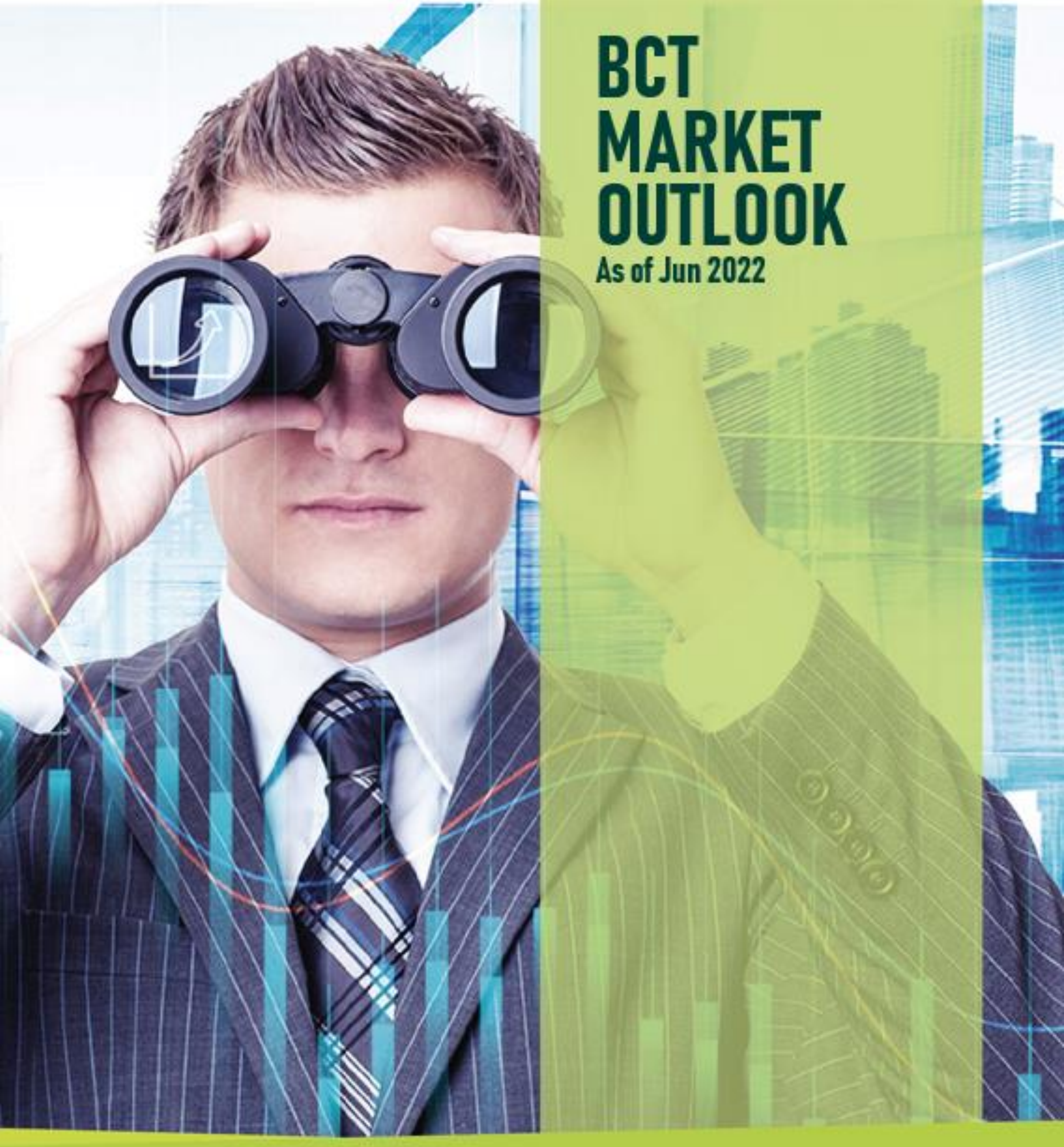
BCT MARKET OUTLOOK

As of Jun 2022



CENTRAL BANK'S MONETARY POLICY MAY IMPACT ECONOMIC OUTLOOK AMID THE CONTINUOUS INFLATION PRESSURE AROUND THE GLOBE

Investment Markets	BCT's Investment Views	Summary
Equities	▬	
U.S.	▲	Strong consumer spending and labour markets will support overall demand, allowing us to believe that a recession is unlikely, while the economy should slow down towards potential growth. Our preference is for quality and non-cyclical value.
Europe	▼	Higher stagflationary risks for Europe put pressure on earnings growth and may lead to further market repricing. Hence, we favour defensive name on one side, and high-quality cyclicals in industrials and materials on the other.
Japan	▬	A mild deterioration in economic momentum leads us to remain vigilant on earnings. On the other hand, the JPY devaluation acts as a support for the market. Therefore, overall we maintain a neutral bias.
Asia Ex-Japan	▬	After the recent price actions, the equity space is becoming more attractive, but divergences are significant. On domestic demand stories, we are more cautious on more expensive Asian countries.
China & Hong Kong	▬	The zero COVID policy continues to weigh on the economic outlook for China, despite the additional recent stimulus. We see room for improvement in second half of the year, along with the expected economic rebound.
Global Bonds	▬	
Government Bonds	▬	We are neutral towards government bonds. In the U.S., given the amount of tightening priced in by the markets, ongoing geopolitical risks and higher inflationary environment come with rising uncertainty on economic growth.
Credit	▲	We are slightly overweight on credit and becoming more constructive on U.S. Investment Grade (IG) given solid macroeconomic backdrop in the U.S., positive corporate fundamentals, low risk of refinancing debt in the near term and stable leverage.

Scales of Weighting	▼ Underweight	▬ Neutral	▲ Overweight

U.S. EQUITIES

The U.S. equity markets had an overall flattish month with volatilities with S&P 500 closing the month with a +0.2% return. Value stocks outperformed growth stocks. At its latest Federal Open Market Committee (FOMC) meeting, the Fed hiked rates by 0.5% and announced that the balance sheet runoff would start in June, at a pace in line with market expectations. The meeting also confirmed the Fed's hawkish stance and focus on inflation, pointing to additional hikes likely in the next two meetings and a possible slowdown of hikes in the rest of the year. In terms of macro data, U.S. inflation showed signs of persistent pressure: the headline consumer price index advanced 8.6% year-on-year in May. Consumer prices for services (less energy services) rose 0.6% month-on-month, indicating inflationary pressures more broadly embedded in the economy. Output growth at manufacturers was strong overall due to good client demand and a further uptick in new orders supported the upturn in production. However, the rate of growth has slowed as producers report ongoing issues with supply chain delays and labour shortages. Input cost pressures meanwhile intensified further during the month.

In U.S. equities, we believe strong consumer spending and labour markets will support overall demand, allowing us to consider that a recession is unlikely, while the economy should slow down towards potential growth. Yet, in a rising rates environment, the pressure on valuation multiples will remain. Hence, we maintain our quality and non-cyclical value tilt. We are slightly overweight on U.S. equities. Despite the recent weak economic growth data, a recession is not our base case because labour markets and consumer balance sheets remain strong. We are overweight on U.S. value equities. Uncertainty around rising costs requires a focus on high-quality value companies that are less cyclical and deliver sustainable earnings growth. While the rotation favouring value may suffer near-term setbacks, the move towards these names is likely to continue in the long term. We are underweight on U.S. growth equities. The long-term valuation of growth as a sector remains high. We closely monitor the repricing in the technology sector and remain focused on long term earnings growth potential.

EUROPEAN EQUITIES

Overall, the European equity indices posted negative returns: the MSCI Europe depreciated 0.3% in local total return and the MSCI EMU lost 0.6%. Eurozone inflation remained high in April, at an all-time peak of 8.1% year-on-year. In May, Eurozone PMI fell to 54.6, down from 55.5 in April, signalling a weaker improvement in manufacturing sector. The economy grew by 0.2% quarter-on-quarter. The Eurozone manufacturing is continuing to struggle against the headwinds of supply shortages, elevated inflationary pressures and weakening demand together with rising uncertainty about the economic outlook. From a monetary perspective, European Central Bank (ECB) President Lagarde displayed a hawkish stance, confirmed an early end to the ECB's bond-buying program in Q3 and made her first explicit call for interest rate increases.

Challenges for the European markets continue. Higher inflation, stagnating growth and rising rates put pressure on company earnings. We expect the economy to post very limited sequential gains for much of the year; high inflation and low confidence are dampening consumption while uncertainty weighs on investments. At the same time, domestic demand is weak, and foreign demand is not better either, thus reducing the contribution of exports. Inflation has become progressively more broad-based. Looking ahead, we continue to expect inflation remain significantly above the ECB target, as pressures on the core will remain high. We are slightly underweight on European equities. Higher stagflationary risks for Europe put pressure on earnings growth and may lead to further market repricing. Hence, we favour defensive name on one side, and high-quality cyclicals in industrials and materials on the other.

JAPANESE EQUITIES

The Nikkei 225 advanced 1.6% in total return terms. Japan further eased border controls, the Bank of Japan (BoJ) committed to aggressive monetary easing, and Yen devaluation supported the markets despite a deterioration in economic momentum. Japan's post-pandemic recovery has remained sluggish. GDP contracted again in Q1, and the overall economic output stayed at a same level as in Q4 2020. Business investments were a particular concern, while the recent slide in sentiment does not bode well for a rebound, considering new supply constraints and the continuous deterioration in terms of trade. Inflation, has become increasingly sticky as expectations hit record high. On policy front, Prime Minister Kishida's "New Capitalism" gave some clarity on policy priorities. The fundamental principles of policy announced at the end of May have switched the focus more explicitly to economic development, which has been well received by the stock market.

Japan's economic recovery has lagged behind, with a deep output gap that is not expected to close before 2024. Consumer inflation, albeit strengthening, has stayed contained. We believe core inflation will rise further throughout the year, but stay comfortably below BoJ's 2% target, hence we believe BoJ will stay dovish. Against this backdrop, BoJ has repeatedly stated that the cost-driven increase in inflation is not sustainable. It has maintained its ultra-loose monetary policy by committing to buy unlimited amount of Japanese Government Bonds, and hence leaving the Japanese Yen (JPY) mostly to Ministry of Finance. We believe BoJ will continue to prioritise the domestic economy and stay accommodative. We are neutral on Japan's equities. A mild deterioration in economic momentum leads us to remain vigilant on earnings. On the other hand, the JPY devaluation acts as a support for the market. Therefore, overall we maintain a neutral bias.

ASIA EX-JAPAN EQUITIES

In Asia, equity returns were mixed. In a surprising inter meeting move, the Reserve Bank of India hiked its policy repo rate by 0.4% to 4.4%. Since the April meeting, inflation drivers have been persistently high while downside risks to growth have increased. In May, policy makers in several countries have been taking monetary and non-monetary measures to counter an upsurge in inflation trends. Central banks such as RBI (India), BSP (Philippines) and BNM (Malaysia) have begun their monetary policy tightening cycles, while the Indonesian and Indian governments have enforced bans on exports of food items like palm oil and wheat aiming at maintaining a good domestic supply and better controlling the prices of these soft commodities. Indonesia has lately lifted the ban due to the poor outcome of attempts to keep cooking oil prices low and increased hoarding.

The high food weights in the Consumer Price Index basket (up to 40%) for some Emerging Markets (EM), coupled with rising commodity and energy prices, have a direct impact on EM inflation, leading us to upgrade our inflation outlook significantly, while possibly leading to social unrest in some geographies. Across the EM universe, Asia is experiencing a more benign inflation picture comparing to other EM countries. Effect on EM countries of the war and China's economic slowdown is uneven: the areas impacted most are those ones close to the conflict zone and net energy importers, as well as Asian economies linked to China. On the other hand, commodity exporters could benefit from higher prices. However, we believe the economy is recovering in Asia. In Singapore, there has been strong inflow of passengers and rebound in production as more borders reopen; in Indonesia, daily reported COVID-19 cases remained low despite relaxed mobility; Thai government continued to ease mobility, approved reopening of night entertainment outlets in 31 provinces. We are neutral on Asian equities, while we are becoming more cautious due to expensive valuations and renewed inflation pressures. However, with Asian countries gradually reopening borders and relaxing mobility, we believe the recovery theme is on track.

CHINA & HONG KONG EQUITIES

The Shanghai Composite Index (+4.6%) and the Hang Seng Index (+1.5%) were both positive performers in May. Chinese stocks rallied as some areas gradually eased COVID-19 lockdown restrictions and the People's Bank of China (PBoC) cut the 5-year Loan Prime Rate (LPR) by 0.15% on 20 May, five days after it had lowered the mortgage rate floor by 0.2%. China's aggressive pandemic measures have slowed the current Omicron wave. However, the rolling lockdowns had a clear impact on international trade as a consequence of China's key role in the supply chain. This situation should improve in second half of the year. In Hong Kong, the number of COVID-19 cases has risen but kept under 1,000 daily, hence government has relaxed the social distancing measures in 3 phases as the possibility of number of cases rebound is low. This has helped the overall economy recovery. However, gross domestic product (GDP) growth in Q1 was -4% year-on-year, so government revised down its 2022 GDP growth target to 1%-2% from 2%-3%.

High-frequency economic data, including truck flows and logistics throughput, have been gradually recovering since early April but is still below its level of end-March. In year-over-year (YoY) terms, the decline has narrowed moderately, and likely rounded up Q2 with a negative growth rate. Despite upgraded easing efforts, we see the zero-COVID policy as the major obstacle on China's growth outlook. We expect GDP to contract by 15.9% quarter-on-quarter (QoQ) annualised (-0.6% YoY). We see growth at 3.5% for 2022, given the broad slowdown in economic activity since March, the extended lockdown in Shanghai and restrictions expanding into other regions. These will harm growth, particularly in Q2, while we expect a rebound in second half of the year, thanks to more incisive policy support. We are neutral on Chinese and Hong Kong equities. The zero tolerance policy has affected China's economy. We expect a transitory recession in Q2, with manufacturing production and retail sales dropping sharply and retail sales plunging. On the bright side, China's economic activity is returning gradually, and realistic assumption would be a full reopening in mid- or late-June.

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GLOBAL BONDS

May was a volatile month with the main theme being the shift from rising inflation and robust growth to lower growth and persistently high inflation. Central banks' monetary tightening, COVID-19 restrictions in China and Russia's invasion of Ukraine continued to undermine investor confidence whilst a number of weak macro data releases and slowing housing market increased concerns about growth. On the central banks front, messages from European Central Bank's members remained hawkish on the need to normalise policy, ultimately adding to less supportive technical and affecting European credit. Equity implied volatility was the main driver of credit spreads in this phase of growing concerns on global growth and U.S. credit market remained generally more resilient than the European one: the Bloomberg Barclays Euro Aggregate index fell 1.2% underperforming the Bloomberg Barclays U.S. Corporate index that posted a positive return of 0.9%.

We are neutral on government bonds. In the U.S., given the amount of tightening priced in by the markets, the high geopolitical and the higher inflationary environment comes with rising uncertainty on economic growth, we believe it is wise to move back towards neutrality. However, we are slightly overweight on China government bonds as from a medium-term perspective, the asset class offers strong diversification benefits. In Europe, we believe that the ECB may deliver less tightening than the Fed due to the higher risk of a recession in Europe, but investors should stay agile on rates moves exposure. We are slightly overweight on credit. We are becoming more constructive on U.S. Investment Grade (IG) on the basis of the solid macroeconomic backdrop in the U.S., positive corporate fundamentals, the low risk of refinancing debt in the near term and the stable leverage. In Europe credit area, we believe some segments have not priced in the risks related to earnings, higher rates and inflation. Hence, geographically, we are more constructive on U.S. IG credit, amid the better fundamentals in the U.S.