Standard Chartered Private Bank

weekly market view

This reflects the views of the Wealth Management Group

macro strategy| 14 March 2014

All eyes on China

Recent data releases reinforce the challenges faced by the Chinese authorities in managing the economy. This has been reflected across all Chinese asset classes – equities, interest rates, credit spreads and the CNY. While we expect China to avert a hard landing, the adjustment process is likely to be prolonged. Against this backdrop, we expect continued EM equity market under-performance.

Within Asian equities, the prospects of increased reforms are being taken very differently in India, which has hit an all-time high, and China. The outlook for Chinese banks is key and the likelihood of rising non-performing loans is a significant headwind. Chinese small-cap stocks look much more resilient.

This week sees Janet Yellen's first Fed policy meeting in charge. She will likely try to persuade markets that hiking interest rates is not going to be on the agenda for a long time to come. However, as signs of economic recovery mount and wage inflation picks up, markets are likely to become increasingly difficult to convince. We expect the 10-year US Treasury yield to break higher in the coming months.

MACRO OVERVIEW

- **US:** Employment report reduces economic concerns. Retail sales growth rebounded in February. Focus to shift to Yellen's thoughts on policy as unemployment approaches the 6.5% threshold
- **Asia:** China remains in focus as the authorities continue to juggle the numerous challenges they face
- **Ukraine:** Weekend referendum key to short-term sentiment
- **Japan:** Approaching the consumption tax hike

FIXED INCOME: Underweight

- **G3 sovereign: UW –** The Fed will likely attempt to keep Treasury yields range-bound, but economic recovery will make this harder to achieve long term
- **Asia high yield (HY): N –** Spreads widen slightly as China shifts towards a more market-determined allocation of credit

EQUITIES: Overweight

- **Global equities: OW –** Taking a breather, but still in a strong uptrend
- **Asian equities: UW –** Reform is a positive in India, but not in China (at least in the short term and for large-cap stocks)

COMMODITIES: Neutral

- **Gold: UW –** Breaks through USD 1,350 on USD weakness. USD 1,400 resistance is now key
- **Base metals: N –** Iron ore and copper prices slump

CURRENCIES: Favour the USD in the medium term

- **CNY:** Policy action surprises, but longer-term outlook unchanged
- **AUD:** Strong employment report counteracts falling iron or prices

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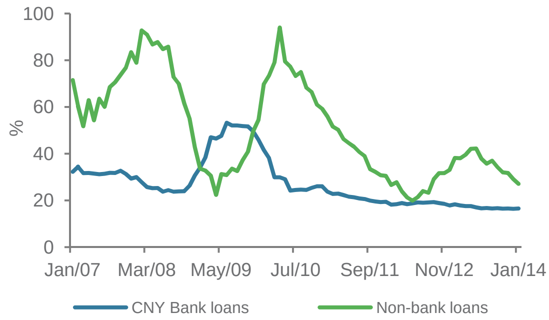
Chinese authorities still balancing the need for credit restraint and economic growth

China CNY bank loans and non-bank loans, % y/y



Source: Bloomberg, Standard Chartered

Key events this week:

Data/Event		Date
-	Ukraine – Crimea referendum	16-Mar
EC	CPI y/y	17-Mar
US	NAHB Housing market index	17-Mar
EC	ZEW survey expectations	18-Mar
US	CPI y/y	18-Mar
UK	BoE minutes	19-Mar
UK	UK budget	19-Mar
US	FOMC rate decision	20-Mar
AU	Conf board leading index m/m	21-Mar

Source: Bloomberg, Standard Chartered

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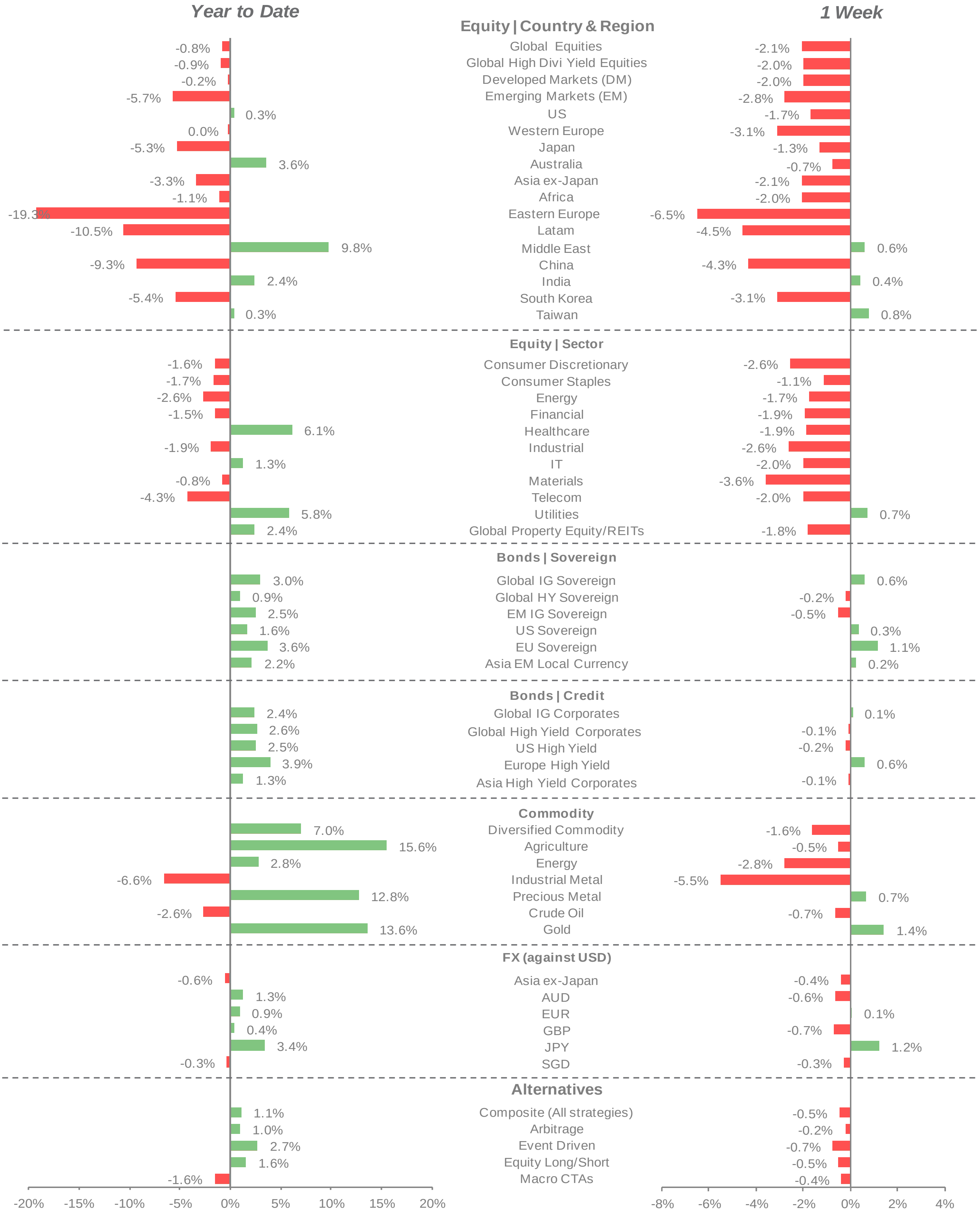
Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2013 to 13 March 2014, 1 week period: 6 March to 13 March 2014*

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

China juggles

A hard landing in China looks unlikely, but so does a strong rebound as the government juggles multiple challenges. In the US, data has turned for the better. Looking ahead, continued tapering looks assured. Changes to the Fed's 'forward guidance' will be key. Ukraine remains in the background, as does the April consumption tax hike in Japan.

Two key takeaways this week are as follows:

1. China juggles multiple, and often conflicting, objectives

One of the biggest uncertainties facing global financial markets is how China will manage its multiple challenges. These include an excessive reliance on credit to fuel growth, rising default risks in both the bonds and wealth management products, the implementation of pro-private sector reforms and interest rate liberalisation, strong capital inflows and the need to maintain social stability and thus growth.

The past two weeks have seen increased uncertainty. The country saw its first default in the bond market. On the face of it, export data was very disappointing, falling over 18% y/y in February. However, in our opinion, the data is distorted and the underlying picture is more benign, with export growth slowing (but positive), import growth accelerating and China still posting a significant trade surplus in January and February.

Bank lending, industrial production and retail sales were also much weaker than expected. Reforms to generate a more market-based approach to the allocation of credit were a key focus at the recently concluded National People's Congress. However, the authorities are likely to have a fluid policy approach as they not only control credit growth, but also limit the economy's downside. This is reflected in the recent decline in interest rates and weakening of the CNY. We believe this will avert a hard landing, but the risks of a policy mistake are rising.

2. US recovery intact; Fed's 'forward guidance' will be key

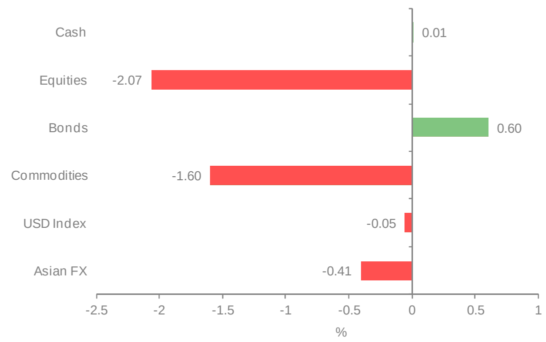
The US employment report came in significantly stronger than expected, with net job creation accelerating to 174k in February, despite very poor weather. Wages also accelerated 2.2% y/y from 2.0% in January, and while the small business confidence survey was weak, the lead indicators for wages held up well. This reinforces our view that Fed is likely to tighten policy as early as the first half of 2015.

This makes the FOMC meeting next week crucial. The Fed is likely to 'taper' quantitative easing by another USD 10bn. Any change to forward guidance will be key. A breach in the unemployment rate below 6.5% had been painted as a pre-requisite for considering a rate hike. We expect the Fed to try to keep interest rate expectations muted, possibly by becoming less prescriptive in its guidance. However, the fact that this is Yellen's first policy meeting in charge adds to the uncertainty and risks of a mis-step. New Zealand's interest rate hike this week was the first hike by a Developed Market and may intensify scrutiny as to who will be next.

Other factors to watch: Outside of the above, the situation in **Ukraine** remains uncertain. US President Obama met the Ukrainian Prime Minister this week and repeated calls for Russia to 'change course' or face the consequences of its actions. We believe this issue is unlikely to be resolved any time soon, but it is also unlikely to be a dominant feature of financial markets on a sustained basis. The weekend's Crimea referendum will be key.

Lastly, **Japan** is approaching a critical period, with the consumption tax due to be hiked on 1 April. This is likely to lead to a sharp contraction in the economy in Q2. All eyes will be on how quickly the economy can recover. We expect significant policy steps in Q2.

Benchmark (USD) performance w/w*



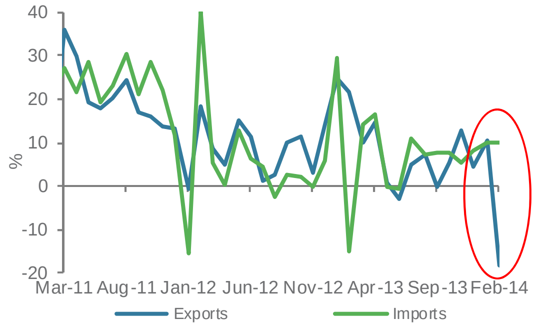
**week of 6 Mar 2014 – 13 Mar 2014*

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, ADXY

Weakness of Chinese exports likely exaggerated

Chinese exports and imports, % y/y



Source:, Bloomberg, Standard Chartered

Wage inflation starting to rise, which will ultimately put pressure on the Fed to hike interest rates

Average earnings (%, y/y) and the NFIB 'jobs hard to fill' index

Source: Bloomberg, Standard Chartered

What does this mean for investors?

It has been a quiet week for global equity markets, which were down marginally. Within Asia, there have been divergent trends between countries. On currencies, the PBoC's decision to push the CNY's reference rate higher was a surprise. The AUD has been resilient to collapsing iron ore prices.

Equities: Taking a breather. Global equities took a breather over the past week following the strong gains seen post the Ukraine-induced sell-off. Markets will be alert to any signs of a potential change in the Fed's forward guidance next week. We continue to expect equities to outperform bonds over the course of the next 6-12 months.

Asia sees divergent trends. Asian equities have given back some of the gains seen since the beginning of February. More interesting, however, is the differing performance between markets. India has reached new all-time highs in recent times (at least in INR terms) and appears to be already pricing in an election outcome that leads to significant policy reforms. This looks rational, in our opinion, although the nature of the coalition will be key.

In China too, the markets are pricing in reforms, but here they expect reforms to undermine corporate earnings for banks and state-owned enterprises – China's small-cap index remains in a strong uptrend. We believe the banking sector, which represents just under 30% of the MSCI broad benchmark, is likely to be weak until NPLs peak.

Bonds: Treading water: Treasury yields have been range-bound in recent times. The Fed will try to avoid putting upward pressure on yields by pushing back expectations of a hike in interest rates. However, as the economic recovery extends, managing expectations will become more challenging. Therefore, our bias remains for significantly higher yields, and once we break through 3.0-3.1%, volatility could increase sharply. Timing this move will be very difficult.

Asian high yield spreads widen slightly. China's first bond default has generally been well received as an indication that future lending is more likely to be allocated to productive projects. However, concerns over the quantum of defaults and 'unintended consequences' indicate that significant spread narrowing is unlikely in the near term.

FX: China increases FX uncertainty. On Monday, the People's Bank of China pushed the USD/CNY reference rate higher by the most since July 2012. We retain our view for an appreciation of the CNY on a 12-month basis. However, the latest move indicates authorities are serious about trying to reduce speculative flows into the currency by increasing the level of uncertainty surrounding the CNY's outlook.

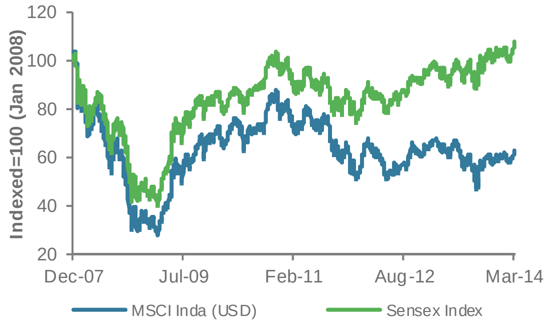
AUD resilient to weak iron ore prices. The AUD weakened significantly early in the week, but then recovered most of its losses on the back of a stronger-than-expected employment report. We continue to highlight that we believe near-term downside is limited given the improving domestic fundamentals and still significant short positioning. A sharper-than-expected slowdown in China, and thus a continued collapse in commodity prices, is the key risk to our view.

Gold: Breaks through 1,350. Gold broke through key USD 1,350 resistance, providing scope for a move towards USD 1400 short term.

Conclusion: FX/commodity markets have dominated the headlines over the past week. The AUD is expected to remain resilient absent sharply weaker commodity prices from here. China's decision to push the CNY's value was a surprise, but does not change the longer-term outlook, in our opinion. Meanwhile, gold breaching USD 1,350 could create scope for more gains in the short term.

In Asia, India is a strong performer, at least in local currency terms, on hopes of reforms

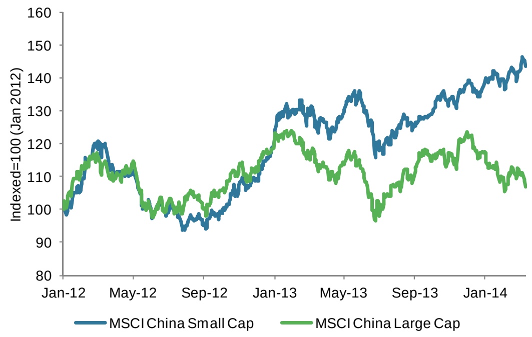
MSCI India index (USD) and Sensex index



Source: MSCI, Bloomberg, Standard Chartered

China still struggling as reforms put SOE; bank earnings under structural pressure

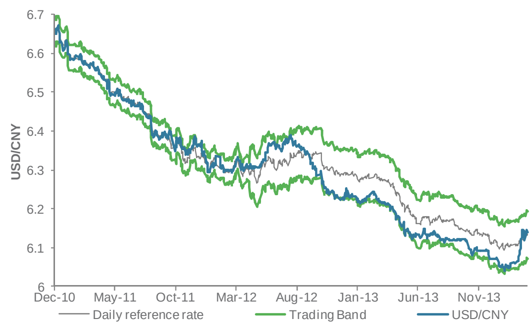
MSCI China large cap and small-cap indices



Source: MSCI, Bloomberg, Standard Chartered

PBoC raises USD-CNY reference rate by most since July 2012

China daily reference rate and USD/CNY currency



Source: Bloomberg, Standard Chartered

Technical Analysis

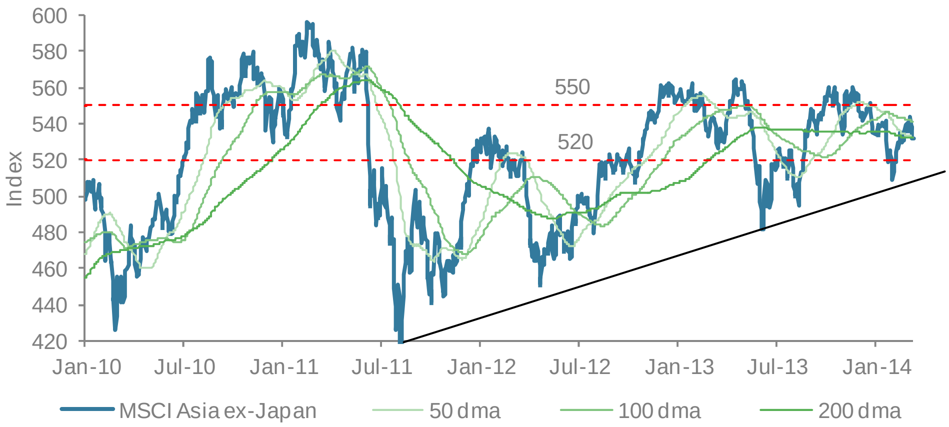
S&P 500 – Moderate Positive

- The index inched closer towards the psychological 1,900 mark on news of easing geopolitical tensions in Ukraine, but thereafter lacked enough follow-through demand. Nevertheless, the short-term trend remains positive, though momentum has moderated somewhat relative to the start of the month. We do not expect the short-term trend to change as long as the index remains supported above 1,820.
- Support–1,820 Resistance–1,920

(Daily Chart)

MSCI Asia Ex-Japan (USD) – Neutral

- The index has so far sustained above the trend-line starting from 2011, a cause for some optimism. However, the weekly momentum indicator is creating a negative divergence, off-setting the bullish bias. Any sharp and convincing drop below 520 and then below the rising trend-line is likely to have bearish implications. Until then, the index is likely to remain within a range.
- Support–520 Resistance–550



(Daily Chart)

AUD/USD – Positive

- The AUD/USD pair appears to have defended support at 0.89, which was likely essential to stop the earlier sharper downtrend. Also, a potential bullish head-and-shoulders chart pattern could favour further upside retracement to 0.920/0.932 if the neckline resistance at 0.907 is overcome. Daily momentum indicators are positively biased, which also support the possibility of more upside.
- Support–0.89 Resistance–0.92

Source: Bloomberg, Standard Chartered

(Daily Chart)

TOPIX – Neutral

- The index has had a relatively mild recovery following its decline from the high of 1,300. Although our longer-term bias remains positive, we remain concerned about momentum, which has been waning and limiting the rebound. Technically, the outlook remains moderately negative in the shorter run, but we expect any fall to be limited and believe the index will attract buyers as it nears support at 1,150.
- Support–1,150 Resistance–1,265

(Daily Chart)

Gold – Moderate Negative

- Gold pushed higher above USD 1,350 and now appears to be targeting the next resistance at USD 1,400. We observe a few short-term momentum indicators have crept back into overbought territory and are approaching previous peaks. The rally from the lows of USD 1,200 has not seen any significant pullback which makes it vulnerable to a sharper pullback once the on-going up-move terminates. We remain cautious at current levels and expect the on-going rally is in its final stages of ascent.
- Support–1,265 Resistance–1,400

(Daily Chart)

US 10-year Treasury yields – Positive

- The 10-year yield appears to be trading within a moderately positive sideways range of 2.6%-3.1%. Yields are likely to find support closer to the lower end of this range (at 2.6%) while the mid-point of this range (at 2.75%) will likely act as the primary resistance. However, we expect yields to gradually strengthen back towards the upper end of the range at 3% as momentum accelerates.
- Support–2.60 % Resistance– 3.1%

Source: Bloomberg, Standard Chartered

(Daily Chart)

Economic & Market Calendar

Next Week: March 17 – March 21

Day		Event	Period	Expected	Prior
MON	EC	CPI y/y	Feb F	–	0.80%
	EC	CPI Core y/y	Feb F	–	1.00%
	US	Empire Manufacturing	Mar	7	4.48
	US	Capacity Utilisation	Feb	78.60%	78.50%
	US	Manufacturing (SIC) Production	Feb	0.40%	-0.80%
	US	NAHB Housing Market Index	Mar	50	46
	CH	Foreign Direct Investment y/y	Feb	8.00%	16.10%
	NZ	Westpac Consumer Confidence	1Q	–	–
	SI	Non-oil Domestic Exports y/y	Feb	–	-3.30%
	HK	Unemployment Rate SA	Feb	–	3.10%
TUE	JN	Machine Tool Orders y/y	Feb F	–	26.00%
	GE	ZEW Survey Current Situation	Mar	–	50
	GE	ZEW Survey Expectations	Mar	–	55.7
	EC	ZEW Survey Expectations	Mar	–	68.5
	US	CPI y/y	Feb	–	1.60%
	US	CPI Ex Food and Energy y/y	Feb	1.60%	1.60%
	US	Housing Starts	Feb	914K	880K
	US	Building Permits	Feb	960K	945K
WED	JN	Exports y/y	Feb	–	9.5
	JN	Leading Index CI	Jan F	–	112.2
	UK	Bank of England Minutes			
	US	MBA Mortgage Applications	14-Mar	–	–
	UK	Chancellor Announces Budget			
	HK	Composite Interest Rate	Feb	–	0.37%
THUR	US	Fed QE3 Pace	Mar	$55	$65
	US	Fed Pace of Treasury Pur	Mar	–	$35
	US	Fed Pace of MBS Purchases	Mar	–	$30
	US	FOMC Rate Decision	19-Mar	0.25%	0.25%
	US	Initial Jobless Claims	14-Mar	–	–
	US	Existing Home Sales m/m	Feb	0.30%	-5.10%
	NZ	GDP y/y	Q4	–	3.50%
	TA	Export Orders y/y	Feb	–	-2.80%
	HK	CPI Composite y/y	Feb	–	4.60%
FRI	AU	Conf. Board Leading Index m/m	Jan	–	0.80%
	MA	CPI y/y	Feb	–	3.40%
	CA	CPI y/y	Feb	–	1.50%
	EC	Consumer Confidence	Mar A	–	-12.7

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

This Week: March 10 – March 14

Day		Event	Period	Actual	Prior
MON	CH	Exports y/y	Feb	-18.10%	10.60%
	CH	CPI y/y	Feb	2.00%	2.50%
	IN	Exports y/y	Feb	-3.70%	3.80%
	CH	New Yuan Loans	Feb	644.5B	1320.0B
	CH	Aggregate Financing RMB	Feb	938.7bn	2584.5bn
	CH	Money Supply M2 y/y	Feb	13.30%	13.20%
	UK	Lloyds Employment Confidence	Feb	-2	-2
	EC	Sentix Investor Confidence	Mar	13.9	13.3
TUE	AU	NAB Business Confidence	Feb	7	9
	JN	Machine Tool Orders y/y	Feb P	26.00%	40.30%
	JN	BOJ 2014 Monetary Base Target	11-Mar	¥270trn	¥270trn
	UK	Industrial Production y/y	Jan	2.90%	1.90%
	UK	Manufacturing Production y/y	Jan	3.30%	1.40%
	US	NFIB Small Business Optimism	Feb	91.4	94.1
WED	SK	Unemployment rate SA	Feb	3.90%	3.20%
	AU	Westpac Consumer Conf Index	Mar	99.5	100.2
	JN	Domestic CGPI y/y	Feb	1.50%	2.50%
	JN	Consumer Confidence Index	Feb	38.3	40.5
	TH	BoT Benchmark Interest Rate	12-Mar	2.00%	2.25%
	IN	Industrial Production y/y	Jan	0.10%	-0.20%
	IN	CPI y/y	Feb	8.10%	8.79%
	EC	Industrial Production WDA y/y	Jan	2.1%	1.2%
	US	MBA Mortgage Applications	7-Mar	-2.1%	9.4%
THUR	NZ	RBNZ Official Cash Rate	13-Mar	2.75%	2.50%
	JN	Machine Orders y/y	Jan	23.6%	6.70%
	AU	Consumer Inflation Expectation	Mar	2.10%	2.30%
	AU	Unemployment Rate	Feb	6.00%	6.00%
	SK	BoK 7-Day Repo Rate	13-Mar	2.50%	2.50%
	MA	Industrial Production y/y	Jan	3.70%	4.80%
	CH	Retail Sales YTD y/y	Feb	11.8%	13.10%
	HK	Industrial Production y/y	4Q	0.50%	-0.90%
	ID	Bank Indonesia Reference Rate	13-Mar	7.50%	7.50%
	US	Retail Sales Ex Auto and Gas	Feb	0.30%	-0.50%
	US	Initial Jobless Claims	7-Mar	315K	324K
FRI	SI	Unemployment rate SA	4Q F	–	1.80%
	JN	Industrial Production y/y	Jan F	–	10.60%
	CH	Foreign Direct Investment y/y	Feb	–	16.10%
	GE	CPI y/y	Feb F	–	1.20%
	UK	Construction Output SA y/y	Jan	–	6.30%
	US	PPI Ex Food and Energy y/y	Feb	–	1.30%
	US	Univ. of Michigan Confidence	Mar P	–	81.6

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

Source: Bloomberg, Standard Chartered

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