Macro Strategy | 12 June 2020

Standard Chartered
Private Bank

Weekly Market View

Is this the second wave?

The pullback in risk assets was overdue, in our view, given the sharp run-up since March lows, rising US COVID-19 cases and Fed warnings of a prolonged downturn. Continued strong policy support leaves us constructive in the medium term

Is this the second wave

Equities: Rotation into cyclical sectors is likely to continue in the near term amid expectations of a recovery in economic growth and earnings

Bonds: We expect US 10-yr Treasury yields to remain anchored below 1% amid the Fed's low-rates guidance

FX: USD likely to bounce near term; EUR/USD faces strong resistance around 1.1495 and AUD/USD faces resistance at 0.7130

Also find out...

Is the Hang Seng index's rise in recent weeks excessive?

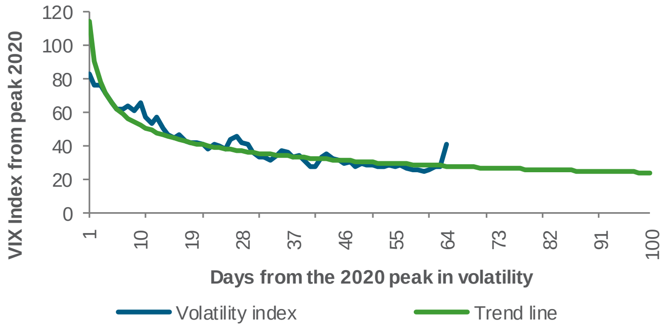
Is it a good time to earn income from the spike in volatility?

Is gold's rally over in the near term?

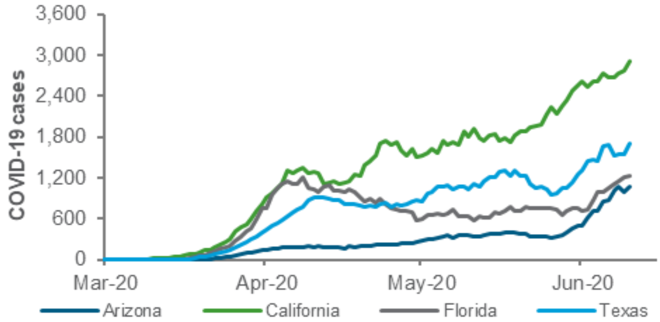
Chart of the week: US COVID-19 surge hits a complacent market

The decline in equity market volatility reflected complacency; a resurgence in COVID-19 cases in southern US is a reminder of a key risk

US S&P500 volatility index (VIX) from peak of 2020



New COVID-19 cases rising in major US southern states



Source: Bloomberg, Standard Chartered;

Editorial

Is this the second wave?

In many ways Thursday's pullback in risk assets was long overdue. We have been highlighting this risk in recent weeks after the V-shaped rebound in US equities since March lows started to broaden into other risk assets worldwide. While we believe investors have good reasons to look beyond the COVID-19 recession (see page 3), the rebound, especially in sentiment – as seen in the fall in the VIX (see chart) - went too far, too smoothly, resulting in one-sided positioning in markets. Against this backdrop, the resurgence of COVID-19 cases in the US and the Fed's warning of a prolonged economic downturn all came to a head.

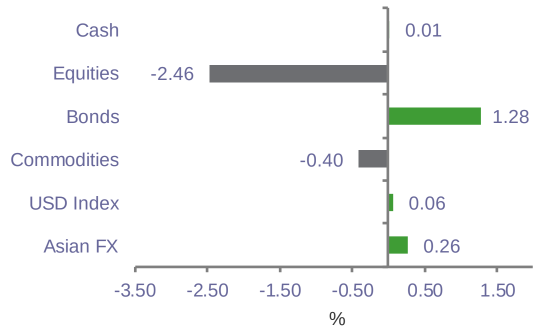
What happens next? If anything, our constructive medium-term view on risk assets has been bolstered by the Fed's pledge this week to keep interest rates at record low levels, continued acceleration in China's credit stimulus and the ECB's pledge to pursue its pandemic stimulus plans. China's and Europe's recovery will be crucial for a sustained broadening of the risk asset rally beyond the US. As growth and earnings expectations turn around, they should help the rotation in equity markets from defensives to cyclicals (see page 4) and extend USD losses.

A second wave of COVID-19 is a key risk – the pick-up in new cases in southern US states and continued rise in cases in Brazil and India are reminders. US-China tensions, as US Democratic challenger Joe Biden expands his lead over President Trump in polls, is another risk. However, this week's bailout of Hong Kong's flag carrier Cathay Pacific by the government and Chinese companies reflects growing economic ties between Hong Kong and China. Economic benefits from the closer links could help alleviate political concerns in Hong Kong.

The European Council meeting on 19 June is the next key focus. At the meeting, Germany, France, Italy and Spain will need to overcome opposition from some EU members for a EUR 750bn fiscal spending plan, mainly consisting of grants to weaker members. The plan needs unanimous support to go through. Success here could result in members of the 27-nation bloc sharing the region's debt for the first time. Markets are not anticipating an immediate breakthrough, but a positive surprise could fuel a rally in European assets and EUR/USD. This would support our 6-12-month preference for Asia ex-Japan equities, Asian and Emerging Market USD bonds and cyclical currencies, such as the AUD.

Global equities pulled back, giving up some gains made in recent weeks, and government bonds rose amid concerns about rising COVID-19 cases in the US and the Fed's warning of a prolonged economic downturn

Benchmark market performance w/w*



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

*Week of 04 June 2020 to 11 June 2020

The S&P500 index has support 3% below current level

Technical indicators for key markets as on 11 June 2020

Index	Spot	1st support	1st resistance
S&P	3,002	2,925	3,084
STOXX 50	3,145	3,065	3,224
FTSE 100	6,077	5,941	6,245
Nikkei 225	22,131	21,782	22,786
Shanghai Comp	2,907	2,892	2,945
Hang Seng	24,237	23,950	24,866
MSCI Asia ex-Japan	643	638	653
MSCI EM	994	987	1,009
Brent (ICE)	37.9	36.3	40.4
Gold	1,726	1,694	1,741
UST 10Y Yield	0.69	0.60	0.72

Source: Bloomberg, Standard Chartered

The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	• New York City lifted restrictions on businesses and households as COVID-19 cases fell to the lowest since March.	• Renewed concerns about second wave of COVID-19 in large southern US states • COVID-19 new cases continued their uptrend in major EMs • Germany extended travel warning to countries outside EU

Our view: New York's experience shows that stringent lockdowns are needed to supress the spread of infections, as it did in most European countries. This raises the risk that southern US states and some Emerging Markets (EMs) may have to re-impose economic lockdowns if cases continue to rise.

	Positive for risk assets	Negative for risk assets
Macro data	• Surprise rebound in US job creation in May; unemployment rate fell 1.4ppt to 13.3% vs expectations of a rise to 19-20% • US weekly initial jobless claims declined for the tenth consecutive week – the longest streak on record • Fed expects growth to bounce back to +5% in 2021, from -6.5% in 2020 • China's aggregate credit growth continued to accelerate to 12.5% y/y rise in May, led by government bond issuance to finance infrastructure • China auto sales rose in May for the first time since June 2019 • Return of flows to Emerging Markets, enabling central banks to be more accommodative	• Fed forecast US growth to contract -6.5% in 2020 and unemployment to stay elevated • US National Bureau of Economic Research confirmed recession started in February • In May, US core CPI fell to 9-year low of 1.2%, China core CPI fell to 1.1% and PPI fell to 4-year low of -3.7%, highlighting disinflationary pressures • German April factory orders fell 26% m/m and Japan May machine tool orders fell 53% - both seen as indicators of future global capital goods demand • Bundesbank forecast economy to shrink -7.1% in 2020 • Italian and Dutch central bank governors voiced concern about building deflationary pressures
Policy developments	• Fed Chair Powell pledged to keep interest rates at record lows till end-2022 • US Treasury Secretary Mnuchin called for bipartisan support for more fiscal stimulus • Reports suggest the Chinese government is planning CNY200bn stimulus for banks • ECB President Lagarde said central bank to provide defence against German court ruling • European Council meeting on 19 June to discuss EUR750bn pandemic recovery fund and debt mutualisation • Hong Kong Chief Executive called for greater connectivity between financial markets in Hong Kong and China	• Fed Chair Powell warned that COVID-19 could have a long-lasting damage on the economy, especially in long-term unemployment levels, unless more stimulus is provided • European Union's Brexit negotiator Michel Barnier said he still sees major hurdles to reach a Brexit deal by 30 June, but the UK Cabinet Office minister said it would be "crazy to extend the Brexit deadline"

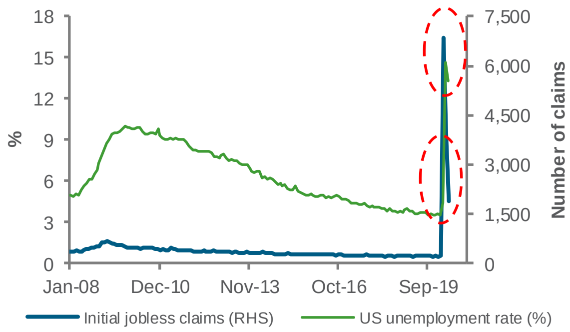
Our weekly net assessment: Supportive of risk assets medium-term (12m)

(+) factor: Sustained policy support; (-) factor: Resurgence in COVID-19

Our view: The surprise rebound in US job creation in May, while debatable in terms of actual numbers, suggests the economy has likely found a bottom. Unprecedented policy stimulus, which drove the recovery in sentiment, is not going away soon. China's credit data confirms the acceleration in lending to infrastructure projects. These indicators raise the probability that the global economy will start to recover in H2. A second COVID-19 wave is a key risk.

US unemployment appears to have peaked, but remains well above previous highs

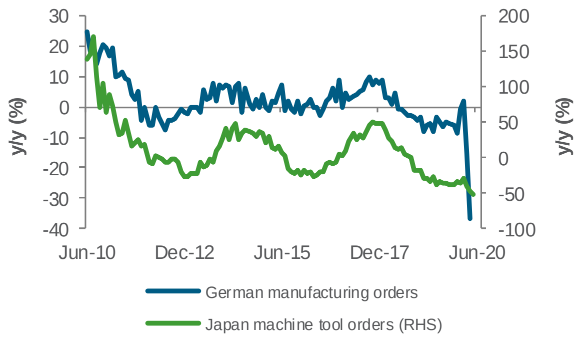
US unemployment rate and initial jobless claims



Source: Bloomberg; Standard Chartered

The slump in German factory orders and Japan machine tool orders underscores still-weak outlook for global capital goods demand

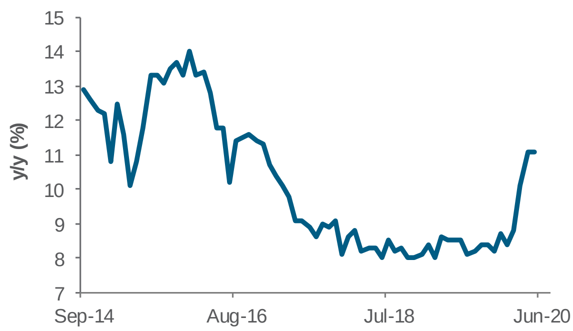
German factory orders and Japan machine tool orders



Source: Bloomberg, Standard Chartered

China's growing credit stimulus is supporting increased infrastructure spending; this is driving the recovery in global cyclical industries and commodities

China's M2 money supply growth



Source: Bloomberg; Standard Chartered

Top client questions

Are we witnessing rotation into previously unloved "cyclical" sectors?

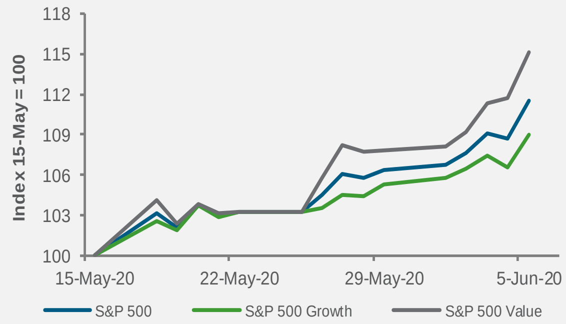
Yes. Since mid-May, we have seen rotation into cyclical sectors in the MSCI all country world index. Characteristics of these sectors include high valuations, due to current low earnings forecasts, and high dividend yields compared to peers. Energy and industrials sectors stand out based on these criteria. Both sectors in the MSCI all country world index have performed strongly over the past 30 days, rising 11% and 15%, respectively.

In our view, rotation into cyclical sectors reflects increased optimism over the outlook for growth in 2021. Strategists have highlighted a number of likely catalysts, such as the recovery in PMIs, improving consumer sentiment and rising personal income growth, driving the rotation. The latter may come as a surprise, but economists note that schemes to keep staff employed in the US and UK are in many cases providing income that is above the minimum wage.

Cyclical sectors, including energy, may continue to outperform in the coming 1-3 months, driven by a recovery in analysts' earnings revisions, which have moved from a 5:1 ratio in favour of downgrades in March to 1.5:1 in May. While energy sector valuations are elevated, this is based on depressed 2020 earnings. Forecasts for 2021 are for a normalisation in earnings growth, which will likely push valuations significantly lower.

US value stocks, heavily weighted by cyclical sectors, have started to outperform growth stocks in recent weeks, underscoring the broadening of the equity rally

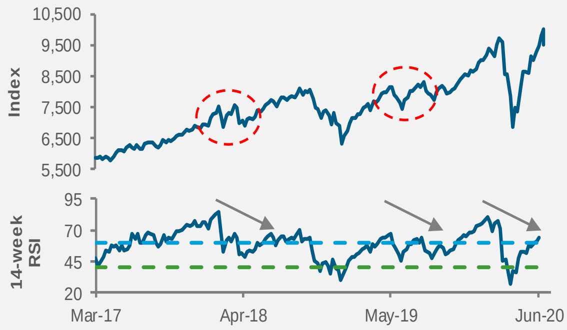
Relative performance of US S&P500 index and its sub-indices for value and growth stocks



Source: FactSet; Standard Chartered

The technology-sector-heavy Nasdaq index scaled a new record high this week, but momentum indicators suggest fatigue in the rally

Nasdaq Composite index and 14-day Relative Strength index (momentum indicator)



Source: Bloomberg; Standard Chartered

The Hang Seng index has risen over 10% from the March lows; is this excessive given the political turmoil?

In our view, the rally in the Hang Seng index reflects both Hong Kong's success in keeping COVID-19 infections low and optimism that policymakers will continue to take a pragmatic stance on supporting Hong Kong economically, despite concerns over recent legislative measures.

Hong Kong's success in keeping COVID-19 infections contained is undisputed. Total infections as of June 11 are 1,108 with 4 deaths, with new daily cases now as low as zero on many days. This is a considerably more positive outcome relative to many regional peers.

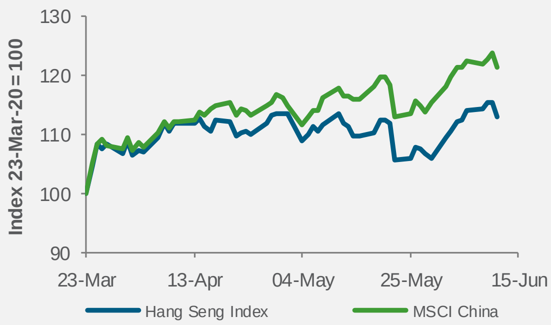
The political environment, though, has been less stable. Nevertheless, we believe the Hang Seng index's continued rally reflects expectations that Chinese policymakers are likely to adopt a pragmatic approach to supporting economic growth in Hong Kong.

There are many specific examples of this. A Chinese state-owned enterprise participated in the rights issue for Hong Kong's leading airline. Additionally, many Chinese stocks listed in the US are selecting the Hong Kong equity market for a dual listing. The dual listing of these stocks is expected to enhance the position of Hong Kong as one of the leading stock exchanges globally.

We continue to view China offshore equities, which include many stocks listed on the Hang Seng index, as preferred.

The rally in Hong Kong-listed shares reflects the city's success in keeping COVID-19 infections low and expectations that China's policymakers will take a pragmatic approach to support Hong Kong's growth

Relative performance of Hang Seng and MSCI China indices (100 = 23 March 2020)



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

Do you expect a further rise in bond yields?

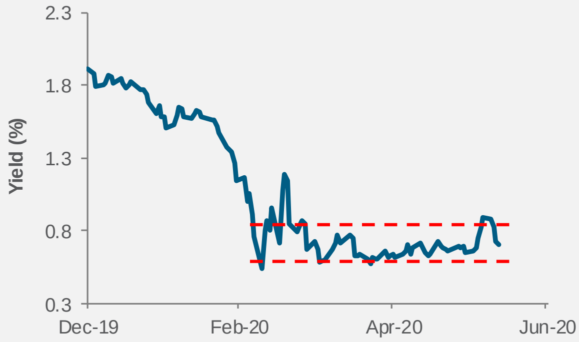
10-year US Treasury yields jumped on 5 June following a stronger-than-expected jobs report, though this rise was short-lived amid continued concerns about the economic outlook. In our opinion, the 10-year US Treasury yield is likely to remain anchored below 1% in the near future owing to the following reasons:

1. In the FOMC meeting earlier this week, Fed Chair Powell stated the Fed is not even thinking about raising rates till at least 2022, something that is reflected in the Fed's 'Dot Plot'.
2. If the 10-year yield rises substantially, it would lead to a steeper yield curve (ie. a widening gap between 2-year and 10-year yields). This could potentially dampen long-term borrowing and hurt growth prospects. This is likely why Fed Chair Powell also noted the Fed will continue to discuss yield curve control at upcoming meetings.
3. While US jobs data did surprise on the upside, there is still a fair bit of uncertainty about recovery prospects, especially with the risk of a second wave of infections in states that have re-opened.

Hence, while a temporary break over 1% cannot be ruled out, we believe the 10-year US Treasury yields are likely to remain anchored below 1%. This, in turn, means that the yield curve is likely to remain relatively rangebound over the coming few months.

We expect 10-year Treasury yields to remain anchored below 1% in the near-term amid Fed's low-rates guidance and uncertainty around a second COVID-19 wave

US 10-year Treasury yields



Source: Bloomberg; Standard Chartered

Is the USD downtrend fading?

On a long-term (12-month) trend basis, we believe the answer is no.

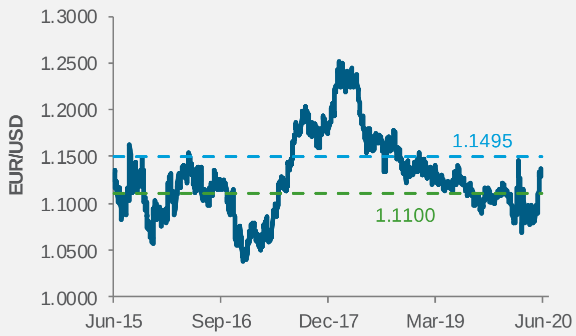
One way of viewing the overall USD trend is through the lens of two key currency pairs – EUR/USD, which accounts for around 57% of the DXY index, and AUD/USD, which is particularly sensitive to global and Asian growth and Chinese economic stimulus.

Both pairs have rallied strongly (by 5-8%) over the past three weeks. Long-term, this is consistent with our 12-month bearish view on the USD – we see rebounding global growth and plentiful global USD liquidity as key drivers. However, short-term technical analysis suggests a corrective USD bounce may be due over a 1- to 4-week time horizon. A dollar rally within this context is likely to be driven by rising "risk-off" sentiment, but we expect this to be only a corrective counter-trend move within the overall USD downtrend bigger picture.

A short-term correction could offer speculative opportunities from a short-term trading perspective but might also provide a price window for investors to sell USD on a rally and hedge longer-term portfolio and loan exposure at better levels. EUR/USD briefly broke through resistance at 1.1395 before falling back. The key medium-term resistance lies at 1.1495. Provided this barrier holds, we are expecting a decline towards the 1.1100-1.1170 initial support band. The correction could further extend towards stronger 1.1000-1.1030 support without raising any concern for our 12-month bullish EUR/USD view. AUD/USD recently peaked at 0.7060, within a strong resistance band between 0.7030 and 0.7130. Initial, and likely robust, support lies around 0.6670. A break here would argue for an extension towards the 0.6450-0.6500 level, from where we would expect the longer-term AUD/USD uptrend to re-assert.

EUR/USD briefly broke above 1.1395 resistance; the next resistance is at 1.1495

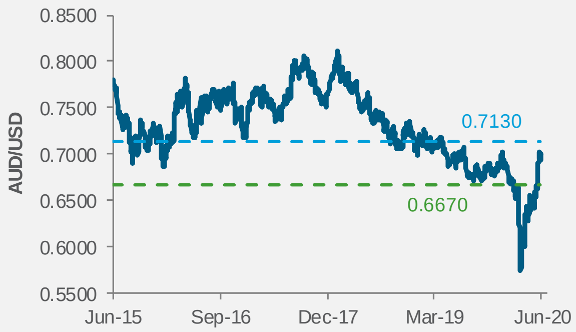
EUR/USD



Source: Bloomberg; Standard Chartered

AUD recently peaked at 0.7060, with a strong resistance band between 0.7030 and 0.7130

AUD/USD



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

Is gold's rally over in the near term?

Gold rose back above USD 1,700/oz after the Fed signalled that policy rates will still be near-zero over the next few years. As we have highlighted previously, we view the recent pullback as a temporary period of consolidation – the uptick in risk appetite and the resulting softening of demand for safe havens had been headwinds for gold. From a technical viewpoint, we believe the precious metal could trade sideways for now in the absence of new catalysts, with key resistance in the 1,745-1,765 range.

Looking beyond a period of consolidation over the next few weeks, gold remains a preferred asset on a 12-month horizon. We continue to expect central banks to keep real (net of inflation) yields low, which is supportive for gold as it caps the opportunity cost (given its non-yielding attributes). Gold also remains a solid portfolio diversifier, in our view, especially if geopolitical risks return to the foreground or if inflation pressures start building over the longer term. Therefore, we would be happy to use pullbacks as an opportunity to increase exposure to the precious metal.

Gold faces near-term resistance in the 1745-1765 range

Gold prices

Source: Bloomberg; Standard Chartered

Given the sharp spike in volatility this week, is this a good opportunity to earn income from selling volatility?

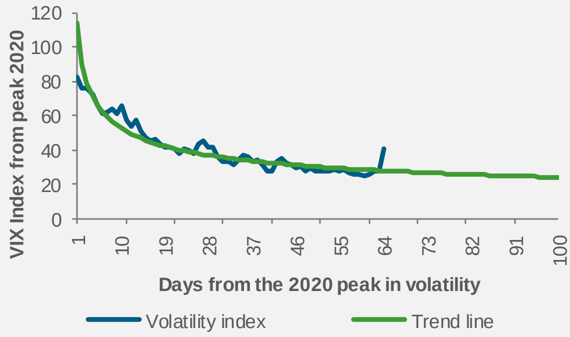
We believe it is a good opportunity to sell volatility for income.

Spikes in volatility during a market recovery is not uncommon. Volatility indices, such as the VIX index, typically follows the "power law". In layman's terms, volatility drops fastest in the first 20% of the normalisation period, and gradually slows thereafter. In the 150 trading days of the recovery period following the Lehman crisis, the VIX index came off sharply in the first 30 trading days, then spiked above its power law trajectory over the next 60 trading days, before gradually coming off again in the final 60 trading days.

In the current COVID-19 crisis, the VIX index has come off faster than during the Lehman crisis. So far, we have entered the "next 60 trading day" period without any significant spikes in volatility. Hence, we believe the rise in volatility overnight is normal, and does not signify any significant derailing of the market recovery. Hence, we see the latest spike in volatility as a good opportunity to sell volatility to earn income.

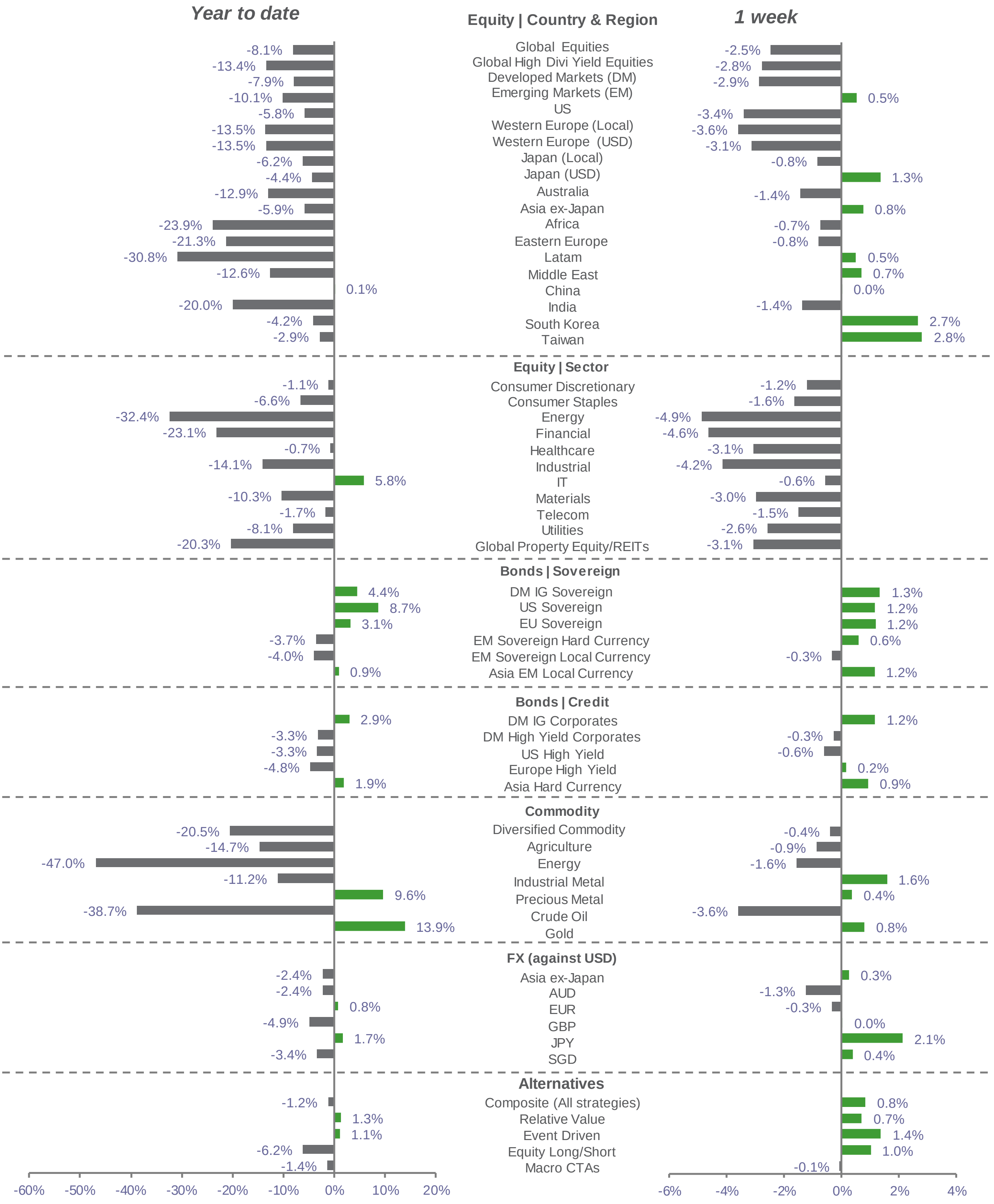
We believe the latest spike in volatility presents a good opportunity to earn income by selling volatility

S&P500 volatility index (VIX)



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 11 June 2020, 1 week period: 04 June 2020 to 11 June 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	CH	Industrial Production y/y	15-Jun-2020	May	5.0%	3.9%
	CH	Retail Sales y/y	15-Jun-2020	May	-2.0%	-7.5%
	CH	Fixed Assets Ex Rural YTD y/y	15-Jun-2020	May	-6.0%	-10.3%
	IN	Exports y/y	15-Jun-2020	May	–	-60.3%
TUE	EC	ZEW Survey Expectations	16-Jun-2020	Jun	–	46.0
	US	Retail Sales Ex Auto and Gas	16-Jun-2020	May	4.0%	-16.2%
	US	Industrial Production m/m	16-Jun-2020	May	2.8%	-11.2%
	US	Capacity Utilization	16-Jun-2020	May	67.1%	64.9%
	JN	BOJ Policy Balance Rate	16-Jun-2020	16-Jun	–	-0.1%
WED	JN	Exports y/y	17-Jun-2020	May	-28.3%	-21.9%
	US	Building Permits	17-Jun-2020	May	1258k	1066k
	US	Housing Starts	17-Jun-2020	May	1100k	891k
THUR	UK	Bank of England Bank Rate	18-Jun-2020	18-Jun	0.1%	0.1%
	US	Philadelphia Fed Business Outlook	18-Jun-2020	Jun	-25.0	-43.1
FRI/SAT	UK	Retail Sales Ex Auto Fuel y/y	19-Jun-2020	May	–	-18.4%
	GE	PPI y/y	19-Jun-2020	May	–	-1.9%
	EC	European Council meeting to discuss EUR 750bn pandemic recovery fund	19-Jun-2020			

	Event	This Week	Date	Period	Actual	Prior
MON	GE	Industrial Production WDA y/y	08-Jun-2020	Apr	-25.3%	-11.3%
	EC	Sentix Investor Confidence	08-Jun-2020	Jun	-24.8	-41.8
TUE	GE	Exports SA m/m	09-Jun-2020	Apr	-24.0%	-11.7%
	JN	Machine Tool Orders y/y	09-Jun-2020	May P	-52.8%	-48.3%
	US	NFIB Small Business Optimism	09-Jun-2020	May	94.4	90.9
	US	JOLTS Job Openings	09-Jun-2020	Apr	5046	6011
WED	CH	PPI y/y	10-Jun-2020	May	-3.7%	-3.1%
	CH	CPI y/y	10-Jun-2020	May	2.4%	3.3%
	FR	Industrial Production y/y	10-Jun-2020	Apr	-34.2%	-17.3%
	CH	Money Supply M1 y/y	10-Jun-2020	May	6.8%	5.5%
	US	CPI Ex Food and Energy y/y	10-Jun-2020	May	1.2%	1.4%
THUR	US	FOMC Rate Decision (Lower Bound)	11-Jun-2020	10-Jun	0.0%	0.0%
	US	PPI Ex Food and Energy y/y	11-Jun-2020	May	0.3%	0.6%
FRI/ SAT	IN	CPI y/y	12-Jun-2020	May	–	–

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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