Standard Chartered
Private Bank

weekly market view

macro strategy | 25 August 2017

This reflects the views of the Wealth Management Group

Editorial

Locking in EUR gains

- **We lock in gains in EUR/USD and close our preference for a selection of EM currencies, as the USD is likely to recover further near term. We also lower expectations for oil gains.**
- **Equities:** We are cautious near term, given challenging US technical indicators, elevated valuations and event risks, but remain constructive medium term, given robust fundamentals.
- **Bonds:** We continue to like EM local currency bonds and would use any USD rebound as an opportunity to add exposure.
- **FX:** We lock in 8.5% gains in EUR/USD, as most positive drivers may have been baked into the price. We no longer expect INR, IDR, RUB and BRL to outperform EM currencies (see page 4).

What's new?

- **Remain cautious on stocks amid challenging US technicals.** The S&P500 rebounded from its 100DMA support, but failed to break above its 50DMA. This, along with uncertainty around US fiscal and monetary policy, leaves us cautious near-term. We note the improving global fundamentals, including earnings and economic growth upgrades and benign financial conditions. A dovish or benign message from Fed Chair Janet Yellen at Jackson Hole on the path of US policy tightening (rates and balance sheet) would make us more constructive on risk assets. Any progress among US lawmakers in pushing ahead with the tax reform bill and an accord to raise the debt ceiling before the 30 September deadline would also be positives for equities.
- **Locking in EUR gains.** We close our bullish EUR/USD view initiated in April after gains of 8.5%. Most positive drivers of EUR gains – including expectations that the ECB will start withdrawing policy accommodation after a strong pick-up in Euro area growth and reduced political uncertainty after the French elections – may have already been factored in, leaving the EUR vulnerable to a near-term pullback. EUR/USD could also retrace if the Fed revives rate hike expectations or ECB President Mario Draghi warns against EUR strength. While we remain constructive on the EUR over the medium term as the Euro area recovers, it would need new catalysts for further gains. Elevated speculative long EUR positions (see chart) also risks a short term pullback.
- **Lowering our expectations of an oil price rebound.** Brent crude prices have recovered above USD 50/bbl. While we still believe there is potential upside from here, we do not expect prices to advance sharply given the continued rise in US output and OPEC's struggle to restrain output by some members. Thus, we close our bullish view. Oil prices have fallen 3.5% since our Outlook 2017 was released (see page 4 for a detailed outlook).

What we are watching

- **Jackson Hole speeches.** Signals from Chair Yellen on the pace at which the Fed plans to reduce its balance sheet (likely to start in September). Any hint from ECB President Draghi on an early withdrawal of accommodative policy may be EUR positive.
- **US jobs and manufacturing data, Euro area inflation, China PMI.** Strong US data may revive chances of a rate hike this year.

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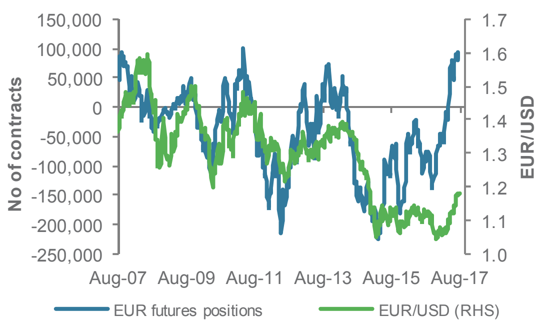
S&P500 has rebounded from its 100DMA, but failed to break above its 50DMA

S&P500 index, 50DMA and 100DMA

Source: Bloomberg, Standard Chartered

Long EUR/USD investor positions are extremely stretched, raising the risk of a pullback

CFTC net speculative positions on EUR; EUR/USD



Source: Bloomberg, Standard Chartered

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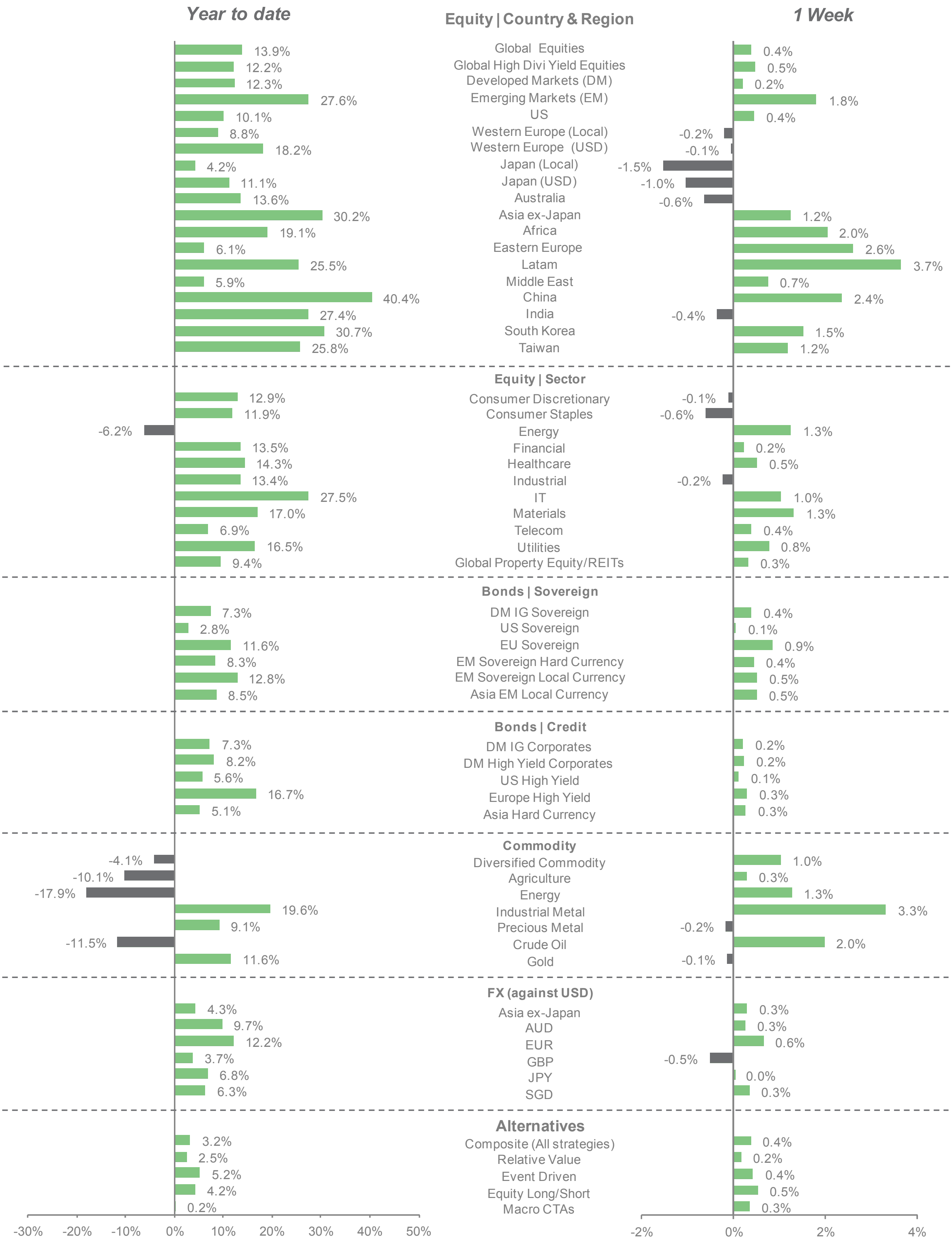
Market performance summary*



*Performance in USD terms unless otherwise stated, YTD period from 31 December 2016 to 24 August 2017, 1 week period: 17 August 2017 to 24 August 2017
Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, HFRX, FTSE, Bloomberg, Standard Chartered

What does this mean for investors?

Emerging Markets led gains in global equities, as Japan and Europe underperformed. Government bonds outperformed corporate debt. Base metals led gains in commodities.

Equities: Positive on fundamentals, cautious on technicals

- **Long-term fundamentals intact.** We retain our constructive 12-month outlook for equities as rising corporate margins continue to drive earnings expectations and markets higher. US 2017 earnings forecasts have been upgraded to 11.6% following positive corporate guidance. We also expect the recovery in base metal prices to trigger earnings upgrades in the global materials sector. Nevertheless, near-term US policy and North Korea-related uncertainty, combined with the S&P500 index testing its 50DMA resistance and elevated valuations, leave us cautious against adding exposure in the near term.
- **China and Hong Kong equities may take a pause near term.** The MSCI China and Hang Seng have outperformed the region YTD on the back of strong fund flows to Emerging Markets (EMs), steady flows from Mainland investors to Hong Kong and positive earnings surprises. However, a near-term pullback is likely given the uncertainty around the impact of the Fed's likely balance sheet reduction, the upcoming Communist Party Congress in China and the lack of near-term earnings drivers. The MSCI China index faces near-term support around 75.71, around 7.5% below current levels.

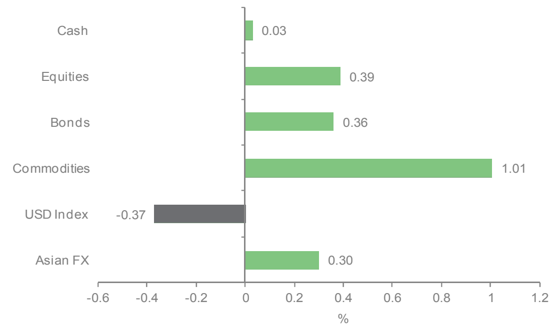
Bonds: EM local currency bonds likely to extend outperformance

- **EM local currency bonds gain from low inflation, rate cut hopes.** The bonds continued to outperform, helped by stable currencies, a surprise rate cut in Indonesia and weaker-than-expected inflation data across several EMs, which is raising expectations of further rate cuts. In Indonesia, the 25bps rate cut was driven by low inflation and soft growth data. Mexico's inflation may have peaked for this cycle, raising the prospect of rate cuts, which could be the catalyst for capital gains for its bonds. We remain positive on the asset class due to its attractive yield and benign outlook for EM currencies on a 12-month horizon. We would use any near-term strength in the USD to add exposure.

FX: USD may continue short-term recovery

- **US rate expectations may drive near-term USD recovery.** The USD continues to trade above its key support at 92. We believe most of the negative sentiment with respect to US inflation has been largely priced-in and view the low probability of another 2017 rate hike (currently at 37%) as too pessimistic. Thus, we continue to believe the USD has the potential to move higher from current levels in the short term, especially if comments at Jackson Hole revive US rate hike expectations.
- **USD/JPY – the preferred way to gain from near-term USD rebound.** This weekend's Jackson Hole meeting could revive Fed rate hike expectations and lift US 10-year Treasury yields. USD/JPY is our preferred way to play the theme, given the pair's close relationship with US bond yields. The pair faces strong support at 108.1. The likely rebound in US bond yields could also hurt gold, which faces resistance at around USD 1,300/oz. We prefer to sell gold at these levels, targeting USD 1,210/0z.
- **AUD may have peaked.** We expect the 0.800 resistance to hold, halting AUD's ongoing rebound. We believe the AUD could retrace to the 0.775 support. A further breach of the support could signal a deeper pullback. The likely trigger for the AUD retracement could be the expected modest pick-up in the USD.

Benchmark (USD) performance w/w*



**Week of 17 August 2017 to 24 August 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)

Technicals for most stock markets remain supportive

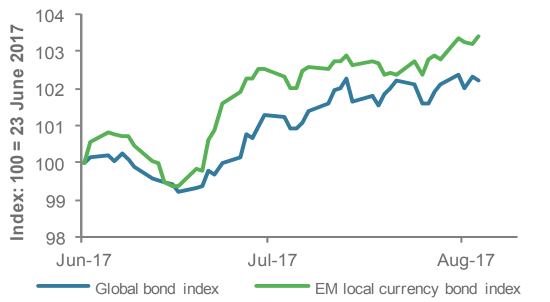
Technical levels of key market indicators as of 24 August

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,439	2,400	2,500	↑
STOXX 50	3,445	3,388	3,500	↗
FTSE 100	7,407	7,290	7,445	↗
Nikkei 225	19,407	18,850	20,300	↘
Shanghai Comp	3,272	3,200	3,300	↗
Hang Seng	27,519	26,850	28,000	↗
MSCI Asia ex-Japan	659	635	665	↗
MSCI EM	1,082	1,039	1,100	↗
Brent crude oil (ICE)	52	48	55	↗
Gold	1,286	1,250	1,337	↗
UST 10Y Yield	2.19	2.10	2.42	↘

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

EM local currency bonds have started to outperform the broader global bond index in recent weeks

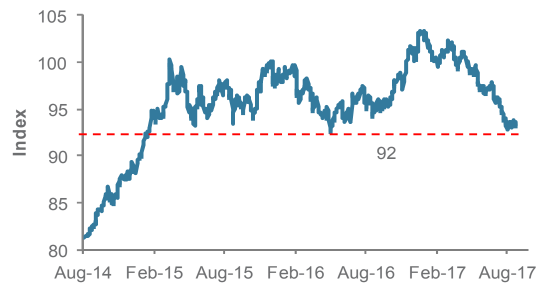
JPMorgan EM local currency bond index; Citi global bond index (Index: 100 = 22 June, 2017)



Source: Bloomberg, Standard Chartered

USD index facing strong technical support around the 92 level

USD (DXY) index



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What is your rationale for closing your bullish Brent oil view? Does this mean you are turning bearish on oil?

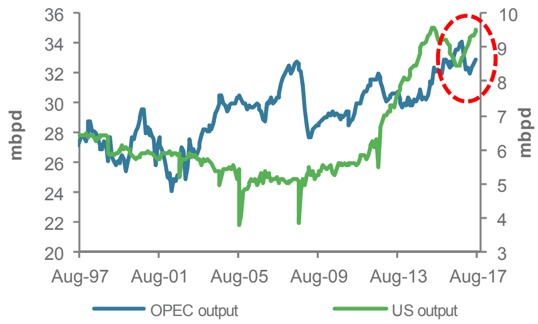
We have closed our bullish oil view, as we believe the risk/reward is no longer attractive following oil's rebound from the mid-USD 40/bbl levels. Our long-term view remains one of flat-to-gradually-higher oil prices over time based on a likely slowing of supply growth and continued demand growth. However, the pace of rebalancing and oil price gains has been slower than we initially expected, and the rebound from mid-USD 40/bbl levels means prices are now close to when we opened the view. The lack of any obvious positive catalysts in the immediate horizon means we believe the risk/reward favours closing our view now.

To be clear, this does not mean we are turning bearish. Instead, our view today is more range-bound with a positive bias. We continue to believe the case for gradual market rebalancing is intact – demand growth remains in place, OPEC and Russia are having reasonable success with efforts to limit output growth, and there is rising evidence US shale producers may not be able to sustain continued output gains without significant capital investments at some point.

However, the pace of rebalancing has been slower than we initially expected and pullbacks are possible, particularly should the USD rebound in the near term as we expect. Weak technicals mean a short-term move towards USD 45/bbl is possible, but this is very much within the bounds of the 'normal' volatility for oil prices.

US and OPEC output have both risen in recent months, putting pressure on oil prices

US and OPEC crude oil production



Source: Bloomberg, Standard Chartered

Q2. What motivated your decision to close your view on the potential INR, IDR, RUB, BRL outperformance against the broader EM FX index?

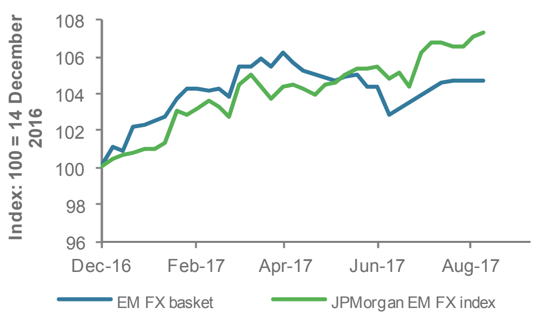
In our *Outlook 2017* publication, we believed the INR, IDR, BRL and RUB would outperform the broad EM FX index. Our main thesis was that currencies with high interest rates and a comfortable and improving balance of payments profile would outperform other EM currencies with weak balance of payments, low yields and/or other structural/political issues. We also believed a sharper rise in oil and commodity prices would support the commodity-sensitive BRL and RUB.

While this view did perform fairly well until April, a stronger-than-expected rebound in EM, in general, allowed fundamentally weaker high-yielding currencies such as the TRY, ZAR and MXN and the low-yielding KRW and TWD to perform much better than what we originally anticipated. Therefore, while our select currency basket delivered positive absolute returns of 4.7%, on a relative basis it underperformed the broader EM currency universe.

We remain positive on EM high-carry currencies broadly on a 12-month basis and believe the best way to capitalise on this is through our overweight on EM local currency bonds. We would use any short term USD strength as an opportunity to add to EM local currency bonds as appropriate.

The select basket of EM currencies consisting of INR, IDR, RUB and BRL has underperformed the broader EM FX universe since May

Customised EM FX basket of select currencies; JPMorgan EM FX index (Index: 100 = 14 Dec, 2016)



Source: Bloomberg, Standard Chartered

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	EC	M3 Money Supply y/y	28-08-2017	Jul	–	5.0%
TUE	JN	Overall Household Spending y/y	29-08-2017	Jul	0.6%	2.3%
	US	Conf. Board Consumer Confidence	29-08-2017	Aug	119	121.1
WED	EC	Economic Confidence	30-08-2017	Aug	–	111.2
THUR	JN	Industrial Production y/y	31-08-2017	Jul P	5.1%	5.5%
	CH	Manufacturing PMI	31-08-2017	Aug	51.2	51.4
	CH	Non-manufacturing PMI	31-08-2017	Aug	–	54.5
	EC	Unemployment Rate	31-08-2017	Jul	–	9.1%
	EC	CPI Core y/y	31-08-2017	Aug A	–	1.2%
	IN	GVA y/y	31-08-2017	2Q	–	5.6%
	US	Personal Income	31-08-2017	Jul	0.3%	0.0%
	US	PCE Core y/y	31-08-2017	Jul	–	1.5%
	US	Chicago Purchasing Manager	31-08-2017	Aug	58	58.9
	SK	BoK 7-Day Repo Rate	31-08-2017	31-Aug	–	1.3%
FRI/SAT	UK	Markit UK PMI Manufacturing SA	01-09-2017	Aug	–	55.1
	US	Change in Nonfarm Payrolls	01-09-2017	Aug	180k	209k
	US	ISM Manufacturing	01-09-2017	Aug	56.3	56.3

	Event	This Week	Date	Period	Actual	Prior
MON						
TUE	EC	ZEW Survey Expectations	22-08-2017	Aug	29.3	35.6
WED	GE	Markit/BME Germany Composite PMI	23-08-2017	Aug P	55.7	54.7
	EC	Markit Eurozone Manufacturing PMI	23-08-2017	Aug P	57.4	56.6
	EC	Markit Eurozone Services PMI	23-08-2017	Aug P	54.9	55.4
	EC	Markit Eurozone Composite PMI	23-08-2017	Aug P	55.8	55.7
	US	New Home Sales	23-08-2017	Jul	571k	630k
THUR	UK	GDP q/q	24-08-2017	2Q P	0.3%	0.3%
	US	Existing Home Sales	24-08-2017	Jul	5.44m	5.51m
	US	Kansas City Fed hosts annual Jackson Hole Policy Symposium	24-08-2017 – 27-08-2017			
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	25-08-2017	Jul	0.1%	0.0%
	GE	IFO Expectations	25-08-2017	Aug	–	107.3
	US	Durable Goods Orders	25-08-2017	Jul P	–	6.4%

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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