BCT 銀聯集團

Unprecedented global economic stimulus measures, Financial markets decoupled from reality

Investment Markets	BCT's Investment Views	Summary
Equities	⬇	
US	⬇	We are negative on the U.S. equities. The correlation between economic data (weak) and market performance (positive) has never been so low and the markets are pricing in a quick recovery which is too optimistic, in our view. We believe that earnings estimates will continue to come down and we stay defensive.
Europe	⬇	Overall we are negative on European equities. The unprecedented economic 'sudden stop' has already impacted demand and supply in an environment where forward visibility is low and the range of outcomes are wide. Therefore, caution is warranted.
Japan	▬	We are neutral on Japanese equities: corporate valuations remain below their long-term averages and balance sheets are under-leveraged; but, the current recession and weak global demand will affect earnings.
Asia ex Japan	▬	We are neutral on Asian ex-Japan equities, as market volatility remains extremely high and it is too early to see a sustainable positive trend. On a regional basis, we maintain our preference for China, South Korea and Taiwan.
China & HK	▬	We are neutral on Chinese equities, even if macro data are supportive for the Chinese market, we remain cautious due to the uncertain outcomes regarding the U.S.-China tensions. In Hong Kong, economic activities have been affected by social distancing measures. Even with the previous government announcement of relief packages, we are cautious due to the political issues that would lead to social protests.
Global Bonds	⬆	
Government Bonds	⬆	Overall, we are slightly positive on government bonds. Treasuries continue to benefit from safe haven flows and, even if to a lower extent, from QE programmes. We are positive on credit. Credit is supported by central bank actions, however, selection is important to identify issuers that will survive the crises.
Credit	⬆	

Scales of weighting	⬇	▬	⬆
	Underweight	Neutral	Overweight

U.S. EQUITIES

The S&P 500 posted a total return of +4.8% for May. Of all the major U.S. indices, it was the tech-heavy Nasdaq that performed the best with a return of +6.8%, in line with the return of the FANG+ index which rose 6.8%. The small-cap Russell 2000 was up 6.4% whereas the narrower Dow Jones 30 returned 4.3%. Growth stocks continued their recent run and outperformed value stocks, with the former up 5.8% against a gain of 2.8% for value stocks. Q1 GDP data confirmed the relative resilience of goods consumption against services consumption and highlighted the discrepancies between residential (up) and non-residential investments. In April, personal income was up by 11% month-over-month, notwithstanding the rise in unemployment rate to 14.7% and the decline in all major components of income, due to the extraordinary rise in transfer from the government. May's payrolls report was unexpectedly strong, rebounding from -20,687K to +2,509K but it was far from recovering the losses of April. Firms reported the second steepest contraction in business activity on record in May, but it moderated from April, as the economy progressively began to reopen. Outputs and new orders kept contracting sharply as the demand remained very weak, both for manufacturers and service providers. In particular, the demand from international clients appeared to be particularly muted in May. Business confidence on future business activity remained very low as firms highlighted the fears of a prolonged economic downturn. Durable goods orders decreased by 17.2% for the second month in April, after a revised 16.6% decline in March. The capital expenditure intention indicator for May showed a little uptick but still remained in negative territory. With corporate profits down by 13.9% (annualized) in Q1, companies seemed reluctant on capital spending projects amidst weak demand and low earnings. There were no major policy changes at June's Federal Open Market Committee (FOMC) meeting, except a commitment to maintain at least the current pace of asset purchases over the coming months, i.e., $80 billion in the U.S. Treasuries and $40 billion in mortgage-backed-securities per month. The Chairman of the Federal Reserve (Fed), Jerome Powell, maintained a dovish tone, indicating that the FOMC is "not even thinking about" raising rates.

The COVID-19 pandemic has pushed the U.S. economy into a sharp downturn, with severe disruptions of businesses and mass layoffs. Unemployment has surged to double-digit territory (13.3% in May); confidence on both the consumer and business sides have plummeted; and consumer inflation has started to reflect the consequences of the lockdowns, with headline consumer price index (CPI) falling to 0.3% year-over-year (1.5% prior). The timing and profile of the recovery are still highly uncertain, but we expect the GDP to contract between 4.5% and 6.5% year-over-year, with inflation remaining significantly subdued and that there will be significant risks of moving into negative territory during the year. As people did not consume due to lockdown, there was temporary decoupling between personal income and personal consumption. Indeed, the saving rate, which have already been in an upward trend, skyrocketed to 33%. Personal saving soared by $4 trillion: consumption plunged by $1.9 trillion; disposable income was boosted to $2.1 trillion by government social benefits. These could prove a strong supporting factor for the resilience of the U.S. consumer. A risk for the second half of the year is coming from the U.S.-China tensions. The U.S. democrats are not much softer on China than Republicans during the campaign. More noise is likely to come, but it is unclear whether disruptive trade (or other) decisions will follow. On the long term, the weakening of global institutions, the re-shoring of production and the de-globalization are the major risks to monitor. We are negative on the U.S. equities. The correlation between economic data (weak) and market performance (positive) has never been so low and the markets are pricing in a quick recovery which is too optimistic, in our view. We believe that earnings estimates will continue to come down and we stay defensive.

EUROPEAN EQUITIES

In Europe, equity indices posted positive returns, with the MSCI Europe appreciating 3.9%. The MSCI EMU outperformed with a return of +4.3% and the narrower Euro Stoxx 50 did even better, finishing the month with an increase of 4.7% in local net return terms. Despite slightly improving performance compared to April, the new flash purchasing managers' indices (PMIs) highlighted a further contraction in business activity across the Eurozone. Both the manufacturing and the service sector PMI were expected to improve in May, however they were still deep in the contractionary territory. Firms reported a sharp contraction in outputs and new orders, both from domestic and foreign clients despite somehow at an easing rate compared to April. The service sector is expected to remain the most severely hit, as firms highlighted how social distancing will continue to impact their business. Job cuts continue to intensify. Detailed data on real personal consumption for Germany showed few trends: goods consumption, in particular food, remained resilient. All other goods consumption suffered in Q1. Within services, almost all categories suffered significant declines. The German government announced 130 billion euro in fiscal measures that specifically aimed to boost demand. Taking into account the existing Germany's COVID-19 stimulus of 4.8% of GDP, this makes the overall German stimulus one of the largest globally now. The European Central Bank (ECB) further extended the monetary easing in the last meeting, topping the Pandemic Emergency Purchase Program (PEPP) to 1.35 trillion euro from 750 billion euro which will be extended for a further 6 months to June 2021. The ECB will reinvest maturing bond proceeds from the PEPP until at least the end of 2022. The European Commission put forward its proposal for a major recovery plan. The new recovery instrument, “Next Generation EU”, will allow the Commission to use its strong credit rating to borrow 750 billion euro on the financial markets. Support will be available to all member states but concentrated on the most affected and where resilience needs are the greatest. This additional funding will be channelled through European Union (EU) programmes and repaid over a long period of time throughout future EU budgets not before 2028 and not after 2058.

The European economy has moved into a severe contraction, as witnessed by the appalling preliminary Q1 GDP data, which are even more concerning, given that in several countries the lockdown did not start until the latter weeks of the quarter. We expect the Eurozone economy to shrink between -7.5% and -10% in 2020. Lockdowns have begun to ease in some countries and will be soon in most countries; this should favour some rebound as activities reopen but we don’t expect a V-shaped recovery. Inflation will remain subdued and at risk of a deflationary trend, due to energy prices and weak demand. Eurozone’s Harmonized Index of Consumer Prices inflation decelerated to 0.4% year-over-year in April from 0.7% in March. In line with the previously pre-announced communication, the ECB finally delivered a sizable increase in its quantitative easing (QE) which will allow the stimulus to increase at least till middle of next year. The new firepower will allow the ECB to also cover most of 2021 net issuance of European government bonds. The announcement about the period planned for reinvestments represents the most interesting piece of news, as it shows that the ECB is committed to keep its stimulus well beyond the phase of the pandemic emergency and for as long as the recovery will need. Overall we are negative on European equities. The unprecedented economic ‘sudden stop’ has already impacted demand and supply in an environment where forward visibility is low and the range of outcomes are wide. Therefore, caution is warranted and we recommend investors to balance near-term risks with medium-term opportunities by maintaining process discipline, focusing on stock selection and ensuring appropriate liquidity.

JAPANESE EQUITIES

Japanese equities continued to appreciate at strong pace in May: the Nikkei 225 outperformed the Topix by rising 8.3% against a rise of 6.8% for the Topix. A severe economic downturn continued in Japan as firms reported a further decline in business activity. The plummeting demand for goods is grounding the manufacturing sector, with firms experiencing an accelerating decline in output. Similarly, new orders continues to contract as both the domestic and global demands remain weak. Firms continue to experience long delivery times. The rate of decline underlying the service PMI slightly eased in May, but it was the second sharpest fall in service output. The Bank of Japan (BoJ) continued to strengthen its easing in April and May. After doubling ETF purchases, it increased QE by removing the annual soft target of 80 trillion yen for Japanese global bonds (currently at 14 trillion yen), to accommodate the increase of fiscal stimulus. It announced to add a significant amount of commercial papers and corporate bonds. In addition, the BoJ unveiled a new fund-provisioning program to support financing of small and medium enterprises (SMEs). The new programme will add 30 trillion yen (US$280 billion) to existing supports for business, bringing the total amount to 75 trillion yen (US$700 billion), with an extension of deadline to the end of March 2021. For the existing special fund operations, the BoJ expanded the eligible collateral range to include all private debts. Tokyo will compile a fresh stimulus package worth US$1.1 trillion, including a 33 trillion yen of direct spending. It will be funded partly by a second extra budget and will take the total stimulus to 234 trillion yen or 40% of GDP. The package will include increasing medical spending, aid to firms which are struggling to pay rent, support to students who lost part-time jobs, and more subsidies to companies which are hit by slumping sales. The prime minister of Japan said the government will separately provide up to 140 trillion yen in financial assistance to firms which are hit by the pandemic.

Given slumping global demand and domestic epidemic control measures introduced in April, we expect Japanese economy to be hit the hardest in Q2, with both private consumption and business investments likely to contract for the third straight quarter. Having said that, we expect Japan to fare better than other advanced economies, thanks to the government’s better control of the COVID-19 outbreak. High-frequency data suggested that the decline in Japanese mobility was shallower than the U.S. and Europe, and similar to that of other East Asian economies. In addition to the first supplementary budget of 48 trillion yen real spending (8.7% of GDP), total fiscal spending will increase by 14.3% of GDP in the fiscal year 2020, without delays in implementation. The second supplementary budget is less buoyant than in the headlines. We are neutral on Japanese equities: corporate valuations remain below their long-term averages and balance sheets are under-leveraged; but, the current recession and weak global demand will affect earnings.

ASIA EX-JAPAN EQUITIES

Global macro data continues to point towards weakness, although the outlook has improved. Manufacturing activity contracted severely in May amidst weak global demand, which slowed down production volumes and new orders (in particular export orders). However, firms reported progressive improvements in business activity compared to the record fall in April as indicated by the ongoing recovery in manufacturing PMIs globally. Global labor markets remained under tremendous pressure and firms reported deep supply chain disruptions globally. The MSCI Asia ex Japan lost 1.2% with Hong Kong (-7.8%) sold off significantly amidst the passing of the National Security Law, which resulted once again in social unrest. Singapore (-3.2%), India (-2.6%) and Taiwan (-2.5%) were other laggards while ASEAN countries were relatively more insulated from the U.S.-China tensions and outperformed; Malaysia (4.8%), Thailand (4.4%) and Indonesia (3.4%) were in the lead in May. All Asian countries saw downward revisions in earnings with the Philippines, Malaysia and Singapore showing the highest negative revisions. In South Korea, a rate cut of 0.25% in May boosted investor sentiment and supported the market rally. Macro data prints remained weak but indicated that a gradual recovery is underway. Inflation remained subdued; prices rose by 0.1% year-on-year in April. Thailand's equity markets was one of the strongest performing markets in Asia, posting a gain of 4.4% in May. The market benefited from being relatively insulated from the U.S.-China tensions and rallied despite the negative macro backdrop. Macro data remains weak; growth has contracted sharply amidst a very weak domestic demand and external shocks driven by COVID-19. The underperformance of Indian equity market was largely driven by financials as investors remained concerned about the asset quality of Indian lenders amidst an extension of the moratorium on debt servicing by the Reserve Bank of India for a further 3 months and the impact of overall lockdown on financial position of borrowers.

Some opportunities exist in Asian equities, but the evolution of the U.S.-China relationship is the key (recent tensions could derail market sentiment). In India, in the last couple of months, economic conditions sharply deteriorated. The limited information in April (Q2 2020) gave a much more awful picture than that anticipated by March data. In April, freight traffic and exports collapsed. We did revise down our GDP growth expectations for 2020 in the range of -2.5%/-1.0% year-over-year from 0%/1.5% previously. The government has recently announced a stimulus package of fiscal and monetary policy measures. The sharp recession is going to significantly deteriorate the fiscal metrics. For the second time in a row, the Reserve Bank of India cut its policy rate in an extra schedule meeting by 0.4% to 4.0%. The Monetary Policy Committee also decided to continue the accommodative stance as long as it is necessary. The rate decision didn't surprise us in the size but maybe so in terms of the timing which was ten days earlier than the regular meeting. Additional measures have been announced to improve the functioning of the markets, provide relief on debt servicing and capital market access, and support imports and exports. We are neutral on Asian ex-Japan equities. We maintain a neutral stance, as market volatility remains extremely high and it is too early to see a sustainable positive trend. On a regional basis, we maintain our preference for China, South Korea and Taiwan, due to sector exposure, strong monetary and fiscal stimulus, and better containment of COVID-19 compared to other countries. More recently, we see value in some ASEAN countries (Thailand, Indonesia and the Philippines) due to cheap valuations, while we remain bearish on India on concerns over the spread of COVID-19.

CHINA & HONG KONG EQUITIES

The worst performance in the Asian region was the Hang Seng Index which fell 6.8% amidst further political unrest in Hong Kong. Instead the Shanghai Composite Index finished the month with a small loss of 0.3%. Chinese equities struggled amidst concerns over slowing global growth and the U.S.-China tensions as the U.S. extended restrictions on Huawei, while a slightly weaker Renminbi against the U.S. dollar also weighed on the market. Macro data indicated some signs of recovery; Chinese manufacturing PMI jumped to 50.7 in April from 49.4 in March as the country continued to recover from the pandemic. Exports expanded by 3.5% year-on-year in April after a deep contraction of 6.6% in March while imports contracted by 14.2% in April. On the political front, China's annual National People's Congress (NPC) meeting took place in May where a fiscal package equivalent to 8.4% of GDP was announced. The People's Bank of China (PBoC) rolled out two credit relief programs for SMEs on 1 June. The PBoC will purchase RMB 400 billion SMEs loans from local banks, to encourage banks to extend lending to SMEs. The amount is relatively small, considering that a blanket 0.50% Reserve Requirement Ratio (RRR) cut will release RMB 1 trillion into the market. The PBoC, jointly with the China Banking and Insurance Regulatory Commission, allowed the SME loans maturing this year to be extended to 31 March 2021, as long as borrowers freeze job cuts. The central bank will use RMB 40 billion to subsidize banks with 1% of the loan principal. The President of the U.S., Donald Trump, announced that the U.S. would revoke Hong Kong's special status as a separate customs territory. Meanwhile, the National Security Law was approved during China's 2020 N PC meeting, which once again sparked social unrest in Hong Kong. The COVID-19 outbreak was largely contained, allowing the government to loosen some restriction measures, which included the gradual resumption of the airport transit from 1 June. Retail sales volume continued to contract, reflecting the hit on tourism and consumption-related activities amidst COVID-19. Labor markets remained under pressure, with the unemployment rate rising to 5.2%. In particular, employment in retail, accommodation and food services sector dropped sharply by 16% year-on-year as a result of both the social unrest in the second half of

2019 and the COVID-19 outbreak.

The latest program will not preclude RRR or rate cuts later this year. We continue to expect an additional 0.20% cut on Open Market Operations rates and the Loan Prime Rate. Besides, blanket RRR cuts are also likely to free up bank funding for the budgeted increase in special bonds issuance. At the NPC meeting, the central government explicitly said to “use a variety of tools such as required reserve ratio reductions, interest rate cuts, and re-lending”. We believe the new credit relief programs are the planned “new monetary policy instruments that can directly stimulate the real economy”, which serve as a complementary part to conventional easing tools. Chinese equities reflect a ‘first-in first-out’ state of play as its economy comes out of the slowdown quicker than the rest of the world. Economic activities are slowly returning to normal. Production could rebound fairly quickly, although this will not be the case for demand. We expect more policy action to support the recovery. Previous RMB depreciation episodes were coincident with escalating U.S.-China tensions. As tensions persist, we expect RMB to remain under depreciation pressures this year. We are neutral on Chinese and Hong Kong equities, even if macro data are supportive for the Chinese market, we remain cautious due to the uncertain outcomes regarding the U.S.-China tensions. In Hong Kong, economic activities have been affected by social distancing measures. Even with the previous government announcement of relief packages, we are cautious due to the political issues that would lead to social protests.

GLOBAL BONDS

Macro data in the U.S. has been weak, reflecting disruptions associated with the COVID-19 pandemic. Employment continued to decrease with many firms furloughing or laying off workers and consumer spending falling further. Manufacturing activity declined and the flash PMIs showed that activity continued to weaken in May across both manufacturing and services. After the extraordinary size and scope of the measures that governments and central banks have taken to underpin liquidity (and to a lesser extent, solvency), the Fed made no meaningful adjustment to policy during May. After the significant volatility in yields during March, April and May were quieter with the 10-year U.S. Treasury yield fluctuating between 0.60% and 0.80%. The U.S.-10 year yield started the month at 0.64% and finished at 0.65%. Likewise in Europe, 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 having profound effects. In this environment, the response from the fiscal and monetary side has been strong. The ECB bought over 125 billion euro in government and corporate bonds over the past month under the terms of its purchase programmes with expectations for an increase in the pandemic purchase programme. During the month, the focus was the development of EU recovery plan and that the proposal from the President of the European Commission, Ursula Von Der Leyen, of a 750 billion euro EU recovery instrument was met positively by investors. Peripheral bonds outperformed the German Bund as investors were cheered by the prospects of progress. In this environment, the German Bund yield trended up: having started the month at -0.59%, German 10-year yields rose steadily and finished May at -0.45%. The JPM Emerging Markets Bond Index Plus Composite generated strong positive returns during the month, appreciating by 6.2%.

We believe that central banks will aim to keep the cost of public debt low to support governments' fiscal needs, leading range-bound movement in for yields. A Treasury yield of around 0.60% is consistent with the Fed's stance and a sharp worsening of the macro picture. The U.S. Treasuries should benefit from safe-haven flows (although to a lower extent than in the past) and the Fed's purchases, especially in short to medium-term segments. As we exit the pandemic, reflationary forces, such as deglobalisation and debt monetisation, should support higher inflation risk premiums and demand for inflation protection. The U.S. Treasuries demand remains strong, as supported by the QE programme and foreign inflows. While the policy rate remained unchanged at the latest FOMC meeting, the U.S. Congress approved additional fiscal measures, leading to a total fiscal stimulus of nearly $3 trillion. Issuance programme, including long dated bonds, will bring more duration to be absorbed by the market. On the credit side, investment grade bond spreads have tightened and markets have absorbed record issuance of corporate bonds, as supported by continued QE. Given this spread-tightening and elevated uncertainties (social, economic and market), selectivity is increasingly important. However, attractive valuations offer compelling return prospects over the next one to two years. We wait to see how the recent agreement between France and Germany to push for a recovery fund is received by other EU member states. We are still mildly constructive on peripheral bonds. Euro investment grade bonds should benefit from the current normalisation environment and the ECB's large liquidity backstop. We remain positive on Euro investment grade bonds, particularly on the subordinated debt financial sector. COVID-19 and oil dynamics are shaping the economic environment for emerging markets and in general we have been cautious. We remain positive on hard currency debt, where we have a constructive stance on selective high yield names. We also believe that some investment grade primary market offerings are attractive. Overall, we are slightly positive on government bonds and positive on credit. Treasuries continue to benefit from safe haven flows and, even if to a lower extent, from

QE programmes. Credit is supported by central bank actions, however, selection is important to identify issuers that will survive the crises.

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