Standard Chartered Private Bank

weekly market view

macro strategy | 16 November 2018

This reflects the views of the Wealth Management Group

Editorial

Oil slump, Brexit talks in focus

- **Oil's pullback and any progress on a Brexit deal are likely positives for risk sentiment. Any breakthrough in US-China trade talks is a possible trigger for a recovery in risk assets.**
- **Equities:** Reports the US and China had resumed trade talks and signs of stabilisation in China's economic data are positives for China and Asia stocks.
- **Bonds:** The drop in oil prices has lowered inflation expectations, limiting the upside for US Treasury yields. We expect oil prices to stabilise, supporting EM USD bonds.
- **FX:** We expect AUD/USD recovery towards 0.7480 on renewed hopes of a US-China trade deal. GBP has supports around 1.2660 and 1.2500 after its drop amid UK minister resignations.

What's new?

- **The post-US election bounce fades.** Global stocks resumed their decline after a brief post-US midterms bounce. Although US Q3 earnings beat expectations, cautious earnings guidance and concerns about new orders have weighed on the US technology sector. Meanwhile, the oil price decline dragged the energy sector lower. In our assessment, the market is over-reacting to normal fluctuations in orders; we retain our preference for the US technology sector given a structurally strong demand outlook that is likely to drive earnings. Also, we believe oil is likely to stabilise around current levels, supporting the US energy sector. Technically, the S&P500 index has strong support at the February low of 2,533, but needs to break above the 2,817 resistance for a sustainable rebound. Hong Kong's Hang Seng index looks deeply oversold as it tests a key support. Any breakthrough in US-China trade talks could trigger a rebound.
- **Oil extends slide.** Crude oil prices have fallen c.25% since October highs on concerns about rising US supplies and select US sanction waivers for Iranian oil exports. A cut in OPEC's global demand outlook by 0.5mbpd also played a part. However, speculative positions have corrected sharply, technical indicators suggest oil is oversold and Brent prices continue to hold above the 100- and 200-week moving averages. Unless global demand outlook drops further (unlikely, in our view, given a still-robust global growth outlook), we expect oil to trade in the USD65-85/bbl range over the next 12 months. The latest pullback in oil prices is positive for major economies worldwide since high prices hurt consumers' disposable income.
- **Brexit deal expectations rise, but May needs House support.** The GBP had a volatile week. Expectations of a UK-EU Brexit deal getting the UK cabinet's approval initially provided a lift to the currency, before cabinet resignations revived the possibility of Prime Minister May losing majority support in parliament. We expect market volatility to continue in the coming weeks, with the possibility of elections. The uncertainty is likely to keep the GBP under pressure near term. (See page 3 for possible scenarios).

What we are watching

- **Italy budget.** Italy has stuck to its budget deficit forecasts for 2019, despite EU objections, raising the risk of a widening rift.

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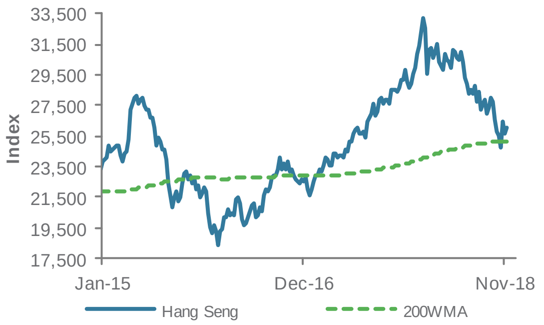
Hong Kong stocks have held above a long-term support level; any breakthrough in US-China trade talks could trigger a rebound

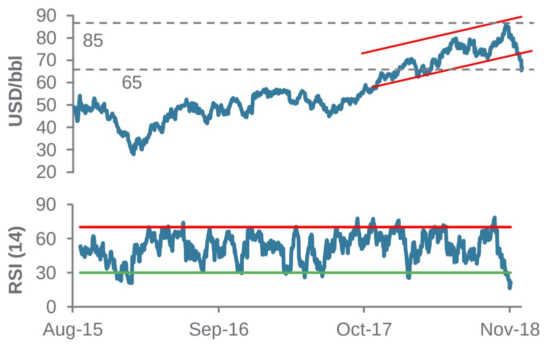
Hang Seng index and 200-week moving average



Source: Bloomberg, Standard Chartered

Brent crude oil prices have fallen below an uptrend line, but remain within the USD65-85/bbl range

Brent crude oil prices and Relative Strength Index (an indicator of overbought or oversold conditions)



Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities gave up early November gains, led by losses in Europe and the US, amid political concerns and cautious earnings guidance. Crude oil extended fall to an eight-month low.

Equities: Awaiting positive catalysts

- **Hong Kong, China markets focus on US-China trade deal likelihood.** Sentiment for HK and China markets has improved after reports of US and China resuming trade discussions. The talks come ahead of the planned meeting between President Trump and Xi at the G20 summit in Buenos Aires later this month. Also, recent Chinese economic data has shown signs of stabilisation in October, with infrastructure investment and industrial production picking up. The MSCI China index is trading at a consensus 12-month forward P/E of 10.3x, which is below its long-term average, while both the Hang Seng Index and CSI 300 indices are near key technical support. We believe positive developments on trade could trigger a near-term rebound. China remains our preferred market in the Asia ex Japan region.
- **EM outlook key for Euro area equities.** European equities have given a muted reaction to the prospects of a Brexit deal that would reduce the risk of a hard Brexit. The muted reaction reflects the greater dependence of equities on Emerging Markets (EM) as opposed to the UK for growth. China economic data has shown some signs of improvement – any recovery here would be positive for Euro area and UK equities, which remain core holdings given their attractive valuations.

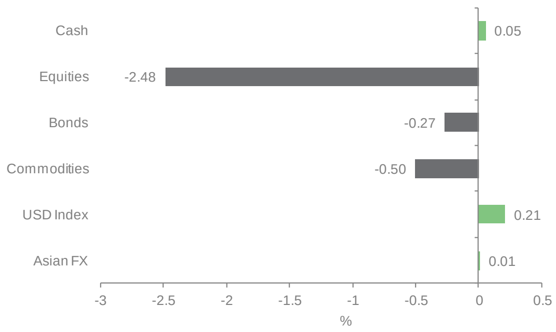
Bonds: Oil drives EM bonds

- **Oil price pullback likely to cap Treasury yields.** The sharp drop in oil prices meant the market's inflation expectations declined. This, along with lower US equities, meant US Treasury yields declined. Reduced risks of an oil-led inflation spike reinforce our view that 10-year yields are likely to be capped at around 3.25%.
- **EM bonds under pressure.** EM USD government bonds delivered negative returns over the past week despite the decline in US Treasury yields. Lower oil prices (many EM countries are oil exporters) and weak sentiment have led to an increase in yield premiums. EM local currency bonds also delivered negative returns, hurt by currency weakness. However, we expect the weakness in oil prices and investor sentiment to stabilise. We continue to favour EM USD government bonds as we like the attractive yield on offer and the relative value offered over US corporate bonds.

FX: GBP falls amid renewed Brexit uncertainty

- **GBP/USD testing key support.** GBP suffered its biggest one-day drop in two years following the resignations of UK ministers in protest against Prime Minister Theresa May's draft Brexit agreement with the EU. Although May has secured cabinet approval for the deal, there is talk of a no-confidence vote (see page 3 for scenarios). GBP/USD is now testing the August low of 1.2660. Any break could pave the way toward 1.2500.
- **Turning positive on AUD/USD.** Optimism over a US-China trade deal has triggered a sentiment change for the USD and is expected to support Australian exports. Iron ore prices remain firm and short AUD speculative positioning is at extremes – both are supportive for AUD. We expect the AUD to recover towards 0.7480 after clearing the immediate hurdle of 0.7315. A key risk is the lack of any US-China breakthrough on trade during talks later this month.

Benchmark (USD) performance w/w*



**Week of 08 November 2018 to 15 November 2018*

Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

Most equity market technicals have turned positive

Technical levels of key market indicators as on 15 Nov.

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,730	2,650	2,775	↘
STOXX 50	3,190	3,160	3,270	↗
FTSE 100	7,038	6,940	7,220	↗
Nikkei 225	21,804	21,470	22,600	↗
Shanghai Comp	2,668	2,520	2,745	↗
Hang Seng	26,103	25,000	26,600	↗
MSCI Asia ex-Japan	605	583	615	↗
MSCI EM	981	955	1,007	↗
Brent (ICE)	67	62	74	↓
Gold	1,214	1,180	1,240	↓
UST 10Y Yield	3.11	3.02	3.27	↗

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

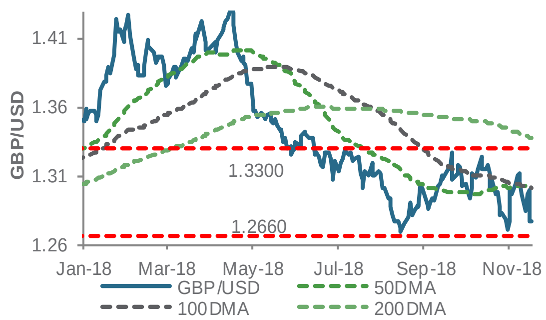
The decline in US inflation expectations due to the pullback in oil prices is likely to cap Treasury yields

US 10-year Treasury yields and inflation expectations

Source: Bloomberg, Standard Chartered

GBP/USD fell the most in two years amid renewed Brexit risks

GBP/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What are the implications of recent Brexit developments?

The past week has seen some progress in the Brexit process, but there is still a lot of uncertainty about how this will play out.

The EU and UK have finally agreed a draft agreement of how Brexit will be managed. Moreover, after intensive discussions, the UK Cabinet accepted this agreement. The next step is for the agreement to be presented for ratification in the UK Houses of Parliament.

For the agreement to pass through Parliament, the government needs 320 votes (out of a possible 639). The challenge is that the government's majority (326) relies on the support of around 40 Conservative MPs who are likely to vote against the Brexit deal, because they are sympathetic to a 'hard' Brexit. The majority also depends on 10 Democratic Unionist Party MPs who want to avoid any trade barriers between Northern Ireland and 1) the rest of the United Kingdom (which would exit the EU) and 2) the Republic of Ireland (which would remain in the EU).

Our assessment is that while the draft agreed between the UK and EU is not perfect for Northern Ireland, many members from both the ruling and opposition parties may well decide that this is the best deal available and be persuaded to vote in favour of the deal.

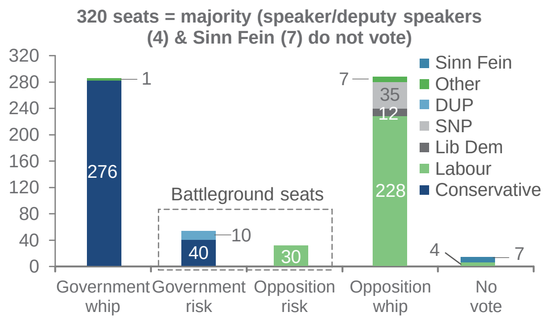
However, Brexiteers are likely to be harder to persuade as the deal requires continued budget payments to the EU for decades (albeit on a declining scale) and the need for UK companies to abide by certain EU regulations. The Brexit minister's resignations merely reinforce the challenges ahead and suggest the government may have to rely on votes from the opposition (around 30 Labour Party MPs are seen as being sympathetic to a 'soft' Brexit or no Brexit).

When announcing the deal, Prime Minister May implicitly acknowledged the challenges ahead by stressing the only options available to Parliament are to accept the deal, accept a 'no-deal/hard' Brexit (unacceptable to the DUP) or go back to people via an election or another referendum (which the Brexiteers do not want, although the Labour Party may want the latter).

Therefore, we are faced with the very strange situation wherein the electorate and possibly a majority of MPs seem to want a soft Brexit or no Brexit, but the path to that outcome is still unclear and muddied by party politics. The optimistic view is that MPs will vote along with either their own preferences or those of the electorate and the agreement is passed in the first vote. We believe a more realistic view is that this becomes a drawn-out process, which includes more than one vote and potentially a return to the electorate in some form. Against this backdrop, we expect UK markets to remain volatile and the GBP under pressure until further clarity emerges from the UK parliament on whether May has sufficient support for her draft agreement.

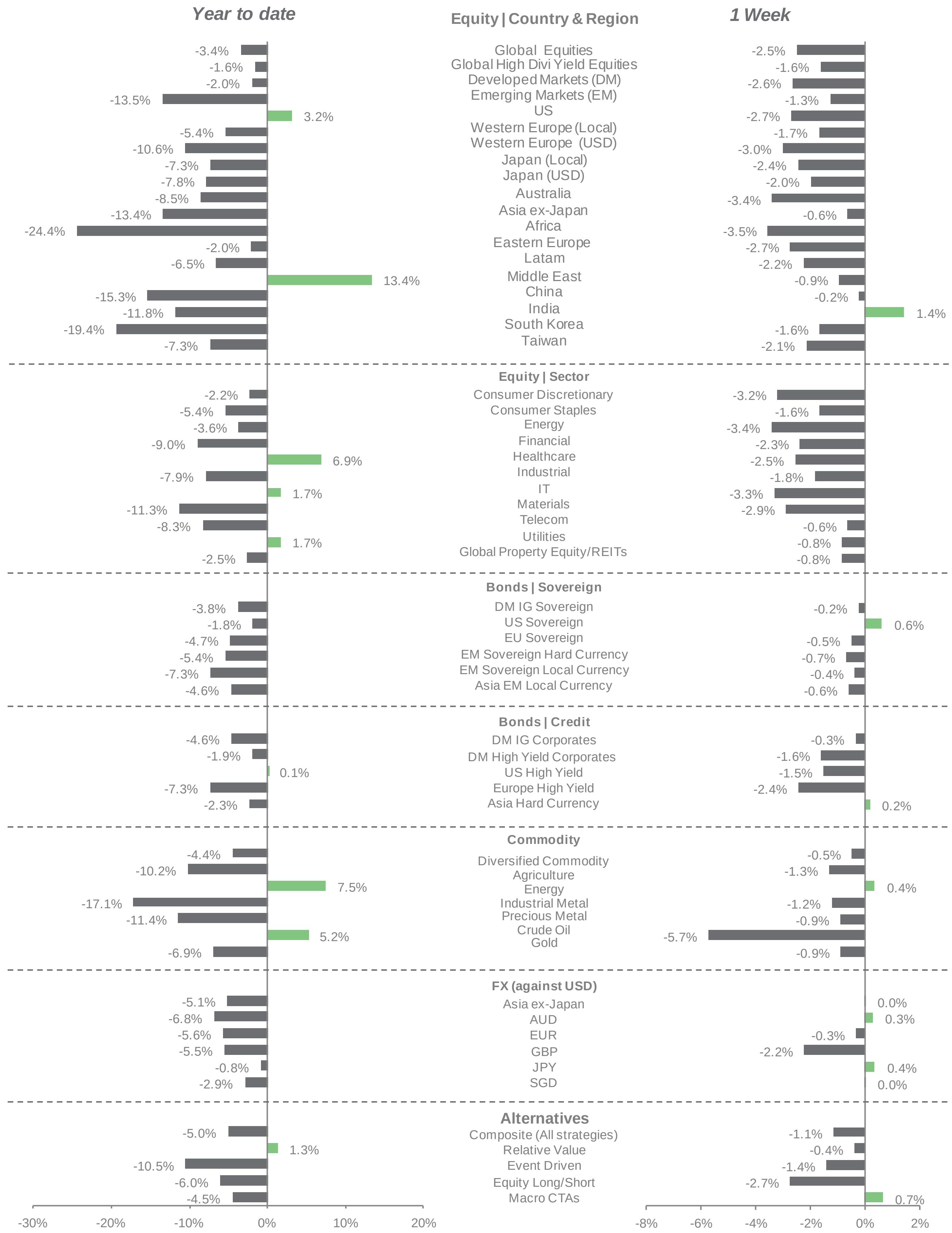
UK Prime Minister May needs the support of members from outside her Conservative Party to win any no-confidence vote and approval for her Brexit plan

Party breakdown of the UK's lower house of parliament, including possible supporters and antagonists of the draft Brexit agreement



Source: Bloomberg, Standard Chartered

Market performance summary*



*Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 15 November 2018, 1 week period: 08 November 2018 to 15 November 2018

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

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	JN	Exports y/y	19-Nov-18	Oct	9.1%	-1.3%
	EC	ECB Current Account SA	19-Nov-18	Sep	–	23.9b
TUE	US	Building Permits	20-Nov-18	Oct	1260k	1270k
	US	Housing Starts	20-Nov-18	Oct	1225k	1201k
WED	US	Cap Goods Orders Nondef Ex Air	21-Nov-18	Oct P	–	-0.1%
	US	Leading Index	21-Nov-18	Oct	0.1%	0.5%
THUR	JN	Natl CPI y/y	22-Nov-18	Oct	1.4%	1.2%
	EC	Consumer Confidence	22-Nov-18	Nov A	–	-2.7
FRI/SAT	GE	Exports q/q	23-Nov-18	3Q	–	0.7%
	GE	Markit/BME Germany Manufacturing PMI	23-Nov-18	Nov P	–	52.2
	EC	Markit Eurozone Composite PMI	23-Nov-18	Nov P	–	53.1
	EC	Markit Eurozone Manufacturing PMI	23-Nov-18	Nov P	–	52.0
	EC	Markit Eurozone Services PMI	23-Nov-18	Nov P	–	53.7
	US	Markit US Composite PMI	23-Nov-18	Nov P	–	54.9

	Event	This Week	Date	Period	Actual	Prior
MON	JN	PPI y/y	12-Nov-18	Oct	2.9%	3.0%
	IN	CPI y/y	12-Nov-18	Oct	3.3%	3.7%
	IN	Industrial Production y/y	12-Nov-18	Sep	4.5%	4.7%
TUE	CH	New Yuan Loans CNY	13-Nov-18	Oct	697.0b	1380.0b
	UK	ILO Unemployment Rate 3m	13-Nov-18	Sep	4.1%	4.0%
	EC	ZEW Survey Expectations	13-Nov-18	Nov	-22.0	-19.4
WED	CH	Retail Sales y/y	14-Nov-18	Oct	8.6%	9.2%
	CH	Industrial Production y/y	14-Nov-18	Oct	5.9%	5.8%
	CH	Fixed Assets Ex Rural YTD y/y	14-Nov-18	Oct	5.7%	5.4%
	UK	CPI Core y/y	14-Nov-18	Oct	1.9%	1.9%
	US	CPI Ex Food and Energy y/y	14-Nov-18	Oct	2.1%	2.2%
THUR	UK	Retail Sales Ex Auto Fuel y/y	15-Nov-18	Oct	2.7%	3.6%
	US	Retail Sales Ex Auto and Gas	15-Nov-18	Oct	0.3%	0.0%
FRI/ SAT	US	Industrial Production m/m	16-Nov-18	Oct		0.3%

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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