Standard Chartered
Private Bank

weekly market view

macro strategy | 19 July 2019 This reflects the views of the Wealth Management Group

Editorial

US Q2 earnings off to a promising start

- **US earnings reported thus far have beaten expectations, supported by a boost from share buybacks. When combined with strong retail sales data, this bodes well for US equities.**
- **Equities:** US Q2 earnings growth estimates have turned positive again, after trending lower since January, with the help of upbeat results from most sectors. We see an earnings recovery in H2.
- **Bonds:** We believe EM USD bonds offer an attractive balance between yields and quality amid the search for yields.
- **FX:** The upcoming ECB meeting could trigger a EUR rebound.

What's new?

- **US Q2 earnings off to a promising start.** Major US banks, which are a window to the underlying economy, have reported better-than-expected Q2 earnings this week. The sector bested consensus estimates with the help of rising net interest income and growth in consumer banking and wealth management. Total lending continued to grow and, while bad loan provisions ticked up, they remained below the long-term average. Banks continue to keep a tight control over costs amid concerns about future net interest income, given declining interest rates. As a result, return on equity has been impressive (in the 11-18% range). Moreover, share buybacks have boosted per-share earnings growth, besides the net income growth. We expect this trend to continue with other sectors, supporting our view of an acceleration in US earnings growth in the coming quarters. This, combined with a healthy economic backdrop (strong job market and retail sales) and increasingly dovish monetary policy, supports our preference for US equities.
- **Consumption remains buoyant worldwide.** Latest retail sales data from the US and China show consumption trends remain healthy. The data imply underlying consumption growth in the US accelerated to 7.5% y/y in Q2, the strongest since 2005. We believe continued strength in the US job market and rising wages are likely to support consumption in the coming quarters. In China, retail sales accelerated to 9.8% y/y in June, the strongest growth in 15 months. This suggests prior tax cuts and other government incentives to boost private consumption are starting to have an effect. The latest data reinforce our view that buoyant consumption, combined with dovish central banks, is likely to more than offset a global slump in manufacturing caused by trade tensions and prolong the current economic cycle.
- **European data build case for ECB easing.** Euro area growth expectations (based on the ZEW survey) have fallen close to their weakest since the 2012 regional crisis. Latest data show Euro area core inflation remains at half the ECB's target 2% level. Trade uncertainty is likely to linger amid concerns the US may target the EU auto sector with tariffs next. This backdrop supports our view that the ECB is likely to ease policy further, possibly with a roadmap unveiled at its 25 July policy meeting.

What we are watching

- ECB meeting (25 July); New UK Prime Minister (23 July); US-China trade talks.

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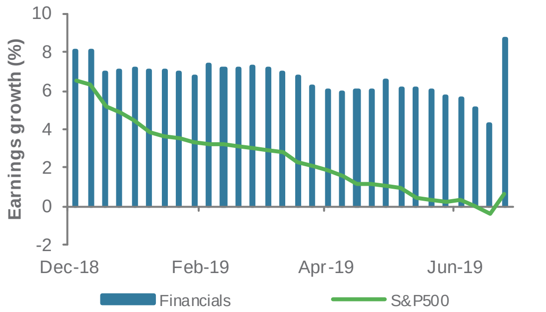
US bank sector earnings delivered positive surprises, lifting overall S&P500 earnings expectations for Q2

Q2 earnings estimate trends for S&P500 and S&P500 financial sector indices



Source: Refinitiv, Standard Chartered

The recovery in US and China retail sales suggests consumption remains buoyant in the world's two biggest economies, despite trade tensions

Growth in US core retail sales, China retail sales

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 continued to consolidate YTD gains. Government bonds gained. Crude oil dragged commodities lower.

Equities: How are US Q2 earnings shaping up?

- **Positive surprise.** The first set of S&P500 earnings has delivered positive surprises, with just over a tenth of the companies reporting so far. Of those which have reported, 80% have exceeded earning expectations and 64% beat revenue expectations. The real estate and technology sectors delivered the biggest earnings surprises, followed by communication services, consumer staples and financials.
- **Q2 earnings expectations turn positive.** Because of the earnings beats, expectations for S&P500 earnings for Q2 have improved to a +0.6% rise, from a -0.2% y/y decline a week ago. Q2 earning expectations had been trending lower since the start of the year until this week. Earnings growth is one of the pillars supporting our preference for US equities among global equities.
- **HK/China market turnover falls.** Investor focus remains on pre-announcements ahead of the H1 results season in August. Meanwhile, weak macro data on Q2 economic growth have led to growing expectations of further easing measures, such as rate cuts and lower bank reserve requirements, to improve liquidity and boost domestic consumption. China's focus on reviving domestic consumption is a key reason behind our preference for consumer discretionary and consumer staples sectors.

Bonds: How should we position for a low-yield environment?

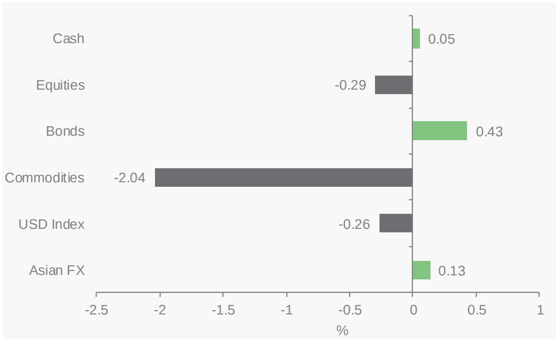
- **"Search-for-yield" continues.** The phenomenon last seen in 2016-17 appears to be returning, given the decline in bond yields and the record amount of negative yielding bonds. Though the Fed is likely to cut rates later this month, we expect US Treasury yields to remain range-bound around current levels. As investors consider taking on more risk to achieve their desired yield, we believe selecting appropriate exposure becomes more important.
- **Emerging Market (EM) USD bonds offer attractive blend of yield and quality.** We continue to prefer EM USD government bonds, despite the decline in yield premiums, given their relatively attractive yield and stabilising credit quality. We also like Asian USD bonds due to their defensive trait and attractive risk/reward trade-off. While investors may also consider Developed Market High Yield bonds to achieve a certain yield, potential deterioration in credit quality remains a risk worth monitoring closely.

FX: What are the likely triggers for EUR/USD uptrend?

EUR/USD building the base for a rally. The USD has barely moved this week, despite strong US data and continuing weak signals from the Euro area. EUR/USD held above the previous lows of 1.1180-90, as the pair continues to build a series of higher lows. This resilience supports our view that EUR/USD is forming a base before an uptrend. Next resistance levels are at 1.1320 and 1.1450. The 25 July ECB meeting and Draghi's press conference are potential triggers.

- **USD/JPY could see downward pressure.** Reports suggest that US-Japan trade negotiations may be advancing towards an agreement after Japan's Upper House elections on 21 July. A deal could include Japan agreeing to a stronger JPY. The Trump administration may seek an opportunity to establish a trade deal blueprint with Japan that guides trade talks with China and the EU. USD/JPY could, therefore, slide below support at 106.75 and 105.00, either in line with a trade deal or due to safe-haven flight if trade tensions escalate. Resistance for the pair is at 109.00.

Benchmark (USD) performance w/w*



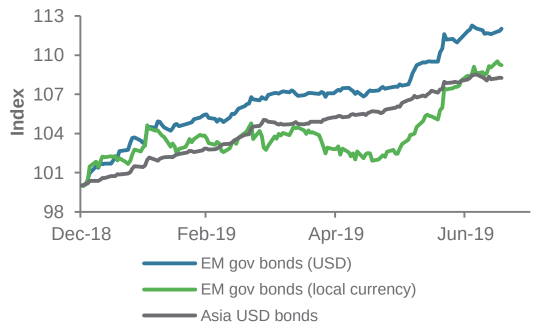
**Week of 11 July 2019 to 18 July 2019*
Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

US equity technicals stay positive, Europe reverses
Technical levels of key market indicators as on 18 July

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,995	2,955	3,020	↑
STOXX 50	3,483	3,449	3,530	↘
FTSE 100	7,493	7,410	7,620	↘
Nikkei 225	21,046	20,950	21,480	↗
Shanghai Comp	2,901	2,825	3,045	→
Hang Seng	28,462	27,850	29,000	↑
MSCI Asia ex-Japan	648	636	661	↑
MSCI EM	1,052	1,032	1,083	↑
Brent (ICE)	63	60	67	↘
Gold	1,442	1,380	1,455	↑
UST 10Y Yield	2.05	1.93	2.15	↘

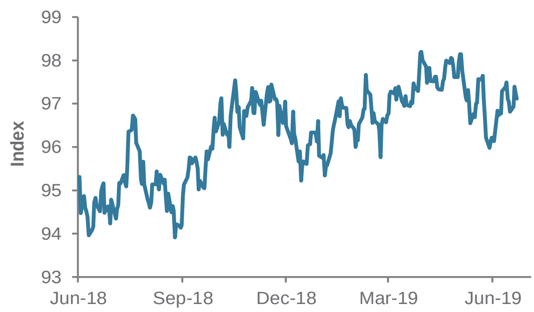
Source: Trading Central, Standard Chartered
Note: Arrows represent short-term trend opinions

EM USD government bonds have outperformed Asia USD and local currency bonds this year amid a dovish turn in global monetary policies
Relative performance of EM USD and local currency government bonds and Asia USD bonds



Source: Bloomberg, Standard Chartered

The USD's bounce has been feeble, despite strong US data
USD index



Source: Bloomberg, Standard Chartered

Top client questions

Q1. GBP – Do you still view risk/reward in owning GBP as attractive? Is it time to catch a falling knife?

Yes, we do over the medium term, despite expected near-term volatility. GBP/USD has fallen to a fresh short-term low as the UK's leadership contest approaches its conclusion. While the election of Boris Johnson as Prime Minister is a strong consensus call, we believe that the risk of a no-deal Brexit is unlikely to increase. We expect the undervalued GBP will recover strongly in the medium-term towards 1.34 initially and, with the anticipation of a weakening USD, a return towards 1.40 – 1.45 is possible.

We believe that the key points of focus are: (1) how long Brexit uncertainty continues, and (2) what will be the Brexit "end state".

- Should PM Johnson move into 10 Downing Street next week, consensus suggests the current 31 October deadline is unlikely to be extended. There are broadly three possible options that Johnson might take; firstly, to renegotiate the current deal – particularly a time limit for the "Irish Backstop". Any changes would still require parliamentary support, which could still be a close call. If a deal can be agreed, a "soft Brexit" with a transition phase means investors would have clarity and businesses may plan with more certainty.
- Should this avenue fail, the next option would likely be to secure Brexit on 31 October with a temporary Free Trade Agreement that would allow the current open market between the UK and the EU to continue, pending a final agreement.
- A move towards the third possibility – leaving with no deal and with no transition period – is likely to be blocked by the parliament, potentially via forcing a second referendum or triggering a general election. An election would be tantamount to a second referendum as Brexit would likely be the dominant campaign platform. Polls have suggested for some time that voters would likely support remaining in the EU in a referendum.
- Any new government would almost certainly require a complicated coalition but would also likely confirm either that a "Deal Brexit" is ratified or that Brexit is cancelled. There would be uncertainty about a coalition government's economic policy, but a coalition could ensure that a shift towards current opposition leader Corbyn's more socialist agenda – currently perceived as a key election risk – would be difficult to deploy.

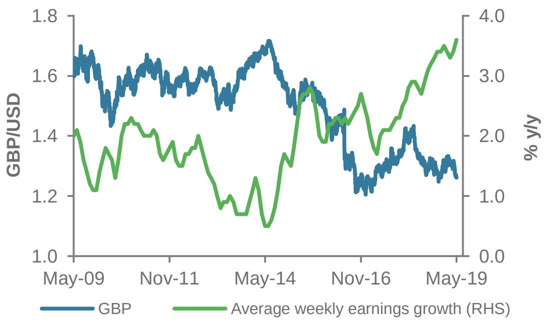
We believe that events in the coming weeks could finally lead to increasing clarity on Brexit. This should be positive for the UK economy and the GBP. We also expect that the worst-case scenario of a no-deal Brexit, which is still on the agenda today, will become a lesser risk after the new PM takes over.

The GBP is undervalued by various medium-term measures. It is possible that GBP/USD could yet slip towards 1.20, but even with a no-deal Brexit we believe 1.15 is a likely initial base and Brexit would likely trigger the launch of a government monetary and fiscal support package. On the other hand, a positive Brexit deal could trigger a wave of deferred capital investment into the UK and business spending could rise markedly. With the relatively robust economy and employment conditions, the BoE may push rates higher.

As Brexit clarity improves and Brexit options shift towards a more benign end state, we believe that GBP/USD offers a strong medium-term risk-reward at current levels and below, with the caveat that short-term volatility is likely to persist a while longer.

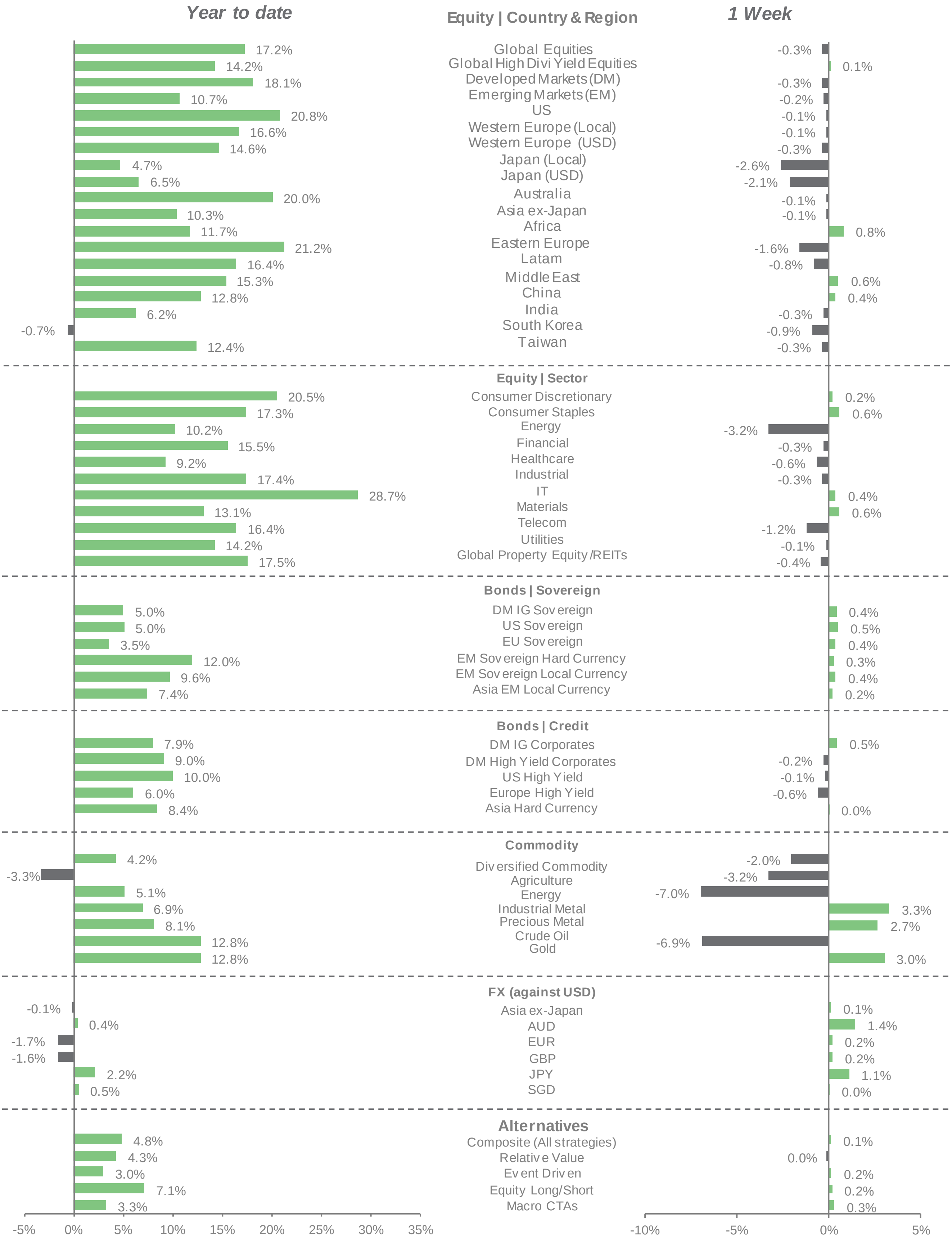
GBP/USD has declined amid Brexit risks, despite continued tightening of the labour market and rising wages

GBP/USD and average UK weekly earnings growth, ex-bonus



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2018 to 18 July 2019, 1 week period: 11 July 2019 to 18 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
TUE	EC	Consumer Confidence	23-Jul-19	Jul A	–	-7.2
	US	Existing Home Sales	23-Jul-19	Jun	5.36m	5.34m
WED	GE	Markit/BME Germany Composite PMI	24-Jul-19	Jul P	52.2	52.6
	EC	Markit Eurozone Composite PMI	24-Jul-19	Jul P	–	52.2
	EC	M3 Money Supply y/y	24-Jul-19	Jun	–	4.8%
	US	Markit US Composite PMI	24-Jul-19	Jul P	–	51.5
	US	New Home Sales	24-Jul-19	Jun	670k	626k
THUR	SK	GDP y/y	25-Jul-19	2Q P	1.8%	1.7%
	GE	IFO Expectations	25-Jul-19	Jul	94	94.2
	EC	ECB Main Refinancing Rate	25-Jul-19	25-Jul	0.0%	0.0%
	US	Cap Goods Orders Nondef Ex Air	25-Jul-19	Jun P	–	0.5%
	US	Initial Jobless Claims	25-Jul-19	20-Jul	–	–
FRI	US	GDP Annualized q/q	26-Jul-19	2Q A	1.7%	3.1%
	US	Personal Consumption	26-Jul-19	2Q A	–	0.9%
	US	Core PCE q/q	26-Jul-19	2Q A	–	1.2%
SAT	GE	Retail Sales NSA y/y	27-Jul-19	Jun	–	4.0%

	Event	This Week	Date	Period	Actual	Prior
MON	CH	Fixed Assets Ex Rural YTD y/y	15-Jul-19	Jun	5.8%	5.6%
	CH	Industrial Production y/y	15-Jul-19	Jun	6.3%	5.0%
	CH	Retail Sales y/y	15-Jul-19	Jun	9.8%	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	3.4%	3.1%
	US	Retail Sales Ex Auto and Gas	16-Jul-19	Jun	0.7%	0.5%
	US	Industrial Production m/m	16-Jul-19	Jun	0.0%	0.4%
WED	UK	CPI Core y/y	17-Jul-19	Jun	1.8%	1.7%
	US	Housing Starts	17-Jul-19	Jun	1253k	1269k
	US	Building Permits	17-Jul-19	Jun	1220k	1294k
THUR	JN	Exports y/y	18-Jul-19	Jun	-6.7%	-7.8%
	UK	Retail Sales Ex Auto Fuel y/y	18-Jul-19	Jun	3.6%	2.2%
	US	Leading Index	18-Jul-19	Jun	-0.3%	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

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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