Standard Chartered Private Bank

weekly **market view**

macro strategy | 26 July 2019

This reflects the views of the Wealth Management Group

Editorial

Policymakers act to sustain expansion

- **The ECB signalled easier policies to revive inflation while the Fed is likely to cut rates for the first time in a decade. The easing policy environment is bullish for stocks, in our view.**
- **Equities:** US Q2 earnings continue to beat estimates. Easier monetary and fiscal policies are positive for economic growth and corporate earnings. The US remains a preferred equity market.
- **Bonds:** Fed forward guidance on its rates policy is key. Markets are expecting a 25bps rate cut on 31 July and two more in 2019.
- **FX:** We believe the UK's new PM Johnson has a few levers to negotiate a better Brexit deal. This would be positive for the GBP.

What's new?

- **Policymakers act to sustain growth.** The ECB signalled it is considering cut rate cuts and renewed bond buying later this year to revive inflation and prolong the economic cycle. With Euro area and German manufacturing sector confidence indicators falling to six-year lows and inflation at half the ECB's target, the additional monetary stimulus should help. We also see a rising probability of fiscal easing as a new line-up of leaders, arguably with a more activist approach to tackling Europe's structural problems, take charge of the ECB and the EU. In the US, the Fed is almost certain to cut rates for the first time in a decade on 31 July as an insurance against the global manufacturing downturn. In Japan, the BoJ could signal more measures to stimulate growth and inflation. The coordinated global monetary policy easing, combined with increasing chances of fiscal easing, is arguably bullish for risk assets like equities and Emerging Market bonds.
- **US budget deal removes a key tail risk.** The agreement between the Democrat-led Congress and the Republican Trump administration to lift the US debt ceiling for another two years prevents a possibly damaging contraction in discretionary spending from October. The deal suggests a policy turnaround for the traditionally fiscally hawkish Republicans. Relatively easier fiscal policies in the US, including President Trump's tax cuts in late 2017, partly explain the US growth outperformance vs other major economies in recent years, in our view. While rising US government debt is clearly a long-term risk, subdued government bond yields suggest investors do not see it as a problem in the next 6-12 months. The latest growth-supportive budget deal is another factor behind our preference for US equities.
- **China's new tech board lifts sentiment.** The Shanghai Stock Exchange's new Star Market (Nasdaq-style tech board) got off to a stellar start on 22 July, with all 25 companies soaring on debut. Star-listed companies were worth on average 120 times earnings by the end of the first day vs c.24 times for stocks listed on the Nasdaq and Shenzhen's tech market. The strong performance helped lift sentiment for China's onshore shares and, in particular, the tech sector. Trading at 11.4x 12m forward earnings, China onshore shares remain preferred in Asia ex-Japan.

What we are watching

- Fed, BoJ, BoE policy meetings (30-31 July); UK PM Johnson's Brexit plan; US-China face-to-face trade talks.

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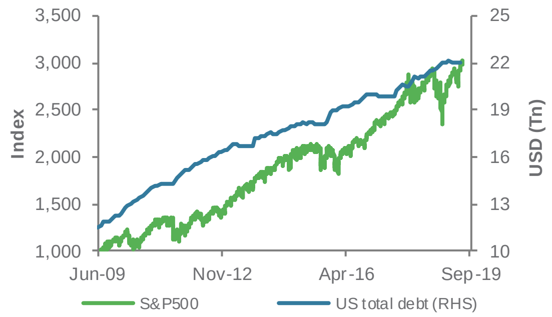
US' rising government spending has helped fuel economic growth and equity markets; the latest raising of the debt ceiling is likely positive for stocks

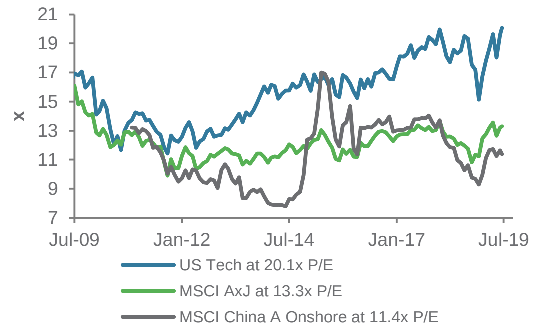
US total debt and S&P500 index over the past decade



Source: Bloomberg, Standard Chartered

China's domestic A-share market is more attractively valued than Asia ex-Japan

P/E ratios of China A-shares, MSCI Asia ex-Japan and US tech sector indices



Source: FactSet, Standard Chartered

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What does this mean for investors?

Global equities recovered, with US stocks hitting new record highs. The USD rebounded strongly amid robust US and weak Euro area data.

<u>Equities</u>: How are Q2 earnings progressing?

- **US earnings beat continues, but industrial earnings fall.** So far, 75% of the companies that have reported have exceeded expectations. This compares favourably with the 72% "beat rate" average in the past five years. All sectors, barring industrials, have surpassed expectations, led by the technology sector (9.2% better than expected), healthcare (6.0%) and real estate (5.4%).
- **Nonetheless, aggregate expectation for S&P500 Q2 earnings growth have eased slightly over the past week** (to 0.2% from 0.6% a week ago). Notably, expectation for 0.2% growth in the industrial sector a week ago has slipped to -10.4% growth this week, with almost 60% of the sector having reported so far. Expectations for 2019 earnings growth have eased to 1.8%, but those for 2020 earnings growth remained in the 11-12% range.
- **In Europe**, where just over a tenth of the Stoxx 600 index companies have reported so far, Q2 earnings expectations have declined from over 3.5% growth three months ago to -0.5% growth. Revenue growth is expected to be slightly better at 0.9%.

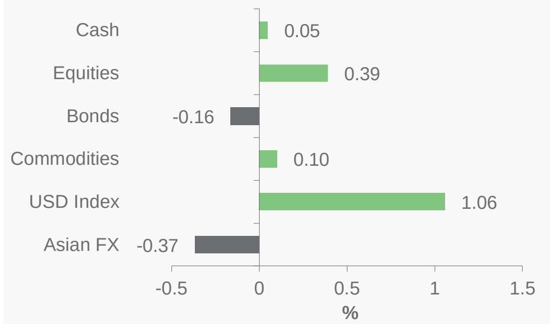
<u>Bonds</u>: How important is the upcoming Fed meeting for bonds?

- **Fed's forward guidance key to outlook.** While a 25bps rate cut is expected widely, investors are focused on guidance from the Fed about the potential for further rate cuts later this year. With markets pricing in nearly three 25bps cuts in 2019, any disappointment could lead to modestly higher US Treasury yields in the short term. Separately, 10-year German Bund yields declined towards all-time lows as weak economic data raised pressure on the ECB to ease further later this year.
- **EM USD bonds continue to outperform:** EM USD government bonds continued to deliver positive returns as expectations of easing monetary policy and higher demand from yield-seeking investors (evidenced by strong fund inflows over the past month) led to lower yield premiums over Treasuries. Our expectations of weaker USD are also supportive for EM bond flows. We continue to prefer EM USD government bonds over other bonds.

<u>FX</u>: How is the GBP's outlook impacted with Johnson as PM?

- **PM Johnson brings charisma and vigour to Brexit.** Johnson, in his first speech as PM, emphasised he was taking control of the "fixed" Brexit timeline of concluding a deal by 31 October and pursuing a more open-minded approach than his predecessor.
- **We believe he has two possible levers to achieve a better Brexit deal quickly:** a) EU leaders need a deal urgently to remove a major risk facing the Euro area economy, which is already decelerating. A "hard" Brexit could be damaging for the EU. This suggests that they may ease their stance and agree to a longer free-trade transition period than the two years agreed earlier. b) Johnson has likely identified the Irish PM Varadkar as a key player in striking a new deal. A "hard" Irish border could be politically catastrophic, and the Irish economy is mostly dependent upon free-flowing trade and capital flows with the UK. We believe the EU will be sensitive to Irish needs.
- **Given this backdrop, we believe EUR/GBP could trade lower and GBP/USD will continue to attract support** even if the coming weeks see increased volatility. We expect the latter to rally towards 1.2580, and possibly 1.2780; initial support is at c.1.2350.

Benchmark (USD) performance w/w*



**Week of 18 July 2019 to 25 July 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, Asia ex-Japan equity technicals remains positive
Technical levels of key market indicators as on 25 July

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	3,004	2,971	3,075	↑
STOXX 50	3,510	3,467	3,573	↗
FTSE 100	7,489	7,410	7,620	↘
Nikkei 225	21,757	20,950	22,350	↗
Shanghai Comp	2,937	2,825	2,985	→
Hang Seng	28,594	28,000	29,000	↑
MSCI Asia ex-Japan	653	636	661	↑
MSCI EM	1,054	1,032	1,083	↑
Brent (ICE)	63	60	67	↘
Gold	1,415	1,380	1,455	↑
UST 10Y Yield	2.07	1.93	2.15	↘

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

EM USD government bond yield premiums over US Treasuries are still above their five-year average despite the recent tightening
Yield premium on EM USD government bonds

Source: Bloomberg, Standard Chartered

We expect GBP/USD to rally towards 1.2580; the pair has support at c.1.2350
GBP/USD

Source: Bloomberg, Standard Chartered

Top client questions

Q1. What would it take for the USD to break out of its recent range?

We are watching for two potential triggers that could push the USD out of its recent range and potentially reverse its recent uptrend.

First, outside the US, there continues to be pressure to ease monetary policy. However, the effectiveness of further stimulus on slowing economies and deflationary risk is likely to be limited unless accompanied by fiscal stimulus. This is most pressing in the Euro area, China and Japan. A shift of emphasis from monetary to fiscal stimulus in these markets, and especially in Europe, would likely trigger capital flows into non-US assets, thereby generating a flow out of dollars. If this is accompanied by stronger US monetary easing, the impact would be greater.

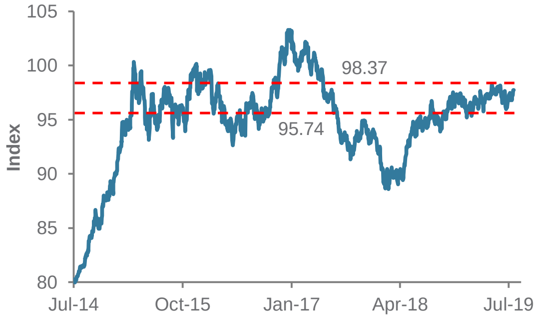
Second, we are watching the US administration's reaction to continued negative interest rate policies in Europe and Japan, which the US views as a thinly veiled attempt to competitively depreciate their currencies. Earlier this year, as trade negotiations with China were progressing, the US claimed that some form of currency agreement would be part of any holistic trade solution. There is growing sentiment that the US may also consider direct unilateral currency market interventions if bilateral or multilateral agreements are not possible. Once again, a significant move by the Fed to cut rates would be one requirement for this strategy to be successful, though such intervention is decided by the US Treasury. We believe any such action would have a meaningful short-term impact and could trigger a sustained reversal in the USD.

Ongoing trade tensions, geopolitical stress, slowing global growth and deflationary momentum are risks to our outlook for a weaker USD.

The USD is pushing towards technical resistance levels now. On specific USD pairs, key technical levels to monitor in EUR/USD are 1.1100 and 1.1450, and in USD/JPY at 105 and 110.

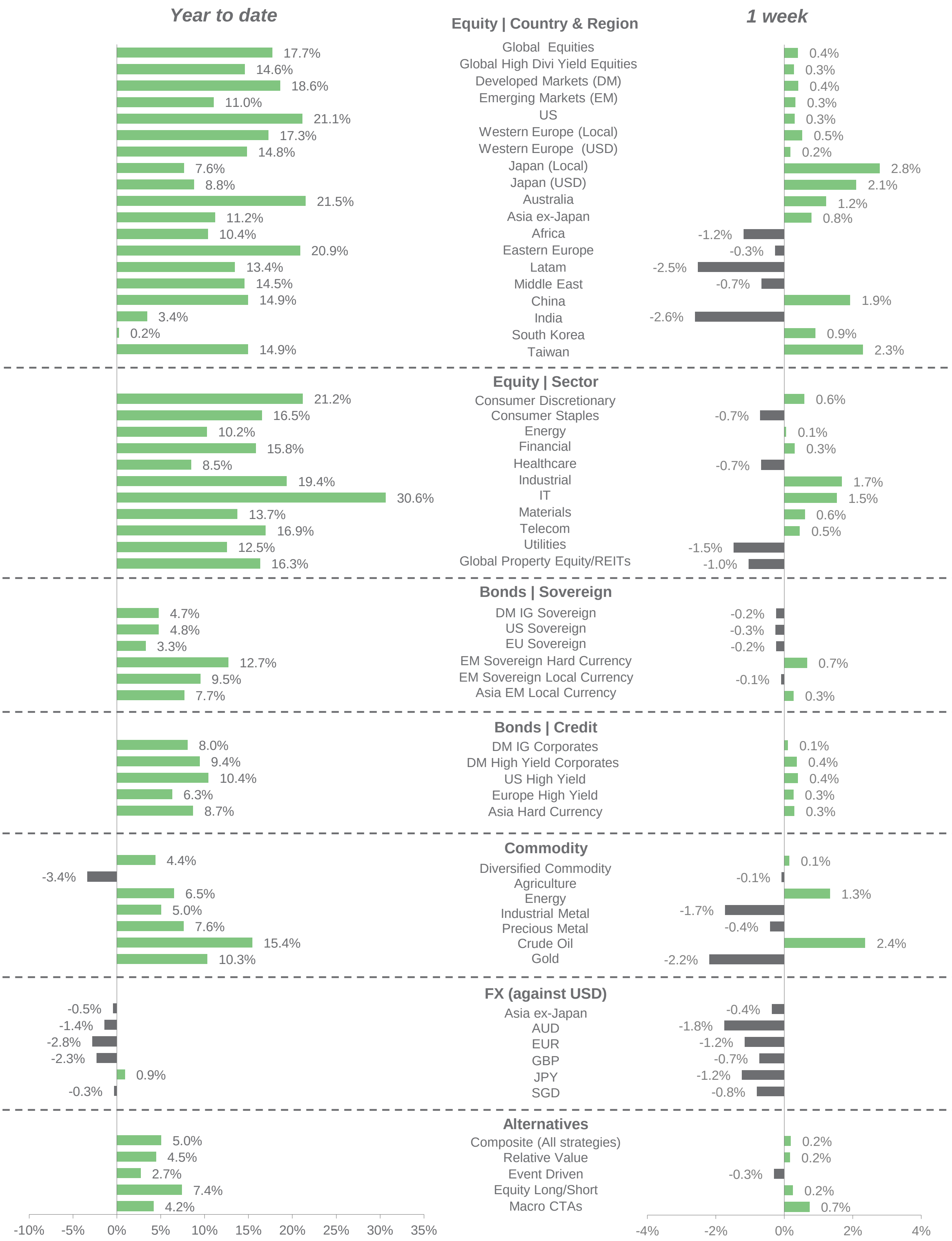
We see growing chances of fiscal stimulus in Developed Markets outside the US; this could be a trigger for the USD to break below its recent range

USD (DXY) index



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 25 July 2019, 1 week period: 18 July 2019 to 25 July 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						
TUE	EC	Economic Confidence	30-Jul-19	Jul	–	103.3
	GE	CPI EU Harmonized y/y	30-Jul-19	Jul P	1.3%	1.5%
	JN	Industrial Production y/y	30-Jul-19	Jun P	-2.5%	-2.1%
	JN	BoJ 10-Yr Yield Target	30-Jul-19	Jul	0.0%	0.0%
	US	Personal Income	30-Jul-19	Jun	0.3%	0.5%
	US	Real Personal Spending	30-Jul-19	Jun	0.2%	0.2%
	US	PCE Core Deflator y/y	30-Jul-19	Jun	1.7%	1.6%
	US	Conf. Board Consumer Confidence	30-Jul-19	Jul	124.4	121.5
WED	CH	Manufacturing PMI	31-Jul-19	Jul	49.7	49.4
	CH	Non-manufacturing PMI	31-Jul-19	Jul	54.0	54.2
	EC	Unemployment Rate	31-Jul-19	Jun	7.5%	7.5%
	EC	CPI Core y/y	31-Jul-19	Jul A	1.0%	1.1%
THUR	US	FOMC Rate Decision (Upper Bound)	01-Aug-19	Jul	2.3%	2.5%
	UK	Bank of England Bank Rate	01-Aug-19	Aug	0.8%	0.8%
FRI/SAT	EC	PPI y/y	02-Aug-19	Jun	–	1.6%

	Event	This Week	Date	Period	Actual	Prior
MON						
TUE	EC	Consumer Confidence	23-Jul-19	Jul A	-6.6	-7.2
	US	Existing Home Sales	23-Jul-19	Jun	5.27m	5.34m
WED	GE	Markit/BME Germany Composite PMI	24-Jul-19	Jul P	51.4	52.6
	EC	Markit Eurozone Composite PMI	24-Jul-19	Jul P	51.5	52.2
	EC	M3 Money Supply y/y	24-Jul-19	Jun	4.5%	4.8%
	US	Markit US Composite PMI	24-Jul-19	Jul P	51.6	51.5
	US	New Home Sales	24-Jul-19	Jun	646k	626k
THUR	SK	GDP y/y	25-Jul-19	2Q P	2.1%	1.7%
	GE	IFO Expectations	25-Jul-19	Jul	92.2	94.2
	EC	ECB Main Refinancing Rate	25-Jul-19	25-Jul	0.0%	0.0%
	US	Cap Goods Orders Nondef Ex Air	25-Jul-19	Jun P	1.9%	0.5%
	US	Initial Jobless Claims	25-Jul-19	20-Jul	206k	216k
FRI/SAT	US	GDP Annualized q/q	26-Jul-19	2Q A		3.1%
	US	Personal Consumption	26-Jul-19	2Q A		0.9%
	US	Core PCE q/q	26-Jul-19	2Q A		1.2%
	GE	Retail Sales NSA y/y	27-Jul-19	Jun		4.0%

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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