



Market Watch

Volatility strikes back

Summary

A confluence of fear factors triggered weakness in global equities. These include 1) China: regulatory tightening and spill-over concerns from Evergrande's debt issues, 2) US: debt ceiling, Fed tapering, 3) Europe: German elections.

Our baseline scenario is that this is a temporary pullback. Seasonal weakness notwithstanding, earnings and growth in US and Europe remains strong, supporting our preference for these equity regions on a 12-month horizon.

China policy tightening, though, unlikely to ease in the short-term. Near-term Hang Seng index technicals remain weak.

Background

Policy pressures in China have continued to weigh on Hong Kong/China equities. These have spread from China's internet sector to other sectors, such as Macau gaming and real estate.

The most recent market weakness trigger was concerns that Evergrande's debt troubles could spill over to other sectors and regions. The Hang Seng Index fell -3.3% yesterday while China's onshore markets were closed.

For the US, the upcoming Fed meeting and debt ceiling discussion are other ongoing concerns. The Fed FOMC meets on Wednesday, with any announcement of Fed tapering and guidance on the future path of policy rates likely to be key focus areas. The US government's debt ceiling is also an upcoming risk, with the government expected to run out of money to pay its debt in October, unless the ceiling is raised.

German elections are scheduled for this weekend. The left-of-centre SPD-Green combination, which is ahead in the polls, would likely lead to more fiscal stimulus. However, the election remains a close call.

Global equities in correction over the last 24 hours

Performance of selected asset classes on 20-Sept



Source: Bloomberg, Standard Chartered

Continued regulatory tightening in China hurting Hang Seng Index. Major support at 24,500 broken yesterday

Hang Seng Index price chart



Source: Bloomberg, Standard Chartered

What is the signal from technicals?

The Hang Seng index close on Monday below the lower edge of a declining channel from July has opened the way towards the September 2020 low of 23124 (4% from Monday's close). Subsequent support is at the May 2020 low of 22520 (6.5% from Monday's close) followed by strong support at the March 2020 low 21139 (12% from Monday's close).

The S&P 500 index's break below key support at the mid-August low of 4368, coinciding with the lower edge of a rising channel, suggests that the upward pressure has faded in the short term. However, there is quite strong support on the 200-DMA (now at 4106; about 6% from Monday's close).

What does this mean for investors?

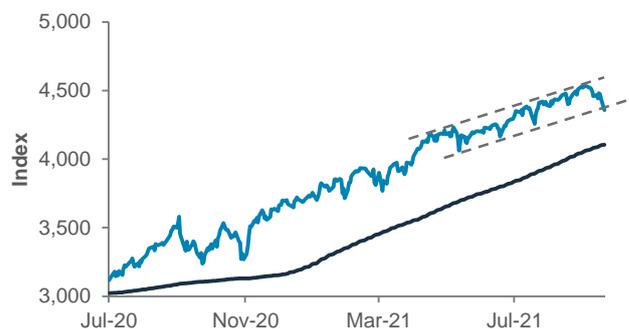
It is likely that market volatility extends over the next few sessions. In the US, greater clarity on the potential tapering path is likely after the FOMC meeting concludes later this week. We also need to watch debt ceiling discussions, though we believe these will be eventually resolved. We favour averaging-in to our preferred US and European equities.

In China, though, it is unlikely that ongoing regulatory challenges will ease quickly. As we have noted before, periods of regulatory tightening tend to be relatively long-lasting and many measures are consistent with longer term policy priorities. How quickly Evergrande's and the property sector's debt challenges are resolved is likely to be another factor. Signs of contagion outside of the property sector remain limited for now, though it is prudent to remain on watch until greater clarity emerges on the sector's debt challenges.

For markets, we maintain a preference for US and Euro area equities, where we believe an averaging-into-seasonal-weakness approach is attractive. Within China, we would favour the energy and industrials sectors which are relatively less exposed to regulatory tightening policy. The property sector's challenges have also hurt Asia USD bonds, though here we believe the risk/reward is more attractive than in equities, and see current valuations (especially in high yield) as attractive on a 12-month horizon.

S&P 500 testing lower-end of the upward channel

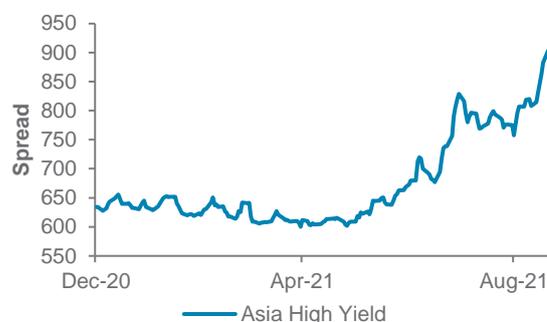
S&P 500 index price chart



Source: Bloomberg, Standard Chartered

Asian HY offers inexpensive valuations

Asian USD non-IG bonds credit spread



Source: Bloomberg, Standard Chartered

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