U.S. election and COVID-19 risks reappearing

Investment Markets	BCT's Investment Views	Summary
Equities	Underweight	
US	Underweight	We remain negative on the U.S. equities. The U.S. equity risky premiums over bonds are still supportive of equity prices, although valuations divergence in some pockets of the markets, such as that of the big 5 mega caps and the rest of the markets, is extreme.
Europe	Neutral	We are neutral on European equities. The economic data improved but the second wave of virus in France, Spain, the U.K. and other countries has increased risks as governments balance the need to impose strict lockdowns with boosting consumption.
Japan	Neutral	We are neutral on Japanese equities. Better global growth prospects should favour cyclical and export oriented markets such as Japan. While the new Prime Minister is likely to continue the economic support provided by the previous administration, investors should stay watchful.
Asia ex Japan	Neutral	We are neutral on Asia ex-Japan equities. Some countries of the region have been better able to handle the crisis and this is reflected in economic data coming out of Asia, which confirms our first-in, first-out story. However, geopolitical risks related to China's more assertive foreign policy must be monitored.
China & HK	Overweight	We are positive on Chinese equities. Still in line with our first-in first-out approach, we remain confident on opportunities in the country. Furthermore, we expect the internal consumption development to benefit domestic themes. We are neutral on Hong Kong equities. Recently-released macro data was disappointing.
Global Bonds	Overweight	
Government Bonds	Overweight	Overall, we remain positive on government bonds and credit. In global fixed income, we keep a positive view on the U.S., although we believe this has to be carefully monitored in light of the recent Fed's comments on inflation. Investment grade markets should remain supported by central banks support.
Credit	Overweight	

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

In September, the S&P 500 took some breath after the rally started in April, losing 3.8%. Among American indexes, the Nasdaq fell the most with 5.2%. The MSCI USA Value outperformed the MSCI USA Growth falling by -2.6%, whilst the Growth Index dropped 4.8%. The U.S. businesses reported a solid end to Q3, with a growing demand. Overall, the economy enjoyed a solid rebound after Q2 slump, but COVID-19 infection rates remain a concern and social distancing measures continue to weigh on the overall pace of expansion. The Federal Reserve (Fed) revealed the new forward guidance associated with the recent changes to its Longer-Run Goals and Monetary Policy Strategy. The current rate will be maintained "until labour market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time". As 3 November approaches, policymakers' focus is shifting, with an increased risk that the 2020 fiscal policy will become more diluted than expected, and little visibility on the bipartisan deal in particular. Uncertainty regarding the presidential election has also intensified with investors in search of clarity with respect to both the path of the pandemic and the election.

Q3 economic rebound exceeded our expectations on GDP, prompting an upside revision to our August forecasts. Yet, the deceleration in September of several indicators is keeping us from extrapolating Q3 momentum into Q4. GDP should recover to pre-crisis levels by the first half of 2022. After some softening in the second half of 2020, headline inflation should move along a gradual upward trend, stabilising at around 2% from mid-2021. The new economic projections show that rates will stay at zero at least through the end of 2023. For the moment, the Fed thinks that the policy setting is appropriate. It made no changes to the asset purchase program and showed no urgency in transitioning to a more traditional Quantitative Easing (QE) that tilts purchases toward longer maturities. It will remain at the current pace "over the coming months". Overall, we remain negative on the U.S. equities. The U.S. equity risky premiums over bonds are still supportive of equity prices, although valuations divergence in some pockets of the markets, such as that of the big 5 mega caps and the rest of the markets, is extreme. This calls for a balanced positioning across sectors as the recent correction reminded investors about the U.S. election risks and the still prevailing risks of a virus resurgence. Investors could focus on the leadership rotation towards cyclical and high quality stocks.

EUROPEAN EQUITIES

European equity markets fell in September as investors were spooked by the rise in COVID-19 cases and subsequent increase in restrictions. Against this backdrop, the Euro Stoxx 50 was down 2.3%. In August, the Euro area unemployment rate increased to 8.1% whilst the annual inflation was -0.2%, down from 0.4% in July. In September, business activity slowed down but we saw some divergence by sector and country. Faster growth of manufacturing was offset by a renewed downturn in the service sector. In the U.K., economic activity rebounded in the first part of the quarter with August having seen the strongest expansion for over six years. More recently, the outlook darkened due to rising COVID-19 infections rate. The European Central Bank (ECB) appeared comfortable with its current monetary policy stance, but stands ready to adjust all of its instruments. It will carefully assess incoming information, including developments in the exchange rate, with regard to its implications for the medium-term inflation outlook. The President of the ECB, Christine Lagarde, emphasised the positive result of the last round of stimulus. Targeted longer-term refinancing operations, which aim to stimulate lending to the economy, has been successful. Indeed, the annual growth rate of loans to non-financial companies stood at 7% in July. Pandemic Emergency Purchase Programme still has around 850 billion euro of unused firepower.

After staging a strong rebound in early Q3, the recovery curve for Eurozone economies has flattened while the virus resurgence from September in several countries posed concerns on economic momentum moving into Q3. We therefore expect a gradual pickup in both domestic and external demand, supported by extraordinary easy monetary policy and counter-cyclical fiscal policies. Inflation will remain subdued in the near term, moving gradually higher into 2021, yet remaining quite below target. Temporary extensions of furlough schemes may prevent severe distress in the labour market. The Bank of England is still expected to move to an extension of QE before year-end. In the short-term, the policy package of QE and forward guidance are likely to remain the preferred ones than other tools, despite the recent decision to explore the negative rates option. For the Brexit, our most likely scenario is a further rise in tensions, followed by a sub-optimal deal. We are neutral on European equities. The economic data improved but the second wave of virus in France, Spain, the U.K. and other countries has increased risks as governments balance the need to impose strict lockdowns with boosting consumption. However, Q2 earnings were better than expected, and we believe, valuation dispersion is still high. This presents an environment where investors should be active, focus on resilient businesses and remain cautious overall.

JAPANESE EQUITIES

Japan’s equity market rose marginally with the Nikkei 225 up 0.7%. Investor sentiment was helped during the period by expectations that existing economic policies will be maintained as

Yoshihide Suga was expected to win the leadership race within the Liberal Democratic Party. The second COVID-19 wave left its mark on the economic recovery, with household spending turning sluggish moving into Q3. Business sentiment was mixed in September: while the manufacturing outlook improved on autos, non-manufacturing was dragged down by the retail sector. There were reports that restrictions put in place for the COVID-19 in Tokyo should be released. The Bank of Japan (BoJ) left its monetary policy unchanged on 17 September, one day after the launch of Suga cabinet. The Governor of the BoJ, Haruhiko Kuroda, stressed that the central bank would maintain coordination with the government under the Prime Minister, Yoshihide Suga. This was reaffirmed at a meeting between the two on 23 September. Indicating he would serve out his term until April 2023, Kuroda reiterated that there was no change in the central bank's target to achieve the inflation target of 2%, amid the latest yen strengthening.

Striving to consolidate power with a snap election, Suga vowed to continue Abenomics and hinted at additional fiscal stimulus. Aside from domestic politics, we expect global factors and positioning to play a key role for Japanese equities and currency. With Suga's election as the President of the Liberal Democratic Party, the initial response of the Japanese Yen was strengthened, as investors started pricing in a possible end of Abenomics. Although the programme failed to achieve its targets, a significant shift in domestic policies seems unlikely at this stage. Odds remain in favour of policy continuity in the short term and we believe the Japanese Yen would be mainly driven by external risk factors. With expectations of a global recovery in 2021, sentiment normalization should offset any potential upside coming from the increased focus on domestic reforms, Suganomics should bring going forward. Overall, we are neutral on Japanese equities. Better global growth prospects should favour cyclical and export oriented markets such as Japan. While the new Prime Minister is likely to continue the economic support provided by the previous administration, investors should stay watchful.

ASIA EX-JAPAN EQUITIES

The MSCI Asia ex-Japan was negative over the month, posting -1.85%. Only Korea (+1.5%), India (+0.9%) and Taiwan (+0.7%) were in positive territory, while the worst performers were Indonesia (-11.1%) and Thailand (-7.9%). On 14 September, the Governor of Jakarta announced a strict lockdown for the metropolitan area. The lockdown has to be renewed every two weeks. The Bank Indonesia stayed on hold, confirming its commitment towards the debt monetization process. The monetary policy stance was confirmed dovish, and pressure for easing had increased due to the new risks to growth. In India, the Reserve Bank of India (RBI) conducted Special Open Market Operations of government bonds to ensure the orderly functioning of financial markets; this was last announced on 24 September. In Korea, economic data showed strength with business confidence index rising from 61 in August to 68 in September and exports in September rising by 7.7% year-over-year, the first increase in 7 months.

In India, after pausing its monetary policy easing in early August (with the Repo Rate kept at 4.0%), the RBI is expected to pause it at its October meeting as well, due to persistent high inflation (6.7% year-over-year for August). As inflation is struggling to take a convincing disinflationary path, we see very little room to ease further ahead. Q4 inflation figures could offer more space for easing. In Indonesia, we expect the lockdown to be renewed for the coming weeks, due to hospital capacity and Jakarta's weight in Indonesia's GDP (about 20%), which is increasing the downside risks to growth. In Thailand, unprecedented mass protests calling for change in the exalted status of the monarchy and changes to Thailand's military dominated government and the constitution raise political and economic uncertainties. With State of Emergency declared amidst the pandemic, we expect the political situation to remain fluid and may drag the economy, which is still in the cusp of recovery. We are neutral on Asia ex-Japan equities. Some countries of the region have been better able to handle the crisis and this is reflected in economic data coming out of Asia, which confirms our first-in, first-out story. However, geopolitical risks related to China's more assertive foreign policy must be monitored.

CHINA & HONG KONG EQUITIES

In September, the MSCI China retreated 6.2% amidst rising tensions with the U.S. ahead of the Presidential election. Sanctions on technology companies in China, including WeChat, TikTok, SMIC, have a negative repercussion on the supply chain, which triggered the sell-off in technology stocks. In October, the Politburo of the Chinese Communist Party will review the 14th Five Year plan (2021 to 2025) during the 5th Plenum and extension of the State-Owned Enterprises reforms, with emphasis on executing the Dual Circulation strategy by boosting domestic consumption and increasing infrastructure and investments, while maintaining external circulation through exports. The external environment remains challenging with the ongoing tension between the two economic giants, while the shift towards internal consumption may not be as feasible as expected in the short term, given that the domestic demand may not be sufficient to soak up the production capacity that was built for exports over the past 4 decades. The MSCI Hong Kong dropped by 5.6% in September. Amidst the tightening restrictions on the resurgence of the virus, retail sales fell by 13.4% year-over-year in August, and again, better than 23.8% drop in July sales.

The People's Bank of China (PBoC) left one-year Loan Prime Rate unchanged at 3.85% for the fifth consecutive month on 20 September. In the interbank market, we believe policy neutralization is mostly completed. Looking ahead, we expect the central bank to guide DR007 to hover around 2.2% by nimbly adjusting the liquidity injection amount. We expect credit growth to stabilise at current levels and do not expect credit tightening to go beyond the targeted property sector. We expect China's sequential growth to normalize down towards trend in the second half 2020, while headline year-over-year growth will continue to firm up to around 6%. As more leading Chinese new economy companies are listed on the Hong Kong Stock Exchange, the Hong Kong stock market is becoming more attractive to global investors, especially mainland investors, who prefer the new economy sectors. Overall, we are positive on Chinese equities. Still in line with our first-in first-out approach, we remain confident on opportunities in the country. Furthermore, we expect the internal consumption development to benefit domestic themes. We are neutral on Hong Kong equities. Recently-released macro data was disappointing.

GLOBAL BONDS

The U.S. curve had a flattening move in September. The U.S. 2-year yield fell approximatively by 0.01% and the U.S. 10-year yield fell by 0.06%, finishing September at 0.69%. In Europe, several countries are experiencing increases in COVID-19 cases with selective lockdowns. Under this environment, the German Bund experienced a flattening over the month. The German 10-year yields fell by 0.13%, reaching -0.52% at the end of September. The German 2-year yields fell also by 0.03% to -0.71%. The JPM Emerging Markets Bond Index Plus Composite generated a negative performance during the month, depreciating by 2%. On the sovereign debt market, there was a big wave of new issuance. The crisis has pushed government deficits to historically high levels. However, huge supply did not push up yields, as central bank purchases absorbed most of additional government issuance. In recent months, sovereign long-term yields fell sharply. On the corporate bond market, there was a record level of issuance. The corporate debt market was boosted by the support of central banks. Credit spreads have narrowed even though they have not yet fully returned to their pre-crisis levels on average. Indeed, companies took advantage of historically low yields and strong investors' appetite to boost their balance sheets and increase their cash holdings. This liquidity cushion has largely contributed to limiting the number of defaults.

To tackle the health crisis, almost all governments implemented large-scale fiscal stimulus and support measures, including corporate loan guarantees. At the same time, major central banks increased their purchases of sovereign debt to levels that have never seen before, played a backstop role in the corporate debt market and provided cheap liquidity to banks (in the case of the ECB). In the second phase, we expect governments to implement stimulus measures. In the U.S., in the future, we expect the sovereign yield curve to steepen slightly, consistent with the economic recovery scenario. However, the Fed would adjust its QE by extending the average duration of Treasury purchases, if yields rise too far and too fast. We expect central banks to continue to absorb a lot of governments' extra issuance. We are optimistic on the outlook for Asian fixed income and Asian credits in particular for the rest of 2020. Markets continue to perceive efforts to combat COVID-19 in Asia to be reasonably successful. Overall, we remain positive on government bonds and credit. In global fixed income, we keep a positive view on the U.S., although we believe this has to be carefully monitored in light of the recent Fed's comments on inflation. Investment grade markets should remain supported by central banks support.

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