BCT MARKET OUTLOOK

As of Jun 2021

Good news fully arises
interest rate hikes expected to come earlier

Investment Markets	BCT's Investment Views	Summary
Equities		
US		We are neutral on U.S. equities. The economic reopening and fiscal spending by the Biden administration should support overall growth and demand, but there are corners of extreme valuations in the market. In addition, supply shortages and potential tax hikes remain issues that could weigh on demand. As a result, investors should remain selective.
Europe		We are neutral on European equities. The performance of corporates in the latest earnings season has been strong, indicating the importance of normalisation of economies. The region is still witnessing reopenings and that should support rotations in sectors linked to economic growth. We believe a lot of good news is already priced into markets. Therefore, we are monitoring inflation trends and focus on relative value and companies with strong fundamentals and pricing power.
Japan		We are neutral on Japanese equities. A pause in global economic momentum could briefly affect Japanese markets. From a medium-term perspective, growth should be supported by exports, rising wages and the yen's weakening.
Asia ex Japan		We are positive on Asian equities. We believe that the positive sentiment in markets has not been derailed. Any economic impact from renewed lockdowns will be better quantified and managed compared with last year. This suggests that market participants are likely to look past near-term events and towards an eventual recovery in emerging markets in Asia.
China & HK		We remain positive on China equities. Although a fall in retail sales and industrial production adds uncertainty to outlook, with vaccination rate hiking up, equities performance will stabilise. We are neutral on Hong Kong equities. Social distancing measures have relaxed as the number of COVID-19 cases stays low. However, the timing of reopening border is still unclear, it may affect Hong Kong's recovery pace.
Global Bonds		
Government Bonds		We are neutral on government bonds. Valuations remain broadly tight, but technical forces, especially in Europe, are providing great support. We remain positive on credit, ECB purchases keep playing a strong role in European credit markets.
Credit		

Scales of weighting			
	Underweight	Neutral	Overweight

U.S. EQUITIES

U.S. equities continued to gain in May, with the S&P 500 advancing by 5.3%. Thanks to the global economic recovery gaining momentum, the U.S. is expected to deliver strong growth this year. With industries reopening and vaccinations rolling out, investor spirits have been lifted driven by a positive earnings season and results showing strength in the U.S. economy. Inflation was a major driver of sentiment for the month, but more modest U.S. macro data suggested that the economy was not overheating and that helped ease the expectations over interest rate hikes by providing support to risky assets. In terms of monetary policy, the Federal Reserve's (Fed) speakers were unanimous in calling the spike temporary and commented that inflation data would not prompt any shift in monetary policy.

Thanks to an extremely accommodative policy mix, the U.S. economy continues to recover strongly and most likely to return to pre-pandemic levels as we wrote. We recently revised up both our growth and inflation outlook for 2021. With strong base effects at play in Q2, inflation is expected to spike and then moderate while remaining very volatile in the near-term on demand/supply mismatch, amplified by low inventories and rising input costs. The Federal Open Market Committee will most likely to consider these developments in line with their goal and continue to read these inflationary pressures as temporary phenomenon. Chairman Jerome Powell reaffirmed that it was not yet time to talk about tapering, stressing that they were a long way from their goals. We are neutral on U.S. equities. The economic reopening and fiscal spending by the Biden administration should support overall growth and demand, but there are corners of extreme valuations in the market. In addition, supply shortages and potential tax hikes remain issues that could weigh on demand. As a result, investors should remain selective.

EUROPEAN EQUITIES

The MSCI Europe was up by +2.56% in local total return terms for the month. Q1 GDP data proved stronger than expected, with a milder contraction than the extension of restrictions would have implied. The latest earnings season has been strong, indicating the importance of normalisation of economies. Vaccination climbed over the last few months and it is expected that 70% of the population could receive at least one dose of vaccine by the end of July. Furthermore, additional vaccine production is now being developed onshore with contracts that ensure domestic priority. The Eurozone's purchasing managers' index (PMI) reached new heights in May advancing from 62.9 in April to 63.1 with new record improvement in operating conditions, confirming that the economy rebounded strongly in Q2. The Eurozone's inflation rose again in April from 1.3% to 1.6% year-over-year driven by energy and food prices while core inflation eased from 0.9% year-over-year in March to 0.7%, confirming that underlying price pressures remained muted in the Eurozone.

Q2 should see moderate growth as restrictions are removed, followed by a stronger acceleration from the summer as vaccination campaigns progress ideally. Governments should continue to offer fiscal support until recovery is on track, while the European Central Bank (ECB) remains accommodative. Inflation should progress along an upward trend, though volatile on transitory factors, while temporarily overshooting the target in Q4 before reverting below trend in 2022. The launch of the European recovery fund, called Next Generation EU, is potentially a big step forward, it is a potentially powerful mechanism that has been agreed and launched by the EU quite rapidly, and is an adequate response to any shortage of fiscal resources that could hinder public investment capacities. We are neutral on European equities. The performance of corporates in the latest earnings season has been strong, indicating the importance of normalisation of economies. The region is still witnessing reopenings and that should support rotations in sectors linked to economic growth. At the same time, we believe a lot of good news is already priced into markets. Therefore, we are monitoring inflation trends and focus on relative value and companies with strong fundamentals and pricing power.

JAPANESE EQUITIES

The Japanese equity market posted positive return in May with the Topix advancing by +1.4%. The yen weakened slightly against the U.S. dollar which provided some support for equity market sentiment. Q1 GDP came in weaker than expected, with all sectors registering some moderation. The contraction in domestic demand, particularly in private consumption, was the main culprit amid soft restrictions on mobility, the slowdown in private consumption contributed more than half to the contraction. Although the share of the population that has been vaccinated remains low (<10%), exposing Japan to a resurgence of infections, the state of emergency was expanded in early May, weighing on mobility. External demand remains a bright spot, as overseas machinery orders skyrocketed. The corporate earnings season came to a close, with the majority of corporates reporting results that were either in line with or slightly better than average forecasts. The number of companies reporting profits below expectations was notably lower than last two quarterly records.

After the Bank of Japan (BoJ)'s upgrade to its growth forecasts on 28 April, Japan's recovery outlook has flattened, with the latest growth and inflation data both less than satisfactory.

Japan's slow pace of vaccination is concerning, with a low vaccination rate (<5 shots per 100 people), the majority of the country returned to a state of emergency amid rising infections. However, towards the end of May, a significant acceleration in the vaccination rate was noticed. This development, albeit unlikely to trigger additional stimulus in the near term, suggests that the BoJ will likely to stay put for longer. We are neutral on Japanese equities. A pause in global economic momentum could briefly affect Japanese markets. From a medium-term perspective, growth should be supported by exports, rising wages and the yen's weakening.

ASIA EX-JAPAN EQUITIES

Asia ex-Japan equities recorded a modest gain, up by +1.2% in total return terms. Among the indexes, India was the strongest index market and outperformed with both the Nifty 50 and the Sensex appreciating by +6.5%, despite its rising number in COVID-19 infections. The Philippine Stock Exchange Index rallied 4.0% month-over-month during the period. It was a broad-based rally and blue-chip companies were among the most actively traded names as the index surged. The rally was fueled by vaccine and reopening optimism as the decline in the daily reported COVID-19 cases in the city was encouraging. Within emerging markets in Asia, there has been a resurgence of COVID-19 as well as the emergence of new and potentially more transmissible strains. However, the impact of this wave of infections is likely to have less of an impact on markets than last year and less likely to derail overall economic growth. The vaccine rollout has been uneven across countries due to supply constraints but bottlenecks are likely to be a result of political tensions and willpower, rather than an existential one of confidence in the scientific process and efficacy.

We believe that Singapore assets continue to be attractive, with positive momentum as the world reopens. Markets are optimistic and expect continued economic recovery, particularly as the government's vaccination plan is well on track and is outperforming the rest of Asia. Looking ahead, Singapore's overall recovery is dependent on the pace of its border reopening, given its outsized dependence on trade. The recent increase in local COVID-19 cases has been handled very well by the authorities; the response has been decisive. This should continue to give investors further confidence. We expect the lingering concerns in Indonesia to spill over into June and would dictate the market direction. However, over the longer term, we are positive on Indonesia given that it will benefit from both structural tailwinds and further fiscal support. In Thailand, in the immediate term, we expect market to remain choppy as investors' focus will be fixed on Thailand's pace of vaccination and inflation expectations in the U.S. We are positive on Asian equities. We believe that the positive sentiment in markets has not been derailed. Any economic impact from renewed lockdowns will be better quantified and managed compared with last year. This suggests that market participants are likely to look past near-term events and towards an eventual recovery in emerging markets in Asia.

CHINA & HONG KONG EQUITIES

The MSCI China was up by +0.8%, and the market had a positive performance with the Shanghai Composite rising by +4.9% for the month, while the Hong Kong Hang Seng appreciated by +1.5% over May. In China, the vaccination rate has greatly sped up. With a capacity of 20 million vaccines per day, China can vaccinate 70% of its population by July. Inflation-wise, although the producer price index is heading towards 8% year-over-year, it is set to lose steam in the coming months on weaker policy momentum. In contrast, the consumer price index (CPI) inflation remained soft, with food inflation dropping and core inflation strengthening slowly. The MSCI Hong Kong went up in April by +1.3%. The total number of new confirmed case fell to 60 in May (April: 302 cases), of which only one locally transmitted case was detected. The total number of vaccinations reached 2.36 million with 1 million people fully vaccinated.

In Renminbi space, we expect the combination of talks, window guidance and Foreign Exchange Reserve Requirement Ratio hike to cool near term Renminbi expectations, after Renminbi drove up risk sentiment in China equities towards the end of May. Upcoming U.S. jobless claims data is the key to the Fed’s taper talk, and could create upside risk for treasury yield and undermine growth/momentum. As such, in terms of stock selection, investors could focus on value and growth with quality, amid policy normalisation in China. We remain positive on China equities. Although a fall in retail sales and industrial production adds uncertainty to outlook, with vaccination rate hiking up, equities performance will stabilise. We are neutral on Hong Kong equities. Social distancing measures have relaxed as the number of COVID-19 cases stays low. As a result, the unemployment rate improved from 6.8% in March to 6.4% in April. However, the timing of reopening border is still unclear, it may affect Hong Kong’s recovery pace.

GLOBAL BONDS

Over the month, U.S. Treasuries had modest gains in May. The month started with the U.S. 2-year breakeven inflation reaching an almost 13-year high, close to 2.9%, driving the U.S. bond yields higher. After labour market data calmed economic overheating worries, much higher-than-expected core inflation figures drove both breakeven inflation and nominal yields higher.

Overall, the U.S. 2-year yield fell from +0.16% to +0.14% and the U.S. 10-year yield started the month at +1.63% and finished May at +1.60%. During the month, core Eurozone bond yield initially rose as higher-than-expected inflation numbers in the U.S. triggered a sell-off in government bonds. Towards month-end sovereign yield eased somewhat thanks to dovish comments from the ECB. The ECB confirmed that the winding down of bond purchases was premature. Policy remained dovish and the ECB reconfirmed its very accommodative monetary policy stance. The ECB's president stressed in relation to other jurisdictions the need to maintain monetary stimulus. The J.P. Morgan EMU Government short-dated bond indices had flattish return as yields finished the month close to the levels seen at the beginning of May.

In the U.S., we are seeing higher-than-expected CPI, supply shortages and the Fed prioritising employment. These, together with strong consumption, deficit concerns and government spending plans, indicate that inflation will rise further, putting pressure on U.S. Treasury rates. In Europe, we believe that improving economic growth (and potentially inflation) in Europe could push core-Euro bonds higher and favor the steepening of the yield curve. However, the ECB will prevent any significant increase in yields in order to support economic growth. On the other hand, we are constructive on peripheral debt. Given the risks associated with a strengthening U.S. dollar, we believe that the strengthening U.S. dollar and rising U.S, rates are headwinds for emerging market debt in local currency, hence warrants a highly selective approach. We are particularly cautious on the rates at least in the short term. Over a long-term horizon, hard currency emerging market debt can be a good complement to investors' income generation strategy. We are neutral on government bonds. Valuations remain broadly tight, but technical forces, especially in Europe, are providing great support. We remain positive on credit, ECB purchases keep playing a strong role in European credit markets.

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