Standard Chartered Private Bank

weekly **market view**

macro strategy | 14 June 2018

This reflects the views of the Wealth Management Group

Editorial

A steady Fed

- **The Fed's reiteration of a gradual rate-hiking path supports our positive stance on global and US equities. A predictable Fed implies the USD is likely to weaken in the near-term.**
- **Equities:** We prefer the US financial sector as it is likely to benefit from rising Fed rates. EM equity inflows have recovered in June; USD weakness is likely to support further inflows.
- **Bonds:** German yields could rise further as the ECB is likely to signal the end of bond purchases by December this year. EM USD government bonds are attractive after the recent pullback.
- **FX:** EUR/USD could break above the 1.185 resistance if the ECB signals end of bond purchases. The GBP is likely to test 1.3600 on a weaker USD and easing concerns of a hard Brexit.

What's new?

- **A steady Fed.** The Fed's signalling a slightly faster pace of rate hikes this year (two, instead of one, more rate hikes expected in 2018) did not come as a surprise to markets. Expectations of another three rate hikes in 2019 still imply a gradual hiking path. This is consistent with our view that policy rates are likely to remain accommodative over the next year or so, supporting risk assets including global and US equities. The hurdle for a further hawkish surprise by the Fed is high and, hence, we expect the USD to weaken in the near term. A weaker USD, in turn, is likely to support flows back into Emerging Market assets which have become attractive after the recent correction.
- **Trump, Kim break the ice.** The first-ever meeting between the leaders of the US and North Korea was notable for the surprise announcement by President Donald Trump that the US would suspend its annual military drills in South Korea. This was in response to the North Korean leader agreeing to gradually eliminate nuclear weapons. China now plans to lobby the UN to lift some of the economic sanctions on North Korea. Though South Korean stocks and the KRW were little changed after these announcements, the focus is likely to shift towards details of North Korea's denuclearisation roadmap. Asia ex-Japan equities are likely to benefit from easing of geopolitical tensions in Asia. South Korean equities remain a core holding within Asia.
- **UK Premier May survives Brexit vote.** UK Prime Minister Theresa May navigated three days of lower house voting, making some compromises towards a softer Brexit. UK data continued to reflect a robust job market, though wage growth slowed a tad. UK inflation was little changed from the previous month but remained above the BoE's 2% target. The economic data and Brexit vote helped the GBP hold above support of 1.3300. We expect the GBP to test 1.3600 in the coming days.

What we are watching

- **US tariff on China.** The US plans to announce details of the 25% tariff on USD 25bn worth of imports from China by 15 June. The uncertainty over the tariffs have led to the outperformance of China's domestic-driven and defensive equity sectors, such as healthcare, mainland property and consumer staples, over the financial and technology sectors in recent weeks.

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Fed forecasts point to gradual rate hikes, but they are still more aggressive than market estimates

Fed forecasts for Fed funds rate vs. market estimates

Source: Bloomberg, Standard Chartered

US bank equities have outperformed their European peers YTD; both are likely to benefit from higher bond yields on the back of tighter monetary policies

Relative performance of S&P500 Banks index and Stoxx Europe 600 Banks index (Index: 100 = 29 Dec. 2017)

Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global stocks were little changed, with Emerging Markets (EM) underperforming Developed Markets, as the USD gained. EM bonds led declines in debt markets.

Equities: Financial sector to benefit from higher rates

- **US, European banks in focus amid Fed, ECB meetings.** Banking sector equities in both regions fell in May along with declines in government bond yields, with European banks underperforming US counterparts. However, the sector has partly recovered in June as investors anticipate higher bond yields ahead, given the guidance for further tightening of monetary policies from both the Fed and the ECB. Financial sector equities remain preferred in the US and a core holding in the Euro area.
- **EM equity flows recover.** Equity flows into EMs have recovered in June following USD 5bn of outflows in May. The recovery is partly due to the recent weakness in the broader USD, which pared back some of the gains YTD. A sustained USD weakness is likely to encourage continued inflows into EMs. Within EMs, we prefer Asia ex-Japan equities, given stronger fundamentals.

Bonds: EM bonds remain under pressure as the Fed raises rates

- **Fed drives yields higher.** US 10-year Treasury yields hovered close to 3% as the Fed hiked rates and indicated that it plans to hike rates two more times in 2018. Nevertheless, we continue to expect US 10-year Treasury yields to remain capped around 3.25%. German 10-year yields recovered half the declines in May, heading towards 0.5%. Any guidance from the ECB on 14 June on the end of bond purchases by the year-end is likely to lead to a further rise in German yields. We would continue to reduce exposure to Developed Market (DM) government bonds.
- **EM pain continues.** EM local currency bonds declined over the past week amid the increasing risk of a tighter monetary policy stance by various countries, as seen in the recent rate hikes in India, Turkey and Indonesia. USD-denominated EM bonds also fell as weak EM sentiment and concerns around Brazil led to an increase in yield premiums. While EM USD government bonds have underperformed since this year, we believe valuations have cheapened significantly and look attractive at current levels.

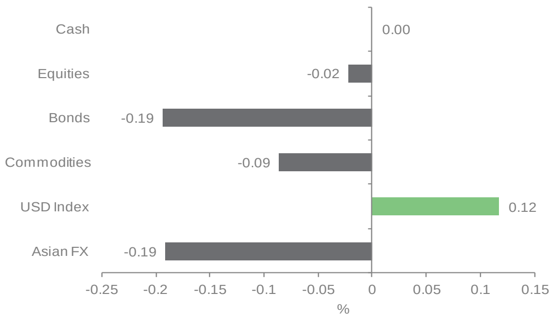
FX: Focus on ECB meeting

- **EUR to get a boost from ECB roadmap for stimulus withdrawal.** The market expects the ECB to indicate today (14 June) the end of bond buying by the end of 2018. Any such confirmation is likely to be positive for the EUR/USD, supporting a test of the next resistance around 1.1850.
- **JPY weakens after Trump-Kim summit.** The US's decision to end joint military exercises with South Korea is likely to unsettle Japan as its security concerns remain unaddressed. USD/JPY broke above a strong resistance around 110.20. We expect further gains towards 111.40, a break of which would lead to a test of an important downtrend channel resistance at 111.90.

Commodities: Focus on OPEC-Russia meeting

- **Oil drifts lower ahead of OPEC meet.** Brent crude prices weakened towards USD 76/bbl from the four-year highs of around USD 80/bbl hit in May. The 22-23 June OPEC meeting, where Saudi Arabia and Russia are likely to propose a gradual relaxation of their previous production-cut agreement, continues to weigh on prices. Reports suggesting Russia has started to produce above its quota support our view that oil prices are unlikely to rise significantly from current levels.

Benchmark (USD) performance w/w*



**Week of 07 June 2018 to 13 June 2018*

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)

S&P500 index has the strongest technical support

Technical levels of key market indicators as on 13 June

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,776	2,718	2,795	↑
STOXX 50	3,480	3,407	3,497	→
FTSE 100	7,704	7,508	7,890	↘
Nikkei 225	22,966	21,900	23,500	↗
Shanghai Comp	3,050	2,925	3,230	↘
Hang Seng	30,725	29,800	31,800	→
MSCI Asia ex-Japan	721	701	750	↗
MSCI EM	1,136	1,097	1,170	↘
Brent crude oil (ICE)	77	72	81	→
Gold	1,299	1,279	1,320	→
UST 10Y Yield	2.97	2.71	3.13	↗

Source: Trading Central, Standard Chartered
Note: Arrows represent short-term trend opinions

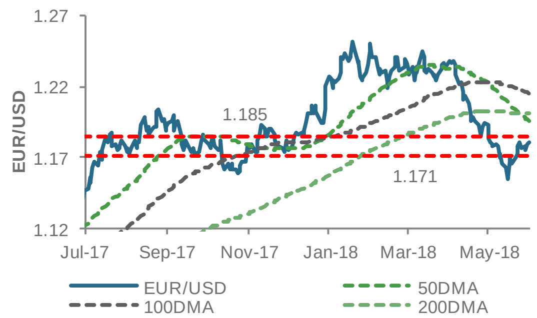
Yield premium on EM USD government bonds have risen above their five-year average

Yield premium of EM USD government bonds over US Treasuries

Source: Bloomberg, Standard Chartered

EUR/USD is likely to break above 1.1850 if the ECB presents a roadmap for ending bond purchases

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What are the implications of the latest Fed decision for my investments?

The Fed hiked interest rates as expected, but more important was a slight increase in its rate expectations. The median forecast is now for a total of four rate hikes in 2018 (ie. 2 more in H2), up from three previously. However, this change should not be over-dramatised. As we highlighted after the May Fed meeting, it only required one person to increase their rate hike expectations to change the median forecast, and this is what the meeting delivered. For 2019, 3 additional rate hikes are still expected by FOMC members.

The subtle shift in rate projections was encouraged by slightly stronger forecasts for growth and inflation, with unemployment seen modestly lower than previously indicated.

As always, there are significant uncertainties with regards to any forecasts. Indeed, we note the tension between the Fed's forecast for 1) inflation to remain under control while 2) growth continues to expand above its view of long-term potential growth and 3) the unemployment rate to fall further below its estimate of the level consistent with stable inflation over the long run. For sure, this combination of events cannot be ruled out through 2018 and even through 2019, but it is something to be watched closely.

The final important announcement was that, starting in 2019, the Fed chairperson will hold a press conference every meeting (instead of once a quarter as is the current practice). Market participants have generally assumed monetary policy changes are more likely at meetings which are followed by a press conference, as this gives the Fed an opportunity to explain in more depth the rationale for any changes. Delaying the implementation of this change to 2019 should mitigate concerns that the more frequent press conference schedule indicates a concern over rising inflationary risks.

Q2. What does it mean for your investments?

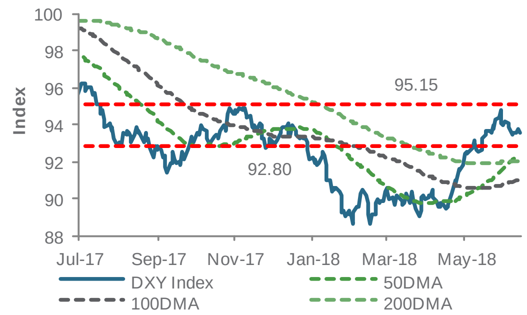
The market price action immediately after the announcement was interesting. The 10-year US government bond yield spiked about 6bps, the US S&P500 index fell 0.5% and the USD index rallied 0.5%. However, both the USD and bond yields subsequently retraced most of these moves. Indeed, at Thursday morning Asia time, the USD was trading weaker than before the Fed's announcement. This reaffirms our view that the near term outlook remains for a weaker US dollar, although the ECB decision later today (14 June) will be another key driver of the USD near-term.

The US equity market remains a preferred market for us. A 'normal' cycle ends when inflation moves too high, forcing the Fed to shift its focus from supporting growth to controlling inflation. We do not believe we are there yet, but the messaging from the Fed is another small step in that direction. The Fed has reiterated its willingness to allow inflation to be slightly above its target, partly to compensate for the past several years it has remained under its target. This suggests monetary policy settings are likely to remain supportive of growth for some time and therefore the US equity market is likely to go on to make new highs.

From a bond market perspective, we expect US bond yields to drift modestly higher, but not in a way that would generate negative returns across other areas of the bond universe. Our preference for Emerging Market USD bonds over Developed Market bonds remains intact.

The USD was little changed after the Fed's rate hike, reaffirming our near-term outlook of a weaker USD

USD (DXY) index



Source: Bloomberg, Standard Chartered

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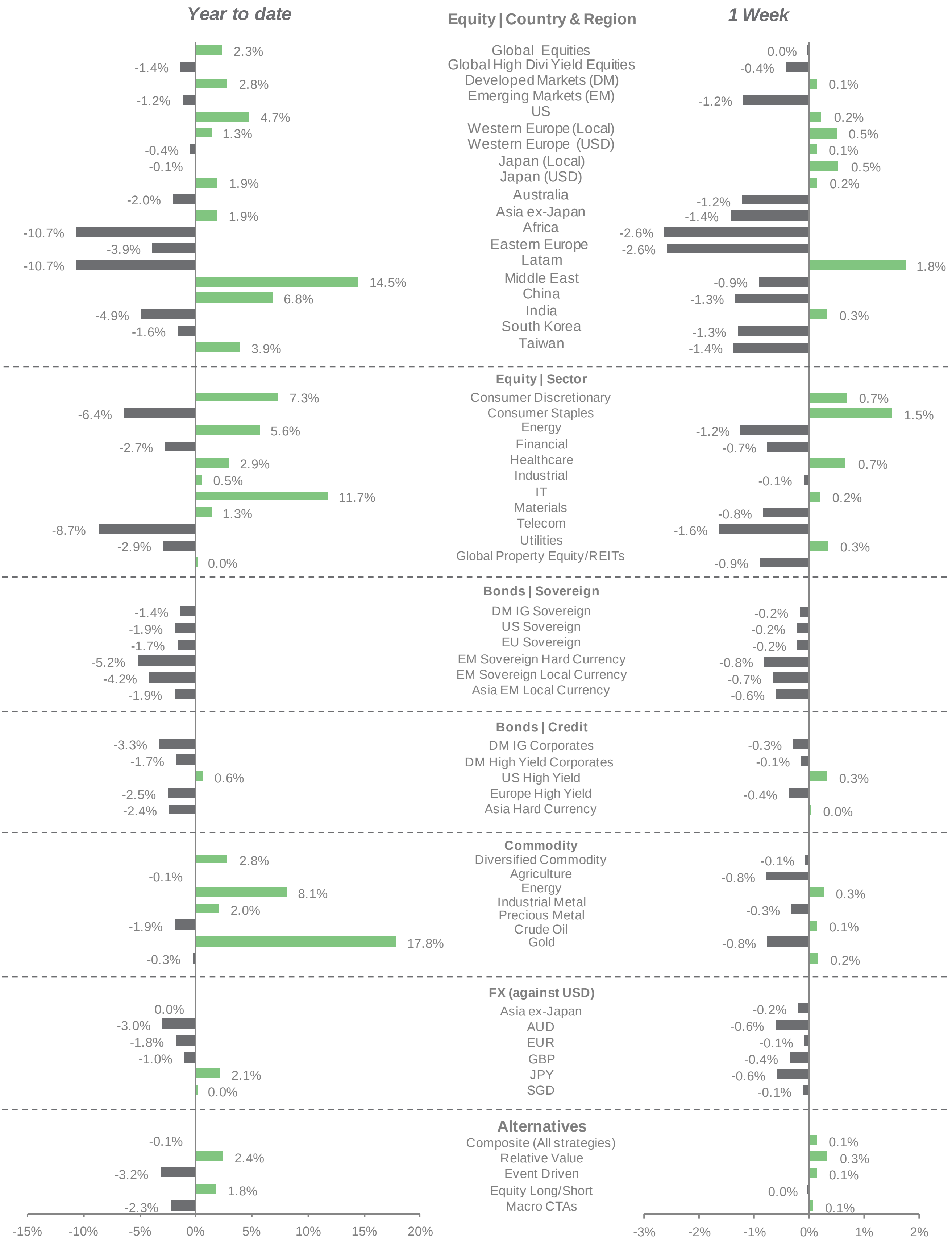
Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 13 June 2018, 1 week period: 07 June 2018 to 13 June 2018*
Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	JN	Exports y/y	18-Jun-18	May	–	7.8%
TUE	EC	ECB Current Account SA	19-Jun-18	Apr	–	32.0b
	US	Housing Starts	19-Jun-18	May	1315k	1287k
	US	Building Permits	19-Jun-18	May	1335k	1364k
WED	US	Existing Home Sales	20-Jun-18	May	5.58m	5.46m
	BZ	Selic Rate	20-Jun-18	20-Jun	–	6.5%
THUR	UK	Bank of England Bank Rate	21-Jun-18	21-Jun	–	0.5%
	US	Leading Index	21-Jun-18	May	0.4%	0.4%
	EC	Consumer Confidence	21-Jun-18	Jun A	–	0.2
FRI/SAT	MX	Overnight Rate	22-Jun-18	21-Jun	–	7.5%
	JN	Natl CPI Ex Fresh Food, Energy y/y	22-Jun-18	May	–	0.4%
	GE	Markit/BME Germany Composite PMI	22-Jun-18	Jun P	–	53.4
	EC	Markit Eurozone Manufacturing PMI	22-Jun-18	Jun P	–	55.5
	EC	Markit Eurozone Services PMI	22-Jun-18	Jun P	–	53.8
	EC	Markit Eurozone Composite PMI	22-Jun-18	Jun P	–	54.1

	Event	This Week	Date	Period	Actual	Prior
MON	JN	Core Machine Orders y/y	11-Jun-18	Apr	9.6%	-2.4%
	UK	Industrial Production y/y	11-Jun-18	Apr	1.8%	2.9%
TUE	UK	Average Weekly Earnings 3m/y/y	12-Jun-18	Apr	2.5%	2.6%
	EC	ZEW Survey Expectations	12-Jun-18	Jun	-12.6	2.4
	IN	CPI y/y	12-Jun-18	May	4.9%	4.6%
	US	CPI Ex Food and Energy y/y	12-Jun-18	May	2.2%	2.1%
WED	UK	CPI Core y/y	13-Jun-18	May	2.1%	2.1%
THUR	US	FOMC Rate Decision (Upper Bound)	14-Jun-18	13-Jun	2.00%	1.75%
	CH	Retail Sales y/y	14-Jun-18	May	8.5%	9.4%
	CH	Industrial Production y/y	14-Jun-18	May	6.8%	7.0%
	CH	Fixed Assets Ex Rural YTD y/y	14-Jun-18	May	6.1%	7.0%
	UK	Retail Sales Ex Auto Fuel y/y	14-Jun-18	May	–	1.5%
	EC	ECB Main Refinancing Rate	14-Jun-18	14-Jun	–	0.0%
	US	Retail Sales Ex Auto and Gas	14-Jun-18	May	–	0.3%
FRI/SAT	US	Industrial Production m/m	15-Jun-18	May	–	0.7%
	US	U. of Mich. Sentiment	15-Jun-18	Jun P	–	98
	IN	Exports y/y	15-Jun-18	May	–	5.2%
	JN	BOJ Policy Balance Rate	15-Jun-18	15-Jun	–	-0.1%

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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