Standard Chartered
Private Bank

weekly market view

macro strategy | 20 April 2018

This reflects the views of the Wealth Management Group

Editorial

Signals from the bond market

- **We do not agree with recent concerns that the bond market is signalling higher risk of a US recession, given solid economic data and strong corporate earnings.**
- **Equities:** US Q1 earnings have surprised positively so far, supporting our bullish view of the market. We believe concerns about China technology sector and HKD stability are overblown.
- **Bonds:** EM local currency bonds rebounded, reversing earlier Russia sanction-related declines. We would continue to switch from DM HY bonds to EM government bonds.
- **FX:** We turn cautious on GBP/USD after weaker-than-expected wage growth and inflation data. We believe AUD/USD could rise further, helped by strong China data and commodity prices.

What's new

- **Bond market signals.** The gap between US 10-year and 2-year bond yields fell to a 10-year low this week, raising concerns among some investors, given that long-term yields falling below short-term yields (an "inverted yield curve") has historically foretold a recession. We do not share these concerns because: a) the curve has not inverted yet, b) recent US economic data has remained robust - notably US retail sales rebounded in March, though industrial production cooled after a surge in February, and c) US companies are set to report their strongest earnings growth in eight years. Short-term yields have also been boosted by the US Treasury borrowing over shorter tenures to fund the growing US budget deficit and due to increased expectations of a Fed rate hike in June. As such, we remain positive on risk assets, preferring equities in Asia ex-Japan.
- **China technology concerns.** The MSCI China and Hang Seng indices fell below their 100DMAs. A US government ban on component supply to a Chinese technology company has raised concerns. We view the decision as company specific and unrelated to trade disputes (see page 3). China remains our preferred market in Asia ex-Japan amid strong earnings expectations.
- **HKD weakness.** We expect HKD weakness to be limited as the HKMA has ample ability to buy the currency to keep it within its target band, while local short-term rates rise to align with USD borrowing costs. Although higher rates are negative for the HK property sector, banks are possible beneficiaries (see page 3).
- **Turning cautious on GBP; remain positive on AUD.** GBP/USD hit a post-Brexit high of 1.4375 before turning lower following weaker-than-expected UK wage and inflation data. We believe caution is warranted as weak data may lead the BoE to defer a rate hike in May. Hence, we have taken profit on our long GBP/USD trade idea. We also see more upside for AUD/USD towards 0.79 amid robust China data and commodity prices.

What we are watching

- **ECB policy.** Euro area business and investor confidence has softened in recent months amid trade tensions, raising the prospect of ECB delaying the end of its bond-buying programme.

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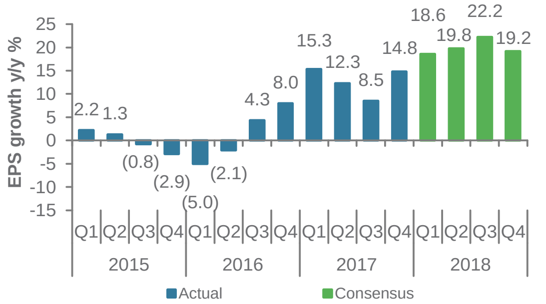
US earnings growth this year is estimated to be the strongest in eight years

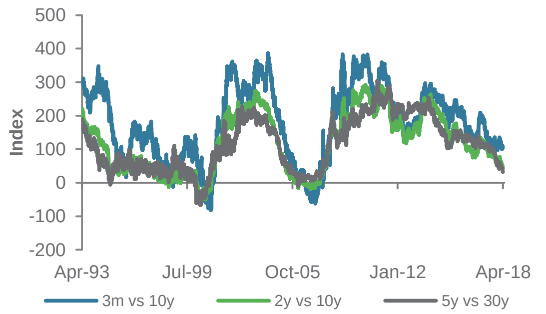
Consensus estimates of quarterly earnings growth at S&P500 index members



Source: FactSet, Standard Chartered

A key set of indicators of a potential US recession not suggesting cause for concern

Gap between US 3m and 10Y bond yields, 2Y and 10Y yields and 5Y and 30y yields



Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities and commodities extended gains amid strong US earnings and rising metal prices. Crude oil prices rose further amid falling US inventory.

Equities: US earnings beat expectations

- **US earnings.** The S&P500 rebounded from its 200DMA to scale above its 50-DMA, driven by strong earnings surprises in the consumer discretionary sector. However, the financial sector underperformed despite posting better-than-expected earnings. Concerns about margins on mortgage loans and lacklustre trading revenue dampened sentiment. Overall guidance remains upbeat despite recent trade tensions. We retain US equities as a core holding as earnings are likely to remain robust amid healthy consumer demand, resurgence of share buybacks, higher capital spending and improved productivity. Valuations have turned cheaper, with the S&P500 trading at a 12m forward P/E of 16.5 versus the January peak of 18.3.
- **Euro area earnings expectations.** Euro area 2018 earnings growth expectations have remained unchanged at 8.5% since the start of the year as EUR strength remains a drag on exporter earnings. We believe the divergence in US and Euro area economic growth momentum could cause a divergence in earnings growth, to the US' benefit, especially against the backdrop of US corporate tax cuts.

Bonds: Opportunity to switch from DM HY to EM bonds

- **US Treasury yields rise.** US 10-year yields rose above 2.9% on robust data and easing concerns about trade wars. The Fed's meeting minutes and Beige Book survey reflected confidence in the outlook, leading markets to assign a 90% probability of a rate hike in June. We remain cautious on Development Market (DM) government bonds given the low level of yields.
- **DM HY bonds rally.** A return in risk appetite and higher oil prices has driven DM HY valuations close to their highest since 2007. We would look to use these gains as an opportunity to rotate into our preferred areas in EM government bonds. Asian USD bonds held steady despite the increase in supply from Chinese HY issuers, helped by strong performance from Indonesian bonds following the sovereign rating upgrade from Moody's.

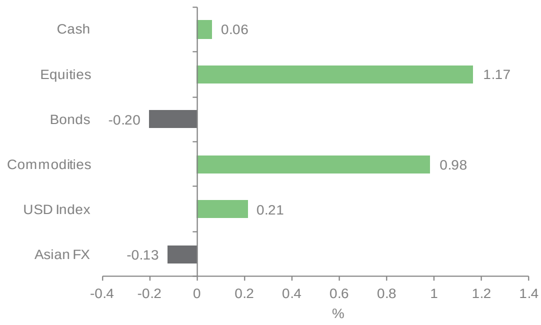
FX: Remain bullish on USD/JPY

- **USD/JPY to benefit from improving risk sentiment.** The pair is likely to be supported by the risk-on sentiment as trade tensions dissipate. The BoJ is likely to reaffirm its statement at its policy meeting next week that it is too early to consider stimulus withdrawal. Given this, we expect further upside for the pair, especially after the recent breach above 107.31.
- **USD/CAD bounces after BoC holds rates.** The BoC statement was less hawkish than expected. Despite concerns about elevated housing markets in Toronto and Vancouver, we believe positive factors, such as high oil prices and expectations of a revised NAFTA agreement being confirmed in the coming weeks, are likely to support the CAD and drive USD/CAD towards 1.24.

Commodities: Oil climbs to a three-year high

- **Metals, oil climb on Russian sanctions, inventory decline.** The US' expanded sanctions against Russia have driven aluminium prices to their highest since 2011 amid concerns about supply shortages. Oil prices rose to their highest in over three years amid a decline in US inventory. We see robust global growth supporting commodity prices, though further significant gains may be limited in the absence of major supply disruptions.

Benchmark (USD) performance w/w*



**Week of 12 April 2018 to 19 April 2018*

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

S&P500 has the strongest near-term technicals

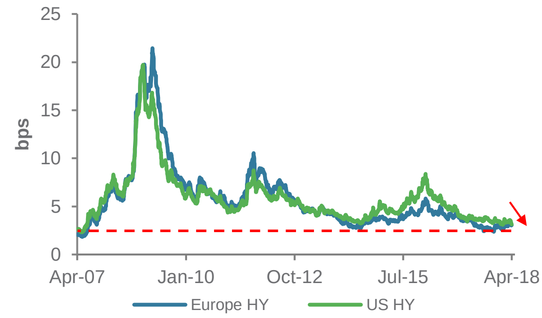
Technical levels of key market indicators as on 19 April

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,693	2,625	2,745	↑
STOXX 50	3,487	3,400	3,523	↗
FTSE 100	7,329	7,159	7,375	↗
Nikkei 225	22,191	21,050	22,500	↗
Shanghai Comp	3,117	3,020	3,230	↘
Hang Seng	30,708	29,130	31,800	→
MSCI Asia ex-Japan	728	691	750	↘
MSCI EM	1,184	1,136	1,227	↘
Brent crude oil (ICE)	74	67	78	↗
Gold	1,344	1,305	1,366	↗
UST 10Y Yield	2.91	2.60	2.95	↗

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

DM HY bond yield premiums over government bonds are near their lowest since 2007

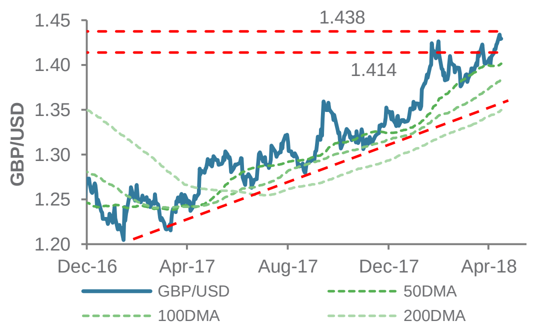
US and European HY bond yield premiums over government bonds



Source: Bloomberg, Standard Chartered

GBP/USD is close to a key resistance

GBP/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What are the implications of recent HKD weakness?

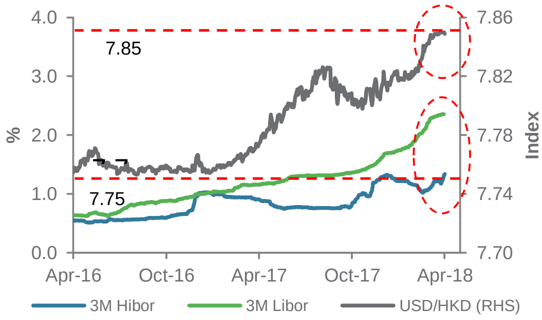
The HKD has weakened to the top of the USD-HKD 7.75-7.85 policy band against the backdrop of a widening gap between short-term USD and HKD interest rates, which make USD deposits relatively more attractive. The Hong Kong Monetary Authority (HKMA) has intervened to keep USD-HKD within the range by selling USDs and buying HKDs. This effective removal of HKD liquidity from the system has put upward pressure on HKD interest rates.

We believe the USD-HKD 'peg' remains a key pillar of HK's monetary policy and expect the HKMA to continue intervening as necessary to stop the HKD weakening beyond the top of the band. This is likely to add further upward pressure on HKD interest rates till the short-term USD-HKD interest rate differentials narrows significantly.

While interest rates are still low from a historical perspective, the fear is that rising local interest rates could undermine support for the HK property market. We believe the HK REITs sector, which has performed very well in recent months, is likely to come under pressure against this backdrop. The property sector may also be negatively impacted by higher interest rates. On the other hand, banks should benefit, though the extent would depend on whether interest rate increases curtail the pace of credit growth.

USD/HKD hits the top of HKMA's trading band as the gap between the USD Libor and HKD short-term rates widened

USD/HKD and HKMA's trading band; USD 3m Libor rates and HKD 3m Hibor rates



Source: Bloomberg, Standard Chartered

Q2. What are the implications of US/China trade tensions?

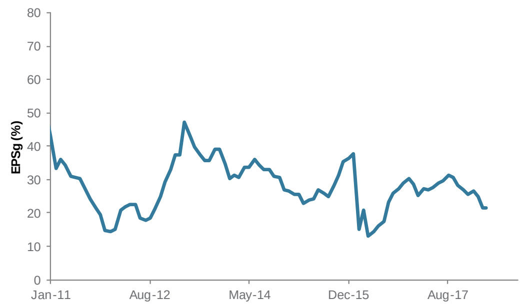
The risks of a trade war between the US and its trading partners appeared to have diminished in recent weeks following conciliatory statements by President Trump. However, a recent US government order to ban US companies from dealing with a large Chinese telecommunications supplier ratcheted up tensions. China has also flexed its muscles by seeking more concessions in its anti-trust investigation into a proposed acquisition by a US telecommunications company with extensive business in China.

These trade skirmishes have impacted individual companies as opposed to the broader equity and fixed income market, which is discounting an outcome that an agreement will eventually be struck between the US and its trading partners, including China. Nevertheless, it is increasingly clear that the real fight is over the licencing and transfer of Intellectual Property from the US to China. The decision to require foreign cloud storage companies to transfer IP to their Chinese joint venture partners is the latest measure likely to provoke a response from the US.

In isolation, each of these measures is modest in size. However, putting these and potential future measures together could raise the risk of a trade war. Nevertheless, we continue to believe that it is in neither country's interest to disrupt trade, but acknowledge concerns on both sides that the playing field is uneven in terms of market access. Our central scenario is for the US and China, as well its other trading partners, to reach a deal and our investment views are positioned for such an outcome.

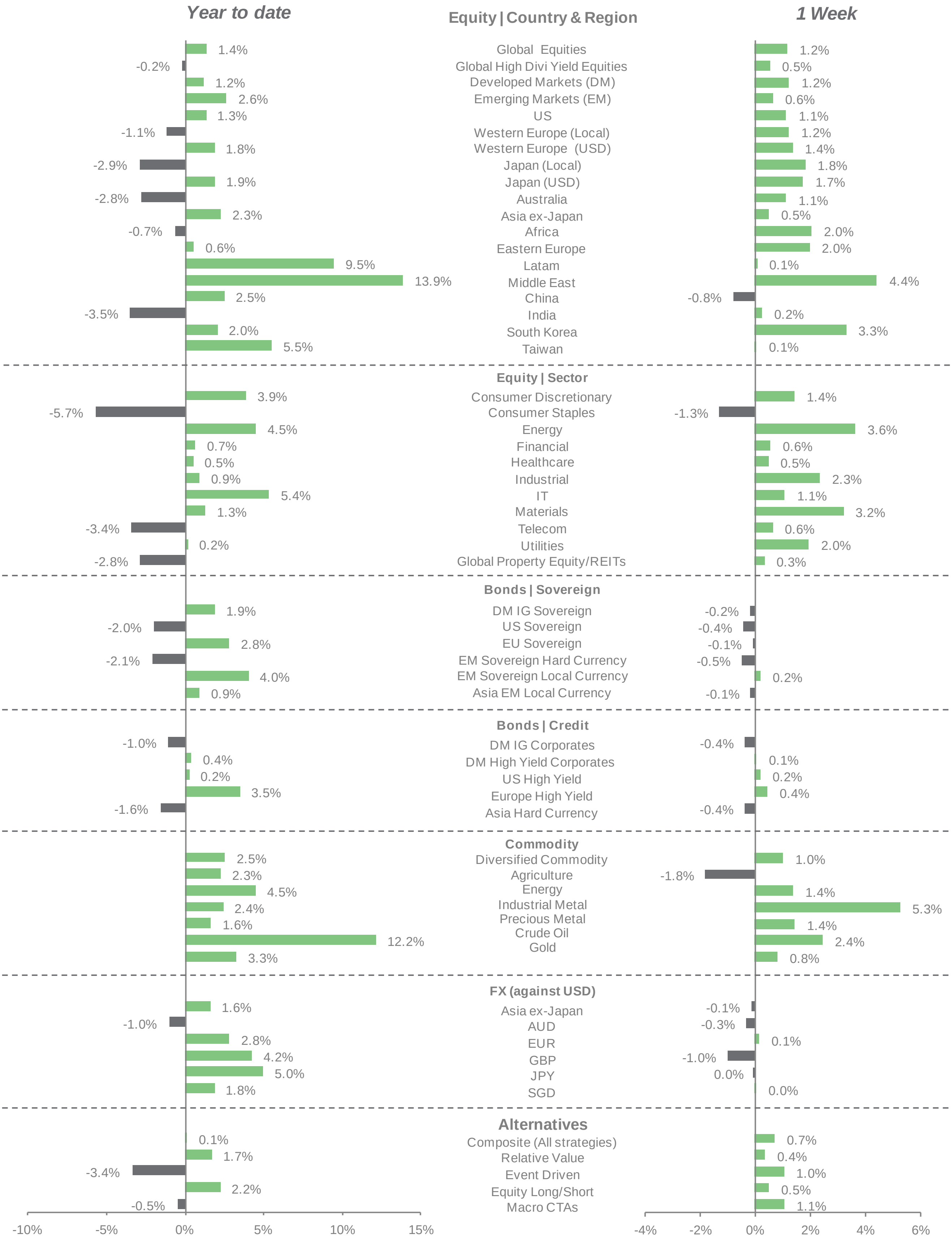
China technology sector's consensus earnings growth remains above 20% despite the ongoing trade frictions

Consensus 12m forward earnings estimates of MSCI China's information technology sector



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 19 April 2018, 1 week period: 12 April 2018 to 19 April 2018*

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

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	JN	Nikkei Japan PMI Mfg	23-Apr-18	Apr P	–	53.1
	GE	Markit/BME Germany Composite PMI	23-Apr-18	Apr P	–	55.1
	EC	Markit Eurozone Composite PMI	23-Apr-18	Apr P	–	55.2
	US	Existing Home Sales	23-Apr-18	Mar	5.57m	5.54m
TUE	GE	IFO Expectations	24-Apr-18	Apr	–	104.4
	US	New Home Sales	24-Apr-18	Mar	628k	618k
	US	Conf. Board Consumer Confidence	24-Apr-18	Apr	126	127.7
THUR	SK	GDP y/y	26-Apr-18	1Q P	–	2.8%
	EC	ECB Main Refinancing Rate	26-Apr-18	26-Apr	–	0.0%
	US	Durable Goods Orders	26-Apr-18	Mar P	1.0%	3.0%
FRI/SAT	JN	Industrial Production y/y	27-Apr-18	Mar P	–	1.6%
	UK	GDP q/q	27-Apr-18	1Q A	–	0.4%
	EC	Economic Confidence	27-Apr-18	Apr	–	112.6
	RU	Key Rate	27-Apr-18	27-Apr	7.3%	7.3%
	US	Employment Cost Index	27-Apr-18	1Q	0.7%	0.6%
	US	GDP Annualized q/q	27-Apr-18	1Q A	2.2%	2.9%
	JN	BOJ Policy Balance Rate	27-Apr-18	27-Apr	–	-0.1%

	Event	This Week	Date	Period	Actual	Prior
MON	IN	Wholesale Prices y/y	16-Apr-18	Mar	2.5%	2.5%
	US	Retail Sales Ex Auto and Gas	16-Apr-18	Mar	0.3%	0.3%
TUE	CH	GDP y/y	17-Apr-18	1Q	6.8%	6.8%
	CH	Retail Sales y/y	17-Apr-18	Mar	10.1%	9.4%
	CH	Industrial Production y/y	17-Apr-18	Mar	6.0%	6.2%
	CH	Fixed Assets Ex Rural YTD y/y	17-Apr-18	Mar	7.5%	7.9%
	UK	Employment Change 3m/3m	17-Apr-18	Feb	55k	168k
	EC	ZEW Survey Expectations	17-Apr-18	Apr	1.9	13.4
	US	Housing Starts	17-Apr-18	Mar	1319k	1295k
	US	Building Permits	17-Apr-18	Mar	1354k	1321k
	US	Industrial Production m/m	17-Apr-18	Mar	0.5%	1.0%
WED	JN	Exports y/y	18-Apr-18	Mar	2.1%	1.8%
	UK	CPI Core y/y	18-Apr-18	Mar	2.3%	2.4%
	CA	Bank of Canada Rate Decision	18-Apr-18	18-Apr	1.25%	1.25%
THUR	UK	Retail Sales Ex Auto Fuel y/y	19-Apr-18	Mar	1.1%	1.2%
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	20-Apr-18	Mar	–	0.5%

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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