Macro Strategy | 7 August 2020

Standard Chartered
Private Bank

Weekly Market View

Rising one-sided trades

After a strong run up in risk assets, our proprietary market diversity indicator is pointing to an elevated pullback risk in some markets. Potential catalysts could be rising US-China tensions, a resurgence in COVID-19 or Biden's choice of vice president candidate. We would use any pullback to add to our preferred assets

Equities: US Q2 earnings are firmly beating expectations, leading to a recovery in 2020 earnings estimates; US remains a preferred market

Bonds: We believe Developed Market High Yield bonds have more room to rise amid a continued growth recovery and search for yield

FX: EUR/USD and AUD/USD could extend their rally towards their next resistance, but we expect any such rally to be brief in the near-term

Also find out...

Can US-China tensions derail the rally in China equities?

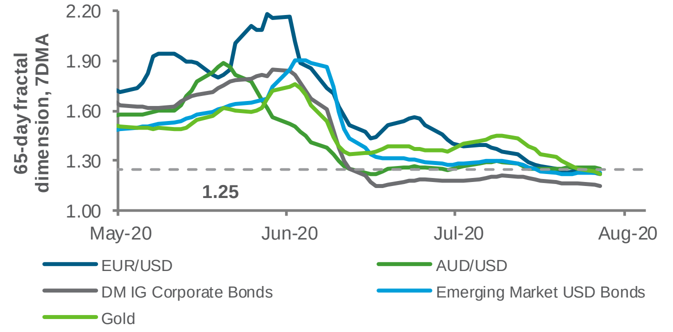
Should we still add exposure to Developed Market High Yield bonds?

Is it time to reduce gold and silver exposure?

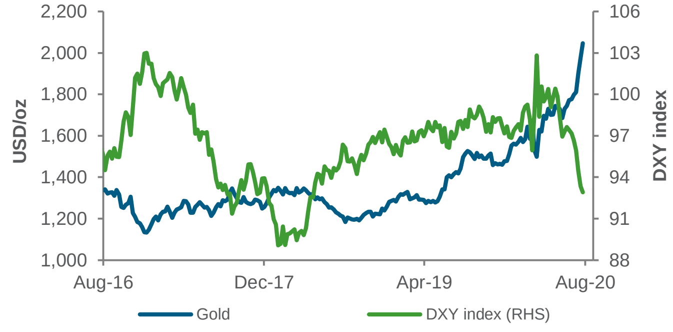
Charts of the week: Time for a pullback?

Gold has soared to a record high, benefitting from a weaker USD, but this trade, along with a few others, risks becoming too crowded

Our proprietary market diversity indicator (a signal <1.25 illustrates heightened risk of a trend reversal)



USD (DXY) index and gold spot price



Source: Bloomberg, Standard Chartered

Editorial

Rising one-sided trades

Risk assets have continued to recover from their initial COVID-19 shock, with the US S&P500 index about 1% away from setting a new record high and Asia ex-Japan stocks breaking to a two-year high. The drivers underpinning our constructive view – a continued recovery in economic data and corporate earnings expectations, unprecedented policy stimulus and record-low bond yields boosting investor liquidity – have been reinforced in recent weeks. These include: 1) another month of expansionary PMI data from the US, Europe and China (see page 3); 2) Q2 earnings beats in the US leading to upward revision of 2020 earnings estimates (see page 4); 3) a game-changing decision by Euro area members to share regional debt to fund a EUR 750bn fiscal stimulus; and 4) rising expectations of another fiscal spending package in the US.

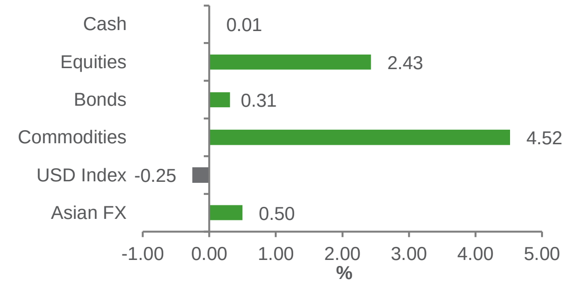
There were some positive surprises along the way, including growing chances of at least one vaccine candidate delivering a marketable product by early 2021, earlier than previously anticipated. In the last two weeks, we have also seen signs of new COVID-19 cases peaking in southern US, which had emerged as the latest hotspot. The USD was the proverbial last shoe to drop, and it has decisively done so, weakening 10% in trade-weighted terms since its March high, thereby easing global financial conditions, especially in Emerging Markets. This has helped the risk rally broaden to non-US assets, gold and commodities.

However, the good news has also created near-term risks, in our opinion. Our proprietary market diversity indicator argues several bullish trades have become extremely crowded, raising the risk of a near-term pullback (see table). While bullish equity trades are not so crowded, August has been seasonally weak for equities. This backdrop is primed for a catalyst, which could test the rally. Possible catalysts include US Democrat presidential candidate Joe Biden naming a vice presidential candidate with plans to increase taxes and regulations, a resurgence of COVID-19 in Europe or President Trump raising the heat against China.

We would view any such short-term reversal as an opportunity to add to our preferred asset classes, given the constructive medium drivers cited above (see also pages 4-6). Meanwhile, a renewed rise in volatility would likely present an opportunity to generate an income.

Equities and commodities rose, USD fell in the past week

Benchmark market performance w/w*



Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered; *Week of 31 July 2020 to 07 August 2020

Our proprietary analysis shows market diversity is extremely low in gold, EUR and Emerging Market bonds

Market diversity across key asset classes

Level 1	Diversity	Diversity trend since 6-July-20	Price trend since 6-July-20	Fractal Dimension
Global Bonds	○	→		1.14
MSCI ACWI	◐	→		1.29
Gold	○	↓		1.18
Equity				
MSCI US	◐	→		1.34
MSCI Europe	◐	→		1.48
MSCI AC AXJ	◐	→		1.28
Fixed Income				
DM Corp Bond	○	→		1.11
DM High Yield	◐	→		1.27
EM USD	○	→		1.23
EM Local Currency	◐	→		1.28
Asia Hard Currency	○	→		1.17
Currencies				
USD/CNY	◐	↓		1.44
EUR/USD	○	↓		1.18
USD/JPY	●	↑		1.93
GBP/USD	◐	↓		1.30
AUD/USD	○	→		1.21

Source: Bloomberg, Standard Chartered; **Fractal dimensions below 1.25 indicate extremely low market diversity**

Legend: ○ Very low ◐ Low ● Moderate/high

The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	• US daily new cases have declined in the past two weeks after peaking in mid-July	• Daily new cases continued their uptrend in India, Spain, Japan and Australia • The UK is considering a partial lockdown if there is a surge in COVID-19 cases
	Our assessment: The apparent peak in US daily new cases is positive amid renewed outbreaks in other parts of the world.	
Macro data	• US, Euro area and China manufacturing PMIs were stronger than expected in July and US services PMI rose more than expected • US initial jobless claims fell more than expected to their lowest level since March, underlining the continued improvement in the job market • US, German factory orders were stronger-than-expected • Euro area, UK composite PMIs rose to expansion territory for the first time since February • Euro area consumer inflation accelerated to 1.2% and German retail sales rose in July, likely signalling the region's consumer recovery	• US personal income fell more than expected and personal spending growth slowed in June, while consumer sentiment weakened in July, suggesting caution among households amid COVID-19 uncertainties • Euro area GDP contracted a record 12.1% q/q in Q2 20; economies of Spain, France and Italy contracted more than the Euro area average • Japan's manufacturing PMI remained in contraction territory for the 15th straight month, while the services PMI remained in contraction for the 6th month
	Our assessment: On balance, the strong PMI data from the US, Europe and China suggests the recovery continued into July.	
Policy developments	• President Trump said he was considering using executive powers to extend jobless insurance payments as Democrat and Republican leaders appeared to narrow their difference over a USD 1trn stimulus package • BoJ and BoE governors said they were ready to provide further policy support as risks remained extremely high • PBoC said it would make its policy more flexible & targeted • RBA said it would start buying government bonds amid a renewed COVID-19 outbreak	• San Francisco Fed President Daly said the US would need more policy support than expected as COVID-19 "will be with us for longer and more vigorously than anyone had hoped for" • ECB Chief Economist Lane said the region's economy was "expected to take a significant amount of time to recover fully" as "the level of economic slack remains extraordinarily high"
	Our assessment: On balance, President Trump's pressure makes a agreement on a wider stimulus package more likely this month.	
Other developments		• US ordered restrictions on doing business with two Chinese apps and moved to tighten rules for US-listed Chinese stocks
	Our assessment: US-China tensions continue to rise in the run-up to the November elections.	

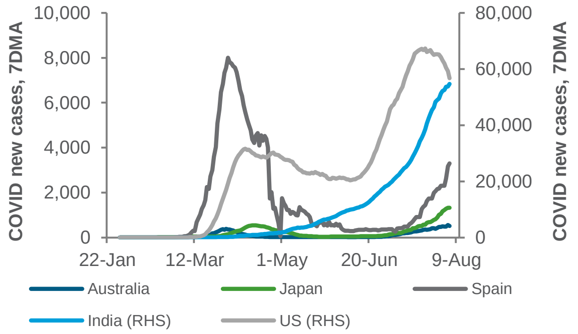
Our weekly net assessment: On balance, we see indications of an apparent peak in US COVID-19 cases, strong PMI data and sustained policy support as positive for risk assets

(+) factor: Peak in US COVID-19 cases, strong PMI data, US fiscal support

(-) factor: Rise in COVID-19 cases ex-US, signs of flagging consumer sentiment in the US after initial rebound, rising US-China tensions

US COVID-19 new cases are showing signs of peaking, though cases are rising again in Spain, Japan and Australia and continue to rise in India

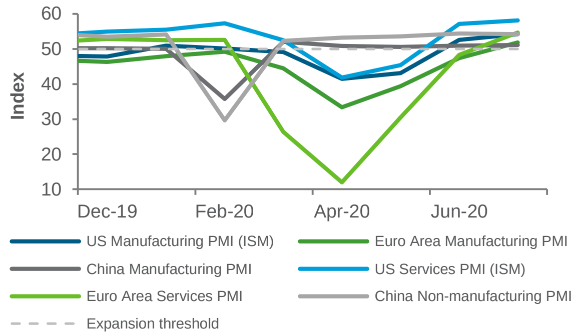
Daily new COVID-19 cases in the US and other major economies



Source: Bloomberg, Standard Chartered

Business confidence indicators (PMIs) showed continued expansion in major economies in July

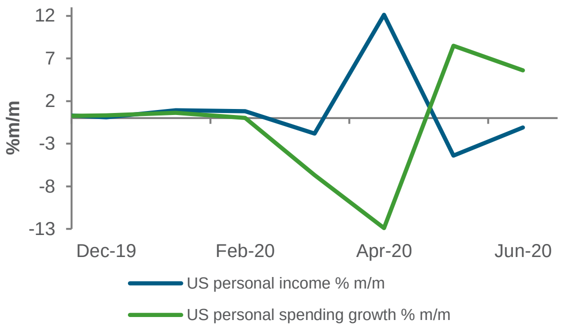
Manufacturing and services sector PMIs in the US, Euro area and China



Source: Bloomberg, Standard Chartered

US personal income fell and personal spending growth slowed in June, suggesting increasing caution among households amid COVID-19 uncertainty

US personal income and personal spending growth, % m/m



Source: Bloomberg, Standard Chartered

Top client questions

How is the US earnings season progressing?

A total of 85% of the companies in the S&P500 index have reported earnings, 82% of which beat expectations. This is better than the five-year average beat rate of 72%. After sharp cuts to 2020 earnings estimates, we are starting to see slight positive adjustments as the Q2 earnings season is turning out to be 'less bad' than expected. Consensus estimates are for 2020 earnings to fall -20.4% now compared with -23.5% a month ago. A rebound of +28.4% is expected for 2021 earnings. By sector, technology and materials lead, with 92% of companies beating expectations, followed by healthcare at 91%. The real estate and consumer discretionary sectors were the worst performers, with only 46% and 72% of companies, respectively, beating expectations.

Greater confidence in a rebound next year has led to US equity market gains broadening out beyond just the large cap leaders. The market cap-weighted S&P500 index has outperformed the equal weighted-S&P500 index YTD as large cap leaders have led gains. However, in the past month, the equal-weighted index has kept pace and even outperformed the market cap-weighted index at various points in time. This implies broad gains across the S&P500 constituents that were not limited to just the top few large caps.

US equities are preferred amid large stimulus measures supporting a recovery, while technology and healthcare are our preferred sectors.

Can US-China tensions derail the rally in China equities?

China and Hong Kong stocks fell on Friday after the US administration took action against Chinese technology companies operating in the US (including restrictions on two Chinese apps). However, within MSCI China, only 2.3% of revenues were generated from the US. The substantial majority (89.9%) of revenues were generated within China itself. By sector, energy and healthcare had the largest exposure to the US, each with 9.2% of sales from the US. This was followed by the technology sector with 8.1%; all other sectors had under 3% revenue exposure to the US. As such, the energy, healthcare and technology sectors may see a dent in revenues from further US actions, but the overall direct impact on China equities should be limited.

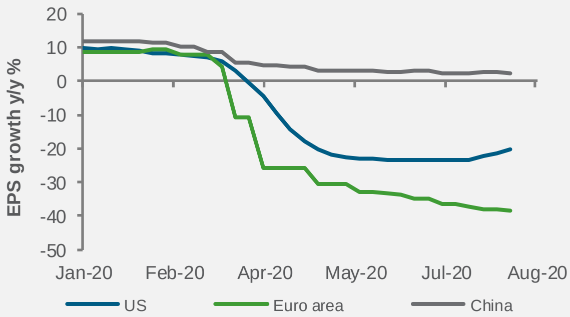
However, in recent years, US-China tensions have triggered a sell-off in China equities. In May 2019 when the US increased tariffs and US-China tensions escalated, MSCI China corrected by 16% and onshore China equities by 14%. This is likely because tensions and trade war risks affect sentiment. The impact on unlisted companies is also not measured above, and a drop in international trade would likely weigh on China's economic growth.

Our net assessment is that while President Trump may wish to keep up the pressure on China in the run-up to the elections, he is unlikely to escalate too far on fears it would risk obstructing the US economic recovery. In May 2019 when US-China tensions escalated, the S&P500 also corrected by 7%.

Within China, we continue to monitor the balance of margin transactions. While elevated, it remains far below the 2015 peak that raised regulators' concerns. China equities, both onshore and offshore, continue to trade at a discount to Asia ex-Japan equities, and remain preferred assets, in our view.

US 2020 earnings growth expectations have started to recover as a stronger-than-expected Q2 earnings season draws to a close

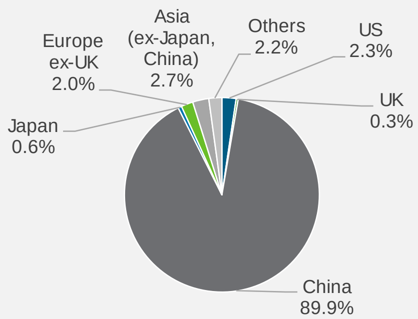
2020 EPS growth expectations for S&P500, MSCI EMU and MSCI China index members



Source: MSCI, Refinitiv, Factset, Standard Chartered

China's listed companies have very limited revenue exposure to the US and other overseas markets

Revenue exposure, by geography, of members of the MSCI China index



Source: MSCI, FactSet, Standard Chartered

S&P500 index faces resistance 0.8% above current level

Technical indicators for key markets as on 06 August 2020

Index	Spot	1st support	1st resistance
S&P	3,349	3,297	3,375
STOXX 50	3,240	3,187	3,281
FTSE 100	6,027	5,915	6,122
Nikkei 225	22,353	21,851	22,714
Shanghai Comp	3,386	3,335	3,412
Hang Seng	24,931	24,558	25,203
MSCI Asia ex-Japan	722	708	729
MSCI EM	1,107	1,087	1,116
Brent (ICE)	45.2	43.9	45.9
Gold	2,068	2,007	2,099
UST 10Y Yield	0.53	0.51	0.55

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Should we still add exposure to DM HY bonds?

Developed Market (DM) High Yield (HY) bonds have delivered nearly +4.8% in H2 20 and outperformed all other major areas within bonds. However, the strong performance means that the yield premiums have declined substantially, and the absolute yield on offer has declined to 5.8% from close to 7.0%. From a valuation perspective, DM HY yield premiums remain higher than long-term median levels, but US HY yield premiums are now close to historical medians.

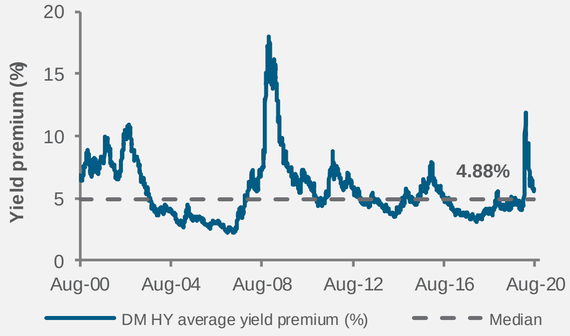
While asset class yields have fallen since the end of June, on a relative basis, we continue to prefer DM HY for the following reasons:

1. DM HY bonds continue to offer among the highest yields in the bond universe. In the current low-yield environment, the search for yield is likely to result in continued strong demand for the asset class.
2. While rating downgrades still outpace upgrades, the pace has slowed down considerably, potentially indicating an upcoming turn in the credit quality trajectory.
3. Historically, yield premiums usually overshoot or undershoot the historical median, but rarely pause or reverse there. If our view of a continued growth recovery plays out, yield premiums still have room to decline further (ie. bond prices have room to rise) from here.

It is also worth noting that DM HY bonds offer an attractive risk-adjusted yield when compared to the broader bond universe. Hence, we still see DM HY bonds as a preferred bond asset class.

We believe Developed Market High Yield bond yield premiums have room to decline further amid a continued growth recovery and search for yield

Developed Market High Yield bond yield premium over US Treasuries



Source: Bloomberg, Standard Chartered

Is it time to reduce gold or silver exposure?

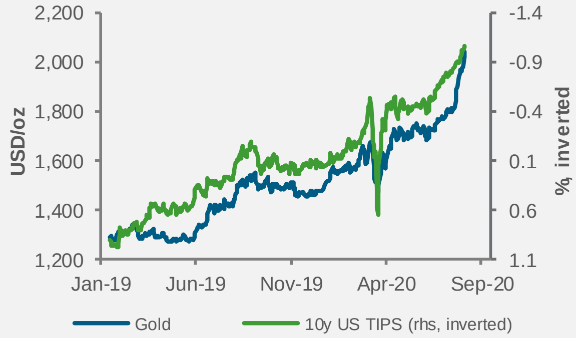
The bull market in gold continues to extend as the precious metal makes new highs above USD 2000/oz. As we highlighted previously, real (net of inflation) yields are a key driver of gold prices. With nominal yields being largely capped by dovish central banks, a continued economic recovery, resulting in a gradual recovery in inflation expectations, means real yields continue to fall. This is an attractive environment for gold given its non-yielding attributes.

Silver benefits from this backdrop as well, but it fluctuates between trading like a precious metal and a base metal. Silver is more responsive to the evolution of global growth compared to gold because over 50% of silver demand is driven by industrial applications. Hence, if global growth and industrial production continue to recover, further gains in silver are likely. However, the presence of two different drivers combined with silver's relatively thinner market means that silver can be considerably more volatile than gold.

Long-term, gold remains preferred as we expect the growth recovery to continue (positive for inflation expectations) but bond yields to remain largely capped. Near-term, net long investor positions in both gold and silver are looking relatively stretched, with technical indicators suggesting both are overbought. Our proprietary measure of investor diversity for gold and silver also suggest a near-term pause or pullback in the underlying upward trend is likely. For gold, we expect key support at around USD 1,920/oz and would continue to add exposure on dips.

Gold broke out to a record high as expectations of US real (inflation-adjusted) yields declined

Gold spot price and US 10-year inflation-adjusted Treasury yield



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Does the rally in the EUR and the AUD have legs?

We have a bullish medium-term view on both EUR/USD and AUD/USD, with a 12-month forecast of 1.24 and 0.75 respectively.

On this 12-month time horizon, we believe the current rally has room to extend based on our expectations of a continued growth recovery in major economies, policy support and our view of a weaker USD.

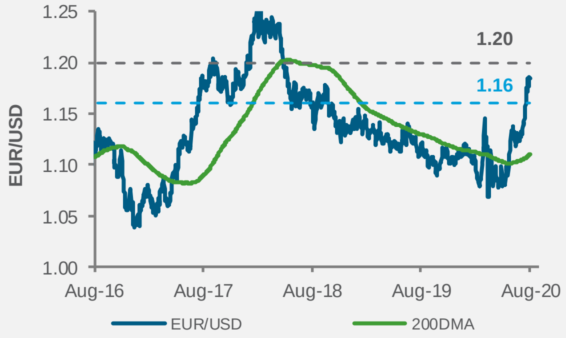
We are, however, cautious about how much further both currencies can rise in the short term (3 months or less) without a correction, or at least a period of consolidation. Our short-term view is driven by technical analysis that shows:

- A large build-up of one-sided speculative short positions (as recorded by the CFTC),
- Elevated RSI readings that are showing signs of divergence – in other words, a weakening trend,
- Proprietary market diversity indicators pointing to very low diversity of sentiment, usually indicative of a reversal.

Although we could see an imminent push higher in EUR/USD towards the 1.2000-1.2100 resistance window or in AUD/USD towards 0.7300, we expect any such rally would be brief and likely provide the trigger for a correction lower. We see strong support levels for EUR/USD around 1.1600 and around 0.6820 for AUD/USD. Given our medium-term view, we would expect the EUR and the AUD rallies against the USD to continue once the current technical constraints ease.

EUR/USD could see an immediate push towards the 1.2000-1.2100 resistance, but we expect any such rally to be brief

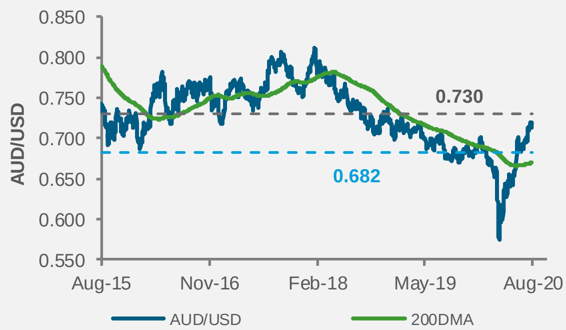
EUR/USD



Source: Bloomberg, Standard Chartered

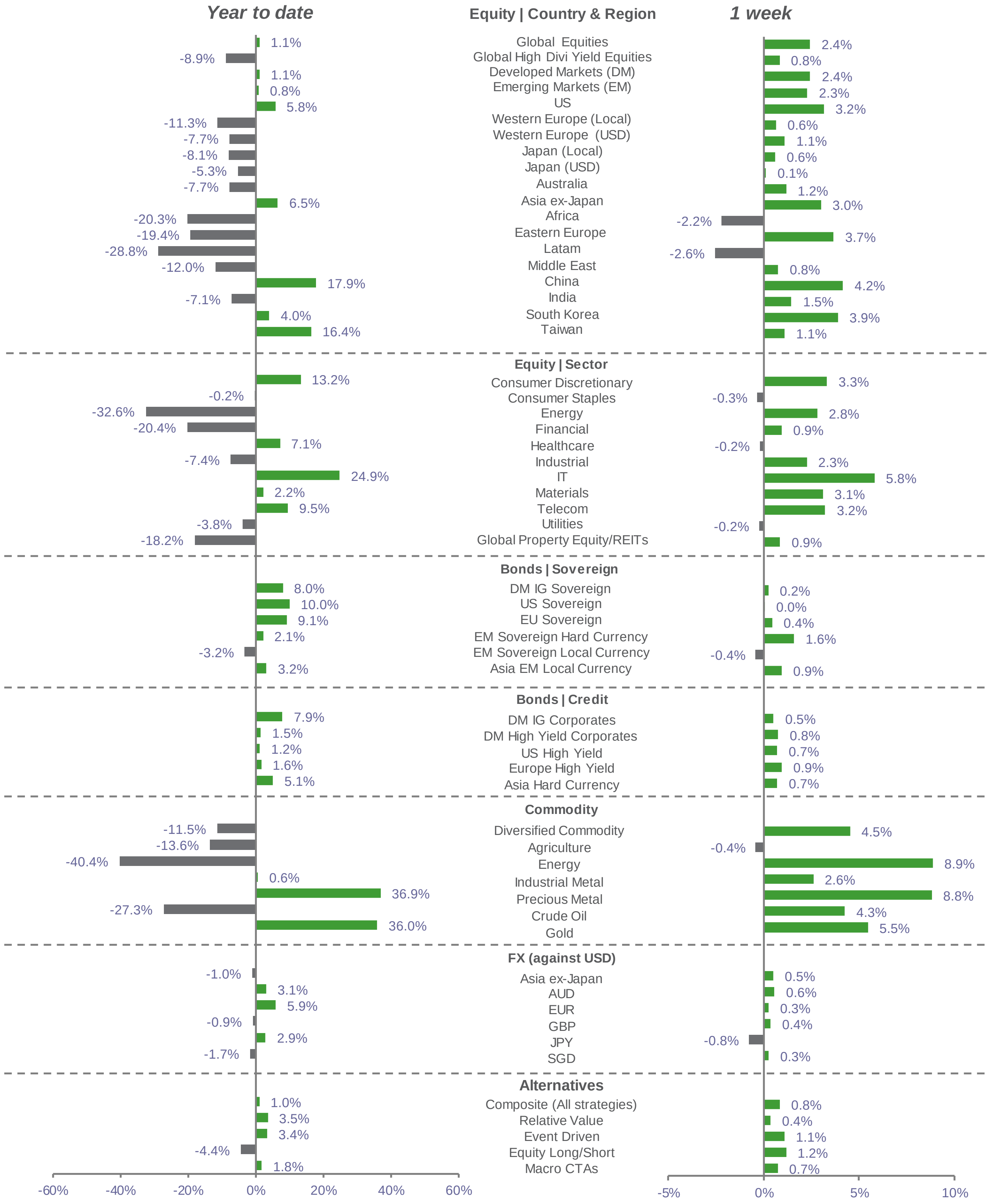
AUD/USD faces resistance around 0.7300

AUD/USD



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 06 August 2020, 1 week period: 31 July 2020 to 06 August 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	CH	Money Supply M2 y/y	10-Aug-2020	Jul	11.1%	11.1%
	CH	CPI y/y	10-Aug-2020	Jul	2.6%	2.5%
	CH	PPI y/y	10-Aug-2020	Jul	-2.5%	-3.0%
	EC	Sentix Investor Confidence	10-Aug-2020	Aug	–	-18.2
TUE	EC	ZEW Survey Expectations	11-Aug-2020	Aug	–	59.6
WED	UK	Industrial Production y/y	12-Aug-2020	Jun	–	-20.0%
	UK	GDP y/y	12-Aug-2020	2Q P	–	-1.7%
	JN	Machine Tool Orders y/y	12-Aug-2020	Jul P	–	-32.1%
	US	CPI Ex Food and Energy y/y	12-Aug-2020	Jul	1.1%	1.2%
	US	Real Avg Weekly Earnings y/y	12-Aug-2020	Jul	–	4.6%
THUR	JN	PPI y/y	13-Aug-2020	Jul	–	-1.6%
FRI/SAT	CH	Industrial Production y/y	14-Aug-2020	Jul	5.1%	4.8%
	CH	Retail Sales y/y	14-Aug-2020	Jul	0.1%	-1.8%
	US	Retail Sales Ex Auto and Gas	14-Aug-2020	Jul	–	6.7%
	US	U. of Mich. Sentiment	14-Aug-2020	Aug P	71	72.5

	Event	This Week	Date	Period	Actual	Prior
MON	SK	Markit South Korea PMI Mfg	03-Aug-2020	Jul	46.9	43.4
	CH	Caixin China PMI Mfg	03-Aug-2020	Jul	52.8	51.2
	US	ISM Manufacturing	03-Aug-2020	Jul	54.2	52.6
TUE	AU	RBA Cash Rate Target	04-Aug-2020	Aug-04	0.3%	0.3%
	EC	PPI y/y	04-Aug-2020	Jun	-3.7%	-5.0%
WED	CH	Caixin China PMI Composite	05-Aug-2020	Jul	54.5	55.7
	EC	Retail Sales y/y	05-Aug-2020	Jun	1.3%	-3.1%
	US	Trade Balance	05-Aug-2020	Jun	-$50.7b	-$54.8b
THUR	GE	Factory Orders WDA y/y	06-Aug-2020	Jun	-11.3%	-29.3%
	UK	Bank of England Bank Rate	06-Aug-2020	Aug-06	0.1%	0.1%
	IN	RBI Repurchase Rate	06-Aug-2020	Aug-06	4.0%	4.0%
	US	US Initial Jobless Claims	06-Aug-2020	Aug-01	1,186k	1,435k
FRI/SAT	GE	Industrial Production WDA y/y	07-Aug-2020	Jun	–	-19.3%
	US	Change in Nonfarm Payrolls	07-Aug-2020	Jul	–	4800k
	US	Unemployment Rate	07-Aug-2020	Jul	–	11.1%
	US	Average Hourly Earnings y/y	07-Aug-2020	Jul	–	5.0%

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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