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Wealth Management Chief Investment Office
16 September 2022

Weekly Market View

The heat is on

→ Markets this week were unsettled by yet another hot US inflation report. The S&P500 index is testing a major support at 3,900 and the US 10-year government bond yield is testing key resistance at 3.5%.

→ We believe the US inflation report has cemented the chance of a third straight 75 bps Fed rate hike next week. Money markets now expect the Fed's benchmark rate to peak at 4.5% next March vs. 3.6% projected a month ago.

→ European governments, led by the UK, have added fuel to the medium-term inflation outlook by providing fiscal support to offset the impact of rising energy costs. This is likely to raise ECB and BoE terminal interest rates.

→ In this report, we discuss how investors can mitigate downside risks and even benefit from these trends.

What is your view on US equities after the inflation report?

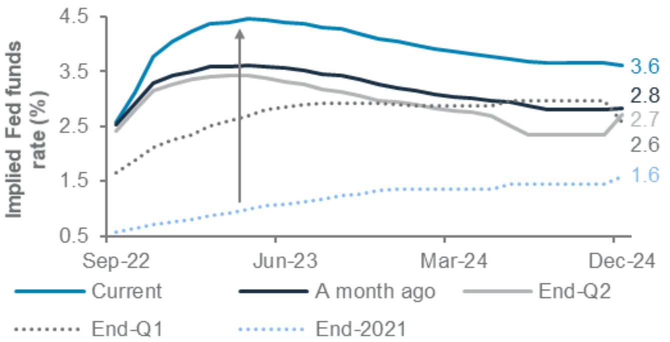
What is your rationale for upgrading Developed Market Investment Grade bonds?

What is your outlook for the USD and how should investors position themselves?

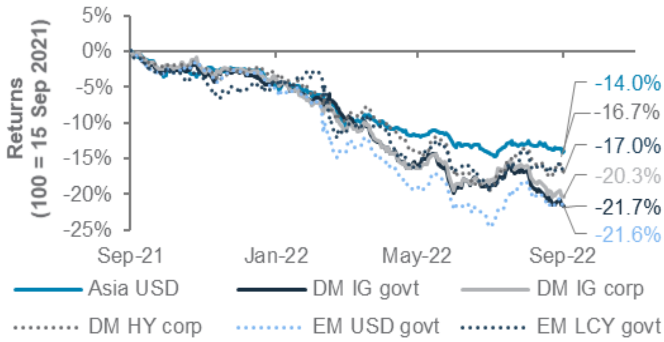
Charts of the week: Inflation continues to unsettle markets

The expected Fed terminal rate has surged, hurting risk assets; Asia USD bonds have held up better than other bonds

Money market estimates of Fed rates over the next two years



One-year relative performance of major bond asset classes



Source: Bloomberg, Standard Chartered

Editorial

The heat is on

Markets this week were again unsettled by yet another hot US inflation report. The S&P500 index is testing a major support at 3,900 (next support 3,700) and the US 10-year government bond yield is testing resistance at 3.5% (followed by 3.68%). Stocks and bonds both fell after US headline and core inflation in August beat estimates to stay near 40-year highs, dousing hopes that slowing inflation would enable the Fed to slow the pace of rate hikes. Instead, we believe the inflation report has cemented the chance of a third straight 75 bps Fed rate hike next week. Money markets now expect the Fed's benchmark rate to peak at 4.5% next March vs. 3.6% projected a month ago. That implies the Fed is expected to hike by almost the same extent over the next six months as it did over the past six.

European governments have added fuel to the medium-term inflation outlook by providing fiscal support to offset the impact of rising energy costs. UK PM Liz Truss's first economic decision after taking charge last week was to cap household energy bills for the next two years at an estimated cost of GBP 150-200bn. The European Union is likely to follow suit. While these plans should curtail near-term inflation in Europe, they are likely to boost household disposable income and, in turn, keep medium-term inflation pressures elevated. This raises the chances of higher BoE and ECB terminal policy rates. Thus, next week's BoE meeting (where it is expected to raise rates by 75bps) will be closely watched. Money markets are pricing a peak BoE rate of 4.5% by June 2022 vs. 3.25% a month ago.

As highlighted here in recent weeks, the increasingly hawkish policy stance of the Fed, ECB and BoE and tighter financial conditions have increased the odds of a recession. We agree with the consensus that the Euro area faces a higher risk of a recession than the US (the consensus expects the Euro area to start contracting from Q4). Business confidence indicators (PMIs) for September, due next week, will thus be scrutinised for signs of further weakness after they signalled stagnation in Euro area activity in July and August. The deteriorating outlook is a key headwind for risk assets.

For investors, we believe the answer is not to cut all exposure (cementing YTD "paper losses") and run to the supposed "safety" of cash, since such a move will hurt long-term wealth accumulation as high inflation erodes the purchasing power of cash. Instead, we believe investors will be better served by de-risking towards a more balanced allocation (adding exposure to higher quality bonds and other income assets such as high dividend equities which outperform in high-inflation periods) and focussing on some of the least expensive equity markets. In our view, Asia USD bonds - an overwhelmingly Investment Grade bond category yielding over 6%, but with lower volatility than other bonds - and historically inexpensive Asia ex-Japan and UK equities offer such qualities. Asian assets should also benefit from China's economic recovery (see page 3). Earlier this month, we also upgraded Developed Market Investment Grade bonds to a core holding – the bonds offer 4.8% yield, the highest in a decade. The attractive yield premiums should cushion against rising government bond yields (see page 4).

Maintaining a diversified allocation has the advantage of benefitting from any upturn in risk assets. A possible upside could come from any cessation of hostilities in Ukraine, after Ukraine troops regained control of key cities from the Russian army. In this scenario, which seemed a pipedream just a couple of weeks ago, energy prices could plunge, lowering inflation and enabling central banks to turn dovish. Risk assets, led by the EUR and European assets, could surge in this scenario. This would bring an end to the USD rally. EUR/USD needs to break above 1.0350 to suggest the USD rally is fizzling.

The downside risk scenario entails Russia launching an air attack on Ukraine, having withdrawn its on-the-ground troops. If this is accompanied by a Russian halt in oil and gas supplies, it could reignite H1's market trends i.e. bearish for both stocks and bonds, bullish for energy assets and the USD. EUR/USD could then fall below key support of 0.9850. For now, we expect EUR/USD and the broad USD to be range-bound and instead favour a bullish EUR/GBP view in the near term (see 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.

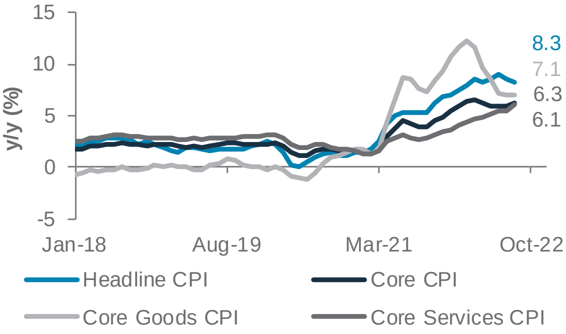
(+) factors: China data and policy support, contained China inflation

(-) factors: Hotter-than-expected US consumer inflation, weak Euro area growth expectations

	Positive for risk assets	Negative for risk assets
COVID-19	• Chengdu allowed residents to leave their homes; slight easing of Xinjiang lockdown • Hong Kong further eased its travel policy	• Some areas in Beijing have been locked down
	Our assessment: Positive – Easing China lockdowns	
Macro data	• China retail sales, industrial output beat estimates; consumer/producer inflation lower than expected • US retail sales unexpectedly rose • US producer inflation rose less than expected • UK unemployment fell to the lowest since 1974 • UK consumer inflation softer than expected	• US consumer inflation hotter than expected • UK July GDP missed consensus • Euro area growth expectations (ZEW) fell below forecast
	Our assessment: Neutral – Improving China retail sales and industrial output, contained inflation vs hot US inflation	
Policy developments	• China authorities eased crackdown on gaming • BoJ checked exchange rates, which is usually a precursor to FX intervention • BoJ committed more bond purchases to cap yields	• More hawkish commentary from Fed officials • IEA sees biggest China oil demand drop in three decades • China held medium-term lending facility rate constant
	Our assessment: Neutral – China, BoJ policy support vs hawkish Fed comments	
Other developments	• Ukraine forces regained control of more eastern and southern cities • President Xi made his first overseas trip in almost three years to Kazakhstan	• Reports of US considering sanctions against China to prevent a Taiwan invasion
	Our assessment: Neutral – Ukraine army advances vs West-China tensions escalating	

US headline and core inflation continued to beat expectations

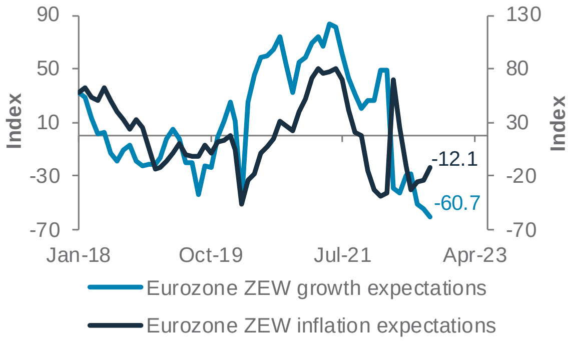
US headline, core, goods and services inflation



Source: Bloomberg; Standard Chartered

Euro area growth expectations continued to decline, while inflation expectations rose again

Euro area ZEW Survey expectations of growth and inflation



Source: Bloomberg, Standard Chartered

China's economy showed signs of recovery in August, with retail sales and industrial production beating estimates

China retail sales, industrial production and fixed asset investment

Source: Bloomberg, Standard Chartered

Top client questions

What is your view on US equities after the latest inflation surprise?

The higher-than-expected US inflation print has re-emphasised the "higher-for-longer inflation" narrative. It is likely to put US equities under short-term pressure, especially the growth-heavy Nasdaq-100 index because higher yields hurt high P/E stocks more. US stock indices have also been making "lower highs" and "lower lows", a technically bearish pattern. The Nasdaq-100 has broken below support at the 12,100 level, which may lead to 11,700 and the June 2022 low of around 11,100. The S&P500 index is hanging just above support at 3,900 and may test 3,700 should price action worsen.

We believe it is critical for investors to maintain a good balance between 1) income and 2) growth, getting paid while awaiting a recovery. Investors should consider global high dividend equities which, as a historical analysis shows, offered annualised returns of 3.6% (vs -2.1% for global equities) during periods when US CPI was higher than 3% and a higher probability of a positive return. We also believe investors should maintain a balanced portfolio, with exposure to high grade bonds (see below).

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

The S&P 500 index is testing key support at 3,900. The next support is at 3,700

S&P 500 index

Source: Bloomberg, Standard Chartered

What is your rationale for upgrading DM IG bonds and downgrading DM HY bonds?

In our Global Market Outlook published earlier this month, we upgraded DM IG bonds to a Core Holding (from less preferred) and downgraded DM HY bonds to a Core Holding (from preferred), leaving us with a balanced view between the two.

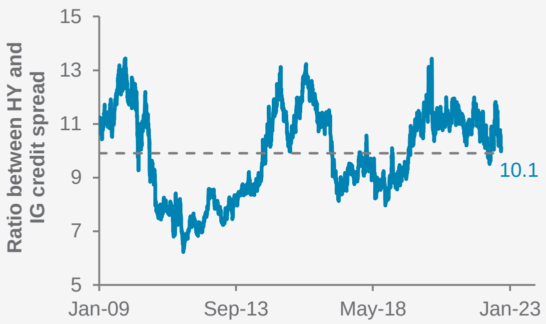
First, we believe the surge in yields has created an attractive entry point for high quality bonds. DM IG corporate bonds now offer about a 4.8% yield, having risen to levels last seen almost 10 years ago, making them much more attractive than in the zero/low-yield world of the past decade. While a similar argument arguably applies to DM HY bonds, we nevertheless decided to trim our view here because of the risks posed by rising chances of a US/European recession, though relatively stable credit fundamentals hold us back from downgrading them further.

Second, we believe the summer rebound in risky assets created a window of opportunity to make the switch from HY to IG bonds. Third, from a valuation perspective, the HY/IG spread multiple has returned to its post-2008 average, consistent with a balanced stance between the two classes of bonds. Fourth, although DM IG bonds have a relatively high sensitivity to interest rate changes, we believe the sharpest moves in bond yields are now likely behind us. Technical charts for the 10-year US govt bond yield suggest 3.5% could be a tougher resistance to break. Fifth, a greater allocation to DM IG bonds should help limit downside risks in a scenario wherein risk assets sell off.

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

Current relative valuation supports a balanced stance between DM IG and HY corporate bonds

Ratio between DM HY and DM IG yield premiums



Source: Bloomberg Standard Chartered

Top client questions (cont'd)

What is your preferred maturity exposure to bonds if Fed funds rate peaks above 4.0%?

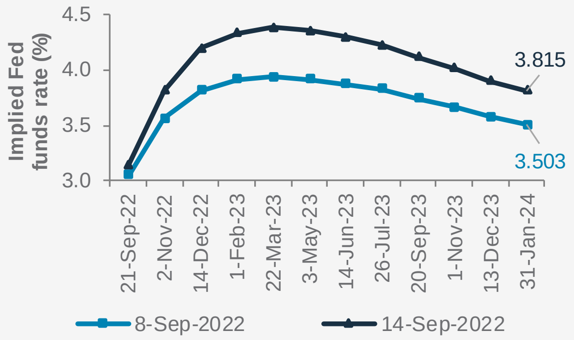
After the release of the US August CPI data on Monday, the market-implied peak Fed funds rate moved higher towards 4.5% in early 2023. While this tends to have a more direct link to short maturity bond yields, longer-term bond yields tend to be driven by several additional factors. One key factor is growth expectations, specifically worries that Fed tightening significantly worsens the growth outlook to the point where Fed policies turn less hawkish in the future. Additionally, an inflation peak in H2 2022 against the backdrop of easing supply chain disruption could support expectations the Fed ends up with more room to support growth.

Given these trade-offs and the absence of a significant gap between short- and long-maturity bond yields, we believe a neutral duration stance (about 5-7 years) offers the most attractive risk and return trade-off.

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

More aggressive rate hike expectations after the latest US CPI release

Money market implied Fed Fund Rates



Source: Bloomberg, Standard Chartered

What are the latest views on the USD, and how should investors position themselves?

We believe that the USD index (DXY) is likely to trade range-bound in the near term ahead of the Fed FOMC decision next week. After the release of the US CPI data, the DXY bounced from 107.70 to 110.00 on concerns about a more hawkish Fed, but remained under the previous intraday high of 110.78, which indicates that the uptrend is likely contained for now. Key levels to watch are resistance at 111.30 and support at 107.70 (50-DMA).

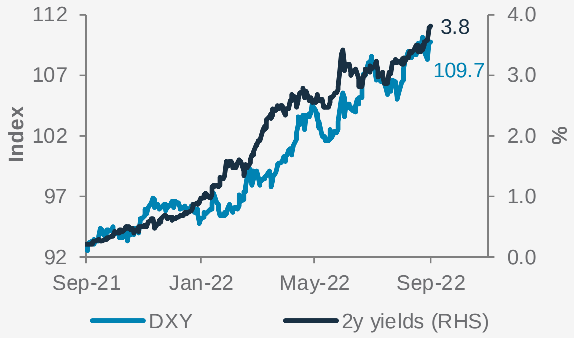
Within this context, EUR/USD is likely to trade within 1.035-0.9850, with a bearish bias, unless it breaks above 1.0350. USD/JPY faced some respite as the BoJ signalled it was considering an intervention, though this is unlikely for now, in our view, given the historical track record of unilateral interventions being ineffective in sustainably reversing major trends. USD/JPY is eyeing initial resistance at 145.0, followed by 147.8; a break above could target 151.5 next.

A cross-currency play which we favour in the short term is a bullish EUR/GBP. The UK is suffering from worsening terms of trade, energy shortage, extremely high inflation and uncertainty around its new fiscal policy, suggesting that the GBP is likely to underperform.

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

The USD (DXY) index has been underpinned by a hawkish Fed narrative and rising US government bond yields

DXY index vs 2y US government bonds yields



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What explains crude oil's strong bounce this week and what is the outlook?

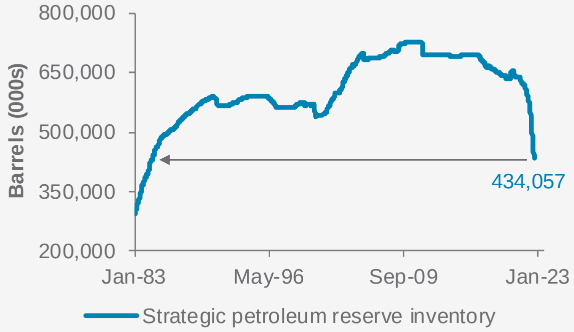
Crude oil gained, driving energy sector equities higher, after reports that the White House is considering a refill of its strategic petroleum reserve (SPR) should prices pull back to around USD 80/bbl. The release of 180m barrels from strategic reserves in recent months has resulted in the reserve falling to the lowest level since 1984. A likely secondary driver of higher prices was the prospect of a US rail union strike, which will stop trains – a major delivery carrier of crude and refined products – across the US. The strike has seen been averted after an agreement between rail companies and labour unions following the intervention of President Biden. Oil markets also shrugged off a cut in the IEA's demand forecast.

The refill of US strategic oil reserve is likely to alleviate some of the downside pressure on oil prices from slowing demand. It also means that the likelihood of an extension of the SPR release ending this October is low. The demand is expected to pick up as China comes out from its renewed lockdowns. Therefore, we see USD 80 being a key support level in the near term. Elevated oil prices are also positive for energy sector equities, with investors gaining confidence that earnings and dividend plans are well supported. We continue to prefer the energy equity sector in the US, Europe and China.

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

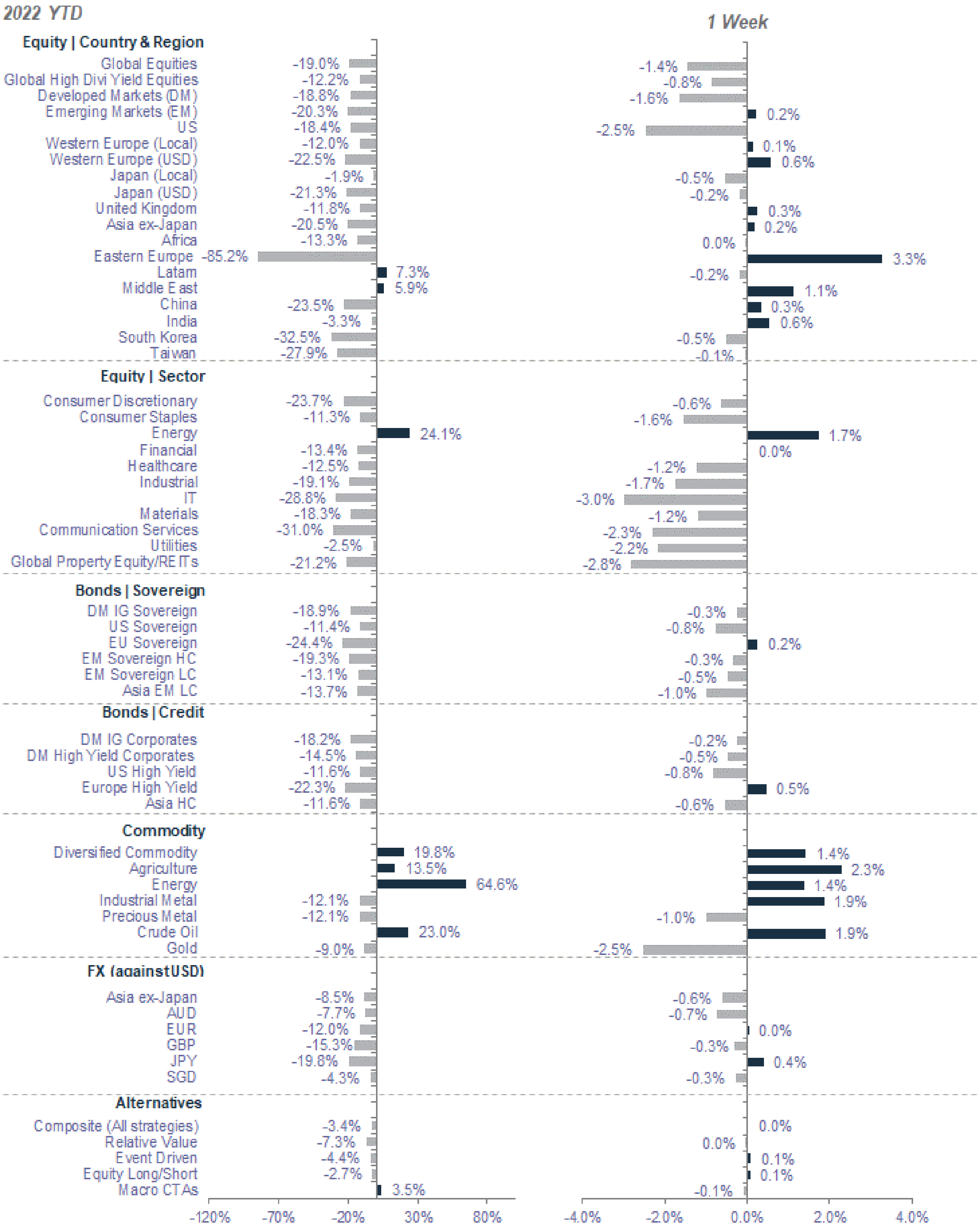
The release of US strategic petroleum reserves since March has resulted in reserves falling to a 38-year low

US strategic petroleum reserve, total inventory



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 15 September 2022; 1-week period: 08 September 2022 to 15 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					
TUE	US	Housing Starts	Aug	1468k	1446k
WED					
THUR	US	FOMC Rate Decision (Upper Bound)	21-Sep-22	3.3%	2.5%
	UK	Bank of England Bank Rate	22-Sep-22	2.3%	1.8%
	US	Leading Index	Aug	0	-0.004
	EC	Consumer Confidence	Sep P	–	-24.9
FRI/SAT	EC	S&P Global Eurozone Manufacturing PMI	Sep P	–	49.6
	EC	S&P Global Eurozone Services PMI	Sep P	–	49.8
	EC	S&P Global Eurozone Composite PMI	Sep P	–	48.9
	UK	S&P Global/CIPS UK Manufacturing PMI	Sep P	–	47.3
	UK	S&P Global/CIPS UK Services PMI	Sep P	–	50.9
	UK	S&P Global/CIPS UK Composite PMI	Sep P	–	49.6
	US	S&P Global US Manufacturing PMI	Sep P	–	51.5
	US	S&P Global US Services PMI	Sep P	–	43.7
	US	S&P Global US Composite PMI	Sep P	–	44.6
	EC	Italian General Election			

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 3.49%

Technical indicators for key markets as on 15 September

Index	Spot	1st support	1st resistance
S&P 500	3,901	3,832	4,041
STOXX 50	3,542	3,507	3,612
FTSE 100	7,282	7,215	7,411
Nikkei 225	27,876	27,591	28,387
Shanghai Comp	3,200	3,179	3,243
Hang Seng	18,930	18,731	19,246
MSCI Asia ex-Japan	615	610	625
MSCI EM	959	951	973
Brent (ICE)	90.8	89.8	93.0
Gold	1,663	1,643	1,704
UST 10y Yield	3.44	3.35	3.49

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 15 September

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	→	1.67
Global Equities	●	↑	1.87
Gold	◐	→	1.35
Equity			
MSCI US	●	→	1.65
MSCI Europe	●	→	1.74
MSCI AC AXJ	◐	→	1.48
Fixed Income			
DM Corp Bond	●	↓	1.90
DM High Yield	●	↑	2.40
EM USD	●	↑	2.29
EM Local	●	↑	2.29
Asia USD	●	↑	1.84
Commodities			
WTI Crude Oil	◐	→	1.42

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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