BCT
銀聯集團

Who will recover faster as pandemic lingers?

Investment Markets	BCT's Investment Views	Summary
Equities	Underweight	
US	Underweight	Overall, we remain negative on the U.S. equities, due to geopolitical risks coming from the U.S.-China tensions, the uncertainty in the pandemic evolution and the lack of clarity on the U.S. election. Furthermore, the latter could potentially lead to changes in regulations and taxation policy.
Europe	Neutral	We are now neutral on European equities. Europe has suffered during the past cycle. Two factors have revived international interest: the Recovery Fund plan, and the cyclical improvements.
Japan	Neutral	We are neutral on Japanese equities. Japan has experienced ups and downs in the previous cycle. Being one of the most cyclical markets in the world, it is benefiting from the current cyclical catch-up. Should it be confirmed, it could benefit the remainder of the year. asia
Asia ex Japan	Neutral	We are neutral on Asian equities. We keep focusing on the 'First in, first out' story. The COVID-19 crisis will further exacerbate the differences between Asian countries, with some of them more resilient to the crisis than those with external vulnerabilities, high debt and limited policy room.
China & HK	Overweight	We are positive on China equities, the Chinese economy is showing signs of a broad based recovery, led by infrastructure and housing, under strong credit support. We are neutral on Hong Kong equities. Markets warmly welcomed the national security law as it will place some economic stability in the market in the near term. However, we cannot rule out the possibility of long term negative impact which this law may bring.
Global Bonds	Overweight	
Government Bonds	Overweight	We remain positive on government bonds. We maintain our preference for the U.S. Treasuries against others, on better absolute and relative valuations and that the Fed have more leeway available through unlimited QE. We remain positive on credit. Major central banks will directly support issuers via their purchasing programmes for an extended period of time.
Credit	Overweight	

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

In June, the U.S. equity market rally slowed down with the S&P 500 up 1.99%. Worries over rich valuations and a rebound in infections are persuading investors to be patient. Yet, the technology sector continued to enjoy strong momentum given its resilience during the pandemic. The NASDAQ was up 6.07% in the month. The pace of the contraction in economic activity was estimated to have accelerated in Q2 2020 with the real GDP contracting by 5% on annualised basis, in Q1. The economic downturn deepened further. More recently, the trend has inverted, the Purchasing Managers' Index (PMI) showed improvements with better manufacturing conditions as goods producers and shops began to reopen thanks to looser restrictions. The downward trend in production eased as new orders stabilised with reports pointing to improved demand conditions. The Federal Open Market Committee made just one policy change, by committing to maintaining at least the current pace of asset purchases over the coming months at $80 billion in the U.S. Treasuries and $40 billion in mortgage-backed securities per month. But it gave investors greater certainty that policy will remain on hold for a long time. The Federal Reserve (Fed) will wait to have more clarity on the path of the recovery before fine-tuning other monetary policy tools. The median of members' projections saw near-zero federal funds rate at least through the end of 2022. The U.S. household debt was at 97.1% of GDP, at the end of 2019. The cost of servicing household debt was at its lowest level since 1980. Savings were also at a healthy 7.7% at the end of 2019, which increased dramatically during the pandemic, to 33% in April. The lockdown weighed heavily on the U.S. consumers, retail sales highlighted a dichotomy between non-durable goods consumption and services consumption, with the former up strongly and the latter in freefall. As lockdown measures are lifted gradually, services seem still far from a recovery. Soft consumer confidence reflected labour market weakness, with the unemployment rate up sharply from 3.5% in February to 14.7% in April. It could peak at about 15% and be volatile in the near term. The massive government support and generous unemployment benefits provide the means for consumers to weather a short but deep recession.

While hard data help to size the lockdown-induced impact on Q2 activity and production, soft and high-frequency data are showing a gradual pickup. As pent-up demand comes through, activity might rebound over Q3, followed by further improvement at the end of the year. We expect the GDP to drop by 4.5% to 6.5% year-over-year in 2020, followed by a rebound of 3 to 4% year-over-year in 2021, and to return to its pre-COVID-19 level by mid-2022. Lockdowns also impacted inflation, driven by shifts in demand and exhibited short-term weaknesses in 2020, with reflating forecast in 2021 on base effects and a pickup in demand. We expect the

2020 presidential election to take place on 3 November. But the pandemic may have changed priorities among voters, highlighting new themes around which the presidential candidates will need to reshape the narrative of their campaigns. Following the debt spike, raising tax revenue will be crucial: a Democratic President may increase taxes on large corporations, high income earners and on financial wealth (capital gains and dividends). The U.S.-China fissures are opening up in many areas, ranging from the COVID-19 response to trade and geopolitics. The U.S. election campaigns and the hard rhetoric from the President of the U.S., Donald Trump, could exacerbate tensions, with negative spill-over effects. Topics such as the technology war and Huawei, the capital war on foreign holdings, reshoring and the recent Hong Kong events are sources of risk for markets. The trade deal remains in place, but phase two negotiation may be more challenging under the deteriorating economic backdrop. Another risk comes from a rising COVID-19 infection. At the end of June, the U.S. recorded 40,000 new cases a day but it could rise to 100,000 if behaviors do not change. Overall, we remain negative on the U.S. equities, due to geopolitical risks coming from the U.S.-China tensions, the uncertainty in the pandemic evolution and the lack of clarity on the U.S. election. Furthermore, the latter could potentially lead to changes in regulations and taxation policy.

EUROPEAN EQUITIES

European equity markets rallied strongly for a third consecutive month, the Euro Stoxx was up 5%, driven by improving macro data and continued monetary and fiscal support from policymakers. The rally was led by cyclical sectors where financials was by far the strongest contributor. Technology and Industrials were also standout performers, both comfortably beating the broad market average. The economy is facing a contraction of a magnitude and speed unprecedented in peace time, with measures to contain the spread of COVID-19 already showing its profound effects. In Q1 2020, the Eurozone's real GDP decreased by 3.8% quarter-on-quarter and incoming data pointed to a further significant contraction of the real GDP in Q2. Surveys of economic activity showed marked improvement through the spring. The flash Eurozone composite PMI for June rose to 47.5, compared to 31.9 in May. The European Central Bank (ECB) delivered a stronger than expected combination of measures by increasing the Pandemic Emergency Purchase Programme (PEPP) in size, the envelope will be increased by 600 billion euro to a total of 1,350 billion euro; extending horizon of net purchases, the horizon for net purchases under the PEPP will be extended to at least the end of June 2021; and fixing long horizon for reinvestments, the maturing principal payments from securities purchased under the PEPP will be reinvested until at least the end of 2022. At its last meeting, the Bank of England (BoE) left rates unchanged and expanded its asset purchases by 100 billion pound, broadly in line with the consensus of expectations. Thanks to the latest extension, quantitative easing (QE) would see purchases run until the end of the year, the BoE is pointing to a slower pace of weekly asset purchases relative to the current one.

After the trough in Q1 (the GDP was down 13%, quarter-over-quarter), we expect economic activity to rebound for the second semester, leading the Eurozone's growth to contract by 8% to 10% year-over-year in 2020, followed by a pickup of 4.5% to 6.5% in 2021. 2019 GDP levels are unlikely to be reached until late 2022. High frequency indicators show that the recovery is on track, although gradual, while confidence is not reaccelerating fast. Disinflationary pressures in 2020 are induced by shifts in demand or production shortages, although underlying components of the basket show diverging trends. In 2021, inflation is expected to normalise while remaining subdued regarding the ECB target. Some European Union (EU) countries will face their third contraction in 12 years, as it is reflected in their labour markets. The average wage growth in the Eurozone was 2.3% year-over-year in early 2020, yet with a mixed picture at the country level. Governments have implemented extraordinary schemes to encourage the use of reduced working hours schemes rather than layoffs. If their implementation is at least partly successful, we could see the Eurozone's unemployment rate peak in a range between 12% to 14%. Cyclical conditions are turning more positive for Europe. Easing geopolitical risks and the prospect of massive fiscal resources and monetary measures could support a recovery in 2021. The improved sentiment could benefit equities that have recently been laggard. This could lead to a catch up of European equities in relative terms against other markets. Compared to the rest of the world, infection rate in European countries fell. Most European countries have already reinforced their healthcare systems and policies to fight a possible second wave that we expect it to be more contained than the first one. However, the evolution and the scale of the second wave are key concerns, following first signs of localised outbreaks in Germany and, most recently, the U.K. and France. We are now neutral on European equities. Europe has suffered during the past cycle. Two factors have revived international interest: the Recovery Fund plan, and the cyclical improvements. This revival has further to go. This view depends on a gradual normalization of economic conditions, continued policy actions, implementation of the recovery fund and no aggressive second wave of the pandemic.

JAPANESE EQUITIES

After a volatile month, Japanese equities posted a slight positive return, with the MSCI Japan up 0.13%. The Government had lifted its COVID-19 alert on 11 June and the focus had been on a resumption of economic activity. However, sentiment suffered from rising market concerns about a second wave outbreak, following an increase in the number of new infections in Tokyo. Following a relatively short lockdown, Japan's domestic economic activities were gradually recovering. Mobility picked up in workplace, retail and recreation areas. By mid-June, these activities were down by only 10% to 20% from March. In contrast, external demand indicators continued to weaken, with Q2 exports in their steepest fall since Q1 2009. We believe that Japan is less impacted than other developed markets, with a better control over the COVID-19 outbreak, and we forecast the GDP to drop by 4.1% to 4.7% for the full year. Inflation will stay soft, as deflationary pressures persist in the services sector. Following up on the government's plan to expand the no-interest/unsecured lending program, the Bank of Japan (BoJ) increased its special lending program from 75 trillion yen to 110 trillion yen in mid-June, in addition to Japanese government bond purchases and exchange-traded fund (ETF) purchases at 12 trillion yen per year. The June meeting statement downplayed the inflation target, reducing the likelihood of further easing. The Governor of BoJ, Haruhiko Kuroda, also hinted that the central bank will not raise interest rates in 2021 and 2022 fiscal years, before the Fed. He reiterated that the stability of the yield curve at low levels is important.

We denote that some cyclicality could lead to a strategy to capture the inflection of the cycle. 'First in, first out' is a prudent way to invest. Japan, lifting its lockdown, is one of the best candidates among some other countries in Asia. We could have an interest into Japan, as it is cheap, has low corporate leverage, an improving earnings profile and an inverse sensitivity to the yen. In terms of currencies, the Japanese yen is the winner, as it is undervalued and its safe-haven status adds support when growth expectations are downbeat. We expect the GDP to be hit hardest in Q2, as the emergency had been declared over the period. The consumption growth turned to be more positive in May, after the lockdown had been relaxed. If it turns to be persistent and the pandemic is contained over time, the GDP growth is likely to recover in subsequent quarters and into 2021. We are neutral on Japanese equities. Japan has experienced ups and downs in the previous cycle. Being one of the most cyclical markets in the world, it is benefiting from the current cyclical catch-up. Should it be confirmed, it could benefit the remainder of the year. However, we must keep monitoring the risks arising from the number of new COVID-19 cases in Tokyo.

ASIA EX-JAPAN EQUITIES

Asian equity markets performance was positive, with the MSCI Asia ex-Japan outperforming and up 8.37% over the month, as investor sentiment was boosted by re-opening of economies as lockdowns were lifted, better-than-expected U.S. economic data, a re-affirmation of the U.S.-

China phase-one trade deal and hopes of fresh stimulus from governments and central banks. The MSCI Taiwan was the best performing market in Asia ex-Japan in June, up 9.12%. The technology sector outperformed, driven primarily by strength in Apple's supply chain given the positive outlook in the second semester, following Samsung Electronics' strong sell through. Despite this positive sentiment, industrial production rose only 1.5% year-over-year in May. Following a 1.4% rise in April, export orders fell 0.6% in May, signalling fatigue from external demand. South Korea garnered 8.09% growth in the month on the strong performance from healthcare, in response to the resurgence of the pandemic. Macro-economic data were mixed with industrial production falling 6.7% month-over-month and a soft manufacturing PMI at 41.3 in May. However, retail sales were surprisingly strong, rising by 4.6% month-over-month and the Producer Price Index was flat in May. The MSCI Thailand was up 2.07% in June, correcting itself after a swift rally in the first week of June, as investors were spooked as the state of emergency was extended by another month. The Bank of Thailand (BOT) encouraged commercial banks to step up debt restructuring, relaxed regulations to encourage loan extension and defer dividends, which led to profit taking in the latter half of the month. BOT held its policy rate at 0.5% after easing 0.75% year to date as domestic demand remained subdued in May, with private consumption rising 3.9% during the month as the economy re-opened.

Taiwan is likely to be one of the biggest beneficiaries from the ongoing demand for 5G. Panel manufacturers should also enjoy the continued demand and rising prices. Rising political tensions between North and South Korea is one of the major concerns in the Korean market. Communication lines were cut and liaison office in North Korea was also destroyed. In the Philippines, slower traffic, lower overseas Filipino workers' remittance and closing of the Philippine Offshore Gaming Operators are likely to drag the economies and the other complementary services. We are neutral on Asian equities. We keep focusing on the 'First in, first out' story. The COVID-19 crisis will further exacerbate the differences between Asian countries, with some of them more resilient to the crisis than those with external vulnerabilities, high debt and limited policy room. Asia is one of the main candidates to exploit the road of recovery. With globalisation under threat, the relocation of supply chains and the domestic demand engine theme will be further reinforced.

CHINA & HONG KONG EQUITIES

With 8.98% rise in June, the MSCI China returned into positive territory in year-to-date terms. Investors remained confident on the government's efforts to contain the outbreak, as new confirmed cases in Beijing were well contained and was trending downwards. Small, localized cases had been handled swiftly, which had negligible impact to the overall health of the economy. Economic recovery appeared to be underway with June's manufacturing PMI rising to 50.9 from 50.6 in May and Caixin PMI rising 0.5% to 51.2. Investors' sentiment remained buoyant despite some rising tensions in geopolitics as China implemented Hong Kong Security Law on the 23rd anniversary of the handover. The Peoples' Bank of China (PBoC) also announced 0.25% cut in the re-lending rate and more easing measures are expected in the coming months. As top financial regulators gathered in Lujiazui Forum in Shanghai, their remarks on monetary policy tilted towards the hawkish side. Easing will be selective going forward, the central bank will continue to guide borrowing costs lower but there is little tolerance for financial arbitrages. The banking sector was advised to share 1.5 trillion renminbi profits with the corporate sector, although two third of it had been implemented through the easing in the first half of the year. This implies further room for lending rate cuts in the second semester. The State Council also vowed for more reserve requirement ratio cut(s) in the near term. The MSCI Hong Kong outperformed in June with 11.04% gain, despite lingering concerns over the rising infection cases and potentially rising geopolitical tensions. Trade activities were weaker than expected in May, reflecting slower demand globally with exports contracting 7.4% year-over-year and imports fell 12.3% year-over-year. Retail sales also fell 33.9% in May, with sales of luxury goods plunging 72.4%. Inflation remained muted with the CPI rising 1.5% in May, which was lower than 1.9% in April as unemployment rate rose0.7% to 5.9%, the highest since 2009.

In China, economy continued to grow above trend sequentially in May, led by public investments and a steady pick-up of consumption. Q2 growth is tracking at 2% to 3% year-over-year, with seasonally-adjusted sequential growth close to 10% quarter-over-quarter, reversing the fall of 9.8% in Q1. We expect sequential growth to normalize down in the second semester. Year-over-year growth will print at 5% to 6% during the same period. Inflation dropped faster than expected, driven by declining pork prices. We expect the CPI to drop to 0% year-over-year in Q4 with subdued inflationary pressures and high base of last year. In April, two months after the peak in new infections, retail sales were still growing below trend. High-frequency data show that sales in catering, travel and the hotel industry – the hardest hit sectors – remained well below their normal levels in May (-30% to -40%), due to a combination of deteriorating household cash flows, ongoing epidemic control and cautious consumer behaviour. Having said that, goods consumption was recovering faster than services consumption, as it was facilitated by online shopping. Pent-up demand supported discretionary consumer goods spending, especially auto sales. Consumer staples demand proved resilient throughout the outbreak, and this strength has extended into the reopening phase. Food sales were particularly strong, up 18.2% year-over-year in April. Against such a backdrop, China's consumption will recover slowly. While the loss in services consumption is permanent, the momentum of goods sales could cool somewhat after the pent-up demand wears out. We are positive on China equities, the Chinese economy is showing signs of a broad based recovery, led by infrastructure and housing, under strong credit support. Positive momentum is also exhibited in the exports data as global economies are starting to reopen. Although inflation remains muted, the PBoC remains prudent and monetary easing has temporarily stopped as the housing sector continues to remain strong with robust sales. We are neutral on Hong Kong equities. Markets warmly welcomed the national security law as it will place some economic stability in the market in the near term. However, we cannot rule out the possibility of long term negative impact which this law may bring, including the removal of special status granted by the U.S. and the emigration of Hong Kong people to other parts of the world. The property sector may be boosted in the short term given stability in the economy.

GLOBAL BONDS

Fixed income markets posted mixed returns over the month, with corporate bonds outperforming government bonds, mainly supported by influence of central banks. The May rally in risk assets extended into June, and credit spreads tightened amid further policy support. Over the quarter, the Fed acted quickly and strongly to flood the system by offering various facilities and aggressive asset purchases. The Fed also made its first ever foray into the high yield market by committing to buy "fallen angels" bonds. In this environment, since March, the U.S. yield curve steepened, moving lower in the short to mid-maturity of its segment with the U.S. 2-year yield falling by 0.10%, ending at 0.15% and the 10-year yield starting the quarter at 0.67% and finished at 0.66%. With the ultra-accommodative monetary policy and the encouraging steps on the EU fiscal front, the German curve finished the quarter close to the values posted at the end of March. Although in April it initially moved further into negative territory, the German 10-year yield then rose from -0.47% to -0.46% at the end of June. The German 2-year yields moved less than 0.1%, closing June at -0.70%. With Brexit back in focus, the U.K. 10-year bond yield was 0.18% lower at 0.17%. The U.K. 2-year yield dropped below zero for the first time, finishing at -0.08%, as the BoE discussed the possibility of negative interest rates.

We believe that growth will remain low in the short to medium term, with downward inflationary pressures. Developed market governments will run up record deficits to address the crisis. In the U.S., the federal budget deficits for 2020 and 2021 fiscal years are to hit their highest levels since the World War II as a share of GDP: 18% in 2020 ($3.7 trillion) and 9.8% in 2021 ($2.1 trillion). We expect this massive supply will not lead to a massive rates sell-off. Central banks are buying assets at an unprecedented pace, absorbing the new government funding needs. Basically, sovereign core bond yields are now controlled by central banks. The Fed announced unlimited treasury and mortgage-backed securities purchase. The ECB is working to reduce financial fragmentation and prevent peripheral spreads from widening. It is ready to do more, as it is committed to ensuring monetary policy transmission to every country in the Eurozone. Ultra-accommodative central banks and strong fiscal support continue to gradually normalize market conditions, causing weakness of US dollar. However, as markets are now addicted to central bank support, there is a risk of an increase in credit defaults when this support fades. Therefore, in their search for yield, investors should ensure that they don't go too low in the credit quality spectrum because the risks are asymmetric. We remain positive on government bonds. We maintain our preference for the U.S. Treasuries against others, on better absolute and relative valuations and that the Fed have more leeway available through unlimited QE. We are constructive on the peripheral countries because the ECB's recent expansion and extension of its PEPP, and the encouraging steps on the EU fiscal front. Core curves should remain stable and close to current yield levels. We remain positive on credit. Major central banks will directly support issuers via their purchasing programmes for an extended period of time. Investment grade corporates are increasing their cash holdings. The primary market has recorded high activity levels. Financing conditions should remain accommodative for investment grade issuers, with solid investor demand, as these bonds offer good investment opportunities in a low yield environment with rising default rates.
