

Weekly Market View

Disjointed markets

→ Financial markets appear to be getting disconnected from fundamentals. Parts of the equity market are in the grips of a frenzy seen during the dot-com bubble on the hope that Generative Artificial Intelligence (AI) is about to transform the world sooner than many expect.

→ Meanwhile, underlying fundamentals in Europe are deteriorating, while China's post-pandemic burst of activity is fading. The agreement to suspend the US debt ceiling is unlikely to be a panacea either, as it entails spending caps until 2025, and a near-term drainage of market liquidity as the Treasury borrows to replenish cash.

→ Amid this noise, we believe it would be prudent for investors to go back to the basics: ensure they have a sound foundational allocation commensurate with their risk appetite.

→ In this report, we examine some of the latest debates and provide a few medium-term opportunities arising from the dislocation in markets.

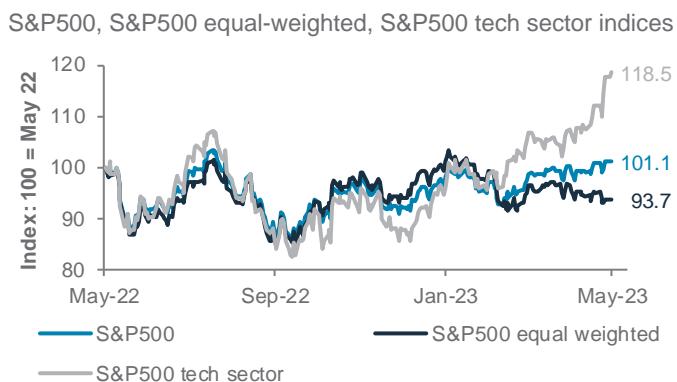
Is the US technology sector rally sustainable?

What could trigger a recovery in China stocks?

Is it time to add exposure to the Japanese yen?

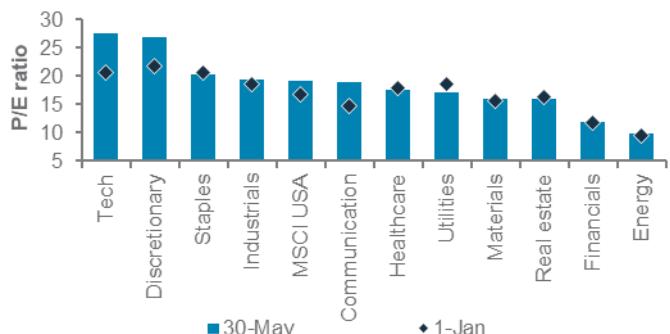
Charts of the week: Narrow breadth

The US equity market has been driven by select technology sector stocks; this has resulted in disparate valuations



Source: Bloomberg, Standard Chartered

2023 forward P/E ratio of US equity sectors today vs 1 Jan '23



Editorial

Disjointed markets

Financial markets appear to be getting disconnected from fundamentals. Parts of the equity market are in the grips of a frenzy seen during the dot-com bubble on the hope that Generative Artificial Intelligence (AI) is about to transform the world sooner than many expect. Meanwhile, underlying fundamentals in Europe are deteriorating, while China's post-pandemic burst of activity is fading. Amid this noise, we believe it would be prudent for investors to go back to the basics: ensure they have a sound foundational allocation commensurate with their risk appetite. Here we examine some of the latest debates and provide a few medium-term opportunities arising from the dislocation in markets.

AI – wave or bubble? Prudence dictates not chasing the AI-driven frenzy in technology stocks. We remain Neutral on the sector in the US, Europe and China, which helps us participate in the rally without actively chasing it. Valuations in the AI subsector have reached the bubble territory comparable to dot-com days. The hope is that AI will turbo-charge productivity, but that could take years, not months, as markets seem to be pricing. Before that, we have a likely US recession to overcome.

US debt-ceiling breakthrough unlikely to be panacea: Be careful about what you wish for! While the US Congress looks likely to pass a bill to suspend the debt ceiling until 2025, after the US Presidential election, it entails capping federal spending for the next two years. The non-partisan Congressional Budget Office estimates USD64bn of spending cuts next year alone. The spending cap also means that the government's hands would be tied in the event the US enters a recession later this year, as we expect. Also, the US Treasury is likely to borrow big once the debt ceiling is raised. This is likely to suck liquidity out of markets at a time when risk assets face headwinds from a global growth slowdown. In that event, the Fed could end its Quantitative Tightening policy early, easing some of the liquidity crunch, but perhaps not enough to sustain the AI-driven rally.

Another Fed rate hike? Since March, markets have unwound bets of three Fed rate cuts by the end of the year and are now pricing in a non-negligible chance of a rate hike in June instead. Expectations of a debt ceiling deal, easing concerns about an imminent banking crisis, resilient consumption, better-than-expected Q1 earnings and elevated inflation have contributed to this Fed repricing. **Strong US job market and inflation data for May would raise the chance of another Fed rate hike in June or July.** However, global economic activity, mainly in manufacturing and trade, continues to slow. This is reflected in the slump in crude oil and copper prices. Euro area and China data have underwhelmed lately, adding to concerns. Germany has already entered a technical recession. Our base case is for a rate pause and a US recession starting in Q4. This is likely to crimp corporate earnings, dragging equity markets.

Investment implications: We see limited upside to stocks following the lifting of the US debt ceiling, given ensuing spending cap, liquidity crunch and further deterioration in global economic activity. We would use the latest rally in equities to rotate to more defensive assets, especially Developed Market investment grade government bonds, where yields are now more attractive than a month ago, and predominantly Investment Grade Asia USD-denominated bonds. Those excessively exposed to technology sector equities after the latest rally should consider rotating into more defensive sectors.

We recently upgraded Japan's stocks due to cheap valuations, improving corporate governance and likely earnings upside for exporters from an undervalued JPY. We believe those with a 6-12-month horizon have an opportunity to add exposure to the JPY (we see at least 10% upside in JPY vs USD over the next 12 months) and park some of it in Japanese equities.

Gold remains a buy below USD 1950/oz as long-term US real rates and USD are likely near their peak. Geopolitical risks and global central bank buying continue to provide support for gold.

— Rajat Bhattacharya

The weekly macro balance sheet

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

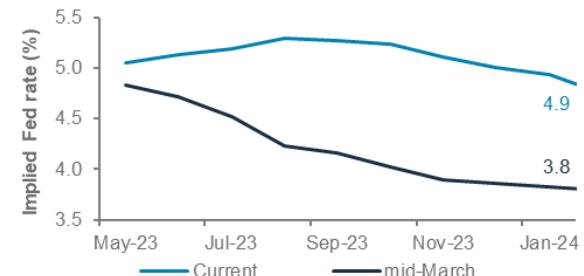
(+ factors: US debt ceiling deal, easing Euro area inflation expectations

(- factors: Sticky US inflation, weaker US consumer confidence, Euro area economic confidence, weaker-than-expected China PMIs

	Positive for risk assets	Negative for risk assets
Macro data	<ul style="list-style-type: none"> US University of Michigan sentiment revised higher in final reading; inflation expectations revised lower US JOLTs job openings rose unexpectedly US durable goods orders rose unexpectedly Euro area inflation expectations fell to the lowest since 2020 China Beige Book showed a pickup in manufacturing activity China Caixin manufacturing PMI rose unexpectedly rose back into expansion territory (50.9) 	<ul style="list-style-type: none"> US PCE inflation rose more than expected by 0.4% m/m; core inflation also rose unexpectedly US Conference Board consumer confidence index fell to a six-month low Euro area M3 money supply growth slowed more than expected to near a nine-year low Euro area economic confidence fell to a six-month low China's NBS manufacturing (48.8) and non-manufacturing PMIs (54.5) fell lower than expected
	Our assessment: Neutral – Strong US job market and falling Euro area inflation expectations vs. still-elevated US inflation, flagging US consumer and Euro area economic confidence and weaker-than-expected China business confidence	
Policy developments	<ul style="list-style-type: none"> Fed's Jefferson and Harker hinted at a potential rate hike pause in June as policymakers assess the impact of past rate hikes 	<ul style="list-style-type: none"> Fed's Mester said that disinflation progress is "slow going"
	Our assessment: Neutral – Diverging Fed commentary	
Other developments	<ul style="list-style-type: none"> The US House passed a bill to suspend the debt ceiling until 1 Jan 2025. The bill, which caps federal spending until 2025, goes to the Senate, where it's likely to be passed before the government runs out of cash tentatively on 5 June 	<ul style="list-style-type: none"> Spain called for a surprise snap election China rejected a US request for a meeting at the upcoming Shangri-La Dialogue Japan called for North Korea to refrain from a planned rocket launch
	Our assessment: Positive – US debt default risk fades	

Markets have pared back expectations of Fed rate cuts and are now pricing in a non-negligible chance of another rate hike in June or July instead

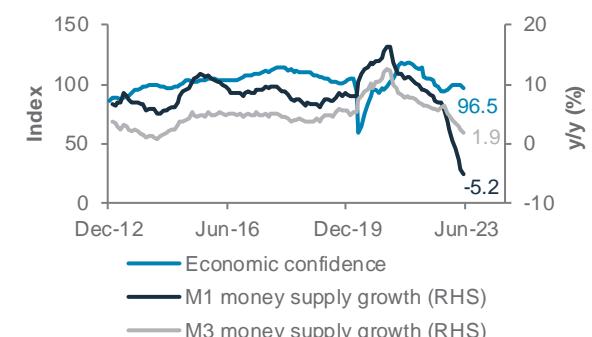
Money market expectations of Fed rate hike, today vs. mid-March



Source: Bloomberg; Standard Chartered

Euro area economic confidence has weakened as rate hikes start to tighten financial conditions

Euro area economic confidence; M1 and M3 money supply



Source: Bloomberg, Standard Chartered

China's business confidence in May fell below expectations, with the manufacturing sector particularly hit by slowing global demand

China NBS manufacturing and non-manufacturing PMI



Source: Bloomberg, Standard Chartered

Top client questions

Q Is the US technology sector equity rally sustainable?

The US technology sector has been the best-performing sector YTD, with c. 35% gain. In Q1, the sector was driven by resilient growth data, lower bond yields (supporting higher valuations) and corporate cost-control measures. In Q2, excitement about a demand boost from AI applications is driving the sector, especially the semiconductor sub-sector. Although we are positive on the structural opportunity presented by AI, our short-term market diversity indicator is signalling stretched conditions for the semiconductor sub-sector (SOX index), raising the odds of a consolidation or a reversal. Technically, the technology sector-heavy Nasdaq 100 index is close to a key resistance level (14,500). Several major stocks in Nasdaq have made highs but subsequently saw pullbacks with high volume, typically a sign of a broader short-term pullback. Valuation of the technology sector has also expanded significantly, with the consensus 2023 forward P/E rising from 21x in January to 28x.

We have a Neutral view on the US technology sector, expecting it to perform in line with the broader market over the next 6-12 months. Investors should consider rotating into our preferred healthcare and consumer staples sectors, which are more defensive ahead of an expected US recession later this year. We are Overweight the communication services sector given its strong earnings momentum, but technical indicators are also stretched in the near term.

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

Q What could trigger a recovery in China stocks?

China stocks have entered a bear market after hitting a peak in January following the lifting of the pandemic restrictions late last year. The brief recovery after the National People's Congress in March has faded. The weakness can be ascribed to the following:

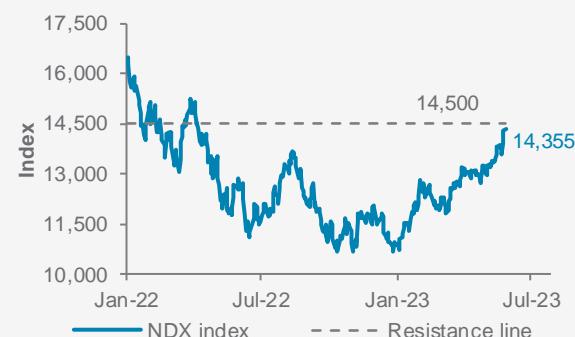
- 1. Sluggish economic recovery** – China's economic data has disappointed expectations lately. This week's below-expectation manufacturing and non-manufacturing PMI added to concerns.
- 2. Geopolitical tensions** – China's decision to ban Micron memory chips after the US slapped restrictions on some hi-tech semiconductor-related exports to China has escalated tensions.

We believe the easiest part of China's post-pandemic recovery is likely behind us. Hence, we recently downgraded China equities to Neutral from Overweight within our Asia ex-Japan equity allocation. While the gradual recovery in domestic consumption is likely to sustain growth this year, slowing global demand is likely to add to disinflationary pressures. Hence, the next leg of China's equity market gains will likely need further policy stimulus. While authorities have already enacted several stimulus measures (see table), we see scope for additional policy easing, especially if the economy deteriorates. Meanwhile, we anticipate more inflows into Asian equity markets, including to Japan, in the coming months as US and European equity markets trend lower due to rising recession risks.

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

The technology sector-heavy Nasdaq 100 index has performed strongly this year, and is testing key resistance at 14,500

Nasdaq 100 index (NDX)



Source: Bloomberg, Standard Chartered

China authorities have already enacted several stimulus measures

Stimulus measures since the 'Two Sessions' in March

Date	Details
18-May	Hangzhou eased home purchase restrictions (HPR) in 7 neighborhoods
16-May	PBoC pledged to keep credit aggregates at reasonable levels in its policy report. Nanjing lifted HPR in some clusters
5-May	State Council meeting to push forward the development of high-tech mfg. industries
28-Apr	The April Politburo meeting maintained pro-growth stance and supportive industrial policies
17-Apr	Beijing provided RMB 1mn home purchase subsidy for selected talents. Ningbo increased the maximum loan amount for university graduates. Quanzhou lowered housing down payment ratios (DPR)
14-Apr	State Council meeting to improve the policies to stabilize employment
4-Apr	Hefei and Zhengzhou narrowed HPR areas. Zhengzhou eased resale restrictions. Hefei lowered DPR on 24 April
24-Mar	State Council meeting to extend and improve some preferential tax policies implemented last year
21-Mar	Wuxi eased HPR
17-Mar	PBoC announced 25bps broad RRR cut, effective 27 March

Source: CREIS, CRIC, Sina, Government websites, Bloomberg, Standard Chartered

Top client questions (cont'd)

Q Is it time to add exposure to the JPY?

We believe that the recent bout of JPY weakness is an opportunity for investors to add exposure to the currency at attractive levels. The rise in USD/JPY (or the JPY weakness) since mid-March 2023 has been driven by a combination of a rise in US government bond yields and markets pricing out the likelihood of a shift towards a tighter BoJ monetary policy.

However, we think that the market reaction is now looking overdone. Our Global Investment Committee expects 10-year US government bond yields to decline below 3.5% over the next three months and eventually fall below 3% in H1 2024 as the Fed starts cutting rates in Q4. This should drive interest rate differentials between the US and Japan lower, pushing USD/JPY lower (or the JPY stronger).

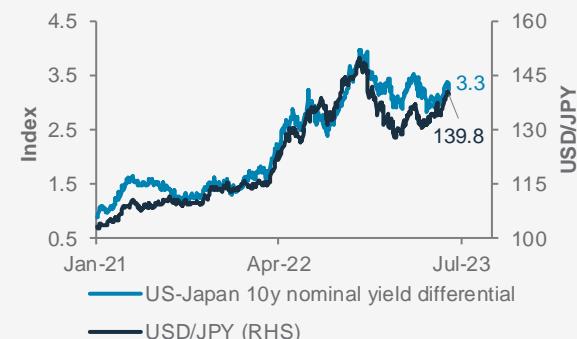
We also believe the pressure on the BoJ to ultimately scrap its extremely dovish Yield Curve Control (YCC) policy and take Japan's benchmark interest rates back to positive territory remains in place. This week, Japanese officials had an unscheduled meeting and currency official Masato Kanda stated that the government would provide "appropriate response" to the JPY weakness, if necessary. The comments raise the risk of a government intervention to prevent excessive weakening of the JPY.

From a technical perspective, we see 142.35 as the near-term resistance for USD/JPY, with 137.25 being the immediate support. We expect USD/JPY to decline towards 134-135 over the next three months.

— **Abhilash Narayan, Senior Investment Strategist**

We expect the USD/JPY to decline towards 134-135 over the next three months

USD/JPY



Source: FactSet, Standard Chartered

Q What is the likely impact on bond markets following any US debt ceiling resolution and from another Fed rate hike?

We expect a US debt ceiling deal and another Fed rate hike to both drive US government bond yields lower over the next 6-12 months. The debt ceiling deal involves a cap on spending, making it disinflationary and growth negative. Increased recession risk is likely to lead to greater demand for long-dated government bonds, driving bond yields lower. While an increase in government bond supply should technically drive yields higher, we believe the impact on the 10-year yield is likely to be limited as the supply pressure is largely confined to the short-maturity T-bills. Meanwhile, another Fed rate hike in June/July, would result in further monetary tightening, further subduing growth. Also, as we edge closer to the end of a rate hike cycle, US government bond yields tend to drop historically.

We expect the 10-year US government bond yield to range between 2.75-3.00% over the next 6-12 months. Against this backdrop, we Overweight DM IG government bonds. We are Neutral DM IG corporate bonds. While they should benefit from lower government bond yields, given their higher interest rate sensitivity, relatively expensive yield premiums temper our optimism. Although the recent corporate earnings were supportive, the business environment is likely to grow more challenging, raising recession risks.

— **Cedric Lam, Senior Investment Strategist**

The yield premium on Developed Market (DM) Investment Grade (IG) corporate bonds is low relative to history

DM IG corporate bond spread

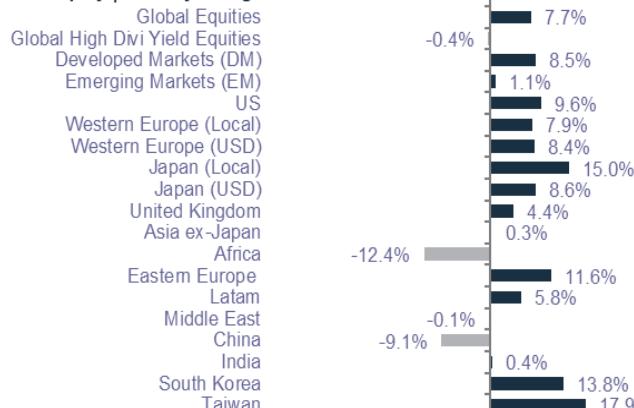


Source: Bloomberg, Standard Chartered

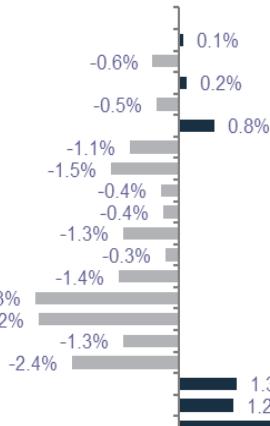
Market performance summary *

2023 YTD

Equity | Country & Region



1 Week



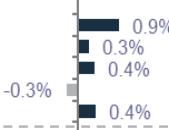
Equity | Sector



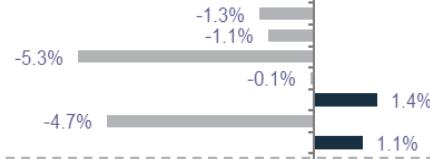
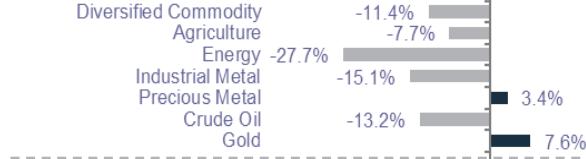
Bonds | Sovereign



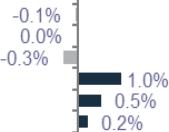
Bonds | Credit



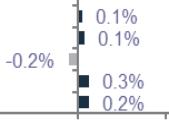
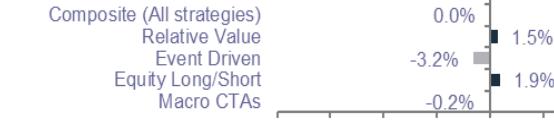
Commodity



FX (against USD)



Alternatives



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 31 May 2023; 1-week period: 24 May 2023 to 31 May 2023

Our 12-month asset class views at a glance

Asset class	
Equities	▼
Euro area	◆
US	▼
UK	▼
Asia ex-Japan	▲
Japan	▲
Other EM	◆
Bonds (Credit)	◆
Asia USD	▲
Corp DM HY	▼
Govt EM USD	◆
Corp DM IG	◆
Bonds (Govt)	▲
Govt EM Local	◆
Govt DM IG	▲

Source: Standard Chartered Global Investment Committee

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

The US S&P500 index remains close to a major resistance

Technical indicators for key markets as of 31 May close

Index	Spot	1st support	1st resistance
S&P 500	4,180	4,152	4,206
STOXX 50	4,218	4,178	4,298
FTSE 100	7,446	7,386	7,567
Nikkei 225	30,942	30,719	31,246
Shanghai Comp	3,205	3,196	3,219
Hang Seng	18,234	18,063	18,576
MSCI Asia ex-Japan	617	615	622
MSCI EM	959	954	968
WTI (Spot)	72.2	70.6	75.5
Gold	1,967	1,950	1,975
UST 10y Yield	3.63	3.57	3.75

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	Caixin China PMI Composite	May	–	53.6
	CH	Caixin China PMI Services	May	55.1	56.4
	EC	Sentix Investor Confidence	Jun	–	-13.1
	EC	PPI y/y	Apr	–	5.9%
	US	ISM Services Index	May	52.5	51.9
TUE	UK	S&P Global/CIPS UK Construction PMI	May	–	51.1
	EC	Retail Sales y/y	Apr	–	-3.8%
WED	CH	Exports y/y	May	–	8.5%
THU	CH	CPI y/y	May	–	0.1%
	CH	PPI y/y	May	–	-3.6%
	CH	Money Supply M2 y/y	May	–	12.4%
	CH	New Yuan Loans CNY	May	–	718.8b

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 remains healthy across asset classes

Our proprietary market diversity indicators as of 31 May

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	→	1.64
Global Equities	●	→	1.54
Gold	○	→	1.44
Equity			
MSCI US	○	→	1.47
MSCI Europe	●	↑	2.11
MSCI AC AXJ	●	→	2.49
Fixed Income			
DM Corp Bond	●	→	1.65
DM High Yield	●	↓	1.96
EM USD	●	↓	1.82
EM Local	○	↓	1.38
Asia USD	●	↑	1.90
Currencies			
EUR/USD	●	↑	1.85

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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