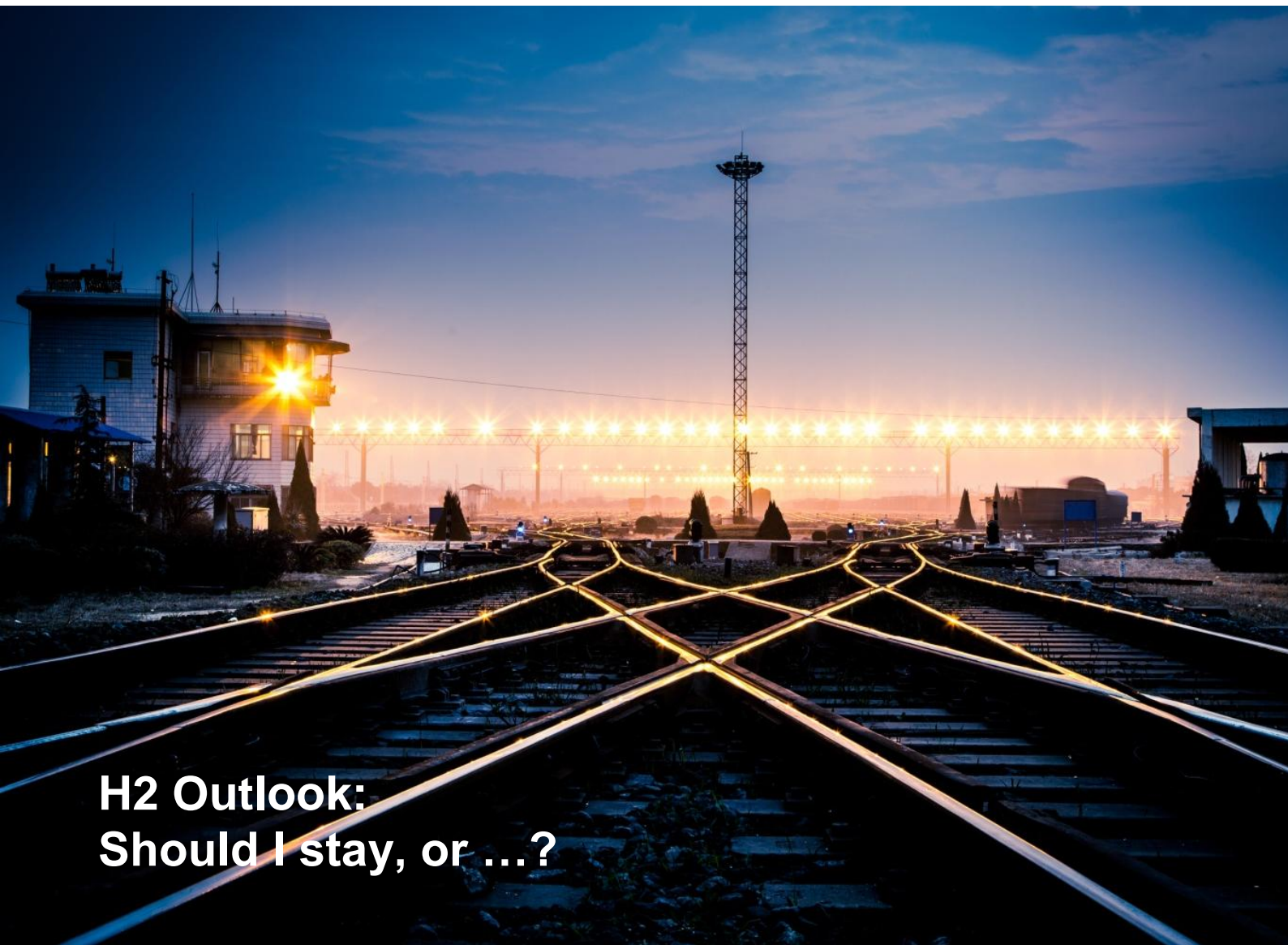


Global Market Outlook



H2 Outlook: Should I stay, or ...?

Our preference for equities remains intact amid strengthening growth and lower-than-expected inflation.

The Euro area and Asia ex-Japan are our preferred regions, given upward revisions to earnings expectations and, for the latter, our view that the USD will not strengthen significantly.

Multi-asset income strategies should remain well supported in either 'reflation' or 'middle-through' scenarios. Strategies with an allocation to growth assets should outperform in the event of a renewed tilt towards reflation, while equities should do well in both scenarios.

We raise allocations to bonds to neutral, with a relative preference for Emerging Market (EM) bonds. EM USD government and EM local currency bonds are now our preferred bond asset classes, given our view that US Treasury yields are likely to rise only gradually, while significant USD strength is likely behind us.

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Investment strategy

IMPLICATIONS FOR INVESTORS

01 Global equities remain our preferred asset class

02 We prefer Euro area and Asia ex-Japan equities and EM USD government and EM local currency bonds within their respective asset classes

03 Balanced strategies offer most attractive risk/reward, in our view, but multi-asset income should remain well supported

Should I stay, or ...?

- Our preference for equities remains intact amid strengthening growth and lower-than-expected inflation. The Euro area and Asia ex-Japan are our preferred regions, given upward revisions to earnings expectations and, for the latter, our view that the USD will not strengthen significantly.
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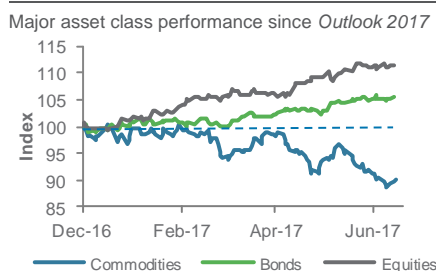
On course for reflation or back to muddle-through?

Financial markets have delivered an exceptionally strong 2017 first half. Since our *Outlook 2017*, global equities have returned over 10%, led by EMs, while global bonds have delivered over 5%. Strong earnings growth, reduced political risks in Europe, a weaker USD and lower US Treasury yields all likely contributed.

We believe inflation trends remain central to the H2 2017 market outlook. A continued move towards reflation (ie, stronger growth with modestly higher inflation) remains one of our most likely economic scenarios. However, markets appear less convinced, with measures of expected inflation at lower levels from where they started 2017. A further decline in inflation would be consistent with our muddle-through scenario.

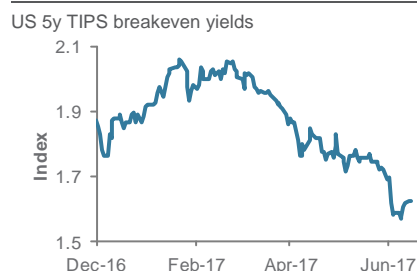
From an investment standpoint, we believe this tug-of-war between muddle-through and reflation outcomes still presents many investment opportunities. We expect equities to do well under either scenario. However, the drop in inflation expectations brightens the outlook for bonds. We also believe that selective opportunities exist to lock in profits, such as in US technology sector equities.

Figure 1: Equities, bonds had a strong H1



Source: Bloomberg, Standard Chartered

Figure 2: Inflation expectations have moderated



Source: Bloomberg, Standard Chartered

Equities stay well supported

The attractiveness of global equities remains unchanged, as does our regional preference for the Euro area and Asia ex-Japan. While markets may be undecided on the likelihood of reflation, we believe the outcome for equities will be still positive, given strong corporate earnings and upward revisions to future expectations, especially in our two preferred regions. Meanwhile, muddle-through, which means lower inflation and bond yields, is ultimately supportive of equity markets, as long as earnings do not falter dramatically.

Despite our constructive outlook, we believe it is prudent to lock in some of the strong market returns in H1 by trimming exposure selectively. This month, we take profit on our long-standing preference for the US technology sector. While we believe the sector will continue to deliver positive absolute returns, we are less certain of its ability to outperform the broader market, given its recent strong run and increasingly high valuations.

One strong challenge to our views has been the sharp fall in oil prices and the decline in related equity sectors in H1 2017. We believe the price decline may have gone too far. Anecdotal reports of falling costs in the US shale sector pose a risk, but output cuts by OPEC and Russia, combined with the still-robust EM demand, could cause prices to rebound at least modestly.

Raising bond allocations to neutral

Our greater comfort with bonds is driven both by (i) reduced concerns of a sharp surge in US Treasury yields and (ii) our rising comfort with EM government bonds. One of the biggest worries for bond investors has been the risk of a sharp yield rise. Low yields in major bond markets (especially Investment Grade (IG) bonds) mean the yield buffer against potential capital losses from a sharp rise in yields remains small. However, rising expectations that inflation (and therefore yields) is likely to remain subdued mean the risk to bonds has arguably reduced.

EM government bonds are arguably good candidates for increased bond allocations. A more range-bound USD is supportive of flows into EM assets and reduces the risk of FX

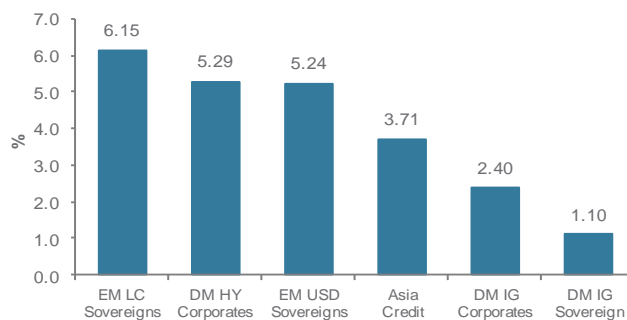
losses outweighing local currency bond gains. Valuations also look far more supportive in EM bonds relative to Developed Market (DM) bond markets. Finally, the relatively high yields on offer mean a more significant yield buffer is available, should yields eventually rise.

Thus our preference for EM USD government bonds remains unchanged from last month. Yields are attractive at just over 5.0% and the asset class remains a pocket of value relative to expensive valuations in many other bond markets.

This month, we also upgrade our view on EM local currency bond markets. We have always viewed yields here as attractive. However, our more benign USD outlook means we are less concerned about the local currency exposure of the asset class.

Figure 3: Bond yields in EMs remain attractive

Yield-to-worst across major bond asset classes
(DM IG corporates, DM IG sovereign yields as of 31 May 2017)







Source: Bloomberg, Standard Chartered

Bonds outlook supports income strategies

We maintain our conviction that multi-asset income strategies remain valid for income-oriented investors, especially amid reduced worries of a yield surge. Our increased preference for EM bonds is an additional source of support. Indeed, we believe an EM-focused allocation is increasingly valid for income-seeking investors.

More broadly, though, we continue to expect a multi-asset balanced strategy to outperform a global multi-asset income approach on a total return basis, given our view that the pivot towards reflation continues.

Figure 4: Our Tactical Asset Allocation views (12M) USD

Asset class	Sub-asset class	Relative outlook	Rationale
 Multi-Asset Strategies	Multi-asset Income	●	Low policy rates, low absolute yields expected to remain a support
	Multi-asset Macro	●	Reduced need for insurance-like assets amid continued growth
 Equities ●	Euro area	●	Earnings outlook robust; Valuations modest; Politics an ongoing risk
	Asia ex-Japan	●	Earnings uptick positive; Valuations reasonable; Trade tensions long-term risk
	US	●	Earnings expectations may be peaking; Margins and valuations are risks
	Japan	●	JPY key to earnings; Valuations reasonable, but risk of extreme move is high
	Non-Asia EM	●	Commodities key to earnings; Valuations mixed; Flows positive; Politics a risk
	UK	●	Brexit talks cloud earnings outlook; Full valuations; GBP rebound a risk
 Bonds ●	EM government (USD)	●	Attractive yield; Reasonable valuations; High interest rate sensitivity is a risk
	EM government (local currency)	●	Attractive yield; USD less of a headwind; Currency volatility is a risk
	DM High Yield corporate	●	Attractive yield; Declining default rates; Expensive valuation
	Asian corporate	●	Moderate yield; Reasonable valuations; Demand/supply favourable
	DM Investment Grade corporate	●	Moderate yield; Full valuations; Defensive characteristics
	DM government	●	Low yield; Full valuations; Fed policy, higher inflation, yield rebound are risks
 Currencies	EUR	●	Strong economic momentum likely to enable the ECB to withdraw stimulus
	USD	●	Policy divergence may be reaching its limits as the ECB prepares to taper
	GBP	●	Tug-of-war between hawkish BoE and political uncertainty
	Asia ex-Japan	●	Supported by consolidating USD and stable China growth
	AUD	●	Shrinking bond yield differential and weaker iron ore prices
	JPY	●	BoJ policy to restrict upside in Japan bond yields, while US yields rise

Source: Bloomberg, Standard Chartered

Legend: ● Likely to outperform ● Core holding ● Likely to underperform

Figure 5: Performance of key #pivot? themes since Outlook 2017

Key Asset Allocation Calls (12 months)	Date open	Absolute	Relative
Corporate Bonds to outperform Government Bonds ^[1]	15-Dec-16		✓
EM USD government bonds to outperform broader bond universe	26-May-17		✗
EM LC government bonds to outperform broader bond universe	23-Jun-17		✓
Europe ex UK to outperform global equities	24-Feb-17		✓
Asia ex-Japan to outperform global equities	30-Mar-17		✓
China to outperform Asia ex Japan equities	24-Feb-17		✗
Korea to outperform Asia ex Japan equities	23-Jun-17		✓
Key themes (Less than 12 months)	Date open	Absolute	Relative
Balanced allocation to outperform multi-asset income allocation ^[6]	15-Dec-16	NA	✓
Multi-asset income allocation to deliver positive absolute return ^[5]	15-Dec-16	✓	NA
Alternative strategies allocation to deliver positive absolute returns ^[3]	15-Dec-16	✓	NA
BRL, RUB, IDR and INR basket ^[4] to outperform EM FX Index	15-Dec-16	NA	✗
Absolute return calls (Less than 12 months)	Date open	Absolute	Relative
Bullish EUR/USD	28-Apr-17	✓	
Bullish USD/JPY	30-Jun-17	-	
Bearish AUD/USD	30-Jun-17	-	
Bullish Brent crude oil price	15-Dec-16	✗	
Bullish Euro area bank sector equities	28-Apr-17	✓	
Bullish US floating rate senior loans	15-Dec-16	✓	
Bullish Korea equities	5-May-17	✓	
Closed calls (Less than 12 months)	Date open	Absolute	Relative
US Technology to deliver positive returns and outperform US equities (as of 23-06-2017)	15-Dec-16	✓	✓
'New China' equities to deliver positive returns (as of 09-06-2017)	15-Dec-16	✓	NA
Positive USD/CNY (as of 02-06-2017)	15-Dec-16	✗	NA
DM HY Bonds to outperform broader bond universe (as of 25-05-2017)	15-Dec-16	NA	P
India to deliver positive returns and outperform Asia ex Japan equities (as of 25-05-2017)	15-Dec-16	✓	✗
Japan (FX-hedged) to deliver positive returns and outperform global equities (as of 27-04-2017)	15-Dec-16	✓	✗
US Small Cap to deliver positive returns and outperform US equities (as of 27-04-2017)	15-Dec-16	✓	✗
Indonesia to deliver positive returns and outperform Asia ex Japan equities (as of 27-04-2017)	15-Dec-16	✓	✗
US equities to deliver positive returns and outperform global equities (as of 30-03-2017)	15-Dec-16	✓	✗
Negative EUR/USD (as of 17-02-2017)	15-Dec-16	✗	NA
Positive AUD/USD (as of 17-02-2017)	15-Dec-16	✓	NA

Source: Bloomberg, Standard Chartered

Performance measured from 15 Dec 2016 (release date of our Outlook 2017) to 29 June 2017 or when the view was closed

^[1] A custom-made composite of 44% Citi WorldBIG Corp Index Currency Hedged USD and 56% Bloomberg Barclays Global High Yield Total Return Index
^[2] 'New China' index is a custom-made market-cap-weighted index of the following MSCI China industry groups: pharmaceuticals, biotech and life sciences, healthcare equipment and services, software and services, retailing, telco services and consumer services
^[3] Alternative strategies allocation is described in 'Outlook 2017: #pivot', Figure 13, page 36
^[4] A custom-made equally weighted index of BRL, RUB, IDR and INR currencies

^[5] Income allocation is as described in 'Outlook 2017: #pivot', Figure 11, page 34
^[6] Balanced allocation is a mix of 50% global equity and 50% global fixed income

✓ - Correct call; ✗ - Missed call; NA - Not Applicable

Past performance is not an indication of future performance. There is no assurance, representation or prediction given as to any results or returns that would actually be achieved in a transaction based on any historical data.

Perspectives

on key client questions



Do you still believe in the 'pivot towards reflation'?

Our 'pivot towards reflation' theme has two aspects: accelerating growth and moderately higher inflation. In our *Outlook 2017* report, we stated we were 'not convinced these shifts will be as seismic as many expect'. This has proved prescient. Global growth is still expected to accelerate this year, but inflation expectations have fallen back to 2016 levels (see Figure 6).

As we look ahead to H2, we expect inflationary pressures to rise modestly, but this would likely require commodity prices to bottom out again and/or wage pressures to accelerate. This trend would likely be reinforced if we were to see a pivot towards greater fiscal stimulus in Developed Markets.

From an investment perspective, this means we continue to expect a multi-asset income allocation to generate 4-5% yields as interest rates and bond yields are expected to rise only gradually. However, it also means that we would continue to allocate to more cyclical areas of equity markets, rather than being solely reliant on high dividend-yielding equities.

Figure 6: Growth strengthens, inflation expectations decline

How consensus estimates of 2017 global economic growth and inflation have evolved over time



Source: Bloomberg, Standard Chartered
As of 22 June 2017

Have political and geopolitical concerns peaked?

We continue to see significant risks in the coming years. In the US, the political environment remains fluid, with the president struggling to develop a constructive working relationship with Congress. In Asia, it is still unclear how competing territorial claims and North Korea's increasing belligerence will be resolved peacefully. In the Middle East, the recent embargo against Qatar highlights a more confrontational geopolitical landscape. Euro area political risks declined in H1, as we expected, although, we believe Italian polls, due by Q2 18, remain a major risk to European unity.

The good news is US President Trump has moved back from a large number of his pre-election promises on the trade front (trade has actually accelerated). Trump has notably not followed through on labelling China a currency manipulator. However, it is not clear how this calm would survive if and when the US goes into recession (not something we see as likely in the short-term). A recession would merely exacerbate the longer-term trend towards populist and nationalist sentiment.



When do you expect the next recession?

Normally there are three causes of a recession: an external shock, significant credit excesses or rising inflationary pressures. The first is clearly very difficult to forecast, but one could argue the risk an external shock could knock us into a recession is slightly higher than normal, given the above political/geopolitical landscape.

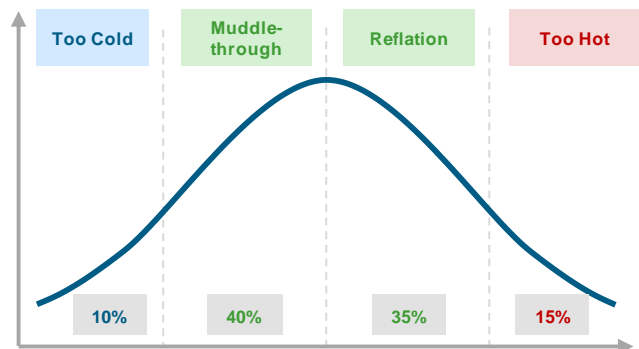
On the second, while financial asset valuations have risen broadly and significantly over the past few years, we do not believe there are generalised excesses that will induce a recession in the next 12 months.

This leads us to the risk of a sharp rise in inflation, which could encourage the Fed to prioritise fighting inflation over supporting growth, risking a recession. However, inflation expectations have fallen in recent months as oil prices have fallen and US wage pressures have failed to increase. As such, we believe the risk of the economy getting too hot has actually declined in the recent months.

Our central scenario is that the US as well as the global economy will continue to grow at a reasonable pace in the coming 12-18 months. Purely statistically speaking, at any point in time, there is a one in five chance of a recession in the next 12 months. Given the length of the recovery and the tightness in the US labour market, we believe the conditional probability is currently slightly higher.

Figure 7: Risks of overheating have likely fallen

Broad global economic scenarios and our view on their probabilities



Source: Standard Chartered Global Investment Committee

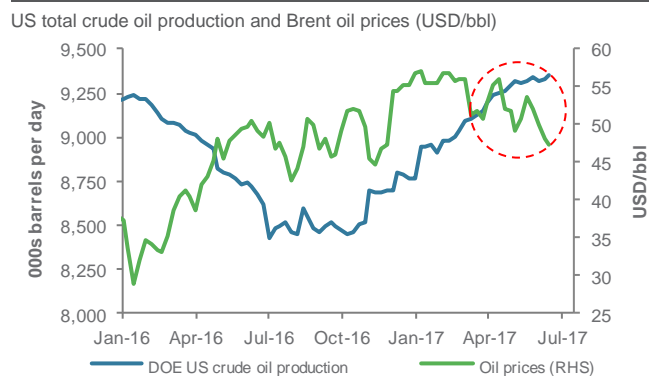
What is your outlook for oil prices?

Most of our investment views have worked well in the first half of the year (see page 6). However, the worst performing view so far has been our expectation that oil prices will rise in 2017.

We continue to believe that the excess supply situation is getting eroded and that this will ultimately push oil prices higher. For sure, US shale production has recovered faster than we anticipated and breakeven costs appear to have fallen sharply. However, oil demand continues to grow, OPEC is proving effective at constraining supply and inventories are falling.

Assuming this continues, the time is likely to come when oil prices will rebound. We are less convinced that oil prices will end the year in the USD 60-65/bbl range, but we see a 75% probability that they will close the year higher than USD 45/bbl.

Figure 8: Oil markets have been focusing on rising US production



Source: Bloomberg, Standard Chartered

Macro overview

IMPLICATIONS FOR INVESTORS

01 Global growth expectations have moderately increased due to upgrades in the Euro area and Asia

02 Inflation expectations have fallen through H1 amid lower oil prices and the absence of wage pressures

03 The Fed is likely to hike rates twice and the ECB likely to start tapering bond purchases over the next 12 months

Steady growth, slowing inflation

- **Core scenario:** We see the global economy still slowly pivoting towards moderately stronger growth, although inflation expectations have softened. Economic activity in the Euro area and Asia is holding up, offsetting moderation in the US.
- **Policy outlook:** The Fed is likely to raise rates twice over the next year, amid full employment and below-target inflation. The ECB may trim stimulus by H1 18. China is likely to sustain fiscal/credit stimulus, while tightening monetary policy.
- **Key risks:** a) Deflation surprise; b) weaker growth in Emerging Markets; c) faster-than-expected Fed rate hikes caused by an inflation surprise; d) early ECB tapering; e) geopolitical risks in the Middle East, North Asia and related to Italy's elections.

Tussle between muddle-through and reflation

Our Global Investment Committee (GIC) assigns a combined 75% probability to reflation or muddle-through scenarios unfolding over the next 12 months (page 8). However, prospects for a muddle-through scenario (40%) of moderate growth and low inflation have increased modestly in recent months amid a decline in inflation worldwide. The Euro area and Asia continue to see growth expectations revised upwards, helping offset a moderation in US activity. Inflationary or deflationary downside remains outside risks (at 15% and 10%, respectively), highlighting the tussle between tightening job markets in developed economies and lower oil prices. Geopolitics remain another source of risk.

Figure 9: Growth upside in the Euro area and Asia is helping offset moderation in the US

Region	Growth	Inflation	Benchmark rates	Fiscal deficit	Comments
US	●	●	●	●	Growth, inflation indicators have moderated from Q1 highs. Fed is likely to raise rates twice in the next 12 months
Euro area	●	●	●	●	Growth expectations remain on an uptrend, but inflation has slowed from Q1 highs. ECB could signal less stimulus later in the year
UK	●	●	●	●	Consumers squeezed by slowing wage growth and rising inflation. BoE is under pressure to raise rates as inflation rises
Japan	●	●	●	●	Growth remains above trend amid strong exports. BoJ to maintain stimulus as deflation concerns return
Asia ex-Japan	●	●	●	●	Growth expectations have been revised higher. Fiscal, credit policy in China to remain supportive despite PBoC tightening
EM ex-Asia	●	●	●	●	Brazil and Russia emerge from two years of recession. Falling inflation could support further central bank easing

Source: Standard Chartered Global Investment Committee

Legend: ● Supportive of risk assets ● Neutral ● Not supportive of risk assets

US – robust job market fails to lift inflation

Strong job market fuelling consumption: The subdued US jobless rate, at a 16-year low, is helping sustain consumption-driven growth. This is reflected in rising home sales and healthy services sector activity. However, some sectors, notably auto sales, are showing signs of saturation. Economic data has surprised negatively of late amid fading expectations of fiscal stimulus.

Gradual Fed tightening: US inflation expectations have declined amid lower oil prices and subdued wage growth. This is likely to enable the Fed maintain its gradual path for withdrawing its stimulus. We expect two rate hikes over the next 12 months, although the pace could change depending on the impact of a plan to slowly reduce its balance sheet.

Euro area – growth forecasts revised higher

Easing political risk lifts confidence: Euro area confidence indicators continue to rise amid easing political risk. There is growing expectation that France's President Macron will push for wide-ranging reforms after winning the parliamentary elections. However, a significant slack exists in southern Europe, leaving regional inflation subdued.

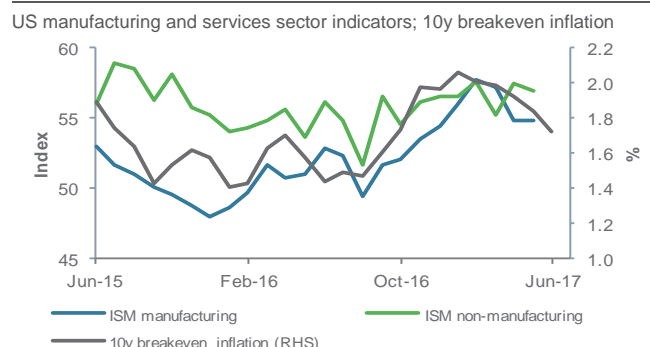
ECB gets some space as inflation slows: The decline in inflation expectations, partly due to lower oil prices, provides the ECB some time before it starts to unwind its stimulus. We expect the ECB to start tapering bond purchases by H1 18.

UK – consumer economy at risk

Inflation to hurt purchasing power: UK retail sales continued its downtrend, highlighting the risk to the consumption-led economy from rising inflation and slowing wage growth. PM May's failure to win a majority in the snap general election adds to the uncertainty around Brexit talks.

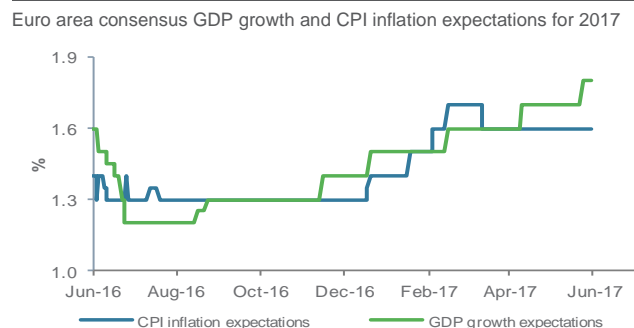
BoE's balancing act: There is growing pressure within the BoE to raise rates as inflation approaches 3%. Governor Carney has cited Brexit risks for keeping rates unchanged. However, a further rise in inflation may force the BoE to act.

Figure 10: US activity indicators are holding up, but long-term inflation expectations have trended lower after peaking in January



Source: Bloomberg, Standard Chartered

Figure 11: Euro area growth expectations continue to be revised higher, although inflation expectations have declined



Source: Bloomberg, Standard Chartered

Figure 12: UK's rising inflation pressures and slowing wage growth are likely to hurt domestic consumption over the coming months



Source: Bloomberg, Standard Chartered

Japan – above-trend growth, zero inflation

Export-driven growth: Japan's economy continues to grow above its trend-rate of recent years. The JPY's weakness since last year, combined with a recovery in global trade, is boosting exports. There are also signs of a gradual pick-up in domestic demand given low oil prices and the impact of last year's fiscal stimulus. However, momentum may be peaking.

Deflationary pressures to keep BoJ accommodative: Japan's core inflation, excluding food and energy, is now at 0%, highlighting continued significant deflationary pressure despite the recovery in growth indicators. Thus, we do not expect the central bank to tighten policy – by raising its 10-year JGB yield target – over the next 12 months.

China – consumption holding up

Shift towards consumption drivers continues: China's services sector activity and domestic retail sales remained robust, despite signs of a slowdown in the manufacturing sector. Rising short-term rates and credit tightening appear to have impacted the small-scale manufacturing sector. However, money supply and 'real' economic data remain robust, suggesting overall economic activity is holding up.

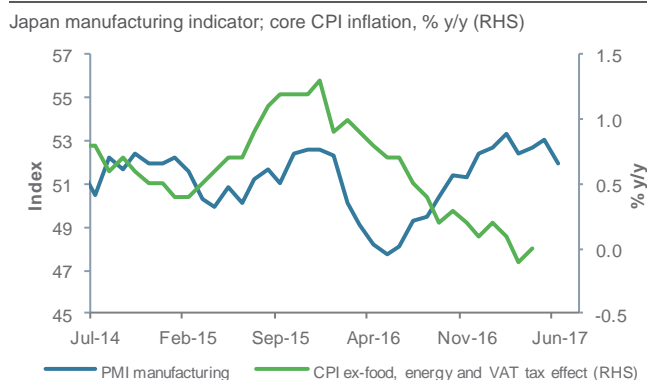
Focus on stable growth: We expect policymakers to maintain growth close to the 6.5% target, while taking steps to mitigate financial sector risks, ahead of the Communist Party Congress in Q4. This would entail sustaining the selective fiscal and credit stimulus, while tightening short-term monetary policy to curb excessive financial leverage.

Emerging Markets – gradually re-emerging

Asia's domestic drivers of growth: Growth expectations in Asia have been revised higher in recent months, partly aided by robust global trade. As exports slow due to base effects, we expect sustained fiscal stimulus in China and India and from the new government in South Korea to buoy domestic consumption, sustaining the region's growth outperformance.

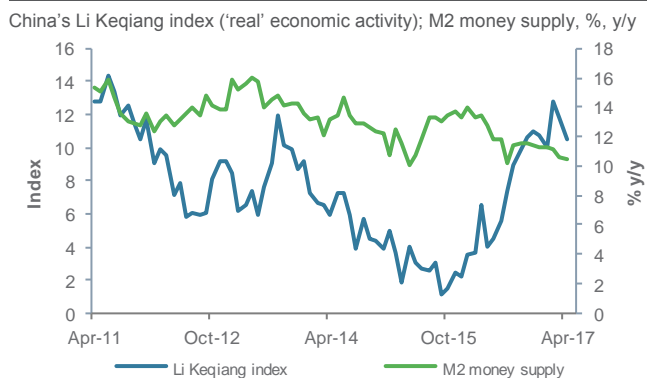
Brazil, Russia emerge from recession: Brazil and Russia emerged from two years of recession in H1. Falling inflation is likely to enable further rate cuts. However, renewed political uncertainty in Brazil has led to a downgrade in growth expectations and has clouded the outlook.

Figure 13: Japan's manufacturing activity remains robust, helped by strong exports, but deflationary pressures have increased lately



Source: Bloomberg, Standard Chartered

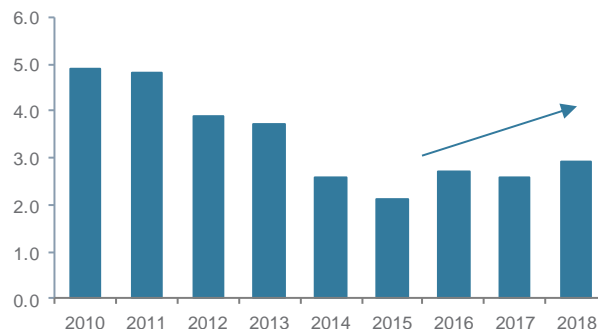
Figure 14: China's economic activity appears to have peaked, although money supply is holding up despite monetary tightening



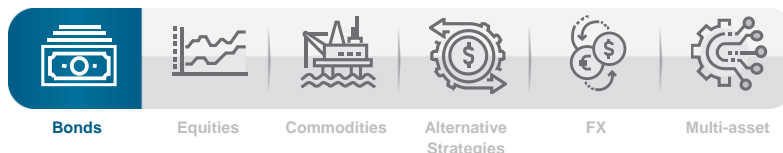
Source: Bloomberg, Standard Chartered

Figure 15: Emerging Markets' growth outperformance versus Developed Markets may slow this year, but then pick up in 2018

Emerging Markets growth outperformance over Developed Markets, ppt (2017 and 2018 data reflects consensus growth expectations)



Source: Bloomberg, Standard Chartered



Bonds

IMPLICATIONS FOR INVESTORS

01 Raising bond allocation to neutral on reduced concerns about a rise in inflation

02 Favour EM USD and local currency government bonds

03 Prefer corporate bonds over government bonds within DM

Raising allocation to bonds

- We raise our suggested allocation to bonds because of reduced concerns of higher inflation, which lowers the risk of a sharp surge in US Treasury yields, and our increasing comfort with Emerging Market (EM) government bonds.
- After upgrading EM USD government bonds last month, we now upgrade EM local currency bonds, resulting in both being our preferred areas within bonds. We continue to view Asian USD bonds as a core holding.
- In Developed Markets (DMs), we retain our preference for corporate bonds over government bonds as we expect them to outperform in a modestly rising yield environment. DM Investment Grade (IG) corporates and DM High Yield (HY) corporates remain core holdings, in our view.

Figure 17: Bond sub-asset classes in order of preference

Bond asset class	View	Rates policy	Macro factors	Valuations	FX	Comments
EM USD government	▲	●	●	●	NA	Attractive yield, reasonable valuations, supportive fundamentals
EM local currency	▲	●	●	●	●	High yield on offer and lower risk of significant USD strength
Asian USD	◆	●	●	●	NA	Defensive allocation. Influenced by China risk sentiment
DM HY corporates	◆	●	●	●	●	Attractive yield on offer, offset by somewhat expensive valuations
DM IG corporates	◆	●	●	●	●	Attractive route for taking high-quality bond exposure
DM IG government	▼	●	●	NA	●	Returns challenged by less-supportive monetary policy

Source: Standard Chartered Global Investment Committee

Legend: ● Supportive ● Neutral ● Not Supportive ▲ Preferred ▼ Less Preferred ◆ Core

Figure 16: Where markets are today

Bonds	Yield	1-month return
DM IG government	*1.1%	0.7%
EM USD government	5.3%	0.3%
EM local currency government	6.2%	1.1%
DM IG corporates	*2.4%	1.1%
DM HY corporates	5.3%	0.4%
Asia USD	3.8%	0.4%

Source: Bloomberg, Standard Chartered

*As of 31 May 2017

Developed Market Investment Grade government bonds – Less preferred

Despite the recent decline in government bond yields, we retain our cautious stance towards DM IG government bonds. We continue to expect the Fed to hike interest rates and the 10-year US Treasury yields to end the year higher from current levels, implying downside risks to bond prices. Indeed, a near-term rebound in US Treasury yields would not come as a surprise, given high positioning. That said, with inflation remaining subdued, we are now less concerned than at the start of the year about a significant surge in Treasury yields. In Europe, barring an unexpected increase in political risks, we expect German Bund yields to drift higher as the ECB prepares to reduce asset purchases.

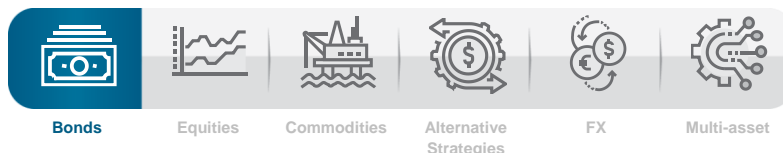
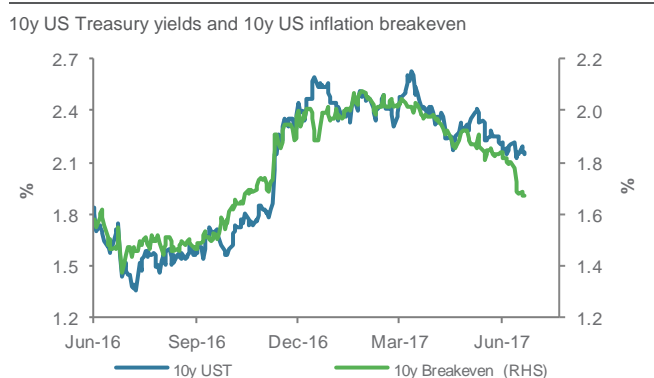


Figure 18: Inflation expectations remain an important driver of 10y US yields



Source: Bloomberg, Standard Chartered

In the US, we expect 10-year yields to stay within the 2.00-2.50% range near term, with this range rising slightly to 2.25-2.50% with an upward bias over a 12-month horizon. As short-term yields are influenced by Fed rate hikes, we expect the differential between short-term yields (2-year) and long-term yields (10-year) to reduce over the next year. Overall, we prefer to maintain a moderate maturity profile (5-7 years) for USD-denominated bonds as it offers a balance between moderate yields and interest rate sensitivity.

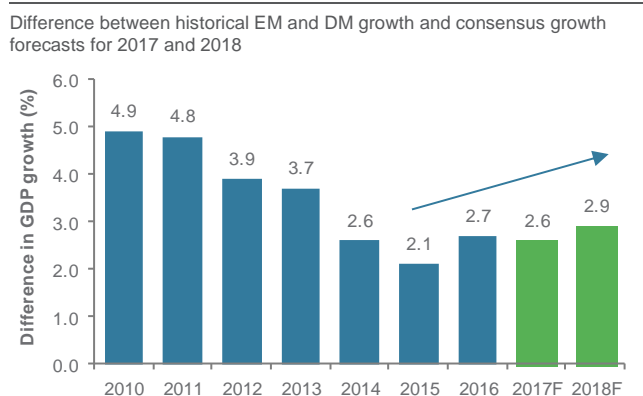
Emerging Market USD government bonds – Preferred

EM USD government bonds remain one of our preferred bond sub-asset classes owing to their attractive yield of over 5%, robust EM growth and a lower risk of substantially higher US Treasury yields. While valuations are marginally expensive compared with the historical average, they are still reasonable compared with other bond sub-asset classes.

We refrain from giving too much emphasis to the recent developments in the Middle East, as bonds from the region account for a small fraction of the universe. EM USD government bonds have continued to receive fund flows despite the recent headlines.

The key risks to our view include a further decline in oil and base metal prices and escalation of EM-specific geopolitical risks. A significant rise in US Treasury yields would also negatively impact returns, given their relatively high interest rate sensitivity compared with other bond sub-asset classes.

Figure 19: Strong EM growth is supportive of EM USD government bonds



Source: Bloomberg, Standard Chartered

Developed Market Investment Grade corporate bonds – Core holding

We retain DM IG corporate bonds as a core holding and view them as an attractive route to take a high-quality bond exposure. The yield premium or credit spread on offer should help them outperform government bonds.

While the yield premium is lower than the long-term average, it is likely to remain range-bound, given the lack of value in other safe-haven assets. Credit quality for both US and European corporates has been supportive as credit rating upgrades have outpaced downgrades so far in 2017.

Developed Market High Yield corporate bonds – Core holding

After a strong start to the year, DM HY bonds' momentum slowed recently due to increasingly expensive valuations, which led us to reduce our suggested allocation in May.

In our view, the high valuations are somewhat justified by the notable decline in default rates over the past year, which reduces the risk for investors. However, the recent decline in oil prices has brought energy-sector bonds into focus again. Sustained low oil prices, while not a central scenario, could raise the risk of an increase in default rates, which could lead to a decline in bond prices.

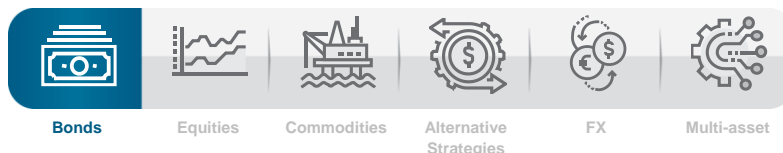
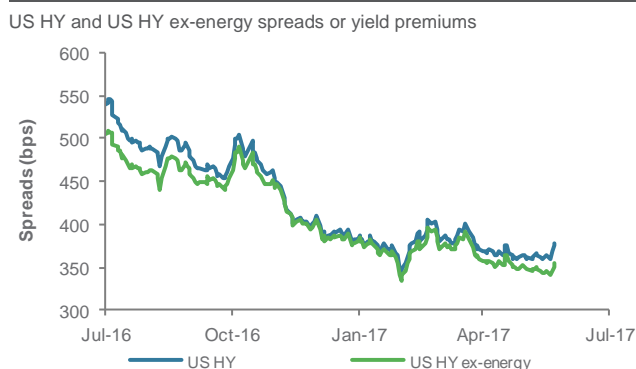


Figure 20: Energy sector bonds have been the main driver of the recent increase in US HY bond yields



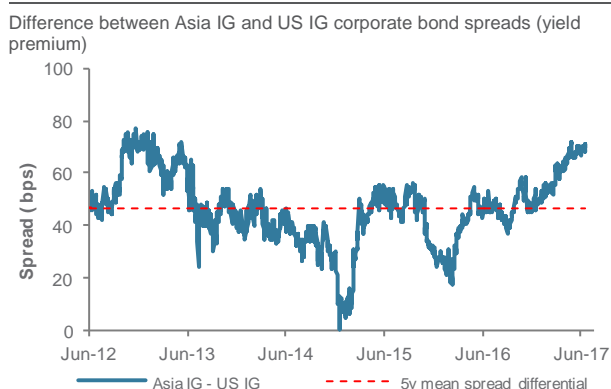
Source: Barclays, Bloomberg, Standard Chartered

US floating rate senior loans remain an attractive alternative to HY bonds as their coupons gradually adjust to higher rates. Historical analysis shows they are one of the few asset classes to consistently deliver positive returns in a rising yield environment.

Asian USD bonds – Core holding

We continue to view Asian USD bonds as a defensive segment within EM bonds and retain them as a core holding. While valuations are somewhat expensive compared with the historical average, we believe they are explained by the rise in average credit quality over the past decade and the low volatility exhibited by Asian USD bonds during the recent bouts of market turmoil.

Figure 21: Asia IG USD bonds offer an attractive yield pick-up over their US counterparts



Source: Bloomberg, Standard Chartered

The strong regional investor base makes Asian USD bonds less vulnerable to fund outflows in case sentiment towards EM sours. Additionally, Asian IG USD credit continues to offer a good yield pick-up over US counterparts, making it our preferred way to take IG corporate bond exposure.

The heavy exposure to China remains both a source of comfort and risk. While we expect a stable macroeconomic environment in China and a limited impact from rising onshore bond yields, Asian USD bonds could be disproportionately impacted if concerns about China return.

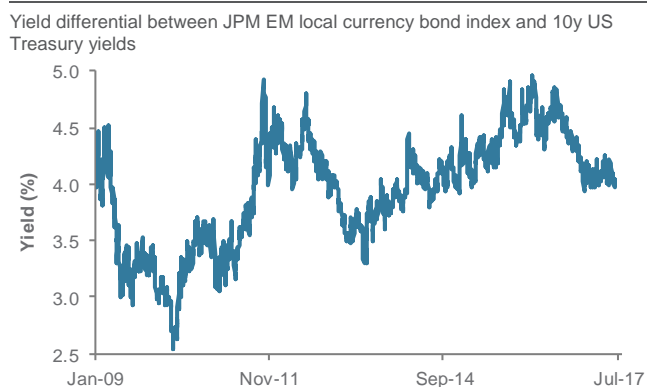
Emerging Market local currency bonds – Preferred

We have upgraded EM local currency government bonds to one of our preferred bond holdings, following a steady rise in our comfort level with EM bonds over the past few months.

Our more positive view is driven by (i) expectations of improved EM growth compared with DM counterparts, (ii) an attractive yield of over 6%, (iii) lower inflationary pressure, which open the door for rate cuts in select countries, leading to capital gains, and (iv) the receding risk of a stronger USD, which could otherwise adversely impact returns for international investors.

In the near term, there is a risk of moderate weakness in EM currencies, which could present a good entry point. EM-specific geopolitical risks, a decline in commodity prices and a surge in USD remain key risks to our view.

Figure 22: EM local currency government bonds offer an attractive yield pick-up over US Treasuries



Source: Bloomberg, Standard Chartered



Equities

IMPLICATIONS FOR INVESTORS

- 01** Global equities our preferred asset class
- 02** Euro area and Asia ex-Japan are our preferred regional markets
- 03** Positive on China and Korea within Asia ex-Japan

Earnings – a positive barometer

- Global equities remain our preferred asset class. While our base case scenario has moved slightly back from deflation to muddle-through over the last six months, the outlook for global equities remains solid, in our opinion, underpinned by resilience in earnings growth momentum.
- The Euro area is one of our preferred regions. Corporate earnings visibility is high, given solid economic data and high operating leverage, while fading political risks could trigger a re-rating.
- We also favour Asia ex-Japan equities, given improving corporate fundamentals, undemanding relative valuations and prospects of further fund inflows into the region with strong USD gains unlikely.
- Within Asia ex-Japan, China and Korea are our preferred markets. For China, the recent inclusion of A-shares in the MSCI Emerging Markets index, alongside improving earnings momentum, is positive. In Korea, the market is likely to be supported by accommodative fiscal policies, improved corporate governance and a higher dividend yield.
- Key risks to our preferred view on equities include high valuations, a downside deflation surprise and weaker growth in Emerging Markets (EMs) such as China.

Figure 23: Where markets are today

Market	P/E ratio	P/B	EPS	Index Level
US (S&P 500)	18x	2.9x	11%	2420
Euro area (Stoxx 50)	15x	1.6x	17%	3471
Japan (Nikkei 225)	14x	1.3x	11%	20,220
UK (FTSE 100)	14x	1.8x	14%	7,350
MSCI Asia ex-Japan	13x	1.5x	14%	629
MSCI EM ex-Asia	11x	1.3x	18%	1336

Source: FactSet, MSCI, Standard Chartered

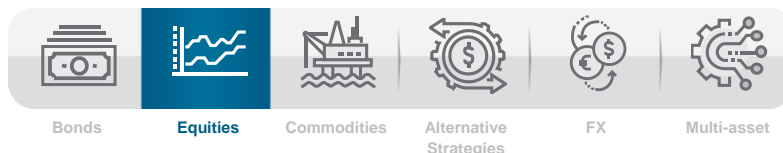
Note: Valuation and earnings data refer to MSCI indices, as of 29 June 2017

Figure 24: Euro area and Asia ex-Japan our preferred regions; the UK is the least preferred

Equity	View	Earnings revision	Earnings	Return on equity	Economic data	Benchmark bond yields	Comments
Euro area	▲	●	●	●	●	●	High earnings visibility, given solid economic momentum
Asia ex-Japan	▲	●	●	●	●	●	Better investor sentiment and attractive valuations supportive
Japan	◆	●	●	●	●	●	Further ETF purchases and share buybacks to limit downside
US	◆	●	●	●	●	●	Corporate tax reforms may be needed to trigger further re-rating
EM ex-Asia	◆	●	●	●	●	●	Resilience to higher US interest rates
UK	▼	●	●	●	●	●	Political risks yet to recede

Source: Standard Chartered Global Investment Committee

Legend: ● Supportive ● Neutral ● Not Supportive ▲ Preferred ▼ Less Preferred ◆ Neutral



Euro area equities – Preferred

The Euro area continues to be one of our preferred equity markets globally. We see fading political uncertainties within the Euro area, particularly after the French parliamentary elections. The ongoing recapitalisation process of two Italian regional banks also highlights the progress in addressing Italy’s EUR 350bn bad debt woes.

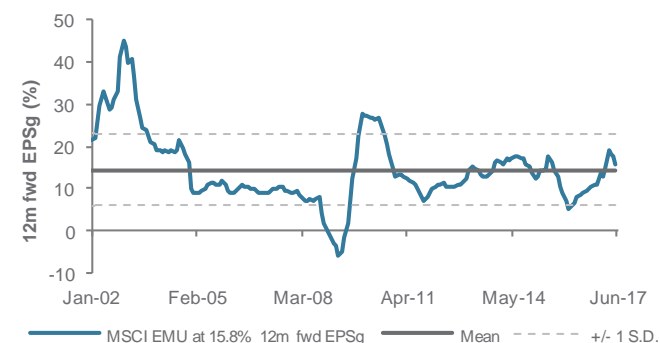
Improving investor confidence should trigger greater fund inflows into the Euro area, given better economic and earnings momentum versus other Developed Markets (DMs). Despite the recent acceleration in fund inflows into the Euro area, only 40% of total outflows in 2016 from Europe have returned this year.

Currently, the Euro area’s net corporate margin is 5.6%, well below its historical high of 7.1% in 2008. Stronger Euro area economic momentum could spur a corporate margin expansion as demand picks up, supporting the earnings outlook. Valuations also remain reasonable relative to global equities, at consensus 12-month forward P/E (Price/Earnings) ratio of 14.6x, representing a discount of 8.3% to Developed Market equities.

ECB tightening, a deteriorating bad debt situation and a negative election outcome in Italy are seen as the key risks to our positive stance on Euro area equities.

Figure 25: Healthy Euro area economic momentum bodes well for earnings growth

Consensus 12-month forward earnings growth expectations



Source: FactSet, Standard Chartered

Asia ex-Japan equities – Preferred

We are constructive on Asia ex-Japan equities. Foreign inflows into Asia ex-Japan equities should sustain in the near term, amid strong interest in Chinese and Korean stock markets. Institutional investors are estimated to be around 5% underweight Asia ex-Japan, suggesting room for further inflows into this region, especially if the USD does not rally significantly.

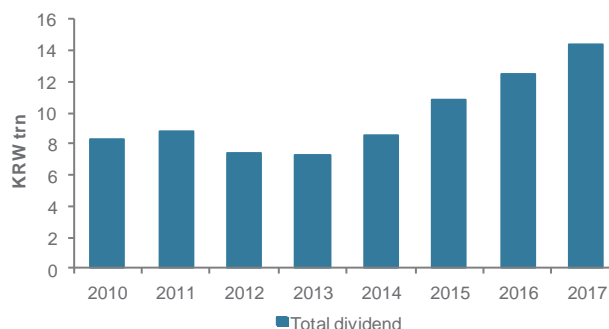
Valuations for Asia ex-Japan equities remain compelling relative to the rest of the world, at 12-month forward P/E ratio of 13.1x, representing a discount of 17.9% to global equities. While the region has been seeing upward earnings revisions, these could ease in the near term as lower commodity and semiconductor prices hurt profits.

China remains our preferred market within Asia ex-Japan. The recent inclusion of A-shares in the MSCI EM index and the stabilisation of CNY are expected to boost market sentiment, while fiscal and monetary policies are likely to stay accommodative heading into China’s leadership transition in October-November 2017.

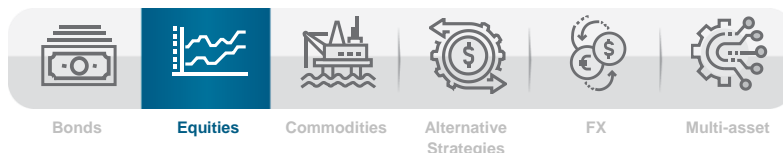
In addition, we have upgraded Korea to a preferred market given expectations of accommodative fiscal policies and improved corporate governance. Dividend yields could also rise, in view of improved earnings and shareholder return policies.

Figure 26: Room for higher dividend yield in Korea

Korea’s total dividend for the past eight years



Source: FactSet, Standard Chartered



US equities – Core holding

Resilience in select economic data points, such as sturdy job creation, as well as easy financial conditions should be supportive of US equities. Another driver for US equities could be the recent resurgence of share buybacks by US corporates. The decline in buyback activity from peaks was a cause for concern for US equities in 2016, as peaks in share buybacks usually occurred around peaks in equity market performance. But now, there are clear signs of improvement, led by US mid and large caps.

On a negative note, US valuations remain high, at 17.8x 12-month forward P/E ratio. Despite positive earnings revisions recently, we believe there is limited room for 12-month forward earnings growth of 11.3% to surprise positively going forward, given our central scenario of US corporate margins remaining largely unchanged.

In this environment, we believe corporate tax reforms are needed to trigger further re-rating. Any disappointment in the size and timing of US corporate tax reforms could trigger a pullback in US equities.

In addition, we have closed our conviction view on the US technology sector. The view returned 19% since initiation in December 2016. The decision to close the view centred on the view's significant outperformance compared with the S&P500 and high valuations.

Figure 27: US corporate margins unlikely to surprise positively



Source: Federal Reserve Bank of St. Louis' Economic Research Division, Standard Chartered

Emerging Markets ex-Asia equities – Core holding

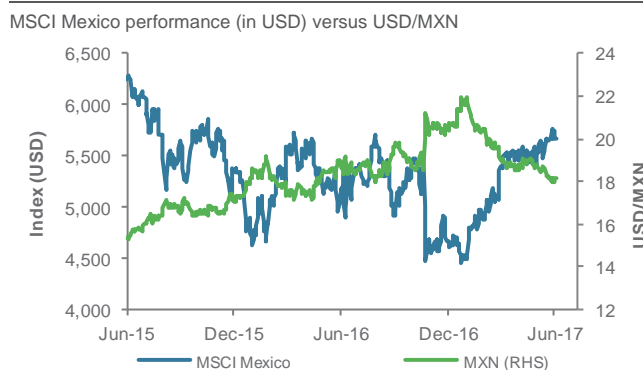
We maintain EM ex-Asia equities as our core holding. While the Fed could keep its hawkish stance in the short term, we expect EM ex-Asia to be more resilient to higher US interest rates, given the sharp improvement in current account deficit positions and the outlook for a range-bound USD in the next 12 months. This is a conducive environment for EM ex-Asia capital inflows and asset prices.

Valuations for EM ex-Asia are reasonable at a 11.4x 12-month forward P/E ratio, above its historical average of 10.6x. We believe this is justifiable, given structural improvements in corporate profitability and corporate discipline.

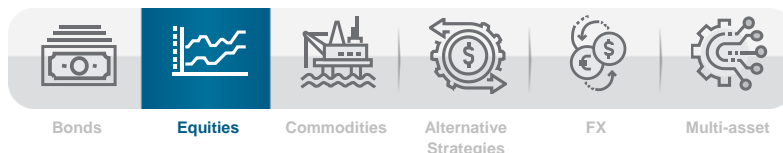
MSCI EM ex-Asia 12-month forward earnings growth remains solid at 18.2%, but the recent weakness in iron ore and oil prices may place these forecasts at moderate risk.

Balancing these positive factors are looming political risks, particularly in Brazil. While courts have dismissed the corruption case against President Michel Temer, there is still ongoing noise that Temer's mandate could be cut short or his ability to deliver economic reforms could be hampered.

Figure 28: Mexico equity market rallied this year due to FX gains



Source: FactSet, Standard Chartered



Japan equities – Core holding

As opposed to other global central banks, which are expected to have a tightening bias over the next 12 months, our base case scenario is for the BoJ to retain current monetary policy settings. This could put a lid on any further JPY appreciation in the near term, reaffirming our slightly bearish stance towards the JPY on a 12-month horizon. This would be positive for corporate earnings.

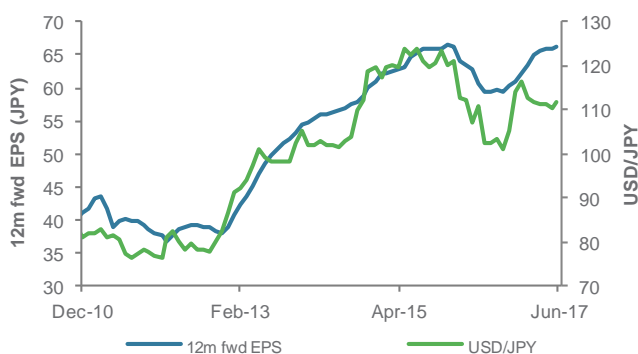
Beyond the JPY direction, corporate earnings (consensus 12-month forward EPS growth of 10.5%) could be aided by cost-saving initiatives, even as revenue growth stays sluggish. Meanwhile, valuations remain compelling, with the 12-month forward P/E ratio at 14.5x, below its historical average of 17.0x.

Finally, further BoJ ETF purchases and stronger momentum in corporate share buybacks are also seen as supportive.

While we maintained Japan equities as our core holdings, we see better value and re-rating drivers in other regions.

Figure 29: Weaker JPY may support earnings

Japan's 12-month forward earnings per share expectations versus USD/JPY



Source: FactSet, Standard Chartered

UK equities – Less preferred

The unexpected UK election result, which saw the Conservative Party lose its majority, could lead to prolonged political uncertainties and more domestically focused policies. The progress of the Brexit negotiations, which started on 19 June 2017, could also set the tone of the negotiations in the near term.

With UK companies deriving more than 60% of their revenue from abroad, the direction of the GBP will be key. We see limited downside for the GBP, which would remove one source of earnings growth. The focus may then shift to the performance of the domestic economy, which is coming under pressure from falling real wages and the economic uncertainty surrounding Brexit.

UK equities have underperformed both global and Euro area equities recently, but the market is still trading at consensus 12-month forward P/E ratio of 14.5x, above its historical average of 12.8x. While consensus 12-month forward earnings growth is healthy at 12.7%, visibility is low, given the ongoing political turmoil in the country.

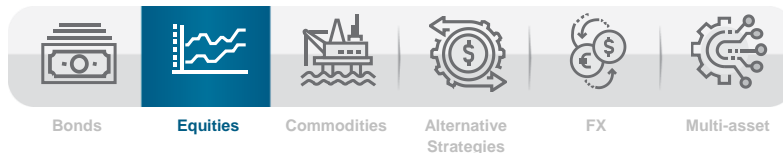
Defensive markets with high dividend yields, such as UK equities, should perform better in a muddle-through scenario, but we do not see any meaningful re-rating catalyst for the market. We stay cautious on the UK relative to other regions.

Figure 30: UK 12-month forward P/E ratio still high

MSCI UK price-earnings ratio



Source: FactSet, Standard Chartered



Equity derivatives

'Pivoting' with derivatives

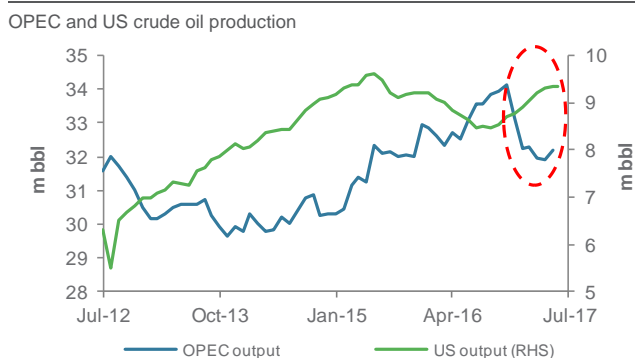
In the current market environment, where investors are constantly pivoting between deflation and muddle-through, derivatives offer investors the flexibility to express their views, beyond just a simple buy or sell.

In the last Global Market Outlook, we highlighted potential opportunities for investors to sell put options on US financials and global diversified miners. While US financials have been edging somewhat higher, the spot prices of global diversified miners were under some pressure, due to the pullback in the US 10-year yield and the pivoting away from the deflationary theme, on the margin. However, due to high volatility in diversified miners, although put option sellers were cushioned by the put option strike price, straight-equity buyers were hurt.

Today, we believe there are opportunities for investors in the oil space. US production continues to surprise on the upside and is being largely blamed for the drop in oil prices. However, three factors could limit the downside in oil prices: 1) US production is close to 2015 peak levels and breakevens are unlikely to fall dramatically near term, 2) stronger seasonal demand could begin to weigh on oil inventories, and 3) we expect sustained EM demand growth.

Against this backdrop, the oil sector may offer an opportunity for investors looking to generate yields by selling put options. The more conservative investors may concentrate on oil services and integrated sub-sectors, which are less affected by the swing in oil prices.

Figure 31: US oil supply has dragged prices down



Source: Bloomberg, Standard Chartered
As of 22 June 2017

The US technology sector is another area of focus. We have closed our conviction view on the sector, after its 19% gain since inception in December 16. While we believe in the sector's long-term prospects, we see 1) a rising risk of investors rotating into other sectors, 2) expensive valuations at 18.4x 12-month forward consensus earnings forecasts, and 3) tax reform delays or disappointments negatively impacting the sector.

Figure 32: Valuations expensive in US technology stocks



Source: Bloomberg, Standard Chartered
As of 22 June 2017

Against this backdrop, it may make sense for investors to consider trimming some exposure into strength. However, due to the sector's stellar performance, many investors would like to 'hold on for a while', because they believe there is 'a little bit more room to go' for these stocks.

For such investors, selling call options against their existing long-equity holdings is an option. Such a strategy allows them to 'target sell' these US technology stocks at a higher level than the current price. The risk, of course, is that the stocks fall before these prices are reached.



Commodities

IMPLICATIONS FOR INVESTORS

01 Oil prices to gradually head higher

02 We expect upside in gold to be limited

03 Further modest retracement of base metal prices still possible

Down, but not out

- We expect commodities to rise modestly as global growth remains resilient and risks of a slowdown in China remain contained.
- We expect crude oil prices to move higher in H2 17 as demand-supply fundamentals remain supportive, although an adjustment higher could take time.
- Gold is expected to trade largely range-bound (USD 1,200-1,300/oz); significant upside unlikely amid gradually rising yields globally.

Figure 34: Commodities: key driving factors and outlook

Commodity	View	Inventory	Production	Demand	Real interest rates	USD	Risk sentiment	Comments
Oil	◆	●	●	●	NA	●	●	OPEC cuts and seasonal demand trends to support prices
Gold	◆	●	●	●	●	●	●	Rising yields globally to weigh on gold
Metals	◆	●	●	●	NA	●	●	Further retracement likely as supply headwinds persist

Source: Standard Chartered Global Investment Committee

Legend: ● Supportive ● Neutral ● Not Supportive ▲ Preferred ▼ Less Preferred ◆ Neutral

Oil supply fundamentals key

We remain constructive on commodities overall as the broader demand-supply picture remains supportive. Although the likelihood of a 'muddle-through' scenario has increased of late, global growth prospects remain on track with China likely maintaining stability in the medium term.

The sharp decline in oil prices has been the key focus of markets with investors zooming in on stubbornly high US oil inventories. We believe seasonal demand trends and OPEC and Russia's resolve to maintain production cuts to be supportive of oil prices, but we are less convinced that oil prices will end the year in the USD 60-65/bbl range.

Gold prices have been supported by declining US Treasury yields, but we do not expect gold to extend its gains. Given our views for gradually higher yields globally, we think gold's upside will likely be limited.

For industrial metals, the immediate demand picture remains broadly unchanged, although supply-side concerns and China's policy path remain key risk factors.

Figure 33: Where markets are today

Commodity	Current level	1-month return
Gold (USD/oz)	1,246	-1.9%
Crude Oil (USD/bbl)	47	-9.9%
Base Metals (index)	114	2.3%

Source: Bloomberg, Standard Chartered



Crude oil – remain constructive longer term

The recent sharp decline in oil prices was due to concerns over higher-than-expected US shale production undermining OPEC efforts to curb supply. While geopolitical risks have risen in the Middle East, we believe this will have a marginal impact on oil prices. Overall, we do not expect any significant downside to oil prices from current levels.

In our view, while OPEC and Russia's agreement to extend supply cuts is supportive of prices, the surge in output from the US, Nigeria and Libya could offset some of these cuts. As US shale production approaches previous peak levels, we believe production is unlikely to be sustained as prices decline past producer breakeven levels. We believe OPEC compliance should remain high, in line with historical data, which should allow markets to rebalance.

Gold – reduce exposure on gains

We expect gold prices to move in a range of around USD 1200-1300/oz until early 2018. In our view, the recent uptick in prices was sparked by concerns over lower real yields, and we are biased towards reducing exposure should gold moves higher towards USD 1,300/oz.

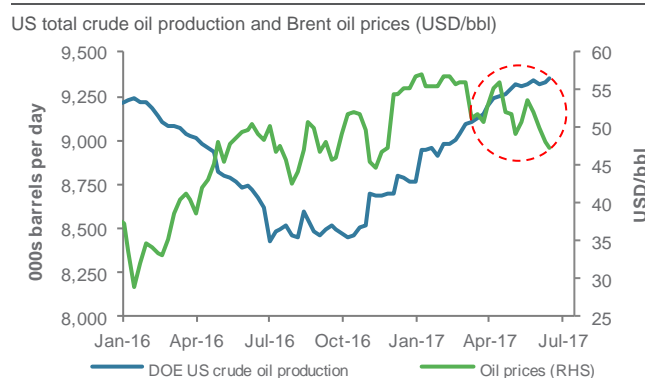
While the odds of a Fed rate hike later this year have fallen, we still believe central banks will gradually raise interest rates and the USD will not weaken significantly. As a result, we think US Treasury and Bund yields could move higher, pushing real yields higher. Against this backdrop, gold's upside should likely be limited.

Industrial metals – maintain limited exposure

Fundamentals in the industrial metals market have not shown significant improvement for us to have a constructive view. We note that there has been some divergence in recent performance as copper prices rose while iron ore prices continued their decline.

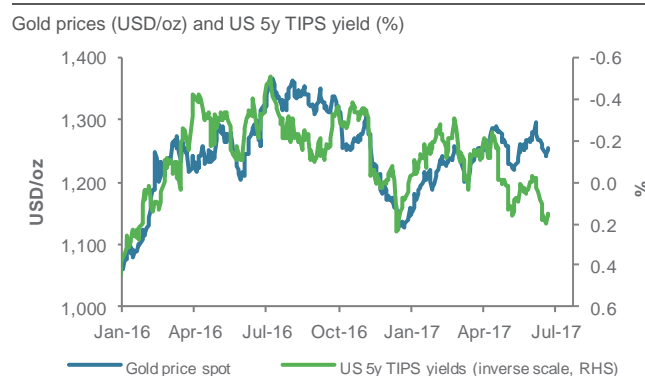
Copper's recent outperformance was largely driven by a drop in copper-refined inventories. While inventory levels remain high, industrial metal demand should slow given the ongoing targeted monetary tightening in China.

Figure 35: Markets have been focusing on rising US production



Source: Bloomberg, Standard Chartered

Figure 36: Rising yields could limit gold price upside



Source: Bloomberg, Standard Chartered

Figure 37: What has changed – Oil

Factor	Recent moves
Supply	OPEC production continues to decline, whereas US production rises further
Demand	Leading economic indicators in the US and China continue to expand
USD	USD has recovered from recent lows

Source: Standard Chartered

Figure 38: What has changed – Gold

Factor	Recent moves
Interest rate expectations	US yields have declined as Fed rate hike expectations have scaled back
Inflation expectations	Decline in US, EU; Japan remains flat
USD	USD has recovered from recent lows

Source: Standard Chartered



Alternative strategies

IMPLICATIONS FOR INVESTORS

01 Actively use both substitutes and diversifiers

02 Equity Hedge (most preferred) and Event Driven are long equity substitutes

03 Scenarios drive our allocation

Framework for alternative strategies

- Rising equity markets are positive for Equity Hedge and Event Driven strategies, with the latter also benefitting from increasing mergers and acquisitions (M&As).
- The higher probability of either a muddle-through or a reflationary economic scenario suggests favouring substitute strategies within our overall diversified alternatives allocation.
- Performance for our diversified alternative strategies allocation is up 3.1% since our *Outlook 2017*; substitute strategies, including Event Driven and Equity Hedge, have been the best performers.

A consolidated framework for alternative strategies

In previous publications, we have talked about two broad categories of alternative strategies, diversifiers and substitutes. Substitutes are strategies that carry strong correlations to traditional assets, but can provide a larger strategy set (eg, Equity Hedge strategies as a substitute for long-only equity). Equity Hedge strategies can benefit from rising equity markets and provide a better risk-adjusted return, although they can lag in performance during strongly trending up-markets. This year, both equity and bond markets have been positive performers, giving rise to the outperformance of substitute strategies versus diversifier strategies as shown in Figure 40. Performance has been led by Event Driven and Equity Hedge, given their close relationship to equity markets, followed by Relative Value.

Diversifiers generally have lower correlations to other assets and can improve the risk-return profile of an allocation. They generally help to cushion an overall allocation against market volatility due to their insurance-like characteristics (e.g., global macro strategies). As expected, they have lagged this year, due to trending equity markets.

Figure 40: Framework for alternative strategies

	Description	Key Drivers
SUBSTITUTES	Equity Hedge	In essence buying undervalued stocks and selling overvalued stocks
	Event Driven	Taking positions based on an event such as a merger or acquisition
	Relative Value	Looking to take advantage of differences in pricing of related financial instruments
DIVERSIFIER	Global Macro	Looking to exploit themes, trends and asset class relationships (correlations) at a global level, generally with leverage
		<ul style="list-style-type: none"> • Positively trending equity markets • Rising equity market dispersion • Positively trending equity markets • Rising mergers and acquisitions • Lower interest rate levels • Cost of funding, narrowing credit spreads • Increasing volatility, rising credit spreads • Increasing cross asset dispersion • Clear market trends (up/down)

Figure 39: Where markets are today

Alternatives	Since outlook	1-month return
Equity Long/Short	3.6%	0.7%
Relative Value	1.7%	0.0%
Event Driven	5.8%	0.2%
Macro CTAs	0.6%	0.9%
Alternatives Allocation	3.1%	0.5%

Source: Bloomberg, Standard Chartered

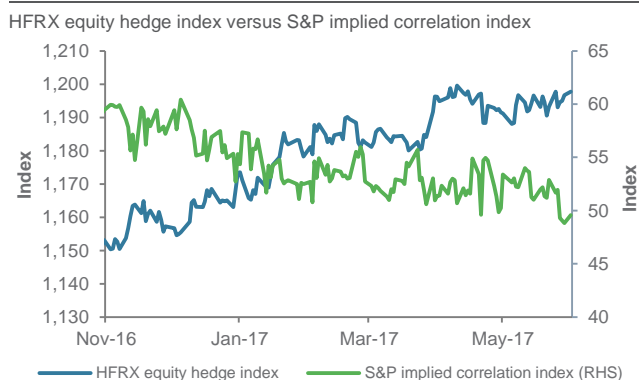
Source: Standard Chartered Global Investment Committee



As diversifiers and substitutes have very different characteristics, it helps to best understand the underlying drivers of individual strategies when positioning an investment allocation. Combining economic intuition with quantitative analysis across market factors, our consolidated framework outlines key drivers for individual alternative strategies (Figure 40).

Both Equity Hedge and Event Driven strategies are heavily supported by positively trending equity markets, which intuitively makes sense given their underlying equity exposure and higher equity market correlation. Equity Hedge strategies also perform better when equity market dispersion is rising, as there are greater trading opportunities amongst long and short pair trades (Figure 41). Equity Hedge strategies are our key preference within our diversified allocation.

Figure 41: Rising dispersion (falling correlation) is positive for Equity Hedge strategies



Source: Bloomberg, Standard Chartered

For Event Driven strategies, increasing M&A activity, often linked with late economic cycle activity, is also a strong indicator of potential outperformance as rising deal activity concurrently increases trading opportunities. 2016 saw USD 3.9trn worth global M&A activity, the third-highest level since 2006, with a notable focus on cross-border transactions (see Figure 42). Early indicators for 2017 are for a continuing trend as companies benefit from the low cost of funding and are facing pressure to improve their modest organic growth.

As Relative Value strategies use leveraged positions to magnify returns from arbitrage trades, the cost of funding

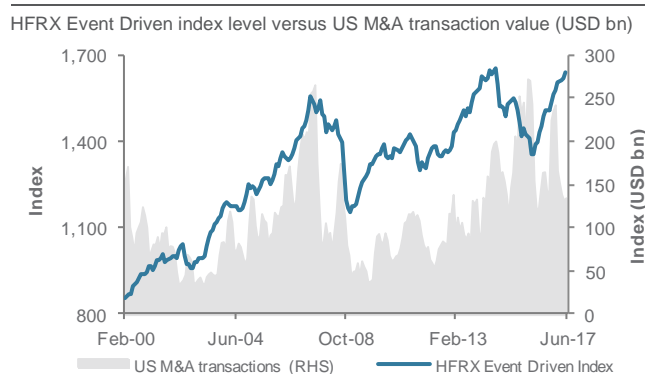
and the level of interest rates can have a material impact on the profitability of individual trades. Narrowing credit spreads, which helps fixed income performance, is also supportive as many of the underlying strategies within Relative Value carry a credit bias.

Global Macro strategies generally do well when markets are falling; indicators include increasing volatility and rising credit spreads. Its insurance-like characteristics are beneficial during periods of increasing market stress. Rising dispersion across FX, equities and fixed income can also lead to stronger performance as more cross-asset trading opportunities present themselves. Low volatility has been a headwind to Global Macro in recent times.

Our economic scenarios are driving the overall allocation

While projecting the future is challenging at best, we can use our view on economic scenarios to position our overall allocation. As we see a greater than 70% probability of either a muddle-through or a reflationary scenario, we continue to place greater emphasis on substitute strategies, namely Equity Hedge, Event Driven and Relative Value, that may outperform in both these scenarios. Our allocation to alternative sub-strategies is Equity Hedge at 34%, Event Driven at 26%, Global Macro at 16% and Relative Value at 24%. For information on how to build an alternatives allocation, please refer to our *Outlook 2017* report.

Figure 42: Increasing M&A activity is a strong indicator of potential outperformance for Event Driven



Source: Bloomberg, Standard Chartered



FX

IMPLICATIONS FOR INVESTORS

- 01** EUR gains to extend
- 02** JPY to weaken further
- 03** Further AUD downside likely

Rising Differentiation

- We remain constructive on the EUR for the medium term, amid increasing possibility of an ECB stimulus withdrawal and reduced political concerns.
- We remain bearish on the JPY, as we believe the BoJ will maintain its current yield curve control policy, and we expect US Treasury yields to rebound modestly.
- We turn bearish on the AUD, as a combination of shrinking interest-rate differentials and declining iron ore prices are likely to weigh.
- Emerging Market (EM) currencies are likely to be stable for now, amid a combination of a sideways USD, low volatility and attractive yields.

Figure 44: Foreign exchange; key driving factors and outlook

Currency	View	Real interest rate differentials	Risk sentiment	Commodity prices	Broad USD strength	Comments
USD	◆	●	●	NA	NA	US not exceptional in withdrawing stimulus
EUR	▲	●	●	NA	●	Economic momentum to support ECB stimulus withdrawal
JPY	▼	●	●	NA	●	BoJ policy to restrict upside in Japan yields
GBP	◆	●	●	NA	●	Lower risks, but BoE likely to maintain policy
AUD, NZD	▼	●	●	●	●	Worsening real-yield differentials negative
EM FX	◆	NA	●	●	●	Low volatility and commodity prices key

Source: Standard Chartered Global Investment Committee

Legend: ● Supportive ● Neutral ● Not Supportive ▲ Preferred ▼ Less Preferred ◆ Neutral

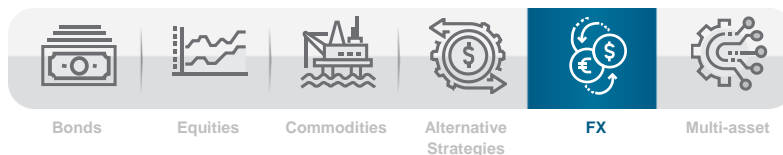
Figure 43: Where markets are today

FX (against USD)	Current Level	1-month change
Asia ex-Japan	106	0.0%
AUD	0.77	3.3%
EUR	1.14	2.5%
GBP	1.30	1.3%
JPY	112	-0.8%
SGD	1.38	0.5%

Source: Bloomberg, Standard Chartered

Limited upside left in the USD, prefer EUR longer term

- We believe the USD is likely to modestly rise in the short term, with risks to the downside over the medium term. However, there is considerable room for differentiation with respect to individual currencies. We believe the EUR is likely to extend gains further amid a continued Euro area recovery and the possibility of an earlier-than-expected withdrawal of monetary stimulus. We believe further JPY weakness is likely as US yields rise modestly and weigh on US-Japan interest rate differentials. We highlight a change in our medium-term AUD outlook to bearish amid shrinking real yields relative to the US and continued weakness in iron ore prices. We expect EM currencies to remain broadly stable.
- In the immediate term, the USD could recover some of its losses as we believe the decline in US yields may have been excessive. We would use this opportunity to accumulate the EUR and EM currencies.



EUR – further gains likely medium term

We expect the EUR to extend gains further over the medium term, based on two key assumptions. First, we believe a continued recovery in the Euro area economy will eventually cause the ECB to withdraw stimulus, sooner than markets currently expect. Second, Euro area political risks have receded; Italian elections will likely take place next year.

The Euro area economic recovery is likely to continue to gather pace, further closing the gap with the US. As a result, we expect the ECB to eventually come under pressure to either reduce bond purchases or hike interest rates. We also believe the sharp reduction in political risks (Figure 46) is likely to further improve sentiment towards Euro area assets, which is likely to support the EUR. In the immediate term, we believe the EUR could continue to trade range-bound as markets grapple with the possibility of the ECB changing policy direction.

JPY – likely to weaken medium term

We remain bearish on the JPY. We believe YTD strength has largely been explained by lower US long-end yields. From current levels, we expect a modest rise in US 10-year yields. Simultaneously, we expect the BoJ's yield curve control policy to likely remain in place, effectively anchoring Japan 10-year yields close to zero. As a result, we believe a widening of yield differentials is likely to weaken the JPY. We also believe geopolitical risks, a potential supporting factor for the JPY, remain largely contained and do not form part of our base case scenarios.

GBP – still looking for a catalyst

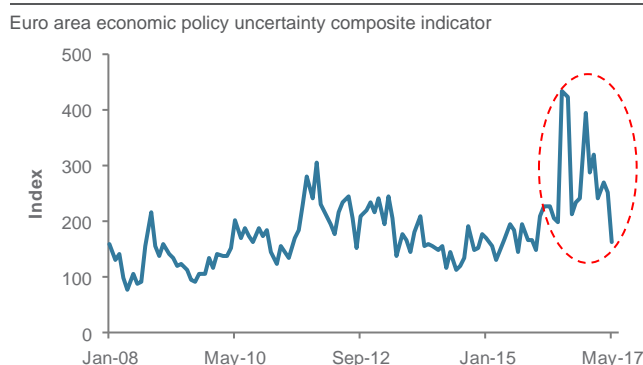
We believe the GBP is likely to remain largely range-bound as it is in a tug-of-war between continued political concerns and the possibility of an earlier than expected BoE rate hike. On the first point, near-term political uncertainty is likely to weigh on sentiment, while longer-term concerns over capital outflows and a large current account deficit could justify inexpensive valuations for now. However, the BoE's concerns regarding inflation have begun to surface, resulting in a slight hawkish tilt in policy messaging. This could lead to an earlier BoE rate hike than what markets expect, which would be supportive of the GBP.

Figure 45: What has changed – G3 currencies

Factor	Recent moves
Real interest rate differentials	Continue to improve in favour of the EUR, the GBP and the JPY recently at the expense of the USD
Risk sentiment	Volatility remains low relative to history, while Euro area risk indicators fall sharply
Speculator positioning	Remains balanced for the USD, moderately net-short for the JPY and the GBP and moderately net-long for the EUR

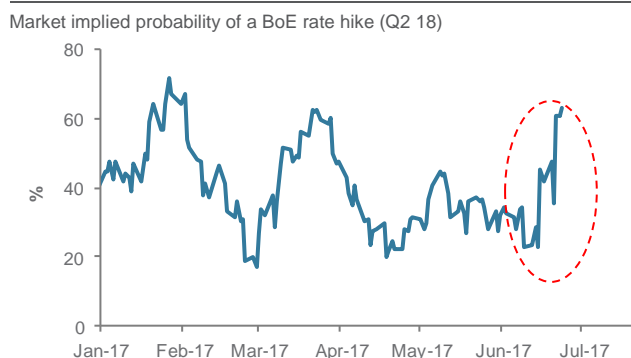
Source: Bloomberg, Standard Chartered

Figure 46: Sharp decline in Euro area policy uncertainty to support economic sentiment and demand for Euro area assets in general

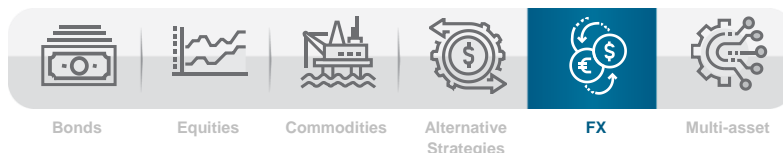


Source: Bloomberg, Standard Chartered

Figure 47: Probability of a BoE rate hike within 12 months has risen sharply



Source: Bloomberg, Standard Chartered



AUD – looking for more downside

We scale down our view on the AUD, as we believe fundamentals suggest potential for a further medium-term downside. Two key considerations motivate our thinking.

First, we believe fundamentals in the iron ore market remain weak as suppliers have not cut output while inventories remain high. In this context, we believe there are still considerable risks to the downside. We also see the significant improvement in Australia's current account balance as largely a result of the earlier surge in iron ore price and is now likely to reverse. Second, Australia's real interest rate differentials with the US continue to deteriorate as the Fed hikes interest rates while the RBA maintains policy for an extended period (see Figure 48).

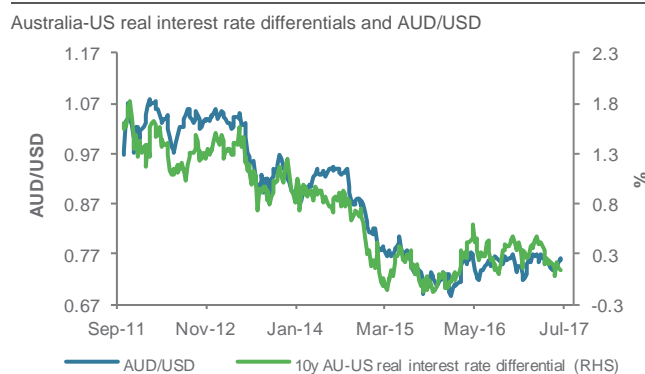
Emerging Market currencies – fundamentals still supportive

We believe overall fundamentals are still constructive for risk assets and EM currencies. In this context, high carry (currencies supported by high bond yields), contained volatility and continued capital flows to the region are likely to be supportive. As a result, we still expect EM currencies to remain broadly stable, although we expect respective central banks to push back against any further strength.

We continue to favour high-yielding currencies in the EM space as these provide a good carry cushion. While respective central banks are likely to push back against significant strength due to its adverse impact on exports, on a total return basis (ie, including the yield on offer), these currencies are likely to remain attractive (also see pg 15).

Elsewhere, we believe risks to further CNY downside remain contained because of 1) limited USD strength and 2) limited capital outflows. With policy continuing to favour a largely neutral stance, we expect the outlook for the SGD to be driven by key trade partner currencies (CNY, MYR, EUR). In the case of the MYR, we believe the recent decline in commodity prices, in addition to any push back from the central bank, is likely to limit further strength. The trade-focused KRW is likely to see limited further gains this year as we believe it has already incorporated some of the recent positives.

Figure 48: Further decline in AU-US real interest rate differentials to push AUD lower



Source: Bloomberg, Standard Chartered

Figure 49: What has changed in EM currencies

Factor	Recent moves
USD	USD has started to stabilise
China risks	China data remains resilient
Capital flows	Capital inflows into EMs remain strong

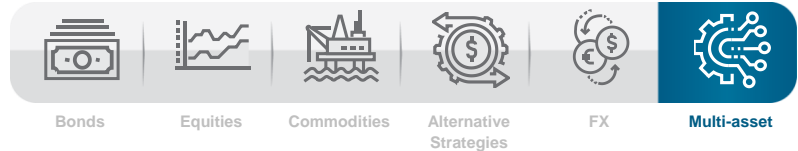
Source: Standard Chartered

Figure 50: Stable EM currencies allowing gains on a total return basis (including the yield on offer)

Bloomberg Emerging Market currency carry index (total return) and JPMorgan Emerging Market currency index



Source: Bloomberg, Standard Chartered



Multi-asset

IMPLICATIONS FOR INVESTORS

01 Focus on Euro area and Asia ex-Japan equities within a growth strategy

02 Interest rate risk less of a concern for income strategy given gradually rising yields

03 EM/Asia income strategy might be suitable for higher-risk investors

EM stars in growth/income

- Emerging Market (EM) and Asia-focused assets play a key role in both a growth-focused strategy, which benefits from a reflatory scenario, and an income-focused strategy, which benefits from a muddle-through economic environment.
- With yields expected to rise only gradually, interest rate risk is less of a concern for a global multi-asset income investor, with the strategy expected to continue to deliver a 4-5% yield alongside a positive total return.
- An EM/Asia-focused income strategy should deliver a sustainable 4-5% yield and might benefit from higher capital appreciation relative to a global income strategy. However, the EM/Asia focus creates potential for greater volatility and pullback.

Mid-year is a somewhat arbitrary checkpoint in an investment timeline that is continuous. However, it is a convenient opportunity for us to step back and assess the investment choices that were made previously. At the end of 2016, after advocating a multi-asset income approach for three years, we suggested total-return investors add a growth tilt to their allocation. Thus far, this approach has been validated with our balanced (growth-tilted) allocation outperforming the multi-asset income allocation by 137bps in terms of absolute returns. The superior performance of the balanced allocation has been primarily driven by a broader reflatory trend beyond the US, with strong returns being delivered by Euro area and Asia-ex Japan equities.

Balanced strategy: higher absolute, lower risk-adjusted return

While the balanced allocation has come out ahead, the performance of multi-asset income should not be overlooked. It has delivered 7.3% since our *Outlook 2017* publication. This performance has been driven by strong performance from EM/Asia assets in both equities and fixed income. Additionally, while US dividend equity has lagged its regional counterparts, non-core investments such as preferred equity and convertible bonds focused on the US market have delivered stellar returns (see Figure 52).

Figure 52: Most asset classes have performed well in recent times

Performance* of various asset classes from *Outlook 2017* publication to 29 June 2017

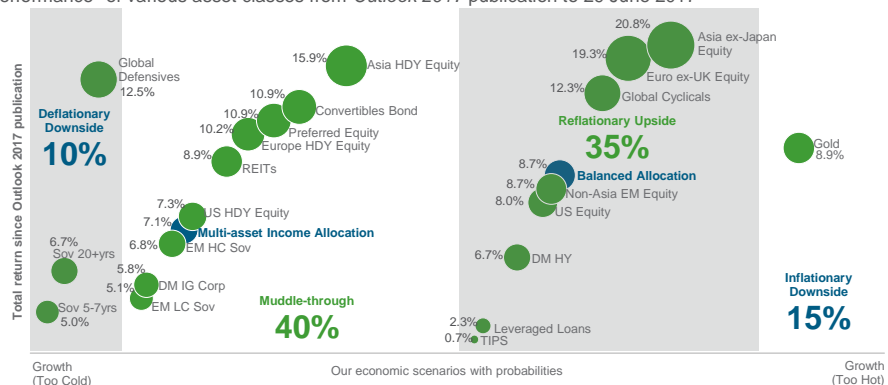
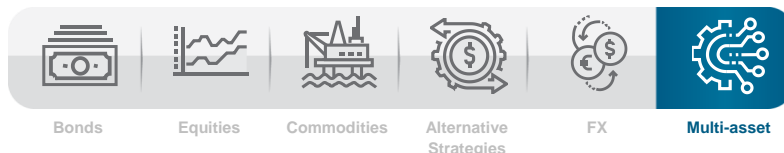


Figure 51: Key multi-asset views

Allocation Performance	Since Outlook	1-month return
Balanced	8.7%	0.5%
Multi-Asset Income	7.3%	0.4%

Source: Bloomberg, Standard Chartered

Source: Bloomberg, Standard Chartered; Size of bubble represents total return of asset class



A point of comfort for yield-seeking investors is that volatility of the multi-asset income allocation has been lower than the balanced allocation (a continuation of the trend from the past three years). Therefore, while the balanced allocation has delivered higher absolute returns, the income allocation has delivered better risk-adjusted returns.

Gradually rising yields not an immediate worry

We expect the multi-asset income allocation to retain this risk profile outside of a scenario of sharply rising yields. While history is not a definitive benchmark, a purview of previous yield moves (Figure 53) provides a degree of comfort that pullback potential for the income allocation in a gradually rising yield environment could be limited. In fact, outside periods where the Fed began its hiking cycle (2004) or the market thought the Fed might tighten monetary policy

(2013 and 2016), pullbacks in both the balanced and income allocation have been limited during periods of rising yields.

Following a slight rise in our probability assessment of the middle-through scenario to 40% from 35% and the associated expectation of only a gradual rise in yields, we make one change to our global multi-asset income allocation. We reduce our position in US High Yield (HY) to 10% from 15% and introduce a new allocation to EM local currency government bonds. Expensive valuations in US HY and an attractive yield alongside reduced currency risks in EM local currency bonds support this rebalancing. We make no changes to the balanced allocation where we retain a conviction in growth-exposed assets in the Euro area and Asia ex-Japan (see Figure 54 on page 30) for the latest allocation breakdown).

Figure 53: An environment of gradually rising yields should reduce the risk of a significant pullback in a multi-asset income strategy

Total return of equity/fixed income/non-core income asset classes in periods of rising 10y US treasury yield (return in USD %, yield move in bps)

Periods	Asset Classes																Yield move		
Oct-93 to Nov-94	5.7				4.7					-17.2	3.3			-6.5					278
Jan-96 to Jun-96	7.0				8.0					6.0	2.6			4.7					154
Nov-96 to Apr-97	-1.6				1.6					3.4	3.9	2.9		-1.0					82
Oct-98 to Jan-00	57.4				41.4					41.9	3.7	6.3		23.1			-3.6	-5.6	263
Mar-01 to May-01	10.3	9.4	9.2	3.2	7.0					5.0	-0.4	0.6		1.5			-2.3	-1.2	70
Nov-01 to Mar-02	4.6	6.0	6.4	41.9	6.5					7.3	4.4	2.8		1.2			-5.3	-2.8	123
Jun-03 to Sep-03	3.4	-1.1	-2.6	17.3	4.3	2.1				-2.2	-0.3	1.9	1.8	-5.8	-1.0		-7.3	-6.8	144
Mar-04 to May-04	-1.8	-0.6	-0.5	-8.5	1.5	0.1				-9.6	-2.3	-3.7	0.6	-8.0	-1.0		-5.9	-5.5	116
Jun-05 to May-06	20.5	3.9	19.5	26.8	7.1	5.0	25.1	-0.8		10.3	5.5	5.6	5.8	-0.9	1.7	0.0	0.1		124
Mar-08 to Jun-08	7.9	0.1	1.1	4.1	5.6	7.4	5.8	3.6		1.4	-2.0	6.2	6.2	-0.5	-0.4		-7.1	-3.3	96
Dec-08 to Jun-09	16.7	3.1	13.8	48.0	10.4	27.0	11.2	16.6		24.2	1.8	37.2	32.9	9.1	7.7		-3.1	6.0	172
Aug-10 to Feb-11	24.0	17.9	21.1	14.4	11.3	16.7	17.9	3.5		-0.2	0.3	10.2	7.3	-1.0	3.0		1.8	3.2	78
Oct-10 to Feb-11	10.9	7.6	7.7	6.9	7.1	9.7	3.0	0.4		-3.1	-1.3	4.8	4.9	-4.4	-0.1		-3.8	-3.3	131
May-13 to Sep-13	5.9	1.6	7.9	-3.5	-0.2	7.2	-7.9	-9.0		-5.2	-3.6	-1.1	0.9	-8.3	-1.2		-1.3	-1.9	100
Jan-15 to Jun-15	4.6	-1.2	3.8	3.1	4.6	4.5	-5.6	0.6		4.5	-0.7	2.8	2.7	-1.1	0.3		-3.5	-2.6	62
Sep-16 to Nov-16	-0.7	1.0	-4.8	-4.7	3.0	-0.6	-8.6	-5.4		-4.7	-1.4	0.0	1.1	-5.9	-0.5		-7.6	-5.0	82
Jul-16 to Mar-17	13.4	9.1	12.6	18.8	7.2	10.8	-1.3	-1.4		5.9	3.5	7.9	6.3	-1.6	0.5		-7.1	-2.2	106

Source: Bloomberg, Standard Chartered
Historical data limitations prevent us from displaying the performance of balanced and income allocations for every period of rising yields

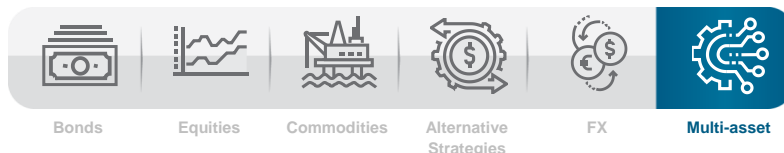
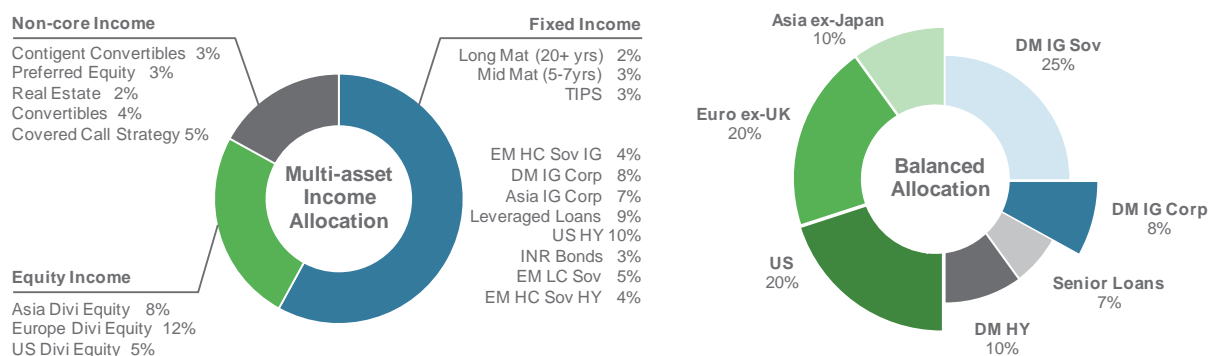


Figure 54: Revised multi-asset income allocation and balanced allocation (asset class weight in %)



Source: Standard Chartered

Exploring EM/Asia multi-asset income...

Since the introduction of our multi-asset income strategy in 2014, our approach has been to look globally and create a diversified basket of assets that could generate a sustainable income of 4-5% per annum for a yield-focused investor. Our house view has gradually moved away from Developed Markets (DMs, particularly the US) and towards EMs both in the equity and fixed income space. Against this backdrop, we explore whether a dedicated EM/Asia multi-asset income allocation makes sense as an alternative to our global allocation.

The universe of EM income assets includes EM USD government bonds, EM local currency government bonds, Asia USD corporate bonds, Asia REITs and Asia high dividend yield equities. While this is by no means an exhaustive set of income assets, we feel it provides us with sufficient tools across the risk spectrum to create a diversified income allocation. Positive prospects for these asset classes could also mean additional return (capital growth) beyond the yield they provide, thereby boosting total returns of the strategy. Our traffic light framework (see Figure 56) provides a useful gauge of yield and capital growth potential of these EM/Asia asset classes and the risk of their pullback.

It is important for an investor to understand the risk of pullback for this allocation could be different relative to the global allocation. As the name suggests, the global income allocation benefits from access to the broadest range of

asset classes on the income spectrum. This includes non-core income assets that help diversify the allocation given their low correlation to remaining asset classes. Except for Asian Real Estate, we do not have equivalent non-core income assets within the EM/Asia multi-asset allocation.

The EM/Asia-focused multi-asset income allocation has been constructed using the same principles as its global counterpart (i.e., use a diversified set of income assets to generate a sustainable 4-5% yield while managing the risk and potential for pullback of the overall allocation). An observation of basic statistics (Figure 55) suggests the EM/Asia allocation is able to generate a similar level of yield to the global allocation, but with a higher level of risk/pullback. This is unsurprising given the higher volatility generally associated with EM assets (compared with their DM counterparts) and the lack of risk diversifying non-core income assets. Additionally, the interest rate risk of EM/Asia assets is higher, making them susceptible to a significant rise in bond yields.

Figure 55: Yield and risk comparison of global and EM/Asia-focused multi-asset income allocations (2012-2017)

	Global	EM/Asia
Risk	5.3%	6.5%
Drawdown	-7.7%	-12.8%
Yield	4.4%	4.7%
Duration (USD)	4.7%	5.6%
Duration (Local)	6.2%	5.2%

Source: Bloomberg, Standard Chartered

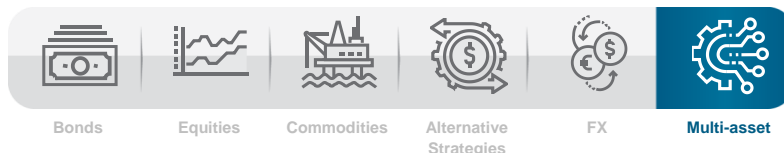


Figure 56: A three-pronged approach to assessing EM/Asia income assets

Income potential, capital growth and risk of pullback

Asset classes	Yield	Income potential	Capital growth	Risk of pullback	Comments
EM HC Sovereign IG	4.1	●	●	●	Need to be selective given diverse risk/reward; high sensitivity to rise in US interest rates a risk; commodity exposure may be a support; valuations reasonable
EM HC Sovereign HY	6.7	●	●	●	Need to be selective given diverse risk/reward; support from commodity exposure; valuations reasonable; idiosyncratic risk
Asia HC IG	3.5	●	●	●	Cautiously positive; fairly valued; yield pickup over DM IG corporate bonds; marginally improving credit quality; China concentration a risk
Asia HC HY	5.4	●	●	●	Cautiously positive; fairly valued; credit quality, China concentration and lower regional demand are key risks
EM LC Sovereign	6.2	●	●	●	Structural story playing out; carry play; credible central bank reforms; foreign demand a recent risk. FX stability a positive, but recovery valuation a potential concern
Asia ex-Japan	4.0	●	●	●	Good payouts; selectively attractive valuations, but pullback a risk from challenges in China/US growth, earnings, Fed and leverage
Property	3.5	●	●	●	Yield diversifier; stable property market; risk from higher rates, rich valuations in some regions. Potential for large pullbacks

Source: Bloomberg, Standard Chartered Global Investment Committee
Yield data as of 20 June 2017. For Indices used, refer to end note at the conclusion of this section

Legend: ● Attractive potential/low risk ● Moderate potential/medium risk ● Unattractive potential/high risk

...and the verdict is

With this background, one might ask whether there is a case for picking the EM/Asia multi-asset income allocation over the global one. There are two potential reasons to make this choice:

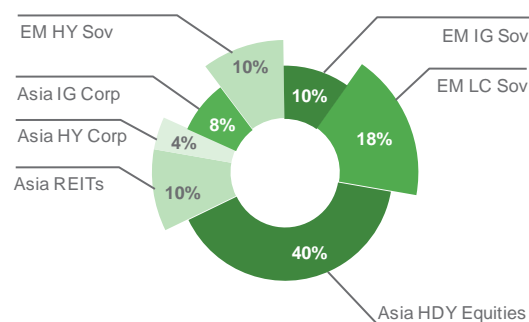
- 1) Our positive view on EM assets suggests a potentially higher capital appreciation for this allocation relative to global multi-asset income, which is primarily focused on DM assets.
- 2) With bond yields expected to rise only gradually, the higher interest rate risk of EM assets is less of an issue in the current environment.

However, it is also important to highlight the potential risks to this strategy:

- 1) While our view on EM/Asia assets has turned increasingly positive, a negative shift in sentiment towards this region could affect all assets as correlations are relatively high.

- 2) Limiting focus to EM/Asia assets reduces the opportunity set available on the global income spectrum.
- 3) Aside from REITs, there are no major diversifying non-core income assets that have a lower correlation to core equities and fixed income.

Figure 57: A sample EM/Asia multi-asset income allocation



Source: Standard Chartered

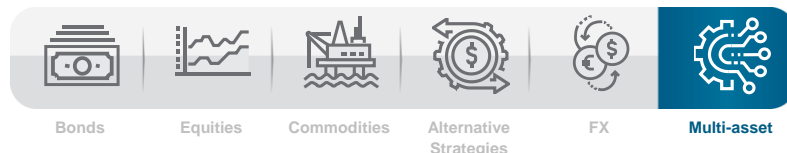


Figure 58: A three-pronged approach to assessing income assets

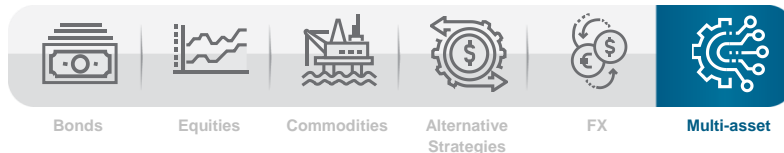
Asset Classes	Yield	Income potential	Capital growth	Risk of pullback	Comments
Fixed Income	4.5	●	●	●	Portfolio anchor; source of yield; some pockets of value but not without risks
Leveraged Loans	5.2	●	●	●	Attractive alternative to traditional HY exposure; senior in capital structure to simple HY bonds; small yield penalty in return; low sensitivity to changes in US interest rates but loan callability a risk
Corporate - US HY	5.7	●	●	●	Valuations have eased modestly, but still relatively full; attractive yields; default rates should trend lower
EM HC Sovereign Debt	5.4	●	●	●	Need to be selective given diverse risk/reward in IG, HY bonds; high sensitivity to a rise in US interest rates a risk; commodity exposure may be a support; valuations reasonable
EM LC Sovereign Debt	6.2	●	●	●	Structural story playing out; carry play; credible central bank reforms; foreign demand a recent risk. FX stability a positive, but recovery valuation a potential concern
INR Bonds	7.5	●	●	●	
Investment Grade*	2.5	●	●	●	Portfolio anchor, structural carry; some interesting ideas but interest rate sensitivity a risk
Corporate - DM IG*	2.4	●	●	●	Yield premiums have narrowed but prices fair; long-term US corporate bonds look appealing if Fed hiking cycle muted
Corporate - Asia IG	3.5	●	●	●	Cautiously positive. Fairly valued, marginally improving credit quality; key risks include concentration risk from Chinese issuers and risk of lower regional demand
TIPS	1.8	●	●	●	Offers value as an alternative to nominal sovereign bonds; impact of a rate rise similar to G3 sovereigns but offers exposure to further rise in US inflation
Sovereign*	1.4	●	●	●	QE offers strong anchors for sovereign yields, but little, if any, value is left. Risks include rate hikes and higher inflation. Prefer higher-yielding/high-quality markets (US Treasury, AU, NZ)
Equity Income	4.6	●	●	●	Key source of income and modest upside from capital growth
North America	3.1	●	●	●	Fair to slightly rich valuations; low yields; some sectors attractive
Europe	5.6	●	●	●	Fair valuations; attractive yields; overhang from political risk, mitigated by improving global growth outlook; improving momentum
Asia ex-Japan	4.0	●	●	●	Good payouts; selectively attractive valuations, but pullback a risk from challenges in China/US growth, earnings, Fed and leverage.
Non-core Income	4.3	●	●	●	Useful diversifier for income and growth
Preferred	5.5	●	●	●	Attractive yields and exposure to financials; risk from higher rates may not be completely offset by improvement in banks' underlying credit
Convertibles	3.5	●	●	●	Moderate economic expansion + gradual pace of rate hikes should be good for converts. Risk: policy mistake
Property	3.9	●	●	●	Yield diversifier; stable real estate market; risk from higher rates, valuations stretched in some regions. Potential for large pullbacks
Covered Calls	3.9	●	●	●	Useful income enhancer assuming limited equity upside
Cocos	5.2	●	●	●	Attractive due to high yields on offer, relatively low sensitivity to rising yields and improving bank credit quality over the past few years

Source: Bloomberg, Standard Chartered Global Investment Committee; Yield data as of 20 June 2017; *Yield data as of 31 May 2017

For indices used, refer to the end note at the conclusion of this section

Please note: The Financial Conduct Authority (FCA) has introduced Permanent Marketing Restrictions on the sale of CoCos to residents of the EEA

Legend: ● Attractive potential/low risk ● Moderate potential/medium risk ● Unattractive potential/high risk



Leverage



A balanced discussion on leverage

- Modest use of leverage can be a useful strategy to build a balanced portfolio with enhanced returns.
- The decision to employ leverage depends on the volatility of the asset being funded and the outlook for borrowing costs. In general, adding leverage to a low volatility asset (high-quality bonds) or a diversified allocation can help provide superior risk-adjusted returns.
- Using leverage potentially introduces additional risks – higher volatility, exposure to a rise in borrowing costs and margin calls. Therefore, only a modest amount of leverage should be employed for an optimal leverage strategy.

Leverage in a low-return environment

For many investors, leverage is simply about increasing risk. However, when used moderately and judiciously, it can be a useful tool to structure sources of return differently in an allocation, when paired with robust risk management. In the current environment of benign yields and extended asset valuations, investors struggle to generate meaningful and diversified returns across their investments – not just bonds but across many other asset classes. To achieve a higher return, the traditional approach for most investors is to increase their exposure to riskier assets. In the case of a multi-asset investor, this can translate to increasing the allocation to equities. For a pure bond investor, it can mean concentrating on lower-quality or longer-maturity bonds to generate higher yields. The concern with this approach is that most asset classes are susceptible to poor performance caused by shifts in economic conditions. Therefore, a heavy concentration in a single asset may expose investors to wild

swings in asset value and potentially significant long-term underperformance in their allocation.

The leverage decision

In deciding whether to employ leverage, one needs to consider 1) one's investment objectives and risk tolerance, 2) the volatility of the assets being leveraged, and 3) the outlook for borrowing costs (Figure 59). Applying leverage to assets with high volatility tends to further exacerbate the absolute risk inherent in these assets. A leveraged position may also sustain losses in excess of the initial investment. In adverse market conditions, investors may be called upon, at short notice, to deposit additional funds when the value of their investment falls below a certain minimum lending value or face forced liquidation of the leveraged positions. For this reason, given the increased risk of leverage, it may make more sense to employ modest leverage only for investments with lower volatility or to a diversified allocation.

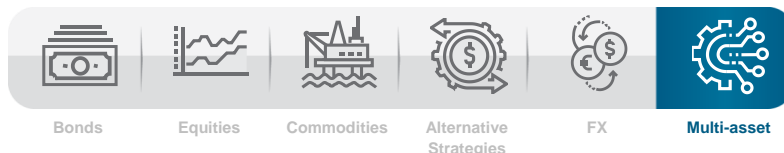
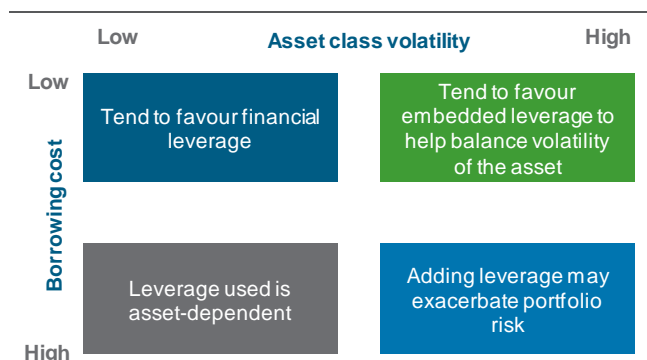


Figure 59: A two-variable framework to approach the leverage decision



Source: Standard Chartered

1. Asset class volatility in the context of leverage

Our core approach to using leverage advocates a more balanced stance – starting with a lower risk and diversified allocation and then applying leverage to achieve the

desired returns. Diversification is often spoken of as the only free lunch in investing and may offer a greater reward per unit of risk than riskier assets or a concentrated allocation.

We illustrate this in the context of a multi-asset investor, using a simple equity-bond allocation (Figure 60). For example, employing a 20% leverage in a conservative allocation helps boost returns without dramatically altering the risk parameters within this allocation.

Conversely, an investor who targets a higher return can choose to leverage a diversified moderate allocation instead of taking on greater concentration risk in equities. Using historical data, the 30% leveraged moderate allocation would have achieved similar returns as an aggressive allocation, but at slightly lower levels volatility. While leverage is by no means riskless, concentration risk in an equity-heavy portfolio, particularly in later stages of the business cycle, could be a significant risk as well, in our view.

Figure 60: Impact of leverage and borrowing costs on a sample of allocations

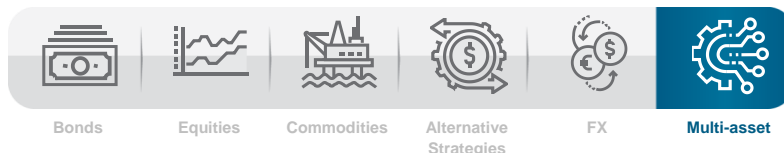


Source: Bloomberg, Standard Chartered

Note: Data from May 2012 to May 2017. Libor at 1.3% at the time of writing.

US Equities represented by the S&P Total Returns index from Jan 1988 to May 2017

Table assumed a base case borrowing cost of 2.5% and a risk-free rate of 1.3%. All returns in USD.



2. Impact of borrowing costs

As rates rise, borrowing costs are likely to increase, which will eat into the returns of leveraged allocations. Questions remain surrounding the use of leverage, particularly on bonds, during periods of rising interest rates. However, interest rate risk is just one of the many exposures within a diversified allocation. There are also many choices available to investors to hedge against rising interest rates, including the use of fixed-rate loans or using interest rate swaps to hedge out a variable rate exposure. Therefore, a diversified allocation may still do well in a moderately rising rate environment and, the reality is, we are expecting a fairly benign rate hike scenario, with two rate hikes by the Fed over the next 12 months. The risk is – periods of sharp rising rates or market dislocations (not our core scenario) – which will hurt any allocation, but particularly more so for a leveraged, bond-heavy allocation.

A suggested rule of thumb for employing leverage

The amount of leverage to employ depends on an individual's risk tolerance and investment objectives. The table below (Figure 61) illustrates the volatility and maximum drawdown across a variety of assets and allocations. As a rule of thumb, the more volatile an asset, the smaller amount of leverage one should apply. This reduces the probability of a margin call, in the event of sharp decline in asset prices. Depending on one's financial objective and tolerance for risk, leverage can be used across different types of assets or allocations to enhance returns.

Leverage can be a useful tool to help diversify sources of risk while maintaining a similar absolute level of risk within an investment allocation. Instead of assuming greater absolute risk (eg, increasing exposure to riskier assets), investors can consider applying some modest leverage to a diversified allocation to generate higher returns at a similar level of risk.

Figure 61: Historical returns volatility and maximum drawdown

Leveraging on assets with higher returns volatility will increase the risk of a margin call

Asset class	One Standard Deviation Return Range			Max Drawdown *
Developed Markets IG Corporate Bonds	0%	-	12%	-18%
Developed Markets HY Corporate Bonds	1%	-	17%	-35%
Global Equities	-11%	-	24%	-57%
Commodities	-21%	-	22%	-79%
Investment profiles				
Conservative	0%	-	13%	-27%
Moderate	-3%	-	17%	-38%
Aggressive	-7%	-	22%	-50%

Source: Standard Chartered, Bloomberg

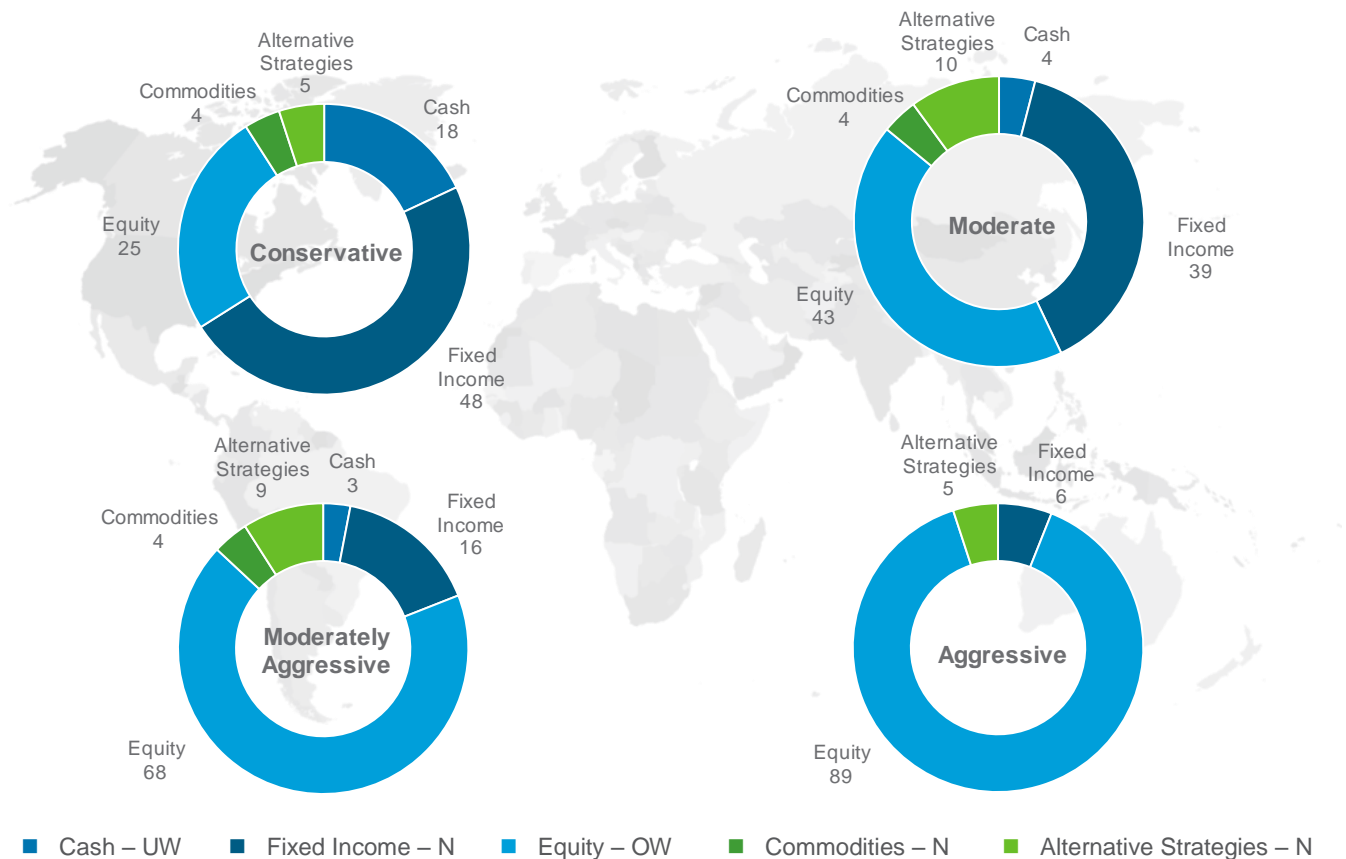
Data based on weekly historical returns from January 2002 to June 2017

* Maximum drawdown based on full period returns

Allocation assumptions: Conservative Profile: 20% Equity versus 80% Bonds; Moderate Profile: 50% Equity versus 50% Bonds; Aggressive Profile: 20% Bonds versus 80% Equity

Global asset allocation summary

Global-focused Tactical Asset Allocation - July 2017 (12M). All figures are in percentages.



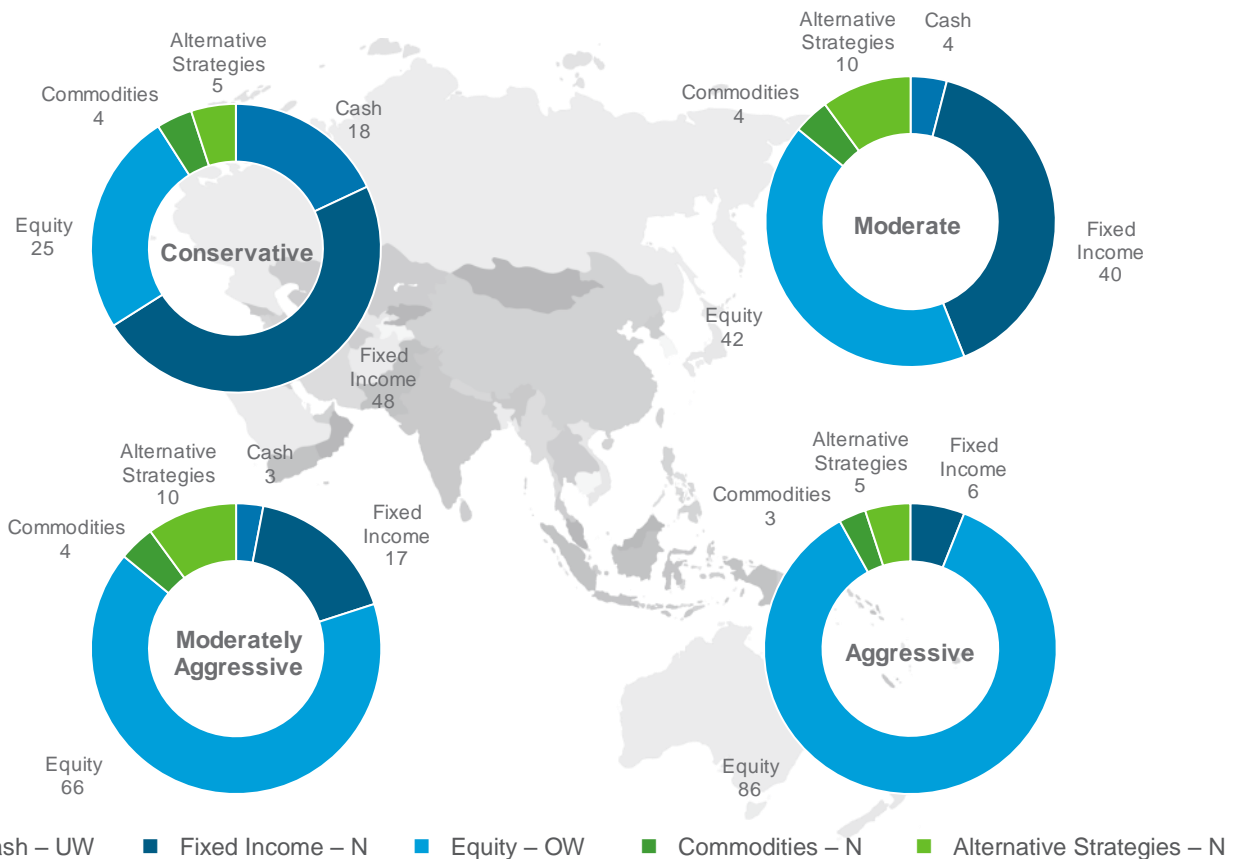
Asset Class	Region	View vs. SAA	Conservative	Moderate	Moderately Aggressive	Aggressive
Cash & Cash Equivalents	USD Cash	UW	18	4	3	0
	DM Government Bonds	UW	26	22	8	2
Developed Market Bonds	DM IG Corporate Bonds	N	9	7	2	0
	DM HY Corporate Bonds	N	4	2	2	2
Emerging Market Bonds	EM USD Sovereign Bonds	OW	5	4	2	2
	EM Local Ccy Sovereign Bonds	OW	2	2	2	0
	Asia Corporate USD Bonds	N	2	2	0	0
Developed Market Equity	North America	N	13	22	38	50
	Europe ex-UK	OW	6	10	13	17
	UK	UW	0	0	0	2
	Japan	N	2	4	6	8
Emerging Market Equity	Asia ex-Japan	OW	4	7	9	12
	Non-Asia EM	N	0	0	2	0
Commodities	Commodities	N	4	4	4	0
Alternative Strategies		N	5	10	9	5

Source: Bloomberg, Standard Chartered

For illustrative purposes only. Please refer to the disclosure appendix at the end of the document.

Asia asset allocation summary

Asia-focused Tactical Asset Allocation - July 2017 (12M). All figures are in percentages.



Asset Class	Region	View vs. SAA	Conservative	Moderate	Moderately Aggressive	Aggressive
Cash & Cash Equivalents	USD Cash	UW	18	4	3	0
	DM Government Bonds	UW	14	11	5	0
Developed Market Bonds	DM IG Corporate Bonds	N	5	4	2	0
	DM HY Corporate Bonds	N	3	3	0	0
Emerging Market Bonds	EM USD Sovereign Bonds	OW	10	8	4	2
	EM Local Ccy Sovereign Bonds	OW	8	8	3	2
	Asia Corporate USD Bonds	N	8	6	3	2
Developed Market Equity	North America	N	7	11	19	25
	Europe ex-UK	OW	7	11	16	21
	UK	UW	0	0	2	2
	Japan	N	2	3	3	4
Emerging Market Equity	Asia ex-Japan	OW	9	15	21	28
	Non-Asia EM	N	0	2	5	6
Commodities	Commodities	N	4	4	4	3
Alternative Strategies		N	5	10	10	5

Source: Bloomberg, Standard Chartered

For illustrative purposes only. Please refer to the disclosure appendix at the end of the document.

Market performance summary*

Source: MSCI, JP Morgan, Barclays, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

*All performance shown in USD terms, unless otherwise stated.

*YTD performance data from 31 December 2016 to 29 June 2017 and 1-month performance from 29 May 2017 to 29 June 2017

Equity

	Year to date	1 month
Global Equities	11.7% ↑	0.6% ↑
Global High Dividend Yield Equities	10.4% ↑	0.4% ↑
Developed Markets (DM)	10.8% ↑	0.6% ↑
Emerging Markets (EM)	18.8% ↑	0.4% ↑
BY COUNTRY		
US	9.0% ↑	0.3% ↑
Western Europe (Local)	8.4% ↑	-2.0% ↓
Western Europe (USD)	16.0% ↑	-0.2% ↓
Japan (Local)	6.7% ↑	3.3% ↑
Japan (USD)	10.5% ↑	2.1% ↑
Australia	10.8% ↑	5.1% ↑
Asia ex- Japan	23.4% ↑	1.7% ↑
Africa	9.4% ↑	-5.3% ↓
Eastern Europe	-2.1% ↓	-3.7% ↓
Latam	9.6% ↑	-1.1% ↓
Middle East	5.1% ↑	4.5% ↑
China	25.6% ↑	2.0% ↑
India	20.3% ↑	-0.7% ↓
South Korea	29.6% ↑	1.0% ↑
Taiwan	22.4% ↑	3.8% ↑
BY SECTOR		
Consumer Discretionary	12.0% ↑	-0.8% ↓
Consumer Staples	11.5% ↑	-1.8% ↓
Energy	-7.0% ↓	-2.5% ↓
Financial	11.2% ↑	3.7% ↑
Healthcare	16.2% ↑	3.6% ↑
Industrial	12.9% ↑	0.8% ↑
IT	20.8% ↑	-0.9% ↓
Materials	10.1% ↑	1.1% ↑
Telecom	3.2% ↑	-1.3% ↓
Utilities	11.1% ↑	-0.9% ↓
Global Property Equity/REITS	7.5% ↑	1.2% ↑

Bonds

	Year to date	1 month
SOVEREIGN		
Global IG Sovereign	4.8% ↑	0.6% ↑
US Sovereign	2.0% ↑	0.3% ↑
EU Sovereign	7.1% ↑	1.6% ↑
EM Sovereign Hard Currency	6.3% ↑	0.0% ↑
EM Sovereign Local Currency	9.9% ↑	1.3% ↑
Asia EM Local Currency	7.4% ↑	0.3% ↑
CREDIT		
Global IG Corporates	5.4% ↑	1.0% ↑
Global HY Corporates	6.5% ↑	0.4% ↑
US High Yield	4.9% ↑	0.2% ↑
Europe High Yield	12.6% ↑	2.5% ↑
Asia High Yield Corporates	3.9% ↑	0.4% ↑

Commodity

	Year to date	1 month
Diversified Commodity	-6.7% ↓	-3.1% ↓
Agriculture	-6.7% ↓	-1.3% ↓
Energy	-21.6% ↓	-9.2% ↓
Industrial Metal	5.5% ↑	2.3% ↑
Precious Metal	6.1% ↑	-2.6% ↓
Crude Oil	-19.2% ↓	-9.9% ↓
Gold	8.1% ↑	-1.9% ↓

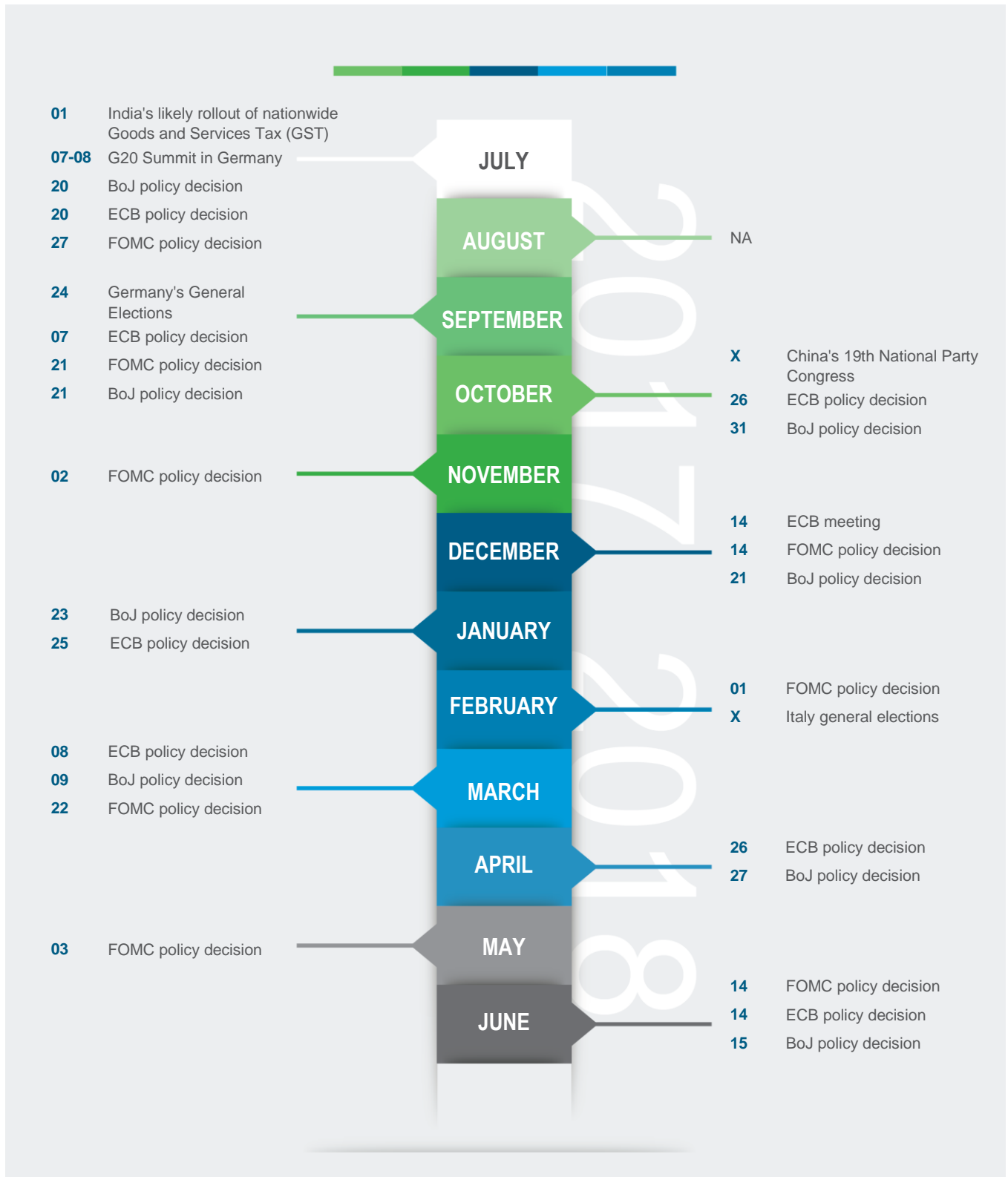
FX (against USD)

	Year to date	1 month
Asia ex- Japan	3.0% ↑	0.0% ↑
AUD	6.6% ↑	3.3% ↑
EUR	8.8% ↑	2.5% ↑
GBP	5.4% ↑	1.3% ↑
JPY	4.3% ↑	-0.8% ↓
SGD	5.0% ↑	0.5% ↑

Alternatives

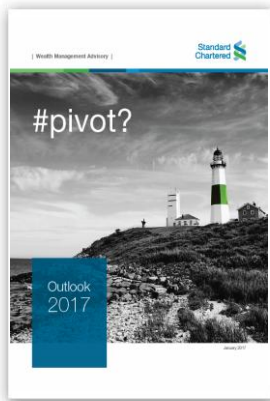
	Year to date	1 month
Composite (All strategies)	2.8% ↑	0.4% ↑
Relative Value	1.5% ↑	0.0% ↑
Event Driven	4.8% ↑	0.2% ↑
Equity Long/Short	3.9% ↑	0.7% ↑
Macro CTAs	0.4% ↑	0.9% ↑

Events calendar



Legend: X – Date not confirmed | ECB – European Central Bank | FOMC – Federal Open Market Committee | BoJ – Bank of Japan

Wealth management advisory publications



Annual

Annual Outlook

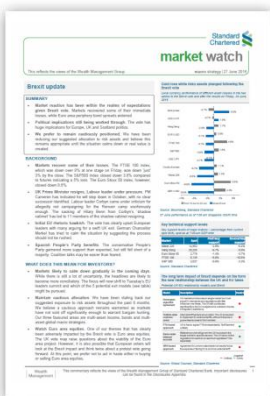
Highlights our key investment themes for the year, the asset classes we expect to outperform and the likely scenarios as we move through the year.



Monthly

Global Market Outlook

Our monthly publication captures the key investment themes and asset allocation views of the Global Investment Committee.



Ad hoc

Market Watch

Analyses key market developments and their likely impacts on our investment views.

Weekly Market View

Update on recent developments in global financial markets and their implications for our investment views.



Weekly

FX Strategy

Weekly update on our currency market views, predominantly from a technical standpoint.



Weekly

Investment Brief

Highlights our key investment themes for the year, the asset classes we expect to outperform and the likely scenarios as we move through the year.



Ad hoc

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