

Market Watch

16 August 2011

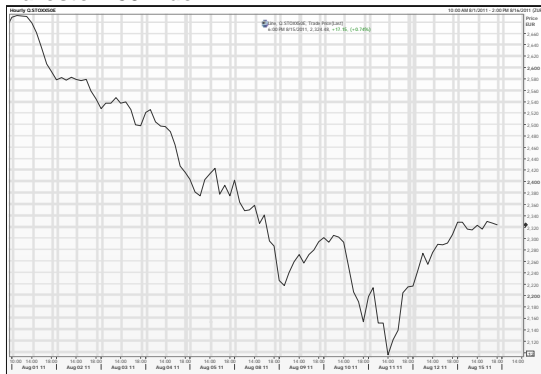
Market stabilises

August price action for selected stock markets

Hang Seng Index



Eurostoxx50 index



S&P500 index



Source: ThomsonReuters, Standard Chartered

SUMMARY

Global equity market sentiment appears more constructive. The MSCI World index is now up 5.8% over the past week

US market is supported by strong insider buying, increased M&A activity and positive technicals

Gold has corrected slightly from extremely overbought levels. Further downside likely in the short term, but strong fundamentals intact

Developments in Europe are the key risk with today's meeting between Merkel and Sarkozy critical

The S&P500 seems well supported at 1100-1120, a breach of that area would be highly negative

High beta currencies (eg. Asian and high yield/commodity currencies) look set to strengthen further

THREE KEY ISSUES

1. Global economic outlook

There are still concerns on the economic front. Friday's US retail sales was slightly stronger than expected, but business and consumer confidence surveys are still depressed. French Q2 GDP struggled to follow on from the strong 0.9% q/q Q1 increase with the economy stagnating in Q2.

Going forward, the key unknown is to what degree the weakness in confidence is caused by political wrangling in the US and Europe. On the former, the signing of the debt ceiling deal may prove a positive for sentiment, especially if stock market continues to stabilise as we expect. In Europe, hopes for an early resolution to the crisis look unlikely (see below), which could continue to depress confidence for the foreseeable future.

In Europe, today's preliminary German GDP data will be important with GDP expected to expand a still-strong 0.5% q/q after the stellar 1.5% growth registered in Q1.

Analyst
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Concerns remain elevated in Europe
 France sovereign 5yr credit default swap spread



Source: Bloomberg, Standard Chartered

US industrial production today will also be important to gauge the risks of a move back into recession, which remains a key fear. Thursday's CPI will also be critical to see whether core CPI continues to accelerate as most expect, given this may limit the chance of QE3 in the near-term.

Conclusion: We are cautiously optimistic that we will see positive data surprises in the months ahead with Japan and the US leading the improvement. Europe and Asia data are still vulnerable to negative surprises, although China is likely to rebound strongly in Q4 as the PBoC shifts away from its easing stance.

2. European sovereign debt crisis

Europe remains behind the curve. Increasingly, we appear to shifting to a stark choice between fiscal union and the collapse of the single currency area. The implementation and expansion of the policies announced following the 21st July EU summit are key.

The ECB bought EUR 22bn of government debt last week to halt the contagion of the crisis to Spain and Italy. ECB action should temporarily limit deterioration in funding liquidity, but new stresses may emerge in the coming weeks. Meanwhile, it will be key for governments to make progress on implementing the changes to the EFSF and expanding its size.

Today's meeting between Merkel and Sarkozy is critical. Germany is insisting that the issue of common Eurozone debt issuance will not be discussed at the meeting. Therefore, the risk of a negative market reaction to today's meeting, especially given the strong equity market performance over the past three days, is very significant.

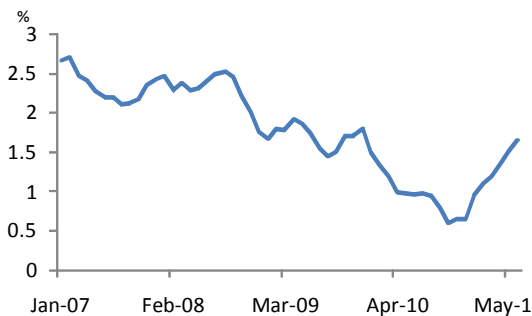
Conclusion: We remain very concerned about the situation in Europe. We see no swift resolution to the problems. The key upside risk is that we see steady moves towards fiscal integration which would highlight the fact that Europe's debt fundamentals as a whole are more manageable than in the US or UK. While business support for such a solution is gaining momentum, we appear to be some way away from such a deal being struck.

3. Quantitative easing

We retain two concerns with respect to quantitative easing (QE). First, rising core inflation in the US means it may take longer than the market would like for it to be implemented. Second, QE has already been proven to be a stop-gap measure at best. Therefore, if the Fed was not aggressive in scope and scale then this would likely be a negative for financial markets.

Conclusions: We see an increasingly high probability that the Fed and BOE will pursue further QE in the coming months, which may provide temporary support for riskier assets and more permanent support for gold.

Core inflation is a potential impediment to QE3
 US core inflation



Source: Bloomberg, Standard Chartered

Disclosure Appendix

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