Wealth Management Chief Investment Office
3 December 2021

Weekly Market View

What to make of Omicron?

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→ Omicron has led investors to reassess their risk appetite. Latest reports indicate the new COVID variant is more transmissible and less severe than those from previous waves, but the impact on vaccine efficacy and hospitalisations remains unclear. This raises near-term uncertainty.

→ As investors, we have been here before. Despite several virus waves, the global stock market index has almost doubled from March 2020 pandemic lows. Authorities are better prepared today versus the first outbreak.

→ While we need to keep a close eye on the latest wave, a bigger concern is how the outbreak impacts the inflation outlook and how the Fed responds to it.

→ We still expect inflation to subside by the middle of next year, enabling the Fed to go slow on rate hikes after finishing bond purchases tapering. Thus, if Omicron plays out like the past waves, we would use any ensuing market volatility to pick up our preferred risk assets and longer-term structural themes.

What are the likely equity and bond market impacts from the Omicron wave and Fed policy?

How should we position in FX markets ahead of the upcoming central bank meetings?

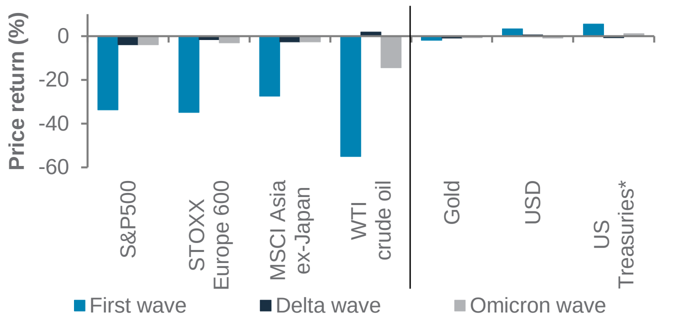
What are the various Omicron risk scenarios?

Important disclosures can be found in the Disclosures Appendix.

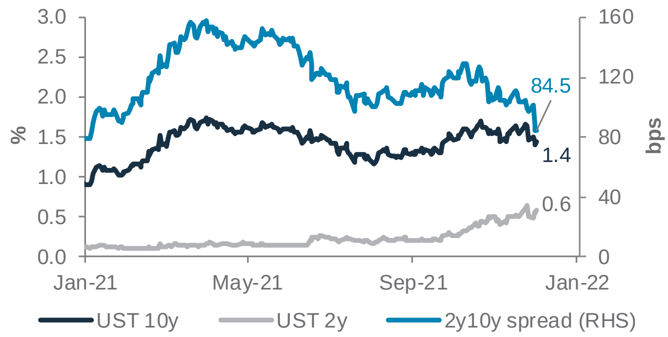
Charts of the week: Building immunity to COVID waves?

Equity drawdowns have become smaller with successive waves, but bond investors are signalling growth concerns

Peak-to-trough drawdowns of assets during COVID waves



US 2-year and 10-year treasury yields and their difference



Source: Bloomberg, Standard Chartered; *Total return; Peak-to-trough: 1st wave (14 Feb-23 Mar 20), Delta (7-12 May 20), Omicron (24 Nov-2 Dec)

Editorial

What to make of Omicron?

Omicron has led investors to reassess their risk appetite. Based on the latest reports, the new COVID variant appears more transmissible and less severe than those from previous waves, but updated vaccines may be needed and that will take a few months to produce. That raises near-term uncertainty until we get more data on the effectiveness of current vaccines, possibly as soon as next week. Next, we will need to watch Omicron's actual impact in over 20 countries that have already detected the variant. New cases in South Africa are now rising sharply as they are in Europe, but this has not triggered a significant rise in hospitalisations, except in the Netherlands where they are close to the highs seen last winter.

As investors, we have been here before, and yet the global stock market index has almost doubled since its March 2020 lows hit during the first COVID outbreak. Authorities are much better prepared today versus the first outbreak. Vaccine makers are already on the case. If anything, authorities now are prone to over-reacting (eg, Japan and Israel shut borders within days). This is good news in terms of battling the virus, although it could cause a near-term slowdown in economic activity. As our chart above shows, investors have progressively become less sensitive to each COVID wave, with the rate of risk asset drawdowns becoming smaller with successive waves. This could, of course, breed a sense of complacency – hence, the need to rebalance allocations to match individual risk appetite, especially after the record-breaking equity market rally.

While we need to keep a close eye on the severity of the latest wave, perhaps our bigger concern as investors is how the latest outbreak impacts the developing inflation outlook, especially in the US, and how the Fed reacts to it. Chair Powell's latest statement suggests the Fed is increasingly concerned that inflation could be more persistent than previously thought. While US job creation continues at a strong pace, there is a risk that persistent COVID waves could stall the expected return of workers who had left the job market, further fuelling wage pressures and long-term inflation expectations. This perhaps explains Powell's call to consider accelerating the pace of bond purchase tapering at the 14-15 December policy meeting. The bond market's reaction suggests a faster pace of tapering could be a mistake. The US government bond yield curve has flattened significantly over the past week as the 10-year yield fell much more sharply than the 2-year yield. Essentially, bond markets are saying they are worried about the medium-term growth outlook if the Fed ploughs ahead with the withdrawal of monetary stimulus, especially in the midst of a COVID outbreak.

We still believe that inflation will subside by the middle of next year as pent-up demand for goods is exhausted and supply bottlenecks fade. The US's strong productivity growth due to technology upgrades during the pandemic is likely to offset wage hikes, keeping inflation pressures at bay. As inflation subsides, we expect the Fed, after ending bond purchases sometime in Q2, to eventually go slow on rate hikes – possibly delivering one rate hike by end-2022, instead of two priced in by the money markets. In the near term, though, the Fed may have an incentive to sound hawkish and allow the USD to strengthen which, in turn, would help keep inflation subdued.

Thus, if Omicron plays out like the past waves, our above scenario points to a modestly bullish bias for the USD and moderately higher equity market volatility in the near term. This would be an opportunity for investors who are still holding excess cash and/or have high exposure to low-yielding Developed Market government or high-grade corporate bonds to rebalance into equities and higher-yielding areas of the bond market. Specifically, we believe US and Euro area equities and high yield US and Asian corporate bonds look attractive. (See pages 4-6 for more market implications and risk scenarios)

— Rajat Bhattacharya

The weekly macro balance sheet

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

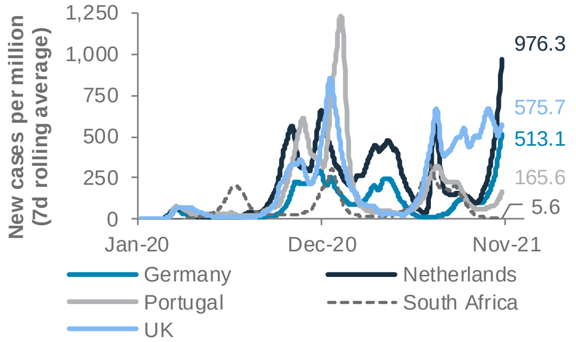
(+) factors: Strong global manufacturing, US job market

(-) factors: Omicron concerns, hawkish Fed, Euro area inflation

	Positive for risk assets	Negative for risk assets
COVID-19	• Hospitalisations in South Africa and most countries where Omicron was first detected remain low • New cases in most of Asia, Australia and Latin America continued to fall and appear to have peaked in New Zealand, Russia, Austria and stabilised in the US • Vaccine makers said it may take few months to produce Omicron shots; current vaccines likely effective against extreme cases	• New Omicron variant found in over 20 countries, leading many to reimpose travel restrictions • Euro area cases continued to rise, hitting records in Germany and Netherlands, leading to partial lockdowns; Netherlands' hospitalisations close to last winter's peak • New cases hit a record in South Korea; China warned of "colossal outbreak" should borders be opened
	Our assessment: Negative – Spreading Omicron variant, rising Euro area cases leading to mobility restrictions	
Macro data	• US ISM Manufacturing PMI and private payrolls rose more than expected • Japan's manufacturing PMI rose to highest since 2018 • China official manufacturing PMI (typically for large companies) rose more than expected to 50.1	• Euro area/German inflation accelerated more than forecast to 4.9%/6.0% • German retail sales unexpectedly declined • China's private (Caixin) Manufacturing PMI fell more than expected to 49.9 • Japan's industrial output decline accelerated
	Our assessment: Neutral – Strong global manufacturing PMIs and US job market vs Euro area inflation, weak retail sales	
Policy developments	• US Congress approved extension of government funding through 18 Feb, averting a shutdown	• Powell said the Fed should consider accelerating the tapering of bond purchases
	Our assessment: Negative – Hawkish Fed	
Other developments	• OPEC+ unexpectedly decided to continue with output hikes	
	Our assessment: Positive – Higher oil output to partially allay inflationary pressures	

Among countries where Omicron has been detected, new cases are rising the fastest in the Netherlands and Germany

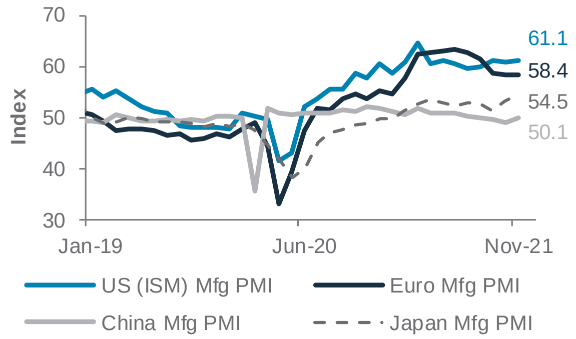
Daily new cases per million in the top 5 countries where Omicron has been detected, 7d average



Source: Our World in Data, Standard Chartered

US and Euro area manufacturing sector business confidence remains strong amid robust demand

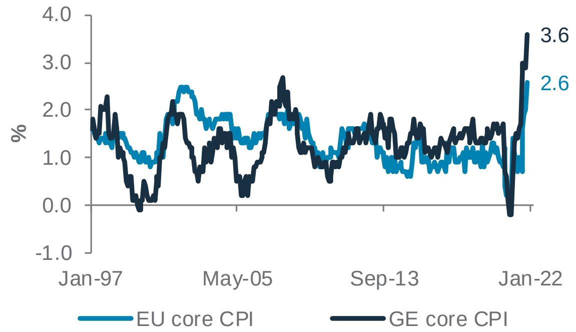
US, Euro area, China, Japan manufacturing PMIs



Source: Bloomberg, Standard Chartered

ECB policymakers face a contentious policy meeting on 16 December as Euro area core inflation pressures rose to the highest since 2002

Euro area and German core consumer inflation



Source: Bloomberg, Standard Chartered

Top client questions

What could be Omicron's impact on equities?

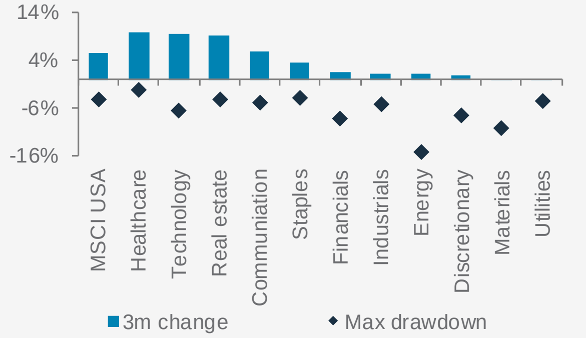
Omicron has already introduced greater volatility into equity markets as investors await further data to understand the variant. A comparison of the market reaction with the Delta variant wave could provide a useful indication of the potential sector impact. It is notable that the US equity market ended higher three months after end-April 2021 (when the Delta wave saw a peak in new cases) as investors gained confidence the Delta variant could be contained.

The healthcare and technology sectors performed best during this time. The Healthcare sector provides defensive attributes in times of uncertainty, but it also reflects wide recognition of the need to invest in health services. The Technology sector saw accelerated growth under the pandemic as home-based working and learning and cloud computing gained importance. However, sectors such as energy and materials suffered significant drawdowns during this three-month period as uncertainty prevailed. Lockdowns imposed to control the virus' spread impacted energy demand. Materials also weakened amid higher commodity prices and the impact of lockdowns on construction and industries. We expect any near-term weakness in US equities to follow a similar pattern, but we continue to be positive on a 12-month basis as we expect the new variant can be contained and investors to once again focus on positive fundamentals ahead.

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

US equity sectors such as energy and materials saw significant drawdowns during the Delta wave, but recovered within a few months

Total returns in US equity sectors (30 April to 2 August 2021)



Source: MSCI, FactSet, Standard Chartered

How could Omicron and a hawkish Fed impact bonds?

Long-term government bond yields declined sharply over the past week as they benefitted from safe-haven demand amid concerns around the Omicron variant. The fact that 10-year yields declined more than 2-year yields also signals that markets view Fed Chair Powell's latest hawkish shift as a potential risk to the medium-term growth outlook.

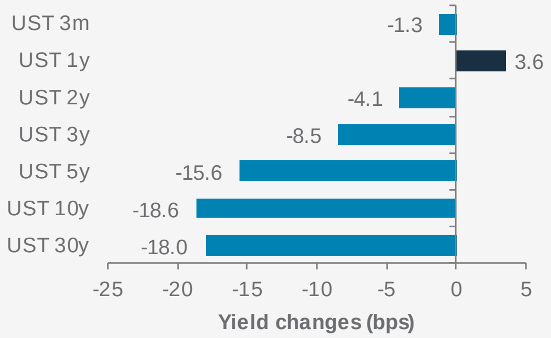
Given our view that the Omicron variant could delay but not derail the global growth recovery and peaking of inflation pressures, we still expect the Fed to hike rates once in 2022, leading 10-year US Treasury yields to rise into the 1.75%-2.0% range. Following the recent yield decline, we favour short maturity (3-5 years) profile for bonds over the next 12 months and would use the recent market moves as an opportunity to shorten the aggregate maturity profile of bond holdings.

Despite the temporary increase in corporate bond yield premiums, we continue to favour DM HY and Asian USD bonds due to their relatively attractive yield and short maturity profiles. However, we view DM IG corporate bonds as less preferred due to their high sensitivity to changes in yields.

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

Longer-term US government bond yields have fallen the most since Omicron appeared on growth concerns and the Fed's hawkish tone

US Treasury yield move across maturities since WHO declared Omicron as a 'variant of interest' on 24 Nov



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

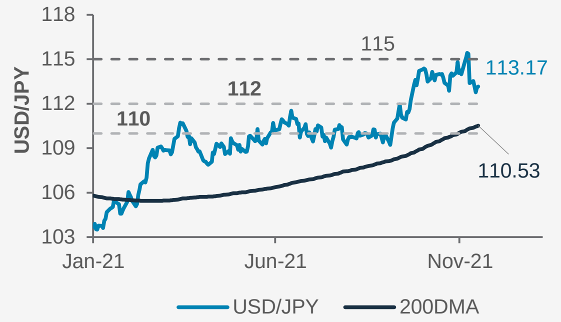
How should one position in FX markets ahead of key central bank meetings?

Most of the six major central banks holding policy meetings over the next two weeks may be caught in a growth-inflation communication dilemma. While the RBA (7 Dec), Bank of Canada (8 Dec), ECB and BoE (16 Dec) and BoJ (17 Dec) could be influential for their own currencies, the main focus remains on the Fed (14-15 Dec) in terms of broad currency direction. US employment and earnings data releases later today may not relieve investor emotions of uncertainty and fear, especially with market liquidity expected to tail off sharply into year-end.

Positioning across asset classes and by currency is, therefore, likely to influence short term market direction. We believe long USD, short JPY and EUR are crowded FX trades. A sustained USD/JPY break below 112 could trigger more selling pressure towards 109-110 and we expect limited upside above 115 ahead of the Fed. EUR/USD has resisted selling pressure and may be basing above key technical support at 1.1165, with the rising risk of a rally towards 1.1525. Commodity currencies have been pressured by the variant's impact on commodity demand, but AUD/USD has held above a strong support zone around 0.70 and USD/CAD has held below strong technical resistance at 1.2950. Both could reverse their recent weakening trend and move towards 0.73 and 1.25, respectively.

Reversal of excessively bearish JPY positions can continue

USD/JPY (daily), 200-day moving average and key technical levels



Source: Bloomberg, Standard Chartered

Has the oil price rally been derailed?

We have seen widespread price weakness across commodities, especially oil, on fears that a new COVID-19 variant could negatively impact demand. The moves lower were likely exacerbated by thin market liquidity on Black Friday.

We would closely watch developments around the Omicron variant and whether additional mobility restrictions are re-imposed. Having said that, we believe the sharp move lower is starting to look excessive for both fundamental and technical reasons.

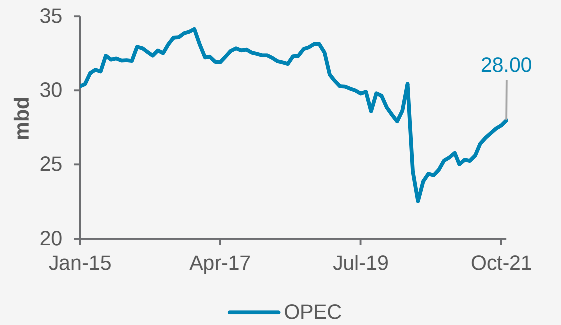
Although OPEC's decision to continue its production hikes was unexpected, we believe excessive pessimism is 'baked in', given the tepid moves in oil. The cartel said it would continue to monitor market conditions and could likely act on short notice. Iranian negotiations are at an impasse, potentially leading to an bullish oil price outcome.

From a demand perspective, we do not expect a significant hit to demand and expect a return to a relatively 'tight' oil market for the foreseeable future. Longer term, we remain moderately constructive on oil prices amid still-low inventory cover.

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

OPEC's output increases continue but the cartel said it would monitor market conditions closely

Total OPEC crude oil production (mbd)



Source: Bloomberg, Standard Chartered

Note: Current OPEC members include Algeria, Angola, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Saudi Arabia, United Arab Emirates, Venezuela, and the Republic of Congo.

Omicron: How could this play out?

Does the discovery of the COVID-19 Omicron variant impact our 2022 outlook? Market sentiment has thus far swung between pessimistic and optimistic extremes, but at the time of writing this, there is relatively little data that can tell us whether its combination of transmissibility, severity and vaccine resistance potential are likely to impact medical systems around the world. A benign outcome would be one where a low hospitalisation rate means the gradual reopening of economies can continue. A less benign scenario is one where governments are forced into slowing or reversing the reopening as new vaccines are developed.

Below, we lay out what we see as the most plausible scenarios from a mobility, policy response and market perspective. While Scenario 1 currently remains our base case, we would continue to watch incoming studies closely for any signs of governments being pushed into scenarios 2 or 3. Scenario 2 may not lead to a significantly different outcome for financial markets, compared with Scenario 1 (although it may be punctuated by sharp bouts of volatility). Scenario 3, though, would pose far more significant challenges for investors.

Possible scenarios for the economy and markets as the Omicron variant starts to spread

Scenario 1 (our Base Case)	Scenario 2	Scenario 3
No new severe mobility restrictions from the Omicron spread	**Severe mobility restrictions, inflation contained, policy supportive**	**Severe mobility restrictions, inflation rises, policy tightens**
Hospitalisation and/or vaccine data show significantly tighter mobility restrictions are not needed	Hospitalisation and/or vaccine data force governments to impose **new mobility restrictions**	Hospitalisation and/or vaccine data force governments to impose **new mobility restrictions**
No impact on growth specifically from the Omicron variant	**Growth slows**, at least for a quarter, until Omicron-specific vaccines are available	**Growth slows**, at least for a quarter, until Omicron-specific vaccines are available
Inflation peaks as supply chain disruptions start to ease	**Inflation peaks** as supply chain disruptions ease amid slowing demand	**Inflation remains elevated or rises further** as mobility restrictions introduce new supply chain disruptions or exacerbate the existing ones
Central banks continue to taper and/or gradually raise rates as planned	**Central banks pause tapering and tightening** and possibly start new easing. Fiscal spending rises	**Central banks continue to taper or tighten** to prevent inflation expectations from rising sharply. No new fiscal spend
Equities and other risk assets outperform Bonds and Cash on a 6-12 month horizon	**Equities and other risk assets initially slump**, but subsequently deliver strong returns on a 6-12 month horizon on policy easing	**Equities and other risk assets slump** on concern that sharply tighter policy will hurt growth
Bond yields creep modestly higher and the US government bond yield curve flattens	**Short-maturity bond yields fall** as rate hike expectations are delayed. Long-maturity bonds range-bound. Yield curve steepens on policy support	**Short maturity yields rise sharply** to price in significant tightening. Long-maturity bond yields rise more moderately. Yield curve flattens or even inverts
USD falls over 6-12 month horizon after initial gains. Oil and gold rise modestly, albeit not in a straight line	**USD falls** on a 6-12 month horizon after initial gains. Oil falls on lower demand. **Gold initially jumps** on equity volatility, **but falls thereafter** on slowing inflation	**USD rises** on safe-haven demand and relative US asset outperformance. Oil falls on lower demand. **Gold and other real assets jump** as real yields fall

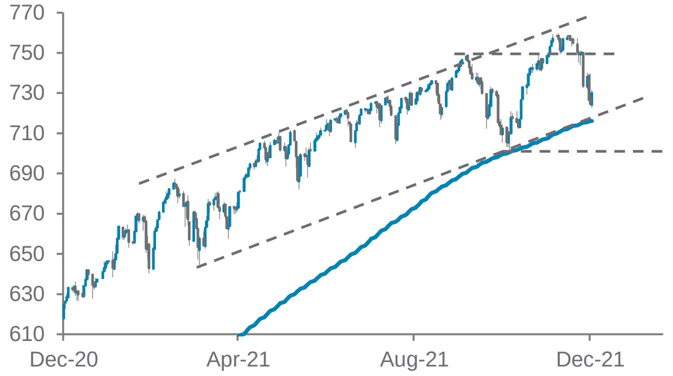
Source: Standard Chartered

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

Global Equities: Limited downside

MSCI All Country World index daily chart with 200-DMA

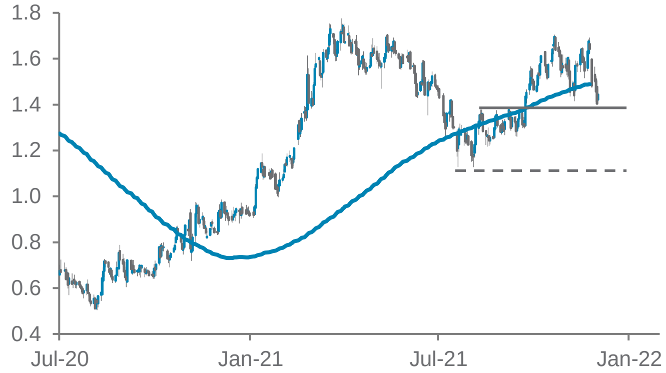


Source: Refinitiv, Standard Chartered

> The index's failure to break above stiff resistance at the September high of 749 has opened the way towards the 200-DMA. However, the October low at 702 is a more significant support. Only a decisive break below would indicate the recent drop was more than just a pause.

US 10-year Treasury yield: Testing lower end of the range

US 10y Treasury yield chart with 200-DMA

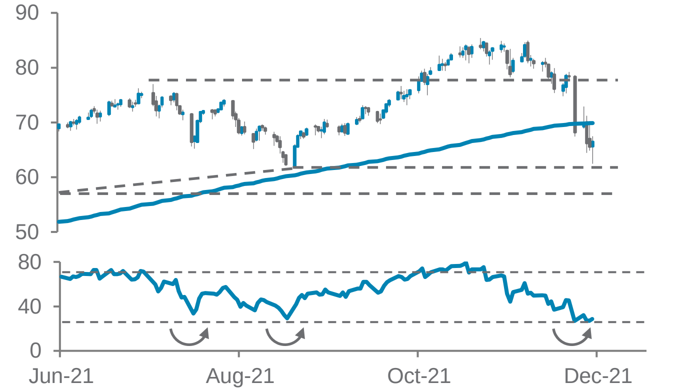


Source: Refinitiv, Standard Chartered

> In recent weeks, we have highlighted the possibility of a range developing in the yield in the near term (ie, fading upward pressure). It is now at the lower end of the range around 1.38%, raising the chances of a floor. However, any break below could pave way towards strong support at 1.13%.

Crude oil: Downside could be supported

Crude oil continuous contract chart with 200-DMA and RSI



Source: Refinitiv, Standard Chartered

> Crude oil's break below support at the July high of 77 indicates the upward pressure has faded for now, and a short-term range of 58-78 is more likely – includes the March 2021 low and the early-November low. Importantly, the broader uptrend remains unaltered despite the recent sharp decline.

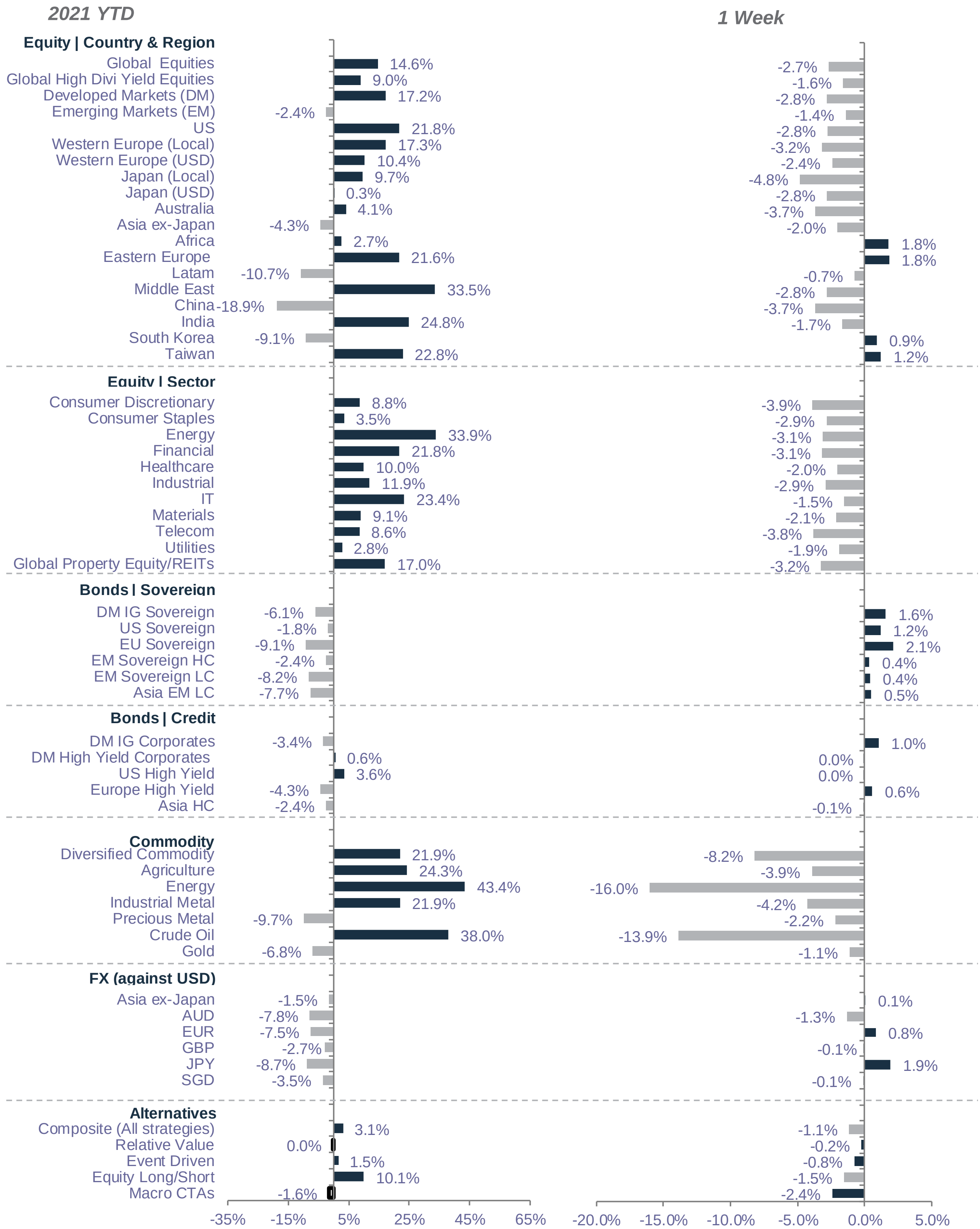
US Energy: Could be settling in a range

MSCI USA Energy sector weekly chart with 200-WMA

Source: Bloomberg, Standard Chartered

> The US Energy sector index has run into stiff resistance on a downtrend line from 2014, slightly above the 200-WMA. The subsequent drop below immediate support at 219 implies that the upward pressure has eased for now. A 185-235 range is likely in the near term.

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 02 December 2021; 1-week period: 25 November 2021 to 02 December 2021

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				
TUE	EC	ZEW Survey Expectations	Dec	25.9
	CH	Trade Balance	Nov	$84.54b
	CH	Exports y/y	Nov	27.1%
WED	US	JOLTS Job Openings	Oct	10438k
THUR	CH	CPI y/y	Nov	1.5%
	CH	PPI y/y	Nov	13.5%
	CH	Money Supply M2 y/y	Nov	8.7%
FRI/SAT	UK	Industrial Production y/y	Oct	2.9%
	US	CPI y/y	Nov	6.2%
	US	CPI Ex Food and Energy y/y	Nov	4.6%
	US	U. of Mich. Sentiment	Dec P	67.4

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 index has support 1.5% below current level

Technical indicators for key markets as on 25 November 2021

Index	Spot	1st support	1st resistance
S&P500	4,577	4,508	4,651
STOXX 50	4,108	4,054	4,170
FTSE 100	7,129	7,059	7,184
Nikkei 225	27,753	27,421	28,419
Shanghai Comp	3,574	3,565	3,580
Hang Seng	23,789	23,483	24,088
MSCI Asia ex-Japan	794	785	799
MSCI EM	1,236	1,220	1,244
Brent (ICE)	69.7	67.9	72.4
Gold	1,769	1,758	1,792
UST 10Y Yield	1.44	1.40	1.49

Source: Bloomberg, Standard Chartered

Investor diversity remains normal across major assets

Our proprietary market diversity indicators as of 24 November

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.39
Global Equities	●	→	1.59
Gold	●	→	1.70
Equity			
MSCI US	●	↑	1.89
MSCI Europe	◐	↓	1.47
MSCI AC AXJ	◐	↓	1.42
Fixed Income			
DM Corp Bond	◐	→	1.45
DM High Yield	◐	↓	1.35
EM USD	◐	↓	1.41
EM Local	◐	↓	1.24
Asia USD	◐	→	1.48
Currencies			
EUR/USD	◐	↓	1.29

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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