Standard Chartered

global **market outlook**

This reflects the views of the Wealth Management Group

macro strategy | 25 April 2014

More constructive on Asia

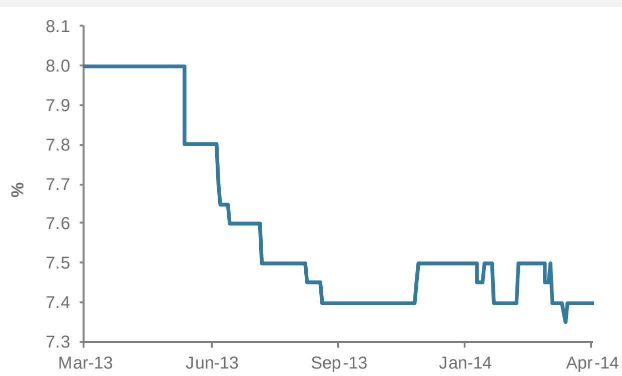
A question that crops up often during our presentations to clients is about the key risks to our preference for Developed Market (DM) equities over Emerging Market (EM) equities. We believe the key risk is a strong rebound in EM equities (rather than weakness in DM equities) on a 12-month view. While it is too early to completely scale back our preference for the US and Europe, we believe Asian markets are increasingly pricing in a lot of bad news. We raise Asia ex-Japan equities to Neutral.

- **US recovery extends, Asia disappointments expected to fade.** The US economy continues to rebound from weather-related weakness. Chinese data has continued to disappoint, but economic disappointments are at post-2009 lows. Growth expectations have already fallen significantly. We doubt we will see significant downward revisions from here.
- **Watch the Fed.** We have seen a slight shift in US monetary policy rhetoric. The key question relates to the magnitude of spare capacity in the US labour market. We believe wages are likely to accelerate in the next 6-12 months, which could bring forward the expected timing of US interest rate hikes to Q1 2015.
- **Entering a seasonally challenging period.** Investors are likely to be nervous as we head into May. Technicals are looking slightly stretched for global equities. However, there is still significant cash on the sidelines and the fundamentals remain supportive, suggesting any weakness should represent a buying opportunity.
- **Asia fundamentals improve, US interest rate cycle a key test.** Growth expectations have already been adjusted significantly, trade deficits have narrowed and political developments have been relatively smooth. We are becoming less concerned about the outlook for Asian assets as a whole and raise Asia ex-Japan equities to Neutral from Underweight.
- **Remain underweight on global bonds.** We prefer DM high yield (HY) bonds, but returns are likely to be modest. EM HY bonds are starting to look more attractive, but we remain Neutral for now.
- **CNY weakness likely a short-term phenomenon.** Our preference for short-maturity CNY bonds remains intact, but we are increasingly constructive on CNH bonds as well.

Contents

China growth forecasts have already adjusted significantly

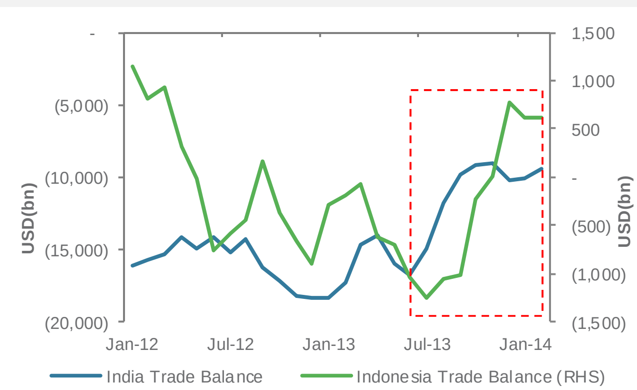
China consensus GDP forecast for 2014



Source: Bloomberg, Standard Chartered

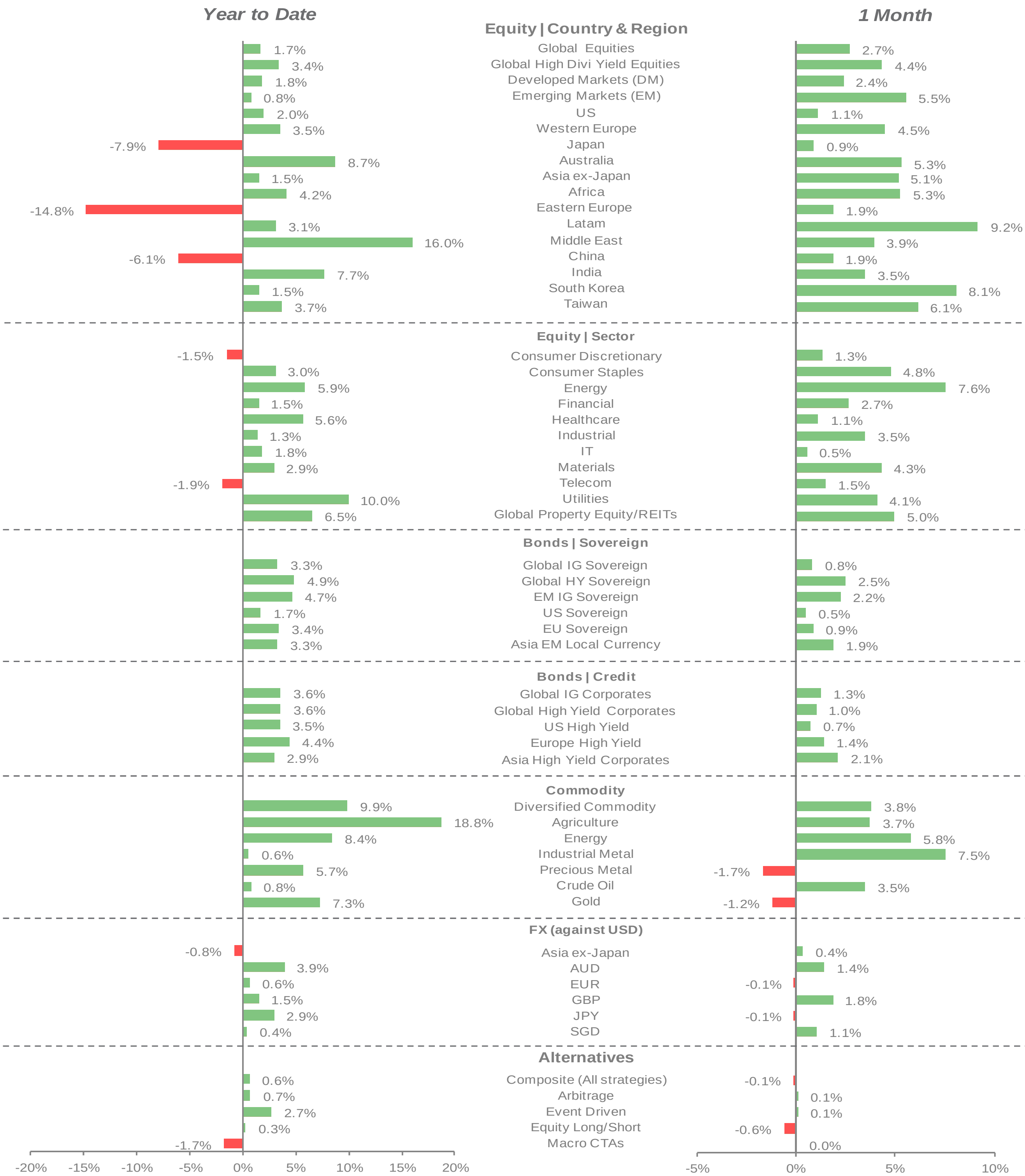
Trade deficits have narrowed in some Asian countries

India and Indonesia monthly trade balances (3mma)



Source: Bloomberg, Standard Chartered

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 24 April 2014 and 1-month performance from 24 Mar to 24 April 2014*

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

Investment strategy overview

- **Equities still the preferred asset class.** Global equities are still our preferred asset class on a 12-month time horizon. We are entering a seasonally challenging period, but significant cash on the sidelines and positive fundamentals suggest any pullback should be limited.
- **More constructive on Asia ex-Japan equities.** Asian assets have priced in significant bad news and there are signs of improving fundamentals. We raise Asia ex-Japan equities to Neutral on a 12-month view.
- **Within bonds, we continue to prefer Developed Market (DM) high yield,** though we are becoming more constructive on EM bond asset classes.

Global equities still preferred to global bonds. We are entering a period where equities have historically faced a challenging time, both seasonally and during the US mid-term election years (see chart). Technicals too are suggesting limited near-term upside, implying that the possibility of short-term weakness is greater than normal.

Longer term fundamentals still positive. Growth is accelerating, monetary policy is likely to remain relatively accommodative and history suggests DM equities have the potential to re-rate as long as inflation remains benign (see last month's Global Market Outlook for more details). In summary, we still expect US and European equities to generate low double-digit returns on a 12-month basis. Therefore, we believe any weakness in the coming months would be a good opportunity to increase exposure.

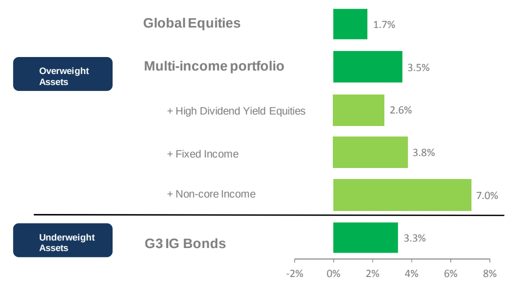
More constructive on Asia ex-Japan equities. Our Underweight on Asia ex-Japan equities was due to 1) deteriorating growth prospects, 2) significant trade deficits, 3) the upcoming elections, and 4) the forthcoming US rate hiking cycle. We have seen progress in most areas (see table), as growth expectations have already fallen significantly, trade deficits have improved somewhat and recent political developments have been reassuring. The key question is whether the above improvements will mitigate the impact of the Fed tightening cycle on Asian currencies. A case can certainly be made that the risks are lower than they were a year ago when then-Fed chairperson Bernanke started talking about 'tapering'. We have raised Asian equities to Neutral from Underweight on a 12-month view while acknowledging the risk of short-term volatility.

CNY and CNH weakness likely temporary. We prefer onshore bonds with a short maturity profile, but the rise in CNH (offshore) bond yields means this asset class is starting to look attractive again.

Our raising of Asia ex-Japan equities is in line with the spirit of the need to be A.G.I.L.E. as we go through 2014. We expect further changes over the rest of 2014.

A.G.I.L.E. themes off to a slow start to 2014

*AGILE performance year-to-date**



** For the period 31 Dec 2013 to 24 April 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.*

US mid-term election years demonstrate 'sell in May' phenomenon

Average performance of S&P 500 for mid-term election years, since 1930

Source: Bloomberg, Standard Chartered

Asia scorecard shows an improvement

*Risk factors for Asia ex-Japan equities and how much progress has been made**

Asia ex-Japan Scorecard	
1	Declining grow th expectations
2	Significant trade deficits
3	Upcoming elections
4	US rate hiking cycle

Source: Standard Chartered

**Shaded area conveys our subjective assessment of the degree to which risk has been priced in by the market*

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	N	Apr-14
	Other EM	UW	Aug-12
Commodities		N	Nov-13
Alternatives		OW	Jun-13

Economic and policy outlook

Data still consistent with a US-led global recovery

- In the **US**, data continues to rebound from weather-related weakness. The focus is likely to shift to when the Fed will tighten policy, especially if wage inflation accelerates.
- In **Europe,** data points to a sustained recovery, with business confidence remaining firm. Bank lending is expanding at last. Japanese confidence is wavering, though, as the consumption tax hike takes effect.
- In **Emerging Markets (EM)**, China data has been very weak, but we doubt it will get much worse from here. EM political news has generally been reassuring, especially in Asia.

US: Fed to watch economic acceleration with interest

Recent data consistent with accelerating economy. Labour market data, particularly wage data, is key going forward.

- **Labour market is strengthening.** Net job creation remained strong in March, bringing the 3-month average to 178k from 142k in February. February's decline in the average workweek was more than reversed in March, and new unemployment benefit claims fell to the lowest level since 2007. All this points to significant strength in the labour market which should support consumer spending.
- **Fiscal policy and corporate spending to support recovery.** Reduced fiscal tightening in 2014 remains a big positive for growth. Meanwhile, a decline in policy uncertainty looks likely to continue supporting business investment, according to regional business confidence surveys. The upbeat prognosis is also supported by ISM surveys, which have rebounded in the past couple of months.

From tapering to tightening

- **Fed expected to hike rates in Q1 2015.** The recovery in US economic activity is expected to shift attention to when the Fed will tighten policy, especially as we approach the end of 'tapering' (quantitative easing is expect to end in October).

  The key uncertainty is the amount of spare capacity in the labour market. Some point to a fall in the level of labour market participation and suggest that, as economic conditions improve, people will re-enter the labour market.

  The counter argument is that the decline in the participation rate is largely structural in nature and that the unemployment rate is a truer reflection of the spare capacity in the labour market. We fall in the latter camp and have brought forward our expectation for the timing of the first US interest rate hike to Q1 2015 from Q2, well ahead of the current market expectation of September 2015.

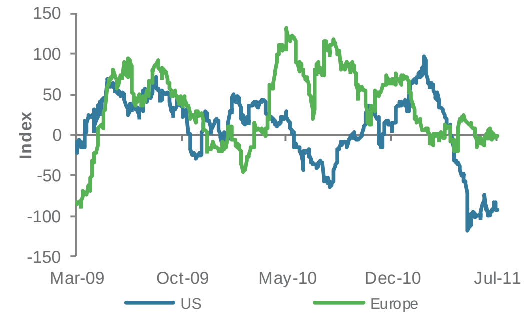
  A potential catalyst for changes to interest rate expectations is wage inflation. Thus far, wage inflation has been benign. If we were to see an acceleration, then the Fed would likely become more worried about being too complacent on the inflation outlook. We believe it is just a matter of time before wage pressures increase, based on survey data from small businesses about how difficult it is to fill vacant positions and on their intentions to increase wages.

Europe: Quietly moving in the right direction

- **Economy still resilient.** Economic data is pointing to a continued recovery, though the pace of recovery is lacklustre and hardly uniform across countries. The good news is that bank lending has finally started to expand, which reinforces a reasonably

US economic surprises likely bottoming

Economic surprise indices – US and Europe



Source: Citigroup, Bloomberg, Standard Chartered

Business confidence surveys improving

US ISM manufacturing and non-manufacturing indices

Source: Bloomberg, Standard Chartered

Wages likely to accelerate

US NFIB jobs hard to fill vs. US average earnings, y/y

Source: Bloomberg, Standard Chartered

Commodities move from disinflationary to inflationary force

DJ-UBS commodity index, y/y %

Source: DJ-UBS, Bloomberg, Standard Chartered upbeat prognosis. Export data has, thus far, been lacklustre, but we expect this to improve as the effects of the US recovery are felt internationally.

- **Inflation remains too low for comfort.** We continue to expect inflation to rise gradually in H2 2014, with commodity prices becoming less of a disinflationary force. The ECB is becoming impatient, especially given the continued strength of the EUR. However, we expect any policy response to be limited in nature unless EUR/USD moves into the 1.45-1.50 area.

Japan: A holding pattern

- **Data over the next two months key.** Markets are holding their breath to see how bad the data will be for April and how quickly the economy will rebound. Consumer confidence has weakened considerably in recent months, while business confidence has been mixed.
- **Policy response critical**. The Bank of Japan has been reasonably upbeat in its commentary, though this may be an attempt to produce self-fulfilling optimism rather than a real belief that it has done enough. We still believe further policies and reform will be required to sustain the economic recovery. June/July will be a critical period from a policy perspective.

EM: A lot of the bad news is priced in

China:

- **Data weak, but likely to trough soon.** Recent data has remained very weak as indicated by the economic surprises index, which is at its lowest level since early 2009. Meanwhile, as the chart on the front page shows, economic growth expectations have already adjusted significantly. While it is possible this trend will continue near term, we believe we are closer to the end of the growth downgrade cycle than to the beginning. China is likely to become less of a negative going forward.
- **Policy response expected to be piecemeal.** The strength of the labour market is as odds with most of the other indicators, and this suggests policymakers are unlikely to come out with an aggressive policy response. So far, we have seen a mini-stimulus package and support for rural financial institutions. The market is speculating that a monetary stimulus is in the offing, and this is certainly possible. However, even if this were to happen, it should not be interpreted as a signal that policy will be loosened significantly, absent a further significant deceleration in growth.

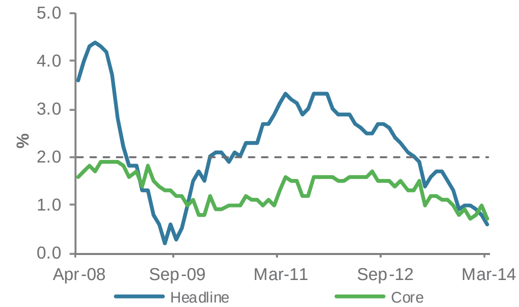
EM elections: Generally positive

- **India: Reforms may dissipate as reality bites.** While there is some cause for optimism, reforms are likely to take considerable time to implement and the stability of the coalition remains key.
- **Indonesia:** The PDI-P and National Democrats joined forces to propose Jakarta Governor, Joko Widodo, as their presidential candidate. The July poll is by no means a foregone conclusion, but Jokowi is the front-runner. This would likely be well received by financial markets.
- **Turkey: Erdogan passes first test.** Local elections saw the ruling AK Party defeating the opposition. Political uncertainty remains elevated ahead of the presidential elections in August.

The global economy continues to recover. We expect markets to bring forward US interest rate hike expectations. In Europe and China, any monetary stimulus may be limited in nature, but the downside risks to their economies look limited from here. Japan is entering a critical period for the success or otherwise of Abenomics.

Inflation key to the ECB policy outlook

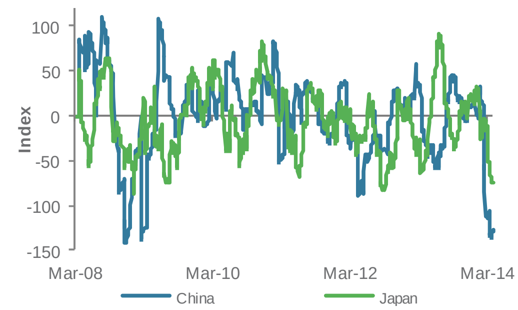
Euro area headline and core inflation



Source: Bloomberg, Standard Chartered

China economic surprises are likely bottoming

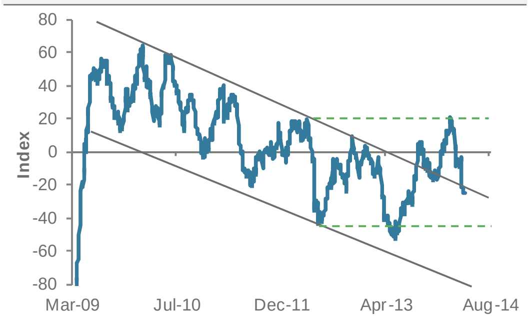
Economic surprise indices – China and Japan



Source: Citigroup, Bloomberg, Standard Chartered

Downtrend in EM economic surprises may have ended

Economic surprise indices – Emerging Markets



Source: Citigroup, Bloomberg, Standard Chartered

Fixed Income – Underweight

- We retain our G3 government bonds Underweight and believe yields will rise over the coming months.
- We remain Overweight Developed Market High Yield (DM HY), but believe risks in Emerging Market (EM) debt are reducing.
- We maintain our preference for onshore CNY bonds, but the rise in CNH bond yields makes us more constructive here as well.

G3 and EM sovereign bonds:

- **We believe there is a growing risk of a rise in USD yields in the coming months.** Despite improving US macroeconomic data and the Fed's own projections of a Fed rate of 1% at end-2015, the market continues to price in an initial Fed rate hike only in September 2015 (see chart on right). We believe the first Fed rate hike will occur much earlier, in Q1 2015. In our opinion, yields will rise as the market brings forward its expectations of Fed rate hikes. We reiterate our preference for short maturity bonds.
- **Take profit on 30-year US Treasuries.** As we noted in the 11 April edition of the *Weekly Market View*, we believe it is time to take profit on ultra-long maturity bonds. However, we continue to expect the spread between the 30-year and 10-year bonds to narrow (ie, the 10-30 year part of the yield curve to flatten). Other parts of the yield curve may flatten on a multi-year horizon, but this is unlikely to commence imminently, in our view.

Corporate credit (USD):

- **Our Overweight on DM HY remains unchanged.** Despite our valuation concerns, we continue to stay Overweight given current lending conditions, default rates and corporate credit quality. Shorter-term, we note DM HY has not been immune from "sell-in-May" seasonality. Over the past four years, spreads widened by 120-438bps (peak-to-trough) during this seasonally weak period, pointing to the risk of a short-term pullback in the months ahead.
- **We remain Neutral EM debt, but believe risks are reducing.** This is most visible in indicators such as current account and trade data. While EM bonds (both IG and HY) have at least partially priced this in, we believe a Neutral (ie, benchmark) level of exposure to EM debt is attractive at this point.

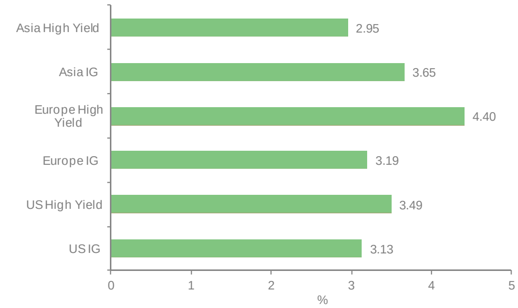
Local currency bonds:

- **Risks to both currencies and local rates may have receded somewhat.** The incremental improvement in select trade and current account balance data in countries such as India, Indonesia and Turkey has seen EM currencies rebound from their lows. We believe risks have reduced, but have not completely receded, especially in light of our view of upside risks to US interest rate expectations.
- **We continue to believe CNY onshore corporate bonds offer the most attractive exposure in local currency markets.** CNY continues to offer one of the lowest volatility exposures to Asian currencies, while the CNY may have already adjusted to the widening of the trading band. Any further policy-induced currency weakness remains the key risk to our view, though the relatively high yields on offer provide a comfortable buffer. While we prefer (onshore) CNY bonds over their (offshore) CNH counterparts, we are also increasingly comfortable with CNH bond exposure.

Conclusion

Retain Overweight DM HY, but watch near-term seasonal risks. China bond markets offer tactical opportunity. Maintain G3 sovereign bond Underweight and short maturity profiles.

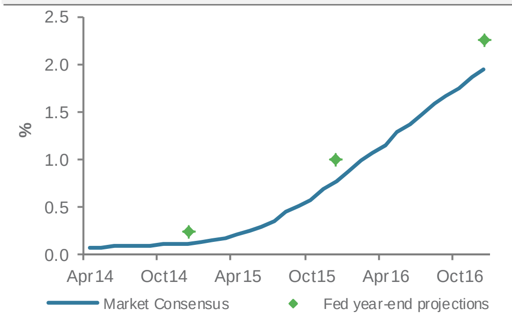
Performance of Fixed income YTD* (USD)



** For the period 31 Dec 2013 to 24 April 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

The market is failing to price in current FOMC policy rate projections

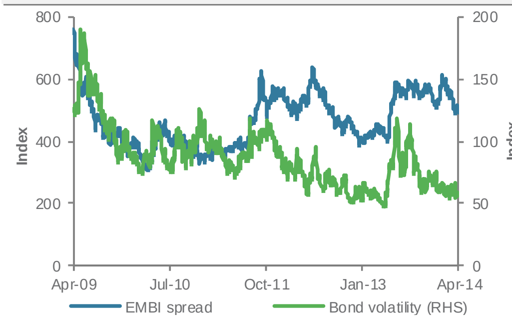
Market (via Fed fund futures) and FOMC projections for the US Fed fund rate



Source: Bloomberg, Standard Chartered

Falling bond market volatility suggests greater room for EM HY bond spreads to tighten

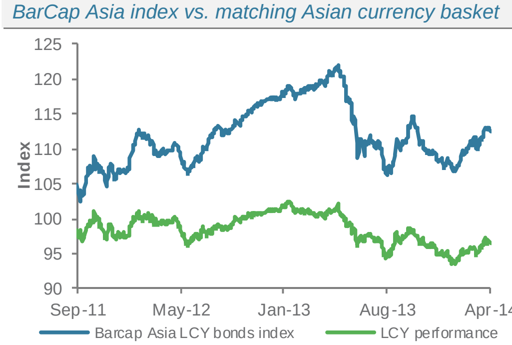
EMBI HY spread vs. bond market volatility



Source: JP Morgan, Bloomberg, Standard Chartered

FX risks to local currency bonds may be receding

BarCap Asia index vs. matching Asian currency basket



Source: Barclays Capital, Bloomberg, Standard Chartered

Equity – Overweight

- Global equities continue to look attractive relative to bonds and cash and remain our key Overweight. While volatility may increase over the next few months, with investors focussing on Q1 results and the possibility of the Fed surprising the market with talk of tightening sooner than currently priced in, we expect US and European equities to produce low double-digit returns on a 12-month view.
- We are raising our view on Asia ex-Japan to Neutral (from Underweight). While China's data continues to disappoint, growth downgrades may be nearing their end. Valuations for the region have improved significantly since we went Underweight.
- As a result of the Asia ex-Japan upgrade, we have a less negative view on Emerging Markets (EM). We feel this is appropriate, given the improvement in the fundamentals and valuations, though volatility may persist in the short term.
- In terms of sector preferences, we are still very comfortable with Technology. After outperforming in Q1, the sector has recently come under pressure, with much of the volatility concentrated in the fairly overvalued parts of technology, such as social media. We continue to prefer Technology, with a focus on software and services which should benefit from the shift to mobile.

Still prefer DM, but upgrading Asia ex-Japan to Neutral

We went Underweight on Other EMs (which is largely Brazil and Russia) in August 2012 and Asia ex-Japan in June 2013. Both calls have worked well, with Developed Markets (DM) outperforming over the respective time frames. More recently, we indicated that while a short-term technical bounce was likely, a final bout of weakness was also likely. We have softened the latter view, upgrading Asia ex-Japan equities to Neutral.

We close our Underweight stance on Asia ex-Japan.

- The position initiated on 21 June 2013 worked well, with the region underperforming global equities by 4.8% even with the recent rally in both Asia local currencies and local bourses.
- Significant downside tail risks have abated, in our opinion, due to 1) strong policy actions taken by the central banks, and 2) improving trade balances, which significantly reduce external funding risks for the fragile Asian economies with current account deficits. The reduction in political uncertainties has also helped, though any positive outcome may be increasingly priced into Indian and Indonesian equities.

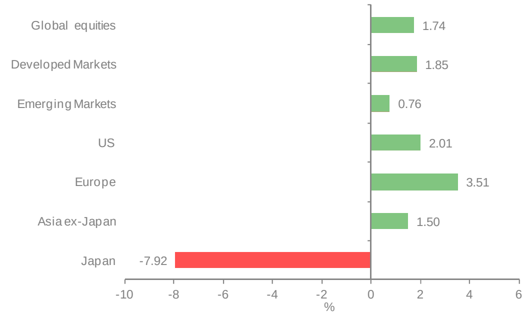
We remain Underweight non-Asia EM. Tensions over Ukraine remain elevated, although Russian equities are very cheap. In the case of Brazil, the market is far from cheap and the political situation is hardly conducive. Therefore, we remain Underweight for now.

Technology is still our key Overweight – but with a preference for the boring old-economy bits of the space

There is a lot more talk that the Technology sector is in a bubble and may significantly underperform. We agree that parts of the sector, such as social media, are very expensive, but the overall sector still trades at reasonable valuations. Furthermore, as we highlighted in a recent Market Watch, the sector offers a number of key positives:

- Cash positive balance sheet overall, which should make it relatively well supported during any significant market sell-off.
- Leveraged to any improvement in the business investment cycle.

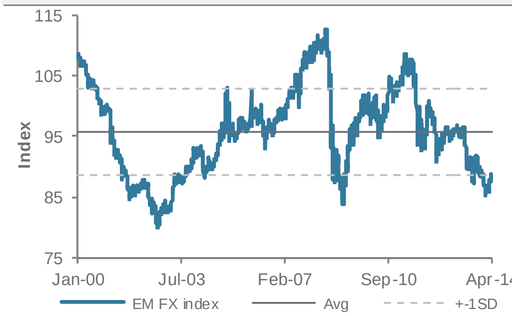
Performance of equity markets YTD* (USD)



** For the period 31 Dec 2013 to 24 April 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

Much of the negatives from Fed tapering are likely priced in

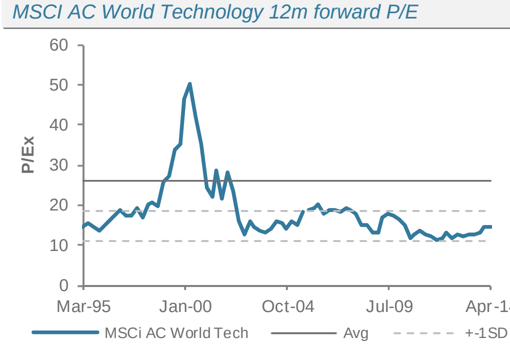
JP Morgan Emerging Market FX index



Source: JPMorgan, Bloomberg, Standard Chartered

Technology sector is not expensive at the index level

MSCI AC World Technology 12m forward P/E



Source: MSCI, Bloomberg, Standard Chartered

- High exposure to EM, where demand growth is structurally strong. Within the sector, we continue to favour Software and parts of the Services space, as well as areas that should benefit from a shift to mobile.

Within Asia ex-Japan, we retain our preference for Taiwan and Korea.

- Our Overweight stance on these two markets is based on expectations that a DM capex recovery, particularly in the US, should be positive for the tech-heavy markets of Taiwan and Korea. Amidst the backdrop of improving capacity utilisation and healthy corporate profits in the US, corporate spending should pick up, in our opinion.
- Both Korea and Taiwan have outperformed Asia ex-Japan year-to-date, the latter more significantly so due to improving earnings revisions on the tech and the consumer sectors.
- Overall, the negative earnings trend in both markets appears to have stopped, with Taiwan earnings being revised up more significantly, while consensus on Korea remains a tad too positive, in our opinion.

China remains a trading market

- We continue to view Chinese equities (Neutral) as a trading market, as authorities support growth with policies during any marked slowdown and take their foot off the accelerator once growth resumes.
- The recent spate of weak data and limited inflation suggests the broader policy setting is currently biased to further easing even against the backdrop of ongoing deleveraging. Already, we have seen selective easing by the authorities (looser lending conditions for rural cooperatives and a mini stimulus for select sectors). Monetary conditions such as interbank rates and the CNY are significantly lower than last year, signalling a less restrictive environment.
- The recent outperformance of China banks may continue into the earnings season in late-April, but we doubt it will be sustained longer term. Rising non-performing loans, falling property collateral values and a peak maturity season for wealth management products in H2 2014 remain key headwinds.

ASEAN and India – growth improvements needed to drive the next rally

- After the initial re-rating from lower risk perceptions, it will likely become increasingly difficult to justify higher valuations unless growth also improves amidst Fed tapering. We are Neutral on Thailand and Indonesia, but have a relative preference for Thailand, given cheaper valuations and the central bank's bias for loose monetary conditions, stalled domestic politics notwithstanding.
- To drive the next leg of the rally, we need to see a pickup in domestic growth and a more cohesive decision-making process on reforms from policymakers. India's general election results on 16 May and the Indonesian presidential elections on 9 July are key.
- We remain Underweight on Malaysia within Asia ex-Japan. The relative appeal for Malaysia is reducing, given more expensive valuations and a poorer outlook relative to other ASEAN peers.

Conclusion

Retain our preference for US/Europe equities, but do not rule out seasonal weakness. Asia ex-Japan offers tactical opportunities on valuation and tentative signs of improving fundamentals.

Asia ex-Japan has underperformed since we made our Underweight call – we now upgrade to Neutral

MSCI AC World and MSCI Asia ex-Japan indices

Source: MSCI, Bloomberg, Standard Chartered

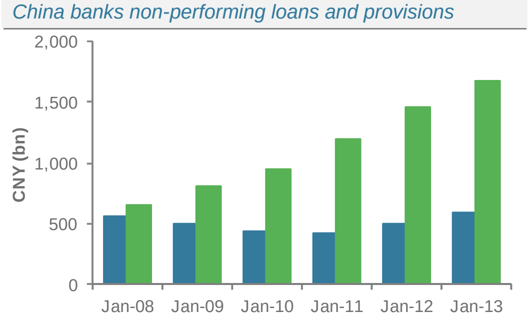
Asia ex-Japan should benefit from a pickup in US growth

MSCI Asia ex-Japan performance, y/y % vs. US ISM manufacturing

Source: Bloomberg, Standard Chartered

Provisions for losses continue to climb on anticipation of a spike in nonperforming loans

China banks non-performing loans and provisions



Source: Bloomberg, Standard Chartered

Commodities – Neutral

- We retain our Neutral view on commodities. The recent rally has been driven largely by agricultural commodities. However, this is not a rally we would chase – many now look very overbought. A modestly stronger USD is also expected to pose a drag on commodity prices, in our view.
- Oil prices (we are Overweight) have remained within their recent range, while gold (we are Underweight) has continued to lack support amidst an absence of demand for safe havens. Little has changed for base metals (we are Neutral) over the past month, both on the demand and inventories side.

We remain Underweight gold. As expected, the precious metal's Q1 rebound was short-lived and prices turned lower from well below USD 1,400/oz. We continue to believe gold prices are likely to move lower by year-end due to the following reasons:

- The inflation-adjusted price of gold remains high. Even a gradual pickup in inflation, as we expect, is unlikely to support gold.
- 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 USD strength, which would also work against the metal.

Expectations for Fed policy, in particular, remain key for many of these factors and, therefore, for gold prices. We note in the Fixed Income section of this document that there is significant room for markets to adjust should the Fed initiate its first rate hike in Q1 2015 (as we expect). This, in turn, is likely to trigger higher yields and a stronger USD, both of which are detrimental to gold.

We remain Overweight oil. Brent oil prices continue to hold within a relatively tight range. While a move to the lower end of this range is possible in the short term, we do not see any obvious near-term catalyst that may push prices out of this range. Longer term, we retain our Overweight as we believe the risk/reward trade-off for oil remains more attractive than gold or industrial metals. However, we expect any gains to be relatively modest unless demand in energy-intensive countries surges.

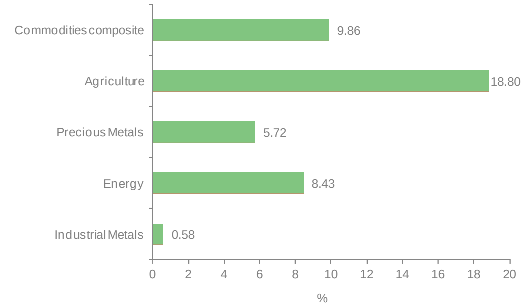
We remain Neutral on industrial metals. Prices rebounded slightly over the past month, led mainly by a few specific metals such as nickel. Bellwether copper prices, however, remained lacklustre. Increasingly subdued price action supports our view that an increasing amount of the bad news is now priced in for a broad cross-section of industrial metals. However, still-high inventories and sluggish demand growth from key markets such as China mean a catalyst to trigger sustained price gains remains absent, in our view.

We remain Neutral on agricultural commodities. Agricultural commodities, led by coffee, corn and wheat, have been amongst the strongest gainers within the commodities space year-to-date. Unsurprisingly, weather was a key driver of these gains – drought-like conditions in Brazil, for example, have been a key driver of coffee prices. While high prices should eventually trigger a rise in production, an increase in acreage can only occur in subsequent seasons, meaning that a drop in prices is unlikely in the short term.

Conclusion

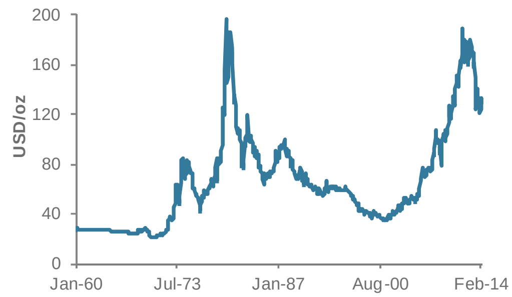
Retain Neutral position on commodities. We continue to believe gold prices have room to fall further from here. The USD outlook remains key to the commodities outlook over the next few months.

Performance of commodities YTD* (USD)



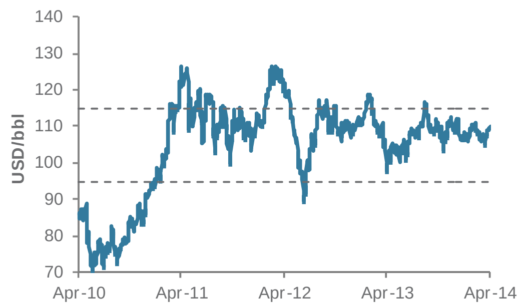
** For the period 31 Dec 2013 to 24 April 2014*
Source: DJUBS, Bloomberg, Standard Chartered
DJUBS, DJUBS Agri, DJUBS Precious metals, DJUBS Energy, DJUBS Industrial metals

Inflation-adjusted gold prices remain elevated
Gold in constant 2013 prices



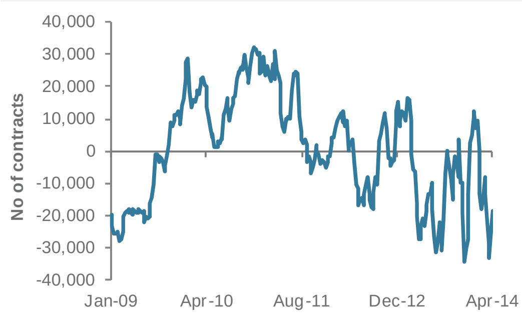
Source: Bloomberg, Standard Chartered

Oil prices likely to remain range-bound for now
Brent crude



Source: Bloomberg, Standard Chartered

Sentiment towards copper is very bearish
Copper net non-commercial positions



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. We believe this may be especially attractive in an environment where the risk of a pullback in equity markets is rising.
- 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.

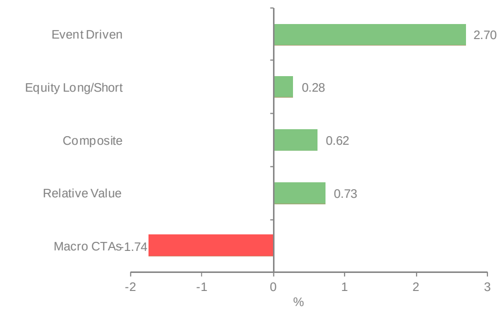
We continue to see equity long/short strategies as attractive for investors who are uncomfortable with accepting the volatility associated with long-only exposure. These strategies can be interesting for investors wanting to raise their equity exposure to benefit from what we view to be an attractive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

A rising risk of seasonal equity market weakness may lead to Alternative Strategies' outperformance in the near term. While we continue to expect equities to outperform over the next 12 months, we believe this performance will be accompanied by more frequent, and potentially larger, pullbacks than in 2013. The fact that we are approaching a seasonally weak period for equity markets means Alternative Strategies may outperform near term.

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 24 April 2014*

Source: HFRX, Bloomberg, Standard Chartered

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

Short term

refers to a horizon of less than 3 months

Medium term

refers to a time horizon of 6 to12 months

Foreign Exchange

USD – We remain medium-term bullish

We believe the USD will resume moderate strength following the recent pullback. Rising US interest rate expectations should be supportive for the USD. Moreover, the significantly improved current account deficit reinforces this outlook.

In the short term, as central banks in Europe and Japan debate further easing, the USD may remain range-bound. We expect greater strength in the USD in 2H, when the monetary policy differential becomes more apparent.

EUR – We remain neutral medium term

ECB Governor Draghi recently cautioned that EUR strength could pose downside risks to inflation, potentially warranting further monetary easing. While the increasing current account surplus, rising real rates, portfolio inflows and central banks increasing EUR FX reserves have kept the currency elevated, deflation risk has not fully abated. Inflation has been trending lower for the last few months, and if this continues, further policy easing may become necessary.

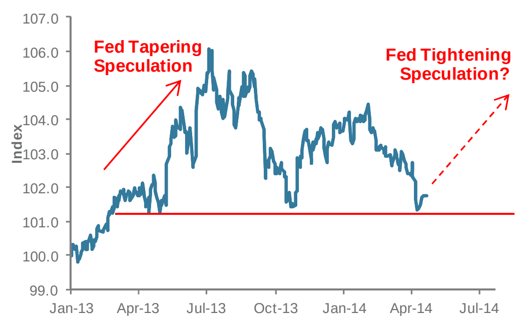
Until more clarity emerges on the monetary policy front, we expect the EUR to remain range-bound.

JPY – We remain bearish medium term

The yen has remained largely range-bound amid demand for safe-haven currencies. Going forward, the key will be the growth impact of the consumption tax hike and the BOJ's response. We believe further policy stimulus will be required to sustain inflation expectations, which, in turn, is likely to trigger further JPY weakness.

USD has likely bottomed near term

*Equally weighted dollar index**

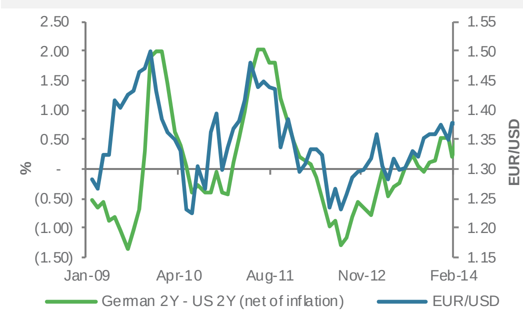


Source: Bloomberg, Standard Chartered

**EUR, JPY, CAD, GBP, CHF, CNH, KRW, BRL, MXN, AUD*

Increasing interest rate differentials in favour of the Euro area continue to support the EUR

German-US 2-year real (inflation-adjusted) interest rate differentials vs. EUR/USD



Source: Bloomberg, Standard Chartered

GBP – We remain medium-term neutral (bearish bias)

The GBP has rallied on the back of continued positive economic surprises and an increasing real (ie, net of inflation) interest rate differential with the US. However, given the expected pickup in US short-term yields and continued focus of BOE on economic slack, we see increased risks of GBP weakness. Furthermore, export growth remains depressed. With inflation continuing to decline and unemployment still significantly high, we do not expect the central bank to be in a hurry to raise interest rates.

AUD – We remain medium-term neutral

The AUD is likely to remain range-bound near current levels, in our view. The central bank has become more tolerant of a stronger currency amidst early signs of an improvement in the labour market. However, weaker inflation does allow the RBA greater room to keep policy loose for longer. Commodity prices, especially those of key Australian exports such as iron ore and coal, have edged up recently, but remain depressed. Further weakness in commodity prices poses a key downside risk to our range-bound AUD view.

CNY – We remain medium-term bullish

While we are cognisant of the fact there may be further short-term volatility, we continue to see the CNY on an upward trending path. Given the extent of depreciation that has already taken place and our view that growth in China may stabilise soon, we believe the authorities are unlikely to favour a weaker exchange rate. In our view, any measures to support weak spots in the economy will be more targeted and are unlikely to involve further weakening of the currency. We posit that the Chinese authorities are unlikely to compromise on long-term reform to the extent that it undermines credibility.

SGD – We remain medium-term neutral

The MAS maintained its tightening policy stance via an appreciation of the trade-weighted SGD. We expect the policy basket to continue to trade in the upper half of the MAS policy band (see chart) as it has done since the establishment of the current monetary stance. Against the backdrop of Fed tapering, we expect the SGD to depreciate modestly against the USD, while strengthening against some of the other currencies in the policy basket.

Other Asia ex-Japan – Upgrade to medium-term neutral (from bearish)

Following the improvement in the external balances in some of the more vulnerable countries in Asia ex-Japan, we have become less concerned about currency risks. While we continue to favour North Asian currencies (the CNY and CNH, KRW and TWD) on the back of a pickup in global growth, we are also increasingly sanguine on South/South East Asian currencies. We note the MYR and IDR remain vulnerable amidst potential Fed tightening due to high foreign ownership of their debit, but we believe improving current account balances and increasingly hawkish central banks have reduced risk. External fundamentals have also improved for the INR. However, the THB may remain under pressure due to political risks and a sluggish growth outlook.

Overall in Asia ex-Japan, we are bullish on the KRW and TWD, neutral on the INR, IDR and MYR and bearish on the THB.

Conclusion

We remain medium-term bullish on the USD and CNY and bearish on the JPY. We raise our view on Asia ex-Japan currencies to neutral (from bearish) and favour KRW and TWD in this space.

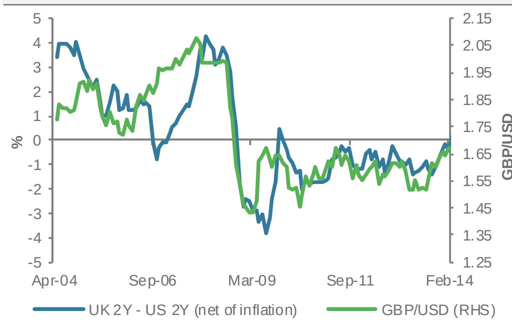
Deteriorating Japan Tankan survey for the retail sector points to downside risks to inflation

Tankan small sector retail outlook and nationwide CPI y/y

Source:, Bloomberg, Standard Chartered

Increasing interest rate differentials driving GBP higher

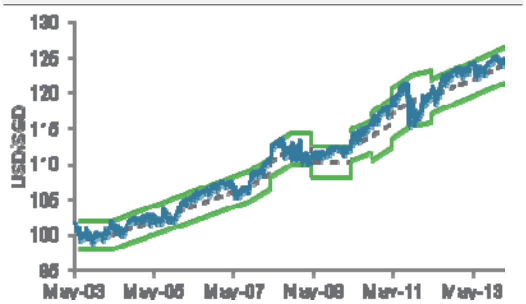
UK-US 2-year real (inflation-adjusted) interest rate differentials vs. GBP/USD



Source: Bloomberg, Standard Chartered

SGD trade-weighted exchange rate expected to trade in upper half of the policy band

SGD trade-weighted exchange rate and policy band



Source: Bloomberg, Standard Chartered

Rise in FX Reserves of India and Indonesia suggests improving external imbalances

India's and Indonesia's net USD FX reserves

Source: Bloomberg, Standard Chartered

Disclosure Statement

Investment involves risks. The prices of investment products fluctuate, sometimes dramatically. The price of investment products may move up or down, and may become valueless. It is as likely that losses will be incurred rather than profit made as a result of buying and selling investment products.

Disclaimer

This document has been issued by Standard Chartered Bank (Hong Kong) Limited ("SCBHK") in the conduct of Hong Kong regulated business. All or any part of this document may not be reproduced or further transmitted, nor should it be distributed in the U.S, Canada or Australia.

This document and its content are not intended and shall not in any way be construed as an offer or solicitation to the public in Hong Kong for the purchase or sale of any product, services, securities, regulated investment agreement or collective investment scheme, or a recommendation to adopt any hedging, trading or investment strategy, nor is it intended to constitute a representation as to future movements in rates or prices or that any such future movements will not exceed those shown in any illustration. This document does not necessarily represent the views of every function within the Standard Chartered Bank, particularly those of the Global Research function.

Whilst every care has been taken in preparing this document, SCBHK makes no guarantee, representation or warranty of any kind, express, implied or statutory regarding, and accepts no responsibility or liability as to its accuracy or completeness. The document is distributed on the express understanding that, whilst the information in it is believed to be reliable, it has not been independently verified by SCBHK. Except as specifically indicated, the expressions of opinions, projections and estimates are those of SCBHK on the publication date only and are subject to change without notice.

SCBHK is not providing any financial or investment advice.

The information set out in this document is meant for general information, reference and evaluation only and has not taken into account your specific investment objects, financial situations, particular needs or your personal circumstances. You should not rely on any contents of this document in making any investment decisions. Before making any investment, you should carefully read the relevant offering documents and seek independent legal, tax and regulatory advice. In particular, you should seek the advice of a licensed financial adviser regarding the suitability of the investment product, taking into account your specific investment objectives, financial situation or particular needs, before you make a commitment to purchase the investment product.

SCBHK accepts no liability and will not be liable for any loss or damage arising directly or indirectly (including special, incidental or consequential loss or damage) from your use of this document, howsoever arising, and including any loss, damage or expense arising from but not limited to, any defect, error, imperfection, fault, mistake or inaccuracy with this document, its contents or associated services, or due to the unavailability of the document or any part thereof or any contents.

Any prediction, projection or forecast contained herein as to likely future movements in rates or prices or likely future events or occurrences constitutes an opinion only and is not necessarily indicative of actual future movements in rates or prices or actual future events or occurrences (as the case may be).

Past performance is not necessarily indicative of future performance; the value, price or income from investments may fall as well as rise.

SCBHK and its parent companies, subsidiaries, affiliate companies, employees and customers, may at times to the extent permitted by applicable law and/ or regulation seek to have interests in the securities (or relevant financial products) covered in this document. Such interests include dealing in, holding, acting as market-makers, or performing financial or advisory services, in relation to any of the products or services referred to in this document. SCBHK and its parent companies or affiliate companies may also have acted as a manager or co-manager of a public offering of the securities or financial products, and may also have an investment banking relationship with any companies mentioned in this document. Accordingly, SCBHK, its parent companies, subsidiaries, affiliate companies may have a conflict of interest that could affect the objectivity of this document. Please note however, unless otherwise stated, the issuer of the securities or products is not SCBHK or its parent companies, associate or connected companies, and the value of the securities or products depends on the ability of the issuer to perform its obligations under the securities or products.

The contents of this document have not been reviewed by the Securities and Futures Commission of Hong Kong (SFC) or any regulatory authorities in Hong Kong.

This document must not be forwarded or otherwise made available to any other person without the express consent of SCBHK. If there is any inconsistency or conflict between the English and the Chinese versions, the English version shall prevail.

THIS IS NOT A RESEARCH REPORT AND HAS NOT BEEN PRODUCED BY A RESEARCH UNIT.