BCT MARTKET OUTLOOK

As of December 2021

NEW OMICRON VARIANT POSES NEW RISKS TO THE GLOBAL ECONOMY

Investment Markets	BCT's Investment Views	Summary
Equities	▬	
 US	▬	We are neutral on U.S. equities. It will be hard to argue that the Fed should not speed up tapering if the labour market reports and inflation show continued strength in the near future.
 Europe	▬	We are neutral on European equities. ECB President Lagarde reiterated the dovish message on prospects for rates stability for 2022, with a pushback against the recent market view.
 Japan	▬	We are neutral on Japanese equities. Q3 GDP came in substantially below expectations, showing a broad weakening in domestic and external demand. As a result, we have lowered our 2021/2022 forecasts, but with little change in the future growth recovery profile.
 Asia ex Japan	▬	We are neutral on Asian equities. In Singapore, the high daily reported cases continue to be the noise to the reopening theme in the near term. The recovery theme is still on track in the medium term.
 China & HK	▬	We are cautious on Chinese equities due to weakness in growth and potential regulatory measures. We are neutral on Hong Kong equities. The emergence of Omicron variant has clouded the prospect of Hong Kong's long-awaited border reopening with mainland China.
Global Bonds	▬	
Government Bonds	▼	We are cautious on government bonds. In U.S., inflation pressures persist, testing the Fed's tolerance threshold, even as the central banks announced its taper plans and moves towards normalisation.
Credit	▲	We remain positive on credit. In U.S., we look for quality credit but prefer company-specific risk over beta exposure in Investment Grade.

Scales of weighting	▼ Underweight	▬ Neutral	▲ Overweight

U.S. EQUITIES

In the U.S., the S&P 500 finished the month with a return of -0.7%, but the NASDAQ Composite returned positively with +0.3%. One of the outcomes of the Omicron variant is U.S. technology stocks cementing their status as the go-to equity haven with technology names seen as defensive in a lockdown scenario. Over the month, growth stocks and value stocks were both on a positive trajectory in the beginning of the month but the news about the Omicron variant changed investor sentiment and favoured growth stocks which gained +1.3% against a loss of -3.5% of value stocks. Unemployment rate fell to 4.2% from 4.6% but job gains were overshadowed by inflation worries with the Consumer Price Index (CPI) increasing to 6.8% year-on-year. In terms of monetary policy, at the beginning of the month, Chair of the Federal Reserve (Fed), Jerome Powell, announced the start of tapering but he emphasized the flexibility to adjust the program depending on the evolution of the economic conditions. However, later during the month, while Jerome Powell acknowledged the risks posed by the Omicron variant, nonetheless appeared more concerned about inflation, raising the possibility of a speedier end to the central bank's asset purchases, signaling an aggressive stance.

We expect a reacceleration in Q4 as several activity indicators signaled sharper-than- expected deceleration in Q3. Looking into 2022, we expect growth to decelerate in sequential terms, while remaining above trend and eventually converging to potential in 2023. The reason for this is that the current inflation spike was generated by significant transitory factors that are expected to progressively fade into next year. And yet, it was also the result of strong demand and second-round effects, which we expect them to be factors keeping inflation significantly above the pre-pandemic trend over the course of our forecast horizon. We are neutral on U.S. equities. At the current pace, tapering is expected to end in June 2022, but some participants suggested an acceleration could be warranted. It will be hard to argue that the Fed should not speed up tapering if the labour market reports and inflation show continued strength in the near future. Regarding the timing of the first rate hike, the debate on labour participation and what employment will be like in this cycle will be critical since a necessary condition of the first hike is to reach full employment. Overall, we expect a first rate hike in June 2022.

EUROPEAN EQUITIES

In November, the MSCI Europe declined by -2.4% in local total return terms. During the first part of the month, stocks in Europe rose on strong corporate earnings results, signals from the European Central Bank (ECB) that interest rates would stay low for some time and optimism about economic growth which helped allay inflation concerns. In the second part of the month, a surge in the number of coronavirus infections drove some countries to impose restrictions again, and this clouded the economic outlook. Markets then fell sharply on fears that the economic recovery might be derailed by the spread of the Omicron variant and imposition of tighter restrictions. The labour market continued to recover with the unemployment rate declining to 7.4%. The Eurozone's Manufacturing Purchasing Managers' Index (PMI) increased from 58.3 in October to 58.4 in November, the first rise in the headline index since June. Demand remained strong but supply chains continued to deteriorate and inflation continued to grow with an expectation of a +4.9% increase in the Eurozone, up from +4.1% in October. From a monetary perspective, President of the ECB, Christine Lagarde, pushed back against interest rates increase because inflation would fade and asset purchase could continue beyond the expiry of the Pandemic Emergency Purchase Programme (PEPP). However, some ECB members warned that drivers of inflation were becoming structural.

We believe peak growth has passed. We expect a deceleration in sequential terms. With the reopening boost over, consumers and businesses will have to face the headwinds of higher energy prices and supply bottlenecks. Inflation is also acting as a drag on domestic demand and consumption and not yet being compensated by higher wage growth. Thus, once the transitory factors supporting Q4 2021 peak in inflation are over, from mid-2022 we expect the current gap between core and headline inflation to close, with a visible deceleration in inflation, although we expect it to stabilise to slightly higher than pre-pandemic trends. We are neutral on European equities. ECB President Lagarde reiterated the dovish message on prospects for rates stability for 2022, with a pushback against the recent market view. The ECB only moderately reduced its quantitative easing (QE) path inQ4 versus the previous two quarters, but PEPP is likely to end by March 2022, following recent communication by ECB President. We expect the ECB to keep its stimulus persisting into 2022, calibrate its size in order to cover for (lower) expected European Government Bonds net issuance and support European Union new bonds. The December meeting is likely to provide guidance on stimulus deployment in 2022.

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JAPANESE EQUITIES

In Japan, the TOPIX and the Nikkei declined by -3.6% and -3.7% in total return terms, respectively. The pace of economic recovery undermined sentiment with Q3 GDP falling below expectations (-0.8% quarter-on-quarter) and overseas coronavirus concern weighing on the markets. The discovery of the Omicron variant shattered initial confidence towards Japan's domestic economy. Currency markets also shifted, with early-month yen weakness fast reversing as investors sought safe-haven assets amid increasing uncertainty. Prior to this month, Prime Minister Kishida had formed his new cabinet following the general election at the end of October, leading to a stable political scenario. In November, details of a massive fiscal stimulus package gradually emerged, which was greater than prior predictions and might have a considerable influence on 2022 GDP.

The state of emergency was lifted at the end of September, and mobility began to improve at a faster pace. We expect private consumption to begin rebounding in late 2021, leading the recovery. Inflation will strengthen more meaningfully in 2022, thanks to fading one-off factors. We are neutral on Japanese equities. Q3 GDP came in substantially below expectations, showing a broad weakening in domestic and external demand. As a result, we have lowered our 2021/2022 forecasts, but with little change in the future growth recovery profile. Kishida's stimulus package introduced upside risks to our 2022 forecasts. With inflation at bay, we do not expect the Bank of Japan (BoJ) to change its policy stance to join the camp of policy normalisation. But in fact tapering has been underway for a while, as exchange-traded fund (ETF) and Japanese Government Bond purchases declined. In addition, an important discussion for 2022 is whether the BoJ will seize the opportunity of reasonably higher inflation (at around 1%) to make some technical adjustment. The most-discussed option is a shift of yield target from 10-year to 5-year, given that the latter is more linked to the asset maturities of Japanese banks.

ASIA EX-JAPAN EQUITIES

In November, it was mainly a negative story in Asia where many indices declined with few exceptions. Market sentiment was strong in the first half but deteriorated later due to the new Omicron variant and concerns about U.S. monetary policy. Among the major developed Asian indices, the Singaporean Straits Times Index (STI) posted a negative return of -4.9% as investors continued to track developments surrounding the new COVID-19 variant and whether existing vaccines would prove to be less effective. In India, the Sensex was down -3.8% and the Nifty declined by -3.9%. India market declined but performed better than the broad region. The uncertainty surrounding the new Omicron variant was a key factor that led to the market correction. Malaysia and Thailand both experienced a negative return with the Malaysian Kuala Lumpur Composite Index (KLCI) declining by-3.1% and the Stock Exchange of Thailand (SET) falling -3.4%. The Bank of Thailand kept its policy rate unchanged at 0.5%. The daily reported cases continued to decline and vaccination rate was around 450,000 doses daily. Among the other major equity indices, only Taiwan and the Philippines were positive, the Taiwan Stock Exchange Corporation Index (TWSE) was up +2.6% and the Philippines Stock Exchange Index (PSEi) also went up +2.1%. The Philippines returned positively and was among outperformers. Relaxed mobility restrictions and a strong beat in Q3 GDP boosted market performance.

In Singapore, the high daily reported cases continue to be the noise to the reopening theme in the near term. The recovery theme is still on track in the medium term. In Indonesia, the government will provide access for booster shots by next year. The average daily cases declined significantly and the accelerated vaccination rollout will lead to higher mobility, implying easing of more economic activities. Thailand covered 59% of the population with at least one dose and had 42% fully vaccinated. With this, the government allowed quarantine-free travel for fully vaccinated tourists from 10 low-risk countries effective November 1. With the easing of border restrictions, the reopening theme continues. We are looking at the Philippines' recovery theme. Daily cases are declining and vaccination rate is accelerating, with 95% of the adult population fully vaccinated. The government rolled out vaccines for 12-17 years-old since November 3. In Malaysia, the government continued to ease mobility. It lifted interstate travel bans and outbound international travel restrictions for fully vaccinated residents, with no states left under Phase 1 and 2 of the National Recovery Plan. At this rate, the recovery theme is on track. The Vietnamese government eased mobility, with Ho Chi Minh City resuming dining with a 50% capacity cap. We continue to be positive on the outlook in the medium term, driven by a structural shift of production hubs to Vietnam.

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China & Hong Kong Equities

In Hong Kong and China, Hong Kong's Hang Seng experienced a depreciation of -7.5% while the Shanghai Composite returned +0.5% amid speculation that Beijing would ease measures to help indebted property companies.
For the third month in a row, China's exports surprised to the upside, increasing by +27% year-on-year in October, owing to robust demand from Europe. The People's Bank of China (PBoC)'s broad 0.5% cut in required rate of return (RRR) released 1.2 trillion renminbi into the interbank market. The PBoC said part of the funds will be used to replace the maturing Medium-term Lending Facility (MLF). It is expected that Hong Kong's border will reopen with China in the coming month with quota. Nevertheless, as the new COVID-19 Omicron variant poses threats to public health, the Hong Kong SAR Government is tightening restrictions towards a few countries. October's retail sales went up by +12% year-on-year, as disbursement of the second batch of electronic consumption vouchers enhanced consumption sentiment. Nevertheless, the growth will be moderated in near future as the impact from consumption vouchers faded.

In Premier Li's statement, it was mentioned that China's policymaking would focus more on demand, a shift from mentioning supply side reforms only for over a year. Markets are likely to start pricing in rate cuts as well. During the Politburo meeting, the overall stance was an emphasis on growth stability, confirming the exit from tightening. The count of "stability" doubled in 2022 communique versus 2021. In terms of monetary policy, we believe that the government is to increase flexibility and maintain appropriate liquidity. It was more dovish than expected, broad easing is happening (RRR cut) and a rate cut now looks possible. The RRR cut means that China's policy will turn more decisively to easing, which we will get confirmation in the coming Politburo meeting/Central Economic Work Conference. We are cautious on Chinese equities due to weakness in growth and potential regulatory measures. We are neutral on Hong Kong equities. Unemployment rate improved from 4.5% in September to 4.3% in October, as the number of COVID-19 cases were low and economic activities gradually recovered. However, the emergence of the Omicron variant has clouded the prospect of Hong Kong's long-awaited border reopening with mainland China.

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GLOBAL BONDS

During the Fed meeting, Chair Jerome Powell stressed the risk of higher inflation, he went so far as to 'retire' the use of the term 'transitory' when describing the current inflation outlook and opened the door to earlier rate hikes that in turn lead shorter-dated Treasury yields to a sharp move higher. In November, the U.S. curve flattened overall, the U.S. 2-year yield rose +0.07% from +0.50% to +0.57% whilst the U.S.10-year yield started the month at +1.56% and finished at +1.45%. The much-watched spread between the 2-year yield and the 10-year yield tightened, moving from +1.06% to +0.88%. In Europe, the Omicron variant strongly weighed on the sovereign bond that delivered positive performance: having started the month at -0.11%, the German 10-year yields fell and finished November at -0.35%; the German 2-year yields fell -0.16% from -0.59% to -0.75%. Overall, the J.P. Morgan Economic and Monetary Union Government short-dated bond indices recorded positive returns during November, as yields fell in core markets. The 3-5 year index rose +0.9% whilst the 5-7 year index posted a positive return of +1.5%. The J.P. Morgan Emerging Markets Bond Index Plus Composite was negative with a performance of -2%.

A positive outlook on ratings and Q3 results sustained credit but volatility in core yields, dispersion in evolution of financial ratios and year-end liquidity conditions were fragilities weighing on this asset class. We are cautious on government bonds. In the U.S., inflation pressures persist, testing the Fed's tolerance threshold, even as the central banks announced its taper plans and moves towards normalisation. The medium-term path for nominal and real rates must be monitored, and we believe that the massive debt and fiscal deficit will put upward pressure on core yields. In Europe, The ECB will maintain a supportive stance to maintain accommodative financial conditions despite slowing its asset buying. We remain positive on credit. In the U.S., we look for quality credit but prefer company-specific risk over beta exposure in Investment Grade (IG). We remain moderately constructive in IG through a more selective lens. In Europe, credit fundamentals are improving, and companies look to be able to withstand supply bottlenecks for now, as evidenced by recent results. However, we are monitoring volatility from core yields, dispersion of credit metrics across companies and liquidity.