Standard Chartered Private Bank

weekly market view

macro strategy | 15 March 2019

This reflects the views of the Wealth Management Group

Editorial

Brexit risks wane

- **The UK parliament's emphatic vote to reject a 'no-deal' Brexit reduces a key risk facing global markets. This is likely positive for the GBP and broader risk assets.**
- **Equities:** After a period of consolidation, we expect Asia ex-Japan to resume its outperformance over Developed Markets amid attractive valuations and China's stimulus.
- **Bonds:** Asia USD and EM USD government bonds, our preferred areas within bonds, are likely to consolidate YTD gains near term. This may open an opportunity to add exposure.
- **FX:** We reiterate our long-held bullish GBP view as the UK parliament's vote diminishes the 'extreme downside' scenario.

What's new?

- **Brexit risks wane.** The UK's parliament voted to take a 'no-deal' or 'hard' Brexit off the table. This reinforces our view that a hard Brexit is the least likely outcome. The focus now shifts to a likely third attempt by PM May to get parliamentarians, who have been supporting a hard-Brexit outcome, to back her agreed Brexit plan or risk the UK staying on in the European Union permanently. If that plan fails, an extension of the Brexit deadline beyond 29 March would become inevitable (subject to the agreement of EU members, which should be forthcoming as they too want to avoid a 'hard' Brexit). We believe Brexit on terms agreed between the UK and EU would be consistent with GBP/USD extending gains to 1.36, followed by 1.40. A no-Brexit ('remain') outcome, possibly after an election or a second referendum, could push the pair towards 1.45. (See page 3 for more details).
- **Slowdown in US job growth, inflation.** US job creation slowed in January to the weakest monthly gains since 2017. The sharp slowdown was partly because smaller businesses curbed hiring amid uncertainty around the US government shutdown. US core CPI inflation fell to 2.1% (close to the Fed's 2% target). Although US retail sales recovered from December's slump and wage growth continues to gradually accelerate, the slowdown in job creation and overall inflation are likely to encourage the Fed to maintain its pause in its rate hiking cycle when it meets on 19-20 March. The Fed's dovish tilt, which led to dovish turns by other leading central banks, has been a key driver of risk assets YTD.
- **Developed Market equities take the lead.** Equity markets have witnessed a switch in leadership away from Emerging Markets (EM) in favour of Developed Markets (DM) in recent weeks, led by US equity market strength and weakness in Non-Asia EMs. USD strength, since the start of February, has also contributed to a slowdown in foreign fund inflows to EMs, which has cooled sentiment after a strong start to the year. However, we retain a preference for EM over DM over the coming 12 months based on a view of a stable USD, attractive valuations and growth-supportive stimulus measures in China.

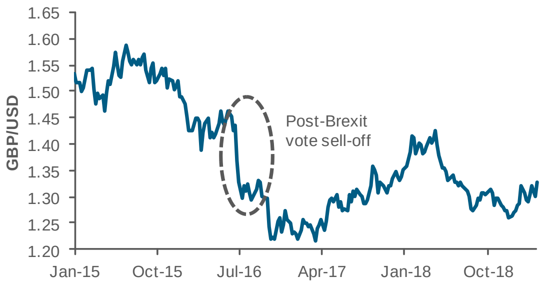
What we are watching

- a) Fed policy decision, including updated growth, inflation and policy rates outlook (20 March), b) likely UK parliament third vote on the UK-EU Brexit deal, c) Bank of England policy decision (21 March), and d) US' decision on auto import tariffs.

Contents

GBP still looks cheap relative to pre-Brexit vote levels

GBP/USD exchange rate



Source: Bloomberg, Standard Chartered

The Fed's pause in rate hikes has led to dovish turns by other leading central banks, lowering bond yields worldwide

10-year government bond yields for major economies

Index	Current yield	12-month average yield	12-month low	12-month high
US	2.63	2.90	2.55	3.24
Germany	0.08	0.37	0.05	0.64
France	0.46	0.71	0.40	0.90
UK	1.36	1.24	1.15	1.35
Japan	-0.05	0.05	-0.06	0.15
China	3.13	3.48	3.06	3.84
India	7.38	7.75	7.16	8.18
South Korea	1.97	2.70	1.94	2.80

Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities rebounded, led by the US and Europe, while EMs consolidated. Corporate bonds outperformed government bonds. The USD gave up some of its recent gains.

Equities: Emerging Markets consolidate

- **China focuses on earnings.** China shares consolidated in March, after a 24% rally in the CSI300 index and 14% rise in Hang Seng Index in the first two months of the year, amid concerns that margin financing activities might be curbed by the government. In fact, the margin financing balance in China remains at a healthy level of c. CNY 850bn, well below the peak of c. CNY 2trn during the 2015 rally. We expect market consolidation to continue in the near term as the focus shifts to Q4 2018 earnings and corporate earnings guidance for 2019. Given consensus expectations for 12% earnings growth over the next 12 months, we believe China equities are attractively valued. China equities (both on- and off-shore) remain our preferred markets within Asia ex-Japan.
- **Interest rate-sensitive sectors gain.** Real estate and industrial sectors have been among the star performers this year as investors reacted to the decline in global government bond yields following dovish policy shifts in the US and Europe. While industrials are a core holding for us in the US and Europe, the real estate sector's gains challenges our medium-term bearish view on the sector. A sustained dovish view from the Fed at its March meeting could support the sector in the near term.
- **Energy and technology sectors have also performed strongly** YTD, despite the weakness in earnings in both sectors. This reflects investor willingness to look through the expected earnings slowdown in 2019, which is partially related to a high base in 2018 due to factors such as corporate tax cuts of late-2017. Energy and technology sectors remain among our preferred sectors in the US and Europe.

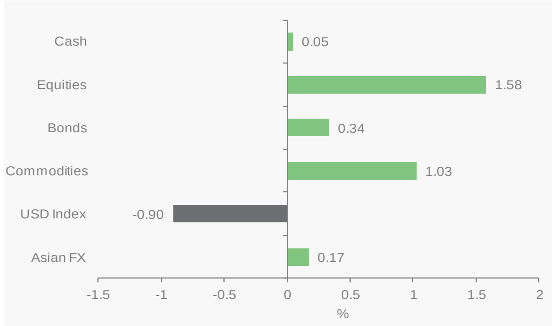
Bonds: Government bond yields likely to rebound

- **Government bond yields pricing in too much pessimism.** Declining inflation in the US and a dovish tone from the ECB have dragged 10-year US Treasury and German bund yields lower. 10-year US Treasury yields are currently close to a key technical level of 2.62%. Globally, government bond yields are close to their one-year lows, which lead us to be vigilant against a rebound in yields, should economic data improve. Thus, we prefer to maintain a moderate maturity profile (around five years).
- **EM bonds regain momentum.** EM government bonds, both USD and local currency-denominated, delivered positive returns, likely helped by renewed inflows, as well as a modestly weaker USD. Inflation in major EM economies has been rather subdued, which increases the possibility of rate cuts in the near future (especially in India) that could lead to capital gains. While we continue to favour EM USD government and Asian USD bonds, short-term indicators suggest heightened risk of a potential consolidation or a slight pull-back in the asset classes near term. Thus, we would wait for a better opportunity to add to our preferred bond asset classes.

FX: EUR/USD rebounds from 21-month low

- **EUR/USD faces resistance at 1.15.** The pair rebounded from a 21-month low just below 1.12 following soft US inflation data that raised the prospects of a prolonged Fed pause. Technical charts suggest a break of 1.1420 could lead to a test of the next key resistance of 1.15. Strong support is at around 1.12.

Benchmark (USD) performance w/w*



**Week of 07 March 2019 to 14 March 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)

Asian equities' technical outlook remains strong

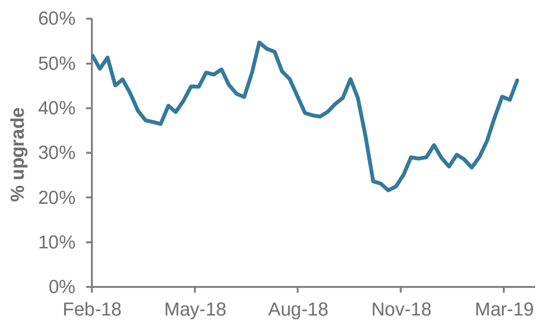
Technical levels of key market indicators as on 14 March

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,808	2,720	2,820	↓
STOXX 50	3,342	3,290	3,395	→
FTSE 100	7,185	7,000	7,262	→
Nikkei 225	21,287	20,850	21,880	→
Shanghai Comp	2,991	2,835	3,135	↑
Hang Seng	28,851	27,850	29,250	↑
MSCI Asia ex-Japan	653	635	663	↑
MSCI EM	1,048	1,027	1,058	→
Brent (ICE)	67	63	72	↑
Gold	1,296	1,275	1,320	↘
UST 10Y Yield	2.62	2.52	2.80	↘

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

China 2019 earnings outlook has started to improve in recent months amid government policy stimulus

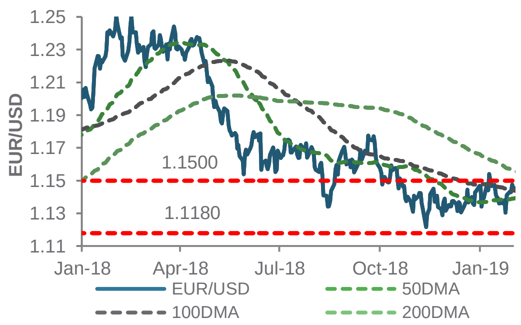
Share of CSI300 index companies which have seen upward revision for 2019 earnings estimates



Source: Bloomberg, Standard Chartered

EUR/USD is likely to test the next resistance of 1.15

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What do the UK parliamentary votes mean for Brexit risks?

The past week has seen the UK parliament vote to 1) reject (again) the deal negotiated with the EU, 2) rule out a no-deal, 'hard' Brexit, and 3) request an extension to the 29 March deadline. We believe this further reduces the probability of a hard Brexit, from the already-low 10% chance we assigned before this week's developments.

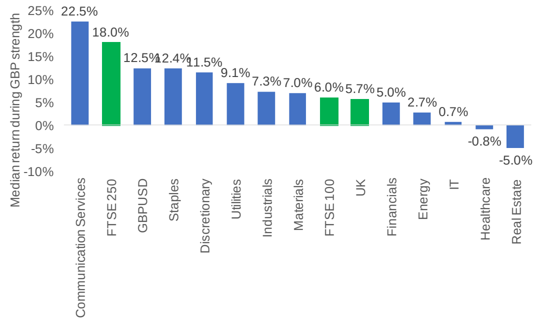
That said, the road to resolution remains unclear. The focus next week will be on the third vote on the UK-EU deal and whether the fear of no Brexit or a worse deal may encourage more MPs to support the deal. Both the UK and EU will want to see how this vote goes before deciding what type of extension make sense. If the deal is voted down by a wide margin again, then a second referendum or a general election could be required to break the deadlock.

Our view that the risks of a hard Brexit are declining leads us to reiterate our view that the GBP outlook is skewed to more upside. Based on post-Brexit history, we see GBP/USD moving to around 1.40 if a deal can be reached and 1.45 under a 'Remain' scenario. Looking over the past 25 years, we have identified 6 periods of trend GBP strength. During these periods, UK equities tend to deliver positive returns with more domestically-focussed mid-cap stocks outperforming their more internationally-oriented large-cap stocks. From a sector perspective, Communication Services, Consumer Staples and Consumer Discretionary have generally outperformed.

The main risk to the above outlook is that the probability of a 'hard' Brexit rises significantly. Of course, it is important to acknowledge that if no deal or delay can be agreed in the next two weeks, then the default setting is a 'hard' Brexit. Therefore, the next week or two may see slightly better GBP buying opportunities and/or opportunities to sell downside GBP risk via the options market.

Communication services, consumer discretionary and consumer staples generally outperform during bouts of GBP strength

MSCI UK sector and FTSE-100/250 median returns during periods of significant GBP strength over the past 25 years



Source: Bloomberg, Standard Chartered

Q2. Does the sharp fall in HKD short-term borrowing rates and the currency since January represent an opportunity?

We believe it represents an opportunity to reduce borrowing costs for investors with USD-denominated borrowings.

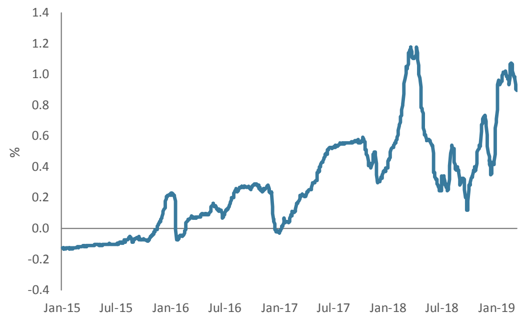
Over the past few weeks, the pegged USD/HKD exchange rate has moved to the top of its allowable policy band, likely reflecting the widening gap between short-term interest rates in the USD and the HKD (to almost 0.9%), similar to an earlier episode in early 2018.

We do not expect this unusually wide gap in US-HK short-term rates to persist. Policy intervention to defend the top of the USD/HKD range means HK policymakers will likely end up reducing domestic market liquidity to the point where short-term HK rates rise to largely match US rates. Until this adjustment happens, we believe an opportunity to lower funding costs exists. Investors with USD-denominated borrowings should consider rotating some of those borrowings into the HKD to lock in current, lower borrowing costs.

The main risk to our view for a USD-based investor is that the HKD strengthens by the full magnitude of its allowable policy range (i.e. about 1.2%). This could occur either because (i) the HKMA intervention is very aggressive, pushing local rates at least as high as USD rates, or (ii) the Fed reverses its rate hiking cycle, causing USD rates to fall to match those in HK. However, we believe this represents an attractive risk/reward opportunity, given our continued confidence in the USD/HKD currency peg effectively limits currency risk.

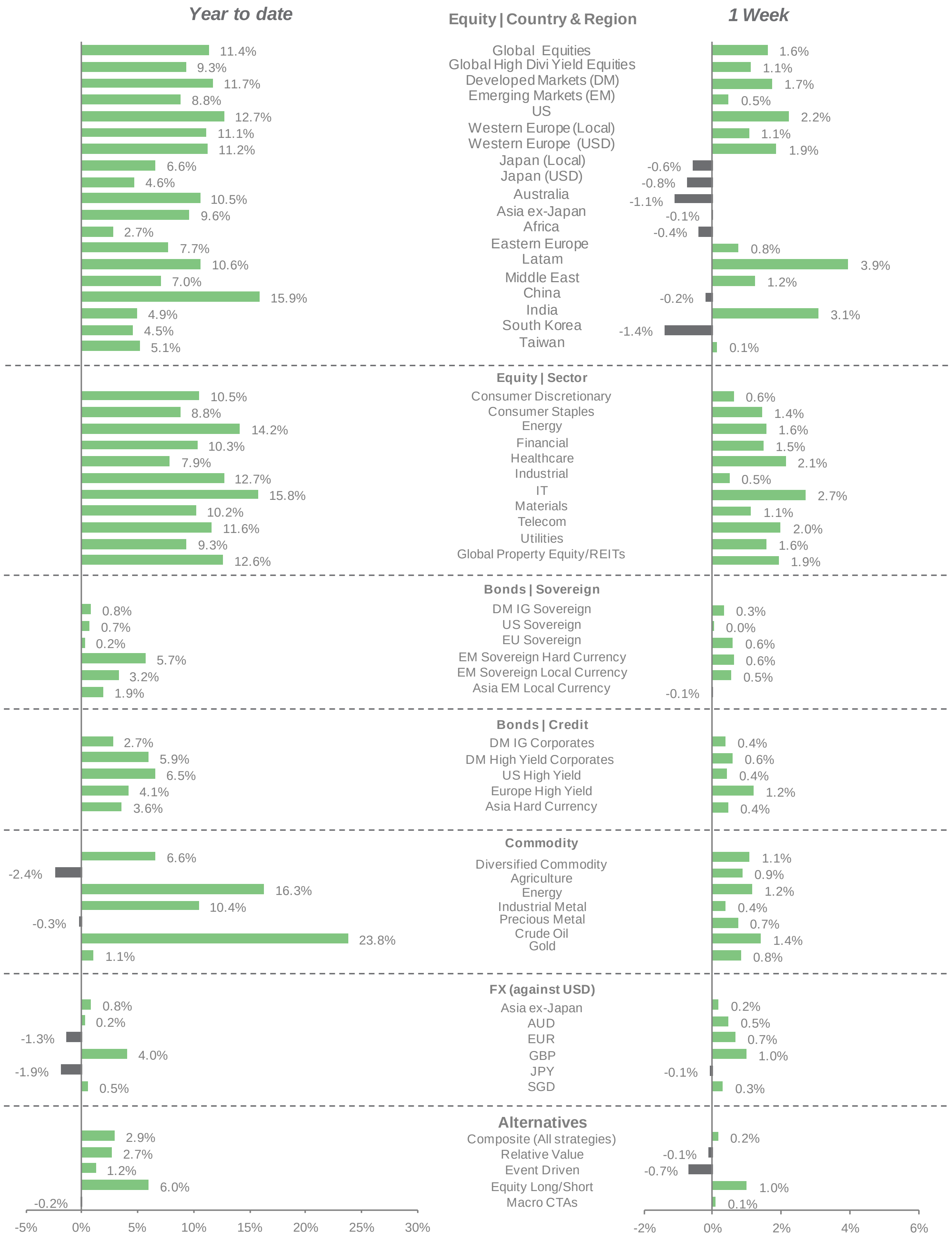
The gap between US and HK rates is close to the widest it has been over the past few years

US 3-month LIBOR – HK 3-month HIBOR (%)



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 14 March 2019, 1 week period: 07 March 2019 to 14 March 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	JN	Exports y/y	18-Mar-19	Feb	-0.6%	-8.4%
TUE	UK	Average Weekly Earnings 3m/ y/y	19-Mar-19	Jan	–	3.4%
WED	UK	CPI Core y/y	20-Mar-19	Feb	–	1.9%
THUR	US	FOMC Rate Decision (Upper Bound)	21-Mar-19	20-Mar	2.5%	2.5%
	UK	Retail Sales Ex Auto Fuel y/y	21-Mar-19	Feb	–	4.1%
	UK	Bank of England Bank Rate	21-Mar-19	21-Mar	–	0.8%
	US	Initial Jobless Claims	21-Mar-19	16-Mar	–	--
	US	Leading Index	21-Mar-19	Feb	0.1%	0.0%
	EC	Consumer Confidence	21-Mar-19	Mar A	–	-7.4
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	22-Mar-19	Feb	0.4%	0.4%
	JN	Nikkei Japan PMI Mfg	22-Mar-19	Mar P	–	48.9
	GE	Markit/BME Germany Composite PMI	22-Mar-19	Mar P	–	52.8
	EC	Markit Eurozone Composite PMI	22-Mar-19	Mar P	–	51.9
	US	Markit US Composite PMI	22-Mar-19	Mar P	–	55.5
	US	Existing Home Sales	22-Mar-19	Feb	5.08m	4.94m

	Event	This Week	Date	Period	Actual	Prior
MON	GE	Industrial Production WDA y/y	11-Mar-19	Jan	-3.3%	-2.7%
	GE	Exports SA m/m	11-Mar-19	Jan	0.0%	1.5%
	US	Retail Sales Ex Auto and Gas	11-Mar-19	Jan	1.2%	-1.6%
TUE	UK	GDP (m/m)	12-Mar-19	Jan	0.5%	-0.4%
	US	CPI Ex Food and Energy y/y	12-Mar-19	Feb	2.1%	2.2%
WED	JN	Core Machine Orders y/y	13-Mar-19	Jan	-2.9%	0.9%
	US	PPI Ex Food and Energy y/y	13-Mar-19	Feb	2.5%	2.6%
THUR	CH	Fixed Assets Ex Rural YTD y/y	14-Mar-19	Feb	6.1%	5.9%
	CH	Industrial Production YTD y/y	14-Mar-19	Feb	5.3%	6.2%
	CH	Retail Sales YTD y/y	14-Mar-19	Feb	8.2%	9.0%
FRI/SAT	US	Industrial Production m/m	15-Mar-19	Feb	–	-0.6%
	US	U. of Mich. Sentiment	15-Mar-19	Mar P	–	93.8
	JN	BOJ Policy Balance Rate	15-Mar-19	3/15/2019	–	-0.1%
	IN	Exports y/y	15-Mar-19	Feb	–	3.7%

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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