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Wealth Management Chief Investment Office
6 January 2023

Weekly Market View

Staying SAFE, preferring Asia

→ For investors, 2023 is likely to play out in two distinct halves. In H1, we expect recessions in the US and Europe and a gradual recovery in China. This is likely to be followed by a revival in sentiment in the later part of the year as western central banks start to ease policy and China's reopening and policy measures feed through to the wider domestic economy.

→ This world view, which we outlined in our 2023 Outlook, "Playing it SAFE", calls for a defensive stance in allocations: earning income through an overweight in high quality bonds and underweight in equities, with a preference for Asia ex-Japan in both, while looking for tactical opportunities in equity sectors and FX.

→ We are likely to get better entry opportunities for equities outside Asia later this year once western central banks cut rates as recession sets in.

Speak to your Relationship Manager to register for our Global Market Outlook 2023 webinar on 11 Jan, when our Chief Investment Officer Steve Brice will discuss the outlook with former Bank of England Governor Mark Carney.

What is the outlook for Hong Kong and China equities?

Where would you opportunistically add to equity sectors today?

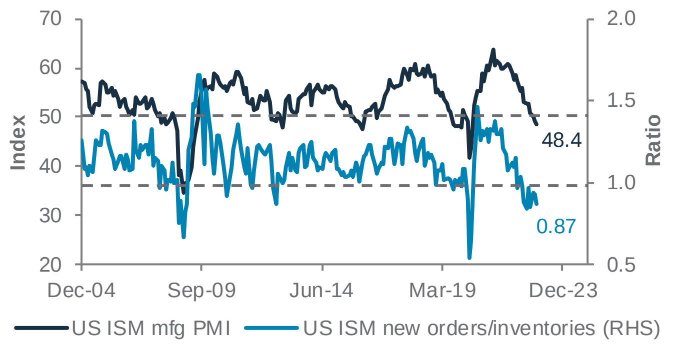
Do you expect USD/JPY to rebound in the near term?

Important disclosures can be found in the Disclosures Appendix.

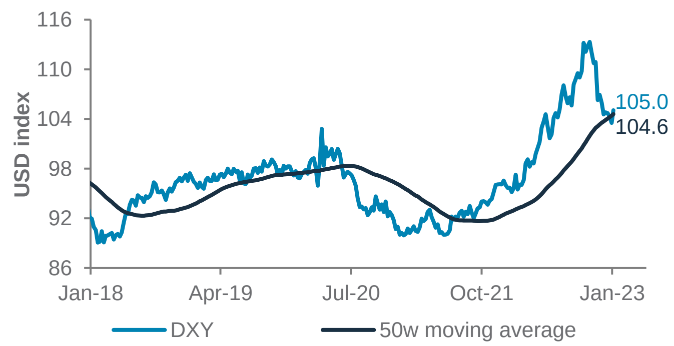
Charts of the week: US recession risk rising

US manufacturing sector business confidence points to contraction in activity, adding downward pressure on the USD

ISM Manufacturing PMI, ISM new orders-to-inventories ratio



USD index (DXY), weekly chart with weekly moving averages



Source: Bloomberg, Standard Chartered

Editorial

Staying SAFE, preferring Asia

For investors, 2023 is likely to play out in two distinct halves. In H1, we expect recessions in the US and Europe and a gradual recovery in China. This is likely to be followed by a revival in global sentiment in the later part of the year as western central banks start to ease policy and China's reopening and policy measures feed through to the wider domestic economy. This world view, which we outlined in our 2023 Outlook, "Playing it SAFE", calls for a defensive stance in investment allocations at the start of the year: earning income through an overweight in high quality bonds and underweight in equities, with a regional preference for Asia ex-Japan, while looking for tactical opportunities in equity sectors and currencies. We are likely to get better entry opportunities for equities outside Asia later this year once western central banks cut rates as recession sets in.

The latest US and Euro area PMI data and China's recent policy measures support our central view. US manufacturing sector business confidence (ISM PMI) for December indicated a second straight month of contraction in underlying activity, with the forward-looking new orders PMI staying in contraction territory for the fourth month (the US services sector remains healthy though, with the consensus expecting ISM Services PMI at 55, as consumer demand shifts from goods to services). European PMIs also remained contractionary, although they improved from October's lows. Meanwhile, China's PMIs fell deeper into contraction due to a surge in COVID-19 infections.

Against this backdrop, Developed Market central banks, especially the Fed, are likely to decide the fate of asset returns this year once again – the key is assessing how soon they are likely to pause tightening. We expect the Fed and ECB to keep tightening in the coming months, likely taking their benchmark rates to a peak of 5.25% and 2.5% (deposit rate), respectively, to sustainably subdue wage and inflation pressures. The Fed's December minutes showed policymakers are concerned about easing financial conditions too soon. Yet, they are conscious that "the lagged cumulative effect of policy tightening could end up being more restrictive than necessary".

The minutes suggest, despite the contraction in manufacturing, policymakers are unlikely to pause tightening in the next few months unless they see signs of a sharp deterioration in overall economic activity and the job market, and a sustained decline in inflation. Data this week showed US job openings remained high and jobless claims low (December's non-farm payrolls report will likely confirm the job market strength). Meanwhile, consensus estimates suggest inflation remains high at 9.5% in the Euro area (data tonight) and 6.6% in the US (due 12 Jan).

Although recessions in the US and Europe are widely anticipated as the central banks keep tightening, we believe they are not priced into equities. In the US, except for the healthcare sector, downward revisions to corporate earnings still fall short of the average of the past three recessions. Asia ex-Japan offers a ray of hope against this backdrop. Mainland China's reopening has been faster than expected, leading to the normalisation of mobility across major cities. China has also announced measures to boost sentiment over the past week, providing more liquidity to property developers, exploring coal imports from Australia and allowing Ant Group to raise capital. It will reopen the Hong Kong-Mainland China border from 8 Jan.

Investment implications: Against this backdrop, we maintain a. SAFE stance in foundation allocation by: i) Securing our yield via income strategies, ii) Allocating to Asian assets that offer long-term value, iii) Fortifying against surprises via defensive assets, and iv) Expanding through alternative strategies.

b. Tactical opportunities in: China's consumer-focussed equity sectors (consumer discretionary, communication services)

c. Opportunistically add to JPY and EUR on pullbacks as the USD structurally breaks lower, aided by the BoJ's recent surprising hawkish shift in policy (see chart above and page 5).

— 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: Supportive China policies, better-than-expected Euro PMI

(-) factors: Contractionary US and China PMIs, hawkish Fed minutes

	Positive for risk assets	Negative for risk assets
Macro data	• Euro area services PMI revised higher to 49.8; mfg PMI unchanged • Euro area PPI and German consumer inflation slowed more than expected to 27.1% and 9.6% y/y • China Caixin services PMI improved more than expected to 48.0	• US ISM mfg PMI contracted more than expected to 48.4 • US JOLTs job openings rose unexpectedly and initial and continuing jobless claims fell unexpectedly, raising the risk of more Fed hikes • China mfg, non-mfg and Caixin mfg PMIs contracted more than expected to 47.0, 41.6 and 49.0, respectively
	Our assessment: Neutral – Better-than-expected Euro area PMI vs weak US ISM mfg PMI, still-robust US jobs data (raising Fed hike risks), contracting China PMIs	
Policy developments	• Mainland China authorities plan further measures to ease liquidity stress at property developers • Beijing granted regulatory approval to Ant Group to raise capital, reflecting a further softening of stance on the internet sector	• Fed's minutes, policymaker comments point to more rate hikes amid concerns about easing financial conditions too soon • China President Xi acknowledged tough challenges ahead in the fight against COVID-19
	Our assessment: Neutral – Supportive China policies vs hawkish Fed minutes, policymaker comments	
Other developments	• OPEC crude output rose last month after Nigeria cracked down on oil theft • China's new foreign minister Qin Gang praised Americans and sought better ties in a phone call with US Secretary of State Antony Blinken • China is exploring a resumption of coal imports from Australia	• US Republican candidate McCarthy unable to gain majority needed to become speaker; no House business can carry on until a speaker is elected • China vowed to retaliate over overseas travel restrictions on its citizens • North Korea fired more missiles and pledged to expand nuclear arsenal
	Our assessment: Positive – OPEC crude output rose, China's conciliatory moves towards the US and Australia	

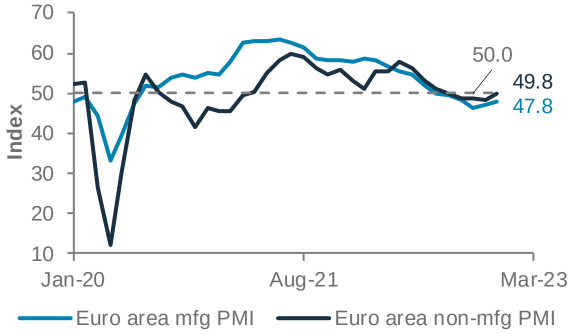
The US job market remains tight, compelling the Fed to continue tightening policy

US job openings (JOLTS) and Quits rate*

Source: Bloomberg; Standard Chartered; *the Quits rate tracks voluntary job separations initiated by the employee

Euro area business confidence remains in contractionary territory, despite improving from earlier lows

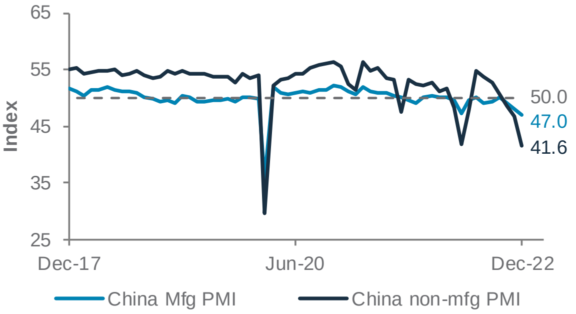
Euro area manufacturing and services PMIs



Source: Bloomberg, Standard Chartered

China's business confidence indicators deteriorated further in December; we expect a recovery this year amid a faster-than-expected relaxation of mobility restrictions

China's manufacturing and non-manufacturing PMIs



Source: Bloomberg, Standard Chartered

Top client questions

Do you expect USD/JPY to rebound in the near term?

USD/JPY has been volatile since we published our 2023 Outlook in mid-December. The surprise announcement by the BoJ to widen the band for its Yield Curve Control (YCC) policy sparked a sharp decline in USD/JPY and a sharp jump in Japanese government bond yields. While we had flagged the risk of adjustment to the YCC policy in 2023, the timing of the move was earlier than expected.

Over the next 1-3 months, we expect USD/JPY to trade in a range between 132-135 owing to three key reasons:

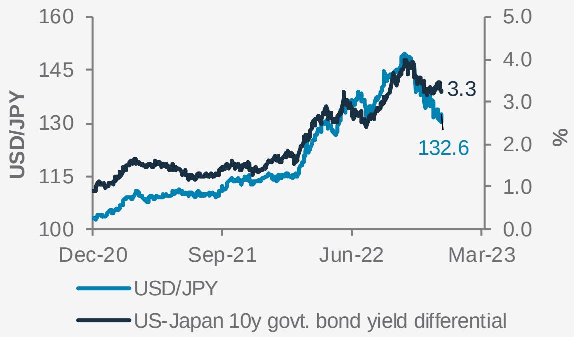
1. BoJ Governor Kuroda has repeatedly emphasised that the YCC adjustment in December was a one-off move to improve the functioning of the bond market. We expect the BoJ to reiterate an accommodative stance in its upcoming meeting on 18 January. This should temper market expectations of a swift pivot in the BoJ policy
2. BoJ increased its bond buying operations over the past few weeks. The differential between 10-year US and Japanese government bond yields has been a key driver for USD/JPY over the past two years and the recent decline in USD/JPY seems overdone relative to the interest rate differentials, especially when viewed in the context of our expectation of a near-term increase in US government bond yields.
3. From a technical perspective, USD/JPY is starting to appear as oversold, which would argue for a period of consolidation.

We see 134.65 followed by 137.30 as the next key resistances.

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

USD/JPY appears oversold, both technically and in terms of rate differentials; we expect the pair to trade in a range in the next 1-3 months

USD/JPY; US-Japan 10-year bond yield differential



Source: MSCI, FactSet, Standard Chartered

What is your outlook for Hong Kong & China equities?

We remain positive on Chinese equities. The speed of removal of mobility restrictions has taken markets by surprise given earlier expectations of a removal of restrictions by Q2-2023. Under these previous estimates, total consumption was expected to add 4.0-4.5ppt to GDP growth in 2023, versus an estimated c.1ppt in 2022. This estimate would most likely be higher now, as the GDP recovery has been brought forward by 6 months. On top of this, if urban households spend half of their excess savings accumulated from 2020-22 in 2023, this could add another 1ppt to annual GDP growth.

While the current surge in COVID-19 cases in Mainland China may impact short-term growth, the Hang Seng Index's short-lived break below key support at 19,380 intraday earlier this week was met with strong volume buying, twice the amount over the second half of December 2022, suggesting growth optimism beyond the immediate challenges. Major resistance for the index lies ahead at 22,200, where investors are more likely to lock-in some partial profit. We would consider adding around support levels at 19,300, followed by 18,400, with a focus on consumption sectors where we are overweight - communication services and consumer discretionary.

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

We see further upside in the Hang Seng index, with resistance at 22,200 level

Hang Seng Index

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Where would you opportunistically add to equity sectors today?

Since we published our Outlook 2023, China's communication services sector – one of the sectors we are overweight– has been the best-performing sector in China's rebounding equity market. We are also overweight consumer discretionary in China, which has performed in line over this period. In Europe, financials, our overweight sector, has also been the best-performing sector. However, our overweight in energy has underperformed a rising market. Meanwhile, in the US, our overweights in healthcare, staples and energy have performed in line with a slightly soft market.

Today, we see an opportunity to add to our two China overweight sectors, communication services and consumer discretionary. The communication services sector in China is dominated by media and entertainment companies that, along with discretionary, should benefit from a rebound in Chinese consumption. An increase in new COVID-19 infections would imply uneven growth in economic activity, but we believe these two sectors can continue to outperform over the next 6-12 months amid economic reopening and easing regulatory headwinds. In Europe, gains in the financials sector look technically stretched on our diversity indicators, which is why we would await a period of consolidation before considering adding further to the sector.

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

We expect China's communication services sector to continue outperforming the broader index, supported by economic reopening and easing regulatory headwinds

MSCI China Communication Services relative to MSCI China indices (rebased 4-Jan-2021=100)

Source: Bloomberg, Standard Chartered

What is the outlook for US Treasury yields after the latest Fed meeting minutes?

The Dec-22 FOMC minutes contained few surprises and were largely in line with Fed Chair Powell's post-meeting press conference. FOMC participants continued to see higher rates as appropriate and none anticipated a rate cut in 2023 without inflation edging towards their long-term target.

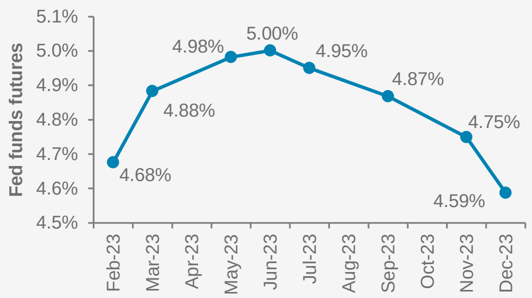
With the Fed likely to retain its tightening stance for now, we continue to see upside pressure on US bond yields over the next three months. A tight labour market and risks of rising non-shelter services inflation are also consistent with this view. Outside the US, the hawkish rhetoric of the ECB, the BoJ's hawkish policy shift and China's reopening should also support yields. Together, these factors cause us to continue to expect 10-year yields to test 3.75%-4.00% over the next three months.

However, by year-end, we expect the 10-year US government bond yield to drop to 3.25% as markets start to price in economic recession and the resulting lower policy rates. This view argues for taking advantage of any yield rebound in the near term to extend bond maturity profiles within high quality government and corporate bonds, especially in Asia USD bonds.

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

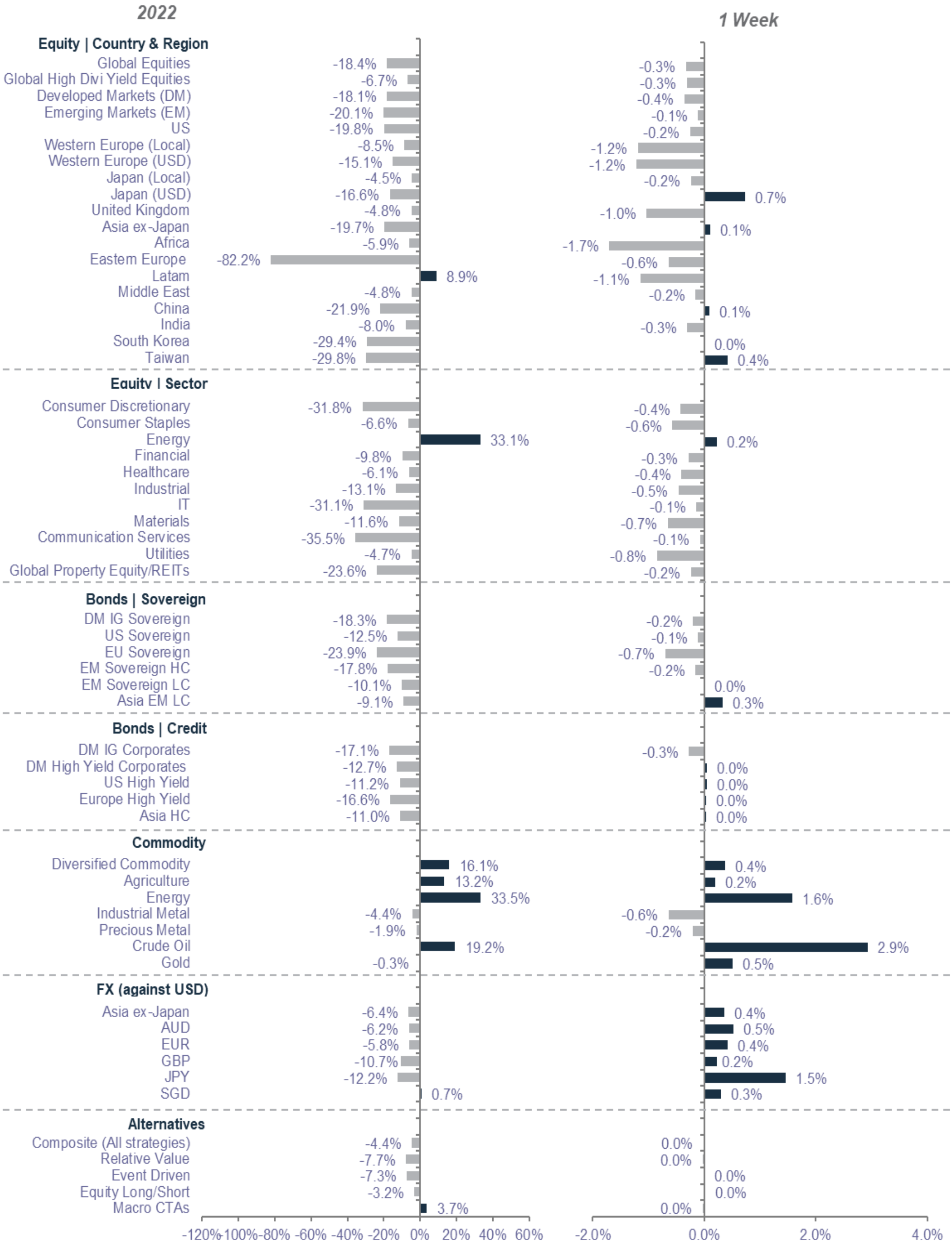
Money markets continue to price a peak Fed Funds Rate of 5% in June 2023

Fed funds futures implied rates



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 performance from 31 December 2021 to 31 December 2022; 1-week period: 29 December 2022 to 5 January 2023

Our 12-month asset class views at a glance

Asset class			
Equities	▼	**Preferred Sectors**	
Euro area	◆	US Energy	▲
US	◆	US Staples	▲
UK	◆	US Healthcare	▲
Asia ex-Japan	▲	Europe Energy	▲
Japan	▼	Europe Financials	▲
Other EM	◆	China Comm. Services	▲
		China Discretionary	▲
Bonds (Credit)	▲		
Asia USD	▲	**Alternatives**	◆
Corp DM HY	▼		
Govt EM USD	◆	**Gold**	◆
Corp DM IG	◆		
Bonds (Govt)	▲		
Govt EM Local	◆		
Govt DM IG	◆		

Source: Standard Chartered Global Investment Committee

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding

Economic and market calendar

	Event	Next week	Period	Expected	Prior
MON	EC	Sentix Investor Confidence	Jan	–	-21.0
	EC	Unemployment Rate	Nov	–	6.5%
	CH	Money Supply M2y/y	Dec	12.4%	12.4%
TUE	US	NFIB Small Business Optimism	Dec	91.3	91.9
WED					
THU	CH	PPI y/y	Dec	-0.1%	-1.3%
	CH	CPI y/y	Dec	1.8%	1.6%
	US	CPI y/y	Dec	6.7%	7.1%
	US	CPI Ex Food and Energy y/y	Dec	5.7%	6.0%
FRI/SAT	UK	Industrial Production y/y	Nov	–	-2.4%
	UK	Manufacturing Production y/y	Nov	–	-4.6%
	US	U. of Mich. Sentiment	Jan P	60.5	59.7
	CH	Exports y/y	Dec	-12.0%	-8.7%

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 next support for the S&P500 index is at 3,793

Technical indicators for key markets as of 05 January close

Index	Spot	1st support	1st resistance
S&P 500	3,808	3,793	3,838
STOXX 50	3,959	3,844	4,024
FTSE 100	7,633	7,512	7,694
Nikkei 225	25,973	25,762	26,139
Shanghai Comp	3,160	3,113	3,183
Hang Seng	21,044	20,200	21,470
MSCI Asia ex-Japan	641	627	649
MSCI EM	984	965	993
WTI (Spot)	79.4	76.2	84.3
Gold	1,838	1,823	1,854
UST 10y Yield	3.71	3.64	3.83

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 deteriorated in the past month

Our proprietary market diversity indicators as of 05 January

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.45
Global Equities	●	↓	1.59
Gold	◐	↓	1.40
Equity			
MSCI US	●	↑	1.85
MSCI Europe	◐	↓	1.29
MSCI AC AXJ	◐	→	1.49
Fixed Income			
DM Corp Bond	◐	↓	1.43
DM High Yield	◐	↓	1.42
EM USD	◐	↓	1.41
EM Local	◐	↓	1.32
Asia USD	●	→	1.54
Currencies			
EUR/USD	◐	↓	1.30

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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