

Weekly Market View

Looking beyond near-term risks

We believe markets are rightly looking beyond the near-term risks of rising US COVID-19 infections, weak Q2 earnings and geopolitical risks. Progress on potential vaccines and cures and improving economic data explain rising risk appetite among investors, in our assessment

Equities: Our preferred technology sector continues to benefit from retail and institutional investors seeking defensive earnings streams

Bonds: We expect the search for yield, weaker USD & rising oil prices to drive Emerging Market USD bonds higher

FX: We believe the fundamental drivers for a medium-term decline in the USD are now largely in place

Looking beyond near-term risks

Also find out...

Does this week's reversal in China A-shares mean the rally is over for now?

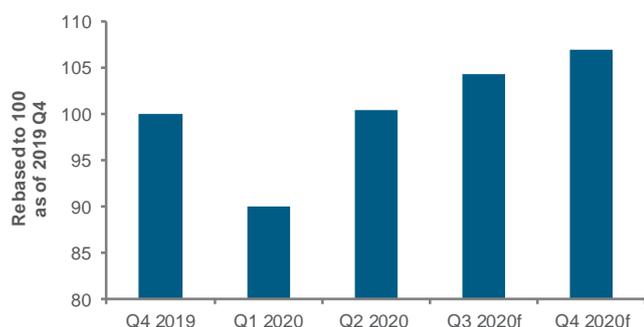
What are the macro drivers underpinning our positive outlook on risk assets?

Does the OPEC meeting outcome impact our outlook on oil prices?

Chart of the week: Markets discounting the future, not the past

China's economy fully recovered in Q2 the ground lost in Q1; US cyclical sector equities are responding to improving outlook

China's GDP level (indexed, 100 = end-2019 level)



S&P500 industrials sub-index



Source: Bloomberg, Standard Chartered; 2020 Q3f and Q4f are Bloomberg consensus estimates

Editorial

Looking beyond near-term risks

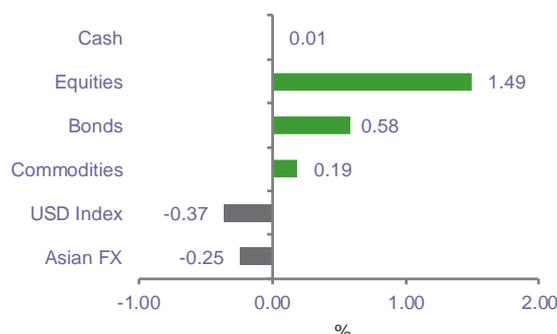
Many investors remain puzzled by the continued rise in risk assets, despite record US COVID-19 infections, the sharpest economic contraction in decades, a thus-far appalling Q2 earnings season and rising geopolitical tensions. How do we square the circle?

The key to answering the question is that **markets discount the future, not the past**. Based on this, let us assess the unfolding risks:

- While a sustained rise in COVID-19 cases in southern US states is causing a revival in fatality rates, **we do not expect this to lead to stringent lockdowns**. Authorities, learning from the experience of northeastern US states, are more likely to adopt a targeted approach to protect the vulnerable, letting the rest of the economy stay open. For investors, **we believe the bigger surprise is positive results from drug and vaccine trials** (see page 3). The growing list of candidates closing in on the finish line has raised the chance of a sooner-than-expected roll-out of preventives and cures.
- The Q2 earnings season was expected to be very weak. However, markets discount the future, not the past, and **consensus expects US S&P500 earnings, for instance, to rebound to 31% growth in 2021**, from a 23% contraction in 2020. **Economic data in recent weeks support this positive outlook**, with US PMIs, job market, retail sales and industrial output all beating forecasts, suggesting the economy is recovering faster than expected. **In China, Q2 data showed the economy fully recovered** the ground lost to COVID-19 lockdowns in Q1; this is much faster than previous expectations.
- US-China tensions continue to rise, quite expectedly ahead of November's US elections. **We do not expect them to come to a boil**, since they would hurt President Trump's re-election prospects, though this is a risk we continue to monitor closely.

The above points, combined with expectations of further policy support, suggest investors are rightly looking beyond near-term risks. That is not to say that the risks will not cause volatility. However, we believe averaging into the market to build a well-diversified allocation focussed on our preferred regions and sectors (see page 4-6), while hedging with safe-havens such as gold, would be a prudent approach.

Global equities extended gains and the USD fell amid improving risk appetite on the back of stronger-than-expected economic data and promising vaccine trials
 Benchmark market performance w/w*



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

*Week of 09 July 2020 to 16 July 2020

S&P500 index faces resistance 0.8% above current level

Technical indicators for key markets as on 16 July 2020

Index	Spot	1st support	1st resistance
S&P	3,216	3,172	3,243
STOXX 50	3,365	3,315	3,397
FTSE 100	6,251	6,133	6,330
Nikkei 225	22,814	22,422	23,076
Shanghai Comp	3,210	3,132	3,366
Hang Seng	24,971	24,704	25,505
MSCI Asia ex-Japan	680	674	693
MSCI EM	1,046	1,038	1,063
Brent (ICE)	43.4	42.8	43.9
Gold	1,798	1,793	1,807
UST 10Y Yield	0.62	0.61	0.64

Source: Bloomberg, Standard Chartered

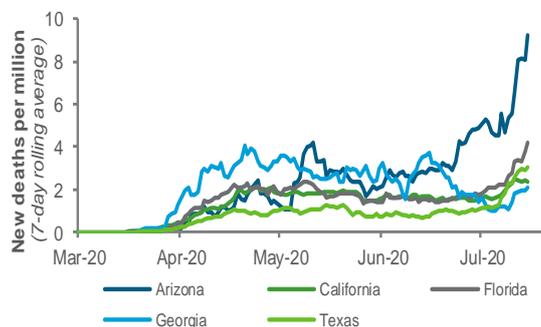
The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	<ul style="list-style-type: none"> US' Moderna said final stage trials for a COVID-19 vaccine will start from 27 July after promising early results US' Gilead said its Remdesivir drug reduced COVID-19 mortality risk by 62% 	<ul style="list-style-type: none"> Rising new cases and deaths in large southern US states have forced New York to add more states to its quarantine list and California to ban indoor dining and entertainment activities Almost a dozen Indian states re-imposed partial lockdowns as new cases hit a record high
	<p>Our assessment: The vaccine and drug test results are a positive surprise, raising chances of an earlier-than-expected rollout</p>	
Macro data	<ul style="list-style-type: none"> Industrial output in the US (June), France, Italy rebounded stronger than expected in May US retail sales rose by more than expected in June, reaching pre-pandemic levels US consumer inflation rose more than expected in June, the first monthly gain since Feb China's GDP rebounded by a stronger-than-expected 11.5% q/q in Q2, fully recovering from a 10% contraction in Q1 China's total financing, exports, imports in June beat forecasts 	<ul style="list-style-type: none"> US initial jobless claims continued to fall last week, but were higher-than-expected Germany's ZEW economic expectations index fell in July, undershooting expectations UK GDP and industrial production rebounded slower than expected in May, after sharp falls in April China's retail sales in June unexpectedly contracted y/y
	<p>Our assessment: On balance, data points to a faster-than-expected global recovery</p>	
Policy developments	<ul style="list-style-type: none"> France added EUR 100bn to its fiscal stimulus package; plans business tax cuts in August US Senate Majority Leader McConnell and House Speaker Pelosi both expressed optimism about approving a new stimulus package in coming weeks EU Council President Michel said he expects member states to approve a EUR 750bn regional recovery package soon Fed's Harker said rates should be held near 0% until inflation rises above the Fed's 2% target 	<ul style="list-style-type: none"> ECB did not confirm whether it would make full use of EUR 1.35tn pandemic emergency programme Two Chinese state-owned funds trimmed equity holdings and state-run China Economic Times cited dangers of a "crazy" bull market, suggesting authorities are getting cautious about the recent sharp run-up BoJ's Kuroda expected a "gradual" economic recovery; this suggests Japan's recovery may be progressing slower than the US and Europe
	<p>Our assessment: No significant surprise, with authorities staying focussed on providing more stimulus, a key driver of our positive 12m view on risk assets</p>	
Other developments	<ul style="list-style-type: none"> The EU granted cross-border access to London's derivatives market for a limited time to mitigate financial instability risk President Trump reportedly ruled out further sanctions against top Chinese officials, suggesting he may be easing his stance, lest an escalation of tension hurts his poll prospects 	<ul style="list-style-type: none"> US President Trump ended Hong Kong's special status, while US Secretary of State Pompeo said most of China's maritime claims in South China Sea are illegal China earlier unveiled sanctions against two US Senators
	<p>Our assessment: A further escalation in US-China tensions remains a risk despite recent signals of a pause</p>	

Our weekly net assessment: On balance, we see this week's vaccine news, data and policy developments as positive for risk assets
 (+) factor: Vaccine news, China rebound, further fiscal policy stimulus
 (-) factor: Rise in US COVID-19 cases, rising US-China tensions

COVID-19 fatalities in southern US are rising again, likely presenting near-term headwind to risk assets

Daily COVID-19 fatalities per million people in key southern US states



Source: Johns Hopkins University; Standard Chartered

Industrial output rebounded in the US and Europe, suggesting the worst of downturn is likely behind us

Industrial production growth in the US, France and Italy



Source: Bloomberg, Standard Chartered

Rising expectations that EU members are likely to approve a EUR 750 pandemic recovery fund soon have helped drive the EUR higher in recent weeks

EUR/USD



Source: Bloomberg; Standard Chartered

Top client questions

Q Are retail investors crowding into FAANG stocks?

Recent gains in the so-called FAANG group of technology sector stocks have been largely attributed to retail investor demand. This conclusion is based on data from online trading platforms that publicise top investor holdings. A breakdown of the gains on equity market indices popular with retail investor, such as the Nasdaq 100, highlights that the FAANG stocks as well as two additional technology sector stocks were responsible for about 90% of index gains for the four weeks ending July 10.

This retail investor data contrasts with mutual fund manager positioning data which shows above-average cash holdings, signalling greater caution on the market outlook. Nevertheless, the positioning data also suggests this same group of investors have increased their allocation to FAANG companies, which are viewed as having more defensive earnings than other sectors. This is reflected in expectations of flat earnings growth for the technology sector in 2020, versus a 23% decline for the S&P500.

The picture that emerges shows both retail and mutual fund managers are raising exposure to a pool of stocks that are forecast to have a defensive earnings stream. US technology sector is preferred and we would suggest investors increase exposure via an average-in approach as opposed to waiting to buy-the-dip.

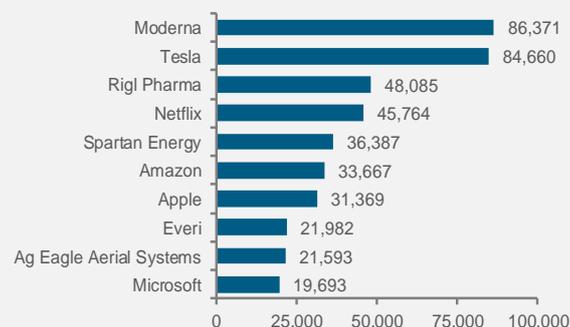
Q Does this week's reversal in China A-shares mean the rally is over for now?

The CSI300 Index has dropped -6.3% over the past week amid a stricter PBoC control on liquidity. Since the start of July, it has refrained from adding additional liquidity through reverse repos. Meanwhile, regulators have started efforts to tame the growth of margin financing. The China Securities Regulatory Commission published a notice on its official website on 8 July signalling a crackdown on irregularities in margin finance. Over the weekend, the PBoC warned banks against margin loans for stock positions and suggested higher capital reserves are needed. Although margin financing has risen 36% YTD to CNY 1.39trn, the overall share of margin is only at 2.2% of the A-share market cap vs the 4.4% peak in June 2015. The margin level is still relatively healthy, in our view.

China has recently undertaken reforms to revive its A-share markets. The government introduced a US-style, registration-based system for new listings on its Nasdaq-style STAR Market launched a year ago and is replicating this on Shenzhen's start-up board ChiNext. We believe these are part of policymakers efforts to have a buoyant equity market, but avoid run-away gains fuelled by excessive margin financing. We believe this means a short-term pullback is possible, but such an outcome would not reverse the trajectory of "a healthy bull market". China equities remain a preferred market in Asia ex-Japan.

FAANG+ stocks (leading technology sector equities) are seeing increased demand from retail clients

Biggest weekly change in Robinhood.com client holdings



Source: Robintrack.net; Standard Chartered

China's onshore equity rally has been accompanied by a sharp rise in margin financing

China's CSI 300 index and outstanding balance of margin transactions



Source: Bloomberg; Standard Chartered

The surge in turnover in China's onshore market lately suggests growing participation of retail investors, but authorities are likely to discourage runaway gains

CSI 300 turnover and outstanding balance of margin transactions



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

Q Would you add EM USD government bonds on dips?

EM USD government bond yield premiums widened (bond prices fell) earlier in the week before retracing part of this move. While much of the weakness was driven by the High Yield (HY) segment, especially the African sovereigns sector, we believe technical factors also played a role. However, we do not see either factor posing a significant obstacle over the next 6-12 months.

The recent underperformance of EM USD government bonds can be largely attributed to:

1. An increase in supply, especially from the HY-rated sovereign sector, as a number of issuers took advantage of lower borrowing costs to meet their funding needs. The virtual closure of the HY market in March-April meant that there was a pipeline of pending issuances.
2. Net investor flows that have turned marginally negative in July.

However, we view the supply surge and lacklustre flows as temporary, as the search for yield and a weaker USD are likely to drive flows into EM USD government bonds over the next 6-12 months. Additionally, our expectation of a further increase in oil prices is supportive for the asset class, especially given that the recent increase in bonds from the Middle-East sovereigns sector has led to greater correlation with oil prices. Thus, we continue to like the value offered by EM USD government bonds and would consider adding exposure on dips.

Q Is the medium-term USD downtrend confirmed?

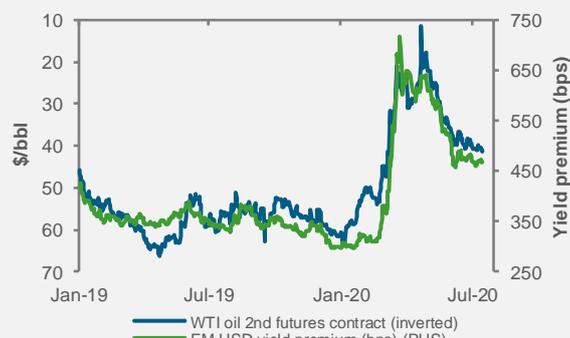
We believe the fundamental drivers of a medium-term USD decline are now largely in place. Technicals are also close to providing confirmation.

The USD's real and nominal yield advantages have been significantly eroded. The Fed has provided massive global USD liquidity and global growth is showing signs of recovery, even as the US battles high COVID-19 infection rates. Geopolitical uncertainty is closely linked with the US election, but as global USD liquidity remains generous, the safe-haven status of the USD may fade. In fact, US political and policy uncertainties may begin to weigh on the USD as the election nears.

The key trigger for medium-term USD weakness is likely to be the strength of the major alternative – the EUR. Germany's shift towards fiscal expansion has set the stage for more domestic-focused growth within the EU. Concerns over the longevity of the single currency have also faded as the proposed pandemic recovery plan, with mutual debt issuance and grants to weaker economies, signals greater fiscal unity. The EU budget and the recovery plan will be debated this weekend. We believe an agreement would be a key support for further EUR/USD strength. As EUR/USD pushes higher, we expect a "domino effect" where other major currencies strengthen against the USD. A strong break above 1.15 in EUR/USD is likely to confirm a broad medium-term USD decline, reversing a multi-year uptrend.

Our expectation of a further increase in oil prices is supportive of EM USD bonds

WTI oil price and EM USD government bond yield premium over US Treasuries



Source: Bloomberg; Standard Chartered

EUR/USD has broken higher in recent weeks; a strong break above 1.15 is likely to confirm a broad medium-term USD decline, reversing a multi-year uptrend



Source: Bloomberg; Standard Chartered

Top client questions (cont'd)

Q Does the OPEC meeting outcome impact your view on oil?

WTI crude oil prices slipped following the OPEC+ meeting after the cartel and its allies agreed to scale back some of their supply curbs. OPEC+ has been cutting output since May by 9.7mbd, but cuts will taper to 7.7mbd by December. While supply cuts have thus far been a supportive factor for oil prices, we note this would be the first real test of the cartel's ability to gradually unwind these measures.

On supply, we believe adding back production amid the COVID-19 pandemic will have to be managed carefully. While the cartel's shift towards a more calibrated approach to inventory management (where lagging members need to offset their non-compliance) is a positive development, we believe this will be mitigated by a likely rebound in US shale production. This is where the marginal cost of US shale barrels plays a crucial role. Given US shale's ability to respond quickly to price signals, further WTI price gains amid an ongoing fall in shale break-evens (currently estimated to be around USD 40/bbl) could see more supply brought back online.

Meanwhile we believe the outlook for demand is improving as evidenced by high-frequency economic data. As economies ease mobility restrictions, oil product demand across various end-user markets should gradually recover. Inventory levels have continued their path towards normalisation, which should lead to higher oil prices over the next few months. The key risk to our view will be a continued acceleration in COVID-19 cases that result in major economies re-instituting mobility restrictions.

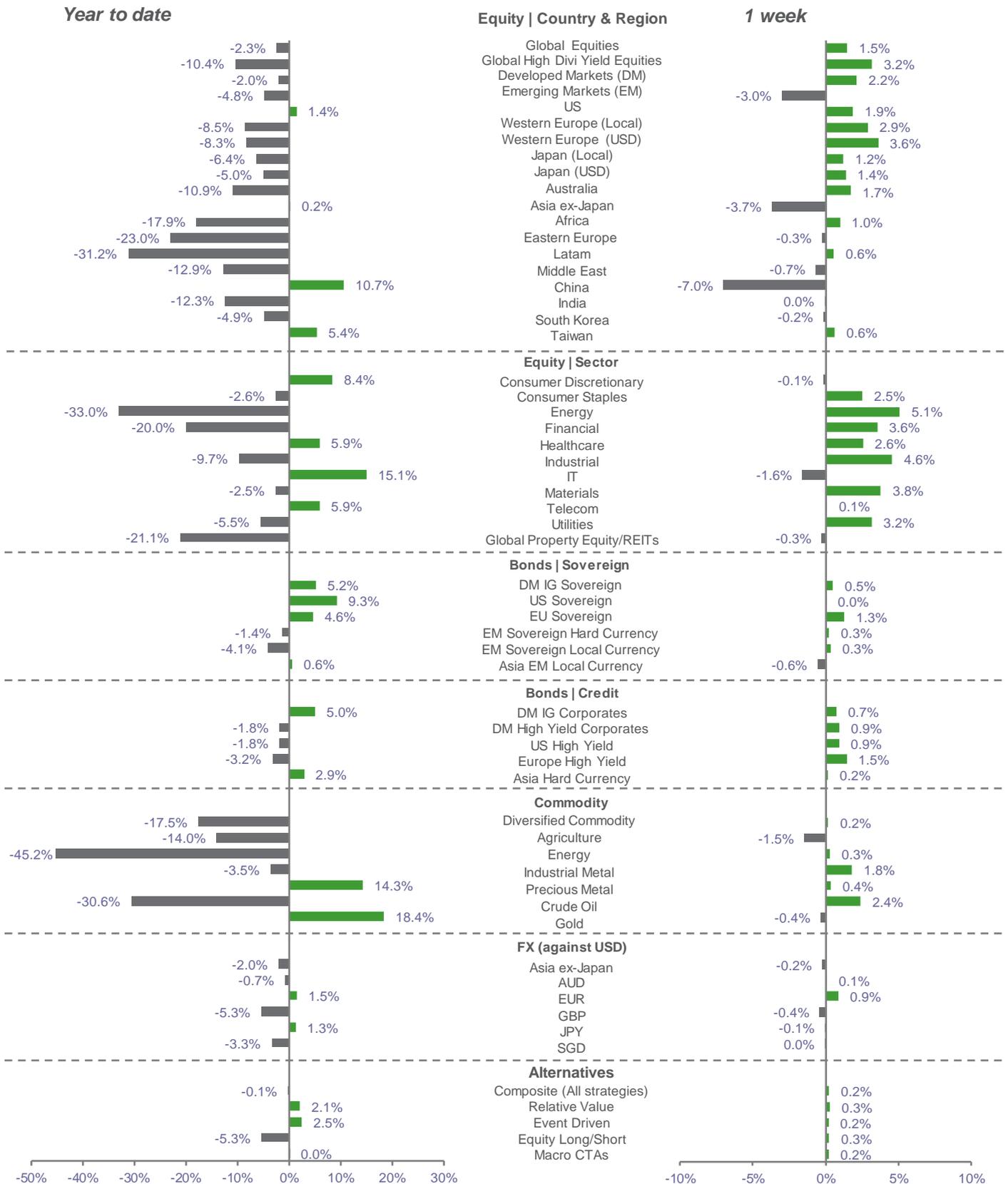
We expect further gains in crude oil prices as demand improves, more than offsetting OPEC's latest decision to scale back supply curbs

WTI crude oil price (front-month contract)



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 16 July 2020, 1 week period: 09 July 2020 to 16 July 2020

Economic and market calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	JN	Exports y/y	20-Jul-2020	Jun	-25.1%	-28.3%
TUE	JN	Natl CPI Ex Fresh Food, Energy y/y	21-Jul-2020	Jun	0.4%	0.4%
	JN	Nationwide Dept Sales y/y	21-Jul-2020	Jun	–	-65.6%
WED	JN	Jibun Bank Japan PMI Composite	22-Jul-2020	Jul P	–	40.8
THUR	US	Leading Index	23-Jul-2020	Jun	2.6%	2.8%
	EC	Consumer Confidence	23-Jul-2020	Jul A	–	-14.7
FRI/SAT	UK	Retail Sales Ex Auto Fuel y/y	24-Jul-2020	Jun	–	-9.8%
	FR	Markit France Composite PMI	24-Jul-2020	Jul P	–	51.7
	GE	Markit/BME Germany Composite PMI	24-Jul-2020	Jul P	–	47
	EC	Markit Eurozone Composite PMI	24-Jul-2020	Jul P	–	48.5
	UK	Markit/CIPS UK Composite PMI	24-Jul-2020	Jul P	–	47.7
	US	Markit US Composite PMI	24-Jul-2020	Jul P	–	47.9
	US	New Home Sales	24-Jul-2020	Jun	690k	676k

	Event	This Week	Date	Period	Actual	Prior
MON	IN	CPI y/y	13-Jul-2020	Jun	6.1%	–
TUE	EC	ZEW Survey Expectations	14-Jul-2020	Jul	59.6	58.6
	US	CPI Ex Food and Energy y/y	14-Jul-2020	Jun	1.2%	1.2%
WED	UK	CPI Core y/y	15-Jul-2020	Jun	1.4%	1.2%
	US	Industrial Production m/m	15-Jul-2020	Jun	5.4%	1.4%
	JN	BOJ Policy Balance Rate	15-Jul-2020	15-Jul	-0.1%	-0.1%
THUR	US	U.S. Federal Reserve Releases Beige Book	16-Jul-2020		–	–
	CH	Industrial Production y/y	16-Jul-2020	Jun	4.8%	4.4%
	EC	ECB Main Refinancing Rate	16-Jul-2020	16-Jul	0.0%	0.0%
	CH	GDP y/y	16-Jul-2020	2Q	3.2%	-6.8%
	CH	Retail Sales y/y	16-Jul-2020	Jun	-1.8%	-2.8%
	CH	Fixed Assets Ex Rural YTD y/y	16-Jul-2020	Jun	-3.1%	-6.3%
FRI/SAT	US	U. of Mich. Sentiment	17-Jul-2020	Jul P	–	78.1
	US	Building Permits	17-Jul-2020	Jun	–	1216k

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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