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Wealth Management Chief Investment Office
4 November 2022

Weekly Market View

The Fed deflates another bear market rally

→ Market hopes of a Fed policy pivot were dashed yet again this week. As we expected, the Fed remains firm on turning its policy rate, now at a 14-year high of 4%, more restrictive until the spectre of inflation has been sustainably quashed.

→ Chair Powell signalled that the central bank's 4.75% terminal rate projection, upgraded only in September, is likely to be revised higher next month. Markets are pricing in a terminal rate of 5.25% by May 2023, up from 5% priced a week ago. Still higher rates, which likely raises the risk of a recession, means the equities rally since mid-October may be long in the tooth.

→ As another bear market rally fizzles, we gain confidence in our 3Rs strategy of rebalancing into investment grade corporate bonds, rotating into a diversified income allocation and risk managing via USD and higher-than-usual allocation to cash, while hedging inflation risks via energy sector equities.

Is the S&P500 index likely to continue outperforming the Nasdaq 100 index?

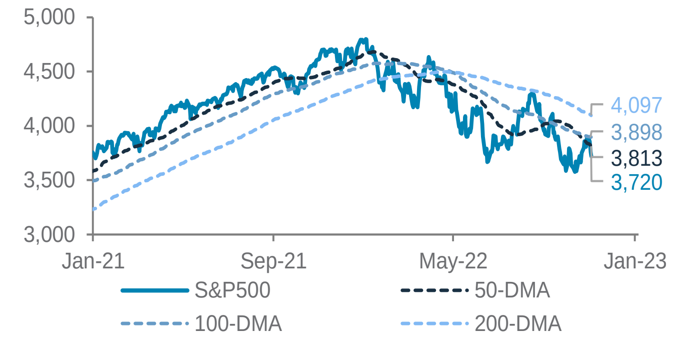
Have we seen the bottom in Chinese equities yet?

What are the implications of the latest Fed meeting on US bond yields and the USD?

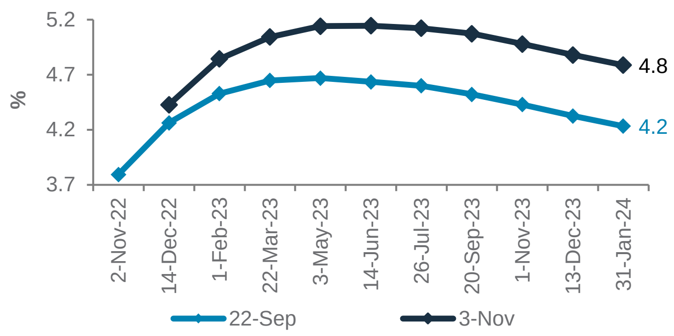
Charts of the week: Bear market rally fizzles as Fed stays hawkish

The US S&P500 index pulled back from a key resistance after Fed Chair Powell reiterated plans to continue raising rates

S&P500 index, with 50-, 100- and 200-day moving averages



Money market expectations of the Fed's median policy rate*



Source: Bloomberg, Standard Chartered; *03 Nov was the day after the latest Fed meeting, 22 Sep was the day after the previous Fed meeting

Editorial

The Fed deflates another bear market rally

Market hopes of a Fed policy pivot were dashed yet again this week. As we expected, the Fed remains firm on turning its policy rate, now at a 14-year high of 4%, more restrictive until the spectre of inflation has been sustainably quashed. Chair Powell signalled that the central bank's 4.75% terminal rate projection, upgraded only in September, is likely to be revised higher next month. Markets are pricing in a terminal rate of 5.25% by May 2023, up from 5% priced a week ago. All this means the equities rally since mid-October may be long in the tooth. As another bear market rally fizzles, we gain confidence in our 3Rs strategy of rebalancing into investment grade corporate bonds, rotating into a diversified income allocation and risk managing via USD and higher-than-usual allocation to cash, while hedging inflation risks via energy sector equities.

When will the Fed turn and when will bond yields peak? History suggests the US 10-year government bond yield peaks just before the Fed rate hiking cycle tops out. Going by this week's surprisingly strong US job openings data and Fed comments, we are likely to see that peak only in H1 2023. Even as some areas of US economic activity starts to slow - as signalled by the near-stagnation in US ISM Manufacturing PMI data - the Fed will need to be sure that the US job market is cooling enough to dampen wage pressures and services sector inflation. Unfortunately, data this week showed that the services sector activity, which accounts for more than two-thirds of US output, while slowing, remains robust. US households have over USD 2trn of savings, which they are deploying for services consumption as life normalises after two years of the pandemic. The robust job market is adding fuel to this consumption trend.

Friday's payrolls data is the next focus. The consensus estimates around 195,000 net new jobs were added in October. That rate of job creation is twice what is needed to maintain the current jobless rate around the 50-year low of 3.5%. The Fed expects the jobless rate to surge to 4.4% by the end of next year, which implies that it anticipates a significant slowdown in the economy over the coming year as tighter monetary policy starts to bite with a lag. A resolutely hawkish Fed in the face of slowing growth suggests the US corporate earnings growth estimate (5% for 2023) has further downside. The S&P500 has pulled back from its 100-DMA resistance, below the prior support of 3,800. The next technical supports are around 3,660 and 3,570.

We believe the prudent course for investors in this scenario is to stay defensive and follow the 3Rs strategy:

Rebalance into Investment Grade corporate bonds in Developed Markets and Asia and some deeply undervalued equity markets such as Asia ex-Japan and the UK.

Rotate into high-quality income assets. Decade-high yields from the bonds segment of our model multi-asset income strategy (yielding c.7%) are likely to more than offset any near-term price declines as Fed rates rise further. The high dividend equities segment, which accounts for almost a quarter of the model allocation, remains more resilient than broader equities – the Global High Dividend equities index is down 14% YTD vs 23% drop in global equities. This segment offers the opportunity to collect attractive dividends, while staying invested in quality companies and awaiting an eventual Fed pivot likely next year.

Risk-manage through cash/cash-like assets and the USD, which would provide dry powder to pick up assets as the rising risk of a recession means more assets go on sale in the coming months. Energy sector equities can provide an inflation hedge.

What we are watching: a) US mid-term elections on 8 Nov: Republicans are most likely to win control of the House, if not also the Senate. A Republican-controlled Congress would constrain President Biden's ability to respond fiscally in a recession. b) US inflation (10 Nov): at 6.6%, the consensus expects no change in core CPI from September's 40-year high.

— Rajat Bhattacharya

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as negative for risk assets in the near term.

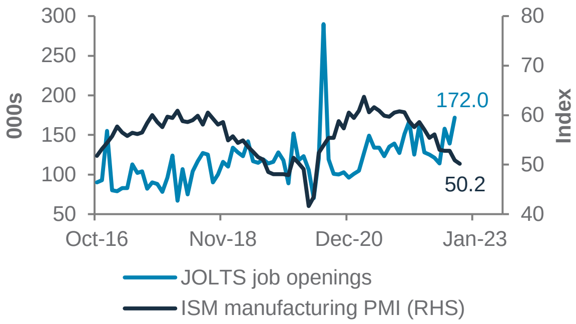
(+) factors: US manufacturing still expanding, still-positive Euro area GDP growth

(-) factors: Hawkish Fed, strong US job market, weaker-than-expected US services PMI, weak China PMIs, record Euro area inflation

	Positive for risk assets	Negative for risk assets
Macro data	• US ISM Manufacturing index fell less than expected at 50.2, new orders PMI was less contractionary at 49.2 • US core capital goods orders (non-defence, excluding aircraft) fell less than expected • Euro area Q3 GDP growth stronger than consensus	• US ISM services PMI was weaker than expected at 54.4 • US job openings surprisingly rose • China manufacturing and non-manufacturing PMIs fell more than expected, dipping below the contractionary level • Euro area consumer inflation rose more than expected • Euro area unemployment rate remained at record low of 6.6%
	Our assessment: Negative – Resilient US job market implies the Fed likely to stay hawkish for now; weaker-than-expected US services PMI, China PMIs; record high Euro area inflation	
Policy developments	• The RBA raised rates by 25bps as expected; forward guidance was more dovish than expected	• The Fed's Powell signalled higher terminal rates after delivering the fourth straight 75bps hike • The BoE raised rates by 75bps as expected, but signalled a slower pace of hikes going forward amid a deteriorating economic outlook
	Our assessment: Negative – Hawkish Fed policy guidance	
Other developments	• China National Development and Reform Commission met with US companies to discuss foreign investments	• North Korea fired one-day record number of ballistic missiles to protest against US and South Korea military drills
	Our assessment: Negative – Geopolitical tensions	

US job openings surprisingly rose in September, which is likely to keep the Fed hawkish for now, adding downward pressure on economic activity

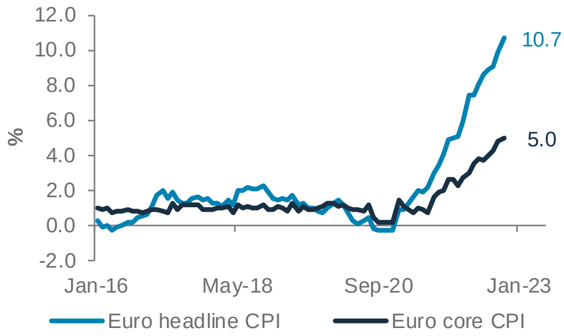
US JOLTS job openings, ISM Manufacturing PMI



Source: Bloomberg; Standard Chartered

Euro area inflation scaled a new record high in October, adding pressure on the ECB to continue raising rates even as economic growth slows

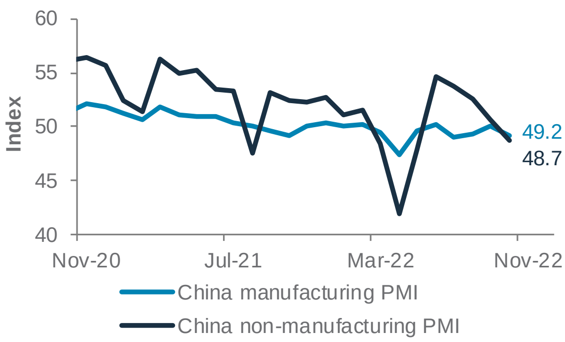
Euro area headline and core consumer inflation



Source: Bloomberg, Standard Chartered

China's business confidence indicators were surprisingly weak in October

China's manufacturing and non-manufacturing PMI



Source: Bloomberg, Standard Chartered

Top client questions

Is S&P500 likely to continue to outperform Nasdaq-100?

The technology, communication services and consumer discretionary sectors comprise c.80% of the Nasdaq-100 index and c.44% of the S&P500 index. These three sectors are dominated by technology and internet companies that have seen a significant valuation de-rating (albeit from relatively high levels) over the past year as interest rates moved to a higher regime, resulting in the Nasdaq-100's underperformance vs the S&P500. In addition, recent Q3 earnings have seen the most positive earnings surprises in the energy, healthcare and financial sectors. Discretionary and Communication sectors saw negative earnings surprises, while technology was in the bottom half in terms of earnings surprises. Hence, the earnings adjustments and expectations of further rate hikes (particularly given the Fed's hawkish message) are likely to favour the S&P500's outperformance over the Nasdaq-100 for now.

Within US equities, we prefer exposure to our preferred sectors of energy and healthcare, which have delivered the most positive Q3 earnings surprises. We still see room for energy stocks to catch up to their strong earnings performance, while healthcare equities are reasonably valued and provide defensive exposure in an uncertain macro environment. We also favour high dividend equities, as they tend to do well in an inflationary environment and have also outperformed both the S&P500 and Nasdaq-100 in the past year.

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

De-rating of technology and internet companies has led to Nasdaq underperforming the S&P500 index. However, high dividend equities have outperformed both indices in the past year

S&P500, Nasdaq-100 and MSCI ACWI High Dividend indices (Rebased to 3-Nov-2021=100)

Source: Bloomberg, Standard Chartered

Have we seen the bottom in Chinese equities yet?

We believe markets are offering attractive tactical opportunities in oversold Chinese large cap equities, as represented by the Hang Seng index. Positioning remains light and valuation remains cheap.

Technicals are positive. First, trading volume in the Hang Seng Index over the last 1.5 weeks has been nearly three times the normal volume in H2 2022. Volume is a useful indicator as it shows the level of activities. This indicates a significant change of hands in shares, in the area between 14,600 and 16,000. This strong indication of large-sized bargain hunting is likely to help stabilise Chinese equities. Moreover, on days where the index "opened at the highs, closed at the lows", there was relatively little volume, suggesting that the "selling power" was relatively limited on these bearish days.

Over the past two months, the following key drivers have also started to set up Chinese equities more positively, in our view: a) Earnings season this month – expectations are already low; b) Central Economic Work Conference in December 2022 – the authorities are expected to propose concrete actions to strengthen growth in line with stated policy goals. These are likely to be catalysts that bargain hunters are relying upon.

While we believe these fundamental drivers and the technical picture are more positive, risks include: a) US mid-term elections this month and b) the continued assessment with regard to auditing of Chinese companies listed in the US.

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

Cheap valuation continues to be a key supporting factor for Chinese equities

Price/earnings ratio: a) MSCI China index, and b) Ratio of MSCI China vs MSCI AC World indices

Source: FactSet, Standard Chartered

Top client questions (cont'd)

What are the implications of the latest Fed meeting on US bond yields and the USD?

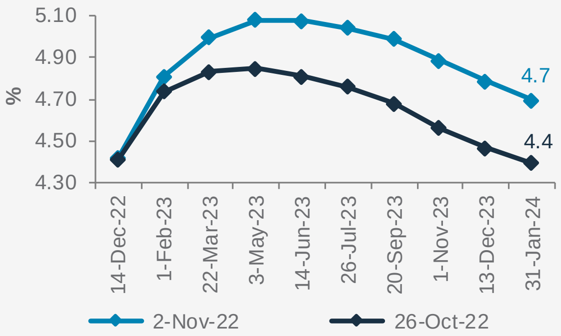
After yet another 75bps policy rate hike, Fed Chair Powell reiterated the Fed's singular focus on taming inflation and added that the terminal rate could be higher than its September estimates. He also hinted that the pace of rate hikes could slow as early as the next FOMC meeting. Over the next 1-3 months, we continue to expect US Government bond yields to maintain an upward bias as investors push back nascent expectation of an early Fed pivot and price a higher terminal rate (which markets now see at 5.25%). This is likely to keep the 10-year US Government bond yield above 4% for now, with technical resistance levels sitting initially at 4.136% and 4.212%. Our long-term (12-month) view of the modestly lower bond yields, to below 3.75%, though remains unchanged as tightening financial conditions start to shift the focus to recession risks.

For the USD, we believe this upward pressure on bond yields is consistent with our 1-3-month view of further USD strength. We expect the USD index (DXY) to rise c.3% to 115.8 over the next 1-3 months amid still-supportive rate differentials, global growth concerns and geopolitical worries.

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

Expectation of the Fed's terminal rate has moved higher and further out after the November policy meeting

Money market expectations of the Fed's policy rate



Source: Bloomberg, Standard Chartered

Is there any change to your Asia USD bond view amid surging credit events in North Asia?

This week, key person risk escalated among Chinese private-owned developers. Senior management resignations are often interpreted as credit-negative developments, and within Asia USD bonds, the JACI Real Estate index bore the brunt of these worries with a negative return of 11.4% in the last 5 trading days. In addition, a surprise default of a KRW-denominated onshore asset-backed security squeezed onshore KRW liquidity, resulting in a spike in KRW yields despite several stabilisation measures imposed by the regulators. The worries were, however, limited largely to onshore Korean markets, with the offshore Korean USD bonds sector remaining largely stable, outside of a limited sell-off in the riskier subordinated bonds sub-asset class.

However, we assess the impact of these credit events on the Asia USD bond asset class as relatively contained for now, given Chinese real estate and Korean bonds account for roughly 3% and 11% respectively of Asia USD bonds' market capitalisation. Hence, we retain our preference for Asia USD bonds at an aggregate level, and a relative preference for higher quality investment grade bonds within this asset class. We are much less constructive on the China USD property sector, with the sector likely to continue to face headwinds in the next 6-12 months. Contagion risks to Korean USD bonds are likely to be well contained, in our view, especially if regulatory stabilisation efforts continue.

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

The surprise Korea onshore bond default has had a limited effect on the offshore bond market

Yield premium on JPMorgan Asia Credit Index (JACI) and Korea USD bonds

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

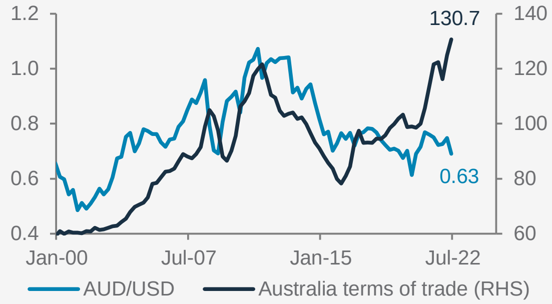
What is your latest view on the AUD?

AUD/USD has weakened recently in the face of USD strength and is currently hovering around the support level of 0.63. We expect the AUD to weaken modestly further to 0.62 levels in the next 1-3 months in view of the relatively less hawkish stance by the RBA. This week, the central bank increased its benchmark interest rate by 25bps, as expected. This means the rate differential vs. the USD is likely to keep downward pressure on the AUD for now. Nonetheless, one of the key takeaways from Governor Lowe's speech this week was his hint that the RBA is leaving an option open for adjusting the pace of rate hikes in need. In addition, the central bank highlighted in its policy statement that major tailwinds existed for an upward bias on inflation, mostly due to "global factors", but added domestic demand was "also playing a role". We believe, in the next 12 months, factors such as global inflation, a relatively strong economic growth in Australia, a weaker USD following a Fed policy pivot and China's reopening would support AUD/USD towards our 12-month target of 0.66.

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

We expect AUD/USD to move higher in the next 6 to 12 months to catch-up with Australia's strong Terms of Trade

AUD/USD and Australia's Terms of Trade (quarterly)



Source: Bloomberg, Standard Chartered

What is the implication for the real estate sector post the FOMC meeting?

The Fed's hawkish rhetoric poses upside pressure on interest rates, which is a headwind for the real estate equity sector. The global real estate equity sector is down close to 30% YTD. Sharply higher mortgage rates are translating into lower affordability and reduced demand for property, putting downward pressure on property prices globally. To put this in perspective, US 30-year mortgage rates more than doubled from 3.2% to 7.2% since the beginning of this year. By some estimates, every 1% move up in mortgage rates is associated with a 10% decline in home sales. The 30-year mortgage rate has risen almost 400bps since January. Monthly pending home sales slumped 30% y/y in September to the lowest since the height of the pandemic and even worse than the sales reported during the Global Financial Crisis. Eventually slower employment growth will be an additional pressure on home prices. This is, however, mitigated by still low housing inventory relative to pre-pandemic levels, slowing pace of construction and existing homeowners being disincentivised to sell given 90% of them enjoy lower 30-year mortgage rates than the rate today. That said, downside risk to home prices will persist so long as the Fed continues to keep rates high and tolerates higher unemployment in order to rein in inflation.

For the rest of the world, where mortgages are typically shorter-tenure loans (1-3 years), there could be greater downside risks as affordability bites with higher mortgage rates. Hong Kong property has already fallen 8% since the beginning of this year. We have a less preferred view on the publicly-listed real estate sector globally.

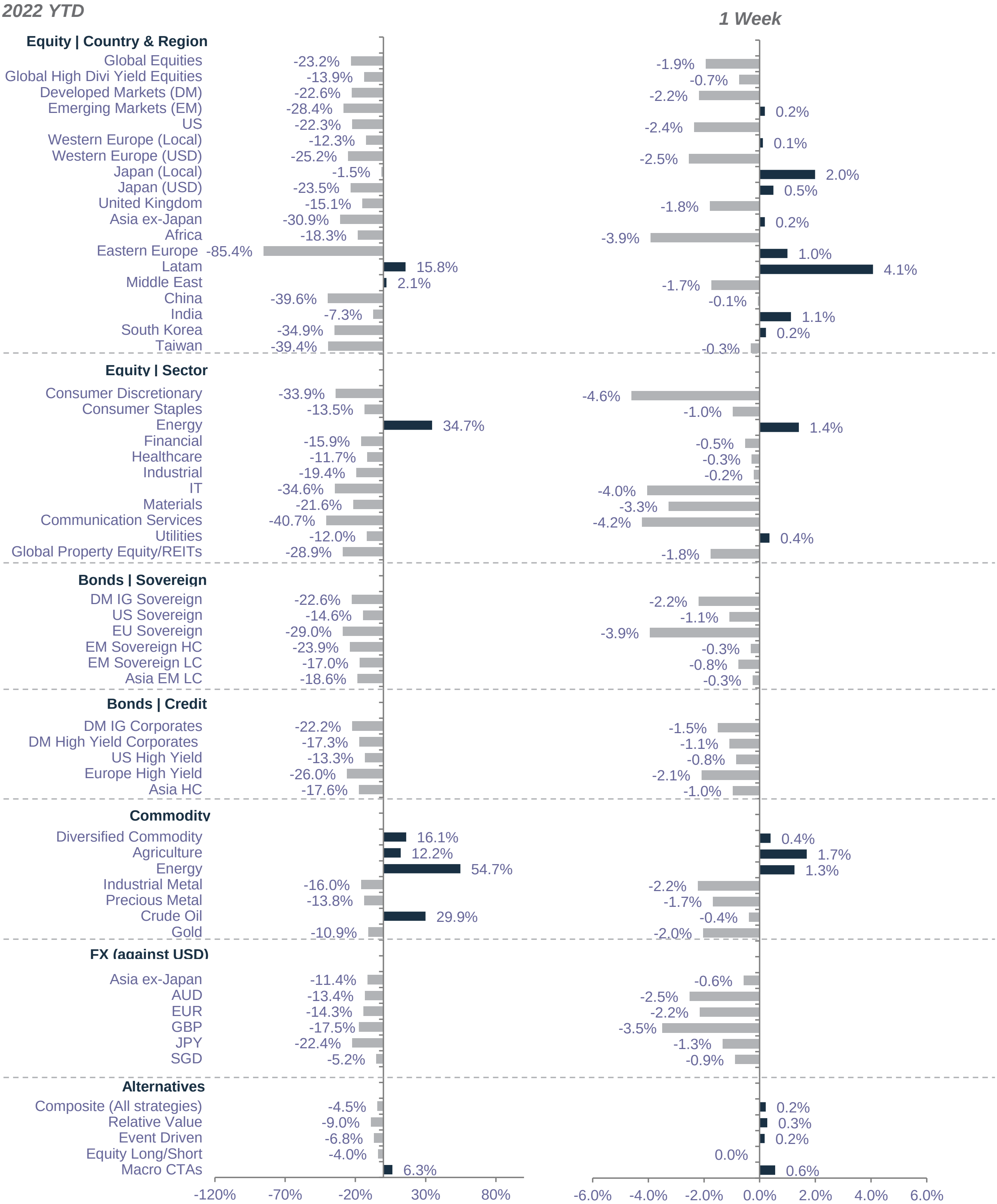
— **Audrey Goh,** *Head, Asset Allocation and Thematic Strategy*

The publicly-traded global real estate equity sector has underperformed broader equity markets over the past year

Relative performance of MSCI All Country World Index and the MSCI World Real Estate 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 03 November 2022; 1-week period: 27 October 2022 to 03 November 2022

Our 12-month asset class views at a glance

Asset class			
Equities	◆	**Alternatives**	◆
Euro area	▼	Equity hedge	◆
US	◆	Event-driven	▼
UK	▲	Relative value	▼
Asia ex-Japan	▲	Global macro	▲
Japan	◆		
Other EM	◆	**Cash**	▲
		USD	◆
Bonds (Credit)	◆	EUR	◆
Asia USD	▲	GBP	◆
Corp DM HY	◆	CNY	◆
Govt EM USD	◆	JPY	▲
Corp DM IG	▲	AUD	▲
		NZD	◆
Bonds (Govt)	▼	CAD	◆
Govt EM Local	▼		
Govt DM IG	▼	**Gold**	◆

Source: Standard Chartered Global Investment Committee

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

Economic and market calendar

	Event	Next week	Period	Expected	Prior
MON	EC	Sentix Investor Confidence	Nov	–	-38.3
	CH	Exports y/y	Oct	4.3%	5.7%
		UN Climate Change Conference 2022 (UNFCCC COP 27)			
TUE	US	Mid-Term Elections			
	EC	Retail Sales y/y	Sep	–	-2.0%
	US	NFIB Small Business Optimism	Oct	–	92.1
WED	CH	PPI y/y	Oct	-1.6%	0.9%
	CH	CPI y/y	Oct	2.4%	2.8%
	CH	Money Supply M2 y/y	Oct	12.0%	12.1%
THU	US	CPI y/y	Oct	8.1%	8.2%
	US	CPI Ex Food & Energy y/y	Oct	6.6%	6.6%
FRI/SAT	UK	GDP y/y	3Q P	–	4.4%
	UK	Industrial Production y/y	Sep	–	-5.2%
	US	U. of Mich. Sentiment	Nov P	60.0	59.9

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

Next support for the S&P500 index is at 3,660

Technical indicators for key markets as of 03 November close

Index	Spot	1st support	1st resistance
S&P 500	3,720	3,660	3,841
STOXX 50	3,593	3,574	3,632
FTSE 100	7,189	7,095	7,236
Nikkei 225	27,200	26,977	27,551
Shanghai Comp	3,071	2,952	3,130
Hang Seng	16,231	15,198	16,755
MSCI Asia ex-Japan	534	524	543
MSCI EM	861	847	874
WTI (Spot)	96.6	95.3	97.3
Gold	1,647	1,635	1,653
UST 10y Yield	4.14	4.05	4.18

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 narrowed for equities and bonds

Our proprietary market diversity indicators as of 03 November

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.34
Global Equities	◐	→	1.47
Gold	◐	→	1.54
Equity			
MSCI US	◐	↓	1.55
MSCI Europe	◐	↓	1.42
MSCI AC AXJ	◐	↓	1.28
Fixed Income			
DM Corp Bond	◐	↓	1.36
DM High Yield	◐	↓	1.63
EM USD	◐	↓	1.53
EM Local	◐	↓	1.52
Asia USD	◐	↓	1.50
Commodities			
WTI Crude Oil	●	↑	1.43

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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