standard chartered

Wealth Management Chief Investment Office
18 February 2022

Weekly Market View

What to make of the Ukraine crisis?

→ The Ukraine crisis has moved to the centre of investors' radars. President Biden warned of a high chance of a Russian invasion in the coming days. However, geopolitical analysts assign a low probability to a protracted conflict.

→ The crisis' main impact on global markets is likely through natural gas prices in Europe and oil prices in general. We see limited scope for a long-drawn interruption to oil and gas supplies. Besides, such geopolitical events have historically impacted financial assets only for a short period of time.

→ Given this, the best course for investors, in our view, would be to stay invested in a diversified allocation, but hedge against any short-term military action through exposure to safe havens, such as gold and an undervalued JPY.

What are the equity and bond market implications of higher oil prices?

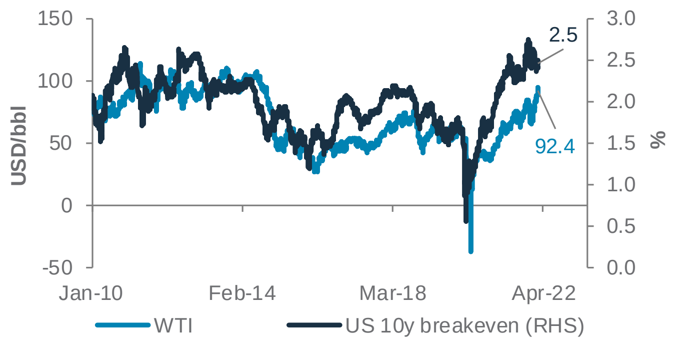
What to expect from the earnings season in Europe and China?

What are technical charts saying about the outlook for global equities, Nasdaq index and crude oil?

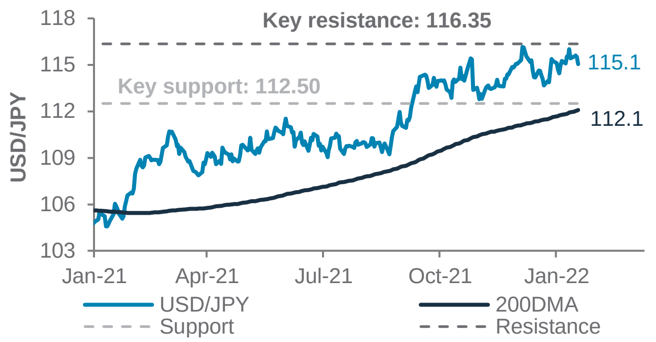
Charts of the week: 'Ukraine premium' in oil and inflation?

Any military escalation in Ukraine is likely to further fuel oil prices; we see the undervalued JPY as a good hedge

WTI crude oil price and US long-term inflation expectations*



USD/JPY and technical indicators



Source: Bloomberg, Standard Chartered; *US 10-year inflation expectations derived from inflation-protected Treasury bonds

Editorial

What to make of the Ukraine crisis?

The Ukraine crisis has moved to the centre of investors' radars. Several geopolitical analysts now assign an elevated risk of an incursion into Ukraine by Russian forces. However, they assign a low probability to a protracted conflict, given the US threat of overwhelming sanctions against Russia. Historically, such geopolitical events have impacted financial assets only for a short period. Given this, the best course for investors, in our view, would be to stay invested in a diversified allocation, but hedge against any short-term military action through exposure to safe havens, such as gold and an undervalued JPY.

The Ukraine crisis comes against the backdrop of a 30% surge in oil prices in the past two months, soaring inflation and expectation of tighter monetary policy. This context is important because the Ukraine crisis' main channel to global markets is through natural gas prices in Europe and oil prices in general. There is concern that Russia might cut off natural gas supplies to Europe, albeit temporarily, in retaliation for any US sanctions. Thus, European equities are likely the most vulnerable to temporary volatility in the event of an escalation. Nevertheless, in the past, limited-duration military conflicts have resulted in a 10%-15% drawdown in US stocks. Since US stocks are already down about 9% from their January record high, the scope for further drawdown is relatively limited, in our assessment.

For the medium term, it is important to assess whether any escalation in Ukraine will fundamentally alter long-term market drivers, just the way the Arab oil embargo and the Iranian revolution contributed to years of high inflation in the 1970s and 1980s. However, we see limited scope for a long-drawn interruption to oil and gas supplies for three reasons. First, this would badly hit the Russian economy in the short term, which is very reliant on energy exports. Second, the US and Europe will want to avoid an escalation because of the damage to the economy it would incur, especially against the backdrop of high inflation. Third, Russia will not want to give Europe an incentive to plan for energy security without Russian gas. It would rather want the new Nord Stream 2 gas pipeline to Europe to proceed.

Hence, instead of geopolitics, we would rather focus on the oil market fundamentals to assess the medium-term impact on financial assets. The market remains structurally tight due to stronger-than-expected demand and depleted inventories after years of underinvestment. However, the global economy has become much less sensitive to oil prices – today, global oil consumption accounts for 3% of global GDP, compared with as high as 7% during the 1970-80s. While oil prices could still start to hurt demand at some stage, the stronger-than-expected US retail sales for January suggests we are not there yet (household income and savings remain strong enough to withstand high oil prices). Also, major OPEC producers such as Saudi Arabia and UAE have room to boost oil supplies in need. We also see signs of US shale producers restarting output. Meanwhile, reports point to progress in Iran nuclear talks; a breakthrough here would also boost oil and gas supplies. These steps should help keep supply-demand balanced this year.

We continue to watch long-term inflation expectations, which have a close link to oil prices. Those expectations have remained within their decade-long range, lessening the urgency for the Fed to aggressively tighten policy. The Fed's January meeting minutes showed policymakers were less hawkish than market estimates. There are also signs of some price pressures ebbing – the latest being lower-than-expected China producer price inflation (which have historically had a significant impact on US consumer prices with a lag). Thus, we expect inflation pressures to subside by H2, reducing the pressure on the Fed to tighten policy significantly. This should keep risk assets supported. Energy sector equities have benefitted from the rise in oil prices and inflation; technical charts remain supportive for the sector in the near term (see pages 4 and 6).

— 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, with a positive bias in the near term

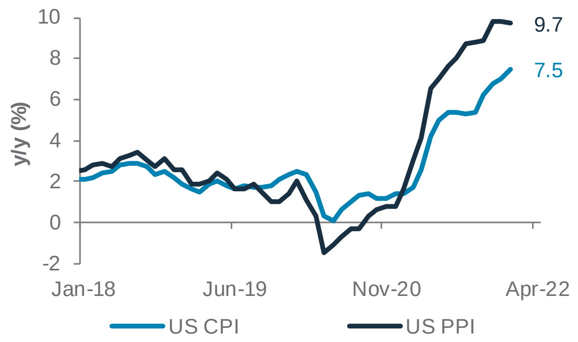
(+) factors: US, Europe COVID cases, US retail sales, less hawkish Fed

(-) factors: Asia COVID case surge, US producer inflation, Ukraine risk

	Positive for risk assets	Negative for risk assets
COVID-19	• New cases continue to fall sharply from recent peaks in the US, Europe, Australia and Latin America; US, UK hospitalisations fall sharply • More countries (eg, France, Germany, Singapore) plan to ease restrictions	• Japan, Korea, Singapore, Hong Kong, parts of Southeast Asia continue to see record new cases, although cases may be peaking in some countries • China asked Hong Kong to adopt 'zero COVID' strategy
	Our assessment: Neutral – Sharp fall in new cases in the US, Europe, Latin America vs record new cases across Asia	
Macro data	• US retail sales rose more than expected • Euro area industrial output rose more than expected; economic sentiment (ZEW) fell less than expected • China's consumer and producer inflation was less than expected	• US producer inflation was more than expected • US Michigan consumer sentiment index fell to the lowest in a decade • UK consumer inflation rose more than expected • IMF said Euro area supply disruptions may last till '23
	Our assessment: Neutral – Strong US retail sales, Euro area industrial output vs surprisingly strong US producer inflation	
Policy developments	• Fed's January meeting minutes suggested officials were not considering more aggressive policy than what the market was expecting • PBoC injected CNY 300bn through medium-term loans	• Fed's Bullard reiterated his call for a faster pace of rate hikes • PBoC said it would not use the property sector to stimulate the economy
	Our assessment: Positive – Less hawkish Fed, PBoC boost	
Other developments	• Russia said it pulled back some troops from Ukraine's borders	• President Biden said chance of a Russian invasion of Ukraine in the next few days remains high • US closed its Ukraine embassy, warning of an imminent Russian invasion
	Our assessment: Neutral – Conflicting claims about Russia's troop pullback from Ukraine's border	

US producer inflation was higher than expected but appears to be peaking; we expect wholesale costs to drag down consumer inflation by H2

US consumer and producer price inflation



Source: Bloomberg; Standard Chartered

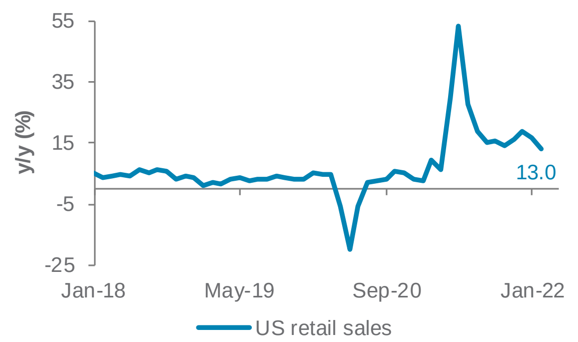
China's producer inflation appears to have peaked; this is likely to lower global inflation with a 6-9-month lag

China consumer and producer price inflation

Source: Bloomberg, Standard Chartered

US retail sales were stronger than expected in January, but the trend is reverting to pre-pandemic levels; this is likely to lower goods inflation by H2

US retail sales growth



Source: Bloomberg, Standard Chartered

Top client questions

What are the equity and bond market implications of higher oil prices?

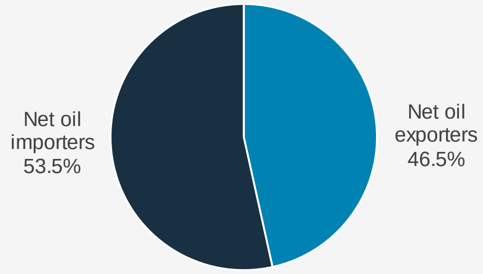
Energy equities have been strong due to high oil prices and demand from investors seeking hedges against inflation. The energy sector's FY2021 earnings rose 16x in the US and 8x in Europe y/y due to an extreme low-base effect. While we expect earnings growth in the sector to normalise in 2022, energy shares have delivered good returns vs risk from a technical perspective, i.e. strong volume buying at key support levels, and steady gains on the upside. As such, we expect investors to buy on dips in this sector – especially when the inflation narrative intact in the near term.

The relationship of Emerging Market (EM) USD bonds and oil is tricky. Based on fundamentals, a higher oil price should improve the economic prospects of oil exporting countries, leading to improved credit quality and higher bond prices. While oil exporting countries form a large chunk of the EM USD bond index (c.46.5% by weight), a historical analysis since 1994 shows little relationship between the bond index and oil prices (an R^2=0.028 on the regression, for more statistically-minded readers). This means we would continue to rely on a wider assessment of EM bonds, including factors such as long-term credit quality and interest rate risk, which currently leads us to view them as a core holding on a 6-12 month horizon.

— **Cedric Lam,** *Senior Investment Strategist*
— **Daniel Lam, CFA,** *Senior Cross-asset Strategist*

Oil exporting countries account for roughly half of Emerging Market USD bond market universe

Weightage of net oil exporters and importers in EM USD government bond index



Source: Bloomberg, Standard Chartered

Will the rise in US Treasury yields improve Investment Grade bond performance over the next 6-12 months?

The recent rise in government bond yields has resulted in negative total returns across Developed Market government and corporate Investment Grade (IG) bonds (YTD -3.6%, and -4.9% respectively), consistent with our least-preferred view. However, we believe they are still likely to underperform High Yield (HY) bonds from here:

1. Even if the Fed eventually hikes at a slower pace than markets project, Treasury yields are unlikely to decline materially from current levels. This limits room for price gains.
2. Credit spreads for IG corporate bonds are expensive, reducing the scope for outperformance through spread compression.

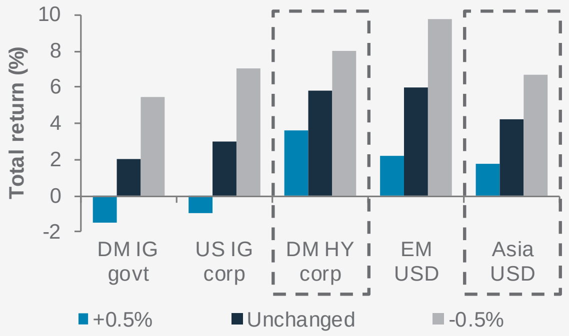
IG bonds are likely to underperform in the likely scenario of yields remaining broadly stable or rising modestly. Even in an unlikely scenario of yields declining by 50bps, US IG corporate bonds are still likely to underperform HY over 6-12 months owing to lower coupons.

Hence, while a pullback in yields could lead to temporary outperformance of DM IG bonds in the short term, on a 6-12 month horizon, we still see them as less preferred.

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

We expect DM IG government and corporate bonds to underperform High Yield bonds over the next 6-12 months due to their low starting yields

Estimated total returns should yields rise or decline by 50bps or remain unchanged, assuming other factors remain unchanged



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What can we expect from the earnings season in Europe and China?

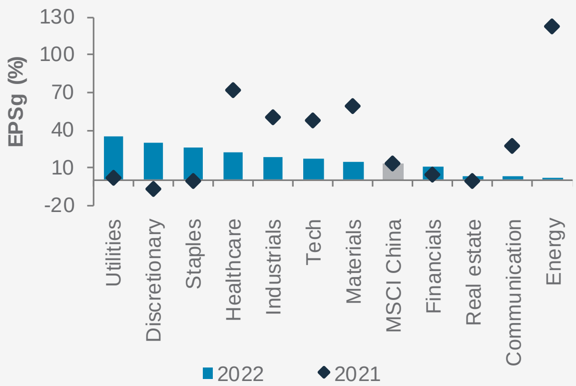
In Europe, 45% of companies in the Stoxx600 index have reported their results and earnings have surprised positively by 4.3% so far. Q4 earnings growth continues to be revised upwards, with consensus now expecting 75% growth, up from 65% expected at the start of the year. The strength has been relatively broad, with most sectors (7 out of 10) surprising positively. Earnings growth is expected to continue to be an important driver for Euro area equities.

In China, the earnings season starts next week, with consensus being cautious, revising estimated 2021 earnings growth down from 16% at the start of the year to 13% currently. For 2022, consensus also expects 13% growth for MSCI China but the sectors driving this growth are very different. Among the large sectors, consumer discretionary and consumer staples are expected to contribute more significantly to 2022 growth, compared with 2021, as government policies to stabilise the economy support a resumption of healthy domestic demand. Meanwhile, communication services, which benefitted significantly from the pandemic-led stay-home restrictions, is expected to see less growth in 2022 due to economic re-opening. The market's overall direction will be influenced by the impact of government policies on overall growth, in our view.

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

Consumer sectors (discretionary and staples) in China are expected to contribute more significantly to 2022 earnings growth

MSCI China consensus earnings estimates by sector



Source: MSCI, FactSet, Standard Chartered

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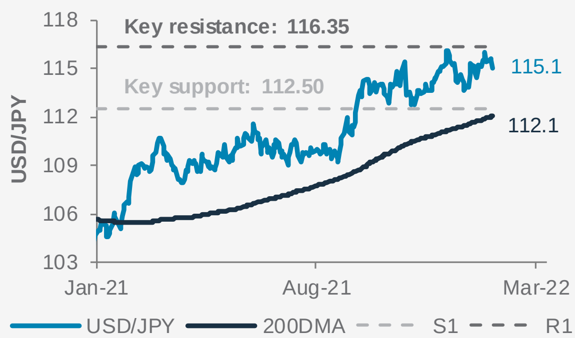
Is the JPY a good risk hedge currently?

The rush among major central banks to talk and act tough on monetary policy has left two laggards in focus – the Swiss National Bank (SNB) and the Bank of Japan (BoJ). For the time being at least, the SNB regards the CHF as too strong and will likely welcome any weakness. The BoJ, on the other hand, may be faced with a different problem. On many medium-term valuation models, the JPY is extremely cheap. As a popular funding currency, the JPY is also oversold. A high proportion of Japanese offshore investments are unhedged. In a scenario where geopolitical risks become a reality, the JPY is a serious contender as a safe haven.

BoJ Governor Kuroda said this week that monetary policy would not turn hawkish on his watch. Yield curve control that caps the JGB 10-year yield at +0.25% was loudly reinforced this week, but the yield remains around 0.22%. Other officials have recently said a weak JPY no longer provides much support for exporters, but it does pass through higher energy costs to households and businesses. USD/JPY has registered a double top around 116.35 and should see strong resistance up to 117. There is downside support from 112 to 113.50, but this support could be quickly tested in a risk-off scenario. The risk-reward of cheap funding via short JPY positions looks less attractive for now, in our view, but it may offer an attractive hedge in the event geopolitical risks escalate.

USD/JPY uptrend may be peaking; cheap valuation, stretched short-positioning and safe-haven status could trigger a sharp reversal

USD/JPY daily chart with technical levels



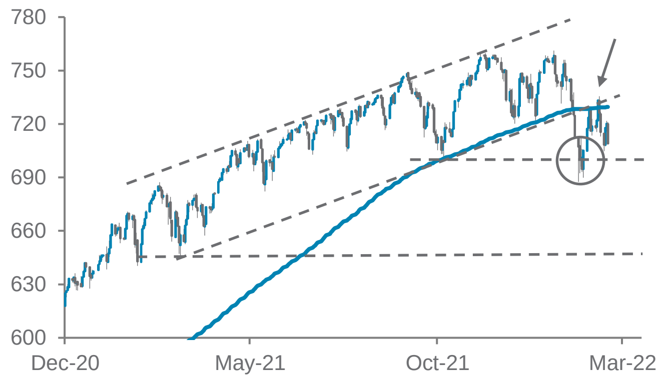
Source: Refinitiv, Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

Global equities: Upward pressure has faded for now

MSCI All Country World index daily chart with 200-DMA

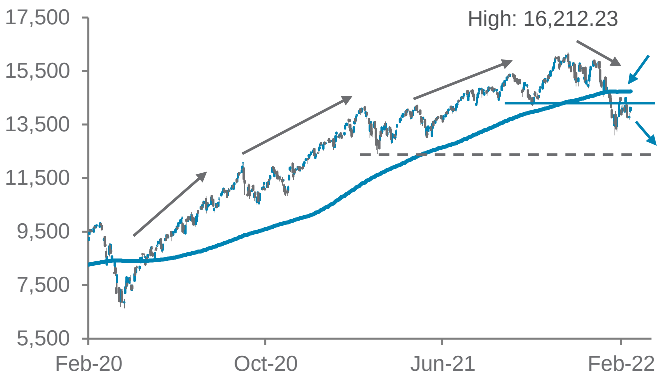


Source: Refinitiv, Standard Chartered

The break below the rising channel confirms that the short-term upward pressure has faded. Moreover, the failure to break above the 200-DMA suggests that the risk of a retest of the January low of 687 remains alive. Below that, there is strong support at 645 (9% from Thursday's close), which could limit the decline.

Nasdaq: A change in trend, not a reversal

Nasdaq Composite index daily chart with 200-DMA

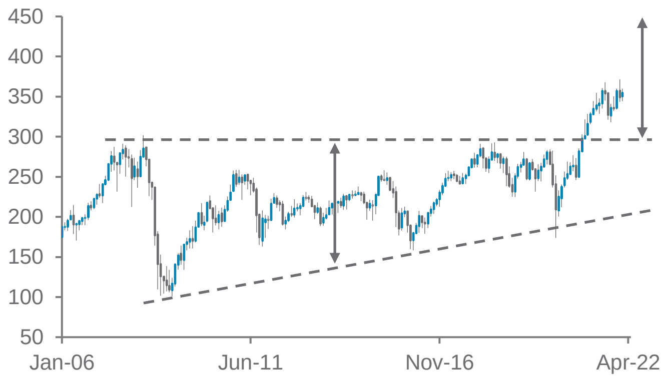


Source: Bloomberg, Standard Chartered

The break below the October low and the change in the higher-highs-higher-lows pattern indicates that the trend has changed to sideways from up in the interim. To be sure, a change does not necessarily imply a reversal (although it can at times). Nevertheless, for now, there is a risk of a fall towards 12,397 (9.6% from Thursday's close).

EU materials: More to come

MSCI Europe Materials sector index monthly chart

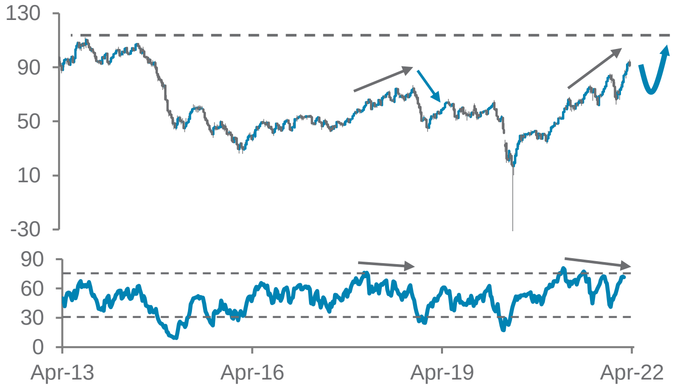


Source: Refinitiv, Standard Chartered

The recent pattern is more of a consolidation following the strong rally from March 2020. That is because a major bullish breakout last year from a multi-year range keeps the upward bias intact. From a medium- or long-term perspective, the sector index could rise towards 450 (27% from Thursday's close), the price objective of the pattern.

Crude oil: Short-term fatigue is setting in

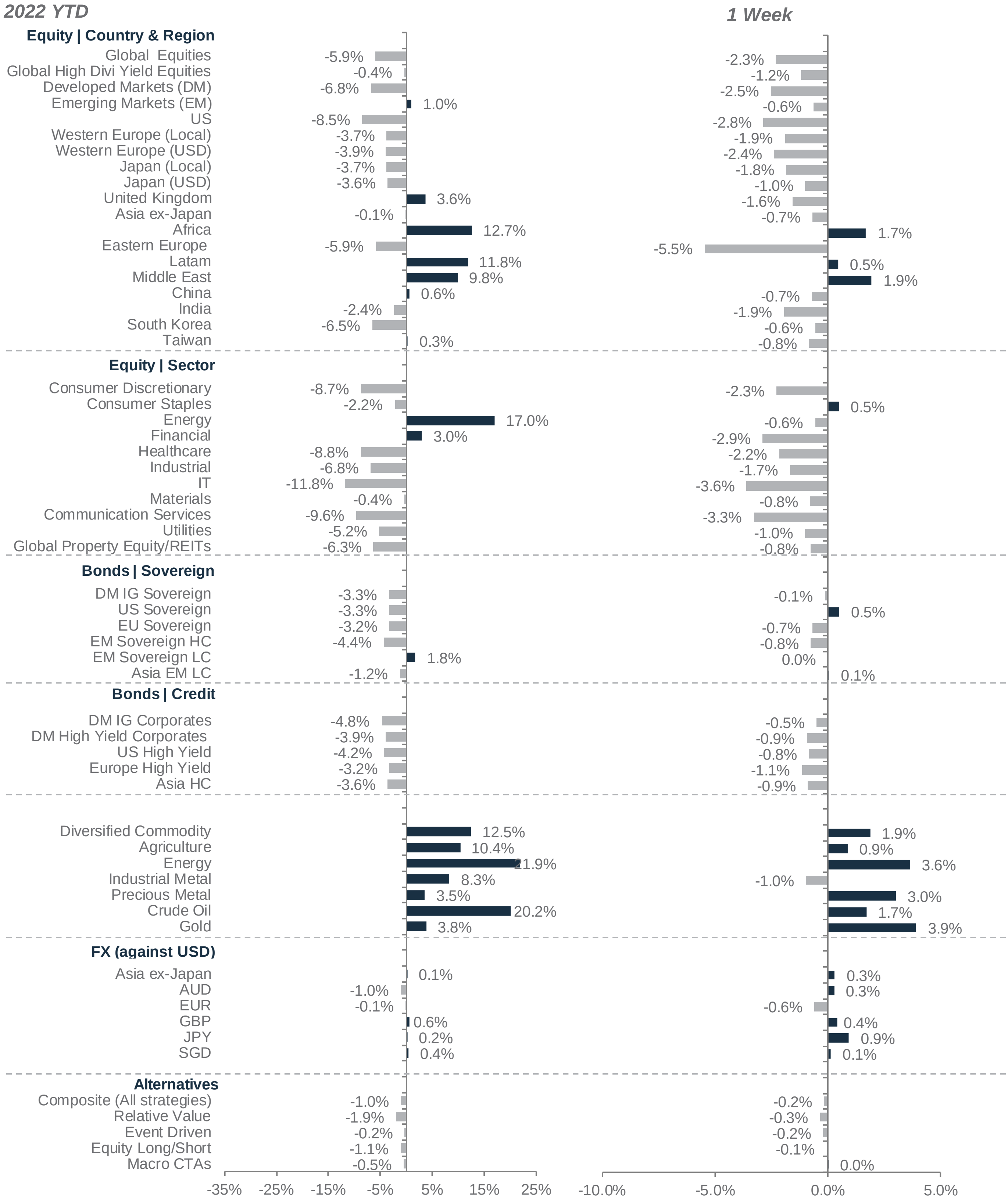
WTI Crude continuous contract weekly chart with RSI



Source: Refinitiv, Standard Chartered

Negative momentum divergence (higher price associated with lower momentum readings) is a sign that the rally is showing signs of fatigue in the short term. But any potential consolidation may not be enough to derail the evolving medium-term uptrend. As we noted last week, oil appears to be on its way towards 112-115.

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 17 February 2022; 1-week period: 10 February 2022 to 17 February 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	Markit Eurozone Manufacturing PMI	Feb P	–	58.7
	EC	Markit Eurozone Services PMI	Feb P	–	51.1
	UK	Markit/CIPS UK Services PMI	Feb P	–	54.1
	UK	Markit UK PMI Manufacturing SA	Feb P	–	57.3
TUE	US	Markit US Manufacturing PMI	Feb P	–	55.5
	US	Markit US Services PMI	Feb P	–	51.2
	US	Conf. Board Consumer Confidence	Feb	110	113.8
WED					
THUR	US	GDP Annualized q/q	4Q S	6.9%	6.9%
FRI/SAT	EC	M3 Money Supply y/y	Jan	–	6.9%
	US	Durable Goods Orders	Jan P	0.6%	-0.7%
	US	PCE Deflator y/y	Jan	–	5.8%
	US	PCE Core Deflator y/y	Jan	5.2%	4.9%

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

The S&P500 index's next support is 1% below current level

Technical indicators for key markets as on 17 February 2022

Index	Spot	1st support	1st resistance
S&P500	4,504	4,463	4,566
STOXX 50	4,197	4,121	4,239
FTSE 100	7,672	7,568	7,724
Nikkei 225	27,696	27,398	27,845
Shanghai Comp	3,486	3,448	3,505
Hang Seng	24,924	24,528	25,123
MSCI Asia ex-Japan	793	780	800
MSCI EM	1,251	1,230	1,262
Brent (ICE)	91.4	90.4	92.9
Gold	1,827	1,813	1,838
UST 10Y Yield	2.03	1.95	2.07

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 normal across major assets

Our proprietary market diversity indicators as of 16 February

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.33
Global Equities	●	→	1.55
Gold	◐	↑	2.29
Equity			
MSCI US	●	↑	1.59
MSCI Europe	●	↑	1.65
MSCI AC AXJ	●	↓	1.54
Fixed Income			
DM Corp Bond	◐	↓	1.33
DM High Yield	◐	↓	1.47
EM USD	◐	↓	1.47
EM Local	●	↑	1.64
Asia USD	◐	↓	1.41
Currencies			
EUR/USD	●	↑	1.86

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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