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Wealth Management Chief Investment Office
6 August 2021

Weekly Market View

Hawks on the horizon

Monetary policy hawks have selectively started to appear along the horizon. Several Emerging Market and commodity exporter central banks have started to taper bond purchases or raise policy rates.

Recent signals from Fed policymakers support our expectation of a tapering announcement later this year. This risks triggering temporary market volatility, but strong growth and earnings data give us confidence to buy US and European equities on any such dips and sell into USD rallies.

Equities: We prefer energy and industrial sectors in China as well as sub-sectors consistent with policy goals and our long-term investment themes

Bonds: The 10-year Treasury yield would need to break above 1.32% for downward pressure to reverse.

FX: EUR/USD may re-test support at 1.1685-1.1750 before a break above 1.20 signals a resumption of the long-term rally.

Are US Treasury bond yields set to rebound?

Is the worst over for Chinese equity markets?

What is the outlook for the AUD and NZD?

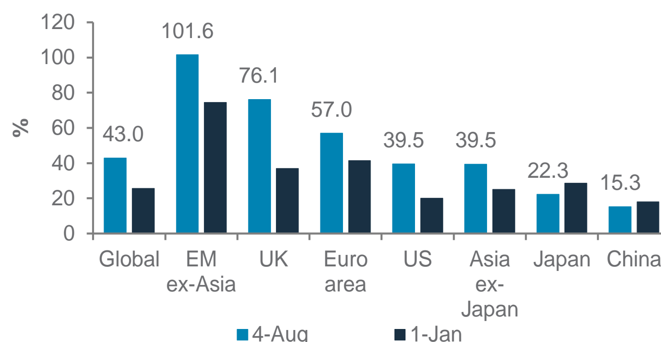
Important disclosures can be found in the Disclosures Appendix.

Charts of the week: Normalising at a strong level

Economic surprises have now largely normalised, but economic and earnings growth remain at very strong levels

US economic surprises

2021 consensus earnings growth*; start of year vs today



Source: Bloomberg, FactSet, Standard Chartered; * MSCI equity indices

Editorial

Talking about tapering

Monetary policy hawks have selectively started to appear along the horizon. While major central banks have remained highly accommodative, Brazil's central bank raised policy rates sharply, Australia's RBA proceeded to taper bond purchases despite renewed COVID-19 restrictions and New Zealand's central bank could hike rates within the year. Could these moves be a microcosm of the future path of policy elsewhere?

For Europe's ECB and China's PBoC, we believe such concerns remain premature. The ECB strategy refresh argues for a greater focus than before on achieving sustainably higher inflation, while the PBoC has started easing policy.

For most investors, it is the direction of the US Fed policy that is key. Here, recent messages have been more balanced. Following the last Fed policy meeting at the end of July, Fed Chair Powell noted that the US economy had made "progress", though he balanced that by noting the jobs market still had "some ground to cover". Fed Vice-Chair Clarida this week added that he would support a tapering announcement later this year should the economy continue to progress as expected.

For investors, there is understandably some concern that a tapering announcement by the Fed could cause a wobble in risky assets. The August to October period has been seasonally weak for equities, COVID-19 cases are rebounding in many major economies and some data argue long US equity positioning is elevated.

However, we take a more balanced view. While some temporary volatility around a tapering announcement is possible, very strong economic and earnings data remain a positive counterbalance. For example, PMI data this week showed services activity jumped in most major economies, while manufacturing activity, though off its peaks, remains at very high levels. A continuation of current trends would mean US earnings growth ends up surprising positively by double digits for a fifth consecutive quarter.

Against this backdrop, upcoming US labour market data is likely to be key. Several Fed policymakers have argued that continued "progress" here will be a key input to whether they support a tapering announcement later this year. Payroll data that achieves or exceeds consensus is likely to strengthen the case for a Fed tapering announcement later this year.

A Fed tapering announcement this year, with actual tapering starting in 2022, remains our base case. The late-August Jackson Hole symposium and September Fed policy meetings are likely to be key upcoming dates in this regard.

From an investment point of view, we would be prepared to buy on any dips in our preferred equity markets (Europe and the US) and to sell into short-term USD rallies. The outlook for equities tends to be positive as long as growth remains well-supported, with buy-on-dips strategies working well.

In Chinese equities, which we view as a core holding, we favour a more nuanced approach. We note that the technical outlook for onshore equities has started to improve in recent days. A reduction in the tone and intensity of regulatory tightening could create a broader buying opportunity. For now, though, our sector preferences are focused on energy, industrials and technology sub-sectors consistent with policy priorities and our long-term themes, such as electric vehicles or 5G.

More broadly, we favour taking advantage of the pullback in Asian High Yield bonds as an alternative route to China exposure, given inexpensive valuations and an attractive yield to help ride through any further short-term volatility.

— Manpreet Gill

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as neutral for risk assets

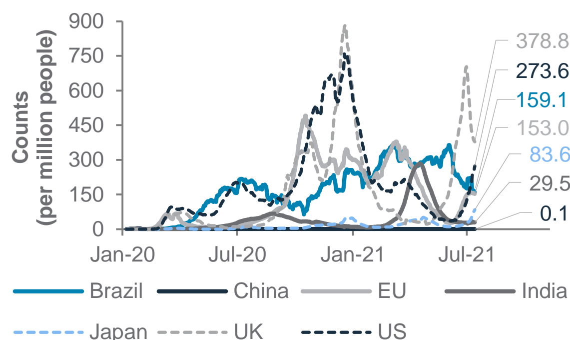
(+) factors: Contained UK hospitalisation rates, improving services PMIs

(-) factors: Falling manufacturing PMIs, some hawkish central banks

	Positive for risk assets	Negative for risk assets
COVID-19	• UK hospitalisation rate remains contained despite prior sharp rise in COVID-19 cases	• New cases continue to rise in many parts of Asia, Europe, the US and India • China imposed travel restrictions across a number of cities to help contain recent outbreaks
	Our assessment: Neutral – Renewed rise in Delta variant infections balanced by success thus far of the UK approach	
Macro data	• US ISM services rose to 64.1 in July • China's Caixin PMI services rose to 54.9 in July • Euro area PMI manufacturing rose to 62.8 in July	• US ISM manufacturing fell to 59.5 in July • Euro area retail sales rose less than expected, by 1.5% m/m, in June • China's Caixin PMI manufacturing fell to 50.3 in July
	Our assessment: Neutral – PMI services rising in most regions, but PMI manufacturing easing from their highs	
Policy developments	• Fed Vice-Chair Clarida said he would support tapering if economy continued to progress as expected • Bank of England to reduce stock of purchases assets when bank reaches 0.5% (from 1.5% earlier)	• Fed Governor Waller favoured tapering if next two payroll reports added in the range of 800k jobs • Australia's RBA started tapering bond purchases • Brazil's central bank hiked rates by 100bps
	Our assessment: Neutral – Taper discussion and tightening, but based on economic improvements	
Other developments		• Chinese state media called for greater curbs on the online gaming industry
	Our assessment: Negative – China regulatory policy tightening	

COVID-19 case counts re-accelerating in many major economies; hospitalisation rates likely to be key to any policy response

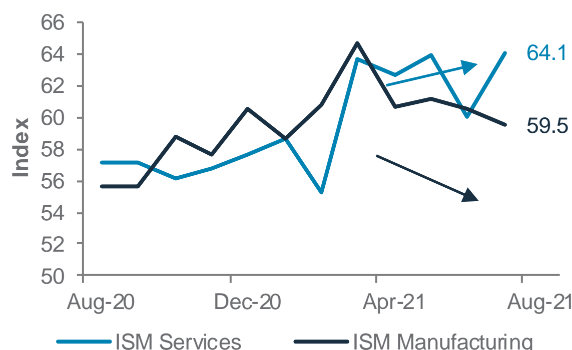
COVID-19 cases per capita



Source: Our World in Data, Standard Chartered

Service activity has accelerated in recent months. Manufacturing easing off peaks, but remains at very high levels

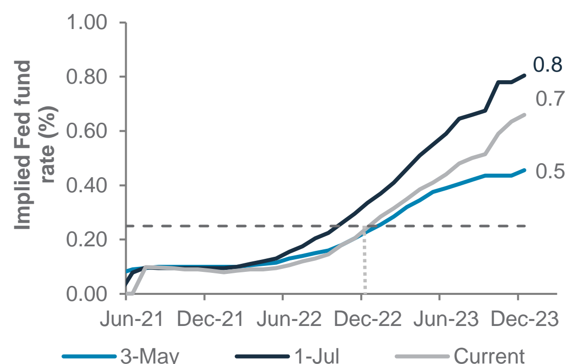
US ISM indices



Source: Bloomberg, Standard Chartered

Markets currently expecting the first Fed rate hike to occur in December 2022

US money market pricing of Fed policy rates



Source: Bloomberg, Standard Chartered

Top client questions

What does regulatory pressure mean for the outlook for Chinese equities?

We currently view Chinese equities (both onshore and offshore) as a core holding and would need to see an easing in the tone and intensity of regulatory tightening before considering turning more constructive.

The new rules imposed on a number of industries are consistent with China's long-term agenda outlined in the 14th Five-Year Plan, which includes expectations for the private sector to contribute more towards social equality. With the shift in economic policy, from setting annual economic growth targets to multi-year planning, policymakers appear more willing to tolerate near-term market volatility in exchange for long-term benefits. Past experiences suggest such regulatory overhang could last another 6 to 12 months.

Having said that, the recent shift in stance from curbing "excessive" credit growth to stabilising growth should help support sentiment and market liquidity.

Within Chinese equities, energy and industrials remain our preferred sectors, both of which are less sensitive to current regulatory pressures. Moreover, within Growth stocks, we would also consider sub-sectors such as electric vehicles, 5G and semiconductors, which are consistent with both policy priorities and our long-term investment themes.

— **Daniel Lam, CFA,** *Senior Investment Strategist*

China technology, real estate sectors continue to follow shallower path post regulatory pressure relative to Macau Gaming in 2014-2016

Relative performance of sector baskets* relative to HSI Index from onset of regulatory pressures

Source: Bloomberg, Standard Chartered
* Each basket consists of equally-weighted HK-listed stocks aiming to provide approximate sector representation: 1) Macau: Galaxy, Sands, 2) China internet: Tencent, Alibaba, JD.com, NetEase, 3) China property: COLI, CR Land, Vanke, Country Garden.

Do technicals argue the worst is over for China equities?

For onshore China equities (CSI 300 index), there is a rising probability that the worst could be over. However, technicals are not yet as convincing for the MSCI China index.

Positive momentum divergence on the weekly charts of the CSI 300 index (lower index prices associated with a higher Stochastic indicator) and the failure to extend the decline this week raise the odds that the end-July slide was a 'capitulation' – what typically occurs at the end of a trend – of the downtrend that began in February. Any break above the 200-DMA (now at 5130; 3.7% above Thursday's close) may suggest the worst is behind us.

Having said that, it is too soon to conclude the same for the MSCI China index, even though the index is holding above major support on the 200-WMA. To be fair, this does not imply that the outlook is bearish – but it would likely need a break above the May low of 102 to raise the likelihood that the MSCI China index is out of the woods. This argues while it may be early to take a strong directional view, strategies that seek to sell the elevated level of volatility to generate a yield may offer an attractive risk/reward.

— **Manish Jaradi,** *Senior Investment Strategist*

China CSI 300: Is the worst over?

CSI 300 index Weekly chart with Stochastics

Source: Refinitiv, Standard Chartered

Top client questions (cont'd)

What are the investment implications from the latest US earnings season?

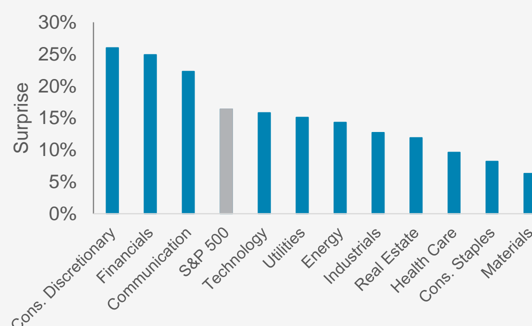
85% of companies in the S&P500 index have reported earnings, which have surprised to the upside by 16%, based on data from Refinitiv. The positive earnings surprise has been broad-based, and 88% of the reported companies have beaten earnings expectations. Sectors showing the biggest earnings surprise to date are consumer discretionary, financials and communication services. Besides earnings, reported revenue has also surprised to the upside by 5%, with broad strength across sectors. The energy sector has shown the biggest revenue surprise to date.

Q2 is expected to show the biggest earnings growth in the US this year at 93% due to a low base. Earnings growth is expected to slow down to 30% for Q3 and 22% for Q4. FY21 earnings expectations have been revised higher since the start of the earnings season to 45% (for the S&P500) and 39.5% (for the MSCI US index). This strong revision supports our preferred view of US equities. Sector wise, our preference for the financials and energy sectors are also supported by the positive surprises seen to date.

— **Fook Hien Yap,** *Senior Investment Strategist*

Most sectors delivered double-digit positive earnings surprises in Q2

S&P500 Q2 2021 earnings growth surprise by sector



Source: Refinitiv, Standard Chartered

What is the outlook for the USD, AUD and NZD?

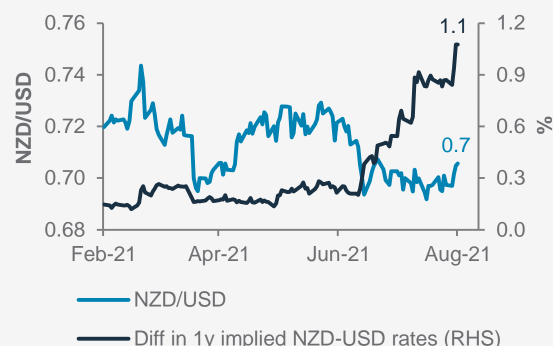
We see scope for USD strength over the coming few weeks, but expect it will stay below its 2021 highs before the medium-term USD downtrend reasserts. The key drivers through the Jackson Hole central bank symposium this month are likely to be competing narratives around the Fed policy, US Treasury yields and risk sentiment. EUR/USD may re-test technical support at 1.1685–1.1750 before the long-awaited rally is signalled by a sustained break above 1.20.

We also expect divergence between non-USD currencies to be driven by domestic economic performance and monetary policies. The NZD and AUD are a good example. New Zealand's economy is strong, unemployment is low and house prices are rising fast. The Reserve Bank of New Zealand looks set to hike rates possibly as soon as this month. Meanwhile, Australia faces lockdown headwinds and Chinese growth concerns. The RBA may taper bond buying slowly, with any imminent rate hikes unlikely.

AUD/USD should consolidate and remain above 0.7230 support, but only a break above key technical resistance around 0.7600 would signal a medium-term rally. NZD/USD is already close to breaking above key 0.7100 resistance and should stay above the 0.6875 near-term support. While we remain bullish on both currencies vs the USD over a 6-12-month horizon, we expect AUD/NZD to face downward pressure in the near term.

Future interest rate differentials point to further NZD gains ahead

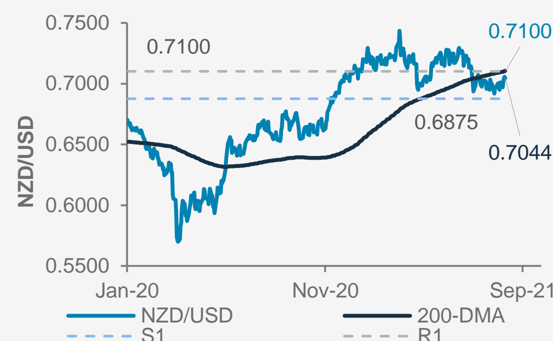
NZD/USD and difference in implied 1y interest rates



Source: Bloomberg, Standard Chartered

A break above key resistance at 0.71 should improve the technical outlook

NZD/USD



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Are US Treasury yields set to rebound from here?

10-year US Treasury yields have continued to decline over the past few weeks, despite the modestly hawkish statements from a number of Fed policymakers. In the near term, we believe several key factors can keep bond yields capped:

1. Lower supply expectations: Recently, the US Treasury guided towards a large reduction in supply in Q3. Given the increasing odds of smaller-than-announced fiscal stimulus package, market expectations of 2022 supply are being revised lower, consistent with higher prices (lower yields).
2. Resurgent COVID-19 concerns: The rapid rise in Delta variant-linked cases has increased economic uncertainty and likely spurred demand for safe-haven assets, such as US Treasuries. The safe-haven demand may persist until current concerns plateau.
3. Deceleration in economic data: While still strong on an absolute basis, US economic data has decelerated from elevated levels and disappointed market expectations.
4. Positioning unwind: The decline is yields may also be partly driven by short-covering. Multiple investor positioning indicators show that the short positioning has declined substantially. Hence, we believe bulk of the positioning normalisation is likely behind us.

From a technical standpoint, the 10-year yield would need to break above immediate resistance at the 22 July high of 1.32% for the downward pressure to reverse. A failure to do so would keep the possibility of a test of the psychological 1.00% mark alive.

However, on a longer horizon, our continued optimism on US economic growth leads us to believe that 10-year US Treasury yields should eventually rebound to 1.75%-2.0% over the next 12 months. Hence, we continue to prefer shorter maturity corporate bonds, as they are likely to be less negatively impacted by the eventual rise in yields. We would use the current decline in yields as an opportunity to rotate into our preferred areas, such as DM HY corporate bonds and Asian USD bonds, which we believe offer attractive risk-reward.

— **Abhilash Narayan,** *Senior Investment Strategist*

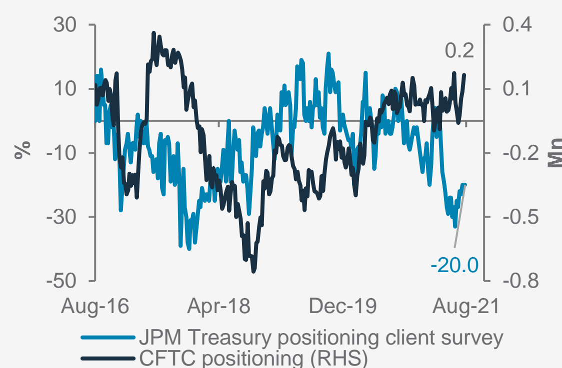
Falling economic surprises partly explain the pullback in US Treasury yields

10-year US Treasury yield and US economic surprise index

Source: Bloomberg, Standard Chartered

Investor positioning on US Treasury bonds appears to have come off its extremes

US Treasury investor positioning data; 10-year (CFTC) and all Treasury bonds (JP Morgan)



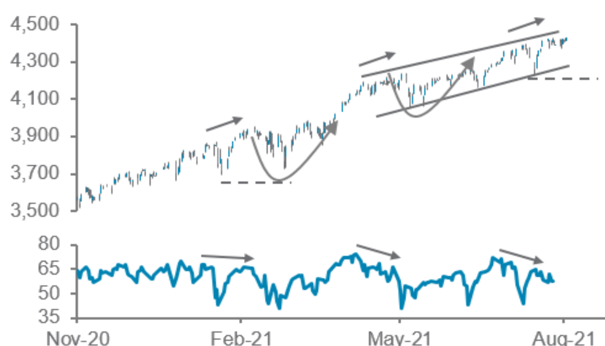
Source: Bloomberg, Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

S&P500: Signs of short-term fatigue

S&P500 index daily chart with Relative Strength Index (RSI)

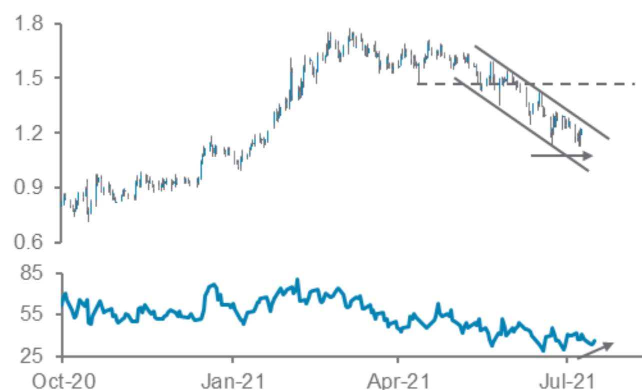


Source: Refinitiv, Standard Chartered

> There are some signs of short-term fatigue on the daily charts of the S&P500 index. Going by the past, a minor pause/retreat would not be surprising. Only a break below immediate support at 4,233 would imply that the short-term upward pressure had faded.

US 10-year Treasury yield: A pause in the slide?

US 10y Treasury yield daily chart with 200-DMA and Relative Strength Index (RSI)

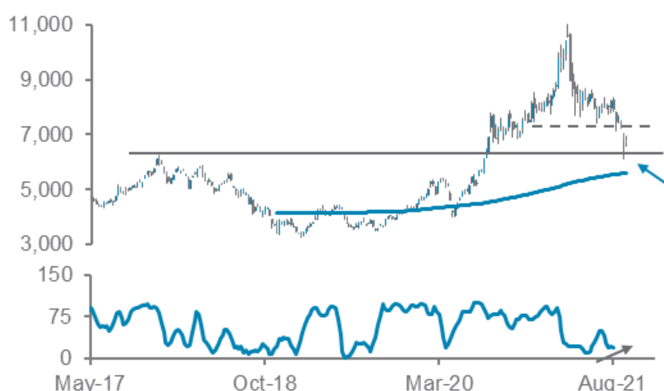


Source: Refinitiv, Standard Chartered

> A positive divergence on the daily charts of the US 10-year Treasury yield indicates that the slide is losing steam. However, the yield would need to break above resistance at 1.32% for the downward pressure to ease. 1.46%-1.50% remains a tough barrier to crack.

HSI Technology: Holding above strong support

Hang Seng Technology index weekly chart with 200-WMA and Stochastics

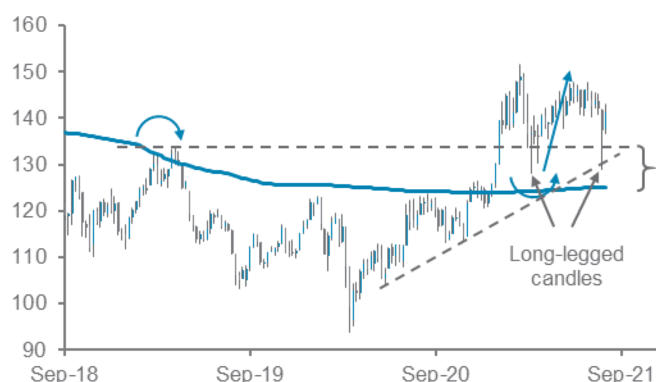


Source: Refinitiv, Standard Chartered

> The Hang Seng Technology index's slide is losing steam as it tests major support (the 200-WMA and the 2017 high). While it is too soon to conclude that it is out of the woods, the hold above the support is encouraging for bulls. Still, a break above 7,750 is needed for the downward pressure to fade.

China Industrials: Resilient in the face of adversity

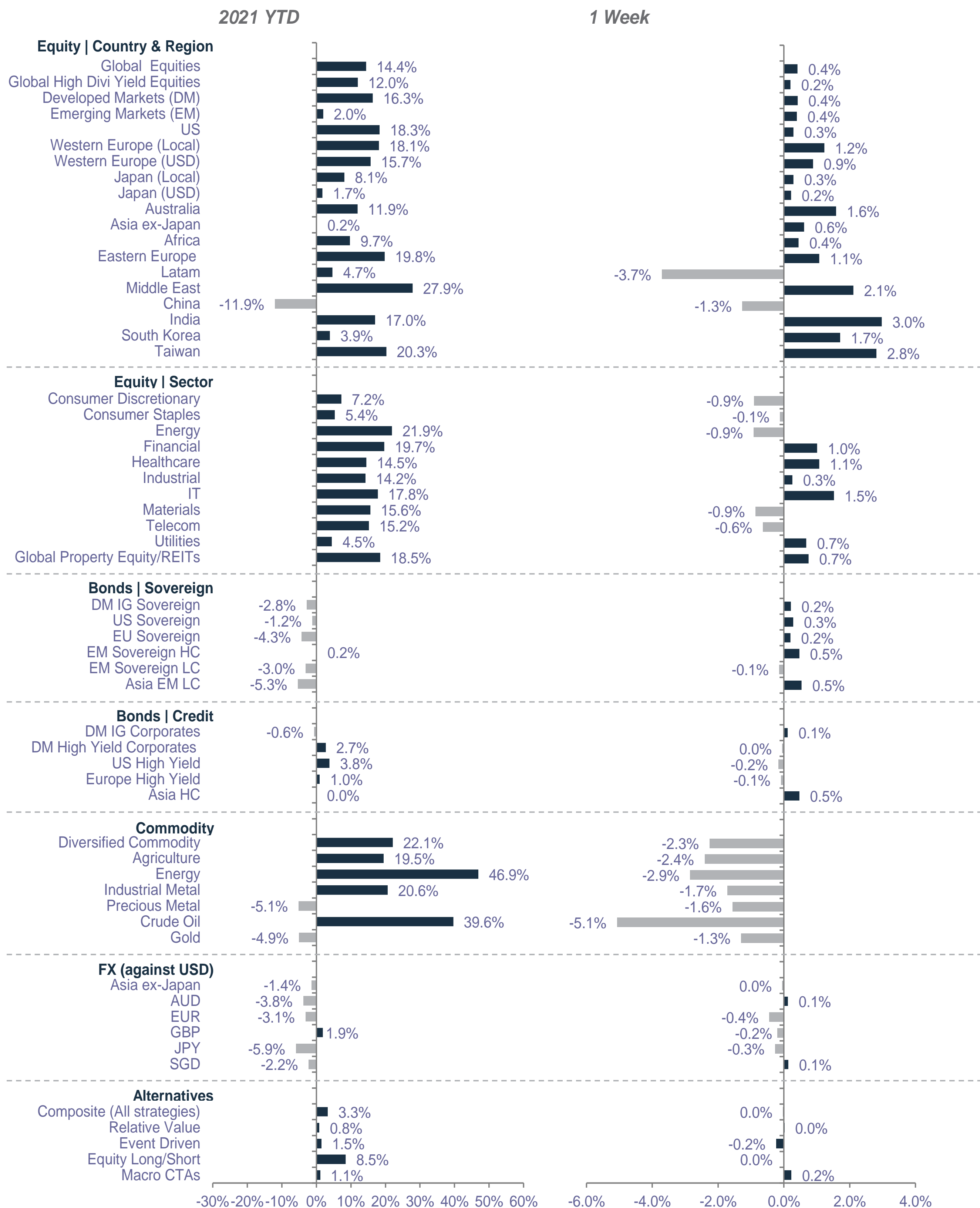
MSCI China Industrials sector index Weekly chart with 200-WMA



Source: Refinitiv, Standard Chartered

> The rebound from the strong support area is an indication that this year's sideway, albeit broad range, is a pause in the uptrend that began in early 2020, and not a reversal. Importantly, the index is holding above the long-term average, unlike the last time in 2019.

Market performance summary *



Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

*Performance in USD terms unless otherwise stated, 2021 YTD performance from 31 December 2020 to 5 August 2021; 1-week period: 29 July 2021 to 5 August 2021

Our asset class views at a glance

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

Source: Standard Chartered Global Investment Committee

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

Economic and market calendar

	Event	Next week	Period	Prior
MON	CH	CPI y/y	Jul	1.1%
	CH	PPI y/y	Jul	8.8%
	GE	Exports SA m/m	Jun	0.3%
	EC	Sentix Investor Confidence	Aug	29.8
TUE	JN	BoP Current Account Adjusted	Jun	¥1866.5b
	EC	ZEW Survey Expectations	Aug	61.2
WED	US	CPI Ex Food and Energy y/y	Jul	4.5%
THUR	UK	GDP y/y	2Q P	-6.1%
	IN	CPI y/y	Jul	6.3%
FRI/SAT	US	U. of Mich. Sentiment	Aug P	81.2

Source: Bloomberg, Standard Chartered
Prior 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

S&P500 has first support 0.2% below current level

Technical indicators for key markets as on 5 August 2021

Index	Spot	1st support	1st resistance
S&P500	4,429	4,401	4,443
STOXX 50	4,161	4,113	4,185
FTSE 100	7,120	7,061	7,152
Nikkei 225	27,728	27,414	27,912
Shanghai Comp	3,467	3,417	3,497
Hang Seng	26,205	25,968	26,434
MSCI Asia ex-Japan	835	824	843
MSCI EM	1,300	1,284	1,310
Brent (ICE)	71.3	69.0	75.0
Gold	1,803	1,800	1,811
UST 10Y Yield	1.23	1.19	1.24

Source: Bloomberg, Standard Chartered

Investor diversity has normalised across assets

Our proprietary market diversity indicators as of 4 August

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.46
Global Equities	◐	↑	1.47
Gold	●	↑	1.72
Equity			
MSCI US	◐	→	1.41
MSCI Europe	◐	↑	1.40
MSCI AC AXJ	●	→	1.61
Fixed Income			
DM Corp Bond	◐	→	1.40
DM High Yield	●	↑	1.55
EM USD	◐	→	1.40
EM Local	●	↑	1.68
Asia USD	●	→	1.68
Currencies			
EUR/USD	●	→	1.55

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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