Standard Chartered Private Bank

weekly **market view**

macro strategy | 12 May 2017

This reflects the views of the Wealth Management Group

Editorial

Follow the earnings

- **Our constructive view on global equities was bolstered by expectations-beating Q1 earnings in the US and Euro area. Pro-EU Macron's win in France eases a key geopolitical risk.**
- **Equities:** Our positive view on Asia ex-Japan was underscored by strong technology sector earnings and a renewed risk-on environment, especially in India and South Korea.
- **Bonds:** Treasury yields are likely to rise further as markets move to price in two more Fed rate hikes in 2017, including one in June. This explains our switch to less rate-sensitive assets.
- **FX:** The EUR has strong support around its 200DMA after its pullback following ECB President Draghi's dovish remarks on inflation. We expect EUR to resume its uptrend towards 1.115.

What's new?

- **Earnings, easing geopolitical risk fuel equity rally.** The global equity index and S&P500 hit record highs, while Euro area, Japan and Asia ex-Japan stocks hit multi-year highs. Although one cannot rule out a near-term correction, especially with equity volatility approaching a record low and amid renewed political rumblings in Washington (see page 4 for near-term risks), the drivers of this rally – strong earnings momentum and receding geopolitical risk, especially in Europe – give us confidence equities can offer sustained outperformance in the medium term.
- **Robust US job market cements June rate hike prospects.** US hiring rebounded in April, dragging unemployment and underemployment to their lowest since 2007. Markets moved to price in a 100% probability of a June Fed rate hike and a c.60% chance of a follow-on hike by year-end following this data.
- **Strong Euro area data likely to overcome ECB's dovishness.** Euro area Sentix Investor Confidence climbed to its highest since 2007 amid easing political risks. Although ECB President Draghi sounded cautious on the upturn amid still-low inflation, we believe improving underlying data will encourage the ECB to remove policy accommodation over the next 12 months. In the UK, the GBP fell despite BoE Governor Carney's optimism of a smooth Brexit. We believe 1.28 is a key support for GBP/USD.
- **Oil likely to recover gradually.** Crude oil recovered from close to the bottom of the USD 45-55/bbl range it has traded in the past year. While falling cost of US shale production could limit price gains, we believe prices are likely to rise higher as global demand catches up with excess supplies (see page 4).

Implications

- **Positive on Euro area, Asia ex-Japan equities.** Strong earnings, improving economic data, reduced geopolitical risks and attractive valuations underscore our positive view. Any near-term correction is likely to create opportunities to add exposure.
- **Switch to US, Euro area HY bonds and floating rate notes.** The bonds are among the best placed to offset the likely rise in Treasury yields as the Fed tightens and ECB withdraws stimulus.
- **What we are watching?** Fallout from Trump firing FBI chief; China retail sales and fixed investment; Japan GDP; UK jobs.

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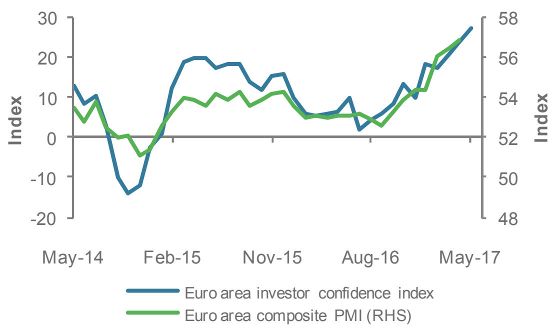
French government bond yield premiums over German Bunds have dropped following Macron's election, highlighting reduced political risk

French 10-year bond yield premium over German Bunds

Source: Bloomberg, Standard Chartered

Euro area investor and business confidence indicators have continued to rise this year, lending support to the equity rally

Euro area Sentix Investor Confidence index and PMI



Source: Bloomberg, Standard Chartered

Steve Brice
Chief Investment Strategist

Clive McDonnell
Head, Equity Strategy

Manpreet Gill
Head, FICC Strategy

Adi Monappa, CFA
Head, Asset Allocation & Portfolio Solutions

Audrey Goh, CFA
Director, Asset Allocation & Portfolio Solutions

Arun Kelshiker, CFA
Executive Director, Asset Allocation & Portfolio Solutions

Rajat Bhattacharya
Strategist

Tariq Ali, CFA
Strategist

Abhilash Narayan
Strategist

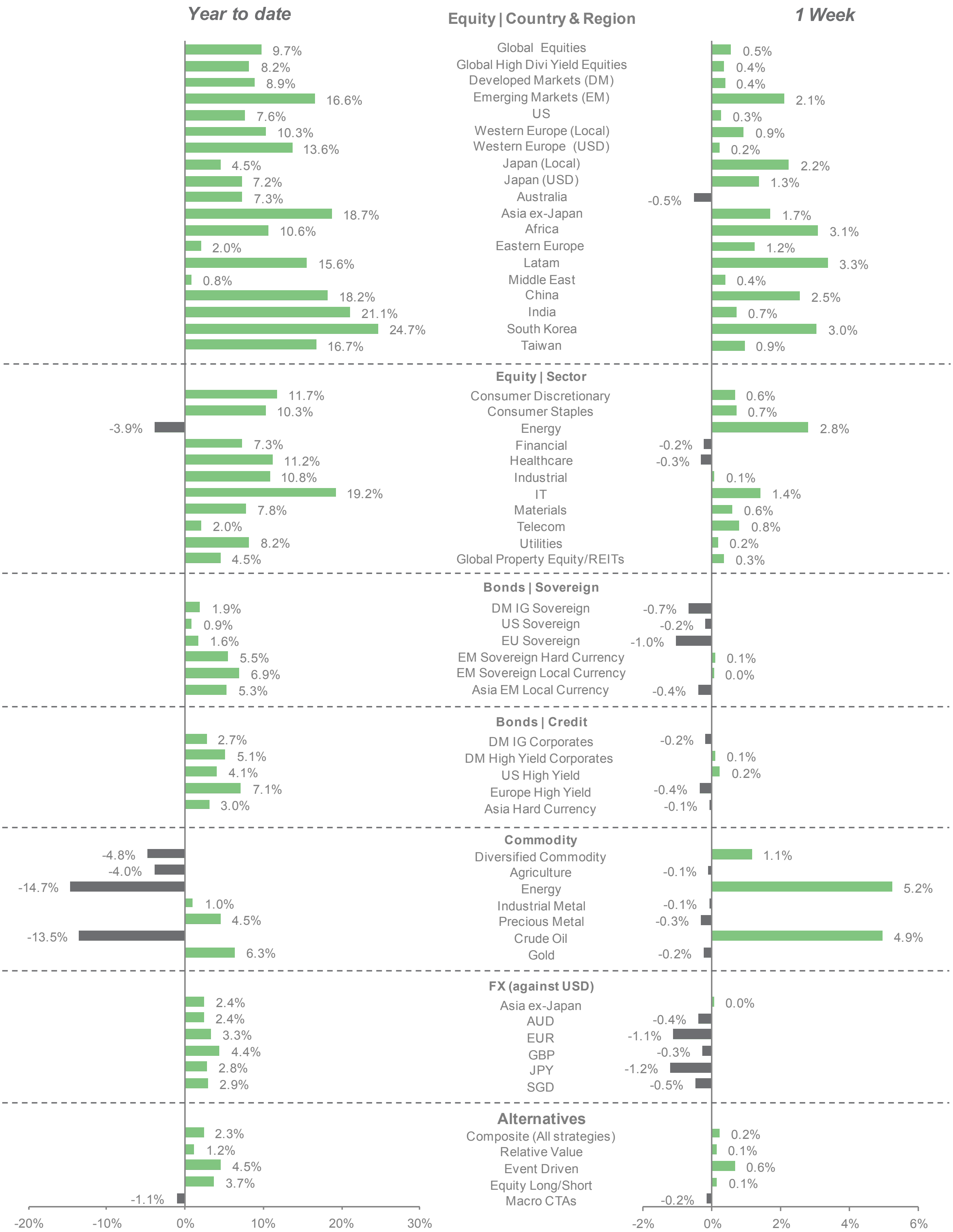
Trang Nguyen
Analyst, Asset Allocation & Portfolio Solutions

DJ Cheong
Strategist

Jeff Chen
Analyst, Asset Allocation & Portfolio Solutions

Audrey Tan
Strategist

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2016 to 11 May 2017, 1 week period: 04 May 2017 to 11 May 2017*

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

What does this mean for investors?

Global stocks hit record highs amid strong earnings momentum in the US and Euro area and receding geopolitical risk after the French elections. Crude oil recovered as US inventory fell.

Equities: US, Euro area Q1 earnings beat expectations

- **Financials and technology drive US earnings higher.** In the US, 75% of companies reported better-than-expected earnings, beating the long-term average of 66%. US Q1 earnings are now estimated to have risen 15% compared with 10% growth expected in early April. In the Euro area, Q1 earnings are estimated to have risen 11% versus 8% expected at the start of April. This could lead to an upward revision of full-year earnings.
- **Talk of China market support.** Financial deleveraging in China continues to tighten liquidity in A-shares, particularly impacting the financial sector. There is talk of a stabilisation fund which may be unveiled mid-May, which could help support the market.
- **Global technology upturn helping China's 'new economy' sectors.** China's technology stocks listed in the US and Hong Kong are in focus, given the series of new highs recorded by the Nasdaq. We remain comfortable with our 'New China' theme, especially given that the sector's solid cash position makes it less vulnerable to tightening liquidity conditions in China.
- **Stay positive on Korean equities.** Korean equities extended gains after the emphatic victory of Democrat President Moon Jae-In. We remain positive amid expectations of a fiscal stimulus.

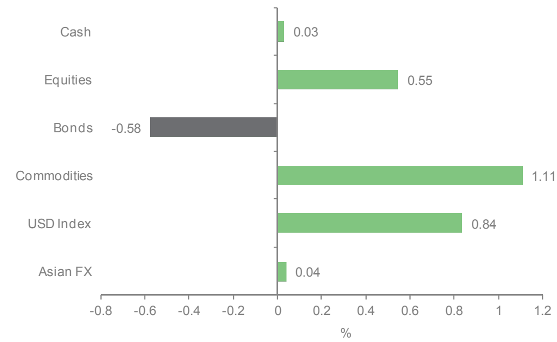
Bonds: Yields grind higher as political risks subside

- **French election eases political risk.** US 10-year Treasury and German Bund yields continued to grind higher as Macron's victory eased demand for safe havens. With the money market currently pricing in a 100% probability of a rate hike in June, US data and Fed comments are likely to be key drivers of yields near term. We expect yields to move gradually higher as improving data raises the prospect of another Fed rate hike in H2 (after June).
- **EM bonds take a breather.** Emerging Market (EM) government bonds, both USD- and local currency-denominated, pulled back marginally over the past week amid a rebound in Treasury yields and a stronger USD. As highlighted last week, May is a seasonally strong month for the USD; further USD strength may provide a better entry point for EM local currency bonds.

FX: EUR close to a key technical support

- **EUR/USD likely to rebound.** The pair has eased slightly from its post-French election peaks, partly as speculative positions normalize and amid ECB President Draghi's cautious comments on Euro area inflation. However, EUR/USD is now approaching its 200DMA and, with the above events behind us, we believe it is likely to resume its rise and move towards 1.115.
- **Rating agency comments supportive for AUD.** The AUD fell to a four-month low below 0.74 amid a continued decline in iron ore prices. However, positive comments from rating agencies (Moody's and Fitch) on the recent Australian budget raises the possibility that S&P may hold off downgrading Australia's rating from AAA. This is likely to support the AUD by mitigating further ratings-related outflows from Australian bonds.
- **Stay bearish NZD.** NZD/USD fell to an 11-month low after the RBNZ Governor's comments that he expects rates to stay at current levels "for the foreseeable future". We remain bearish as the pair's break below the 0.690 support implies a weak technical outlook. A move towards the next support at 0.667 is likely.

Benchmark (USD) performance w/w*



**Week of 04 May 2017 to 11 May 2017*

Source: MSCI, JP Morgan, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi Non-MBS WorldBig Govt/Govt Sponsored, Bloomberg Commodity, DXY and ADXY)

S&P500 is 1.1% away from its technical resistance

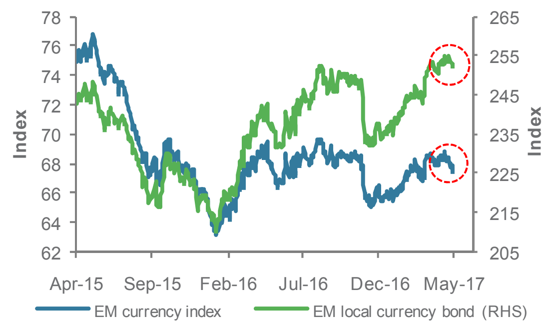
Technical levels of key market indicators as of 11 May

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,394	2,328	2,420	↑
STOXX 50	3,624	3,480	3,674	↗
FTSE 100	7,387	7,243	7,450	↗
Nikkei 225	19,936	19,100	20,400	↗
Shanghai Comp	3,062	3,000	3,135	↘
Hang Seng	25,126	24,350	25,330	↗
MSCI Asia ex-Japan	608	590	610	↗
MSCI EM	1,000	979	1,017	↑
Brent crude oil (ICE)	51	46	51	↗
Gold	1,225	1,194	1,260	→
UST 10Y Yield	2.39	2.27	2.53	↘

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

EM local currency bonds have pulled back slightly amid a rebound in US Treasury yields and a seasonally stronger USD which hurt EM currencies

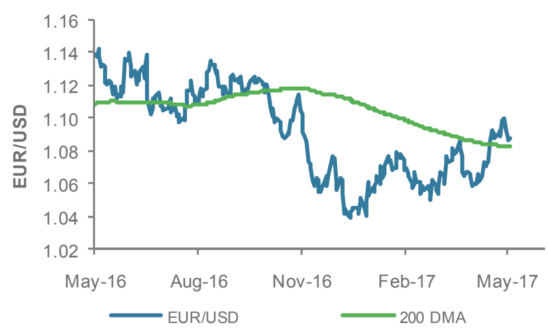
EM currency index; EM local currency bond index



Source: JP Morgan, Bloomberg, Standard Chartered

EUR is close to a key technical support

EUR/USD and 200DMA



Source: Bloomberg, Standard Chartered

Top client questions

Q. What are the likely triggers for any equity market pullback?

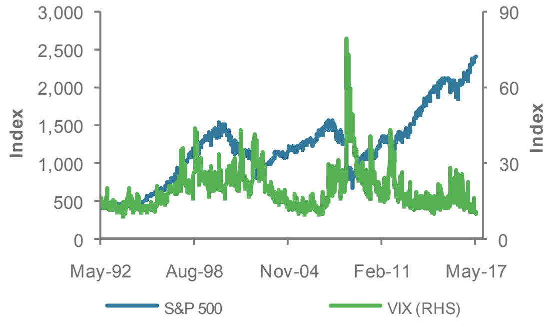
We remain positive on the prospects for global equity markets. However, the risk of a short-term correction is ever present. At the start of the year, we cited the Euro area election calendar as a source of risk. Since then, we have successfully overcome two of the three political risk factors identified: the Dutch and French elections. The third political risk event – the German Federal election in September – has become less of a concern following Angela Merkel's SPD party's strong showing in a recent state election.

However, future risks on the horizon include:

1. **Shrinking central bank balance sheets.** While policymakers are carefully tiptoeing around this issue, it is possible that the Fed will start to shrink its balance sheet in 2017. The risk for markets centres around the uncertainty associated with this move. Bond yields and/or the USD could experience volatility, which could lead to a risk-off environment for equities.
2. **Volatility spike.** Measures of volatility in Developed Markets (DM) have fallen significantly YTD. The VIX, a measure of US market volatility, declined to a multi-year low and is approaching its all-time low recorded in 1993. Political or economic surprises could lead to a spike in the VIX, putting downward pressure on equity markets, as investors reassess the near-term outlook.
3. **A commodity price slump.** Commodity prices led by oil and iron ore have fallen significantly YTD. The risk for Emerging Markets (EM) ex-Asia is that this starts to negatively impact the nascent recovery in growth and reverse the current positive trend of equity and fixed income inflows to EMs.

S&P500 is at a record high and its volatility index is close to a record low, raising the risk of a near-term pullback

S&P500 and S&P500 volatility index



Source: CBOE, Bloomberg, Standard Chartered

Q. What is the outlook for oil prices and energy sector equities?

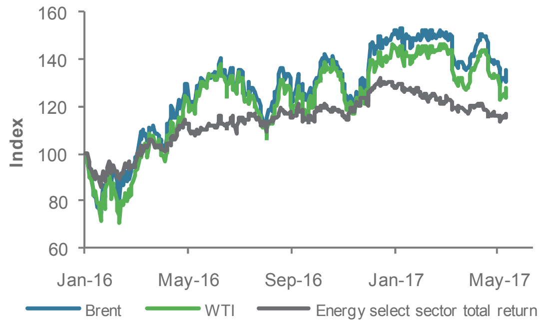
We continue to believe oil prices are likely to gradually rise over the rest of 2017. In our view, little has changed to alter this belief from a very simple demand-supply perspective. Outside of a recessionary outcome, we believe global demand will continue to rise gradually and some of the largest producers (via OPEC plus Russia) are likely to make efforts to constrain supply growth, even if production limit agreements are not fully adhered to.

While prices have undoubtedly been volatile recently, we are mindful that 'usual' volatility for oil prices is about 10%, and recent weakness has been approximately within this range. Either a sustained price fall below USD 45/bbl (a deteriorating technical picture) or an improving outlook for US shale production (a deteriorating fundamental picture) would likely be needed in order for us to turn more bearish on oil.

US energy sector equities have been following a similar path to oil, tracking US WTI prices (as opposed to Brent, which has performed modestly better). Our analysis above suggests that downside from here is possible (up to about USD 45/bbl in a short-term bearish scenario), but significant weakness beyond this is unlikely in our base case. Having said the above, what appears to be missing in the immediate horizon is a clear catalyst for oil (and energy equities) to move decidedly higher. Falling breakeven prices for US shale producers below USD 60-65/bbl is also a risk that could end up capping price gains lower than we expect. We continue to monitor these two variables while looking for opportunities in oil and energy sector equities.

Energy sector equities have pulled back with the decline in oil prices

Brent and WTI crude oil and S&P500 Energy Select Sector Total Return index (100 = 01 Jan, 2016)



Source: Bloomberg, Standard Chartered

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	CH	Retail Sales y/y	15-05-2017	Apr	10.9%	10.9%
	CH	Fixed Assets Ex Rural YTD y/y	15-05-2017	Apr	9.1%	9.2%
	CH	Industrial Production y/y	15-05-2017	Apr	7.0%	7.6%
TUE	UK	CPI Core y/y	16-05-2017	Apr	2.2%	1.8%
	EC	ZEW Survey Expectations	16-05-2017	May	–	26.3
	US	Housing Starts	16-05-2017	Apr	1250k	1215k
WED	JN	Machine Orders y/y	17-05-2017	Mar	0.5%	5.6%
	UK	Average Weekly Earnings 3M/y/y	17-05-2017	Mar	2.4%	2.3%
	UK	ILO Unemployment Rate 3Mths	17-05-2017	Mar	4.7%	4.7%
	UK	Employment Change 3M/3M	17-05-2017	Mar	15k	39k
THUR	JN	GDP Annualized SA q/q	18-05-2017	1Q P	1.8%	1.2%
	UK	Retail Sales Ex Auto Fuel y/y	18-05-2017	Apr	–	2.6%
	US	Philadelphia Fed Business Outlook	18-05-2017	May	19.4	22
FRI/SAT	EC	Consumer Confidence	19-05-2017	May A	–	-3.6
		Fed's Mester and ECB's Praet and Constancio speaks at different events	19-05-2017			

	Event	This Week	Date	Period	Actual	Prior
MON	GE	Factory Orders WDA y/y	08-05-2017	Mar	2.4%	4.7%
	EC	Sentix Investor Confidence	08-05-2017	May	27.4	23.9
	CH	Exports y/y	08-05-2017	Apr	8.0%	16.4%
		Fed's Mester speaks at Chicago Council	08-05-2017			
TUE	GE	Industrial Production WDA y/y	09-05-2017	Mar	1.9%	2.0%
WED	CH	CPI y/y	10-05-2017	Apr	1.2%	0.9%
		Fed's Rosengren speaks at NYU Conference	10-05-2017			
THUR	UK	Industrial Production y/y	11-05-2017	Mar	1.4%	2.5%
	UK	Bank of England Bank Rate	11-05-2017	11-May	0.25%	0.25%
		Fed's Rosengren and Dudley speaks at different events	11-05-2017			
FRI/SAT	IN	CPI y/y	12-05-2017	Apr	–	3.8%
	US	CPI Ex Food and Energy y/y	12-05-2017	Apr	–	2.0%
	US	Retail Sales Ex Auto and Gas	12-05-2017	Apr	–	0.1%
	US	U. of Mich. 1 Yr Inflation	12-05-2017	May P	–	2.5%
		Fed's Evans speaks in Dublin	12-05-2017			

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; key indicators highlighted in blue

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