



Weekly Market View

Will equities pass the earnings test?

→ Bond markets appear to be catching up to what equity markets have suspected for a while – that slowing growth, especially in the US and Europe, could eventually be a bigger risk than inflation. For the past three weeks, US government yields have sharply pulled back alongside long-term inflation expectations, while the US 10-year yield fell below the 2-year yield for the third time since April.

→ The moves suggest bond markets, after worrying about inflation, are now preparing for a downturn in US growth as the Fed tightens policy further. Meanwhile, US equities have been largely resilient in recent weeks, after having already suffered a more than 20% drop this year.

→ This diverging backdrop between bonds and equities raises the stakes for the US earnings season starting next week. Will Q2 earnings and corporate guidance for H2 2022 confirm worries about recession risks or will companies be able to reassure investors that the underlying earnings drivers remain healthy?

How does the US recession narrative impact your equity sector preferences?

Will PM Johnson's resignation change the GBP outlook?

Deep Dive: What are the factors underlining your preference for Asia USD bonds?

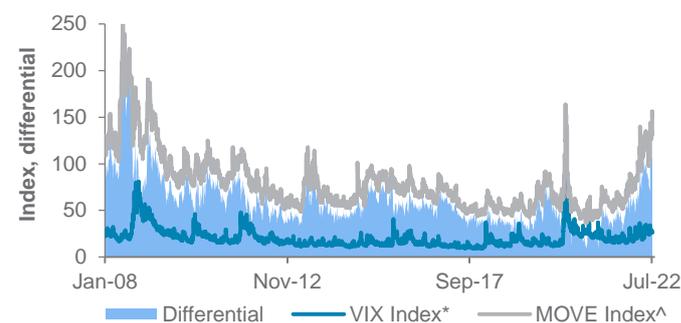
Charts of the week: US earnings in focus as recession risk rises

US Q2 earnings estimates have fallen since March, but full-year estimates have been resilient; bond volatility has surged

S&P500 Q2 and 2022 full year earnings consensus estimates



US government bond & S&P500 volatility indices; differential



Source: Refinitiv, Bloomberg, Standard Chartered; *VIX represents S&P500 index volatility, ^MOVE index represents US government bond volatility

Editorial

Will equities pass the earnings test?

Bond markets appear to be catching up to what equity markets have suspected for a while – that slowing growth, especially in the US and Europe, could eventually be a bigger risk than inflation. For the past three weeks, US government yields have sharply pulled back alongside long-term inflation expectations, while the US 10-year yield fell below the 2-year yield for the third time since April. The moves suggest bond markets, after worrying about surging inflation, are now preparing for a sharp downturn in US growth as the Fed tightens policy further. Meanwhile, US equities have been largely resilient over the past three weeks, after having already suffered a more than 20% drop this year, as investors consider whether a growth slowdown has already been factored into stock prices.

This diverging backdrop between bonds and equities raises the stakes for the US earnings season starting next week. Will Q2 earnings and corporate guidance for H2 2022 confirm worries about recession risks or will companies be able to reassure investors that the underlying earnings drivers remain healthy? As the chart above shows, although US Q2 earnings estimates have been downgraded since April, full-year 2022 US earnings estimates have continued to rise steadily. Hence, equities face further downside risk in the near term if corporate earnings guidance for the rest of 2022 underwhelms.

According to Refinitiv consensus estimates, Q2 earnings for the S&P500 index rose 5.6% y/y on the back of 10.4% revenue growth. The earnings gains were likely driven by a surge in energy (+223%), industrial (+31%) and material (+19%) sector earnings. However, excluding the energy sector, Q2 earnings are estimated to have declined 2.4%. That would be the first earnings contraction since the pandemic-driven slump in 2020. Such a contraction would mirror macroeconomic data. The Atlanta Fed's real-time GDPNow forecast for Q2 growth is now signalling a 1.9% annualised contraction. While the forecast has yet to consider most economic data for June, another GDP contraction in Q2, following the 1.6% contraction in Q1, would mean the US entered a technical recession in H1.

Financial sector earnings will be closely watched to assess the underlying health of the economy. Headline earnings for the sector are estimated to have fallen 20%, but that is primarily because of the write-backs of pandemic loan-loss provisions in the year-ago period. We believe underlying earnings likely rose on the back of higher net interest margins that typically rise with higher interest rates. We will also follow banks' outlook for loan demand amid a slump in mortgage applications. Consumer credit has risen this year as lower-income households depleted their pandemic-era savings. This trend is likely to extend as long as the job market holds up, which may help offset lower demand for mortgages in the coming quarters.

A strong jobs data for June would come with its own risks (the consensus estimates 268,000 net new jobs were created). A strong number will likely encourage Fed policymakers to hike the policy rate by another 75bps to 2.5% later this month, especially if US inflation for June (due on 13 July) remains close to May's 40-year high. Minutes from the Fed's June policy meeting showed policymakers want to maintain their tightening stance until they see a consistent decline in near-term inflation.

The mix of a resolutely hawkish Fed policy and downside growth and corporate earnings risks is a key reason why we reduced our exposure to equities in our benchmark asset allocation last month and raised our allocation to bonds. Within bonds, we believe Asia USD bonds offer investors some of the best value, given their overall high quality, relatively low volatility, inexpensive valuations and China's gradual policy-driven recovery (see our focus on Asia USD bonds on page 7).

Also on our radar: (i) Biden's visit to Saudi Arabia and Israel. Will the Saudis agree to boost oil output, or will Biden turn to Iran with a deal? (ii) The G20 meeting in Bali of foreign and finance ministers – with Russia's Foreign Minister Sergey Lavrov attending; host Indonesia is trying to mediate a resolution to the Ukraine war (iii) China's new loans and money supply data to confirm if the credit upturn continued into June amid rising infrastructure financing.

— 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: Recovering China PMIs, resilient Euro area retail sales, US-China tariffs rollback talk

(-) factors: China COVID cases, PBoC liquidity cut, hawkish Fed minutes

	Positive for risk assets	Negative for risk assets
COVID	<ul style="list-style-type: none"> Hong Kong's John Lee reviewing quarantine period 	<ul style="list-style-type: none"> A highly infectious variant spreading in China; Beijing scrapped vaccine mandate Cases rising in Singapore
	Our assessment: Negative – Rising cases in China	
Macro data	<ul style="list-style-type: none"> Caixin China Mfg and Services PMIs rose above 50, higher than consensus Euro area retail sales growth stayed positive Euro area producer inflation rose less than expected US JOLTs job openings were above market estimates US ISM Services PMI slowed less than expected 	<ul style="list-style-type: none"> Euro area Sentix investor confidence fell more than expected
	Our assessment: Positive – Rebounding China PMIs, resilient Euro retail sales	
Policy developments	<ul style="list-style-type: none"> China's policymakers committed to control pork prices 	<ul style="list-style-type: none"> Fed minutes showed policymakers favoured more restrictive policy until inflation slows PBoC cut its daily short-term liquidity operation to the lowest since Jan 2021 RBA hiked rates by 50bps to 1.35% as expected
	Our assessment: Negative – Hawkish Fed, China liquidity	
Other developments	<ul style="list-style-type: none"> China and US discussed rollback of sanctions and tariffs 	<ul style="list-style-type: none"> UK PM Boris Johnson resigned after several cabinet ministers quit earlier Japan's former PM Shinzo Abe shot while campaigning for upper house elections
	Our assessment: Neutral – Talks on rollback of China tariffs vs UK political instability	

US job openings remained close to record highs, even as business confidence flagged

US job openings, ISM manufacturing & services PMIs



Source: Bloomberg; Standard Chartered

Euro area sentiment continued to decline; retail sales growth unexpectedly stayed positive

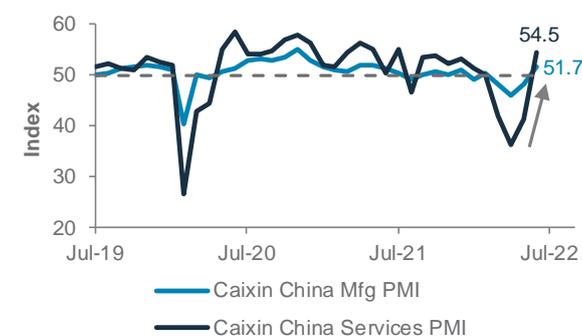
Euro area Sentix investor sentiment, retail sales



Source: Federal Reserve, Standard Chartered

China's business confidence indicator for small firms recovered to positive territory

China Caixin manufacturing and services PMIs



Source: Bloomberg, Standard Chartered

Top client questions

Q How does the recession narrative impact the upcoming earnings season? Does it impact your US sector preferences?

Although the US S&P500 has seen a correction of over 20% from its highs, equity earnings expectations have not yet followed the index lower and consensus estimates remain resilient. The price action may be pointing to potential downgrades and investors will look to companies' guidance on the impact of inflation, higher interest rates and signs of a growth slowdown.

Consensus estimates, according to Refinitiv, suggest S&P500 earnings grew by 5.6% y/y in Q2. This estimate has been revised down from 6.8% expected in April, but it is up from 5.1% expected at the start of the year. Nonetheless, Q2 is expected to have the slowest earnings growth since Q4 2020 (due to statistical base effects following the large Q2 rebound last year) before recovering in Q3. For 2022 full year, the consensus estimate is for growth of 9.5%, revised up from 8.8% expected at the start of Q2 and 8.4% expected at the start of the year. This upgrade at an index level, however, masks a wide dispersion in changes faced by various sectors. Since the start of Q2, the consumer discretionary and communication services sectors have seen significant earnings downgrades, affected by inflation and a shift in consumer spending from goods towards services. Meanwhile, energy and materials have seen significant upgrades following elevated commodity prices.

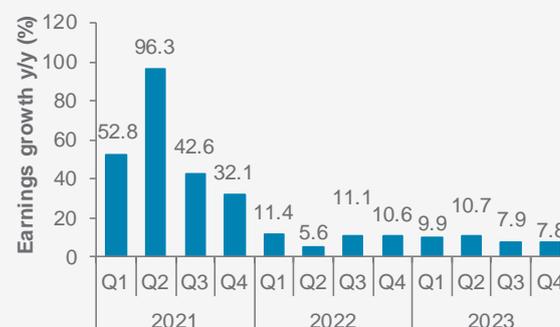
We have a preferred view on the US for the energy, financial and healthcare sectors, which we believe can outperform the market over the next 6-12 months. US recession fears have led to a pullback in oil prices and the energy sector. However, we believe a tight demand-supply balance will keep oil prices elevated as oil producers maintain supply discipline, while demand remains relatively resilient. This should continue to support strong earnings growth in the energy sector. Energy equities have lagged the rebound in their earnings and valuations are attractive; we maintain our preferred view of the energy sector. The financial sector would also be impacted by a recession as demand for loans and financial products decline. However, the US financial sector benefits from rising interest rates and we expect the Fed to continue raising rates to battle inflation. We also expect loan demand to remain resilient as US households are starting from a healthy position with the ability to borrow more.

Our preference for healthcare reflects defensive positioning as it offers relatively dependable earnings growth, that is less sensitive to the economy, for a reasonable valuation.

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

The consensus expects S&P500 companies to report 5.6% earnings growth in Q2. Full year 2022 earnings growth is expected at 9.5%

S&P500 earnings growth y/y by quarters, from Q1 2021 to Q4 2023 (actual and consensus forecasts)



Source: Refinitiv, Standard Chartered

Energy and Material sectors have seen the largest upgrade to 2022 earnings growth since the start of Q2; Discretionary and Communication sectors have seen the largest downgrades

Consensus 2022 earnings growth by sectors in the S&P500 index, as of 1-Jul-22 and 1-Apr-22



Source: Refinitiv, Standard Chartered

Top client questions (cont'd)

Q What is the near-term outlook for US Treasuries given the increased volatility?

US government bond yields have been unusually volatile over the past month, peaking at 3.49% on 14 June before declining to 2.74% earlier this week and subsequently rebounding to close to 3%, after the release of the FOMC meeting minutes. In fact, the 50-day moving average for the MOVE Index, which represents the volatility of US government bond yields, is at the highest level since 2009.

The elevated volatility is not surprising given the immense focus on the Fed and the path of potential future rate hikes. In our view, this means bond yields are likely to continue to be prone to large movements around major economic data releases leading up to the Fed policy meeting in late July.

As another 75bps Fed rate hike appears likely, 10-year US government bond yields are likely to again retest the 3.26% resistance level and potentially even the 3.50% mark over the coming few weeks. However, following any Fed-driven knee-jerk moves higher, we believe a renewed focus on elevated recessionary concerns are likely to exert downward pressure on yields. Hence, we continue to expect 10-year US government bond yields to trade in a wide range of 2.8%-3.5% over the next few weeks. However, on a 12-month horizon, we still expect the Fed to hike by slightly below their current guidance given recession risks, which should lead the 10-year US government bond yield to trade around 3.25%.

— **Abhilash Narayan**, Senior Investment Strategist

Q Will PM Johnson's resignation change the GBP outlook?

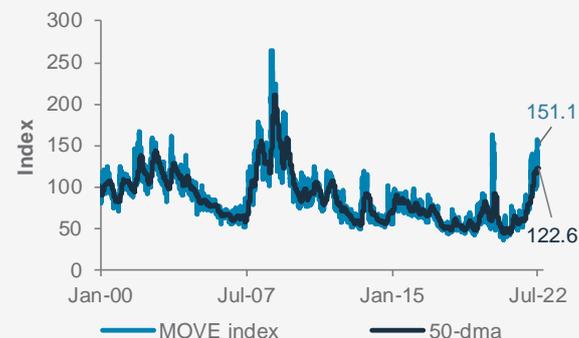
The GBP has had a harrowing time in 2022 amid both economic and political challenges. It is unclear if Prime Minister Boris Johnson's resignation, by itself, will provide much support for the GBP and UK assets. Even his resignation plan appears unpopular, and much will depend on the popularity and policy direction of the new PM. The key areas that could become significant positive drivers for the undervalued GBP include improving the UK's relations with the EU, executing appropriate and well-structured fiscal policy alongside the BoE's monetary stewardship to combat stagflation fears and averting a push for Scottish independence in 2023. A weighty "to-do" list.

If Johnson dawdles, a policy vacuum and a summer of uncertainty may result. A weakened UK government with key members vying for the top job is unlikely to be a market-friendly backdrop given current economic and geopolitical tensions. It could also create a ripple effect across Europe, especially for economically vulnerable Italy that may trigger an early election well before 2023.

However, if the transition is fast and the new UK leader has strong cross-party support, then an air of optimism should underpin the GBP. It could also provide one of several triggers needed for the USD to peak and revive European and global currencies. GBP/USD technicals suggest the downtrend is dominant for now, targeting 1.17-1.18 next, and a possible extension towards 1.14. Only a break above 1.24 would turn the outlook more positive for the GBP.

US bond market volatility has surged in recent weeks as expectations shifted from rising inflation to slowing growth

US government bond market volatility index (MOVE)



Source: Bloomberg, Standard Chartered

PM Johnson's resignation potentially supports the GBP medium-term, but near-term weakness may continue if the new leadership process drags on

GBP/USD daily chart with technical levels



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Q How far can gold decline?

Gold has fallen more than 15% from its March 2022 peak of USD 2,070/oz, which was also a near double-top to 2020's all-time high of 2,072. After a sideways consolidation around the 200-day moving average in May and June, the past week has seen gold break lower through 1,800 and decline sharply towards key technical support at 1,715-1,725. Gold has now seemingly succumbed to the broad "sell everything" sentiment that has dominated asset markets this year.

Two key tailwinds for gold, rising inflation and geopolitical tensions, have faded in recent weeks, and key headwinds of rising rates and a stronger USD have dominated. However, we believe that gold could rebound strongly as geopolitical tensions continue to run high, the Fed turns less hawkish as inflation peaks and the USD broadly weakens over a 12-month horizon.

A drop below 1,715 could see a decline towards the key 1,675-1,685 support, which we expect to hold. A further break could trigger a volatile fall towards 1,615 – but this is not our base case. We expect the USD index (DXY) to peak in the coming weeks, possibly around 109. This should coincide with gold finding a base and rebounding towards the 200-day moving average initially and above 1,900 in the medium term. We also continue to see gold as an attractive portfolio diversifier and expect accumulation at the current low levels.

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

We expect key support for gold at 1,675 to hold

Gold (XAU/USD) daily chart with technical levels



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Q What factors drive your preference for Asia USD bonds?

Achieving positive absolute returns from bonds has been challenging in H1 2022 as the hawkish turn in monetary policies lifted yields across the board. Among various bond asset classes, Asian USD bonds outperformed in relative terms vs. other major bond asset classes year-to-date, despite the negative absolute return.

Looking forward, we expect Asia USD bonds to continue outperforming global bonds over the next 6-12 months, likely with total returns stabilising, as the upward pressure on bond yields broadly starts to soften. This is based on the following factors:

- Strong credit quality** – Over 80% of Asia USD bonds comprise Investment Grade bonds. We believe the deterioration in credit quality during the pandemic years are behind us as we see rating upgrade actions consistently surpassing downgrades in the last few quarters. Amid rising US recession worries, we believe strong corporate fundamentals will be crucial, an area of strength for Asian USD bonds thanks to their stronger balance sheets.
- Signs of policy easing in China** – Almost half of Asia USD bonds comprise Chinese bonds; hence, the country-specific macro factors are key. Here, we believe the outlook is brightening. After several rounds of industry-specific crackdowns and pandemic lockdowns, Chinese policymakers are increasingly turning to growth-supportive policies. We expect this trend to continue as policymakers aim for their full-year growth target.
- Valuation attractive** – For the first time in more than a decade, Asia USD bonds offer a yield more than 6%. Together with undemanding yield premiums (credit spreads), we see the risk/reward as attractive and offering investors a good entry point.
- Contained price volatility** – Asia USD bonds offer an attractive balance between yields and sensitivity to rising interest rates. Being an asset class with relatively low interest rate sensitivity, we believe Asia USD bonds can outperform should Fed policy rates and US government bond yields rise further.

Within Asia USD bonds, we have a relative preference for High Yield bonds. While stress across several key sectors has not abated, we believe the relatively low bond prices mean default worries have likely been priced-in and China's increasingly growth-supportive policies could eventually offer a catalyst.

Key risk factors to this investment call include: a. Weaker-than-expected regional economic growth; b. Geopolitical concerns; c. Higher-than-expected default or payment restructuring events; and d. Sharp decline in regional liquidity that prohibits issuer refinancing.

— **Cedric Lam**, Senior Investment Strategist

Asia USD bonds have outperformed other bond asset classes this year, despite negative absolute returns

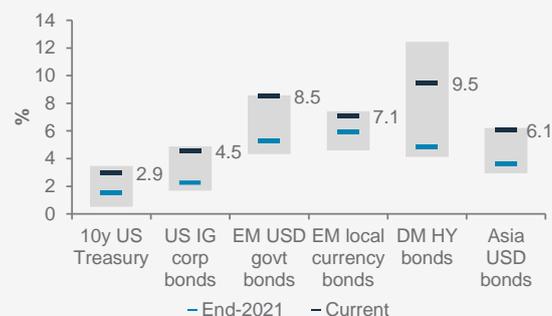
Percentage return of major bond asset classes, YTD



Source: Standard Chartered

Asia USD bonds offer the highest yield since 2010

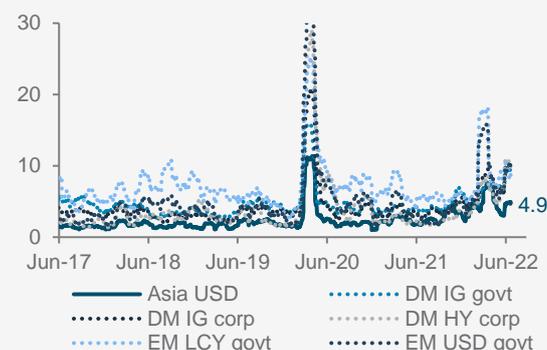
Current yields of major bond asset classes vs end 2021; range of bond yields since 2010



Source: Standard Chartered

Asia USD bond prices have relatively low volatility compared with other bond asset classes

30-day price volatility of bond major asset classes, since June 2017

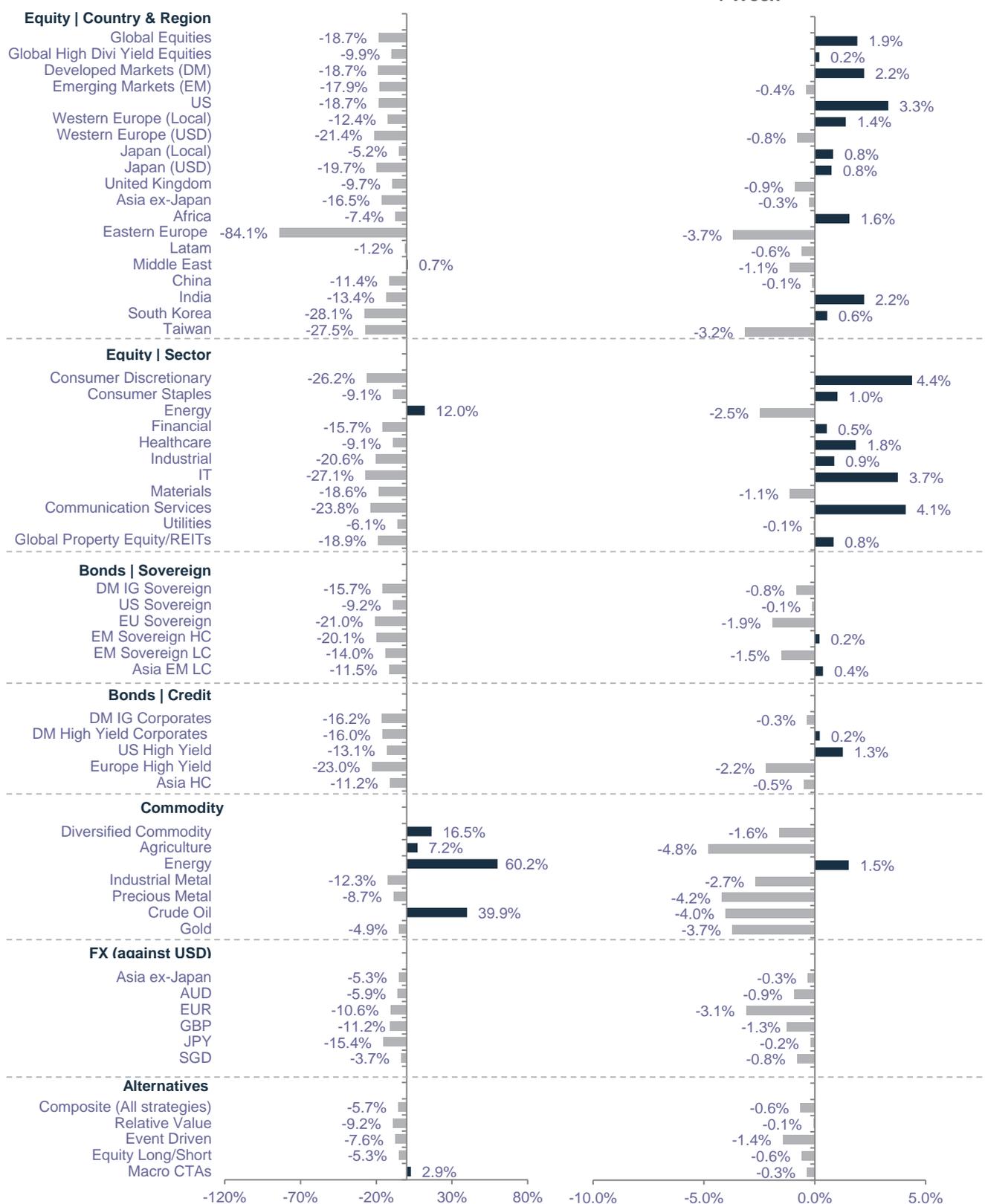


Source: Standard Chartered

Market performance summary *

2022 YTD

1 Week



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 07 July 2022; 1-week period: 30 June 2022 to 07 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

US 10-yr government bond yield faces resistance at 3.1%

Technical indicators for key markets as on 07 July 2022

Index	Spot	1st support	1st resistance
S&P 500	3,785	3,743	3,870
STOXX 50	3,455	3,411	3,524
FTSE 100	7,169	7,019	7,322
Nikkei 225	25,917	25,709	26,587
Shanghai Comp	3,392	3,338	3,427
Hang Seng	21,860	21,283	22,428
MSCI Asia ex-Japan	653	643	667
MSCI EM	1,001	987	1,022
Brent (ICE)	109	107	115
Gold	1,801	1,797	1,816
UST 10y Yield	2.96	2.91	3.10

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

Economic and market calendar

Event Next week		Period	Expected	Prior
MON				
TUE	EC ZEW Survey Expectations	Jul	-	-28.0
WED	CH Exports y/y	Jun	12.5%	16.9%
	UK Industrial Production y/y	May	-	0.7%
	US CPI y/y	Jun	8.8%	8.6%
	US CPI Ex Food & Energy y/y	Jun	5.7%	6.0%
THUR	US PPI Final Demand y/y	Jun	-	10.8%
	US PPI Ex Food and Energy y/y	Jun	-	8.3%
FR/SAT	CH Fixed Assets Ex Rural YTD y/y	Jun	6.0%	6.2%
	CH Retail Sales y/y	Jun	0.3%	-6.7%
	CH GDP y/y	2Q	1.2%	4.8%
	CH Industrial Production y/y	Jun	4.3%	0.7%
	US Retail Sales Ex Auto and Gas	Jun	-	0.1%
	US Empire Manufacturing	Jul	0.0	-1.2
	US Industrial Production m/m	Jun	0.0%	0.2%
	US U. of Mich. Sentiment	Jul P	50.1	50.0

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

Investor diversity has normalised in global bonds

Our proprietary market diversity indicators as of 06 July

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	→	1.29
Global Equities	●	↓	1.35
Gold	●	↓	1.32
Equity			
MSCI US	●	↓	1.39
MSCI Europe	●	↓	1.31
MSCI AC AXJ	●	→	1.40
Fixed Income			
DM Corp Bond	●	→	1.31
DM High Yield	●	→	1.28
EM USD	●	→	1.30
EM Local	○	→	1.23
Asia USD	●	→	1.40
Currencies			
EUR/USD	●	↓	1.34

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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