

Weekly Market View

Green shoots?

The broad-based rebound in risk assets this week reflects growing expectations of an economic and earnings recovery by year-end

Equities: Earnings estimates for 2020 are likely bottoming; we expect a recovery in 2021 earnings to drive the ongoing equity market rally

Bonds: Recent oil price-driven High Yield bond rally appears overdone; we prefer Emerging Market USD bonds

FX: EUR/USD jumped on the Merkel-Macron proposal for a EUR 500bn coronavirus recovery fund; the next resistance is at 1.1025

Green shoots

Also find out...

What are the implications of the latest US sanctions on China technology companies?

Is the Merkel-Macron agreement a game changer for the EUR?

How does oil's recovery impact US High Yield and Emerging Market bonds?

Chart of the week: Investors expecting a turnaround

Investors are anticipating a medium-term global growth recovery; this likely explains the possible bottoming of earnings forecasts

ZEW survey expectations of economic growth in 6 months



Consensus earnings growth estimates for 2020



Source: Bloomberg, Standard Chartered

Editorial

Green shoots?

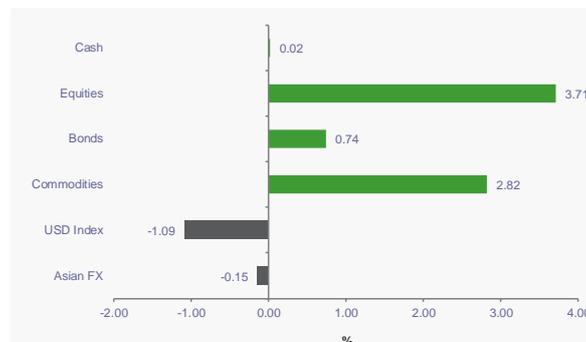
The broad-based rebound in risk assets this week – from equities to Emerging Market (EM) bonds, crude oil, the AUD and metals – reflects, in our view, a stabilisation in several key factors that we have been watching since COVID-19 turned into a global pandemic. These drivers include: 1) the continued decline in new infections in the US and Europe, enabling more regions to re-open (following China's restart since March), 2) promising vaccine tests (which follow previous reports of success of early stage trials of a drug cure), 3) pledges of more stimulus measures from policymakers worldwide (China's National People's Congress [NPC] being the latest), 4) tentative signs of a bottoming in corporate earnings expectations, and 5) rising hopes of a gradual move towards an EU fiscal union to support weak regional economies, following a pact between Germany's Merkel and France's Macron.

The last factor is likely behind Euro area equities' outperformance this week versus US stocks as well as EUR gains. The Merkel-Macron plan could be a potential game-changer for Europe, but only if it crosses several hurdles (see page 3).

There are other potential obstacles to the risk asset rally in the near term. US-China tensions ticked higher (see page 4 for new flashpoints). These geopolitical risks are likely to rise as the November US Presidential election approaches - countering China is a likely vote-winner (to the extent that it does not damage the US economy). There is also the risk of disappointments from COVID-19 vaccine and drug trials as well as on the ability of policymakers to revive economies and bring back lost jobs, given soaring debt, budget deficits and regulatory limitations. Then there is the risk of a second pandemic wave as economies relax restrictions. New daily cases are still rising in major EMs (India and Brazil).

Nevertheless, the positive turn in some forward-looking indicators suggest expectations of economic and corporate fundamentals have likely hit a bottom, with investors anticipating a recovery later this year. While US stocks have rallied, a broader turnaround is likely to benefit other risk assets, especially given still-high cash balances among institutional investors. We believe Asia ex-Japan stocks, EM and Asian USD bonds and the AUD are best placed to benefit from an upturn. Gold remains our preferred hedge, as volatility is unlikely to fade soon.

Global equities rose with other risks assets, including Emerging Market bonds and crude oil, and the USD fell amid expectations of economic recovery later this year
 Benchmark market performance w/w*



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

*Week of 14 May 2020 to 21 May 2020

S&P500 index is less than 1% from its first resistance

Technical indicators for key markets as on 21 May 2020

Index	Spot	1st support	1st resistance
S&P	2,949	2,832	2,972
STOXX 50	2,905	2,750	2,929
FTSE 100	6,015	5,748	6,071
Nikkei 225	20,579	19,847	20,690
Shanghai Comp	2,868	2,860	2,885
Hang Seng	24,280	23,651	24,470
MSCI Asia ex-Japan	609	595	613
MSCI EM	930	899	933
Brent (ICE)	36.2	31.3	36.8
Gold	1,729	1,731	1,745
UST 10Y Yield	0.67	0.60	0.68

Source: Bloomberg, Standard Chartered

Factors to watch

Merkel-Macron pact – a potential Euro area game changer?

The proposal by Germany and France to launch a EUR 500bn coronavirus recovery fund has the potential to cement the Euro area into a fiscal union. The announcement boosted Euro area stocks and the EUR this week (see page 4). A stronger fiscal union would likely help counter pressure from economically weaker members of the union, such as Italy and Spain, thus mitigating a key risk facing the currency union, which has historically undermined the EUR. Here, we assess the chances of the proposal taking off.

The strongest arguments that the proposal will succeed include: 1) Germany finally agreeing to a pan-European fund, financed from the EU's central budget, and distributed as grants to typically weaker member states. With French, Italian and Spanish support, the Euro area's four largest economies are already on board; 2) the EU directly issuing bonds, guaranteed by its own revenues (rather than of its member states). This would allay concerns about direct transfers from member state budgets. It would also reduce the average funding costs of weaker member states, given the EU's AAA debt rating.

The plan faces considerable challenges, though, including: 1) pushback from fiscally stronger EU members (Netherlands, Austria, etc.) which oppose fiscal transfers to member states through grants. These members prefer loans, with attached conditions that insist upon reforms in recipient states. As EU decisions need to be unanimous, we expect months of political negotiations ahead; 2) overcoming opposition to boost the EU federal budget to pay for the fund. While some of the increases would be met through proposed taxes on carbon emissions, financial transactions and e-commerce, it would also entail greater contributions from member states; 3) a proposed EUR 500bn seed fund, when distributed among member states, would be insignificant for individual member states unless it is leveraged substantially.

On balance, we believe the proposal has the potential to be a game-changer. However, there are significant political challenges to overcome.

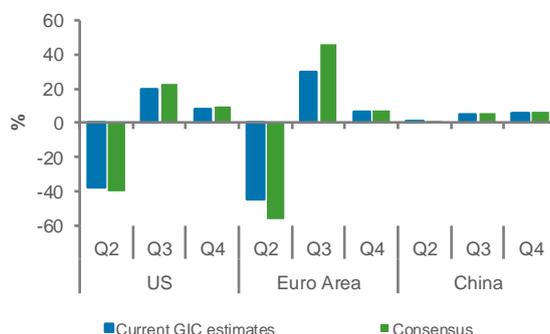
China signals more stimulus as tensions with the US rise

For the first time in history, China's parliament has not set a specific GDP growth rate target for 2020. It has set the unemployment target at c. 6% (versus 5.5% in 2019 and vs. official urban jobless rate peak of 6.2% in February). The NPC also indicated more fiscal stimulus, as it raised the budget deficit target and expanded the local government special bond quota. We believe the NPC's announcements also imply a faster pace of monetary stimulus, through further cuts to bank reserve requirements, lower interest rates and stronger credit growth in the coming months. Local governments have already begun issuing bonds to finance infrastructure projects. Those initiatives have started to filter through to the economy, with infrastructure investment accelerating in April.

Further stimulus measures should also help support investor sentiment amid renewed US-China tensions – the latest decision by the US to restrict equipment sales to Huawei, the passing of a Senate bill that bans foreign companies with ties to the government from listing on US stock markets and renewed tensions around Taiwan and Hong Kong. While we expect geopolitical tensions to rise in the run-up to the November Presidential election, we do not expect they will rise to a point that risks damaging the nascent prospects for an US economic recovery. Given this, we see any volatility as an opportunity to average into our preferred Asian assets – Asia ex-Japan and China equities and Asia USD bonds.

Euro area faces the largest growth contraction among major economies; this increases the urgency for EU leaders to build a stronger fiscal union

GDP growth estimates by our Global Investment Committee (GIC) versus market consensus (China estimates are y/y and US and Euro area are q/q SAAR)



Source: Bloomberg; Standard Chartered

EUR jumped vs. the safe-haven CHF this week from the Merkel-Macron plan to launch a EUR 500bn coronavirus recovery fund; the plan faces substantial political challenges

EUR/CHF and key technical levels



Source: Bloomberg; Standard Chartered

China's recovering bond yields reflect its relatively early return towards normalcy; we expect policymakers to work towards limiting any rise in yields

10-year government bond yields for the US, Germany and China



Source: Bloomberg, Standard Chartered

Top client questions

Q What are the implications of the latest US sanctions on Chinese technology companies?

On 19 May, the US Department of Commerce announced a tightening of restrictions on the sale of semiconductors to Chinese technology company Huawei and its affiliates on national security grounds. The announcement effectively extends the existing ban on the sale of semiconductors made in the US to Huawei and its affiliates to semiconductors made globally with US hardware.

The US and Chinese technology sectors are preferred, and we do not expect the announcement to have a significant impact on sector performance. The weight of the semiconductor industry group within the technology sector in China and the US is almost 20%. The largest industry group is hardware in the Chinese technology sector and software in the US.

YTD demand for semiconductors has been higher than expected, likely partially in anticipation of the US announcement. Although demand is likely to slow in H2 20, it is expected to be in line with full-year expectations. Looking ahead to 2021, analysts expect demand from other hardware suppliers and the transition to the next generation of logic chip technology (7 nanometre) to raise industry revenues.

Q Have corporate earnings expectations started to recover?

Consensus expectations are for US and Euro area earnings to decline -23 and -30% respectively in 2020, followed by a 30 and 35% recovery in 2021. To put the US number in context, at the start of the earnings season in mid-April, expectations were for a -4% cut in 2020.

How do we square the deterioration in earnings forecasts with the rally in the market since mid-April? Markets are driven by changes at the margin as opposed to actual events – in this case, earnings. While aggregate earnings continue to deteriorate, the number of analysts cutting earnings relative to those raising them, or the marginal change, started to turn in late March. This coincided with a rally in the market. To be clear, downgrades still exceed upgrades; hence, 2020 earnings are falling. However, on the margin, the decline in earnings is slowing, which is being interpreted positively by investors.

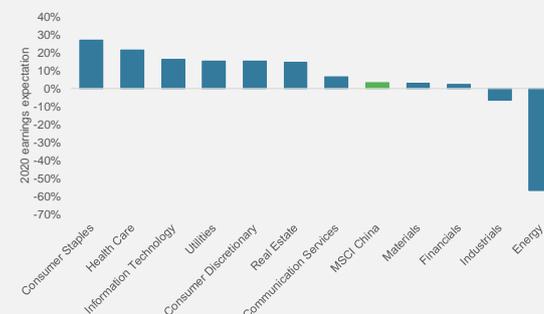
Looking ahead, we expect to see a resumption of earnings growth in 2021 in the US and Euro area as economies benefit from the unprecedented monetary and fiscal stimulus and the potential COVID-19 vaccine. While companies are reluctant to give guidance on the outlook, the rally in the market likely reflects investor expectations that the recession, while sharp, will be short lived.

Q Is the Merkel-Macron agreement a game changer for the EUR?

The outcome of the Merkel-Macron proposal is likely to be pivotal for the EUR. In the near term, optimism may prove to be enough to lift the EUR near-term, but significant political compromise will likely be needed to help the EUR shake off the shackles that have weighed on it since early 2018.

Expectations for China's technology sector earnings remain robust, despite growing restrictions facing the semiconductor sector from US regulations

Consensus 2020 earnings expectations of MSCI China sectors



Source: MSCI; FactSet; Standard Chartered

Consensus earnings estimates are likely bottoming in key equity markets; expectations of earnings recovery in 2021 should provide further support to the ongoing rally

Consensus 2020 earnings estimates for the S&P500, MSCI Euro area and MSCI China indices



Source: Bloomberg; Standard Chartered

Optimism around the Merkel-Macron proposal lifted the EUR this week; 1.1025 is a key resistance

EUR/USD



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

The technical landscape gives some clues to watch out for. The initial resistance around 1.1025 is the first hurdle to clear, and a sustained break suggests a downtrend challenge is under way with a focus on the 1.1410 level. However, a break below the 1.0725 support shifts the emphasis to a continuation of the downtrend, targeting 1.0635 initially, but risking a sell-off towards the 2016 low at 1.0340.

Brexit is another ingredient. The UK must decide by the end of June if it is to request a delay for further trade deal talks. A no-deal Brexit would almost certainly damage the economy of both parties, particularly the UK, but talks have been disappointing thus far.

Q Are the easy gains over for oil?

WTI crude oil prices (measured by front-end contracts) have rallied 16% over the past week. We believe this can be attributed to positive surprises in recent inventory data amid sharp output cuts. However, further gains in WTI crude oil prices from here may be more tough to come by without a significant improvement in demand.

We had previously outlined a roadmap to normalisation in our *Market Watch* (28 April 2020), where we noted both an inventory normalisation and end-user product markets recovery are likely needed for a sustained move higher in prices. In our view, while downward pressure on physical markets has been alleviated by recent developments, an excessive level of optimism may be baked in at current levels. We note that end-user inventories (ie, gasoline and distillates) continue to build.

Q What are the implications of oil's recovery on US HY and EM bonds?

- **US HY** – The recent increase in oil prices have been a big positive for US HY bonds, especially the energy sector. Yield premiums have declined nearly 1,200bps from their recent peak. However, given that most estimates suggest that the breakeven price for most shale oil producers hovers around USD 40-50/bbl, the sector may remain under stress, in our opinion. This suggests the recent rally might be overdone, especially as defaults rise. Therefore, we continue to view DM High Yield (HY) bonds as a core holding amid what we see as a balanced risk/reward trade-off.
- **EM USD government bonds** – As the share of energy exporters in the EM USD government bond universe has increased following the inclusion of bonds from the Middle East (Gulf Cooperation Council countries), we view the recent rise in oil prices as a clear positive for the asset class. While current oil prices are still well below fiscal breakeven levels, higher oil prices still reduce the stress on some HY-rated oil producing countries.

Meanwhile, while higher oil prices are a marginal negative for oil importers, we believe the positive impact on exporters outweighs this. Additionally, recent comments from multilateral organisations, such as the World Bank, urging developed countries to offer debt moratoriums on loans to poor countries, is a positive for the most vulnerable EM countries. While bond issuance has risen, as countries try to finance fiscal spending in the absence of oil revenues, recent signs that fund flows might be returning to EMs could help support the demand-supply balance.

EUR/GBP has gained in recent weeks from renewed Brexit uncertainty as the 30 June deadline for the UK to request for a delay in trade talks approaches

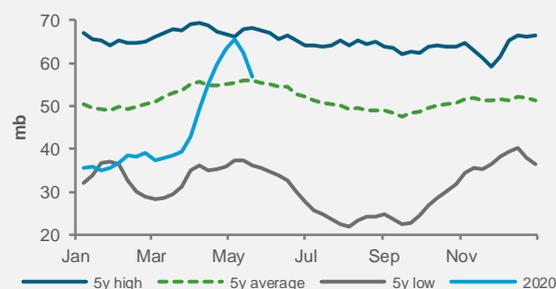
EUR/GBP



Source: Bloomberg; Standard Chartered

US crude oil inventory (Cushing, Oklahoma) has started to decline amid output cuts, lifting oil prices lately

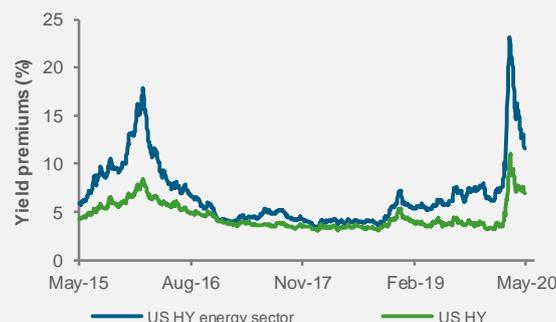
Cushing, Oklahoma crude oil inventory vs. historical average



Source: Bloomberg; Standard Chartered

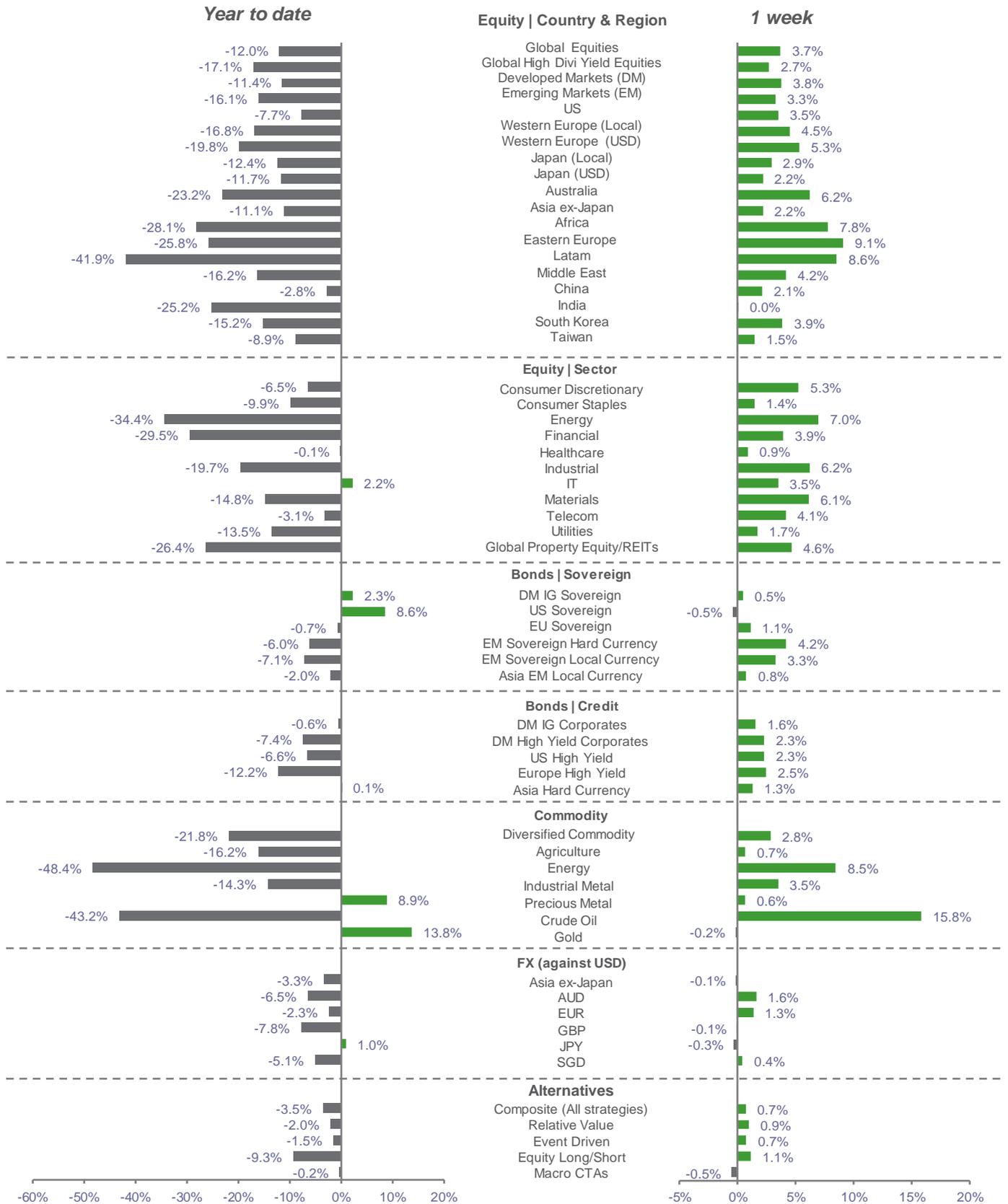
Recent gains in oil prices have significantly reduced yield premiums on US energy sector High Yield bonds

Yield premiums on US HY bonds and energy sector bonds



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 21 May 2020, 1 week period: 14 May 2020 to 21 May 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	GE	IFO Expectations	25-May-2020	May	–	69.4
TUE	US	Conf. Board Consumer Confidence	26-May-2020	May	87	86.9
	US	New Home Sales	26-May-2020	Apr	500k	627k
WED	CH	Industrial Profits y/y	27-May-2020	Apr	–	-34.9%
	GE	Retail Sales NSA y/y	27-May-2020	Apr	–	-1.2%
THUR	GE	CPI EU Harmonized y/y	28-May-2020	May P	–	0.8%
	US	Durable Goods Orders	28-May-2020	Apr P	-18.0%	-14.7%
	US	Cap Goods Orders Nondef Ex Air	28-May-2020	Apr P	–	-0.1%
FRISAT	JN	Industrial Production y/y	29-May-2020	Apr P	–	-5.2%
	EC	M3 Money Supply y/y	29-May-2020	Apr	–	7.5%
	EC	CPI Core y/y	29-May-2020	May P	–	0.9%
	IN	GDP y/y	29-May-2020	1Q	0.5%	4.7%
	US	Personal Income	29-May-2020	Apr	-6.8%	-2.0%
	US	Real Personal Spending	29-May-2020	Apr	–	-7.3%

	Event	This Week	Date	Period	Actual	Prior
MON	JN	GDP Annualized SA q/q	18-May-2020	1Q P	-3.4%	-7.3%
TUE	UK	Average Weekly Earnings 3m/y/y	19-May-2020	Mar	2.4%	2.8%
	EC	ZEW Survey Expectations	19-May-2020	May	46.0	25.2
	US	Building Permits	19-May-2020	Apr	1074k	1356k
	US	Housing Starts	19-May-2020	Apr	891k	1276k
WED	EC	ECB Current Account SA	20-May-2020	Mar	27.4b	37.8bb
	UK	CPI Core y/y	20-May-2020	Apr	1.4%	1.6%
	EC	Consumer Confidence	20-May-2020	May A	-18.8	-22.0
THUR	US	Philadelphia Fed Business Outlook	21-May-2020	May	-43.1	-56.6
	US	Markit US Composite PMI	21-May-2020	May P	36.4	27
	US	Leading Index	21-May-2020	Apr	-4.4%	-7.4%
	US	Existing Home Sales	21-May-2020	Apr	4.33m	5.27m
FRISAT	FR	Markit France Composite PMI	22-May-2020	May P	–	11.1
	GE	Markit/BME Germany Composite PMI	22-May-2020	May P	–	17.4
	EC	Markit Eurozone Composite PMI	22-May-2020	May P	–	13.6

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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