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Wealth Management Chief Investment Office
20 August 2021

Weekly Market View

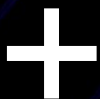
Is Fed tapering really a risk?

Risk assets wobbled and stock market volatility jumped as Fed meeting minutes showed most policymakers want to start tapering bond purchases this year. Should investors be worried? While the minutes surprised markets, given prior expectations of an early 2022 tapering start, we do not see a slightly earlier tapering imparting a lasting drag on risk assets.

Equities: European companies significantly beat Q2 earnings expectations, leading to upward revisions of H2 earnings estimates. This supports our preference for the region's equity market.

Bonds: We believe Asian High Yield USD bonds are pricing in excessively high default risk. Hence, we view the bonds as attractive, given the risk-reward balance.

FX: We expect GBP/AUD to rise towards 1.94, and then to 2.00, amid widening economic and policy fundamentals and supportive technical indicators.



What are the key takeaways from the latest earnings season in Europe?

Should we be worried about rising bond defaults in China?

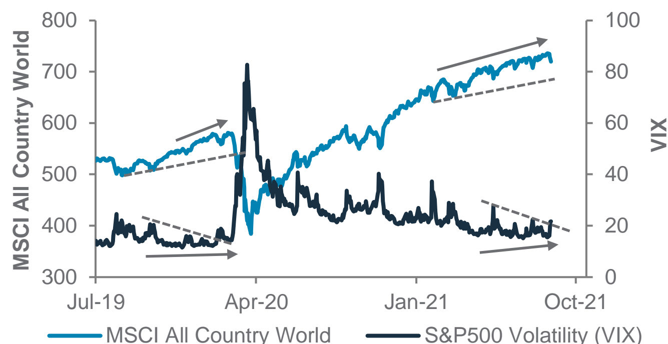
What are the charts saying about European and China stocks and USD/CNH?

Important disclosures can be found in the Disclosures Appendix.

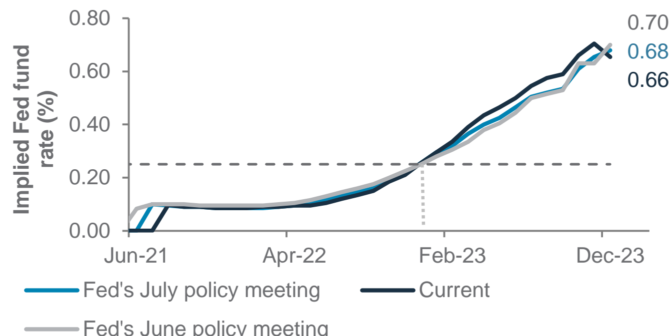
Charts of the week: Fed to stay accommodative for extended period

Fed tapering could cause near-term volatility, but low policy rates are likely to keep supporting risk assets for some time

MSCI All Country World equity index; S&P500 volatility index



Money markets estimate first Fed policy rate hike in early 2023



Source: Bloomberg, Standard Chartered

Editorial

Is Fed tapering really a risk?

Risk assets wobbled and stock market volatility jumped as Fed meeting minutes showed most policymakers want to start tapering bond purchases this year. Should investors be worried? While the minutes surprised markets, given prior expectations of an early 2022 tapering start, we do not see a slightly earlier tapering imparting a lasting drag on risk assets.

First, the Fed will taper from a position of strength. The US economy is likely to grow well above trend over the coming year on the back of strong services consumption as households pare down pent-up savings and businesses rebuild inventory (the consensus estimates 4.2% GDP growth in 2022 following a 6.5% rise this year). The US job market has healed significantly since last December when policymakers promised to wait till there was "substantial further progress" in job creation before they considered tapering (since that December statement, the total number of jobs lost since the pandemic has been cut by half). At the current pace of job gains, the US unemployment rate is likely to fall below 5% by end-2021 and well below the Fed's long-run 4% unemployment rate target by end-2022. When the Fed last started to taper bond purchases in November 2013, the unemployment rate was 6.9%.

Second, we believe the Fed will retain the option to alter the timing and pace of tapering if it perceives any financial stability risk (having achieved its inflation target) or if the recovery slows due to COVID-19 resurgence. We have seen repeatedly that the Fed does not want to upset the stock market through its policy moves. That suggests it will only tighten policy when it is certain that the market is ready for it. Clear messaging will be vital here as any missteps could be punished by markets.

Third, tapering is not the same as hiking interest rates. We believe the latter matters more to risk assets in the medium term. The Fed's greater tolerance for inflation means US policy rates are likely to remain well below the inflation rate for at least the next 12 months. This, in our view, remains a key driver of continued outperformance of stocks over bonds.

Thus, we believe any announcement of tapering – possibly at the Fed's Jackson Hole summit next week or at the September policy meeting – is likely to create only a temporary bout of market volatility. We would use any such dip to add exposure to risk assets, especially to US and European stocks that are benefitting from a relatively faster pace of vaccinations (leading to early economic reopening and strong upgrades to corporate earnings estimates). The MSCI Europe index, which is heavily weighted towards Value sectors which are likely to gain the most from the recovery in growth and bond yields, has strong momentum (see pages 4, 6). In bonds, Developed Market High Yield bonds and Emerging Market debt is preferred due to attractive yields and as likely beneficiaries of a global recovery.

Asian USD High Yield bonds are particularly attractive, with default risks largely priced in after the latest sell-off, amid signs that China's policymakers are starting to stabilise growth (see page 4). We expect local governments to accelerate targeted infrastructure spending for the rest of the year. The provinces have sizeable ammunition to do so, given that they have used up barely half of their yearly bond issuance quota. While regulatory pressures on some online and property sectors are likely to remain in the run up to next year's Party Congress, as authorities focus on social and income redistribution, this is unlikely to come in the way of sustaining healthy economic growth, especially in the manufacturing and hi-tech sectors that are crucial to China's global leadership. Thus, the industrial and energy equity sectors are preferred areas for adding exposure in China apart from the excessively beaten down USD bonds.

— Rajat Bhattacharya

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

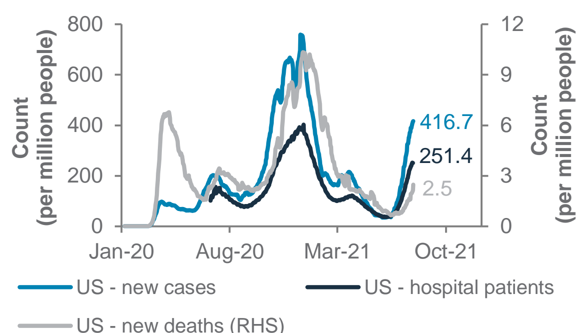
(+) factors: UK COVID-19 vaccine efficacy, strong US industrial output

(-) factors: Rising COVID-19 cases, risk of Fed tapering from this year

	Positive for risk assets	Negative for risk assets
COVID-19	• The UK hospitalisation rate stayed at levels well below prior waves despite a rebound in new cases • Vaccinations continue to rise steadily globally; 50% of US population, 55% of Europe are fully vaccinated • The US to provide a third booster shot later this year	• US hospitalisations, new cases continued to surge; new cases continue to rise in parts of Asia, Europe and Australia • Cases, hospitalisations in widely-vaccinated Israel continued to surge • China maintained travel restrictions to curb outbreak
	Our assessment: Neutral – Vaccine efficacy in the UK vs. a continued rise in new infections	
Macro data	• US initial jobless claims fell below expectations and industrial production rose more than expected • German wholesale prices rose less than expected • Japan's Q2 GDP rose more than expected (0.3% q/q) • UK's consumer inflation slowed unexpectedly	• US retail sales, housing starts, consumer sentiment fell more than expected • China's retail sales rose less than expected; industrial output slowed • Japan's export growth slowed more than expected
	Our assessment: Neutral – Stronger-than-expected US jobs, industrial data vs surprisingly weak US, China retail sales	
Policy developments	• A China government committee called for efforts to ensure stable economic growth and prevent financial risks	• Fed's meeting minutes showed most policymakers favoured starting reduction of bond purchases this year • Chair Powell said the Fed's tools were limited and it was unlikely the economy returns to pre-pandemic levels soon
	Our assessment: Negative – Risk of Fed tapering this year	
Other developments		• China issued new internet sector regulations to curb unfair competition and restrict consumer data use
	Our assessment: Negative – Tighter China regulations	

Rising US new cases and hospitalisations could cause short-term market volatility, but increased vaccinations should limit medium-term impact

US COVID-19 new cases, hospitalisations and fatalities per million people



Source: Our World in Data, Standard Chartered

US retail sales and industrial output are likely to continue growing at a healthy pace even after the initial surge from base effects fades

US retail sales and industrial production growth

Source: Bloomberg, Standard Chartered

China retail sales and industrial output growth have slowed this year, but renewed policy easing should help stabilise growth

China retail sales and industrial production growth

Source: Bloomberg, Standard Chartered

Top client questions

What are the key takeaways from the latest earnings season in Europe?

About 80% of Europe's Stoxx 600 companies have reported Q2 earnings. Of these, 72% beat revenue expectations and 65% beat earnings expectations. The strength has been broad based, with every sector beating revenue and earnings expectations. Overall, earnings have positively surprised by 24%.

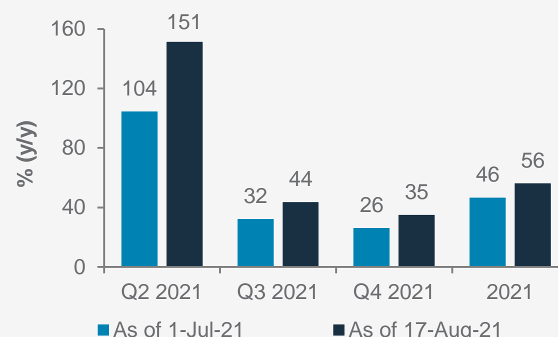
This broad strength has been supported by vaccine-driven reopening, a strong cyclical recovery and policy stimulus. Consensus earnings estimates have been revised up for Q3, Q4 and 2021. Earnings in 2021 are now expected to grow by 56%, up from 46% expected at the start of July, prior to the earnings season.

This strong earnings growth supports our preferred view of European equities. Our preferred sectors in Europe are financials, energy, materials and technology. These sectors delivered positive Q2 earnings surprises of 13-27%. Expected 2021 earnings growth are energy (543%), materials (93%), financials (43%) and technology (15%). Energy and materials have high earnings growth from a depressed base last year, while technology sector earnings growth is below average as it largely avoided the downswing in 2020.

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

European companies significantly beat earnings expectations in Q2, leading to upward revisions in H2 earnings estimates

Europe's Stoxx 600 index earnings growth estimates



Source: Bloomberg, Standard Chartered

Should we be worried about rising bond defaults in China?

China's recent weakness in economic data and regulatory scrutiny across the property, state-owned and the technology sectors have heightened worries of a rise in defaults. We believe investors are better served by breaking this problem down into smaller questions:

1. **How long is the regulatory scrutiny likely to continue?** It is hard to pinpoint exact timing. However, broader policy goals and past instances of regulatory scrutiny on other sectors suggest the latest regulatory tightening is unlikely to end imminently.
2. **Can regulatory scrutiny translate into defaults?** Most technology sector bond issuers face relatively low default risks given strong balance sheets. Default risks may be greater in the property and state-owned enterprise sectors, where many companies face weaker balance sheets.
3. **What is currently priced into the markets?** According to our estimates, the recent increase in credit spreads has resulted in markets pricing in a double-digit default rate. Excluding 2008-09, default rates in Asian USD bonds have usually been below 5%.

Thus, while we expect default rates to increase somewhat compared to prior years, we believe that markets are pricing in an excessively high risk of defaults today. Hence, we view the risk-reward offered by Asian HY bonds as attractive.

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

Asian High Yield USD corporate bonds offer an unusually high yield pick-up versus US High Yield corporate bonds

Yields premiums over US Treasuries for Asian High Yield USD and US High Yield corporate bonds

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Do you see any opportunities in the AUD following the recent weakness?

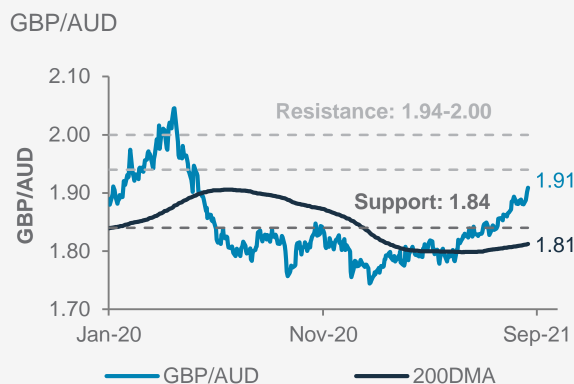
The key drivers weighing on the AUD appear to be the latest pandemic wave, central bank monetary policy and a broader risk off (USD-supportive) sentiment.

We believe the first two drivers highlight a broader trend in FX markets, namely the global dislocation of COVID-19 strategies. This is clearly visible in the GBP/AUD cross rate. In the UK, 62% of the population is fully-vaccinated, whereas Australia's vaccination rate is around 22%. This reflects differing strategies – "vaccinate and live with it" vs "zero COVID". With the UK closer to its 80% target threshold, the resumption of normal activity has led to stronger economic data, more inflationary pressure and a more hawkish BoE. The Australian experience has required lockdowns, curtailed economic activity and a more dovish RBA.

While we expect vaccinations in Australia to eventually catch up, it will take time. This, combined with technicals, means the outlook for GBP/AUD is biased towards further upside following the break of technical resistance at 1.9000. A break above 1.9400 could signal a technical target of around 2.0000. Short-term technicals appear overbought, but we expect buyers on dips towards initial support around 1.8750, with 1.8500 likely to provide strong support.

We believe GBP/AUD is biased towards further upside towards 1.94, and then to 2.00, following the break of technical resistance at 1.90

GBP/AUD



Source: Bloomberg, Standard Chartered

Are there market implications for investors from geopolitical events in Afghanistan?

The swift pace of unfolding events in Afghanistan is unlikely to have a direct impact on financial markets. However, they pose the risk of raising geopolitical tensions, potentially impacting oil prices and have domestic US political implications that impact policy initiatives.

The unrest in Kabul following the US troop withdrawal could impact pricing of broader geopolitical risk. More cautious risk sentiment could be supportive of safe-haven plays, particularly the USD, the JPY, government bonds and perhaps gold. It may also amplify weakening risk sentiment in countries that have recently been hit by another pandemic wave and do not have high vaccination rates.

Second order effects of rising regional uncertainty could be felt directly through oil prices, though we currently view this only as a tail risk. Markets may reflect concern around more unstable supply from the region, with a growing focus on how US talks with Iran progress.

The US political environment may also shift as Republicans try to position themselves as supportive of the troop withdrawal, in line with US voter sentiment, but critical of its execution by the Biden administration. As President Biden's approval rating slips, the administration could then face a tougher task in pushing through legislation on infrastructure spending and the debt ceiling.

President Biden's job approval rating has declined steadily, but remains above Trump's; the Afghanistan crisis appears to have dented his popularity further since July

Job approval rating for Presidents Biden and Trump

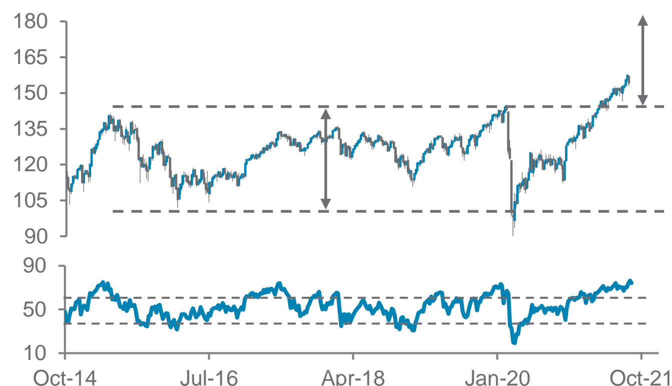
Source: RealClearPolitics, Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

Europe equities: Scope to rise further

MSCI Europe index weekly chart with Relative Strength index

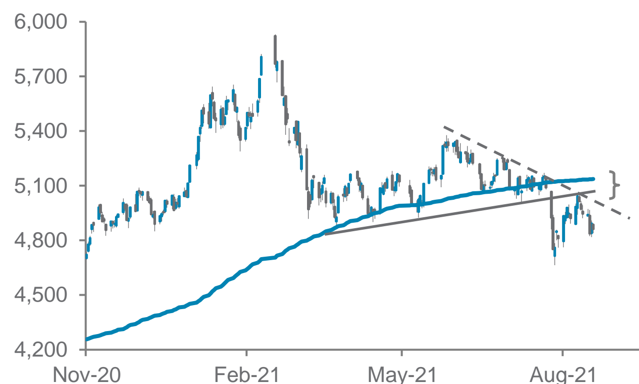


Source: Refinitiv, Standard Chartered

Strong momentum, coupled with the recent break above a major horizontal trendline resistance, points to further upside in European equities over the medium term. The 14-week RSI has risen above 76, the highest level since 2005; back then the index rose for over two years after the RSI rose above 76.

China CSI 300: Still not out of the woods

CSI 300 index daily chart with 200DMA

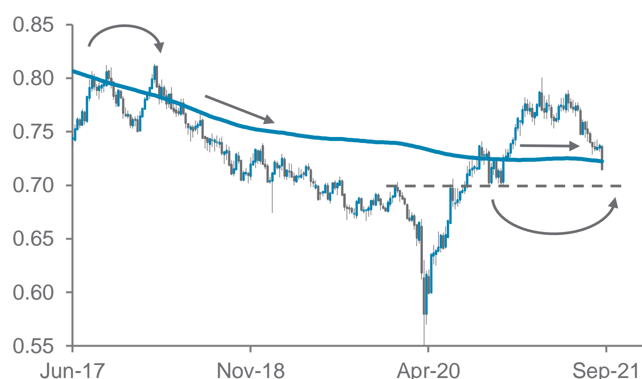


Source: Refinitiv, Standard Chartered

The stalling of the end-July decline is an encouraging sign for bulls, but it may be premature to conclude that the worst is over for China equities while the CSI 300 index remains below stiff resistance area of 5,050-5,150.

AUD/USD: Strong support around 0.7000

AUD/USD weekly chart with 200WMA

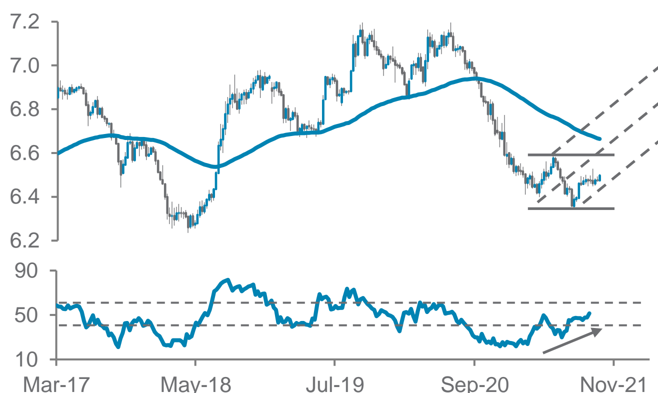


Source: Refinitiv, Standard Chartered

AUD/USD's fall below the September 2020 high of 0.7413 has raised the risk of a drop toward the late-2020 lows of around 0.7000. This support is strong and a break below is by no means inevitable. Indeed, the flat slope of the 200WMA diminishes the odds of an extended slide (like the 2018 slide).

USD/CNH: Range scenario could continue for now

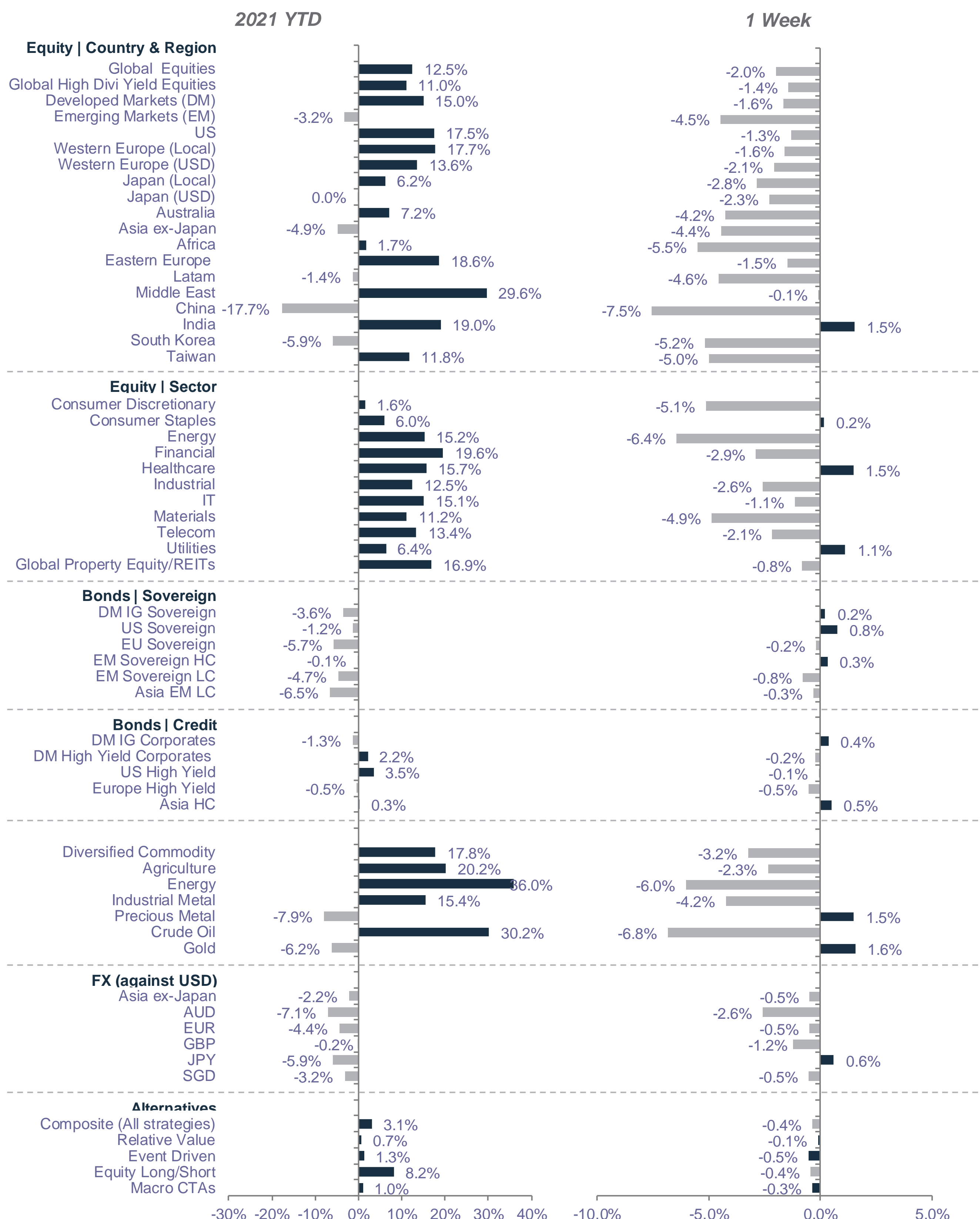
USD/CNH weekly chart with 100WMA and 14-week RSI



Source: Refinitiv, Standard Chartered

A positive momentum divergence on the weekly charts (the decline in USD/CNH associated with ascending RSI) suggests that the year-long slide is losing steam. There is a good chance that USD/CNH could be settle in a 6.35-6.60 range in the short term.

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 19 August 2021; 1-week period: 12 August 2021 to 19 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	▲	CNY	◆
Govt EM USD	▲	JPY	◆
Corp DM IG	▼	AUD	▲
		NZD	▲
Bonds (Govt)	▼	CAD	▲
Govt EM Local	◆		
Govt DM IG	▼	**Gold**	◆

Source: Standard Chartered Global Investment Committee

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

Economic and market calendar

	Event	Next week	Period	Prior
MON	GE	Markit/BME Germany Composite PMI	Aug P	62.4
	EC	Markit Eurozone Composite PMI	Aug P	60.2
	US	Markit US Composite PMI	Aug P	59.9
	US	Existing Home Sales	Jul	5.86m
	EC	Consumer Confidence	Aug A	-4.4
TUE				
WED	GE	IFO Expectations	Aug	101.2
THUR	SK	BoK 7-Day Repo Rate	26-Aug	0.5%
FRI/SAT	CH	Industrial Profits y/y	Jul	20.0%
	US	Fed's Annual Jackson Hole Policy Retreat		
	US	Fed's Annual Jackson Hole Policy Retreat		

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 0.7% below current level

Technical indicators for key markets as on 19 August 2021

Index	Spot	1st support	1st resistance
S&P500	4,406	4,377	4,457
STOXX 50	4,125	4,090	4,195
FTSE 100	7,059	7,006	7,165
Nikkei 225	27,281	27,049	27,745
Shanghai Comp	3,466	3,436	3,506
Hang Seng	25,316	24,958	26,033
MSCI Asia ex-Japan	791	782	811
MSCI EM	1,232	1,216	1,265
Brent (ICE)	66.5	65.1	69.2
Gold	1,779	1,776	1,785
UST 10Y Yield	1.24	1.23	1.27

Source: Bloomberg, Standard Chartered

Investor diversity has normalised across major assets

Our proprietary market diversity indicators as of 18 August

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	●	↑	1.67
Global Equities	◐	→	1.43
Gold	◐	↓	1.45
Equity			
MSCI US	◐	↓	1.32
MSCI Europe	◐	↓	1.29
MSCI AC AXJ	◐	→	1.46
Fixed Income			
DM Corp Bond	●	↑	1.52
DM High Yield	●	↑	1.69
EM USD	◐	→	1.43
EM Local	●	↓	1.53
Asia USD	●	↑	1.62
Currencies			
EUR/USD	◐	↓	1.30

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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