

Weekly Market View



The oil price slump raises deflation risks, although the unprecedented policy measures taken so far should help mitigate these

Equities: We remain positive in the next 6-12 months, although there is a risk of a pullback over the next month or so

Bonds: Cheaper valuations tip the scale in favour of Emerging Market bonds, despite risks in some markets

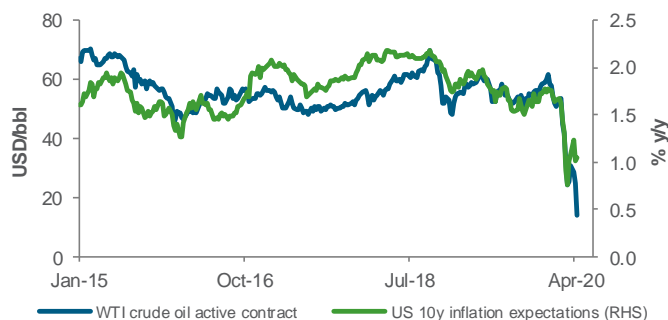
FX: USD is likely to remain stable against major currencies, while staying strong vs. Emerging Markets

Implications of the oil slump

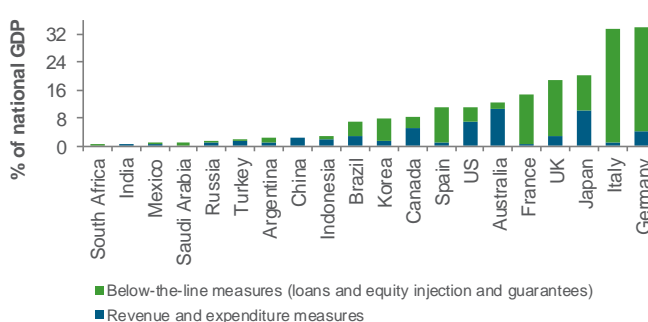
Chart of the week: Lower oil to subdue inflation as stimulus picks up

Lower oil prices have cut inflation expectations, which should keep interest rates low, enabling governments to finance fiscal spending

Oil price (active contract) and 10-year inflation expectations



G20 fiscal response to COVID-19 pandemic, % of GDP



Source: Bloomberg, Standard Chartered; fiscal stimulus are IMF estimates, which include budgetary and non-budgetary measures, including loan guarantees

Editorial

Implications of the oil slump

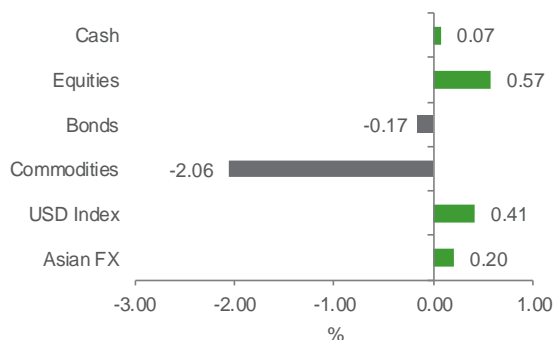
Risk assets consolidated after their sharp rebound since end-March. The plunge in oil prices likely means higher disposable income for consumers worldwide and lower energy costs for manufacturers and businesses. Lower oil prices have also dragged down the market's long-term inflation expectations. This, in turn, should enable central banks to maintain ultra-accommodative policies for longer. The resulting lower interest rates should also help governments finance the record surge in fiscal spending. However, the plunge in oil prices is likely to increase solvency risks for energy producing economies and sectors, especially in the US shale industry. In the following pages, we assess the implications of this across asset classes, including US High Yield (HY) and Emerging Market (EM) bonds and energy sector equities. More broadly, it raises concerns about deflationary risks. The key here is to break the negative feedback loop in consumer expectations. We believe the unprecedented monetary and fiscal measures should help mitigate this risk. More such steps would likely be needed if the growth outlook remains depressed.

Sentiment outside the oil sector continues to improve, with equity markets consolidating on previous gains. COVID-19 infections have decelerated in recent weeks across Europe, and Germany has allowed some shops and schools to reopen. Italy, the epicentre of the outbreak in Europe, is due to lay out plans to lift restrictions from 4 May. In the US, new infections have plateaued, enabling some states (Texas and Minnesota) to ease lockdowns. Meanwhile, policymakers have stepped up stimulus measures: the US Congress approved another c. USD 500bn package for small businesses, the EU is considering a EUR 1trn spending plan and China is accelerating spending on infrastructure.

These policy measures (with pledges from governments of more to come), in our assessment, are decidedly positive for risk assets in the next 6-12 months, although there is elevated risk of a pullback in the next month or so. Since it is hard to time market bottoms, we believe the prudent course would be to follow a disciplined strategy to gradually add exposure (see our recent publication "4 strategies for the current environment"). In the near term, investors also have an opportunity to earn income by selling volatility at the current elevated levels.

Global equities consolidated gains made since late March, despite a sharp drop in oil prices; the USD extended gains

Benchmark market performance w/w*



Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered

*Week of 17 April 2020 to 23 April 2020

US and Asia ex-Japan equity market technicals remained positive; European equity technicals remain weak

Technical indicators for key markets as on 23 April 2020

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,798	2,640	2,875	↑
STOXX 50	2,852	2,693	2,990	↓
FTSE 100	5,827	5,478	5,900	↓
Nikkei 225	19,429	18,400	20,300	↗
Shanghai Comp	2,838	2,775	2,880	→
Hang Seng	23,977	23,500	24,600	↑
MSCI Asia ex-Japan	589	560	615	↗
MSCI EM	889	855	930	↗
Brent (ICE)	22	13	29	↓
Gold	1,725	1,645	1,745	↑
UST 10Y Yield	0.60	0.30	1.27	↓

Source: Trading Central, Standard Chartered

Note: Arrows represent short-term trend opinions

Factors to watch

COVID-19 cases decelerate in Europe, peak in the US

New daily cases of COVID-19 continued to decelerate in the main hotspots of Europe, notably in Italy. However, mortality rates, especially in care homes across Europe, remain elevated. The UK plans to step up testing significantly in the coming days, which raises the possibility of a rise in the number of confirmed cases. In the US, the numbers have plateaued, albeit at a high level. In Asia, new confirmed cases rose significantly in Singapore as it accelerated testing and extended its lockdown by a month to 1 June.

Germany re-opens; lockdowns eased in some US states

Some shops and business establishments re-opened in Germany this week as the outbreak subsided. Germany's early return to normalcy reflects its relatively strong healthcare infrastructure (including adequate number of hospital ICU beds vs. population) and its ability to test a large segment of its residents for the virus. Germany's example shows raising testing capacity will be critical for other major economies as they plan to ease restrictions over the coming weeks, especially with leading medical experts suggesting that a vaccine or drug could be at least a few months away. This is particularly relevant for Italy, which is due to unveil a roadmap for re-opening its economy from 4 May. Easing restrictions too quickly, without widespread testing, could risk a second wave of infections. In the US, some states, such as Texas and Minnesota, eased lockdowns, while others plan to re-open in the coming weeks. This raises the risk of a second wave, given the low levels of testing nationwide.

Yet more stimulus in the US, Europe and Asia

The US Congress approved another c.USD 500bn stimulus package for the small business sector, after an earlier lending programme was exhausted within weeks of its launch. House of Representatives Speaker Nancy Pelosi promised more stimulus for the states and local governments that will not benefit from the latest package. EU leaders have proposed a new EUR 1trn spending plan. The key to watch here would be whether they can overcome opposition from Germany and Netherlands to share the region's debt burden by issuing common regional bonds. Meanwhile, commercial banks in China followed through with rate cuts after the PBoC cut a key medium-term rate last week. In India, the RBI cut rates and promised to take more easing measures.

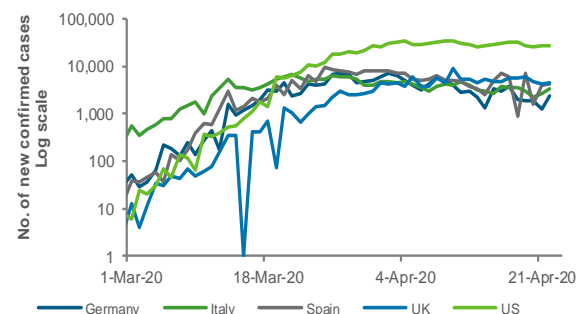
Are the stimulus measures adequate?

We believe the unprecedented size and speed of the policy response so far should be sufficient to drive an economic recovery by H2, if the COVID-19 spread is tamed in the next few months. Further stimulus would be needed if the pandemic lasts longer, hurting the prospects of an early return to normal economic activity. The good news is strict lockdowns appear to have worked in China and South Korea, where activity has started to return gradually towards normal.

North Asia's experience implies Europe and the US should see a similar recovery with a 1-2 month lag. Also, most governments and central banks have cast aside rule books and have pledged to do "whatever it takes" to mitigate the economic damage to households and businesses and to prevent the temporary liquidity crisis from evolving into a solvency crisis. Some Emerging Markets face a more challenging outlook due to limitations to healthcare infrastructure, which could prevent a faster return to normal economic activity. Those with chronic budget and current account deficits are particularly likely to come under strain.

New COVID-19 cases have continued to decelerate in Europe and have plateaued in the US

Daily new COVID-19 cases in countries ranked among the top five in terms of number of total confirmed cases globally



Source: Bloomberg; Standard Chartered

Euro area medium-term growth expectations have recovered amid stimulus measures and as the virus outbreak peaked; near-term sentiment remains downbeat

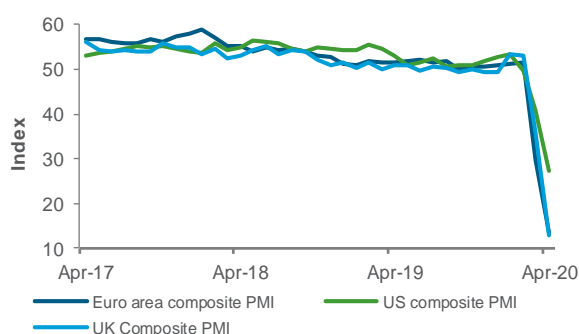
Euro area ZEW survey indices for current conditions and medium-term expectations



Source: Bloomberg; Standard Chartered

Business confidence indicators show the depth of the downturn; stimulus policies are likely to be sufficient to start a recovery by H2 if the virus outbreak is tamed soon

Markit PMIs for the Euro area, UK and the US



Source: Bloomberg, Standard Chartered

Top client questions

Q Can you help me understand the moves across various types of oil prices?

WTI crude oil prices (measured by the active month contract) plunged into negative territory earlier this week. This was a result of technical factors, such as lower liquidity and a lack of storage.

Understanding how oil price contracts, for current and future months, are structured is key to understanding why these technical problems occurred. From a professional trader's perspective, holding an active month contract will mean choosing to either take actual delivery of oil at the end of the month, or rolling over into a contract for a later date.

On the first, storage capacity constraints worked to push prices lower. Most US storage facilities are close to full or are available at increasingly higher prices.

On the second, oil price contracts for future months are currently at higher prices than the active month. This means a professional trader in the industry faces a significant cost of making this switch.

These constraints notwithstanding, we expect a gradual recovery in oil prices over the next 3-12 months. This is underpinned by the recent OPEC+ action (effective as of 1 May), as well as our expectations of global demand picking up as countries slowly restart their economies. Given the factors we have highlighted above, we believe expressing this view via other energy-linked asset markets may be more prudent.

Note that the oil futures market is very complex and is dominated by professional investors. The unique characteristics of physical delivery can lead to extreme volatility and is therefore not suitable for retail investors, in our opinion.

Q What is the macroeconomic impact of lower oil prices?

One significant macroeconomic risk from lower oil prices is the likelihood of further downward pressure in inflation.

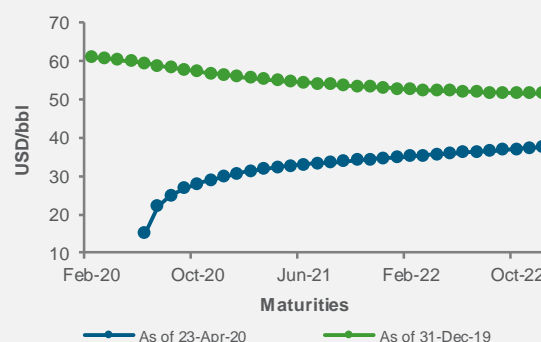
Economic shutdowns aimed at slowing the spread of COVID-19 have arguably created a deflationary shock. This comes through from the sudden stops in demand (from consumers and corporations), which government spending aims to at least partly offset. A fall in oil prices risks reinforcing this deflationary shock – as the chart alongside illustrates, the change in oil prices can have a significant impact on the market's expectations for future inflation. This is significant because expectations of falling prices mean consumers tend to put off purchases until prices fall further, leading to a downward spiral in demand and prices. Japan's experience since the 1990s show that policymakers have struggled to break such a price spiral.

Generally speaking, deflationary pressures push bond yields low (and hence tend to be positive for income-oriented assets) and are positive for the currency (by pushing net-of-inflation yields higher). A stronger USD would, in turn, reinforce deflationary pressures in the US and globally. The impact on equity markets is more difficult to isolate, but widespread deflation would generally have a negative impact on equities (and on overall wealth) if prices of their output continue to fall.

However, we do not see a sustained move into deflation given unprecedented fiscal/monetary easing and the clear commitment by policymakers to do what it takes to avoid such a negative spiral.

Acute shortage of crude oil storage facilities has led to a sharp drop in near-term prices; prices have fallen less significantly over the longer-term contracts

WTI oil prices for delivery across various maturities; current vs end-2019



Source: Bloomberg; Standard Chartered

The plunge in crude oil prices have lowered long-term inflation expectations significantly

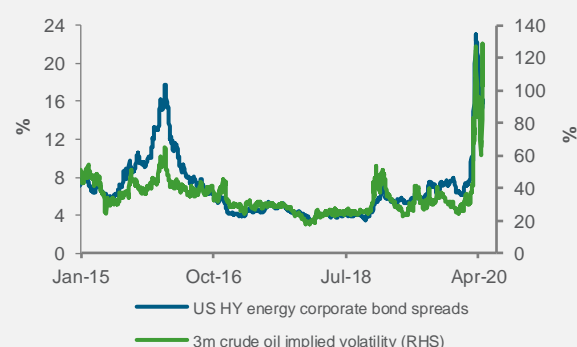
Crude oil prices (measured by price for delivery in 12 months) and US 10-year inflation expectations



Source: Bloomberg; Standard Chartered

US energy sector High Yield bond yield premiums have surged as oil price volatility increased and prices fell

US energy sector HY corporate bond premiums over US Treasuries; 3-month crude oil price implied volatility



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

Q What are the implications for energy-linked asset markets?

For all the headlines around oil prices, the recent market impact on equity, bond or currency markets have been fairly contained. However, each asset class offers a slightly different perspective:

- **Oil-linked FX:** USD/CAD – sensitive to oil prices given crude is a key Canadian export – could retrace lower in the near term if headlines around crude oil prices turn around, as we expect over the next 3-12 months. Immediate resistance is seen at 1.4260.
- **US HY corporate bonds:** Despite nominally attractive yields, we see further stress within the HY energy sector and would caution against adding exposure as the risk-reward remains unattractive.
- **Energy sector equities:** Energy is a less preferred sector in the US, Europe and China. Since the February high for global equities, the sector is the worst performer, down 37%.

Following this painful capital loss, a key question facing investors in the sector is whether dividends are secure. The sector currently offers a dividend yield of 7%, although investors who gained exposure to the sector in January will have an effective dividend yield of 3.7%. The outlook for dividends among major oil companies in the US companies are secure, in our opinion. Historically, US oil majors have maintained dividends, even during the prior price collapse in 2008. For European oil majors, there is a risk of dividend cuts. European oil majors have historically adjusted dividends to reflect the oil price environment, cutting dividends in 2010 following the 2008 price collapse.

Q Should investors raise or reduce global equities exposure?

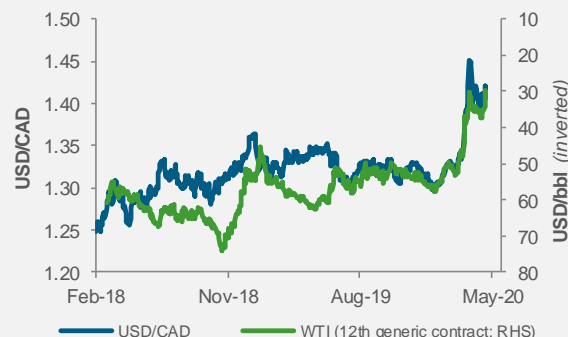
Global equities are a preferred asset class and, while the next 1 month is likely to remain challenging, we believe steadily increasing exposure to equities on a 3-12-month view remains the best strategy. While consensus expectations are for global equity earnings to decline 11% in 2020, they are forecast to rebound 21% in 2021. This rebound in 2021 earnings expectations, in combination with the unprecedented policy response, is driving markets higher currently, in our view.

Bullish equity strategists frequently cite the unprecedented monetary and fiscal policy stimulus as reasons for optimism. Specifically, actions by the Fed, ECB and PBoC have lowered the 'risk-free' rate benchmark, which is a key input analysts use to calculate the present value of future profits. The decline in the risk-free rate has increased the value of those future profits, thus justifying higher valuations. This implies the market may not fall to the valuation lows witnessed in prior bear markets.

Bearish strategists frequently cite the permanent loss of sales and profits as a result of the unprecedented recession that is likely to be experienced in 2020. Lower risk-free rates will only partially help offset lost sales and profits as a result of new ways of working and changing consumption patterns. They acknowledge that valuations may not fall to prior bear market averages, but even using a higher valuation multiple to value smaller profits implies the equity market faces further downside risk in the short term.

USD/CAD is sensitive to oil prices given Canada's oil exports; the pair could retrace lower if crude oil prices rebound (as we expect over the next 3-12 months)

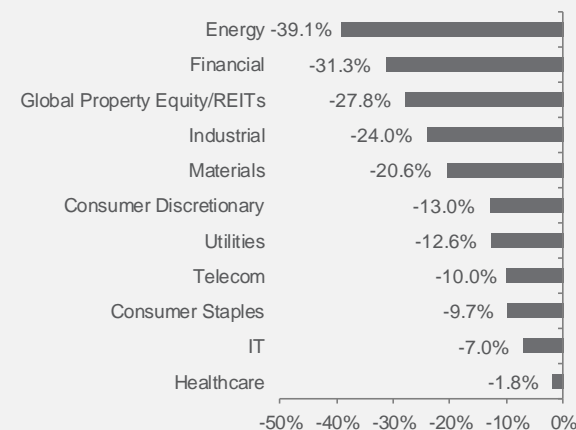
USD/CAD; WTI oil price for delivery in 12 months



Source: Bloomberg, Standard Chartered

Energy sector equities have been the worst performers so far this year, dragged lower by the drop in oil prices

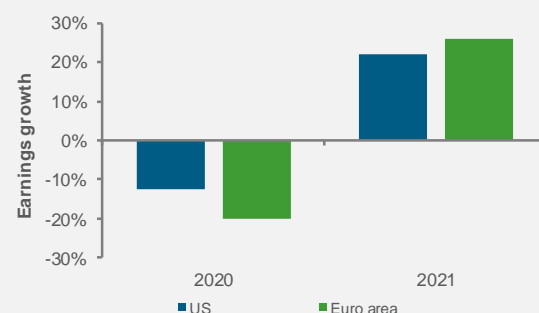
Relative performance of various global equity sectors YTD



Source: Bloomberg; Standard Chartered

Consensus expectations suggest a sharp drop in 2020 earnings, followed by a significant rebound in 2021

Consensus estimates of 2020 and 2021 earnings for the US and Euro area



Source: Refinitiv; Standard Chartered

Top client questions (cont'd)

Our view sits somewhere in the middle; global equities are a preferred asset class, and in our view, markets will be higher in 12 months compared to today. In the short term, we expect equities to pare back recent gains in the next month or so. Technical analysis indicates that we are at the upper end of a range for the S&P500 that extends to 3,000 on the upside and February's low of 2,237 on the downside.

Q Are EM USD bonds still preferred amid risk of rising defaults following the drop in oil prices?

EM USD government bond yield premiums over Treasuries remain elevated and have lagged the recent Fed policy-led rally in US IG and HY corporate bonds. The ongoing global growth slowdown, reduction in trade and decline in lower commodity prices have brought EM USD government bonds under greater scrutiny.

The plunge in oil prices is, on its own, a negative for the asset class since EM countries are net oil exporters, with the recent inclusion of Gulf country bonds into EM bond indices intensifying this somewhat. Defaults by Argentina and Lebanon recently highlight the rising risk of sovereign defaults.

However, we believe that EM countries may be slightly better positioned to navigate the fall in oil prices than corporates, since sovereigns are likely to have more tools at their disposal to manage their finances. Additionally, multi-lateral institutions like the IMF have stepped in to help frontier countries manage their external liabilities.

In our view, cheaper valuation tips the scales in favour of the asset class. Yield premiums are closer to their historical recessionary peaks than most corporate bond markets. Additionally, in 2008, the default rate for EM issuers was lower than that of US HY bonds. Thus, while the risk of defaults has increased, we still believe that EM USD government bonds offer an attractive risk-reward.

Q Will USD strength continue in the coming weeks?

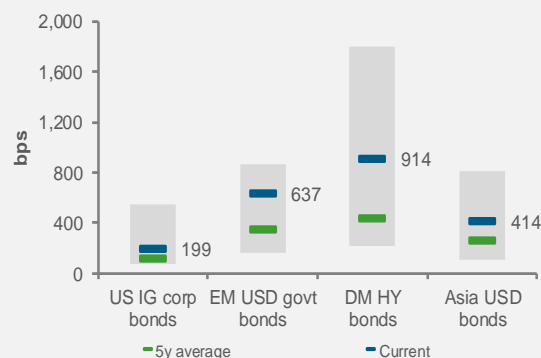
The USD index (DXY) has been trading in a tight range, but this has masked more complex price action. While it has stayed rangebound against core major currencies, the USD has been strong against EM and Asian currencies and weak against "recovering currencies" like the AUD and NZD. We expect these trends to continue.

The key currency pair for the overall USD trend is EUR/USD. While the Fed has massively increased global USD liquidity to limit USD gains, EUR/USD has been unable to accelerate due to European policy uncertainty. We see key technical supports around 1.0750 and then the March low at 1.0635. If these levels give way, we expect momentum to carry the pair lower towards the 2016 low at 1.0340. A falling EUR/USD would likely mean an even stronger USD versus EM and Asia. However, if this support holds, key resistance between 1.1000 and 1.1065 must break for a positive trend to establish.

A strong USD dampens global growth. We expect the Fed to continue to manage monetary policy to provide more global USD liquidity if needed, or "talk" the USD lower. In the interim, we expect the EUR to be supported on the crosses, and we currently have bullish high conviction ideas on EUR/JPY and EUR/SGD.

Yield premium on EM USD government bonds are closer to their historical recessionary peaks than most corporate bond markets, making valuations attractive

Yield premium of various bond sub-asset classes vs. their five-year average



Source: Bloomberg, Standard Chartered

EUR/USD has technical support around 1.0750, followed by the March low of 1.0635; a falling EUR would likely mean an even stronger USD against EM currencies

EUR/USD



Source: Bloomberg, Standard Chartered

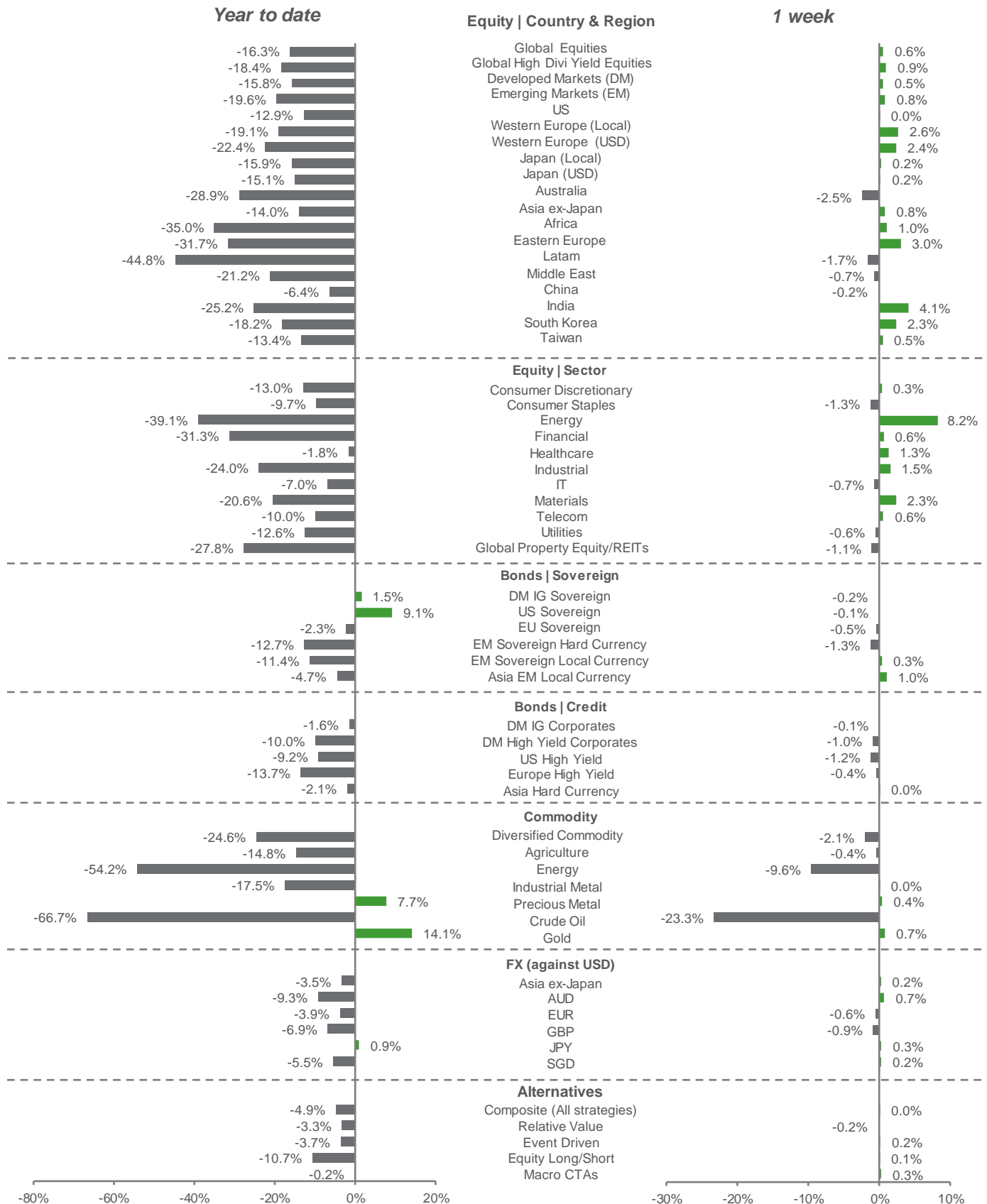
The USD has risen primarily against Emerging Market currencies, less so against Developed Market currencies

USD (DXY) index; JPMorgan EM currency index (inverted)



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 23 April 2020, 1 week period: 17 April 2020 to 23 April 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	JN	BOJ Policy Balance Rate	27-Apr-2020	28-Apr	–	-0.1%
	CH	Industrial Profits y/y	27-Apr-2020	Mar	–	–
TUE						
WED	EC	M3 Money Supply y/y	29-Apr-2020	Mar	–	5.5%
	EC	Economic Confidence	29-Apr-2020	Apr	–	94.5
	US	Core PCE q/q	29-Apr-2020	1Q A	–	1.3%
	US	GDP Annualized q/q	29-Apr-2020	1Q A	-3.7%	2.1%
THUR	US	FOMC Rate Decision (Upper Bound)	30-Apr-2020	29-Apr	0.3%	–
	JN	Industrial Production y/y	30-Apr-2020	Mar P	-9.6%	-5.7%
	CH	Manufacturing PMI	30-Apr-2020	Apr	51	52
	CH	Non-manufacturing PMI	30-Apr-2020	Apr	50.5	52.3
	EC	CPI Core y/y	30-Apr-2020	Apr P	–	1.0%
	EC	ECB Main Refinancing Rate	30-Apr-2020	30-Apr	–	0.0%
	US	Initial Jobless Claims	30-Apr-2020	25-Apr	–	–
	US	Personal Income	30-Apr-2020	Mar	-1.2%	0.6%
	US	Real Personal Spending	30-Apr-2020	Mar	-1.8%	0.1%
FR/ SAT	US	ISM Manufacturing	01-May-2020	Apr	39.1	49.1

	Event	This Week	Date	Period	Actual	Prior
MON	JN	Exports y/y	20-Apr-2020	Mar	-11.7%	-1.0%
TUE	EC	ZEW Survey Expectations	21-Apr-2020	Apr	25.2	-49.5
	US	Existing Home Sales	21-Apr-2020	Mar	5.27m	5.76m
WED	UK	CPI Core y/y	22-Apr-2020	Mar	1.6%	1.7%
	EC	Consumer Confidence	22-Apr-2020	Apr A	-22.7	-11.6
THUR	UK	Retail Sales Ex Auto Fuel y/y	23-Apr-2020	Mar	–	0.5%
	GE	Markit/BME Germany Composite PMI	23-Apr-2020	Apr P	17.1	35
	EC	Markit Eurozone Composite PMI	23-Apr-2020	Apr P	13.5	29.7
	US	Initial Jobless Claims	23-Apr-2020	18-Apr	4427k	5237k
	US	Markit US Composite PMI	23-Apr-2020	Apr P	27.4	40.9
	US	New Home Sales	23-Apr-2020	Mar	627k	741k
FR/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	24-Apr-2020	Mar	0.6%	0.6%
	GE	IFO Expectations	24-Apr-2020	Apr	–	79.7
	US	Cap Goods Orders Nondef Ex Air	24-Apr-2020	Mar P	–	-0.9%
	US	Durable Goods Orders	24-Apr-2020	Mar P	–	1.2%

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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