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WM Chief Investment Office
19 February 2021

Weekly Market View

Will the Fed blink?

Rising global growth and inflation expectations have paradoxically raised some alarm bells. Will the resulting rise in bond yields force the Fed to tighten monetary policy, impacting risk assets? We do not expect the Fed to tighten policy anytime soon, given still-weak job markets. Nevertheless, there is a chance of short-term pullbacks after a rapid rise in yields, which we would use to average into our preferred asset classes and themes.

Equities: The improving economic outlook and rising bond yields are supportive for the rotation from Growth to Value sectors

Bonds: The rise in Treasury yields due to improved growth prospects supports our bullish view on corporate and Emerging Market bonds

FX: The USD could get near-term support from rising Treasury yields; we would use this opportunity to average into the EUR

+

How should equity investors position for rising US Treasury yields?

What are the prospects for the European financial sector?

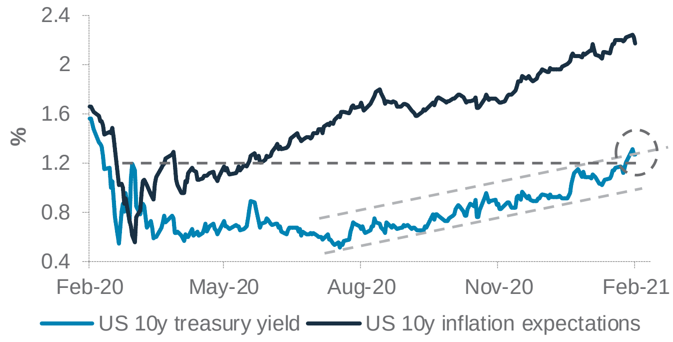
Is it time to reduce exposure to gold?

Important disclosures can be found in the Disclosures Appendix.

Charts of the week: Shifting towards Value

Rising bond yields on the back of an improving economic outlook support the rotation from Growth to Value

US 10-year government bond yield is testing a key resistance level as long-term inflation expectations rise



Source: Bloomberg, Standard Chartered

Global and US value-style equities' underperformance appears to have bottomed around the US elections

Source: Bloomberg, Standard Chartered

Editorial

Will the Fed blink?

The year of the Ox has started on an upbeat note in financial markets. New COVID-19 cases and hospitalisations are falling worldwide. The pace of vaccinations is picking up. Another giant US fiscal stimulus is around the corner. However, all the good news has set off some alarm bells – US government bond yields have surged over 35bps since the start of 2021 (about half of which can be attributed to rising inflation expectations), triggering concerns that rising borrowing costs could derail the rally in risk assets.

In recent years, a rapid rise in yields has often been a harbinger of short-term equity market corrections as investors price in a tighter monetary policy. While there is a risk that yields could push somewhat higher (see page 4), leading to a temporary reversal in crowded segments of the market, we believe the drivers of rising yields – rising global growth and inflation expectations – are likely to be ultimately positive for risk assets. This is consistent with the history of equity and bond market correlations in the last 50 years.

The proposed USD 1.9trn US fiscal package (which comes with a USD 1,400 per person cheque) has become a particular area of concern. The worry is that the new round of spending, which follows a USD 900bn package approved in December, will lead to an overheating of the US economy and force the Fed to start unwinding its stimulus. Money markets have already brought forward their Fed tapering expectations by almost 12 months (to June 2022) since Q3 last year.

While we see some merit in this argument – especially after the stronger-than-expected US retail sales in January following the distribution of the previous round of USD 600 cheques in late December – we still side with the view that the Fed will hold its nerve. We expect the Fed to look through a likely temporary rise in inflation this year, caused primarily due to statistical base effects after last year's rock-bottom levels, and maintain its highly accommodative policy over the coming year. This is supported by the minutes of its January policy meeting.

After all, the job market still has significant slack, which will probably take a couple of years to absorb. The US unemployment rate will probably need to fall well below 4.0% (vs 6.3% in January) before wage pressures become a risk. Also, the Fed is likely to welcome the ongoing rise in inflation expectations given this is an explicit goal of its Average Inflation Targeting (AIT) policy. Nevertheless, investors need to watch this closely as long-term inflation expectations edge towards the critical 2.5% mark. All eyes will be on Fed Chair Powell's semi-annual testimony to Congress on 23 February.

In the meantime, a resolutely accommodative Fed in the face of rising growth, inflation and corporate earnings expectations is likely to be positive for equities and risk assets (especially for the ongoing shift from Growth to Value equity sectors) and negative for the USD. Hence, we would continue to accumulate stocks and higher yielding corporate bonds, especially in Emerging Markets (EMs), on any near-term technical pullback in risk assets. We would also switch from the USD and average into the EUR, GBP and AUD, using the short-term USD bounce.

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as positive for risk assets

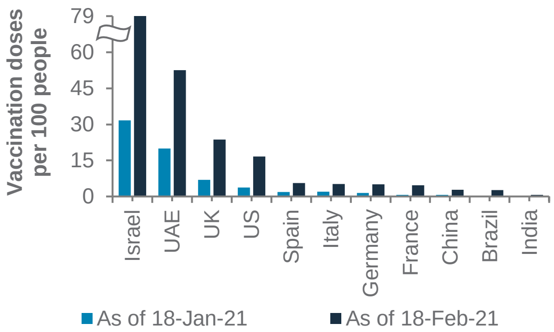
(+) factor: Fading COVID, rising vaccinations, supportive Fed

(-) factor: US-China tensions; slowing US job market

	Positive for risk assets	Negative for risk assets
COVID-19	• New cases continued to decline is most countries • The US boosted weekly vaccine shipments to states to 13.5m vs 11.0m • The EU plans to order 150m more vaccines after signing up for 200m	• Decline in new cases stall in France and Italy, stabilising at still-high levels
	Our assessment: Positive – declining new cases worldwide, accelerating pace of vaccinations	
Macro data	• US retail sales, industrial output, factory utilisation rose more than expected • Euro area economic outlook (ZEW survey) stronger than expected • Japan exports were stronger than expected • Japan, UK Q4 20 GDP rose more than expected; Euro area Q4 GDP contraction was less than expected	• US initial jobless claims rose more than expected and consumer confidence (Michigan) declined unexpectedly • US housing starts fell more than expected • Euro area industrial production fell m/m more than expected amid chip supply constraints
	Our assessment: Positive – strong US consumption, factory data, Euro area sentiment, Japan exports	
Policy developments	• Fed minutes showed policymakers are willing to look through a temporary inflation rise, given substantial slack • Reports said Germany is planning support of EUR 900m for airports • PBoC injected liquidity	• Fed minutes, the BoJ's Kuroda warned of downside risks amid new virus strains • ECB's Schnabel warned sustained rise in real rates could make equities less attractive
	Our assessment: Positive – supportive Fed, PBoC	
Other developments	• Former US President Trump was acquitted by the US Senate in an impeachment trial	• Reports state that China is considering banning rare earth exports to the US
	Our assessment: Negative – US-China tensions	

Vaccinations continue to progress globally, though Euro area still lagging the US

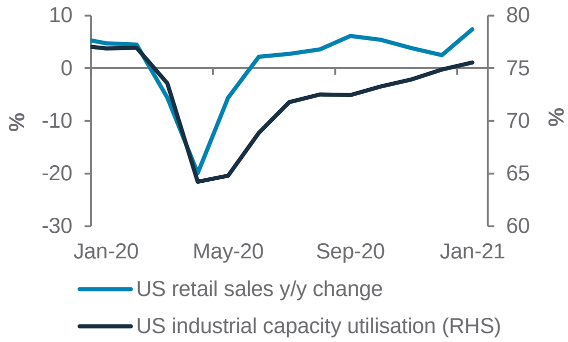
Number of COVID-19 vaccine doses administered per 100 people vs a month ago



Source: Our World in Data, Standard Chartered

Strong US retail sales have helped lift factory capacity utilisation to near pre-pandemic levels

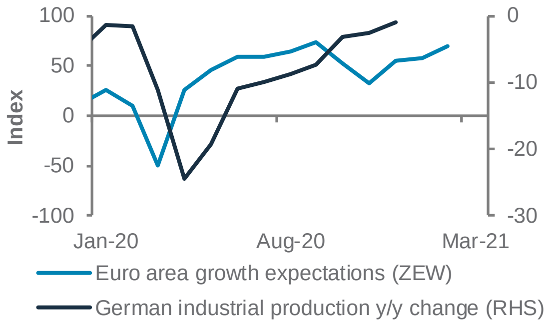
US retail sales and industrial capacity utilisation



Source: Bloomberg, Standard Chartered

Euro area growth expectations have risen, but factories are facing supply constraints

Euro area growth expectations and industrial production



Source: Bloomberg, Standard Chartered

Top client questions

Are rising Treasury yields a threat to riskier bonds?

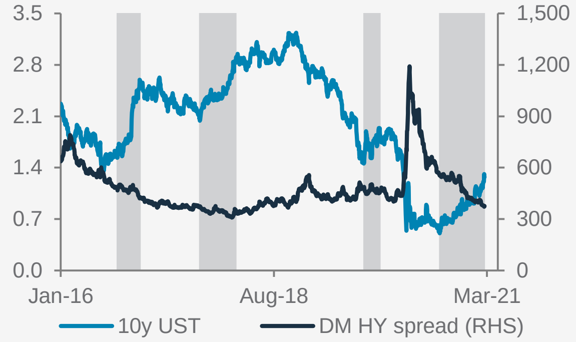
US Treasury yields have surged as the market brought forward its expected end date for the Fed's easy policy amid improving growth and inflation expectations. Technical factors, such as a weak Treasury auction, may have also been a factor. However, Fed officials reaffirmed their commitment to easy policy till the job market improves.

Although the US 10-year Treasury yield has broken above our expected 1.00-1.25% range, we believe the Fed will aim to limit any further significant rise in yields. Overall, the rise in Treasury yields due to improved growth prospects supports our bullish view on corporate and EM bonds and hence we would use the current weakness as an opportunity to add exposure to Developed Market High Yield corporate bonds and EM USD and Asian USD bonds.

On technical charts, the US 10-year Treasury yield is testing a fairly strong converged resistance at the mid-March high of 1.283%, coinciding with the upper edge of a rising channel from the March low of 0.318%. Any break below the immediate support at the mid-January high of 1.187% would confirm that the upward pressure had eased, opening the way towards the psychological 1.00% mark.

Yield premium on riskier bonds usually tighten when US Treasury yields rise

US Treasury yield and DM HY bond yield premium over Treasuries



Source: Bloomberg, Standard Chartered; shaded areas denote periods of rising Treasury yields

Can the USD benefit from rising US Treasury yields?

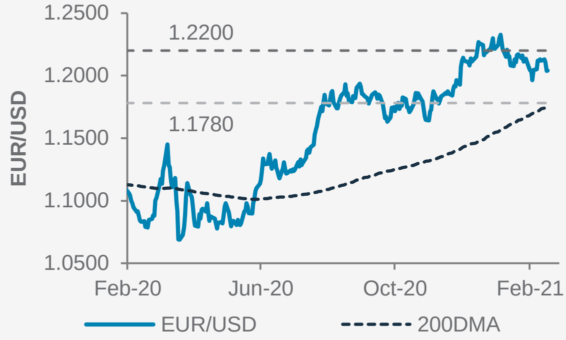
The USD is slowly making corrective gains. While currencies such as the GBP, AUD and NZD have remained supported, low-yield currencies like the EUR, CHF and JPY have weakened. We believe once this correction is exhausted, the USD is likely to resume its decline, perhaps quite forcefully. EUR/USD will likely signal the timing of this turn.

In the very short term, EUR/USD may face more downside. Rising US nominal rates, a delay in the Euro area economic recovery and long (but reducing) EUR positioning could see the pair re-test the recent 1.1950 low. A break below can target supports at 1.1890 and 1.1780. We do not expect a fall below the November 2020 low around 1.1600.

Opportunistic EUR/USD shorts can still be attractive, but we should also keep our eyes on the medium-term "prize". A rally above 1.2200 would signal a test and potential break of the 1.2350 high that would target a move towards 1.2800. We expect accumulating EUR/USD from around 1.2000 down to around 1.1800 to be a rewarding strategy. The Euro area is likely to re-join the global growth party in the coming weeks amid strong global stimulus and greater vaccinations.

We see near-term EUR/USD weakness as an opportunity to average in

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

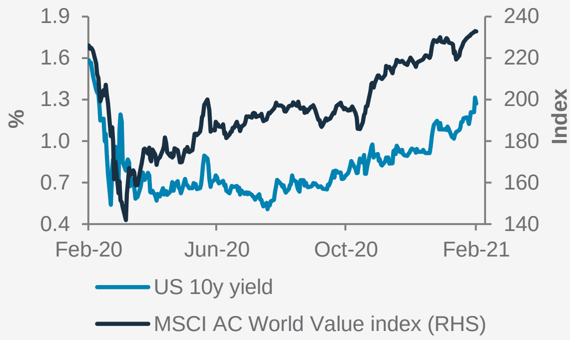
How should equity investors position for rising US Treasury yields?

The rise in the US 10-year Treasury yield has fuelled strong performance of Value-style stocks. However, over the last few sessions, concerns about the return of inflation, and therefore the spectre of potentially tighter liquidity at some point, has entered the narrative. This is moving the needle subtly from a "reflation" narrative, ie. rising tide lifting all boats, to a "rotation" narrative, ie. strong performance for selective areas. The slowdown in market volume indicates that instead of fresh liquidity equally reflating all stocks, a rotation from Growth into Value stocks is looking more likely.

Thus, we believe a focus on Value sectors, such as financials, materials, industrials and energy, is increasingly attractive. These sectors suffered the biggest earnings decline in 2020 but are likely to deliver the biggest earnings rebound in 2021. Still-elevated levels of volatility mean both direct exposure and a strategy to earn income by selling volatility are attractive, in our assessment.

Rising US Treasury yields have revitalised global Value sector equities

MSCI All Country World Value index vs US 10-year Treasury yield



Source: Bloomberg, Standard Chartered

What are the prospects for European financials?

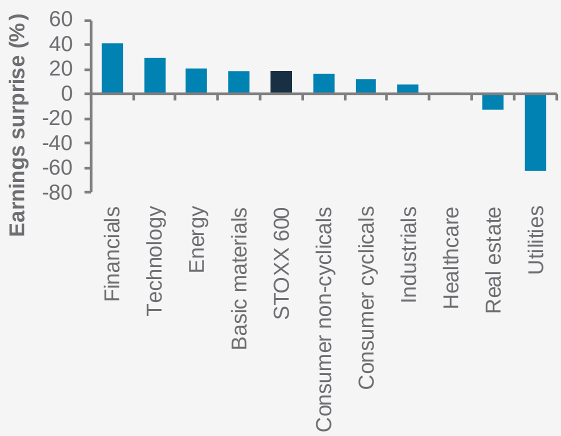
The financial sector is one of our preferred areas in Europe. After a sharp fall in earnings in 2020 due to COVID-19, the sector is likely to benefit from the vaccination-driven economic recovery. In terms of style, it is well positioned in the ongoing rotation from Growth into Value stocks. Fundamentally, higher bond yields and steeper yield curves (ie. a widening gap between long and short maturity bond yields) support banks' net interest income. Politically, the recent stabilisation in Italian politics is likely to lend an additional tailwind to the European financial sector.

60% of European financials have already reported in the Q4 20 earnings season. Among the market's 11 main sectors, European financials have delivered the largest earnings surprise, at 41%. This is better than the next best sector, technology, at 29%, and the broader STOXX Europe 600 index, at 18%.

Technically, the STOXX Europe 600 Banks index has broken above resistance, with good support 3% and 8% below current levels. Similar to our broader view on Value-style equities, we believe still-elevated levels of volatility make both direct exposure and a strategy of selling volatility on the sector to earn an income attractive.

European Financials have delivered the region's strongest positive Q4 20 earnings surprise

STOXX Europe 600 Q4 20 earnings vs consensus estimates (earnings surprise)



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Is it time to reduce exposure to gold?

Gold has struggled in recent days following the latest surge in US Treasury yields. In our assessment, real (net of inflation) bond yields, the USD and safe-haven demand remain key drivers of gold.

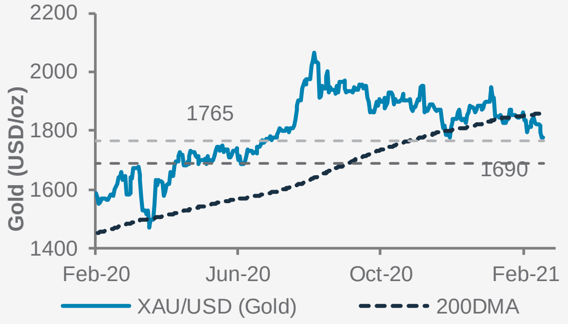
As we've noted before, bond yields are unlikely to drive further gains in gold. The Fed will likely welcome the rise in inflation expectations under its Average Inflation Targeting framework. This means a further rise in real yields could be harder to come by.

While the USD has been resilient in recent weeks, a resolutely accommodative Fed in the face of rising growth and inflation expectations is likely to be negative for the USD over the next 6-12 months. This can be a positive driver for gold, helping it still deliver absolute gains. However, while this makes it easier to maintain a core holding in gold given its diversification benefits during unexpected market moves, this factor may not be sufficient for gold to outperform other assets like equities and credit.

Technicals are admittedly weak, given the formation of a "death-cross", which increases the risk of an unwind of stale longs built up over the past year. In terms of momentum, we are in oversold territory; hence, some consolidation is likely in the near term. Key supports are at 1,765 and 1,680-1,690.

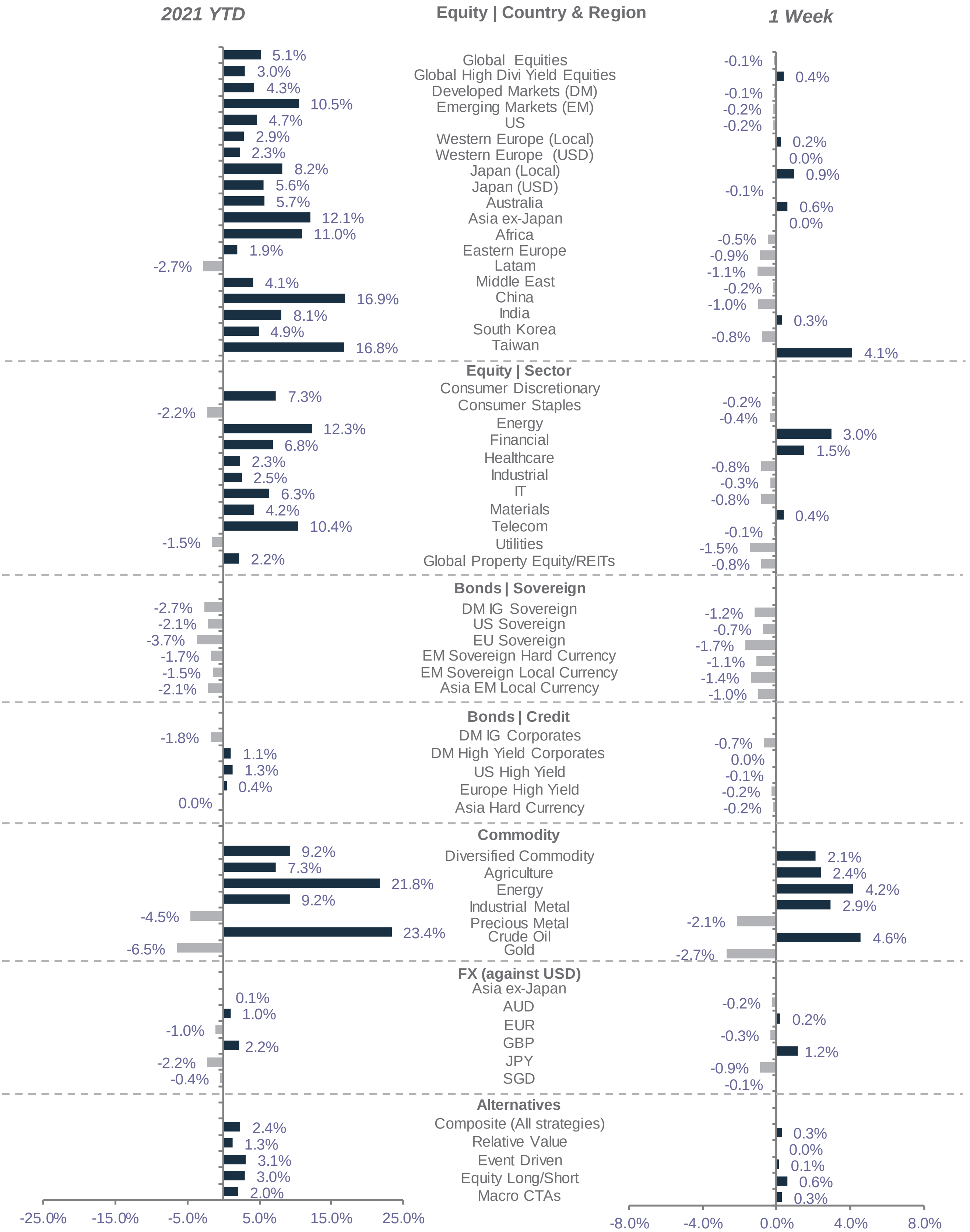
We see strong support for gold around USD 1,765/oz, followed by USD 1,690/oz

Gold price



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, 2021 YTD performance from 31 December 2020 to 18 February 2021; 1-week period: 11 February 2021 to 18 February 2021

Our asset class views at a glance

Asset class			
Equities	▲	**Alternatives**	◆
Asia ex-Japan	▲	Equity hedge	▲
US	▲	Event-driven	◆
Euro Area	▲	Relative value	◆
Japan	▲	Global macro	▼
Other EM	◆		
UK	◆	**Cash**	▼
		USD	▼
Bonds (Credit)	▲	EUR	▲
Asia USD	▲	GBP	▲
Govt EM USD	▲	AUD	▲
Corp DM HY	▲	CNY	▲
Corp DM IG	▼	JPY	◆
Bonds (Govt)	▼		
Govt DM IG	▼		
Govt EM Local	▲		

Source: Standard Chartered Global Investment Committee

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding

Economic and market calendar

	Event	Next Week	Period	Prior
MON	CN	1-Year Loan Prime Rate	Feb 22	3.9%
	EC	ECB's Lagarde Gives Keynote		
TUE	US	Powell To Deliver Semi-Annual Monetary Policy Report		
	US	Conf. Board Consumer Confidence	Feb	89.3
WED				
THUR	EC	M3 Money Supply y/y	Jan	12.3%
	EC	Economic Confidence	Feb	91.5
	US	Cap Goods Orders Nondef Ex Air	Jan P	0.7%
	US	GDP Annualized q/q	4Q S	4.0%
	US	Personal Consumption	4Q S	2.5%
FRI/ SAT	JN	Industrial Production y/y	Jan P	-2.6%

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

S&P500 has resistance 0.4% above current level

Technical indicators for key markets as on 18 Feb 2021

Index	Spot	1st support	1st resistance
S&P500	3,914	3,907	3,928
STOXX 50	3,681	3,663	3,716
FTSE 100	6,617	6,553	6,719
Nikkei 225	30,236	29,682	30,629
Shanghai Comp	3,675	3,675	3,675
Hang Seng	30,595	30,432	30,922
MSCI Asia ex-Japan	944	939	953
MSCI EM	1,425	1,419	1,438
Brent (ICE)	63.9	62.8	64.7
Gold	1,776	1,760	1,808
UST 10Y Yield	1.30	1.23	1.34

Source: Bloomberg, Standard Chartered

Elevated risk of short-term reversal in Asian equities

Our proprietary market diversity indicators as of 17 Feb

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	1.65
Global Equities	◐	→	1.25
Gold	◐	↓	1.49
Equity			
MSCI US	◐	→	1.28
MSCI Europe	◐	→	1.38
MSCI AC AXJ	○	→	1.23
Fixed Income			
DM Corp Bond	●	↑	1.55
DM High Yield	◐	→	1.28
EM USD	●	↑	1.90
EM Local	●	↑	1.52
Asia USD	●	↑	1.63
Currencies			
EUR/USD	●	↑	1.55

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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