BCT
銀聯集團

Global stock markets crash as COVID-19 crisis escalates

Investment Markets	BCT's Investment Views	Summary
Equities		
US		We are negative on the U.S. equities. We believe the U.S. equities are likely to remain volatile driven by virus news flow and the economic impacts of containment efforts which will increase the likelihood of a U.S. recession.
Europe		We are negative on European equities. Balancing risks amid high volatility and low earnings visibility, and improving liquidity should be the priority. Idiosyncratic opportunities have emerged, but equities still look vulnerable overall.
Japan		We are neutral on Japanese equities. Many Japanese companies are exporters that could be hurt by a stronger yen. However, valuations are attractive and companies' balance sheets are also underleveraged.
Asia ex Japan		We are cautious overall, particularly in names and countries which are dependent on services and tourism. We favour China and Korea as they reach a recovery phase in COVID-19 cases. As the situation improves, there could be pockets of opportunities due to attractive valuations and policy stimulus measures.
China & HK		We are neutral on China equities, as market volatility remains extremely high and risks still tilt to the downside. But we will continue to closely monitor potential trades. We are neutral on Hong Kong equities, as economic activities are still affected by social distancing measures and the timing to lift these measures is still unknown.
Global Bonds		
Government Bonds		We are positive on government bonds, we take a constructive view on the U.S. (safe-haven flows), a close to neutral view on core euro and a negative view on Japan. We are positive on credit bonds. Quality of issuers is also important especially in the riskier segments.
Credit		

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

The U.S. equity market collapsed in March (the S&P500 lost 12.5%), and volatility spiked (the VIX was up to 85) in the worst month since the global financial crisis as the COVID-19 crisis deepened in the US and became a pandemic. Due to the spread of the virus, many countries adopted lockdown measures from early March, which prompted a sharp slide of global GDP. Global growth expectations collapsed. In the U.S., the boost from monetary and fiscal policy was massive. On the back of fast "evolving risks" posed by COVID-19 as cited by Jerome Powell, and in order to stabilize financial conditions, the Federal Reserve (Fed) rapidly moved from statement to action by cutting rates by a cumulative 1.5% and announcing a USD 700 billion quantitative easing (USD 500 billion government bonds & USD 200 billion mortgage-backed securities). The Fed introduced supporting facilities for commercial papers (CPs) markets, provided liquidity to the system through massive repos and acted on banks reserves requirements and capital buffers. On the fiscal front, an historic rescue package was approved which is worth more than USD 2.2 trillion in spending and tax breaks. The plan was designed to protect the U.S. economy against an extreme shock. This largest economic-relief plan in history (10% of GDP) will provide broad support to all segments of the economy, including self-employed and independent workers whom has been hit by COVID-19's economic fallout.

We expect the U.S. to head towards a sharp contraction in the first half of the year. Then, once the post-containment normalization phase starts, the recovery will be shaped by the duration of the crisis and the effectiveness of policy responses. While a state of emergency was declared by the President, almost all states are implementing emergency measures with various degrees of severity, from preventing gatherings to state-wide quarantines. Our estimate for 2020 GDP growth range is between -3.1% and -1.9%. The Fed is stepping up to address liquidity issues, recalibrating sovereign risks and broadly anchoring yields. We expect them to succeed, which can limit the spillover from the financial markets into the real economy via the credit sector. However, we are aware that the Fed has limited firepower on the solvency front. This will be within the perimeter of economic policies. The Fed is back at zero interest-rate policy (ZIRP): it used its whole firepower on rates, cutting it by a cumulative 1.50%, and pushing them back close to zero. A move from ZIRP to negative interest rate policy (NIRP) regime is unlikely to us, as most members of the Fed expressed against such a move many times and privileged quantitative easing tools. Liquidity is the principal target of the Fed, a wide range of measures and more actions on corporate bonds could be the next steps. We are negative on the U.S. equities. We believe the U.S. equities are likely to remain volatile driven by virus news flow and the economic impacts of containment efforts which will increase the likelihood of a U.S. recession.

EUROPEAN EQUITIES

European equities experienced sharp drops and the Euro Stoxx 50 was down 16.30%. Italy and Spain were the worst performers, which went down 22.44% and 22.21% respectively. During the March meeting, the European Central Bank increased quantitative easing, through an additional net asset purchases of EUR 120 billion, approved liquidity tools, new long-term loans, and full allotment of liquidity at very preferential rates to support Small and Medium Enterprises (SMEs) refinancing. At the same time, the Banking Supervision Department provided temporary capital and operational relief in reaction to the crises. One week after, an additional quantitative easing programme worth EUR 750 billion with ample flexibility in its design was announced. The Bank of England decided to first deliver an emergency, intra-meeting 0.50% rate cut. It was combined with a later announcement of easier fiscal policy. The central bank announced a new GBP 200 billion quantitative easing targeting government bonds, and cut rates by a further 0.15%. The European Council confirmed the suspension of budget rules and allowed members to ease corporate state aid restrictions. At the country level, significant measures were announced, for instance, a EUR 45 billion package in France (2% of GDP) and a EUR 120 billion package in Germany (4% of GDP).

The Eurozone economy is entering a recession as most European countries are facing severe COVID-19 outbreak and have implemented increasingly stricter measures of containment, with ripple effects coming via the fall in domestic demand, disruption of supply chains, and loss of external demand. We expect the GDP growth to be in the interval of -5.2% to -3% in 2020. Almost all sectors of economic activity have been affected. The most likely scenario is a U-shaped recovery, with the belly of the U shape dependent on the duration of the public health emergency and the effectiveness of fiscal packages delivered to support the economy once the normalisation phase starts. The U.K. economy is set to face recession this year in the range between -5 and -3.2%. An unprecedented governmental, fiscal and monetary policy response has followed, with the goals of containing the spread of the virus, helping households and businesses to weather the storm and preparing the ground for the recovery, once the emergency is over. Europe has witnessed an unprecedented sudden economic stop which could lead to temporary recession. We are negative on European equities. Balancing risks amid high volatility and low earnings visibility, and improving liquidity should be the priority. Idiosyncratic opportunities have emerged, but equities still look vulnerable overall.

JAPANESE EQUITIES

March was another heavy month for Japanese equities, the Nikkei lost 10.53% in the month. The yen's trade-weighted index ended the month in slightly positive territory, as supported by strong risk aversion. The Bank of Japan joined other central banks in calling for more accommodation. In line with statements by other major central banks, it announced that it would provide ample liquidity and ensure stability in financial markets through appropriate market operations and asset purchases. The Bank of Japan said it would inject ample funds via market operations to make sure that banks have enough funding through the end of the Japanese fiscal year on 31 March, and launch measures to maintain stability of the repo market. As far as fiscal policy is concerned, two packages totalling USD 9.6 billion was announced in February and March. Those included cheap loans to support hard-hit SMEs (first in tourism activities, then in other sectors) as well as help for working parents and other social aids.

By the end of March, the overseas COVID-19 risk to the economy turned into an endogenous one with the number of cases escalating in Tokyo and large cities. After having postponed the Tokyo Olympics to 2021, the Prime Minster of Japan, Shinzo Abe, had not yet taken the decision to implement stricter lockdown measures. Japanese economy is expected to fall into a profound recession as most economies go through a double shock of collapses in both internal and external demands. Capital investment in Japan is narrowly linked to its export dynamics. Japan is currently preparing a much bigger package (up to USD 515 billion, or 10% of GDP) that should include direct payments to households and loan guarantees. Part of the funds would be drawn from a previous stimulus package that was intended to minimize the damage from the U.S.-China trade war. We have revised down our GDP growth forecasts for 2020 to a range between -3 and -1.9% and we expect a rebound of 1 or 2% for 2021 as the outlook looks more fragile due to the growing COVID-19 risks. We are neutral on Japanese equities. Many Japanese companies are exporters that could be hurt by a stronger yen, which acts as a safe haven in times of extreme volatility. As a result, their earnings are linked to global purchasing managers' indexes (PMIs) and economic activity. However, valuations are attractive and companies' balance sheets are also underleveraged. We therefore remain neutral.

ASIA EX-JAPAN EQUITIES

Markets remained under severe pressure from the spread of COVID-19 globally as investors began to price in the impacts of lockdowns across several major economies on global growth. The dramatic sell-off in oil prices due to production disagreements between the Organization of

Petroleum Countries and Russia created further headwinds. The MSCI Emerging Markets lost 15.4% against this backdrop. Meanwhile, the MSCI Asia ex-Japan outperformed the index and fell 12.1%. Malaysia (-11.5%) and Korea (-11.6%) outperformed the index while Indonesia (-29.4%), India (-25.1%), and the Philippines (-21.7%) were the worst performers. All Asian countries saw downward revisions in 2020 earnings growth estimates, with the largest negative revisions across ASEAN countries. Global central banks and governments took unprecedented policies to support their economies, provide liquidity and stabilize markets amidst signs of a second wave of COVID-19. In Korea, the government announced a KRW 1 trillion emergency relief package to support its economy. Most of the Asia ex-Japan currencies ended lower in March. Among the worst performing Asian emerging market currencies were Indonesian Rupiah (-12.0%), Thai Baht (-3.8%) and Indian Rupee (-3.7%). On the other hand, Hong Kong Dollar (0.6%), Philippine Peso (0.3%) and Taiwan Dollar (0.1%) saw some gains.

Investors should remain cautious on Asian markets, due to their vulnerability to the economic impact and uncertain commodity markets. Overall they must be very defensive on countries and sectors driven by services and tourism as it will take them longer to recover. Likewise, we are cautious on names whose supply-demand balance looks increasingly unfavorable. At this stage, we remain selective and focus on domestic stories, for example, in Korea. Asian trade growth will be very subdued, and lower than expected. Some countries might be heavily affected by weak global trade trend, with exports to the rest of the world down since the beginning of the year. Tourism will be significantly hurt in the first half of the year. We are neutral on Asian equities. Given the vulnerability of the area to the economic impacts of COVID-19 and the uncertainty on the commodity markets, we are cautious overall, particularly in names and countries which are dependent on services and tourism. We favour China and Korea as they reach a recovery phase in COVID-19 cases. As the situation improves, there could be pockets of opportunities due to attractive valuations and policy stimulus measures.

CHINA & HONG KONG EQUITIES

China was the most resilient equity market in Asia in March and lost 6.6%. The equity market benefited from the positive investor sentiment as China remained ahead of the curve on controlling the spread of COVID-19. Policy actions undertaken by the government and the People’s Bank of China (PBoC) to provide liquidity and support for the domestic economy also helped restore investor confidence. The PBoC announced quantitative measures equivalent to approximately RMB 3.5 trillion, of which RMB 2.5 trillion is targeted at SMEs and small banks, as well as a cut in the 7-day reverse repo rate by 0.20%. Moreover, on 27 March, the meeting of the Politburo of the Communist Party of China focused on preventing a second wave of COVID-19 and emphasised the need for normalization of work, production and everyday life. The meeting also outlined three areas of fiscal policy response including an increase in the budgetary fiscal deficit, special local government bond quota and issuance of a special government bond. On the macro front, the final reading of the Markit Manufacturing PMI rebounded sharply to 50.1 given the resumption of manufacturing operations. However, the month-on-month improvement was small compared with the extent of the decline. Additionally, the pandemic weighed on demand conditions and production chains. The MSCI Hong Kong suffered heavily in March (-12.2%). In the same month, the Hong Kong SAR government announced additional measures to curb the domestic spread of COVID-19. Retail sales data remained under pressure.

In China, household consumption, investments and trade data for January and February were terribly weak. Those data have triggered a sharp downward revision in our growth expectations for 2020, now in a range between 2.7% and 3.7%. Economic activity is slowly resuming and the recovery is now on track, but downside risks persist, in particular a second wave of COVID-19 and vanishing external demand for Chinese products with the world in recession. As the shock to global economy adds uncertainties to China's outlook, we expect the PBoC to maintain its easing stance and keep interbank liquidity loose. Targeted medium-term lending facility and the loan prime rate are expected to be lowered. The PBoC also hinted that a deposit rate cut is still on the table, but it will be less likely if the consumer price index (CPI) inflation remains elevated or the cut adds depreciation to the RMB exchange rate. Fiscal policy in China remains expansionary, even if the scale may be relatively modest than elsewhere. Deficit is expected to be raised by approximatively 2% in 2020 fiscal year, including +0.7% from the official fiscal budget and +1.3% from the government fund. The latter will be financed by special local government bonds and mainly used for land-related transactions. We are neutral on China equities, as market volatility remains extremely high and risks still tilt to the downside. But we will continue to closely monitor potential trades. We are neutral on Hong Kong equities, as economic activities are still affected by social distancing measures and the timing to lift these measures is still unknown. The global growth is under pressure, which will affect Hong Kong economy. The government announced relief packages to help the economy, but the effectiveness is still a question mark.

GLOBAL BONDS

The Eurozone's core government bond yields reached an all-time low before a rebound when markets started to price in higher debt because of huge fiscal stimulus. At the 10-year segment, Germany went up 0.14% and the U.S. fell 0.48% to end the month at -0.47% and 0.67% respectively. In contrast, spread products suffered because of the amplified COVID-19 crisis over the month (particularly peripherals and credit segment). Governments and central banks rolled out huge fiscal and monetary policies to cushion the hit to households and companies, and prevent a global solvency crisis. Indeed, they took exceptional and coordinated measures by unleashing their "bazookas" to respond to global recessionary fears and inject liquidity. In the big picture, the Fed cut its rate to the zero lower bound (0.00-0.25% range), and took unprecedented measures to reduce the impact of COVID-19 on the U.S. economy. Those measures included an unlimited opened-ended quantitative easing, a slew of emergency facilities to bolster credit markets, actions with foreign central banks to ease the supply of USD worldwide and programs for lending directly to the U.S. businesses. On the government side, the U.S. Senate passed a USD 2 trillion (9% GDP) COVID-19 relief package to support the economy. In Europe, among others, the ECB created the new buying program in Economic and Public Policy of EUR 750 billion (to be conducted until at least end of 2020), increased existing Asset Purchase Programme for 2020 by EUR 120 billion, expanded the pool of eligible assets (to include commercial papers and buy more corporate bonds) and eased some banking capital requirements. Many governments announced huge fiscal stimulus packages to prop up local economy which was affected by COVID-19. Germany launched a EUR 750 billion package and abandoned long-held commitment to balanced budgets.

The focus on resilient business models that can survive the economic downturn is critical to preserve assets from permanent impairment. Volatility is extremely high, and liquidity management with cash and similar assets is a top priority. It is crucial to position portfolios to build capacity to recover when markets improve. We are cautious on emerging market bonds. The macro deterioration is significant for the area, and the global recovery expected in 2021 is likely to be stronger for developed nations than that for emerging nations, which will reduce the growth gap. In addition, the oil price at current levels is a strong headwind for many countries in the emerging markets bond index. We expect market volatility to remain extremely high for several months and emerging bonds spreads to remain under pressure. Although overall fundamentals still point to tighter spreads, we think that emerging markets bonds will be more driven by technical factors (such as market volatility) than fundamentals for several months. We are positive on government bonds, we take a constructive view on the U.S. (safe-haven flows), a close to neutral view on core euro and a negative view on Japan. The Eurozone's peripheral bonds continue to offer attractive yields and we remain constructive (EC's massive liquidity injection), although a bit less so than in the past in Italy and Spain. We still expect high volatility on peripherals and liquidity shortages. We are positive on credit bonds. Quality of issuers is also important especially in the riskier segments. We are constructive on investment grade bonds, but we have increased the focus on liquidity. We prefer European investment grade bonds to that of the U.S. (strong fundamentals and support from quantitative easing) as well as in high yield bonds.

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