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Wealth Management Global Chief Investment Office
4 August 2023

Weekly Market View

Weighing the odds

- After three straight weeks of gains, global equities got their first jolt this week following Fitch's downgrade of the US credit rating. The rating cut has turned the spotlight on soaring US fiscal deficit, raising concerns about higher bond yields.

- We do not expect yields to rise significantly higher as US growth continues to slow. Given this, we see opportunities from this market dislocation: for one, Developed Market government bond yields have become increasingly attractive.

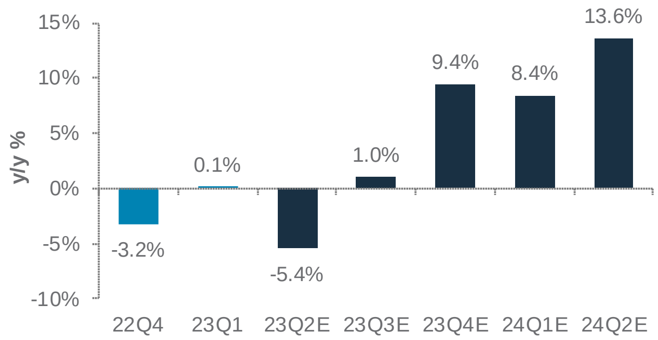
- US Technology sector equity market investor positioning is no longer crowded, opening a window to average in, especially after the positive Q2 earnings beats.

- We also expect relatively inexpensive China equities to benefit from rotation out of Developed Market equities as Beijing finetunes support for the ailing property sector and boosts consumption.

Charts of the week: The pros and the cons

An H2 rebound in US corporate earnings would support a short-term risk-asset rally, but rising real* yields are a headwind

US quarterly earnings and consensus estimates (dark bars)



S&P500 index y/y change, US 10-year real* yield

Source: Bloomberg, Standard Chartered; *Inflation-adjusted yield derived from US 10-year inflation protected government bonds

Editorial

Weighing the odds

After three straight weeks of gains, global equities got their first jolt this week following Fitch's downgrade of the US credit rating. The rating cut has turned the spotlight on soaring US fiscal deficit, raising concerns about higher bond yields. We do not expect yields to rise significantly higher as US growth continues to slow. Given this, we see opportunities from this market dislocation: for one, DM government bond yields are increasingly attractive. US Technology sector equity market investor positioning is no longer crowded, opening a window to average in, especially after the positive Q2 earnings beats. We also expect relatively inexpensive China equities to benefit from rotation out of Developed Market equities as Beijing finetunes support for the ailing property sector and boosts consumption. Here, we look at some of the recent market drivers:

US fiscal surge: Fitch's downgrade of US credit rating, while not a game changer, highlights the challenging fiscal outlook. US fiscal deficit has surged this year, primarily due to falling tax receipts. This led the government to announce a higher-than-expected USD 1trn borrowing plan for Q3. The Treasury's borrowing comes at a time when the Fed is expected to reduce Treasury purchases in Q3 by USD180bn. Put together, these dynamics are likely to put upward pressure on real (inflation-adjusted) bond yields in the near term. Nevertheless, we expect long-term yields to be capped by slowing growth and a possible recession in the next 6-12 months (see page 3 for more details).

Weak data: This week's US ISM and China PMI data confirmed global manufacturing remains in contraction and services activity is slowing. The Fed's quarterly Senior Loan Officers survey showed continued tightening of lending standards. US private hiring based on ADP data did beat expectations (non-farm payrolls data tonight is the next focus, with the consensus expecting 200,000 net new jobs). However, US job openings underwhelmed. Historically, a sharp drop in y/y job postings has signalled a rise in unemployment over the next 6-12 months.

Earnings, manufacturing rebound? US Q2 earnings continued to beat expectations, despite a 5.4% y/y drop. The consensus expects earnings to rebound in H2, aided by summer boost to consumption and rising real incomes due to disinflation. US profit margins are also expected to improve as input costs fall with disinflation (all eyes on CPI data next week).

President Biden's green fiscal subsidy package appears to be filtering through to the economy, supporting investment (investment partly propped up US GDP growth in Q2, as consumption slowed). There is also an increasing chance of US inventory restocking after a sharp decline over the past year.

Technicals, liquidity support: Technical factors are less of a headwind for the risk asset rally. Our Fear & Greed indicator shows scope for further near-term upside after this week's wobble. Our investor diversity indicator no longer points to crowded positions in US equities, including in the Technology sector. Meanwhile, plenty of cash at institutional investors could potentially sustain this year's Artificial Intelligence-themed (AI), followed by Fear of Missing Out (FOMO), rally in the near term.

Investment implications: The contrasting drivers argue for maintaining a broadly diversified asset allocation. Within this, we see an opportunity to average into Developed Market government bonds to lock in the higher yields on offer. The bonds are also likely to hedge against an expected slowdown in economic activity over the next 6-12 months as two-decade-high policy rates start to bite. There is also scope to add to Asian assets, which stand to benefit from any rotation out of relatively expensive US markets. China equities are attractively valued. Data surprises are at a rock bottom, lowering the bar for upside surprises, especially if Beijing cranks up stimulus. China's consumer discretionary and communication services sectors are likely to benefit from policies to boost consumption. We also prefer Japan equities amid earnings lift to exporters from a weak JPY and improving corporate governance.

— 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

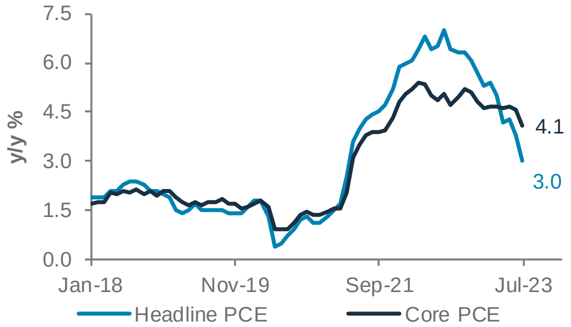
(+) factors: Disinflation in US and Euro area, supportive China policies

(-) factors: Weak China, US PMI, US rating cut, tighter lending standards

	Positive for risk assets	Negative for risk assets
Macro data	• US headline PCE inflation rose 3.0% y/y as expected; core PCE rose less than expected, by 4.1% y/y • US employment cost index rose less than expected • US private payrolls (ADP) rose more than expected • Euro area consumer inflation slowed to 5.3% y/y as expected; producer prices fell more than expected • Euro area's economy expanded more than expected by 0.3% q/q in Q2 • China manufacturing PMI improved to 49.3 unexpectedly; Caixin services rose to 54.1 unexpectedly	• US ISM manufacturing rose less than expected to 46.4; ISM services fell more than expected to 52.7 • US job openings fell more than expected • Fed Q2 senior loan officers' survey reflected tighter lending standards • China non-manufacturing PMI fell more than expected to 51.5; Caixin manufacturing PMI fell more than expected to 49.2 • China home sales fell 33% y/y in July
	Our assessment: Neutral – Disinflation in the US and Euro area, resilient Euro area economy vs weak US ISM PMIs, China PMIs, and tighter US lending standards	
Policy developments	• China's cabinet urged cities to roll out policies to support the property sector	• Fed's Goolsbee said he needs more inflation cooling before ending rate hikes • BoJ marginally tightened its monetary policy by effectively widening the target band in which it seeks to contain Japan's 10-year bond yield • BoE hiked rate by 25bps to 5.25% as expected
	Our assessment: Neutral – China's supportive policies vs hawkish Developed Markets central banks	
Other developments		• Fitch downgraded US credit rating by one notch to AA+
	Our assessment: Negative – US credit rating cut	

US inflation continued to cool, but we expect the Fed to hold rates this year until core inflation shows sustained decline towards its 2% target

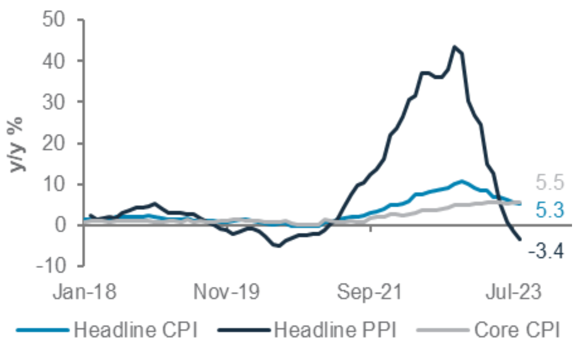
US headline and core PCE inflation*



Source: Bloomberg; Standard Chartered; *Personal consumption expenditure deflator

Euro area inflation extended its downtrend, aided by falling energy costs, but core inflation remains well above the ECB's comfort zone and 2% target

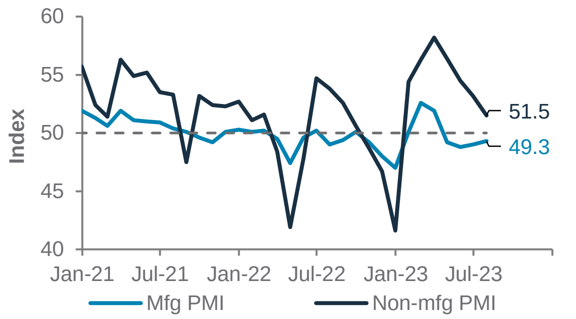
Euro area headline and core consumer inflation and producer price inflation



Source: Bloomberg, Standard Chartered

China's manufacturing contraction eased in July, but service sector business confidence softened more than expected

China's manufacturing and non-manufacturing PMI



Source: Bloomberg, Standard Chartered

Top client questions

How does the US credit ratings downgrade affect your view on US Treasury yields, equities and the USD?

US government bond yields surged this week after strong employment data, a larger-than-expected government bond supply pipeline and Fitch's sovereign ratings downgrade. Out of these three recent events, we view the ratings downgrade to have imposed the smallest long-term impact on bond yields.

Historically, when AAA-rated Developed Market (DM) sovereign bonds were downgraded, the associated sell-off usually lasted no more than a week. We believe the current episode will be no exception and investor focus would soon revert to economic factors. In addition, we note Fitch affirmed the US "Country Ceiling" at "AAA". This is key because it allows other AAA-rated US securities, such as bonds of municipal governments or government-sponsored entities, to retain their AAA ratings without being automatically downgraded (aside of issuer-specific downgrades). Finally, we remain confident that the statutory role of US government bonds and the USD in the global financial market will stay largely unchanged.

Hence, we believe the recent spike in US government bond yield is driven to a larger extent by (i) a Treasury refunding plan that seemed to have caught the market by surprise, and (ii) strong private sector (ADP) employment data. The US 10-year government bond yield broke the 4.06% resistance and closed at 4.17% on Thursday. Technical charts suggest next resistance level at 4.24%. While short-term pressure on yields is skewed to the upside, we believe current levels are attractive to add exposure, as further tightening in US financial conditions is likely to impact economic growth. We expect the 10-year yield to fall to 3-3.25% in the next 12 months.

For US equities, the downgrade has provided a catalyst for a mild pullback. Having said that, we do not expect US equities to experience the dramatic drop following the Aug 2011 downgrade by S&P – today, inflation is much higher and growth much stronger.

More broadly, this downgrade may prompt investors to consider rotating to other regions, such as China, where equities are trading at 35% discount to global equities. The Chinese economic surprise indicator is at its lowest level in five years, excluding H1 20 when COVID-19 broke out globally; and government policy support continues to rise.

The US sovereign rating downgrade had a limited impact on the USD. The currency edged higher amid risk-off sentiment. However, we are modestly bearish on the USD in the near term given the recent move higher. We see 103.4 as the next resistance, with 102.3 being a key support.

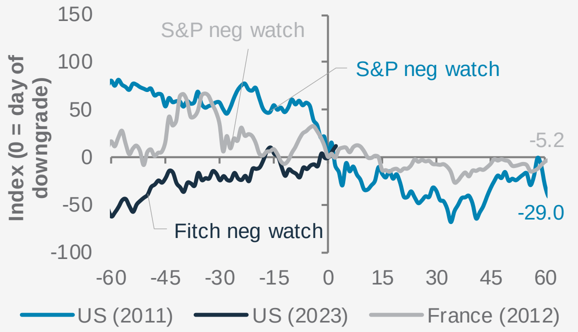
— **Cedric Lam,** *Senior Investment Strategist*

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

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

Historically, a sell-off in DM sovereign bonds after a credit rating downgrade has not lasted for long

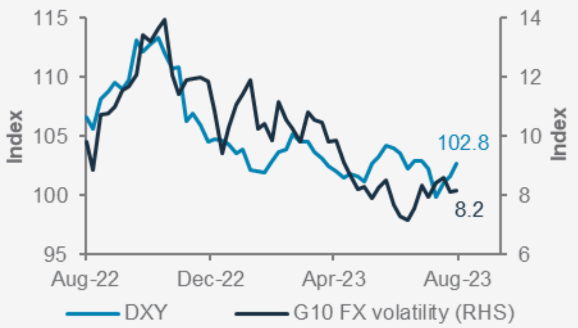
US and France 10Y government bond yield changes; 0 denotes the day of the rating downgrade



Source: Bloomberg, Standard Chartered

The US sovereign rating downgrade has had limited impact on the USD; we remain modestly bearish on the USD in the near term

USD (DXY) index vs. G10 FX volatility



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

How will the BoJ policy shift impact the JPY and Japan equities?

Last week, the BoJ announced a policy shift to allow Japan's benchmark 10-year bond yield to rise beyond 0.5%. In recent days, it also followed up with unscheduled bond purchases to manage the pace of rise in bond yields. This comes against Japan's largest-ever minimum wage hike. While the hike was still lower than those seen in other developed economies, a continued move towards higher inflation and greater policy normalisation are likely to be positive for the JPY. We expect USD/JPY to maintain a bearish bias over the next 2-4 weeks, with key support levels at 140.9, followed by 137.30.

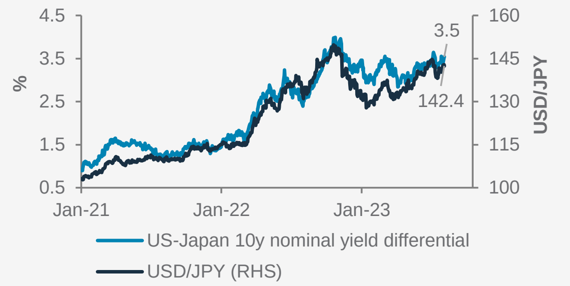
For Japanese equities, expectations of rising interest rates could be a valuation headwind, especially for long-duration "Growth" sectors. However, the largest sector in MSCI Japan index is Industrials (c.23% of the index), which is why Japan is typically seen as a cyclically exposed market. We also expect any increase in Japan's rates to start from a very low base, likely occur at a moderate pace and be accompanied by some inflation and nominal growth. We believe this potential shift away from a 'no-growth regime', along with exposure to improving growth in China, would be positive for Japan equities. Rising rates would also benefit the banks' interest income. Therefore, we do not expect the BoJ policy shift to have a material effect on Japan equities. Our Overweight rationale for Japan, based on improving corporate governance, remains unchanged.

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

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

Japan's gradual policy normalisation and rising bond yields are likely to be positive for the JPY

US vs Japan 10-year bond yield differential, USD/JPY



Source: Bloomberg, Standard Chartered

Is it time to fade the rally in DM High Yield bonds?

Developed Markets (DM) High Yield (HY) corporate bond yield premiums over Treasuries (ie, the 'spread') have recently tightened:

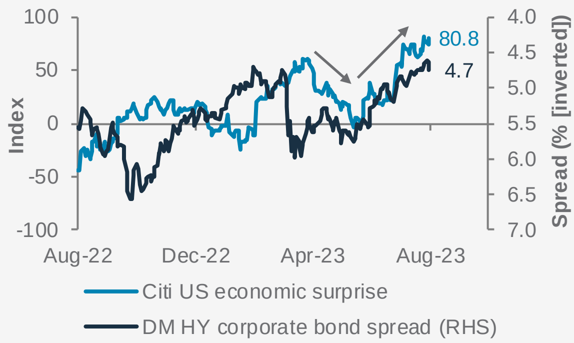
1) The HY corporate bond spread tends to move in lockstep with economic growth, where US growth has been resilient.
2) US Q2 earnings have beaten expectations so far (see page 6).
3) Credit metrics are deteriorating, but from a high starting point. For example, the net-debt-to-EBITDA ratio for DM HY issuers rose in the last two quarters, but remains well below its Covid peak.
4) Many companies frontloaded borrowing prior to the start of the central bank rate hiking cycle, cushioning the impact of hikes.

Data suggests US recession risk is likely delayed, but not averted. This, in turn, poses a risk to corporate earnings, risk sentiment and, therefore, DM HY corporate bond spreads. Moreover, this comes against a relatively expensive valuation starting point. Thus, while gains could extend in the very short term, we remain Underweight DM HY corporate bonds on a 6-12-month horizon and believe investors should use the recent rally to trim exposure.

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

Risk-on sentiment, on the back of positive economic surprises, typically leads to narrowing HY bond yield premiums

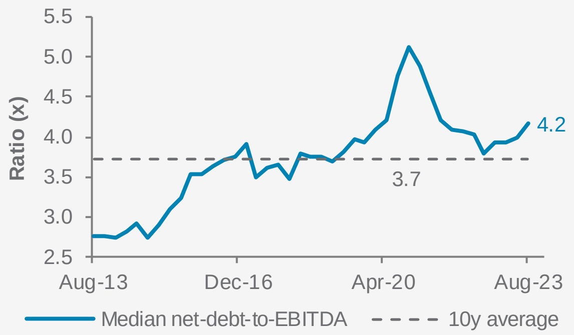
Citi US economic surprise vs. DM HY corporate bond yield premium over US government bonds



Source: Bloomberg, Standard Chartered

DM HY net-debt-to-EBITDA ratio is creeping up but remains well below its Covid peak

Median Net-Debt-to-EBITDA of Bloomberg Global HY corporate bond index



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What are your thoughts on the Q2 23 US earning season?

Almost two-thirds of the companies in the S&P500 index have already released their earnings. Overall figures have been positive – 80% of reported companies announced better-than-expected earnings, with earnings and revenue surprises at 7% and 1.7%, respectively. In particular, the US technology sector – one of our key Overweight sectors – was among the leaders in earnings surprises.

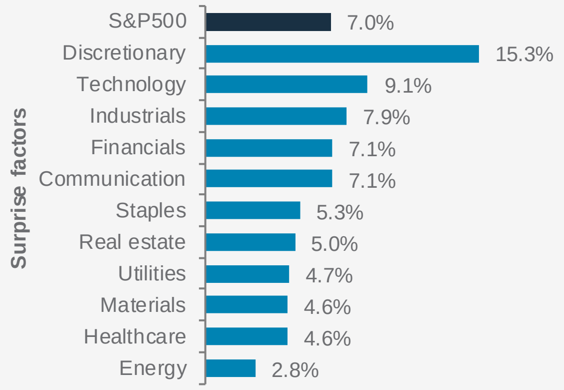
That said, we believe the earnings beat is, to a large extent, due to a low base in expectations. Cooling US leading indicators and aggressive interest rate hikes are headwinds for US equities over a 6-12-month horizon. Overall, Q2 earnings expectations remain in contraction at -5.4%. Earnings growth in 2023 was also revised lower m/m, while expectations of a potential ending of Fed rate hike next year drove 2024 earnings growth expectations higher to 12.3% in Aug (vs 11.7% on 1 Jul).

Going forward, we continue to prefer a barbell strategy in US sectors – the US Technology and Communication services sectors for their strong earnings and AI-related frenzy, and the US Healthcare sector as a defensive exposure to hedge against elevated US recession risk over a 6-12 month horizon.

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

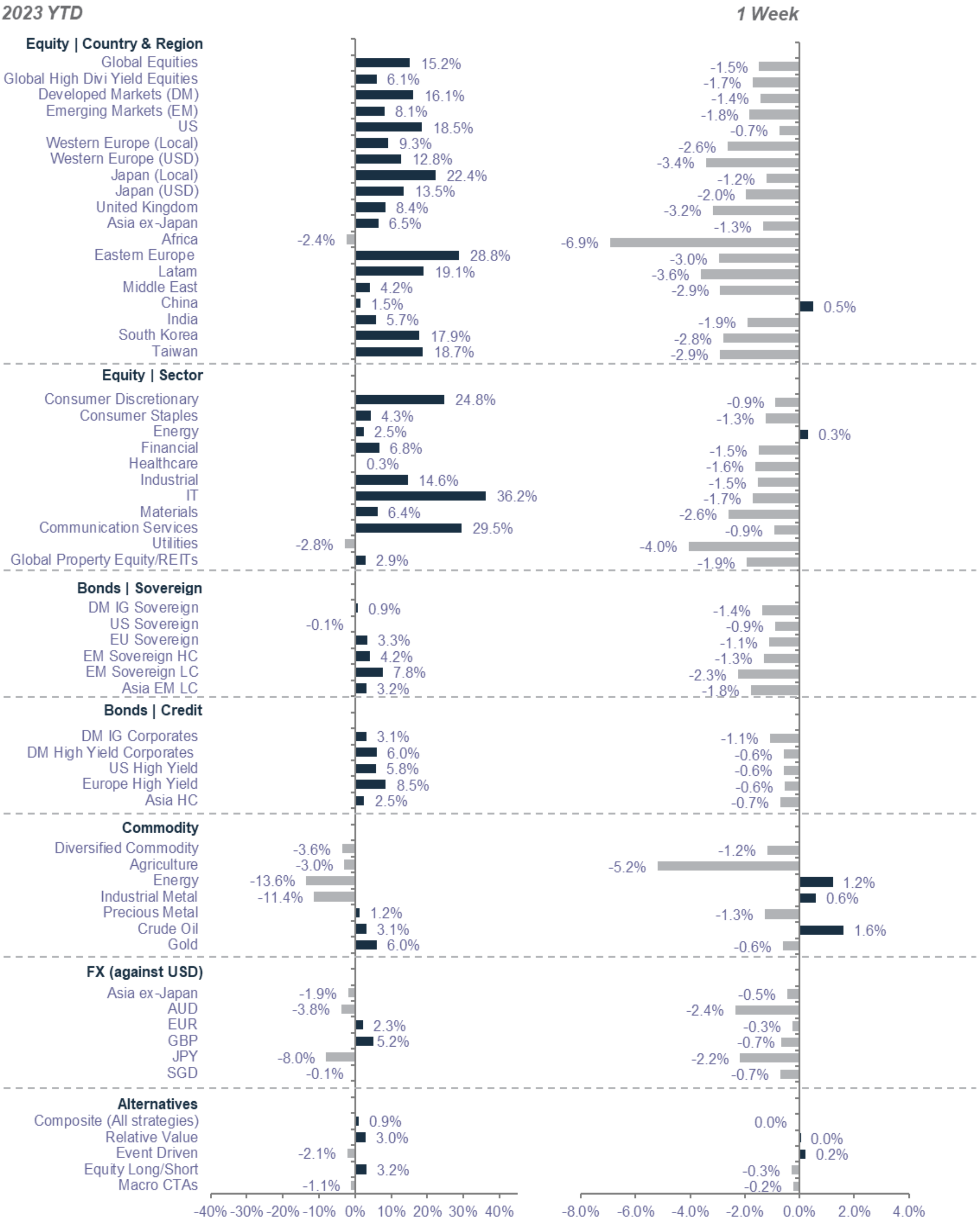
US Q2 earnings surprise has been positive across sectors, but particularly for the Consumer Discretionary and Technology sectors

US earnings surprise by sectors



Source: Refinitiv, 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 03 August 2023; 1-week period: 27 July 2023 to 03 August 2023; Alternatives data is until 02 August 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	EC	Sentix Investor Confidence	Aug	–	-22.5
TUE	US	NFIB Small Business Optimism	Jul	–	91.0
	CH	Exports y/y	Jul	–	-12.4%
	EC	ECB Consumer Expectations Survey	Jul		
WED	CH	CPI y/y	Jul	–	0.0%
	CH	PPI y/y	Jul	–	-5.4%
	CH	New Yuan Loans CNY	Jul	–	3050b
	CH	Money Supply M2 y/y	Jul	–	11.3%
THU	US	CPI y/y	Jul	3.2%	3.0%
	US	CPI Ex Food & Energy y/y	Jul	4.8%	4.8%
FRI/SAT	UK	Industrial Production y/y	Jun	–	-2.3%
	UK	GDP q/q	2Q P	–	0.1%
	US	PPI Final Demand y/y	Jul	–	0.1%
	US	PPI Ex Food & Energy y/y	Jul	–	2.4%
	US	U. of Mich. Sentiment	Aug P	–	71.6

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 support for the S&P500 index is at 4,473

Technical indicators for key markets as of 03 August close

Index	Spot	1st support	1st resistance
S&P 500	4,502	4,473	4,560
STOXX 50	4,305	4,249	4,416
FTSE 100	7,529	7,472	7,643
TOPIX	2,268	2,245	2,314
Shanghai Comp	3,280	3,264	3,294
Hang Seng	19,421	19,202	19,860
MSCI Asia ex-Japan	649	643	661
MSCI EM	1,016	1,005	1,037
Brent (ICE)	85.1	83.7	86.1
Gold	1,934	1,924	1,955
UST 10Y Yield	4.18	4.03	4.25

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 is less crowded in Global & US equities

Our proprietary market diversity indicators as of 03 August

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.48
Global Equities	◐	→	1.37
Gold	◐	↓	1.42
Equity			
MSCI US	◐	→	1.28
MSCI Europe	●	↑	1.77
MSCI AC AXJ	●	→	1.59
Fixed Income			
DM Corp Bond	●	↑	1.67
DM High Yield	●	→	1.52
EM USD	●	→	1.54
EM Local	●	→	1.51
Asia USD	●	↑	1.92
Currencies			
EUR/USD	●	↑	1.77

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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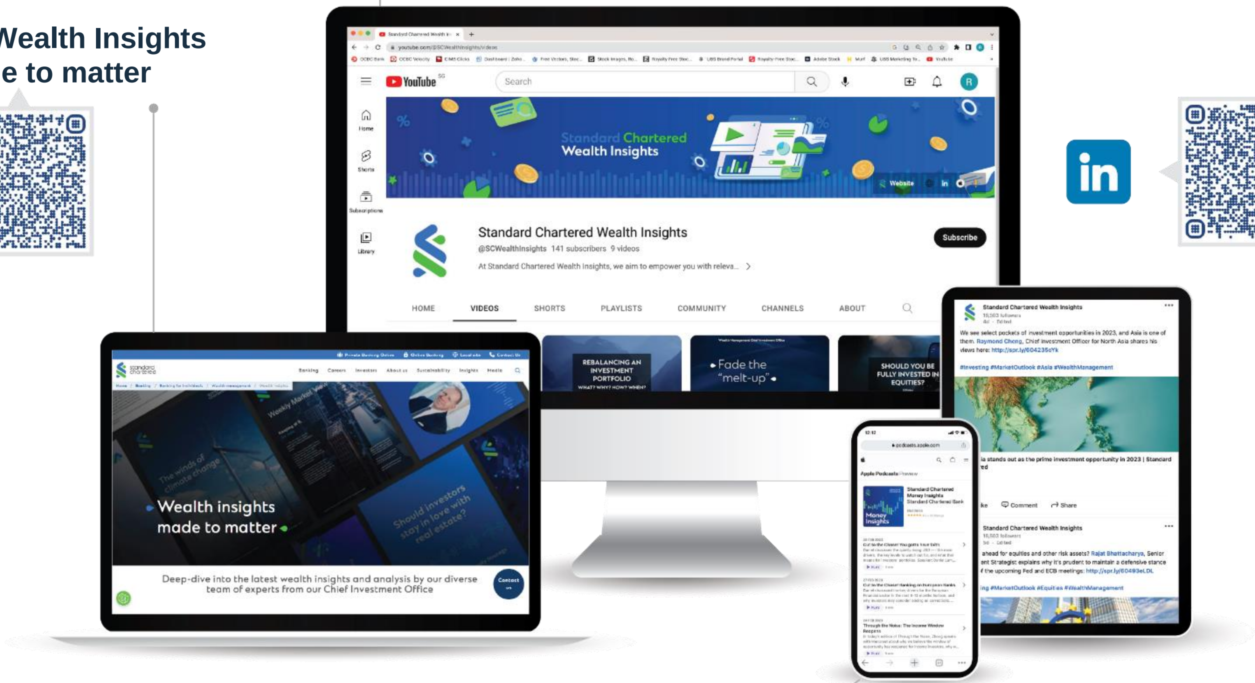

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