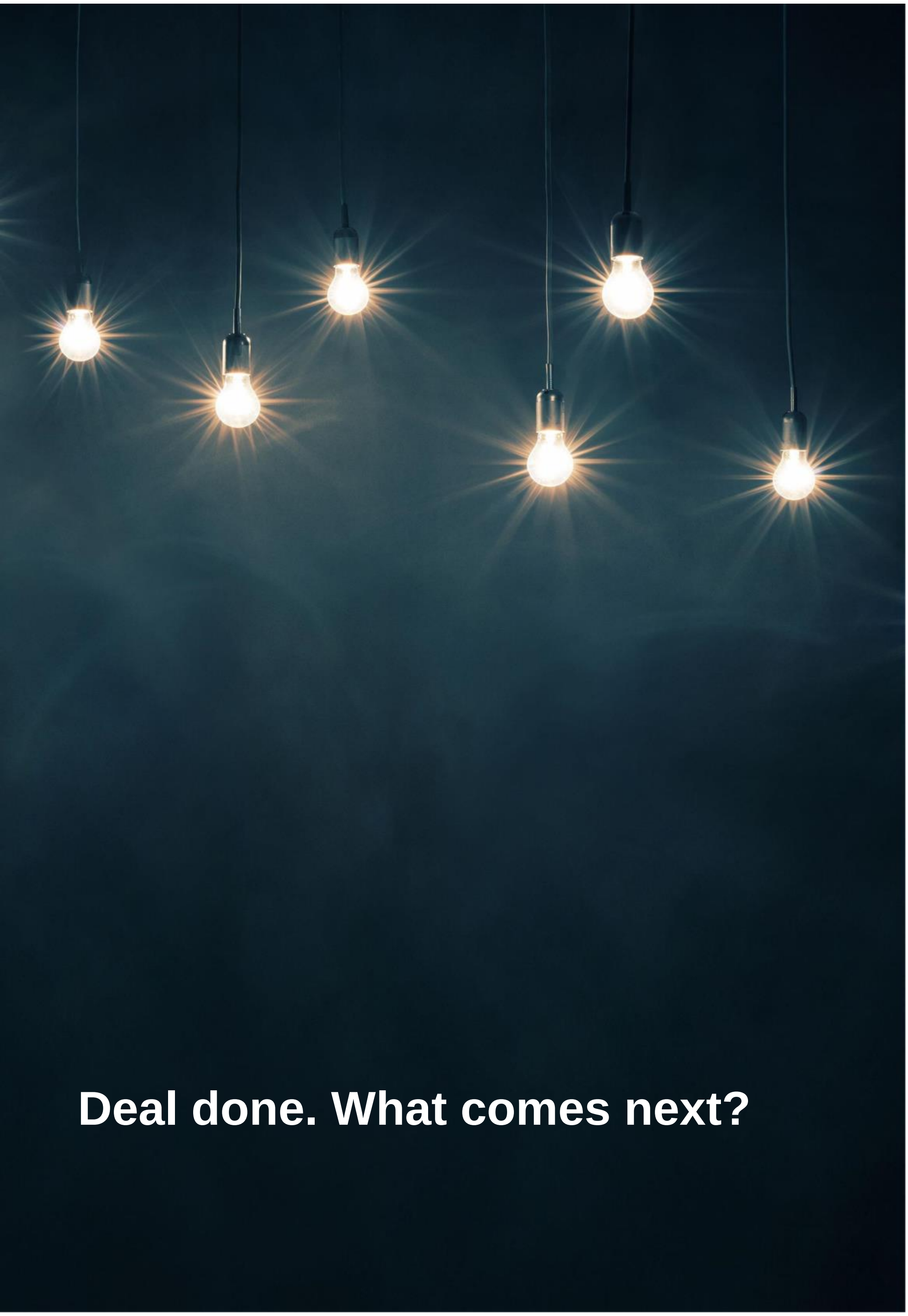
Macro Strategy | 17 January 2020

Standard Chartered Private Bank

Weekly Market View



Deal done. What comes next?

The US-China 'phase one' trade deal is done, but this may already be priced in. Investor positioning, earnings, US-EU trade talks and US politics are next likely market drivers

Equities: Markets are stretched near term, but we would buy the dip. US and Euro area equities remain preferred as focus shifts to a rebound in 2020 earnings

Bonds: Still-strong demand likely remain key driver for Asia USD bonds

FX: A likely break above 1.1250-70 may accelerate EUR/USD gains

Contents

Chart of the week: Equity pullback risk rising despite trade deal

US Equities (MSCI US Index): Shaded areas illustrate periods where our proprietary market diversity indicator signalled a high probability of a trend reversal

Source: Bloomberg, Standard Chartered

Editorial

Deal done. What comes next?

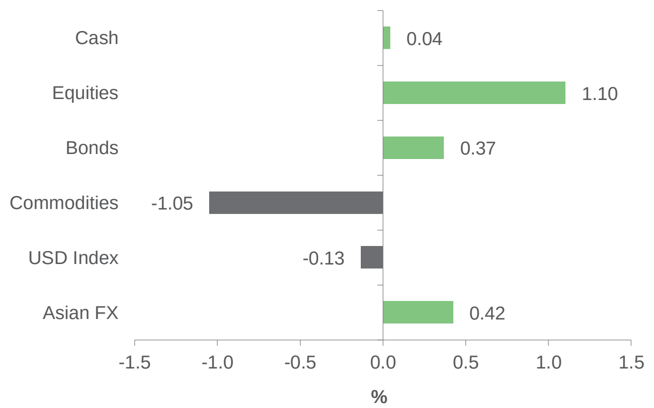
The US and China finally put pen to paper, signing a 'phase one' trade deal. This is likely to marginally support economic growth both in the US (from increased goods purchases by China) and China (from reduced tariffs) over the coming year. Having said that, the 'phase one' agreement leaves out some relatively more difficult topics (such as intellectual property theft safeguards). With few-to-no surprises in the agreement, it is most likely priced in.

This returns the focus to economic, earnings and positioning data. Stretched equity market positioning and low market diversity point to a relatively high chance the market rally may take a breather (though this may not occur immediately, as the chart illustrates). However, still-strong US labour markets and what is likely to be a reasonably strong US earnings season mean we would be prepared to buy any dip in equities.

Near term, we would also watch US politics closely. We see low chances of President Trump being impeached in the Senate, but shifting prospects of Democrat Presidential candidates could impact markets.

Global equities had another strong week as the US earnings season started, but commodities eased despite a softer USD

Benchmark market performance w/w*



Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

*Week of 9 January 2020 to 16 January 2020

US-China sign 'phase one' trade deal

The US and China signed a 'phase one' trade deal on 15 January. Key elements of the agreement include (i) a commitment by China to increase purchases of US goods (especially agriculture, energy and manufactured goods) significantly, (ii) reducing the September rise in US tariffs by half to 7.5% from 15% (though other US and Chinese tariffs remain unchanged), and (iii) commitments on intellectual property protection, market access and avoidance of persistent Chinese intervention in its currency market. The agreement also allows either side to unilaterally take 'remedial measures' if they believe the other side has breached the deal following a consultation process.

In our assessment, the deal is modestly positive, both from a growth and risk perspective. Most reports argue for a small positive impact (on the scale of 0.1-0.2% of GDP growth) for both US and Chinese growth. The agreement also reduces the risk of a new round of tariff escalation, at least in the short term.

However, most tariffs remain in place with no plans for reductions, and the feasibility of meeting purchase targets is unclear. It is also not clear how a 'phase two' process on more thorny subjects (such as intellectual property safeguards and state subsidies) is likely to proceed.

For financial markets, measures of sentiment and valuations suggest that trade optimism may already be priced in. This raises the question of what is likely to drive markets from here – key candidates are US domestic politics, US-European trade relations and economic and earnings data.

Domestic US politics, data likely more important

One of the possible focus areas for markets could be the ongoing trends in the race for the US Democrat Party nomination. Polls suggest Biden retains his lead, though this has been narrowing somewhat. As we discussed in *Outlook 2020*, markets are likely to be sensitive to a rise in the chances of a Bernie Sanders or Elizabeth Warren win. We would continue to watch this closely in the six weeks between now and 'Super Tuesday' (March 3, when the largest number of US states and territories vote on party Presidential nominees). The ongoing impeachment process is likely to capture headlines, but the risk of the impeachment process being carried in the Senate remains low, in our view.

Economic data and European trade

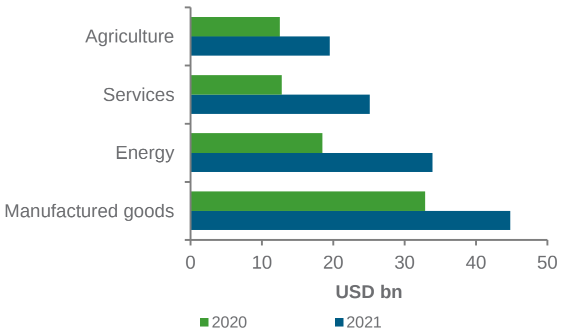
A shift away in focus from China also raises the risk of US trade authorities renewing their efforts with Europe. The EU's trade chief held talks with US trade negotiators this week in the context of US plans to apply tariffs on French imports, threats of EU retaliation and the US Treasury's decision to add Switzerland to their currency manipulator watchlist (following China's removal).

Finally, incoming earnings and economics data remain key. Consensus continues to expect earnings growth to accelerate through the rest of 2020. US labour market data remained reasonably strong (despite its disappointment relative to consensus) and inflation data continued to show few signs of trending higher.

These data points support our view that, while extreme positioning and renewed risks from US politics and US-EU trade relations pose a near-term risk to equities, we would stay prepared to buy into any dips.

Proposed increase in China's imports of US goods most significant in sectors such as energy and agriculture

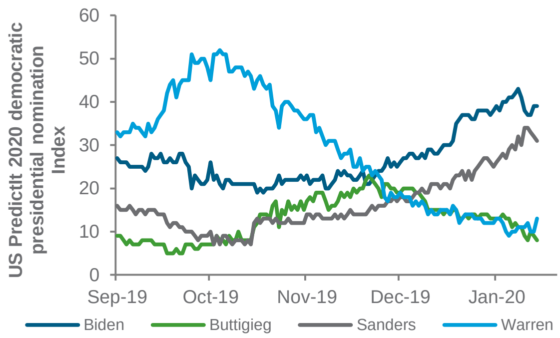
US-China trade agreement – proposed increase in China's purchase of US goods



Source: Bloomberg, Standard Chartered

Biden remains most likely to win the Democrat Presidential nomination, though his lead has narrowed

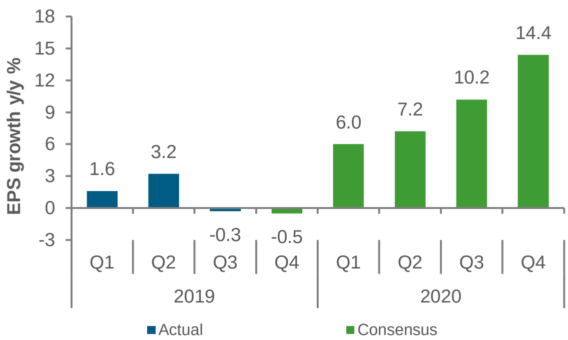
US Democrat Presidential nominee candidate – probability of winning the nomination



Source: Bloomberg, PredictIt, Standard Chartered

US equities' earnings growth expected to accelerate through 2020

S&P500 earnings growth, actual and expected



Source: Refinitiv, Standard Chartered

What does this mean for investors?

Equities

What are the prospects for the US earnings season? The Q4 2019 earnings season has kicked off with a solid earnings performance by US banks – their bond business stood out as the primary driver of the upside surprise. US banks have actually recorded negative returns in 2020 YTD, despite these results, after a 36% gain in 2019. Nevertheless, with reduced chances of interest rate cuts in 2020 and a steepening yield curve, we continue to view the financial sector as likely to outperform. While consensus expects US S&P500 corporate earnings to decline slightly in Q4 2019, the market is already looking ahead at expectations of about 10% full year growth in 2020. We continue to prefer US equities.

What does a stronger CNY mean for China offshore equities? CNY gains could extend following its removal from the US Treasury's currency manipulator watchlist. This is positive for China offshore equities given their correlation to the currency. Chinese companies with large overseas debt also benefit from the CNY strength. China offshore remains a preferred market in Asia ex-Japan (see page 5 for more).

Singapore REITs are also likely to be a focus area next week, with many office and industrial REITs reporting Q4 earnings. The outlook for office rents in Singapore has improved as the prior year's supply has been digested by the market. Asia ex-Japan REITs are a core holding.

Bonds

Is the US-China trade deal positive for Asian USD bonds? We see the direct impact being limited because, similar to equities, a lot of good news may already be in the price. Instead, we continue to see strong demand for Asian USD bonds on supportive housing and credit policies in China. Within Asian bonds, High Yield (HY) outperformed Investment Grade (IG) last week, a trend we expect to continue.

Interestingly, US Treasury yields fell, while the yield curve (the gap between long and short-maturity bonds) flattened this week. While lower yields (therefore, higher bond prices) were an additional tailwind for Asian and Emerging Market (EM) bonds, they remain another example of how trade optimism could be well-priced by markets in the short term.

FX

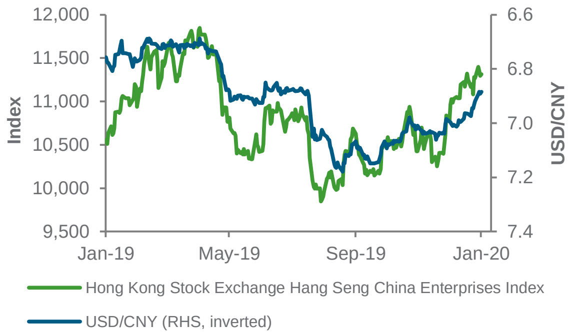
What can the move in the CHF tell us about the EUR and JPY? USD/CHF has edged to fresh near-term lows and is entering a new leg in its decline. EUR/CHF is also making new lows and could be targeting Q1 2017 lows around 1.0630, but near-term technicals suggest it is in oversold territory.

This suggests that, on technical grounds, EUR/USD should remain supported, consistent with our current bullish high conviction idea. EUR/USD has support at 1.1065 initially and then at 1.0980. If key resistance at 1.1250-70 is overcome, the rally could gain momentum and target the June 2019 high of 1.1410.

Meanwhile, CHF/JPY has accelerated sharply and is very close to being overbought and approaching key resistance near the Q4 2018 high at 114.70. Similar to the EUR rationale, we believe this may support the JPY. We expect robust resistance around 110.65, and a break back below the recently broken resistance around 109.50-70 would likely send USD/JPY back towards its range support at 107.50-108.00.

Stronger CNY positively correlated with offshore China equities

USD/CNY and HSCEI Index



Source: Bloomberg, Standard Chartered

Equity market technicals are positive across the board

Technical levels of key markets as of 16 January 2020

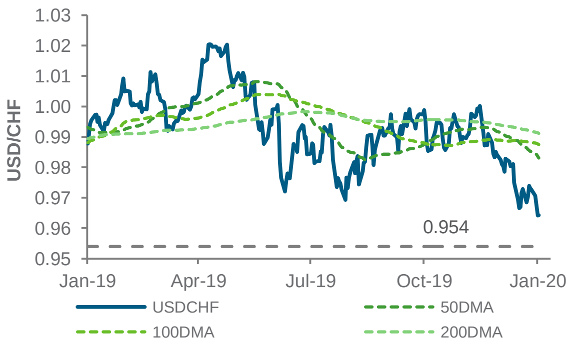
Index	Spot	1st support	1st resistance	Short-term trend
S&P 500	3,317	3,215	3,376	↑
STOXX 50	3,774	3,705	3,836	↗
FTSE 100	7,610	7,510	7,726	↗
Nikkei 225	23,933	23,300	24,400	↑
Shanghai Comp	3,074	2,985	3,155	↑
Hang Seng	28,883	28,200	29,500	↑
MSCI Asia ex-Japan	710	684	733	↑
MSCI EM	1,141	1,107	1,170	↑
Brent (ICE)	65	63	68	↘
Gold	1,553	1,530	1,575	↑
UST 10Y Yield	1.82	1.68	2.00	↗

Source: Trading Central, Standard Chartered

Note: Arrows represent short-term trend opinions

The CHF has gained significantly since late 2019 and has subsequently been added to the US Treasury's currency manipulator watchlist

USD/CHF



Source: Bloomberg, Standard Chartered

Top client question

Is the current rally in the MSCI China index likely to continue?

There have been some important developments on long-term charts suggesting the worst for the MSCI China index could well be over, and the index could be on its way towards the 2018 high of 101.31 (around 14% from Thursday's close).

On the monthly charts, in 2019, the index held twice (in January and August) above strong support at both the 50 and 200-month moving averages and the lower edge of a rising channel from 2015 (see chart). It also coincided with strong support around the 2010 and 2011 highs. However, a hold above the support was not enough to confirm that the worst was over.

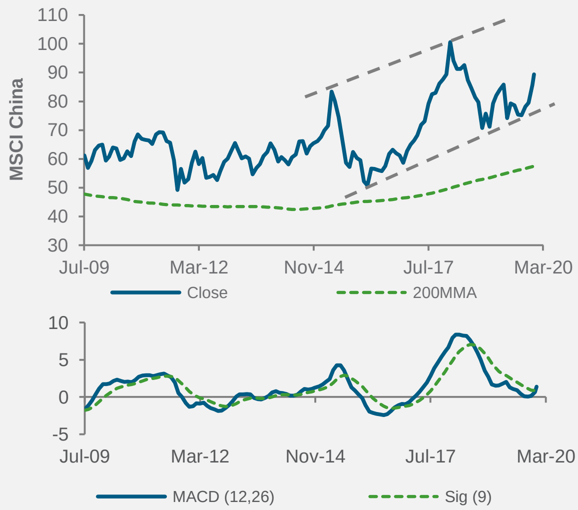
This month, the index has broken above key resistance at the April high of 86.47. This has been associated with a bullish crossover by the MACD (Moving Average Convergence Divergence) indicator on the monthly charts, indicating the uptrend has resumed. A noteworthy aspect is that, despite the large swings in recent years, the MACD indicator has failed to go in negative territory (that is, it has failed to give a Sell signal).

The 'phase one' US-China trade deal, the reserve requirement ratio cut by the People's Bank of China at the beginning of the month and expectations that Chinese growth could be bottoming have pushed the index higher recently. There is minor resistance at the mid-2018 high of 95.21, and stronger resistance at the January 2018 high of 101.31. Subsequent resistance is at the pre-Great Financial Crisis high of 104.06 and the 1997 peak of 110.81.

In the near term, though, the index looks quite overbought. A minor pause in the rally cannot be ruled out. However, dips could prove to be limited to the near-term support range of 86.20-86.50.

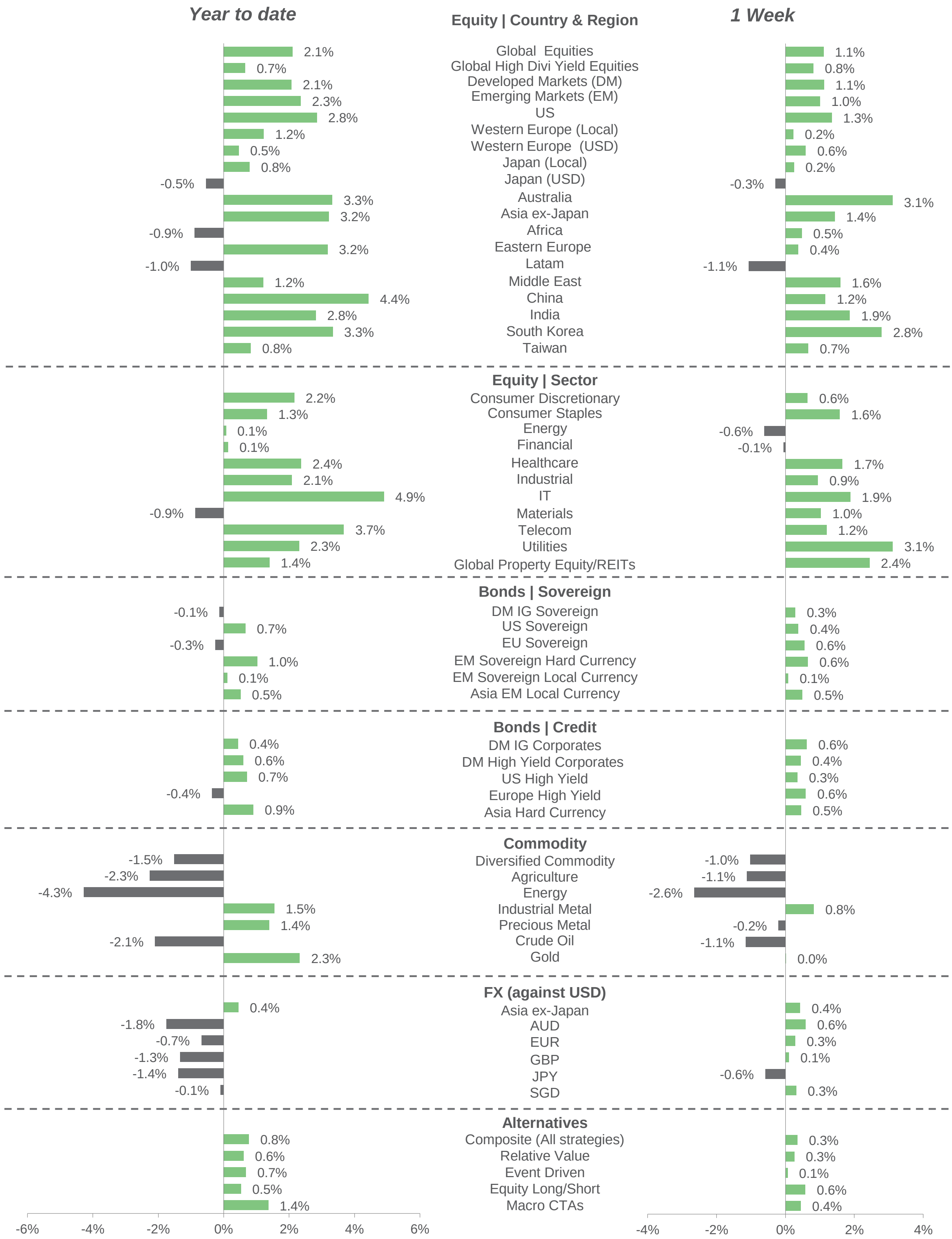
Technicals currently support our buy-on-dips view

MSCI China and 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, 2019 performance from 31 December 2019 to 16 January 2020, 1 week period: 9 January 2020 to 16 January 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON						
TUE	UK	Average Weekly Earnings 3m/y/y	21-Jan-20	Nov	–	3.2%
	EC	ZEW Survey Expectations	21-Jan-20	Jan	–	11.2
	JN	BOJ Policy Balance Rate	21-Jan-20	21-Jan	-0.1%	-0.1%
WED	US	Existing Home Sales	22-Jan-20	Dec	5.42m	5.35m
THUR	JN	Exports y/y	23-Jan-20	Dec	–	-7.9%
	EC	ECB Main Refinancing Rate	23-Jan-20	23-Jan	–	0.0%
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	24-Jan-20	Dec	–	0.8%
	JN	Jibun Bank Japan PMI Composite	24-Jan-20	Jan P	–	48.6
	FR	Markit France Manufacturing PMI	24-Jan-20	Jan P	–	50.4
	GE	Markit/BME Germany Manufacturing PMI	24-Jan-20	Jan P	–	43.7
	EC	Markit Eurozone Manufacturing PMI	24-Jan-20	Jan P	–	46.3
	UK	Markit/CIPS UK Composite PMI	24-Jan-20	Jan P	50.7	49.3
	US	Markit US Composite PMI	24-Jan-20	Jan P	–	52.7

	Event	This Week	Date	Period	Actual	Prior
MON						
TUE	US	NFIB Small Business Optimism	14-Jan-20	Dec	104.9	104.7
	US	CPI Ex Food and Energy y/y	14-Jan-20	Dec	2.3%	2.3%
	US	Real Avg Weekly Earnings y/y	14-Jan-20	Dec	–	1.1%
	CH	Exports y/y	14-Jan-20	Dec	1.9%	-1.3%
WED	UK	CPI Core y/y	15-Jan-20	Dec	–	1.7%
	US	PPI Ex Food and Energy y/y	15-Jan-20	Dec	–	1.3%
THUR	JN	Core Machine Orders y/y	16-Jan-20	Nov	–	-6.1%
	US	Retail Sales Ex Auto and Gas	16-Jan-20	Dec	–	0.0%
FRI/SAT	CH	Industrial Production y/y	17-Jan-20	Dec	5.9%	6.2%
	CH	Fixed Assets Ex Rural YTD y/y	17-Jan-20	Dec	5.2%	5.2%
	EC	CPI y/y	17-Jan-20	Dec	–	1.0%
	US	Building Permits	17-Jan-20	Dec	1470k	1482k
	US	Housing Starts	17-Jan-20	Dec	1378k	1365k
	US	Industrial Production m/m	17-Jan-20	Dec	0.1%	1.1%
	US	U. of Mich. Sentiment	17-Jan-20	Jan P	99.0	99.3
	SK	BoK 7-Day Repo Rate	17-Jan-20	17-Jan	–	1.3%

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue
Previous 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

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