Wealth Management Chief Investment Office
22 July 2022

Weekly Market View

What will sustain the upturn?

→ The broad-based turnaround in risk assets this week suggests it is too soon to worry about the global recession narrative. Risk assets were, of course, poised for a technical rebound as investor positioning had turned extremely bearish.

→ Even after this week's rebound, positioning and sentiment remain bearish, which, as a contrarian signal, could help extend the recovery in risk assets in the near term. The bigger question: Is this rebound sustainable beyond the near term?

→ In this report, we discuss the upside and downside risks, which we believe are evenly balanced. This suggests investors should remain broadly diversified, without taking concentrated risks.

Deep Dive: What is your view on US Healthcare and Technology sectors?

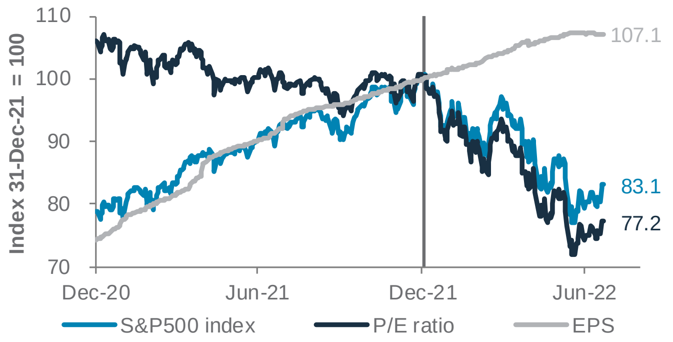
What should we expect from the Fed's policy meeting next week?

Is the EUR rebound sustainable after the ECB's first rate hike in over a decade?

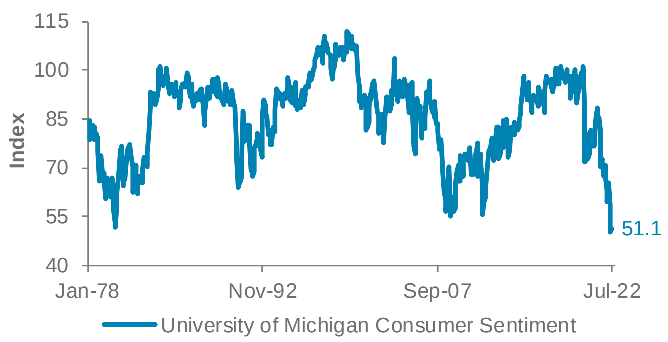
Charts of the week: Investor & consumer sentiment at rock-bottom

This year's fall in equity prices has been driven by a slump in P/E multiples, which mirror a drop in consumer sentiment

S&P500, Price/Earnings (P/E) ratio, 12m forward est. EPS*



US consumer sentiment index (University of Michigan)



Source: Bloomberg, Standard Chartered; *All three series indexed to 100 = 31 Dec 2021

Editorial

What will sustain the upturn?

The broad-based turnaround in risk assets this week suggests it is too soon to worry about the global recession narrative. Risk assets were, of course, poised for a technical rebound as investor positioning had turned extremely bearish. Even after this week's rebound, positioning and sentiment remain bearish, which, as a contrarian signal, could help extend the recovery in risk assets in the near term. The bigger question: Is this rebound sustainable? We believe the upside and downside risks are evenly balanced, which suggests investors should remain broadly diversified, without taking concentrated risks.

The good news is that part of this week's market recovery was driven by fundamental factors. Stronger-than-expected US retail sales indicate the robust job market continues to support household consumption. The past week also saw a nascent recovery in US consumer sentiment from record low levels. Historically, US stocks have delivered an average 14% return in the 12 months after the US Michigan Consumer Sentiment index hit similarly rock-bottom levels. Also, the US Q2 earnings season is thus far turning out to be better than expected, helping support investor sentiment, albeit with only 20% of S&P500 index companies having reported so far (see page 4).

US data next week is likely to be less cheerful, with the Q2 GDP estimates likely to show the US economy entered a technical recession in H1. The Atlanta Fed's latest GDPNow estimate indicates the US economy contracted 1.6% in Q2, following a similar contraction in Q1. Meanwhile, excluding the energy sector, US Q2 earnings are estimated to have contracted for the first time since Q3 2020. However, these data are backward looking and likely already discounted by markets. The real question for investors is whether the US will see a deeper and protracted recession and earnings contraction, accompanied by a weak jobs market, which the markets have yet to factor in?

A significant part of the answer lies with how the Fed proceeds with policy tightening from here. We (and the markets) expect the Fed to slow the pace of rate hikes after a 75bps hike next week, followed by another 75bps hike in September. The pullback in US inflation expectations, slowdown in business confidence indicators (PMIs) and a sharp decline in housing markets since April (see page 3 chart), if sustained, would support such a pause. However, the Fed will also want to see a sustained decline in near-term inflation and a cooling of the red-hot job market before it hits the brakes on rate hikes. There are signs that the job market is cooling, with initial jobless claims rising since April. A peak in Fed rate expectations would likely lead to a cascading downward effect on US government yields and the USD, in turn lifting global risk assets.

The risk to the above scenario is that US inflation stays high, instead of falling below 4% over the next 12 months as markets expect. Inflation has been broadening beyond supply-driven factors in recent months, with rising shelter and services sector cost pressures. Russia's (Gazprom) decision to declare force majeure on gas supplies to some European clients (even as it restarted supplies after a planned pipeline maintenance) is a potential threat to adequate supplies this winter, which could exacerbate the global energy crisis. This is one of the risk scenarios where the Fed may have to hike much more than the peak of c.3.5% in 2023 currently priced in by markets.

Europe remains another source of downside risks. The political crisis in Italy after Prime Minister Mario Draghi resigned does not help the case for Euro area risks assets. Although the ECB announced this week a new tool aimed at containing southern European bond yield spreads vs German bonds, Italian bond yield spreads versus German bonds rose. The central bank also raised its policy rate this week (by 50bps) for the first time in more than a decade amid surging inflation pressures. The market is pricing another 70bps hike in September. These rate increases are likely to hurt Euro area growth in the coming quarters, keeping the USD well-bid in the near term, especially with the BoJ vowing to maintain its ultra-easy monetary policy (see page 5). Meanwhile, a renewed rise in China's COVID cases and uncertainty around mortgage repayments is a dampener on near-term sentiment.

— 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.

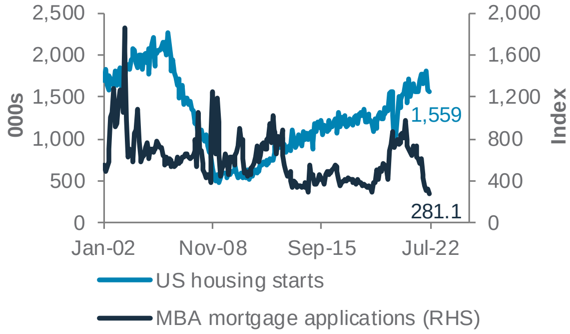
(+) factors: China policy support, US consumer sentiment, retail sales

(-) factors: COVID cases in China, Japan; Russia gas supply cut fears

	Positive for risk assets	Negative for risk assets
COVID		• China reported highest number of cases since May; testing widened in Shanghai; Macau extended lockdowns to 29 July • Japan cases at record high
	Our assessment: Negative – China lockdowns, rising cases	
Macro data	• Univ. of Michigan sentiment rose more than expected, with inflation expectations dropping • US retail sales higher than expected	• US housing starts rose lesser than consensus • Euro area consumer confidence lower than expected • US leading index weaker than estimate
	Our assessment: Neutral – Recovering US consumer sentiment, robust retail sales vs weaker housing market	
Policy developments	• China Premier Li signalled growth flexibility and targeted COVID measures • China policymakers exploring mortgage holidays; banks urged to boost lending to developers as mortgage boycotts spread to other loans	• ECB hiked rate by 50bps and unveiled plans to contain bond yields of weaker peripheral members • BoJ's Kuroda vowed to keep ultra-loose policy • IMF warned it will cut global growth forecast drastically • China kept loan prime rates unchanged
	Our assessment: Neutral – China policy support vs ECB hike	
Other developments	• UK Conservative lawmakers move closer to electing next PM; list of candidates whittled down to two choices: Rishi Sunak and Liz Truss	• Italian PM Draghi resigned after failing to rebuild his governing coalition • Gazprom declared force majeure on gas supply; Nord Stream 1 resumed • President Biden left Saudi Arabia without a deal on boosting oil supplies
	Our assessment: Neutral – Improving UK political outlook vs Italy politics, EU energy supply uncertainty	

The US housing market is softening, with high interest rates driving mortgage applications to a 20-year low

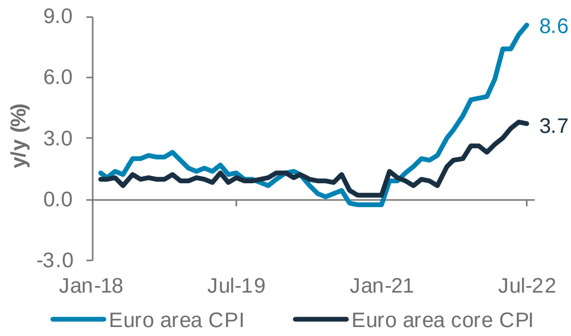
US housing starts, mortgage applications



Source: Bloomberg; Standard Chartered

Euro area consumer inflation continued to rise

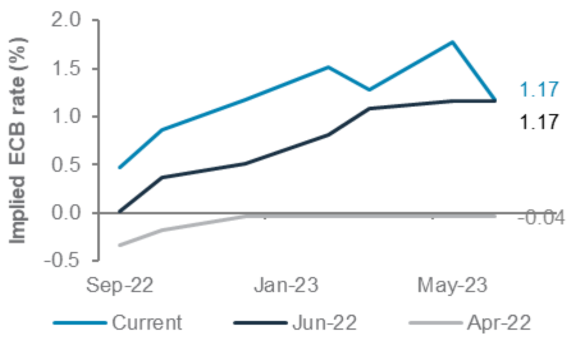
Euro area headline and core consumer inflation



Source: Bloomberg, Standard Chartered

The markets are increasingly pricing a more aggressive front-loaded ECB interest rate hiking cycle

Money market implied European Central Bank rate over the next 12 months



Source: Bloomberg, Standard Chartered

Top client questions

How is the US earnings season progressing? What is your view on the US healthcare and technology sectors?

So far, almost 20% of S&P500 index companies have reported Q2 earnings, with encouraging results. According to Refinitiv data, 78% of these companies have beaten earnings expectations (above the long-term average of 66%). Companies that reported have delivered a 5.1% positive earnings surprise. Consensus expectations now are for Q2 earnings to grow by 6.3% y/y, up from 5.6% expected before the start of the earnings season. However, while Q2 expectations are being nudged up, cautious guidance from companies and a backdrop of slower economic growth have prompted analysts to trim their earnings growth expectations for the full year. Consensus 2022 earnings growth is now estimated at 9.3%, down from 9.5% before the earnings season started. Likewise, 2023 earnings growth is now estimated at 8.6%, down from 9.3% previously.

Having said that, equity markets have already corrected significantly, with the S&P500 witnessing a more-than-20% peak-to-trough fall in H1 this year. Against, this backdrop, we view the Q2 results so far as relatively encouraging. We have a core holding view on US equities and expect it to perform in line with global equities over the next 6-12 months.

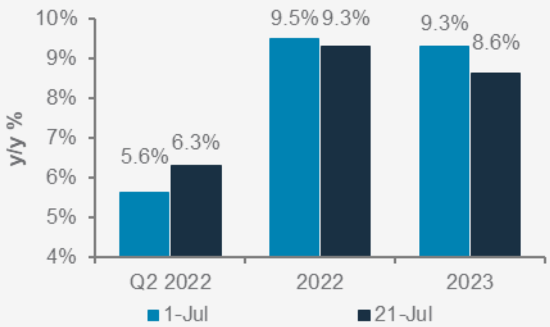
Amid growth uncertainty and volatile markets, we like the defensive nature of the US healthcare sector. We have a preferred view of the US healthcare sector and expect it to outperform the broader US market over the next 6-12 months. The sector offers steady earnings growth that has historically been less volatile than for the broader market. Sector valuation also appears reasonable; consensus 12-month forward P/E ratio of 17x is in line with the broader market and it has historically traded in line with the market. The sector generates high return on equity and we expect a post-pandemic pick-up in healthcare visits and elective procedures to support earnings growth.

The US technology sector has also offered consistently positive earnings growth for the past decade, driven by structural growth trends such as digitalisation, cloud computing and 5G upgrades. We expect these trends to continue supporting earnings growth in the years ahead, highlighting the sector's attraction. However, valuation for the sector continues to be elevated, even though it has de-rated this year. Consensus 12-month forward P/E of 21x is at a 25% premium to the broader market, compared with a long-term premium of 17%. As bond yields have risen this year and future earnings are discounted more heavily, the technology sector faces stronger de-rating pressure than the broader market. We have a core holding view on the US technology sector, expecting it to perform in line with the broader US market over the next 6-12 months.

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

Positive surprises so far have led to Q2 earnings expectations being revised up. However, earnings estimates for 2022 and 2023 have been trimmed

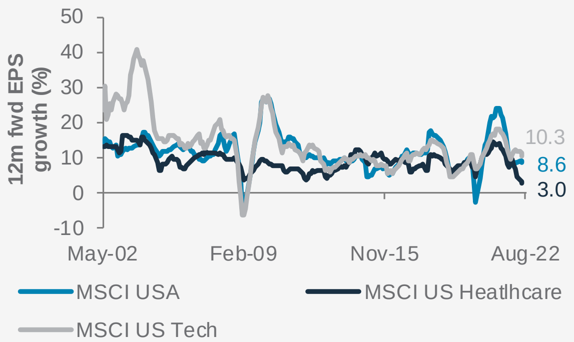
Consensus earnings growth expectations for Q2 2022, full year 2022 and 2023; as of 1 July and 21 July



Source: Refinitiv, Standard Chartered

US healthcare sector earnings growth has historically been less volatile than for the broader market and has remained positive through cycles

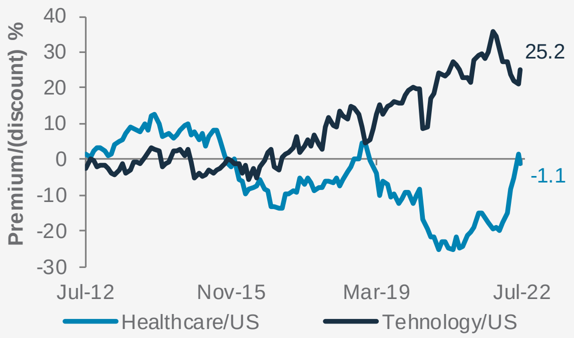
Consensus 12m forward EPS growth for MSCI US, MSCI US Healthcare & MSCI US Technology indices



Source: MSCI, FactSet, Standard Chartered

US healthcare sector valuation is undemanding, in line with the market, while US technology sector valuation remains elevated

Consensus 12m forward P/E for MSCI US Healthcare and MSCI US Technology, both relative to MSCI US



Source: MSCI, FactSet, Standard Chartered

Top client questions (cont'd)

What should we expect from the Fed's policy meeting next week? What are the likely implications for US Treasury yields?

The recent strong June inflation print and a surprise 100bps hike by the Bank of Canada caused markets to price in a more hawkish Fed (100bps in July and 75bps in September) in mid-July. The July expectations were dialled back later after several Fed officials expressed their support for a 75bps hike, which now appears to be the most likely outcome.

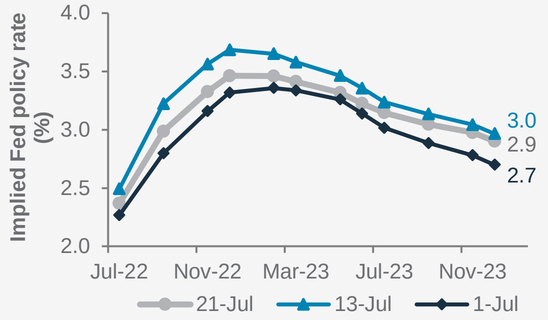
Although market expectations of the Fed rate have been volatile lately, longer maturity bond yields have been more stable, with 10-year yields ending up rangebound as growth concerns start to balance out worries of higher inflation and policy rates. Having said that, in the near term, we expect the 10-year US Treasury yield to retest the 3% and 3.25% levels as one-sided positioning starts to balance out. We would view any rise in yields as an opportunity to add to bonds, where appropriate, which we view as a core holding.

Within Developed Market bonds, we retain a preference for High Yield corporate bonds. Corporate profit margins are challenged by higher energy and wage costs. However, slowing hiring activity, the lack of a new energy price surge and a front-loading of corporate borrowing in previous years are likely to help offset these risks.

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

US rate hike expectations jumped after June inflation print and Bank of Canada rate hike, but have subsequently eased a bit

Implied Fed policy rate as indicated by Fed Funds Futures



Source: Bloomberg, Standard Chartered

Is the EUR's rebound sustainable after the ECB's first rate hike in a decade? What about the other G10 currencies?

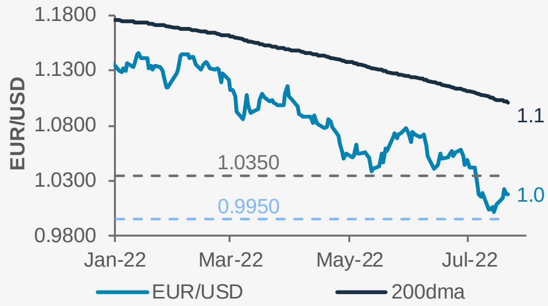
The ECB took an aggressive first step towards policy normalisation with a 50bps hike, bringing an end to negative policy rates. However, the headwinds for the Euro area economy and the EUR, namely inflation and slow growth, continue. Russian energy supply concerns, Italian political uncertainty and weak Chinese and global demand remain risks.

A key market message from the ECB's move could be that further sharp EUR weakness is unwelcome. With sentiment bearish and EUR/USD having fallen over 12% since January, a push towards 1.0350 resistance is possible. Beyond this, we believe EUR headwinds will continue near term and the USD is unlikely to give up the benefits of economic exceptionalism and safe-haven status for now. Only a sustained break of 1.0350 could trigger further gains towards the next key resistance band at 1.06-1.08. Therefore, we expect investors to look to sell into EUR strength and a trading range between 0.9850 and 1.0350 could be established in the near term.

We continue to prefer accumulating commodity currencies backed by hawkish central banks, such as the AUD and CAD. The BoJ has once again spurned the window to join "Team Normalisation" by keeping its policy unchanged, leaving the JPY under pressure despite being extremely oversold and undervalued.

EUR/USD faces near-term resistance at 1.0350 amid Euro area growth headwinds; we expect investors to sell into near-term EUR strength

EUR/USD 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 21 July 2022; 1-week period: 14 July 2022 to 21 July 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	Jun	–	0.01
TUE	US	Conf. Board Consumer Confidence	Jul	97.0	98.7
	US	New Home Sales	Jun	675k	696k
WED	EC	M3 Money Supply y/y	Jun	–	5.6%
	US	Durable Goods Orders	Jun P	-0.3%	0.8%
THUR	US	FOMC Rate Decision (Upper Bound)	27-Jul	2.5%	1.8%
	EC	Economic Confidence	Jul	–	104.0
	US	GDP Annualized q/q	2Q A	0.8%	-1.6%
	US	Personal Consumption	2Q A	–	1.8%
FRI/SAT	EC	CPI Estimate y/y	Jul	–	8.6%
	EC	CPI Core y/y	Jul P	–	3.7%
	US	Employment Cost Index	2Q	1.1%	1.4%
	US	PCE Deflator y/y	Jun	–	6.3%
	US	PCE Core Deflator y/y	Jun	4.8%	4.7%
	US	MNI Chicago PMI	Jul	56.5	56.0

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

US 10-yr government bond yield faces resistance at 2.99%

Technical indicators for key markets as on 21 July 2022

Index	Spot	1st support	1st resistance
S&P 500	3,999	3,887	4,055
STOXX 50	3,597	3,517	3,636
FTSE 100	7,271	7,188	7,325
Nikkei 225	27,936	27,171	28,318
Shanghai Comp	3,261	3,225	3,301
Hang Seng	20,599	20,301	20,894
MSCI Asia ex-Japan	645	634	650
MSCI EM	991	971	1,000
Brent (ICE)	104.8	101.5	107.7
Gold	1,714	1,701	1,723
UST 10y Yield	2.89	2.84	2.99

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 has normalised in global bonds

Our proprietary market diversity indicators as of 20 July

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↑	1.40
Global Equities	◐	↓	1.42
Gold	◐	→	1.25
Equity			
MSCI US	◐	↓	1.45
MSCI Europe	◐	↓	1.42
MSCI AC AXJ	◐	↓	1.40
Fixed Income			
DM Corp Bond	◐	→	1.44
DM High Yield	◐	↓	1.35
EM USD	◐	↓	1.34
EM Local	◐	↓	1.27
Asia USD	◐	↓	1.36
Currencies			
EUR/USD	◐	↓	1.37

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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