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WM Chief Investment Office
16 July 2021

Weekly Market View

Is China policy tightening over?

China's cut in bank reserve requirements raises the chance of further policy easing. We would need to see signs of further relaxation, especially with regard to regulatory policies, before we consider turning more bullish on Chinese equities.

We believe USD-denominated corporate bonds are a more attractive route to taking exposure to China, besides select equity sectors which are likely to benefit from targeted government policy support and the ongoing global economic expansion.

Equities: We expect Value-style equities to resume their outperformance over Growth peers amid a robust global growth outlook and a recovery in bond yields.

Bonds: We have a preference for High Yield USD corporate bonds in Asia, given their attractive valuation over Investment Grade peers.

FX: We see an opportunity for short-term JPY gains versus the EUR and AUD

+

What are the implications of China's policy easing on Asia USD bonds?

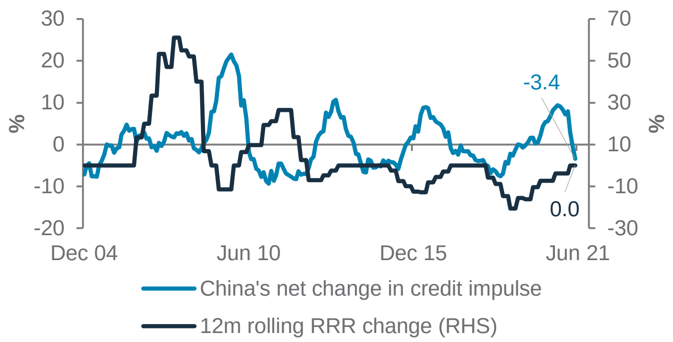
What are the catalysts for G10 currencies to rise against the USD?

What are technical charts saying about US stocks and the Treasury yield?

Charts of the week: Rising chance of further policy easing

China's sharply slowing credit growth heralded the latest easing of monetary policy

12m net change in credit impulse* & bank reserve ratio**



Change in total financing aggregate stock, nominal GDP

Source: Bloomberg, Standard Chartered; *Change in new credit as a proportion of GDP; **Share of deposits banks required to hold as reserves

Editorial

Is China policy tightening over?

China's 50bps cut in bank reserve requirements this week – which should boost liquidity by c. CNY 1trn - is a sign that authorities are starting to unwind some of the tight monetary policies pursued in H1 that were aimed at preventing the economy from overheating. While the latest move raises the chances of further policy easing – China has never cut the reserve ratio only once during an easing cycle – signs of further easing, especially with regard to regulatory policies, are needed before considering turning more bullish on China equities. We believe USD-denominated corporate bonds are a more attractive route to taking exposure in China, besides select equity sectors that are likely to benefit from targeted government policies and the ongoing global economic expansion.

The PBoC's latest policy shift was in line with our expectations - we turned neutral on China's monetary policy outlook from a hawkish stance in May. A couple of indicators heralded this shift, in our view: First, overall credit growth had slowed below nominal GDP growth for the first time in three years. Second, although China's growth accelerated to 1.3% q/q in Q2 from 0.4% in Q1, it is the only major economy which is expected to grow at a slower pace in 2022 than before the pandemic. We believe policymakers are unlikely to let growth slow significantly and risk any financial instability ahead of next year's crucial Party Congress.

The good news is China's successful vaccination campaign. Starting well behind the US and Europe, China has now inoculated half its population. That is similar to the rates in the US and the UK, which had started their vaccination campaign earlier than China. As China's campaign continues apace, it is likely to achieve the so-called herd immunity (broadly seen as 70%-80% of the population inoculated) in the next few months. This should help further normalisation of daily activities, supporting consumption and services sector growth.

Inflation is likely a key constraint for authorities to ease policy further. Although China's headline inflation eased to 1.1% in June, inflation excluding pork prices accelerated to 1.9%. Consensus estimates point to an acceleration in headline inflation to 2.5% by Q4 as producers pass rising raw materials costs to consumers.

Tightening regulations, aimed at curbing monopolistic behaviour in the internet sector and deleveraging in the property sector, are other risks. This was evident from last week's crackdown on a ride-hailing platform, this week's blocking of a merger between two gaming apps and the tightening of data gathering rules. This explains our neutral view on China technology sector equities.

Within China equities, we instead prefer industrials and energy that are less impacted by domestic policies and are driven by the global economic expansion cycle. Some Chinese sub-sectors having strategic importance, such as electric vehicles or semiconductors, remain attractive routes for adding long-term exposure.

In bonds, Asia USD bonds remain one of our preferred areas, given improving corporate sector profitability, contained defaults, low volatility and attractive valuations compared with US corporate bonds. The PBoC's cut in bank reserve requirements should help ease liquidity for Chinese issuers, further boosting their bonds.

— 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

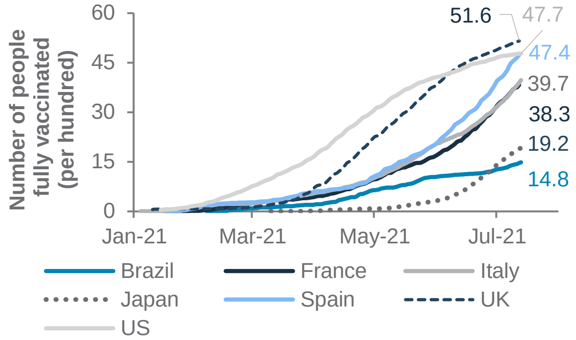
(+) factors: Supportive central banks, rising vaccinations

(-) factors: COVID concerns, US inflation, China tech restrictions

	Positive for risk assets	Negative for risk assets
COVID-19	• Vaccinations continued to rise globally, led by China, which has given 1.4bn doses so far; more than half of EU adults fully vaccinated • New cases appear to have peaked in Brazil and South Africa and fell to a 3-month low in India	• Sharp rise in new cases in the US, Europe, parts of Asia and other EMs • US saw the largest weekly percentage rise in cases since April 2020 • WHO said Delta variant is spreading globally at a "scorching pace" and is a variant of concern • Vaccination pace slowing in the US and Europe
	Our assessment: Neutral – Rising vaccinations vs concern about the spread of the Delta variant	
Macro data	• US NFIB small business optimism index rose to 8 month-high; initial jobless claims at pandemic low • China exports, retail sales, industrial output, fixed asset investment rose more than expected	• US inflation rose more than expected to 13-year high (5.4% y/y); producer price inflation rose more than expected • Euro area industrial output decelerated • China y/y GDP growth slower than expected
	Our assessment: Neutral – Strong US business sentiment, China data vs surprisingly strong US inflation	
Policy developments	• Fed's Powell said it was too soon to scale back bond purchases • ECB's Lagarde said bond purchases will continue at least until March 2022 • China cut bank reserve ratio requirements	• Powell, Yellen said US inflation likely to stay high in the coming months before moderating • President Biden issued an order to promote competition across tech and other sectors
	Our assessment: Positive – Dovish Fed, ECB, PBoC	
Other developments		• China blocked mergers, tightened data rules for internet companies
	Our assessment: Negative – China regulatory policy tightening	

Pace of vaccinations is slowing in the US and the UK, but accelerating in Europe and Asia

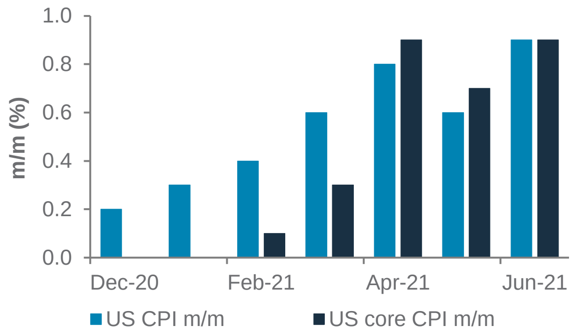
Percentage of people fully vaccinated



Source: Our World in Data, Standard Chartered

US consumer inflation remained elevated in June; we expect it to decelerate in H2

US headline and core consumer inflation



Source: Bloomberg, Standard Chartered

China's consumer inflation remained subdued, but rising producer prices are likely to push consumer inflation higher in H2

China headline and core consumer prices; producer prices

Source: Bloomberg, Standard Chartered

Top client questions

What are the implications of China's cut in banks' required reserve ratio (RRR) on Asia USD bonds?

The RRR cut of 50bps is likely to inject c. CNY 1trn into the financial system. The Asian USD bond market has reacted positively to the surprise move - Chinese USD bonds were outperformers among Asia USD bonds, with spreads tightening by nearly 7.5bps since last Friday.

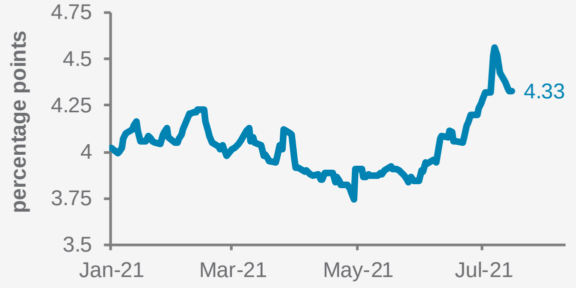
While the one-week spread tightening has been exceptional, the RRR cut is likely signalling 'policy fine-tuning' in order to (i) prepare for near-term liquidity needs from the soon-expiring medium-term lending facilities (MLF) and (ii) cater to local government credit demand to support the real economy. Further RRR cuts, or other forms of policy easing, are likely needed to confirm that policy has turned decisively dovish.

Having said that, we see this as an attractive opportunity to reduce exposure to Investment Grade-rated bonds, which are typically more sensitive to yield changes, and to the local government-backed sector bonds and average into our preferred bond asset classes. In Asia USD bonds, we have a preference for HY bonds, which offer attractive valuation and controllable credit risk. Globally, we also favour US/European HY corporate bonds given attractive valuation vs. credit risk.

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

Asia USD High Yield bonds offer attractive yield premiums over Investment Grade peers

Asia USD HY bond yield premium over IG counterparts



Source: Bloomberg, Standard Chartered

Is Value-style equity underperformance ending?

We still expect Value-style equities to outperform Growth-style equities (see our Ready, Steady, Rotate theme) over the next 12 months. Such temporary bouts of underperformance are likely as economic growth transitions to a more modest pace, but we remain comfortable with our 12-month view as long as global growth remains well-supported.

Renewed fears of the COVID-19 Delta variant and weaker-than-expected US economic data have dragged bond yields. This has, in turn, weighed on Value-style equities given their sensitivity to cyclical growth prospects (see chart). However, the decline in the 10-year US Treasury yield is likely overdone with positioning off its extremes, suggesting a recovery towards 1.75% over the next 6-12 month remains likely.

These factors (still-robust growth, gradually rising bond yields) remain supportive of the outperformance of Value equities relative to Growth peers. From a sector perspective, this means we continue to favour financials and energy in the US and the Euro area. Although financials have lately slipped on lower bond yields and subdued trading income, we expect loan growth and yields to gradually recover.

— **DJ Cheong, CFA,** *Investment Strategist*

Value-style equities outperform Growth-style equities typically during periods of rising global growth and bond yields

MSCI All Country World Value/Growth (ratio) vs. 10-year US Treasury yields (%, RHS)

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What would be the catalysts for G10 currencies to rise against the USD?

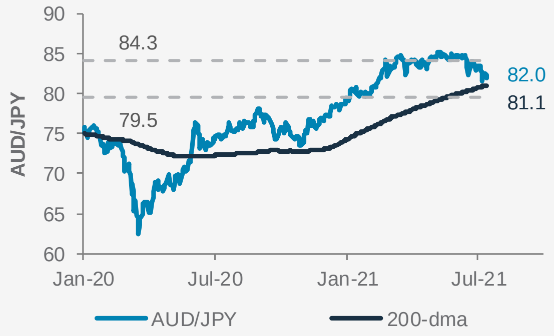
The G10 currency basket contains not only high-beta "risk-on" currencies, such as the AUD, NZD, CAD and GBP, but also safe-haven "risk-off" currencies, such as the JPY and CHF. FX markets could remain rangebound during the remaining summer weeks when market liquidity is usually lighter and one-off catalysts can trigger greater-than-usual volatility.

High beta currencies should respond well to the continuing Fed policy accommodation, the passage of substantial US fiscal stimulus by Congress, improving global growth and the removal of lockdowns across Europe. Any negative surprise in one or more of these, though, could induce further pressure on key technical support levels, such as 0.7375 for AUD/USD and 1.17 for EUR/USD. Given our bearish USD medium-term view, we would "buy the dip". A rally above 0.7615 and 1.20 on the two pairs would provide technical signals that the next leg of the currency rally is underway.

In the coming weeks, choppy markets could see bouts of short-term USD strength, but we believe the safe-haven and undervalued JPY can strengthen against non-USD major currencies, which may provide a better opportunity. EUR/JPY and AUD/JPY are testing their 200-day moving averages and a sustained break below them would open-up targets around 126.50 and 79.50 respectively. Buying the JPY could also provide near-term "insurance" for investor's risk portfolios.

We expect a deeper decline for AUD/JPY in the near-term on any break below its 200DMA

AUD/JPY (daily) and key technical levels



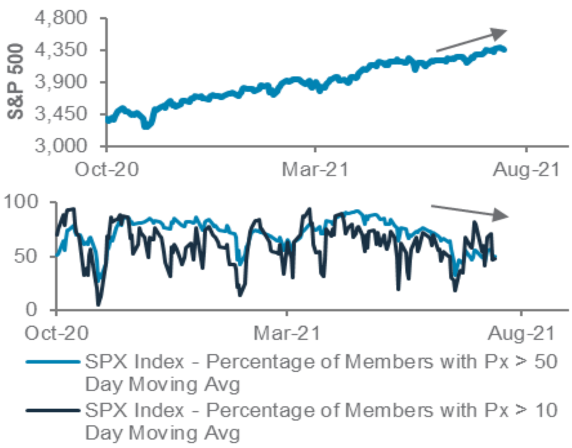
Source: Bloomberg, Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

S&P500: Tentative signs of loss of steam

S&P500 index daily chart

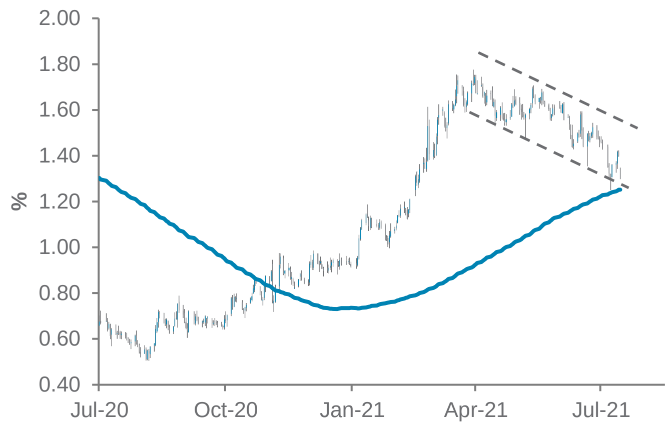


Source: Refinitiv, Standard Chartered

> Declining number of stocks in the index which are above their respective 10-DMA and 50-DMA is a sign that the recent rally has been associated with reduced participation in the short term. The index has quite strong support at the June low of 4164.

US 10Y Treasury yield: Nearing fairly strong support

US 10-year Treasury yield daily chart with 200-DMA

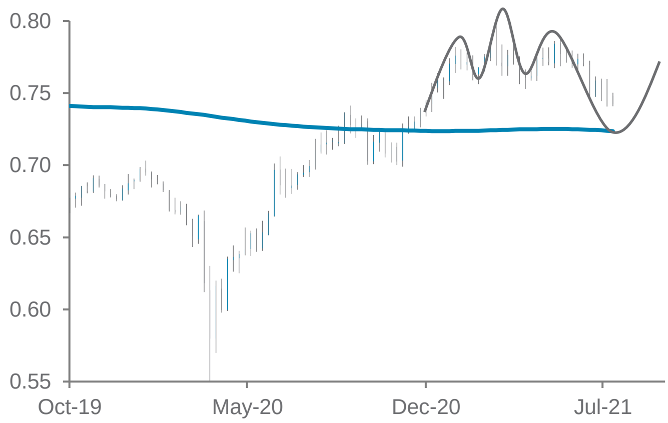


Source: Refinitiv, Standard Chartered

> We see the recent fall in yields as a correction, and not a reversal of the uptrend. It has retraced 38% of the rise since mid-2020. 38%-50% retracements are considered reasonable after a rally. There is strong support at 1.20%-1.25%, which could cushion the fall.

AUD/USD: Downside could be supported

AUD/USD weekly chart with 200-WMA

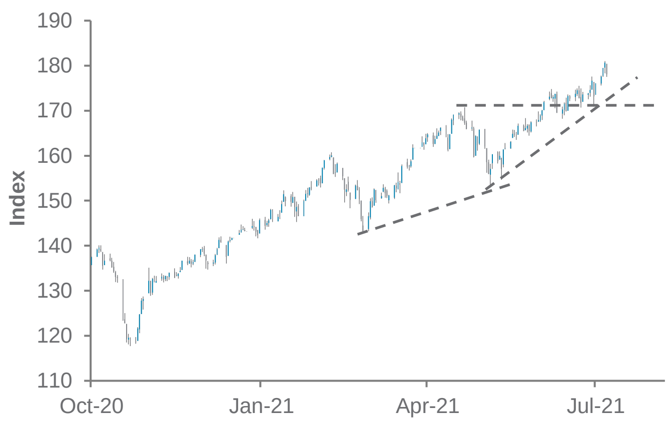


Source: Refinitiv, Standard Chartered

> While the triggering of a minor head and shoulders pattern explains the recent weakness, AUD/USD has strong support around 0.7000-0.7200, which could limit the downside. Immediate support is at 0.7375–0.7415.

EU Technology sector: Rally strengthens

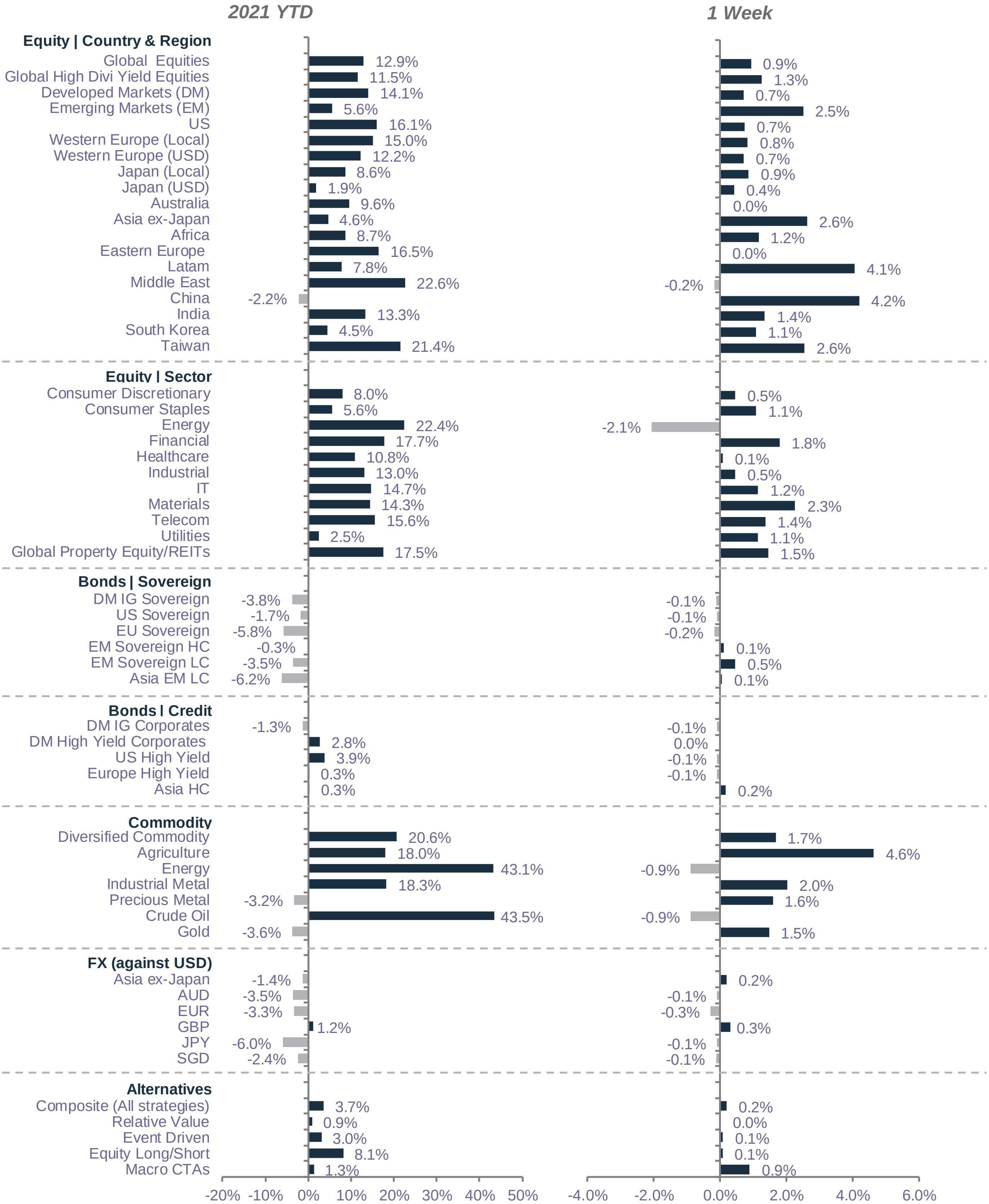
MSCI Europe Information Technology index daily chart



Source: Bloomberg, Standard Chartered

> The steepening of uptrend lines in the EU Technology index is a sign that the uptrend is solidifying. It is also a reflection that after a hesitant H1 rally, the index is on a much stronger footing going into H2.

Market performance summary*



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

*Performance in USD terms unless otherwise stated, 2021 YTD performance from 31 December 2020 to 15 July 2021; 1-week period: 08 July 2021 to 15 July 2021

Our asset class views at a glance

Asset class			
Equities	▲	**Alternatives**	◆
Euro area	▲	Equity hedge	▲
UK	▲	Event-driven	▲
US	▲	Relative value	▼
Asia ex-Japan	◆	Global macro	◆
Japan	▼		
Other EM	◆	**Cash**	▼
		USD	▼
Bonds (Credit)	◆	EUR	▲
Asia USD	▲	GBP	▲
Corp DM HY	▲	AUD	▲
Govt EM USD	▲	CNY	◆
Corp DM IG	▼	JPY	◆
Bonds (Govt)	▼	**Gold**	◆
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	Prior
MON				
TUE	US	Housing Starts	Jun	1572k
	US	Building Permits	Jun	1683k
WED	JN	Exports y/y	Jun	49.6%
THUR	US	Initial Jobless Claims	17-Jul	–
	EC	ECB Main Refinancing Rate	22-Jul	0.0%
	US	Existing Home Sales	Jun	5.8m
	EC	Consumer Confidence	Jul A	-3.3
FRI/SAT	EC	Markit Eurozone Composite PMI	Jul P	59.5
	UK	Markit/CIPS UK Composite PMI	Jul P	62.2
	US	Markit US Composite PMI	Jul P	63.7

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

S&P500 has first support 0.2% below current level

Technical indicators for key markets as on 15 July 2021

Index	Spot	1st support	1st resistance
S&P500	4,360	4,352	4,376
STOXX 50	4,056	4,042	4,085
FTSE 100	7,012	6,974	7,088
Nikkei 225	28,279	27,907	28,685
Shanghai Comp	3,565	3,537	3,579
Hang Seng	27,996	27,562	28,214
MSCI Asia ex-Japan	873	859	881
MSCI EM	1,348	1,328	1,359
Brent (ICE)	73.5	72.5	75.5
Gold	1,830	1,814	1,838
UST 10Y Yield	1.30	1.26	1.38

Source: Bloomberg, Standard Chartered

Investor diversity has normalised across assets

Our proprietary market diversity indicators as of 14 July

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↓	1.61
Global Equities	◐	↑	1.45
Gold	◐	↑	1.44
Equity			
MSCI US	◐	→	1.41
MSCI Europe	◐	↑	1.41
MSCI AC AXJ	●	↓	1.78
Fixed Income			
DM Corp Bond	◐	↓	1.44
DM High Yield	◐	→	1.42
EM USD	◐	↓	1.43
EM Local	●	↑	1.60
Asia USD	◐	↓	1.49
Currencies			
EUR/USD	●	→	1.61

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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