Standard Chartered
Private Bank

weekly **market view**

macro strategy | 11 January 2019

This reflects the views of the Wealth Management Group

Editorial

Risk sentiment improves

- **The broad recovery in global risk sentiment offers support to risky assets. We see tactical opportunities in US equities, especially in the energy sector, and EM USD bonds.**
- **Equities:** We expect the recovery in the US and Europe energy sectors to continue as oil extends its rebound. US corporate earnings guidance for 2019 is likely to be a key driver of equities.
- **Bonds:** The bounce in US High Yield bonds is an opportunity to rotate towards Emerging Market (EM) USD government bonds, which offer comparable yields with lower credit risk.
- **FX:** EUR/USD's break above the 1.1500 resistance opens the way towards 1.1850. We also remain bullish on GBP/USD.

What's new?

- **Risk sentiment improves.** Global equities have recovered almost 9% from their two-year lows hit in late December. We see four primary drivers of this rally: (i) strong US job numbers for December (including rising wage growth), which suggest US consumption is likely to stay robust; (ii) comments from several Fed policymakers suggesting rising chances of a pause in interest rate hikes in the coming months; (iii) more growth-boosting measures in China, including release of more liquidity for banks; and (iv) signals that both the US and China are keen to reach an agreement in ongoing trade talks. Further confirmation of these drivers would potentially help sustain the equity rally. The rebound in the S&P500 index from a key technical support is especially positive for US equities, our preferred market. The key risks are worsening Euro area economic data and a prolonged US government shutdown.
- **Opportunity to switch to EM USD government bonds.** US High Yield (HY) bonds have outperformed other bonds on the back of a revival in risk sentiment and a rebound in oil prices. The rally has made the bonds increasingly expensive, in our view. We would use the opportunity to rotate to EM USD government bonds, which offer similar yields but lower credit risk.
- **Turning bullish on EUR; staying bullish on GBP.** EUR/USD rallied to a 13-week high, breaking 1.1500 resistance amid broad-based USD weakness. We expect a test and break of 1.1620 amid ongoing dovish Fed commentary, followed by a test of stronger resistance close to 1.1850. GBP/USD extended its four-week rally after the UK parliament passed a motion that makes a default "no-deal Brexit" more difficult. We expect PM May's soft-Brexit plan to be voted down by parliament on 15 January, which would turn focus to her Brexit 'Plan B'. We see GBP/USD rallying towards the next resistance around 1.3070.

What we are watching

- **US Q4 corporate earnings.** US banks will jumpstart the earnings season in the week of 14 January. Consensus S&P500 earnings growth expectations have been cut, led by downgrades to the technology sector. 2019 guidance will be key.
- **US government shutdown.** Historically, any equity pullbacks due to the shutdowns have been buying opportunities. However, a prolonged shutdown could threaten the US's AAA credit rating.

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The S&P500 index has rebounded from its 200-week moving average, a key technical support from which the index had recovered in 2016 and in 2011

S&P500 index and its 200-week moving average

Source: Bloomberg, Standard Chartered

After the latest rally, US HY bond yield premium over Treasuries are now similar to EM USD government bonds, although the latter carry lower credit risk

Yield premiums over US Treasuries on US HY bonds and EM USD government bonds

Source: Bloomberg, Standard Chartered

Steve Brice
Chief Investment Strategist

Clive McDonnell
Head, Equity Investment Strategy

Manpreet Gill
Head, FICC Investment Strategy

Arun Kelshiker, CFA
Head, Portfolio Strategy

Audrey Goh, CFA
Senior Cross-asset Strategist

Daniel Lam, CFA
Senior Cross-asset Strategist

Belle Chan
Senior Investment Strategist

Rajat Bhattacharya
Senior Investment Strategist

Francis Lim
Senior Investment Strategist

Thursten Cheok, CFA
Senior Portfolio Strategist

Abhilash Narayan
Investment Strategist

Cedric Lam
Investment Strategist

Trang Nguyen
Portfolio Strategist

DJ Cheong
Investment Strategist

What does this mean for investors?

Global equities rebounded, led by US stocks, amid a broad-based revival in risk sentiment. US High Yield bonds led gains in debt markets. Oil extended its recovery amid OPEC output cuts.

Equities: Energy sector preferred; rally likely to extend

- **Energy sector supported by oil rebound.** Energy sector equities in the US and Europe have been strong performers in the new year, rising c.9% and 4.4% respectively led by the 14% rally in crude oil prices. We expect the rally to continue amid a recovery in oil prices as OPEC cuts output and global growth expectations normalise from overly pessimistic levels. Our central scenario is for Brent crude oil prices to rise in 2019 (see page 3).
- **Watching US Q4 corporate earnings.** US banks will jumpstart the reporting earnings during the week of 14 January. Consensus expects 14.5% earnings growth for S&P500 index members. This is down from 20% growth expected in early October, primarily due to downgrades in the technology sector following profit warnings. Q1 earnings guidance is also likely to be clouded by uncertainty created by the US government shutdown and the US-China trade dispute. Nevertheless, we believe the US economy is resilient as reflected in the strong employment data and the still-strong manufacturing and services sector confidence data. Corporate margins remain resilient and valuations are fair. These factors contribute to our preference for US equities.
- **Stimulative measures lift China market sentiment.** China and Hong Kong markets rebounded on news of further policy stimulus. The larger-than-expected reduction of reserve requirement ratios (RRR) announced on 4 January and reports that authorities will introduce measures to boost auto and home appliance consumption have lifted market sentiment. The 12-month forward P/E ratio of the MSCI China A onshore index is at 9x, below its long-term average of 11x and close to historical troughs. We continue to prefer China onshore equities within Asia ex-Japan.

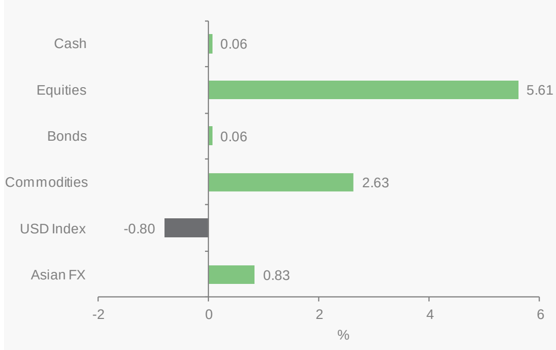
Bonds: Corporate and EM bonds rebound

- **Developed Market High Yield bonds outperform.** The bonds gained amid a revival in risk sentiment. A rebound in oil prices was particularly supportive for US HY bonds. However, we continue to believe valuations for HY bonds remain elevated, reducing the scope for future outperformance. Therefore, we believe the current rebound is an opportunity to reduce exposure.
- **Opportunity to switch to EM USD bonds.** EM bonds, both USD and local currency, delivered strong returns amid a weaker USD and improved risk sentiment. EM USD government bond yield premiums declined by over 30bps, also helped by higher commodity prices. Despite the rebound, we view EM USD bond valuations as attractive and would use the recovery in Developed Markets (DM) HY bonds to rotate to EM USD government bonds.

FX: Opportunities in AUD/USD and USD/CAD

- **Looking to turn bearish in AUD/USD.** AUD/USD has rallied strongly following the recent "flash-crash", although we believe that the domestic economy continues to face headwinds that will not be quickly offset by any US-China trade deal. We see strong technical resistance up to 0.7430 and expect another test of 0.7000. We would turn bearish on the pair if it rallies to 0.7300.
- **Looking to turn bearish on USD/CAD.** USD/CAD fell sharply from 1.3665 to 1.3155 in the past week as oil prices recovered and the Fed turned more dovish. We believe a correction is due and would turn bearish if the pair rallies to 1.3350, expecting another leg lower towards 1.30 in the coming weeks.

Benchmark (USD) performance w/w*



**Week of 03 January 2019 to 10 January 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 market technicals have turned positive

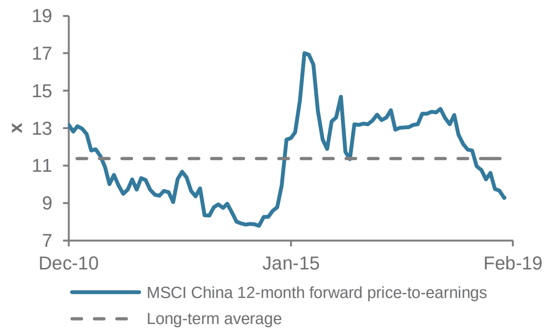
Technical levels of key market indicators as on 10 Jan.

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,597	2,520	2,627	↗
STOXX 50	3,076	3,000	3,100	→
FTSE 100	6,943	6,730	6,960	→
Nikkei 225	20,345	19,700	20,490	↗
Shanghai Comp	2,535	2,440	2,600	↓
Hang Seng	26,521	25,650	26,600	↓
MSCI Asia ex-Japan	610	568	615	↗
MSCI EM	999	945	1,020	↗
Brent (ICE)	62	55	64	→
Gold	1,288	1,265	1,305	↗
UST 10Y Yield	2.73	2.52	2.82	↘

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

MSCI China A onshore index is trading at a lower valuation compared with its long-term average

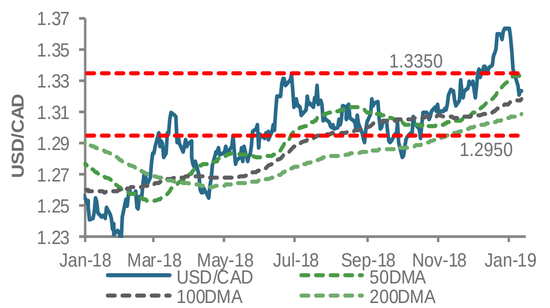
12-month forward P/E ratio of MSCI China onshore index and its long-term average



Source: FactSet, Standard Chartered

We would turn bearish on USD/CAD if the pair rallies to 1.3350, expecting another leg lower towards 1.30

USD/CAD



Source: Refinitiv EIKON, Standard Chartered

Top client questions

Q1. Does your technical view that Brent oil remains in a USD 60-85/bbl range still hold after the recent weakness?

Yes. We still expect Brent oil to return to a USD 60-85bbl range, revisiting the 2018 range of $61-87.

After hitting a 17-month low of USD 49.93/bbl, Brent crude oil has retraced about 22% amid signs that OPEC members are executing their planned output cuts, US supply has plateaued and global demand remains robust. The recovery in risk sentiment amid constructive US-China trade talks have also aided the recovery.

Based on the charts, crude oil now appears to be stabilising, given fairly strong technical support around USD 50/bbl (the 61.8% Fibonacci retracement of the 2016-2018 rise). The bullish reversal on the daily charts since December 26 raises the possibility that the psychological (and technical) USD 50 level could mark the base in the current cycle. We also note that, despite the sharp fall since October, the 14-month Relative Strength Index (RSI, a momentum indicator which shows whether an asset is overbought or oversold) failed to dip below the key 40-mark. In sustained uptrends, the RSI tends to stay above 35-40. This raises the probability that the Q4 slide was a retracement of the two-year bull run, rather than a reversal of the uptrend.

Speculative investor positioning has stabilised and we have seen a recovery in the diversity of oil market views in recent weeks from extremely bearish levels in December.

However, given the pullback in recent months, any rebound could turn out to be choppy, with frequent retests of lows. Brent oil faces immediate resistance at the end-November low of USD 57.50/bbl, followed by USD 63.75/bbl. A break above USD 63.75/bbl would confirm that the medium-term downward pressure has faded.

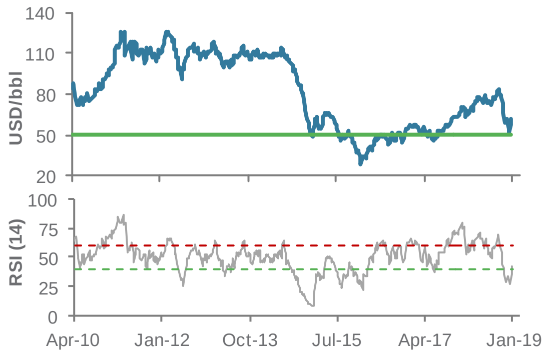
We believe supply will be a key driver of oil markets going forward. Iran's supply dynamics, as well as the outlook for US waivers on Iran's oil-related sanctions, could also keep prices volatile.

Nevertheless, risks to prices are skewed upwards as long as OPEC members continue to comply with their output cut decision.

A key risk to this view is slowing global growth, especially in major oil consumers (China and Europe).

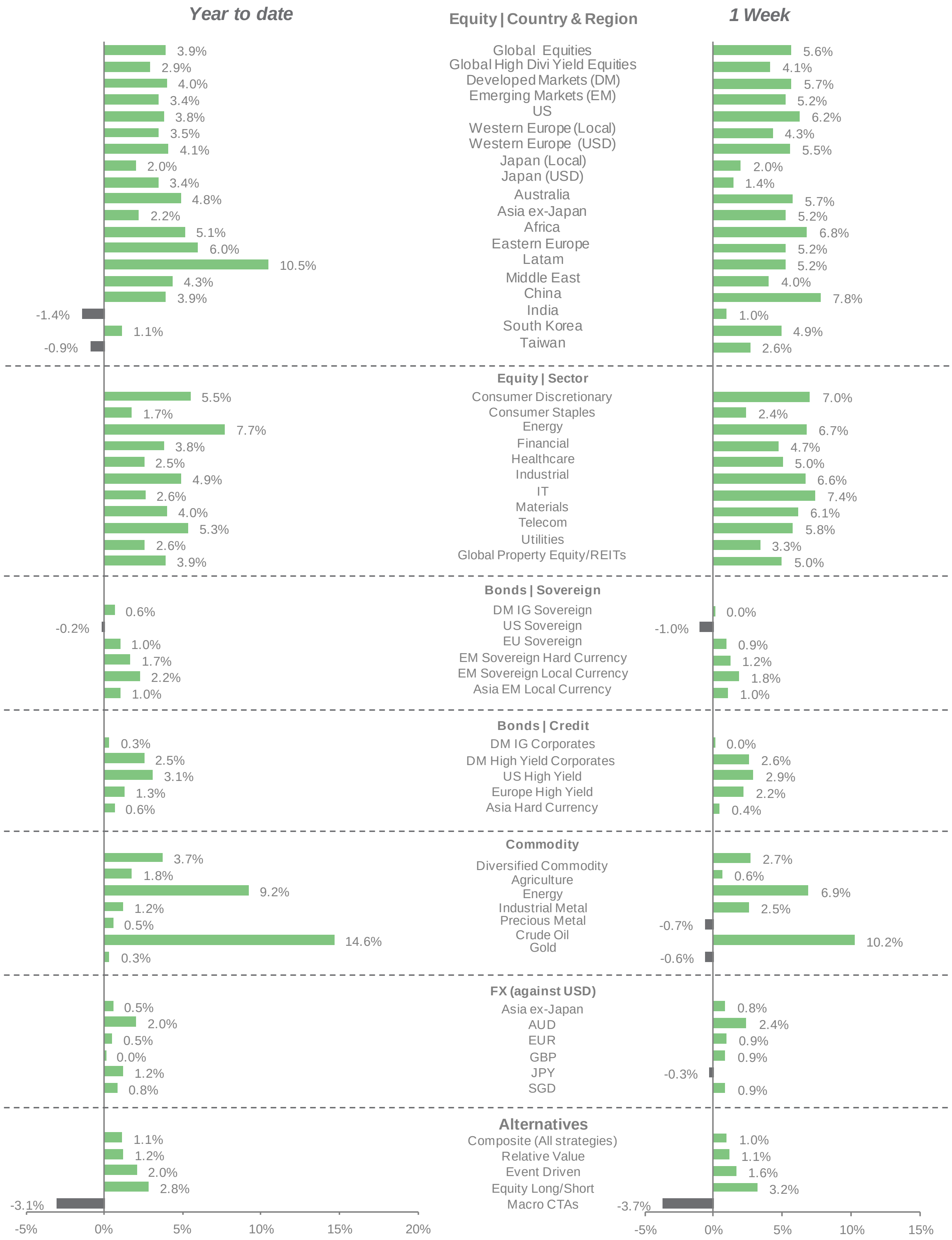
Brent crude oil appears to have a strong technical support around the USD 50/bbl level

Brent crude oil; Relative Strength Index
[a momentum indicator which shows whether an asset is overbought (over 70) or oversold (below 30)]



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 10 January 2019, 1 week period: 03 January 2019 to 10 January 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	IN	CPI y/y	14-Jan-19	Dec	2.2%	2.3%
	CH	Exports y/y	14-Jan-19	Dec	2.0%	5.4%
TUE	JN	Money Stock M2 y/y	15-Jan-19	Dec	–	2.3%
	US	PPI Ex Food and Energy y/y	15-Jan-19	Dec	–	2.7%
	IN	Exports y/y	15-Jan-19	Dec	–	0.8%
WED	JN	Core Machine Orders y/y	16-Jan-19	Nov	–	4.5%
	UK	CPI Core y/y	16-Jan-19	Dec	–	1.8%
	US	Retail Sales Ex Auto and Gas	16-Jan-19	Dec	0.6%	0.5%
THUR	US	Building Permits	17-Jan-19	Dec	1280k	1328k
	US	Housing Starts	17-Jan-19	Dec	1244k	1256k
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	18-Jan-19	Dec	–	0.3%
	UK	Retail Sales Ex Auto Fuel y/y	18-Jan-19	Dec	–	3.8%
	US	Industrial Production m/m	18-Jan-19	Dec	0.3%	0.6%
	US	U. of Mich. Sentiment	18-Jan-19	Jan P	96.4	98.3

	Event	This Week	Date	Period	Actual	Prior
MON	GE	Factory Orders WDA y/y	07-Jan-19	Nov	-4.3%	-3.0%
	EC	Sentix Investor Confidence	07-Jan-19	Jan	-1.5	-0.3
	EC	Retail Sales y/y	07-Jan-19	Nov	1.1%	2.3%
	IN	GDP Annual Estimate y/y	07-Jan-19	2019	7.2%	6.7%
	US	ISM Non-Manufacturing Index	07-Jan-19	Dec	57.6	60.7
TUE	GE	Industrial Production WDA y/y	08-Jan-19	Nov	-4.7%	0.5%
	EC	Economic Confidence	08-Jan-19	Dec	107.3	109.5
	US	NFIB Small Business Optimism Index	08-Jan-19	Dec	104.4	104.8
WED	GE	Exports SA m/m	09-Jan-19	Nov	-0.4%	0.9%
	EC	Unemployment Rate	09-Jan-19	Nov	7.9%	8.0%
	CH	CPI y/y	09-Jan-19	Dec	1.9%	2.2%
	CH	PPI y/y	09-Jan-19	Dec	0.9%	2.7%
THUR	US	Initial Jobless Claims	10-Jan-19	5-Jan	216k	233k
FRI/SAT	IN	Industrial Production y/y	11-Jan-19	Nov	–	8.1%
	US	CPI Ex Food and Energy y/y	11-Jan-19	Dec	–	2.2%

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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