Wealth Management Chief Investment Office
24 March 2023

Weekly Market View

The Fed
versus markets

→ US rate cuts are coming – that's the memo from the markets, even as Fed Chair Powell stuck to his message of remaining focussed on curbing inflation despite the banking sector turmoil. Markets are now expecting more than 75bps of rate cuts by the end of the year versus the Fed's latest projection foreseeing no cuts.

→ We side more closely with the markets, especially after the recent stresses among small US banks which are likely to tighten bank lending conditions further, even though the liquidity crunch appears to have dissipated for now.

→ Our US recession indicators, except for two market-based ones - equities and credit spreads - point towards increased risk of a recession this year. That suggests both equities and High Yield bonds are under-pricing recession risks.

Given this, we would continue to rebalance from equities and High Yield bonds, especially in the US, into high grade USD bonds, with a preference for Asia.

Are the US and European financial sectors stabilising after the recent liquidity and confidence boosting measures?

Do you see further downside to US government bonds yields after the latest Fed meeting?

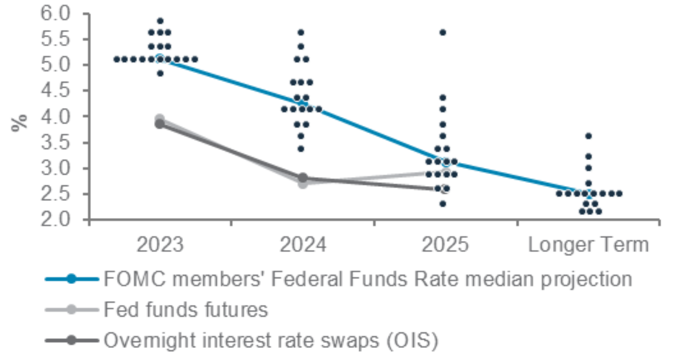
Should we switch away from the CHF as a funding currency?

Important disclosures can be found in the Disclosures Appendix.

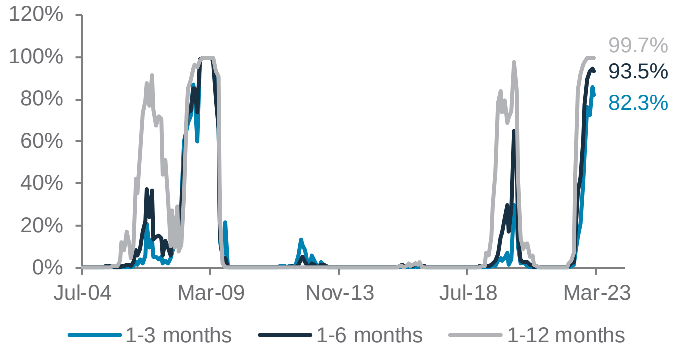
Charts of the week: Investors are not buying the Fed narrative

Markets are expecting the Fed to cut rates by more than 75bps by the end of this year as the economy enters a recession

Market estimates of Fed rates vs Fed's own projections



Our recession probability model: Recession in 3m, 6m, 12m



Source: Bloomberg, Standard Chartered

Editorial

The Fed versus markets

US rate cuts are coming – that's the memo from the markets, even as Fed Chair Powell stuck to his message of remaining focussed on curbing inflation despite the banking sector turmoil. Markets are now expecting more than 75bps of rate cuts by the end of the year versus the Fed's latest projection (and Powell's statement) foreseeing no cuts. We side more closely with the markets, especially after the recent stresses among small US banks which are likely to tighten bank lending conditions further, even though the liquidity crunch appears to have dissipated for now. Our US recession indicators, except for two market-based ones (equities and credit spreads), point towards increased risk of a recession this year. That suggests both equities and HY bonds are under-pricing risks. Given this, we would continue to rebalance from equities and HY bonds, especially in the US, into high grade USD bonds, with a preference for Asia.

The message from the Fed this week, as it raised its benchmark rate to a 15-year high of 5.0%, was clear: while the two recent bank failures have tightened financial conditions, the central bank remains focussed on bringing inflation, still running above 5%, back down towards its 2% target. As a result, Fed policymakers are prepared to tighten some more, ending the year with a policy rate of 5.0-5.25%, so that US GDP growth slows to well below the 1.8% long-term trend. The growth slowdown is seen to lift the jobless rate almost 1 percentage points (ppt) to 4.6% by the end of 2024, slightly above the 4% mark that the Fed considers as the long-run optimal jobless rate required to keep inflation in check. Despite these, it expects inflation to fall back closer to its 2% target only by 2025.

The Fed's benign soft-landing scenario challenges the lessons from the past 60 years, which suggests that when the unemployment rate rises, it usually shoots up at least 2ppt. The median recession since the 1960s, excluding the COVID recession of 2020, resulted in a 3ppt increase in the jobless rate and 1.8ppt decline in GDP, with the recession lasting an average of 10 months. Regardless of the nature of a recession, a downturn seems more imminent than even a month ago. Our quant model is indicating 90% chance of a recession in the next 6 months, with our more subjective view not far behind at 80% in the next 12 months. As a result, the US bond yield curve has steepened (2-year yield has fallen more sharply than 10-year yield) as investors price in rate cuts. Other signals include some early job market indicators, such as the first y/y fall in the hiring of temporary workers and y/y rise in jobless claims in this cycle. A segment of the US yield curve that Powell believes is the best indicator of a coming recession (spread between 3m T-bill yield in 18 months and the current 3m T-bill yield) has fallen to a new record low (below the levels at the onset of 2000 and 2008 recessions). Meanwhile, US money supply is contracting y/y for the first time in history as banks tightened lending conditions significantly even before the current turmoil hit the small banks.

To be sure, US and European authorities have taken forceful measures in recent weeks to reassure bank depositors that their savings are safe. As a result, money market measures of liquidity stress have eased significantly this week. US Treasury Secretary Yellen's comments suggested that authorities are open to the idea of temporarily guaranteeing all bank deposits at stressed lenders, if not the entire US banking system. Such reassurances and the latest liquidity boost could still lift risk assets in the very near term. However, the challenging 6-12-month outlook argues for investors to fade any such rally.

Investment implications: We remain defensive in our investment stance, preferring to rebalance from equities to income assets, including high grade Developed Market government bonds and Asia USD bonds, which are likely to be more resilient. We see further downside in the USD in the next three months, dragging the USD index (DXY) towards the next support around 100.75. Gold faces strong resistance around USD2,000/oz after a sharp rally, but we would continue to accumulate on any dips due to its safe haven characteristics.

— 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: Central bank liquidity boost, Credit Suisse rescue

(-) factors: Hawkish central banks, Credit Suisse junior debt write-down before equity

	Positive for risk assets	Negative for risk assets
Macro data	• US University of Michigan inflation expectations fell to the lowest since April 2021 • US existing home sales rose more than expected, bucking 12 months of decline	• US Michigan consumer sentiment fell unexpectedly • US new home sales fell more than expected • Euro area ZEW Survey growth expectations fell • UK inflation came in above expectations at 10.4% y/y
	Our assessment: Neutral – Recovering US home sales vs falling US consumer sentiment, Euro area growth expectations	
Policy developments	• Fed and five other central banks agreed to increase the frequency of USD swap line operations • ECB and BOE reassured markets that owners of junior bonds (AT1s) should bear losses only after shareholders • PBoC caught markets by surprise by cutting reserve requirement ratio by 25bps; kept 1-year and 5-year loan prime rates unchanged • BoJ played down immediate risks of a policy pivot	• Fed hiked rates by 25bps and said it was prepared to hike more, if needed, to subdue inflation, despite banking uncertainty • Swiss banking regulator ordered the write-down of Credit Suisse's junior (AT1) debt, while equity holders received some value from the UBS acquisition • US Treasury Secretary Yellen said the government was not considering a "blanket insurance" on deposits, but stands ready for further steps if required • ECB's Lagarde kept open the prospect of more hikes as inflation is "still high" • BoE hiked rates by 25bps
	Our assessment: Neutral – Central bank liquidity boost vs hawkish rates outlook	
Other developments	• UBS acquired Credit Suisse, which involved the SNB providing liquidity assistance and loss guarantees	• France strikes intensify as anger mounts over Macron's proposed retirement age hike
	Our assessment: Positive – A global bank rescued	

The Fed's new projections point to slower growth, higher inflation and a higher jobless rate over the next two years and a rate cut only in 2024

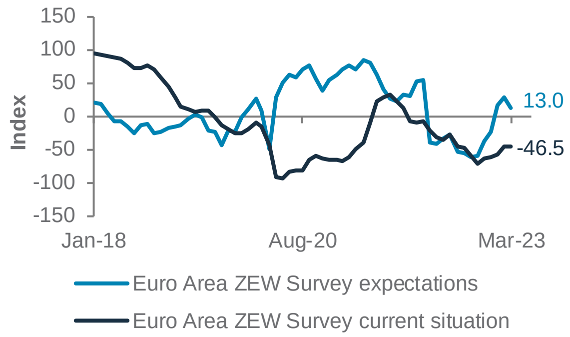
The Fed's new economic projections

	GDP		Unemployment		Core PCE		Rates estimates	
Dates	**Old**	**New**	**Old**	**New**	**Old**	**New**	**Old**	**New**
2023	0.5	0.4	4.6	4.5	3.5	3.6	5.1	5.1
2024	1.6	1.2	4.6	4.6	2.5	2.6	4.1	4.3
2025	1.8	1.9	4.5	4.6	2.1	2.1	3.1	3.1
LR*	1.8	1.8	4.0	4.0			2.5	2.5

Source: Bloomberg; Standard Chartered
*Longer Run
Old - Dec projections, **New** - Mar projections

Euro area growth expectations surprisingly fell

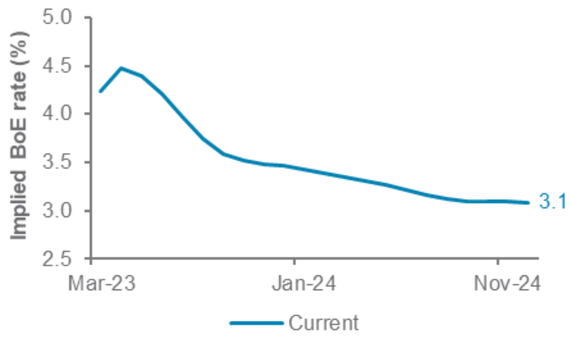
Euro area growth expectations and current sentiment, according to ZEW survey



Source: Bloomberg, Standard Chartered

Money markets expect the BoE to keep hiking rates until September, before cutting early next year

Money market estimates of BoE policy rates until 2024



Source: Bloomberg, Standard Chartered

Top client questions

Are the financial sectors in the US and Europe stabilising after the recent liquidity and confidence-boosting measures?

It was yet another volatile week for the banking sector, with the UBS-Credit Suisse merger over the weekend shifting the focus towards the European banking sector. The Swiss regulator's decision to write down CHF 16bn of Additional Tier-1 (AT1) bonds was the largest such write-down in the relatively short history of the asset class and triggered a sharp knee-jerk reaction. However, we believe that the peak of European banking sector worries are likely behind us.

Over the past few days, authorities from multiple jurisdictions, including the ECB, BoE, MAS and HKMA, have publicly stated that they would respect the hierarchy of the capital structure, indicating that, unlike the SNB, they would impose losses on equity holders before asking bondholders to take losses. These statements boosted market sentiment and we have seen AT1 bond prices recover partially over the past few trading sessions. Arguably, investors will demand an additional risk premium for holding AT1s. While this suggests credit spreads are unlikely to return to early-March levels, we do view today's yields on the broader high quality financials subordinated debt asset class as attractive and would consider using the opportunity to add exposure.

Meanwhile, credit spreads for senior unsecured bonds for European banks is largely unchanged, indicating limited fears of a full-blown banking sector crisis. In the US, while we believe more work needs to be done to improve confidence in regional banks, we are unlikely to see widespread contagion, given bonds from regional banks account for a very small fraction of the overall universe.

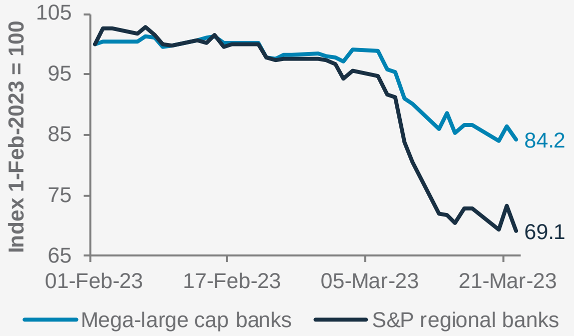
Within financial sector equities, we continue to see an opportunity in the US "mega-large cap" financials sub-sector. Relative to regional banks, they have stronger liquidity profiles and much less exposure to unrealised losses on high-quality assets held to maturity. Many of them have significant retail deposits, which tend to be sticky and are likely to grab market share on the back of this turmoil. M&A activity is beginning to rebound from the current trough in this market, while equity and debt capital markets activity are likely to rebound from historic lows, benefitting "mega-large cap" financials with revenue exposure in these areas.

European financials could face more difficulties in raising capital in the near term given the dent in confidence in the AT1 bond sub-asset class. However, we see strategies that make use of high equity volatility in European financials as more attractive at this time.

— **Daniel Lam,** *Head, Equity Strategy*
— **Abhilash Narayan,** *Senior Investment Strategist*

Mega-Large Cap banks sold off in sympathy with issues surrounding regional banks

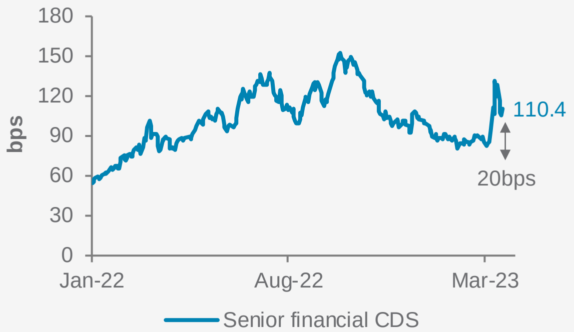
Performance of Mega-Large Cap banks and regional banks, rebased to 100, as of 01-Feb-23



Source: Bloomberg, Standard Chartered

Credit derivatives market signal limited signs of stress in the European Senior bank bond market

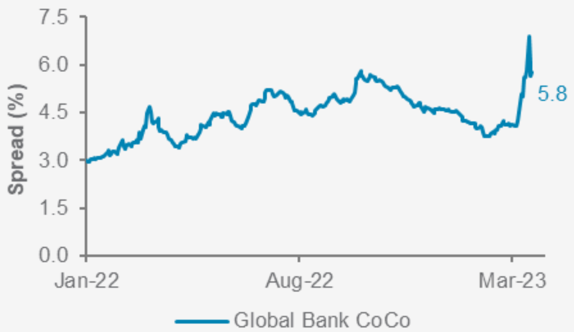
iTraxx Senior Financial 5-year CDS spread



Source: Bloomberg, Standard Chartered

The yield premium on most junior bank debt* is unlikely to return to early-March levels

Yield premium on global bank Contingent Convertible bonds (CoCos)* over US government bonds



Source: Bloomberg, Standard Chartered
*See explanatory note on page 9

Top client questions (cont'd)

Do you see further downside to US government bond yields after the latest Fed meeting?

The Fed hiked policy rate by another 25bps to 5%, as expected. In its statement, the median Fed Funds target rate for 2023 remained unchanged at 5.125% and the phrase "ongoing increases in interest rate" was dropped and replaced by "some additional policy firming may be needed". Markets interpreted this as a relatively dovish signal; money markets moved to price the start of rate cuts as soon as September and the US government bond yield curve steepened as the fall in shorter-maturity yields outpaced longer-maturity yields.

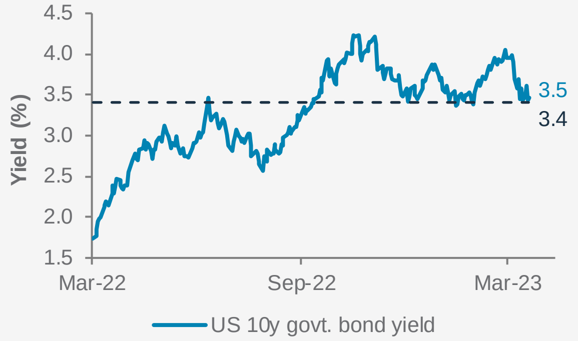
Although the fall in the 10-year yield was relatively small (c.10bps), we believe risks continue to be tilted to the downside. First, bond volatility is likely to remain elevated given the recent turbulence in the financial sector. In addition, lending conditions are likely to tighten as regional US banks focus on capital preservation, further tightening overall financial conditions and slowing growth. Third, our macro indicators still point towards a recession ahead. Lastly, technical charts show the 10-year yield remains within the descending channel from March, with support at ~3.4%.

Against this backdrop, we believe adding to high-quality income assets continue to be attractive. We would use any rebound in bond yields as an opportunity to add to our preferred income assets, including Asia USD bonds.

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

The 10Y US government bond yield is testing key support at ~3.4%

US 10-year government bond yield



Source: Bloomberg, Standard Chartered

How is China's corporate earnings season shaping up?

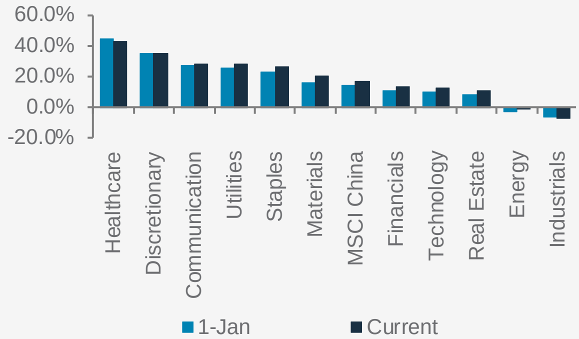
Earning reports in China typically come out later than in the US and Europe. About 60% of the Hang Seng index members have reported earnings for 2022 so far. In aggregate, reported sales and earnings have been lower than expected, following the negative trend seen in companies' pre-announcements of results. The consensus estimates MSCI China index earnings declined 0.5% in 2022, compared with an expected growth of 1.0% at the start of the year.

However, the outlook for 2023 has nudged up, with 16.6% earnings growth expected vs 14.6% expected at the start of the year. This improvement is observed broadly across 9 out of 11 sectors, underpinned by China's economic reopening and the removal of mobility restrictions. There are signs of consumption recovery, with consumer services gaining demand and digital advertising improving, although sales of home appliances and consumer electronics linked to the property market are still sluggish. Regulatory pressures in the media and entertainment segments are easing, supporting growth there, while loan growth has accelerated YTD. We expect China's earnings recovery to continue in 2023, supporting the outperformance of China equities over the next 6-12 months.

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

2023 earnings growth expectations in China have nudged up since the start of the year, with improvement seen in 9 out of 11 sectors

Consensus expectations of earnings growth by sectors in MSCI China, as of 1-Jan-2023 and currently



Source: MSCI, FactSet, Standard Chartered

Top client questions (cont'd)

Should we switch away from CHF as a funding currency?

USD/CHF volatility has spiked over the past two weeks following banking system stress in the US and Switzerland. While the Fed chose to hike rates by 25bps, the SNB stuck to a 50bps hike, despite facing greater domestic banking sector scrutiny. In contrast to Fed Chair Powell, SNB President Jordan struck a hawkish tone, guiding towards further rate hikes and indicating that the SNB would be willing to sell FX reserves in order to support the CHF, if necessary.

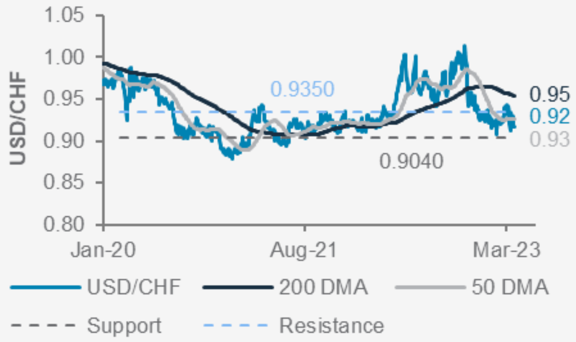
Given this backdrop, we see a risk of further CHF strength over the next few weeks, with 0.9040 being the key support for USD/CHF. However, CHF gains are likely to prove temporary on a longer 3-12-month horizon. This suggests short-term CHF strength would make it more attractive as a funding currency. Tactically, we also believe USD/JPY looks oversold and risk/reward favours positioning for a move higher should the pair fall below 130, a view we would take with a tight stop-loss at 128.4. Such a move below 130 would make the JPY more attractive as a funding currency.

These views notwithstanding, we would note that (i) FX markets are no longer trending as they were in 2022 and (ii) our bearish 3- and 12-month USD view implies it will become increasingly challenging to find attractive funding currencies, where gains from lower borrowing cost are not offset by borrowing currency strength. Hence, implementing tight stop-losses and maintaining discipline will be key to implementing FX views from a funding perspective.

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

CHF is likely to remain supported near-term after the 50bps SNB hike and hawkish guidance

USD/CHF, with key technical levels



Source: Bloomberg, Standard Chartered

Do you expect further downside in oil prices?

WTI crude oil fell from a high of USD 80.5/bbl to as low as USD 66.7/bbl over the past two weeks. This was likely driven by:

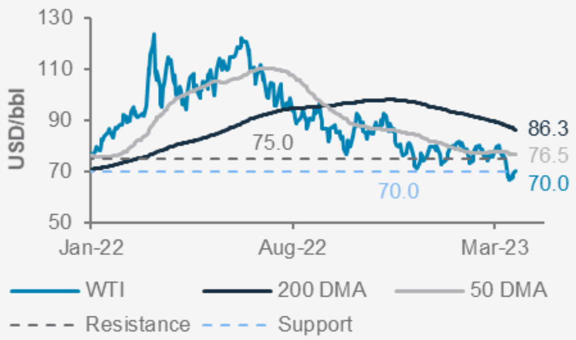
1. Risk-off selling triggered by growing concerns over the health of the economy and financial system.
2. Reports suggested selling from banks seeking to manage the risks of put options placed by oil producers around USD 70/bbl and USD 75/bbl also were a contributor.
3. Trend-following commodity strategies likely accelerated the fall.
4. The IEA and OECD both warned about a short-term crude oil surplus due to the resiliency of Russian exports.

Given these drivers, we believe the recent drop is more technical in nature and therefore likely temporary. A blowing over of the banking sector stress is likely to improve risk sentiment. The US Department of Energy is also likely to take advantage of lower prices at some point to replenish the US Strategic Petroleum Reserve (SPR). These suggest prices are likely to bounce back above USD 70/bbl.

— **Zhong Liang Han, CFA,** *Investment Strategist*

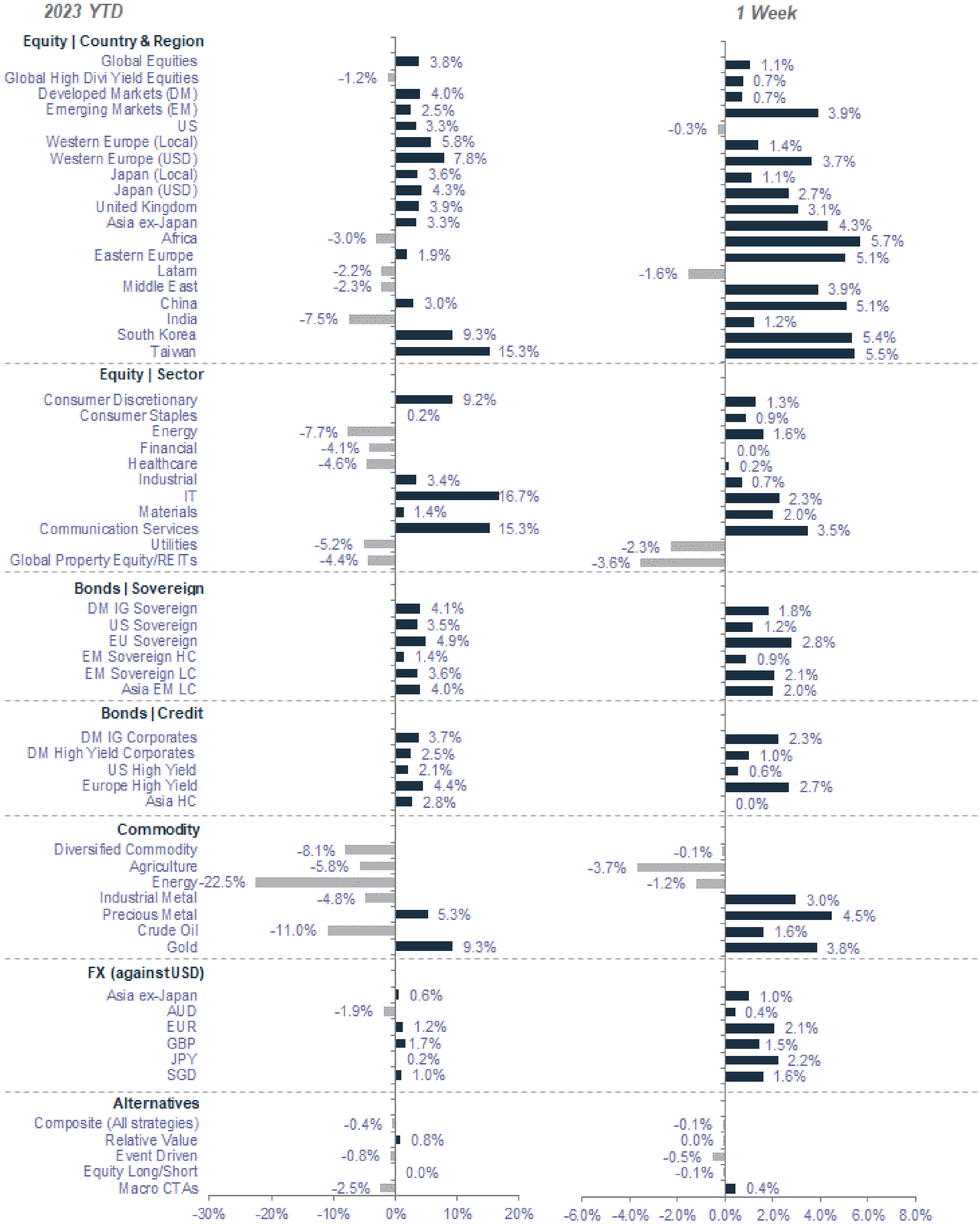
Oil prices have started to steady after the risk-off drop as the market focus returns to fundamentals

WTI crude oil



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, 2023 YTD performance from 31 December 2022 to 23 March 2023; 1-week period: 16 March 2023 to 23 March 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	M3 Money Supply y/y	Feb	–	3.5%
TUE	US	Conf. Board Consumer Confidence	Mar	101.5	102.9
WED					
THU	EC	Economic Confidence	Mar	–	99.7
FRI/SAT	CH	Manufacturing PMI	Mar	–	52.6
	CH	Non-manufacturing PMI	Mar	–	56.3
	EC	Unemployment Rate	Feb	6.6%	6.7%
	EC	CPI Estimate y/y	Mar	7.5%	8.5%
	EC	CPI Core y/y	Mar P	5.8%	5.6%
	US	Personal Income	Feb	0.3%	0.6%
	US	Real Personal Spending	Feb	-0.1%	1.1%
	US	PCE Deflator y/y	Feb	–	5.4%
	US	PCE Core Deflator y/y	Feb	4.7%	4.7%
	US	MNI Chicago PMI	Mar	43.6	43.6
	EC	ECB's Largarde speaks in Florence			

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 US 10-year bond yield is at 3.37%

Technical indicators for key markets as of 23 March close

Index	Spot	1st support	1st resistance
S&P 500	3,949	3,909	3,996
STOXX 50	4,207	4,112	4,255
FTSE 100	7,500	7,368	7,599
Nikkei 225	27,420	27,088	27,609
Shanghai Comp	3,287	3,247	3,307
Hang Seng	20,050	19,350	20,399
MSCI Asia ex-Japan	639	621	648
MSCI EM	978	953	990
WTI (Spot)	70	68	72
Gold	1,993	1,944	2,018
UST 10y Yield	3.43	3.37	3.55

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 healthy across asset classes

Our proprietary market diversity indicators as of 23 March

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	1.65
Global Equities	●	↑	1.72
Gold	◐	↑	1.38
Equity			
MSCI US	●	↑	1.84
MSCI Europe	◐	↑	1.49
MSCI AC AXJ	●	↑	1.81
Fixed Income			
DM Corp Bond	●	↑	1.66
DM High Yield	●	↑	1.84
EM USD	●	↑	2.24
EM Local	◐	↑	1.49
Asia USD	●	↑	1.64
Currencies			
EUR/USD	●	↑	1.52

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

Explanatory notes

*1. Contingent Convertibles are complex financial instruments and are not a suitable or appropriate investment for all investors. This document is not an offer to sell or an invitation to buy any securities or any beneficial interests therein. Contingent convertible securities are not intended to be sold and should not be sold to retail clients in the European Economic Area (EEA) (each as defined in the Policy Statement on the Restrictions on the Retail Distribution of Regulatory Capital Instruments (Feedback to CP14/23 and Final Rules) ("Policy Statement"), read together with the Product Intervention (Contingent Convertible Instruments and Mutual Society Shares) Instrument 2015 ("Instrument", and together with the Policy Statement, the "Permanent Marketing Restrictions"), which were published by the United Kingdom's Financial Conduct Authority in June 2015), other than in circumstances that do not give rise to a contravention of the Permanent Marketing Restrictions.

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