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Wealth Management Chief Investment Office
13 January 2023

Weekly Market View

Are we there yet?

→ Risk markets have cheered rising expectations of a growth acceleration in China and signs of a slowdown in US growth and inflation, hoping for an early pause in Fed rate hikes. We believe they are half right – there is room for further rise in China and Asia assets but beware of chasing the US equity rally until the Fed indicates it will cut rates.

→ Still-bearish investor positioning on US equities (bearish US equities remains a crowded trade for now) implies they could go higher in the near-term, especially after data showed further cooling of inflation and wages.

→ However, the rally is likely to falter as the US is likely at the doorstep of a recession, while the Fed remains hawkish, given the still-hot job market. In this report, we discuss various tactical opportunities in this environment, including fading the rally in equities, adding to income assets and Asian exposure and positioning for a USD bounce.

What are your expectations from the upcoming earnings season?

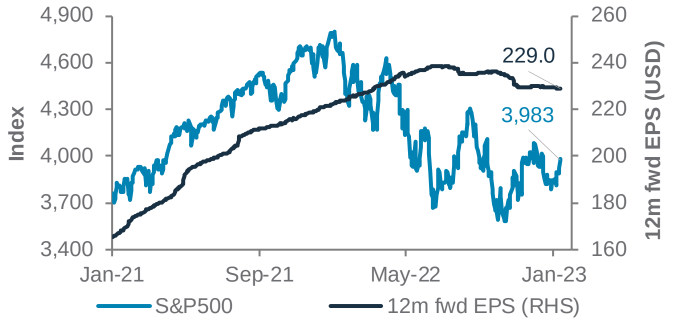
Are you still bullish on the USD in the near term?

Do you see further upside in gold?

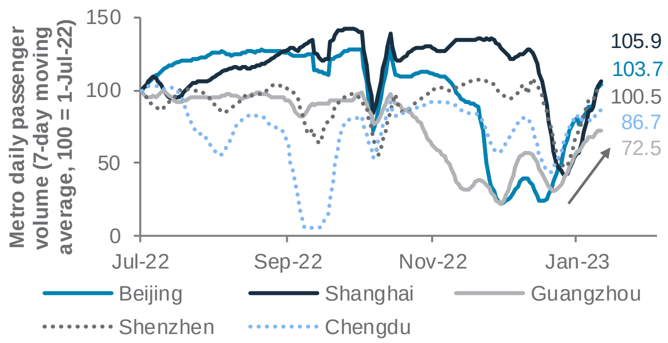
Charts of the week: US earnings risk vs China mobility rebound

We expect US earnings estimates to fall as recession looms; China's mobility is rebounding, reviving economic activity

S&P500 index, 12-month forward earnings estimate



China metro daily passenger volumes (Index: 100 = 1 Jul 2022)



Source: FactSet, Bloomberg, Standard Chartered

Editorial

Are we there yet?

Risk markets have cheered rising expectations of a growth acceleration in China and signs of a slowdown in US growth and inflation, hoping for an early pause in Fed rate hikes. We believe they are half right – there is room for further rise in China and Asia assets but beware of chasing the US equity rally until the Fed indicates it will cut rates. Still-bearish investor positioning on US equities (bearish US equities remains a crowded trade for now) implies they could go higher in the near-term, especially after data showed further cooling of inflation and wages. However, the rally is likely to falter as the US is likely at the doorstep of a recession, with the last leg supporting the US economy, its services sector, showing signs of buckling, while the Fed remains hawkish, given the still-hot job market.

US services sector business confidence (ISM Services PMI) in December surprisingly plunged to just below 50 for the first time since the depth of the pandemic. Except for the post-pandemic plunge, the December services PMI was the weakest since the Global Financial Crisis. Forward-looking new orders sub-indices have started contracting, following similar contraction seen in US manufacturing sector activity. While a slowdown in US average hourly earnings have also raised hopes of a Fed pause, we believe they are premature, given still-sturdy job creation and renewed decline in jobless claims.

Slowing wage growth and contractionary PMIs could, of course, lead the Fed to slow the pace of hikes to 25bps at the 31 Jan-01 Feb meeting, but it will need to see a steady decline in the core inflation to below 0.2% m/m for a few months (to bring annual inflation towards the Fed's 2% target) and a consistent fall in job openings and a steady rise in jobless claims (to lower wage growth) before it pauses. Core inflation slowed to 5.7% y/y in Dec but, on a monthly basis, it accelerated to 0.3% m/m.

US corporate earnings, which have provided partial support to US equities last year, could be the other shoe to drop. According to Refinitiv estimates for Q4 22, S&P500 companies are expected to report the first y/y contraction in earnings since the peak of the pandemic. Ex-energy, S&P500 earnings are estimated to have contracted for the third straight quarter. The energy sector, which has been propping up earnings in 2022, is expected to report the second straight q/q decline. Although the consensus has been cutting forward earnings estimates, these have significant room to fall further if a recession hits.

Against this backdrop, we believe the growth and earnings outlook for China and Asia will continue to improve. COVID infections in Mainland China appear to have peaked in major cities, with infections now moving inland. As a result, mobility indicators are rebounding strongly in these cities. As mobility improves, we expect normalisation of activity to unleash a strong pick up in domestic consumption this year, more than making up for a likely slump in exports. Although monetary and fiscal policy is likely to ease further, investment is likely to lag due to challenges faced by local governments in raising funds from land sales. Thus, for the first time in the modern era, a China recovery is likely to be driven by domestic consumption.

Investment implications: The above outlook calls for: a) Fading the US equity rally. Those seeking to add exposure to US risk assets could consider less-volatile US High Yield bonds or alternative assets; b) Adding exposure to China equities, especially in consumer discretionary and communication services sectors; c.) Adding exposure to income assets and predominantly investment grade Asia USD bonds, which still offer a sizable discount to similarly-rated Developed Market corporate bonds and d) Positioning for a likely USD bounce in the near-term. Next week's BoJ meeting (18 Jan) is likely to see it dampen calls for abandoning its yield curve control policy. However, we would refrain from adding JPY loans as we see it strengthening this year as the USD weakens further and the BoJ likely tightens policy after Governor Kuroda departs in April.

— Rajat Bhattacharya

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as marginally positive for risk assets in the near term.

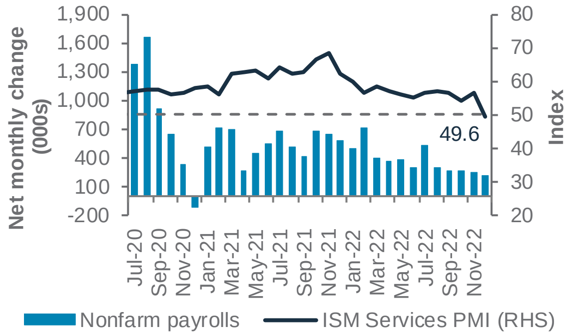
(+) factors: China policy support; strong US jobs report, slowing inflation

(-) factors: Contractionary US ISM services, slower China money growth

	Positive for risk assets	Negative for risk assets
Macro data	• US job creation higher than expected at 223,000, with jobless rate falling to 3.5%; average hourly earnings below expectations • US CPI continued to slow • Euro area consumer inflation (9.2%) softer than expected, but core inflation accelerated to 5.2% • Euro area retail sales grew more than expected • Euro area Sentix Investor Confidence recovered more than expected	• US ISM services PMI saw biggest drop outside of a recession since 1997, falling to contraction (49.6) • US jobless claims fell further; small business optimism fell more than expected • China M2 money supply growth decelerated more than expected • German factory orders fell more than expected • China producer prices fell more than expected
	Our assessment: Neutral – Slowing inflation, wage growth despite strong US job creation vs US ISM services contraction	
Policy developments	• Mainland China authorities plan to relax their 'three red lines' policy for the property sector to boost confidence • China signalled an end to the two-year tightening of regulations against the internet sector	• Fed officials called for more rate hikes amid concerns about easing financial conditions too early • ECB governing council members gave hawkish commentary
	Our assessment: Neutral – Supportive China policies vs hawkish Fed, ECB	
Other developments	• US President Biden asked Yellen to stay on as Treasury Secretary amid looming battle in Congress to raise the debt ceiling • US Republican candidate McCarthy elected as the House speaker after 15 rounds of voting • China representative to Australia claimed a turnaround in relations	• China suspended short-term visas for South Korean and Japan citizens in retaliation for COVID-19-related travel restrictions • Media reports said China reportedly took 'golden shares' in Alibaba and Tencent, giving the government more control
	Our assessment: Positive – US political leadership stability	

US services sector business confidence plunged in Dec, but a still-strong job market is likely to keep the Fed hiking rates, albeit at a slower pace

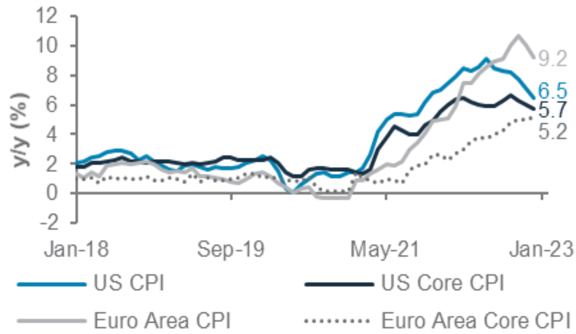
US ISM Services PMI, US non-farm payrolls



Source: Bloomberg; Standard Chartered

US and Euro area consumer inflation is slowing, but core inflation remains significantly above Fed, ECB targets

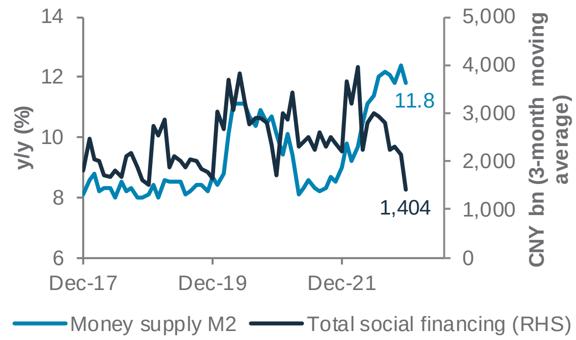
US and Euro area headline and core inflation



Source: Bloomberg, Standard Chartered

China's money supply growth and total loans fell in December; we expect a recovery this year amid a boost to fiscal and credit stimulus

China's M2 money supply growth, total social financing



Source: Bloomberg, Standard Chartered

Top client questions

What are your expectations from the upcoming US earnings season?

S&P500 Q4 FY22 earnings are expected to fall 2.2% y/y, according Refinitiv estimates. This compares with expectations of a 5.8% rise at the start of October 2022. This will mark the first earnings decline since Q3 2020, while revenue growth will likely have been the lowest since Q4 2020. A cocktail of inflation and slowing growth has led to companies lowering their guidance over the last few months.

Only four out of eleven S&P500 index sectors are expected to show positive earnings growth, led by the energy sector. However, even for energy, the growth rate has been slowing.

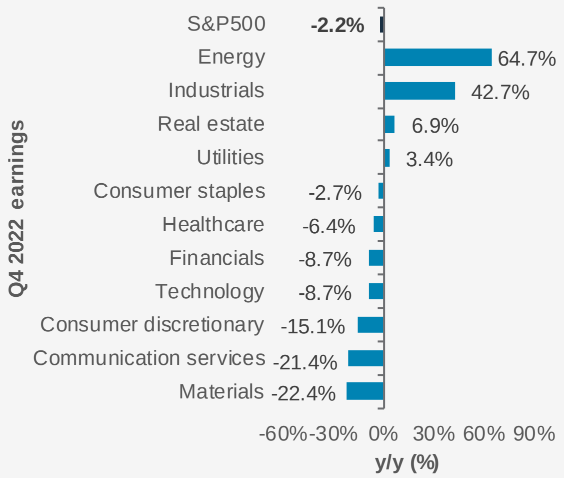
Therefore, we continue to take a defensive stance in US markets, with consumer staples and healthcare among our preferred sectors. Historically, they have shown the least volatility in their earnings, even during recessions.

In terms of technicals, the S&P500 index has been staging a mild rebound. However, the 4,100 level has proven to be a strong level of resistance, followed by 4,300. Thus, we maintain our neutral view on US equities and hold a relative preference for Asia ex-Japan, and Chinese equities in particular, as policies are likely to remain supportive and expansionary.

— **Daniel Lam, CFA,** *Head, Equity Strategy*

S&P 500 Q4 FY'22 earnings are expected to fall by 2.2% y/y, the first negative earnings growth rate since Q3 2020

Expected US earnings growth in Q4 22



Source: Refinitiv, Standard Chartered

Are you still bullish on the USD in the near term?

Over the past few weeks, our near-term expectation of a temporary rebound in the USD index (DXY) has been thwarted by a combination of a warm winter in Europe (which has led to a stronger EUR, the biggest component of the DXY) as well as a decline in US government bond yields, which has lowered the USD's interest rate differential advantage.

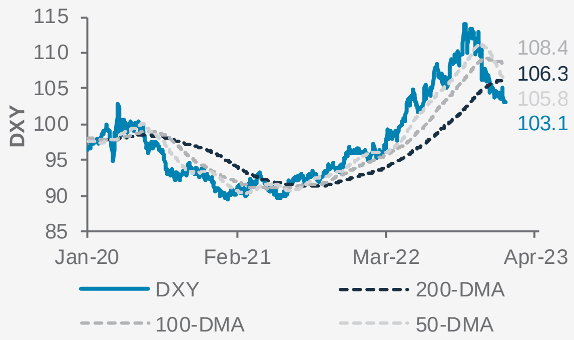
However, we continue to see a significant risk of a near-term bounce in the USD over the next month owing to the following factors:

1. While technicals are not yet at extremely oversold levels, the USD has declined nearly 9% since its recent peak in late 2022. History suggests markets or currencies rarely witness such large moves without being followed by a period of consolidation.
2. Over the next 1-3 months, we expect US government bond yields to rise towards 4% as we expect another 75bps of Fed rate hikes in H1 23, which should be supportive for the USD.
3. Finally, China's rapid reopening could lead to a slower-than-forecast decline in inflation. This could lead to a market reassessment of the current expectations of a relatively rapid Fed policy easing in 2023, which could drive flows into the safe-haven USD, at least temporarily.

— **Abhilash Narayan,** *Senior Investment Strategist*

We expect a near-term bounce in the USD as the Fed continues to tighten

USD index (DXY)



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Do you see further upside in gold?

Gold has started the year on a strong footing, with its price rising to the highest level since early June last year. The 4% year-to-date rally can be largely attributed to the following reasons:

1. The USD's weakness is historically positive for gold. This has meant the DXY's fall to its lowest level since June 2022 was inversely reflected in gold prices.
2. Real (net-of-inflation) yields, which we see as a key driver for gold prices, fell this year, supporting the relative attractiveness of gold (which pays no interest).
3. Near-term retail gold purchases rose ahead of the Chinese New Year, likely boosted by China's ongoing reopening.
4. Central banks buying is likely to remain strong. According to the World Gold Council, central banks bought almost 400 tons in Q3 2022, a record high quarterly total, and more recent data showed they added a further 85 tonnes in October and November. It is likely that this trend will continue into 2023.

Having said that, we believe a consolidation could be imminent in the short term. We continue to see real yields as a headwind given the risk of a nominal rebound in US government bonds yields. From a technical standpoint, a stretched RSI (reflecting overbought conditions) and narrowing investor diversity also point to a consolidation. USD 1,900/oz will likely be a psychological resistance level, followed by 1,950, the upper bound of the trend channel since 2020.

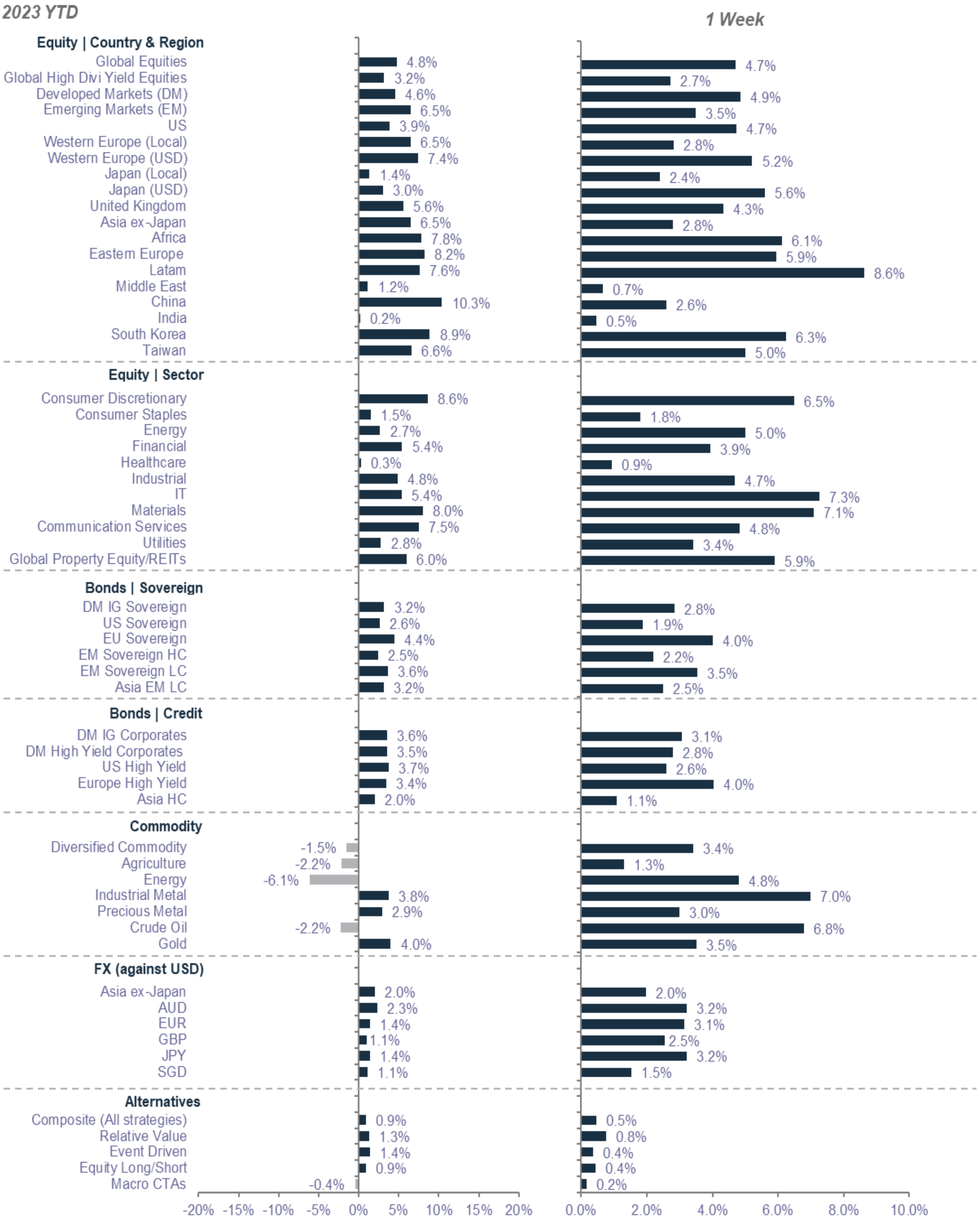
— **Zhong Liang Han, CFA,** *Investment Strategist*

Gold is likely to consolidate in the near term if it fails to break above 1,900 amid overbought technicals and narrowing investor diversity

XAU/USD and resistance levels

Source: Bloomberg, Standard Chartered

Market performance summary *



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

*Performance in USD terms unless otherwise stated, 2023 YTD performance from 31 December 2022 to 12 January 2023; 1-week period: 05 January 2022 to 12 January 2023

Our 12-month asset class views at a glance

Asset class			
Equities	▼	**Preferred Sectors**	
Euro area	◆	US Energy	▲
US	◆	US Staples	▲
UK	◆	US Healthcare	▲
Asia ex-Japan	▲	Europe Energy	▲
Japan	▼	Europe Financials	▲
Other EM	◆	China Comm. Services	▲
		China Discretionary	▲
Bonds (Credit)	▲		
Asia USD	▲	**Alternatives**	◆
Corp DM HY	▼		
Govt EM USD	◆	**Gold**	◆
Corp DM IG	◆		
Bonds (Govt)	▲		
Govt EM Local	◆		
Govt DM IG	◆		

Source: Standard Chartered Global Investment Committee

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

Economic and market calendar

	Event	Next week	Period	Expected	Prior
MON					
TUE	CH	Industrial Production y/y	Dec	0.3%	2.2%
	CH	Retail Sales y/y	Dec	-8.0%	-5.9%
	CH	Fixed Assets Ex Rural YTD y/y	Dec	5.0%	5.3%
	CH	GDP y/y	4Q	1.7%	3.9%
	UK	ILO Unemployment Rate 3Mths	Nov	–	3.7%
	EC	ZEW Survey Expectations	Jan	–	-23.6
	US	Empire Manufacturing	Jan	-7.5	-11.2
WED	JP	BoJ Policy Rate	Jan		
	UK	CPI y/y	Dec	–	10.7%
	US	Retail Sales Ex Auto and Gas	Dec	-0.1%	-0.2%
	US	PPI Final Demand y/y	Dec	6.9%	7.4%
	US	Industrial Production m/m	Dec	0.0%	-0.2%
THU	US	Housing Starts	Dec	1350k	1427k
FRI/SAT	UK	Retail Sales Ex Auto Fuel y/y	Dec	–	-5.9%

Source: Bloomberg, Standard Chartered
Prior data are for the preceding period unless otherwise indicated. Data are % change on previous period unless otherwise indicated
P - preliminary data, F - final data, sa - seasonally adjusted, y/y - year-on-year, m/m - month-on-month

The S&P500 index faces resistance at 4,014

Technical indicators for key markets as of 12 January close

Index	Spot	1st support	1st resistance
S&P 500	3,983	3,922	4,014
STOXX 50	4,127	4,054	4,163
FTSE 100	7,794	7,728	7,827
Nikkei 225	26,143	25,928	26,404
Shanghai Comp	3,180	3,165	3,187
Hang Seng	21,593	21,192	21,795
MSCI Asia ex-Japan	659	648	665
MSCI EM	1,018	999	1,028
WTI (Spot)	83.7	80.2	85.6
Gold	1,898	1,877	1,909
UST 10y Yield	3.47	3.40	3.58

Source: Bloomberg, Standard Chartered
Note: These short-term technical levels are based on models and may differ from a more qualitative analysis provided in other pages

Investor diversity has deteriorated in the past month

Our proprietary market diversity indicators as of 12 January

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.32
Global Equities	◐	↓	1.35
Gold	◐	↓	1.31
Equity			
MSCI US	◐	↑	1.44
MSCI Europe	○	↓	1.20
MSCI AC AXJ	○	↓	1.19
Fixed Income			
DM Corp Bond	◐	↓	1.31
DM High Yield	◐	↓	1.31
EM USD	◐	↓	1.34
EM Local	○	↓	1.20
Asia USD	◐	→	1.40
Currencies			
EUR/USD	◐	↓	1.27

Source: Bloomberg, Standard Chartered; **Fractal dimensions below 1.25 indicate extremely low market diversity/high risk of a reversal**

Legend: ● High | ◐ Low to mid | ○ Critically low

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