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WM Chief Investment Office
16 April 2021

Weekly Market View

Is reflation fading?

We believe the so-called global reflation trade is taking a pause, as reflected in the pullback in US Treasury yields and a few other market indicators. However, fundamental data, including upbeat corporate earnings, point to a sustained recovery in the global economy. Hence, we would use the current dislocations to position for a continued cyclical recovery in risk assets.

Equities: Stronger-than-expected US bank earnings in Q1 reflect the cyclical economic upturn. Most other sectors have seen a rise in earnings expectations, supporting our positive view on the US.

Bonds: We continue to favour Asia High Yield bonds as we do not see recent asset manager concerns in China as a systemic issue

FX: We expect any near-term rally in USD/CNH to encounter resistance at around 6.60

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What is the Q1 earnings outlook for key US sectors?

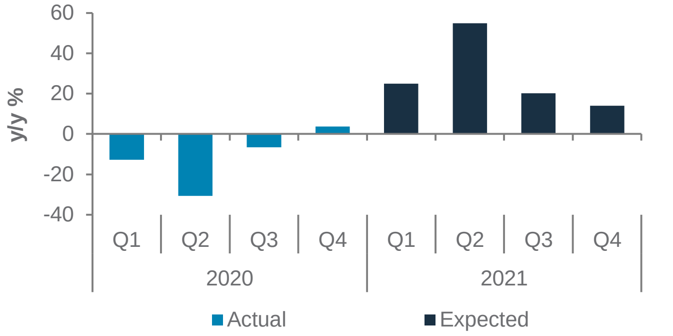
What are the implications of risks in China's asset management sector?

Are market technical indicators supportive of risk assets?

Charts of the week: Solid earnings to revive reflation trade

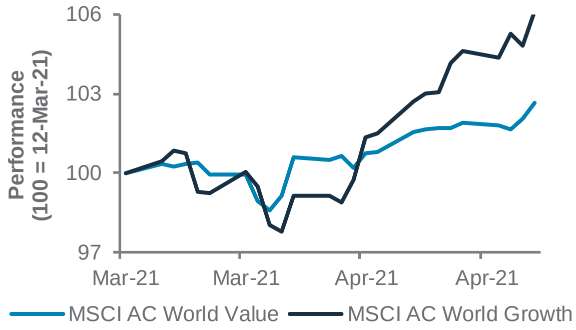
We expect Q1 earnings, led by the US, to surprise positively, helping sustain the rally and rotation to Value

S&P500 quarterly earnings growth from Q1 20 to Q4 21



Source: Refinitiv, Standard Chartered; 2021 = consensus expectations

Value has underperformed Growth in recent weeks



Source: Bloomberg, Standard Chartered

Editorial

Is reflation fading?

Some market indicators are pointing to a possible loss of momentum in the reflation trade – witness the pullback in US Treasury yields and the recent underperformance of the so-called cyclical vs defensive equities, small-cap vs large-cap stocks and Value vs Growth equity styles.

We believe this is a pause in the evolving reflation trade after a sharp run-up in risk assets since President Biden's election. We expect fundamentals, on balance, to support our constructive medium-term view:

1. US major bank Q1 earnings have surprised positively amid strong investment banking/trading revenue. The release of loan-loss provisions made in prior quarters is a sign that the banks had over-estimated bad loans. This, we believe, is a vote for the sustainability of the ongoing recovery. Overall, US Q1 earnings are expected to show a significant turnaround from last year (see page 4);

2. The Fed's Beige Book survey of the US economy pointed to a strong pick-up in activity in the coming months. This was validated by stronger-than-expected retail sales. President Biden's USD 2.3trn infrastructure spending plan is likely to further fuel this recovery theme;

3. US core inflation has started to pick up, beating expectations in March. 'Shelter' inflation, which accounts for a third of the indicator and which was suppressed through the pandemic crisis, has also started to recover, reflecting the turnaround in the economy and job market;

4. Despite the upturn in activity and sentiment, Fed and ECB policymakers remain resolutely dovish. This points to extremely supportive financial conditions this year;

5. China's imports and retail sales surged more than expected, signalling strength in the economy despite talk of policy and regulatory tightening. We do not see recent asset manager concerns as a systemic issue (page 5);

6. Finally, the International Energy Agency raised its forecasts for global crude oil demand.

These indicators suggest the economic recovery is gathering pace (as the IMF confirmed earlier this month), which, in turn, should help corporate earnings beat expectations in the coming months. The setbacks to vaccinations in Europe and the re-emergence of the pandemic in major EMs, such as India, and in Germany and Japan, are dampeners to near-term risk sentiment. However, the pace of vaccination is picking up globally, which should help contain the spread. Authorities expect US and Europe to reach herd immunity by H2. Meanwhile, US-China tensions around Taiwan are simmering, raising the risk of an accident, although the probability of significant escalation appears low.

This constructive worldview and supportive technical indicators (see page 6) leads us to seek opportunities as the reflation trade takes a breather. US Value equity sectors are likely to benefit from the earnings recovery. China's equity market pullback has made valuations more attractive, presenting an opportunity in the beaten down technology and online consumption-linked sectors. While the broader implications of Huarong's problems need to be watched closely, we retain our preference for Asia HY USD bonds given the still wider-than-usual yield premium vs. HY bonds in other regions such as the US.

— **Rajat Bhattacharya,** *Senior Investment Strategist*

The weekly macro balance sheet

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

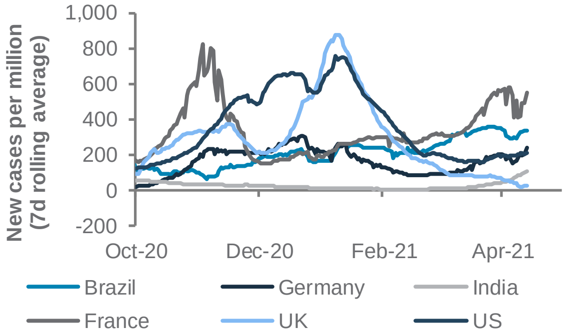
(+) factor: End of UK lockdown, supportive Fed

(-) factor: Renewed COVID-19 restrictions, geopolitical risks

	Positive for risk assets	Negative for risk assets
COVID-19	• UK ended 100-day lockdown as cases fell to lowest since Q3 FY20 • Cases appear to have peaked in Italy, France • The US said it had enough vaccines to meet targets after suspending the use of a vaccine	• Germany imposed nationwide curbs, while some Indian states re-imposed lockdowns, amid a surge in cases • US paused the use of Johnson & Johnson vaccine pending review of link to blood clots
	Our assessment: Neutral – US, UK progress vs resurgence and renewed restrictions in Germany, India	
Macro data	• Fed's Beige Book report and Chair Powell's comments indicated the US was going into a period of faster growth and job creation • US retail sales rose more than expected; new jobless claims fell to post-pandemic low • China imports, retail sales beat expectations • Euro area retail sales rose more than expected	• US consumer and producer inflation rose more than expected • China's producer inflation accelerated the most since July 2018 • China's money supply, total financing, exports were less than expected • Euro area industrial output fell more than expected and German investor sentiment (ZEW) unexpectedly fell
	Our assessment: Positive – Strong retail sales data	
Policy developments	• Fed's Clarida said there was no plan to raise rates until 'hard numbers' showed progress • Villeroy said ECB policy will stay easy for years	• ECB officials warned governments' delay in a joint fiscal stimulus plan would be a 'disaster'
	Our assessment: Positive – Policy to stay supportive	
Other developments		• US and China warned each other on Taiwan • US imposed more sanctions on Russia
	Our assessment: Negative – Geopolitical tensions	

COVID-19 cases have subsided in the UK and the US, but are rising in Germany and India

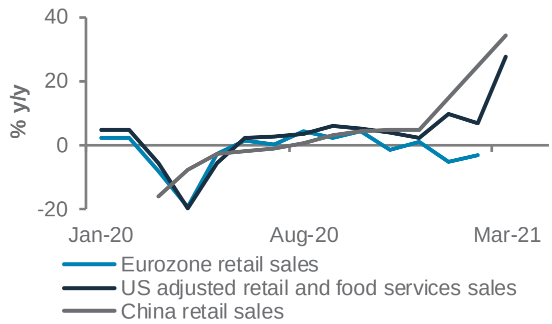
New COVID-19 cases per million (7d average)



Source: Our World in Data, Standard Chartered

China and US retail sales have been stronger than those in the Euro area as the latter re-imposed restrictions due to the pandemic

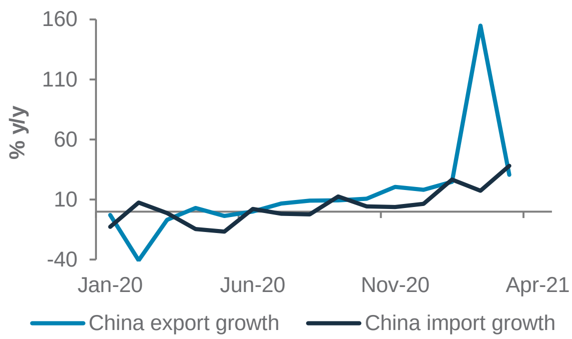
US, China and Euro area retail sales growth



Source: Bloomberg, Standard Chartered

The acceleration in China's imports points to a recovery in domestic economic activity

China export and import growth



Source: Bloomberg, Standard Chartered

Top client questions

What should investors expect from US Q1 earnings?

The consensus expects US Q1 earnings (S&P500) to rebound by 25%, continuing the cyclical recovery from the pandemic-induced recession last year. The reporting season has started and will peak in the week of 26 April. Nearly 85% of the companies will have reported by 7 May.

Traditionally, consensus estimates have been managed down ahead of the reporting season as companies prefer to under-promise and over-deliver. However, for Q1 FY21, earnings expectations for the S&P500 have been climbing steadily, from 16% at the start of the year to 25% currently. This reflects the confidence among companies and analysts that the economic recovery is intact.

There is a risk that investor expectations are already high, as reflected in the market's strong performance, with the S&P500 index up 11% YTD. As such, even consensus beating results may be met with muted stock price reactions in the near term. Nevertheless, we see the strength of the cyclical recovery through the year supporting our preferred view of the US equity market over the next 6-12 months.

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

The consensus expects a 25% y/y rise in Q1 earnings for S&P500 index members

S&P500 index earnings growth, Q1 20 – Q4 21

Source: Refinitiv, Standard Chartered; 2021 earnings are consensus estimates

What is the Q1 earnings outlook for key US sectors?

Major US banks have reported Q1 results this week, beating consensus expectations. Broadly, capital market revenues were strong, particularly with the surge in IPOs and elevated trading activity levels. Banks also released loan loss reserves as economic conditions are turning out better than previously expected. Net interest income was under pressure from lower interest rates vs. a year ago and muted loan demand, but interest margins could start to improve from here.

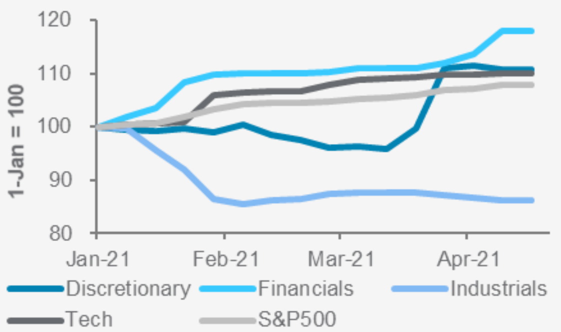
Despite the strong results, the US financials sector has hardly moved, up just 0.1%, this week, following 19% YTD gains thus far. Q1 consensus earnings growth for the financial sector has been revised up from 49% at the start of the year to 76% currently, though this follows a low comparison base last year, where US financial sector earnings fell 38% y/y.

The revision to earnings growth is key to the equity market outlook and here, all S&P500 sectors, apart from consumer staples and industrials, have seen Q1 growth expectations revised up this year. This is supportive of our positive view of US equities. We have a preferred view on the financial, industrial, material and energy sectors in the US, a preference that reflects our view of a cyclical recovery benefitting cyclically sensitive sectors the most.

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

Most US equity sectors have seen a rise in Q1 earnings expectations this year

Consensus estimates for Q1 earnings across key S&P500 sectors (rebased 1-Jan=100)



Source: Refinitiv, Standard Chartered

Top client questions (cont'd)

What are the broader bond market implications from challenges in the Chinese asset management sector?

Asia USD bonds weakened somewhat over the past two weeks, led by the China IG sector. This followed a sharp fall in bond prices of China Huarong, a state-owned asset management company, owing to a delay in the release of its earnings and concerns about a reduction in government support. It was also reported that China's State Council urged local government financing vehicles (LGFVs) to restructure their debt or default if they are unable to service their debt, further reinforcing concerns over the extent of state support.

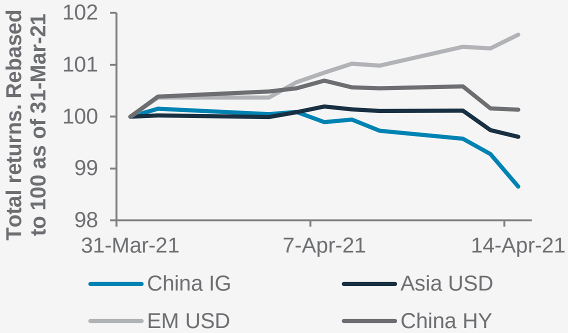
While reports on LGFVs come as less of a surprise to markets, the key focus this time has been on the future of state support for bonds of central government-owned enterprises, one key factor for the China IG sector.

While our base scenario is that the immediate storm is likely to pass as a significant default is avoided in the Asia USD bond market (modest restructurings cannot be ruled out), China IG bonds could witness higher volatility than usual over the next few months as markets assess any shifts in implicit state support. We remain comfortable with our preference for Asian HY bonds within Asia USD bonds, particularly given the HY segment is less impacted by state support concerns.

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

China's Investment Grade bonds have been mainly impacted by issues at Huarong

Performance of various Asian and Emerging Market bond segments since start of April



Source: Bloomberg, Standard Chartered

What is your near/medium-term view on USD/CNH?

From a fundamental standpoint, we see near-term bond yield and growth differentials erring towards USD strength as the US recovery extends and US consumer spending on domestic services strengthens. Medium term, though, this balance could shift away from the USD as the pace of new US fiscal stimulus slows and tax policies may dampen activity.

Meanwhile, US-China tensions are likely to remain elevated over the long-term. Markets tend to under-price geopolitical risk as, in most cases, the market impact is averted, softened or quickly passes. We believe that Chinese authorities will want to maintain a stable-to-stronger CNH to support its candidacy as a regional or global reserve currency. We expect any near-term CNH weakness will be temporary, and the "natural" medium-term trend suggests CNH strength.

Any broad near-term USD rally should encounter technical resistance against the CNH at 6.60 and then around 6.67. Our 12-month USD/CNH view is bearish. A sustained break below 6.40 would turn technicals more bearish towards 6.25. We expect investors to fade any USD/CNH rally.

We expect any near-term USD/CNH rally to encounter resistance around 6.60

USD/CNH

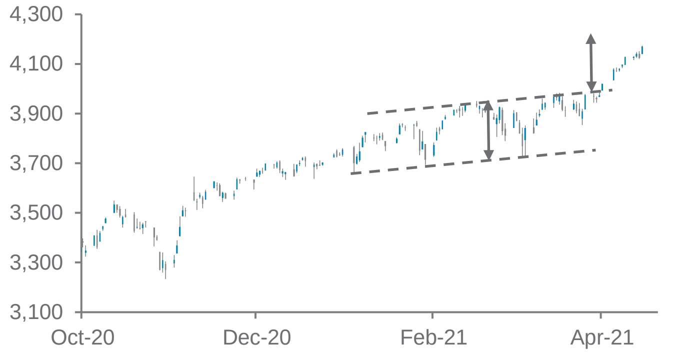
Source: Bloomberg, Standard Chartered

Technicals for the week

Manish Jaradi
Senior Investment Strategist

S&P500: Momentum has improved recently

S&P500 index daily chart

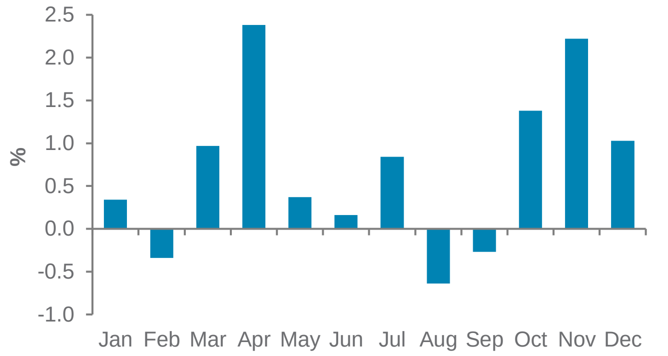


Source: Bloomberg, Standard Chartered

S&P500's recent break higher from a range has opened the way towards 4,220.

S&P500: Seasonality is supportive this month

S&P500 index monthly average returns in last 25 years

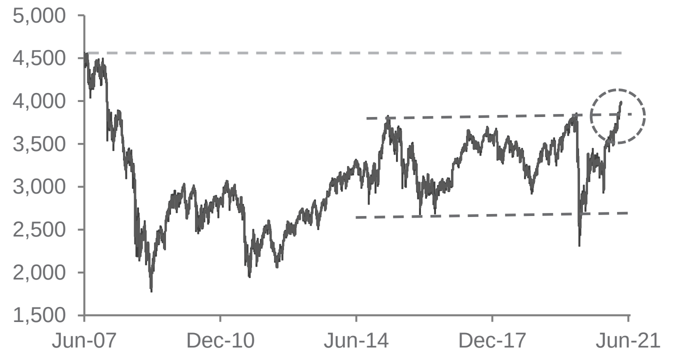


Source: Bloomberg, Standard Chartered

Historically, April has been the best from a monthly returns' perspective.

Euro Stoxx 50: Breaks higher

Euro Stoxx 50 weekly chart

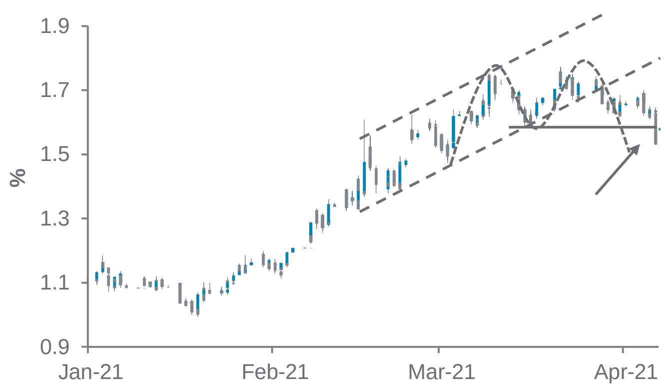


Source: Bloomberg, Standard Chartered

Euro area equities have broken out of a multi-year sideway range. Next resistance is at the 2007 high of 4,572.

US 10-year Treasury yield: Fading upward pressure?

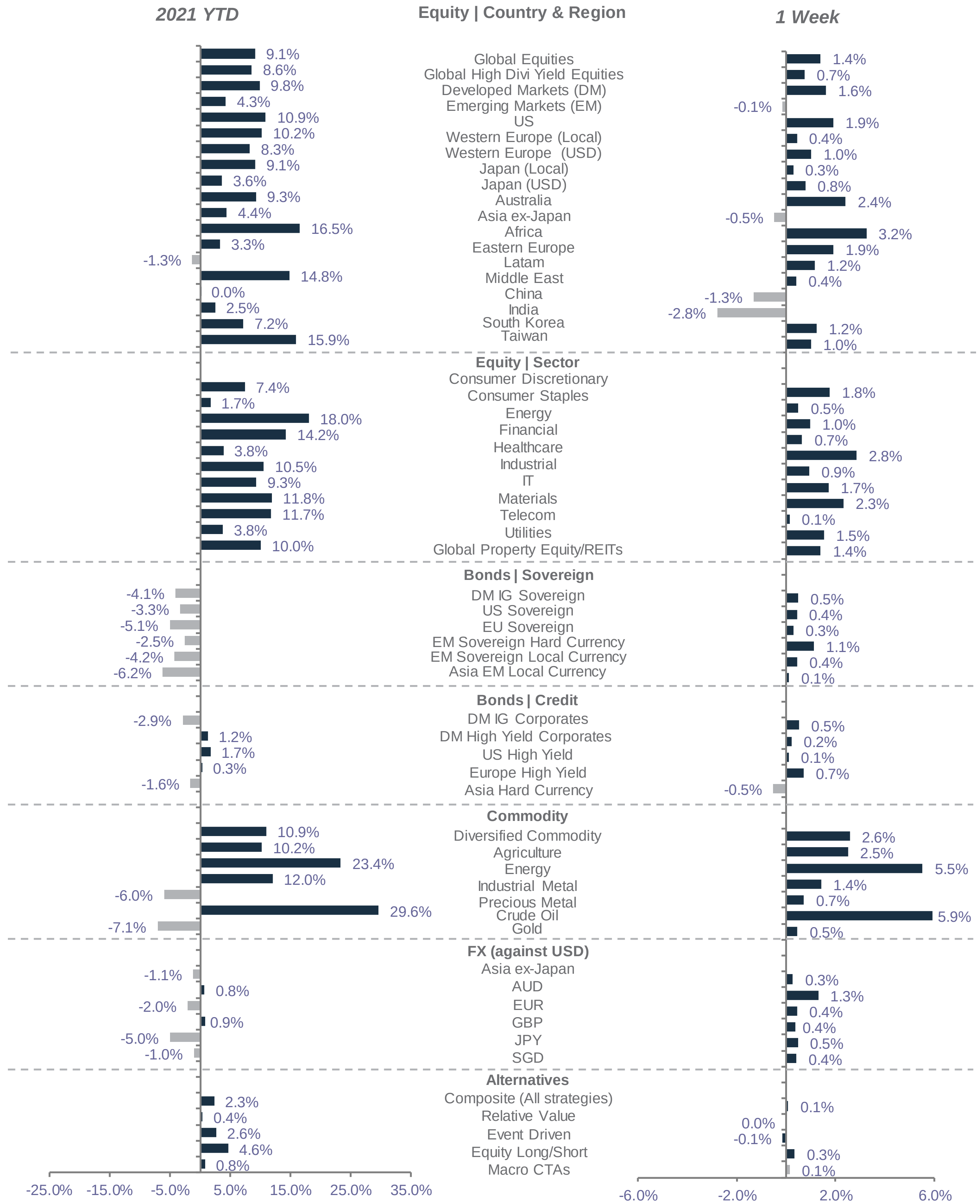
US 10-year Treasury yield 240-minute chart



Source: Bloomberg, Standard Chartered

The break below key support at 1.587% has triggered a minor double top, potentially opening the way towards 1.420%.

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 15 April 2021; 1-week period: 8 April 2021 to 15 April 2021

Our asset class views at a glance

Asset class			
Equities	▲	**Alternatives**	◆
US	▲	Equity hedge	▲
Japan	▲	Event-driven	▲
Asia ex-Japan	▲	Relative value	◆
UK	▲	Global macro	▼
Euro area	▼		
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 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	JN	Exports y/y	Mar	-4.5%
	EC	Construction Output y/y	Feb	-1.9%
TUE				
WED				
THUR	EC	ECB Deposit Facility Rate	22-Apr	-0.5%
	EC	Consumer Confidence	Apr A	-10.8
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	Mar	0.2%
	JN	Nationwide Dept Sales y/y	Mar	-10.7%
	EC	Markit Eurozone Composite PMI	Apr P	53.2
	UK	Markit/CIPS UK Composite PMI	Apr P	56.4
	US	Markit US Composite PMI	Apr P	59.7
	US	New Home Sales	Mar	775k

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 resistance 0.4% above current level

Technical indicators for key markets as on 15 April 2021

Index	Spot	1st support	1st resistance
S&P500	4,170	4,140	4,186
STOXX 50	3,993	3,972	4,004
FTSE 100	6,984	6,921	7,015
Nikkei 225	29,643	29,532	29,761
Shanghai Comp	3,399	3,380	3,434
Hang Seng	28,793	28,531	28,978
MSCI Asia ex-Japan	878	871	881
MSCI EM	1,341	1,329	1,347
Brent (ICE)	66.9	64.3	68.3
Gold	1,764	1,743	1,775
UST 10Y Yield	1.58	1.55	1.64

Source: Bloomberg, Standard Chartered

Investor diversity in bond markets has normalised

Our proprietary market diversity indicators as of 14 April

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.32
Global Equities	◐	→	1.47
Gold	◐	→	1.44
Equity			
MSCI US	◐	↓	1.42
MSCI Europe	◐	→	1.37
MSCI AC AXJ	●	↑	1.81
Fixed Income			
DM Corp Bond	◐	→	1.47
DM High Yield	●	↑	1.84
EM USD	●	→	1.66
EM Local	◐	↓	1.41
Asia USD	●	↓	1.83
Currencies			
EUR/USD	◐	↓	1.49

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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