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BCT MARKET OUTLOOK

As of Jul 2022

SIGNS OF ECONOMIC SLOWDOWN MAY GRADUALLY EMERGE AMID CENTRAL BANKS' TIGHTENING POLICY AND WEAKENING DEMAND

Investment Markets	BCT's Investment Views	Summary
Equities	▬	
U.S.	▲	Recession is not our base case scenario, but the continuing policy tightening by the Fed amid high inflation could affect growth and corporate earnings. We prioritise value, quality and dividend oriented stocks while avoiding expensive growth and mega-caps.
Europe	▼	The Russia-Ukraine war is exacerbating pressures on inflation and could weigh on demand in the region, affecting corporate earnings and valuations. We remain watchful but believe businesses with strong balance sheets and ability to pass on rising costs to consumers could preserve profits.
Japan	▬	A deceleration in global growth could weigh on the export-driven Japanese market but a weak yen may be supportive for the country's equities. We are neutral in light of the cyclical nature of country's market.
Asia Ex-Japan	▬	We are neutral on Asian equities, although most central banks took steps to normalise policy, Southeast Asian countries continued to make progress on reopening.
China & Hong Kong	▲	As the country moves towards a healthy domestic consumption-driven growth model, the desynchronization of China from the global economy, supportive policies and the economic reopening paint a better picture. We are constructive on mainland shares.
Global Bonds	▬	
Government Bonds	▬	We are neutral on government bonds. In the U.S., as the Fed continues its aggressive tightening trajectory, the pressures on core yields are twofold, coming from economic growth and higher Fed rates.
Credit	▲	We remain slightly positive on investment-grade equities. In the U.S., corporate fundamentals are strong due to the ability to pass higher input costs to consumers.

Scales of Weighting	▼ Underweight	▬ Neutral	▲ Overweight

U.S. EQUITIES

The U.S. equity markets had a negative month, with the S&P 500 fell 8.3% in June. This quarterly performance was the second worst since the Global Financial Crisis in Q4 2008. Multiple signs pointing to slower growth together with high prints of inflations and a more aggressive pace of rate hikes from the Federal Reserve (Fed) affected investors' sentiment. Central banks are acting aggressively to curb inflation, while higher borrowing cost together with the squeeze on consumers is affecting economic growth. June's Consumer Price Index (CPI) at 9.1% year-on-year topped consensus estimates was disappointing those investors looking for price increases to slow down. U.S. Manufacturing Index was 52.7 in June, down from 57 in May. The headline Purchasing Managers' Index (PMI) dropped to its lowest level since July 2020. Demand growth is cooling as households are facing increased living cost and capital spending by companies is also showing signs of moderating due to tightening policy. Further reduction in new orders in June contributed to the drop in the headline Index.

The loss of asset value in the U.S., coupled with high inflation, may cause growth to slow. From our point of view, however, a recession is not likely. High inflation and slower growth are the consensus now, though it is not completely understood by the markets. Consumption and labour markets remain strong. We are slightly overweight in U.S. equities. Recession is not our base case scenario, but the continuing Fed's policy tightening amid high inflation could affect growth and corporate earnings. We are overweight in U.S. value equities. The sell-off in June failed to curtail value equities' outperformance but investors should be selective, explore companies in less cyclical segments and maintain a quality bias. We are underweight in U.S. growth equities. As the repricing in equities and rates continues, growth names whose valuations depending on future cash flows could be further dragged down. Although valuations have fallen in some areas, they are still not cheap and we remain cautious overall in growth stocks.

EUROPEAN EQUITIES

The European equity indices posted negative returns during the month, with MSCI Europe depreciating 7.7%. Markets had a negative quarter but a large portion of negative returns was experienced in June due to concerns over global growth, inflation and the ability of the European Central Bank (ECB) to contain inflation. Eurozone inflation soared to a record level of 8.1% year-on-year, feeding concerns of a more hawkish move from the ECB. Markets reacted strongly after the speech of ECB's President Christine Lagarde, increasing investors' expectations of rate hikes and suggesting the ECB will act strongly to fight inflation even at the expense of economic growth. Consumer confidence has fallen dramatically with raising concerns of outright gas supplies shortage and potential rationing. Inflation in the Eurozone hit another record high in June, as the war in Ukraine stokes energy and food prices. Inflation pressures have broadened and intensified following the sharp increase in prices for many goods and services. In June, Eurozone PMI fell to 52.1 from 54.6 in May signalling a broad-based weakening of the Eurozone manufacturing with production dropping for the first time within two years.

The Russia-Ukraine war is exacerbating pressures on inflation and could weigh on demand in the region, thereby affecting corporate earnings. Hence, we remain vigilant in the near term, and believe businesses with the ability to pass on rising costs to consumers should be able to preserve profits. The upside revision to Q1 Gross Domestic Product (GDP) figure, from 0.3% to 0.6%, masks weak domestic demand, especially on consumption side, and does not bode well for the rest of the year. Higher realised and projected inflation will translate into weaker domestic demand making us to expect a broadly flat growth this year, with contraction risks concentrated on Q2 and Q4. The ECB remained hawkish at its last regular meeting and had its rate hikes in July, followed by a likely +0.5% in September, if the inflation does not improve. This should be followed by "a gradual but sustained path of further increases". Europe is facing challenges on multiple fronts, we are underweight in European equities and we believe rising input prices and rates will weigh on corporate earnings and valuations.

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JAPANESE EQUITIES

The Nikkei 225 declined to 3.1% in total return terms in June. For the first time in 20 years, the yen breached the 130 level versus the U.S. dollar. Japan's easing of border controls, Bank of Japan's (BoJ) relatively dovish attitude and Yen devaluation supported the markets, despite a deterioration in economic momentum. The BoJ stood firmly as a dovish outlier, resisting pressures from bond and Forex markets to make a policy change. Governor Haruhiko Kuroda delivered two clear messages. Firstly, BoJ will stick to the yield curve control (YCC) policy in order to support the economic recovery, and an expansion of YCC band is equivalent to a tightening. Secondly, a sharp yen depreciation will hurt the economy, especially business investments. His statement gained support from Prime Minister Fumio Kishida, who believes foreign exchange (FX) is only one of several factors to consider for monetary policy.

We believe a deceleration in global growth could weigh on the export-driven Japanese market but a weak yen may be supportive to the country's equities. We are neutral in light of the cyclical nature of the Japanese market. Inflation rates have been trending up in the country but it has remained comfortably low. Optimism on an economic reopening is triumphing over inflation concerns for now, driving the services PMI to multi-year high in May. On the contrary, manufacturing PMI eased for the second consecutive month, reflecting the cooling global expansion and weakening external demand. Hence, we expect Japan's economic recovery to gain momentum from the rebound in private consumption. We are neutral on Japanese equities. A mild deterioration in economic momentum leads us to remain vigilant on earnings. On the other hand, the Japanese Yen devaluation acts as a support for the market. Therefore, overall we maintain a neutral stand.

ASIA EX-JAPAN EQUITIES

In Asia, inflation has been rising across the board but most countries keep the reopening trend and relaxed COVID-19 policies. In Singapore, core CPI rose 0.4% month-on-month and 3.6% year-on-year. Headline inflation rose 0.3% month-on-month and 5.6% year-on-year. This was mainly attributable to food, retail and utility costs with underlying price pressures likely to persist as the economy opens up. In Indonesia, daily-confirmed cases rose to above two thousand on average in recent weeks, 4 times higher from last month with half of the cases contributed by Jakarta. In Malaysia, CPI rose to 2.8% year-on-year, accelerating from 2.3% a month ago, and is driven by food inflation and the increase in transportation costs from the spike in fuel prices. In Thailand, as the daily-confirmed number of COVID-19 cases declined, Thai authorities change the facemask mandate – to purely voluntary outdoors or in uncrowded places. As restrictions ease, the government expects the total number of foreign visitors to exceed 10 million this year.

Across Emerging Market (EM) Asia, CPI inflation remained on an upward trajectory. Both Thailand and Singapore's headline CPI inflation rose to their highest level since 2008, adding pressure on the countries' central banks to tighten policy. In June, the Reserve Bank of India (RBI) and the Central Bank of the Philippines (BSP) hiked again by 0.5% and 0.25% respectively, while the Bank Indonesia (BI) and the Bank of Thailand (BoT) kept policy rates on hold. Due to the rising inflation outlook, the BSP will gradually raise policy rates. In India, the RBI board voted unanimously in June to continue its monetary policy normalisation, raising its policy rates by 0.5% to 4.9%. We are neutral on Asian equities, although most central banks took steps to normalise policy, Southeast Asian countries continued to make progress on reopening.

CHINA & HONG KONG EQUITIES

The Shanghai Composite Index was positive, with a gain of 4.5% in Q2 and 6.7% in June whilst the Hang Seng Index experienced a depreciation of 0.6% in Q2 but gained 2.1% in June. Chinese equities rallied over the past month, benefiting from its attractive valuation and China's unique monetary policy cycle. Following Shanghai's partial reopening, households have returned to buy homes and cars, while mobility data consistently shows a steady but moderate recovery nationwide. A refined Zero-COVID policy is taking shape. Despite its firm stance, Chinese authorities have started to relax travelling restrictions on various fronts. High frequency data in June showed a rebound in economic activities along with the broadening of supply chain normalization and factory reopening. In Hong Kong, the unemployment rate improved from 5.4% in April to 5% in May, as social distancing measures started to be relaxed in mid-April. In addition, the Consumption Voucher Scheme and the 2022 Employment Support Scheme have also helped the employment market.

As the country moves towards a healthy domestic consumption-driven growth model, the desynchronization of China from the global economy, supportive policies and the economic reopening paint a better picture. Since the Shanghai reopening, the biggest debate has been how strong the recovery is. At the same time, mortgage rates plunged again in June to their lowest level since 2014, and interbank market rates stayed ultra-low. We have observed a steady but moderate pick-up in national truck flows. Although cross-region travel has been much restricted due to local governments' cautious stance on inbound cases, mobility in each city has recovered more quickly. In Hong Kong, the number of Omicron cases hovered around 2000 cases per day. The government has extended phase two's social distancing measures till July 13, and would subsequently review the situation to decide whether to relax social distance measures. We are slightly overweight in Chinese and Hong Kong equities. More supportive policy signals and a gradual lift of the restrictions are leading to a more positive growth outlook, which should stabilise the equity markets in the near future.

GLOBAL BONDS

Sovereign bonds lost ground and the decline in European sovereigns was one of the worst in the last 20 years. Treasuries lost further ground, increasing their year-to-date (YTD) losses. Inflationary pressures and tightening financial conditions hit government bonds with markets pricing in further increases in interest rates on top of what has already been announced. Central banks are acting aggressively to curb inflation and higher borrowing cost together with the squeeze on consumption are affecting economic growth. In June, the Fed raised its benchmark interest rates by 0.75%, which is its most aggressive hike since 1994. The Federal Open Market Committee (FOMC) took the level of its benchmark funds rate to a range of 1.5%-1.75%, the highest level since just before the COVID-19 pandemic began in March 2020. ECB confirmed its intention to start raising its key deposit rate, which stands at -0.5% currently, by 0.25% in July to contain record inflation.

We are neutral on government bonds. In the U.S., as the Fed continues on its aggressive tightening trajectory, the pressures on core yields are twofold, coming from economic growth and higher Fed rates. We remain close to neutrality for now with a marginal negative tilt, and remain ready to adjust this stance depending on the evolution of terminal rates and inflation. In Europe, economic uncertainty and fragmentation risks, coupled with high inflation and a tightening ECB, warrant a close to neutral stance on rates sensitivity in core Europe. However, we remain flexible and tactical in our approach across the European curves, and are closely monitoring the policy path. We are slightly overweight in credit and remain mildly positive on U.S. investment-grade equities, particularly higher-rated credit as it offers attractive carry and the country displays strong consumption and resilient labour markets. Corporate fundamentals are also strong due to the ability of companies to pass higher input costs to consumers. We are neutral on European credit. Persistent uncertainties over growth, ECB's hawkish overtures and concerns over earnings cloud the outlook, even as corporate fundamentals remain robust for the time being. Investors should consider adding high-quality liquid securities over highly leveraged names.

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