Standard Chartered
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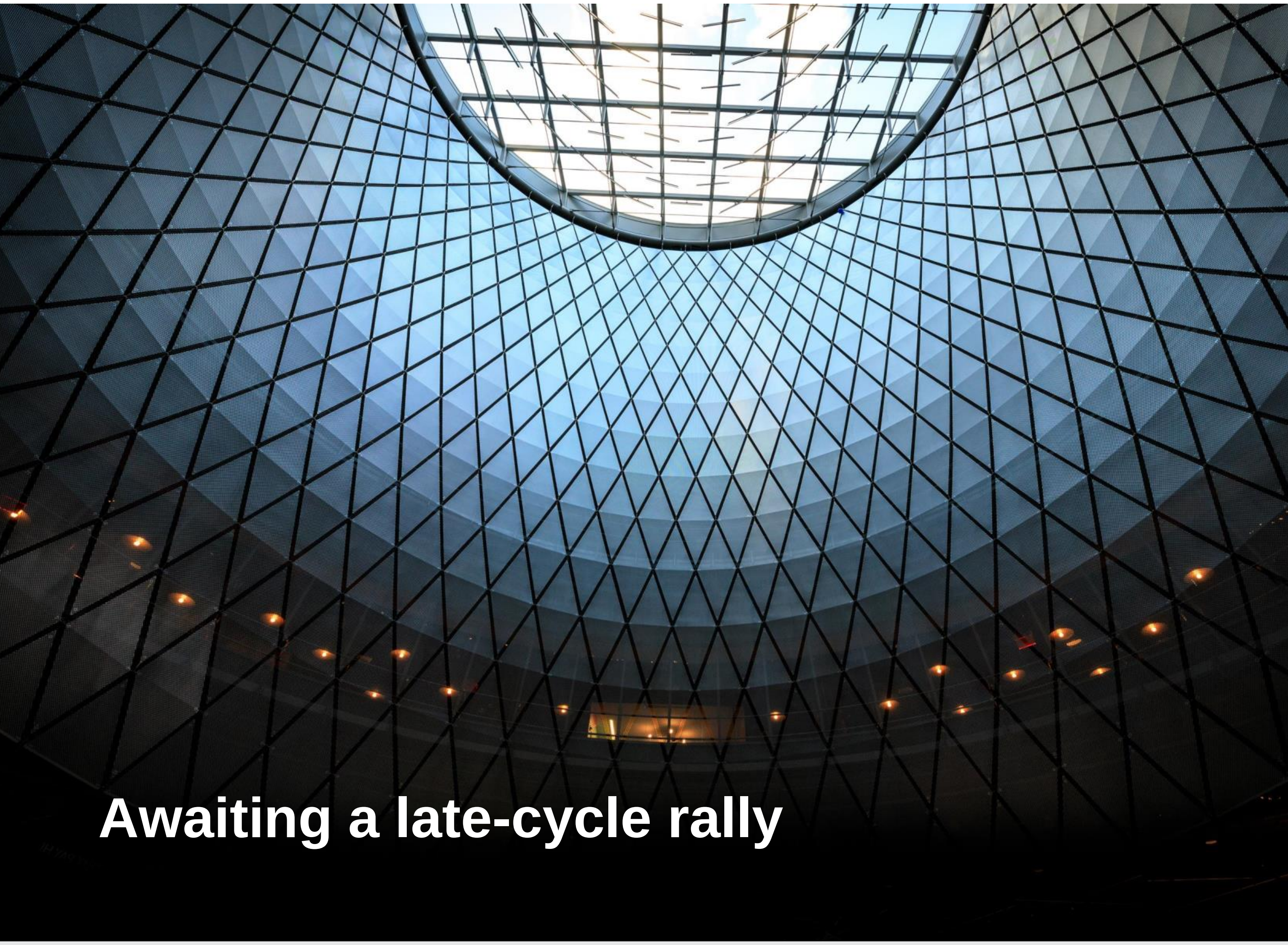
Global Market Outlook



Awaiting a late-cycle rally

The reflationary outlook has not been dampened by the turn lower in several economic lead indicators as they continue to signal strong growth. US 10-year Treasury yields may move modestly higher as inflation expectations normalise, though a sustained move above 3.25% is unlikely.

Our preference for global equities remains in place as we believe a late-cycle rally may still be ahead of us. We raise our view on US equities to preferred following a pullback in valuations and robust earnings growth. Asia ex-Japan equities also remain preferred.

Higher bond yields continue to offer an attractive entry point to Emerging Market (EM) government bonds, both USD and local currency, **as well as multi-asset income strategies**, in our view. We retain our conviction in USD weakness, with the EUR and CNY likely to be key beneficiaries. However, positioning and technical indicators remain short-term headwinds to this view.

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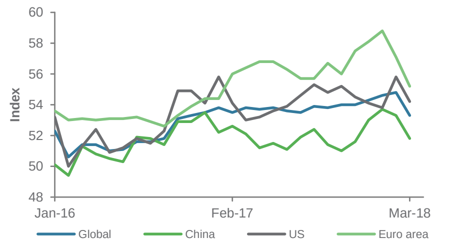
Global equities and corporate bonds were largely range-bound in the past month as moderate valuations and strong earnings were likely offset by ongoing worries about global trade, a potential spillover from the Syria conflict and a renewed rise in bond yields. The USD rose about 1% against the EUR and over 2.5% against the JPY in the past month.

Key economic lead indicators have softened over the past month across most major regions (see chart), with trade tensions being one possible source of the dip. We note PMIs remain well above the 50 mark, which separates expansion from contraction, signalling a still-robust growth environment. However, we would watch future releases closely. Much has also been made of the continued flattening of the yield curve (ie, a narrowing gap between 10-year and 2-year bond yields). However, we note this signals a recession only when the gap turns negative, which has not happened so far.

Rising inflation expectations, meanwhile, are likely a major driver behind the renewed rise in US bond yields. As we have stated earlier when yields were at similar levels, we would not worry excessively. A return of 2% inflation would likely be consistent with

Figure 1: Lead indicators have fallen recently

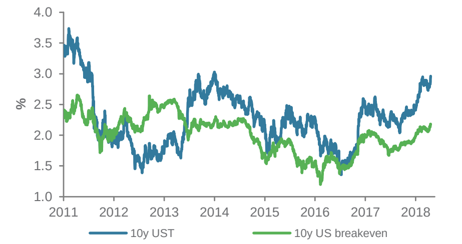
PMI by region



Source: Bloomberg, Standard Chartered

Figure 2: Inflation expectations behind yield rise

US 10y Treasury yields vs. 10y inflation expectations



Source: Bloomberg, Standard Chartered

10-year yields just above 3%; we believe yields are likely to be capped below 3.25% short of an inflation overshoot, and strong earnings growth suggests any spillover into equities is likely to be very limited.

Equities: upgrade US

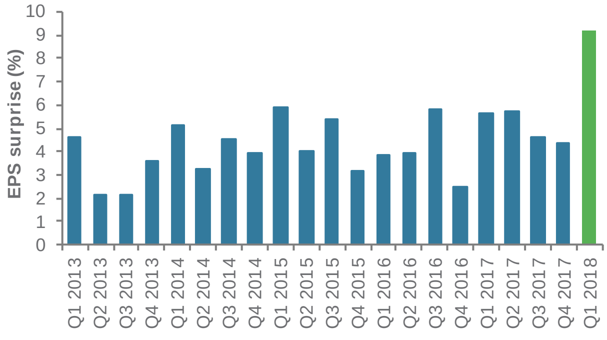
We maintain our preference for global equities, reminding readers that some of the strongest equity market returns tend to occur late in the cycle (averaging about 20% in the 12 months leading to the pre-recession equity market peak). This also explains our preference largely for cyclical sectors in most regions, and our preference for multi-asset balanced strategies from a total return perspective.

Our preference for Asia ex-Japan equities, and our preference for China within the region, remains in place, with the continued presence of value relative to Developed Markets (DMs) still offering room for further outperformance. However, we close our preference for South Korea equities in the region given the market remains among the more vulnerable to a renewed rise in trade tensions.

We raise our preference for US equities. The equity pullback earlier this year has created a more attractive point to raise exposure, in our view, as valuations have now moderated to a more reasonable level than before. Meanwhile, the ongoing Q1 earnings season continues to illustrate strong earnings growth, while also offering significant upside surprise relative to market expectations (see chart).

Figure 3: US earnings continue to surprise positively

S&P500 earnings surprises (%); Q1 2018 data incorporates earnings from 156 companies (out of 500) that have reported at the time of writing



Source: FactSet, Standard Chartered

Prefer EM government to corporate bonds

Corporate and EM bond valuations (as measured by credit spreads) have also eased year-to-date (YTD) alongside moderating equity valuations. History suggests a further easing of valuations (credit spread widening) is unlikely – usually valuations tend to hold around elevated levels late in the business cycle.

We still believe corporate bonds form a solid core holding, particularly in Asia ex-Japan, where they remain less volatile than in other regions. However, we continue to prefer an aggregated exposure via multi-asset income strategies.

Having said that, we still see more attractive relative value in EM USD government bonds than in corporate bonds. Relative to their own history, valuations in the former still appear less elevated than in corporate bonds, where valuations remain close to current-cycle highs. EM local currency bonds also offer the advantage of diversification into bond markets that are less correlated with rising US Treasury yields.

Risk of near-term USD gains

Our view of medium-term USD weakness remains in place, given the significantly greater room for interest rate hikes to be priced in outside the US.

Having said that, we do see a near-term risk of USD strength. This stems partly from technical indicators following the USD index's break above its recent range, and partly from speculative positioning, which continues to be very short.

We turn bullish on the CNY, noting that this is consistent with our long-term bearish view on the USD, given CNY's tight correlation with the USD index. Worries of policy-driven CNY weakness are also likely overblown, in our opinion. We close our bullish view on the SGD as further gains are less likely for now given policymakers tightened policy, as expected. We also close our bullish view on the MYR amid increased uncertainty ahead of upcoming elections.

Figure 4: Our Tactical Asset Allocation views (12m) USD

Asset class	Sub-asset class	Relative outlook	Rationale
Multi-asset Strategies	Multi-asset income	🟢	Low policy rates and yields remain a support; attractive entry point
	Multi-asset balanced	🟢	Growth tilt to help in a late cycle rally; equity volatility a risk
Equities 🟢	Asia ex-Japan	🟢	Double-digit earnings growth; fair valuations; trade tensions a long-term risk
	US	🟢	Strong earnings growth; more reasonable valuations; bond yields a risk
	Other EM	🟡	Commodities, EM flows offer support; valuations elevated; politics a risk
	Euro area	🟡	Muted earnings growth; valuations fair; EUR strength a risk
	Japan	🟡	Strong domestic growth; valuations attractive; JPY key to earnings
	UK	🔴	Earnings under pressure; valuations fair; GBP rebound a risk
Bonds 🟡	EM government (local currency)	🟢	Attractive yield; FX offers entry opportunity; USD rebound, inflation risks
	EM government (USD)	🟢	Attractive yield; fair valuations; high-rate sensitivity; USD rebound a risk
	Asian USD bonds	🟡	Moderate yield; fair valuations; less favourable demand/supply balance
	DM IG corporate	🟡	Moderate yield; elevated valuations; defensive characteristics
	DM HY corporate	🟡	Attractive yield; credit quality mixed; expensive valuations
	DM government	🔴	Still low yield; policy, higher inflation risks
Currencies	EUR	🟢	Room exists for policy rate expectations to re-price higher, ECB constructive
	EM currencies	🟢	Medium-term EM fundamentals supportive; USD weakness key
	GBP	🟡	Short-term Brexit uncertainty reduced, longer-term challenges remain
	AUD	🟡	Downside risks better priced amid decline; however, no catalyst for big gains
	JPY	🟡	Supported by risk-off sentiment short term; BoJ policy to ultimately limit gains
	USD	🔴	Medium-term downtrend to persist; technicals/positioning a short-term risk

Source: Standard Chartered Global Investment Committee

Legend: 🟢 Overweight 🟡 Neutral 🔴 Underweight

Figure 5: Performance of key themes since *Outlook 2018*

Asset class		Date Open	Date Closed	Absolute	Relative
Equities	Asia ex-Japan equities to outperform global equities	7-Dec-17		–	✓
	China equities to outperform Asia ex-Japan equities	7-Dec-17		–	✓
	US equities to outperform global equities	26-Apr-18		–	–
Bonds	Emerging Market (EM) USD government bonds to outperform global bonds	7-Dec-17		–	×
	Emerging Market (EM) LCY government bonds to outperform global bonds	25-Jan-18		–	×
Multi-asset and alternative strategies	Multi-asset balanced[2] strategies to outperform multi-asset income[1] strategies	7-Dec-17		–	✓
	Equity Hedge strategies to outperform other alternative strategies[3]	7-Dec-17		–	✓
Currencies	US Dollar to weaken modestly	7-Dec-17		✓	–
	EM currencies to gain against the USD	7-Dec-17		✓	–
	EUR to strengthen against the USD	7-Dec-17		✓	–
	CNY to strengthen against the USD	26-Apr-18		–	–
Closed calls					
Asia USD corporate bonds to outperform global bonds		7-Dec-17	25-Jan-18	–	×
KRW to strengthen against the USD		7-Dec-17	23-Feb-18	✓	–
JPY to weaken against the USD		7-Dec-17	23-Feb-18	×	–
Euro area equities to outperform global equities		7-Dec-17	2-Mar-18	–	×
South Korea equities to outperform Asia ex-Japan equities		7-Dec-17	26-Apr-18	–	×
SGD to strengthen against the USD		22-Feb-18	26-Apr-18	×	–
MYR to strengthen against the USD		28-Mar-18	26-Apr-18	×	–

Source: Bloomberg, Standard Chartered

Performance measured from 8 December 2017 (release date of our *2018 Outlook*) to 26 April 2018 or when the view was closed

[1] Multi-asset income allocation is as described in '*Outlook 2018: Turning up the heat*', Figure 10, page 43

[2] Multi-asset balanced allocation is as described in '*Outlook 2018: Turning up the heat*', Figure 8, page 39

[3] Alternative strategies allocation is described in '*Outlook 2018: Turning up the heat*', Figure 1, page 89

✓- Correct call; × - Missed call; NA - Not Applicable

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.

Perspectives
on key client questions

What is the obsession with the US yield curve and should I be worried?

The greatest fear for an equity investor is a recession as this generally leads to a collapse in corporate profitability and, therefore, sharp equity declines – the average peak-to-trough US equity market decline around recessions since 1980 is 33%.

Historically, when the yield curve becomes inverted – long-term yields fall below short-term yields – it has often signalled a forthcoming recession. When the curve is inverted, bond investors believe short-term interest rates will slow the economy and, thus, be reduced in the future. In theory, these interest rate cuts could stabilise the economy and avoid a recession. In practice, such examples have been rare.

Why are people talking about this? The yield curve has flattened significantly in recent months as short-term interest rates have risen more than long-term yields. This has led to concerns that the yield curve could invert in the coming months.

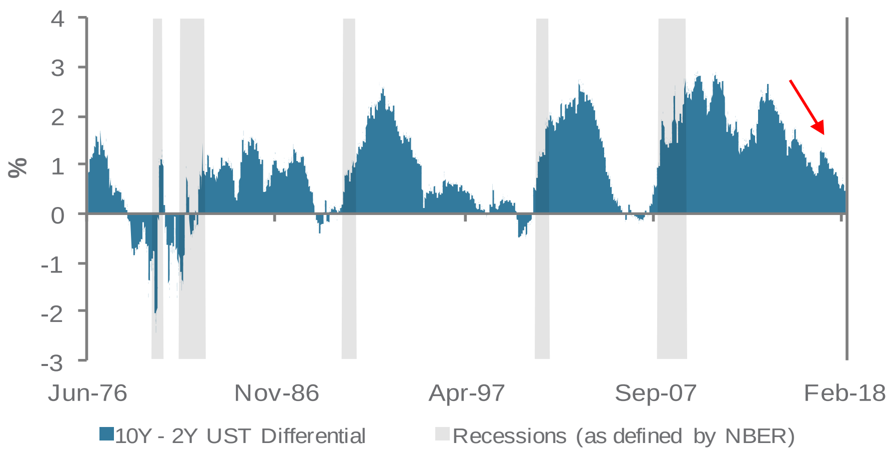
In response to this, we would make the following points:

1) It is normal for the yield curve to flatten during rate hiking cycles
2) The lead-lag relationship between yield curve inversion and recession is variable (range of 10-23 months, median of 17 months), with some false signals (1982/1998)
3) Equity markets normally peak around 6-9 months before a recession
4) Equity markets usually continue to perform well when bond yields are rising, and short-term yields are rising faster than long-term yields. This is consistent with the view that equities normally perform well in the late stage of the economic cycle

In conclusion, we believe it is too early to worry about the flattening of the yield curve.

Figure 6: Yield curve inversions are often a precursor to a recession

Difference between the 10-year and 2-year US Treasury bond yield and US recessions



Source: Bloomberg, Standard Chartered

But aren't there a lot of risks out there?

There are a lot of things that investors are worried about. These include peaking growth expectations, tightening monetary policy, rising trade tensions and geopolitics.

However, these have opposing arguments leading to a healthy diversity in investor positioning, which suggests we should not be too worried; growth is peaking but is expected to hold up, monetary policy settings are still quite loose, trade tensions are unlikely to escalate dramatically and geopolitical risks in North Korea and Syria appear to have peaked.

Figure 7: Equity valuations have fallen sharply this year

MSCI AC World 12m forward P/E

Source: Bloomberg, Standard Chartered

Meanwhile, with valuations having fallen sharply this year, on the back of price declines and a sharp increase in earnings expectations, one could argue that a lot of this 'bad' news may already be priced in. This does not preclude the risk of short-term volatility, especially against the backdrop of forthcoming US-China trade negotiations and the US's decision on whether or not to withdraw from the Iran nuclear deal. However, we believe that the 6-12 month outlook for global equities remains positive, and we may see markets 'climb the wall of worry' in the coming months.

Do rising 10-year bond yields worry you?

Gradually rising bond yields are consistent with our view that we are in the late stage of the economic cycle. For now, it is important to note that US 10-year Treasury yields are yet to decisively break through key resistances in the 3.00-3.05% region. Moreover, the market remains positioned for a move higher, which may actually limit the pace of a rise in yields. We expect yields to be in the 2.75-3.25% range in the coming 6-12 months.

Against this backdrop, we continue to advocate a more pro-growth tilt to investing. However, for income-focused investors the recent rise in yields may provide an opportunity to add bond and/or multi-asset income investments.

Asia ex-Japan equities continue to outperform global equities. Is this still your preferred market?

Asia ex-Japan remains our preferred region. However, we have also raised US equities to preferred status.

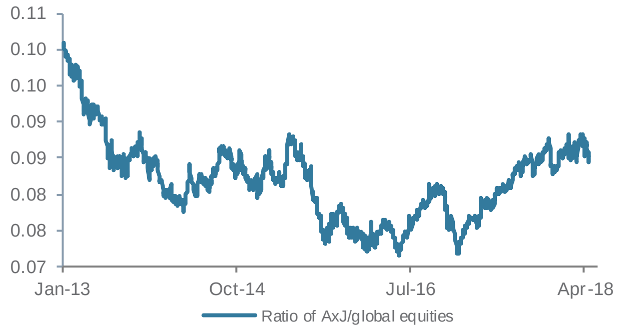
Corporate earnings expectations remain robust in both the regions.

Meanwhile, we see USD weakness as positive for both, albeit for different reasons. For the US, a weaker USD increases competitiveness, but more importantly increases the USD value of foreign earnings. For Asia, USD weakness cuts imported inflationary pressures, allowing central banks to pursue policies that support domestic growth, reduces USD borrowing costs and encourages portfolio flows into the region.

Although the USD has stabilised in the past two months, we believe it is likely to weaken further in the coming 6-12 months as the focus shifts towards the potential tightening in Euro area monetary policy settings. This is likely to be a tailwind for US and Asia ex-Japan markets.

Figure 8: Asia ex-Japan outperformance expected to resume

Ratio of Asia ex-Japan to global equity performance (total returns, USD)



Source: Bloomberg, Standard Chartered

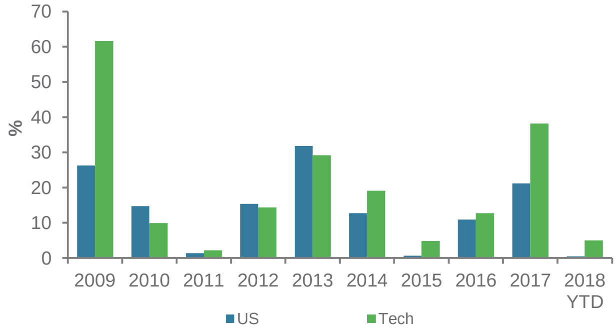
What is the outlook for the US technology sector following recent setbacks?

Although the technology sector has been hit by fears of increased regulation, it is important to put this into context. Consensus earnings growth forecast for the sector for 2018 has risen to over 18% from 13% in early January.

That said, it is important to note that the US technology sector has outperformed in each of the past four years and this trend has continued into the beginning of this year. Therefore, while we continue to expect the tech sector to outperform, for those who have a large weighting to this sector, it may make sense to broaden investments into other pro-cyclical sectors such as energy, materials, industrials and financials.

Figure 9: Consider broadening tech exposure to other pro-cyclical sectors

MSCI US and MSCI US Information Technology, total returns



Source: Bloomberg, Standard Chartered

Macro overview

IMPLICATIONS
FOR INVESTORS

01 The Fed likely to raise rates two or three more times in 2018

02 The ECB likely to keep withdrawing policy stimulus, while the BoJ stays accommodative

03 China likely to continue reforms, while stimulating domestic demand

Robust growth, but upgrades stall

- **Core scenario:** The economic outlook remains reflationary, although there are signs growth momentum may have peaked in the Euro area and Japan. US inflation is likely to rise moderately, although price pressures remain subdued elsewhere.
- **Policy outlook:** We continue to expect the Fed to hike rates two or three more times in 2018. The ECB is likely to further withdraw its stimulus, while the BoJ stays accommodative and the PBoC keeps policy tight as it focuses on deleveraging.
- **Key risks:** a) An inflation surge, especially in the US, remains the biggest risk to 'reflation'; b) trade tensions, geopolitical disputes and tighter liquidity conditions have become greater sources of downside risks.

Core scenario

The Global Investment Committee assigns a 40% probability to a reflation scenario of strong growth and moderately higher inflation unfolding in the next 12 months. This is slightly down from 45% a month ago and reflects expectations that global growth upgrades have likely peaked, especially in the Euro area and Japan. However, growth remains above-trend across Developed Markets, particularly in the US, which is likely to benefit from strong consumer demand and accelerating private investments following last year's tax cuts. An inflation surge in the US remains the biggest source of risk (20% probability) to this constructive scenario, while trade tensions and tighter USD liquidity, as the Fed raises interest rates, have emerged as other potential sources of risk. Thus, the probability of a 'muddle-through' scenario has rebounded to 30% from 25%.

Figure 10: US growth and inflation outlook has been upgraded after the tax cuts in December

Region	Growth	Inflation	Benchmark rates	Fiscal deficit	Comments
US	🟢	🟡	🟡	🟢	US 2018 growth estimates stabilised at 2.8%, driven by business investment. Inflation is a key risk. Fed to raise rates 2-3 times more in 2018
Euro area	🟢	🟡	🟢	🟡	Business confidence softens due to trade worries, but growth above-potential. Inflation still tepid. The ECB to keep withdrawing stimulus
UK	🟡	🟡	🟡	🟡	Brexit transition agreement eases growth concerns, but transition details key to outlook. Reduced expectations of a BoE rate hike in May
Japan	🟢	🟡	🟢	🟡	Export slowdown clouds outlook, but businesses continue to invest, given tight spare capacity. The BoJ to maintain easy policy amid low inflation
Asia ex-Japan	🟢	🟡	🟢	🟡	China's economy has a strong start to 2018, enabling policymakers to pursue reforms. Asia to raise rates modestly to align with the Fed
EM ex-Asia	🟢	🟡	🟢	🟡	Mexico likely to cut rates as inflation peaks. Brazil and Russia may be close to the end of their rate-cutting cycle

Source: Standard Chartered Global Investment Committee

Legend: 🟢 Supportive of risk assets 🟡 Neutral 🔴 Not supportive of risk assets

US – solid growth, rising inflation

Business investment to drive growth acceleration. US consensus growth estimates for 2018 have stabilised at 2.8%, after steadily rising since the tax cuts in December. That would be the fastest pace of growth in three years. We expect domestic consumption to stay strong as the job market remains robust. However, private investment is emerging as the main growth driver as businesses take advantage of lower taxes and easing business regulations. Higher business spending has the potential to drive productivity growth and extend a mature business cycle.

Fed rate hikes to continue. Inflation has started to rebound, partly on base effects, but also due to continued uptrend in wages. We believe the Fed is likely to raise rates 2-3 more times this year, despite the ongoing trade uncertainty, as it seeks to prevent the economy from overheating.

Euro area – trade doubts dampen confidence

Business confidence dips. Euro area consensus growth estimates for 2018 have dipped for the first time in a year, but remains at a healthy 2.3%. Trade tensions have dampened business confidence in recent months (given exports remain the main growth driver), although the Euro area has been exempted from US duties for now. Record-low borrowing costs continue to support domestic consumption. There are also signs Germany could relax fiscal tightening, which could support growth.

ECB to continue withdrawing stimulus. Euro area inflation remains subdued, raising doubts among policymakers about the extent of a slack in the economy. We still expect the ECB to withdraw stimulus, but rate hikes are unlikely before 2019.

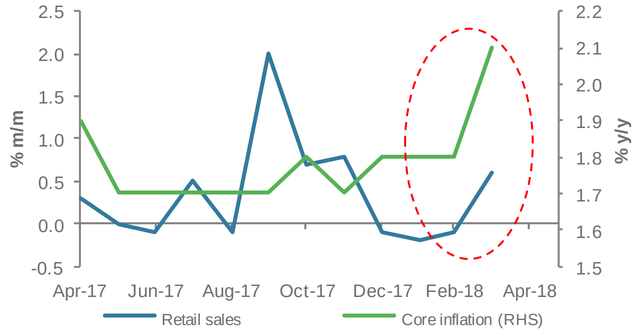
UK – focus turns to Brexit details

Growth stabilises. The 21-month post-Brexit transition pact has reduced downside risks. However, uncertainty around the details, including the status of the Irish border and a post-Brexit free trade agreement, is likely to cloud the outlook.

May rate hike in doubt. Market-based probability of a BoE rate hike in May fell below 50% from 90% in end-March as inflation fell below expectations. However, wage growth has picked up, offering support to the consumer-driven economy.

Figure 11: US retail sales have rebounded after three months of decline, while inflation has risen above 2%

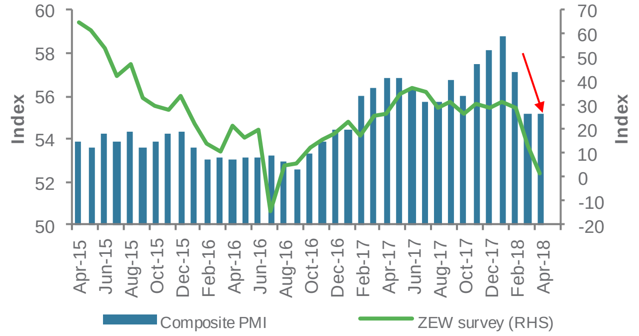
US adjusted retail and food services sales; US CPI, ex-food and energy



Source: Bloomberg, Standard Chartered

Figure 12: Euro area economic and business confidence has softened from elevated levels amid trade tensions

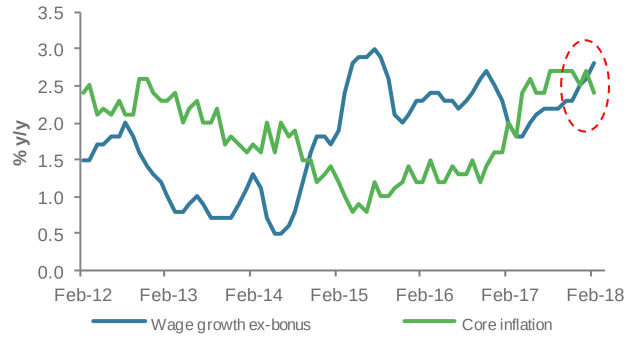
ZEW survey of Euro area growth expectations; Euro area composite PMI



Source: Bloomberg, Standard Chartered

Figure 13: UK's wage growth exceeded inflation for the first time in a year, supporting the consumer-driven economy

UK core consumer inflation; average weekly earnings ex-bonus, 3m average



Source: Bloomberg, Standard Chartered

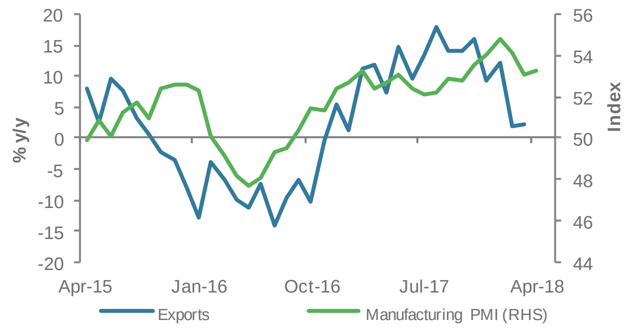
Japan – trade, politics cloud outlook

Trade uncertainty dampens exports. Japan's export growth, the main driver of the economy, has slowed since the start of the year. The latest trade disputes between the US and China have added to the uncertainty. Still, the latest quarterly Tankan survey indicates manufacturers remain constructive on the outlook for business and investment, given the economy's tight spare capacity. This is likely to support growth above potential for the second straight year.

BoJ to stay accommodative. We expect no change in BoJ policy as inflation stays below its 2% target and there is uncertainty surrounding PM Abe's government.

Figure 14: Japan's export growth has slowed, clouding the outlook for the manufacturing sector

Japan's exports; Manufacturing PMI



Source: Bloomberg, Standard Chartered

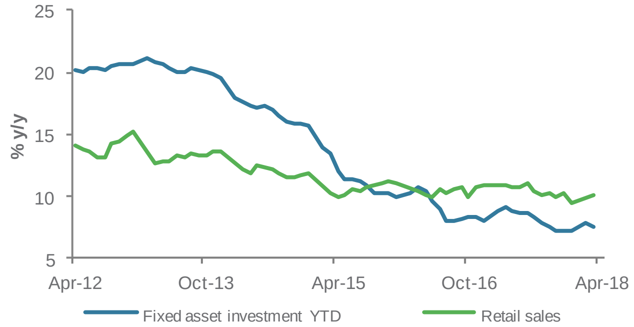
China – consumption trumps trade tensions

Strong start to 2018. China's economy grew 6.8% in Q1, holding the pace from the previous two quarters, as strong consumption offset a slowing manufacturing sector with the government curbing excess capacity. Trade tensions with the US have raised near-term uncertainty. However, China's steps to further open up key sectors, including finance and autos, have raised the prospect of a negotiated settlement.

Focus on reform. PBoC Governor Yi Gang plans to open up the financial sector to overseas insurance and securities companies. We believe the economy's strong start to 2018 and low inflation enable the PBoC to pursue measures to cut corporate leverage, while stimulating domestic demand.

Figure 15: China's domestic consumption growth remains stable, offering support to the economy as investment growth slows

China's fixed asset investment YTD; Retail sales



Source: Bloomberg, Standard Chartered

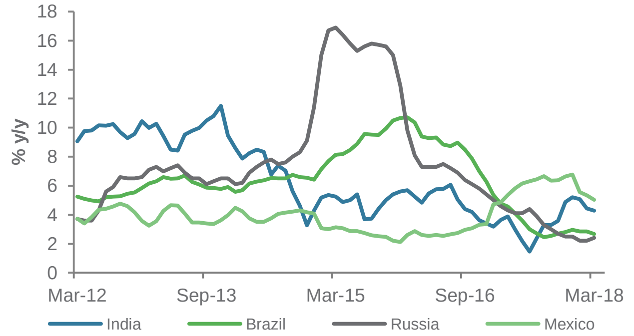
Emerging Markets – still recovering

EM acceleration on track. India, Brazil, Russia, Mexico and South Africa are all expected to see accelerating growth in 2018, according to consensus estimates. The rebound in commodity prices is likely to benefit four of those five economies, India being an exception, given its dependence on imported oil. Trade and domestic politics remain key sources of risk, although NAFTA renegotiation and a US pact with China should be positive for the medium-term outlook.

Divergent policies. Market estimates show Asia ex-Japan central banks are likely to gradually raise rates over the next 12 months to align with the Fed. However, Mexico is likely to cut rates as inflation peaks. Brazil and Russia may be close to the end of their rate-cutting cycle.

Figure 16: Inflation remains subdued across most major Emerging Markets

Consumer inflation in Brazil, Russia, India and Mexico



Source: Bloomberg, Standard Chartered

Bonds

IMPLICATIONS
FOR INVESTORS

01 Prefer EM USD and local currency government bonds

02 Expect 10-year US Treasuries to trade in the 2.75%-3.25% range

03 Favour maturity profile of around five years for USD-denominated bonds

US yields under focus

- We view bonds as a core holding and expect government bond yields to consolidate around current levels. We expect 10-year US Treasury yields to trade in the 2.75%-3.25% range over the next 12 months.
- Emerging Market (EM) bonds, both USD and local currency denominated, remain our favoured areas. Potential easing of trade tensions and higher commodity prices (compared with last year) would be positive.
- We view Asia USD bonds as a defensive allocation within EM and retain them as a core holding. We expect Developed Market (DM) Investment Grade (IG) and High Yield (HY) corporate bonds to outperform government bonds.

Figure 18: Bond sub-asset classes in order of preference

Bond asset class	View	Rates policy	Macro factors	Valua-tions	FX	Comments
EM local currency	Preferred	Neutral	Supportive	Neutral	Supportive	Attractive yield, bullish EM FX and positive EM sentiment are supportive
EM USD government	Preferred	Not Supportive	Supportive	Neutral	NA	Attractive yields, relative value and positive EM sentiment are supportive
Asian USD	Core	Not Supportive	Supportive	Neutral	NA	High credit quality, defensive allocation. Influenced by China risk sentiment
DM IG corporate	Core	Not Supportive	Supportive	Neutral	Supportive	Likely to outperform DM IG government bonds. Yield premium is relatively low
DM HY corporate	Core	Not Supportive	Neutral	Not Supportive	Supportive	Attractive yields on offer, offset by expensive valuations
DM IG government	Less Preferred	Not Supportive	Not Supportive	NA	Supportive	Returns challenged by normalising Fed and ECB monetary policy

Source: Standard Chartered Global Investment Committee

Legend: Supportive | Neutral | Not Supportive | Preferred | Less Preferred | Core

Figure 17: Where markets are today

Bonds	Yield	1m return
DM IG government	*1.40%	-2.2%
EM USD government	6.03%	-0.5%
DM IG corporates	*2.82%	-1.2%
DM HY corporates	5.84%	-0.1%
Asia USD	4.72%	-0.5%
EM local currency government	6.26%	-2.8%

Source: Bloomberg, JPMorgan, Barclays, Citigroup, Standard Chartered
*As of 31 March, 2018

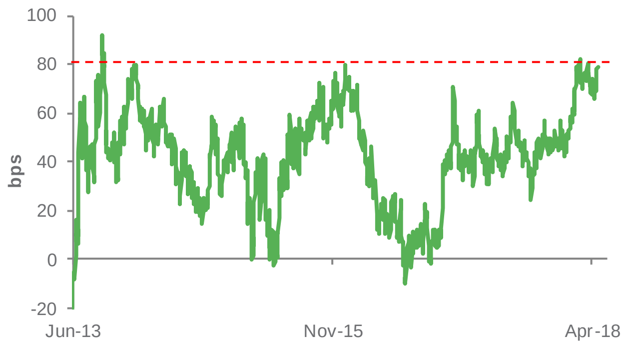
Focus on real yields and short-term funding costs

The past month saw a number of developments that pushed bond yields higher. Investors appear increasingly focussed on the rise in short-term funding costs in the past few months, which has started to hurt bond demand. An easing of trade tensions and stronger US data led to lower safe-haven demand and 10-year US Treasury yields rose by nearly 15bps, briefly breaching 3.0%. Shorter maturity yields rose at a faster pace as the market implied probability of a Fed rate hike in June rose to exceed 90%.

Interestingly, the recent rise in US Treasury yields has come at a time when the market-implied inflation expectations have increased only marginally. This means that real yields (government bond yields net of inflation) have increased to close to post taper-tantrum highs. Given the close link between inflation and yields, we believe 10-year US Treasury yields could consolidate around the current level.

Figure 19: Real yields back to top of 5 year range

10y US Treasury yields – 10y US inflation breakeven



Source: Bloomberg, Standard Chartered

Emerging Market local currency bonds – Preferred

EM local currency government bonds underperformed last month as a number of country-specific factors and weaker currencies hurt performance. Nevertheless, we retain them as a preferred area within bonds and elevate them above EM USD government bonds in the pecking order.

Figure 20: Attractive yield pick-up over global bonds and our outlook for stronger EM currencies support EM local currency bonds

Yield pickup offered by EM local currency bonds over global bonds

Source: Bloomberg, Standard Chartered

EM countries remain supported by firm economic growth, higher commodity prices and broadly stable monetary policy. The bonds continue to offer attractive yield pickup over global bonds. Although near-term USD strength is a risk, our bullish stance on EM currencies means currency gains could potentially add to the attractive yield of 6.3% on offer.

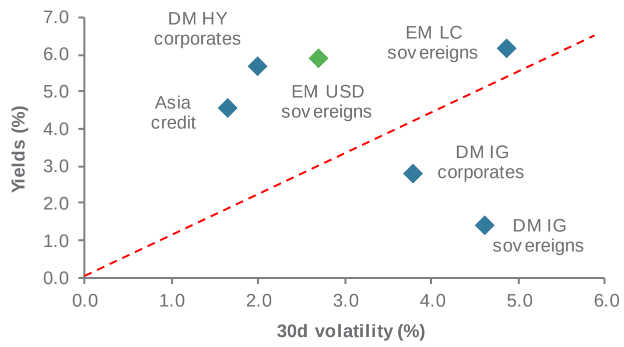
Emerging Market USD government bonds – Preferred

In line with our preference for EM assets, we continue to like EM USD government bonds as a preferred area within bonds. Though the bonds have been hurt by their relatively higher interest rate sensitivity, we believe that is less of a risk going forward, given our expectation of a consolidation of US yields. Valuations remain reasonable and we expect credit spreads to remain broadly range-bound.

Technically, the asset class has been impacted by higher-than-expected supply and the stalling in investor flows, which have disturbed the demand-supply equilibrium. However, there are some green shoots in credit quality (the recent rating upgrade for Indonesia), and we believe stronger fundamentals and the attractive yield of 6.0% on offer are likely to help the asset class outperform global bonds.

Figure 21: EM USD government bonds offer attractive yield and reasonable valuations for an asset class with moderate volatility

EM USD government bonds yield and 30-day return volatility



Source: Bloomberg, Standard Chartered

Asian USD bonds – Core holding

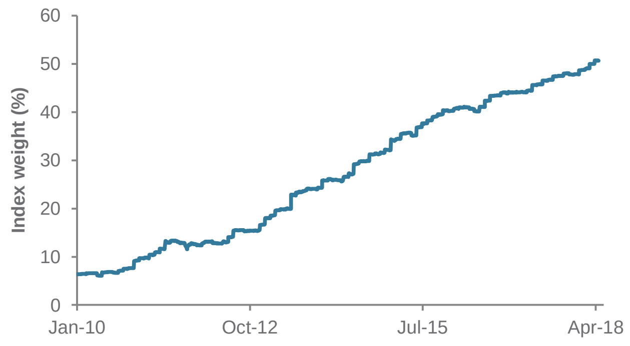
Asian USD bonds remain a core holding, supported by our overall preference for EM bonds. We view them as a core holding and like their relatively higher credit quality compared with other regions within EM.

However, we acknowledge that Asian USD bonds have seen their demand-supply balance worsen moderately. Supply remains high and the increasing concessions offered for new bond issuance indicates that companies from China remain profligate issuers, resulting in a rise in the share of China bonds in Asia USD bonds from below 10% at the start of the decade to over 50% at present.

On a positive note, credit quality, as measured by the ratio of rating upgrades to downgrades, seems to be stabilising. In our opinion, strong regional demand and the yield of over 4.7% on offer are likely to provide support for the asset class over the next few months.

Figure 22: Persistently high supply from China issuers has pressured technicals and led to higher geographical concentration

Weight of bonds from China issuers in Asian USD bond index



Source: Bloomberg, Standard Chartered

Developed Market Investment Grade corporate bonds – Core holding

DM IG corporate bonds remain a core holding for us. While we expect them to outperform DM IG government bonds, we believe they are likely to underperform EM bonds.

Yield premiums have increased meaningfully from the lows seen in January, which has coincided with weaker demand. Higher short-term funding costs and hedging costs have dented demand from foreign investors who account for nearly 40% US corporate bond holdings. Though the trend is unlikely to reverse in the near term, we take comfort from lower supply, an increase in coupons and the stabilisation in credit quality, which should keep the asset class supported.

Developed Market High Yield corporate bonds – Core holding

DM HY corporate bonds outperformed other bond sub-asset classes over the past month. The strong performance was driven by a sharp reduction in yield premiums, helped by improved risk sentiment and higher oil prices, which supported energy sector bonds.

Given the recent rally, yield premiums are now approaching multi-year lows. This, combined with the overall increase in market volatility, leads us to believe there are strong headwinds for yield premiums to reduce further. Therefore, we retain DM HY bonds as a core holding as we expect coupon-like returns going forward.

Figure 23: Recent rally has led to yield premiums tightening close to multi-year lows

DM HY bond credit spreads or yield premiums (bps)

Source: Bloomberg, Standard Chartered

Developed Market Investment Grade government bonds – Less preferred

DM IG government bonds remain our least favoured area within bonds. We expect government bond yields in the US and Europe to rise modestly over the next 12 months, which is likely to make it challenging for the bonds to deliver positive returns in local currency terms.

In the US, we expect 10-year US Treasury yields to consolidate around current levels as the lack of an increase in inflation expectations and excessive speculative positioning are likely to cap yields in the near term. Nevertheless, we continue to expect short-term yields to rise faster than long-term yields (flatter yield curve).

Balancing the potential rise in yields and interest rate sensitivity leads us to favour a maturity profile of around five years in USD-denominated bonds.

Equities

IMPLICATIONS
FOR INVESTORS

01 Global equities our preferred asset class

02 Asia ex-Japan and the US are preferred markets

03 Prefer China within Asia ex-Japan

Upgrading US equities to preferred

- Global equities remains our preferred asset class. We have upgraded US equities, which joins Asia ex-Japan as a preferred region.
- Asia ex-Japan is our most preferred region, implying we expect it to outperform global equities in the next 12 months. Rising margins driven by strong demand and limited price pressures are leading to a higher return on equity (ROE). Valuations have fallen back to the long-term average following an increase in 2017, while earnings growth remains on track.
- US equities are upgraded to preferred. The upgrade is driven by a solid outlook for earnings growth, a forecast of re-acceleration in share buybacks and an improved outlook for the energy sector following the recent rise in crude oil prices.
- Euro area equities are a core holding, implying we expect the region to perform in line with global equities in the next 12 months. Prior EUR strength is a headwind for earnings, despite the improvement in domestic demand. Resilient global demand could bolster capex in the coming year, but balancing this is the effect of faster-than-expected monetary tightening on sentiment.
- Emerging Market (EM) ex-Asia is a core holding. The recovery in energy and material prices, driven by a combination of coordinated oil supply restraint by OPEC and Russia and synchronised global growth for material prices, is a clear positive. Balancing this is the uncertainty over the upcoming elections in Mexico and Brazil, which could lead to policy shifts. Russia is our preferred market in EM ex-Asia.
- We have reduced Korea to a core holding within Asia ex-Japan. This is driven by concerns the semiconductor sector is witnessing a convergence of rising supply and weakening demand growth.
- Risks to our equity view include: USD strength, margin weakness and the risk of a trade war.

Figure 24: Where markets are today

Market P/E ratio	P/B	EPS	Index level
US (S&P 500)			
16x	3x	17%	**2,677**
Euro area (Stoxx 50)			
14x	1.6x	9%	**3,506**
Japan (Nikkei 225)			
13x	1.3x	8%	**22,320**
UK (FTSE 100)			
14x	1.7x	8%	**7,421**
MSCI Asia ex-Japan			
12x	1.5x	11%	**705**
MSCI EM ex-Asia			
12x	1.5x	19%	**1,524**

Source: FactSet, MSCI, Standard Chartered.
Note: Valuation and earnings data refer to MSCI indices, as of 26 April 2018

Figure 25: Asia ex-Japan and the US are preferred, the UK is least preferred

Equity	View	Valuations	Earnings	Return on Equity	Economic Data	Bond yields	Comments
Asia ex-Japan	Preferred	Supportive	Supportive	Neutral	Supportive	Neutral	Earnings recovery, improving margins and attractive valuations
US	Preferred	Neutral	Supportive	Supportive	Supportive	Neutral	Robust earnings growth, potential for share buybacks
EM ex-Asia	Core Holding	Neutral	Neutral	Neutral	Supportive	Neutral	Commodity price recovery is leading to earnings recovery
Euro area	Core Holding	Neutral	Neutral	Neutral	Supportive	Neutral	Earnings under pressure from EUR strength, ROE improving
Japan	Core Holding	Supportive	Not Supportive	Supportive	Supportive	Neutral	JPY strength is a drag on earnings outlook
UK	Less Preferred	Supportive	Neutral	Not Supportive	Neutral	Neutral	Earnings under pressure and domestic demand remains weak

Source: Standard Chartered Global Investment Committee

Legend: Supportive Neutral Not Supportive Preferred Less Preferred Core Holding

Asia ex-Japan equities – Preferred

Asia ex-Japan equities are a preferred holding, which means we expect them to outperform global equities over the next 12 months in USD terms. Our preferred view is supported by attractive valuations, a steady recovery in margins and ROE and modest USD weakness.

The recovery in margins and ROE are driven by rising demand, higher selling prices and subdued wage costs. In addition, rising interest rates could see margin expansion for banks and the recovery in oil prices is positive for energy.

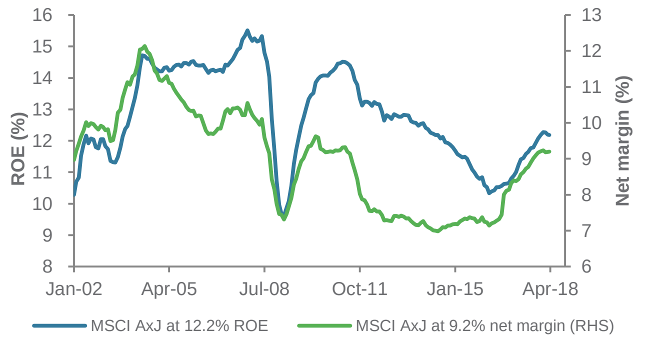
Consensus 12m forward earnings growth forecast for Asia ex-Japan has held broadly steady at 11%, but valuations have become more attractive with 12m forward price to earnings ratio (P/E) of 12x after the recent correction.

US-China trade tensions are near-term headwinds and have contributed to recent market volatility. History suggests a 57% probability of positive returns for Asia ex-Japan markets from current valuations in the coming 12 months, and our three-factor model signals the potential for 14% returns.

China is a preferred market within Asia ex-Japan. Its growing affluence and rising middle class are a driver for domestic consumption, supported by prudent fiscal policies and a stable political environment.

Figure 26: Asia ex-Japan margins and ROE have been rising

MSCI Asia ex-Japan's ROE and net margins



Source: FactSet, MSCI, Standard Chartered

US equities – Preferred

We have upgraded US equities to preferred (from core) holding, which means we expect them to outperform global equities over the next 12 months in USD terms. Our preferred view is underpinned by sustained momentum in EPS growth, expectations of resurgence in share buybacks, as well as our 12m bearish USD view.

We see an upside to consensus 2018 EPS growth forecast of 17%, aided by benefits from US tax reforms, healthy consumer demand, and higher business investments.

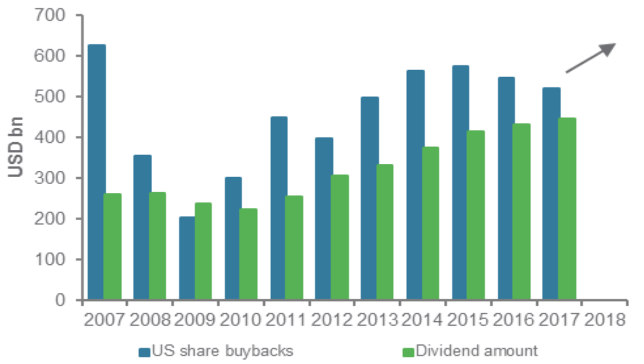
In addition, share buybacks could gain traction in 2018, as repatriation of profits from overseas accelerates. In 2017, share buybacks fell but this trend should reverse in 2018.

Valuations have also turned more attractive, given the recent market retracement. 12m consensus forward P/E is at 16x, down from its recent peak of 18.5x. We see near-term opportunities to accumulate in this region.

Risks to our positive view include a decline in the IT index and slower earnings growth. From current valuations, history suggests an 86% probability of positive returns for US equities in the coming 12 months. Our three-factor model signals the potential for 13% returns over the same period.

Figure 27: Share buybacks and dividends supportive of US equities

US Share buyback and dividends



Source: Bloomberg, Standard Chartered

EM ex-Asia equities – Core holding

EM ex-Asia equities remain a core holding, which means we expect them to perform in line with global equities over the next 12 months in USD terms. Upward earnings revisions and a modestly weaker USD are positive factors.

Energy and materials together account for 24% of MSCI EM ex-Asia. The Q1 increase in oil and industrial metal prices have contributed to better-than-expected corporate earnings. Consensus 12m forward earnings growth forecast has risen to 19%, with net margin at 10% and ROE of 13%. The upward earnings revision has reduced EM ex-Asia 12m forward P/E to 11.8x.

The increased likelihood of renegotiation of the North America Free Trade Agreement (NAFTA) is positive and has improved market sentiment for Mexico. Recent US sanctions against Russia are an earnings risk for the market if the situation prolongs. Moreover, the upcoming general elections in Mexico in July and Brazil in October raise uncertainty over the future fiscal policy stance of these two countries as there are no clear winning candidates at this stage.

History suggests a 57% probability of positive returns from current valuations for EM ex-Asia equity markets in the coming 12 months, and our three-factor model signals the potential for 16% returns over the same period.

Figure 28: MSCI EM ex-Asia performance is correlated to commodity price movement

MSCI EM ex-Asia and CRB index

Source: FactSet, Bloomberg, MSCI, Standard Chartered

Euro area equities – Core holding

Euro area equities are a core holding, which means we expect them to perform broadly in line with global equities over the next 12 months in USD terms. A strong EUR could offset benefits from rising business investments and near-term stabilisation of macro data points. The EU's exemption from US import tariffs so far could also provide some relief for the export-oriented market.

Prior EUR strength prompted a rebasing of forward earnings expectations, particularly for Euro area exporters, with 12m EPS growth expectations moderating 9%. Going forward, given our base case of a stronger EUR in the next 12 months, the adverse effect on Euro area exporters could offset positives from stabilising economic surprise indicators and fiscal stimulus.

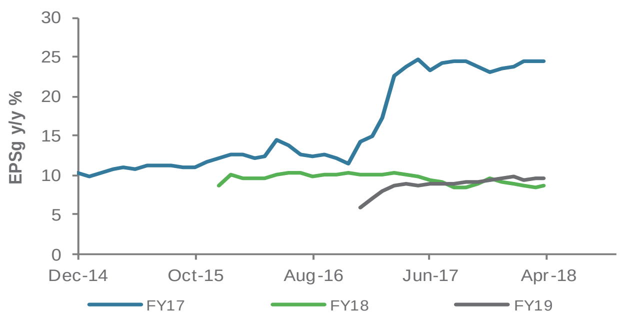
In addition, we hold the view that the resilience in global demand could bolster investment spending. We expect markets to begin rewarding Euro area companies for growing capex, after a decade of weak investment growth.

Valuations have turned cheaper following the recent market retracement. The market is currently trading at 12m forward P/E of 14x, down from its recent peak of 14.8x.

Quicker-than-expected monetary tightening, extension of tariffs to Euro area exporters and poor earnings outlook are key risks to our view. From current valuations, history suggests an 70% probability of positive returns for Euro area equities in the coming 12 months, and our three-factor model signals the potential for 10% returns over the same period.

Figure 29: Stagnating Euro area earnings momentum

Consensus 2017–2019 corporate earnings growth estimates, % y/y



Source: MSCI, FactSet, Standard Chartered

Japan equities – Core holding

Japan equities remain a core holding, which means we expect them to perform broadly in line with global equities over the next 12 months in USD terms. An expected acceleration in share buybacks and attractive valuations are supportive of the market. But this could be partially offset by peaking profit margins and the moderation in global macro data, which could hurt Japan exporters.

Share buybacks could accelerate going forward, underpinned by strong free cash generation from Japan corporates. We expect share buybacks and dividend payouts to accelerate after the moderation in 2017, recovering from JPY 1.7trn and JPY 5.1trn, respectively.

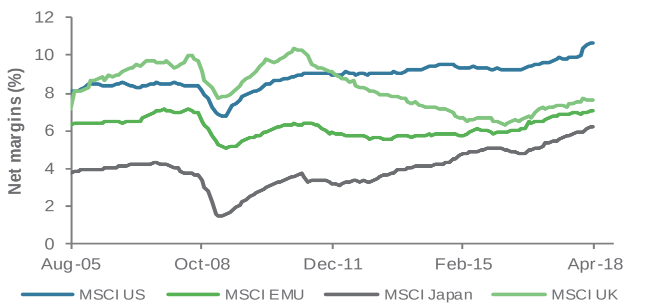
Valuations remain compelling at 12m forward P/E of 12.9x, which is below the long-term historical average of 16.8x.

Earnings outlook remains lacklustre with 12m forward earnings growth at 8%, down from 9.7% in January 2018, as the adverse impact from prior JPY strength and easing economic momentum takes hold. However, we anticipate earnings downgrades from JPY appreciation to ease, given our base case of a range-bound JPY in the next 12 months. But risks of peaking profit margins could limit any meaningful upside for Japan corporate earnings.

Using current valuations, history suggests a 62% probability of positive returns for Japan equities in the coming 12 months, and our three-factor model signals the potential for 10% returns over the same period.

Figure 30: Moderating economic momentum and higher wages could lead to peaking margins in Japan

Net margin trends for major markets



Source: FactSet, MSCI, Standard Chartered

UK equities – Less preferred

UK equities remain our least preferred region, which means we expect them to underperform global equities over the next 12 months in USD terms. Our cautious view reflects concerns surrounding EPS growth outlook, unattractive valuations and limited upside for commodity prices.

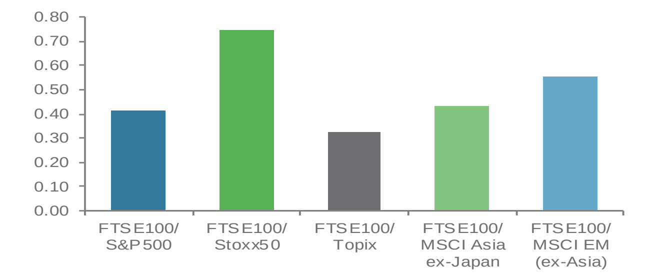
Economic growth remains tepid, with consumer sentiment remaining lukewarm. This could curtail forward earnings growth expectations. Consensus expectations for UK EPS growth is currently at 8%, which may see further downward revisions and remain moderate than MSCI AC World's 12.8%.

Given our range-bound view on the GBP and commodities, (which are historically key drivers for UK equities), we see limited room for outperformance in UK equities. Valuations are also not compelling, trading at consensus 12m forward P/E of 14x, which is above its long-term (LT) historical average of 12.9x and represents an 8.9% discount to global equities (versus its LT average of 10.5% discount).

Key risks to our least preferred stance on UK equities are (1) sustained funds inflows into the UK amid abating Brexit concerns, (2) escalating trade friction between US-China could see UK better-off given its low correlation with other regions and the exemption from US import tariffs so far, and (3) a continued sell-off in global IT may spur outperformance, as MSCI UK has a 1% weight to this sector versus global equities' 18%. From current valuations, history suggests there is a 60% probability of positive returns for UK equities in the coming 12 months, and our three-factor model signals the potential for 11% returns over the same period.

Figure 31: Key risk to our cautious view is if global trade friction escalates, UK could outperform given low correlation with other regions

FTSE100's 3y correlation with the rest of the regions



Source: Bloomberg, Standard Chartered

Commodities

IMPLICATIONS FOR INVESTORS

01 Oil prices unlikely to rise significantly from current levels

02 Gold to remain range-bound

03 Modest retracement of base metal prices likely

Geopolitics dominate

- We remain broadly constructive on commodities amid robust global growth, a weaker USD outlook and rising inflation risks, although risks are skewed towards the downside.
- A temporary move in Brent oil prices above USD 75/bbl remains possible, but a lot of price-supportive news already appears to be in the price
- Gold is expected to trade range-bound from here, supported by rising geopolitical tensions and a weaker USD but capped by rising real US interest rates.

Figure 33: Commodities: key driving factors and outlook

Commodity	View	Inventory	Production	Demand	Real interest rates	USD	Risk sentiment	Comments
Oil	Neutral	Neutral	Neutral	Supportive	NA	Neutral	Neutral	OPEC cuts to offset rising US shale output; supportive of prices
Gold	Neutral	Neutral	Neutral	Not Supportive	Neutral	Neutral	Neutral	Gradually rising real yields to weigh on gold
Metals	Neutral	Neutral	Not Supportive	Neutral	NA	Neutral	Neutral	Modest retracement likely as China demand stalls

Source: Standard Chartered Global Investment Committee

Legend: Supportive | Neutral | Not Supportive | Preferred | Less Preferred | Neutral

What a month!

Commodities have recouped some of their YTD gains, buoyed by rising geopolitical risks and stronger fundamentals, albeit with higher volatility. Crude oil and industrial metals registered gains of 7.5% and 6.0%, respectively, while gold was down 2.7%.

We believe there is a high probability of oil prices trading within USD 55-75/bbl. Although prices could trade above this range briefly, our view is that this is unlikely to sustain as the upside will be capped by resurgent US shale oil production growth.

Gold prices could remain supported by elevated concerns over US-China trade rhetoric and broader geopolitical tensions. However, any upside would be limited given the Fed remains on track to increase interest rates.

Industrial metals have given up their gains after the US showed some intent to ease proposed sanctions on Russia. However, we believe the broader narrative surrounding China (ie, slowing fixed asset investments) has not changed.

Figure 32: Where markets are today

Commodity	Current level	1-month return
Gold (USD/oz)	1,317	-2.7%
Crude Oil (USD/bbl)	75	7.5%
Base Metals (Index)	136	6.0%

Source: Bloomberg, Standard Chartered
As of 26 April 2018

Crude oil – as good as it gets

Oil prices have benefitted from a combination of factors such as stronger-than-expected demand, rising geopolitical risks and weather. Although we believe chances of a move above USD 75/bbl have risen a little, we believe that oil prices should not rise significantly from here given the relatively stretched investor positioning. (See *chart*).

We expect oil prices to trade within USD 55-75/bbl, but with prices currently at the top end of our range, there is a risk of a move lower looking further out. Investors have also largely focused on the impact on supply, if (1) US President Donald Trump does not waive trade sanctions against Iran and (2) the US enacts sanctions against Venezuela.

US shale production has continued to grow, even as US shale producers face capacity constraints, as seen in the rise in US oil rig counts. However, this should be offset by continued OPEC discipline as OPEC spare capacity has become more limited. Lastly, one-off factors such as weather should fade in the coming months.

Gold – still resilient

Gold was previously testing one-year highs, but its momentum has stalled given recent USD strength. In our view, gold should trade largely range-bound and will continue to be caught between geopolitical and economic headlines.

Although its relationship with real yields (net of inflation) has broken down since the start of the year, this relationship should reassert itself as the Fed continues to normalise policy. While this would be a headwind for gold prices, we believe prices may be supported in the near term by rising US-China trade tensions and the uncertainty over US sanctions on Russia (See *chart*).

Industrial metals – China remains key

Although proposed US sanctions against a Russian aluminium producer rattled industrial metal markets, they have since given up some gains as the US has signalled that it could potentially ease sanctions. We believe a modest retracement of industrial metal prices remains likely as China (which remains key to demand) is expected to slow as it continues to focus on financial deleveraging.

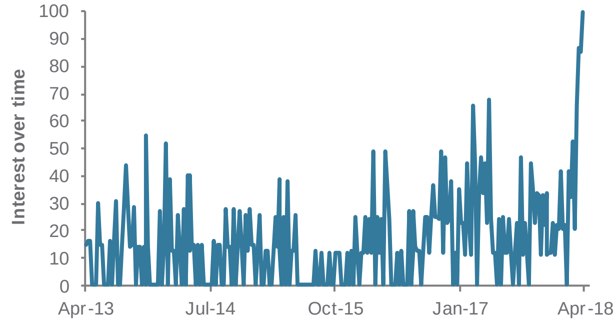
Figure 34: Elevated investor positioning leaves oil prices susceptible to a correction

Crude oil net-commercial net position (quantity of contracts in thousands)

Source: Bloomberg, Standard Chartered

Figure 35: US-China trade tensions may have supported gold prices

Google searches for 'trade tensions' globally



Source: Google Trends, Standard Chartered

*Note that interest over time represents search interest relative to the highest point on the chart; a value of 100 is the peak popularity for the term

Figure 36: What has changed – Oil

Factor	Recent moves
Supply	OPEC compliance firm; US crude oil stocks still below five-year averages
Demand	Leading economic indicators in the US and China stabilising
USD	Consolidating within a weaker trend

Source: Standard Chartered

Figure 37: What has changed – Gold

Factor	Recent moves
Interest rate expectations	US yields have resumed their move upwards given a rising growth outlook
Inflation expectations	Rising in the US; stabilising in Europe
USD	Consolidating within a weaker trend

Source: Standard Chartered

Alternative strategies

IMPLICATIONS FOR INVESTORS

01 Use both substitutes and diversifiers

02 Equity Hedge (most preferred) supported by our reflationary scenario

03 Event Driven and Global Macro (least preferred)

Equity Hedge still preferred

- Our alternatives allocation has delivered -0.3% this year and +0.9% since we published our *Outlook 2018*.
- We continue to favour Equity Hedge, up 1.0% YTD, supported by an outlook of continuing positive global growth, trade tensions notwithstanding.
- We move Event Driven to less preferred as implications of President Trump's actions over business-friendly policies remain ambiguous.

Updating our traffic light framework

Our alternatives allocation was up 0.2% month to date. A possible peaking of global growth, trade tensions and geopolitical events has the potential to increase market volatility. Given this backdrop, Equity Hedge, our preferred strategy, may benefit from wider dispersion among equity sectors and lower correlations among stocks in the index.

We downgrade Event Driven to less preferred because of concerns around the appetite for M&As due to a lack of clarity on business-friendly policies from the Trump administration. At present, global M&A volume remains healthy. However, a further pickup in bond yields would lead to higher funding costs, which, in turn, could dampen US deal makers' confidence. We maintain our least preferred view on Global Macro, despite viewing this strategy as a diversifier as we move towards the end of the cycle.

Following recent changes, we have revised our alternatives strategies allocation weights as follows: Equity Hedge 40% (from 45%), Relative Value 30% (from 25%), Event Driven 17% (from 24%) and Global Macro 13% (from 6%). For more information on our alternatives allocation, please refer to *Outlook 2018*.

Figure 38: Where markets are today

Alternatives	YTD	1m return
Equity Long/Short	1.0%	-0.2%
Relative Value	1.1%	0.1%
Event Driven	-3.9%	0.0%
Macro CTAs	-1.7%	-1.5%
Alternatives Allocation	0.9%	-0.2%

Source: Bloomberg, Standard Chartered

Figure 39: Traffic light framework alternatives strategies

		Description	View	Drivers for strategies to perform	
SUBSTITUTES	Equity Hedge	In essence, buying undervalued stocks and selling overvalued stocks	▲	• Positively trending equity markets	🟢
				• Rising equity market dispersion	🟡
	Relative Value	Looking to take advantage of differences in pricing of related financial instruments	◆	• Lower interest rate levels	🟢
				• Cost of funding, narrowing credit spreads	🟡
	Event Driven	Taking positions based on an event such as a merger or acquisition	▼	• Positively trending equity markets	🟢
				• Rising mergers and acquisitions	🟡
				• Narrowing credit spreads	🟡
DIVERSIFIERS	Global Macro	Looking to exploit themes, trends and asset class relationships (correlations) at a global level, generally with leverage	▼	• Rising volatility and credit spreads	🟡
				• Increasing cross asset dispersion	🟡
				• Clear market trends (up/down)	🔴

Source: Standard Chartered

Legend: 🟢 Supportive 🟡 Neutral 🔴 Not Supportive ▲ Preferred ▼ Less Preferred ◆ Neutral

FX

IMPLICATIONS FOR INVESTORS

01 USD weakness medium term

02 EUR strength medium term

03 CNY strength medium term

USD gains likely to be short lived

- We expect USD weakness in the next 6-12 months as Fed rate hikes likely priced in and as US twin deficits weigh in. In the short term, excessively short positioning a risk of USD gains.
- We expect further EUR gains in the coming 12 months as balance-of-payment fundamentals are supportive, though excessive net-long positioning remains a risk in the short term.
- We believe monetary policy fundamentals still argue for a weaker JPY. However, in the short term, a lot depends on the outlook for safe-haven demand.
- In our view, Emerging Market (EM) currencies are likely to deliver positive returns in 2018 amid supportive growth fundamentals; we believe the CNY is likely to extend gains, but we scale back our bullish view on the SGD and the MYR.

Figure 41: Foreign exchange; key driving factors and outlook (6-12m)

Currency	View	Real interest rate differentials	Risk sentiment	Commodity prices	Broad USD strength	Comments
USD	Less Preferred	Neutral	Neutral	NA	NA	Rate hiking trajectory priced in
EUR	Preferred	Neutral	Supportive	NA	Supportive	Monetary policy normalisation not yet complete
JPY	Neutral	Not Supportive	Not Supportive	NA	Supportive	Range-bound amid weaker USD
GBP	Neutral	Neutral	Supportive	NA	Supportive	Brexit risks to prevent further gains
AUD	Neutral	Not Supportive	Supportive	Neutral	Supportive	RBA policy could hamper gains
EM FX	Preferred	NA	Supportive	Neutral	Supportive	Synchronised global growth environment

Source: Bloomberg, Standard Chartered Global Investment Committee

Legend: Supportive Neutral Not Supportive Preferred Less Preferred Neutral

Figure 40: Where markets are today

FX (against USD)	Current level	1m change
Asia ex-Japan	111	-0.9%
AUD	0.76	-1.6%
EUR	1.21	-2.4%
GBP	1.39	-1.7%
JPY	109	-3.6%
SGD	1.33	-1.3%

Source: Bloomberg, Standard Chartered

USD remains on a cyclical weakening path

The USD has traded in a relatively tight range over the past few months. We believe this has largely been a result of the lack of a major catalyst and historically stretched net long speculator positioning.

Though the USD could continue to find support in the short term from positioning and sentiment, we believe, over a 12m horizon, the USD is likely to resume its downtrend. We do not believe the current Fed rate hiking trajectory is likely to support the USD, with markets already pricing in 2-3 more rate hikes in 2018. Moreover, the US current account and trade deficits continue to expand, especially relative to the Euro area, and we believe these are negative for the USD over the medium to long term.

EUR – balance of payments supportive

We believe the prospect of higher policy rates in Europe argues for a stronger EUR medium term, though short-term consolidation could continue until a clear catalyst emerges. Over the past year, the significant improvement in Euro area current account surplus, coupled with reduced capital outflows, has been EUR positive. Going forward, we believe the most prominent EUR supportive catalyst is likely to be ECB communication regarding a potential interest rate hike, which we believe is likely to take place earlier than current market expectations of around Q2 2019. Although recent Euro area economic data has been less inspiring, we believe only a marked deterioration from here would force the ECB to revisit its intent to taper quantitative easing.

JPY – recovery in risk sentiment key

The JPY failed to make new highs this month. We believe this is likely due to an improvement in overall market risk sentiment and abatement in immediate trade tensions. We believe, short term, the JPY could weaken further as most medium-term drivers of the JPY, especially monetary policy, are likely to remain excessively accommodative for now. The JPY had earlier diverged from its medium-term fundamentals based on US-Japan real interest rates (see the adjacent chart). We believe this relationship could come back as risk aversion and safe-haven demand fade as we move into the second half of the year. In addition, the exceptionally large short JPY positioning has also normalised somewhat, which could provide a tailwind to a weaker JPY.

GBP – risks to long-term recovery intact

The GBP failed to breach its 2018 high this month, following an earlier rally. Recent GBP gains have been driven by positive sentiment following the EU-UK transition agreement and improvement in the overall balance of payments, driven by a reduced current account deficit and supportive capital inflows. We believe long-term uncertainties regarding a Brexit deal are likely to continue to restrict significant further gains in the GBP. Recent weaker UK data and comments from BoE governor Carney highlight that the rate hiking trajectory is unlikely to be smooth. As a result, we believe the GBP could trade in a broad range.

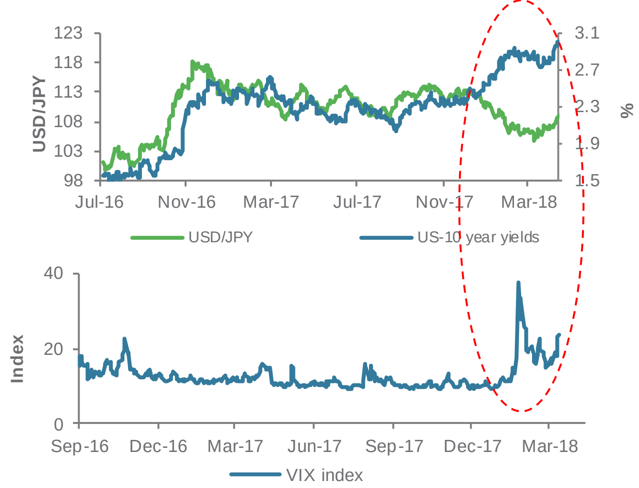
Figure 42: What has changed – G3 currencies

Factor	Recent moves
Real interest rate differentials	Have widened in support of the USD, but relationship with FX has broken down recently
Risk sentiment	Market sentiment remain fragile with the VIX continuing to be above 15
Speculator positioning	JPY positioning has evened out, EUR net-longs remain at historical highs, GBP net-longs above historical average

Source: Bloomberg, Standard Chartered

Figure 43: USD/JPY relationship with US 10-year yields could re-emerge when risk sentiment improves

US 10y yields and USD/JPY spot (top panel), VIX index (bottom panel)



Source: Bloomberg, Standard Chartered

Figure 44: Both trade-weighted GBP and GBP/USD have covered significant ground, though further upside could be challenging

GBP trade-weighted index and GBP/USD spot

Source: Bloomberg, Standard Chartered

AUD – breaking lower, but downside limited

The AUD fell below a key medium-term trendline support this month; this suggests potential for further short-term downside as sentiment deteriorates. Nevertheless, we believe significant AUD downside is likely to be limited as major anchors, such as our view of a stable China, remains supportive.

China is likely to continue to grow, which is likely to keep demand for industrial metals, including iron ore, supportive. In addition, we believe it is too early for the RBA to hike interest rates and will likely maintain status quo in 2018. Moreover, the AUD remains one of the most exposed G10 currencies to a global risk-off environment and USD strength. The confluence of these factors at this time restricts us from turning bullish on the AUD over the 12m horizon, despite our outlook for a weaker USD.

Emerging Market currencies – longer-term positive fundamentals to prevail

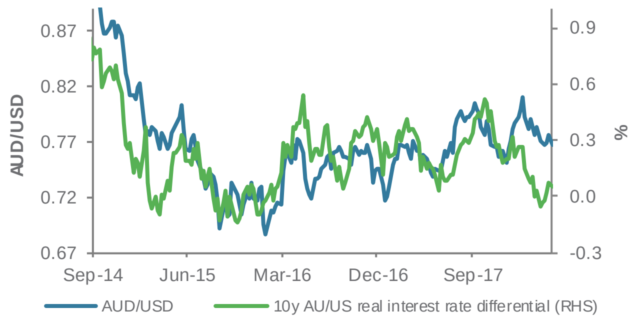
EM currencies have remained relatively resilient to trade tensions/geopolitical concerns over the past few months. This, we believe, is largely due to the fact that most positive drivers remain intact. The three most significant factors supporting our positive view are 1) the continuation of robust growth and positive risk sentiment, 2) a weaker USD, and 3) a modest uptick in commodity prices.

Within EM currencies, we believe there is potential for the CNY to extend gains. Recently, some concerns have arisen regarding the reaction by China policymakers to a more aggressive US trade policy. We do not believe China authorities are likely to abandon their structural policies in response to trade rhetoric. So far, the PBoC has preferred a slight CNY appreciation against trade partner currencies, and any shift is more likely to be based on cyclical factors as opposed to a reaction to US trade policy.

The SGD remained relatively insensitive to the MAS modifying its policy towards modest tightening. This suggests, it could have been priced in, and, hence, we scale back our bullish SGD view. Similarly, we turn more cautious on the MYR given a possible short-term USD rebound.

Figure 45: Possibility of modest AUD downside based on real interest rate differentials

AUD/USD spot and 10y AUD-USD real interest rate differentials



Source: Bloomberg, Standard Chartered

Figure 46: What has changed in Emerging Market currencies

Factor	Recent moves
USD	USD has remained largely range-bound
China risks	China economic surprises remain positive but have eased recently
Risk sentiment	EM FX volatility has remained generally contained

Source: Standard Chartered

Figure 47: USD/CNY has closely followed the USD index since the establishment of the current FX policy regime

USD/CNY spot and USD index

Source: Bloomberg, Standard Chartered

Multi-asset

IMPLICATIONS
FOR INVESTORS

01 Total-return investors can consider a balanced allocation with exposure 'baskets'

02 'Baskets' focus on growth, inflation, quality bonds and alternative strategies

03 Multi-asset income investors can focus on fixed income, equity income and non-core income exposures

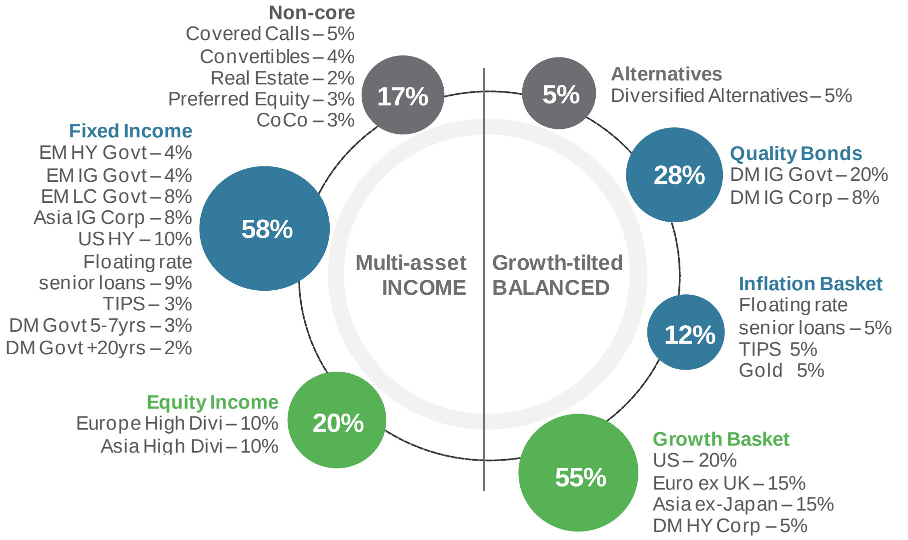
Prefer a balanced allocation over a multi-asset income allocation

- We continue to believe a growth-tilted balanced allocation will outperform a multi-asset income allocation this year.
- However, for investors focused on income, a multi-asset income allocation can continue to help an investor's regular income goal.
- For a balanced allocation, we diversify across a growth basket (55%), an inflation basket (12%), quality bonds (28%) and alternative strategies (5%).

In *Outlook 2018*, we shared two distinct asset allocations focusing on goals for i) total-return focused investors and ii) income focused investors (Figure 49).

This year has experienced increased volatility, driven by US-China trade tensions, monetary tightening, inflationary concerns, geopolitical risks and potential implications of a flattening US yield curve. Despite these headwinds, both our balanced allocation and multi-asset income allocation are essentially flat YTD, 0.0% and -0.1% respectively.

Figure 49: Breakdown of multi-asset income allocation and balanced allocation



Source: Bloomberg, Standard Chartered.

Figure 48: Key multi-asset views

Allocation performance	YTD	1m return
Total return balanced	0.0%	-0.1%
Multi-asset income	-0.1%	-0.2%

Source: Bloomberg, Standard Chartered

Given a global reflationary scenario (i.e., a controlled recovery in growth and inflation) still carries a 40% probability in our opinion, we continue to favour a growth-tilted balanced allocation over a multi-asset income allocation.

Looking at our balanced allocation, a key contributor this year has been floating rate senior loans within our 'inflation basket', which are up +1.9% YTD. We expect US inflation to rise moderately. With this backdrop, we maintain our 'inflation basket' with the view that global inflation will rise in due course.

For our multi-asset income allocation, alongside floating rate senior loans, other strong contributors have been convertibles, European high dividend equities and EM LC government bonds.

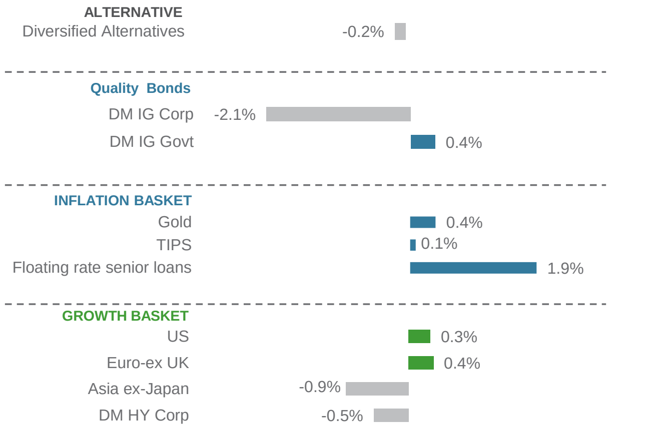
One potential headwind for income assets could be rising global interest rates, with the US having already embarked on a hiking cycle. Although US 10-year Treasury yields may move modestly higher as inflation expectations normalise, we believe that a sustained move above 3.25% is unlikely.

We continue to believe that for total-return investors, our growth-tilted balanced allocation, with baskets across growth, inflation, quality bonds and alternatives, is an effective way to diversify one's allocation.

For investors focused on income, our multi-asset income allocation provides a diversified allocation across fixed income, equity and non-core income, to help an investor meet a regular income goal.

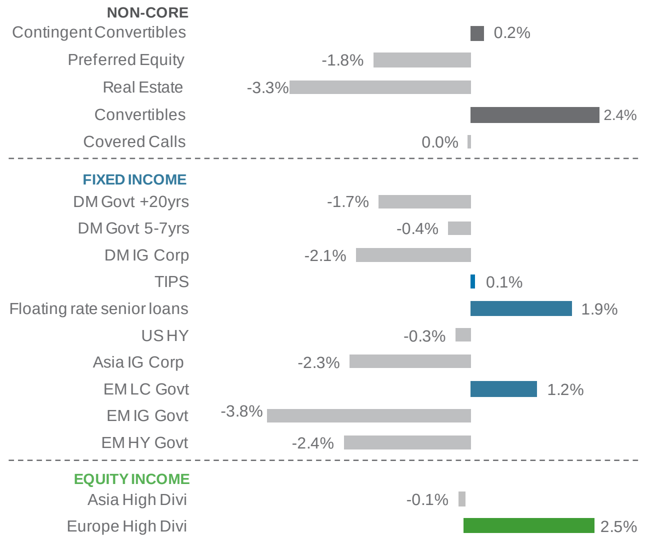
For more information on our balanced and multi-asset income allocations, please refer to *Outlook 2018* publication.

Figure 50: YTD performance of growth-tilted balanced component asset classes



Source: Bloomberg, Standard Chartered

Figure 51: YTD performance of multi-asset income component asset classes



Source: Bloomberg, Standard Chartered

Figure 52: Multi-asset view

Income potential, capital growth and risk of pullback

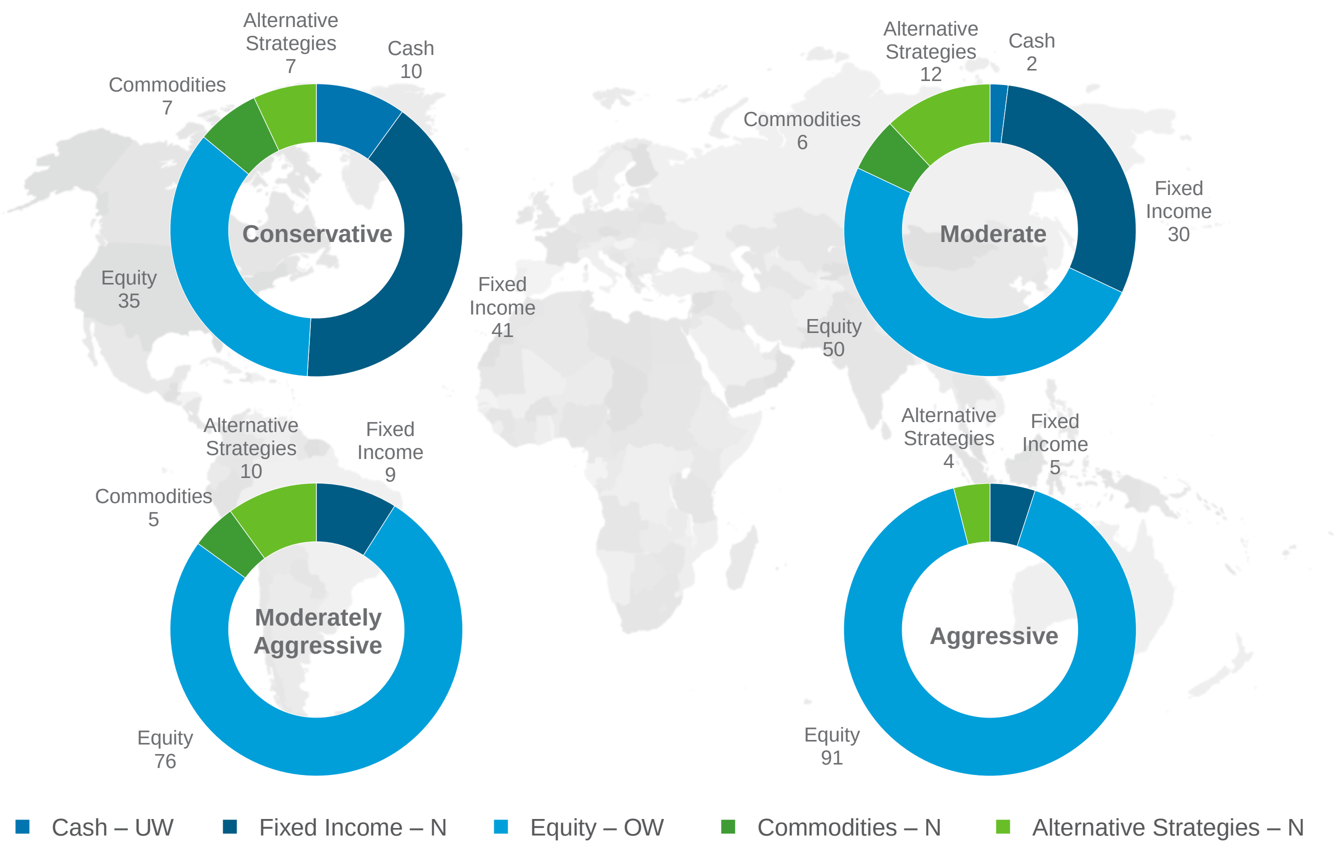
Asset classes	Yield	Income potential	Capital growth	Risk of pullback	Comments
Fixed Income	**4.8**	🟡	🟡	🟡	**Portfolio anchor; source of yield; some pockets of value, but not without risks**
Leveraged Loans	**5.3**	🟢	🟡	🟡	Attractive alternative to traditional HY exposure; senior in capital structure to simple HY bonds; small yield penalty in return; returns positively correlated to short-term US interest rates; callable loans a risk
Corporate - US HY	**6.3**	🟢	🟡	🔴	Valuations remain expensive; attractive yields; default rates remain contained
EM USD Sovereign Debt	**6.0**	🟢	🟡	🟡	Diverse risk/reward in IG, HY bonds; high sensitivity to a rise in US interest rates a risk; commodity exposure may be a support; valuations fair and attractive yield with an IG/HY mix
EM LCY Sovereign Debt	**6.3**	🟢	🟡	🔴	Carry play; policy rates mostly flat; foreign demand a recent risk. Expectation of stronger EM FX is supportive
Investment Grade*	**3.1**	🔴	🟡	🟡	Portfolio anchor, structural carry; some interesting ideas, but interest rate sensitivity a risk
Corporate - DM IG*	**2.8**	🔴	🟡	🟡	Yield premiums have widened, but valuations are fair; long-term US corporate bonds look appealing if Fed hiking cycle muted
Corporate - Asia IG	**4.3**	🟡	🟡	🟢	Cautiously positive. Lower volatility given large regional demand. Fairly valued, stable credit quality; key risks include concentration risk from China issuer supply and lower regional demand
TIPS	**2.7**	🔴	🟢	🟡	Offers value as an alternative to nominal sovereign bonds; impact of a rate rise similar to G3 sovereigns, but offers exposure to a further rise in US inflation and Fed policy rates
Sovereign*	**1.7**	🔴	🔴	🟡	Limited value with rising inflation risk. Risks include rate hikes, higher inflation and end of quantitative easing
Equity	**4.9**	🟡	🟡	🔴	**Modest upside from capital growth and source of dividend income**
Global Equity	**2.6**	🟡	🟡	🔴	Earnings backdrop remains supportive; valuations slightly elevated
US	**3.1**	🔴	🟡	🟡	Elevated valuations; upside from share buybacks; Fed rate hikes positive for banks
Europe	**5.7**	🟢	🟢	🟡	Fair valuations; attractive yields; overhang from political risk mitigated by improving global growth outlook
Asia	**3.9**	🟡	🟢	🔴	Selectively attractive valuations; but pullback a risk due to China/US trade tensions, higher Fed Funds rate and China leverage
Non-core	**6.3**	🟡	🟡	🟡	**Useful diversifier for income and growth**
Preferred	**5.6**	🟢	🟡	🔴	Attractive yields and exposure to financials; risk from higher rates may not be completely offset by improvement in banks' underlying credit
Convertibles	**3.1**	🟡	🟡	🟡	Moderate economic expansion and gradual pace of rate hikes should be good for converts. Policy mistake a risk
Property	**4.1**	🟡	🟡	🔴	Yield diversifier; stable real estate market; risk from higher rates, valuations stretched in some regions. Potential for large pullbacks
Covered Calls	**11.1**	🟢	🟡	🟡	Useful income enhancer assuming limited equity upside
Cocos	**4.9**	🟡	🟡	🔴	Moderate yields; relatively low sensitivity to rising yields and improving bank credit quality over the past few years
Gold	**--**	N/A	🟡	🟢	Traditionally low correlation with other assets, potential inflation hedge
Alternatives	**--**	N/A	🟡	🟢	One of our key preferences among equities, fixed income and cash; can provide diversification benefits

Source: Bloomberg, Standard Chartered Global Investment Committee; Yield data as of 26 April 2018;*Yield data as of 31 March 2018
For indices used, refer to the end note at the conclusion of this section
Please note: The Financial Conduct Authority (FCA) has introduced Permanent Marketing Restrictions on the sale of CoCos to residents of the EEA

Legend: 🟢 Attractive potential/low risk 🟡 Moderate potential/medium risk 🔴 Unattractive potential/high risk

Global asset allocation summary

Global-focused Tactical Asset Allocation - May 2018 (12m). All figures are in percentages.



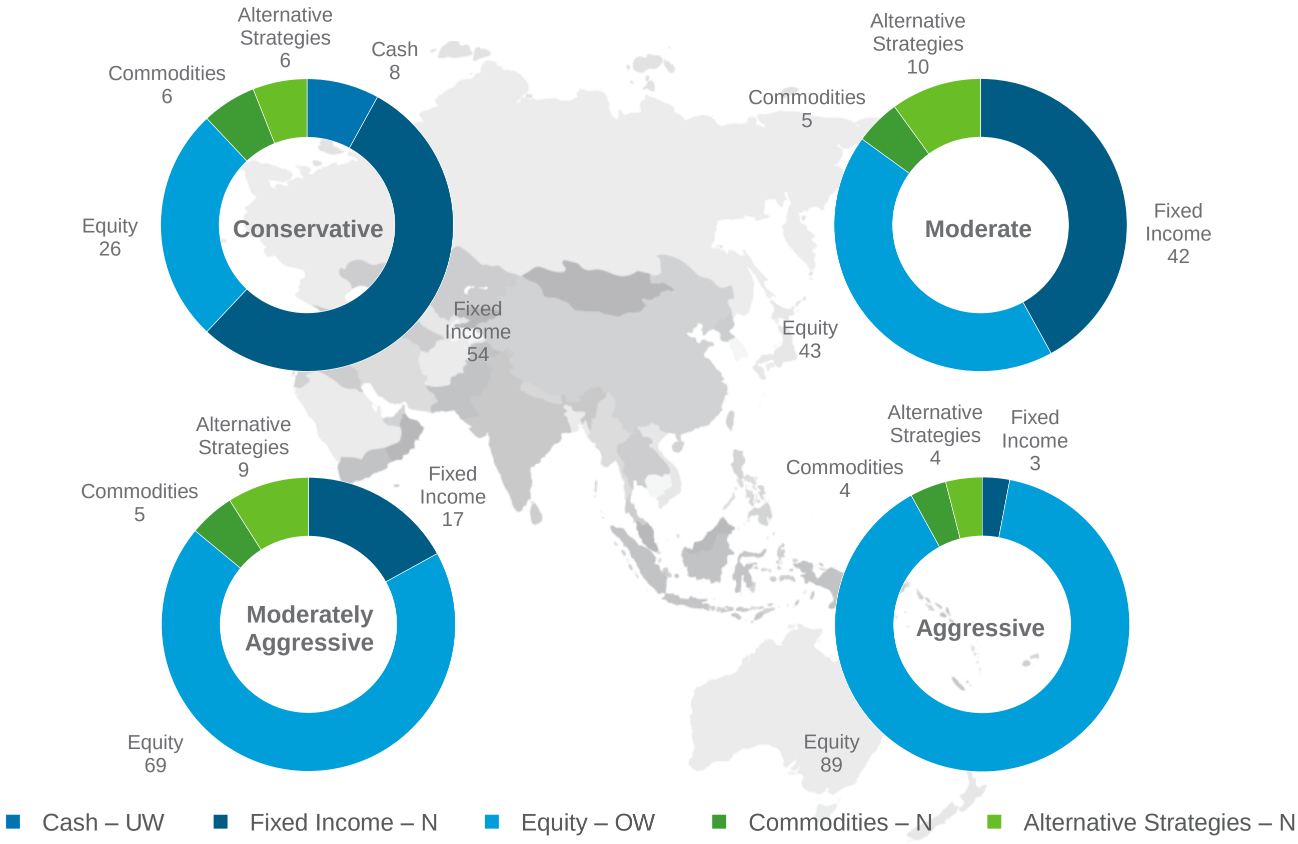
Asset class	Region	View vs. SAA	Conservative	Moderate	Moderately aggressive	Aggressive
Cash & Cash Equivalents	USD Cash	UW	10	2	0	0
Developed Market Bonds	DM Government Bonds	UW	18	14	5	2
	DM IG Corporate Bonds	N	15	10	4	3
	DM HY Corporate Bonds	N	4	2	0	0
Emerging Market Bonds	EM USD Sovereign Bonds	OW	4	4	0	0
	EM Local Ccy Sovereign Bonds	OW	0	0	0	0
	Asia Corporate USD Bonds	N	0	0	0	0
Developed Market Equity	North America	OW	20	30	46	55
	Europe ex-UK	N	5	7	11	12
	UK	UW	0	0	0	0
	Japan	N	3	3	5	6
Emerging Market Equity	Asia ex-Japan	OW	7	10	12	15
	Non-Asia EM	N	0	0	2	3
Commodities	Commodities	N	7	6	5	0
Alternative Strategies		N	7	12	10	4

Source: Bloomberg, Standard Chartered

For illustrative purposes only. Please refer to the disclosure appendix at the end of the document.

Asia asset allocation summary

Asia-focused Tactical Asset Allocation - May 2018 (12m). All figures are in percentages.



Asset class	Region	View vs. SAA	Conservative	Moderate	Moderately aggressive	Aggressive
Cash & Cash Equivalents	USD Cash	UW	8	0	0	0
Developed Market Bonds	DM Government Bonds	UW	8	7	3	0
	DM IG Corporate Bonds	N	8	6	3	0
	DM HY Corporate Bonds	N	3	3	0	0
Emerging Market Bonds	EM USD Sovereign Bonds	OW	13	10	4	0
	EM Local Ccy Sovereign Bonds	OW	13	10	4	0
	Asia Corporate USD Bonds	N	9	6	3	3
Developed Market Equity	North America	OW	9	14	22	29
	Europe ex-UK	N	2	7	11	14
	UK	UW	0	0	0	0
	Japan	N	2	0	3	3
Emerging Market Equity	Asia ex-Japan	OW	11	19	27	36
	Non-Asia EM	N	2	3	6	7
Commodities	Commodities	N	6	5	5	4
Alternative Strategies		N	6	10	9	4

Source: Bloomberg, Standard Chartered

For illustrative purposes only. Please refer to the disclosure appendix at the end of the document.

Market performance summary*

Equity

	Year to date		1 month	
Global Equities	0.0%	↑	0.8%	↑
Global High Dividend Yield Equities	-1.6%	↓	1.0%	↑
Developed Markets (DM)	0.1%	↑	1.4%	↑
Emerging Markets (EM)	-0.8%	↓	-3.0%	↓
BY COUNTRY				
US	0.3%	↑	0.4%	↑
Western Europe (Local)	-0.4%	↓	6.5%	↑
Western Europe (USD)	0.5%	↑	3.5%	↑
Japan (Local)	-1.6%	↓	6.7%	↑
Japan (USD)	1.3%	↑	2.5%	↑
Australia	-4.9%	↓	0.3%	↑
Asia ex- Japan	-0.9%	↓	-2.3%	↓
Africa	-5.5%	↓	-6.3%	↓
Eastern Europe	-1.3%	↓	-5.1%	↓
Latam	6.6%	↑	-1.4%	↓
Middle East	13.3%	↑	4.3%	↑
China	-0.8%	↓	-4.9%	↓
India	-4.2%	↓	2.2%	↑
South Korea	-0.5%	↓	1.2%	↑
Taiwan	-1.2%	↓	-6.0%	↓
BY SECTOR				
Consumer Discretionary	2.9%	↑	1.0%	↑
Consumer Staples	-6.9%	↓	0.0%	↑
Energy	4.6%	↑	8.5%	↑
Financial	-0.5%	↓	0.2%	↑
Healthcare	0.2%	↑	1.8%	↑
Industrial	-1.6%	↓	0.5%	↑
IT	2.9%	↑	-2.1%	↓
Materials	-1.5%	↓	2.3%	↑
Telecom	-4.0%	↓	2.6%	↑
Utilities	0.4%	↑	3.7%	↑
Global Property Equity/REITS	-3.3%	↓	1.8%	↑

Bonds

	Year to date		1 month	
SOVEREIGN				
Global IG Sovereign	0.4%	↑	-2.2%	↓
US Sovereign	-2.3%	↓	-0.6%	↓
EU Sovereign	0.7%	↑	-3.1%	↓
EM Sovereign Hard Currency	-3.0%	↓	-0.5%	↓
EM Sovereign Local Currency	1.2%	↑	-2.8%	↓
Asia EM Local Currency	-1.1%	↓	-1.2%	↓
CREDIT				
Global IG Corporates	-2.1%	↓	-1.2%	↓
Global HY Corporates	-0.5%	↓	-0.1%	↓
US High Yield	-0.3%	↓	0.7%	↑
Europe High Yield	1.3%	↑	-2.0%	↓
Asia High Yield Corporates	-2.1%	↓	-0.5%	↓

Commodity

	Year to date		1 month	
Diversified Commodity	1.9%	↑	2.6%	↑
Agriculture	2.2%	↑	0.9%	↑
Energy	6.4%	↑	5.4%	↑
Industrial Metal	-1.7%	↓	6.0%	↑
Precious Metal	-1.1%	↓	-2.7%	↓
Crude Oil	13.6%	↑	7.5%	↑
Gold	1.1%	↑	-2.7%	↓

FX (against USD)

	Year to date		1 month	
Asia ex- Japan	0.8%	↑	-0.9%	↓
AUD	-3.3%	↓	-2.5%	↓
EUR	0.8%	↑	-2.7%	↓
GBP	3.0%	↑	-2.2%	↓
JPY	3.1%	↑	-3.6%	↓
SGD	0.6%	↑	-1.4%	↓

Alternatives

	Year to date		1 month	
Composite (All strategies)	-0.7%	↓	-0.3%	↓
Relative Value	1.1%	↑	0.0%	↑
Event Driven	-3.9%	↓	0.1%	↑
Equity Long/Short	1.0%	↑	-0.2%	↓
Macro CTAs	-1.7%	↓	-1.5%	↓

Source: MSCI, JPMorgan, Barclays, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

*All performance shown in USD terms, unless otherwise stated

*YTD performance data from 31 December 2017 to 26 April 2018 and 1-month performance from 26 March 2018 to 26 April 2018

Events calendar

2018

APRIL

- 08 BoJ Governor Kuroda starts his second term
- 26 ECB policy decision
- 27 BoJ policy decision
- 27 North Korean leader Kim Jong Un to meet South Korean President Moon Jae-in

MAY

- 03 FOMC policy decision
- X President Trump and North Korean Leader Kim to meet (tentative)
- 09 Malaysia General Election
- 12 President Trump to decide on Iran nuclear pact

JUNE

- 14 FOMC policy decision
- 14 ECB policy decision
- 15 BoJ policy decision
- 8-9 G7 Summit in Canada
- 22 OPEC meeting

JULY

- 01 Mexico Presidential and Parliamentary elections
- 26 ECB policy decision
- 31 BoJ policy decision

AUGUST

- 02 FOMC policy decision

SEPTEMBER

- X Japan LDP President election where Prime Minister Abe faces challengers
- 13 ECB policy decision
- 19 BoJ policy decision
- 27 FOMC policy decision

OCTOBER

- 7 Brazil elections – 1st round
- 25 ECB policy decision
- 28 Brazil elections – 2nd round
- 31 BoJ policy decision

NOVEMBER

- 06 US House (all 435 seats) and Senate (33 out of 100 seats) elections
- 09 FOMC policy decision
- 12-18 APEC Summit

DECEMBER

- 13 ECB policy decision
- 20 FOMC policy decision
- 20 BoJ policy decision

2019

JANUARY

- 31 Fed policy meeting

FEBRUARY

- 16 Nigeria general election due
- X Thailand to hold general elections

MARCH

- 29 UK to leave the EU

Legend: X – Date not confirmed | **ECB** – European Central Bank | **FOMC** – Federal Open Market Committee (US) | **BoJ** – Bank of Japan

Wealth management

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Annually	Monthly	Weekly	Daily	Ad Hoc
Annual Outlook	Global Market Outlook	Weekly Market View	Global Wealth Daily	Market Watch Investment Brief 360 Perspectives

The team

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Investment Strategist

Disclosure appendix

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