standard chartered

Wealth Management Chief Investment Office
3 March 2023

Weekly Market View

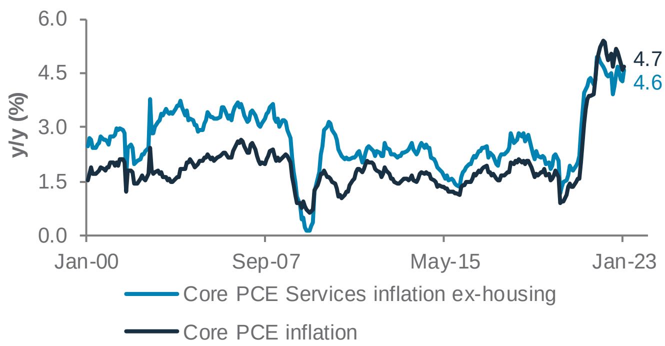
Goldilocks narrative challenged

- Stronger-than-expected US and Euro area inflation has challenged the Goldilocks outlook ("cooling inflation and no recession") prevailing in markets at the start of the year.
- While the strong data have likely delayed the start of a recession, we believe they have made a sharp downturn more likely over a one-year horizon. This is because elevated inflation, against the backdrop of historically tight job markets, is likely to encourage the Fed and the ECB to push for higher-for-longer rates.
- In this report, we explore how soon a US recession is likely to start, how high US government bond yields are likely to rise and why our defensive (SAFE) investment strategy makes sense.
- We also discuss expectations from the National Peoples' Congress in China. China and, more broadly, Asia ex-Japan are likely to be the biggest drivers of global growth this year and thus our preferred area for equities and USD bonds.

Charts of the week: Still-elevated inflation raises US recession risk

Stronger-than-expected US inflation is likely to encourage the Fed to keep rates higher for longer, causing a recession

US core PCE inflation; core PCE services inflation, ex-housing



US recessions after first Fed rate hike and yield curve inversion

First Fed rate hike	Yield curve first inversion (10-2y)^	US recession date*	Months to US recession after first rate hike	Months to US recession after first curve inversion
Mar-72		Nov-73	20	
Dec-76	Aug-78	Jan-80	37	16
Feb-80	Sep-80	Jul-81	16	9
Mar-88	Dec-88	Jul-90	27	18
Jun-99	Feb-00	Mar-01	20	12
Jun-04	Jan-06	Dec-07	41	22
Mar-22	**Jul-22**	**?**	**?**	**?**
Range			**16 to 41**	**9 to 22**
Median			**24**	**16**

Source: Bloomberg, NBER, Standard Chartered; *as defined by NBER, excludes 2020 recession; ^2-year govt bond yield only available after 1976

Editorial

Goldilocks narrative challenged

Stronger-than-expected US and Euro area inflation has challenged the Goldilocks outlook ("cooling inflation and no recession") prevailing in markets in January. While the strong data have likely delayed the start of a recession, we believe they have made a sharp downturn more likely over a one-year horizon. This is because elevated inflation, against the backdrop of historically tight job markets, is likely to encourage the Fed and the ECB to push for higher-for-longer rates. Not surprisingly, Fed and ECB terminal rate estimates have jumped to about 5.5% and 4%, hurting stocks and bonds in February.

Timing of a US recession matters as equities have historically hit a cycle-bottom only after a recession has started. Hence, we are likely to see new lows in US equity markets as a recession strikes later this year or early next year and corporate earnings are downgraded further. This scenario supports our defensive investment stance (SAFE strategy) adopted in our 2023 Outlook where high grade bonds are preferred over stocks and earning income through a diversified basket is a preferred way to tide over another volatile year ahead. Within bonds, we expect the predominantly Investment Grade Asian USD corporate bonds to outperform as China's economy recovers.

Historically, most US recessions have been caused by excessive Fed tightening, with a lag. As the table above shows, since 1972, a US recession started an average 24 months after the first Fed rate hike (if we exclude the 2020 pandemic aberration). Also, a recession started on average 16 months after the US government bond yield curve inverted (ie, after the 10-year yield has fallen below the 2-year yield). Extrapolating these averages, there is a high chance of a US recession by the end of this year or early next year because the Fed started its current hiking cycle in March 2022 and the US yield curve inverted in July 2022. While the range of the expected start of a recession is wide, this time, a recession is likely sooner than the past averages as the current Fed hiking cycle has been the second steepest in history, likely providing a shock to activity (as visible in the US housing and manufacturing sectors).

Risks to the view: The key 'known unknown' to the above view is the behaviour of the US consumer. The post-pandemic experience confirmed the US consumers' historical propensity to spend. US consumers still have c. USD 1.4trn of excess savings and China consumers are starting to spend the savings built during the pandemic. Thus, it is possible for the consumer-driven global growth to last a while longer. Nevertheless, the US savings rate appears to have bottomed and has been rising lately (see the chart on page 3) - not a promising sign for a sustained consumer-driven growth. Also, any sustained burst of consumer activity is likely to fuel further wage pressures in the US and Europe, given historically tight job markets (watch job openings and payrolls data next week), forcing further Fed and ECB rate tightening. This is not a scenario for sustained outperformance of equities, especially with US corporate profit margins already under pressure and US earnings estimates still elevated (consensus expects 1.7% earnings growth in 2023).

Investment implications: The above backdrop confirms our concerns that equity markets, especially in the US and Europe, were under-pricing recession risks and that the equity run-up since October was another bear market rally (similar to Q3 last year). Hence, we would: a) fade the rally in US and Europe and take advantage of elevated bond yields to rebalance towards income assets and high grade bonds (see page 5 for how bonds would offer attractive returns even if US Treasury yields rise a bit higher); b) within equities, rebalance towards China equities – the upcoming National Peoples' Congress is likely to set a healthy target for a domestic consumer-driven economic recovery (see page 4); and c) the USD could still see further short-term upside as Fed terminal rates and US Treasury yields rise, but we would sell into the USD rally as markets eventually start pricing in a US recession and Fed rate cuts.

— 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.

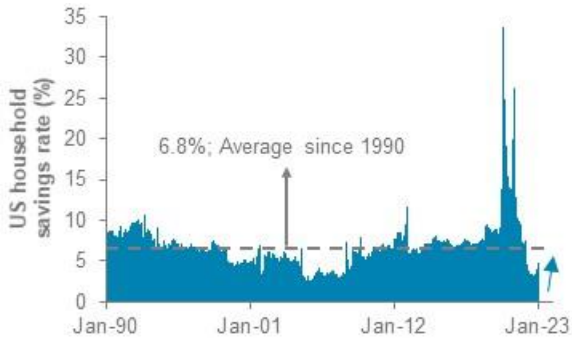
(+) factors: Strong China recovery, still-dovish BoJ; Brexit deal

(-) factors: Accelerating US and Euro area consumer inflation

	Positive for risk assets	Negative for risk assets
Macro data	• China official manufacturing and non-manufacturing PMI rose more than expected to 52.6 and 56.3, respectively; Private sector (Caixin) manufacturing and services PMI also rose more than expected • US core capital goods orders rose more than expected by 0.8% m/m	• US PCE headline and core inflation accelerated unexpectedly to 5.4% y/y and 4.7% y/y, respectively • US Conference Board consumer confidence fell unexpectedly • US ISM Manufacturing PMI was weaker than expected at 47.7; new orders PMI improved but remained in contraction territory (47.0) • Euro area headline and core inflation rose more than expected to 8.5% y/y and 5.6% y/y. Germany, France and Spain inflation rose unexpectedly
	Our assessment: Negative – Accelerating US and Euro area consumer inflation	
Policy developments	• BoJ Governor nominee Ueda reiterated the need to maintain ultra-low interest rates • China's President Xi signalled an overhaul of the government at the National People's Congress	• Fed officials said elevated inflation supported a policy rate higher than 5% • ECB's Lagarde called for a 50bps hike in March and said ECB would be data-dependent thereafter • China reportedly looking to curb addiction to short videos, renewing concerns about curbs on tech giants
	Our assessment: Negative – Hawkish Fed & ECB comments	
Other developments	• UK and EU agreed on Northern Ireland's post-Brexit trading rules, a key point of contention • Hong Kong removed mask mandate	• The US reportedly reviewing existing licenses for exporting items to Huawei
	Our assessment: Neutral – New post-Brexit deal vs US-China tensions	

US household savings rate appears to have bottomed after a sharp decline following the pandemic; rising savings rate would challenge the consumption-driven economy

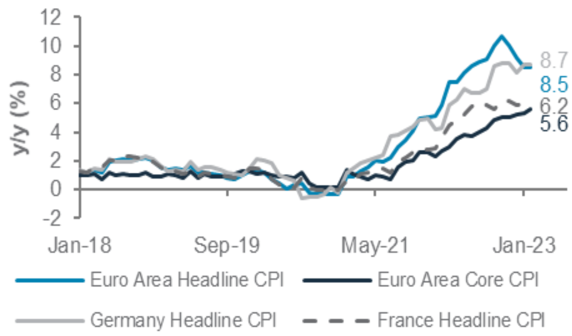
US household savings rate



Source: Bloomberg; Standard Chartered

Euro area inflation continues to deliver upside surprises, raising the chance of higher ECB rates

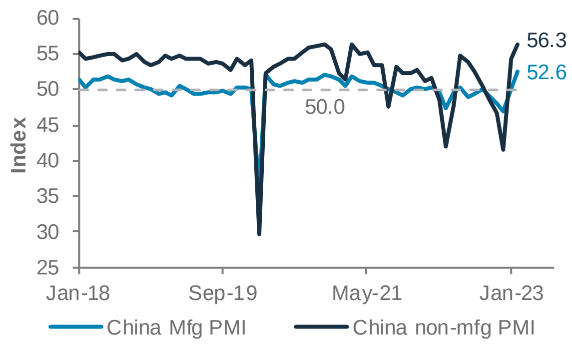
Euro area headline and core inflation; Germany and France headline inflation



Source: Bloomberg, Standard Chartered

China's stronger-than-expected rebound in manufacturing and services sector business confidence in February likely signals the start of a sustained upturn this year

China manufacturing and non-manufacturing PMI



Source: Bloomberg, Standard Chartered

Top client questions

China's National People's Congress 2023 – what are the key things to watch out for?

Mainland China's annual National People's Congress (NPC), starting on 5 March, has always been a closely watched event. It is especially so this year given the appointment of a new set of government leaders. We would focus specifically on the following:

Growth target: The policy priority remains on reviving growth and domestic demand. So, the growth target is likely to be set above 5%.

Policy reforms: Policymakers are likely to use the event to announce policy reforms. Potential areas of structural reform are promoting green development, boosting self-sufficiency to ensure supply chain security and further opening-up of capital markets.

Fiscal policy: With growth being a top priority, fiscal policy is likely to remain expansionary, while maintaining discipline. The consensus expects budget deficit to increase slightly to 3%, from 2.8% in 2022, targeted towards strategic industries (semiconductors, energy, Artificial Intelligence, robotics and rural community infrastructure).

Monetary policy: We expect policy to stay accommodative. Watch for any support for the property sector by encouraging first-time buyers. The appointment of a PBoC governor will be a key focus.

We believe markets have largely priced in these expectations. However, we cannot rule out the possibility of a policy bazooka which could drive risk assets higher. China's economy is rebounding following the removal of mobility restrictions, with the official manufacturing PMI rising to its highest in more than 10 years. The services PMI also beat expectations. The value of new home sales by the 100 biggest real estate developers climbed +16% y/y, the first y/y increase since June 2021, after policymakers expanded support for the sector. The strength of the recovery signals pent-up demand.

As a result, the Hang Seng Index rebounded strongly, recovering the psychological level at 20,000. Digging deeper into the technicals, we could be entering the "b-wave" (i.e. the rebound leg) of an "a-b-c" wave pattern, which could take us to the major resistance level at 21,300. Incidentally, this level roughly coincides with 21,240, which is the 50% Fibonacci retracement level of the range between 1) 22,700, which is the intraday peak of 2023, and 2) 19,783, the intraday low since the correction started at the end of Jan-23.

Ongoing geopolitical risks, very short-term USD strength and concerns about new internet regulations could act as near-term headwinds. If the resistance level holds, the index could test the 19,300-19,600 zone that we have previously highlighted. We would consider adding exposure to communication services and consumer discretionary sectors should the index retreat to such levels.

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

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

China likely to signal growth as a policy priority

China's GDP y/y growth targets for last 10 years

Year	Growth target	Reported
2012	7.50%	7.90%
2013	around 7.5%	7.80%
2014	around 7.5%	7.40%
2015	around 7%	7.00%
2016	6.5 - 7.0%	6.80%
2017	around 6.5%	6.90%
2018	around 6.5%	6.70%
2019	6.0 - 6.5%	6.00%
2020	None	2.20%
2021	above 6%	8.10%
2022	around 5.5%	3.00%
2023	**?**	**?**

Source: Bloomberg, Standard Chartered

Fiscal policy is likely to remain expansionary

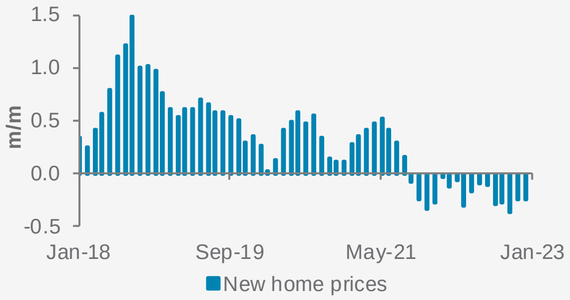
China's fiscal targets for last 5 years

Year	Fiscal deficit	Local government special bond quota (RMB trn)
2019	2.80%	2.15
2020	3.60%	3.75
2021	3.20%	3.65
2022	2.80%	3.65
2023	**?**	**?**

Source: Bloomberg, Standard Chartered

Home prices flat after 16 months of contraction

China's 70-city house prices



Source: Bloomberg, Standard Chartered

The Hang Seng Index has key resistance at 21,300

Hang Seng Index

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

How high can US government bond yields go?

The US 10-year government bond yield has broken key resistance level of 4% this week. Technical indicators (chart patterns and Fibonacci retracement levels) argue further upside is likely in the short term, with the next resistance at 4.11%, followed by 4.25%.

In our view, waning near-term recession fears and surprisingly strong inflation were key factors behind the yield reversing its prior downtrend. The upside pressure could persist if data continues to signal strong economic growth. Key data releases include Feb US payrolls (10 Mar) and CPI (14 Mar). Money markets now expect a 25bps hike at the next Fed meeting on 22 March, followed by another 25bps each in May and June meetings, before a pause. This implies one 25bps hike more than prior Fed projections. Hence, bond yields could peak if the Fed maintains its prior rate projections this month.

However, we would emphasize that we continue to view the rebound in yields as more tactical than a fundamental reversal. We continue to expect a US economic recession as a result of the Fed policy tightening. This, in turn, is likely to eventually cap bond yields as the tug of war between higher policy rates and prospects of slower growth are ultimately dominated by the latter. We continue to expect yields to move lower over the year. This suggests extending average maturities in bond portfolio. We are tempted to use the spike in long-term yields as an opportunity to add exposure to income assets.

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

Estimated annualized return for major bond asset classes under different yield change scenarios

Sensitivity to change in bond yields as of 2 Mar 2023

		EM USD govt	DM HY corp	EM LCY govt	Asia USD	DM IG corp	DM IG govt
Yield		8.6%	9.2%	6.8%	6.5%	5.3%	3.2%
Duration		6.7	4.1	5.0	4.5	6.1	7.4
Change in yield*	-1.5%	18.7%	15.3%	14.3%	13.2%	14.5%	14.4%
	-1.0%	15.4%	13.2%	11.8%	10.9%	11.4%	10.7%
	-0.5%	12.0%	11.2%	9.3%	8.7%	8.4%	6.9%
	0.0%	8.6%	9.2%	6.8%	6.5%	5.3%	3.2%
	0.5%	5.3%	7.2%	4.3%	4.2%	2.2%	-0.5%
	1.0%	1.9%	5.1%	1.8%	2.0%	-0.8%	-4.2%
	1.5%	-1.5%	3.1%	-0.7%	-0.3%	-3.9%	-8.0%

Source: Bloomberg, Standard Chartered

Is the recent decline in AUD a buy-on-dip opportunity?

In our assessment, the recent decline in AUD/USD was largely driven by the broad-based USD strength over the past month, owing to the market's reassessment of the Fed rate hike trajectory.

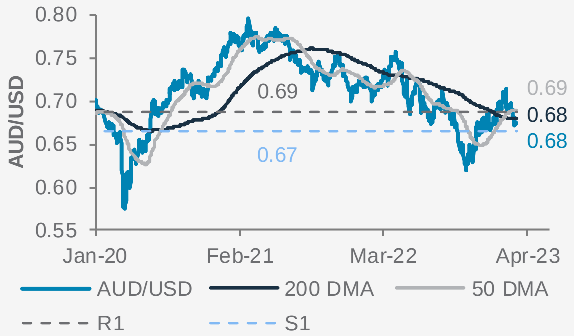
From a fundamental perspective, the recent weakness in Australian GDP data and the downside surprise in inflation could reduce the pressure on the RBA to hike rates, especially given the weakness in the real estate market. Hawkish Fed rhetoric could also narrow the US interest rate differential with the AUD. However, we see China's reopening, especially the faster-than-expected growth rebound, as a positive for the AUD given the trade linkages and a potential increase in commodity prices. Additionally, we believe the USD rally is showing signs of exhaustion, which, combined with the skewed positioning, could lead to a near-term bounce in AUD/USD.

In technical charts, we see signs of a near-term bottom in AUD/USD, which could present a good entry point for investors with a 3–6-month horizon. We see 0.6655, followed by 0.6540, as near-term supports, while 0.6885 and 0.7020 are likely resistance levels.

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

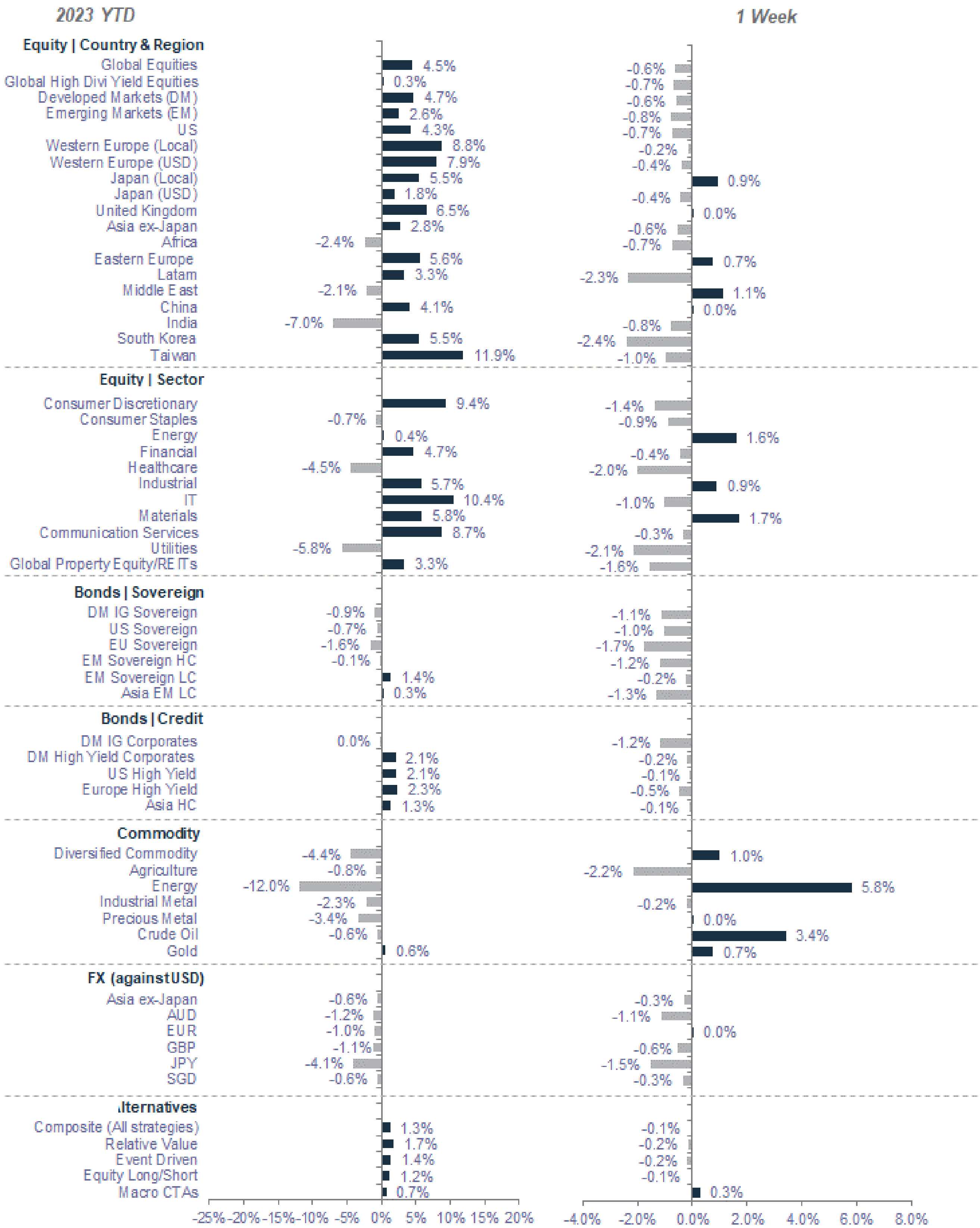
AUD/USD could consolidate between 0.6655 and 0.6885 before moving higher on a 3-month horizon

AUD/USD 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 2 March 2023; 1-week period: 23 February 2023 to 2 March 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	Sentix Investor Confidence	Mar	–	-8
	EC	Retail Sales y/y	Jan	–	-2.8%
TUE	AU	Reserve Bank of Australia Meeting	Feb		
WED	US	ADP Employment Change	Feb	200k	106k
	US	JOLTS Job Openings	Jan	–	11012k
	CA	Bank of Canada Meeting	Feb		
THU	CH	CPI y/y	Feb	1.9%	2.1%
	CH	PPI y/y	Feb	-1.3%	-0.8%
	CH	Money Supply M2 y/y	Feb	12.2%	12.6%
	CH	New Yuan Loans CNY	Feb	1500b	4900b
FRI/SAT	UK	Industrial Production y/y	Jan	–	-4.0%
	US	Change in Nonfarm Payrolls	Feb	220k	517k
	US	Unemployment Rate	Feb	3.4%	3.4%
	JP	Bank of Japan Monetary Policy Meeting	Feb		

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 4.1%

Technical indicators for key markets as of 02 March close

Index	Spot	1st support	1st resistance
S&P 500	3,981	3,961	3,992
STOXX 50	4,241	4,197	4,266
FTSE 100	7,944	7,899	7,967
Nikkei 225	27,805	27,552	27,929
Shanghai Comp	3,311	3,275	3,329
Hang Seng	20,429	19,937	20,771
MSCI Asia ex-Japan	636	627	641
MSCI EM	980	968	988
WTI (Spot)	84.5	83.1	85.4
Gold	1,840	1,821	1,850
UST 10y Yield	4.05	3.96	4.10

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

Investor diversity has normalised across asset classes

Our proprietary market diversity indicators as of 02 March

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	2.15
Global Equities	●	↑	2.16
Gold	●	↑	1.54
Equity			
MSCI US	●	↑	1.64
MSCI Europe	◐	↑	1.42
MSCI AC AXJ	●	↑	1.71
Fixed Income			
DM Corp Bond	●	↑	1.95
DM High Yield	●	↑	1.61
EM USD	●	↑	1.94
EM Local	◐	↑	1.45
Asia USD	●	→	1.51
Currencies			
EUR/USD	●	↑	1.66

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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