

Weekly Market View

13 January 2012

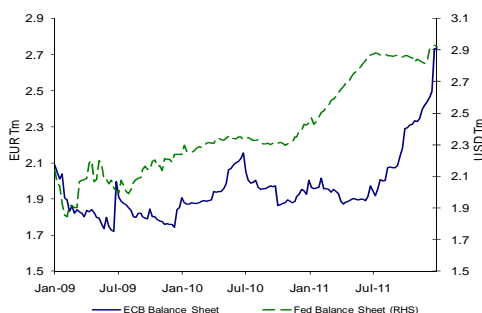
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CHART OF THE WEEK:

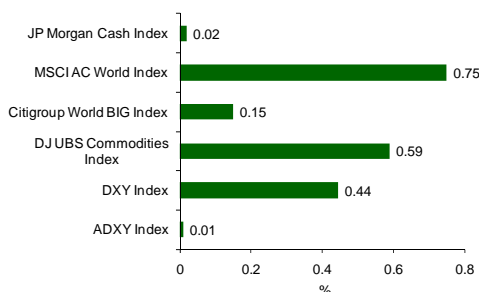
Expect further quantitative easing in 2012

Central Bank size of Balance Sheet



Sources: Bloomberg, Standard Chartered

Benchmark (USD) performance w/w*



*week of Jan 6 to Jan 12

Sources: Bloomberg, Standard Chartered

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Staying alert to upcoming risks

- Macro data strength persists, but we remain mindful of Euro risks
- Specifically, we are concerned about potential rating downgrades, Greece negotiations and peripheral country redemption payments
- We continue to advocate the “VIP Strategy” of managing *Volatility*, protecting against *Inflation* and getting *Paid*

MACRO OVERVIEW

- Italy and Spain sold debt at lower yields compared with December
- We remain alert to a mid-January Moody’s review of the French sovereign credit rating
- China’s lower inflation number opens the door to measured monetary easing, but we do not expect rate cuts
- Strong US consumer credit data and incrementally slower Asian export data remain consistent with our view of a muddle-through growth environment in 2012

FIXED INCOME

- Italy and Spain sold EUR 18.8bn new debt at lower yields compared with December, but demand was lower
- Inflows into high yield, emerging market bond funds were muted, but we believe high yield remains attractive

EQUITIES

- Lack of significant Euro bad news caused markets to creep higher this week
- We continue to believe portfolio diversification and dividend yields are important components of a successful investment strategy

COMMODITIES

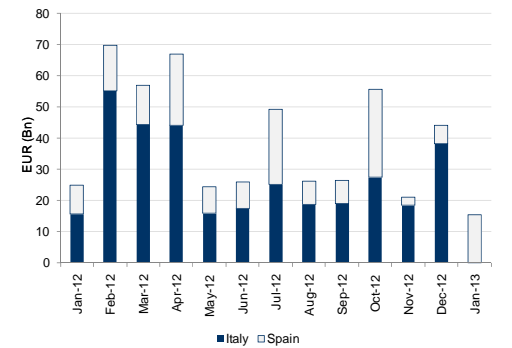
- Gold prices extend rebound as key drivers remain intact
- Markets perception of escalation risk in Iran are mixed, but we believe tensions will keep oil prices elevated

CURRENCIES

- USD was flat due to mixed signals on further QE, but we expect it to do well near-term in an uncertain environment
- INR gains may be short-lived as impact of short-term deposit rating upgrade may be insignificant to offset risk aversion in Q1

A good start for bond auctions, but a lot of work remains

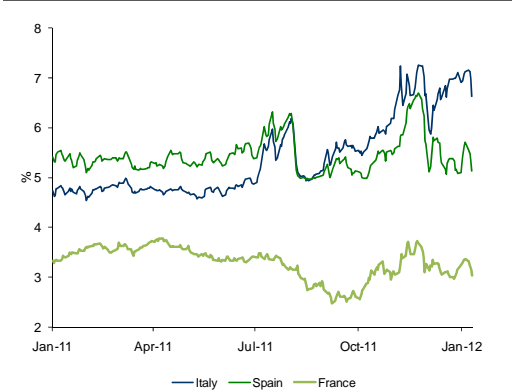
Italy and Spain debt redemption schedule



Sources: Bloomberg, Standard Chartered

Potential rating action for France a key concern

10 yr government bond yield



Sources: Bloomberg, Standard Chartered

Europe money market stress remains elevated

Europe – 3m EURIBOR less Euro Overnight Index Avg (EONIA)



Sources: Bloomberg, Standard Chartered

Macro overview

Relative strength in economic data persisted for another week, but we remain mindful of the risks that have not been cleared from the system. Upcoming event risk around the Euro area sovereign debt issues in particular mean that it may pay to be cautious. We continue to guide our strategy through the three key macro drivers.

1. Europe: Auctions and upcoming risks

Germany, Spain and Italy all sold debt this week and the tone was noticeably positive throughout. Both Spanish and Italian debt was sold at yields substantially lower than that for similar instruments sold in December, helping bring short-end yields lower. The reduction in the bid-to-cover ratio (a measure of demand), however, dropped from December auctions. We would be cautious about interpreting the results of the auction too positively in view of upcoming risks. We note that the EURIBOR-Overnight Index spread, an indicator of money market stress, remains elevated.

This was the first Spanish auction after Spain’s parliament approved a EUR 15bn austerity package whereby Prime Minister Rajoy aims to reduce the budget gap to 4.4% of GDP. Spain also plans to issue EUR 12bn less debt as compared with last year.

One of our key concerns continues to be the risk of a ratings downgrade of the French sovereign rating. This could create knock-on effects via the EFSF fund because the lowering of one country’s rating from would place the AAA rating of the fund at risk. Existing EFSF issues in the market currently do not appear to be pricing in this risk. Moody’s has indicated that it would review France’s rating by mid-January, which is a key event risk in our view.

Finally, the ECB held interest rates steady at 1.00% after two consecutive cuts. ECB President Draghi said that there were “tentative signs” of stabilization in the Euro area, citing recent auctions, but noted that “substantial downside risks” remained.

Conclusion: We continue to be concerned about the risk of rating downgrades, money market stress and event risks over the coming months.

Support needed for China's declining growth

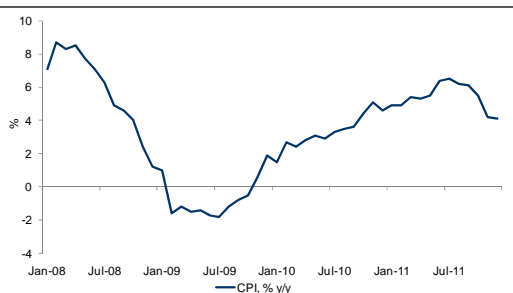
China industrial production, % y/y



Source(s):Bloomberg, Standard Chartered

Lower inflation could open door to monetary easing

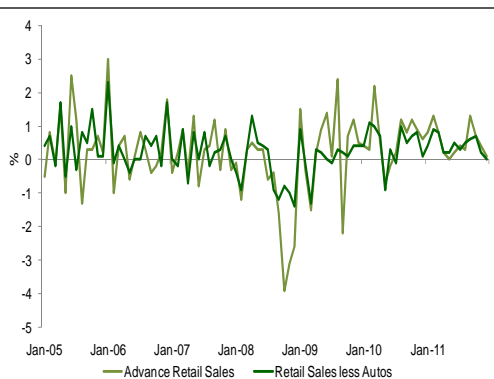
China Consumer Price Index, % y/y



Source(s):Bloomberg, Standard Chartered

Consumer spending slowed of late?

US advance retail sales, US retail sales ex Autos



Sources: Bloomberg, Standard Chartered

2. Monetary easing: Focus on China

We continue to expect monetary easing in most regions to come through in 2012. Our attention continues to be centered on the likelihood of QE3 from the Fed. We highlighted last week that the Fed's decision to announce interest rate forecasts by monetary policy committee members is likely merely an action to increase transparency of the decision-making process and is unlikely to be a measure to support a policy stance. This week Atlanta Fed President Lockhart said that while he was sceptical about the effectiveness of a new round of quantitative easing on the economy, he remained open-minded on the subject.

The release of China's CPI inflation number also focused attention on the extent of possible monetary easing in China. While China's CPI fell by a little less than expectations (to 4.1% YoY) this reinforced the point that lower inflation numbers could open the door to monetary easing. We continue to believe that a cut in policy rates is unlikely in 2012 because of the bluntness of this tool. Many policymakers have argued sectors such as real estate require policy to continue to be tight to avoid the risk of a bubble. Reductions in the required reserve ratio (RRR) or larger loan amounts, thus, are likely to be the preferred method of monetary easing in the months ahead. We would not be surprised to see some of these measures implemented quite soon.

Conclusion: QE3 still likely, but timing is less certain. Monetary easing in China likely to start trickling through as CPI trends lower.

3. Growth: A mixed bag

US consumer credit rose to a 2-year high of USD 7.65bn in November, led higher by gains in non-revolving debt such as auto and student loans. US retail sales grew 0.1% MoM, lower than the consensus expectations of 0.3%. The slowdown in consumer spending followed strong demand during the holiday season of November and December.

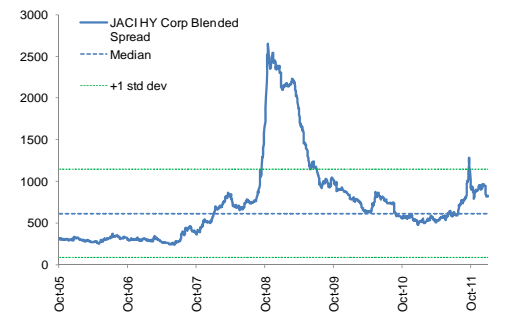
China's pace of export growth slowed slightly to 13.4% YoY in December (from 13.8% a month ago), a slowdown that was echoed by Taiwan and Philippines export numbers as well. Chinese inflation continued to slow, rising by 4.1% YoY in December compared with 4.2% earlier.

Indonesia and Korea's central banks both left rates unchanged. This comes as no surprise as they continue to strike a balance between the risk of higher inflation, especially if a new global round of quantitative easing goes through, against the risk of substantially slower growth.

Conclusion: Economic data supports our view that a muddle-through environment is likely to continue through 2012.

Credit spread movement remained muted

JP Morgan Asia Credit Index



Sources: JP Morgan, Bloomberg, Standard Chartered

Bonds – Auctions strike positive tone

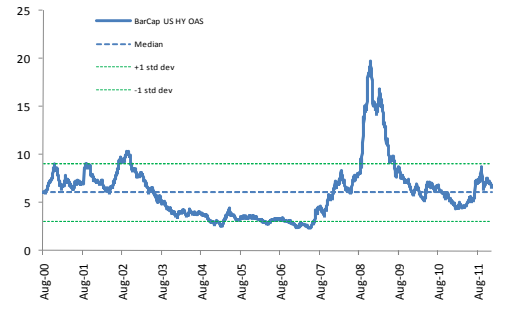
Spain and Italy held their first auctions of 2012, selling over EUR 18.8bn of new debt between them across a range of relative short-term maturities. Yields were noticeably lower than those for auctions for similar instruments in December, but bid-to-cover ratios (a measure of demand) dropped noticeably. The tone is clearly positive, but we would remain cautious and watch for (a) how prolonged an effect this has on market yields and (b) the impact of event risks such as ratings reviews.

Credit markets were largely flat this week despite positive cues from other risky assets and inflows into high yield and emerging market funds remained muted. Markets awaited the outcome of European sovereign auctions and the ongoing middle-through economic environment, however, remains our central outcome. We continue to believe high yield bonds offer an attractive risk-return trade-off in this kind of environment. Spreads are currently pricing in a large probability of a recessionary outcome while evidence suggests that total returns from current spread levels can lead to attractive long-term returns. Spread-widening in the short-term would not surprise us due to the extent of risks present in Europe, but we would be happy to continue using any such spread widening to average into this asset class.

Conclusion: We maintain our high yield overweight in our asset allocation and reiterate that investors should consider using any volatility in coming weeks to average into the high yield asset class.

US high yield spreads still wide to fundamentals

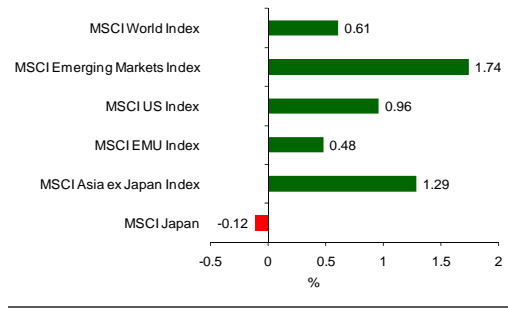
BarCap US High Yield Credit Index



Sources: Barclays Capital, Bloomberg, Standard Chartered

Equities – No news is good news

Selected equity market performances over the last week (USD)*



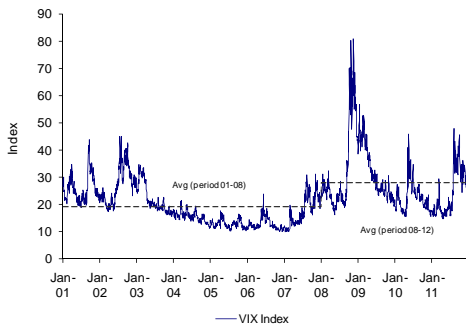
*week of Jan 6 to Jan 12
Sources: Bloomberg, Standard Chartered

Equity markets crept up this week on the back of no significant negative developments in the Euro debt crisis. Conversely, there were some slight positives in China as inflation continued to ease. Year to date, the MSCI World index is up 2.1% in USD terms, compared to the 7.6% decline in the whole year of 2011. While the equity markets are up YTD, the issues facing the market remain unchanged.

The European sovereign debt crisis is not an issue which can be resolved easily and will take some time to be worked out. Any default of a major European sovereign would have major implication for all assets classes. While policy makers are still reticent to formulate an effective plan, we believe the market will eventually force their hand. It is also increasingly likely that the ECB will play a greater role in stabilising the markets increasing their balance sheet and the underlying money supply. There is, though, a significant risk of policy mistakes as the ECB continues to fight with the notion of undertaking significant unsterilised quantitative easing.

Volatility stabilising at higher levels

VIX Index



Sources: Bloomberg, Standard Chartered

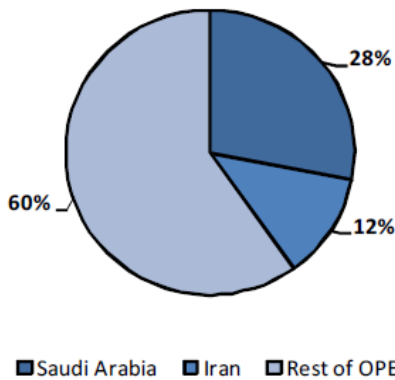
We, therefore, continue expect volatility to remain elevated, with the markets being punctuated by bouts of optimism and pessimism. While we would advocate a defensive posture towards the equity markets, we would also advocate investors use volatility to their advantage, to add exposure to attractively priced high quality companies. Similarly, dividend yields remain high for many equities, representing another way to capture returns.

Conclusion: We continue to recommend a VIP strategy: manage Volatility by being well diversified and defensively positioned, be cognisant of the risks of higher Inflation on the longer term and look for ways to add to performance (being Paid), through higher dividend yields.

Commodities – watch geopolitical risks

Iran a significant contributor to OPEC supply

OPEC crude oil production share %

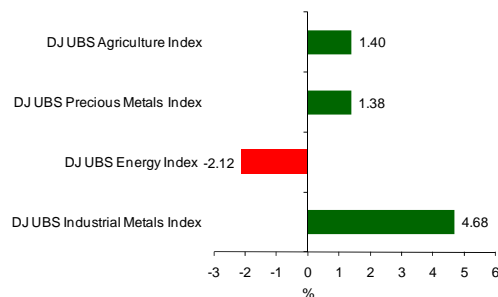


Sources: Bloomberg, Standard Chartered

Commodity prices continued to move higher this week. Industrial metals led the charge higher as risk appetite remained buoyed after stronger US consumer credit data and lower Chinese inflation numbers. Gold prices drifted higher but oil prices recorded a loss for the week at the time of writing as mixed messages from Iran-related risks led prices to first rise early in the week before falling.

Oil prices were buffeted by geopolitical risks in the early part of the week. Concern rose that a strike in Nigeria could disrupt supplies helped support oil prices. Geopolitical risks arising out of Iran remained a key theme in the market as US policymakers pushed key Iran oil importers to reduce their oil purchases from Iran. Markets continue to have a mixed outlook on the likelihood of the Iran situation escalating, but the fact that Iran produces approximately 12% of OPEC's total production causes us to be cautious and recognize that oil price risks are biased to the upside.

Commodities sub-sector performances over the last week (USD)*



*week of Jan 6 to Jan 12
Sources: Bloomberg, Standard Chartered

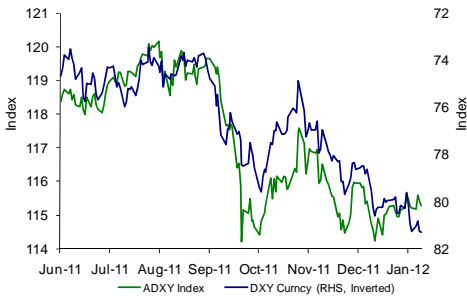
Gold prices extended their rebound after the holiday period sell-off. We expect the price to continue to move higher as the main drivers (the likelihood of quantitative easing and risk of events that cause investors to flee risky assets) remain intact. Broader uncertainty means that holding gold in a portfolio could help reduce overall portfolio volatility; a factor we think will be an important component of designing an investment strategy for the investment environment in 2012.

Conclusion: Gold prices are expected to continue moving higher as the key drivers remain intact

FX – INR gains may be short-lived

QE still key to US Dollar outlook

DXY and ADXY Indices



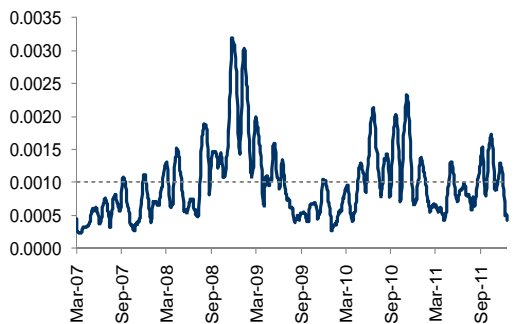
Sources: Bloomberg, Standard Chartered

The US Dollar remained largely flat on most broad measures as a continued run by risky assets was counterbalanced by further Euro weakness. These opposing forces meant that the Dollar index (DXY) drifted slightly higher while the Dollar lost ground against Asian currencies. Mixed signals from Fed policymakers on further quantitative easing may have also contributed to the lack of clear direction. We continue to believe that the Dollar will weaken over the medium term on renewed quantitative easing by the Fed, but near-term Euro area risks may cause Dollar strength in the short term.

The Euro strengthened this week, riding the positive tone from the Italian and Spanish bond auction. The positive tone was reinforced by the fact that Euro volatility continued to drop. We strike a note of caution, however, by noting that this Euro strength occurs in the context of an unusually extreme number of net short positions against the currency. Even a small reversal of this extreme positioning may lead to a short, sharp run higher in the single currency even if fundamentals remain unchanged.

Euro volatility has fallen recently

EUR-USD Currency 30 day Volatility



Sources: Bloomberg, Standard Chartered

India's Rupee jumped higher early this week as Moody's upgraded India's short-term ceiling on foreign currency bank deposits from non-prime (NP) to prime (P-3). This means that, in the view of the credit rating agencies, Indian banks have a stronger profile to re-pay short term deposits up to 13 months. The currency gained on expectations that this may incrementally support further foreign or non-resident Indian investment flows into the country. While we view this as a positive development, we do not see this being a strong-enough development to change our expectations that the Rupee may weaken in the short-term due to the lack of global investor risk appetite before strengthening later in the year.

The Swiss Franc weakened slightly against the US Dollar in the aftermath of Swiss National Bank Chairman Hildebrand's departure. Against the Euro, however, the Franc has continued to drift higher, closer to the central bank's 1.20 cap for EUR-CHF. While the formal appointment of a new Chairman may take time, we expect policy continuity under interim head Jordan, and thus do not see a need to amend our existing views on the CHF.

Conclusion: US Fed policy communication on QE3 will be a key factor influencing currency performances in 2012.

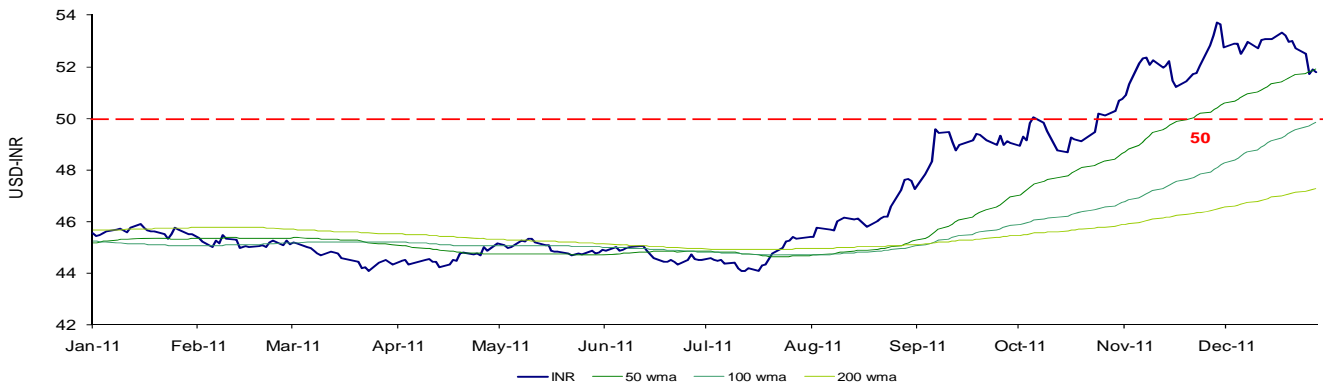
Conclusion

We advocate investors follow the VIP Strategy going into 2012:

1. manage portfolio *Volatility* (gold and macro hedge funds/commodity trading advisers).
2. protect against *Inflation* (gold and their related equities) and
3. be *Paid* (HY bonds and high dividend equities)

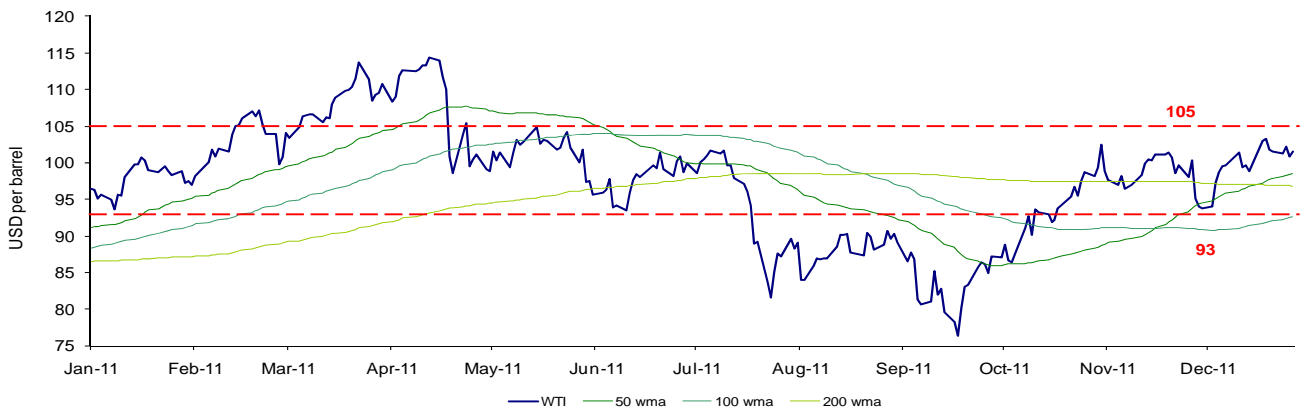
Technical Analysis

- USD-INR** – is getting oversold and should consolidate around 51.50 - 52.00. We do not, however, rule out further losses for the pair if it fails to trade above 52.00 (50 DMA) in the near future. Technically, the next key support is at 50.00 (100 DMA).



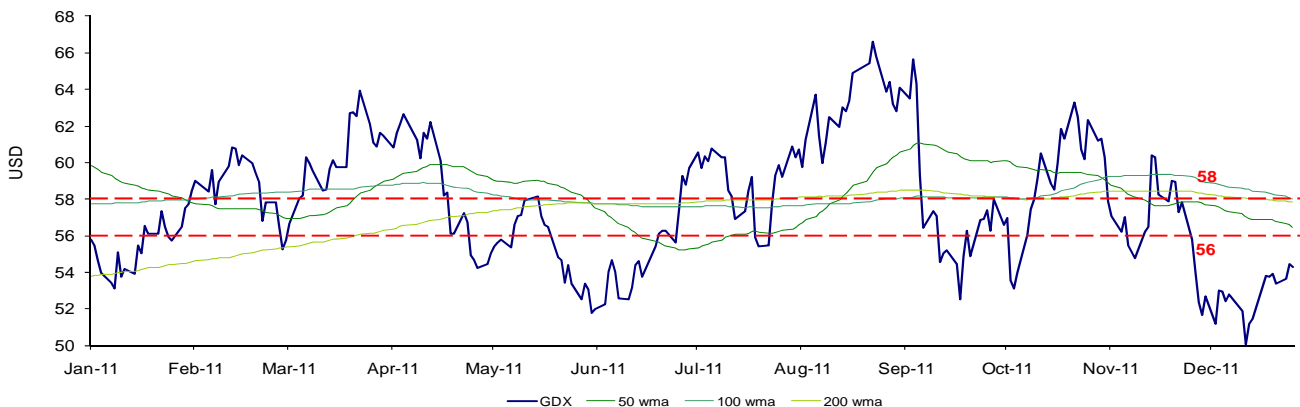
Source: Bloomberg, Standard Chartered

- WTI Crude Oil** -- WTI is heavily overbought with a declining momentum. We favour selling into the rally, with gains expected to be capped at USD 103 – 105 in the near-term. A drop towards USD 93 - 95 is expected on the coming correction.



Source: Bloomberg, Standard Chartered

- GDX US Equity** – is getting overbought on its corrective rallies. The momentum indicator is declining. Given this, we favour selling into rallies as GDX approaches massive resistance at USD 56 – 58.



Source: Bloomberg, Standard Chartered

Economic & Market Calendar

13 January 2012

	Next Week: Jan 16 - Jan 20				This Week: Jan 9 - Jan 13			
	Event	Period	Expected	Prior	Event	Period	Actual	Prior
MON	JN Machine Orders YOY%	NOV	--	1.50%	EC Sentix Investor Confidence	JAN	-21.1	-24
	JN Machine Tool Orders (YoY)	DEC F	--	--	GE Industrial Prod. YoY (nsa w da)	NOV	3.60%	4.10%
					TA Total Exports (YoY)	DEC	0.60%	1.30%
TUE	UK CPI (YoY)	DEC	--	4.80%	US Consumer Credit	NOV	\$20.374B	\$6.022B
	UK Retail Price Index	DEC	--	238.5	US NFIB Small Business Optimism	DEC	93.8	92
	EC Euro-Zone CPI (YoY)	DEC	--	3.00%	MA Industrial Production YoY	NOV	1.80%	2.90%
	EC ZEW Survey (Econ. Sentiment)	JAN	--	-54.1	MA Manufacturing Sales Value YoY%	NOV	6.30%	11.80%
	US Empire Manufacturing	JAN	10	9.53	CH Exports YoY%	DEC	13.40%	13.80%
	CA Bank of Canada Rate		1.00%	1.00%	CH Imports YoY%	DEC	11.80%	22.10%
	SI Non-oil Domestic Exports (YoY)	DEC	1.10%	1.60%				
	CH Industrial Production (YoY)	DEC	12.30%	12.40%				
	CH Real GDP (YoY)	4Q	8.70%	9.10%				
WED	JN Industrial Production YOY%	NOV F	--	-4.00%	JN Leading Index Cl	NOV P	92.9	92
	JN Capacity Utilization (MoM)	NOV F	--	4.10%	GE GDP (Annual Growth Rate)	2011	3.00%	3.70%
	EC Construction Output WDA YoY	NOV	--	-2.80%	US MBA Mortgage Applications	6-Jan	4.50%	-4.10%
	US Producer Price Index (YoY)	DEC	4.80%	5.70%	MA Exports YoY%	NOV	8.00%	15.80%
	US Industrial Production	DEC	0.50%	-0.20%	MA Imports YoY%	NOV	8.40%	4.00%
	US Capacity Utilization	DEC	78.10%	77.80%	SK South Korea FDI (YoY)	4Q	4.8	-24.3
THUR	EC Euro-Zone Current Account nsa	NOV	--	1.7B	CH Consumer Price Index (YoY)	DEC	4.10%	4.20%
	US Consumer Price Index (YoY)	DEC	3.10%	3.40%	JN Machine Tool Orders (YoY)	DEC P	17.40%	15.80%
	US CPI Ex Food & Energy (YoY)	DEC	2.20%	2.20%	UK Industrial Production (YoY)	NOV	-0.70%	-1.00%
	US Philadelphia Fed.	JAN	11	10.3	UK Manufacturing Production (YoY)	NOV	-0.60%	0.10%
	PH Overnight Borrowing Rate		--	4.50%	EC Euro-Zone Ind. Prod. w da (YoY)	NOV	-0.30%	1.00%
					UK BOE Asset Purchase Target	JAN	275B	275B
					UK BOE ANNOUNCES RATES	12-Jan	0.50%	0.50%
					EC ECB Announces Interest Rates	12-Jan	1.00%	1.00%
					US Advance Retail Sales	DEC	0.10%	0.40%
					US Initial Jobless Claims	7-Jan	399K	375K
FRI	JN Coincident Index Cl	NOV F	--	--	IN Industrial Production YoY	NOV	5.90%	-4.70%
	JN Leading Index Cl	NOV F	--	--	ID Bank Indonesia Reference Rate	12-Jan	6.00%	6.00%
	CA Consumer Price Index YoY	DEC	--	2.90%				
	TA Export Orders (YoY)	DEC	--	2.54%	SK South Korea 7-Day Repo Rate	13-Jan	3.25%	3.25%
	TA Industrial Production (YoY)	DEC	--	-3.55%	SK Export Price Index (YoY)	DEC	2.50%	5.40%
	PK Benchmark Interest Rate	Jan-12	--	12.00%	SK Import Price Index (YoY)	DEC	7.10%	11.80%
				US Import Price Index (YoY)	DEC	--	9.90%	
				US Trade Balance	NOV	--	-\$43.5B	
				US U. of Michigan Confidence	JAN P	--	69.9	
				EC Euro-Zone Trade Balance	NOV	--	1.1B	
Previous data are for the preceding period unless otherwise indicated				Data are % change on previous period unless otherwise indicated				
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3 -12 Month Market Outlook

Central bank policy rates							
	Spot	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013
US	0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
Europe	1.00	0.75	0.75	0.75	0.75	0.75	0.75
UK	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Australia	4.25	3.75	3.75	3.75	3.75	4.00	4.25
China	6.56	6.56	6.56	6.56	6.56	6.81	6.81
Taiwan	1.88	1.88	1.88	1.88	1.88	2.00	2.13
Malaysia	3.00	2.75	2.50	2.50	2.50	2.50	2.50
Indonesia	6.00	5.75	5.75	5.75	5.75	6.25	6.25
South Korea	3.25	3.25	3.00	3.00	3.00	3.00	3.25
India	8.50	8.50	8.25	7.75	7.25	7.00	7.00
Philippines	4.50	4.25	4.00	4.00	4.00	4.00	4.00
Thailand	3.25	3.00	2.75	2.75	2.75	2.75	2.75

Forex							
	Spot	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013
EUR/USD	1.28	1.20	1.22	1.25	1.30	1.27	1.25
GBP/USD	1.53	1.46	1.5	1.52	1.55	1.51	1.49
USD/JPY	76.8	81	79	77	74	74	76
USD/CAD	1.02	1.1	1.08	1.02	0.98	0.98	0.96
USD/CHF	0.94	1.04	1.07	1.06	1.04	1.1	1.12
AUD/USD	1.03	0.92	0.95	1.00	1.05	1.08	1.06
NZD/USD	0.79	0.72	0.76	0.83	0.88	0.89	0.85
USD/CNY	6.32	6.36	6.31	6.26	6.21	6.18	6.15
USD/SGD	1.29	1.35	1.32	1.28	1.25	1.23	1.25
USD/MYR	3.13	3.30	3.22	3.11	3.03	2.98	3.03
USD/IDR	9198	9400	9200	9000	8700	8600	8700
USD/KRW	1152	1210	1155	1095	1050	1030	1050
USD/TWD	29.94	31.40	30.80	29.90	29.00	28.80	28.70
USD/INR	51.58	53.00	51.80	50.50	48.50	48.00	48.50
USD/THB	31.75	32.50	32.20	31.50	30.50	30.00	30.50
USD/PHP	43.83	45.25	44.50	43.50	41.50	40.50	41.00

Commodities							
	Spot	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013
Gold	1642.28	1800	1800	1925	1975	1875	1875
Silver	30.09	39	39	39	39	39	39
WTI Crude Oil	99.42	85	92	109	115	100.3	100.3
Copper	7950.00	8000	8500	9000	9500	8750	8750
Aluminium	2151.75	2100	2200	2300	2300	2225	2225
Corn	610.50	700	735	700	675	703	703
Soybeans	1192.50	1350	1380	1330	1340	1350	1350
Wheat	605.00	700	725	695	650	693	693

Source: Bloomberg, Standard Chartered Global Research (13 January 2012 Economics Weekly publication)
 * Period averages for each quarter.

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