BCT Market Outlook

As of Oct 2019

Investment Markets	BCT's Investment Views
Equities	**Neutral**
US	Neutral
Europe	Overweight
Japan	Neutral
Asia ex Japan	Neutral
China & HK	Overweight
Global Bonds	**Neutral**
Government Bonds	Neutral
Credit	Overweight

Scales of weighting: Underweight, Neutral & Overweight.

US Equities

Recent data show that deceleration is taking place, however we still forecast decent U.S. growth ahead. Fixed investments have been trending down markedly since the second half of 2019, while personal consumption expenditures have remained resilient overall. The protracted weakness in global trade and manufacturing, coupled with uncertainty over the implementation of tariffs, may have played a role in discouraging investments, which have partially offsetted the benefits of fiscal policy. Inflation was low (1.7% overall, 2.4% for core inflation) but remained close to the Federal Reserve (Fed)'s target. There have been some steps towards the U.S.-China trade deal, but so far short of significant improvements. Negotiations are still ongoing. Monetary policy continues to be supportive. The Fed delivered a second 0.25% cut in its September's Federal Open Market Committee meeting and remained open to act again if needed. Renewed talks between the U.S. and China, tariff delays and accommodative central bank policy helped equity markets stage a recovery in September. During the month, the S&P 500 gained 1.87%. The VIX Index, which can be considered a proxy for global risk aversion, slightly rose from very low level to 16 during the second half of the month.

GDP forecasts for 2019 and 2020 have been revised down globally. For the U.S., we expect year-on-year GDP growth at 2.3% for 2019 and 1.7% for 2020 (revised slightly down from previous quarter), and year-on-year CPI inflation at 1.8% for 2019 and 2.3% for 2020. Fiscal policy, which was a strong growth support in 2018, is decelerating and is expected to continue to do so unless a very negative scenario materializes on the growth side. On monetary policy front, after September's rate cut, the Fed remained open to act again in case of need. The Fed signalled reasonable pragmatism and cautiousness in using its "policy ammunition", but recent trends in trade disputes and risks to financial conditions (mostly driven by strong USD) may make an additional rate cut likely by the end of 2019. The earnings season has been somewhat better than market expectations, but the trade war effects are starting to materialize, resulting in a more uncertain earnings outlook, despite a still resilient economic backdrop. **Currently there is little political risk premium priced in the U.S. assets, with credit spreads near recent lows, and equity prices near record highs. If investors consider slowing U.S. and global growth, trade policy**

uncertainty, and geopolitical risks, they should be prudent to be defensive on equity positioning with a focus on quality companies that trade at reasonable valuations, to guard against potential downside risks. We remain cautiously neutral on the U.S. equities.

European Equities

The Eurozone economy is adversely affected by the weakness in industrial activity. In September, the Eurozone's Purchasing Managers' Indices further challenged the optimism in hard data, mounting the uncertainty underlying the economy. The newly released data confirmed the softening momentum of the Eurozone manufacturing and service sectors. The Eurozone manufacturing sector has been impacted by the intensification of trade war. The Eurozone is highly exposed to international trade and protectionist measures are particularly hurting the European automotive sector. On 12 September, the European Central Bank (ECB) delivered a package of aggressive easing measures, which included the reopening of quantitative easing and a 0.10% deposit rate cut (set at -0.5% from -0.4%). To dampen the effect of this cut on the banking sector, the ECB also announced a new two-tier deposit reserving scheme. Uncertainty about the Brexit is extremely high. The Prime Minister, Boris Johnson, continues to state that Brexit will happen on 31 October, even without a withdrawal agreement. However, the Parliament passed a motion instructing him to request an extension of the Brexit deadline from the European Union, should there be no deal approved by 19 October. In Europe, equity markets posted positive results (Euro Stoxx 50 went up 4.29% during September), driven by renewed talks between the U.S. and China, tariff delays and accommodative central bank policy. European banks (+8.97%) strongly outperformed the index.

We expect GDP growth of the region to stay subpar. We confirmed the Eurozone's year-on-year GDP growth forecast at 1% for 2019 while we lowered our 2020 forecast (revised down to 1% from 1.2% previously). We do not expect a prolonged recession although technical recessions are possible in some countries. Risks remain tilted to the downside, raising concerns on whether the resilience in the service sector will last and whether a spillover into service sector will materialize soon. Domestic demand should remain well supported by the strong labour market and some wage pick-up, which contribute to a positive trend in real disposable income. Economic policy should stay stimulative: fiscal support is set to come, but will probably not cause a major "big bang". From the monetary policy side, we expect a continuation of the accommodative stance, with a possible additional 0.10% deposit rate cut in the next 12 months, but there is very limited room for further cuts and additional negative effects to the banking system which the central banks are required to provide compensation. **Corporate fundamentals remain solid, although forward earnings visibility has deteriorated. Valuations seem reasonable although there is a significant dispersion among sectors. We believe that heightened volatility and market dislocations could provide opportunities. Overall we are slightly positive on the European equities.**

Japanese Equities

Japanese economy is suffering from weak global demand. Corporate revenues have become anaemic and profits have plunged markedly, although exports has shown signs of stabilization. Private machinery orders lacked strength, reflecting companies' reluctance to boost capacity and/or renew plant and equipment amid growing uncertainties surrounding global trade. So far, resiliency in the service sector is keeping capital spending afloat as the Ministry of Finance's corporate survey showed a massive 8.3% increase in capital expenditure plans this year. However, business morale of non-manufacturers fell to a 3-year low, though much better than the case of manufacturers, which hit a 6.5-year low. Job vacancy dropped for the third month in a row, mirroring slower domestic economic growth. Consumption could be another source of pain for the economy. Real household spending was affected by weaker corporate earnings and fears of a consumption tax hike. The U.S.-China trade tensions had strong impacts on equity markets: with the easing of trade tensions, Japan was the best performer of the major equity indexes, with the Topix up 5.92% and the Nikkei up 5.74%. The cheap valuations supported the strong upside movement of Japanese indexes.

Japan's GDP is expected to grow at subpar rate, our forecast is 1.0% for 2019 and 0.5% for 2020. The evolution of external headwinds – trade disputes, global growth, etc – and the way domestic challenges will be addressed (will the economic package be sufficient to alleviate the pain of consumption tax hike?) will be crucial for Japan to keep a certain degree of resiliency. The Bank of Japan tilted dovishly on global growth concerns, there are market expectations for additional easing as the Bank of Japan announced an upcoming deeper economic analysis at the next meeting. On interest rates, the Governor of the Bank of Japan, Haruhiko Kuroda, said the Bank of Japan has more room for easing than the ECB, therefore not ruling out the possibility of a rate cut. At the same time, he said a steeper yield curve is desirable. We expect that the Bank of Japan might launch a package of rate cut and measures to steepen the curve. **Equity valuations are attractive and so are dividend yields. Corporate governance standards are also improving. The market is expected to have some room for mild upside due to relative resilience of Tankan (Short-term Economic Survey of Enterprises in Japan). However, corporate earnings' sensitivity to global manufacturing and foreign exchange appreciation, plus the risks of trade war are headwinds that underpin our neutral view. Overall, we remain neutral on Japanese equities.**

Asia ex Japan Equities

Economic conditions in the region keep worsening, driven by a further decline in external demand and soft domestic demand. The outlook for exports is poor, due to a re-escalation in trade tensions. The new round of negotiations between China and the U.S. could offer some relief if an interim deal is achieved. The region's inflation figures have remained very benign. Inflation in August picked up mildly, except South Korea (year-on-year inflation rate dropped to 0% from 0.6%) and the Philippines (year-on-year inflation rate dropped to 1.7% from 2.4%). In September, the Bank of Indonesia resumed its easing with a 0.25% rate cut, while the Bank of Thailand remained on hold. The Indian government surprisingly cut the corporate income tax rate from its current level at 35% to 25% for companies in operation, and to 17% for companies that are going to set up after 1 November 2019 in an attempt to revive domestic investments and attract foreign investments. The MSCI AC Asia ex-Japan registered a gain of 1.65% in USD terms. Returns in Asia were mixed: Korea and India were on the top of the ranking with +4.84% for the KOPSI and +3.57% for the SENSEX while Indonesia and the Philippines recorded -2.52% and -2.50% respectively.

The outlook for the Asia ex-Japan remains dependent on the evolution of trade discussions between the U.S. and China. Economic conditions in the region keep deteriorating, driven by a further decline in external demand and soft domestic demand. The outlook for Korean exports is dark, due to a re-escalation in trade tensions. India's growth outlook, broadly based, is weaker than expected. Given the benign inflation trend of the region, we expect more easing by every countries. Several countries are trying to stimulate their economies through fiscal leverage. The Philippines, Thailand and India recently announced different fiscal packages/measures. On the opposite side, in its 2020 budget announcement, Indonesia is pursuing its virtuous fiscal consolidation path. **Geopolitical risks and uncertainty remain elevated, leading to an increase in investor risk aversion and market volatility, and we expect this could only be partly offsetted by central banks' accommodative stance. In this environment, despite attractive valuations and favourable technical conditions (light positioning in Korea), we prefer not to have directional bets at the moment. We are neutral on Asia ex-Japan equities.**

China & Hong Kong Equities

Chinese macroeconomic data continue to decelerate on a broad basis, including manufacturing, consumer goods and fixed capital investments. The Chinese policy mix continues to support the economy in a limited way, through both the monetary and fiscal levers. The loan prime rate fell by another 0.05% on 20 August. In a recent speech, the Governor of the People Bank of China, Yi Gang, said that unlike other central banks, the People Bank of China would not rush to slash its policy rates or introduce any quantitative easing, but hoped to pursue an orthodox monetary policy. In Hong Kong, protests continued despite the decision of the Chief Executive, Carrie Lam, to withdraw the extradition bill on 5 September. Retail sales slumped in August (-23% year-on-year). In addition to the HK$19.1 billion (0.7% GDP) fiscal package announced in mid-August, other fiscal measures were introduced to support the business sector amid social unrest. The MSCI China returned flat this month (0.03%). Although there has been a lot of negative comments on the trade situation, the year-to-date performance is still looking good with a gain of 7.91%. Despite that the political tension with China weighed on Hong Kong, the Hang Seng Index returned positive at 1.87%.

In China, economic growth appears to hit a soft patch, and escalating tensions with the U.S. may further deteriorate the slowing economy. Different kinds of stimulus will be introduced. Monetary and fiscal policies are expected to lift investment sentiment and help slow the descent in growth. Next trade talks between the U.S. and China could bring some temporary relief but the challenges on the trade front are still huge. In Hong Kong, the economic outlook is still largely driven by global trade disputes, but the escalation of protests is now having economic impact: the depressed sentiment is hitting retail sales and real estate prices are expected to suffer. GDP growth is expected to drop into negative territory in the 3rd quarter. **We are positive on China equities; there is still room for monetary and fiscal policy to stimulate the economy. Valuations are neutral, technical are favourable, in particular, the MSCI inclusion remains a key support for money flows. We are cautious on Hong Kong equities due to the ongoing domestic social issues. Money flows are not supportive, de-escalation of protests is needed for the asset class to become appealing.**

Global Bonds

Fixed income markets were more volatile as markets weighed geopolitical uncertainty against central bank expectations. The 10-year U.S. Treasury yields spiked by almost 0.30% to 1.9% earlier in the month because the measures by the Fed were not perceived as dovish as expected, but sold-off came back once the President, Donald Trump, announced that he did not need to secure a trade deal with China before the 2020 election. The U.S. Treasury yields rose 0.17% to 1.67% at the end of the month. Bond yields in Europe followed a similar pattern: the 10-year German bond yields rose 0.13% to -0.57% at the end of the month. Meanwhile, in the periphery regions, the 10-year Italian bond yields were volatile given the political uncertainty surrounding the formation of a coalition government, which compressed 0.12% to end the month at 0.82%. Emerging market sovereign bonds also struggled amidst deteriorating macroeconomic data, which led to rate cuts from central banks of several developed and emerging markets. The JP Morgan EMBI Global Diversified Composite lost 0.5% after 8 consecutive months of gains. Corporate bonds' returns were also negative with the exception of the U.S. high yield bond, which gained 0.4%. European high yield bond was down 0.1%. With related bond yield going up, the U.S. and European non-financial investment grade bonds were down 0.7% and 0.9% respectively.

In the recent weeks, the likelihood of a heightened trade war, no-deal Brexit and a return of Italian political crisis has receded. Against this more supportive risk backdrop, the policies of central banks are taking central stage. While the ECB delivered a comprehensive monetary easing package including rate cuts of 0.10% and an asset purchase programme, markets still expect massive monetary easing by central banks to be unrealistic. All in all, investors should adopt a flexible approach to duration management and maintain a positive view on credit, with selection and liquidity management in focus. In global fixed income, investors should continue to seek opportunities at yield curve levels, as well as at the country allocation level. We think investors should remain active in tactically adjusting the duration exposure when the market expectations get extreme. Among European sovereign bonds, we remain positive on the main peripheral European countries that are supported by monetary easing by the ECB and the willingness of the new coalition government of Italy to find an agreement with the European Commission on the 2020 budget. **In credit, we favour European credit because of strong fundamentals and relatively limited leverage. Such market participation is strong due to hunt for yield and ECB support. There is still a quite benign environment for emerging markets bonds. Attractive carry, low U.S. rates, subdued inflation, dovish stance of the Fed and the central banks of emerging markets are supportive for emerging markets duration. However, in spite of uncertainty around trade negotiations, fragile growth dynamics and liquidity issues, investors are recommended to take a more cautious and selective approach. We are neutral on government bonds and positive on corporate credit.**

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