BCT MARKET OUTLOOK

As of Feb 2021

Reflation expectations heat up, stock markets are under pressure as U.S. Treasury yields rise

Investment Markets	**BCT's Investment Views**	**Summary**
Equities	⬆	
US	▬	We are neutral on U.S. equities. 2021 is likely to be a strong year for earnings growth, driven by the health of U.S. consumers which has a lot of savings and pent-up demand. However, excessive valuations, potential tax rises, and higher interest rates, coupled with inefficiencies in logistics and higher input costs, require high selectivity.
Europe	▬	We are neutral on European equities, given that a recovery regime should be supportive, but we are mindful of segments where valuations are excessive and discounts have closed in. We suggest a barbell position, with segments that can benefit from a recovery.
Japan	⬆	We are positive on Japanese equities. Japan is a cheap, cyclical market with growing return on equity and an improving shareholder focus which is not yet appreciated by the market. Overall, it is an attractive long-term opportunity tied to a recovery in large global markets such as China.
Asia ex Japan	⬆	We are positive on Asian equities. We believe the rebalancing of North Asia towards internal dynamics and demand could act as a good diversifier for portfolios. In addition, the past experience of Chinese authorities in better handling the pandemic should help them deal with new lockdowns.
China & HK	⬆	We remain positive on China equities. We think that policymakers will stay accommodative to support economic recovery. We are neutral on Hong Kong equities. The availability of vaccines seems to backlogged. As the result, Hong Kong economy in the first half of the year will remain under pressure.
Global Bonds	⬆	
Government Bonds	▬	On government bonds, we are now neutral. Upside pressure on U.S. bond yields could continue, in light of additional monetary stimulus. However, the Fed is still expected to avoid extreme moves of yields, in order to keep financial conditions supportive. We stay positive on credit, as demand for carry and central banks' purchases support the asset class.
Credit	⬆	

Scales of weighting	⬇	▬	⬆
	Underweight	Neutral	Overweight

U.S. EQUITIES

After hitting new record highs, U.S. equity markets dropped with the S&P 500 down -1%, during the last week of the month. After the initial optimism led by the announcement of the huge U.S. fiscal stimulus of the new Biden Administration, sentiment turned negative on a mix of news, ranging from poor tech earnings announcements, new virus variants, delayed vaccine deployment and worries around rising interest rates and high equity valuations. The overall economic growth slowed considerably in Q4 but the GDP grew at an annualized rate of 4.0%, in line with expectations. January's U.S. Purchasing Managers' Index (PMI) signaled an improvement in the manufacturing sector, with the reading moving to 59.2. This increase was driven by the expansion in output and new orders with the ease of restrictions and boosting sales. On the inflation side, January's Consumer Price Index (CPI) rose moderately in January (+0.3%) and underlying inflation remained benign as the pandemic continues to be a drag on the labor and services industry. In terms of monetary policy, the tone of the January Federal Open Market Committee meeting was dovish. Chairman Powell made it clear that discussions on the timeline for tapering and gradually reversing its quantitative easing measures, are premature. The meeting confirmed the scenario of a tapering on treasury purchases starting in 2022.

After a deceleration in Q4 on the back of a fresh rise in COVID-19 cases, we expect the potential weakness in 2021 to be offset by the fiscal support approved in January. Based on stronger fiscal support than previously expected, we have revised up our growth outlook and inflation forecast, we expect the latter to remain within the target. New rounds of fiscal stimulus, not currently included, would represent an upside risk to our 2021 outlook. We are neutral on U.S. equities. 2021 is likely to be a strong year for earnings growth, driven by the health of U.S. consumers which has a lot of savings and pent-up demand. However, excessive valuations, potential tax rises, and higher interest rates, coupled with inefficiencies in logistics and higher input costs, require high selectivity. While maintaining the view of rotation towards Quality, Value and Cyclical stocks, investors should move away from companies that will be unable to withstand these pressures.

EUROPEAN EQUITIES

In Europe, a relatively slow rollout of COVID-19 vaccines dominated the headlines and led to a sell-off in equities. The EURO STOXX 50 lost -1.9%. Germany and France reported relatively resilient GDP, providing some hopes that the Eurozone might avoid a deeper recession. The German economy expanded by 0.1% thanks to strength in exports and construction. In France, thanks to robust exports, steady business investment and a rebound in consumer spending, the economy contracted only by -1.3%, an upside surprise relative to consensus estimates. The Eurozone's manufacturing output continued to expand at a solid pace at the start of 2021, though growth had weakened and the PMI had declined from 55.2 to 54.8. Annual inflation rate in the Eurozone jumped to 0.9% in January, the highest rate since February 2020. The European Central Bank (ECB) did not changed the monetary policy. The current objective is to preserve favourable financing conditions, confirming that the Pandemic Emergency Purchase Programme envelope for bond purchases might not be used in full, but could be extended. The symmetry of flexibility in managing Quantitative Easing remains fully in place, as a crucial means to reach the above target.

Based on the extended lockdowns implemented at the beginning of the year, Q1 will likely see a contraction in GDP, as high frequency activity indicators currently imply. The extended lockdowns and the very gradual rollout of the vaccination campaign weigh on our forecast for the first half of the year; we expect much stronger growth from the second part of the year, based on a mix of improved sentiment, released pent-up demand, lift-off of major mobility restrictions and support from the Next Generation European Union (NGEU). Inflation should remain subdued in the near term before moving gradually higher in 2021, although it should remain significantly below target. We are neutral on European equities, given that a recovery regime should be supportive, but we are mindful of segments where valuations are excessive and discounts have closed in. We suggest a barbell position, with segments that can benefit from a recovery. Above all, investors should continue to focus on non-disrupted business models with strong balance sheets and potential for sustainable growth.

JAPANESE EQUITIES

Thanks to a positive stance from the U.S. Federal Reserve (Fed), Japanese equities were pushed higher at the beginning of the month, before falling at the end of the month. The Nikkei 225 posted +0.8%. Amid a worsening of the outbreak, the Government continued to report high numbers of new COVID-19 cases, and announced that the state of emergency might be extended beyond 7 February. The Japanese government approved an extra budget of 19 trillion yen, to fund additional government measures to counter the novel COVID-19 pandemic. Monetary policy was kept unchanged as expected. Interestingly, the central bank revised up its growth outlook for fiscal years 2021 and 2022, to 3.9% and 1.8%, respectively, amid the worsening of the outbreak.

The upward revision of GDP forecasts by the Bank of Japan is read as a vote of confidence in the global recovery, where Japan is well positioned. Meanwhile, the focus is on the monetary policy assessment due in March. Governor Kuroda said a suppression of side effects, such as excessive decline in the super-long rates while stabilizing the remaining yield curve, is desired. Given the deep negative output gap, inflation will remain close to zero. However, we do not expect the economy to fall into outright contraction again due to resilient external demand. Overseas machine tool orders rebounded strongly by 15.9% year-over-year in Q3, the first positive data since 2018. We are positive on Japanese equities. Japan is a cheap, cyclical market with growing return on equity and an improving shareholder focus which is not yet appreciated by the market. Overall, it is an attractive long-term opportunity tied to a recovery in large global markets such as China.

ASIA EX-JAPAN EQUITIES

Asian equity markets' performance was positive as the rollout of COVID-19 vaccine programmes and hopes for additional U.S. fiscal stimulus boosted investor sentiment. In local terms, the MSCI Asia ex-Japan was up +4.5%. South Korea ended the month higher but underperformed the region while, in India, the equity market was in negative territory as investors awaited the announcement of the crucial 2021 budget. The Indonesian market experienced some pull-back in the second half of January, due to a combination of profit taking after the strong 2020 performance and fears over higher U.S. rates. The Philippines market experienced a decline in January, with the weak Q4 GDP headline and guidance for Q1 2021 fuelling investors' disappointment, as market expectations were high going into the new year. On the back of a recent virus outbreak, Malaysia re-introduced the Movement Control Order, which will be lifted in February if the pandemic is brought back under control. Accordingly, a new fiscal package has been announced, though much smaller than in the previous phase.

Indonesia economy should benefit from both structural tailwinds (further finalization and implementation of the Omnibus law) and from the relatively quicker post-COVID recovery, which is supported by the country's ability for further fiscal support. In the Philippines, the lacklustre market will continue in the short term especially with the country's slower vaccine procurement and the lack of distribution infrastructure covering the whole country. The Bank Negara Malaysia remained on hold in January and we reiterate our easing call (-0.25%) at the next Member of Parliament meeting in March. Inflation is still negative and we do not expect it to move to an upward trend until March 2021. We are positive on Asian equities. We are optimistic on the region. We believe the rebalancing of North Asia towards internal dynamics and demand could act as a good diversifier for portfolios. In addition, the past experience of Chinese authorities in better handling the pandemic should help them deal with new lockdowns.

CHINA & HONG KONG EQUITIES

Chinese equity markets were driven higher by some of the large technology companies and stable domestic economic data, which was ahead of consensus forecasts. The MSCI China was up +7.3%. China's GDP growth firmed to 6.5% year-over-year in the last quarter, ending the year on a high note. But the recovery is uneven. Exports and industrial production consistently surprised on the upside, consumption recovery was less impressive. Income growth was slow, despite the tightening of the labour market. Biden administration postponed the U.S. investment restrictions on Chinese companies in May. The People's Bank of China communicated on the fact that the monetary policy would remain unchanged. The MSCI Hong Kong was up +2% in January. Hong Kong's Q4 GDP fell by 3% year-over-year, which implies a 6.1% decline in full year GDP. The weaker-than-expected economic performance was largely due to the prolonged fourth wave of the pandemic.

In China, we expect consumers to lead the overall recovery in 2021, given ongoing restoration of household balance sheets and narrowing excess savings. We revised up our 2021 growth forecasts on persistent strength in exports, vaccine supply and carry-over from 2020. We expect slower sequential growth in Q1, particularly in the service sector, as the government has tightened travel control during the Lunar New Year holiday. We remain positive on China equities. During the last week of January, the market concerned about the People's Bank of China's net liquidity withdrawals. We think that policymakers will stay accommodative to support economic recovery. We are neutral on Hong Kong equities. Vaccines should be available in February. The impact from vaccines will not be reflected until late in Q2, when a majority of people have been vaccinated. In addition, the availability of vaccines seems to backlogged. As the result, Hong Kong economy in the first half of the year will remain under pressure.

GLOBAL BONDS

The increasing likelihood of a record U.S. stimulus package, and consequently much stronger growth and inflation anticipation put upside pressure on U.S. Treasuries yields. Corporate bonds suffered due to the move in Treasury yields, but healthy demand from a month-end buying trend limited the losses. The general move away from riskier asset classes weighed on the high yield bond market. Overall the U.S. 2-year yield fell approximatively by 0.01% to +0.11%, and the U.S. 10-year yield started the month at +0.92%, rose above the +1% barrier for the first time since March 2020, reaching +1.15% before benefitting from some risk aversion towards month-end and finishing January at +1.07%. With better-than-expected GDP figures in Q4, the German Bund curve steepened and yields were mixed. Having started the month at -0.57%, the German 10-year yields finished at -0.52%. The J.P. Morgan Asia Credit Index Diversified had a marginally positive return: +0.1%. Asian investment grades underperformed Asia high yields, led by underperformance in quasi (including some Chinese state-linked names affected by the U.S. Executive Order) and investment grade sovereigns.

Our central scenario indicates growth reacceleration for 2021 in both developed markets and emerging markets, based on the persistence of stimulative economic policy mix and on the optimism around the vaccine campaign. Inflation trends remain broadly in check, even if we can expect some noise and volatility. On government bonds, we are now neutral. Upside pressure on U.S. bond yields could continue, in light of additional monetary stimulus. However, the Fed is still expected to avoid extreme moves of yields, in order to keep financial conditions supportive. In the Eurozone, yields look more capped by the gap with the U.S. in terms of potential fiscal support and in light of ongoing impacts of restrictions on growth. We stay positive on credit, as demand for carry and central banks' purchases support the asset class.

"BCT" - BCT Financial Limited (Plan Sponsor)
- Bank Consortium Trust Company Limited (Trustee & Administrator)

Issued by BCT Financial Limited

The content of this Market Outlook is contributed by Amundi Hong Kong Limited.