weekly **market view**

macro strategy | 21 September 2018

This reflects the views of the Wealth Management Group

Editorial

China stimulus expectations

- **China's growing support for its economy and markets is likely to mitigate the fallout of escalating trade tensions, helping stabilise Emerging Markets and other risk assets.**
- **Equities:** We remain bullish on US equities, but note the first signs of caution among some market strategists. Any sustained rebound in the GBP would be negative for UK large-cap equities.
- **Bonds:** We believe the rebound in US High Yield (HY) bonds provides an opportunity to rebalance to the more attractively valued Emerging Market (EM) USD government bonds.
- **FX:** China Premier Li Keqiang's ruling out any CNY devaluation could help USD/CNH correct towards the 6.7800 support level.

What's new?

- **China stimulus expectations to offset growing trade rift.** The US-China trade spat has escalated, with the US deciding to impose tariffs on another USD 200bn of imports from China starting 24 September and China retaliating with tariffs on another USD 60bn of US imports. However, we believe some mitigating factors could provide some respite to risk assets in the near term: 1) initial tariff rates imposed by both sides are lower than expected; 2) Premier Li pledged not to devalue the CNY to offset any impact from higher tariffs; 3) Continued Hong Kong share buybacks and reports of China's state-owned institutions supporting local equities; and 4) expectations that Beijing will revive infrastructure spending, cut tariffs on imports from major trading partners and accelerate other stimulus measures to support domestic growth.
- **Asian equities, currencies look oversold.** Charts suggest the seven-month downtrend in the MSCI Asia ex-Japan index is likely to show some signs of fatigue in the near term as it tests a strong support at the 2015 high, roughly coinciding with the 100-week moving average (WMA). Key resistance is around the July 2018 high (c.5% from current levels). The Asia Dollar index has also stabilised over the past month after a four-month slide. The index looks deeply oversold, raising the chance of a short-term rebound. Any break above the August high of 105.73 would imply that the downward pressure has eased in the short term.
- **Japan's Abe wins mandate to extend rule, stimulus.** Prime Minister Shinzo Abe's comfortable win for a third consecutive three-year term as the head of Japan's ruling party gives him the mandate to pursue further structural reforms and extend unprecedented monetary and fiscal stimulus. Abe's policies have helped the economy experience its longest period of growth since the 1990s. We expect Abe to focus on rebuilding infrastructure damaged by the recent earthquakes, flooding and typhoons. We also note the BoJ's policy decision this week to continue with its ultra-loose monetary policy for an extended period. This supports our positive view on Japan equities.

What we are watching

- **Fed policy.** Markets expect a 25bps rate hike to 2.25% on 26 Sept and another hike by year-end. The focus will be on the Fed's longer-term growth, inflation and interest rate forecasts.

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MSCI Asia-ex-Japan index has a strong support at the current level, which coincides with the 2015-high and its 100WMA

MSCI Asia ex-Japan index

Source: Bloomberg, Standard Chartered

Asia Dollar index looks oversold; any break above the August high of 105.73 would imply that the downward pressure has eased in the near term

Asia Dollar index (ADXY)

Source: JP Morgan, Bloomberg, Standard Chartered

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What does this mean for investors?

Global stocks and commodities rose for the second week, with US equity indices hitting new record highs, while the USD weakened further, amid signs of easing stress as China stepped up measures to offset the impact of rising trade rifts.

Equities: US market strategists turning cautious

- **Caution emerging in the US.** While US stocks hit another record high, a minority of market strategists are cutting their view on US equities to neutral (or core holding in our language) from overweight (preferred), as well as their earnings growth estimates. For S&P500 companies, negative Q3 earnings pre-announcements outpace positive guidance by a 2:1 ratio, compared with 1.4:1 ahead of Q2 earnings. Historically, negative pre-announcements usually outnumber positives, as companies typically manage expectations lower ahead of the earnings season so that they can deliver a positive surprise to investors when they eventually release earnings. While the US remains our preferred equity market, we will watch the upcoming Q3 earnings and any revisions in analyst earnings estimates closely.
- **GBP recovery to hurt UK large-cap earnings.** The GBP has recovered from a 14-month low hit in August. However, the GBP's recovery is negative for UK large-cap equities because it reduces the GBP value of overseas revenues (almost 2/3 of the revenue of FTSE100 index members are generated overseas). As a result, over the past month, more analysts have been cutting their UK earnings' forecasts than those who have been raising them, reversing the April-August trend when the GBP was declining. UK equities remain a core holding amid strong commodity prices, although the GBP's recovery is a key risk.

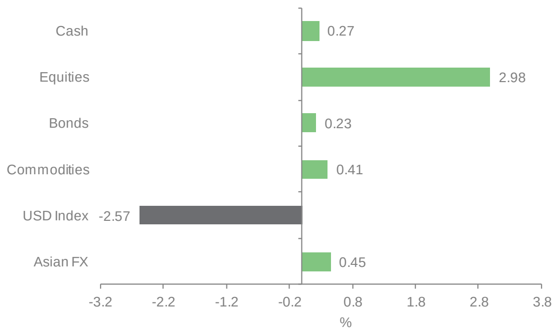
Bonds: Opportunity to switch to EM USD government bonds

- **US 10-year Treasury yields rise above 3%.** The yield has risen 10bps for the second straight week as robust data led markets to price in a slightly faster pace of Fed rate hikes in 2019. Despite the recent increase in yields, we continue to assign a high probability that the 10-year yield will likely remain capped below 3.25% over the next 12 months as US long-term inflation expectations remain stable. We expect the Fed to hike rates twice this year, including on 26 September, and three times in 2019.
- **Switch from US HY bonds to EM USD bonds.** US High Yield (HY) bonds had another strong week as yield premiums continued to decline, owing to robust economic data in the US and higher oil prices. However, this has led to expensive valuations as the yield premiums are close to their lowest in the past decade. Hence, while US HY bonds offer attractive headline yields, we see little scope for capital appreciation and would prefer getting similar yields through EM USD government bonds. EM USD government bonds provide yields similar to EM local currency bonds, but with lower volatility.

FX: CNH stabilises after Premier Li's supportive comments

- **USD/CNH stable on currency assurances.** USD/CNH has traded in the 6.80-6.90 band through September. The pair showed little impact from the latest escalation in the trade spat between the US and China, partly due to supportive comments from Premier Li, who said that China would not use currency devaluation to counter the effects of US tariffs. Hence, we believe that this year's high of 6.96 hit in August and the psychological 7.00 levels are likely to provide strong resistances for the pair. A modest correction towards 6.78 is possible.

Benchmark (USD) performance w/w*



**Week of 13 September 2018 to 20 September 2018*

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)

S&P500 technical indicators remain the strongest

Technical levels of key market indicators as on 20 Sept.

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,931	2,873	2,940	↑
STOXX 50	3,403	3,330	3,436	↗
FTSE 100	7,367	7,146	7,500	↘
Nikkei 225	23,814	22,600	24,100	↑
Shanghai Comp	2,729	2,630	2,795	↘
Hang Seng	27,478	26,200	28,000	↘
MSCI Asia ex-Japan	651	618	662	↓
MSCI EM	1,037	1,000	1,060	↓
Brent (ICE)	79	75	81	↗
Gold	1,209	1,182	1,212	↘
UST 10Y Yield	3.06	2.92	3.13	↗

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

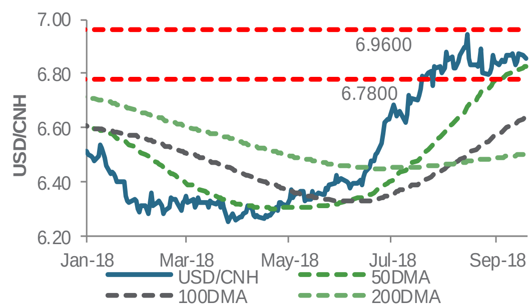
EM USD government bonds provide similar yields as local currency bonds with much less volatility

Relative performance of EM USD government bond index and EM local currency bond index (100 = 20 Sep. 2017)

Source: JPMorgan, Bloomberg, Standard Chartered

USD/CNH has a strong resistance around 6.9600

USD/CNH



Source: Bloomberg, Standard Chartered

Top client questions

Q1. Does the escalation in trade tensions between the US and China alter your positive outlook for Chinese equities?

This past week saw the US administration go ahead and impose an additional USD 200bn of tariffs at 10% (rising to 25% in January 2019) on Chinese imports. President Donald Trump's decision – taking effect on 24 September – came as a continuation of the tit-for-tat trade tactics officially aimed at reducing its bilateral trade deficit. President Trump also announced a possible additional USD 267bn of tariffs if China decided to proceed with retaliation measures.

While the US tariffs allowed for some exceptions in the tech goods space, China retaliated with its own levies between 5% and 10% on goods worth USD 60bn. Although this decision might trigger another response by the US administration, markets shrugged off the worst fears as these retaliatory measures came in below the previously announced level of (up to) 25%.

In fact, China A shares (CSI 300 index) rose 2.3% and HSI gained 1.7% this week despite the escalation in trade talks. We believe there are several factors contributing to the positive market reaction:

1) Market participants were anticipating higher levies on a shorter-time frame;
2) The oversold CNY has stabilised so far around 6.85. A stable CNY is positive for the mainland property and Macau gaming sectors as both are sensitive to CNY movements. The former is highly exposed to USD-denominated loans, while the latter is vulnerable to reduced tourist flow from China (moreover, typhoon Mangkhut had exacerbated the market's already negative sentiment);
3) We also noted that HK-listed blue chips have been actively buying back shares in recent weeks. The move has provided support to their share prices in the short term;
4) Market sentiment was buoyed by hopes that the Chinese government could reduce tariffs on imports from major trading partners and launch more stimulative measures to stabilise the economy amid an escalating trade war with the US.

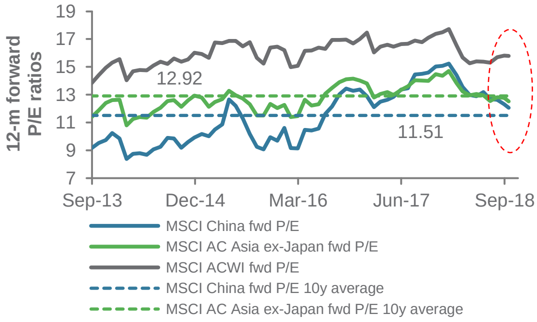
From a technical perspective, various indicators are pointing to a stabilisation of the current rout. Technical indicators for Asia ex-Japan and China-related indices point to the slide losing steam and markets falling into oversold territory.

Also, valuation multiples for Chinese markets have compressed and look much cheaper on a relative basis, both versus earnings growth forecasts (ca. 9.5% for the next 12 months) and the MSCI Asia ex-Japan index forward price-to-equity multiples.

While it is difficult to say with conviction that the market has definitively reached a bottom, we believe that risk-reward favours averaging into China shares.

China and Asia ex-Japan equity indices are both more attractively valued compared with global equities and close to their ten-year averages

P/E multiple trends of MSCI Asia ex-Japan, MSCI China and MSCI All Country World indices



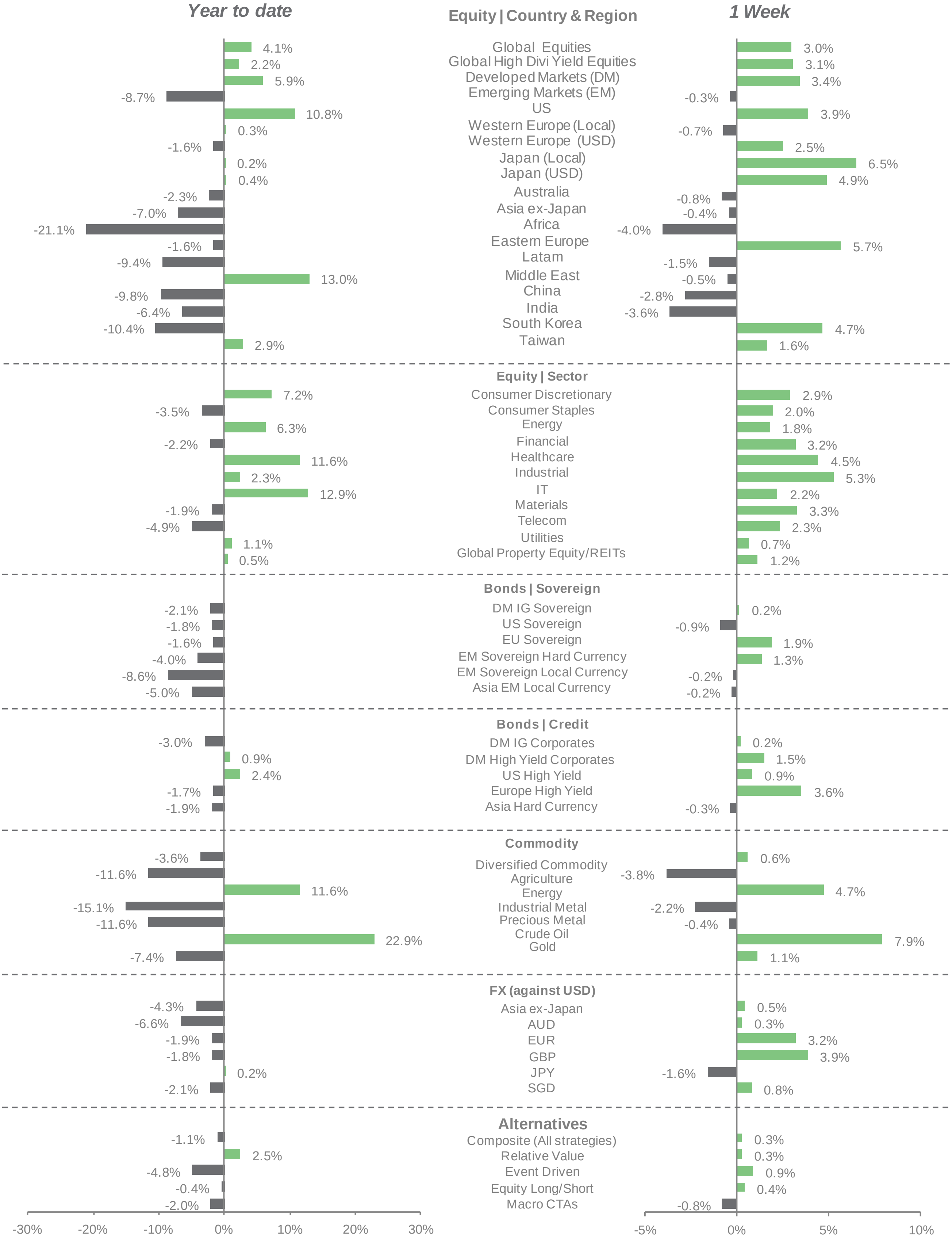
Source: Bloomberg, Standard Chartered

China and Asia ex-Japan equity indices appear to have stabilised lately, opening up opportunity to close the performance gap vs. global equities

Relative performance of MSCI Asia ex-Japan, MSCI China and MSCI All Country World indices: 100 = 29 December 2017

Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 20 September 2018, 1 week period: 13 September 2018 to 20 September 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
MON	GE	IFO Expectations	24-Sep-18	Sep	–	101.2
TUE	US	Conf. Board Consumer Confidence	25-Sep-18	Sep	131	133.4
WED	US	New Home Sales	26-Sep-18	Aug	631k	627k
THUR	US	FOMC Rate Decision (Upper Bound)	27-Sep-18	26-Sep	2.3%	2.0%
	EC	Business Climate Indicator	27-Sep-18	Sep	–	1.22
	GE	CPI EU Harmonized y/y	27-Sep-18	Sep P	–	1.9%
	US	Cap Goods Orders Nondef Ex Air	27-Sep-18	Aug P	0.3%	1.6%
FRI/SAT	JN	Industrial Production y/y	28-Sep-18	Aug P	–	2.2%
	CH	Caixin China PMI Mfg	28-Sep-18	Sep	–	50.6
	EC	CPI Core y/y	28-Sep-18	Sep A	–	1.0%
	US	PCE Core y/y	28-Sep-18	Aug	–	2.0%
	US	Real Personal Spending	28-Sep-18	Aug	–	0.2%
	US	Chicago Purchasing Manager	28-Sep-18	Sep	62	63.6

	Event	This Week	Date	Period	Actual	Prior
WED	JN	Exports y/y	19-Sep-18	Aug	6.6%	3.9%
	UK	CPI Core y/y	19-Sep-18	Aug	2.1%	1.9%
	US	Housing Starts	19-Sep-18	Aug	1282k	1174k
	US	Building Permits	19-Sep-18	Aug	1229k	1303k
	JN	BOJ Policy Balance Rate	19-Sep-18	19-Sep	-0.1%	-0.1%
THUR	UK	Retail Sales Ex Auto Fuel y/y	20-Sep-18	Aug	3.5%	4.0%
	EC	Consumer Confidence	20-Sep-18	Sep A	-2.9	-1.9
	US	Existing Home Sales	20-Sep-18	Aug	5.34m	5.34m
	SA	SARB Announce Interest Rate	20-Sep-18	20-Sep	6.5%	6.5%
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	21-Sep-18	Aug	0.4%	0.3%
	GE	Markit/BME Germany Composite PMI	21-Sep-18	Sep P	–	55.6
	EC	Markit Eurozone Manufacturing PMI	21-Sep-18	Sep P	–	54.6
	EC	Markit Eurozone Services PMI	21-Sep-18	Sep P	–	54.4
	EC	Markit Eurozone Composite PMI	21-Sep-18	Sep P	–	54.5

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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