Wealth Management Chief Investment Office
7 January 2022

Weekly Market View

Sticking with risk, buying the dip

→ As we start 2022, we plan on averaging into risk assets on dips, despite the latest concerns about Omicron, inflation and a seemingly aggressive Fed policy.

→ The developed economies of US and Europe, where COVID booster shots are in progress, retain their advantage of normalising their economies earlier than others. We retain our preference for US and Euro area equities.

→ While Omicron could prolong inflation pressures, we lay out several counterforces that lead us to believe these pressures will subside later this year. Thus, we expect central banks, including the Fed, to remain accommodative this year, even if they unwind emergency stimulus measures.

→ Against this backdrop, markets in 2022 should favour risk takers, despite higher volatility. We lay out asset class strategies, supported by technical indicators, that should benefit from the developing scenario.

Is there room for Treasury yields to rise further?

What are the implications of rising Treasury yields on equity sectors?

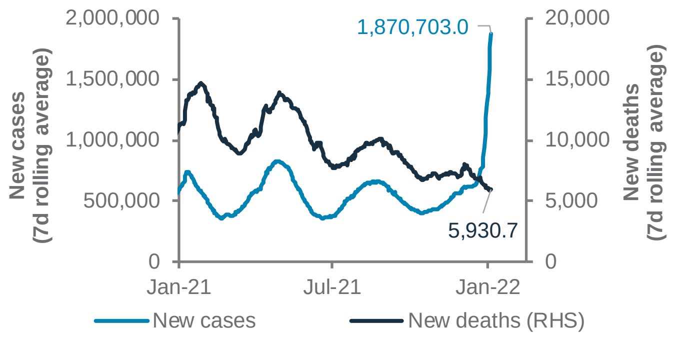
Do you expect a turnaround in Asia USD bonds soon?

Important disclosures can be found in the Disclosures Appendix.

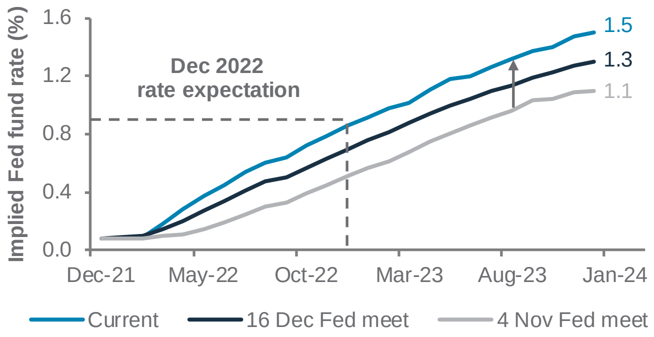
Charts of the week: Will Omicron complicate Fed policy?

The COVID surge has not been accompanied by casualties, but it could complicate the inflation outlook and Fed policy

Global daily COVID cases and deaths, 7-day rolling average



Current Fed rate expectations vs after prior Fed meetings



Source: Bloomberg, Standard Chartered

Editorial

Sticking with risk, buying the dip

As we start 2022, the question on every investor's mind is whether we are going to see another strong year for risk assets, following three straight years of double-digit gains in global equities. The answer depends on three related themes: Does Omicron mark the end of COVID waves? Will inflation accelerate further, especially in the US? Are policymakers significantly behind the curve in normalising policies?

On Omicron, health experts cannot guarantee that this is the last of the COVID waves. However, Omicron is turning out to be less severe than previous variants based on hospitalisation and death data, especially in highly vaccinated countries. This means that developed economies like the US and Europe have a higher chance of returning to normality quickly, given they are almost halfway through providing booster shots to the adult populations. The developed world's vaccination advantage and their capacity to provide fiscal and monetary stimulus in times of need were key factors behind US and Euro area equities ending 2021 as the biggest winners, in our view. We see little reason so far to believe that this year is going to be different. The US Congress is considering plans for USD 1.8trn in fiscal stimulus and the EU has automatic fiscal stabilisers in place if Omicron hits US and European economies severely.

Nevertheless, Omicron has complicated the inflation outlook. The global economy was returning to normality before Omicron hit. The latest wave raises the risk of a more prolonged disruption to job markets as workers stay away. With the US job market already tight (Bloomberg consensus forecasts a 4.1% jobless rate in December compared with the Fed's 4.0% long-term goal), any delay in greater labour participation, along with any further supply disruptions, could fuel inflation pressures, especially in the US. However, as noted in our *Outlook 2022*, there are several counterforces that lead us to believe that inflationary pressures will subside later this year: (i) the US fiscal cliff is likely to slow growth significantly by H2 22; (ii) booster doses will allow more workers to return to the job market; (iii) businesses are already stepping up investments into new capacity in areas like semiconductors and rebuilding inventory. We also expect excessive demand for goods to fade by H2 22, which could drag down prices as the new inventory arrives; (iv) capex is likely to boost productivity further; and, finally, (v) China's slowdown (we expect China's growth to stabilise around 5% this year) and a strong USD in the early part of the year are two powerful deflationary forces for 2022.

Against these factors, we see little reason to believe that central banks are significantly behind the curve in tackling inflation. The Fed's latest meeting minutes suggest it is considering unwinding accommodative policies at a faster pace than previously expected, possibly starting rate hikes as early as Q2 22 after ending bond purchases by March. This is in line with the significant improvement in job markets in the US. For investors, this sends a positive message – that the Fed is confident about the recovery. While we have pencilled in just one Fed rate hike this year (vs 3 hikes priced by markets), a sustained tightening of the job market could lead to one or two more hikes in 2022. However, as we noted in our *Outlook 2022,* equity bull markets are generally threatened when monetary policy becomes too restrictive, such as when Fed rates exceed the inflation rate or the economy's long-term growth rate. We believe Fed policy is unlikely to reach such levels this year.

Hence, our strategy is to stick with risk assets, looking to buy or average into dips. Markets in 2022 are likely to be more volatile than last year, but should favour risk takers. Investors keen to hedge against inflation may add exposure to gold, real estate and commodities-based assets, while those worried about tighter monetary policies could benefit from exposure to financial sector equities (see pages 4-6 for detailed strategies).

— Rajat Bhattacharya

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as moderately negative for risk assets in the near term

(+) factors: Robust US job market, low COVID hospitalisations/deaths

(-) factors: Omicron concerns, hawkish Fed, Ukraine standoff

	Positive for risk assets	Negative for risk assets
COVID-19	• Hospitalisations remain below previous peaks in most countries where Omicron cases have surged • New cases have declined over the past month in most of Asia, though some have started to see a rebound in infections • The US allowed booster shots for 12-15 year olds	• Omicron led to a record surge in infections in the US, Europe and Australia, leading to further mobility restrictions • China locked down a second city over the past month as new cases were detected
	Our assessment: Negative – Surging Omicron variant, another China lockdown, but relatively low hospitalisation rate	
Macro data	• US private job creation rose more than expected • China, Japan and UK Manufacturing PMIs rose more than expected • US, German factory orders rose more than expected • German retail sales rose unexpectedly	• US ISM Manufacturing and Services PMI fell more than forecast to a still-robust 58.7 and 62.0 respectively • Euro area Services PMI fell more than expected; German Composite PMI fell more than expected to 49.9
	Our assessment: Positive – Strong China, Euro area manufacturing, strong US job market	
Policy developments		• Fed's December meeting minutes showed policymakers are considering a faster pace of stimulus withdrawal than previously expected
	Our assessment: Negative – Hawkish Fed	
Other developments	• OPEC+ agreed to boost oil output by 400,000 bpd in February	• The US, EU voiced support for Ukraine amid concerns about a Russian invasion • China's cyberspace regulator plans new rules in February
	Our assessment: Negative – Ukraine stand-off	

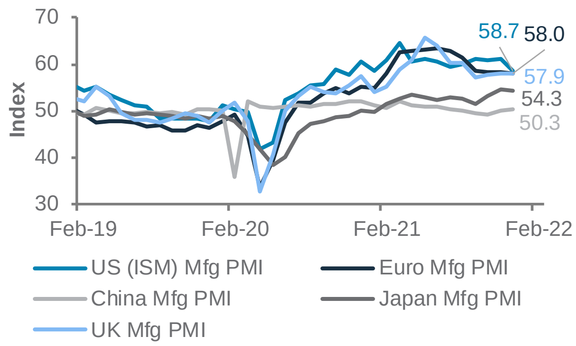
US long-term inflation expectations remain range-bound, offering the Fed some breathing room on the pace of its rate hiking cycle

Market-based US long-term inflation expectations

Source: Our World in Data, Standard Chartered

Manufacturing sector business confidence remains strong globally amid robust demand

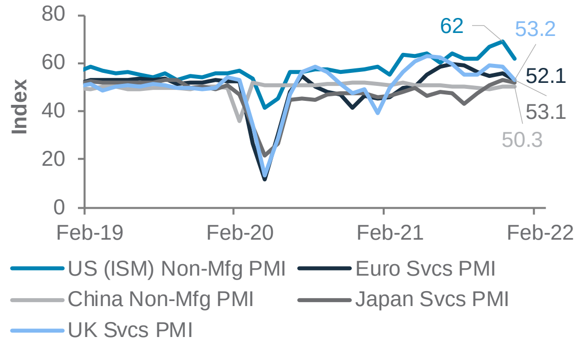
US, Euro area, China, UK, Japan Manufacturing PMIs



Source: Bloomberg, Standard Chartered

Global services sector activity is likely to take a hit in the near term due to Omicron's surge

US, Euro area, China, UK, Japan services sector PMIs



Source: Bloomberg, Standard Chartered

Top client questions

Is there room for US Treasury yields to rise further?

US Treasury yields have risen sharply, by nearly 20bps, since the start of the year, driven by two factors, in our assessment:

1. Incoming data that indicates a lower hospitalisation rate for Omicron led to a reduction in safe-haven demand. Moreover, any resulting supply-chain disruptions may further lead to higher inflation in the near term.
2. Hawkish guidance from the latest Fed minutes, which indicated that the Fed plans to start reducing its balance sheet this year.

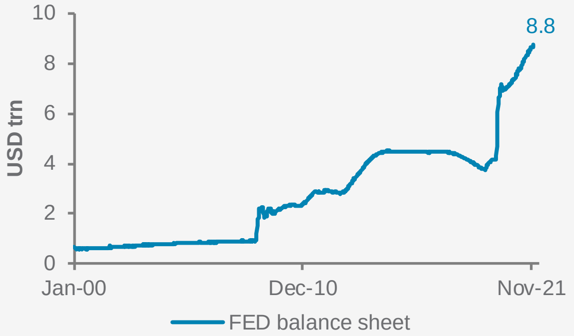
Although the odds of less accommodative Fed policy have risen in the near term, we expect inflation to start to subside by mid-year, somewhat reducing the pressure on the Fed. A signal of earlier-than-expected balance sheet reduction is likely to lead to greater volatility in longer-term bond yields. However, the projected reduction in US Treasury supply this year should help alleviate some pressure.

In the near term, we view 1.77% and subsequently 1.97% as key technical resistance levels. While a near-term overshoot of these levels is certainly possible, we continue to expect US 10-year Treasury yields to trade within 1.75-2.00% on a 12-month horizon.

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

Similar to 2018, Fed balance sheet reduction is likely to be gradual and only partially reverse the surge during the pandemic

Size of US Federal Reserve's balance sheet



Source: Bloomberg, Standard Chartered

What are the implications of rising US Treasury yields on equity sectors?

Higher yields have a direct impact on borrowing costs. Conversely, it benefits banks, which can earn higher interest income. Along with strong economic growth boosting demand for loans and financial services, higher yields can be a strong tailwind for bank earnings. Our preferred exposure is through Europe's financial sector, which we expect to outperform the broader market over the next 6-12 months. Aside from the tailwind from higher yields, the European financial sector continues to be attractively valued, trading at a significant 34% discount to the broader market.

Having said that, higher yields are a headwind for equity valuations in the short term, especially for stocks with high P/E multiples. Such stocks typically derive most of their value from their long-term earnings potential, and higher yields would discount these future earnings more heavily. The technology sector falls in this camp – given its valuations, bond yields may have to stabilise before these sectors can once again outperform. However, we also believe that bond yields are more of a short-term headwind. In the longer term, yields have a relatively weak correlation with the tech sector's performance, as earnings growth tends to be the ultimate performance driver. Therefore, on a 6-12 month horizon, we continue to prefer the US and European tech sector given we see support from strong structural earnings growth.

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

Europe's financial sector is attractively valued compared with the broader market

Consensus 12-month forward P/E of MSCI Europe financial sector index vs MSCI Europe index and 10-year average premium/discount

Source: MSCI, FactSet, Standard Chartered

Top client questions (cont'd)

Do you expect a turnaround in Asia USD bonds soon?

Asia USD bond spreads tightened by nearly 60bps after peaking on 6 Nov 2021. The significant move was due to exclusion of defaulted Chinese real estate issuers. On a total returns basis though, Asian USD bonds dropped 1.0% in the past week after another Chinese developer reportedly missed a loan payment. However, we do see some signs of initial recovery in the Chinese real estate sector after signals of policy intervention and easing. The reduction of the PBoC's Loan Prime Rate (LPR) for the first time in almost two years was a key factor. In addition, local government-backed entities are raising stakes in several distressed developers. Looking ahead, we would also watch for any positive catalysts from the following:

- Signals of further monetary policy easing or a reversal of restrictive measures
- Bail-ins from state-owned entities
- Improvement in corporate fundamentals

Overall, recent events support our positive view on Asia USD bonds given still-attractive valuations and relatively low sensitivity to US bond yields. We see room for the recovery to continue, especially in Chinese USD bonds. However, individual defaults could still rise, especially since Chinese real estate developers are approaching a more intensive debt repayment window in the coming months.

— **Cedric Lam,** *Senior Investment Strategist*

Asia USD bond yield premiums tightened recently, albeit with exclusion of defaulted issuers being a key driver

Asia and China USD bond yield premiums over US Treasuries

Source: Bloomberg, Standard Chartered

USD/JPY has rallied strongly. What is the near-term outlook?

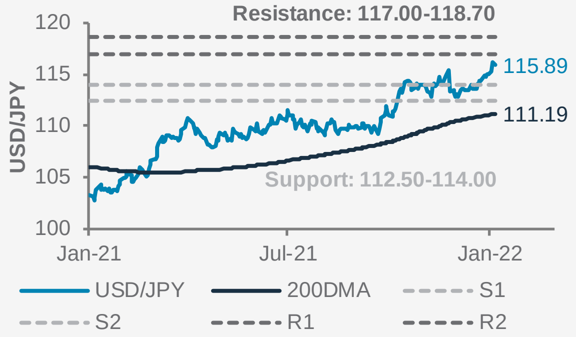
USD/JPY pushed above its late-2021 high of 115.50 as hawkish Fed comments drove US Treasury yields sharply higher. In the near term, a move towards resistance at 116.50-117.00 is likely, although a sharp rally may be short-lived since technicals are flagging near overbought conditions on both the daily and weekly charts. Having said that, the overall short-term USD/JPY trend is up. A slide back below 115.50 should attract buyers on a dip towards 113.50-114.00.

A key support level for the medium-term uptrend is 112.50, and only a sustained break below here would signal potential for a trend change, in our view. We believe the USD/JPY is overbought in the short term and overvalued in the longer term.

More broadly, our 12-month view is for potential USD strength early in 2022 on a hawkish Fed, followed by falling inflationary pressure and a less hawkish Fed in H2 22 that biases the USD to the downside. USD/JPY is particularly sensitive to US yields as the BoJ is expected to keep the policy stable through 2022; hence market expectations for the pace and extent of Fed policy tightening in the coming weeks is likely to be a key driver of USD/JPY price action.

USD/JPY's break to new trend highs suggests a push towards 117 is likely; overbought technicals may cap further progress near-term

Daily USD/JPY chart with technical indicators



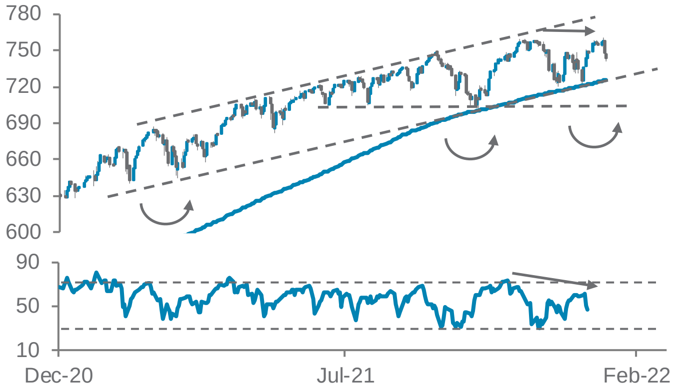
Source: Bloomberg, Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

Global equities: Short-term fatigue

MSCI All Country World index daily chart with 200DMA and RSI

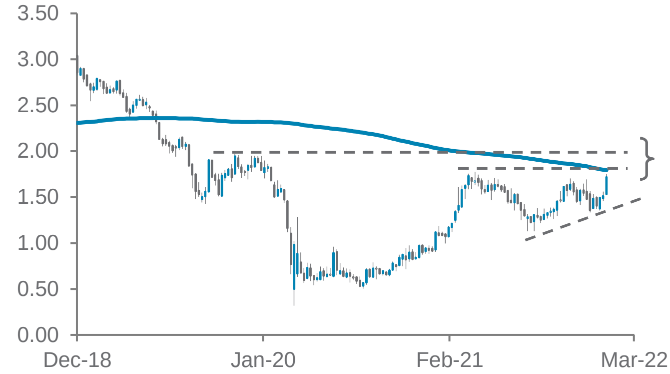


Source: Refinitiv, Standard Chartered

Negative RSI divergence (lower peaks in RSI associated with a potential double-top in the index) is a sign of fatigue. A drop towards the 200DMA (currently at 726), 2.4% from Thursday's close, is possible. However, there is strong support at the October low of 702 (5.6%), which could limit the decline.

US 10y Treasury yield: Flexes muscles again

US 10y Treasury yield weekly chart with 200WMA

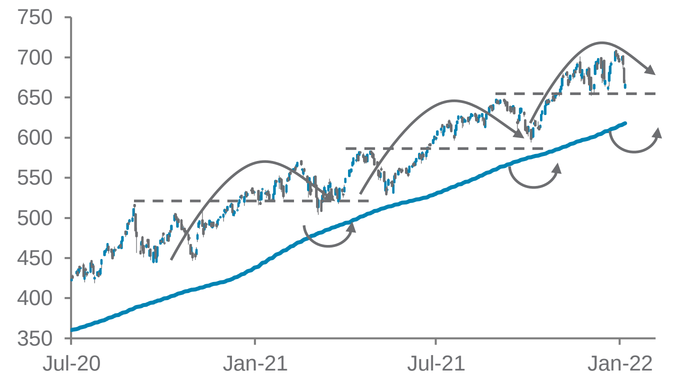


Source: Refinitiv, Standard Chartered

The US 10-year Treasury yield is retesting crucial resistance at 1.77-1.97%. While the yield has tested resistance lately – it has made two false attempts in recent months – any break above could pave the way towards 2.15% initially, possibly 2.45%. For the bullish scenario to hold, at minimum, the yield needs to stay above 1.34%.

US technology: Strong support on the 200DMA

MSCI US Technology daily chart with 200DMA

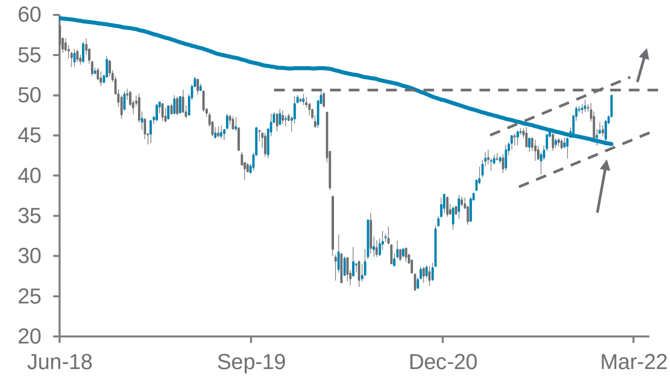


Source: Refinitiv, Standard Chartered

It has been a tale of two steps forward, one step back. Going by this pattern, the index could be supported around current levels. In addition, there is strong support on the 200DMA (now at 617; 7% from Thursday's close), coinciding with the October low of 594 (11%). Only a break below 594 would indicate that the short-term trend had turned bearish.

EU banks: Trend remains up

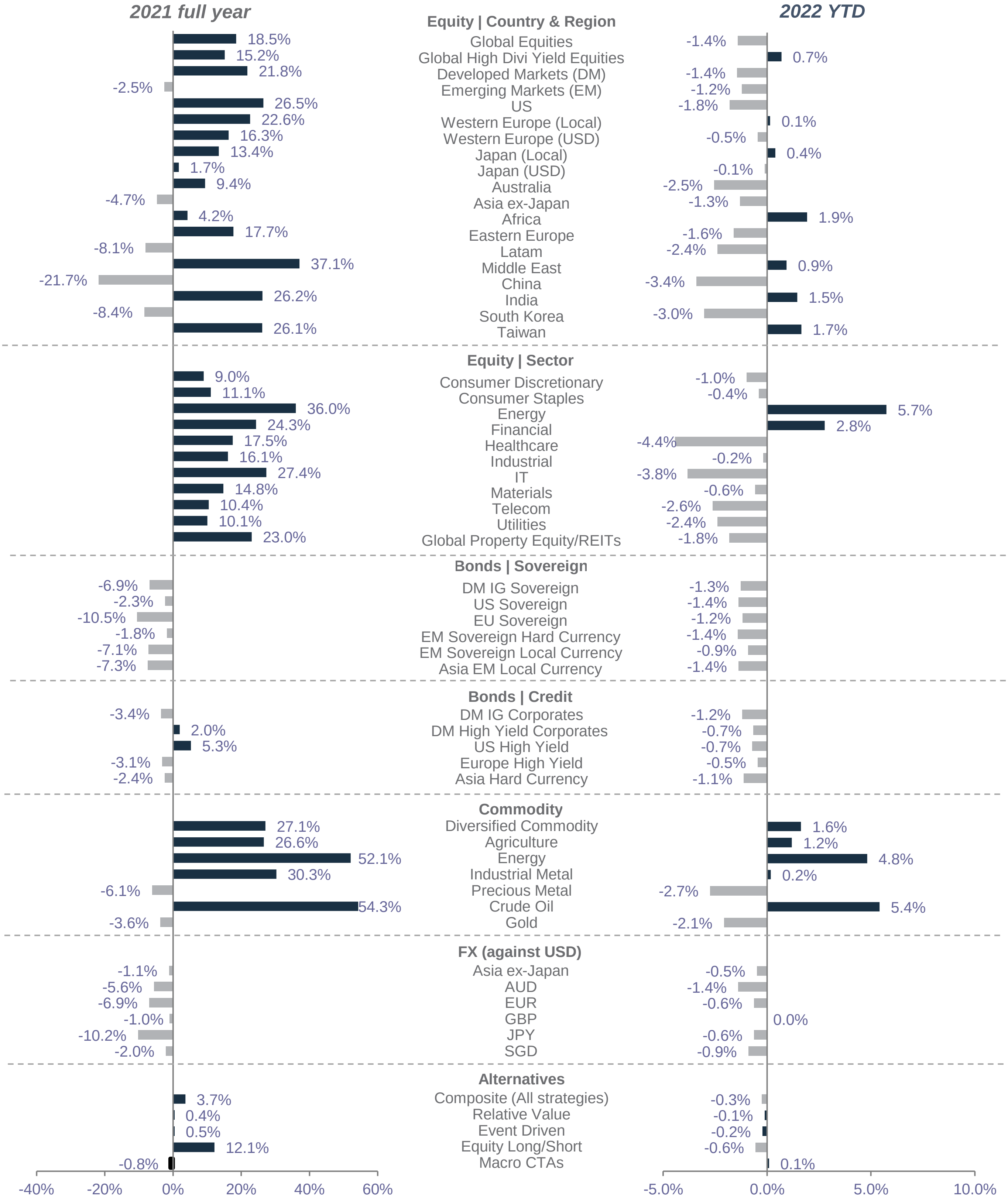
MSCI Europe Banks weekly chart with 200WMA



Source: Refinitiv, Standard Chartered

The rebound from the 200WMA, coupled with the pattern of the higher highs and higher lows, confirms that the uptrend remains intact. However, the index needs to clear the immediate resistance at 50.37 for the trend to turn unambiguously bullish. A break above could pave the way towards 58.00 (16% from Thursday's close).

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 full-year performance from 31 December 2020 to 31 December 2021; 2022 YTD: 31 December 2021 to 06 January 2022

Our 12-month asset class views at a glance

Asset class			
Equities	▲	**Alternatives**	◆
Euro area	▲	Equity hedge	▲
US	▲	Event-driven	◆
UK	▼	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	EC	Unemployment Rate	Nov	7.3%
TUE				
WED	CH	PPI y/y	Dec	12.9%
	CH	CPI y/y	Dec	2.3%
	US	CPI y/y	Dec	6.8%
	US	CPI Ex Food and Energy y/y	Dec	4.9%
THUR	US	PPI Ex Food and Energy y/y	Dec	7.7%
	US	PPI Final Demand y/y	Dec	9.6%
FRI/SAT	UK	Industrial Production y/y	Nov	1.4%
	US	Retail Sales Ex Auto and Gas	Dec	0.2%
	US	Industrial Production m/m	Dec	0.5%
	CH	Trade Balance	Dec	$71.7b

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

The US 10-year Treasury yield is approaching resistance

Technical indicators for key markets as on 06 January 2022

Index	Spot	1st support	1st resistance
S&P500	4,696	4,663	4,763
STOXX 50	4,325	4,285	4,379
FTSE 100	7,450	7,384	7,517
Nikkei 225	28,801	28,415	29,259
Shanghai Comp	3,586	3,568	3,622
Hang Seng	23,073	22,854	23,345
MSCI Asia ex-Japan	779	775	787
MSCI EM	1,217	1,211	1,229
Brent (ICE)	82.0	79.2	83.4
Gold	1,792	1,779	1,817
UST 10Y Yield	1.72	1.58	1.79

Source: Bloomberg, Standard Chartered

Investor diversity remains normal across major assets

Our proprietary market diversity indicators as of 05 January

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↑	1.50
Global Equities	◐	↓	1.45
Gold	●	↓	1.59
Equity			
MSCI US	◐	→	1.41
MSCI Europe	◐	↓	1.37
MSCI AC AXJ	●	↑	4.07
Fixed Income			
DM Corp Bond	●	↑	1.60
DM High Yield	●	↑	1.86
EM USD	●	↑	1.95
EM Local	●	↑	1.53
Asia USD	●	↑	1.76
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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