As of March 2020

BCT
銀聯集團

Sell-off on COVID-19 Pandemic

Investment Markets	BCT's Investment Views	Summary
Equities	Underweight	
US	Underweight	In U.S. equities, we are negative. The tactical themes have changed because they were dependent on a nascent global economic recovery that at this point is postponed, leading to cyclicals underperforming vs defensive.
Europe	Underweight	We are negative on European equities. The virus outbreak will delay the expected cyclical recovery and lead to a more cautious approach. The future earnings outlook remains crucial to identifying potential areas of value.
Japan	Neutral	We are neutral on Japanese equities: Japanese corporates have lower debt and their profits are also growing. However, a rising yen, given its safe haven status, amid the spreading risks of the coronavirus and if geopolitical risks emerge.
Asia ex Japan	Neutral	We are neutral on Asian equities. There are some attractive valuations relative to the developed markets and expectations of earnings growth should support Asian equities, but short term volatility is likely to persist.
China & HK	Neutral	We are slightly positive on Chinese equities, (in relative terms vs. Emerging Markets). Having lost 3.9% in year-to-date, the MSCI China seems attractively valued. However, the recent spread of the outbreak brought uncertainties on financial markets. We are neutral on Hong Kong equities, as 30% of Hong Kong index is exposed to global trade and the economic growth remains unstable due to the coronavirus.
Global Bonds	Overweight	
Government Bonds	Overweight	We are positive on government bonds, we continue to prefer U.S., despite some profit-taking, as safe-haven demand is likely to support U.S. Treasury. We are positive on credit bonds. It remains an area of opportunity but selection is crucial.
Credit	Overweight	

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

The S&P 500 made a new all-time high at 3,386 on 19 February but then closed the month with an underperformance of 8.23%. Overall technology stocks did better with the Nasdaq posting a -6.38% return while the widely followed FANG+ posting a small loss of -0.54%. The narrower Dow Jones 30 recorded a loss of 10.07% for the month. Consumption is holding up well, thanks to the solid labour market and retail sales trends in consumer spending (excluding base effects). Labour income growth is slowing, which is in line with our expectations, following both a decline in the growth rate of working hours and hourly earnings. On 3 March, on the back of rapidly “evolving risks” posed by the coronavirus (COVID-19) cited by the Chairman of the Federal Reserve (Fed), Jerome Powell, the Fed signaled openness to easing policy and rapidly moved from statement to action by cutting rates by 0.50%. In light of persistent and highly disrupted financial markets, the Fed had a new emergency rate cut of 1% on 15 March and launched a massive USD 700 billion quantitative easing. The oil price dropped around 20% amid a disagreement on oil production cuts between the Organization of the Petroleum Exporting Countries (OPEC) and allies. Until now, weakness in energy was entirely the result of the demand shock caused by COVID-19 with some hope that the OPEC would continue to provide some support. With that hope now off the table, the sector is facing supply and demand concerns.

We expect to see a hit on confidence indicators, with lower global Purchasing Managers' Indexes (PMIs) eventually hurting earnings formation. The U.S. economy should prove to be more resilient thanks to its strong domestic demand, but the reaction to the spread of COVID-19 around the world would have an impact. In the medium term, the U.S. economy is expected to continue with its moderate pace of expansion as supported mainly by personal consumption. The potential growth of economy will be intact as far as monetary and fiscal actions promptly materialize. Once the pandemic stabilizes, economy will rebound (much more likely in the 2nd half of the year) and catch up some of the lost ground. The supply shock will disappear and "pent-up demand" will materialize. The Fed's actions of last week and this weekend served to address the tightening in financial conditions, the sharp decline in real rates and the collapse of inflation expectations to below 1%. Finally, the liquidity infusion can go a long way in easing funding stress in money markets and narrow the cross currency basis significantly. Earnings per share growth forecasts are still too high and will likely be revised down as a consequence of the outbreak. We are negative on the U.S. equities. The tactical themes have changed because they were dependent on a nascent global economic recovery, which at this point is postponed. Therefore, cyclicals will underperform defensives.

EUROPEAN EQUITIES

All main equity markets posted negative results, with the MSCI Europe down 8.25%. The MSCI EMU and the Euro Stoxx 50 returned respectively -8% and -8.46% for the month. Some markets limited the loss, such as defensive indices like the Danish dropping 4.31%, the Nordic Bourse and the Finnish market falling 6.39%. The other European markets experiencing worse negative returns were the German DAX dropping 8.41% and the French CAC40 falling 8.55%. The Eurozone's composite PMI moved up to 51.6 in February thanks to better perceived conditions following the positive developments on the trade war and the Brexit. The improvement was also reflected in German manufacturing data in January. Services remained in expansionary territory. However, the momentum in economic data worsened in the second part of the month due to the weakening demand driven by the news on COVID-19. The Eurozone's inflation picked up slightly in December, however we do not expect headline inflation to move significantly higher on aggregate. Indeed, we expect a gradual convergence to 1.5 but the weakness in growth in 2019 will translate into lower domestic inflationary pressures. The worst performing country index was the U.K. with the FTSE 100 falling 8.99% due to the index exposure to commodities and basic materials stocks. GDP growth was flat in the final three months of 2019 as the underlying momentum in the U.K. economy continued to show signs of slowing. However, manufacturing rebounded from its long decline following the reduction in political uncertainty.

In the Eurozone, domestic demand seems to be the main driver of growth going forward, with resilient consumption in aggregate, as supported by the moderate wage growth and good labour market conditions overall. However, the momentum in economic data has worsened amid the COVID-19 outbreak and weak world trade. The February Flash PMI in Germany and the Eurozone showed the impact of the COVID-19 outbreak, with sharp declines in the PMI sub-components for export orders and a lengthening of delivery times. These effect may intensify further in March as countries attempt to limit the spread, which may bring disruption to production. In view of the risks for both macroeconomic and financial outlook, the European Central Bank (ECB) joined other major central banks in opening the door for more accommodation to come, despite limited margins of maneuver for further rates cuts. "Appropriate and targeted measures" cited by the ECB point to more efforts in support of liquidity and financial conditions. We expect the ECB to focus on leeway offered by more quantitative easing and renewed measures on long term refinancing operations. A further rate cut remains an option, but it looks less effective than other measures in terms of monetary stimulus. Overall, we are negative on European equities. The virus outbreak will delay the expected cyclical recovery and lead to a more cautious approach. The future earnings outlook remains crucial to identifying potential areas of value.

JAPANESE EQUITIES

The pandemic nudged Tokyo market to the second straight monthly downward streak. The Topix returned -10.28% and the Nikkei dropped 8.89%, which went back to the level recorded last September. The market opened higher and tested its upside as the People's Bank of China provided outsized liquidity to the system to soothe the financial market. Also, China’s decision to repeal retaliatory tariffs on some of the U.S. products encouraged investors. However, the relief rally was soon overtaken by massive sell-off. More than 40% of companies reported poor Q4 profits, which were more than 10% lower than initial projections. On the economic front, GDP shrank by an annualized 6.3% in Q4 due to higher sales tax and typhoons. External demand showed weakness, leading to a drop in exports. Apple Inc. sent the market into a tailspin as the company warned that the first quarter sales would fall short of the estimate due to the virus spillover. Investors accelerated selling towards the end of the month as the pandemic spread to Middle East and Europe while passengers of a seriously-affected cruise ship died in Japan. The equity market collapsed on the final trading day after the Dow Jones Industrial Average posted the largest retrieval.

We have revised down our GDP growth forecasts for 2020 to 0.3% and 2021 to 0.7% as the outlook looks more fragile due to growing COVID-19 risks. The Bank of Japan (BOJ) may still consider additional easing in 2020 if geopolitical risks increase again and the Japanese yen strengthens materially. We expect a 0.10% rate cut in the next 12 months on two conditions. First, a cut in the short-term interest rate target must be accompanied by realignment of the three-tiered structure in the BOJ’s current account deposit in order to mitigate adverse effects on financial institutions. Second, the BOJ will obviously keep the longer-end of the curve from declining, in order to secure the slope of the curve. In line with the statements released by other major central banks, the BOJ said that it will provide ample liquidity to ensure stability in financial markets, through appropriate market operations and asset purchases (500 billion yen). Therefore, we expect more liquidity to be injected into the system, and we keep our previous expectations for a rate cut over the next 12 months. We are neutral on Japanese equities. Japanese corporates have lower debt and their profits are also growing. However, most Japanese companies are exporters and could be vulnerable to a rising yen given its safe haven status, amid the spreading risks of COVID-19 and if geopolitical risks emerge.

ASIA EX-JAPAN EQUITIES

Amidst heightened global uncertainty due to the COVID-19 fears, the MSCI World and the MSCI Emerging Markets lost 8% and 8.6% respectively. Meanwhile, the MSCI Asia excluding Japan outperformed and fell 2.9%, helped by gains from Chinese equity markets. Global trade releases indicated that trade growth continued to fall in Q4 2019. Manufacturing activities contracted across Asia as the virus outbreak disrupted the supply chain while shortages in materials and key components temporarily stopped production in plants across Asia, including automobiles, mobile phones, building materials and construction. Global central banks turned dovish on their policy outlook amidst concerns on global growth and deflationary scares. In Asia, Singapore, Hong Kong, China, South Korea, Thailand and Malaysia announced a slew of measures, including monetary easing and expansionary fiscal policies to boost their economies. Given the expected negative impact on corporate earnings, earnings for the region saw further negative revisions with the Philippines, Singapore, Taiwan and China weakening the most. Most Asian currencies depreciated against the U.S. Dollar. The worst performing emerging market currencies in Asia was Indonesian Rupiah (-4.9%), Malaysian Ringgit (-2.9%) and Singapore Dollar (-2.2%) while Chinese Renminbi (-1.2%) and Indian Rupee (-1.1%) were less volatile.

Fiscal authorities will likely to support the outlook with a massive fiscal expansion aimed at restoring both production and consumption trends. However, some countries have limited room for maneuver, and may not be able to put in place powerful countercyclical tools. Shocks to Chinese economy impacted Asian countries, primarily exports and tourism. We have become very cautious on Chinese exports and tourism-related sectors such as hospitality, aviation and consumer discretionary. In this regard, we keep monitoring companies listed in countries such as Thailand, Korea and the Philippines that are beneficiaries of demand from Chinese tourists. We think the level of uncertainty is unusually high given the lack of clarity over the spread of the virus and the unprecedented nature in which businesses are reacting across the world. Higher uncertainty necessitates lower risk-taking, in our view. We are neutral on Asian equities.

There are some attractive valuations as compared to the developed markets and that expectations of earnings growth should support Asian equities, but short term volatility is likely to persist. We focus on companies related to domestic consumption that are relatively insulated from COVID-19 and can potentially benefit from the strong domestic demand or the continuing shift in the value chain (Indonesia, Vietnam). We are watchful to names directly impacted by Chinese tourism and trade.

CHINA & HONG KONG EQUITIES

Chinese equities remained resilient amid the market turmoil in February and gained 1.0%. The MSCI Hong Kong lost 1.4%. In China, the stock market started February with a sell-off, but it quickly recovered as new monetary and fiscal policy measures were implemented to control the impact of the COVID-19 pandemic and stabilize the economy. More specifically, on the monetary side, the People's Bank of China lowered the reverse repo/medium-term lending facility/loan prime rate by 0.10% in the second half of the month. Local authorities also further loosened real estate policies. The central government increased the credit support for corporates (especially for SMEs). Regarding fiscal stimulus, the government implemented targeted tax cuts/reductions in fees and relaxed unemployment benefit criteria. China's inflation rate jumped to 5.4% year-on-year in January. The pick-up in January's consumer price index (CPI) inflation came on the back of the Chinese New Year holiday effect and the early impact of COVID-19 mainly on food prices. Core inflation remained subdued at 1.5% year-on-year. As far as trade figures are concerned, exports expanded by 7.9%. In Hong Kong, Q4 advance GDP, indicating 0.4%, is above consensus but indicated an extremely weak economy owing to a series of negative shocks including the US-China trade tensions, domestic social unrest and the COVID-19 outbreak. The Hong Kong SAR government announced a bold fiscal budget to cushion the domestic economy from these shocks. The budget released in February mandated approximately HKD 120 billion short-term, one-off relief measures, which equals to almost 4.1% of GDP. Headline CPI rose 1.4% year-on-year in January, mainly due to the government's subsidy on public housing and electricity charges beginning in January.

In China, the PMI is likely to drop well below 50, as the production lines stopped. China needs to balance the rising debt levels and the economy slowdown, which started from the trade war with the U.S. and the lower production because of COVID-19. It will be likely to trigger central authorities to introduce further economic stimulus. We consider the pandemic as a risk factor in Chinese and Hong Kong stock markets, i.e. an unanticipated event that could be short-term in nature, but has an impact on global market sentiment as well as on economy. The main trigger in our decision to reload risk in the portfolio is the global pandemic evolution, which becomes the epicentre of the supply/demand issue. On top of that, we are monitoring the economic data released and measures taken by the central banks, we favour fiscal more than monetary accommodative measures, which could help markets to stabilize. We are slightly positive on Chinese equities (in relative terms vs. emerging markets). Having lost 3.9% year-to-date, the MSCI China seems attractively valued. However, the recent spread of the outbreak brought uncertainties on financial markets. We are neutral on Hong Kong equities, as 30% of Hong Kong index is exposed to global trade and that the economic growth remains unstable due to COVID-19.

GLOBAL BONDS

With the volatility spikes affecting the equity markets and the VIX touching 40, investors moved to safe assets like the U.S. dollar and the Treasury. Core government bonds had a strong performance with the 10-year U.S. Treasury yields closing the month at record lows. Credit had a slight positive performance, with the Barclays Global Aggregate Total Return posting 0.67%. As investors started to price in the strong effect of COVID-19 because of the wide spread in the developed countries, fixed income markets experienced large moves and the flight to safety pushed the U.S. Treasury yield to achieve historical lows. The U.S. Treasury yield curve moved lower with the U.S. 2-year yield falling from +1.32% to +0.92% and the U.S. 10-year yield starting at +1.51% and finishing at +1.15%. In February, the Fed delivered a 0.50% rate cut, which was the first intra-meeting ease since the 2008 crisis. Market volatility and liquidity concerns was likely the trigger for the emergency cut. On Sunday, 15 March, the Fed cut rates by 1% to near zero citing the effects of COVID-19 on growth in the near term, and its risks to the long-term economic outlook. In response to severe tightening of financial conditions, the Fed also jumpstarted its quantitative easing program. Having started February at -0.44%, German 10-year bond yields fell further in negative territory to finish the month at -0.61%. Over the month, German 2-year bond yields fell 0.10% to -0.78%. Overall, the JP Morgan EMU Government bond indices were flat, with both the 3-5 year index and the 5-7 year index posting -0.03%. The JP Morgan Emerging Markets Bond Index Plus Composite, on the other hand, did worse and depreciated -0.82% during the month.

With elevated uncertainties on the macro side and investors' continued search for safety, we expect the core government bond yields to remain very low, with limited upside pressure. Negative yielding debt is back to USD14 trillion in value and this continues to push investors towards the 'oasis of yield' in credit, securitized assets and peripheral debts. Here, a close look at the evolution of the macro economic situation is crucial. While abundant macro-liquidity supports financing of corporations, a deterioration of the economic environment could affect the most leveraged areas of the market. We are positive on government bonds and we continue to prefer the U.S. Treasury despite some profit-taking, as safe-haven demand is likely to support the U.S. Treasury. Fiscal stimulus is likely to push rates higher for Japanese and U.K. bonds even though the Bank of England has turned dovish and cut interest rates from 0.75% to 0.25% in an emergency move in March to bolster the economy during the coronavirus outbreak. We are positive on credit. It remains an area of opportunity but selection is crucial. Euro investment grades have been resilient and remain our conviction, as it should benefit from the ECB program, in particular subordinated debt financial sector. Solid economic data and corporate earnings have helped the U.S. credit spreads to near all-time tight levels before coronavirus risk erupted. Tail risks to economic growth remain, which will potentially weigh on credit fundamentals.

"BCT" - BCT Financial Limited (Plan Sponsor)
- Bank Consortium Trust Company Limited (Trustee & Administrator)

Issued by BCT Financial Limited

The content of this Market Outlook is contributed by Amundi Hong Kong Limited.