Wealth Management Chief Investment Office
21 April 2023

Weekly Market View

Staying defensive

- A raft of US data this week confirmed our concerns that US economic activity is weakening significantly.

- We agree with market pricing of one last 25bps of Fed rate hike on 3 May. The central bank wants to amplify its determination to cool the job market, stamp out service sector inflation and prevent inflation expectations from building.

- We then expect the Fed to pause briefly, before cutting rates in the second half of the year as a recession likely sets in. This outlook calls for a defensive positioning for investors with a 6-12-month cyclical horizon.

- In this report, we highlight a few tactical opportunities, including adding to US defensive sectors and Asia ex-Japan and China equities, reducing exposure to US financial sector equities, averaging into gold and staying bullish on the EUR.

Can China equities outperform if the US enters a recession?

Which markets should investors consider in their search for higher yields?

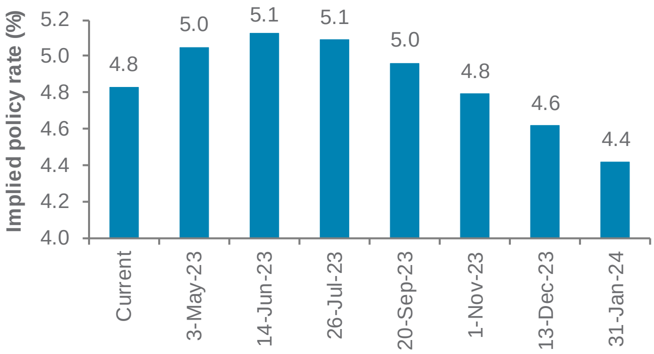
What are your views on the US dollar, given geopolitical risks?

Important disclosures can be found in the Disclosures Appendix.

Charts of the week: The case for defensive equities

Defensive equity sectors have historically outperformed after the Fed started cutting rates

Market expectations of Fed rates over the next nine months



US equity sector performance* during the last four Fed easing

	US average equity performance post first rate cut*		
	3 months	6 months	12 months
Utilities	4%	3%	-10%
Staples	2%	3%	11%
Healthcare	1%	4%	8%
MSCI US	-1%	2%	5%
Comm.	-1%	-1%	-7%
Materials	-3%	2%	-1%
Energy	-3%	0%	-12%
Industrials	-4%	3%	-4%
Financials	-4%	-3%	-12%
Discretionary	-7%	-3%	1%
Tech	-9%	-5%	0%

Source: Bloomberg, Standard Chartered; *Real estate is excluded due to a shorter dataset

Editorial

Staying defensive

A raft of US data this week confirmed our concerns that US economic activity is weakening significantly. We agree with market pricing of one last 25bps of Fed rate hike on 3 May. The central bank wants to amplify its determination to cool the job market, stamp out service sector inflation and prevent inflation expectations from building. We then expect the Fed to pause briefly, before cutting rates in the second half of the year as a recession likely sets in. This outlook calls for a defensive positioning for investors with a 6-12 month cyclical horizon.

Economic headwinds intensify: This week, the Conference Board's Leading Economic Index, which combines 10 indicators designed to forecast economic activity, missed consensus estimates. It extended its month-on-month decline for the 12th straight month. The indicator has also contracted 7.8% year-on-year. Meanwhile, jobless claims rose to a 17-month high and manufacturing activity continued to decline (according to Philadelphia Fed survey). The Fed's Beige Book survey confirmed banks are tightening credit. The array of data supports our belief that the US economy is likely to enter a recession in the next 6-12 months. Business confidence indicators (PMIs) for April are likely to confirm the downturn.

Earnings recession baked in: Of the 81 companies in the S&P 500 index that have reported Q1 earnings so far, almost three-fourth have exceeded estimates, based on Refinitiv data. Large banks were among the prominent ones beating expectations as they benefitted from higher net interest margins. However, the consensus is still expecting US earnings to have declined 4.7% y/y in Q1. That would mark the second straight quarter of year-on-year earnings contraction.

Investment implications: Against this backdrop, we see the rally in risk assets this year as an opportunity to rebalance towards the assets that traditionally outperform during a downturn. This includes Developed Market government bonds, among other income assets, and gold. Within equities, we see an opportunity to rebalance from the US and Europe towards Asia ex-Japan, where the economy is likely to be more resilient as China's economy accelerates. This week's data showed China's economy is recovering on the back of domestic consumption. For investors with US equity exposure, it would be prudent to rebalance into defensive sectors such as Consumer staples, Healthcare and Utilities, which have historically shown earnings resilience during downturns.

Tactical opportunities: Add defensive equities in the US: A review of the past four Fed easing cycles show defensive sectors such as Utilities, Consumer Staples and Healthcare are the only areas which deliver positive returns in both 3 and 6 months after the start of a Fed easing cycle. This explains our Overweight stance on these US sectors. These sectors have underperformed the broader market YTD, providing an opportunity to build exposure as US recession risks rise.

Reduce exposure to US financials: The recent bounce in US financial sector equities offers an opportunity to reduce exposure – while larger banks have beaten Q1 earnings expectations so far, we expect smaller bank earnings to be impacted by tightening credit conditions and slowing demand for loans in the coming months.

We see **opportunities in US government bonds** as the 10-year yield pulls back from a strong resistance around 3.66%.

We would also **average into gold** on further pullbacks below 2000/oz as we expect the precious metal to benefit from safe-haven demand amid US recession risks, geopolitical uncertainty, and sustained demand from EM central banks.

We also **remain bullish on the EUR** on a 1-month horizon. The ECB is likely to keep hiking rates (after an expected hike in May) well after the Fed has paused.

— 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

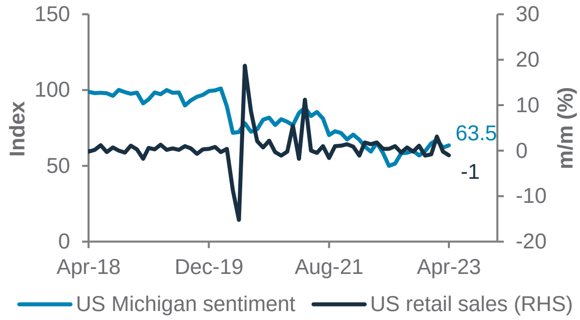
(+) factors: US consumer sentiment, accelerating China growth

(-) factors: Tighter US credit conditions, weak US retail sales, Euro area growth expectations and China property sector

	Positive for risk assets	Negative for risk assets
Macro data	• US Michigan consumer sentiment improved more than expected to 60.3 • US housing starts fell less than expected; NAHB housing index improved as expected • New York Fed manufacturing survey rose unexpectedly to 10.8 • China economy expanded more than expected by 4.5% y/y in Q1 23 • China retail sales rose more than expected	• US retail sales fell more than expected by -1% m/m • US Michigan 1-year inflation expectations rose sharply to 4.6% • US leading index declined more than expected by 1.2% m/m • Fed's Beige Book survey showed a tightening in credit conditions following the March banking crisis • Euro area ZEW expectations for economic growth fell • China factory output and fixed assets investment rose less than expected • China's property investment declined more than expected • UK inflation rose more than expected by 10.1% y/y
	Our assessment: Negative – Weak US retail sales, tightening US credit conditions, weak Euro area growth expectations, China factory output and property market	
Policy developments	• China's officials acknowledged there's still work to do to revive the economy after the mixed data	• Fed officials continued with their calls for more hikes • RBA policy meeting minutes were hawkish
	Our assessment: Negative – Hawkish Fed officials	
Other developments	• US Treasury Secretary Yellen defended Biden's ban on sale of semiconductors to China	• Taiwan will buy up to 400 missiles intended to deter a potential China invasion • China warned of unspecified major military actions in the Yellow Sea
	Our assessment: Negative – Geopolitical tensions	

Improving US consumer sentiment reflects a still-robust job market, but retail sales has been slowing as consumer demand shifts from goods to services

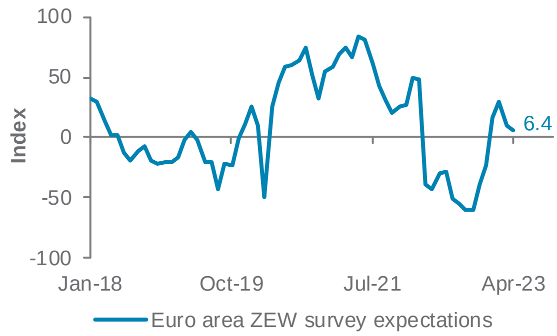
US retail sales and Michigan consumer sentiment



Source: Bloomberg; Standard Chartered

Euro area economic growth expectations are deteriorating again after a brief upturn in winter as the region averted an energy crisis

Euro area ZEW survey of growth expectations



Source: Bloomberg, Standard Chartered

China's retail sales continued to improve in March as economic activity normalised, but factory output and fixed asset investment languished

China's retail sales, industrial production and fixed asset investment

Source: Bloomberg, Standard Chartered

Top client questions

Can China equities outperform if the US enters a recession?

Historically, China equities have exhibited higher volatility and underperformed in most global equity downturns. At present, we see **China equities being 40% below their peak while global equities are only 12% below their peak**. We see a high likelihood of a US recession, which we expect will lead to further weakness in global equities.

However, **China equities are already pricing in substantial negative sentiment**, in our view. With policymakers in the US and Europe keen to tame inflation and slow down growth, while **China is moving in the opposite direction toward a cyclical upswing**, we see China equities outperforming over the next 6-12 months.

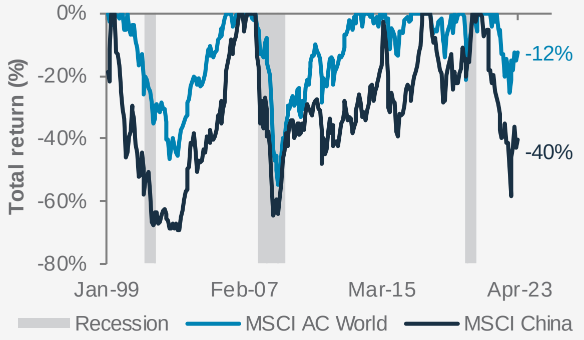
The recent macro data in China with strong retail sales and weaker-than-expected fixed asset investments is in line with our view that **China's economic recovery is likely to be consumption driven**.

As such, **our preferred sectors in China include consumer discretionary and communication services**, which we believe would benefit from greater spending by consumers. Communication services is dominated by media and entertainment companies that are exposed to consumer spending. In addition, **we favour the technology and industrials sectors**, where we expect attractive valuation and policy support from the Chinese government.

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

China equities have priced in substantially more negative sentiment than global equities, offering investors attractive value

Drawdown in MSCI AC World and MSCI China from their peak; both indices measure total return in USD



Source: Bloomberg, Standard Chartered

Which markets should investors consider in their search for higher yields?

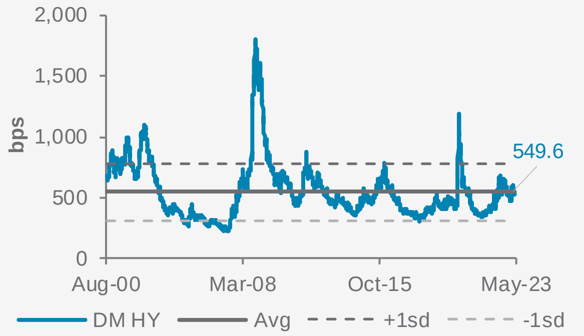
Compared to yields of sub-1% during the policy loosening era, we **see the current nominal yield of around 3.6% from global bonds as attractive** opportunity to add into bonds. We prefer **high quality over High Yield (HY) bonds**, as their defensive nature should provide shelter in a backdrop of rising recession risks. **We are not convinced the risk-adjusted return for HY bonds is attractive,** despite the 9% yield on offer, based the following three reasons:

1. The yield premium for HY bonds is hovering around its long-term average, which, in our view, is still too tight to price a surging recession risk
2. HY bond issuers have weaker credit fundamentals and are vulnerable to an economic slowdown
3. We believe the Fed is approaching the end of its rate hike cycle. Until the Fed pivots, we expect Investment Grade (IG) bonds to outperform their HY counterparts

In Asia, **China has started the year on a solid note** with both Q1 GDP and credit growth coming in stronger than expected. Although better growth prospects could push onshore yields higher, we see headwinds such as

We believe HY bond yield premiums have not fully priced in recession risks

Bloomberg Global High Yield Bond Spread Index



Source: Bloomberg, Standard Chartered

(i) disinflation concerns emerging after lower CPI and PPI data in March,

(ii) heightened global recession concerns that could weigh on China's recovery, and

(iii) the monetary policy remaining intact as the PBoC maintains the one-year Medium-term Lending Facility (MLF) rate at 2.75% for the eight consecutive month.

Against this backdrop, we believe **China onshore yields are unlikely to surge materially higher from here** in the near term. Having said that, we believe the current yield pick-up of China offshore USD bonds to be more attractive and reiterate our Overweight in Asia USD bonds.

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

Top client questions (cont'd)

What are your views of the USD as a safe-haven given growing geopolitical risks?

Recent headlines around bilateral trade settlement agreements denominated in the CNH and talks of a potential BRICS currency have renewed concerns around the role of the USD as a reserve currency and safe haven. In our opinion, **the risk of de-dollarisation is overblown, but we see the JPY and the CHF as potentially more effective safe-haven currencies**.

The two key arguments cited with regards to the risk of de-dollarisation include:

1. Rising number of bilateral trade settlement agreements denominated in currencies of the trading countries, including the recent agreement between Saudi Arabia and Brazil to settle trade in the CNH
2. An increase in purchase of gold by various central banks

In our assessment, the concerns are overblown. While the reliance on the USD is likely to decline as we move from a unipolar to a multi-polar world, **any eventual de-dollarisation is a multi-decade story**.

The US offers large, liquid and freely tradeable financial markets. This allows FX reserve managers to invest their holdings in short-term government debt, and even equities, to earn a better rate of return. We believe this is a key advantage for the USD over potential contenders, ensuring that **the USD will continue to be the major reserve currency even if its share declines gradually**.

While the risk of geopolitical risk spikes is elevated, we **see limited attractiveness of the USD as a safe-haven** for three key reasons:

1. We assign an 80% probability of a US recession over the next 12 months. Historical data shows **the USD tends to weaken during US-led recessions.**
2. US interest rate cuts later in the year and a decline in US bond yields are likely erode the USD's interest rate advantage, pushing the USD lower on a 12-month horizon.
3. The USD remains expensive from a valuation perspective.

In our assessment, the JPY stands out as an attractive safe-haven currency due to multiple factors:

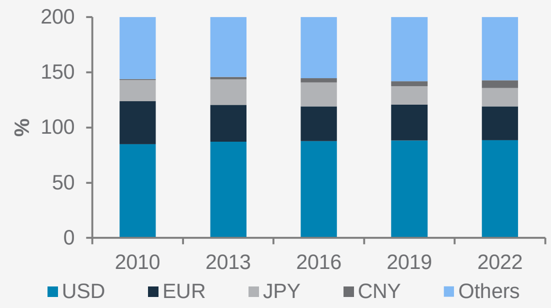
1. Narrowing interest rate differentials should result in a gradual appreciation of the JPY over the next 12 months.
2. We see a high likelihood of a less accommodative BoJ over the next few months, which should further strengthen the JPY
3. Finally, the JPY has a long track record as a safe-haven currency

We expect USD/JPY to trend towards 125 in the next 12 months, with risks of it testing 120 should the BoJ turn more hawkish than expected.

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

USD's share in global FX transactions has remained largely steady, highlighting the structural importance of the USD in global trade.

BIS Over the Counter Foreign Exchange turnover by currency

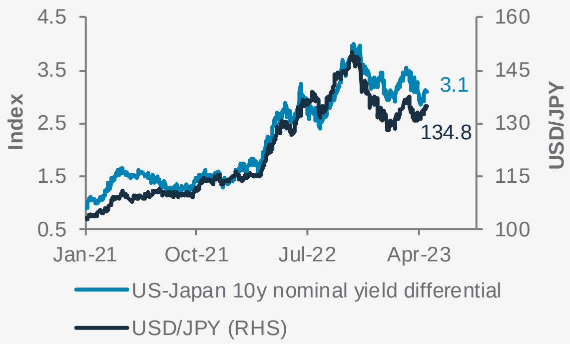


Source: BIS, Standard Chartered

*Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%.

Our expectation of lower US bond yields and less accommodative BoJ policy should lead to lower interest rate differential and lower USD/JPY

USD/JPY and difference between 10-year US and Japanese government bond yields



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is the outlook for India equities? Are there any implications from fluctuating foreign investor flows?

India equities have trailed Emerging Market (EM) and Developed Market (DM) peers since the start of 2023 (MSCI India is down 5.2% vs MSCI EM [up 4%] and MSCI World [up 8.5%]). India's strong relative outperformance in both 2021 and 2022 drove valuation premiums, both in absolute and relative terms, to peak levels. Nevertheless, **strong earnings delivery and the recent underperformance of India equities have improved the risk-reward for India equities** in our opinion due to

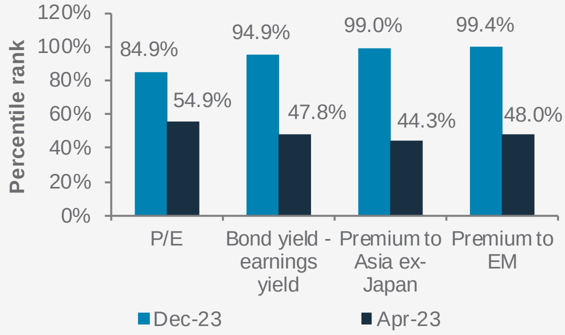
- **Valuations trading closer to fair value:** MSCI India's 12-month forward price-earnings ratio premium over MSCI Asia-ex-Japan has eased to 48% from a peak of 117% in October 2022 and is now trading around its 10-year average premium of 51%. Further, its P/E ratio is at 20.2x, just below its 10-year average of 20.8x.
- **Corporate earnings delivery:** India's earnings growth continues to outperform relative to peers, with expectations of a fourth consecutive year of double-digit EPS growth (15% for fiscal year ending March 2024) for the benchmark Nifty index and earnings expectations are being revised higher.
- **Domestic flows resilience:** Although, foreign investor flows have been tepid so far in 2023, stable equity inflows from domestic investors amid a structural shift in household savings towards financial assets continues to be a key support for the market.

Within India equities, we are Overweight large-cap equities over mid- and small-cap equities on relatively better macro fundamentals and a greater margin of safety in terms of earnings and valuations. We see attractive value in financials, domestic cyclicals and investment-led themes – infrastructure and manufacturing.

— **Vinay Joseph,** *Head, Investment Products and Strategy, India*

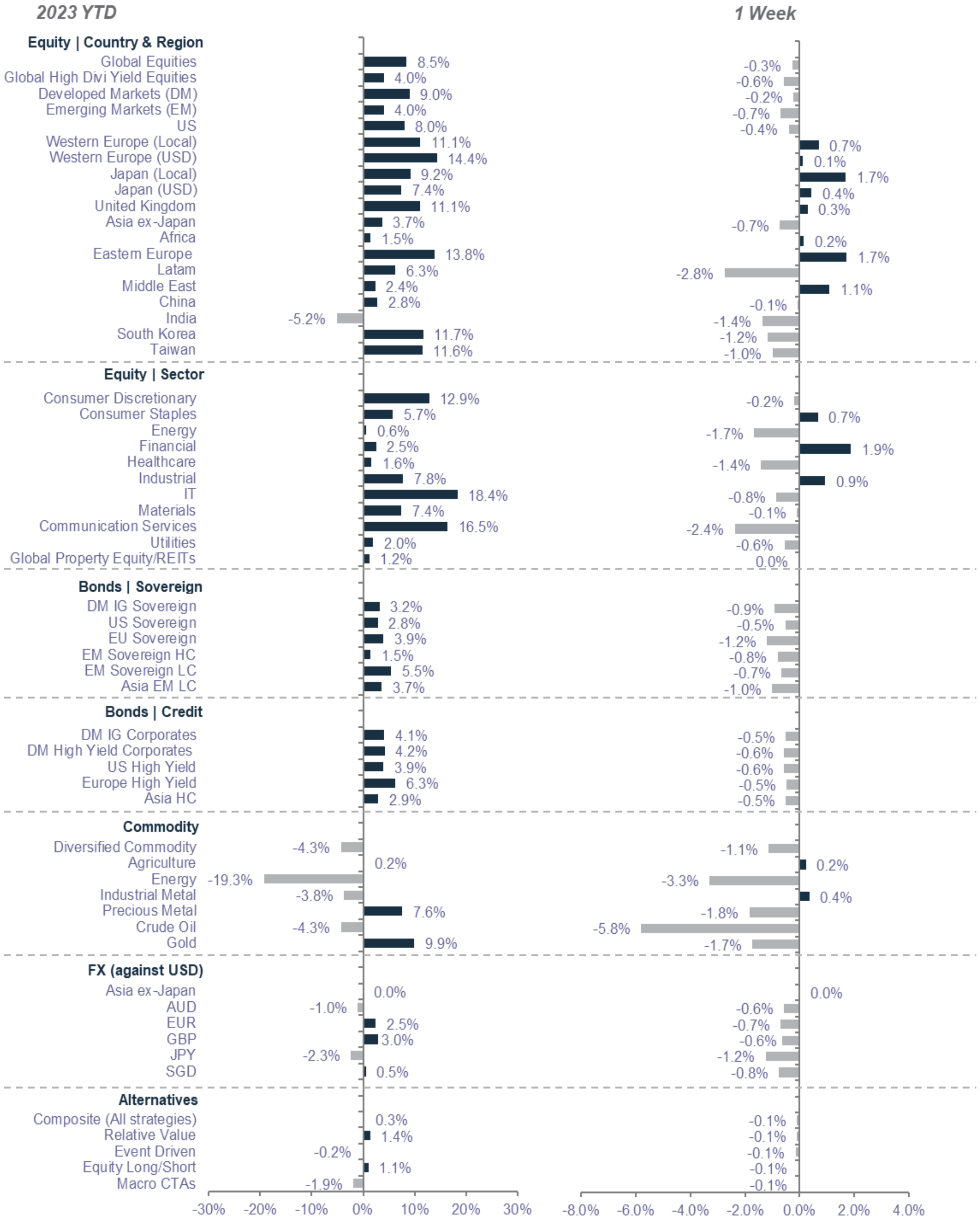
The valuation premium of Indian equities relative to its historical average has receded across parameters

Percentile ranking of key valuation parameters for Indian equities versus their respective historical values*



Source: Bloomberg, Standard Chartered; 10-year average

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 20 April 2023; 1-week period: 13 April 2023 to 20 April 2023

Our 12-month asset class views at a glance

Asset class			
Equities	▼	**Preferred Sectors**	
Euro area	◆	US Healthcare	▲
US	◆	US Staples	▲
UK	▼	US Utilities	▲
Asia ex-Japan	▲	Europe Utilities	▲
Japan	◆	China Discretionary	▲
Other EM	◆	China Comm. Services	▲
		China Technology	▲
Bonds (Credit)	◆	China Industrials	▲
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	US	Chicago Fed Nat Activity Index	Mar	–	-0.19
TUE	US	New Home Sales	Mar	630k	640k
	US	Conf. Board Consumer Confidence	Apr	104.1	104.2
WED	UK	Durable Goods Orders	Mar P	1.0%	-1.0%
THU	EC	Economic Confidence	Apr	–	99.3
	US	GDP Annualized q/q	1Q A	2.0%	2.6%
	US	Personal Consumption	1Q A	–	1.0%
	US	Core PCE q/q	1Q A	–	4.4%
FRI/SAT	US	Employment Cost Index	1Q	1.1%	1.0%
	US	Personal Income	Mar	0.2%	0.3%
	US	PCE Deflator y/y	Mar	–	5.0%
	US	PCE Core Deflator y/y	Mar	4.5%	4.6%
	US	MNI Chicago PMI	Apr	43.3	43.8
	JP	Monetary Policy Meeting	Apr		

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

Next support for the US 10-year bond yield is at 3.5%

Technical indicators for key markets as of 20 April close

Index	Spot	1st support	1st resistance
S&P 500	4,130	4,121	4,147
STOXX 50	4,385	4,370	4,397
FTSE 100	7,903	7,880	7,917
Nikkei 225	28,643	28,538	28,703
Shanghai Comp	3,367	3,339	3,394
Hang Seng	20,397	20,249	20,664
MSCI Asia ex-Japan	640	636	647
MSCI EM	990	985	999
WTI (Spot)	80.9	79.1	84.5
Gold	2,004	1,997	2,008
UST 10y Yield	3.54	3.50	3.59

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 remains healthy across asset classes

Our proprietary market diversity indicators as of 20 April

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	1.72
Global Equities	●	→	1.58
Gold	●	→	1.53
Equity			
MSCI US	●	↓	1.51
MSCI Europe	●	↑	1.57
MSCI AC AXJ	●	↓	1.60
Fixed Income			
DM Corp Bond	●	→	1.86
DM High Yield	●	↑	1.89
EM USD	●	↓	1.63
EM Local	●	↑	1.76
Asia USD	●	↑	2.61
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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