Wealth Management Chief Investment Office
14 January 2022

Weekly Market View

Bouncing back?

→ Global stocks and bonds rose and the USD fell this week, *despite* a tighter-than-expected US job market and rising US, Euro area inflation. This suggests markets have largely priced in these concerns.

→ Emerging Markets, particularly China, led the equity market gains, following yet another strong reiteration by China's State Council of the need and availability of policy support.

→ We see the market moves supportive of our world view this year: above-trend growth leading to the outperformance of US and Euro area equities and Developed Market High Yield bonds, and China's policy support enabling the recovery of beaten down Asia USD bonds.

→ US Q4 earnings and companies' outlook for 2022 profits are the next focus. Estimates for 2022 earnings suggest the bar for another year of outperformance is low.

How do you interpret the recent strong performance in Hong Kong/China equities? Are technicals for China markets supportive?

What are the implications of higher Fed rates and balance sheet reduction on your preferred bond asset classes?

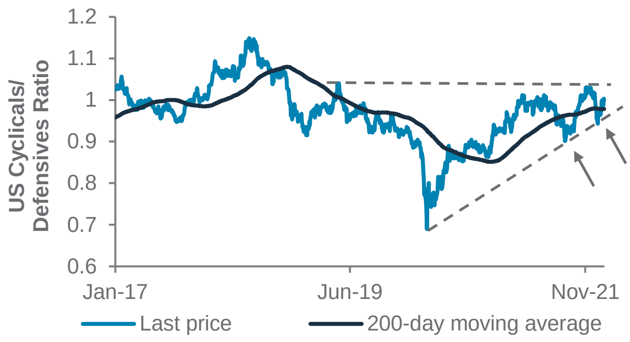
Is the USD rally over?

Important disclosures can be found in the Disclosures Appendix.

Charts of the week: The cyclical recovery continues

Cyclical sectors continue to lead the equity market recovery; the US Q4 earnings season is the market's next focus

Relative performance of S&P500 cyclical vs defensive sectors*



Consensus earnings estimates for US Q4 21 and full-year 2022

Source: Bloomberg, Refinitiv, Standard Chartered; *Cyclical sectors: Consumer discretionary, Energy, Industrials, Materials; Defensive sectors: Consumer staples, Healthcare, Communications, Utilities

Editorial

Bouncing back?

Investors ruffled by the start-of-the-year jitters should be reassured by recent market moves.

- First, equities and bonds rose and the USD fell this week, *despite* data showing a tighter-than-expected US job market and rising US, Euro area inflation. This suggests markets have largely priced in these concerns that had led investors to factor in at least three Fed rate hikes this year.
- Second, the gains this week were led by Emerging Markets, particularly China equities, following yet another strong reiteration by China's State Council of the need and availability of policy support to stabilise the economy.
- Third, the equity rally continues to be led by cyclical sectors, which suggests investors remain confident about the global recovery and not so concerned about inflation (long-term inflation expectations remain rangebound).

We see the market moves supportive of our world view this year: we expect COVID-19 vaccinations to enable economies to gradually normalise, despite intermittent bouts of the pandemic (such as Omicron). The US and Europe have an edge here because of their early start with vaccinations and easier access to the new COVID-19 anti-viral pills. However, Emerging Markets could start to catch up later this year once enough people have been vaccinated or when they start to 'live with COVID', leading a recovery in domestic consumption.

The USD is the key signal to watch. This week's USD weakness, despite strong jobs and inflation data in the US and Europe, is likely signalling that investors are starting to see value in some beaten down Emerging Markets. We continue to prefer gaining exposure to Emerging Markets through USD-denominated bonds, particularly the beaten down Asia USD corporate bonds, and select equity sectors.

In the coming weeks, equity markets are likely to be driven by the earnings season, which starts in earnest in the US next week. Lofty valuations mean companies will need to beat earnings estimates to sustain the US equity rally. The consensus expects S&P500 earnings rose 22.4% y/y in Q4 on the back of solid 12% y/y revenue growth. The estimates have risen over the past six months (from 17% growth estimated at the start of July 2021) as the US economic recovery gained ground, job markets improved and consumption boomed. This explains why the cyclical sectors (energy, materials and industrials) are estimated to have led the US earnings rebound.

For 2022, consensus expectations for US S&P500 and MSCI Euro area index earnings (+8.6%, +4.7% respectively) are not too aggressive, in our view, ie, the bar for outperformance is low. This sets the stage for another year of earnings beats and strong investor returns – albeit not the high double-digit gains seen last year – on the back of our expectations of above-trend economic growth and still-supportive monetary policies. Bank earnings will be a focus, especially the outlook for loan demand and net interest margins against the backdrop of rising rates.

As highlighted last week, we continue to prefer averaging into the recently beaten down technology sector in the US and Europe. We believe rate expectations are mostly baked in, thus turning the market focus back to the sector's strong long-term revenue growth potential and high profit margins. We also prefer the financial sector in Europe, where valuations are particularly attractive and net interest margins are likely to rise. Other preferred sectors in Europe and China include industrials, supported by infrastructure spending (especially on 'green' projects), and consumer discretionary (including the auto sub-sector) amid an expected demand recovery as their economies normalise and supply bottlenecks in semiconductors eventually ease (see pages 4-6 for details).

— 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 in the near term

(+) factors: China policy hope, Euro area retail sales, low COVID deaths

(-) factors: Omicron spread, tight US job market, rising US/EU inflation

	Positive for risk assets	Negative for risk assets
COVID-19	• Casualties remain well below previous peaks in most countries where Omicron cases have surged	• Omicron fuelled new record infection rates in the US, Europe and Australia, leading to more restrictions • A WHO official said more than half of Europe's population could be infected with Omicron within weeks • China locked down a third city in recent weeks, impacting factories, ports; Asia seeing cases rebound
	Our assessment: Neutral – Surging Omicron variant, another China lockdown, but relatively low casualty rates	
Macro data	• US NFIB Small Business Optimism index rose more than expected; producer prices inflation slowed • Euro area retail sales unexpectedly rose; jobless rate fell to a 20-month low of 7.2%; industrial output rose more than forecast • China consumer and producer prices rose less than forecast	• US jobless rate fell more than expected to 3.9%, below the Fed's long-term jobless rate; payrolls gains were below forecasts • US consumer inflation rose to 39-year high of 7% • Euro area inflation rose more than forecast; economic sentiment fell more than expected
	Our assessment: Neutral – Strong Euro area retail sales, industrial output vs tightening US job market, US/EU inflation	
Policy developments	• China's State Council said the nation has significant room for policy easing • Fed's Powell said monetary policy normalisation was backed by strong recovery	• Fed's Brainard said the central bank could raise interest rates as soon as March
	Our assessment: Positive – Scope for China policy easing	
Other developments		• NATO-Russia talks on Ukraine deadlocked
	Our assessment: Negative – Ukraine stand-off	

Inflation pressures are particularly challenging in the US, but we expect inflation to subside by H2 as goods demand eases and supply bottlenecks fade

US, Euro area and China core inflation

Source: Bloomberg, Standard Chartered

US jobless rate has fallen below the Fed's 4% long-run goal, but labour participation has some distance to catch up with pre-pandemic levels

US jobless rate and prime-age labour participation rate

Source: Bloomberg, Standard Chartered

Euro area retail sales were starting to pick up before Omicron hit; industrial output remains constrained by supply bottlenecks

Euro area retail sales and industrial output growth

Source: Bloomberg, Standard Chartered

Top client questions

What are expectations from the US earnings season?

Major US banks will kick off the Q4 2021 earnings season when they start reporting their results on 14 January. Overall S&P500 index Q4 earnings are expected to grow by about 22.4% y/y, continuing the strong earnings rebound from the pandemic recession. Earnings growth is expected to be the highest for cyclical sectors, namely Energy, Materials and Industrials, as their recovery extends. Growth is expected to be the lowest for Utilities, Financials and Staples – Financials are likely to see prior benefits of provision releases fall away, while Utilities and Staples are low-growth defensive sectors. Nonetheless, all sectors are expected to show positive growth.

Investors will watch out for the guidance on 2022 earnings, where consensus currently expects 8.6% growth, a more normalised rate compared with near 50% growth for 2021. Again, cyclical sectors are expected to lead growth in 2022, though all sectors are expected to show positive growth, apart from Financials. We expect earnings growth to continue supporting US equities, one of our preferred markets on a 6-12 month horizon. We like the Technology sector in the US, where we expect robust structural growth to ultimately drive the sector to outperform despite short-term valuation concerns.

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

Earnings expectations for 2022 are not so aggressive; this raises the prospect of continued earnings beats this year

S&500 index earnings growth (historical and consensus expectations)

Source: Refinitiv, Standard Chartered

How do you interpret the recent strong performance in Hong Kong/China equities?

US inflation and policy tightening worries have led some investors to reassess the relative prospects for undervalued Emerging Markets. This was amplified by the rising prospects of policy easing in China. The statement by China's State Council last week emphasising the need to prioritise economic stability and signalling significant scope for policy stimulus, bolstered investor confidence.

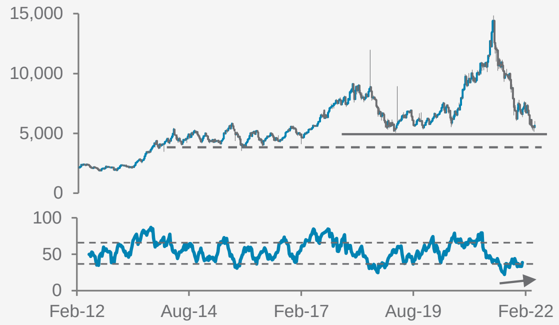
China's internet/consumer technology sector was one of the strongest performers. We believe the sector is of strategic importance in the government's drive to rebalance the economy's growth mix and increasing domestic consumption. This is a central pillar of the "China Common Prosperity" programme, one of our preferred multi-year investment themes.

After 2021's significant regulatory tightening, moderating regulatory intensity related to the China internet/consumer technology sector so far this year has also led to the favourable price action. Technically, the MSCI China index has tested and rebounded from a strong support level in the monthly charts. The Hang Seng Index is holding the uptrend line from the 2008 Global Financial Crisis lows, the 200 Month Moving Average and the 2020 low. Therefore, we believe the oversold conditions and favourable January seasonality are likely to lead to more short-term gains in Hong Kong/China equities.

— **Daniel Lam,** *Senior Cross-asset Strategist*

China's internet/consumer technology sector index is testing a very strong support

CSI Overseas China Internet USD index weekly chart with 200-WMA and RSI



Source: MSCI, FactSet, Standard Chartered

Top client questions (cont'd)

What are the implications of higher Fed rates and balance sheet reduction on your preferred bond asset classes?

Quantitative Tightening (QT) – to shrink a central bank's balance sheet – was implemented once before by the US Fed in the last decade. It started in October 2017, roughly one year after the first Fed rate hike of that cycle and after rates had already been raised four times. It ended in August 2019 following equity market volatility, by which time the Fed had hiked rates five more times to 2.5%.

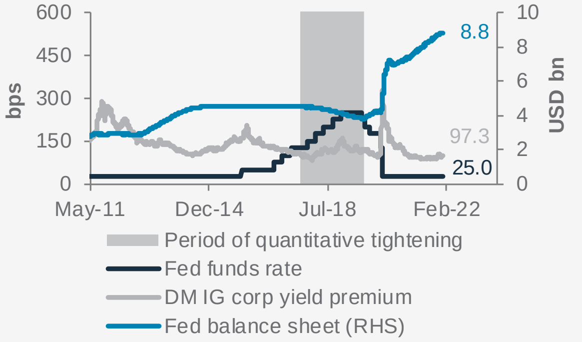
Investment grade (IG) bonds are typically more sensitive to changes in Fed policy rates and government bond yields. Developed Market (DM) IG yield premiums widened by nearly 60bps, before peaking in early 2019. DM High Yield (HY) and Asian USD bonds behaved similarly, with yield premiums surging by roughly 210bps and 85bps respectively.

Based on this (admittedly single) experience, DM IG bond returns could face headwinds as the Fed shrinks its balance sheet. However, there are several differences today relative to the last QT experience: (1) the Fed's balance sheet is much larger and may take longer to unwind; (2) we expect above-trend economic growth in the next 6-12 months, which should support HY bonds. Hence, while QT could raise volatility in our preferred bond asset classes, particularly DM HY bonds, we would stay the course through any such volatility based on our above-trend growth and low default rate views.

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

Fed policy tightening has historically led to higher corporate bond yield premiums, although strong growth this time is likely to support US HY bonds

DM IG bond yield premiums; Fed policy rate and balance sheet



Source: Bloomberg, Standard Chartered

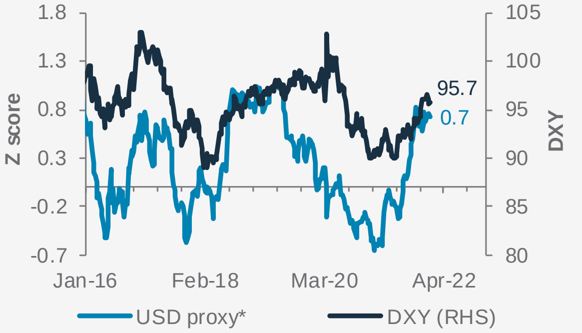
Is the USD rally over?

The broad USD decline after very strong, but unsurprising, US inflation data suggests that the FX market is in a correction mode, with hawkish Fed expectations priced-in and long USD positioning over-stretched. There is a risk of a medium-term USD top emerging relatively quickly, but we suspect that the current move is more likely just one of the several gyrations that will define the USD peaking process. The near-term outlook could see the USD slip further before the USD bulls are able to wrestle back the advantage and the reality of central bank policy divergence dominates again. Geopolitical tensions could trigger safe-haven USD strength.

Our expectation that high-beta currencies will perform well appears to be playing out, with the CAD, GBP and AUD leading the charge. Momentum is strong, and GBP/USD and USD/CAD have near-term potential to move to 1.38 and 1.24, respectively, before consolidating. Short AUD positioning could provide a stronger tailwind for AUD/USD to push towards expected strong resistance around 0.7400. The cheap and oversold JPY has also staged a rebound, and USD/JPY's break back below 115.50 is pushing towards our expected next support at 113.50 –114.00, with 112.50 support still a key level to preserve the USD/JPY uptrend.

A hawkish Fed appears to be largely priced in, so further catalysts may be needed to lift USD higher

Net positioning for the USD (proxied, standardised) vs USD index (DXY)



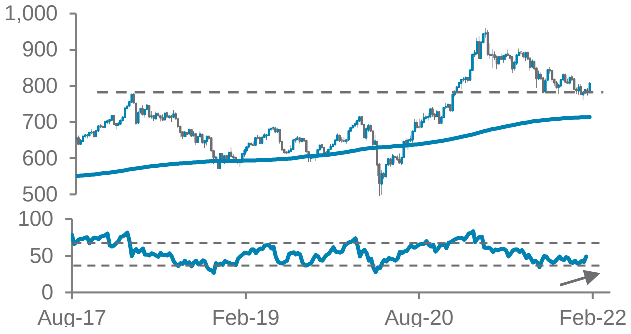
Source: Bloomberg, Standard Chartered
*Proxied by CFTC FX Net non-commercial futures positions; Represents the average of inverted standardised scores from EUR, GBP, JPY, AUD, CAD, NZD net positions

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

Asia ex-Japan: A temporary respite

MSCI Asia ex-Japan weekly chart with 200-DMA and RSI

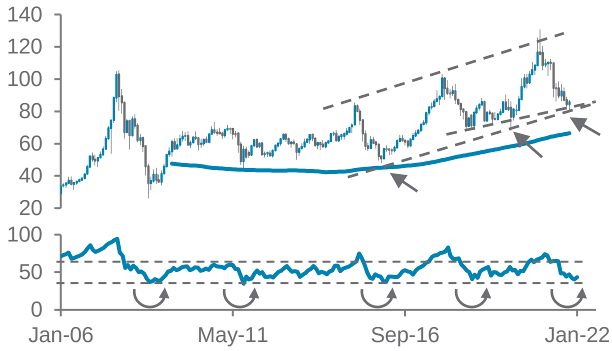


Source: Refinitiv, Standard Chartered

In recent months, the index is holding above quite strong support. Although upward momentum has picked up a bit most recently, it has quite a bit of work to do to return to an uptrend. Most immediately, it needs to break above resistance on the 200-DMA (now at 834; 3.4% above Thursday's close) for the downward pressure to fade.

China equities: At multi-year channel support

MSCI China monthly chart with 200-MMA and RSI



Source: Refinitiv, Standard Chartered

As the title suggests, such supports do not get tested every other month, but when faced with it, there is a tendency for markets to pause at the very least. Interestingly, the index is in the process (to be confirmed at end of the month) of posting back-to-back long-legged candles – similar long-legged candles in the past have been associated with a pause.

Hang Seng: Time for a pause in the slide?

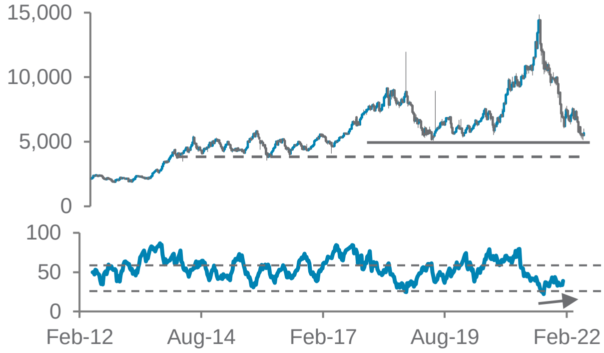
Hang Seng index monthly chart with 200-MMA and RSI

Source: Refinitiv, Standard Chartered

The Hang Seng index is at major support area – an uptrend line from the Global Financial Crisis, the 200-MMA and the 2020 low. Oversold conditions and favourable seasonality (January has been the best month for the index in the past three years) raise the chance that the slide could pause. However, it is too soon to say if the worst is over.

China Internet: Downtrend far from over

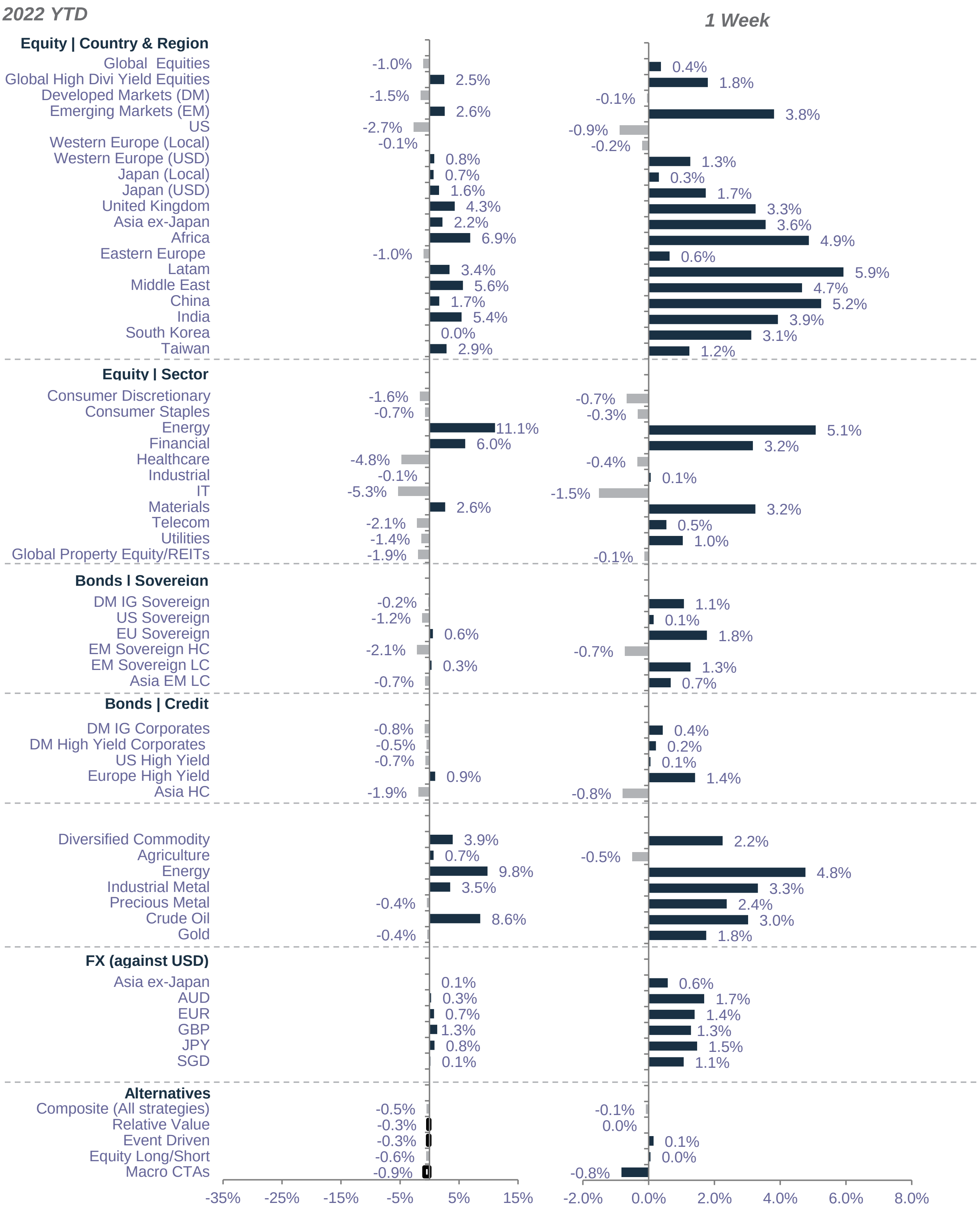
CSI Overseas China Internet USD index weekly chart with 200-WMA and RSI



Source: Bloomberg, Standard Chartered

The confluence of support for the benchmark indices on this page raises the odds that a turn is likely. However, this is not the first time the internet index is at key support (as we highlighted a few times last year). Only a break above 7585 (34% above Thursday's close) would indicate a meaningful uptrend had started.

Market performance summary *



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

*Performance in USD terms unless otherwise stated, 2022 YTD performance from 31 December 2021 to 13 January 2022; 1-week period: 06 January 2022 to 13 January 2022

Our 12-month asset class views at a glance

Asset class		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	CH	Industrial Production y/y	Dec	3.8%
	CH	Fixed Assets Ex Rural YTD y/y	Dec	5.2%
	CH	GDP y/y	4Q	4.9%
	CH	Retail Sales y/y	Dec	3.9%
TUE	EC	ZEW Survey Expectations	Jan	26.8
	US	Empire Manufacturing	Jan	31.9
	JP	BoJ Monetary Policy Decision	Jan	
WED	UK	CPI y/y	Dec	5.1%
	US	Housing Starts	Dec	1679k
THUR	US	Philadelphia Fed Business Outlook	Jan	15.4
	EC	ECB Monetary Policy Accounts	Dec	
FRI/SAT	EC	Consumer Confidence	Jan A	-8.3

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

The S&P500 index is 1% away from next resistance

Technical indicators for key markets as on 13 January 2022

Index	Spot	1st support	1st resistance
S&P500	4,659	4,637	4,704
STOXX 50	4,316	4,265	4,342
FTSE 100	7,564	7,485	7,603
Nikkei 225	28,489	28,219	28,762
Shanghai Comp	3,555	3,541	3,583
Hang Seng	24,430	23,806	24,742
MSCI Asia ex-Japan	807	791	815
MSCI EM	1,263	1,237	1,278
Brent (ICE)	84.5	82.0	85.8
Gold	1,822	1,804	1,833
UST 10Y Yield	1.70	1.68	1.74

Source: Bloomberg, Standard Chartered

Investor diversity remains normal across major assets

Our proprietary market diversity indicators as of 12 January

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	◐	→	1.47
Global Equities	◐	↓	1.47
Gold	●	→	1.67
Equity			
MSCI US	◐	↓	1.39
MSCI Europe	◐	→	1.50
MSCI AC AXJ	●	↑	1.94
Fixed Income			
DM Corp Bond	●	→	1.55
DM High Yield	●	↑	1.82
EM USD	●	↑	1.60
EM Local	●	↑	1.62
Asia USD	●	↑	1.72
Currencies			
EUR/USD	●	↑	1.61

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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