policy easing measures.
- **China risk overblown.** One continued concern is the potential contagion of EM weakness on the European economy through both trade and financial linkages. Only if China makes a policy mistake which hits its growth significantly would this undermine Europe's recovery, in our opinion. We believe this is a low risk.
- **Turkey is the key EM risk.** While the Ukraine situation is dominating headlines, we do not believe the economy is big enough to create significant contagion risks. Turkey offers the biggest risk to both Europe and EM contagion, in our opinion. The combination of declining FX reserves, a significant reliance on external debt, a sizeable current account deficit and elections is worrying, especially as we head into local elections at the end of March. The exposure of Greece's economy and the banking sector to Turkey could be an irritant for the Euro area, with Greece facing an EUR 11bn debt repayment in May.

Asia: Japan recovering, positive surprises in Asia ex-Japan wane

Japan:

- **On the attack.** With the markets holding their breath ahead of the consumption tax hike on 1 April, the Bank of Japan recently reinforced its willingness to do whatever is required to ensure the economic recovery continues by increasing the size of a bank lending programme. The government is also calling on companies to increase wages in an attempt to ensure the recovery does not falter. Our central scenario is that a prolonged recession is avoided, but it is possible this is a case of hope over experience.

China:

- **The new normal.** We expect the authorities to keep economic growth above 7% in 2014, but they are unlikely to sanction an acceleration towards 8%. While bank credit rose sharply in January, this is largely due to banks front-loading loans in order to boost profitability. We expect the authorities to retain tight control on credit creation.

  Recent policy announcements have reinforced this outlook, with the PBoC indicating borrowing costs will rise. Meanwhile, President Xi Jinping stated that the government will reduce its focus on regional growth numbers. That said, the authorities will keep a close eye on labour conditions to determine whether a stimulus is required.

Rest of Asia:

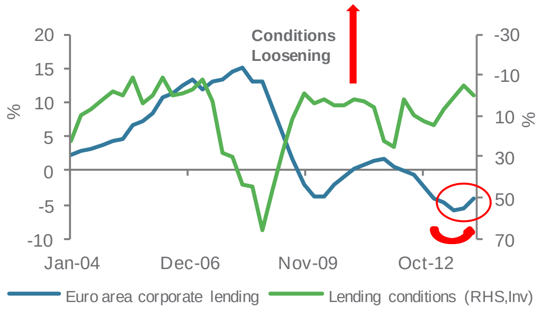
- **Gradual recovery intact.** Most countries are seeing a modest pickup in economic activity. It is likely that we will see a slight softening in the near term on the back of weakness in the US (export data in Taiwan and Korea softened in January), but we expect this to be short-lived. The lack of a strong China rebound will likely cap the recovery for the rest of Asia.

Data, overall, has not been encouraging over the past month, particularly in the US and China. However, we still expect the US to be the key driver of the growth acceleration in 2014. This should reverse the disinflationary trend in the coming months.

Business confidence supported
Euro area manufacturing and services PMI

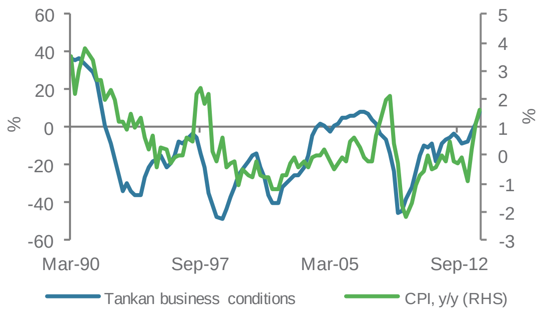
Source: Bloomberg, Standard Chartered

Banks becoming more willing to lend
Euro area corporate lending and lending conditions



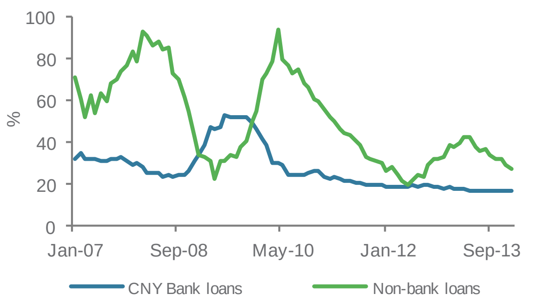
Source: Bloomberg, Standard Chartered

'Abenomics' is working, but is about to face its biggest test yet as the consumption tax is hiked
Japan Tankan business conditions and CPI,% y/y



Source: Bloomberg, Standard Chartered

China still clamping down on credit growth
China CNY bank loans and non-bank loans, % y/y



Source: Bloomberg, Standard Chartered

Fixed Income – Underweight

- We retain our G3 government bonds Underweight. Treasury yields' recent fall was likely temporary
- We raise Investment Grade (IG) Emerging Market (EM) sovereigns to Neutral (from Underweight earlier) following spread stabilisation
- We remain Overweight Developed Market (DM) High Yield (HY). It remains an expensive asset class, but macro catalysts remain supportive

G3 and EM sovereign bonds:

- **10-year US Treasury yield remains well-supported by fundamentals, in our view.** We would not be surprised if yields gradually return to recent highs of 3.0-3.1%. However, recent experience and technicals have illustrated that a strong catalyst is likely required for yields to rise sustainably above this level. Maintain short maturity profiles for now.
- **We raise EM IG sovereign exposure to Neutral (from Underweight).** Spreads widened by about 47bps during the late January sell-off, but have since stabilised. We, therefore, believe the risk/reward trade-off has now become more constructive.

Corporate credit (USD):

- **We believe DM HY credit remains supported by the macro backdrop despite valuations.** It is well known that DM HY bonds are not cheap. Despite this, we believe macro catalysts (low rates, loose lending conditions, low defaults) remain in DM HY's favour. The spread-widening in late January likely provided a much-needed breather.
- **Floating rate loans (FRLs) provide a similar risk-reward profile to HY.** FRLs largely offer exposure to HY credit risk. However, absolute yields on loans are lower than on HY bonds because of their seniority (i.e. they get paid before bondholders in the event of a default) and their floating yield. Given this, a large rise in yields would likely be needed for loans to outperform HY.
- **Total portfolio allocation to HY and loans remains key.** We are not averse to FRL exposure. However, we believe it is key that any allocation to FRLs is made within (rather than in addition to) an overall portfolio allocation towards HY bonds because, ultimately, both provide exposure to HY credit risk.

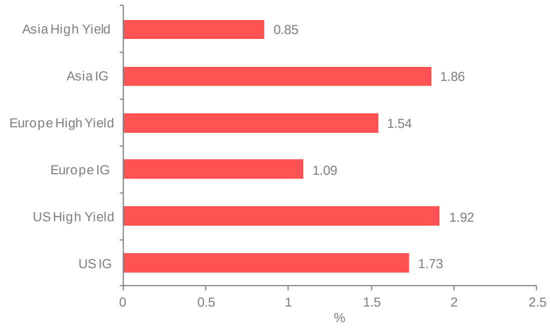
Local currency bonds:

- **China onshore credit markets offer a tactical opportunity.** Short-maturity government bonds offer a reasonable yield, credit spreads are wide, and the CNY is likely to remain stable. Therefore, short-duration, high-quality onshore credit likely offers an opportunity at this time, in our view.
- **EM local currency bond risks remain elevated, but sustained weakness means more of the risks may now be priced in.** With yields now close to 7%, additional FX losses from current levels would need to be sizeable for total returns to turn negative. There may be more volatility in the offing in the short term, but this is an asset class we are watching with interest.

Conclusion

Retain Overweight DM HY. China local bond markets offer tactical opportunity. Maintain G3 sovereign bond underweight and short maturity profiles.

Performance of Fixed income YTD* (USD)



** For the period 31 Dec 2013 to 20 Feb 2014*
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

10-year Treasury yields likely to return to 3.0-3.1%

US 10-year Treasury yield (%)

Source: Bloomberg, Standard Chartered

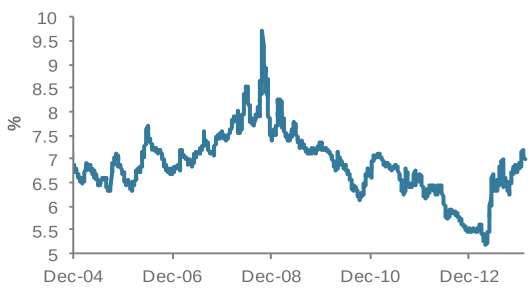
EM IG bond spreads have likely stabilised for now

EMBI IG Broad Diversified spread

Source: Bloomberg, Standard Chartered

EM local currency bonds yields approaching a peak?

JPMorgan GBI-EM broad diversified index, YTM

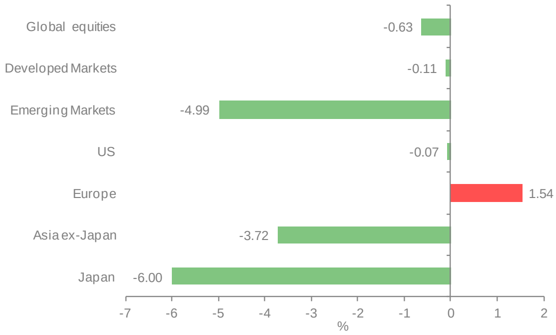


Source: Bloomberg, Standard Chartered

Equity – Overweight

- Our 'buying on the dips' strategy for Developed Market (DM) equities was quickly put to the test. DM equities fell around 6% before swiftly recovering. This is a similar pattern to that seen in 2013
- DM equities continue to look attractive relative to bonds and cash. However, returns are likely to become increasingly dependent on earnings growth and dividend yield, rather than increasing valuations. Thankfully, recent US/Europe earnings releases surprised on the upside
- Emerging Markets (EM) equities are still vulnerable as fears surrounding China's shadow banking system reverberate around financial markets and Turkey faces structural weaknesses at a time when US monetary policy becomes less accommodative
- We continue to prefer the 'defensive cyclicals' (Technology, Energy and Industrials) over 'expensive defensive' sectors (Staples, Utilities and Telecoms)

Performance of equity markets YTD* (USD)



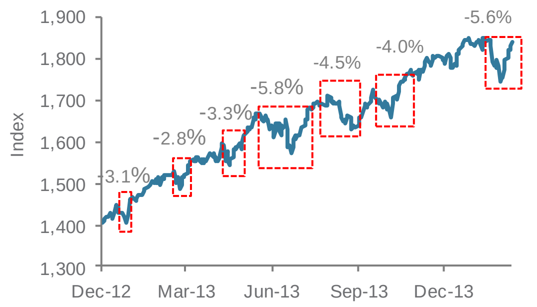
** For the period 31 Dec 2013 to 20 Feb 2014*
Source: Bloomberg, Standard Chartered. Indices are MSCI World TR, MSCI Emerging Markets TR, MSCI USA TR, MSCI Europe TR USD, MSCI Asia ex-Japan TR USD, MSCI Japan TR USD

Is the equity market rally sustainable?

We believe global equities have further upside potential and expect high single-, possibly low double-, digit 'mid-cycle' returns over the next 12 months. This is still well above the returns we expect to see for most other asset classes.

- Valuations are fair and are not yet expensive DM equities still look cheap against bonds, both Investment Grade and High Yield.
- Economic growth, low inflation and central bank liquidity are all supportive for equity returns.
- Earnings expectations have already been revised down and are expected to start levelling off. Recent DM earnings have surprised on the upside.
- While fund managers are overweight, cash balances remain high, giving them the capacity to buy on dips.
- Share buybacks will likely continue to be supportive.
- Many of the excesses we saw in the financial crisis, such as too much consumer and banking leverage, have been largely rectified, particularly in the US; the EU, though, still has a long way to go in this regard.
- Key risk to earnings in the US is a decline in profit margins due to rising wages. This is unlikely to be a major issue this year. In Europe, the key focus will be bank lending data.

'Buying the dip' worked again in February 2014
S&P 500 index



Source: Bloomberg, Standard Chartered

We prefer DM (US and EU) over EM:

Coming into the year, the market has focussed on two concerns: a) the impact of tapering on countries with current account deficits, and b) the risks in China's trust market and thus its economy. We expect these concerns to continue acting as a headwind over the next few months. There are a number of additional factors that explain our preference:

- DM growth outlook is improving relative to EM.
- A stronger USD is expected to negatively impact returns from EM.
- Parts of EM are in a rising-rate environment which is not conducive to high equity returns. This contrasts with most of DM, where central banks are still providing significant liquidity.
- Valuations are not yet compelling in EM. Certainly, they can go significantly lower if there is a broader EM crisis (though this is not our base case).

Earnings growth expectations have been revised down, more so though in EM
12m forward EPS growth

Source: IBES, Datastream, Standard Chartered

Within DM our preferred markets remain the US and EU:

We believe the US and EU still offer the most upside within equities. Within the US and EU, our preferred sectors are Technology, Energy and Industrials. We also like parts of the Financials, Consumer Discretionary and Healthcare space.

Within the EU, we have noticed that the peripheral banks and some weaker areas of the market (parts of Autos and Telcos) have performed relatively well on the expectations of improving economic growth. While we prefer not to take a definitive stance between core vs. periphery, finding opportunities in both, we do like France and are increasingly constructive on Italy and Spain, where sentiment has improved dramatically. While we see the opportunity for further upside here, it is not without higher risk, and we would advocate that investors be prudent across these markets:

- The peripheral banks risk share dilution should they need to raise capital following the ECB stress tests.
- ‘Deep value’ in Europe is starting to perform. While there is plenty of potential upside, the underlying fundamentals are still very weak, and debt levels high, in a number of sectors.

While Japan looks interesting with the expectation that the BoJ is likely going to provide further liquidity, the risks around this market have increased, given the planned increase in consumption tax in April. The recent moves by the BoJ to increase loan growth should be supportive to the equity markets in the short term.

We remain Underweight Asia ex-Japan:

We believe the MSCI AxJ will continue to lag DM. Corporate earnings forecasts have been revised down since December 2013 on the back of very disappointing Q4 results. Also, while the improvement in DM growth could support Asia, it may be offset by a tightening in liquidity and slower domestic growth.

Within Asia, upgrade Taiwan to Overweight. Recent economic data has been positive, with both external and domestic indicators improving. The market has outperformed Asia ex-Japan since the beginning of the year, and we believe this trend is likely to continue.

- Domestic growth has likely bottomed and appears to be firming.
- A further improvement in cross-straits relationships may provide further upside.
- Valuation is inexpensive at c.14 P/E, and we believe the TWD may be less volatile than most other EM currencies.

Upgrade Indonesia to Neutral. We have closed our Underweight. The market is down 18% since we initiated this stance (August 2013).

- The market is no longer expensive at c.13.6x 12-month forward P/E, trading in line with its long-term mean.
- We believe Indonesia’s monetary policy is probably close to the tail end of the rate hike cycle.

Downgrade Malaysia to Underweight on concerns over further ringgit weakness. While the trade balance has improved since May 2013, there are concerns over portfolio flows, which tend to be a larger swing factor on balance of payments.

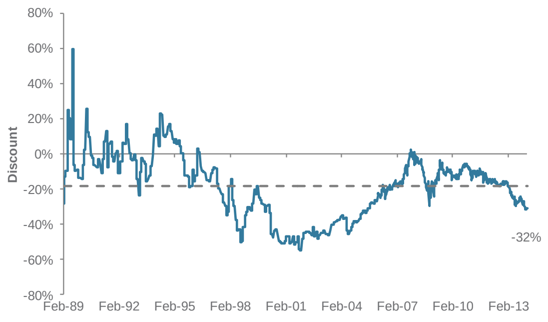
Both Singapore and India are on watch for a possible downgrade to Underweight. Key factors to watch here are elections (India) and domestic wage pressures (Singapore).

Conclusion

We expect DM equities to continue outperforming. While it is a very policy-driven environment and risks persist, earnings growth surprised in Q4, which should help support valuations.

EM is becoming more attractively valued but still too early to go bottom-fishing

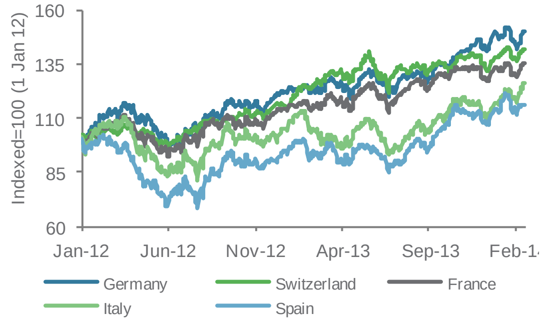
EM valuation at a discount to DM (12m forward P/E)



Source: MSCI, Bloomberg, Standard Chartered

Spain and Italy starting to play catch up

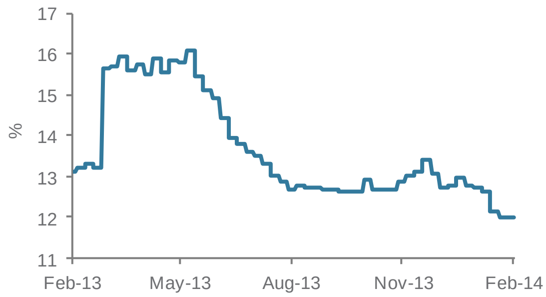
Performance of European countries (from 2012)



Source: MSCI, Bloomberg, Standard Chartered

Earnings expectations for Asia have come off

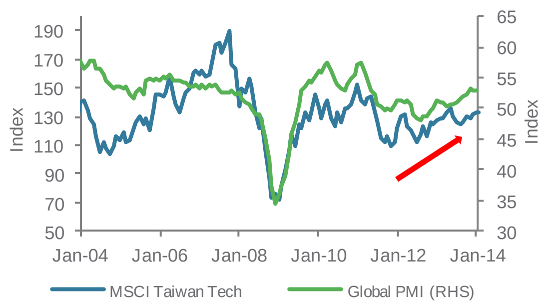
MSCI Asia ex-Japan 12m forward EPS growth



Source: Bloomberg, Standard Chartered

Taiwan technology should perform with rising PMI

Global PMI and MSCI Taiwan Technology index



Source: JPMorgan, MSCI, Bloomberg, Standard Chartered

Commodities – Neutral

- We retain our Neutral view on commodities. Increasingly limited downside risk remains a key theme, with the exception of gold. Sustained industrial metal price weakness over the past year suggests China weakness concerns may be increasingly priced in. The recent uptick in demand is also encouraging. Oil's small rebound is supported by demand, in our view, but we see little that could cause it to break out of its recent ranges.
- On gold, however, we remain bearish. The recent rebound can extend further in the short term, but long-term fundamentals remain largely unchanged, in our view.

We remain Underweight gold. In our view, the recent rebound in prices was driven by a combination of risk aversion (equity market weakness), US dollar weakness and technicals (a break above the 200 DMA). The last factor, in particular, argues that the rebound may hold the potential to extend a little further over the next 1-2 months.

However, we see the current rebound as just another opportunity to continue reducing exposure to gold. We maintain our bearish view on gold because, in our opinion, long-term fundamentals have not really changed:

- The inflation-adjusted price of gold remains very high, inconsistent with the low level of US inflation and inflation expectations.
- Further gains in equity returns and bond yields are expected to continue increasing the opportunity cost of holding gold.
- We continue to expect modest long-term US dollar strength, which would also work against the metal.
- Geopolitical concerns and broader risk aversion have, in recent history, not been a source of support.

We remain Overweight oil. We continue to believe Brent oil is unlikely to break out of its relatively broad USD 99-112 range, where it has held since mid-2013. However, we believe the recent uptick in demand may help oil prices remain elevated close to the upper end of this range.

We remain Neutral on industrial metals. Demand indicators have shown an encouraging uptick. While we would not read too much into one data point alone, the rise is consistent with the view that more of the risks may now be priced in.

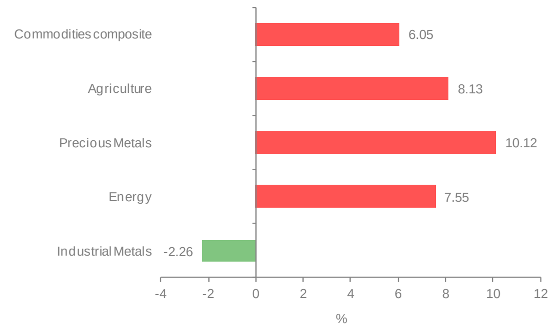
However, inventories remain high (with the exception of copper, where some reduction may have commenced) and there is little reason to expect the growth rate of metals demand to rebound strongly anytime soon.

We remain Neutral on agricultural commodities. Smaller-than-expected planting intentions in the US across most commodities (i.e. smaller acreage than expected) and seasonal strength proved to be initially supportive for most agricultural commodity prices. Total demand, however, remains subdued, which in turn is likely to keep a lid on agricultural prices.

Conclusion

Retain Neutral position on commodities due to more limited downside risk, but strong gains remain unlikely for now. Gold remains our key Underweight, as the recent rebound appears largely technical in nature. Uptick in industrial metals demand is encouraging, but not sufficient to impact prices significantly, in our view.

Performance of commodities YTD* (USD)



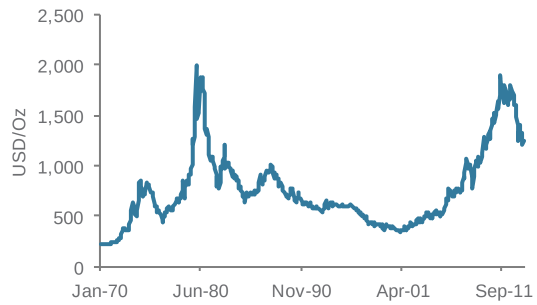
** For the period 31 Dec 2013 to 20 Feb 2014*

Source: DJUBS, Bloomberg, Standard Chartered

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

Gold remains expensive, arguing risks remain tilted to the downside

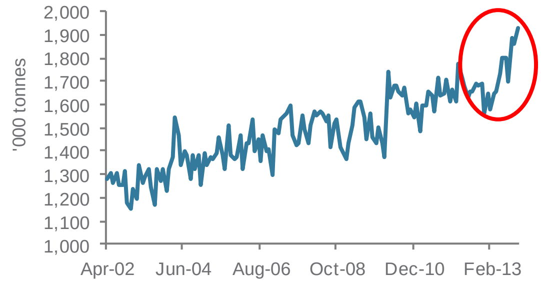
Gold price (USD/oz) adjusted for CPI inflation



Source: Bloomberg, Standard Chartered

Growth in copper demand has ticked higher recently

Copper demand ('000 tonnes)



Source: Bloomberg, Standard Chartered

Alternative Strategies – Overweight

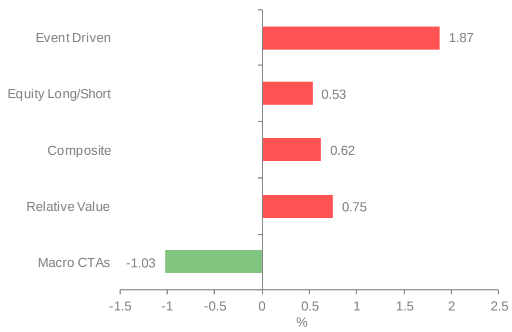
- We remain Overweight Alternative Strategies, based on our view that the asset class offers exposure to our preferred asset classes, but with the potential for lower volatility.
- A diversified approach offers attractive exposure by itself, but equity long/short offers an alternative way of gaining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

We continue to 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. The recent episode of volatility in late January/early February was a great example of an environment when these strategies can outperform. Meanwhile, we are seeing a larger dispersion of stock returns, which creates more opportunities for such strategies to perform well.

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.

Performance of alternative strategies YTD* (USD)



** For the period 31 Dec 2013 to 20 Feb 2014*

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 less than 3 months

Foreign Exchange

USD – We remain bullish in the medium term

We believe recent USD weakness has been a result of temporarily softer economic data and risk-off trades (a result of Emerging Market [EM] volatility). However, in our view, growth momentum in the US remains intact, and we anticipate better data showing continued acceleration in US growth in the coming months. On the same note, we expect the Fed to continue with tapering and largely ignore patchy data. With 10-year yields likely to rise from current levels and inflation expectations remaining subdued, we foresee a continued favourable environment for USD assets.

From current levels, we see the USD strengthening modestly against most major currencies and expect this trend to continue over the medium term.

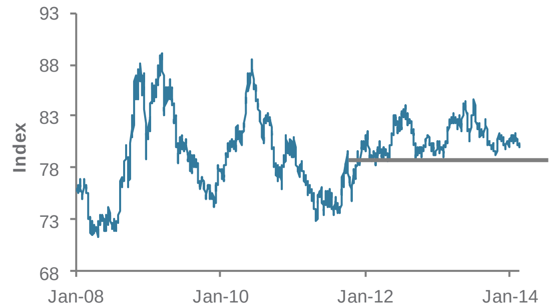
EUR – We remain bearish in the medium term

So far this year, the decline of the EUR against the USD has been modest against the backdrop of strong EU economic data, increasing real interest rates and supportive portfolio flows. The European Central Bank (ECB), in its recent monetary policy statement, deferred further easing until more economic data is available. Given the continued fall in inflation expectations and an uptick in real interest rates, we expect the ECB to remain under pressure to ease policy further in the next 1-3 months.

In the short term, we see the EUR edging lower in anticipation of further easing. We expect the decline to extend moderately on a 12-month horizon on the back of USD strength.

USD index near key support levels

DXY Index



Source: Bloomberg, Standard Chartered

Inflation expectations and interest rates showing a divergent trend

1-year EONIA Swap and 1-year Inflation` Swap

Source: Bloomberg, Standard Chartered

JPY – We remain bearish medium term

Most of the JPY strength seen so far this year is likely the result of the correction of very short JPY market positioning and safe-haven trades amid concerns of slowing growth in China and contagion risks from Turkey. While we continue to see bouts of risk-aversion in EM, we believe the trend for JPY weakness remains in place. Given the recent disappointing GDP growth numbers and the risks surrounding the consumption tax, we see a strong chance of the Bank of Japan (BOJ) moving towards accelerated asset purchases by Q3. This view has been reinforced by the BOJ's moves to support bank lending and signalling its commitment to meeting inflation goals through an accelerated expansion of the monetary base, if required.

In the short term, the JPY may maintain strength if EM volatility remains high. On a 12-month basis, we see the JPY weakening significantly further as monetary easing takes its toll on the currency.

GBP – We remain neutral on the GBP versus the USD, but bullish against the EUR and CHF.

The Bank of England (BoE) has recently shifted its forward guidance from the unemployment threshold alone to broader measures of a continued economic recovery. While the market interpreted the BoE's upward growth forecast revision as positive for the pound, we believe the focus remains on its larger goal of regaining lost output post the crisis. Furthermore, the BoE also cited currency appreciation as a major headwind in the way of economic adjustment. In this context, we see limited further upside gains for the currency against the USD.

We continue to prefer the GBP to the EUR and CHF due to the likely divergence in the direction of monetary policies in the UK and Europe.

AUD – We turn medium-term neutral on the AUD (from bearish earlier).

In our view, the continued improvements in leading economic indicators and uptick in inflation, as well as significant correction in the currency since the beginning of last year, have prompted the central bank to adopt a slightly less dovish stance. The Reserve Bank of Australia (RBA) maintained the cash rate while foreseeing stable interest rates going forward. While we contend there is likely to be a pullback in mining sector investment with unemployment continuing to trend higher, recent economic adjustments in the form of improving terms of trade, increasing exports, consumer spending and business optimism limit downside risks to overall economic activity.

However, we also see limited gains in the AUD against the USD, mainly due to a tepid outlook for commodity prices, slower China growth, and the RBA being wary of an elevated exchange rate. Against this backdrop, we prefer the AUD against the EUR and JPY, where further easing is still on the cards.

CNY – We remain medium-term neutral on the CNY with a bullish bias.

China's external surpluses, strong capital flows and policy reforms are supportive for a stronger CNY going forward. The external growth environment remains supportive, with growth in the US and Europe expected to accelerate in 2014. Against this backdrop, we continue to expect a gradual appreciation of the CNY for the rest of the year. Any weakness, which we witnessed in a limited manner recently, is likely to offer an entry opportunity.

EM anxiety results in USD/JPY weakness

USD/JPY

Source: JPMorgan, Bloomberg, Standard Chartered

GBP near post-crisis highs

GBP/USD

Source: Bloomberg, Standard Chartered

Gap between the AUD and commodity prices has narrowed

AUD/USD and RBA index of commodity prices

Source: Bloomberg, Standard Chartered

SGD – We remain medium-term neutral on the SGD

The SGD has strengthened against the USD over the previous month as a regional safe-haven against the backdrop of increased EM volatility. At the same time, recent economic data has been largely disappointing: exports, PMIs and retail sales have come in lower than market expectations. Nonetheless, we see better prospects for growth in the US and Europe limiting downside for the Singapore economy. Inflation pressure may also decrease going forward as the Fed maintains its pace of tapering. In the short term, USD/SGD may recoup some of its losses following volatility in EM. In the medium term, however, improvement in domestic economic activity may limit significant USD/SGD upside.

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

In our view, fundamentals in Asia ex-Japan have improved compared to the time corresponding to last year's EM sell-off. Current account deficits in India and Indonesia have improved, while growth in Malaysia has picked up. At the same time, we believe tapering has largely been priced into currency markets and the likelihood of a major sell-off is low. In this regard, a short-term rebound cannot be ruled out, especially in countries where fundamentals seem to be improving. Nonetheless, prospect for slower growth in China, local politics and elections, contagion effects from weaker EMs and market concerns over the timing of the first potential Fed rate hike will likely keep anxiety elevated over a 6-12 month period.

On balance, since the risk of volatility remains elevated, we believe the current risk-return trade-off does not favour EM currencies. We prefer to remain on the sidelines for further adjustment. Moreover, a stronger dollar, coupled with better economic prospects in the US and Europe, should keep net EM fund-flows contained.

Conclusion

We remain medium-term bullish on the USD and bearish on the JPY, EUR and Asia ex-Japan currencies. We raise our view on the AUD to neutral (from bearish earlier).

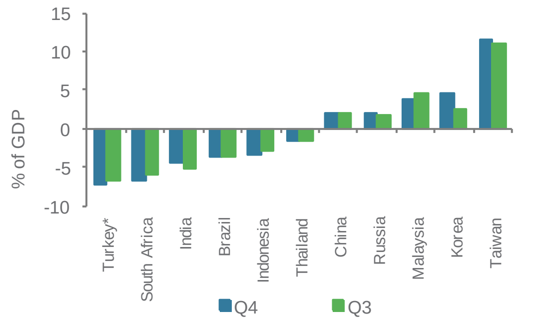
Conclusion

Risk assets have had a difficult start to the year. In Developed Markets (DM), this is largely due to markets taking a breather after a very strong performance in Q4 and US economic data weakening. In Emerging Markets (EM), continued concerns about a hard landing in China and the fragility of certain EM countries (especially Turkey) led to continued underperformance.

We expect DM equities to recover from here as growth reaccelerates, DM central banks continue to provide ample liquidity and earnings recover. We are more cautious on the outlook for EM equities as central banks remain on the defensive, growth forecasts continue to be revised lower and contagion fears remain elevated.

Large EM current account deficits still remain a worry

Major emerging market current account balances



Source: Bloomberg, Standard Chartered

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