Global Market Outlook macro strategy | 12 August 2015

This reflects the views of the Wealth Management Group

Standard Chartered

Risks are receding

A month ago, we highlighted the risks of a significant pullback in global equities. This risk now appears to be receding, with Greece having been dealt with, at least for now, and China stabilising. Meanwhile, fund managers have more cash on the sidelines than even at the height of the global financial crisis.

All this suggests that global equities (particularly Europe and Japan, currency-hedged) and income-generating assets are likely to start rising again from here. We are also slightly more constructive on Asia ex-Japan equities than before. Finally, we still expect USD gains, resulting from higher Fed rates this year.

Looking back…

The clouds are lifting. Two of the four concerns flagged last month appear to be behind us. Greece avoided Grexit, as we predicted, and China has recently calmed down after a period of extreme market volatility. A Fed rate hike and the fallout from the El Nino weather phenomena are two risks that remain on the table.

Looking forward…

A lot of positives. Against this backdrop, the Global Investment Council (GIC) was able to focus on the US recovery, consensus growth upgrades in the Euro area and Japan and loose global monetary policy. A shift from zero interest rates in the US still risks creating some volatility. However, this is mitigated to an extent by Fed Chair Janet Yellen's strong signal that the rate hiking cycle is likely to be gradual.

Markets expected to rise further from here. Any weakness is likely to be limited. In addition to positive fundamentals, one survey noted that fund managers hold the highest amount of cash since at least 2002 (notably including the peak of the 2008-2009 global financial crisis). This is seen as a contrarian indicator, as it leaves significant cash to be deployed in equities. Therefore, compared with last month, we are considerably less concerned about a renewed and significant (ie, greater than 5%), fall in global equities (see chart below).

Tilting back towards a risk-on approach. Within equities, we prefer the Euro area and Japan (both on a currency-hedged basis). We also like the China (offshore) market within our increasingly constructive outlook on Asia ex-Japan equities. From a sector perspective, we continue to like global technology and global banks. Meanwhile, we expect a diversified income allocation, which weathered the recent volatility relatively well, to start delivering positive returns once again. The USD outlook remains positive ahead of a likely Fed lift-off.

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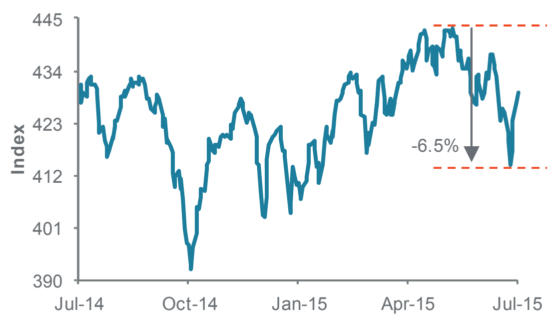
Global equities have already witnessed a 6.5% peak-to-trough pullback

MSCI AC World Index



Source: Bloomberg, Standard Chartered

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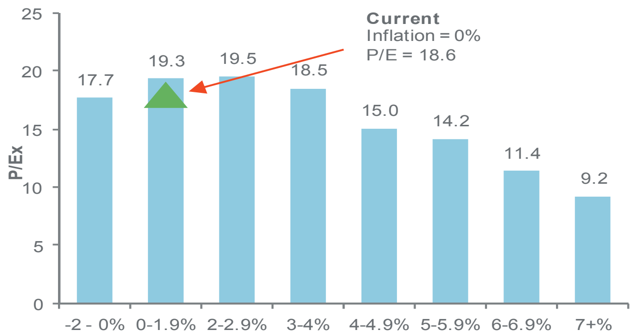
Equities expected to perform until inflation becomes a concern

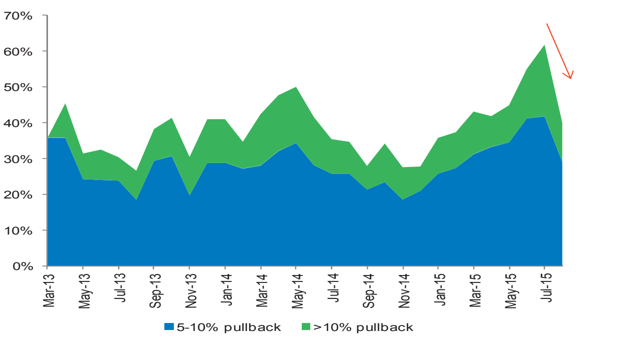
US S&P500 Index average valuations in different inflation environments (since 1970)



Source: Standard Chartered

We are less concerned than last month about an equities pullback

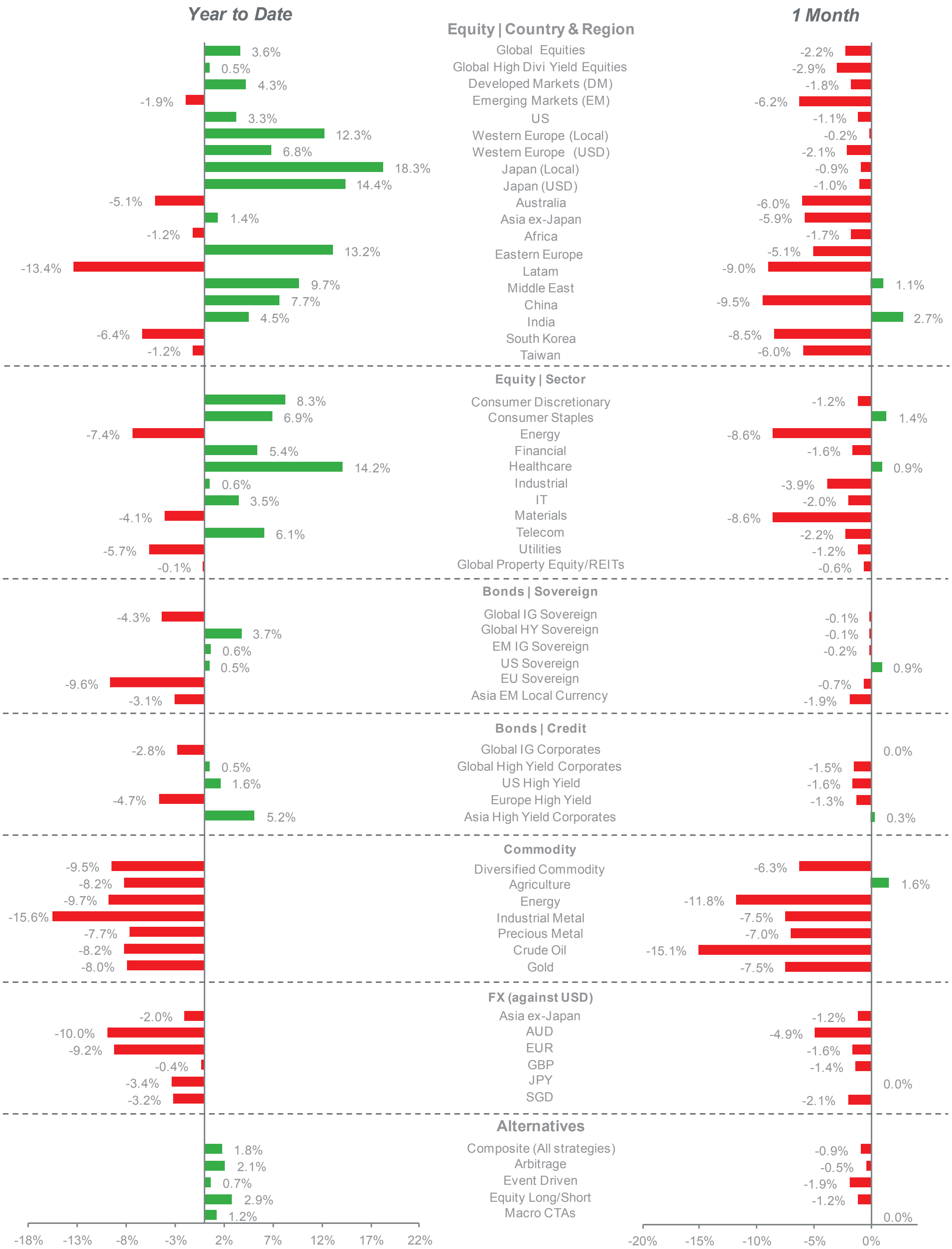
Standard Chartered GIC opinion on the likelihood of a 5-10% and >10% global equities pullback in the next three months



Source: Standard Chartered

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 23 July 2015 and 1-month performance from 23 June to 23 July 2015*

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

Investment Strategy

- **We are less concerned about downside risks, following global equities' 6.5% correction since mid-May. We would consider rotating back into global equities and diversified income.**
- **Within equities, the Euro area (FX-hedged) appears particularly attractive as the Greek crisis fades. The USD remains attractive ahead of a potential Fed rate hike this year.**
- **Fading China risks and bottoming economic surprises means we are increasingly constructive on Asia ex-Japan equities.**

Environment improving for risky assets. Over the past two months, our preference for relatively defensive assets (covered calls, leveraged loans and CNY bonds) paid off amid a 6.5% decline in global equities.

However, with Greece and China risks fading over recent weeks, we believe it is an opportune time to start rotating back into our preferred W.I.D.E.N. themes, particularly global equities and diversified income. Within global equities, our highest conviction remains on Euro area and Japanese equities (on an FX-hedged basis), while in Asia, our two most preferred markets are China (H-shares) and Taiwan.

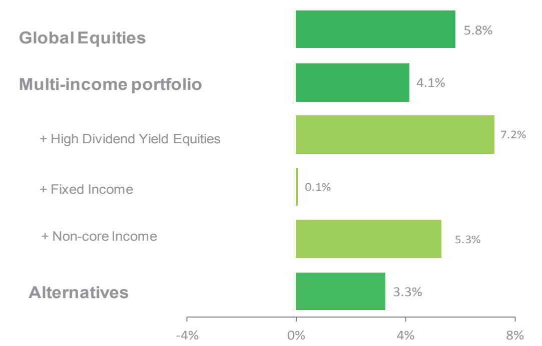
The Fed move could still create volatility, but we would not be excessively concerned. History suggests a Fed lift-off could still create additional volatility. However, any volatility should be temporary and limited in size, as rising Fed rates tend to coincide with an improving economy, and the rate hiking cycle is likely to be gradual, at least to start with. Equity markets are also at a lower starting point than their mid-May peak. Finally, diversified income and alternative strategies should help manage any volatility.

Implications for investors:

- **Current levels offer an opportunity to add to global equities and diversified income.** Euro area equities look particularly attractive as Greece debt risks fade from the headlines. Japanese equities also remain a key conviction. However, we would maintain our FX hedge on both regions for the time being.
- **Raise Asia ex-Japan equity allocations slightly.** Bottoming China economic surprises, policy support for equity markets and improving risk appetite globally are likely to be key sources of support.
- **The USD outlook remains positive.** We continue to expect the USD to be the prime beneficiary of a Fed rate hike.
- **Commodities to remain under pressure.** Higher Fed rates worsen the outlook for gold further by raising the opportunity cost of holding an asset without a yield. Meanwhile, the potential for additional oil supply from Iran further worsens the near-term outlook for an already-oversupplied oil market.

W.I.D.E.N. themes have held up well YTD

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



** For the period 12 December 2014 to 23 July 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*

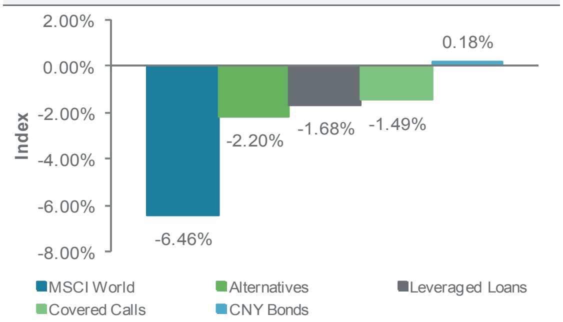
Global equities have already witnessed a 6.5% peak-to-trough pullback

MSCI AC World Index

Source: Bloomberg, Standard Chartered

Defensive assets did their job throughout the summer equity market pullback

Asset class returns over the equity correction (21 May 2015 to 8 July 2015)



Source: Bloomberg, Standard Chartered

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

	Sub-asset Class	Relative Outlook	Start Date
Cash		UW	Feb-12
Fixed Income	DM IG	UW	Jan-11
	EM IG	OW	Dec-14
	DM HY	N	Jul-14
	EM HY	N	Dec-14
Equity	US	N	Feb-15
	Europe	OW*	Jul-13
	Japan	OW*	Nov-14
	Asia ex-Japan	N↑	Jul-15
	Other EM	UW	Aug-12
Commodities		UW	Dec-14
Alternatives		OW	Jun-13

**Currency-hedged*

Economic and policy outlook

Growth recovered across major economies in Q2, especially in the US, which came out of a temporary blip in Q1. Improving labour markets are likely to support modest US wage increases in H2, setting the stage for the Fed to start raising rates by year-end. The ECB and BoJ are likely to maintain their record bond purchases amid still-low inflation. China's data stabilised in June. A recovery would provide support for Emerging Markets (EM).

- **The Fed prepares for a rate hike in H2**. The recovery in the job market in Q2 has helped revive the economy – from housing to manufacturing. As the labour market tightens, wage increases are likely to accelerate modestly in H2, providing ample reason for the Fed to start raising rates, as early as September. However, rate increases are likely to be gradual as a strong USD and low energy prices are likely to keep inflation subdued.
- **European outlook improves as the Greek impasse is resolved for now**. Greece's parliament approved tough conditions required for a third bailout, ending months of uncertainty and helping sustain the recovery seen across the region. The ECB is likely to maintain stimulus well into 2016 amid low inflation, enabling the recovery to continue. Rising wage pressures in the UK are likely to allow the BoE to follow the Fed in hiking rates by H1 16, if not earlier.
- **BoJ likely to maintain stimulus amid positive data surprises**. Japan's data has exceeded expectations over the past couple of months, providing the BoJ confidence that it is likely to achieve its inflation target by 2016. Although growth slowed in Q2, corporate investment plans remain robust. Given the improving outlook, we expect the BoJ to maintain stimulus in Q3.
- **China halts slowdown, raising chances of an EM recovery**. Months of policy easing appears to have helped stem a slowdown in China. Industrial production, retail sales and exports recovered in June, helping the economy achieve its 7% growth target in Q2. Any recovery in China is likely to benefit Asia and other EMs.

US: Recovery prepares ground for a Fed hike by year-end

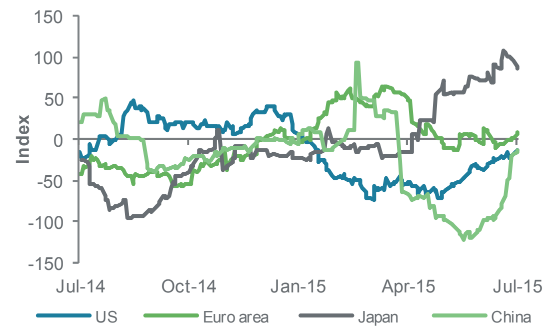
- **Economy recovers from the temporary blip in Q1**. Consensus estimates suggest that the US economy grew at an annualised 2.7% in Q2 after contracting 0.2% in Q1. The recovery has been led by some of the laggards of Q1, such as housing and manufacturing. However, consumption has failed to pick up decisively, probably held back by subdued wage growth.
- **Strong job market recovery likely to boost wages in H2.** Hiring picked up pace in Q2, helping lift some indicators of employee earnings and lowering the US unemployment rate to a seven-year low of 5.3%. US job openings remain at record highs, implying a sustained pace of hiring in H2. As the labour market tightens, we expect wage increases to pick up pace in the coming quarters.
- **Tightening labour market sets stage for Fed hike in H2**. US unemployment is likely to fall to the Fed's 5.0-5.2% target in H2. This, supported by a broad-based recovery, is likely to provide the Fed with enough confidence to start raising rates this year for the first time since 2006. Fed Chair Yellen told US lawmakers recently that starting the hiking cycle early would allow for a gradual pace of increases later. This raises the chance of a September rate hike.

Euro area: Greek agreement removes overhang, improves outlook

- **Growth set to accelerate**. Consensus estimates suggest Euro area growth is likely to accelerate to 1.6% in Q3 and 1.7% in Q4 from 1.4% in Q2. Greek parliament's approval of tough conditions paves the way for its third bailout, removing a key uncertainty for now.

Japan's data continues to surprise positively, while US and China data rebound strongly

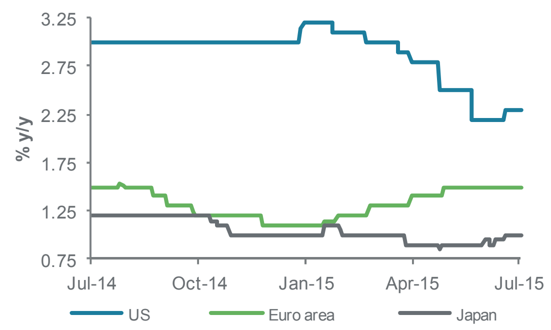
Citigroup economic surprises index for major economies



Source: Citigroup, Bloomberg, Standard Chartered

Consensus growth forecasts have been revised higher for the US and Japan in the past month

Consensus GDP forecasts for 2015 (%, y/y)



Source: Bloomberg, Standard Chartered

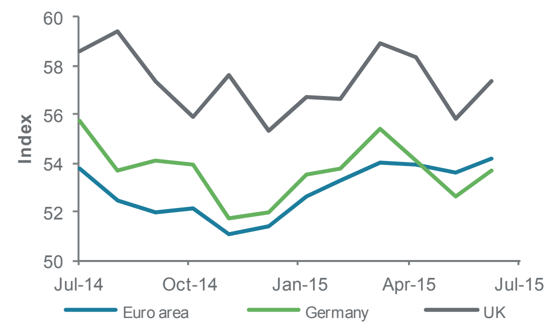
US existing home sales rose to an eight-year high in June, but retail sales have disappointed lately

US retail sales (%, m/m); Existing home sales (m SAAR)

Source: Bloomberg, Standard Chartered

Euro area and UK business confidence rebounded in June despite the Greek uncertainties

Composite PMIs for key European economies



Source: Bloomberg, Standard Chartered

- **Business confidence holds up through Greek uncertainty.** Euro area business confidence remained robust through Q2, with Germany's business confidence recovering in June, despite the uncertainty around Greece. However, a recent ZEW survey indicated investors' outlook for Euro area growth was starting to deteriorate amid worries about Greece's tenure in the Euro area.
- **Low inflation to ensure continued ECB easing until 2016**. Although Euro area consumer prices rose in June for the second straight month, after five months of declines, we expect inflation to stay well below the ECB's 2% target into 2016 or beyond. The renewed decline in oil prices and continued deflation in producer prices should keep consumer prices subdued. This is likely to allow the ECB to continue with its bond-buying programme until its planned end in September 2016, if not longer.

UK: The BoE likely to follow the Fed in hiking rates as wages rise

- **Tighter job market to boost wages, revive inflation**. UK wages rose 3.2% in the three months to May, their fastest pace since 2010. With unemployment close to its lowest since 2008, wage pressures are likely to rise further in the coming months, helping drive overall consumer inflation sharply higher from 0% in June.
- **BoE policymakers worried about inflation.** Although Governor Mark Carney said the timing of the first rate hike would become clearer by the year-end, BoE's July meeting minutes showed more policymakers were getting concerned about the risk of rising inflation. This raises the chances of a rate hike by early next year.

Japan: The BoJ to maintain stimulus amid positive data surprises

- **Economic data continues to surprise positively**. Although Japan's growth likely slowed in Q2, after a sharp acceleration in Q1 primarily because of slowing exports to China, data continues to exceed expectations. BoJ's quarterly Tankan survey showed large manufacturers' investment intentions are the strongest since 2007. This should support growth in the coming quarters.
- **Improving data likely to hold back more BoJ easing**. BoJ Governor Kuroda said policymakers are likely to overlook near-term declines in inflation due to lower oil prices. Improving data, strong corporate investment plans and rising inflation expectations should allow the BoJ to hold back from boosting stimulus for now.

China: Growth stabilises on the back of sustained stimulus

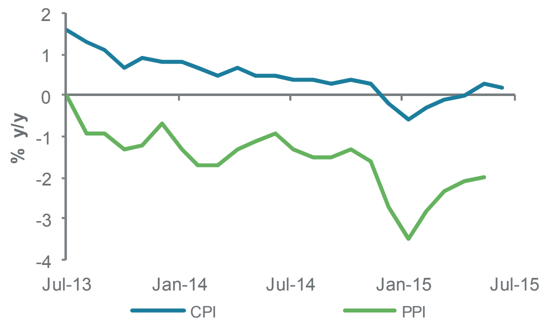
- **Q2 growth meets 7% target amid recovery in June**. Retail sales and industrial production accelerated in June, along with a pick-up in total financing and exports, indicating the economy may have bottomed. The recovery in June helped the economy achieve its 7% growth target for Q2. A sustained recovery would benefit other EMs in Asia and Latin America.
- **More policy easing likely in H2.** The recovery so far has been driven by a broad range of policy easing, including rate cuts and lower bank reserve requirements. We expect more targeted easing in H2 partly to offset the impact from this month's equity market downturn. Low inflation and still relatively tight policy settings provide the central bank significant scope to ease policy further.

Other EMs: India's inflation challenges RBI rate cut expectations

- **Indian inflation rises for the second straight month.** The rebound in inflation to 5.4% in June brings it closer to the upper end of RBI's target (6%). However, concerns about food inflation abated after the near-normal monsoon in June and the early part of July. Although a continued slowdown in industrial production and exports warrant further RBI rate cuts, the progress of the monsoon is likely to be key to the near-term outlook for rates.

Low consumer inflation and continued producer price deflation implies sustained ECB easing

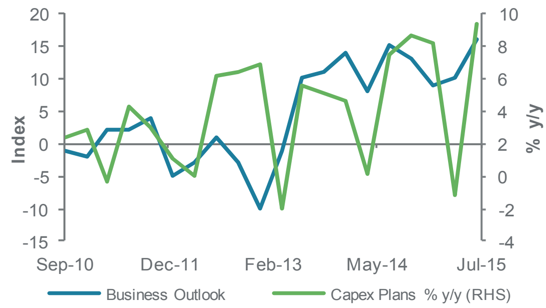
Euro area CPI and PPI (%, y/y)



Source: Bloomberg, Standard Chartered

Japan's largest companies have robust investment plans as business outlook improves

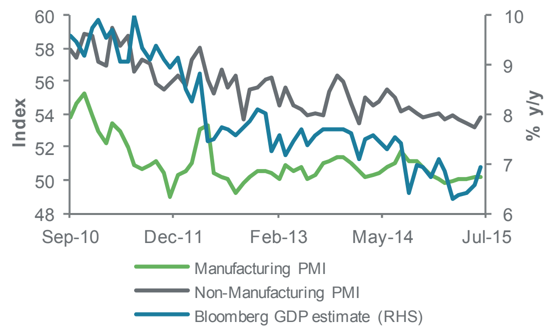
Tankan survey of large manufacturers' business outlook and fixed asset investment plans (RHS)



Source: Bloomberg, Standard Chartered

China's economy appears to have bottomed after the services sector rebounded in June

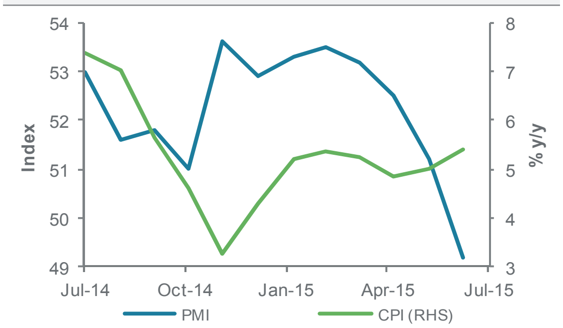
China's manufacturing and non-manufacturing PMIs; Bloomberg monthly GDP growth estimate (%, y/y) (RHS)



Source: Bloomberg, Standard Chartered

India's inflation has gathered pace in the past two months even as other sectors of the economy have slowed

India's PMI and CPI (%, y/y) (RHS)



Source: Bloomberg, Standard Chartered

Bonds – Underweight

- Our improved outlook on risk assets means we continue to favour USD Emerging Market (EM) sovereign bonds and CNY, CNH and INR bonds, potentially within a diversified income allocation.
- High Yield (HY) bond yields remain attractive, but risk/reward continues to favour capping exposure.

G3 and EM (USD) sovereign bonds

- **Do not fear the Fed.** With the recent episode of the Greek crisis behind us, the spotlight shifts back to the US Fed. While we continue to believe the Fed is likely to hike rates this year, we would not be excessively concerned as it is unlikely to come as a surprise to financial markets. Long-term yields are arguably pricing in a number of rate hikes through 2017. Hence, barring an unexpected surge in inflation or wages, long-term USD bond yields are likely to trend higher, but only gradually.

  We believe the largest adjustment is likely to happen in short-term yields. A history of Fed rate hikes over the past few decades suggests short-term yields (such as two-year yields) tend to rise substantially following the Fed's initial rate hike. We expect a similar reaction this time too. This also supports our view that the differential between the 10-year and 2-year yields will continue to narrow and favours maintaining a moderate maturity profile (around five years) across USD bond allocations.
- **We continue to like EM USD government bonds, with a preference for the Investment Grade (IG) component.** USD EM IG government bonds continue to be in the sweet spot, offering an attractive combination of quality, a spread cushion over US Treasuries and inexpensive valuations. We maintain our preference for IG-rated EM government bonds, given their lower exposure to commodity prices.

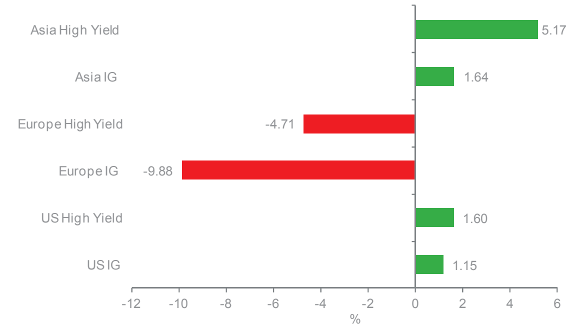
Asian local currency bonds

- **CNY and CNH bonds continue to be rocks of stability.** They have continued to deliver steady returns despite the turmoil in the Chinese equity market. We continue to favour them given the likelihood of further interest rate cuts, the attractive absolute yield on offer and their very low correlation to volatility in other major asset classes. A currency band-widening event remains the key risk. However, we believe there is a low likelihood of this happening in the near future.
- **We continue to favour INR bonds**. They have delivered strong returns in the past month, despite concerns that a weak monsoon may result in higher inflation and have a negative impact on bonds. While the Indian Meteorological Department forecasts a poor monsoon, Skymet, a private agency with a good track record, forecasts close to normal rainfall. Ultimately, the government's management of food supply constraints remains the key to keeping a lid on inflation even in the event of a rainfall deficit. On balance, we remain positive on INR bonds over the medium term.

Corporate credit (USD)

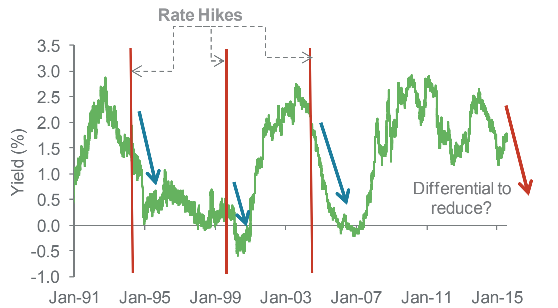
- **Maintain benchmark exposure to Developed Markets (DM) High Yield (HY) bonds.** While US HY has cheapened slightly and may offer limited opportunities to add exposure, we believe it is still prudent to cap exposure at benchmark levels (see page 13 for potential levels). The attractive yield on offer is balanced by the continued deterioration in corporate credit health, which increases the chances of default rates creeping higher. In addition, the renewed slump in oil prices could place renewed pressure on US energy sector bonds.

Performance of fixed income YTD* (USD)



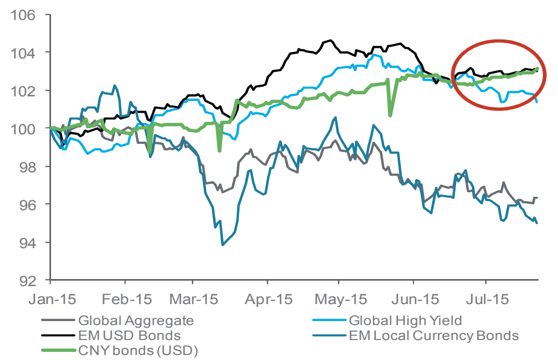
** For the period 31 December 2014 to 23 July 2015*
Source: Barclays Capital, JPMorgan, Bloomberg, Standard Chartered. Indices are Barclays Capital US Agg, US High Yield, Euro Agg, Pan-Euro High Yield, JPMorgan Asia Credit Index

Differential in US Treasury yields is likely to decline
Differential between 10-year and 2-year US Treasury yields (10-2 yield curve)



Source: Bloomberg, Standard Chartered

CNY bonds have been providing stable returns throughout the year, including the recent sell-off
Barclays total return indices (January 2015 = 100)



Source: Bloomberg, Standard Chartered

Aggregate corporate credit quality is deteriorating in the US
BCA US corporate health indicator

Source: BCA, Standard Chartered

Standard Chartered

Equity – Overweight

- **We remain bullish on equities and have increased conviction on Asia ex-Japan.** Global equities have rebounded from the lows recorded on 8 July as bargain hunters have emerged to support markets. Our highest conviction market is the Euro area, followed by Japan, both on a currency-hedged basis. We have reduced our cash position to reflect our increased conviction on Asia ex-Japan. We remain constructive on the US and cautious on other EMs.
- **Less concern over China, the Fed and earnings.** These topics pose lesser risks for investors following the recent market correction. We highlight investor concerns and our conclusions in the text that follows:
  1) Does the correction in China create a buying opportunity? What are our views on A-shares listed in China and H-shares in HK?
  2) Given the increased confidence with which the Fed is signalling its intention to raise interest rates later this year, does this imply that the coming rate hike cycle will be similar to the 2004 period, when the Fed gave explicit signals on rates? The recent performance of Asian equities is comparable to the 2004 cycle.
  3) Earnings revisions have deteriorated in Europe, China and the UK. Does this signal the end of the cycle for these markets?

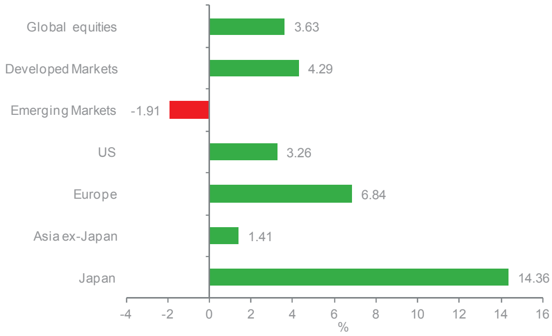
China – A-shares find a floor, H-shares offer value

- **Remain positive on H-shares.** The correction in China's A-share market has worried many investors. However, with the government stepping in to stabilise the market and the economy, a floor appears to have been created. The floor that the government has created implies that upside is also capped. As such, we suggest that investors look to H-shares as a better source of opportunities. While H-shares do not have a floor, there is also no ceiling, given the market is driven by fundamentals, as opposed to policy, factors.
- **A-H spread to decline.** The premium of A-shares over H, the A-H spread, has increased to 44%. We believe this should decline over time. H-shares are trading at levels that offer value in our view, trading at 9.5x 12-month forward earnings compared with a long-term average of 10x.

The Fed and equities – Lessons from prior rate cycles

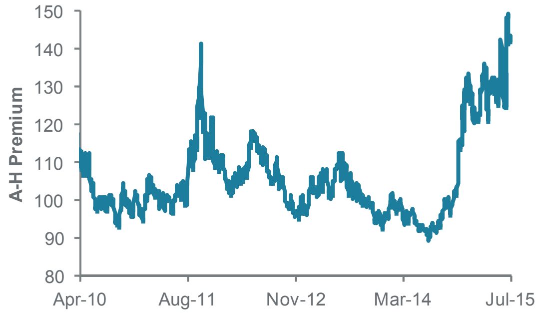
- **Similarities between 2015 and 2004**. Investors continue to debate the pattern of rate hikes once the Fed starts the hiking cycle. Recent signals by the Fed indicate its increased confidence over the economic outlook and a possible rate hike in H2. Given the weakness in global equity markets since Q2, in combination with what may in the future be re-interpreted as clear signals by the Fed, there are signs that the next rate hiking cycle has the greatest similarity to the 2004 cycle.
- **Similarities with prior rate-hiking cycles are particularly important for Asia ex-Japan**. The region's average performance during the prior three rate-hiking cycles indicates a somewhat benign performance in markets. However, this masks widely different outcomes in each cycle: six months after the initial 1994 rate hike, markets fell 7%, compared with a 19% gain over the same period in the 2004 rate-hiking cycle.
- **2004 cycle: Positive for Europe.** A similar pattern of robust gains in the six months after the first rate hike in the 2004 cycle was observed in Europe, with the US posting mid-single-digit returns over the same period. Japan is one of the few markets to record declines, falling 3% six months after the first rate hike in 2004. However, it should be noted that the JPY was strong over this period in 2004, whereas currently, the JPY is weak, which in turn, should be a major support for earnings and the market.

Performance of equity markets YTD* (USD) update



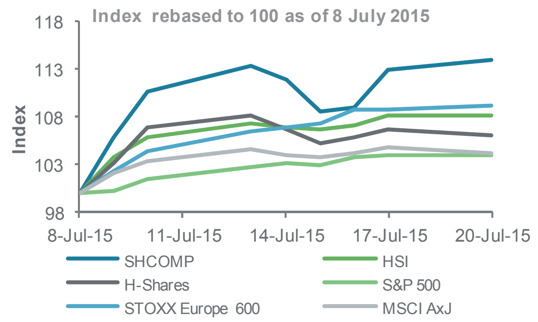
** For the period 31 December 2014 to 23 July 2015*
Source: Bloomberg, Standard Chartered. MSCI Indices are USD total return

A-H Spread



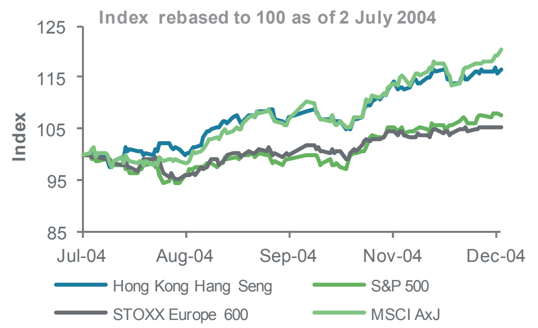
Source: Bloomberg, Standard Chartered

China A-shares have led the rebound
2015 market performance



Source: Bloomberg, Standard Chartered

Hong Kong led Asia higher after the first rate hike in 2004
2014 market performance



Source: Bloomberg, Standard Chartered

Earnings revisions rolling over

- **Earnings revisions in China and Europe roll over**. Earnings revisions in most global markets have rolled over in the past month. The only exception to this is the US and Japan, where earnings revisions have continued to improve.
- **China to remain under pressure**. China is likely to witness continued pressure on earnings revisions in the short term, given the correction in equity markets and the concurrent negative implications for select sectors. Nevertheless, we also note that the economic surprise index in China has rebounded, indicating that the government's efforts to stimulate demand may be starting to work. Renewed euro weakness is likely to support earnings in the Euro area.

Europe – Positive on Euro area, cautious on the UK

- **We remain positive on Euro area equities on a currency-hedged basis**. We suggest putting aside the recent roll over in earnings revisions and focusing instead on the positive effect of renewed euro weakness on earnings and prospects for continued M&A.
- **We are cautious on UK equities**. This is partially related to the opposite drivers for Euro area equities: GBP strength. An increase in taxes on middle-income earners, a reduction in welfare payments for lower-income households, as well as government-mandated increases in wage costs, could weigh on earnings expectations and sentiment in the near term.

Japan – Abenomics is working

- **We remain positive on Japan on a currency-hedged basis**. It is our second-most preferred market after the Euro area. A pick-up in wage growth and signs of increased investment, in combination with a weak JPY, are buoying domestic equity markets, which remain fairly valued by historical standards.

US – Earnings season underway

- US earnings may surprise. The S&P500 has had a lacklustre start to 2015, posting a 1% gain in H1. Weak earnings growth, which expanded a mere 2% in Q1, was partially responsible for the slow pace of gains. Looking ahead, expectations are for a 2% decline in earnings growth in Q2. However, the bulls expect earnings growth forecasts to turn positive by the end of the reporting season, despite the negative implications of a stronger USD and lower oil prices.

Asia ex-Japan and EMs ex-Asia – Redeploying cash

- We have become incrementally more positive on Asia ex-Japan. This follows the 14% correction from the start of May to 8 July. This increasingly positive stance has been funded by reducing our suggested cash position.
- We remain cautious on other EMs, noting their heavy dependence on commodities, which remain under pressure due to a combination of slower demand and a pick up in supply.
- We remain Neutral on the Korean market, noting that its outperformance during the June-July sell-off was partially a reflection of an earlier weakness during the MERS crisis.

Conclusion

Investors who reduced their allocation to equities in May in anticipation of a correction, or have been sitting with cash on the sidelines, are well-placed to take advantage of the recent correction by redeploying this cash into Europe, Japan and Asia ex-Japan.

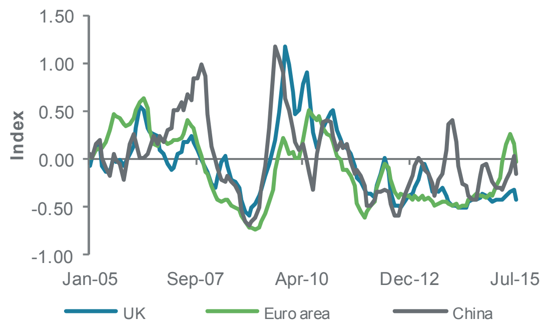
Economic data has recently started to improve

China economic surprise index

Source: Bloomberg, Standard Chartered

China and Euro area earnings revisions have rolled over

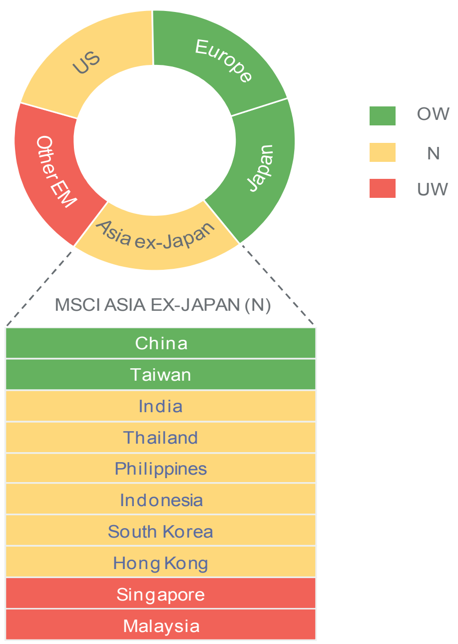
China, Euro area and UK earnings revisions



Source: FactSet, 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 capped amid a supply-demand imbalance.
- We expect gold to see further downside as the Fed hikes interest rates.

We remain bearish on commodities overall. Despite the recent fall, a continued demand-supply imbalance and a stronger USD are likely to lead to further commodity price weakness. We also continue to see little divergence in the outlook for individual commodities.

We expect oil prices to remain under pressure. We do not expect oil prices to rally from the current level, with upside likely limited to USD 60/bbl-USD 65/bbl. Both OPEC and non-OPEC oil production continue to increase. In particular, US oil production was revised higher by the EIA to the highest level on record. US oil inventories are still considerably elevated relative to history. Furthermore, the recent Iran nuclear deal poses the risk of additional supply, assuming the US ratifies the deal.

On the demand side, there is still no evidence of a major growth pick-up from most Emerging Markets (EM). Modest growth in Developed Markets (DM) is likely to prevent any major pick-up in prices. The main risk to our view remains geopolitical in nature. There remains the possibility of a more overt conflict among players in the Middle East, which directly impacts oil production. However, currently, we believe this is a low probability event.

We expect further downside in gold. The recent break in gold prices, below the 1,120-1,220 range, creates room for further weakness. The easing of tensions on the Greek debt impasse, Iran's nuclear agreement, as well as China's higher-than-expected gold reserve data, may have contributed to the sharp fall. Recent data suggests investor sentiment in gold has fallen further; total holdings in ETFs saw a sharp outflow.

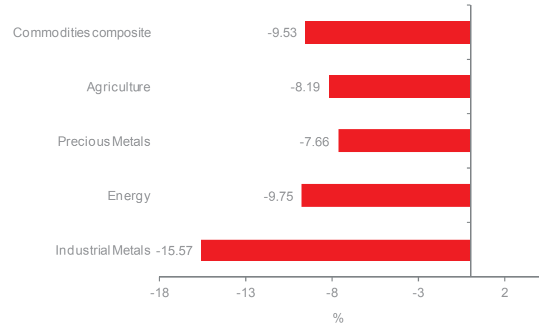
We believe higher interest rates (net of inflation), as the Fed hikes interest rates, a stronger USD and limited incremental demand from slowing EMs are negative for gold. While inflation has begun to pick-up in most places from low levels, we do not see it accelerating significantly. Higher interest rates, thus, may increase the opportunity cost of holding gold.

We expect base metal prices to remain under pressure. Notwithstanding the possibility of a tactical rebound, we expect prices of most industrial metals to remain under pressure. For copper, in particular, consumption has been much slower than both refined and copper ore productions, given the mixed outlook for the China property sector. Elsewhere in this space, the nickel market remains in surplus, amid disappointing demand and slower production cuts. With respect to zinc, despite more constructive demand fundamentals, a pick-up in China production is likely to offset any possibility of a price pick-up.

In the short term, we highlight that historically, nickel and copper prices have been adversely affected by El Nino. Overall, despite recent price declines, we see little reason for a substantial pick-up in base metal prices over a 12-month horizon.

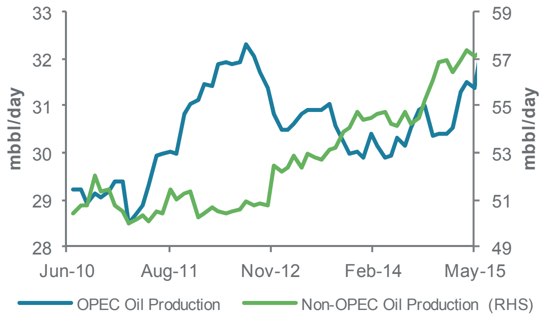
We remain on the sidelines with respect to agricultural commodities. Despite substantial indications of a strong El Nino this year, the impact on soft commodity prices differs over commodities and regions. Hence, we refrain from taking a broad fundamental view on agri-commodities as a whole. Historically, in previous instances of El Nino, coffee, palm oil and cocoa prices have increased.

Performance of commodities YTD* (USD)



** For the period 31 December 2014 to 23 July 2015*
Source: DJUBS, Bloomberg, Standard Chartered
DJUBS, DJUBS Agri, DJUBS Precious metals, DJUBS Energy, DJUBS Industrial metals

Crude production continues to grow
OPEC and non-OPEC daily crude production

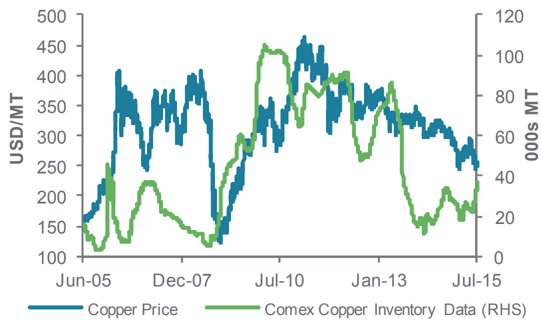


Source: Bloomberg, Standard Chartered

Sentiment on gold deteriorates substantially
Gold prices and total known gold ETF holdings

Source: Bloomberg, Standard Chartered

Copper prices remain under pressure as inventories pick-up
Comex Copper inventory and copper price



Source: Bloomberg, Standard Chartered

Alternative Strategies – Overweight

- Alternative strategies remain one of our most preferred asset classes. Policy divergence, clearer market trends and demand for protection against volatility remain key asset class drivers.
- Macro strategies have led gains over the past month amid a rebound in the USD. We continue to favour equity long/short, macro/CTA and event-driven strategies.

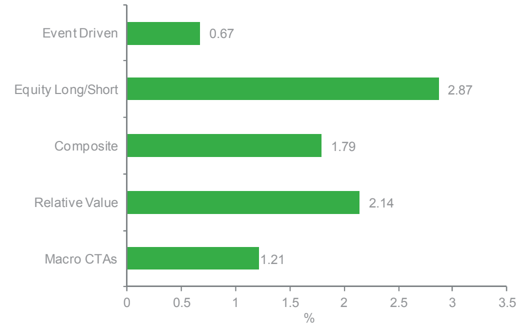
Alternative strategies did their job to contain volatility over the summer. Equity markets faced a 6.5% drawdown from about mid-May to early July, but alternative strategies weakened by only 2.2% over the same period. This performance highlights what we see as one of the key benefits of alternative strategies – providing exposure to our preferred asset classes on one hand, but also helping smoothen the journey when it is punctuated by bouts of volatility.

Key drivers for alternative strategies remain in place for H2 15. A Fed rate hike is likely to intensify policy divergence, favouring macro strategies. Further gains in global mergers and acquisitions (activity is now above the 2014 levels in annualised terms) are likely to continue supporting event-driven strategies. Finally, equity long/short strategies are likely to prove beneficial in an environment that favours global equities, but is also buffeted by bouts of volatility. We continue to see alternative strategies as a key stalwart of a well-constructed investment allocation.

Conclusion:

Alternative strategies remains one of our most preferred asset classes. We favour diversified exposure. Within the asset class, we like equity long/short, event-driven and macro/CTA strategies.

Performance of alternative strategies YTD* (USD)



** For the period 31 December 2014 to 23 July 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 to12 months

Foreign Exchange

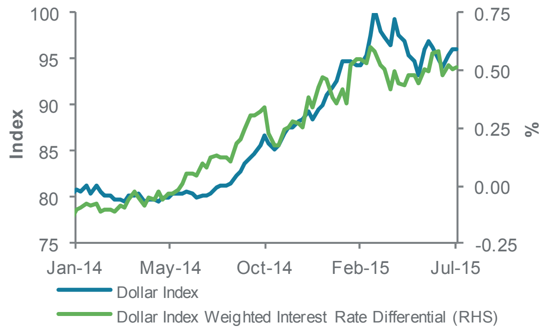
- We continue to expect (a) USD strength against the EUR, JPY and AUD, and (b) GBP strength against non-USD pairs.
- We expect further downside in the KRW, TWD and SGD and limited downside in the MYR, INR, IDR and THB.

USD: We expect medium-term appreciation: We expect USD strength over a 12-month horizon. We believe little has changed in terms of our fundamental view. Recent communication from the Fed supports our view that the US is likely to begin hiking interest rates in H2, while most major central banks maintain their easing stance. We believe short-term US interest rates are yet to price additional rate hikes. Even if rate hikes are fairly gradual, we believe the increase in the interest rate differential in favour of the US is likely to push the USD higher (see adjacent chart).

Following the easing of immediate concerns on Greece, we believe major risks in H2 have receded, which has seen reduced safe-haven buying (including JPY) against the USD. Net long USD positioning has eased considerably recently. Hence, we believe the short-term consolidation is complete, with the USD likely to head higher in the months ahead.

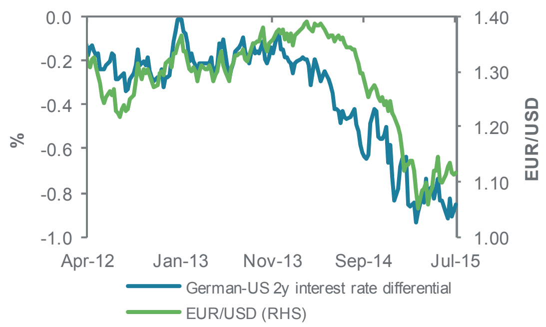
EUR and JPY: We expect medium-term depreciation: We expect further weakness in the EUR over a 12-month horizon. With the easing of immediate Greek debt concerns, short-term yields in Europe have once again started to fall, increasing the US yield advantage and pressuring the EUR. In our view, European yields are likely to remain capped as a result of the continued ECB quantitative easing (QE) programme. In addition to this, the recent decline in the current account surplus is likely to further reduce support for the EUR.

Fed rate hikes remain key to USD strength
USD Index weighted interest rate differentials and USD Index



Source: Bloomberg, Standard Chartered

EUR/USD interest rate differentials resume their slide
German-US 2-year interest rate differentials and EUR/USD



Source: Bloomberg, Standard Chartered

We expect the JPY to weaken over the medium term. A stronger USD, amid widening interest rate differentials, and continued net outflows from Japan remain the main basis for our view. Furthermore, given the continued focus on reviving inflation expectations, we believe the BoJ is unlikely to be tolerant of currency strength.

GBP: We remain medium-term neutral: We remain neutral on the GBP over a 12-month horizon. 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. We believe recent UK activity indicators and wage data are consistent with continued reduction of slack in the economy. We also see the low inflation in the UK as a temporary phenomenon, driven largely by food and oil prices. However, we contend that the main risks to the UK economy stem from an inflated current account deficit, which increases the GBP's vulnerability to shocks.

AUD: We remain bearish on the AUD: We continue to expect further downside in the AUD. Second-round effects (including lower employment and domestic activity) of weak commodity prices, increased potential for further policy easing and gradually higher global currency volatility are the main drivers of this view. The recent fall in iron ore prices reinforces our view of continued weakness in Australia's key commodity markets. The RBA has continued to express concerns regarding weak commodity prices and elevated levels of the exchange rate. Furthermore, the recent weaker inflation data is also likely to allow the RBA room to further ease policy, further reducing the AUD's yield advantage. This is likely to increase the attractiveness of AUD debt for domestic investors.

NZD: We are medium-term neutral: We believe the expected rate cuts are largely pricing in the recent sharp fall in the NZD and may not have a substantial impact on the currency going forward. Also, we believe the RBNZ is unlikely to opt for aggressively lower policy interest rates. Hence, on a risk-reward basis, we prefer to remain neutral medium term.

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, the SGD, KRW and TWD to underperform, and the IDR, PHP and MYR to perform in line with the region. On an absolute basis, we expect the CNY, INR, IDR, THB and MYR to remain broadly stable, while we expect further downside in the KRW and TWD.

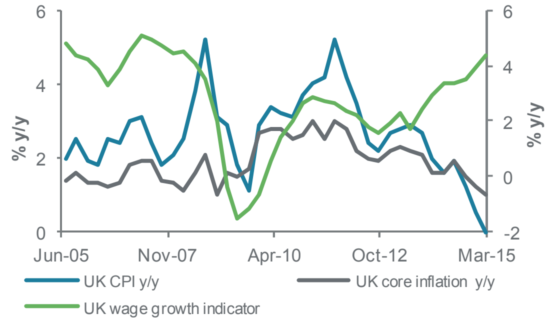
We believe broad USD strength amid higher US interest rates is likely to drive further weakness in the SGD. Although the MAS did not signal an imminent policy easing, further weakening of Singapore data could tip the balance towards further easing.

In our view, China will continue to favour a stable CNY, as it seeks greater internationalisation of the currency. With restricted two-way capital flows, we do not believe recent weaker macroeconomic data and easing monetary policy are negatives 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. The recent dip in oil prices has also lowered near-term risks.

The Korean central bank has continued to surprise markets with additional monetary easing, as the domestic economy slows further. We believe authorities are likely to continue to favour a weaker currency to support exports. In the case of the MYR and IDR, we believe a majority of the potential risks have largely been priced in by the substantial fall in both currencies.

Accelerating UK wages to eventually exert pressure on prices

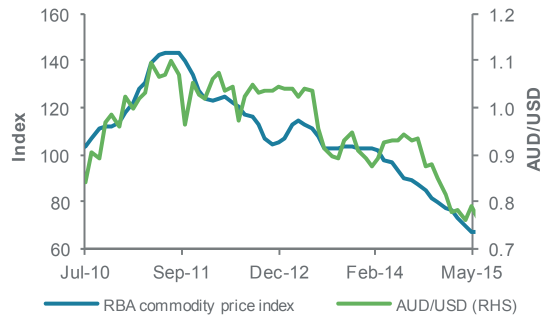
UK CPI, UK core CPI and UK weekly wage growth



Source: Bloomberg, Standard Chartered

Commodity slide has been driving the AUD lower

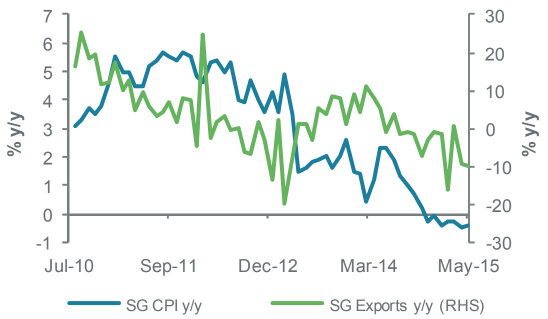
RBA commodity price index and AUD/USD



Source: Bloomberg, Standard Chartered

Weak Singapore exports and inflation increase chances of policy action

Singapore exports y/y and CPI inflation y/y



Source: Bloomberg, Standard Chartered

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