BCT Market Outlook

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US Equities

The US Fed raised rates by 0.25% as widely expected and revealed plans to shrink its USD 4.5 trillion balance sheet. It will initially be reduced by USD 10 billion per month (USD 6 billion in treasuries & USD 4 billion in mortgage-backed securities). Data slowed generally during the month with Non-farm Payrolls increased by 138K in May, far below the downwardly revised 174K in April and market expectations of 185K. In addition, domestic demand softened with CPI further easing to 1.9% year-on-year in May from a 2.2% rise in April, and below market estimates of 2%, mainly due to lower sales of motor vehicles and discretionary spending. Meanwhile, retail sales dropped 0.3% month-over-month in May, down from a 0.4% rise in April. Also, housing starts slumped 5.5% from April, marking the 3rd consecutive month of decline. However, ISM Manufacturing PMI edged up to 54.9 in May from April's 54.8.

Although the US Fed was more hawkish than expected, the softening of the latest economic data casts doubt on further policy tightening this year, which is reflected by the weaker US dollar. Trump's policy uncertainty continues with Senate Republicans delaying the vote on healthcare bill as the party still lacked sufficient support to pass the bill. The potential defeat of the bill will further dampen the confidence on Trump's administration and lower market expectations for his economic agenda (e.g. tax plan). On the other hand, as the impact of balance sheet reduction is uncertain, it may trigger market corrections, especially for US stock markets with high valuation and rising political uncertainty. Thus, we maintain **SLIGHTLY NEGATIVE** outlook.

European Equities

At the European Central Bank (ECB) policy meeting, ECB left its monetary policy unchanged as expected and removed wording of a future rate cut, but added that it would be ready to extend its bond-purchase program if needed. However, Mario Draghi subsequently hinted at the ECB's annual conference in Portugal that he may unwind the monetary stimulus amid continuous economic recovery. In the UK, Theresa May's Conservative Party failed to win majority in the UK general election, and eventually reached an agreement with Democratic Unionist Party (DUP) to support May's government. On the contrary, French President Macron's party won a solid majority in the parliamentary elections, giving him considerable power to push through reforms. Eurozone data remained positive in June with unemployment rate continued its declining trend at 9.3% in April, down from a downwardly revised 9.4% in the previous two months. ZEW Economic Sentiment further rose to June's 37.7 from May's 35.1. Eurozone Manufacturing PMI sustained its growth, which rose from May's 57 to June's 57.3. However, CPI fell to 1.4% year-on-year in May from 1.9% in April, marking the lowest rate this year, mainly dragged by lower oil prices, while core CPI also dropped to 0.9% from 1.2% previously.

The stronger euro weighed on European equities in June. However, the outlook on European stocks remains optimistic amid upbeat economic data, its potential for double-digit earnings growth this year and lower valuation. The victory of Macron's party in the French parliamentary elections further lessens the political concerns in eurozone and boosts market confidence. Although ECB turns hawkish, the drop in inflation still hinders its decision of tapering in the near term. On the other hand, the defeat of the UK ruling conservative party brings more uncertainty to "Brexit" negotiation, but it may reduce the likelihood of a hard Brexit. The euro is expected to strengthen given improving macro outlook, eased political risks, a weak US dollar and potential tapering of ECB. We maintain **SLIGHTLY POSITIVE** on European equities.

Japanese Equities

Bank of Japan (BoJ) kept its monetary policy steady and upgraded its view on private consumption, backed by steady improvements in employment and income. Economic data were still mixed with Manufacturing PMI dropped to 52 in June from a final figure of 53.1 in May. Unemployment rate stayed at a low level at 2.8% in April, the same as in the previous two months, the lowest level since June 1994. However, real cash earnings growth remained sluggish, which recorded 0% in April following a 0.8% decrease in March. Meanwhile, household spending fell 0.1% in May from a year earlier, extending its declining streak of over a year. On the other hand, retail sales and CPI continued to improve mildly, with the former marking the 7th straight month of increase with 2% growth in May, albeit down from 3.2% in April; while the latter increased 0.4% year-on-year in May, the same as in April. Exports remained robust, rising 14.9% year-on-year in May, up from 7.5% in April. It is the 6th straight month of increase and the fastest since January 2015.

Japanese stocks continued to post gains in June, supported by BoJ's unchanged monetary policy and its optimistic outlook on consumer spending. Amid the stabilizing yen, exports continued to benefit from global growth, which remains the main driver for corporate earnings growth. Although household spending continued on a downtrend, BoJ expects the low unemployment rate and the improved exports growth to eventually spur consumer spending and inflation in the mid-term. In the near term, expectations of stronger corporate earnings could continue to underpin Japanese stocks. We remain **NEUTRAL** on Japanese equities.

Asia ex Japan ex China & Hong Kong Equities

Asia markets were mixed in June with Asian currencies fell amid US Fed's rate hike. South Korea's new government drafted an 11.2 trillion won (USD 10 billion) supplementary budget to boost jobs in both public and private sectors. Its exports increased for the 7th straight month, rising 13.4% year-on-year in May, down from a revised 24.1% growth in April. India's inflation continued to slow further from 2.99% in April to 2.18% in May, mostly driven by falling food prices. However, the central bank continued to keep interest rates unchanged, and lowered its inflation forecasts for the year ahead. In Taiwan, exports rose 8.4% in May, decelerating further from a 9.4% growth in April, while Manufacturing PMI fell to May's 53.1 from April's 54.4, the lowest level in seven months. Singapore's exports posted the 2nd month of declines at -1.2% in May, widening from -0.8% in April.

The further tightening signal from the US Fed weighed on Asian currencies and pared gains of Asian equities in US dollar terms. In South Korea, the new administration's fiscal stimulus can hopefully boost domestic demand, and at the same time, its push for better corporate governance and reforms on family-owned conglomerates, or Chaebol, could be a potential catalyst for share re-rating and reduction in the "Korean discount". For India, the forthcoming implementation of the goods and services tax (GST) may cause some execution risks and near-term business disruption, but along with the recent demonetization, these initiatives are positive for India in the longer term. In addition, although India's inflation has retreated, the upcoming balance sheet reduction by the US Fed could hamper Indian central bank from lowering its interest rates. Asian exports could continue to benefit from global growth, but it is expected to decelerate in 2H after a strong 1H amid the economic slowdown in China. Also, the Asian currencies, which has surged considerably this year, could be vulnerable against the backdrop of the US Fed's further policy tightening. We remain **NEUTRAL** on Asian ex Japan ex China & Hong Kong equities.

China & Hong Kong Equities

MSCI announced to include 222 China A-shares in its Emerging Markets Index beginning 2018, which will account for around 0.73% of the Index's value. Economic data generally stabilized with official Manufacturing PMI came in at 51.2, the same as in April, while Services PMI rose to 54.5 in May from 54 in April. PPI and CPI continued to trend divergently. PPI slowed for the 3rd straight month from 6.4% in April to 5.5%, while CPI rose 1.5% year-on-year in May, up from a 1.2% growth in April. Retail sales grew 10.7% year-on-year in May, unchanged from April. On the other hand, fixed investments grew 8.6% year-on-year in the first 5 months of the year, down from an 8.9% growth in the year ended April. The growth of new home prices in 70 Chinese cities continued to fall, from 10.7% in April to 10.4% in May, the slowest since August 2016. Exports kept rising, up 8.7% from a year earlier in May, faster than an 8% rise in April. Foreign reserves grew to USD 3.05 trillion in May and hit a seven-month high.

China markets surged in June and outperformed other major Asian markets, mainly stimulated by the MSCI's decision. In contrast, Hong Kong market was under pressure after 5 straight months of increase, but still closed with marginal gains. Although the inclusion percentage of weighting is small and it will not happen until next year, it could improve market sentiment in the near term, and support the performances of Hong Kong and China markets. On the other hand, given the US Fed is on course to shrink its balance sheet and China's economy could potentially slow down, RMB could face higher volatility in 2H. However, RMB is expected to rise modestly in 2H amid improving market sentiment. Moreover, with the China Party Congress approaching, balanced growth, macro and currency stability are the likely targets of the central government. We remain **NEUTRAL** on overall China & Hong Kong equities, with a better outlook on China-related stocks due to improving market sentiment and cheaper valuation.

Global Bonds

Major market bond yields were mixed in June. US 10-year treasury yield was volatile and rose above 2.2 level amid the US Fed's rate hike and its signal of balance sheet reduction. German 10-year government yield and the euro initially dropped given the unfavorable result of UK election, ECB's dovish stance and its lower inflation projection, but subsequently jumped sharply after Mario Draghi's hawkish comments at the ECB's annual conference in Portugal. The US dollar dropped to 96 level mainly due to the surge in euro boosted by Draghi's comments. Meanwhile, RMB hit 6.7 level amid a weaker US dollar and speculation of central bank intervention. In addition, oil prices continued to fall with WTI slid below USD 45 level amid worries over increasing global supply.

Despite the US Fed's ongoing policy tightening, the US dollar lacked upward momentum as the recent slowdown in US data cast doubt on another rate hike this year. As Trump's tax cut plan is unlikely to be implemented in the near term, coupled with the slowdown of US data especially for inflation, the US dollar should remain weak. However, since the US Fed has decided to cut its balance sheet by year-end, and the 10-year treasury yield has hit a year-low, the upward pressure on the US long-term yields could increase in 2H. German government bond yields are expected to edge higher amid eased political risk and continuous economic recovery. Given the continuous weakness of the US dollar, the euro is believed to rise amid growing economic momentum, while RMB is expected to rise with the central government's capital control measures and improving sentiment towards the China market. We downgrade overall bonds from SLIGHTLY POSITIVE to **NEUTRAL**, given the US Fed's further policy tightening and recent eased global political risk, but upgrade RMB bonds from NEUTRAL to **SLIGHTLY POSITIVE**, mainly due to a better outlook on RMB.