Standard Chartered Private Bank

weekly **market view**

macro strategy | 24 May 2019

This reflects the views of the Wealth Management Group

Editorial

Cooling-off period?

- **US-China tensions are likely to drag on for the next few months, making a defensive stance a prudent course for investors near term.**
- **Equities:** The US ban on Huawei makes us increasingly cautious about the global technology sector.
- **Bonds:** Emerging Market (EM) and Asia USD bonds have been relatively steady despite the trade tensions. We retain our preference for the two segments within bonds.
- **FX:** Asian trade-focussed currencies are likely to see downside pressure in the near-term, while INR remains relatively resilient.

What's new?

- **Cooling off period?** China and Asia equity indices fell through key technical support levels (200DMA) after the US banned its companies from doing business with China's leading mobile phone equipment producer, Huawei. Other major equity markets were relatively stable. Following the ban on Huawei, we believe the ongoing US-China tensions are likely to be more prolonged than previously expected and see reduced prospects for a deal by the June G20 meeting. We believe this warrants a defensive stance near-term (see page 3). In equities, the energy sector remains preferred area in the US and Euro area and consumer staples in China. Asia USD bonds are likely to benefit from increased demand for USD assets among Asian investors seeking protection from currency weakness (see page 2).
- **Indian assets jump as ruling coalition voted back to power.** India's equity index scaled an all-time high, the INR strengthened and the 10-year government bond yield fell as PM Narendra Modi's party won a bigger majority than in the 2014 elections, ensuring political stability for the next five years. The emphatic victory is likely to encourage further pro-business reforms and should be positive for institutional flows given foreign investor positioning in Indian equities relative to other EMs is close to a 7-year low. India's domestic-focussed economy is also less impacted by global trade uncertainty. The focus now turns to policies to reverse a growth slowdown, with markets expecting a central bank rate cut in the next quarter. We expect further gains in the INR in the near-term, although RBI is likely to weigh against significant strength over the medium term (see page 3).
- **GBP likely oversold.** We believe GBP selling pressure is likely to abate as it approaches a key support around 1.2550. A bounce to 1.2900 could lead to gains towards 1.3200. UK political uncertainty continues to undermine the GBP, with the EU elections and talk of PM May resigning reviving worries about a hard Brexit. We believe the UK parliament will prevent a hard Brexit regardless of the bias of the next premier. Given this, any decline in GBP/USD towards 1.2550 would offer an opportunity to add exposure. A break below this level risks decline towards the c.1.20 January 2017 low. Volatility is likely to stay elevated.

What we are watching

- US-China trade developments; China stimulus; EU elections (23-26 May); US core PCE inflation; China PMI; UK politics.

Contents

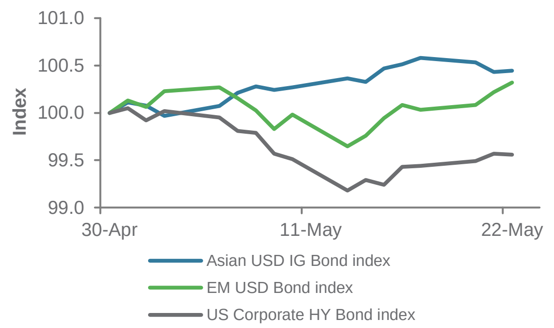
Asia's equity benchmark fell through a key support; the next support is 2.3% lower

MSCI Asia ex-Japan index with next support level

Source: Bloomberg, Standard Chartered

Asia USD bonds and EM USD government bonds have been resilient despite the trade tensions

Relative performance of Asia USD, EM USD government and US HY bond indices MTD (Index: 100 = 30 April 2019)



Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities and commodities declined and Developed Market bonds gained amid a revival of US-China trade tensions.

Equities: What are key takeaways from Euro area Q1 earnings?

- **Earnings disappoint.** Euro area earnings declined 6% in Q1, with most companies having reported. Similar to the US, consensus forecasts for Euro area started to deteriorate in February 2019. However, in contrast to the US, where expectations for S&P500 earnings rebounded from a contraction to reflect positive growth by the end of the reporting season, Euro area earnings expectations have continued to contract.
- **Euro area financial sector earnings contract.** Almost 50% of Euro area financial sector companies have exceeded earnings expectations. However, in aggregate, earnings still contracted in the quarter. This is reflected in the underperformance of the equity sector YTD. Technology sector earnings outperformed, with 70% of the sector reporting earnings ahead of expectations. The sector has been among the top performers YTD, rising 20%.

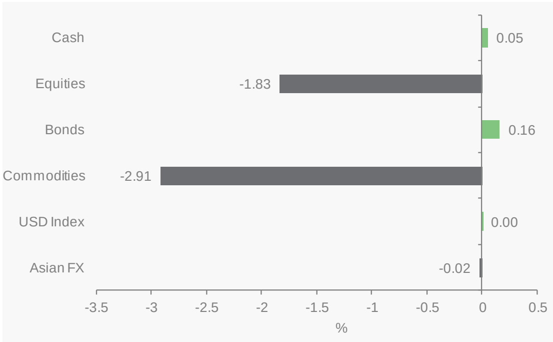
Bonds: How will the US-China trade tensions impact bonds?

- **Safe-haven bonds likely to benefit.** US, German and Japanese government bonds remained largely resilient over the past week. Further escalation in trade tensions could lead to lower yields, both due to greater demand for safe-haven assets and the expectation of easier monetary policies as central banks seek to offset concerns about slowdown in growth. Although some allocation to high-quality government bonds is warranted, low absolute yields lead us to still prefer other areas in bonds, such as EM USD government bonds and Asia USD bonds.
- **Fund flows crucial for EM bonds.** EM USD government bonds and Asia USD bonds have been relatively stable despite the flare-up in trade tensions. Although EM bond yield premiums could increase, we believe the yield on offer should act as a buffer for investors if trade tensions escalate or drag longer than expected. As highlighted last week, we continue to prefer Asia USD bonds as a relatively small proportion of bond issuers are directly exposed to the US market. Also, any Asian FX weakness could lead to higher demand for USD bonds.

FX: What is the outlook for Asian currencies amid trade tensions?

- **Trade-focused currencies extend declines.** The TWD, KRW, IDR, SGD and MYR are the worst-performing Asian currencies month-to-date (MTD), following the CNY's lead. The TWD, MYR and SGD extended declines over the past week as trade tensions escalated. The break in the Bloomberg JPMorgan Asia USD index below the key 200DMA support has opened the way towards the 2018 low of 103.16 (about 0.7% below current levels), which should provide a strong support.
- **AUD downtrend likely to continue.** We expect AUD/USD to remain within the downtrend channel towards 0.6750, with rallies likely to be capped between 0.7070 and 0.7140. The RBA has turned dovish, with markets expecting two rate cuts this year to buffer the negative effects of slowing global trade and the cyclical downturn in domestic property prices. Nevertheless, Australia's terms of trade are now relatively attractive and the government has room to cushion the economy with fiscal stimulus if needed. Given this, AUD is unlikely to fall sharply near-term unless a significant deterioration of US-China and global trade tension occurs, in our opinion.

Benchmark (USD) performance w/w*



**Week of 16 May 2019 to 23 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 Hong Kong equity technicals turned negative

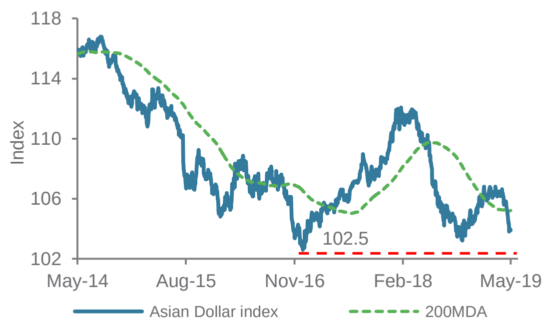
Technical levels of key market indicators as on 23 May

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,822	2,785	2,870	↓
STOXX 50	3,327	3,312	3,388	→
FTSE 100	7,231	7,146	7,373	→
Nikkei 225	21,151	20,750	21,635	↘
Shanghai Comp	2,853	2,800	3,000	↘
Hang Seng	27,267	26,600	28,430	↓
MSCI Asia ex-Japan	614	595	657	↘
MSCI EM	985	967	1,049	↘
Brent (ICE)	68	64	73	↓
Gold	1,284	1,270	1,291	↗
UST 10Y Yield	2.32	2.20	2.57	↘

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

Asia USD index's break below its 200DMA opens the way for a further 0.7% decline

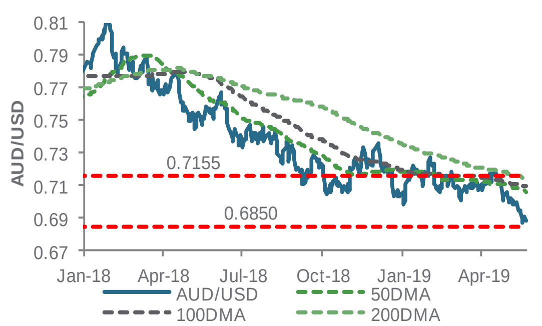
Asia USD currency index



Source: JPMorgan, Bloomberg, Standard Chartered

AUD/USD is close to a key support

AUD/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What is the investment impact of the US ban on Huawei?

The US banned American companies from doing business with Huawei, China's leading mobile telecom equipment provider, opening up another flank in its ongoing trade dispute with China. The impact of the ban would depend on whether China retaliates and how long the ban remains in place. Although President Trump said he plans to meet Chinese President Xi at the G20 summit in June, we expect the broader US-China trade tensions to extend for at least a few more months, making us increasingly cautious about the outlook for global technology sector equities.

How important is Huawei? Huawei is the world's third-largest supplier of smartphones, with a 16% market share. It has a leading 21% global share of the communication services market, selling equipment for mobile phone networks and communications systems.

Potential implications of the ban: As Huawei's phones use Google's Android software, the ban on US companies from doing business means Huawei's retail customers face uncertainty about future support for their mobile phone software. For corporate customers, the main impact would be through the likely disruption in supply chains.

Investment implications: US semiconductor equities have been directly impacted, while the wider US technology sector is down 7% MTD (although it is still up 18% YTD). In China, despite a 14% correction in its technology sector MTD, the sector is up 9% YTD. We continue to see it as a core holding as supply chain adjustments are likely to take time. We have turned cautious on the global technology sector in anticipation of any retaliation from China.

China's technology sector equities have underperformed US counterparts following the revival of trade tensions in May

Relative performance of US and China technology sector equity indices (Index: 100 = 31 December 2019)

Source: Bloomberg, Standard Chartered

Q2. What does the Indian election mean for investors?

Political certainty is likely to boost near-term market sentiment. The stronger-than-expected mandate for the incumbent government is likely to boost expectations of a growth recovery amid optimism over continued pro-business reforms. This may be supported by our assessment that macro data and earnings outlook are at a better starting point than immediately after the 2014 election.

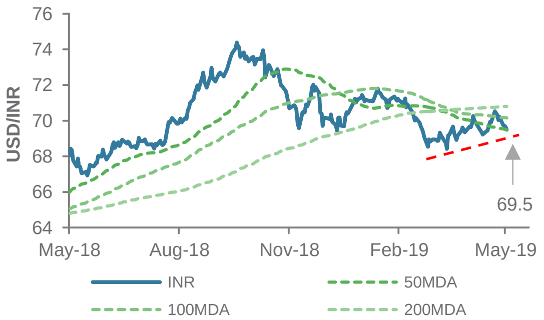
Liquidity to improve. Foreign flows are likely to rise given foreign investor positioning in Indian equities relative to other EMs is close to a seven-year low. Additionally, domestic inflows (a key support for markets in 2017 and 2018) may improve as uncertainty abates.

Indian equities remain a core holding in Asia. Fundamentals are still supportive, in our view. Fiscal stimulus and the likelihood of further policy easing by the RBI are likely to boost growth ahead. We prefer mid- and small-cap equities over large-cap equities, given greater relative valuation comfort amid an improving relative earnings outlook.

What we are watching? Government formation is now key**.** The market is likely to focus on who leads finance, commerce and infrastructure ministries. The other focus is likely to be whether the RBI cuts rates by more than market expectations (key for faltering consumption growth) and efforts to assuage liquidity concerns.

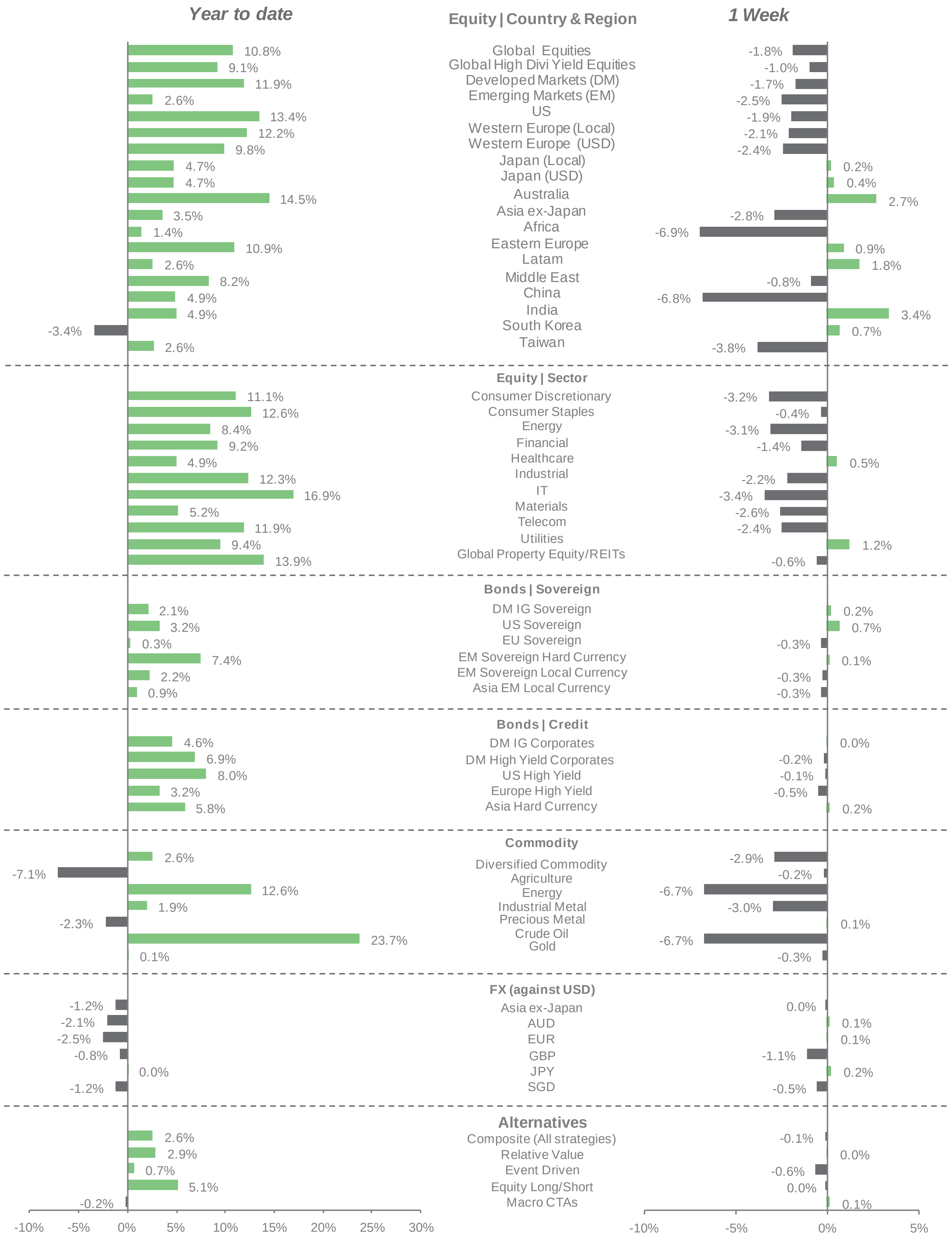
The USD/INR is approaching a key support around 69.5

USD/INR



Source: Bloomberg, Standard Chartered

Market performance summary*



*Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 23 May 2019, 1 week period: 16 May 2019 to 23 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	CH	Industrial Profits y/y	27-May-19	Apr	–	13.9%
	GE	Retail Sales NSA y/y	27-May-19	Apr	–	-2.1%
TUE	EC	M3 Money Supply y/y	28-May-19	Apr	–	4.5%
	EC	Economic Confidence	28-May-19	May	–	104
	US	Conf. Board Consumer Confidence	28-May-19	May	130	129.2
THUR	US	GDP Annualized q/q	30-May-19	1Q S	3.1%	3.2%
	US	Initial Jobless Claims	30-May-19	25-May	–	–
FRI/SAT	JN	Industrial Production y/y	31-May-19	Apr P	–	-4.3%
	CH	Manufacturing PMI	31-May-19	May	49.9	50.1
	CH	Non-manufacturing PMI	31-May-19	May	54.3	54.3
	GE	CPI EU Harmonized y/y	31-May-19	May P	–	2.1%
	IN	GDP y/y	31-May-19	1Q	–	6.6%
	US	Personal Income	31-May-19	Apr	0.3%	0.1%
	US	Real Personal Spending	31-May-19	Apr	–	0.7%
	US	PCE Core Deflator y/y	31-May-19	Apr	1.6%	1.6%

	Event	This Week	Date	Period	Actual	Prior
MON	JN	GDP Annualised SA q/q	20-May-19	Mar	2.1%	1.6%
TUE	EC	Consumer Confidence	21-May-19	May A	-6.5	-7.3
	US	Existing Home Sales	21-May-19	Apr	5.19m	5.21m
WED	JN	Exports y/y	22-May-19	Apr	-2.4%	-2.4%
	US	FOMC Meeting Minutes	22-May-19	1 May		–
THUR	JN	Nikkei Japan PMI Mfg	23-May-19	May P	49.6	50.2
	GE	Markit/BME Germany Composite PMI	23-May-19	May P	52.4	52.2
	EC	Markit Eurozone Manufacturing PMI	23-May-19	May P	47.7	47.9
	EC	Markit Eurozone Services PMI	23-May-19	May P	52.5	52.8
	EC	Markit Eurozone Composite PMI	23-May-19	May P	51.6	51.5
	GE	IFO Expectations	23-May-19	May	95.3	95.3
	US	New Home Sales	23-May-19	Apr	673k	723k
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	24-May-19	Apr	0.6%	0.4%
	UK	Retail Sales Ex Auto Fuel y/y	24-May-19	Apr	–	6.2%
	US	Cap Goods Orders Nondef Ex Air	24-May-19	Apr P	–	1.4%

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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