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Wealth Management Chief Investment Office
27 May 2022

Weekly Market View

Is the Fed winning?

- It is early days, but the Fed seems to be gaining an upper hand in its battle against inflation. The US central bank, through its aggressive talk and action, has been able to cap long-term inflation expectations for now.
- US 10-year expected inflation rate has fallen from April's 3.1% peak to 2.6%. This has helped drag down US government bond yields and the USD.
- A Fed victory over inflation and a USD peak are critical for a sustainable recovery in global risk assets. This explains this week's first weekly rebound in global stocks in eight weeks.
- Besides undervalued Emerging Market stocks and bonds, we see opportunities in our preferred income generating assets which are yielding more than 5%.

Should we be concerned about earnings risks for US equities, given growth fears and margin pressures?

Have US government bond yields peaked? What is the implication for other bond assets?

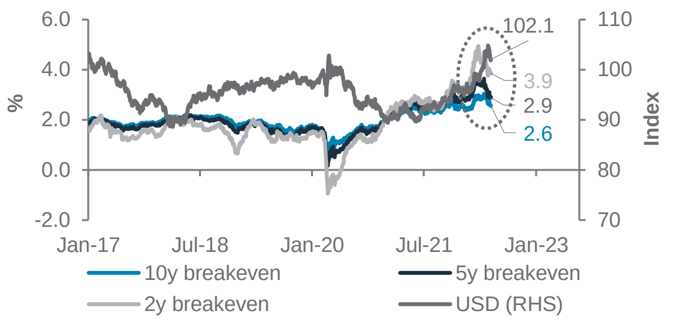
Which commodity currency is most preferred?

Important disclosures can be found in the Disclosures Appendix.

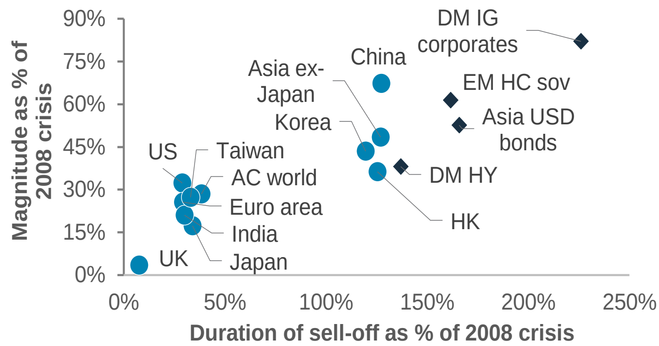
Charts of the week: Peak inflation expectations good for risk assets

The Fed appears to have capped inflation expectations for now. This is positive for beaten down Emerging Market assets

US 2-, 5- and 10-year inflation expectations* and USD index



Extent and duration of current sell-off vs 2007-09 bear market



Source: Bloomberg, Standard Chartered; *Based on US inflation-protected bonds

Editorial

Is the Fed winning?

It is early days, but the Fed seems to be gaining an upper hand in its battle against inflation. The US central bank, through its aggressive talk and action, has been able to cap long-term inflation expectations for now: 10-year expected inflation rate based on inflation-protected bonds has fallen from April's 3.1% peak to 2.6%. This has helped drag down US government bond yields and the USD and turn inflation-adjusted long-term yields positive. A Fed victory over inflation and a USD peak are critical for a sustainable recovery in global risk assets. This explains this week's first weekly rebound in global stocks in eight weeks.

Although Fed Chair Powell and others have warned in recent weeks that they may have to take the benchmark interest rate to restrictive territory (ie. above the Fed's estimated 'neutral rate' of 2.4%) to tamp down inflation pressures, the latest Fed minutes from its last policy meeting confirmed that most policymakers are no more aggressive than what is already priced into markets. The minutes suggested that policymakers are likely to remain data-dependent after pushing through 50bps rate hikes each in June and July meetings.

Also, data suggests the Fed is in a good place in its bid to cool the US economy without causing a recession in the next 6-12 months. This week's business confidence data (PMI) for May indicated economic activity in the US and the Euro area remained at healthy levels, although it confirmed a further slowdown from last year's peak. US core durable goods orders, which reflect business spending plans, rose a less-than-expected 0.3% m/m, but core goods shipment used in calculating GDP rose a more-than-expected 0.8% m/m. US job openings and non-farm payrolls data for May due next week are the next focus. Powell's goal would be to slow job creation, without causing a surge in unemployment. The record number of job openings points to a tight labour market, which we expect will ease as more low-income workers return to the labour force in the coming months. This should help curb wage pressures.

The USD's nascent pullback from 19-year highs is also good news for risk assets. Besides a peak in US Treasury yields, other global central banks need to turn more hawkish for the USD to ease and global risk assets to recover sustainably. This week saw the New Zealand central bank take the lead here – it raised rates by 50bps to a five-year high of 2% and projected that the rate could double to 4% in a year. Meanwhile, ECB President Lagarde hinted at a rate lift-off in July and positive rates by Q3. Persistently high inflation in May (data due next week) could force the ECB to turn more hawkish. The Bank of Canada is next, with the consensus expecting a 50bps hike to 1.5%, followed by Australia's RBA meeting on 7 June.

Meanwhile, China appears to be picking up the pace of policy easing after extremely weak April data (PMI for May are due next week). This week, Premier Li Keqiang told local government officials to focus on reviving the economy, while authorities unveiled more tax cuts. The PBoC, after cutting a key rate linked to mortgages and infrastructure lending last week, met with big banks to discuss boosting lending. However, stringent COVID-19 policies remain a dampener for consumer and risk sentiment. While infections in Shanghai have sharply declined, enabling authorities to allow the restart of factories and gradually relax restrictions there, Beijing recorded a new high in COVID-19 infections. An infection peak across major cities will likely be needed for zero-COVID-19 policies to ease.

China's COVID-19 challenges notwithstanding, the chart above shows that Asia ex-Japan equities (including China stocks) stand out in terms of the degree and duration of pullback, compared with the 2007-09 bear market. Asia ex-Japan and China stocks are also extremely undervalued, trading at a 20-30% discount to global equities. This shows the extent to which downside risks have been priced in. President Biden's plans to lift tariffs on imports from China could revive sentiment.

US financial sector equities also look attractive. Higher interest rates are likely to boost net interest margins, further boosting profitability, while loans continue to grow and credit concerns remain muted. Meanwhile, income-generating assets are going on sale, with several of our preferred bond markets and hybrid asset classes offering more than 5% yields. This is a far cry from the start of the year when investors had to take on more risk to generate 4% income. We believe these beaten down markets offer opportunities for long-term investors as global inflation expectations likely peak and China jumpstarts growth.

— 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.

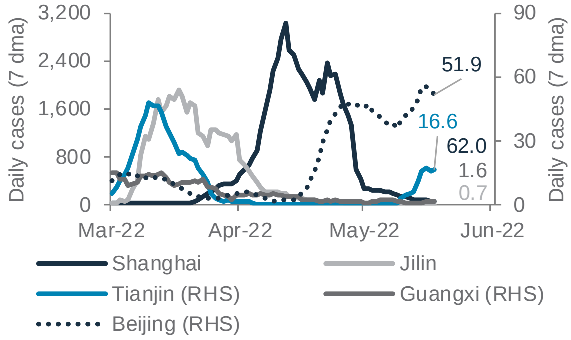
(+) factors: China policy stimulus, US-China tariffs review

(-) factors: Weak US home sales, manufacturing and services PMI data

	Positive for risk assets	Negative for risk assets
COVID	• Cases in Shanghai and other Chinese regions continued to decline	• Beijing infections rose to a new high; China top pandemic control official proposed stricter measures • Hong Kong's Lam ruled out the removal of hotel quarantine requirements
	Our assessment: Neutral – Beijing surge vs falls elsewhere	
Macro data	• US initial jobless claims fell more than expected • US core durable goods shipment rose more than expected, although core orders fell below estimates	• US new home sales fell more than expected • US and European manufacturing and services PMI softer than expected
	Our assessment: Negative – Strong US job market vs weaker-than-expected home sales, business confidence data	
Policy developments	• China Premier Li Keqiang urged officials to focus on growth-boosting measures • PBoC met 24 banks to discuss lending boost • China unveiled more tax relief • Biden reconsidering tariffs on China goods • UK announced GBP15bn support package for households	• Fed's minutes revealed support for half-point hikes in next two meetings • ECB's Lagarde guided for a rate lift-off in July, followed by positive rate by end-Q3 • IMF raised the possibility of more growth cuts • RNBZ raised rate by 50bps
	Our assessment: Neutral – China stimulus, US tariffs review vs ECB rate lift-off, RNBZ rate hikes	
Other developments	• New economic initiative by Indo-Pacific nations aimed at countering China's influence	• Biden said US will step in if China invades Taiwan • Rising monkeypox cases in Europe and North America • North Korea fired missiles after Biden visit
	Our assessment: Neutral – New Asia economic partnership vs geopolitical tensions	

Most Chinese regions, except Beijing and Tianjin, have seen a sharp decline in COVID-19 infections in recent months

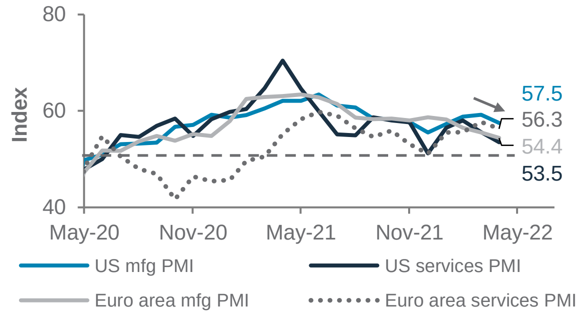
COVID-19 new cases in China's five regions with the strictest restrictions, 7-day moving average



Source: Bloomberg; Standard Chartered

US and Euro area business confidence data continued to suggest expansion, despite slowing from last year's peak

US and Euro area manufacturing and services PMIs



Source: Bloomberg, Standard Chartered

US home sales have come under pressure amid rising mortgage rates

US new home sales

Source: Bloomberg, Standard Chartered

Top client questions

Should we be concerned about earnings risks for US equities given growth fears and margin pressures?

Although US GDP growth expectations have been downgraded since the start of the year and there are increasing concerns about the impact of inflation on profit margins, consensus earnings estimate for the US equity market overall remains slightly up compared with the start of the year. According to Refinitiv data, the latest estimate for 2022 EPS growth is 9.3%, compared with 8.4% expected at the start of the year.

There are key differences between sectors. Materials, energy and real estate sectors have seen the largest upward revision to earnings growth, while communication services, consumer discretionary and consumer staples have seen the largest downward revisions. This partly reflects the uneven impact of inflation and elevated commodity prices that benefit certain sectors, while consumer-facing sectors or those with constrained pricing power suffer downgrades, as profit margins and earnings are squeezed due to their inability to pass on cost increases fully to consumers.

Another driver of earnings is interest rates. Higher interest rates benefit the financial sector, as we saw this week when a major US bank upgraded its guidance for net interest income. Hence, even as GDP growth slows and costs rise, various earnings drivers interact to result in overall earnings growth that has been robust so far. While a further deterioration in GDP growth would undoubtedly present a headwind for corporate earnings, we expect such a sharp slowdown will be avoided, as inflation fears recede in H2 2022 and the Fed can take a more measured pace in tightening monetary policy.

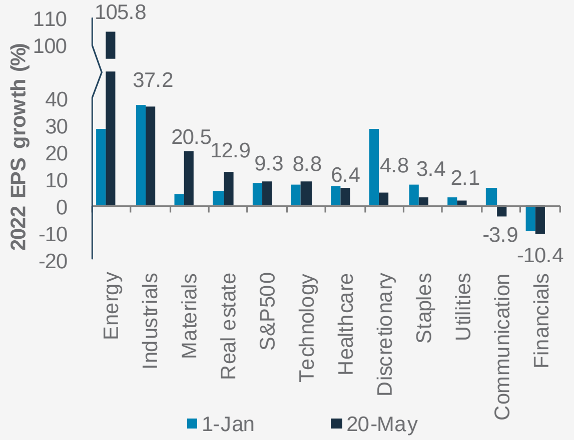
We expect global equities to outperform other major asset classes in the coming 6-12 months, within which we expect US equities to perform in line with global equities. In terms of our US sector views, we have a preference for energy, financials and healthcare, which we believe will outperform the overall market over the next 6-12 months.

From a technical perspective, the US equity benchmark, the S&P500 index, broke below its previous intraday low at 3,858 last Friday, but it was met with strong buying volume, with the index closing near its day high. Since then, we have seen good volume buying whenever the index tried to test its low, resulting in three consecutive days of 'opening low, closing near the day's high'. We see this as strong indication the S&P500 is well supported around the 3,800 level. We believe that its near-term resistance lies at 4,100, followed by 4,300.

— **Fook Hien Yap,** *Senior Investment Strategist*

Materials, energy and real estate sectors have seen the largest upward revision to earnings estimates this year, while consumer facing sectors (discretionary, staples) have seen downgrades

Consensus 2022 EPS growth by US sectors



Source: Refinitiv, Standard Chartered

The S&P500 index has seen strong volume buying near recent lows, which indicates 3,800 as a strong technical support level. We see near-term resistance at 4,100

S&P500 index, with technical support and resistance levels

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Have US government bond yields peaked? What are the implications for other bond asset classes?

The 10-year US government bond yield has declined by nearly 50bps since hitting its recent high of 3.2% on 9 May, driven by a combination of rising growth concerns and less hawkish than expected Fed guidance. The sharp decline in long-term inflation expectations over the past few weeks has also reduced the upward pressure on bond yields. As a result, market expectations of rate hikes this year have declined notably.

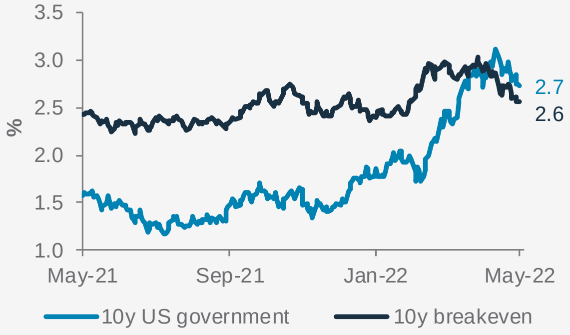
However, after the sharp pullback, yields could consolidate in the near term. The 10-year yield has technical support around current levels and investor views are no longer one-sided. There is scope for the yield to retest the May high of 3.2%, as the Fed persists with rate hikes in the next couple of months, before it settles in 2.5-2.75% range amid an expected slowdown in inflation pressures in H2.

Given that the decline in yields has led to an increase in prices (a fall in yields) of Developed Market Investment Grade bonds, we would take this opportunity to rotate out of them into our preferred bond markets – DM High Yield corporate bonds, Asian USD bonds and Emerging Market USD government bonds – especially since valuations here have cheapened further in recent weeks.

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

US 10-year government bond yield has declined almost 50bps since its early May high of 3.2% as inflation expectations pulled back

US 10-year government bond yield and 10-year inflation expectations*



Source: Bloomberg, Standard Chartered; *Based on inflation-protected securities

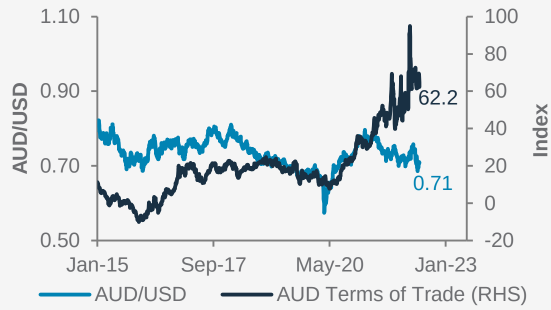
Which commodity currency is most preferred?

We maintain a bullish outlook for the AUD, CAD and NZD over the near-term and 12-month time horizons as we expect the broad USD uptrend to peak and, at a minimum, significantly correct lower. Key drivers for these three currencies are robust commodity demand, hawkish central banks, cheap valuations and neutral positioning. The RBNZ surprised markets this week with a more hawkish than expected outlook alongside a consensus 50bps rate hike. Of the three, though, the RBNZ is more advanced in its rate normalisation cycle and New Zealand exports are less diversified; hence, the NZD is likely to be a "follower" rather than a "leader" in the coming weeks. We prefer the AUD slightly more than the CAD as (i) Terms of Trade (higher export prices relative to import prices) look very attractive, (ii) the RBA is at an earlier stage of its rate hiking cycle compared with the BoC, and (iii) the AUD is relatively cheaper and under-owned.

While the CAD is driven by oil, lumber and agricultural exports and is highly sensitive to US economic performance, the AUD is driven by coal, gas and metals and is particularly sensitive to China growth. US economic outperformance has been a tailwind for the CAD, but China lockdowns, slowing growth, and geopolitical tension have been a headwind for the AUD. The recent change of Australian political leadership provides an opportunity for a diplomatic reset with China, and if signs of more aggressive China stimulus continue and lockdowns fade, the AUD has ample scope to appreciate. Slowing US growth may also dampen CAD performance on a relative basis.

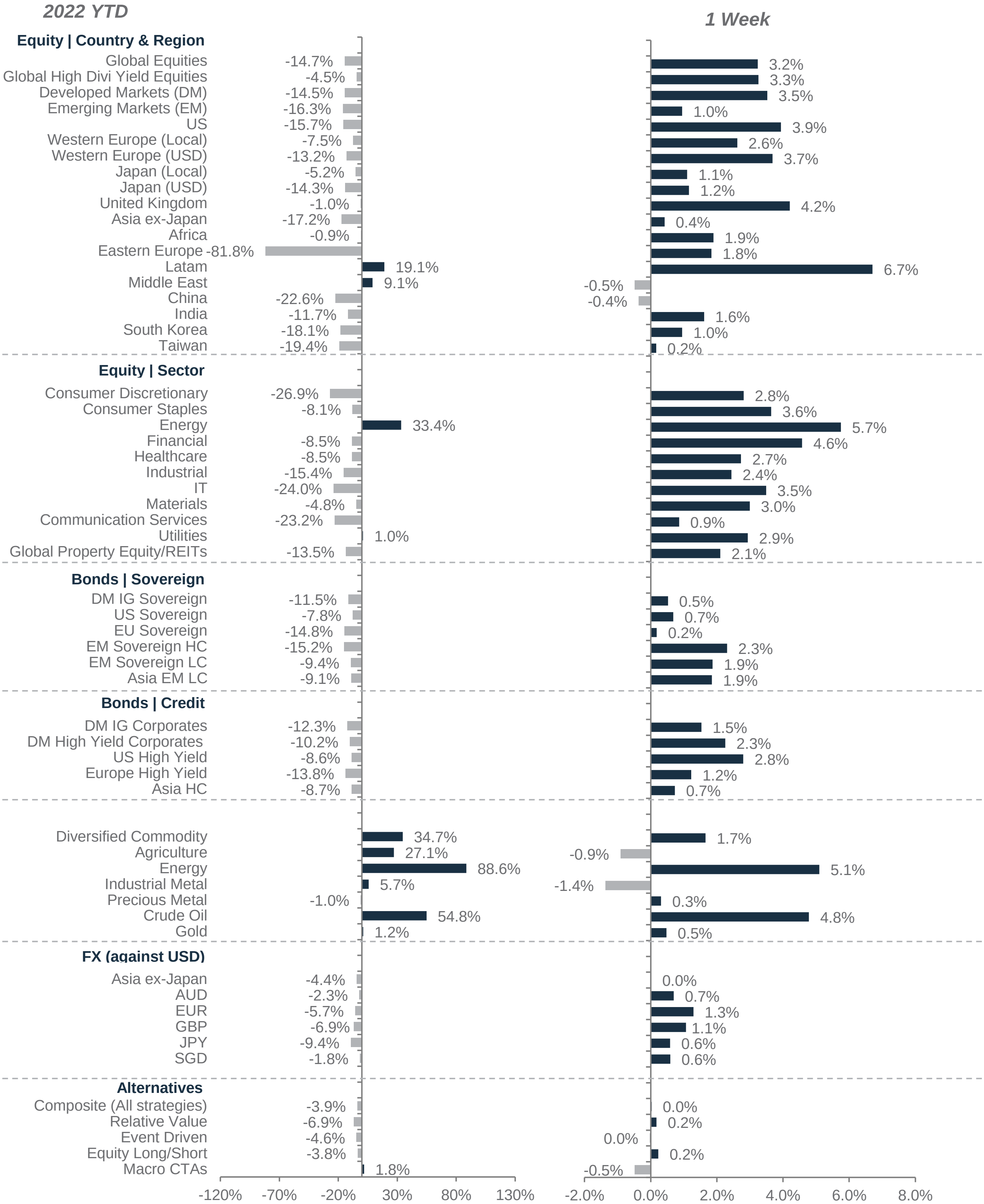
AUD/USD has been constrained by Chinese economic and geopolitical headwinds, but a significant improvement in Terms of Trade provides the AUD scope for a strong rally

AUD/USD and Australia Terms of Trade



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, 2022 YTD performance from 31 December 2021 to 26 May 2022; 1-week period: 19 May 2022 to 26 May 2022

Our 12-month asset class views at a glance

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

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	Economic Confidence	May	–	105.0
TUE	CH	Manufacturing PMI	May	48.7	47.4
	CH	Non-manufacturing PMI	May	46.2	41.9
	EC	CPI Estimate y/y	May	–	7.5%
	US	Conf. Board Consumer Confidence	May	104.0	107.3
WED	CH	Caixin China PMI Mfg	May	50.2	46.0
	EC	Unemployment Rate	Apr	–	6.8%
	US	ISM Manufacturing	May	55.0	55.4
	US	JOLTS Job Openings	Apr	–	11549k
	US	Start of Quantitative Tightening			
THUR	EC	PPI y/y	Apr	–	36.8%
	US	US Federal Reserve Beige Book			
FRI/SAT	EC	Retail Sales y/y	Apr	–	0.8%
	US	Change in Nonfarm Payrolls	May	350k	428k
	US	Unemployment Rate	May	3.5%	3.6%
	US	ISM Services Index	May	57.0	57.1

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

The US 10-year Treasury yield has next support at 2.71%

Technical indicators for key markets as on 26 May 2022

Index	Spot	1st support	1st resistance
S&P 500	4,058	3,954	4,110
STOXX 50	3,740	3,678	3,771
FTSE 100	7,565	7,448	7,623
Nikkei 225	26,605	26,473	26,869
Shanghai Comp	3,123	3,080	3,156
Hang Seng	20,116	19,913	20,518
MSCI Asia ex-Japan	650	645	660
MSCI EM	1,023	1,015	1,033
Brent (ICE)	117.4	114.1	119.1
Gold	1,854	1,845	1,865
UST 10y Yield	2.75	2.71	2.82

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 in global bonds

Our proprietary market diversity indicators as of 25 May

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.26
Global Equities	◐	→	1.50
Gold	●	↓	1.65
Equity			
MSCI US	●	→	1.61
MSCI Europe	◐	→	1.45
MSCI AC AXJ	◐	→	1.38
Fixed Income			
DM Corp Bond	◐	→	1.33
DM High Yield	◐	→	1.38
EM USD	◐	→	1.36
EM Local	◐	→	1.27
Asia USD	◐	→	1.44
Currencies			
EUR/USD	◐	→	1.43

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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