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WM Chief Investment Office
14 May 2021

Weekly Market View

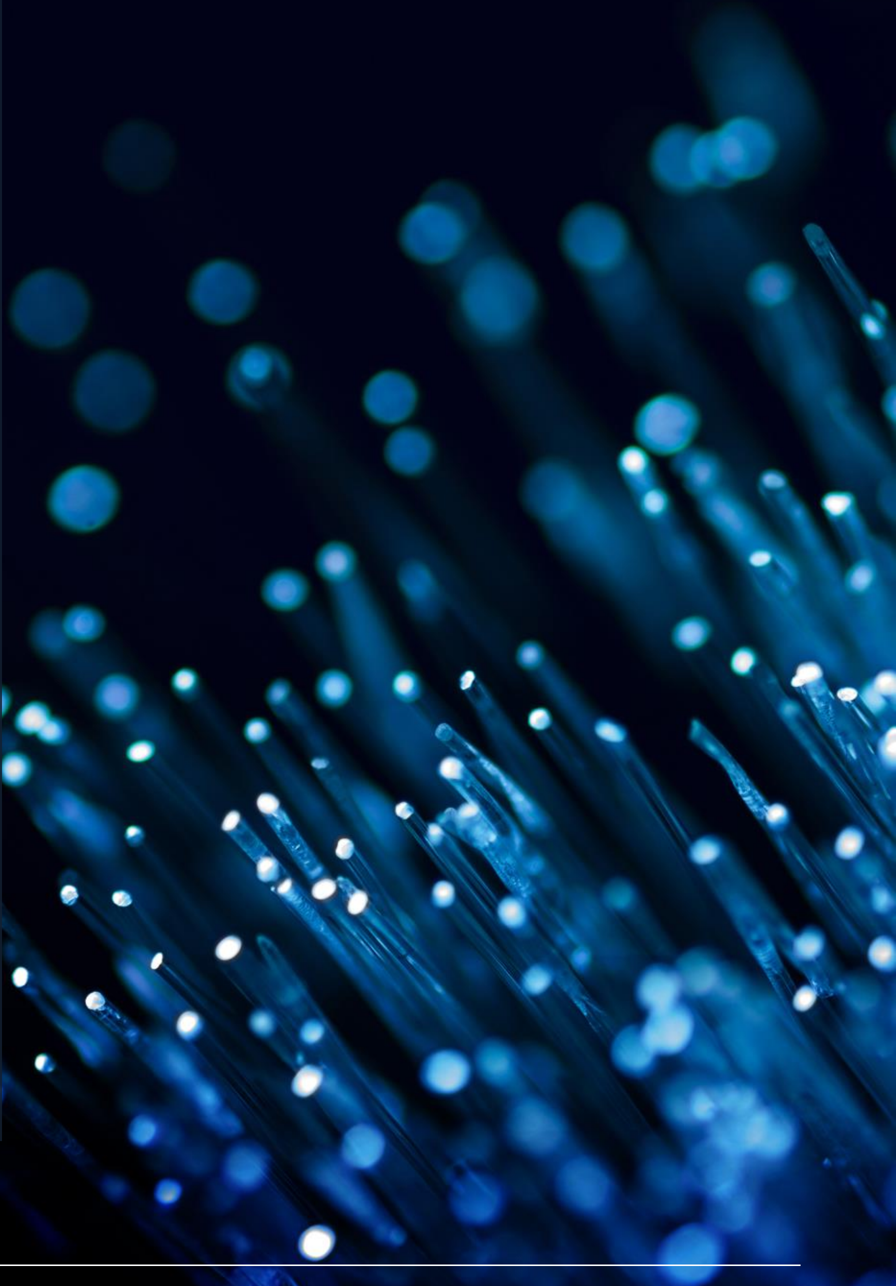
The inflation conundrum

A surge in US inflation jolted markets this week on concerns it could force the Fed to tighten policy sooner than expected. We lay out reasons why we believe the inflation spike is likely to be temporary, caused by short-term distortions in the labour market and supply bottlenecks. Since fundamentals continue to improve, we would use any dislocation in markets to build on our medium-term investment themes.

Equities: Technical chart indicators point to further downside in the technology sector-heavy Nasdaq index. We continue to prefer the cyclical Value sectors

Bonds: Emerging Market USD bonds offer yields close to 5%, which make them attractive for diversified investors despite their sensitivity to rising US bond yields

FX: We expect the CAD to benefit further from a tighter BoC monetary policy and rising commodity prices



How will GBP strength influence the performance of UK equities?

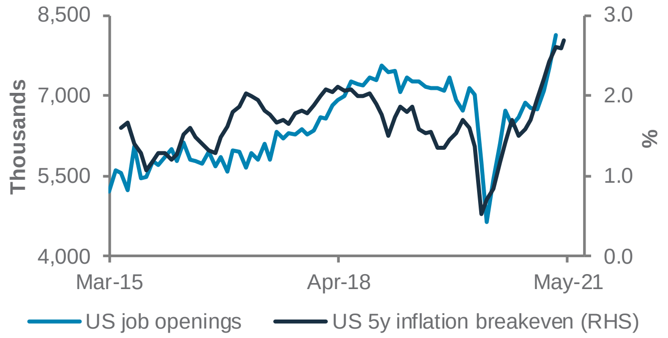
Is the upward pressure on the S&P500 index fading?

What are the pros-and-cons of the macro data announced this week?

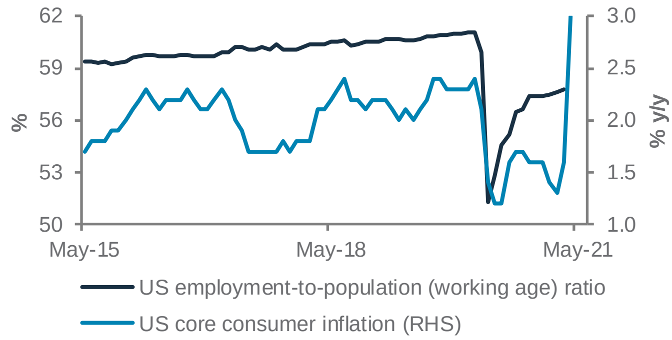
Charts of the week: Short term vs medium term

US inflation expectations are rising, but job market slack suggests wage pressures are likely to be short-lived

US job openings; US 5y inflation expectations



US employment-to-population ratio; US core inflation



Source: Bloomberg, Standard Chartered

Editorial

The inflation conundrum

"Jobs, jobs everywhere, not a soul to hire" – this reconstructed adage more or less sums up US economic data over the last week. While US job vacancies rose to their highest in two decades, hiring in April missed expectations by a wide margin. The data has raised concerns about emerging labour shortages adding to existing pandemic-driven supply bottlenecks to fuel a sustained rise in inflation, which could force the Fed to tighten monetary policy sooner than the markets currently expect. These concerns partly explain a further pullback in the interest-rate sensitive technology and other 'Growth' equity sectors. We believe concerns about labour shortages and supply bottlenecks are overblown.

Let us assess the labour market first. While there are several explanations for the US jobs data miss, the one that stands out, in our view, is the Biden unemployment benefits package. We believe this is working as a disincentive for potential employees to look for work, especially in the lower-income segment, where average weekly earnings surged the most (eg. McDonald's decision to boost hourly wages). These benefits are due to end in October, which should ultimately alleviate wage pressures. As our chart on the US employment-to-population ratio shows, there is a significant job market slack as millions of workers stay home either until they get vaccinated or until unemployment benefits run out.

Meanwhile, supply bottlenecks, for example in the semiconductor and auto sectors, are already accentuating the pressure from rising commodity prices, especially when measured vs a year ago - as April's 3.0% y/y jump in US core consumer inflation showed. While the problems in the semiconductor sector could last beyond a year, we believe most of pandemic-driven shortages are likely to last for a few months, not years, in a world awash with productive capacity. The continued surge in exports from China and Germany testify to the spare capacity in a globalised economy. A steady rise in US capital investment over the past year shows that businesses too are reacting to meet these shortages.

While these factors could create a window for US inflation data to surprise on the upside, we agree with the Fed that the inflation surge is likely to be temporary as vaccinated workers eventually return to jobs, businesses boost supplies and the base effects have less distortionary effect on by Q4. Hence, we expect the Fed to remain accommodative for at least the next 6-12 months and not react to the near-term turbulence in inflation data.

The above scenario does imply the next few months could unsettle markets from time to time as investors react to every turn in jobs and inflation data and continue to second-guess Fed action. Nevertheless, the longer-term global reflation story remains intact, as seen through the lens of fundamental drivers, such as a faster pace of vaccinations and improving economic and business confidence worldwide. This improvement is also reflected in upbeat corporate earnings. Given this, we would use the ensuing dislocation in markets to build on our medium-term investment themes, favouring cyclical-recovery-driven Value sectors, as well as longer-term structural trends around infrastructure development, among others. In currencies, commodity currencies linked to the cyclical story (AUD and CAD) are preferred.

— 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

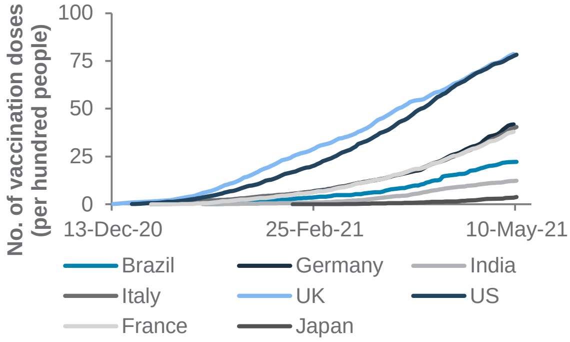
(+) factor: US, Europe pandemic progress, Europe data

(-) factor: US jobs and inflation surprise, India pandemic

	Positive for risk assets	Negative for risk assets
COVID-19	• New cases continued to fall in the US & Europe, allowing authorities to further ease restrictions • German Health Minister Spahn predicted a 'good summer' amid rising vaccinations • India's growth in new cases has peaked	• More Indian states imposed lockdowns, while others extended restrictions, as fatality rates continued to rise • New cases in Japan, Malaysia and Thailand continued to trend higher; Japan extended restrictions in Tokyo
	Our assessment: Neutral – UK, Europe progress vs extended lockdowns in India and parts of Asia	
Macro data	• US new jobless claims fell more than expected • Euro area investor confidence (Sentix) rose more than expected and economic sentiment (ZEW) rose to the highest since 2000 • China, Germany exports rose more than expected • Japan personal spending rose more than expected	• US non-farm jobs rose less than expected; job openings rose to the highest since 2000 • US consumer and producer prices jumped more than expected • China's producer prices rose more than expected while consumer prices rose less than expected • German inflation hit 2%
	Our assessment: Neutral – Rising Euro area sentiment vs US jobs disappointment and inflation surprise	
Policy developments	• Fed's Evans said it would take 'quite some time' to conclude the economy has made enough progress • Rehn said ECB should accept an overshoot of its inflation target, given years of sub-par inflation	
	Our assessment: Positive – Policy to remain supportive	
Other developments		• Israel-Palestinian tensions
	Our assessment: Negative – Middle East tensions are on the rise	

COVID-19 vaccinations are accelerating in Europe and rising worldwide

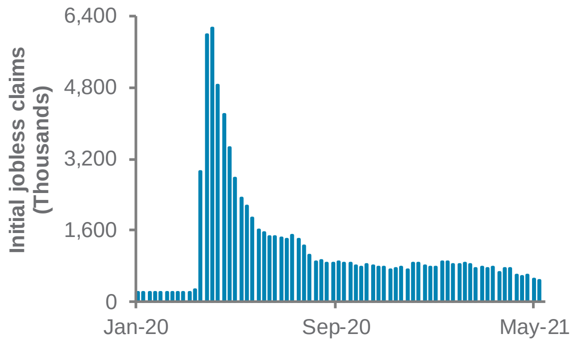
No. of vaccine doses per hundred people



Source: Our World in Data, Standard Chartered

Continued decline in US jobless claims suggests the job market is improving despite the big miss in April new job creation data

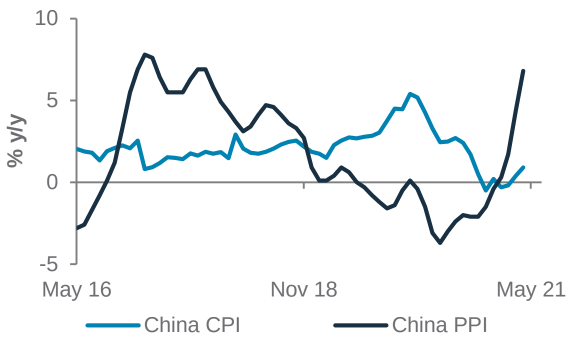
US initial jobless claims



Source: Bloomberg, Standard Chartered

China's consumer inflation remains subdued despite the surge in producer prices

China's consumer and producer price inflation



Source: Bloomberg, Standard Chartered

Top client questions

Is the Nasdaq-100 vulnerable to further downside?

We wrote last week that we were expecting short-term weakness in the Nasdaq index, with the key arguments being the rotation into Value sectors and concerns about Biden's capital gains tax agenda leading to profit-taking.

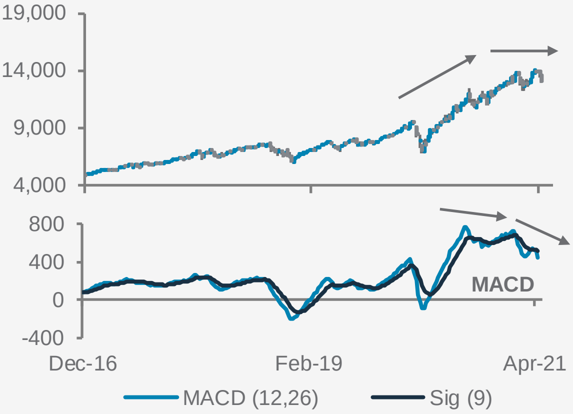
Since then, the index has been under further pressure. The lower-than-expected number of jobs created in the latest employment report and the sharp spike in wages and inflation fuelled speculation of runaway inflation. Despite Fed speakers repeatedly reaffirming their plan to remain accommodative, market participants are speculating that the Fed may be forced to tighten as a result of the inflation.

This creates a strong headwind for the Nasdaq index. As a measure of short-term weakness, only 27% of the Nasdaq Composite index constituents were above their 50-day moving average, while over 75% of the Dow Jones Industrial Average constituents were above their 50-day moving average. Other chart indicators, such as bearish cross-over and negative divergence in MACD, are signalling further downside for the index. Technically, there is likely to be a sharper fall if the index breaks below the critical 12,397 level.

— **Daniel Lam, CFA,** *Senior Cross-Asset Strategist*

Technical chart indicators suggest further downside to the Nasdaq index

Nasdaq 100 index and MACD indicator*



Source: Bloomberg, Standard Chartered; *MACD is a trend-following momentum indicator

How will GBP strength influence the performance of FTSE 100 and FTSE 250 indices?

We believe a strong GBP is likely to support the continued outperformance of FTSE-250 index over the FTSE-100 index. FTSE-250 companies are less impacted by a stronger GBP as they generate 50% of their revenue domestically (compared with 20% for the FTSE-100). We expect the GBP to stay strong as the risk of a Scottish referendum subsides, with good support at 1.4000 and in the 1.3600-1.3800 region.

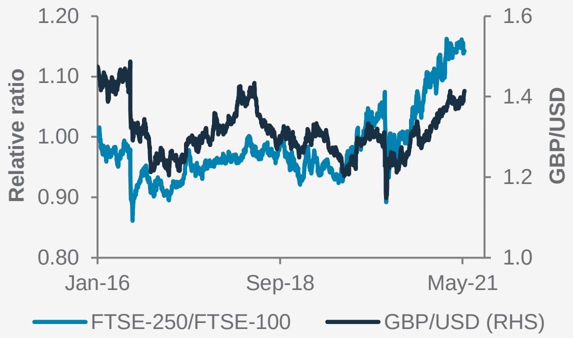
Having said that, the FTSE-250 is trading at an all-time high relative to FTSE-100. If the rally in global energy and commodities continue, it may lend a tailwind to FTSE-100 because of the index's heavier exposure to cyclicals and commodity-based Value sectors. Hence, a short-term underperformance in FTSE-250 is possible.

Overall, we expect positive absolute returns across both FTSE-100 and FTSE-250 indices. The UK is one of our two preferred equity markets (alongside the US). The UK and the US are ahead of other key markets in terms of the speed of COVID-19 vaccinations and UK equities are cheaper versus other regions. Furthermore, over 50% of MSCI UK is in our preferred Value sectors, much more than the other regions.

— **Daniel Lam, CFA,** *Senior Cross-Asset Strategist*

The UK's FTSE 250 index has been strongly outperforming the FTSE 100 index, helped by strong momentum in the GBP

Ratio of FTSE 250/FTSE 100 indices; GBP/USD



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Is higher US inflation a risk for EM USD government bonds?

EM USD government bonds have a high sensitivity to US bond yields, ie, bond prices falling as US government bond yields rise. For instance, if US government bond yields rise by 25bps, EM USD government bond prices would typically fall by about 2%, assuming nothing else changes.

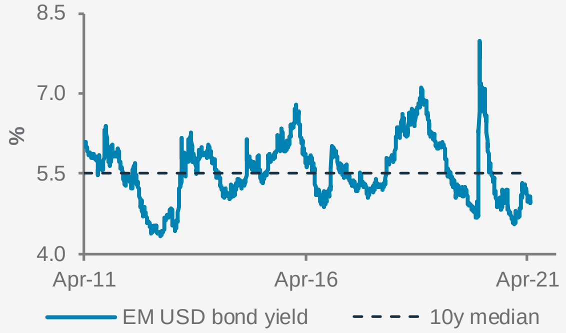
If US inflation expectations surge in a sustained manner, then this is a significant risk, but as we outline in the editorial, this is not our central scenario as we see supply chain disruptions and labour market shortages being temporary. Therefore, we expect US government bond yields to remain relatively flat over the next 6-12 months.

This – together with the relatively healthy valuations on EM USD government bonds, rising commodity prices and a weaker US dollar – makes the nearly 5% yield on offer attractive for diversified investors, in our opinion.

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

The 5% yield offered by the EM USD government bonds make them attractive, despite their high sensitivity to US yields

EM USD government bond yield



Source: Bloomberg, Standard Chartered

What is the near-term outlook for commodity currencies like the AUD and CAD?

As seen this week, short-term equity market weakness can weigh on riskier commodity-linked currencies (ie, AUD, NZD, CAD). As the debate around the return of inflation rages, we see near-term price pressures and talk of a gradual unwind in monetary policy stimulus in several Developed Markets as an affirmation of improving underlying fundamentals. Therefore, we would use pullbacks to add exposure to commodity-linked currencies such as the AUD and CAD.

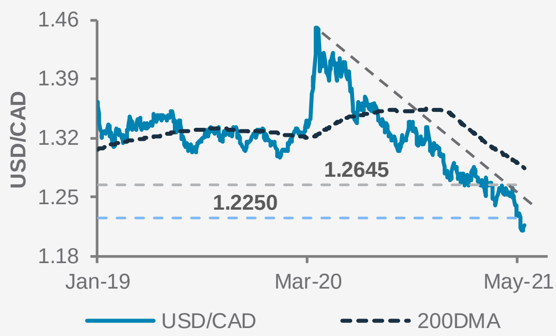
We believe there are many reasons to remain bullish on the AUD. Resilient commodity prices (particularly iron ore prices) should remain AUD-supportive as the global economy continues to recover. The recently announced Australian budget should also provide additional support, which means we could also see less RBA dovishness going forward. In our view, these factors favour adding exposure to the pair on dips. Immediate support is expected at around 0.7700 and 0.7500-0.7530 thereafter.

Fundamentals also remain supportive of further CAD strength. The Bank of Canada has started to taper bond purchases and is signalling that rate hikes could begin in the H2 2022, well ahead of the Fed. Although positioning may be a hurdle to CAD gains in the near term, we believe fundamentals will prevail in the medium term. We expect USD/CAD initial support at 1.2250-1.2350.

— **DJ Cheong, CFA,** *Investment Strategist*

We expect further declines in USD/CAD as the CAD benefits from a tighter BoC monetary policy and rising commodity prices

USD/CAD



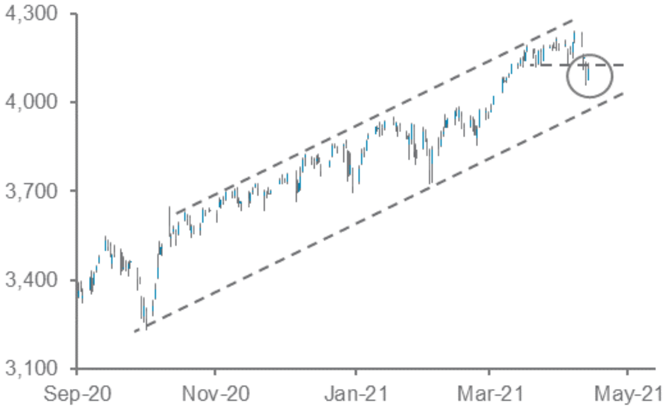
Source: Bloomberg, Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

S&P500: Is the upward pressure fading?

S&P500 index daily chart

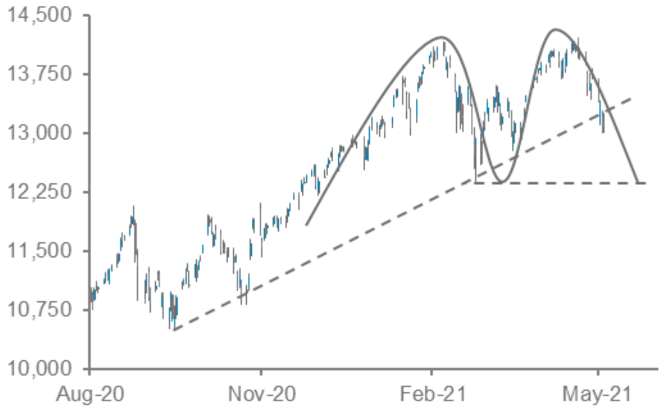


Source: Bloomberg, Standard Chartered

The break below immediate support at 4,118 isn't enough to suggest the upward pressure is fading – the index remains within its well-established upward channel.

Nasdaq: Looking vulnerable

Nasdaq Composite index daily chart

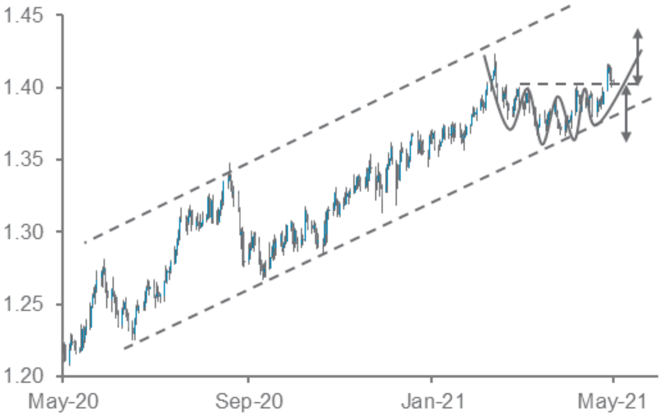


Source: Bloomberg, Standard Chartered

12,397 is crucial support. While we do not want to pre-empt, any break below this would trigger a minor double top, potentially opening a way towards 10,620.

GBP/USD: Well guided within the uptrend channel

GBP/USD daily chart

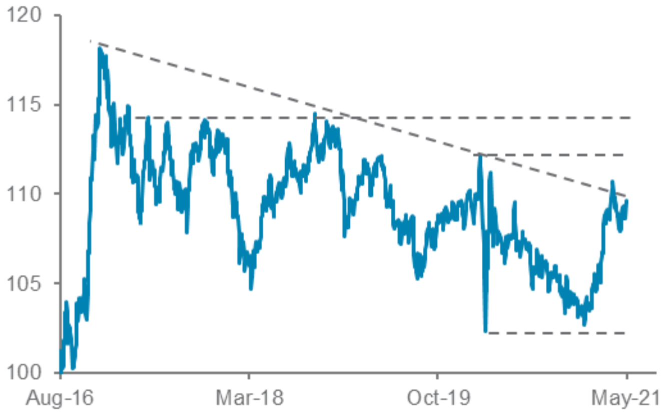


Source: Bloomberg, Standard Chartered

A breakout from the recent complex reverse head and shoulders pattern points to a rise towards 1.4330.

USD/JPY: Still within the 2020 range

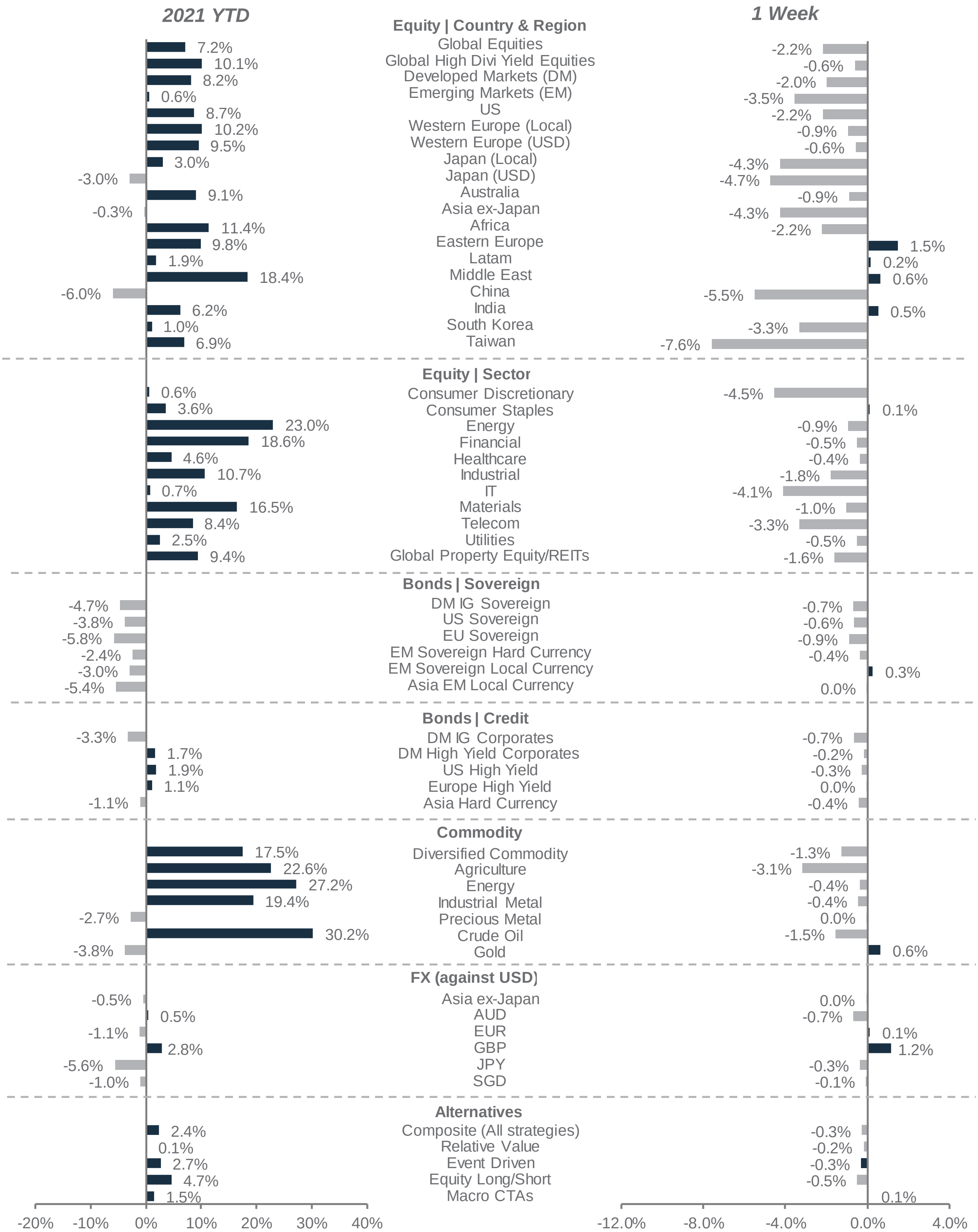
USD/JPY daily chart



Source: Bloomberg, Standard Chartered

A break above last year's high of 112.20 is needed to confirm that the recent rise was more than just a move within the range. 114.50 is the next level to watch.

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 13 May 2021; 1-week period: 06 May 2021 to 13 May 2021

Our asset class views at a glance

Asset class			
Equities	▲	**Alternatives**	◆
US	▲	Equity hedge	▲
UK	▲	Event-driven	▲
Japan	◆	Relative value	◆
Asia ex-Japan	◆	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	CH	Fixed Assets Ex Rural YTD y/y	Apr	25.6%
	CH	Retail Sales y/y	Apr	34.2%
TUE	JN	GDP Annualized SA q/q	1Q P	11.7%
	US	Housing Starts	Apr	1739k
WED				
THUR				
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	Apr	0.3%
	JN	Jibun Bank Japan PMI Composite	May P	51
	EC	Markit Eurozone Composite PMI	May P	53.8
	UK	Markit/CIPS UK Composite PMI	May P	60.7
	US	Markit US Composite PMI	May P	63.5
	EC	Consumer Confidence	May A	-8.1

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 1.8% below current level

Technical indicators for key markets as on 13 May 2021

Index	Spot	1st support	1st resistance
S&P500	4,113	4,039	4,209
STOXX 50	3,952	3,921	4,009
FTSE 100	6,963	6,898	7,079
Nikkei 225	27,448	26,758	28,828
Shanghai Comp	3,430	3,411	3,455
Hang Seng	27,719	27,421	28,313
MSCI Asia ex-Japan	837	824	864
MSCI EM	1,293	1,274	1,330
Brent (ICE)	67.1	66.3	68.6
Gold	1,825	1,815	1,837
UST 10Y Yield	1.66	1.59	1.71

Source: Bloomberg, Standard Chartered

	Event	This week	Period	Data
MON	EC	Sentix Investor Confidence	May	21.0
TUE	JN	Household Spending y/y	Mar	6.2%
	CH	CPI y/y	Apr	0.9%
	EC	ZEW Survey Expectations	May	84.0
	US	JOLTS Job Openings	Mar	8123k
WED	UK	GDP q/q	1Q P	-1.5%
	US	CPI Ex Food and Energy y/y	Apr	3.0%
THUR				
FRI	US	Retail Sales Ex Auto and Gas	Apr	-
	US	Industrial Production m/m	Apr	-
	US	U. of Mich. Expectations	May P	-

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