BCT 銀聯集團

Market risks surge as U.S.-China tensions escalate

Investment Markets	BCT's Investment Views	Summary
Equities	Underweight	
US	Underweight	Overall, we remain negative on the U.S. equities. Equities continue to offer better value than bonds; however, the momentum and valuation divergence between mega caps and large caps versus the rest of the market is extreme. This is despite the uncertainty around the U.S. election and a resurgence of COVID-19 cases in some states.
Europe	Neutral	We are neutral on European equities. The economic environment is improving, but the risk of a second wave of COVID-19 has emerged, and it could affect a staggered recovery.
Japan	Neutral	We are neutral on Japanese equities. Improving prospects for global growth and a favourable environment for cyclical stocks should benefit Japanese equities, given the country's dependence on exports.
Asia ex Japan	Neutral	We are neutral on Asian equities. Geopolitical issues such as the U.S.-China relations and the COVID-19 pandemic are the key indicators to monitor at the moment.
China & HK	Overweight	We are positive on Chinese equities. Most of the main economies will not recover to pre-COVID-19 levels before 2022. China is the only country expected to recover in 2020. We are neutral on Hong Kong equities. Escalating tensions with tit-for-tat sanctions between the U.S. and China/Hong Kong and the suspension of bilateral tax treaty and re-labelling of all products as "made in China" will have negative impacts to the economy.
Global Bonds	Overweight	
Government Bonds	Overweight	Overall, we are positive on government bonds. From a global fixed income standpoint, we prefer the U.S. Treasuries for their safe-haven status. We are positive on credit. Stimulus measures continue to support demand for investment grade (IG) credit, but markets are now already discounting the impact of additional stimulus and vaccine effects.
Credit	Overweight	

Scales of weighting	Underweight	Neutral	Overweight

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U.S. EQUITIES

The outperformance of the U.S. equities continued in August, with the S&P 500 up 7.01% and the Nasdaq up 11.05%. The later rallied sharply as the technology sector continued to rally. Earnings season was positive, as most of the Q2 earnings were better than expected and the earnings-per-shares revisions stabilized. The number of COVID-19 cases rose but the speed of the spread decreased. With many states reopening for business, economic data pointed to solid growth, although at moderating pace. Hopes of improving demand conditions and an end of the pandemic have driven business confidence up, with employment rate increasing for the first time since February, and input price inflation accelerating due to raw material shortages and supplier price hikes. The Flash Purchasing Manager Indexes (PMIs) for both manufacturing and services beat expectations, with readings of 53.6 (versus 52.0 expected) and 54.8 (versus 51.0 expected) respectively. The ongoing recovery in the manufacturing sector continued, despite remaining domestically driven. The high level of uncertainty due to the evolution of the pandemic remains the key concern defining its figure. The housing market remains healthy with new house building, second-hand house sales, and homebuilder sentiment beating expectations. Nonfarm payrolls increased by 1.76 million in July, while the unemployment rate declined to 10.2%. However, the gap with the pre-COVID-19 labour market situation is still wide, the U.S. economy has now regained 42% of the 22.1 million jobs lost between February and April. As widely expected, the last Federal Open Market Committee (FOMC) failed to deliver policy changes, while reaffirming quite a dovish stance of the Federal Reserve (Fed). In the Jackson Hole's speech, Powell explained that the changes undertaken is a part of the Fed's strategy review and announced the adoption of a flexible form of average inflation targeting. The Fed has formalized a new reaction function and a more dovish path than previous recoveries, with the FOMC aiming to push unemployment as low as possible, at least until inflation pressures are reflected in the data. The U.S. dollar index has fallen to its lowest level since August 2018, down more than 10% from March. The global growth outside the U.S. and the more dovish Fed might be the main reasons for the dollar weakness.

A new COVID-19 outbreak in several states in July and August imposed more caution in reopening the economy, slowing recovery momentum. The labour market remains distressed. We expect quarterly growth to remain supported by recovering domestic and external demand, although uncertainty stemming from November election may delay new investments. Inflation, which has been more volatile due to lockdown-induced distortions, will gradually return towards target, with temporary mild overshooting in mid-2021 due to energy base effects. On top of the technology war and Huawei, capital war on foreign holdings and reshoring out of the global supply chain, the situation in Hong Kong introduces risks of possible U.S. sanctions on Chinese banks and an exclusion from the US dollar system. The Phase 1 trade deal looks to hold for now but both sides have dim hopes of a phase 2 deal. In extreme, this “cold war” might also involve Europe. Accidental confrontations in the South China Sea or Taiwan Strait might push the situation to a point of no return. Autumn’s focus will be on the U.S. election campaign and that the hard rhetoric from the President Trump could exacerbate tensions with negative spillover effects. The equally hawkish tone from the Democratic Party brings new policy uncertainties to the bilateral relation in a Biden-win scenario. The President Trump faces an uphill but not impossible path of re-election. The investment implications of a Biden win are likely to be a mixed bag where defense, healthcare and energy sectors will struggle. However a likely weaker US dollar and expectations of an infrastructure bill should be well received by the broader markets. Overall, we remain negative on the U.S. equities. Equities continue to offer better value than bonds; however, the momentum and valuation divergence between mega caps and large caps versus the rest of the market is extreme. This is despite the uncertainty around the U.S. election and a resurgence of COVID-19 cases in some states. In this environment, it is important to remain balanced. We believe a leadership rotation is likely, and investors should look to high quality value names.

EUROPEAN EQUITIES

European equity markets performed well in August (the MSCI Europe appreciating by 2.7%, the MSCI EMU did better with a positive return of 3.4% and similarly the Euro Stoxx 50 finished the month up 3.2%), but lagged the U.S. market, in the absence of large technology companies. Germany outperformed as data remained supportive, with the DAX up 5.1%; Spain lagged amid a pick-up in COVID-19 infections, with the IBEX posting +1.3%, and the U.K. returned positive, with the FTSE100 up 1.8%, despite October’s fiscal cliff and Brexit stalemate. The number of COVID-19 cases has increased recently in some European countries, raising fears about a second wave of infection. However, we are far from the health crisis of early 2020, when the governments were not prepared. Business confidence in manufacturing sector remains positive. It is interesting to notice the divergent dynamics within the Eurozone as the manufacturing sector continues to recover in Germany and Italy, while France and Spain highlighting a modest contraction (stabilization). German manufacturers reported a sustained increase in new orders from key international trade partners, notably from China. The service sector continues to suffer the most, as it is still severely disrupted by the restrictions in place. Labor markets improved in July. The Eurozeone’s unemployment rate rose by 0.2%, reaching 7.9% in July. The Brexit is returning to the headlines, as the latest round of negotiations between the U.K. and the

European Union (EU) takes place. The probability of a deal seems to be reducing with state aid, the current sticking point. On the monetary policy side, the low-for-long stance has continued over the past month in Europe, the Bank of England officials have left open the negative interest rates path. As for fiscal stimulus, in Germany, an extension of COVID-19 relief measures amounting 10 billion euro was agreed, and more details were released on the French's 100 billion euro stimulus plan due on 3 September.

The Eurozone's inflation rose to 0.4% year-on-year in July, slightly above expectations, but far below the European Central Bank's (ECB) inflation target. In 2021, inflation is expected to normalise while remaining subdued regarding the ECB target (we expect the Harmonized Index of Consumer Prices to print a 0.7% growth year-on-year for 2020 and 1.3% for 2021). Economic activity recovered fast in the early stages of Q3, although new COVID-19 hotspots in several countries, during July and August, prompted a deceleration in high-frequency indicators of activity. As schemes to avoid massive layoffs are still in place, the unemployment rate did not surge to all-time highs, but did increase nonetheless. Uncertainty linked to risks of new outbreaks may keep economic activity from returning to pre-crisis levels for several quarters, while we expect a gradual pickup in both domestic and external demand, supported by extraordinary easy monetary policy and counter-cyclical fiscal policies. The agreement reached on the Recovery Fund is a very significant step in Europe. For the first time, the EU will mobilize the budget in a counter-cyclical manner. Fiscal policy becomes a stabilisation instrument in the event of a crisis. We see this Recovery Fund as a permanent tool to promote real convergence. It will increase the resilience of the EU, but will not stabilise activity in the next 12 months. Indeed, this Recovery Fund will not be operational before Q1 2021. The economic impact will not be felt until 2022. Cyclical stabilisation policies therefore remain the responsibility of the member states. We are neutral on European equities. The economic environment is improving, but the risk of a second wave of COVID-19 has emerged, and it could affect a staggered recovery. Q2 earnings season surpassed expectations which were already depressed, with very low forward visibility. As a result, valuation dispersions remain high. Looking ahead, investors should stay very selective and aim to identify resilient business models.

JAPANESE EQUITIES

August was a strong month for Japanese equities, the Nikkei 225 performed +6.6% and the Topix posted +8.2%. Speculation over the potential resignation of the Prime Minister Abe arose during market hours on 28 August, and caused a small dip in share prices. After the confirmation of his resignation, the market was basically unchanged. However, the Japanese yen did strengthen but, for the month as a whole, there was a small net weakening against most of major currencies. Concerns grew over the impact of trade frictions between the U.S. and China, with markets largely dictated by trade news flow. Despite the negativity surrounding trade issues, the household consumption and capital expenditure supported the economic growth. Away from politics, a further (and decelerating) contraction in economic activity took place in August, as the Japanese economy remains severely disrupted by the pandemic. Both manufacturers and service providers reported a contraction in new orders and output levels. Operating conditions remain challenging, with firms reporting significant job cuts in August. Expectations on future business activity deteriorated as the uncertainty underlying the evolution of the pandemic remains high. Although corporate profits are clearly under pressure, the recent quarterly earnings season brought more positive surprises than what might have been expected. The pandemic has made it very hard to form a clear consensus for earnings, with many companies unwilling to provide their usual guidance due to the extreme uncertainty.

The central bank's latest economic outlook re-confirmed guidance of keeping rates low for longer and basically ruled out policy normalization in 2021. While we expect loose monetary policy to continue, we are not expecting the central bank to cut rates further in light of the concerns voiced by officials on the cost of negative rates. The policy combination of fiscal spending and asset purchases with Yield Curve Control will continue. Forward guidance and special credit programs are likely to be strengthened if the second wave outbreak starts to weigh on the economy. The economy continues to bounce back from the second quarter dip, albeit at a slower pace in August amid the COVID-19 resurgence. The government has refrained from declaring another state of emergency, despite the fact that daily new cases have far exceeded the previous peak. Having said that, the risk of recurring epidemic waves adds uncertainties to the recovery path, together with a worse-than-expected GDP performance in Q2. We are therefore downgrading our full year growth forecast from a range of -4.7% to -4.1%, to a range of -5.1% -4.5%. Inflation will remain soft in the rest of 2020, given a negative output gap. We are neutral on Japanese equities. Improving prospects for global growth and a favourable environment for cyclical stocks should benefit Japanese equities, given the country's dependence on exports.

ASIA EX-JAPAN EQUITIES

The MSCI Asia ex-Japan continued its positive momentum, gaining 3.6% in August, which marked 3 consecutive months of gains. Positive news of decreasing rate of infections, plus a possible discovery of vaccine and easing of restrictions as the re-opening of Asian economies lifted hopes and fueled optimism amongst investors. In addition, better-than-expected earnings, coupled with dovish outlook by central banks lifted consumer sentiment and pushed equity markets higher. It was a mixed story across countries. The Australian AS30 continued to benefit from the recovery in commodity prices and advanced by 3.1%. Positive performance was also seen in the export-oriented South Korean Kospi with a 3.4% positive return and in India with the Sensex up 2.7%. The worst performer in the region was the Malaysian bourse that fell by 4.9%, as investors opted for selective rebalancing among their portfolios following some earnings reporting at the end of the month. Among other negative markets, the Thai SET and the Taiwanese TWSE posted -1.3% and -0.6% respectively. The hope of earnings recovery, given the positive earnings momentum in Q2, continued to push prices of risky assets higher. Out of the 80% of the companies that had reported, 50% had beaten, while 37% missed expectation. Most of the better-than-expected results came from North Asia, primarily in the Technology sector, while traditional sectors including Real Estate, Materials and Consumer Staples reported in line, or better results. Southeast Asian markets generally reported disappointing results in Q2. In Indonesia, the easing in the lockdown has brought partial relief, as the pandemic continues to spread. The Ministry Of Finance and the Bank of Indonesia (BI) have embarked on a burden-sharing scheme, with the BI acting as a backstop for funding a very high deficit. In the past two months, monetary policy has been prudent with only 0.25% of easing, notwithstanding very subdued inflation (1.5% year-over-year), a narrow current account deficit and a huge output gap. The 2021 budget announced in mid-August, slightly widened the fiscal deficit expected for next year from 5.2% to 5.5% out of the GDP. As of today, the revenue shortage is being offset by a very timid fiscal disbursement. While pausing monetary policy easing in early August (Repo Rate unanimously kept at 4.0%), the Reserve Bank of India (RBI) conducted Special Open Market Operations (OMOs) of government bonds to ensure the orderly functioning of financial markets.

Asian countries are likely to be the first ones to emerge from the pandemic crisis. Investors should aim to identify such stories, coupled with new themes, including the Belt and Road Initiative. In India, recent headline inflation levels which have been well above the target range are limiting the RBI's room to ease further, even though they are maintaining a dovish stance due to dire economic conditions. On the back of inflation struggling to take a convincing disinflationary path, we see very small room to ease further ahead. Year to date, driven by the glove manufacturing sector, the Malaysian equity market was the best performing market in ASEAN. While the measures announced by the government may help cushion the impact of economic downturn, we don't expect domestic spending to rise in the subsequent months. In

Thailand, the first half of the year results was a mixed bag, with banks and construction companies reporting disappointing results, while transport sector reported better-than-expected traffic numbers and lower operating expenses. Non-bank financials including micro financing companies reported strong loans growth year over year, offsetting lower margins. A task force was set up to focus on improving the economy, including lifting restrictions, easing domestic travel, further fiscal and monetary stimulus, including reducing 0.25% of the policy rate from 0.5%, controlling the yield curve and allowing banks to resume interim dividends. We are neutral on Asian equities. Geopolitical issues such as the U.S.-China relations and the COVID-19 pandemic are the key indicators to monitor at the moment.

CHINA & HONG KONG EQUITIES

Despite increasing political noise between the U.S. and China, the MSCI China maintained positive momentum, rising 5.7%. Investors optimism was fueled by the better-than-expected macroeconomic data and corporate earnings, especially within the technology sector. On the macro side, August's PMI stood at 53.1. Exports also expanded by 7.2% year-over-year in July. The data suggests the economy continues to recover upon entering Q3, albeit at a slower pace sequentially. We expect the headline Consumer Price Index (CPI) to resume its downtrend throughout the rest of the year and no pickup in inflation until 2021. On politics, following hot on the heels of Huawei, TikTok became the next center of attention amidst the rife between the U.S. and China. The U.S. State Department is also asking institutional endowments to divest holdings in Chinese companies. On the positive side, both parties reaffirmed the Phase 1 trade deal. The MSCI Hong Kong rose by 7.9%. Exports rose by 7.9%, but falling 3% year over year, while imports dropped by 3.4% on the weak global economy, rising trade tensions between the U.S. and China and the effect of the pandemic. However, exports to China remained strong at +5.2% year-over-year. Meanwhile, inflation, as measured by CPI fell 2.3% as the third wave of infections prompted the government to impose restrictions even as unemployment rose to 6.1%.

The end-July's Politburo meeting marked an end of broad monetary easing. We no longer expect medium-term lending facility or loan prime rate cuts this year. The People's Bank of China (PBoC) reiterated that it would not over flood the market. Instead, the central bank is likely to deploy targeted relending tools that can "direct new financing to the real economy precisely, in particular to small- and micro-sized enterprises". In addition, banks were encouraged to break the "implicit floor" of actual lending rates and reduce their fee charges. With strong take up in the primary housing market (+15%), authorities had taken precautionary measures, including enlargement of the share ownership housing scheme, tightening loan restrictions (buyers & developers), which so far had proven to be ineffective to curb rising property prices. Despite 890 billion renminbi of cash injection, the liquidity remains tight as interbank rate rose. The PBoC is reluctant to ease liquidity on fears that the funds will be diverted into the financial markets, fuelling a potential stock market bubble. Its strategy, focusing on growth via internal consumption should benefit domestic consumer names. We are positive on Chinese equities. Most of the main economies will not recover to pre-COVID-19 levels before 2022. China is the only country expected to recover in 2020. We are neutral on Hong Kong equities. Escalating tensions with tit-for-tat sanctions between the U.S. and China/Hong Kong and the suspension of bilateral tax treaty and re-labelling of all products as “made in China” will have negative impacts to the economy.

GLOBAL BONDS

In light of the Fed’s new monetary policy framework and in the prospect of modest inflation overshoots, the U.S. yield curve moved higher and steepened. During August the U.S. 2-year yield rose approximatively by 0.03% to +0.13%, and the U.S.-10 year yield started the month at +0.53% and finished at +0.71%. The much-watched spread between the 2-year yield and the 10-year yield widened, moving from +0.42% to +0.57%. The German Bund experienced a similar trend to the U.S. Treasury with some yield-curve steepening and higher yields: having started the month at -0.53%, German 10-year yields rose steadily finishing August at -0.4%. Over the month the German 2-year yields rose 0.06% to -0.66%. Peripheral countries continued to benefit from the 750-billion-euro EU Recovery Fund with spread tightening: the spread between the 10-year German Bunds and the 10-year Italian BTP’s started August close to +1.54%, bottomed in the middle of the month at +1.38% and then finished at +1.49%. The JPM Emerging Markets Bond Index Plus Composite generated a positive performance during the month appreciating by 0.3%. The European iTraxx Main Credit Index tightened by approximatively 0.06% during the month from +0.61%. The Bloomberg Barclays U.S. Corporate Index underperformed its European counterpart, posting a negative return of 1.4%. The Credit Suisse European HY Index rose by 1.3% over the month slightly outperforming the wider Credit Suisse HY Index of 1.2%.

In the U.S., high frequency and real data remain encouraging even as the Fed maintained an easing stance. However, we are seeing a socioeconomic divide among classes and between large and small businesses. While we realise a democrat win could be a headwind for corporate growth, but the President Trump should not be written off completely yet. As a result, our overall stance is caution, with sufficient liquidity buffers. We remain defensive on the U.S. Treasuries

(USTs) (overvalued): increased UST issuance, a pickup in economic activity and deficit spending are all elements to monitor. The last two are likely to push long- and medium-term inflation upwards. , we are positive on corporate credit but we recommend investors to take profits in bonds and loans where valuations are full. Markets are being influenced by the news flow around fiscal and monetary interventions, which continue to drive rates and spreads lower even though governments are scrambling to restore fiscal support in some countries. However, increasing debt levels, the risk of a second wave of COVID-19 and geopolitical tensions in the U.S. election year remain an overhang. From investors' perspective, while the temptation to move further down the credit quality spectrum for that extra yield remains high, this should be balanced with the need for high selection and a focus on liquidity. Overall, we are positive on government bonds. From a global fixed income standpoint, we prefer the U.S. Treasuries for their safe-haven status. We maintain our cautious stance on core Euro and remain positive on peripherals, although investors should lock in some gains. Core Euro yield-curve steepening seems unlikely for the time being, as the ECB should limit rate hikes amid subdued inflation. We continue to favour Hard Currency (Euro over U.S. dollar) Asian debt. We are positive on credit. Stimulus measures continue to support demand for investment grade (IG) credit, but markets are now already discounting the impact of additional stimulus and vaccine effects. We recommend investors to maintain appropriate liquidity buffers and take profits in bonds and loans where appropriate. We are constructive on European IG, and believe that overall defaults in European credit have been stable. The leverage of IG companies in the Eurozone remains lower than that of their U.S. counterparts and overall cost of funding is also lower thanks to ECB's support. While we maintain our positive view on financial and subordinated debt in IG, overall, we are keeping an eye on heavy issuance in September. All in all, selection remains paramount.

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