Weekly Market View

Blowing hot and cold

The current bout of risk aversion, fuelled by trade tensions and weakening economic data in China and Europe, highlights the importance of staying well diversified

Equities: We remain constructive towards global equities over the medium-term, with a preference for US stocks; a strong job market, corporate margins and share buybacks remain key positives

Bonds: Although major government bond yields fell to new lows, extremely long investor positions suggest limited scope for further significant downside in yields

FX: We continue to believe the USD is likely peaking. As global growth slows and FX volatility rises, safe-haven currencies, such as the JPY, are likely to benefit the most

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Chart of the week: US 10-year bond yield below 2-year yield

The flat or inverted US Treasury yield curve is one potential recession signal, though not a definitive one

Yield premium offered by US 10-year government bond yields over 2-year and 3-month yields (the 'yield curve')

Source: Bloomberg, Standard Chartered

Editorial

Stay well-diversified

Risk aversion continued for the third week in global markets. Long-term bond yields in several Developed Markets (DM) hit new lows as disappointing economic data from Europe and China added to the uncertainty caused by an escalation in the US-China trade dispute. President Trump's decision to delay the imposition of a 10% tariff on key imports from China to 15 December (from 1 September), only days after announcing the plan, underscores the flip-flop in US policy that has undermined business confidence worldwide.

Manufacturing and export-based economies, such as China and Europe, have been hardest-hit. There is a risk that the slowdown could spill over to the US (see page 5), which likely explains why the gap between US 10-year and 2-year bond yields turned briefly negative for the first time since 2007.

The market action of the past three weeks highlights why staying well-diversified is so important. While we remain positive on risk assets for the next 6-12 months (and look for opportunities to add exposure), we believe doing this within a diversified allocation, balancing with exposure to safe-havens, such as bonds, gold and JPY, remains the best way forward.

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China, German data disappoint; policy stimulus next?

China reported weaker-than-expected growth in industrial output, retail sales, credit growth and fixed asset investment for July. Its industrial production grew 4.8% in July, the slowest pace since 2002. Coming on the heels of the first annual contraction in producers' factory gate prices since 2016, the data highlight the stress in the manufacturing sector, likely led by global trade uncertainty. Given the risk the weakness in industrial activity could spread to the domestic consumer sector, we believe authorities may implement more policy measures to support consumption. This could include rate cuts, easing of bank reserve requirements, targeted tax cuts and infrastructure spending.

Germany's economy contracted 0.1% in Q2, its second quarterly contraction in a year. The primary drivers of weakness were a slump in exports and industrial output, while domestic consumption remained buoyant. Forward-looking surveys (such as the ZEW survey) suggest the weakness may continue into Q3. We believe deteriorating data in the Euro area's largest economy is likely to increase pressure on the ECB to ease policy – while we anticipate rate cuts in September, there is also a growing likelihood of renewed bond buying.

Argentina's political upset hurts Emerging Market assets

The Argentinian Peso plunged more than 20% over the past week after the country's Presidential primary elections showed the market-friendly and reformist incumbent President Macri is likely to lose to populist opposition candidate Fernandez in the October elections.

We believe the reaction reflects the market's surprise at the shock results and exaggerates the country's solvency risks, especially to broader Emerging Market (EM) assets. For one, assuming Fernandez wins, he may prove to be more moderate in his economic policies than former President Kirchner. Besides, Argentina has sufficient FX reserves, following its latest IMF bailout, and its need to maintain its international market access means Fernandez is likely to maintain good relations with markets and the IMF. Finally, Argentina has a 1.5% weight in the EM USD government bond index. Therefore, while the latest moves in Argentinian assets have been large, we do not believe there is an imminent risk of EM contagion stemming from Argentina.

US equities close to key support; long-term uptrend intact

The S&P 500 Index has made a feeble attempt since July to decisively break above resistance at the 2018 high of 2,941 on the monthly charts. This month's fall below the 2018 high (which became the new support) raises the odds that the index could be settling back in its H1 2019 range. Typically, the break of a resistance, when accompanied by momentum (greater 'force', reflecting decisiveness), is far more comforting for bulls. Negative divergence on longer-term charts (rising index levels associated with falling momentum/lesser force) suggests that the index's rally is losing steam in the short term. To be clear, it does not necessarily mean a reversal of the long-term uptrend.

The index has immediate support at the June low of 2,729 (4% below Thursday's close), followed by 2605 (the 62% retracement of the December 2018-July 2019 rise, about 9% below Thursday's close). The long-term uptrend remains intact, while the index holds above the converged support at the December low of 2347.

What we are watching

Key technical levels; Likely Trump-Xi phone call; China policy moves; Fed's meeting minutes and Jackson Hole conference; HK unrest.

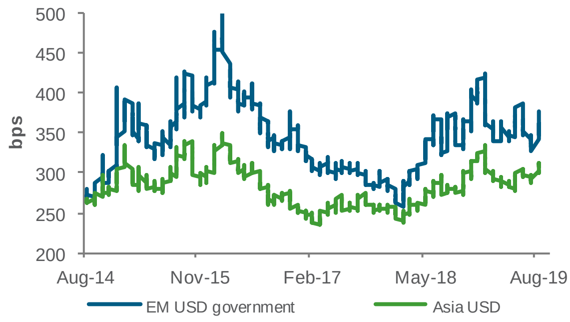
China's industrial output growth slowed to a 17-year low

China's annual industrial production growth

Source: Bloomberg, Standard Chartered

EM USD government bond yield premiums rose amid concerns about Argentina; Asian USD bond yield premiums were relatively stable

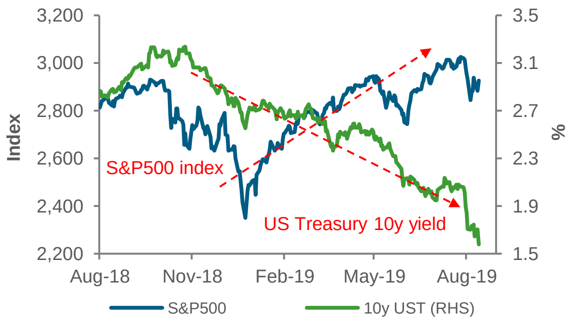
Yield premium on EM USD and Asia USD bonds over US Treasuries



Source: Bloomberg, Standard Chartered

US stocks still in an uptrend, even as bond yields fell

S&P500 index and US 10y government bond yields



Source: Bloomberg, Standard Chartered

What does this mean for investors?

Equities

Are you still bullish on equities, given recent weakness? We remain constructive towards global equities, our most-preferred asset class. Investor confidence has clearly been shaken due to the weak Europe and China data, President Trump's criticism of the Fed for not moving fast enough to cut rates and his trade policy flip-flops. Risk aversion is reflected in the outperformance of select defensive sectors, including consumer staples and real estate investment trusts, which have risen 13-19% YTD, compared with 9% for global equities.

Nevertheless, we believe these are short-term challenges set against an otherwise positive US economic backdrop. Selected cyclicals have also performed well, including the global technology sector, which is the top performing global sector this year (up 21% YTD). We still prefer US equities, especially the healthcare, industrials and energy sectors. Potential risks to our view include weak US employment data, a downturn in corporate margins and any reversal in share buyback plans.

Bonds

Is the global bond yield decline overdone? Global bond yields continued to decline over the past week, following heightened global growth concerns and with the US 10-year yield briefly falling below the 2-year yield (a common recession indicator). The 10-year US Treasury yield and the 10-year Japanese government bond yield are at their lowest since 2016, whereas the 10-year German Bund yield ploughed new all-time lows. However, fund manager surveys indicate that investors are extremely long on DM government bonds, suggesting limited chances of further declines without a new catalyst.

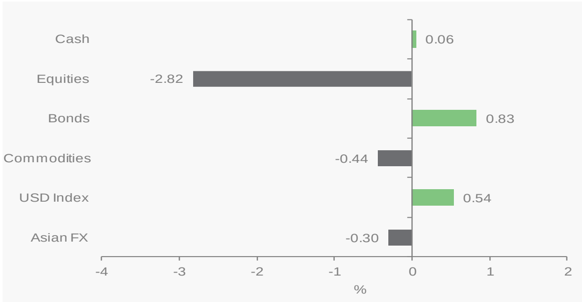
How do recent developments impact Emerging Market bonds? EM USD government bond yield premiums rose over the past week on significant weakness in Argentina's sovereign bonds. Though we believe the risk of EM contagion from Argentina is low (see page 3), ongoing trade tensions remain an overhang. Conversely, Asian USD bond yield premiums were stable as they were likely supported by lower supply and strong regional demand. Asian USD bonds again demonstrated their defensive quality. We still view Asian USD bonds as a core holding in a diversified bond allocation.

FX

What are the drivers behind your view of a stronger JPY? We continue to believe the USD is likely peaking as interest rate differentials narrow. FX volatility may rise, and safe-haven currencies, particularly the JPY, could strengthen against those that suffer from slowing global growth. Japanese institutions and individuals have extensively invested overseas. These investors may increase FX hedging as US rates fall, or simply sell foreign assets, creating strong repatriation demand for the JPY.

Markets are concerned the BoJ could intervene to prevent a stronger JPY. However, we do not expect the BoJ to act unless a clear disorderly decline occurs in USD/JPY, given the US's focus on currency manipulation. Near-term resistance appears strong around 107.20, and a break of key support around 104.50 could trigger a fall towards 100. AUD/JPY is near a key pivot level (71.90). We expect resistance at 74.00 to hold if the downtrend continues, and a break of the recent 70.75 low would trigger a decline towards 66.00.

Benchmark (USD) performance w/w*



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)

*Week of 08 August 2019 to 15 August 2019

Equity market technicals remain bearish in the short-term

Technical levels of key markets as of 15 August 2019

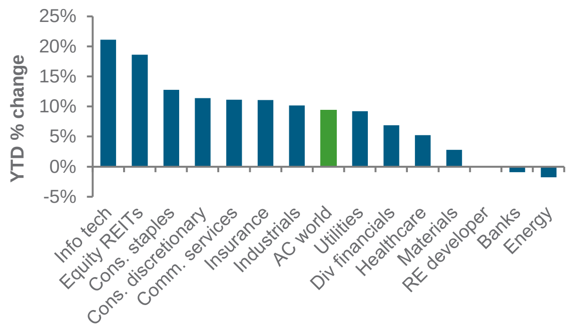
Index	Spot	1st support	1st resistance	Short-term trend
S&P	2,848	2,820	2,950	↘
STOXX 50	3,283	3,210	3,420	↘
FTSE 100	7,067	7,000	7,305	↘
Nikkei 225	20,406	19,650	21,000	↘
Shanghai Comp	2,816	2,700	2,885	↓
Hang Seng	25,495	24,550	26,300	↓
MSCI Asia ex-Japan	597	579	612	↓
MSCI EM	964	930	1,000	↓
Brent (ICE)	58	58	62	↓
Gold	1,526	1,465	1,565	↑
UST 10Y Yield	1.53	1.45	1.94	↓

Source: Trading Central, Standard Chartered

Note: Arrows represent short-term trend opinions

Defensive equity sectors, such as consumer staples and REITs, have outperformed global equities YTD

Relative performance of various global equity sectors YTD



Source: FactSet, Standard Chartered

USD/JPY is close to a key support

USD/JPY

Source: Bloomberg, Standard Chartered

Top client question

Bond yields have dipped to new lows – should we be worried about an impending recession?

The YTD decline in global government bond yields across the US, Europe, Japan likely started with the dovish turn by the Fed and other major global central banks. Concerns over slowing global growth and the US-China trade war likely pushed yields further lower. The US 10-year Treasury yield and the 10-year Japanese government bond yield are at their lowest since 2016, with the US 30-year Treasury yield hitting an all-time low below 2%. The 10-year German Bund yield fell to new all-time lows below -0.7%. In fact, even 30-year German bonds now offer a negative yield. From a technical standpoint, the US 10-year Treasury yield's break below the key psychological and technical support (includes the late-2017 low) at 2% has opened the way towards the 2016 record low of 1.32%.

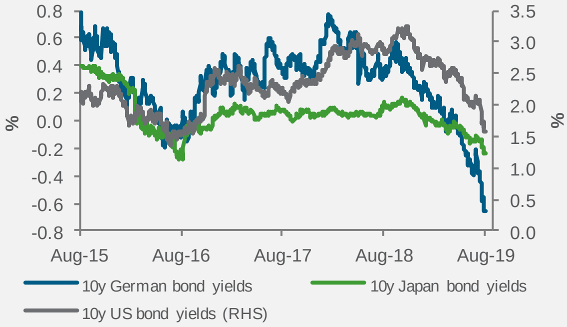
The sharp decline in long-term bond yields has led to falling differentials between short and long-term yields. Earlier this week, the 10y2y yield curve (the difference between 10-year and 2-year yields) briefly turned negative for the first time since 2007. This follows the 10y3m yield curve, which has largely been in negative territory since May. The market's focus on the US yield curve is understandable, given it remains one key signal of a potential US recession.

However, we note that it is not a perfect indicator, having offered false signals before, and is also not helpful as a timing signal. Historically, the time gap between curve inversion and equity market peak has ranged from 0 to 20 months. A confirmation by higher frequency US data, like ISM indices, is therefore important in gauging the actual risk. While US manufacturing data has been softening, it remains in expansionary territory. The unemployment rate is still low and inflation is contained. Additionally, the Fed (along with other major central banks worldwide) has turned more accommodative and markets are pricing in a near certainty of another rate cut in September. Putting these together, we continue to view the current environment as a slowdown, rather than a harbinger of an imminent recession.

Should the current bout of weakness indeed end up being a temporary slowdown, equity markets could rebound strongly. Thus, while we maintain our view that investment allocation should stay well diversified, we retain our relative preference for equities and gold within this allocation.

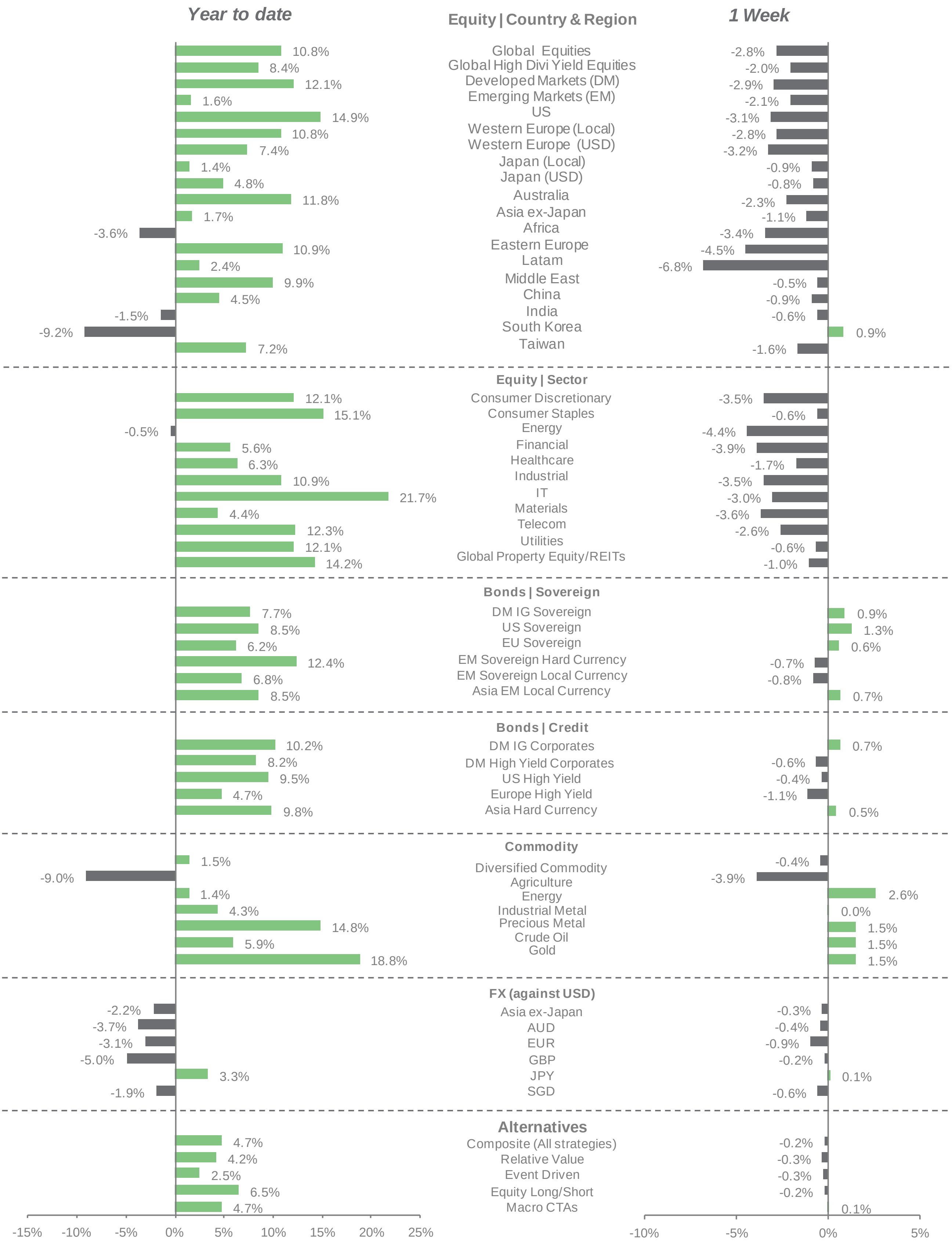
Developed Market bond yields fell to new lows

10-year government bond yields in the US, Germany and Japan



Source: Bloomberg, Standard Chartered

Market performance summary *



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

*Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 15 August 2019, 1 week period: 08 August 2019 to 15 August 2019

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	JN	Exports y/y	19-Aug-19	Jul	-2.4%	-6.6%
TUE	GE	PPI y/y	20-Aug-19	Jul	1.1%	1.2%
WED	SA	CPI y/y	21-Aug-19	Jul	4.3%	4.5%
	US	Existing Home Sales	21-Aug-19	Jul	5.38m	5.27m
THUR	FR	Markit France Composite PMI	22-Aug-19	Aug P	–	51.9
	GE	Markit/BME Germany Composite PMI	22-Aug-19	Aug P	51	50.9
	EC	Markit Eurozone Manufacturing PMI	22-Aug-19	Aug P	47	46.5
	EC	Markit Eurozone Services PMI	22-Aug-19	Aug P	52.9	53.2
	EC	Markit Eurozone Composite PMI	22-Aug-19	Aug P	51.2	51.5
	BZ	IBGE Inflation IPCA-15 y/y	22-Aug-19	Aug	–	3.3%
	US	Markit US Manufacturing PMI	22-Aug-19	Aug P	–	50.4
	US	Markit US Services PMI	22-Aug-19	Aug P	–	53
	US	FOMC Meeting Minutes	22-Aug-19	31 Jul	–	-
	US	Leading Index	22-Aug-19	Jul	0.2%	-0.3%
FRI/ SAT	JN	National CPI y/y	23-Aug-19	Jul	0.5%	0.7%
	US	Fed's Annual Jackson Hole Policy Symposium	23-Aug-19		-	-

	Event	This Week	Date	Period	Actual	Prior
MON	CH	Money Supply M2, y/y	12-Aug-19	Jul	8.1%	8.5%
	CH	New Yuan Loans CNY	12-Aug-19	Jul	1060b	1664b
TUE	JP	Producer Prices, Domestic, y/y	13-Aug-19	Jul	-0.6%	-0.1%
	GE	Harmonized Consumer Prices, y/y	13-Aug-19	Jul	1.1%	1.1%
	UK	ILO Unemployment Rate	13-Aug-19	Jun	3.9%	3.8%
	GE	ZEW Survey Expectations	13-Aug-19	Aug	-44.1	-24.5
	EC	ZEW Survey Expectations	13-Aug-19	Aug	-43.6	-20.3
	US	CPI Ex Food and Energy y/y	13-Aug-19	Jul	2.2%	2.1%
WED	JP	Core Machinery Orders, y/y	14-Aug-19	Jun	12.5%	-3.7%
	CH	Fixed Asset Investment ex-Rural YTD	14-Aug-19	Jul	5.7%	5.8%
	CH	Industrial Output, y/y	14-Aug-19	Jul	4.8%	6.3%
	CH	Retail Sales, y/y	14-Aug-19	Jul	7.6%	9.8%
	GE	GDP Flash, q/q	14-Aug-19	Q2	-0.1%	0.4%
	IN	Wholesale Prices, y/y	14-Aug-19	Jul	1.1%	2.0%
	UK	CPI Core y/y	14-Aug-19	Jul	1.9%	1.8%
	EU	GDP Flash Estimate, q/q	14-Aug-19	Q2	0.2%	0.2%
THUR	US	Unit Labour Costs	15-Aug-19	Q2 P	2.4%	5.5%
	UK	Retail Sales ex-Auto Fuels, y/y	15-Aug-19	Jul	2.9%	3.6%
	US	Initial Jobless Claims	15-Aug-19	10-Aug	220k	211k
	US	Retail Sales ex-Auto and Gas, m/m	15-Aug-19	Jul	0.3%	0.4%
	US	Industrial Production, m/m	15-Aug-19	Jul	-0.2%	0.2%
FRI/ SAT	MX	Overnight Rate	15-Aug-19	15 Aug	8.00%	8.25%
	US	Housing Starts	16-Aug-19	Jul	-	1253k

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue
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

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ESG data			
A	Excellent	**C**	Fair
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