

Weekly Market View

Oversold markets in search of catalysts

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What is the outlook for China equities after another round of weak economic data for April?

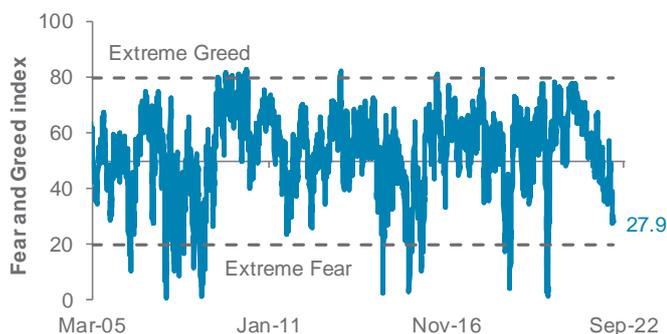
Is it a good time to dip back into China High Yield bonds?

Has the US dollar peaked in the near-term?

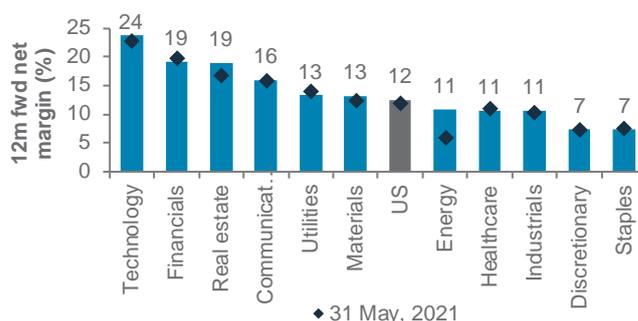
Charts of the week: Peak margin concerns stoke latest bout of fear

Our Fear and Greed index is showing the most fear since the depths of the pandemic; it is usually a contrarian indicator

Our Fear and Greed index*



S&P500 12m forward net profit margin estimates vs May 2021



Source: Bloomberg, Standard Chartered; *Based on market momentum, breadth and volatility; equity strength; equity vs bond returns; put-call ratio

Editorial

Oversold markets in search of catalysts

The last few weeks have been gruelling for investors. However, some of the missing ingredients for risk assets to sustainably recover appear to be gradually falling into place. US long-term inflation expectations have retraced from April's multi-decade highs, enabling the 10-year government bond yield to pull back before approaching the strong 3.26% resistance. As a result, the USD index is showing signs of peaking; it failed to rise after Fed Chair Powell and other officials this week warned that they are willing to take US rates into restrictive territory if inflation stays high. This shows how much investors have already factored in the inflation and policy rate outlook in the US.

Our "Fear and Greed" index and our proprietary measure of market positioning based on diversity of investor views across various asset classes also confirm investors' currently one-sided positions. The "Fear and Greed" index is showing the highest 'fear' level since the height of the pandemic in early 2020. The fractals data is indicating extremely low diversity of views on Emerging Market local currency bonds, USD/CNH, USD/JPY, GBP/USD, natural gas, the real estate equity sector across major markets and Emerging Markets ex-Asia equities. The diversity on global government bonds has been extremely low for several weeks. All of these imply those assets have a high chance of reversing their recent trends. Also, after several months, the correlation between stock and bond moves appears to have broken down – bonds rose on days stocks fell, once again offering investors benefits from diversification.

Concerns that corporate profit margins have peaked is the latest fear stalking markets, following warnings from major US retailers of the impact of rising input costs and wages. The profit margin concerns have also dragged consensus US earnings estimates for the coming year, despite all-round earnings beats in Q1 (the consensus is still forecasting record earnings for 2022 and 2023). We would make a few counterpoints against peak margin concerns: a) peak margins have been anticipated for a while; b) as the chart above shows, they are potentially problematic in low-margin sectors such as consumer staples and discretionary, while the consensus still expects high double-digit margins in other sectors; c) US consumption

remains very strong – retail sales in April remained well above pre-pandemic trends, helping companies offset some cost pressures; d) Cost pressures should subside by H2 2022 if our view of peak inflation and peak goods demand in H1 is correct.

Meanwhile, the outlook in China appears to be turning around after an extremely weak April (the economy likely contracted in April due to the severe lockdowns). China's COVID-19 infections continue to decline sharply, enabling Shanghai to gradually reopen. This week, the PBoC cut its benchmark 5-year lending rate which determines the cost of mortgage and infrastructure loans by a record 15bps, highlighting its desire to support the property sector. Meanwhile, Vice Premier Liu He voiced support for internet platforms.

Of course, near-term technicals for risk assets remain weak. After the S&P500 index broke below key support of 4,063, the next major support is at 3,600. Our "Fear and Greed" indicator highlights the risk of further downside before we reach the "extreme fear" levels from where markets have historically rebounded strongly. Nevertheless, as highlighted earlier, pockets of opportunities are emerging, with several markets oversold. This provides long-term investors opportunities to average into some of our preferred markets that are going on sale – especially Asia ex-Japan (and China) equities and Emerging Market and Asia USD bonds. Gold remains a good portfolio diversifier – it has become even more attractive after the recent sell-off as US rate expectations peak. We see an opportunity to add exposure if 1,775 technical support holds.

Investors need to keep an eye on the ministerial meetings in the build-up to the G7 Summit in Germany on 26-28 June. Will Euro area and Japan policymakers push back against EUR, JPY weakness? A peak in the USD would be a big relief for investors. Russia's reaction to Finland and Sweden joining NATO or to any EU decision to ban imports of Russian oil is another risk. Meanwhile, the Fed's last meeting minutes should indicate the level of consensus among policymakers behind multiple 50bps hikes in the coming months. US and Euro area PMIs, US durable goods orders, new home sales, personal consumption and inflation are other key data points to watch.

— Rajat Bhattacharya

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as positive for risk assets in the near term.

(+) factors: Robust US retail & industrial data, China policy easing

(-) factors: Weak US consumer sentiment, China retail & industrial data

	Positive for risk assets	Negative for risk assets
COVID	<ul style="list-style-type: none"> Hong Kong relaxed virus curbs despite new cases Shanghai continued to ease restrictions 	<ul style="list-style-type: none"> Several parts of China remain under lockdown
	Our assessment: Positive – Gradual reopening of Shanghai	
Macro data	<ul style="list-style-type: none"> US retail sales ex-autos rose more than expected US industrial production rose more than consensus China M2 money supply rose more than expected Euro area Q1 GDP grew faster than expected; April m/m inflation eased sharply 	<ul style="list-style-type: none"> US initial jobless claims rose more than expected US Michigan consumer sentiment fell to a new low US housing starts fell more than expected China retail sales and industrial production declined more than forecast
	Our assessment: Neutral – Robust US retail sales and industrial output, Euro area's easing inflation vs record-low US consumer sentiment, weak China retail sales, industrial data	
Policy developments	<ul style="list-style-type: none"> PBoC cut key rate used for mortgages, infrastructure loans by record 15bps Vice Premier Liu He expressed support for internet platforms Japan approved additional budget to fight inflation 	<ul style="list-style-type: none"> Powell stressed the need to curb inflation, willing to raise rates to restrictive levels, if needed China bond trading platform stopped publishing data on foreign investor trades ECB's last policy meeting minutes confirmed end of bond purchases in June
	Our assessment: Positive – China rate cut, Japan stimulus	
Other developments	<ul style="list-style-type: none"> US is preparing a military aid package to steer India away from Russian arms 	<ul style="list-style-type: none"> Russia and Ukraine failed to hold talks Finland and Sweden applied to join NATO but Turkey is reportedly blocking the applications US blocking Russia from making bond payments
	Our assessment: Negative – Finland and Sweden's decision to join NATO could harden Russia's stance in Ukraine	

US retail sales remained well above pre-pandemic trend, indicating consumer demand stayed strong

US retail sales and pre-pandemic trend



Source: Bloomberg; Standard Chartered

US long-term inflation expectations have pulled back from above 3% in recent weeks, putting downward pressure on government bond yields

US 10-year inflation expectations*, 5-year inflation expectations 5 years from now**, 10-year government bond yield



Source: Bloomberg, Standard Chartered; *based on inflation-protected government bonds; **based on inflation swaps

China's retail sales and industrial output contracted sharply, while fixed asset investment slowed more than expected in April

China's industrial output, retail sales and fixed asset investment



Source: Bloomberg, Standard Chartered

Top client questions

Q What is the outlook for Hong Kong and China equities after the latest round of weak China growth data?

Hong Kong/China equities have held up despite the extremely weak retail sales and industrial output figures for April. This is likely because several other factors are turning increasingly supportive. This week, the PBoC cut a key interest rate to support mortgages and infrastructure lending, in stark contrast to the Fed's tightening stance. Several reports suggest more public spending stimulus for infrastructure build and electric vehicle (EV) subsidies, are in the pipeline. Importantly, Vice Premier Liu He made soothing comments to technology executives this week, in another sign that the regulatory tightening on the sector may be easing. Liu He said the government supports the development of the sector and public listings for technology companies.

Valuation-wise, MSCI China is trading at a deep 29% discount to global equities. The Omicron outbreak has led to earnings downgrades. However, there are signs that China is emerging from the lockdowns, with Shanghai announcing reopening in June 2022.

Together, we believe these factors offer an increasingly supportive fundamental backdrop for Hong Kong and China equities. Hang Seng technical show resistance levels are at 20,323 and 20,712, while there is support at 19,179. We would consider buying Chinese equities, in stages, should the Hang Seng index fall below 20,000.

— Daniel Lam, Head, Equity Strategy

Q Is China's property sector turning around? Is it good time to dip back into China High Yield bonds?

Over the last couple of weeks, regulators have loosened policies further for the China property sector by launching more demand side support measures, such as mortgage rate cuts, and removing more home buying restrictions. However, sentiment towards the Chinese High Yield (HY) property sector remained weak after another major player missed a USD bond coupon payment this week.

In our assessment, while financing conditions for private developers remain rigid, they are starting to get looser. The recent announcement that three developers were selected as 'model housing companies' scheduled to issue bonds alongside credit protection tools may be the light at the end of the tunnel. In addition, potentially easing COVID-19 lockdowns, a more supportive macro outlook and a gradually improving financing environment for private-owned developers could help reprice Asian HY bonds higher, especially with default risks excessively priced, in our view.

More broadly, we continue to prefer Asia USD bonds with a relative preference for HY bonds. Although default risks in the Chinese HY property sector are likely to persist, we believe risk-reward has grown increasingly appealing.

— Cedric Lam, Senior Investment Strategist

Chinese equities are trading at a significant discount compared to global equities

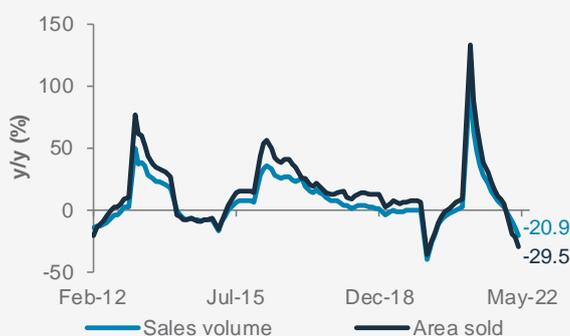
12-month forward P/E of MSCI All Country World (ACWI) and China indices



Source: MSCI, FactSet, Standard Chartered

China's property market could get a lift from recent mortgage rate cuts and removal of home buying restrictions

China's property sales volume and area sold



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Q Has the USD peaked in the near term?

The USD index (DXY) hitting a peak of 105 last Friday represents a rally of just under 10% since January 2022. It coincided with a EUR/USD low at key support near 1.0340, the level in January 2017 that set the foundation for a 20% rally over the ensuing 12 months. It may be too early to be confident that the USD has peaked, but the “peaking process” continues to play out, in our view. In the near term, we expect at least a correction lower for the USD.

The major components of the DXY index, the EUR, JPY and GBP, all have fractal (our proprietary positioning indicator based on diversity of investor views) readings that suggest a trend reversal may be close at hand. We expect strong EUR/USD resistance around 1.0640, but a sustained break could see a sharp rally towards 1.08-1.09. For GBP/USD, resistance sits around 1.2650 and a break could target 1.29 next. USD/JPY is in a potential topping formation where a break of support at 126.90 could trigger a decline towards 125 initially, and possibly as deep as 121 to partially retrace the rally since March that began below 115.

Failure to break these key supports in the EUR and GBP and resistance in the JPY would likely consign the USD to another, perhaps final, leg higher before the medium-term top is reached. An extension of the DXY index uptrend could see 109, with EUR/USD near 1.00, GBP/USD at 1.18 and USD/JPY close to 135.

A sustained EUR/USD break above 1.0640 would turn the technical outlook bullish; failure to break higher risks a decline to new trend lows

EUR/USD, with key technical levels



Source: Refinitiv, Standard Chartered

A break below 126.90 in USD/JPY could see a sharp decline below 125 on position unwinding

USD/JPY, with key technical levels

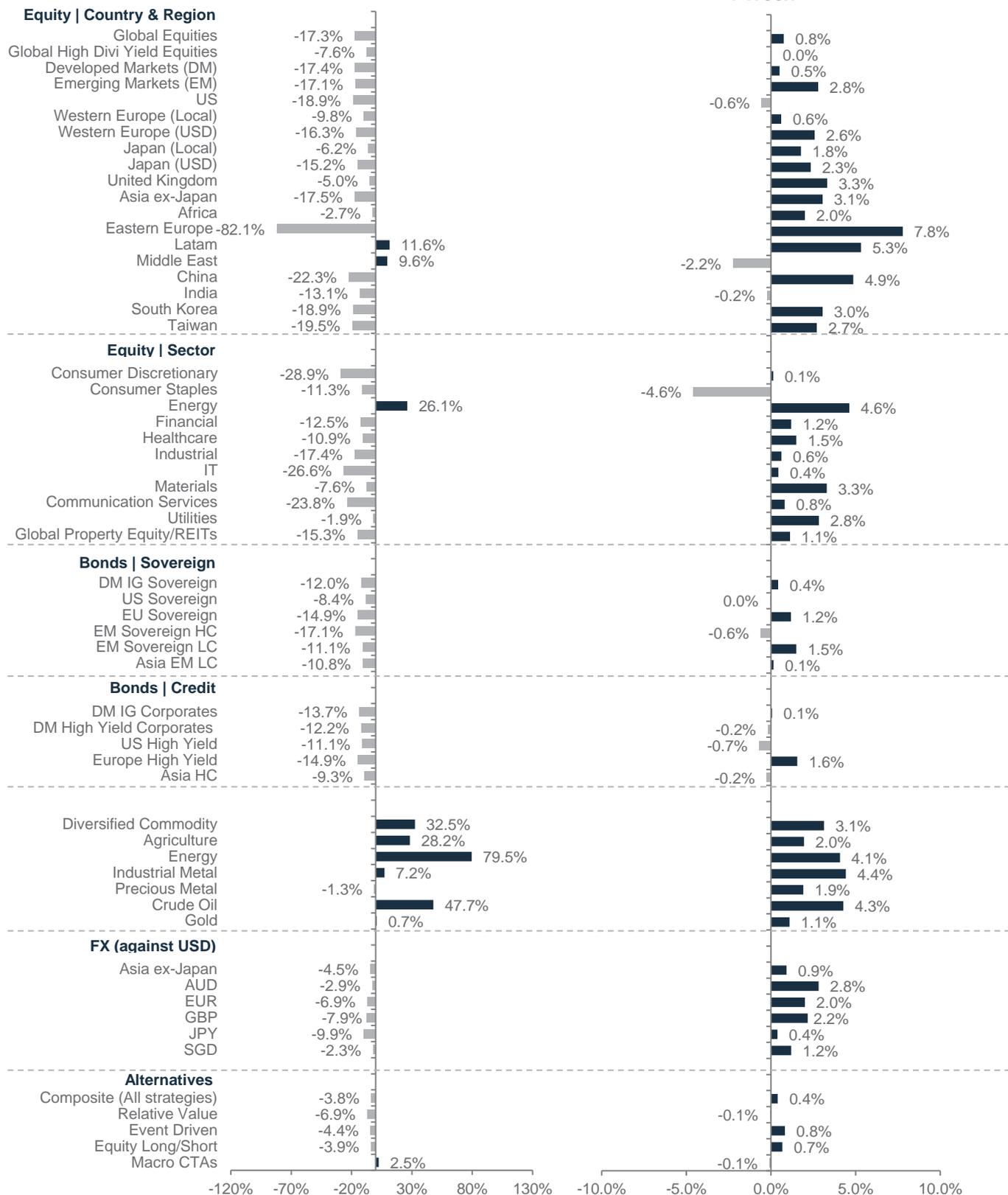


Source: Refinitiv, Standard Chartered

Market performance summary *

2022 YTD

1 Week



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 19 May 2022; 1-week period: 12 May 2022 to 19 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

The US 10-year Treasury yield has next support at 2.79%

Technical indicators for key markets as on 19 May 2022

Index	Spot	1st support	1st resistance
S&P 500	3,901	3,838	4,026
STOXX 50	3,641	3,607	3,708
FTSE 100	7,303	7,231	7,446
Nikkei 225	26,403	26,233	26,742
Shanghai Comp	3,097	3,081	3,105
Hang Seng	20,121	19,798	20,544
MSCI Asia ex-Japan	648	639	660
MSCI EM	1,015	1,002	1,031
Brent (ICE)	112.0	109.4	114.5
Gold	1,844	1,823	1,855
UST 10y Yield	2.84	2.79	2.94

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

Economic and market calendar

	Event	Next week	Period	Expected	Prior
MON	US	Chicago Fed Nat Activity Index	Apr	-	0.44
	EC	S&P Global Eurozone Manufacturing PMI	May P	-	55.5
TUE	EC	S&P Global Eurozone Services PMI	May P	-	57.7
	UK	S&P Global/CIPS UK Manufacturing PMI	May P	-	55.8
	UK	S&P Global/CIPS UK Services PMI	May P	-	58.9
	US	S&P Global US Manufacturing PMI	May P	58	59.2
	US	S&P Global US Services PMI	May P	56	55.6
	US	New Home Sales	Apr	755k	763k
	JP	Quad Summit			
WED	US	Durable Goods Orders	Apr P	0.6%	1.1%
THUR	US	FOMC Meeting Minutes	May		
FRI/SAT	EC	M3 Money Supply y/y	Apr	-	6.3%
	US	PCE Deflator y/y	Apr	-	6.6%
	US	PCE Core Deflator y/y	Apr	4.9%	5.2%

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

Investor diversity remains low in global bonds

Our proprietary market diversity indicators as of 18 May

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	○	→	1.22
Global Equities	●	→	1.37
Gold	●	→	1.65
Equity			
MSCI US	●	↓	1.43
MSCI Europe	●	→	1.36
MSCI AC AXJ	●	↓	1.36
Fixed Income			
DM Corp Bond	●	→	1.27
DM High Yield	●	→	1.31
EM USD	●	→	1.29
EM Local	○	↓	1.21
Asia USD	●	→	1.39
Currencies			
EUR/USD	●	↓	1.28

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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