Standard Chartered Private Bank

weekly market view

macro strategy | 14 September 2018

This reflects the views of the Wealth Management Group

Editorial

The US economy powers on

- **The continued strength in the US economy supports our preference for equities, especially in the US. The pick-up in wage growth is a risk as it could hasten Fed rate hikes.**
- **Equities:** Our preference for the US technology sector got support from easing regulatory concerns and new product launches. Asian equities remain hostage to US-China trade spat.
- **Bonds:** Although US Treasury yields rebounded after strong US jobs data, we expect further gains to be limited as long-term inflation expectations remain anchored.
- **FX:** Emerging Market currencies could extend their recovery near-term amid renewed expectation of US-China trade talks.

What's new?

- **The US economy powers on.** US economic data in recent weeks suggests that the growth acceleration seen in H1 following last year's tax cuts is likely to sustain through the rest of the year. The latest employment report showed 201,000 net new jobs created in August, matching the average monthly pace since 2011. Together with the sustained pick-up in wage growth (strongest since 2009), the jobs report portends continued strength in domestic consumption. Meanwhile, small business optimism and job openings surged to record highs. The strength in the underlying economy, despite political and global trade uncertainties, is a key factor behind our bullish view on equities and our preference for US stocks. However, the data also underscores a tightening labour market, which carries the risk of a faster pace of Fed rate hikes in 2019.
- **Renewed hopes of US-China trade talks.** The US offer for a new round of talks with China to resolve their trade disputes has helped stabilise EM assets. However, cautious sentiment prevails, given President Trump's earlier comments to impose tariffs on all imports from China. In Hong Kong and China, where equity indices have fallen more than 20% from their January peaks, defensive and domestic-focussed sectors have been more resilient. The telecom sector could benefit from the potential merger of two industry leaders. We remain positive on China stocks amid efforts to stabilise growth. Hang Seng China Enterprise index faces resistance 2.5% above current level.
- **EUR tests resistance after ECB; USD slips as EMs stabilise**. EUR/USD continued to test resistance just above 1.17 after the ECB confirmed it would end bond purchases by year-end. We expect the pair to peak ahead of 1.1850 before another test of the 1.15 support. The USD index slipped to initial support of 94.4 after China accepted US invitation for trade talks and optimism among key EU members for a more structured Brexit. Turkey's surprise 625bps rate hike also provided support for TRY and other EM currencies vs. the USD. We continue to view the recent softness in USD as a consolidation period prior to at least one more rally. Initial support for the USD index lies around 93.65.

What we are watching

- **Brexit plans.** The GBP bounced amid talks of a softer Brexit deal. However, PM May faces opposition within her party.

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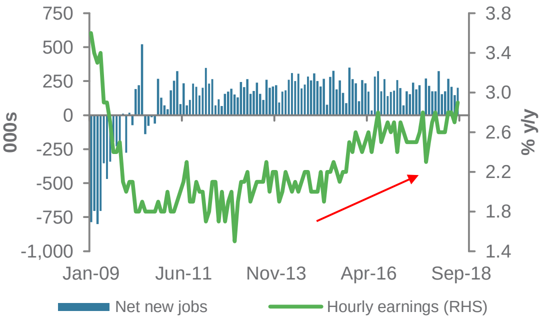
Sustained US job creation continues to support consumption; accelerating wage growth is a risk

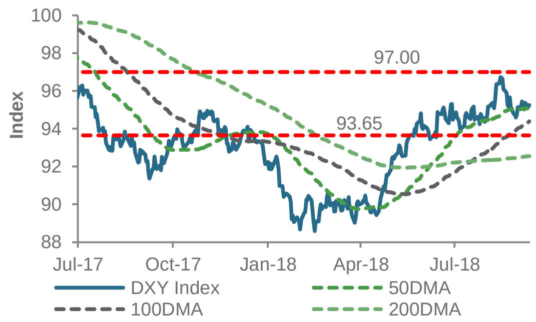
US monthly net new jobs, annual rise in hourly wages



Source: Bloomberg, Standard Chartered

The USD has consolidated recently, but has strong support around 93.65

USD (DXY) index



Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global stocks rebounded, with Developed Markets leading gains, while Emerging Markets stabilised amid easing concerns about US-China trade dispute. EM USD government bonds rebounded, while the USD weakened, primarily against the GBP and EUR.

Equities: US technology and banking sectors recover

- **The US technology sector** has recovered from February's sell-off, rising c. 20% from that month's lows. Sentiment has recovered as concerns over new regulations targeting social media companies have eased following the industry leaders' testimony to the US Senate intelligence committee. Additionally, new product launches by a sector leader have also been well received, sustaining earnings growth expectations for the sector. This supports our preference for the sector within the US.
- **US banks** have rallied c.7% from their June lows, benefiting from a rise in US Treasury yields amid strong job reports and pick-up in hourly wages, which cemented the prospect of further Fed rate hikes. We remain positive on US banks as they tend to be among the beneficiaries in the early stage of rate hikes. In the near term, investors are likely to watch hurricane Florence for any impact on the insurance sector due to a potential spike in claims.
- **Large-cap UK equities** have recently come under pressure as the likelihood of a Brexit deal at the November UK-EU summit boosted the GBP – a negative for large-cap UK equities that generate a significant portion of their sales overseas. In contrast, the domestic-focused FTSE 250 index of small- and mid-cap companies outperformed the large cap by 4% in the past month. UK equities remain a core holding amid strong commodity prices, although Brexit outcome remains a key risk.

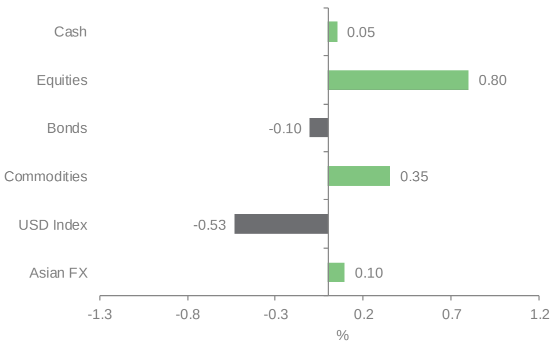
Bonds: Strong US job report lifts Treasury yields

- **Strong US data lifts Treasury yields.** 10-year US Treasury yields rose by nearly 10bps on the back of strong US job and wage data. Stronger-than-expected wage growth led to the market pricing in a faster pace of Fed rate hikes. Though we expect two more rate hikes this year and three more in 2019, we believe the 10-year US Treasury yield is likely to remain capped at around 3.25% over the next 12 months as long-term inflation expectations remain relatively well-anchored. However, accelerating US wage growth, if sustained, would be a key risk.
- **Oil drives High Yield bond performance.** US High Yield (HY) bonds delivered strong performance as yield premiums compressed, helping offset rising Treasury yields. A rise in oil prices, owing to concerns about lower US inventories, likely helped energy sector bonds. However, the recent rally has, if anything, amplified valuation concerns, which holds us back from turning more positive on the sub-asset class.

FX: INR depreciates to a record low vs. USD

- **INR catches up with other EM currencies.** The INR is the latest EM currency to weaken sharply. It depreciated to a new record low vs. the USD amid continued worsening of India's current account deficit, partly due to rising oil prices. However, bond and equity market flows have stabilised this quarter after significant outflows in Q2. Also, after allowing INR to weaken over the past month in line with other EM currencies, policymaker comments suggest efforts to reduce excessive volatility are now more likely. We believe India, like most other Asian economies, is relatively more resilient to EM uncertainties given stronger fundamentals. (See page 3 for more)

Benchmark (USD) performance w/w*



**Week of 06 September 2018 to 13 September 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 13 Sept.

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,904	2,860	2,916	↑
STOXX 50	3,334	3,262	3,360	↘
FTSE 100	7,282	7,128	7,477	↘
Nikkei 225	23,048	22,170	23,050	↗
Shanghai Comp	2,687	2,630	2,805	↘
Hang Seng	27,014	25,150	28,000	↘
MSCI Asia ex-Japan	640	618	662	↓
MSCI EM	1,018	980	1,060	↓
Brent (ICE)	78	75	81	↗
Gold	1,203	1,182	1,212	↘
UST 10Y Yield	2.97	2.80	3.13	↗

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

US technology and banking sector equities have recovered from sell-offs earlier in the year

S&P500 technology and bank sector indices

Source: JPMorgan, Bloomberg, Standard Chartered

US bond yields have risen on strong data, although long-term inflation expectations have barely changed

US 10Y Treasury yields, US 10Y breakeven inflation rate

Source: Bloomberg, Standard Chartered

Top client questions

Q1. What is the outlook for CNY, INR following recent declines?

The CNY and INR have weakened 6.8% and 14.5% YTD amid a 5.1% gain in the USD Index (DXY) over the same period. Emerging Market currencies have broadly been under pressure as a strong USD has acted as a magnet for capital flows into the US in a rising rate environment. 'Safe-haven' demand for the USD has also risen amid ongoing trade tensions and declining USD liquidity globally.

INR has been one of the weakest performers in 2018 due to a combination of outflows and structural issues:

- A persistent and worsening trade deficit that has been exacerbated by rising oil prices
- Official comments suggesting a relaxed attitude towards INR depreciation
- Foreign investors selling Indian bonds and equities as USD-based returns have become less attractive

The current issue is one of confidence and control, in our view. We believe authorities have already realised the need to address the underlying problems to prevent further decline in the INR. PM Modi is expected to discuss economic scenarios this weekend and the market anticipates some measures targeting the current account deficit, inflation and investment flows. This speculation has already had a positive impact with the USD/INR falling over 1.5% from the record high around 72.90 earlier this week.

In addition, we will be watching for signs of inflationary pressure as a result of INR weakness. A threat to the MPC's 4% inflation threshold could raise the expectation of an early interest rate hike. As long as the US economy continues to outperform global markets, the Fed is likely to maintain its path of rate hikes. Combined with President Trump's continued aggressive stance on trade and sanctions, we continue to expect EM FX to weaken broadly, with only occasional waves of relief. We expect the INR will follow the same pattern.

The USD/CNY has stabilised following the more-than-10% rally that peaked above 6.95. The likely drivers behind CNY weakness are a mixture of domestic and external factors:

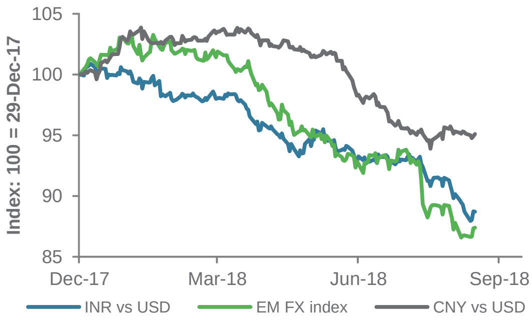
- Deleveraging of the economy to reduce systemic risks
- Recalibration of domestic productivity and more effective capital investment that requires stabilisation of employment
- Addressing the challenges posed by Trump's aggressive and China-focused trade tariffs

While domestic economic rebalancing continues, we expect narrowly focused monetary and fiscal accommodation, along with controlled currency flexibility, as the main response to the US tariff strategy. The trade talks will show if the US is keen to "make a deal" or if the Sino-US dispute will be longer-lasting and increasingly combative. The USD/CNY's moves since trade talks were mooted suggests that the market remains cautious of an imminent result. Although further weakness in CNY is possible, we believe the authorities will want to control the pace of any future depreciation, using multiple levers in order to pre-empt capital outflows on the scale experienced in 2015.

Overall, we believe that ongoing pressure on EM FX is largely dependent upon Trump's trade strategy. Both INR and CNY are expected to weaken further in the event of an escalation, but would likely be controlled robustly to ensure the pace of depreciation does not threaten significant outflows. Any abatement or reversal of Trump's strategy would be positive for both currencies.

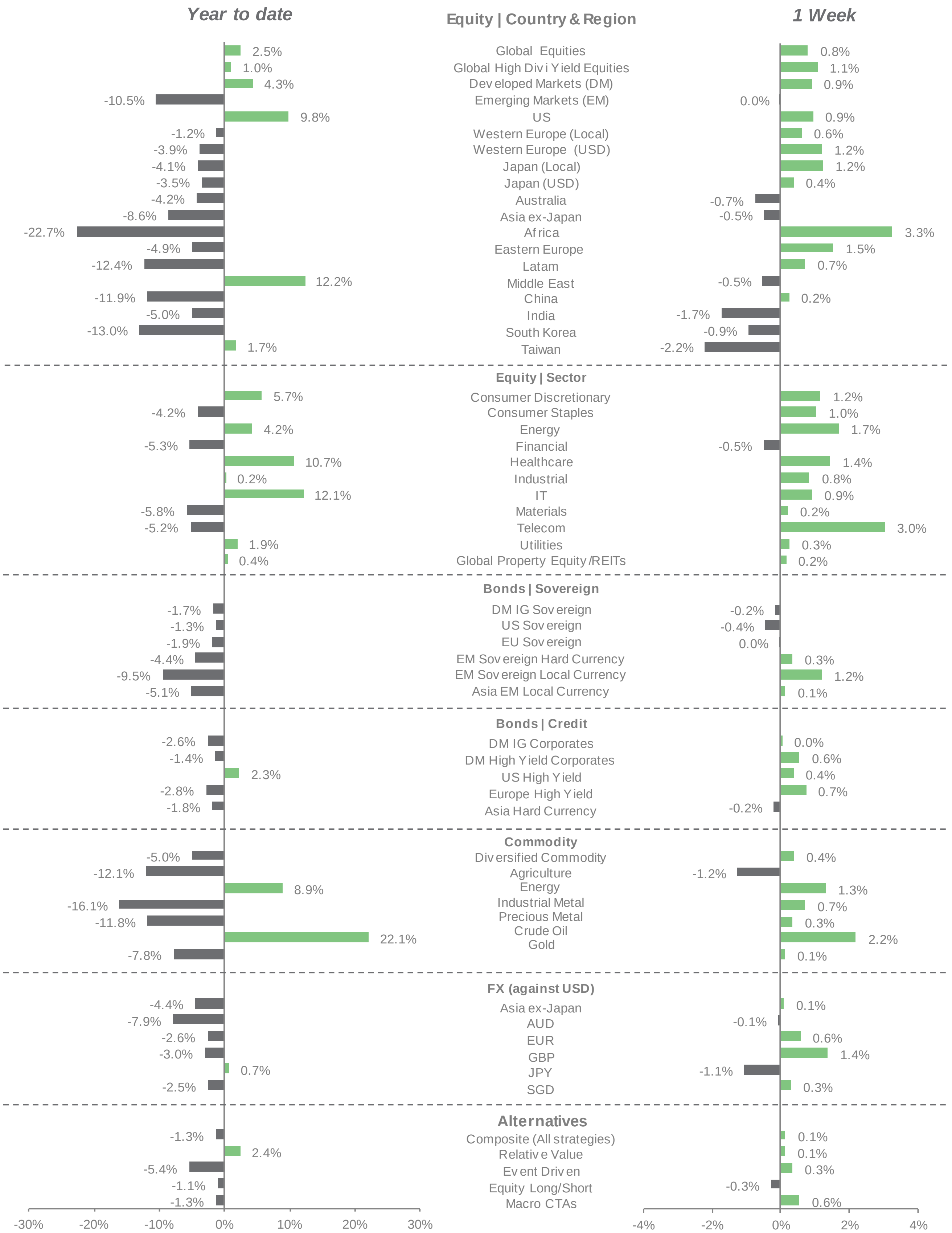
The CNY has outperformed other EM currencies in this year's EM FX drawdown, while the INR has closely tracked EM currencies

Relative performance of CNY, INR and EM currencies YTD; Index: 100 = 29 December 2017



Source: JP Morgan, Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 13 September 2018, 1 week period: 06 September 2018 to 13 September 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
WED	JN	Exports y/y	19-Sep-18	Aug	5.5%	3.9%
	UK	CPI Core y/y	19-Sep-18	Aug	–	1.9%
	US	Housing Starts	19-Sep-18	Aug	1232k	1168k
	US	Building Permits	19-Sep-18	Aug	1313k	1303k
	JN	BOJ Policy Balance Rate	19-Sep-18	19-Sep	–	-0.1%
THUR	UK	Retail Sales Ex Auto Fuel y/y	20-Sep-18	Aug	–	3.7%
	EC	Consumer Confidence	20-Sep-18	Sep A	-2	-1.9
	US	Existing Home Sales	20-Sep-18	Aug	5.35m	5.34m
	SA	SARB Announce Interest Rate	20-Sep-18	20-Sep	6.5%	6.5%
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	21-Sep-18	Aug	–	0.3%
	GE	Markit/BME Germany Composite PMI	21-Sep-18	Sep P	55.0	55.6
	EC	Markit Eurozone Manufacturing PMI	21-Sep-18	Sep P	54.6	54.6
	EC	Markit Eurozone Services PMI	21-Sep-18	Sep P	54.5	54.4
	EC	Markit Eurozone Composite PMI	21-Sep-18	Sep P	54.4	54.5

	Event	This Week	Date	Period	Actual	Prior
MON	CH	PPI y/y	10-Sep-18	Aug	4.1%	4.6%
	CH	CPI y/y	10-Sep-18	Aug	2.3%	2.1%
	UK	Industrial Production y/y	10-Sep-18	Jul	0.9%	1.1%
	EC	Sentix Investor Confidence	10-Sep-18	Sep	12.0	14.7
TUE	EC	ZEW Survey Expectations	11-Sep-18	Sep	-7.2	-11.1
WED	IN	CPI YoY	12-Sep-18	Aug	3.7%	4.2%
	IN	Industrial Production y/y	12-Sep-18	Jul	6.6%	6.9%
	US	PPI Ex Food and Energy y/y	12-Sep-18	Aug	2.3%	2.7%
THUR	JN	PPI YoY	13-Sep-18	Aug	3.0%	3.0%
	UK	Bank of England Bank Rate	13-Sep-18	13-Sep	0.75%	0.75%
	TU	One-Week Repo Rate	13-Sep-18	13-Sep	24.0%	17.75%
	EC	ECB Main Refinancing Rate	13-Sep-18	13-Sep	0.0%	0.0%
	US	CPI Ex Food and Energy y/y	13-Sep-18	Aug	2.2%	2.4%
FRI/SAT	CH	Retail Sales y/y	14-Sep-18	Aug	–	8.8%
	CH	Industrial Production y/y	14-Sep-18	Aug	–	6.0%
	CH	Fixed Assets Ex Rural YTD y/y	14-Sep-18	Aug	–	5.5%
	US	Retail Sales Ex Auto and Gas	14-Sep-18	Aug	–	0.6%
	US	Industrial Production m/m	14-Sep-18	Aug	–	0.1%
	US	U. of Mich. Sentiment	14-Sep-18	Sep P	–	96.2

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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