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Wealth Management Global Chief Investment Office
7 July 2023

Weekly Market View

Lean towards Asia

- US and European equity market rallies appear to be losing momentum, which, combined with softer economic data and hawkish central bank policies, raise the risk of consolidation. This reinforces our preference of allocating more to Asian assets.

- Stronger economic data and supportive policy argue for rotating into Asian equities. We prefer to take diversified exposure across Japan, China, India, Korea and other Asian markets.

- The support to China's LGFV sector is positive for Asian USD bonds. The sharp decline in bond supply, along with largely resilient demand, argues for a further narrowing of credit spreads.

What are the potential catalysts for Chinese equities in July?

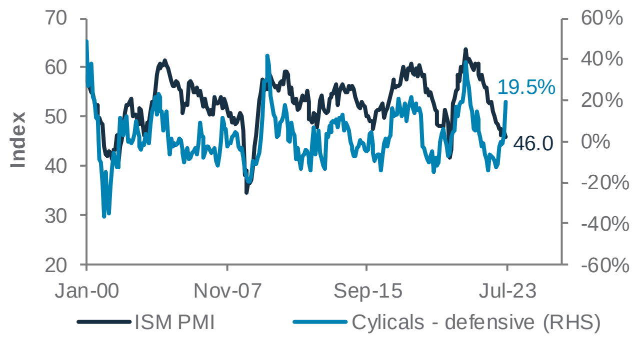
What is your near-term outlook for the USD and USD/JPY?

Will hawkish Fed guidance push 10-year US yields above 4%?

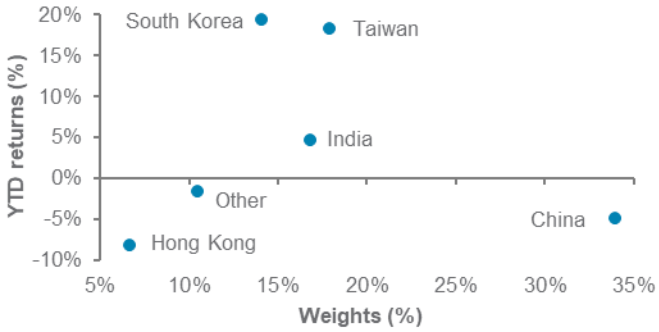
Charts of the week: Favourable policy argues for rotating to Asia

Fundamentals point towards risk of consolidation in US stocks; Asian equity returns are not solely reliant on China

US mfg PMI index and cyclical/defensive stocks performance



YTD returns and index weights of MSCI Asia ex-Japan index



Source: Bloomberg, Standard Chartered

Editorial

Lean towards Asia

Equity markets gave up their gains earlier in the week, to end largely flat w/w, as softer economic data points to slowdown in the US and Europe. Hawkish guidance from US and European central banks led government bond yields edged higher. This reinforces our preference of allocating more to Asian assets.

DM conundrum – Softer data yet hawkish policy. US Manufacturing PMI fell to the lowest since May 2020. European Manufacturing PMI was also revised lower to 43.4, while services PMI was revised lower towards 52.0. However, Fed speakers, as well as the minutes of the latest FOMC meeting, continue to signal further rate hikes. In Europe, despite the recent downside surprise in the region's inflation, policymakers and German Chancellor Scholz reiterated the need for more rate hikes. The hawkish theme was also evident in Australia, as the RBA kept the door open for more rate hikes, which should keep the AUD rangebound.

Are we nearing a peak in bond yields? Unless we see a sharp upside surprise in US jobs data on Friday night and CPI data next week, we believe 4.0% is key resistance for the 10-year US government bond yield. Thus, we would use the recent rise in yields as an opportunity to add exposure to high-quality Developed Market (DM) government bonds.

Supportive data and policy in Asia. India's manufacturing PMI remained resilient which, combined with recent investor inflows, helped Indian equity markets reach new all-time highs. Similarly, South Korean equities delivered strong returns, helped by their large exposure to the semiconductor sector as AI-related stocks continued to edge higher. China's Caixin services PMI and NBS non-manufacturing PMI declined from elevated levels, but remained in expansionary territory.

While investors continue to wait for an eye-catching stimulus, there were three subtle, but important, developments – (i) PBoC Deputy Governor Pan was named as the bank's new communist party chief, indicating he is likely to be the next governor, ensuring policy continuity, (ii) the PBoC continued to set the CNY fix stronger to ensure currency stability, and (iii) media reports indicated that state-owned banks had started offering 25-year loans to local government financing vehicles (LGFVs), reducing refinancing for local governments, who have seen their revenues decline due to lower land sales.

Limited impact of geopolitics. We view China's curbs on the export of Gallium and Germanium – metals used in semiconductor manufacturing – as part of the ongoing geopolitical tussle and do not see material implications for financial markets. Saudi Arabia and Russia also announced extension of production cuts, which led to a bounce in oil prices, but also signals the softening of underlying global demand

Investment implications. US and European equity market rallies appear to be losing momentum, which, combined with softer economic data and hawkish central bank policies, raise the risk of consolidation. Forward guidance from companies will be key as we enter the Q2 earnings season. Stronger economic data and supportive policy argue for rotating into Asian equities. We prefer to take diversified exposure across Japan, China, India, Korea and other major Asian markets.

The recent rise in government bond yields offers a good entry point to add exposure to longer maturity DM IG government bonds. The support to the LGFV sector is positive for Asian USD bonds, as it reduces the risk of defaults. From a technical perspective, the sharp decline in bond supply (due to more favourable onshore borrowing costs) means the market is likely to see net negative supply, which, along with largely resilient demand, argues for further narrowing of credit spreads.

Market diversity indicators highlight the risk of a reversal of recent weakness in the JPY and CNH, but the recent trend could continue until we get a policy catalyst. We continue to view gold as a hedge and would use any dip below USD 1,900/oz as an opportunity to add exposure.

— Abhilash Narayan, CFA

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

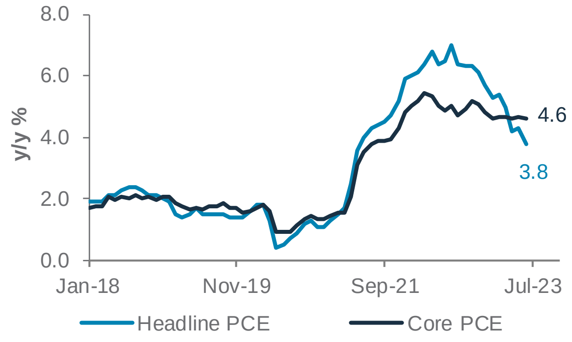
(+) factors: Easing US, Euro area inflation, supportive policies in China

(-) factors: Weakening US, Euro area and China PMIs

	Positive for risk assets	Negative for risk assets
Macro data	• US PCE consumer inflation eased as expected to 3.8% y/y, while core data slowed more than expected to 4.6% y/y • US ISM services rose more than expected to 53.9 • US Uni. of Michigan revised higher to 64.4 • Euro area inflation slowed more than expected to 5.5% y/y; producer prices fell more than expected • China mfg. PMI rose slightly as expected; Caixin mfg. PMI fell less than expected to 50.5	• US ISM mfg. fell more than expected to 46.0, the lowest since May 2020 • US job openings fell more than expected to 9824k • US new factory orders slowed unexpectedly to 0.3% m/m; durable goods orders revised upwards • Euro area mfg. PMI revised lower to 43.4; services PMI revised lower to 52.0 • Euro area retail sales fell more than expected • China non mfg. PMI fell more than expected to 53.2; Caixin services fell more than expected to 53.9 • China's home sales resumed decline in June
	Our assessment: Neutral – Easing US, Euro area inflation vs weakening US, Euro area and China PMIs	
Policy developments	• RBA held policy rate, but left door open to more hikes • China lowered corporate USD deposit rates after last Friday's commitment to stabilise the currency • China's state-owned banks extended long-term loans to the LGFV sector	• US Supreme Court overturned the student debt relief programme • Fed officials were divided over a pause in June, meeting minutes show
	Our assessment: Neutral – Supportive China policies vs hawkish Fed	
Other developments		• Saudi Arabia and Russia voluntarily extended oil supply cuts • China restricted exports of chipmaking metals
	Our assessment: Negative – Extended oil output cuts	

US headline PCE inflation continues to ease, while core gauge remains sticky

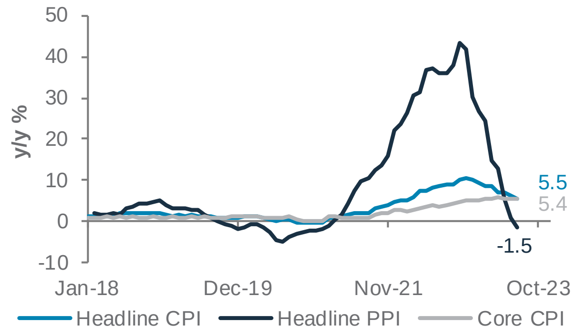
US headline and core PCE consumer inflation



Source: Bloomberg; Standard Chartered

Euro area producer prices fell into deflationary territory, foreshadowing a deceleration in consumer inflation ahead

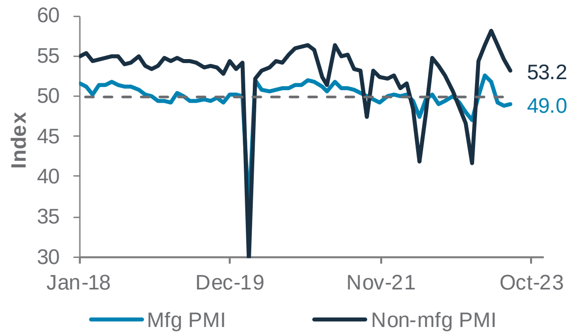
Euro area producer prices, headline and core consumer inflation



Source: Bloomberg, Standard Chartered

China manufacturing PMI remained in contractionary territory while services PMI is showing signs of having peaked

China manufacturing and non-manufacturing PMI



Source: Bloomberg, Standard Chartered

Top client questions

What are the potential catalysts for Chinese equities in July?

Geopolitical risks and a softer-than-expected economic recovery led to a disappointing performance for Chinese equities in H1 23. China's metal export controls on 4 July – widely interpreted as an extension to the US-Sino trade war – further dampened investor sentiment. That said, we do see emerging green shoots in Chinese equities.

US Treasury Secretary Janet Yellen's China visit is the second visit by a senior US official to Beijing in the last few months and is expected to address topics such as national security and trade disputes. Ahead of the visit, Yellen had a "frank and productive" discussion with Xie Feng, China's ambassador to the US, which we believe may lead to a thaw between the two nations in the short term.

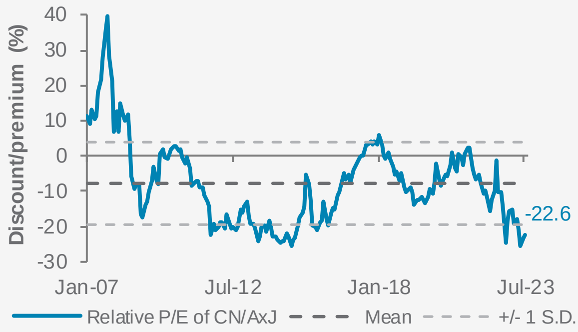
China's Politburo meeting later this month is also a potential catalyst. Any government stimulus, in alignment with Premier Li Qiang's speech last week to "take steps to boost demand", could drive consumption and internal circulation.

We retain our Neutral stance on China equities within Asia ex-Japan (AxJ). Valuations remain attractive, with the 12m forward price-earnings ratio currently trading at a 23% discount to AxJ equities, over one standard deviation below its historical average.

— **Michelle Kam,** *Investment Strategist*

China equities is trading at a significant valuation discount to Asia ex-Japan equities

12m fwd P/E ratio of MSCI China index relative to MSCI Asia ex-Japan index



Source: FactSet, Standard Chartered

What is your near-term outlook for the USD and USD/JPY?

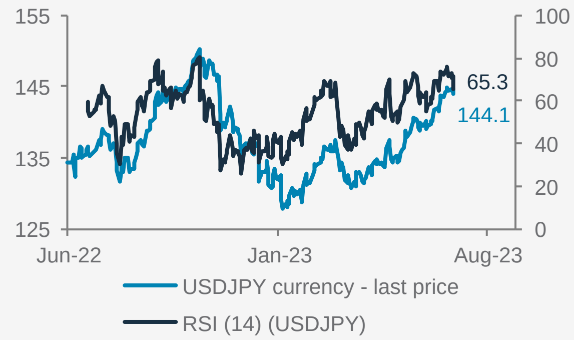
The USD index (DXY) has been gradually trending higher since mid-June, helped by the renewed hawkish tilt from the Fed and the rise in 2-year US government bond yields. With markets having priced in a 25bps rate hike in the July FOMC meeting, we see a high likelihood of consolidation in yields, unless we see an upside surprise in labour market data tonight and CPI data next week. Hence, over the next 2-4 weeks, we expect the USD to trade in a 102.90-104.70 range, before eventually heading lower.

After having risen rapidly since mid-June, USD/JPY appears to be consolidating around 144.0-145.0 – the levels seen in September 2022 when the Japanese authorities intervened for the first time. While the BoJ has not given any indication that it plans to start normalising its policy in the July meeting, our expectation of US government bond yields means interest rate differentials between the US and Japan should stabilise, capping the near-term upside in USD/JPY. The pair is looking overbought based on RSI and stochastic oscillator. Our proprietary fractal indicator indicates elevated risk of a pullback, with a sustained break below 144.0 potentially opening up a move towards 139.0-140.0.

— **Abhilash Narayan, CFA,** *Senior Investment Strategist*

Recent rally in USD/JPY has left it looking modestly overbought

USD/JPY and 14-day RSI



Source: Refinitiv EIKON, Standard Chartered

Top client questions (cont'd)

Will the hawkish Fed guidance push 10-year US yields above 4%?

The 10-year US government bond yield has broken out of a one-month channel as US macro data continue to suggest a resilient economic outlook. This surge in yields is fuelled by the June FOMC minutes, which showed "almost all" participants judged that additional rate hikes are appropriate later this year.

The strong US labour data released on Thursday has pushed the 10-year US government bond yield higher to 4.03% (at the time of writing), which has broken our short-term target range of 3.5 - 4.0%. While more positive data surprises could likely keep bond yields at recent highs, we believe the room for yields to go further upward has reduced substantially after the rapid move in only a few trading days. Technical analysis suggests near-term momentum on yields remains to the upside with resistance at 4.06% and 4.21%.

As the Fed rate hiking cycle is close to an end and yields tend to fall after Fed Fund Rate peaked, we see any surge of yields above 4% as an excellent opportunity to add to duration, especially when we see a recession being delayed into 2024, rather than being avoided altogether.

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

10-year US government bond yield has broken above the 4.0% threshold

10Y US government bond yield

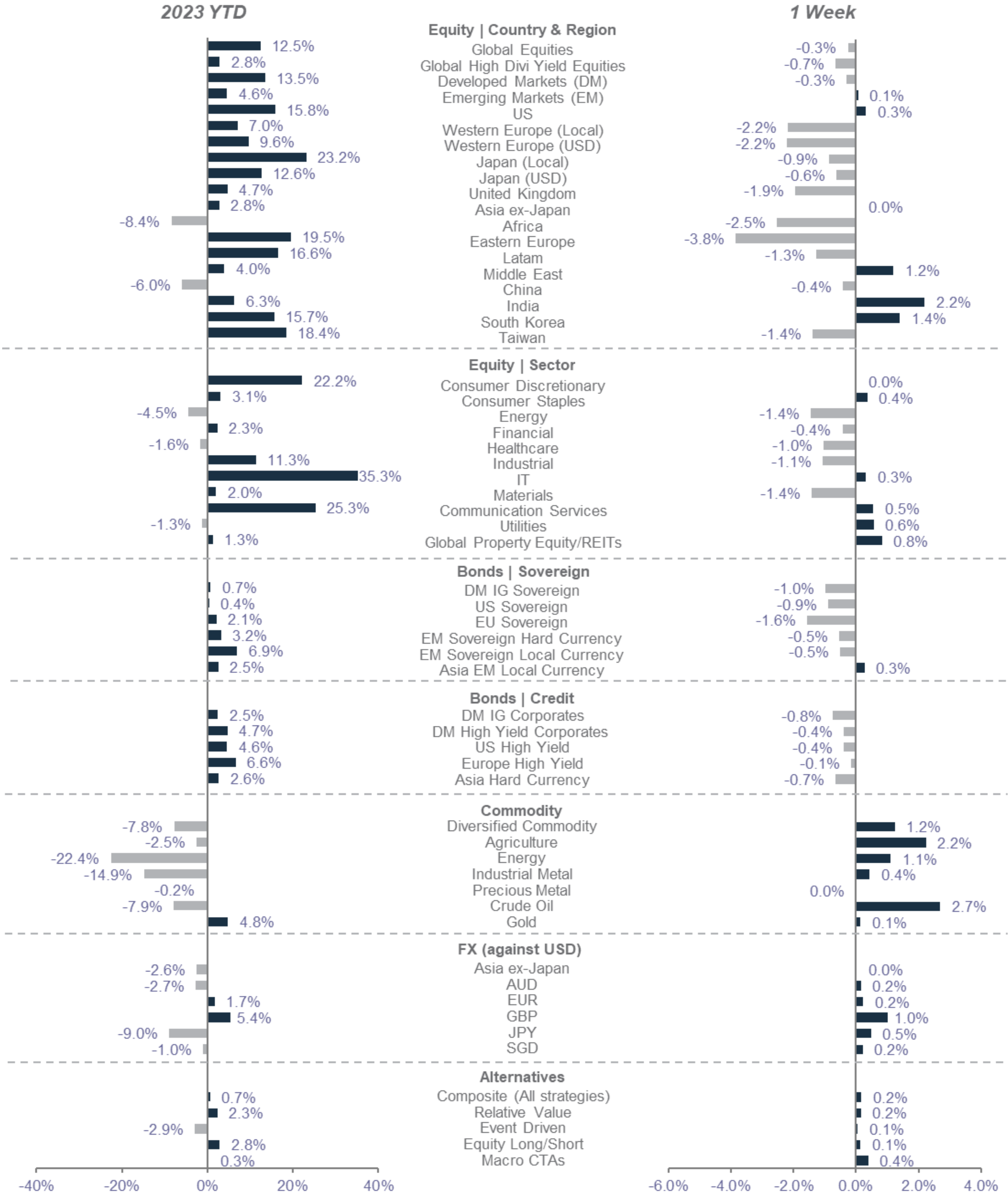
Source: Bloomberg, Standard Chartered

US government bond yield curve has bear flattened (more inverted) in the last month as short-term rate rose more than long-term rates

2Y/10Y US government bond yield difference

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 06 July 2023; 1-week period: 29 June 2023 to 06 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	▲
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	CH	CPI y/y	Jun	0.2%	0.2%
	CH	PPI y/y	Jun	-5.0%	-4.6%
	EC	Sentix Investor Confidence	Jul	–	-17.0
TUE	UK	Average Weekly Earnings 3M/y/y	May	–	6.5%
	UK	ILO Unemployment Rate 3Mths	May	–	3.8%
	EC	ZEW Survey Expectations	Jul	–	-10.0
	US	NFIB Small Business Optimism	Jun	–	89.4
WED	US	CPI y/y	Jun	3.0%	4.0%
	US	CPI Ex Food and Energy y/y	Jun	5.0%	5.3%
THU	US	PPI Final Demand y/y	Jun	–	1.1%
	US	PPI Ex Food and Energy y/y	Jun	–	2.8%
	CH	Exports y/y	Jun	-9.3%	-7.5%
FRI/SAT	US	U. of Mich. Sentiment	Jul P	65.8	64.4

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 resistance for US 10Y govt. bond yield is at 4.09%

Technical indicators for key markets as of 6 July close

Index	Spot	1st support	1st resistance
S&P 500	4,412	4,397	4,441
STOXX 50	4,223	4,164	4,340
FTSE 100	7,281	7,197	7,448
TOPIX	2,277	2,263	2,306
Shanghai Comp	3,206	3,190	3,233
Hang Seng	18,533	18,239	19,121
MSCI Asia ex-Japan	627	622	638
MSCI EM	985	977	1,000
Brent (ICE)	76.5	75.2	77.2
Gold	1,911	1,906	1,921
UST 10Y Yield	4.03	3.90	4.09

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 narrowed in Global and US equities

Our proprietary market diversity indicators as of 6 July

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↑	1.49
Global Equities	◐	↓	1.40
Gold	◐	↑	1.43
Equity			
MSCI US	◐	↓	1.32
MSCI Europe	●	↓	2.41
MSCI AC AXJ	●	↑	1.92
Fixed Income			
DM Corp Bond	●	→	1.66
DM High Yield	●	↓	1.55
EM USD	●	↓	1.56
EM Local	◐	↓	1.45
Asia USD	●	↓	2.01
Currencies			
EUR/USD	●	→	1.79

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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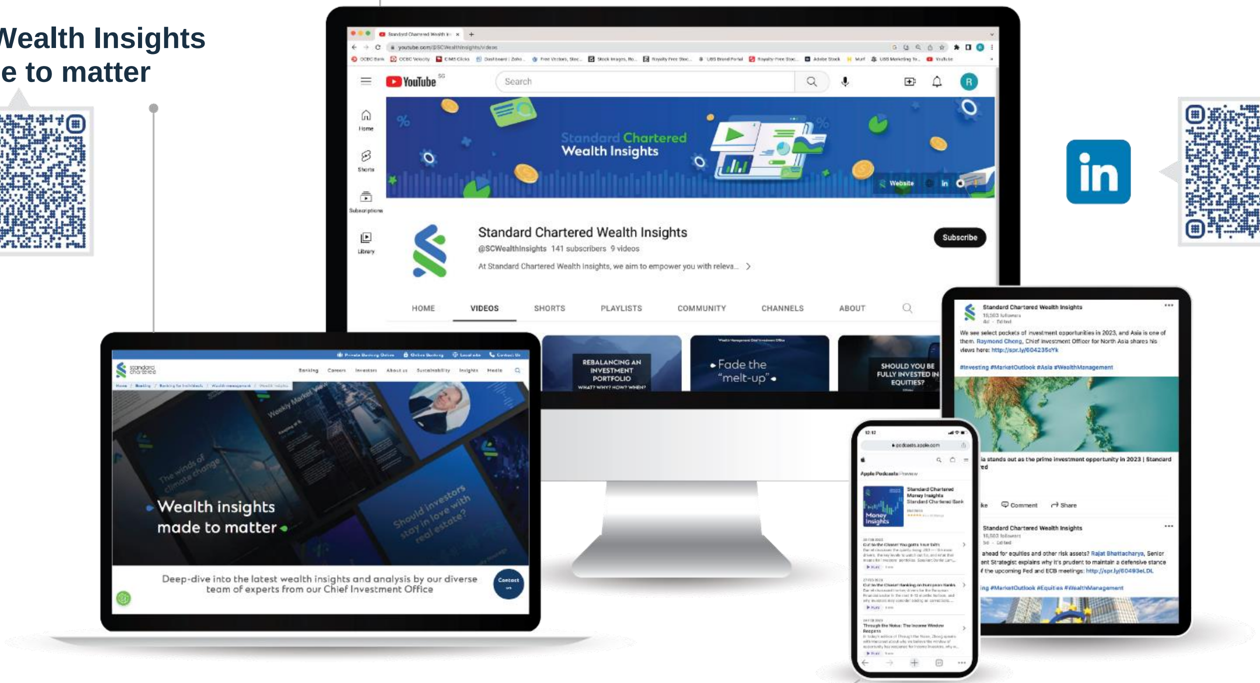

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