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Wealth Management Chief Investment Office
11 November 2022

Weekly Market View

Peak rate expectations?

→ The surge in equities and the plunge in US government bond yields and the US dollar below key technical support levels, after US inflation narrowly fell below estimates, showed how pessimistic investors had become about the US inflation and rates outlook.

→ While the data does suggest that US inflation has likely peaked in this cycle, we believe the Fed will need to see further signs of a significant slowdown in cost pressures and job creation before it pauses rates hikes. Thus, a slower pace of rate hikes is more likely in the coming months, rather than an imminent pause.

→ As such, government bond yields are probably closer to their peak in this cycle. Equities still have to contend with the elevated risk of slowing growth and earnings downgrades. As rates and the USD approach a cycle peak, we continue to prefer adding exposure to Investment Grade corporate bonds and beaten down equity markets such as Asia ex-Japan.

What is the impact of US mid-term elections on US equities?

Does China’s equity market rebound have legs?

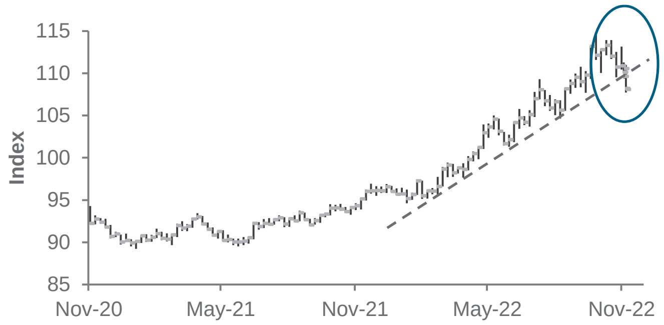
Do the recent developments in the UK change your view on the GBP?

Important disclosures can be found in the Disclosures Appendix.

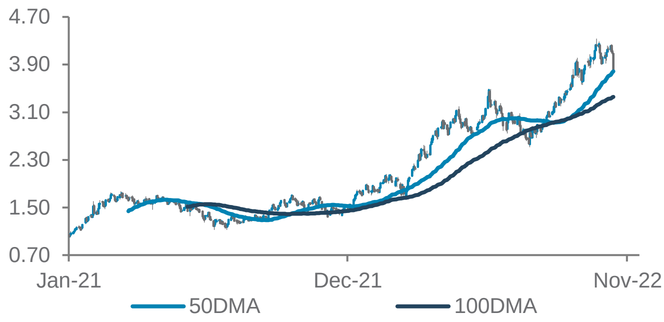
Charts of the week: Have the US dollar and bond yields peaked?

The USD broke below a key support level and the US 10-year bond yield is testing support after the US inflation report

USD index (DXY)



US 10-year government bond yield (%) and moving averages



Source: Bloomberg, Standard Chartered

Editorial

Peak rate expectations?

A lot was riding on the US inflation report for October. The surge in equities and the plunge in US government bond yields and the US dollar below key technical support levels, after price gains narrowly fell below estimates, showed how pessimistic investors had become about the US inflation and rates outlook. While the data does suggest that US inflation has likely peaked in this cycle, we believe the Fed will need to see further signs of a significant slowdown in cost pressures and job creation before it pauses rates hikes. The Fed is cognisant of the risk of going easy on inflation too early, following the lessons learnt in 1980s when it eased too soon. Thus, a slower pace of rate hikes is more likely in the coming months (including a 50bps hike in December to 4.5%), rather than an imminent pause.

As such, government bond yields are probably closer to their peak in this cycle as they have already priced in a Fed terminal rate of close to 5% by mid-2023. Equities still have to contend with the elevated risk of growth and earnings downgrades. As rates and the USD approach a cycle peak, we continue to prefer adding exposure to Investment Grade corporate bonds and beaten down equity markets such as Asia ex-Japan. A diversified basket of income assets is also likely to perform better in this environment than a more balanced allocation as the basket is weighted towards fixed income assets which are likely to benefit the most from peak rate expectations.

The US inflation report missed estimates, but not by a wide enough margin, in our view, to convince the Fed that they have already tightened financial conditions too much. Headline inflation, at 0.4% m/m, missed estimates of 0.6%, but retained the previous month's pace of gains. Core inflation, stripping out energy and food costs, decelerated to 0.3% m/m, from the previous month's 0.6%, falling short of 0.5% estimates. The owners' equivalent rent component of shelter inflation, which has been driving core inflation higher this year, decelerated to 0.6% m/m from 0.8%, although a sharp acceleration in the cost of lodging away from home meant overall shelter inflation was broadly unchanged. Durable goods deflation intensified to -0.7% from -0.1% as overall consumption shifted to services as the economy continued to normalise after the pandemic.

Nevertheless, looking further under the hood, we notice a continued broadening of some underlying inflation trends - the percent of inflation sub-categories whose three-month percentage changes were greater than the y/y changes accelerated. The Atlanta Fed's so-called 'sticky-price' inflation is still at 7.2% annualised for the past three months, although the core measure decelerated to 5% from 8.3% on a monthly annualised basis. The overall 0.3% m/m core inflation figure itself, when annualised, is well above the Fed's 2% target.

The indecisive US mid-term elections – where the Republicans are likely to get a much narrower-than-expected majority in the US House of Representatives, while the Democrats still have a path to retaining their razor-thin majority in the Senate – means uncertainty around the US government hitting its debt ceiling next year is likely to persist. This points to further government bond issuances, supporting bond yields. With the job market still hot, as signalled by last week's stronger-than-expected non-farm payrolls numbers for October (261,000 net new jobs were created), and two more key inflation and job market data points to come before the Fed's next policy on 14 December, we believe it's still too soon to confirm a peak in Fed rates.

Against this backdrop, while risk assets including rate-sensitive Growth stocks could still outperform in the near term, we continue to believe a basket of income assets remains the most attractive way for investors with a 6-12-month horizon to ride out the emerging macroeconomic landscape. Asia ex-Japan equities are likely to outperform global equities if there are further signs of US interest rates peaking and the USD topping out. Mainland China's measured reopening plans are likely to provide a further fillip to Asia ex-Japan assets (see pages 4-6).

— 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.

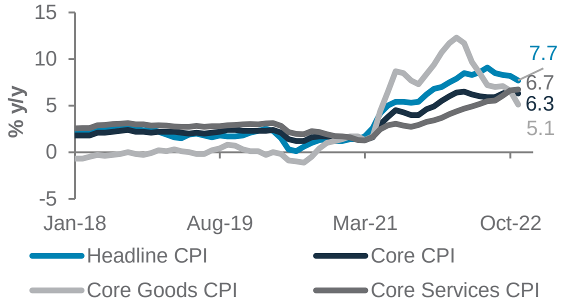
(+) factors: Slower pace of Fed hikes likely after US inflation missed estimates; US Congress gridlock reduces risk of higher bond issuance

(-) factors: Stronger-than-expected US job creation to keep the Fed hawkish

	Positive for risk assets	Negative for risk assets
Macro data	• US jobless rate rose more than expected to 3.7% • US headline (0.4% m/m) and core inflation (0.3% m/m) below estimates • Euro area producer price inflation slowed sharply to 1.6% from 5.0% • Euro area Sentix investor confidence improved more than expected • Euro area retail sales rebounded 0.4% m/m	• US non-farm payrolls rose more than expected by 261,000; the average hourly earnings rose more than expected 0.4% m/m • China exports slumped unexpectedly -0.3% y/y • China's consumer inflation slowed more than expected to 2.1% y/y; new loans missed estimates
	Our assessment: Neutral – Strong US job creation is likely to keep the Fed on its rate hiking path, although the slower-than-expected inflation data means the pace of hikes is likely to slow	
Policy developments	• China boosted its credit support for developers, eased COVID restrictions, lifted flight bans; officials also signalled more targeted approach towards controlling the pandemic	• Fed officials said the softer-than-expected inflation data signalled a slower pace of rate hikes and not a pause
	Our assessment: Neutral – China boost vs slower Fed hikes	
Other developments	• Russia ordered troops to withdraw from Ukraine's Kherson, the only regional capital seized since Feb • US midterm polls pointed to a smaller-than-expected majority for Republicans in the House; control over Senate to be decided by a 6 Dec run-off in Georgia	• Russian President Putin dropped plans to attend the G20 summit in Indonesia, reducing the prospects of a rapprochement; Xi and Biden to meet • China's new COVID-19 cases continued to rise to their highest daily level since May
	Our assessment: Neutral – A gridlocked US Congress is likely to reduce the chances of higher taxes, but the likely narrow Republican majority is likely to sustain the uncertainty around the US government hitting its debt ceiling next year)	

US inflation decelerated in October, but remains well above the Fed's 2% target

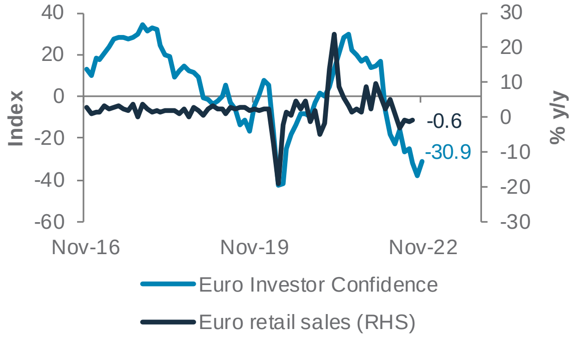
US headline, core, goods and services inflation



Source: Bloomberg; Standard Chartered

Euro area investor confidence and retail sales are showing signs of bottoming

Euro area Sentix Investor Confidence; retail sales



Source: Bloomberg, Standard Chartered

We expect China to continue easing policy as slowing global and domestic demand revives disinflationary pressures

China's exports growth and consumer inflation

Source: Bloomberg, Standard Chartered

Top client questions

What is the impact of the US midterm elections on US equities?

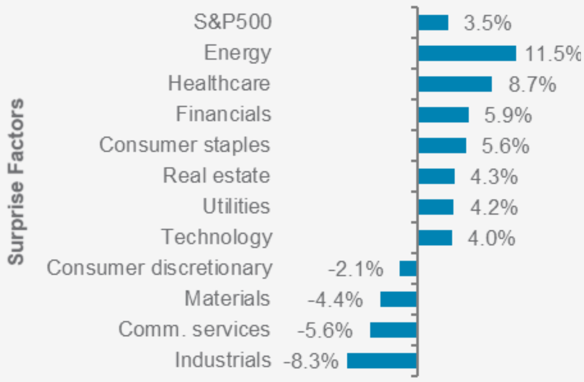
Preliminary midterm election results available at the time of writing point to a turn from the previously expected "Republican sweep" to an outcome where the Democrats could retain control of the Senate. At a broad level, we see the midterms as having a largely neutral impact on US equities given the relative importance of other factors such as inflation, the Fed policy and earnings.

One area of pressure has been the US energy sector as Republicans have been regarded as more "pro-carbon" than the Democrats. However, we retain our Overweight stance on the sector and see price weakness as a buying opportunity. The US energy sector has delivered robust earnings beat in Q3 22. The sector's earnings surprise of 11.5% beats the other sectors across the S&P 500 index, driven by elevated oil prices and effective cost management measures. Meanwhile, valuations in the sector remain attractive, with the P/E at a discount of c.40% to the broader market, wider than the historical average. Finally, a macro backdrop of higher rates and poor risk appetite should also benefit Value sectors like energy.

— **Michelle Kam,** *Investment Strategist*

The US energy sector has delivered the most positive earnings surprise so far in Q3 2022

US earnings surprise by sector for Q3 2022 (as of 4 Nov 2022)



Source: Refinitiv, Standard Chartered

Does China's equity market rebound have legs?

China equities have had a strong bounce off the bottom since October, with MSCI China and the Hang Seng indices rallying over 10%. This is consistent with our view that China offers tactical opportunities, underpinned by light positioning and cheap valuation.

Domestic drivers include further re-opening measures, including Friday's decision to ease quarantine restrictions and lift flight bans, and the plan to widen the bond financing program by CNY250 billion for privately-owned property developers. Externally, a weakened greenback also helps, led by the cooling October inflation in the US.

Following this strong market reaction, we will be watching the upcoming Mainland China technology sector earnings releases from 14 Nov, given the soft economic data released of late. October trade figures came in much weaker than expected, with negative growth readings for both exports and imports. CPI moderated to 2.1% and PPI even slipped into negative territory, down 1.3% y/y.

Against these macro headwinds, whether the strength of China equities can sustain going forward, in our view, depends on whether (1) rhetoric against China would lessen from the potentially divided US Congress; (2) any policy boost comes sooner than the December Central Economic Work Conference; and (3) mobility restrictions would be relaxed further.

— **Raymond Cheng CFA, CPA,** *Chief Investment Officer, North Asia*

China and HK stocks have rebounded strongly this month; Q3 earnings are the next focus

MSCI China index and Hang Seng Index price performance; performance in grey bar denotes returns since 31 October

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What can we learn from Europe's Q3 22 earnings season?

About two-thirds of the companies in Europe's Stoxx600 have reported Q3 22 results, according to data from Refinitiv. The results have been broadly positive so far. A total of 60% of the companies that reported have beat earnings expectations, above a historical average of 53%. Most sectors have delivered a positive earnings surprise, led by materials (18% surprise) and industrials (14% surprise). At the index level, earnings have surprised positively by 4.2%. Q3 22 is poised to deliver 32% earnings growth, revised slightly down from 33% growth estimated on 1 October. We believe a significant portion of the earnings growth is driven by euro weakness translating to higher euro-denominated profits, as European companies derive a majority of their revenues abroad. Consensus estimate for the full year 2022 is for earnings growth of 19.5%, similar to the estimate of 20.0% on 1 October.

We continue to see downside risks for Euro area equities as high energy prices and a slowdown in growth contribute to earnings risk for 2023. Within Europe, we prefer to gain exposure via our preferred sectors of energy (5.5% Q3 22 earnings surprise) and financials (Q3 22 earnings in line). Both sectors continue to be attractively valued at a wide discount to the market.

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

In Europe, the Energy sector has outperformed significantly in the past year, while financials have outperformed slightly. We expect both sectors to continue outperforming over the next 6-12 months

Total return of MSCI Europe, MSCI Europe Financials and MSCI Europe Energy indices. Rebased to 100=10-Nov-2021

Source: Bloomberg, Standard Chartered

Do the recent developments in the UK change your view on the GBP?

GBP/USD has had a roller-coaster ride since the mini-budget announcement by Finance Minister Kwarteng in September. The pair's 1-month volatility remains unusually high (+2 standard deviations), and GBP/USD has bounced off 50-year lows and has broken above 1.1700, helped by the recent weakness in USD and the optimism around the new government under Prime Minister Rishi Sunak. In the near term, a positive surprise in the fiscal plan announcement on 17 November can push GBP/USD above the key resistance at 1.1790.

However, on a 6-12 month horizon, we expect macroeconomic fundamentals to reassert themselves. GBP/USD remains hamstrung by the weak economic growth outlook for the UK, especially relative to the US. While inflation in the US is showing signs of slowing, inflation in the UK remains stubbornly above 10%, which could lead to unfavourable real interest rate differentials versus the USD. Additionally, we believe the recent political and financial system uncertainty has led to investors embedding a higher risk premium for the GBP. Hence, we continue to expect GBP/USD to retest 1.1000 and potentially 1.0800 levels.

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

We expect GBP/USD to retest 1.1000 amid near-term technical resistance and medium-term headwinds from slowing growth, rising inflation

GBP/USD

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Can the weakness in China's real estate sector turn into a systemic risk?

The main challenge for Mainland China's real estate developers continues to be access to liquidity. However, we would need to consider three different aspects of the challenge to assess if this could pose a systemic risk:

1) Banks – exposure to the real estate sector is largely through loans to developers, project loans and mortgages to homebuyers. According to the China Banking and Insurance Regulatory Commission (CBIRC), the estimated exposure via these loans is roughly 26% of banks' total loan book, which the regulator assessed to be "reasonable", especially since the historical non-performing ratio of the sector was a mere 1%. More recently, Chinese regulators also announced several measures to assist distressed developers.

2) Homebuyers – the collapse of several highly leveraged developers has delayed home deliveries in certain cities, which resulted in mortgage boycott events in early 2022. Banking regulators have restored market confidence by setting up emergency funds to ensure project delivery. We believe the boycott events are idiosyncratic; the chance of a broadening or boycott appears minimal for now.

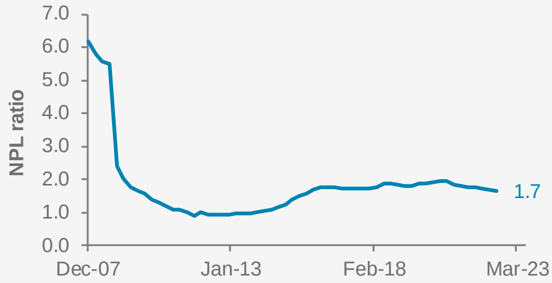
3) Real estate developers – regulators have used state-backed credit enhancement tools to allow "model developers" to issue bonds in the onshore market. Lately, the PBoC also reintroduced "the second arrow" facility, where the central bank will provide re-financing facilities to buyers of bonds issued by developers. Although we believe the steps are still preliminary in terms of helping resolve the sector's debt challenges, they should be sufficient in preventing individual risks from escalating.

These three lenses suggest the risk of a systemic fallout remains low, in our assessment. Having said that, we continue to see more attractive risk/reward in higher quality bonds. Together, these factors stand behind our preference for the broader Asia USD bonds asset class, which is a predominantly Investment Grade (IG) asset class.

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

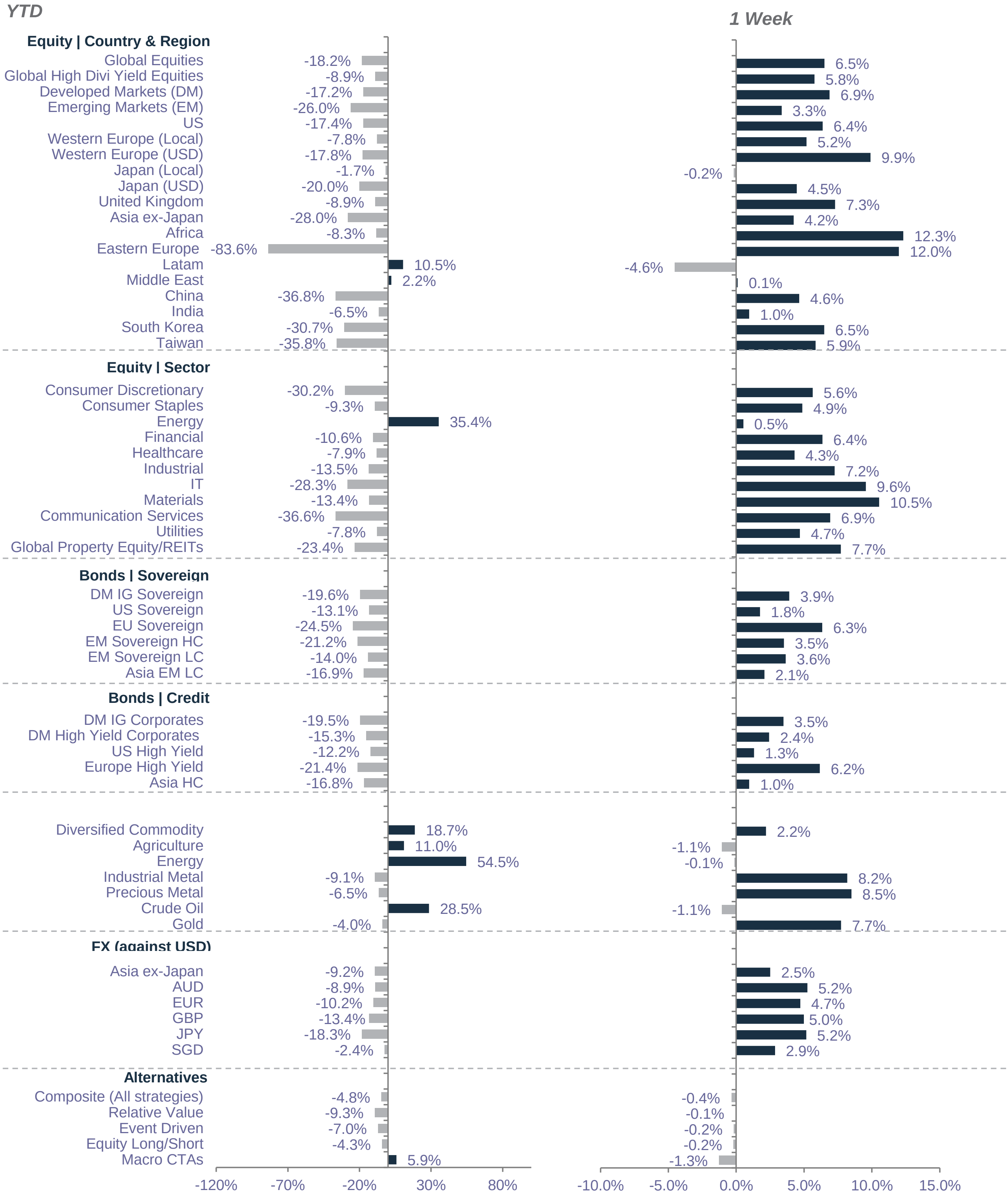
We see low systemic risks from China's distressed property sector and, thus, continue to prefer Asia USD bonds, which are dominated by Investment Grade bonds

China banks' non-performing loans ratio



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, 2022 YTD performance from 31 December 2021 to 10 November 2022; 1-week period: 03 November 2022 to 10 November 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

Economic and market calendar

	Event	Next week	Period	Expected	Prior
MON					
TUE	ID	G20 Summit in Bali Indonesia			
	CH	Industrial Production y/y	Oct	5.2%	6.3%
	CH	Retail Sales y/y	Oct	0.7%	2.5%
	CH	Fixed Assets Ex Rural YTD y/y	Oct	5.9%	5.9%
	EC	ZEW Survey Expectations	Nov	–	-59.7
	US	PPI Ex Food & Energy y/y	Oct	–	7.2%
WED	US	Retail Sales Ex Auto and Gas	Oct	0.2%	0.3%
	US	Industrial Production m/m	Oct	0.0%	0.4%
THU	US	Housing Starts	Oct	1425k	1439k
	US	Building Permits	Oct	1520k	1564k
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	Oct	2.3%	1.8%
	US	Existing Home Sales	Oct	4.38m	4.71m
	US	Leading Index	Oct	-0.4%	-0.4%

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 has next resistance at 3,818

Technical indicators for key markets as of 10 November close

Index	Spot	1st support	1st resistance
S&P 500	3,956	3,818	4,026
STOXX 50	3,847	3,741	3,899
FTSE 100	7,375	7,323	7,402
Nikkei 225	28,201	27,533	28,534
Shanghai Comp	3,082	3,051	3,097
Hang Seng	17,022	16,398	17,329
MSCI Asia ex-Japan	557	550	563
MSCI EM	890	883	898
WTI (Spot)	94.0	91.6	97.5
Gold	1,751	1,700	1,779
UST 10y Yield	3.81	3.68	4.08

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 improved for global equities

Our proprietary market diversity indicators as of 10 November

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.29
Global Equities	●	↑	1.56
Gold	●	↑	1.74
Equity			
MSCI US	●	→	1.61
MSCI Europe	●	↑	1.69
MSCI AC AXJ	◐	→	1.35
Fixed Income			
DM Corp Bond	◐	→	1.33
DM High Yield	◐	↓	1.49
EM USD	●	→	1.51
EM Local	◐	→	1.42
Asia USD	◐	↓	1.36
Commodities			
WTI Crude Oil	●	↑	1.77

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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