Standard Chartered
Private Bank

weekly **market view**

macro strategy | 7 December 2018

This reflects the views of the Wealth Management Group

Editorial

*We are releasing our **2019 Outlook** report next week. Today, we are focusing on where we see short-term investment opportunities.*

Year-end rally?

- **Equities:** Equity markets look set for a strong recovery into the year-end. Asia ex-Japan equities showed resilience following the sharp US market sell-off earlier in the week.
- **Bonds:** USD bond yields dip as speculative positioning (on an outlook for higher yields) corrects. Fed's statement after its 18-19 December meeting on the path of future rate hikes will be key.
- **FX:** The USD remains rangebound. Brexit developments are key for the GBP as we head towards the parliamentary Brexit vote.

What's new?

- **US-China trade relief.** Trade talks have delivered some breathing space. The three-month hiatus on additional tariffs will provide time for China to show its willingness to address some of the US' concerns while formal talks continue. China has already indicated it will increase US LNG and soybean imports and also passed a bill that will penalise companies that violate intellectual property rights. This is a good start, and the respite might be enough to support Emerging Market assets in the near term. That said, geopolitical tensions are unlikely to go away, as reinforced by the arrest of a senior China tech company official.
- **Yield curve inversion, sort of.** US equities were rocked on Tuesday by the five-year US government bond yield falling below the two-year yield. Given that a yield curve inversion can be an indicator of a potential recession in the ensuing 6-18 months, this clearly led to some concerns of more challenging times ahead. However, there are some mitigating circumstances:
  1) Firstly, curve inversions have sometimes produced false recession signals. Also, we prefer watching the 10-2 year yield curve (which has not inverted) as it has a better track record than the 5-2 year segment.
  2) Secondly, the latest US manufacturing business confidence data was much stronger than expected, especially the forward-looking new orders component, and the inflation indicator dropped significantly. This may allow the Fed to take a step back and monitor economic developments before ploughing ahead with further rate rises. This possibility has been reinforced by Fed Chair Powell, who indicated that interest rates are approaching the lower bound of the Fed's estimate of where monetary policy settings are neither stimulatory not contractionary.
  3) Finally, the equity market sell-off was apparently exacerbated by algorithm-based selling in thin market liquidity conditions ahead of the holiday on Wednesday.

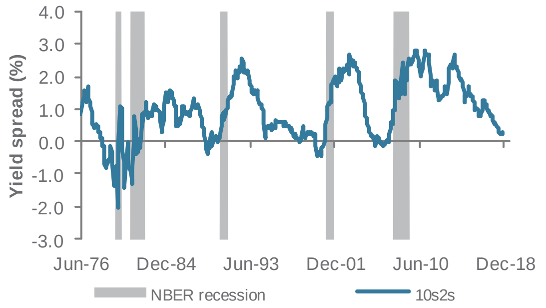
What we are watching

- **US December FOMC meeting:** Markets are still pricing in a 70% probability of a rate hike, but the accompanying message will be key. We expect language that indicates a less pre-determined approach to hiking interest rates in 2019.
- **The UK House vote on Brexit** will also be key for UK assets.

Contents

Bond yield curve inversions (long-term yields falling below short-term yields) are important for predicting recessions, but we prefer to focus on the 2-10 year yield spread, which has not inverted yet

Slope of the US bond yield curve (10-year over 2-year bond yield premiums) and US recessions



Source: Bloomberg, Standard Chartered

Goldilocks returns? US business confidence remains high, while inflationary pressures ease

US ISM manufacturing business confidence and prices paid indices

Source: Bloomberg, Standard Chartered

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Top client questions

As we hit the inflection point in the calendar year cycle, the questions we have received from clients largely revolving around the same theme, i.e., which markets are at an inflection point? We turn to technical analysis using chart patterns to offer perspectives on this question.

Q1. Is the MSCI Asia ex-Japan index finally coming back to life?

Likely yes.

Technical charts suggest a meaningful rebound in MSCI Asia ex-Japan could be unfolding. The index, which fell as much as 27% from its January high, is attempting to break above the key horizontal trendline resistance around 610 – a clear break would be an early sign that the index may have set an interim low in October (at 569). This follows a hold above the 100-month moving average (at 565). The recovery since October has been associated with reasonably strong momentum – the 14-day Relative Strength Index (RSI) hit 67, the first time since the downtrend began at the start of 2018. This reflects a shift higher in the RSI range.

For sustainable uptrends to unfold, the RSI needs to consistently stay above 40 and go above 70. So far, in the current rebound, the index has not hit 70.

The index faces stiff resistance at the 100-day moving average (DMA; now at 632), which could stall the nascent rally. However, the odds of an eventual rise above are increasing, in our view. Such a break could initially open the way towards the September high of 661 (c. 9% from here), followed by the July high of 682.

A meaningful rebound in Asia ex-Japan equities could be unfolding

MSCI Asia ex-Japan index daily chart

Source: Bloomberg, Standard Chartered

Q2. Is USD/CNH's multi-month uptrend coming to a close?

Probably.

The 1.7% slide in USD/CNH following the G20 summit on 30 November-01 December was noteworthy, especially given the pair has been trading in a narrow range since August. The slide raises the probability that this year's uptrend may be cracking.

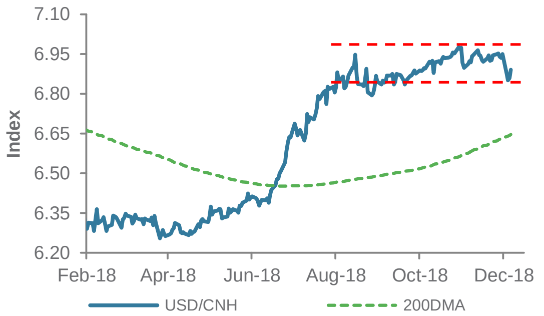
USD/CNH has faced a major resistance at the 2016 high of 6.9900, and given that the rally since January has been very sharp, some consolidation/minor correction would not be surprising. A negative technical signal (14-week RSI divergence at the October high of 6.9794), just around the strong resistance at the 2017 high, is a sign that the USD/CNH rally is likely losing steam.

A negative divergence needs to be confirmed by the break of a key price support. The fall below minor support of 6.9093 on *intraday* charts could be an early sign of possible cracks in the uptrend. Given that the rally has been strong, it might be prudent to wait for a confirmation on the *daily* charts. In this regard, USD/CNH is now testing crucial support at the early November low of 6.8514. A decisive break below would open the way towards 6.7000 (the 38.2% retracement of the 2018 rise).

Having said that, a downward correction of this sort would not necessarily imply a reversal of the entire uptrend. The medium-term uptrend would remain intact as long as USD/CNH holds above the 200DMA (now at about 6.64). This roughly coincides with the 50% retracement (at 6.61), which should provide a fairly strong support. Whether USD/CNH stays above, or breaks below, this level will be key for the long-term trend.

USD/CNH: Cracks in the uptrend?

USD/CNH daily chart



Source: Bloomberg, Standard Chartered

The **relative strength index (RSI)** is a measure of momentum to gauge overbought and oversold conditions (above 70 implies overbought conditions, while below 30 indicates oversold conditions).

Support is a price level where a downtrend can be expected to pause due to a concentration of demand.

Resistance is a price level where an uptrend can be expected to pause due to a concentration of supply.

A **moving average** is used to define a trend.

Top client questions (cont'd)

Q3. Has GBP/USD hit an inflection point ahead of next week's key UK parliament vote on the Brexit deal?

Probably not.

GBP/USD has been choppy ahead of the key UK parliament vote on Brexit on 11 December. UK Prime Minister May faces tough resistance to her current Brexit deal and the recent swings in GBP/USD are a reflection of how fluid the situation is. However, despite the noise, GBP/USD hasn't broken below the bottom of the recent range at 1.2660.

The continued hold above the range points to two possibilities: either the market has priced in the uncertainties and is looking for a catalyst to go higher (buy-the-rumour-sell-the-fact), or it is looking for (negative) catalyst to go lower.

Zooming out a bit and assessing the longer-term trend, we see three noteworthy aspects. First, the retreat from the April high of 1.4358 was from tough resistance on the 200-week moving average (WMA) and 50% retracement of the 2014-2016 downtrend. 38.2% to 50.0% retracements are generally corrections within a broader trend (down in this case). Second, the rally in August-September stalled at 38.2% retracement of the April-August slide, which again suggests a correction, rather than a reversal, of the entire downtrend. Third, shorter moving averages (10WMA, 30WMA) and longer moving averages (200WMA) continue to decline, suggesting the downward pressure remains intact.

Having said that, since the surprise Brexit referendum vote in 2016, GBP/USD has been well supported at 1.2000. The last time it was decisively below 1.2000 was more than 30 years ago. While this does not mean another sustained move lower is impossible, such a move would likely require a significantly negative catalyst.

To sum up, while a knee-jerk reaction lower (down in GBP/USD) is possible on near-term disappointments, the downside could be limited. On the other hand, if GBP/USD continues to hold above 1.2660 going into the vote, the probability of a rebound post the vote would increase.

Q4. Is the S&P500 index's slide coming to an end?

Likely yes.

Since 2015, there have been three episodes of >10% corrections (excluding the current one). That template suggests the S&P500 index could be near an inflection point in the current downtrend. The July-September 2015 correction lasted for 50 days with a price decline of 12%. The December 2015-February 2016 correction lasted for 48 days with a price decline of 14%. The January 2018-April 2018 correction lasted for 44 days with a price decline of 11%.

The current correction started in October. Adding 45 days to the start date gives the week starting 10 December as the potential end of the correction based on past patterns alone. So far, the index is down 11% (Thursday's low). Going by the recent past's template, a further 1-3% decline may yet be in the offing. Two key events in the next two weeks – the UK parliament vote on 11 December and the US Federal Open Market Committee meeting on 18-19 December – may define the index's direction thereafter.

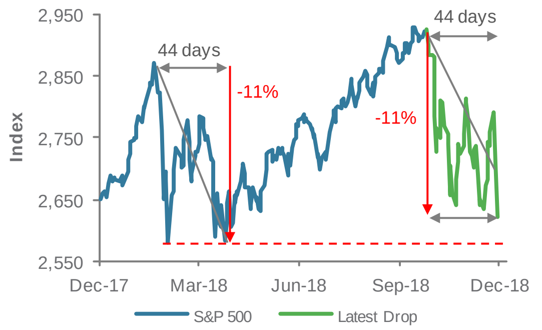
GBP/USD may not have hit an inflection point yet

GBP/USD weekly chart with the 200WMA, 30WMA and 10WMA

Source: Bloomberg, Standard Chartered

S&P500 could be reaching an inflection point…..

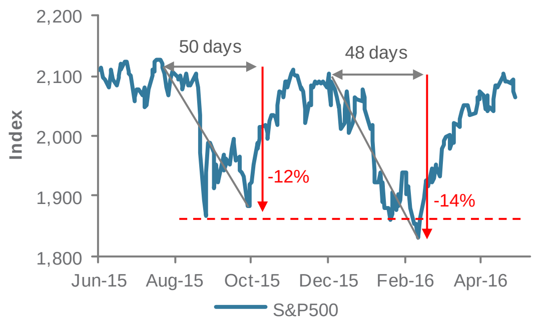
S&P500 index daily chart



Source: Bloomberg, Standard Chartered

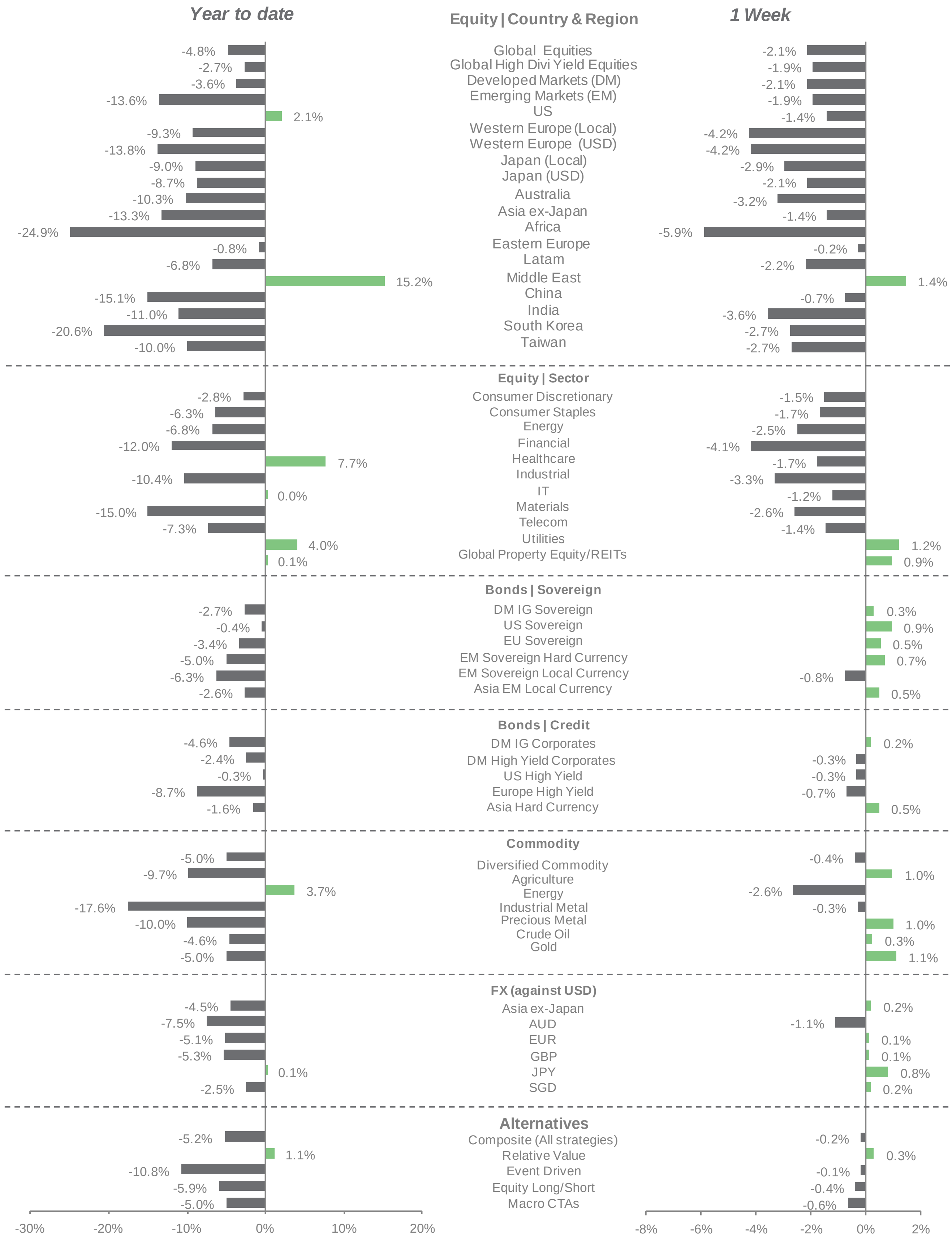
…..given the index has recovered from 10%+ corrections before, including twice in 2015

S&P500 index daily chart



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 06 December 2018, 1 week period: 29 November 2018 to 06 December 2018*

Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	GE	Exports SA MoM	10-Dec-18	Oct	–	-0.7%
	EC	Sentix Investor Confidence	10-Dec-18	Dec	–	8.8
	UK	Manufacturing Production y/y	10-Dec-18	Oct	–	0.5%
TUE	EC	ZEW Survey Expectations	11-Dec-18	Dec	–	-22.0
	US	PPI Ex Food and Energy y/y	11-Dec-18	Nov	–	2.6%
	JN	Core Machine Orders y/y	11-Dec-18	Oct	–	-7.0%
	EC	ZEW Survey Expectations	11-Dec-18	Dec	–	-22
WED	IN	CPI y/y	12-Dec-18	Nov	–	3.3%
	US	CPI y/y	12-Dec-18	Nov	2.2%	2.5%
THUR	EC	ECB Main Refinancing Rate	13-Dec-18	13-Dec	0.0%	0.0%
	CH	Industrial Production y/y	13-Dec-18	Nov	5.9%	5.9%
	CH	Retail Sales y/y	13-Dec-18	Nov	8.8%	8.6%
FRI/SAT	GE	Markit/BME Germany Composite PMI	14-Dec-18	Dec P	–	52.3
	US	Retail Sales Ex Auto and Gas	14-Dec-18	Nov	–	0.3%
	US	Markit US Manufacturing PMI	14-Dec-18	Dec P	–	55.3

	Event	This Week	Date	Period	Actual	Prior
MON	US	ISM Manufacturing	03-Dec-18	Nov	59.3	57.7
TUE	AU	RBA Cash Rate Target	04-Dec-18	4-Dec	1.5%	1.5%
	EC	PPI y/y	04-Dec-18	Oct	4.9%	4.6%
WED	CH	Caixin China PMI Composite	05-Dec-18	Nov	51.9	50.5
	IN	RBI Repurchase Rate	05-Dec-18	5-Dec	6.5%	6.5%
	EC	Retail Sales y/y	05-Dec-18	Oct	1.7%	0.3%
	US	ISM Non-Manufacturing Index	05-Dec-18	Nov	60.7	60.3
THUR	GE	Factory Orders WDA y/y	06-Dec-18	Oct	-2.7%	-2.6%
	US	Trade Balance	06-Dec-18	Oct	-$55.5b	-$54.6b
FRI/SAT	CH	Foreign Reserves	07-Dec-18	Nov		$3053.10b
	US	Average Hourly Earnings y/y	07-Dec-18	Nov		3.1%
	US	Change in Nonfarm Payrolls	07-Dec-18	Nov		250k
	US	Unemployment Rate	07-Dec-18	Nov		3.7%
	US	U. of Mich. Sentiment	07-Dec-18	Dec P		97.5

Previous data are for the preceding period unless otherwise indicated

Data are % change on previous period unless otherwise indicated

P - preliminary data, F - final data, sa - seasonally adjusted

y/y – year-on-year, m/m - month-on-month

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue

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