weekly **market view**

macro strategy | 5 July 2019

This reflects the views of the Wealth Management Group

Editorial

Preparing for more stimulus

- **US President Trump's picks for the Fed board and Europe's nominee for the ECB's President prepare the ground for global policy easing. This is arguably bullish for equities.**
- **Equities:** Historically, strong H1 performance has led to a strong H2. We stay bullish in anticipation of more policy easing.
- **Bonds:** Yields fell further, with the US 10-year Treasury yield below 2.0%. We prefer higher-yielding EM USD bonds.
- **FX:** EUR/USD likely to trend higher amid a narrowing yield gap.

What's new?

- **Preparing for more stimulus.** President Trump's nomination of Christopher Waller and Judy Shelton for the Fed board and EU leaders' choice of IMF chief Christine Lagarde to head the ECB support rising expectations of a dovish shift in global policy making, in our assessment. Slowing global growth and still-subdued inflation, despite years of accommodative monetary policies, have increased pressure on world leaders to think out-of-the-box to sustain the current economic expansion. In the US, this would mean the Fed dials back on last year's monetary tightening (as President Trump has repeatedly insisted on), while in the EU, it raises the chances of a coordinated monetary and fiscal policy stimulus. We believe Lagarde's experience as a finance minister in France and as the IMF's leader during Greece's bailout should enable her to develop a consensus within EU's political leadership for counter-cycle fiscal policies and reverse the region's growth slowdown. We believe these appointments, if confirmed, would be positive for risk assets.
- **US stocks set another all-time high.** The US-China truce on trade at the G20 summit and President Trump's move to lift the ban on US companies from selling equipment to China's Huawei have provided some relief to investors, spurring the S&P500 index to a new record. The thaw turns focus on the upcoming earnings season. Market consensus estimates a 0.3% rise in US S&P500 earnings in Q2, down from 2.8% at the start of Q2. With US equity indices approaching key technical barriers, a further break higher would probably require positive earnings surprises and forward guidance. Expectations of supportive monetary policies make equities, especially in the US, our preferred asset.
- **Weak data point to more policy easing.** US manufacturing and services sector activity continued to slow into June. A forward-looking manufacturing new orders indicator pointed to stalling demand in the coming months. In China, manufacturing activity has started to contract again, while in Europe the sector has been contracting for a few months (although the services sector in both economies remains healthy). Slowing manufacturing activity partly reflects the disruption caused by the US-China trade dispute. The weakening data support our view that the Fed, ECB and PBoC are likely to ease policy over the coming months. This explains the continued decline in bond yields, which, in turn, supports the equities rally, despite the weak data.

What we are watching

- US jobs report; US-China trade talks; UK premiership race.

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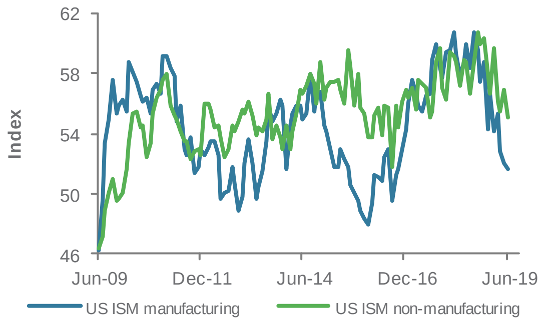
The S&P500 set a new record high; expectations of global policy easing are likely to drive it higher

S&P500 index, with near-term support and resistance

Source: Bloomberg, Standard Chartered

US manufacturing and services sector activity have slowed, raising the prospect of policy easing in H2

US ISM manufacturing and non-manufacturing indices



Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities and bonds rose in tandem on expectations of further policy easing as economic data weakened. Crude oil fell.

Equities: With S&P500 at record high, where do we go from here?

- **Historically, strong H1 equity performance has led to a strong H2** (see our H2 *Global Market Outlook* published on 2 July)**.** Also, 'insurance' Fed rate cuts that are not followed by a recession (our anticipated scenario) have led to strong equity market performance over the following 12 months. Having said that, summer months can be seasonally weak for equities.
- **How to position defensively for summer volatility?** In the US, healthcare is a preferred sector, given its defensive quality and attractive valuation. Also, healthcare has historically outperformed other sectors in the 12 months following the first rate cut. In Europe, another defensive sector, consumer staples, is preferred. It is dominated by diversified (and more resilient) multinationals. The sector is up 21% YTD. We expect healthy returns in H2.
- **US-China truce lifts sentiment for China equities.** Sentiment towards China's technology sector has improved after President Trump's move to lift the US ban on sales to Huawei. Trading at a valuation of 12x 12-month forward earnings, China onshore equities are preferred within Asia ex-Japan.

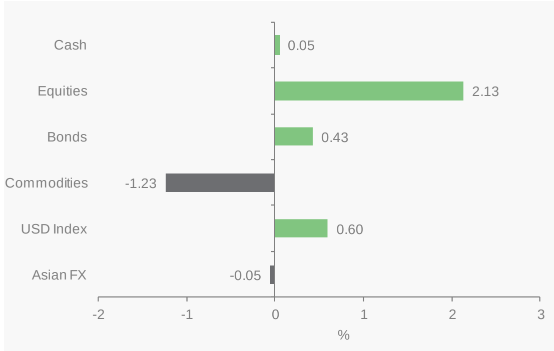
Bonds: How has the recent G20 meeting impacted bonds?

- **The US 10-year Treasury yields fell below 2.0%** to its lowest since 2016 and the German 10-year bund yields fell close to the ECB deposit rate as the US-China trade truce failed to erase concerns about slowing growth and inflation. The fall in Treasury yields appears consistent with continued weakness in global economic data and the decline in long-term inflation expectations.
- **Most bonds gained on the back of lower Treasury yields.** Our preferred EM USD government bonds – that offer attractive yields close to 5.5% – delivered strong gains, benefiting significantly from lower Treasury yields. Our next-ranked Asia USD bonds continued to see strong demand despite a surge in issuance in Q2. We see them as a core holding amid strong regional demand.
- **Focus on US jobs data.** Although investor positioning is not extreme, any surprise in US jobs data risks a significant move in Treasuries. As such, we prefer a strategy of holding both shorter- (3-5 years) and longer-maturity (10 years+) bonds, given our expectation that yields are unlikely to fall significantly lower, while also hedging against an unexpected growth downturn.

FX: Can the EUR/USD uptrend last?

- **EUR/USD uptrend since May's triple-bottom just above 1.1100 still intact.** Since the last attempt to break lower on 30 May, the 2-year US Treasury-German Bund yield gap has narrowed by around 18bps, helping the EUR/USD gain 1.5%. We expect this yield differential to continue to narrow, enabling the EUR to sustain its one-month rally. While supports at 1.1180 and 1.1100 remain intact, we expect a test of the key 1.1450 level – the top of the current uptrend channel and the March 2019 high.
- **What could accelerate the EUR uptrend?** The appointment of Christine Lagarde to replace Mario Draghi as ECB President, if confirmed, could lift the chances of a coordinated Euro area fiscal stimulus to support ECB's highly accommodative monetary policy. This should boost capital inflows and the EUR. President Trump's criticism of the EU and China about alleged currency manipulation raises the prospects for the US Treasury to instruct the Fed to intervene in FX markets for the first time since 2011 – even if "currency agreements" are not part of US trade deals.

Benchmark (USD) performance w/w*



Week of 27 June 2019 to 04 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)

Equity market technicals are bullish across the board

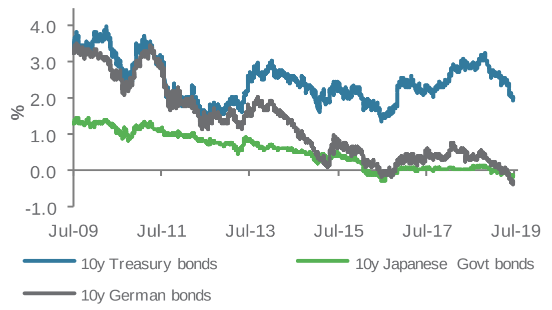
Technical levels of key market indicators as on 04 July

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,996	2,910	3,020	↑
STOXX 50	3,544	3,424	3,596	↑
FTSE 100	7,604	7,350	7,730	↑
Nikkei 225	21,702	20,950	22,350	↗
Shanghai Comp	3,005	2,925	3,175	↗
Hang Seng	28,796	27,850	29,450	↑
MSCI Asia ex-Japan	658	636	687	↑
MSCI EM	1,065	1,032	1,097	↑
Brent (ICE)	63	62	67	↗
Gold	1,421	1,380	1,455	↑
UST 10Y Yield	1.95	1.93	2.07	↘

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

Government bond yields have fallen across major economies amid slowing growth and inflation; this is supporting equities and other risk assets

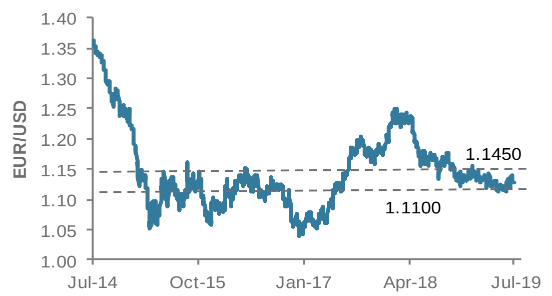
10-year government bond yields in the US, Germany and Japan



Source: Bloomberg, Standard Chartered

EUR/USD faces key resistance at 1.1450

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. How would the recent changes in USD, HKD and SGD money market rates affect borrowing decisions?

Earlier this year, we noted the widening gap between USD and HKD rates (almost 90bps at the time) represented an opportunity to reduce borrowing costs. Given how yields have moved recently, this may no longer be the case.

In the US, 3-month yields fell from a recent peak of just over 2.8% at the end of 2018 to about 2.3% today. In contrast, HKD 3-month yields have risen from a 2019 low of below 1.6% to over 2.6% today. As a result of this narrowing (and then inverting) yield differential, the Hong Kong currency has moved from the weaker end of its policy band towards the stronger end.

In our view, HIBOR rates are likely to stay above USD LIBOR rates for some time until downward pressure on the currency eases (especially with the latest political uncertainty likely prolonging outflow pressures). This has been consistent with the historical experience around periods of currency weakness and is supported by the fact that the HKMA has considerable reserves to defend the HKD peg to the USD (i.e. maintaining the exchange rate within the HKD7.75-7.85 band) by keeping HKD rates high. From a borrower's perspective, though, it looks much less attractive to borrow in HKD for now, in our assessment, especially if rates rise further.

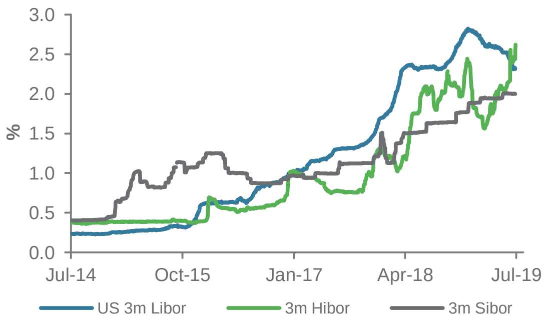
Borrowing in SGD has often been seen as another alternative for borrowers, given slightly lower 3-month rates and expectations of a moderately weaker currency due to potentially incremental policy easing by the MAS. However, in our assessment, the risk/reward is much less compelling given the gap in rates remains small and it is far from clear-cut that the SGD would weaken against the USD. Instead, today's rates argue for a reduction in currency risk by borrowing largely in the same currency as the underlying investment.

Looking ahead, two factors may help guide how this view could evolve in the coming months:

1. If a weakening USD trend indeed takes hold, as we expect, it may become much more attractive to borrow in USD to take advantage of a weaker currency.
2. How strongly a renewed search for yield takes hold will also be key. From a total return perspective, this could mean the focus shifts away from lowering borrowing costs towards potentially using other sources of risk (such as assuming more credit risk or going for longer maturities) to add to investment returns.

HKD short-term rates have surged, even as USD rates have gradually moved lower this year

3-month money market rates in USD, HKD and SGD



Source: Bloomberg, Standard Chartered

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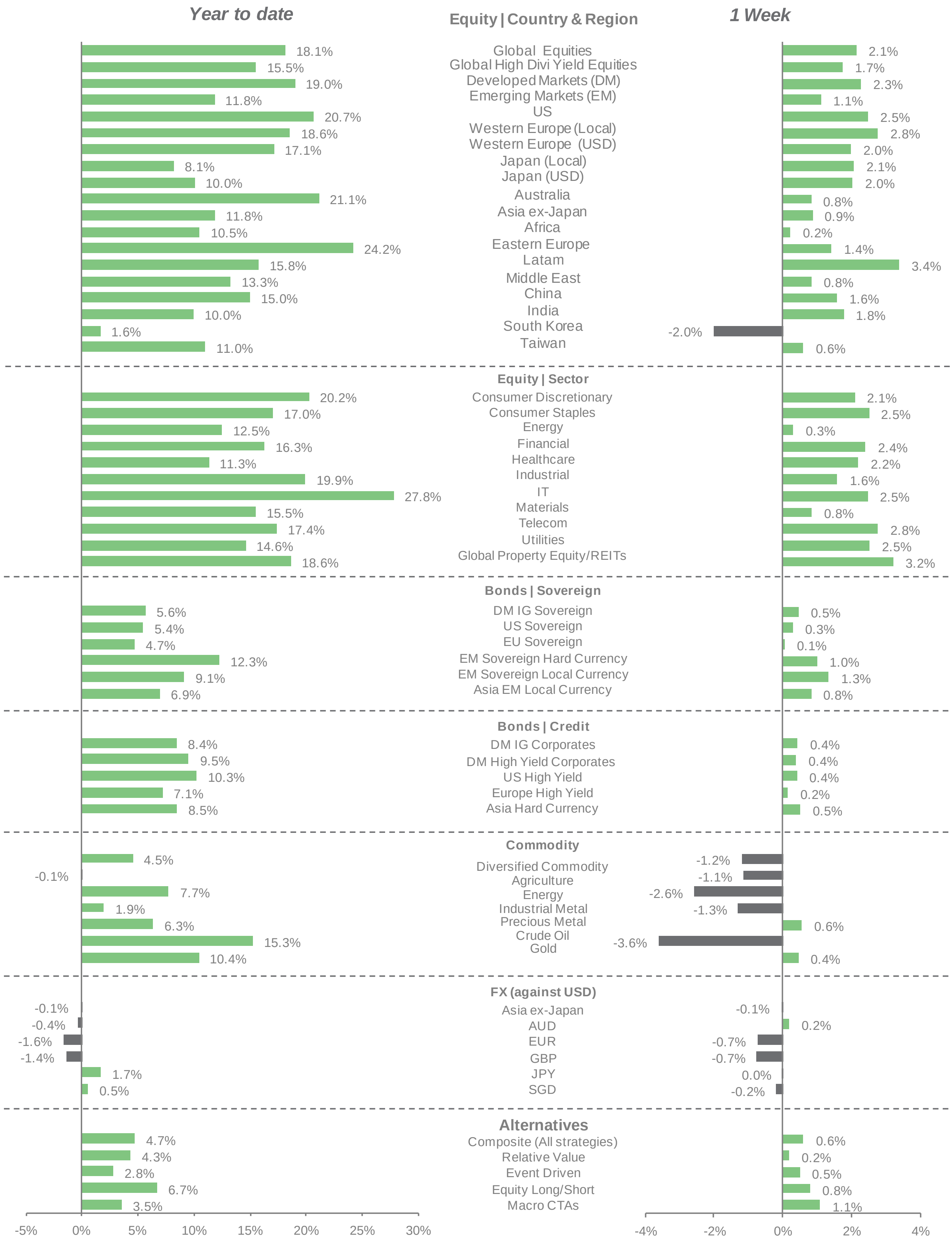
Market performance summary*



*Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 04 July 2019, 1 week period: 27 June 2019 to 04 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	JN	BoP Current Account Adjusted	8-Jul-19	May P	¥1231.2b	¥1600.1b
	JN	Core Machine Orders y/y	8-Jul-19	May	-0.7%	2.5%
	GE	Industrial Production WDA y/y	8-Jul-19	May	–	-1.8%
	GE	Exports SA m/m	8-Jul-19	May	–	-3.4%
	EC	Sentix Investor Confidence	8-Jul-19	Jul	–	-3.3
TUE	US	Consumer Credit	9-Jul-19	May	$15.000b	$17.497b
WED	CH	CPI y/y	10-Jul-19	Jun	2.7%	2.7%
	CH	PPI y/y	10-Jul-19	Jun	0.3%	0.6%
	UK	Industrial Production y/y	10-Jul-19	May	0.4%	-1.0%
	CA	Bank of Canada Rate Decision	10-Jul-19	10-Jul	1.8%	1.8%
THUR	US	CPI Ex Food and Energy y/y	11-Jul-19	Jun	2.0%	2.0%
FRI/SUN	IN	CPI y/y	12-Jul-19	Jun	3.2%	3.1%
	IN	Industrial Production y/y	12-Jul-19	May	2.8%	3.4%
	US	PPI Ex Food and Energy y/y	12-Jul-19	Jun	–	2.3%
	CH	Exports y/y	12-Jul-19	Jun	-0.5%	1.1%

	Event	This Week	Date	Period	Actual	Prior
MON	EC	Unemployment Rate	1-Jul-19	May	7.5%	7.6%
	US	ISM Manufacturing	1-Jul-19	Jun	51.7	52.1
	US	ISM New Orders	1-Jul-19	Jun	50.0	52.7
TUE	AU	RBA Cash Rate Target	2-Jul-19	2-Jul	1.0%	1.25%
	EC	PPI y/y	2-Jul-19	May	1.6%	2.6%
WED	CH	Caixin China PMI Composite	3-Jul-19	Jun	50.6	51.5
	UK	Markit/CIPS UK Composite PMI	3-Jul-19	Jun	49.7	50.9
	US	ADP Employment Change	3-Jul-19	Jun	102k	41k
	US	Trade Balance	3-Jul-19	May	-$55.5b	-$51.2b
	US	Initial Jobless Claims	3-Jul-19	29-Jun	221k	229k
	US	Continuing Claims	3-Jul-19	22-Jun	1686k	1694k
	US	ISM Non-Manufacturing Index	3-Jul-19	Jun	55.1	56.9
THUR	EC	Retail Sales y/y	4-Jul-19	May	1.3%	1.8%
FRI/SUN	GE	Factory Orders WDA y/y	5-Jul-19	May	–	-5.3%
	US	Change in Nonfarm Payrolls	5-Jul-19	Jun	–	75k
	US	Average Hourly Earnings y/y	5-Jul-19	Jun	–	3.1%

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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