



Weekly Market View

Cooling economies, heating markets

→ Markets cheered softer-than-estimated US inflation and jobs reports on expectation that an end to Fed tightening is near and the economy is headed for a soft-landing. For investors with a 6-12-month horizon, why still maintain a balanced allocation, instead of chasing the risk asset rally?

→ We believe there are three reasons for staying with a balanced allocation, despite being positive on equity markets near-term: Tighter US real (inflation-adjusted) policy rates, dwindling excess savings and resolutely hawkish central banks.

→ Against this backdrop, a balanced allocation, highlighted in our CALM strategy, is prudent for investors with a 6-12-month horizon. We see tactical opportunities in high quality Developed Market government bonds and Asia USD-denominated bonds and Asian equities. We also turn short-term bearish on the GBP after the recent sharp rally.

Which sectors look particularly attractive within China equities?

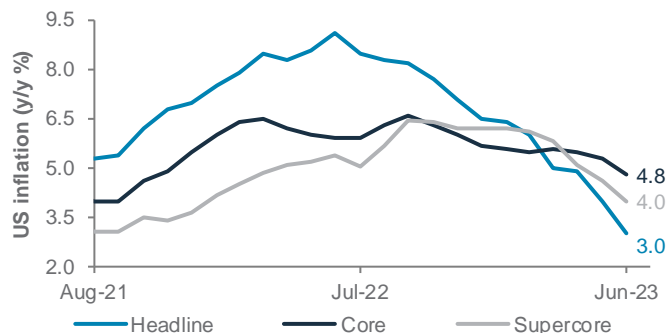
Has your outlook on Asia USD bonds changed following the recent property support measures?

Should we chase the GBP higher after its strong outperformance in recent weeks?

Charts of the week: The disinflation conundrum

The ongoing disinflation is likely to boost US real incomes and consumption, but tighten inflation-adjusted policy rates

US headline, core and supercore[^] inflation



US real (inflation-adjusted) wages and real policy rate*



Source: Bloomberg, Standard Chartered; [^]core services inflation, excluding housing; *Fed Funds rate minus US core CPI inflation

Editorial

Cooling economies, heating markets

Markets cheered softer-than-estimated US inflation and jobs reports on expectation that an end to Fed tightening is near and the economy is headed for a soft-landing. The disinflationary trend is likely to boost real (inflation-adjusted) incomes and consumption, potentially supporting growth longer. This was a key reason why we pushed back US recession expectations to Q1 24. Strong momentum and institutional cash on the side lines could drive the risk asset rally higher in the coming weeks, spurred by the fear of missing out. This is especially so if US Q2 earnings surpass beaten down expectations (consensus estimate: -6.4% y/y). Against this backdrop, it is fair to ask why one should maintain a balanced allocation for investors with a 6-12-month horizon, as opposed to chasing risk assets higher? We believe there are three reasons for staying with a balanced allocation, despite being positive on equity markets near-term.

Tighter real policy rates: The ongoing disinflation is likely to tighten real (inflation-adjusted) policy rates. Measures of US real policy rates, adjusted especially for longer-term inflation expectations, are already above the Fed's estimated neutral rate (the rate which keeps the economy from overheating). There are also signs that the steep rate hikes of the past year in the US and Europe are starting to impact job markets.

Dwindling excess savings: New estimates from the San Francisco Fed and other independent researchers suggest household excess savings are dwindling fast and could be drained, especially for lower and median income households, by Q4 or early next year, removing a key prop supporting the economy. Moreover, the US Supreme Court's decision to strike down student debt forgiveness is likely to add a financial burden on c.40m people. Meanwhile, global manufacturing is in outright recession, with new orders contracting. This is also reflected in indicators from key global exporters from Asia.

Resolutely hawkish central banks: Developed Market central banks appear focussed on bringing inflation back towards their

2% target, even at the cost of growth. This suggests policy is likely to remain a headwind for risk assets for the rest of the year, until the Fed and the ECB relent and cut rates.

Investment implications: Against this backdrop, a balanced allocation, highlighted in our CALM strategy, is prudent for investors with a 6-12-month horizon: Capitalise on market opportunities, Allocate broadly, Lean to Asia, Manage volatility.

Tactical opportunity in bonds: Tactically, the risk-reward balance now favours adding to Developed Market government bonds and Asia USD corporate bonds. High-quality bonds are relatively cheap compared with equities, especially in the US and Europe. On technical charts, the US 10-year government bond yield has failed to sustainably break above 4%, marking a key resistance. Long-term yields are unlikely to go much higher even if the Fed hikes another 25-50bps. If anything, slowing growth and disinflationary pressures (including from China) are likely to drag long-term bond yields lower. Hence, they are likely to provide capital gains on top of attractive yields, outperforming cash over the longer run. In contrast, US and Europe equities face derating risks if expectations of a strong earnings rebound in H2 fail to materialise. The S&P500 index, having broken out into a 15-month high, faces the next major resistance at c.4,637 (2.8% above current levels), the previous high in March 2022.

Asia ex-Japan equities are inexpensive vs US and European equities. We remain diversified across Asian equity markets. Tactically, we anticipate a new round of policy support at the upcoming China politburo meeting which should revive sentiment towards Asia. Indian equities, after hitting record highs, are due for a short-term correction, but strong earnings should make this a buying opportunity for long-term investors.

Turning short-term bearish on GBP: While rate differentials have driven the GBP higher in recent weeks, the UK faces heightened risk of a recession in H2 as the BoE drives rates higher to quell demand and bring inflation back to its 2% target.

— Rajat Bhattacharya

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 in the near term

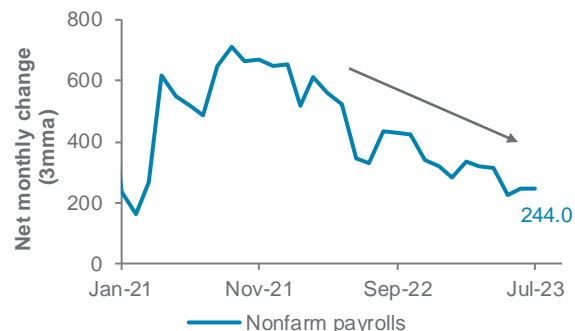
(+) factors: Cooling US inflation, supportive policies in China

(-) factors: Weak Euro area sentiment, restrictive Fed policies

| | Positive for risk assets | Negative for risk assets |
|---------------------|--|---|
| Macro data | <ul style="list-style-type: none"> US added less jobs than expected at 209,000, allaying overheating concerns; jobless rate fell as expected to 3.6% US consumer inflation slowed more than expected to 3.0% y/y; core inflation slowed more than expected to 4.8% y/y US producer prices rose less than expected US NFIB small business optimism improved to a 7-month high of 91.0 China M2 money supply growth and new CNY loans were higher than expected | <ul style="list-style-type: none"> Fed's Beige Book reflected a pick-up in overall economic activity since late May, but warned it is unsustainable Euro area Sentix investor confidence fell more than expected to -22.5 Euro area ZEW survey of growth expectations fell further to -12.2 China consumer inflation slowed more than expected to 0% y/y; factory prices fell more than expected by 5.4% y/y China exports and imports fell more than expected |
| | Our assessment: Moderately positive – Cooling US consumer and producer inflation, resilient US jobs market vs weak Euro area sentiment, disinflation pressures in China | |
| Policy developments | <ul style="list-style-type: none"> China extended policy support for property developers and signalled more to come China's President Xi called for greater opening of the economy to focus on foreign cooperation Hawkish Fed policymaker Bullard to step down | <ul style="list-style-type: none"> Fed's Williams, Daly and Mester called for more hikes, while Bostic asked for more patience to allow the effects of tighter policy to feed through The Fed said big banks are expected to face stricter capital requirements |
| | Our assessment: Neutral – Supportive China policies vs restrictive Fed policies | |
| Other developments | <ul style="list-style-type: none"> US Treasury Secretary Yellen described her Beijing trip as "direct, substantive and productive" | <ul style="list-style-type: none"> Saudi Arabia lifted official selling prices for its flagship Arab light crude oil NATO pledged to offer Ukraine a faster path to join the bloc |
| | Our assessment: Positive – Improved Sino-US relations | |

US job creation has been on a downtrend since last year, but remains robust

US net nonfarm payrolls, 3m moving average



Source: Bloomberg; Standard Chartered

Euro area growth expectations and investor sentiment continued to weaken

Euro area ZEW survey of growth expectations and Sentix investor confidence indicator



Source: Bloomberg, Standard Chartered

China's disinflationary pressures extended into June, raising the prospects of further stimulus measures at the Politburo meeting this month

China's consumer and producer price inflation



Source: Bloomberg, Standard Chartered

Top client questions

Q Does the latest US inflation data reinforce your view on bond yields?

US government bond yields plunged after the release of a softer-than-expected US June consumer inflation report. The benchmark 10-year yield failed to break above resistance at 4.06%, which we highlighted last week, and instead turned sharply lower. Technical analysis suggests key near-term supports sit at 3.82% and 3.69%.

While moderating inflation has put the Fed in a better position to consider ending the current rate hike cycle, money markets continue to anticipate a “dovish hike” of 25bps at the July FOMC meeting, followed by a pause in September. We are mindful that two further CPI and PCE inflation reports will be released between the July and September policy meetings. A further softening of inflation in these releases is likely needed for bond yields to break lower more firmly.

As we noted in our Outlook 2023, bond yields likely peak when the Fed hiking cycle peaks as well. Hence, we see the current environment as attractive for locking in long-term yields in high-quality bonds, regardless of whether a recession is delayed. As such, we retain our view that high-quality bonds, such as DM IG government bonds, are likely to outperform other bond asset classes over the next 12 months.

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

Q Has your outlook on Asia USD bonds changed following the recent property-related developments?

There have been several notable headlines around the China real estate sector in recent weeks:

- 1) Several major Chinese developers said they were facing issues with debt restructuring and sale of distressed assets.
- 2) New home sales by the 100 largest property developers resumed y/y decline in June after a brief four-month rebound. The chairman of China’s second largest developer noted the industry is “seeing pressure in the short term”.
- 3) The PBoC extended two policies that were set to expire within the 16-point plan implemented last November to support the ailing property sector. Broadly, they involve extending the maturity of the existing construction and trust loans by one year, with no change to risk classifications in developer loan books.

We believe the last-mentioned policy measure is likely to have limited impact on the property sector given that it is not a new measure and is relatively small scale in nature. Moreover, there has been a lack of material policy easing in the property sector YTD. Hence, we remain cautious on the China property sector. Within bonds, we retain our preference for Asia USD bonds, with the goal of obtaining exposure to high-quality bonds (the asset class comprises about 85% IG-rated bonds). The China real estate sector remains a fairly small (4%) part of this universe.

— **Zhong Liang Han**, *CFA, Investment Strategist*

US 10-year government bond yield plunged after softer-than-expected US June inflation reports

US 10-year government bond yield



Source: Bloomberg, Standard Chartered

China’s property sector easing measures this year have been modest

China property sector policies implemented in 2023

| Date | Policy |
|--------|--|
| 5-Jan | Extension of measures to allow lower mortgage rates for first home buyers |
| 13-Jan | Action plan to improve good quality developers' balance sheet |
| 18-Jan | China housing regulator committed to ensuring house delivery and resolving developers' liquidity risks |
| 10-Feb | Expanding scope of "Second Arrow" financing support for private-owned enterprises |
| 5-Mar | One of the focus areas of the National People's Congress was improving top developers' balance sheets and lowering risks |
| 20-Jun | PBoC cut 5y Loan Prime Rate – a benchmark for mortgage loans – by 10bps |
| 10-Jul | Extend valid period for 2 specific policies in the 16-point plan |

Source: PBoC, Bloomberg, Standard Chartered

Top client questions (cont'd)

Q Which sectors look particularly attractive within China equities?

Chinese equities outperformed global equities in the past week. This followed a positive tone from US Treasury Secretary Yellen's visit to China, pro-growth comments from Premier Li Qiang and supportive policy measures for the property sector. We expect further targeted stimulus measures at the upcoming Politburo meeting.

We believe the most attractive way to position in China equities is for a consumption rebound. As such, we are Overweight on the communication services and consumer discretionary sectors. We believe these sectors will benefit from greater consumer spending and regulatory support. Both these sectors are dominated by internet platform companies that are increasingly recognised by policymakers as growth engines for the economy. Li Qiang recently called them "trailblazers of the era."

In addition, the automobiles segment, which is buoyed by the transition to new energy vehicles (NEVs), accounts for 18% of China's discretionary sector. The NEV industry has been recognised by the government as a key strategic industry that can help boost consumption and investment. China has been the largest NEV producer globally since 2015 and became a net car exporter in 2020. We expect global demand for NEVs to continue to rise, which is supportive of our Overweight view of the Discretionary sector.

— Fook Hien Yap, Senior Investment Strategist

Q Should we chase the GBP higher after its strong outperformance in recent weeks?

The GBP has recently outperformed following a repricing of interest rate expectations. Markets anticipate a more aggressive tightening cycle than before from the BoE given UK consumer inflation at 8.7%, the highest level among major developed economies. Comparatively, we believe the Fed and ECB are much closer to the end of their tightening cycles as inflation declines more quickly than in the UK. This divergence in the monetary policy narrative is likely favouring the GBP.

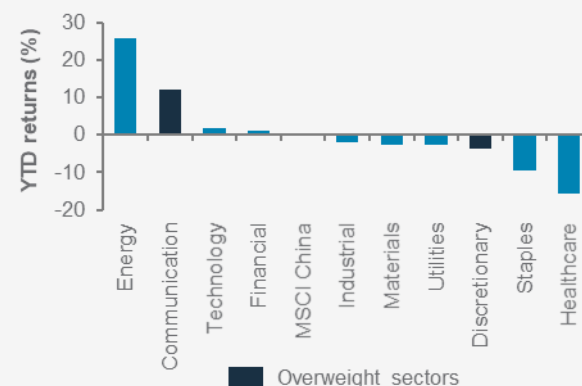
However, we are less optimistic in the near term. Still-high inflation means real (net-of-inflation) yields remain capped despite expectations of further rate hikes. Downside risks to growth due to high and rising interest rates are another potential challenge. Recent job market data suggests the labour market is softening. Stagflation (low growth and high inflation) risk remains elevated, in our view. Therefore, we expect the BoE to adopt a cautious approach to policy tightening and hike rates by less than what markets expect.

Technically, GBP/USD looks overbought, with RSI (a momentum indicator) on the daily chart staying over 70. GBP/USD is also testing the upper limit of the long-term ascending regression channel resistance at 1.2990. Both are likely to trigger a downward correction. We expect the pair to test its near-term support at 1.2850.

— Iris Yuen, Investment Strategist

We prefer to position for a consumption rebound in China through the communication services and consumer discretionary equity sectors

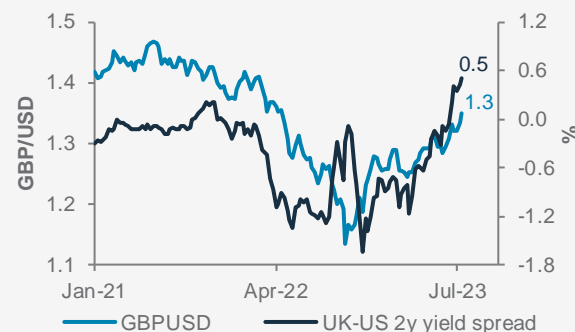
Total returns year-to-date for each sector in MSCI China index



Source: Bloomberg, Standard Chartered

GBP/USD has been boosted by a rising nominal yield differential, but the pair now looks overbought and downside growth risks are rising

GBP/USD, UK-US 2-year yield differential

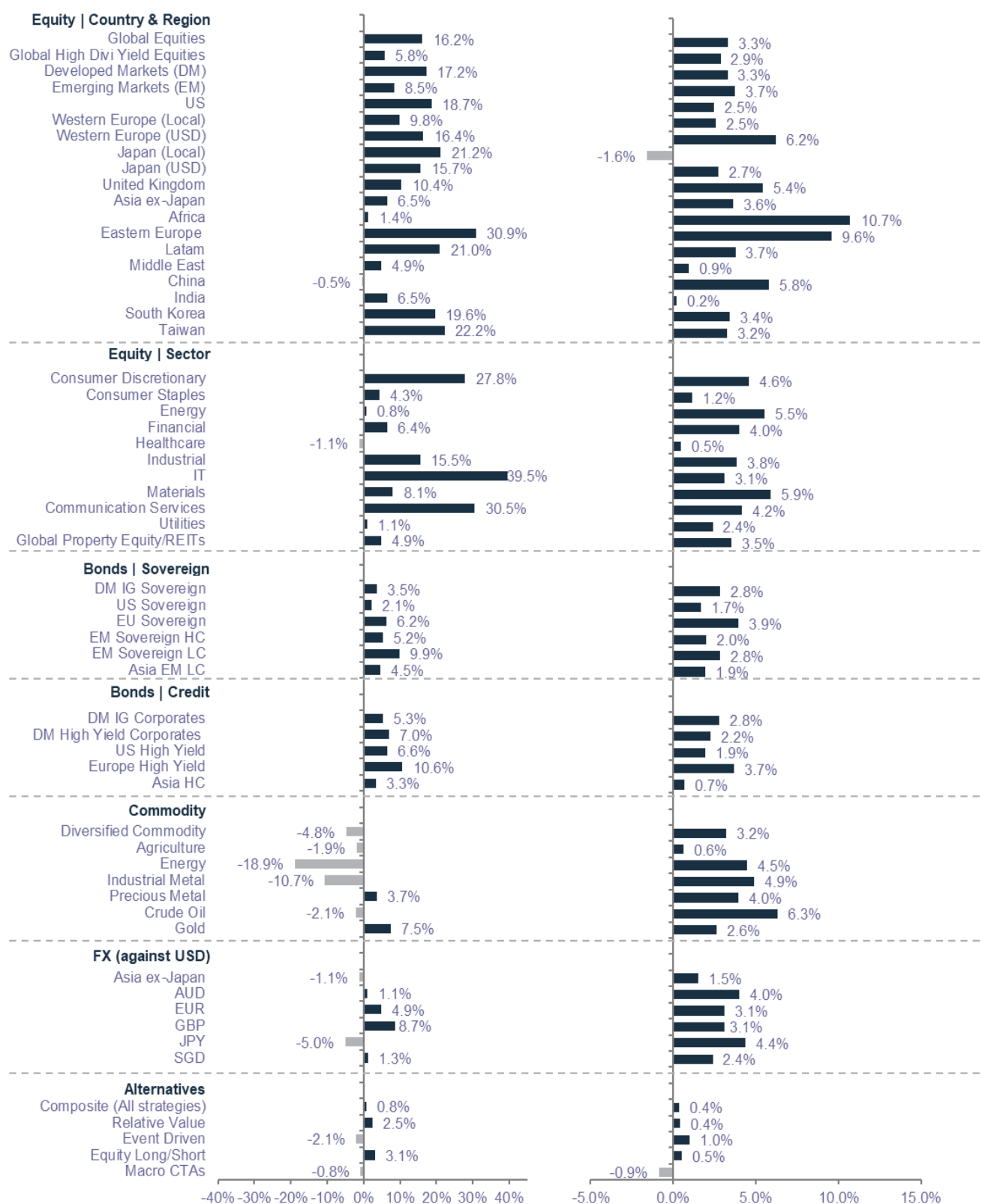


Source: Bloomberg, Standard Chartered

Market performance summary *

2023 YTD

1 Week



Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

*Performance in USD terms unless otherwise stated, 2023 YTD performance from 31 December 2022 to 13 July 2023; 1-week period: 06 July 2023 to 13 July 2023

Our 12-month asset class views at a glance

| Asset class | |
|-------------------------|--------------------------|
| Equities ◆ | Preferred Sectors |
| Euro area ◆ | US Communication ▲ |
| US ◆ | US Technology ▲ |
| UK ▼ | US Healthcare ▲ |
| Asia ex-Japan ▲ | Europe Technology ▲ |
| Japan ▲ | Europe Discretionary ▲ |
| Other EM ◆ | Europe Financials ▲ |
| | China Communication ▲ |
| | China Discretionary ▲ |
| Bonds (Credit) ◆ | |
| Asia USD ▲ | |
| Corp DM HY ▼ | Alternatives ◆ |
| Govt EM USD ▼ | |
| Corp DM IG ◆ | Gold ◆ |
| Bonds (Govt) ▲ | |
| Govt EM Local ◆ | |
| Govt DM IG ▲ | |

Source: Standard Chartered Global Investment Committee

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

The next support for US 10Y gov. bond yield is at 3.66%

Technical indicators for key markets as of 13 July close

| Index | Spot | 1st support | 1st resistance |
|--------------------|--------|-------------|----------------|
| S&P 500 | 4,510 | 4,436 | 4,547 |
| STOXX 50 | 4,392 | 4,288 | 4,443 |
| FTSE 100 | 7,440 | 7,318 | 7,501 |
| TOPIX | 2,243 | 2,225 | 2,258 |
| Shanghai Comp | 3,236 | 3,210 | 3,250 |
| Hang Seng | 19,351 | 18,694 | 19,679 |
| MSCI Asia ex-Japan | 650 | 631 | 659 |
| MSCI EM | 1,021 | 994 | 1,034 |
| Brent (ICE) | 81.4 | 78.9 | 82.6 |
| Gold | 1,961 | 1,937 | 1,972 |
| UST 10Y Yield | 3.76 | 3.66 | 3.96 |

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 | CH | GDP y/y | 2Q | 7.0% | 4.5% |
| | CH | GDP SA q/q | 2Q | 0.8% | 2.2% |
| | CH | Industrial Production y/y | Jun | 2.5% | 3.5% |
| | CH | Retail Sales y/y | Jun | 3.1% | 12.7% |
| | CH | Fixed Assets Ex Rural YTD y/y | Jun | 3.4% | 4.0% |
| | US | Empire Manufacturing | Jul | -1.8 | 6.6 |
| | EC | ECB's Lagarde speaks at 9th ECB conference | | — | — |
| TUE | US | Retail Sales Ex Auto and Gas | Jun | 0.4% | 0.4% |
| | US | Industrial Production MoM | Jun | 0.0% | -0.2% |
| WED | UK | CPI y/y | Jun | — | 8.7% |
| | UK | CPI Core y/y | Jun | — | 7.1% |
| | US | Housing Starts | Jun | 1450k | 1631k |
| THU | US | Philadelphia Fed Business Outlook | Jul | -10.2 | -13.7 |
| | US | Existing Home Sales | Jun | 4.21m | 4.30m |
| | US | Leading Index | Jun | -0.6% | -0.7% |
| | EC | Consumer Confidence | Jul P | — | -16.1 |
| FRI/ SAT | | | | | |

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 narrowed in Global and US equities

Our proprietary market diversity indicators as of 13 July

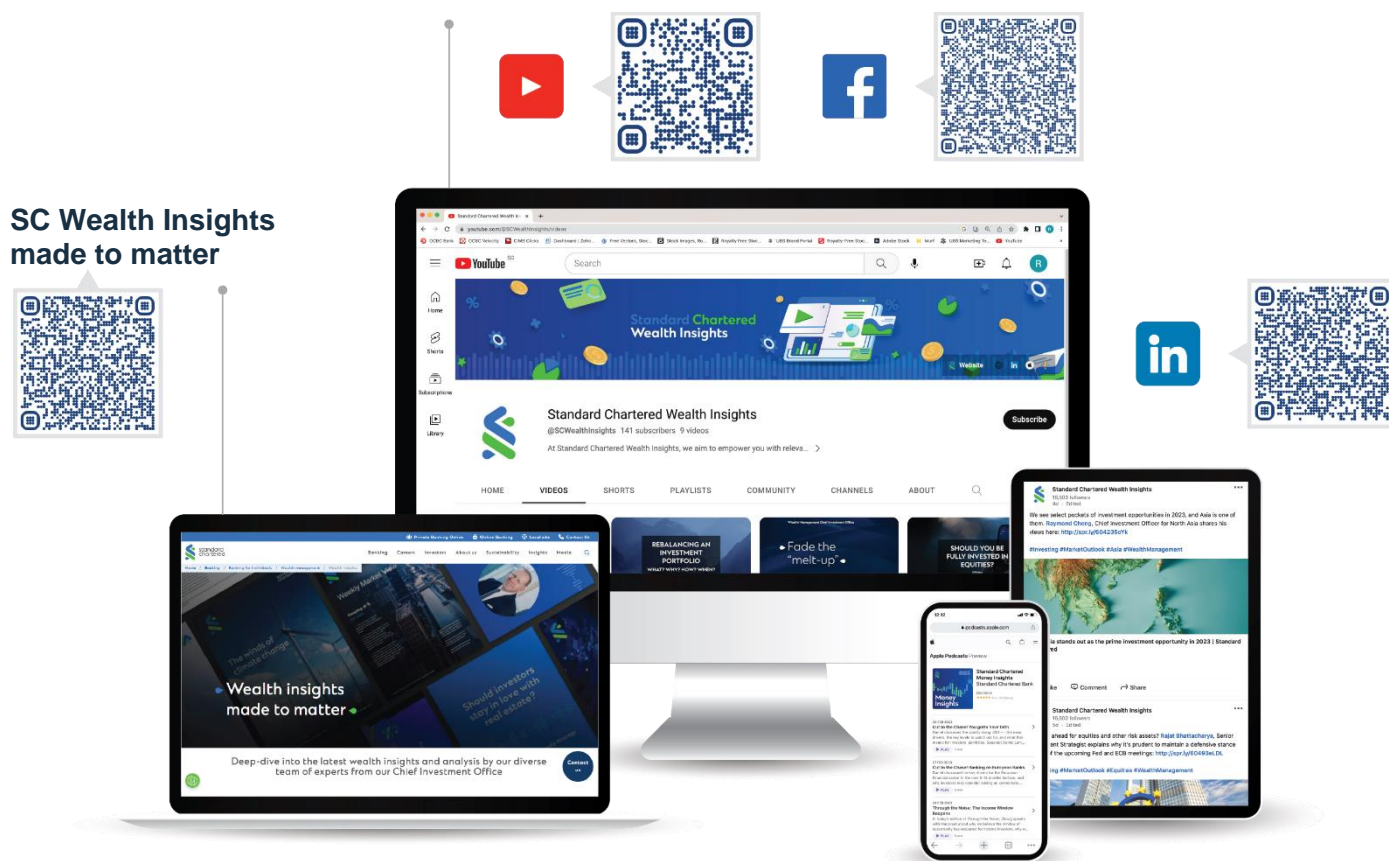
| Level 1 | Diversity | 1-month trend | Fractal dimension |
|---------------------|-----------|---------------|-------------------|
| Global Bonds | ● | ↑ | 1.78 |
| Global Equities | ● | ↓ | 1.40 |
| Gold | ● | ↑ | 1.57 |
| Equity | | | |
| MSCI US | ● | ↓ | 1.32 |
| MSCI Europe | ● | ↓ | 2.16 |
| MSCI AC AXJ | ● | ↑ | 1.95 |
| Fixed Income | | | |
| DM Corp Bond | ● | → | 2.31 |
| DM High Yield | ● | ↓ | 1.51 |
| EM USD | ● | ↓ | 1.56 |
| EM Local | ● | ↓ | 1.41 |
| Asia USD | ● | ↓ | 1.93 |
| Currencies | | | |
| EUR/USD | ● | → | 1.72 |

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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