Wealth Management Chief Investment Office
27 January 2023

Weekly Market View

Complacent markets?

→ Resurgent markets are about to collide with central bank policy as the Fed and the ECB meet next week for the first time this year. It promises to be a sequel to the saga which unfolded a year ago, but with a discernible twist.

→ A year ago, central banks sought to stamp their authority on markets as they took on then-raging inflation, embarking on one of the sharpest rate hikes in history. Most asset classes suffered.

→ This year, central banks appear to have gained the upper hand, with headline inflation peaking across economies. While some central banks such as the Bank of Canada have signalled a pause in rate hikes, we believe it is too early for the Fed and ECB to declare victory.

→ Hence, we believe our SAFE portfolio is still a good way to balance the risks with the emerging opportunities until we get further clarity on central bank policy.

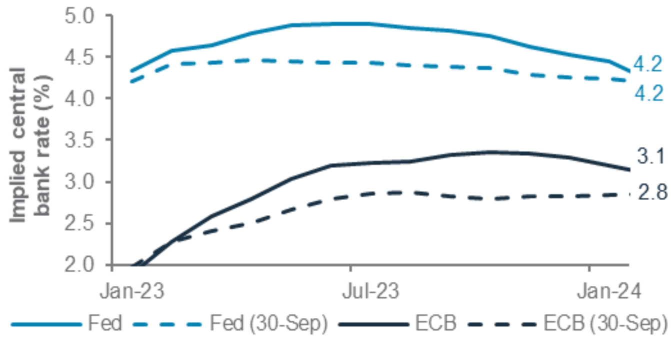
Important disclosures can be found in the Disclosures Appendix.

Charts of the week: Complacent markets into Fed, ECB meetings

Narrowing breadth suggests stretched positioning in some assets; hawkish Fed and ECB policies could trigger a reversal

US Greed/Fear indicator shows narrowing breadth/rising greed

Fed, ECB forward rate expectations curves: today vs Sep 22



Source: Bloomberg, Standard Chartered

Editorial

Complacent markets?

Resurgent markets are about to collide with central bank policy as the Fed and the ECB meet next week for the first time this year. It promises to be a sequel to the saga which unfolded a year ago, but with a discernible twist. A year ago, central banks, led by the Fed, sought to stamp their authority on markets as they took on then-raging inflation, embarking on one of the sharpest set of rate hikes in history. Most asset classes suffered. This year, central banks seem to be gaining the upper hand, with headline inflation peaking. As a result, some have started to call truce – the latest being the Bank of Canada, which signalled a pause after hiking rates 425bps since March.

We believe it's too soon for the Fed and the ECB to declare victory as their job markets remain hot. The two central banks are worried about easing financial conditions too soon and letting underlying wage inflation pressures accelerate. Given this backdrop, it would be prudent to fade the rally in some asset classes where investor positioning particularly look stretched. We believe our SAFE portfolio, which has performed strongly since we issued our 2023 Outlook in mid-December, is still a good way to balance the risks with the emerging opportunities until we get further clarity on central bank policy.

In our view, three broad themes have driven the rally in some assets this year: a) Europe's record warm winter removing the tail risk of an energy crisis; b) further signs of weakness in US economic activity and easing inflation, raising the odds of an early pause in Fed hikes; and c) China's early lifting of mobility restrictions. However, our proprietary indicator shows investor positioning has become crowded in most assets that have led the rally, raising the odds of at least some consolidation. These assets include European and Asia ex-Japan equities, Asia local currency and Europe HY bonds, industrial metals, gold and the AUD. Next week's Fed and ECB policy meetings could be the catalysts for a near-term reversal, with expectations of a dovish shift in Fed policy raising the risk of a disappointment.

Markets have pared back expectations of the terminal Fed Funds rate by 10bps, expecting 25bps rate hikes in Feb and March before a pause. However, Fed officials have thus far remained resolutely hawkish until they see clearer signs of the job market and service sector wages easing. In Europe, the better-than-expected weather, which helped revive consumer and business confidence, raises the odds of a more hawkish ECB. A hawkish ECB, against the backdrop of stretched technicals, would challenge the Euro area equity rally.

There is a window for risk assets to continue rallying, after perhaps a near-term consolidation. Essentially, markets would need a confirmation that the US and Europe are heading for a soft-landing, followed by an economic revival, to justify the rally in risk assets so far. On this front, this week's US Q4 GDP data (2.9% growth) was stronger than expected, boosted mainly by private inventory, although personal consumption slowed. A hot job market, seen in high job openings and near-record low jobless claims, point to a resilient services sector (Jan jobs data due on 3 Feb). However, contracting US PMIs and sustained negative reading of the leading index suggest activity is slowing significantly after a robust Q4 22. The contrast in the forward- and backward-looking data poses a quandary for the Fed. Meanwhile, Euro area's outlook continued to improve, with services PMI returning to positive territory for the first time since July 22, providing further ammunition for hawkish ECB policymakers to propose a 50bps rate hike next week.

Investment implications: We would a) Refrain from chasing the rallies, given crowded positioning; b) Ensure portfolios are diversified and in line with your risk tolerance; c) Remain watchful for signs of the Fed preparing to cut rates before turning more constructive on risk assets (we expect the Fed to cut rates only in H2); d) Favour income: A diversified income portfolio remains a good way to play the current situation – earning income, while awaiting clarity on central bank policies.

— 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.

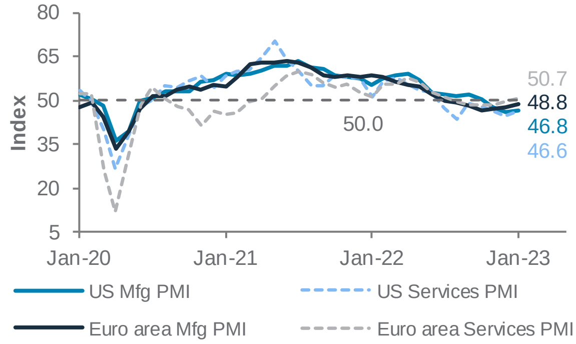
(+) factors: Recovering Euro area PMIs, strong US Q4 GDP

(-) factors: Still-hawkish DM central banks, sluggish US leading indicator

	Positive for risk assets	Negative for risk assets
Macro data	• US mfg. and services PMI recovered more than expected, but remained in contraction territory at 46.8 and 46.6, respectively • Euro area mfg. PMI recovered more than expected to 48.8; services PMI back into expansionary territory to 50.7 • German IFO Expectations index rose to its highest since May 22 • Stronger-than-expected US Q4 GDP growth of 2.9% (annualised)	• US leading indicator contracted more than expected by 1.0% m/m • Lower-than-expected US initial jobless claims • US business spending (core durable goods orders) fell 0.2% m/m • Euro area consumer confidence improved less than expected • UK composite PMI fell more than expected to 47.8, led by drop in services PMI (48) • Australia consumer inflation surprised to the upside
	Our assessment: Neutral – Recovering Euro area PMIs, strong US Q4 GDP vs still-contracting US PMIs, sluggish US leading indicator	
Policy developments	• BoJ minutes revealed that the central bank is satisfied with its accommodative monetary policies; board members expect inflation to moderate in 2023 • Bank of Canada hiked rates by 25bps as expected, but signalled a pause as it assesses past hikes' impact	• Fed's Harker favoured raising rates slightly above 5%, while Waller favoured a 25bps hike at next meeting • ECB's Lagarde and Simkus said rates will continue rising significantly, while Panetta wants to reassess policy outlook based on latest data
	Our assessment: Negative – Still-hawkish DM central banks	
Other developments		• US confronted China with evidence that some Chinese state-owned enterprises are aiding Russia's war effort • Germany and the US decided to supply battle tanks to Ukraine, escalating tensions
	Our assessment: Negative – Geopolitical tensions	

US business confidence indices remained in contraction territory, while Euro area indicators continued to recover

US and Euro area manufacturing and services PMIs



Source: Bloomberg; Standard Chartered

The US leading index continued to contract, raising the risk of a recession in the coming quarters

US leading index

Source: Bloomberg, Standard Chartered

Euro area consumer confidence and economic expectations continued to improve as a warm winter reduced the risk of energy shocks

Euro area consumer confidence; German IFO Expectations index

Source: Bloomberg, Standard Chartered

Top client questions

What is the near-term outlook for US 10-year yields?

US government bond yields continued to trade in range, with the 10-year yield hovering around 3.5%. We attribute the recent moves to:

1. Dovish global policy developments, such as the Bank of Japan reiterating its support for its accommodative policy and the Bank of Canada signalling a "pause" in rate hikes, have bolstered investors' expectation for the Fed to signal an imminent pause in its rate hiking cycle. Money markets are pricing in two 25bps Fed rate hikes by the end of Q1 followed by a pause until mid-2023.
2. Economic data was mixed. Although manufacturing data was weaker, the US labour market appeared strong as initial jobless claims hit the lowest since March 2022.
3. Short-term technical indicators are still looking bearish and point to a strong support for the US 10-year yield at 3.408%.

Against this backdrop, we expect US government bond yields to rebound in the coming weeks. First, we believe markets have significantly priced in the dovishness of the Fed. The surprisingly hawkish shift of the BoJ last December was a one-off event, in our view, at least until BoJ Governor Kuroda retires in April. We also expect the ECB and BoE to stay on their rate-hiking course. We would use any rebound in US government bond yields to add to quality income assets, such as Asia USD bonds.

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

The US 10-year government bond yield is testing near-term technical support

US 10-year Treasury yield and 200-day moving average

Source: Refinitiv, Standard Chartered

What is the outlook for the USD and gold after the sharp moves in recent months?

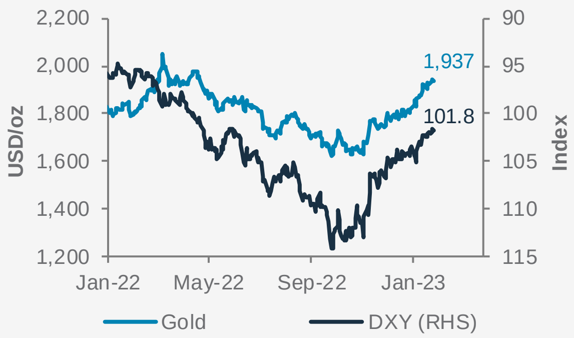
Since November 2022, we have seen a sharp decline in the USD index (DXY), driven by markets pricing fewer Fed rate hikes and a more hawkish ECB stance, eroding the USD's expected interest rate advantage. Elevated recession concerns have also pulled long-term bond yields in the US lower. However, ahead of the Fed meeting next week, we see the risk of complacency in markets. With multiple Fed members still sticking to their hawkish stance, there is a risk that any hawkish surprise from the Fed could lead to a short-term bounce in the USD, especially the light positioning and stretched technicals. However, given the large weight of the EUR in DXY, we see a hawkish ECB capping any near-term bounce in DXY around 103.

Gold prices have rallied sharply, driven by lower US government bond yields and the recent decline in the USD, given the relatively high correlation. Our proprietary indicator, fractals, is signalling that the recent rally has led to stretched technicals for gold, which has shot past our end-2023 price target of 1,890. Hence, we see elevated risk of a consolidation or even a pullback in the safe-haven metal over the next few weeks. We would prefer to wait for a pullback towards the 1,840 area before adding further exposure to gold.

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

The gold rally appears stretched after strong gains on the back of lower government bond yields and a weaker USD, raising the risk of a pullback

Gold and USD index (DXY, inverted)



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

How is the US earnings season shaping up?

About 25% of companies in the S&P500 index have reported so far with mixed results. According to Refinitiv, 69% of these companies have "beaten" expectations (compares with the long-term average of 66%), delivering a positive earnings surprise of 2.4%. However, earnings growth for Q4 FY22 is still expected to be negative at -2.7% and this estimate is revised down from the -1.6% expected at the start of the year. In fact, earnings estimates for every quarter in 2023 have been trimmed since the start of the year, as analysts reassess the likelihood of a growth slowdown and companies provide softer guidance. For FY23, consensus expectation stands at 3.1%, revised down from 4.4% at the start of the year. While earnings expectations are being revised down, revenue expectations have been stable since the start of the year, at 4.1% growth for Q4 FY22. This points to a weakening in margin expectations as the earnings season is progressing.

Sector wise, the US financial sector is most advanced in reporting, with over 50% of companies having reported, delivering a slight 1.0% positive earnings surprise. Q4 FY22 earnings growth is negative for the sector as credit provisions increased and the "provision releases" witnessed in 2021 were not repeated. The credit provisions, however, have been largely within expectations and the sector is expected to benefit from rising interest rates driving 12% earnings growth in 2023.

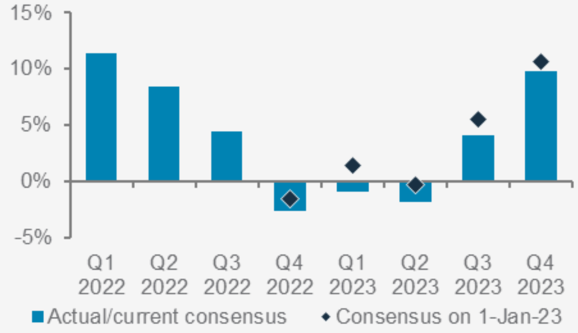
The coming weeks will see several mega cap technology and internet heavyweights reporting earnings. Technology, the largest sector in US equities (weighing over 25%), is expected to see 8.6% y/y decline in Q4 FY22 earnings. We have already seen warnings of a slowdown in cloud computing as growth rates normalise from the acceleration witnessed during the COVID-19 pandemic. There are also signs of weaker corporate spending on software and other technology products. Tech companies have been reacting with job cuts, a rare move after years of robust growth enjoyed by the sector. The technology sector is expected to grow its 2023 earnings by 2.6%, just below the broader market.

We have a neutral view on the financial and technology sectors, which we expect to perform in line with the broader US equities over the next 6-12 months. As we see a high likelihood of a recession in the US, we prefer defensive sectors such as healthcare and consumer staples. We are also Overweight the US energy sector, where we see strong cashflows and attractive valuation.

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

US earnings growth expectations for Q4 FY22 and every quarter in 2023 have been revised down since the start of the year

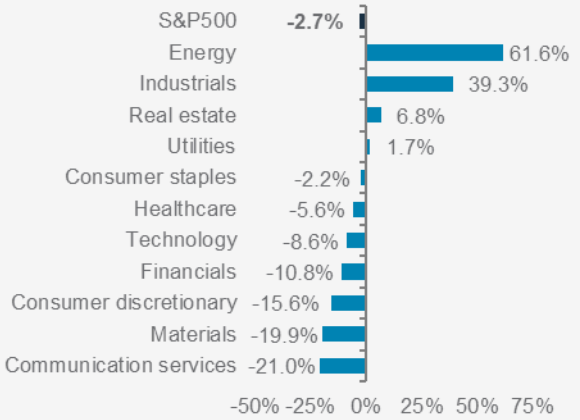
S&P500 index earnings growth (y/y) by quarters



Source: Refinitiv, Standard Chartered

Most US equity sectors are expected to see earnings decline in Q4 FY22, with expectations for weaker profit margins overall

US Q4 FY22 earnings growth (y/y) by sector



Source: Refinitiv, Standard Chartered

Top client questions (cont'd)

Do you expect the crude oil rally to sustain?

Oil prices declined sharply in the first two trading days of 2023 before recovering steadily in the past few weeks. The gradual, but steady, climb in oil prices can be attributed to:

1) A rebound in energy demand in China, the world's largest crude importer, following the government's rapid relaxation of mobility restrictions. China's growth spillovers to Asia are also helping to boost oil demand from the region.
2) An improvement in global economic growth sentiment on positive economic data surprises in Europe and China.
3) Signs of falling crude exports from Russia due to existing sanctions. Seaborne crude exports slumped to 22% to 3.0mb/d last week, according to Bloomberg ship tracking data.

We believe the crude rally can continue to grind higher in the short term. The additional cap on the price of Russia's fuel exports, effective from 5 February, is likely to take away about 600kd/d of diesel supply. The upcoming OPEC+ meeting on 1 February is unlikely to see any tweaks to the current policy. On the demand side, China's reopening will remain supportive of oil prices. From a technical perspective, WTI crude oil's breakout from a seven-month long downtrend that started on 8 June 2022 could see prices move higher towards 83.

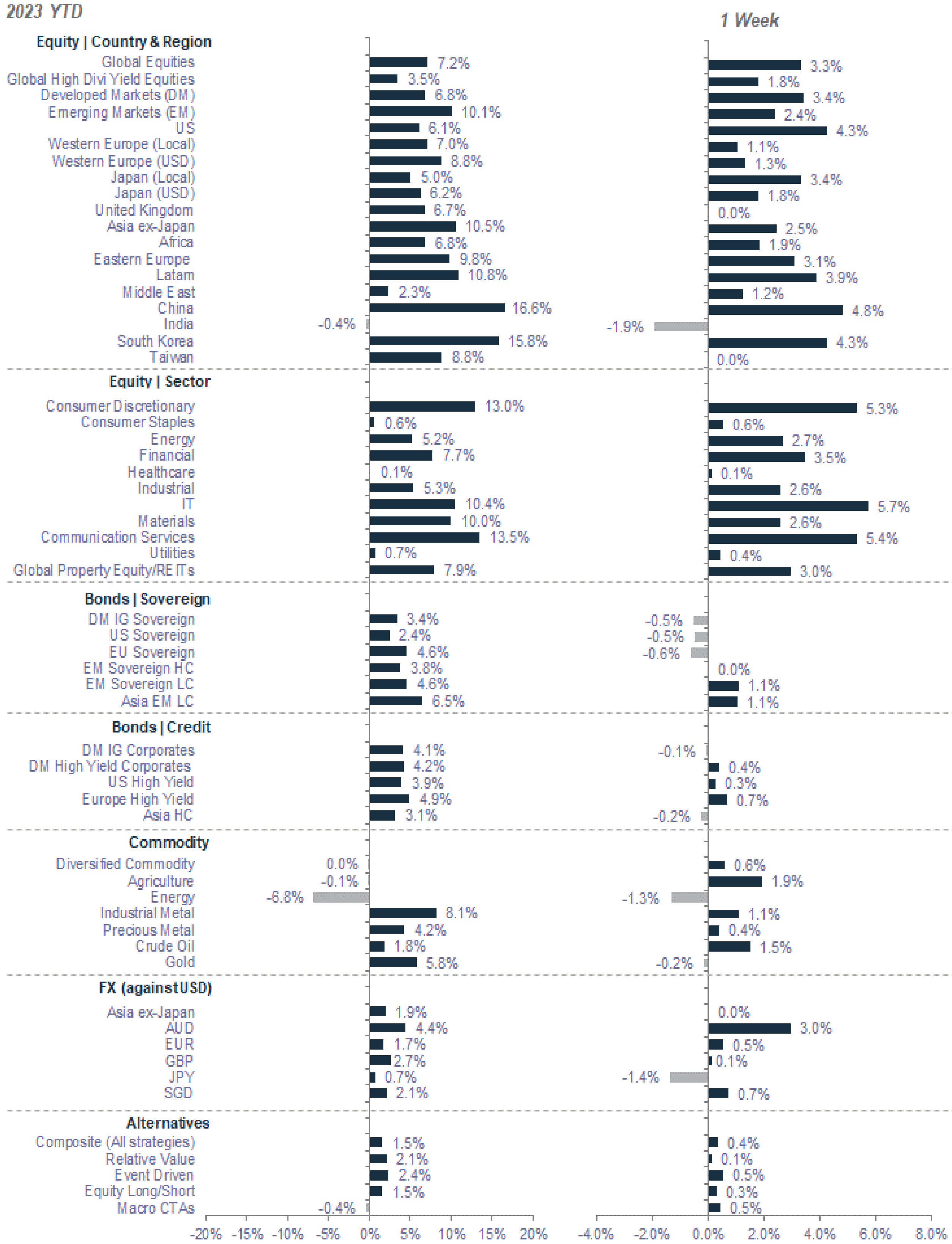
— **Zhong Liang Han, CFA,** *Investment Strategist*

Crude oil rally can continue to grind higher in the near term after breaking out from a seven-month long downtrend

WTI crude oil

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 26 January 2023; 1-week period: 19 January 2023 to 26 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	EC	Economic Confidence	Jan	–	95.8
TUE	CH	Manufacturing PMI	Jan	49.9	47.0
	CH	Non-manufacturing PMI	Jan	51.5	41.6
	CH	Industrial Profits y/y	Dec	–	0.8%
	US	Employment Cost Index	4Q	1.2%	1.2%
	US	Conf. Board Consumer Confidence	Jan	109.4	108.3
WED	CH	Caixin China PMI Mfg	Jan	49.5	49.0
	EC	Unemployment Rate	Dec	–	6.5%
	EC	CPI Estimate y/y	Jan	–	9.2%
	EC	CPI Core y/y	Jan P	–	5.2%
	US	ISM Manufacturing	Jan	48.1	48.4
	US	JOLTS Job Openings	Dec		–10458k
THU	US	FOMC Rate Decision (Upper Bound)	1-Feb	4.8%	4.5%
	UK	Bank of England Bank Rate	2-Feb	4.0%	3.5%
	EC	ECB Deposit Facility Rate	2-Feb	–	2.0%
FRI/SAT	CH	Caixin China PMI Composite	Jan	–	48.3
	CH	Caixin China PMI Services	Jan	–	48.0
	EC	PPI y/y	Dec	–	27.1%
	US	Change in Nonfarm Payrolls	Jan	183k	223k
	US	Unemployment Rate	Jan	3.6%	3.5%
	US	ISM Services Index	Jan	50.5	49.6

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 next resistance at 4,090

Technical indicators for key markets as of 26 January close

Index	Spot	1st support	1st resistance
S&P 500	4,060	4,002	4,090
STOXX 50	4,174	4,138	4,192
FTSE 100	7,761	7,742	7,782
Nikkei 225	27,416	26,841	27,703
Shanghai Comp	3,265	3,218	3,288
Hang Seng	22,567	22,219	22,741
MSCI Asia ex-Japan	684	677	688
MSCI EM	1,052	1,042	1,058
WTI (Spot)	87.5	86.3	88.4
Gold	1,932	1,924	1,944
UST 10y Yield	3.50	3.46	3.53

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 Asia ex-Japan stocks

Our proprietary market diversity indicators as of 26 January

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.32
Global Equities	◐	↓	1.41
Gold	○	↓	1.23
Equity			
MSCI US	●	↑	1.59
MSCI Europe	◐	↓	1.25
MSCI AC AXJ	○	→	1.23
Fixed Income			
DM Corp Bond	◐	↓	1.29
DM High Yield	◐	↓	1.31
EM USD	◐	↓	1.28
EM Local	○	↓	1.19
Asia USD	◐	→	1.27
Currencies			
EUR/USD	○	↓	1.25

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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