

Weekly Market View

Is the USD breaking lower?

Risk appetite continues to be supported by recent developments, especially policy efforts such as the European stimulus fund, but we remain on watch for any further weakening in US high frequency economic data

Equities: The launch of the Hang Seng TECH Index is likely to be constructive for China technology, a preferred sector

Bonds: The significant rise in Asia USD new bond supply is likely to be well-absorbed. Asia USD bonds remain a preferred bond asset class

FX: The EUR/USD's break above key technical resistance suggests the US dollar is likely to weaken further

Is the USD breaking lower

Also find out...

Is the ECB likely to ask banks to extend their dividend suspension?

Does equity and FX volatility usually rise in August?

Is gold likely to revisit its prior record high?

Charts of the week: USD breaking lower?

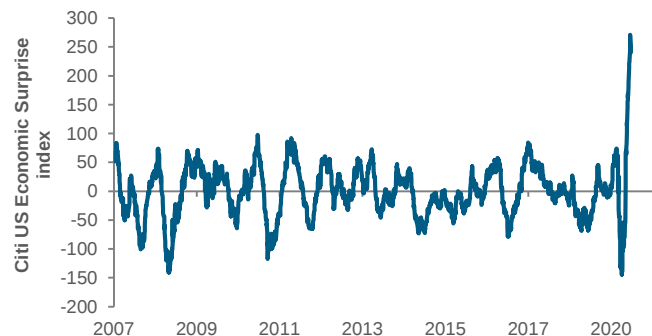
EUR/USD's breakout leaves the USD index on the verge of breaking lower. However, the surge in the mean-reverting US economic surprise index appears unsustainable, especially given the turn lower in some high frequency US data

USD index (DXY) and EUR/USD



Source: Bloomberg, Standard Chartered

US Citigroup Economic Surprise index



Editorial

Is the USD breaking lower?

We see increasing signs that the USD is breaking lower as incoming events continue to support risk appetite.

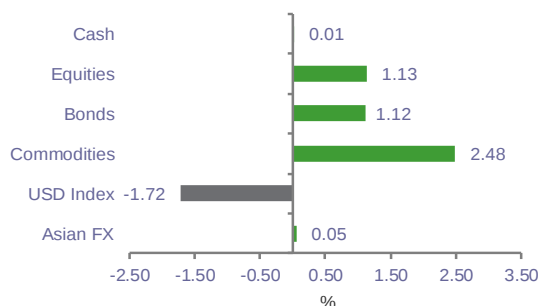
- The EU's agreement on a EUR 750bn stimulus fund was arguably a game-changer. The fact that policymakers agreed to fund the initiative via European Commission-issued debt, as opposed to individual country sovereign debt, marks a significant shift, potentially favouring a more unified fiscal policy, especially as it occurred without the external pressure of a debt crisis.
- While some form of EU stimulus was expected, EUR/USD's break above a key technical threshold (see page 4) suggests the final outcome was a positive surprise. EUR/USD gains are key for our bearish USD view, given its large weight in the USD index.
- Another COVID-19 early stage vaccine trial yielded a positive outcome. Recent economic and earnings data surprised positively.

Broadly, these factors are supportive of risk appetite and our preference for equities and corporate/EM bonds. A sustained break lower in the USD is likely to reinforce this (see table).

Having said that, we are mindful of economic data risks. The magnitude of positive surprises is unsustainable, especially given the recent turn lower in high frequency US data. We would also be concerned if revenue stabilisation and re-opening data for small businesses falters (see page 3). Finally, the US decision to close a Chinese consulate raises the risk of a resurgence in US-China geopolitical tensions.

Our net assessment is that recent developments are supportive for risk assets, particularly Euro area equities and EUR/USD, where we see room for gains to extend. We would not be surprised by a bout of volatility/weakness in the coming few weeks, given some of our proprietary market diversity indicators across asset classes are starting to look a little stretched. However, we believe it would make sense to be ready to take advantage of any volatility to generate a yield or buy the dip (see page 6).

Last week, the USD fell while most risky assets gained
Benchmark market performance w/w*



Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered; *Week of 16 July 2020 to 23 July 2020

Outside view: Periods of USD weakness historically positive for risky assets

Median 12-month returns in USD index return environments

		Median 12m return (%)		
		USD falls > 5%	USD between -5 and 5%	USD rises > 5%
L1	Global Bonds	10.6%	4.3%	-1.2%
	MSCI ACWI	15.9%	12.0%	0.6%
	Gold	18.0%	8.5%	-1.6%
Equities	MSCI US	12.0%	13.7%	6.1%
	MSCI EU	22.8%	11.4%	-7.8%
	MSCI UK	19.7%	11.0%	-4.3%
	MSCI AXJ	22.7%	9.4%	-4.7%
	MSCI EMxAsia	30.8%	4.8%	-12.0%
FX	USD/CNY	0.0%	0.0%	0.0%
	EUR/USD	14.0%	-0.3%	-11.0%
	USD/JPY	-9.0%	-1.0%	4.8%
	GBP/USD	9.3%	-1.2%	-8.1%
	AUD/USD	7.5%	-0.6%	-8.2%
FI	DM Govt Bond	9.0%	3.7%	-0.9%
	DM Corp Bond	8.6%	5.3%	-0.1%
	DM High Yield	10.1%	8.9%	-0.8%
	EM USD	8.2%	8.3%	4.3%
	EM Local	14.5%	5.4%	-3.3%
	Asia HC	6.7%	5.8%	5.5%

Source: Bloomberg, Standard Chartered; equity returns represented by MSCI indices; bond returns represented by JPMorgan, Barclays indices

The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	- UK's Oxford University said its early COVID-19 vaccine trials showed promising results - A major pharmaceutical firm agreed to supply 100m doses of its COVID-19 vaccine to the US government	- Global daily COVID-19 cases continued to accelerate - In Asia, Japan and Hong Kong both reported new daily case records, with HK imposing new preventive measures - The WHO cautioned that the vaccine's first use cannot be expected until early 2021
	Our assessment: Early vaccine trials continue to show promising results. However, it remains unclear if a vaccine will be widely available this year.	
Macro data	- The June Chicago Fed Activity index rose to a record high - US home sales rebounded 20.7% in June, largely in line with expectations - US continuing jobless claims continued to fall - The Euro area consumer confidence indicator rose to -14.7 in June from -18.8 in May	- Japan's Jibun Bank Composite PMI rose to 43.9, but remained below the 50-mark separating expansion and contraction - US small business change-in-revenue data dipped - US initial jobless claims data showed an acceleration in benefit claims for the first time in almost 4 months
	Our assessment: On balance, recent data continue to illustrate a faster-than-expected global recovery. Next week's Fed meeting is likely to be key.	
Policy developments	- EU leaders agreed EUR 750bn stimulus, with EUR 390bn of the total comprising grants. It will be financed mutually by EC bond issuance - US Senate Republican leader said a "framework" had been agreed for a new stimulus proposal, but a plan would likely be delayed to next week. - US Treasury Secretary Mnuchin said he would consider extending some emergency jobless benefits - The Fed said it extended its Main Street Lending programme to include non-profit organisations. - The Australian government said it would extend its wage subsidy programme, raise unemployment benefits, raise small business support	- Reports said the ECB was considering halting banks' dividend payments till the end of the year - China's PBoC left policy rates unchanged
	Our assessment: On balance, policy efforts are positive for risk assets. The passing of the EU stimulus overcomes a key hurdle. Focus is now likely to shift to new stimulus efforts in the US.	
Other developments	Standard & Poor's said the EU recovery fund is a "breakthrough" for member-state creditworthiness	The US ordered China to close its consulate in Houston, escalating US-China tensions
	Our assessment: A further escalation in US-China tensions remains a risk despite recent signals of a pause.	

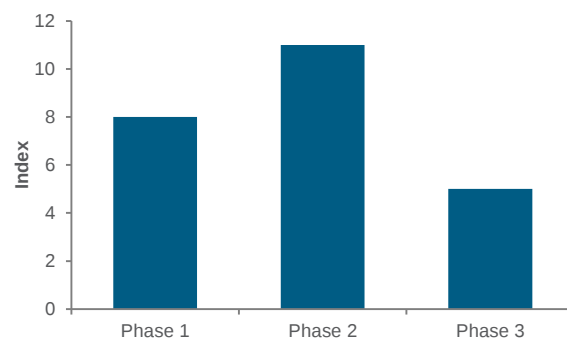
Our weekly net assessment: On balance, we see the EU stimulus, vaccine news, data and policy developments as positive for risk assets

(+) factor: Further fiscal stimulus, vaccine news, upside data surprises

(-) factor: Rise in COVID-19 cases, rising US-China tensions

WHO is tracking 166 vaccine development efforts, 24 of which are currently in clinical trial stages

Clinical trial stages of COVID-19 vaccine candidates

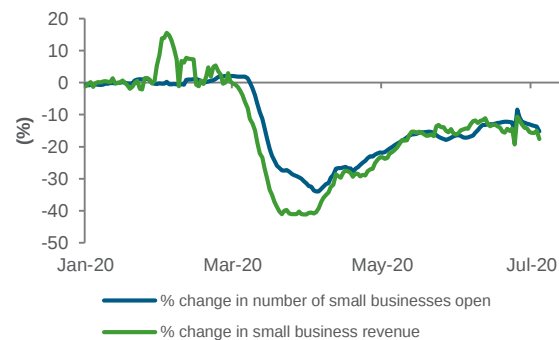


Source: WHO, Standard Chartered

Note Vaccines quoted as being in Phase 1/2 trials have been included in Phase 2

A renewed turn lower in US high frequency data, like small business revenue growth, would be a concern

Percentage change in number of small businesses open/change in revenue



Source: tracktherecovery.org, Standard Chartered

EU stimulus fund agreement likely to support further narrowing of peripheral yield premium over Bunds

Spain and Italy 10-year government bond yield premiums over German 10-year Bund yields



Source: Bloomberg, Standard Chartered

Top client questions

Q Will the ECB extend its request for banks to refrain from paying FY19/20 dividends?

The results of the ECB's "vulnerability assessment" of Euro area banks, which analyses the likely evolution of loan losses based on the ECB's economic forecasts, are expected by the end of July. Initial comments from ECB board members indicate they are leaning towards extending the moratorium on bank dividends through the end of 2020 to preserve capital in the face of rising loan losses. This represents an extension in current guidance to withhold FY19 and FY20 dividends until October 2020.

The news will come as a disappointment, but not a surprise, for investors. Prior underperformance of Euro area banks resulted in them offering an average dividend yield of 7%, which fell to zero following the ECB's original dividend announcement in March.

Comments by the ECB's supervisory board chair, Andrea Enria, hold out some hope that banks could engage in share buybacks or special dividends in the future. However, this is now unlikely until 2021 and is dependent on the evolution of Euro area economic growth and loan losses. Moreover, even if select banks are in a better position to pay dividends than others, analysts believe the ECB will retain the blanket no-dividend policy through end-2020. Euro area financials are still preferred as we see opportunities for capital gains outweighing disappointment on dividends.

Q Can you tell me more about the Hang Seng TECH index?

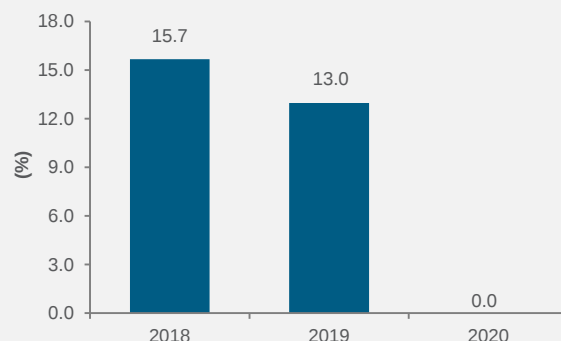
Hang Seng Indexes Company will launch the Hang Seng TECH Index on 27 July 2020, an index that aims to track the 30 largest technology companies listed on the Hong Kong Stock Exchange.

According to the Hang Seng Indexes Company press release, technology stocks potentially eligible for inclusion in this new index would need to have "high business exposure to selected technology themes, including Internet, fintech, cloud, e-commerce and digital activities". This pool would subsequently be "further screened by whether they operate via a technology-enabled platform, their research and development expenses to revenue ratio, and their revenue growth." The top 30 stocks, ranked by market capitalisation, that pass these criteria will be selected as index constituents weighted by their market capitalisation. The index constituents will be subject to a quarterly review, "with a Fast Entry Rule such that sizable newly listed companies...could be included in the index in a timely manner".

We believe this new index is constructive for the Chinese new economy sector – not only could it induce more investment interest towards the sector, but it could also attract more quality Chinese technology companies to be listed in Hong Kong. Granted, the dotcom experience of 2000 suggests there is a risk a flood of new listings could signal the top of the tech wave. This is an indicator to monitor. Having said that, though, current valuations for the Chinese new economy sector are reasonable, in our assessment. China equities remain a preferred market in Asia ex-Japan, with the Chinese technology sector a preferred sector.

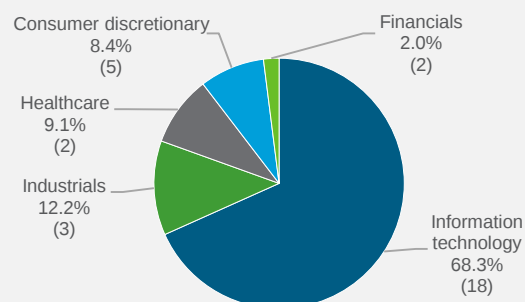
The banking sector currently does not contribute to Euro area dividends

Percentage share of banks in Euro area dividends



Source: MSCI, Factset, Standard Chartered

Constituent weighting distribution by industry (%) of the Hang Seng TECH Index



Source: Hang Seng Indexes Company, Standard Chartered

Top client questions (cont'd)

Q Should we worry about significant new bond supply in Asian USD bond markets?

Asian USD bond markets have seen a significant increase in new issuance over the past few weeks, as issuers take advantage of the reduction in yields and robust investor appetite. As a result, the YTD issuance is now running only 6% below the same period in 2019, which saw a record amount of bonds issued. In fact, issuance in July has already surpassed the previous three-year average, with a few days to spare. Part of the increase in issuance has been driven by greater issuance from High Yield (HY) issuers.

In our assessment, we believe the issuance should be well-absorbed:

1. Orders for new bonds are substantially surpassing the total amount being issued, indicating strong investor demand.
2. YTD, HY issuers have accounted for nearly 28% of the bonds issued, below the nearly 40% share they had at the same time last year. We remain bullish on Asian HY, as we believe valuations remain attractive and should benefit from an ongoing search-for-yield.
3. While market diversity is very low for Asian USD bonds – which would normally suggest an elevated risk of a short-term trend reversal – it would not be unusual for this indicator to continue flashing red for some time for low volatility asset classes before a reversal occurs.

Q What's next for the USD?

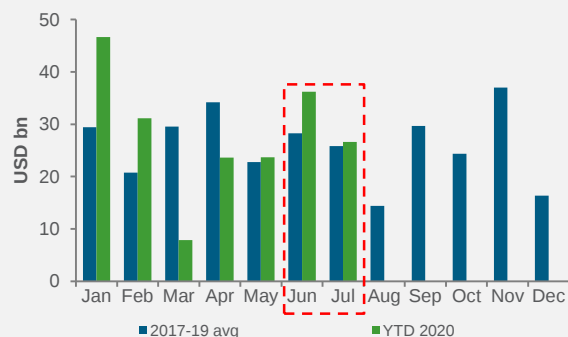
We continue to expect EUR/USD to lead the medium-term USD downtrend, with other G7 and some EM currencies eventually following the trend. This week's EUR/USD rally, driven by the EU recovery fund game changer (see *Market Watch* dated 21 July), pushed the pair to a new 21-month high at 1.1600 and has provided technical confirmation that its medium-term uptrend has entered a new phase.

This dovetails well with our assessment that key fundamentals, such as 1) relative interest rates, 2) relative growth rates, and 3) rising US policy uncertainty are no longer USD supportive. AUD/USD has also broken higher, but technical breaks are still anticipated for several currencies. NZD/USD needs to break above 0.6760, GBP/USD above 1.2815, and USD/CAD below 1.3300. We would be more confident that the broad USD medium-term trend has turned down once these levels are clearly broken.

In the coming days, we believe there is still room for the USD to weaken further. EUR/USD short term technical indicator readings, such as RSI, are approaching overbought levels, but further gains are possible before a correction lower. The next strong resistance in EUR/USD is expected at 1.1820. We believe speculative positions are long and profit-taking could be seen ahead of this level. Longer-term investors and short-term buyers looking to deploy the "buy the dips" strategy may be seen around retracement levels at 1.1430, 1.1370 and 1.1230.

New bond issuance has accelerated in recent months, but this has been well-absorbed thus far

Asia USD new bond issue by month (USD bn)



Source: Bloomberg, Standard Chartered

EUR/USD's break higher points to the start of a medium-term uptrend, albeit with consolidation likely along the way

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Q Is gold headed to its prior high?

Gold has hit multi-year highs after breaching USD 1,875/oz over the past few days. In our assessment, the recent rally can be attributed to lower real (net of inflation) yields and broad USD weakness. With dovish central banks anchoring nominal yields, the recovery in inflation expectations has driven real yields down. This has reduced the opportunity cost of holding gold given its non-yielding attributes.

Market expectations of further policy stimulus with interest rates remaining low or negative for a prolonged period, as well as prospects of further USD weakening, underpin our bullish view on gold. Investment demand has also mitigated a subdued physical market. With gold showing strong momentum in recent weeks, we believe a test of key resistance at around USD 1,920/oz (the 2011 high) is likely. Having said that, net long investor positioning in gold is looking relatively stretched, with technical indicators also suggesting the precious metal is in overbought territory. This suggests a possibility of a correction lower over the coming weeks. We expect key support at around 1,790 and would continue to buy-the-dips.

Q Is equity and currency market volatility likely to rise?

We believe there will be a rise in volatility. First of all, as risk assets have been grinding higher this month, volatility has been steadily declining. The VIX index, which is a measure of US S&P 500 equity index volatility, is about 2 volatility points below what the "power law" would suggest (refer to our publication dated 12 June 2020).

Moreover, there has been a pattern of seasonality in August. On average, over the last 10 years, the VIX index in August has been 3 volatility points higher than the level in July. This is the highest m/m average change in volatility. This is not just an equities phenomenon either. In the FX space, the CVIX index rose an average of 0.5 volatility points in August over the last 10 years (the second-largest m/m change).

With the return of geopolitical risk, and arguably some euphoric sentiment in certain risky assets becoming more evident, pullbacks may lead to a rise in volatility over the next five weeks, which may give investors better levels to sell volatility to generate a yield.

Falling real (net of inflation) bond yields continue to be a key source of support for gold

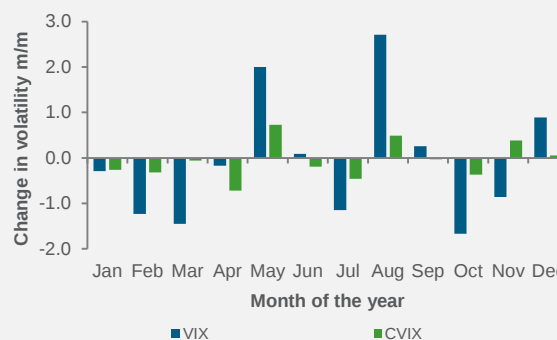
Gold price (USD/oz)



Source: Bloomberg, Standard Chartered

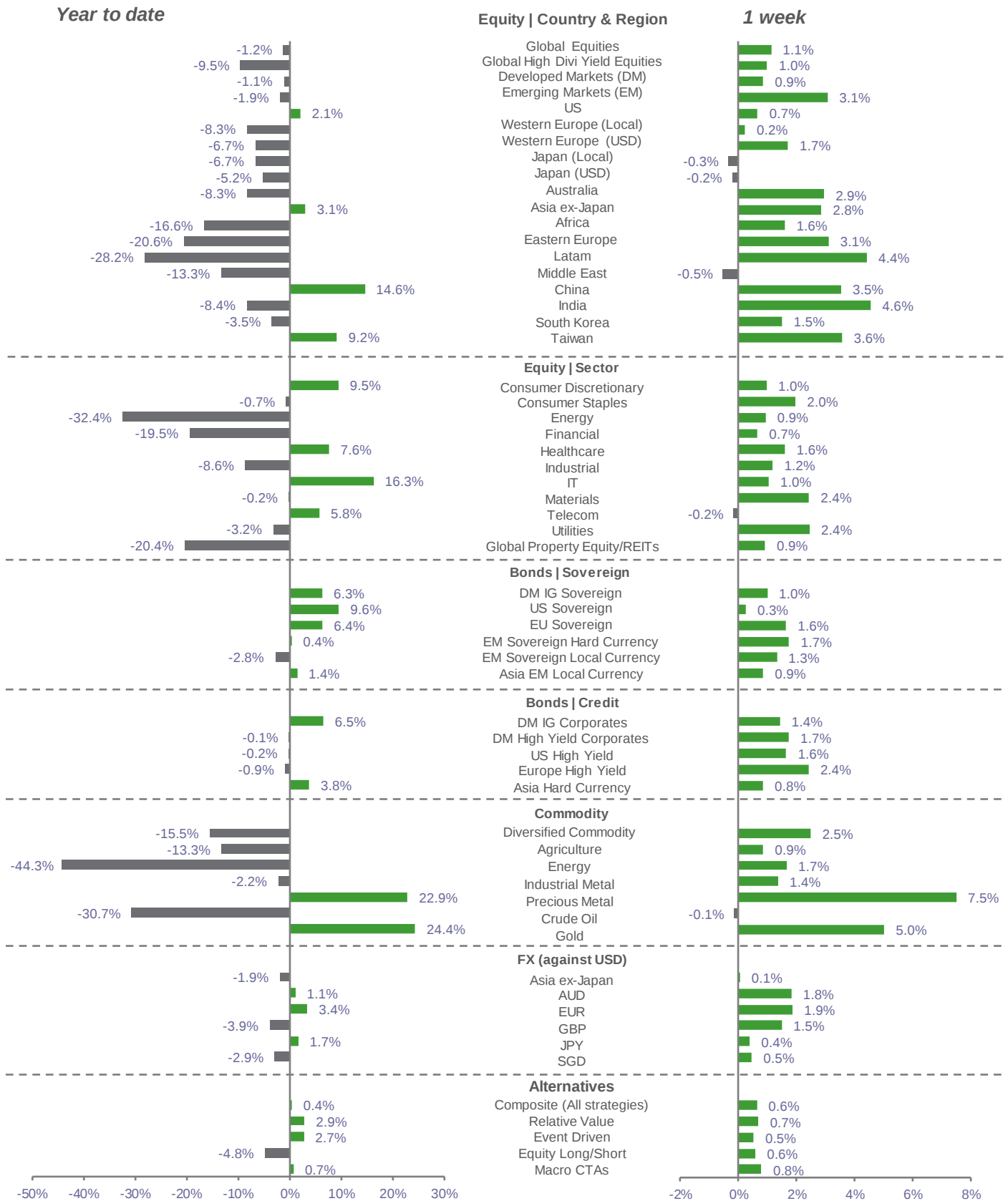
Equity (and, to a lesser extent, FX) volatility has risen in August in recent years

Average change in m/m volatility over the last 10 years



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 July 2020, 1 week period: 16 July 2020 to 23 July 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	CH	Industrial Profits y/y	27-Jul-2020	Jun	–	6.0%
	EC	M3 Money Supply y/y	27-Jul-2020	Jun	–	8.9%
	GE	IFO Expectations	27-Jul-2020	Jul	–	91.4
	US	Durable Goods Orders	27-Jul-2020	Jun P	7.0%	15.7%
	US	Cap Goods Orders Nondef Ex Air	27-Jul-2020	Jun P	2.3%	1.6%
	GE	Retail Sales NSA y/y	27-Jul-2020	Jun	–	3.2%
TUE	US	Conf. Board Consumer Confidence	28-Jul-2020	Jul	95.1	98.1
WED						
THUR	JN	Retail Sales y/y	30-Jul-2020	Jun	-6.0%	-12.5%
	US	Initial Jobless Claims	30-Jul-2020	Jul-25	–	–
	US	Fed FOMC Rate Decision (Upper Bound)	30-Jul-2020	Jul-29	0.3%	0.3%
	GE	CPI EU Harmonized y/y	30-Jul-2020	Jul P	–	0.8%
	US	GDP Annualized q/q	30-Jul-2020	2Q A	-34.5%	-5.0%
FRI/SAT	JN	Industrial Production y/y	31-Jul-2020	Jun P	-19.2%	-26.3%
	CH	Manufacturing PMI	31-Jul-2020	Jul	–	50.9
	FR	GDP y/y	31-Jul-2020	2Q P	–	-5.0%
	EC	CPI Core y/y	31-Jul-2020	Jul P	–	0.8%
	Event	This Week	Date	Period	Actual	Prior
MON	JN	Exports y/y	20-Jul-2020	Jun	-26.2%	-28.3%
TUE	JN	Natl CPI Ex Fresh Food, Energy y/y	21-Jul-2020	Jun	0.4%	0.4%
	JN	Nationwide Dept Sales y/y	21-Jul-2020	Jun	-19.1%	-65.6%
WED	JN	Jibun Bank Japan PMI Composite	22-Jul-2020	Jul P	43.9	40.8
THUR	US	Leading Index	23-Jul-2020	Jun	2.0%	3.2%
	EC	Consumer Confidence	23-Jul-2020	Jul A	-15.0	-14.7
FRI/SAT	UK	Retail Sales Ex Auto Fuel y/y	24-Jul-2020	Jun	–	-9.8%
	FR	Markit France Composite PMI	24-Jul-2020	Jul P	–	51.7
	GE	Markit/BME Germany Composite PMI	24-Jul-2020	Jul P	–	47
	EC	Markit Eurozone Composite PMI	24-Jul-2020	Jul P	–	48.5
	UK	Markit/CIPS UK Composite PMI	24-Jul-2020	Jul P	–	47.7
	US	Markit US Composite PMI	24-Jul-2020	Jul P	–	47.9
	US	New Home Sales	24-Jul-2020	Jun	690k	676k

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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