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WM Chief Investment Office
9 July 2021

Weekly Market View

Bond yields: warning or opportunity?

The pullback in US government bond yields has contrasted with the ongoing reflation and recovery narrative. Are lower bond yields signalling challenges ahead?

We believe not, given the fall in yields is driven by positioning, falling economic surprises and inflation expectations. Instead, we believe it is creating an entry opportunity in Value and non-US equities and High Yield bonds.

Equities: In China, we continue to favour energy and industrial sectors amid the rising regulatory pressures on the technology sector.

Bonds: Treasury yields are testing key support. We favour US/European High Yield and Asia USD bonds for their lower sensitivity to changes in yield.

FX: Upcoming central bank meetings in New Zealand and Canada could provide an impetus to further NZD and CAD gains.

What are the implications of regulatory pressure on China's tech sector?

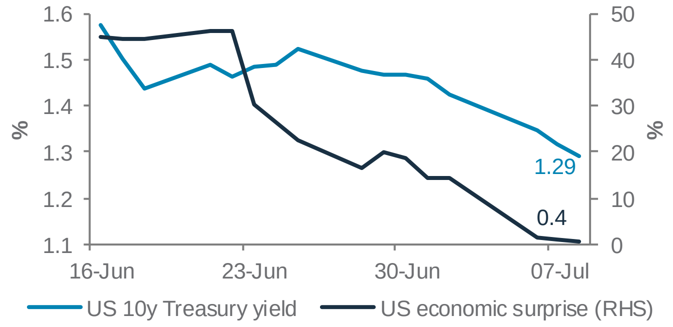
Is US earnings growth likely to peak in Q2?

What is the likely impact of the OPEC+ meeting?

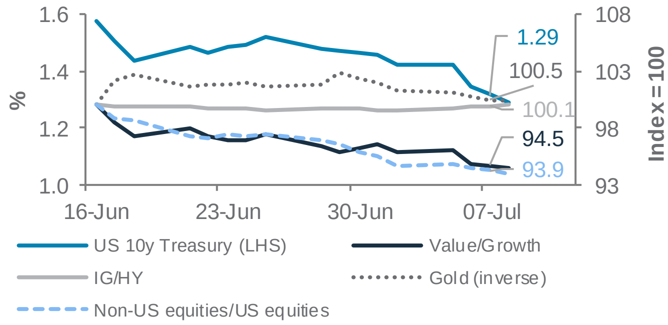
Charts of the week: The fallout from falling bond yields

Falling Treasury yields, led by falling economic surprises, may have created opportunities to average in

10-year Treasury yield vs US economic surprise index



Asset class performance since the 16 June yield peak



Source: Bloomberg, Standard Chartered

Editorial

Bond yields: warning or opportunity?

The US government bond yield pullback has contrasted with the ongoing recovery and reflation narrative. Are lower bond yields signalling challenges ahead?

We believe the message is benign and expect the bond yield reversal to be temporary given we see reducing economic surprises, positioning normalisation and falling inflation expectations as key drivers of the move lower. Economic data cannot surprise positively (or negatively) indefinitely and, therefore, is usually a short-term factor. The same can be said of positioning. The key issue is inflation. Yields can still move gradually higher even if inflation proves transitory if growth confidence sustains, though whether this pans smoothly is key.

For now, the 10-year yield is testing technical support at 1.27-1.29%, with subsequent support not far at 1.20-1.23% and 1.13%. With positioning coming off its extremes and economic surprises approaching zero, we believe a significant portion of the move lower in bond yields is behind us now.

This leaves us with some interesting implications for investors. The fall in bond yields over the past several weeks has been accompanied by an outperformance of Growth- (over Value-) style equities, US (over non-US) equity markets, Investment Grade (over High Yield) bonds and a rise in gold prices. A bottoming of bond yields would mean that risk/reward favours taking advantage of these moves to average into our preferred asset classes: namely value-style equity sectors, European equities and shorter maturity and higher yielding bonds. On gold, though, while we remain long-term bullish, we would await a more attractive entry level.

The Fed's latest meeting minutes largely support this view. While the taper-timing debate is ongoing, they noted the condition of a significant economic recovery was 'generally seen as not having yet been met'. We expect bond purchase tapering to start only in early 2022.

Our buy-on-dips view notwithstanding, we are monitoring three near-term risks. Foremost is the resurgence in COVID-19 cases in several major regions amid the spread of the Delta variant and/or economic re-openings. Countries like the US are also exhibiting a slowdown in the pace of vaccinations. While many regions remain on track to achieve a high level of vaccinations by year-end, the journey is likely to be a volatile one.

In China, policymakers extended regulatory investigations to several technology firms recently listed in the US. Beyond risks from regulatory pressures alone, these also threaten to reawaken geopolitical tensions via US 'retaliation', as sharp reactions from many US Senators regarding US listings already point to. However, China's State Council said monetary policy could be used to shore up support for the economy. A follow-through with actual PBoC policy easing could brighten the outlook for Chinese equities and our preferred sectors – we prefer energy and industrials.

Finally, a stalemate on a potential output hike at the OPEC+ meeting raises the prospect of higher oil prices in the near term, but potentially lower prices in the long term if output quota discipline starts to falter. Currently, we do not see a significant risk to our energy sector preference given room for equities to catch up to energy prices, but will watch for any emerging downside risks.

— **Manpreet Gill,** *Head FICC Investment Strategy*

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as modestly negative for risk assets

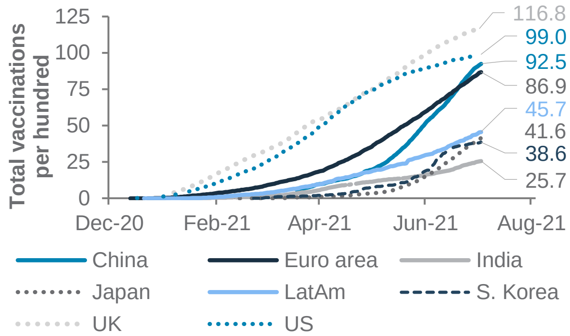
(+) factors: US labour market data, vaccine efficacy studies

(-) factors: COVID-19 case growth, China tech restrictions

	Positive for risk assets	Negative for risk assets
COVID-19	• Number of studies showed current vaccines effective against the Delta variant • UK continuing with its plans to remove most restrictions by 19 July	• Sharp rise in new cases in Europe following re-openings, spread of the Delta variant • Tokyo Olympics to be held without spectators; Sydney extended restrictions
	Our assessment: Negative – Renewed rise in cases fuelled by the Delta variant; slowing vaccination pace	
Macro data	• US non-farm payrolls expanded by 850k, highest in 10 months, as wages rose 0.3% m/m • US jobless rate rose slightly to 5.9%, likely capping inflation worries • European Commission raised region's 2021 growth forecast to 4.8%	• China CPI inflation fell to 1.1% y/y in June • US ISM services fell to 60.1 in June (from 64.0) • Euro area ZEW sentiment fell to 61.2 in July (from 81.3)
	Our assessment: Neutral – Strong US job market balanced by falling positive surprises	
Policy developments	• Fed minutes showed taper timing debate as recovery progress 'generally seen as not having yet been met' • ECB shifted its inflation target to 2% and allowed for overshoots following its strategy review	• OPEC+ failed to reach an agreement on potential output rise
	Our assessment: Neutral – Tapering likely only in 2022; OPEC+ stalemate creates uncertainty	
Other developments		• Chinese regulators imposed restrictions, cybersecurity reviews on recently listed firms
	Our assessment: Negative – China regulatory policy tightening	

Pace of vaccinations starting to slow in some countries

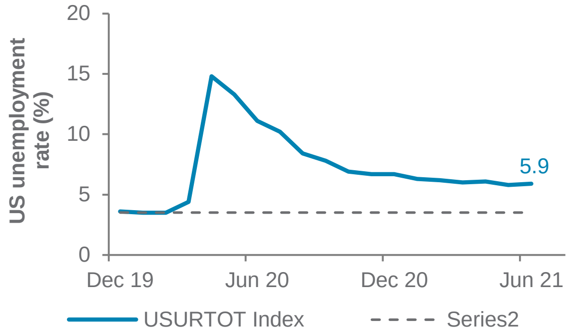
Total vaccine doses per hundred people



Source: Our World in Data, Standard Chartered

A long road to a full US labour market recovery, sustained inflationary pressures

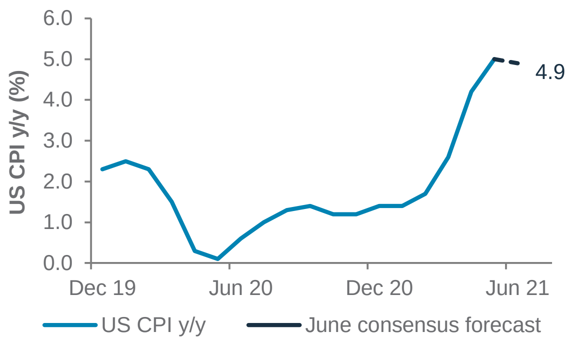
US unemployment rate



Source: Bloomberg, Standard Chartered

Statistical base effects on inflation likely approaching their peak

US CPI inflation



Source: Bloomberg, Standard Chartered

Top client questions

What are the implications of regulatory pressure on China's internet sector?

There is likely to be increasing regulatory pressure on the China internet sector, the latest being this week's probe into Didi, which recently listed in the US. This is also likely to raise the bar for capital raising, especially in the US where the SEC may announce policy addressing potential de-listing of foreign companies that do not satisfy its auditing rules.

As an indication of sector performance under regulatory pressure, we draw experience from the Macau gaming sector. During the 2014-2016 anti-corruption campaign, they underperformed the Hang Seng index by more than 50%. More recently, major Chinese internet stocks, as well as Chinese property stocks subject to 'Three Red Lines', have underperformed the Hang Seng index by more than 15% since the end of last year.

Having said that, Chinese internet and property sectors are of greater strategic importance than gaming, with revenue growth likely to be an additional pillar of support. Hence, we hold a Neutral stance on the technology sector. In China equities, we currently prefer industrials and energy sectors that we believe will benefit from a continued economic recovery. We also expect China onshore and offshore equities to perform broadly in line with Asia ex-Japan equities, which, in turn, we view as a core holding.

— **Daniel Lam, CFA,** *Senior Cross-Asset Strategist*

China tech, real estate thus far following much shallower paths post regulatory pressure vs. Macau gaming in 2014-2016

Relative performance of sector baskets* relative to HSI Index from onset of regulatory pressures

Source: Bloomberg, Standard Chartered
* Each basket consists of equally-weighted HK-listed stocks aiming to provide approximate sector representation: 1) Macau: Galaxy, Sands, 2) China internet: Tencent, Alibaba, JD.com, NetEase, 3) China property: COLI, CR Land, Vanke, Country Garden.

Is US earnings growth likely to peak in Q2?

US equities remain a preferred holding, with continued earnings growth being one key factor driving this view. In this context, the upcoming Q2 earnings season is key.

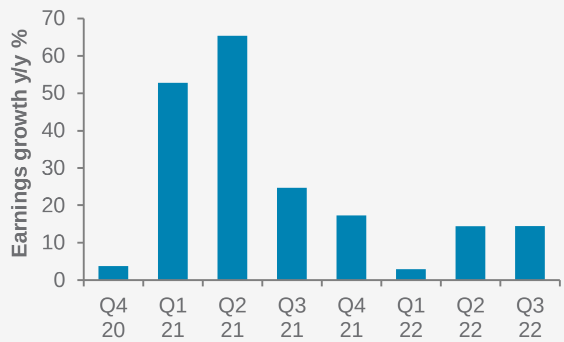
While Q1 2021 y/y earnings growth for the S&P500 index was stellar (c.50%), earnings growth is expected to peak in Q2 2021 (consensus growth is 65%) before moderating in Q3 (25%) as statistical base effects fade. Industrials and consumer discretionary sectors are expected to record their highest earnings growth rates in Q2 as US activity levels accelerated. This is followed by Value sectors, such as energy, materials and financials.

The correlation between earnings and global PMIs remains strong, demonstrating earnings are leveraged to economic momentum. Our view of continued economic growth and still-supportive policy should see Value-style equities extend their outperformance over Growth-style equities. Within the US, we favour financials and energy sector equities.

— **DJ Cheong, CFA,** *Investment Strategist*

Earnings growth is expected to peak in Q2 2021 as statistical base effects fade

Actual/Consensus earnings growth forecasts (y/y, %) for the S&P 500



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What are the implications of falling US Treasury yields on our preferred bond asset classes and gold?

As we note in our editorial, we are of the view that the recent move lower in US Treasury yields is likely a result of narrowing economic surprises, easing inflation expectations and one-sided market positioning, a move we expect will be temporary. On a 6-12 month horizon, we expect the 10-year Treasury yield to move back to a range around 1.75%. Technically, the 10-year yield is currently testing support at 1.27%-1.29%. Should this break, subsequent supports sit close to the 200-day moving average at 1.20-1.22% and at the 50% Fibonacci retracement at 1.13%.

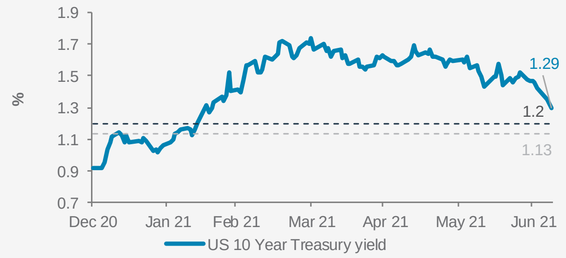
Within bonds, a return to higher bond yields argues for rotating out of Investment Grade-rated bonds, typically more sensitive to changes in yields, and averaging into our preferred bond classes. US/European High Yield and Asian USD bonds are likely to be less affected by any rebound in Treasury bond yields, with Asia USD bonds benefitting additionally from supportive valuations.

A view of rising bond yields, though, means we would await more attractive entry levels before considering adding to Gold. Technical support and resistance sit at 1,750 and 1,830.

— **Cedric Lam,** *Senior Investment Strategist*

US 10-year government bond yield approaching several technical supports

10-year US Treasury yield



Source: Bloomberg, Standard Chartered

What are the likely impacts of the OPEC meeting outcome on oil prices, energy equities and EM bonds?

Failed attempts to resolve a deadlock between the UAE and Saudi Arabia on potential output increases raises both upside risks (the current disagreement to raise output) and downside risks (the stalemate risking lower compliance with output quotas) to oil prices.

Our constructive 12-month view on oil remains unchanged as we see an improved demand picture mitigating recent supply-side developments. Continued vaccine rollouts and reopening of economies should lay the foundation for further price gains.

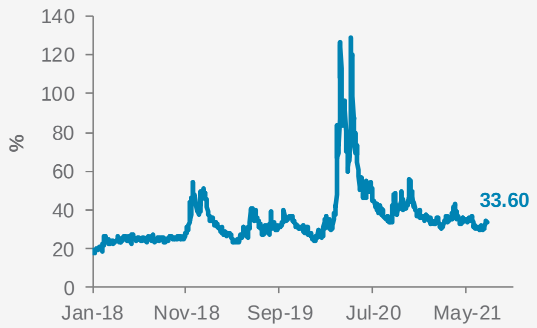
EM USD government bonds, a preferred bond asset class, have been correlated to commodity returns over the past few months. This and the asset class's sensitivity to Treasury yields could pose a headwind for EM USD government bonds in the short term. However, we believe an attractive yield and modest valuations more than offset these on a 6-12 horizon.

For energy equities, oil prices are important but the value of oil production matters more. We believe a continued demand recovery will likely offset any risks of increase in oil supply.

— **DJ Cheong, CFA,** *Investment Strategist*

Oil price volatility has picked up, but remains a far cry from the peak in April last year

3-month implied volatility of WTI crude oil



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is the outlook for the CAD and NZD ahead of next week's central bank meetings?

Broad USD strength will, in our view, likely fade soon. We are bullish on both the NZD and CAD over a 12-month horizon, and believe current corrective weakness offers attractive investment entry points over the short and medium term.

Both economies have rebounded quickly with similar drivers. Growth and employment data are strong. Both have buoyant housing markets, favourable trade positions and central banks that have already begun the path to monetary policy normalisation. We expect the latter to be reinforced by both the Reserve Bank of New Zealand and the Bank of Canada next week. Canada has benefited from higher oil prices and strong US growth. New Zealand has gained from strong agricultural product demand and high dairy prices. One key difference is vaccination rates, with Canada now among the world leaders; NZ is lagging behind due to supply constraints.

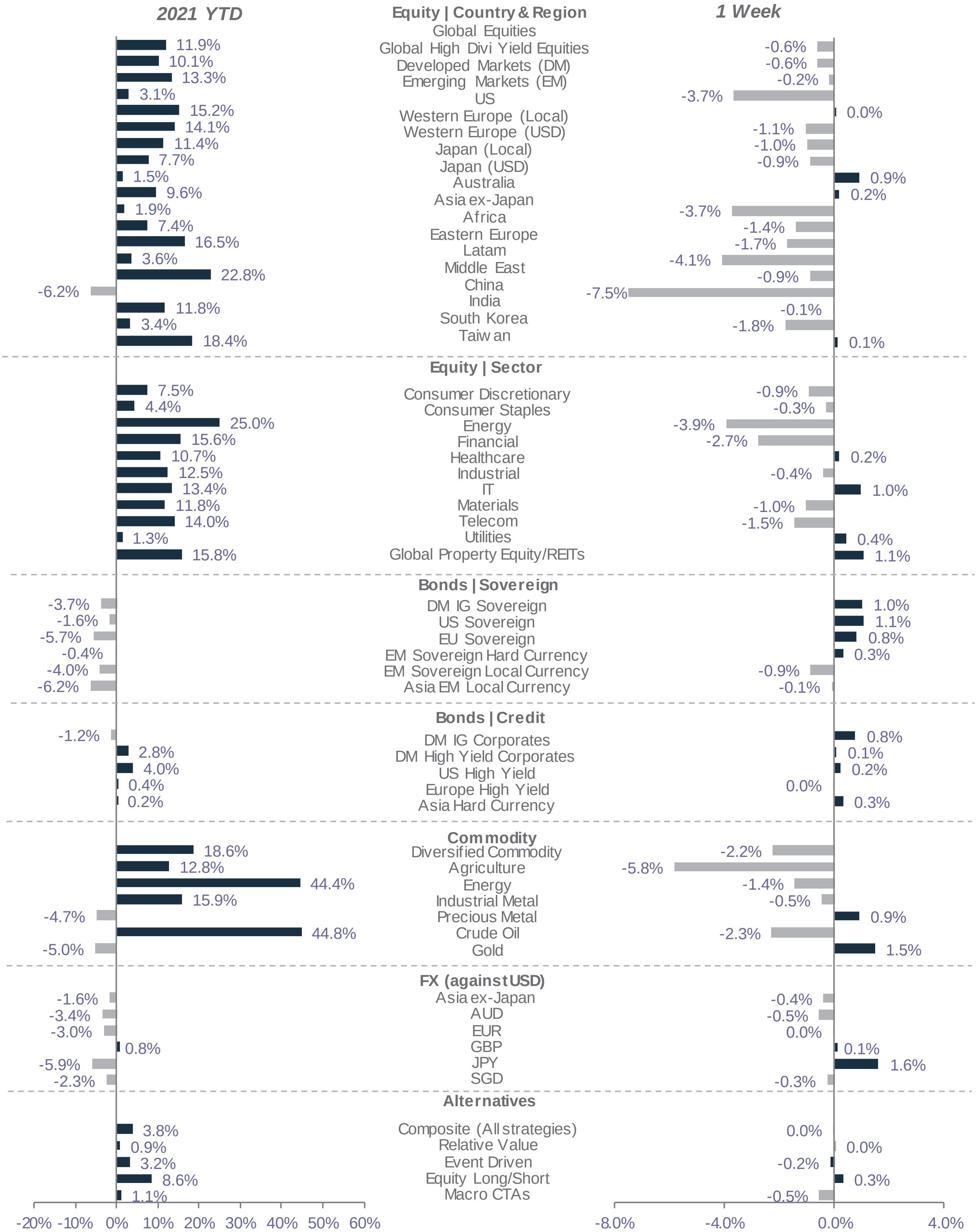
NZD/USD has initial technical support around 0.6860-0.6920 and very strong support between 0.6700 and 0.6800 that should hold any stronger sell-off. Once this correction ends, we expect a rally above 0.7130 to signal another leg higher towards 0.7400. USD/CAD should encounter a band of strong resistance between 1.2550 and 1.2700, which can provide an attractive entry level for an eventual decline below 1.2250 towards 1.2000.

USD/CAD likely to turn lower as it approaches strong resistance

USD/CAD

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, 2021 YTD performance from 31 December 2020 to 08 July 2021; 1-week period: 01 July 2021 to 08 July 2021

Our asset class views at a glance

Asset class			
Equities	▲	**Alternatives**	◆
Euro area	▲	Equity hedge	▲
UK	▲	Event-driven	▲
US	▲	Relative value	▼
Asia ex-Japan	◆	Global macro	◆
Japan	▼		
Other EM	◆	**Cash**	▼
		USD	▼
Bonds (Credit)	◆	EUR	▲
Asia USD	▲	GBP	▲
Corp DM HY	▲	AUD	▲
Govt EM USD	▲	CNY	◆
Corp DM IG	▼	JPY	◆
Bonds (Govt)	▼	**Gold**	◆
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	Prior
MON	IN	CPI Inflation y/y	Jun	6.6%
TUE	US	CPI inflation y/y	Jun	4.9%
	US	CPI inflation, core y/y	Jun	3.8%
	CH	Exports y/y	Jun	27.9%
WED	UK	CPI inflation, y/y	Jun	2.1%
	US	PPI, core y/y	Jun	4.8%
THUR	CH	Industrial production	Jun	8.8%
	CH	GDP, y/y	Q2	18.3%
FRI/SAT	SG	Non-oil exports, y/y	Jun	8.8%

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

S&P500 has first support 0.6% below current level

Technical indicators for key markets as on 8 July 2021

Index	Spot	1st support	1st resistance
S&P500	4,321	4,308	4,346
STOXX 50	3,992	3,960	4,055
FTSE 100	7,031	6,986	7,120
Nikkei 225	28,118	27,896	28,562
Shanghai Comp	3,526	3,512	3,547
Hang Seng	27,153	26,767	27,925
MSCI Asia ex-Japan	851	843	867
MSCI EM	1,316	1,303	1,342
Brent (ICE)	74.1	72.6	76.4
Gold	1,804	1,793	1,809
UST 10Y Yield	1.31	1.27	1.39

Source: Bloomberg, Standard Chartered

Investor diversity has normalised across assets

Our proprietary market diversity indicators as of 7 July

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↓	1.55
Global Equities	◐	↑	1.41
Gold	●	↓	1.57
Equity			
MSCI US	◐	↑	1.37
MSCI Europe	◐	↑	1.42
MSCI AC AXJ	●	↑	1.78
Fixed Income			
DM Corp Bond	◐	→	1.40
DM High Yield	◐	↑	1.37
EM USD	◐	→	1.38
EM Local	●	↑	1.54
Asia USD	●	↑	1.66
Currencies			
EUR/USD	●	↑	1.83

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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