Global Market Outlook

13 April 2017

Fresh opportunities to pivot

The Euro area, our preferred equity market, has witnessed improving economic data and upgrades to earnings expectations, consistent with broadening reflation.

We would pivot towards Euro area and Asia ex-Japan equities, as we have become more confident that further significant USD gains are unlikely. Meanwhile, our relative view on US equities is turning more balanced as the 'Trump trade' runs its course and is increasingly in need of new catalysts, such as tax reforms.

We see the modest yield pullback as an opportunity to continue pivoting towards less rate-sensitive bonds. We believe US and European High Yield bonds still offer carry opportunities, despite potential volatility, and we continue to like floating rate loans.

Contents

Investment strategy

We prefer equities over bonds

Prefer Euro area, Asia ex-Japan equities and DM HY bonds

Multi-asset income remains relevant for income investors

IMPLICATIONS FOR INVESTORS

Favour Euro, Asia equities

- The Euro area, our preferred equity market, has witnessed improving economic data and upgrades to earnings expectations, consistent with broadening reflation.
- We would pivot towards Euro area and Asia ex-Japan equities, as we have become more confident that further significant USD gains are unlikely. Meanwhile, our relative view on US equities is turning more balanced as the 'Trump trade' runs its course and is increasingly in need of new catalysts, such as tax reforms.
- We see the modest yield pullback as an opportunity to continue pivoting towards less rate-sensitive bonds. We believe US and European High Yield (HY) bonds still offer carry opportunities, despite potential volatility, and continue to like floating rate loans.

Reflation broadens, but the 'Trump trade' matures

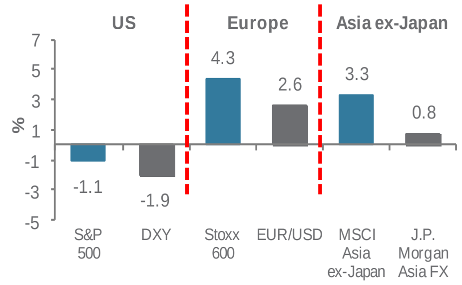
Our balanced investment approach and reflationary tilt appear to be panning out well thus far. Within this, though, the investment outlook for the US and other major regions began to diverge last month. In the US, equities and the USD weakened given a less-hawkish-than-expected Fed statement and renewed challenges to Trump's policy agenda in Congress. Volatility made a long-awaited comeback, albeit only modestly.

In Asia and the Euro area, though, equity markets and currencies rallied, likely because worries of a much stronger USD eased (positive for Asia ex-Japan) and data supported the view that reflation was broadening (most so in the Euro area, but also in Asia to some extent). In major markets, 10-year bond yields remained range-bound as central banks dampened speculation of a sharp tightening of monetary policies.

In our view, these trends offer greater comfort that the pivot towards reflation remains in place. However, regional asset class leadership could rotate. The Euro area appears increasingly in the reflationary 'sweet spot', but in the US, the post-Trump rally is pausing and awaiting the next big catalyst, as talks over tax cuts are likely to start.

Figure 1: Europe, Asia ex-Japan outperform

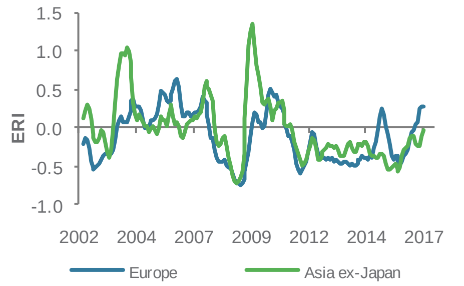
MSCI US, Euro, Asia ex-Japan in USD terms and FX performance over the past one month



Source: Bloomberg, Standard Chartered

Figure 2: Earnings outlook positive

Euro area and Asia ex-Japan earnings revisions



Source: FactSet, Standard Chartered

Investment strategy

Rotate within equities

Our view of a continued pivot to reflation suggests our preference for global equities remains justified. However, regional market leadership may rotate.

We continue to like Euro area equities. We believe the reflationary 'sweet spot' for asset markets may be shifting to this region – forward-looking growth data is increasingly robust, inflation is showing signs of picking up modestly, corporate earnings expectations have started to improve and the Fed and the USD may be less of a headwind. Elections remain a risk, but the recent Euroskeptic loss in Dutch elections has offered a more positive perspective. We continue to believe elections in France will be a source of volatility, but ultimately, we believe, any election worries-led pullback will represent buying opportunities, given our view that it will be very difficult for French Euroskeptics to win control of both the presidency and the parliament, a necessary condition for a 'Frexit' outcome.

Our second preferred equity region is now Asia ex-Japan. Improved stability in China, a rebound in export growth in several trade-oriented economies and attractive long-term prospects in India tell the fundamental side of the story. These partly support our continued preference for India, China and the 'New China' sectors.

Our view that further significant gains in the USD from here now appear less likely is also a key catalyst. Strong USD environments have historically tended to be challenging for Asia ex-Japan equities. However, we note, reflationary environments are not unambiguously positive for the USD. We believe the Fed is likely to raise rates twice more this year (+50bps in total), but longer-maturity bond yields are likely to rise less than that. From a currency perspective, though, higher inflation is likely to largely erode these yield gains and offer little support to the USD. This removes a key potential headwind for Asia ex-Japan equities.

On the other side, we moderate our positive **relative** view on US equities. We believe recent gains offer an opportunity to lock in profit, given the 'Trump trade' looks increasingly mature and markets await the next significant catalyst (a renewed focus on corporate tax reforms, for example).

Taking advantage of the yield pullback

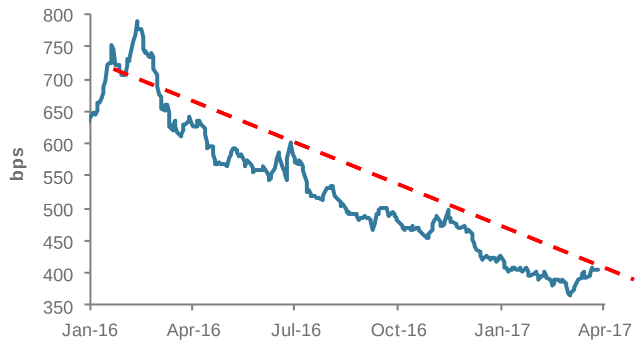
A Fed decision to hike rates that largely met expectations, but did not support increasing expectations of a more dramatic tightening cycle, helped 10-year US Treasury and German Bund yields pull back lower within their recent ranges (2.30-2.65% for Treasuries, 0.20-0.50% for Bunds). This comes at a particularly opportune time, given US and European HY bond valuations have eased somewhat. Together, we believe they offer an opportunity to rotate away from higher-quality, long-maturity bonds (which are more directly at risk from a move higher in interest rates) towards high-yielding, shorter-maturity bonds (which are less directly at risk from a move higher in interest rates).

Senior floating rate notes also remain attractive, in our view, given that we believe the risk of loans being called back at below-market prices remains modest.

More broadly, we believe recent yield trends reinforce the attractiveness of multi-asset income strategies for income-oriented investors. While a balanced (and equity-tilted) approach is still likely to outperform in the long run as reflation takes hold (both are about neck-and-neck at the moment), our view that any yield gains will be modest means multi-asset income continues to offer reasonably attractive prospects for income-oriented investors.

Figure 3: Recent easing in valuations has created an opportunity to rotate into HY bonds; we prefer the US and Europe regionally

Barclays Global HY credit spread



Source: Bloomberg, 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 absolute yields expected to remain a support
	Multi-Asset Macro	🔴	Broadening reflation reduces the need for insurance-like assets
Equities 🟢	US	🟡	Earnings expectations may be peaking; Margins and valuations are risks
	Euro area	🟢	Earnings outlook improving; Valuations modest; Politics a short-term risk
	UK	🔴	Brexit clouds earnings outlook; Full valuations; GBP rebound a risk
	Japan	🟡	JPY key to earnings; Valuations reasonable, but risk of extreme move is high
	Asia ex-Japan	🟢	Earnings uptick positive; Valuations reasonable; Trade tensions long-term risk
	Non-Asia EM	🟡	Commodities key to earnings; Valuations full; Flows supportive
Bonds 🔴	DM govt	🔴	Low yield; Full valuations; Fed policy and higher inflation are risks
	EM govt (USD)	🟡	Moderate yield; Reasonable valuations; Trade policy a long-term risk
	DM IG corporate	🟡	Moderate yield; Full valuations; Defensive characteristics
	DM HY corporate	🟢	Attractive yield; Default rates should trend lower; Valuations elevated
	Asian corporate	🟡	Moderate yield; Reasonable valuations; Demand/supply favourable
	EM (LCY)	🟡	Attractive yield; USD less of a headwind; Rate hikes a risk
Currencies	USD	🟡	Rate differentials stabilising; Inflation and policy outlook are key risks
	EUR	🟡	Rate differentials stabilising; Improving outlook but elections a near-term risk
	JPY	🟡	More range-bound movement amid a confluence of risks in both directions
	GBP	🟡	A lot of negatives may be priced in; Brexit progress could lead to a bumpy ride
	AUD	🟡	China stability positive; Iron ore pullback, higher volatility are risks
	Asia ex-Japan	🟡	Capital flows, USD outlook supportive; Trade tensions, valuations are risks

Source: Standard Chartered Global Investment Committee

Legend: 🟢 Overweight 🟡 Neutral 🔴 Underweight

Investment strategy

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

Asset class	View	Theme	Date open	Absolute	Relative
Bonds	↑	Corporate bonds to outperform government bonds [1]	15 Dec 2016	NA	✓
	↑	DM HY bonds to outperform the broader bond universe	15 Dec 2016	NA	✓
	↑	US floating rate senior loans to deliver positive returns	15 Dec 2016	✓	NA
Equities	↑	US equities to deliver positive returns and outperform global equities *(Closed as of 31-Mar-2017)*	15 Dec 2016	✓	✗
	↑	Japan (FX-hedged) to deliver positive returns and outperform global equities	15 Dec 2016	✗	✗
	↑	Asia ex-Japan to deliver positive returns and outperform global equities	30 Mar 2017	---	---
	↑	Europe ex-UK to deliver positive returns and outperform global equities	24 Feb 2017	✓	✓
	↑	India to deliver positive returns and outperform Asia ex-Japan equities	15 Dec 2016	✓	✓
	↑	China to deliver positive returns and outperform Asia ex-Japan equities	24 Feb 2017	✓	✗
	↑	Indonesia to deliver positive returns and outperform Asia ex-Japan equities	15 Dec 2016	✓	✗
	↑	US technology to deliver positive returns and outperform US equities	15 Dec 2016	✓	✓
	↑	US small cap to deliver positive returns and outperform US equities	15 Dec 2016	✓	✗
	↑	'New China' equities to deliver positive returns[2]	15 Dec 2016	✓	NA
Commodities	↑	Brent crude oil to be higher in 2017	15 Dec 2016	✗	NA
Alternatives	↑	Alternative strategies allocation to deliver positive absolute returns[3]	15 Dec 2016	✓	NA
Currencies	↑	Positive USD/CNY	15 Dec 2016	✗	NA
	↑	BRL, RUB, IDR and INR basket[4] to outperform EM FX index	15 Dec 2016	NA	✓
Multi-asset	↑	Multi-asset income allocation to deliver positive absolute return[5]	15 Dec 2016	✓	NA
	↑	Balanced allocation to outperform multi-asset income allocation[6]	15 Dec 2016	NA	✗

Source: Bloomberg, Standard Chartered

Performance measured from 15 Dec 2016 (release date of our 2017 Outlook) to 30 Mar 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
Overweight (↑) - Expected to return more than the relative benchmark
Underweight (↓) - Expected to return less than the relative benchmark

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

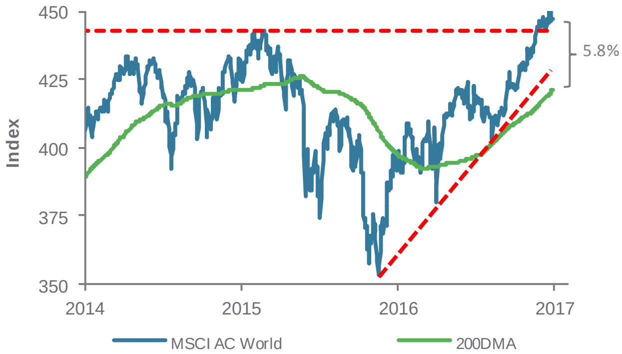
What is the short-term outlook for global equities?

We see the short-term equity market outlook as positive, with the chances of a significant (greater than 10%) pullback being relatively low. In our view, global equities' break to new record highs (see chart) illustrates both their strong positive momentum and the presence of strong supports that are likely to limit pullbacks.

A purely technical approach argues this view holds across regions. Momentum remains reasonably strong. Technical, positioning and sentiment indicators all remain well away from extremes that could signal a significant pullback.

Figure 6: Global equities close to a key support

MSCI All-Country World index



Source: Bloomberg, Standard Chartered

Of course, none of these preclude the possibility that markets could still pull back a little further. However, the global equities index is less than 2.5% from a key support (the 2014 high), while the important 200-day moving average (DMA) is approximately 5% lower. Together, all these factors suggest a significant (10% or greater) pullback in equities is unlikely at this stage.

Has the US Dollar peaked?

While we would be cautious against trying to time the specific peak in the USD, we believe the case for significant USD gains from here appears to have weakened.

First, monetary policy divergence is eroding. While the Fed is likely to gradually tighten monetary policy, the next step for other major central banks also remains skewed towards a withdrawal of stimulus. Second, Trump's recent setbacks in Congress illustrate it will not be as easy to enact key campaign promises as expected by many market participants, potentially limiting any USD upside. Third, the fact that trade conflict worries are not imminently materialising means demand for Emerging Market currencies against the USD may remain well-supported.

Further modest weakness is possible in the near term, given seasonality. European elections and a potential border-adjustment tax pose upside risks to the USD. However, unless these risks materialise, the path of least resistance is likely to be to the downside. The EUR and the GBP offer the most room for a short-term rebound, in our view.

Q What are the implications of the presidential election in France?

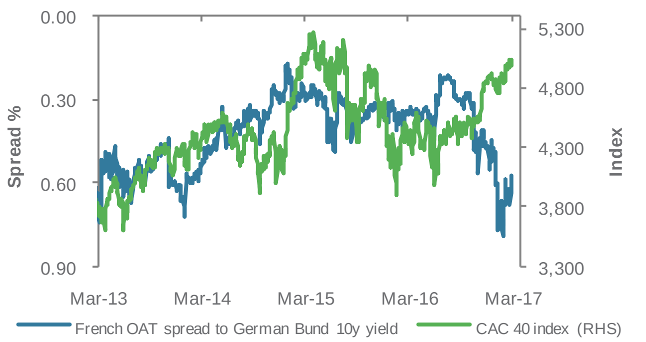
A Market volatility could rise temporarily as we approach the first and second rounds of the presidential election in France on 23 April and 7 May, respectively. However, our base case continues to be that Euroskeptic Marie Le Pen fails to win the presidency (or a parliamentary majority, a worst-case scenario), which are both necessary for her to follow through on threats of 'Frexit'. Therefore, once the elections are behind us, we expect the market focus to return to structural reforms – the implementation of which should support earnings and equity markets.

That said, the threat of a possible Le Pen victory (she remains one of the two leading candidates) poses a risk. Should it eventuate, this may cause a knee-jerk equity market sell-off akin to the reaction immediately following the UK referendum. However, under such a scenario, earnings of French companies may benefit from a fall in the Euro, much like the UK's experience, given the significant proportion of sales derived offshore.

Therefore, on a 12-month time horizon, given the growth potential of the region, we would take advantage of any short-term equity market weakness to add to holdings, with a particular focus on sectors that may benefit from any Euro weakness.

Figure 7: Local equity markets continue to rise despite increased political risk

French OAT spread to German Bund 10y yield and CAC 40 index



Source: Bloomberg, Standard Chartered

Q Are you still convinced oil prices are heading higher?

A We believe the oil market continues to tighten (ie, a closing demand-supply balance). This causes us to remain positive on oil prices on a 12-month outlook.

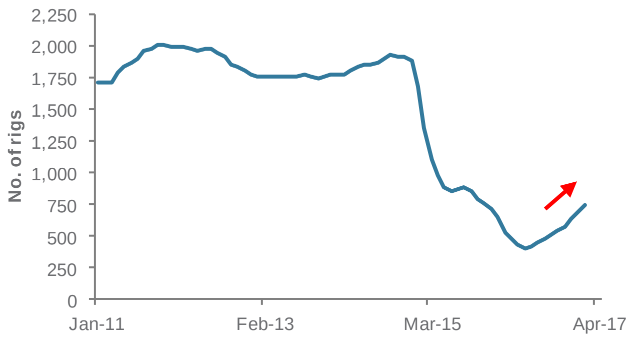
A few factors may have come together to cause oil prices to weaken recently. US oil production rebounded faster than many expected. OPEC's discipline on agreed production cuts was once again called into question. There were also concerns whether Asian demand growth was holding up as well as initially expected.

We believe it is important to look through many of these short-term worries, particularly when a 10% price move could be considered 'normal' volatility for oil. Stability in China bode well for continued demand growth. We would worry less about OPEC's supply discipline. With many producers already close to their maximum capacity, it is unlikely that OPEC production can increase rapidly enough to significantly alter the demand-supply balance on its own.

US production remains the key risk. A rebound in US oil rig count earlier in the year and reports suggesting US shale producers' breakeven price was falling below USD 60/bbl could have been causes of concern. However, broader evidence of falling breakeven prices has not been forthcoming yet.

Figure 8: US rig count points to upside supply risks from the US

US oil rig count



Source: Bloomberg, Standard Chartered

Q Government bond yields have remained range-bound. Should bond allocations still be positioned for higher yields or interest rates?

A We believe bond allocations should continue to be positioned for higher yields.

Short-lived moves in yields aside, we maintain our view that the economy continues to pivot towards higher growth and inflation. This is consistent with higher government bond yields, particularly if the Fed hikes at least twice more this year, as we expect. The gradual, but rising emphasis on fiscal policy also argues for modestly higher bond yields.

Short-term, extreme positioning may have kept 10-year US Treasury yields range-bound. However, this extreme positioning has begun to normalise, raising the risk that yields move above the 2.30-2.65% range from here. Additionally, a reduction in ECB and BoJ stimulus at some point would also likely exert upward pressure on bond yields across major regions. Having said that, we expect any such move to be modest, with 3% a likely cap on 10-year Treasury yields this year.

Given this context, we continue to favour bonds that are less sensitive to the risk of higher interest rates. Developed Market High Yield bonds and US senior floating-rate loans remain our preferred ways to do this.

Figure 9: Treasury yields remain range-bound for now

US 10-year Treasury yields (%)

Source: Bloomberg, Standard Chartered

Standard Chartered

Macro overview

The Fed is likely to raise rates at least twice this year

Rising probability of the ECB tapering bond purchases this year

China to increasingly focus on fiscal policies to manage growth

IMPLICATIONS FOR INVESTORS

A broad-based upturn

- **Core scenario:** Our conviction in the global ‘reflation’ scenario remains in place, with growth estimates rising in the Euro area and Japan, China stable and exports recovering in Asia. However, this also means inflation risks have risen slightly.
- **Key risks:** a) Some of Trump’s proposed fiscal stimulus measures may be delayed or diluted; b) Euro area politics, but we do not expect Le Pen to win the French polls; c) a US inflation surge, although long-term inflation expectations are anchored for now.
- **Policy outlook:** The Fed’s proactively signalled March rate rise gives us confidence it may be able to deliver at least two more hikes this year. We also expect a gradually tighter monetary policy in China. ECB and BoJ tightening is likely to be a 2018 theme.

Reflation theme spreads beyond US shores

The broadening of the growth upturn beyond the US, amid signs of a revival in global manufacturing and exports, gives our Global Investment Committee confidence in the global ‘reflation’ theme. We continue to assign a 70% probability of pivoting from ‘muddle-through’ to ‘reflation’ in the coming year. However, the risk of an inflationary downside scenario (higher inflation, but without growth) is creeping up (at 20%) as job markets tighten in the US, Europe and Japan. There is also a growing risk that Trump’s key fiscal stimulus measures, such as tax cuts, deregulation and infrastructure spending, may be diluted or delayed beyond this year. This potentially poses a risk to the reflation scenario.

Figure 10: Reflation theme sustains

Region	Growth	Inflation	Benchmark rates	Fiscal deficit	Comments
US	Yellow	Green	Red	Green	Growth holding up well despite the lack of fiscal stimulus thus far. The Fed is on track for a total of three rate hikes this year.
Euro area	Green	Green	Yellow	Yellow	Tick up in growth and inflation suggests reflation may be taking hold. The ECB could signal less stimulus later in the year. Elections are a key risk.
UK	Green	Green	Yellow	Yellow	Brexit path and impact on growth remain uncertain. The BoE is likely to tolerate a temporary inflation rise.
Japan	Green	Green	Yellow	Yellow	Fiscal easing remains probable amid the BoJ’s anchor on long-term yields. However, JPY weakness as support for exports now less certain.
Asia ex-Japan	Yellow	Yellow	Yellow	Yellow	China likely to maintain stable growth even as the PBoC tightens modestly. US trade policy is a key risk for the region.
EM ex-Asia	Yellow	Red	Green	Red	Brazil and Russia on track to emerge from recession. Falling inflation could support further central bank easing.

Source: Bloomberg, Standard Chartered Global Investment Committee

Legend: Green: Supportive/lower rates; Yellow: Neutral; Red: Not Supportive/higher rates

Macro overview

US – robust, but growing doubts on stimulus

Stimulus hopes wane: US consensus growth estimates for 2017 have been cut for the first time since Trump's election win in November. US consumer and business confidence remains robust. However, there are growing risks that some of Trump's key stimulus proposals (tax cuts, deregulation and infrastructure spending) may be either diluted or delayed. Trump's inability to replace 'Obamacare' has raised serious questions and caused markets to begin reassessing his ability to push through tax cuts.

Fed turns proactive: The Fed actively guided markets before hiking rates in March, signalling confidence in meeting its unemployment and inflation objectives. We now expect the Fed to raise rates twice more (50bps) this year.

Euro area – gathering pace

Reflation broadens: Euro area consensus growth and inflation expectations continue to be revised higher as economic activity picks up region-wide, helped by record low borrowing costs and a weak EUR.

Political risks: Although political risks remain, we do not expect anti-EU candidate Le Pen to win enough seats in the French parliament (even if she wins the presidential elections) to enact changes to the Constitution.

Growing risk of ECB tapering: Although Euro area headline inflation hit the ECB's 2% target in February for the first time since 2013, core inflation remains subdued. Thus, we believe the ECB has some time before its starts withdrawing stimulus, possibly in H2.

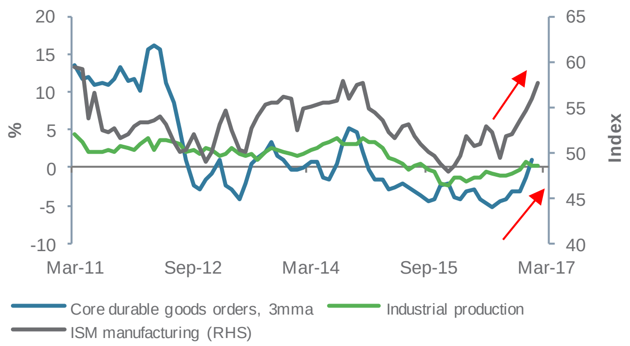
UK – Brexit risks rise

Brexit talks key to outlook: The UK formally started the Brexit process, giving it two years to negotiate a favourable deal. We believe, from here on, the ensuing uncertainty is likely to dampen business and consumer confidence as rising inflation risks curtail consumers' purchasing power.

BoE patient for now: The BoE is likely to look through the import-cost-led inflation for now. However, it may have to tighten policy if inflation rises above 3%.

Figure 11: US underlying manufacturing activity indicators are still improving

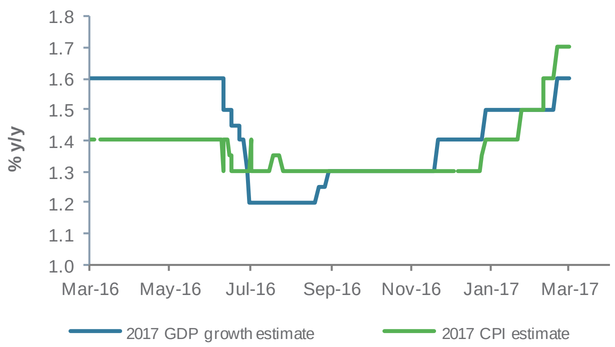
US core durable goods orders, 3mma, % y/y; industrial production, % y/y; ISM manufacturing index (RHS)



Source: Bloomberg, Standard Chartered

Figure 12: Euro area growth and inflation expectations continue to be revised higher

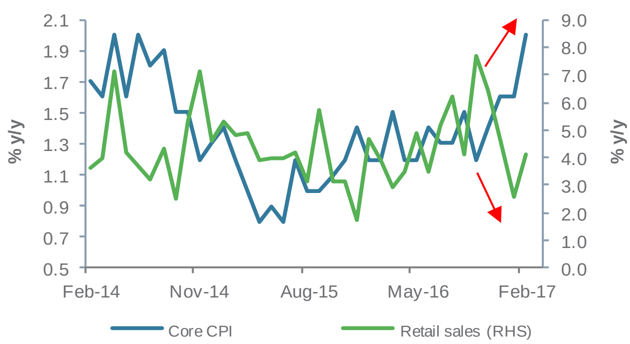
Euro area consensus growth and inflation estimates for 2017, % y/y



Source: Bloomberg, Standard Chartered

Figure 13: UK consumption growth has slowed as rising inflation hurts consumers' purchasing power

UK consumer inflation, % y/y; retail sales, excluding auto fuel, % y/y (RHS)



Source: Bloomberg, Standard Chartered

Macro overview

Japan – recovery gradually taking hold

Growth picking up, inflation lacklustre: Japan's economy has been growing above its 1% potential rate since Q3 2016, with JPY weakness and a pick-up in global trade supporting exports. The government's fiscal stimulus implemented last year is likely to support growth for the rest of the year. Ongoing wage negotiations, amid a tight job market, are key to whether inflation accelerates.

BoJ tapering unlikely soon: The rise in global yields counters the BoJ's attempts to keep 10-year bond yields close to 0%, but we doubt the BoJ will relax its 'yield-curve control' measures this year, given low inflation.

China – stabilisation continues

Government sets 6.5% growth target for 2017: China's economy has started the year on a steady note, helped by a pick-up in property sales, investment and industrial production, driven by relatively calibrated policy efforts. Private investment is gradually picking up the slack left by a slowdown in state-sector investment as the government shutters old industries facing surplus capacity.

Policy focus on curbing financial risks: The PBoC's capital controls and gradually tightening monetary policy appear to have stemmed capital outflows, stabilising the CNY. The slightly lower target for M2 money supply growth (12%) suggests authorities remain focussed on curtailing corporate leverage. We expect a relaxed fiscal policy to help support growth ahead of a crucial Party Congress in Q4.

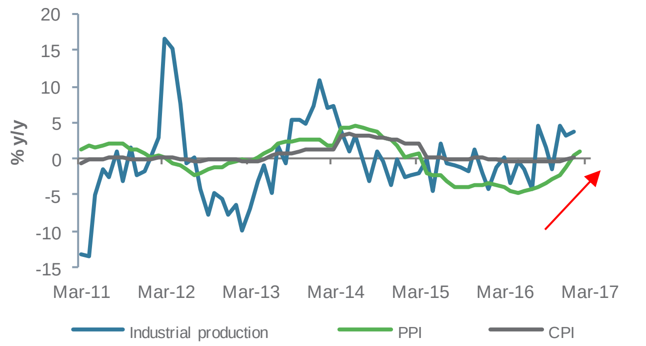
Emerging Markets – reform hopes rise in India

Asia getting a lift from exports: The region's more-open economies (eg, South Korea or Taiwan) are benefitting from a pick-up in global demand. In India, PM Modi's party won a landslide majority in a key state election, likely boosting his chances of pushing through tough economic reforms.

Brazil and Russia on track to emerge from recession: Consensus estimates show the two economies are likely to record growth in H1 for the first time since 2014. Falling inflation should allow their central banks to ease further.

Figure 14: Japan's manufacturers are benefitting from a weak JPY and a recovery in producer prices

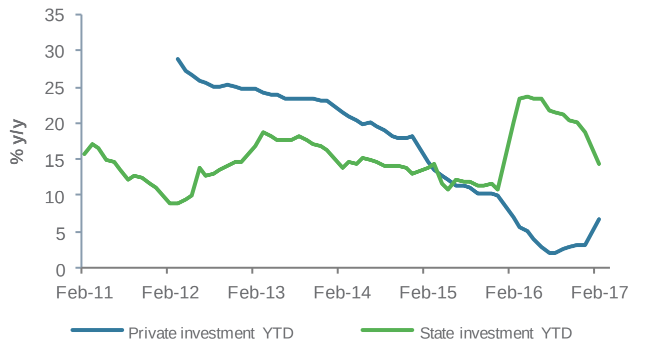
Japan industrial production; core CPI; PPI; %, y/y



Source: Bloomberg, Standard Chartered

Figure 15: China's private investment is picking up even as the state-sector cuts back overcapacity in some sectors

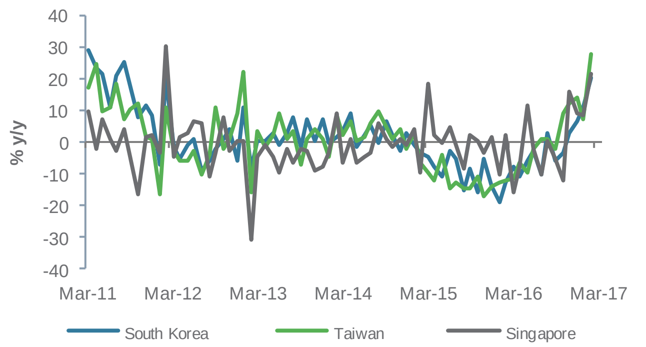
China's aggregate financing, CNY bn; consumer and producer inflation, %, y/y



Source: Bloomberg, Standard Chartered

Figure 16: Asia's export-driven economies are getting a lift from a gradual recovery in global trade

Exports from South Korea, Taiwan and Singapore (non-oil); %, y/y



Source: Bloomberg, Standard Chartered

Bonds

We favour corporate bonds over government bonds

DM HY bonds remain our preferred asset class within bonds

Increasing comfort with EM USD and local currency bonds

IMPLICATIONS FOR INVESTORS

High Yield bonds still preferred

- We continue to favour corporate bonds over government bonds as they are likely to deliver better returns in a rising yield environment due to their lower interest rate sensitivity and higher yields on offer.
- The recent increase in yield premium offers an opportunity to switch to Developed Market (DM) High Yield (HY) bonds—our preferred bond sub-asset class—from higher-quality bonds. Senior floating-rate loans offer an attractive alternative to DM HY exposure.
- We are more comfortable with Emerging Market (EM) USD government bonds and EM local currency government bonds due to receding risks of a stronger USD and US-led trade disruptions. Asian USD bonds and DM Investment Grade (IG) corporate bonds are seen as core holdings.

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

Bond asset class	Preference order	Yield	Value	FX	YTW	IR sensitivity
DM HY	Preferred (loans over bonds)	🟢	🟡	🟡	5.56%	4.3
EM USD government	Core holding	🟢	🟡	NA	5.34%	6.6
EM local currency	Core holding	🟢	🟡	🟡	6.44%	5.1
Asian USD	Core holding (IG over HY)	🟡	🟡	NA	3.82%	4.8
DM IG corporate	Core holding	🟡	🟡	🟡	2.51%*	6.7
DM IG government	Least preferred	🔴	🔴	🟡	1.13%*	7.4

Source: Bloomberg, Citigroup, JP Morgan, Barclays, Standard Chartered Global Investment Committee

Traffic light signal refers to whether the factor is positive, neutral or negative for each asset class, in our opinion. YTW = yield to worst; DM = Developed Markets, EM = Emerging Markets, IR sensitivity – interest rate sensitivity

* As of 28 February 2017

Developed Market Investment Grade government bonds – Least preferred

Over the past few weeks, US Treasury yields have edged lower (Figure 9) due to less hawkish Fed commentary and greater concerns about the pace of US reforms and stimulus, especially after the healthcare bill setback. Despite the recent moves, we see the 10-year Treasury yield trading in the 2.30-2.65% range near term, edging higher later in the year, but likely capped at 3%. In Europe, barring an unexpected result in French elections, we expect stronger growth and inflation to lead to higher German Bund yields.

Bonds

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Additionally, due to our less constructive stance on the USD (see page 25), risks to EUR and JPY bonds have declined, in our view, and we do not see value in retaining an FX hedge for DM IG bond exposures.

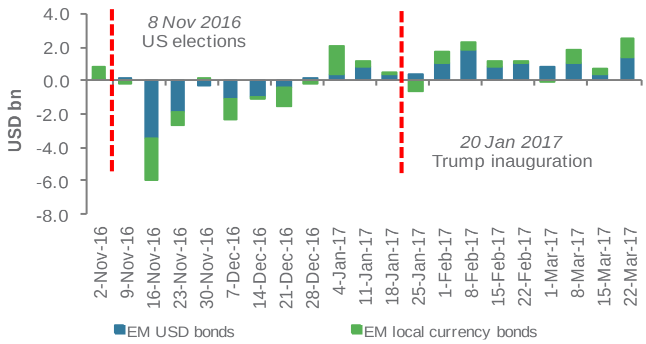
Emerging Market USD government bonds – Core holding

We remain comfortable with an allocation to EM USD government bonds. Lower risks of a damaging trade conflict and our less positive view on the USD (see page 25) eases the headwind for EM bonds, in our view.

Reduced external risks, an attractive 5.5% yield and inexpensive valuations have likely been the key drivers for strong investor flows over the past few weeks. While we acknowledge their relatively higher interest rate sensitivity, in the absence of a sharp decline in commodity prices or a spurt in geopolitical concerns, EM USD government bonds can continue to deliver positive returns.

Figure 18: EM bonds have benefitted from stable inflows

Weekly EM debt fund flows since Nov 2016



Source: EPFR, Standard Chartered

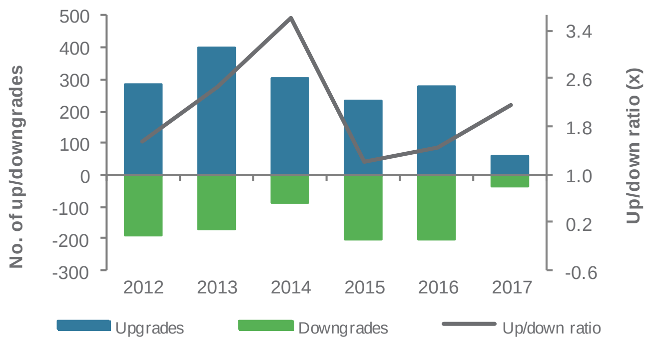
Developed Market Investment Grade corporate bonds – Core holding

DM IG corporate bonds remain our preferred route for taking high-quality bond exposure. Our view has worked well as IG corporates have outperformed government bonds since our Outlook 2017 publication.

We are beginning to see signs of credit quality bottoming out across multiple measures. In the US, credit upgrades have outnumbered downgrades and leverage has been broadly stable over the past quarter. We view the high issuance in 2017 as front-loading and expect yield premiums to remain largely range-bound.

Figure 19: Rating upgrades have outnumbered downgrades

US IG corporate rating upgrades, downgrades and upgrade/downgrade ratio



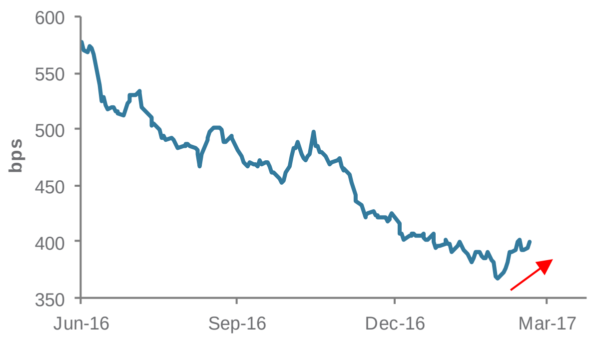
Source: S&P, Bloomberg, Standard Chartered

Developed Market High Yield corporate bonds – Most preferred

DM HY corporate bonds and floating rate senior loans continue to be our preferred sub-asset classes. We view the recent increase in yield premiums as an opportunity to switch to HY bonds. Concerns about lower oil prices and questions about the pace of US reforms have been key contributors to the recent pullback. We prefer to look through the recent oil price weakness, which we view as temporary.

Figure 20: Recent pullback offers an entry opportunity

DM HY bond spreads or yield premium



Source: Bloomberg, Standard Chartered

Bonds

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Though yield premiums remain below the historical average despite the recent correction, at a current yield of 6.0%, we believe they still provide adequate compensation, when we factor in the lower expected default rates going forward.

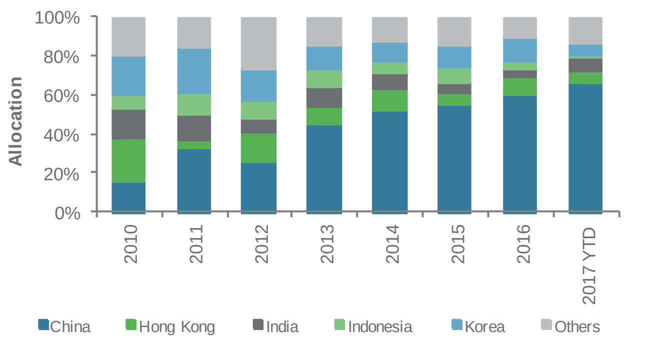
We continue to view US senior floating-rate loans as an attractive alternative to HY bonds due to their very low interest rate sensitivity. In the loans market, the issuer can call back the loan at par or re-price if the loan prices rise above par. This reduces the potential for capital gains. The recent surge in loan re-pricing activity is a slight drag on the potential for capital appreciation. However, re-pricing activity remains below 2013 levels and we do not expect it to be a significant detractor to performance.

Asian USD bonds – Core holding

Despite relatively tight valuations, we continue to view Asian USD bonds as a core holding due to their defensive nature within the EM bond universe and supportive demand-supply dynamics. Strong regional demand has been a key factor in driving spreads lower, despite the heavy supply over the past month.

Figure 21: Chinese issuers are dominating new issuance

Issuance from various countries as a percentage of total annual issuance



Source: BAML, Standard Chartered

However, Chinese and Hong Kong (HK) companies are becoming increasingly dominant players in the Asian USD bond market. This exposes investors to higher concentration risks. Any increase in concerns about China or reduced flows from Chinese investors could lead to sharp pullbacks in the market. Additionally, High Yield valuations look stretched and there is a risk that investors might be complacent given the low default rate in the recent past. We prefer IG over HY and favour higher-quality exposure within HY.

Emerging Market local currency bonds – Core holding

We turn more constructive on EM local currency bonds, though we maintain them as a core holding for now. The more positive view is driven by our reduced concerns about a potential trade conflict and more upbeat view on EM currencies (see page 25), which are a key driver of returns. As depicted in Figure 18, the attractive yield and lower risks have helped local currency bonds attract steady investor flows over the past few weeks.

Within Asia, Chinese local currency bonds have been in focus due to talks about their inclusion in major EM bond indices and the announcement of the mainland-HK bond connect, which would provide an easier channel for international investors.

In the near term, we believe there are better investment opportunities for international investors due to the following three reasons:

- China has a tightening monetary policy bias and has increased short-term rates by 10bps twice in 2017. Further potential rate increases could reduce returns for investors.
- Recent corporate bond defaults are leading to a re-pricing of risk. Yield premiums could increase further before stabilising.
- A weaker CNY could lead to negative currency returns for international investors.

Equities

Global equities have performed well YTD, rising over 7%

Euro area is our preferred market, followed by Asia

Positive on US, but see less scope for out-performance

IMPLICATIONS FOR INVESTORS

Equities still preferred

- Global equity, in aggregate, remains our preferred asset class. Earnings growth expectations are robust and the pivot from 'muddle-through' to 'reflation' suggests this is unlikely to change dramatically. However, a gradual shift away from extremely loose monetary policy settings and, in some regions, elevated valuations suggest equity market gains may be limited.
- The Euro area is our preferred equity market. Valuations are relatively low compared to the US, while 2017 earnings growth expectations have risen YTD. Political developments remain the key risk, especially in the short term, but we expect this risk to dissipate in the coming 6-12 months.
- We have become more constructive on the outlook for Asia ex-Japan equities, raising it to the preferred status. The economic situation appears to be improving and the USD's stability, assuming it continues, should be a positive as it means domestic policy settings can remain loose. Valuations are also relatively cheap and the region remains under-owned. China's macro outlook and geopolitical tensions are the key risks to our positive outlook.
- We remain positive on the US market outlook. However, it is no longer a preferred region on a relative basis. We believe more-stretched valuations, margin pressure and a more hawkish Fed could be headwinds when it comes to outperformance, going forward. Earnings growth expectations for 2017 also appear to have peaked recently.

Figure 22: Euro area our preferred region, followed by Asia ex-Japan

Key factors to consider when investing in equity markets

Region	Valuations versus history	Earnings growth	Liquidity	Momentum	Positioning
Global	Broadly Neutral	Supportive	Broadly Neutral	Supportive	Broadly Neutral
US	Not Supportive	Broadly Neutral	Not Supportive	Supportive	Not Supportive
Euro area	Broadly Neutral	Supportive	Broadly Neutral	Broadly Neutral	Broadly Neutral
UK	Broadly Neutral	Supportive	Not Supportive	Supportive	Supportive
Japan	Broadly Neutral	Supportive	Supportive	Broadly Neutral	Broadly Neutral
Asia ex-Japan	Broadly Neutral	Supportive	Broadly Neutral	Broadly Neutral	Supportive
Non-Asia EM	Broadly Neutral	Broadly Neutral	Supportive	Broadly Neutral	Supportive

Source: Standard Chartered Global Investment Committee

Legend: Supportive Broadly Neutral Not Supportive

Equities

Euro area – Outperformance likely to extend

The Euro area ranks as our favoured market. Earnings expectations have risen sharply against the backdrop of rising business confidence and benign cost pressures. Meanwhile, the ECB continues to prioritise supporting economic growth over controlling inflation.

Elsewhere, in Germany, the debate has shifted towards increasing government spending. While this is not a solution to all of the Euro area's problems, it would clearly help support regional growth and mitigate concerns of the periphery slumping back to recession, which may ease financing concerns.

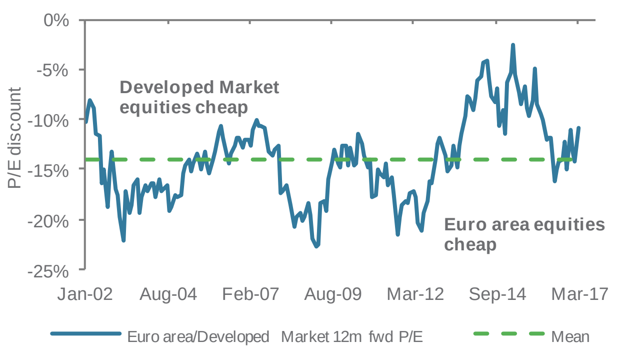
The main risk is the upcoming elections in France. We actually believe Euro area political risks are likely to diminish over the coming 6-12 months. However, this is unlikely to be a smooth journey.

Thankfully, the polls in France are nothing like as close as they were in the UK or the US and the electoral process is very different. Meanwhile, even if the National Front candidate, Marine Le Pen, were to win the presidency, she is highly unlikely to win the ensuing parliamentary elections. As such, her ability to call for a referendum on France's membership of the single currency would likely be severely curtailed. (see GIC perspectives on page 7)

Therefore, while Euro area equities may experience bouts of significant weakness in the coming months, we would use this as a buying opportunity, where appropriate.

Figure 23: Euro area equities relative valuation discount normal

Euro area P/E ratio relative to Developed Markets



Source: FactSet, Standard Chartered

Asia ex-Japan – Outlook improving

We have upgraded our outlook for Asia ex-Japan to the preferred status. From a valuations perspective, Asia ex-Japan equities remain relatively cheap, as they have been for several years. However, we have become more constructive on the economic outlook for Asia and this is feeding through to our improved earnings outlook.

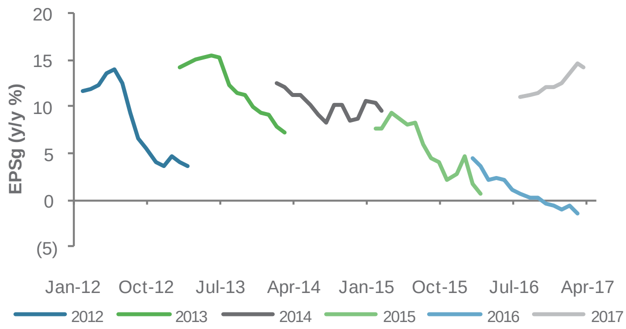
The below chart shows corporate earnings have disappointed for five years in a row, with analysts downgrading their expectations each year. So far, this year has been different. Companies have clearly had a challenging few years, but there are signs that the outlook may be improving.

Another key factor is our outlook for the USD. In our Outlook 2017, we suggested there was scope for modest USD strength this year on the back of rising US interest rates. However, we have become less concerned about the outlook for USD strength, as we expect the global reflationary trend to put pressure on other central banks to gradually tighten their monetary policies. A more benign USD outlook is a significant positive for the outlook for Emerging Market (EM) equities in general, including Asia ex-Japan.

One caveat of note is that Asia ex-Japan equities have not definitively broken out from the underperformance trend of the past five years and are approaching the 2015 peak. The key risks for the region include a sharp USD appreciation and rising trade tensions.

Figure 24: Asia ex-Japan surprising on the upside at last

Trend for corporate earnings expectations over the past 5-6 years



Source: FactSet, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

US – Still positive, but headwinds increasing

We remain positive on the outlook for US equities, but we believe headwinds to further outperformance are rising. The first headwind, which has been prevalent for some time, is US valuations, which are elevated compared with historical valuations and relative to peers.

Second, there are signs that earnings expectations may have peaked, after being revised significantly higher earlier in the year.

Third, investors are generally overweight on US equities relative to other regions, which may limit the potential for a further reallocation towards US equities.

Finally, the Fed has become more hawkish over the past 3-6 months. Normally US valuations decline during a hiking cycle. While this often does not get in the way of the market grinding higher, it does usually limit the pace of gains.

Of course, there are always upside risks to the outlook. Our view that the USD may have peaked is a significant positive, as a weaker USD could help US exporters. Meanwhile, the shift of policy focus towards fiscal stimulus could support earnings expectations and valuations. Indeed, this is the key factor to monitor in the coming weeks, especially against the backdrop of the White House's failure to push healthcare reforms through Congress.

On balance, we believe a neutral allocation to US equities makes sense against the backdrop outlined above.

Figure 25: Earnings growth may have peaked

Consensus US earnings growth and earnings revision ratio

Source: FactSet, Standard Chartered

Non Asia-EM – USD stability supportive

We are becoming more constructive on the outlook for non-Asia EM equities. There are two main reasons for this.

First, we believe that the USD is unlikely to strengthen dramatically in the coming 6-12 months, as the Fed is likely to continue hiking interest rates in a relatively gradual manner.

Second, we remain generally positive on the outlook for commodity prices over the same time horizon.

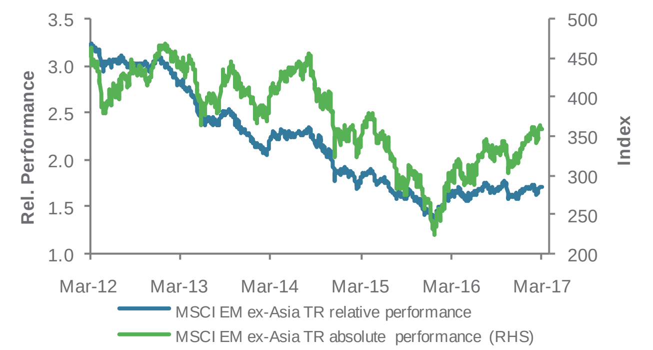
Valuations are fair despite strong earnings growth, although one could argue that non-Asia EMs are much earlier in the cycle, with Brazil and Russia just emerging from recession.

The above factors should allow investors to focus on the outlook for continued earnings growth, with some initial signs that earnings growth expectations may have topped out at a healthy level (around 20%). Meanwhile, this is the one region where we expect further monetary policy easing in the coming months.

Moreover, given the fact that fund managers are generally underweight, it should be supportive of the outlook. That said, we remain slightly cautious as we see the potential for further commodity price weaknesses in the near term.

Figure 26: Non-Asia EM recovery looks set to continue

EM ex-Asia index performance in absolute terms and relative to the MSCI AC World index



Source: Bloomberg, Standard Chartered

Equities

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

Japan – Strengthening economy a positive

The Japan market appears to be facing a tug of war. On the positive side, the domestic recovery continues with consensus economic and earnings growth expectations trending higher. On the other hand, USD/JPY has fallen from a high of over 118 in Q4 2016 to around 111. This has led to concerns that the earnings recovery may falter, especially against the backdrop of continued challenges when it comes to pushing inflation and inflation expectations higher.

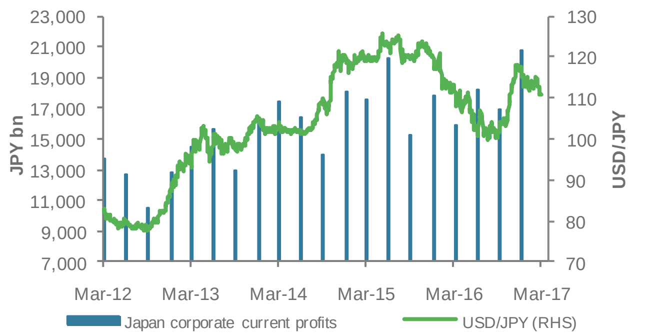
We remain hopeful that the Japan equity market rally will continue. Valuations are hardly stretched and there are signs that the economic recovery may be more sustainable than in the past, with private sector demand outpacing public sector demand. There is also the sense that while JPY's performance is still important, at the margin it is less critical in determining the economic outlook.

We believe that, absent a severe increase in global trade tensions and/or a risk-off environment, authorities will be able to limit JPY strength against the backdrop of gradual US interest rate hikes and the BoJ's continued policy of 'yield-curve control' that caps long-term bond yields.

Overall, we expect the Japan equity market to grind higher, with the short-term technical outlook remaining relatively healthy. Although, we doubt that the market will outperform global equities over the next 12 months.

Figure 27: USD/JPY still important for corporate profitability

USD/JPY versus Japan corporate profits



Source: Bloomberg, Standard Chartered

UK – Brexit uncertainties remain

Uncertainty remains high as the UK formally kicks off Brexit negotiations. We remain cautious on the UK equity market. The good news is there has been a slight softening of the UK's negotiating stance in recent weeks. However, it is highly unclear exactly what deal, if any, will be reached. This should keep the risk premium on UK equities relatively elevated.

There has been a divergence of performance with regards to the UK stock market. In GBP terms, it has soared as exporters get the double benefit of increased competitiveness and translation gains from any overseas earnings due to GBP weakness. However, in USD terms, the market performance has been much less impressive.

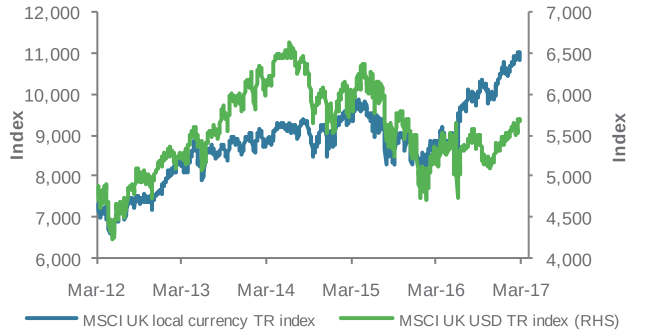
So far, consensus earnings forecasts have continued to rise. However, we believe there are two risks to the outlook. First, rising inflation is eating into real incomes, which could undermine consumer spending, placing the BoE in a quandary of whether to hike interest rates or not.

Second, we believe the majority of the GBP's weakness is behind us and the risks, at least on a 12-month basis, are increasingly skewed to the upside. This would reduce the tailwind for corporate profitability going forward.

While we are not overtly negative on the outlook for UK equities, we believe that it is likely to underperform the global benchmark over the coming 12 months.

Figure 28: GBP weakness has been a key driver of returns

MSCI UK total return equity indices in GBP and USD



Source: Bloomberg, Standard Chartered

Equity derivatives

European banks: Compelling fundamentals and volatility

The Euro area has become our preferred region for equities. We believe put-option strategies on European banks may be interesting for yield-seeking investors for three reasons:

- **Healthy volatility premium**: 6-month implied volatility is 11 vol points higher than that for the Euro-Stoxx 50. This compares with an average of 8 vol points over the last four years.
- **Valuation support**: The historical 10-year trough P/B ratio is around 30% below the current share price for many large-cap Euro area banks.
- **Other tailwinds:** Interest rate expectations may rise amid higher-than-expected inflation and the fact that the European economic surprise index has been outperforming other regions over the past six months.

The risk lies in uncertainties from upcoming elections and potential capital raisings due to litigation costs. As such, investors may like to opt for low strikes or knock-in levels to minimise the chances of receiving the underlying.

Figure 29: 6-month realised volatility 13 points higher than the broad benchmark's

6-month implied volatility spread: Euro Stoxx Banks versus Euro Stoxx 50

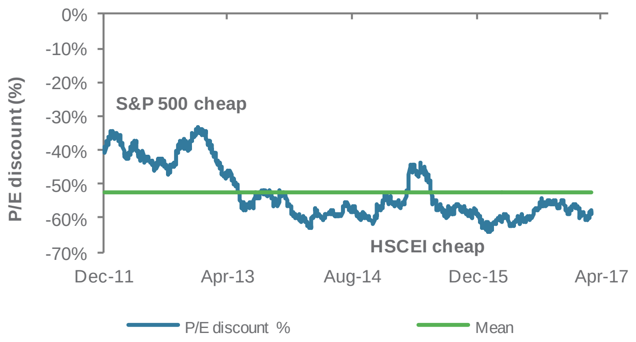
Source: Bloomberg, Standard Chartered
As of 27 March 2017

Focusing on Chinese insurers and banks

Elsewhere, we are turning more positive towards Asia ex-Japan equities. Within the region, we continue to be overweight on Chinese equities. Growth has been picking up modestly and capital flight has diminished following a less-hawkish-than-expected Fed and domestic monetary policy tightening.

Figure 30: Chinese equities valuations undemanding

12M forward P/E discount: HSCEI versus S&P 500



Source: Bloomberg, Standard Chartered
As of 27 March 2017

- **Valuations inexpensive:** We have been highlighting how cheap valuations in Chinese equities may make them ideal 'put option' candidates.
- **Other tailwinds:** China is focusing on fiscal stimulus, while tightening its monetary policy to 'control' capital outflows. This 'trapped liquidity' is helping the reflationary sectors in general. For example, banks are benefitting from rising net interest margins, while insurers are being helped by improving investment yields.

Yield-seeking investors may wish to focus on these two sectors due to their healthy fundamentals, the technical support from cheap valuations and good trading liquidity.

Consolidation before gains

- Commodities could continue their uptrend but supply fundamentals to weigh on prices in the short term.
- Oil prices are likely to move higher by the year end, but further weakness is likely in the near term.
- Gold is expected to trade largely range-bound (most likely USD 1,175-1,300/oz); hence, we prefer to reduce near current levels.

Looking for better opportunities for long exposure

At the headline level, we remain constructive on commodities as most of the positive drivers we highlighted since our Outlook 2017 remain in place, including better global growth prospects, resilient China demand and continued supply-side rebalancing. In the short term, however, we are seeing signs of some consolidation.

The recent pullback in oil prices is not surprising, given excessive initial optimism and stretched speculator positioning. We believe the rebalancing of the supply-demand gap is likely to continue. However, risks of a delay have increased based on strong US production and inventory data.

We expect gold to trade largely range-bound as markets weigh in the prospects of higher inflation (positive) and the Fed's expected rate hikes (negative). From here, we expect the upside in gold to be contained as the focus ultimately returns to higher US rates this year.

Some of the short-term risks we highlighted in last month's outlook have started to reflect in industrial metal prices as both iron ore and copper have retreated. We believe there is room for limited near-term downside as inventories remain high.

Higher oil prices by the year end, but consolidation first

Gold largely range-bound, but reduce at current levels

Lower iron ore and copper prices short term

IMPLICATIONS FOR INVESTORS

Figure 31: Commodities; key driving factors and outlook

Commodity	View	Inventory	Production	Demand	Real interest rates	USD	Risk sentiment	Comments
Oil	Supportive	Not supportive	Neutral	Supportive	NA	Neutral	Supportive	Short-term supply headwinds can delay demand-supply adjustment
Gold	Neutral	Neutral	Neutral	Neutral	Neutral	Neutral	Not supportive	Real interest rates likely to remain relatively stable
Metals	Neutral	Not supportive	Not supportive	Supportive	NA	Neutral	Supportive	Excess supply to weigh on prices short term

Source: Bloomberg, Standard Chartered Global Investment Committee

Legend: Supportive Neutral Not supportive

Crude oil – Opportunity to add

We expect oil prices to further consolidate in the USD 45-55/bbl range, before moving higher later in the year. Further short-term risks to oil prices have increased, amid greater-than-expected US supply and risks to OPEC production cuts.

However, the broad reasons supportive of higher oil prices remain intact. We expect OPEC countries to maintain their commitment of reducing output (ie, 1.0-1.5m barrels) from supply. US production has surged, but is only 0.5m barrels away from peak production in 2015. Going forward, we expect a cyclical pick-up in demand amid higher global growth in 2017 and positive seasonal factors in the summer to ultimately limit the pullback in oil prices.

Gold – Looking to reduce exposure

We believe gold is likely to remain range-bound amid a confluence of positive and negative factors. We do not see gold exceeding USD 1,300/oz and are biased towards reducing exposure near current levels (above USD 1,250).

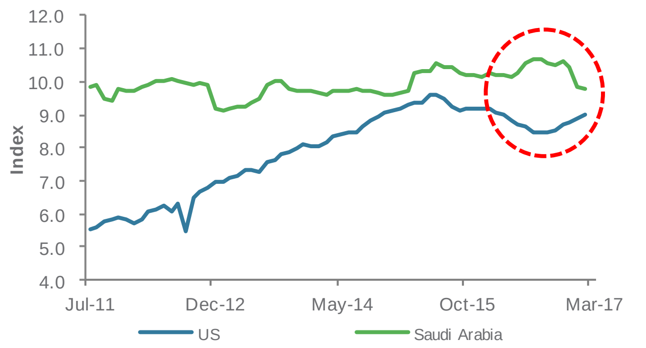
We believe gold prices are likely to struggle to find direction broadly. The recent rally in gold is likely driven by a pullback in US Treasury yields that has increased the appeal of the non-yielding asset. However, we do not expect yields to fall to a large extent from here, given two or more Fed rate hikes are still likely this year. In this context, we are comfortable reducing gold on strength. However, we still see value in holding small amounts of gold to hedge against unforeseen policy risks.

Industrial metals – Further pullback likely

In the short term, we expect a further pullback in copper and iron ore prices. In copper, transitory supply disruptions and financial demand had supported prices. Going forward, we expect production to resume strongly, which is negative for prices. Similarly for iron ore, we believe a significant amount of new production has been used to re-stock China inventories, which remain near extreme highs. Although we are positive on China growth and capital spending, we believe iron ore prices will need to adjust further to incorporate the current supply-demand imbalance.

Figure 32: US crude production offsetting cuts by Saudi Arabia

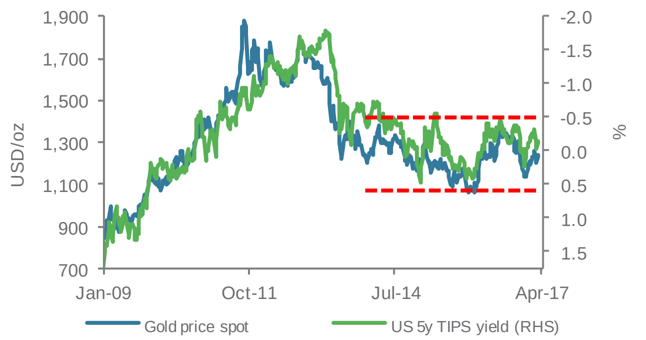
US and Saudi Arabia crude oil production (m bbl)



Source: Bloomberg, Standard Chartered

Figure 33: Gold to track range-bound real interest rate expectations

US 5y TIPS yields (inverted) and gold prices



Source: Bloomberg, Standard Chartered

Figure 34: What has changed – Oil

Factor	Recent moves
Supply	US production continues to surge, while Saudi Arabia production declines sharply
Demand	Demand likely to remain strong
USD outlook	USD has weakened further amid reduced expectations of faster Fed hikes

Source: Standard Chartered

Figure 35: What has changed – Gold

Factor	Recent moves
Interest rate expectations	US 10-year yields pullback amid waning confidence in US fiscal stimulus
Inflation expectations	Inflation expectations in both the US and the Euro area have flattened recently
USD outlook	USD has weakened further amid reduced expectations of faster Fed hikes

Source: Standard Chartered

Favouring equity substitutes

- Equity substitute alternative strategies (Equity-Hedge and Event-Driven) remain a strong conviction in an environment of broadening reflation and increasing dispersion.
- The pivot to reflation also suggests a reduced need for insurance-like assets such as global macro strategies.
- Our alternatives allocation is up 1.8% since our Outlook 2017 publication, supported by increased dispersion across asset classes and within respective markets.

Alternative strategies have performed during periods of rising rates

A historical analysis of periods of rising rates illustrates that, on average, global alternative strategies have outperformed global bonds and marginally lagged global equities (see Figure 36). This demonstrates that maintaining exposure to an alternative allocation in a reflationary environment ensures not only upside participation alongside equities but also better capital preservation compared with traditional 'safe' assets including bonds.

Tweaking our allocation mix

Equity-Hedge strategies remain a strong conviction. We believe an environment of broadening reflation together with the rising dispersion across equity market regions and sectors should support the strategy. The pivot to reflation reduces the importance of global macro strategies, which traditionally act as risk diversifiers within the allocation.

We also believe risks to Relative Value strategies have reduced. Rising interest rates may expand the opportunity set for some Relative Value strategies (eg, convertible arbitrage and select fixed income strategies) as companies reconsider their funding options.

In light of the above, we revise our diversified allocation to reflect the latest view (earlier values in brackets). Our allocation stands as: Equity Hedge 34% (31%), Event-Driven 26% (26%), Global Macro 16% (21%) and Relative Value 24% (22%). For more information on how to build an alternative allocation, please refer our Outlook 2017 report.

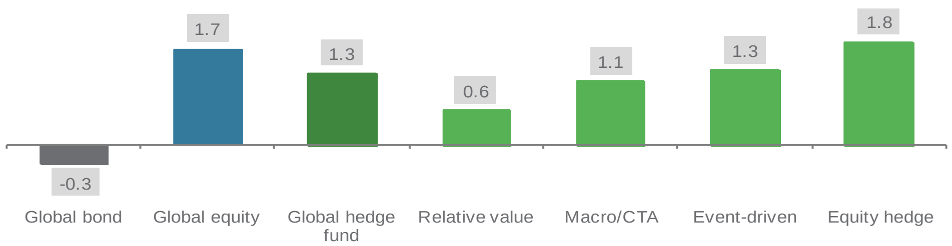
Equity-Hedge strategies remain a strong conviction

Risks to relative value strategies have reduced

Broadening reflation reduces need for global macro strategies

IMPLICATIONS FOR INVESTORS

Figure 36: Average monthly returns* across different Fed rate-rising periods between 1996 and 2017



Source: Hedge Fund Research Inc., Barclays, MSCI, Bloomberg, Standard Chartered

*Performance (%) is the mean average of returns across different Fed rate hiking periods; these periods saw Fed fund futures rise, US 10y Treasury yields rise more than 50bps and last for more than four weeks

EUR upside risks rising

- We believe the EUR and the GBP are close to bottoming but the timing for positive catalysts uncertain.
- The JPY to remain range-bound amid opposing risk factors (107-108 support).
- We expect the AUD to consolidate before moving higher.
- Asia ex-Japan currencies are likely to be stable for now; CNY, SGD downside limited.

Monetary divergence eroding

- We believe USD risks are biased towards the downside over the medium term. Two factors have led us to this outlook. First, further evidence of erosion of the monetary divergence theme has emerged. We believe a gradual Fed rate hiking scenario is largely priced-in, but this is not the case for a policy reversal by the ECB and the BoE. Second, Emerging Market (EM) growth pick-up is likely to continue (see pg. 12), which is increasing the demand for EM currencies at the expense of the USD.
- In the immediate term, we expect the USD to remain under pressure, ahead of a seasonally weaker period. Beyond this, we expect the USD to trade largely range-bound. However, provided no major upset in Euro area elections, downside risks are likely to become more prominent later in the year.

Increasing upside risks to the EUR

Limited GBP downside likely

AUD longer-term positive but lacks catalyst for now

IMPLICATIONS FOR INVESTORS

Figure 37: Foreign exchange; key driving factors and outlook

USD index (DXY) and 10y DXY weighted real interest rate differentials

Currency	Outlook	Real interest rate differentials	Risk sentiment	Commodity prices	Broad USD strength	Comments
USD	Neutral	Neutral	Neutral	Not supportive	NA	Policy divergence reaching its limits
EUR	Neutral	Neutral	Neutral	NA	Neutral	ECB moves towards normalisation, EU election risks reduced
JPY	Neutral	Not supportive	Neutral	NA	Neutral	BoJ's 'yield-curve control' policy negative, but limited JPY upside
GBP	Neutral	Neutral	Neutral	NA	Neutral	Next BoE move likely to be higher, Brexit risks likely priced-in
AUD, NZD	Neutral	Neutral	Supportive	Supportive	Neutral	Moderately higher commodity prices to be supportive
EM FX	Neutral	Neutral	Supportive	Supportive	Neutral	Downside risks reduced amid a softer USD, moderately improving commodity prices

Source: Bloomberg, Standard Chartered Global Investment Committee

Legend: Supportive Neutral Not supportive

FX

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

EUR – Turning more positive

We are increasingly turning constructive on the EUR longer term, notwithstanding short-term volatility ahead of the upcoming French and German elections. We believe two factors support this view: 1) the ECB is likely to move towards withdrawal of stimulus later in the year and 2) the US is likely to only gradually hike rates.

The pick-up in economic momentum in the Euro area is encouraging and is likely to add further upside pressure on Bund yields, thus narrowing the yield gap with Treasuries. At the same time, we do not believe that the Fed is poised to deliver faster-than-expected rate hikes, which is likely to contain any further deterioration in EU-US yield differentials.

JPY – Limited upside for now

We expect the JPY to trade range-bound in the short term amid balanced directional risks. The BoJ is likely to maintain its current yield-curve control policy, while a gradual rise in US yields is likely to translate into a weaker JPY. However, we would not ignore the possibility of trade tensions picking up, which would be very supportive of the JPY. Putting these scenarios together, we would not take a strong directional view. Nevertheless, a drop in the JPY to the strong technical support at 107.50 would suggest better risk-reward to take advantage of the JPY as a funding currency.

GBP – Upside risks increasing

We are increasingly of the opinion that most of the GBP downside risks are priced-in and the longer-term outlook is more constructive. With respect to pricing of risks, we observe that speculative positioning is near all-time lows. Further reflecting the excessively negative sentiment, UK-US interest rate differentials are near record lows. Therefore, we believe modest signs of improvement from here on could result in GBP gains. One such catalyst could be a less dovish BoE interest rate outlook, which recent data is supportive of. Capital outflows and further worsening of the UK balance of payment position remain the main risks, in our view.

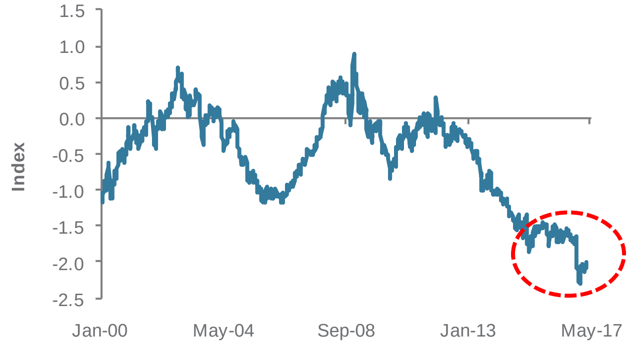
Figure 38: What has changed – G3 currencies

Factor	Recent moves
Real interest rate differentials	Have moved slightly in favour of a weaker USD as US Treasury yields have moved lower
Risk sentiment	Remains buoyant for risk assets with European election risks receding recently
Speculator positioning	Close to neutral for the USD, EUR and JPY, extreme short for the GBP

Source: Bloomberg, Standard Chartered

Figure 39: Bund-Treasury rate differential at a record low since Euro creation

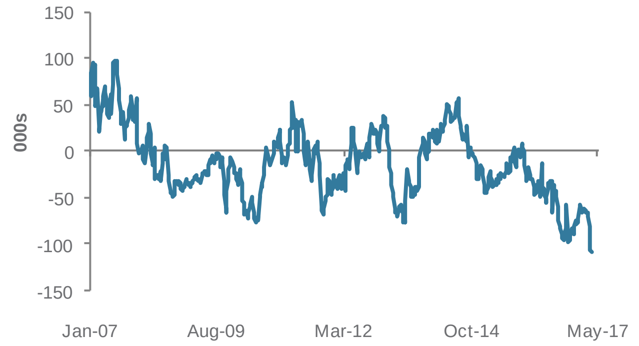
German-US 10y nominal interest rate differential



Source: Bloomberg, Standard Chartered

Figure 40: GBP speculative net shorts at historically extreme levels

GBP CFTC net non-commercial positioning



Source: Bloomberg, Standard Chartered

FX

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

AUD – Range-bound amid lack of catalyst

Although we believe the AUD will eventually move higher in line with global inflation, we do not see a strong catalyst in the short term. Therefore, we are likely to see continued range-bound action, most likely within the 0.715-0.785 range. In our view, three key variables are the drivers of the AUD in the medium term: 1) iron ore prices, 2) local monetary policy settings and 3) the Fed rate outlook.

We expect iron ore prices to consolidate over the short term, given high inventories. We believe the RBA is likely to maintain its policy for now as it maintains a balance between supporting growth and addressing housing market risks. However, we believe that the next rate move is likely to be higher. Finally, we expect the Fed to hike gradually, limiting any AUD weakness.

Asia ex-Japan – Risks contained for now

Our base case is Asia ex-Japan currencies would remain broadly stable as China continues to grow moderately and as the Fed hikes rates gradually. Risks related to trade conflicts have receded, though these remain key concerns for later in the year.

We prefer the high yielding INR and IDR given generally constructive fundamentals and low exposure to a potential trade conflict, should this become an issue. Though the CNY and the SGD remain least preferred, downside risks here have decreased.

Recently, the PBoC maintained USD/CNY stability, at a time of broad-based USD weakness, implying authorities may not be comfortable with any CNY appreciation yet. Either way, even as CNY strength appears elusive, we are more confident that the downside risk is likely contained, following the recent liquidity tightening and capital control measures. We believe downside risks to the SGD have also decreased, given our softer USD outlook. Singapore's monetary policy is likely to remain neutral. Therefore, the SGD is likely to trade in a -2/+2% band (relative to its major trade partners), which suggests a broadly sideways USD/SGD outlook for now.

Figure 41: AUD has not reflected the majority of the movement in iron ore; hence, downside could be contained in a pullback

China iron ore prices and AUD/USD

Source: Bloomberg, Standard Chartered

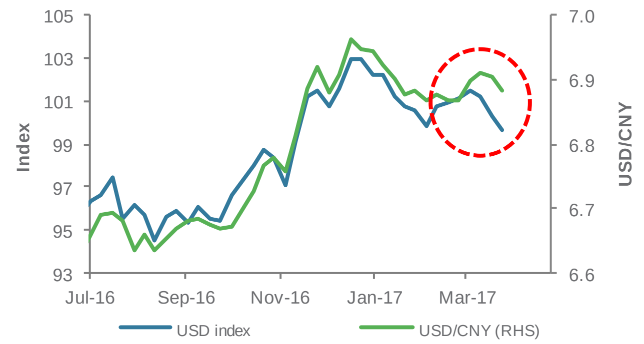
Figure 42: What has changed in Asia-ex-Japan currencies

Factor	Recent moves
USD outlook	USD has weakened further amid reduced expectations of a faster Fed hike trajectory
China risks	China data continues to show improvement but incrementally less so than before
Capital flows	Capital inflows to EMs remain strong

Source: Standard Chartered

Figure 43: USD/CNY diverging from the USD index, suggesting authorities are still not comfortable with any CNY appreciation

USD/CNY and USD index



Source: Bloomberg, Standard Chartered

Multi-asset

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX **MULTI-ASSET**

The reflation rotation

- Reduce our US equity allocation in favour of Euro area and Asia ex-Japan equities in the balanced allocation on a broadening reflationary theme.
- In the balanced allocation, we use the recent pullback in yields to replace some interest-rate sensitive sovereign bond exposure with senior floating rate loans.
- For both balanced and multi-asset income allocation, remove FX hedges on Developed Market (DM) Investment Grade (IG) bonds and European equity on diminishing prospects of US Dollar strength.

A shift in the reflation needle

Over the past month, the reflationary theme remains supported with evidence most pronounced in the Euro area. Our balanced allocation (most likely to benefit in a reflationary scenario), up 3.9%, has played catch-up with our multi-asset income allocation (most likely to benefit in a muddle-through scenario), which was up 4.1%. However, the underlying regional trends within this point to a potential shift in the reflation needle.

Within global equities, we have seen strong performance from Euro area equities relative to the US. This is a reversal in position from a month ago, when Euro area equities were the weakest performer among the three major regions since we published our Outlook 2017. The contingent convertible asset class, which is strongly linked to Euro area reflation, and the region's banks have also done well over the past month. This trend perhaps indicates an initial move towards a broadening (global) reflationary trend.

A scenario-based approach to multi-asset investing remains valid

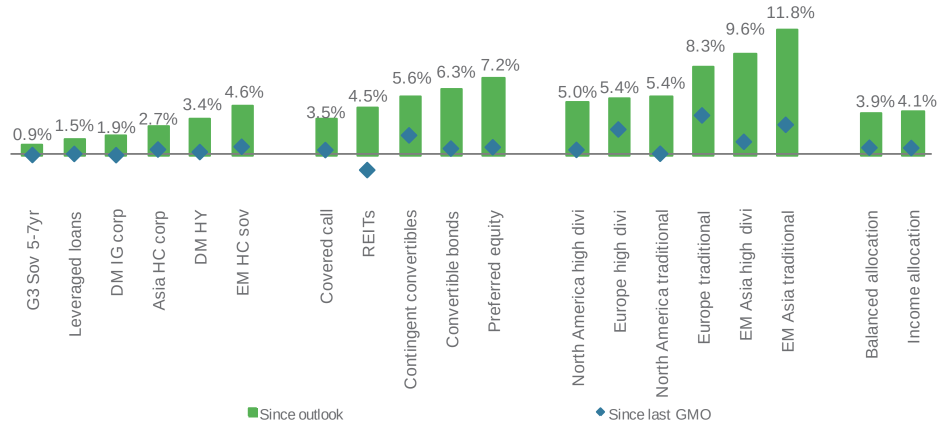
Multi-asset income strategy is still relevant in a muddle-through scenario

FX-hedging less of a priority on diminishing USD strength

IMPLICATIONS FOR INVESTORS

Figure 44: Key assets associated with a pivot to reflation have performed well

Performance of asset classes since 2017 Outlook versus since the last GMO publication



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

Multi-asset

BONDS EQUITIES COMMODITIES ALTERNATIVE STRATEGIES FX MULTI-ASSET

While a rise in inflation has traditionally generated headwinds for dividend strategies, it is important to remember that we are still pivoting from a muddle-through to a reflationary scenario. Global high yielding equities are now running neck-and-neck with traditional global equities after underperforming earlier this year. The significant spread versus 10-year bond yields, particularly in Europe and Asia, suggests a continuation of our tilt towards these regions in the multi-asset income allocation.

At 5.2% yield, Europe equities offer the highest dividend yield globally, with all sectors yielding in excess of the 10-year German Bund. Given their high yields and reasonable valuations, there remains scope for European dividend equities to rally further, in our view.

With reduced potential for USD strength going forward, in our opinion, we remove our currency hedge on Europe dividend equities. The FX hedge has hurt performance, with the hedged version of the asset class underperforming the un-hedged index by 2% over the past month. In a similar vein, we also remove our FX hedges on DM IG bonds in both the balanced and multi-asset income allocations.

Rotation theme #1: Take advantage of recent yield pullback

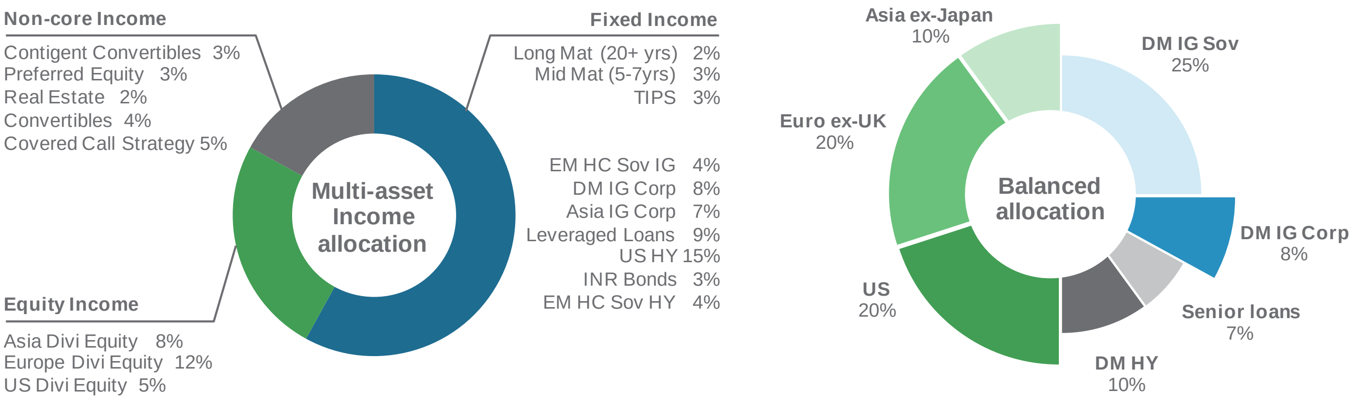
Following the Fed decision in mid-March that largely met expectations, yields have pulled back to the lower end of their recent ranges. We use this opportunity to reduce our exposure to sovereign bonds (which are extremely sensitive to rising interest rates) in the balanced allocation from 32% to 25%. The proceeds of this rebalancing are deployed in senior floating rate loans, which are less sensitive to the impact of rising rates.

Rotation theme #2: Rebalance regional equity to capture broadening reflation

As discussed in the Investment Strategy section of this publication, reflation remains a broadening theme. The Euro area appears increasingly in the reflationary 'sweet spot' and Asia ex-Japan is likely to benefit, given our view that significant gains in the USD from here appear less likely.

With this is mind, we partially rotate our regional equity exposure in the balanced allocation to reflect this shift. We increase our exposure to Euro area and Asia ex-Japan equities at the expense of US equities. Our total equity exposure remains unchanged at 50%.

Figure 45: Revised Multi-Asset Income allocation and balanced allocation (asset class weight in %)



Source: Barclays, JP Morgan, S&P, MSCI, Bloomberg, Standard Chartered

Multi-asset

Figure 46: A three-pronged approach to assessing income assets

Income potential, capital growth and risk of pullback

Asset classes	Yield	Income potential	Capital growth	Risk of pullback	Comments
Fixed Income	4.7	🟡	🟡	🟡	Portfolio anchor; source of yield but not without risks
Leveraged Loans	5.2	🟢	🟡	🟡	Attractive alternative to traditional HY exposure; senior in capital structure to HY bonds; small yield penalty in return; low sensitivity to changes in US interest rates, but loan callability a risk
Corporate - US HY	6.1	🟢	🟡	🟡	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 rise in US interest rates a risk; commodity exposure may be a support; valuations reasonable
INR Bonds	7.5	🟢	🟡	🔴	Structural story playing out; carry play; credible central bank reforms; foreign demand a recent risk. FX stability a positive with reduced risks from significant USD strength, in our view
Investment Grade*	2.6	🔴	🟡	🟡	Portfolio anchor, structural carry; some interesting ideas, but interest rate sensitivity a risk
Corporate - DM IG*	2.6	🔴	🟡	🟡	Yield premiums have narrowed but prices fair; corporate bonds look appealing if Fed hiking cycle is muted
Corporate - Asia IG	3.6	🟡	🟡	🟢	Cautiously positive. Fairly valued, marginally improving credit quality; key risks include concentration risk from Chinese issuers and risk of lower regional demand
TIPS	1.6	🔴	🟢	🟢	Offers value as an alternative to nominal sovereign bonds; impact of a rate rise similar to G3 sovereign 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	4.5	🟡	🟡	🔴	Key source of income and modest upside from capital growth
North America	3.2	🔴	🟡	🟡	Fair to slightly rich valuations; low yields; some sectors attractive
Europe	5.2	🟢	🟢	🟡	Fair valuations; attractive yields; overhang from political risk, mitigated by improving global growth outlook; improving momentum
Asia ex-Japan	4.2	🟡	🟡	🔴	Good payouts; selectively attractive valuations, but pullback a risk from challenges in China/US growth, earnings, Fed and leverage.
Non-core Income	4.1	🟡	🟡	🟡	Useful diversifier for income and growth
Preferred	5.7	🟢	🟡	🔴	Attractive yields and exposure to financials; risk from higher rates may not be completely offset by improvement in banks' underlying credit
Convertibles	3.8	🟡	🟡	🟡	Moderate economic expansion and gradual pace of rate hikes should be good for convertible bonds. 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	2.3	🔴	🟡	🟡	Useful income enhancer assuming limited equity upside
CoCos	6.0	🟢	🟡	🔴	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 27 March 2017;*Yield data as of 28 February 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

Market performance summary *

Equity	Year to date	1 month
Global Equities	7.4%	5.2%
Global High Dividend Yield Equities	6.9%	5.7%
Developed Markets (DM)	6.7%	4.9%
Emerging Markets (EM)	12.7%	7.7%
By country		
US	6.3%	4.9%
Western Europe (Local)	6.0%	5.9%
Western Europe (USD)	7.6%	5.8%
Japan (Local)	0.7%	1.0%
Japan (USD)	5.6%	2.6%
Australia	12.3%	8.3%
Asia ex- Japan	14.0%	8.7%
Africa	9.7%	5.4%
Eastern Europe	2.1%	2.5%
Latam	14.1%	6.0%
Middle East	0.6%	-0.8%
China	13.7%	8.2%
India	16.9%	14.4%
South Korea	17.5%	10.1%
Taiwan	12.5%	7.6%
By sector		
Consumer Discretionary	8.0%	4.7%
Consumer Staples	7.7%	6.1%
Energy	-2.8%	-1.5%
Financial	6.3%	5.0%
Healthcare	8.8%	8.0%
Industrial	7.7%	5.2%
IT	13.3%	9.0%
Materials	8.3%	2.3%
Telecom	3.2%	0.5%
Utilities	6.5%	5.9%
Global Property Equity/REITS	3.2%	1.6%

Bonds	Year to date	1 month
Sovereign		
Global IG Sovereign	1.7%	0.7%
US Sovereign	0.5%	0.1%
EU Sovereign	0.4%	-0.2%
EM Sovereign Hard Currency	4.1%	2.6%
EM Sovereign Local Currency	7.0%	5.5%
Asia EM Local Currency	5.3%	2.7%
Credit		
Global IG Corporates	1.4%	0.6%
Global HY Corporates	3.2%	1.7%

Commodity	Year to date	1 month
Diversified Commodity	-2.3%	-3.6%
Agriculture	-3.2%	-8.8%
Energy	-12.0%	-6.3%
Industrial Metal	8.7%	2.8%
Precious Metal	9.3%	3.1%
Crude Oil	-8.8%	-5.6%
Gold	7.8%	2.0%

FX (against USD)	Year to date	1 month
Asia ex- Japan	2.4%	0.9%
AUD	6.0%	0.8%
EUR	1.5%	-0.8%
GBP	1.0%	-0.5%
JPY	4.5%	0.7%
SGD	3.6%	1.4%

Alternatives	Year to date	1 month
Composite (All strategies)	1.6%	1.3%
Relative Value	0.9%	0.5%
Event Driven	2.7%	1.9%
Equity Long/Short	2.6%	1.9%
Macro CTAs	-0.3%	0.9%

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 30 March 2017 and 1-month performance from 23 January 2017 to 30 March 2017

Events calendar

APR

15 US Treasury department's semi-annual forex report

20 Deadline for Greece's debt repayment

23 France's Presidential Elections (first round)

27 BoJ/ECB Policy Decision

MAY

07 France's Presidential Elections (final round)

04 FOMC Policy Decision

26-27 G7 summit in Italy

JUN

08 ECB Policy Decision

11, 18 French Legislative Elections

15 FMOC Policy Decision

16 BoJ Policy Decision

17-20 Greek debt repayment

30 OPEC output agreement expires

JUL

01 India's likely rollout of nationwide Goods and Services Tax (GST)

20 BoJ Policy Decision

20 ECB Policy Decision

27 FOMC Policy Decision

AUG

NA

SEP

24 Germany's General Elections

07 ECB Policy Decision

21 FMOC Policy Decision

21 BoJ Policy Decision

OCT

X China's 19th National Party Congress

26 ECB Policy Decision

31 BoJ Policy Decision

NOV

02 FOMC Policy Decision

DEC

14 ECB meeting

14 FOMC Policy Decision

20 Korea official election due date

21 BoJ Policy Decision

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

The team

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