



# Weekly Market View

## Fed moves ahead of the curve

→ For the first time since inflation reared its head in early 2021, western central banks have turned more hawkish than the markets. The Fed's projection for its policy rate at the end of 2023, for instance, is now much higher than market expectations.

→ That is a 180-degree reversal when compared with the start of the year, when the central banks were well behind the (market expectations) curve. Fed Chair Powell and ECB President Lagarde this week emphasised that rising inflation is a bigger risk to their economies than any growth slowdown.

→ As a result, the central banks are willing to significantly tighten policies to quash inflation pressures, even if that leads to a sharp growth slowdown. In this report, which follows our H2 Outlook publication last week, we discuss how investors can position themselves for the emerging macroeconomic landscape.

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Where are the current opportunities in Chinese equities?

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What are the implications for global bond yields and JPY from BoJ's policy stance?

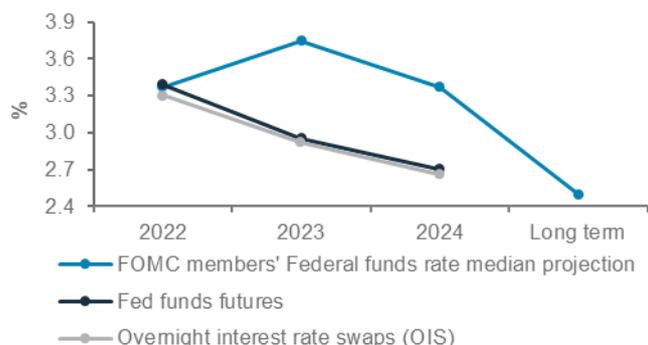
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What is your favoured funding currency?

## Charts of the week: The Fed is now ahead of the curve

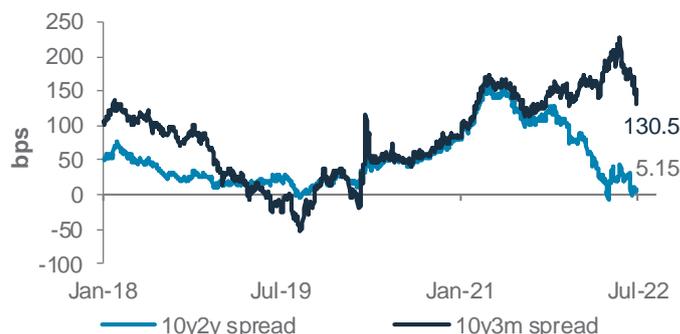
**Fed rate projections are above market expectations; the US 10y-2y yield curve is close to inverting amid growth concerns**

Fed median rate projections vs money market expectations



Source: Bloomberg, Standard Chartered

US 10y government bond yield premium vs 2y and 3m yields



## Editorial

### Fed moves ahead of the curve

For the first time since inflation reared its head in early 2021, western central banks have turned more hawkish than the markets. The Fed's projection for its policy rate at the end of 2023 (3.8%), for instance, is now much higher than market expectations (around 3%). That is a 180-degree reversal when compared with the start of the year, when the central banks were well behind the (market expectations) curve. Fed Chair Powell and ECB President Lagarde, speaking at an ECB event this week, emphasised that rising inflation is a bigger risk to their economies than any growth slowdown. As a result, they said they are both willing to significantly tighten policies to quash inflation pressures, even if that leads to a sharp growth slowdown. How should investors position themselves?

While central banks are likely to maintain this hawkish stance over the next few months as they are keen to restore their inflation-fighting credentials, we believe they are unlikely to fully follow their hawkish talk with action as growth and inflation expectations subside in H2. Significant tightening of financial conditions this year – thanks to the sharp drop in equities, the surge in bond yields and energy prices and a stronger USD – is already clouding the growth outlook. US and European consumer and business confidence (PMIs) dipped further in June, business inventories are rising and mortgage applications are slowing. The US 10-year vs 2-year government bond yield curve, one key recession indicator, is about to invert again after inverting briefly in April, signalling investors are concerned the Fed is about to over-tighten, leading to a growth downturn. Meanwhile, long-term inflation expectations have pulled back significantly from their April highs.

Given this, we expect the Fed to slow the pace of rate hikes once it raises the rate to restrictive territory (above the so-called 'Neutral' rate estimate of 2.5%) by the end of Q3, from the current 1.75%. The Fed's minutes from its June meeting, due next week, are likely to show consensus among policymakers for another 75bps hike in July. We expect the Fed policy rate to end the year at c.3.25%, below the Fed's own 3.4% projection.

Meanwhile, policymakers in Europe, being on the frontlines of the Ukraine crisis, are torn between whether to pull out all stops to subdue inflation, or to ensure growth remains supported. We believe, after taking the benchmark deposit rate back to positive territory, they are eventually likely to shift back to supporting growth later this year as inflation peaks, partly due to base effects on energy prices. Hence, our ECB policy rate (deposit rate) forecast for the end of the year, at 0.50%-0.75%, is below the market's estimates of 0.93%.

The health of the US and European job markets is key to assessing how far the Fed and ECB are likely to tighten policy. So far, both job markets remain very strong. The US jobless rate, at 3.6%, is just above the pre-pandemic 50-year low of 3.5%. Meanwhile, the Euro area jobless rate fell to a record low of 6.6% in May. The tight job markets are sustaining domestic consumption and fuelling wage pressures, especially in the US. We believe the Fed's primary goal, as it tightens monetary policy, is to slow the pace of job creation and thus prevent wages and home rental costs from spiralling out of control. Thus, upcoming data on job openings (JOLTS), jobless claims and the pace of job creation in June will be closely scrutinised for any signs of a slowdown. The Fed is unlikely to tone down its hawkish stance until the jobless rate rises towards its long-term target of 4%.

The central banks' near-term hawkish stance suggests the risk to equities has risen in recent weeks. Meanwhile, the surge in bond yields this year, combined with the deteriorating growth outlook, has made a wide swathe of bond markets more attractive. This shift in risk-reward balance has led us to dial up our preference for bonds at the expense of equities in our tactical asset allocation for H2 22. Within equities, we prefer the relatively inexpensive Asia ex-Japan, especially with China continuing to relax COVID-19 restrictions and economic policies to stimulate growth (page 4). We also upgraded UK equities due to its high exposure to energy, financial and material sectors, to hedge against elevated commodity prices amid the Ukraine war. Meanwhile, our diversified multi-asset income basket now offers an attractive yield of more than 6%.

— 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:** China eased COVID-19 measures, economic policies

**(-) factors:** Falling US consumer sentiment, hawkish Fed and ECB, rising geopolitical tensions

	Positive for risk assets	Negative for risk assets
<b>COVID</b>	<ul style="list-style-type: none"> <li>China shortened quarantine time for inbound visitors</li> <li>Hong Kong mulls easing quarantine rules</li> <li>Beijing, Shanghai reported zero new local cases this week, first since Feb</li> </ul>	<ul style="list-style-type: none"> <li>President Xi said Zero-COVID policy is the most economic and effective policy for China</li> </ul>
	<b>Our assessment: Positive</b> – China reopening	
<b>Macro data</b>	<ul style="list-style-type: none"> <li>China Mfg and Non-Mfg PMIs rose above 50</li> <li>US durables goods orders rose more than expected</li> <li>US PCE inflation came in lower than consensus</li> <li>Euro area unemployment rate fell more than expected</li> </ul>	<ul style="list-style-type: none"> <li>US Conference Board consumer confidence fell below expectations, inflation expectations rose</li> <li>Euro area M3 money supply lower than consensus</li> </ul>
	<b>Our assessment: Neutral</b> – Positive China PMIs, slowing US inflation vs weak US consumer sentiment	
<b>Policy developments</b>	<ul style="list-style-type: none"> <li>Chinese authorities are allowing homeowners to demolish their old properties in return for housing vouchers that can be used for new homes</li> <li>China to offer subsidies to refiners if oil price exceeds USD 130/bbl</li> </ul>	<ul style="list-style-type: none"> <li>Fed's Powell, ECB's Lagarde said subduing inflation is topmost priority, even at the cost of growth</li> <li>Fed's Williams said it is reasonable to get Fed funds rate to 3.5%-4.5%; Fed's Mester backed a 75bps July hike</li> </ul>
	<b>Our assessment: Neutral</b> – China-supportive policies vs tightening Fed and ECB policy stance	
<b>Other developments</b>	<ul style="list-style-type: none"> <li>Xi Jinping attending Hong Kong 25<sup>th</sup> anniversary events</li> </ul>	<ul style="list-style-type: none"> <li>EU formally invited Finland and Sweden to join NATO after Turkey dropped opposition</li> <li>G7 nations banned gold exports and discussed capping Russian oil prices</li> </ul>
	<b>Our assessment: Negative</b> – Geopolitical tensions rising	

### US consumer confidence has declined this year as inflation erodes disposable income; consumption growth is likely to slow as a result

US consumer confidence index; personal consumption



Source: Bloomberg; Standard Chartered

### US consumer inflation, as measured by the PCE deflator, seems to be peaking

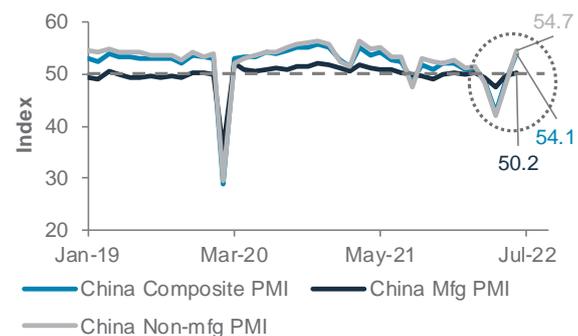
US personal consumption expenditure price deflators



Source: Federal Reserve, Standard Chartered

### China's business confidence rose to expansion territory for the first time since February

China manufacturing, services and composite PMIs



Source: Bloomberg, Standard Chartered

## Top client questions

### Q Where are the current opportunities in Chinese equities?

After its solid performance over the last six weeks, the Hang Seng index has hit resistance at 22,500. We believe pullbacks will create opportunities for investors to add to Chinese equities, which we view as a preferred market within Asia ex-Japan (we view Asia ex-Japan as a preferred region relative to global equities). This week, China (i) halved the quarantine period for incoming arrivals and 2) removed COVID-19 risk indicator in digital travel passes. This has led to increasing expectations of further normalisation of economic activity. These measures, together with accommodative and stimulatory policies from the PBoC as well as the central government, are likely to catalyse the outperformance of Chinese equities, in our assessment. Fund flows continue to rotate out of US equities into Hong Kong/China equities. The average daily turnover in the Hong Kong market in June 2022 was 25% higher than that in April and May this year. We see China equities as being in a sweet spot in the economic cycle, where GDP growth expectations appear to be at their trough, in contrast to the US and Europe where monetary policy tightening is likely to lead to slower growth ahead.

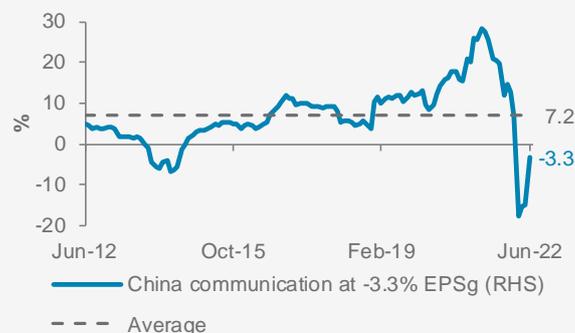
Technically, 21,600 appears to be a key support level for the Hang Seng index, followed by 20,800 and 19,900. We would use any pullbacks to these levels to average in.

Within Chinese equities, we prefer cyclical sectors which are likely to benefit the most from the recovery in the economy. (This compares with our more defensive preferences in the US/Europe.) In China: 1) we have recently upgraded communication services to a preferred sector, as we see regulations turning more positive on internet and media companies to support economic growth. This is likely to be a strong driver for a continued earnings recovery. Earnings per share growth in the sector is currently negative – the first time since 2014 – vs a 10-year historical average of 7%; 2) we have also upgraded materials to a preferred sector, as policies turn more pro-growth, following calls from government authorities for “all-out efforts” to revive infrastructure spending. The investments are particularly targeted at the transportation, energy, smart grids, water conservancy, cloud computing and Artificial Intelligence sectors. In our view, these investments should improve demand for building materials and drive revenue for the equity sector. The reopening of the Chinese economy is also likely to be a strong catalyst for increased investment inflow from overseas. Fundamentally, the sector’s return on equity is high vs its historical mean, and it has continued to trend higher.

— Daniel Lam, Head, Equity Strategy

### We expect China’s communications sector earnings to recover as a result of easing regulations on internet and media companies

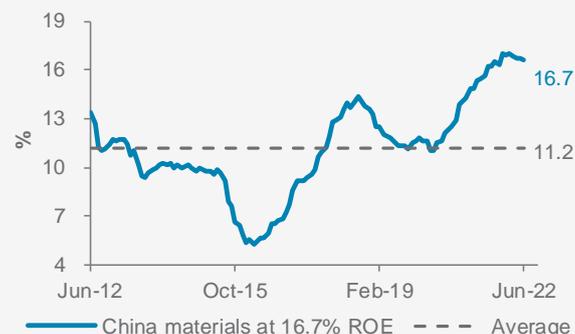
Consensus MSCI China communications sector earnings per share growth against 10-year historical average



Source: MSCI, FactSet, Standard Chartered

### China’s materials sector return on equity is high versus historical mean

Consensus MSCI China materials sector return on equity against 10-year historical average



Source: MSCI, FactSet, Standard Chartered

## Top client questions (cont'd)

### Q What is your view on Bank of Japan policy? What are its implications on global bond yields and the JPY?

The BoJ reaffirmed its dovish stance at its latest monetary policy meeting, keeping its short-term rate at -0.1% and longer 10-year Japanese government bond (JGB) yield target at “around 0%”. Markets continue to question the sustainability of such policy in light of higher policy rates elsewhere and are pricing 110bps of rate hikes by year-end. This has meant growing selling pressure on Japanese Government Bonds (JGBs), putting upward pressure on bond yields. To defend its Yield Curve Control (YCC) policy, the central bank announced its unlimited fixed-rate bond buying operation would last for an extended period of time. The BoJ also relaxed some lending facilities in response to falling market liquidity.

In our view, while the BoJ has demonstrated strong intent in defending current policy, its dual mandate of maintaining price stability and economic growth, combined with a rapidly weakening JPY, raise the risk of an unexpected policy shift. This is especially so given rising public discontent towards the BoJ’s inflation policy. Any signs of a shift from current policy could result in higher JGB yields and a sharply stronger JPY. We believe the impact from any such move is likely to be limited for Developed Market government bonds, given more than half of this asset class comprises US and European government bonds. However, under such a scenario, any move lower in USD/JPY could be large. This is why we remain very reluctant to view the JPY as a funding currency (see below).

— Cedric Lam, Senior Investment Strategist

### Q What is your preferred funding currency?

The CHF has been investors’ favoured funding currency for years as the Swiss National Bank (SNB) actively suppressed policy rates below 0% to limit currency strength. However, the SNB’s surprise policy pivot in mid-June has changed the outlook for the CHF, in our view, and we no longer view it as an attractive funding currency.

The SNB highlighted that inflation is spreading and may become entrenched. A further 50bps hike in September would take the base rate out of negative territory. The SNB also has more flexibility to tighten its policy compared with the ECB, where inflation is higher but growth and peripheral bond market risks are higher. The SNB now likely prefers a stronger currency to combat inflation. We are also mindful of escalating geopolitical tensions amid rising Russian sanctions and NATO’s decision to include Sweden and Finland. Any Russian response may target EU energy supply and thereby growth.

This may result in more EUR/CHF downside. We expect the recent break below 1.00 can extend towards the 0.94 level as 1.06 resistance holds. We also now see the EUR as a much more attractive funding currency in the short-term, at least until we see evidence that the broad USD rally has peaked.

### USD/JPY has risen with widening US rate differential vs Japan; any shift in BoJ policy to allow higher JGB yields could drag USD/JPY lower

USD/JPY vs US-Japan rate differentials



Source: Bloomberg, Standard Chartered

### EUR/CHF has declined as the SNB tightens monetary policy and shifts away from a policy of subduing CHF strength; the EUR becomes a preferred funding currency in the near term

EUR/CHF daily chart with technical levels

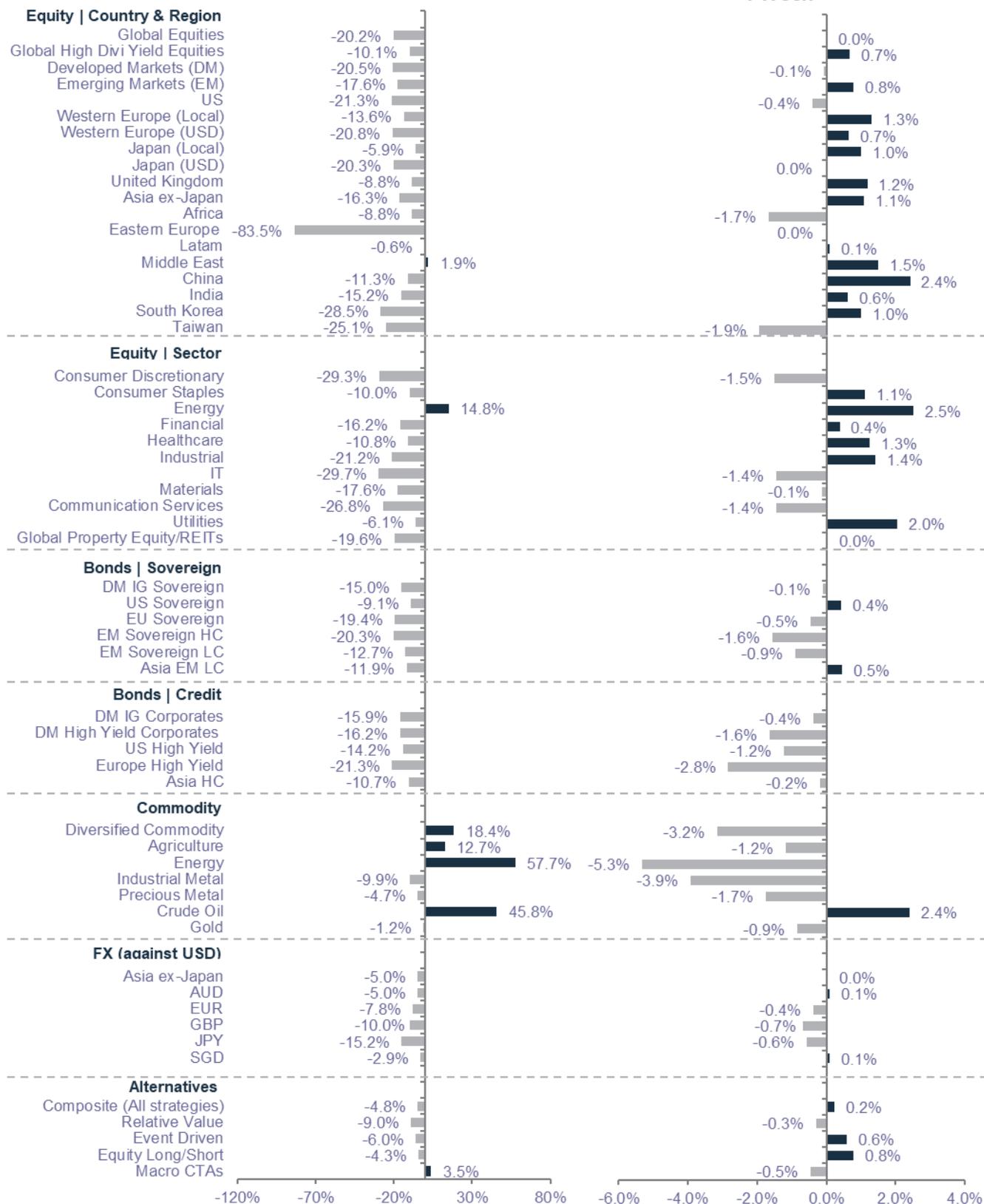


Source: Bloomberg, Standard Chartered

## Market performance summary \*

2022 YTD

1 Week



Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

\*Performance in USD terms unless otherwise stated, 2022 YTD performance from 31 December 2021 to 30 June 2022; 1-week period: 23 June 2022 to 30 June 2022

### Our 12-month asset class views at a glance

Asset class	
<b>Equities</b> ◆	<b>Alternatives</b> ◆
Euro area ◆	Equity hedge ◆
US ◆	Event-driven ▼
UK ▲	Relative value ▼
Asia ex-Japan ▲	Global macro ▲
Japan ◆	
Other EM ◆	<b>Cash</b> ◆
	USD ▼
<b>Bonds (Credit)</b> ◆	EUR ▲
Asia USD ▲	GBP ▲
Corp DM HY ▲	CNY ▲
Govt EM USD ◆	JPY ▲
Corp DM IG ▼	AUD ▲
	NZD ▲
<b>Bonds (Govt)</b> ◆	CAD ▲
Govt EM Local ◆	
Govt DM IG ◆	<b>Gold</b> ▲

Source: Standard Chartered Global Investment Committee

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding

### The S&P500 has next support 2.1% below current level

Technical indicators for key markets as on 30 June 2022

Index	Spot	1st support	1st resistance
S&P 500	3,785	3,743	3,870
STOXX 50	3,455	3,411	3,524
FTSE 100	7,169	7,019	7,322
Nikkei 225	25,917	25,709	26,587
Shanghai Comp	3,392	3,338	3,427
Hang Seng	21,860	21,283	22,428
MSCI Asia ex-Japan	653	643	667
MSCI EM	1,001	987	1,022
Brent (ICE)	109	107	115
Gold	1,801	1,797	1,816
UST 10y Yield	2.96	2.91	3.10

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

### Economic and market calendar

	Event	Next week	Period Expected	Prior	
MON	EC	Sentix Investor Confidence	Jul	-	-15.8
	EC	PPI y/y	May	-	37.2%
TUE	CH	Caixin China PMI Composite	Jun	-	42.2
	CH	Caixin China PMI Services	Jun	49.5	41.4
WED	UK	S&P Global/CIPS UK Construction PMI	Jun	-	56.4
	EC	Retail Sales y/y	May	-	3.9%
	US	ISM Services Index	Jun	54.2	55.9
	US	JOLTS Job Openings	May	-	11400k
	US	FOMC Meeting Minutes	June		
THUR	US	ADP Employment Change	Jun	183k	128k
	US	Trade Balance	May	-\$85.0b	-\$87.1b
FRI/SAT	US	Change in Nonfarm Payrolls	Jun	250k	390k
	US	Unemployment Rate	Jun	3.6%	3.6%

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

### Investor diversity remains very low in global bonds

Our proprietary market diversity indicators as of 29 June

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	○	→	1.24
Global Equities	●	→	1.33
Gold	●	↓	1.42
<b>Equity</b>			
MSCI US	●	→	1.35
MSCI Europe	●	→	1.31
MSCI AC AXJ	●	→	1.45
<b>Fixed Income</b>			
DM Corp Bond	○	→	1.24
DM High Yield	●	→	1.27
EM USD	●	→	1.28
EM Local	●	→	1.32
Asia USD	●	↑	1.57
<b>Currencies</b>			
EUR/USD	●	→	1.35

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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