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WM Chief Investment Office

Weekly Market View

Sticking with risk, buying the dip

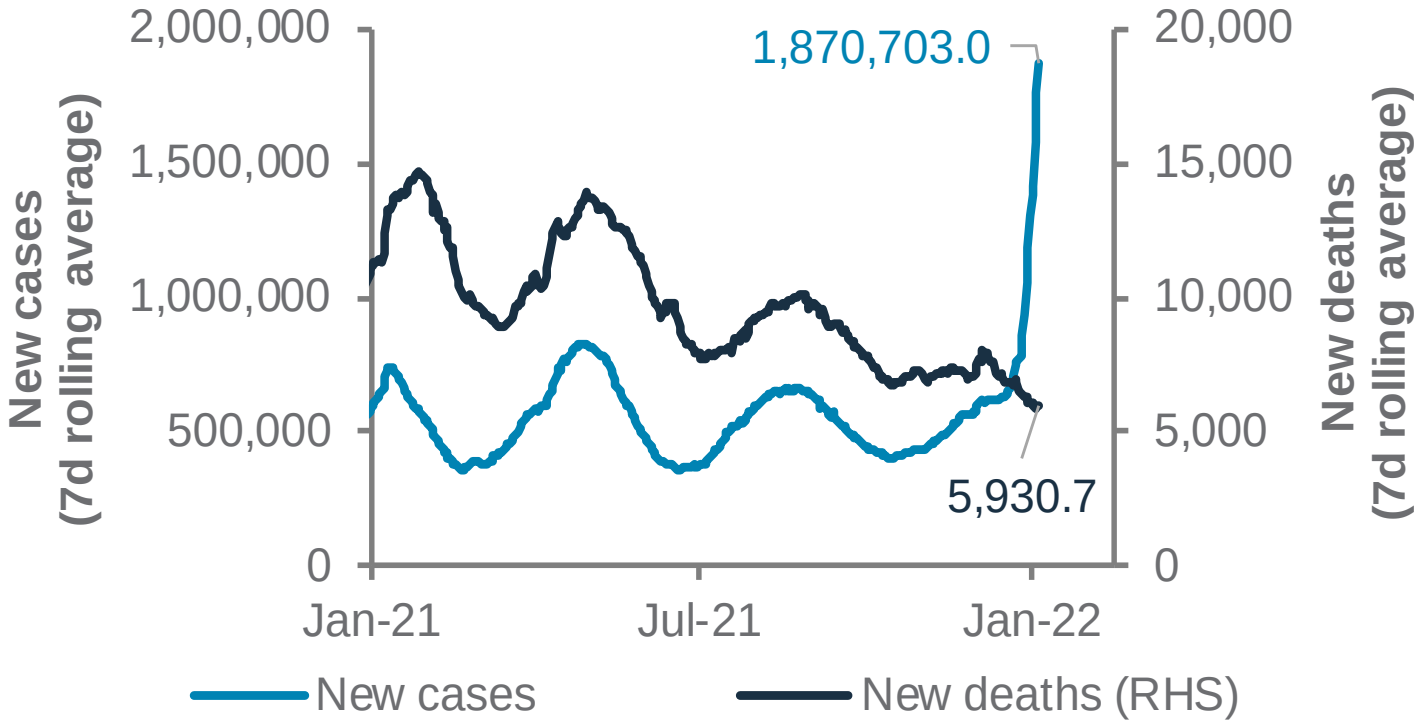
7 January 2022

Charts of the week: Will Omicron complicate Fed policy?

- Omicron is turning out to be **less severe than previous** variants, but a bigger concern is how the outbreak impacts the inflation outlook and how the Fed responds to it
- We still expect **US inflation to subside by the middle of next year**, enabling the Fed to go slow on rate hikes after finishing bond purchases tapering
- 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**

The COVID surge has not been accompanied by casualties, but it could complicate the inflation outlook and Fed policy

Global daily COVID cases and deaths, 7-day rolling average



Source: Bloomberg, Standard Chartered
As of 6 January 2022

Editorial: Sticking with risk, buying the dip

- We see little reason to believe that central banks are significantly behind the curve in **tackling inflation**
- The **Fed's latest meeting minutes** suggest it is considering starting rate hikes as early as Q2 22 after ending bond purchases by March
- While we have pencilled in just one Fed rate hike this year (vs 3 hikes priced by markets), a sustained tightening of the job market could lead to **one or two more hikes in 2022**
- Equity bull markets are generally truly threatened when monetary policy becomes too restrictive. We believe Fed policy is **unlikely to reach such levels this year**
- Hence, our strategy is to stick with risk assets, looking to buy or **average into dips**

Signposts to watch for Fed policy tightening

Economic Drivers	CIO View	Favorable for tightening?
Labour Markets	The US job market is already tight; Bloomberg Dec. consensus forecast is 4.1% which is broadly in line with the Fed's 4.0% long-term goal.	✓
Omicron	Omicron to prolong supply bottlenecks and keep workers away from job markets, sustaining inflation pressures.	✓
Vaccine Boosters	The rise in booster shot take up rate following the surge in Omicron should enable more workers to return to the job market.	✗
Fiscal Cliff	The large drop in government spending this year is likely to slow US growth significantly by H2.	✗
China	We expect China's growth to stabilize around 5% which indicates a slowing down from previous years. This is likely to be a drag on global inflation.	✗
	We expect China's pass-though from high producer prices (combined with rising energy prices) to sustain inflation pressures near-term.	✓
Inflation Expectations	US long-term inflation expectations have remained rangebound in recent months, despite the surge in near-term inflation pressures.	✗
Inventory Rebuild	New production capacities should enable businesses to rebuild inventory, just as demand for goods slows by the middle of this year.	✗
Productivity	Productivity boost from CapEx is a headwind for inflation in the long-term.	✗
USD Strength	The USD's strength last year and early part of this year is likely to be a powerful deflationary force.	✗

The weekly macro balance-sheet

	Positive for risk assets	Negative for risk assets
COVID-19	• Hospitalisations remain below previous peaks in most countries where Omicron cases have surged • New cases have declined over the past month in most of Asia, though some have started to see a rebound in infections • The US allowed booster shots for 12-15 year olds	• Omicron led to a record surge in infections in the US, Europe and Australia, leading to further mobility restrictions • China locked down a second city over the past month as new cases were detected
	Our assessment: Negative – Surging Omicron variant, another China lockdown, but relatively low hospitalisation rate	
Macro data	• US private job creation rose more than expected • China, Japan and UK Manufacturing PMIs rose more than expected • US, German factory orders rose more than expected • German retail sales rose unexpectedly	• US ISM Manufacturing and Services PMI fell more than forecast to a still-robust 58.7 and 62.0 respectively • Euro area Services PMI fell more than expected; German Composite PMI fell more than expected to 49.9
	Our assessment: Positive – Strong China, Euro area manufacturing, strong US job market	

The weekly macro balance-sheet

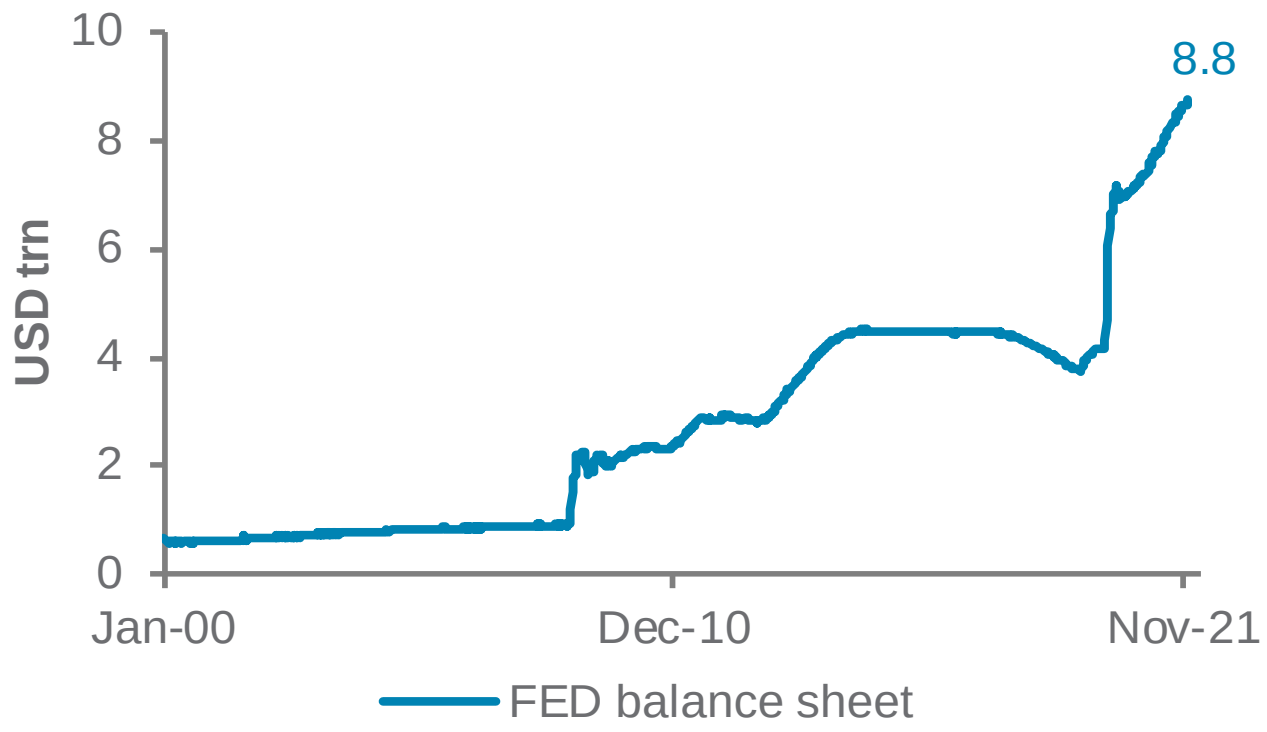
	Positive for risk assets	Negative for risk assets
Policy developments		• Fed's December meeting minutes showed policymakers are considering a faster pace of stimulus withdrawal than previously expected
	Our assessment: Negative – Hawkish Fed	
Other	• OPEC+ agreed to boost oil output by 400,000 bpd in February	• The US, EU voiced support for Ukraine amid concerns about a Russian invasion • China's cyberspace regulator plans new rules in February
	Our assessment: Negative – Ukraine stand-off	
	Our weekly net assessment: On balance, we see the past week's data and policy as moderately negative for risk assets near term (+) factors: Robust US job market, low COVID hospitalisations/deaths (-) factors: Omicron concerns, hawkish Fed, Ukraine standoff	

Is there room for US Treasury yields to rise further?

- US Treasury yields have risen sharply, by **nearly 20bps**, since the start of the year due to:
  - *Lower hospitalisation rate for Omicron and possible supply-chain disruptions leading to higher inflation in the near term*
  - *Hawkish guidance from the latest Fed minutes*
- We expect inflation to start to **subside by mid-year**, reducing the pressure on the Fed
- The projected **reduction in US Treasury supply** this year should help alleviate some volatility arising from the Fed's balance sheet reduction plans
- While a near-term overshoot is certainly possible, we continue to expect US 10-year Treasury yields to **trade within 1.75-2.00%** on a 12-month horizon

Similar to 2018, Fed balance sheet reduction is likely to be gradual and only partially reverse the surge during the pandemic

Size of US Federal Reserve's balance sheet



Source: MSCI, FactSet, Standard Chartered
As of 6 January 2022

What are the implications of rising US Treasury yields on equity sectors?

- Higher yields can be a strong **tailwind for bank earnings**
- Our preferred exposure is via **Europe's financial sector**, which we expect to outperform the broader market over the next 6-12 months thanks also to a **significant (34%) discount** to the broader market
- While higher yields can hurt high P/E stocks with earnings growth derived far in the future (e.g. Tech stocks), long-term strong earnings growth should **overcome this near-term headwind**
- Therefore, on a 6-12 month horizon, we continue to prefer the **US and European tech** sector given that we see support from **strong structural earnings growth**

Europe's financial sector is attractively valued compared with the broader market

Consensus 12-month forward P/E of MSCI Europe financial sector index vs MSCI Europe index

Source: Bloomberg, Standard Chartered
As of 6 January 2022

Will the recovery in Asia USD bonds last?

- Asia USD bond spreads tightened by nearly 60bps after peaking on 6 Nov 2021 due to **exclusion of defaulted Chinese real estate issuers**
- Though, Asian USD bonds dropped as default concerns reignited after another top-tier Chinese developer reportedly **missed a loan payment**
- The reduction of the PBoC's **Loan Prime Rate (LPR)** for the first time in almost two years was a key policy easing factor
- Local government-backed entities are **raising stakes** in several distressed developers
- We **retain our positive view** on Asia USD bonds on still-attractive valuations and relatively low sensitivity to US bond yields

Asia USD bond yield premiums tightened recently, albeit with exclusion of defaulted issuers being a key driver

Asia and China USD bond yield premiums over US Treasuries

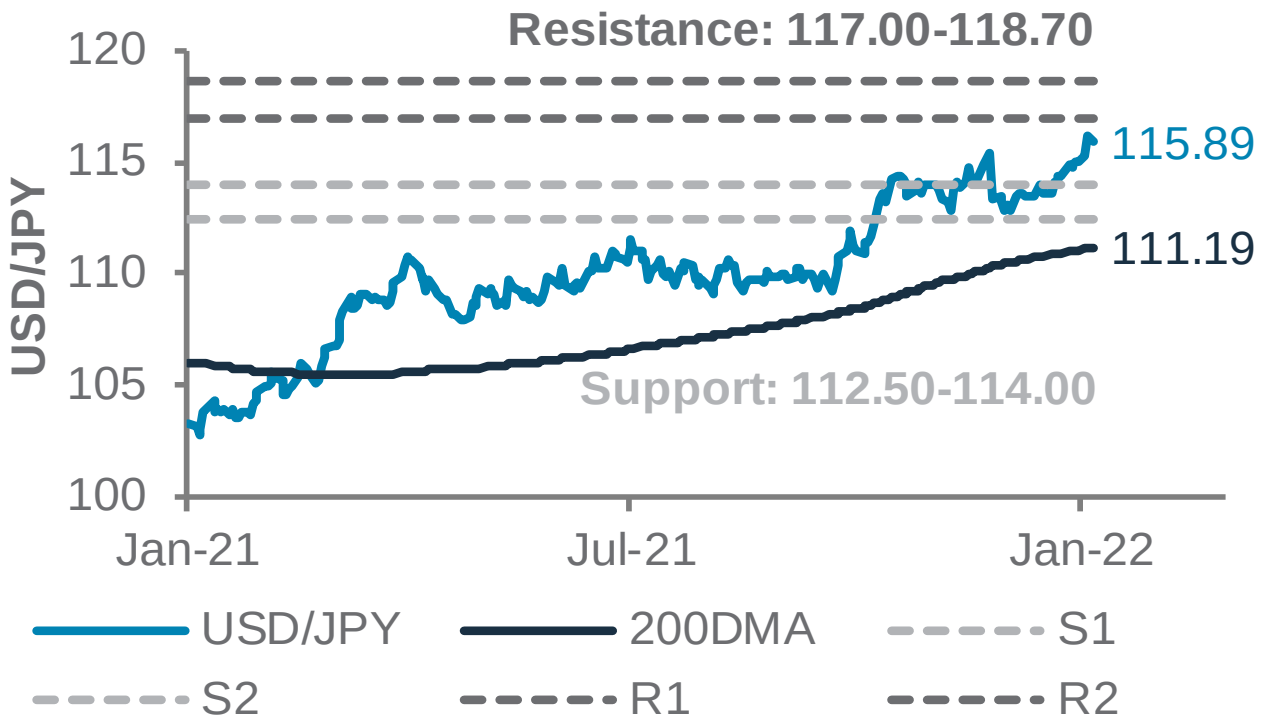
Source: Bloomberg, Standard Chartered
As of 6 January 2022

USD/JPY has rallied strongly. What is the near-term outlook?

- **USD/JPY** pushed above its late-2021 high of 115.50
- Near-term a move towards resistance at 116.50-117.00 is likely, though **a rally may be short-lived** due to near overbought conditions on daily and weekly charts
- However, the overall short-term **USD/JPY trend is up**. A slide back below 115.50 should attract buyers on a dip towards 113.50-114.00
- USD/JPY is particularly sensitive to US yields as the **BoJ** is expected to keep the **policy stable through 2022**
- Market expectations for the **Fed policy actions** in the coming weeks are a key driver of USD/JPY price action

USD/JPY's break to new trend highs suggests a push towards 117 is likely; overbought technicals may cap further progress near-term

Daily USD/JPY chart with technical indicators



Source: Bloomberg, Standard Chartered
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Technicals for the week

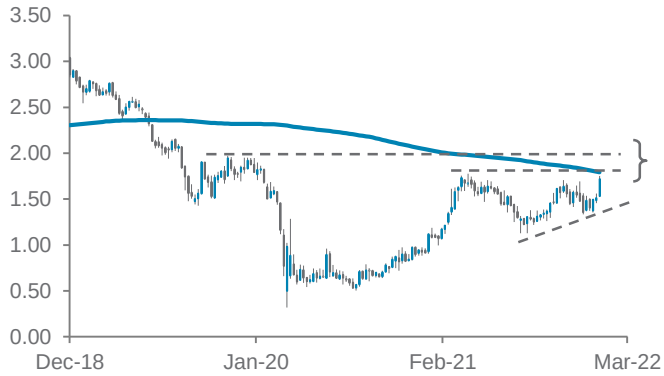
Global equities: Short-term fatigue

MSCI All Country World index daily chart with 200DMA and RSI

Negative RSI divergence (lower peaks in RSI associated with a potential double-top in the index), is a sign of fatigue. A drop towards the 200DMA (currently at 726) 2.4% from Thursday's close, is possible. However, there is strong support at the October low of 702 (5.6%), which could limit the decline.

US 10y Treasury yield: Flexes muscles again

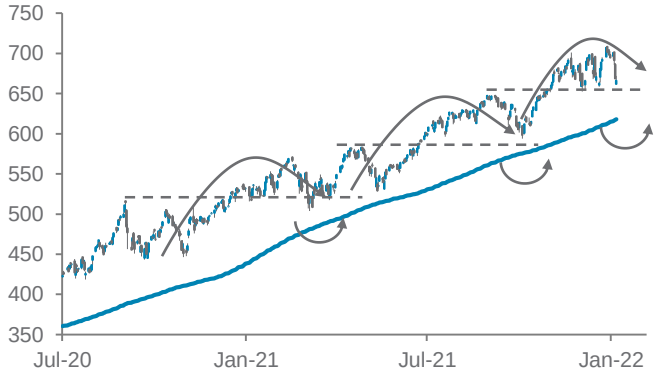
US 10y Treasury yield weekly chart with 200WMA



The US 10-year Treasury yield is retesting crucial resistance at 1.77-1.97%. While the yield has tested resistance lately – it has made two false attempts in recent months – any break above could pave the way towards 2.15% initially, possibly 2.45%. For the bullish scenario to hold, at minimum, the yield needs to stay above 1.34%.

US technology: Strong support on the 200DMA

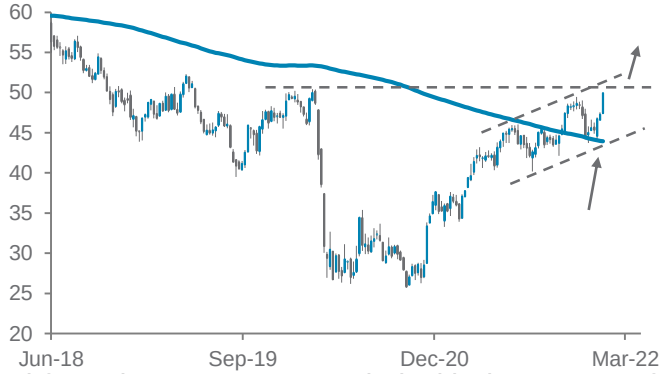
MSCI US Technology daily chart with 200DMA



It has been a tale of two steps forward, one step back. Going by this pattern, the index could be supported around current levels. In addition, there is strong support on the 200DMA (now at 617; 7% from Thursday's close), coinciding with the October low of 594 (11%). Only a break below 594 would indicate that the short-term trend had turned bearish.

EU banks: Trend remains up

MSCI Europe Banks weekly chart with 200WMA



The rebound from the 200WMA, coupled with the pattern of the higher highs and higher lows, confirms that the uptrend remains intact. However, the index needs to clear the immediate resistance at 50.37 for the trend to turn unambiguously bullish. A break above could pave the way towards 58.00 (16% from Thursday's close).

Source: Bloomberg, Refinitiv, Standard Chartered

Key Events Next Week

- Economic & Market Calendar

Week of 10 - 14 Jan

Country	Economic Indicator	Date
EZ	Unemployment Rate	10 Jan
CN	PPI and CPI y/y	12 Jan
US	Headline and Core CPI y/y	12 Jan
US	PPI ex. Food and Energy y/y, PPI Final Demand	13 Jan
UK	Industrial Production y/y	14 Jan
CN	Trade Balance	14 Jan
US	Retail Sales and Industrial Production y/y	14 Jan

Shaded rows refer to upcoming political or monetary policy events
Source: Standard Chartered
Singapore local time zone applied
As of 7 January 2022

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