Standard Chartered
Private Bank

weekly market view

macro strategy | 9 November 2018

This reflects the views of the Wealth Management Group

Editorial

The post-election relief bounce

- **US equities have technical and fundamental support for a year-end rally after the mid-term elections, in our view. EMs could also benefit from a moderation in trade tensions.**
- **Equities:** After a strong Q3, US earnings are estimated to grow 10% in 2019, underpinning our preference for the market. Asian stocks could gain from a planned revival of US-China trade talks.
- **Bonds:** Emerging Market (EM) bonds are likely to benefit from improved risk sentiment after the US election.
- **FX:** The USD index rebounded from a key support as the Fed signalled a December rate hike. EUR/USD's failure to decisively break above the 1.1429 resistance has raised downside risks.

What's new?

- **The post-election relief bounce.** US stocks led a global rebound in equities after US mid-terms delivered a split Congress, as expected, easing concerns about an extreme outcome. A Democrat majority in both the House and Senate could have led to significant policy conflicts with the Trump administration. While a divided Congress reduces the chances of further tax cuts, we expect the focus to return to the still-robust US economic growth and earnings outlook. We note US stocks historically deliver positive returns the year after the mid-term elections (see chart). These factors continue to drive our preference for US equities. See page 3 for a more detailed discussion of the mid-term election's market implications.
- **US oil price slumps to eight-month low.** The 20% fall in US crude oil prices since the start of October has been led by rising supplies from the US and Saudi Arabia, which have more than offset falling Iranian exports as the US re-imposed sanctions. The US' exemption for eight major Iranian oil buyers from the sanctions has also assuaged concerns about supply shortages. Money managers have reduced bullish positions as Saudi Arabia pledged to keep the oil market adequately supplied. Given that high oil prices usually act like a tax on consumers, the paring of prices from the October highs is a positive for major economies, including Asia. However, dwindling spare production capacity is likely to put a floor under oil prices.
- **Global equity market technicals turning supportive.** The US equity downtrend has abated following the S&P500 index's break above the 2 November high of 2,756. This follows an earlier break above a key resistance line (see chart) and a rebound from near a strong support at the February low of 2,533. While there is little reason to be bearish as long as the support holds, the index faces stiff resistance at the mid-October high of 2,817. The MSCI Asia ex-Japan index's slide also appears to be losing steam as it tests a major support on the 100-month moving average. For the downtrend to reverse, the index would need to clear resistance on the 100DMA, about 6% above current levels.

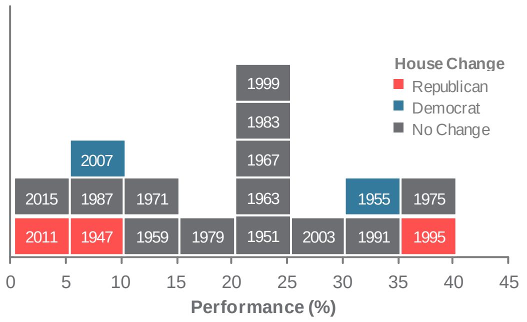
What we are watching

- **China data, trade talks.** Retail sales, investment and loans data will show whether growth is stabilising amid policy easing. Also watching Xi-Trump trade talks at the end of the month.

Contents

US equities have historically delivered positive returns in the year after mid-term elections regardless of the outcome

S&P500 index performance for the year after mid-term elections (since World War II)



Source: Oppenheimer, Bloomberg, Standard Chartered

The US equity downtrend has abated but faces a strong resistance at mid-October highs

S&P500 index

Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global equities rebounded, led by US stocks, as the US mid-term elections removed a key event risk. EM local currency bonds led gains in bond markets. Oil extended drop amid rising supplies.

Equities: US stocks supported by strong earnings

- **US Q3 earnings exceed expectations.** Consensus expects earnings to have risen 28% y/y during the quarter. This should allay concerns that we passed peak earnings in this cycle. Although Q3 may represent a cyclical high for earnings *growth*, this is not the same as peak earnings. US earnings are expected to continue to grow, albeit by a more moderate 10% rate in 2019, which would still be above the long-term average 9% growth rate. A strong earnings outlook, historical gains in the year after mid-term polls and strong seasonal performance in Q4 and Q1 underpin our preference for US equities.
- **Euro area stocks under pressure from EM weakness.** The Euro Stoxx 50 index has de-rated from a P/E ratio of 15x in April 2017 to 12x currently on concerns that corporate growth is likely to be hurt by EM weakness. The gradual withdrawal of ECB stimulus has led to a tightening of financial conditions (a measure of the 'health of financial markets', usually via indicators like government and corporate bond yields, the currency and equity prices) in the Euro area, weighing on equities. This trend is likely to continue once the ECB ends its bond purchase programme this year. A weaker EUR may offset some of this tightening of financial conditions but may not completely offset it. We continue to see Euro area equities as a core holding on increasingly attractive valuations and an elevated dividend yield.
- **Asian equities rebound strongly.** Stocks have responded positively to the renewed weakness in the CNY over the past week, with the Hang Seng China Enterprise index rising c. 7% since the end of October. Positive comments from US President Donald Trump on the prospects of a trade deal with China have also buoyed sentiment. Asia ex-Japan equities are a core holding.

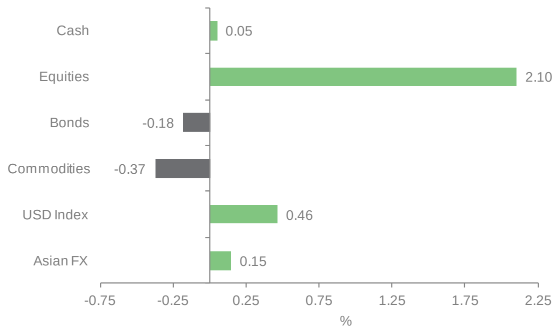
Bonds: EM bonds buoyed by renewed risk appetite

- **EM bonds benefit from improved risk sentiment.** EM government bonds gained amid improved risk sentiment in the wake of the US mid-term elections and as USD weakness buoyed EM currencies. While trade-related uncertainty will likely persist, we believe a lot of bad news has been priced into EM bonds. That said, we prefer to obtain EM exposure via USD government bonds as local currency bonds remain vulnerable to FX swings.
- **US policy status quo positive for HY bonds.** The US election likely implies a gridlocked Congress, which implies the current policy status quo is likely to be maintained. We believe this could lead to lower yield premiums on HY bonds in the near term as policy risks subside. However, a combination of rising geopolitical risks, hawkish Fed sentiment and a realisation that earnings growth will likely moderate in 2019 are likely to limit gains in DM HY corporate bonds in the next 6-12 months. We would use any rebound in HY bonds to switch to EM USD bonds.

FX: USD rebounds after Fed meeting

- **EUR/USD fails to break above resistance.** The USD rebounded after the Fed raised expectations for a December rate hike, recouping its post-mid-term election loss. We believe the USD's path of least resistance is up as long as the Fed's diverging monetary policy with the rest of the world stays intact. EUR/USD's failure to decisively break above the early-October low of 1.1429 has exposed downside risk towards 1.1299.

Benchmark (USD) performance w/w*



**Week of 01 November 2018 to 08 November 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)

Most equity market technicals have turned positive

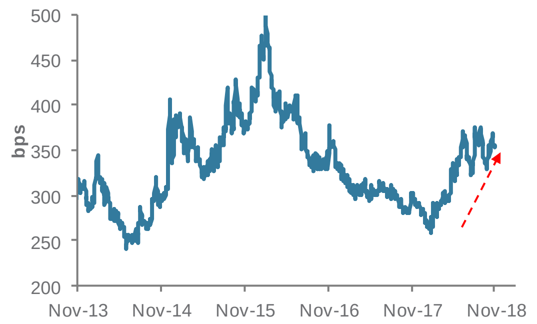
Technical levels of key market indicators as on 08 Nov.

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,807	2,735	2,865	↑
STOXX 50	3,238	3,197	3,270	↗
FTSE 100	7,141	6,975	7,220	↗
Nikkei 225	22,487	21,620	23,000	↗
Shanghai Comp	2,636	2,520	2,830	↗
Hang Seng	26,228	25,000	26,900	↗
MSCI Asia ex-Japan	609	583	628	↗
MSCI EM	994	955	1,038	↗
Brent (ICE)	71	66	78	↓
Gold	1,223	1,209	1,240	↑
UST 10Y Yield	3.23	3.02	3.27	↗

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

EM bond yield premiums have risen significantly this year, making them attractive vs. historical average

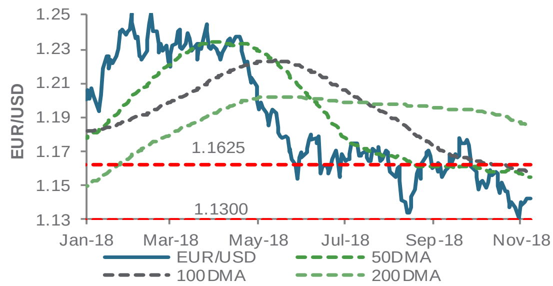
EM Bond Index Global Diversified blended spread (yield premium over US Treasuries)



Source: JPMorgan, Bloomberg, Standard Chartered

EUR/USD has bounced from a key support

EUR/USD



Source: Bloomberg, Standard Chartered

Top client questions

Q1. What are the market implications of the US mid-term elections?

The US mid-term elections resulted in a divided Congress, as expected, with the Democrats regaining control of the House of Representatives and the Republicans moderately increasing their thin majority in the Senate. Equities and other risk assets, including EM bonds, bounced following the results, with the key political event risk out of the way. While a divided Congress raises the prospects of policy gridlock and increased political challenges for the Trump administration, the election outcome is unlikely to be a constraint for risk assets. Here we look at the implications for various asset classes in the aftermath of the elections.

Equities: We believe the gridlock is unlikely to deter US equity market performance. This is the lesson from the 1986 and 2009 US mid-term elections that resulted in a split between the two houses of Congress. The Democrats under President Barack Obama lost the House of Representatives in 2009 during his first mid-term election in office. In the two years following a split Congress in 2010, the S&P500 market rose 18%. Similarly, when the Republicans under President Ronald Reagan lost control of the Senate in the 1986 mid-terms but retained control of the House, gridlock ensued; yet the market rose 15% in the following two years. While it is difficult to assign causality, one possible rationale behind the positive performance during a split Congress may be due to lower expectations of likely policy errors, ie, politicians will not be able to pass legislation or stimulate the economy that would necessitate a more hawkish Fed (which, in turn, would shorten the economic cycle). More broadly, historical patterns are supportive of US equities after the mid-term elections regardless of its outcome. As the chart on page 1 shows, the S&P500 has delivered positive returns in the year after a mid-term election on every occasion since WWII.

Bonds: There is likely to be little direct impact from the mid-term elections on bond markets. For Treasury yields, the one potential area of risk is further fiscal spending. There is also talk of boosting infrastructure spending, which would require building a cross-party consensus to fund such a plan. However, we believe a divided Congress makes new legislation of this kind less likely than before. Corporate and EM bonds, meanwhile, are likely to benefit from renewed appetite for risky assets following the election.

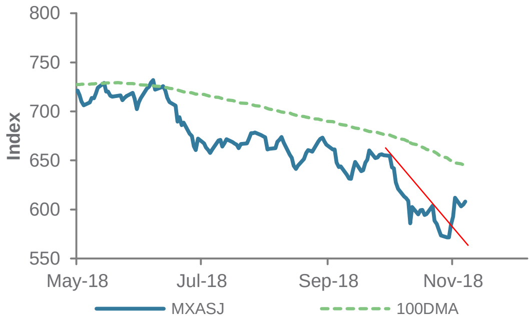
FX: The response in currency markets have been muted so far. A brief extension of the corrective USD selling faded quickly at 1.15 for the EUR/USD pair. Notably, the USD remained steady against the CNY. We expect the China-US trade talks to be in focus ahead of the Trump-Xi meeting. We do not believe the election results would constrain Trump's strategy, and despite a willingness to talk and possibly find interim agreements, the broader issue is likely to remain unresolved and lead to a higher USD/CNY. Concerns over the US budget deficit and bond issuance will support Treasury yields, and the Fed is likely to reinforce expected rate hikes.

While the USD (DXY) index has pulled back from key resistance at the August high of 96.98, the retreat appears to be a pause rather than a reversal of the uptrend. The index has not broken any meaningful support so far. It is holding above the mid-October low of 94.79 and, more importantly, above strong support at the September low of 93.81.

Given these fundamental and technical factors, we continue to expect a broadly stronger USD in the near term.

Asian equity downtrend appears to be losing steam; the index needs to sustainably break above its 100DMA for a trend reversal

MSCI Asia ex-Japan index and 100DMA



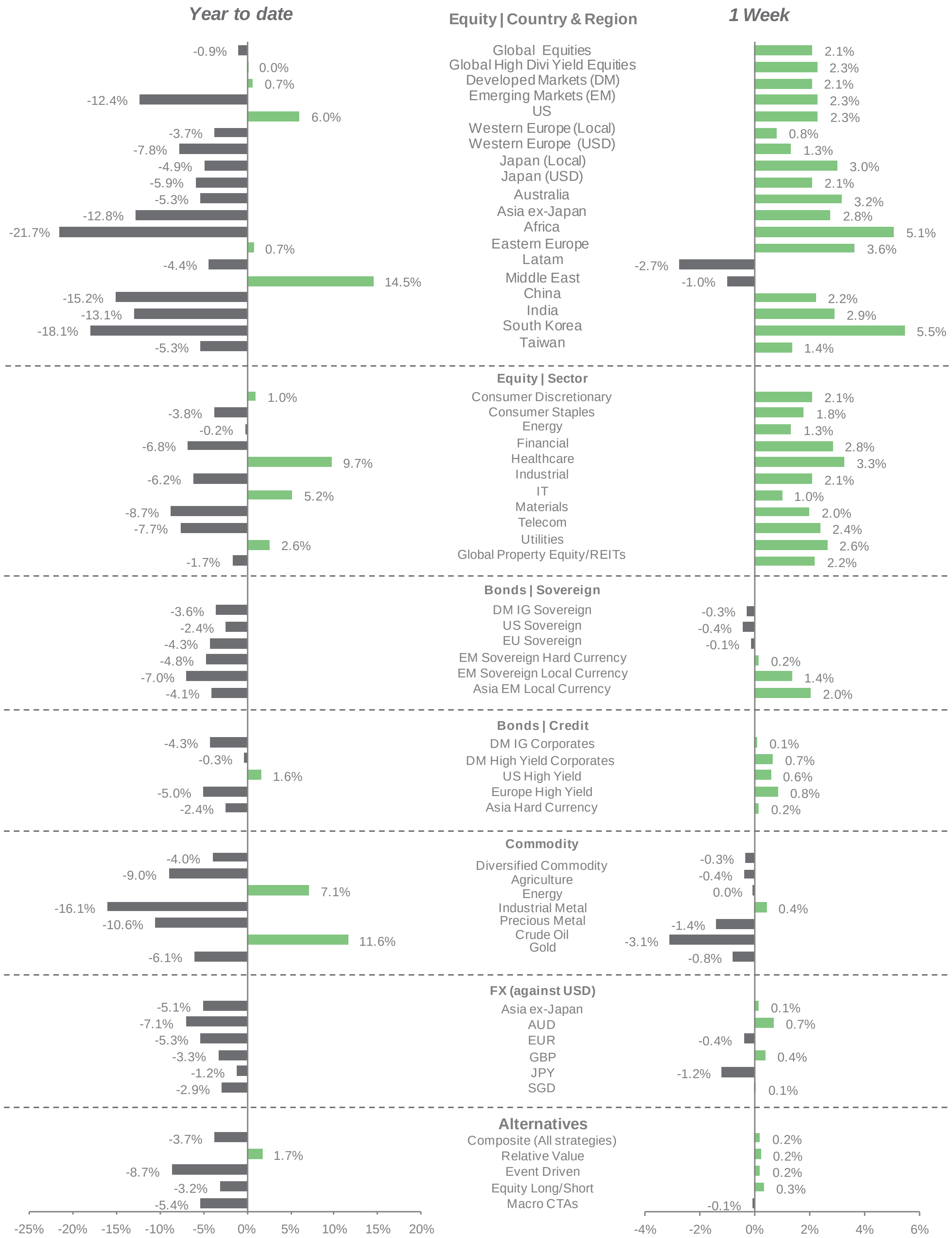
Source: Bloomberg, Standard Chartered

USD index has not broken any meaningful support so far

USD (DXY) index

Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 08 November 2018, 1 week period: 01 November 2018 to 08 November 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	JN	PPI y/y	12-Nov-18	Oct	2.8%	3.0%
	IN	CPI y/y	12-Nov-18	Oct	3.6%	3.8%
	IN	Industrial Production y/y	12-Nov-18	Sep	4.3%	4.3%
TUE	UK	Average Weekly Earnings 3m/y/y	13-Nov-18	Sep	–	2.7%
	UK	ILO Unemployment Rate 3m	13-Nov-18	Sep	–	4.0%
	EC	ZEW Survey Expectations	13-Nov-18	Nov	–	-19.4
WED	CH	Retail Sales y/y	14-Nov-18	Oct	9.2%	9.2%
	CH	Industrial Production y/y	14-Nov-18	Oct	5.8%	5.8%
	CH	Fixed Assets Ex Rural YTD y/y	14-Nov-18	Oct	5.5%	5.4%
	UK	CPI Core y/y	14-Nov-18	Oct	–	1.9%
	US	CPI Ex Food and Energy y/y	14-Nov-18	Oct	2.2%	2.2%
THUR	UK	Retail Sales Ex Auto Fuel y/y	15-Nov-18	Oct	–	3.2%
	IN	Exports y/y	15-Nov-18	Oct	–	-2.2%
FRI/SAT	US	Industrial Production m/m	16-Nov-18	Oct	0.2%	0.3%

	Event	This Week	Date	Period	Actual	Prior
MON	JN	Nikkei Japan PMI Composite	5-Nov-18	Oct	52.5	50.7
	CH	Caixin China PMI Composite	5-Nov-18	Oct	50.5	52.1
	UK	Markit/CIPS UK Composite PMI	5-Nov-18	Oct	52.1	54.1
	EC	Sentix Investor Confidence	5-Nov-18	Nov	8.8	11.4
	US	ISM Non-Manufacturing Index	5-Nov-18	Oct	60.3	61.6
TUE	AU	RBA Cash Rate Target	6-Nov-18	6-Nov	1.5%	1.5%
	GE	Factory Orders WDA y/y	6-Nov-18	Sep	-2.2%	-1.8%
	EC	PPI y/y	6-Nov-18	Sep	4.5%	4.3%
WED	EC	Retail Sales y/y	7-Nov-18	Sep	0.8%	2.2%
THUR	GE	Exports SA m/m	8-Nov-18	Sep	-0.8%	0.1%
	CH	Exports y/y	8-Nov-18	Oct	15.6%	14.4%
FRI/SAT	US	FOMC Rate Decision (Upper Bound)	9-Nov-18	8-Nov	2.25%	2.25%
	CH	CPI y/y	9-Nov-18	Oct	2.5%	2.5%
	UK	GDP y/y	9-Nov-18	3Q P	–	1.2%
	CH	PPI y/y	9-Nov-18	Oct	3.3%	3.6%
	US	PPI Ex Food and Energy y/y	9-Nov-18	Oct	–	2.5%

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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