weekly **market view**

macro strategy | 10 November 2017

This reflects the views of the Wealth Management Group

Editorial

Growing investor confidence

- **Fundamentals, including economic data and earnings, continue to support risk appetite. A strong run in new equity offerings in HK is another sign of rising investor confidence.**
- **Equities:** A raft of HK initial public offerings, mainly from China's new economy sectors, reflects buoyant sentiment across Asia. Euro area investor confidence rose to a 10-year high.
- **Bonds:** We continue to prefer EM USD bonds despite recent weakness, which stemmed partly from concerns over Venezuela. Global HY bond valuations pulled back from 10-year highs.
- **FX:** The USD index's momentum has slowed; we believe 94.0 is a key technical support level. Although USD/JPY failed to breach resistance at 114.50, the chart set-up remains bullish.

What's new?

- **Strong investor sentiment.** Hong Kong's Hang Seng rose to its highest level since 2007, driving the MSCI Asia ex-Japan to a new record, helped by a stream of well-received initial public offerings. An increasingly successful primary market is indicative of growing investor optimism, in our view. This is also reflected in other markets, including the US, Japan and the Euro area (where the Sentix Investor Confidence rose to a 10-year high). Any delay in US tax cuts could dent sentiment, though. We also expect increasing interest in China A-shares in the medium term ahead of MSCI's inclusion in its major indices from mid-2018.
- **Dip in EM USD, global HY bonds likely temporary.** Valuations (as measured by yield premiums over US Treasuries) in Emerging Market USD bonds and global High Yield bonds have pulled back. EM bonds may have been affected partly by Venezuela's decision to reschedule repayments, while HY bond weakness has been focused on US telecom and healthcare sectors and the possible delay in implementing US tax reforms. We see these drivers as transitory and would use any pullback in EM USD bonds, in particular, as an opportunity to add exposure.
- **USD momentum slows.** The USD index consolidated after breaking above its prior resistance at 94.0. We believe 94.0 is now a critical support level that could determine if the uptrend seen since September is likely to be sustained or if it was a 'false dawn'. The USD/JPY pair, which is closely aligned with US Treasury yields, failed to breach key resistance at 114.50. Nevertheless, the chart set-up remains moderately bullish.

What we are watching

- **Saudi politics.** Brent crude rose to a two-year high above USD 63/bbl, fuelled by political uncertainty in Saudi Arabia, the biggest exporter. While the evolution of Saudi Arabia's domestic politics needs to be watched closely, demand remains strong – US gasoline demand rose at its fastest pace in 18 months, while China, the largest importer, raised crude oil import quotas for its private refiners for 2018 by 63% – providing support to prices. However, the recent price gains are likely to encourage US shale producers to boost output, putting a cap on prices. Meanwhile, speculative long positions are at extreme levels, leaving limited room for further positive surprises (see page 4 for details).

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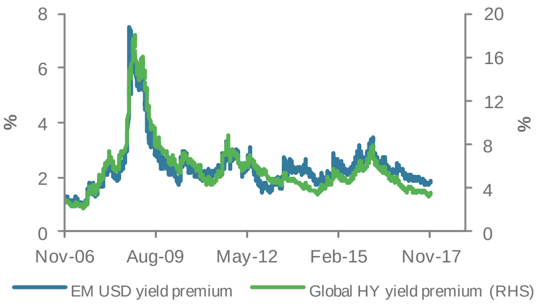
MSCI Asia ex-Japan equities scaled a new record high, while the Hang Seng index rose to its highest since 2007 amid increased investor confidence

MSCI Asia ex-Japan index; Hang Seng index

Source: Bloomberg, Standard Chartered

Yield premiums over Treasuries on EM USD government bonds and global HY bonds have ticked higher from multi-year lows

Yield premiums on EM USD govt and global HY bonds



Source: JPMorgan, Barclays, Bloomberg, Standard Chartered

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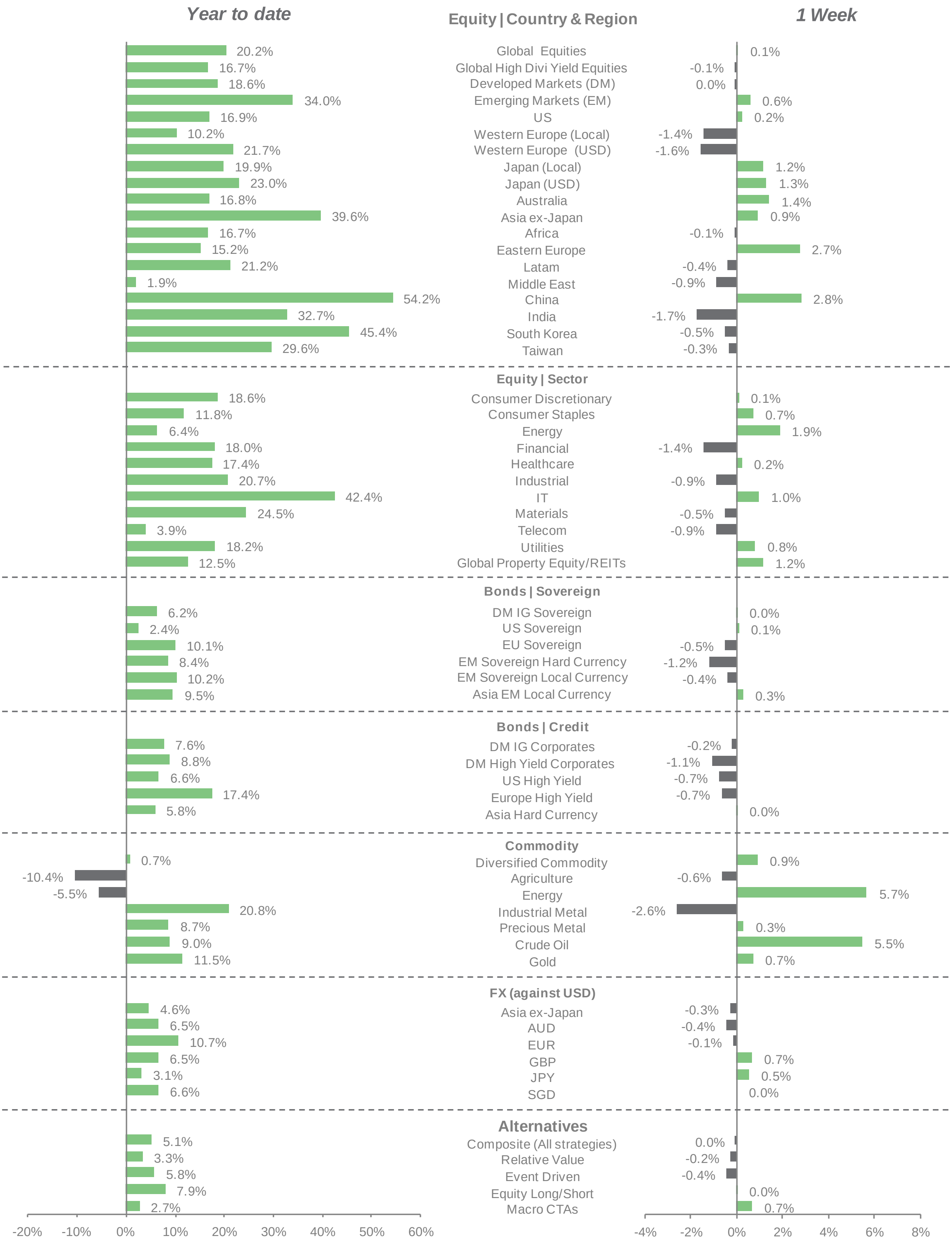
Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2016 to 09 November 2017, 1 week period: 02 November 2017 to 09 November 2017; Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, HFRX, FTSE, Bloomberg, Standard Chartered*

What does this mean for investors?

Global equities held near record highs, as gains in Asian equities were offset by declines in Europe due to weaker-than-expected earnings. Crude oil rose to a two-year high on Saudi uncertainty.

Equities: Remain positive on Euro area banking sector

- **Euro area banking sector remains compelling despite weak earnings.** Weak trading income, particularly due to a decline in bond trading, and weaker-than-expected corporate lending were key detractors for Euro area banks' Q3 earnings. Concerns about sustained periods of low interest rates and the recent flattening of the yield curve (long-term yields falling more than short-term yields) have also dampened investor sentiment. Despite the challenging quarter, we still favour the sector due to its attractive valuations and dividend yields. The sector is trading at a 23.5% discount to the broader Euro area equity market, and the consensus 12-month forward dividend yield of 4.2% is also compelling against broader Euro area regional equities.
- **Potential delay in US tax reform.** As negotiations over proposed tax cuts continue in the Congress, we believe the re-emergence and linking of repealing Obamacare with the tax cut proposals complicates matters. The proposed combination of eliminating individual mandate with tax cuts, ostensibly to reduce the deficit, risks re-igniting past disputes and potentially scuppering the tax cut package. The Senate's proposal to delay corporate tax cuts to 2019 adds to the complexity. The challenges have had little impact on market sentiment, but we continue to watch this space.

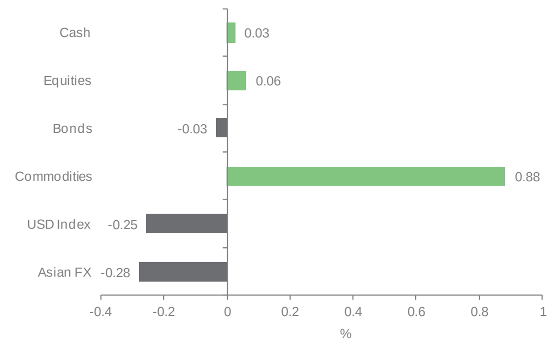
Bonds: Remain positive on EM USD bonds

- **One-off factors weigh on EM USD bonds.** Emerging Market (EM) USD government bonds declined this week as Venezuelan bonds fell more than 30% due to concerns the country would default on its debt. However, the risk of default has been very well known for some time now. Looking through this one-off factor, we remain positive on EM USD government bonds and would use any pullback as an opportunity to add exposure.
- **HY bond premiums rise.** Global High Yield (HY) bond yield premiums rebounded from 10-year lows, rising for the third consecutive week. A rally in energy sector bonds, driven by higher oil prices, was offset by weakness in the telecom and healthcare sectors. Concerns about a possible delay in US tax reforms, which is likely to benefit the US HY sector more than the Investment Grade (IG) sector, also acted as a negative overhang on the bonds. While we acknowledge the relatively expensive valuations, we would not ignore the attractive yield on offer.

FX: Remain bearish on AUD, JPY

- **RBA's dovish tone adds pressure on AUD.** The RBA maintained its policy rate and signalled status quo in policy for the foreseeable future. Its inflation outlook was also dovish. The central bank said that the recent improvement in employment and household leverage has not been matched by wage gains. Meanwhile, weaker iron ore prices, coinciding with slowing China data, are likely to start weighing on Australia's trade balance. Thus, we believe there is potential for further AUD weakness. Technical indicators for AUD/USD remain bearish.
- **USD/JPY fails to breach key resistance.** The pair failed to breach resistance at 114.50 for the second week. Nevertheless, the chart set-up remains moderately bullish. The pair has a close correlation with US Treasury yields, which implies expectations of a faster pace of Fed rate hikes and/or progress on US tax reforms are likely to drive US yields and USD/JPY higher.

Benchmark (USD) performance w/w*



**Week of 02 November 2017 to 09 November 2017*

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

Equity market technicals are positive across regions

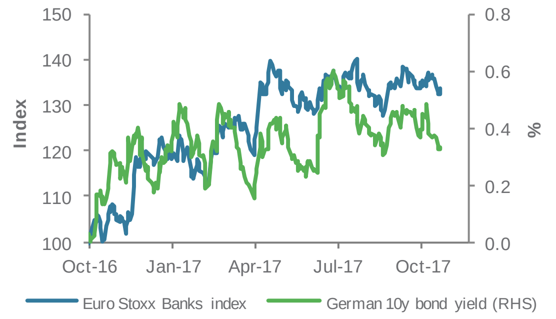
Technical levels of key market indicators as of 09 Nov.

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,585	2,530	2,610	↑
STOXX 50	3,613	3,580	3,709	↗
FTSE 100	7,484	7,438	7,599	↗
Nikkei 225	22,581	21,600	23,500	↗
Shanghai Comp	3,428	3,330	3,490	↗
Hang Seng	29,137	28,000	30,000	↑
MSCI Asia ex-Japan	704	665	725	↗
MSCI EM	1,134	1,080	1,180	↗
Brent crude oil (ICE)	64	58	68	↑
Gold	1,286	1,240	1,306	→
UST 10Y Yield	2.34	2.21	2.53	↗

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

Euro area banks have lately come under pressure with the fall in Euro area bond yields; they remain attractive, given their compelling dividend yields

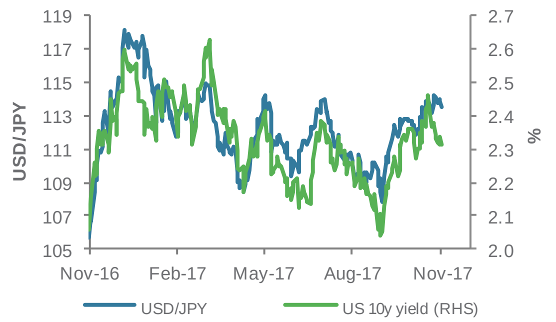
Euro Stoxx banks index; German 10y yields



Source: Bloomberg, Standard Chartered

USD/JPY is correlated with US Treasury yields

USD/JPY; US 10y Treasury yields



Source: Bloomberg, Standard Chartered

Top client questions

Q1. Japan's stock prices have continued to surge despite a stabilisation in USD/JPY? Is this significant?

Historically, there has been a strong positive correlation between USD/JPY and Japan's stocks. The relationship reflects the positive translation effect from overseas earnings when USD/JPY rises.

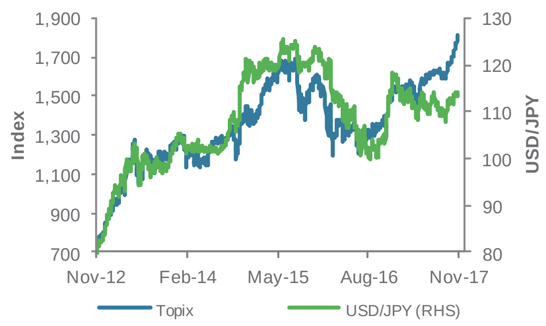
In recent weeks, Japan's equities have continued to rise even as USD/JPY consolidated, raising concerns that the equity rally be stretched.

However, there have been significant developments in Japan since September which are bullish for local equities. Specifically, the re-election of Shinzo Abe as Prime Minister with an overwhelming majority has increased his political capital. This is likely to encourage him to re-invigorate his economic reform programme which he first launched after the 2012 general elections.

Abe has already started to spend some of his new-found political capital with a call for large companies to raise wages by 3%. If implemented, this step will help boost consumption, potentially leading to increased investment by Japanese companies. Japan's corporate earnings are expected to rise 20% in 2017 and lead indicators point towards a possible increase in the consensus forecast. Meanwhile, valuations remain attractive, with the market trading on a price-to-earnings ratio of 15x 12-month forward consensus earnings. We see Japan as a core holding within our positive global equity view.

Japan's stocks have continued to rise despite the JPY remaining range-bound lately

Topix index; USD/JPY



Source: Bloomberg, Standard Chartered

Q2. Does the ongoing situation in Saudi Arabia affect the outlook for oil prices in any way?

Several members of the Saudi elite, including ministers and a number of prominent princes from the extended royal family, have been arrested on corruption charges, raising uncertainty. This may have added a geopolitical risk premium to oil prices.

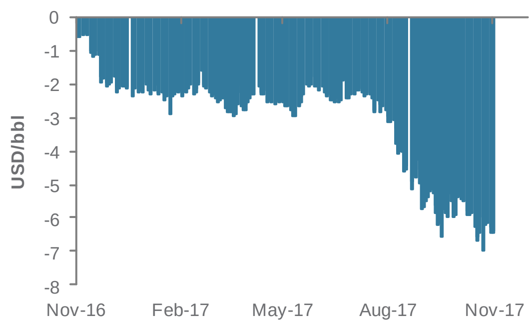
Meanwhile, Saudi-Iranian tensions also remain high after a missile was fired at Riyadh from Yemen by the Iranian-backed Houthis, increasing the political risk premium within Saudi Arabia. However, we believe there is an incentive for Crown Prince Mohammed bin Salman to maintain political stability, given his push for economic reform and encouragement of foreign investment.

We continue to believe that fundamentals will ultimately prevail in the oil markets. The markets have been largely focused on supply factors in recent months, specifically rising US shale oil output and OPEC supply cuts. As a result, while prices of both US WTI crude and Brent crude have risen to two-year highs, WTI's price discount relative to Brent has increased. In recent weeks, geopolitics has also returned to the forefront, driving both WTI and Brent prices higher following Saudi Arabia's political crackdown in early November.

While we retain our constructive view on oil over the medium term, we think the upside in oil prices could be limited as prices above USD 60/bbl is likely to encourage more US shale oil output.

Discount on WTI crude prices vs. Brent prices has increased in recent months amid rising US output and supply curbs among OPEC producers

Gap between WTI and Brent crude prices



Source: Bloomberg, Standard Chartered

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	IN	CPI y/y	13-Nov-17	Oct	3.4%	3.3%
TUE	CH	Retail Sales y/y	14-Nov-17	Oct	10.4%	10.3%
	CH	Fixed Assets Ex Rural YTD y/y	14-Nov-17	Oct	7.3%	7.5%
	CH	Industrial Production y/y	14-Nov-17	Oct	6.3%	6.6%
	UK	CPI Core y/y	14-Nov-17	Oct	2.8%	2.7%
	EC	ZEW Survey Expectations	14-Nov-17	Nov	–	26.7
WED	JN	GDP Annualized SA q/q	15-Nov-17	3Q P	1.5%	2.5%
	UK	ILO Unemployment Rate 3mths	15-Nov-17	Sep	4.3%	4.3%
	US	CPI Ex Food and Energy y/y	15-Nov-17	Oct	1.7%	1.7%
	US	Retail Sales Ex Auto and Gas	15-Nov-17	Oct	0.3%	0.5%
THUR	US	Philadelphia Fed Business Outlook	16-Nov-17	Nov	24.1	27.9
	US	Industrial Production m/m	16-Nov-17	Oct	0.5%	0.3%
FRI/SAT	EC	ECB Current Account SA	17-Nov-17	Sep	–	33.3b
	US	Housing Starts	17-Nov-17	Oct	1183k	1127k
	US	Building Permits	17-Nov-17	Oct	1242k	1225k

	Event	This Week	Date	Period	Actual	Prior
MON	JN	Nikkei Japan PMI Composite	06-Nov-17	Oct	53.4	51.7
	GE	Factory Orders WDA y/y	06-Nov-17	Sep	9.5%	8.3%
	EC	Sentix Investor Confidence	06-Nov-17	Nov	34.0	29.7
	EC	PPI y/y	06-Nov-17	Sep	2.9%	2.5%
TUE	AU	RBA Cash Rate Target	07-Nov-17	7-Nov	1.5%	1.5%
	GE	Industrial Production WDA y/y	07-Nov-17	Sep	3.6%	4.6%
	EC	Retail Sales y/y	07-Nov-17	Sep	3.7%	2.3%
	CH	Foreign Reserves	07-Nov-17	Oct	$3109.2b	$3108.5b
WED	US	Consumer Credit	08-Nov-17	Sep	$20.8b	$13.1b
	CH	Exports y/y	08-Nov-17	Oct	6.9%	8.0%
THUR	JN	Core Machine Orders y/y	09-Nov-17	Sep	-3.5%	4.4%
	CH	CPI y/y	09-Nov-17	Oct	1.9%	1.6%
	CH	PPI y/y	09-Nov-17	Oct	6.9%	6.9%
	US	Initial Jobless Claims	09-Nov-17	4 Nov	239k	229k
FRI/SAT	IN	Industrial Production y/y	10-Nov-17	Sep	–	4.3%
	US	U. of Mich. Sentiment	10-Nov-17	Nov P	–	100.7

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

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue

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