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Wealth Management Chief Investment Office
5 November 2021

Weekly Market View

The Fed cycle turns

The Fed's decision to start tapering bond purchases from this month has been received well by investors. Global stocks hit a new record high and Treasury yields and the USD remained range-bound as investors continued to focus on strong corporate earnings beats. We expect easy financial conditions to prevail and growth and earnings to continue surprising positively over the next 6-12 months, helping equities outperform bonds and cash.

Equities: European Q3 earnings have surprised positively, following solid earnings beats in the US, amid strong profit margins. The European earnings beats were led by our preferred financial and technology sectors.

Bonds: We believe property sector risks have increasingly been priced into China High Yield bonds. Thus, Asian High Yields bonds offer attractive value, in our view.

FX: We see scope for near-term relative GBP weakness as the BoE held interest rates, despite rising inflation, to support growth.

What are the asset class implications of the Fed's latest policy guidance?

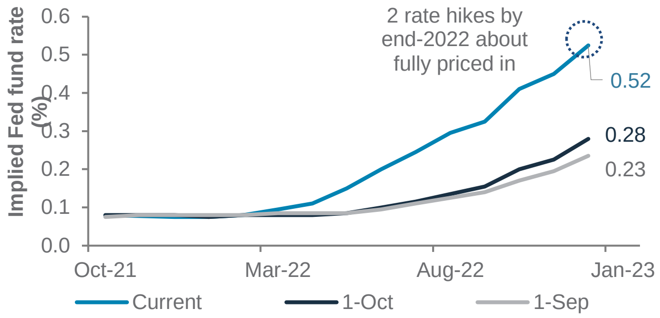
Which assets and sectors are likely to benefit from the COP26 climate summit?

What is the technical outlook for the US Treasury yield, European Financials?

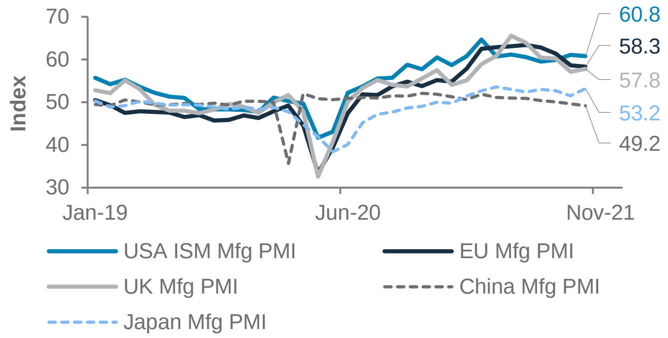
Charts of the week: Business confidence robust as the Fed tapers

Rising Fed rate hike expectations have come against the backdrop of strong business confidence in Developed Markets

Fed rate hike expectations today vs early September/October



Business confidence indicators (PMIs) for major economies



Source: Bloomberg, Standard Chartered

Editorial

The Fed cycle turns

The Fed's decision to start tapering its bond purchases from this month has been received well by investors – global stocks hit a new record high, recovering from the 5% pullback in September, while Treasury yields and the USD remained within recent ranges. We should not be surprised. As the Fed gets ready to withdraw its ultra-accommodative monetary policy, it is important to remember that the world is in a vastly different place than when those emergency stimulus measures were applied during the depths of the pandemic. Most Developed Markets, and many Emerging Markets, have started to "live with COVID", having vaccinated most of their populations. Business confidence in major economies (eg. PMIs) is robust. Corporate earnings in the US and Europe in Q3 have once again beaten expectations, helping lift future earnings expectations.

Looking at the world in this light, it's not surprising that investors now expect the Fed to start hiking interest rates as early as mid-2022, almost half a year sooner than what was forecast a few months ago. Indeed, markets are now factoring in about two Fed rate hikes by end-2022 and the first ECB hike in H1 2023. The Fed and the ECB would only be following the lead of the central banks in Norway, Canada, New Zealand, among others, which have already started to hike. We view the build-up of rate hike expectations from a position of strength as economies recover and job markets tighten faster than anticipated earlier.

It has been a relatively smooth recovery for risk assets since the depths of the pandemic last year – the MSCI All Country World equity index has not corrected more than 10% even once since the lows of March 2020 (it has corrected more than 5% only three times since then). The path ahead is unlikely to be as smooth. Markets (and, arguably, central banks) are starting to factor in the possibility of a more prolonged bout of inflation as companies struggle to meet rising consumer demand due to shortages of semiconductor chips and supply bottlenecks in shipping and transportation. Skills mismatches and early retirements are also hampering the US job market recovery, lifting wage costs (annualised q/q gains in the US Employment Cost Index jumped to a 30-year-high in Q3). Fed Chair Powell acknowledged these risks, keeping the pace of bond purchase tapering flexible (for now, the Fed will reduce bond purchases by USD 15bn a month, ending the programme by June 2022).

Meanwhile, China's manufacturing sector contracted in October despite strong exports, highlighting the challenges faced by producers from rising input costs. Some Emerging Markets, such as Brazil and Russia, face localised inflationary risks, forcing their central banks to hike rates aggressively.

For investors, this developing scenario emphasises the need to stay diversified, but tactically nimble. History suggests equities continue to outperform bonds and cash if growth remains at or above-trend and central bank policy stays accommodative e.g. interest rates stay well below economic growth. We expect these conditions to prevail in the US and Euro area in the next 6-12 months. Hence, our preference for these equity markets.

Within stocks, we believe a tilt towards the likely sectoral winners - energy, globally, financials in the US and Europe, and technology and industrials in Europe and China – would provide investors an edge. US financials and energy delivered the biggest Q3 earnings surprises. Long-term structural investment themes linked to climate change are likely to get a boost from the decisions at the COP26 meet in Glasgow. Within bonds, an environment of rising inflation calls for reducing exposure to Developed Market government bonds and rebalancing to Asian and Emerging Market USD bonds where yields remain attractive. Gold offers a time-tested hedge in the event inflation surprises higher in the coming months. Tactically, we see scope for near-term relative GBP weakness, as the BoE held rates despite rising inflation, to support growth (see page 6).

— 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

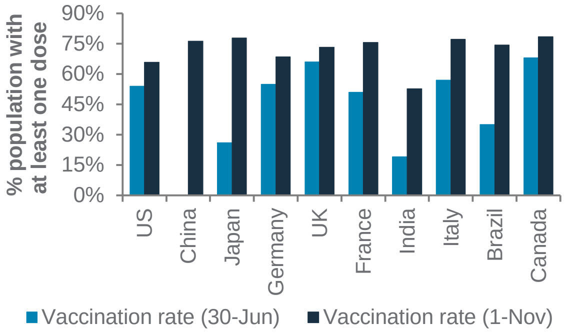
(+) factors: Falling global COVID cases, strong US PMI, supportive BoE

(-) factors: Weaker-than-expected China activity, Euro area PMIs

	Positive for risk assets	Negative for risk assets
COVID-19	• New cases in the US and most of Euro area, Asia, Japan, Latin America stablised at low levels after their recent declines • Hospitalisations in the UK remained well below last winter's peak levels • The US approved Pfizer vaccines for 5-11 year olds; 80% of US adults received at least one vaccine dose	• New cases surged in Germany, stayed at elevated levels in South Korea, UK, and hit record highs in Australia, New Zealand, Russia, Singapore • China locked down Lanzhou, a city of 4m people, and Shanghai Disneyland after a COVID outbreak; China's cases rose to a 3-month high
	Our assessment: Neutral – Falling global cases, subdued hospitalisations vs revival in Germany, Oceania, parts of China	
Macro data	• US ISM Services PMI rose more than estimated and Manufacturing PMI fell less than forecast • US initial jobless claims fell below estimates • Euro area GDP expanded more than forecast in Q2 • UK Manufacturing PMI rose more than expected to 57.8	• Euro area composite PMI fell more than expected • German retail sales unexpectedly fell • China's manufacturing PMI contracted more than forecast
	Our assessment: Neutral – Better-than-expected US, UK PMIs vs weaker-than-expected Euro area, China PMIs	
Policy developments	• BoE held rates, preferring to support growth • RBA ended yield curve control, but bond buying will continue till February	• China's PM Li Keqiang warned economy faces new downward pressures
	Our assessment: Neutral – Supportive BoE vs weaker China	
Other developments		• UK proposed opening trade dispute case vs. France • China tightened user data rules for internet companies
	Our assessment: Negative – UK-France tensions; China rules	

Most major economies have vaccinated close to 75% of their populations, which should enable economic activity to normalise in 2022

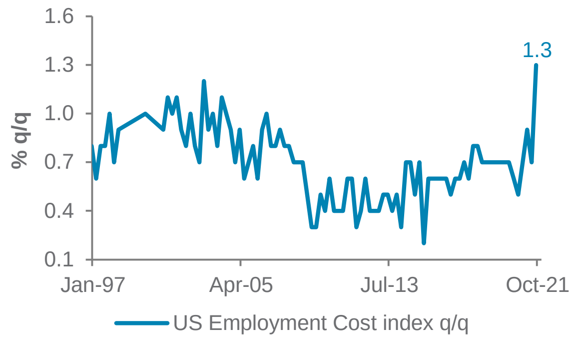
COVID-19 vaccination rates in the world's 10 largest economies



Source: Our World in Data, Standard Chartered

US price pressures have started to spill over into the labour market, with labour costs rising sharply in Q3; this is fuelling Fed rate hike expectations

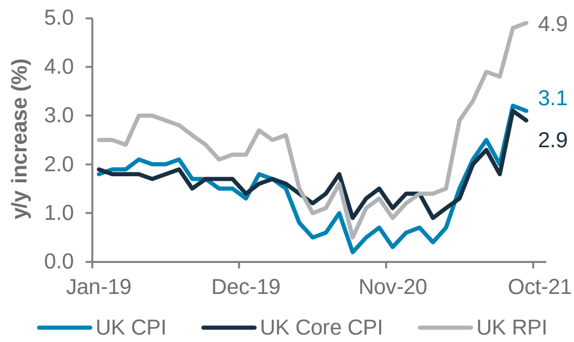
Changes in US Employment Cost Index



Source: Bloomberg, Standard Chartered

UK inflation pressures have risen due to Brexit and pandemic-related bottlenecks, but the BoE chose to hold interest rates to support growth

UK headline and core consumer price inflation and retail price inflation



Source: Bloomberg, Standard Chartered

Top client questions

What are the asset class implications of the Fed's latest policy guidance?

We believe the Fed's policy guidance is consistent with our preference for risky asset classes on a 12-month horizon.

10-year US Treasury yields were largely in a range following the Fed policy meeting, with upward pressure from the tapering announcement partly offset by downward pressure on major government bond yields following the Bank of England's decision to leave policy rates unchanged, against market expectations of a hike. Fed Chair Powell's comments that, tapering notwithstanding, rate hikes remain some distance away and that he expects inflation pressures to fade by the middle of next year helped soften market expectations of rate hikes that had been rising for the past 2 weeks, thus supporting risk assets.

While we continue to expect 10-year Treasury yields to rise over the next 12 months as markets prepare for rate hikes, we believe the Fed's reiteration that (i) it remains open to adjusting the pace of tapering based on incoming data, and (ii) the end of asset purchases does not automatically translate into higher policy rates, means the 10-year Treasury yield is likely to remain largely contained below 2% over the next 12 months. However, similar to prior rate hike cycles, a gradual flattening of the yield curve (ie. a narrowing gap between long and short maturity Treasury yields) is likely. Having said that, we continue to favour modestly short maturities within bonds.

For risky assets, we believe the outcome supports our positive views. We believe the Fed's tapering decision is a signal of confidence in the growth recovery and its willingness to adjust the pace of tapering based on incoming data means liquidity is likely to remain ample and policy should remain supportive for the ongoing growth recovery in the US. For equities, this means markets are likely to remain free to focus on earnings growth, where we expect positive outcomes to continue to drive equities performance. Global equities, with a preference for the US and Euro area, remain preferred. Value stocks are likely to particularly benefit from an environment of above-trend growth and rising bond yields. This environment is also likely to favour higher yielding bonds and asset classes with low sensitivity to rising Treasury yields. These include Emerging Market and Asia USD bonds and US and European High Yield corporate bonds where investors continue to expect low default rates.

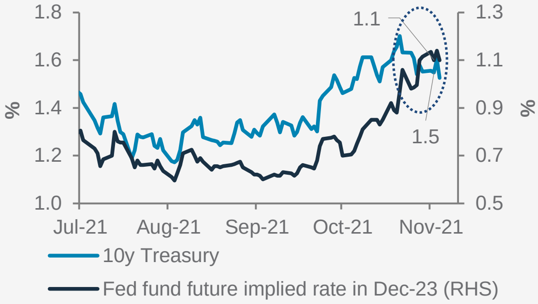
— **Manpreet Gill,** *Head of FICC Strategy*

Abhilash Narayan, *Senior Investment Strategist*

Fook Hien Yap, *Senior Investment Strategist*

Fed Chair Powell's reassurance that rate hikes are some distance away helped soften market expectations of rate hikes and Treasury yields

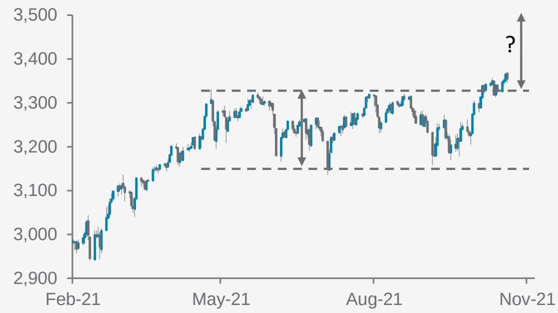
Market expectations of Fed funds rate in end-2023; 10-year US Treasury yield



Source: Bloomberg, Standard Chartered

Value-style equities are likely to particularly benefit from an environment of above-trend growth and rising bond yields

MSCI World Value index



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

How are earnings progressing in Europe and the US?

In the Stoxx Europe 600 index, 51% of reporting companies have given their Q3 update. Earnings have surprised by 11% to the upside and, as a result, Q3 earnings growth expectations have risen to 57% y/y growth, from 46% expected at the start of October. Sectors delivering the biggest earnings surprise have been financials (20% surprise) and technology (14% surprise). The 11% earnings surprise also exceeded the 3% positive revenue surprise, which is supportive of Q3 profit margin estimates as investors watch for companies' ability to navigate rising cost pressures. Earnings growth expectations for the full year of 2021 have also been revised up for Stoxx Europe 600 to 63%, from 58% at the start of October.

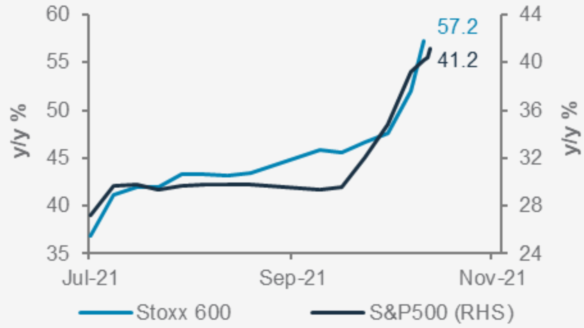
In the US, 84% of S&P500 index companies have reported results and earnings have surprised by 11% to the upside, led by financials (19% surprise), energy (14% surprise) healthcare (12% surprise) sectors. Q3 earnings are expected to grow by 41% y/y, up from 29% at the start of October. Earnings growth expectations for 2021 have also been revised up to 49%, from 46% at the start of October.

We believe the strong earnings season continues to support our preferred view for US and Euro area equities over the next 6-12 months, with earnings growth the main driver of performance.

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

A positive earnings season in Europe and US is driving upward revisions to Q3 earnings growth

Q3 2021 consensus earnings growth for Stoxx Europe 600 and US S&P500 indices



Source: Refinitiv, Standard Chartered

Do you expect a turnaround in Asian High Yield USD bonds soon?

Asian HY bonds remained under pressure despite China Evergrande making coupon payments for two of its bonds during the grace period over the past two weeks, thus avoiding a default. The bulk of the stress in Asia HY remains concentrated in the China property sector, and while we have seen an easing of mortgage policy and softening of economic data in China, the three potential catalysts for a turnaround that we had highlighted in our Weekly Market View on 15 October (policy intervention following weak economic data, reversal of regional property tightening measures, policy to support sector liquidity) have not yet been forthcoming.

With weakening contracted sales and limited access to bond markets due to prohibitive costs, the focus has now clearly shifted towards upcoming bond maturities of over USD 30bn for Chinese property developers till H1 2022. Several property developers have been downgraded in recent weeks, adding to the cautious sentiment.

Policy easing measures, which would lower refinancing costs (and default risk) are likely needed for spreads to start compressing (ie. bond prices to start rising) on a sustained basis. However, with the China HY component of the bond index now yielding over 20%, we believe a lot of bad news has been priced in. Hence, we believe retaining exposure to Asia HY bonds within a well-diversified investment allocation is the appropriate course of action at this time.

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

We believe most of the risks to China's property sector have been priced into High Yield bonds; thus, we continue to prefer Asian HY USD bonds

Yields offered by China and Asian HY bonds

Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

What is the outlook for the AUD and GBP after their central bank meetings?

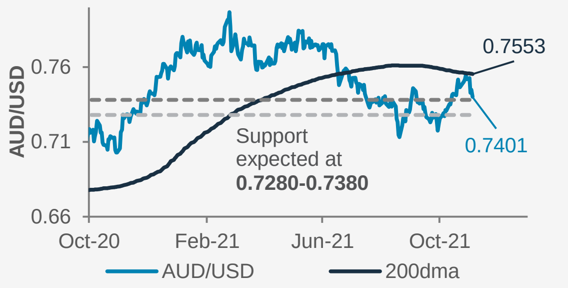
AUD/USD and GBP/USD held key resistance levels at 0.7560 and 1.3850 respectively and overbought conditions are now unwinding.

The RBA's forecast of 5.5% growth in 2022 and faster progress towards its inflation target meant it ended its yield curve control. Looking through headline inflation exacerbated by supply chain disruptions, it said highly supportive monetary conditions will continue until wage growth drives up core inflation. It also implied that the currency was still within a comfortable range. AUD/USD has traded between 0.71-0.80 this year and strong growth, policy support and favourable terms of trade suggest AUD/USD should attract buying interest in the 0.7280–0.7380 technical support band.

The BOE surprised markets with no rate change, but a hike in the coming months is possible. Concern that supply-side inflation risks may trigger a wage-price spiral were balanced with a need to monitor employment data now that job furlough support has ended. The UK economic recovery remains exposed to post-Brexit spats and supply chain issues. GBP/USD's break below 1.3570 could trigger a test of the September low near 1.3400 and then technical support at 1.3275. We are less optimistic on GBP/USD near-term as accumulated long positions may be unwound as uncertainty lingers.

The AUD/USD correction is likely to attract buyers at technical support above 0.7280

AUD/USD (daily) with key technical levels



Source: Bloomberg, Standard Chartered

What are the key developments to watch for at the ongoing COP26 summit and what sectors will benefit?

The UN's 26th Conference of Parties (COP26) kicked off last weekend in Glasgow. Global policymakers will strive to reach deals and set targets to tackle the climate crisis and prevent temperatures from rising above the 1.5°C target set in the Paris Agreement. Major announcements made at COP26 so far include India's 2070 net zero emissions target, a pledge to cut methane emissions and end deforestation by 2030, and a slew of private sector initiatives. Despite these announcements, UN reports still point to concerning gaps between policymakers' pledges and on-the-ground efforts.

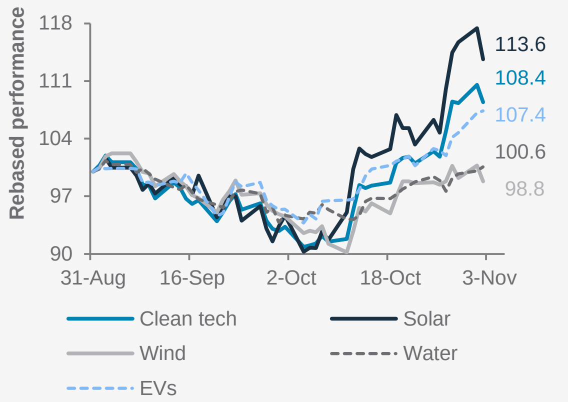
Businesses will need to sieve through sensationalised headlines to assess any proposed regulations, policies on disclosures and clarity on the speed of the low-carbon transition. A successful COP26 would result in an acceleration of these climate policies, in our view.

The summit is likely to offer continued support to our Time for Climate Investing theme. Growth in alternative energy is set to remain elevated, thanks to several structural drivers, including policy tailwinds. Within this context, companies and sectors geared towards enabling the energy transition could benefit from increased investments. These include firms offering clean energy generation, improved energy efficiency technologies, sustainable land, forestry and water management practices, and sustainable solutions finance.

— **Marco Iachini,** *Cross Asset Strategist*

Climate commitments at the COP26 summit are likely to support our long-term structural investment themes related to climate change

Recent performance of key climate-related themes (Index: 100 = 31 August, 2021)



Source: Bloomberg, Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

US 10Y Treasury yield: Could be settling in a range

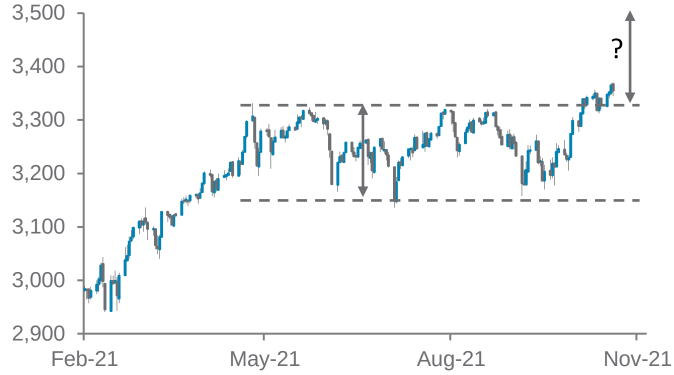
US 10-year Treasury yield daily chart with RSI

Source: Refinitiv, Standard Chartered

The negative divergence (higher yields with fading momentum) suggests that the yield rally is losing momentum. Still, the upward pressure is unlikely to ease while it remains above the mid-October low of 1.507%. Any break below would point to the possibility of a 1.35%-1.70% range in the near term.

World Value equities: Breaks higher

MSCI World Value Index daily chart

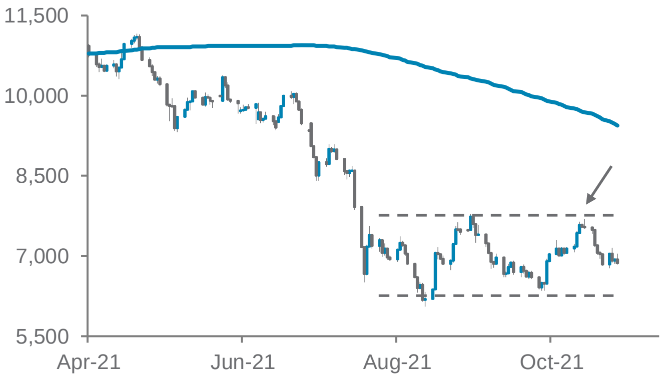


Source: Refinitiv, Standard Chartered

After staying in a range for months, the MSCI World Value index has broken above key horizontal trendline resistance from May around 3320. The break has opened the way towards 3485 (about 4% above Thursday's close) – the price objective of the sideway pattern.

China Internet: Base building in play

CSI China Internet USD index daily chart with 200-DMA

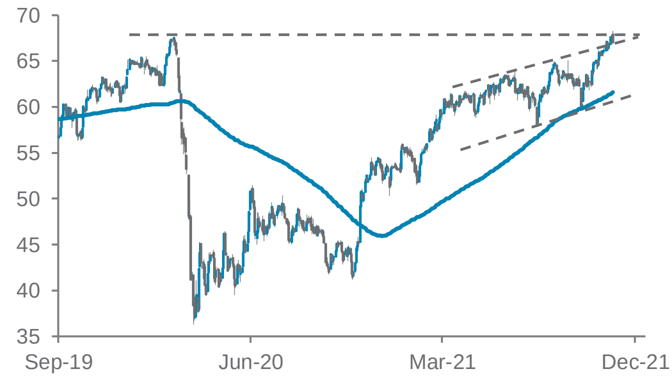


Source: Bloomberg, Standard Chartered

A failed attempt to break past resistance at 7,791 indicates that the index is not ripe for a bullish break just yet, raising the possibility of an extended base-building scenario. Still, the August low of 6,055 (about 12% below Thursday's close) continues to be a strong floor in the process.

Europe Financials: Attempting to break above key hurdle

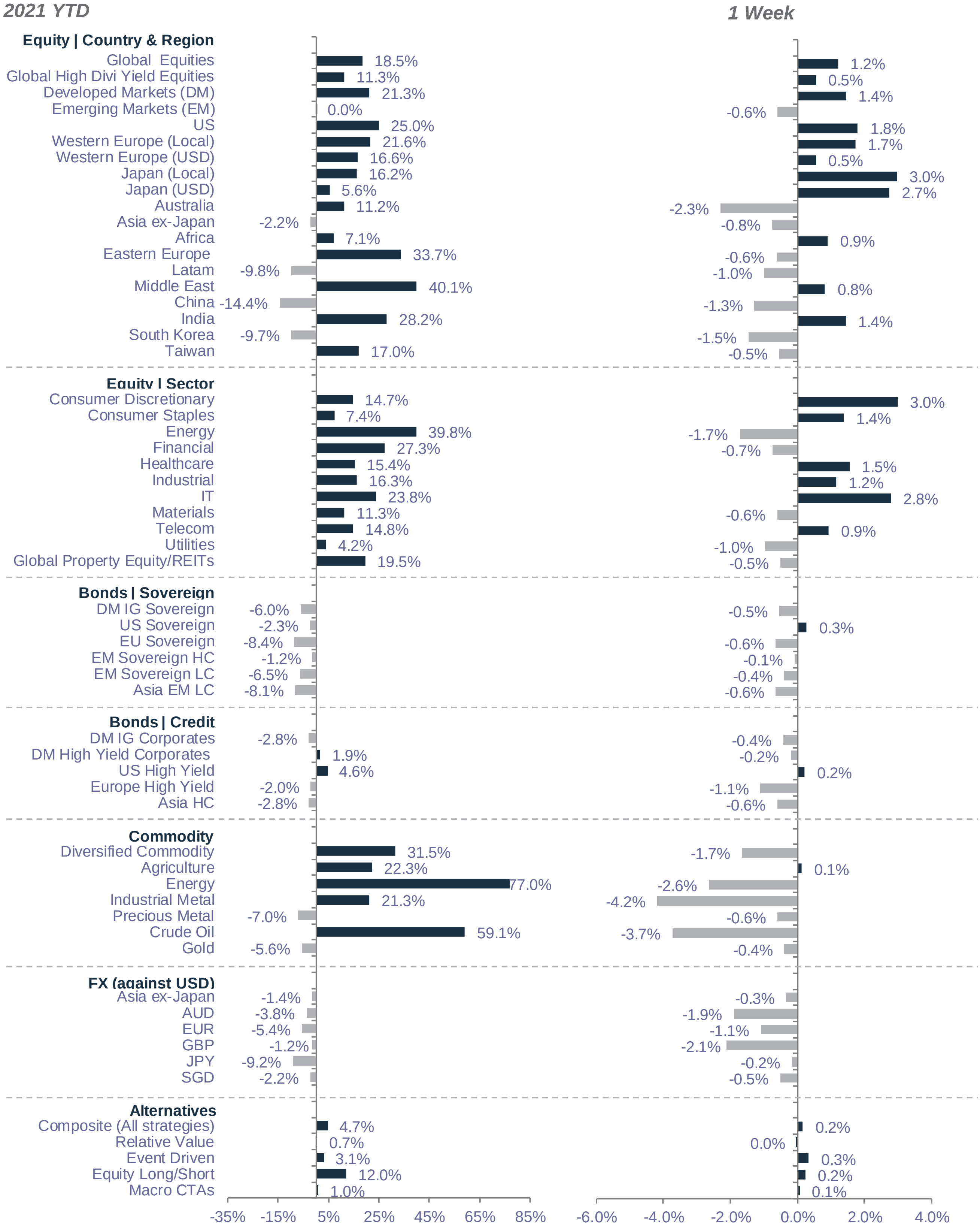
MSCI Europe Financials daily chart with 200-DMA



Source: Bloomberg, Standard Chartered

While it may not happen in the first attempt, the probability of an eventual break above converged resistance around 68 remains high. Any break above the key hurdle could pave way towards the 2018 high of 75 (about 12% above 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 YTD performance from 31 December 2020 to 04 November 2021; 1-week period: 28 October 2021 to 04 November 2021

Our 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				
TUE	EC	ZEW Survey Expectations	Nov	21
	US	PPI Final Demand y/y	Oct	8.6%
	CH	New Yuan Loans CNY	Oct	1660.0b
	CH	Money Supply M2 y/y	Oct	8.3%
WED	CH	CPI y/y	Oct	0.7%
	CH	PPI y/y	Oct	10.7%
	US	CPI y/y	Oct	5.4%
	US	CPI Ex Food & Energy y/y	Oct	4.0%
THUR				
FRI/SAT	US	JOLTS Job Openings	Sep	10439k
	US	U. of Mich. Sentiment	Nov P	71.7

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 S&P500 faces resistance 0.5% above current level

Technical indicators for key markets as on 04 November 2021

Index	Spot	1st support	1st resistance
S&P500	4,680	4,630	4,705
STOXX 50	4,333	4,278	4,361
FTSE 100	7,280	7,249	7,300
Nikkei 225	29,794	29,193	30,095
Shanghai Comp	3,527	3,501	3,550
Hang Seng	25,225	25,041	25,393
MSCI Asia ex-Japan	812	810	813
MSCI EM	1,268	1,264	1,270
Brent (ICE)	80.5	79.1	83.3
Gold	1,792	1,777	1,800
UST 10Y Yield	1.53	1.50	1.58

Source: Bloomberg, Standard Chartered

Investor diversity remains normal across major assets

Our proprietary market diversity indicators as of 03 November

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	↓	1.32
Global Equities	●	↓	1.58
Gold	●	↓	1.77
Equity			
MSCI US	◐	→	1.48
MSCI Europe	●	↓	1.92
MSCI AC AXJ	●	↑	1.68
Fixed Income			
DM Corp Bond	◐	↓	1.44
DM High Yield	●	↓	1.58
EM USD	●	→	1.54
EM Local	◐	↓	1.34
Asia USD	◐	↓	1.48
Currencies			
EUR/USD	◐	→	1.39

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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