Standard Chartered Priority

weekly market view

This reflects the views of the Wealth Management Group

macro strategy | 5 February 2016

Editorial

USD, oil at pivotal points

- **Global equities and crude oil held their ground, but government bond yields and the USD slumped after the BoJ's rate cut and weaker economic data from the US.**
- **We believe the USD and oil are at pivotal levels. Any further decline in the USD and stabilisation in oil may be positive for corporate earnings and global equities.**
- **China's capital control measures and CNY policy remain in focus. The central bank's pledge to make the CNY more flexible has raised expectations of a band widening.**

BoJ's rate cut drives global yields lower. The BoJ's cut in a key interest rate to negative for the first time last week has dislocated global bond markets. Japanese government bonds for maturities up to nine years now carry a negative yield. This has dragged German Bund and US Treasury yields lower, especially for maturities longer than 10 years. US 10-year Treasury yields have dropped to a one-year low of 1.83%. US economic data has also softened – the latest being the weaker-than-expected ISM non-manufacturing index. However, the US yield premium over German and Japanese yields has remained largely unchanged, suggesting the BoJ policy move may have been the main driver of US yields, much more so than the US outlook. This implies Treasury yields may be close to bottoming.

USD tumbles as Fed rate hike seen delayed. A string of weak US data has dampened the chances of another Fed rate hike. Money markets now see less than 50% chance of another Fed rate hike this year. This is in sharp contrast to the start of the year, when the markets indicated a 50% chance of a hike as early as March. The pushing back of Fed hike expectations has hurt the USD, with the EUR and JPY both rising around 3% over the past week. Friday's payrolls report is likely to be a key driver of near-term USD trend.

A stabilisation in oil is likely to provide relief to corporate earnings. Oil has stayed above USD30/bbl for the past couple of weeks and may be nearing a bottom. Inflation-adjusted prices are below the lows of 1980s and 1990s. A reversal in the USD is also likely to boost oil as the two are inversely correlated (see page 3 for other rationale for an oil rebound). A gradual recovery (or at least a stabilisation) in oil could halt the downtrend in energy and financial sector earnings revisions in the US and Europe. It could also prove supportive for US High Yield (HY) bonds.

Weaker USD and stabilisation in oil may be positive for global equities. US corporate earnings have been dragged lower in recent years due to the USD strength and decline in oil prices, while European earnings have been weighed by the drop in energy sector earnings. Any decline in the USD and stabilisation in oil prices are likely to boost corporate profits, and by extension equities. Energy-exporting Emerging Markets are also likely to benefit from such a reversal.

China currency policy, capital controls in focus. While China's markets will close next week for the Lunar New Year, the focus is likely to remain on further measures to limit capital outflows. China's recent steps have hurt Hong Kong property and insurance stocks. Authorities have pledged to make the CNY more flexible, raising expectations that it could allow the currency to trade in a wider band.

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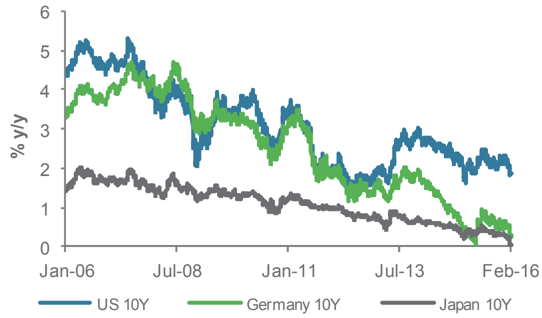
US 10-year Treasury yields have been dragged below 2%, partly by the relentless decline in Japanese and German government bond yields

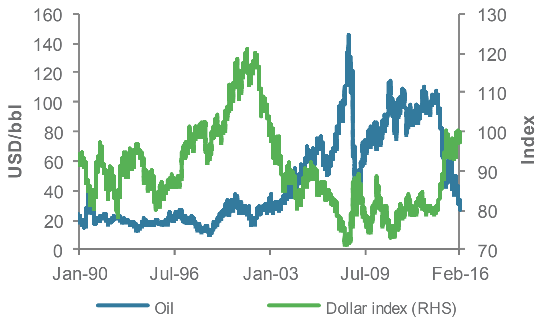
US, Germany and Japan 10-year government bond yields (%, y/y)



Source: Bloomberg, Standard Chartered

The inverse correlation between crude oil and the USD suggests that oil may bottom in the near term as the USD peaks

US WTI crude oil (USD/bbl); US Dollar (DXY) Index (RHS)



Source: Bloomberg, Standard Chartered

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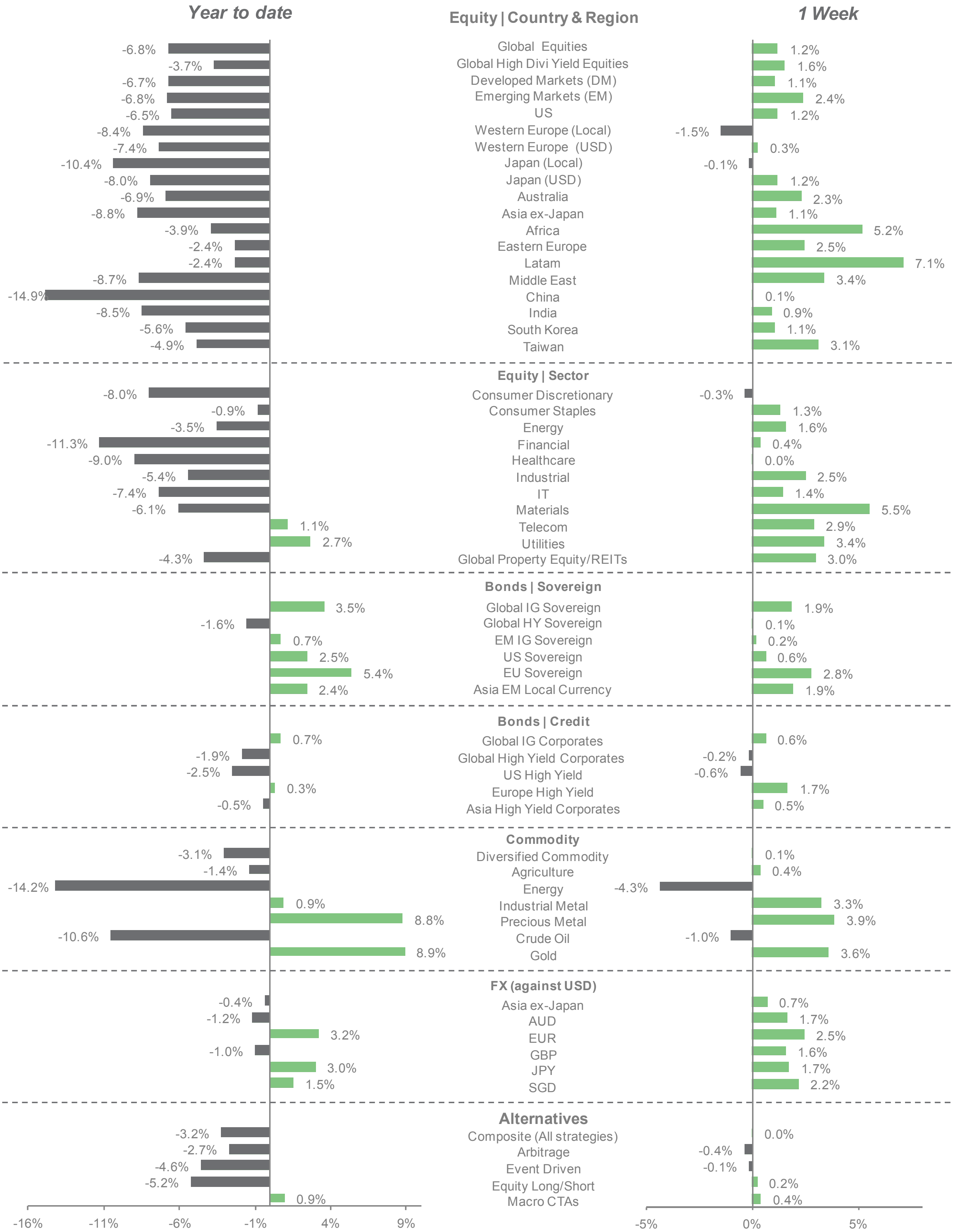
Market performance summary*



*Performance in USD terms unless otherwise stated, YTD period from 31 December 2015 to 04 February 2016, 1 week period: 28 Jan 2016 to 04 Feb 2016
Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

What does this mean for investors?

Global equities recovered for the second week as oil stabilised and the USD weakened with the paring back of US rate hike expectations. Government bonds gained after the BoJ cut rates.

Equities: Energy sector continues to dampen earnings outlook

- **US 2016 earnings expectations pared back.** The 2016 earnings growth estimate at S&P500 companies has been pared back to 6% from 10% at the start of the year. Energy sector earnings continue to weigh on the market, with full-year earnings expected to decline 30% this year, after an estimated 60% decline in 2015.
- **US banks hurt as Fed rate hike expectations pushed back.** Weaker US economic data imply the next Fed rate hike is likely to be delayed. This means US bank interest margins are unlikely to rise as much as previously estimated. We would hold off adding exposure to the sector amid muted loan growth and deterioration in credit quality, besides concerns about margins.
- **China capital controls hurt Hong Kong property and insurance sectors.** China limited the ability of mainland investors to buy insurance policies in Hong Kong, extending targeted capital controls. These measures have hurt Hong Kong's property, insurance and gaming sectors. We would focus on adding exposure to China's 'new economy' sectors instead.

Bonds: US yields may be close to a bottom

- **US 10-year yields fall to one-year low of around 1.83%.** We believe the latest decline is a result of the BoJ's cut in a key rate to negative. The BoJ move dragged 10-year yields on German Bund and Japanese government bonds to 0.3% and 0.05%, respectively, making Treasuries attractive. However, the US yield premium over German and Japanese bonds remains within recent ranges, which suggests the decline in US yields may be near a bottom as the BoJ-led move runs its course.
- **US High Yield (HY) bonds remain under pressure, contrary to our expectations.** A second consecutive month of tightening of US bank lending standards is negative for US HY bonds. However, yields at around 9.5% look attractive if defaults stay contained within the energy/materials sectors. Our scorecard is flashing orange for a few factors, but there are no reds so far.

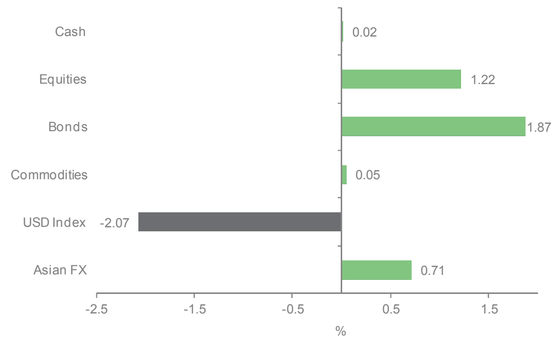
FX: USD falls after weak services sector report; JPY pares losses

- **USD falls to a three-month low.** The decline followed a weaker-than-expected business confidence report on the US non-manufacturing sector. The report further pushed back US rate hike expectations. Friday's jobs report for January will be in focus next.
- **JPY pares back losses.** The JPY recovered its loss suffered after BoJ's rate cut amid scepticism about the impact of the cut and due to a weaker USD. The JPY's safe-haven appeal amid global weakness and its undervaluation are likely to support the currency.
- **GBP reaction muted as BoE lowers inflation forecasts**. Although the GBP has bounced back from a seven-year low hit in mid-Jan, it was little changed after the BoE lowered its inflation forecast, suggesting markets had already priced in the move.

Commodities: Oil may be close to a bottom

- **Key indicators mixed.** Crude oil has bounced back from a 12-year low in mid-January. Among the drivers we track, sentiment, inflation-adjusted prices and risk of a peak in the USD suggest oil may be near a bottom. Additionally, US storage capacity is far from exhausted, providing some support. However, net long investor positions and Saudi Arabia's strategy to maximise output to drive out marginal producers mean further declines are possible. The next major technical support is at USD 25/bbl.

Benchmark (USD) performance w/w*



**Week of 28 January 2016 to 04 February 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)

US earnings expectations for 2016 have been revised downwards amid downgrades to the energy sector

US earnings revision index; 12m forward EPS growth (%)

Source: FactSet, Standard Chartered

US HY bond indicators are mixed, with credit and volatility risk indicators flashing warning signals

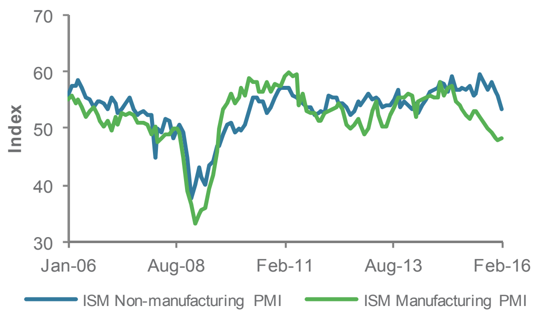
Our scorecard of US HY bonds

Factor	Status
Credit risk	
Interest rate risk	
Volatility risk	
Valuations	

Source: Bloomberg, Standard Chartered

US services sector business confidence deteriorated for the third straight month, in addition to ongoing contraction in manufacturing sector confidence

US ISM Manufacturing PMI and Non-manufacturing PMI



Source: Bloomberg, Standard Chartered

Economic & Market Calendar

	Next Week: Feb 08-Feb 12					This Week: Feb 01-Feb 05				
	Event		Period	Expected	Prior	Event		Period	Actual	Prior
MON	JN	BoP Current Account Balance JPY	Dec	–	1143.5b	ID	CPI Core y/y	Jan	3.6%	4.0%
	JN	Bank Lending Ex-Trusts y/y	Jan	–	2.2%	SK	BoP Current Account Balance	Dec	$7459.5m	$9910.3m
	JN	Labor Cash Earnings y/y	Dec	–	0.0%	AU	TD Securities Inflation y/y	Jan	2.3%	2.0%
	JN	Real Cash Earnings y/y	Dec	–	-0.4%	SK	Exports y/y	Jan	-18.5%	-14.1%
	GE	Industrial Production WDA y/y	Dec	–	0.1%	CH	Manufacturing PMI	Jan	49.4	49.7
	EC	Sentix Investor Confidence	Feb	–	9.6	CH	Non-manufacturing PMI	Jan	53.5	54.4
	IN	GVA y/y	4Q	7.1%	7.4%	SK	Nikkei South Korea PMI Mfg	Jan	49.5	50.7
	IN	GDP y/y	4Q	7.3%	7.4%	CH	Caixin China PMI Mfg	Jan	48.4	48.2
	IN	GDP Annual Estimate y/y	1Q A	7.4%	7.2%	JN	Nikkei Japan PMI Mfg	Jan F	52.3	52.4
						IN	Nikkei India PMI Mfg	Jan	51.1	49.1
						AU	Commodity Index y/y	Jan	-25.8%	-22.7%
						GE	Markit/BME Germany Manufacturing PMI	Jan F	52.3	52.1
						EC	Markit Eurozone Manufacturing PMI	Jan F	52.3	52.3
						UK	Markit UK PMI Manufacturing SA	Jan	52.9	52.1
						US	Personal Income	Dec	0.3%	0.3%
						US	Real Personal Spending	Dec	0.1%	0.4%
						US	PCE Deflator y/y	Dec	0.6%	0.4%
						US	PCE Core y/y	Dec	1.4%	1.4%
						US	ISM Manufacturing	Jan	48.2	48.0
						US	ISM New Orders	Jan	51.5	48.8
TUE	JN	Money Stock M2 y/y	Jan	–	3.0%	SK	CPI Core y/y	Jan	1.7%	2.4%
	JN	Money Stock M3 y/y	Jan	–	2.5%	JN	Monetary Base y/y	Jan	28.9%	29.5%
	JN	Machine Tool Orders y/y	Jan P	–	-25.7%	AU	RBA Cash Rate Target	2-Feb	2.0%	2.0%
	GE	Current Account Balance	Dec	–	24.7b	IN	RBI Cash Reserve Ratio	2-Feb	4.0%	4.0%
	GE	Exports SA m/m	Dec	–	0.4%	IN	RBI Repurchase Rate	2-Feb	6.75%	6.75%
	UK	Trade Balance	Dec	–	-Â£3170	GE	Unemployment Change (000's)	Jan	-20k	-16k
	US	NFIB Small Business Optimism	Jan	94	95.2	EC	PPI y/y	Dec	-3.0%	-3.2%
	US	JOLTS Job Openings	Dec	–	5431	EC	Unemployment Rate	Dec	10.4%	10.5%
	US	Wholesale Inventories m/m	Dec	-0.1%	-0.3%					
	US	Wholesale Trade Sales m/m	Dec	–	-1.0%					
WED	AU	Westpac Consumer Conf SA m/m	Feb	–	-3.5%	CH	Caixin China PMI Services	Jan	52.4	50.2
	JN	Housing Loans y/y	4Q	–	2.4%	CH	Caixin China PMI Composite	Jan	50.1	49.4
	JN	PPI y/y	Jan	–	-3.4%	JN	Nikkei Japan PMI Services	Jan	52.4	51.5
	AU	HIA New Home Sales m/m	Dec	–	-2.7%	JN	Nikkei Japan PMI Composite	Jan	52.6	52.2
	UK	Industrial Production y/y	Dec	–	0.9%	IN	Nikkei India PMI Services	Jan	54.3	53.6
	UK	NIESR GDP Estimate	Jan	–	0.6%	IN	Nikkei India PMI Composite	Jan	53.3	51.6
						JN	Consumer Confidence Index	Jan	42.5	42.7
						RU	Markit Russia PMI Composite	Jan	48.4	47.8
						TU	CPI y/y	Jan	9.6%	8.8%
						GE	Markit Germany Services PMI	Jan F	55.0	55.4
						GE	Markit/BME Germany Composite PMI	Jan F	54.5	54.5
						EC	Markit Eurozone Services PMI	Jan F	53.6	53.6
						EC	Markit Eurozone Composite PMI	Jan F	53.6	53.5
						UK	Markit/CIPS UK Services PMI	Jan	55.6	55.5
						UK	Markit/CIPS UK Composite PMI	Jan	56.1	55.3
						EC	Retail Sales y/y	Dec	1.4%	1.6%
						BZ	Markit Brazil PMI Composite	Jan	44.4	43.9
						US	ADP Employment Change	Jan	205k	267k
						US	ISM Non-Manf. Composite	Jan	53.5	55.8
THUR	AU	Consumer Inflation Expectation	Feb	–	3.6%	EC	Markit Eurozone Retail PMI	Jan	48.9	49
						GE	Markit Germany Retail PMI	Jan	49.5	50.5
						UK	Bank of England Bank Rate	4-Feb	0.5%	0.5%
						UK	Bank of England Inflation Report			
						US	Nonfarm Productivity	4Q P	-3.0%	2.1%
						US	Unit Labor Costs	4Q P	4.5%	1.9%
FRI/SAT	AU	Home Loans m/m	Dec	–	1.8%	MX	Overnight Rate	4-Feb	3.25%	3.25%
	IN	Industrial Production y/y	Dec	–	-3.2%	AU	Retail Sales Ex Inflation q/q	4Q	–	0.6%
	IN	CPI y/y	Jan	–	5.6%	GE	Factory Orders WDA y/y	Dec	–	2.1%
	GE	CPI y/y	Jan F	–	0.5%	BZ	IBGE Inflation IPCA y/y	Jan	–	10.7%
	GE	GDP SA QoQ	4Q P	–	0.3%	CA	Net Change in Employment	Jan	–	22.8k
	GE	GDP WDA y/y	4Q P	–	1.7%	US	Trade Balance	Dec	–	-$42.4b
	EC	Industrial Production WDA y/y	Dec	–	1.1%	US	Change in Nonfarm Payrolls	Jan	–	292k
	EC	GDP SA QoQ	4Q A	–	0.3%	US	Unemployment Rate	Jan	–	5.0%
	EC	GDP SA y/y	4Q A	–	1.6%	US	Average Hourly Earnings y/y	Jan	–	2.5%
	US	Import Price Index y/y	Jan	–	-8.2%	US	Average Weekly Hours All Employees	Jan	–	34.5
	US	Retail Sales Advance m/m	Jan	0.1%	-0.1%	US	Underemployment Rate	Jan	–	9.9%
	US	Retail Sales Ex Auto m/m	Jan	0.1%	-0.1%	CA	Ivey Purchasing Managers Index SA	Jan	–	49.9
	US	Retail Sales Ex Auto and Gas	Jan	–	0.0%					
	US	Retail Sales Control Group	Jan	–	-0.3%					
	US	Business Inventories	Dec	0.2%	-0.2%					
	US	U. of Mich. Sentiment	Feb P	93	92					
	US	U. of Mich. Current Conditions	Feb P	–	106.4					
	US	U. of Mich. Expectations	Feb P	–	82.7					
	US	U. of Mich. 1 Yr Inflation	Feb P	–	2.5%					
	US	U. of Mich. 5-10 Yr Inflation	Feb P	–	2.7%					

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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