Wealth Management Advisory

Global Market Outlook

October 2016

Yields peaking?

Global equities are close to 12-month highs again; we remain cautious. After weakening on fears that less-supportive monetary policies will lift government bond yields, equities have recovered almost all their losses over the past week.

Looking forward, we see significant short-term risks to the global market outlook, including the US Presidential election, expectations of rising US interest rates and political uncertainty in Italy. However, the extreme fund manager positioning (they are overweight cash and underweight equities) means a continued rally in equity markets cannot be ruled out.

Bond yields are unlikely to rise significantly from here. We believe central banks still have an incentive to limit any increase in bond yields. The Fed remains on hold, at least for now. The BoJ has explicitly targeted 10-year government bond yields around 0% and the ECB could follow suit. Therefore, we expect interest rate increases to be very gradual, leaving us comfortable with our preference for multi-asset income investing.

A balanced approach to investing makes sense. We are likely in the late stages of the US economic cycle and, in recent years, September-October have seen significant weakness. Investors should maintain a balanced exposure to major asset classes. However, we believe it is important to complement this with an allocation to multi-asset global macro strategies, given the gradually rising risks of the global economic cycle taking an abrupt turn for the worse.

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Investment strategy

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Advanced economies are at different stages of the economic cycle. US expansion mature, but consumer spending to drive growth in 2016

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Deflationary pressures to abate in Developed Markets due to gradually tightening labour markets and bottoming oil prices

A

Asia and Emerging Markets still dependent on China, which is transitioning towards consumer-led growth. Oil prices also key

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Policies of central banks to remain supportive of growth, notwithstanding Fed tightening

T

Transition to late cycle likely to lead to higher volatility

The yield challenge

- Fears of higher Fed rates and the BoJ's efforts to raise long-maturity yields pushed 10-year bond yields higher across major regions over the past month. This undermined equity markets, given a rising correlation between the two asset classes.
- The Fed's decision to leave rates unchanged for now has halted the rise in yields, supporting equity markets in the near-term. However, we see opportunities to start protecting recent gains by owning insurance against drawdown risks (via multi-asset macro strategies or gold, for example), akin to an increasingly barbell-like approach.
- Long term, we believe an extended muddle-through environment will keep policymakers supportive – a positive outcome for multi-asset income strategies.

Fiscal policy efforts could improve the outlook

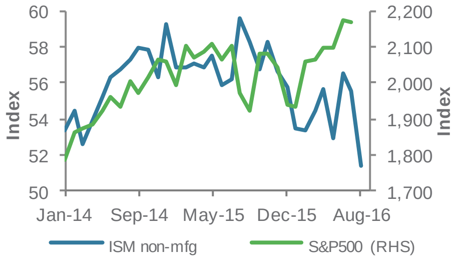
Last month, we concluded that a muddle-through scenario was the most likely outcome, but that the risk of a downside scenario was much greater than usual. We believe little has changed over the past month to alter this view.

In this context, two developments over the past month are worth noting. First, the US Presidential election and renewed growth challenges in Japan have reopened the question of whether fiscal spending should also rise to support growth. We believe such an outcome is not imminent, but is reasonably likely in the US and Japan. This would likely raise the chances of a more positive scenario.

Second, the debate over the longevity of the economic cycle remains intense. Economic and corporate data suggest chances of a US recession within the next 12 months have ticked higher (see ISM in the chart below, for example). However, the key question is whether policymakers' efforts will be able to push out the recession further – this is crucial to investment decisions as it argues for the continuation of a balanced approach (ie, owning defensive asset classes, but ensuring sufficient exposure to risky assets as well).

Figure 1: Recent economic data point to downside risks for equity markets

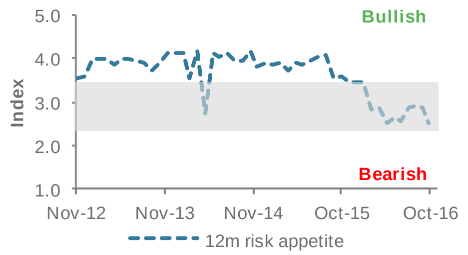
S&P500 vs. US ISM non-mfg index (brought forward by one month)



Source: Bloomberg, Standard Chartered

Figure 2: We remain relatively cautious on the long-term outlook for risky assets

Standard Chartered Group Investment Committee's 12-month outlook on risky assets



Source: Standard Chartered

Investment strategy

Retain preference for Emerging Markets and income strategies

The above backdrop supports continuity in our long-term investment themes. We believe two themes stand out today, in particular.

First, the likelihood that policymakers will continue to support growth. Short-term rises in yields notwithstanding, recent comments and forecasts from the Fed and the BoJ make us more confident the broadly low-yield environment remains in place, directly benefitting multi-asset income strategies.

Second, our pivot towards Emerging Markets continues. Recent economic, commodities and earnings trends keep us confident in taking selective exposure. In equities, we would focus on Asia ex-Japan, where earnings revisions offer more room for optimism than commodity-dominated markets elsewhere. In bonds, we continue to believe EM USD government bonds offer the best risk/reward trade-off.

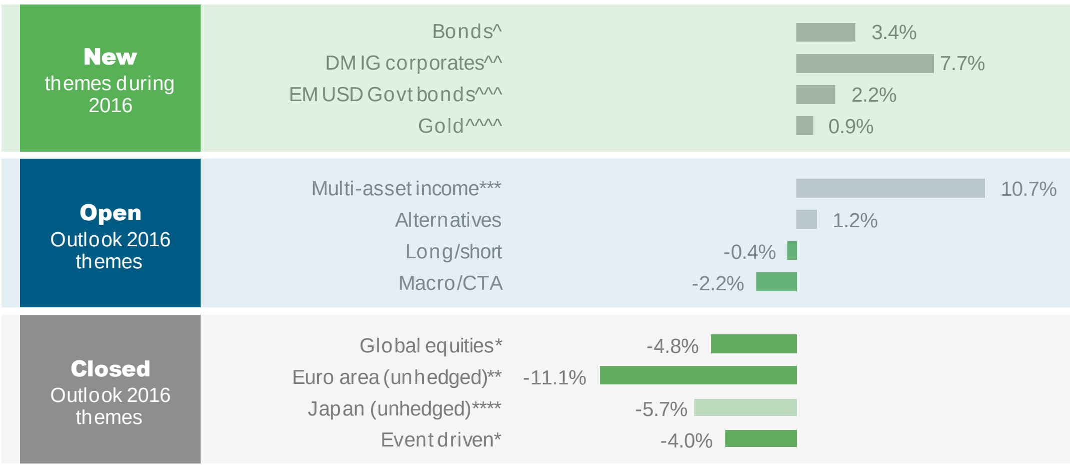
Market insurance attractive in the short term

Our unchanged long-term outlook notwithstanding, the high correlation between equities and bonds (driven by the market's hyper-sensitivity to short-term data) and its implications for the Fed worry us in the short term. Historically, this has made equity markets vulnerable to higher yields and has tended to worsen short-term sell-offs.

However, outside very select areas, we believe owning insurance against a sell-off is a better approach to deal with short-term risks than simply withdrawing to the sidelines. A few key factors – high fund manager cash levels on the sidelines and the lack of extreme positioning – mean a sharp pullback (10% or more) in global equities is far from certain. While the generally low volatility means the insurance has not been needed thus far, reducing long exposure could mean being forced to re-enter markets at a higher price, a far more expensive option than just paying for insurance (via multi-asset macro strategies or gold, for example).

Figure 3: Income theme once again the strong performer

Performance of A.D.A.P.T. themes since Outlook 2016***
'Themes during 2016' consist of sub-asset classes where we are OW or N the main asset class and OW the sub-asset class



* Closed on 25 February 2016
**FX-hedge removed as of 25 February 2016. Theme closed on 27 June 2016.
*** For the period 11 December 2015 to 22 September 2016. Income basket is as described in the Outlook 2016: A year to A.D.A.P.T. to a changing landscape, Figure 38 on page 60, and revised in the Global Market Outlook, 28 March 2016;
**** Closed on 25 March 2016
^ Returns from 25 May 2016 to 22 September 2016; ^^ Returns from 25 February 2016 to 22 September 2016; ^^^ Returns from 21 July 2016 to 22 September 2016; ^^^^ Returns from 27 June 2016 to 22 September 2016.
Source: Bloomberg, Standard Chartered

Standard Chartered

Investment strategy

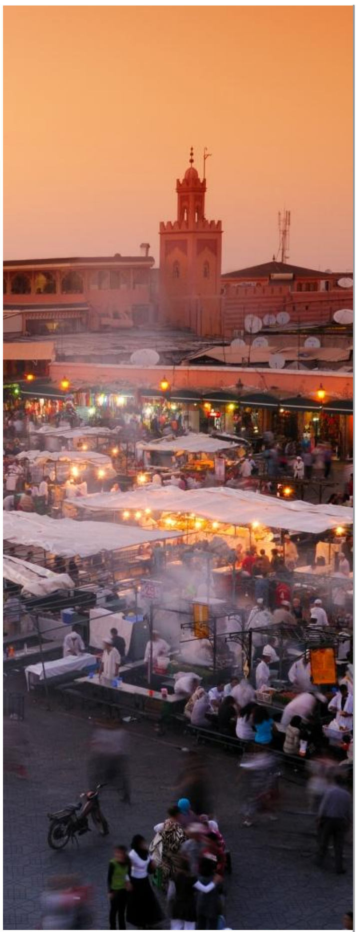
Figure 4: Our Tactical Asset Allocation views (12m) USD

Asset class	Sub-asset class	Relative outlook	Rationale
Multi-Asset Strategies	Multi-Asset Income	↑	Low policy rates, low/negative yields remain a support
	Multi-Asset Macro	↑	Insurance policy against a surge in yields or an end of the cycle
Equities ↓	US	↔	Earnings growth expected; valuations not cheap; US elections a risk
	Euro area	↔	Earnings visibility poor; valuations reasonable; Brexit impact a concern
	UK	↔	Brexit vote clouds earnings outlook; high valuations, weak GBP helps
	Japan	↓	Inexpensive valuations; risk of extreme outcomes (up or down) is high
	Asia ex-Japan	↑	Earnings/dividends uptick positive; valuations reasonable; flows supportive
	Non-Asia EM	↔	Commodities key to earnings; valuations high; flows supportive
Bonds ↑	DM Govt	↓	Low yields; high valuations; Fed policy and inflation are risks
	EM Govt (USD)	↑	Attractive yields; fair valuations; supportive flows
	DM IG corporate	↑	Reasonable yields; valuations fair; preferred route to IG bond exposure
	DM HY corporate	↔	Valuations full; tightening US credit standards, credit quality risks
	Asian corporate	↔	Reasonable yields; valuations fair; demand/supply favourable; prefer IG
	EM (LCY)	↔	Reasonable yields; reduced currency risk; prefer selective exposure
Currencies	USD	↔	Rate differentials stabilising; rate outlook remains key
	EUR	↔	Rate differentials stabilising; Fed likely the key driver
	JPY	↔	Risk of extreme policy outcomes is high; BoJ efforts key
	GBP	↓	Rate differential falling on BoE easing; current account, political stress risks
	AUD	↔	Rate premium reduced; China stability positive, but metal prices a risk
	Asia ex-Japan	↔	Rate premium over G3 currencies; central banks may limit gains

Legend: ↑ Overweight ↔ Neutral ↓ Underweight

Source: Standard Chartered

Perspectives on key client questions



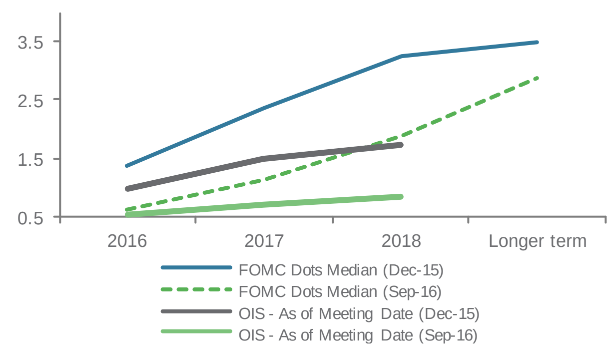
Q What are the implications of the latest Fed and BoJ announcements?

A In our opinion, the Fed remains focused on gradually tightening financial conditions, amid a falling unemployment rate and modest inflation, but without creating volatility.

In 2014, much of this tightening was carried out by a stronger USD. This year, the USD and corporate borrowing costs have fallen, making conditions more accommodative. This means, a December rate hike to offset this loosening of monetary conditions is likely. However, we expect the Fed to tighten policy only gradually given that, beyond consumer spending, the overall recovery remains fragile.

Figure 5: The Fed continues to lower its interest rate forecasts

The US Fed's interest rate forecasts over time versus market expectations



Source: Bloomberg, Standard Chartered

For the BoJ, we believe the latest easing measures (see page 10) are unlikely to dramatically alter Japan's outlook. While the BoJ likely has the ability to boost growth and inflation, political impediments appear too great for it to pursue sufficiently aggressive policies for now. We have downgraded Japanese equities to underweight and remain watchful of the potential knock-on effects on US and European bond markets, as markets consider whether we may see a spill-over from BoJ's change in policy to other markets.

Q Should investors worry about a pick-up in inflation?

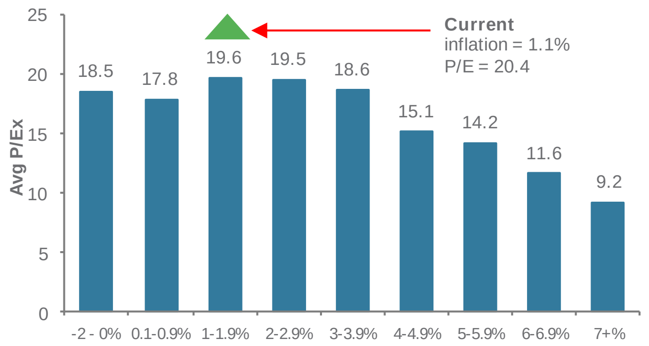
A It depends how much inflation increases. At the structural level, higher inflation is a positive, as this would erode high levels of debt globally. However, rapidly rising inflation would also have an impact on asset markets. From a bond market perspective, a shift in focus from deflationary concerns to sustained inflationary pressures would likely put upward pressure on bond yields. Meanwhile, as the chart on the next page highlights, equities generally fall in value when the inflation rate rises significantly above 3-4%.

That said, while we see inflationary pressures rising modestly in the US, we do not believe they will rise dramatically. This should limit any sell-off in bond markets as the Fed retains its preference for gradual policy tightening (see page 8). It also suggests inflation is unlikely to cause equity markets to sell-off dramatically as inflation expectations remain well-anchored at low levels.

Within FX, we expect the USD to be largely range-bound (see pages 21-23 for ranges) through the end of the year, as monetary policy divergence is likely to be modest.

Figure 6: A small increase in inflation would be reassuring, but too much would be damaging for equity markets

Average S&P500 trailing price-earnings ratios under different inflation environments (1990-2016)



Source: Bloomberg, Standard Chartered

Q Who will win the US Presidential election and what does this mean for financial markets?

A Over the past month, Donald Trump has clawed back a huge deficit versus Hillary Clinton in the US Presidential polls. Predicting the likely winner is tough, given there are still six weeks before the election. The next focus will be on the Presidential debates (starting 26 September).

Of course, it is not only the Presidency that matters, but also the House and Senate outcomes. A clean sweep of the three legislative branches would increase the probability that Presidential campaign promises will be implemented. Markets suggest a 44% probability of a split Congress.

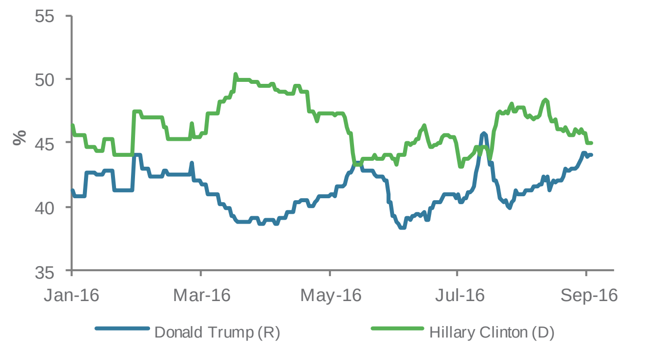
On this, one can make the case that a Democratic clean sweep is likely to be less supportive of equities as Clinton would likely be less pro-corporate America than if she were tempered by having to deal with a Republican House.

Trump, on the other hand, would likely be more conciliatory towards the oil and banking sector, which may somewhat offset his confrontational immigration and trade policies, although his policy framework may push bond yields higher.

Our central scenario remains a split in Legislative branches, which may temper the longer-term impact of the election.

Figure 7: US Presidential race tightens

National Presidential Election Poll showing support for the two candidates



Source: Bloomberg, Standard Chartered

Q Are you expecting the increase in market volatility over the past month to continue?

A There are clearly a number of factors that could lead to market weakness in the coming weeks. These include rising US interest rate expectations, US political uncertainty and the Italian referendum. Thus, a period of short-term weakness in risk assets is our central scenario.

Two factors suggest we could see a strong Q4 for equities. First, a recent survey shows fund managers' largest overweight position is in cash and the second-most underweight position is in equities. Such extreme positioning has often led to strong equity returns in the short-term.

Second, after a seasonal weakness in September-October, markets are usually positive in the November-January period. That said, over the past 12 months, equity markets have not followed the typical seasonal patterns.

Given the above, we would 1) maintain a significant allocation to equities in case the expected pullback does not arrive and 2) look for opportunities to take advantage of any potential weakness/increase in volatility, especially in our preferred regions of Asia ex-Japan and the US.

Please see pages 3-5 for a summary of our key asset class views.

Macro overview

The Fed is likely to remain cautious

The ECB and the BoE to ease further; Japan needs more fiscal and monetary easing

China is likely to maintain targeted policy easing

IMPLICATIONS FOR INVESTORS

Fiscal easing enters the scene

- **Growth** has surprised positively in Asia and the UK. Asia could deliver more upside surprises as China stabilises. The US and the Euro area have weakened lately.
- **Inflation** remains subdued worldwide, but US inflation could rise as the job market keeps tightening. Euro area and Japan continue to face disinflation challenges.
- **Policy:** The Fed is likely to raise rates in December and maintain a gradual hiking pace in 2017. The Euro area and Japan are likely to ease further. However, growing monetary policy limitations suggest fiscal easing will rise up the priority lists. It figures prominently in the 'to-do' lists of both US Presidential candidates.

Chugging along, but mindful of risks ahead

Global growth has been mixed in the aftermath of the UK's Brexit vote, with Asia and the UK delivering positive surprises and the US and Euro area underwhelming. Against this backdrop, the US election and Italian referendum are even more important.

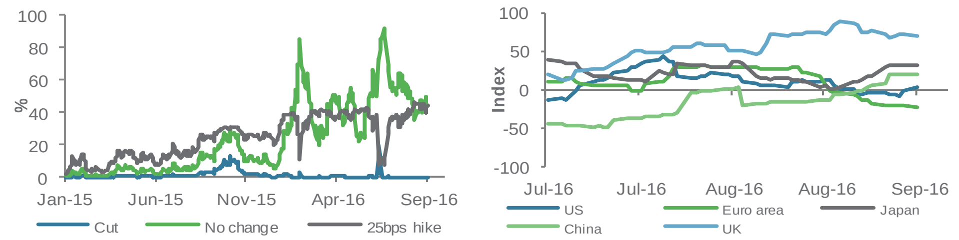
We are mindful of a likely modest pick-up in US inflation as the job market continues to tighten. Inflation remains subdued in the rest of the world, especially in Europe and Japan, putting pressure on policymakers to explore new ways to revive their economies.

Given this, we see the following policy implications:

- The Fed to raise rates in December; fiscal easing may offset monetary tightening
- The ECB and the BoE to ease policy further as data turn weaker
- Japan to roll out more fiscal easing to supplement monetary stimulus

Figure 8: Market expectations of a Fed rate hike by December have increased in recent weeks, although US data has remained lacklustre

Probability of a Fed rate hike/cut/no-change by December, based on Fed funds futures; %; economic surprises indices for the US, UK, Euro area, Japan and China



Source: Citigroup, Bloomberg, Standard Chartered

Macro overview

Fed sets stage for December rate hike

US economic data has weakened lately, with the manufacturing sector contracting again, and business confidence in the services sector falling to its weakest since 2010. Consumption, which accounts for more than two-thirds of the economy, too has slowed. Upcoming job market data will be closely watched for signs of weakness, as robust hiring has been driving consumption in recent years.

Fed policymakers appear divided on the need for raising rates in the face of weakening data and still-subdued inflation. The latest policy review suggests a majority of policymakers expect a rate hike this year, likely in December. While we agree, the upcoming US Presidential election is a key risk, as is the weakening dataset. Both candidates have supported increased fiscal stimulus, though, which would be supportive of growth in the medium term.

ECB likely to ease further amid low inflation

Euro area activity has underwhelmed lately, with business confidence in the manufacturing and services sectors softening. Although loans to companies and households continue to accelerate, helped by record low interest rates, industrial output has faltered, especially in Germany.

The ECB took note of the lending recovery in its latest policy review and refrained from announcing any extension to its current bond purchase programme, which is due to end in March 2017. We expect further easing as inflation, while recovering from negative levels, remains well below the ECB's 2% target.

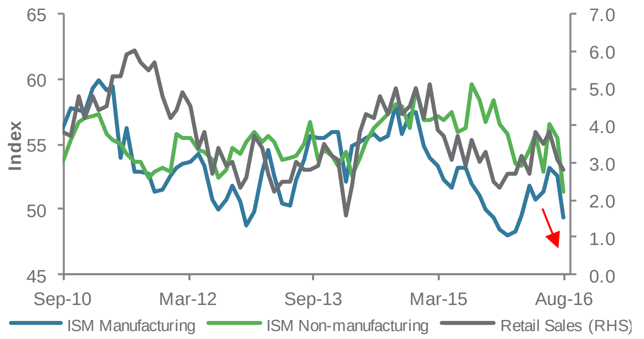
BoE may have to ease if recovery falters

UK manufacturing and services sector confidence indicators rebounded sharply in August, while consumption and hiring held firm, adding to signs the economy has remained largely resilient, despite the surprise Brexit vote in June.

We expect the economy to weaken in Q4 as a summer boost to consumption fades. Although the weak GBP has helped exports, the uncertainty around Brexit talks is likely to keep business investment subdued and BoE policy easy for now.

Figure 9: US manufacturing and services sector data have deteriorated lately, along with a slowdown in consumption

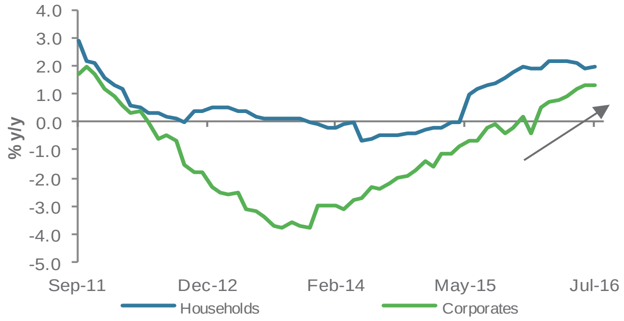
US ISM Manufacturing & Non-manufacturing indices; core retail sales, %, y/y



Source: Bloomberg, Standard Chartered

Figure 10: Euro area corporate and household lending have continued to improve on the back of record low interest rates

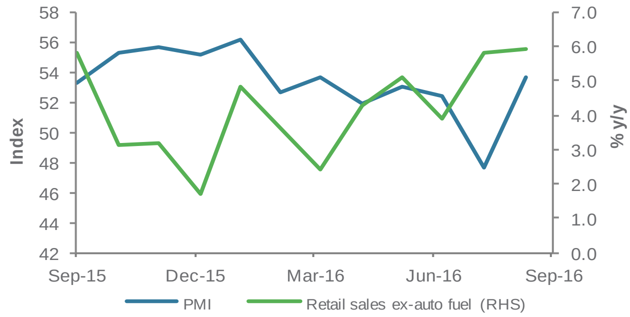
Euro area lending to non-financial companies and households, %, y/y



Source: Bloomberg, Standard Chartered

Figure 11: The UK's business confidence rebounded and consumption was resilient for the second month after the Brexit vote

UK Composite PMI; retail sales ex-auto fuel, %, y/y



Source: Bloomberg, Standard Chartered

Macro overview

BoJ likely to ease more to revive inflation

Japan's business confidence remains depressed, as a strong JPY likely dampens the outlook for exports and corporate investment. Meanwhile, inflation expectations remain near record lows despite easing in recent years.

The BoJ's revised policy, which focuses on supporting long-term bond yields near current levels (while keeping short-term yields low), is likely to help the banking and insurance sector's profitability (which had been hurt by negative interest rates). The commitment to expand the BoJ's monetary base until inflation stabilises above its 2% target, opens up the possibility of further policy easing in the coming months.

China fiscal stimulus to support recovery

China's fiscal and credit stimulus continues to help the economy stabilise. A key driver is the property sector, which has benefitted from relaxed government rules. However, a surge in property prices and lending this year has increased concerns about the sector's medium-term financial stability.

We believe authorities are likely to calibrate monetary and fiscal policy stimulus in the coming months to maintain growth within 6.5-7.0% in 2016. Recent commentary suggests policymakers are concerned about stability, raising the risk of withdrawal of some of the credit levers in Q4 to rein in runaway property prices. However, China's political cycle, with the crucial party congress due in late-2017, argues against a negative policy-driven economic shock.

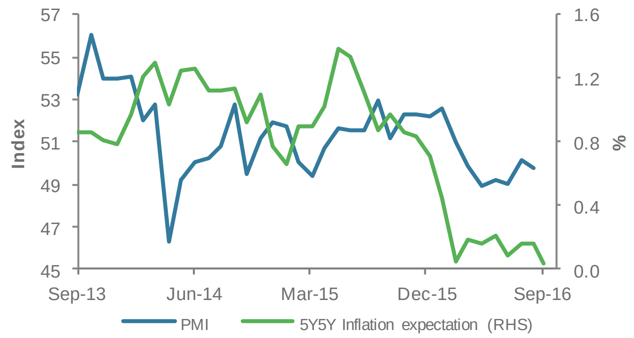
Asian exports bottom; room for lower rates

Asia's export contraction, which started in 2015, is showing signs of nearing an end. A stabilisation in China's economy and an upturn in technology demand are partly responsible, as seen from the export recovery in South Korea and Taiwan – two Asian exporters most exposed to the two markets.

With Asian inflation still subdued (and below policy rates in many markets), we believe there is scope for several central banks across the region – notably Indonesia, India, Thailand, Malaysia and South Korea – to lower rates further. The latest dip in India's inflation has revived rate cut expectations there.

Figure 12: Japan's business confidence indicator remains subdued, while inflation expectations are at new record lows

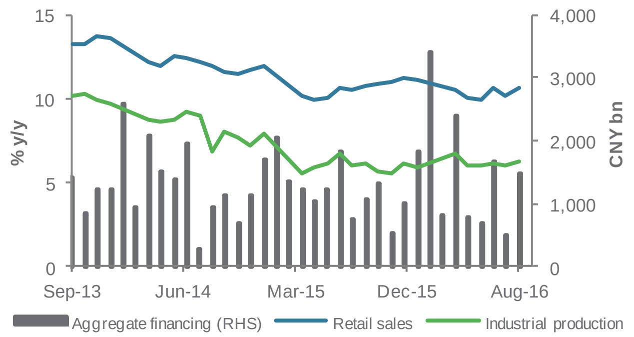
Japan's PMI; market implied five-year inflation expectations starting in 2021



Source: Bloomberg, Standard Chartered

Figure 13: China's consumption remains firm and industrial output has stabilised lately, amid this year's property-driven lending upturn

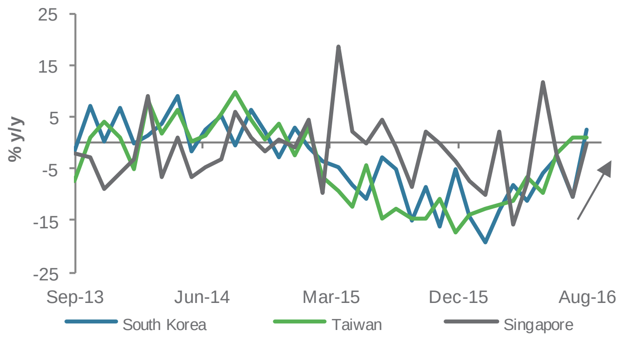
China's aggregate financing, CNY bn; industrial production, %, y/y; retail sales, %, y/y



Source: Bloomberg, Standard Chartered

Figure 14: Asian exports are stabilising after a long slump

Exports from South Korea, Taiwan and Singapore; %, y/y



Source: Bloomberg, Standard Chartered

A rebalancing opportunity

- Bonds remain our preferred asset class. The rebound in yields over the last month presents an opportunity to rebalance the allocation within bonds. Investors could use this opportunity to increase allocation to our preferred areas within bonds.
- Emerging Market (EM) USD government bonds remain our favoured sub-asset class and are our preferred route to take EM exposure.
- We continue to like US Investment Grade (IG) corporate bonds and believe the recent rise in yields presents investors an opportunity to add exposure.
- We maintain Asian corporate bonds, EM local currency government bonds and Developed Market (DM) High Yield (HY) bonds as core holdings, though our conviction on the last sub-asset class has declined at the margin.

Figure 15: Our preferred areas within bonds

Bond Asset Class	Preference	Yield	Value	FX
USD government bonds in Emerging Markets (EM)	Preferred	🟢	🟡	🟡
Investment Grade (IG) corporate bonds in Developed Markets (DM)	Preferred (US over Europe)	🟡	🟡	🟡
USD corporate bonds in Asia	Core holding	🟡	🟡	🟡
Local currency government bonds in EMs	Core holding	🟢	🟡	🟡
High Yield corporate bonds in DMs	Core holding (US over Europe)	🟢	🔴	🟡
IG government bonds in DMs	Least preferred	🔴	🔴	🟡

Traffic light signal refers to whether the factor is positive, neutral or negative for each asset class.
Source: Standard Chartered

We favour EM USD government bonds and US IG corporate bonds

HY still a core holding, but caution warranted given gains thus far

Take EM exposure through USD-denominated bonds

IMPLICATIONS FOR INVESTORS

Government bonds – Developed Market

The rebound in G3 government bond yields, especially US Treasuries, over the past month validated our cautious stance towards them. We had been highlighting over the past few months that the low absolute yields on offer leave very little buffer, and even a small uptick in yields can lead to negative returns for investors.

Following the recent rebound in yields, we believe the 10-year US Treasury yield is likely to remain range-bound for the rest of the year. An unexpected jump in inflation expectations or a large fiscal stimulus from the new US president remains the key risks.

Low yields and an ongoing debate on the length of the credit cycle place investors in a tough spot. In the past, investing into high-quality government bonds was one of the ways to hedge against the recession risk. In light of the low yields today, we favour gaining exposure to high-quality bonds through IG corporate bonds. On balance, we continue to prefer maintaining a 5-7 year maturity profile for USD-denominated government bonds.

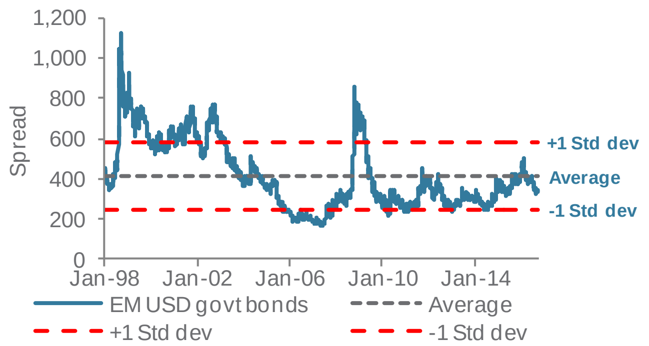
Bonds

Government bonds – EM USD government bonds

EM USD government bonds remain one of our favourite areas. We remain optimistic as supportive factors, such as easy DM monetary policies, a range-bound USD and favourable commodity price outlook, remain in place. However, while they continue to offer an attractive yield of around 5.1%, the recent rally means valuations are gradually becoming less compelling.

Figure 16: EM USD government bonds are not cheap anymore

EM USD government bond spreads

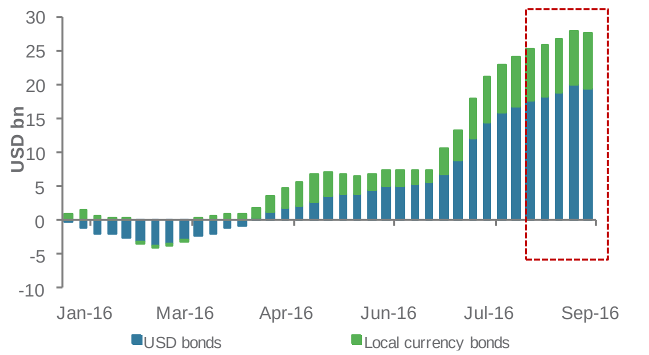


Source: Bloomberg, Standard Chartered

Additionally, investor fund inflows into EM bonds have stagnated over the past few weeks. We continue to closely monitor them, as a reversal to outflows would be a headwind for EM USD government bonds. A sharp decline in commodity prices and a tighter-than-expected Fed policy stance remain the major risks over the next six months.

Figure 17: Inflows into EM bonds take a breather

Cumulative EM USD and Local currency government bond fund inflows



Source: EPFR, Standard Chartered

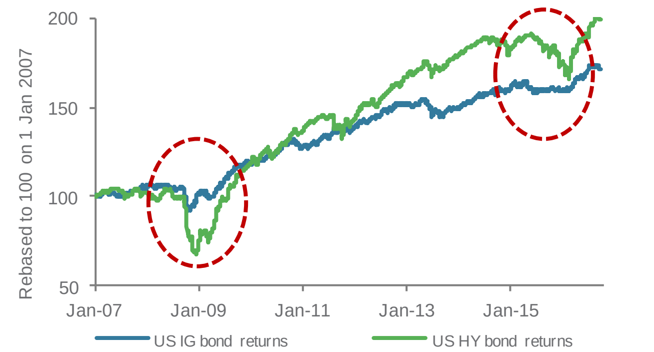
Corporate bonds – DM IG corporate bonds

As discussed in the previous page, we choose to take the high-quality bond exposure through IG corporate bonds, and within that class, US IG corporate bonds remain our top pick.

As we highlighted in our last weekly publication, we believe the recent rise in yields could provide a good entry point for long-term investors. Although the yields are still lower when compared with the start of the year, we believe IG corporate bonds have become more important as we move closer towards the end of the cycle. Over the past decade, IG bonds have provided lower returns than HY bonds, but with much lower drawdowns in times of stress.

Figure 18: US IG corporate bonds witness lower drawdowns in times of stress

Comparison of cumulative US IG and US HY corporate bond returns



Source: Barclays, Bloomberg, Standard Chartered

Corporate bonds – DM HY corporate bonds

Over the past month, we have turned more cautious on global HY bonds, but we continue to see them as a core holding because of the 6.1% yield on offer, given our view of a persistent low growth and low rates environment. There are also some signs that the pace of increase in default rates in US HY corporate bonds is slowing.

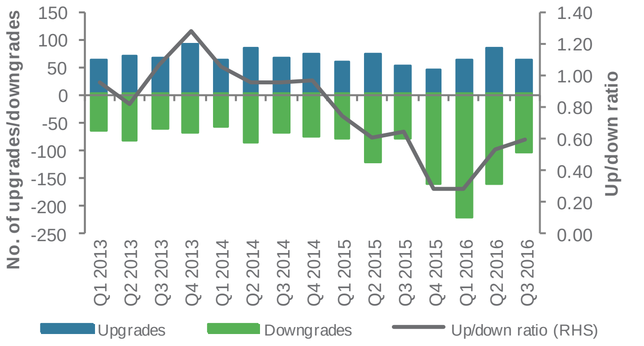
However, weaker fundamentals, lower corporate profitability and tighter loan standards raise the risk of a correction over the next 3-6 months, especially given the strength of the rally thus far.

Bonds

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Figure 19: Rating downgrades have outnumbered the upgrades

S&P US HY rating upgrades and downgrades



Source: S&P, Bloomberg, Standard Chartered

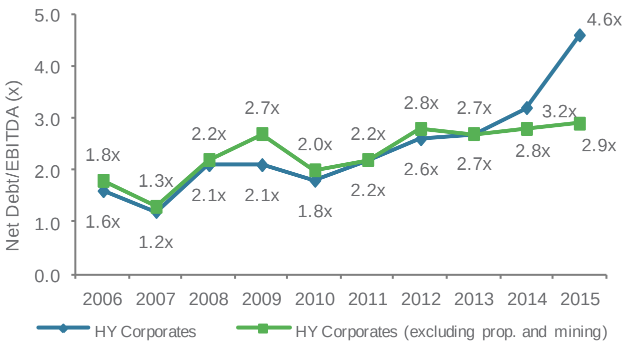
Corporate bonds – Asian credit

Despite posting small negative returns over the last month, Asian corporate bonds were yet again among the more resilient bond asset classes. However, we are getting increasingly selective on Chinese corporate bonds, which account for almost half of Asian credit. The continuous increase in debt levels, given the backdrop of lower growth, presents a challenging picture.

We acknowledge that strong demand relative to supply available could continue to support their valuations for some time. We believe it is prudent to maintain a preference for IG credit over HY credit.

Figure 20: Rising leverage in Asian credit, particularly in the property and mining sector

Net debt/EBITDA for Asian HY credit



Source: JP Morgan, Standard Chartered

EM local currency bonds

EM local currency government bonds delivered roughly flat performance over the past month. Nevertheless, we retain our slight preference to take EM exposure through USD-denominated government bonds, which not only offer a better risk-adjusted return, but also offer a higher currency-adjusted yield than local currency government bonds.

Figure 21: Local currency government bonds offer attractive yields for most local investors

Country	Current 10y yield	Currency view*	Investor flows**
Indonesia	6.91%	🟢	🟡
India	6.85%	🟢	🟢
Malaysia	3.56%	🔴	🟢
Philippines	3.36%	🟡	🟡
S. Korea	1.58%	🟡	🟢
Thailand	2.22%	🟡	🔴

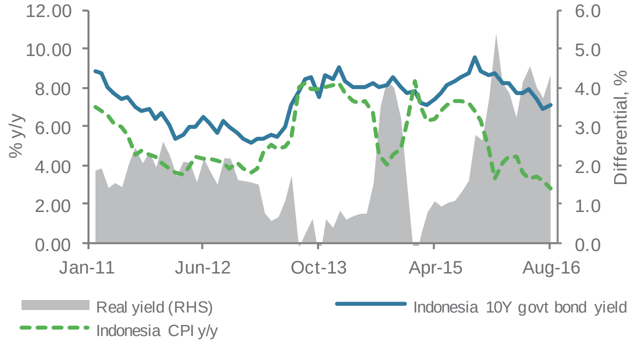
*Standard Chartered Wealth Management currency views. **Bloomberg MTD Foreign Portfolio flows, greater than USD 100mn.

Traffic light signal refers to whether the factor is positive, neutral or negative for each country. Source: Bloomberg, Standard Chartered

Within Asia, we continue to like IDR government bonds. Benign inflation allows the central bank room to cut interest rates, which is a positive for these bonds. Additionally, the demand dynamics are still favourable and real yields are still attractive. For USD-denominated investors, we remain broadly comfortable with the currency (see page 23).

Figure 22: Indonesian real yields remain attractive

Real yields = 10y Indonesian govt bond yield – CPI inflation



Source: Bloomberg, Standard Chartered

Domestic consumption in focus

- Global equities have recouped early losses over the past 30 days, led by Emerging Markets (EM).
- Rising expectations of fiscal easing in DMs have been offset by continued easy monetary policy and in the case of Japan, a commitment to keep 10 year bond yields at zero.
- The recent uptick in EM and DM equity market fluctuations reflects the proximity of a series of event risks in the coming two months. (see page 29 for a full list of events)
- Performance of Asia ex-Japan, our most preferred region, has disappointed YTD relative to the broader EM index (underperforming 3%). We believe this represents an opportunity as some of the prior concerns – bank NPLs in China, weakness in global trade and US rate-hike risks – are abating.
- As expectations for a fiscal stimulus in both EM and DM increase, the outlook for domestic consumer sectors has come into focus. We believe this theme could gain traction among investors over the next 12 months.

We remain cautious on global equities

Asia ex-Japan has underperformed EM YTD

Domestic consumption is emerging as a new theme

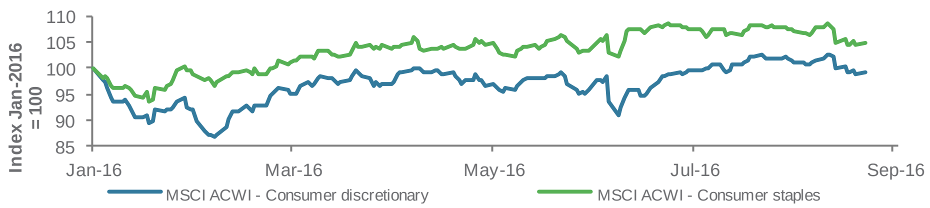
IMPLICATIONS FOR INVESTORS

Drivers of the domestic consumption theme are the following:

1) A potential increase in fiscal spending in both EM and DM in 2017
2) Attractive valuations in the cyclical consumer sector
3) Fiscal policy can be used to stimulate consumption in a more effective way than corporate investment
4) Consumer cyclicals have been in the shadow of technology and pharmaceuticals, which have attracted most investor interest in 2016
5) Risks to the view include continued weakness in wages, a roll over in the economic cycle and deflation.

Figure 23: Consumer sectors have performed positively YTD, but are not leading the performance pack yet

MSCI World consumer sector performance YTD



Source: MSCI, Bloomberg, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Asia ex-Japan – sentiment improves

We remain positive on Asia ex-Japan equities, which rank as our most preferred market globally. The region has outperformed peers over the past month as investors have focused on the declining tail risk among Chinese banks and the potential for central banks in the region continuing to lower rates, despite the Fed moving in the opposite direction.

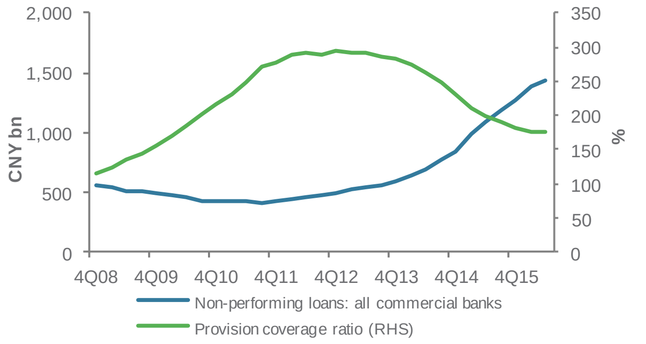
Official and unofficial estimates of non-performing loans for banks in China continue to climb. Nevertheless, banks have been steadily increasing the pace of write-offs in recent quarters. While this has led to a decline in the coverage ratio, as can be seen in the chart below, the increase in the pace of provisioning has been viewed positively by investors. This is reflected in banks holding six of the top ten positions of the biggest contributors to YTD gains in the HSCEI index.

Indonesia and India rank as our two most preferred regions within Asia ex-Japan, with South Korea third. The improved outlook for Indonesia reflects the success of its tax amnesty programme and the potential for this to enable the government to lower corporate taxes to boost growth. Singapore and Malaysia are our least preferred markets, with Hong Kong climbing out of the lowest ranking, thanks to a more benign US rate outlook.

Consensus expectations are for an 11% gain in Asia ex-Japan earnings in 2017, with technology leading the sector pack. Valuations remain reasonable at 13x 2017 forecasts.

Figure 24: Non-performing loans are up and provisioning coverage is down, but this is viewed positively as banks are writing off NPLs

Non-performing loans and provisioning ratios for banks in China



Source: CBRC, Standard Chartered

US – S&P500 reaches a short-term ceiling

We have turned cautiously positive on US equities, from positive previously. The S&P500 has recovered from earlier losses over the past month and is close to reaching a new all time high of 2,190 reached in mid August this year.

The recent weakness in oil prices, which remain within our forecast range of USD 45-55 per barrel, also led investors to question the likelihood of the forecast earnings recovery in 2017.

Consensus forecasts 14% EPS growth for the S&P500 in 2017. Oil prices and the USD are the key drivers of the energy and technology sectors and the trend for these factors will determine if the 2017 aggregate market earnings forecast will be achieved.

Valuations in the US remain high at 17x 2017 consensus earnings forecasts. The uncertainty over the likelihood of achieving next year's earnings growth forecasts appears to be creating a ceiling for the market in the short term.

Figure 25: S&P500 earnings and sales growth are forecast to recover

S&P500 12-month rolling EPS and sales growth

Source: FactSet, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Euro area – taking a less pessimistic view

We have turned cautiously positive on Euro area equities, from cautious previously. After declining 7% YTD and under-performing US equities by 9% in USD terms over the same period, there is potential for a reversal in some of this under-performance. As such, a less pessimistic view is warranted.

Consensus expects 13% growth in 2017 Euro area earnings. While there are risks to this forecast, particularly in the banking sector, a considerable amount of disappointment has already been priced in.

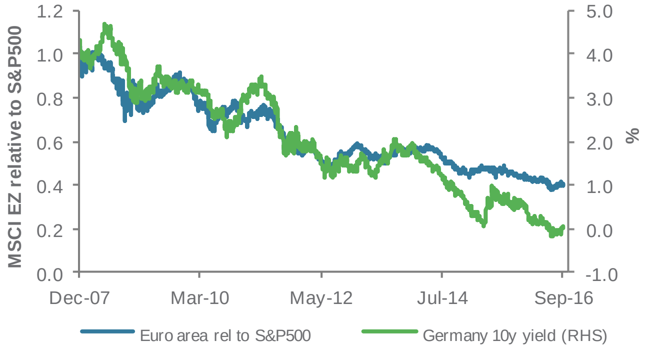
A scenario which could drive of out-performance for Euro area equities relative to those in the US over the remainder of the year is rising German bond yields, possibly driven by an increase in fiscal spending. As highlighted in the chart below, German bond yields are positively correlated with the relative performance of Euro area versus the US equities.

The improvement in the outlook for the US and EMs is also a positive factor. Slightly more than half of Euro area revenues are generated outside the currency block. Therefore, a pick-up in EM and US growth can have a leveraged positive effect on Euro area equity performance.

Valuations of Euro area equities relative to those in the US are sitting on fair value levels on a P/E basis. Historically, Euro area equities trade at a discount to US equities; the discount is currently 18%, in line with the long-term average.

Figure 26: Euro area equities' performance relative to the S&P500 is linked to German bond yields

Euro area equities relative to S&P500 and German bond yields



Source: FactSet, Standard Chartered

UK – robust post-Brexit performance

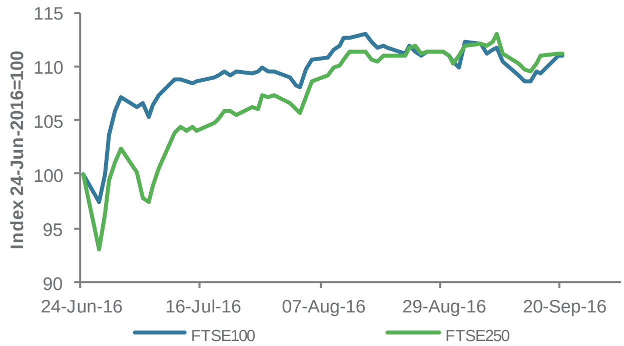
We remain cautious towards UK equities, believing that the impact of the Brexit vote will eventually filter through and its effect on the economy is unlikely to be positive.

Both the domestically focused FTSE250 and the internationally focused FTSE100 have performed in line with the MSCI World in USD terms since the vote to leave the EU on 23 June. In absolute local currency terms, both the indices are up 10%.

Looking ahead, we believe the domestically focused FTSE250 should underperform the more diversified FTSE100.

Figure 27: Both the FTSE250 and FTSE100 have performed well since the Brexit vote

FTSE100 and FTSE250 performance trend



Source: FactSet, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Non-Asia EMs – flows driving performance

We are becoming more constructive on the outlook for non-Asia EMs. The two key drivers of non-Asia EMs, commodity prices and the USD, have been supportive of these markets YTD. An additional tailwind has been portfolio inflows, which stand in contrast to the outflows from Asia ex-Japan.

Latin America, Europe Middle East and Africa have each seen USD 1.4bn in inflows, Asia ex-Japan witnessed USD 18.5bn outflows. Global EM funds have witnessed healthy inflows of USD 30bn YTD.

On an individual country basis, Russia stands as our preferred non-Asia EM, reflecting our view that oil prices are currently at the bottom of our 12-month forecast range of USD 45-55 per barrel.

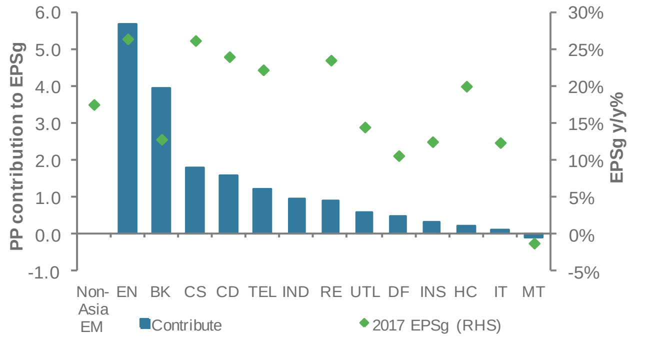
Reflecting the recovery in energy prices and the positive effect this has on economies dependent on energy, Brazilian and Russian energy and banking sectors have been among the top performers YTD.

Energy and banks are the primary drivers of 18% consensus forecast earnings growth in non-Asia EMs in 2017. Sector-wise earnings breakdown is shown in the chart.

Valuations in non-Asia EMs are at historical highs. At 12x 2017 consensus forecasts, valuations are more than one standard deviation above the long-term average.

Figure 28: Energy and banks are driving the recovery in 2017 non-Asia EM earnings

Non-Asia EM sector earnings



Source: MSCI, Bloomberg, Standard Chartered

Japan – more stimulus, less confidence

We have turned cautious on the outlook for Japan, focusing on the negative effect of a strong JPY on corporate profitability. The BoJ's recent decision to put a ceiling on 10-year bond yields at 0% and its focus on raising inflation expectations is welcome. However, investors remain sceptical of the BoJ's ability to deliver, given past failures.

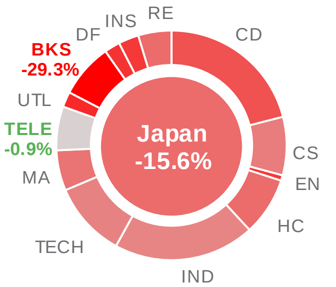
A clear positive outcome from the BoJ's 'comprehensive review' is the impact on Japanese banks. By targeting 10-year bond yields and reducing its purchases of longer-term bonds, the BoJ will steepen the yield curve, which could be positive for bank profitability. This unwinds some of the damage done by the move to negative rates in January.

Consensus expectations are for 9% growth in 2017 earnings, which is lacklustre compared with other regions. Industrials and consumer discretionary (dominated by autos) are responsible for almost 50% of 2017 earnings growth. These sectors are also among the most sensitive to JPY strength. They are also among the worst performers YTD, as reflected in the chart below. We interpret this as the market signalling it disagrees with the earnings forecasts, anticipating they will be cut in the coming months.

Japanese market valuations are at a historically attractive level, at 14x 2017 earnings forecasts. However, the true level of valuations may be higher if earnings forecasts are reduced, as signalled by the market and lead indicators of earnings such as analysts' revisions.

Figure 29: Japanese banking and consumer discretionary sectors have been among the worst performers YTD

YTD Japanese market and sector performance



Size: Index weights;
positive returns; negative returns; darker shades = better/worse returns
Source: FactSet, MSCI, Standard Chartered

Gradual recovery

- We expect commodities to remain largely flat in the short term but post a gradual yet uneven recovery over the medium term.
- We expect gold prices to trade between USD 1,250/oz and USD 1,400/oz in the short term (three months) as we expect interest rates to remain low globally.
- We believe oil may trade around USD 45-55/bbl in the short term, before eventually moving higher in the medium term.

Retain preference for gold and oil over base metals

A largely stable China growth outlook and a range-bound USD is our core scenario for our commodities outlook. We expect gold and energy prices to outperform industrial metals.

While we remain constructive on gold in our 'muddle-through' scenario, we also see it as a hedge against risks late in the economic cycle. Historically, gold tends to perform when inflation unexpectedly increases. At present, we believe central banks are likely to tolerate some inflation risk while keeping rates excessively low; an environment that is positive for gold. The main downside risk to our outlook is a steeper Fed rate-hiking path and a more favourable global growth outlook.

In energy, we expect the current process of rebalancing to continue to support oil prices in the medium term, but believe this process is unlikely to be smooth. Near-term downside risks to oil prices include any resumption of production from previous outages and seasonally weak product uptakes. In industrial metals, limited demand catalysts in China, amid a largely oversupplied market, do not support a constructive outlook for now.

Key upside risks to our commodity outlook are stronger-than-expected producer cutbacks and a weaker USD. Downside risks include any deterioration in China's growth, more aggressive Fed hikes and increased market volatility.

Oil likely to trade in USD 45-55/bbl in the short term

Gold could see further upside to USD 1,400/oz in the short term

Expect a pull-back in base metals in the short term

IMPLICATIONS FOR INVESTORS

Figure 30: Follow China's growth outlook for the trend in commodities

China's Leading Economic Index and Bloomberg Commodity Index

Source: Bloomberg, Standard Chartered

Commodities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Crude oil – gradually moving higher

We expect crude prices to gradually recover through the year, but remain capped at USD 60-65/bbl. While the supply -demand gap continues to narrow, it may now be mid-2017 before any significant upside pressure on prices can be expected. US production remains a key component in this re-balancing process; a more gradual cut-back in production could further delay a price recovery.

In the short term, a number of factors could make oil more volatile. On the supply side, the resumption of output from a number of countries facing supply disruptions (Nigeria, Iraq, Canada) can be negative for prices. A potential deal among Saudi Arabia, Russia and Iran to stabilise oil markets could be a positive catalyst.

Gold – remain constructive with lower rates

Gold is expected to trade in the USD 1,250-USD 1,400/oz range over the next three months. We believe three factors could drive gold over the medium term; net-of-inflation interest rates (real), the broad USD and financial stability concerns. Of the three, real-rates (TIPS yield is a proxy) are by far the most important (see chart).

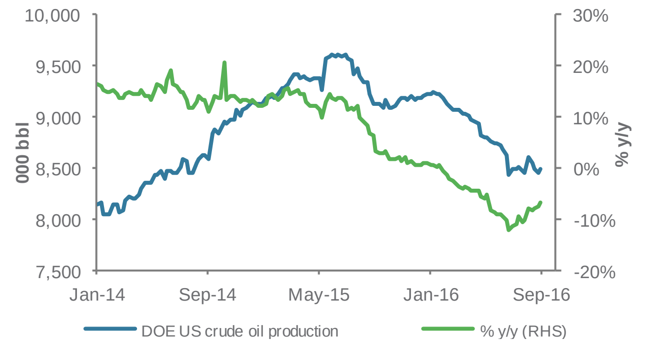
As long as the decline in interest rates outpaces inflation expectations, real-rates are likely to remain negative, which supports gold. Recent BoJ measures are likely to keep rates low in Japan and, hence, support gold. With the USD in largely consolidation, the downside in gold is likely to be limited. Should stability concerns for the banking sector come to the forefront, a potential risk in Europe, we could see a more pronounced gold rally.

Industrial metals – rally unsustainable

We expect any broad upside in industrial metals to remain limited. As China continues to transition away from investment-driven growth, demand for raw materials, such as copper and iron ore, is likely to remain limited. For now, speculator positioning and inventories seem to have adjusted to reflect less-immediate downside risks to prices; however, we do not believe there is much room for upside barring a strong upside China growth surprise.

Figure 31: US oil production decline a key factor for rebalancing

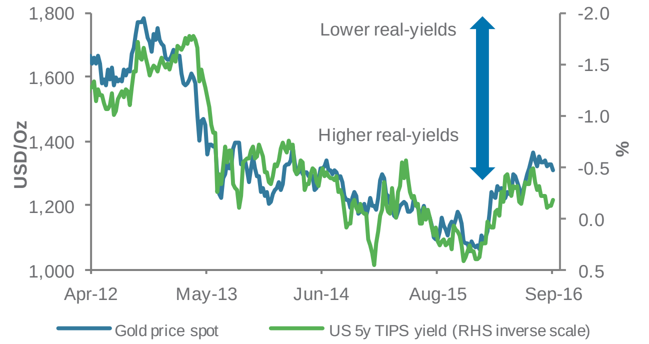
DOE US crude oil production and % change y/y



Source: Bloomberg, Standard Chartered

Figure 32: Gold has rebounded this year amid falling inflation-adjusted bond yields

US 5-year TIPS yields (inverted) and gold prices



Source: Bloomberg, Standard Chartered

Figure 33: What has changed – Oil

Factor	Recent moves
Supply	Production declines in non-OPEC regions accelerated but stabilised in the US
Demand	Demand remains resilient in EM, but US product inventories remain high
USD outlook	Recent uptick but largely range-bound

Source: Standard Chartered

Figure 34: What has changed – Gold

Factor	Recent moves
Interest rate expectations	Higher yields globally, but 2016 Fed rate-hike expectations still around 50%
Inflation expectations	Continue to decline outside the US
USD outlook	Recent uptick but largely range-bound

Source: Standard Chartered

Profiting from a pullback

- Alternative strategies were largely flat over the past month. Equity long/short and event-driven strategies outperformed on the back of positive equity market returns, while macro and trend-following (CTA) strategies suffered.
- We continue to strongly favour multi-asset macro strategies as insurance against downside risks, given our short-term pullback concerns and the fact that we are moving closer to the end of the US cycle.

Mix of upside and downside risks

As we discuss in more detail in the investment strategy section, we are becoming a little more concerned both about the short-term outlook and the fact that we continue to creep closer to the eventual end of the cycle. Having said that, a simple retreat to defensive assets is unlikely to be the solution as policymakers are clearly attempting to remain very supportive of growth, an outcome that can end up extending the run in risky assets. Risks lie in both directions.

Lower risk and add insurance

At this time, we believe this creates a strong case for owning insurance via multi-asset macro strategies, given both our short-term and long-term concerns. While few of us enjoy paying for insurance, we believe holding insurance against market pullbacks is valuable at a time when pullback risks remain high, as it offers an opportunity to profit from a market drawdown.

We also believe equity long/short strategies fit well into this scenario. Under a continued muddle-through environment, equities should continue to eke out gains amid bouts of volatility. Given its lower volatility, this can be a good environment for long/short exposure.

Global macro strategy offers diversification

Equity long/short a substitute for long-only

Managing volatility is a key focus

IMPLICATIONS FOR INVESTORS

Figure 35: Our preferences within alternative strategies

Sub-strategy	Our view
Equity long/short	**Positive:** Attractive substitute to long-only equities in volatile markets
Relative value	**Neutral:** Volatility has increased opportunities, but liquidity challenging
Event-driven	**Neutral:** M&A activity a positive, but vulnerable to broad market volatility
Credit	**Neutral:** Volatility/sector-stress positive for long/short, but defaults are a risk
Global macro	**Positive:** Most preferred sub-strategy as it offers diversification amid volatility
Commodities	**Neutral:** Rising oil prices may be supportive
Insurance-linked	**Negative:** Insurance losses below average in 2015, which could reverse

Source: Standard Chartered

Standard Chartered

FX

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Limited USD strength for now

- We expect the USD to remain largely range-bound as the Fed continues to follow a very gradual rate-hiking path. The EUR is likely to remain in the 1.10-1.15 range in the short term. Recent BoJ action is likely to limit JPY gains, though a big fall is unlikely. The GBP could remain flat in the short term but downside risks increasing.
- We expect the AUD to remain resilient, though a significant rally is unlikely. In general, we expect the USD to maintain 2016 ranges against Asia ex-Japan, with the IDR and INR outperforming in the region and the SGD and CNY underperforming.

Balance of risks still not favouring a USD trend

- We expect the USD to remain broadly stable over a 12-month horizon, trading within its 2016 range (92-100 on the USD index). We do not believe the USD can extend gains in the case of a single 2016 rate hike, as Fed guidance is likely to remain dovish.
- Going forward, we would need to see a more hawkish Fed and, hence, a steeper rate-hike path to justify pronounced USD gains against major currencies. At the same time, we believe downside risks remain limited as central banks remain highly accommodative, though a revolution in such policies is unlikely. Therefore, recent BoJ easing measures could limit further JPY appreciation rather than weakening it substantially.
- In the Asia-ex-Japan space, in addition to a change in the Fed outlook, China growth stability is likely to remain the main anchor. A significant deterioration in China growth outlook or concerns regarding its financial stability could be a catalyst for major USD gains against regional currencies. Conversely, should China's growth outlook improve, we could see further capital inflows and gains in their currencies.
- With the risks largely balanced, we continue to expect sideways moves in the USD.

EUR to trade in the 1.10-1.15 range short term

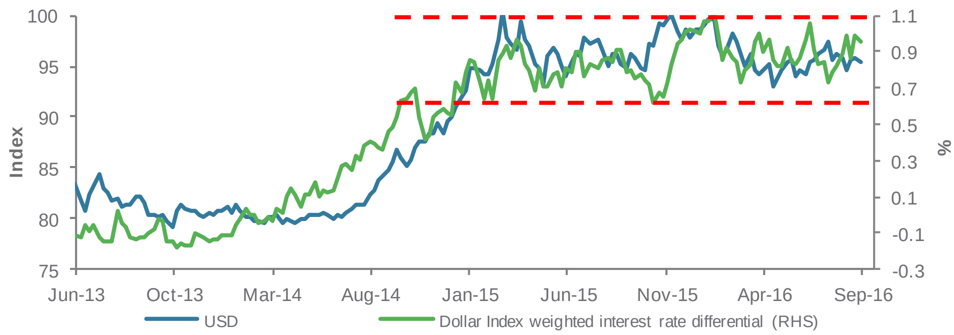
Remain bearish GBP longer-term

AUD range-bound, but close to a short-term top

IMPLICATIONS FOR INVESTORS

Figure 36: US interest rate differentials have not risen significantly, keeping USD gains in check

USD index weighted nominal interest rate differentials and USD index (DXY)



Source: Bloomberg, Standard Chartered

FX

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

EUR – the 'real' story

The EUR is expected to largely trade in the 1.10-1.15 range over the next three months. We see the EUR as being strongly correlated with net-of-inflation interest rate differentials. This is logical, given that downside in interest rates seems limited. A bigger impact can come from changes in inflation expectations.

In this regard, we would need to see a rebound in Euro area inflation to see a meaningful fall in the EUR. Conversely, the Fed suspending rate hikes and a fall in US inflation-adjusted rates would be EUR positive. Other medium-term risks to the EUR include a busy political calendar in 2017 and concerns regarding the banking sector (particularly Italy).

JPY – impact of recent measures

We believe the recent BoJ policy easing measures are unlikely to be significantly JPY negative, but they may limit further JPY gains. We believe the following takeaways from the policy could limit JPY strength: 1) reiteration of the 2% inflation target and emphasising its willingness to accept an inflation overshoot and 2) placing of a limit on 10-year JGB yields. Both these measures can potentially limit further gains in real interest rates, which have been the main driver of the JPY (see figure 39).

The biggest risk here is these measures failing to turn the trend in inflation expectations meaningfully, which could result in further JPY gains.

GBP – risks of further downside rising

We expect the GBP to consolidate in the near term, but ultimately weaken further over the medium term. UK data following the Brexit vote have been better than expected, but its full-impact is expected to be felt over a longer time horizon. Leading indicators of credit growth, for example, point to a more pronounced slowdown in UK growth, going forward.

In addition, a large current account funding gap, low interest rate differentials and the considerable uncertainty regarding the UK's relationship with the EU are likely to remain GBP-negative. We believe a weaker GBP would help mitigate the need for major UK economic adjustments.

Figure 37: What has changed – G3 currencies

Factor	Recent moves
Interest rate differentials	Rate differentials have moved slightly in favour of the USD, with a modest pick-up in US yields coupled with flat-to-slightly lower Euro area and Japan yields
Economic differentials	Recent US data have been weaker; UK surprises are beginning to moderate and there has been a further deterioration in Euro area data
Speculator positioning	USD positioning remains neutral; the JPY still remains excessively net-long

Source: Bloomberg, Standard Chartered

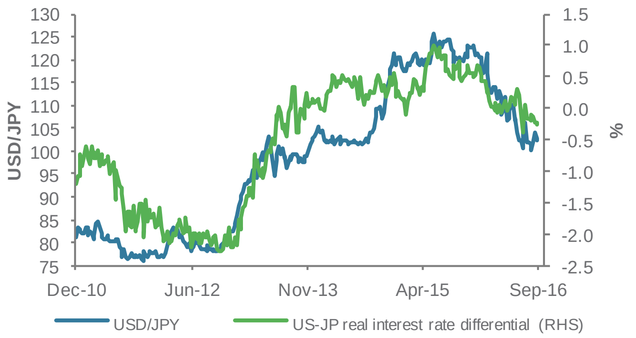
Figure 38: Real (net of inflation) interest rates across regions

Country/region	10y-Nominal	Inflation	10y-Real
US	1.64	1.10	**0.54**
Euro area	-0.05	0.20	**-0.25**
Japan	0.00	-0.40	**0.40**
UK	0.75	0.60	**0.15**
Canada	1.15	1.30	**-0.15**
Switzerland	-0.44	-0.10	**-0.34**
Sweden	0.24	1.10	**-0.86**

Source: Bloomberg, Standard Chartered

Figure 39: Recent policy could limit further deterioration in US-Japan real yields, which could limit JPY gains

US-Japan real interest rate differentials and USD/JPY



Source: Bloomberg, Standard Chartered

FX

AUD – in line with commodities and rates

We expect the AUD to remain largely range-bound and, hence, we are not expecting the current rally to extend.

We believe three factors continue to be the dominant drivers of the AUD: rate differentials with the US, iron ore prices and global financial market volatility. Recently, yields have shot up in Australia amid expectations of no further RBA rate cuts. This has modestly widened the rate differential in favour of the AUD. However, iron ore prices have continued their recent downtrend, which has negated this effect.

Going forward, we expect both rate differentials and iron ore prices to remain contained, which could limit AUD upside. At the same time, a gradual Fed rate-hike cycle and a largely stable China could also limit downside. However, periods of higher volatility or risk-aversion can result in short-term AUD declines.

Asia ex-Japan – follow the 'big' drivers

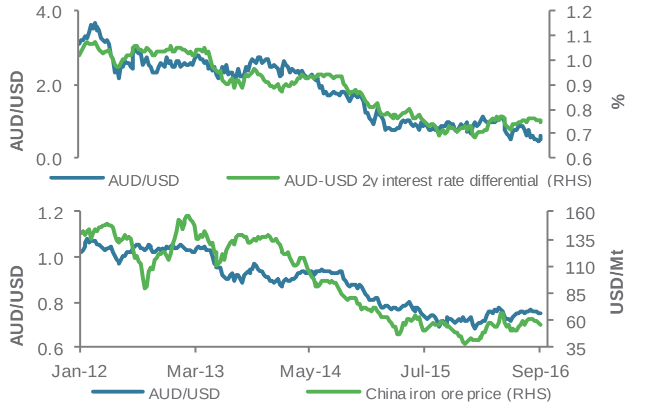
We expect Asia-ex-Japan currencies to remain stable over the medium term. In our view, external macro factors – namely the broad USD and China risks – dominate the outlook for Asia-ex-Japan currencies because of the importance of capital flows (see figure 42). We believe, as long as the USD remains stable, regional currencies particularly sensitive to the USD, such as the KRW, are likely to trade largely range-bound. Similarly, any stability in China's growth outlook is likely to be an anchor for capital flows, particularly for commodity-related currencies, such as the MYR.

Within Asia, we expect the SGD and the CNY to underperform. We see increasing risks of a further MAS policy easing (ie, downward adjustment of the policy band), as the continued appreciation in the trade-weighted SGD since the initiation of policy easing last year might compel authorities to take more drastic measures. We believe there is likely to be further weakness in the CNY, as China allows its currency to weaken on a trade-weighted basis to ease domestic monetary conditions.

We expect the INR and the IDR to outperform in a range-bound USD scenario, given the market's focus on domestic growth fundamentals and attractive deposit rates amid declining inflation. However, we believe central bank interventions to limit gains may limit any significant rally in these currencies.

Figure 40: AUD remains strongly correlated with iron ore prices and interest rate differentials, suggesting limits to the AUD rally

Iron ore prices, AU-US interest rate differentials and AUD/USD



Source: Bloomberg, Standard Chartered

Figure 41: What has changed in Asia ex-Japan currencies

Factor	Recent moves
USD outlook	USD has ticked up recently, putting some pressure on Asia ex-Japan currencies
China risks	Most China economic data still holding up well, risks appear to have receded further
Capital flows	Capital flows to the region have pulled back modestly but remain healthy overall

Source: Standard Chartered

Figure 42: Broad USD outlook is the most important factor for Asia ex-Japan currency trends

Broad trade-weighted USD and Asia USD index (reverse scale)

Source: Bloomberg, Standard Chartered

Multi-asset

Rainy day strategy for income

- In a low-to-negative interest rate world, multi-asset income remains a valid strategy.
- Post-Brexit, the strategy has matched global equity performance with lower risk.
- However, rising correlations between income assets suggest that drawdowns for the strategy may be larger during market pullbacks.
- As we have recently indicated, bundling multi-asset macro strategies (which have lower correlation to traditional assets) with multi-asset income could act as an insurance strategy and manage drawdowns in the overall allocation.

Multi-asset income keeps pace despite post-Brexit equity rally

We published our last update on the multi-asset income allocation in June 2016 (H2 2016 Outlook). Since then, global equity markets have shrugged off the Brexit event and rebounded over the past few months.

Despite adopting a more conservative stance earlier this year, the multi-income allocation has kept pace, outperforming global equity from the time we published our Annual Outlook in December 2015. This has been primarily driven by the strong performance of Emerging Markets (EM) across asset classes. The bulk of our EM exposure thus far has been in the fixed income space. That said, our increasing comfort with Asia ex-Japan equity leads us to increase our allocation to Asian dividend equity (from 5% to 8%) at the expense of European dividend equity (from 12% to 9%). In Europe, while the sustainability of dividend payouts is being called into question, we are more comfortable with the potential for improved payout ratios in Asia ex-Japan. The rest of our allocation remains unchanged.

Low/negative interest rate regime supports the multi-asset income theme

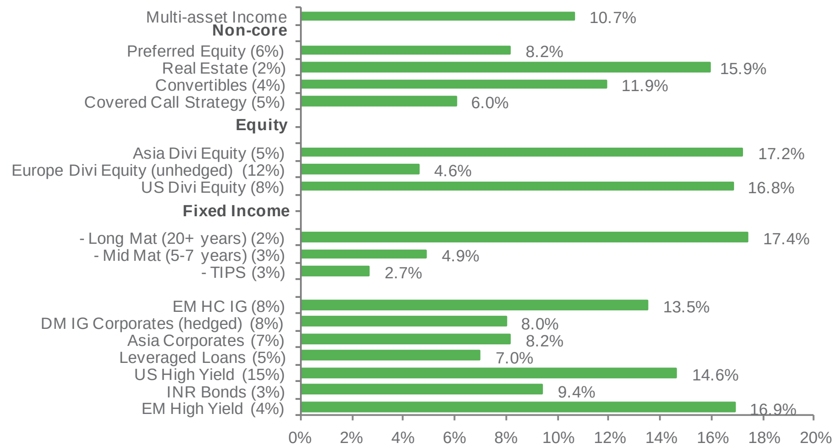
Managing risk takes priority over the search for additional yield

Higher yields from option strategies, given a potential rise in volatility

IMPLICATIONS FOR INVESTORS

Figure 43: Multi-asset income allocation continues to deliver performance despite bouts of volatility

Performance of the multi-income allocation since the Annual Outlook (December 11, 2015)



Source: Barclays, Citi, CRISIL, J.P. Morgan, FTSE, S&P, MSCI, Bloomberg, Standard Chartered

Multi-asset

Rising correlations make multi-asset macro a good rainy-day strategy

In recent months, our focus on multi-income has been on managing the risk of drawdown. We have taken a three-pronged approach to achieving this goal: 1) diversifying within and across asset classes, 2) paring dividend equity in favour of fixed income assets, and 3) reducing exposure to assets with a large potential drawdown risk.

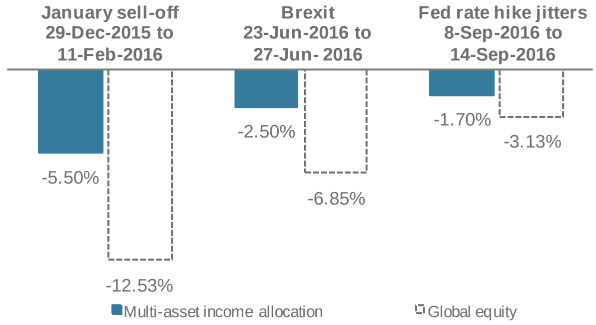
This approach has worked reasonably well during the episodes of high volatility we have seen this year – market pullback in January 2016, Brexit-related volatility in June and this month's pullback around Fed rate-hike jitters. In all these episodes, we managed to limit the downside to between 35% and 55% of equity market drawdowns, while keeping pace with equity market returns.

However, cross-asset correlations have been rising recently. This reduces the effectiveness of the diversification we have built into the allocation and makes a multi-asset income investor more susceptible to pullbacks in the market.

Against this backdrop, we continue to advocate a healthy allocation to multi-asset macro strategies to help manage the risk of drawdowns. By virtue of their lower correlations to traditional assets, such strategies should provide a buffer against rising correlations in other areas of the market. Additionally, we suggest yield-seeking investors take advantage of a potential increase in volatility (after a period of post-Brexit calm) and generate income through option strategies (see box on this topic).

Figure 44: Income strategy has limited drawdown in pullbacks

Comparison of multi-asset income and global equity drawdowns in 2016



Source: MSCI, Bloomberg, Standard Chartered

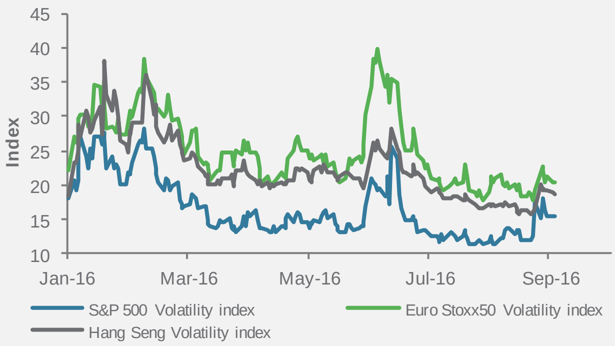
Potential rebound in volatility presents opportunities

Volatility has generally fallen in Q3, as equities rebounded post-Brexit. For most of the quarter, global volatility was below the YTD average. All else being equal, higher volatility translates to a higher yield that can be extracted from equity options markets. For most of the last three months, extracting high yields by selling equity options has been challenging.

However, Q4 16 may present a different picture given potential risks: rising US interest rate expectations, US elections and the Italian referendum. These events may lead to the return of volatility, and potentially more broad-based opportunities for investors to exploit equity option markets. Technology, one of our sector preferences, is an area that investors could look to generate attractive yields through the option markets.

Figure 45: Global equity volatility below YTD average. Macro events may lead to a rebound

Comparison of asset returns and risk post-rebalancing



Source: S&P, Euro Stoxx, Bloomberg, Standard Chartered

Multi-asset

Asset allocation (Multi-asset income)	Yield	Income potential	Capital growth	Drawdown potential	Comments
Equity Income	**4.5**	🟡	🟡	🔴	**Key source of income and modest upside from capital growth**
North America	**3.3**	🟡	🟡	🟡	Fair to slightly rich valuations; subdued sales/profit growth means below average returns; some sectors attractive
Europe	**5.4**	🟢	🟡	🟡	Fair valuation; ECB support; attractive yield; challenges from global growth; still consensus trade; poor momentum. FX a wild card
Asia ex-Japan	**4.6**	🟡	🟢	🔴	Good payouts; selectively attractive valuations, but drawdown a risk from challenges in China/US growth, earnings, Fed and leverage. Themes > markets
Non-core income	**4.5**	🟡	🟡	🟡	**Useful diversifier for income and growth**
Preferred	**5.3**	🟢	🟡	🟡	Benefits from 'global search for yield', supported by strong financials B/S. Potential benefit from higher rates fading; high sensitivity to investor flows
Convertibles	**4.0**	🟡	🟡	🟡	Moderate economic expansion + gradual pace of rate hikes should be good for converts. Risk: policy mistake
Property	**3.8**	🟡	🟡	🔴	Yield diversifier; stable real estate market; risk from higher rates dissipating, but valuations (mostly) stretched. Asymmetric risk profile
Covered Calls	**4.2**	🟡	🟡	🟡	Useful income enhancer assuming limited equity upside
Fixed income	**4.3**	🟡	🟡	🟡	**Portfolio anchor; source of yield, but not without risks**
Corporate - DM HY	**5.9**	🟢	🟡	🟡	Valuations have tightened recently; attractive yield; biggest risks are fund flows, oil, and speed of default cycle (falling US credit quality)
EM HC Sovereign Debt	**5.0**	🟢	🟡	🟡	US interest rate exposure a positive; commodity exposure negative; valuations fair
EM Local Currency	**3.5**	🟡	🟡	🔴	Broad risk/reward unattractive. Local outlook stable, rate cut cycle well advanced, FX is the main risk. Idiosyncratic stories only
INR bonds	**7.5**	🟢	🟡	🔴	Structural story playing out; carry play; credible central bank, reforms; foreign demand a recent risk. FX stability needed
Investment Grade		🔴	🔴	🟢	Portfolio anchor, structural carry; some interesting areas
Corporate - DM IG	**2.1**	🟡	🟡	🟢	Yield premiums have narrowed but prices fair, not expensive; long-term US corporate bonds look appealing if Fed hiking cycle muted
Corporate - Asia IG	**3.0**	🟡	🟡	🟢	Cautiously positive. fairly valued, stable quality, but issuers in China face economic growth headwinds. Risk(s): China, reversal in flows
TIPS	**1.1**	🔴	🔴	🟢	Offers value as an alternative to nominal sovereign bonds; impact of rate rise similar to G3 sovereign but offers exposure to an eventual jump in US inflation
Sovereign	**1.0**	🔴	🔴	🟢	Risk-off momentum, disinflation and QE offer strong anchors for sovereign yields, but little, if any, value left. Prefer higher-yielding/high-quality markets (US Treasury, AU, NZ)

Source: Barclays, Citi, CRISIL, J.P. Morgan, FTSE, S&P, MSCI, Bloomberg, Standard Chartered

Standard Chartered

Market performance summary *

Equity	Year to date	1 month
Global Equities	7.5% ↑	0.7% ↑
Global High Dividend Yield Equities	11.8% ↑	0.7% ↑
Developed Markets (DM)	6.4% ↑	0.6% ↑
Emerging Markets (EM)	18.2% ↑	2.1% ↑
By country		
US	7.7% ↑	0.0% ↑
Western Europe (Local)	2.7% ↑	2.1% ↑
Western Europe (USD)	1.3% ↑	1.4% ↑
Japan (Local)	-12.1% ↓	3.5% ↑
Japan (USD)	4.9% ↑	3.0% ↑
Australia	9.2% ↑	-1.4% ↓
Asia ex-Japan	14.3% ↑	3.3% ↑
Africa	22.1% ↑	-2.9% ↓
Eastern Europe	23.2% ↑	2.5% ↑
Latam	34.8% ↑	-0.9% ↓
Middle East	-1.6% ↓	-2.2% ↓
China	11.8% ↑	4.9% ↑
India	9.4% ↑	2.9% ↑
South Korea	15.7% ↑	2.6% ↑
Taiwan	22.2% ↑	5.0% ↑
By sector		
Consumer Discretionary	2.8% ↑	-0.1% ↓
Consumer Staples	8.9% ↑	-0.5% ↓
Energy	19.1% ↑	-1.2% ↓
Financial	4.4% ↑	2.6% ↑
Healthcare	0.6% ↑	-0.6% ↓
Industrial	10.6% ↑	-0.1% ↓
IT	13.6% ↑	3.1% ↑
Materials	19.7% ↑	-0.4% ↓
Telecom	11.0% ↑	-0.4% ↓
Utilities	12.6% ↑	1.6% ↑
Global Property Equity/REITS	12.4% ↑	-0.4% ↓

Bonds	Year to date	1 month
Sovereign		
Global IG Sovereign	10.5% ↑	-0.9% ↓
US Sovereign	4.9% ↑	-0.5% ↓
EU Sovereign	10.6% ↑	-1.0% ↓
EM Sovereign Hard Currency	15.0% ↑	0.6% ↑
EM Sovereign Local Currency	15.0% ↑	0.1% ↑
Asia EM Local Currency	12.6% ↑	-0.1% ↓
Credit		
Global IG Corporates	8.8% ↑	-0.6% ↓
Global HY Corporates	13.1% ↑	0.2% ↑
US High Yield	14.6% ↑	0.4% ↑
Europe High Yield	8.1% ↑	-0.7% ↓
Asia High Yield Corporates	11.5% ↑	0.3% ↑

Commodity	Year to date	1 month
Diversified Commodity	9.1% ↑	-0.2% ↓
Agriculture	5.3% ↑	-0.7% ↓
Energy	2.9% ↑	-0.4% ↓
Industrial Metal	11.1% ↑	0.8% ↑
Precious Metal	30.7% ↑	1.8% ↑
Crude Oil	10.4% ↑	-3.9% ↓
Gold	26.0% ↑	-0.2% ↓

FX (against USD)	Year to date	1 month
Asia ex- Japan	0.8% ↑	0.2% ↑
AUD	4.9% ↑	0.2% ↑
EUR	3.2% ↑	-1.0% ↓
GBP	-11.3% ↓	-0.4% ↓
JPY	19.3% ↑	-0.4% ↓
SGD	4.6% ↑	-0.4% ↓

Alternatives	Year to date	1 month
Composite (All strategies)	0.9% ↑	-0.2% ↓
Relative Value	-0.9% ↓	-0.2% ↓
Event Driven	7.4% ↑	0.4% ↑
Equity Long/Short	-1.2% ↓	0.4% ↑
Macro CTAs	-1.9% ↓	-1.8% ↓

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

*YTD performance data from 31 December 2015 to 22 September 2016 and 1-month performance from 22 August 2016 to 22 September 2016

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

Events calendar

Oct

15 EU's evaluation of Spain's budget deficit targets

20 ECB Policy Meeting

31 Oct-01 Nov Bank of Japan Policy Meeting

China Communist Party Sixth Plenum

Nov

02 US Federal Reserve Policy Meeting

08 US Presidential Elections

30 Australia Parliamentary Elections

20 Nov-04 Dec France Republican and Socialist primary elections

APEC Annual APEC Summit, Peru

Italy Constitutional Referendum

Dec

08 ECB Policy Meeting

14 US Federal Reserve Policy Meeting

19-20 Bank of Japan Policy Meeting

11 WTO – China expects to gain 'market economy' status

Jan

19 ECB Policy Meeting

20 US Presidential Inauguration Day

30-31 Bank of Japan Policy Meeting

Feb

01 Federal Reserve Policy Meeting

Mar

09 ECB Policy Meeting

15 US Federal Reserve Policy Meeting

15 Netherlands Parliamentary Elections

15-16 Bank of Japan Policy Meeting

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