Global Market Outlook

Navigating choppy EM waters

Equities remain a preferred asset class given our continued view that a late-cycle rally is still ahead of us. Asia ex-Japan and the US remain our most preferred regions, especially following the recent market corrections which have made valuations more attractive.

We view the recent weakness in Emerging Market (EM) assets as an opportunity to increase exposure. This is based on our view that the investment case for Asia ex-Japan equities and EM government bonds remains valid. A key assumption is that the USD is likely to weaken over a 12m horizon.

Our continued confidence that we are in the late-stage of the economic cycle should benefit balanced multi-asset strategies, given their focus on growth-oriented assets. Multi-asset income strategies remain relevant for income generation, in our view. However, their returns are unlikely to keep up with balanced strategies.

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Investment strategy

IMPLICATIONS
FOR INVESTORS

01 Global equities our preferred asset class

02 Relative preference for Asia ex-Japan and US equities, EM USD government bonds and EM local currency bonds

03 Balanced strategies offer attractive risk/reward; multi-asset income remains relevant for income investors

Navigating choppy EM waters

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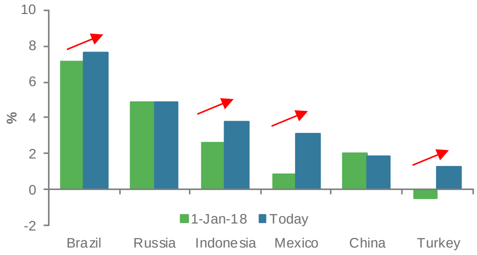
- Our continued confidence that we are in the late-stage of the economic cycle should benefit balanced multi-asset strategies, given their focus on growth-oriented assets. Multi-asset income strategies remain relevant for income generation, in our view. However, their returns are unlikely to keep up with balanced strategies.

In the past month, EM equities and bonds remained under pressure as the USD continued to gain against both major and EM currencies. Asia ex-Japan equities were an exception and stayed largely range-bound. Most Developed Market (DM) equities gained, while corporate bonds fell, though the latter was largely a result of lower US Treasury prices (as 10-year yields crossed 3%) rather than increased concerns of corporate creditworthiness.

Major economic indicators showed some signs of stabilisation following the slight decline we flagged last month. However, a sharp drop in Argentina's currency following a central bank rate cut has brought back a renewed focus on balance of payments data in major EMs. We note that one of the outcomes has been a sharp rise in 'real' (ie, net of inflation) bond yields across major EMs. From a 'glass-half-empty' perspective, one may see this as an eventual risk for EM equities. However, our 'glass-half-full' view is that this is indicative of increasingly attractive levels to own local currency government bonds given our expectations of long-term USD weakness. A full-fledged EM currency crisis is a key risk to our view, though we continue to see a fairly low likelihood (30%) of such an outcome.

Figure 1: 'Real' yields higher in many EMs

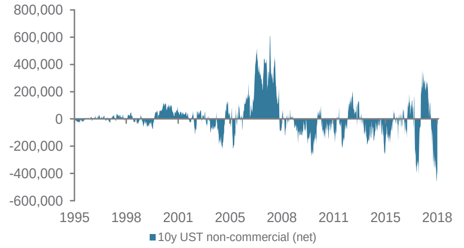
10y bond yields, net of CPI inflation ('real' yields)



Source: Bloomberg, Standard Chartered

Figure 2: Investors still quite short Treasuries

US 10y Treasury non-commercial positions



Source: Bloomberg, Standard Chartered

Equities: Prefer Asia within EM

Our preference for Asia ex-Japan equities remains unchanged despite the recent stress on EM assets. The factors which support our view include: a) expected earnings growth remains reasonably robust b) EM equities continue to offer value relative to DM ones and c) EM equities have recently become less expensive relative to their own history following price weakness earlier this year and continued earnings growth (see chart).

Figure 3: Asia ex-Japan equity valuations have corrected back towards their long-term average

MSCI Asia ex-Japan 12m forward P/E ratio

Source: FactSet, MSCI, Standard Chartered

Fiscal and current account deficits have been cited as potential sources of risk, should the mood toward EMs sour further. However, we note that at a general level, most Asian economies compare very well on these metrics relative to EMs outside Asia. We believe this helps explain why Asian equities, currencies and bonds have held up better than non-Asian EM assets recently. Oil prices are cited as another risk. However, in aggregate, higher oil prices (up to a point) have generally been supportive for EM equities (though less so for Asia).

Our preference for US equities remains intact. Their 12m earnings expectations remain at a very high level and valuations are more attractive following weakness earlier this year. Keeping up with increasingly lofty earnings expectations will likely be the main near-term challenge.

Higher yields from EM bonds

We still see value in staying invested in, or adding to, EM government bonds despite the recent declines caused by rising US Treasury yields (which implies lower bond prices) and softening valuations (rising credit spreads).

Yields are now well over 6% in both USD and local currency government bonds and we note that 'real' yields (ie, net of inflation) in many key local currency bond markets are now at attractive levels. We also expect pressure from rising US Treasury yields to ease as the market's US inflation expectations normalise to just above 2%, particularly given derivative positioning is still very net-short US Treasuries (see Figure 2).

Our view of long-term USD weakness, based on a likely change in interest rate differentials against the USD, remains a key assumption (see p23 for more).

Asian corporate bonds remain attractive assets for a core holding, in our view. However, we are closely watching rising defaults in China for any spill-over into the offshore USD corporate bond market.

Multi-asset: Prefer balanced strategies

Our late-cycle economic view (one in which equities perform well) and our continued positive view on EM assets cause us to maintain our positive view on balanced strategies. Their relative tilt towards growth-oriented assets should result in outperformance compared to multi-asset income strategies.

A better starting point offered by higher yields should be positive for multi-asset income strategies. While we continue to believe this strategy remains relevant for income-oriented investors, we note that the strategy faces two impending challenges. First, is the risk of relative underperformance in a late-cycle rally, should growth-oriented assets outperform significantly. Second, is a rising yield threshold offered by cash. With 3-month USD interest rates now above 2.3%, there is a risk that relatively more expensive elements of multi-asset income may have to adjust lower in order to compensate investors with higher yields.

Figure 4: Our Tactical Asset Allocation views (12m) USD

Asset class	Sub-asset class	Relative outlook	Rationale
Multi-asset Strategies	Multi-asset income	🟡	Higher yields, gradual Fed hikes positive; rising cash yields a risk
	Multi-asset balanced	🟢	Growth tilt to help in a late cycle rally; equity volatility a risk
Equities 🟢	Asia ex-Japan	🟢	Double-digit earnings growth; fair valuations; trade war a risk
	US	🟢	Strong earnings growth; more reasonable valuations; bond yields a risk
	Other EM	🟡	Commodities a support; valuations elevated; politics, USD strength risks
	Euro area	🟡	Muted earnings growth; valuations elevated; trade war a risk
	Japan	🟡	Strong domestic growth; valuations attractive; JPY strength a risk
	UK	🔴	Earnings under pressure; valuations fair; slower domestic growth a risk
Bonds 🟡	EM government (USD)	🟢	Attractive yield; fair valuations; high-rate sensitivity; USD strength a risk
	EM government (local currency)	🟢	Attractive yield; USD strength, inflation risks
	Asian USD bonds	🟡	Moderate yield; fair valuations; less favourable demand/supply balance
	DM IG corporate	🟡	Moderate yield; elevated valuations; defensive characteristics
	DM HY corporate	🟡	Attractive yield; credit quality mixed; expensive valuations
	DM government	🔴	Still low yield; policy rates, higher inflation risks
Currencies	EUR	🟢	Policy rate expectations to re-price higher; economic slowdown is a risk
	EM currencies	🟡	Medium-term EM fundamentals supportive; USD strength a risk
	GBP	🟡	Brexit risks to limit upside, economic slowdown poses downside risks
	AUD	🟡	Recent downturn prices-in most major risks, though positive catalyst lacking
	JPY	🟡	Short-term JPY likely to extend weakness, longer term risks balanced
	USD	🔴	Medium-term drivers USD negative, though short-term gains can extend

Source: Standard Chartered Global Investment Committee

Legend: 🟢 Overweight 🟡 Neutral 🔴 Underweight

Figure 5: Performance of key themes since *Outlook 2018*

Asset class		Date Open	Date Closed	Absolute	Relative
Equities	Asia ex-Japan equities to outperform global equities	7-Dec-17		–	✓
	China equities to outperform Asia ex-Japan equities	7-Dec-17		–	✓
	US equities to outperform global equities	26-Apr-18		–	✓
Bonds	Emerging Market (EM) USD government bonds to outperform global bonds	7-Dec-17		–	×
	Emerging Market (EM) LCY government bonds to outperform global bonds	25-Jan-18		–	×
Multi-asset and alternative strategies	Multi-asset balanced[2] strategies to outperform multi-asset income[1] strategies	7-Dec-17		–	✓
	Equity Hedge strategies to outperform other alternative strategies[3]	7-Dec-17		–	✓
Currencies	USD to weaken modestly	7-Dec-17		✓	–
	EUR to strengthen against the USD	7-Dec-17		×	–
	CNY to strengthen against the USD	26-Apr-18		×	–
Closed calls					
Asia USD corporate bonds to outperform global bonds		7-Dec-17	25-Jan-18	–	×
KRW to strengthen against the USD		7-Dec-17	23-Feb-18	✓	–
JPY to weaken against the USD		7-Dec-17	23-Feb-18	×	–
Euro area equities to outperform global equities		7-Dec-17	2-Mar-18	–	×
South Korea equities to outperform Asia ex-Japan equities		7-Dec-17	26-Apr-18	–	×
SGD to strengthen against the USD		22-Feb-18	26-Apr-18	×	–
MYR to strengthen against the US		28-Mar-18	26-Apr-18	×	–
EM currencies to gain against the USD		7-Dec-17	24-May-18	×	–

Source: Bloomberg, Standard Chartered
Performance measured from 8 December 2017 (release date of our *2018 Outlook*) to 24 May 2018 or when the view was closed
[1] Multi-asset income allocation is as described in '*Outlook 2018: Turning up the heat*', Figure 10, page 43
[2] Multi-asset balanced allocation is as described in '*Outlook 2018: Turning up the heat*', Figure 8, page 39
[3] Alternative strategies allocation is described in '*Outlook 2018: Turning up the heat*', Figure 1, page 89
✓- Correct call; × - Missed call; NA - Not Applicable

Past performance is not an indication of future performance. There is no assurance, representation or prediction given as to any results or returns that would actually be achieved in a transaction based on any historical data.

Perspectives

on key client questions

Are we heading to an Emerging Market crisis?

We believe the recent weakness in Emerging Market (EM) currencies, bonds and equities is an opportunity for investors.

We have seen significant weakness in many EM assets. However, it is important to put this in perspective both in terms of depth and breadth. In terms of depth, for instance, EM currencies have fallen in aggregate by 7-8% from this year's peak. But compared to the 30%+ decline we saw in the 2013-2016 period, we have yet to break through 12m lows, let-alone the 2016 low (see chart). Meanwhile, in terms of breadth, EM equities, bonds and currencies outside Asia have weakened much more so than those in Asia, where equities have been largely range-bound and currency/bond weakness has been minimal.

Of course, you can read this in two ways. One is possibly that the worst is yet to come. The more optimistic view is this is not indicative of a crisis in the making; rather, these are isolated instances of EM economies – especially those that previously received the most foreign inflows – coming under significant pressure, which has led some investors to scrutinise their allocations to other EM assets.

In our opinion, the performance of the USD (and US bond yields) is very important to the outlook from here. A strengthening USD, like we have seen in the past 2 months, is clearly a challenging environment for EMs as it 1) increases the financing costs of USD debt and 2) increases domestic inflationary pressures. The latter, in turn, forces EM central banks to focus on controlling inflation rather than supporting growth, which is naturally challenging for local currency bonds and equities alike.

However, we believe the longer-term drivers for USD weakness – rising government and trade deficits in the US and a likely normalisation of Euro area monetary policy – are intact. Therefore, we believe the recent cheapening of EM government bonds (both USD and local currency) as well as Asia ex-Japan equities offers a good opportunity.

Figure 6: Emerging Markets under pressure, but should be placed in context

JPMorgan Emerging Market currency index

Source: Bloomberg, Standard Chartered

Figure 7: Asia equity markets holding up reasonably well relative to EM equities elsewhere in the world

MSCI Asia ex-Japan and non-Asia EM indices (rebased to 100 on 1 January 2018)

Source: Bloomberg, Standard Chartered

Are rising interest rates a risk or an opportunity for income-focused investors?

It depends. For existing investors, rising yields may prove to be challenging for income-generating assets. For those with large cash holdings, higher yields can offer a good opportunity to build a more balanced multi-asset income allocation.

In recent years, one of the main challenges for income-focused investors has been the low yields on offer across traditional sources of investment income, such as high-quality government and corporate bonds. This has encouraged investors to take on additional risks, either through more volatile asset classes (for example, corporate bonds with higher credit risk and high dividend-yielding equities) or by leveraging income-generating allocations (ie, borrowing money to finance additional investments).

At the most basic level, rising interest rates mean the 3-month yield on cash is significantly higher than that was 12-24 months ago (2.33% in USD today versus as little as 0.25% at the start of 2015). This increases the competition for income-focused investments, putting upward pressure on bond yields and, by extension, becoming challenging for other income-generating assets more broadly. (We will be exploring this in more detail in our H2 Outlook publication next month).

Rising interest rates also increase the funding costs for investors, which is likely to reduce the incentive to leverage investments and put further downward pressure on income-generating assets.

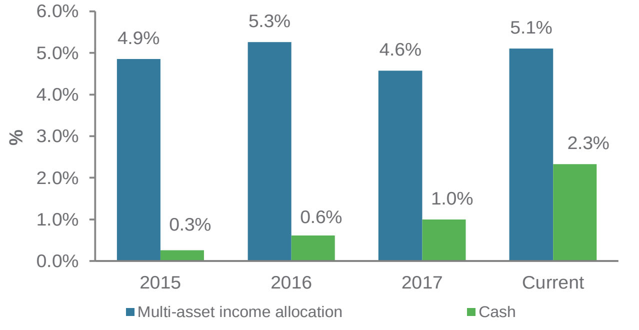
However, for investors who are yet to invest as much as they would like to, rising interest rates/yields provide an opportunity to build a balanced income allocation with a lower risk profile, assuming the target yield of the allocation is held constant.

We started highlighting the positive outlook for multi-asset income allocations in 2012 against the backdrop of ultra-low interest rates. However, at the end of 2016, we highlighted that, for investors not fixated on the objective of income generation, a more pro-growth tilt made sense as we entered the later stage of the economic cycle.

Put simply, this suggests a pivot away from high yield bonds and high dividend-yielding equities to more pro-cyclical areas of the equity market, which tend to do well when economic growth strengthens. We continue to believe this is appropriate, even with the assumption that the US Fed continues to hike interest rates gradually.

Figure 8: Rising interest rates a headwind for multi-asset income

3-month USD LIBOR rate and the yield on our model multi-asset income allocation (as outlined in our 2018 Outlook)



Source: Bloomberg, Standard Chartered

Macro overview

IMPLICATIONS
FOR INVESTORS

01 The Fed to raise rates 2-3 more times in 2018 and at least twice more in 2019

02 The ECB to continue withdrawing policy stimulus, while the BoJ stays accommodative

03 China to maintain its tight monetary policy as it reigns in excess debt

Reflating at a moderate pace

- **Core scenario:** The world's economic outlook remains positive, although growth momentum has moderated in Europe, Japan and China. The outlook for Emerging Markets (EMs) remains constructive, although the USD's rebound is a challenge.
- **Policy outlook:** We expect the Fed to hike rates 2-3 more times in 2018 and at least twice more in 2019, ECB to keep withdrawing stimulus, BoJ to stay accommodative and PBoC to maintain tight policy, while ensuring sufficient liquidity.
- **Key risks:** a) Inflation surge, especially in the US, remains the biggest risk to our core scenario; b) Tighter liquidity conditions, especially in EMs, as the USD rebounds; c) Trade tensions, with US-China talks a key determinant.

Core scenario

The Global Investment Committee continues to assign a 70% probability to a scenario of moderate-to-strong growth with limited inflation (around 2% in the US) unfolding in the next 12 months. However, global growth momentum has moderated, with the US, Euro area and Japan all reporting slower growth in Q1. We still expect global growth to remain above-trend, especially in the US where private investments have accelerated following last year's tax cuts. An inflation surge remains the biggest source of risk (20% probability) to this constructive scenario, with wage pressures building in the US as the job market tightens. Higher oil prices have also lifted near-term inflation expectations. Tighter liquidity conditions, especially in EMs, are another source of risk to this constructive global outlook, as the USD rebounds on the back of rising US bond yields.

Figure 9: US growth and inflation outlook has been upgraded after the tax cuts in December

Region	Growth	Inflation	Benchmark rates	Fiscal deficit	Comments
US	🟢	🟡	🟡	🟢	Growth to recover from Q1 slowdown, led by consumption, investment. Fed to accept inflation pick-up, pursue a gradual pace of rate hikes
Euro area	🟢	🟡	🟢	🟡	Growth to rebound on domestic consumption, investment. ECB to keep withdrawing stimulus, but bond purchases could continue into 2019
UK	🟡	🔴	🟡	🟡	Brexit risks override underlying resilience amid a strong job market. BoE rate hike postponed, but further tightening likely as wages accelerate
Japan	🟢	🟡	🟢	🟡	Economy likely to recover from Q1 contraction, although at a slower pace than recent years. BoJ to maintain easy policy amid still-low inflation
Asia ex-Japan	🟢	🟡	🟢	🟡	China's growth to moderate, but remain supported by strong consumption. PBoC to ensure liquidity, while tightening overall credit
EM ex-Asia	🟢	🟡	🟢	🟡	Growth outlook remains solid amid rising commodity prices, but USD rebound turns focus on current account deficit economies

Source: Standard Chartered Global Investment Committee

Legend: 🟢 Supportive of risk assets 🟡 Neutral 🔴 Not supportive of risk assets

US – powered by consumption, investment

Growth to rebound. We expect US growth to recover after a slowdown in Q1 that was driven by seasonal factors. Although consumption remains the underlying driver of the economy as the job market tightens (the jobless rate fell in April to the lowest level since 2000), business spending is emerging as the main engine of growth following the tax cuts last year. Consensus points to 3% annualised growth for the rest of the year, the desired pace for the government to pay for the coming decade's tax cuts. Productivity will eventually need to rise to sustain this pace of expansion.

Gradual rate hikes. The Fed's latest guidance introduced the concept of a 2% 'symmetric' inflation target, which suggests it may be relaxed about inflation overshooting for a while. This indicates it is likely to continue with its gradual pace of hikes. We expect 2-3 rate hikes for the rest of 2018.

Euro area – subdued, but robust

Above-trend growth to continue. Euro area growth slowed in Q1, dampened partly by trade tensions, bad weather and prior EUR strength. Although business confidence remains subdued, it still points to above-trend growth for the rest of the year. Strong consumer confidence suggests continued support from domestic consumption, while record-low borrowing costs help sustain business investment. Italy's new governing coalition of Eurosceptic parties is a risk, especially if they plan to ignore Euro area fiscal rules.

ECB to reduce bond purchases. Continued low inflation points to sizeable slack in the economy. We expect the ECB to reduce bond purchases further.

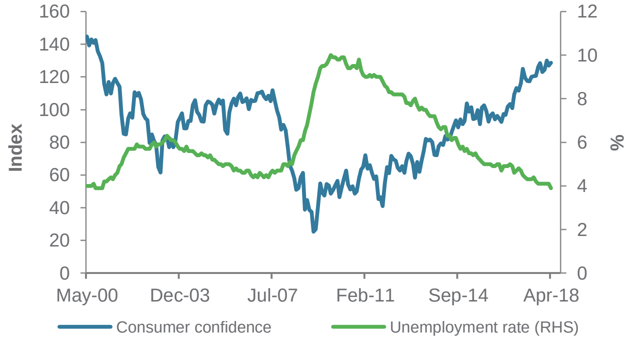
UK – Brexit risks dominate

Brexit terms key to outlook. The government remains divided over the terms of Brexit, including the UK's trade relationship with the EU and also the status of the Irish border. The uncertainty continues to override the underlying strength of the economy, supported by a strong job market.

Rate hike postponed. Brexit risks and moderating inflation have led the BoE to postpone a rate hike. We expect the BoE to hike rates in the next 12 months as wages accelerate.

Figure 10: US consumer confidence remains strong amid a tightening job market

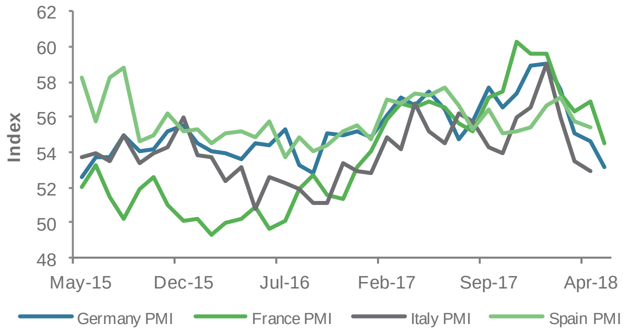
US consumer confidence, jobless rate



Source: Bloomberg, Standard Chartered

Figure 11: Euro area business confidence continues to moderate amid trade tensions; current levels still point to above-trend growth

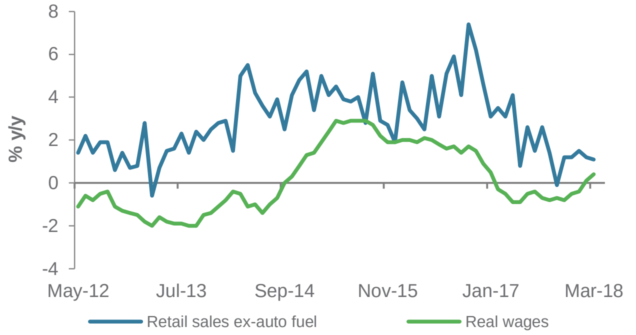
Composite PMIs for Germany, France, Italy and Spain



Source: Bloomberg, Standard Chartered

Figure 12: UK consumption remains subdued, although inflation-adjusted wages have started to rise after a year of contraction

UK inflation-adjusted wage growth; Retail sales, excluding auto fuels



Source: Bloomberg, Standard Chartered

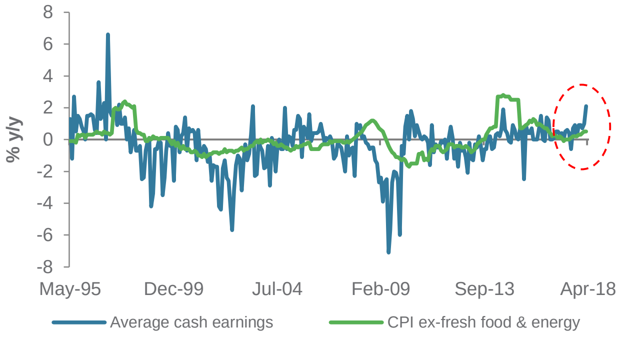
Japan – growth momentum slows

Growth hits a speed bump. Japan's economy contracted in Q1 for the first time since 2015 as slowing exports and trade tensions with the US dampened business investments, while bad weather hurt consumption. Consensus estimates point to a recovery for the rest of 2018, although not at the above-trend pace of the past couple of years. The tightening job market is likely to support consumption. A key risk is whether P M Abe survives the ongoing political challenges.

BoJ to stay easy. The BoJ is likely to stay accommodative in the next 12 months. While wage pressures are rising, inflation remains significantly below the BoJ's 2% target.

Figure 13: Japan's wages have picked up on the back of a tight job market, but inflation remains well below the BoJ's 2% target

Japan's average cash earnings and core consumer inflation



Source: Bloomberg, Standard Chartered

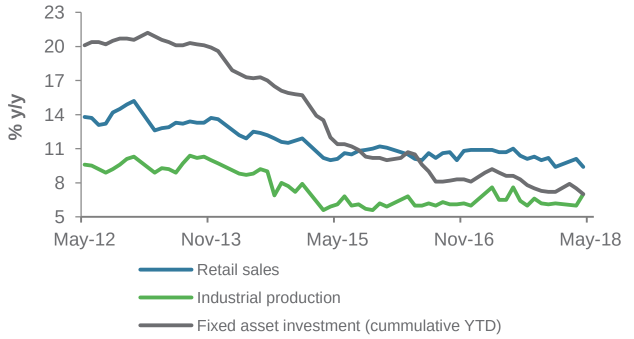
China – consumption to support growth

Slower, but more balanced, growth. After a strong Q1, consensus estimates point to a moderation in China's growth for the rest of 2018. Domestic consumption and services remain robust, as seen in c. 10% y/y retail sales growth this year, which is helping to offset a slowdown in exports and investments. Trade disputes with the US, despite the recent truce, are likely to lead to measures that would continue rebalancing the economy towards domestic consumption.

PBoC eases liquidity. The cut in bank reserve requirements signal a subtle change in policy where the PBoC ensures sufficient liquidity to targeted sectors, even as it moderates credit growth to reduce overall leverage in the economy.

Figure 14: China's economic rebalancing continues, as consumption remains strong, while investment slows

China's fixed asset investment YTD; Retail sales; Industrial production



Source: Bloomberg, Standard Chartered

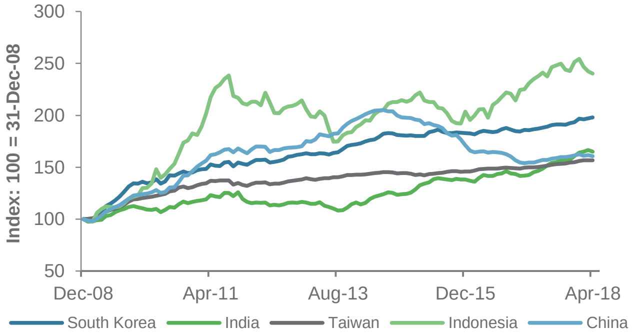
Emerging Markets – diverging trends

Asia more resilient than others. EM growth outlook remains solid amid a recovery in commodity prices. However, the USD's rebound has increased scrutiny of EM economies with chronic current account or budget deficits. We believe most Asian economies are more resilient since the Global Financial Crisis as they have significantly boosted FX reserves over the past decade. Politics is a key risk in some markets, such as Mexico and Brazil, given upcoming general elections.

Policy turns neutral-to-hawkish. Brazil held rates in May, against expectation of further cuts, while Indonesia raised rates in a bid to support a flagging currency. Markets expect Asian central banks to tighten modestly in the coming year.

Figure 15: Asian foreign exchange reserves have risen significantly

Rise in FX reserves in major Asian economies (Index: 100 = Dec. 2008)



Source: Bloomberg, Standard Chartered

Bonds

IMPLICATIONS
FOR INVESTORS

01 Prefer EM USD and local currency government bonds

02 Expect 10-year US Treasuries to hover around 3.0%-3.25%

03 Favour maturity profile of around five years for USD-denominated bonds

Figure 16: Where markets are today

Bonds	Yield	1m return
DM IG government	*1.61%	-1.7%
EM USD government	6.20%	-1.2%
DM IG corporates	*2.93%	-1.3%
DM HY corporates	6.10%	-1.5%
Asia USD	4.84%	-0.3%
EM local currency government	6.54%	-4.8%

Source: Bloomberg, JPMorgan, Barclays, Citigroup, Standard Chartered

*As of 30 April 2018

Retaining preference for EM bonds

- We view the recent sell-off in Emerging Market (EM) bonds as a potential buying opportunity and retain both USD and local currency denominated government bonds as our preferred areas within bonds. Asia USD bonds remain a core holding, owing to their defensive characteristics and our overall preference for EM.
- We view the Fed's target of 2% inflation being consistent with 10-year yields between 3.0%-3.25%. Although the recent spike in 10-year US Treasury yields has increased the risks of a temporary overshoot, especially if inflation exceeds 2% temporarily, we expect yields to be broadly range-bound over a 12m horizon.
- We expect short-term (2-year) yields to rise faster than long-term (10-year) yields. This leads us to favour a maturity profile centred around 5 years.

Figure 17: Bond sub-asset classes in order of preference

Bond asset class	View	Rates policy	Macro factors	Valua-tions	FX	Comments
EM USD government	Preferred	Not Supportive	Supportive	Neutral	NA	Attractive yields, relative value and positive EM sentiment are supportive
EM local currency	Preferred	Neutral	Supportive	Neutral	Neutral	Attractive yield and positive EM sentiment offset by higher volatility
Asian USD	Core	Not Supportive	Supportive	Neutral	NA	High credit quality, defensive allocation. Influenced by China risk sentiment
DM IG corporate	Core	Not Supportive	Neutral	Neutral	Supportive	Likely to outperform DM IG government bonds. Yield premium is relatively low
DM HY corporate	Core	Not Supportive	Neutral	Not Supportive	Supportive	Attractive yields on offer, offset by expensive valuations
DM IG government	Less Preferred	Not Supportive	Not Supportive	NA	Supportive	Returns challenged by normalising Fed and ECB monetary policy

Source: Standard Chartered Global Investment Committee

Legend: Supportive | Neutral | Not Supportive | Preferred | Less Preferred | Core

Further rate hike expectations push yields higher

Over the past month, 10-year US Treasury yields rose sharply as stronger economic data and comments from Fed members led the market to reassess rate hike expectations. 10-year US yields broke through the key technical level of 3.05% before retracing modestly. European bond yields diverged as 10-year German Bund yields declined, while Italian bond yields rose due to the formation of Eurosceptic coalition.

Fundamentally, the Fed's target of 2% inflation is consistent with 10-year yields between 3.0%-3.25%. Markets have largely priced in that, by 2020, US interest rates will be close to the Fed's long-term projections. Hence, we believe yields are unlikely to rise significantly above 3.25%. Our assessment is short-term yields are likely to rise faster than long-term yields.

Figure 18: Markets have largely priced in future Fed rate forecast

Interest rates implied by Fed Funds rate futures for end of 2018, 2019 and 2020

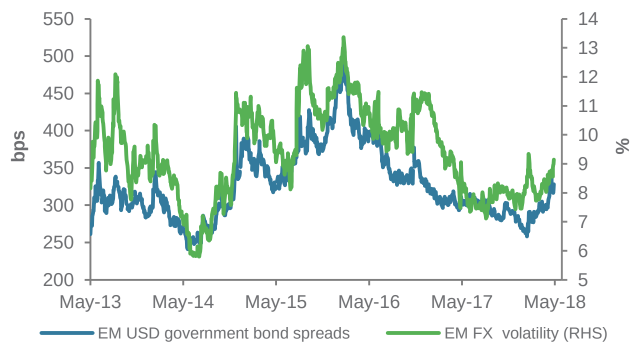
Source: Bloomberg, Standard Chartered

Emerging Market USD government bonds – Preferred

EM USD government bonds underperformed owing to higher US yields and deteriorating EM risk sentiment (proxied through EM FX volatility), which led to cheaper valuations. This, combined with higher US Treasury yields, has resulted in yields of nearly 6.2%, the highest since early-2016. We view the current sell-off as a good entry point and retain EM USD bonds as one of our preferred areas within bonds.

Figure 19: EM USD government bonds credit spreads have been closely tied to EM risk sentiment (proxied through EM FX volatility)

EM USD government bonds credit spreads and EM FX volatility



Source: Bloomberg, Standard Chartered

The weak performance reminds us of similar phases in 2013 and 2015-16. In both those instances, the 100bp increase in yields proved to be a good entry point for the asset class. Fundamentally, we remain constructive on EM assets as the region continues to benefit from strong growth and higher commodity prices. The supply-demand balance for this category of bonds is likely to turn more favourable.

Thus, we expect the credit spreads (or yield premiums over US Treasuries) to remain range-bound around current level. Nevertheless, fund outflows and higher-than-expected US yields are the key risks to our positive view.

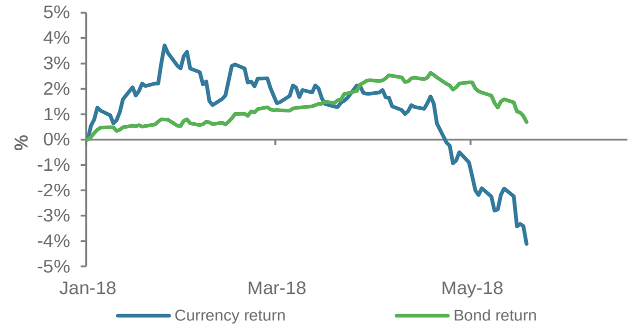
Emerging Market local currency bonds – Preferred

EM local currency bonds were the worst hit area within bonds in the past month as currency weakness and idiosyncratic events led them to decline over 4.8%. Higher US yields and stronger USD led to central banks in Indonesia and Turkey to hike rates, while a few others signalled a move to a less dovish monetary policy to support their currencies.

We view central bank moves as pre-emptive as most EM countries have much stronger FX reserves compared to the taper tantrum in 2013 and, therefore, we retain EM local currency bonds as a preferred area within bonds.

Figure 20: Weaker currency has hurt EM local currency bond returns

FX and local currency bond returns for EM local currency bonds



Source: Bloomberg, Standard Chartered

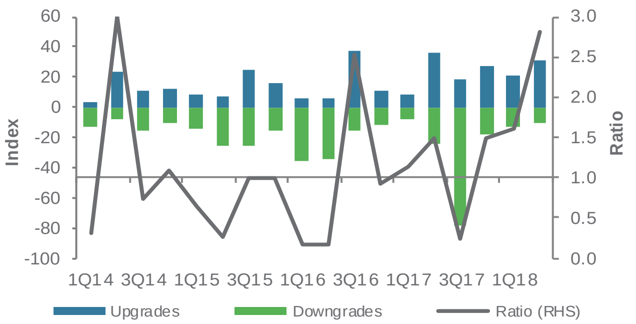
Asian USD bonds – Core holding

Asian USD bonds demonstrated their defensive nature and low volatility in the past month. We continue to like these qualities and retain them as a core holding. While large supply from Chinese issuers remains a drag, there are some green shoots of a potential recovery. First, the increase in foreign investment limits by Chinese authorities should help increase demand for Asian USD bonds. Second, credit quality (proxied by the ratio of credit rating upgrades and downgrades) appears to be on an upward trend.

Though the uptick in onshore defaults in China has attracted media headlines, we believe defaults would need to rise substantially before they start to hurt Asia USD bonds. We believe the combination of more reasonable valuations and improving fundamentals should help support the asset class.

Figure 21: Credit quality appear to be improving as rating upgrades have outnumbered downgrades

Rating upgrades and downgrades for Asia ex-Japan bonds



Source: S&P, Bloomberg, Standard Chartered

Developed Market Investment Grade corporate bonds – Core holding

Developed Market (DM) IG corporate bonds are a core holding for us as we expect them to outperform DM IG government bonds, owing to the yield premium on offer. However, the relatively low absolute yields and high interest rate sensitivity lead us to have a balanced view on them.

While the rise in yields, especially in the US, has made this sub-asset class more appealing, it is largely offset by the rise in borrowing costs that could put pressure relatively highly leveraged companies, and increase downgrade risks.

Developed Market High Yield corporate bonds – Core holding

The yield on DM HY bonds increased to 6.1% in the past month due to higher US Treasury yields and increase in yield premiums. While valuations remain expensive (see Figure 22), the now more attractive yield leads us to expect positive returns from the bonds and we retain them as a core holding.

The recent increase in yield premiums occurred despite the rally in energy prices – which could point to the fact that valuations are expensive. Indeed, the yield premium offered by US HY bonds over their IG peers is at multi-year lows. We expect the valuations to retrace (yield premiums to rise) moderately from the current levels.

Figure 22: Yield premium offered by US HY bonds over US IG corporate bonds is at multi-year lows

Difference in the yields premiums offered by US HY bonds and US IG corporate bonds

Source: Bloomberg, Standard Chartered

Developed Market Investment Grade government bonds – Less preferred

DM IG government bonds remain our least preferred area within bonds as we believe they are likely to struggle to deliver positive returns. As highlighted earlier, we believe fundamentals indicate that the 10-year US Treasury yields are unlikely to rise significantly above 3.25%, though a short-term overshoot cannot be ruled out. Our expectation of modestly higher yields and flatter yield curve leads us to continue to favour a maturity profile of around 5 years.

The outlook in Europe remains nuanced. While the prospects of a reduction in ECB stimulus argue for higher German Bund yields, the increase in concerns around Italy could lead cap German yields in the near term as European investors could favour them over the government bonds of peripheral countries such as Italy. However, over 12m, we continue to expect German yields to edge higher.

Equities

IMPLICATIONS FOR INVESTORS

01 Global equities are our preferred asset class

02 Asia ex-Japan is our preferred regional market

03 Prefer China within Asia ex-Japan

Figure 23: Where markets are today

Market P/E ratio	Market P/B	EPS	Index level
US (S&P500)			
17x	3.1x	16%	**2,728**
Euro area (Stoxx 50)			
14x	1.6x	8%	**3,522**
Japan (Nikkei 225)			
13x	1.3x	6%	**22,437**
UK (FTSE 100)			
14x	1.8x	7%	**7,717**
MSCI Asia ex-Japan			
12x	1.5x	12%	**714**
MSCI EM ex-Asia			
11x	1.4x	19%	**1,425**

Source: FactSet, MSCI, Standard Chartered.
Note: Valuation and earnings data refer to MSCI indices, as of 24 May 2018

Remain positive on equities

- Global equities remain our preferred asset class. US and Asia ex-Japan are preferred markets. Attractive valuations in Asia ex-Japan, exceptional earnings growth and potentially higher share buybacks in the US drive our preference for these markets. The USD has turned to a headwind for Emerging Markets from a tailwind in 2017, but we reiterate our view of a supportive, modestly weaker USD in H2 2018.
- Asia ex-Japan is our most preferred region. As the risk of a US-China trade war recedes, there is the potential for a re-rating given upside risks to earnings and trade growth forecasts.
- US equities are also preferred. A potential increase in share buybacks, in combination with the 20% consensus earnings growth in 2018, drives our positive view, as is our constructive assessment on the technology sector. Signs that corporate investment is accelerating is also supportive and could offset the impact of rising interest rates.
- Euro area equities are a core holding. The outlook for the region is balanced by the positive effect of higher interest rates on the heavyweight financial sector and the negative effect of EUR strength on earnings forecasts.

  Emerging Markets (EM) ex-Asia is a core holding. USD strength and macro weaknesses in selected EM ex-Asia including Turkey have weighed on performance year-to-date. Nevertheless, we forecast a modestly weaker USD in H2 2018, which should alleviate some of the pressure.
- Risks to our equity view: policy mistakes, margin weakness and a trade war.

Figure 24: Asia ex-Japan is a preferred region, the UK is least preferred

Equity	View	Valuations	Earnings	Return on Equity	Economic Data	Bond yields	Comments
Asia ex-Japan	Preferred	Supportive	Supportive	Supportive	Supportive	Neutral	Earnings recovery, improving margins and attractive valuations
US	Preferred	Neutral	Supportive	Supportive	Supportive	Neutral	Robust earnings growth, potential for share buybacks
EM ex-Asia	Core Holding	Neutral	Neutral	Neutral	Supportive	Neutral	US dollar strength is weighing on earnings recovery
Euro area	Core Holding	Neutral	Neutral	Neutral	Neutral	Neutral	Earnings under pressure from euro strength, ROE improving
Japan	Core Holding	Supportive	Not Supportive	Supportive	Neutral	Neutral	Yen strength is a drag on earnings outlook
UK	Less Preferred	Neutral	Neutral	Not Supportive	Neutral	Neutral	Earnings under pressure and domestic demand remains weak

Source: Standard Chartered Global Investment Committee

Legend: Supportive | Neutral | Not Supportive | Preferred | Less Preferred | Core Holding

Asia ex-Japan equities – Preferred holding

Asia ex-Japan equities are a preferred holding, which means we expect them to outperform global equities over the next 12 months in USD terms. Our view is underpinned by margin expansion, easing trade tensions and modest USD weakness.

We see an upside to consensus 12m forward earnings growth forecast at 12% - margins have expanded on rising demand and higher prices, oil prices have helped energy companies, while rising rates could boost banks' net interest margins.

Valuations have become more attractive with 12m forward valuation multiple or price-to-earnings ratio (P/E) of 13x. A potential catalyst for a re-rating is the reducing risk of a US-China trade war, a risk that appears to be diminishing.

Downside risks include a technology sector slowdown and slower earnings growth. History suggests a 57% probability of positive 12-month returns from current valuations. Our three-factor model* signals the potential for 13% returns.

China is a preferred market within Asia ex-Japan. Growing domestic consumption remains the driver, supported by rising middle class, favourable economic measures, prudent fiscal policies and a stable political environment. Chinese A share inclusion in MSCI indices is a potential positive catalyst for renewed investor interest in Chines equities.

Figure 25: Asia ex-Japan's valuations have become more attractive

MSCI Asia ex-Japan's PER

Source: FactSet, MSCI, Standard Chartered

*Our 3-factor model averages the implied returns from consensus analyst earnings forecast (bottom up and top down) and options markets

US equities – Preferred holding

US equities continue to be our preferred holding, which means we expect them to outperform global equities over the next 12 months. Rising capex and government spending are key drivers. Share re-purchases and fair valuations are also positives.

Ongoing fiscal stimulus and rising investment spending by US corporates should support growth. In addition, we believe risks of a US recession is low, assigning only a 31% probability in the coming 12 months. This healthy macro backdrop is supportive of US equities.

Share re-purchases could also accelerate. We see room for share buybacks to increase from 2017's USD 519bn. This is expected to be driven by healthy US corporate profitability and repatriation of profits from overseas.

Valuations have become more attractive. Consensus 12m forward valuation multiple or P/E is 17x. Earnings upgrades due to tax cuts and solid demand have boosted earnings forecast. Although we acknowledge that consensus 2018 EPS growth of 20% present a high water mark to beat, the outlook for US corporate earnings remains buoyant.

Key risks to our positive view include potential P/E de-rating due to higher bond yields and IT sector sell-off. From current valuations, history suggests there is an 86% probability of positive returns for US equities in the coming 12 months, and our three-factor model* signals the potential for 12% returns over the same period.

Figure 26: Valuations have turned more attractive

MSCI US's consensus 12m forward P/E

Source: MSCI, Factset, Standard Chartered

EM ex-Asia equities – Core holding

EM ex-Asia equities remain a core holding, which means we expect them to perform broadly in line with global equities over the next 12 months in USD terms. Our view is supported by a positive earnings outlook on the backdrop of steady commodity prices and a modestly weaker USD.

Consensus 12m forward earnings growth forecast for EM-ex Asia is 15%, with net margins steady at 10%. Valuations are attractive at a 12m forward valuation multiple or P/E of 11x.

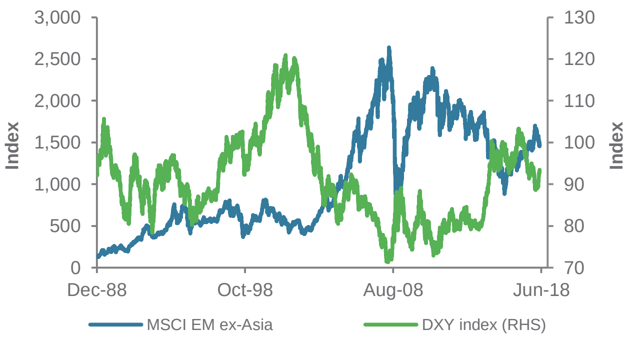
Energy and materials together account for 26% of the MSCI EM ex-Asia index. Higher commodity prices, driven by rising global industrial output and disciplined oil supply by OPEC and Russia, are positive for earnings. In addition, the banking sector, which represents 25% of the same index, could benefit from rising interest rates.

The recent strength in USD is a headwind for EM ex-Asia equities. Given our view of a modestly weaker USD view on a 12m horizon, we see buying opportunities arising from a correction in markets.

Risks to our core holding view include weaker commodity prices, unfavourable political changes and further USD strength. History suggests a 57% probability of positive returns from current valuations in the coming 12 months, and our three-factor model* signals the potential for 15% returns over the same period.

Figure 27: EM ex-Asia equity market performance is often inversely correlated to the US dollar

MSCI EM ex-Asia and USD Index



Source: FactSet, Bloomberg, MSCI, Standard Chartered

*Our 3-factor model averages the implied returns from consensus analyst earnings forecast (bottom up and top down) and options markets

Euro area equities – Core holding

Euro area equities are a core holding, which means we expect them to perform in line broadly with global equities over the next 12 months in USD terms. Higher German bund yields and strong investment spending are positives. A strong EUR and unattractive valuations are negatives.

Higher Euro area bond yields could support relative performance. The Euro area is heavily tilted towards interest rate-sensitive sectors, including financials, which account for 20% of the region. Net interest margins and investment yields of Euro area financials could benefit from our view of stable to higher bond yields in the next 12 months.

Rising investment spending is also a potential driver. Following weak investment growth in the last ten years, Euro area companies could increase investment spending to meet rising consumer demand, supporting corporate profitability.

Our view of a strong euro is a headwind to earnings. The positives from rising investment spending could be offset by a strong euro. We see limited room for consensus 12 month earnings growth expectation of 7.8% to surprise on the upside. Valuations have turned less attractive after recent rebound. The market currently trades at consensus 12-months forward forward valuation multiple or P/E of 14x.

From current valuations, history suggests an 70% probability of positive returns for Euro area equities in the coming 12 months, and our three-factor model* signals the potential for 8% returns over the same period.

Figure 28: Strong EUR could cap meaningful upside to earnings

MSCI EMU12-month EPS growth (y/y) versus EUR currency direction

Source: MSCI, Factset, Standard Chartered

Japan equities – Core holding

Japan equities remain a core holding, which means we expect them to perform broadly in line with global equities over the next 12 months in USD terms. This is supported by share re-purchases and cheap valuations, but is offset by rising political uncertainty and easing earnings expectations.

Share re-purchases tend to rise in the Q2 period, historically accounting for c.38% of annual purchases. We expect strong momentum in repurchases going forward, backed by strong free cash flow generation. 12-months forward valuation multiple or P/E of 13x remains compelling.

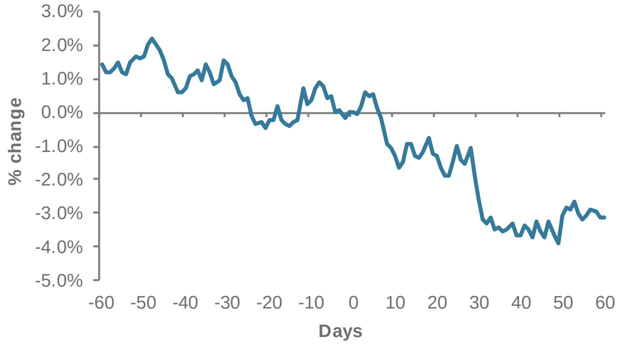
Political risk is in focus. PM Abe's ability to win September's LDP president elections could be in doubt. Although a change in leadership is not our base case scenario, historically, this is associated with poor Japanese equity performance. The Topix has historically declined 1-3% in the 60 days following the previous 18 such transitions.

Earnings outlook remains modest. The 12-months forward earnings growth fell to 2.0% from 9.7% in January 2018. We see rising risks of peaking profit margins for export-driven corporates, as global growth is in a late-stage expansion.

Using current valuations, history suggests a 62% probability of positive returns for Japan equities in the coming 12 months, and our three-factor model* signals the potential for 8% returns over the same period.

Figure 29: Topix returns usually muted around PM transitions

Topix Performance before and after PM change (%)



Source: FactSet, MSCI, Standard Chartered

*Our 3-factor model averages the implied returns from consensus analyst earnings forecast (bottom up and top down) and options markets

UK equities – Less preferred

UK equities remain our least preferred market, which means we expect them to underperform global equities over the next 12 months in USD terms. This is due to rising bond yields, slower economic growth and renewed concerns about the eventual EU withdrawal and the trade deal the UK strikes as part of Brexit.

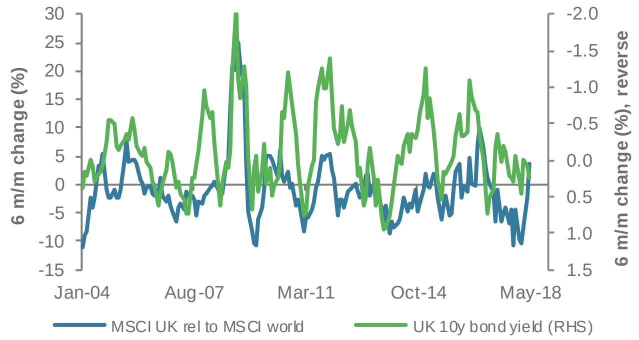
UK equities have the highest dividend yield of 4.3% among the large global markets we cover. Dividend and bond yields are usually positively correlated. Hence as bond yields rise, dividend yields could increase via lower stock prices. A range-bound GBP and lower energy prices could also restrain the upside potential for UK earnings, which are forecast to rise by 7.6% in the next 12 months.

Most UK activity indicators, including recent business sentiment surveys, are sluggish. This is mainly due to lingering concerns about Brexit. Rising inflationary pressures and expectations of further interest rate increases do not bode well for growth. This could limit potential valuation multiple re-rating for the market. The market is currently trading at 12m forward valuation multiple or P/E of 14x.

Key risks to our less preferred stance include higher-than-expected commodity prices or falling bond yields. Adverse FX movement could also negate our view. From current valuations, history suggests there is a 60% probability of positive returns for UK equities in the coming 12 months, and our three-factor model* signals the potential for 8% returns over the same period.

Figure 30: UK equites underperform when bond yields are rising

MSCI UK relative performance versus UK 10y bond yields



Source: MSCI, Bloomberg, Standard Chartered

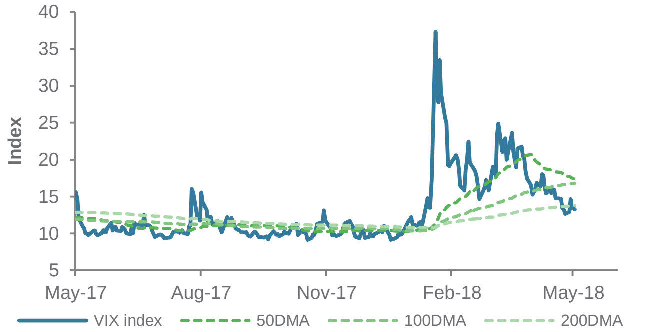
Equity derivatives

Ranging VIX between 10% to 15%

We believe, in the next couple of months, the VIX index (a measure of US equity market volatility) will likely be trading between 10% and 15% most of the time, ie, a lower region than the 15% to 20% levels that we have seen in most of this year so far.

Figure 31: VIX may trade in the 10% to 15% range in next couple of months

VIX Level



Source: Bloomberg, Standard Chartered

In our previous update two months ago, we suggested the trade war was unlikely to lead to a significant rise in volatility. In the market correction that we subsequently saw, VIX barely spent any time above 20%.

Indeed, the drop in markets measured by market capitalisation erased, was 1-2 times the total announced value of the tariffs. However, we continue to believe it is in everybody's interests to avoid escalating tit-for-tat tariffs.

Meanwhile, we continue to see fundamental factors taking hold, as short-term factors subside. Positive factors include, 1) US tax reform, 2) record US earnings, and 3) robust economic growth. Valuation-wise, the S&P500's 12m P/E is currently at 17x, below the recent peak at 18x.

Positioning continues to point towards less risk of a sharp shock after the sell-off in February this year, volatility targeting strategies are likely near the lows of equity allocation, and retail holdings of short volatility positions are significantly lower.

There were talks about a sharp rise in US 10-year Treasury yields and how tighter liquidity may cause more volatility in the markets. The 70bps gain in yields this year appears primarily driven by higher oil prices and strong US growth/inflation data, given long-term inflation expectations have remained anchored (10-year inflation expectations have risen by only 20bps YTD). This "good" rise in bond yields should be positive for risk assets, such as equities, and should limit the level of VIX.

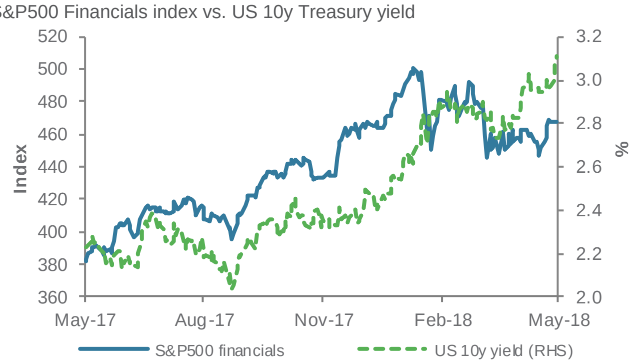
What may cause the VIX to go higher from here? We believe the biggest risk would be inflation expectations catching up with growth. One such source could be oil prices staying at elevated levels, or even rising further.

Opportunities in US financials from higher US 10-year yield

With short-term risk factors subsiding, US financials shares are trading higher on the back of the pick-up in US 10-year yield.

Figure 32: US Financials catching-up with US 10y yield

S&P500 Financials index vs. US 10y Treasury yield



Source: Bloomberg, Standard Chartered

Other positive factors include: 1) robust loan demand with improving employment figures, 2) beneficiaries of US corporate tax cuts, and 3) strong consensus earnings forecast (29% vs. 19% for the S&P500). We believe there is limited downside for the US financial sector.

Volatility-wise, US financials overall have been consistently a few volatility points higher than the S&P500 index throughout the last 12 months. As such, we believe there is value for investors to sell put options for premium in this sector.

Commodities

IMPLICATIONS
FOR INVESTORS

01 Oil prices unlikely to rise sustainably from current levels

02 Gold to remain range-bound

03 Modest retracement of industrial metal prices likely

Supply woes

- Our assessment is oil prices could trade above USD 75/bbl in the near term on continuing geopolitical tensions, but should trend lower in the medium term.
- Gold will likely trade in a broad range (USD 1,250-1,400/oz) as gold demand from rising geopolitical tensions is offset by a stronger USD and rising real yields (net of inflation).
- We are slightly cautious on industrial metals as the outlook surrounding US trade policies, as well as China's growth dynamics remain uncertain.

Figure 34: Commodities: key driving factors and outlook

Commodity	View	Inventory	Production	Demand	Real interest rates	USD	Risk sentiment	Comments
Crude Oil	◆	Neutral	Neutral	Supportive	NA	Not Supportive	Neutral	OPEC cuts to offset rising US shale output; supportive of prices
Gold	◆	Neutral	Neutral	Not Supportive	Neutral	Not Supportive	Neutral	Gradually rising real yields to weigh on gold
Industrial Metals	◆	Neutral	Not Supportive	Neutral	NA	Not Supportive	Neutral	Modest retracement likely as China demand stalls

Source: Standard Chartered Global Investment Committee

Legend: ● Supportive ● Neutral ● Not Supportive ▲ Preferred ▼ Less Preferred ◆ Neutral

Figure 33: Where markets are today

Commodity	Current level	1-month return
Gold (USD/oz)	1305	-1.9%
Crude Oil (USD/bbl)	78.8	7.8%
Industrial Metals (index)	136	0.2%

Source: Bloomberg, Standard Chartered

Diverging performances

Commodities nudged higher in the past month, although the performance within the complex diverged. Crude oil remains a standout performer, registering a gain of 7.8%, while gold fell 1.9% and industrial metals were little changed.

We see a relatively high probability that prices will retrace below USD 75/bbl on a 12-month basis. However, we do not rule out prices climbing higher in the near term given heightened geopolitical uncertainty.

Gold remains caught between competing narratives. We believe rising yields (net of inflation) and USD strength will weigh on prices, although increased geopolitical tensions could provide some support to prices.

The trajectory of industrial metal prices remains highly dependent on still-evolving US trade policies and China demand dynamics. Furthermore, USD strength will also weigh on the industrial metal complex in the near term.

Crude oil – Fundamentals take a break

Oil prices edged higher, amid the Trump administration's announcement that it will withdraw from the Iran deal and reinstate sanctions. Although oil could trade above USD 75/bbl in the near term, we believe oil prices will struggle to rise in a sustained manner from current levels.

Firstly, we believe the bulk of geopolitical risk premia has already been priced in as investors await further clarity on the implications for oil flows. OPEC (especially Saudi Arabia) could also intervene to make up for the expected decline in Iranian and Venezuelan supply.

Secondly, US shale production continues to grow, given their quick reactions to higher oil prices. The operating environment for US shale producers has become tougher due to pipeline transportation bottlenecks. Nevertheless, new pipeline infrastructure should be up and running by mid-2019, which should signal higher US shale production.

Gold – Focus shifts back to real yields

Gold has given back its gains (YTD) as it has been weighed down by rising real yields (net of inflation) and continued USD strength. We believe gold will remain caught between rising geopolitical tensions and US macroeconomic data, and should trade range-bound for the remainder of the year.

Although gold's correlation with the USD remains firm, its relationship with real yields has reasserted itself (*see chart*). We believe gold could face downward pressures as investors turn their attention towards the June FOMC meeting. However, we also believe Middle East geopolitical uncertainties, trade protectionism and the renewed political impasse in Italy could limit the downside for gold prices.

Industrial metals – All eyes on China

Industrial metals were largely flat month-on-month after the US looked to ease sanctions against Russia. Nickel's performance stood out as investors focused on China's push to become a leading electric vehicle (EV) producer.

However, sustained USD strength is a headwind to the broader complex. Additionally, while China has surprised to the upside in Q1, we believe the emphasis on deleveraging will continue – which will impact demand.

Figure 35: Oil prices continue to push higher in spite of a stronger USD

Brent crude oil prices (USD/bbl), US Dollar Index (DXY)

Source: Bloomberg, Standard Chartered

Figure 36: Gold's correlation with 5Y real yields (net of inflation) strengthens again

Gold prices (USD/oz, 5Y UST TIPS yield (%, inverted)

Source: Bloomberg, Standard Chartered

Figure 37: What has changed – Crude oil

Factor	Recent moves
Supply	OPEC compliance firm; US crude oil stocks around five-year averages
Demand	Leading economic indicators in the US rising; China stabilising
USD	Recent uptick; Longer-term trend bearish

Source: Standard Chartered

Figure 38: What has changed – Gold

Factor	Recent moves
Interest rate expectations	US yields have resumed their move upwards given a rising growth outlook
Inflation expectations	Rising in the US; Decreasing in Europe
USD	Recent uptick; Longer-term trend bearish

Source: Standard Chartered

Alternative strategies

IMPLICATIONS
FOR INVESTORS

01 Use both substitutes and diversifiers

02 Global Macro moved to core holding

03 Equity Hedge (most preferred) supported by our reflationary scenario

Global Macro moved to Neutral

- Our alternatives allocation has delivered 0.1% this year and 1.3% since we published our *Outlook 2018*.
- We have upgraded Global Macro to a core holding alongside Relative Value. The positioning of Global Macro as a "diversifier" can be beneficial in a diversified investment allocation.
- We continue to expect our alternatives allocation with a strong tilt toward Equity Hedge to deliver positive returns within a rising rate environment.

Review our diversified alternative strategies

Global Macro strategy has delivered 1.8% month to date, benefitting from higher commodity prices led by oil and strong performance from specific global macro strategies, namely trending-following strategies/CTAs. As we move toward the end of the cycle, the role of Global Macro as a "diversifier" will become increasingly important, given its lower correlations to traditional assets and potentially insurance-like characteristics. The recent upgrade is also supported by our expectation of higher market volatility seen in late stage of the cycle, continued preference for EM assets as well as higher commodities prices.

Our preference towards Equity Hedge, up 1.1% YTD, has contributed significantly to the positive performance of alternatives allocation, up 0.1% over the same period. That said, we acknowledge that potential rebound in volatility due to geopolitical uncertainties, especially closer to the US mid-term election in November, can add downward pressure on risky assets. While Equity Hedge remains the most preferred strategy, we have actively trimmed exposure to Event Driven given its sensitivity to rising rates.

Following recent changes, we have revised our alternatives strategies allocation weights as follows: Equity Hedge 46% (from 40%), Relative Value 28% (from 30%), Event Driven 8% (from 17%) and Global Macro 18% (from 13%). For more information on our alternatives allocation, please refer to *Outlook 2018*

Figure 39: Where markets are today

Alternatives	YTD	1m return
Equity Hedge	1.1%	-0.1%
Relative Value	1.6%	0.5%
Event Driven	-4.1%	-0.1%
Macro CTAs	0.0%	1.8%
Alternatives Allocation	0.1%	0.3%

Source: Bloomberg, Standard Chartered

Figure 40: Traffic light framework alternatives strategies

		Description		View Drivers for strategies to perform	
Substitutes	Equity Hedge	In essence, buying undervalued stocks and selling overvalued stocks	Preferred (▲)	• Positively trending equity markets • Rising equity market dispersion	Supportive Neutral
Substitutes	Relative Value	Looking to take advantage of differences in pricing of related financial instruments	Neutral (◆)	• Falling interest rates/cost of funding • Narrowing credit spreads	Neutral Neutral
Substitutes	Event Driven	Taking positions based on an event such as a merger or acquisition	Less Preferred (▼)	• Positively trending equity markets • Rising mergers and acquisitions • Narrowing credit spreads	Supportive Neutral Neutral
Diversifiers	Global Macro	Looking to exploit themes, trends and asset class relation-ships (correlations) at a global level, generally with leverage	Neutral (◆)	• Rising volatility and credit spreads • Increasing cross asset dispersion • Clear market trends (up/down)	Supportive Neutral Neutral

Source: Standard Chartered

Legend: Supportive | Neutral | Not Supportive | Preferred | Less Preferred | Neutral

FX

IMPLICATIONS
FOR INVESTORS

01 USD weakness medium term

02 EUR strength medium term

03 CNY strength medium term

The USD just had its day in the sun

- We continue to expect USD weakness medium term, as fundamentals remain USD negative. However, in the short term, there is scope for further USD strength
- The EUR is likely to strengthen over the next 12 months as balance-of-payment flows remain supportive. However, weakness could continue near term
- The JPY could extend losses short term as risk sentiment improves, though the medium-term trend remains more uncertain
- We scale back our view on Emerging Market currencies but continue to see pockets of opportunity; we expect further gains in the CNY as policy remains supportive

Figure 42: Foreign exchange; key driving factors and outlook

Currency	View	Real interest rate differentials	Risk sentiment	Commodity prices	Broad USD strength	Comments
USD	Less Preferred	Not Supportive	Neutral	NA	NA	Rate hiking trajectory priced in; twin deficits structurally bearish
EUR	Preferred	Supportive	Supportive	NA	Supportive	Balance of payment fundamentals positive
JPY	Neutral	Not Supportive	Not Supportive	NA	Supportive	Range-bound amid weaker USD
GBP	Neutral	Neutral	Supportive	NA	Supportive	Brexit risks to prevent further gains
AUD	Neutral	Neutral	Supportive	Neutral	Supportive	Fundamental drivers mixed
EM FX	Neutral	NA	Supportive	Neutral	Supportive	More differentiation with this space

Source: Bloomberg, Standard Chartered Global Investment Committee

Legend: Supportive Neutral Not Supportive Preferred Less Preferred Neutral

Figure 41: Where markets are today

FX (against USD)	Current level	1m change
Asia ex-Japan	107	-1.2%
AUD	0.76	-0.4%
EUR	1.17	-4.2%
GBP	1.33	-4.3%
JPY	110	-0.4%
SGD	1.34	-1.3%

Source: Bloomberg, Standard Chartered

Short-term USD strength should not mask longer-term negatives

The USD has continued to strengthen in the past month, in line with our view last month that extreme positioning and sentiment may offer near-term support. Meanwhile, economic momentum outside the US has decelerated and the USD was significantly misaligned from values implied by interest rate differentials. And finally, greater risk-aversion supported the USD against pro-cyclical G10 and EM currencies.

Nevertheless, over the medium term, USD bearish structural factors are likely to prevail. These include an expanding fiscal deficit, which would increase the supply of USD-denominated securities. A rising current account deficit also implies greater need for foreign capital into the US economy. The fact that many Fed hikes are already priced by the market means we expect the rising deficit to result in a weaker USD rather than significantly higher yields. Hence, we continue to believe the USD remains in a long-term structural downtrend, which will likely resume once shorter-term drivers fade.

EUR – short term down, medium term up

The EUR has fallen roughly 6% from its 2018 levels. Sentiment was extremely positive on the EUR and some tempering of optimism was warranted given softer Euro area data. Moreover, concerns related to Italy seeking debt forgiveness following the establishment of a new government has undermined sentiment. Nevertheless, we believe the Euro area recovery remains on track. Economic sentiment indicators have deteriorated from elevated levels, but our assessment is this is not enough to signal a meaningful shift in the ECB's policy outlook and eventual narrowing of interest rate differentials. In conclusion, while there could be further EUR downside in the short term, we would use this as an opportunity to increase exposure to the EUR.

JPY – Short term down, medium term range

Until recently, the JPY was the best performing G10 currency YTD. However, the JPY has now given up almost all of those gains. We believe speculation regarding an earlier BoJ stimulus withdrawal as well as safe-haven demand was largely responsible for the surge in the JPY. With recent easing of trade tensions and less geopolitical noise, we believe risk assets should recover, which implies a JPY weakness. Moreover, recent disappointing Japan data as well BoJ communication has eroded any possibility of a hawkish policy shift. Medium-term, slowing overseas investments coupled with a large current account surplus could limit JPY downside.

GBP – Short term down, medium term range

The GBP has been one of the worst performing G10 currencies over the past month. We attribute two main factors to this. First, the GBP has been very tightly correlated with the USD post-Brexit vote. Second, there has been a significant scaling-back in BoE rate hike expectations in response to weaker UK data. Nevertheless, we believe both these factors are short-term in nature. Although this suggests the recent downturn in the GBP is likely to be temporary, we are not too confident regarding a sustained rally either as Brexit and balance of payment concerns are likely keep GBP from appreciating significantly.

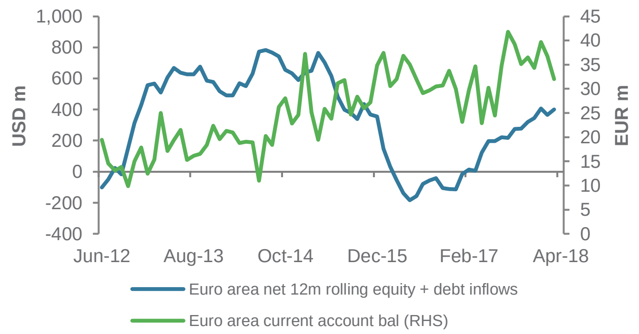
Figure 43: What has changed – G3 currencies

Factor	Recent moves
Real interest rate differentials	Correlation with the USD improving recently; US real interest rate differentials continue to expand
Risk sentiment	Market sentiment improved considerably over the last month; VIX now below 15
Speculator positioning	EUR net-long speculative positioning still at extreme levels, JPY and GBP have become more balanced

Source: Standard Chartered

Figure 44: Euro area capital inflows (debt + equity) continue to rise even as the current account surplus remains elevated

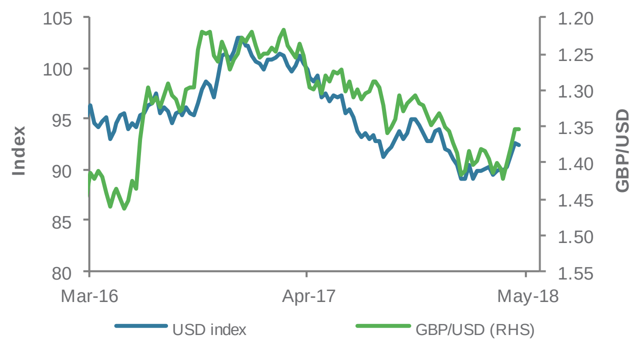
Euro area net 12m equity + debt inflows and current account balance



Source: Bloomberg, Standard Chartered

Figure 45: The GBP has remained closely correlated with the USD post-Brexit vote in the absence of a major local catalyst

GBP/USD (inverse scale) and USD index



Source: Bloomberg, Standard Chartered

AUD – short term down, medium term range

The AUD has weakened further in the last month, amid Australia's worsening yield differential with the US and elevated investor anxiety over trade/geopolitical issues. Given that we have already seen a sharp rise in US yields and the USD, we believe a significant new negative catalyst is needed to push AUD lower from here.

We do not believe fundamentals in Australia have deteriorated sufficiently to warrant a significant dovish shift in monetary policy expectations. At present, market-implied pricing suggests about an even chance of a rate hike within the next 12 months. Moreover, China economic data has remained resilient and this should help to support industrial metal prices in the medium term.

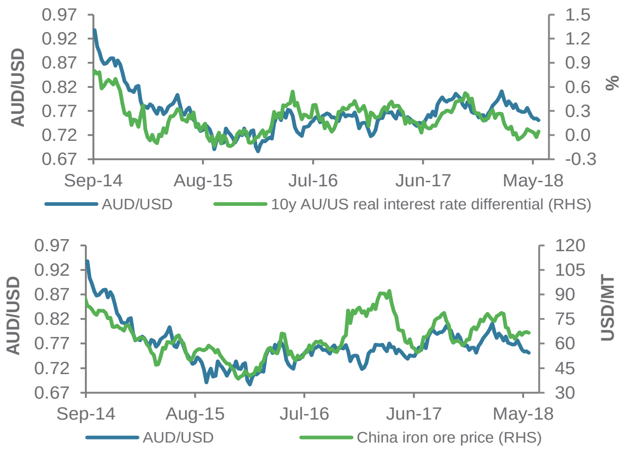
Emerging Market currencies – opportunities likely to be more idiosyncratic

Emerging Markets currencies have come under pressure in the last month against the backdrop of a stronger USD and a surge in US yields. Nevertheless, performance across currency pairs has not been uniform. For example, within Asia, relatively low yielding currencies, such as the KRW and CNY, have remained resilient, while the higher yielding INR and IDR have weakened considerably. In addition to this, we have seen a number of idiosyncratic factors play out including the currency/debt crisis in Argentina, sanctions on Russia, elections in Brazil and political/economic risks in Turkey. Given the significant differentiation within EMs, we have closed our broad bullish view on EM currencies as a whole, and instead focus on specific opportunities.

The CNY has remained resilient to USD strength as the PBoC has not guided the daily USD/CNY fixing higher in response to the weaker USD. This has resulted in the trade-weighted CNY appreciating further. This suggests that authorities are still comfortable allowing exchange rate appreciation. China data surprises still remain positive, even as they have turned negative in many other major economies. Furthermore, we believe the bar for China devaluing its currency remains high against the current backdrop of trade issues. As a result, we expect further CNY strength as the recent USD rally matures and sentiment towards riskier assets improves.

Figure 46: Declining yield differential has pushed the AUD lower, though iron ore prices have been more supportive

AUD/USD, AU-US 10y real interest rate differential, China iron ore prices



Source: Bloomberg, Standard Chartered

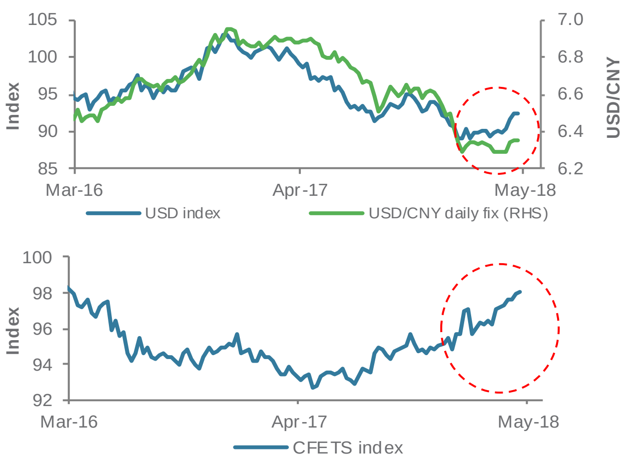
Figure 47: What has changed in Emerging Market currencies

Factor	Recent moves
USD	The USD continues to trend higher
China risks	China economic surprises remain positive though have moderated recently
Risk sentiment	EM FX volatility picked up meaningfully over the last 1 month

Source: Standard Chartered

Figure 48: PBoC hasn't been fixing USD/CNY higher in response to a stronger USD, tolerating more CNY exchange rate strength

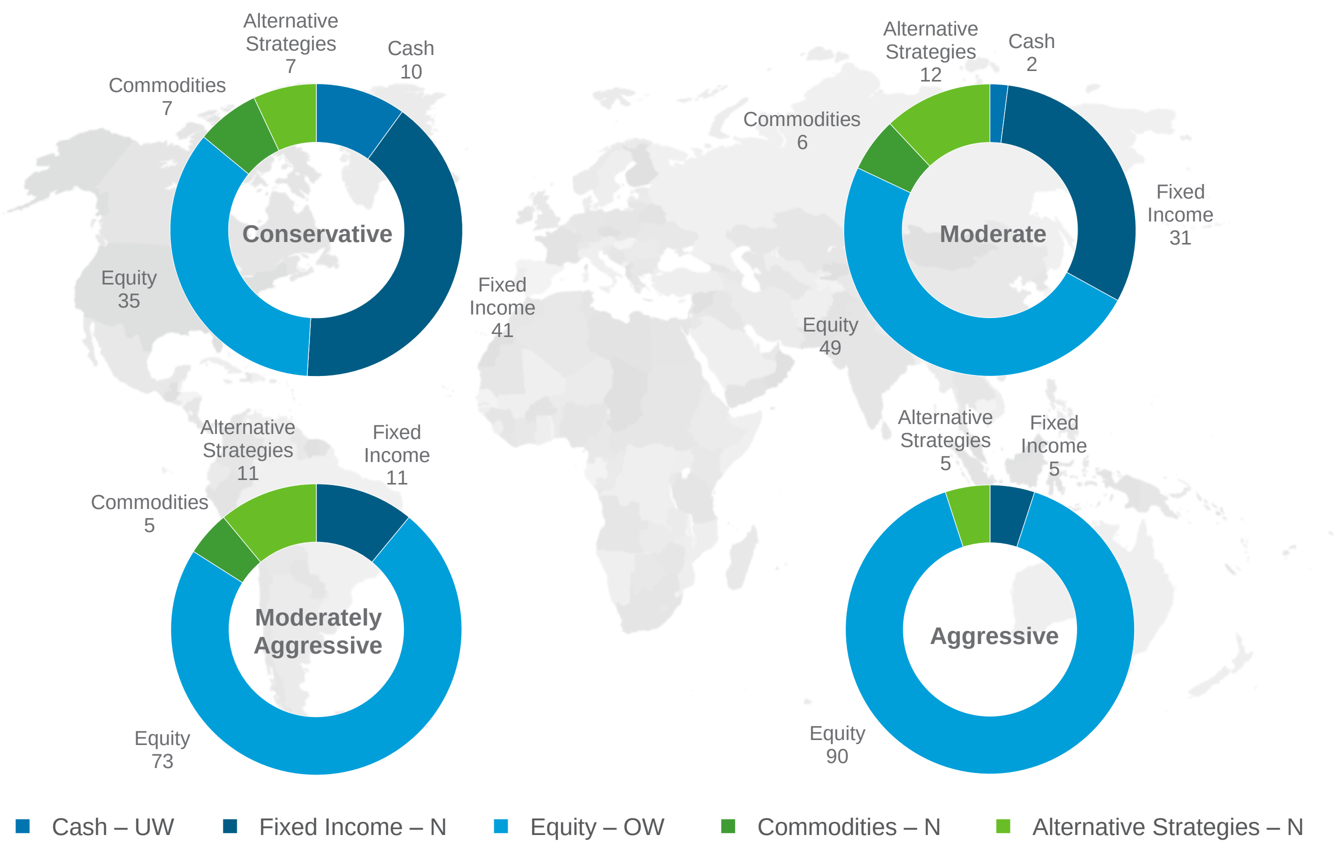
PBoC daily CNY fix, USD index and CFETS China trade-weighted index



Source: Bloomberg, Standard Chartered

Global asset allocation summary

Global-focused Tactical Asset Allocation - June 2018 (12M). All figures are in percentages.



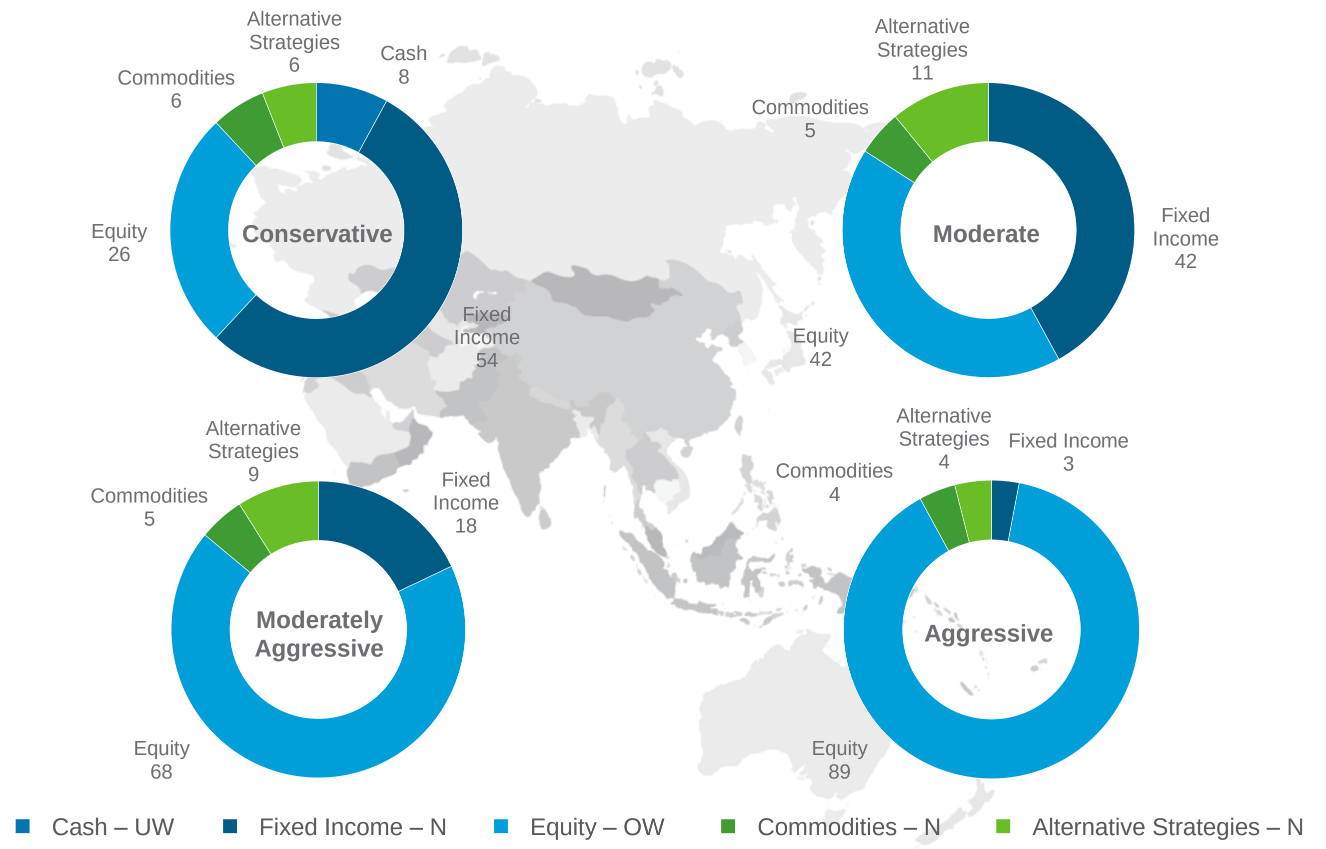
Asset class	Region	View vs. SAA	Conservative	Moderate	Moderately aggressive	Aggressive
Cash & Cash Equivalents	USD Cash	UW	10	2	0	0
Developed Market Bonds	DM Government Bonds (FX hedged)	UW	18	14	5	2
	DM IG Corporate Bonds (FX hedged)	N	14	11	4	3
	DM HY Corporate Bonds	N	4	2	2	0
Emerging Market Bonds	EM USD Sovereign Bonds	OW	5	4	0	0
	EM Local Ccy Sovereign Bonds	OW	0	0	0	0
	Asia Corporate USD Bonds	N	0	0	0	0
Developed Market Equity	North America	OW	19	28	41	51
	Europe ex-UK	N	6	7	11	13
	UK	UW	0	0	2	2
	Japan	N	3	4	5	6
Emerging Market Equity	Asia ex-Japan	OW	7	10	12	15
	Non-Asia EM	N	0	0	2	3
Commodities	Commodities	N	7	6	5	0
Alternative Strategies		N	7	12	11	5

Source: Bloomberg, Standard Chartered

For illustrative purposes only. Please refer to the disclosure appendix at the end of the document.

Asia asset allocation summary

Asia-focused Tactical Asset Allocation - June 2018 (12M). All figures are in percentages.



Asset class	Region	View vs. SAA	Conservative	Moderate	Moderately aggressive	Aggressive
Cash & Cash Equivalents	USD Cash	UW	8	0	0	0
Developed Market Bonds	DM Government Bonds (FX hedged)	UW	8	7	3	0
	DM IG Corporate Bonds (FX hedged)	N	7	6	3	0
	DM HY Corporate Bonds	N	3	3	0	0
Emerging Market Bonds	EM USD Sovereign Bonds	OW	13	10	5	0
	EM Local Ccy Sovereign Bonds	OW	13	10	4	0
	Asia Corporate USD Bonds	N	10	6	3	3
Developed Market Equity	North America	OW	8	13	20	26
	Europe ex-UK	N	3	7	11	14
	UK	UW	0	0	0	2
	Japan	N	2	0	3	4
Emerging Market Equity	Asia ex-Japan	OW	11	19	28	36
	Non-Asia EM	N	2	3	6	7
Commodities	Commodities	N	6	5	5	4
Alternative Strategies		N	6	11	9	4

Source: Bloomberg, Standard Chartered

For illustrative purposes only. Please refer to the disclosure appendix at the end of the document.

Market performance summary*

Equity

	Year to date		1 month	
Global Equities	1.2%	↑	1.6%	↑
Global High Dividend Yield Equities	-1.5%	↓	0.2%	↑
Developed Markets (DM)	1.6%	↑	2.1%	↑
Emerging Markets (EM)	-1.4%	↓	-1.5%	↓
BY COUNTRY				
US	2.7%	↑	3.6%	↑
Western Europe (Local)	1.7%	↑	2.3%	↑
Western Europe (USD)	-0.4%	↓	-1.4%	↓
Japan (Local)	-1.6%	↓	0.1%	↑
Japan (USD)	1.7%	↑	0.2%	↑
Australia	-1.9%	↓	2.4%	↑
Asia ex- Japan	0.6%	↑	0.5%	↑
Africa	-7.6%	↓	-3.0%	↓
Eastern Europe	-2.6%	↓	-1.7%	↓
Latam	-4.0%	↓	-9.7%	↓
Middle East	11.4%	↑	-2.2%	↓
China	4.2%	↑	3.3%	↑
India	-9.3%	↓	-5.8%	↓
South Korea	-1.2%	↓	-0.1%	↓
Taiwan	2.0%	↑	1.9%	↑
BY SECTOR				
Consumer Discretionary	4.2%	↑	2.2%	↑
Consumer Staples	-7.8%	↓	-0.1%	↓
Energy	5.9%	↑	2.1%	↑
Financial	-1.5%	↓	-1.6%	↓
Healthcare	1.0%	↑	1.7%	↑
Industrial	0.2%	↑	1.4%	↑
IT	8.4%	↑	6.7%	↑
Materials	0.2%	↑	1.2%	↑
Telecom	-7.9%	↓	-4.9%	↓
Utilities	-1.1%	↓	-0.7%	↓
Global Property Equity/REITS	-1.2%	↓	2.6%	↑

Bonds

	Year to date		1 month	
SOVEREIGN				
Global IG Sovereign	-1.1%	↓	-1.7%	↓
US Sovereign	-2.0%	↓	0.3%	↑
EU Sovereign	-2.0%	↓	-3.3%	↓
EM Sovereign Hard Currency	-3.8%	↓	-1.2%	↓
EM Sovereign Local Currency	-3.0%	↓	-4.8%	↓
Asia EM Local Currency	-2.8%	↓	-2.3%	↓
CREDIT				
Global IG Corporates	-3.1%	↓	-1.3%	↓
Global HY Corporates	-1.7%	↓	-1.5%	↓
US High Yield	-0.2%	↓	0.0%	↑
Europe High Yield	-2.7%	↓	-4.7%	↓
Asia High Yield Corporates	-2.3%	↓	-0.3%	↓

Commodity

	Year to date		1 month	
Diversified Commodity	4.5%	↑	2.9%	↑
Agriculture	4.9%	↑	3.6%	↑
Energy	11.8%	↑	6.0%	↑
Industrial Metal	-1.7%	↓	0.2%	↑
Precious Metal	-1.8%	↓	-1.8%	↓
Crude Oil	20.3%	↑	7.8%	↑
Gold	0.1%	↑	-1.9%	↓

FX (against USD)

	Year to date		1 month	
Asia ex- Japan	0.0%	↑	-1.2%	↓
AUD	-3.0%	↓	-0.4%	↓
EUR	-2.4%	↓	-4.2%	↓
GBP	-1.0%	↓	-4.3%	↓
JPY	3.1%	↑	-0.4%	↓
SGD	-0.3%	↓	-1.3%	↓

Alternatives

	Year to date		1 month	
Composite (All strategies)	-0.3%	↓	0.4%	↑
Relative Value	1.6%	↑	0.5%	↑
Event Driven	-4.1%	↓	-0.1%	↓
Equity Long/Short	1.1%	↑	-0.1%	↓
Macro CTAs	0.0%	↑	1.8%	↑

Source: MSCI, JPMorgan, Barclays, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

*All performance shown in USD terms, unless otherwise stated

*YTD performance data from 31 December 2017 to 24 May 2018 and 1-month performance from 24 April 2018 to 24 May 2018

Events calendar

2018

APRIL

- 08 BoJ Governor Kuroda starts his second term
- 26 ECB policy decision
- 27 BoJ policy decision
- 27 North Korean leader Kim Jong Un meets South Korean President Moon Jae-in

MAY

- 03 FOMC policy decision
- 09 Malaysia General Election
- 12 President Trump to decide on Iran nuclear pact

JUNE

- 8-9 G7 Summit in Canada
- 14 FOMC policy decision
- 14 ECB policy decision
- 15 BoJ policy decision
- 22 OPEC meeting

JULY

- 01 Mexico Presidential and Parliamentary elections
- 26 ECB policy decision
- 31 BoJ policy decision

AUGUST

- 02 FOMC policy decision

SEPTEMBER

- X Japan LDP President election where Prime Minister Abe faces challengers
- 13 ECB policy decision
- 19 BoJ policy decision
- 27 FOMC policy decision

OCTOBER

- 7 Brazil elections – 1st round
- 25 ECB policy decision
- 28 Brazil elections – 2nd round
- 31 BoJ policy decision

NOVEMBER

- 06 US House (all 435 seats) and Senate (33 out of 100 seats) elections
- 09 FOMC policy decision
- 12-18 APEC Summit

DECEMBER

- 13 ECB policy decision
- 20 FOMC policy decision
- 20 BoJ policy decision

2019

JANUARY

- 31 Fed policy meeting

FEBRUARY

- 16 Nigeria general election due
- X Thailand to hold general elections

MARCH

- 29 UK to leave the EU

Legend: X – Date not confirmed | **ECB** – European Central Bank | **FOMC** – Federal Open Market Committee (US) | **BoJ** – Bank of Japan

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