Wealth Management Chief Investment Office
17 February 2023

Weekly Market View

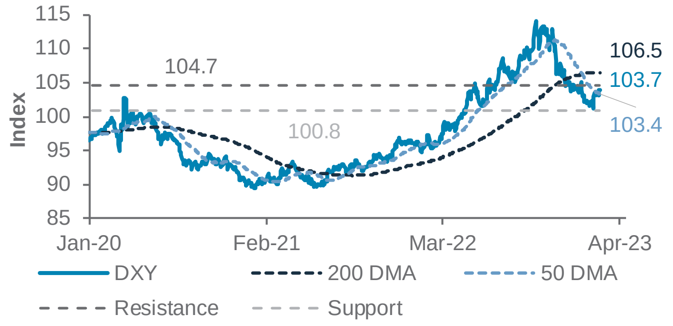
Dollar catches a (brief) tailwind

- The US Dollar appears to have caught a tailwind after a string of upside US economic data surprises. While the strong data reduces the risk of a near-term US recession, it makes it more likely that the Fed will keep raising rates for now.
- Such a scenario, set against the backdrop of elevated wage pressures, would be negative for corporate margins, and by extension equities and other risk assets over the medium-term.
- Hence, we would use the rally in risk assets in the past three months to rebalance into higher quality bonds and other income assets.
- We also expect a near-term rebound in the USD to fade over the next three months, along with US government bond yields, as it becomes clearer that higher policy rates would eventually cause a recession, leading to a paring back of Fed rate expectations.

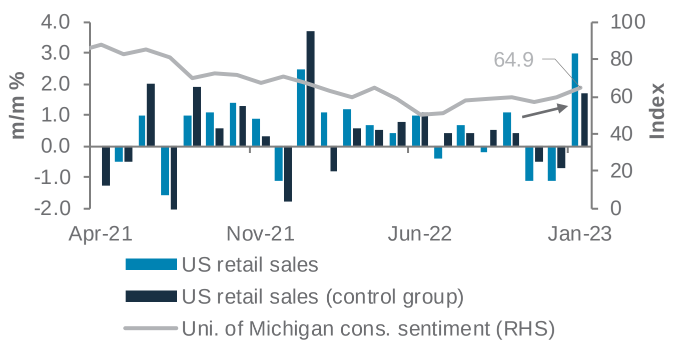
Charts of the week: USD revived by strong data

Positive US economic surprises have lifted Fed policy rate expectations, providing a boost to the USD in February

USD index, with key technical levels



US headline, core retail sales; Michigan consumer sentiment



Source: Bloomberg, Standard Chartered

Editorial

Dollar catches a (brief) tailwind

The US Dollar appears to have caught a tailwind after a string of upside US economic data surprises. While the strong data reduces the risk of a near-term US recession, it makes it more likely that the Fed will keep raising rates for now. Such a scenario, set against the backdrop of elevated wage pressures, would be negative for corporate margins, and by extension equities and other risk assets over the medium-term. Hence, we would use the rally in risk assets in the past three months to rebalance into higher quality bonds and other income assets. We also expect the rebound in the USD to fade in the next three months, along with US government bond yields, as it becomes clearer that higher policy rates would eventually cause a recession, leading to a paring back of Fed rate expectations.

The latest boost to the USD came from stronger-than-expected retail sales and consumer sentiment indicators, which followed surprisingly strong payrolls growth and a sharp rebound in services sector business confidence in January. The series of strong data points to a resilient consumer-driven US economy despite still-elevated inflation and a noticeable weakness in manufacturing and housing sectors. It shows consumers are willing to keep spending their savings accumulated during the pandemic (currently estimated at over USD1 trn). This was also reflected in the University of Michigan survey of US consumer sentiment which rose to a 13-month high. With the job market still robust, as seen from the surge in job creation in January, still-elevated job openings and near-record-low jobless claims and unemployment rate, there is scope for this consumer-driven economy to support risk assets in the very near term.

Nevertheless, this week's inflation data also showed that consumer (6.4% y/y, 0.5% m/m) and producer price inflation (0.7% m/m) both remain elevated and are likely to take longer to revert back to the Fed's 2% target – worrisome signs for the Fed. While US goods inflation continued to decline sharply, core services sector inflation continued to rise, primarily due to still-rising shelter costs. While private sector indicators (Zillow) point to fading rental prices later this year, the Fed would be worried about the uptick in the core services inflation, excluding shelter, which reflects underlying wage pressure trends.

Investment implications: The combination of surprisingly strong services activity and inflation (which next week's flash PMI and personal consumption expenditure data is likely to confirm) explains the rebound in Fed rate expectations and US government bond yields this month (especially the c. 45bps rise in the 2-year bond yield). The jump in short-term yields has again widened the US bond yield advantage vs other major currencies. Money markets are already starting to partly price in a third 25bps Fed rate hike in June (after March and May). The USD index has broken above 50DMA, with the next resistance around 104.7. While the USD is getting strong support near-term from resilient US data and hawkish Fed messaging, ultimately, we believe markets will likely pare back Fed rate hike expectations as the outlook for US growth deteriorates with tighter policy. Thus, we see the USD index eventually turning lower towards 102 in the next 3 months.

Tightening policy rates are also likely to crimp already declining US corporate profit margins and earnings further, while challenging valuations – this is likely to hurt US stocks. This partly explains why S&P500 index has failed to break above the 4100-4200 range despite the recent string of strong US data. We believe Asia ex-Japan equities and bonds (especially in China) offer better value for medium-term investors with 6-12-month horizon. The Hang Seng index has fallen close to 10% correction territory; 19,300-19,600 appears to be a strong technical support zone offering long-term investors an opportunity to add exposure to HK and China stocks. High quality bonds and other income assets are also increasingly attractive, with US 10-year yield approaching a major resistance around 3.9%.

— 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.

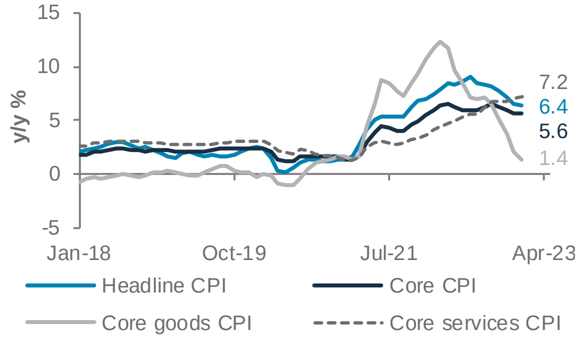
(+) factors: Recovering US retail sales, surging China credit growth

(-) factors: Stubborn US inflation, hawkish central bank officials

	Positive for risk assets	Negative for risk assets
Macro data	• US Michigan consumer sentiment recovered more than expected to 13-month high of 66.4; 1-year inflation expectations rose • US retail sales excluding auto and gas rose more than expected by 2.6% y/y • Euro area's economy expanded by 0.1% q/q in Q4 as expected; the EU upgraded its 2023 GDP forecast to 0.9%, while cutting inflation outlook • China new loans were higher than expected • UK's economy avoided a contraction in Q4	• US consumer inflation slowed down but above estimates at 6.4% y/y • Japan Q4 GDP missed expectations (0.6% q/q vs consensus 2.0% q/q) • US industrial output was unchanged m/m vs expectations of a 0.5% rise • US housing starts fell more than expected and building permits rose less than expected • US producer inflation rose more than expected by 0.7% m/m
	Our assessment: Neutral – Recovering US retail sales, still-expanding Euro area economy, surging China credit growth vs stubborn US consumer inflation	
Policy developments	• Fed's Harker said central bank is close to peak rate • China injected more funds into the system and kept 1-year medium-term lending facility unchanged • China announced nine measures to boost rural development	• Fed's Barkin and Logan indicated the need to do more rate hikes to dampen inflation • ECB's Lagarde affirmed a 50bps hike is likely in March • BoJ nominated Kazuo Ueda (who was critical of BoJ's YCC) as the next governor
	Our assessment: Neutral – Supportive China policies vs hawkish central bank officials	
Other developments	• US released more oil from its strategic petroleum reserves • Oil exports out of Turkey have resumed, according to news reports	• Russia threatened to cut supply by 500kb/d • US-China tensions continued to rise over more unidentified flying objects over each other's territory
	Our assessment: Neutral – Higher crude oil supply vs rising US-China tensions	

US core services inflation continued to rise, bucking the declining trend in headline inflation which is driven by sharply slowing goods inflation

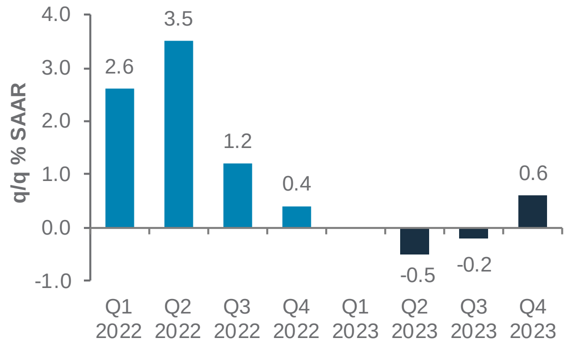
US headline, core, core goods and core services inflation



Source: Bloomberg; Standard Chartered

Euro area GDP avoided a contraction in Q4 22, but faces headwinds this year

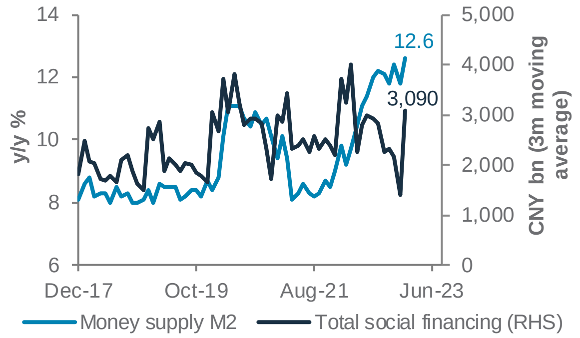
Euro area GDP q/q seasonally adjusted annualised change in 2022 (actuals), 2023 (consensus estimates)



Source: Bloomberg, Standard Chartered

China's accelerating credit growth and money supply bode well for a growth recovery this year

China total social financing growth (3m moving average) and M2 money supply growth



Source: Bloomberg, Standard Chartered

Top client questions

How is Europe's Q4 22 earnings season shaping up?

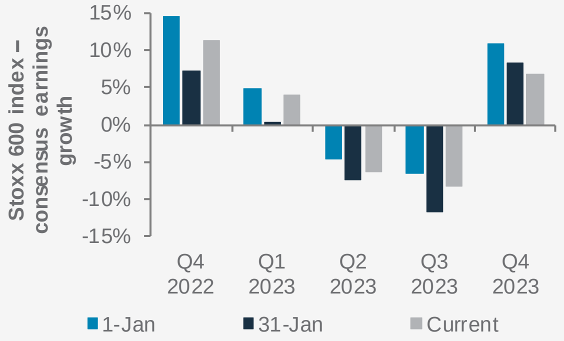
Nearly half of Europe's Stoxx 600 companies have reported and the results have been encouraging so far; 62% of companies that have reported have delivered earnings above consensus expectations, with a 7.6% earnings surprise. This compares with a historic average of 53% of companies beating earnings estimates. Stoxx 600 index companies are expected to see an 11.3% y/y growth in Q4 22 earnings, lower than the 14.5% growth expected at the start of the year but better than trough expectations of 7.3% on 31-Jan. Excluding the energy sector, the Stoxx 600 is still expected to see earnings growth of 5.3% for Q4 22.

Along with a milder-than-expected winter, the earnings season has been a supportive tailwind for European equities so far. However, we remain cautious on a 6-12-month horizon as higher interest rates become more restrictive on growth in Europe. Our preferred sectors in Europe are energy and financials, where over half the companies have reported Q4 results. Encouragingly, energy and financials have delivered two of the top three earnings surprises across all sectors. We continue to expect these two sectors to outperform the broader market over the next 6-12 months.

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

Earnings growth expectations in Europe have been revised lower since the start of the year, but upgraded since end-Jan 2023 as the earnings season progresses

Consensus earnings growth estimates by quarter for Europe Stoxx 600 index



Source: Refinitiv, Standard Chartered

What investment implications can we draw from the strong interest in Artificial Intelligence and ChatGPT?

The rapid popularity of ChatGPT highlights the significant and still growing interest in the development and potential applications of Artificial Intelligence (AI). We expect this to become more prevalent as its ability to synthesise large volumes of complex data demonstrates how it could be put to use.

Although the industry is still exploring ways to monetise AI applications, the fear of being put at a competitive disadvantage is likely to spur investments in AI across sectors. This, we believe, is likely to boost demand for specialised semiconductor chips that are able to process large amounts of data. This is likely to benefit manufacturers in this sector in the long term. This notwithstanding, the semiconductor sector remains exposed to cyclical demand risks and could face headwinds from any potential growth slowdown in the US or Europe. That said, the US semiconductor index has delivered a strong return YTD, partly reflecting the growing interest in AI. We believe investors interested in gaining exposure to this trend need to be selective, given volatility in the semiconductor index, and await a more attractive opportunity to average in.

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

The semiconductor index (SOX) has rebounded strongly YTD

Philadelphia Stock Exchange Semiconductor Index, since 1 Jan 2022

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is your outlook for USD/JPY, following the announcement of the new BoJ governor?

Earlier this week, Japan's government announced its nomination of Kazuo Ueda as the new BoJ governor. Ueda's nomination needs to be approved by both houses of Parliament, which are controlled by the ruling coalition. While Ueda is an academic, he previously served as a member of the BoJ policy board in the early 2000s.

The appointment has been closely tracked by the market due to its implications for BoJ's ultra-accommodative policy, Japanese bond yields and the JPY. While the initial USD/JPY decline suggested that markets expected Ueda to normalise the policy quickly, his subsequent statement that an accommodative policy is appropriate tempered market expectations of an imminent policy readjustment.

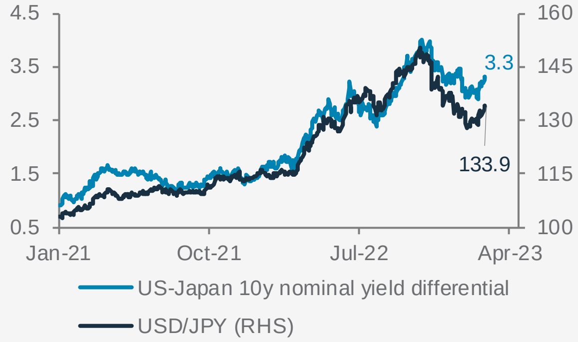
The BoJ's massive bond purchases under the Yield Curve Control (YCC) policy have raised questions over its ability to source new bonds to purchase. This practical challenge is the reason we believe a modification of the YCC policy (to widen the yield band) or even an outright end of the policy is likely. However, we believe that any major change is unlikely until at least the April policy meeting.

The recent rally in USD/JPY has been driven by the broad USD strength and a reassessment of market expectations of the BoJ policy. While positioning and rising US economic surprises argue for further USD strength, we continue to see 135.75 as a key resistance for USD/JPY given we expect any such USD gains to be relatively moderate. Thereafter, given our base case for no major BoJ policy change till April, we expect USD/JPY to trade in the 128-132 range.

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

Interest rate differentials continue to be the key driver for USD/JPY

Difference between 10-year US and Japanese government bond yields, USD/JPY



Source: Bloomberg, Standard Chartered

Is there a buying opportunity in gold after the recent drop?

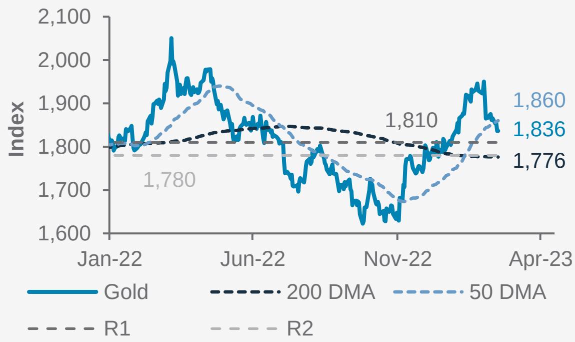
In January, we pointed out that gold appeared overbought and that a near-term consolidation was likely, with 1,950 being a key resistance level. The call worked out in our favour and gold has been trending downwards after testing the 1,950 level. The recent weakness has been largely driven by a few factors: (1) Real yields and the USD – two key drivers of gold – rebounding on higher US bond yields; (2) receding Chinese demand and record prices weighing on retail purchases; and (3) ETF flows turning negative.

Gold broke below a strong support level at 1,840; the next support is at 1,810, followed by 1,780. We would gradually add exposure to gold (especially those who are underinvested), given that gold is starting to look oversold. Moreover, central bank demand remains strong and we expect that to continue supporting gold prices. The rebound in real yields and the USD is likely to level off, in our view, fading headwinds against gold. Gold can also serve as an attractive hedge against short-term volatility due to geopolitical tensions.

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

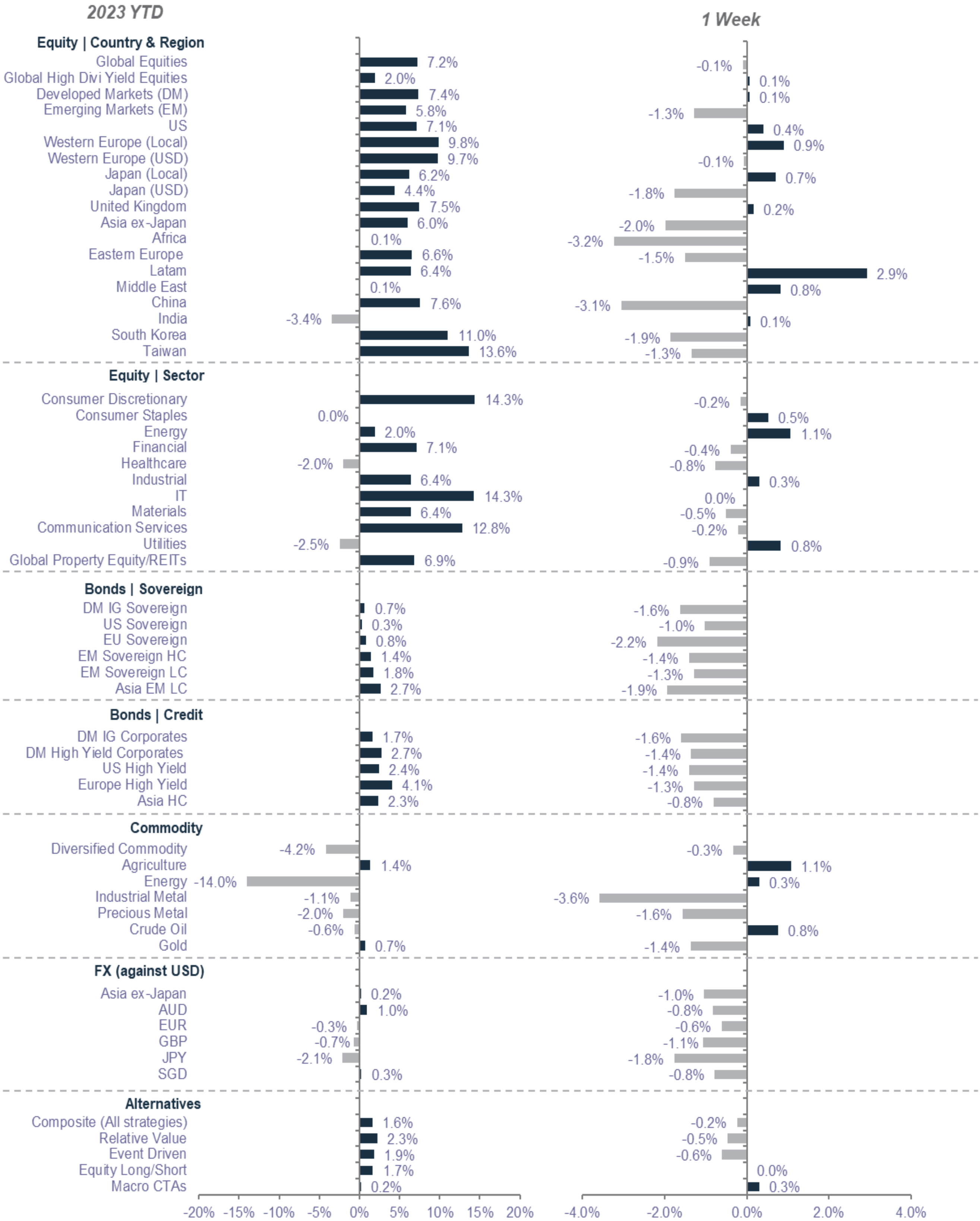
Subsequent technical supports for gold are at 1,810, followed by 1,780

Gold with key technical levels



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 16 February 2023; 1-week period: 9 February 2023 to 16 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	EC	Consumer Confidence	Feb P	–	-20.9
TUE	EC	S&P Global Eurozone Manufacturing PMI	Feb P	–	48.8
	EC	S&P Global Eurozone Services PMI	Feb P	–	50.8
	UK	S&P Global/CIPS UK Manufacturing PMI	Feb P	–	47.0
	UK	S&P Global/CIPS UK Services PMI	Feb P	–	48.7
	EC	ZEW Survey Expectations	Feb	–	16.7
	US	S&P Global US Manufacturing PMI	Feb P	47.2	46.9
	US	S&P Global US Services PMI	Feb P	–	46.8
	US	Existing Home Sales	Jan	4.12m	4.02m
WED					
THU	US	Chicago Fed Nat Activity Index	Jan	–	-0.49
	US	GDP Annualized q/q	4Q S	3.0%	2.9%
FRI/SAT	US	PCE Deflator y/y	Jan	–	5.0%
	US	PCE Core Deflator y/y	Jan	4.3%	4.4%
	US	New Home Sales	Jan	621k	616k

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 3.92%

Technical indicators for key markets as of 16 February close

Index	Spot	1st support	1st resistance
S&P 500	4,090	4,071	4,129
STOXX 50	4,297	4,231	4,330
FTSE 100	8,013	7,926	8,056
Nikkei 225	27,548	27,418	27,687
Shanghai Comp	3,249	3,234	3,279
Hang Seng	20,988	20,803	21,181
MSCI Asia ex-Japan	656	651	661
MSCI EM	1,011	1,006	1,015
WTI (Spot)	85.1	84.6	86.1
Gold	1,833	1,822	1,855
UST 10y Yield	3.87	3.76	3.92

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 normalised across asset classes

Our proprietary market diversity indicators as of 16 February

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	→	1.67
Global Equities	◐	→	1.49
Gold	●	→	1.56
Equity			
MSCI US	●	→	1.57
MSCI Europe	◐	→	1.34
MSCI AC AXJ	◐	→	1.44
Fixed Income			
DM Corp Bond	●	→	1.54
DM High Yield	◐	→	1.47
EM USD	●	→	1.54
EM Local	◐	→	1.36
Asia USD	◐	↓	1.38
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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