weekly **market view**

macro strategy | 5 January 2018

This reflects the views of the Wealth Management Group

Editorial

A strong start to 2018

- **Global equities and EM assets have extended their rally into the new year. Strong data, US tax cuts and still-loose global monetary policies are likely to keep supporting risk assets**.
- **Equities:** Tax cuts have lifted earnings expectations for the US financial sector, a preferred sector. Strong Euro area fundamentals are likely to overcome the impact of a strong EUR.
- **Bonds:** EM USD government bonds and Asia USD bonds, our preferred areas, likely to continue benefitting from capital flows.
- **FX:** The USD is likely to extend its decline after a brief pause. We turn bearish on USD/SGD, which fell below a support level.
- **See *Outlook 2018: Turning up the heat*, published on 8 December, for more details on our key investment themes.**

What's new?

- **Strong fundamentals sustain equity rally.** Global stocks have scaled new highs since we published ***Outlook 2018***, led by Emerging Markets and the US. Strong business confidence data in the US, Euro area and Japan for December portend above-trend global growth for the second straight year in 2018. In Asia, while China's economy continues to moderate, services sector business confidence is rising. South Korea's strong export growth in December suggests global trade remains resilient. US tax cuts are likely to support consumption and boost corporate profits, especially in the financial sector. Monetary policies are also likely to remain supportive for risk assets. The solid fundamentals support our continued preference for equities (especially in Asia ex-Japan and the Euro area) over bonds.
- **USD falls further.** The USD continued its decline for the third week, despite strong US data and Fed's December meeting minutes that show most members support a gradual rise in interest rates. While the USD remains oversold, we believe any USD rebound is likely to be temporary, given a gradual rise in US rates is unlikely to surprise markets. We would go short USD/SGD given the pair's technical break lower (see chart).
- **EM assets benefit as a weak USD to support capital inflows.** Emerging Market (EM) USD government bonds and Asia USD bonds, our preferred areas in bonds, have delivered flat-to-positive returns over the past month despite the rise in US Treasury yields. A weaker USD and strong global economic data have supported the bonds, leading to a decline in yield premium over US Treasuries. We remain comfortable adding exposure.

What we are watching

- **US, Euro area government bond yields, inflation.** The 10-year US Treasury and German Bund yields have trended higher over the past month, edging close to the top of the range set over the past year following US tax cuts (which raise the risk of a higher fiscal deficit), continued strong economic data and marginally hawkish central bank comments. We would follow Fed speeches (several are scheduled over the coming week), US inflation and ECB meeting minutes closely, given that faster-than-expected policy tightening is a key risk to our constructive outlook.

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US financial sector earnings estimated to accelerate the most following corporate tax cuts

US sectors' consensus earnings estimates for 2017/18

Source: Bloomberg, Standard Chartered

We turn bearish on USD/SGD after it broke through key support levels

USD/SGD, with 50-, 100-, 200-week moving averages

Source: Bloomberg, Standard Chartered

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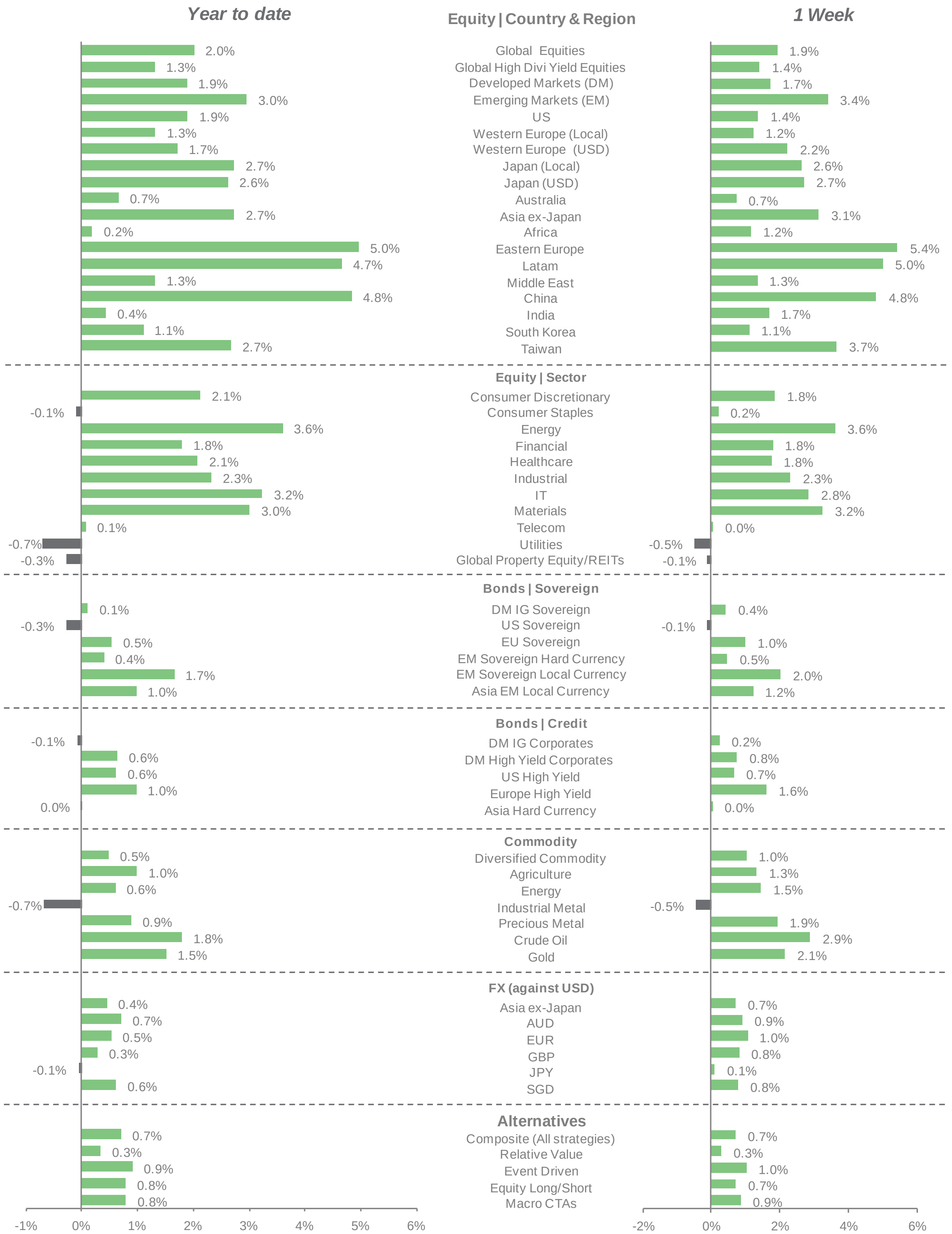
Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 04 Jan 2018, 1 week period: 28 Dec 2017 to 04 Jan 2018*

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

What does this mean for investors?

Global stocks scaled new record highs, led by Emerging Markets and the US. EM local currency bonds led gains in debt market as the USD continued to weaken. Crude oil extended gains amid political unrest in Iran, a key supplier.

Equities: Rally extends into the new year

- **US tax cuts to boost financial sector profits.** US corporate tax cuts are likely to benefit the US financial sector the most, as it has a domestic focus and pays high effective tax rates compared to other sectors. This view is supported by rising earnings forecasts, with consensus estimates for earnings growth in 2018 for the financial sector rising to 18%, from a forecast of 12% in October 2017. US financials remain a preferred sector.
- **Euro area fundamentals to overcome impact of strong EUR.** Euro area equities have come under pressure from EUR strength despite strong economic data. We acknowledge that currency strength is a drag on both corporate performance and sentiment, given more than 50% of corporate revenue comes from outside the Euro area. Nevertheless, we believe the current weakness in Euro area equities is likely to be temporary; we believe further USD weakness is likely to be only modest in 2018 and strong Euro area fundamentals are likely to overcome the negative impact on corporate profits from EUR strength.
- **Hong Kong stocks driven by southbound flows.** The Hang Seng rose to its highest since 2007. The Hong Kong/China Stock Connect is expected to continue to be a key driver of market performance in 2018. Southbound flows via the Stock Connect now accounts for 10% of the average daily turnover in Hong Kong, up from 5% in early 2017. China, including Hong Kong-listed exposure, remains a preferred equity market in Asia.

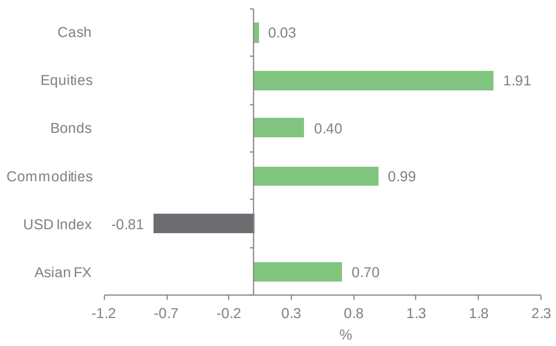
Bonds: Continue rotation into our preferred EM bonds

- **EM bonds preferred.** Since the publication of our Outlook 2018, 10-year US Treasury yields and German Bund yields have risen by over 10bps due to a combination of the impact from the US tax reform, strong economic data and marginally hawkish comments from central bank policymakers. Emerging Market (EM) bonds still delivered positive returns despite this rise in Developed Market yields. We would continue to rotate into our preferred areas (EM USD government and Asia USD) as the latter offer a more attractive balance of yield and quality, in our view.

FX: Bearish on USD/SGD; cautious against chasing AUD higher

- **Turning bearish on USD/SGD.** The USD/SGD pair broke below a key support (1.334), which now confirms a continuation of the downtrend, in our view. The break came after the announcement of Singapore's stronger-than-consensus Q4 GDP growth data. The immediate focus is on support at 1.3270-1.3150, which includes the 50% retracement of the rally from the 2011 low and the 2015 low. Against this backdrop, we now shift our bias in USD/SGD to bearish, preferring to sell any short-term rebounds towards 1.334.
- **Retain negative bias on AUD/USD.** The AUD rose to its highest since October following strong global PMI numbers, buoyant investor sentiment and higher iron ore prices, Australia's largest export. Technically, however, the AUD appears to be testing an important resistance (0.784); this corresponds with its Q2 16 top (daily chart) and is close to the 200-week moving average (weekly chart). Without a sustained break above 0.784, we remain cautious and retain our bias to sell AUD at these levels.

Benchmark (USD) performance w/w*



Week of 28 December 2017 to 04 January 2018

Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

S&P500 1% away from its next key resistance

Technical levels of key market indicators as of 04 Jan

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,724	2,626	2,750	↑
STOXX 50	3,569	3,469	3,590	↗
FTSE 100	7,696	7,544	7,781	↑
Nikkei 225	23,582	22,450	24,000	↑
Shanghai Comp	3,386	3,250	3,450	↗
Hang Seng	30,736	29,300	31,000	↗
MSCI Asia ex-Japan	733	678	740	↑
MSCI EM	1,193	1,097	1,195	↑
Brent crude oil (ICE)	68	61	70	↑
Gold	1,323	1,265	1,358	↑
UST 10Y Yield	2.45	2.27	2.53	↗

Source: Trading Central, Standard Chartered
Note: Arrows represent short-term trend opinions

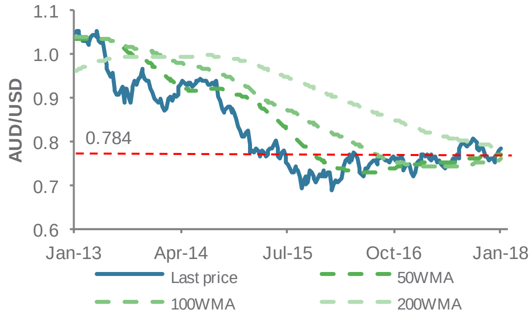
US Treasury yields have risen to the top of their one-year range

US 10-year Treasury yields

Source: Bloomberg, Standard Chartered

AUD/USD faces key resistance around 0.784

AUD/USD with 50-, 100-, 200-week moving averages



Source: Bloomberg, Standard Chartered

Standard Chartered Private Bank

Top client questions

Q1. How have markets panned out relative to your expectations since you published the annual outlook?

The strong momentum in global equity and corporate bond markets continued through the past month since we published our ***Outlook 2018***. Since we published on 8 December, global equities have risen 3.9%, within which Emerging Markets (EMs) outperformed with a 7.6% rise. Global investment grade corporate bonds rose 0.8%, while EM USD government bonds were up 0.9%. The USD continued to weaken (-2.2%), but both oil (+8.0%) and gold (+5.9%) recorded strong gains.

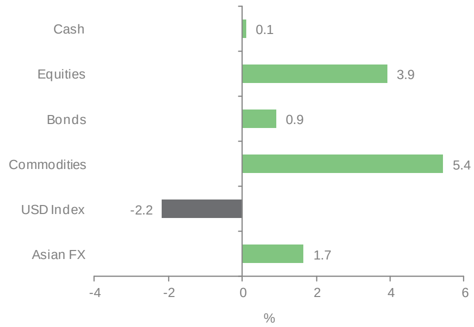
These strong gains occurred against the backdrop of key events and economic data that were supportive for markets. The Fed raised rates along expected lines, while the US government made significant progress toward implementing the tax reform.

In our ***Outlook 2018***, we argued the case for a move towards reflation (ie, one characterised by strong growth and modestly accelerating inflation), an environment we believe would favour equities outperforming bonds, with Asia ex-Japan and Euro area equities outperforming other regions, EMs outperforming Developed Markets (DM) within bonds and the USD weakening modestly.

While one month is too short a time to pass judgment on these full-year views, the past month has been a good start. Continued robust growth and a modest uptick in inflation in December have been consistent with our broad view of a continued shift towards reflation. Our view that equities are likely to outperform bonds is off to a strong start, though within that, our regional preference for Asia ex-Japan has done better than our preference for Euro area. Similarly, EM USD government bonds have done a better job of outperforming global bonds than Asia USD bonds, which have lagged somewhat. The USD has weakened in line with our expectations, but the continued, steady rise in oil prices has been greater than expected.

Equities and commodities have significantly outperformed bonds since we published *Outlook 2018, while the USD has weakened*

Performance of key asset classes (08 Dec 2017-04 Jan 2018)



Source: Bloomberg, Standard Chartered

Q2. What's the outlook for the USD following its recent decline?

The USD index fell to its lowest level in three months earlier in the week. Overall, 2017 was the worst year for the USD since 2003, despite the Fed hiking rates thrice last year. This would suggest the USD is no longer reacting to the cyclical upturn in the US economy, and developments elsewhere in the global economy might be more important to follow. In particular, the pace at which the ECB decides to move towards policy normalisation will be critical. ECB Executive Board Member Benoit Coeure recently hinted markets were underestimating the pace and extent of Euro area monetary policy tightening. Indeed, Euro area economic momentum has remained consistently strong and this could lead to a faster unwinding of policy stimulus than what markets currently expect.

The USD finally got some relief on Wednesday following strong US data and the release of the Fed's minutes from the 12-13 December meeting. Although these held few surprises, it was nonetheless supportive for an increasingly oversold USD, which had been declining for the past three weeks. However, we continue to believe any USD rebounds higher will prove to be temporary.

Technically, the DXY index impulsively broke below the neckline support of the head-and-shoulders pattern, a bearish outcome. We would remain bearish unless there is a break above the resistance at the neckline level at 92.20. However, a breach of the next major resistance at 93.40 is needed to reverse the downtrend.

The USD has declined for the third straight week; a rebound above 93.40 will be needed to reverse the downtrend

USD index

Source: Bloomberg, Standard Chartered

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	GE	Factory Orders WDA y/y	08-Jan-18	Nov	–	6.9%
	EC	Sentix Investor Confidence	08-Jan-18	Jan	–	31.1
	EC	Retail Sales y/y	08-Jan-18	Nov	–	0.4%
TUE	US	Consumer Credit	09-Jan-18	Nov	$18.000b	$20.519b
	JN	Real Cash Earnings y/y	09-Jan-18	Nov	-0.1%	-0.1%
	GE	Industrial Production WDA y/y	09-Jan-18	Nov	–	2.7%
	GE	Exports SA m/m	09-Jan-18	Nov	–	-0.3%
	EC	Unemployment Rate	09-Jan-18	Nov	–	8.8%
WED	CH	PPI y/y	10-Jan-18	Dec	4.8%	5.8%
	CH	CPI y/y	10-Jan-18	Dec	1.9%	1.7%
FRI/SAT	IN	CPI y/y	12-Jan-18	Dec	–	4.9%
	IN	Industrial Production y/y	12-Jan-18	Nov	–	2.2%
	US	CPI Ex Food and Energy y/y	12-Jan-18	Dec	–	1.7%
	US	Retail Sales Ex Auto and Gas	12-Jan-18	Dec	–	0.8%
	CH	Exports y/y	12-Jan-18	Dec	10.0%	12.3%

	Event	This Week	Date	Period	Actual	Prior
MON	SK	Exports y/y	01-Jan-18	Dec	8.9%	9.5%
TUE	EC	Markit Eurozone Manufacturing PMI	02-Jan-18	Dec F	60.6	60.6
WED	US	ISM Manufacturing	03-Jan-18	Dec	59.7	58.2
	US	Wards Domestic Vehicle Sales	03-Jan-18	Dec	13.72m	13.46m
THUR	CH	Caixin China PMI Composite	04-Jan-18	Dec	53.0	51.6
	IN	Nikkei India PMI Composite	04-Jan-18	Dec	53.0	50.3
	GE	Markit/BME Germany Composite PMI	04-Jan-18	Dec F	58.9	58.7
	EC	Markit Eurozone Services PMI	04-Jan-18	Dec F	56.6	56.5
	EC	Markit Eurozone Composite PMI	04-Jan-18	Dec F	58.1	58.0
	UK	Markit/CIPS UK Composite PMI	04-Jan-18	Dec	54.9	54.8
FRI/SAT	JN	Nikkei Japan PMI Composite	05-Jan-18	Dec	–	52.2
	EC	CPI Core y/y	05-Jan-18	Dec A	–	0.9%
	IN	GDP Annual Estimate y/y	05-Jan-18	2018	–	7.1%
	US	Change in Nonfarm Payrolls	05-Jan-18	Dec	–	228k
	US	Average Hourly Earnings y/y	05-Jan-18	Dec	–	2.5%
	US	ISM Non-Manf. Composite	05-Jan-18	Dec	–	57.4

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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