Standard Chartered Priority

weekly market view

This reflects the views of the Wealth Management Group

macro strategy | 15 January 2016

Editorial

CNY calms; stocks at key support levels

- **The CNY and CNH stabilized near a five-year low after China's central bank reportedly intervened. Major global stock indices are at or close to September lows.**
- **Commodities fell to 1999 lows and oil briefly fell below USD30/bbl to 2003 lows, further hurting market sentiment.**
- **Stability in the CNY combined with policy stimulus are key to a likely rebound in Chinese equities.**
- **European Q4 earnings are expected to rise strongly, backing our bullish view on equities. US earnings are also in focus.**

Global stocks extended their decline, which began at the end of 2015, with the MSCI AC World Index losing 7% year-to-date to levels last seen in 2013. Major indices such as the US S&P500, Euro Stoxx 50 and Japan's Topix are at or near key support levels from where they last rebounded in August-September. The MSCI China Index has broken through its September lows and has now lost 38% since peaking in April.

Possible factors behind the weakness include (i) the sustained decline in oil and commodity prices, (ii) persistent worries about China's economic and currency outlook, (iii) a very tight Chinese stock market circuit breaker (since lifted), and (iv) heightened geopolitical risks (North Korea's nuclear test, Saudi-Iran tensions, risk of the UK leaving the EU following an expected referendum this year and uncertainty around the US Presidential elections).

Stability in CNY is key for a market recovery. The PBoC's reported intervention in the Hong Kong interbank CNH lending market to prevent speculators from selling the CNY helped calm the currency markets and enabled CNY's offshore exchange rate (CNH) to appreciate towards the onshore rate. A relatively stable USD/CNY fix over the past few days also helped, as did China's near-record trade surplus in December as such surpluses help offset capital outflows. With the PBoC now managing the CNY's exchange against a basket of currencies of China's major trade partners, we expect the CNY to increasingly move in line with other major non-USD currencies.

The next focus is on China's stimulus measures. We expect further monetary and fiscal policy easing in the coming months, which is likely to trigger a recovery in stocks. Although reserve requirements have been cut four times since early 2015, at 17.5% for major banks, they remain significantly above the 6%-8% levels maintained until 2006.

US, European earnings surprises likely triggers for recovery. European Q4 2015 earnings are estimated to have risen 38% y/y, while US earnings, excluding the energy sector, are forecast to have risen 1.1%. Earnings trends over the past years suggest there may be scope for positive surprises. We remain bullish on stocks in the Euro area (FX-hedged) and Japan, and positive on US High Yield (HY) bonds, taking comfort from the latter's recent stability despite the sharp decline in oil prices.

High-grade bonds, alternative strategies helping offset volatility. In December, we raised our preferred allocation to bonds, anticipating increased volatility. The shift has paid off, with investment-grade government and corporate bonds outperforming in recent weeks, providing a buffer against weaker equity markets.

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Global equity indices are at key support levels after declining to September lows

MSCI AC World Index and S&P500 Index (RHS)

Source: Bloomberg, Standard Chartered

Our preferred asset classes or strategies

Diversified income assets
Global equities
Euro area equities (currency-hedged)
Japan equities
Chinese equities (MSCI China)
US banks
US-listed technology sector equities
US HY bonds
USD vs EUR, CHF, AUD, NZD
Alternative strategies

Source: Bloomberg, Standard Chartered

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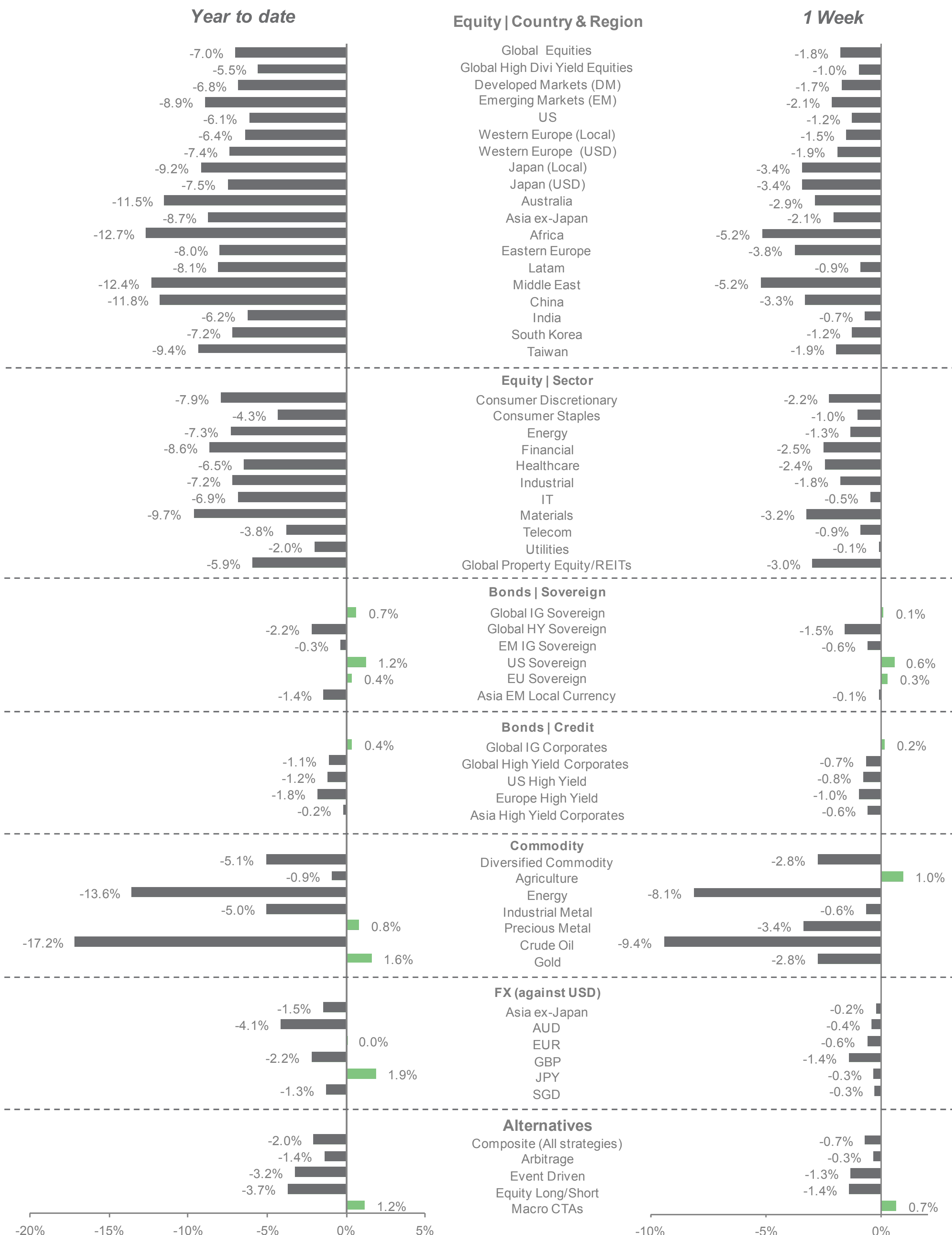
Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2015 to 14 January 2016, 1 week period: 07 Jan 2016 to 14 Jan 2016*

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

What does this mean for investors?

Global equity markets continued to decline for the third straight month, amid broad-based losses across markets. Crude oil lost another 9%, bonds rose, while the USD gained across the board.

Equities: Major markets poised at key technical levels

- **Global stock index falls below September lows**. The MSCI AC World Index has declined 7% year-to-date amid the continued decline in commodity prices and concerns about China's currency. Major global equity indices in the US, Europe and Japan fell close to or below September lows. The Shanghai Composite Index has lost 16% year-to-date and is down 38% from its recent peak in April.
- **Still constructive on Euro area and Japan equities**. In line with our 2016 outlook, we expect Euro area (FX-hedged) and Japanese stocks to outperform on the back of relatively stronger earnings growth. In the Euro area, record-low borrowing costs, weak EUR and lower energy prices are helping the services sector and consumption. Earnings at the top 300 European companies are forecast to have risen by 38% y/y in Q4 2015, led by the financial sector (source: Thomson Reuters).
- **US Q4 earnings key near-term driver of stocks**. S&P500 company earnings in Q4 are estimated to have fallen about 5% y/y, largely due to the decline in energy and material sectors. Excluding the energy sector, earnings are estimated to have risen 1.1%. However, based on recent quarters, we expect most companies to beat profit estimates. An eventual (albeit modest) recovery in oil prices, likely in H2 2016, could help earnings recover from a low base.

Bonds: Raise exposure to bonds, alternative strategies

- **Higher bond exposure helps manage volatility**. A key theme for 2016 is to raise exposure to bonds and alternative strategies as a way to manage an expected increase in volatility. The theme has worked well as US Treasuries, and German and Japanese government bonds have gained over the past month, acting as a buffer against weak equity markets.
- **US High Yield (HY) bonds resilient against oil prices**. Although oil prices have plunged almost 20% in the past three weeks, US HY bonds have been fairly resilient, with the yield premium over US Treasuries widening by only c. 50bps. We believe the bonds are pricing in an excessively pessimistic scenario and see the current weakness as an opportunity to add exposure.

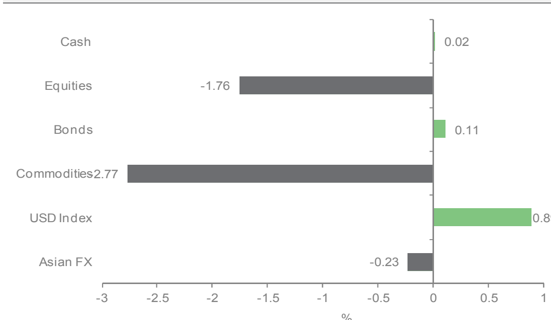
FX: Currency markets stabilise as China intervenes

- **Offshore CNY (CNH) strengthens following reports of PBoC intervention.** The intervention helped the CNH move closer to the onshore CNY. We expect PBoC to stabilise the CNY against a basket of currencies of China's major trade partners. However, broad-based USD strength could lead to further CNY weakness.
- **GBP breaks through key support**. The breach of 1.45 to a five-year low follows weaker-than-expected industrial production data. A pick-up in volatility reflects increased concerns about the possibility of the UK leaving the EU following a referendum this year. Although risk of short-term downside remains, we believe any weakness would be an opportunity to add exposure.

Commodities: Index testing 1999 lows; oil close to USD30/bbl

- **Downside risks in the short term.** The Bloomberg Commodity Index fell close to its 1999 lows, with oil falling to its lowest since 2003. Momentum remains negative, with a break of USD 30/bbl opening up the next key support at USD20/bbl. However, the supply-demand balance is likely to improve going into H2 2016.

Benchmark (USD) performance w/w*

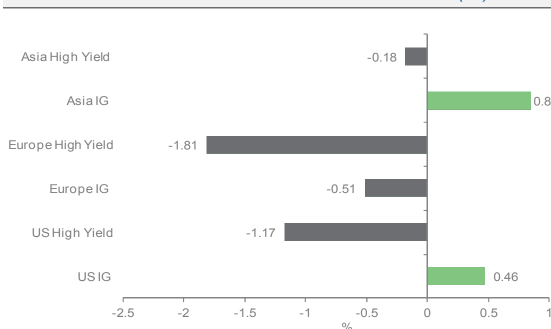


**Week of 07 January 2016 to 14 January 2016*

Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

Investment-grade USD corporate bonds in Asia and the US have outperformed equities this year

Performance of bond indices in 31 Dec-14 Jan (%)



Source: Bloomberg, Standard Chartered

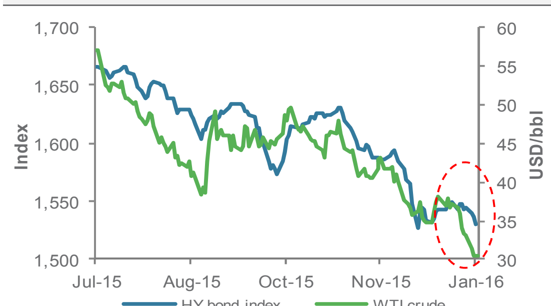
CNY has remained range-bound vs. PBoC's basket of currencies, while the gap between the CNH and the CNY has narrowed over the past week

CFETS RMB Index; USD/CNY, USD/CNH (RHS)

Source: Bloomberg, Standard Chartered

US HY bonds have held their ground lately despite a sharp decline in oil prices

Barclays US Corporate HY Total Return Index; WTI crude oil (USD/bbl) (RHS)



Source: Bloomberg, Standard Chartered

As you would probably expect, we have been giving a lot of client presentations early in the year and, given the recent market volatility, there have been a few consistent themes. Below is a summary of the five recurring questions and how we would address them. We hope you find this helpful.

Steve Brice

Global equities have had a very challenging start to the year. Is this a sign of something more sinister?

The answer may depend on your time horizon. Over the longer term (6-12 months), we are not excessively worried about the recent volatility. It is normal for equities to lose some value in the initial few weeks after the Fed hikes interest rates before recovering strongly over 6-12 months. Given we believe the US economic expansion is likely to continue well into 2017, global equities should deliver positive returns in 2016, outperforming bonds, commodities and cash once again.

Over a short-term time horizon, it is much less clear to us when equities will bottom. We believe much of the China-inspired volatility may be behind us. However, the near-term US earnings outlook is clouded by uncertainty, especially given the further decline in oil prices at the beginning of the year. Ultimately, oil prices are likely to stabilise and recover, but this looks unlikely near- term. It is very early days, but so far Q4 2015 earnings are outperforming much-reduced expectations. Sales forecasts, on the other hand, have been disappointed.

Where does this leave us? We continue to believe that the current period of weakness is a good opportunity to increase exposure to equities. However, exactly when to buy is more challenging and we cannot rule out the possibility of the S&P500 index testing around 1700, which is about 10% below where we are today. For the full year, we expect mid-to-high single-digit returns for global equities, and retain our preference for Euro area (FX-hedged) and Japan equities.

Is China pursuing a policy of competitive devaluations and what does this say about 1) the state of the domestic economy and 2) the outlook for the stock market?

We do not think the latest move is a devaluation, but a shift in FX policy to more focus on the trade-weighted exchange rate rather than the bilateral USD-CNY exchange rate. This makes sense. On the trade-weighted measure, the CNY has weakened in the past two months, but not outside recent ranges. As such, we do not see recent weakness as an indication of rising economic concerns.

As far as the stock market is concerned, we think it is increasingly important to acknowledge there is not one China stock market, but many - including the Shanghai Composite index, the Hang Seng China Enterprises index and the MSCI China index. We strongly favour the MSCI China index because we believe this is becoming more and more reflective of the 'New Economy' in China. It is here that we are bullish as the economy is likely to increasingly shift away from investment, manufacturing and exports to focus more on consumption and services.

Oil prices are continuing to fall. Where will the low be and what are the implications for US high yield bonds?

Forecasts of USD 20/barrel have gone from risk scenarios to increasingly mainstream. We continue to focus on excess capacity in the short term which can push prices significantly lower. However, we expect oil prices to bottom at some point in the year and close the year higher than they are today. Therefore, we believe US high yield bonds, which are offering yields of above 8.5%, are more than pricing in the downside risks to credit quality. This is reinforced by our view that a spike in interest rates is unlikely.

In an environment of narrowing US dollar strength, what do you see as the key winners and losers?

We believe the EUR and CHF are vulnerable to divergent monetary policies while the AUD and NZD are still vulnerable to weak commodity prices. The JPY is incredibly undervalued, but we expect the authorities to fight any excessive JPY strength. In the near- term, we favour the GBP which has fallen sharply and we expect a rebound.

Does an increased weight to REITs make sense within the context of an income allocation?

We reduced our allocation to REITs versus other non-core income assets given their interest rate sensitivity (they become less attractive in an environment of rising US interest rates). REITs also tend to be more volatile and suffer a bigger drawdown than other income assets. Given that we're much more focused on risk management (including managing volatility and drawdown risks) in the portfolio, we would keep REIT allocation to a minimum. Instead of a broad-based allocation to REITs, we would be more selective.

In Singapore, rising supply of office space is negative for the local REITs outlook. Meanwhile, the retail and hotel REITs sectors are suffering from over-supply and weak tourist arrivals. Combined with an outlook for high rates, other income assets offer better returns on a risk-adjusted basis.

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Economic & Market Calendar

	Next Week: Jan 18-Jan 22					This Week: Jan 11-Jan 15				
	Event		**Period**	**Expected**	**Prior**	**Event**		**Period**	**Actual**	**Prior**
MON	AU	TD Securities Inflation y/y	Dec	–	1.80%	EC	Sentix Investor Confidence	Jan	9.6	15.7
	JN	Industrial Production y/y	Nov F	–	1.60%					
TUE	SK	PPI y/y	Dec	–	-4.60%	JN	BoP Current Account Balance	Nov	1143.5b	¥1458.4b
	CH	Industrial Production y/y	Dec	6.10%	6.20%	JN	Bank Lending Ex-Trusts y/y	Dec	2.2%	2.3%
	CH	Retail Sales y/y	Dec	11.30%	11.20%	UK	Industrial Production y/y	Nov	0.9%	1.7%
	CH	Fixed Assets Ex Rural YTD y/y	Dec	10.20%	10.20%	IN	CPI y/y	Dec	5.61%	5.41%
	CH	GDP SA q/q	4Q	1.80%	1.80%	IN	Industrial Production y/y	Nov	-3.2%	9.9%
	CH	GDP y/y	4Q	6.90%	6.90%	US	JOLTS Job Openings	Nov	5431	5383
	JN	Machine Tool Orders y/y	Dec F	–	–					
	GE	CPI EU Harmonized y/y	Dec F	–	0.20%					
	EC	ECB Current Account SA	Nov	–	20.4b					
	UK	CPI y/y	Dec	–	0.10%					
	UK	CPI Core y/y	Dec	–	1.20%					
	UK	ONS House Price y/y	Nov	–	7.00%					
	EC	Construction Output y/y	Nov	–	1.10%					
	EC	ZEW Survey Expectations	Jan	–	33.9					
	GE	ZEW Survey Current Situation	Jan	–	55					
	GE	ZEW Survey Expectations	Jan	–	16.1					
	TU	Benchmark Repurchase Rate	19-Jan	–	7.50%					
WED	JN	Cabinet Office Monthly Economic Report for January				CH	Trade Balance	Dec	$60.09b	$54.10b
	AU	Westpac Consumer Conf SA m/m	Jan	–	-0.80%	CH	Exports y/y	Dec	-1.4%	-6.8%
	GE	PPI y/y	Dec	–	-2.50%	CH	Imports y/y	Dec	-7.6%	-8.7%
	UK	Average Weekly Earnings 3m/y/y	Nov	–	2.40%	SK	Unemployment rate SA	Dec	3.4%	3.4%
	UK	ILO Unemployment Rate 3mths	Nov	–	5.20%	JN	Money Stock M2 y/y	Dec	3.0%	3.3%
	UK	Employment Change 3m/3m	Nov	–	207k	JN	Money Stock M3 y/y	Dec	2.5%	2.7%
	US	Housing Starts	Dec	1194k	1173k	EC	Industrial Production WDA y/y	Nov	1.1%	2.0%
	US	Building Permits	Dec	1200k	1289k					
	US	CPI y/y	Dec	0.80%	0.50%					
	US	CPI Ex Food and Energy y/y	Dec	2.10%	2.00%					
	CA	Bank of Canada Rate Decision	20-Jan	0.50%	0.50%					
	CA	Bank of Canada Releases Monetary Policy Report								
THUR	JN	All Industry Activity Index m/m	Nov	–	1.00%	SK	BoK 7-Day Repo Rate	Jan 14	1.50%	1.50%
	EC	CPI y/y	Dec F	–	–	US	U.S. Federal Reserve Releases Beige Book			
	EC	CPI Core y/y	Dec F	–	0.90%	JN	Machine Orders y/y	Nov	1.2%	10.3%
	EC	ECB Main Refinancing Rate	21-Jan	0.05%	0.05%	JN	PPI y/y	Dec	-3.4%	-3.60%
	EC	ECB Deposit Facility Rate	21-Jan	-0.30%	-0.30%	AU	Employment Change	Dec	-1.0K	74.9k
	US	Philadelphia Fed Business Outlook	Jan	-0.9	-5.9	AU	Unemployment Rate	Dec	5.8%	5.8%
	EC	Consumer Confidence	Jan A	–	-5.7	JN	Machine Tool Orders y/y	Dec P	-25.8%	-17.7%
						IN	Wholesale Prices y/y	Dec	-0.73%	-1.99%
						GE	GDP NSA y/y	2015	1.7%	1.6%
						EC	ECB account of the monetary policy meeting			
						UK	Bank of England Bank Rate	Jan 14	0.50%	0.50%
						ID	Bank Indonesia Reference Rate	Jan 14	7.25%	7.50%
FRI/SAT	JN	Nikkei Japan PMI Mfg	Jan P	–	52.6	ID	Exports y/y	Dec	–	-17.58%
	GE	Markit/BME Germany Manufacturing PMI	Jan P	–	53.2	EC	EU27 New Car Registrations	Dec	–	13.70%
	GE	Markit Germany Services PMI	Jan P	–	56	EC	Trade Balance SA	Nov	–	19.9b
	GE	Markit/BME Germany Composite PMI	Jan P	–	55.5	US	Retail Sales Advance m/m	Dec	–	0.20%
	EC	ECB Survey of Professional Forecasters				US	Retail Sales Control Group	Dec	–	0.60%
	EC	Markit Eurozone Manufacturing PMI	Jan P	–	53.2	US	PPI Final Demand y/y	Dec	–	-1.10%
	EC	Markit Eurozone Services PMI	Jan P	–	54.2	US	PPI Ex Food and Energy y/y	Dec	–	0.50%
	EC	Markit Eurozone Composite PMI	Jan P	–	54.3	US	Empire Manufacturing	Jan	–	-4.59
	UK	Retail Sales Ex Auto Fuel y/y	Dec	–	3.90%	CA	Existing Home Sales m/m	Dec	–	1.80%
	BZ	IBGE Inflation IPCA-15 y/y	Jan	–	10.71%	US	Capacity Utilization	Dec	–	77.00%
	CA	Retail Sales m/m	Nov	–	0.10%	US	Industrial Production m/m	Dec	–	-0.60%
	CA	CPI y/y	Dec	–	1.40%	US	Business Inventories	Nov	–	0.00%
	CA	CPI Core y/y	Dec	–	2.00%	US	U. of Mich. Current Conditions	Jan P	–	108.1
	US	Chicago Fed Nat Activity Index	Dec	–	-0.3	US	U. of Mich. Expectations	Jan P	–	82.7
	US	Existing Home Sales	Dec	5.11m	4.76m	US	U. of Mich. 5-10 Yr Inflation	Jan P	–	2.60%
	US	Leading Index	Dec	0.00%	0.40%	US	U. of Mich. 1 Yr Inflation	Jan P	–	2.60%
						US	U. of Mich. Sentiment	Jan P	–	92.6

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

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Source: Bloomberg, Standard Chartered

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