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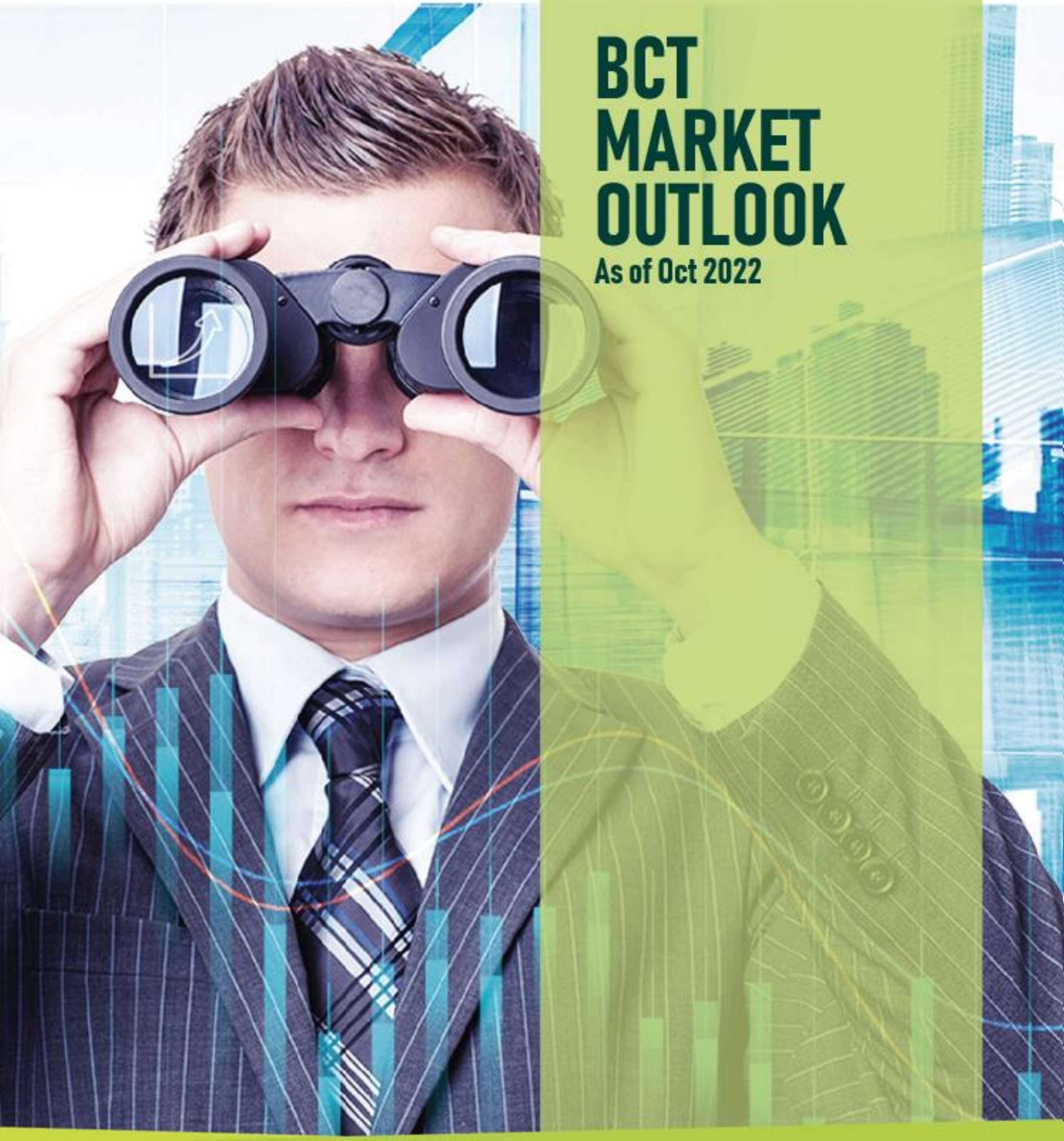
BCT MARKET OUTLOOK

As of Oct 2022



GLOBAL STOCK MARKETS TUMBLE AS INVESTORS WORRY ABOUT ECONOMIC SLOWDOWN

Investment Markets	BCT's Investment Views	Summary
Equities	▼	
U.S.	▲	We think strong consumer demand, tight labour markets, and improving consumer surveys indicate support for corporate earnings. We stay selective and look for businesses that reward shareholders through dividends, share buybacks, etc.
Europe	▼	Recession uncertainty and geopolitics lead us to stay cautious on Europe amid a rising cost of living. Given that Europe is a cyclical market, a global downturn is negative for European earnings.
Japan	▬	We stay neutral amid the headwinds on global growth, given the export-oriented nature of Japanese markets. However, we see relatively attractive valuations of the Japanese markets.
Asia Ex-Japan	▬	We are neutral on Asian equities, most central banks took steps to normalise policy. However, Asian countries continued to make progress on reopening.
China & Hong Kong	▬	While monetary and fiscal policies are accommodative, problems in the housing sector and the sporadic COVID-19 lockdowns are affecting household incomes and spending.
Global Bonds	▬	
Government Bonds	▬	Inflation and Fed policy remain the key variables in the U.S. Treasury yield direction, which recently has been affected by economic growth concerns.
Credit	▲	In terms of U.S. credits, in the lookout for strong corporate fundamentals, valuations are not very far from long-term averages, but we remain selective.
Cash	▲	

Scales of Weighting	▲ Neutral	▬ Overweight	▼ Underweight

U.S. EQUITIES

The U.S. equity markets had a negative month with the S&P 500 falling 9.2% in September. The prospect of a more aggressive pace of rate hikes from the Federal Reserve (Fed) and weaker macro data affected investors' sentiment. In terms of monetary policy, the Fed increased rates by 0.75% that brought the official rate to 3.25% in September, its highest level since March 2008. In terms of macro data, consumer prices slowed down slightly to 8.2% year-on-year, against 8.3% in August. Excluding energy and food, core inflation accelerated to 6.6% year-on-year, after 6.3% in August. The U.S. unemployment rate fell to 3.5% in September, against the consensus projection of 3.7%. At the moment, labour remains tight, with demand for workers substantially exceeding available supply. September's U.S. Manufacturing index was 52, up from 51.5 in August. However, the headline index continued to signal muted improvements in the health of the manufacturing sector.

The U.S. labor market remains tight, which should support the Fed in its rapid rate hike. Markets moved to price in a much more aggressive path of future rate hikes, with rates now expected to rise to 4.5% by next year. We are slightly overweight on U.S. equities. The U.S. economy is resilient even if decelerating to sub-par growth levels. The main theme remains how far the Fed is willing to hike rates and how earnings would be affected by slowing growth. Thus, we remain cautious of any indication of falling demand. We are overweight on U.S. value equities. Value outperformance has continued year-to-date. Investors should focus on companies with strong and sustainable earnings and a track record of rewarding shareholders. Conversely, they should avoid cyclical companies whose activity is strongly linked to economic activity. We are underweight on U.S. growth equities. As the Fed looks committed to hiking rates to tame inflation, this could put further pressure on growth stocks, especially the expensive and unprofitable ones.

EUROPEAN EQUITIES

The European equity markets had a negative month with the MSCI Europe falling 4.1% in Q3 and 6% in September. Concerns of a stronger economic slowdown due to the energy shock and central banks aggressively tightening to keep inflation under control weighed on the markets. In September, the European Central Bank (ECB) increased rates by 0.75% that brought the official rate to 0.75%. In terms of macro data, Eurozone Purchasing Manager Index (PMI) fell to 48.4 in September, from 49.6 in August, signalling a further worsening of operating conditions for euro area. On the inflation front, the flash estimate for September rose to 10% after having hit 9.1% in August. In the UK, most data released in the quarter illustrated the loss of momentum in the economy. In September, the largest surprise for investors was the announcement of a new UK fiscal plan proposing large tax cuts, energy subsidies, and sizable borrowing. However, Prime Minister Liz Truss announced the abandonment of the aggressively radical policy platform after adverse market reaction.

In Europe, the outlook remains highly uncertain as highlighted by recent geopolitical events related to gas supply and prices. We now see a deeper recession in autumn-winter period of 2022-2023, followed by a shallower recovery than before. We expect the Eurozone economy to contract by 0.5% in 2023 and then slowly recover to 1.3% in 2024. We confirm our call in inflation to peak below 10% in Q4 2022 and decelerate towards 4% by Q4 2023. Thus, the ECB remains in a tough position, needing to calibrate policy tightening in a stagflationary context. Markets are now pricing the ECB to increase rates by another 0.75% in October and 0.5% in December, bringing them to 2% by year-end. A recession would affect European equities as falling consumption impacts corporate earnings and rising rates affect valuations. As Europe is a cyclical market, a global downturn would be negative for European earnings. We are underweight on European equities. We see near-term risks on earnings and are becoming slightly more conservative, but continue to focus on stock selection and long-term earnings resilience.

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JAPANESE EQUITIES

The Japanese equity markets had a negative month with the Nikkei 225 falling 7% in September. Despite some encouraging economic readings and the easing of the bans related to COVID-19, investors were concerned by the outlook for the global economy, the effect of rising interest rates and U.S. dollar strength. In a press conference, the Governor of the Bank of Japan (BoJ) reaffirmed their accommodative stance, triggering a sharp depreciation of the yen. Hence, the Ministry of Finance did intervene directly in the foreign exchange markets to support the yen for the first time since 1998. The yen weakened throughout September against the U.S. dollar, closing the month at 144.6. On inflation front, the headline rate edged up to 3%, while the core rate, excluding fresh food and energy, reached 1.6%. Meanwhile, the preliminary estimate of Q2 GDP showed a quarter-on-quarter annualised growth rate of 2.2%, slightly below consensus expectations. The detailed breakdown was interpreted more positively with some resilience in consumption and capital expenditure.

In Japan, the government relaxed inbound travel further in September. The reopening of the borders, along with resumed domestic travel subsidies and an ultra-weak yen, will lend support to services consumption in the coming months. Household inflation expectations remain at a historic high. We expect core inflation to climb further, and overshoot the BoJ's 2% target in Q4 2022 - Q1 2023. The BoJ is likely to downplay this overshooting and repeat that it is not sustainable. Thus, we do not expect any change in the foreseeable future, as the BoJ appears to be buying time, waiting for the U.S. rates to peak and close the policy gap automatically. The stock market is expected to continue to be unstable amid increasing concerns about inflation, rising long-term interest rates, and concerns about a recession in the global economy. We are neutral on Japan's equities, in light of slowing global growth and thus potential impacts on exports, but relatively attractive valuations of the Japanese markets are positive.

ASIA EX-JAPAN EQUITIES

In September, Asia ex-Japan equities continued to fall as investor concerns over the U.S. dollar strength, rising inflation, higher interest rates and fears over a global slowdown. Korea and Taiwan, being export-oriented economies, were among the worst performers with a return of -12.8% and -11.1% respectively as the outlook for global trade deteriorated. In Taiwan, manufacturing PMI dropped to 42.7 in August. The central bank acted in line with consensus, raising their policy rates by 0.125% in a bid to tackle inflation. In Korea, the won fell 6.5% to its lowest level in the past 13 years. However, the government has signalled upcoming action at an appropriate time to temper this volatility. In India, the Reserve Bank of India (RBI) hiked its policy rates by 0.5% to 5.9% in September. Since May 2022, the RBI has pursued its front-loading actions in order to keep inflation expectations under control. In Indonesia, the Bank Indonesia (BI) hiked its rates by 0.5% (versus consensus and our expectations at 0.25%). While the surprise was on the size of the hike, it is fair to highlight that the headline inflation figure for September at 5.9% year-on-year has incorporated the subsidies reduction implemented in early part of the month.

Across Asian countries, inflation remained on an upward trajectory. Asian central banks are acting aggressively to control inflation by large interest rate hikes. In India, we expect inflation to remain above 6% until the end of Q1 2023 and then slowly moderate below the upper range band of 6%. The RBI is expected to hike its rates by another 0.25%, taking the repo rate to 6.15%. In Indonesia, based on these measures, we expect inflation to trend higher in Q4 2022 to around 7%, calling for further hikes by the BI and at higher than what we were expecting before by 1% but with some easing possibly by the end of next year. We are neutral on Asian equities, as most central banks took steps to normalise policy. However, Asian countries continued to make progress on reopening.

CHINA & HONG KONG EQUITIES

In September, the Shanghai Composite Index returned -5.6% whilst the Hang Seng Index experienced a depreciation of 13.7%. Chinese equities underperformed during the summer as a result of increased Taiwan Strait tensions and slow-growth concerns. Some concerns on the housing sectors and the tightening of the COVID-19 controls weighed on investors' sentiment too. In terms of monetary policy, the People's Bank of China (PBoC) kept policy rates unchanged in September after the surprising cuts of the previous month. It stepped up support to the faltering housing sector, reducing the mortgage rate for the housing provident fund by 0.15% for first-home buyers and allowing banks in qualified regions to reduce mortgage rate floors. China's high-frequency data, including housing sales and mobility, improved towards the end of September, thanks to the partial relaxation of COVID-19 restrictions. Consumer price index remained to be less than 3% as pork and energy prices became steady while overall inflation was contained after the service industry had been hit by COVID-19 control measures for multiple times. In Hong Kong, unemployment rate improved from 4.1% in August to 3.9% in September as social distancing measures relaxed. In addition, Consumption Voucher Scheme also helped the employment market.

In China, the zero-COVID policy and the slowing housing market weighing on the economy. We expect the central bank to continue with its accommodative monetary policy. Further rate cuts will depend on whether housing sales manage to stabilise. We expect the COVID-19 restrictions to remain tight in October, as local governments are doubling down on measures before the 20th Party Congress. But most of this extra tightening will likely be reversed in November, paving the way for a soft recovery beyond that. In Hong Kong, the government has eased quarantine policy to 3-day home quarantine starting from October, and it has relaxed a number of social distancing measures since 6 October. These actions could help inbound and outbound travel. We are neutral on Chinese and Hong Kong equities. While monetary and fiscal policies are accommodative, problems in the housing sector and the sporadic COVID-19 lockdowns are affecting household incomes and spending. Long-term drivers in the form of balanced, high-quality growth are in place. Desynchronisation of the country's economic cycle from global markets could be beneficial. We also expect housing sales to return to their long-term supply-demand equilibrium in 2023.

GLOBAL BONDS

Persistent inflation and more hawkish central banks than expected put sovereign bonds under pressure, experiencing their third negative quarter so far this year. In September, the UK Gilts were the worst performer given the market turmoil but both the U.S. Treasuries and European sovereigns bonds also lost significant ground. Central banks are acting aggressively to control inflation by large interest rate hikes. These tight monetary measures are putting pressure on the momentum of global economic activity. In the U.S., the Fed continued to be hawkish and prioritised inflation control over growth prospects by increasing rates by 0.75% that brought the official rate to 3.25% in September, its highest level since March 2008. In Europe, the energy crisis has worsened, intensifying upside risks to inflation. The ECB has further tightened its stance to keep inflation under control and increased rates by 0.75% in September.

We are neutral on government bonds. The Fed downgraded its economic growth outlook recently but reiterated its intent to tame inflation by hiking rates. This, coupled with attractive yield levels, leads us to believe bonds can offer protection. Hence, we stay neutral. In the Eurozone, despite the ECB's commitment to bringing prices under control, economic pressures in Europe may limit how far the bank can go with its rate hikes. However, it has to balance this with the need to prevent fragmentation. We stay neutral on core Europe for now while maintaining a flexible view and looking for opportunities across geographies. We are slightly overweight on credit. In the U.S., robust earnings, attractive carry and valuations encourage us to prefer high-quality credit over other weaker credit, but we prefer selective names that can withstand the risks of a "hard landing" and show earnings resilience. In Europe, the near-term recession outlook, high inflation and a hawkish ECB mean potential pressures on earnings, although corporate fundamentals remain robust. We are monitoring the default outlook, which is relatively low for now. However, if financial conditions tighten and markets come under stress, highly indebted companies may struggle.