Global Market Outlook

Policy tailwinds

Policy stimulus, positive earnings surprises and a falling USD suggest the economic recovery is likely to remain intact. However, a potentially stormy campaign ahead of the US Presidential election and rising COVID-19 infections in Europe are risks.

These risks mean a short-term pullback remains a possibility. However, low and falling real bond yields mean we remain comfortable adding equities, credit and gold on dips and selling volatility on spikes to generate income.

Within equities, we prefer the US, Euro area and Asia ex-Japan. In credit, we prefer Developed Market High Yield and USD-denominated bonds in Emerging Markets and Asia. The AUD, GBP and EUR offer the most attractive FX exposure against further USD weakness.

This commentary reflects the views of the Wealth Management Group of Standard Chartered Bank
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**Investment strategy**

**IMPLICATIONS FOR INVESTORS**

- Global equities, credit and multi-asset income strategies likely to outperform government bonds and cash over a 12-month horizon
- Gold likely to extend gains on falling real yields, while the USD is likely to fall
- Within bonds, we believe DM HY, EM USD and Asia USD bonds are attractive
- Within equities, we have a slight preference for US, Asia ex-Japan and Euro area equities

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**Equities gain, while gold corrects**

Global equities continued their gradual pace of gains, rising 5.6% over the past month, with US equity implied volatility (measured by the VIX index) falling for most of August, despite it usually being a seasonally volatile month. The 10-year US Treasury yield rose above 0.75%, while gold corrected sharply.

**Why are ‘real’ bond yields important?**

From an investor’s point of view, we believe ‘real’, or net-of-inflation, bond yields are key, both in terms of explaining major asset class behaviour so far this year and in offering an insight into how they are likely to evolve over the next 6-12 months.

For instance, the suppression of real bond yields by central banks this year (i.e. bond yields remained range-bound after March, even as inflation expectations rose) helped drive gold prices and equity valuations higher, in our assessment. The Fed’s new average-inflation-target policy means it is likely to tolerate higher inflation, further suppressing real yields.

We see the same drivers supporting higher equity valuations and gold prices in the coming year, since there is a reasonably strong chance of real bond yields grinding lower in the next 6-12 months. On one hand, recent comments from the Fed and other major central banks suggest they are likely to help keep nominal bond yields capped. On the other hand, inflation expectations could continue edging higher if the economic recovery continues, as we expect.
Economic data, USD positive for risky assets

A broad cross-section of data and events lead us to believe that the economic recovery remains largely on track:

(i) Major economic indicators continue to strengthen in most regions. While pockets of weakness in consumer confidence or small business openings remain, major indicators, such as PMIs, continue to indicate expansion.

(ii) The Q2 US earnings season was ‘less bad’ than initially expected and earnings are expected to recover through the rest of this year and next.

(iii) US policymakers are signalling they may be close to agreeing on a new stimulus package, while Fed minutes show that any rise in policy rates is not on their forecast horizon.

(iv) The USD has continued to weaken. Falling relative US real interest rates and increasingly plentiful USD liquidity continue to support a bearish USD view, but technicals are also turning increasingly bearish.

In our assessment, these four factors, in addition to falling real bond yields, are supportive of our positive view on equities, credit (corporate and EM bonds) and gold.

What could go wrong?

The above-mentioned positive case notwithstanding, what could go wrong? We see three likely candidates.

The first is technicals and positioning, some of which point to the risk of a short-term pullback. US equity markets and the EUR/USD are testing key resistance levels, where a period of consolidation is likely. This comes alongside some relatively stretched positioning indicators – our proprietary market diversity indicator is pointing to heightened pullback risk in select bond and currency markets.

The second candidate is (geo)political risk. Upcoming US elections could raise domestic policy uncertainty (the risk a Biden win revives worries of higher taxes, for example) or geopolitical risk (Trump continues to escalate tensions with China to burnish his credentials as a ‘war President’, for example). In our view, this also has the potential to create short-term pullbacks, particularly if US-China tensions continue to rise and/or there is any uncertainty over the election’s outcome.

The third factor is a renewed rise in COVID-19 cases. While the number of new cases in the US appear to have peaked, they are rebounding in Europe and parts of Asia. While we do not expect a repeat of Q2’s widespread economic shutdowns, resurgent infections do pose the risk of authorities imposing localised lockdowns, thus slowing the recovery.

We would continue to buy-the-dip

Overall, a number of factors argue the risk of a short-term pullback in Q3 remains elevated, with US elections a key risk. However, low and falling real bond yields (and broadening policy stimulus) create a strong tailwind for equities and corporate/EM bonds over 6-12 months, in our assessment.

Therefore, our preferred strategy remains unchanged. We would continue to use any pullbacks to add to our preferred equity and bond markets and gold, while using any rebound in volatility to generate income.
## Our Tactical Asset Allocation Views (12m USD)

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Sub-Asset Class</th>
<th>Relative Outlook</th>
<th>Rationale (+ Positive factors II – Negative factors)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multi-asset Income</td>
<td>☀️</td>
<td>+</td>
<td>Bond yields capped, still-wide credit spreads</td>
</tr>
<tr>
<td>Multi-asset Balanced</td>
<td>☀️</td>
<td>-</td>
<td>Diversification benefits</td>
</tr>
<tr>
<td>Alternatives</td>
<td>☀️</td>
<td>-</td>
<td>Diversifier characteristics</td>
</tr>
<tr>
<td><strong>Equities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US</td>
<td>☀️</td>
<td>+</td>
<td>Low bond yields, growth rebound</td>
</tr>
<tr>
<td>Asia ex-Japan</td>
<td>☀️</td>
<td>+</td>
<td>Low bond yields, weak USD</td>
</tr>
<tr>
<td>Euro area</td>
<td>☀️</td>
<td>+</td>
<td>Low bond yields, policy support</td>
</tr>
<tr>
<td>Japan</td>
<td>☀️</td>
<td>+</td>
<td>Low bond yields, high cash levels</td>
</tr>
<tr>
<td>Other EM</td>
<td>☀️</td>
<td>+</td>
<td>Inexpensive valuations</td>
</tr>
<tr>
<td>UK</td>
<td>▼</td>
<td>+</td>
<td>Attractive valuations</td>
</tr>
<tr>
<td><strong>Bonds</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>DM HY corporate</td>
<td>☀️</td>
<td>+</td>
<td>Attractive yield, attractive value</td>
</tr>
<tr>
<td>EM government (USD)</td>
<td>☀️</td>
<td>+</td>
<td>Attractive yield, attractive value</td>
</tr>
<tr>
<td>Asian USD</td>
<td>☀️</td>
<td>+</td>
<td>Moderate yield, low volatility</td>
</tr>
<tr>
<td>EM government (local currency)</td>
<td>☀️</td>
<td>+</td>
<td>Moderate yield, weak USD view</td>
</tr>
<tr>
<td>DM IG corporate</td>
<td>▼</td>
<td>+</td>
<td>Moderate yield, policy support</td>
</tr>
<tr>
<td>DM IG government</td>
<td>▼</td>
<td>+</td>
<td>High credit quality, policy support</td>
</tr>
<tr>
<td><strong>Currencies</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>AUD</td>
<td>☀️</td>
<td>+</td>
<td>Policy stimulus, growth rebound</td>
</tr>
<tr>
<td>EUR</td>
<td>☀️</td>
<td>+</td>
<td>Policy stimulus, growth rebound</td>
</tr>
<tr>
<td>GBP</td>
<td>☀️</td>
<td>+</td>
<td>Undervaluation, eventual Brexit deal</td>
</tr>
<tr>
<td>JPY</td>
<td>☀️</td>
<td>+</td>
<td>Safe-haven demand, real yields</td>
</tr>
<tr>
<td>CNY</td>
<td>☀️</td>
<td>+</td>
<td>Policy stimulus, growth rebound</td>
</tr>
<tr>
<td>USD</td>
<td>▼</td>
<td>+</td>
<td>Safe-haven demand</td>
</tr>
</tbody>
</table>

Source: Standard Chartered Global Investment Committee

Legend: ☀️ Preferred ☀️ Core holding ▼ Less preferred
As part of our Investment Philosophy, we strive to achieve diversity of insights by constantly monitoring a wide array of investment views and analysis. This part of our process is what we call the Inside View, where we gather lots of research and analysis, consider the specifics of the situation, and combine them with our analysis of historical probabilities – the Outside View – to create scenarios for the future.

The below charts show the percentage of investment research (broker and independent) houses and asset management companies who are Overweight, Underweight and Neutral on different asset classes.

Source: Standard Chartered Global Investment Committee

*Alternatives represent a combination of views on liquid and private alternative strategies, as well as real estate
Is it time to rotate equity exposure into 'Value'-based investment strategies?

Based on our recent re-assessment of the fundamentals underpinning Value-based investment strategies for both US and global equities, we conclude that it is not yet time to rotate into this investment style on a 12-month investment horizon.

We show that, while some of the key drivers for Value-style investing have improved recently, uncertainty around them remains high, suggesting we may need stronger evidence of a sustainable improvement before shifting our preferences.

Fig. 5 In the US, 'Value' strategies have reached their most extreme point of underperformance against 'Growth' strategies in 45 years

MSCI US Value Total Return Index divided by the MSCI US Growth Total Return Index

Source: Datastream, Standard Chartered
Data rebased to 1 as of 31 Dec 1975
Shaded areas indicate US recessions

Growth vs. Value in the post financial crisis era

At its core, 'Value' investing implies buying stocks at relatively low valuations with the goal of achieving high returns over a long time horizon, while trying to minimise exposure to 'value traps' (i.e. stocks or sectors that are inexpensive, but fail to revalue higher because of structural challenges). This investment strategy has been at the centre of academic and professional research for over a century as studies have shown Value strategies to outperform benchmark indices over long time periods and has been the fundamental tenet of many legendary investors. However, the performance of Value since the early days of the Global Financial Crisis has significantly lagged Growth- or Quality-style investing.

Value’s underperformance has extended under the current pandemic environment, causing researchers to further debate what market factors may be driving this. While some additional catalysts may exist (e.g. the higher weightage of technology stocks in benchmark indices, or accounting measures failing to correctly capture the value of patents and intangibles on firms’ balance sheets), Value investing continues to have a high degree of correlation to nominal government bond yields, inflation expectations and valuation metrics, as we explain in more detail below. Valuation metrics clearly point in favour of this strategy both in the US and in global equities given the relative valuation gap versus other strategies. However, the COVID-19 pandemic and the stimulus response to it has increased uncertainty around the first two factors - nominal bond yields and inflation expectations.
The unclear path ahead doesn’t bode well for ‘Value’ yet

A solid upturn in key drivers is needed for Value to start outperforming Growth. Here are the drivers in more detail:

- **Economic growth**: Value generally outperforms when real economic growth is strong. However, high frequency activity indicators have recently plateaued short of pre-COVID-19 levels, while early business sentiment indicators (PMIs) for August are also showing a slowdown in momentum. Still high rates of infections in EMs and a resurgence of cases in parts of Europe may be primarily responsible for this development. While we believe economic growth will recover, we may not see the typical high rates of growth that accompany rallies in Value stocks.

- **Bond yields**: Historically, Value stocks have a positive correlation with nominal bond yields – i.e. when yields rise, Value-style strategies generally outperform. We believe the Fed and other DM central banks will work to maintain rates lower for longer to stimulate the economic recovery, which is likely to weigh on Value. Moreover, growth stocks remain attractive as they tend to benefit from lower interest (or discount) rates (this is due to the long maturity profile of their expected cash flows). We would need to see a significant jump higher in bond yields for a rotation toward Value to happen.

- **Inflation expectations**: High inflation expectations can benefit Value stocks as they represent a large portion of cyclical sectors of the economy (e.g. Financials, Energy). 10-year inflation expectations have rebounded from March lows (now c. 168 bps in US, c. 160 in Europe) as they tend to move closely with assets, such as oil prices (on which we have a positive view). However, inflation expectations may need to rise sustainably higher, closer to central bank targets, to become a tailwind for Value.

- **COVID-19 vaccine/cure**: The prospects of a quick macroeconomic recovery are dependent on the discovery and distribution of a vaccine/cure for COVID-19 which would, in turn, benefit Value stocks. Recent studies by various research houses indicate that markets are inferring an approximately 25-40% chance of a successful vaccination programme by mid-2021. Therefore, investors may need more credible vaccine developments in order to believe in a faster economic recovery and turn to Value strategies.

- **US election**: Finally, should the US elections in November result in a Democratic sweep, we may witness a rotation out of large-cap technology stocks on fears of stronger antitrust regulation, which would likely benefit Value names. The impact on Value from policy measures under a divided Congress is less clear, however.

On balance, after having considered the above factors, we conclude a rotation toward Value stocks is not justified yet.

**Q** What style does SCB have for the next 12-months then?

Given our assessment that it is not quite the time to switch into Value-based investment strategies, we maintain our preference for the Quality style (i.e. firms with high return on equity, low earnings volatility and low debt levels) within both US and global equities. In the US, we also prefer Growth style.

As the table below illustrates, Quality has offered an attractive risk-reward trade-off. As global central banks provide a backstop by cutting interest rates, flushing markets with liquidity and easing credit conditions in response to the COVID-19 pandemic, they are likely to maintain an environment favourable to fast-growing firms with strong balance sheets as lower discount rates inflate the valuation of future cash flows.

**Fig. 7** The Quality style universe appears to offer the best risk-adjusted performance

Performance measures for MSCI Quality, Value and Growth indices

<table>
<thead>
<tr>
<th>Measure</th>
<th>Quality</th>
<th>Value</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annualised Return</td>
<td>12.7%</td>
<td>10.9%</td>
<td>11.6%</td>
</tr>
<tr>
<td>Max drawdown</td>
<td>-40.5%</td>
<td>-54.9%</td>
<td>-68.5%</td>
</tr>
<tr>
<td>Annual volatility</td>
<td>14.9%</td>
<td>14.8%</td>
<td>16.5%</td>
</tr>
<tr>
<td>Sharpe ratio*</td>
<td>0.44</td>
<td>0.33</td>
<td>0.32</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Measure</th>
<th>United States</th>
<th>World</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annualised Return</td>
<td>11.9%</td>
<td>14.2%</td>
</tr>
<tr>
<td>Max drawdown</td>
<td>-44.5%</td>
<td>-56.3%</td>
</tr>
<tr>
<td>Annual volatility</td>
<td>14.2%</td>
<td>14.7%</td>
</tr>
<tr>
<td>Sharpe ratio*</td>
<td>0.42</td>
<td>0.31</td>
</tr>
</tbody>
</table>

Source: Datastream, Standard Chartered
Data since 31 Dec 1975

*Sharpe ratio: measures the return of an index per unit of volatility after subtracting a ‘risk-free’ rate, such as the US 3m Treasury Bills yield.
Macro overview – at a glance

Key themes

We expect the global economy to return to growth in H2 20 and continue to expand in 2021 after a lockdown-induced sharp contraction in H1 20. China is leading this recovery, being the first major economy to return to growth in Q2. We expect the US and Europe to follow in Q3 as restrictions on activity are gradually eased. A key risk is a resurgence of COVID-19 in parts of Europe, forcing authorities to slow the pace of economic re-openings, which in turn could slow the recovery. The global recovery so far has been primarily driven by government-led infrastructure investments in China and fiscal stimulus in the US and Europe, while service sectors remain a drag. We expect continued fiscal and monetary stimulus worldwide as authorities focus on reviving growth, given subdued inflation. The Fed, in particular, is likely to tolerate higher inflation under its new policy. The US elections could intensify US-China tensions near-term, as President Trump, trailing in the polls, seeks to revive his electoral prospects.

Key chart

Our Global Investment Committee expects the global economy to start growing again in H2 20 and continue to expand in 2021 as economic restrictions are eased and monetary and fiscal stimuli are expanded further.

Fig. 8  Highly accommodative monetary policy, reflected in negative real (inflation-adjusted) bond yields, and growing fiscal stimulus are driving the recovery in global growth

Real (inflation-adjusted) 10y government bond yields; Consensus estimates of 2020 budget deficits

Source: Bloomberg, Standard Chartered

<table>
<thead>
<tr>
<th>Country</th>
<th>Key Themes</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>The US economy to return to growth in H2 20 after a deep-but-short recession in H1. The Congress is likely to pass another stimulus package in H2 and the Fed appears set to keep monetary policy accommodative for years under its new policy. US-China tensions ahead of November’s polls and a third pandemic wave are key risks</td>
</tr>
<tr>
<td></td>
<td>○ Growth</td>
</tr>
<tr>
<td>Euro area</td>
<td>The Euro area to grow again in H2 20, after a deep-but-short recession in H1, as governments and the ECB extend record fiscal and monetary stimulus. We see the EUR 750bn regional recovery fund agreement cementing the economic union, lowering breakaway risk. The revival in COVID-19 cases in parts of Europe is a key risk</td>
</tr>
<tr>
<td></td>
<td>○ Growth</td>
</tr>
<tr>
<td>China</td>
<td>China, which returned to growth in Q2 20, is likely to emerge as the only major economy to report y/y expansion in 2020. Government-led infrastructure investments to lead the recovery, while service sector activity and consumption gradually return to pre-pandemic levels. US-China tensions ahead of the US elections are a key risk</td>
</tr>
<tr>
<td></td>
<td>○ Growth</td>
</tr>
<tr>
<td>Japan</td>
<td>Japan to see a slow recovery from a prolonged contraction following last year’s sales tax hike and the pandemic. There is growing expectation of another stimulus amid PM Abe’s sliding popularity and weak global trade outlook</td>
</tr>
<tr>
<td></td>
<td>○ Growth</td>
</tr>
<tr>
<td>UK</td>
<td>The UK, the last major economy to ease lockdowns, to return to growth in H2 20 amid record fiscal and monetary stimulus. Proposed withdrawal of UK’s job-support programme in H2 and Brexit talks with EU are key risks</td>
</tr>
<tr>
<td></td>
<td>○ Growth</td>
</tr>
</tbody>
</table>

Source: Standard Chartered Global Investment Committee

Legend: ○ Weaker/lower in 2020 | ● Neutral | ● Stronger/higher in 2020
The USD’s decline extended further during the first half of August, with our preferred currencies, the EUR, GBP and AUD, making new YTD highs. A brief USD rebound is likely under way, which should relieve short-term oversold technical conditions. In our view, the USD downtrend will continue over the next 3- and 12-month periods. We expect EUR/USD to rise towards 1.25.

Our base case is that real interest rates and growth differentials will work against the USD, with the rising US twin deficits adding to investor concerns. We expect this to prompt outflows of long-term foreign investments from the USD and reduce USD reserve allocations. The US election process and results could trigger uncertainty and increase USD volatility.

Real rate differentials suggest the USD has further to fall in the medium term. Peaking US COVID-19 data and rising Euro area cases may support a brief USD rally as shown in the PMI data chart, but we see ample Fed liquidity and US political risk weighing on the USD.

**USD (DXY)**
- Core medium-term USD supports have faded, and momentum for the USD downtrend should be persistent

**EUR/USD**
- The EU recovery plan is a game-changer for fiscal unity; we expect EUR/USD to reach 1.25 over 12 months

**GBP/USD**
- Brexit deal uncertainty may keep GBP steady near term; we expect a deal and a GBP rally to 1.37 medium-term

**USD/CNY**
- Chinese stimulus and currency management should see stable USD/CNY despite rising US-China tensions

**USD/JPY**
- Monetary, fiscal stimulus and safe-haven flows will balance yield-seeking outflows, likely keeping USD/JPY range-bound

**AUD/USD**
- Global economic recovery from the pandemic shock should support an AUD/USD rally towards 0.73 medium term

Source: Bloomberg, Standard Chartered
Events calendar

**SEPTEMBER 2020**
- 10: ECB policy decision
- 16: FOMC policy decision
- 17: BoJ policy decision
- 17: BoE policy decision
- 29: First US presidential election debate

**OCTOBER 2020**
- 15: Second US presidential election debate
- 15-16: G20 finance ministers and central bankers meet
- 22: Third US presidential election debate
- 29: BoJ policy decision
- 29: ECB policy decision

**NOVEMBER 2020**
- 03: US presidential and congressional elections
- 05: FOMC policy decision
- 05: BoE policy decision
- 08-12: APEC Summit in Malaysia
- 21-22: G20 Summit in Saudi Arabia

**DECEMBER 2020**
- 10: ECB policy decision
- 16: FOMC policy decision
- 17: BoE policy decision
- 18: BoJ policy decision
- 31: End of Brexit transition period

**JANUARY 2021**
- 20: US presidential inauguration day
- 21: ECB policy decision
- 27: FOMC policy decision

**FEBRUARY 2021**
- 04: BoE policy decision

**MARCH 2021**
- 11: ECB policy decision
- 18: BoE policy decision

**APRIL 2021**
- 22: ECB policy decision

**MAY 2021**
- 06: BoE policy decision

**JUNE 2021**
- 10: ECB policy decision
- 24: BoE policy decision

X – Date not confirmed  |  ECB – European Central Bank  |  FOMC – Federal Open Market Committee (US)  |  BoJ – Bank of Japan  |  BoE – Bank of England
The team

Our experience and expertise help you navigate markets and provide actionable insights to reach your investment goals.

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Senior Investment Strategist

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