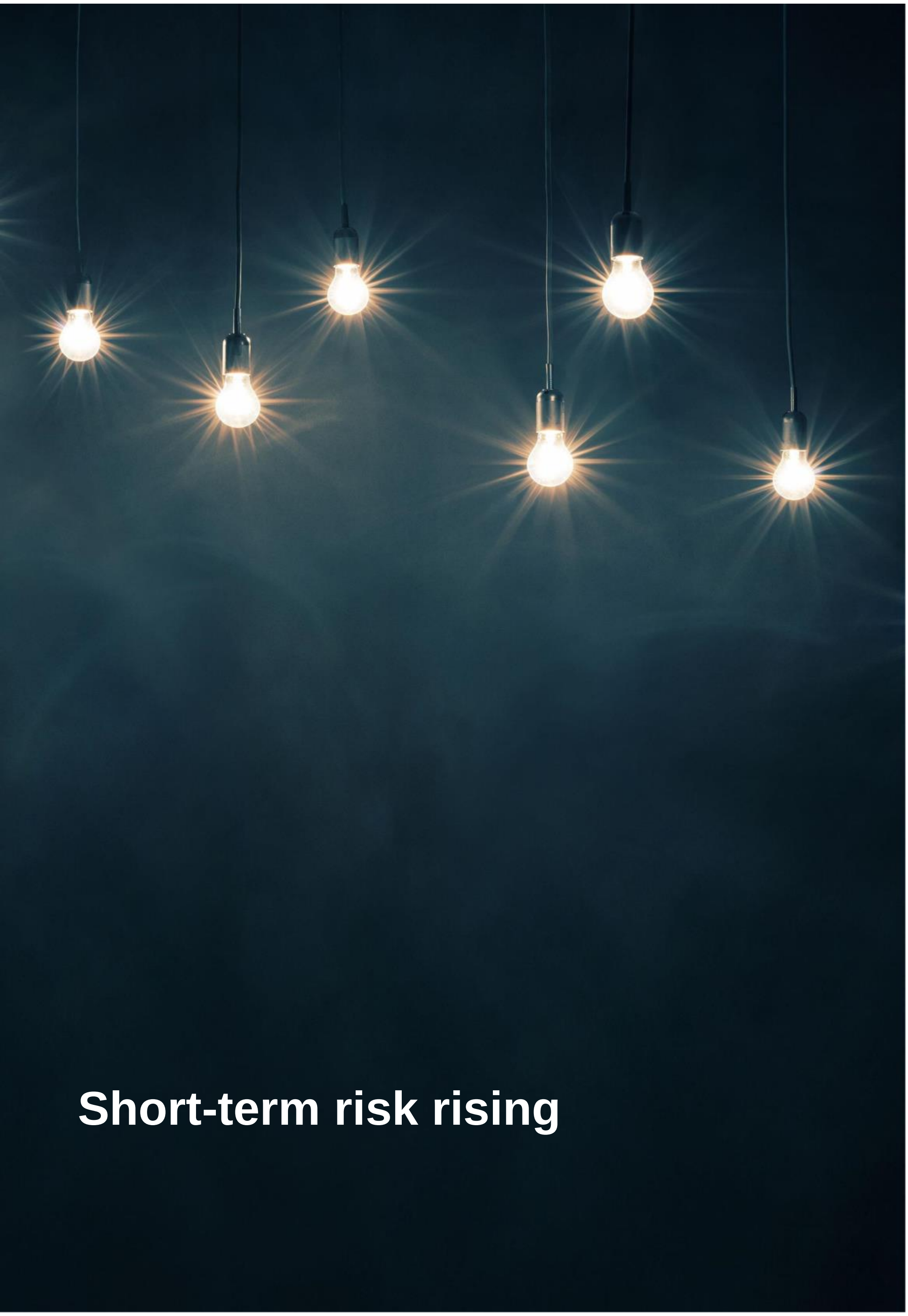
Macro Strategy | 31 January 2020

Weekly Market View



The risk from coronavirus highlights the importance of staying diversified. In this report, we address client questions and suggest investment themes if the outbreak escalates (page 4)

Equities: US and European equities have been relatively resilient amid the pullback in risk assets. Fundamentals and technicals remain supportive

Bonds: Any pullback in Asia USD bonds due to the virus would be an opportunity to add exposure, in our view

FX: JPY, CHF and gold are likely to benefit if the risk-off sentiment extends

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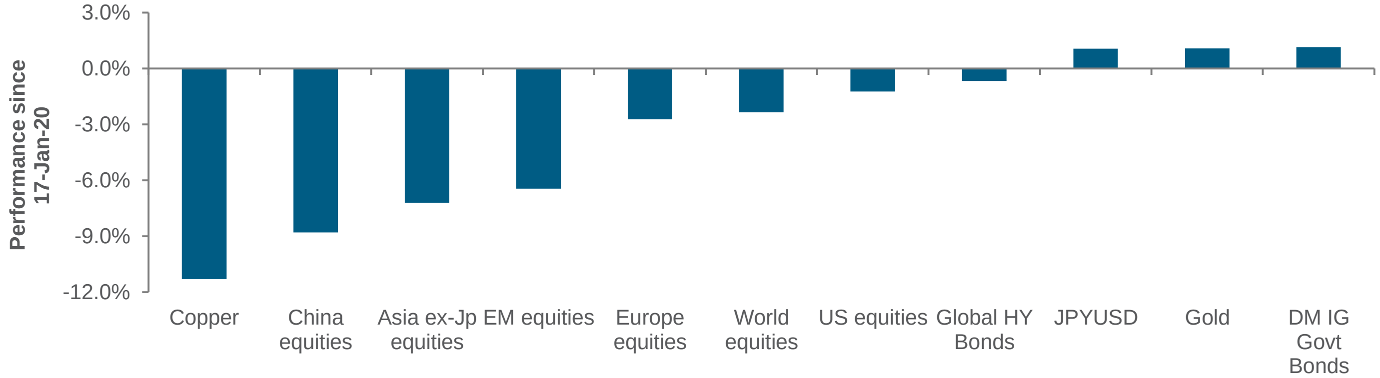
Chart of the week: Safe-havens gained with the spread of virus

Performance of various asset classes since the global stock index (MSCI AC World) peaked on 17 January



Source: Bloomberg, Standard Chartered; performance measured from 17 January 2020 to 30 January 2020; All equity indices are MSCI indices

Editorial

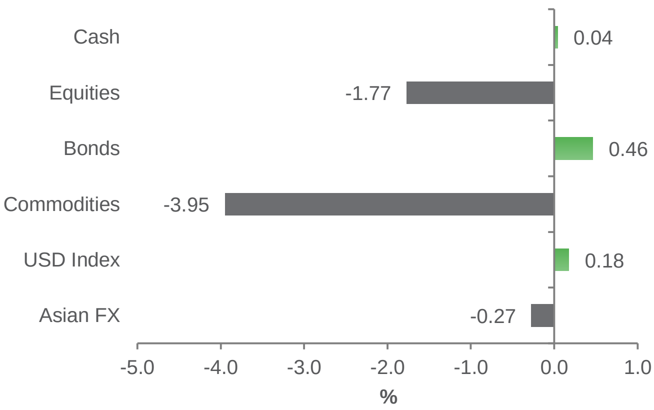
Short-term risk rising

The escalation of the coronavirus outbreak over the past week likely poses a near-term headwind to risk assets, in our view. While the present outbreak is more contagious than SARS in 2003, it has so far been less lethal and mostly confined within China. Authorities have taken prompt action, which could help curb the spread of the infection. However, the short-term economic damage could be greater this time as lockdowns temporarily curtail economic activity. We remain on watch for any risks this could pose to our 2020 full year views. Uncertainty around the channel of spread of the virus, combined with stretched and overly bullish market positioning in recent weeks, could also lead to a pullback in risk assets.

In the following pages, we lay out scenarios if the outbreak escalates, and propose investment themes, based on history, fundamentals and technical (see page 4 onwards). We note some of the positive factors that could mitigate the damage, including signs of a cyclical upturn in the global economy and corporate earnings and highly supportive monetary and fiscal policies. This backdrop leaves us tactically cautious in the near term as we monitor the spread of the virus. For medium-term investors, we reiterate the need to stay diversified.

Global equities and commodities extended losses over the past week, while government bonds gained amid rising concern about the coronavirus outbreak

Benchmark market performance w/w*



Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

*Week of 23 January 2020 to 30 January 2020

Economic indicators turning up, but virus scare a risk

The rise in key business confidence indicators (PMIs) for January in the US, Euro area, UK, Germany and Japan, including those for the manufacturing sector, is another sign that the global economy is turning around after a two-year slowdown. The partial trade deal between the US and China alleviates a key risk to the global outlook and sets the stage for a business investment recovery. We remain on watch for the sustainability of the recovery through the virus scare.

Global central banks remain highly accommodative, as evidenced from this week's Fed policy meeting and the recent ECB and BoJ policy meetings. The Fed, while holding rates this week, tweaked its language to indicate its strong commitment to lift inflation. This suggests it is likely to keep policy accommodative, even if inflation crosses its 2% target for a while – a supportive message for global risk assets.

Corporate earnings have also been supportive of risk assets lately, with both the US financial and technology sectors beating Q4 earnings expectations. These factors underscore our constructive view on risk assets over the next 6-12 months, near-term risks notwithstanding.

What is the impact of the virus scare on Asian USD bonds?

We expect the impact to be limited, short-term drags on investor sentiment notwithstanding. Sectors most exposed to the negative impact (gaming, retail and airlines) account for less than 2% of the Asian USD bond index, limiting the direct impact. From a total return perspective, the biggest risk stems from the Chinese property sector, since at least 22 cities have temporarily closed sales centres. However, should the outbreak peak in the next 1-2 months, the sector could be poised to see a swift recovery owing to the accumulation of pent-up demand. Additionally, the concerns could lead to lower bond supply over the coming weeks, improving the demand-supply balance. Thus, we remain constructive on Asian USD bonds and would view any sell-off as a buying opportunity.

Is the bullish 2020 technical outlook for equities intact?

Yes. In our *Outlook 2020*, we focused on two equity markets in the technical section – the S&P 500 index and the MSCI Europe index – where we continue to see well-established long-term uptrends.

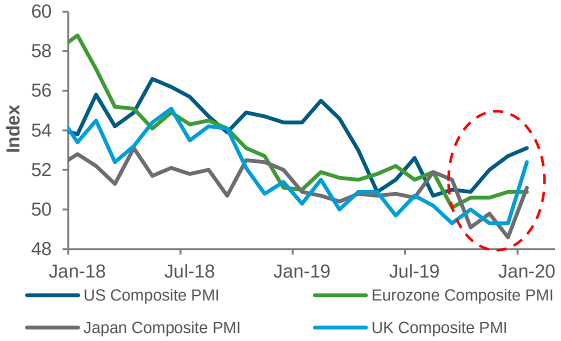
The S&P500 index rose to a new cycle high of 3,338 on 23 January, slightly above the secondary target of 3,295 highlighted in the Outlook. The index's recent retreat is unsurprising given extreme overbought conditions (the 14-day RSI, a measure of momentum, rose to unsustainable levels). The S&P500 index has initial support at 3,215 (the early January low). Any break below the support would indicate the short-term uptrend has temporarily eased. However, there is quite strong support on the 100-day moving average (DMA, now at about 3,105) followed by stronger support on the 200DMA (now at about 3,000). Only a break below the long-term moving averages would cast doubts on the sustainability of the long-term uptrend.

The MSCI Europe index rose to a fresh record high earlier this month and seems to be on its way to the initial technical target of 175 (2.6% above Thursday's close). The secondary target is 185.

We view the recent retreat as a pause within well-established uptrends. Indeed, the lack of a meaningful support breaks so far, despite the negative news flow, reinforces our overall bullish view.

Business confidence indicators across major economies have been recovering in recent months

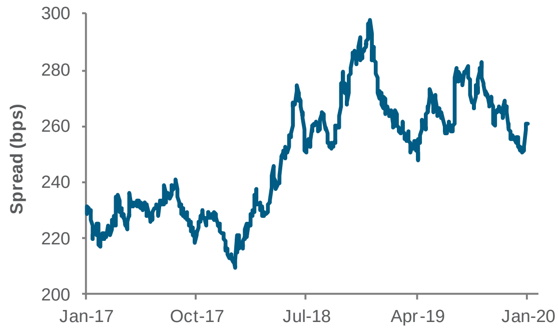
Composite PMIs for the US, Euro area, Japan and the UK



Source: Bloomberg, Standard Chartered

Asian USD bond yield premiums could rise near term due to concerns related to the coronavirus. This could open up an opportunity to add exposure

Asian USD bond yield premium over US Treasuries



Source: Bloomberg, Standard Chartered

The S&P500 index remains above key long-term moving averages despite the recent consolidation, supporting our medium-term bullish view on the market

S&P500 index

Source: Bloomberg, Standard Chartered

Top client questions

What are the investment implications if the coronavirus escalates?

Based on reports available at the time of writing, the novel coronavirus outbreak has displayed almost textbook signs of a localised pandemic. More than 95% of the confirmed cases are confined to China, with almost all assorted cases confirmed in other countries traced back to Hubei. While authorities are still assessing the severity of the crisis, data available thus far shows it is more contagious, but less lethal, than the SARS outbreak of 2003. There are many unknowns, including whether the virus can spread without the original carrier showing any symptoms of the infection, though more prompt precautionary measures taken this time could limit the outbreak sooner.

Though it is early days, our assessment is that China's economic growth for 2020 could be impacted by as much as 1ppt if the outbreak peaks within Q1 2020 and less than 1.5ppt if it extends into Q2. The impact on global growth could be less than 0.5ppt, although China's significantly bigger share of the global economy and its status as a driver of global growth mean the global impact could be greater than during the SARS outbreak in 2003. An economic policy response from China and other economies could also help mitigate the damage, especially with recent data supporting the view that the global economy may be cyclically recovering.

Against this backdrop, while we remain structurally bullish on risk assets over the next 6-12 months, we lay out a guide below of potential winners and losers should the virus outbreak end up being the trigger for a short-term sell-off:

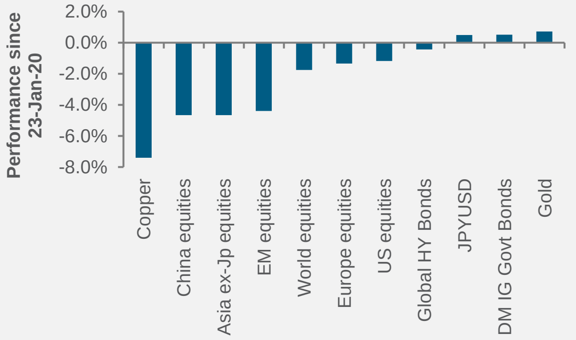
Bonds: The impact on bonds from a short-term sell-off in risk-assets is likely to be varied. High quality government bonds stand to benefit the most in such a scenario. The impact for Investment Grade (IG) corporate bonds are likely to be mixed as the gains from falling government bond yields could be easily offset by losses from higher yield premiums. High Yield (HY) bonds are likely to suffer more, given already stretched valuations and correlation with equities. In Asia, USD bonds could face a drag from worries of a short-term hit to China property sector sales.

Equities: Stocks in China and Asia have led the decline in equities, with sectors such as airlines, luxury goods, travel and leisure and automobiles leading the decline. US and European stocks have been relatively resilient. We believe China and Hong Kong equities will likely underperform global and regional benchmarks under a short-term risk-off scenario, led by concerns over the economic impact of the virus outbreak. A drag on valuation multiples is likely to be the main driver, particularly in the most directly impacted sectors, such as transportation, infrastructure, retail, gaming, restaurant and leisure. Healthcare, though, is likely to get a boost from increased demand.

Elsewhere, we can expect a more severe reaction from European equities than US equities, as c. 10% of Euro Stoxx 50 revenues come from China, compared to 6% for the S&P500. Sector wise, we expect those exposed to the Chinese consumer and traveller to be directly impacted (ie., autos, airlines, luxury goods, and travel and leisure). However, the utilities sector may benefit as a safe haven given domestic exposure and lower raw material prices.

Asian equities and copper have been hurt the most since China took tougher measures to curb the spread of the virus; Developed Market equities were relatively resilient and safe-havens gained

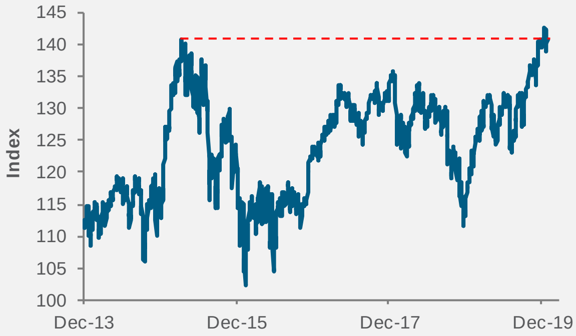
Performance of asset classes since 23 Jan, when China locked down Wuhan, the origin of the coronavirus



Source: Bloomberg, Standard Chartered; performance measured from 23 Jan 2020 to 30 Jan 2020; All equity indices are MSCI indices

European equities have performed well so far, but the region's exposure to China make them vulnerable near-term; US equities are relatively less exposed to China

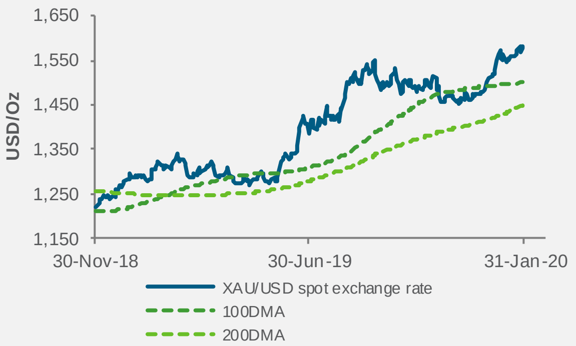
MSCI Europe index



Source: Bloomberg, Standard Chartered

Gold has played its part as a safe-haven amid the recent pullback in risk assets

Spot gold price



Source: Bloomberg, Standard Chartered

FX: A temporary risk-off environment would likely encourage flows to safe-haven currencies – mainly the JPY, CHF, gold and the USD. However, USD gains could be limited amid the likely heated and polarising presidential election process that kicks off next week with the Iowa Democratic Caucus. We also believe that the SNB would push back against further CHF strength. Thus, we see the JPY and gold as key potential beneficiaries of near-term uncertainty. The JPY may benefit disproportionately given significant unhedged borrowings to fund US assets by Japanese investors, which could unwind if risks rise. Gold has potentially completed a healthy technical retracement and could benefit if the global monetary policy turns even more accommodative. As long as support at 1545 holds, a break of 1587 opens a re-test of the 1610 high. In an extreme flight to safety the next big technical target is around 1715.

Derivatives: Equity volatility (as measured by the VIX index) has spiked to levels last seen at the end of Q3 2019, when equities were falling amid fears of a global slowdown. This rise in volatility could extend further during any short-term sell-off. However, we would view any such move as an opportunity to generate income through structured strategies, where appropriate, given our medium-term positive view on equities remains intact.

Since you published Outlook 2020, Global IG bond yields are only slightly lower and Global HY bond yields are roughly flat. Should bonds still be part of a diversified investment allocation? What kinds specifically do you prefer?

In our assessment, bonds remain a crucial part of a diversified investment allocation. It is easy to forget that investors can choose among many different types of bonds to meet their investment objectives. High quality bonds can provide a buffer in periods of sharp short-term sell-offs (see question 1, for example), while higher yielding EM bonds and HY bonds can provide income and equity-like exposure, but sometimes with lower volatility. While we expect equities to outperform bonds over the next 12 months, striking the right balance between equities and bonds, and within bonds, is crucial to achieving an attractive reward for the risk taken.

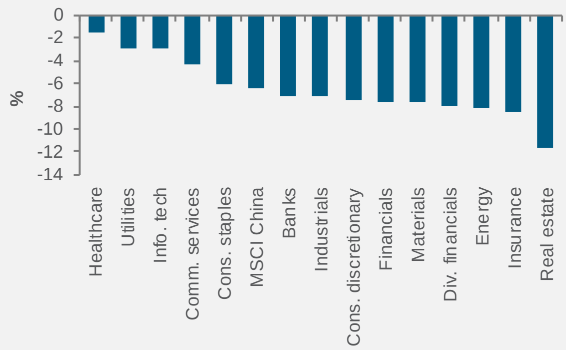
In the latest risk-off move, US Treasury yields have already declined more than 20bps. The 10-year Treasury yield could test 1.45% if concerns around the virus escalate. Developed Market High Yield bond yield premiums have increased by almost 50bps and could widen by another 50-75bps, in our view.

We continue to like EM USD and local currency bonds given the attractive yields of about 5% on offer and the fact that, apart from China, the direct impact of the virus scare is likely to be limited. Asian USD bonds are naturally in the eye of the storm, given over 50% exposure to China, though we still expect them to outperform given still-strong regional demand, the possibility that supply could slow and the asset class' relatively high quality. While gaming and travel-related sectors could be impacted, the sectors' share of Asian USD bonds is small.

We view DM HY bonds as a core holding, despite it having the highest yield in our bond universe. Relatively expensive valuations and the recent announcements by major oil service providers that shale oil production in the US may have peaked further strengthen our view that the energy sector could be a source of stress.

China's real estate sector has suffered the most in the latest drawdown caused by the coronavirus scare; healthcare and utilities have been the most resilient

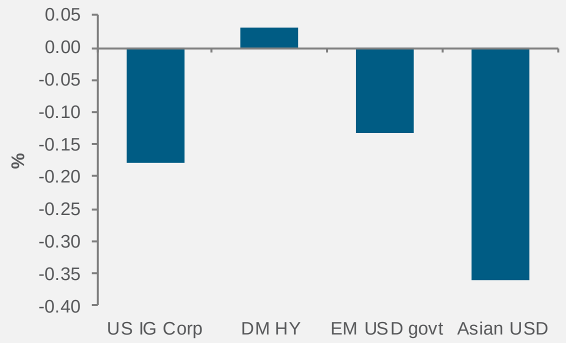
MSCI China index sector performance from 17-29 Jan 2020



Source: Bloomberg, Standard Chartered

Global bond yields have declined only modestly over the past few years

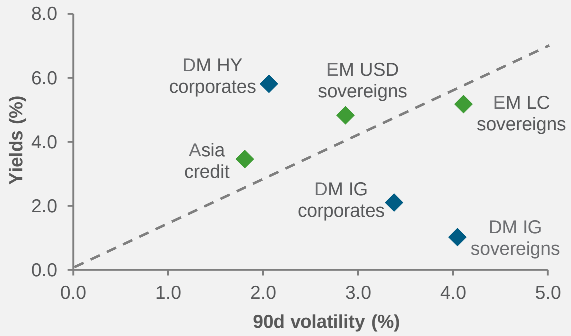
Change in yields for various bond asset classes since our 2020 outlook (13 December 2019 to 28 January 2020)



Source: Bloomberg, Standard Chartered

We continue to prefer EM and Asian USD bonds as they continue to offer attractive yields and low volatility respectively

Yield and 90-day volatility of various bond asset classes



Source: Bloomberg, Standard Chartered

How significant is the risk of onshore corporate bond defaults in China spreading to the offshore USD bond market?

We see a fairly limited risk of rising onshore corporate defaults in China spilling over to the Asia USD bond market in a significant way.

While investors are more concerned with more Chinese bond defaults in the Asia USD bond market, it is worth noting that default ratio of onshore state-owned entities has been consistently lower than 1% since 2018. It is in onshore privately-owned entities where the default ratio has surged to roughly 5%. Despite this, the default ratio in the Asian USD bond market has remained below 2% during the same period. We believe rising investors' concern was due to the rise in cases of default among Chinese government-backed entities within the Asian USD market. The reduction in implicit government support has challenged investors' belief for many such entities.

Another reason for the growing concern around Chinese credit defaults has been the slowing economic growth in recent years. This exposed entities that improperly leveraged themselves in an effort to capitalise on growth opportunities in the past. Unsurprisingly, such strategies have led to liquidity challenges when growth has slowed.

Having said that, we expect defaults in both the onshore and offshore markets to remain largely contained and in line with recent years. Measures, such as the PBoC's interest rate reform and the required reserve ratio cuts, are also likely to help sooth a tight funding channel. Short-term volatility notwithstanding, we continue to prefer Asia USD bonds on a 12-month horizon.

Is it a good time to get back into HK and China equities?

Given the scale and economic impact of the coronavirus is yet to be fully ascertained, it is too early to bottom-fish, in our view.

We expect the China A-share market to open lower on 3 February when it resumes trading after the Lunar New Year holidays, catching up with recent developments, and the pressure could remain in place. Although the SARS experience suggests that the outbreak peaked about 3-4 months after the first case was reported and was mostly contained after 6-7 months when the flu season passed, it remains far from certain that the current virus outbreak will follow a similar pattern. The quarantine measures undertaken have already affected consumption spending in China; if prolonged, they risk posing downside risks to earnings growth. Having said that, there is clearly room for policy stimulus should the growth impact be significant, potentially mitigating the impact somewhat.

Historical virus outbreaks suggest that travel, entertainment and shopping could be the most affected. According to the Ministry of Transport, passenger traffic in the first three days of the Lunar New Year has dropped 56% y/y. Among the sectors, the tourist-related aviation, Macau gaming and offline retail sector could be hurt by reduced travel. Reduced outdoor activities, however, are constructive for e-commerce, online gaming and food delivery sectors. Meanwhile, growing health awareness could boost demand for pharmaceutical products and lift sentiment for healthcare stocks.

That said, we see a heightened risk of continued weakness in China and Hong Kong equities in the short term until signs of virus outbreak stabilisation emerge (ie. number of new cases tapering off). Therefore, we prefer to wait for more attractive entry levels before

Asian USD bond yield premiums could rise near term due to concerns related to the coronavirus. This could open up an opportunity to add exposure

Asian USD bond yield premium over US Treasuries

Source: Bloomberg, Standard Chartered

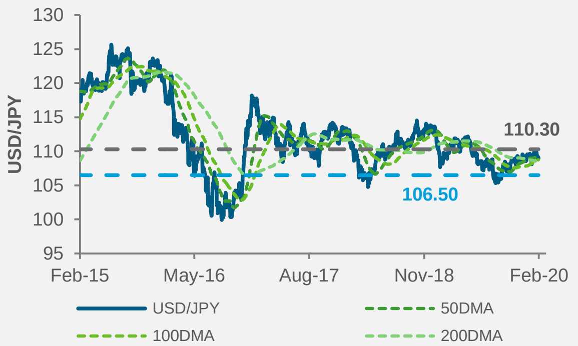
We prefer China offshore equities given comparable growth to China onshore equities, but lower valuation

EPS growth at MSCI China and MSCI China A Onshore

Source: MSCI, FactSet, Standard Chartered

The JPY is the least attractive funding currency compared to USD, CHF and EUR, in our view

USD/JPY overlaid with 50, 100, 200-day moving averages and key technical levels



Source: Bloomberg, Standard Chartered

adding exposure. On a longer 12-month time horizon, China offshore equities remain our preferred market in Asia ex-Japan.

On technical charts, the MSCI China index's hold above key support on the 200-week moving average in 2018 and 2019 and the rise this year to an 18-month high indicate that the medium-term uptrend remains intact. A monthly close above key resistance at the April 2019 high of 88.17 would have been encouraging for bulls. However, the Lunar New Year holidays in China have partly distorted readings. The recent retreat in the index has come about from very overbought conditions – a possibility we highlighted a couple of weeks ago – but we believe downside could be limited. The index has immediate support on the 20-week moving average (now at about 80.10), followed by support on the 200-week moving average (now at about 76.10). Strong support is at the 2018 low of 67.96. A break below 67.76 would negate the uptrend.

What will be the best currency in which to borrow (ie. funding currency) over the next 1-3 months?

At a broad level, matching investment and loan currencies is the appropriate strategy for those who do not wish to directly add FX risk to their investments. For those who are willing and able to accept additional FX risk to try to enhance investment returns, the decision to select a borrowing currency has two key components: (i) the difference in borrowing costs, and (ii) any movement in the currencies themselves.

The comparative loan interest cost is known at the outset, but a view on the potential move in the currency pair itself helps in assessing whether the saving in loan interest cost is worth the risk, or not.

Below, we consider four potential lending currencies, the CHF, JPY, EUR and USD, and provide our subjective ranking on their relative attractiveness as a funding currency.

Central bank policy – supports funding in USD, CHF: ECB and BOJ policies are likely to remain on hold. However, the Fed remains committed to add significant USD liquidity through June and remains asymmetrically poised towards easing. Meanwhile, the SNB is likely to be concerned about the recent CHF strength against the EUR and could tweak policy to lower rates despite the US Treasury placing Switzerland on the "Currency Manipulator Watchlist".

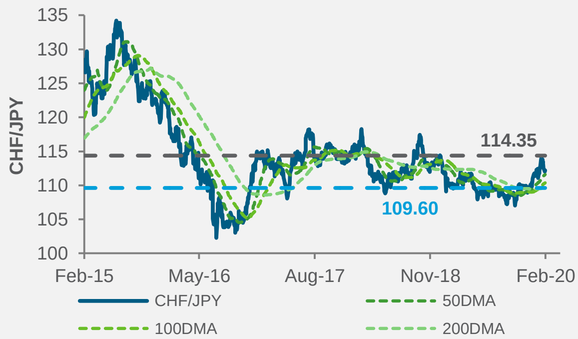
Growth – supports funding in USD: Our Global Investment Committee's view is for global growth to slowly pick up relative to US growth in 2020, with the likelihood and impact of greater fiscal stimulus from countries where monetary policy is already very accommodative. We expect the greatest room for a positive surprise is in the Euro area.

Safe-haven demand – a risk to CHF, JPY funding: Worries over the economic impact of the coronavirus outbreak risk are triggering safe-haven flows to the USD, a negative factor from a funding currency perspective. Meanwhile, a fragile environment prevails in the Middle East, with any rise in tensions risking an impact on risk sentiment and oil prices. From a funding currency perspective, this would represent a short-term risk for the CHF and the JPY, which may strengthen temporarily under such a scenario.

US domestic politics – supports funding in USD: The US Presidential election season begins in earnest on Monday, with the Democratic caucus in Iowa starting the process to select a nominee

We believe CHF/JPY could still head lower as the SNB is growing more concerned over recent CHF strength

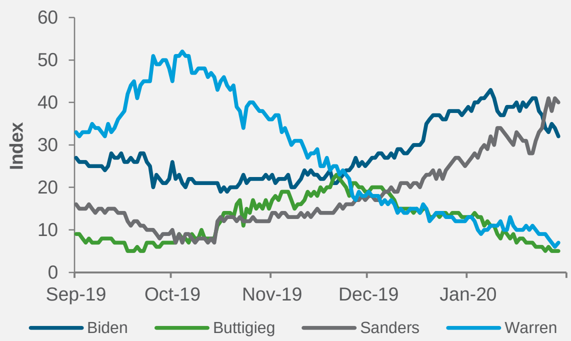
CHF/JPY overlaid with 50, 100, 200-day moving averages and key technical levels



Source: Bloomberg, Standard Chartered

US domestic politics will pose a headwind to the USD

US PredictIt 2020 Democratic Presidential Nomination Index



Source: Predictit, Standard Chartered

We expect further declines in USD/JPY and gains in EUR/USD

Our 1-3 month view on major currency pairs

Currency pair	View
EUR/USD (Spot 1.1010)	We expect 1.0875-1.0970 support to hold and a rally towards 1.1250.
USD/JPY (Spot 109.20)	We expect 109.70-110.30 to hold and a decline towards 106.50
USD/CHF (Spot 0.9730)	We expect a trading range of 0.96 to 1.01 to hold
EUR/CHF (Spot 1.0730)	We expect support around 1.06 to hold and a rally towards 1.1050
EUR/JPY (Spot 120.25)	We expect a trading range of 118.50 to 122.85 to hold
CHF/JPY (Spot 112.20)	We expect the correction to push towards 109.60 as 114.35 caps

Source: Bloomberg, Standard Chartered

to oppose President Trump. By April, 87% of Democratic votes for a nominee will be decided. The market's main concern is likely to be a Sanders or Warren win given their stated policies on US regulations, taxation and international relations. This could weaken the USD.

Technicals – supports funding in USD: See the table alongside for our technical views. Technical charts are not favourable for the USD, in our assessment.

Pulling this together, based on both fundamentals and technicals, we would rank the four currencies as follows from a funding currency point of view: (i) USD; (ii) CHF; (iii) EUR; and (iv) JPY.

Should we worry about the risk of an oil price spike in the next six months?

The likelihood of a sustained rise in oil prices is relatively contained, in our assessment.

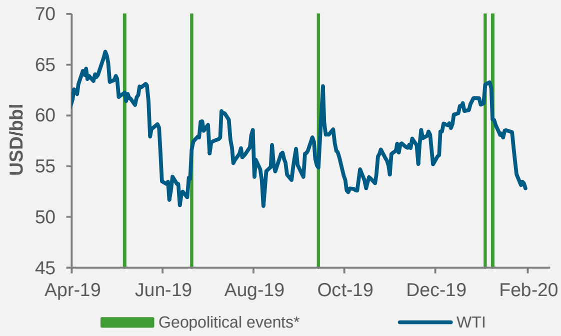
On the supply side, a disruption led by geopolitics-related events is one factor which could push oil prices higher. However, a further escalation of US-Iran tensions appears unlikely in the short term, in our view. We also believe the oil market is better-positioned to absorb supply disruptions (including from Libya and Iraq) in the short term, considering OPEC's plentiful spare capacity. Oil supply from non-OPEC countries is also expected to rise, while fears of a significant decrease in US shale production growth also appear over-stated given the rise in drilled, but unexploited, wells.

We believe a backdrop of robust demand growth is needed for a sustained increase in prices. While we expect a modest rise on the back of a recovery in global growth, the recent coronavirus outbreak presents a threat to our view. This likely explains why crude oil prices (WTI) have fallen from a high of 65.65 in January to around 55, despite geopolitical risks.

Taking all these factors into consideration, any oil price spike will unlikely be sustained unless the relatively weak demand growth outlook changes significantly. Longer term, we continue to expect oil prices (WTI) to remain in their broad USD 50-60/bbl range in the next 6-12 months.

Sustained gains in oil prices are unlikely if demand growth remains muted

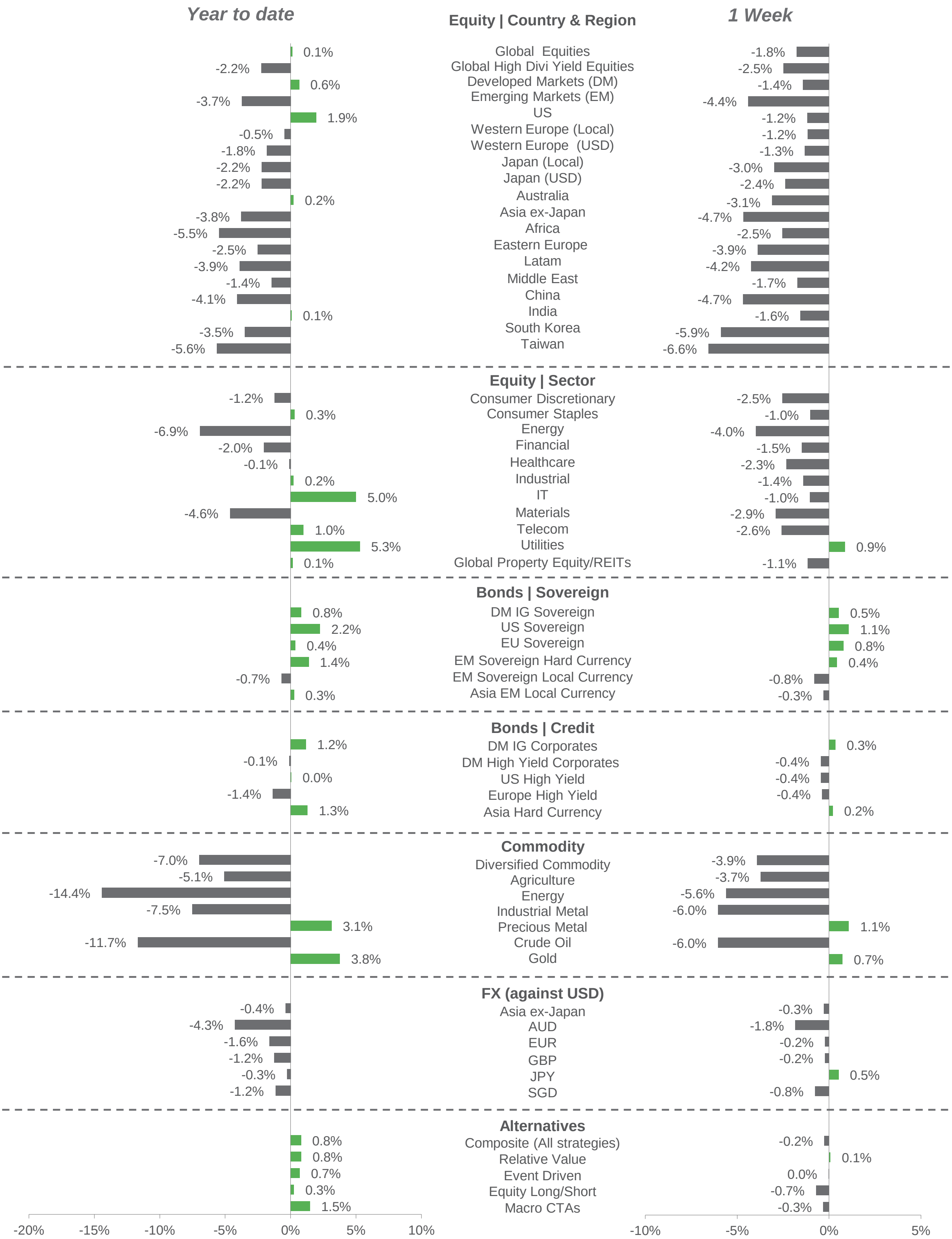
WTI oil price (USD/bbl) overlaid with geopolitical events*



Source: Bloomberg, Standard Chartered

**Events include the following: Start of Persian Gulf Crisis, Saudi Aramco drone attacks, US missile strikes and recent Iranian retaliation*

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 30 January 2020, 1 week period: 23 January 2020 to 30 January 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	SK	Markit South Korea PMI Mfg	03-Feb-20	Jan	–	50.1
	CH	Industrial Profits y/y	03-Feb-20	Dec	–	5.4%
	US	ISM Manufacturing	03-Feb-20	Jan	48.4	47.2
TUE	AU	RBA Cash Rate Target	04-Feb-20	4-Feb	0.5%	0.8%
	EC	PPI y/y	04-Feb-20	Dec	–	-1.4%
WED	CH	Caixin China PMI Composite	05-Feb-20	Jan	–	52.6
	IN	Markit India PMI Composite	05-Feb-20	Jan	–	53.7
	EC	Retail Sales y/y	05-Feb-20	Dec	–	2.2%
	US	Trade Balance	05-Feb-20	Dec	-$46.0b	-$43.1b
	US	ISM Non-Manufacturing Index	05-Feb-20	Jan	55.0	55.0
THUR	GE	Factory Orders WDA y/y	06-Feb-20	Dec	–	-6.5%
FRI/SAT	GE	Exports SA MoM	07-Feb-20	Dec	–	-2.3%
	GE	Industrial Production WDA y/y	07-Feb-20	Dec	–	-2.6%
	US	Unemployment Rate	07-Feb-20	Jan	3.5%	3.5%
	US	Average Hourly Earnings y/y	07-Feb-20	Jan	–	2.9%
	CH	Exports y/y	07-Feb-20	Jan	–	7.9%

	Event	This Week	Date	Period	Actual	Prior
MON	GE	IFO Expectations	27-Jan-20	Jan	92.9	93.8
	US	New Home Sales	27-Jan-20	Dec	694k	719k
TUE	US	Durable Goods Orders	28-Jan-20	Dec P	2.4%	-2.1%
	US	Cap Goods Orders Nondef Ex Air	28-Jan-20	Dec P	-0.9%	0.2%
	US	Conf. Board Consumer Confidence	28-Jan-20	Jan	131.6	126.5
WED	EC	M3 Money Supply y/y	29-Jan-20	Dec	5.0%	5.6%
THUR	US	FOMC Rate Decision (Upper Bound)	30-Jan-20	29-Jan	1.8%	1.8%
	UK	Bank of England Bank Rate	30-Jan-20	30-Jan	0.8%	0.8%
	GE	CPI EU Harmonized y/y	30-Jan-20	Jan P	1.6%	1.5%
	US	Personal Consumption	30-Jan-20	4Q A	1.8%	3.2%
	US	Core PCE q/q	30-Jan-20	4Q A	1.3%	2.1%
	US	Initial Jobless Claims	30-Jan-20	25-Jan	216k	211k
FRI/SAT	JN	Industrial Production y/y	31-Jan-20	Dec P	-3.0%	-8.2%
	CH	Manufacturing PMI	31-Jan-20	Jan	50.0	50.2
	US	Personal Income	31-Jan-20	Dec	–	0.5%

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue
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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