Wealth Management Chief Investment Office
9 June 2023

Weekly Market View

What could sustain the risk-on rally?

- Risk assets have cheered the end of the US debt ceiling drama, turning their focus to seemingly resilient Developed Market growth, hopes of new policy stimulus in China and an Artificial Intelligence (AI)-driven ‘mania’.

- While the narrow AI-led rally could last longer, we remain sceptical about the sustainability of the broader market rally, given leading indicators are still pointing towards a US recession.

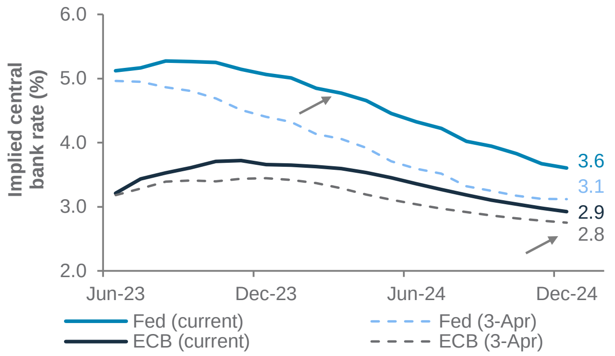
- Meanwhile, US markets are likely to see a USD 1-1.5trn liquidity squeeze in the coming months as the government replenishes its cash reserves post the suspension of the debt ceiling.

- In this report, we assess three potential drivers for a risk asset rally and explain why we do not expect them to last over the next 12 months.

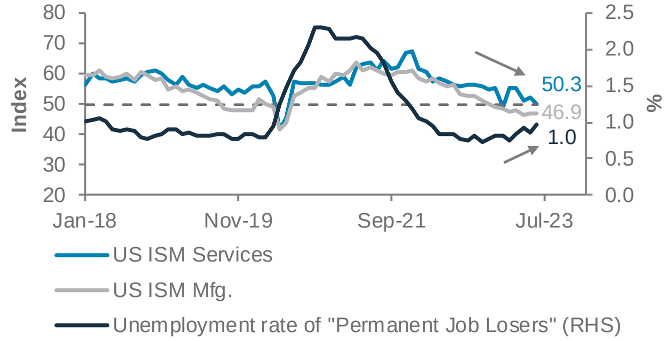
Charts of the week: Hawkish central banks, despite slowing growth

Markets are expecting higher-for-longer Fed and ECB rates due to still-elevated inflation even as economic activity slows

Money market expectations of Fed and ECB rates



US ISM Manufacturing, Services PMIs; permanent job losers*



Source: Bloomberg, Standard Chartered; *percentage of unemployed whose employment ended involuntarily and are not on temporary layoff

Editorial

What could sustain the risk-on rally?

Risk assets have cheered the end of the US debt ceiling drama, turning their focus to seemingly resilient Developed Market growth and hopes of new policy stimulus in China. The S&P500 index, after several false bear market rallies, has broken above key resistance. Are we in for a sustained bull market?

While the narrow Artificial Intelligence (AI)-related technology sector 'mania' – seen in the outperformance of the market-weighted vs. the equal-weighted S&P500 index – could last longer (how does one estimate how long a 'mania' will last!), we remain sceptical about the sustainability of the broader market rally, given leading indicators are still pointing towards a US recession. If anything, the past week's weaker-than-expected ISM Services PMI data suggests the main driver of the ongoing US expansion is deteriorating. The unexpected jump in the US jobless rate to 3.7% in May adds another potential red flag to our US recession checklist. Meanwhile, US markets are likely to see a USD 1-1.5trn liquidity squeeze in the coming months as the government replenishes its coffers post the debt ceiling suspension. Also, data this week showed the Euro area entered a technical recession in Q1. Against this weak backdrop, we assess three potential drivers for a risk rally and explain why we do not expect them to last over the next 12 months:

Immaculate disinflation: There is a very narrow window for this scenario to play out. It involves a rapid decline in DM inflation towards central bank targets this year, without a sharp rise in jobless rates. Elevated core inflation across DMs (see chart on page 3) amid still-tight job markets suggests inflation is unlikely to fall to target without a much weaker job market. Leading indicators of the US job market, including the falling rate at which workers are quitting and the rise in permanent job losers (see chart), are pointing to a deteriorating US job market.

Central banks easing up on their inflation fight: Any sign that central banks are tolerating above-target inflation would be bullish for stocks and negative for bonds. As of now, we see no such signals from the central banks. If anything, recent weeks have seen the reverse playing out: US rate cut expectations have been pared back since March, with markets now pricing in another 25bps rate hike by July. The ECB is signalling higher rates to fight inflation, even as economic activity deteriorates (we expect the Fed and ECB to reiterate higher-for-longer rates next week). The RBA and BoC surprised markets this week with rate hikes, with talk of more to come, amid resilient core inflation and labour markets. While our base case is that of a pause in Fed rates until Q4, there is a rising risk of higher rates if US and Euro area recession expectations are pushed back into 2024. Higher DM rates would challenge the rally in risk assets.

AI-driven, capex-led expansion: This is the new narrative for bulls, reminiscent of the internet "mania" of the late 1990s. The hope is that the so-called AI revolution will trigger large-scale corporate spending on technology, transforming productivity. This in turn is expected to prolong the economic cycle. Like the internet revolution, the transformative potential of AI cannot be ignored. However, like the internet, it is likely to take years for firms to monetise AI's benefits. Meanwhile, the narrow AI-led equity rally (driven mainly by a few tech-sector leaders) faces stretched valuations and positioning. The lessons from the dot-com bubble also suggest it is hard to pick the winners in any "Mania". Several supposed internet leaders collapsed once the internet bubble burst. Hence, prudence dictates position-sizing any exposure to this sector according to one's risk appetite.

Investment implications: The AI mania could well last for a while. However, the challenging fundamental backdrop means we remain reluctant to chase the narrowly supported frenzy in some risk assets and instead rebalance into more defensive assets such as DM government bonds, within a diversified foundation allocation. Asia USD bonds and Japanese stocks are among our other top picks (see pages 4-5).

— **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

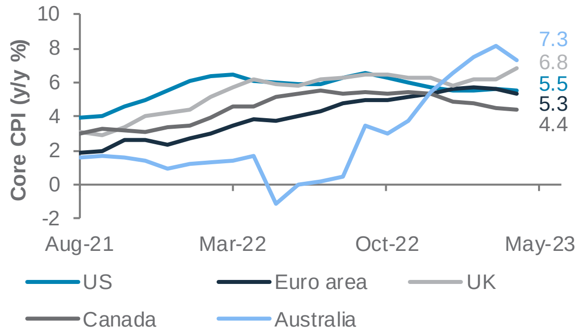
(+) factors: US debt ceiling suspended, supportive China policies

(-) factors: Weak US services, Euro area investor confidence, China exports, still-rising Developed Market rates

	Positive for risk assets	Negative for risk assets
Macro data	• US added more-than-expected jobs (339,000); however, unemployment rate rose more than expected to 3.7%; wage growth and number of hours worked eased • China Caixin services PMI improved unexpectedly to 57.1 • China's imports contracted less than expected (-4.5%) • China consumer inflation rose 0.2% y/y as expected; producer prices slumped 4.6% y/y	• US ISM services fell unexpectedly to 50.3; all four components deteriorated; S&P US services PMI revised lower in final reading • US initial jobless claims rose more than expected • Euro area Sentix investor confidence fell more than expected to -17.0 • Euro area retail sales were flat m/m, below expectations • China exports fell unexpectedly by -7.5%
	Our assessment: Neutral – Robust US job creation, strong China services vs rising US jobless rate and weaker services, weak Euro area investor confidence, contracting China exports	
Policy developments	• China authorities are reportedly considering another property sector support package • The PBoC asked large banks to lower deposit rates	• RBA delivered yet another surprise rate hike of 25bps and signalled more ahead • BoC hiked rates unexpectedly by 25bps • China Communist Party Politburo meeting skipped post-meeting statement in May, the third month of missing readouts
	Our assessment: Neutral – Supportive China policies vs surprise rate hikes in Australia, Canada	
Other developments	• US President Biden signed the bill to suspend debt ceiling, averting a default • US Secretary of State Blinken plans to visit Beijing in the coming weeks	• Saudi Arabia announced voluntary cut of 1mb/d, while OPEC+ stayed put • China and US dispute over the interceptions of US ship and surveillance aircrafts
	Our assessment: Neutral – US debt default risk fades vs surprise Saudi oil output cut to prop oil prices	

Core inflation, while mostly having peaked, remains elevated across Developed Markets, forcing central banks to stay hawkish

Core consumer inflation in key Developed Markets



Source: Bloomberg; Standard Chartered

Euro area consumption and investor sentiment continued to deteriorate

Euro area retail sales and Sentix Investor Confidence

Source: Bloomberg, Standard Chartered

China's exports fell unexpectedly in May amid falling goods demand from key trade partners

China exports and imports growth

Source: Bloomberg, Standard Chartered

Top client questions

What can we learn from the decline in volatility (the VIX Index) for US equities?

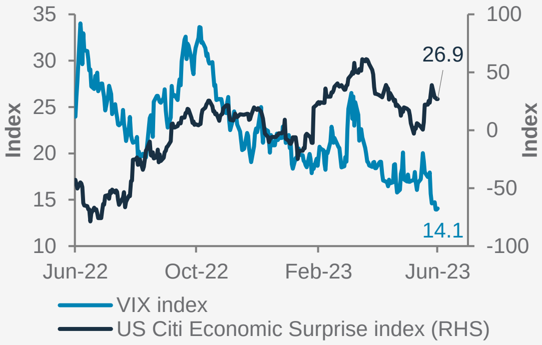
The VIX index, an indicator designed to produce a measure of constant, 30-day expected volatility of the US stock market, is firmly back at the pre-pandemic levels. This comes against the backdrop of US economic data that is slowing, but at a measured pace, and company earnings that have been beating expectations. Supportive fiscal and monetary policies through 2020 and 2021 helped US companies' profitability and many used the opportunity to lock-in low borrowing costs by extending the duration of their debt. This has helped the companies mitigate the impact of surging benchmark interest rates as the Fed hiked rates since early 2022.

Low market volatility could lead to more equity-buying from a section of institutional investors (CTAs) and volatility-targeting funds, supporting US equities over the very short-term (1-month horizon). Having said that, the VIX index was near similarly low levels prior to previous bear markets as well. Were there to be a change in narrative (an underperformance of US economic data relative to expectations, for example), a low VIX Index would not stand in the way of renewed downward pressure on US equities.

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

VIX has been falling as US economic data surprises on the upside

VIX index vs. US Economic Surprise Index*



Source: Bloomberg, Standard Chartered
* The index rises as economic data surprises above expectations

Is it too late buy Japanese equities?

The strong rebound in Japan equities YTD and the influx of foreign fund inflows have raised questions over the sustainability of the recent rally. We are, however, more constructive and believe the region is still likely to outperform global equities over the next 6-12 months from here.

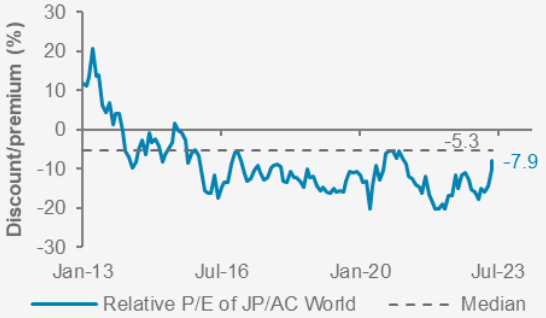
The rise in Japanese equities does not appear stretched. Our short-term market diversity indicator is not flashing warning signs. The relative strength index, a technical indicator of price momentum, remains far from the overbought territory. Index technicals argue that any pullback in the TOPIX index to the 'gap zone' between 2,183 and 2,206, or to stronger support below at 2,128, would offer opportunities to add.

From a fundamental perspective, we expect strengthening corporate governance and strong buybacks to support ROE, offsetting the negative impact from any strengthening of the JPY expected over the next 12 months. Valuations remained attractive, with 12-month forward P/E multiple of the MSCI Japan index still trading at an 8% discount to global equities, below its long-term median of a 5% discount.

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

Japan equities continue to trade at a valuation discount to global equities

Relative 12m forward P/E multiple of the MSCI Japan index vs MSCI ACWI index; median is based on the ratio since Jan 2007



Source: FactSet, Standard Chartered

Top client questions (cont'd)

What are the implications of the recent China supportive measures on Asia USD bonds?

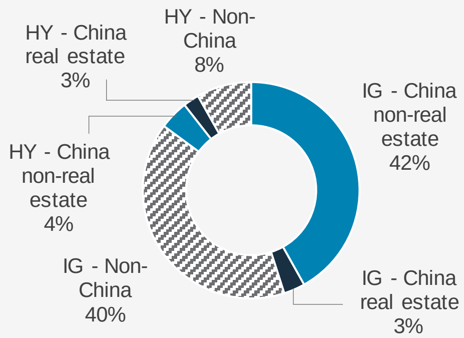
This week, we saw revived optimism that Chinese policymakers are likely to unveil further measures to revive the faltering economic recovery. First, the PBoC asked big banks to lower deposit rates, which could be a precursor to a policy rate cut. Second, there were reports of policymakers considering another property support package. Both are positive for Asia USD bonds, especially given that Chinese issuers constitute about c.52% of the index and many ASEAN corporate revenues are likely sensitive to growth in China.

Having said that, we would also reiterate our preference for Asia Investment Grade (IG) bonds over High Yield (HY). The initial details of the property support package suggest it is likely to be just an extension of the 16-point package enacted late last year. Measures to ease payments and provide subsidies are unlikely to be sufficient to significantly reinvigorate the relatively weak appetite for property purchases. This, together with a likely slowing of global growth, means we see a much more attractive risk/reward in higher-quality IG bonds and a much poorer outlook for riskier HY bonds.

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

Chinese issuers constitute more than half of the Asia USD bond index, of which only a small percentage are real estate issuers

Breakdown of JP Morgan Asia Credit Index (JACI)



Source: Bloomberg, Standard Chartered

Do you expect the surprise RBA and BoC rate hikes to boost the AUD and CAD?

Over the past week, both the Reserve Bank of Australia (RBA) and Bank of Canada (BoC) surprised markets by unexpectedly hiking rates by 25bps each. This was RBA's second consecutive surprise rate hike (following a similar action in May 2023) as the recent 5.75% increase in minimum wages complicates its fight against the already sticky inflation. The surprise hike helped the AUD extend its rally since it bottomed out in late May. However, we see elevated odds of near-term consolidation in the AUD/USD, with resistances at 0.6690, followed by 0.6765.

In Canada, strong GDP data, a tight labour market and stalling disinflationary pressures meant that BoC had several reasons to hike rates and keep the door open for future rate hikes. The latest move brings the benchmark rate in Canada to the highest level since 2001. While higher oil prices and near-term hawkish sentiment can push USD/CAD towards 1.3260 support, we would look for opportunities to go long USD/CAD given the pair's move is starting to look overstretched on technical indicators.

At a broader level, the surprise hikes by central banks, which had earlier signalled a pause, highlight persistent inflationary pressures. The focus now shifts to the US Fed's meeting next week, where our base case is for a Fed pause. However, a hawkish surprise may push the USD index (DXY) above 104.70, while there is a risk EUR/USD could decline towards 1.05.

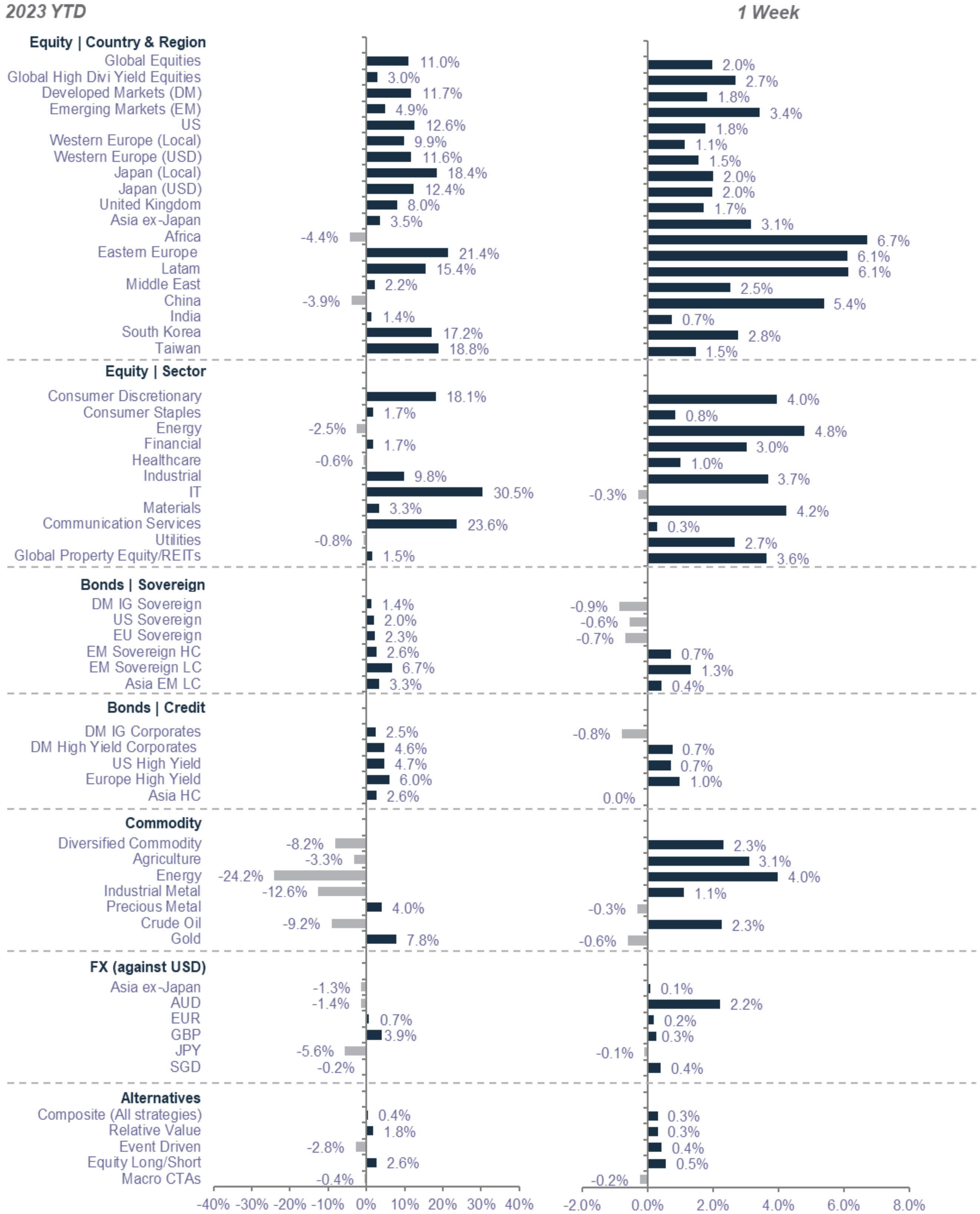
— **Abhilash Narayan,** *Senior Investment Strategist*

Any decline in USD/CAD towards the 1.3260 support due to the hawkish RBC tilt and higher oil prices may be an opportunity to go long USD/CAD

USD/CAD and key technical levels

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 08 June 2023; 1-week period: 01 June 2023 to 08 June 2023

Our 12-month asset class views at a glance

Asset class			
Equities	▼	**Preferred Sectors**	
Euro area	◆	US Healthcare	▲
US	▼	US Staples	▲
UK	▼	US Communications	▲
Asia ex-Japan	▲	Europe Healthcare	▲
Japan	▲	China Discretionary	▲
Other EM	◆	China Comm. Services	▲
Bonds (Credit)	◆	**Alternatives**	◆
Asia USD	▲		
Corp DM HY	▼	**Gold**	▲
Govt EM USD	◆		
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					
TUE	UK	ILO Unemployment Rate 3Mths	Apr	–	3.9%
	EC	ZEW Survey Expectations	Jun	–	-9.4
	US	CPI y/y	May	4.2%	4.9%
	US	CPI Ex Food and Energy y/y	May	5.2%	5.5%
WED	UK	Manufacturing Production y/y	Apr	–	-1.3%
	US	PPI Final Demand y/y	May	1.5%	2.3%
	US	PPI Ex Food & Energy y/y	May	2.9%	3.2%
THU	US	FOMC Rate Decision (Upper Bound)	14-Jun-23	5.3%	5.3%
	CH	Industrial Production y/y	May	3.8%	5.6%
	CH	Retail Sales y/y	May	13.9%	18.4%
	CH	Fixed Assets Ex Rural YTD y/y	May	4.4%	4.7%
	EC	ECB Deposit Facility Rate	15-Jun-23	–	3.3%
	US	Retail Sales Ex Auto & Gas	May	0.3%	0.6%
	US	Industrial Production m/m	May	0.1%	0.5%
FRI/SAT	US	U. of Mich. Sentiment	Jun P	60.0	59.2
	JP	BoJ Rate Decision	Jun	-0.1%	-0.1%

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 US S&P500 index's next resistance is at 4,303

Technical indicators for key markets as of 08 June close

Index	Spot	1st support	1st resistance
S&P 500	4,294	4,276	4,303
STOXX 50	4,298	4,285	4,317
FTSE 100	7,600	7,590	7,619
Nikkei 225	31,641	31,275	32,257
Shanghai Comp	3,214	3,195	3,232
Hang Seng	19,299	19,066	19,416
MSCI Asia ex-Japan	637	633	638
MSCI EM	994	987	998
WTI (Spot)	75.4	74.9	76.4
Gold	1,965	1,948	1,973
UST 10y Yield	3.73	3.66	3.80

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 08 June

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	→	1.57
Global Equities	◐	→	1.48
Gold	◐	→	1.45
Equity			
MSCI US	◐	→	1.43
MSCI Europe	●	↑	1.80
MSCI AC AXJ	●	→	1.96
Fixed Income			
DM Corp Bond	●	→	1.58
DM High Yield	●	↓	1.63
EM USD	●	↓	1.58
EM Local	◐	↓	1.32
Asia USD	●	↑	1.75
Currencies			
EUR/USD	●	↑	1.68

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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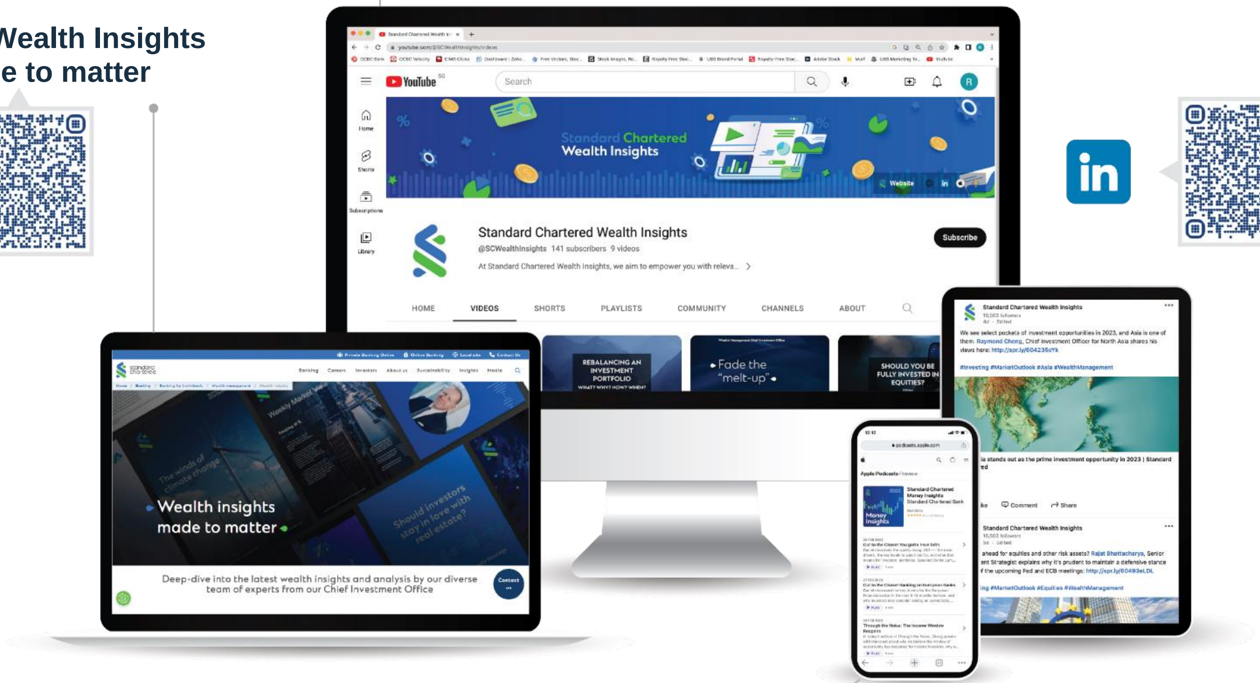

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