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Wealth Management Global Chief Investment Office
11 August 2023

Weekly Market View

Disinflation continues

→ The latest US inflation data supports the global disinflation theme currently driving markets. China's building deflationary pressure accentuates it. Sustained global disinflation supports expectations that policy rates in the US and Europe have peaked.

→ We expect this 'goldilocks' scenario of cooling inflation and moderate growth to sustain the risk asset rebound in the next few months.

→ Nevertheless, over a 6-12-month horizon, elevated wage pressures due to tight job markets and rising crude oil prices are key risks to this benign outlook. Then there is the drag on growth itself from the past year's rate hikes.

→ Given these divergent drivers, we believe a balanced foundation allocation is still warranted. Within this, we see an opportunity to add to Developed Market government bonds and rotate from expensive US equities to depressed China stocks.

Is there any evidence of rotation away from US Growth stocks?

Do you expect US government bond yields to rise further?

What is driving the rise in oil prices? What are the implications for commodity currencies?

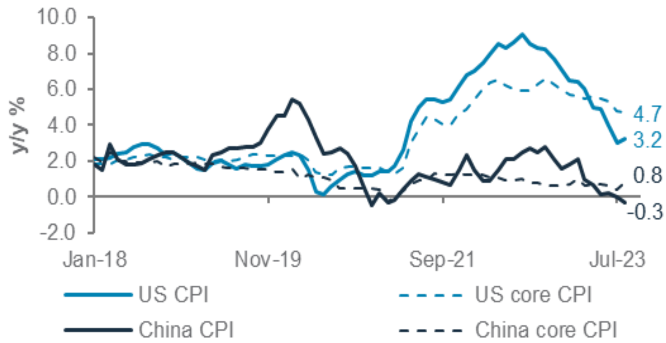
Important disclosures can be found in the Disclosures Appendix.

Charts of the week: Oil boost vs China drag

The impact of a rebound in oil prices on inflation expectations is likely to be offset by China's deflationary pressures

US (WTI) crude oil and 10-year inflation expectations

US and China headline and core consumer inflation



Source: Bloomberg, Standard Chartered

Editorial

Disinflation continues

The latest US inflation data supports the global disinflation theme currently driving markets. China's building deflationary pressure accentuates it. Sustained global disinflation supports expectations that policy rates in the US and Europe have peaked. At the same time, job markets in the US and Europe remain tight, sustaining the consumption-driven growth.

We expect this 'goldilocks' scenario of cooling inflation and moderate growth to sustain the risk asset rebound in the next few months. Nevertheless, over a 6-12-month horizon, elevated wage pressures due to tight job markets and rising crude oil prices (see page 5) are key risks to this benign outlook. Then there is the drag on growth itself from the past year's rate hikes. Given these divergent drivers, we believe a balanced foundation allocation is still warranted. Within this, we see an opportunity to add to Developed Market government bonds and rotate from expensive US equities to depressed China stocks.

US disinflation: US headline and core inflation both stabilised at 0.2% m/m in July. Monthly core inflation fell below 2% on an annualised basis for the second straight month. This trend needs to sustain over the coming months to avoid a rebound in y/y inflation as base effects fade in Q4. The good news is that prices of used cars, trucks and new vehicles fell m/m, leading to a drop in overall goods prices. While core services inflation accelerated to 0.4% m/m, this is primarily driven by 0.4% m/m rise in the shelter component. We expect shelter inflation to cool in the coming months as slowing rents filter through to official shelter inflation data with a 6-9-month lag. Similarly, private used car prices point to subdued used car inflation ahead.

China's building deflationary pressures add to the global disinflation trend. China's consumer prices contracted 0.3% y/y, falling for the first time in two years. Meanwhile, producer prices fell 4.4% y/y, marking the tenth consecutive month of annual decline. The inflation data followed indicators showing a deepening contraction in exports and imports, highlighting a downturn in global goods trade. We believe China's deflationary pressures raise the prospect of more stimulus measures to boost domestic consumption. President Biden's latest executive order to regulate US investment into China's quantum computing, advanced chips and Artificial Intelligence sectors add urgency to rolling out of further stimulus.

Investment implications:

Good value in Developed Market government bonds: The global disinflationary trend is positive for US and European government bonds. Although yields have risen lately, partly because of oil price-driven rise in inflation expectations and concerns about rising US government bond issuance, we expect slowing global growth to eventually cap yields. At current yield levels, the risk-reward balance from investing in US and European government bonds is attractive. For example, the US 10-year yield could rise to a new cycle high of 4.5%, in line with nominal trend GDP growth, and bond investors would still not lose money on a 12-month horizon. Meanwhile, a drop in the 10-year yield by an average 260bps experienced during past recessions would imply a 14% total return in a year.

Rotation to China equities: We expect increased incentives to build self-sufficiency in China's high-tech infrastructure. These factors explain our preference for Consumer Discretionary and Communications Services sectors. Overall, China's 12-month forward P/E ratio is almost half that of US equities and 35% lower than global equities. Given this, we see favourable risk-reward in locking in some of this year's gains from US equities and rotating into China equities (see page 4).

Avoid China High Yield bonds: China's sustained disinflation, partly driven by the depressed property sector, confirms our cautious view on HY bonds. This week's reports of missed payments from a major property developer (Country Garden) highlights the stresses faced by the sector. We continue to prefer the predominantly Investment Grade Asia USD bonds.

— Rajat Bhattacharya

The weekly macro balance sheet

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

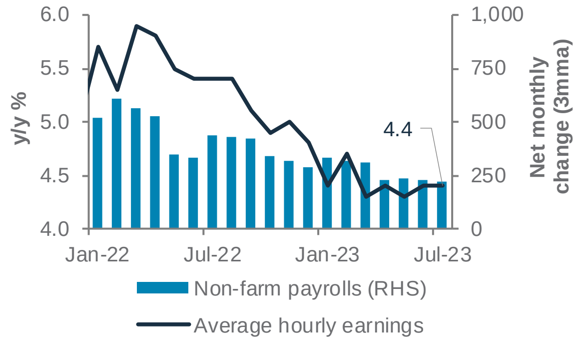
(+) factors: US disinflation, improving Euro area investor confidence

(-) factors: Weak China data, Saudi Arabia extended oil output cut

	Positive for risk assets	Negative for risk assets
Macro data	• US consumer inflation rose less than expected by 3.2% y/y; core inflation rose 4.7% y/y as expected; on a monthly basis, headline and core inflation stabilised at 0.2% m/m • US NFIB small business optimism rose more than expected • Euro area Sentix investor confidence improved unexpectedly to -18.9 • ECB's consumer inflation expectations fell further	• US added fewer-than-expected jobs (187,000) in July; average hourly earnings rose more than expected • China exports and imports fell more than expected • China consumer prices fell 0.3% y/y, the first decline since early 2021; producer prices fell 4.4% y/y, exceeding expectations of -4.0% y/y
	Our assessment: Neutral – US disinflation vs. weaker-than-expected China trade, inflation data	
Policy developments	• Fed's Bostic and Goolsbee expected a slower pace of rate hikes amid a further slowdown in employment gains and inflation; Fed's Harker said the Fed can stop hiking rates • China securities watchdog met property firms to discuss support measures	• Fed's Bowman signalled more rate hikes • The BoE expects above-target inflation till 2026 • Italy introduced new windfall tax on banks following bumper earnings
	Our assessment: Neutral – Mixed Fed commentary	
Other developments	• US President Biden imposed narrower-than-expected limits on US investments in China's hi-tech sector	• Saudi Arabia extended its voluntary oil output cut further to September • Russia attacked Ukrainian ports after Ukrainian drones damaged Russian naval vessel; Ukraine has warned of a retaliation • Moody's cut its credit rating on some mid-sized banks
	Our assessment: Negative – Saudi Arabia oil output cut, increased geopolitical tensions	

US job market is cooling but remains robust enough to sustain wage pressures

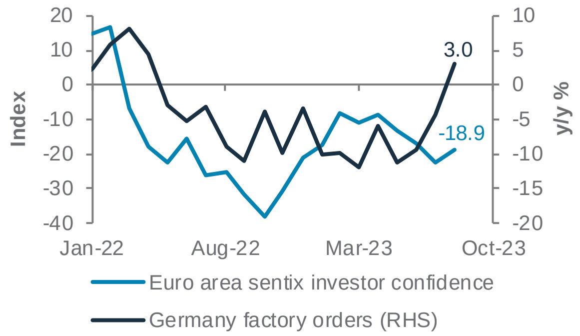
US non-farm payrolls and average hourly earnings



Source: Bloomberg; Standard Chartered

Euro area investor confidence appears to be bottoming while German factory orders recover

Euro area Sentix Investor Confidence; German factory orders



Source: Bloomberg, Standard Chartered

China's slumping external trade is raising the prospect of more stimulus measures to boost domestic demand

China's import and export growth

Source: Bloomberg, Standard Chartered

Top client questions

Is there any evidence of rotation away from US growth stocks?

Since the start of H2 23, the Nasdaq 100 index has underperformed the S&P500 index by 1% after a stellar outperformance of 22% in H1 23. Technically, the Nasdaq 100 index has entered a correction phase, making lower lows and lower highs, with resistance falling from 15,932 to 15,803. Also, in the current US Q2 23 earnings season, the sectors that do not feature heavily in the Nasdaq-100 index – ie, financials, Industrials and Materials – have delivered solid positive earnings surprises. This is encouraging a trimming of the Nasdaq 100 index's exposure in favour of other US sectors as gains broaden, especially against elevated technology sector valuations.

Looking at US equities more broadly, almost 90% of S&P500 companies have reported, delivering an earnings surprise of 7.7%. Earnings growth for 2023 is currently estimated at 1.5%, slightly up from 1.3% expected at the start of July 2023. Given resilient US economic data, earnings data suggest a major decline in US equities is unlikely in the near term. However, modest regional rotation away from US equities is possible given US economic data has been slowing and US equities remain relatively expensive at a 19x 12-month forward P/E.

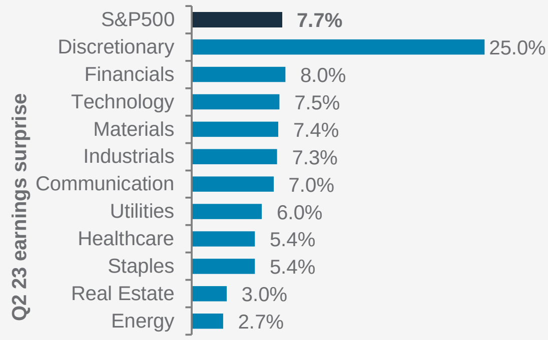
One of the likely rotation choices is Asia ex-Japan, specifically China equities, which is trading at a 35% discount to global equities. The "bar-to-beat" is currently low in China – the difference in economic surprise between China and the US is at its lowest level since the start of the COVID-19 pandemic. This week's data, including soft trade figures, the negative turn in inflation and the issues that property developers are facing, has increased the urgency for potential stimulus action by the government, in our view. While we believe wide-scale stimulus is unlikely, even more modest support can lead to short-covering in China equities.

We continue to favour consumer-driven sectors ie., Communication Services and Consumer Discretionary. There are encouraging signs from the earnings of a bellwether stock in China's internet space this week. Besides delivering the strongest quarterly revenue growth in almost two years, key for the sector outlook was the notable recovery in consumer purchases, especially for lower-cost goods.

— **Daniel Lam,** *Head, Equity Strategy*

US Financial, Industrial and Material sectors delivered reasonable earnings surprise in Q2

US Q2 earning surprise by sectors



Source: Refinitiv, Standard Chartered

Relative performance of Hang Seng Index vs. S&P 500 Index closely mimics the difference in economic surprise between China and the US

Spread between economic surprise indicators in China and the US (left-axis) vs. Hang Seng Index over S&P 500 Index (right-axis) *

Source: Bloomberg, Standard Chartered
* Both Hang Seng Index and S&P 500 Index rebased to 100 as of 31-Dec-22

Top client questions (cont'd)

Do you expect US government bond yields to rise further?

After an initial surge, US government bond yields appear to have shrugged off recent headlines. The 10-year bond yield fell 10bps from last Thursday's peak of 4.20% and closed 4.11% this Thursday.

Several factors are likely behind this turn in sentiment. First, several Fed policymakers delivered relatively dovish signals in speeches this week. The softer-than-expected US July CPI data should help extend this sentiment. Second, concerns of an oversupply of US government bonds (likely a key driver behind the initial yield surge) subsided after relatively strong auction results for US 3- and 10-year government bonds this week. The 10-year auction result closed at 3.999%, slightly lower than the technical chart resistance level of 4.000%. We believe this strong result has built a psychological resistance against the yield to move substantially higher from here.

We continue to expect US government bonds yields to fall over a 6–12-month horizon as we pass the peak in Fed rates, near-term concerns of oversupply recede, and fundamental data show a slowing of both inflation and growth. Hence, we remain Overweight Developed Market (DM) Investment Grade (IG) government bonds.

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

We believe the US 10-year government bond yield has limited room to rise significantly

US 10-year bond yield

Source: Bloomberg, Standard Chartered

What is driving the rise in oil prices, and what are the implications for commodity currencies?

Crude oil prices continued their rise this week as escalating tensions in the Black Sea raised the risk of supply disruptions. Saudi Arabia's extended voluntary output cut is another possible factor. These likely helped investors shrug off concerns following weak China economic data and the surprise rise in US oil inventories last week. However, technical charts for WTI crude oil point to overextended and overbought conditions. We do not expect the recent gains to sustain and expect oil to drift lower to USD 79/bbl in the next three months.

The performance of commodity currencies has diverged. The CAD has been well-supported on a trade-weighted basis, consistent with the rebound in oil prices. We believe USD/CAD is overbought based on the RSI (a momentum indicator) due to USD safe haven flows earlier this week. We expect a technical correction in the pair towards the near-term support at 1.3320. Meanwhile, AUD/USD and NZD/USD have weakened due to a dip in gold prices, which slipped to its one-month low. This supports our bearish AUD/CAD conviction idea. We expect the pair to head towards 0.8650.

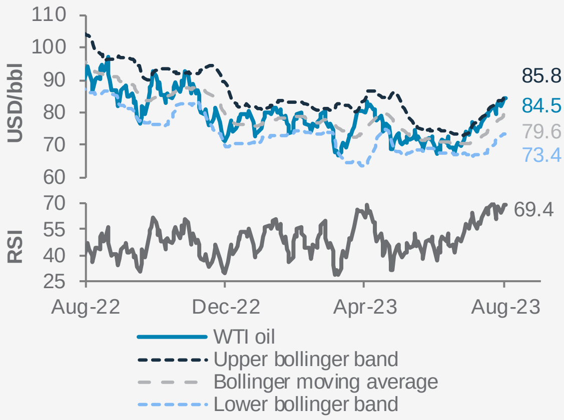
US energy sector equities outperformed on higher oil prices. We remain Underweight the sector given relatively weaker earnings. Investors could use the recent rally to reduce exposure to the sector.

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

— **Iris Yuen,** *Investment Strategist*

Technical indicators are pointing to a looming consolidation in crude oil prices

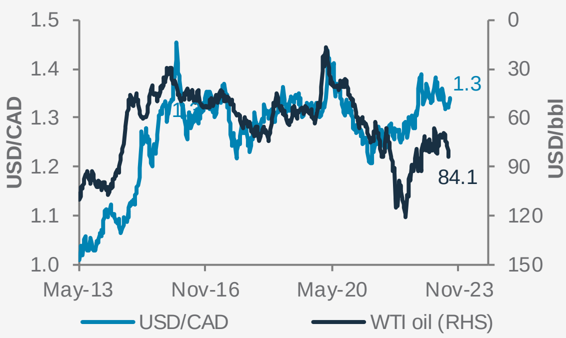
US (WTI) crude oil with Bollinger band and Relative Strength index



Source: Bloomberg, Standard Chartered

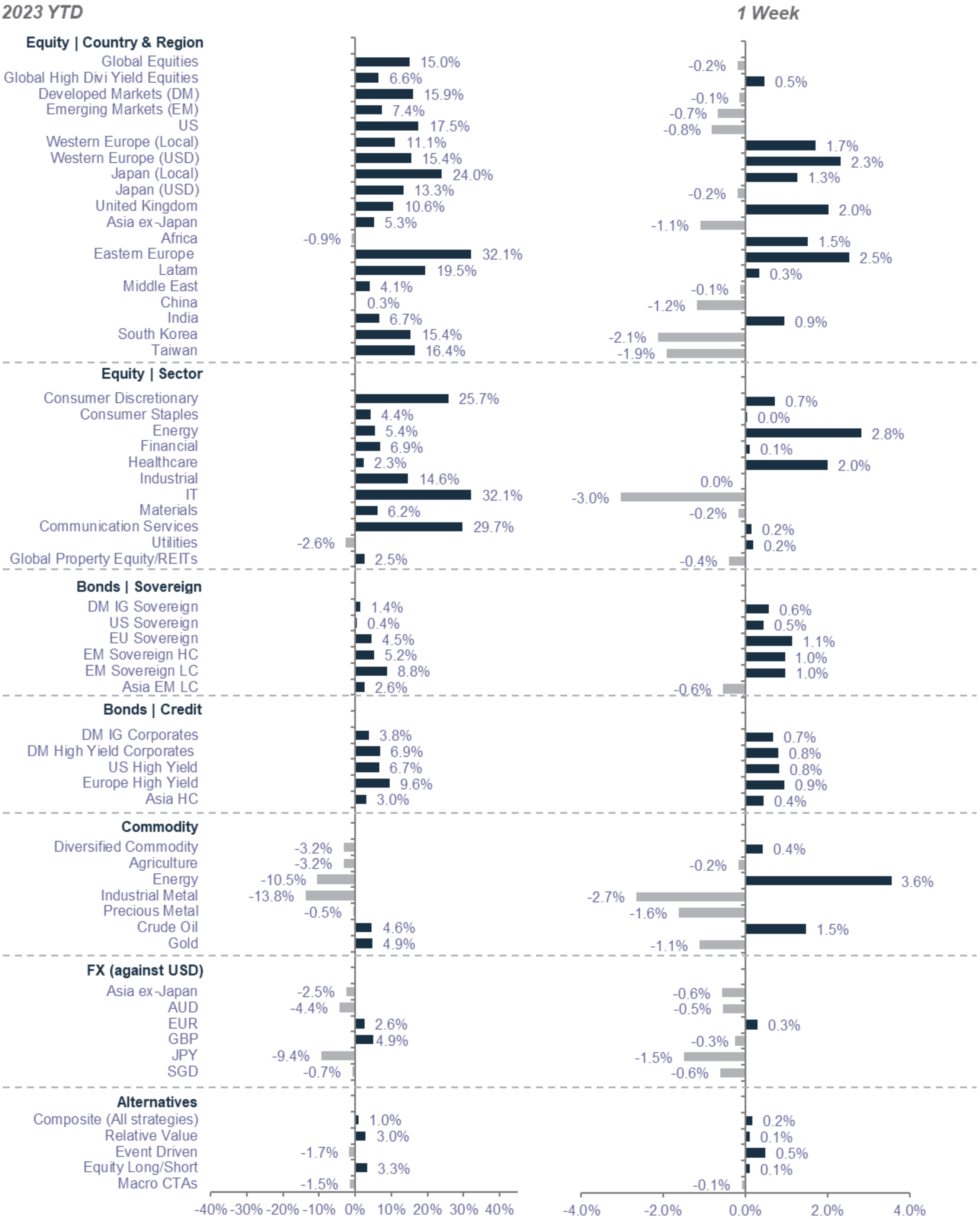
Rebounding oil prices are supportive for the CAD

USD/CAD and WTI oil 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, 2023 YTD performance from 31 December 2022 to 10 August 2023; 1-week period: 03 August 2023 to 10 August 2023; Alternatives data is until 09 August 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	▲
Bonds (Credit)	◆	China Discretionary	▲
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

Economic and market calendar

	Event	Next week	Period	Expected	Prior
MON					
TUE	CH	Industrial Production y/y	Jul	4.3%	4.4%
	CH	Retail Sales y/y	Jul	4.0%	3.1%
	CH	Fixed Assets Ex Rural YTD y/y	Jul	3.8%	3.8%
	UK	ILO Unemployment Rate 3Mths	Jun	–	4.0%
	EC	ZEW Survey Expectations	Aug	–	-12.2
	US	Retail Sales Ex Auto & Gas	Jul	0.4%	0.3%
	US	Empire Manufacturing	Aug	-0.8	1.1
WED	UK	CPI y/y	Jul	–	7.9%
	UK	CPI Core y/y	Jul	–	6.9%
	US	Building Permits	Jul	1482k	1440k
	US	Housing Starts	Jul	1445k	1434k
	US	Industrial Production m/m	Jul	0.4%	-0.5%
THU	US	FOMC Meeting Minutes	Jul		
	US	Philadelphia Fed Business Outlook	Aug	-10.6	-13.5
	US	Leading Index	Jul	-0.4%	-0.7%
FRI/SAT	UK	Retail Sales Ex Auto Fuel y/y	Jul	–	-0.9%

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

The next support for the S&P500 index is at 4,452

Technical indicators for key markets as of 10 August close

Index	Spot	1st support	1st resistance
S&P 500	4,469	4,452	4,502
STOXX 50	4,384	4,321	4,416
FTSE 100	7,619	7,558	7,649
TOPIX	2,304	2,284	2,313
Shanghai Comp	3,255	3,237	3,280
Hang Seng	19,248	19,108	19,464
MSCI Asia ex-Japan	641	638	646
MSCI EM	1,008	1,002	1,016
Brent (ICE)	86.4	85.3	87.5
Gold	1,912	1,902	1,933
UST 10Y Yield	4.11	4.04	4.14

Source: Bloomberg, Standard Chartered
Note: These short-term technical levels are based on models and may differ from a more qualitative analysis provided in other pages

Investor diversity is less crowded in Global & US equities

Our proprietary market diversity indicators as of 10 August

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↓	1.59
Global Equities	◐	→	1.43
Gold	◐	↓	1.38
Equity			
MSCI US	◐	→	1.34
MSCI Europe	●	↑	1.92
MSCI AC AXJ	●	→	1.75
Fixed Income			
DM Corp Bond	●	↑	2.13
DM High Yield	◐	→	1.47
EM USD	●	→	1.51
EM Local	●	→	1.64
Asia USD	●	↑	2.20
Currencies			
EUR/USD	●	↑	1.86

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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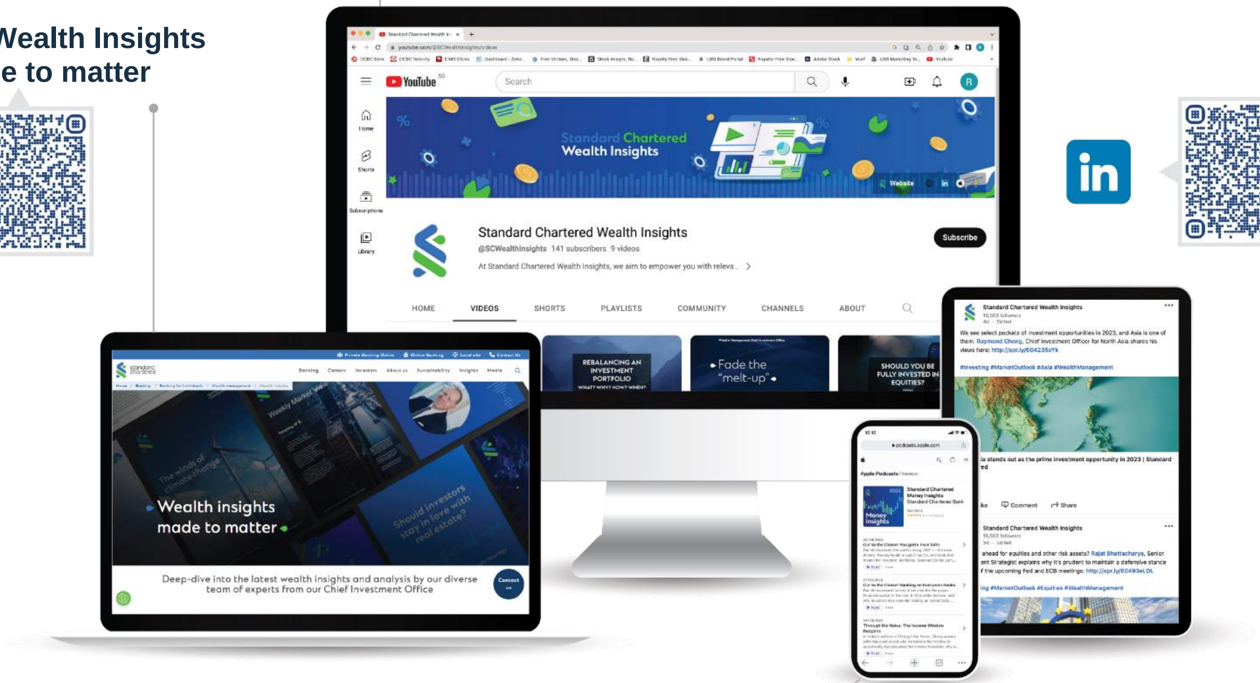

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