Wealth Management Chief Investment Office
19 August 2022

Weekly Market View

Bear market rally topping out?

→ US equities are at a pivotal point. The two-month-long US stock market rally faces a major technical resistance, with the S&P500 index testing its 200-day moving average.

→ A break higher would, of course, be a bullish signal, potentially spurring the index towards the next big resistance around 4,600. However, the challenging technical outlook and an increasingly hawkish monetary policy backdrop raise the odds of a pullback.

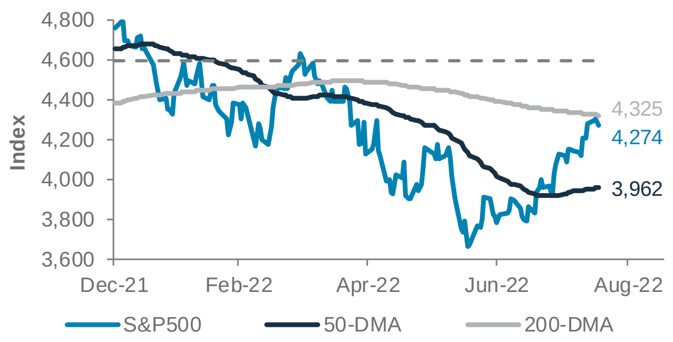
→ As such, we believe there is an opportunity for those over-exposed to US equities to take some profits and rebalance towards Asia ex-Japan equities and Asia USD bonds, which are more attractively valued and likely to benefit from China's increasing policy stimulus over the next 6-12 months.

Important disclosures can be found in the Disclosures Appendix.

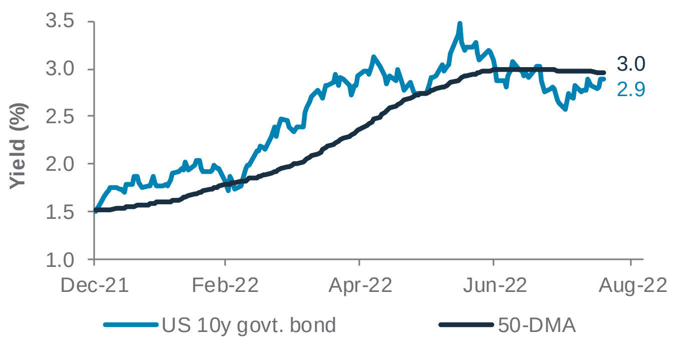
Charts of the week: A pivotal moment for US stocks

The US S&P500 index and 10-year government bond yield are testing major technical resistance levels

S&P500 index and 50- and 200-day moving averages



US 10-year government bond yield



Source: Bloomberg, Standard Chartered

Editorial

Bear market rally topping out?

US equities are at a pivotal point. The two-month-long US stock market rally, which has delivered 18% gains since this year's bottom in June, faces a major technical resistance, with the S&P500 index testing its 200-day moving average. A break higher would, of course, be a bullish signal, potentially spurring the index towards the next big resistance around 4,600. However, the challenging technical outlook and an increasingly hawkish monetary policy backdrop raise the odds of a pullback. As such, we believe there is an opportunity for those over-exposed to US equities to take some profits and rebalance towards Asia ex-Japan equities and Asia USD bonds, which are more attractively valued and likely to benefit from China's increasing policy stimulus over the next 6-12 months.

The fundamental challenge to major developed equity markets over the next 3-6 months comes from aggressive central bank monetary policies. In the past week, major central banks, except the PBoC, reiterated their singular focus on taming inflation, running at multi-decade highs, before they slow or pause rate hikes. For instance, minutes from the Fed's July meeting showed that policymakers, after delivering the first back-to-back 75bps rate hikes in decades, were considering further policy tightening until inflation declines "substantially".

With the Fed's 2.5% policy rate already at the so-called 'neutral' level, further rate hikes would tighten financial conditions, hurting economic activity further (the US economy contracted for the second straight quarter in Q2, amid a slump in private investment). Nevertheless, the Fed will likely be emboldened to continue tightening policy after stronger-than-expected consumption and factory output data in July and the tightest job market in 50 years. We see the Fed raising its policy rate to 3.25% by the end of the year. The risk is that the so-called 'neutral' rate is higher than what the Fed currently perceives, in which case it will have to continue raising rates beyond 3.25% until the job market and consumption falter and inflation falls towards its 2% target. The Fed's annual Jackson Hole summit (25-27 August) will cast more light on its latest thinking.

Meanwhile, New Zealand's central bank, after delivering a 50bps rate hike to 3% this week, turned more hawkish in its forward guidance. It now expects its policy rate to rise to 4% by early 2023 vs previous estimates of 3.7%. The global inflation backdrop is not helping. Although oil prices have fallen 30% since March highs, UK inflation rose above 10% for the first time in 40 years. The BoE expects UK inflation to remain in double-digits for some time, implying it will remain hawkish as well, even though the economy contracted in Q2. Meanwhile, Euro area inflation at 8.9% in July is likely to keep the ECB in tightening mode, especially after data showed the economy continued to expand (0.6% q/q) in Q2. However, economic indicators, such as PMIs, showed manufacturing activity started to contract in July and services activity was close to contracting. Thus, PMIs for August, due next week, will be watched closely.

China's economy stands apart against this global policy backdrop. This week, the PBoC delivered a surprise 10bps rate cut as data showed China's retail sales, industrial output and fixed asset investment all missed estimates in July, after a rare q/q contraction in the overall economic output in Q2. We expect the rate cut to be followed next week with a cut in the loan prime rate which is used by banks for mortgage and infrastructure lending. Meanwhile, Premier Li Keqiang's meeting with provincial officials, to discuss pro-growth measures, suggests authorities remain committed to reviving growth. Still-tight COVID restrictions remain a drag on economic activity and investor sentiment, but this gives investors an opportunity to acquire beaten down assets, including domestic stocks and Asian USD bonds, at a bargain. While Asia High Yield USD bonds offer an average 15% yield, conservative investors could explore the broader Asian USD bond segment, which consists 85% of Investment Grade bonds and offers 6.1% yield.

— Rajat Bhattacharya

The weekly macro balance sheet

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

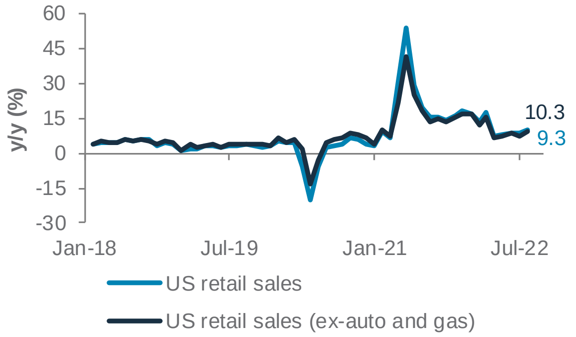
(+) factors: US retail sales, factory output; supportive China policies

(-) factors: Hawkish Fed; China COVID cases, slowing economic activity

	Positive for risk assets	Negative for risk assets
COVID	• Hong Kong exploring expansion of traveller flow to China	• Still-elevated daily cases in some China cities such as Tibet and Hainan
	Our assessment: Negative – Elevated case numbers in China	
Macro data	• US core retail sales rose a better-than-expected 0.7% • US factory output beat expectations • US Michigan consumer sentiment index beat consensus estimates • US initial jobless claims fell more than expected • UK Q2 GDP contracted less than forecast	• China retail sales, industrial production and fixed assets investment rose less than expected; youth jobless rate rose to a record high • Euro area Q2 GDP expanded less than forecast • Euro area ZEW survey of growth expectations weakened further • UK inflation hit double digit for the first time in 40 years
	Our assessment: Neutral – Robust US retail sales, factory output vs slowing China economic activity, weak Euro area growth expectations	
Policy developments	• President Biden signed the Inflation Reduction Act that focuses on climate and healthcare investment • The PBoC cut a key rate by 10bps unexpectedly • China Premier Li met local officials to discuss pro-growth measures	• The Fed's July meeting minutes showed consensus among policymakers to continue raising rates until inflation slowed "substantially"
	Our assessment: Neutral – US fiscal boost, supportive China policies vs hawkish Fed	
Other developments	• Iran responded to a European proposal on a nuclear deal, raising hopes of a return of Iranian oil to the market	• China warned the US against sailing warships through Taiwan Strait
	Our assessment: Positive – Hopes of lower oil prices from a possible Iran nuclear deal	

US consumption remains strong on the back of a robust job market

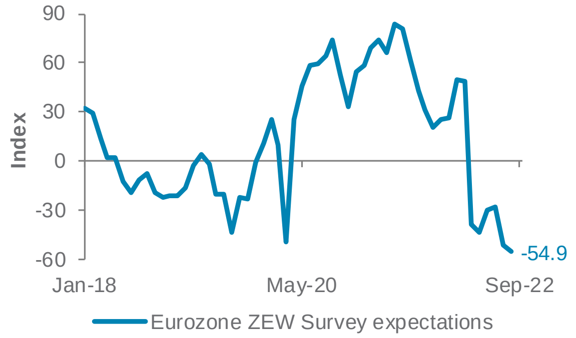
US headline and core retail sales



Source: Bloomberg; Standard Chartered

Euro area economic growth expectations remain close to pandemic levels

Euro area ZEW Survey expectations of economic growth



Source: Bloomberg, Standard Chartered

China's retail sales, industrial output and fixed asset investments remained weak

China retail sales, industrial output, fixed asset investment

Source: Bloomberg, Standard Chartered

Top client questions

What are the key catalysts driving Hong Kong and China equities?

The PBoC surprisingly cut its one-year Medium-Term Lending Facility Rate (MLF) earlier this week by 10bps after a series of disappointing economic indicators. The rate cut lowers borrowing cost for local corporations and individuals, which may stimulate manufacturing and consumer spending. In the near term, it may alleviate investors' worries over the sustained economic slowdown amid China's prolonged 'Zero-Covid' policy and is expected to inject further liquidity into the onshore economy.

Meanwhile, headwinds include: 1) escalating tensions between the US and China, and 2) delisting of Chinese companies (ADRs) from the US stock market.

We believe rising geopolitical uncertainties could act as a catalyst for China's self-sufficiency strategy. Communication services, one of our preferred sectors in China, is expected to benefit from the drive for self-generated growth. Industrials and materials are our other preferred sectors which should be supported by the drive to develop semiconductors and high-technology manufacturing.

Over the next few weeks, Q2 2022 corporate earnings release from Chinese and Hong Kong companies will be in focus. Valuations and earnings expectations remain depressed. Chinese and Hong Kong equities currently trade at a big discount vs global equities. Besides, there have been downward revisions for consensus earnings estimates, with MSCI China earnings growth estimates plummeting to 3.5%, from 13% at the start of the year, amid headwinds over the property sector and macro-economic uncertainties caused by COVID-19 lockdowns.

That said, signs of relaxation in China's COVID-19 restrictions and policy stimulus from the Chinese government are likely to support Hong Kong and China equities over the next 6-12 months. We stay Overweight China within our preferred region in Asia ex-Japan, and we prefer Chinese onshore equity market over its offshore counterparts since onshore equities are less susceptible to geopolitical events. Recent significant underperformance in the China and Hong Kong stock market has triggered cautious investor sentiment in the near term. Yet, as the government rolls out further policy stimulus, the market conditions are likely to improve with extra liquidity.

— **Michelle Kam,** *Investment Strategist*

Earning expectations for 2022 remain depressed in China

MSCI China earnings growth forecast for 2022 and 2023

Source: MSCI, FactSet, Standard Chartered

Top client questions (cont'd)

What are the investment implications of the new US Inflation Reduction Act?

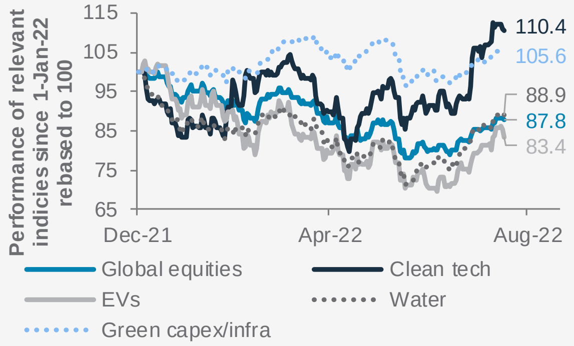
The US Inflation Reduction Act - the scaled-down version of Build Back Better Act - is designed to reduce the federal deficit and lower inflation, while also investing in boosting domestic energy production and reducing healthcare costs. It is estimated to reduce federal deficit by about USD 300bn over the next ten years but is unlikely to have a significant impact on the near-term growth/inflation outlook.

There are, however, potentially huge ramifications in the area of energy security and climate change. An estimated investment of USD 369bn is planned to increase cleaner energy production and reduce carbon emissions by 40% by 2030. Some notable provisions include tax credits for zero-carbon power plants, incentives for electric vehicles (EV) and building of domestic clean energy manufacturing facilities. We view this bill as positive for our "winds of climate change" theme, especially for our clean energy, green capex/infrastructure and EV sub-themes. While climate-related themes have rebounded in tandem with the broad equity markets, valuations are still fair relative to historical averages. Hence, investors could look to add exposure to these themes on pullbacks.

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

The new US Inflation Reduction Act is likely to boost climate-related investments

YTD performance of climate subthemes vs. global equities



Source: Bloomberg, Standard Chartered

Is your bullish outlook for US High Yield bonds still valid?

US High Yield (HY) bonds have delivered nearly +7% returns since end-June 2022, largely driven by an over 150bps decline in yield premiums, while five-year US government bond yields have largely traded in a range. Given the strong performance of the bonds and the decline in yield on offer, it is valid to ask whether US HY bonds have run ahead of the fundamentals.

While the relative attractiveness of US HY bonds has reduced in the past few months, we believe they continue to look attractive owing to the following reasons:

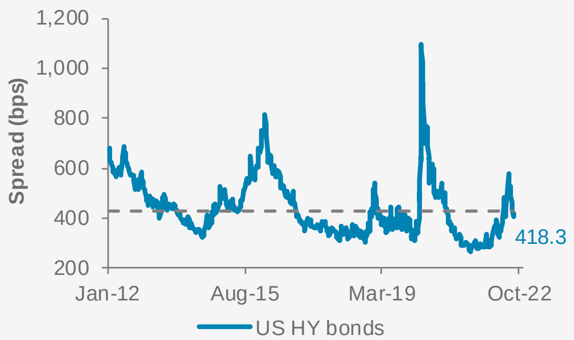
1. In the latest earnings season, US companies not only surprised to the upside (on aggregate), but their forward-looking guidance was more upbeat than expected.
2. As we have previously highlighted, low issuance this year mean the US HY bond market is likely to contract by nearly USD 100bn, creating favourable demand-supply dynamics.
3. Given the strong labour market and upbeat commentary from US officials, at the margin, markets may have become less concerned about a deep recession, which means that default rates may not rise as much as previously feared.

Combining the above factors, we continue to view US HY bonds as attractive, though we would wait for a better opportunity to add exposure.

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

The recent rally in US High Yield bonds has brought yield premiums close to long-term averages

US High Yield bond yield premium over government bonds



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Where are opportunities in FX markets amid a range-bound USD?

Recent developments have been negative for the EUR. European benchmark gas prices have soared more than 40% since last month, growth expectations are starting to wane – with Q2 GDP flash estimate disappointing at 3.9% y/y – and risk sentiment turning more bearish. Inflation in the region is further exacerbated by severe rain shortages in Germany, leading to disrupted river shipping routes and elevated freight costs.

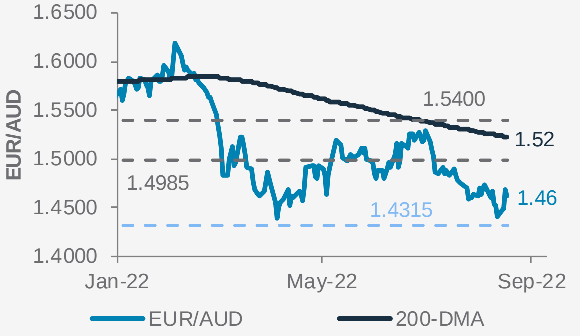
On the other hand, the AUD looks fundamentally attractive, with strong Terms-of-Trade, driven by elevated commodity prices this year. Interest rate differentials are in favour of the AUD, and once the Fed tightening cycle and potential growth slowdown have been priced in, the AUD could rally.

Over a 12-month horizon, we are bullish on both the AUD and EUR. However, on a shorter term, three-month horizon, we believe there could be further downside for EUR/AUD. Support for the pair is around this year's low of 1.4315, where a sustained break could open the next leg lower towards 1.3600. Initial resistance is at 1.4985, followed by 1.5400.

— **Nataniel Tang,** *Investment Strategist*

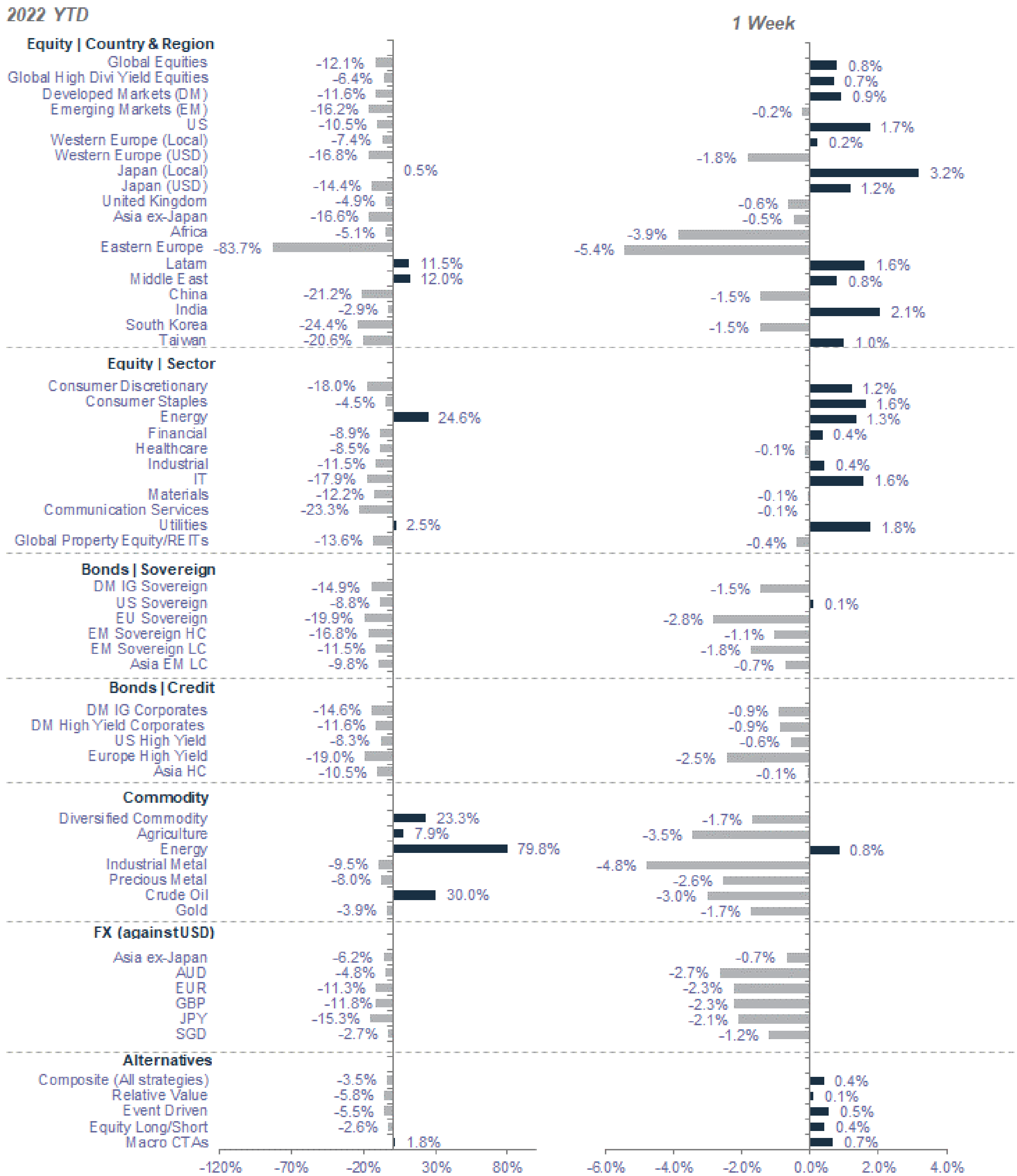
Key support for EUR/AUD sits at 1.4315; a break lower would reaffirm our bearish view on the pair

US index (DXY) with technicals



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, 2022 YTD performance from 31 December 2021 to 18 August 2022; 1-week period: 11 August 2022 to 18 August 2022

Our 12-month asset class views at a glance

Asset class		Asset class	
Equities	◆	**Alternatives**	◆
Euro area	◆	Equity hedge	◆
US	◆	Event-driven	▼
UK	▲	Relative value	▼
Asia ex-Japan	▲	Global macro	▲
Japan	◆		
Other EM	◆	**Cash**	◆
		USD	▼
Bonds (Credit)	◆	EUR	▲
Asia USD	▲	GBP	▲
Corp DM HY	▲	CNY	▲
Govt EM USD	◆	JPY	▲
Corp DM IG	▼	AUD	▲
		NZD	▲
Bonds (Govt)	◆	CAD	▲
Govt EM Local	◆		
Govt DM IG	◆	**Gold**	▲

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	EC	S&P Global Eurozone Manufacturing PMI	Aug P	–	49.8
	EC	S&P Global Eurozone Services PMI	Aug P	–	51.2
	UK	S&P Global/CIPS UK Manufacturing PMI	Aug P	–	52.1
	UK	S&P Global/CIPS UK Services PMI	Aug P	–	52.6
	US	S&P Global US Manufacturing PMI	Aug P	–	52.2
	US	S&P Global US Services PMI	Aug P	–	47.3
	EC	Consumer Confidence	Aug P	–	-27.0
	US	New Home Sales	Jul	590k	590k
WED	US	Durable Goods Orders	Jul P	0.6%	2.0%
THUR					
FRI/SAT	US	Personal Income	Jul	0.6%	0.6%
	US	PCE Deflator y/y	Jul	–	6.8%
	US	Fed's Jackson Hole summit	Jul	–	–

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

Next resistance for the US 10-year bond yield is at 2.92%

Technical indicators for key markets as on 18 August

Index	Spot	1st support	1st resistance
S&P 500	4,284	4,270	4,301
STOXX 50	3,777	3,754	3,803
FTSE 100	7,542	7,515	7,556
Nikkei 225	28,942	28,585	29,261
Shanghai Comp	3,278	3,272	3,288
Hang Seng	19,764	19,627	20,038
MSCI Asia ex-Japan	647	645	650
MSCI EM	1,010	1,007	1,014
Brent (ICE)	96.6	93.2	99.0
Gold	1,758	1,744	1,788
UST 10y Yield	2.88	2.81	2.92

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 widened across the board

Our proprietary market diversity indicators as of 17 August

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	1.64
Global Equities	●	→	1.60
Gold	●	↓	1.58
Equity			
MSCI US	◐	↑	1.48
MSCI Europe	●	→	1.84
MSCI AC AXJ	●	↓	1.83
Fixed Income			
DM Corp Bond	●	↑	1.95
DM High Yield	●	→	2.36
EM USD	●	→	2.45
EM Local	●	→	1.92
Asia USD	●	→	1.86
Currencies			
EUR/USD	◐	→	1.46

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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