

Weekly Market View

Here comes the pullback

The pullback in US stocks was overdue, in our view, given overbought conditions, especially in the technology sector. We expect rising volatility heading into the US elections. However, improving economic fundamentals and growing policy support leaves us constructive on equities and other riskier assets

Equities: S&P500 index has strong support 3% below current level - a breach could lead to a retreat, but the long-term uptrend remains intact as long as the index stays above 3091

Bonds: We believe the Emerging Market USD bond rally has room to run further before valuations, especially in the High Yield segment, become stretched relative to fundamentals

FX: USD weakness has hit the pause button, with reward for holding EUR turning unattractive. US poll uncertainty could support the USD near-term

Here comes the
pullback

Also find out...

Is this the start of a correction, according to technical charts?

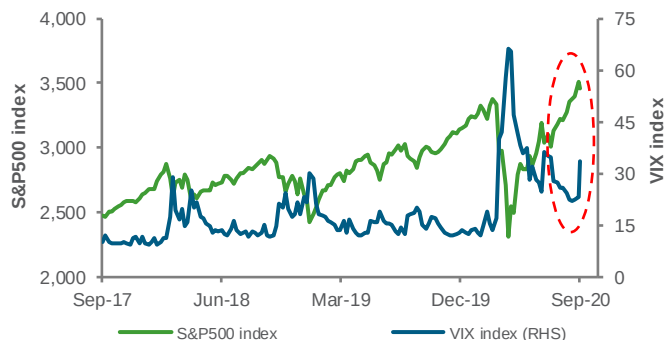
What is the outlook for Euro area and China equities after the Q2 earnings season?

What's next for the USD and the CNH?

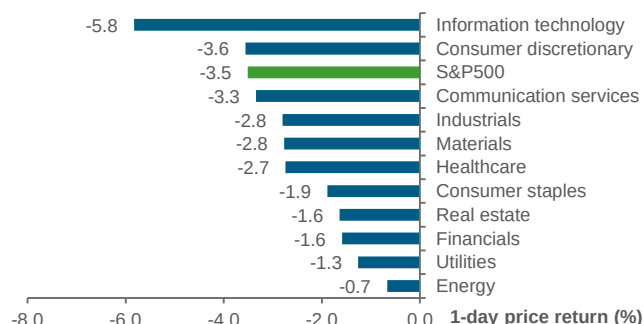
Charts of the week: Calming an overheated market

S&P500 index suffered its biggest one-day decline since June, led by losses in the technology sector

S&P500 volatility (VIX) rising again as the index pulled back from record



S&P500 index sector returns show technology led Thursday's decline



Editorial

Here comes the pullback

Risk assets were due for a correction. In these pages, we have previously alerted readers about the rising risk from an overheated and overbought market, particularly in the technology sector. While it is hard to pin down a specific trigger, we believe Thursday's Fed policymaker warning that another fiscal stimulus is urgently needed to sustain the economic recovery led markets to pull back.

What next after US stocks suffered their biggest one-day decline since June? Based on the charts, the S&P 500 index's sharp retreat on Thursday from near a key resistance and overbought territory raises the risk of a pause in the rally. Seasonality studies have shown that monthly returns on US stocks tend to be negative in September - a trend especially reinforced during US presidential election years. The index has key support at 3,355. Any break below would raise the odds of a consolidation/minor retreat over the next one month or so (see page 4).

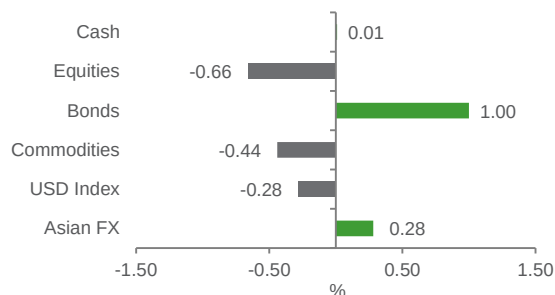
There are other pitfalls that could lead to near-term volatility: 1) Trump is catching up with Biden in the US polls, raising the risk of a tight finish at the November election, leading to vote recounts; 2) rising US-China tensions as the two parties burnish their hawkish credentials; 3) Second COVID-19 wave in Europe, slowing economic re-openings.

Nevertheless, we believe any such short-term volatility is likely to present an opportunity to add exposure to our preferred assets (see page 7) because the fundamental and policy drivers of the risk asset rally since March remain intact. Indeed, Fed Chair Powell's announcement of a more relaxed monetary policy framework last week sets the stage for further monetary policy easing, possibly as soon as its next meeting on 15-16 September. This should provide significant ballast to risk assets amid chances of more near-term market volatility.

A further pullback in stocks is also likely to put pressure on Republicans to set aside partisan politics and agree to a Democrat proposal for c. USD 2-3tn stimulus. More fiscal and monetary stimulus, against the backdrop of improving global economic fundamentals and expectations of a corporate earnings recovery in 2021 (see page 4) support our medium-term investment outlook, including our bearish 12-month view on the USD, bullish view on gold and constructive view on risk assets.

Equities, commodities and the USD pulled back in the past week, and bonds rose amid rising risk aversion

Benchmark market performance w/w*



Source: Bloomberg; *Week of 27 August 2020 to 3 September 2020

Our proprietary analysis shows market diversity is extremely low in Developed Market corporate bonds, raising the risk of a short-term trend reversal

Market diversity across key asset classes

Level 1	Diversity	Diversity trend since 4-Aug-20	Fractal Dimension
Global Bonds	○	→	1.24
MSCI ACWI	●	→	1.38
Gold	●	↑	1.34
Equity			
MSCI US	●	→	1.40
MSCI Europe	●	↑	2.09
MSCI AC AXJ	●	→	1.34
Fixed Income			
DM Corp Bond	○	→	1.23
DM High Yield	●	→	1.35
EM USD	●	→	1.30
EM Local Currency	●	↑	1.69
Asia Hard Currency	●	→	1.27
Currencies			
USD/CNY	●	↓	1.31
EUR/USD	●	↑	1.35
USD/JPY	●	↓	1.47
GBP/USD	●	→	1.33
AUD/USD	●	→	1.29

Source: Bloomberg, Standard Chartered; **Fractal dimensions below 1.25 indicate extremely low market diversity**

Legend: ○ Very low ● Low ● Moderate/high

The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	- Daily new COVID-19 cases in the US continued to fall for the second month after peaking in mid-July; cases in Japan and Australia continued to decline - US authorities told states to prepare for a possible vaccine by early November	- Daily new cases continued to rise in Europe, notably in Spain and France, prompting Germany's Merkel to warn the pandemic is likely to get worse before it gets better - Daily new cases in India scaled a new record high; new cases in Indonesia and Brazil stayed close to peak
	Our assessment: Neutral, on balance, as continued downtrend in US cases is offset by a revival of cases in Europe.	
Macro data	- A Fed survey showed accelerating economic activity and US initial jobless claims fell below estimates - US manufacturing business confidence index showed stronger-than-expected output and new orders in July; factory orders rose more than expected in July - China's private manufacturing sector business confidence (PMI) rose to its highest since 2011; non-manufacturing activity accelerated by more than expected	- US ISM services sector confidence index fell in August, missing estimates - Euro area core consumer inflation fell in August, turning negative y/y for the first time in four years; unemployment rate rose to 7.9% in July - Euro area retail sales fell m/m in July, missing estimates; consumer confidence, business climate indices remained negative
	Our assessment: Positive, on balance, as stronger-than-expected US and China activity indicators more than offset surprisingly weak data from Europe.	
Policy developments	- Fed's Williams said the central bank is focussing on maximum employment and that rate hike issues remain far off in the future - Fed's Brainard said monetary policy should "pivot from stabilisation to accommodation" - BoE signalled it has headroom for more bond purchases if needed - Japan's Cabinet Secretary Suga, front-runner to replace PM Abe, said he would maintain Abe's fiscal and monetary stimulus policies - French PM announced a EUR 100bn stimulus package and German policymakers are weighing relaxing debt limits	- US Senate majority leader McConnell said another stimulus package in the next few weeks is still uncertain, despite calls by Treasury Secretary Mnuchin to restart talks with Democrats - Fed's Brainard and Evans said US economic recovery 'critically' depends on another fiscal stimulus - A UK parliamentary committee is weighing an increase in taxes
	Our assessment: Neutral, on balance, with supportive monetary policy offset by delays in the US fiscal package.	
Other developments	- EU Brexit negotiator Barnier said he was "worried and disappointed" as the UK had not changed its stance - Reports suggested China could block a sale of the TikTok app to US investors	
	Our assessment: US-China tensions and Brexit talks remain risks.	

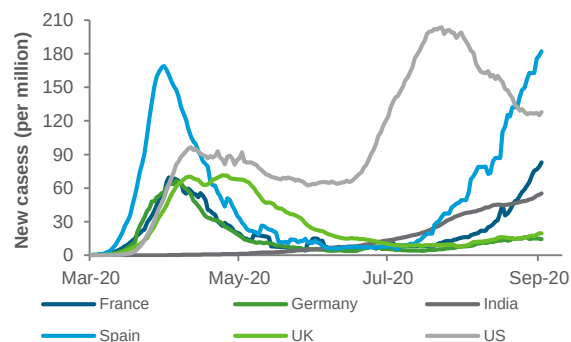
Our weekly net assessment: On balance, this week's data and policy were positive, though uncertainty over another US fiscal package is a risk.

(+) factor: Peak in US COVID-19, vaccine hopes, strong US and China data

(-) factor: Europe's COVID-19 cases and slowing data, US-China tensions

New COVID-19 cases have continued to decline in the US, but are on the rise in Europe and India

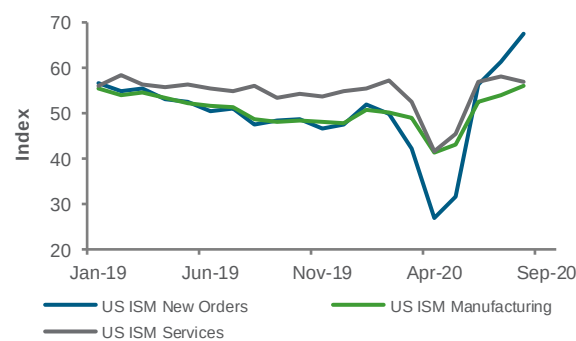
Daily new COVID-19 cases per million people in the US, key European markets and India



Source: Our World in Data, Standard Chartered

US manufacturing sector business confidence continued to rise in August; the surge in new manufacturing orders likely portends strong activity in the coming months

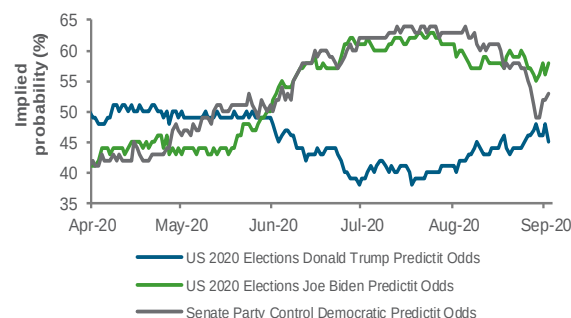
US ISM Manufacturing, New Orders and Non-Manufacturing Purchasing Managers Indices



Source: Bloomberg, Standard Chartered

The race to the White House has tightened recently, raising the risk of political uncertainty in the event of a close finish in November

PredictIt odds for presidential and Senate elections



Source: PredictIt, Standard Chartered

Top client questions

Q Is this the start of a correction in the S&P 500 index?

The S&P 500 index's sharp retreat on Thursday from near key resistance on an uptrend line from 2018 raises the risk of a short-term pause in the rally.

The 14-day Relative Strength Index (RSI), a measure of momentum, hit 82 earlier this week, well above the 70 level considered overbought. As the accompanying chart shows, RSI levels above 75 in the past have been followed by periods of consolidation in a rally. Similarly, seasonality studies have shown the VIX index tends to rise during August-October. Also, monthly returns from the S&P 500 index tend to be negative in September, a trend reinforced during US Presidential election years.

There is initial support at 3413, followed by 3355. Any break below 3355 would raise the odds of a consolidation or minor retreat over the next few weeks, in our view. After the largest move down in nearly three months, the risk arises both from profit-takers as well as technical selling pressure, especially on the technology sector, from hedging strategies which are forced to sell as markets fall. We believe it would be prudent to wait for another leg lower before considering selling volatility. However, the medium-term uptrend is unlikely to change while the index holds above the 200-day moving average (at 3091; ~10% below Thursday's close).

Q What is the outlook for Euro area and China equities based on Q2 earnings season disclosures?

Europe is 86% through the Q2 earnings season. Stoxx 600 Q2 earnings are expected to decline 52% (all percentages y/y), better than the 67% dip expected a month ago.

Healthcare is the only sector reporting positive earnings growth of 1% with all other sectors declining, energy being the hardest hit. UK earnings growth is among the lowest, with an expected fall of 125% (i.e. a loss). For 2020, Stoxx 600 consensus earnings are expected to drop 30%, an improvement from the 34% dip expected a month ago.

Although all of this argues earnings will fall sharply in 2020, we expect the market to focus on a potential earnings recovery in 2021 over the coming months. Our Group Investment Committee views Euro area equities as preferred, expecting earnings growth to rebound by 35% in 2021. UK equities are less preferred amid a likely slower 2021 earnings recovery.

China offshore equities beat Q2 earnings expectations while China onshore delivered in-line results. Healthcare, consumer discretionary, information technology and communication services (driven by strong media and entertainment demand) reported the biggest beats while financials, real estate and transportation were the laggards.

Q2 results reaffirmed our view that corporate earnings bottomed in Q1 and are on track for a recovery. We expect earnings expectations to continue rising as domestic consumption accelerates. We believe China offshore and onshore equities are on track to deliver 12-month forward EPS growth of 13% and 15% respectively. China equities remain preferred relative to Asia ex-Japan with healthcare, technology and consumer discretionary sectors preferred.

S&P500 charts suggest a near-term pause in the rally, but the medium-term uptrend remains intact

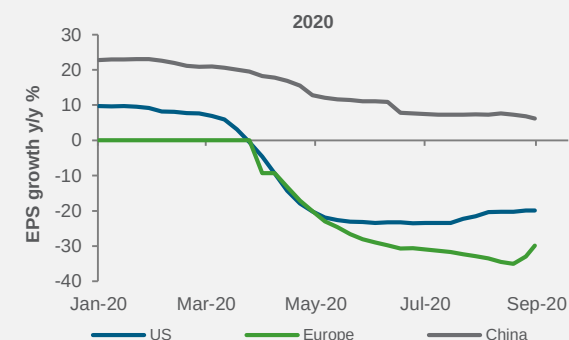
S&P500 index and RSI (a momentum indicator)



Source: Bloomberg, Standard Chartered

Earnings expectations for 2020 have stabilised across key markets, with some markets starting to recover, supporting our bullish outlook for equities

12-month forward earnings expectations



Source: Bloomberg, Standard Chartered

S&P500 index has support 1.2% below current level

Technical indicators for key markets as on 03 Sept. 2020

Index	Spot	1st support	1st resistance
S&P500	3,455	3,413	3,539
STOXX 50	3,304	3,272	3,337
FTSE 100	5,851	5,813	5,926
Nikkei 225	23,239	22,926	23,509
Shanghai Comp	3,385	3,376	3,402
Hang Seng	25,008	24,869	25,284
MSCI Asia ex-Japan	729	724	735
MSCI EM	1,109	1,100	1,120
Brent (ICE)	43.8	43.2	45.0
Gold	1,939	1,923	1,962
UST 10Y Yield	0.63	0.61	0.69

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Q Is the rally in HY within EM USD bonds sustainable?

Emerging Market (EM) USD bond yield premia continue to decline steadily. However, notably, the dip in yield premiums has been led by the High Yield (HY) segment, which accounts for nearly half of the EM USD government bond universe.

We believe there is scope for a further decline in yield premiums in the HY bonds, causing them to drive further yield premium declines for the EM USD bond asset class:

- 1) Yield premiums for IG bonds are back in line with historical medians, whereas HY bonds continue to trade cheap. Hence, relative valuations argue there is room for further gains in HY bonds within EM USD.
- 2) Recent USD weakness, and our expectations of more, is supportive for EM external balances. This should benefit EM HY as they are usually more sensitive to USD liquidity pressures.
- 3) Foreign investor flows into EM USD bonds are likely to sustain amid falling EM-specific concerns and the search for yield.

Therefore, while the recent rally in EM USD government HY bonds has been significant, we believe it can run further before valuations start becoming stretched relative to fundamentals. EM USD government bonds remain a preferred area within bonds.

Q What's next for the USD and the CNH?

The USD appears to be pausing after declining about 10% since March. Several currency pairs have also hit key resistance levels, including EUR/USD at 1.2000.

Indicators suggest the risk-reward for buying EUR/USD is currently unattractive, in our assessment. The first hint of EU discomfort with the strong EUR rally came from ECB's Chief Economist Lane, who said that though the ECB does not target the exchange rate, the level "does matter". Fundamentals have also shifted as the US reported stronger relative economic data, including PMI and new orders, and US COVID-19 numbers stabilise. Technicals show signs of trend fatigue and loss of momentum and a pullback towards the initial key support around 1.1685 is likely. Any rise in geopolitical uncertainty ahead of the US election would likely trigger a deeper pullback towards 1.1500-1.1600.

USD/CNH has also declined steadily. Economic and COVID-19 data have supported inflows into Chinese markets, and controlled economic stimulus continues. There has been no indication via the daily fixing rate that authorities are uncomfortable with a stronger currency. The US election process and outcome could cause a near-term bounce towards resistance at 6.9000-6.9200. It is interesting to note that since President Trump assumed office, the broad USD index has fallen by around 8%, but USD/CNH has been almost unchanged. Longer-term investors could, therefore, regard any CNH weakness as an opportunity to accumulate the currency if they believe future geopolitical uncertainty is already priced in. Notably, foreign inflows into China government bonds rose to a two-year high in August.

Although EM HY USD bond yield premiums have tightened vs IG peers, they remain wide relative to history, suggesting still-attractive valuations

Yield premium differential between High Yield and Investment Grade within EM USD government bonds



Source: Bloomberg, Standard Chartered

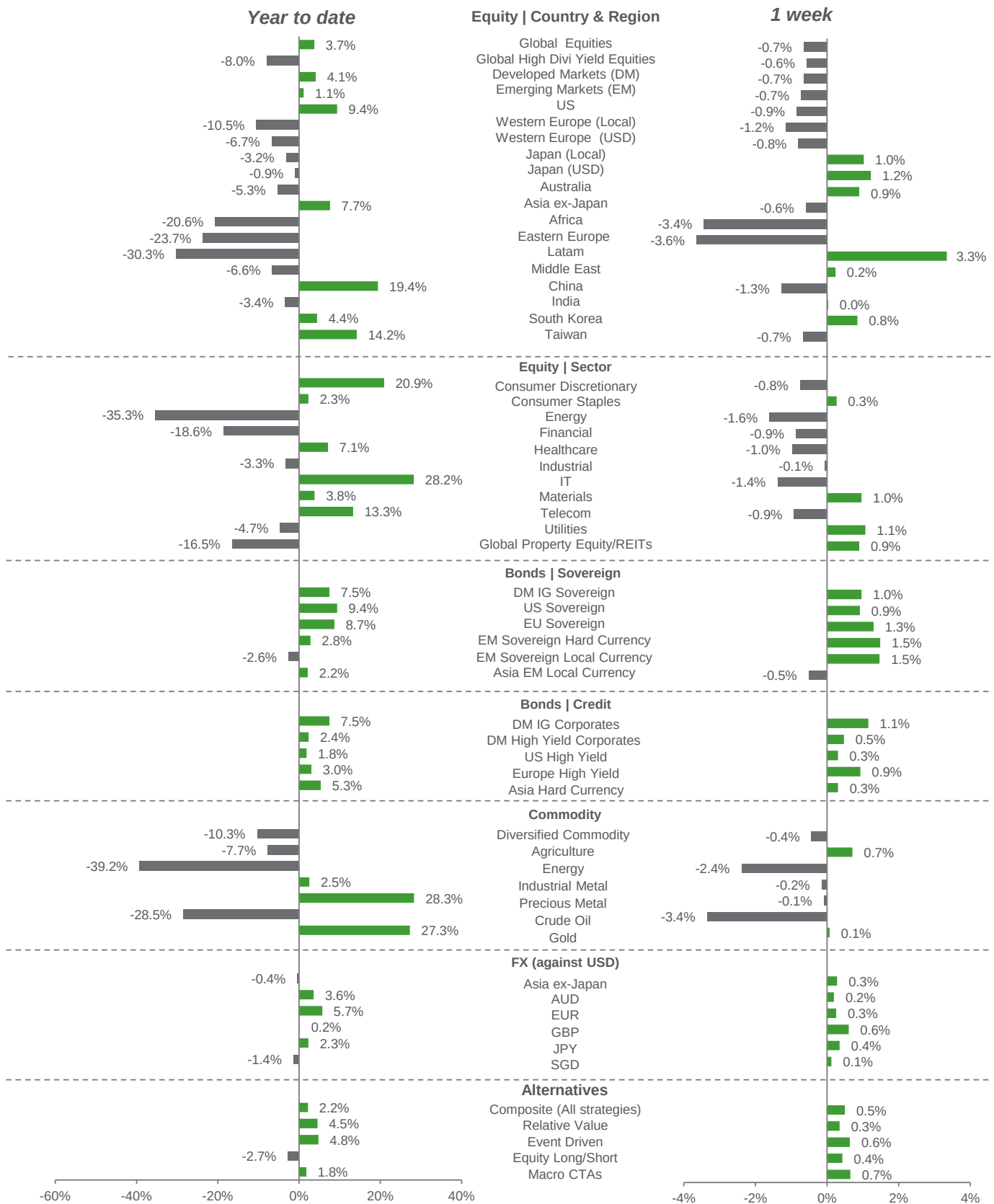
The broad USD has weakened almost 10% since President Trump assumed office in 2017, but USD/CNH is little changed, underscoring CNY's resilience

USD (DXY) index and USD/CNH



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 3 September 2020, 1 week period: 27 August 2020 to 3 September 2020

Our asset class views at a glance

					
Equities ▲	Bonds (Rates) ▼	Bonds (Credit) ▲	Alternative Strategies ◆	Cash ▼	Gold ▲
Asia ex-Japan ▲	Govt EM local ◆	Asia USD ▲	Equity hedge ◆	USD ▼	
US ▲	Govt DM IG ▼	Govt EM USD ▲	Event-driven ◆	EUR ▲	
Euro area ▲		Corp DM HY ▲	Relative value ◆	GBP ▲	
Japan ◆		Corp DM IG ▼	Global macro ◆	AUD ▲	
Other EM ◆				CNY ◆	
UK ▼				JPY ◆	

Source: Standard Chartered Global Investment Committee

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

Economic and market calendar

	Event	This Week	Period	Actual	Event	Next Week	Period	Prior
MON	JN	Industrial Production y/y	Jul P	-16.1%	GE	Industrial Production WDA y/y	Jul	-11.7%
	JN	Retail Sales y/y	Jul	-2.8%	EC	Sentix Investor Confidence	Sep	-13.4
	CH	Manufacturing PMI	Aug	51.0	CH	Exports y/y	Aug	7.2%
	JN	Consumer Confidence Index	Aug	29.3				
TUE	JN	Jobless Rate	Jul	2.9%	JN	Household Spending y/y	Jul	-1.2%
	EC	Unemployment Rate	Jul	7.9%				
	EC	CPI Core y/y	Aug P	0.4%				
	US	ISM Manufacturing	Aug	56.0				
WED	GE	Retail Sales NSA y/y	Jul	4.2%	CH	CPI y/y	Aug	2.7%
					JN	Machine Tool Orders y/y	Aug P	-31.1%
THUR	IN	Markit India PMI Composite	Aug	46.0	FR	Industrial Production y/y	Jul	-11.7%
	EC	Retail Sales y/y	Jul	0.4%	EC	ECB Deposit Facility Rate	10-Sep	-0.5%
	US	ISM Non-Manufacturing PMI	Aug	56.9	CH	Money Supply M2 y/y	Aug	10.7%
					CH	New Yuan Loans CNY	Aug	992.7b
FRI/SAT	GE	Factory Orders WDA y/y	Jul	—	UK	Industrial Production y/y	Jul	-12.5%
	UK	Markit/CIPS UK Construction PMI	Aug	—	IN	Industrial Production y/y	Jul	-16.6%
	US	Change in Nonfarm Payrolls	Aug	—	US	CPI Ex Food and Energy y/y	Aug	1.6%
	US	Unemployment Rate	Aug	—	US	Real Avg Weekly Earnings y/y	Aug	4.3%
	US	Average Hourly Earnings y/y	Aug	—				

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue; *refers to Jan-Feb 2020 combined data

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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