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Wealth Management Chief Investment Office
10 February 2023

Weekly Market View

Central banks starting to be heard

- Central banks' hawkish messages, ignored by markets in recent weeks, are starting to sink in. Policy rates at the Fed, ECB and RBA are likely go higher than markets were pricing and, crucially, likely to stay there for longer than markets were anticipating.

- The blowout US jobs and services business confidence indicators, while accentuated by seasonality, were the triggers for the latest repricing of rates, which also led to a mild pullback in risk assets and a rebound in bond yields.

- We believe the strong rally in risk assets in recent months has overpriced the improvement in global fundamentals. Risk assets are likely to face headwinds from tightening real (inflation-adjusted) policy rates and weakening economic and corporate earnings fundamentals.

- Hence, we would trim any overweight allocations to US and Euro area equities, and gradually rebalance into higher quality bonds and other income assets.

Do you expect US government bond yields and the US dollar to rise further after the latest blowout jobs report?

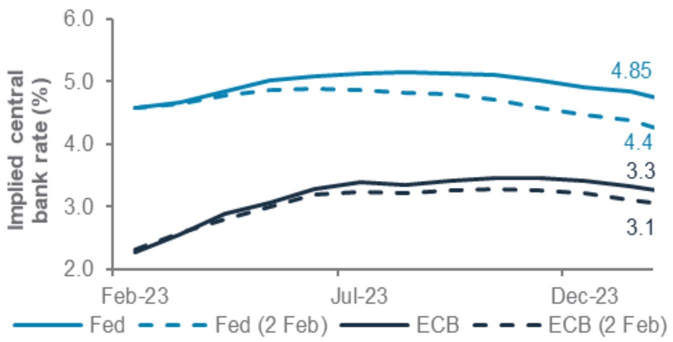
What is the outlook for crude oil prices and energy sector equities?

What is the outlook for semiconductor sector equities amid US-China tensions?

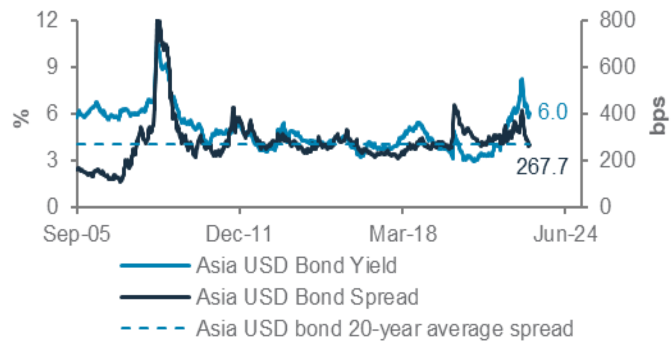
Charts of the week: Opportunities amid rates repricing

We expect Asia USD bonds to outperform as US and Euro area interest rate expectations rise

Fed Funds, ECB deposit rate expectations, today vs week ago



Asia USD bond yield and premium over US government bonds



Source: Bloomberg, Standard Chartered

Editorial

Central banks starting to be heard

Central banks' hawkish messages, ignored by markets in recent weeks, are starting to sink in. Policy rates at the Fed, ECB and RBA are likely go higher than what markets were pricing and, crucially, likely to stay there for longer than markets were anticipating. The blowout US jobs and services business confidence (PMI) indicators, while accentuated by seasonality, were the triggers for the latest repricing of rates, which also led to a mild pullback in risk assets and rebound in bond yields.

We believe the strong rally in risk assets in recent months has overpriced the improvement in global fundamentals (as Europe averted widespread energy shortages due to a mild winter and China's economy reopened earlier-than-expected). Risk assets are likely to face headwinds from tightening real (inflation-adjusted) policy rates and weakening economic and corporate earnings fundamentals. Hence, we would continue to fade the rally in risk assets and gradually rebalance into higher quality bonds and other income assets. Better opportunities in riskier assets are likely to arise when core inflation and wages decline sustainably (watch core services, ex-housing inflation in next week's US data) or the job market deteriorates sharply, allowing central banks to cut rates and focus on supporting growth.

US government bond yields have jumped more than 30bps and the USD has bounced since the January US jobs report, which saw payroll gains nearly three times consensus estimates. While average weekly wage growth moderated to 4.4% y/y, aggregate weekly payrolls (payrolls x hours x earnings) jumped in January, reversing past year's trend. Separately, US services PMI (ISM) rebounded strongly from contraction territory (55.2), driven by a surge in new orders (60.4), new export orders (59.0) and business activity (60.4). Taken together, the data points to a still-robust economy, driven by services consumption.

This incoming data explains why Fed Chair Powell and other policymakers highlighted the need for continuing with monetary tightening and holding rates restrictive for a long period of time (New York Fed President Williams this week said he expects to keep rates restrictive "for a few years" to bring inflation back to 2%). Similarly, ECB officials warned they are a long way off from pausing rate hikes, given a more challenging inflationary backdrop (especially core inflation) than the US.

While central banks remain hawkish due to inflation concerns, other US leading indicators, especially in the manufacturing and housing sectors, are deteriorating. These include declines in the job quits-to-layoffs ratio from very high levels, manufacturing sector inventories growing faster than new orders, orders backlog shrinking, building permits contracting, persistent inversion of the US government bond yield curve, rising auto loan defaults and a contraction in money supply. The latest Fed loan officers' survey too pointed to flagging demand for loans and tightening lending conditions at banks.

Investment implications: Given the combination of strong services sector, a weakening manufacturing sector, elevated wage pressures and hawkish central banks, we expect headwinds for corporate earnings and valuations. As a result: a) We would trim any overweight allocations in US, Euro area equities (we retain a Neutral weight in both those markets within equities) – the S&P500 index has broken below the 4,100 technical support level, raising the risk of declines towards the next supports (4,015 and 3,886). The EuroStoxx 50 index is approaching key resistance levels around 4,288 and 4,396; b) Equity investors may consider rotating into Hong Kong and China equities, particularly if the Hang Seng index reaches key support levels at 20,300 and 19,300; c) More broadly, we would rebalance from equities to an income basket, which now offers better yields. For those looking for better entry levels – the next key resistance levels for US 10-year yield are 3.7% and 3.9%. Asia USD bonds remain our preferred area in bonds as spreads continue to tighten amid China's improving growth outlook.

— **Rajat Bhattacharya**

The weekly macro balance sheet

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

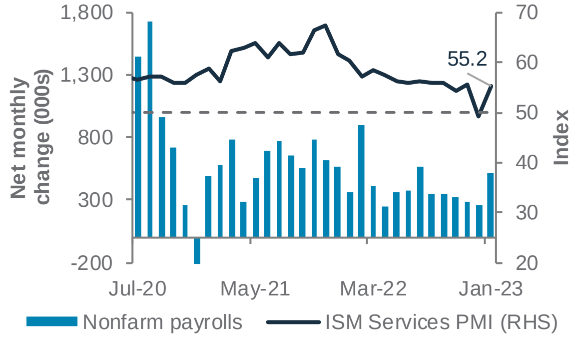
(+) factors: Resilient US labour market and services

(-) factors: Hawkish central bank officials, higher crude oil prices

	Positive for risk assets	Negative for risk assets
Macro data	• US job creation (517k in Jan) surprised to the upside, Nov and Dec data revised higher; unemployment rate fell to 3.4%, lowest since 1969 • US ISM services PMI surged more than expected to 55.2, the largest monthly gain since June 2020 • Euro area Sentix investor sentiment rose for fourth consecutive month to -8.0 • China consumer inflation rose as expected (2.1% y/y); producer prices fell more than consensus	• Euro area retail sales fell more than expected by 2.8% y/y • German industrial production missed estimates, falling 3.1% m/m in December
	Our assessment: Positive – Resilient US labour market and services, recovering Euro area sentiment, still-stable China inflation	
Policy developments	• Current BoJ Deputy Governor Amamiya, widely regarded as a dove, is reported to be the leading contender to replace Governor Kuroda in April	• Fed Chair Powell, Kashkari and Bostic highlighted labour market resilience and flagged the need to continue rate hikes • ECB officials pushed back against rate hike pause • The RBA hiked 25bps and signalled more hikes
	Our assessment: Negative – Hawkish central bank officials	
Other developments	• US President Biden committed to raising the debt ceiling to avoid default; hinted at a reduced budget deficit of USD 2trn • China plans to resume food imports from Taiwan	• Saudi Aramco announced a rise in crude oil prices for Asia in anticipation of a recovery in demand • US-China tensions rose over what the US called a Chinese spy balloon over the coast of South Carolina
	Our assessment: Negative – Higher crude oil prices inflationary, US-China tensions	

Strong US job market and continued services sector strength point to elevated policy rates for the coming quarters

US monthly net new jobs, ISM Services PMI



Source: Bloomberg; Standard Chartered

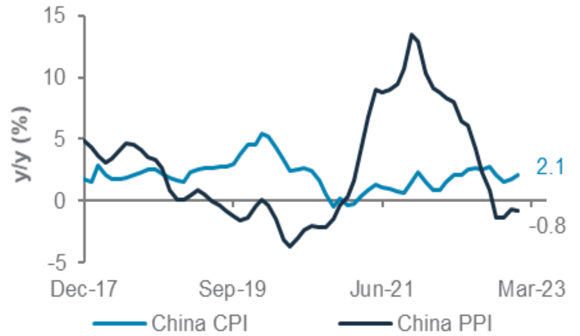
Euro area investor confidence rose for the fourth straight month, but retail sales fell more than expected

Euro area Sentix Investor Confidence index, retail sales

Source: Bloomberg, Standard Chartered

China's consumer inflation remained well within the central bank's 3% target, while producer prices fell more than expected; this should support sustained stimulus measures

China consumer and producer price inflation



Source: Bloomberg, Standard Chartered

Top client questions

Do you expect US government bond yields and the USD to rise further after the latest blowout jobs report?

Both the 10-year US government bond yield and the USD soared after the strong January payrolls data. The market has priced a higher likelihood of a soft-landing scenario in which the labour market remains tight even as growth slows. On monetary policy, the market seems to have given up on its earlier expectations of a Fed pause following a 25bps hike in March. Money markets have now priced in an extra 25bps hike in June, driving the expected terminal rate higher to 5.25%. In addition, multiple Fed speakers this week have voiced their support for higher rates.

For US government bonds, we see slim odds for the 10-year yield to break significantly higher from here. The money market implied terminal rate, after moving higher over the past week, is now aligned with the Fed's December median projection of 5.125%. With rate hike expectations now looking more normalised, yields are likely to be capped going forward. From a technical standpoint, the 10-year yield failed to break 3.7% this week, reaffirming it as reasonable resistance. If we break higher, we see the next resistance near 3.9%. As such, we view the recent spike in yields as an opportunity to add into high quality income assets. Within bonds, we still find Asia USD bonds attractive given the dominance of Investment Grade bonds.

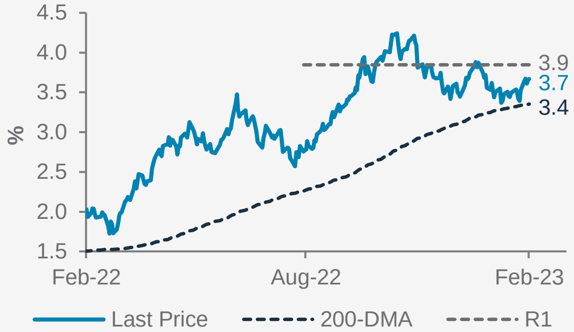
We expect the recent USD bounce to be short-lived and the greenback to consolidate in the next few weeks before resuming its downtrend. While Fed Chair Powell's hawkish rhetoric has contributed to the USD bounce, we expect the increase in Fed funds rates to be lower than what is priced by the markets for ECB, RBA and RBNZ rates. Therefore, we expect real (net of inflation) interest rate differentials to move against the USD in the coming months. China's re-opening and the recent optimism around global growth are likely to remove the marginal safe-haven demand for the USD. From a technical perspective, the speed of the recent USD rebound, and corresponding EUR decline, suggests stretched long-USD positioning has likely moderated significantly. The relative strength index (a momentum indicator) for the USD has moved from close to oversold territory to a neutral zone. Therefore, we see the 50-day moving average at 103.5, followed by 104.7, as strong resistance levels, while technical support levels are at 102.0, followed by 100.8.

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

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

US 10-year government bond yield failed to break above 3.7%; the next resistance is around 3.9%

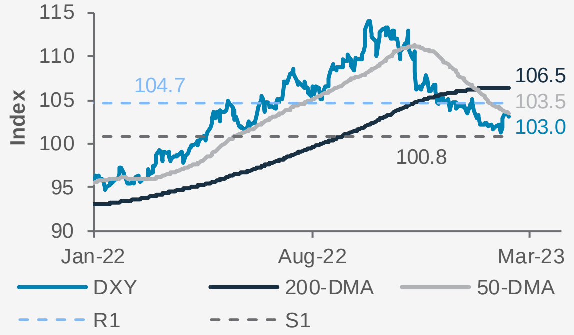
US 10-year government bond yield



Source: Bloomberg, Standard Chartered

We expect the USD to face strong resistance around the 50DMA of 103.5, followed by 104.7

USD index (DXY)



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is your outlook on crude oil and energy equities?

Crude oil seesawed in the last few weeks amid a tug of war between demand and supply factors. There were also a few significant developments that drove price action.

On the demand side, rising inventories in the US suggest weakening demand. In Europe, a price cap on Russian diesel kicked in on 5 February. In China, while reopening demand remained strong, Chinese traders were absent due to the Lunar New Year holiday.

On the supply side, OPEC+ stayed put on its output against market expectations of an output cut. Meanwhile, Saudi Aramco raised crude oil prices, especially in Asia, as it expects stronger demand from the region on China's reopening. Earthquakes in Turkey also led to a temporary reduction in supply from its Ceyhan oil terminal.

The medium-term impact from supply disruptions in Turkey is probably minimal given the low flows (c.1mb/d) and likely quick resumption of operations at the oil terminal. The new EU price cap on Russian diesel will likely redirect flows to non-EU countries, limiting supply reductions. However, we expect OPEC+ to keep its supply tight despite emerging signs of higher demand, particularly from China. On balance, we believe oil prices are likely to grind higher in the near term. In the long run, we see a deteriorating growth outlook fading the rally to stabilise at USD 75/bbl.

Within equities, we are Overweight both US and European energy sectors. About half of the US energy stocks have reported so far in the Q4 FY22 earnings season, delivering +1.7% earnings surprise. Even though the magnitude is less versus previous quarters, the US energy sector is still registering earnings growth at +60% y/y, the highest amongst the 11 sectors in the S&P500 index.

The S&P500 energy sector index has been range-bound for the last three months, in a tight 10% range. The sector continues to lag its earnings rebound and its cheap valuation provides a good entry opportunity, in our opinion. Companies in the sector have been taking advantage of the strong crude prices over the last two years to pay down debt, improve interest coverage ratios and boost share buybacks and dividends. Investors should consider buying the S&P500 energy sector index at the lower end of the trading range, which is c.5% lower from the current spot price.

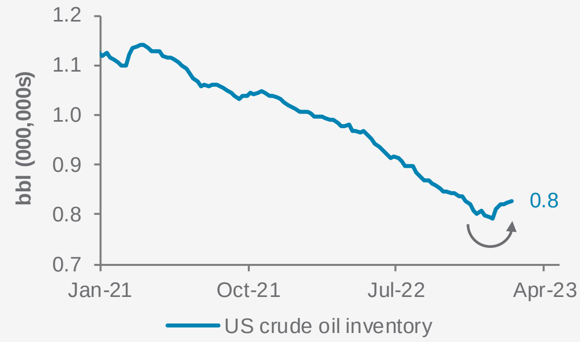
In Europe, the energy sector continues to offer attractive valuation and is at deep discount to the broader market. The sector is highly cash generative and sector leaders have shown the ability to innovate and adapt to a cleaner energy portfolio.

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

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

The recent build-up of US crude oil inventories suggests weakening demand

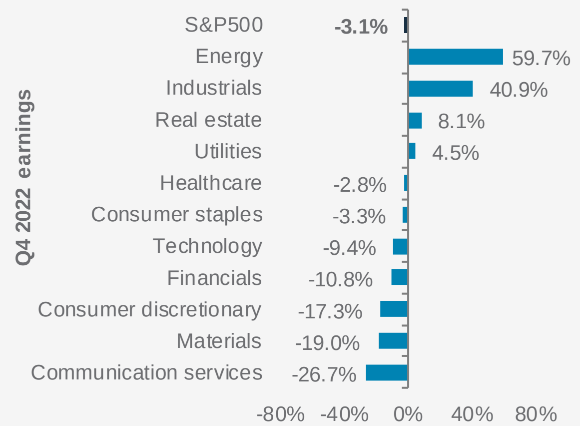
US crude oil inventories



Source: Bloomberg, Standard Chartered

US energy sector earnings in Q4 22 have significantly outperformed other sectors

S&P500 Q4 22 earnings growth by sectors



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is the outlook for the global semiconductor industry, especially given the escalating US-China tensions?

Amid rising US-China geopolitical tensions, there are reports of 1) the US government considering a ban of direct investments in certain high-tech sectors in China and 2) other countries joining the US in restricting the sale of advanced machinery to China. These moves are not surprising, with increasing rivalry in a multi-polar world. For US semiconductor companies, China comprises 31% of sales and while it is unlikely all of these will be deemed "high-tech", any sales restriction would have a negative impact on US companies selling to China. The negative impact could be mitigated if sales can be diverted to other countries. Indeed, non-China Asian companies could benefit if they can make the necessary semiconductor investments and sell end-products to China. With decreased competition, they would be able to generate higher returns.

Aside from geopolitics, the downtrend in memory chip prices is likely to continue until Q2/Q3 FY'23. The structural demand for chips remains robust, with AI grabbing more attention now, in addition to the digitalisation and electrification trends. However, we would not underplay the impact from a potential US recession that could hit demand cyclically. We have a Neutral view on the US technology sector, including semiconductor stocks, over the next 6-12 months.

— **Fook Hien Yap,** *Senior Investment Strategist*

Do you expect issues related to the Adani Group to impact India's consistently high equity market valuations?

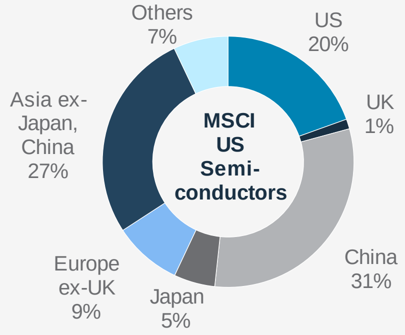
One of India's largest conglomerates, Adani, has come under pressure on concerns about corporate governance, with the group's total market capitalization of bonds and shares down over USD 100bn since the publication of a report by Hindenburg. MSCI has cut its weighting for four Adani firms in its indices after the report. Indian equities have partly recovered from the initial drop, with the Nifty Index down just 1.7% YTD.

In our view, the risk of a contagion is limited given the low exposure of Indian banks and domestic mutual funds to the group. India's macro fundamentals remain strong as the recent pro-growth budget, while maintaining fiscal prudence, is likely to keep inflationary expectations muted and support India's growth recovery, which remains superior to peers. Further, domestic interest rates are expected to peak, with the RBI rate hike this week likely the final in this tightening cycle. Corporate earnings are the strongest since 2004. The consensus expects the Nifty index to deliver 13% and 15% EPS growth for FY 2023 and FY 2024, making it four consecutive years of double-digit gains. In addition, light foreign investor positioning in Indian equities (~USD 20bn outflows over the last 12 months) and resilient domestic equity flows supported by strong monthly inflows into stable systematic investment plans are key supports for the equity market. We expect Indian equities to perform in line with Asia-ex Japan equities given elevated valuations.

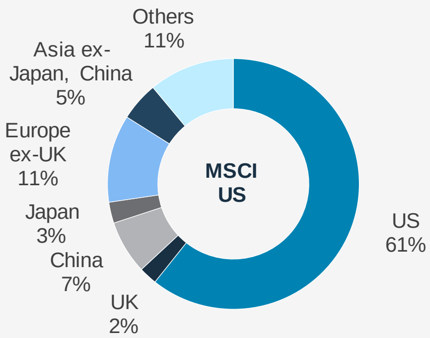
— **Vinay Joseph,** *Head of Investment Products and Strategy, India*

US semiconductor companies generate a significant 31% of sales from China, more than the broader US equity market. Any sales restriction to China could have a negative near-term impact

Revenue exposure for MSCI US semiconductors index, by geography



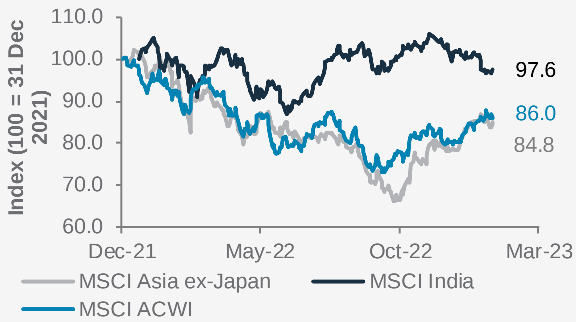
Revenue exposure for MSCI US index, by geography



Source: MSCI, FactSet, Standard Chartered

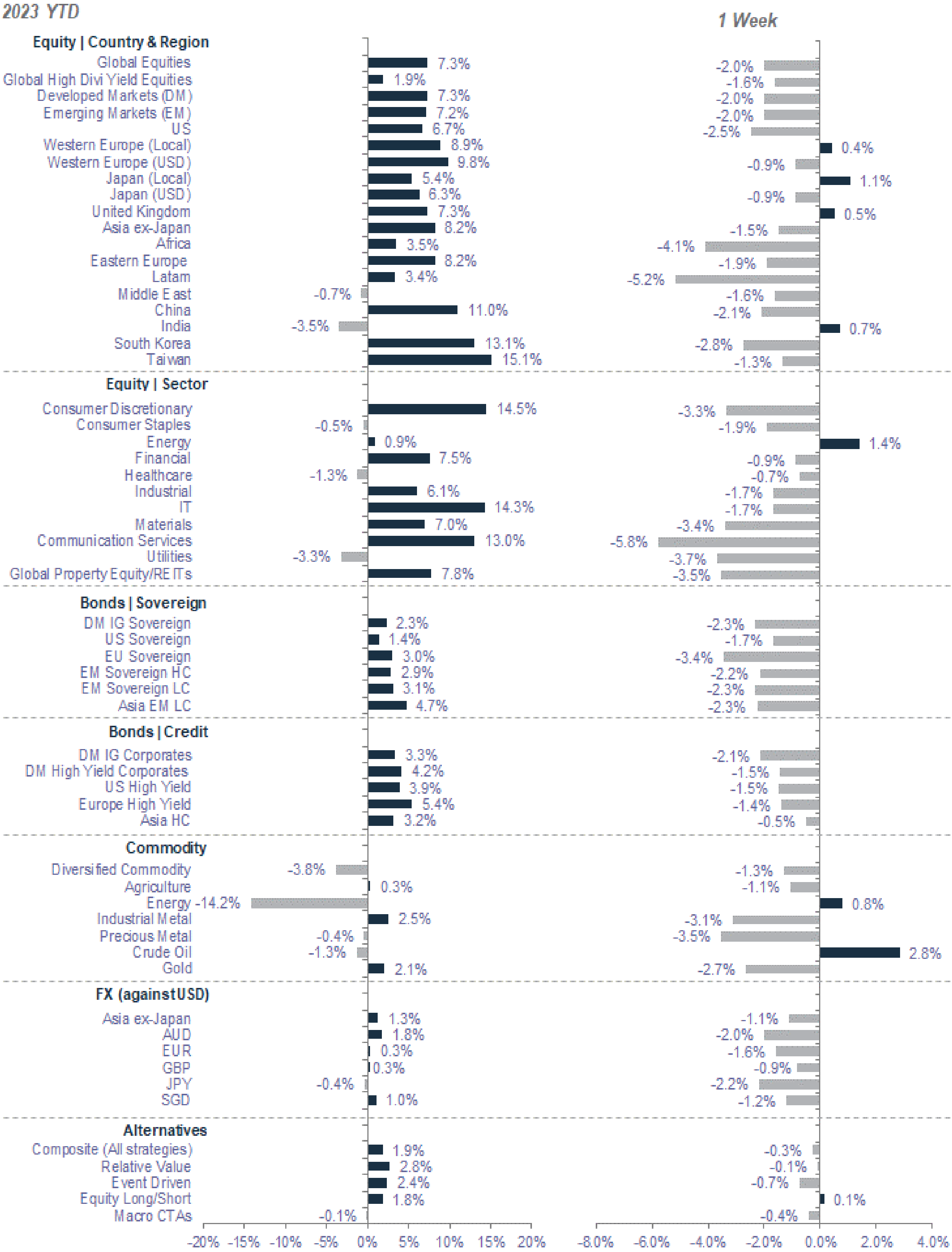
Indian equities have underperformed global and Asia ex-Japan stocks lately after significantly outperforming both the benchmarks last year

Relative performance of MSCI India index vs MSCI All Country World and MSCI Asia ex-Japan indices (100 = 31 Dec 2021)



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 9 February 2023; 1-week period: 2 February 2023 to 9 February 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	UK	Jobless Claims Change	Jan	–	19.7k
	UK	ILO Unemployment Rate 3mths	Dec	–	3.7%
	US	NFIB Small Business Optimism	Jan	–	89.8
	US	CPI y/y	Jan	6.2%	6.5%
	US	CPI Ex Food & Energy y/y	Jan	5.5%	5.7%
WED	UK	CPI y/y	Jan	–	10.5%
	UK	CPI Core y/y	Jan	–	6.3%
	US	Empire Manufacturing	Feb	-22	-32.9
	US	Retail Sales Ex Auto and Gas	Jan	0.5%	-0.7%
	US	Industrial Production m/m	Jan	0.7%	-0.7%
THU	US	Housing Starts	Jan	1363k	1382k
	US	PPI Final Demand y/y	Jan	5.5%	6.2%
	US	PPI Ex Food and Energy y/y	Jan	–	5.5%
FRI/SAT	UK	Retail Sales Ex Auto Fuel y/y	Jan	–	-6.1%
	US	Leading Index	Jan	-0.3%	-0.8%

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

US 10-year Treasury yield faces next resistance at 3.72%

Technical indicators for key markets as of 9 February close

Index	Spot	1st support	1st resistance
S&P 500	4,082	4,054	4,137
STOXX 50	4,250	4,218	4,270
FTSE 100	7,911	7,862	7,936
Nikkei 225	27,711	27,576	27,779
Shanghai Comp	3,270	3,245	3,283
Hang Seng	21,624	21,344	21,783
MSCI Asia ex-Japan	670	661	677
MSCI EM	1,025	1,013	1,037
WTI (Spot)	84.5	81.3	86.4
Gold	1,862	1,858	1,871
UST 10y Yield	3.67	3.57	3.72

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 remains low in European stocks

Our proprietary market diversity indicators as of 9 February

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.38
Global Equities	◐	↓	1.36
Gold	◐	↓	1.34
Equity			
MSCI US	◐	↑	1.42
MSCI Europe	◐	↓	1.25
MSCI AC AXJ	◐	→	1.30
Fixed Income			
DM Corp Bond	◐	↓	1.33
DM High Yield	◐	↓	1.32
EM USD	◐	↓	1.35
EM Local	○	↓	1.27
Asia USD	◐	→	1.27
Currencies			
EUR/USD	◐	↓	1.36

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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