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Wealth Management Chief Investment Office
2 December 2022

Weekly Market View

Santa Claus rally?

→ The last quarter of the calendar year is historically one of the strongest quarters for risk assets. This year, global stocks have already rallied around 15% from the start of the quarter on expectations of a peak in Fed rates in H1 2023 and a faster relaxation of mobility restrictions in China.

→ The S&P500 index now faces major resistance. A break higher is possible if inflation slows. However, we believe fundamentals do not support chasing the rally into 2023. Records show none of the US bear markets in the past 100 years ended before the associated recession has begun.

→ We expect a recession to start in the US and Euro area by mid-2023. More indicators are flashing warnings. The evolving scenario calls for a defensive allocation. In the following pages, we discuss some of the cyclical and tactical opportunities.

Should we chase the rally in Hong Kong and Mainland China equities?

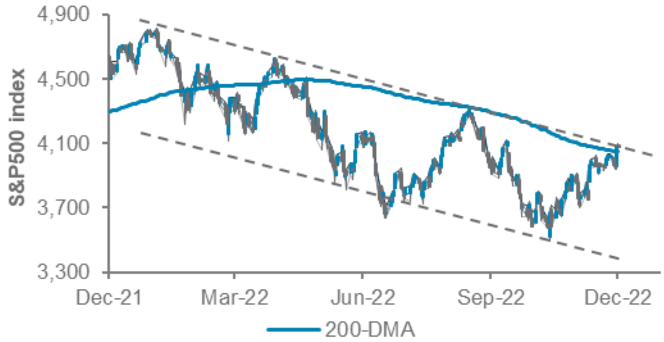
Is credit risk in Developed Markets likely to escalate given rising recession risks?

What are the tactical opportunities arising from the recent USD slump?

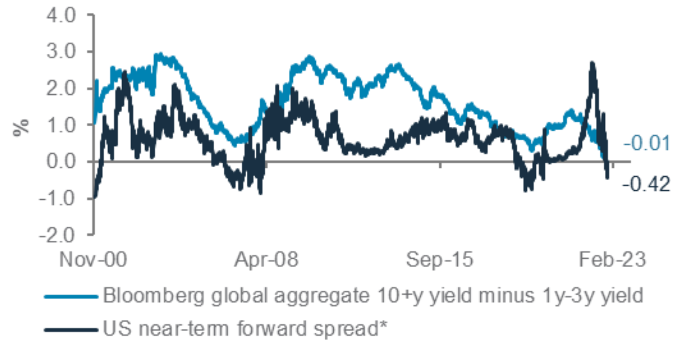
Charts of the week: Challenging technicals and fundamentals

The US equity rally is facing technical resistance, while bond markets are signalling heightened risk of a global recession

S&P500 index, with 200-day moving average (DMA)



Global and US government bond yield curves



Source: Bloomberg, Standard Chartered; *Fed's preferred recession indicator: implied yield on 3m T-bills in 18 months minus 3m T-bill yield

Editorial

Santa Claus rally?

The last quarter of the calendar year is historically one of the strongest quarters for risk assets, with global equities delivering an average 3.6% return since the turn of the century. This year, global stocks have already rallied around 15% from the start of the quarter on expectations of a peak in Fed rates in H1 2023 and a faster relaxation of mobility restrictions in China. The rally has helped investors recover some of this year's losses. The S&P500 index now faces major resistance around 4120 (top of a downtrend channel since January). It could potentially break higher if we see signs of inflation slowing. However, we believe fundamentals do not support chasing the rally into 2023. Records show none of the US bear markets in the past 100 years ended before the associated recession has begun.

We expect a recession to start in the US and Euro area by mid-2023. More indicators are flashing warnings. This week the global bond yield curve inverted for the first time in 20 years. This follows inversions of several US government bond yield curves (see chart). In November, the US ISM Manufacturing index fell into contractionary territory (below 50) for the first time since the depths of the pandemic, and the forward-looking ISM New Orders PMI remained below 50 for the third straight month. Moreover, the Chicago PMI plunged below the critical 40 level which has historically signalled an imminent recession. In Europe, the German government bond yield curve inverted from one year out, a rare occurrence which has historically led to a recession in Europe's largest economy.

The deterioration in activity data signals pain ahead for US and European corporate earnings and, by extension, equities, since earnings estimates in these markets have not yet factored in a recession, in our opinion. Central banks are unlikely to come to the rescue soon enough. This week, Fed Chair Powell did signal a likely slowdown in the pace of rate hikes from this month but hastened to add that there is still "a long way to go" to restore price stability (US core PCE deflator rose 5% y/y in October). He also reiterated that the Fed terminal rate will likely be "somewhat above" the 4.75% projection in September. This implies that the Fed is likely to keep hiking rates into 2023 after possibly delivering a 50bps hike to 4.5% on 14 December. Meanwhile, ECB President Christine Lagarde warned that the central bank must continue to hike even as the economy weakens into 2023 as inflation remains well above its 2% target (Euro area core inflation was 5% y/y in October).

Investment conclusions: The evolving scenario calls for a defensive allocation. This involves, among others:

1. Fading any US and European equity rally going into Christmas and rebalancing into Investment Grade bonds and other income assets. Bond yields at multi-decade highs offer attractive income as investors wait out the coming downturn.

2. Within equities, rebalance into Asia ex-Japan equities, which are still inexpensive and have the tailwind of China's sustained policy stimulus and a gradual normalisation of economic activity (see page 4). Major Mainland China cities including Guangzhou this week relaxed mobility restrictions after authorities unveiled a plan to accelerate vaccinations. The USD's 9% decline since its 20-year peak in September amid lower US government bond yields is also likely to revive flows back into Emerging Markets.

3. In the US, rotate into more defensive equity sectors, such as healthcare; the energy sector remains preferred in the US and Europe given the sector's strong earnings outlook.

4. With increased recession risks, we see tactical opportunities in FX: we expect EUR/JPY and GBP/USD to weaken (page 5).

What we are watching: US payrolls (consensus: 200,000 jobs); OPEC+ meeting on Sunday to decide whether to cut output; EU agreement on the price cap on Russian oil exports before embargo starts 5 Dec; US Services PMI (consensus: 53.5); Euro area retail sales; and China exports (-4.8% y/y).

— 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: China reopening, slower US rate hike signal, softer inflation

(-) factors: Contractionary China, US PMIs, strong US job openings

	Positive for risk assets	Negative for risk assets
Macro data	• US Conference Board consumer confidence better than consensus • US Dallas Fed manufacturing index beat expectations • Euro area inflation slowed more than expected to 10%y/y • US core PCE inflation was softer than expected at 0.2% m/m	• US JOLTs job openings fell less than expected (supports further rate hikes) • US Chicago PMI fell deeply into contraction (37.2) • US ISM mfg fell more than expected to below 50 • China manufacturing and non-manufacturing PMIs declined deeper into the contractionary territory • Euro area's M3 money supply saw a record monthly contraction
	Our assessment: Neutral – US consumer confidence pickup, softer US, Euro area inflation vs contractionary US, China PMIs	
Policy developments	• Several Mainland China cities eased mobility restrictions after Beijing unveiled a plan to boost vaccination rates for elders • The PBoC cut bank reserve requirement ratio (RRR) by 25bps • China allowed listed developers to sell new local shares to repay debt • Fed Chair Powell signalled a slower pace of rate hikes	• Fed officials stayed hawkish and signalled more hikes ahead; Powell said there is still "a long way to go" to restore price stability • ECB's chair Lagarde said inflations risks are to the upside and the ECB will hike rates as long as needed
	Our assessment: Positive – Supportive China policies, likely slower pace of Fed rate hikes	
Other developments	• US granted Chevron a license to resume oil production in Venezuela	• Saudi energy minister said OPEC+ is ready to reduce supplies if needed • EU members yet to agree on a Russian oil price cap
	Our assessment: Neutral – The outcome of the upcoming OPEC+ meeting and Russia oil price cap remain uncertain	

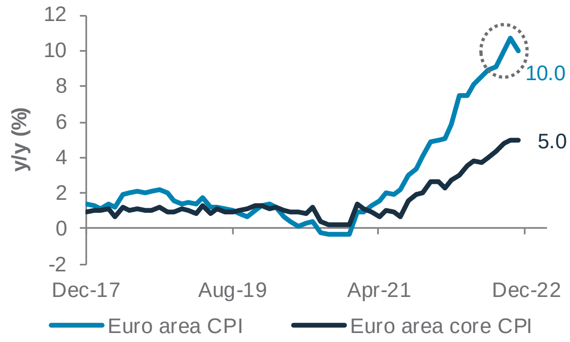
The Fed is likely to keep hiking until US job openings decline significantly, even if activity indicators point to increased risk of a recession

US job openings (JOLTS), ISM Manufacturing and Chicago PMI

Source: Bloomberg; Standard Chartered

Euro area consumer inflation appears to have peaked, although still-elevated core inflation means the ECB is likely to continue hiking rates

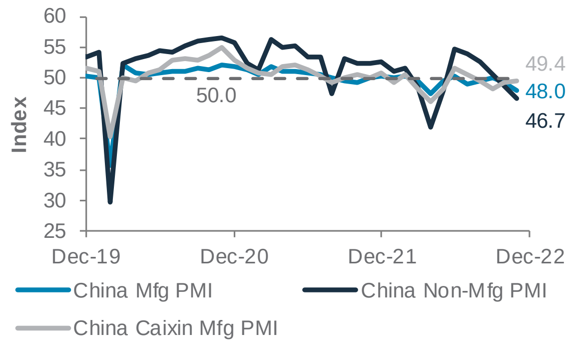
Euro area headline and core consumer inflation



Source: Bloomberg, Standard Chartered

We expect China's economy to recover in 2023 as easing mobility restrictions and easier credit policies revive consumption and business activity

China's manufacturing and non-manufacturing PMIs



Source: Bloomberg, Standard Chartered

Top client questions

Should we chase the rally in Hong Kong and Mainland China equities?

After dipping briefly at the start of the week, Chinese equities saw strong buying interest in recent days, as seen by the volume in the Hang Seng index this week being 2.5x the average daily volume in H2 22. The easing of mobility restrictions in key Mainland China cities such as Guangzhou and the central government's plans to boost the vaccination rate among elders have fuelled expectations of further relaxations. These moves, coupled with the "third arrow" to support the property sector, allowing Chinese developers to raise equity to repay debt and fund acquisitions, propelled the Hang Seng index to break key technical resistance levels of 18,400 and 19,200.

We believe further economic reopening would favour sectors that benefit from a rebound in consumption. The Communications Services sector, in our opinion, offers attractive risk-reward in this regard. The sector's earnings have beaten expectations, and positioning in the sector remains relatively less crowded, based on our measures of investor diversity.

We would consider averaging into Chinese equities on pullbacks. Key support levels for the Hang Seng Index are at 17,400 and 18,100, representing the 61% and 76% Fibonacci retracement levels for the trading range since the end of October (14,600 to 19,200), while 3,767 is a key level of support for the CSI 300 index.

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

The Communications Services sector in China may benefit from easing mobility restrictions

Earnings revisions* for MSCI China Communication Services and MSCI China indices

Source: MSCI, FactSet, Standard Chartered
* Earnings revision = 3 months moving average of (number of earnings upgrades / number of earnings downgrades – 1)

Is credit risk in Developed Markets likely to escalate given the elevated recession risk in the US?

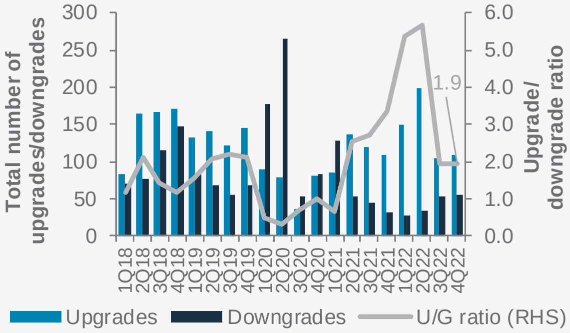
With the Fed policy arguably already at restrictive levels, we believe the recession risk has surged amid tight financial conditions. We observe the corporate bond market is also starting to price recession risk, as illustrated by some portions of the global bond yield curve turning negative (inverting), with investors likely starting to add more longer maturity bonds to lock in long-term yields.

Against this recessionary outlook, corporate credit quality is likely to deteriorate as corporate earnings growth slows and interest burden piles up, resulting in a widening of corporate bond yield premiums (spreads over government bonds). However, we expect this impact to vary considerably across different types of corporate bonds. For Developed Markets (US/Europe) Investment Grade (IG) corporate bonds, we expect the impact to be contained for two reasons. First, credit rating upgrades of IG bonds continue to outpace downgrades, which, in our view, reflects their relatively strong balance sheets and resilient business profiles to weather a recession. In addition, most issuers have pre-funded and strengthened their capitalisation in previous years of low interest rate environment. Hence, despite the possible risks from a recession, we retain our preference for DM IG corporate bonds.

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

Credit rating upgrades in DM IG bonds continue to outpace downgrades, albeit at a slower pace

Credit ratings 1Q 2018 to QTD 4Q 2022



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What are the tactical opportunities arising from the recent USD slump?

Fed Chair Powell's comments this week, where he guided markets towards a slower pace of rate hikes than before amid signs of softness in the job market and elevated recession risks, pushed US government bond yields and the USD index (DXY) lower. As a result, November was the worst month for the USD since 2010. Given this rapid adjustment over the past month, we see a high likelihood of a period of consolidation for the USD, with the 200-dma at 105.50 and Fibonacci retracement at 104.70 acting as key supports.

On a tactical (2-4 week) basis, we see two opportunities in FX markets:

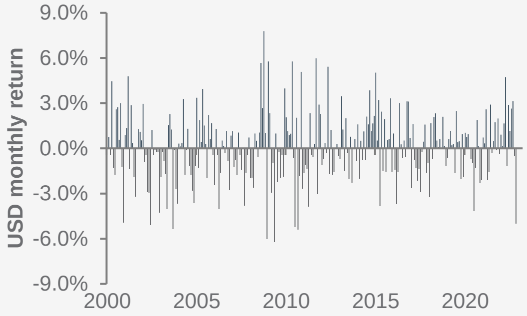
a. With most major G10 central banks (with the notable exception of RBNZ) softening their rate hike stance modestly, we see scope for the JPY to extend recent gains as markets start to price in a narrowing of interest rate differentials. In particular, we expect EUR/JPY to head down towards the 141.00-141.50 range.

b. GBP/USD is starting to look stretched after the nearly 17% bounce from the September 2022 lows. With the UK's challenging growth outlook, we see elevated risk of an incrementally more dovish BoE as well. This means GBP/USD could decline to retest the 1.1700-1.1790 support in the next few weeks.

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

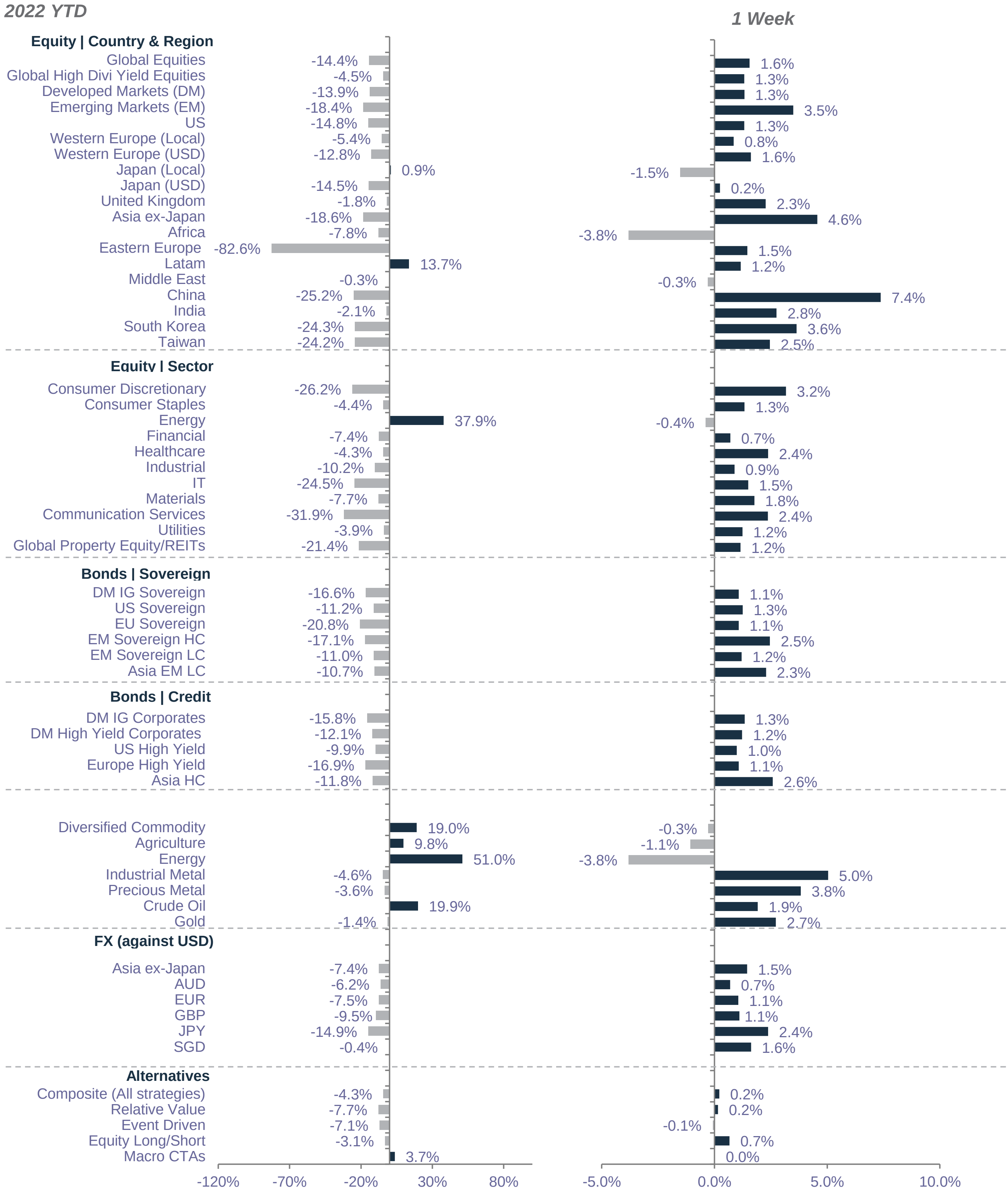
The USD delivered in November the worst monthly return since 2010

Monthly return for the USD (DXY) index



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 01 December 2022; 1-week period: 24 November 2022 to 1 December 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	CH	Caixin China PMI Composite	Nov	–	48.3
	CH	Caixin China PMI Services	Nov	48.0	48.4
	EC	Sentix Investor Confidence	Dec	–	-30.9
	EC	Retail Sales y/y	Oct	–	-0.6%
	US	ISM Services Index	Nov	53.7	54.4
TUE	US	Trade Balance	Oct	-$71.0b	-$73.3b
WED	CH	Exports y/y	Nov	-4.8%	-0.3%
THU					
FRI/SAT	CH	PPI y/y	Nov	-1.4%	-1.3%
	CH	CPI y/y	Nov	1.6%	2.1%
	US	PPI Ex Food and Energy y/y	Nov	–	6.7%
	US	PPI Final Demand y/y	Nov	–	8.0%
	US	U. of Mich. Sentiment	Dec P	56.0	56.8
	CH	Money Supply M2 y/y	Nov	–	11.8%

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 resistance around 4,119

Technical indicators for key markets as of 01 December close

Index	Spot	1st support	1st resistance
S&P 500	4,077	3,996	4,119
STOXX 50	3,985	3,951	4,001
FTSE 100	7,558	7,497	7,596
Nikkei 225	27,680	27,479	28,082
Shanghai Comp	3,160	3,104	3,191
Hang Seng	18,643	17,715	19,153
MSCI Asia ex-Japan	629	604	641
MSCI EM	978	947	994
WTI (Spot)	87.1	84.4	88.5
Gold	1,798	1,759	1,820
UST 10y Yield	3.54	3.45	3.69

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 gold in the past month

Our proprietary market diversity indicators as of 01 December

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	1.94
Global Equities	●	↑	2.47
Gold	●	↑	1.79
Equity			
MSCI US	●	↑	2.10
MSCI Europe	●	↑	1.54
MSCI AC AXJ	●	↑	1.68
Fixed Income			
DM Corp Bond	●	↑	1.99
DM High Yield	●	↑	1.95
EM USD	●	↑	3.08
EM Local	●	↑	2.13
Asia USD	●	↑	1.71
Currencies			
EUR/USD	◐	↑	1.58

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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