

global market outlook

This reflects the views of the Wealth Management Group

macro strategy | 22 August 2014

Equities still preferred over bonds

Global equities and bonds have performed well so far this year. While we expected equities to do well, the resilience of the USD bond market to rising growth and inflation pressures caught us slightly off guard. However, it supports the outlook for global equities and our diversified income theme.

Key themes:

- **Recent decline in US bond yields is not a cause of concern.** When US bond yields decline, the natural concern is whether this signals weaker US economic growth going forward. We do not believe so. The more likely causes are 1) a global savings glut and 2) the increased relative attractiveness of US bonds given the collapse in EUR bond yields this year.
- **Global equities likely to remain supported.** US, European Q2 corporate earnings surprised positively. Asia's growth forecasts are being revised higher. Lower bond yields support the outlook for global equities and a diversified income allocation.
- **Weakness in Europe equities likely to be short-lived.** Rising geo-political concerns and weakening domestic growth have undermined the European market. However, with over 50% of European revenues coming from overseas, the improving external environment and EUR weakness should boost corporate profitability.
- **Prefer Emerging Market (EM) bonds within a multi-income allocation,** including CNY (and CNH), Asia local currency and EM USD High Yield (HY) sovereign bonds. Developed Market (DM) HY bonds still warrant an allocation (see page 6).

Short-term outlook:

- **Equity market pullback may be over.** Last month, we highlighted that 'any weakness is expected to be short term, with any losses likely to be quickly recouped.' Peak to trough, the pullback was less than 5% and we have already recovered about 4%. Recent history suggests we may make a new high soon.
- **Increased cash holdings reinforce this outlook.** A recent survey of fund managers suggests cash holdings are at their highest level since June 2012. This means there is a risk of a short-term 'melt-up' scenario, as asset managers are forced to chase the market higher to limit any under-performance.

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Risk indicators still largely flashing green

BCA Research's S&P500 risk indicators

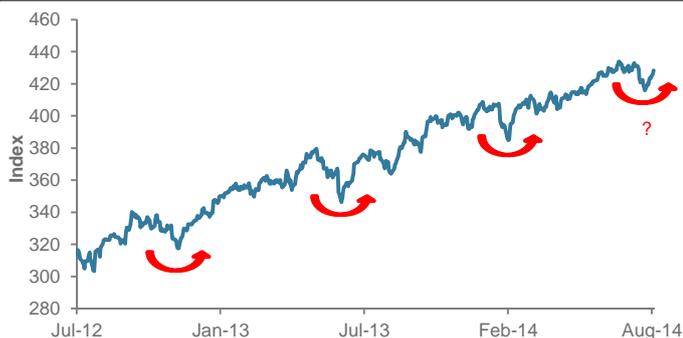
Market indicators	July
Valuations at 17x forward P/E	
Unsustainable pace of appreciation	
Domestic outperforming global	
Defensives outperforming cyclicals sectors	
Treasury rally	x
Global indicators	July
Negative surprises from Europe/Japan	
Significant slowing in EM growth	x
Reversal of Manufacturing recovery	
Significant USD strength	
Domestic indicators	July
Fading employment momentum	
Stalled housing recovery	
Policy wildcard	

Source: BCA Research, Standard Chartered

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Another pullback, another bounce

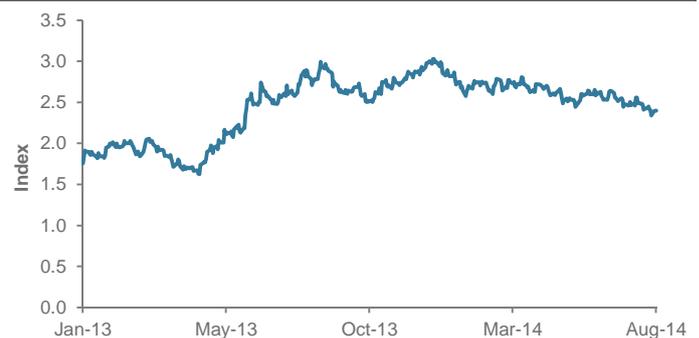
Global equity (MSCI all-country world) index



Source: Bloomberg, Standard Chartered

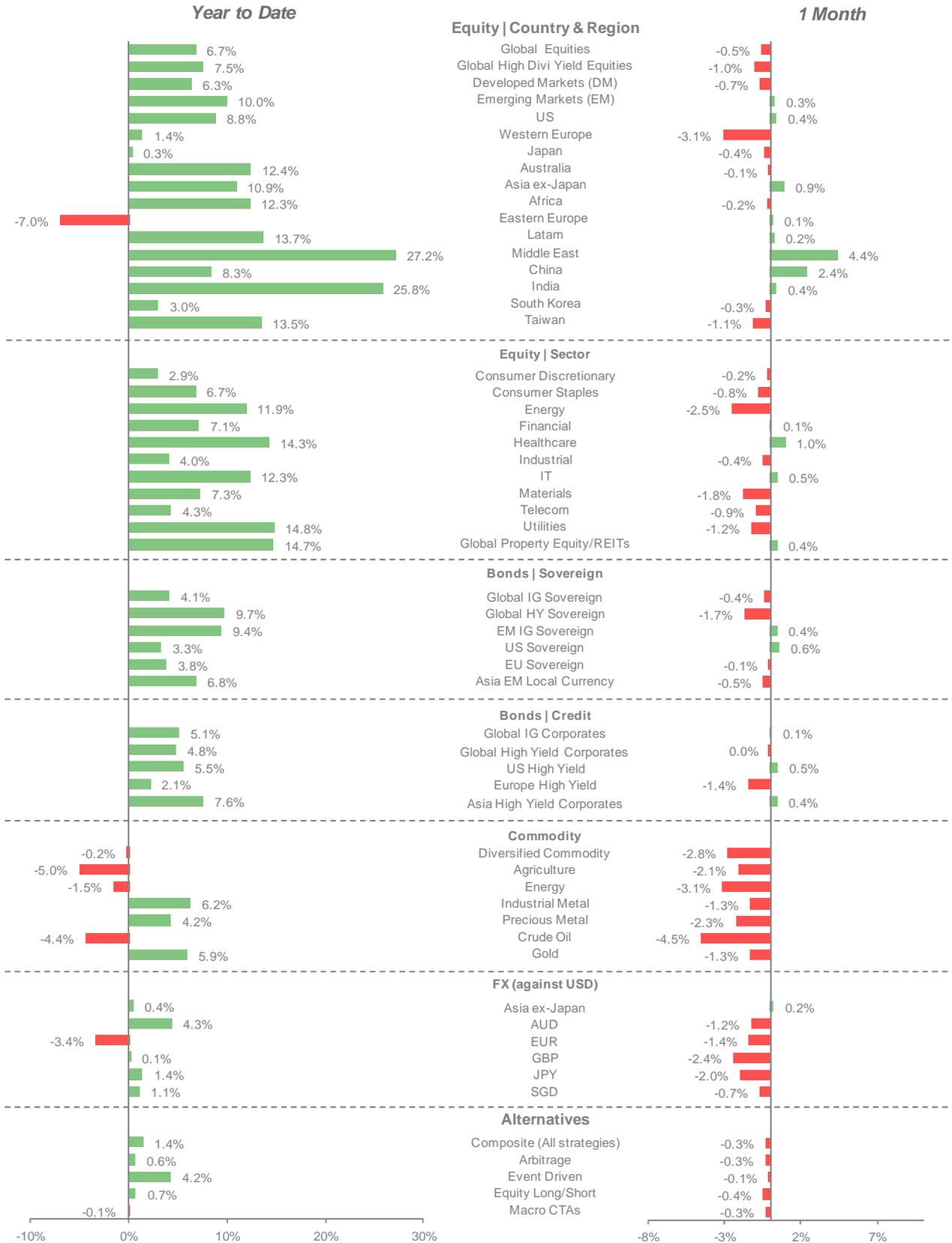
US bond market stubbornly resistant to stronger growth

10-year Treasury yield testing key support



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 December 2013 to 21 August 2014 and 1-month performance from 24 July to 21 August 2014

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

Investment Strategy:

- Increased fund manager cash holdings suggest a lot of bad news regarding the geo-political environment is already priced in. Global equities are likely to rally in coming months
- Bond market strength supportive of equities
- European equities likely to perform well in the coming 6-12 months, recent weakness notwithstanding

Bounce in volatility short-lived. Rising geo-political fears led to a short term increase in volatility. However, volatility peaked at a relatively low level – well below the highs seen earlier in the year – and has now fallen back towards recent lows (below the lows seen between 2008 and 2012).

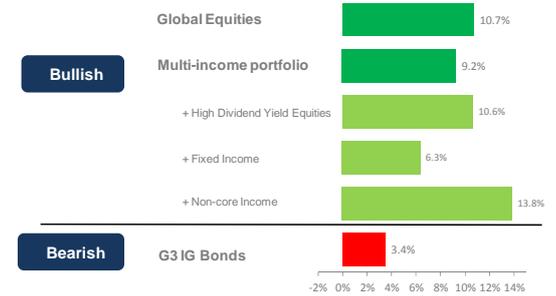
Increased cash holdings, corporate earnings bullish for global equities. A Bank of America-Merrill Lynch survey suggests fund managers increased their cash holdings to the highest level since June 2012, as they became more concerned about geo-political risks and the slowdown in Europe. This means the key risk for the global stock market may be a ‘melt-up’ as fund managers are forced to buy equities to limit their under-performance in a rising market. This outlook is reinforced by the strong performance of US and European corporate earnings.

Implications for investors:

- **Short-term equity market risks have eased.** While there is always the risk of a short-term pullback, we believe this risk has reduced sharply in the near term as markets recover from recent weakness. We expect global equities to make new all-time highs in the coming weeks (see Box 1 for a seasonal patterns analysis).
- **Bond market performance not a concern.** The one key investment theme ‘flashing red’ is G3 Investment Grade (IG) bonds. We had expected negative 2014 returns but thus far, they have rallied. We believe this is mostly because of a savings glut in certain parts of the world (eg Asia) being channeled towards US Treasuries, especially due to the very sharp drop in European yields, rather than a reflection of concerns about the global growth outlook.
- **This challenges our expectation for negative returns in G3 IG bonds** this year, but the resultant loose financial conditions should support global equities, which we expect will outperform in the coming 6-12 months, and our diversified income theme (See August Global Market Outlook).
- **European equities expected to rebound.** European equities have weakened significantly in recent times due to slowing growth and rising geo-political concerns. Loan demand and supply are both increasing and the ECB is determined to support the recovery. Cheaper valuations and an earnings recovery, helped by the global recovery and a weaker EUR, merely add to this positive backdrop.

Bullish A.G.I.L.E. themes have performed well

AGILE performance since Outlook 2014 was published*



* For the period 16 December 2013 to 21 August 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 and then revised in the August Global Market Outlook (Volatility likely to remain low for a while)

Box 1: Seasonal effects - September

Since 1970, 23 out of the 44 Septembers generated negative returns, slightly worse than flipping a coin.

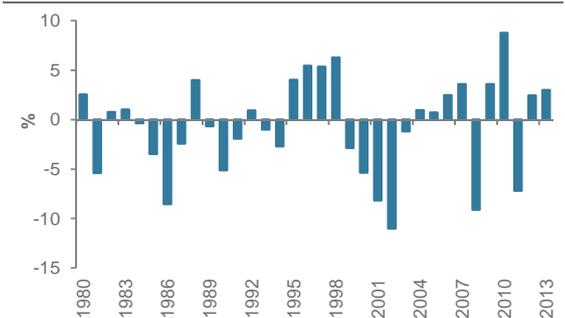
There are two potential caveats to this analysis:

- 1) we have just seen some weakness and that has rarely been followed by another pullback
- 2) there are many similarities between now and the late 1990s – during 1995-1999, the average September performance was +3.5%.

To put seasonality in context, January is historically one of the strongest months of the year. However, following on from the almost 10% gain in Q4 2013, Jan 2014 saw negative returns. **We remain constructive in the short term on global equities.**

September has been seasonally weak on average

Performance of the S&P500 index in September, % m/m



Source: 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

Source: Standard Chartered

Sub-asset Class	Relative Outlook	Start Date
Cash	UW	Feb-12
Fixed Income	DM IG	UW
	EM IG	N
	DM HY	N
	EM HY	OW
Equity	US	OW
	Europe	OW
	Japan	N
	Asia ex-Japan	N
	Other EM	UW
Commodities	N	Nov-13
Alternatives	OW	Jun-13

Economic and policy outlook

US 'Goldilocks' theme plays on; ECB under pressure to ease

- **US** companies added workers at the fastest pace since 1997 while reporting higher-than-expected profits. The optimism is also reflected in the strengthening housing market. Inflation remains relatively subdued, leaving the Fed room to keep policy accommodative for a while. We believe the strengthening job market should push up salaries over the coming quarters, forcing the Fed to raise rates in H1 15, ahead of market expectations.
- The **Euro area** economy stalled in Q2. Yet, business confidence, reflected in purchasing managers' indices, is holding up, while bank lending is recovering from low levels. We expect the ECB to give its cheaper lending programme (starting from September) a chance to revive growth. However, weak growth data, coupled with declining inflation and still-high unemployment, may force the central bank to embark on quantitative easing next year.
- In **Emerging Markets (EM)**, **China's** exports accelerated in July on the back of strong US demand, while its services sector slowed due to continued weakness in the property sector. Although bank loans declined sharply, we expect more targeted lending in H2 to help the government achieve its 7.5% annual growth objective. In **Eastern Europe**, tensions over Ukraine increased as Russia banned food imports from the US and EU in response to Western business restrictions.

US: Jobs growth, subdued inflation mean Fed policy to stay easy

- **Fastest pace of hiring since 1997.** The US economy created almost 1.5m jobs in the six months to the end of July, reflecting growing corporate confidence in its outlook. The improving optimism was reflected in better-than-expected Q2 corporate profits and a rebound in the housing market. Housing starts in July were the second highest since 2008.
- **Subdued wages keep inflation in check.** Despite the robust pace of hiring, average earnings were restrained, growing 2% y/y in July and staying within the range seen since 2009. The subdued wage growth is also curtailing consumer demand. Growth in retail sales stalled in July, slowing for the fourth straight month. As a result, consumer inflation averaged 2% in July, slowing from 2.1% in June and staying within the Fed's target.

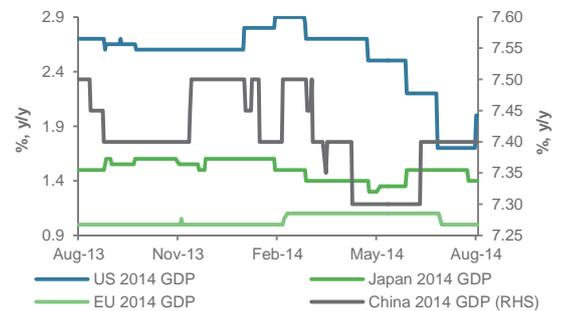
Fed: Accommodative stance for now, rate hike likely in 1H 15

- **Tame wages and inflation are likely to keep the Fed on hold for a while.** Fed minutes from its July meeting showed some policymakers are increasingly concerned that the strong job market is reducing slack faster than expected. They have warned that the Fed risks stoking inflation if it doesn't start raising rates as early as Q1 15. Others, including Chair Yellen, have cautioned against tightening too soon, pointing to the high levels of under-employment and the still-low labour participation rate. We believe Yellen's argument is likely to prevail for now, given the subdued inflation, although the strengthening labour market is likely to create wage pressures, forcing the Fed to raise rates in H1 15.

Europe: Euro area slowdown adds urgency to ECB easing

- **Europe unexpectedly slows.** The Euro area's top three economies slowed in Q2, with Germany contracting, France stagnating and Italy returning to recession. Spain's reform-driven economy expanded, highlighting the need for economic reforms in the rest of the region. However, business confidence, especially in the services sector, is holding up, as seen through the still-robust purchasing managers' indices.

US, China growth estimates revised up, EU lowered Consensus 2014 GDP growth estimates (% y/y)



Source: Bloomberg, Standard Chartered

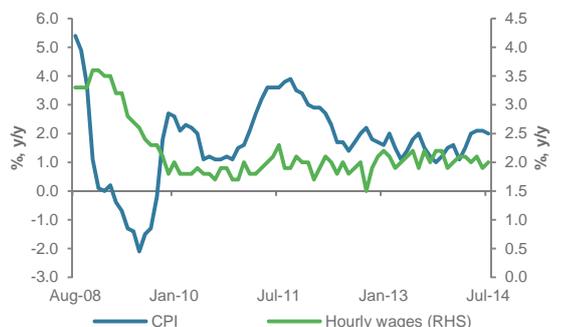
Strongest US hiring since 1997 helps housing market 6-month av. payrolls ('000), housing starts ('000s, RHS)



Source: Bloomberg, Standard Chartered

US inflation and wages remain subdued

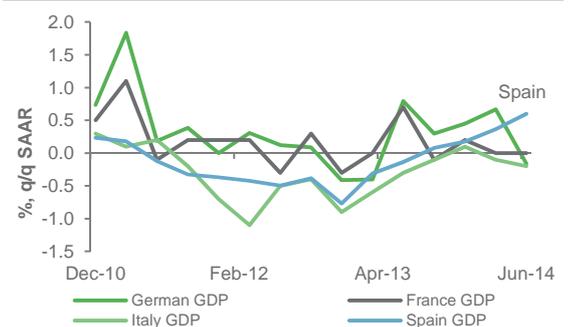
US CPI (% y/y), average hourly earnings (% y/y, RHS)



Source: Bloomberg, Standard Chartered

Euro area's top three economies slowed in Q2

Q2 GDP growth in key economies (% q/q SAAR)



Source: Bloomberg, Standard Chartered

- ECB under pressure as inflation expectations decline.** The ECB, after cutting the benchmark interest rate to negative, is set to start a low-interest-rate lending programme in September. While bank lending has been recovering from a low base, we expect the ECB plan to boost lending further, reducing borrowing costs for companies and consumers. The Euro's weakness since May should also support exports in H2. We expect ECB policymakers to give these measures a chance to revive growth. President Draghi's speech at Jackson Hole should provide some pointers. However, if inflation expectations continue to deteriorate the ECB may have to start quantitative easing next year.

EM: Asia benefitting from US and China's recovery

China: Targeted policy easing helps turnaround

- China's targeted lending to help offset property slowdown.** Concerted effort by Chinese policymakers since Q2 to provide targeted lending to priority sectors of the economy, such as social and rural housing, transportation and agriculture, has helped the economy recover after two quarters of slowdown. Manufacturing growth accelerated to a two-year high in July and retail sales growth remained healthy at 12.2%, although the broader services industry slowed, dragged by a property sector slump.
- July's lending decline is likely to be temporary.** While bank lending in July dropped significantly – primarily due to changes in risk-management rules for banks – we expect lending to recover in the coming months as the government is determined to achieve its 7.5% annual growth target. Subdued consumer inflation, which remained unchanged at 2.3% in July, should allow such targeted easing. Meanwhile, a recovery in the US is boosting overseas sales. China's exports growth accelerated to 14.5% in July.

Other EMs: Asian exports pick up; Ukraine hurts sentiment

- Asian exports rise on US rebound.** South Korea and Taiwan reported a pick-up in July exports, helped by growing demand from the US and EMs. We expect the ongoing recovery in the US to help prolong the Asian exports rebound, although Europe's unexpected slowdown remains a cause for concern.
- Ukraine tensions hurt European sentiment.** Investor confidence in the Euro area as well as in Germany slumped in August as tensions escalated between Russia and the West. Russia banned food imports from the US and Europe, retaliating against embargoes imposed against some of its companies. Although these measures are likely to affect Eastern Europe more than the Euro area, any escalation may hurt the region's already fragile business confidence, given slowing growth.

Japan: Inflation expectations rise, but stay below BoJ's targets

- Low inflation, weak growth add pressure on central bank.** Consensus inflation expectations have risen since Japan raised sales tax in April. However, 2015 inflation forecasts remain below the BoJ's 2% target. The 6.8% annualised contraction in Q2 GDP has added pressure on the central bank to consider further easing measures to revive growth. We expect the BoJ to assess the economy's strength over the next few months before adding further stimulus. Exports rose 3.9% in July, aiding a recovery.

Conclusion:

The US economy is hiring workers at the fastest pace since 1997. However, weak wage growth is likely to keep the Fed's policy accommodative for now. Euro area economy slowed unexpectedly in Q2, adding pressure on the ECB to ease further. China's economy is responding to targeted stimulus, with exports aiding the recovery.

Euro area inflation expectations weaken

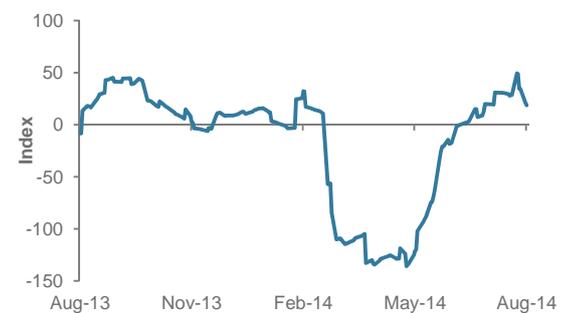
Consensus CPI estimates for 2014, 2015 (% y/y)



Source: Bloomberg, Standard Chartered

China's positive economic surprises waning

China economic surprises index



Source: Citigroup, Bloomberg, Standard Chartered

Asian export growth picked up in July

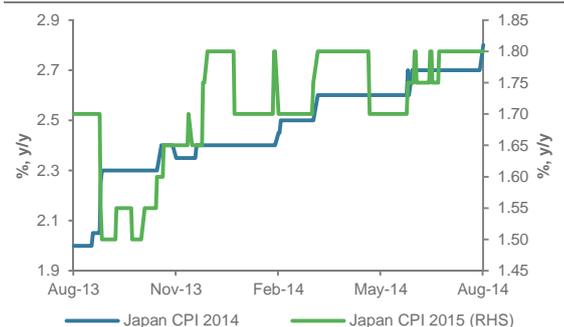
Export growth in China, South Korea and Taiwan (% y/y)



Source: Bloomberg, Standard Chartered

Japan inflation forecasts stay below BoJ target

Consensus CPI estimates for 2014, 2015 (% y/y)



Source: Bloomberg, Standard Chartered

Fixed Income – Underweight

- Strength in US Treasuries has surprised us, but we still believe they are likely to underperform other asset classes
- Our preferred bond asset classes are CNY or CNH, Asia local currency and Emerging Market High Yield (EM HY) sovereigns
- We are Neutral Developed Market High Yield (DM HY). We would use any rebound to reduce exposure to appropriate levels

G3 and EM (USD) sovereign bonds:

- **The fall in G3 government bond yields has surprised us.** A number of possible explanations present themselves, including the possibility of a new ‘bond conundrum’ where strong overseas demand for US Treasuries cap yields even when fundamentals argue for an increase. We remain concerned that yields could rise sharply over a short period of time should expectations of Fed policy shift. In Europe, yields are likely to remain low for some time.
- **Most scenarios (short of an outright recession) still point to under-performance relative to other asset classes.** Therefore, we remain Underweight G3 government bonds. While slightly positive total returns are possible, we still believe they are likely to underperform other bond asset classes and equities.
- **Spread widening may offer an opportunity to raise exposure to EM HY government bonds.** Key factors behind our Overweight view include (i) attractive absolute yields, (ii) value relative to DM HY due to wider spreads, and (iii) continued comfort with diversified exposure from a credit risk perspective.
- **Ukraine, Argentina risks dominate headlines, but we are less concerned.** Spreads widened only briefly following Argentina’s technical default while Ukraine remains well supported politically and by the IMF. Diversified exposure also means bad news from any one country would likely be well cushioned by the yield.

Asia local currency bonds:

- **CNY or CNH bonds remain strongly supported by the currency.** The CNY has strengthened by almost 2% since the trough of band-widening weakness. While we believe the CNY is unlikely to resume a straight line appreciation, the relative currency stability makes the yields on offer quite attractive, in our view.
- **Asia local currency bonds also remain attractive, though USD strength could be a short-term risk.** Attractive yields (c.4%) and a stable currency outlook are key positives. We would treat any pullbacks as opportunities to add exposure.

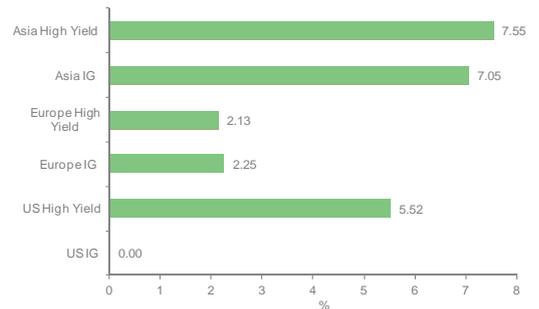
Corporate credit (USD):

- **Neutral, not Underweight, DM HY bonds. Managing total exposure is key.** We downgraded DM HY to Neutral in July due to expensive valuations and deteriorating credit quality. However, low policy rates and still loosening lending standards mean the asset class still receives significant support. Total allocation remains key – while we believe risk/reward no longer justifies an Overweight allocation, a smaller Neutral position (part of a multi-income allocation, for example) remains justified, in our view.

Conclusion:

Asian local currency bonds (mostly CNY and CNH) and EM HY sovereigns remain our preferred bond asset classes. We believe a Neutral allocation to DM HY remains justified. We remain Underweight G3 government bonds.

Performance of fixed income YTD* (USD)



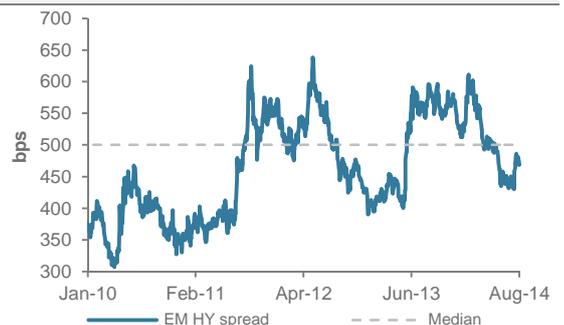
* For the period 31 December 2013 to 21 Aug 2014
 Source: Barclays Capital, JPMorgan, Bloomberg, Standard Chartered. Indices are Barclays Capital US Agg, US High Yield, Euro Agg, Pan-Euro High Yield, JPMorgan Asia Credit Index

Sharply falling German Bund yields may have shifted flows to US Treasuries instead, capping yields 10-year US Treasury and German Bund yields (%)



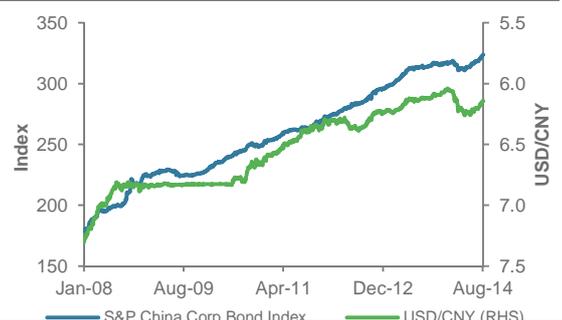
Source: Bloomberg, Standard Chartered

Slight widening of spreads may have created an entry opportunity for EM HY sovereign bonds EM HY spreads (bps)



Source: Bloomberg, Standard Chartered

CNY has been supportive for onshore China bonds S&P China corporate bond index (USD) and USD/CNY



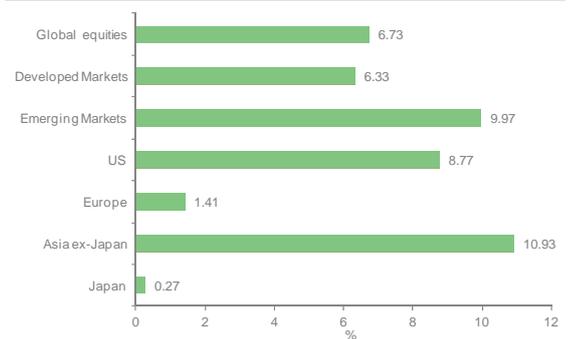
Equity – Overweight

- Global equity market volatility increased over the past month as investors digested weaker-than-expected economic data in Europe and rising tensions in Ukraine. Our view that ‘any weakness is expected to be short term, with any losses likely to be quickly recouped’ (Global Market Outlook, Volatility likely to remain low for a while, 25 July 2014) played out nicely. Peak to trough, the global equity market pullback was less than 5% and we have already recovered about 4%.
- We maintain our bullish stance towards US, European and Asian markets.
- Portfolio flows over the past one month have benefited Emerging Markets (EM), particularly Asia. The increased share of flows to actively managed funds over ETFs is a positive development in terms of the sustainability of the Asian market rally.
- The decline in US bond yields creates a conundrum for equity investors, noting that it could be interpreted as a signal of slower growth ahead. However, we believe the decline in yields is consistent with strong growth and equity market performance.
- Cross border trading between Hong Kong and China equity markets, known as Mutual Market Access (MMA), remains on track for an October launch with system testing underway this month. For overseas investors, a key outstanding issue is the 10% withholding tax on dividends and capital gains imposed by China.

Global equities – investors switch to Asia

- Europe wobbles, but equity fundamentals remain solid.** We remain bullish on European equities, despite recent evidence of a growth wobble. Domestically, bank lending intentions and credit costs are improving. Meanwhile, it is important to remember that more than half of European revenues come from overseas. Therefore, the pick-up in global economic activity and a weaker EUR are significant positives for corporate profitability.
- Constructive on Asia.** Asian equity markets have been the star performers over the past one month, rising 3%, with MSCI China leading the charge higher, rallying 7%. Catalysts for the improvement in Asian equity market performance include evidence of a rotation away from Developed Markets (DMs) to EMs based on fund flows data, as well as recognition that the wide valuation gap between the two may be unjustified given resilient growth in Asia.
- China shrugs off weak lending data.** Investors are increasingly convinced China will hold the line on its 7.5% GDP growth target. Support for this view comes from the market reaction to weak bank lending data. Expectations for total society financing in July were for CNY 1.5trn, with an out turn of CNY 273bn. However, investors appear to have looked at June-July combined, rather than July in isolation, and view the government’s policy of targeting credit to priority sectors as supportive of the 2014 GDP target.
- The first two weeks of August have witnessed a surge in equity fund inflows to EM,** amounting to USD 5.5bn, with Asia accounting for 95% of these inflows. Of even more significance is the trend of outflows from DM over the same period, amounting to USD 19bn. The trend of inflows to EM and outflows from DM is unusual. The pattern over the past two years has been inflows/outflows to both or more typically outflows from EM and inflows to DM.

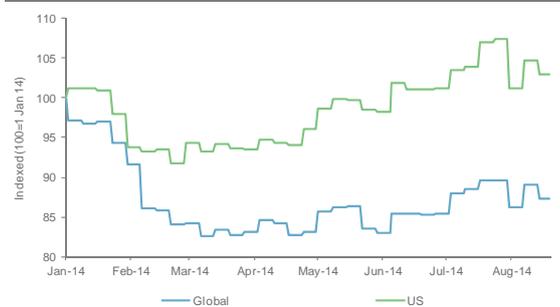
Performance of equity markets YTD* (USD)



* For the period 31 December 2013 to 21 Aug 2014
Source: Bloomberg, Standard Chartered. MSCI Indices are USD total return

Corporate earnings are recovering

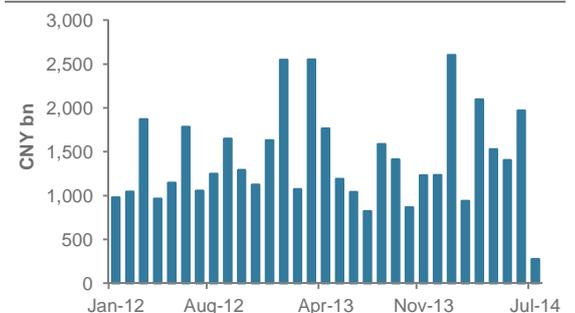
Global and US 12-month forward y/y growth (indexed)



Source: Bloomberg, Standard Chartered

Chinese loan growth

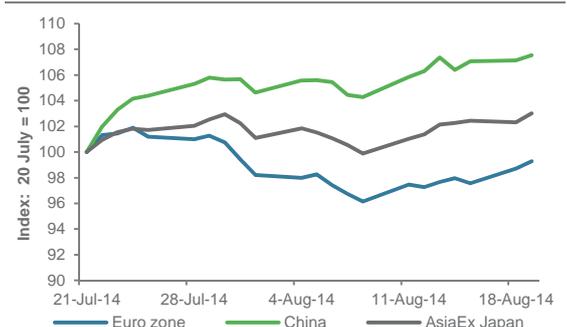
China total social financing



Source: Bloomberg, Standard Chartered

Equity market performance trends

MSCI Europe, Asia ex-Japan and China index performance



Source: MSCI, Bloomberg, Standard Chartered

Bond market signals for equity investors

- **Interpreting signals from the bond market.** A concern for investors is the diverging year-to-date trend for US equity markets and bond yields. Traditionally, falling bond yields are interpreted as signalling slower growth and/or lower inflation ahead. Historically, this has not been a positive signal for equities. Nevertheless, we note a number of special factors that may explain the breakdown in the relationship in this cycle:
 1. A global savings glut. In recent times, this has been driven by China's expanding external (current account) surplus.
 2. A diminishing supply of Treasuries, as the Fed's holdings of bonds has surged to 25% from 10% of Treasury bonds outstanding, related to its QE programme as well as an increased in the relative attractiveness of US bonds given the collapse in EUR bond yields this year
 3. A decline in long-term growth expectations.
- **The savings glut and the impact of Fed bond buying are uncontroversial factors, depressing US Treasury yields.** The decline in long-term growth expectations is a controversial viewpoint, with potentially negative implications for equities. We justify our Overweight stance on US equities in the face of this negative structural backdrop by acknowledging that in prior periods approaching a US rate hike, valuations tend to expand. It is only after the rate hike that valuations soften and earnings takeover as a key factor in driving returns.
- As opposed to focusing on long-term bond yields, another way of looking at the signals emanating from the bond market is to focus on the yield curve. The US yield curve has flattened 60bps year-to-date, as 10-year bond yields have declined amidst broadly steady 2-year yields. We can characterise this as a bull flattening of the yield curve; as the title suggests a bull flattening of the yield curve has historically been positive for equities.

MMA between HK and China

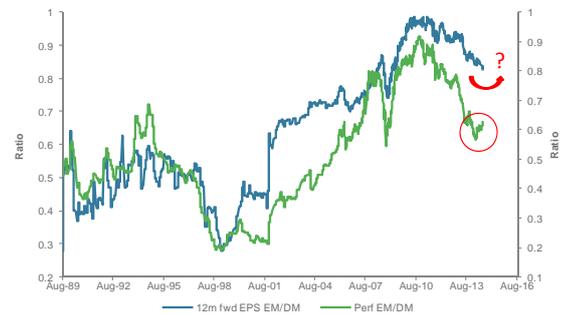
- **Cross border trading between Hong Kong and China.** Scheduled for launch in October, MMA between the exchanges in Hong Kong and Shanghai is viewed as a potentially positive development for both markets. Further deregulating foreign investor access to the domestic A share market in China and boosting interest in Chinese stocks listed in Hong Kong should be positive for both markets.
- There are a number of issues that remain undecided and are of significant importance for the so called Northbound flow, that is foreign investors buying China A shares. Chief amongst these is the applicability of the current 10% withholding tax on dividends and capital gains on A shares. The Hong Kong exchange has indicated it is awaiting confirmation from Chinese regulators on whether these taxes will be levied. Investors view them as unfair as Chinese investors will not be subject to the same taxes on Hong Kong shares.
- Also of relevance for Northbound investors is the status of sell orders once the daily quota of CNY 13bn is reached – specifically, whether they will be able to sell their positions. The Hong Kong exchange guidelines highlight the daily quota is “net buy value”, hence, while investors may not be able to buy as much as they want, they can sell their position even if the quota is reached.

Conclusion:

We maintain our Overweight stance on equities. European markets are recovering from their August correction and Chinese equities are performing well as investors turn more constructive.

EM vs. DM earnings trend

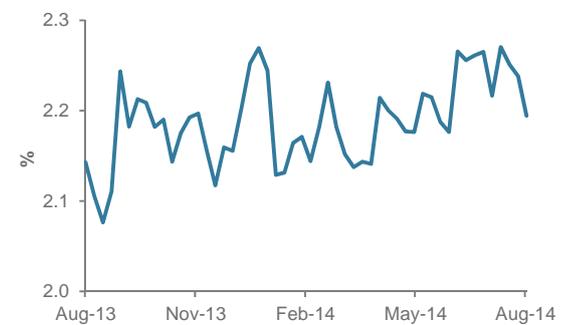
MSCI EM vs. DM – 12m forward EPS and performance



Source: MSCI, Bloomberg, Standard Chartered

US inflation expectations

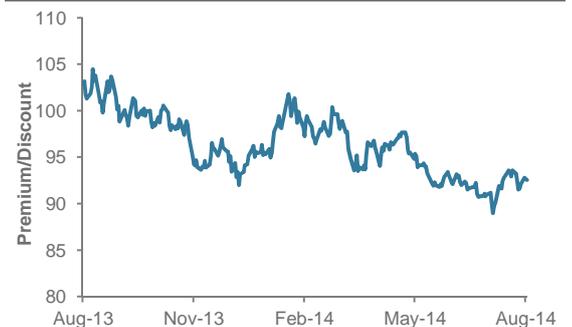
US breakeven inflation rate (10-yr UST less 10 yr TIPS)



Source: Bloomberg, Standard Chartered

China Hong Kong A-H Spread

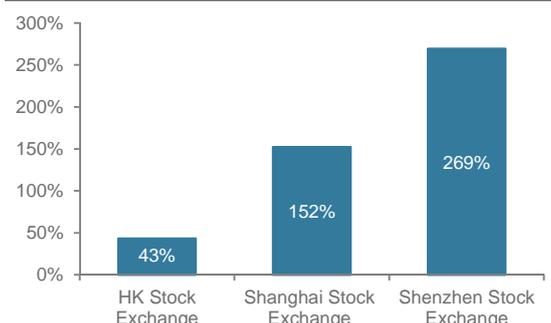
China and Hong Kong A/H Premium



Source: Bloomberg, Standard Chartered

China Hong Kong exchange velocity

Velocity= annual trading turnover/market cap



Source: Bloomberg, Standard Chartered

Commodities – Neutral

- We maintain a Neutral view on commodities.
- Gold has been range-bound, compared with our expectations of outright weakness. We believe an end to Fed QE purchases and an eventually stronger USD are likely to ultimately push gold lower.
- Energy remains our preferred sub-asset class. Continued weakness in oil prices has significantly improved the risk/reward trade-off, in our view, given little has changed in terms of the fundamental demand/supply balance.

We remain Underweight gold. The precious metal has been relatively unresponsive in both directions, lacking upside in response to a rise in geopolitical risks while lacking downside despite USD strength.

We believe the end of Fed QE and an eventual market adjustment for the likelihood of higher Fed policy rates pose significant downside risks to gold prices. The key opposing risk is rising inflation expectations, but we remain unconvinced this will be sufficient to offset downside pressure as the opportunity cost of holding gold (a non-yielding asset) continues to rise.

We remain Overweight energy. The fall in the Brent oil price extended further, leaving it just above USD 100/bbl and only a little above April 2013 lows. The only key driver over the past month appears to be a further reduction in geopolitical risks, following US intervention in Iraq. Little appears to have changed in terms of the basic demand and supply balance, especially given the continued strength in economic data in the US and Asia.

Based on this, we continue to believe it is more likely than not that oil prices will rise from here. The pace of demand growth appears unchanged while there has been no obvious new source of supply. Geo-political concerns have eased, no doubt, but fighting in Iraq were never near key oil-producing regions at any point. Prices are also near the bottom of their post-2010 range, suggesting a move higher may be in the offing soon.

We remain Neutral on industrial metals. Prices rebounded slightly following a pullback earlier in the month. The recent improvement in Chinese macro data was likely a key driver, as the country remains a major source of demand for many industrial metals.

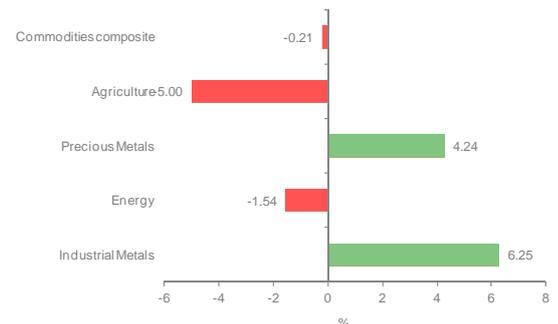
However, there are a number of factors that hold us back from extrapolating this trend. First, the weakness in China's housing market remains a key concern given the sector is a key source of demand for many metals. Second, onshore inventories remain elevated. We believe these offsetting factors justify holding on to our Neutral view on industrial metals at this time.

We remain Neutral on agricultural commodities. Prices continued to grind lower over the past month amid a rise in key crop output forecasts, suggesting increasing supply. Our focus remains on the potential effect of El Nino weather patterns. The first half of the Indian monsoon season has been somewhat disappointing, though not as bad as some policymakers had originally feared. We continue to watch for potentially greater volatility in agricultural prices over the next few months.

Conclusion:

We retain our Neutral stance on commodities. Energy remains our most preferred sub-asset class, particularly given the magnitude of recent price weakness, while gold remains the least preferred.

Performance of commodities YTD* (USD)



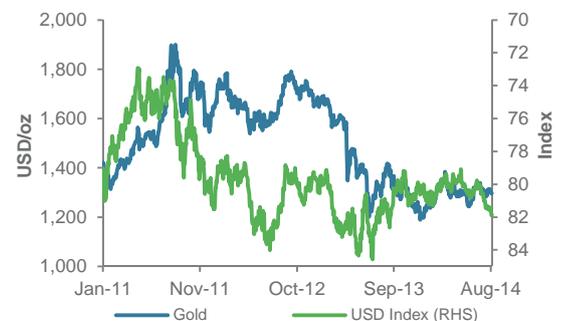
* For the period 31 Dec 2013 to 21 Aug 2014

Source: DJUBS, Bloomberg, Standard Chartered

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

USD strength poses downside risks for gold

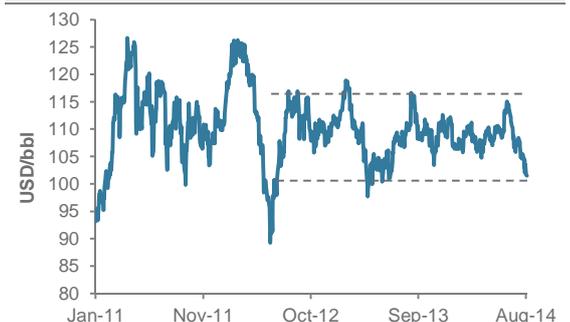
Spot gold vs. USD index



Source: Bloomberg, Standard Chartered

Oil prices are now at the bottom of their recent range

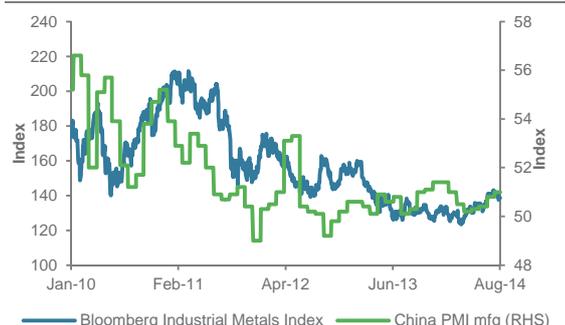
Brent oil price (USD/bbl)



Source: BP Statistical Review 2014, Standard Chartered

Improving China macro data has offered some support to industrial metals

Industrial metals index vs. China PMI manufacturing.



— Bloomberg Industrial Metals Index — China PMI mfg (RHS)

Alternative Strategies – Overweight

- We remain Overweight alternative strategies, as they offer exposure to equities, our preferred asset class.
- We believe alternative strategies may be especially attractive in an environment where volatility is low and equity market pullbacks have been small. 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 volatility associated with a long-only position. Recent performance has been along expected lines: correlation with global equities has been positive, but volatility has been lower.

Protection against any equity volatility, stock correlations and acquisitions activity are key factors leading to our Overweight. We continue to expect equities to outperform over the next 12 months. However, we believe alternative strategies can help offer some protection against any short-term volatility. We also note stock correlations remain low, suggesting a more positive environment for equity long/short strategies.

Conclusion:

Stay Overweight on alternative strategies. We favour diversified exposure and equity long/short strategies to ensure portfolio diversification and lower volatility relative to long-only equities.

Foreign Exchange

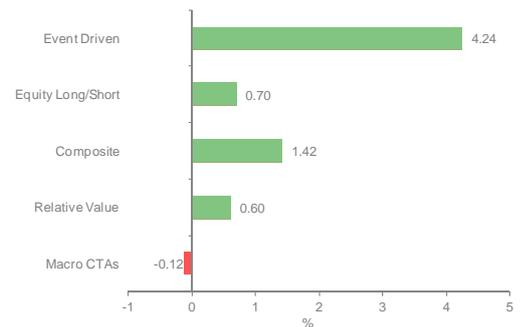
USD: We expect appreciation over the medium term

We expect the USD to continue its uptrend over a 6-12 month horizon. In this regard, we believe two factors will be key. First, continued improvement in US data, particularly with respect to the labour market and housing, which is likely to continue building a case for an earlier-than-expected Fed rate hike. Second, most other major central banks continue to mull over either adopting additional monetary policy easing or maintaining highly accommodative policies for an extended period. As a result, we believe, monetary policy divergence between the US and other major central banks is likely to continue, increasing the relative attractiveness of US assets.

EUR: We expect depreciation over the medium term

Notwithstanding its recent weakness, we expect the EUR to continue trending lower over the next 6-12 months. Recent weak economic data, particularly from Germany, has heightened concerns about deflationary risks and the European economic recovery. As a result, capital outflows are beginning to eclipse the record current account surplus (see chart on next page). This backdrop, in our view, is likely to compel the ECB to undertake comprehensive measures to encourage lending and support asset prices. Furthermore, as Fed rate hike expectations begin to get priced in, the yield differential between the US and Europe is expected to widen further, thus continuing to reduce the attractiveness of European assets. In the short term, we believe, any oversold rebound in the EUR is likely to be temporary.

Performance of alternative strategies YTD* (USD)



* For the period 31 December 2013 to 21 Aug 2014
 Source: HFRX, Bloomberg, Standard Chartered
 HFRX global hedge, HFRX equity hedge, HFRX event driven, HFRX relative value, HFRX macro/CTA

Short term

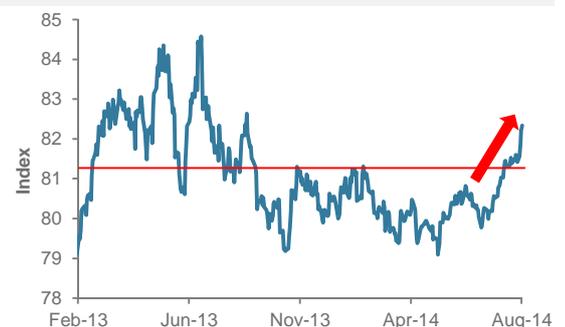
refers to a horizon of less than 3 months

Medium term

refers to a time horizon of 6 to 12 months

USD Strength beginning to come through

US Dollar Index



Source: Bloomberg, Standard Chartered

JPY: We expect depreciation over the medium term

We expect the JPY to weaken over a 12-month horizon, but it may continue to trade in a tight range in the very short term. The lack of any major catalyst has kept the currency largely stable, but we believe rising US long-term yields augur a weaker JPY. In addition, we see early signs of declining inflation expectations and hence do not rule out further BoJ easing measures.

GBP: We remain medium-term Neutral

We remain medium-term Neutral on the GBP, but see further weakness in the short term. In our view, the strong upward trend in the GBP was largely based on excessive market optimism with respect to the UK economy and interest rate hikes. However, following recent softer inflation data, we believe some of the optimism has begun to erode. In addition, unwinding of excessive short positioning has further augmented weakness in the GBP. In our view, the BOE is unlikely to hike rates this year given the recent weak spots in the UK economy including manufacturing and low inflation

AUD: We remain medium-term Neutral

We are medium-term Neutral on the AUD and expect the currency to trade within 0.92-95 in the short term. The main factor supporting the currency is the considerable demand for Australia's AAA debt amid higher yields relative to peers and low volatility. Forward-looking measures such as consumer and business confidence continue to improve. On the other hand, depressed commodity prices (especially iron-ore) and the unemployment rate continue to restrict a major rally in the AUD. Overall, economic data continues to be mixed. However, we believe the risks to the AUD are tilted to the downside.

SGD: We remain medium-term Neutral

We remain medium-term neutral on the SGD. We expect the Monetary Authority of Singapore (MAS) to maintain its tightening bias, with a modest appreciation of the trade-weighted exchange rate. We expect Singapore's growth outlook to steadily improve as the global upswing accelerates. However, we believe SGD strength is likely to manifest itself against currencies other than the USD and the CNH.

Other Asia ex-Japan: We remain medium-term Neutral

We expect the CNY to appreciate over the medium term. The People's Bank of China has continued to fix the CNY reference rate in a sideways range, suggesting comfort with the current level of the exchange rate. However, appreciation is likely to be accompanied by higher volatility than before, in our view, likely resulting in short-term spells of depreciation along the way.

Elsewhere in Asia, we remain Neutral on Asia ex-Japan currencies overall, but favour the KRW and TWD due to their positive correlation with the global industrial cycle. The KRW has led gains among Asian currencies over the past month, even as the Korean central bank cut interest rates, against the backdrop of improving growth outlook in both the US and China. We believe the TWD will begin to rally as the global growth outlook steadily improves.

Among high-yielding Asian currencies, we prefer the INR over the IDR due to India's stronger external balance of payments position and greater visibility on policy reform. The MYR may pause once US yields start to rise. We believe increased political stability in Thailand is likely to be a positive for the currency but await greater clarity on investment pick-up prior to taking a more constructive view.

Conclusion:

We remain medium-term bullish on the USD and the CNY and remain bearish on the JPY and the EUR. We favour the KRW and the TWD in Asia.

EUR: Weakening external position

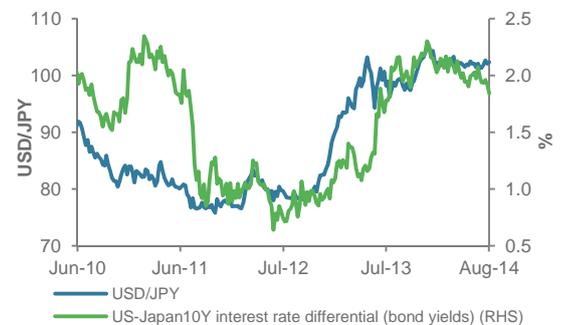
Euro-Area balance of payments (current account + foreign direct and portfolio investment) and trade-weighted EUR



Source: Bloomberg, Standard Chartered

JPY: An eventual rise in US 10-year yields likely to drive USD/JPY higher

US-Japan 10-year interest rate differentials and USD/JPY



Source: Bloomberg, Standard Chartered

GBP: Decrease in optimism around earlier rate hikes weakens the GBP

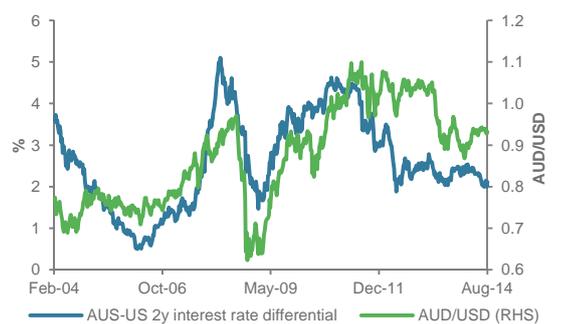
UK-US 2-year interest rate differentials vs. GBP/USD



Source: Bloomberg, Standard Chartered

AUD: High interest rate differentials of around 2% supporting the AUD

AUS-US 2-year interest rate differentials vs. AUD/USD



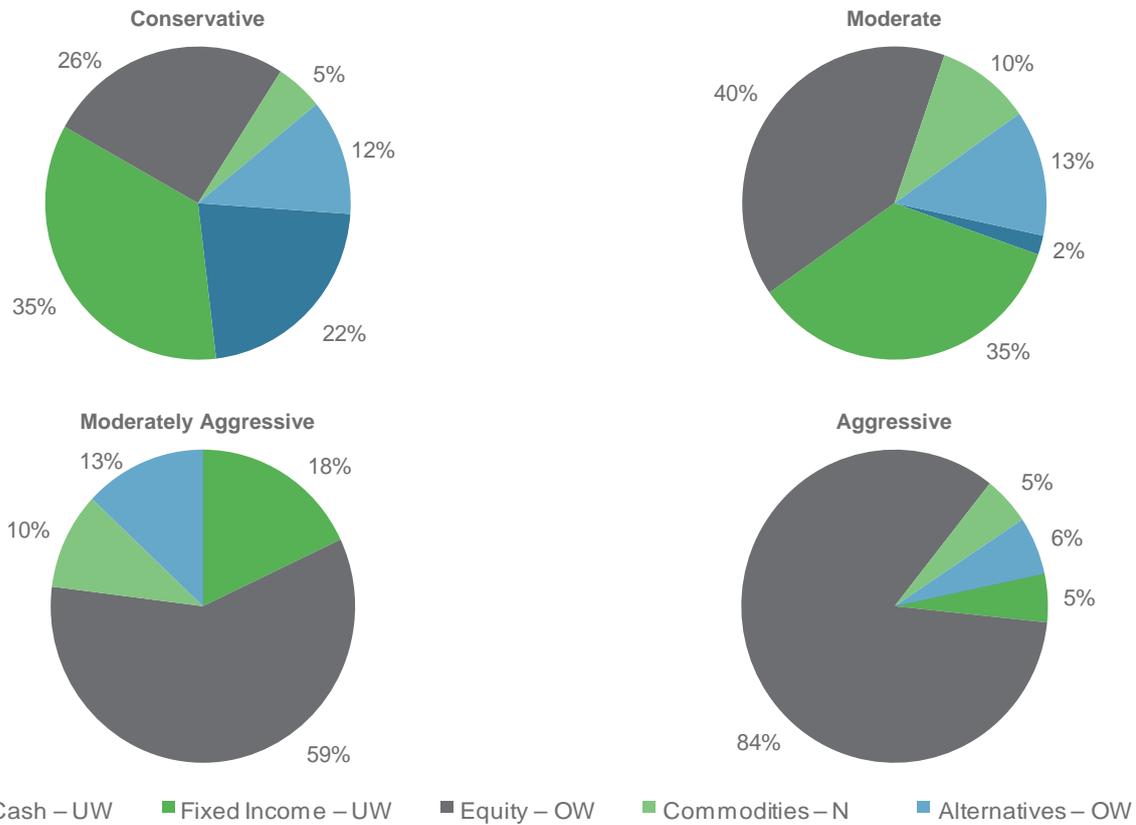
Source: Bloomberg, Standard Chartered

Asset Allocation Summary

Tactical Asset Allocation - September 2014 (12M)

All figures are in percentages

Currency: USD



Asset Class	Region	View vs. SAA	Conservative	Moderate	Moderately Aggressive	Aggressive
Cash & Cash Equivalents	USD Cash	UW	22	2	0	0
Investment Grade	IG Developed World	UW	23	15	0	0
	IG Emerging World	N	5	9	4	0
High Yield	HY Developed World	N	2	5	4	2
	HY Emerging World	OW	5	6	9	3
Developed Market Equity	North America	OW	8	12	17	24
	Europe	OW	8	11	17	24
	Japan	N	0	2	3	4
Emerging Market Equity	Asia ex-Japan	N	8	13	19	26
	Other EM	UW	2	2	4	6
Commodities	Commodities	N	5	10	10	5
Alternatives		OW	12	13	13	6

Source: Standard Chartered

Economic & Market Calendar

Next Week: Aug 25 - Aug 29						This Week: Aug 18 - Aug 22				
	Event	Period	Expected	Prior		Event	Period	Actual	Prior	
MON	GE IFO Business Climate	Aug	-	108.0	UK	Rightmove House Prices y/y	Aug	5.3%	6.5%	
	GE IFO Expectations	Aug	-	103.4	AU	New Motor Vehicle sales y/y	Jul	-0.4%	-2.0%	
	US Markit US Composite PMI	Aug P	-	60.6	EC	Trade Balance SA	Jun	13.8	15.2B	
	US Markit US Services PMI	Aug P	-	60.8	US	NAHB Housing Market Index	Aug	55	53	
	US New Home Sales SAAR	Jul	-	406K	SI	Non-oil Domestic Exports SA m/m	Jul	2.5%	1.5%	
	UK Nationwide House Prices m/m	Aug	-	0.1%	TH	GDP q/q SA	Q2	0.9%	-1.9%	
	SI CPI y/y	Jul	1.9%	1.8%	CH	Foreign Direct Investment y/y	Jul	-17.0%	0.2%	
	HK Exports y/y	Jul	-	11.4%						
TUE	JN Small Business Confidence	Aug	-	48.7	SK	PPI y/y	Jul	0.2%	0.1%	
	US Durable Goods Orders	Jul	3.5%	1.7%	JN	Nationwide Dept store sales y/y	Jul	-2.5%	-4.6%	
	US Capital Goods Orders Non-Def, Ex-Air	Jul	-0.3%	1.4%	EC	ECB Current Account SA	Jun	13.1B	19.8B	
	US S&P/CS 20-City Home Price y/y	Jun	-	9.34%	UK	CPI y/y	Jul	1.6%	1.9%	
	US Consumer Confidence Index	Aug	89.5	90.9	UK	CPI core y/y	Jul	1.8%	2.0%	
	NZ Trade Balance	Jul	-	247M	US	CPI y/y	Jul	2.0%	2.1%	
	SI Industrial Production y/y	Jul	3.6%	0.4%	US	CPI ex food and energy m/m SA	Jul	1.9%	1.9%	
					US	Housing Starts SAAR	Jul	1093K	945K	
					US	Building Permits	Jul	1052K	973K	
					NZ	2-Year Inflation Expectation	3Q	2.23%	2.36%	
WED	SK Consumer Confidence	Aug	-	105	AU	RBA Gov. Semi-annual Testimony	-	-	-	
	GE GfK Consumer Confidence	Sep	-	9.0	JN	Trade Balance Adjusted (JPY Bn)	Jul	-1023.8	-1067.8	
	FR Manufacturing Confidence	Aug	-	97	JN	Exports y/y	Jul	3.9%	-1.9%	
	FR Business Confidence	Aug	-	93	JN	Imports y/y	Jul	2.3%	8.4%	
	GE Retail Sales y/y	Jul	-	0.4%	GE	PPI m/m	Jul	-0.1%	0.0%	
	AU Construction Work Done	Q2	-	0.3%	UK	Bank of England Minutes	-	-	-	
					CA	Wholesale trade sales m/m	Jun	0.6%	2.2%	
					TA	Export orders y/y	Jul	5.7%	10.6%	
					TA	BoP Current Account Balance	Q2	\$16.47B	\$15.45B	
					US	Fed Minutes from July meet				
THUR	SK BoP Current Account Balance	Jul	-	\$7.92B	CH	HSBC China Manufacturing PMI	Aug P	50.3	51.7	
	CH Industrial Profits y/y	Jul	-	17.9%	EC	Markit Eurozone Manufacturing PMI	Aug P	50.8	51.8	
	GE Unemployment Rate	Aug	-	6.7%	EC	Markit Eurozone Services PMI	Aug P	53.5	54.2	
	EC Economic Confidence	Aug	-	102.2	UK	Retail sales including auto fuel y/y	Jul	2.6%	3.4%	
	EC Business Climate Indicator	Aug	-	0.17	MX	GDP q/q SA	Q2	1.0%	0.4%	
	GE CPI EU Harmonised y/y	Aug P	-	0.8%	US	Markit US Manufacturing PMI	Aug P	58.0	55.8	
	CA Current Account Balance	Q2	-	-\$12.4B	US	Philadelphia Fed Business Outlook	Aug	28.0	23.9	
	US GDP Annualised q/q	Q2 S	3.8%	4.0%	US	Existing Homes Sales	Jul	5.15M	5.03M	
	US Core PCE q/q	Q2 S	-	2.0%	US	Leading Index	Jul	0.9%	0.6%	
	US Pending Home Sales y/y	Jul	-	-4.5%	EC	Consumer Confidence	Aug A	-10.0	-8.4	
	PH GDP SA q/q	Q2	-	1.2%	NZ	ANZ Consumer Conf Index m/m	Aug	-5.4%	0.6%	
	HK Retail Sales value y/y	Jul	-	-6.9%	HK	CPI Composite y/y	Jul	4.0%	3.6%	
FRI	JN CPI y/y	Jul	-	3.6%	CA	Retail Sales m/m	Jun	-	0.7%	
	JN Retail Trade y/y	Jul	-	-0.6%	CA	CPI y/y	Jul	-	2.4%	
	JN Industrial Production	Jul P	-	3.1%	CA	CPI Core y/y	Jul	-	1.8%	
	EC Unemployment Rate	Jul	-	11.5%	TA	Unemployment rate	Jul	-	3.97%	
	EC CPI Estimate y/y	Aug	-	-	US	Fed Jackson Hole Conf (21-23 Aug)				
	EC CPI Core y/y	Aug A	-	0.8%						
	IN Fiscal Deficit INR Bn	Jul	-	570.22						
	IN GDP y/y	Q2	-	4.6%						
	CA GDP m/m	Jun	-	0.4%						
	US Personal Spending	Jul	0.2%	0.4%						
	US PCE Core m/m	Jul	0.2%	0.1%						
	US PCE Core y/y	Jul	-	1.5%						
	US Chicago Purchasing Manager	Aug	56.0	52.6						
	US University of Michigan Confidence	Aug F	80.6	79.2						
	Previous data are for the preceding period unless otherwise indicated Data are % change on previous period unless otherwise indicated P - preliminary data, F - final data, sa - seasonally adjusted y/y - year on year, m/m - month-on-month, q/q - quarter on quarter						Previous data are for the preceding period unless otherwise indicated Data are % change on previous period unless otherwise indicated P - preliminary data, F - final data, sa - seasonally adjusted y/y - year on year, m/m - month-on-month, q/q - quarter on quarter			

Source: Bloomberg, Standard Chartered

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