Macro Strategy | 29 May 2020

Standard Chartered
Private Bank

Global Market Outlook

Valuation conundrum

Early indicators after economic re-openings have been positive and policymakers remain very supportive. However, risks of a second pandemic wave and US-China tensions mean an equity and credit market pullback over the summer is probable.

Longer term, we remain positive on equities and corporate bonds. Low and capped bond yields are likely to be a key source of support for both. We favour US and Asia ex-Japan equities and EM USD government and Asia USD bonds.

Over a three-month horizon, gold is likely to face a period of consolidation while the USD remains supported. Longer term, though, gold remains our favoured diversifier, while the AUD, GBP and EUR remain our preferred routes to express a bearish USD view.

Also find out...

Should investors chase the equity market rally?

Are valuations and market breadth a concern?

Are capped bond yields positive for income strategies?

Contents

Investment strategy

IMPLICATIONS
FOR INVESTORS

- Global equities, credit and multi-asset income strategies likely to outperform government bonds and cash over a 12-month horizon
- Gold remains a preferred diversifier while the USD is likely to weaken
- However, a pullback or consolidation in equity and credit markets remains probable over a three-month horizon
- Within bonds, we believe Emerging Market (EM) USD and Asia USD bonds are most attractive
- Within equities, we have a preference for Asia ex-Japan and US equities

Valuation conundrum

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- Longer term, we remain positive on equities and corporate bonds. Low and capped bond yields are likely to be a key source of support for both. We favour Asia ex-Japan and US equities and EM USD government and Asia USD bonds.
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Rally extends…

The risky asset rally continued over the past month, despite significant concern of its imminent demise. Global equities rose about 6%, led by the US, while global bonds rose about 1%, led by EM USD government bonds. However, the USD and gold were both range-bound.

…but risks a collision with geopolitics?

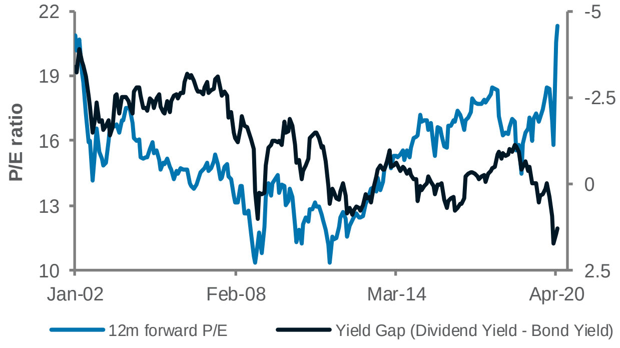
Following last month's review of where economic and market indicators stood, we believe early signs of economic re-openings are positive and in line with our expectations. Germany's forward-looking business confidence surveys showed a rise in optimism, Japan ended its state of emergency and China budget deficits signalled a moderate stimulus is underway. In the Euro area, a proposed EUR 750bn recovery plan that followed an earlier 'Merkel-Macron' pact, mainly comprising of grants to weaker members, could be very positive for Euro area markets given it could signal the start of a more united Euro area fiscal response. However, it still needs to overcome opposition from Austria, Denmark, the Netherlands and Sweden.

On the downside, though, US-China geopolitical risk rose almost continuously over the month. The initial impact has remained contained to HK equities, but further escalation holds the potential to trigger a broader pullback. In our view, this raises upside risks for USD/CNY, causing us to close our bearish 12m view on the pair.

Recent history also argues that geopolitical risk can be sufficient to trigger an equity pullback. However, we remain comfortable with our preference for Chinese equities given they tend to be far more sensitive to domestic demand and policy stimulus than global drivers.

Equities expensive on measures like price/earnings (P/E) ratio, but still cheap relative to government bonds

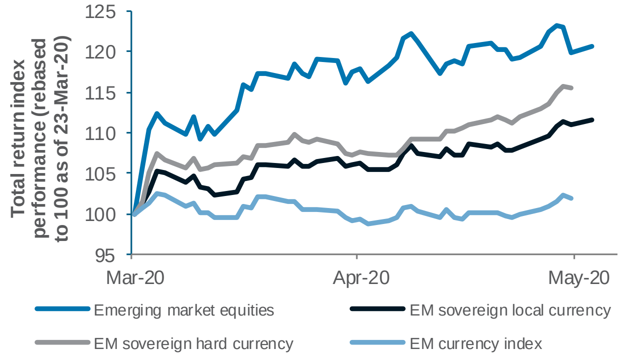
MSCI US: 12m fwd P/E (LHS); dividend yield - bond yield (RHS, inverted); higher on chart signals more expensive valuations



Source: Standard Chartered

Equities initially led EM rebound, but EM USD government bonds have been catching up. Currencies, though, are lagging

Major EM asset classes (23-Mar-2020=100)



Global COVID-19 cases also do not appear to have yet peaked as the source of new cases shifts away from Developed Markets (DM) to Emerging Markets (EM), though improved testing rates are also a likely factor. This means, that while we remain bullish on risk assets on a 12-month horizon, we also remain on watch for consolidation or a pullback over a three-month horizon.

Are equities now expensive?

One data point that we are often questioned about when considering a positive long-term (12-month) view on equities is valuations. With a 12m forward price-earnings (P/E) ratio on the S&P 500 index nearing 22, aren't equities now expensive?

On this metric alone, the answer would be yes. However, as is usually the case, it is rarely this simple. History shows that the P/E ratio can be quite volatile around recessionary periods as earnings expectations (the 'E' in P/E) collapse. However, as the chart above illustrates, valuation metrics, such as the dividend yield gap, which incorporate today's low bond yields, look far less elevated.

In our view, long-term valuation metrics are not elevated enough to stand against a 12-month equity market rally, especially if bond yields stay low and policymakers remain ultra-supportive. Instead, we believe, following a structured strategy – averaging in, for example, to well-diversified allocations – remains the best way to manage this risk.

EM bonds catching up

EM assets initially lagged through the current rally. However, sovereign bonds, in particular, are now closing the gap somewhat amid a rebound in commodity prices and flows.

In the government bonds space, we continue to prefer USD-denominated EM bonds. Yield premiums over Treasuries have tightened over the past month, but the gap relative to pre-COVID-19 levels remains wide. The oil price rebound is also likely to be a significant support.

However, we believe EM local currency bonds are less attractive unless the USD takes a firm turn lower. While we expect USD weakness over the next 12 months, EM currencies are likely to underperform the GBP, EUR and AUD.

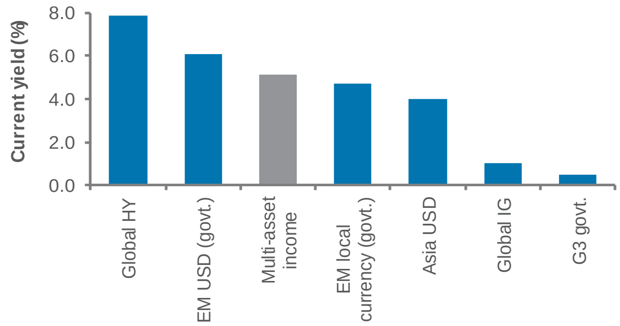
Among corporate bonds, we still favour Asia USD bonds given their significant exposure to re-opening North Asian economies. Global High Yield (HY) bond yields look more attractive than those for other bonds, but we believe risk/reward is less attractive than in our preferred asset classes given a likely rise in bankruptcies ahead.

Low yields a support for income assets

Recent cuts in equity dividend yields have raised the question of whether income strategies remain valid in the current environment. We believe they do, especially through diversified multi-asset income strategies.

Fig. 1 Major income asset classes continue to appear attractive amid very low Treasury yields

Yields across major income asset classes



Source: Bloomberg, Standard Chartered
See "Outlook 2020 – A Balancing Act" for composition of multi-asset income

As the chart illustrates, many major income asset classes continue to offer attractive yields. Meanwhile, government bond yields remain low and central banks are likely to keep them capped. Together, we believe this significantly supports multi-asset income strategies on a 12-month horizon.

Fig. 2 Our tactical asset allocation views (12m) USD

Asset class	Sub-asset class	Relative outlook	Rationale (+ Positive factors II – Negative factors)
Multi-asset Strategies	Multi-asset income	▲	**+ Contained bond yields, weaker USD, diversification || - Equity volatility** 4-5% yield remains achievable, in our view. Dividend cuts a risk
	Multi-asset balanced	◆	**+ Diversification benefits || - Equity volatility** Equity tilt means near-term volatility a risk, but long-term valuations a help
	Alternatives	◆	**+ Diversifier characteristics || - Equity, corporate bond volatility** Diversifier characteristics help amid volatility
Equities	Asia ex-Japan	▲	**+ Low bond yields || - Fund flows a risk** Asia has held up better amid a more mature COVID-19 infection cycle
	US	▲	**+ Low and likely capped bond yields, policy stimulus || - Growth shock** Growth a risk, but massive policy stimulus, low yields are positives
	Euro area	◆	**+ Low and likely capped bond yields, fiscal policy || - Growth shock** Significant COVID-19-related impact, but policy support a positive
	UK	◆	**+ Broad-based fiscal support || - Brexit, energy sector risks** Valuations have declined significantly, but earnings downgrades a risk
	Japan	◆	**+ Fiscal support || - Fund flows** Inexpensive valuations a support, but growth shock a key risk
	Other EM	▼	**+ Falling bond yields || - Deteriorating earnings outlook** Commodity price weakness, especially oil, a key risk
Bonds	Asian USD	▲	**+ Attractive yields, contained volatility || - China concentration** Volatility remains lower than peers, but high China exposure a risk
	EM USD government	▲	**+ Attractive yields, inexpensive valuations || - Sentiment to EMs a risk** Valuations, yield at attractive levels. Oil, sentiment to EM are risks
	DM HY corporate	◆	**+ Attractive yields || - Credit quality** Risk of greater-than-expected defaults balances against attractive yield
	DM IG corporate	◆	**+ Moderate yields, attractive value || - Falling credit quality** Fed support led to reduction in yield premiums; credit quality to deteriorate
	DM IG government	▼	**+ High credit quality, policy support || - Low yields** Easier monetary policy a support, but yields are very low now
	EM local currency government	▼	**+ Attractive yields, weak USD view || - FX volatility** Risk of near-term USD strength reduces risk/reward attractiveness
Currencies	GBP	▲	**+ Undervaluation, monetary and fiscal policies || - COVID-19 and Brexit** Coordinated monetary and unprecedented fiscal policies a significant support
	EUR	▲	**+ ECB and large fiscal stimulus || - Banks and peripheral EU vulnerability** Movement towards joint debt issuance is a potential EUR game-changer
	AUD	▲	**+ Undervaluation, global growth, fiscal stimulus || - China trade risk** Strong fiscal and monetary support and global growth rebound supportive
	JPY	◆	**+ Safe-haven demand and real yields || - Japanese foreign asset demand** JPY caught between global safe-haven status and outflows seeking returns
	CNY	◆	**+ Strong monetary and fiscal stimulus || - Geopolitical risk, export risks** Stimulus should support growth stability, despite rising US-China tensions
	USD	▼	**+ Safe-haven "dash for dollars" || - Low rate differentials, Fed liquidity** Medium-term USD fundamental supports fading and US political risk in focus

Source: Standard Chartered Global Investment Committee

Legend: ▲ Preferred ◆ Core holding ▼ Less preferred

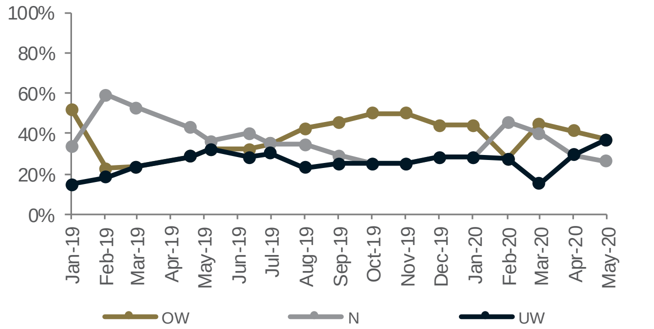
Major brokers' and investors' views

As part of our Investment Philosophy, we strive to achieve diversity of insights by constantly monitoring a wide array of investment views and analysis. This part of our process is what we call the Inside View, where we gather lots of research and analysis, consider the specifics of the situation, and combine them with our analysis of historical probabilities - the Outside View – to create scenarios for the future.

The below charts show the percentage of investment research (broker and independent) houses and asset management companies who are Overweight, Underweight and Neutral on different asset classes.

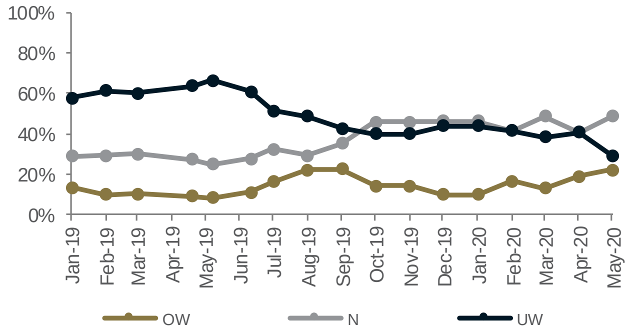
Cash

OUR VIEW
UW



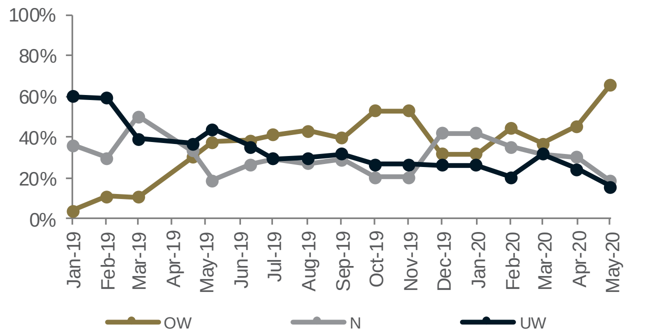
Bonds

OUR VIEW
UW



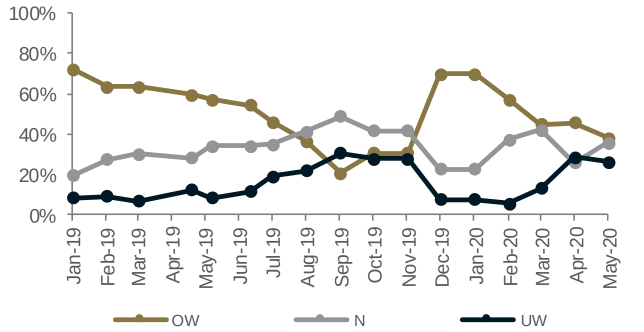
Credit

OUR VIEW
OW



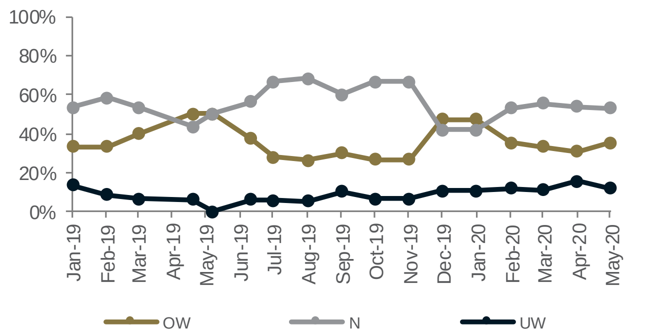
Equities

OUR VIEW
OW



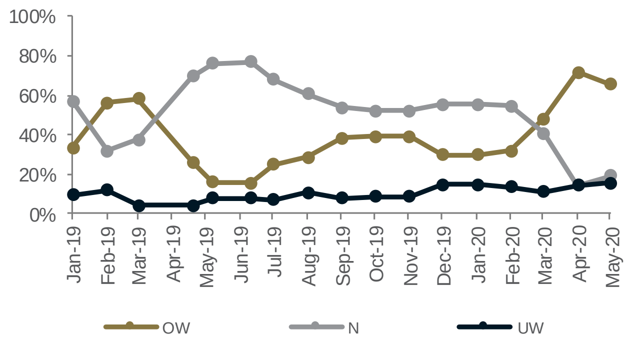
Alternatives*

OUR VIEW
N



Gold

OUR VIEW
OW



Source: Standard Chartered Global Investment Committee

*Alternatives represent a combination of views on liquid and private alternative strategies, as well as real estate

Perspectives on key client questions

Should investors chase the rally?

Global equities have rebounded by 33% from the 23 March 2020 low. The rapid price appreciation against the backdrop of expensive valuations and narrow market breadth have perplexed investors. According to fund manager surveys we track, most institutional investors are bearish on stocks and risk assets, with a majority believing this to be a bear market rally. Yet, despite this pessimism, markets have continued to march higher. Should investors be concerned?

Rising P/E valuations are common in recessions

As analysts slash profit forecasts for 2020, the price-earnings (P/E) ratio of the S&P 500 index has climbed to around 22x from 13.5x (23 March lows), driving valuations above February pre-crisis highs. However, this is not dissimilar to past recessions, where the same alarm was raised over valuations as forward multiples climbed sharply on the back of a decline in profitability estimates.

A second – more long-term – group of valuation metrics may help build a more complete picture. These metrics – such as (i) the Cyclically-Adjusted Price to Earnings ratio (CAPE - a measure that uses real earnings per share over a 10-year period to smooth out fluctuations in profits over a business cycle) and (ii) the market capitalisation to GDP ratio – paint a different view. Today, both measures have declined since their February peak.

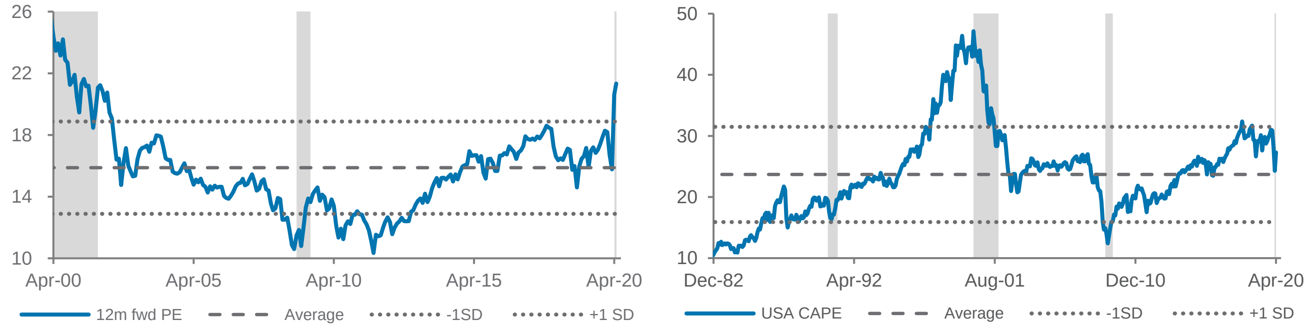
Indeed, this mirrored the experience during the 2008-2009 recession. Over this period, these long-term measures fell while forward looking price multiples were rising as earnings estimates were cut. For example, the CAPE ratio fell from 27x to 13x, while Buffet's preferred market capitalisation to GDP ratio declined from 105% to 52% in Q3 2008 and Q1 2009, respectively.

A third perspective is offered by the equity risk premium – the excess return over a risk-free rate that can be earned by investing in stocks. The collapse in risk-free rates means this equity risk premium has now been driven higher (i.e. cheaper valuations).

Hence, despite high headline P/E valuations, stocks may well continue to grind higher if policymakers have their way, capping volatility with asset purchases, keeping interest rates low, and as long as the long-term global economic growth potential remains intact.

Fig. 3 Forward P/E ratio rose sharply while longer-term CAPE measure declined as markets climbed

Forward P/E ratio versus CAPE. Shaded areas indicate US recessions



Source: Refinitiv Eikon, Standard Chartered. CAPE = Cyclically-Adjusted Price to Earnings Ratio, is calculated using 10-year inflation-adjusted earnings

Narrow market breadth consistent with past episodes

To give some perspective, the top five stocks now account for ~23% of the S&P 500 index exceeding the ~18% seen in March 2000. While the S&P 500 index trades at just 12% below its all-time high, the median stock in S&P 500 trades 22% below its record high, reflecting a huge bifurcation of performance within the index amid the largest economic shock since the 1929 Great Depression.

Fig. 4 While the S&P is 12% below its high, the median stock is 22% away from the 52-week high

Distance below 52-week high (as of 26 May, 2020)

Sector	Aggregate index	Median stock
Consumer Discretionary	5%	29%
Health Care	5%	13%
Information Technology	6%	15%
Communication Services	7%	21%
Materials	11%	25%
Consumer Staples	11%	15%
S&P 500	**12%**	**22%**
Real Estate	20%	32%
Utilities	20%	22%
Industrials	22%	20%
Financials	26%	32%
Energy	38%	47%

Source: FactSet, Bloomberg, Standard Chartered

Looking at the last two recessions, it is not unusual for a market rally to be initially led by a few stocks. Similar to the rebound off the lows in 2009 and 2002, 50% of the gains so far came from just under 10% of the stocks in S&P 500. The rally this time, however, has been much faster. This should not be a complete surprise given how much positioning (Fig. 6) has capitulated, which could have augured for an unusually rapid turnaround.

Fig. 5 Narrow stock leadership consistent with past recessionary episodes thus far

% number of stocks contributing 50%, 60%,75% of gains in S&P 500

% of gains	Number of stocks contributing	% of SPX constituents
Since 2020 low	**S&P perf 31%**	
50%	38	8%
60%	86	17%
75%	127	25%
2m perf since 2009 low	**S&P perf 34%**	
50%	46	10%
66%	91	20%
75%	132	30%
2m perf since 2002 low	**S&P perf 16%**	
50%	26	7%
66%	55	14%
75%	88	22%

Source: Bloomberg, Standard Chartered

Easy gains likely behind us given positioning

Looking across various positioning metrics, the extreme level of short positioning in March has largely normalised. Indeed, large and rapid market moves historically have almost always required a starting point of relatively large short or underweight positioning that needed to be squared to begin with.

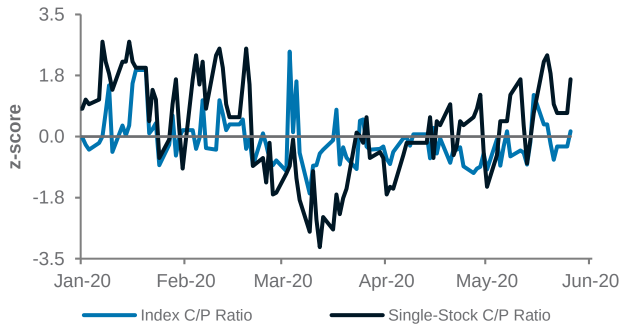
Most of the gains so far, however, appear to be retail-led, which continues to concern investors about this rally. Major online brokers in the US saw a huge spike in new account opening and trading volume as retail investors bought into the market sell-off.

Institutional investors, on the other hand, remain largely defensive and significantly underweight stocks. For example, systematic and macro strategies have yet to meaningfully add exposure back after deleveraging in March. Exposure of volatility-targeting funds remains near record lows and could also provide support as market volatility recedes.

Some short-term consolidation notwithstanding, we remain constructive long term (12 months) on risky assets. As detailed in our '4 strategies for the current environment' presentation (published on 15 April 2020), there are several ways to take advantage of markets today, depending on one's situation. A "prudent averaging-in" approach can be both rewarding and one of the most comfortable, emotionally.

Fig. 6 Investors positioning has normalised from the extreme capitulation in March

US index and single stock equities call to put ratio (z-score)



Source: Bloomberg, Standard Chartered

Note: Call to put ratio is a technical indicator reflecting investor's sentiment. The ratio represents the proportion between all the call and put options purchased on a given day. A lower reading suggests a bearish sentiment as investors buy more puts for protection, anticipating a down trend.

Macro Overview – at a glance

Key themes

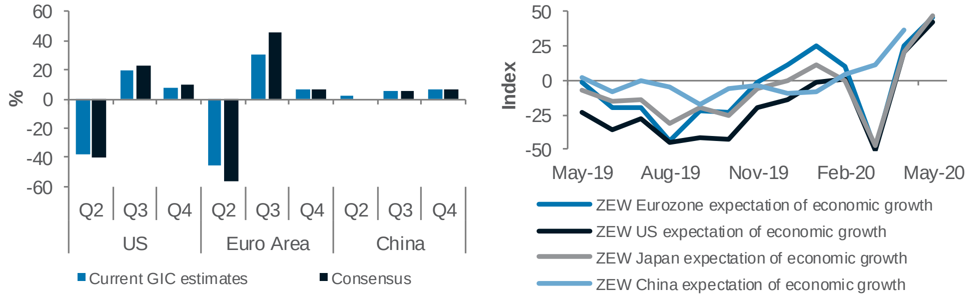
Our Global Investment Committee (GIC) expects waning pandemic risks and sustained policy support to drive a recovery in major economies in H2 2020. The phased re-opening of economies in China, Europe and the US over the past couple of months has not led to a second pandemic wave, likely reviving consumer and business confidence. We are, however, more cautious than consensus about the strength of the recovery, given renewed US-China tensions ahead of the US elections. Also, the pandemic is yet to peak in EM. Thus, policymakers will likely need to step up support to mitigate downside risks.

Key chart

Our GIC is somewhat more cautious about the pace of economic recovery than the consensus as we see a more protracted global impact of the lockdowns; renewed US-China tensions is another near-term risk

Fig. 7 We expect an economic recovery in H2 amid easing lockdowns and policy support

GIC and consensus growth estimates; ZEW survey of analyst expectations of growth in six months



Source: Standard Chartered Global Investment Committee (GIC) (% q/q SAAR, except % y/y for China); Bloomberg

US	We expect growth to rebound in Q3 as most states relax restrictions on economic activity by June and as record fiscal and monetary stimulus take effect. The strength of the recovery will depend on how soon the economy can re-generate the record number of jobs lost. Rising US-China tensions ahead of November's elections is a key risk ○ Growth ○ Inflation ○ Benchmark rates ● Fiscal deficit
Euro area	The Euro area faces the sharpest Q2 contraction among major economies, but flexible job furloughs, strong policy support, a weak EUR and low oil prices can potentially help activity recover significantly by Q3. The EU plan for a EUR 750bn recovery fund, mainly comprising of grants to weaker members, financed by common Euro area debt can potentially create a fiscal union. It could counter breakaway pressures among weaker members of the union ○ Growth ○ Inflation ○ Benchmark rates ● Fiscal deficit
China	China's economic activity is gradually returning to normal after a sharp slump in Q1, with industrial activity leading the recovery. Service sector activity remains 20-30% below pre-pandemic peaks, highlighting cautious consumer sentiment. The parliament's approval to step up policy stimulus is likely to drive a stronger recovery in H2 ○ Growth ○ Inflation ○ Benchmark rates ● Fiscal deficit
Japan	Japan has lifted its state of emergency, ending a less-stringent lockdown compared with other major economies, but the economic recovery is likely to be hampered by weak outlook for global trade and tourism (after the postponement of the Olympics). Record fiscal and monetary stimulus should mitigate some risks ○ Growth ○ Inflation ○ Benchmark rates ● Fiscal deficit
UK	Strong policy stimulus should support a recovery as restrictions are gradually relaxed after a prolonged lockdown. Uncertainty around a post-Brexit trade deal remains a key risk, with the UK resisting EU calls to extend the current transition phase by another two years beyond the 31 December deadline ○ Growth ○ Inflation ○ Benchmark rates ● Fiscal deficit

Source: Standard Chartered Global Investment Committee

Legend: ○ Weaker/easier in 2020 | ◐ Neutral | ● Stronger/higher in 2020

Bonds – at a glance

Key themes

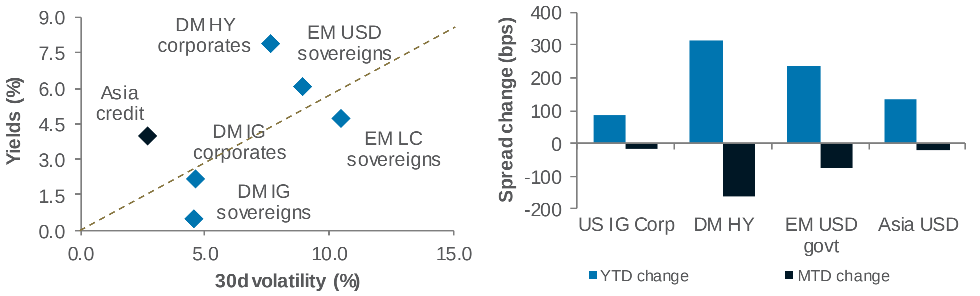
Global bonds delivered about a 1% return over the past month despite higher government bond yields, as decline in yield premiums in DM corporate, EM and Asian USD bonds helped them register positive returns. Bond market volatility returned to normal levels, possibly helped by the commencement of the Fed's long-awaited corporate bond buying programme.

Asian USD bonds remain a preferred holding as their high credit quality and low volatility present an attractive risk-reward in our opinion, especially since they have lagged the recent rally in global corporate bonds. EM USD government bonds are preferred too, despite clocking nearly 6% return in May, as they are supported by the increase in oil prices, still cheap valuations, relief offered by a moratorium on certain bilateral loans and a reduced pace of fund outflows from EM. We continue to view DM IG and HY corporate bonds as core holdings, despite the central bank bond buying programmes, as we believe a lot of good news has been priced in IG bonds and that HY bonds' attractive yields are balanced by the risk of underpricing potential default rates.

Key chart

Current Yield-to-Worst (YTW) and 30d volatility for various bond asset classes; Year-to-date and month-to-date changes in yield premiums

Fig. 8 A stabilisation in market sentiment has led to a normalisation of bond market volatility and a reduction in yield premiums across most bond asset classes



Source: Citigroup, J.P. Morgan, Barclays, Bloomberg, Standard Chartered. As of 25 May 2020.

Preference order

Asset class	View	Comment	Key drivers		
Asia USD	▽ ◇ ▲	Asia USD bonds are a ***preferred*** holding given their relatively high credit quality, attractive yield pick-up over US IG corp bonds and defensive characteristics. A slower-than-expected recovery in China is a risk.	● Credit fundamentals	◐ Macro factors	● Valuation vs govt bonds
EM USD government	▽ ◇ ▲	EM USD government bonds are ***preferred,*** owing to their attractive yield, cheap valuations and the rebound in oil prices. A sharp deterioration in EM risk sentiment and spike in defaults are risks.	◐ Rates policy	◐ Macro factors	● Valuation vs govt bonds
DM HY corporate	▽ ◆ △	We view DM HY bonds as a ***core holding*** as their attractive yield and valuations are balanced by the outlook for significantly higher defaults and rating downgrades.	○ Credit fundamentals	● Attractive yield	● Valuation vs govt bonds
DM IG corporate	▽ ◆ △	We view the asset class as a ***core holding***. In our assessment, the attractive yield premiums and high credit quality are balanced by expectations of a deterioration in credit fundamentals.	○ Credit fundamentals	○ Macro factors	● Valuation vs govt bonds
EM local currency	▼ ◇ △	EM local currency bonds are ***less preferred*** as their reasonable yield and supportive EM central bank policies are offset by high currency volatility and our short-term bullish USD bias.	◐ Rates policy	◐ Macro factors	○ FX outlook
DM IG government	▼ ◇ △	DM IG government bonds are ***less preferred***. Their high credit quality and supportive central bank policy are offset by the low yields they offer. A renewed growth slowdown is an upside risk for this asset class.	● Rates policy	○ Macro factors	○ Valuation

Source: Standard Chartered

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding | ○ Not supportive | ◐ Neutral | ● Supportive | ▭ Key driver

Equity – at a glance

Key themes

The outlook for global equities remains uncertain in the near term due in part to US-China tensions. Risks related to COVID-19 appear to be diminishing as economies re-open without a significant second wave of infections. Changes to analysts earnings forecasts are becoming less negative as they increasingly focus on the prospects for a rebound in 2021. Risks include a second wave of infections and US-China relations.

Asia ex-Japan equities are preferred. In China, the National People's Congress has emphasised job creation as a central goal, which in combination with reopening of the economy, will boost investment, consumption and earnings. US equities are preferred, with a focus on technology and healthcare. Euro area equities are a core holding amid an uncertain path to recovery.

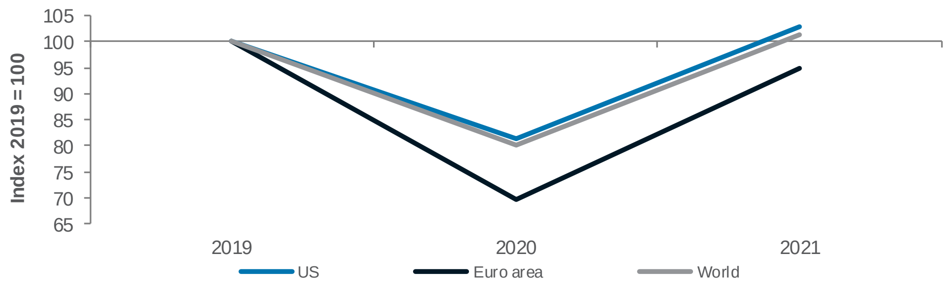
Key chart

Consensus expectation is for global earnings growth to regain all of 2020's decline by 2021

This will likely be led by the US. Euro area is not expected to fully recover until 2022

Fig. 9 Cumulative changes in global earnings are expected to turn positive by 2021

US, Euro area and global cumulative consensus earnings growth forecasts, rebased to 2019=100



Source: MSCI, FactSet, Standard Chartered. As of 21 May 2020.

Asia ex-Japan equities ▽ ◇ ▲	Asia ex-Japan is ***preferred***. A re-opening of US and EU economies should increase demand for Asian exports, which in combination with government stimulus is expected to lead to a recovery in earnings. USD weakness would be a positive for the region. China, onshore and offshore, are our most preferred markets.	● Bond yields	● Valuations	○ Economic data
US equities ▽ ◇ ▲	US equities are ***preferred.*** Traditional valuation metrics, such as S&P 500 2020 P/E ratio, are high, however, valuation measures that take into account the structural decline in bond yields indicate that equities are fairly valued, relative to bonds. Earnings are expected to recover sharply in 2021.	● Bond yields	◐ Valuations	◐ Fund Flows
Euro area equities ▽ ◆ △	The Euro area is a ***core holding***. Expectations for a major EU stimulus package is leading to improved sentiment of an earnings recovery in 2021, but uncertainty remains. Dividend cuts remain a concern.	● Bond yields	● Valuations	○ Economic data
UK equities ▽ ◆ △	UK is a ***core holding***. The reopening of the Euro area and US economies is a positive for globally dependent UK companies. Nevertheless, concerns remain over domestic recovery prospects.	● Bond yields	● Valuations	○ Economic data
Japan equities ▽ ◆ △	Japan is a ***core holding***. Japan could be a beneficiary of the US/China trade dispute as its technology companies seek to gain market share. Increase in deflation remains a risk for the corporate sector.	● Bond yields	● Valuations	○ Economic data
EM ex-Asia equities ▼ ◇ △	EM ex-Asia is ***less preferred***. Brazil is experiencing a sharp increase in COVID-19 cases, which is impacting domestic demand. Earnings growth in EM ex-Asia continues to deteriorate as others recover.	● Bond yields	◐ Valuations	○ Economic data

Source: Standard Chartered

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding | ○ Not supportive | ◐ Neutral | ● Supportive | ▭ Key driver

FX – at a glance

Key themes

Near term, the USD is likely to remain range-bound and potentially volatile if geopolitical tensions continue to rise. There is a risk of a final USD spike before the long-lasting USD uptrend reverses. The EU faces a critical period of talks around the funding and distribution of stimulus for the pan-EU COVID-19 recovery plan and the GBP may weaken as the June Brexit deadline nears.

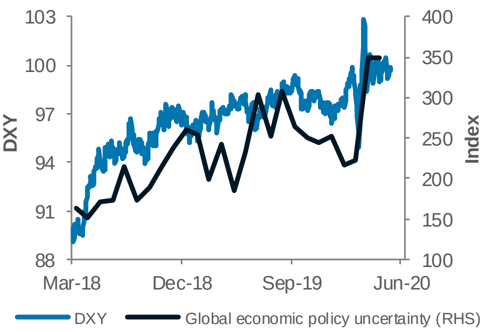
Consensus around the Franco-German recovery proposal would be strongly EUR-supportive, whereas failure to agree would exacerbate doubts over the common-currency's longevity. We expect a positive resolution. Narrowing interest rate and growth differentials and a more positive risk sentiment support our bearish medium-term USD view. EUR, GBP and AUD are preferred.

Key chart

Geopolitics is a rising near-term risk supporting a strong USD. But we expect better global growth and risk sentiment to support DM and EM currencies if Europe can reach consensus on mutualised debt, the US and China navigate escalating tensions and the EU and UK gain clarity over Brexit

Fig. 10 **Geopolitics is near-term USD-supportive**

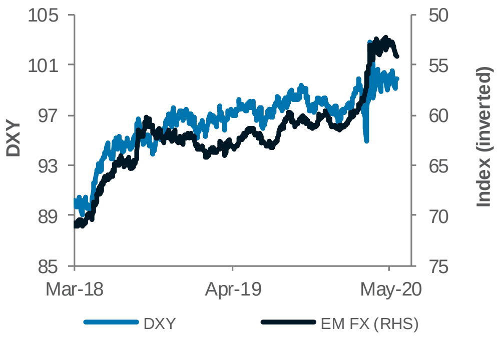
DXY, Global Economic Policy Uncertainty Index



Source: Bloomberg, Standard Chartered

Fig. 11 **EMFX shows signs of improvement**

DXY, JP Morgan EM currency index (RHS, inverted)



Source: Bloomberg, Standard Chartered

Pair	View	Outlook	Relative interest rates	Relative growth rates	Flows & sentiment
USD (DXY)	▼ ◇ △	A final near-term rally is possible on geopolitical uncertainty, but the core medium-term USD supports are receding	○ Relative interest rates	○ Relative growth rates	○ Flows & sentiment
EUR/USD	▽ ◇ ▲	Recovery plan may require extensive talks amid uncertainty, but a new unity deal would support the cheap EUR	● Relative interest rates	● Relative growth rates	● Flows & sentiment
GBP/USD	▽ ◇ ▲	Concerns over Brexit to weigh near term, but an eventual deal would support cheap GBP as USD weakens in H2	◐ Relative interest rates	● Relative growth rates	● Flows & sentiment
USD/CNY	▽ ◆ △	Chinese stimulus and currency management should see stable USD/CNY despite rising US-China tensions	○ Relative interest rates	◐ Relative growth rates	◐ Flows & sentiment
USD/JPY	▽ ◆ △	Policy stimulus and safe-haven flows likely to balance yield-seeking outflows, keeping USD/JPY range-bound	○ Relative interest rates	◐ Relative growth rates	◐ Flows & sentiment
AUD/USD	▽ ◇ ▲	AUD to consolidate amid China tensions, but global growth should support a continued rally for commodities, AUD	● Relative interest rates	● Relative growth rates	● Flows & sentiment

Source: Standard Chartered Global Investment Committee

Legend: ▲ Bullish view | ▼ Bearish view | ◆ Range view | ○ Not supportive | ◐ Neutral | ● Supportive | ▭ Key driver

Technicals

S&P 500: Flirting with crucial resistance

Since our last monthly publication, the S&P 500 index has been flirting with crucial resistance on the 200-day moving average (now at about 3,000). The 2,727-3,000 range in recent weeks shows that neither bulls nor bears are letting up, notwithstanding the attempt this week to rise above the upper end of the range. While bears have been active around the 200-DMA resistance, bulls have kept key support levels intact. A vital support for the index is the April 21 low of 2,727 – any break below the support would imply that the upward pressure from March had faded. Subsequent support comes in at the March 31 high of 2,641.

So long as support at 2,727 holds, a rise above the 200-DMA is possible, which could initially push the index towards the early-March high of 3,137, coinciding with 78.6% retracement of the February-March fall. However, for the index to decisively stay above the average, a sustained improvement in risk sentiment is key, clearing the path towards the February record high of 3,394.

Stoxx 600: Growing chance of a catch-up rally

While the S&P 500 index has retraced around 70% of its February-March decline, the rise in Europe's Stoxx 600 index has been relatively shallower so far. The initial rally since March stalled last month at stiff resistance around 350 (the 50% retracement of the February-March fall), following which the index settled in a narrow range.

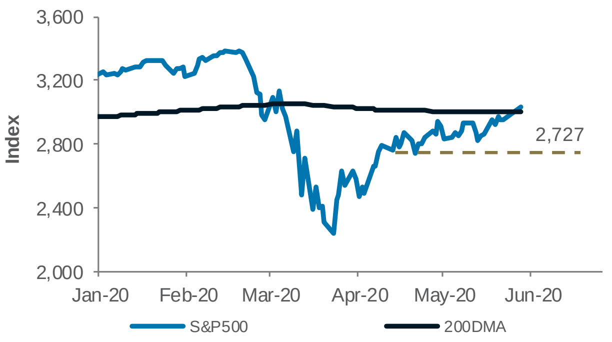
However, there are growing signs of a catch-up rally in European equities for two reasons: the repeated test and hold above key support at the April 15 low of 322 and improved momentum in recent days. A catch-up rally in Europe could open the way towards 375-380 (the 200-week MA and the 200-day MA).

Gold: Bullish triangle break

Gold's (XAU/USD) break above resistance on a minor downtrend line from April has triggered a bullish triangle from mid-April. The lower edge of the triangle is a minor uptrend line from mid-April. Triangles are continuation patterns, that is, a continuation of the trend prior to the pattern formation. In the case of gold, the previous trend was up, and this month's bullish break implies further gains for the yellow metal in the short term, potentially towards 1,790.

Fig. 12 S&P 500: Testing resistance on the 200-DMA

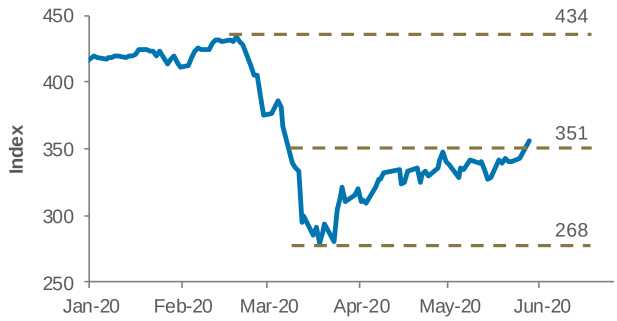
S&P 500, daily chart with the 200-day moving average



Source: Refinitiv Eikon, Standard Chartered

Fig. 13 Stoxx 600: Upward momentum is improving

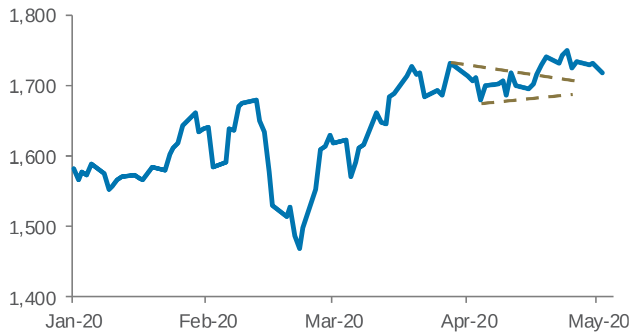
Stoxx 600, daily chart



Source: Refinitiv Eikon, Standard Chartered

Fig. 14 Gold: Breakout from a continuation pattern

XAU/USD, daily chart



Source: Refinitiv Eikon, Standard Chartered

Tracking market diversity

About our market diversity indicators

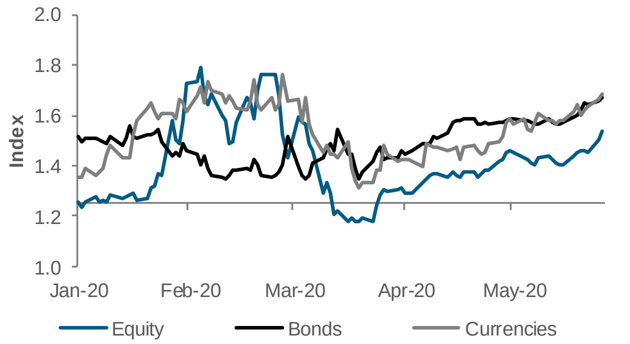
Our market diversity indicators help to identify areas where shorter-term market trends could break or reverse due to a reduction in the breadth of market participant types at any given time. Effectively, the indicator tries to quantify to what extent a tug-of-war is going on between different types of investors with different objectives and/or time horizons. When market diversity declines, it means that one type of investor is generally dominating price movements. This can create an environment whereby something happens to reduce the 'dominant' investors' ability or appetite to continue buying or selling, and this leads to a sharp reversal in the recent trend.

Where is diversity falling or rising this month?

Market diversity has broadly remained stable since its recovery from the collapse in March. The average of our market diversity indicator (fractal dimension) within each asset class is above 1.25 – the cut-off in the indicator to signal increased likelihood of a trend reversal or break point.

Fig. 15 Average fractal dimension within each asset class on 26-May-20

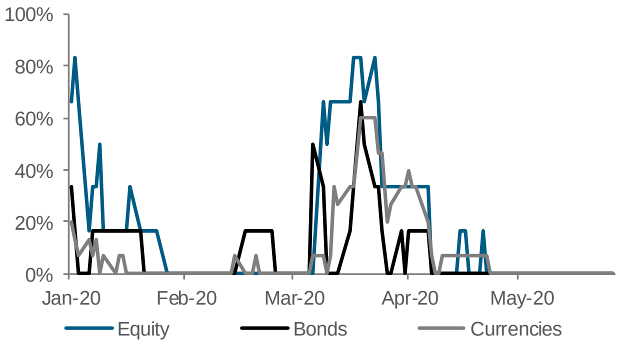
Market diversity across asset classes continues to improve



Source: Standard Chartered

Fig. 16 % of assets with fractal dimension <1.25 for each asset class on 26-May-20

None of the assets tracked show very low market diversity



Source: Standard Chartered

Major equity markets except Asia ex Japan recorded slower gains in April after a strong March. Our diversity indicator suggests none of these markets are at risk of a near-term reversal. Europe, UK and EM ex-Asia have the lowest diversity, but all three remain comfortably above the critical level of 1.25.

Diversity elsewhere has also been broadly stable or rising slightly as bond markets continue to record gains (albeit slower) and as the USD turns more resilient after a weak March. Depreciation of the USD against the GBP is the only exception where diversity has fallen, but its diversity remains healthy at current levels.

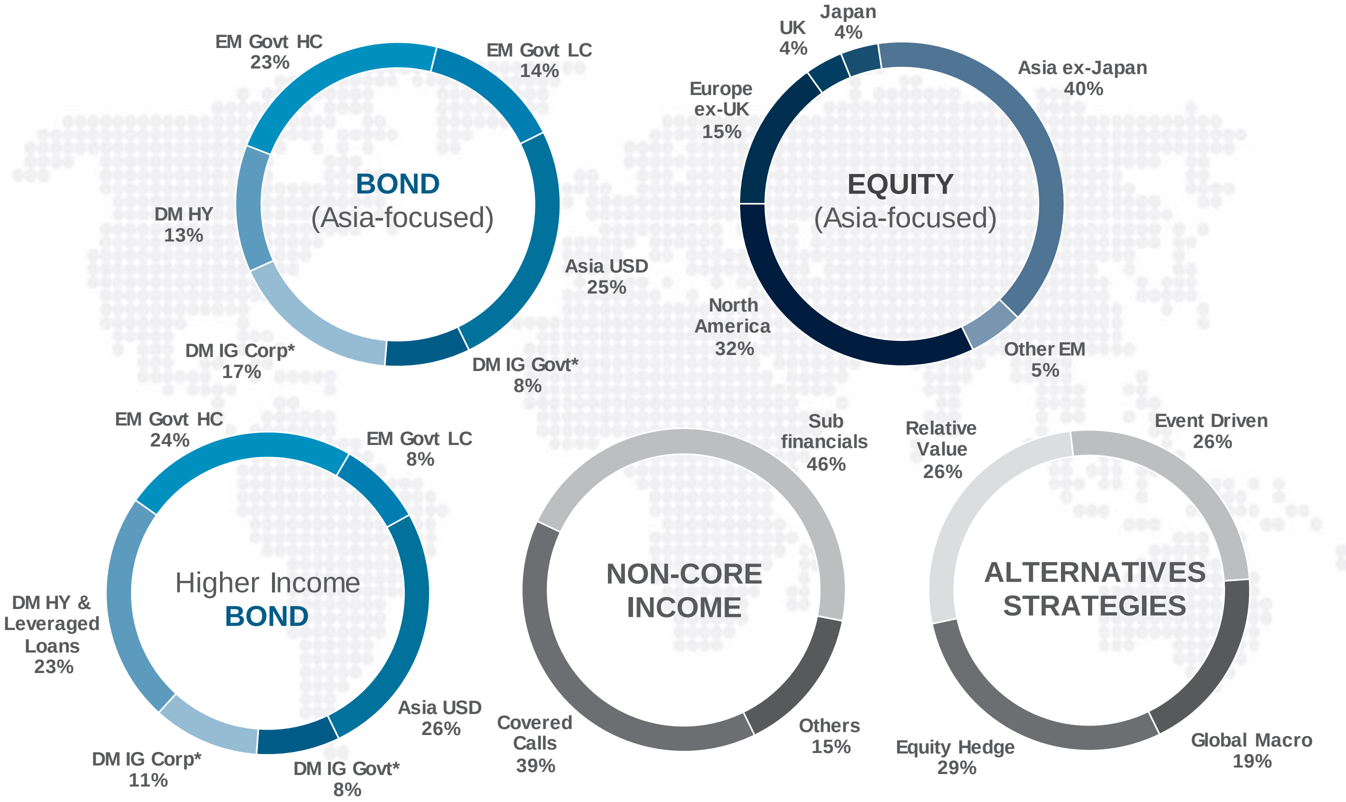
Fig. 17 Assets with lower market diversity, but none are looking stretched

Level 1	Diversity	Direction since April
HFRX Global Hedge Fund	◐	→
Equity		
MSCI Europe	◐	→
MSCI UK	◐	→
MSCI EM ex-Asia	◐	→
Currencies		
USD/GBP	◐	↓
USD/INR	◐	→
US Treasury Yields		
US 10-year Treasury yield	◐	→

Source: Bloomberg, Standard Chartered; Data as on 26 May 2020

Legend: ○ Very low ◐ Low ● Moderate/high

Our recommended allocations



Allocation figures may not add up to 100 due to rounding. *FX-hedged

Tailoring a multi-asset allocation to suit an individual's return expectations and appetite for risk

- We have come up with several asset class “sleeves” across major asset classes, driven by our investment views
- Our modular allocations can be used as building blocks to put together a complete multi-asset allocation
- These multi-asset allocations can be tailored to fit an individual’s unique return expectations and risk appetite
- We illustrate allocation examples for both Global and Asia-focused investors, across risk profiles

BOND Allocation (Asia-focused)	Higher Income BOND Allocation	EQUITY Allocation (Asia-focused)	NON-CORE INCOME Allocation	ALTERNATIVES STRATEGIES Allocation
For investors who want a diversified allocation across major fixed income sectors and regions Asia-focused allocation	For investors who prefer a higher income component to capital returns from their fixed income exposure Includes exposures to Senior Floating Rate bonds	For investors who want a diversified allocation across major equity markets and regions Asia-focused allocation	For investors who want to diversify exposure from traditional fixed income and equity into “hybrid” assets Hybrid assets have characteristics of both fixed income and equity Examples include Covered Calls, REITs, and sub-financials (Preferred Shares and CoCo bonds)	For investors who want to increase diversification within their allocation Include both “substitute” and “diversifying” strategies

Note: Allocation figures may not add up to 100% due to rounding. *FX-hedged

Asset allocation summary

12-month view		ASIA FOCUSED				GLOBAL FOCUSED			
Summary	**View**	**Conservative**	**Moderate**	**Moderately Aggressive**	**Aggressive**	**Conservative**	**Moderate**	**Moderately Aggressive**	**Aggressive**
Cash	▼	15	7	3	0	15	7	3	0
Fixed Income	◆	64	39	29	7	64	39	29	7
Equity	▲	20	36	51	81	20	36	51	81
Gold	▲	0	8	8	7	0	8	8	7
Alternatives	◆	0	10	9	4	0	10	9	4
Asset class									
USD Cash	▼	15	7	3	0	15	7	3	0
*DM Government Bonds**	▼	5	3	2	1	8	5	3	1
*DM IG Corporate Bonds**	◆	11	7	5	1	15	9	7	2
DM HY Corporate Bonds	◆	8	5	4	1	11	7	5	1
EM USD Government Bonds	▲	15	9	7	2	11	7	5	1
EM Local Ccy Government Bonds	▼	9	5	4	1	7	4	3	1
Asia USD Bonds	▲	16	10	7	2	12	7	5	1
North America Equities	▲	7	12	16	26	11	19	27	43
Europe ex-UK Equities	◆	3	5	8	12	2	3	4	6
UK Equities	◆	1	1	2	3	1	1	2	3
Japan Equities	◆	1	1	2	3	1	1	2	3
Asia ex-Japan Equities	▲	8	14	20	32	5	9	13	21
Non-Asia EM Equities	▼	1	2	3	4	1	2	3	4
Gold	▲	0	8	8	7	0	8	8	7
Alternatives	◆	0	10	9	4	0	10	9	4

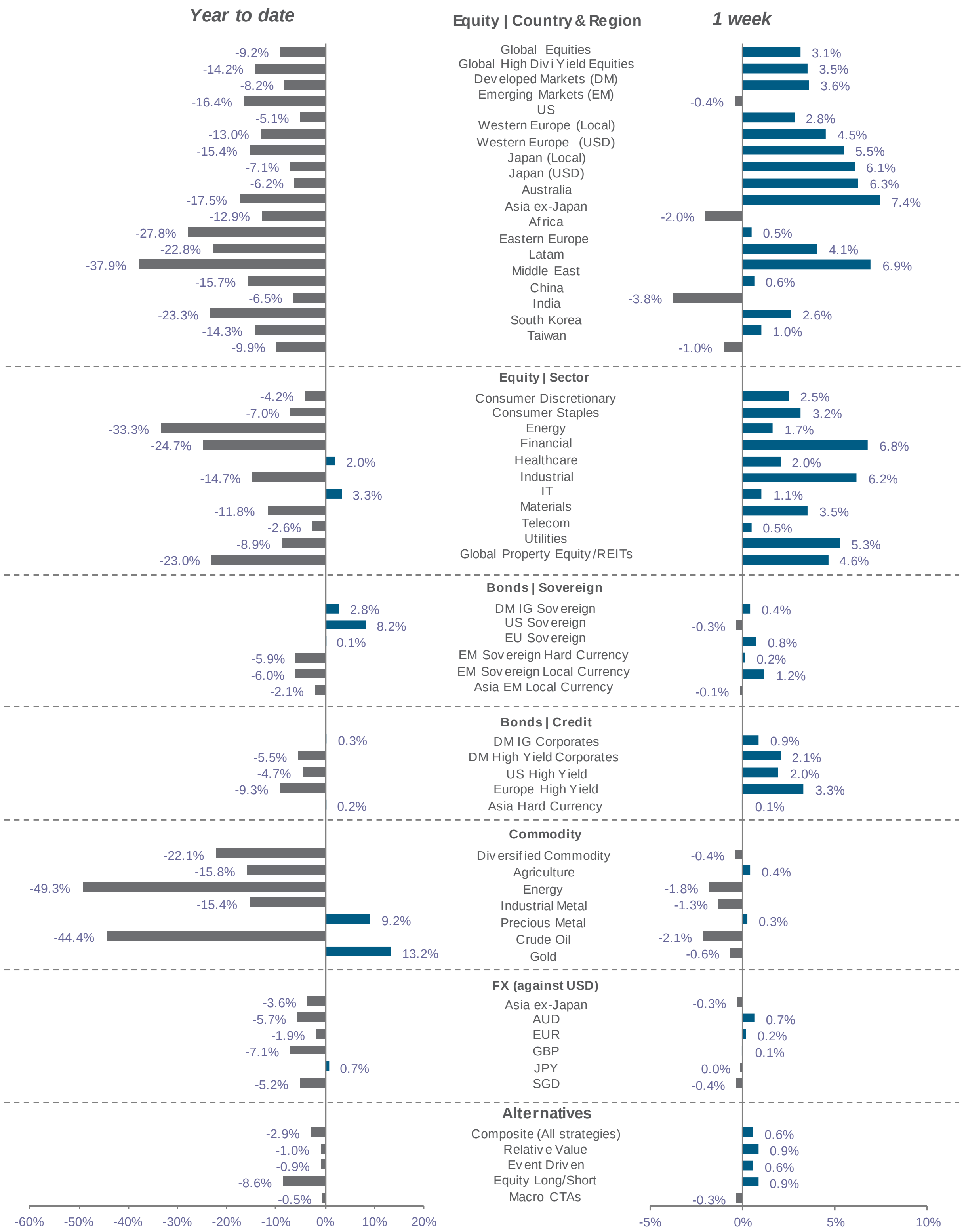
All figures in %. Source: Standard Chartered.

Note: (i) For small allocations we recommend investors to allocate through broader global equity/global bond solutions; (ii) Allocation figures may not sum to 100% due to rounding effects.

*FX-hedged

Legend: ▲ Most preferred | ▼ Least preferred | ◆ Core holding

Market performance summary*



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 2019 to 28 May 2020 and 1-week performance from 21 May 2020 to 28 May 2020

Events calendar

JUNE

04	ECB policy decision
10-12	G7 summit
11	FOMC policy decision
19	European Council meeting to review common debt proposal

JULY

30	FOMC policy decision
30	ECB policy decision

AUGUST

07	BoE policy decision

SEPTEMBER

x	China's President Xi visits Germany for summit with EU state leaders
04	ECB policy decision
11	FOMC policy decision
18	BoE policy decision
29	1st US presidential debate

OCTOBER

15	2nd US presidential debate
22	3rd US presidential debate
29	ECB policy decision
29	BoJ policy decision

NOVEMBER

03	US presidential election
05	BoE policy decision
06	FOMC policy decision
21-22	G20 Summit in Saudi Arabia

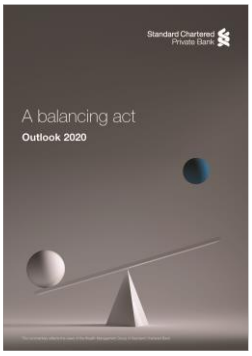
DECEMBER

10	ECB policy decision
17	FOMC policy decision
17	BoE policy decision
18	BoE policy decision
31	Deadline for Brexit transition period

Central bank policy | Geopolitics | EU politics

X – Date not confirmed | ECB – European Central Bank | FOMC – Federal Open Market Committee (US) | BoJ – Bank of Japan | BoE – Bank of England | RBA – Reserve Bank of Australia

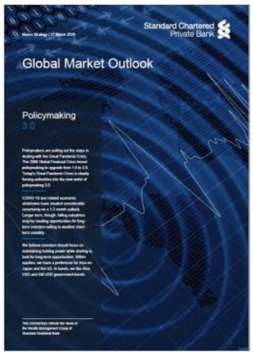
Wealth management



ANNUAL OUTLOOK
annually

The Annual Outlook highlights our key investment themes for the year, the asset classes we expect to outperform and the likely scenarios as we move through the year.

GLOBAL MARKET OUTLOOK
monthly



Our monthly publication which presents the key investment themes and asset allocation views of the Global Investment Committee for the next 6-12 months.

WEEKLY MARKET VIEW
weekly

Our weekly publication which provides an update on recent developments in global financial markets and their implications for our investment views.

GLOBAL WEALTH DAILY
daily

Global Wealth Daily is an early morning update of major economic and political events and their day-to-day impact on various assets classes the previous day.

MARKET WATCH
ad hoc

Market Watch focuses on major events or market developments and their likely impact on our investment views.

360 PERSPECTIVES
ad hoc

360 Perspectives provides a balanced assessment of the outlook for an asset class. It presents both the positives and negatives of the asset class, as well as the major drivers, instead of offering a specific view.

INVESTMENT BRIEF
ad hoc

Investment Brief explains the rationale behind our views on an asset class, incorporating the fundamental and technical drivers.

The team

Our experience and expertise help you navigate markets and provide actionable insights to reach your investment goals.

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Chief Investment Officer
Chair of the Global Investment Committee

Manish Jaradi
Senior Investment Strategist

Francis Lim
Senior Investment Strategist

Ajay Saratchandran
Senior Portfolio Manager

Steve Brice
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Samuel Seah, CFA
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Daniel Lam, CFA
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