Standard Chartered Private Bank

weekly market view

macro strategy | 10 May 2019

This reflects the views of the Wealth Management Group

Editorial

And then came the tweet

- **Escalation in US-China trade tensions has revived a key risk for markets near term. We expect the dispute to be resolved eventually, making ‘buy-on-dips’ a strategy to consider.**
- **Equities:** Asia ex-Japan is likely to be impacted from trade tensions initially, but the dovish shift in global monetary policies and China’s stimulus are supportive over 6-12 months.
- **Bonds:** Trade tensions could hurt riskier assets near term, but a dovish Fed, reasonable valuations and attractive yields suggest EM USD and Asia USD bond outperformance medium term.
- **FX:** USD/CNH at risk of a rally towards 7.00 if US tariffs are imposed on all imports from China.

What’s new?

- **Trade tensions escalate.** US President Trump’s decision to increase tariffs to 25% (from 10%) on USD 200bn of imports from China surprised markets, given earlier indications that a trade deal was imminent. Equities in Asia ex-Japan and Europe may be most at risk near-term based on the market reaction in 2018 following the initial rise in trade tariffs. However, we note that US markets joined the downturn by the end of Q4 amid signs that the dispute was hurting the US economy too.
- A key difference from last year is the dovish tilt in monetary policies worldwide, led by the Fed, but also by China’s stimulus measures (which it could accelerate). Also, a softening in Trump’s stance after US equities dropped c.20% by December 2018 may be indicative of the ‘pain threshold’. We expect the two sides to eventually reach an agreement, given that a full-scale trade war is detrimental to both parties. Hence, we believe the ensuing volatility would present an opportunity to add exposure to equities and bonds, especially in Asia ex-Japan (see page 3).
- **Equity markets pull back from resistance.** The S&P 500 index failed to decisively break above the previous record high set in 2018. This suggests a meaningful pause cannot be ruled out, given overbought conditions and the extent and pace of the rally this year. 2,720 (38.2% retracement of this year’s rise and close to the 200-day moving average) is a key support. There is stronger support at 2,650 (50% retracement). The MSCI China equity market index has initial support 3.5% below current levels.
- **USD/CNH breaks higher.** In our assessment, there is scope for USD/CNH to rally towards October’s high near 6.98 if trade talks break down and the US imposes tariffs on the remaining USD 325bn of imports from China. Markets had expected stability in the Chinese currency embedded within a broader trade pact. If trade tensions escalate, China is likely to deploy a range of policies to soften the economic impact, which may include allowing controlled currency weakness. A break of the psychological 7.00 barrier could see a further rally to 7.20. However, a re-commitment to immediate constructive talks would likely see USD/CNH revert to the 6.67-6.75 band.

What we are watching

- Will China retaliate against US tariffs? US decision on car import tariffs by 18 May; Brexit talks; US trade talks with Japan, Europe.

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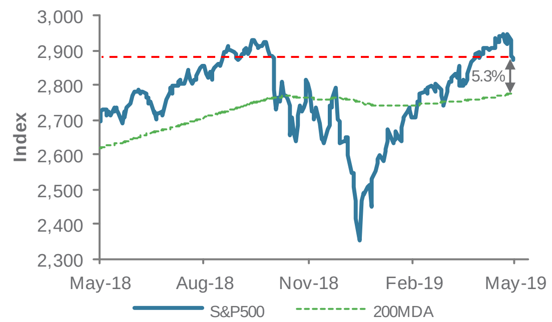
The US S&P500 stock index has initial support 5.3% below current levels, coinciding with the 200DMA

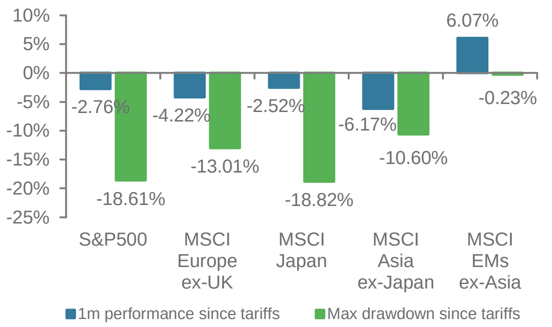
S&P500 index and 200 Day Moving Average (DMA)



Source: Bloomberg, Standard Chartered

Asia ex-Japan equities fell the most in the first month after the US raised tariffs in September 2018; US and Japan subsequently suffered the biggest drawdown

One-month performance & max drawdown of key equity indices since the US last raised tariffs on 17-Sep-18



Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities and other riskier assets fell amid renewed trade tensions. Emerging Market stocks and bonds underperformed.

Equities: What lessons can we draw from 2018's trade tensions?

- **Fallout from the September 2018 tariff hike suggests Asia ex-Japan is likely to be impacted more than the US initially.** However, other factors, such as bond yields, monetary and fiscal policies and oil prices, are also important in driving equity performance. This year, a dovish shift among global central banks and China's fiscal stimulus are likely to be particularly supportive for Asia ex-Japan equities.
- **The last time the US announced a 10% tariff on USD 200bn of Chinese imports** on 17 September 2018, US and Asia ex-Japan equity markets rose 1% and 2%, respectively, in the following week as investors believed an agreement could be reached. However, a month later, US and Asia ex-Japan equities were down 3% and 6%, respectively.
- **In the US, the materials and real estate sectors fared the worst,** while the healthcare and utilities sectors were the best performers in the one-month period. Rising US bond yields were likely a key factor behind real estate sector's underperformance, despite its usually defensive nature.
- **In Asia ex-Japan, the real estate and consumer discretionary sectors fared worst in the one-month period**, while communication services and energy (usually seen as cyclical sector) outperformed, the latter aided by an oil price rebound.

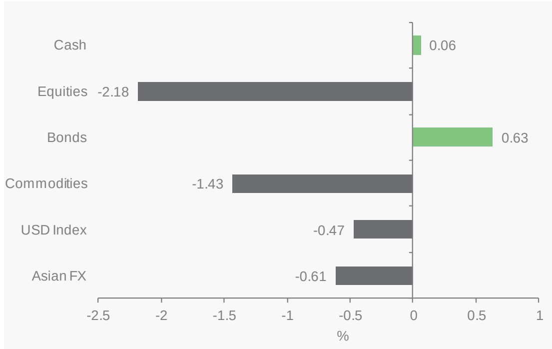
Bonds: What is the impact of trade tensions on EM bonds?

- **Higher US tariff is likely to hurt risk sentiment near term.** Over the past week, yield premiums on Emerging Market (EM) USD government bonds rose, hurting returns, while EM local currency bonds suffered from FX weakness. Should tensions escalate, EM bond yield premiums could rise further. However, a dovish Fed, reasonable valuations and attractive yields lead us to believe EM USD government bonds are still likely to outperform global bonds over the next 6-12 months.
- **Asian USD bonds** have been relatively stable despite the trade tensions and rising onshore defaults in China. While we acknowledge the risks from these factors, we believe the recent easing in China's policy stance towards deleveraging should help prevent any spill-over to the USD-denominated bond market. Additionally, our expectation of a weaker CNY could lead to higher local demand, which could help support the asset class.

FX: Can the GBP break free of Brexit?

- **Positive Brexit outcome likely to trigger GBP/USD rally.** GBP/USD remains in the 1.2870-1.3170 range. Our medium-term expectation for a positive Brexit outcome remains unchanged. Therefore, we expect buying interest to support any dip towards the 1.2770-1.2870 region. A break of resistance around 1.3170-1.3230 could signal that the GBP breakout is underway, targeting the previous high of 1.3385 and beyond. European parliamentary elections in the UK on 23 May could be a significant indicator of the electorate's desire for Brexit (or Bremain), which could finally help move the process towards a conclusion.
- **What is the outlook for ZAR after the elections?** The scale of ANC's victory is key. USD/ZAR could move back towards 14.00 if the ANC wins more than 63% share of vote, while a share below 57% and a strong performance by the radical EFF party could see a test of the 14.75 March high. Also, rating reviews could be brought forward in the event of policy surprises post elections.

Benchmark (USD) performance w/w*



**Week of 02 May 2019 to 09 May 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)

US and China equity technicals have turned negative

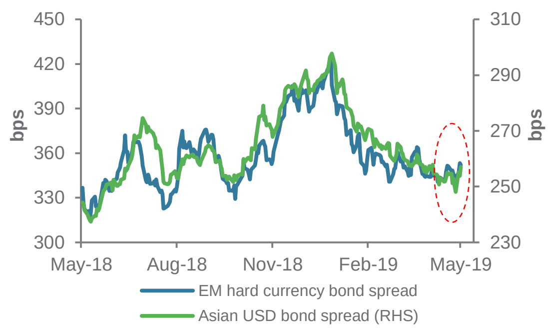
Technical levels of key market indicators as on 09 May

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,871	2,785	2,916	↓
STOXX 50	3,351	3,334	3,423	→
FTSE 100	7,207	7,148	7,405	→
Nikkei 225	21,402	20,900	22,350	↘
Shanghai Comp	2,851	2,800	3,090	↓
Hang Seng	28,311	28,000	29,500	→
MSCI Asia ex-Japan	643	635	670	↘
MSCI EM	1,028	1,028	1,084	→
Brent (ICE)	71	67	73	↘
Gold	1,284	1,266	1,300	↘
UST 10Y Yield	2.46	2.34	2.62	→

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

Yield premiums on EM USD government bonds and Asian USD bonds have risen marginally so far; they have tightened significantly YTD

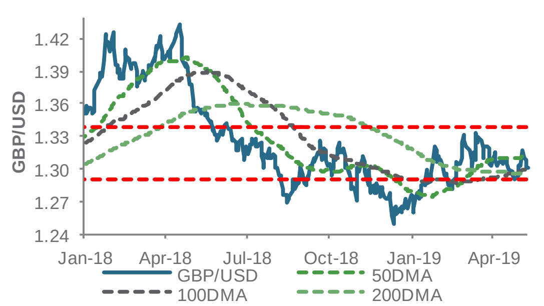
Yield premium on EM USD and Asia USD bonds



Source: Bloomberg, Standard Chartered

The GBP has strong support around 1.28; sustained gains above 1.32 would signal a breakout of its range

GBP/USD



Source: Refinitiv, Standard Chartered

Top client questions

Q1. What are the implications of the recent increase in trade tensions?

We see two key scenarios emerging from renewed US-China trade tensions, which the US has emphasised is due to China backtracking on previous commitments:

1) China retaliates aggressively
2) China negotiates

In **Scenario 1**, China and the US trade tit-for-tat measures, which would be damaging for the global economy and equity market sentiment. Trade wars are damaging economically through 3 main channels: i) higher inflation reduces consumers' purchasing power; ii) heightened uncertainty reduces businesses' incentive to invest; and 3) productivity is undermined, leading to reduced wealth generation, at least in aggregate. Therefore, higher the trade tariffs go and the longer uncertainty extends, the more economic damage trade tensions will inflict and more investors will worry.

The good news is this does not appear to be a central scenario at this stage. China's decision to proceed with trade talks this week with the country's lead negotiator, Vice Premier Liu He, included in the delegation is a positive sign, in our assessment. Therefore, for now at least, China appears committed to **Scenario 2** (i.e. continued negotiation). While this is unlikely to be a smooth process, it does suggest that the fallout for equity markets may be relatively limited.

For the US S&P500 index, Scenario 2 implies that key support around 2,720 is likely to hold (5.3% below the current level), whereas under Scenario 1, a retest of December lows should not be ruled out (18% below the current level). One thing that makes us less concerned is we believe that the US President, to some extent, uses the stock market as an indicator of whether his policies are successful or not. Therefore, should the market fall below 2,720, then we believe it increases the probability of President Trump becoming more conciliatory.

For the MSCI China index, the equivalent levels are around 3.5% and 15% lower from 9 May's close. While the US President is clearly less interested in supporting the Chinese stock market, we have seen the authorities ease monetary and fiscal policy significantly in the past 12 months. Indeed, the easing of liquidity conditions for small- and medium-sized banks in the past week suggests authorities are sensitive to any perceived threat of trade tensions to the local economy. More such measures are likely, which could help to limit the downside to China's equities, at least to some extent.

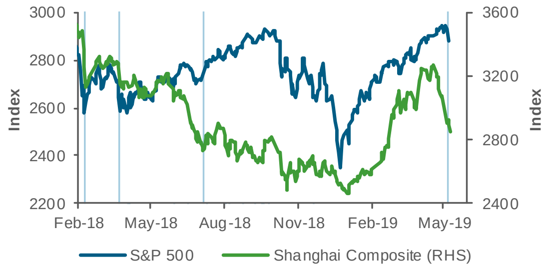
Our short-term bullish USD-CNH trade, published just before Trump's tweet, has clearly benefited from increased trade tensions. Scenario 1 would suggest a break of the psychological level of 7 could not be ruled out, whereas Scenario 2 would suggest gains may be unlikely to extend dramatically from here.

Don't forget the big picture

One final point worthy of note is that, while trade tensions between the US and China have been the most severe, the US is taking an aggressive stance with all of its major trading partners. Therefore, should the US-China trade negotiations proceed and a deal be reached before the June G20 summit, it is likely that the US's trade focus would shift elsewhere, with Europe and Japan potentially in the firing line. As such, trade tensions of some sort are likely to sustain for the remainder of the year, with the geographical focus and the US's negotiating stance being the main variables.

A timeline of major trade tariff events and their impact on equity markets

S&P500, Shanghai Composite Indices; lines mark key trade-tariff announcements/events

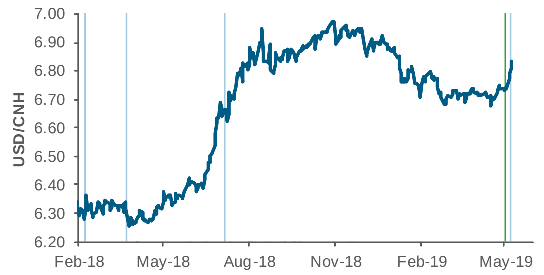


Source: Bloomberg, Standard Chartered

** Vertical lines indicate announcements/implementations of US-China tariffs*

Our long USD/CNH view, triggered 1 May, is likely a good way to prepare for any rise in volatility in the short-term

USD/CNH

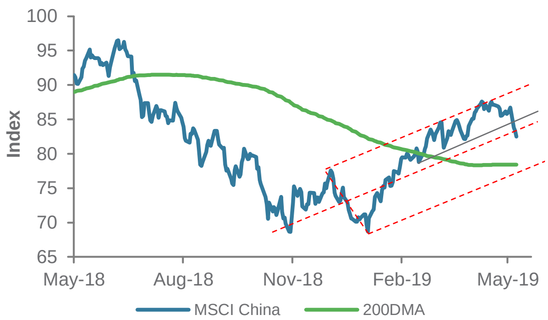


Source: Bloomberg, Standard Chartered

** Vertical lines indicate announcements/implementations of US-China tariffs; green line indicates the date long USD/CNH trade was triggered (1 May)*

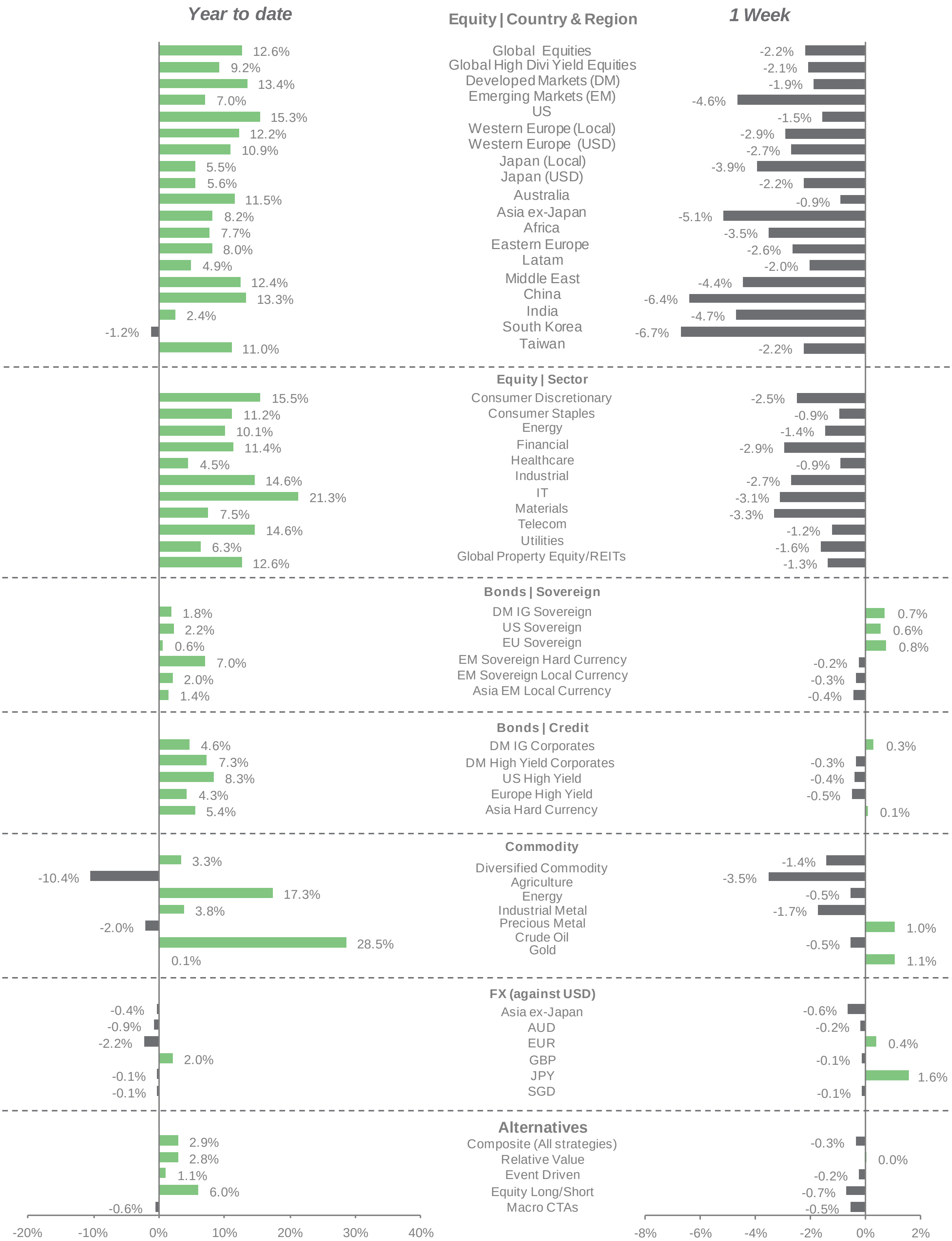
China's equity index's break below the uptrend line from February suggests the upward pressure may have faded near term; the next support is around the 200DMA, 3.5% below current levels

MSCI China index



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 09 May 2019, 1 week period: 02 May 2019 to 09 May 2019*

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	IN	CPI y/y	13-May-19	Apr	3.0%	2.9%
TUE	JN	BoP Current Account Adjusted	14-May-19	Mar P	–	¥1957.6b
	EC	ZEW Survey Expectations	14-May-19	May	–	4.5
WED	IN	Exports y/y	15-May-19	Apr	–	11.0%
	CH	Fixed Assets Ex Rural YTD y/y	15-May-19	Apr	6.4%	6.3%
	CH	Industrial Production y/y	15-May-19	Apr	6.5%	8.5%
	CH	Retail Sales y/y	15-May-19	Apr	8.6%	8.7%
	US	Retail Sales Ex Auto and Gas	15-May-19	Apr	–	0.9%
	US	Industrial Production m/m	15-May-19	Apr	0.1%	-0.1%
THUR	JN	PPI y/y	16-May-19	Apr	–	1.3%
	US	Housing Starts	16-May-19	Apr	1228k	1139k
	US	Building Permits	16-May-19	Apr	1295k	1269k
	US	Initial Jobless Claims	16-May-19	11-May	–	–
FRI/SAT	MX	Overnight Rate	17-May-19	16-May	8.3%	8.3%
	US	U. of Mich. Sentiment	17-May-19	May P	97.7	97.2

	Event	This Week	Date	Period	Actual	Prior
MON	EC	Sentix Investor Confidence	6-May-19	May	5.3	-0.3
	EC	Retail Sales y/y	6-May-19	Mar	1.9%	3.0%
TUE	AU	RBA Cash Rate Target	7-May-19	7-May	1.5%	1.5%
	US	JOLTS Job Openings	7-May-19	Mar	7488k	7142k
WED	US	Consumer Credit	8-May-19	Mar	$10.281b	$15.452b
	JN	Nikkei Japan PMI Composite	8-May-19	Apr	50.8	50.4
	GE	Industrial Production WDA y/y	8-May-19	Mar	-0.9%	0.2%
	CH	Exports y/y	8-May-19	Apr	-2.7%	13.8%
	BZ	Selic Rate	8-May-19	8-May	6.5%	6.5%
THUR	CH	CPI y/y	9-May-19	Apr	2.5%	2.3%
	CH	PPI y/y	9-May-19	Apr	0.9%	0.4%
	CH	Money Supply M2 y/y	9-May-19	Apr	8.5%	8.6%
	US	PPI Ex Food and Energy y/y	9-May-19	Apr	2.4%	2.4%
FRI/SAT	GE	Exports SA m/m	10-May-19	Mar	–	-1.2%
	UK	GDP y/y	10-May-19	1Q P	–	1.4%
	IN	Industrial Production y/y	10-May-19	Mar	–	0.1%
	US	CPI Ex Food and Energy y/y	10-May-19	Apr	–	2.0%

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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