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Wealth Management Chief Investment Office
8 April 2022

Weekly Market View

Learning to live with a hawkish Fed

→ The Fed has turned decisively hawkish in recent weeks amid rising inflation pressures. Money markets are pricing close to 250bps in rate hikes over the next 12 months. Does this still gel with our constructive view on equities?

→ We believe it does. As long as the US job market holds up (job creation in March was strong), monetary policy stays accommodative (as it is likely to be throughout this year) and growth remains above-trend (as we expect this year), we believe the economic environment will remain reflationary this year, despite rising inflation and slowing growth.

→ During reflation, history shows equities and commodities tend to outperform bonds. Hence, while market volatility is likely to stay elevated near term as the Fed raises rates, we would use the volatility to add to our equities and riskier bond exposures.

Will energy sector stocks continue to outperform?

Is the nascent recovery in China High Yield bonds sustainable?

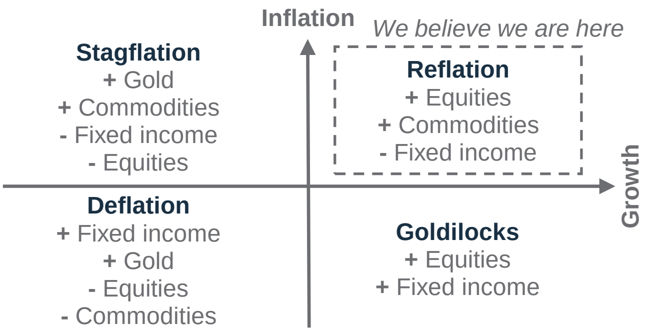
What is the near-term outlook for commodity currencies?

Important disclosures can be found in the Disclosures Appendix.

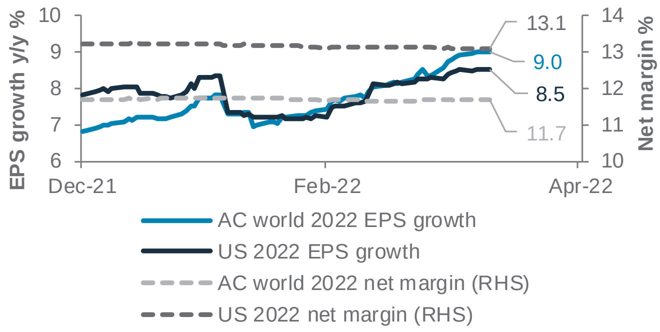
Charts of the week: Still in reflation mode

We believe the US economy remains in a reflationary scenario, which is positive for earnings and, ultimately, equities

Our macroeconomic framework, with asset class implications



US and global* 2022 corporate earnings and margin estimates



Source: FactSet, Standard Chartered. *MSCI All Country World Index (AC world)

Editorial

Learning to live with a hawkish Fed

The Fed has turned decisively hawkish in recent weeks amid rising inflation pressures. Money markets are pricing close to 250bps in rate hikes over the next 12 months. Does this still gel with our constructive view on equities? We believe it does. As long as the US job market holds up (job creation in March was strong), monetary policy stays accommodative and growth remains above-trend, we believe we are in a reflationary environment, despite rising inflation and slowing growth. During reflation, history shows equities and commodities tend to outperform bonds. Hence, while market volatility is likely to stay elevated near term as the Fed raises rates, we would use the volatility to add to our equities and riskier bond exposures.

A few definitions are in order. As the chart above shows, our macroeconomic outlook, which feeds into our tactical asset allocation calls, can be simplified into a four-quadrant framework. In this framework, reflation is characterised by above-trend growth, accompanied by above-trend inflation. We believe the US is still in a reflationary environment. While growth has slowed sharply since the post-pandemic rebound peak – the consensus is estimating 1.5% q/q annualised expansion in Q1 – we expect above-3% full-year growth for 2022, well above the US' long-term trend growth of 1.8% (the consensus estimates 3.4% growth for 2022; see chart on page 3). Meanwhile, we expect inflation to average 5% this year, even if price pressures ebb in the second half. That is still well above the Fed's 2% long-term inflation target (March inflation data, due next week, is likely to show accelerating price pressures). Meanwhile, the US job market remains very strong, with the jobless rate falling in March to 3.6%, below market estimates and the Fed's 4% long-term unemployment target.

In fact, we believe the Fed has been emboldened by the strong US job market and business confidence (PMI) data, as it turned more hawkish. The Fed believes it can now singularly tackle inflation as long as the job market and business confidence hold up. Also, US real interest rates (rates after adjusting for inflation) are at rock bottom and highly supportive of reflation. Even if the Fed hikes by 250bps over the next 12 months to 3%, as the market is pricing, US real rates will remain negative as inflation is likely to remain above 3% early next year. There is also a growing probability the Fed's so-called 2.4% 'neutral' policy rate, above which monetary policy starts to restrict growth, could be higher. A higher 'neutral' rate would enable the Fed to tighten more than current market estimates without causing a recession. The rise in US 10-year yield above 2.6% and re-steepening of the 10y-2y yield curve over the past week arguably point to rising expectations of a higher 'neutral' rate.

Of course, there is a risk that the current environment shifts towards stagflation. Technically, stagflation is defined as slowing or stagnating growth and rising inflation, accompanied by high or rising unemployment. It is a rare phenomenon last seen in Developed Markets (especially the US) in the 1970-80s, when the Fed was forced to raise rates sharply to bring inflation to sustainable levels. Typically, equities and bonds both suffer negative returns during stagflation periods. While US growth has slowed and inflation has risen this year, we believe the US is some distance away from a stagflation environment, crucially because its job market remains strong, with the jobless rate still falling. The solid job market is, in turn, supporting consumption (retail sales data due next week). It would take a sustained rise in the jobless rate to significantly raise stagflation risk.

The above macro framework does point to continued bouts of volatility, which is par for the course during early stages of a Fed rate hiking cycle. Nevertheless, our reflation outlook supports our call for long-term investors to use the current volatility to add to equities and riskier bonds and reduce exposure to long-maturity Developed Market Investment Grade bonds. Asia ex-Japan is our top pick within equities due to cheap valuation and more policy support in China. The energy and financial equity sectors are likely to continue benefitting from high oil prices and rising rates. The upcoming Q1 earnings season is a key catalyst for risk assets. The bar is low for US earnings beats, given current consensus estimates of 6.4% y/y growth. We would, of course, hedge against stagflation risks through gold, commodity-based assets and private real estate.

— **Rajat Bhattacharya**

The weekly macro balance sheet

Our weekly net assessment: On balance, we see the past week's data and policy as negative for risk assets in the near term

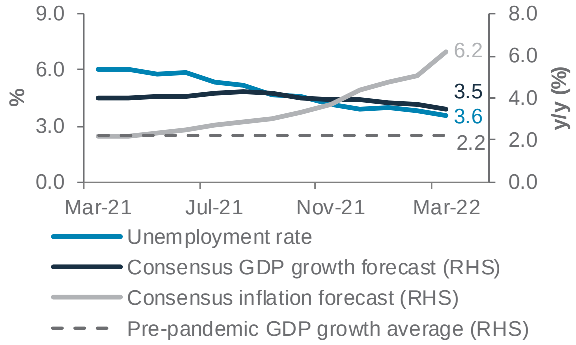
(+) factors: Strong US payrolls, services PMI, release of oil reserves

(-) factors: Hawkish Fed, extended China lockdowns, weak China PMI

	Positive for risk assets	Negative for risk assets
COVID-19	• US infections drop to lowest in a year; UK, Germany cases fall from recent peak • Singapore, South Korea, Taiwan ease restrictions • Hong Kong cases fall back to February lows	• Shanghai extended lockdown, with mass testing underway amid surging infections • Cases in Japan, Australia remain elevated
	Our assessment: Negative – Longer lockdowns in China	
Macro data	• US payrolls rose 431,000 in March, dragging the jobless rate down more than expected to 3.6% • US ISM Services PMI rose to 58.3	• US ISM Manufacturing PMI unexpectedly fell to 57.1 • China Caixin PMI fell to 43.9, lowest since Mar 2020 • Euro area Sentix Investor Confidence index fell more than forecast; producer inflation hit record 31.4% • German factory orders fell more than expected
	Our assessment: Neutral – Strong US labour market, services vs weak China PMI, Euro area confidence	
Policy developments	• China's regulators proposed easing confidentiality rules for offshore-listed companies, enabling oversight of accounts by US auditors	• Brainard said Fed to start "rapid" balance sheet runoff from May; minutes show Fed ready to raise rates sharply to stem inflation • RBA turned more hawkish while holding rates constant
	Our assessment: Negative – Hawkish Fed talk, minutes	
Other developments	• Russia moved more troops away from Kyiv as talks continue • US and allies released strategic oil reserves to plug energy shortage	• NATO said Russian troops advancing in east Ukraine • G7 unveiled more Russia sanctions; US revoked normal trade relations • French polls showed Macron's lead narrowing ahead of 10 April election
	Our assessment: Negative – More Russia sanctions amid escalation of tensions	

Our US reflation outlook is based on expectation that growth will remain above trend and inflation above the Fed's 2% target, while the jobless rate will not rise significantly in 2022

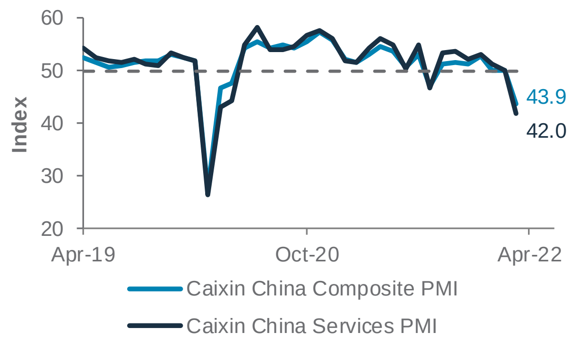
US consensus 2022 growth and inflation estimates and actual unemployment rate



Source: Bloomberg; Standard Chartered

China's business confidence fell sharply in March amid lockdowns, adding pressure on policymakers to accelerate stimulus measures

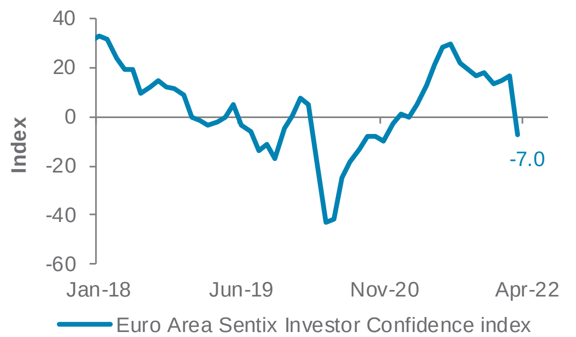
China Caixin Services and Composite PMIs



Source: Bloomberg, Standard Chartered

Euro area investor confidence plummeted this month, making it harder for the ECB to tighten policy significantly even as inflation surges

Euro area Sentix Investor Confidence index



Source: Bloomberg, Standard Chartered

Top client questions

Will energy sector stocks continue to outperform?

To address this question, we will need to first address the outlook for oil prices. WTI oil prices have slipped from a multi-year high as the US and IEA announcements to release strategic oil reserves coincided with an unwinding of technically overbought conditions. Russia exported about 4.3 million barrels per day (mbpd) of crude oil in 2021, but only 2.3 mbpd of oil supply is expected to be lost due to Western sanctions as other countries continue purchases. Near-term global supply is also likely to be supported by the release of 240mn barrels of oil reserves over the next six months by the US and IEA members (c.1.3 mbpd*), limiting the net reduction in supply.

On technical charts, we expect support for WTI crude oil price at USD 93-95/bbl to hold in the near term, though a break below could extend the correction towards the USD 84-88. Strong technical resistance sits at USD 105-115, and we anticipate choppy rangebound price action in the near term.

Geopolitical risks around Russia and the Middle East remain elevated. Therefore, we believe oil price risks remain skewed to the upside as long as global demand stays robust and supply remains vulnerable and volatile. We have a bullish 12m WTI oil price target of USD 120/bbl, and expect near-term dips to be relatively brief and attract buying interest from refiners looking to rebuild inventory.

One of our technical indicators (fractals, an indicator of investor diversity) show investor positions are extremely bullish for US energy equities, raising the risk of a near-term pullback. However, given our constructive view on oil prices and the ongoing gap between oil and energy sector equities, we expect any pullback to be brief and would take advantage of any weakness to add exposure.

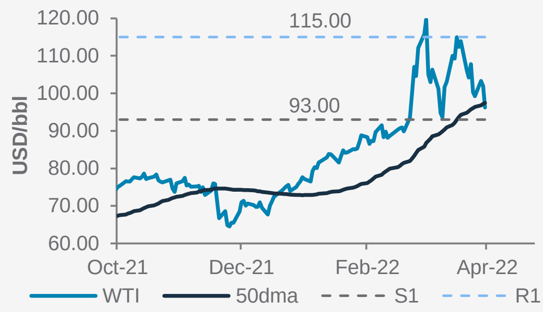
We expect energy equities in the US, Europe and China to outperform the broader market over the next 6-12 months. This is supported by our constructive view of the oil price. However, even with a pullback in the oil price, we believe energy equities can outperform. There is a sizeable performance gap between the oil price (+87% over last five years) and energy equities (-2% to +10%) that we believe can narrow via energy equities' outperformance. Taking another perspective, the energy sector contributes 6.5% of the MSCI US index earnings today, but comprises only 3.7% of the index's market value, a gap that we believe should narrow.

Oil producers today are increasingly disciplined when it comes to capex and reluctant to invest in new oil supply. Companies have also trimmed operating costs significantly through the pandemic phase. This has led to a supply crunch as demand is recovering. Within the energy complex, we like integrated oil, oil & gas producer and equipment & services sub-sectors.

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

WTI crude oil has broken below the 50dma trend line, suggesting upward momentum has faded

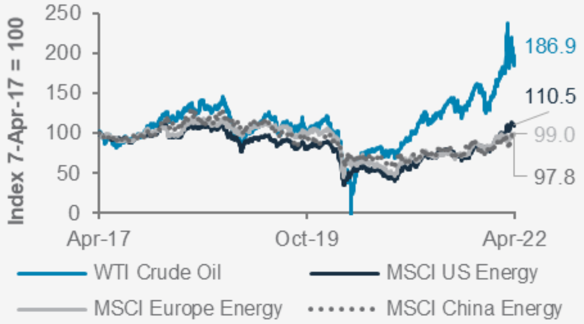
WTI oil with technical indicators



Source: Bloomberg, Standard Chartered
*Assume 183 calendar days over the next 6 months

There is a significant gap between the performance of crude oil price and energy equities; we believe energy equities can catch up

Performance of WTI crude oil, MSCI US Energy, MSCI Europe Energy and MSCI China Energy indices over the past five years (Rebased Apr-17=100)



Source: Bloomberg, Standard Chartered

Top client questions (cont'd)

Is the nascent recovery in China High Yield bonds sustainable?

China High Yield bonds rebounded significantly after Chinese authorities sent positive signals on the possibility of more supportive policy measures in recent weeks. Since its most recent bottom on 15 March, the asset class has rebounded nearly 25%, with the property sector also making a partial recovery from deeply distressed levels.

Having said that, we believe catalysts for a sustainable rebound remain lacklustre for now. While COVID-19 lockdowns may bring rapid policy easing, there is a risk that significant policy support expectations may increasingly be in the price.

We also highlighted previously that access to liquidity is another factor to watch. Here, there has been little improvement. In Q1, capital market activities for High Yield issuers tumbled year-on-year, with only a handful of issuers gaining access to the onshore interbank market. Asset disposals or M&A activities were limited amid weak market sentiment and rising funding costs. Looking ahead, the asset class faces a heavy maturity wall of roughly USD 7bn in April alone. Without a meaningful reopening of access to refinancing channels, there is a risk of further market volatility in the short term, led by more restructuring or default events, before the asset class firmly bottoms.

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

China High Yield bonds have rebounded almost 25% from their bottom on March 15 amid pledges by regulators to further ease policies

China High Yield bond total return index

Source: Bloomberg, Standard Chartered.

What is the near-term outlook for commodity currencies?

A more hawkish RBA triggered an AUD/USD spike above technical resistance at 0.7610, providing a tailwind for the NZD and CAD as well. For AUD/USD, the surge completed a 10% gain from the January low, and from a technical perspective, we regard the current consolidation as constructive for the expected medium-term uptrend towards 0.80. However, it is valid to question how deep this correction could be, and what tactical strategy may be appropriate?

The Fed is signalling that robust tightening via rate hikes and balance sheet reduction lies ahead. A drop in aggregate commodity demand is the likely outcome, and this may limit commodity price pressures and expectations. This could mean more downside corrections for commodity currencies which have been rising since February. We expect a strong band of technical support for AUD/USD at 0.7275-0.74. Similar support is anticipated for NZD/USD at 0.6780-0.6840 and resistance for USD/CAD at 1.2650-1.2710.

One tactical approach that could capture this temporary pullback would be bearish AUD/JPY or CAD/JPY, combining a correction in commodity currencies with the oversold JPY. We expect AUD/JPY resistance at 94.25 to hold in the near term with support at 89-90, with the respective CAD/JPY levels at 100.25 and 96-97.

AUD/USD near-term consolidation to below 0.7400 could be constructive for more medium-term gains

AUD/USD with technical indicators

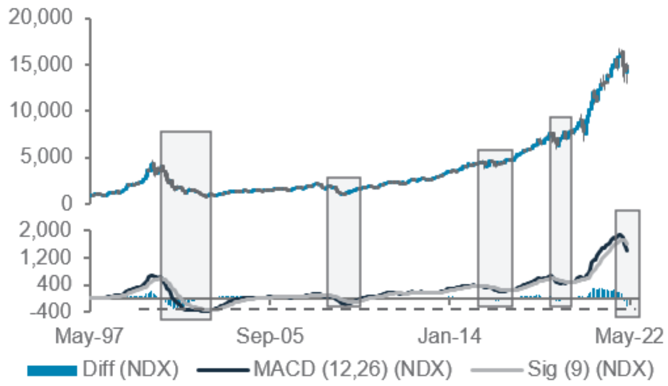
Source: Bloomberg, Standard Chartered.

Technical charts of the week

Manish Jaradi
Senior Investment Strategist

Nasdaq 100 index: Consolidation could continue

Nasdaq 100 index monthly chart with MACD histogram (the spread between the MACD and the Signal Line)



Source: Bloomberg, Standard Chartered

A bearish crossover by the MACD suggests there is a high chance that the (up) trending phase could be over for now. This does not mean the broader uptrend has ended. Indeed, the index could retest the 2022 high at some point. However, the crossover suggests it may need to consolidate a bit more before another leg higher (like it has done in the past).

Asia ex-Japan equities: Still a pause in the downtrend

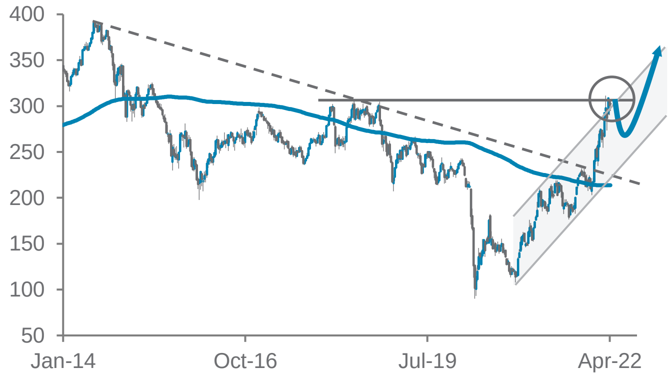
MSCI Asia ex-Japan index weekly chart with 50-WMA and 100-WMA

Source: Refinitiv, Standard Chartered

There is no doubt the recovery has been the strongest since the downtrend began in 2021, but it is too soon to conclude the worst is over. It could well be, but there is not enough on the charts to infer that just yet. The moving average slopes continue to point downwards and the index has not broken key resistance on the 100-DMA.

US energy sector: A short-term pause is possible

MSCI US Energy sector index weekly chart with 200-WMA

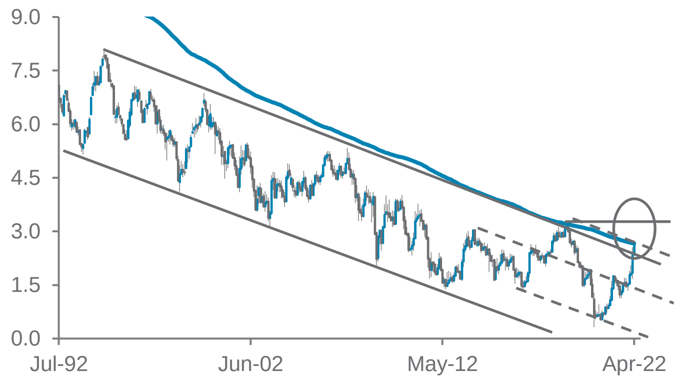


Source: Bloomberg, Standard Chartered

The sector index's break last year above a major downtrend line from 2014 and the 200-WMA confirms that its medium-term fortunes have changed. However, the index is now testing stiff converged resistance (the 2018 highs and the uptrend channel from 2020), raising the prospect of a brief retreat before an eventual break above the resistance.

US 10-year government bond yield: At a crucial crossroad

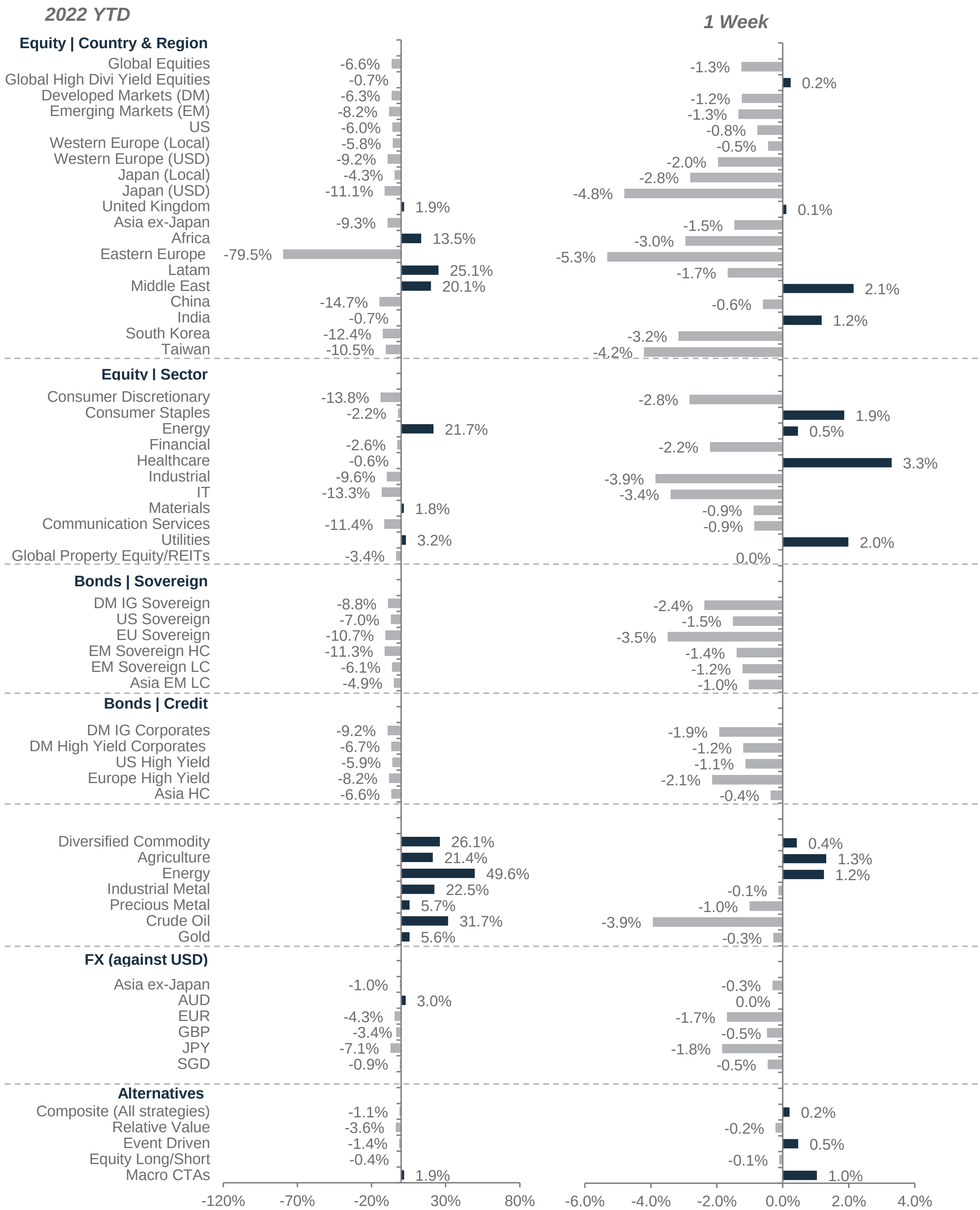
US Treasury 10-year yield monthly chart with 200-MMA



Source: Refinitiv, Standard Chartered

The yield is testing major converged resistance (2.66%) on the downtrend channel and the 200-MMA. Previous attempts have been unsuccessful and it may not be different this time. Still, given that monthly momentum is highest since 2002, a brief break higher cannot be ruled out. Even then, the 2018 high of 3.26% would be tough to crack, at least in this move.

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 07 April 2022; 1-week period: 31 March 2022 to 07 April 2022

Our 12-month asset class views at a glance

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	Expected	Prior
MON	CH	PPI y/y	Mar	7.7%	8.8%
	CH	CPI y/y	Mar	1.5%	0.9%
	UK	Industrial Production y/y	Feb	–	2.3%
TUE	EC	ZEW Survey Expectations	Apr	–	-38.7
	US	CPI y/y	Mar	8.3%	7.9%
	US	CPI Ex Food and Energy y/y	Mar	6.6%	6.4%
WED	UK	CPI y/y	Mar	–	6.2%
	CH	Exports y/y	Mar	13.0%	20.9%
THUR	EC	ECB Deposit Facility Rate	14-Apr	–	-0.5%
	US	Retail Sales Ex Auto and Gas	Mar	0.2%	-0.4%
	US	U. of Mich. Sentiment	Apr P	58.9	59.4
FRI/SAT	US	Empire Manufacturing	Apr	3.0	-11.8
	US	Industrial Production m/m	Mar	0.4%	0.5%

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

US 10-year Treasury yield faces next resistance at 2.75%

Technical indicators for key markets as on 07 April 2022

Index	Spot	1st support	1st resistance
S&P 500	4,500	4,460	4,562
STOXX 50	3,802	3,752	3,901
FTSE 100	7,552	7,522	7,598
Nikkei 225	26,889	26,589	27,488
Shanghai Comp	3,237	3,221	3,268
Hang Seng	21,809	21,578	22,271
MSCI Asia ex-Japan	714	706	729
MSCI EM	1,126	1,114	1,150
Brent (ICE)	100.6	98.3	105.2
Gold	1,933	1,927	1,936
UST 10y Yield	2.66	2.47	2.75

Source: Bloomberg, Standard Chartered

Note: These short-term technical levels are based on models and may differ from a more qualitative analysis provided in other pages

Investor diversity remains low in global bonds

Our proprietary market diversity indicators as of 06 April

Level 1	Diversity	1-month trend	Fractal dimension
Global Bonds	○	→	1.24
Global Equities	●	↑	1.60
Gold	◐	↓	1.44
Equity			
MSCI US	●	↑	1.66
MSCI Europe	●	→	1.55
MSCI AC AXJ	●	→	1.56
Fixed Income			
DM Corp Bond	◐	→	1.30
DM High Yield	◐	→	1.43
EM USD	◐	→	1.38
EM Local	◐	↓	1.46
Asia USD	◐	→	1.38
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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