weekly **market view**

macro strategy | 24 August 2018

This reflects the views of the Wealth Management Group

Editorial

The longest-ever bull market. What next?

- **The S&P500 index scaled a new record high. We continue to like equities and see strong fundamentals as a key support behind this record run.**
- **Equities:** US equities remain our preferred market due to solid corporate earnings and margins, and rising share buybacks.
- **Bonds:** The sell-off in Emerging Market (EM) USD government bonds has created an opportunity to add exposure; they currently offer a higher yield than US High Yield (HY) bonds.
- **FX:** Fed comments at Jackson Hole could drive FX markets next week. We see room for temporary USD consolidation, although we still expect the near-term uptrend to continue.

What's new?

- **The longest-ever US bull market.** The S&P500 index posted a new intra-day all-time high, past the previous high scaled on 26 January. The index has now gone 9 years, 5 months and 14 days without a 20% drawdown, which, according to some measures, qualifies the uptrend as the longest bull market in US history. However, this bull-run is not the biggest ever – that record belongs to the 1990s' rally when the index rose 417%, compared with 322% gains for the current bull-run. This implies the index would need to rise another 23% to 3,500 to make it the longest- and biggest-ever bull rally. Records notwithstanding, we continue to prefer US equities over other major markets on the back of strong earnings and profit margins and a significant rise in ROE this year, which we believe should provide strong fundamental support for the market (see page 3 for more).
- **Evolving risks.** While the outlook for equities remains positive, in our view, there are several sources of risk that could cause volatility over the coming months. These include the ongoing US-China trade tensions (the two sides did not make any progress in talks this week) and NAFTA negotiations, the Fed's plans to proceed with a gradual rate hiking cycle and the latest convictions against President Trump's former campaign manager and lawyer. The latter could influence the investigations into Russian collusion, bolster Democrat support in the US mid-term polls and lead Trump to take a more hawkish stance on trade. These uncertainties imply that it remains important to rebalance diversified allocations to keep them consistent with one's risk tolerance and liquidity needs over the coming months.
- **USD consolidates.** The USD index has pulled back from a 13-month high. The reversal in the USD's four-month rally followed President Trump's pushback against USD strength, including charges of currency manipulation against China and Europe, and concerns about Trump's rising political challenges. The USD index is testing its 50DMA, from which it has rebounded three times in the past two months. We believe any dips would provide a near-term opportunity to add USD exposure.

What we are watching

- **Fed comments at Jackson Hole.** The meeting of central bankers could provide more clarity on the Fed's policy outlook, in light of Trump's actions/comments on trade and monetary policy.

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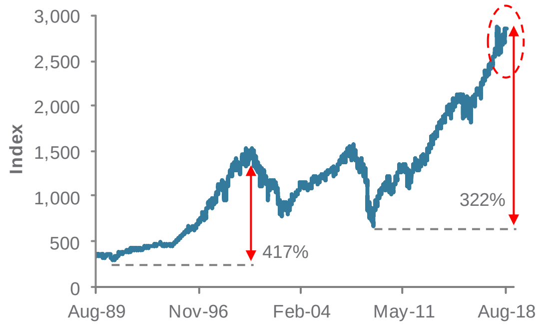
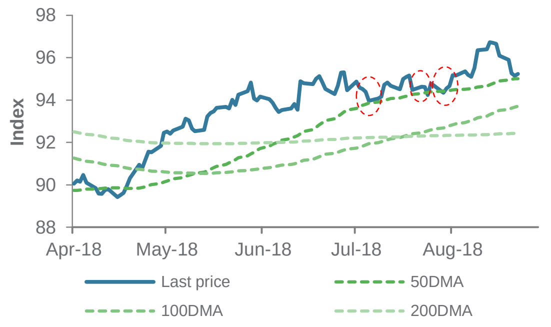
We believe the S&P500 index has fundamental support to extend its record-setting bull-run
S&P500 index



Source: Bloomberg, Standard Chartered

The USD index has rebounded from its 50DMA over the past three months; we believe any dip would offer a near-term opportunity to add exposure
USD index



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

Jill Yip, CFA
Senior Investment Strategist

Abhilash Narayan
Investment Strategist

Cedric Lam
Investment Strategist

Trang Nguyen
Portfolio Strategist

DJ Cheong
Investment Strategist

What does this mean for investors?

Global stocks rebounded, with US stocks setting record highs and EM equities rebounding as concerns about Turkey eased. The USD gave up some of its recent gains.

Equities: US-Euro area divergence to continue

- **US equities backed by solid fundamentals.** Our preference for US equities is based on strong corporate fundamentals. These include non-financial sector net margins at 11% – a cyclical high – and operating margins (profitability before the effect of recent tax cuts) at 14%. US ROE has risen sharply to 19% from 17% at the start of the year. We believe these trends are likely to provide fundamental support to the ongoing US bull market.
- **Euro area earnings remain challenging.** Euro area corporate earnings are forecast to decline 3.2% in Q2, according to consensus estimates. However, earnings growth is expected to recover to 15% in Q3, helping nudge the estimated full-year growth to 7%. Nevertheless, this remains slower than the full-year earnings growth of 23% expected in the US, underscoring our preference for the latter.

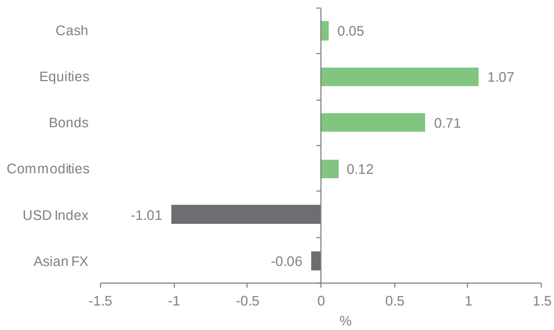
Bonds: Stabilisation in EM bonds

- **Opportunity to add EM USD bonds.** Emerging Market (EM) government bonds, both USD and local currency, rose over the past week as the USD pulled back from a 13-month high and concerns surrounding Turkey eased somewhat. Recent weakness has led to a meaningful increase in yield premiums, and the bonds now offer higher yields than even US High Yield (HY) bonds. Although renewed USD strength remains a risk, we believe the recent sell-off represents an opportunity to add exposure to EM USD government bonds.
- **Potential Tran-Atlantic policy divergence.** US 10-year Treasury yields declined for the fourth straight week towards 2.8%, as inflation expectations continued to edge lower. The recent Fed meeting minutes indicated its commitment to continue hiking rates gradually, confirming the market's expectation of 1-2 more hikes in 2018. These expectations should support US yields. In contrast, bond yields in Italy have risen over the past month, as concerns over Italy's budget have elevated risk premiums in peripheral European countries. These concerns risk delaying policy normalisation by the ECB.

FX: EUR/USD faces resistance near term

- **EUR/USD to test 1.1700 resistance.** EUR/USD broke easily through resistance at 1.1500 but could not sustain the corrective rally, peaking at 1.1620. We believe a further rally towards 1.1700 is possible as long USD positions are trimmed. On a slightly longer timeframe, we continue to expect EUR/USD weakness and a return to test the recent 1.13 lows, and possibly our 1.12 target.
- **GBP/USD rally unlikely to sustain.** GBP/USD rebounded from a 14-month low and briefly traded above 1.2900 as the USD consolidated, but slipped back as the government issued advisories on a 'no-deal' Brexit scenario. We believe there is still room for a further brief GBP rally towards 1.3050. However, this is unlikely to be sustained amid Brexit uncertainty.
- **Gold continued to underperform as a safe haven**, amid higher US rates and tighter global liquidity. Last week's drop to USD1160/oz was likely capitulation by long positions. The subsequent rally to 1200 relieved an oversold technical position. We view the 1200-1215 level as important resistance. If gold holds below this resistance, there is a risk that a more sustained decline could materialize.

Benchmark (USD) performance w/w*



**Week of 16 August 2018 to 23 August 2018*

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)

EM equity market technical indicators remain weak

Technical levels of key market indicators as on 23 August

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,857	2,818	2,910	↑
STOXX 50	3,419	3,340	3,465	↘
FTSE 100	7,563	7,474	7,714	↘
Nikkei 225	22,411	21,850	23,050	↗
Shanghai Comp	2,725	2,630	2,845	↘
Hang Seng	27,790	26,850	28,750	↘
MSCI Asia ex-Japan	660	636	675	↓
MSCI EM	1,048	1,000	1,084	↓
Brent (ICE)	75	68	75	↘
Gold	1,184	1,145	1,212	↘
UST 10Y Yield	2.82	2.80	3.01	↘

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

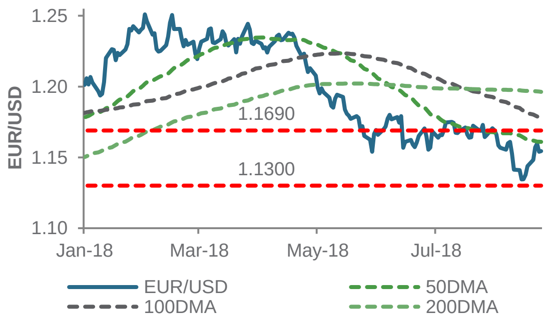
EM USD government bonds now offer higher yields than US HY bonds

Yields on EM USD government bonds and US HY bonds

Source: JPMorgan EMBI Global Diversified Index, Bloomberg, Standard Chartered

EUR/USD faces resistance around 1.1700

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. Should I add to my US equity holdings or reduce exposure, now that the US equity market has scaled a new record high?

The record run for the S&P500 has raised the question of whether it is too late for investors to increase exposure to the US equity market. There is understandable concern about buying a market which has reached an all-time high – no one wants to buy at the peak. Our view remains it is appropriate to add to investments in US equities, which is a preferred market.

The underlying driver of this view is the notion that a nominal high for any index does not necessarily imply a market top in other fundamental metrics such as valuations and profit margins.

The factors driving our optimism towards US equities include the high level of non-financial net margins, which have increased to 11%; strong earnings - on track for 23% growth this year; and return on equity – a measure of corporate profitability – which has surged to 19%. Valuations remain elevated at 17x 12-month forward earnings forecasts, but this is actually lower than the 19x recorded in January this year.

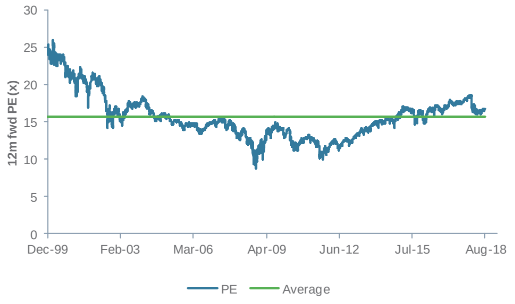
Concerns remain about buying a market which has reached a record high. Nevertheless, we note that every bull market by definition sees the market reach an all-time high. For investors, it is more important to assess whether valuations have reached an all-time high and, by this measure, the market has not in the current cycle. This implies that investors would not be paying too much today for a share of tomorrow's profits. The S&P500's valuations today are significantly below that recorded during the dot-com boom in 2000.

There are concerns that the surge in share buybacks has artificially increased earnings per share and return on equity. However, our analysis highlights that the level of outstanding equity, one measure of shares outstanding, continues to increase. Over the past twelve months, equity outstanding has increased 6% and profits are up 15%. This implies that the surge in the return on equity to 19% is driven by clear improvements in profits, as opposed to an artificial reduction in equity or shares outstanding.

We estimate that if the S&P500 rose to 3,500 – which would imply the current bull market would be not only the longest, but also the biggest in history - valuations would rise to 19x 12-month forward earnings. This level of valuations would elevated, but sustainable given the current economic and earnings backdrop. Given this, the US equity market remains a preferred market, with technology, energy and financial sectors our preferred areas.

Although the S&P500 index scaled an all-time high, it's valuations remain below the recent highs and well below the highs recorded during the dot-come boom of 2000

12-month forward P/E for S&P500 index



Source: Bloomberg, Standard Chartered

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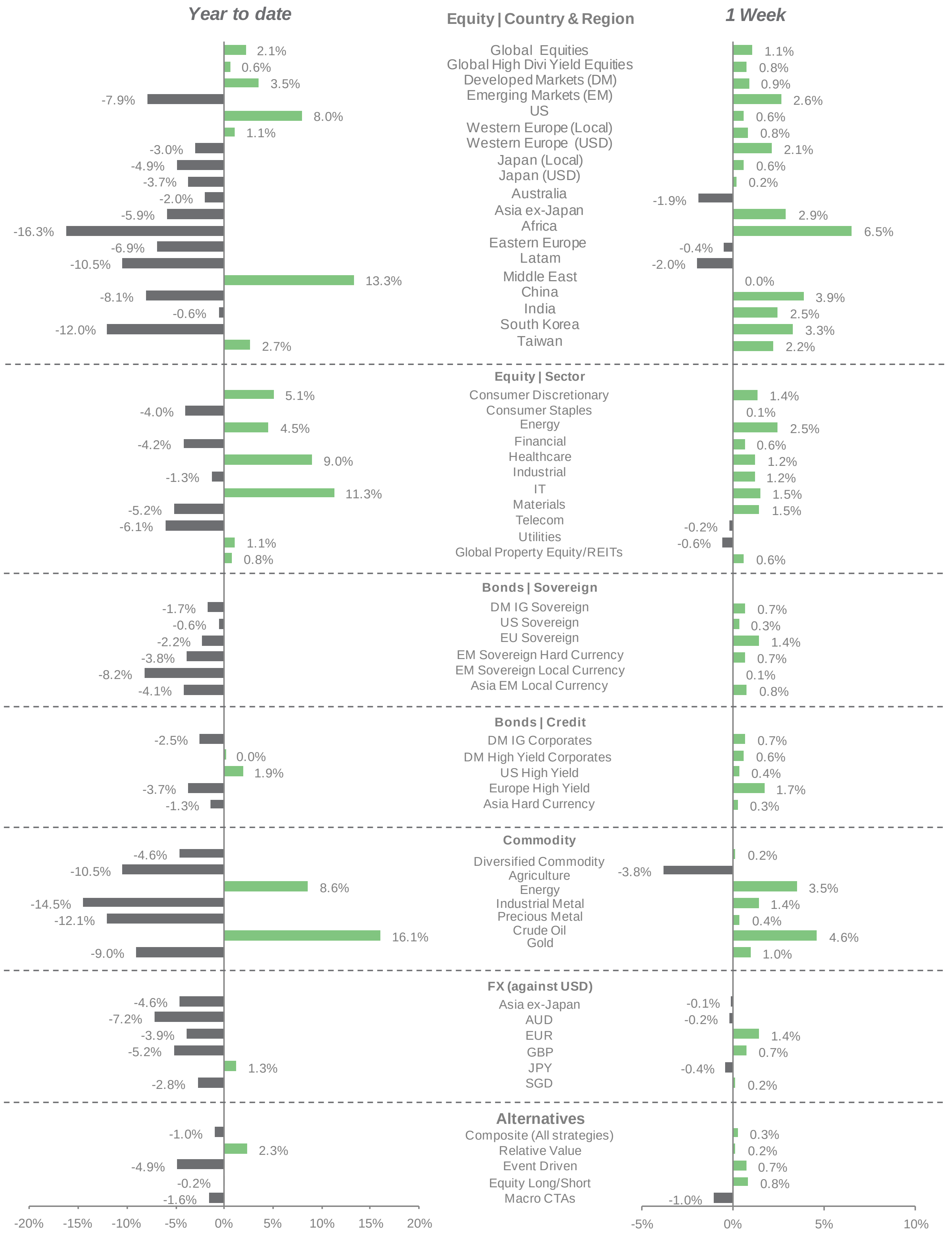
Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 23 August 2018, 1 week period: 16 August 2018 to 23 August 2018*

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	GE	IFO Expectations	27-Aug-18	Aug	98.5	98.2
TUE	US	Conf. Board Consumer Confidence	28-Aug-18	Aug	126.5	127.4
THUR	EC	Economic Confidence	30-Aug-18	Aug	112.4	112.1
	GE	CPI EU Harmonized y/y	30-Aug-18	Aug P	2.1%	2.1%
	US	PCE Core y/y	30-Aug-18	Jul	2.0%	1.9%
	US	Personal Income	30-Aug-18	Jul	0.4%	0.4%
	US	Real Personal Spending	30-Aug-18	Jul	–	0.3%
FRI/SAT	JN	Industrial Production y/y	31-Aug-18	Jul P	2.7%	-0.9%
	CH	Non-manufacturing PMI	31-Aug-18	Aug	–	54.0
	CH	Manufacturing PMI	31-Aug-18	Aug	51.2	51.2
	EC	Unemployment Rate	31-Aug-18	Jul	8.2%	8.3%
	EC	CPI Core y/y	31-Aug-18	Aug A	–	1.1%
	IN	GDP y/y	31-Aug-18	2Q	–	7.7%
	US	Chicago Purchasing Manager	31-Aug-18	Aug	63.0	65.5
	SK	BoK 7-Day Repo Rate	31-Aug-18	31-Aug	–	1.5%

	Event	This Week	Date	Period	Actual	Prior
WED	US	Existing Home Sales	22-Aug-18	Jul	5.34m	5.38m
THUR	GE	Markit/BME Germany Composite PMI	23-Aug-18	Aug P	55.7	55.0
	EC	Markit Eurozone Manufacturing PMI	23-Aug-18	Aug P	54.6	55.1
	EC	Markit Eurozone Services PMI	23-Aug-18	Aug P	54.4	54.2
	EC	Markit Eurozone Composite PMI	23-Aug-18	Aug P	54.4	54.3
	US	New Home Sales	23-Aug-18	Jul	627k	638k
	EC	Consumer Confidence	23-Aug-18	Aug A	-1.9	-0.5
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	24-Aug-18	Jul	0.3%	0.2%
	GE	Exports q/q	24-Aug-18	2Q	–	-1.0%
	US	Cap Goods Orders Nondef Ex Air	24-Aug-18	Jul P	–	0.2%

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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