EMs outperform, despite rising yields

- We would continue to average into stocks, primarily in Asia. Emerging Markets have outperformed in the latest rebound, reflecting their resilience against rising bond yields.

- Equities: Strong US earnings surprises and forward guidance cement our constructive view on US equities. We are reviewing our preference for Euro area amid lack of earnings upgrades.

- Bonds: EM USD bonds delivered positive returns despite the rise in Treasury yields. We see the decline in EM local currency bonds due to FX weakness as an opportunity to add exposure.

- FX: We close our bullish view on the KRW and our bearish view on the JPY. We also turn bullish on the SGD.

What’s new?

- US Treasury yields approach a key level. US 10-year Treasury yields rose to a four-year high of 2.95% after the Fed’s latest meeting minutes solidified the chances of three rate hikes this year. Fed policymakers expect US growth to remain well-supported and expect inflation to rise towards the 2.0% target in ‘the medium term’. We believe the rise in the market’s growth and inflation expectations justifies the recent increase in Treasury yields. Although rising US bond issuance as a result of a higher fiscal deficit is likely to keep an upward pressure on yields, we expect risk assets to outperform as long as the robust growth outlook holds (see page 3 for our Treasury yield view).

- EMs lead equity rebound. Emerging Market (EM) equities have recovered more than 5% from their 9 February low, outperforming the 3.3% recovery in Developed Markets (DMs). We believe this outperformance is due to positive fundamental factors, including robust earnings outlook and attractive valuations, which are likely to offset the impact of the recent rise in bond yields. Technical factors have also improved, with the Hang Seng index rising above its 50DMA. This fundamental resilience underscores our preference for Asia ex-Japan equities and increasingly constructive view on non-Asia EM equities.

- We close our bullish view on KRW, bearish view on JPY and upgrade SGD. We believe the pro-cyclical global economic environment still favours EM currencies and now prefer to express this through a bullish view on the SGD. However, we believe gains in the KRW could be reaching its limits after a strong run-up since October. Hence, we close our bullish KRW view. We also expect the JPY to be range-bound (from a bearish view earlier) given increasingly balanced expectations of a potential shift in BoJ policy, higher equity market volatility and the recent unwinding of net-short JPY positions. More broadly, though, our modestly bearish view on the USD over the next 12 months remains unchanged (see page 3 for details).

What we are watching

- Fed Chair Powell’s testimony to Congress on 28 February is likely to be his first opportunity to share his US economic outlook. Markets are likely to focus on his views on the potential impact of the rising US fiscal deficit on the Fed’s rates outlook against the backdrop of rising growth and inflation expectations.
What does this mean for investors?

Global stocks gave up some of their recent gains following the correction, but EMs continued to outperform. EM USD bonds outperformed other bonds. The USD extended its rebound.

**Equities: Strong US earnings; Euro area under review**

- **US earnings surprise positively.** Around 76% of US corporate earnings for Q4 17 have exceeded consensus forecasts, relative to a long-term average ‘beat’ of 64%. Consensus forecasts for 2018 have continued to be revised higher, reaching 19%, with the energy, financials and technology sectors expected to report the strongest earnings growth. The strong earnings outlook supports our view of US equities as a core holding and the three sectors remain among our preferred sectors in the US market.

- **Preference for Euro area under review.** Consensus expectations for 2018 earnings have been stuck at 7% since the start of the year, which contrasts with significant upgrades to the US, Asia ex-Japan and other Emerging Markets.

- **Focus on China/Hong Kong earnings.** The banking sector kicked off the China earnings season this week and will likely drive equity markets near-term. The Hang Seng index has rebounded 5.1% from its 9 February lows, recovering almost half its earlier correction. Technically, the next resistance is 1.6% above current levels. The earnings outlook for Hong Kong and China equities remain positive, and we retain China as a preferred Asian market.

**Bonds: Opportunity to add to EM bonds**

- **USD strength hurts EM local currency bonds.** Emerging Market (EM) USD government bonds delivered positive returns despite higher US Treasury yields as the stabilisation in market volatility helped reduce yield premiums. On the contrary, EM local currency bonds gave negative returns due to weakness in EM currencies. We view the current dip as an attractive entry point, given our positive 12-month view on EM currencies.

- **Rebalance away from HY bonds.** US High Yield (HY) bonds rallied over the past week as energy sector bonds benefitted from higher crude prices. However, yield premiums have returned close to multi-year lows, reducing the scope for future outperformance. We would consider using the opportunity to rotate to our preferred EM USD and EM local currency bonds.

**FX: USD likely to be range-bound near term**

- **USD index faces near-term resistance.** We expect the USD to be range-bound in the near term and weaken over a 12-month horizon. We believe most factors that weakened the USD in 2017 remain intact. Positive US economic momentum is not exceptional when compared with the strong growth upgrades in the rest of the world. We expect flows to EMs to resume amid a revival in risk sentiment. This is likely to be bullish for EM currencies and bearish for the USD in the medium term.

- **EUR likely to remain volatile ahead of Italy’s election.** However, the low probability of a non-mainstream (Euro-sceptic) party forming a government on their own is likely to reassure investors after the election on 4 March. Euro area inflation data before the ECB policy meeting on 8 March is likely to be in focus.

- **Further AUD downside limited, in our view.** We believe the outlook remains positive for commodity producers, given the healthy outlook for China and global trade. We see good support for the AUD around 0.760 if the next support at 0.775 fails to hold.
Top client questions

Q1. What has driven US Treasury yields higher YTD? Is there a risk of yields rising significantly further from here?
From a fundamental perspective, three factors offer a reasonable explanation for the 52bps rise in US 10-year Treasury yields YTD. The first has been the rising expectations of future inflation - 10-year inflation expectations have risen by 14bps YTD. The second has been the pricing in of a faster pace of rate hikes by the Fed. Markets are now pricing in three Fed rate hikes by end-2018, from two hikes expected at the start of the year. Also, the extra yield investors demand in order to hold longer-maturity Treasuries (term premium) have risen this year amid expectations of greater government bond issuance as a result of the higher US fiscal deficit.

Technically, 10-year yields have broken through a number of resistance levels, fuelling further gains. For example, we had highlighted in the Weekly Market View dated 26 January 2018 that a break above 2.63% would likely accelerate the rise in yields.

Looking forward, we believe inflation and market expectations of US inflation in the future are key. Historically, inflation of 2.0% has been associated with long-term market inflation expectations of 2.3-2.5%. This approach suggests yields may yet have a little further to rise.

Having said that, we note that short-term positioning on US 10-year Treasuries is now net-short at an extreme level, which usually tends to limit the size of further moves.

Putting this together, it appears likely that a bulk of the rise is behind us for now. A rise in 10-year yields into the 3.00-3.25% range is possible, but it is difficult to see yields rising significantly beyond this.

Inflation, of course, remains the key risk to this view. A ‘reflationary’ outcome (our baseline scenario) would be consistent with ‘normalisation’ of inflation around 2%, supporting a near-term cap in yields a little above 3%. However, an upside inflation surprise is the main risk scenario in which yields climb rapidly, though we believe the chances of such an outcome remain low.

Q2. Has the USD bottomed around current levels? Do we expect further significant JPY gains?
The USD has rebounded higher this week after falling year-to-date. We believe this is just another counter-trend rally, noting that most medium-term negative factors on the USD remain intact:

- Synchronised global growth – the strength of US growth is not unique and non-US monetary policy will likely catch up
- The pro-cyclical environment that supports an allocation away from the USD and towards riskier assets globally
- US fiscal and external deficits, which suggest more structural reasons for taking a bearish USD view

In the short term, however, the USD rebound could extend modestly. Speculative positioning remains considerably net-short the USD, and there is room for further normalization. Risk sentiment is also key – a continuation of de-risking would also support further USD gains.

A number of factors have likely been behind JPY gains this month:
1) Expectations of a potential BoJ policy shift, 2) Risk-off sentiment, and 3) Unwinding of net-short JPY positioning. However, in our view, room for further significant JPY gains is limited. In particular, we do not believe the expectation of the BoJ moving to a less accommodative policy has merit at this point, especially against the backdrop of the re-appointment of Governor Kuroda, which suggests monetary policy continuity.
Market performance summary*

**Year to date**
- Global Equities: -0.1%
- Global High Divi Yield Equities: 1.2%
- Developed Markets (DM): 0.8%
- Emerging Markets (EM): 3.8%
- US: 1.4%
- Western Europe (Local): -2.4%
- Western Europe (USD): 0.4%
- Japan (Local): -4.6%
- Japan (USD): 1.5%
- Australia: 19.3%
- Asia ex-Japan: 3.8%
- Eastern Europe: 10.2%
- Latam: 4.4%
- Middle East: 6.7%
- China: -4.4%
- India: -3.9%
- South Korea: 2.6%
- Taiwan: -1.0%

**1 Week**
- Global Equities: -0.5%
- Global High Divi Yield Equities: -0.6%
- Developed Markets (DM): -0.6%
- Emerging Markets (EM): -0.6%
- US: -1.0%
- Western Europe (Local): -0.2%
- Western Europe (USD): 1.0%
- Japan (Local): -0.1%
- Japan (USD): 1.1%
- Australia: -0.1%
- Asia ex-Japan: -0.2%
- Eastern Europe: -2.2%
- Latam: -2.2%
- Middle East: -1.8%
- China: -1.6%
- India: -0.5%
- South Korea: -3.3%
- Taiwan: -1.5%

**Equity | Country & Region**
- Consumer Discretionary: -0.6%
- Consumer Staples: -1.6%
- Energy: -0.5%
- Financial: -0.5%
- Healthcare: -0.6%
- Industrial: -1.1%
- IT: -0.4%
- Materials: -0.1%
- Telecom: -0.5%
- Utilities: -0.9%
- Global Property Equity/REITs: 2.1%

**Equity | Sector**
- DM IG Sovereign: -0.6%
- US Sovereign: -0.2%
- EM Sovereign: -1.1%
- EM Sovereign Hard Currency: -0.6%
- EM Sovereign Local Currency: -1.1%
- DM IG Corporates: -0.5%
- DM High Yield Corporates: 0.0%
- US High Yield: 0.3%
- Europe High Yield: -1.1%
- Asia Hard Currency: 0.1%

**Commodity**
- Diversified Commodity: -1.7%
- Agriculture: 0.5%
- Energy: 3.5%
- Industrial Metal: -0.2%
- Precious Metal: 2.2%
- Crude Oil: 1.2%
- Gold: 3.5%

**FX (against USD)**
- Asia ex-Japan: -0.3%
- AUD: -1.2%
- EUR: -1.4%
- GBP: -1.0%
- JPY: -0.6%
- SGD: -0.8%

**Alternatives**
- Composite (All strategies): -0.1%
- Relative Value: 1.2%
- Event Driven: 1.3%
- Equity Long/Short: 1.1%
- Macro CTAs: 2.4%

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*Performance in USD terms unless otherwise stated. YTD period from 31 December 2017 to 22 Feb 2018, 1 week period: 15 Feb 2018 to 22 Feb 2018
Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

This reflects the views of the Wealth Management Group
### Economic & Market Calendar

<table>
<thead>
<tr>
<th>Event</th>
<th>Next Week</th>
<th>Date</th>
<th>Period</th>
<th>Expected</th>
<th>Prior</th>
</tr>
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<tr>
<td><strong>MON</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US New Home Sales</td>
<td></td>
<td>26-Feb-18</td>
<td>Jan</td>
<td>647k</td>
<td>625k</td>
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<tr>
<td>Economic Confidence</td>
<td></td>
<td>27-Feb-18</td>
<td>Feb</td>
<td>–</td>
<td>114.7</td>
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<tr>
<td>Durable Goods Orders</td>
<td></td>
<td>27-Feb-18</td>
<td>Jan P</td>
<td>-2.3%</td>
<td>2.8%</td>
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<tr>
<td>Conf. Board Consumer Confidence</td>
<td></td>
<td>27-Feb-18</td>
<td>Feb</td>
<td>125.7</td>
<td>125.4</td>
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<tr>
<td>BoK 7-Day Repo Rate</td>
<td></td>
<td>27-Feb-18</td>
<td>27-Feb</td>
<td>1.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td><strong>TUE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial Production y/y</td>
<td></td>
<td>28-Feb-18</td>
<td>Jan P</td>
<td>5.1%</td>
<td>4.4%</td>
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<tr>
<td>Non-manufacturing PMI</td>
<td></td>
<td>28-Feb-18</td>
<td>Feb</td>
<td>–</td>
<td>55.3</td>
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<tr>
<td>Manufacturing PMI</td>
<td></td>
<td>28-Feb-18</td>
<td>Feb</td>
<td>51.2</td>
<td>51.3</td>
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<td>CPI Core y/y</td>
<td></td>
<td>28-Feb-18</td>
<td>Feb A</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Exports y/y</td>
<td></td>
<td>01-Mar-18</td>
<td>Feb</td>
<td>–</td>
<td>22.2%</td>
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<tr>
<td>Caixin China Mfg</td>
<td></td>
<td>01-Mar-18</td>
<td>Feb</td>
<td>51.3</td>
<td>51.5</td>
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<tr>
<td>Unemployment Rate</td>
<td></td>
<td>01-Mar-18</td>
<td>Jan</td>
<td>–</td>
<td>8.7%</td>
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<tr>
<td>PCE Core y/y</td>
<td></td>
<td>01-Mar-18</td>
<td>Jan</td>
<td>1.6%</td>
<td>1.5%</td>
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<tr>
<td>ISM Manufacturing</td>
<td></td>
<td>01-Mar-18</td>
<td>Feb</td>
<td>58.6</td>
<td>59.1</td>
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<tr>
<td><strong>WED</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Nikkei Japan Mfg</td>
<td></td>
<td>21-Feb-18</td>
<td>Feb P</td>
<td>54.0</td>
<td>54.8</td>
</tr>
<tr>
<td>Markit/BME Germany Composite PMI</td>
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<td>21-Feb-18</td>
<td>Feb P</td>
<td>57.4</td>
<td>59.0</td>
</tr>
<tr>
<td>Markit Eurozone Manufacturing PMI</td>
<td></td>
<td>21-Feb-18</td>
<td>Feb P</td>
<td>58.5</td>
<td>59.6</td>
</tr>
<tr>
<td>Markit Eurozone Services PMI</td>
<td></td>
<td>21-Feb-18</td>
<td>Feb P</td>
<td>56.7</td>
<td>58.0</td>
</tr>
<tr>
<td>Markit Eurozone Composite PMI</td>
<td></td>
<td>21-Feb-18</td>
<td>Feb P</td>
<td>57.5</td>
<td>58.8</td>
</tr>
<tr>
<td>Average Weekly Earnings 3-month/y/y</td>
<td></td>
<td>21-Feb-18</td>
<td>Dec</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Existing Home Sales</td>
<td></td>
<td>21-Feb-18</td>
<td>Jan</td>
<td>5.38m</td>
<td>5.56m</td>
</tr>
<tr>
<td><strong>THUR</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IFO Expectations</td>
<td></td>
<td>22-Feb-18</td>
<td>Feb</td>
<td>105.4</td>
<td>108.3</td>
</tr>
<tr>
<td>GDP q/q</td>
<td></td>
<td>22-Feb-18</td>
<td>4Q P</td>
<td>0.4%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Natl CPI Ex Fresh Food, Energy y/y</td>
<td></td>
<td>23-Feb-18</td>
<td>Jan</td>
<td>0.4%</td>
<td>0.3%</td>
</tr>
</tbody>
</table>

Previous data are for the preceding period unless otherwise indicated.
Data are % change on previous period unless otherwise indicated.
P - preliminary data, F - final data, sa - seasonally adjusted.
y/y – year-on-year, m/m – month-on-month.

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue.
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