Standard Chartered
Private Bank

Weekly Market View

A melt-up in China equities?

China and Asia ex-Japan equities have broken higher on the back of China's economic recovery, growing policy support, stabilisation in earnings estimates, attractive valuations and rising institutional and retail flows. We expect further gains

Equities: We expect China offshore and onshore equities to outperform Asia ex-Japan stocks and help the latter outperform global equities

Bonds: We still see value in our preferred markets: US High Yield, Emerging Market and Asia USD bonds

FX: We see more downside in USD/CNH after it broke below a key support level and fell below 7.00

A melt up in China equities

Also find out...

What is driving China equity market gains? Can it continue?

Do corporate and Emerging Market bonds still offer value at current yields?

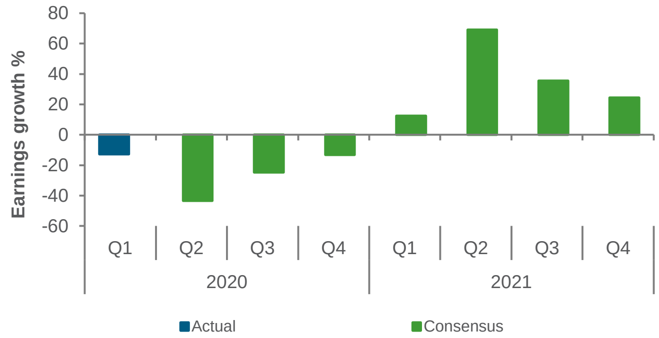
Is the HKD's peg to the USD really under threat?

Chart of the week: Next stop 2015 high?

China stocks surged to a 5-year high amid rising risk appetite among retail investors; US earnings growth seen turning positive in 2021

CSI 300 index (China A-shares)

Consensus earnings growth estimates for US S&P500 index, % y/y



Source: Bloomberg, Refinitiv, Standard Chartered;

Editorial

A melt-up in China equities?

The three-month long rally in China and Asia ex-Japan stocks got perkier this week, with China onshore shares (CSI 300 index) jumping to a five-year high. As risk sentiment improves, we believe the rally has more upside. Our Global Investment Committee has assessed Asia ex-Japan and, within Asia, China onshore and offshore, as preferred equity markets since February. China onshore and Asia ex-Japan equities have returned 22% and 7.5% since then vs. 6.2% for global equities. Charts suggest further 13% upside for China onshore till next resistance.

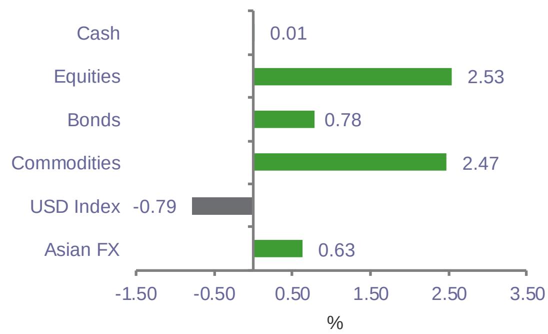
We believe a confluence of factors have helped drive the rally: 1) China's successful reopening after lockdowns without a major resurgence of infections and an overall return to growth in Q2, well ahead of other major economies, 2) policymakers' pledge to quicken credit growth and support infrastructure spending, lifting domestic liquidity, 3) stabilisation in corporate earnings estimates, 4) attractive valuations, 5) the rise in Stock Connect flows, and 6) strong retail participation, with the state-owned media signalling a "healthy bull market" (see page 4 for details).

The above factors are likely to remain supportive for China and Asia ex-Japan. The prospect of more US-listed Chinese companies (ADRs) relisting in Hong Kong, driving Mainland flows, are an additional positive. Historically, liquidity-driven rallies in China have lasted for months. There is little sign of euphoria yet – our investor diversity indicator is not flashing red and margin financing remains below 2015 levels. Asia-ex-Japan equities have the additional support from their positive correlation with the global technology sector, which is benefitting from a cyclical recovery and 5G-induced demand. Finally, our weak-USD view in the next 12 months is also likely to support fund flows to the region.

Nevertheless, any liquidity-powered rally warrants caution. Thus, diversification remains our core tenet, especially given the risk of a second pandemic wave and rising US-China tensions ahead of the US elections. The US and Euro area are our other preferred equity markets. We expect the coming earnings season, ECB meeting on 16 July and EU leaders' summit on 17-18 July (to discuss the proposed recovery fund) to be key drivers of risk assets. Improved risk appetite is also likely to support our positive view on EM USD and Asia USD bonds and our tactically bullish view on the CNY (see page 5).

Global equities extended their gains, led by China and Asia ex-Japan stocks; Gold jumped to an 11-year high, while rising risk appetite also lifted other commodities

Benchmark market performance w/w*



Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered

*Week of 01 July 2020 to 08 July 2020

S&P500 index faces resistance 0.6% above current level

Technical indicators for key markets as on 08 July 2020

Index	Spot	1st support	1st resistance
S&P	3,170	3,140	3,190
STOXX 50	3,286	3,265	3,329
FTSE 100	6,156	6,113	6,243
Nikkei 225	22,486	22,183	22,752
Shanghai Comp	3,403	3,195	3,508
Hang Seng	26,129	25,389	26,604
MSCI Asia ex-Japan	700	678	711
MSCI EM	1,070	1,039	1,086
Brent (ICE)	43.3	43.0	43.5
Gold	1,808	1,786	1,819
UST 10Y Yield	0.66	0.64	0.68

Source: Bloomberg, Standard Chartered

The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	• US' Operation Warp Speed, tasked with developing a COVID-19 vaccine, gave USD 1.6bn to a Phase 3 clinical trial candidate; aims to deliver 100m doses by late 2020 • US average daily fatality rate remained little changed w/w • Beijing reported no new cases for the first time in 26 days	• New daily COVID-19 cases in the US and India hit new record highs in the past week, with India now ranking third-highest in terms of cumulative cases • New York added more US states to travel quarantine list • Australia imposed a six-week lockdown in Melbourne; Tokyo reported more than 100 new cases for the 6th straight day
Macro data	• US non-manufacturing activity indicator (ISM PMI) returned to expansionary levels in June for the first time since the pandemic (up 11.7pts to 52.6), beating consensus estimates; this follows stronger-than-expected manufacturing PMI last week • US job openings rose by a higher-than-expected 400,000 to 5.4m in May • Euro area retail sales jumped stronger-than-expected 18% m/m in May • China's Caixin services sector PMI rose to 10-year high of 58.4 in June, from 55.0 in May • Japan's services PMI jumped 18.5pts to 45.0 in June	• European Commission cut its 2020 Euro area growth forecast by 1ppt to -8.7% • Euro area's Sentix indicator of investor confidence rose to its highest since March, but fell below expectations • German industrial output and factory orders rose for the first time since the pandemic in May, but gains were weaker than expected • China's holiday spending during the recent Dragon Boat festival was more than 50% below last year's levels, underscoring continued consumer caution • China's Caixin service sector employment PMI contracted for the fifth straight month in June • Japan's household spending fell by larger-than-expected 16% in May; exports fell 5.4% m/m
Policy developments	• The US President's office said it expects Congress to pass a USD 1trn stimulus package by early August • The UK unveiled a GBP 30bn stimulus package to keep workers in jobs, cut taxes on home purchases and to provide incentives for dining out • Bank of France's Villeroy said 'provisional (monetary and fiscal) weapons' against the pandemic 'will be long-lasting' • RBA left its benchmark rate unchanged at 0.25%; the governor said the 'downturn has been less severe' than expected	• Fed's Bostic said the economic recovery may take longer than he had expected amid a 'lack of confidence' among consumers and that Fed may need consider more stimulus • ECB's Knot said Europe should not lean too heavily on monetary policy to drive the recovery amid reports of disagreement on extending the emergency bond purchase programme • German Chancellor Merkel urged EU members to 'quickly' agree on a Pandemic Recovery fund as the region's recovery remains 'rocky' and will require 'compromises' among members
Other developments	• An editorial in the state-owned China Securities Journal said investors should look forward to the "wealth effect of the capital markets" and the prospect for a "healthy bull market"	• China's Ambassador to the UK warned of "consequences" if the UK treated China as "hostile"

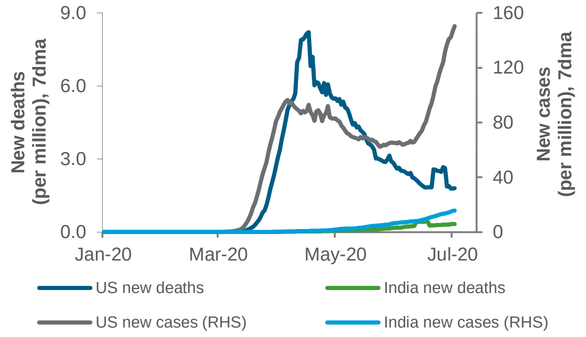
Our weekly net assessment: On balance, we see this week's data and policy developments as neutral, with a positive bias towards China assets

(+) factor: Services PMIs, Euro area retail sales, China's risk appetite

(-) factor: Rise in US COVID-19 cases, Euro area data disappointments

Daily new COVID-19 cases continued to rise in the US and India, but the fatality rates have declined

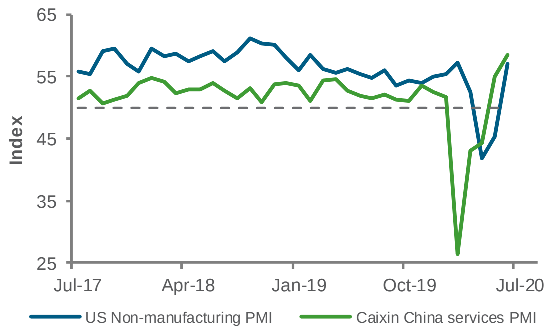
Daily new COVID-19 cases and fatalities per million in the US and India



Source: Our World in Data; Standard Chartered

The services sectors in the US returned to expansion in June; China's services sector continued to expand

US ISM Non-manufacturing PMI and Caixin China Services PMI



Source: Bloomberg, Standard Chartered

German industrial production and factory orders rebounded m/m in May, but continued to contract y/y

German industrial output and factory orders, % y/y

Source: Bloomberg; Standard Chartered

Top client questions

What is driving China equity market gains? Can it continue?

Onshore China equities have been particularly strong in the past week, climbing over 13% since the start of July on very strong volumes and outperforming other major markets. The dominant narrative is the Chinese government's support of a strong market, encouraging broad participation, especially retail, in the equities market. This has been accompanied by various policy changes that support a more robust and efficient market, including IPO market reforms, capital market reforms, launch of A-share market-linked derivative products and an abundance of liquidity. In addition, strong data buoyed investor sentiment: some activity trackers suggest China's economy is operating at pre-pandemic levels now, daily new COVID-19 cases remain low, PMI data continues to show expansion and earnings downgrades are slowing.

In terms of fund flows, the data suggests two sources are driving the market higher: retail investors in China and northbound flows from Hong Kong. Retail investor interest is illustrated by data on margin trading levels (see chart) that have been climbing steadily to a four-year high. While this is elevated compared to recent years, margin trading levels remain far below the June 2015 peak. Another source of buying has been northbound flows from Hong Kong through the Stock Connect scheme, even though this is less significant than local Chinese retail demand. Stock Connect demand is likely led by foreign institutional investors increasing their exposure to onshore China equities. Northbound flows have been steadily positive since April, but picked up further in July.

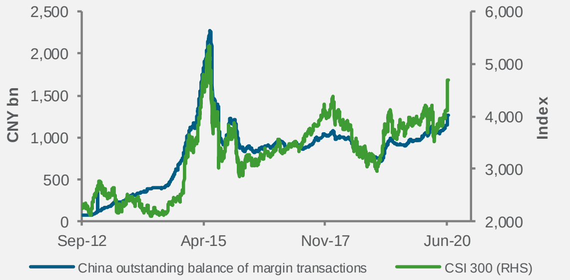
Can the rally continue? Investors who experienced 2015 would be wary of a rally driven by margin trading that can collapse abruptly. China equities collapsed in the second half of 2015 on fears of an economic hard landing and as regulators cracked down on risky financing. Valuations are elevated now: consensus 12-month forward P/E is 14x, 23% higher than its long-term average and at the upper end of its long-term range. Geopolitical tensions, particularly US-China relations, are also a risk, with the possibility of an escalation in the run-up to US presidential elections. Meanwhile, COVID-19 remains a risk until a permanent solution such as a vaccine, is available.

On the other hand, margin trading remains far below the 2015 peak and is unlikely to trigger a regulatory crackdown just yet. Valuations of China equities are high relative to their own history, but they remain at a deep 28% discount to global equities; historically, the average discount has been c.20%. Therefore, relative to global equities, China equities are still attractively valued. Onshore China equities also continue to be less sensitive to global turbulence, with domestic investors being the main drivers. Foreign investors remain lightly positioned and further inflows would be a tailwind for the market. Last but not the least, we do see policy reforms in China as positive for the market's development, on top of monetary easing measures.

On balance, our net assessment is that China equities still have room to outperform further. We expect onshore and offshore China equities to outperform Asia ex-Japan (AxJ), and help AxJ outperform global equities. Offshore China equities have the added catalyst of secondary listings of Chinese ADRs, typically well-known companies with keen investor demand.

China's onshore equities broke higher to a five-year high amid rising risk appetite among retail investors

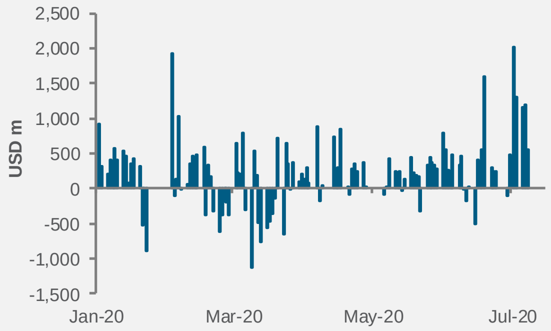
CSI 300 index (China A-shares); margin transactions* outstanding



Source: Bloomberg; Standard Chartered; *This data series shows equity purchases done with funds borrowed from a broker

Stock Connect 'northbound' flows (from Hong Kong to mainland China) have surged in recent weeks

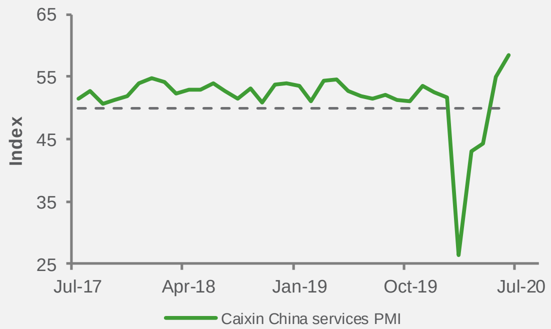
Daily Stock Connect 'northbound' flows



Source: Bloomberg; Standard Chartered

China's services sector activity accelerated in June, supporting the equity market rally

China's Caixin services sector PMI



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

Can the CNH rally extend?

We believe it can. There are several fundamental and technical factors why we believe USD/CNH will remain biased to the downside in the coming weeks.

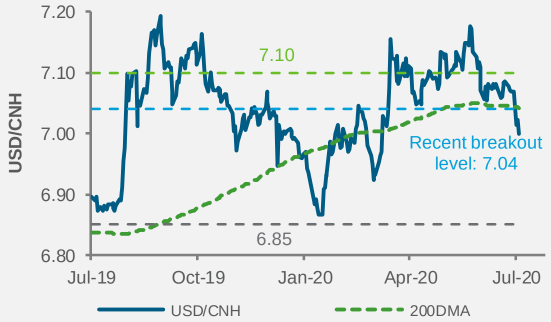
A relatively successful management of the pandemic and steady monetary and fiscal policy support are expected to drive China's economic recovery in absolute terms and relative to the US. Local equity markets have recently made impulsive gains, driven by institutional and retail buying, and are increasingly attracting foreign inflows. This trend appears to have more room to run, and along with Chinese government bond yields providing good relative returns for overseas investors, we expect net positive capital flows to underpin further near-term CNH gains.

From a technical perspective, this week's fall under the 7.04 is supportive of a new leg lower for USD/CNH. Although this may not be a quick move, we believe that moves to around 6.93 and 6.85 are now likely, while resistance around 7.09-7.10 is not broken.

The key risk to our view is ongoing geopolitical tensions. While these are likely to remain a source of longer-term uncertainty, a sudden escalation would likely trigger investor caution. That said, such periods are not expected to derail the factors behind a stronger CNH, unless extreme future policy actions replace strong current rhetoric.

USD/CNH broke below a key support level this week and further fell below 7.00; we expect further downside

USD/CNH



Source: Bloomberg; Standard Chartered

Do corporate/EM bonds still offer value at current yields?

Yields of global corporate, Emerging Market (EM) and Asian USD bonds ('credit') have fallen sharply from their late-March peaks. However, comparing headline yields with recent history may not offer the best perspective. US Treasury yields have fallen 127bps YTD, which means corporate and EM bond yields were likely to move similarly lower since they offer a yield premium over this Treasury baseline.

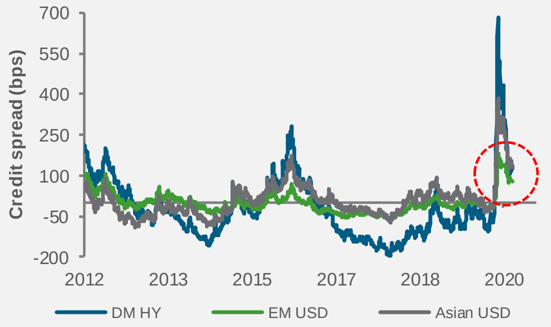
We believe credit spreads offer a better assessment of value. As the chart shows, spreads on most major bond sub-asset classes are still wide relative to their long-term averages and 2016/19 market pullback levels. The gap between credit yields and short-term funding costs also remains wider than usual. This suggests there is still value in credit markets, especially in our preferred areas of Developed Market (DM) HY bonds, EM USD government and Asian USD bonds.

Specifically, we see the following rebalancing opportunities today:

1. High Yield (HY) bonds: In Asia USD, we have a slight preference for HY over IG bonds as we believe they have lagged the rebound and offer better relative value.
2. Moderately longer maturities: We prefer a moderate maturity profile in USD bonds over a short maturity profile as we believe a sharp Treasury yield rebound is unlikely.
3. Subordinated bonds: Going 'down' the capital structure is one way of improving yields without reducing issuer credit quality, in our view.

Yield premiums on US High Yield bonds, EM USD government and Asia USD bond remain higher than their long-term averages despite tightening in recent months

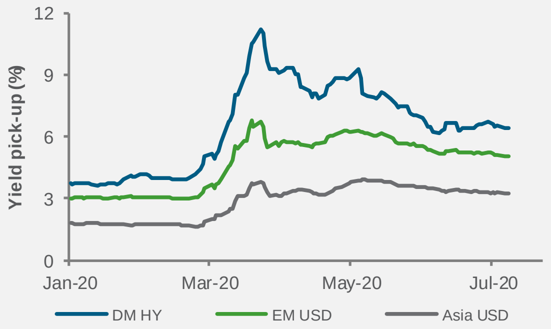
Yield premiums on US HY, EM USD and Asia USD bonds over US Treasuries



Source: Bloomberg; Standard Chartered

Developed Market High Yield bonds and EM USD and Asia USD bonds still offer attractive yields

Yield pick-up on DM HY, EM USD and Asia USD bonds over US 3-month money market rates



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

Is the HKD's peg to the USD really under threat?

The USD-HKD peg was a policy decision taken unilaterally by the Hong Kong (HK) authorities. In order for the US to threaten the peg, it would have to undermine HK's ability to hold or transact USDs, which would be a very extreme step and could undermine the USD's reserve currency status, especially if it encourages other countries with USD pegs to evaluate their policy options.

The US's largest trade surplus globally is with HK, which may reduce the US's incentive to take strong measures.

Chinese authorities are heavily invested in making HK a success. Arguably, this incentive has increased following the signing of the national security law. In any case, HK is likely to be a major beneficiary of any US delisting of Chinese companies and the new Greater Bay Area Wealth Connect is an indication of the support HK is likely to receive from the Mainland.

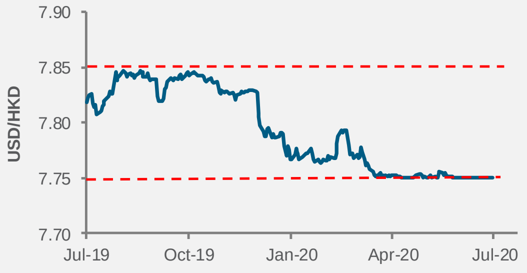
The fundamental underpinnings for the USD-HKD peg remain very robust. The HKMA's aggregate balance has risen sharply on the back of strong capital inflows in recent months and foreign reserves have risen to USD 446bn (up USD 8.4bn since March). Meanwhile, the HKD has been trading on the stronger side of the band for the past 6 months despite speculation about the USD-HKD peg.

The banking system is robust with a strong capital adequacy ratio (around 20%), a strong liquidity ratio (160%), and high asset quality (classified loan ratio at 0.6%).

Therefore, while more US 'sabre-rattling' is likely and measures such as cancelling the Fed's swap facility with the HKMA cannot be ruled out, our net assessment is a significant disruption of the peg is unlikely.

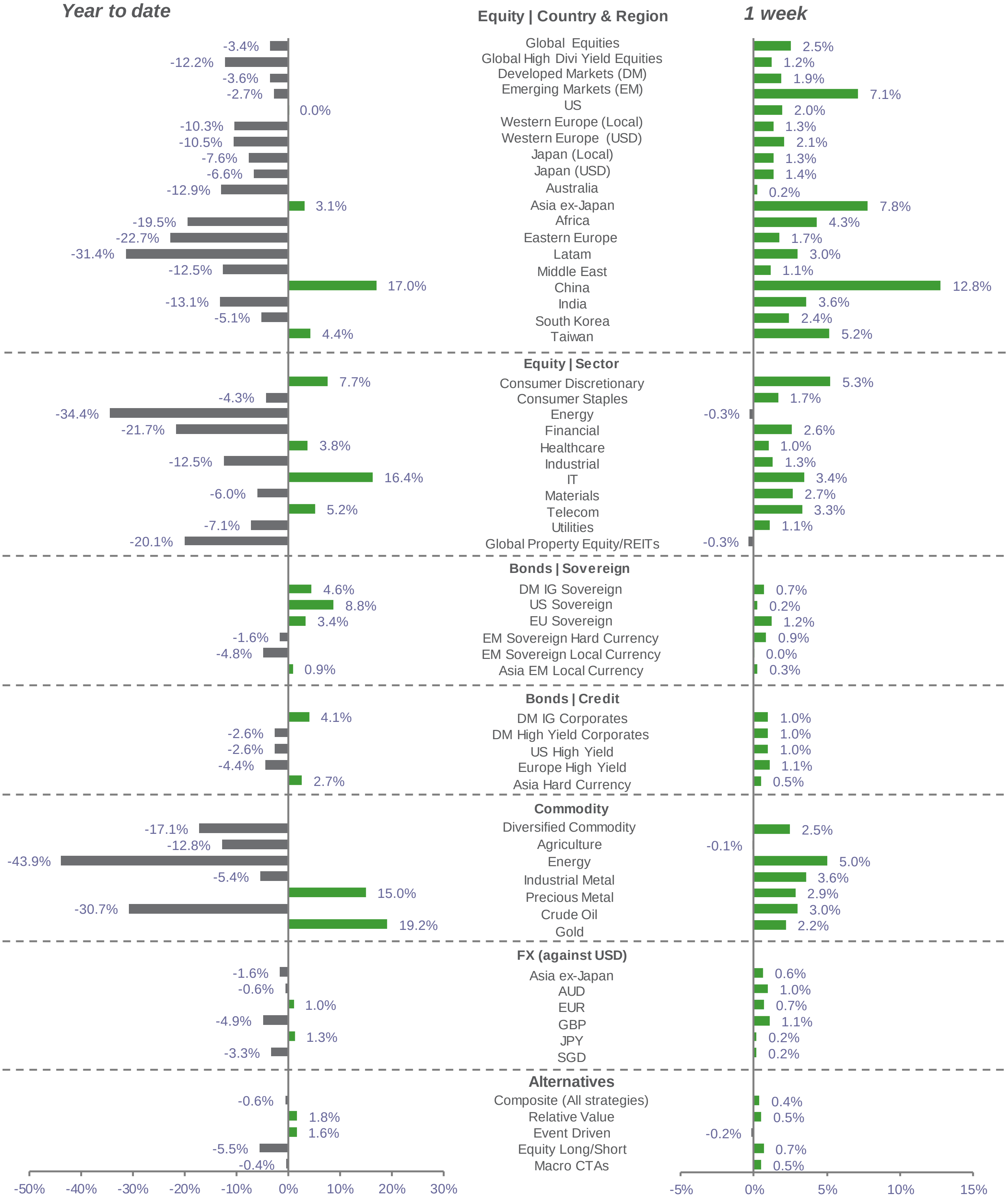
The HKD has remained at the stronger end of the USD/HKD band (7.75 – 7.85) in recent months, despite speculation about the currency's peg to the USD

USD/HKD and the HKMA's target band for the pair



Source: Bloomberg; Standard Chartered

Market performance summary*



Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered
*Performance in USD terms unless otherwise stated, 2019 performance from 31 December 2019 to 08 July 2020, 1 week period: 01 July 2020 to 08 July 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	IN	CPI y/y	13-Jul-2020	Jun	5.1%	–
TUE	EC	ZEW Survey Expectations	14-Jul-2020	Jul	–	58.6
	US	CPI Ex Food and Energy y/y	14-Jul-2020	Jun	1.1%	1.2%
WED	UK	CPI Core y/y	15-Jul-2020	Jun	–	1.2%
	US	Industrial Production m/m	15-Jul-2020	Jun	4.4%	1.4%
	JN	BOJ Policy Balance Rate	15-Jul-2020	15-Jul	–	-0.1%
THUR	US	U.S. Federal Reserve Releases Beige Book	16-Jul-2020		–	–
	CH	Industrial Production y/y	16-Jul-2020	Jun	4.8%	4.4%
	EC	ECB Main Refinancing Rate	16-Jul-2020	16-Jul	--	0.0%
	CH	GDP y/y	16-Jul-2020	2Q	2.5%	-6.8%
	CH	Retail Sales y/y	16-Jul-2020	Jun	0.4%	-2.8%
	CH	Fixed Assets Ex Rural YTD y/y	16-Jul-2020	Jun	-3.4%	-6.3%
FRI/SAT	US	U. of Mich. Sentiment	17-Jul-2020	Jul P	80.0	78.1
	US	Building Permits	17-Jul-2020	Jun	1300k	1216k

	Event	This Week	Date	Period	Actual	Prior
MON	GE	Factory Orders WDA y/y	06-Jul-2020	May	-29.3	-36.9%
	EC	Sentix Investor Confidence	06-Jul-2020	Jul	-18.2	-24.8
	EC	Retail Sales y/y	06-Jul-2020	May	-5.1%	-19.6%
	US	ISM Non-Manufacturing Index	06-Jul-2020	Jun	57.1	45.4
TUE	JN	Household Spending y/y	07-Jul-2020	May	-16.2%	-11.1%
	GE	Industrial Production WDA y/y	07-Jul-2020	May	-19.3	-25.0%
WED						
THUR	CH	CPI y/y	09-Jul-2020	Jun	–	2.4%
	GE	Exports SA m/m	09-Jul-2020	May	–	-24.0%
	JN	Machine Tool Orders y/y	09-Jul-2020	Jun P	–	-52.8%
FRI/SAT	JN	PPI y/y	10-Jul-2020	Jun	–	-2.7%
	FR	Industrial Production y/y	10-Jul-2020	May	–	-34.2%
	US	PPI Ex Food and Energy y/y	10-Jul-2020	Jun	–	0.3%
	CH	Money Supply M2 y/y	10-Jul-2020	Jun	–	11.1%
	CH	New Yuan Loans CNY	10-Jul-2020	Jun	–	1482.1b

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue; *refers to Jan-Feb 2020 combined data
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

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