WM Chief Investment Office | 15 January 2021

Standard Chartered

Weekly Market View

Are markets frothy?

Some riskier asset classes, especially in Emerging Markets, look crowded, raising the risk of a short-term pullback. We see several reasons why any such drawdown would present medium-term investors (and those who missed the earlier rally) an opportunity to add exposure to our preferred asset classes and themes

Equities: In the upcoming earnings season, we expect US companies to confirm market expectations of a strong recovery in earnings in 2021

Bonds: Fed Chair Powell's comments this week confirm our belief that the central bank will limit further significant gains in US Treasury yields.

FX: We expect a temporary rebound in the USD in the near-term, which would present an opportunity to average into our preferred currencies

+

Are technical indicators pointing to a major correction in equities?

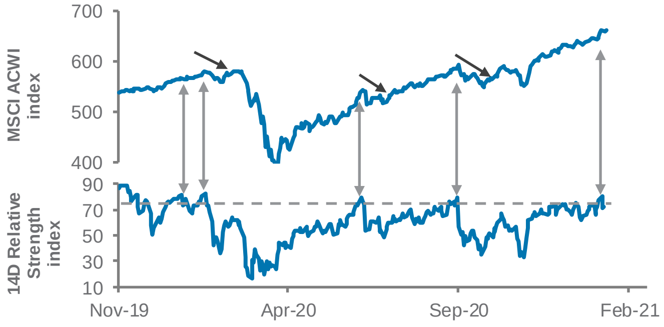
What levels would be attractive to buy major non-USD currencies?

What is the outlook for oil prices after the recent OPEC meeting?

Charts of the week: Earnings outlook trumps near-term risk

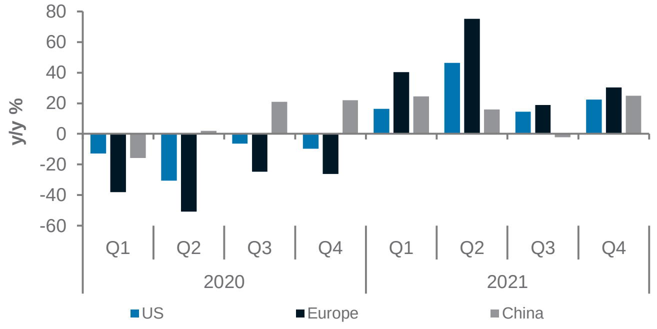
Equities and other risk assets look stretched in the near term, but strong earnings should offer support

MSCI All Country World index and Relative Strength Index (a measure of overbought/oversold conditions)



Source: Bloomberg, Standard Chartered

Consensus earnings estimates by quarter for S&P500, Stoxx600 and MSCI China equity indices



Source: MSCI, Refinitiv, FactSet; Q1-Q3 20 are actual earnings

Editorial

Are markets frothy?

After a strong rally since the US elections, we believe some asset classes, including Emerging Market (EM) stocks and bonds, appear increasingly crowded. Froth is also visible in other markets levered to global growth (such as bank equities and the AUD; see pages 4 and 8). There is a risk that stretched investor positions and rising US government bond yields could trigger a short-term pullback, especially if the COVID situation in the US and parts of Europe worsens in the coming weeks or if US political tensions boil over. Nevertheless, we see a longer list of reasons why any such drawdown would present an opportunity for medium-term investors (and those who missed the earlier rally) to add exposure to our preferred asset classes and themes.

Our positive long-term outlook is based on expectations of a rebound in the global economy as COVID vaccines are rolled out on a mass scale. As pandemic fears wane, we expect households to further pare down savings and companies to resume investments. Meanwhile, we see low risk of policymakers unwinding extremely stimulative fiscal and monetary policies till job markets have recovered significantly and the market's inflation expectations have risen sustainably above central banks' 2% target. We remain far from either of those outcomes, as Fed Chair Powell confirmed this week. Indeed, incoming US President Biden has proposed another USD 1.9tn fiscal stimulus, including additional USD 1,400 cheques to most individuals and investment in "green infrastructure" projects. A sustainable global growth recovery should lift corporate earnings (see page 4).

Rising Treasury yields have raised concerns that higher US borrowing costs could threaten risk assets as financial conditions tighten. We view a modest rise in yields as a sign of investor optimism about the economic recovery and revival in inflation expectations (see page 5). Yet, we see limits to significantly higher yields: this week's auction of US Treasuries showed that global demand remains strong; Asian central bank demand for US Treasuries is likely to stay, especially as they seek to contain their currency strength; and the Fed is likely to remain a steady buyer and enabler of Biden's ambitious infrastructure spending programme.

The USD, another contrarian measure of global risk sentiment, has started to rebound, raising concerns that further gains could tighten global financial conditions. However, we see the gains as temporary amid limited prospects for a significant rise in US bond yields, widening US fiscal and current account deficits and an improving global economic outlook. Technical charts suggest EUR/USD has strong support around 1.2000. A near-term USD bounce should create opportunities to move to EUR, AUD, GBP and CNY (see pages 5-6).

Overall, we believe any correction in risk assets in the coming days would be an opportunity to add to our favoured EM asset classes, in addition to US equities (see page 8). It would also present a chance to tilt equity allocations increasingly towards Value-style stocks and consider adding exposure to some of our multi-year themes around innovations in medical technology, Internet-of-Things, electrical vehicle technology and "green infrastructure".

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as Neutral

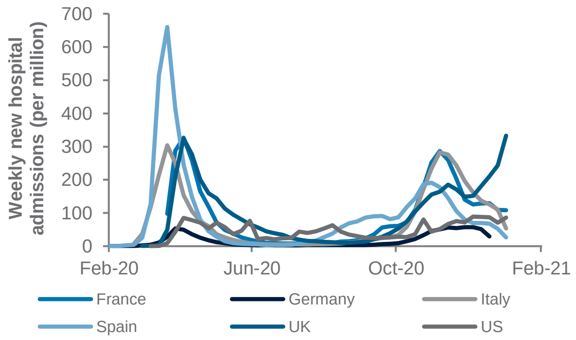
(+) factor: Another US fiscal stimulus, resilient Euro area data

(-) factor: Worsening COVID-19 trends in US, UK, Germany; US political tensions; weaker-than-expected US job data

	Positive for risk assets	Negative for risk assets
COVID-19	• New cases continue to decline in some parts of EU, India, South Korea • US allowed vaccinations for everyone over 65 years; India, Indonesia starting vaccinations	• Hospitalisations, deaths hit new highs in US, UK, Germany, Japan • Merkel said Germany may need a lockdown till April; Japan extended its lockdown beyond Tokyo
	Our assessment: Neutral – surge in US and UK hospitalisations offset by vaccination progress	
Macro data	• Euro area industrial production rose more than expected; jobless rate fell unexpectedly • German GDP shrunk by less-than-expected 5% in 2020	• US job creation in December contracted unexpectedly; weekly jobless claims rose by the most since March • US small business outlook fell unexpectedly
	Our assessment: Neutral – US job contraction offset by surprisingly resilient Euro area industry	
Policy developments	• Incoming US President Biden proposed USD 1.9tn of new stimulus, including direct cheques to households • Fed Chair Powell said it is too premature to talk about tapering of monetary policy • ECB officials said short-term inflation would not lead to tighter policy	• Italy's ruling coalition lost its majority support in parliament after former Prime Minister Renzi pulled his party's ministers from the cabinet
	Our assessment: Positive – more US fiscal stimulus	
Other developments	• China expects air passenger traffic to rebound to 90% of pre-pandemic levels in 2021	• US House of Representatives voted to impeach President Trump for the 2nd time, raising political tensions
	Our assessment: Negative – US political tensions	

COVID-19 hospitalisations have hit record highs in the UK and the US

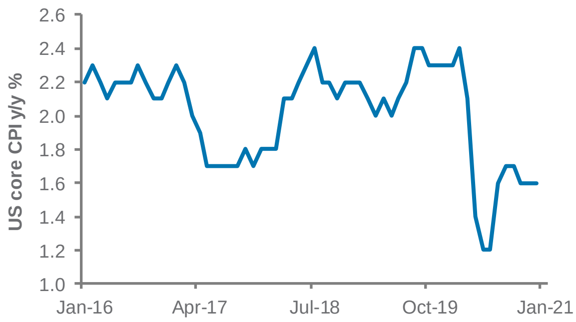
Weekly hospital admissions per million people



Source: Our World in Data, Standard Chartered

US core inflation remains well below past trends and the Fed's goals

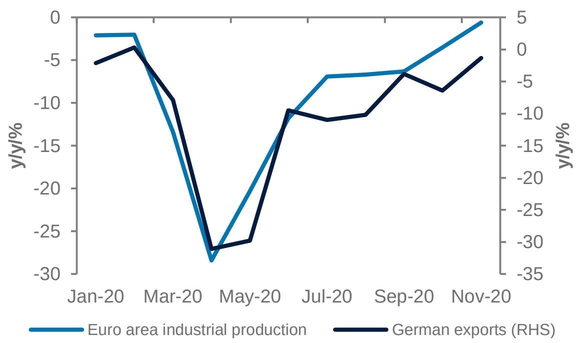
Core US consumer price inflation



Source: Bloomberg, Standard Chartered

Euro area industrial output and German exports suggest a recovery in global trade

Euro area industrial output and German exports



Source: Bloomberg, Standard Chartered

Top client questions

Are technical indicators pointing to a major correction in equity markets?

From a near-term perspective, a minor retreat cannot be ruled out given the recent sharp gains in the MSCI All Country World index (MXWD). However, the broadening of the rally suggests any retreat is likely to be short lived.

Historically low levels of the CBOE US Equity Put/Call Ratio (lowest since 2010) is a reflection of optimism running high in stocks. Also, the 14-day Relative Strength index of the MXWD is in the 78-80 window, levels that have historically been associated with at least a short-term pause. In addition, our proprietary market diversity indicator (see table) is close to levels that indicate a relatively high probability of a short-term consolidation or reversal.

What is encouraging for longer-term investors, though, is that market breadth (the number of stocks in the index above their respective 200-day moving average in the S&P500, Europe Stoxx 50 and UK FTSE 100) is improving. The Hang Seng and Nikkei have also shown nascent signs of improving breadth. In our view, the broadening of the rally internally (within indices) and globally (a synchronised improvement in market breadth) raises the likelihood that the uptrend continues.

What can we expect from the US earnings season?

The Q4 US corporate earnings season kicks off this week, with banks leading the charge. Consensus expectations are for S&P500 earnings per share to contract 10% y/y.

Investors might question how the index can rise to an all-time high when earnings are declining. We believe two factors explain this. First, the ability of the S&P500 to reach an all-time high at a time when earnings are expected to shrink reflects the huge monetary and fiscal policy response to the COVID-19 pandemic. Second, the market is always looking ahead and aiming to reflect future expectations. Consensus expectations for S&P500 earnings growth in 2021 is 24%. It is this optimism about future earnings growth, driven by expectations of an economic recovery in 2021, that we believe is driving the index to all-time highs.

US banks will report earnings this week and big technology stocks report in the last week of January. US financials and technology, our two preferred sectors, are expected to deliver -4.5% and +4.0% earnings growth in Q4 21, but growth is expected to accelerate to +23% and +15%, respectively, in 2021.

Global equities look stretched near term

MSCI ACWI* and Relative Strength Index**

Source: Bloomberg, Standard Chartered; *MSCI All Country World Index; **a measure of overbought/oversold conditions

EM equity markets look particularly crowded

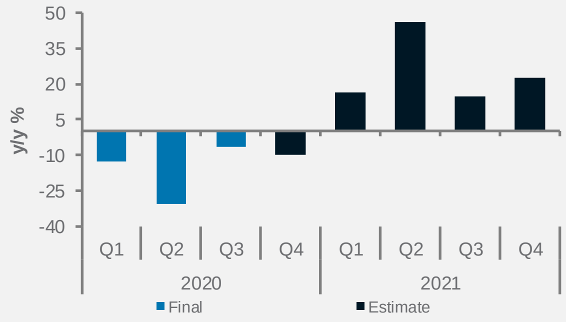
Our market diversity indicator* as on 13 Jan.

Level 1	Diversity	One-month Diversity trend	Return over past 30 days	Fractal dimension
MSCI All Country World Index	◐	↓	5.25%	1.28
MSCI USA Index	◐	↓	4.39%	1.36
MSCI Europe Index	◐	↓	4.32%	1.34
MSCI UK Index	◐	→	3.66%	1.28
MSCI Japan Index	◐	↓	5.47%	1.27
MSCI AC Asia ex-Japan Index	○	↓	10.53%	1.20
MSCI EM ex-Asia Index	○	↓	6.64%	1.22

Source: Bloomberg, Standard Chartered; *Fractal dimensions below 1.25 indicates low market diversity and high risk of trend reversal

US earnings expected to rebound strongly

S&P500 index earnings growth by quarter



Source: Refinitiv, Standard Chartered

Top client questions (cont'd)

How far do you expect US Treasury yields to rise?

US Treasury yields have risen in recent weeks as some Fed speakers left open the question of whether an earlier-than-expected tapering is likely in late 2021. Fed Chair Powell's comments this week should allay those concerns as he ruled out tightening of the Fed's highly accommodative monetary policy without a sustained rise in growth and inflation.

Instead, we continue to believe the Fed is likely to work towards keeping bond yields contained (via measures such as yield curve control, for example). Modest rises in Treasury yields could also induce foreign purchases, as we have already witnessed in strong demand at 10-year and 30-year bond auctions this week, where the ratio of demand vs supply was above their one-year average.

On the technical front, the 10-year Treasury yield's break last week above the June 2020 high of 0.959% and the rise above the 200-day moving average confirms yields may have found an interim floor at the August low of 0.504%. A reasonable target could be the March 2020 high of 1.283%, with stiff resistance at the September 2019 low of 1.429%. On the downside, a fall below initial support at 0.959% would imply that the bullish outlook had faded.

Fed Chair Powell's pledge to keep policy easy should cap US bond yields

US 10-year Treasury yield

Source: Refinitiv, Standard Chartered

Is this the start of a strong USD rally?

We expect the USD to move lower through 2021, but also expect short-term rebounds along the way. The 13% decline from March 2020 was punctuated by the September-October rebound, and current conditions suggest another pause may be due.

One driver is likely to be positioning; here, we see EUR/USD long positions being, by far, the most elevated and significant for the broad USD. In that context, additional drivers of a near-term EUR/USD decline are likely to be the recent rise in US Treasury yields, a steeper US yield curve and a widening USD-EUR yield differential. The large fiscal stimulus planned by the incoming Biden administration could potentially boost short-term US sentiment and economic outperformance. There may also be trouble brewing in Italian politics that could lead to a snap election. With elections also due in the Netherlands (in March) and Germany (by October), the recent closer regional collaboration could soon be tested by populist politics. We look to technicals to determine if the current consolidation might turn into a larger correction. We expect robust EUR/USD supports around 1.2060 and 1.2000. A mild USD rally could end there. A break lower would suggest a deeper EUR/USD decline into the 1.1600-1.1900 window.

We expect strong technical support for EUR/USD around 1.2000

EUR/USD

Source: Refinitiv, Standard Chartered

Top client questions (cont'd)

What levels would be attractive to buy major currencies against the US Dollar?

Short-term rebounds notwithstanding, we continue to see key structural drivers remaining USD-bearish. These include rising US fiscal and trade deficits, narrowing real interest rate differentials and possible US tax and regulation policies. Therefore, we would look for opportunities to accumulate major non-USD currencies as the USD enjoys a corrective bounce. One strategy could be "averaging in". Buying EUR/USD at 1.2060, 1.2000, 1.1890 and 1.1780 support levels would generate an average rate of 1.1955, for example. This would be an attractive average given our year-end EUR/USD expectation of 1.3000, especially since we do not expect a decline much below 1.1600.

We also suggest deploying a similar strategy in other currencies. The GBP has been slow to follow the recent EUR fall, but if the USD does correct higher, the GBP will likely be dragged lower. We look for GBP/USD support around 1.3460, 1.3300 and 1.3190, expecting 1.3000 to hold, with expectations of 1.4000 in 2021. AUD/USD has also been well supported amid a bullish commodities outlook, though tensions with China could impact exports. We would look at AUD/USD supports at 0.7625, 0.7510 and 0.7410 as levels to accumulate the AUD, expecting the pair to hold above 0.7200, with a medium-term expectation of 0.8000.

We would look to accumulate AUD/USD around 0.7410-0.7625 levels

AUD/USD

Source: Bloomberg, Standard Chartered

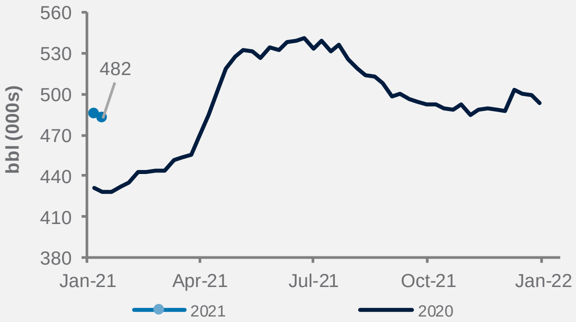
What is the outlook for oil prices after the latest OPEC+ meeting and recent Saudi actions?

We continue to expect higher WTI crude oil prices (around USD 60/bbl) over the next 6-12 months as the world emerges from the COVID-19 pandemic. While there is widespread optimism around the availability of vaccines, we would caution that current supply-demand balances matter more for oil markets. In our assessment, demand is the more important driver to monitor. A key development this week is the release of the Energy Information Administration (EIA) 2022 forecast, which suggests global oil demand should gradually recover to pre-pandemic levels by 2022 as global growth reaccelerates. Peak oil demand fears are largely overblown, in their view.

While inventories continue to be drawn down, we note gasoline demand remains subdued. The recent Saudi decision to restrict production has helped prop up front-end crude oil prices, but further price gains could be tough to come by if we do not see sustained drawdowns in global crude inventories. We would pay close attention to the pace of vaccine inoculation programmes and the trajectory of mobility restrictions over the coming weeks.

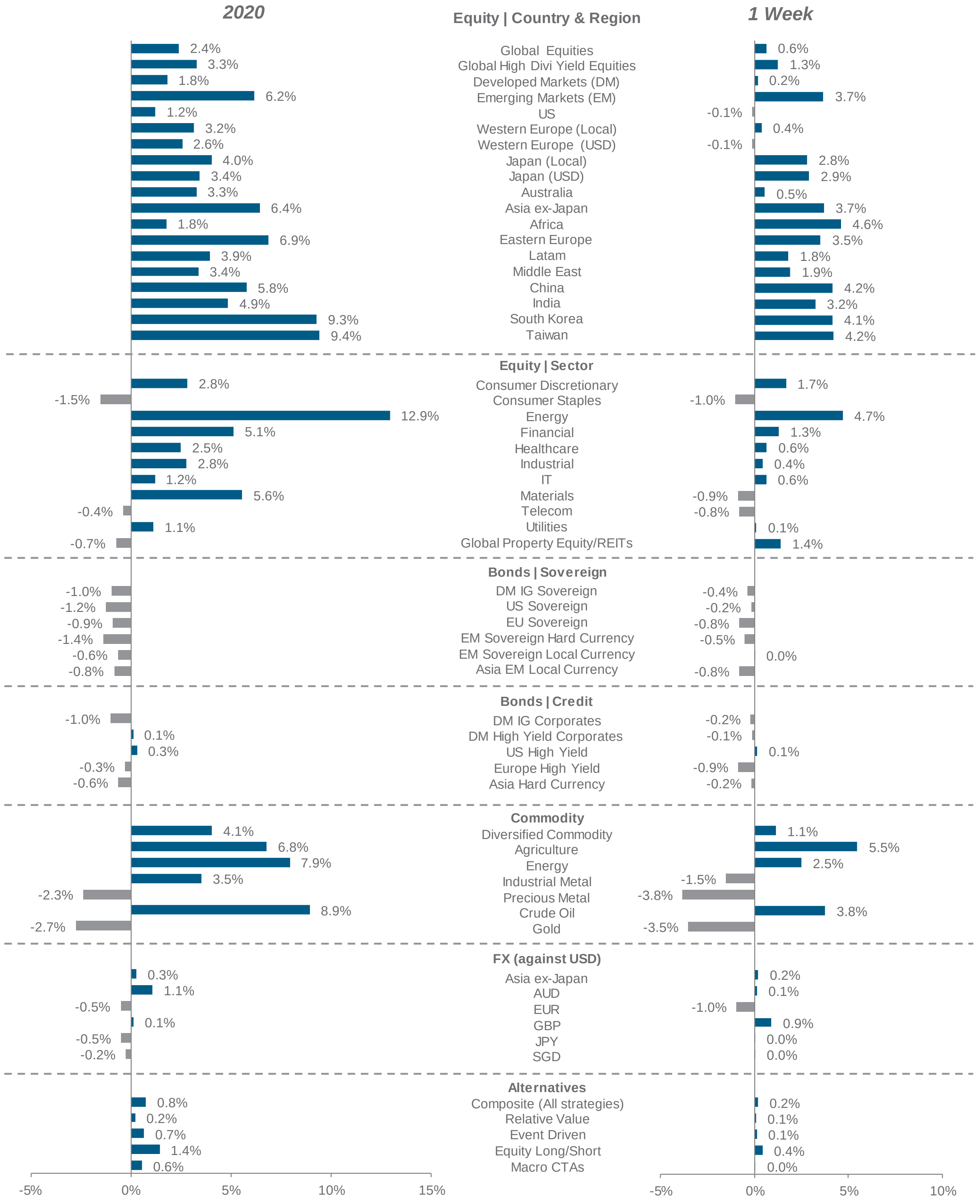
Sustained crude oil inventory drawdowns are necessary for further price gains

US crude oil inventory levels in 2020 and 2021



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; year-to-date performance from 31 December 2020 to 14 January 2021, 1 week period: 07 January 2021 to 14 January 2021

Our asset class views at a glance

Asset Class			
Equities	▲	**Alternatives**	◆
Asia ex-Japan	▲	Equity hedge	▲
US	▲	Event-driven	◆
Euro Area	▲	Relative value	◆
Japan	▲	Global macro	▼
Other EM	◆		
UK	◆	**Cash**	▼
		USD	▼
Bonds (Credit)	▲	EUR	▲
Asia USD	▲	GBP	▲
Govt EM USD	▲	AUD	▲
Corp DM HY	▲	CNY	▲
Corp DM IG	▼	JPY	◆
Bonds (Govt)	▼	**Gold**	◆
Govt DM IG	▼		
Govt EM Local	▲		

Source: Standard Chartered Global Investment Committee

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding

Economic and market calendar

	Event	Next Week	Period	Prior
MON	CH	GDP y/y	4Q	4.9%
TUE	EC	ZEW Survey Expectations	Jan	54.4
WED	UK	CPI y/y	Dec	0.3%
	US	US Presidential Inauguration	20-Jan	
THUR	EC	ECB Policy Rate (marginal lending facility)	Jan-21	0.25%
	JN	BOJ Policy Balance Rate	Jan-21	-0.1%
	US	Building Permits	Dec	1639k
	US	Housing Starts	Dec	1547k
FRI/SAT	JN	Jibun Bank Japan PMI Composite	Jan P	48.5
	EC	Markit Eurozone Composite PMI	Jan P	49.1

Source: Bloomberg, Standard Chartered

Prior data are for the preceding period unless otherwise indicated. Data are % change on previous period unless otherwise indicated

y/y - year-on-year, m/m - month-on-month

S&P500 has resistance 0.5% above current level

Technical indicators for key markets as on 14 Jan. 2021

Index	Spot	1st support	1st resistance
S&P500	3,796	3,786	3,815
STOXX 50	3,641	3,621	3,654
FTSE 100	6,802	6,741	6,868
Nikkei 225	28,698	28,325	28,885
Shanghai Comp	3,566	3,529	3,606
Hang Seng	28,497	28,084	28,703
MSCI Asia ex-Japan	897	889	901
MSCI EM	1,371	1,357	1,378
Brent (ICE)	56.4	55.9	56.8
Gold	1,849	1,843	1,854
UST 10Y Yield	1.13	1.09	1.16

Source: Bloomberg, Standard Chartered

Risk of a near-term trend reversal in some markets

Our proprietary market diversity indicators as of 13 Jan.

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.46
Global Equities	◐	↓	1.28
Gold	◐	↑	1.64
Equity			
MSCI US	◐	↓	1.36
MSCI Europe	◐	↓	1.34
MSCI AC AXJ	○	↓	1.22
Fixed Income			
DM Corp Bond	◐	→	1.42
DM High Yield	◐	↓	1.29
EM USD	◐	↓	1.53
EM Local	◐	→	1.27
Asia USD	◐	↓	1.73
Currencies			
EUR/USD	◐	→	1.38

Source: Bloomberg, Standard Chartered; **Fractal dimensions below 1.25 indicate extremely low market diversity/high risk of a reversal**

Legend: ● High | ◐ Low to mid | ○ Critically low

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