Wealth Management Global Chief Investment Office
16 February 2024

Weekly Market View

Speed bump?

→ A hotter-than-expected US inflation report has raised doubts about the chances of early Fed rate cuts, interrupting the US equity rally and boosting the USD. There are elements of the report that need to be watched closely, notably the continued uptrend in services inflation.

→ However, it is too soon to conclude that this signals a reversal of the ongoing disinflationary process. While recent US activity indicators have been mostly resilient, there are signs of emerging weakness which we expect to eventually weigh on inflation later this year.

→ The latest US data supports one of our core investment themes: i) maintaining an Overweight to global equities, with a preference for US and Japan, given continued resilience in economic activity and corporate earnings; ii) remaining Overweight on Developed Market Government bonds to capture attractive yields on offer.

→ Investors concerned about a revival in inflation could add inexpensively priced short-term US inflation protected bonds.

Where do you see opportunities to add to US equities after the recent inflation-led volatility?

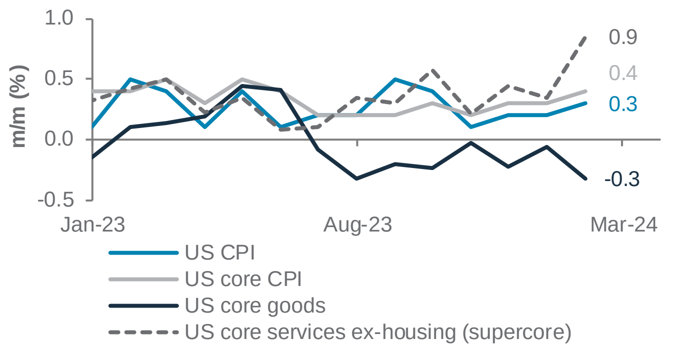
What are the implications of the latest US inflation report on US government bonds and the USD?

As Japan equities make new highs, do you expect a pullback? What is the outlook for the JPY?

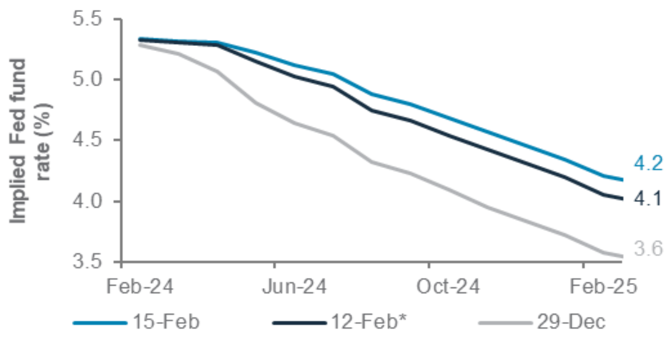
Charts of the week: Soft-landing challenged?

Hotter-than-expected US inflation has raised doubts about the disinflation theme, pushing back Fed rate cut expectations

US headline, core, core goods, core services ex-housing CPI



Money market expectations of Fed rates in 2023-24



Source: Bloomberg, Standard Chartered; *day before the US inflation report for January

Editorial

Speed bump?

A hotter-than-expected US inflation report has raised doubts about the chances of early Fed rate cuts, interrupting the US equity rally and boosting the USD. There are elements of the report that need to be watched closely, notably the continued uptrend in services inflation. However, it is too soon to conclude that this signals a reversal of the ongoing disinflationary process. While recent US economic activity indicators have been mostly resilient, there are signs of emerging weakness which we expect to eventually weigh on inflation later this year.

The latest US data supports one of our core investment themes: maintaining an Overweight to global equities, with a preference for US and Japan, given continued resilience in economic activity and corporate earnings, while remaining Overweight on Developed Market Government bonds to capture attractive yields. Investors concerned about a revival in inflation could add inexpensively priced short-term US inflation protected bonds.

Hotter-than-expected inflation: The January report showed that the disinflationary trend seen since last year is unlikely to be smooth from here. Core inflation accelerated to 0.4% m/m, more than twice the rate needed to bring annualised inflation back towards the Fed's 2% target. Core service sector inflation was stickier than its goods counterpart, which is now in outright deflation. While shelter costs, the main driver of service sector inflation, is likely to cool gradually, as seen from forward-looking asking rents, other components, such as medical care (0.7% m/m), pose a challenge to disinflation. Core services inflation, excluding shelter, which the Fed is especially concerned about, rose 0.7% m/m in January, the strongest since 2022. Following the inflation report, markets have dialled back expectations of Fed rate cuts and are now expecting the first cut in June, which has been our base case from the start of the year.

Cooler-than-expected consumption: The much softer-than-anticipated US retail sales report provided an antidote to the hot inflation report, partly calming market concerns about an overheating economy. Controlled group retail sales, a more precise measure of consumption, contracted 0.4% m/m. Some of the weakness can be ascribed to a moderation in sales following December's holiday binge, falling goods prices and bad weather. Nevertheless, slowing consumption data supports underlying weakness in the job market, seen in the continued decline in average hours worked that we flagged last week.

Investment implications: On balance, the latest series of US inflation, consumption and job market indicators are providing mixed messages. The Fed will likely need more convincing signs of a cooling in economic activity and continued disinflation before it considers cutting rates (next week's Fed meeting minutes and PMI data will be closely monitored). Against this backdrop, we continue to maintain our Overweight to global equities and Developed Market (DM) government bonds.

US government bonds: The rebound in the US 10-year government bond yield above 4.25% has left the window open to average into the bonds. We continue to expect a slowdown in US growth later this year due to the impact of high interest rates. This should cap bond yields. Investors looking to hedge against any revival of inflation could consider short-maturity inflation protected bonds, which are not pricing inflation upside.

US equities stretched: In equities, we remain overweight on US and Japan in our foundation portfolios. These two markets have strong momentum and are the only major regional equity markets to have risen YTD. Nevertheless, positioning in US equities remains stretched and our indicators are still flagging the risk of a near-term reversal. We would await a further pullback before considering adding further exposure.

Prefer Japan: Japan equities continue to look attractive, especially with the weak JPY. Latest data showing a technical recession in H2 2023 is likely to further delay any BoJ tightening – this should be supportive of Japanese equities.

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: Dovish central banks, improving Euro area econ. sentiment

(-) factors: Accelerating US inflation, weak US retail sales, factory output

	Positive for risk assets	Negative for risk assets
Macro data	• Euro area ZEW economic sentiment improved to a one-year high • US empire manufacturing improved more than expected • China aggregate financing rose more than expected • UK consumer inflation held steady at 4.0% y/y versus expectations of a rebound; core inflation was unexpectedly steady at 5.1% y/y	• US consumer inflation rose more than expected to 3.1% y/y; core inflation rose more than expected to 3.9% y/y • US retail sales contracted the most m/m since March • US factory output fell unexpectedly • China M2 money supply slowed more than expected • UK's and Japan's economy contracted more than expected in Q4 23, marking a technical recession
	Our assessment: Negative – Higher-than-expected US inflation data, contracting US retail sales, factory output	
Policy developments	• Fed's Goolsbee stated that higher inflation data for a few months could be consistent with a path back to the Fed's 2% target • BoE Governor Bailey stated that he was encouraged by the inflation data • Japan authorities warned that they are ready to intervene the FX market	
	Our assessment: Positive – Dovish central bank officials	
Other developments	• OPEC top official stated that global oil demand is expected to see strong expansion this year	• The IEA stated that supply growth is likely to be able to meet global consumption
	Our assessment: Neutral – Mixed agency oil market outlook	

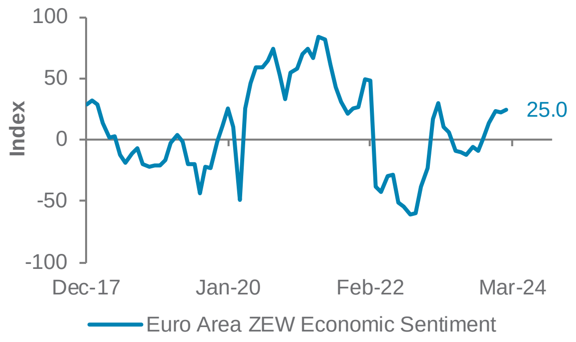
US consumption slumped in January, partly due to moderation after December's holiday season and bad weather; industrial output also fell

US retail sales and industrial production

Source: Bloomberg; Standard Chartered

Euro area economic growth expectations continued to improve

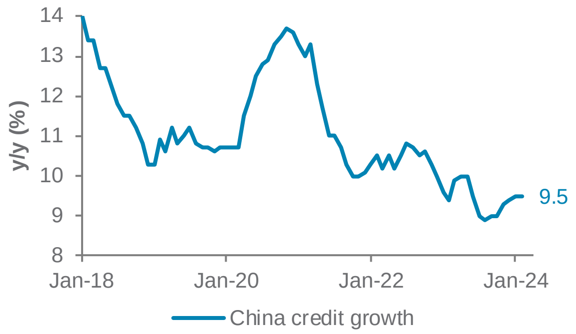
Euro area expectations of economic growth (ZEW survey diffusion index)



Source: Bloomberg, Standard Chartered

China's credit growth remains weak despite a nascent upturn

China's growth in total social financing



Source: Bloomberg, Standard Chartered

Top client questions

Where do you see opportunities to add exposure to US equities after the inflation-led volatility?

One key driver for the US stock market is interest rate expectations; higher rates are a headwind for valuations and vice versa. These expectations can be volatile, though, moving alongside data prints (eg. the latest inflation report), Fed-speak or events that might influence the Fed's interest rate decision. Market expectations for rate cuts in 2024 have swung from c.75bps at end-Q3, c.150bps at end-Q4 23 and back to about 100bps today. We continue to expect 125bps of rate cuts in 2024.

We continue to see stretched investor positioning in US equities. In our view, this implies that a short-term pullback is still likely. The catalyst for such a pullback could be changes in interest rate or growth expectations. We see support for the S&P500 at around 4,700, a level where we would consider adding exposure; next support is at 4,550. We remain positive on US equities over a 6-12 month horizon, with earnings growth expected to drive the market higher. In opportunistic allocations, we would also consider allocating to our preferred sectors of technology, communication services and healthcare, where we expect strong earnings growth in 2024 to drive outperformance.

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

Stretched investor positioning raises the chance of a short-term pullback in US equities. We would consider adding back at 4,700 and 4,550 technical support levels for the S&P500 index

S&P500 index

Source: Bloomberg, Standard Chartered

What are the implications of the latest US January CPI data on US government bonds and the USD?

After the US inflation report, market expectations of the first Fed rate cut were pushed back to June, and the extent of the cuts expected this year has been reduced to 100bps. While recent US data has been strong, leading indicators continue to point towards slower growth over the next 6-12 months. Therefore, we retain our view that the Fed is likely to begin cutting rates from June. Also, market rate cut expectations are now more closely aligned with those of the Fed.

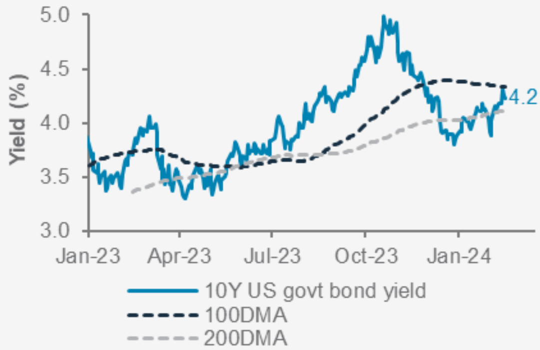
Technical charts suggest the 10-year yield is consolidating around 4.25% after testing key resistance at 4.33%. Any break of this resistance could see the 10-year yield briefly testing 4.55%. However, Investor positioning in rate markets now looks less stretched and risk-reward balance has turned more attractive. Hence, we remain Overweight Developed Market Investment Grade government bonds and would take this opportunity to add exposure.

Although recent US data have led to a pricing of a less dovish Fed and a stronger USD, the key question is whether this sustains the US exceptionalism theme. The Dollar index (DXY) appears to be consolidating after rising to its highest level since mid-November. We see limited risk of further gains in the near term, hence would refrain from chasing. We retain our three-month target for the DXY at 102.

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

We believe the recent rebound in US bonds yields have improved their risk-reward trade-off

10-year US government bond yield



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

As Japan equities make new highs, do you expect a pullback? What is the outlook for the JPY?

Upbeat momentum in major Japan equity benchmarks YTD, with the Nikkei 225 index breaching above 38,000 level this week to a 3-decade high, has been raising investor concerns about a short-term technical consolidation. While a short-term pullback cannot be ruled out, we maintain our Overweight view on Japanese equities and expect gains to extend, driven by fundamental catalysts.

Earlier this year, the Tokyo Stock Exchange published an overview of corporate disclosures with plans to boost cost of capital and stock prices. As a result, almost half of the prime market issued some form of a disclosure as of December 2023, up significantly from 31% in July 2023. Proactive share buybacks, in addition to media reports on reduced cross-held shares by major insurers in Japan, are expected to promote better corporate governance by allocating resources towards maximising shareholder value. Besides, a low interest rate policy and robust Q3 FY24 results should further inject optimism towards corporates' earnings growth outlook.

From a technical perspective, our diversity indicator also implies that the positioning is not stretched yet. While potential JPY strength can be a temporary headwinds on corporate earnings and limit the prospect of a near-term upside in the market, we believe Japan equities can still outperform over the next 6-12 months on the aforementioned factors.

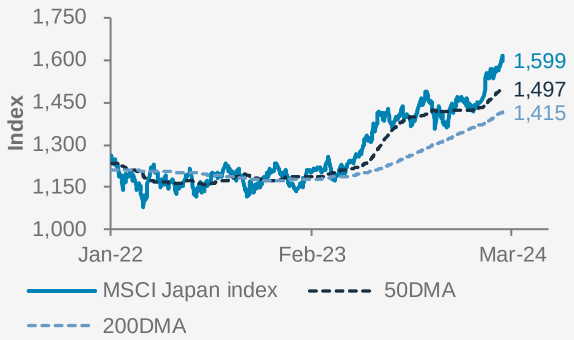
A stronger greenback did pull USD/JPY over 150 at one point, which prompted Japan's central bank officials to verbally intervene by stating they stood ready to step in the market, if needed, to curb rapid moves in the JPY. Besides intervention risk from the BoJ, the pair also faces downside risk from a potential BoJ rate hike later this year, which will likely be a tailwind for the JPY. Technical indicators for USD/JPY look overbought, and we believe further upside is likely limited. The pair may test the first support at the 50-day moving average of 145.70.

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

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

Japan, one of our two preferred equity markets, have delivered among the strongest returns this year, rising 4.2% YTD in USD terms

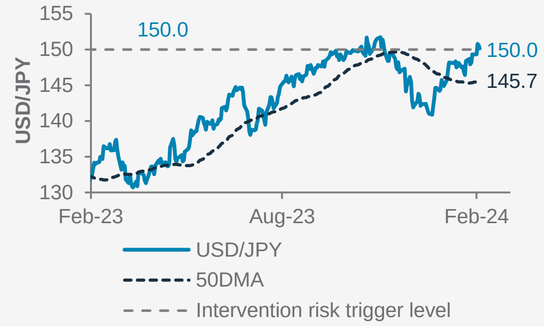
MSCI Japan index



Source: Bloomberg, Standard Chartered

USD/JPY looks overbought, hence we believe further upside is likely limited

USD/JPY, with expected BoJ intervention level



Source: Bloomberg, Standard Chartered

Do you expect further upside in USD/CHF?

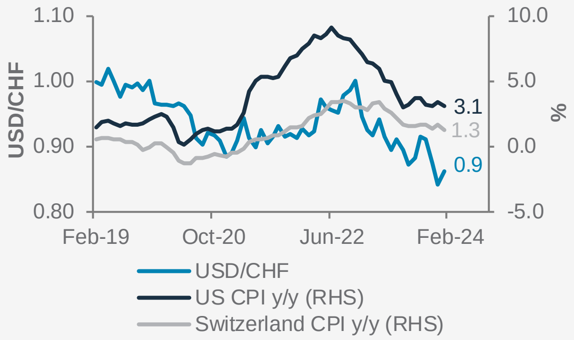
USD/CHF has edged higher since the start of the year amid resilient US economic data. Fed Chair Powell dismissed the possibility of a rate cut in March, and the latest US inflation report was hotter-than-expected. As a result, money markets pushed back the anticipated timing of the first Fed rate cut. Meanwhile, the non-seasonally adjusted Swiss unemployment rate rose to 2.5% y/y in January and inflation slowed to 1.3%, raising expectations of a dovish shift in the Swiss central bank's policy.

However, we need to see further confirmation in data to affirm the diverging growth and inflation data between the US and Switzerland is indeed the start of a trend, including the y/y change in the Fed's preferred inflation indicator, the core personal consumption expenditure (PCE), due later this month. Therefore, we expect USD/CHF to be largely rangebound in the near term, with a bearish bias, given overbought technicals. We see 0.8950 acting as the key resistance level, while the pair is likely to test its support around the 50-day moving average currently at 0.8620.

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

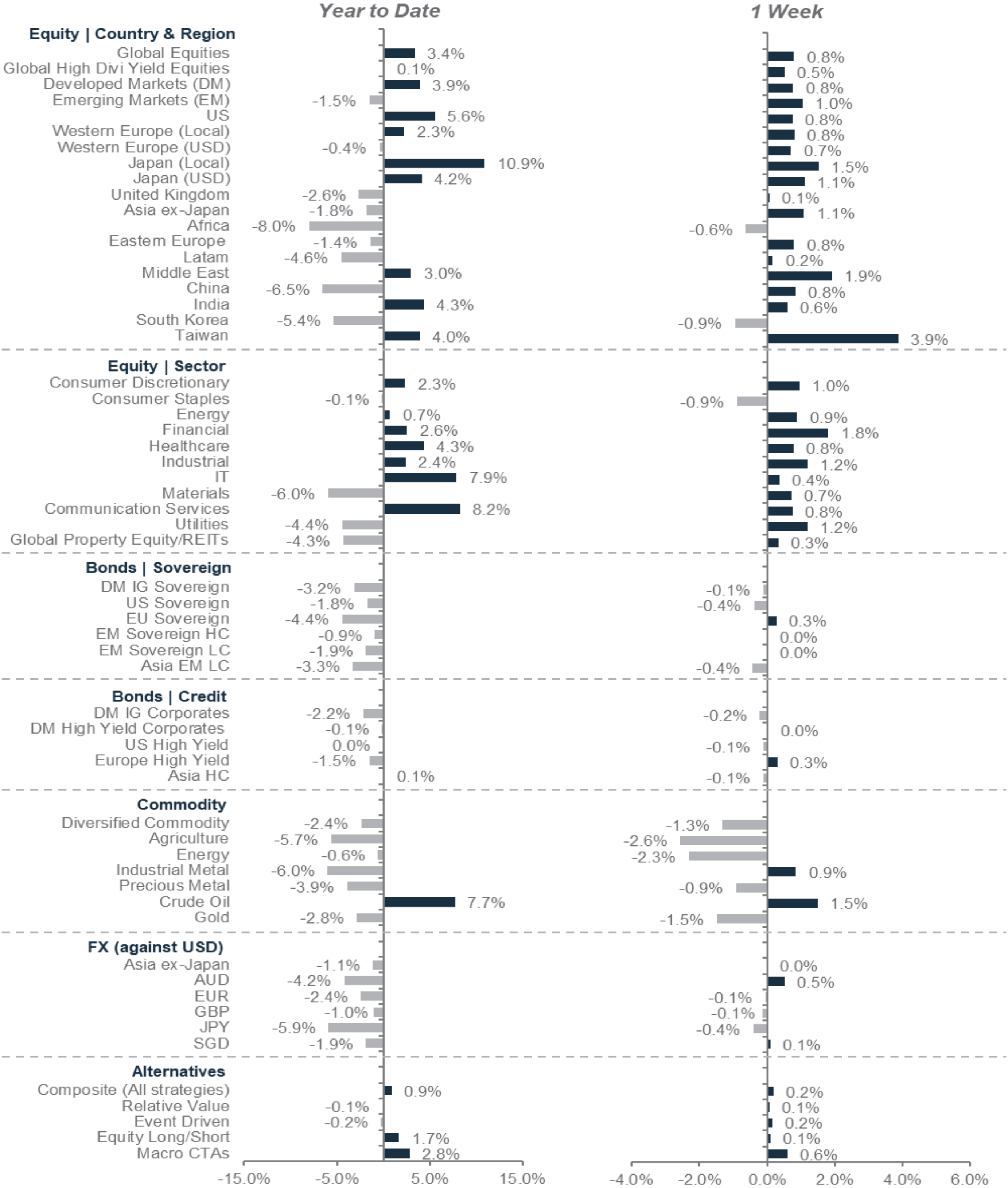
We expect USD/CHF to be largely rangebound in the near term, with a bearish bias on the back of overbought technicals

USD/CHF with US and Switzerland CPI y/y



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, 2024 YTD performance from 31 December 2023 to 15 February 2024; 1-week period: 08 February 2024 to 15 February 2024

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 Healthcare	▲
Other EM	◆	China Discretionary	▲
		China Communication	▲
Bonds (Credit)	◆	China Technology	▲
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	US	Leading Index	Jan	-0.3%	-0.1%
WED	EC	Consumer Confidence	Feb P	–	-16.1
THU	EC	HCOB Eurozone Manufacturing PMI	Feb P	–	46.6
	EC	HCOB Eurozone Services PMI	Feb P	–	48.4
	UK	S&P Global UK Manufacturing PMI	Feb P	–	47.0
	UK	S&P Global UK Services PMI	Feb P	–	54.3
	US	Chicago Fed Nat Activity Index	Jan	–	-0.15
	US	S&P Global US Manufacturing PMI	Feb P	–	50.7
	US	S&P Global US Services PMI	Feb P	–	52.5
	US	Existing Home Sales	Jan	3.97m	3.78m
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

S&P500 index has immediate resistance at 5,055

Technical indicators for key markets as of 15 February close

Index	Spot	1st support	1st resis-tance	12m forward P/E (x)	12m forward dividend yield (%)
S&P 500	5,030	4,979	5,055	20.6	1.5
STOXX 50	4,743	4,706	4,763	13.2	3.5
FTSE 100	7,598	7,541	7,626	11.0	4.3
Topix	2,592	2,562	2,617	15.4	2.3
Shanghai Comp	2,866	2,757	2,920	9.7	3.6
Hang Seng	15,945	15,813	16,011	7.5	4.8
Nifty 50	21,911	21,714	22,009	20.1	1.5
MSCI Asia ex-Japan	629	624	632	12.1	2.8
MSCI EM	1,008	1,000	1,012	11.6	3.2
WTI (Spot)	78.0	77.1	78.5	na	na
Gold	2,004	1,990	2,022	na	na
UST 10Y Yield	4.23	4.17	4.30	na	na

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 points to a reversal in US equity markets

Our proprietary market diversity indicators as of 15 February

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	1.53
Global Equities	◐	→	1.27
Gold	●	↑	1.70
Equity			
MSCI US	○	→	1.24
MSCI Europe	◐	↑	1.40
MSCI AC AXJ	●	↑	2.17
Fixed Income			
DM Corp Bond	◐	↑	1.47
DM High Yield	◐	→	1.32
EM USD	◐	→	1.36
EM Local	●	↑	1.64
Asia USD	◐	→	1.39
Currencies			
EUR/USD	●	↑	1.64

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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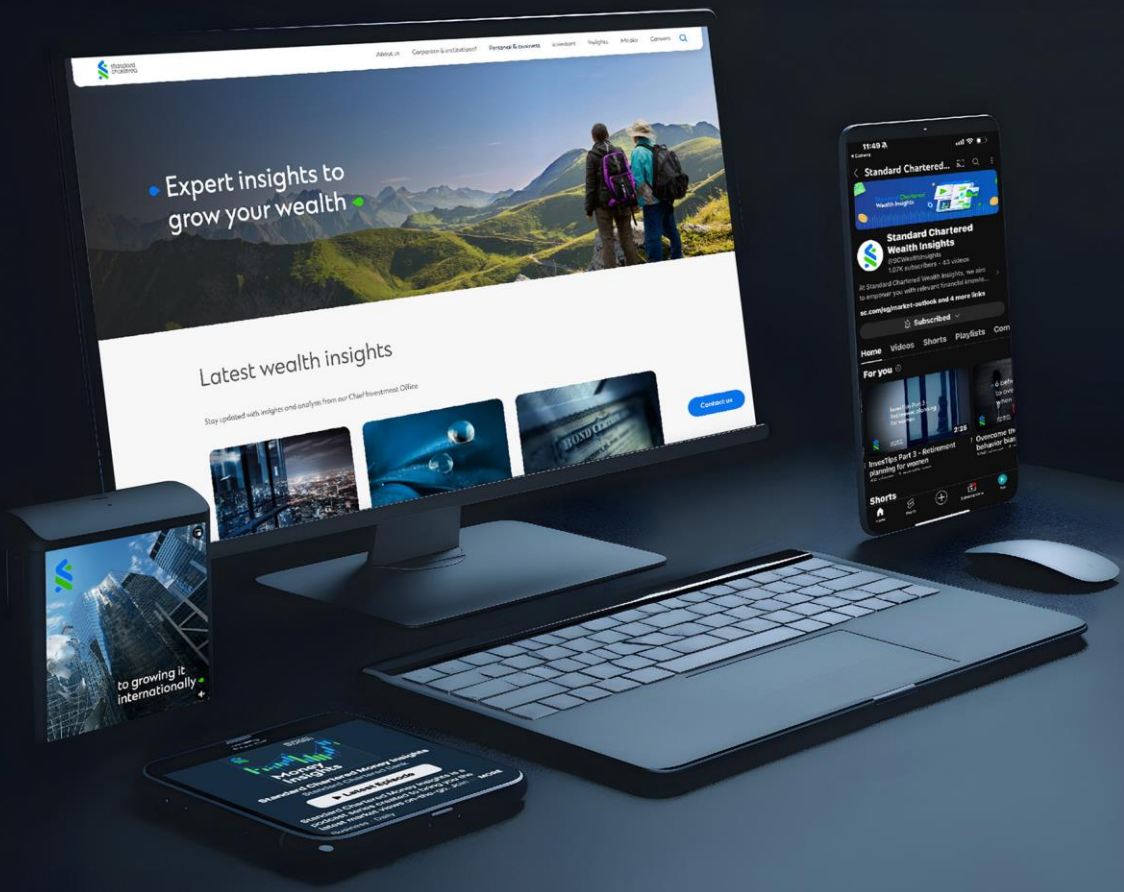

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