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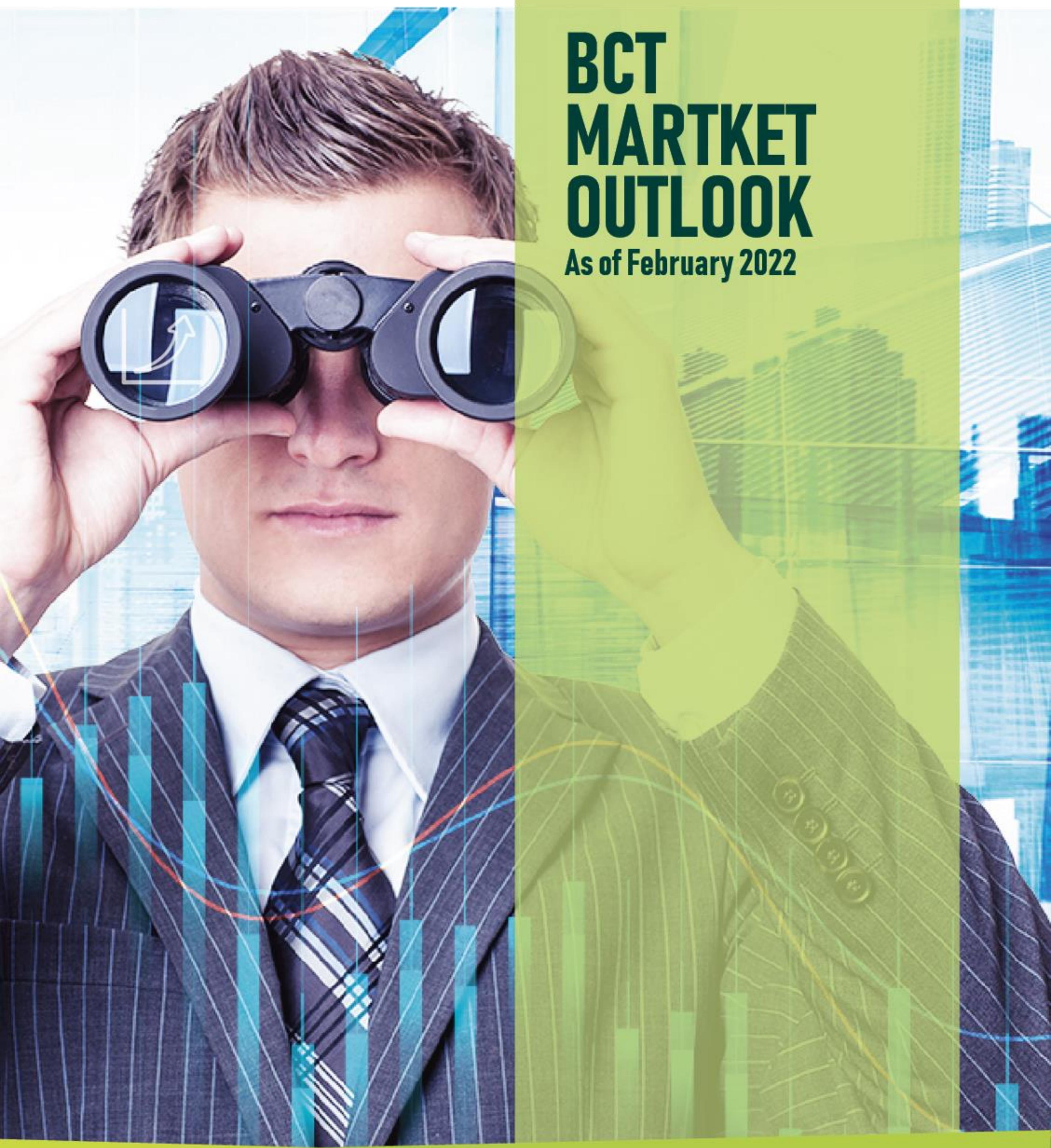
BCT MARTKET OUTLOOK

As of February 2022



Inflation worsens, tensions between Russia and Ukraine escalate

Investment Markets	BCT's Investment Views	Summary
Equities	▬	
US	▬	We are neutral on U.S. equities. Company-specific factors will increasingly drive allocation because inflation pressures will affect each company differently, depending on their ability to pass rising costs on to consumers.
Europe	▬	We are neutral on European equities, valuations are less stretched compared to U.S. and earnings growth is expected to stay robust. However, amid expectations of a milder economic impact from the latest COVID-19 variant, investors should focus on earnings growth.
Japan	▬	We are neutral on Japanese equities. Japan should benefit from improving earnings momentum, attractive valuations vs the rest of the developed world, and a weakening yen. Improving external demand is also positive for the export-oriented Japanese economy. However, Japan's borders remain restricted to outsiders until at least the end of February.
Asia ex Japan	▬	We are neutral on Asian equities regarding fragmentation in the Emerging Market (EM) landscape. Tourism still at risk with COVID-19 cases increasing and Chinese business still closed, impacting other Asian countries but vaccination progress, , EM/DM growth premium, economic rebound and earnings recovery are the main drivers of Asia ex-Japan equities.
China & HK	▲ / ▬	We are overweight on Chinese equities. We maintain a long position in China equity due to improving policy visibility (from tightening to target easing) amidst a stabilizing regulatory framework. Positioning, valuation and sentiment are becoming more supportive. We are neutral on Hong Kong equities. Having the same view as China, but more balanced by uncertainties brought by the recent COVID-19 outbreak.
Global Bonds	▬	
Government Bonds	▬	We stay neutral and flexible on government bonds. Chinese debt provides attractive carry opportunities and could be supported by risks from the new COVID-19 situation and structural inflows.
Credit	▲	Corporate credit is another area where we stay cautiously overweight in some segments. We focus more on selection and prefer short-term maturities. Indeed, credit long end suffered less than the rest, price sensitivity has been contained thanks to curve's bear flattening and spreads resilience.

Scales of weighting	▼	▬	▲
	Underweight	Neutral	Overweight

U.S. EQUITIES

In the U.S., the equity market had a rocky start of the year: inflation concerns and fears that the Federal Reserve (the Fed) will need to act aggressively with further rate led to a -5.2% return for the SPX 500 index. Headline Consumer Price Index (CPI) inflation rose +0.6% in January, annual inflation was up +7.5%. Core component (less food and energy) also increased 0.6% in January. Inflation acceleration was driven by the core component (goods and services). Activity indicators are pointing to a notable deceleration at the end of the Q4 and start of the Q1 (partially related to COVID-19). The labour market has shown signs of strength and tightness, translating into healthy fundamentals for consumers, who are nonetheless facing higher prices and greater uncertainty on the inflation outlook. On the supply side, while acknowledging early signs of easing, we still see bottlenecks capping production. Fed's central scenario remains that a rapid cycle of rate hikes will be enough to contain inflationary pressures. The tone of the Fed turned decisively hawkish amidst the strong labour market and the high inflation. The Fed also communicated a set of principles on balance sheet policy, including that the quantitative tightening will start after the start of rate hikes.

In 2022, we believe the U.S. economy will face a progressive deceleration, hovering above trend first and eventually converging to potential in 2023. We expect progressively less fiscal and monetary policy accommodation will drive the normalisation. Inflation will gradually retrace lower from recent highs while remaining above 3% for most of the year, as transitory drivers fade, leaving more structural drivers supporting inflation. The Fed will raise rates quickly until the Fed is comfortable with the outlook for inflation. This cycle is very different from the previous ones. We expect four hikes this year, possibly at two consecutive meetings (March and May) and a reduction in the Fed’s balance sheet starting in June or July. Global geopolitical risk spiked up with the escalation of tensions between Russia and Ukraine and the deployment of massive amount of Russian troops to the border with Ukraine’s Donbas region. The situation is still evolving, we attribute a limited probability a full scale invasion, but the implications on risk assets globally would be broad. We are neutral on U.S. equities. Company-specific factors will increasingly drive allocation because inflation pressures will affect each company differently, depending on their ability to pass rising costs on to consumers. On the other hand, operational challenges such as supply chain shortages and labour issues persist. Thus, selectively, we look for relative value and rotation plays.

EUROPEAN EQUITIES

In January, European equity indices posted negative returns, the MSCI Europe depreciated -3.1% in local total return terms. Lockdown severity and mobility data point to softer growth in the eurozone, deferring the recovery in sectors of the economy affected by social distancing restrictions, and already put under stress by higher energy prices and supply bottlenecks. January Eurozone PMI rose to 58.7, up from 58.0 in December, though slightly lower than the initial Flash estimate of 59.0. Data showed the Eurozone manufacturing sector has regained some momentum at the beginning of 2022, with production, new orders and employment all registering faster increases. In the latest meeting, the European Central Bank (ECB) turned more hawkish, as communication points to a data dependent stance on calibrating policy in the future. Despite confirming the forward guidance and the sequence between end of quantitative easing (QE) first and lift-off to follow later, Mrs Lagarde did not push back against rate hike lift-off implied in markets, as she had previously done in the past defining a rate hike in 2022 unlikely.

In Europe, we believe peak growth is now past and that the impact of Omicron and some new restrictions will translate into deceleration in activity between the end of 2021 and the beginning of 2022. We project Eurozone inflation to decline from recent peaks but to remain above the ECB’s target for most of the year due to the persistence of higher energy prices and supply bottlenecks. The recovery in domestic demand has been very uneven across the Euro area countries, with highly divergent recovery paths in terms of household consumption expenditure. We believe the spike in inflation poses a challenge for the ECB to conduct monetary policy for all Eurozone countries. A reduction in monetary accommodation would benefit certain countries while others would be negatively impacted. We are neutral on European equities, valuations are less stretched compared to U.S. and earnings growth is expected to stay robust. However, amid expectations of a milder economic impact from the latest COVID-19 variant, investors should focus on earnings growth. The key aspects are selection and pricing power to be assessed via a company balance sheet’s strength.

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JAPANESE EQUITIES

In Japan, the Nikkei 225 fell -6.2% and the TOPIX declined -4.8% in total return terms. Concerns over the U.S. Federal Reserve tightening its monetary policies further impacted on the Japanese market. The release of the minutes from the U.S. Fed meeting, as well as the corresponding adjustment in expectations for U.S. interest rates, set the tone for the equities market. Market sentiment has suffered as a result of this. The rapid increase in COVID-19 infections, driven by the Omicron strain, was another key contributor in January. Throughout the pandemic, the absolute number of infections in Japan has remained extremely low, but the current variation has once again exhibited a higher level of risk aversion. Monetary policy was left unchanged at the January meeting. Responding to a Reuters report on January 14th stating that the Bank of Japan (BoJ) is discussing a potential rate hike, Governor Kuroda pushed back hard on the possibility of early policy normalisation, indicating a hold in 2022.

Domestic demand saw decent rebounds in Q4, as the chip shortage eased and social distancing rules were lifted. However, the increase of Omicron cases in the new year and the return to soft social distancing rules brings uncertainties to Japan's economic recovery outlook, likely further delaying the "catch-up" in consumption. In its latest outlook, the Bank of Japan (BoJ) raised its 2022/2023 inflation forecasts, expecting core Consumer Price Index (CPI) to strengthen to just above 1%. In our view, the increase in CPI will be transitory this year, which is mainly driven by one-off positive base effects. This will be insufficient for the BoJ to justify a hike. We are neutral on Japanese equities. From a positive note, Japan should benefit from improving earnings momentum, attractive valuations vs the rest of the developed world, and a weakening yen. Improving external demand is also positive for the export-oriented Japanese economy. However, Japan's borders remain restricted to outsiders until at least the end of February, though the government has avoided reinstating the state of emergency. Omicron's overall effect has been to set back hopes for a full recovery of Japan's domestic economy.

ASIA EX-JAPAN EQUITIES

In Asia, returns were generally negative in January with few exceptions. Top of the table was Singapore with the Straits performing +4% lead by strong banking performance. In Singapore, the government expanded its vaccination requirements to more activities; allowing staff to return to office effective 1st January 2022 at 50% capacity. The Philippines +3.4% and Indonesia are also in positive territory with the Jakarta Stock Price Index (JCI) advancing by +0.8%, regarding the vaccine rollout in Indonesia, around 50% of the total population received a first dose and close to 30% were fully vaccinated. However, negative returns were seen in the other Asian markets. We find India with the Sensex down by -0.4% explained by the insurgency of the new Omicron wave in the country increasing the risks of deterioration of the economy. The Stock Exchange of Thailand (SET) managed to limit the loss to -0.5% whilst down in our table we find the Malaysian FTSE Kuala Lumpur Composite Index (KLCI) returned -3.5% with vaccine travel lane between Malaysia and Singapore frozen for now due to Omicron concerns. Australian Stock Exchange All Ordinaries Index (AS30) had a performance of -6.6% over the month. At the bottom of our table was the export-oriented and technology-rich (sector significantly affected in January) South Korea Composite Stock Price Index (KOSPI) with a return of -10.6%.

In Asia, we continue to believe investors begin to think that COVID-19 is becoming endemic. As vaccines and treatment options improve, we expect periodic sprouts in new infections across the region, with well-managed treatments and lower hospitalisation rates allowing the global economy to normalise. Some central banks have tightened policies, and we reiterate our expectations of a policy shift and the first Policy Rates hike in April 2022 from the central bank of India (RBI). In Indonesia, the COVID-19 outbreak is so far proving much more moderate than in other countries in the region, and Indonesia remains on a gradual recovery path. Despite increasing, inflation is unlikely to pose a serious threat to the inflation target and to push Bank Indonesia (BI) to hike, we have moved ahead the first hike by BI to Q2 2022. We are neutral on Asian equities regarding fragmentation in the Emerging Market (EM) landscape. Tourism still at risk with COVID-19 cases increasing and Chinese business still closed, impacting other Asian countries but vaccination progress, EM/DM growth premium, economic rebound and earnings recovery are the main drivers of Asia ex-Japan equities.

China & Hong Kong Equities

In China, the Chinese Shanghai Composite Index was a negative performer tin the region with a fall of -7.6%. In contrast, the Hong Kong Hang Seng Index experienced an appreciation of +1.7% in the last 30 days. The renewed COVID-19 outbreak has complicated China's recovery path. Holding to the zero tolerance policy, local governments started to tighten social distancing rules just ahead of the Chinese New Year, exerting downward pressures on growth in Q1. Responding to heightened downward pressures on growth, the People's Bank of China (PBoC) explicitly signaled additional front-loaded easing. Walking the talk, it cut the 7-day repo and 1-year Medium-term Lending Facility rate by 0.1% on 17th January, for the first time since March 2020. In Hong Kong, given that there were local Omicron cases, the government has flagged that social distancing measures will be tightened if there is an outbreak.

In China, we are revising our full-year growth forecast down to 4.5% from 4.7%. Inflation numbers have surprised on the downside lately, due to unusual declines in food prices. However, we are watchful of selective opportunities amid a more supportive policy stance now, and the country's long-term transition towards a balanced growth model and 'common prosperity.' Similar in China, Hong Kong listed stocks appear attractive now, as policy visibility has improved and current low valuations already reflect future uncertainty. We have to monitor de-rating risks arising from the COVID-19 variant, quicker-than-expected Federal Reserve (Fed) tightening, property sector volatility and trade talks. We see near-term risks in the zero-COVID policy and measures, along with a subdued environment around consumption and the real estate sector. We are overweight on Chinese equities. We maintain a long position in China equity due to improving policy visibility (from tightening to target easing) amidst a stabilizing regulatory framework. Positioning, valuation and sentiment are becoming more supportive. We are neutral on Hong Kong equities. Having the same view as China, but more balanced by uncertainties brought by the recent COVID-19 outbreak.

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GLOBAL BONDS

Global bond markets fell 2% last month, but still outperformed equities. However, January provided a stark warning to investors that in times of heightened inflationary risks, bonds provide less protection to portfolios than in times of recessionary risk. Recent yield movements are similar, but more aggressive to those seen at the beginning of last year, while the pace of increase and monetary policy stances are much different. The Fed has no choice but to act quickly: the labour market is historically tight and inflation is well above target. It is determined to move quickly and steadily away from its highly accommodative monetary policy. The priority is to address the risk of more persistent inflation with the strong rise in wages. The ECB confirmed its much less hawkish than Fed stance and the Bank of England's, keeping open-ended QE running for all of 2022, calibrating its size to cover most of next year's net debt issuance. Markets have been pricing in faster Fed rate rises resulting in a challenging start for traditional safe haven assets like sovereign bonds and precious metals. Credit also struggled whilst growing geopolitical tensions did prove supportive for oil prices.

Medium-term inflation risks are causing the Fed to indicate its quantitative tightening plans, which we think will depend on the strength of economic recovery. However, the Fed will balance the need to hike rates with high government debt and uncertain growth. We think there could be some room for surprises, as inflation will be structural in Europe too, led by commodity prices, supply bottlenecks and resurging demand. Inflation pressures arising from resurging demand caused core yields to rise and led the ECB to indicate tapering plans, although the central bank has been relatively dovish. We are also watching elections in France and Italy, and the Next Generation European Union plan. We stay neutral and flexible on government bonds. Chinese debt provides attractive carry opportunities and could be supported by risks from the new COVID-19 situation and structural inflows. Near-term pressures on the RMB persist. Thus, we stay overweight amid Chinese government bonds. Corporate credit is another area where we stay cautiously overweight in some segments, but they can suffer from a recalibration of the monetary policy in the U.S. and in Euro area. We focus more on selection and prefer short-term maturities. Indeed, credit long end suffered less than the rest, price sensitivity has been contained thanks to curve's bear flattening and spreads resilience.