BCT MARKET OUTLOOK

As of January 2020

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Long-term Pension Investing Under the Serious Epidemic

Investment Markets	BCT's Investment Views	Summary
Equities		
US		We remain cautiously neutral on the U.S. equities, the market is currently close to fair value. The rally in stock markets has been extreme, mainly driven by multiple expansion of price earnings ratio.
Europe		We are slightly positive on European equities. Europe is well positioned to benefit from the positive tactical factors (light positioning and increasing inflows, the signing of phase 1 trade deal between the U.S. and China, as well as the ECB's stance).
Japan		We are neutral on Japanese equities. Japanese equities rebounded but their valuations still remain attractive. This is a cyclical market that could benefit from a cyclical rebound. The phase 1 trade deal between the U.S. and China will stimulate trade and improve investment sentiment.
Asia ex Japan		We are slightly positive on Asia ex-Japan equities. As we head into 2020, we expect these markets to remain buoyant as trade tensions have de-escalated with the signing of phase 1 trade deal and the start of phase 2 trade deal negotiations.
China & HK		We are positive on China equities and we continue to maintain a preference for A-shares market, the domestic economic sector which should benefit the most from the economic policy stimulus. We are slightly negative on Hong Kong equities due to the ongoing domestic issues. Valuations are attractive on selective stocks, but there is little catalyst for price appreciation unless peace returns.
Global Bonds		
Government Bonds		We are neutral on government bonds and positive on corporate credit. We continue to maintain a positive credit exposure as the asset class is still favored in a late cycle environment, supported by the continued search for yield and technical factors especially in Europe.
Credit		

Scales of weighting:			
	Underweight	Neutral	Overweight

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U.S. EQUITIES
Domestic demand keeps slowing, with investment spending being hit worse than private consumption. Business climate surveys have worsened over the past few months but have recently shown signs of a tentative bottoming-out. The latest job market highlighted softer payrolls, which was still above the level needed to maintain current unemployment rate at 3.5%. The rate of slowing labor income growth was in line with our expectations, following both a decline in growth rate of working hours and hourly earnings. Payrolls growth also slowed, but it still depicted a sound labor market overall. Inflation remained low (2.1% for headline inflation and 2.3% for core inflation). Core personal consumption expenditures (1.6% year-over-year) remained close to, but below, the Federal Reserve (the Fed)'s target. The Fed considered its policy stance appropriate and well calibrated to support moderate growth and resilience on the labour market, and that another rate cut would require a "material reassessment of the economic outlook". Yet, as we expect some disappointment to come on growth, we are still penciling another rate cut for the first half of 2020. The U.S. S&P 500 made a new all-time high just before year-end by closing at 3,240 on 27 December. Despite a minor little pull-back into month-end, the index still managed to gain 3% in total return terms for December, and 9.07% in total return in Q4.

We expect a slight growth deceleration in the U.S. for 2020, with GDP running at 1.7% (from 2.3% expected for 2019). We continue to expect an upside move in headline inflation in the near term (2.3% in 2020), followed by slight moderation to 2.1% in 2021. The U.S. consumer market is moving along our scenario. While the labor market remains resilient in terms of the overall levels of working hours, payrolls and income, the momentum is slowing which implies decelerating labor income growth (it expands at 3.7% year-over-year, which is in line with the average value of last ten years). On the trade factor, phase 1 trade deal between the U.S. and China was formalized. In our risks map, we decrease the probability of trade war escalation. However, this is just a short-term relief, which is unlikely to end long lasting disputes. Critical issues remain unsolved and further negotiations will be required. While the uncertainty on the U.S.-China phase 1 trade deal dissipated, geopolitical risk spiked due to tensions between the U.S. and Iran after the killing of military commander, Qasem Soleimani, upon the order of the President of the U.S., Donald Trump. So far, no further escalations are expected and the risk sentiment on financial market has been impacted only temporarily. We are not changing our oil price targets (61 U.S. dollars over the next 12 months), as we expect volatility spikes to remain contained if no escalation takes place. We remain cautiously neutral on the U.S. equities, the market is currently close to fair value. The rally in stock markets has been extreme, mainly driven by multiple expansion of price earnings ratio. Corporate earnings are still in the final phase of this cycle and the high debt leverage specifically for the U.S. corporates tend to weight on margins. We would need to see earnings acceleration or material improvement in macroeconomic data to consider the valuations of U.S. equities appealing again.

EUROPEAN EQUITIES
Q3 GDP growth (+0.2% quarter-over-quarter) was slightly better than expected, leaving the year-over-year growth rate at 1.2%, we therefore might have to make a mild upward revision to our growth outlook for 2019 (currently 1.1%). After a very strong performance of gross fixed capital formation in Q2, investments moderated in Q3 while household consumption improved above expectations. The Purchasing Managers' Indexes (PMIs) of the Eurozone in December were more mixed, highlighting ongoing weakness in manufacturing and resilience/expansion in services. Inflation remained subdued and well below the target. The European Central Bank (ECB)'s new leadership team announced the initiation of a strategic review, which will be a long process that should be concluded in one year's time. About Brexit, the Conservative Party's large win in December's election set the scene for an orderly Brexit at the end of January 2020. However, there is still a big question mark as to whether the U.K. and the E.U. can sign a free trade agreement by the end of 2020 (scheduled deadline of the transition period in which the U.K. does not want to extend). In Europe, all the equity markets posted positive results in December, with the MSCI Europe up 1.67% in local currency total return terms, and up 4.49%

for the quarter.

In light of a more constructive global trade outlook, the Eurozone is expected to stabilize around potential level. Currently, there are little signs of an accelerating momentum ahead but a potentially bottoming out manufacturing sector. We forecast a 1.1% growth for 2020 and 1.3% for 2021. Household consumption should be the main driver of growth in the Eurozone, which plays a pivotal role in shaping its way along the growth stabilization process, while investments moderate. Fiscal incentives to new investments (e.g., "green" investments) may pose upside risks to our forecast. The labor market is sound in aggregate terms, the unemployment rate remains low, and wage growth is moderate. Price dynamics are expected to keep a positive momentum during 2020 across the Eurozone, but still far away from the ECB's target Inflation level. Inflation is expected to stay at 1.3% in 2020 and 1.4% in 2021. Although the labor market remains relatively strong, wage growth is not homogeneous among countries. Signals of expansionary fiscal policies remain limited to country-level implementation, given that all countries have not taken shape so far as a coordinated effort. A further push remains theoretically possible, in particular when the economy worsens and struggles to rebound. Overall, we are slightly positive on European equities. Europe is well positioned to benefit from the positive tactical factors (light positioning and increasing inflows, the signing of phase 1 trade deal between the U.S. and China, as well as the ECB's stance). Valuations are attractive considering the current phase of the cycle.

JAPANESE EQUITIES

The Japanese government announced the third largest economic package worth 26 trillion yen, in which one third of it will go directly to stimulate the economy. The National Diet is expected to approve the 2019 fiscal year supplementary budget by the end of January and to launch a project worth 4.4 trillion yen. The Bank of Japan (BOJ) suspended its taper in Japanese government bond purchase in December. Consumer sentiment, which dipped more than that in 2014, eventually bounced back. Weekly retail sales improved following the increase in consumer confidence, which marked the first year-over-year gain in three months. Consumer spending (excluding utility fees and including service) continued to narrow its year-over-year contraction. The announcement of a large-scale economic stimulus accentuated the improvement. On the corporate front, exports eventually stopped deterioration although export volume was still falling short of last year's level. Industrial production demonstrated harsh contraction primarily because stagnant car sales dampened auto and steel industries, which could not be completely offset by reviving electronics industry. Nonetheless, the December Tankan revealed that companies' aspiration to expand capital investment remained sanguine despite faltering sales and profits. Companies have accelerated the replacement of the old equipment and tools to boost productivity and to cope with labor shortage. As for investment in structure, the service industry has accentuated the refurbishment of hotels and shops for the Tokyo 2020 Olympic Games. Japanese market performed well, with the Topix up 8.4% and Nikkei up 8.9% over the quarter.

The combination of accommodative fiscal and monetary policy is expected to prompt the reacceleration of the economy in 2020 after quarter-over-quarter contraction of GDP in Q4. We revised upward our forecasts for growth and inflation on the back of the fiscal stimulus (adding 0.7% GDP in two years) and the newly released macroeconomic figures. We forecast the year-over-year GDP growth at 0.9% for 2020 and 0.8% for 2021, and inflation rate (year-over-year Consumer Price Index) at 0.8% for 2020 and 0.6% for 2021. At the December meeting, the BOJ kept its policy unchanged as widely expected. The forward guidance was unchanged as in the last meeting. The BOJ might still consider additional easing in 2020 if geopolitical risks increase again and yen strengthens materially. We expect a 0.1% rate cut in the next 12 months on the following two conditions. First, a cut in the short-term interest rate target must be accompanied by realignment of the three-tiered structure in the BOJ's current account deposit in order to mitigate adverse effects on financial institutions. Second, the BOJ will obviously keep the longer-end of the curve from declining, in order to secure the slope of the curve. Overall,

we are neutral on Japanese equities. Japanese equities rebounded but their valuations still remain attractive. This is a cyclical market that could benefit from a cyclical rebound. The phase 1 trade deal between the U.S. and China will stimulate trade and improve investment sentiment. Corporate balance sheets are under-leveraged and buybacks are increasing. However, this market remains more exposed to yen dynamics and sensitive to the delicate evolution of the U.S.-China trade dispute. We prefer to keep a neutral stance.

ASIA EX-JAPAN EQUITIES

After many deep negative quarters, Asia has finally improved its macroeconomic momentum driven by the performances of Taiwan and Korea. South Korea's exports in the first 20 days of December (one of the leading indicators on the external sector) showed signs of stabilization (even at relatively weak levels). The base effect alleviated November's negative figures somewhat. The region's inflation figures remained very benign. Notably, November's figures came once again from India and China, with higher-than-expected food basket components (fuel prices, too, in India), at 5.5% year-over-year and 4.5% year-over-year, respectively. Emerging markets' central banks kept their easing of policy rates, although at a slower pace than before. In December, the Reserve Bank of India unexpectedly put the rate on hold (at 5.15%) given that inflation levels approached the upper band level. Indonesia announced a recalibration of its fiscal deficit target at above 3% of GDP. Improved prospects of the US-China trade deal resulted in a positive outlook on global demand and corporate earnings recovery, particularly in the technology sector. Earnings expectations for Asia ex-Japan equities were revised up in December, with positive revisions across Indonesia, Malaysia, South Korea, Singapore and Taiwan. Asian equity markets were the top beneficiaries of the risk-on investor sentiment. The MSCI Asia ex-Japan rallied (6.7%) and significantly outperformed the MSCI World Index (3.0%). Most Asia ex-Japan currencies finished higher against the U.S. dollar, which depreciated given a dovish Federal Reserve (Fed) and easing trade frictions.

The economic growth outlook of the emerging markets in 2020 is constructive. We expect Asia to continue to benefit from progress in trade negotiations. Externally, the signing of the phase 1 trade deal should provide some support. Following a further leg down in the emerging market exports due to September's new round of tariffs, the latest figures released for November and December showed some signals of stabilisation (though only a few countries released their figures for December). Policy bias remains, in general, tilted towards accommodation for Asian economies. Liquidity conditions remain conducive to economic growth going forward. Some scattered signs showed that the fiscal stance of emerging markets in Asia is more expansionary. In December, a bold 2020 budget law was approved in Indonesia. South Korea, the Philippines and India also announced larger expenditure plans. We maintain the preference for Korea which shows some signals of bottoming out. Korea is well positioned to benefit from the short-term mild recovery in the global economic cycle and that the stock market has already discounted many negative news. We are slightly positive on Asia ex-Japan equities. As we head into 2020, we expect these markets to remain buoyant as trade tensions have de-escalated with the signing of phase 1 trade deal and the start of phase 2 trade deal negotiations. Asian equities are attractive on a relative value basis. We favour domestic consumption stories.

CHINA & HONG KONG EQUITIES

Most of the economic data rebounded (except in the property sector), which was in line with prior's market expectation of data stabilisation. However, economic conditions remained quite sluggish. The trade surplus with the U.S. kept narrowing as exports continued to decline while imports mildly increased. Headline inflation kept rising driven by the food component prices, while core inflation and producer price index remained muted (core consumer price inflation grew at 1.4% year-over-year). On 1 January 2020, the People's Bank of China cut the reserve requirement ratio by 0.5% from 10.5% to 10.0%. The cut was system-wide, which was expected to inject liquidity into the system.

The phase 1 deal between the U.S. and China was formalized. The Central Economic Working

Conference set out next year's targets (not yet official): stable growth, no change in the policy mix and enhancing growth quality. Hong Kong's economic activity slowed further amid the prolonged social unrest, which severely hit consumption and tourism-related segments. Retail sales have lost momentum since June, and contracted by 26.2% year-over-year in October, which was the sharpest decline since 1982. China equities rose 8.3% in December, closing 2019 on a strong note with an impressive 23.5% annual gain. The main factor for this strong finish was the agreement between the U.S. and China on a phase 1 trade deal. Hong Kong's equity market also benefitted from the trade deal and rose 4.0% in December.

We confirm our GDP forecast in China at below 6% for 2020 (5.8% year-over-year for 2020 and 2021). China's policy mix will continue with its stimulating stance, though far from the massive stimulus implemented in recent years. Both expansionary fiscal and accommodative monetary stimulus will be deployed to positively impact the economy in 2020. The People's Bank of China will continue its accommodative stance with every tool considered necessary. New headline inflation figures (4.5% increase year-over-year in December, which was about the same as in November) shouldn't prevent the Central Bank from remaining accommodative. We are positive on China equities and we continue to maintain a preference for A-shares market, the domestic economic sector which should benefit the most from the economic policy stimulus. Also, flows will continue to be supported from the gradual lift of the A-share inclusion factor following the plan set by MSCI. In Hong Kong, after 6 months of incessant protests, tensions remain high and it does not appear to have any end in sight. Valuations are attractive on selective stocks, but there is little catalyst for price appreciation unless peace returns. We are slightly negative on Hong Kong equities due to the ongoing domestic issues.

GLOBAL BONDS

Fixed income markets generally suffered in December because of the trade deal agreement between the U.S. and China, and some stabilisation/improvements in economic data. But the absolute level of bond yields also affected overall returns, with Europe and its negative bond yields notably underperforming the U.S., where higher yields and coupons of the latter offered some protection against falling prices. With the Fed still supporting the front end of the yield curve via liquidity injections, the short-dated part of the yield curve actually saw falling yields during December and Q4, with the U.S. 2-year Treasury bond yield falling 0.04% in December to 1.57%, and falling 0.05% over the quarter. Further out the curve, the U.S. 10-year Treasury bond yield started December at 1.78% and finished at 1.92% (a rise of 0.25% during Q4) whilst 30-year bond yield moved up 0.18% in December and up 0.28% in Q4 to finish the year at 2.39%. The much-awaited spread between the 2-year U.S. bond yield and the 10-year bond yield widened substantially from 0.05% at the end of Q3 to 0.35% by year-end. The trend in breakeven inflation rates during the quarter was steadily higher, starting October at 1.52% and finishing the quarter near the highs at 1.79%. The European fixed income markets mainly took their direction from the U.S. Treasuries, but with some added underperformance coming from the cutting of long duration positions. December was a record month for spread tightening both for Euro and U.S. dollars high yield bonds, which was one-fourth of the overall spread tightening in 2019 (roughly 0.50% of the 2% yearly tightening).

The global slowdown that began in mid-2018 is expected to extend into 2020, implying sub-potential growth in most countries. As a result, inflation is set to remain contained and below central banks' targets. Apart from the ongoing weakness of the manufacturing sector, subdued inflation is the prerequisite for monetary policy easing. Against such backdrop, nominal rates will continue to go lower and breakeven inflation will remain bounded in its sub-par ranges, therefore real yields will not move too much away from historical lows. The market is pricing 0.20% cut from the Fed and no move on the rate from the ECB over the next 12 months. The U.S. 10-year nominal bond yield does not look dislocated right now, which is in line with market expectations on growth and inflation. In the medium term, the U.S. Treasury bond yield is expected to move in the range of 1.70 to 2.00%. We continue to maintain a positive credit exposure as the asset class is still favored in a late cycle environment, supported by the

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continued search for yield and technical factors especially in Europe. Valuations are tight especially in high yield segments, so selection becomes crucial. In Europe, we continue to maintain a positive view on peripheral spreads as a yield enhancing strategy. We are neutral on government bonds and positive on corporate credit.

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