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Wealth Management Chief Investment Office
23 September 2022

Weekly Market View

The Fed leads yields higher, stocks lower

→ The US Federal Reserve took another decisive step this week to burnish its inflation-fighting credentials as it signalled an aggressive pace of rate hikes in the coming months. In doing so, we believe it has raised the odds of a US recession to 75% in the next 12 months.

→ As we have flagged in recent months, the near-term implications are likely significant. By the end of the year, we expect the 10-year US government bond yield to rise towards 4%, the 2-year yield to rise above 4.5% and the USD to strengthen further, resulting in a further drawdown in equities.

→ We prefer a three-pronged approach (the '3 Ds') to mitigate the impact for investors: 1. **De-risking** of allocations; 2. **Diversifying** into less volatile USD-denominated Investment Grade corporate bonds; and 3. Increasing exposure to other income assets, including consistently high **dividend** paying equities.

Given the hawkish Fed stance, is it the right time to invest in income generating assets?

What are the implications of the latest Fed decision for equity investors?

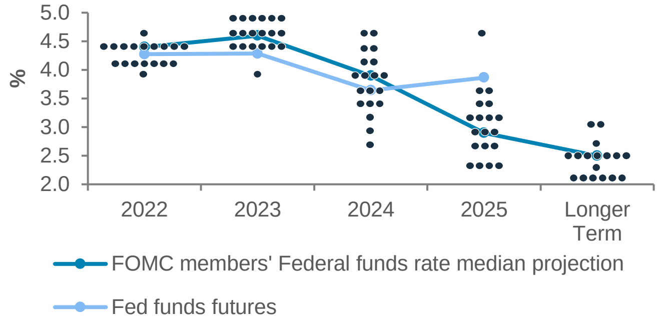
What is the outlook for Emerging Market currencies, given USD strength?

Important disclosures can be found in the Disclosures Appendix.

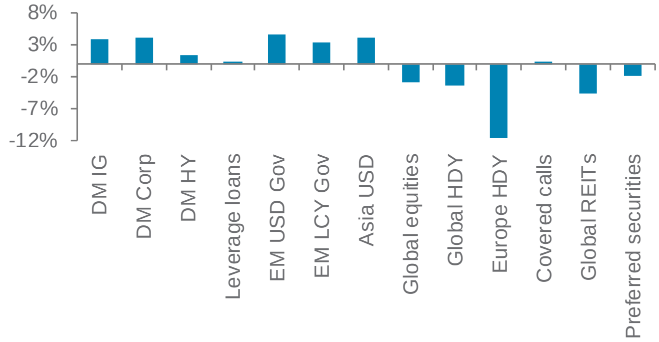
Charts of the week: Where to seek refuge as the Fed keeps hiking

Asia USD and Developed Market bonds have historically provided attractive returns during similar regimes

Fed and money market estimates of the Fed policy rate*



12m asset returns in a falling-growth, rising-inflation regime**



Source: Bloomberg, Standard Chartered; *dots represent Fed member forecasts; **global economic regimes identified by BCA Research (2005-21)

Editorial

The Fed leads yields higher, stocks lower

The US Federal Reserve took another decisive step this week to burnish its inflation-fighting credentials as it signalled an aggressive pace of rate hikes in the coming months. In doing so, we believe it has raised the odds of a US recession to 75% in the next 12 months. As we have flagged in recent months, the near-term implications are likely significant. By the year end, we expect the 10-year US government bond yield to rise towards 4%, the 2-year yield to rise above 4.5% and the USD to strengthen further, resulting in a further drawdown in equities.

The Fed, besides delivering its third consecutive 75bps rate hike, projected the benchmark rate to rise 125bps in the remaining two meetings of this year and another 25bps next year to a peak of 4.75%. Almost a third of the Fed's 19 policymakers are more hawkish, projecting the so-called 'terminal' rate at 5% next year. That is steeper than the 4.5% money markets were pricing for the peak rate going into this week's Fed meeting. The main message from the Fed was that it is willing to sacrifice growth to soften the US job market and accept an unemployment rate above its 4% long-term target so that it can sustainably bring down inflation towards its 2% goal.

As higher rates eventually lower growth and inflation, the central bank expects to cut rates in 2024, a year later than previous market expectations. At his press conference, Fed Chair Powell gave three conditions for pausing or slowing the pace of rate hikes: below-trend growth, softer labour markets and clear evidence that inflation is moving back to 2%. Based on the latest projections, while growth is expected to remain below trend until 2024 - driving up the unemployment rate to 4.4% by next year – inflation is not expected to return to the 2% target until 2025. This week's lower-than-expected jobless claims is only likely to embolden the Fed. This portends higher-for-longer rates, in our view, which is likely to tighten global financial conditions, especially with the ECB and the BoE also hiking rates (the BoE delivered a 50bps hike this week to a 14-year high of 2.25%, even as it warned that the UK economy likely contracted again in the July-September quarter).

We prefer a three-pronged approach (the '3 Ds') to mitigate the impact for investors: 1. **De-risking** of allocations by reducing exposure to equities and government bonds, which are among the most vulnerable to rising rates; 2. **Diversifying** into less volatile and high quality USD-denominated Investment Grade corporate bonds in Asia and the Developed Markets (DM), which now carry the added attraction of paying the highest yields in a decade; and 3. Increasing exposure to other income assets, including a basket of consistently high **dividend** paying equities, which tend to outperform in high inflation regimes.

Within equities, the de-risking could start with reducing exposure to Euro area equities, especially with the rising risk of another Russian incursion into Ukraine. There is also the risk of Russia cutting off oil supplies after having already sharply cut gas supplies to Europe. Meanwhile, the US S&P500 index, which entered a bear market this week for the second time this year, is likely to test June's intra-day low of 3,637. Momentum indicators show US stocks are oversold in the near-term, but a break below June's lows could lead to a test of 3250-3540. Stocks in Asia ex-Japan and UK offer much better value, in our view, given their 28% and 45% price-to-earnings discount vs. US equities. Asia ex-Japan stocks have the added advantage of a steady stream of policy stimulus from Mainland China. Next week's China business confidence indicators (PMIs) will be closely watched for signs of further economic recovery.

Asia and DM USD-denominated corporate bonds are our top picks in bonds given their relatively low volatility and yields above 5%, which are likely to cushion against further rise in government bond yields. These bonds have historically delivered some of the highest returns in an environment of slowing growth and rising inflation (see chart above). They also provide exposure to the rising USD, which we expect to strengthen further in the next 3 months, despite Japan's FX intervention to revive the JPY. History suggests unilateral FX interventions provide only a short-term respite, but underlying fundamentals (rate differentials) prevail over the medium term.

— 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: Easing China lockdowns, Euro area fiscal support

(-) factors: Hawkish Fed, ECB and BoE; Ukraine crisis

	Positive for risk assets	Negative for risk assets
COVID-19	• Chengdu and Dalian lifted lockdowns • Hong Kong planned to relax travel curbs; China expressed support for Hong Kong easing	
	Our assessment: Positive – Easing China lockdowns	
Macro data	• US housing starts rose more than expected • Uni. of Michigan inflation expectations trended lower • US jobless claims were lower than expected	• Michigan consumer sentiment weaker than consensus • US Housing Market index fell more than expected • Japan consumer inflation stronger than expected
	Our assessment: Neutral – Strong US housing starts and job market, lower inflation expectations vs weak consumer sentiment	
Policy developments	• Germany agreed to nationalise gas importer Uniper for EUR 29bn and earmarked USD 2.5bn for LNG purchases to avoid shortages; the Netherlands unveiled a support package for households • BoJ held rates, announced unscheduled bond buying to cap yields and intervened in the FX markets to bolster the JPY	• Fed hiked rates by 75bps and signalled another 125bps hike by end-2022 • BoE hiked rates by 50bps, while the Swiss National Bank hiked by 75bps • PBoC held loan prime rate constant • ECB's Lagarde signalled more hikes over coming meetings
	Our assessment: Neutral – Euro area fiscal policy support, BoJ intervention vs hawkish Fed, ECB, BoE policies	
Other developments		• Russia mobilised 300,000 reservist troops and renewed nuclear threat over Ukraine
	Our assessment: Negative – Escalation of the Russia-Ukraine conflict	

The Fed raised its US inflation, unemployment and rates forecasts and cut its growth estimates

Fed's macroeconomic forecasts, September vs June

	GDP		Unemploy-ment		Core PCE		Rates estimates	
Dates	Old	New	Old	New	Old	New	Old	New
2022	1.7	0.2	3.7	3.8	4.3	4.5	3.4	4.4
2023	1.7	1.2	3.9	4.4	2.7	3.1	3.8	4.6
2024	1.9	1.7	4.1	4.4	2.3	2.3	3.4	3.9
2025		1.8		4.3		2.1		2.9

Source: Bloomberg; Standard Chartered
Old - June projections; New - September projections

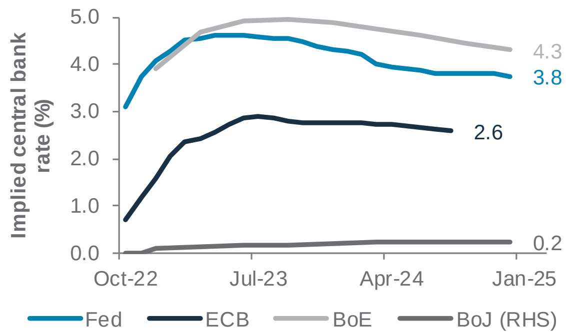
US housing starts rebounded in August, but the trend remains downward amid rising rates

US housing starts

Source: Bloomberg, Standard Chartered

BoE rates are expected to rise just above Fed rates over the next two years, but the ECB and BoJ rates are expected to lag behind

Money market estimates of Fed, ECB, BoE and BoJ policy rates over the next two years



Source: Bloomberg, Standard Chartered
Fed rate estimates are derived from Fed Fund Futures, while others are based on 3m futures

Top client questions

Given the hawkish Fed stance, is it the right time to invest in income generating assets?

By any count, the latest Fed meeting was a hawkish one. Fed guidance not only pointed to faster and higher rates than previously expected, but also highlighted its willingness to sacrifice growth to curb inflation.

Having said that, in our assessment, the level of long-term bond yields suggest markets are being pulled in opposite directions by the risk of a hawkish Fed and downside risks to growth. In this context, we expect the 10-year bond yield to rise towards 4% by the end of the year, before falling back towards the 3.5-3.75% range by the end of Q3 2023. Corporate bond yields across most major regions are trading close to their highest level in over a decade.

Additionally, history shows high dividend equities tend to outperform broader equity markets during periods of high inflation as their high dividend yield and generally lower P/E ratios make them less vulnerable to the impact of rising interest rates.

Together, these factors argue that while timing the peak in yields remains difficult, we believe risk/reward across bond and dividend yield equities are increasingly attractive to start adding exposure as part of income generation strategies.

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

Most higher yielding corporate and Emerging Market bonds now offer sufficient yield cushion to offset any decline in prices as a result of up to 1% rise in yields over a 12-month period

Simulated total returns of fixed income assets assuming different shifts in bond yields

		EM USD Govt	DM HY	EM LCY Govt	Asia USD	FRNs	DM IG Corp	DM IG Govt
Yield to maturity		8.7%	9.4%	7.0%	6.7%	7.2%	4.9%	2.7%
Duration		6.8	4.4	5.0	4.6	0.3	7.8	7.1
Change in yield*	-1.5%	18.9%	16.0%	14.4%	13.5%	7.6%	16.6%	13.4%
	-1.0%	15.5%	13.8%	12.0%	11.3%	7.5%	12.7%	9.8%
	-0.5%	12.1%	11.6%	9.5%	9.0%	7.3%	8.8%	6.3%
	0.0%	8.7%	9.4%	7.0%	6.7%	7.2%	4.9%	2.7%
	0.5%	5.3%	7.2%	4.5%	4.4%	7.1%	1.0%	-0.9%
	1.0%	1.9%	5.0%	2.0%	2.2%	7.0%	-2.9%	-4.4%
	1.5%	-1.5%	2.8%	-0.4%	-0.1%	6.8%	-6.8%	-8.0%

Source: Bloomberg, Standard Chartered
*Simulated returns are calculated assuming a parallel shift across the whole bond yield curve; yields as of 21 September

What are the implications of the latest Fed rate decision for equity investors?

A continued rise in the Fed policy rate poses a risk to equity markets because higher interest rates lead investors to apply a higher 'discount' to future corporate earnings, putting pressure on equity valuations. The rising rates come against the backdrop of faltering technical indicators - the S&P500 index has already broken below the 3,900 support level. Key support now sits at 3,637, which is the year-to-date intraday low reached in June. We believe it may be difficult to break that level in the short term as momentum indicators such as the RSI are already at heavily oversold levels. However, a scenario where the 3,637 level breaks could open the door to the S&P500 testing its next key support zone between 3,250 and 3,540.

This backdrop notwithstanding, we note that high-dividend equities outperform broader equity markets during rising inflation regimes due to their consistent earnings and income generation potential. We retain our sectoral preference for the energy sector globally, which continues to lead in terms of earnings. We also retain our preferred stance on UK equities due to the market's high exposure to defensive sectors and high dividend yields relative to global equities.

— **Michelle Kam,** *Investment Strategist*

The next key support level for the S&P 500 index is at 3,637

S&P 500 Index

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

USD/CNH recently rose past 7. How will this affect China equities?

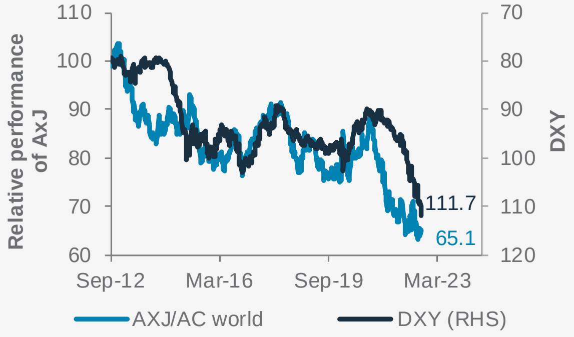
The CNH has weakened against the USD within the context of broad USD strength. Historically, a strong USD has been a headwind to Asia ex-Japan equities, including China equities. This is likely linked to capital flows, where a strong USD has been correlated with a flow of capital out of Emerging Markets and back towards the US. For Hong Kong-listed Mainland China equities trading in HKD (which, in turn, is pegged to the USD), the currency translation impact from a weaker CNH is also a headwind on HKD-denominated share prices. A stronger USD could also raise the cost for companies reliant on imported raw materials and energy.

On the other hand, MSCI China equities have a heavy domestic focus, generating 87% of their revenue domestically. As such, the majority of MSCI China companies are less exposed to currency fluctuations. Instead, government policies and China's economic growth have a greater bearing on MSCI China equities. The investor base for onshore China equities is also strongly biased towards domestic Chinese investors. With China at a phase where policy is turning more stimulatory (as opposed tighter policies in the US and Europe), we continue to expect China equities to outperform global equities on a 12-month horizon.

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

Broad USD strength has historically been a headwind to Asia ex-Japan equities, including China equities

Relative performance of MSCI Asia ex-Japan to MSCI AC World and the US dollar DXY index (inverted axis)



Source: Bloomberg, Standard Chartered

What is the outlook for EM currencies given the USD strength?

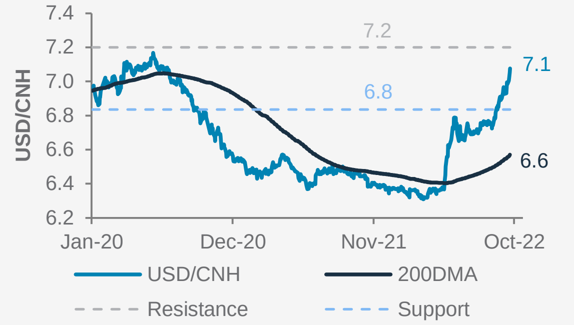
The USD surged to a fresh 20-year high after the Fed raised rates by 75bps and projected further hikes at upcoming meetings. Yield differentials continue to favour the USD, which, in turn, has been a key headwind for EM currencies this year. We believe that the USD uptrend has not exhausted itself, suggesting these headwinds could continue for EM currencies in the near term.

USD/CNH broke above the key psychological level of 7.00 last week. While the PBoC is likely to continue efforts to slow currency weakness, by setting stronger daily reference rates and cutting FX reserve requirements, for example, these are unlikely to be sufficient to completely reverse the current downtrend in the CNH. The next key resistance for the USD/CNH sits at 7.20. USD/SGD is also back above 1.42, a level last seen in 2020. The MAS is likely to continue tightening policy at its October meeting amid continued inflationary pressures in Singapore, offering further support to the SGD. Against the backdrop of a stronger USD, we believe USD/SGD is likely to be range-bound near-term, with support at 1.390 and resistance at 1.442.

— **Nataniel Tang,** *Investment Strategist*

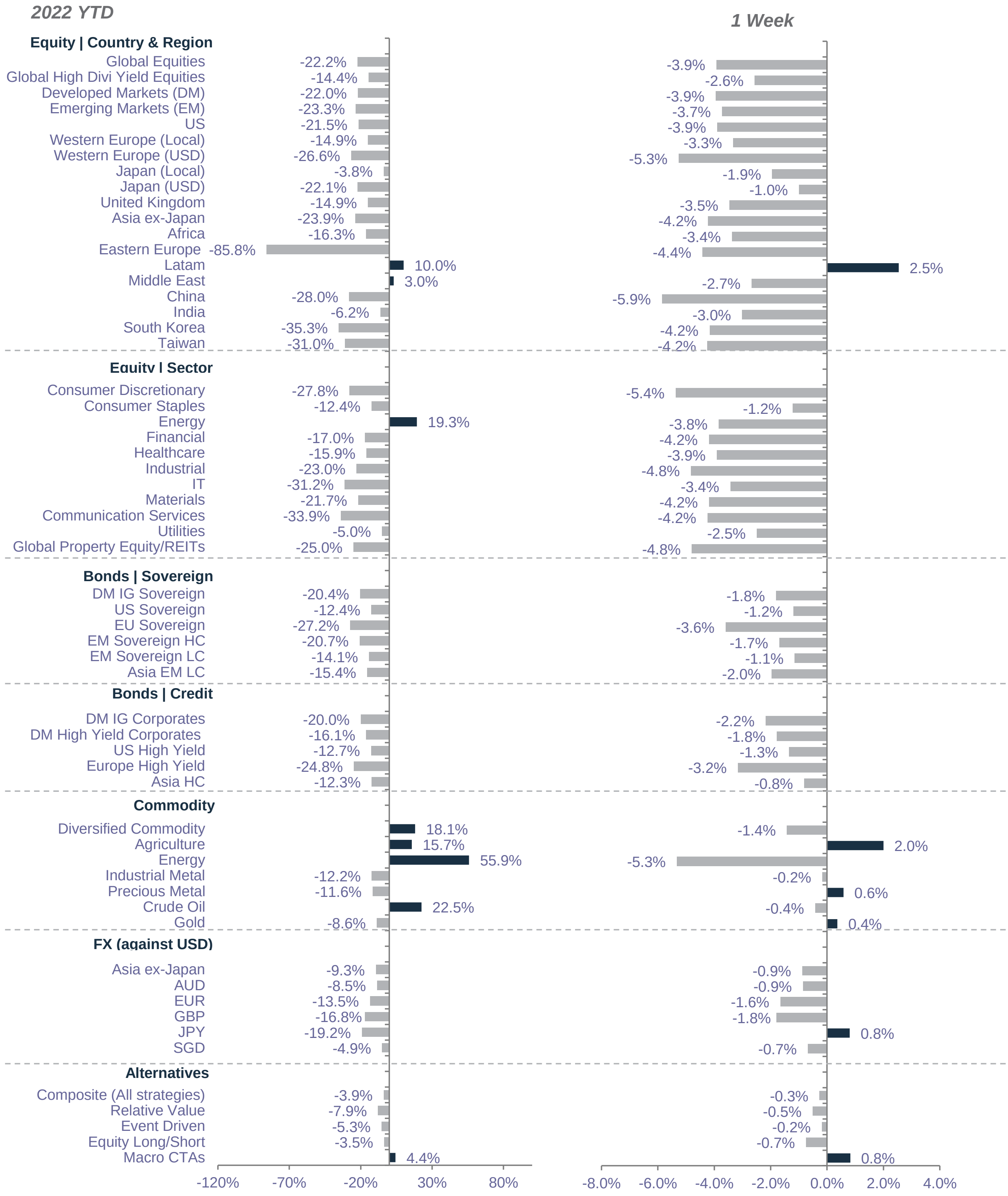
USD/CNH continues to trend higher towards key resistance at 7.2

USD/CNH with technical levels



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 22 September 2022; 1-week period: 15 September 2022 to 22 September 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	US	Chicago Fed Nat Activity Index	Aug	–	0.27
TUE	US	Conf. Board Consumer Confidence	Sep	104.0	103.2
WED					
THUR					
FRI/SAT	CH	Manufacturing PMI	Sep	49.2	49.4
	CH	Non-manufacturing PMI	Sep	52.3	52.6
	CH	Caixin China PMI Mfg	Sep	–	49.5
	EC	Unemployment Rate	Aug	–	6.6%
	EC	CPI Estimate y/y	Sep	–	9.1%
	EC	CPI Core y/y	Sep P	–	4.3%
	US	Personal Income	Aug	0.2%	0.2%
	US	PCE Deflator y/y	Aug	–	6.3%
	US	PCE Core Deflator y/y	Aug	4.8%	4.6%
	US	MNI Chicago PMI	Sep	51.9	52.2

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 resistance for the US 10-year bond yield is at 3.8%

Technical indicators for key markets as on 22 September

Index	Spot	1st support	1st resistance
S&P 500	3,758	3,711	3,853
STOXX 50	3,427	3,403	3,476
FTSE 100	7,160	7,133	7,212
Nikkei 225	27,154	26,976	27,510
Shanghai Comp	3,109	3,103	3,121
Hang Seng	18,148	17,937	18,570
MSCI Asia ex-Japan	589	583	601
MSCI EM	923	915	938
Brent (ICE)	90.5	89.5	91.7
Gold	1,672	1,666	1,677
UST 10y Yield	3.71	3.54	3.80

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 remains reasonably high across assets

Our proprietary market diversity indicators as of 22 September

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↓	1.55
Global Equities	●	→	1.77
Gold	◐	↓	1.30
Equity			
MSCI US	●	↓	1.58
MSCI Europe	●	↓	1.70
MSCI AC AXJ	◐	↓	1.47
Fixed Income			
DM Corp Bond	●	↓	1.64
DM High Yield	●	↑	2.33
EM USD	●	↓	2.00
EM Local	●	↑	1.85
Asia USD	●	→	1.73
Commodities			
EUR/USD	◐	→	1.38

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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