weekly market view

macro strategy | 12 July 2019

This reflects the views of the Wealth Management Group

Editorial

Sealing a July Fed rate cut?

- **Fed Chair Powell all but confirmed an interest rate cut in July. Growing chances of further 'insurance' cuts in H2 should prove supportive for equities and other risk assets.**
- **Equities:** US profit margins are narrowing, but remain above their long-term trend and those in other regions. Earnings growth could recover by Q4, supporting our preference for US equities.
- **Bonds:** Powell's indication of a rate cut, despite a strong US jobs data, is positive for Emerging Market USD bonds.
- **FX:** EUR/USD needs to break above 1.1450 for sustained gains.

What's new?

- **Did Powell just seal a July Fed rate cut?** Fed Chair Powell, at his semi-annual testimony to the US Congress, built a case for the Fed's first rate cut in over a decade, citing international risks to the economy and still-subdued inflation. In doing so, he cast aside doubts against a cut that had crept in following the stronger-than-expected US June jobs report. Powell appears to have confirmed what markets have already priced in – a 25bps cut in July (and 18% probability of a 50bps cut). We expect the Fed to deliver another cut by the end of 2019. Lower US rates are likely to drive the USD lower and support Emerging Market (EM) bonds, especially those denominated in USD, and gold. Lower borrowing costs are also likely to be positive for riskier assets such as equities, especially in the US, where investors are expecting an earnings recovery over the next 12 months.
- **US earnings primed for beats?** The US Q2 earnings season begins in earnest, with major banks reporting from 15 July. Expectations are muted, with consensus forecasting a -0.2% dip in S&P500 earnings, down from +2.8% growth expected three months ago. This trend was also witnessed in Q1, when analyst expectations were managed down to a -2.3% decline entering the results season, but actual earnings "beat" expectations with 1.6% growth. The lacklustre earnings growth estimates for 2019 are primarily due to statistical reasons (a high base set in 2018 following the late-2017 tax cuts). Corporate commentary on developing costs and wage pressures, besides forward-looking guidance, will be crucial in assessing the evolution of margins and earnings. With the S&P500 index setting all-time highs, investors will need to be assured that revenue and earnings can rebound in H2 and in 2020 (see chart) to push the market higher.
- **China deflation concerns return; policy stimulus next?** Although China's food inflation stayed high in June, leaving consumer inflation stable at 2.7%, producer prices continued to decelerate and look set to turn negative in H2. The disruption to manufacturing and global trade caused by US-China trade tensions has likely dampened China's nascent economic recovery. This raises the chances of more policy easing, possibly through cuts to bank reserve requirements and credit growth.

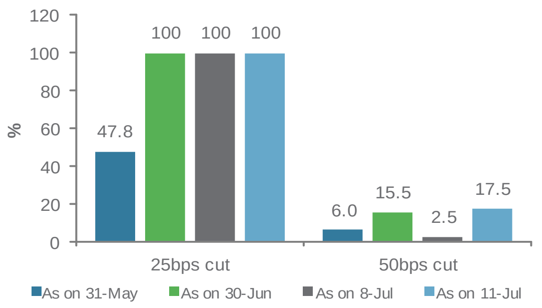
What we are watching

- China credit growth and investment data for June; US retail sales; US-China trade talks; New UK Prime Minister.

Contents

Expectations of a 25bps Fed rate cut in July have stayed firm since June; Powell's comments have revived the chance of a 50bps cut later this month

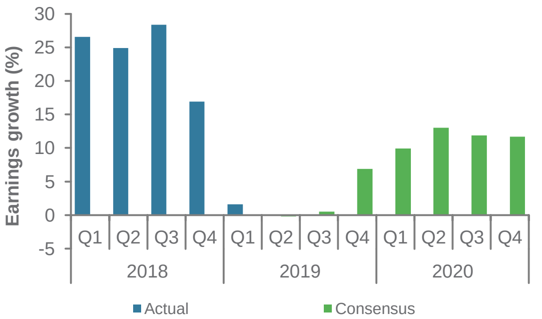
Market-based probabilities of Fed rate cuts in July



Source: Bloomberg, Standard Chartered

US earnings growth is expected to accelerate by Q4 after a lacklustre H1 caused by high base effects

S&P500 earnings growth and consensus expectations



Source: Bloomberg, Standard Chartered

Alexis Calla
Global Head, Investment Advisory & Strategy

Steve Brice
Chief Investment Strategist

Clive McDonnell
Head, Equity Investment Strategy

Manpreet Gill
Head, FICC Investment Strategy

Manish Jaradi
Senior Investment Strategist

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

Marco Iachini, CFA
Cross-Asset Strategist

What does this mean for investors?

Global equities consolidated gains as bonds fell (yields rose) following better-than-expected US jobs data. The USD rose.

Equities: What are the underlying drivers of US earnings?

- **Broad-based revenue growth, but margin pressure building.** The consensus expects eight US sectors to report Q2 revenue growth and three (energy, technology and materials) to report declines. In contrast, earnings growth is expected only in five sectors, with declines seen in six. This is primarily due to growing margin pressures in sectors such as consumer discretionary, industrials and consumer staples, where earnings are set to decline despite positive revenue growth. Indeed, margin pressure is visible for the overall S&P500, as Q2 revenue growth is estimated at 3.4%, against expected earnings decline of -0.2%.
- **US equities still attractive**. US margins, despite the recent decline, remain above the long-term trend and above other regions. Besides, the consensus still expects US earnings growth in 2019 and acceleration in 2020, while lower bond yields support higher equity valuations and share buybacks. These factors explain our preference for US equities.
- **China focuses on earnings guidance**. A major automaker's profit warning surprised the market. Corporate guidance ahead of the Q2 earnings season is the near-term focus. Consensus 12m forward earnings growth for both China onshore and offshore equities stands at 15%. We expect our preferred defensive consumer staples sector to report stronger growth.

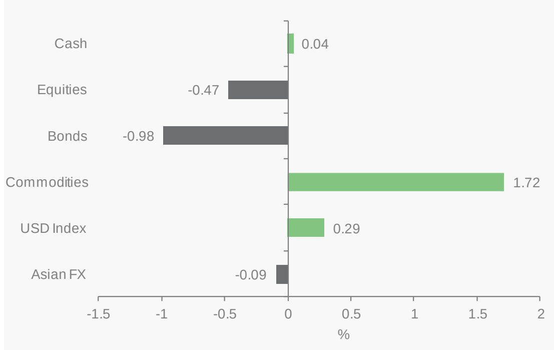
Bonds: What does the latest US jobs report mean for bonds?

- **US yields likely range-bound**. Strong US jobs data drove US Treasury yields higher amid reduced rate cut expectations. However, Fed Chair Powell's comments partly revived rate cut prospects. We continue to expect US 10y Treasury yields to stay within 2.00-2.25% unless inflation accelerates significantly, a risk that appears unlikely for now given contained US wage growth and chances of producer price deflation in China.
- **EM bonds still preferred**. EM USD government bond and Asian USD bond yield premiums continued to decline following the US-China trade truce and positives from India's budget (see page 3). In contrast, yield premiums for DM corporate bonds rose. While we continue to like the attractive yield of nearly 5.5% offered by EM USD bonds, index changes (exclusion of Venezuela) are likely to modestly reduce the headline yield on offer.

FX: Is EUR/USD finally taking off?

- **Building the base for a sustained rally**. We expect EUR/USD support at 1.1180-90 to hold as the pair continues to build a series of higher lows and higher highs – usually indicative of the start of a sustained uptrend. Powell reiterated the Fed's dovish policy stance. The ECB meeting on 25 July may clarify chances of more stimulus in the Euro area. This could trigger a EUR/USD break above the key resistance at 1.1450, leading to acceleration.
- **Is the bout of GBP weakness over?** GBP/USD slumped recently, but held support at January's low of around 1.2435 amid concerns that Conservative PM contender Johnson may attempt a no-deal Brexit. However, the concerns were somewhat allayed after the opposition Labour Party promised to push for a second Brexit referendum and support keeping the UK in the EU in case of a no-deal. Opinion polls suggest the UK electorate is likely to vote to stay in the EU. A recovery in GBP/USD above resistance at 1.2780 would signal a reversal and a likely new uptrend. The next focus is the confirmation of the new PM in just over a week.

Benchmark (USD) performance w/w*



*Week of 04 July 2019 to 11 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)

Major equity market technicals remain positive
Technical levels of key market indicators as on 11 July

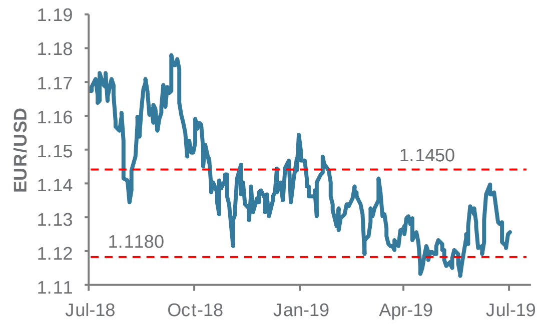
Index	Spot	1st support	1st resistance	Short-term trend
S&P500	3,000	2,910	3,020	↑
STOXX 50	3,497	3,424	3,596	↑
FTSE 100	7,510	7,350	7,730	↑
Nikkei 225	21,644	20,950	22,350	↗
Shanghai Comp	2,918	2,825	3,045	→
Hang Seng	28,432	27,850	29,000	↑
MSCI Asia ex-Japan	649	636	661	↑
MSCI EM	1,055	1,032	1,066	↑
Brent (ICE)	67	62	70	↗
Gold	1,405	1,380	1,455	↑
UST 10Y Yield	2.13	1.93	2.15	↘

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

EM USD government bond yield premiums have compressed lately following the US-China trade truce
EM USD government bond yield premium over US Treasuries

Source: Bloomberg, Standard Chartered

EUR/USD faces key resistance at 1.1450
EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What does the Indian budget mean for investors?

In the run-up to the budget, markets were concerned about the possibility of a wider fiscal deficit following the government's strong election mandate and amid signs of a slowing economy. However, the Indian government surprised markets positively by maintaining fiscal prudence (lowering the fiscal deficit target for the fiscal year ending March 2020 to 3.3% from 3.4% projected earlier) and policy certainty. We believe the Reserve Bank of India (RBI) is likely to consider the government's commitment to fiscal consolidation and further ease monetary policy, given benign inflation dynamics.

The government's focus on revitalising the financial sector is likely to be supportive for Indian assets. Further recapitalisation of state-owned banks should provide them growth capital to improve credit flow to the economy. The government's credit guarantee and RBI's additional lines of liquidity for state-owned banks for buying loans from non-banking financial companies and housing finance companies should partially address credit market concerns, given the backdrop of bad debts in the shadow banking sector.

The government's emphasis on increasing foreign participation in Indian markets is particularly positive for the INR. For the first time, the government said it will issue foreign currency sovereign bonds to meet 10-12% of its annual borrowing requirement. This should significantly reduce domestic bond issuances, lowering demand for domestic savings and driving INR bond yields down. Additionally, the government eased restrictions on foreign direct investments for several sectors and eased norms for foreign portfolio investors. Moreover, investor positioning in Indian equities is close to a seven-year low, which is likely to be a key support for India equities, one of our two preferred equity markets in Asia ex-Japan (besides China onshore equities).

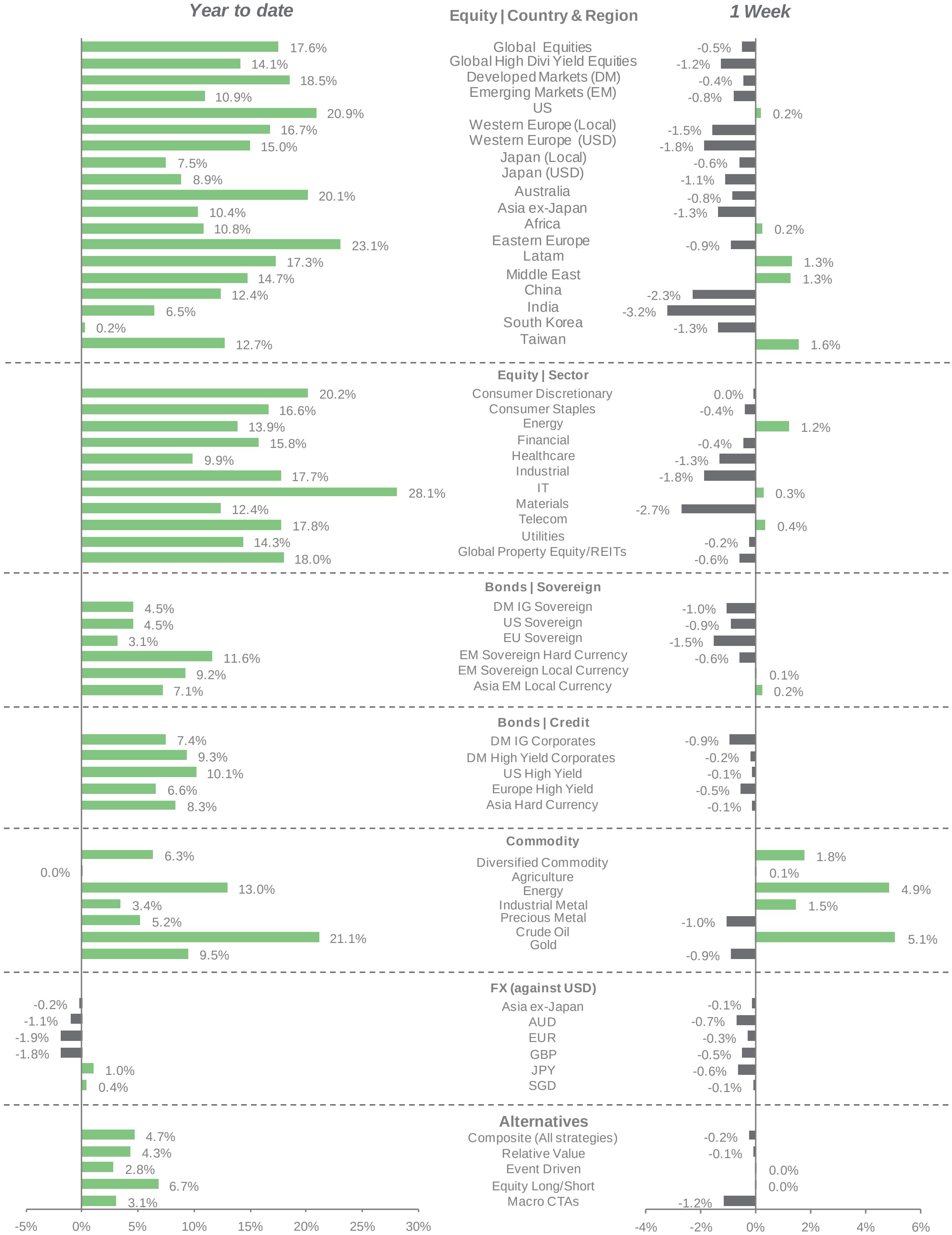
International bond investors have reacted positively to the above-mentioned announcements, with USD-denominated Indian quasi-government and corporate bond yield premiums declining nearly 10bps over the past week. The offshore sovereign bond issuance is likely to benefit from strong demand, given the scarcity value. However, given that bonds from Indian-government-owned entities already trade somewhat expensive for their ratings, the sovereign bond issuance is unlikely to lead to a material rally across the USD-denominated Indian bond complex.

Indian bonds yields have declined sharply after the government surprised markets by lowering its fiscal deficit target; USD/INR is testing a key support

The 10-year Indian government bond yield; USD/INR

Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 11 July 2019, 1 week period: 04 July 2019 to 11 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	CH	Fixed Assets Ex Rural YTD y/y	15-Jul-19	Jun	5.6%	5.6%
	CH	Industrial Production y/y	15-Jul-19	Jun	5.3%	5.0%
	CH	Retail Sales y/y	15-Jul-19	Jun	8.5%	8.6%
	CH	GDP y/y	15-Jul-19	2Q	6.2%	6.4%
TUE	UK	Average Weekly Earnings 3m/y/y	16-Jul-19	May	–	3.1%
	US	Retail Sales Ex Auto and Gas	16-Jul-19	Jun	–	0.5%
	US	Industrial Production m/m	16-Jul-19	Jun	0.2%	0.4%
WED	UK	CPI Core y/y	17-Jul-19	Jun	–	1.7%
	US	Housing Starts	17-Jul-19	Jun	1260k	1269k
	US	Building Permits	17-Jul-19	Jun	1300k	1299k
THUR	JN	Exports y/y	18-Jul-19	Jun	-4.6%	-7.8%
	UK	Retail Sales Ex Auto Fuel y/y	18-Jul-19	Jun	–	2.2%
	US	Leading Index	18-Jul-19	Jun	0.1%	0.0%
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	19-Jul-19	Jun	0.5%	0.5%
	EC	ECB Current Account SA	19-Jul-19	May	–	20.9b

	Event	This Week	Date	Period	Actual	Prior
MON	JN	BoP Current Account Adjusted	8-Jul-19	May P	¥1305.7b	¥1600.1b
	JN	Core Machine Orders y/y	8-Jul-19	May	-3.7%	2.5%
	GE	Industrial Production WDA y/y	8-Jul-19	May	-3.7%	-2.3%
	GE	Exports SA m/m	8-Jul-19	May	1.1%	-3.4%
	EC	Sentix Investor Confidence	8-Jul-19	Jul	-5.8	-3.3
TUE	US	Consumer Credit	9-Jul-19	May	$17.09b	$17.497b
WED	CH	CPI y/y	10-Jul-19	Jun	2.7%	2.7%
	CH	PPI y/y	10-Jul-19	Jun	0.0%	0.6%
	UK	Industrial Production y/y	10-Jul-19	May	0.9%	-1.1%
	CA	Bank of Canada Rate Decision	10-Jul-19	10-Jul	1.75%	1.75%
THUR	US	CPI Ex Food and Energy y/y	11-Jul-19	Jun	2.1%	2.0%
FRI/SAT	IN	CPI y/y	12-Jul-19	Jun		3.1%
	IN	Industrial Production y/y	12-Jul-19	May		3.4%
	US	PPI Ex Food and Energy y/y	12-Jul-19	Jun		2.3%
	CH	Exports y/y	12-Jul-19	Jun		1.1%

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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