Standard Chartered Private Bank

weekly market view

macro strategy | 28 December 2018 — This reflects the views of the Wealth Management Group

Editorial

A turbulent December

- **Opportunities may be emerging in US equities, but diversification likely to remain a winning strategy.**
- **Equities:** Still-stretched sentiment could help extend US equity rebound, but further evidence of markets forming a base is key (see page 2).
- **Bonds:** High quality bonds have rallied sharply, making yields less attractive, but they demonstrated their benefit as diversifiers.
- **FX:** Recent gains in gold could extend further near-term.

What's new?

- **Policy, technicals likely key factors behind volatility.** December's equity market weakness kicked off with an inversion of one part of the US yield curve early in the month, reigniting growth concerns. The Fed's decision to subsequently hike rates did not help despite downward growth and inflation forecast revisions. Finally, concerns that President Trump was considering firing Fed Governor Powell, US Treasury Secretary Mnuchin's comments regarding US banking sector liquidity and an ongoing US government shutdown extended worries ahead of Christmas. US equity markets also broke through several key technical supports, while reports suggested larger-than-usual pension fund rebalancing and low year-end liquidity also contributed to market volatility. However, as the chart on the right illustrates, weakness remained focused on Developed Market (DM) equities, while bonds and gold gained.
- **Don't lose sight of the bigger picture.** We continue to believe a US recession is unlikely within the next 12 months – the key 10-year to 2-year yield curve has not inverted, US corporate profits are still expected to increase and lead economic indicators continue to point to robust growth ahead. Together, these factors argue current equity market levels are more likely a buying opportunity than the first leg of a prolonged bear market.
- **Technical indicators stretched, but evidence of basing is key.** Very short-term sentiment and positioning indicators remain stretched at excessively negative levels. However, although we believe it is time to start looking for opportunities, further evidence markets are forming a bottom would raise our confidence levels (see page 2 for details). We have also pointed out previously that Asia ex-Japan equity markets may also be poised for a rebound, while our preferred EM USD bonds continue to eke out gains.
- **Diversification remains the winner.** Short-term opportunities notwithstanding, we continue to believe a diversified approach to investment allocations remains a robust strategy. December's US government bond gain illustrated how they can act as an attractive diversifier to US equities. We also believe an allocation to cash helps create firepower to take advantage of opportunities amid late-cycle volatility, such as the one possibly emerging in US equities (see page 2 for details).

What we are watching

- **Length of US government shutdown, any further policymaker comments are key.** Any stimulus in China or progress on the US-China trade talks is also likely to be positive.

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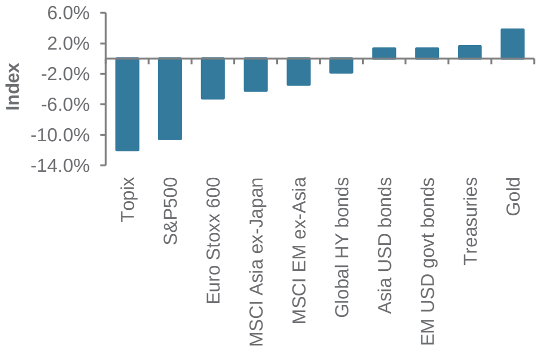
Market weakness centred around US equities. Bonds and gold demonstrated their value as diversifiers

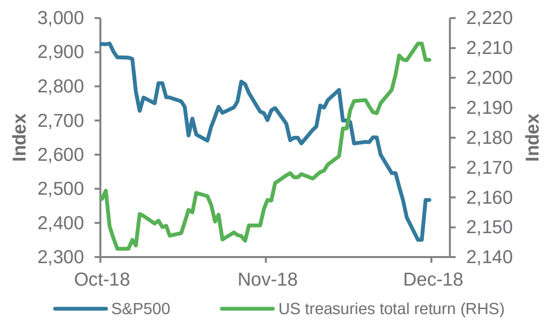
Major equity and bond market total returns 30-Nov-2018 to 26-Dec-2018



Source: Bloomberg, Standard Chartered
Global HY and Treasury bond returns based on Bloomberg Barclays indices. Asia USD and EM USD govt. bonds returns based on JPMorgan indices.

Diversification was of value in Q4 18

S&P 500 Index and Bloomberg Barclays Treasuries Total Return unhedged (USD) Index



Source: Bloomberg, Standard Chartered

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Top client questions

Q1. How do you read the fall in the S&P 500 index below the February low?

While the index has indeed fallen below the February low, the sharp rebound in the past two sessions back to close to the February low suggests it may be premature to conclude that the level has been broken.

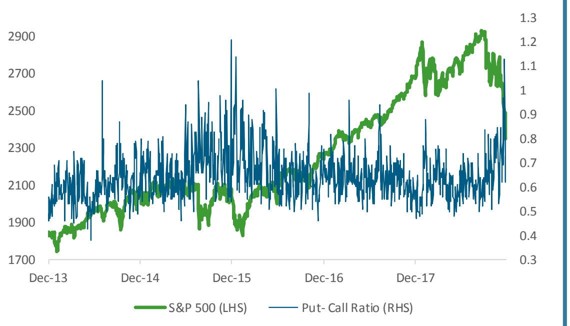
Firstly, the pessimism in US equity market sentiment looks very stretched. The put-call ratio (one tool to gauge market sentiment via the ratio of investors taking bearish [put] or bullish [call] views on the market) hit the highest since 2015-2016 (the 'taper tantrum' episode). Before 2015-2016, the ratio hit similar levels around the European sovereign crisis (the 'Grexit' episode) in 2011. Interestingly, both episodes of a peak in the ratio were associated with a low in the S&P 500 index. Likewise, the American Association of Individual Investors (AAII) Bearish Sentiment Index is at levels which have historically been associated with an index low. Our own measure of market diversity is also very low, close to levels usually associated with a reversal.

Secondly, we are at a time in the year when liquidity tends to be relatively low. We note the February low is an important support level and that a potential bullish reversal on the weekly charts may be developing from the 200-week moving average (also a major support level). Therefore, we believe it is prudent to wait another week before concluding that the February low has been broken decisively.

Finally, in early 2016, the index tested a similar strong support (the October 2014 low) intra-week, but failed to break lower decisively. The current episode may be no different.

US Equities: peak pessimism?

S&P 500 Index and the Put-Call ratio



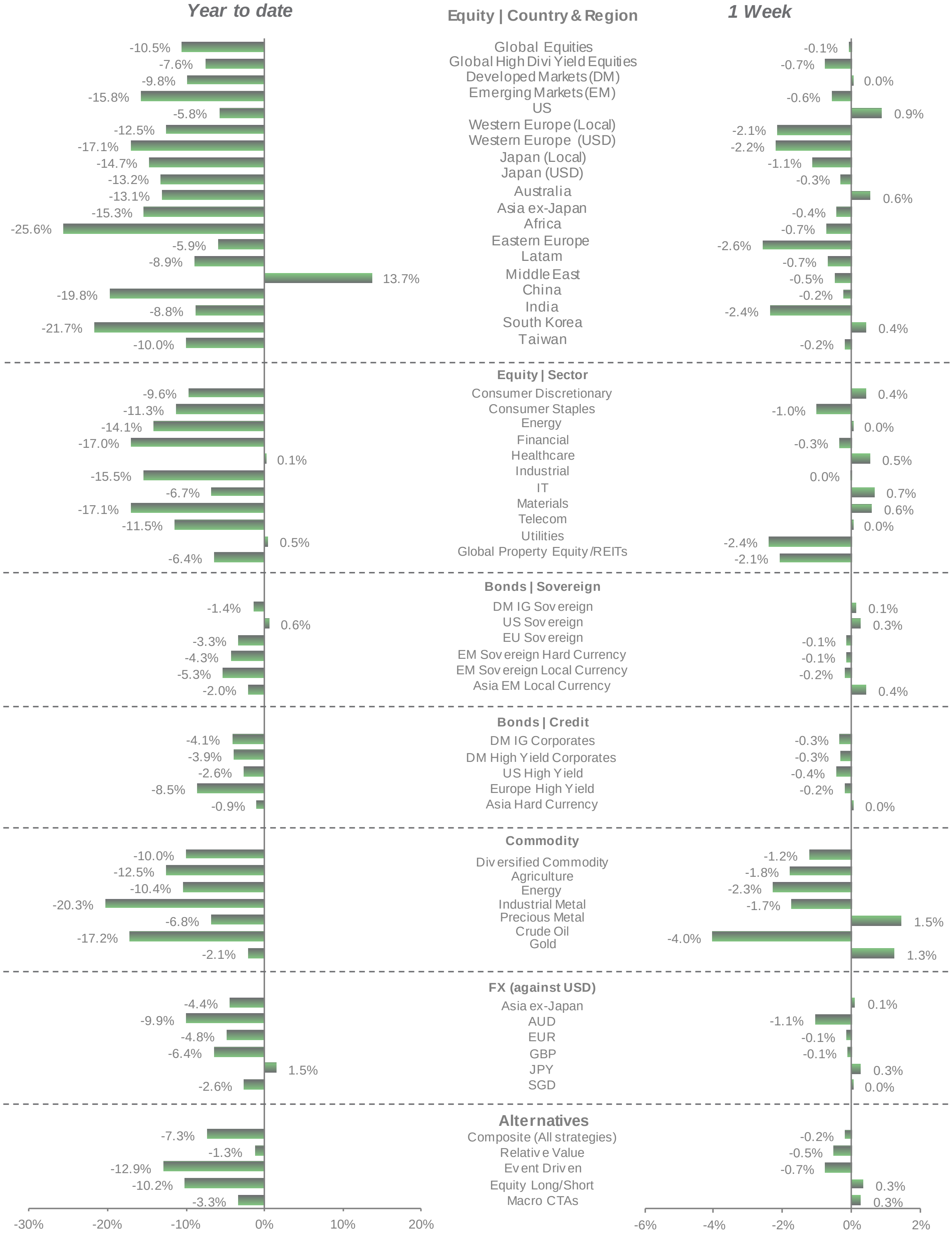
Source: Bloomberg, Standard Chartered

The S&P 500 Index is attempting to rebound from strong support

S&P 500 Index weekly chart and the 200-week MA

Source: Refinitiv Eikon, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 27 December 2018, 1 week period: 20 December 2018 to 27 December 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
FRI	US	Advance Goods Trade Balance	28-Dec-18	Nov	-$76.0b	-$77.2b
	US	New Home Sales	28-Dec-18	Nov	566k	544k
	JN	Tokyo CPI y/y	28-Dec-18	Dec	0.5%	0.8%
	JN	Tokyo CPI Ex-Fresh Food y/y	28-Dec-18	Dec	0.9%	1.0%
	JN	Industrial Production y/y	28-Dec-18	Nov P	0.6%	4.2%
	JN	Retail Trade y/y	28-Dec-18	Nov	2.1%	3.5%
	CH	BoP Current Account Balance	28-Dec-18	3Q F	–	$16.0b
MON	CH	Manufacturing PMI	31-Dec-18	Dec	50	50
WED	EC	Markit Eurozone Manufacturing PMI	02-Jan-19	Dec F	51.4	51.4
	SI	GDP y/y	02-Jan-19	4Q A	–	2.2%
	CH	Caixin China PMI Mfg	02-Jan-19	Dec	50.2	50.2
THUR	US	ADP Employment Change	03-Jan-19	Dec	180k	179k
	US	Initial Jobless Claims	03-Jan-19	29-Dec	–	–
	US	ISM Manufacturing	03-Jan-19	Dec	58	59.3
FRI/SAT	EC	Markit Eurozone Composite PMI	04-Jan-19	Dec F	51.3	51.3
	EC	PPI y/y	04-Jan-19	Nov	4.2%	4.9%
	EC	CPI Core y/y	04-Jan-19	Dec A	1.0%	1.0%
	US	Change in Nonfarm Payrolls	04-Jan-19	Dec	180k	155k
	US	Unemployment Rate	04-Jan-19	Dec	3.7%	3.7%
	US	Average Hourly Earnings y/y	04-Jan-19	Dec	3.0%	3.1%

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

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