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Wealth Management Global Chief Investment Office
20 October 2023

Weekly Market View

Turning point?

→ Global markets appear to be at a turning point, at least in the near term. Investor diversity for two benchmark assets - the USD and US 10-year government bonds - have collapsed to levels that typically signal a trend reversal.

→ US 10-year bonds appear oversold after the yield scaled a new 16-year high close to 5%. Any pullback in the USD and US bond yields usually benefit risk assets. However, the Israel-Gaza conflict complicates the outlook, especially after the tragic bombing of a Gaza hospital.

→ We would continue to average into DM government bonds, given the attractive risk-reward balance, and continue to hedge geopolitical risks with energy sector equities and gold.

How have US Q3 corporate earnings fared so far?

What is the outlook for Emerging Market local currency bonds amid the Developed Market bond turbulence and USD strength?

What is your view on the GBP amid signs of a cooling UK labour market?

Charts of the week: Bonds outperformed equities after rates peaked

The US government bond yield tends to peak around the last Fed rate hike; bonds then typically deliver strong returns

Fed funds target rate, US 10-year government bond yield

Source: Bloomberg, Standard Chartered

12m forward total return on assets after peak of 10y bond yield

Date of peak in 10-year bond yield	Peak US 10-year govt. bond yield	S&P 500 index	US govt. bond	Cash	Gold	DM HY Corp bond	EM USD bond
20-Mar-89	9.5%	21.9%	12.4%		0.3%		
7-Nov-94	8.0%	29.9%	16.7%	5.8%	1.3%	10.8%	12.5%
20-Jan-00	6.8%	-6.0%	14.6%	6.2%	-8.4%	5.9%	16.7%
12-Jun-07	5.3%	-8.7%	10.7%	3.4%	33%	2.0%	7.3%
8-Nov-18	3.2%	12.5%	9.8%	2.3%	19%	6.8%	13.4%
Average		**9.9%**	**12.9%**	**4.4%**	**9.1%**	**6.4%**	**12.5%**

Editorial

Turning point?

Global markets appear to be at a turning point, at least in the near term. Investor diversity for two benchmark assets - the USD and US 10-year government bonds - have collapsed to levels that typically signal a trend reversal. US 10-year bonds appear oversold after the yield scaled a new 16-year high of 5%. Any pullback in the USD and US bond yields usually benefit risk assets. However, the Israel-Gaza conflict complicates the outlook, especially after the tragic bombing of a Gaza hospital. We would continue to average into DM government bonds and hedge geopolitical risks with energy sector equities and gold.

Strong US data: Sustained strength in US economic data has been a key driver of the surge in US bond yields and the USD in recent months. This week, data showed US retail sales rose stronger than expected in September and initial jobless claims fell to a nine-month low. Meanwhile, the monthly University of Michigan survey showed a surprising jump in 1-year inflation expectations to 3.8% and 5-10-year inflation expectations to 3.0%. These data followed stronger-than-expected job creation and still-elevated core inflation for September.

Fed, ECB outlook: While recent US data remains supportive of high-for-longer rates, we do not expect the Fed to hike rates any further (including at the 1 November policy meeting) since growth is likely to slow in the coming quarters amid tightening financial conditions following the latest surge in bond yields and 525bps of rate hikes since March 2022. Fed Chair Powell's latest comments that the bond yield surge has lessened the need for further rate hikes supports our peak-rates view. We also expect the ECB to hold rates next week, given stagnant growth, although any resurgence in oil prices risks reviving the inflation pressure, which has been downtrending this year.

Middle East update: Markets are still pricing a relatively benign scenario, wherein diplomatic efforts aimed at confining and resolving the conflict within Israel and Gaza succeeds, preventing any disruption to oil supplies from the Middle East. Crude oil has risen c.10% since the Gaza conflict flared but remains 4% below this year's high hit in late September.

US President Biden and UK Prime Minister Sunak's recent visits indicate western powers do not want to see the conflict escalate and engulf the region. Success in these diplomatic efforts would limit the impact of the conflict on markets. The alternative scenario of an escalation in the conflict involving other participants, notably Iran, and disrupting oil supplies would be negative for risk assets. Of course, Saudi Arabia has spare oil production capacity of close to 1mbpd to alleviate some disruption to supplies, but widespread disturbance to shipping channels in the Middle East would limit the benefit.

Investment implications:

Averaging into DM bonds: Although US data remains strong, technical indicators such as those for investor diversity (fractals below 1.25) and momentum (Relative Strength Index above 70) and geopolitical risk raise the chance of a pullback in US government bond yields. Historically, the US 10-year bond yield has peaked around the peak in Fed rates. Since we believe Fed policy rate has peaked, we would average into DM government bonds. If the US 10-year yield breaks above 5%, the next resistance is c. 5.25% (just below the likely peak Fed rate). After the recent surge, the yield on the benchmark US government bond index would have to rise 90bps from here for the bonds to deliver negative returns over the next 12 months. Therefore, we find the risk-reward attractive despite near-term volatility.

Equities face resistance: Besides a pullback in the US 10-year yield, we will probably also need to see a decisive reversal in the USD for global equities and broader Emerging Market assets to recover. The S&P500 index has failed to break above the convergence of its 50DMA and 100DMA resistances for the past couple of weeks but remains above 200DMA support.

Hedging risk: We would continue to hedge against any escalation in the Israel-Gaza conflict by adding exposure to energy sector and defence sub-sector equities and gold. These assets have performed well in the past couple of weeks. Gold's next resistance is around USD 1,990, followed by USD 2,050.

— 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: Robust US retail sales, China growth recovery

(-) factors: Israel-Gaza conflict, falling US consumer sentiment

	Positive for risk assets	Negative for risk assets
Macro data	• US retail sales rose more than expected by 0.7% m/m • US factory output slowed less than expected • Euro area ZEW survey expectations improved • China exports and imports fell less than expected • China's economy grew more than expected in Q3 by 4.9% y/y • China factory output and retail sales rose more than expected	• US Michigan consumer sentiment fell more than expected; inflation expectations rose unexpectedly • US housing starts rose less than expected • US leading index fell more than expected • China new loans rose less than expected; credit growth and fixed assets investment slowed more than expected • UK consumer inflation rose more than expected
	Our assessment: Neutral – Robust US retail sales, China recovery vs falling US consumer sentiment, leading index	
Policy developments	• Fed's Chair Powell signalled a rate pause following bond yield rise • Fed's Beige Book showed easing jobs market and moderating prices • China injected more liquidity than expected, while keeping one-year lending facility rate unchanged as expected	• US Treasury Secretary Yellen said high rates might persist
	Our assessment: Positive – Fed rate pause, China liquidity	
Other developments	• US House speakership uncertain as Republican Jordan lost his second vote	• Israel-Hamas conflict escalated following a hospital bombing in Gaza; US's Biden, UK's Sunak visited the Middle East to prevent an escalation
	Our assessment: Negative – Israel-Gaza conflict	

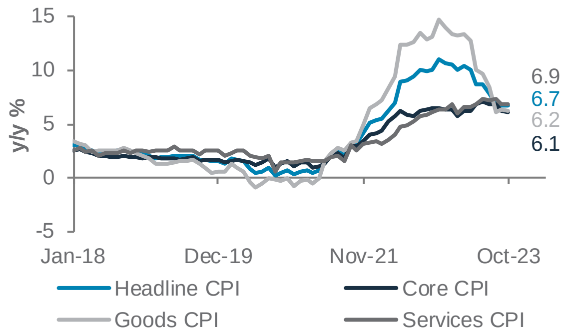
US consumption remains strong, sustaining the high-for-longer rates outlook

US headline, core and controlled group* retail sales

Source: Bloomberg; Standard Chartered; *excludes autos, building materials, gasoline, office supplies, mobile homes and tobacco

UK disinflationary trend has stalled in recent months, raising the risk of further BoE rate hikes

UK headline, core, goods and services inflation



Source: Bloomberg, Standard Chartered

China's industrial output and retail sales were stronger than expected, although fixed asset investment faced a drag from the property sector

China's retail sales, industrial production and fixed asset investment (YTD) growth

Source: Bloomberg, Standard Chartered

Top client questions

What is your outlook on EM local currency government bonds amid bond market turbulence and USD strength?

Emerging Markets (EM) local currency (LCY) government bonds have declined with the surge in Developed Market bond yields and the USD. However, the premium on EM LCY bonds over US government bond yields has further compressed. While spreads appear marginally tight, we continue to expect EM LCY government bonds to outperform over the next 6-12 months due to these drivers:

1. **Easing monetary policy** – Some EMs, such as Brazil, Chile and Hungary, have already started cutting policy rates as inflation pressures ease. We expect more EM central banks to join the pack. Furthermore, the historically high real (net-of-inflation) policy rates mean that there is plenty of room for rate cuts.
2. **Robust EM growth outlook is credit positive** – The consensus expects EM economies to grow 4% y/y in 2024, roughly in line with their 10-year average (4.5%) and higher than the DM growth forecast (1.1%). Positive economic growth could improve the sovereign credit quality, sustaining the spread compression.
3. **Strong aggregate credit quality** – EM LCY bonds offer a higher aggregate credit quality than EM USD bonds (BBB vs BB+), consistent with our broader preference for higher quality bonds.
4. **Weaker USD positive for EM FX** – In our base case of a weaker USD, EM FX would strengthen and add to EM LCY bond returns.

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

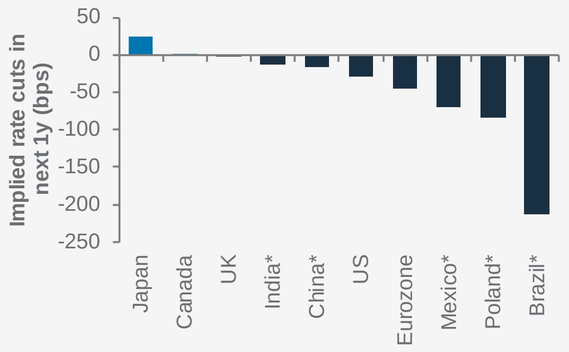
The Emerging Market local currency bond yield premium over US government bonds could keep tightening as growth momentum sustains

Emerging Markets Local Currency bond yield and spread

Source: Bloomberg, Standard Chartered

More rate cuts are priced in Emerging Markets vs. Developed Markets

Market-implied rate cuts over the next 12 months

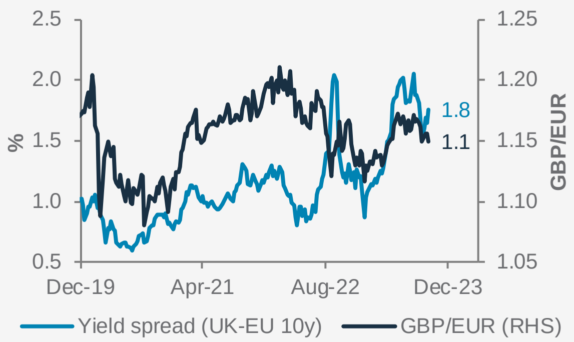


Source: Bloomberg, Standard Chartered

* These EM economies account for 45.9% of the EM LCY debt index

The yield spread between UK and Euro area suggests upside risk for GBP/EUR

GBP/EUR and interest rate differentials



Source: Bloomberg, Standard Chartered

What is your view on GBP amid signs of a cooling UK labour market?

UK wage growth slowed moderately in August, with the three-month average total pay rising 8.1% y/y, down from 8.5% last month, but still close to record highs. Policymakers are likely to wait for more convincing signs from the employment change and unemployment rate that the labour market has cooled down. Meanwhile, UK inflation data was slightly higher than expected and is the highest among G7 economies. This suggests the BoE is likely to remain open to further tightening of its monetary policy. Despite these data points, market expectations of a c.30% chance of a 25bps rate hike has now been pushed back from November to December.

Meanwhile, we believe the 'higher for longer' view is now largely reflected in the USD Index (DXY); 107.3 is a key resistance level.

Therefore, GBP/USD is likely to consolidate around its first support at 1.20. Furthermore, interest rate differentials between the UK and EU suggest there is upside risk for GBP/EUR. We expect the pair to rebound towards 1.16.

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

Top client questions (cont'd)

Would the recent set of strong China data trigger a recovery in Chinese equities?

Chinese onshore and offshore equities initially rose after data for GDP, retail sales, industrial output and the jobless rate exceeded expectations. However, the positive price action quickly faded.

While some data has beaten low expectations, property investment continued to contract. This deepened to -9.1% YTD from the same period last year, which was below expectations of -8.9%. Residential property sales in the first nine months this year contracted 3.2% y/y.

The other, perhaps more important, reason was the "good news is bad news" mantra. Chinese policymakers have been implementing gradual and targeted stimulus with the aim of putting a floor under the economy, rather than spurring a significant recovery that would risk reflating the housing and credit bubbles. The latest set of data beats arguably decreases the probability of a "bazooka" style of stimulus.

We believe policymakers are likely to continue their current policy of "piece-meal" stimulus for now – the latest being the issuance of "debt-swap" bonds for Chinese local governments – to balance support for growth with limiting local government financial stress. The Hang Seng Index is likely to remain in a narrow range, between 17,000 and 18,350, with subsequent resistance around 19,000 in the near term.

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

The Hang Seng index is facing strong resistance at 18,350, while support lies at 17,000

Hang Seng Index

Source: FactSet, Standard Chartered

How has US Q3 earnings fared so far?

These are early days, with major US banks reporting first. According to LSEG I/B/E/S, over one-third of the financial sector has reported so far, delivering a 9.8% positive earnings surprise. High interest rates and loan growth continue to support net interest income (NII), while loan loss provisions were not as bad as feared. Capital market and investment banking advisory revenues were soft as expected.

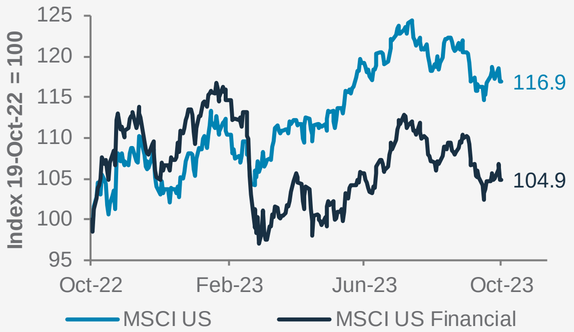
Banks, however, sounded cautious in their outlook. As rates stay higher for longer, NII is expected to come under pressure as banks gradually adjust to paying higher rates to depositors. Weakness in the office commercial real estate sector is also becoming more apparent as valuation appraisals weaken. Loan losses are climbing, with expectations of more to come. Overall, banks are responding with strategic action to control their expenses heading into 2024.

A source of concern has been potential losses in banks' bond portfolios with rising bond yields. Among the large banks, this risk appears to be contained as potential losses look unlikely to be realised. These comprise mainly US government bonds, which are expected to be fully repaid as large banks can hold them to maturity. We have a Neutral view on US financials and expect the sector to perform in line with the broader market over the next 6-12 months.

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

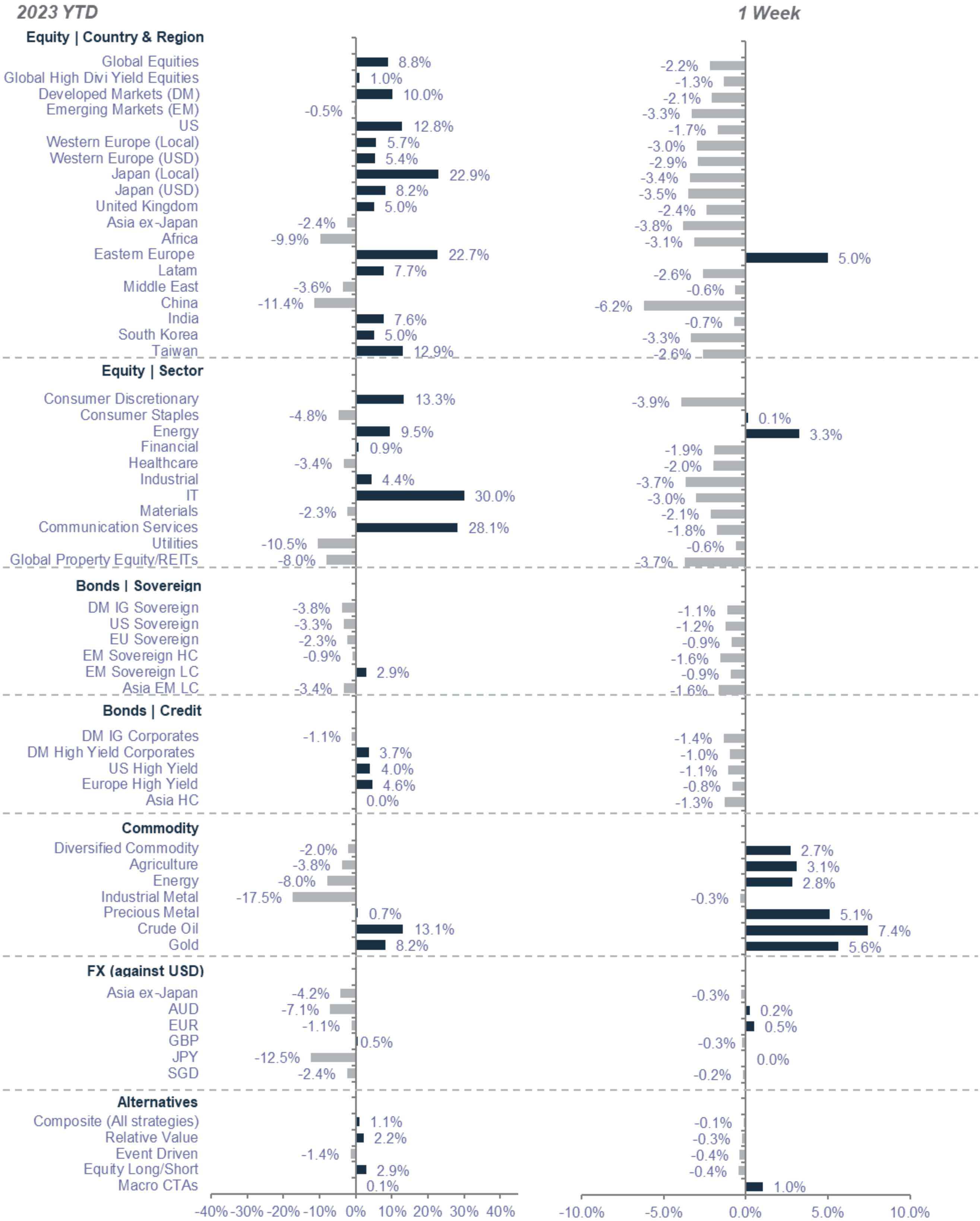
US financial sector equities have shown some recovery from the slump in March when several regional banks collapsed

MSCI US and MSCI US financial sector equity indices



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 19 October 2023; 1-week period: 12 October 2023 to 19 October 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 Healthcare	▲
Other EM	◆	China Discretionary	▲
		China Communication	▲
Bonds (Credit)	◆		
Asia USD	◆	**Alternatives**	◆
Corp DM HY	▼		
Govt EM USD	◆	**Gold**	◆
Corp DM IG	◆		
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	Sep	–	-0.16
	EC	Consumer Confidence	Oct P	–	-17.8
TUE	UK	ILO Unemployment Rate 3Mths	Aug	4.3%	4.3%
	EC	HCOB Eurozone Manufacturing PMI	Oct P	–	43.4
	EC	HCOB Eurozone Services PMI	Oct P	–	48.7
	UK	S&P Global/CIPS UK Manufacturing PMI	Oct P	–	44.3
	UK	S&P Global/CIPS UK Services PMI	Oct P	–	49.3
	US	S&P Global US Manufacturing PMI	Oct P	–	49.8
	US	S&P Global US Services PMI	Oct P	–	50.1
WED	EC	M3 Money Supply y/y	Sep	–	-1.3%
	US	New Home Sales	Sep	684k	675k
THU	EC	ECB Deposit Facility Rate	26-Oct-23	–	4.0%
	US	GDP Annualized q/q	3Q A	4.0%	2.1%
	US	Durable Goods Orders	Sep P	1.1%	0.1%
	US	Cap Goods Orders Nondef Ex Air	Sep P	–	0.9%
FRI/SAT	US	PCE Deflator y/y	Sep	3.4%	3.5%
	US	PCE Core Deflator y/y	Sep	3.7%	3.9%

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 resistance for US 10-year bond yield is at 5.12%

Technical indicators for key markets as of 19 October close

Index	Spot	1st support	1st resis-tance	12m forward P/E (x)	12m forward dividend yield (%)
S&P 500	4,278	4,246	4,342	18.0	1.7
STOXX 50	4,090	4,070	4,132	11.2	4.2
FTSE 100	7,500	7,441	7,617	10.4	4.4
Topix	2,264	2,249	2,294	14.1	2.6
Shanghai Comp	3,005	2,978	3,061	9.8	3.6
Hang Seng	17,296	17,123	17,641	8.1	4.5
Nifty 50	19,625	19,562	19,749	18.8	1.9
MSCI Asia ex-Japan	592	587	602	12.1	2.9
MSCI EM	931	924	944	11.4	3.2
WTI (Spot)	89.4	87.6	90.3	na	na
Gold	1,974	1,938	1,993	na	na
UST 10Y Yield	4.99	4.74	5.12	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 in the USD has fallen to critical levels

Our proprietary market diversity indicators as of 19 October

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.28
Global Equities	◐	↓	1.37
Gold	●	↑	1.69
Equity			
MSCI US	◐	→	1.44
MSCI Europe	◐	↓	1.33
MSCI AC AXJ	◐	↓	1.43
Fixed Income			
US 10Y yield	○	→	1.20
DM High Yield	◐	↓	1.46
EM USD	◐	↓	1.38
EM Local	◐	↓	1.30
Asia USD	◐	↓	1.50
Currencies			
USD index (DXY)	○	→	1.24

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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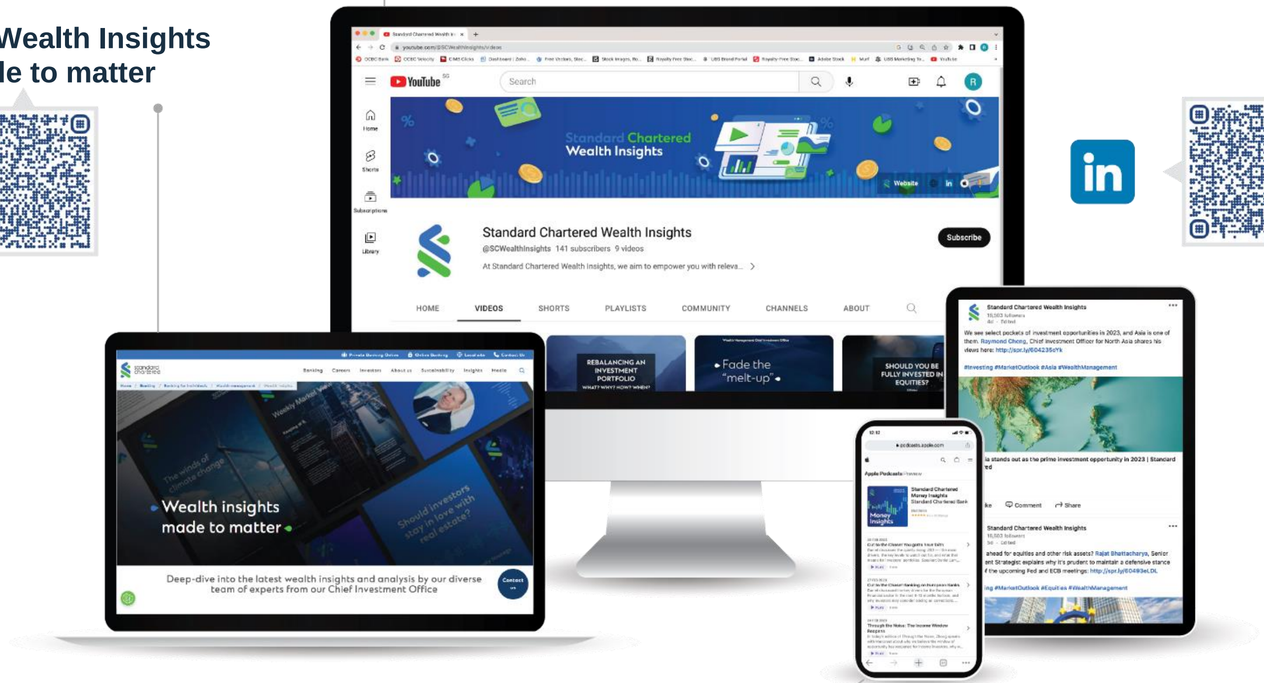

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