BCT MARKET OUTLOOK

As of Aug 2020

BCT 銀聯集團

A Fragmented Recovery Across the World amid COVID-19

Investment Markets	**BCT's Investment Views**	**Summary**
Equities	Underweight	
US	Underweight	We remain negative on the U.S. equities. We maintain our slightly cautious stance on the U.S. equities due to an unfavourable risk/return profile. The U.S. markets reflect a contrasting picture with fundamentals, as expectations from the earnings season are muted and some key states have pulled back their economic re-opening plans.
Europe	Neutral	We are neutral on European equities. Risk sentiment towards Europe has improved in light of Europe leading the economic recovery and a reduction in the political risk premium given the progress on the EU's Recovery Fund, which is a short-term game changer.
Japan	Neutral	We are neutral on Japanese equities. Japan has experienced ups and downs in the previous cycle. Being one of the most cyclical markets in the world, Japan could benefit from a catch-up of cyclical stocks and an improvement in the prospects for global growth and demand given its export-oriented economy.
Asia ex Japan	Neutral	We are neutral on Asia ex-Japan. The economic outlook remains quite heterogeneous across the region in terms of the pace of the ongoing recovery. The main differences between countries have been the outbreak's evolution (it is still virulent in countries such as India) and the policy accommodation in place.
China & HK	Overweight	We are positive on Chinese equities. We favour new economy business models, whose development have been accelerated rather than hampered by the COVID-19 outbreak, and we continue to see some of these names thrive, even in a recovery phase, as the cyclicality of consumption drives their top-line growth. We are neutral on Hong Kong equities. Escalating tensions between China and the U.S., the U.K. and Canada over the introduction of the National Security Law may have negative impact in terms of sanctions against the territory.
Global Bonds	Overweight	
Government Bonds	Overweight	Overall, we are positive on government bonds. We favour the U.S., it provides little income and capital preservation against a backdrop where inflation is higher than yields. We are positive on credit. Easing financial conditions continue to support credit, however, we maintain a very selective approach (sectors and names).
Credit	Overweight	

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

In July, the U.S. equity market outperformed (the S&P 500 +5.51%, the Nasdaq +7.37%), as supported by big technology names and vaccine optimism, despite a pick-up in infections, fears of a second wave and rising tensions between the U.S. and China. The U.S. private sector's business activity stabilised in July, as firms reported a moderating decline in service activity and, on the other side, a modest upturn in manufacturing activity. New orders however further contracted as they were impacted by the surge in COVID-19 cases domestically and the new containment measures. The service sector struggled the most as it was severely disrupted by the restrictions being introduced since the pandemic began. Conversely, export orders stabilised in July as the demand from key international partners progressively recovered. Employment grew in July, but the pressure on the labour market remained high due to the uncertainties linked to the evolution of the pandemic across the country. Inflationary pressure rose. Optimism on future business activity further improved. The Federal Open Market Committee did not add any major policy change in the July meeting, but signalled that changes in forward guidance will be announced soon, possibly in the autumn. The tone was dovish which gave investors greater certainty that policy would remain on hold for a long time. The Federal Reserve (Fed) will wait to have more clarity on the path of the recovery before fine-tuning other monetary policy tools (strengthening in forward guidance, calibration of asset purchases with more clarity regarding its goal, and possibly introducing a front-end yield curve control). The Chairman, Jerome Powell, also advocated support of further fiscal action – the fiscal package represents a key variable that the Fed is monitoring at this stage. Real GDP contracted at a 32.9% annualized rate in Q2, a record plunge which was largely expected, and primarily caused by the collapse in services consumption and investments (both fixed investments and inventories) as effects of "stay-at-home" orders. Goods consumption also contracted (-11.3% annualized rate) but it was just a small amount compared to services (-43.9% annualized rate). The U.S. Dollar Index fell by 4.15%, due to the reduced appeal of safe haven assets, expectations of stronger growth outside the U.S., and optimism in Europe following the agreement on the Recovery Fund. The U.S. dollar remains an overvalued currency. We expect volatility through the summer and convergence to the fair value to materialize from Q3.

The U.S. reopening process has been slowed by the pickup in COVID-19. We do not expect a V-shape full speed recovery but a long U-shape path. We have to wait until 2021 before seeing GDP growth go up to 3%-4% and inflation rise above 1%. July readings of inflation posed upside risks to our inflation forecast of 1% year-over-year for 2020. Headline CPI moved higher by

0.6% month-over-month (consensus at 0.3%), from 0.6% to 1.0% year-over-year. Core CPI moved up by 0.6% month-over-month (consensus at 0.2%), from 1.2% to 1.6% year-over-year. As far as the labour market is concerned, data showed that in July 1.76 million jobs were added, bringing the overall payrolls level up to 1.40 million but it was still 8% below 2020 February levels (when payrolls were 1.52 million). The hit was taken by the private sector mostly, in particular the service sector. In the goods producing sector the recovery recently slowed while the service sector is progressing at a somewhat slower pace than May and June. Within the service sector, leisure and hospitality are still the biggest laggards. While we have positive surprises on the claims side, both new claims and continuing claims kept trending down slowly, confirming that the recovery is progressing but in a gradual way. On election front, Joe Biden has a historically large lead over the President, Donald Trump, in the polls, but that could narrow closer to the election. The pandemic may have changed priorities among voters, highlighting new themes around which the presidential candidates will need to reshape the narrative of their campaigns. The U.S.-China tensions continued in July, with diplomatic skirmishes, and Trump's threatening action against the Chinese-owned social media app, TikTok. We don't expect any relaxation of the tensions as the elections date approaches. Overall, we remain negative on the U.S. equities. We maintain our slightly cautious stance on the U.S. equities due to an unfavourable risk/return profile. The U.S. markets reflect a contrasting picture with fundamentals, as expectations from the earnings season are muted and some key states have pulled back their economic re-opening plans. Sentiment indicators are now mixed, with flows being supportive and price-driven factors at euphoric levels. Some market excess continues to build up – the outperformance of the Nasdaq versus the S&P 500, for example. The momentum and valuation divergence between the big five U.S. mega caps, plus that of the higher-growth large cap against the rest of the market, looks extreme and goes back to tech bubble levels. The growth versus value ratio is extreme globally. It is difficult to call the timing for a reversal of this trend, but certainly this is an area to focus on, in our view.

EUROPEAN EQUITIES

Most of European equity markets finished the month in negative territory, lagging the U.S. stock market. (The Euro Stoxx 50 -1.9%, the Euro Stoxx 600 -1.1%, the DAX 30 +0.02%, the CAC40 -3.1%, the FTSE MIB -1.5%, the IBEX -4.9%, the FTSE 100 -4.4% with Spain underperforming due to a rise of infections.) Business surveys were improving: the technical rebound was confirmed by July's flash Purchasing Managers Index (PMI) as business activity expanded for the first time since the pandemic began as countries continued to ease the restrictions, allowing firms to reopen to a larger extent. Both outputs and new orders grew in July as the domestic demand rebounded after the deep collapse in previous months. Softer data came out from export flows which continued to be affected by weak demand from key international markets. Both manufacturers and service providers reported remarkable improvements in operating conditions. Job cuts continued in July across the Euro area, while optimism on future business activity further strengthened. Central banks continued to play the role of lender as a last resort. Since the onset of the COVID-19 crisis, more than 1 trillion euro has been injected into the system by the European Central Bank (ECB) through targeted longer-term refinancing operations (TLTROs). The ECB confirmed its current monetary policy stance as adequate in the July meeting. As far as fiscal stimulus is concerned, at the end of the longest European Council in history, the European Union (EU) leaders agreed to a comprehensive package worth 1,824 billion euro which combines the Multiannual Financial Framework (MFF) and an extraordinary recovery effort under the Next Generation EU (NGEU) instrument. Under the agreement, the Commission will be able to borrow up to 750 billion euro in the markets. 390 billion euro from the package will be distributed in the form of grants and 360 billion euro in loans.

The Eurozone's GDP fell 1.1% quarter-on-quarter, the sharpest drop in 25 years. We continue to expect economic activity to rebound in Q3 and Q4, leading the Eurozone growth to contract 8%-10% year-over-year in 2020, followed by a pickup of 4.5%-6.5% in 2021. 2019 GDP levels are unlikely to be reached until late 2022. High frequency indicators showed that the recovery is on track but it will be slow and uneven. The Eurozone's inflation rose to 0.4% year-on-year in July, slightly above expectations but far below the ECB's inflation target. In 2021, inflation is expected to normalise while remaining subdued vis-à-vis the ECB's target (we expect the Harmonized Index of Consumer Prices to print at 0.7% year-on-year for 2020 and 1.3% for 2021). The agreement reached on the Recovery Fund is a very significant step in Europe. For the first time, the EU will mobilize the budget in a counter-cyclical manner. Fiscal policy thus becomes a stabilisation instrument in the event of a crisis. We see this Recovery Fund as a permanent tool to promote real convergence. The Recovery Fund will increase resilience of the EU, but it will not stabilise activity in the next 12 months. Indeed, this Recovery Fund will not be operational before Q1 2021. The economic impact will not be felt until 2022. Cyclical stabilisation policies therefore remain the responsibility of the member states. We are neutral on European equities. Risk sentiment towards Europe has improved in light of Europe leading the economic recovery and a reduction in the political risk premium given the progress on the EU's Recovery Fund, which is a short-term game changer. In addition, attractive valuations, light investor positioning and a shift towards cyclicals and value names should be supportive.

However, markets have priced in that everything is fine and this is too optimistic. The case for selectivity and resilient business models remains stronger than ever now.

JAPANESE EQUITIES

After a volatile month, Japanese stocks posted further negative returns, with the Nikkei 225 down 2.6%. It was partly in reaction to short-term strength of the Japanese yen against the generally weak U.S. dollar. The economic activity further contracted in July despite a significantly lower rate. The Japanese economy continued to be severely impacted by the very subdued global trade, as firms kept reporting a steep contraction in business with foreign clients. New orders continued to contract, weighting on production levels. Employment continued to fall as firms kept cutting costs in particular within the manufacturing sector. As the COVID-19 infection rate continued to rise which led to growing uncertainty, the Tokyo Metropolitan Government increased the alert level. The reporting season began this month and, so far, a higher percentage of companies have reported positive rather than negative surprises. The Bank of Japan (BoJ) kept policy unchanged in July while lowering its growth forecasts. At the press conference, the Governor, Kuroda Haruhiko, saw the current level of accommodation as appropriate, but he highlighted that the BoJ will pay close attention to developments in credit costs, which could rise if negative effects of COVID-19 persist.

GDP was hit hardest in Q2, decreasing 7.8, as an emergency was declared over the period. The consumption growth turned to be more positive in May, after the lockdown had been relaxed. If it is going to be persistent over time, and the pandemic is contained over time, GDP growth is likely to recover in subsequent quarters and into 2021. We believe that Japan is less impacted than other developed markets, with a better control over the COVID-19 outbreak, and we forecast GDP to drop 4.1% to 4.7% for the full year. Inflation will stay soft, as deflationary pressures persist in the services sector. The latest messages from the Governor, Kuroda Haruhiko, confirmed our view that the BoJ is likely to keep policy rates unchanged not only in the near term but also in the next years, which is in line with the Fed and the ECB’s forward guidance. At the same time, we expect the central bank to keep focusing on the stability and the slope of the curve, in order to maintain the effectiveness of monetary stimulus. We are neutral on Japanese equities. Japan has experienced ups and downs in the previous cycle. Being one of the most cyclical markets in the world, Japan could benefit from a catch-up of cyclical stocks and an improvement in the prospects for global growth and demand given its export-oriented economy.

ASIA EX-JAPAN EQUITIES

Although there were mixed stories in Asia, the MSCI Asia ex-Japan continued to rally with a gain of 8.5% in July. Taiwan was the best performer, with the MSCI Taiwan up 16.3% (thanks to its Information Technology sector exposure). Southern Asian markets continued their underperformance with Malaysia as the only outstanding market, rising 8.3% as driven by demand gloves. Thailand was the worst performer, falling 4.6%, as economic reforms were expected to stall on the resignations of several high profile ministers. Asian consumption and industrial output levels were showing signs of a continued uptick. Mobility data also indicated signs of a resumption in activity. The recovery could be uneven, but high frequency economic indicators showed the first signs of an upturn. Asian corporates thus stood to benefit rather than the rest of the world. Overall, policy accommodation reached new expansionary levels: monetary policy authorities cut reference rates to historic low levels thanks to the very benign inflation environment, and fiscal authorities have stretched their fiscal plans with the addition of many supplementary plans as they tried to not completely neglect their fiscal prudence needs. Central banks are approaching tools that are less conventional, although they are doing so in a thoughtful manner. Quantitative easing measures have applied in the form of monetary policy but rarely in quasi-fiscal and fiscal forms. Indonesia is an exception: the Central Bank of Indonesia (BI) and the Ministry of Finance (MOF) have embarked on a 'burden-sharing' plan, allowing the BI to buy private placement debt issued by the MOF at rates lower than market rates. The current policy accommodation is expected to remain longer due to the very fragile economic backdrop and the supportive global financial conditions dictated by the world's main central banks. The monetary policy easing has not run its course yet and we do expect further fine-tuning on the fiscal side. In Malaysia, the Bank Negara Malaysia lowered its overnight policy rate by 0.25%, its fourth time this year, to 1.75% to encourage investments and spending. In the Philippines, the Banko Sentral Philippines (BSP) maintained its policy rate at 2.25% in July with flexibility to ease, if necessary. The BSP slashed reserve requirements for small banks by 1%.

The economic outlook remains quite heterogeneous across the region in terms of the pace of the ongoing recovery. The main differences between countries have been the outbreak's evolution (it is still virulent in countries such as India) and the policy accommodation in place. The region has been showing a gradual resumption in domestic activity since May, when major lockdown restrictions were lifted (fully or partially), and preliminary June data suggested that Asian economies had emerged from the dip in Q2, with a brightening export outlook. Asian region was the first part of the world to be hit by COVID-19, but it has also been the first region to navigate a way out of it, thanks to its good management of the pandemic and supported by fiscal and monetary actions. Strong fundamentals pave the way for a strong catch-up in Asia, driven by China. We are neutral on Asia ex-Japan. We believe that there are opportunities to watch in Asian equities. We think Taiwan is doing very well, mainly driven by the excellent performance of the technology sector and the partial supply chain relocation implemented by many companies that operate in China. We are more constructive on Indonesia on the back of attractive valuations and rates that have come back down globally. Within ASEAN countries, we are positive on Singapore, Indonesia and Thailand, while avoiding the Philippines and Malaysia. Overall, however, the rally has been intense since the bottom in March, and a pause or consolidation phase may be due. Moreover, the risks are quite numerous, with the evolution of the US-China relationship being the key (recent tensions could derail market sentiment).

CHINA & HONG KONG EQUITIES

Despite escalating tensions with the U.S., with tit-for-tat closures of consulates, and the U.K. government stripping Huawei equipment in its upcoming 5G networks, the MSCI China edged out another month of strong performance of 9.4% gains. All the sectors garnered positive returns in July because of better than expected corporate earnings and investors piling into China on expectations of further monetary easing and expansionary fiscal stimulus, as well as accelerated capital market reforms. China deserved particular attention as a driver for global growth. Having reopened earlier than most other economies, China registered a strong V-shaped recovery in Q2. Headline GDP growth turned positive, to 3.2% year-over-year (against -6.8% year-over-year in Q1). With a notable improvement on the production side, consumer demand for services remained depressed. June's PMI beat expectations again, rising 0.5 points to 51.2 while industrial and service production registered gains of 4.8% and 2.3% year-over-year respectively. Exports rose by 1.6% month-over-month and imports by 10.7% month-over-month. Inflation rose by 2.5% year-over-year in June. We see on an almost daily basis news that tensions between China and the U.S. are escalating. The latest decision announced by the U.S. to close China's Consulate-General in Houston with 72 hours' notice starting from 21 July, was strongly condemned by China. According to latest updates, the U.S. officials are discussing measures to limit or ban the use of Chinese social media such as TikTok and WeChat on the presumption of a national security threat to the U.S. elections. With rising geo-political tension between the U.S. and China, and the resurgence of COVID-19, the MSCI Hong Kong returned negative, with a drop of 0.74% for the month. Q2 GDP contracted 9% year-over-year after a 20.3% contraction in Q1. Private consumption and fixed asset investments fell by 14.5% and 20.6% year-over-year respectively while retail sales volume fell by 25.4%. Given this backdrop, the property sector fell by 5.2%, led by retail landlords, but developers gained on resilient sales. Hong Kong announced a slew of tightening measures to fend off the rising number of infections, including closure of entertainment venues, social distancing and banning dine-in services in the evening till dawn. The postponement of legislative election by 1 year received backlash from the U.S. government and the President, Donald Trump, ordered the end of Hong Kong's special status, while extradition treaties between Hong Kong and Australia, Canada, Germany and the U.K. were suspended.

In the second half of the year, we expect China's overall growth to continue firming up to about 6%. Its strength will mainly stem from consumer services sectors, given further relaxation of outdoor activity restrictions in early July and the improvement in household cash flows. Industrial production growth is likely to climb at a slower pace, as China's early reopening advantage decreases. The policy stance should remain supportive, but tilt towards less easing. Fiscal policy will shoulder more of the stimulus burden, while monetary easing will roll back. On the U.S.-China relationship side, it is worth noting that despite the still poor performance of Chinese imports from the U.S. in comparison with what was agreed in the phase one trade deal, we still believe that the agreement will hold for the time being. The slowing Chinese purchases could bring further turbulence in the absence of a commitment from the authorities in the two countries to pull the trigger. Our base case is for the U.S.-China relationship to remain bumpy. Although political and policy uncertainties will remain high, sanction measures from the U.S. and China's retaliations are likely to remain targeted. The cost of the global financial system derailing from stability is so high that the U.S. and China will refrain from overwhelming measures. As proof of the approach that we expect (tit-for-tat), China retaliated on 24 July, asking the U.S. to close its consulate in Chengdu, after the U.S. closed China's Consulate-General in Houston. One of the most serious challenges remains in the technology cold war. According to the latest announcement of the ban, measures are likely to be followed by similar retaliatory actions from China. Overall, this will contribute to a more restricted data circulation and higher costs for companies looking to protect their data. Some European countries have decided to follow the U.S. steps by banning Huawei from 5G business, antagonising their relations with China, as it was the case with the recent announcement by the U.K. government. We are positive on Chinese equities. We believe that there are opportunities to watch. We favour new economy business models, whose development have been accelerated rather than hampered by the COVID-19 outbreak, and we continue to see some of these names thrive, even in a recovery phase, as the cyclicality of consumption drives their top-line growth. We are neutral on Hong Kong equities. Escalating tensions between China and the U.S., the U.K. and

Canada over the introduction of the National Security Law may have negative impact in terms of sanctions against the territory.

GLOBAL BONDS

In the U.S. the COVID-19 pandemic has led to the worst GDP slump since the Second World War, however investors have been more focused on the recovery in economic data with the PMI improving thanks to renewed upturns in output and new orders. The contraction in employment softened despite further evidence of spare capacity as new sales rose. During July, the U.S. yield curve moved lower and flattened, with the U.S.-10 year yield started the month at +0.66% and finished at +0.53%.The German Bund experienced a similar trend to the U.S. Treasury with some yield-curve flattening and lower yields. Having started the month at -0.46%, German 10-year yields fell steadily, finishing June at -0.53%. In Europe the lockdown measures imposed by most governments have succeeded in slowing the spread of the virus and reducing the death toll but the impact on the economic outlook has been severe. Germany's economy shrank the most in at least half a century in Q2 with a drop of 10.1% in GDP. France's GDP shrank -13.8% (-15.2% expected), with the construction sector seemed to be hit the hardest after falling around 24% in Q2. Italy similarly showed a slightly better GDP than expected, coming in at -12.4% (versus -15.5%). In the U.K. the government has also lifted activity restrictions and introduced measures to sustain the economy by reducing stamp duty, cutting Value Added Tax for food and hospitality sectors and offering support to companies through furlough schemes. Looking at more recent economic data, output growth accelerated thanks to a rise in new orders picking in some parts of Europe, the U.S. and Asia. Employment continued to fall but at a lower speed and business sentiment jumped to its highest levels in about 2 years. During the month the U.K. yields experienced some flattening with the main moves seen in the middle part of the yield curve. The 10-year U.K. yields fell by 0.07% from +0.17% to +0.10%. The JPM Emerging Markets Bond Index Plus Composite generated strong positive returns during the month, appreciating by 3.5%.

The current environment is characterized by a fragmented recovery across the world and new instances of virus outbreaks. But the news flow related to central banks and government actions, as well as the EU's Recovery Fund, continues to drive rates and spreads lower. This combination of policies is likely to keep rates low, driving investors to search for yield in other areas. In this environment, it is crucial to maintain a cautious stance, focus on credit selection and manage duration actively, given that high inflation or a deceleration in central banks action could put upward pressure on yields. The Fed indicated that it might use the ongoing purchase programme of the U.S. Treasuries to keep longer-term yields low in future and so we now see curve flattening opportunities in the U.S.. We also believe that the ECB's measures will likely cause curve flattening in Euro peripherals, but overall these are relative value trades and are dependent on upcoming debt supply, and rates and inflation differentials across countries. In Asia, we expect continuous strong technicals in support of Asian debt, where we still favour countries with attractive positive real rates and credible central banks and governments. Asian currencies have actually outperformed other peers year-to-date due to a combination of improved reserve levels, stability in commodity prices and Asian central banks remaining quite active in monitoring their currency movements. We expect these to continue, lending further support to Asian currencies. Overall, we are positive on government bonds. We favour the U.S., it provides little income and capital preservation against a backdrop where inflation is higher than yields. We are positive on credit. Easing financial conditions continue to support credit, however, we maintain a very selective approach (sectors and names). Segments under the Fed's asset purchase umbrella remain attractive. Idiosyncratic risks, especially in the high yield space, must be tracked as even a couple of such risk events could potentially wipe out the gains experienced this year. Another key aspect is liquidity, which must be maintained at reasonable levels.

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