BCT 銀聯集團

The Post COVID-19 Pandemic World

Investment Markets	BCT's Investment Views	Summary
Equities	Underweight	
US	Underweight	We are negative on the U.S. equities. In an environment where risks remain clearly tilted on the downside, we prefer to stay defensive and consider a change of the current exposure only if valuations become more appealing.
Europe	Underweight	Overall in European equities, we are negative. Earnings will have to come down significantly from current market expectations and this will be a painful process. We prefer quality stocks with resilient business models. The strength of balance sheet and strong competitive position remain critical to us.
Japan	Neutral	We are neutral on Japanese equities. Strong support from the government but a very cyclical market, which will need the earnings revision process to be more advanced and some weakness of the Yen to be really able to benefit.
Asia ex Japan	Neutral	We are neutral overall on Asian equities. 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.
China & HK	Neutral	We are neutral on Chinese equities, as market volatility remains extremely high and risks still tilt to the downside. But we will continue to closely monitor potential trades. We are neutral on Hong Kong equities. The global growth is under pressure, which will affect Hong Kong economy. The government announced relief packages to help the economy, but the effectiveness is still a question mark.
Global Bonds	Overweight	
Government Bonds	Overweight	Overall, we are slightly positive on government bonds. The U.S. Treasuries continue to benefit from safe haven flows and, even if to a lower extent, global search for yields. We are positive on credit, but we have increased the focus on liquidity. The investment grade sector should remain more resilient in the coming months while continuing to offer an attractive spread compared to historical levels.
Credit	Overweight	

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

The U.S. S&P 500 hit its lows on 23 March, but it has rallied significantly since then, posting a gain of 12.8% for April alone, and up 28.6% from those lows. Since the start of April, both hard and soft data have begun to show the impact on the economy. American job loss in April ballooned, and unemployment moved up sharply to 14.7% from 3.5% two months earlier, which was the highest since the Great Depression. In this first round, job losses were concentrated in frontline sectors (i.e. service and hospitality related), small/medium enterprises and lower pay sectors/lower pay employees. Part of the unemployed were reported as temporary layoffs. Currently the 14.7% unemployment rate could be underestimating the full damage which will become visible in next few months (second round effect on deeper economic damages). We estimate that approximatively 30 million jobs could be at risk, unemployment could rise to 22% and then decline gradually (peak in Q2 or Q3). To assess the labour market, focus will be on continuing claims (if and how they decline in the U.S. states that are opening up) and labor force participation rate evolution (if it remains weak or not, i.e. people coming back to look for a job). Sentiment plunged across business lines, especially in service and consumer sectors. Retail sales fell the most since 1992. The inflation was moderated in March. In order to stabilize financial conditions, the Federal Reserve (Fed) rapidly moved to action, making full use of conventional and unconventional tools. In the April meeting, the Fed renewed the commitment to use the “full range of tools to support the U.S. economy in this challenging time”. Liquidity and coverage of extraordinary financing needs on the fiscal side represented the major targets of the Fed.

We revised down 2020 GDP growth projection due to weaker than expected Q1. Based on lower oil prices and weaker demand, we now forecast a growth range between -6.5% and -4.5% for 2020 and a pickup to the range between +2.5 to +4.5% for 2021. Inflation will remain subdued, headline inflation is expected to remain in 1% on average, as well as core inflation. We reiterate that the uncertainty around the macro forecasts is very high and it triggers frequent reassessments. While we acknowledge the unprecedented policy responses from central banks and the exceptional fiscal boost, we believe that the negative economic spiral triggered by the pandemic will take time to stabilize. On earning growth, consensus for 2020 has corrected but remains very optimistic for 2021 despite low visibility of future developments. The market is discounting the year 2021 which will fill the holes created in 2020 in terms of real growth and earnings growth: everything looks priced to perfection. Our focus is now on the evolution of COVID-19 given the easing lockdown measures and the progress on the medical research (vaccine, effective treatments, etc.). We are also closely monitoring the evolution of geopolitical risks in particular the U.S.-China relationship, and the geopolitical tensions that could arise from oil price swings. In an environment where risks remain clearly tilted on the downside, we prefer to stay defensive and consider a change of the current exposure only if valuations become more appealing. We are negative on the U.S. equities.

EUROPEAN EQUITIES

In Europe, all equity indices that we tracked posted positive returns, with the MSCI Europe appreciating 5.5% in local total return terms. Amongst the major mainland European indices, the German DAX was a standout performer, appreciating 9.3%. At the other end of the relative performance scale, some of the peripheral European markets had modest returns. During the April meeting, the European Central Bank (ECB) kept rates unchanged but further eased liquidity conditions by introducing new refinancing operations (the ECB eased the conditions of Targeted Longer-term Refinancing Operations III by lowering the rate corridor of the facility by 0.25%; and introduced a new liquidity facility, PELTROs, which consists of a series of non-targeted pandemic emergency longer-term refinancing operations with an interest rate that is 0.25% below the refinancing rate). The Bank of England kept rates at 0.10%, and left its quantitative easing program unchanged. While considering the existing quantitative easing was both aggressive and appropriately-sized, the Governor left the door open for an increase of purchases at the June meeting. Within the specific architecture of the Eurozone, European institutions have played a major part by lifting restrictions so that member states can deploy their national program. A European-level mutualized response is also underway, with a number of programs already decided and the larger ones currently being negotiated.

Q1 GDP surprised on the downside in the Eurozone. We now expect a contraction close to 9% for the year. As hard data releases lag behind, soft data provides an up-to-date indication of a sharp downturn, with manufacturing Purchasing Managers' Indexes (PMIs) remaining in contraction territory and the service PMIs falling sharply. Preliminary data on March retail sales, in particular car sales, was appalling (car sales declined 56.4% on a monthly basis). The U.K. economy is set to face a recession which is expected to significantly drag down the economic growth in the first half of the year. The shock will play out via domestic and external demands. We forecast a significant contraction in household consumption, in particular discretionary spending and investments. Business surveys are moving deeper into contraction territory both in manufacturing and services, and the construction industry is also showing significant weakness. Overall in European equities, we are negative. Earnings will have to come down significantly from current market expectations and this will be a painful process. We prefer quality stocks with resilient business models. The strength of balance sheet and strong competitive position remain critical to us.

JAPANESE EQUITIES

April was a positive month for Japanese equity market, led by short covering and optimism related to flattening of COVID-19 curves. The Nikkei 225 rose 6.8% and the Topix increased by 4.4%. The Bank of Japan (BoJ) joined other central banks in calling for more accommodation. The BoJ strengthened its quantitative easing in late April, after doubling ETF purchases. It removed the annual soft target of JPY 80 trillion for Japanese government bonds (currently at JPY 14 trillion), to accommodate the increase in fiscal stimulus, and also announced to add a significant amount of commercial papers and corporate bonds. For special fund operations, the BoJ expanded the eligible collateral range to include all private debts. The BoJ's balance sheet rapidly increased to new highs, both in terms of public debt (more than 50%) and GDP (111%). The BoJ has so far focused on measures to support corporate financing, by purchasing more ETFs and corporate bonds, while leaving the moment policy rate unchanged. We expect the BoJ to keep policy rates unchanged in the near term, as a rate cut is seen to counter the government's COVID-19 containment efforts. At the same time, we expect the BoJ to keep focusing on the slope of the curve, in order to maintain the effectiveness of monetary stimulus. The BoJ has already increased the volume of ETFs purchases in its daily operations and is likely to keep it higher in order to stabilize markets at least in the short term, despite the limited leeway at disposal. The BoJ said it would inject ample funds via market operations to make sure that banks have enough funding through the end of the Japanese fiscal year on 31 March, and announced measures to maintain stability of the repo market. As far as fiscal policy is concerned, the government announced a JPY 39 trillion (USD 357 billion) package of public support equivalent to about 7% of GDP in April. The Prime Minister of Japan, Shinzo Abe, also stated that the government will propose an additional economic package, following the package announced a month ago.

The Japanese economy is expected to sink into a deep recession, as most economies go through a double shock of collapses in both internal and external demands. We expect GDP to contract by 4.5% in 2020, and to recover to around 2.3% in 2021. Inflation will stay subdued at 0.3% in 2020 and 0.6% in 2021. The PMI collapsed again in April. After plunging by 10.8 points in March, the composite PMI fell further by 8.5 points to the record low of 27.8 in April, which was the worst number since the 2011 earthquake. As much of the global economy remains under lockdown, we continue to expect a soft trade and business investment outlook. The state of emergency declaration by the government, now extended to the end of May, will hit hard on the economy in Q2. High-frequency mobility data suggested that private consumption will drop further in April and May after a sharp deceleration in March. But the contraction would be relatively smaller than other advanced economies given Japan's better control over the pandemic. Cash handouts to all households will also help mitigate some downside. We are neutral on Japanese equities. Strong support from the government but a very cyclical market, which will need the earnings revision process to be more advanced and some weakness of the Yen to be really able to benefit.

ASIA EX-JAPAN EQUITIES

Emerging markets experienced a good month and managed to deliver some solid returns. The MSCI Emerging Markets rose 9% in USD total return terms during April whilst in local terms the Emerging Markets complex was slightly better and up 9.2%. The emerging markets in Asia appreciated 9.1% with some regional disparities in terms of overall performance. In terms of the major indices, the winners were some of the Southeast Asian markets, both the Indian indices (Sensex and Nifty) were the best performers, rising 14.4% and 14.7% respectively, whilst the Thai SET took the prize for the month's best absolute return, which was up 15.6%. The export-oriented South Korean KOSPI followed the tone of other Southeast Asian markets, rising 11%. Economic momentum collapsed in emerging markets in Asia with COVID-19 effects devastating growth expectations, domestic and external demands, and budget balance. Authorities have shifted to more aggressive easing, exacerbating vulnerabilities in some countries. More action is expected and should come on the fiscal side. The International Monetary Fund and the World Bank have stepped in to support emerging economies. In India, fiscal efforts remained insufficient (0.8% GDP) to tackle the lockdown impact on industries. Although the Reserve Bank of India took advantage of the deceleration of a still high inflation (5.9% in March) to keep lowering its reverse repo rate and announced other key actions (e.g. refinancing facility, easing of liquidity coverage ratio, moratorium of 3 months for loan due for payment between March and May), their impact on the real economy is still limited.

COVID-19 pandemic is expected to cause a strong and prolonged contraction. Our scenario is coherent for extended weakness for the rest of 2020 and Q1 2021 with some recovery expected from next 12 month forward, when commodities, global demand and emerging markets exports will recover. Inflation is declining sharply in some cases, which is opening up more room for central banks on the dovish side. We remain relatively defensive but are witnessing encouraging signs in countries that look to be at a later stage of the COVID-19 cycle. Countries with fiscal buffers and strong domestic bases (such as China, Korea and Taiwan) present a strong investment case as they are close to being autonomous regarding internal demand and are less dependent on global supply chains and trade. However, we are extremely defensive on names dependent on export, commodities and tourism. We are neutral overall on Asian 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, due to sector exposure, strong monetary and fiscal stimulus and better containment of COVID-19 compared to other countries.

CHINA & HONG KONG EQUITIES

In April, the Shanghai Composite rose 4%. Although the MSCI Hong Kong posted strong gains (7.3%) in April, it was one of the biggest laggards in Asia. In China, high-frequency data pointed to a decent recovery of domestic demand, although services consumption rebounded at a relatively slower pace than goods consumption. Downward growth pressures shifted back to the manufacturing sector. Export orders indicator dropped sharply in April, indicating weakness of external demand ahead. The People's Bank of China continued its easing in March and April, cutting the 7 days reverse repurchase rate and medium-term lending facility rate by 0.20% to 2.20% and 2.95%, respectively. It also lowered the interest rate on excess reserve by 0.37% to 0.35%. The reserve requirement ratio was also reduced for smaller banks, along with an expansion of relending program for small and medium enterprises (SMEs). In Hong Kong, no new local cases were recorded for 15 consecutive days and the government announced that it would resume most public services on 4 May. It announced additional relief measures of HKD 137.5 billion (approximately 4.8% of GDP) in April to support the private sector, including wage subsidies to eligible employers and enhancing the SME financing guarantee scheme. Hong Kong's Consumer Price Index (CPI) growth came in at 2.3% in March. Netting out the effect of the government's one-off relief measures, the underlying CPI rose 2.6%. The labour market remained under pressure, with unemployment rate rising by 0.5% to 4.2% in March. In particular, employment in retail, accommodation and food services sector dropped sharply by 12.4% year-on-year.

We forecast that the GDP growth in China will stay in the range of around 2% in 2020 and recover to 8% in 2021. We expect underlying inflationary pressures to stay contained, with the CPI continuing to peak out, mainly driven by a downward normalisation of food prices and a subdued Producer Price Index, under the depressed global outlook and low oil prices. Service sector is building back jobs while pressures in manufacturing employment are building up. Balancing these two factors, unemployment rate is likely to hover at just below 6% in the near term. The U.S.-China tensions escalate on the ramping rhetoric on China's role in handling the pandemic. Tensions involving tariffs and extra tariffs measures (such as those against Huawei) will lead to retaliation from China, rendering previous efforts futile. On a broader perspective, COVID-19 might exacerbate current trade tension into a more structural contentious "Cold War". In Hong Kong, unprecedented fiscal stimulus will help limit the downside in domestic demand and support a rebound in the second half of the year and into 2021. We are neutral on Chinese equities, as market volatility remains extremely high and risks still tilt to the downside. But we will continue to closely monitor potential trades. We are neutral on Hong Kong equities, as the economic activities are still affected by social distancing measures and the timing to lift these measures is still unknown. The global growth is under pressure, which will affect Hong Kong economy. The government announced relief packages to help the economy, but the effectiveness is still a question mark.

GLOBAL BONDS

The economic backdrop, as shaped by the pandemic, is characterized by global recession with sequencing sharp slowdowns followed by de-synchronized recovery paths. The length of the weakness, the extent of permanent output loss and demand destruction will depend, among other factors, on lockdown duration and the effectiveness of the fiscal and monetary push. Q1 2020 GDP data was in line or weaker than expected, triggering a further downward revision in the GDP forecasts. Inflation dynamics were weaker than anticipated, due to the depressed oil price and the weak global demand. We confirm the scenario of growth stabilization around the last quarter of the year. Global monetary stimulus is likely to increase in the short term, on the back of higher fiscal needs and deteriorated macro picture. In April, markets were driven by the prospect of a gradual easing of the lockdown, and hence the assumption of better growth ahead, as well as extremely accommodative policies by central banks. The 10-year German Bund and the U.S. Treasury yield fell 0.12% and 0.05% respectively during the month. Despite better liquidity conditions on the sovereign segment, volatility persisted on European peripherals mainly due to worries concerning the huge public debt engaged to fight against the crisis and the downgrade race by rating agencies. The ECB's actions helped put a ceiling on Italian government bond yields and the level of volatility of the spread. The recent German Constitutional Court ruling, which challenged the legality of the ECB policy, represented a downside risk for peripherals.

Current levels of the U.S. Treasury yield (0.60%) are consistent with monetary policy perspectives and a sharp worsening in the macro picture. The ECB and the Bank of England are likely to increase the current size of their quantitative easing, while the Fed will keep its unlimited quantitative easing. Central banks' role will be crucial to keep the cost of public debt low and cover for huge fiscal needs, supporting the persistence of current range trading in a sort of curve control environment. In this context, we prefer not to have strong directional bets. We are more confident on the U.S. inflation. Inflation linked bonds and inflation swaps are historically cheap. In the short term, volatility in energy prices and deflationary pressures from the recession may hamper a rapid appreciation of the asset class. However, as we exit the pandemic, reflationary forces (de-globalization, debt monetization tendencies) should eventually support higher inflation risk premium and demand for inflation protection. We stay positive on credit, under the umbrella of central banks in the U.S. and the Eurozone. We prefer investment grade to high yield. Liquidity assessment remains crucial. In emerging markets debt, there is a high repayment risk. A wide gap between investment grade and high yield countries remains in place, with a high component of debt in distress. Rating agencies continue to deliver downgrades across emerging markets sovereigns on deteriorating macroeconomics, fiscal positions and downside risks due to uncertainty over the duration and intensity of the pandemic. On local rates, the main driver for local debt is currency exposure, with room for further compression being quite limited now. On external debt, the investment grade sector should remain more resilient in the coming months while continuing to offer an attractive spread compared to historical levels. On the other side, the high yield segment incorporates the binary risks between the default of distressed countries and the catch up from very depressed valuations. 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, global search for yields. Besides, the Fed is aggressively buying the U.S. Treasuries, especially in short to medium terms segments.

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