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WM Chief Investment Office
2 July 2021

Weekly Market View

Much ado about nothing?

Concerns about the longevity of the economic expansion, new COVID-19 variants and Fed policy are likely overdone. We see the recent gains in Developed Market bonds and in Growth-style equities as opportunities to rotate into our preferred risk assets.

Equities: Value-oriented equity markets and sectors are likely to resume their outperformance as recent economic and policy concerns fade.

Bonds: We prefer shorter maturity bonds, including Development Market High Yield and Asian USD debt, which are less sensitive to an expected rebound in US government bond yields.

FX: The USD is likely to weaken after a brief consolidation. We expect European and commodity currencies to be the key beneficiaries.

Do you see opportunities following the flattening of the Treasury yield curve?

Are regulatory concerns in China priced into equity and bond markets?

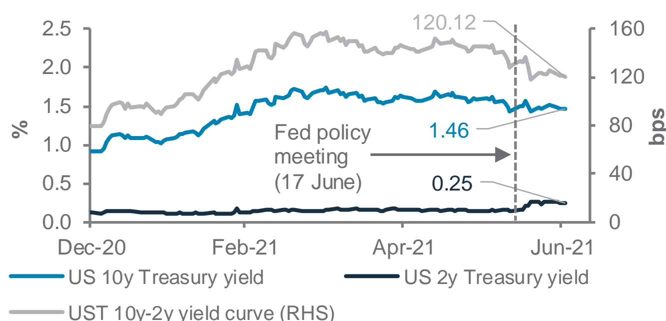
Which currencies are likely to benefit most from central bank tightening?

Important disclosures can be found in the Disclosures Appendix.

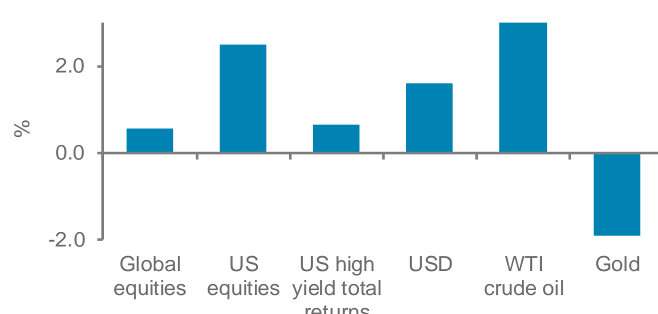
Charts of the week: Reading into the curve

The flatter Treasury yield curve has raised doubts about Fed policy, but risk assets have performed well lately

US 2y,10y Treasury yields & their difference (yield curve)



Performance of assets since the 17 June Fed meeting



Source: Bloomberg, Standard Chartered

Editorial

Much ado about nothing?

The Treasury yield curve – which plots US government bond yields across maturities – is seen as an indicator of the economy's health. The flattening of the curve in recent weeks – due to a fall in long-term yields and a rise in short-term yields – has raised doubts about the longevity of the economic expansion. Some have attributed the flattening to the rise of the more infectious COVID-19 Delta variant that could threaten the recovery. Others have questioned whether the Fed is jumping the gun in signalling a faster unwinding of its accommodative monetary policy. We believe the concerns are overdone.

The pullback in long-term Treasury yields in recent months, in our view, partly reflects an unwinding of inflation expectations, forcing overly bearish Treasury investors to cover their short positions. We believe inflation pressures likely peaked in the US and Europe in Q2 and are likely to decelerate as short-term distortions caused by economic re-openings fade.

In China, which is celebrating the 100th anniversary of the Communist Party, consumer inflation remains under control (as seen in the latest PMI data). Beijing has taken steps, including the release of stockpiles of critical raw materials, to curb input prices for industries. Meanwhile, OPEC is considering adding crude oil supplies to meet rising demand. These moves are likely to put a cap on global commodity prices, dampening inflation pressures.

We also see signs of a continued strong recovery in economic activity across the US and Europe – witness the sustained improvement in job markets and robust business confidence indicators (PMIs). Renewed fears about COVID-19 strains are overdone, in our view. Countries with the highest vaccinations rates are seeing sharp declines in hospitalisations, enabling governments to re-open economies – witness the largely mask-less crowd that thronged Wimbledon this week in the UK. The same is occurring in the US, with airplanes packed with summer vacationers. A UK study recently concluded that large-scale events did not cause any outbreaks, a finding which should give governments confidence to re-open as soon as herd immunity is reached. We expect the US, China and Europe to reach that stage in the next few months. Until then, temporary revival of infections could cause volatility in markets as governments recalibrate re-opening plans. Slow vaccination rates in the rest of the world are another likely source of intermittent volatility.

On balance, we believe the above scenario supports the ongoing global economic expansion and justifies the Fed bringing forward its median rate hike expectations to 2023 (which explains the modest rise in short-term Treasury yields). We see the Fed's move as a sign of growing confidence in the US economy, rather than a hawkish scramble to tighten policy due to inflation concerns. Even with these shifts, monetary policy is likely to remain accommodative in the US and Europe for at least a year. Thus, we see ongoing market dislocations as an opportunity for medium-term investors to add to risk assets, especially in US and European equities and High Yield bonds as well as Asian and Emerging Market USD debt. It is also a chance to switch away from the USD. The recent flattening of the US yield curve also presents an opportunity to add to Value-oriented equities, especially in the financial sector, which are likely to benefit from a renewed steepening of the curve.

— **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

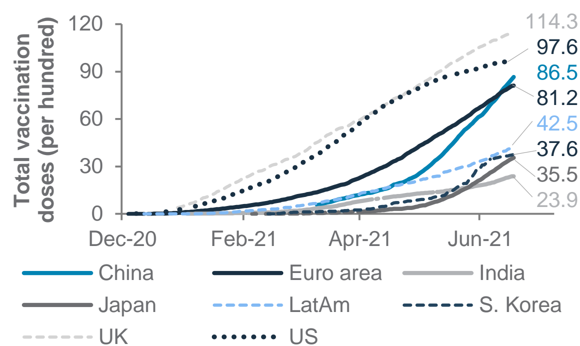
(+) factor: Euro area COVID gains; Biden's infrastructure deal

(-) factor: UK/Asia COVID rise; slower China services PMI

	Positive for risk assets	Negative for risk assets
COVID-19	• US, Euro area new cases, fatalities, hospitalisations fell to the lowest level since early days of pandemic; India cases fell to 3-month low • Moderna study showed its vaccine is effective against new variants • UK study showed large-scale events did not cause any outbreaks	• New cases continued to rebound in the UK, South Africa, parts of southeast Asia; cases in Brazil, Japan stayed elevated • Several countries banned UK travellers • 70% of Australians went into lockdown • Rate of US vaccinations slowed in recent weeks (47% fully vaccinated)
	Our assessment: Neutral – US, Euro area progress vs rising new cases in the UK, parts of Asia	
Macro data	• US private job creation, consumer confidence rose more than expected • US initial jobless claims fell to a pandemic low • US core PCE inflation rose less than expected • Euro area economic confidence rose more than expected	• China non-manufacturing PMI fell unexpectedly • US personal spending stagnated unexpectedly • US ISM manufacturing PMI slowed marginally (but still at a robust 60.6) • Euro area core CPI inflation accelerated to 0.3% m/m in June
	Our assessment: Neutral – Strong US job market, slowing inflation vs slower China non-manufacturing PMI	
Policy developments	• President Biden secured a bipartisan deal on USD1tn infra spending • All 23 US lenders passed Fed stress tests • US Supreme Court maintained ban against eviction of tenants	
	Our assessment: Positive – US infrastructure deal	
Other development		• India moved 50,000 troops to China border
	Our assessment: Negative – India-China relations	

Countries with high vaccination rates are seeing rapid re-opening of their economies

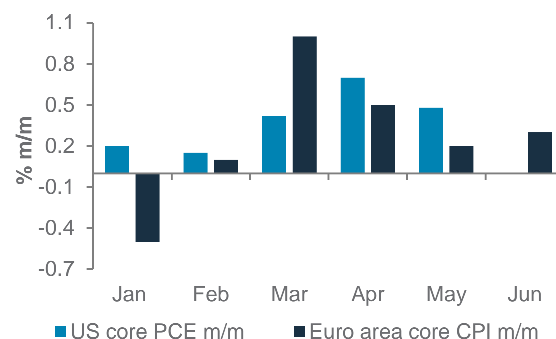
Total vaccine doses per hundred people



Source: Our World in Data, Standard Chartered

US and Euro area inflation likely peaked in Q2

US, Euro area core inflation, m/m



Source: Bloomberg, Standard Chartered

Euro area economic confidence has continued to improve

Euro area economic confidence indices

Source: Bloomberg, Standard Chartered

Top client questions

Do you see investment opportunities following the recent flattening of the yield curve?

We view the recent flattening of the US Treasury yield curve (i.e. narrowing gap between 10-year and 2-year yields) as temporary and expect the curve to steepen (the gap to widen) over the next 12 months. The recent flattening was likely driven by 1) higher short-term yields as investors brought forward Fed rate hike expectations and 2) lower long-term yields as inflationary concerns waned. However, unless these trends extend significantly further from here, short-term yields are unlikely to rise significantly, while growth expectations are likely to push the 10-year yield, which is currently testing the 1.46% technical support, back towards 1.75%. Together, these point to a steeper yield curve in 6-12 months' time.

Implications for bond markets

1. We prefer shorter maturity bonds (3-5 years) as they are less price-sensitive to the move higher in bond yields than longer maturity bonds.
2. DM HY corporate bonds and Asian USD bonds, which offer lower average maturity and reasonable yields, are likely to outperform longer maturity DM IG bonds. We would use current levels to rebalance out of DM IG bonds to our preferred asset classes.
3. A steeper yield curve usually supports financial sector earnings as banks typically borrow short term (eg. deposits) and lend long term (eg. mortgages). Hence, we continue to favour subordinated financial bonds.

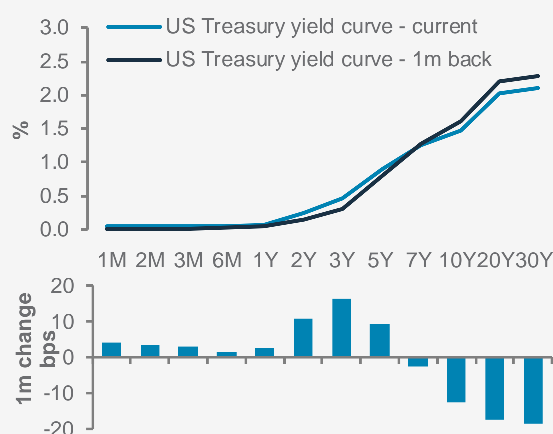
Implications for equity markets

1. A steeper yield curve is likely to support a renewed outperformance of Value-style equities relative to Growth-style equities as seen since start of the year. The flattening of the curve in recent weeks has caused Value to underperform Growth since mid-May. However, this underperformance should reverse as the yield curve resumes its steepening trend over the next 6-12 months. This suggests today's levels offer an opportunity to add exposure to the Value investment style.
2. From a sector perspective, we continue to favour financials and energy in the US and Euro area, both Value-style sectors. In addition to positive tailwinds from economic re-opening and reflation, US financials are stepping up their buybacks and dividends after passing the Fed's stress tests. Meanwhile, energy stocks are expected to benefit from elevated crude oil prices.

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

We expect the US Treasury yield curve to resume steepening as longer-term yields rise

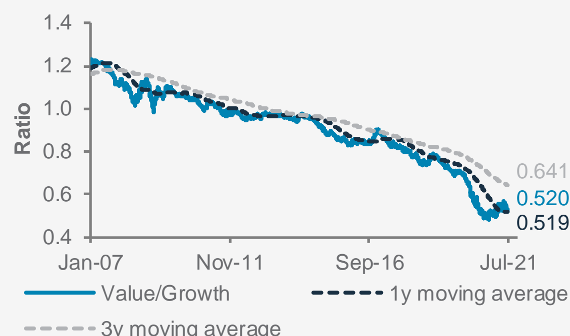
US Treasury yield curve plotting yields across maturities; 1m change in yields across maturities



Source: Bloomberg, Standard Chartered

We expect this year's outperformance of Value-style equities to resume as the US Treasury yield curve steepens again

Ratio of MSCI All Country World Value index vs. MSCI All Country World Growth index



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Are regulatory concerns in China now priced into equity and bond markets?

While we have not seen any new regulatory pressures recently in China, it seems too early to conclude that concerns are fully priced by equities. This is reflected in the sideways trend of the MSCI China index. We see China equities as a core holding, while our preferences are for the Euro area, UK and US, where we see a stronger case for outperformance relative to global equities on a 12-month horizon.

We believe bonds are a more attractive route to gaining exposure to China's real estate sector (we prefer Asia HY USD bonds, of which the sector is a key component) than the equity market (we have a less preferred view on China's real estate equity sector). As we have discussed in a previous *Weekly Market View*, China's Three Red Lines policy is likely to lead to credit differentiation, which, on a 12-month horizon, is likely to result in stronger balance sheets, a credit positive.

However, the renewed focus on debt sustainability could raise risks for weaker parts of the State-owned Enterprises (SOEs) and Local Government Financing Vehicles (LGFVs) sectors. In our assessment, these sectors in the Asian USD bond markets may not be fully pricing the risks.

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

We see China equities as a core holding. The index has been rangebound in recent months

MSCI China index

Source: Bloomberg, Standard Chartered

Which currencies are likely to benefit from central bank tightening ahead of the Fed?

Since the 17 June Fed meeting, 2-year government bond yields in New Zealand have risen by around 25bps compared with the 10bps rise in US yields. Canadian and Australian yields have approximately matched the US move, while the UK, European, Japanese and Swiss yields have lagged.

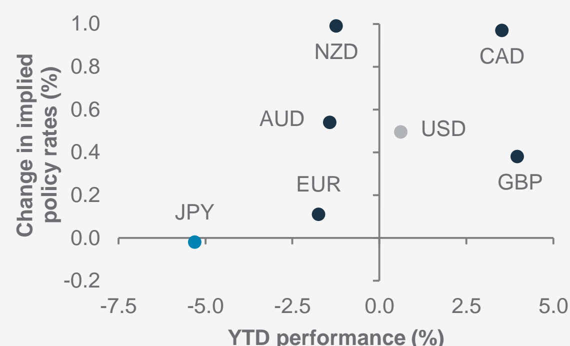
Implied policy rate changes in the next 12-months (see chart) show markets expect New Zealand and Canada to tighten faster than the Fed, with Australia and the UK largely in line and the Euro area and Japan likely lagging.

Aside from rate differentials, economies sensitive to international trade and capital flows should benefit as US economic growth radiates globally. This would be a positive for the NZD, CAD, AUD and GBP over the medium term.

COVID-19 trends, especially of variants, and slow vaccination rates, besides geopolitics are key risks. Nevertheless, our base case is for USD weakness to reassert, with the NZD, CAD, AUD, EUR and GBP to be among the best performers.

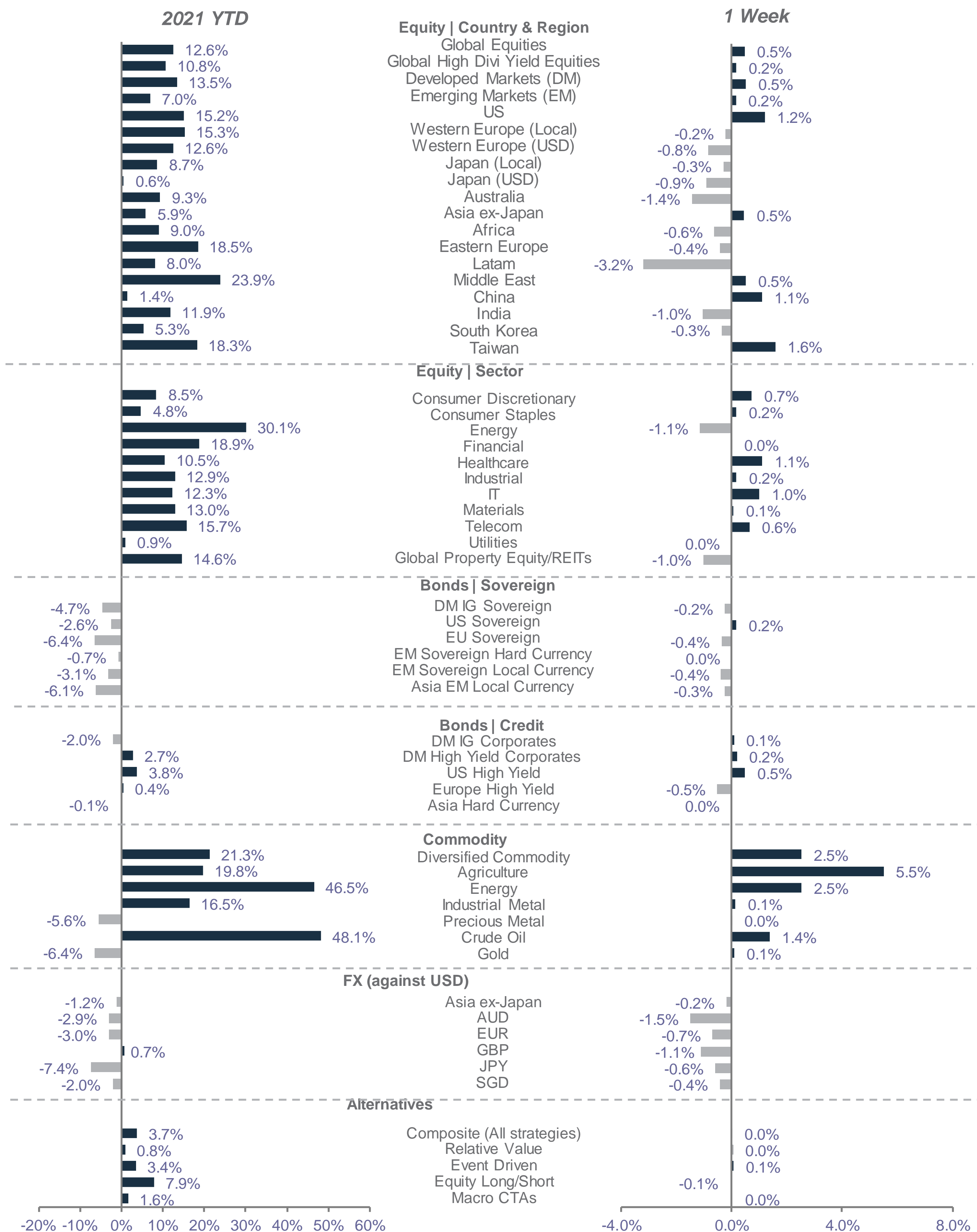
USD to weaken after consolidation; AUD, GBP, CAD, NZD are likely beneficiaries

Market expectation of central bank policy rate change in 1 year vs. YTD FX performance*



Source: Bloomberg, Standard Chartered; *measured by trade weighted currency indices

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 01 July 2021; 1-week period: 24 June 2021 to 01 July 2021

Our asset class views at a glance

Asset class		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	CH	Caixin China PMI Services	Jun	55.1
	CH	Caixin China PMI Composite	Jun	53.8
TUE	US	ISM Services Index	Jun	64
	AU	RBA Cash Rate Target	6-Jul	0.1%
	EC	Retail Sales y/y	May	23.9%
WED	US	JOLTS Job Openings	May	9286k
THUR	US	Initial Jobless Claims	3-Jul	--
FRI/SAT	CH	CPI y/y	Jun	1.3%
	CH	PPI y/y	Jun	9.0%
	CH	Money Supply M2 y/y	Jun	8.3%

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 0.6% below current level

Technical indicators for key markets as on 01 July 2021

Index	Spot	1st support	1st resistance
S&P500	4,320	4,294	4,333
STOXX 50	4,079	4,055	4,112
FTSE 100	7,125	7,063	7,162
Nikkei 225	28,707	28,587	28,946
Shanghai Comp	3,589	3,572	3,607
Hang Seng	28,828	28,675	29,135
MSCI Asia ex-Japan	885	883	891
MSCI EM	1,368	1,364	1,377
Brent (ICE)	75.8	75.0	76.5
Gold	1,775	1,764	1,784
UST 10Y Yield	1.46	1.44	1.51

Source: Bloomberg, Standard Chartered

Investor diversity has normalised across assets

Our proprietary market diversity indicators as of 30 June

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.48
Global Equities	◐	↓	1.34
Gold	●	→	1.54
Equity			
MSCI US	◐	↓	1.34
MSCI Europe	◐	→	1.39
MSCI AC AXJ	●	↑	1.31
Fixed Income			
DM Corp Bond	◐	↓	1.36
DM High Yield	◐	↓	1.34
EM USD	◐	↓	1.34
EM Local	◐	↓	1.37
Asia USD	●	→	1.60
Currencies			
EUR/USD	●	→	1.63

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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