BCT
銀聯集團

# Hopes of epidemic control and economic recovery lift cyclical stocks

| Investment Markets | BCT's Investment Views | Summary |
|---|---|---|
| **Equities** | Overweight | |
| US | Neutral | We are neutral on U.S. equities. Expectations of continued recovery, improving earnings forecasts, and a low possibility of an all-encompassing national lockdown should support prices, particularly for cyclical and quality components of the market. |
| Europe | Neutral | We are neutral on European equities. The economy is improving, but resurgence of COVID-19 cases and subsequent lockdowns in the region may make the recovery bumpy. |
| Japan | Overweight | We are positive on Japanese equities. Pro-cyclical markets such as Japan should be supported by global growth prospects and attractive valuations. However, investors should stay watchful and balanced till there is more visibility on the growth path. |
| Asia ex Japan | Overweight | We are positive on Asian equities, to play the rebound in the economy. Their higher operating leverage suggests that margins should grow proportionally to the higher sales we expect for next year. We favour economies that are laggards and have not benefited yet from a large growth recovery. |
| China & HK | Neutral | We are neutral on Hong Kong and Chinese equities. The rationale behind this relative value trade is that improving macro indicators support a factor rotation towards laggard economies. Chinese equities already benefitted from a high growth. In Hong Kong, we do not expect the market to outperform in the month ahead on the resurging number of COVID-19 cases in recent days, which may dampen local consumption and economic activities. |
| **Global Bonds** | Overweight | |
| Government Bonds | Overweight | We are positive on both government bonds and corporate credits. Demand for carry and QE buying support the asset class. Spreads have tightened considerably since the March widening, but credit is the asset class which investors participated in the rally in risky assets. |
| Credit | Overweight | |

| Scales of weighting | Underweight | Neutral | Overweight |
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**U.S. EQUITIES**

Diminishing political uncertainty and optimism on the vaccines helped the S&P 500 post a performance of +10.9% and the Nasdaq Composite post a brilliant +11.8%. U.S. retail sales showed a decelerating trend while only online sales held up well. U.S. manufacturers and service providers reported a sound growth momentum in business activity, with both Purchasing Managers' Indices (PMIs) on new orders and production volumes increasing at a sustained rate. The service sector led the expansion as increasing numbers of companies adapted to living with COVID-19, while manufacturing continued to report solid growth thanks to a strong demand from both households and businesses. November inflation (Consumer Price Index (CPI)) was up +1.6%, above market expectations. Core goods supported the increase while on the other hand, core service decelerated over the month. The Federal Reserve (Fed) was satisfied with the amount of accommodation being provided by the current Asset Purchase Program ($80 billion in Treasuries and $40 billion in Mortgage Backed Securities per month), which has materially eased financial conditions.

After an extraordinary rebound in Q3, we expect a significant deceleration for Q4, influenced by the new rise in COVID-19 cases. Next year's growth outlook remains supported by the mix of monetary and fiscal policies. Headline inflation should move higher, with a temporary mid-year overshoot due to reversing oil price base effects. It would then revert to the target. A Democrats' sweep is unlikely and a divided government means that the implementation of the President-elect Biden's platform will only be limited. The Republicans are not likely to agree with Biden on most of his proposed tax increases, particularly on the corporate tax rise. Tough regulation against the tech industry is unlikely to happen while bipartisan legislation will likely prevail. We are neutral on U.S. equities. Expectations of continued recovery, improving earnings forecasts, and a low possibility of an all-encompassing national lockdown should support prices, particularly for cyclical and quality components of the market.

**EUROPEAN EQUITIES**

In Europe, the stock markets rallied strongly, the MSCI Europe appreciated by +13.9%. The cyclical bias of the index helped Europe be the best performing area. Hard and soft data confirmed the deceleration in economic activity due to the resurgence of COVID-19 cases and new lockdowns. Many countries recorded a weakening of their respective PMIs but remained in the positive growth territory. The new lockdown measures led to a significant contraction in business activity. However, business confidence improved. Manufacturing remained resilient, while services continued to be negatively affected with further contraction in business activity.

Eurozone inflation remained stable in October, printing at -0.3% year-over-year. The European Central Bank committed to strong actions in December that will take the form of a full package, supporting the "low for longer" scenario on bond yields, combining an expansion of Quantitative Easing (QE), mostly through Pandemic Emergency Purchase Programme, an extension of QE new purchases and reinvestment horizons, plus an extension and/or cheapening of the favourable terms of the targeted longer-term refinancing operations.

Q4 2020 is set to print a new GDP contraction, as new rises in COVID-19 cases have induced Eurozone governments to new lockdowns. After a mild pickup in Q1, availability and initial distribution of the vaccine will help confidence and release pent-up demand from Q2 2021, from then on we expect growth to remain supported above potential by an extraordinarily mix of monetary and fiscal policies. Inflation should remain subdued in the near term with significant downside risks in Q4 before moving gradually higher in 2021, yet remaining evidently below target. We are neutral on European equities. The economy is improving, but resurgence of COVID-19 cases and subsequent lockdowns in the region may make the recovery bumpy. The result will be extreme market dispersions, which will create opportunities for active stock pickers. We look for names with strong balance sheets and resilient business models.

**JAPANESE EQUITIES**

Japan's equity market rallied in November, posting a gain of +11.1%, driven by vaccine-related news and slow-motion results from the U.S. presidential election. The economy is recovering from a deep recession, after the hit from consumption tax hike in October 2019 and the global COVID-19 pandemic. In Q3, GDP bounced back by 5% quarter-over-quarter, reversing less than half of the decline since the last quarter of 2019. The path to recovery remains challenging. As of November, Japan's PMIs had not yet returned to 50. A renewed wave of outbreak has started to weigh on sentiment and outdoor activities. Governor Kuroda's speech on 24 November called for attention to the financial imbalance of the private sector after the crisis. This remark indicated increasing flexibility in assets purchase amount. The Bank of Japan let the monetary policy unchanged.

With the recent new surge of COVID-19 cases, we are not expecting the economy to return to pre-crisis level until 2022. With a wide output gap, inflation will remain depressed. The central bank noted that inflation could stay negative for a while before turning positive, projecting a slow improvement in the economy and output gap. It also acknowledged difficulties in achieving the 2% inflation target, and focused more on sustainability of monetary policy. Amid renewed pandemic outbreaks at home and abroad, it has become a consensus call that the Bank of Japan will maintain its accommodative stance in 2021, and announce an extension of its Special Funding Program for the corporate sector in December. We are positive on Japanese equities. Pro-cyclical markets such as Japan should be supported by global growth prospects and attractive valuations. However, investors should stay watchful and balanced till there is more visibility on the growth path.

**ASIA EX-JAPAN EQUITIES**

The MSCI Asia ex Japan recorded a high return of +7.3%, as the news of vaccines boosted investor sentiment. Thailand and Singapore led the index higher. In Thailand, new COVID-19 cases remain low, containment measures have been relaxed very gradually, suggesting a careful approach to reopen the economy. The data flow in Thailand depicted a solid Q3 2020 recovery, led by external demand and private consumption. Capital spending, though stabilizing, has yet to recover to the same degree. Singapore's macroeconomic prospects turned supportive, with Q3 2020 GDP data stronger than expected, driven by industrial production and normalization of private consumption. The Bank Indonesia cut its policy rate by 0.25% to 3.75%, after keeping the policy rate on hold since July meeting. The central bank also reiterated its commitment to maintain accommodative monetary policy going forward.

Indonesia should benefit from both structural tailwinds (the Omnibus law) and relatively quicker economic recovery. However, there should be volatility from further bouts of tightening and relaxation of economic activities with subsequent waves of COVID-19 infections. Singapore requires the reopening of its borders as a precondition for the economy to recover, meaning that the Singaporean economy will likely to recover later than Indonesia. While it waits for this to occur though, the country's strong fiscal position will be able to tide the economy over. The profits growth in the first half of 2021 will be more concentrated in emerging Asia, which is much more advanced in the recovery and more linked to booming e-commerce profits. We are positive on Asian equities, to play the rebound in the economy. Their higher operating leverage suggests that margins should grow proportionally to the higher sales we expect for next year. We favour economies that are laggards and have not benefited yet from a large growth recovery (as opposed to China).

**CHINA & HONG KONG EQUITIES**

China, which has outperformed significantly on a year-to-date basis, underperformed the Asian region due to a factor rotation towards value stocks. The MSCI China posted +2.6%. The economy grew at a buoyant pace entering in Q4, led by the services sector. Industrial production continued to expand above trend sequentially. The MSCI Hong Kong went up +11.1%. Local pandemic situation worsened in November. The government has tightened some of the social distancing measures. Hong Kong's CPI remained in deflation territory and fell by 0.2%. Labour market continued to face pressure amid the subdued local economic activities. Chief Executive Carrie Lam delivered the following policy address: additional relief measures with $600 million support to tourism industry, the removal of double stamp duty for commercial properties, and an expansion of the scope of eligible securities in the Mutual Market Access program.

In China, in light of credit growth normalisation, monetary policy should hold at neutral instead of tightening further. Against a backdrop of policy normalisation, we expect credit to grow at a slower pace in 2021. Public spending will give way to private consumption. Headline CPI is due for further corrections in Q4 2020 and Q1 2021, as pork prices reverse previous gains, but underlying inflation has already bottomed out. In Hong Kong, we do not expect the market to outperform in the month ahead on the resurging number of COVID-19 cases in recent days, which may dampen local consumption and economic activities. We are neutral on Hong Kong and Chinese equities. The rationale behind this relative value trade is that improving macro indicators (i.e. PMIs, Producer Price Indexes, Industrial profits …) support a factor rotation towards laggard economies. Chinese equities already benefitted from a high growth, posting +24.8% on a year-to-date basis.

**GLOBAL BONDS**

In November, the U.S. yield curve lowered and flattened. After the initial announcements of the trial vaccine's success, the U.S. yields moved higher, but then, mixed economic outlook and growing COVID-19 concerns pushed the yield lower. Overall the U.S. 2-year yield fell -0.01% from +0.16%, and the U.S.-10 year yield started the month at +0.88% and finished at +0.84%. With the lockdown measures starting to have some positive effect in terms of new COVID-19 cases, the German Bund experienced a parallel move of the curve with higher yields. The German 2-year yields rose by 0.05% to -0.75% and the 10-year yields started the month at -0.63% and finished at -0.57%. The JP Morgan Asia Credit Index Diversified posted a positive return. Asian High Yield bonds recovered and outperformed Asian Investment Grade, which were dragged down by spread widening across Chinese companies as affected by the U.S. Executive order.

A balanced outcome in the U.S. elections and positive news on the vaccine triggered a sharp rebound in risk assets. We believe that this positive momentum should continue in the near term, particularly in credit, on the back of expectations of growth and continuous monetary support. The Fed is likely to keep rates lower for longer, amid less support from the fiscal side. It would be interesting to see if there is pressure from Biden to incorporate economic inequality into its mandate. On the other hand, vaccine availability may support a curve steepening but it would not be immediate, given that deployment on a large scale could take time. Emerging market bonds should benefit from a strong appetite for yield-search among investors as rates in the developed world are at record lows. We are positive on both government bonds and corporate credits. Demand for carry and QE buying support the asset class. Spreads have tightened considerably since the March widening, but credit is the asset class which investors participated in the rally in risky assets.

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