Standard Chartered
Private Bank

weekly **market view**

macro strategy | 21 June 2019

This reflects the views of the Wealth Management Group

Editorial

A flock of doves

- **The Fed and BoJ followed the ECB in signalling likely policy easing in H2. Easier monetary policy, coupled with chances of a US-China trade truce, is potentially bullish for equities.**
- **Equities:** Dovish central banks and lower bond yields make equities more attractive. We remain bullish.
- **Bonds:** The US 10-year Treasury yield tested 2.0% for the first time since 2016 and riskier bonds gained. The upcoming G20 summit could determine near-term performance.
- **FX:** The USD appears increasingly likely to reverse the uptrend since February 2018. This is helping gold break higher.

What's new?

- **A flock of doves**. This week, the Fed set the stage for potentially its first rate cut since 2008. Chair Powell's comment ("An ounce of prevention is worth a pound of cure") suggests policymakers are increasingly willing to lower rates to ensure the sustainability of the ongoing 10-year-long expansion amid uncertainties caused by trade tensions and cooling inflation. Revised rate projections by the Fed's 17 policymakers suggest it would take one more member to support a rate cut for the Fed to cut rates. This could come as soon as July, especially if the G20 meeting on 28-29 June does not lead to a breakthrough in the US-China trade dispute. The Fed's dovish turn came after ECB President Draghi reiterated the possibility of rate cuts and renewed bond buying. The BoJ, in turn, signalled flexibility in its targeting of the 10-year government bond yields after it tested the lower boundary. A concerted easing of monetary policies would be positive for risk assets, in our assessment.
- **Gold breaks out into five-year high**. The surge followed the fall in US inflation-adjusted yields and, in turn, the USD. We believe the gold rally has legs – the broad decline in global bond yields makes a non-yielding metal like gold more attractive. Geopolitical tensions have led major central banks (including those in Russia, China, India and Turkey) to significantly boost gold holdings. While technicals suggest gold may be temporarily overbought, an eventual break of key resistance at the August 2013 high of 1,433 could open the way towards 1,485, followed by 1,525.
- **US-China to resume trade talks**. The S&P500 index reached a new record high and Asian stocks jumped after US President Trump broke the ice with a call with Chinese President Xi. The two sides plan to resume trade talks in the lead-up to an "extended meeting" at the G20 Summit. Hong Kong's Hang Seng index has now regained almost half of the losses suffered since the start of May, when talks between the two sides fell apart. While we do not expect a trade agreement at the G20 meeting itself, any indication the US would postpone tariffs on another USD 300bn of imports from China and continue negotiations is likely to be positive for risk assets, including Emerging Markets (EM) and Asian USD bonds. (see page 3 for more details)

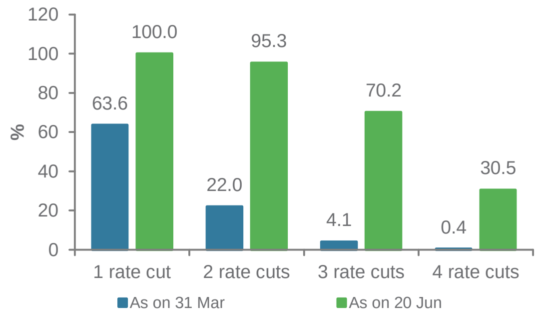
What we are watching

- G20 Summit (28-29 June); OPEC meeting (postponed to 1 July); US-China trade talks; new ECB President; UK premiership race.

Contents

Expectations of Fed rate cuts have surged over the past quarter, with money markets now pricing in almost three rate cuts by end-2019

Market implied probabilities of Fed rate cuts in 2019 (now vs. 31 March)



Source: Bloomberg, Standard Chartered

Gold has broken out to a five-year high; next resistances are USD1,433/oz and USD1,485/oz

Gold price

Source: Bloomberg, Standard Chartered

Alexis Calla
Global Head, Investment Advisory & Strategy

Steve Brice
Chief Investment Strategist

Clive McDonnell
Head, Equity Investment Strategy

Manpreet Gill
Head, FICC Investment Strategy

Manish Jaradi
Senior Investment Strategist

Audrey Goh, CFA
Senior Cross-asset Strategist

Daniel Lam, CFA
Senior Cross-asset Strategist

Belle Chan
Senior Investment Strategist

Rajat Bhattacharya
Senior Investment Strategist

Francis Lim
Senior Investment Strategist

Thursten Cheok, CFA
Senior Portfolio Strategist

Abhilash Narayan
Investment Strategist

Cedric Lam
Investment Strategist

Trang Nguyen
Portfolio Strategist

DJ Cheong
Investment Strategist

Marco Iachini
Cross-Asset Strategist

What does this mean for investors?

Global equities extended their recovery, led by US and Emerging Market equities, as expectations of central bank easing dragged bond yields lower. Crude oil and gold led gains in commodities.

Equities: What does a more dovish Fed mean for equities?

- **Lower bond yields make equity markets more attractive.** Studies show that each 10 basis point decline in US 10-year Treasury yields raises the 'fair value' of MSCI All Country World Index by 1%. Leaving aside other factors, this means the 123bps decline in the 10-year US Treasury yield from its high in August 2018 on its own implies the fair value of the MSCI AC World index should be 12% higher. If we use the long-term average P/E multiple as a measure of fair value for the index, the lower bond yields suggests a 5% upside for the index from current levels.
- This is borne out by the strong historical performance of US equities in the 12 months following Fed rate cuts which did not lead to a recession (which is our view). Of course, rates cuts followed by a recession would lead equities lower (see chart).
- **A Fed rate cut could also benefit rate-sensitive Hong Kong property and banking sectors.** The property sector is trading close to its trough discount-to-net-asset-value of 55% (currently 48%), despite rising land prices. Easing political tensions in HK may also lift sentiment towards the sector. With a yield of over 4% and price-to-book-value of less than 1.5x, we believe the HK banking sector is attractively valued.

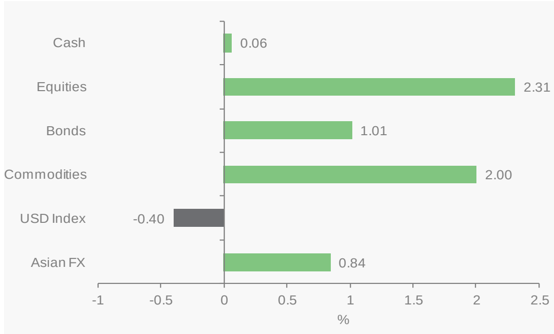
Bonds: What does the Fed's latest outlook mean for bonds?

- **10-year US Treasury yields tested 2.0%** for the first time since 2016 after the Fed signalled rate cuts and also lowered its long-term rate and inflation forecasts.
- **The G-20 meeting is the next focus.** Progress in trade talks could ease global growth concerns, likely leading to a rebound in yields. For the 10-year yields, if the psychological 2.0% threshold is sustainably breached, the next key technical support level rests in the 1.90%-1.92% range on the downside. On the upside the next resistance is at 2.08%.
- **US corporate, Emerging Market (EM) USD government and Asian USD bonds delivered strong weekly gains**. Sentiment was buoyed by expectation of easier Fed policy and easing trade tensions. Similar to Treasuries, we believe progress on trade talks, especially at the G20 Summit, is key to near-term performance of corporate and EM bonds.

FX: Is the USD breaking lower?

- **We believe the USD is increasingly likely to reverse the uptrend since February 2018** as the Fed opens the door to a possible rate cut. The US has more scope to cut rates than other major central banks, suggesting rate differentials may place downward pressure on the USD. For the USD (DXY) index, a break below key technical levels of 96.45 and 95.74 would provide conviction to this view. For EUR/USD, a sustained move above 1.1350, followed by a break of the March high at 1.1450, would provide conviction for a longer-term uptrend.
- **The next critical date will be the G20 meeting** where Presidents Trump and Xi will try to forge a trade deal. Success – which could also include some type of currency adjustment to placate President Trump's persistent "strong dollar" complaint – could drive the USD lower. Some central banks (in the UK, Canada and Norway) have indicated they might raise rates (Norway raised rates this week by 25bps). Their currencies could be the primary beneficiaries from any USD decline.

Benchmark (USD) performance w/w*



**Week of 13 June 2019 to 20 June 2019*

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)

Equity technicals have turned broadly positive

Technical levels of key market indicators as on 20 June

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,954	2,895	2,976	↑
STOXX 50	3,468	3,359	3,515	↗
FTSE 100	7,424	7,290	7,520	↑
Nikkei 225	21,463	20,630	22,350	↗
Shanghai Comp	2,987	2,875	3,050	↗
Hang Seng	28,550	27,500	29,450	↗
MSCI Asia ex-Japan	651	612	652	↗
MSCI EM	1,054	1,011	1,073	↗
Brent (ICE)	65	60	67	↓
Gold	1,393	1,335	1,400	↑
UST 10Y Yield	2.01	1.93	2.35	↓

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

US stocks have delivered strong returns after Fed rate cuts that were not followed by a recession

Performance of US equities 12 months before and after Fed rate cuts which did not lead to a recession (1995 and 1998) and which did lead to a recession (2000 and 2007)

Source: Bloomberg, Standard Chartered

US 10-year Treasury yield is testing the key 2% level

US 10-year government bond yield

Source: Bloomberg, Standard Chartered

Top client questions

Q1. G20 meeting – What to watch?

The past week has been focused on the shift in the US Federal Reserve's messaging on the monetary policy outlook. However, there is another critical event on the horizon in the form of the G20 meeting in Japan.

To set the context, one of the major themes we highlighted in our *2017 Outlook* publication was the likely pivot from 'Pax Americana' to 'multi-polarity'. We continue to view this as a multi-year - even a multi-decade - trend. The theme is predicated on China's increased economic, technological and military power challenging the US's global dominance and influence, particularly in Asia. Avoiding a confrontation would require the US to accept China's rise and the two countries to work together to agree to new global rules that meet the interests of both parties. A failure to do so would increase the risk of extreme 'black swan' events.

Unfortunately, the relationship between the US and China has become more confrontational, with the US taking a more aggressive stance against the existing global trade system generally, but especially against China. Amid accusations that China has backtracked on previously agreed actions, the US has implemented a third round of tariff hikes (which had been delayed in December as talks seemed to be making good progress) and is setting the stage for a fourth round of tariffs on the remaining USD 300bn of Chinese imports that have not faced punitive tariffs so far.

Clearly, we are approaching a critical phase of negotiations, with the final round of tariffs due to be implemented on July 8. It is against this backdrop, that the G20 summit takes place. The good news is that US President Trump and China President Xi are due to sit down together. Historically, such meetings have gone well, which means there is some level of optimism that the July tariff increases may be put on hold.

However, the overall political environment is not positive on either side of the Pacific. If there is one thing that a highly divided US political system can agree on, it is that China has used local industrial, economic and monetary policies to gain an unfair trade advantage. Therefore, Trump is under pressure to gain very significant concessions from China. In China, there has clearly been a hardening of rhetoric as the authorities fight any perception that they are making huge concessions.

In our opinion, this means a comprehensive trade deal is the least likely outcome, with uncertainty around key structural differences likely to extend in the coming months. There could be some "wins" for Trump that might mitigate an escalation of tariffs, including a China-brokered progress on the Korean peninsula, revisiting China's promise to purchase US goods in significant volume and perhaps even a nod to one of Trump's perennial complaints regarding an overly strong dollar. These are possible – but nothing is by any means certain with the US President.

Equity markets are close to key technical levels – the US S&P500 index has broken into a new all-time high, while global equities are approaching the top of the range seen since February 2018. As attention shifts from last week's euphoria surrounding the Fed keeping the door open to a potential rate cut to the G20 meeting, we may see some near-term consolidation/weakness in equity indices. However, we continue to believe that the global economy will 'muddle through' these uncertainties. As such, we see any equity market dips as a buying opportunity.

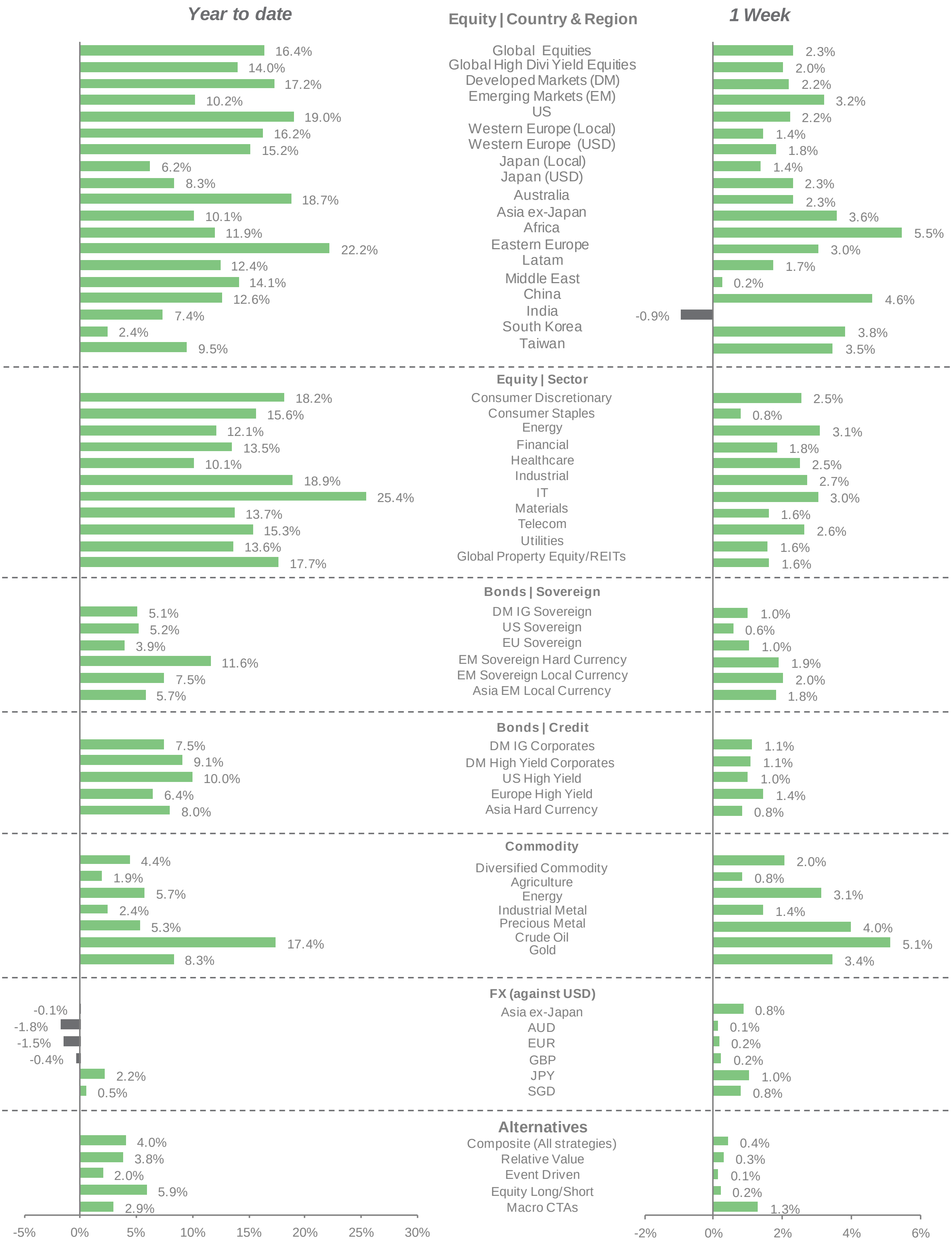
A comprehensive US-China trade deal at the G20 meeting is the least likely scenario

Key US-China trade scenarios and implications

	Trade agreement reached	Escalation extends (3-6 months)	Full blown escalation
Probability	5%	60%	35%
US monetary/fiscal policy response	Increases probability of no or very limited easing	July easing more likely	Multiple rate cuts and potential fiscal easing ahead of 2020 election
China policy response	Wait and see	Measured easing	Significant easing, fiscal and monetary
FX impact	USD weakens, especially if agreement includes FX provisions	USD weakness likely limited	USD, JPY to appreciate; USD-CNY to breach 7.00
USD bonds	Bond yields to rise, EM credit outperforms	Bond yields to remain low until resolution confirmed	Bond yields likely to decline despite short-term inflationary consequences of higher import tariffs
Equity markets	Bullish, EM to outperform	Ultimately bullish after short-term volatility	20% correction likely, China equities to rebound strongly on stimulus

Source: Standard Chartered Global Investment Committee

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 20 June 2019, 1 week period: 13 June 2019 to 20 June 2019*

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

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Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	GE	IFO Expectations	24-Jun-19	Jun	–	95.3
TUE	US	New Home Sales	25-Jun-19	May	685k	673k
	US	Conf. Board Consumer Confidence	25-Jun-19	Jun	132	134.1
WED	US	Durable Goods Orders	26-Jun-19	May P	0.0%	-2.1%
	US	Cap Goods Orders Nondef Ex Air	26-Jun-19	May P	0.0%	-1.0%
THUR	CH	Industrial Profits y/y	27-Jun-19	May	–	-3.7%
	EC	Economic Confidence	27-Jun-19	Jun	–	105.1
	GE	CPI EU Harmonized y/y	27-Jun-19	Jun P	1.3%	1.3%
	US	Initial Jobless Claims	27-Jun-19	22-Jun	–	–
FRI/SUN	JN	Industrial Production y/y	28-Jun-19	May P	-3.3%	-1.1%
	EC	CPI Core y/y	28-Jun-19	Jun A	0.8%	0.8%
	US	Personal Income	28-Jun-19	May	0.3%	0.5%
	US	Real Personal Spending	28-Jun-19	May	–	0.0%
	CH	Manufacturing PMI	30-Jun-19	Jun	–	49.4
	CH	Non-manufacturing PMI	30-Jun-19	Jun	–	54.3

	Event	This Week	Date	Period	Actual	Prior
TUE	US	Housing Starts	18-Jun-19	May	1269k	1281k
	US	Building Permits	18-Jun-19	May	1294k	1290k
WED	JN	Exports y/y	19-Jun-19	May	-7.8%	-2.4%
	UK	CPI Core y/y	19-Jun-19	May	1.7%	1.8%
	BZ	Selic Rate	19-Jun-19	19-Jun	6.5%	6.5%
THUR	US	FOMC Rate Decision (Upper Bound)	20-Jun-19	19-Jun	2.5%	2.5%
	JN	BoJ Policy Decision (10-year yield target)	20-Jun-19	20-Jun	0.0%	0.0%
	UK	Bank of England Bank Rate	20-Jun-19	20-Jun	0.75%	0.75%
	US	Leading Index	20-Jun-19	May	0.0%	0.1%
	EC	Consumer Confidence	20-Jun-19	Jun A	-7.2	-6.5
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	21-Jun-19	May	0.5%	0.6%
	GE	Markit/BME Germany Composite PMI	21-Jun-19	Jun P		52.6
	EC	Markit Eurozone Manufacturing PMI	21-Jun-19	Jun P		47.7
	EC	Markit Eurozone Services PMI	21-Jun-19	Jun P		52.9
	EC	Markit Eurozone Composite PMI	21-Jun-19	Jun P		51.8
	US	Existing Home Sales	21-Jun-19	May		5.19m

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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