

## Themes working, but volatility to rise

When our Group Investment Council spent two days to reflect on the mid-year mark, it is with a mix of satisfaction and concern – satisfaction that our views have generally worked well so far this year, concern that the coming 2-3 months may be more challenging for investors. This half-year update attempts to help you navigate through these potentially challenging times.

Looking back...

Our three key convictions from our 2015 W.I.D.E.N. theme – bullish global equities, a globally diversified income basket and alternative strategies – and a majority of our more granular calls have performed well so far. The outperformance of European and Japanese equity markets on a currency-hedged basis has been particularly pleasing. Also pleasing is the absence of large absolute losses on any of our calls. (See pages 4-6)

Looking forward...

During our Global Investment Council (GIC), we noted many encouraging macro developments. The US economy appears to be recovering from its soft patch. Europe and Japan data has surprised on the upside. Deflation fears have eased markedly. Accordingly, monetary policies are accommodative. China's economic outlook is worrying, but at least the authorities are easing policy. Overall, these developments point to a constructive outlook for our three key themes on a 6-12-month horizon. (see page 7-9)

However, there are also clouds developing near term. We spent a lot of time discussing the short-term outlook and are increasingly concerned about the possibility of a short-term pullback. (see page 3)

Watch Greece, the US Fed, China and the weather. The situation with Greece and its creditors has deteriorated. The risk of a default is rising (page 9). 'Grexit' is still unlikely, in our opinion, but fears of this are likely to rise. Meanwhile, the Fed is expected to start tightening policy, something that is normally associated with increased short-term volatility (page 3). In China, we continue to monitor the equity market closely given how volatile it has been (page 13). Finally, El Nino is by its nature difficult to predict, but it could add to the uncertainty, particularly in Emerging Markets (EM) (page 15).

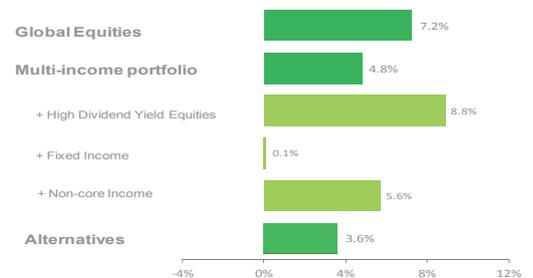
Trying to plot the future direction of asset markets is very challenging against this backdrop. This publication is our attempt to do just that and help guide you through the next 6-12 months.

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### Performance of 2015 key convictions

W.I.D.E.N. performance since Outlook 2015 publication\*



\* For the period 12 December 2014 to 18 June 2015

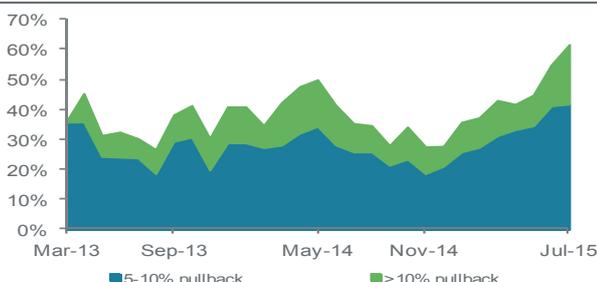
Source: Bloomberg, Standard Chartered

\* Income basket is as described in the Outlook 2015: A Year to W.I.D.E.N. Investment Horizons, Figure 60

- |                         |  |
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### We are increasingly concerned about a pullback in global equities

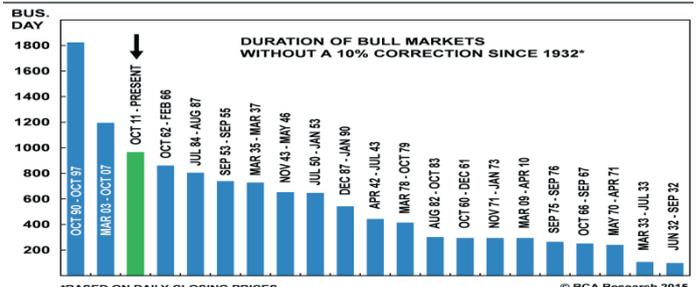
Standard Chartered GIC opinion on likelihood of 5-10% and >10% global equities pullback in the next three months



Source: Standard Chartered

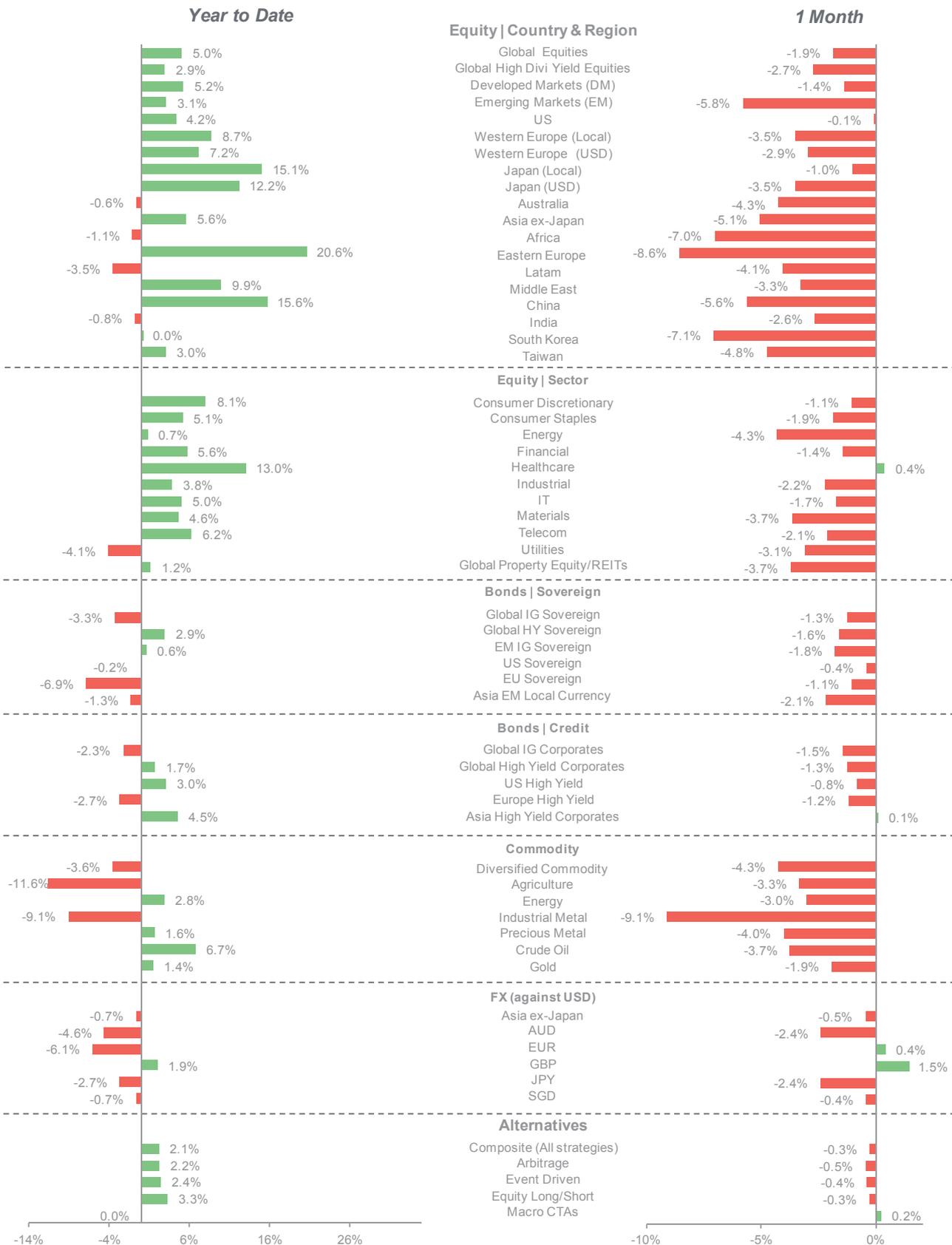
### The rally in US equities is now the third longest since 1932 without a 10% pullback

Duration of bull market without 10% correction



Source: BCA, 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 2014 to 18 June 2015 and 1-month performance from 18 May to 18 June 2015

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

## Investment Strategy

- We believe W.I.D.E.N. themes remain valid in H2 15. Favour global equities, diversified income and alternative strategies.
- History points to a rising risk of a pullback in global equities in coming months. Rotating into less risky asset classes (instead of withdrawing into cash) may be the best response.

**W.I.D.E.N. themes remain valid in H2 15.** The US economy seems to be on course to accelerate after a soft Q1, while inflation in most regions appears well contained. A Fed rate hike would intensify policy divergence and may create short-term volatility. Emerging Markets (EM) continue to reform. Together, this suggests that the three investment themes building off W.I.D.E.N. – global equities, diversified income and alternative strategies – should continue to do well.

**History offers valuable lessons on asset class behaviour following a Fed rate hike.** Data on Fed hiking cycles since 1970 shows us that (a) volatility has risen, albeit temporarily, following a Fed lift-off, (b) equities, High Yield (HY) and EM sovereign debt (USD) have performed well in the 12 months following a rate hike, and (c) 2-year US Treasury yields tend to rise rapidly around an initial rate hike, but the impact on longer maturity bonds is more muted.

**We are increasingly concerned about the possibility of a larger-than-usual global equities pullback in the coming months.** History suggests a Fed lift-off can lead to short-term weakness. However, such pullbacks have generally been temporary, suggesting they offer an attractive opportunity to add to our preferred asset classes.

### Implications for investors:

- **W.I.D.E.N. themes – global equities, diversified income and alternative strategies – remain valid on a 6-12 month horizon.** More specifically, we would use volatility to add to European and Japanese equities, diversified income assets and equity long/short, macro and event-driven alternative strategies. The rising 2-year US Treasury yields are also likely to push the USD higher between now and the Fed lift-off.
- **Our rising concern of a short-term pullback suggests rotation into somewhat less risky assets.** We believe the best way for fully-invested allocations to prepare for rising pullback risk is to partially rotate into less risky asset classes over the summer. The advantage of doing this over simply withdrawing into cash is that it helps ensure some market exposure in case a pullback is either shallower than expected or does not occur altogether. We believe leveraged loans, covered calls, CNY bonds and alternative strategies are attractive assets to rotate into.
- **Maintain FX hedge on Europe (ex-UK) and Japanese equities for now.** The path of the USD in the second half of this year is key to determining whether we maintain these hedges or consider removing them at some point.

Asset Class	Relative Outlook	Start Date
Cash	UW	Feb-12
Fixed Income	UW	Jan-11
Equity	OW	Aug-12
Commodities	UW	Dec-14
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

### W.I.D.E.N. themes remain valid in H2 15

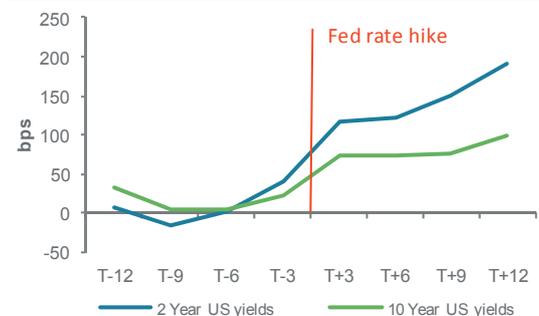
#### W.I.D.E.N. themes

<b>W</b>	<b>World economy to keep expanding, led by an accelerating US</b> Remain overweight risky assets, especially Developed Market equities
<b>I</b>	<b>Inflation to remain low</b> Maintain an allocation to diversified income
<b>D</b>	<b>Divergent monetary policies to create multiple investment opportunities</b> Position yourself for a strong US dollar Keep alert to local opportunities as they arise
<b>E</b>	<b>End of US zero interest rates to create short-term volatility in many asset classes</b> Prepare for, and take advantage of, greater volatility
<b>N</b>	<b>Need for reform key to Emerging Market returns</b> Retain selective stance for now

Source: Bloomberg, Standard Chartered

### Short-maturity yields tend to exhibit the largest moves when the Fed initiates a hiking cycle

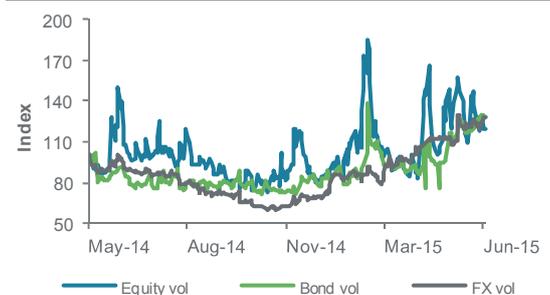
2-year US Treasury yields across six previous Fed hiking cycle initiations. T=months from Fed hike



Source: Bloomberg, Standard Chartered

### Volatility has been trending up across asset classes

VIX, MOVE and JPMorgan Global FX Volatility indices



Source: Bloomberg, Standard Chartered

Sub-asset Class	Relative Outlook	Start Date
Cash	UW	Feb-12
Fixed Income	DM IG	UW
	EM IG	OW
	DM HY	N
	EM HY	N
Equity	US	N
	Europe	OW*
	Japan	OW*
	Asia ex-Japan	UW
	Other EM	UW
Commodities	UW	Dec-14
Alternatives	OW	Jun-13

\*Currency-hedged

## H1 2015 Performance

The table below summarises our key investment calls as published in the Outlook 2015 document (published 12 December 2014) and whether each call performed in line with our expectations or not between 12 December 2014 and 18 June 2015.

Theme	Index Name <sup>#</sup>	Relative Benchmark <sup>##</sup>	Status	Date Closed	Absolute <sup>###</sup>	Relative <sup>####</sup>
<b>Bonds</b>						
Underweight Bonds	Citi WorldBIG Index USD	MSCI All-Country World Daily Total Return Net USD	Open		n/a	✓
Overweight EM Investment Grade Bonds	J.P. Morgan EMBI Global Diversified Index	Citi WorldBIG Index USD	Open		✓	✓
Overweight Global Corporate Credit	Citi WorldBIG Corporate Index USD	Citi WorldBIG Govt/Govt Sponsored Index USD	Open		X	✓
Favour CNY local bonds (USD)	S&P China Corporate Bond Index		Open		✓	n/a
Favour CNH local bonds (USD)	Barclays Offshore Renminbi Index		Open		✓	n/a
Favour INR local bonds (USD)	CRISIL Composite Bond Fund US Dollar Index		Open		✓	n/a
Flattening 30-10 UST	US Treasury 30-10 yield spread		Open		X	n/a
Flattening 10-2 UST	US Treasury 10-2 yield spread		Open		X	n/a
<b>Equities</b>						
Equities preferred over bonds	MSCI All-Country World Daily Total Return Net USD	Citi WorldBIG Index USD	Open		✓	✓
Overweight US	MSCI Daily Total Return Net USA USD	MSCI All-Country World Daily Total Return Net USD	Closed	12 Feb	✓	✓
Overweight Euro (Hedged)	MSCI Europe Index Hedged to USD	MSCI All-Country World Daily Total Return Net USD	Open		✓	✓
Overweight Japan (Hedged)	MSCI Japan US Dollar Hedged Net Index	MSCI All-Country World Daily Total Return Net USD	Open		✓	✓
Underweight Asia ex-Japan*	MSCI All-Country Daily Total Return Net Asia ex-Japan USD	MSCI All-Country World Daily Total Return Net USD	Open		✓	✓
Overweight India	MSCI Emerging Markets India Net Total Return USD	MSCI All-Country Daily Total Return Net Asia ex-Japan USD	Closed	19 May	✓	X
Overweight Global Technology	MSCI All-Country World Daily Total Return Information Technology USD	MSCI All-Country World Daily Total Return Net USD	Open		✓	X
Overweight US Consumer Food & Beverages	MSCI US Food Beverage & Tobacco Index (Total Return)	MSCI Daily Total Return Net USA USD	Closed	21 May	✓	X
<b>Commodities</b>						
Underweight Commodities	Bloomberg Commodity Index	MSCI All-Country World Daily Total Return Net USD	Open		✓	✓
Underweight Gold	Gold Spot US Dollars Per Troy Ounce	Bloomberg Commodity Index	Closed	13 Feb	X	X
<b>Alternatives</b>						
Overweight Alternative Strategies	HFRX Global Hedge Fund Index	Citi WorldBIG Index USD	Open		✓	✓
Overweight Equity Long/Short Strategies	HFRX Equity Hedge Index	HFRX Global Hedge Fund Index	Open		✓	✓
Overweight Macro/Commodity Trading Advisors	HFRX Macro/CTA Index	HFRX Global Hedge Fund Index	Open		✓	X
Event-driven strategies	HFRX Event Driven Index	HFRX Global Hedge Fund Index	Open		✓	✓
<b>FX</b>						
Bullish USD	U.S. Dollar Index		Open		✓	n/a
Moderately Bearish AUD	Australian Dollar/United States Dollar Cross		Open		✓	n/a
Moderately Bearish NZD	New Zealand Dollar/United States Dollar Cross		Closed	24 Apr	✓	n/a
CNY to outperform Asia ex-Japan	Chinese Renminbi/United States Dollar Cross	Bloomberg JP Morgan Asia Dollar Index	Open		n/a	✓
INR to outperform Asia ex-Japan	Indian Rupee/United States Dollar Cross	Bloomberg JP Morgan Asia Dollar Index	Open		n/a	X
Moderately Bearish KRW	South Korean Won/United States Dollar Cross		Closed	27 Mar	X	n/a
Moderately Bearish TWD	Taiwanese Dollar/United States Dollar Cross		Closed	27 Mar	X	n/a
<b>Multi-Asset Income</b>						
Flexible** in Fixed Income			Open		n/a	n/a
Conviction in Equity Yield/Equity-Income			Open		✓	n/a
Non-core Income			Open		✓	n/a

\*For Asia ex-Japan Equities, we were UW, but highlighted our expectation for positive returns and a tale of two halves with H1 delivering positive returns and then performance in H2 deteriorating

\*\* Favouring unconstrained fixed income strategies

Source: Bloomberg, Standard Chartered. Performed measured from 12-Dec-2014 to 18-Jun-2015 or when the view was closed

### Explanatory Notes:

✓ - Call resulting in positive return; X - Call resulting in negative return; n/a - Not Applicable  
 # - Market index or reference used to measure performance  
 ## - Market index or reference against which relative performance is measured  
 ### - Simple absolute returns of the market index  
 #### - Performance of the market index used to measure performance vs. the relative benchmark

Underweight (UW) - Expected to return less than the relative benchmark

Bullish/Favour/Conviction - Expected to deliver positive returns

Flattening - A narrowing spread between long maturity and short-maturity yields

Past performance is not an indication of future performance. There is no assurance, representation or prediction given as to any results or returns that would actually be achieved in a transaction based on any historical data.

Overweight (OW)/preferred/outperform - Expected to return more than the relative benchmark

Bearish - Expected to bring about negative returns

## Performance of our key themes

Our W.I.D.E.N. investment framework embedded three key bullish investment themes – global equities, diversified income and alternative strategies. It was believed these best embodied our outlook on the economic, policy and financial market environment heading into 2015. So far, all three key convictions have worked well:

**Global Equities** – Since 12 December 2014 (the release date of our Outlook 2015 publication), we have seen an increase of 7.2%.

**Diversified Multi-income Portfolio** – The performance here has been significantly positive, notwithstanding weakness in the very recent past as interest rate expectations rose. This suggested allocation, which was revised slightly in May, brought about a 4.8% return. This performance was led by high-dividend-yielding equities, as expected, followed by reasonable performance by non-core income assets.

**Alternative Strategies** – The introduction of a bullish conviction on alternative strategies is the biggest difference between our 2014 A.G.I.L.E framework and the W.I.D.E.N framework. The theme has worked well, with alternative strategies witnessing a 3.6% return over the past six months.

### Performance of more granular themes

Besides the above three key convictions, we recommended more granular views. The below summarises their performance.

#### Bonds

**At the headline level, we entered the year Underweight on bonds.**

Not only did this underperform our preferred asset classes (equities and alternative strategies), they also generated negative returns on an absolute basis.

**Within the USD bond universe, we favoured Emerging Market (EM) Investment Grade (IG) bonds and global corporate credit.** In absolute terms, the former generated positive returns (2.2%) and outperformed the global bond benchmark. On a relative basis, global corporate credit also outperformed, but unfortunately has delivered negative absolute returns, due partly to EUR and JPY weakness.

We also suggested three Asian local currency bond markets – the CNY, CNH and INR – for investors to consider. All three have delivered positive returns so far, although we have to admit, we are disappointed with the performance of our INR bond view. While we expected modest INR weakness, we expected bond yields to fall significantly on policy easing. The rate cuts came, but we have seen yields spike on expectations that the monsoon may disappoint, resulting in higher inflation and, thus, the central bank's reluctance to cut interest rates further.

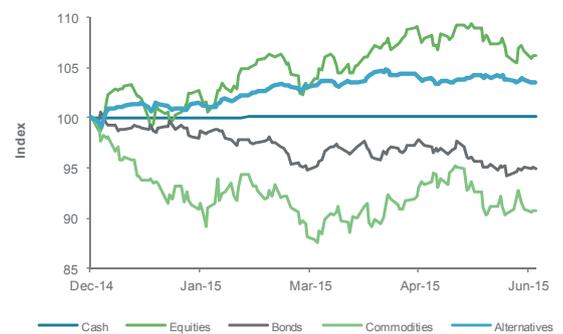
Where our views did worse than expected was on the USD yield curves (i.e. spread between long and short maturity government bonds). We expected the USD curve to flatten (narrowing spread) as we moved towards the first rate hike, but at the time of writing, the two highlighted areas of the curve have actually steepened.

#### Equities

As highlighted above, equities were our preferred asset class, and this has once again been validated. Heading into 2015, we were Overweight the US, as well as Europe and Japan on a currency-hedged basis. We closed our Overweight position on US stocks on 12 February (up 4.8% in absolute terms, outperforming the global benchmark at that time). Meanwhile, European and Japanese markets have also outperformed with the currency hedge enhancing returns in both cases, to deliver 11.5% and 15.5%, respectively.

We started the year Underweight Asia ex-Japan, but we expected positive returns for the full year characterised by a strong first half

**Equities and alternative strategies have outperformed bonds, commodities and cash**  
Level 1 asset class performance (100 = 12 December 2014)



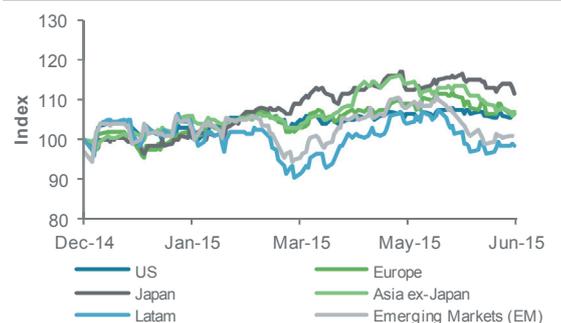
Source: Citigroup, Bloomberg, Standard Chartered

**HY bonds have outperformed**  
Level 2 bonds performance (100 = 12 December 2014)



Source: Citigroup, Barclays, JP Morgan, Bloomberg, Standard Chartered

**Japan equities have outperformed, while Latin American equities have underperformed**  
Level 2 equities performance (100 = 12 December 2014)



Source: Bloomberg, Standard Chartered

followed by a weaker second half. The first half has worked out well with the index performing strongly (up 6.9%). While Asia ex-Japan outperformed the global benchmark for a while, recent weakness on a relative basis has pushed it into marginal underperformance territory. Within this, although not flagged as a key theme, we were Overweight China relative to the region, a call which has performed well (see Investment Brief: “China – Receding tail risks, policy easing to boost equities”, 30 December 2014).

Our top sector picks in 2015 were global technology (up 7.1%) and US food and beverages (which we closed in mid-May at a 5.6% gain). Both performed well in absolute terms, but both underperformed their relevant benchmarks.

**Commodities**

We ventured into 2015 with a bearish view on commodities, and they performed as expected. However, we were less successful within commodities. At the start of the year, gold was our key Underweight in determining which area would do worse, and this posted positive absolute returns (0.6%) by the time we closed the Underweight in mid-February and outperformed the global commodities benchmark. To rub salt into the wound, gold has since fallen 2.2%.

**Alternatives**

In accordance with our W.I.D.E.N framework, we argued that alternative strategies would be a valuable addition to allocations. This has worked out well with the alternative strategies benchmark index outperforming, cash, bonds and commodities.

Within alternatives, all three recommended areas have generated positive returns, with two of three (equity long/short and event-driven strategies) outperforming the headline alternatives index.

**Multi-asset Income**

As discussed above, our income allocation has performed well, up 4.8%. Within this, we indicated the need to be flexible in fixed income, as we believe that rising yields would create a challenging environment, particularly for USD bonds. The recent spike in USD and EUR bond yields has validated these concerns.

Our conviction for high-dividend-yielding equities was strongly rewarded, particularly in Europe. Our focus on non-core income (a key driver of returns in 2014 as well) also posted strong gains over the last six months.

**Foreign Exchange**

Our continued bullish USD stance performed well earlier in the year before economic disappointments in the US and strength in European and, more recently, Japanese data led to a correction and consolidation. Despite this, the USD Index has risen 6.4% over the last six months.

We highlighted our bearish view on commodity currencies of Australia and New Zealand, and we are pleased to say that our views were right. Since the publication of our Outlook 2015, these currencies have fallen 5.4% and 2.3% (till 24<sup>th</sup> April 2015 when we closed our bearish view on NZD – prematurely, as it turned out), respectively.

Within Asia ex-Japan, we expected the CNY and INR to outperform when benchmarked against the Bloomberg-JP Morgan Asia Currency Index (ADXY). We were partially right as the CNY did outperform the ADXY by 0.7%. However, the INR underperformed by 1.2%.

Elsewhere within Asian Currencies, we were moderately bearish on the KRW and TWD. We closed our position on them on 27 March, but neither performed in accordance with our outlook.

Overall, we are happy with the performance of our views in H1 15. However, we expect H2 to provide a more challenging backdrop.

**The currency hedge on Europe and Japan equities has added value**

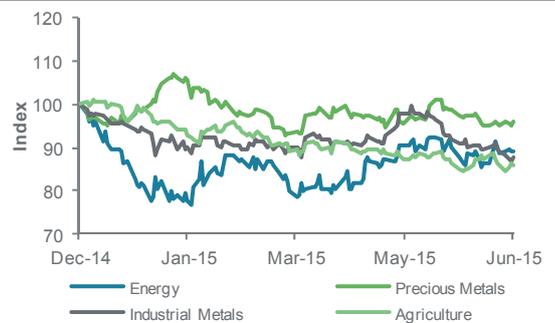
Level 2 equities performance (100 = 12 December 2014)



Source: Bloomberg, Standard Chartered

**Precious metals have outperformed within commodities**

Level 2 commodity performance (100 = 12 December 2014)



Source: Bloomberg, Standard Chartered

**Performance of main alternative strategies has been closely clustered**

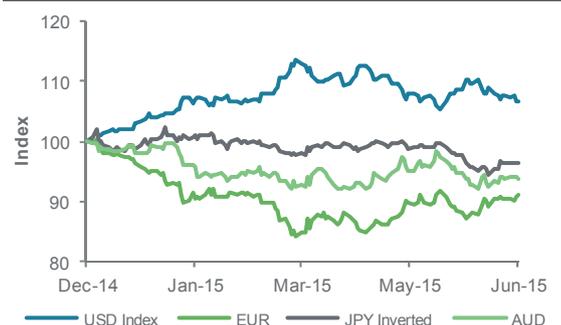
Level 2 alternative strategies performance (100 = 12 December 2014)



Source: Bloomberg, Standard Chartered

**The USD has strengthened**

Level 2 currency performance (100 = 12 December 2014)



Source: Bloomberg, Standard Chartered

## Economic and policy outlook

Greece bailout talks dominate the headlines, but Fed policy is equally key for markets. A September rate hike is still the most likely outcome, but the pace may be slow. ECB easing is likely to continue well into 2016 despite the pickup in inflation. Furthermore, BoJ easing faces hurdles as growth recovers. China is likely to stimulate further to defend its 7% growth target.

- **Greece's default risk rises, but contagion likely to be short-lived.** The deadlock in talks with creditors has raised the risk of Greece defaulting on its debt. However, this is unlikely to lead to its departure from the Euro area. Contagion risks for the Euro area are much lower compared with 2011 due to improved regional fundamentals (especially bank lending) and ECB backstops.
- **Fed hike in September likely as US emerges from winter chill.** The strong pickup in job creation and consumption in May should provide the Fed enough comfort that the Q1 slump was fleeting. As the labour market tightens and wages start to rise faster, the Fed is likely to start hiking rates in September. However, the pace of tightening is likely to be slow as inflation remains subdued.
- **Japan's rebound, JPY weakness raise hurdle for BoJ easing.** The economy recovered strongly in Q1 on business spending and exports. As focus turns to stimulating domestic consumption, the BoJ is unlikely to increase the pace of bond buying further as further JPY weakness may hurt small industries and real incomes.
- **China, EMs remain under pressure from slowing exports, low commodity prices.** Weak commodity prices continue to weigh on EM economies. India, South Korea and New Zealand cut rates in the past month. El Nino's impact (see page 16) and the Fed rate hiking cycle are likely to guide EM's interest rate outlook in H2.

### US: Fed likely to start measured pace of hikes in September

- **Strong jobs rebound to drive unemployment lower.** A strong recovery in job creation in May reinforces our view that Q1 weakness was primarily caused by temporary factors. Job openings at a record high suggest a strong pace of hiring in H2. This is likely to drive the unemployment rate, currently at 5.5%, towards the Fed's optimal rate of 5.0-5.2% later this year.
- **Robust hiring supports consumer confidence, retail sales.** US consumer confidence has risen close to its highest since 2008. This is reflected in rising sales of autos (10-year high in May) and homes. With consumption accounting for 70% of the economy, we expect consumption gains to help offset the slowdown in mining investment and impact on exports from the stronger USD.
- **A wage pickup could trigger a Fed rate hike in September.** Average earnings rose by 2.3% in May, accelerating from the 2% increases seen since 2009. As wages pick up, we expect the Fed to start hiking rates in September. However, with US inflation, excluding food and energy, remaining well below the Fed's 2% target, we expect a measured pace of hikes of around 25bps per quarter. There is also a risk the Fed may start hiking in December. This outlook aligns with the Fed's latest estimates.

### Euro area: Greece's impasse clouds signs of a nascent recovery

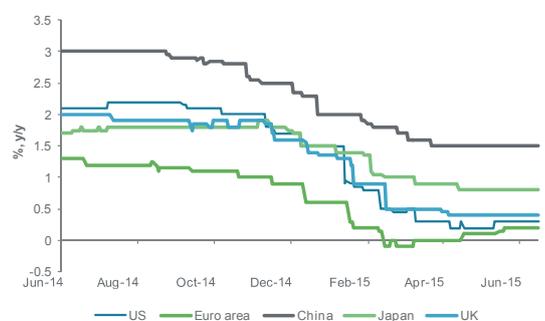
- **Greece's default risk rises as talks break down.** Greece declined to implement reforms required by the IMF and European institutions. Although this could be a bargaining tactic, it raises the risk of a (technical) default. However, a default is unlikely to lead to Greece's departure from the Euro area, in our opinion (see page 9).

Japan's data continues to surprise positively, China underwhelms, while US data appears to be stabilising  
Citigroup economic surprises index for major economies



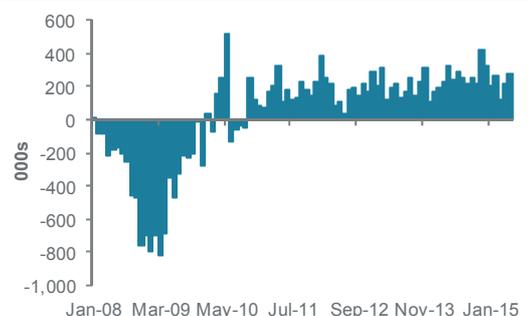
Source: Citigroup, Bloomberg, Standard Chartered

Inflation seems to have bottomed worldwide, led by a recovery in the Euro area and firmer oil prices  
Consensus headline CPI forecasts for 2015 (% y/y)



Source: Bloomberg, Standard Chartered

US job creation rebounded strongly after a winter blip  
US monthly net non-farm payrolls ('000s)



Source: Bloomberg, Standard Chartered

PMIs for Germany and the UK weakened in May though all Euro area indices remained expansionary  
Composite PMIs for key European economies



Source: Bloomberg, Standard Chartered

- **Confidence hurt by Greece uncertainty.** Euro area investor confidence fell for the second month in June while German business confidence fell to a 5-month low in May. However, major economies (Germany, France and Spain) continued to expand.
- **Contagion risks lower compared with 2011.** Euro area fundamentals are much stronger today, with growth expected to accelerate for the third year and most peripheral economies joining the recovery. Also, the ECB has built several mechanisms to maintain liquidity during times of crisis. These measures are likely to help keep peripheral bond yields from rising sharply.
- **Deflation risks fade, but ECB to persist with QE amid low inflation.** Euro area consumer prices rose in May for the first time in six months, ending a brief bout of deflation. However, with inflation expected to stay well below the ECB's 2% target at least until 2017, we expect the central bank to continue with its bond buying programme until its scheduled end in September 2016.

**UK: The BoE expects inflation to pick up as wages accelerate**

- **The tightening job market is likely to lift inflation, but a rate hike is unlikely soon.** UK's unemployment rate is at its lowest since 2008 and wages are rising at the fastest pace since 2011, helping sustain consumption growth. The BoE expects inflation to rise 'notably' by year-end from 0.1% in May. However, the pace of house price growth increases has slowed sharply since last year while business confidence fell for the second month, easing pressure on the BoE to consider hiking rates anytime soon.

**Japan: Growth rebound, weak JPY lower chances of a BoJ easing**

- **Growth rebounds on business spending, exports.** Japan's GDP growth accelerated to a higher-than-expected 3.9% in Q1 on rising business investment and exports. However, consumption remained subdued as the weaker JPY hurt real incomes.
- **Kuroda's unease over weak JPY implies further policy easing is unlikely.** The BoJ governor said the trade-weighted JPY was unlikely to weaken further, reflecting growing unease among Japanese policymakers of the impact of further weakness on domestic small businesses and households. We believe this raises the hurdle for the BoJ to ease policy further, at least in Q3.

**China: Further stimulus likely amid nascent signs of stabilisation**

- **Slowing services sector, weak manufacturing.** Services sector growth slowed to a six-year low while manufacturing barely grew in May. Exports fell for the third straight month, and business investment slowed to a 14-year low. However, retail sales and industrial production showed signs of stabilisation.
- **We expect more policy easing in H2.** Although bank lending picked up in May, we expect further cuts in interest rates and more targeted lending to priority sectors, adding to the steps taken since September, as authorities aim for 7% growth.

**Other EMs: El Nino likely to guide near-term India rate outlook**

- **India, South Korea cut rates.** India's central bank said further rate cuts will depend on the impact of the monsoon on inflation. India and Indonesia are among the most vulnerable in Asia to El Nino, but we believe the government's ability to maintain food supplies is likely to offset any inflationary impact of crop damage. South Korea's rate cut was aimed at bolstering consumption following the MERS outbreak, which appears to have peaked.
- **Brazil likely to see further rate hikes as inflation soars.** Brazil's sixth rate hike since October may not be the last in this cycle. Inflation running at an 11-year high (and rising) raises the prospects for further tightening.

**Before the recent blip, Euro area PMI was on an uptrend as the ECB continued to ease monetary policy**  
Euro area M1 money supply growth brought forward by nine months (% y/y); Euro area Composite PMI (RHS)



Source: Bloomberg, Standard Chartered

**Japan's bank lending and money supply is on an uptrend, supporting its growth rebound**  
Japan bank lending, M2 and M3 money supply (% y/y)



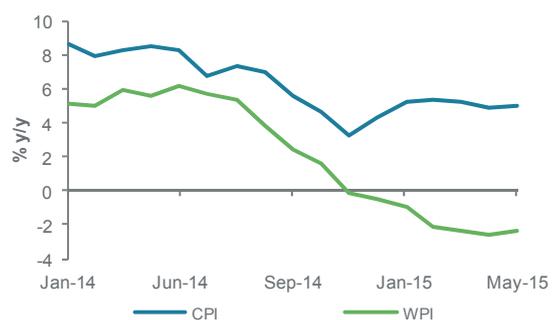
Source: Bloomberg, Standard Chartered

**China's services sector continued to slowdown while manufacturing barely expanded in May**  
China's manufacturing and non-manufacturing PMIs



Source: Bloomberg, Standard Chartered

**India's inflation has slowed significantly over the past year, allowing the central bank to cut rates**  
India's consumer and wholesale price indices (% y/y)



Source: Bloomberg, Standard Chartered

## Greece may default, but stay in Euro area

Risk of a default has risen following the breakdown in talks with creditors. With most of Greece's debt held by the IMF and European institutions, contagion risks are much lower than 2011. ECB's liquidity support mechanisms should also help. A default would unlikely lead to Greece's departure from the Euro area.

### Reasons behind the breakdown of talks

- **Greece's case.** The new government has argued that past bailout conditions have caused the economy to shrink by a quarter since 2007, with little sign of any revival. It has also argued the debt burden, at 175% of GDP, is unsustainable and needs to be restructured (with creditors taking write-offs) even if the bailout is extended and EUR 7.2bn of balance bailout funds are released.
- **Greece's debt restructuring proposal.** The plan involves extensive write-offs and extension of repayment deadlines aimed at cutting Greece's public debt-to-GDP ratio to c.100% from 175% (bringing it close to that of Italy, Portugal and Ireland). A big 'haircut' (anything above 20%) would impose a heavy cost on European taxpayers, making it politically challenging for EU governments to accept.
- **Creditors' argument.** There are some differences in the stance of major official creditors. While EU institutions and the IMF have both insisted that Greece agree to a workable plan to achieve a primary surplus through privatisations, spending cuts and tax reforms (which Greece's officials have accepted), the IMF has insisted on pension cuts and tax increases (which Greece's negotiators have rejected).

### Next deadlines

- **The most immediate deadline is IMF debt payment.** A EUR 1.6bn payment will be due to the IMF on 30 June. Greece may miss this deadline and impose capital controls, even if only as a bargaining tactic, to get a bigger haircut and more concessions on bailout terms. It could get a grace period which it can use to discuss a better deal. However, IMF chief Christine Lagarde has ruled out this option.
- **The next payment is due to the ECB.** Another EUR 6.7bn will be due to the ECB in July/August. Greece has proposed another European institution (ESM) buys these bonds and then extends their maturity. This would avoid a default to the ECB (ensuring ECB's liquidity to Greek banks) but shift risks to Euro area governments.
- **Defaulting on T-bills and private debt are less likely.** T-bills account for less than 5% of Greece's debt. Also, Greek banks use them as collateral to get ECB's liquidity. Another fifth of Greece's debt is still held by private investors. However, Greece has ruled out defaulting on this debt as write-downs would hurt Greek banks.

### Potential scenarios

- **A default on IMF debt is likely to focus minds, encourage policymakers to reach a middle ground.** A critical assumption here is the ECB continues to provide liquidity to the Greek banking system, buying time for politicians to settle their differences.
- **Agreement is a win-win for both sides.** Creditors should realise a debt write-off is inevitable at some point. Greece should understand it needs to reform to revive growth and reduce its debt burden. Therefore, it is in both sides' interest to come to an agreement.
- **Strong Greek support for Euro membership is key.** This could encourage Syriza to compromise and strike a deal, potentially via a referendum to appease hard-liners within its own party. An alternative scenario would be Syriza loses popular support, leading to the formation of new interim government which would likely be more open to further reforms. Either way, we believe a deal will be reached, although we doubt the path will be smooth.

Contagion has been limited so far, but may increase in the coming days if no deal is reached

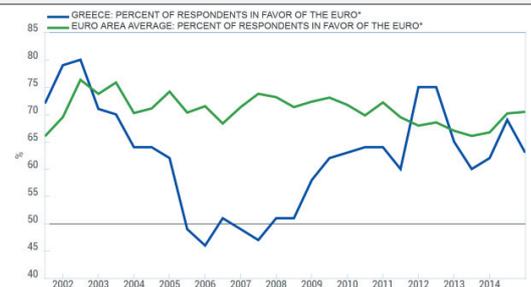
Euro stoxx 600 index and Spanish 10-year government bond yield premium over German bund yield (inverted)



Source: Bloomberg, Standard Chartered

Support for a single currency remains high in both Greece and the broader EU

Survey of Greece and Euro area nationals, % favouring the Euro



Source: BCA Research, Standard Chartered

Greece's restructuring proposal aims to cut its debt-to-GDP ratio to a more sustainable level

Table of Greece's debt breakdown and possibly write-offs

Type of Debt	Size (€bn)	% of GDP	Maturity	Interest Rate (%)	Impact of 50% write-down on debt ratio (%)
T-bills	14.8	8.2	2015	2.3	-4.1
IMF	24.3	13.5	2015 - 2025	3 to 4	-6.8
ECB	27	15	2015 - 2026	4.9	-7.5
GLF	52.9	29.4	2020 - 2041	0.52	-14.7
Private	55.1	30.6	2017 - 2042	4.9	-15.3
EFSF	141.8	78.8	2022 - 2054	Funding cost + 1 bp	-39.4
<b>Total</b>	<b>315</b>	<b>175</b>	<b>2015-2054</b>	-	<b>-88</b>

Source: Capital Economics, Standard Chartered

## Multi-income update

Despite recent bouts of volatility, the multi-income allocation has performed well (up 4.8%) since our Outlook 2015 publication, led by strong performance from dividend equity (up 8.0%) and non-core income (up 5.6%). While rising US interest rates may provide headwinds at some point over the summer months, low bond yields relative to their long-term history are likely to keep the search for yield intact.

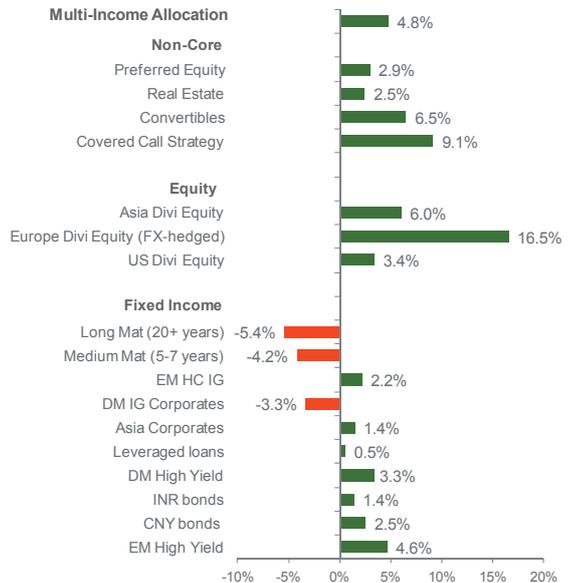
In the near term, the potential of a rate hike by the Federal Reserve could lead to elevated levels of volatility. In light of this, we considered two main objectives when making recent changes to the portfolio.

1. **Tackling volatility** – As indicated earlier in the publication, we prefer to stay invested rather than trying to time short-term volatility. However, to minimise the effect of volatility in the portfolio, we hedge the currency risk back to USD in our G3 Sovereign and Developed Market (DM) Investment Grade (IG) Corporate positions. Given the yield on offer in the assets provides little buffer, we feel the hedge is appropriate. This is also consistent with our view on USD strength going forward.

In addition, we made adjustments in previous months to help weather the potential volatility while generating sustainable yield. The list below highlights changes (see Global Market Outlook June 2015 for rationale) since our 2015 Outlook publication:

- **Addition to leveraged loans:** Attractive gross yield (4.81%), incrementally stronger investor protection in the event of a default and a floating rate arguably bring a more defensive risk profile to the income portfolio.
- **Rotation within non-core income:** Reduced allocation to rate-sensitive REITs in favour of other non-core assets, such as convertible bonds and preferred stock.
- **Addition to CNY bonds for diversification:** Chinese onshore bonds provide an attractive yield while maintaining a low correlation with other asset classes. This allows investors to continue to benefit from income during heightened volatility.

Performance of 2015 multi-income allocation  
Inception to date total return performance\*(%)

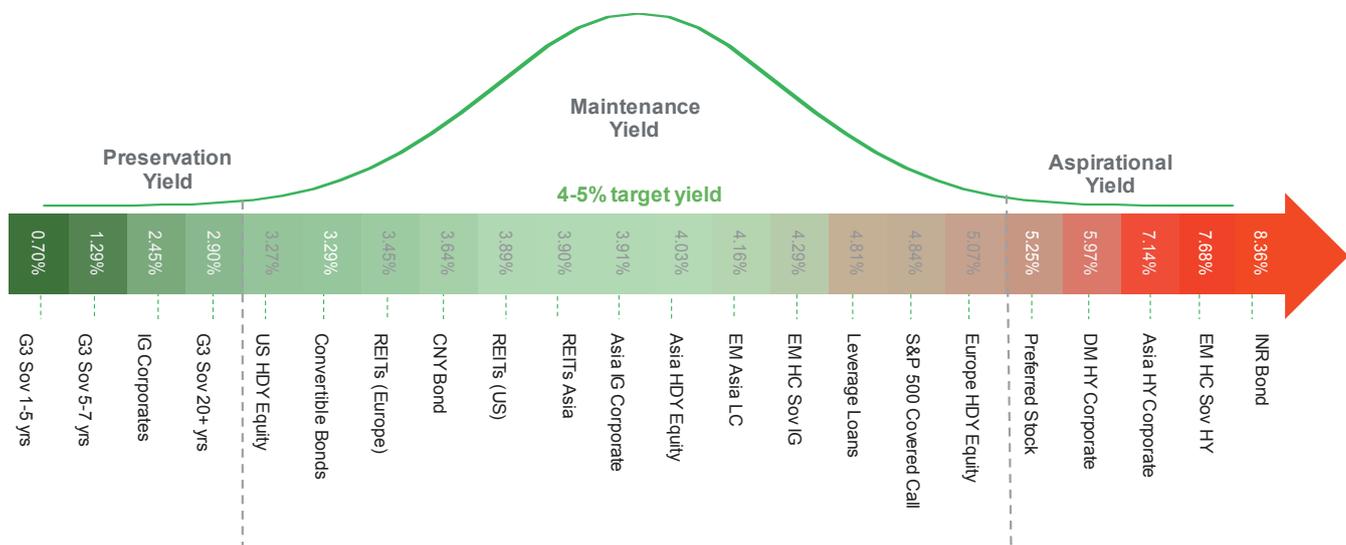


\* For the period 31 December 2014 to 18 June 2015  
Source: Bloomberg, Barclays, JPMorgan, Citigroup, MSCI, FTSE, CRISIL, Standard Chartered

Indices are IShares preferred stock ETF, FTSE NAREIT global index TR USD, SPDR Barclays convertible ETF, S&P 500 Covered Call index, MSCI EM Asia High Divi TR, MSCI Europe High Divi USD, MSCI North America High Divi TR, Citigroup WBIG 20+y USD, Citigroup WBIG 5-7y USD, JPMorgan EMBI IG, Citigroup WBIG Corp USD, S&P/LSTA US Leveraged loan 100 index, Barclays Global HY TR USD, CRISIL Composite Bond Fund Index, S&P China Corporate Bond, JPMorgan EMBI HY

## Widen the mix – A range of yields on offer beyond core fixed income

Yield to maturity/dividend yield (%)



Source: S&P, JPMorgan, Barclays Capital, Citigroup, MSCI, SPDR, FTSE, IShares, Bloomberg, CRISIL, Standard Chartered Bank

- **Monetisation of equity volatility:** Increased allocation to covered calls, which give us exposure to the equity market while slightly reducing downside risks and enhancing the yield.
2. **Protection of Income** – In our 2015 Outlook publication, we described three buckets of yield as being key components of an income portfolio – Preservation, Maintenance and Aspiration. The majority of the income portfolio consisted of assets in the Maintenance bucket with moderate allocations to Preservation and Aspiration. Since the Outlook, we have made the following adjustments to the allocation between various buckets of yield:
- **Reduced Preservation bucket (-6% since Outlook):** Traditionally, the Preservation bucket (consisting of traditional fixed income) would be the primary source of portfolio protection during periods of rising volatility. However, in light of a potential rate hike, it is precisely this bucket that could be adversely affected by rising yields. Additionally, the low yields (0-3%) on offer within this bucket provide little buffer from capital loss. As a result, we maintain a lower-than-normal allocation to the Preservation bucket.
  - **Increased the Maintenance bucket (+6% since Outlook):** We have moved to a larger-than-normal allocation to this sleeve at the expense of the Preservation bucket. Specifically, this has involved increasing allocation to assets, such as leveraged loans, covered calls, and CNY bonds, which offer attractive risk/reward profiles, given our concerns that volatility may rise.
  - **Maintained Aspiration bucket:** We remain comfortable with our allocation to assets in the Aspiration yield bucket.

#### 2015 multi-income allocation

Combination of core and non-core income assets

	Preservation (0 - 3%)*	Maintenance (3 - 5%)*	Aspiration (5 - 8%)*
<b>Core Fixed Income</b> 44%	DM IG Corporates (FX-hedged)	CNY Bond	INR Bond
	G3 Sovereigns (FX-hedged)	EM HC IG Leveraged Loans Asia Corporates	DM High Yield EM High Yield
<b>Core Equity</b> 38%		DM High Dividend EM High Dividend	
<b>Non-core Income</b> 18%		REITs Convertible Bonds Covered Call	Preferred Stock

\*Range of yields for each income basket

Source: Bloomberg, Standard Chartered

## Bonds – Underweight

- A five-year average maturity profile in USD bond allocations remains valid. Yield rises are likely to be increasingly muted.
- We continue to favour corporate credit, CNY, CNH and INR local currency bonds and USD Emerging Market (EM) sovereign bonds.

### G3 and EM (USD) sovereign bonds

- **A rough H1 for G3 sovereign bonds.** We highlighted in our 2015 Outlook report that our Underweight view on G3 bonds was underpinned by our expectation that the rise in yields could wipe out the gains through bond coupons. While yield rises have been relatively small (US 10-year Treasury yields are up by only about 20bps in 2015 YTD), currencies (the EUR and JPY) have actually been the principal driver of losses so far this year. The past two months have been particularly rough.
- **Our view on the likely path of bond yields remains unchanged.** Barring an unexpected surge in inflation, we believe Treasury yields are likely to trend gradually higher over the rest of the year as the market adjusts to a Fed rate hike. History suggests short-term yields are likely to rise more than the long-term yields. This outlook favours maintaining a moderate maturity profile (centred around five years) across USD bond allocations.
- **We continue to like EM sovereign bonds, with a preference for the Investment Grade (IG) component.** EM IG sovereign bonds are relatively more sensitive to changes in yields. Hence, it is not surprising that the spike in yields was the primary driver for weak performance over the past month. However, given our view that US yield gains are likely to be increasingly gradual, we continue to prefer EM IG sovereign bonds, as we believe they are in a sweet spot, combining IG credit quality, a spread cushion over US Treasuries and fair valuations.

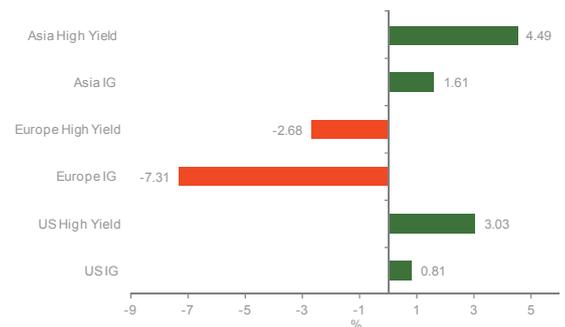
### Asian local currency bonds

- **Comfortable holding INR bonds over the long term.** Despite the RBI cutting the benchmark interest rates by 25bps, INR bonds were hit by a double-whammy of a weaker currency and rise in yields due to rising inflation expectations. However, we believe concerns are overdone. Hence, while there can be some volatility around the time of a Fed rate hike, we remain comfortable holding INR bonds over a longer period as a part of a diversified portfolio.
- **Favour CNY and CNH bonds.** Although a surprise currency move is the key risk, we believe their low correlation with other asset classes tilts risk/reward in favour of maintaining exposure, especially as we head towards a period of increased volatility.

### Corporate credit (USD)

- **We continue to prefer corporate credit in both Developed Markets (DM) and Asia.** As we had expected in our 2015 Outlook, corporate credit has outperformed government bonds in 2015. The recent market volatility underscored the value of their spread over Treasuries in helping cushion against yield rises.
- **Maintain benchmark exposure to global High Yield (HY) credit.** HY bonds have been among the best-performing bond asset classes in 2015. While a case can be made for favouring them, history suggests that they can underperform a few months before a Fed rate hike. Hence, in light of mildly expensive valuations and deteriorating credit fundamentals, we prefer to maintain benchmark exposure (see page 19 for details) and look for a better entry point.

### Performance of fixed income YTD\* (USD)



\* For the period 31 December 2014 to 18 June 2015  
 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

### Despite the sharp move, 10-year US yields have increased only marginally in 2015

#### US 10-year Treasury yield in 2015



Source: Bloomberg, Standard Chartered

### EM IG bond weakness has been almost entirely led by higher G3 government bond yields

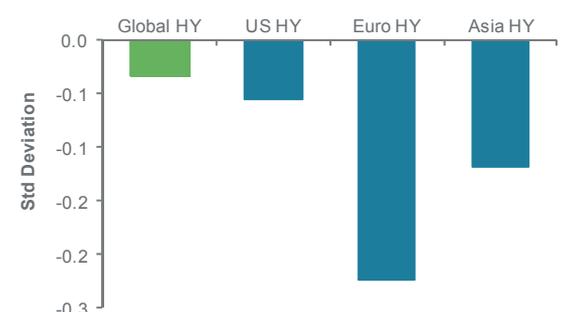
#### EM IG bonds, US 7-10-year Treasuries, total returns



Source: Barclays, Bloomberg, Standard Chartered

### HY bonds are expensive relative to historical levels

Deviation from historical valuations. A more negative number implies more expensive valuations



Source: Bloomberg, Standard Chartered

## Equity – Overweight

- **We are bullish on equities in H2 15, but expect volatility to rise.** Risk aversion is likely to rise as we approach the first rate hike by the Fed, which we estimate is most likely to occur in September. We attribute a 65% probability that equity markets will witness a correction of 5% or more in the coming months.
- **Our eight key views outlined in our 2015 Outlook report have generated positive returns.** We have closed three of our eight views: positive on the US, India and US food and beverages. Our other five views remain active: equities to outperform bonds, positive on Europe and Japan on a currency-hedged basis, positive on technology and bullish, albeit Underweight, on Asia ex-Japan. Conviction around our three themes – rising margins in Japan, impact of falling oil prices and impact of US rate hikes on Asia – remains intact.
- **In order of preference, we prefer markets in Europe, followed by Japan, both on a currency-hedged basis, followed by the US.** Our positive views on European and Japanese equities on a currency-hedged basis worked well in H1 15, and we retain these views as liquidity and earnings revisions are positive. We remain bullish on US equities, but are less convinced that they will outperform. High current margins and low corporate investment are highlighted as sources of concern.
- **Remain cautious on Asia ex-Japan, continuing to expect a year of two halves for performance.** We expect markets in Asia ex-Japan to weaken in H2 as risk aversion rises as we approach the first rate hike by the Fed. China and Taiwan are likely to be more resilient as the rate hiking cycle begins.

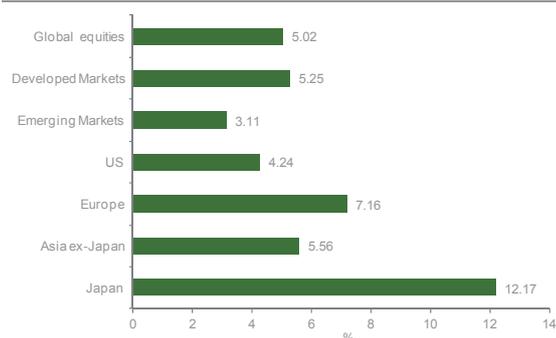
### Bullish on equities, but expect higher volatility ahead

- **Market performance likely to be negative after the Fed rate hike.** An analysis of prior rate hiking cycles clearly indicates that market performance is positive in the 3, 6, 9 and 12 months before a rate hike, turning negative three months after the first rate hike, rebounding somewhat thereafter. This performance trend is consistent across the US, Europe, Japan and Asia ex-Japan.

### Recap on our eight views and three themes for 2015

- **Five of the eight views outlined in December 2015 remain open.** All eight views recorded positive returns in H1 15 while they were open. We continue to stand behind five of the eight views: equities to outperform bonds, positive on Europe and Japan on a currency-hedged basis, positive on technology and cautious on Asia ex-Japan. We have removed our preference for US equities, the US food and beverages sector and India.
- **We stand behind our three themes** – rising margins in Japan, positive impact of falling oil prices and negative impact of US rate hikes on Asia.
- **Japanese margins recovering.** Our Overweight Japan equities is in part driven by our positive view on Japanese margins, which is one of our key themes. The chart on the right indicates a modest improvement in Japanese margins since we released the view in December. This has been driven by tentative signs of a pick-up in consumer spending and the positive effect of a weaker yen.
- **Impact of falling oil prices.** We continue to believe that the decline in oil prices will eventually have a positive impact on US consumption. The impact so far has been less than expected, as consumers have saved a greater share of their windfall gains relative to expectations.

### Performance of equity markets YTD\* (USD) update



\* For the period 31 December 2014 to 18 June 2015  
Source: Bloomberg, Standard Chartered. MSCI Indices are USD total return

### Our conviction equity market themes and views

#### Views

1. Equities preferred over bonds
2. Bullish Euro area equities (fx hedged)
3. Bullish Japan equities (fx hedged)
4. Cautious Asia ex-Japan, but expect positive returns
5. Bullish global technology

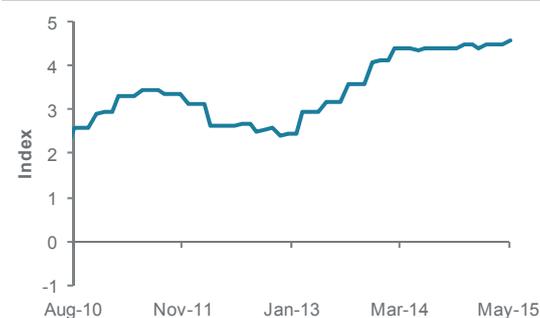
#### Themes

- A. Japanese margins to rise
- B. Lower oil prices - impact on US consumption
- C. Rising interest rates - impact on Asia

Source: Standard Chartered

### Japanese margins are trending higher

#### MSCI Japan ex-financials margins



Source: FactSet, Standard Chartered

- **Nevertheless, as wage growth picks up, we expect rising US household confidence to bring down the savings rate.** This can already be seen in the survey data, which highlights that 23% of US households' plan to save the gains from lower oil prices, down from 32% in January.
- **Negative impact of US rate hikes on Asia.** Relative to our expectations in December, the timing of the first rate hike by the Fed has been pushed back to September from June. This has resulted in better-than-expected performance in Asia ex-Japan. However, as we highlighted in our December report, we expect performance in Asia ex-Japan to be a year of two halves. As such, we continue to expect Asia ex-Japan to weaken in H2.

**Positive trends in Europe and Japan**

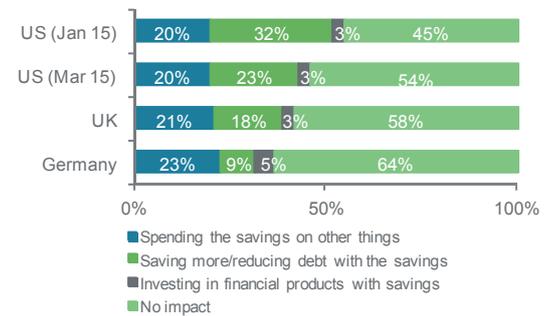
- **MSCI Euro area and Japan up 12-16% YTD.** Driven by a combination of improving liquidity and positive earnings revisions, equity markets in Europe and Japan have surged since the start of the year. The ECB's decision to front-load quantitative easing (QE) over the summer months and evidence that the deflation scare is behind us are supportive of equity markets in our view. Yen weakness and the first increase in real wages in almost two years are also supportive of Japan.
- **Earnings revisions trump valuations in the short term.** Investors have expressed some concern over the level of valuations in Europe. 12m forward P/E in the Euro area is 15x compared with the long-term average of 12x. These concerns are trumped by the positive trend for earnings revisions in our view. Upgrades account for 52% of all changes to earnings in the Euro area, exceeding the percentage for the US at 49% and Asia ex-Japan at 42%. The percentage of upgrades in the Euro area is only exceeded by Japan at 59%.
- **Cautious on the UK.** Within Europe, we are positive on equities in the Euro area, but are more cautious on the UK. This is driven by divergent monetary policy paths and the negative impact on business investment due to the uncertainty surrounding the referendum on EU membership.

**Bullish on the US, but outperformance is unlikely**

- **We are bullish on US equities, but believe outperformance is unlikely.** Our concern centres on the outlook for corporate margins, which are currently at cyclical highs. Earnings revisions and, in turn, earnings growth continues to be constrained by the slowdown in investment in the energy sector. We are watching for signs of a pickup in investment elsewhere in the economy, but these remain elusive for now.
- **Consensus expects 1.3% earnings growth for the S&P500 in 2015.** Analysts remain cautious on the prospects for earnings growth this year, forecasting a mere 1.3% growth. This forecast has been dragged down by a 56% drop in energy sector earnings growth. Growth in 2016 is forecast to rebound by 12%.

**US consumers are saving a greater share of the petrol price windfall**

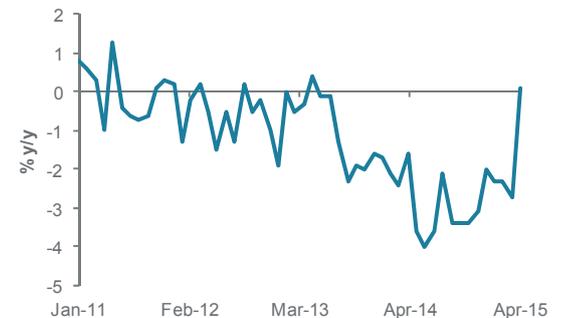
*Survey on consumer preference after oil price drop*



Source: BCA, Standard Chartered

**Japanese real wages are increasing**

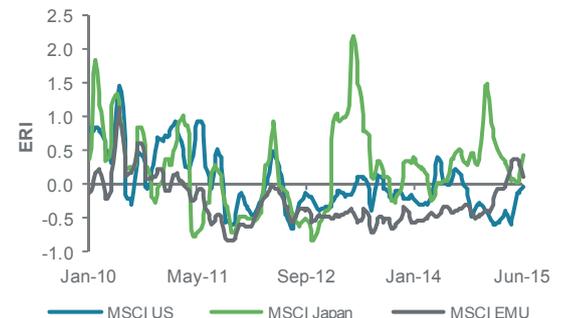
*Japan real wage trends*



Source: Bloomberg, Standard Chartered

**Earnings revisions in the Euro area and Japan are positive**

*Earnings revisions in the US/ Euro area and Japan*



Source: Bloomberg, Standard Chartered

**Cautious on Asia ex-Japan, positive on China and Taiwan**

- **A year of two halves for Asia ex-Japan.** Markets in Asia ex-Japan have risen 5% YTD, marginally outperforming MSCI World and MSCI Emerging Markets (EM). We expect returns to turn negative after the first rate hike by the Fed, which could be as soon as September. China and Taiwan are viewed as among the more resilient markets as the rate cycle turns.
- **China outlook improving.** Chinese equity markets have performed well YTD, led by a 43% gain in domestic A-shares. H-shares listed in Hong Kong have performed well, rising 11%, albeit less spectacularly than their domestic peers.
- **We remain positive on H-shares and more cautious on A-shares.** Drivers of our optimism towards China centre on the likelihood of further policy easing by the authorities. Fixed income markets are currently discounting such an outcome, as reflected in the decline in yields YTD and the steepening of the yield curve, which is positively correlated with the H-share index. We will monitor developments in the China market carefully as there signs of irrational exuberance in the A-share market.
- **Bullish view on technology remains intact.** We remain bullish on the global technology sector, citing International Data Corporation's (IDC) forecast of 3.8% growth in technology spending in 2015. While this is slightly lower than last year, this is attributed to a slowdown in handset spending to 11% in 2014 from 27% last year. Excluding this segment, all other technology segments will witness an increase in spending.

**Conclusion:**

We remain positive on equities in H2, focusing on Europe and Japan on a currency-hedged basis and China and Taiwan in Asia ex-Japan. We add a new market view to the existing five we are monitoring: positive on Singapore banks. On average, this sector has returned 11% in the 12 months following the start of the rate tightening cycle by the Fed.

**As the Chinese yield curve steepens, equities rise on bullish sentiment**

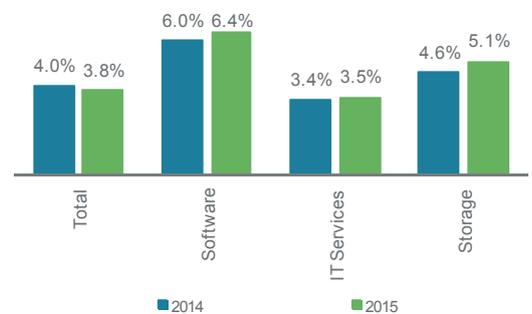
*Chinese yield curve and H-shares*



Source: Bloomberg, Standard Chartered

**Global technology spending is forecast to rise, ex-handsets**

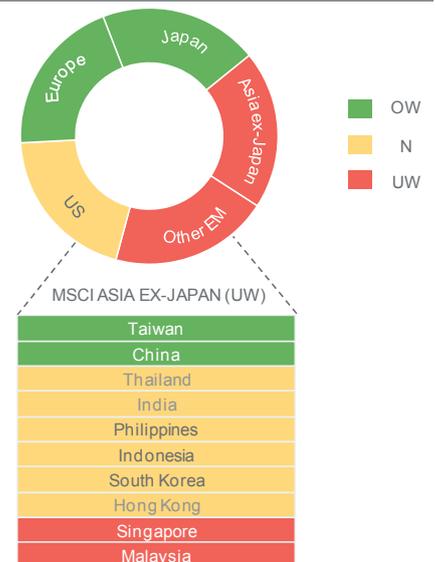
*IDC forecasts on global technology spending*



Source: IDC, Standard Chartered

**Bullish Europe, Japan (currency-hedged), China and Taiwan**

*Global and Asian country preferences*



Source: Standard Chartered

## Commodities – Underweight

- We expect oil prices to remain rangebound near current levels, while a short-term correction remains a possibility.
- We expect gold to remain rangebound in the short term, but weaken in the long term.

**We remain Underweight on commodities.** We expect modest weakness in commodity prices amid continued demand-supply imbalances and a stronger USD. After rallying since the middle of March, commodity prices have recently undergone a pullback and have turned rangebound, which may persist. However, a potentially severe impact of El Nino could result in the outperformance of agricultural commodities at some point. We are monitoring developments closely.

**We remain Neutral on energy.** We expect oil prices to remain rangebound but see potential for a short-term correction. We base this view on persistent oversupply amid increased production from OPEC and Russia. We believe conventional oil producers have an incentive to increase production at current levels. Meanwhile, US conventional production has also increased, offsetting lower production from shale producers. US inventories, although lower from peak levels, have only declined marginally.

On the demand side, slower growth from most Emerging Market (EM) countries and modest growth in Developed Markets (DM) are likely to prevent any major pick up in prices. The main risk to our view is geopolitical; the possibility of a more overt conflict among Middle East players directly threatens oil production.

**We remain Neutral on gold.** We expect gold prices to remain rangebound in the short term, but head modestly lower over a 12-month horizon. We believe higher interest rates (net of inflation) amid Fed rate hikes, contained inflation, a stronger USD and limited incremental demand from slowing EMs are negative for gold. While inflation has begun to pickup in most places from low levels, we do not see it accelerating. This, together with higher interest rates, may increase the opportunity cost of holding gold.

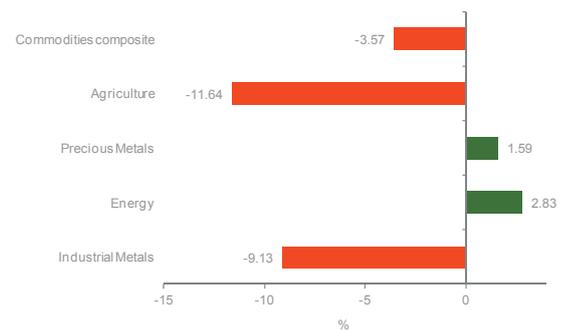
Recent data suggests investor sentiment in gold remains weak. Total holdings in ETFs continue to decline (see adjacent chart), while speculator positioning remains largely stable. A significant improvement in sentiment for gold is possible should Greece's debt issues result in a full-blown crisis, although we assign a low probability to this event (see page 9).

**We remain Neutral on base metals.** We do not expect base metal prices to rally. In our view, a structural downturn in both residential and non-residential properties in China, weaker growth in EMs, a stronger USD and still largely an oversupplied market are likely to remain major headwinds for base metal prices.

Copper prices have fallen as inventories rose. Last month, we highlighted the recent rally in copper prices was unlikely to be sustained. Notwithstanding the recent short-term pickup in China property sales, the supply-demand situation remains fundamentally poor. We also believe the recent rally in iron ore is unsustainable. Lower seasonal steel demand and higher output as smaller mines in Australia and China resume output, are likely to increase the surplus.

**We remain Neutral on agricultural commodities.** As highlighted earlier, forecasts by government agencies point to a greater-than-90% chance of El Nino in 2015. We do acknowledge this increases the probability of a rise in agricultural prices over the medium term, although the impact may differ depending on seasonal and geographic factors. On the other hand, high stock levels in most major commodities may also help cushion against a sharp spike in prices.

### Performance of commodities YTD\* (USD)

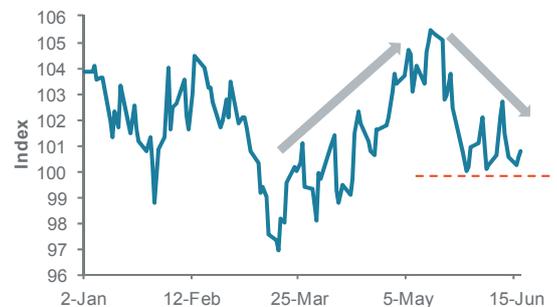


\* For the period 31 December 2014 to 18 June 2015

Source: DJUBS, Bloomberg, Standard Chartered  
DJUBS, DJUBS Agri, DJUBS Precious metals, DJUBS Energy, DJUBS Industrial metals

### Commodity prices consolidate following a short-term rally

Bloomberg commodity index



Source: Bloomberg, Standard Chartered

### Gold ETF holdings continue to decline gradually

Gold prices and total known gold ETF holdings



Source: Bloomberg, Standard Chartered

#### What is El Nino?

A prolonged warming of temperatures in the Pacific Ocean, happening at irregular intervals, lasting between 9 months to 2 years. The US, South America, Australia, South and South-East Asia are the regions generally affected by El Nino.

Source: Climate Prediction Centre, National Oceanic and Atmospheric Administration

## Alternative Strategies – Overweight

- We remain Overweight alternative strategies. Our supportive themes – policy divergence, clearer market trends and demand for protection against volatility – remain in place for H2 15.
- We continue to favour equity long/short, macro/CTA and event-driven strategies over relative value.
- Last month's returns reinforced the asset class' diversification value as it held up well amid equity and bond market weakness.

**Equity market weakness imposed a drag on total returns.** Unsurprisingly, equity long/short and event-driven strategies were hurt due to their positive correlation with equities. However, they still outperformed global equities, underscoring their value with a diversified allocation. Macro strategies recovered slightly, and a rebound in the US dollar is likely to help in the coming months.

**Key drivers for alternative strategies remain in place for H2 15.** A Fed rate hike is likely to intensify policy divergence, favouring macro strategies. Rising global mergers and acquisitions activity is likely to continue supporting event-driven strategies. Finally, equity long/short strategies are likely to prove beneficial in an increasingly uncertain environment, leading up to the Fed lift-off. Their lower volatility (relative to global equities) is likely to help should we indeed face a significant equity market correction. However, they also ensure exposure to equities is maintained in the event no such pullback takes place.

### Conclusion:

Stay Overweight on alternative strategies, favouring diversified exposure. Within the asset class, we favour equity long/short, event-driven and macro/CTA strategies.

## Foreign Exchange

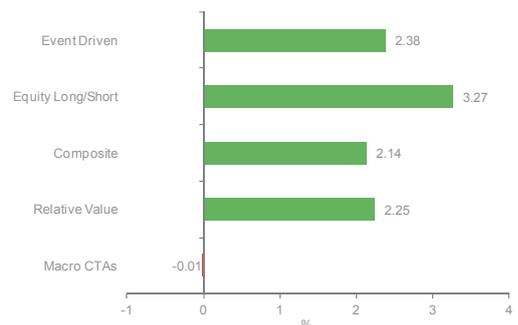
- We highlight current levels as an attractive buying opportunity in the USD against the EUR, JPY and AUD.
- We are Neutral on Asia ex-Japan currencies, but expect the CNY and INR to outperform and the SGD and KRW to underperform.

**USD: We expect medium-term appreciation.** We expect USD strength over a 12-month horizon. We believe Fed interest rate hikes and monetary policy divergence remain the main drivers of a stronger USD. In our view, the US is likely to begin hiking interest rates in September while most major central banks continue with their easing stance. We have observed the adjustment for subsequent rate hikes generally occurs around the time of the first rate hike. This, in our view, is likely to further expand interest rate differentials and attract capital flow to US assets. As the adjacent chart shows, interest rate differentials have correlated very strongly with the USD recently. Based on our expectations of an expanded rate differential, we would not be surprised by high single digit percentage USD gains in the coming months vs. other major currencies.

While the USD has corrected from its peak levels earlier in the year, we do not see significant additional weakness. Earlier, the USD overshot interest rate differentials amid a build-up of extreme long positions. However, following the recent pullback, the USD is in line with interest rate differentials, while positioning has gradually receded from extreme levels. **Hence, we see this as a good opportunity to enter long USD positions vs. the EUR, JPY and AUD.**

**EUR and JPY: We expect medium-term depreciation.** Recently, the EUR has been supported, as excessive short positioning has unwound and German yields have surged from low levels. However, we believe continued bond buying by the ECB is likely to limit significant upside in

### Performance of alternative strategies YTD\* (USD)



\* For the period 31 December 2014 to 18 June 2015  
 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 index has correlated quite closely with interest rate differentials since mid-2014

USD index weighted interest rate differentials and USD index



Source: Bloomberg, Standard Chartered

European bond yields. In addition to policy divergence, Greece's debt impasse is likely to be a continued source of uncertainty and weaken Euro area investor sentiment.

We expect the JPY to weaken over the medium term. A stronger USD amid widening interest rate differentials and continued net outflows from Japan are the main basis for our view. Recent statements from BoJ's Governor Kuroda suggest that he sees a low possibility of a significantly weaker JPY against a basket of major trade partner currencies. However, we believe the JPY can weaken further against the USD even if it strengthens against other major peers. In particular, we expect JPY strength against the EUR.

**GBP: We remain medium-term Neutral.** We continue to see both positive and negative factors. On the positive side, we expect the BoE to be the first major central bank after the Fed to raise interest rates. The 12-month BoE inflation forecast has now risen back above the inflation target rate of 2% after falling initially. The BoE also highlighted recently that it expects the economic slack to recover completely in about one year, paving the way for the first rate hike, in our opinion. On the negative side, a large current account deficit increases vulnerability to shocks, while budget deficit cuts may weigh on growth. Both these factors may keep the currency under pressure.

**AUD: We remain moderately bearish on the AUD.** In our view, second-round effects of weak commodity prices, potential for further policy easing and a pickup in volatility are the main drivers of this view. Although iron ore prices have rebounded following a sharp downturn, they still remain significantly lower than the average levels seen last year. This has resulted in a sharp deterioration in export prices, which are now at their lowest level in over a decade (see adjacent chart) relative to import prices. The RBA has continued to express concerns regarding weak commodity prices and the elevated level of the exchange rate (see adjacent chart). In our opinion, the central bank is likely to reduce interest rates further in H2, reducing the AUD yield advantage. In addition to this, we expect a further pickup in currency volatility around the Fed rate hike, further reducing the attractiveness of holding the currency to capture yield.

**Other commodity currencies: Neutral on the NZD and CAD.** While we did not initially expect the RBNZ to reduce interest rates, we believe these are now largely priced-in. On a risk-reward basis, we prefer to remain Neutral at current levels. On the CAD, while we do not expect oil prices to pick up meaningfully from current levels, an acceleration in US growth is likely to provide support to the Canadian economy. Hence, we remain Neutral.

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

We remain Neutral on Asia ex-Japan as a whole, but expect the CNY and INR to outperform and the SGD and KRW to underperform.

In our view, China will continue to favour a stable CNY as it seeks greater internationalisation of the currency (including its inclusion in IMF's Special Drawing Rights [SDR] basket). With restricted two-way capital flows, we do not believe recent weaker macroeconomic data and easing monetary policy is negative for the CNY. While the possibility of a further widening of the trading band may increase volatility, we do not see this as a definite negative for the CNY. We believe the INR is likely to remain resilient amid a stronger USD compared with other regional peers as a result of larger interest rate differentials and a comfortable balance of payments position.

We continue to expect modest weakness in the SGD over the medium term. The Korean central bank has continued to surprise on additional monetary easing as the domestic economy slows further. We believe authorities are likely to continue to favour a weaker currency to support exports.

**USD net-long positioning has eased recently**  
*CFTC USD net-long futures positioning (average against the EUR, JPY, GBP, CHF and CAD)*



Source: Bloomberg, Standard Chartered

**GBP: UK 2-year government bond yields rise following a revision in BoE inflation expectations**  
*BoE 12-month inflation expectations and UK 2-year government bond yields*



Source: Bloomberg, Standard Chartered

**AUD: trade-weighted AUD (adjusted for inflation) remains elevated relative to a fall in terms of trade (export prices/import prices)**  
*AUD's real effective exchange rate and Australia terms of trade index*



Source: Bloomberg, Standard Chartered

## Disclosure Appendix

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