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Wealth Management Global Chief Investment Office
28 July 2023

Global Market Outlook

Can this continue?

Easing inflation means the positive market narrative remains dominant. We believe this can continue over the next month or so, but we struggle to turn more bullish on a 6-12-month horizon unless economic fundamentals improve.

Asia-including-Japan equities and cyclical sectors in the US remain our preferred route of participating in any short-term equity upside. Asia USD bonds should also benefit from a weaker USD.

On a 6-12-month horizon, though, we see more attractive risk/reward in high-quality government bonds relative to equities and cash. Yields are attractive. They are also likely to fall as growth slows, providing an opportunity for capital gains.

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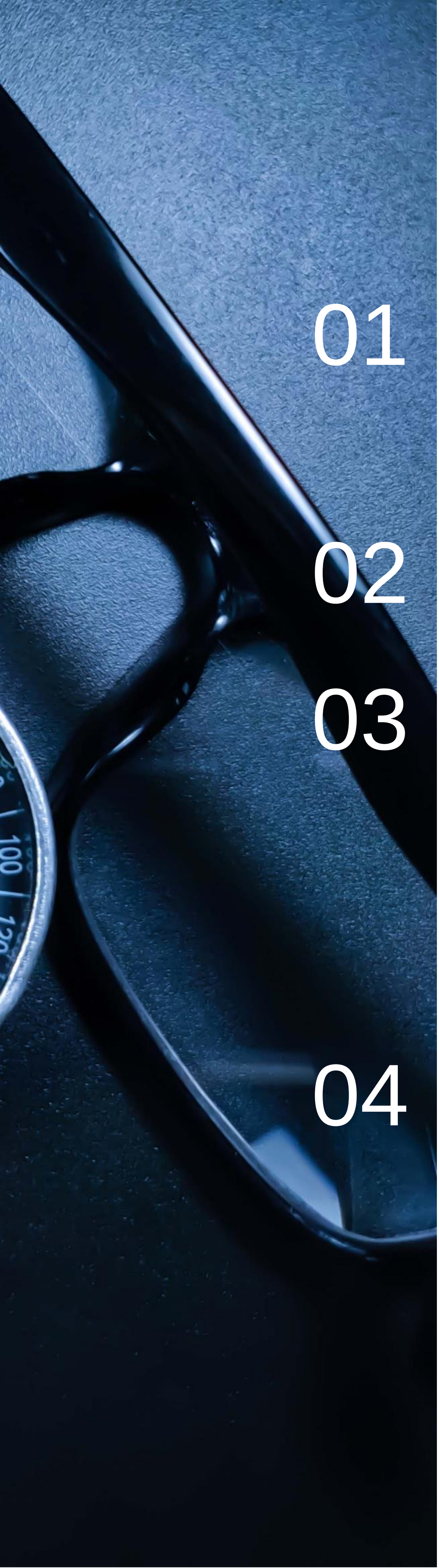
What is driving the near-term uptrend in equities?

Has the economic outlook changed since June?

What is the message from your quantitative indicators?

Important disclosures can be found in the Disclosures Appendix.



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Global Chief Investment Officer

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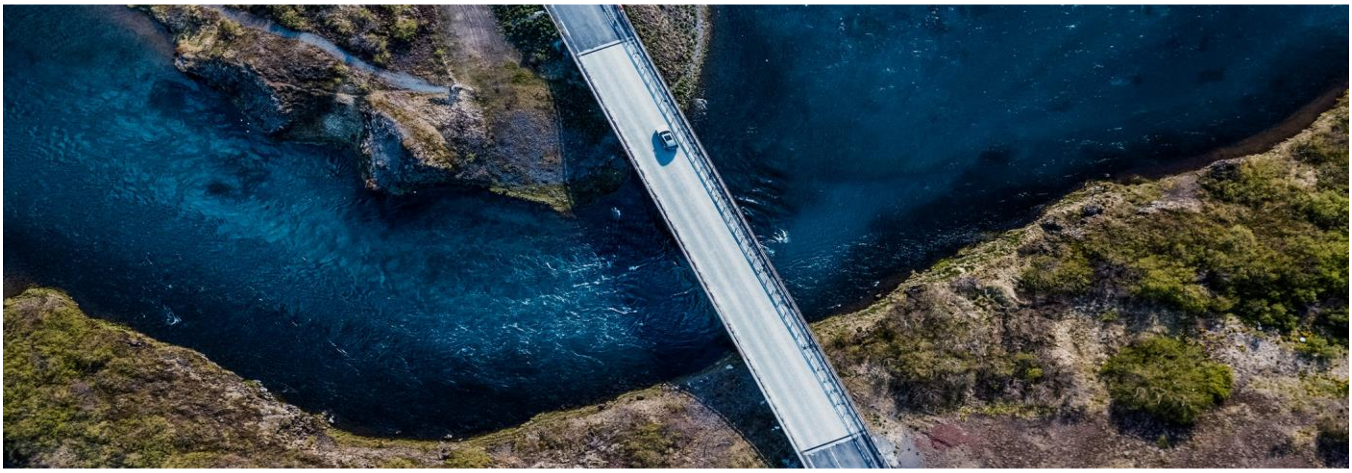
Chief Investment Officer, AMEE

Raymond Cheng
Chief Investment Officer, North Asia



Our top preferences
(12-month outlook)

Foundation overweights

- Government bonds
- *In equities:* Asia ex-Japan, Japan
- *In bonds:* Developed Market IG government, Asia USD

Sector overweights

- *US:* Healthcare, Technology, Communication services
- *Europe:* Technology, consumer discretionary, financials
- *China:* Comms. Services, Consumer Discretionary

FX views

- Modestly weaker USD

Structural macro trends*

- A digital tomorrow
- Preparing for an ageing world
- From unipolarity to multipolarity
- Investing in a climate-constrained world

*Individual reports available

Can this continue?

- Easing headline inflation means the positive market narrative remains dominant. We believe this can continue over the next month or so, but we struggle to turn more bullish on a 6-12-month horizon unless economic fundamentals improve.
- Asia-including-Japan equities and cyclical sectors in the US remain our preferred route of participating in any short-term equity upside. Asian assets, particularly Asia USD bonds, should also benefit from a significant move lower in the USD.
- On a 6-12-month horizon, though, we see more attractive risk/reward in high-quality government bonds relative to equities and cash. Developed Market government bond yields are likely to fall as growth eventually slows, providing an opportunity for capital gains. Meanwhile, they continue to offer attractive yields.

Staying CALM, focus on upside risks for now

In our H2 Outlook, we argued that investors were expected to face two competing narratives. In the short term, the focus would likely be on the chances of further gains in equity markets as still-strong economic growth, particularly in the US, slowing inflation and a continued 'AI mania' support the bulls who argue any growth slowdown is either already in the price or unlikely to occur at all. In the long term, an alternative narrative argues that markets face significant downside risks, with the history of past Fed hiking cycles suggesting an eventually sharper growth downturn.

The Fed rates outlook and inflation will likely remain key drivers of markets going forward. We now believe the Fed is done with rate hikes, having raised rates this week by a further 25bps to a 22-year high of 5.5%. While a peak in Fed rates should be positive for equities, the Fed is likely to hold rates at current highs for the rest of the year unless it sees clear signs that inflation is heading towards its 2% target. Here, the month-on-month inflation data remains key given at least part of the slowing in headline inflation is due to statistical base effects. A sustained slowdown in core CPI to less than 0.2% m/m is likely needed to bring inflation on the Fed's desired path.

Against this backdrop, we believe a CALM approach remains valid: Capitalise on market opportunities, Allocate broadly, Lean to Asia and Manage volatility.

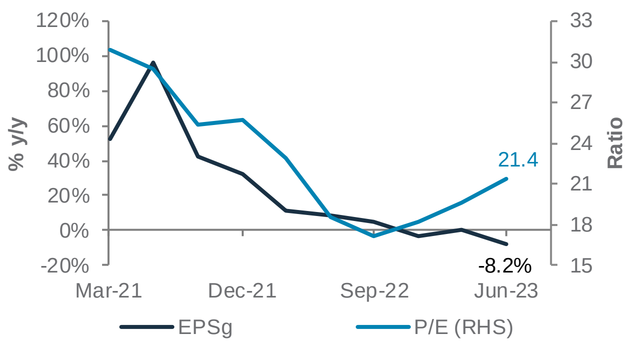
Fig. 1 **Investor sentiment firmly in the Greed territory – this is positive short term, but negative long term**

Our proprietary Fear and Greed index* for S&P500 index

Source: Bloomberg, Standard Chartered; *An average of market momentum, breadth, equities vs bonds, volatility and put-call ratio

Fig. 2 **US equities will need a turn in earnings growth and cannot be sustained by rising multiples alone**

S&P500 quarterly earnings growth, P/E valuations



Source: Bloomberg, Standard Chartered

Upside risks in the near term

Over the next 1-3 months, we believe equity market risks remain tilted to the upside. Momentum in the equity market, including the technology sector, remains strong. Fund manager surveys suggest investors remain bearishly positioned in equities, which risks extending the short squeeze as imminent recession worries fade. Technical charts also remain bullish, at least on a shorter time horizon.

We believe taking limited risks remains the most appropriate way to position against this short-term upside risk. In equities, this could be through regional allocations ('Lean to Asia'). Japanese equities remain a more inexpensive route to take equities exposure relative to the more fully valued US. Within US equities, a barbell sector approach is another route ('Manage Volatility'). Our Overweight on the technology sector captures the possibility of the 'AI mania' extending further. Meanwhile, our Overweight on healthcare ensures a higher chance of exposure to positive earnings growth should markets take a sudden turn lower.

More broadly, we prefer to take more of our risk exposure in equities rather than through High Yield bonds, given equities offer a more attractive risk/reward, in our view.

Avoiding getting caught up in a mania

Beyond a 1–3-month horizon, though, we would not ignore the still-bearish signals from long-term fundamental indicators. Our recession checklist remains bearish, US mortgage yields continue to rise and indicators of bank lending continue to tighten. It remains a challenge turning more constructive long term without an improvement in fundamental indicators.

Our Greed and Fear index is one lens through which we can capture the contrast between short- and long-term risks. As the chart above illustrates, the Greed and Fear index continues to march towards 'Extreme Greed'. This can point to strong rallies on shorter horizons, but can be an indicator of excessive investor optimism beyond that.

Therefore, on a 6-12-month horizon, we retain our Overweight on high-quality government bonds and a more balanced core allocation to equities ('Calibrate your risk'). History shows US government bond yields peaked not far from the peak in the Fed rate. Bond yields usually fall (ie, bond prices rise) as growth slows, with longer-maturity bonds benefiting more; but we believe the asset class also pays an attractive yield for investors to wait. Cash yields undoubtedly appear optically interesting at this point in the cycle, but the headline yield fails to capture reinvestment risk, ie, any cash deposit is likely to be reinvested at lower yields. Historical data supports this view, with government bonds outperforming cash significantly from the peak of previous rate hiking cycles.

The USD breaks lower

One notable event in markets in recent weeks was the USD weakness, with the greenback taking a significant leg lower. This remains consistent with our expectation of further USD weakness, though the size of the move causes us to shift our expected levels for major pairs (see page 11).

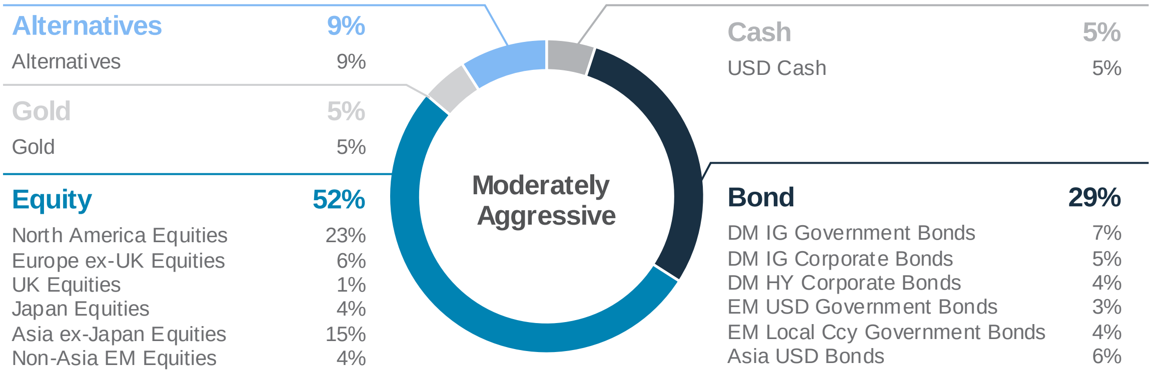
The weak USD's impact is likely to be felt across markets. A weak USD has generally been supportive for non-US asset classes, particularly Emerging Markets (EMs). Arguably, this effect is already starting to appear in capital flows data to EMs.

This supports our view to 'Lean to Asia'. In equities, this explains why we prefer Asia-including-Japan equities. Japanese equities offer value and exposure to upside risks, in our view, while the extent of bearish sentiment towards Chinese equities means a positive policy catalyst could drive a significant rebound. Indian equities offer a counterbalance in the form of less value, but stronger earnings outlook.

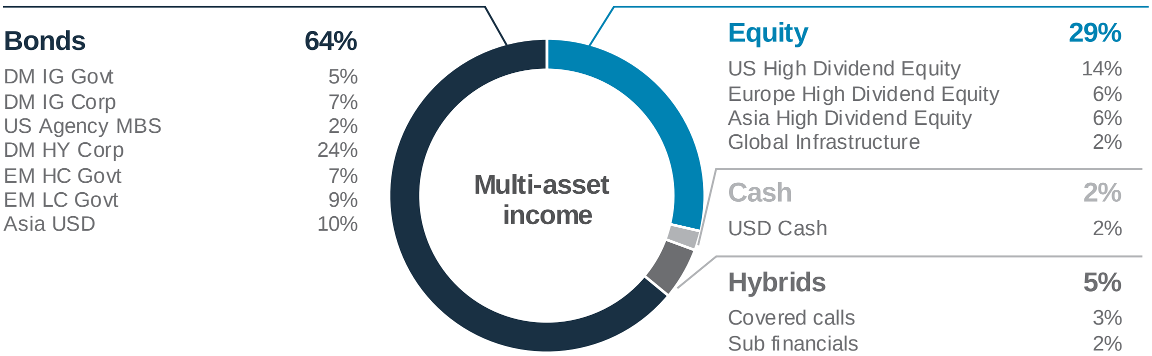
The positives are not limited to equites, though. We expect Asia USD bonds to also benefit from the USD's weakness and from lower US government bond yields. We would retain a focus on Investment Grade bonds, though, given that elevated property sector risks in China make it unattractive to add to High Yield bonds.

Foundation: Our tactical asset allocation

Global* allocation for a moderately aggressive risk profile



Multi-asset income allocation for a moderate risk profile



	View	Detail
USD cash	◆	+ Safety, positive real yields || - Reinvestment risk, risk of long-term underperformance
Bonds	◆	
DM Govt	▲	+ High credit quality, outperformance during a recession || - Still-elevated inflation
DM IG Corporate	◆	+ High credit quality, moderate yields || - Fairly valued
DM HY Corporate	▼	+ Attractive yield, low rate sensitivity || - Deteriorating credit quality, wider spreads
EM USD Govt	▼	+ Attractive yield and value || - Weakening EM credit quality
EM Local Ccy Govt	◆	+ Moderate yield, potential for FX appreciation || - Higher volatility
Asia USD	▲	+ Mainly IG credit quality, declining default rates || - Fairly valued
Equities	◆	
North America	◆	+ Resilient growth, disinflation || - Restrictive monetary policy
Europe ex-UK	◆	+ Resilient margins || - Still-elevated inflation, hawkish ECB
UK	▼	+ Attractive valuations, dividend yield || - Prolonged BoE tightening
Japan	▲	+ Domestic economic recovery || - Potential BoJ tightening
Asia ex-Japan	▲	+ China’s policy support || - Escalating China-US tensions
Gold	◆	+ Falling yields, portfolio hedge || - Risk of a USD rebound
Alternatives	◆	+ Diversifier characteristics || - Equity, corporate bond volatility

Source: Standard Chartered Global Investment Committee; *See page 19 for other risk profiles and Asia-focused allocations

Legends: ▲ Overweight | ▼ Underweight | ◆ Neutral

Perspectives on key client questions

Audrey Goh, CFA
Head, Asset Allocation and Thematic Strategy

Tay Qi Xiu
Investment Strategist

Holding steady amid short-term upside risks

In the previous edition of the Global Market Outlook, we outlined three essential conditions for the equity market uptrend to persist in the near term. Firstly, economic data should remain resilient, allowing investors to continue pricing in the possibility of a "soft landing." Secondly, a deceleration in inflation should occur to mitigate the risks of a policy-led selloff in equities. Lastly, positioning and sentiment should remain contained, signalling potential for further upside in equity markets.

Since these conditions were met, we upgraded our Underweight in equities to Neutral as a hedge against further upside risks. This has proven effective. Both the MSCI ACWI index and the S&P500 index have gained over 4% since our H2 Outlook was published.

This month, we revisit our framework to assess if these conditions still support further gains in risk assets. While our long-term fundamental indicators continue to point towards a bearish outlook, with an expected recession by early 2024, the conditions for the equity market uptrend to persist in the near-term remain intact. Specifically, we observed that:

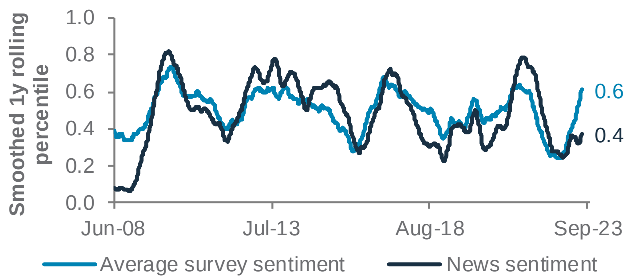
1) Equity market bears have not fully capitulated, and that it is possible that a recalibration of bearish expectations is still in its early stages
2) The high inflation narrative is expected to recede in the coming months, with US shelter inflation decelerating, suggesting further disinflation is likely
3) Resilient economic conditions in the US are challenging the consensus recession narrative, leaving room for a "soft landing" scenario

Bullish sentiment prevails; positioning has yet to capitulate

While survey-based sentiment indicators showed extreme bullishness, equity positioning remains neutral at best, indicating that bearish investors may not have fully adjusted their positions. Asset managers, who had positioned for a recession at the beginning of the year, have likely begun facing pressure to increase their equity exposure after the strong YTD performance in stock markets. A recalibration of their expectations to increase allocations to equities, if it occurs, could thus provide further momentum to equity markets in the near-term.

Fig. 3 Investor sentiment has outpaced economic sentiment reflected in news articles

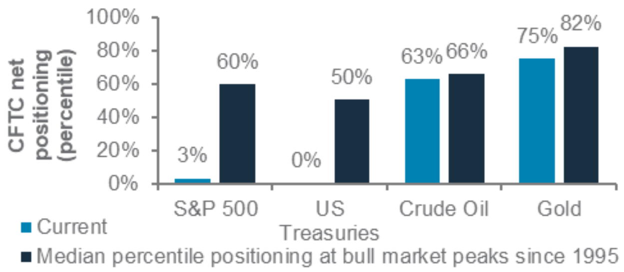
Average survey-based investor sentiment and economic news sentiment*



*Investor sentiment is based on the average one-year rolling percentile of the AAII Bull-Bear Spread and the NAAIM Exposure Index, smoothed over a one-year period. News sentiments is a high frequency measure of economic sentiment based on lexical analysis of related news articles. Source: AAII, NAAIM, Federal Reserve Bank of San Francisco, Standard Chartered

Fig. 4 However, positioning in equities remains far lower than levels during previous market peaks

CFTC net positioning, current vs previous bull market peaks

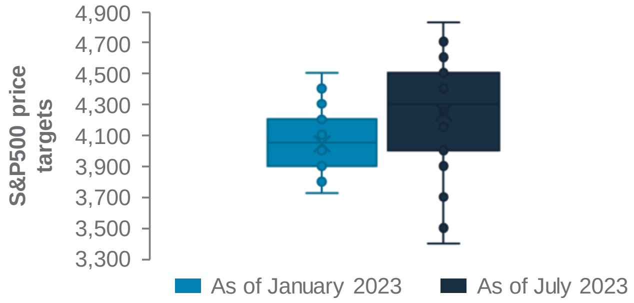


*Non-commercial and non-reportable net positions. Crude oil includes WTI futures traded on the NYMEX only. US Treasuries include 2y, 5y, and 10y notes. Percentiles based on full sample starting March 1995 due to data availability.
Source: Bloomberg, Standard Chartered

Meanwhile, as the strong equity market performance in the first half of the year blow past analysts' year-end targets, a self-reinforcing cycle is formed. Analysts raise their price targets as equities advance, leading to further momentum in share prices, creating, in effect, what Bloomberg called a "strategist short squeeze". This effect could be pronounced, especially when consensus expectations are notably bearish, as was the case at the start of the year. For example, a poll conducted by Bloomberg showed the average year-end S&P500 price target at the start of the year was 4,044. This has now been revised to 4,245. Notably, 18 of the two dozen houses surveyed by Bloomberg still expect S&P500 to decline by the end of the year. If these houses do capitulate, it would add further upward pressure on the market in the near term.

Fig. 5 Majority of analysts have revised their 2023 year-end price targets higher

S&P500 year-end price targets



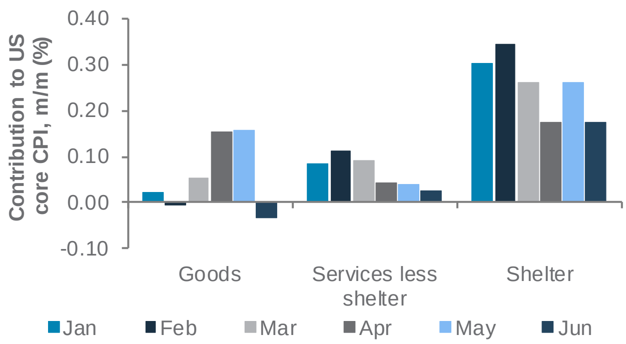
Source: Bloomberg, Standard Chartered

Disinflation likely over the next few months

The challenges posted by sticky inflation are expected to ease over the coming months, thanks to the statistical base effect. This is particularly evident in the June inflation report, where core CPI from goods inflation has now slipped into negative territory. Core services excluding shelter – what some economists term as "supercore" inflation – has also eased, indicating a cooling of demand. Crucially, shelter inflation, which makes up almost 44% of the US core CPI basket, has moderated, and its contribution to monthly core CPI has fallen to 0.17%, almost 10bps lower than the YTD average. Given the lagged effect of prior decline in private rental data, official shelter inflation is likely to decelerate in the coming months.

Fig. 6 Disinflation is likely over in the coming months

Contribution to monthly US core CPI



Source: Bureau of Labour Statistics, Standard Chartered

However, it is still too early to sound "all clear" on inflation. Monthly core CPI must rise at a pace slower than 0.2% m/m to avoid a rebound in core CPI as base effects fade. At a constant 0.1% m/m pace for example, core inflation is expected to hit the Fed's 2% target by March 2024. This would provide the Fed with policy room to cut interest rates, especially if a recession were to occur by then. On the other hand, at a pace faster than 0.2% m/m, annual core inflation could see a rebound in the fourth quarter. Monthly changes in inflation would thus be crucial in the coming months.

Fig. 7 Core CPI must rise by less than 0.2% m/m in the coming months for the disinflation trend to continue

Annual core CPI based on constant m/m changes

Date	0% m/m	0.1% m/m	0.2% m/m	0.3% m/m	0.4% m/m
Jul-23	4.49%	4.59%	4.70%	4.80%	4.90%
Aug-23	3.95%	4.16%	4.36%	4.57%	4.78%
Sep-23	3.51%	3.82%	4.13%	4.44%	4.75%
Oct-23	3.21%	3.62%	4.03%	4.45%	4.87%
Nov-23	3.11%	3.62%	4.14%	4.66%	5.19%
Dec-23	2.93%	3.55%	4.17%	4.80%	5.43%
Jan-24	2.30%	3.02%	3.74%	4.47%	5.20%
Mar-24	1.12%	2.04%	2.96%	3.89%	4.82%

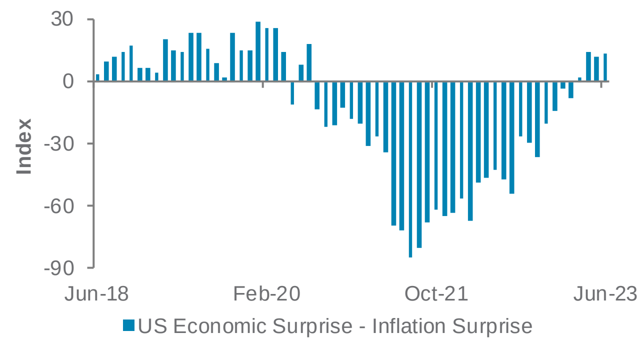
Source: Bloomberg, Standard Chartered

Services sector to continue supporting growth

US growth is showing signs of slowing, but a resilient services sector is expected to continue driving consumption and keep the economy from falling into a recession. The labour market remains tight but has likewise slowed, though, at the current more-than-200,000 monthly growth rate in non-farm payrolls, it has historically taken another 5-6 months before a recession occurs. Meanwhile, US economic resilience has continued to positively surprise consensus expectations, while inflation has surprised to the downside, fuelling a narrative of an economic "soft-landing" and benefitting equities.

Fig. 8 In the US, growth has been more resilient than expected but inflation has been lower than expected

US Citi Economics Surprises (growth data) minus Bloomberg Inflation Surprise (inflation data)



Source: Citibank, Bloomberg, Standard Chartered

Macro overview – at a glance

Rajat Bhattacharya
Senior Investment Strategist

Key themes

Services sector supporting growth; manufacturing in recession. Global growth continued to slow, with manufacturing sector activity contracting. Services consumption, supported by still-robust job markets, excess savings built during the pandemic and wealth boost from a rebound in house prices and equity markets remain key drivers of growth, especially in the US. Cooling inflation is helping lift household real (inflation-adjusted) incomes, which in turn should sustain consumption in the coming months. Risk: Policy rates have likely turned restrictive, keeping the risk of a recession by early 2024 elevated.

Disinflation broadens: Inflation continued to soften globally as supply bottlenecks eased and economies slowed. In the US and Europe, headline inflation trended lower, aided by base effects, but core inflation remains well above central banks' 2% target. China's disinflationary pressures are likely to weigh on global inflation with a 6-12-month lag.

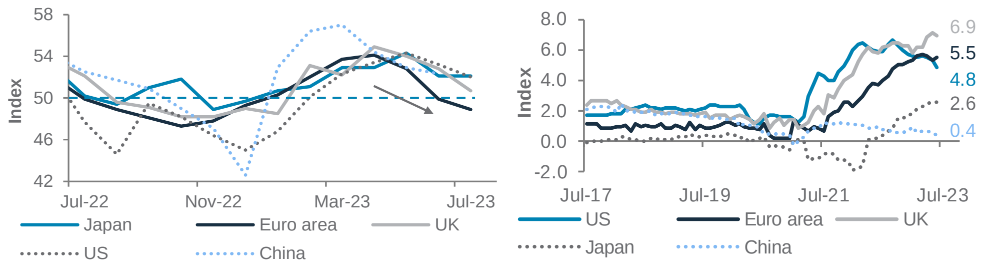
Fed, ECB to hold rates; China to ease: We expect the Fed to hold rates at a cycle-high of 5.5% for the rest of 2023 and the ECB to hike once more to take the deposit rate to 4.0% before going on hold as it assesses the impact of past hikes. Meanwhile, China is likely to provide further targeted policy support to sustain the post-COVID-19 expansion.

Key chart

We expect core inflation to decline in H2 as the global economy slows and supply bottlenecks fade, enabling the Fed and ECB to hold rates; China is likely to provide targeted stimulus to sustain the expansion

Fig. 9 **Global business activity is slowing, which should help inflation to abate in H2**

Composite PMIs (business confidence indicators) and core inflation in major economies



Source: Bloomberg, Standard Chartered

Macro factors to watch

Manufacturing slump: Recent data point to slowing global business activity and cooling inflation. Global manufacturing and trade appear to be in recession, based on contractionary business confidence indices (PMIs) for manufacturing sectors in the US, Europe, China and Japan, double-digit contraction in exports from China, Korea, Taiwan and Singapore, Germany's recession, and cooling goods inflation worldwide.

Resilient services: Resilient services sectors have kept economies from falling into outright recession. The services sectors are being propped up by strong, albeit slowing, job markets and residual excess savings, which in turn are driving services consumption. This year's rebound in equity markets and house prices have bolstered household balance sheets. Then there is the expected boost to household disposable incomes from falling inflation and summer bump-up in travel-related consumption. We expect this services-led expansion to continue for the rest of the year. This near-term resilience is reflected in our own US recession indicators, where many consumption-related indicators have improved once again.

Dwindling excess savings: However, latest data suggest US excess savings have dwindled to USD 500bn-1.0trn, down from a peak of USD 2.0-2.5trn. The excess savings are expected to run out by early next year, a key reason why we expect a mild recession to start by Q1 FY24.

Peak in policy rates: Major central banks, except for the BoE, are likely done with their rate hikes as headline inflation continues to fall with fading growth and supply bottlenecks. Nevertheless, we expect the Fed and the ECB to hold rates at cycle highs for the rest of the year as core inflation remains well above their 2% target. There is also a growing chance of the BoJ reversing its ultra-loose monetary policy in the next 6-12 months as domestic inflation pressures build.

China policy: China's policy outlook could determine whether global disinflationary trends continue into H2. The supportive policy statement from China's Communist Party Politburo has once again raised expectations of more stimulus, especially for the property sector. We expect modest fiscal support for local governments facing funding challenges and targeted support to revive consumption and business sentiment in H2.

Bonds – at a glance

Abilash Narayan, CFA
Senior Investment Strategist

Cedric Lam
Senior Investment Strategist

Key themes

We still like high-quality bonds. Better-than-expected US data and corporate earnings have reduced imminent recession risk and raised the prospect of the Fed holding benchmark rate at its current 22-year high for the rest of the year. Yields have edged higher in July, but we view this an opportunity to add to high-quality bonds, such as Developed Market (DM) Investment Grade (IG) government bonds or Asia USD bonds, to lock in longer-term return as we approach the end of the economic cycle.

We remain Overweight DM IG government bonds. We expect the US 10-year government bond yield to hover around 3.75-4.00% over the next three months. Over a 6-12-month horizon, the yield is likely to decline towards 3.00-3.25% due to more risk aversion and demand for longer-tenure bonds as growth slows. Hence, we would use the current window to lock in longer-term yield to benefit from likely capital gains (from a rise in bond price) as yields fall towards our 12-month target.

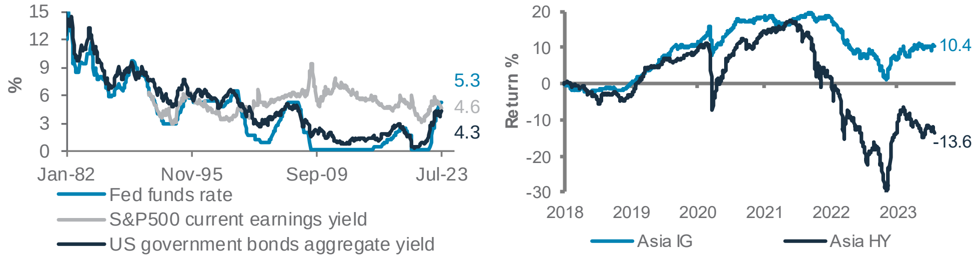
We remain Overweight Asia USD bonds, with a relative preference for IG bonds. The positive signals delivered in the recent Chinese Politburo meeting should support growth. However, a challenging global trade outlook and still-weak Chinese HY bond fundamentals suggest retaining our preference for IG bonds, despite their relatively tight yield premiums over Treasuries.

We are Neutral on DM IG corporate bonds and Underweight US HY bonds. Although US recession is likely delayed, we still believe the current yield premiums do not look attractive, particularly in HY. **We are Neutral EM local currency (LCY) government bonds and Underweight EM USD government bonds.** Our view of a weaker USD and prospect for EM central banks to cut rates are positive for EM LCY government bonds. However, sticky inflation and weaker credit quality, especially in a few distressed EM issuers, have moved us to a more defensive stance.

Key chart

Bonds now offer yields that are comparable to equity earnings yield; despite a less compelling valuation, we continue to prefer Asia USD IG bonds over HY bonds due to stronger fundamentals and China policy stimulus.

Fig. 10 **The gap between bond yields and equity earnings yields has narrowed; Asia HY bonds have underperformed IG bonds as the Chinese property sector stayed weak**



Source: Bloomberg, Standard Chartered.

When longer-term bond yields are lower than cash yields, who need bonds?

Short-term rates, such as the three-month SOFR, have surged from nil to over 5% in only 1.5 years. On the contrary, longer-term bonds, such as the US 10Y government bond, are offering yields above 3%. Although longer-term bond yields are lower than cash yields, we still see value in adding into bonds due to three reasons:

1. **Bond yields have likely peaked.** According to our study, bond yields have historically peaked when central banks ended hiking interest rates. At present, we believe the current global aggregate bond yield of c.4% is attractive. Valuation also looks compelling as well, when compared with the era of policy loosening over the past decade when global bonds were offering below 1% yield.
2. **Scope for capital gains.** Bond prices increase as yields fall. Although a US recession has likely been pushed back, economic growth is slowing. We believe slowing growth is likely to drive yields lower. In this environment, longer-term bonds are likely to outperform short-term bonds due to the former's higher interest rate sensitivity.
3. **Hedging reinvestment risk.** Cash deposits offer short investment horizons. In a monetary loosening cycle, which we expect to start next year, short-term investment suffers from the risk of having to roll over matured deposits at lower rates. Hence, we believe locking in longer-term bond yields today would reduce the risk of diminishing investment returns during periods of falling bond yields.

Equity – at a glance

Daniel Lam, CFA
Head, Equity Strategy

Fook Hien Yap
Senior Investment Strategist

Michelle Kam
Investment Strategist

Jason Wong
Equity Analyst

Key themes

We remain Neutral on global equities as we expect the timing of a recession in the US and Europe to be pushed out to Q1 FY24. Economic data, particularly in the US, remain relatively resilient. However, we are **Neutral US equities** due to expensive valuation, offsetting this resilient growth backdrop.

Our highest conviction Overweight is on **Asia ex-Japan**. Valuation remains at a discount vs global equities, and monetary policies are more supportive vs DMs. We believe **China equities** are likely to perform in line with the region. Economic data has been under-delivering, but Chinese policymakers are likely to continue with targeted stimulus to support growth. It is becoming easier to beat lowered economic expectations in China, compared with heightened economic expectations in the US and in Europe. We believe **India equities** are also likely to perform in line with the region due to a tug-of-war between high valuation premium vs strong estimated (consensus) EPS growth in excess of 20% in FY23 and FY24.

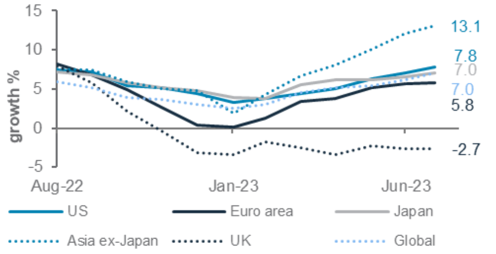
We are Overweight Japan. Companies are increasingly focused on delivering strong profitability, dividends and share buybacks to investors. The BoJ is also likely to keep the economy "running hot" for a while longer. We are **Neutral Euro area equities.** Valuation discount continues to be significant and corporate margins resilient; however, this is offset by the ECB's hawkish policies. Finally, we are **Underweight UK equities** where we see the weakest earnings growth this year, offsetting its low valuation. The risk lies in a shift in investor sentiment back in favour of Value stocks.

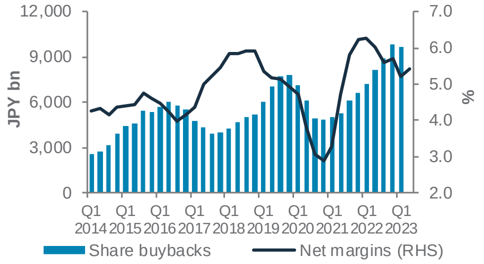
Key chart

Earnings growth prospects are relatively better in Asia ex-Japan, our most preferred market. We are also Overweight Japan, where companies are increasingly focused on shareholder value

Fig. 11 **Earnings growth outlook is improving in most regions, led by Asia ex-Japan, our most preferred market; Japanese companies have increased share buybacks and a profitability focus should drive profit margins higher**

Evolution of consensus 12m forward EPS growth estimates for various regional MSCI equity indices (chart on the left). Share buybacks and net profit margins for Japan's Topix index





Source: FactSet, Bloomberg, Standard Chartered

Developed Markets in balance

Since our upgrade of Global and US equities to Neutral in June, the US equity market has risen further, pushing valuations higher. 12m forward P/E for MSCI US is at 19.9x, almost 1 standard deviation above its historical mean, driven by the rally in the technology sector. Fed tightening and expected earnings contraction in Q2 2023 present mild headwinds for the market.

We are Neutral Euro Area and Underweight UK equities. Both regions are cheap. Inflation has been cooling, but recession risks remain. The UK's 12m forward expected 2.7% decline in EPS growth remains the weakest among key regions. Business momentum remains subdued, with fund outflows YTD.

Asian market opportunities

Easing policies in China offer a contrasting picture to investors relative to DMs. We remain Overweight Asia ex-Japan (AxJ). We expect more targeted stimulus and an improved growth outlook following Chinese officials' pledge to step up policy support in late July. MSCI China is trading at a 23% discount to AxJ, close to the lowest since 2007. Korea and Taiwan are likely to benefit from continued growth in AI-related areas lending tailwind to the semiconductor sector.

We are also Overweight on Japan. Tailwinds include improved corporate governance, substantial fund inflows and record share buybacks YTD. The corporate focus on profitability is likely to improve profit margins. Rising consumer spending is also a key driver supporting earnings growth.

FX – at a glance

Abhilash Narayan
Senior Investment Strategist

Iris Yuen
Investment Strategist

Key themes

We turn modestly bearish on the USD over the next three months and lower our 12-month forecast. Over the next three months, failure to break 102.3 resistance could spark a reversal of the recent rebound in the USD and push the greenback back towards 100, especially as the US Treasury finishes refilling its cash balances (which has been marginally USD supportive).

The resilience of US labour markets and economy has raised the risk that US core inflation could be stickier than previously anticipated. While the Fed kept the door open for further rate hikes, our expectation of bond yields remains largely unchanged. When we combine this with downside growth and inflation surprises in Europe and the UK, it raises the risk of real (net of inflation) interest rates turning unfavourable for the USD going forward. **On a 12-month horizon, in addition to the real interest rate differentials, the lower risk of a deep recession is likely to reinforce the "Dollar smile" framework**, which argues that the USD should weaken when global growth outpaces US growth. This should also push the USD lower.

We now expect EUR/USD to rise towards 1.12 over the next three months and push towards 1.15 on a 12-month horizon. Despite the recent downside surprise in the European economic data, we have raised our ECB rate forecasts, which combined with our expectation of a rapid decline in inflation, should lead to more favourable interest rate differentials. **We also raise our 3-month and 12-month GBP/USD forecast** as the recent reduction in peak BoE rate expectations reduces the downside risk for the pair. Additionally, China's policy stimulus should be positive for both currencies over the near term.

USD/JPY could trade in a range over the next three months, before declining towards 130 over the next 12 months as the recent upgrade in BoJ's inflation forecasts and the YCC policy to make it more flexible points to looming policy normalisation. **USD/CHF is likely to trade sideways over the next 3 and 12 months**, as we expect the SNB to pause its tightening.

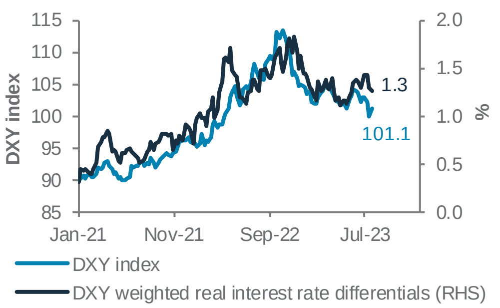
Commodity currencies (AUD, NZD and CAD) and the CNY are likely to benefit from China's stimulus measures. We expect higher commodity demand to lead to modest upside for commodity currencies. While USD/CNY could rise in the near term due to policy divergence, eventual growth pick-up should push the pair towards 7.0 over the next 12 months.

Key chart

Lower real interest rate differentials should push the USD down. EUR, JPY and GBP to be the key beneficiaries. Table of our revised 3-month and 12-month FX forecasts

Fig. 12 **Decline in US real (net of inflation) interest rate differentials to drive USD lower**

DXY-weighted real interest rate differentials and DXY; Table of forecasts



Currency	3m forecast	12m forecast
USD (DXY)	100.1	97.6
EUR/USD	1.12	1.15
GBP/USD	1.29	1.33
USD/JPY	138	130
AUD/USD	0.69	0.70
NZD/USD	0.63	0.64
USD/CAD	1.32	1.31
USD/CNY	7.20	7.00
USD/CHF	0.88	0.87

Source: Bloomberg, Standard Chartered

How to approach funding currency selection in a weaker USD environment?

The rise in US interest rates has led to renewed investor interest in switching their funding to currencies such as EUR, JPY and CHF, which offer lower borrowing costs. While the approach worked extremely well in 2022, when USD was appreciating, the risk-reward for the approach sharply deteriorates when the USD is expected to decline.

Our forecasts for EUR and JPY imply that FX appreciation could more than offset the benefit of lower borrowing cost they offer. While CHF is expected to trade largely sideways, in case of a deep recession, investors could face a double whammy of CHF appreciation and decline in asset prices.

Hence, investors should consider diversifying risk across multiple funding currencies and even switching back some loans to USD or HKD.

Gold, crude oil – at a glance

Zhong Liang Han, CFA
Investment Strategist

Key themes

We remain Neutral on gold vs other major asset classes with a 12-month forecast of USD 2,050/oz. After a lacklustre June, gold rebounded from its three-month low on lower real yields (adjusted for higher long-term inflation expectations) and weaker USD. We expect further moderation of real yields and the USD over a 6-12-month horizon to boost gold prices as the Fed ends its hiking cycle and cuts rates as the economy slows. Continued demand from global central banks and physical demand are other key drivers behind our constructive view. A recent revival in ETF flows was short-lived, with total gold ETF holdings falling back to its March-low. In contrast, managed money positioning has risen in July. Put together, investor positioning appears mixed, and the shiny metal is likely to trade rangebound at around USD 1,950/oz in the short term.

We are still bearish on crude oil and see WTI oil trending lower to USD 65/bbl in the next 12 months. The oil market saw some signs of life in July after two straight months of range trading between USD 67/bbl and USD 73/bbl. WTI oil broke higher and hit a 3-month high amid signs of supply tightness and increased prospect of further China stimulus. There is more concrete evidence of OPEC+ members, especially Russia, complying with their committed output cuts. We also expect China to provide further stimulus, supporting oil demand in the near term. Against this backdrop, we lift our three-month expectation to USD 79/bbl. In the long run, however, we expect WTI oil to trend lower on (1) weaker oil demand from a slowing global economy, (2) increasingly bearish investor positioning in anticipation of a recession, and (3) the build-up of inventories as demand slows.

Key chart

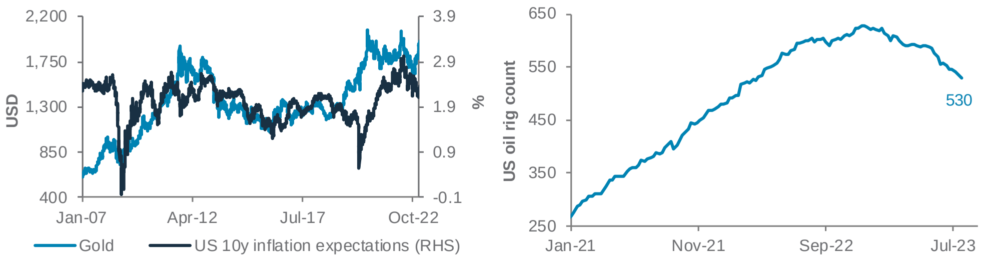
Gold is a good hedge should inflation expectations surge again in a "no landing" scenario

US oil drillings fell to a 15-month low, further restricting supply

Fig. 13 **Gold is highly correlated with inflation expectations; US oil rig count, which indicates future oil production, fell to a 15-month low of 530**

LHS chart: Gold (USD/oz) vs 10-year inflation expectations (%)

RHS chart: US oil rig count



Source: Baker-Hughes, Bloomberg, Standard Chartered

Gold works in recessions, no landing scenario

We have highlighted gold's stellar track record in past recessions previously and, given our base case of an eventual US recession, that anchors our bullish outlook for the yellow metal on a 12-month horizon.

In recent weeks, the "no landing" scenario is gaining traction as US economic data were surprisingly resilient. Under this scenario, the economy does not slow down, and inflation is likely to stay elevated or surge again. Market volatility is likely to spike as well.

If this scenario materialises against our expectations, gold could still perform well as a hedge against both inflation and uncertainty. Historically, gold is highly correlated with both inflation and inflation expectations. Hence, we continue to see gold as an anchor asset in any portfolio.

Supply factors taking hold of oil markets

Demand factors drove most of the oil price moves earlier this year. However, supply factors are increasingly dominating oil market sentiment. First, Saudi Arabia extended its voluntary output cut, while Russia bumped up its voluntary cut to 1mb/d in August, taking the total OPEC+ pledged cuts since Aug-22 to 5.16mb/d. Next, OPEC+ committed to more transparency in regard to Russian's output data during the June meeting, which they followed through by publishing third-party estimates. In our view, this would restore credibility to the OPEC+ mechanism, in turn increasing sensitivity of oil prices to supply cuts. Third, the US oil rig count fell for six straight weeks to a 15-month low of 530, from the post-pandemic high of 627 rigs in Dec 2022, further restricting supply.

These supply factors increase the upside risks to oil prices. However, we expect demand contraction to catch up.

Quant perspective

US risk model turns positive on equity market risks

Francis Lim
Senior Quantitative Strategist

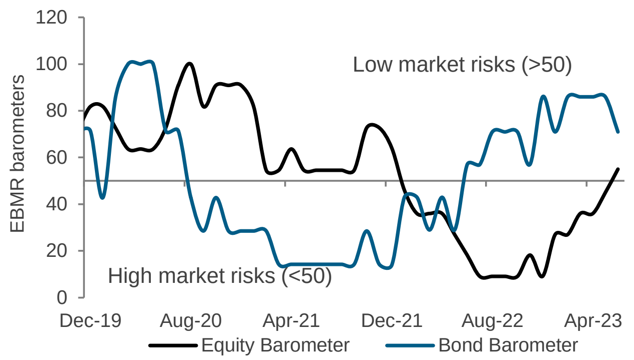
Model projects low equity market risks

Our US Equity-Bond Market Risk (EBMR) models the downside risks in US equities and the US 10-year government bonds. It uses 11 economic and market factors to create equity and bond risk barometers. If the value of a barometer falls below 50, it signals higher downside risks and vice versa.

The model shifted to Stage 2 in July, from Stage 1. The shift means the model expects lower US equity market risk for the first time after 18 months. Continued easing in US inflation and strong equity market momentum have been the primary factors for the shift. Under Stage 2, the model also continues to predict lower upside risks to US 10-year government bond yield as we approach peak rates. The model has previously captured a 2.2% rise in US 10-year government bond yield before turning bullish in Jun-22.

Fig. 14 EBMR bullish on equity and bond market risks

US equity and bond market risk barometers



Source: Standard Chartered

The equity barometer has continued to improve since Dec-2022 to current 55, just above the bull-bear cut-off of 50. Previously, the improvement in the equity barometer was driven by equity market momentum without any support from macro factors. More recently, its improvements have been supported by easing inflation, a pause in the contraction of monetary base and US housing starts. However, all these three factors are only modestly positive. A slight deterioration could turn them bearish on equity market risk again. Given the equity barometer is just above 50 (weighed by interest rate factors remaining negative for equities), we suggest caution when participating in the current equity market rally.

The bond barometer remains bullish on US government bond market risks. It deteriorated slightly to 71 from 86 due to the upward spike in housing starts, which is a bullish signal for risk assets but a bearish one for bonds. Other growth indicators, such as US PMI and commodity prices, remain contractionary and supportive of the bond barometer. They should reduce inflationary pressure and the need for further Fed rate hikes (bond price falls when interest rate rises).

Our model's projections for the coming months are split into Stage 2 or 3. In Stage 3, government bond market risks are expected to rise significantly as the US moves into late cycle. We believe Stage 3 is less likely until we see a broad-based recovery in growth first.

Implications on global assets

Data since 1999 suggest equities and alternative are the most preferred in Stage 2. The model's preference for the assets is based on its long-term relationship with the market cycle, which favours riskier assets in Stage 2.

Fig. 15 Scenarios over the coming months till October 2023 vs December 2022 projections

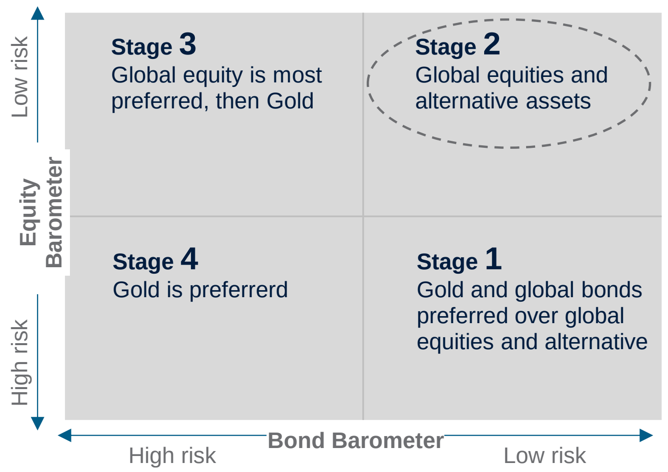
Probability of the evolution of financial market risk cycle from the current Stage 2 and preferred assets

Model's estimated probabilities in December 2022

Stage	Jan-23	Feb-23	Mar-23	Apr-23
1	**100%**	**99%**	**90%**	41%
2	0%	1%	10%	**58%**
3	0%	0%	0%	1%
4	0%	0%	0%	1%

Model's estimated probabilities in June 2023

Stage	Jul-23	Aug-23	Sep-23	Oct-23
1	8%	5%	20%	8%
2	**51%**	20%	36%	**25%**
3	38%	**71%**	**38%**	61%
4	2%	3%	5%	6%



Source: Standard Chartered

Tracking market diversity

Francis Lim
Senior Quantitative Strategist

About our market diversity indicators

Our market diversity indicators help to identify a potential change in short-term trends due to a fall in market breadth across equities, credit, FX and commodities. When market diversity falls, it implies either buyers or sellers are dominating, leading to a rapid rise or fall in asset prices. This is usually unsustainable and is likely to be followed by a slowdown or a reversal. Our diversity indicator is based on a statistical index called fractal dimension; a value below 1.25 serves as a guideline that prices are rising or falling too fast.

Where is diversity falling or rising this month?

Average market diversity across asset classes has fluctuated within a range in July. This includes equities, which have performed well YTD. However, our diversity indicator identified areas of risk in the US information technology sector, which could affect US or even global equities.

On an index level, the diversity of MSCI World Index is low at 1.31. Even though this is above the 1.25 cut-off, which we typically use to identify reversal risk, any reversal in the US technology sector is unlikely to exclude US or the global equity indices due to the sector being the primary source of equity returns this year, and with the sector's significant representation in the index today. Currently, we identified high reversal risk in US equities and the US information technology sector, as our diversity indicator stands at 1.25 and 1.24, respectively. A shallow correction should be sufficient in balancing near-term supply-demand imbalances.

Fig. 16 Diversity of bonds have risen steeply

Average market diversity score by asset class

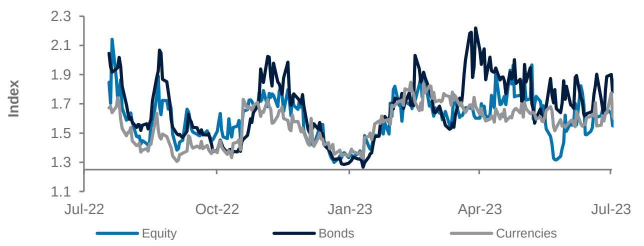
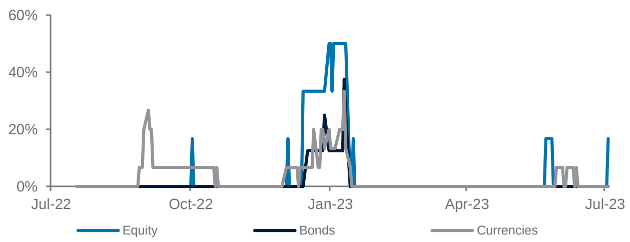


Fig. 17 US equity showing reversal risks

Percentage of assets by with diversity score <1.25



Source: Bloomberg, Standard Chartered

Meanwhile, bond markets are relatively calm, as major bond asset classes have diversity indicator comfortably above 1.25. Bonds have generated positive absolute returns this year. EM local bonds and Global High Yield bonds led with 10.1% and 6.8% YTD gains and have the lowest diversity due to their upward trends. Other bond markets with greater sensitivity to rates (higher duration) and lower correlation to equities have the highest diversity. These include DM government bonds and IG credits, which have fluctuated alongside the US 10-year government bond yield due to Fed hike uncertainties.

Currency markets are also relatively calm and diversity indicators healthy. We have previously flagged stretched positioning in USD/CNH, USD/JPY and USD/MYR. All these three currency pairs have since corrected due to the broad USD weakness. They have declined 0.4%, 1.5% and 2.4%, respectively, since the publication of our H2 Outlook on 23 June. Near-term outlook will likely be more dependent on changes in rate hike expectations across economies.

Fig. 18 Diversity across key assets

Equities	Market diversity	30-day diversity
MSCI US	○	→
MSCI Europe	●	↑
MSCI UK	●	↑
MSCI Japan	◐	↓
MSCI Asia ex Japan	●	→
Fixed Income		
DM Government Bonds	●	↓
DM IG Corporate Bonds	●	↑
Global High Yield Bonds	◐	→
EM USD Bonds	◐	↓
EM Local Bonds	◐	→
US Sector		
Information Technology	○	→

Source: Bloomberg, Standard Chartered; as on 26 July 2023

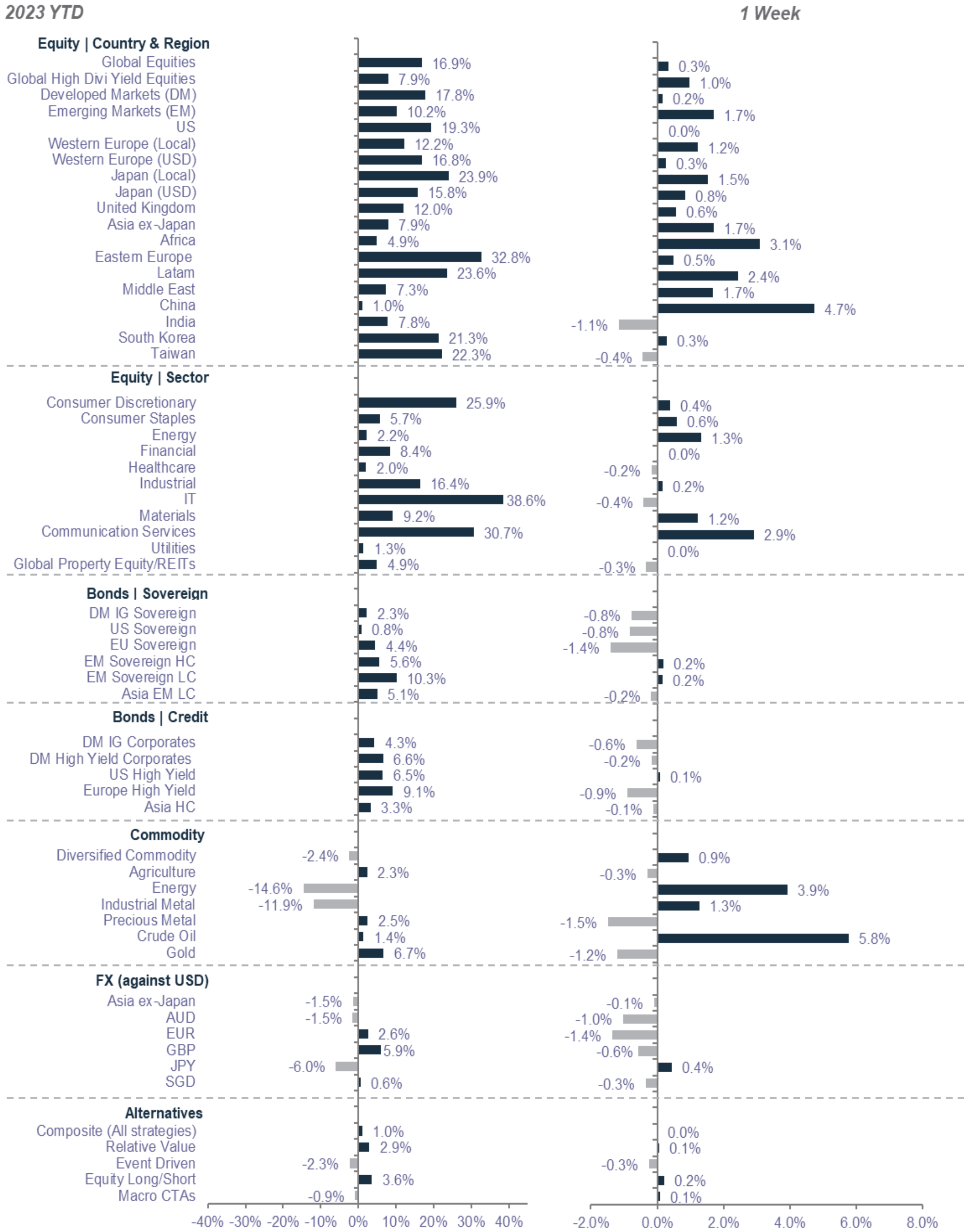
Legends: ○ Very low ◐ Low/moderate ● High

Foundation: Asset allocation summary

Summary	View	ASIA FOCUSED				GLOBAL FOCUSED			
		Conservative	Moderate	Moderately Aggressive	Aggressive	Conservative	Moderate	Moderately Aggressive	Aggressive
Cash	◆	9	10	5	5	9	10	5	5
Fixed Income	◆	77	48	29	8	77	48	29	8
Equity	◆	9	29	52	77	9	29	52	77
Gold	◆	0	5	5	5	0	5	5	5
Alternatives	◆	4	8	9	4	4	8	9	4
Asset class									
USD Cash	◆	9	10	5	5	9	10	5	5
*DM Government Bonds**	▲	14	8	5	1	19	12	7	2
*DM IG Corporate Bonds**	◆	11	7	4	1	14	9	5	2
DM HY Corporate Bonds	▼	8	5	3	1	11	7	4	1
EM USD Government Bonds	▼	11	7	4	1	8	5	3	1
EM Local Ccy Government Bonds	◆	13	8	5	1	10	6	4	1
Asia USD Bonds	▲	21	13	8	2	15	10	6	2
North America Equities	◆	3	11	19	28	4	13	23	34
Europe ex-UK Equities	◆	1	3	5	7	1	3	6	8
UK Equities	▼	0	1	1	2	0	1	1	2
Japan Equities	▲	1	2	3	5	1	2	4	5
Asia ex-Japan Equities	▲	3	11	19	29	3	8	15	22
Non-Asia EM Equities	◆	1	3	5	7	1	2	4	6
Gold	◆	0	5	5	5	0	5	5	5
Alternatives	◆	4	8	9	4	4	8	9	4

Source: Standard Chartered, * FX-hedged
All figures in %; Allocation figures may not add up to 100 due to rounding.
Legends: ▲ Overweight | ▼ Underweight | ◆ Neutral

Market performance summary*



Source: MSCI, JPMorgan, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered
*All performance shown in USD terms, unless otherwise stated
*YTD performance data from 31 December 2022 to 27 July 2023 and 1 week-performance from 20 July 2023 to 27 July 2023

Our key forecasts and calendar events

Currency	USD (DXY)	EUR/ USD	GBP/ USD	USD/ JPY	AUD/ USD	NZD/ USD	USD/ CAD	USD/ CNY	USD/ CHF	Oil (WTI, USD/bbl)	Gold (USD/ oz)	Fed policy rate (upper bound)	US Treasury 10y yield (%)	ECB policy rate
3m forecast	100.1	1.12	1.29	138	0.69	0.63	1.32	7.20	0.88	79.0	1,950	5.50% (Dec-23)	3.75-4.0%	4.00% (Dec-23)
12m forecast	97.6	1.15	1.33	130	0.70	0.64	1.31	7.00	0.87	65.0	2,050	4.75% (Jun-24)	3.00-3.25%	3.75% (Jun-24)

Source: Standard Chartered

AUG

- 3 Aug > UK: Bank of England meeting
- 17 Aug > US: FOMC Meeting Minutes
- 22-24 Aug > South Africa: China Chairing BRICS Leaders' Summit
- 24-26 Aug > US: Federal Reserve Jackson Hole Economic Symposium

SEP

- 4-7 Sep > Indonesia: 43rd Asean Leaders' Summit
- 9-10 Sep > India: 18th G20 summit
- 12 Sep > US: UN General Assembly
- 14 Sep > EU: ECB policy meeting
- 21 Sep > UK: Bank of England policy meeting
- 19-20 Sep > US: Federal Reserve policy meeting
- 19-20 Sep > US: UN Sustainable Development Goal Summit
- 21-22 Sep > Japan: Bank of Japan policy meeting

OCT

- 13-15 Oct > Morocco: World Bank annual meeting
- 26 Oct > EU: ECB policy meeting
- 30-31 Oct > Japan: Bank of Japan monetary policy meeting
- 31 Oct – 1 Nov > US: Federal Reserve policy meeting
- Late Oct > China: Politburo meeting
- Late Oct > China: Communist Party's 3rd Plenum

NOV

- 2 Nov > UK: Bank of England policy meeting
- 30 Nov-12 Dec > UAE: UN Climate Change Conference 2023 (UNFCCC COP 28)

DEC

- Early Dec > China: Politburo meeting
- 12-13 Dec > US: Federal Reserve policy meeting
- 14 Dec > EU: ECB policy meeting
- 14 Dec > UK: Bank of England policy meeting
- Mid Dec > China: Central economic work conference
- 18-19 Dec > Japan: Bank of Japan policy meeting

Legends: Central bank policy | Geopolitics

X – Date not confirmed | ECB – European Central Bank | FOMC – Federal Open Market Committee (US) | BoJ – Bank of Japan | BoE – Bank of England | RBA – Reserve Bank of Australia

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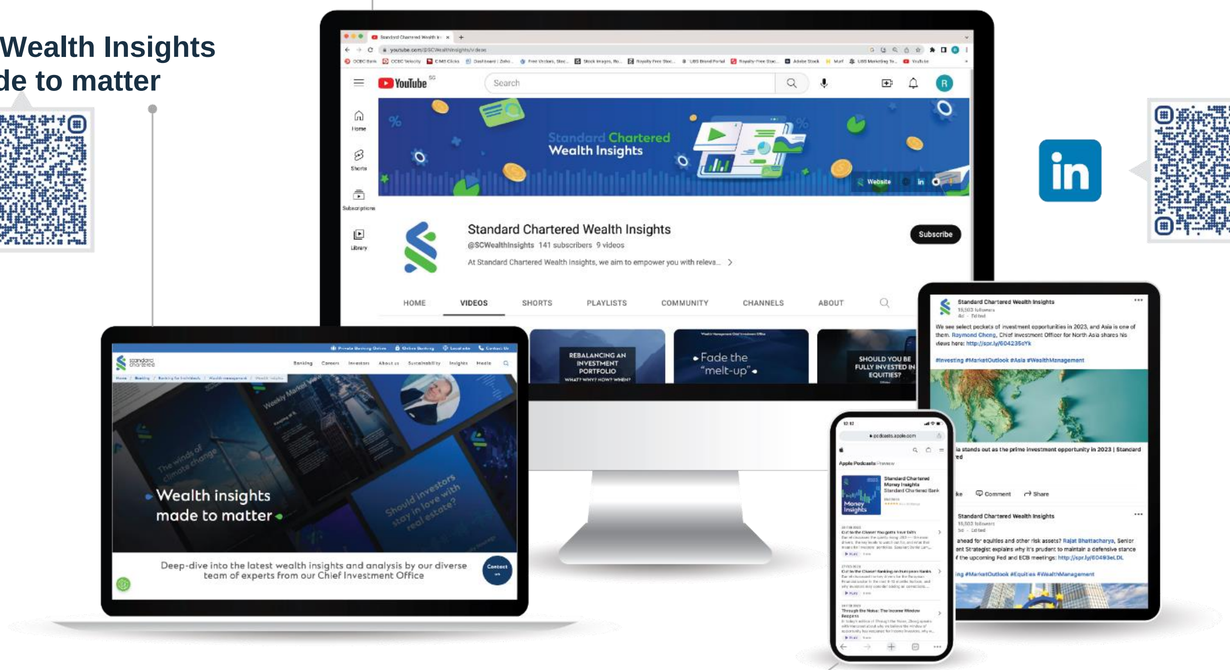

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