Wealth Management Chief Investment Office
3 February 2023

Weekly Market View

Nearing the end

→ This week, three of the world's most powerful central banks raised rates to new 14-year highs and signalled they are likely to hike at least once more and remain restrictive for a while. However, markets chose to look at the bright side – that the sharpest series of rate hikes in more than four decades is nearing its end.

→ We are more sceptical about the outlook for risk assets. We now expect the Fed and ECB to raise policy rates to 5% and 3.0-3.25% respectively in H1 and maintain them near the peak for the rest of the year. This is likely to impact equity valuations and corporate earnings.

→ This macro backdrop, combined with stretched investor positioning, argues for fading the rally in US and Euro area equities and looking for opportunities to rebalance to bonds and stocks in Asia ex-Japan, where the outlook is brightening.

→ We also see further USD downside and broadly stable US bond yields near term, which should support flows to Asia.

Is further consolidation likely in the Hang Seng index?

What is the outlook for US government bond yields after the latest Fed meeting?

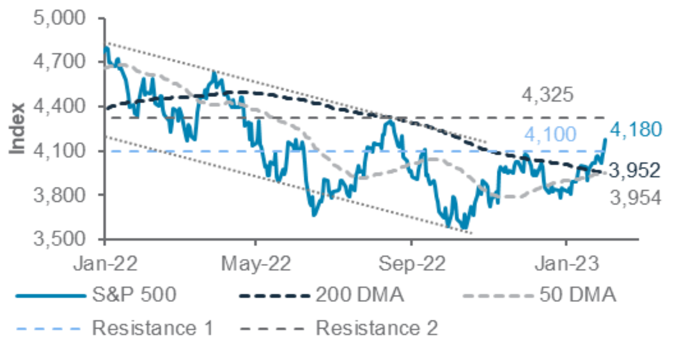
Are you still expecting a near-term bounce in the USD?

What is the implication of India's budget on markets?

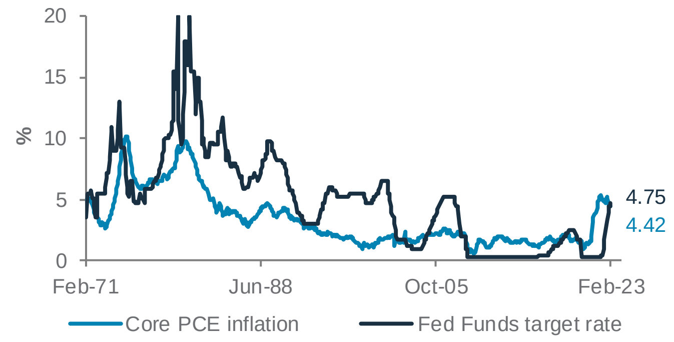
Charts of the week: Breaking higher?

S&P500 index broke above a key technical resistance, even as the Fed tightened its policy rate above inflation

S&P500 index, with next key technical resistance levels



Fed rate, US core inflation (personal consumption expenditure)



Source: Bloomberg, Standard Chartered

Editorial

Nearing the end

This week, three of the world's most powerful central banks raised rates to new 14-year highs and signalled they are likely to hike at least once more and remain restrictive for a while. However, markets chose to look at the bright side – that the sharpest series of rate hikes in more than four decades is nearing its end. US stocks broke above key resistance and European stocks rose to a nine-month high, having recovered more than four-fifths of the losses since the end of 2021.

We are more sceptical about the outlook for risk assets, though; we now expect the Fed and ECB to raise policy rates to 5% and 3.0-3.25% respectively in H1 and maintain them near the peak for the rest of the year even as economic data deteriorates. Restrictive rates and wage gains are likely to impact equity valuations and erode corporate margins, leading to earnings estimate downgrades. This outlook confirms our SAFE asset allocation stance at the start of the year: staying overweight on higher grade bonds and other income assets at the expense of equities. Add to that crowded investor positioning (see page 10), and we would continue to fade the rally in US and Euro area equities and look for opportunities to rebalance to bonds and stocks in Asia ex-Japan, where the outlook is brightening.

Of course, our latest review of the macro environment indicated several improvements since late 2022:

a) Headline inflation has peaked in major economies, enabling central banks to slow the pace of (and in some cases end) rate hikes; b) China and the Euro area economies are recovering, aided by policy stimulus and a plunge in gas prices (the IMF this week bumped up 2023 growth forecasts sharply); c) A weaker USD is easing global financial conditions and risk sentiment; d) Institutional investor positioning remains bearish on equities (although less so since Q3 last year); e) As a result of the above factors, risk assets are pricing in a goldilocks scenario of a shallow downturn in the US and Euro area, without severe dislocation to job markets and consumption as inflation gradually settles back towards central bank targets.

Nevertheless, we believe the scenario that markets are pricing in, extrapolating the above improvements, is too optimistic:

a) Global growth is set to slow this year as policy rates become restrictive, even as the dire outcome in Europe has faded; b) the US economy is slowing decisively (this week's contractionary ISM Manufacturing and New Orders PMIs attest to that); c) Yet labour markets in the US and Europe remain tight (as seen in bigger-than-expected rise in US job openings, drop in initial jobless claims to near-record lows and Euro area jobless rate staying close to near-record lows); d) Core inflation, especially in services sector ex-housing, remains high in the US and continues to rise in Europe; e) China's recovery is likely to add almost 0.5-1 percentage points to global inflation, challenging the disinflation narrative in the coming quarters; f) Corporate earnings are likely to slow as margins tighten, while earnings estimates have yet to be downgraded significantly; g) Expectations of an economic soft-landing and central bank policy pivots are contradictory – central banks are unlikely to cut rates if the economy and job markets don't deteriorate sharply. Central banks are also unlikely to tolerate a significant easing of financial conditions (through higher stock markets and narrower HY spreads) before the inflation battle has been won; and h) several risk assets are showing one-sided investor positioning, raising the risk of a near-term reversal. These include Europe and Asia ex-Japan stocks, the EUR and gold.

Investment implications: On balance, we believe many risk assets have likely run ahead of fundamentals. While strong momentum points to near-term upside for US and Europe equities, we would look for opportunities to switch to Asian ex-Japan equities (see page 5). We also see further downside for the USD and broadly stable US bond yields in the near term (see page 4), which should support flows to Asia.

— 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.

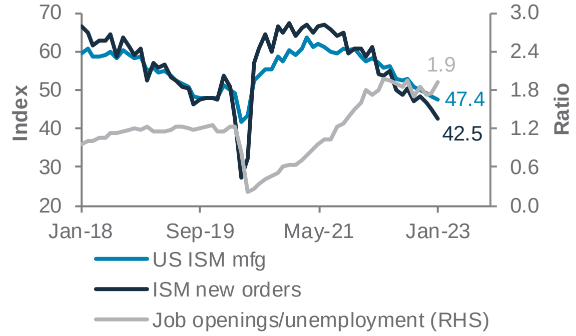
(+) factors: Easing US inflation, resilient Euro area economy

(-) factors: Falling US PMIs, hiking central banks, geopolitical tensions

	Positive for risk assets	Negative for risk assets
Macro data	• US headline and core PCE inflation slowed to 5.0% and 4.4% y/y, respectively • US employment cost index decelerated more than expected in Q4 to 1.0% q/q • US Michigan sentiment revised higher, while 5-10-year inflation expectation revised lower to 2.9% • Euro area economic confidence beat estimates • Euro area staved off a Q4 contraction with GDP growing 0.1% q/q • China mfg. (50.1) and non-mfg. PMI (54.4) rebounded into expansionary territory	• US real personal spending contracted more than expected • US conference board confidence index slipped unexpectedly • US ISM mfg. PMI fell more than expected to 47.4; new orders PMI fell to 42.5 • US JOLTs job openings rose more than expected • US initial jobless claims fell to a nine-month low • China Caixin manufacturing PMI rose less than expected to 49.2 • Euro area core inflation unchanged at 5.2%
	Our assessment: Neutral – Easing US inflation, resilient Euro area economy, recovering China PMIs vs. falling US PMIs, tight job market and elevated Euro area inflation	
Policy developments	• IMF raised 2023 global growth forecast for the first time in a year to 2.9%; China's growth upgraded 80bps to 5.2%, 40bps upgrade to US growth to 1.4% and 20bps upgrade to Euro area growth to 0.7% • The BoE hiked by 50bps as expected, but toned down its forward guidance	• Fed raised rates by 25bps as expected and signalled 1-2 more 25bps hikes in the coming months • The ECB hiked 50bps as expected and signalled another 50bps hike in Mar
	Our assessment: Negative – IMF growth outlook upgrades vs. still-hiking central banks	
Other developments		• US is considering cutting off Huawei from its American suppliers • US and South Korea plan to step up military exercises
	Our assessment: Negative – Geopolitical tensions	

US manufacturing activity continued to deteriorate, but the job market remained robust

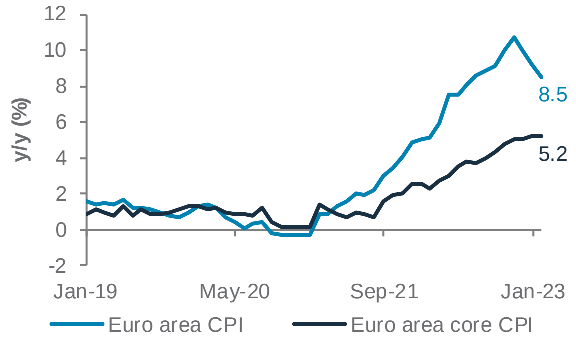
US ISM Manufacturing and new orders PMI, US job openings (JOLTS)



Source: Bloomberg; Standard Chartered

Euro area headline inflation continued to decline with falling energy prices, but core inflation remained elevated

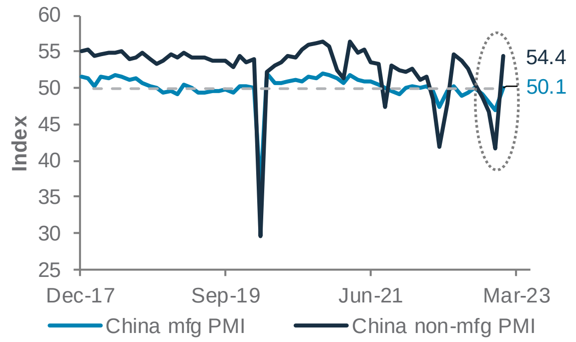
Euro area headline and core inflation



Source: Bloomberg, Standard Chartered

China's economic activity rebounded strongly in January as mobility restrictions were removed

China manufacturing and non-manufacturing PMIs



Source: Bloomberg, Standard Chartered

Top client questions

Are you still expecting a near-term bounce in the USD?

We have revised our near-term (three-month) outlook for the USD modestly lower and other major currencies higher following the Fed, ECB and BoE meetings earlier this week.

Fed Chair Powell appeared to be less hawkish relative to our expectations after slowing down the pace of rate hikes. Since multiple economic data indicators continue to point towards a slowdown in growth and inflation, we believe the Fed is likely to be under pressure to cut rates late in 2023, which means that markets are likely to push the USD lower in anticipation of rate cuts. Hence, we look for a modest downside in the USD in the next 3 months.

Our upward revision in ECB rate hike projections, along with an improvement in the energy security situation in Europe and positive growth surprise in Q4 growth, lead us to revise our near-term EUR/USD forecast higher to 1.12. A narrowing of real interest rate differentials with the US and positive investor sentiment are likely to be supportive for the common currency.

We also expect near-term strength in the AUD, NZD and CAD as the commodity currencies are likely to benefit from the faster-than-expected re-opening in China. As we head closer to the end of BoJ Governor Kuroda's term in April, market expectations of a shift in monetary policy are likely to push USD/JPY lower.

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

We revise our 3-month forecasts for the USD and other major currency pairs

Revised 3-month forecasts

Currency	3m forecast
USD (DXY Index)	100.5
EUR/USD	1.12
GBP/USD	1.2
AUD/USD	0.72
USD/JPY	128
USD/CNY	6.8
NZD/USD	0.65
USD/CAD	1.31
USD/CHF	0.92

Source: Standard Chartered Global Investment Committee

Our assessment of the current global macro backdrop and its impact on risk assets

	Factors supporting risk-on	Factors supporting risk-off
Economy	• EU and China growth outlook improving • Rising expectations of a soft landing; continued labour market strength, diminished drag from tighter fiscal and monetary policy	• Growth is still expected to slow from last year • US growth has taken a turn for the worse • Recession risks are merely postponed rather than diminished
Monetary Policy	• Major central banks likely to end their tightening cycle soon • Expectations that the Fed will cut rates in H2 if inflation continues to slow and growth decelerates sharply	• Real policy rates are now in increasingly restrictive territory • Fight against inflation is not over – tight labour market. Fed is unlikely to cut rates unless jobless rate rises above target • Fed unlikely to cut rates until inflation moves towards 2% target • Expectations of a soft landing and a Fed pivot are contradictory • ECB is in the long game with QT coming
Valuations	• Equities are prepared for non-severe recession	• Risk assets have not priced in a recession • Markets vulnerable to negative surprises, not ready for recession
Sentiment	• Improving risk sentiment from a weaker USD and falling gas prices and China's reopening	• Central banks are unlikely to be happy with the risk asset rally, as easing financial conditions make their jobs harder
Corporate Earnings		• Further downward earnings revisions • Margin expectations still too optimistic • European revenue growth to be hurt by strengthening EUR
Investor Positioning	• Net speculative positioning in US equity futures remains short	• Equity positions are no longer extremely bearish as in Q3 22

— **Zhong Liang Han**, *Investment Strategist*

Top client questions (cont'd)

Is further consolidation likely in the Hang Seng Index?

We believe the medium-term case for rising Chinese equities remains intact. This is because we believe the four factors that drove the downtrend in the Hang Seng Index since Q1 2021 – properties, internet regulations, threat of ADR delisting in the US, and mobility restrictions – are likely to continue to subside.

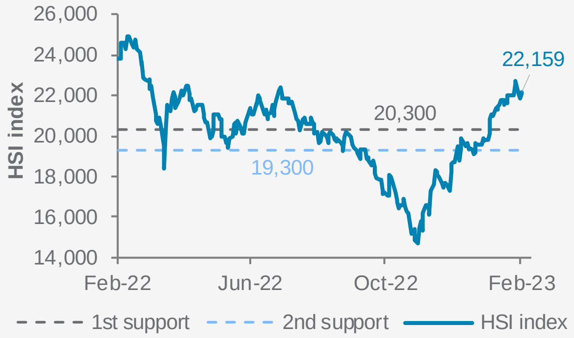
However, a pullback is likely in the short term (1-3 months). Chinese equities have become a consensus overweight. While the index has been climbing for most of January, volume has not been increasing, suggesting a lack of sustaining power in the rally. Moreover, there is risk from short-term fund rotation back into US equities. Nearly half the companies in the S&P500 index have reported earnings thus far, with 70% beating consensus estimates, giving a positive earnings surprise of 2.2%. The S&P500 index has just broken above a key resistance level at 4,100, propelled by a dovish FOMC meeting.

Hence, technicals argue the S&P500 index may have more room to run, possibly reaching key resistance levels at 4,325 and 4,512. We believe it will become more attractive to consider rotating back into the Hang Seng Index once the S&P500 index approaches these resistance levels, especially if the Hang Seng Index reaches key support levels at 20,300 and 19,300.

— **Daniel Lam,** *Head, Equity Strategy*

The Hang Seng index could see a pullback towards the "support zone" around 19,300 to 20,300

Hang Seng index



Source: Bloomberg, Standard Chartered

What is the outlook for US government bond yields after the latest Fed meetings?

The February Fed policy meeting concluded with Fed Fund Rate being raised by 25bps and the statement reiterating the need to hike rates further as inflation remains above long-term target. However, the market focused on the dovish takeaways in the post-meeting conference, resulting in US government bond yields falling. At his speech, Fed Chair Powell said he recognized disinflation has started and appeared to be relatively unconcerned about the discrepancy between market expectation and the Fed dot plots.

We revise our 3-month 10Y US government bond yield target lower to 3.25% - 3.5%. In our view, markets are likely to continue to look through forthcoming Fed rate hikes if Chair Powell continues to refrain from fighting the market. Macroeconomic data continues to deliver a mixed picture. Although the US labour market showed signs of lingering tightness, leading indicators are pointing towards higher downside risk to the economy. In addition, bond technicals favour largely anchored yields, which we believe will remain in place through to the last Fed rate hike of this cycle.

The 10-year yield is currently testing key support level of c.3.3%. Nonetheless, the building up of net short future positions since the start of the year should help yields from breaking substantially lower. Hence, we see high likelihood that the 10-year yield trades in range going forward, as we retain our year-end target at 3.25%.

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

Net short positions in US 10-year government bonds have surged since the start of the year

US 10-year government bond yield and net futures positions

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is the implication of India's budget on markets?

India's budget surprised markets by taking significant steps to spur growth while maintaining fiscal prudence. Announced measures to boost growth include: 1) Higher capital expenditure: FY 2024 capital expenditure is forecast to increase by 33% to a record USD 123bn (c.3.3% of GDP), with a focus on key infrastructure sectors such as railways and roads; 2) Boost to manufacturing, with the doubling of allocation for manufacturing subsidies. This follows other long-term reforms (such as corporate tax cuts, import duty changes and the production-linked incentive scheme) initiated in recent years as part of the push to develop India as a global manufacturing hub; and 3) A cut in personal income taxes could boost middle class disposable income and spur domestic spending, aiding economic recovery. These measures were balanced by the government sticking to its fiscal consolidation path, with FY 2024 budget deficit set at 5.9% of GDP vs 6.4% of GDP for FY 2023. More importantly, the shift in the quality of spending towards capex and cuts in subsidies towards pre-pandemic levels are likely to support India's macro fundamentals.

A pro-growth budget that also maintains fiscal prudence is likely to keep inflationary expectations muted. India's growth-inflation dynamics remain superior to that of its peers, which could better support its assets against external shocks. Indian equities have struggled this year to replicate their spectacular outperformance vs Asia ex-Japan in 2021 and 2022 given elevated valuations. We expect Indian equities to perform in line with Asia-ex Japan equities.

However, in our assessment, still-robust earnings growth, possible return of foreign investment flows and resilient domestic inflows through stable systematic investment plans are key supports for equities. Within Indian equities, we are Overweight large-cap equities. The budget is likely to support structural equity themes that have a longer runway for growth. We continue to see attractive value in financials, domestic cyclicals, and investment-led themes mainly focused on the manufacturing and infrastructure sectors.

Bond yields are likely to trend lower, with the budget unlikely to be inflationary given the improving quality of spending. Furthermore, with inflation trending lower over the last few months, interest rates are expected to peak out with consensus expecting the RBI to deliver its final rate hike in the current cycle at its February review next week. We continue to see increasing value in bonds, especially relative to equities. The budget is mildly positive for the INR as continued fiscal consolidation, strong focus on capex outlay and lower market borrowings are supportive for Indian assets. However, near-term risks remain on the downside for the INR given still-wide trade deficit, foreign portfolio outflows from equity markets, and likely RBI intervention as it tries to rebuild its FX reserves.

— **Vinay Joseph,** *Head of Investment Products and Strategy, India*

India's government stuck to fiscal consolidation path; significant increase in capital expenditure

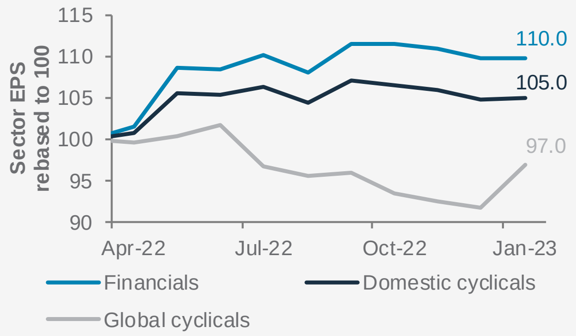
Key numbers from the Indian federal budget

	FY24 BE	FY23 RE
Fiscal deficit as % of GDP	5.9%	6.4%
Gross borrowing (INR trn)	15.4	15.0
Disinvestment (INR trn)	0.51	0.65
Gross tax revenue growth	10.4%	12.3%
Expenditure growth	7.5%	10.4%
Capital expenditure growth	37%	23%

Source: Bloomberg, Standard Chartered.
BE = Budget estimates; RE = Revised estimates; FY24 is the fiscal year ending 31 March 2024

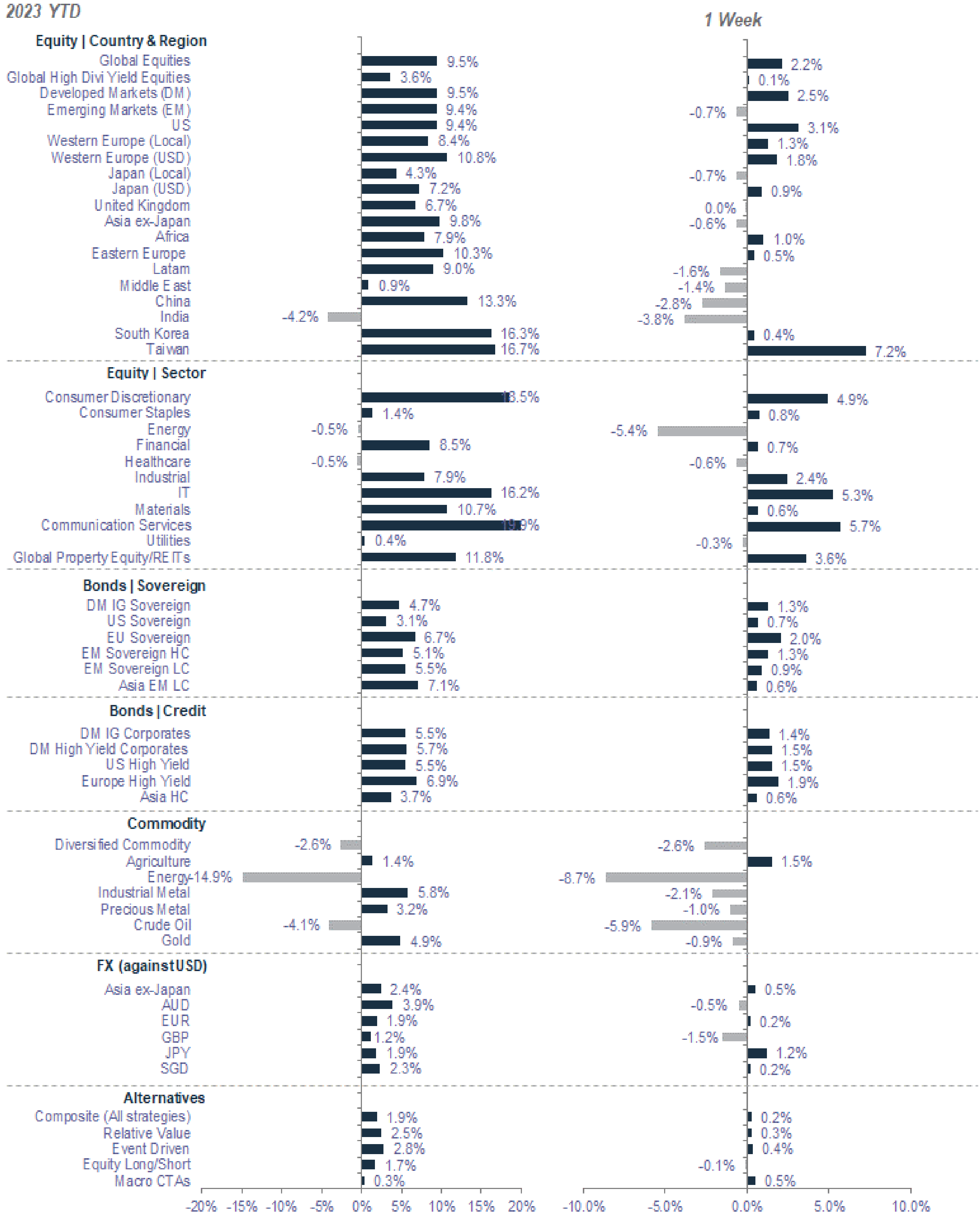
Trends in India's equity sector earnings estimates

Sector EPS trends since the start for FY23



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, 2023 YTD performance from 31 December 2022 to 2 February 2023; 1-week period: 26 January 2023 to 2 Febuary 2023

Our 12-month asset class views at a glance

Asset class			
Equities	▼	**Preferred Sectors**	
Euro area	◆	US Energy	▲
US	◆	US Staples	▲
UK	◆	US Healthcare	▲
Asia ex-Japan	▲	Europe Energy	▲
Japan	▼	Europe Financials	▲
Other EM	◆	China Comm. Services	▲
		China Discretionary	▲
Bonds (Credit)	▲		
Asia USD	▲	**Alternatives**	◆
Corp DM HY	▼		
Govt EM USD	◆	**Gold**	◆
Corp DM IG	◆		
Bonds (Govt)	▲		
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	Expected	Prior
MON	EC	Sentix Investor Confidence	Feb	–	-17.5
	UK	S&P Global/CIPS UK Construction PMI	Jan	–	48.8
	EC	Retail Sales y/y	Dec	–	-2.8%
TUE	US	Trade Balance	Dec	-$68.7b	-$61.5b
WED					
THU	CH	Money Supply M2 y/y	Jan	–	11.8%
	CH	New Yuan Loans CNY	Jan	4200.0b	1400.0b
FRI/SAT	CH	CPI y/y	Jan	2.3%	1.8%
	CH	PPI y/y	Jan	-0.6%	-0.7%
	UK	Industrial Production y/y	Dec	–	-5.1%
	UK	GDP q/q	4Q P	–	-0.3%
	UK	GDP y/y	4Q P	–	1.9%
	US	U. of Mich. Sentiment	Feb P	65.0	64.9

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 S&P500 index faces next resistance at 4,234

Technical indicators for key markets as of 2 February close

Index	Spot	1st support	1st resistance
S&P 500	4,180	4,072	4,234
STOXX 50	4,241	4,186	4,269
FTSE 100	7,820	7,781	7,840
Nikkei 225	27,490	27,382	27,544
Shanghai Comp	3,286	3,266	3,296
Hang Seng	21,958	21,637	22,484
MSCI Asia ex-Japan	680	672	686
MSCI EM	1,046	1,034	1,054
WTI (Spot)	82.2	80.7	85.2
Gold	1,916	1,902	1,940
UST 10y Yield	3.39	3.34	3.49

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 deteriorated in Europe stocks

Our proprietary market diversity indicators as of 2 February

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.32
Global Equities	◐	↓	1.35
Gold	○	↓	1.20
Equity			
MSCI US	◐	↑	1.43
MSCI Europe	○	↓	1.23
MSCI AC AXJ	○	→	1.25
Fixed Income			
DM Corp Bond	◐	↓	1.28
DM High Yield	◐	↓	1.31
EM USD	◐	↓	1.28
EM Local	○	↓	1.19
Asia USD	◐	→	1.25
Currencies			
EUR/USD	○	↓	1.18

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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