weekly **market view**

macro strategy | 14 June 2019

This reflects the views of the Wealth Management Group

Editorial

Next stop, the Fed

- **The Fed is unlikely to cut rates at its 18-19 June meeting, but any indication it is considering lowering rates in H2 19 would likely be supportive for equities and, possibly, gold.**
- **Equities:** Lower bond yields are likely to weigh on bank margins and sector performance. We prefer the energy sector instead.
- **Bonds:** The US 10-year Treasury yield is approaching a strong support around 2.0%. A minor near-term rebound is likely.
- **FX:** EUR/USD faces resistance at its 200DMA around 1.1360.

What's new?

- **Next stop, the Fed.** The Fed meeting on 18-19 June is likely to set the tone for markets over the coming months. Although we do not expect the US central bank to cut rates yet, its statements will be scrutinised for signs policymakers are veering towards a rate cut in H2 19. Recent data suggest the economy is slowing towards long-term trend growth closer to 2% as the impact of 2017's fiscal stimulus fades and as a result of the USD's ongoing strength. Inflation too is slowing towards the Fed's 2% target. When combined with the uncertainty around global growth and business investment caused by trade tensions, this raises the prospects for a pre-emptive rate cut to support a soft landing for the economy. Money markets are pricing in a cut as early as July and the S&P500 index is 2% away from its all-time high (see page 3). A dovish Fed policy tone would be positive for equities, especially in the US, and is likely to fuel the ongoing gold rally.
- **EM bonds rally.** EM USD and local currency government bonds rallied as a combination of renewed risk appetite and weaker USD helped the asset class. EM USD bonds, in particular, benefitted from sharply lower yields in a number of markets, such as Turkey and Russia, as investors priced in a greater degree of central bank easing to counter growth concerns. EM USD bond yield premiums compressed, led by those of lower-rated countries. While EM assets remain at a risk from any escalation in trade tensions, we derive comfort from improving aggregate credit quality, with the average rating for the asset class rising to Investment Grade for the first time since 2015.
- **Hong Kong protests weigh on local markets.** The one-month Hong Kong interbank lending rate climbed above 2.6% – the highest since 2008 – weighing on the property sector's outlook and dragging the Hang Seng index towards its four-month lows reached earlier this month. The Hang Seng index looks deeply oversold following the 10% drop from its April peak. Some consolidation or minor rebound is possible in the short term. However, for a sustained rebound to occur, the index would need to decisively break above the mid-May high of 28,428. The protests against the city's proposed bill allowing extraditions to Mainland China need to be watched closely. For now, we believe domestic-focussed utilities, with steady income streams and attractive yields, offer a safe-haven amid the uncertainty.

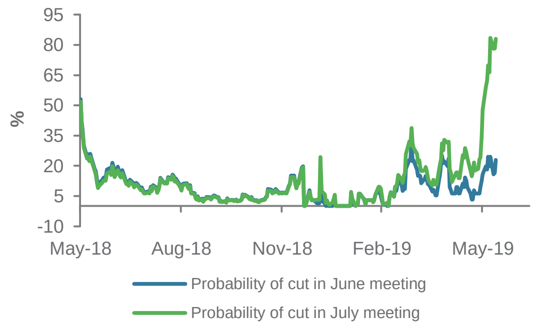
What we are watching

- Fed meeting (18-19 June); OPEC meeting (25-26 June); G20 Summit (28-29 June); US-China trade; UK premiership race.

Contents

Money markets are pricing in a US interest rate cut at the Fed's July meeting; expectations for a cut in June remain low

Market implied probabilities of a US rate cut in June, July



Source: Bloomberg, Standard Chartered

Hong Kong's utilities sector has been resilient amid global trade and domestic political uncertainty, while the property sector has taken a hit

Relative performance of the Hang Seng Property and Utilities indices since the start of April (100 = 31 March)

Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities extended their recovery as expectations of Fed rate cuts dragged bond yields lower. Gold prices rose towards early-June's 14-month highs.

Equities: What is the implication of lower bond yields on banks?

- **US and Euro area 10-year bond yields have declined** in Q2 19 by c.30bps and c.20bps, respectively, to 2.09% and -0.24%. Although this is good news for companies with high levels of debt, as the costs of servicing that debt has declined, it can be negative for banks. In a low-interest rate environment, where deposit rates are at their lower boundary (zero), a dip in bond yields and a concurrent reduction in the interest rate charged to borrowers squeezes the margin banks earn from their loans.
- **Banks' margin squeeze is reflected in the sector's performance** in the US and Euro area. The sector has declined 6.2% (in EUR terms) in Euro area and 0.5% in the US over the past month. We believe the sector's performance is likely to remain under pressure as long as bond yields are declining and expectations build for interest rate cuts. The financial sector in the US and Euro area are a core holding. We prefer the energy sector instead, both in the US and Euro area, given attractive valuations and expectations of moderately higher oil prices.

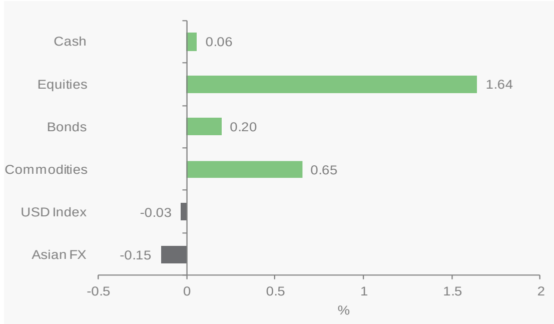
Bonds: Have US Treasury yields bottomed?

- **Fed and trade issues to drive yields.** Although US 10-year Treasury yields stabilised over the past week, they remain lower than 3-month rates – a pattern that typically signals an impending economic slowdown. Safe-haven demand and expectation of rate cuts, which drove the yields lower, are likely to remain key drivers. Markets are likely to look for further signals from the upcoming Fed meeting.
- **The 10-year Treasury yield is approaching a strong support area –** the psychological 2.00%, the September 2017 low of 2.01% and the lower edge of a rising channel from 2012 (now 2.15%). It is looking deeply overstretched on the charts, and a minor rebound cannot be ruled out in the near term. However, for the downtrend pressure to fade, the yield would need to break above resistance at the March low of 2.34%.

FX: Is the EUR breaking higher?

- **EUR/USD is testing key resistance levels** after completing a double-bottom around 1.1100 in May, in line with the broad USD weakness and lower US yields. A sustained break would suggest a more significant USD sell-off is underway. The 200DMA at 1.1360 is the next target. EUR/USD last fell below this line in early 2018 and has fallen over 6% thereafter. We would look for confirmation of the uptrend with a break above 1.1450, which was the previous high registered in March this year. A break here would open a move towards 1.1815, the September 2018 high. A failure would suggest a re-test of the support at 1.1100.
- **The underlying fundamentals that could support this move** are the narrowing of interest rate differentials and relative growth rates. The ECB has little room to ease rates, whereas the market is now expecting multiple Fed rate cuts. The Euro area also has room to add fiscal stimulus and is expected to benefit from anticipated measures from China to boost its own economy.
- **Uncertainty over US trade policy and Brexit could hold back the EUR in the near term,** but the Trump administration has increased rhetoric over a "too strong USD", and a possible compromise solution for trade tensions is a currency agreement that could trigger a stronger EUR.

Benchmark (USD) performance w/w*



**Week of 06 June 2019 to 13 June 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 equity technicals are positive, Asia's are negative

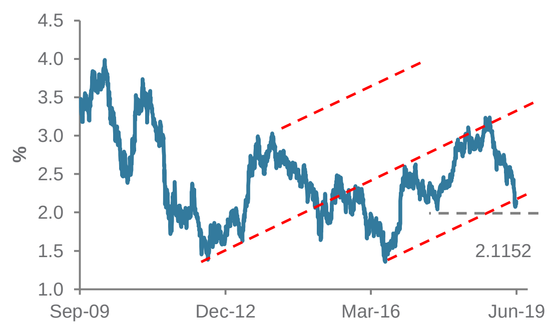
Technical levels of key market indicators as on 13 June

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,892	2,850	2,913	↑
STOXX 50	3,391	3,313	3,487	↗
FTSE 100	7,369	7,210	7,415	↑
Nikkei 225	21,032	20,300	21,415	↓
Shanghai Comp	2,911	2,800	2,956	→
Hang Seng	27,295	26,730	27,950	→
MSCI Asia ex-Japan	629	620	637	↓
MSCI EM	1,022	1,000	1,052	↗
Brent (ICE)	61	55	67	↓
Gold	1,345	1,300	1,365	↑
UST 10Y Yield	2.09	1.93	2.35	↓

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

US 10-year government bond yield is close to a strong support area; a minor rebound is likely in the near term

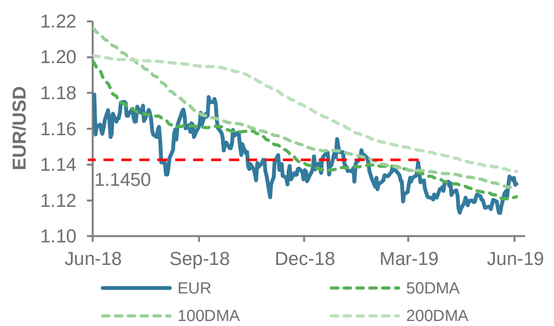
US 10-year Treasury yield



Source: Bloomberg, Standard Chartered

EUR/USD is testing a key resistance around 1.1360; the next target is the March high of 1.1450

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. S&P 500: Is it ready to test all-time highs?

The S&P 500 index is 2.0% from its May record high of 2,954. Given it is already up 6.0% since the beginning of the month, a gain of few more percentage points is possible. From a technical perspective, we are watching three things as the index goes higher.

Firstly, the rebound in the index from January has not been associated with broader participation – only 46% of the stocks are above their respective 200DMA. In general, a broader participation ensures greater sustainability of a trend. Currently, more than half the number of stocks are below their long-term average, just as the index is approaching record highs. However, declining participation has been a feature of the rally since 2016 (from 75% in September 2016). So, by itself, this is not factor that can change the equation.

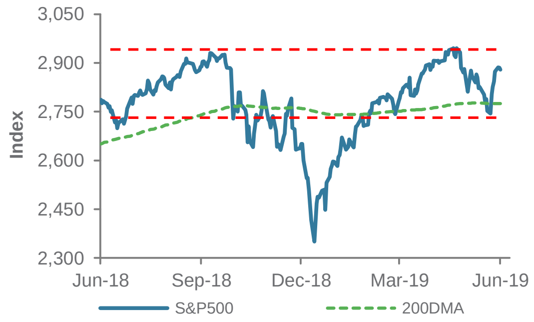
Secondly, the American Association of Individual Investors' (AAII) Bullish sentiment index, at 27, is only slightly above its 19-month low of 21 hit in December. Back in September, when the S&P 500 index hit its previous record high, the index was at 46. The AAII Bullish sentiment reading is derived from the survey question regarding how investors feel about the direction of the stock market over the next six months. Although sample bias can skew the reading, investor optimism is key for sustainability of the uptrend.

Lastly, a negative divergence on longer-term charts indicates that the multi-year bull-run is losing steam. That is, the 14-month Relative Strength Index has been declining since 2018, whereas the S&P 500 index has been rising. Declining momentum would not necessarily mean that the uptrend is reversing. It is always comforting to see index rallies accompanied by improving momentum.

On balance, we believe fundamentals outweigh technicals, for now. Indeed, any break above immediate resistance at the May's record high could initially open way toward 3030 (the 50% Fibonacci projection of December 2018-March 2019 rise), followed by 3100 (the 61.8% projection). From a fundamental perspective, we expect global and US equities to rise and outperform other asset classes over the next 6-12 months.

The S&P500 index is 2% away from its May all-time high of 2,954; a break higher would open way towards 3,030

S&P500 index



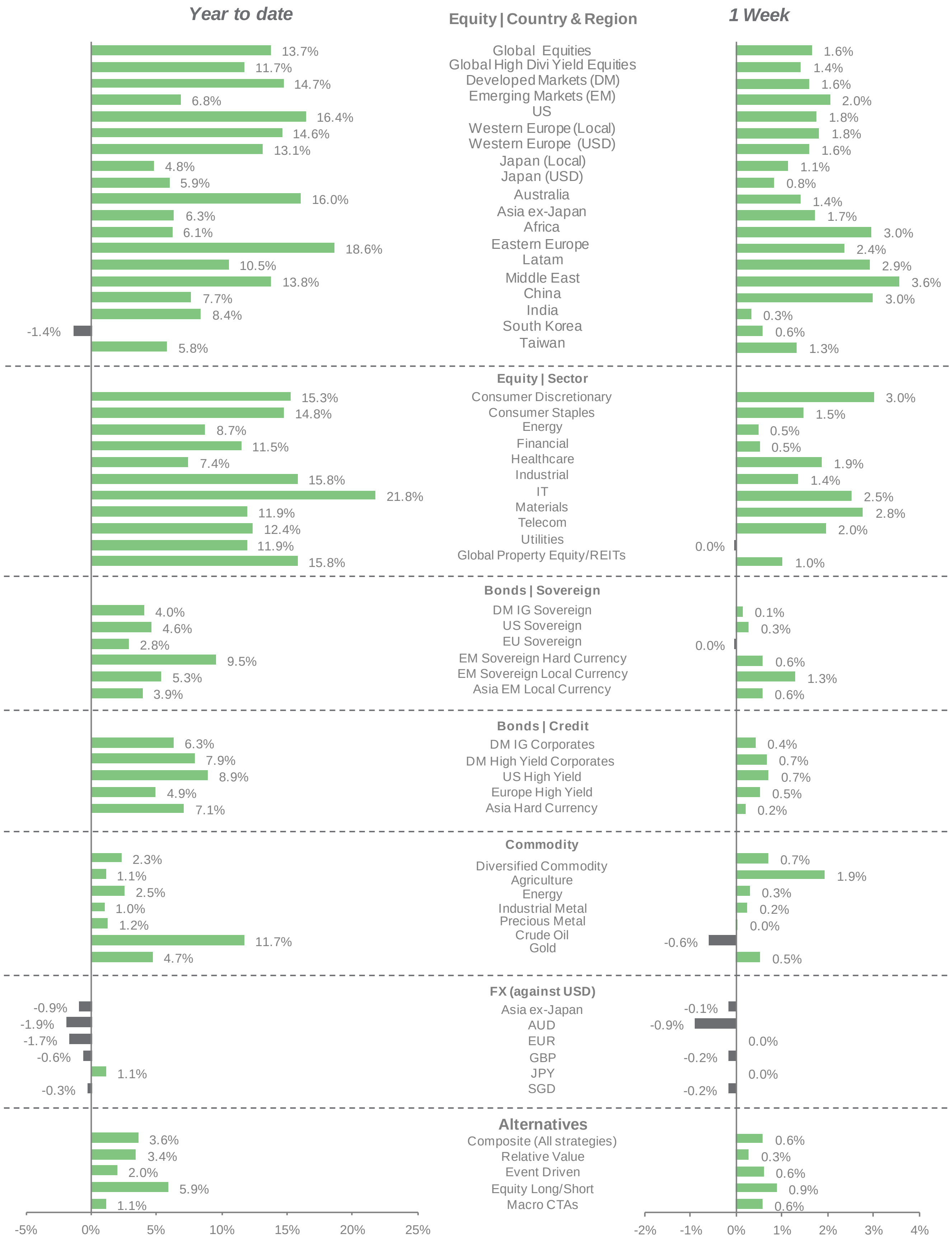
Source: Bloomberg, Standard Chartered

The S&P500 index's surge higher has not been associated with bullish investor sentiment

S&P500 index and AAII Bullish Sentiment Index

Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 13 June 2019, 1 week period: 06 June 2019 to 13 June 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
TUE	US	Housing Starts	18-Jun-19	May	1240k	1235k
	US	Building Permits	18-Jun-19	May	1300k	1290k
WED	JN	Exports y/y	19-Jun-19	May	–	-2.4%
	UK	CPI Core y/y	19-Jun-19	May	–	1.8%
	BZ	Selic Rate	19-Jun-19	19-Jun	6.5%	6.5%
THUR	US	FOMC Rate Decision (Upper Bound)	20-Jun-19	19-Jun	2.5%	2.5%
	JP	BoJ Policy Decision (10-year yield target)	20-Jun-19	20-Jun	–	0.0%
	UK	Bank of England Bank Rate	20-Jun-19	20-Jun	–	0.8%
	US	Leading Index	20-Jun-19	May	0.1%	0.2%
	EC	Consumer Confidence	20-Jun-19	Jun A	–	-6.5
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	21-Jun-19	May	–	0.6%
	GE	Markit/BME Germany Composite PMI	21-Jun-19	Jun P	–	52.6
	EC	Markit Eurozone Manufacturing PMI	21-Jun-19	Jun P	–	47.7
	EC	Markit Eurozone Services PMI	21-Jun-19	Jun P	–	52.9
	EC	Markit Eurozone Composite PMI	21-Jun-19	Jun P	–	51.8
	US	Existing Home Sales	21-Jun-19	May	5.30m	5.19m

	Event	This Week	Date	Period	Actual	Prior
MON	CH	Exports y/y	10-Jun-19	May	1.1%	-2.7%
TUE	UK	Average Weekly Earnings 3m/y/y	11-Jun-19	Apr	3.1%	3.3%
	EC	Sentix Investor Confidence	11-Jun-19	Jun	-3.3	5.3
	US	PPI Ex Food and Energy y/y	11-Jun-19	May	2.3%	2.4%
WED	JN	Core Machine Orders y/y	12-Jun-19	Apr	2.5%	-0.7%
	CH	CPI y/y	12-Jun-19	May	2.7%	2.5%
	CH	PPI y/y	12-Jun-19	May	2.5%	0.9%
	IN	CPI y/y	12-Jun-19	May	3.1%	3.0%
	IN	Industrial Production y/y	12-Jun-19	Apr	3.4%	0.4%
	US	CPI Ex Food and Energy y/y	12-Jun-19	May	2.0%	2.1%
	CH	Money Supply M2 y/y	12-Jun-19	May	8.5%	8.5%
FRI/SAT	CH	Fixed Assets Ex Rural YTD y/y	14-Jun-19	May		6.1%
	CH	Industrial Production y/y	14-Jun-19	May		5.4%
	CH	Retail Sales y/y	14-Jun-19	May		7.2%
	US	Retail Sales Ex Auto and Gas	14-Jun-19	May		-0.2%
	US	Industrial Production m/m	14-Jun-19	May		-0.5%
	US	U. of Mich. Sentiment	14-Jun-19	Jun P		100

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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