Macro Strategy | 21 August 2020

Standard Chartered
Private Bank

Weekly Market View

What to expect from the US elections?

US stocks testing record highs and volatility slumping to post-pandemic lows suggest investors are less concerned about the upcoming US presidential election. While renewed volatility cannot be ruled out in the coming months, we would use any dislocation to add to our preferred risk assets

Equities: We believe US earnings likely bottomed in Q2 20; earnings are likely to grow again y/y from early 2021, supporting our constructive 12-month view on the market

Bonds: Fed meeting minutes showed policymakers do not expect to raise rates for a few years; we expect the 10-year Treasury yield to remain below 1.00% in the next 12 months

FX: EUR/USD is likely to see a near-term correction following its recent rally

Also find out...

Is margin financing driving the rally in China onshore equities?

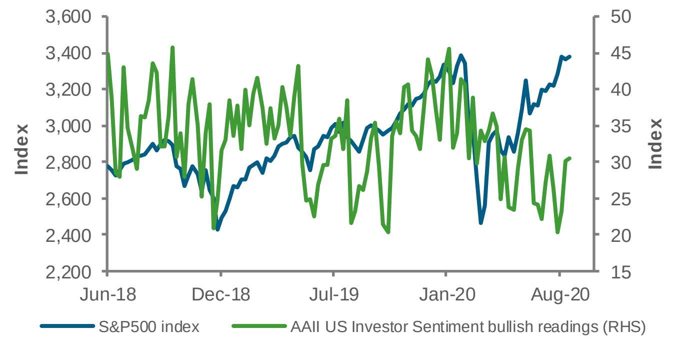
Are technical indicators pointing to a reversal in some bond markets?

Are some of the macroeconomic drivers of risk assets fading?

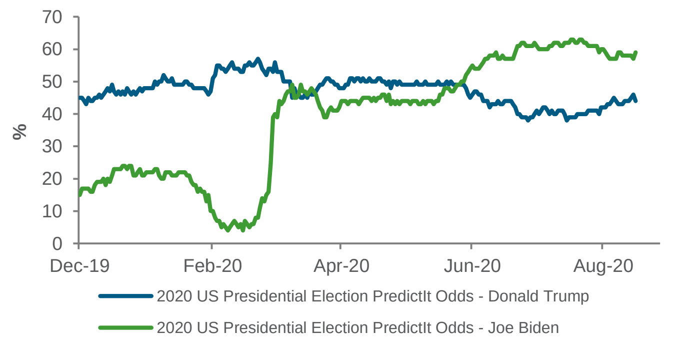
Charts of the week: Breaking out?

The S&P500 index set a new record high, but faces a near-term challenge from rising political uncertainty as Trump trails in polls

S&P500 index; AAII index* shows investors are not overly bullish



PredictIt odds show Biden has c.60% chance of winning the election



Source: Bloomberg, PredictIt, Standard Chartered; *American Association of Individual Investors' sentiment index

Editorial

What to expect from the US elections

The world's largest economy and financial market is barely 10 weeks away from one of the most contentious elections in generations. While the two US parties outline their opposing policy agenda this month, investors appear to be nonplussed – the S&P500 index scaled a new record high this week, and volatility of US stocks (a measure of market risk) fell to its lowest since the COVID-19 outbreak in February.

We see three likely reasons why investors are so sanguine:

1) Opinion polls show Democrat challenger Joe Biden is almost 8 points ahead of President Trump. Incumbents have rarely emerged as winners from this starting point. A Biden win would likely mean a greater likelihood of a "green" fiscal stimulus package, expanded healthcare for all, wider social security programmes and a less confrontational approach against China. These benefits, we believe, would offset the risk of more regulations and taxes, though the latter depends on whether the Democrats manage a "blue wave" by also winning the Senate;

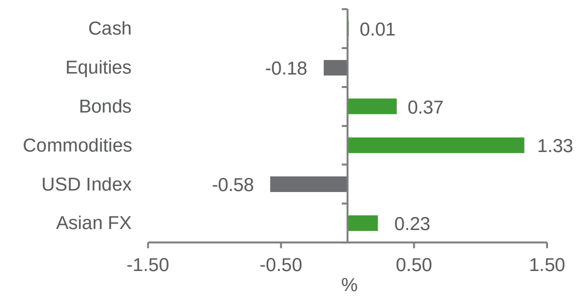
2) Even if President Trump pulls off a surprise win in November, it would likely mean a continuation of his investor-friendly business-deregulation policies. Add to that the possibility of more tax cuts and trillions of dollars in infrastructure spending, especially if the Republicans retain the Senate and win control of the House. Tensions with China would likely remain elevated, but extreme scenarios (eg. barring access to dollars or outright military conflict) remain unlikely at this stage, in our assessment;

3) Finally, there are fundamental underpinnings to the optimism, with an improving economic and corporate earnings outlook, continued expansion of record stimulus measures, a weakening USD and increased expectations of a vaccine.

However, the ride from here to the November election is unlikely to be smooth. Recent US policy moves – from the ban against Huawei to pressure on US institutions to sell US-listed China stocks – suggest President Trump will target China in his election campaign. A slowdown in the job market in the US and Europe is another risk we are watching closely. There are renewed concerns about a rise in COVID-19 cases in Europe, which could dampen consumer and investor sentiment. These could cause short-term air-pockets for markets, but are likely to present opportunities to add exposure to our preferred assets (see page 4-5).

Equities consolidated prior gains, commodities rose and USD fell in the past week

Benchmark market performance w/w*



Source: Bloomberg; *Week of 13 August 2020 to 20 August 2020

Our proprietary analysis shows market diversity is extremely low in some bonds and the EUR, raising the risk of a short-term trend reversal

Market diversity across key asset classes

Level 1	Diversity	Diversity trend since 20-July-20	Fractal Dimension
Global Bonds	○	→	1.18
MSCI ACWI	◐	→	1.29
Gold	◐	→	1.39
Equity			
MSCI US	◐	→	1.35
MSCI Europe	◐	→	1.48
MSCI AC AXJ	◐	→	1.30
Fixed Income			
DM Corp Bond	○	→	1.16
DM High Yield	◐	→	1.28
EM USD	◐	→	1.28
EM Local Currency	◐	↑	1.41
Asia Hard Currency	○	→	1.24
Currencies			
USD/CNY	◐	↓	1.39
EUR/USD	○	→	1.23
USD/JPY	●	→	1.61
GBP/USD	◐	↓	1.27
AUD/USD	◐	→	1.27

Source: Bloomberg, Standard Chartered; **Fractal dimensions below 1.25 indicate extremely low market diversity**

Legend: ○ Very low ◐ Low ● Moderate/high

The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	• US daily new COVID-19 cases continued to fall for the fourth week after peaking in mid-July; cases in Japan and Australia continued to decline from the recent peak • UK authorities are considering tests at airports to reduce quarantine restrictions for travellers • A Chinese vaccine maker stepped up testing abroad to help accelerate regulatory approvals	• Germany and France reported the highest number of new cases in four months, prompting Chancellor Merkel to rule out easing economic restrictions • Daily new cases continued to trend up in India, Spain and Italy and remained close to peak in Brazil and Indonesia
	Our assessment: Neutral, on balance, as continued downtrend in US cases is offset by the revival of cases in Europe.	
Macro data	• US housing starts increased by a more-than-expected 23% in July, recording its sharpest rise since 2016. A builder confidence index rose to a record high • US retail sales (excluding autos and gas) beat forecasts and industrial production rose in July • UK value of agreed home sales jumped to a record high in July and house prices in August had their biggest m/m increase since 2016	• US initial jobless claims unexpectedly rose last week • Euro area core consumer inflation fell below estimates and exports fell 10% in June • China industrial output rose less-than-expected y/y; retail sales fell unexpectedly • Japan's exports and industrial output dipped 19% y/y and 18% y/y in June, underlining global economic and trade weakness
	Our assessment: On balance, this week's data was neutral for risk assets as strong housing numbers in the US were offset by signs of slower-than-expected economic activity in Europe and China.	
Policy developments	• US House Speaker Pelosi said Democrats were ready to cut their USD 3trn stimulus proposal in half to help reach an agreement with the government as the Congress went into recess until 8 September • The ECB said it was ready to adjust its policy tools, as needed, amid elevated uncertainty. German Finance Minister Scholz proposed extending employment subsidies • China's PBoC injected CNY 700bn of liquidity, but left its benchmark interest rate unchanged	• Fed's July meeting minutes showed policymakers expect the pandemic to "weigh heavily on economic activity, employment and inflation in the near term" and pose "considerable risks to the economic outlook" • Fed members were sceptical about using bond purchases to manage Treasury yields across maturities, but refrained from offering forward guidance on policy
	Our assessment: On balance, policy drivers were neutral. Focus remains on a possible agreement on another US fiscal stimulus.	
Other developments	• UK Prime Minister Johnson's spokesman said the government expects to reach a Brexit deal by September as talks resumed this week	• US President Trump postponed trade talks with China, raising concerns about the trade deal • The US urged universities to divest from US-listed Chinese stocks before their possible delisting in 2021
	Our assessment: US-China tensions remain a key near-term risk as US policies turn more hawkish in the run-up to November polls.	

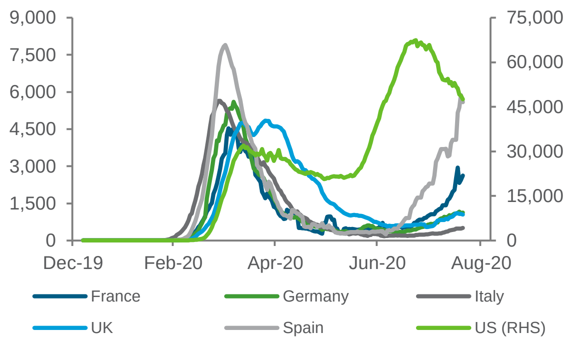
Our weekly net assessment: On balance, this week's data and policy were neutral, with a key focus now on the next round of US fiscal stimulus

(+) factor: Peak in US COVID-19, strong US housing data, PBoC stimulus

(-) factor: Europe COVID-19 cases, slowing ex-US data, US-China tensions

New COVID-19 cases have continued to decline in the US, but are on the rise in Europe

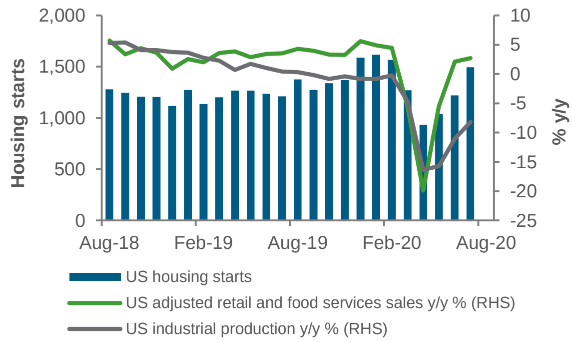
Daily new COVID-19 cases in the US and key European markets



Source: Our World in Data, Standard Chartered

US housing market and retail sales continue to recover strongly; industrial output is still down y/y, but is recovering from Q2 20 lows

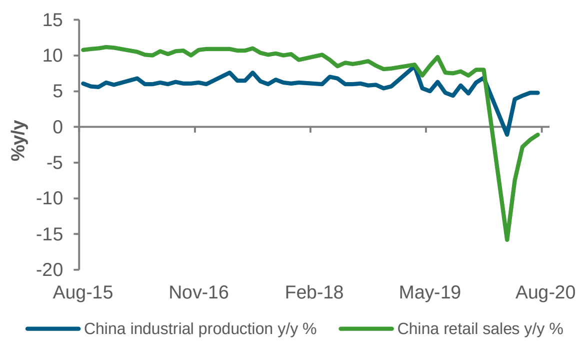
US housing starts, retail sales and industrial production



Source: Bloomberg, Standard Chartered

China's industrial production growth has plateaued lately after a strong rebound in Q2 20, while retail sales remain below year-ago levels

China's industrial production and retail sales



Source: Bloomberg, Standard Chartered

Top client questions

Now that the Q2 US earnings season is over, what is the outlook for earnings in H2 20 and 2021?

The outturn for Q2 US corporate earnings was a decline of 31% y/y, better than expectations of a 41% y/y dip at the start of the earnings season. The upside surprise was driven by better-than-expected earnings in the technology and healthcare sectors.

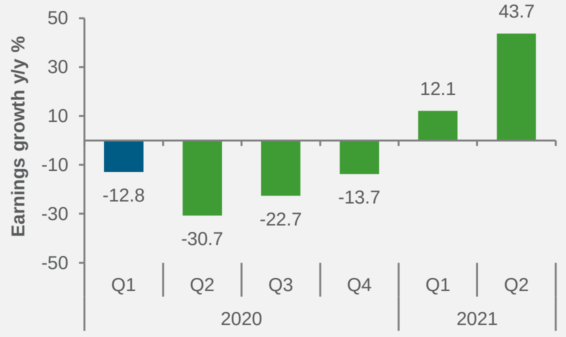
Looking ahead to H2 20, expectations currently are for an 18% y/y contraction, which consensus expects will be followed by an impressive 28% y/y rebound in 2021. Such an outturn would nudge earnings slightly ahead of the prior peak recorded in 2019.

Select forecasters are emphasising a preference for sectors with high operating leverage and the potential for margin expansion. These include technology, diversified financials and energy. We would agree that technology benefits from high operational leverage and the sector is preferred. Diversified financials and energy will likely benefit if the economic recovery sustains, though there are some uncertainties for the sectors, starting with the US presidential election. The financials and energy sectors are not preferred areas in the US.

Short-term S&P500 technicals show the index's rally appears to be losing steam as it tests major resistance at the February high of 3,394. Some consolidation would not be surprising given the sharp gains since March. However, dips could be limited given the positive fundamental backdrop. There is quite strong support on the 200-day moving average (now at 3,072, 9% below Thursday's close), following the initial support at 3376.

US earnings are expected to start growing again y/y from early 2021, after contracting this year

Consensus estimates for y/y earnings growth for S&P500 index members



Source: Refinitiv, Standard Chartered

Is margin financing driving Chinese onshore equities?

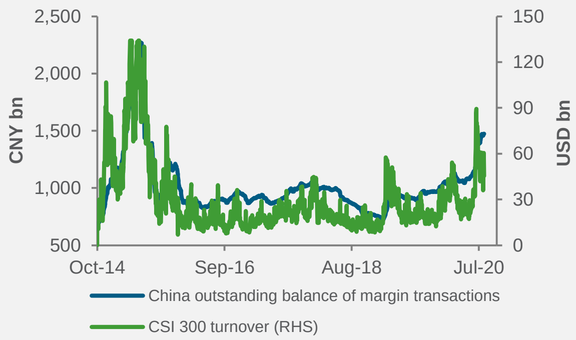
The CSI300 index has rallied 36% from its trough in March amid improving retail sentiment. The A-share margin balance, an indicator of debt-financed purchases by retail investors, reached CNY 1.47trn, the highest since June 2015, with the average daily turnover going higher. Retail investors account for around 86% of the trading volume in the China onshore market, making margin financing a driver for onshore equity performance, in our assessment.

Despite the 45% YTD increase, margin financing remains 35% below the June 2015 peak, suggesting retail speculation is not stretched relative to 2015, in our view. We also do not see an imminent risk of government policies to curb the "healthy bull" market, with the PBoC recently injecting CNY 700bn to boost liquidity in the economy.

Looking ahead, we see further room for growth in retail participation. Chinese households' asset allocation in equities remain low at only 7% of the total assets, below 9% in Japan and 32% in the US. China's household deposits amount to c.CNY 90trn, a fraction of which could be channelled to domestic equity markets should sentiment improve. Meanwhile, interest rate reform in China could lower borrowing costs for individual investors, easing the financial burden for margin financing. China equities remain our preferred market in Asia ex-Japan.

While China's retail investors have helped drive the rally in onshore stocks, margin financing remains 35% below the 2015 peak, suggesting retail speculation is not so stretched

China's outstanding balance of margin transactions and daily turnover of stocks in the CSI 300 index



Source: Bloomberg, Standard Chartered

S&P500 index faces resistance 0.2% above current level

Technical indicators for key markets as on 20 August 2020

Index	Spot	1st support	1st resistance
S&P 500	3,386	3,376	3,393
STOXX 50	3,274	3,259	3,303
FTSE 100	6,013	5,975	6,089
Nikkei 225	22,881	22,744	23,153
Shanghai Comp	3,364	3,332	3,423
Hang Seng	24,791	24,599	25,175
MSCI Asia ex-Japan	706	701	717
MSCI EM	1,081	1,072	1,097
Brent (ICE)	44.9	44.6	45.3
Gold	1,949	1,918	1,992
UST 10Y Yield	0.65	0.63	0.69

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is the outlook for bond yields following the Fed minutes?

The minutes of the July Fed FOMC meeting were quite similar to the previous meeting, with policymakers continuing to assess the outlook for the US economy amid the pandemic-related uncertainty. 10-year US Treasury yields jumped higher intra-day following the minutes, likely due to disappointment about the lack of comments on further easing measures. However, the Fed noted that the labour market is still far away from a full recovery, suggesting it is unlikely to consider raising rates until the unemployment rates fall sharply.

Overall, in our assessment, the Fed remains accommodative, and the minutes do not change our expectation that the 10-year US Treasury yield is likely to stay capped to a 0.75-1.00% range over the next 12 months. However, as the short-term yields are likely to remain anchored around current levels, this does imply that the yield curve could steepen slightly (ie. the difference between long- and short-term Treasury yields could increase) over the next 6-12 months.

Markets are now looking forward to the September meeting with expectations that the Fed could offer further guidance about its revised inflation targeting framework. Given a move towards an "average inflation targeting" was on the cards even before the pandemic, it could be argued that in today's context, any potential Fed inflation framework is likely to cap or reduce rate hike expectations over the next 12 months.

Markets do not expect a Fed rate hike at least until 2022

Fed policymakers' estimates of Fed funds rate in the coming years vs. market estimates (based on interest rates swaps, Fed funds futures)

Source: Bloomberg, Standard Chartered

What is the near-term outlook for the USD?

While our 12-month view continues to be USD-bearish, some near-term risks to the dominant USD downtrend are emerging, in our assessment.

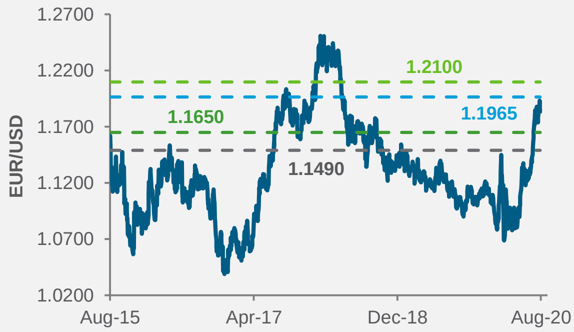
From a fundamental perspective, the recent Fed meeting minutes could underpin relative US interest rates in the near term. The COVID-19 data in the US could improve relative to the worsening trend that has started to appear in Europe and Australia. Finally, the US election process, tactics and news headlines will likely hit "peak velocity" over the next 10 weeks. The recently concluded Democratic National Convention has provided some indication of the expected aggressive campaigning to come.

In a market environment where speculative positioning is extended, a flight to safety and a move towards risk-off would be USD-supportive, in our assessment. EUR/USD has rallied over 12% since its March low and a technical correction would not surprise. We see key supports around 1.1650, followed by 1.1490.

Having said that, we believe any near-term USD rally could provide investors with an opportunity to hedge USD exposure at better levels. On EUR/USD, a technical correction would not derail our expectations for a medium-term advance towards 1.2400, with resistances at 1.1965 and 1.2100 being initial targets on a break of the recent peak.

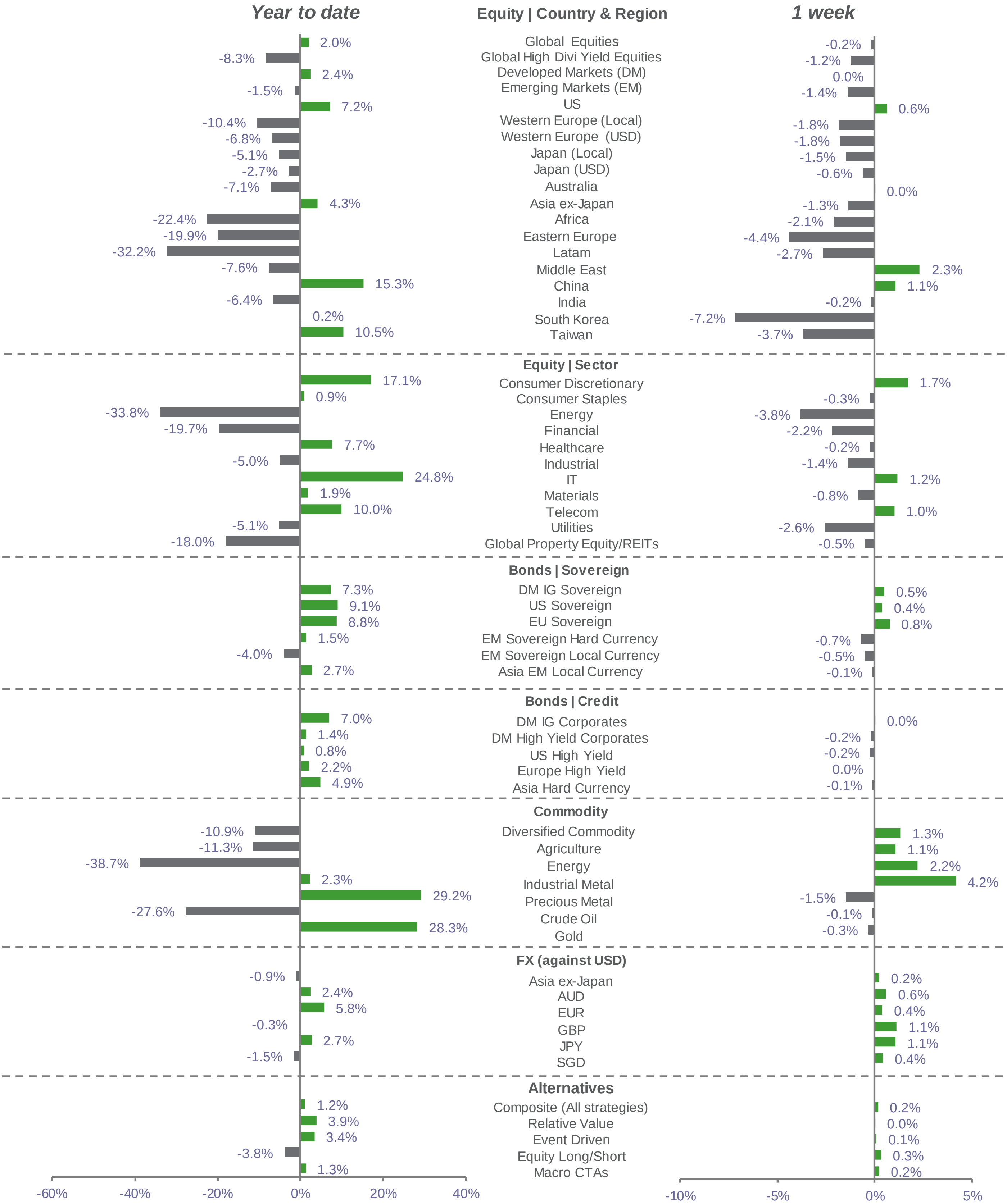
EUR/USD is likely due for a technical correction after its sharp run up since March lows; key supports lie around 1.1650

EUR/USD, with technical resistance and support 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, 2019 performance from 31 December 2019 to 20 August 2020, 1 week period: 13 August 2020 to 20 August 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON						
TUE	GE	IFO Expectations	25-Aug-2020	Aug	–	97.0
	US	Conf. Board Consumer Confidence	25-Aug-2020	Aug	93.2	92.6
	US	New Home Sales	25-Aug-2020	Jul	775k	776k
WED	JN	PPI Services y/y	26-Aug-2020	Jul	–	0.8%
	US	Cap Goods Orders Nondef Ex Air	26-Aug-2020	Jul P	–	3.4%
THUR	CH	Industrial Profits y/y	27-Aug-2020	Jul	–	11.5%
	EC	M3 Money Supply y/y	27-Aug-2020	Jul	–	9.2%
	US	GDP Annualized q/q	27-Aug-2020	2Q S	-32.5%	-32.9%
	US	Personal Consumption	27-Aug-2020	2Q S	–	-34.6%
	US	Core PCE q/q	27-Aug-2020	2Q S	–	-1.1%
	GE	Retail Sales NSA y/y	27-Aug-2020	Jul	–	6.0%
FRI/SAT	US	Personal Income	28-Aug-2020	Jul	-0.1%	-1.1%
	US	Real Personal Spending	28-Aug-2020	Jul	–	5.2%
	EC	Economic Confidence	28-Aug-2020	Aug	–	82.3

	Event	This Week	Date	Period	Actual	Prior
MON	JN	GDP Annualized SA q/q	17-Aug-2020	2Q P	-27.8%	-2.5%
TUE	US	Building Permits	18-Aug-2020	Jul	1495k	1258k
WED	JN	Exports y/y	19-Aug-2020	Jul	-19.2%	-26.2%
	JN	Trade Balance Adjusted	19-Aug-2020	Jul	-¥34.8b	-¥410.9b
	JN	Core Machine Orders y/y	19-Aug-2020	Jun	-22.5%	-16.3%
	UK	CPI Core y/y	19-Aug-2020	Jul	1.8%	1.4%
THUR	US	FOMC Meeting Minutes	20-Aug-2020	29-Jul		
	EC	ECB July Monetary Policy Meeting Account	20-Aug-2020	July		
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	21-Aug-2020	Jul	–	0.4%
	UK	Retail Sales Ex Auto Fuel y/y	21-Aug-2020	Jul	–	1.7%
	EC	Consumer Confidence	21-Aug-2020	Aug A	–	-15.0
	JN	Jibun Bank Japan PMI Composite	21-Aug-2020	Aug P	–	44.9
	GE	Markit/BME Germany Composite PMI	21-Aug-2020	Aug P	–	55.3
	EC	Markit Eurozone Composite PMI	21-Aug-2020	Aug P	–	54.9
	US	Markit US Composite PMI	21-Aug-2020	Aug P	–	50.3
	UK	Markit/CIPS UK Composite PMI	21-Aug-2020	Aug P	–	57.0

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue; *refers to Jan-Feb 2020 combined data
Previous 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

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