BCT MARKET OUTLOOK

As of Sep 2021

The Fed's hawkish tilt, tapering could be faster than expected

Investment Markets	BCT's Investment Views	Summary
Equities	Overweight	
US	Neutral	We are neutral on U.S. equities. As inflation continues to rise and fiscal stimulus fades, real disposable incomes are being affected. COVID-19 cases are rising due to the spread of variants, but we think this will not cause national lockdowns.
Europe	Neutral	We are neutral on European equities. Rising input costs and fading growth momentum are risks to watch for in the second half of the year, but we witnessed a strong corporate earnings season despite high market expectations and support from "Next Generation EU" plan funds.
Japan	Neutral	We are neutral on Japanese equities. The cyclical nature of export-oriented Japanese markets linked to the global recovery should be positive, but we see some headwinds in the form of a stabilisation in economic momentum.
Asia ex Japan	Neutral	We are neutral on Asian equities. In our view, the situation is broadly improving and hospitalizations remain manageable but vaccination rates remain low in pockets of emerging markets Asia which may hinder re-opening progress. We also see growing risks related to concerns over Chinese growth, regulatory actions and lower earnings per share growth expectations.
China & HK	Neutral	We are neutral on Chinese equities. We expect policy loosening to come from the fiscal sides, while the PBoC should keep an accommodative liquidity stance without rate cuts (with mounting expectations of a required rate of return (RRR) cut in Q4 2021). We are neutral on Hong Kong equities. Hong Kong will start allowing visitors from China to skip the strict quarantine process required for most arrivals, though it has lagged other finance hubs in terms of mobility, this is a key first step towards reopening the border with the mainland.
Global Bonds	Overweight	
Government Bonds	Underweight	We are cautious on government bonds. Even as inflation numbers are matching high expectations, U.S. Treasury yields remain at low levels, which are not consistent with the economic growth environment, high debt and deficits. We remain positive on credit. Trends in credit remain benign, supported by a recovery in fundamentals.
Credit	Overweight	

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

The S&P 500 continued its rally growing +3% in total return terms and reached new highs. U.S. equities were favoured by strong corporate earnings, dovish messages from the Federal Reserve (Fed) and good progress on the bipartisan infrastructure package which includes $550 billion of new spending. Q2 gross domestic product (GDP) growth rate was revised slightly higher, by +0.1% to 6.6% year-on-year with minor subcomponent changes. The upward revisions reflected slightly more robust growth in export and non-residential investments. The U.S. jobs report for July that was released at the start of August showed nonfarm payrolls were up +943,000, the strongest in 11 months. The U.S. manufacturing Purchasing Managers' Index (PMI) posted 61.1 in August, broadly in line with the flash estimate. In terms of monetary policy, the Federal Open Market Committee (FOMC) Chair Powell gave a dovish speech at Jackson Hole meeting that calmed investor nerves about an imminent tapering of asset purchases. Powell confirmed the Fed System could start to scale back its purchases later this year but he gave no details on the tapering size and timing. The Fed considered inflation transitory and that the delta variant should not undermine the labour market recovery.

The U.S. economy continued its recovery, albeit signs of deceleration. While inflation is expected to peak in Q2 to Q3, our projections incorporate more persistence and upside pressure from protracted production bottlenecks and expected deceleration in domestic demand. The policy mix will remain accommodative, although on the Fed side we expect more precise communication about tapering in the middle of the second half of the year; with similar timing, we expect news on the fiscal side, with new infrastructure spending. The focus will be on the next U.S. Employment Situation report published by the Bureau of Labor Statistics. The FOMC stressed earlier that it would provide an “advance warning” that tapering is coming; this could be at the September FOMC Meeting. The formal announcement could take place in November or December. The normalisation of its quantitative easing (QE) policy is expected to be very progressive. The Delta variant poses a major risk in the short term. We are neutral on U.S. equities. As inflation continues to rise and fiscal stimulus fades, real disposable incomes are being affected. COVID-19 cases are rising due to the spread of variants, but we think this will not cause national lockdowns. Investors should look for companies with a sustainable earnings potential.

EUROPEAN EQUITIES

The MSCI Europe went up +2.2% in local total return terms in August. Eurozone annual inflation increased to 3% in August 2021, up from 2.2% in July. The price increases were driven by the economic rebound from the impact of the pandemic, higher energy costs, the reversal of last year's German cut in value added tax and bottlenecks in supply chains. Eurozone GDP rebounded in Q2 as restrictions were broadly lifted; with vaccination campaigns progressing and consumer and business confidence improving. Eurozone manufacturing PMI posted 61.4 in August, down from July's 62.8 and slightly lower from the earlier flash estimates of 61.5. Eurozone economic recovery is continuing but growth seems to have peaked slowing to a six-month low in August. From a monetary perspective, the release of the minutes from the July meeting confirmed the European Central Bank (ECB)'s new strategy which will let inflation overshoot the 2% target and allow them to stay dovish for longer.

In Europe, we continue to believe in a recovery supported by vaccinations but we are also monitoring hospitalisations. This data may affect reopening in certain countries. We believe in rotations towards quality value and cyclical stocks. On the other hand, we acknowledge the risks to some peaking of growth momentum and keep a balanced stance. If rates remain low for a long period of time, this will mean a more persistent stimulus, as the asset purchase programme is linked to the timing of the first rate hike. The ECB now turns its focus to the discussion of QE composition and calibration for next year, starting from the September meeting, at which the new set of economic projections will be available. The fiscal and monetary policy mix will remain accommodative, underpinning the recovery. Inflation should progress along an upward trend, with upside risks due to pipeline pricing pressure and base effects, overshooting in Q4 before reverting again below trend in 2022. We are neutral on European equities. Rising input costs and fading growth momentum are risks to watch for in the second half of the year, but we witnessed a strong corporate earnings season despite high market expectations and support from "Next Generation EU" plan funds.

JAPANESE EQUITIES

In Japan, the TOPIX and the Nikkei advanced respectively by +3.2 and +3% in total return terms. The Japanese economy returned to growth with a GDP of +1.3% in Q2 2021, ahead of consensus estimates. The recovery path ahead has become more challenging for Japan. While Q2 growth was supported by exports, U.S. PMI and Korean exports (the regional trade bellwether) suggest external demand is peaking. In Japan, the vaccination pace slowed sharply after the summer Olympics, bringing additional uncertainties to consumption, which was already lagging behind the overall recovery. Inflationary pressures remain subdued, with a negative output gap. On 3 September, Prime Minister Yoshihide Suga announced his intention to resign without contesting the Liberal Democratic Party leadership election. The Bank of Japan (BoJ) extended the Special Funding Program by another six months at its June meeting, and maintained a cautiously optimistic outlook. In July, it announced a new green fund provision scheme.

Core inflation hovered around 0%, and is expected to strengthen more meaningfully in 2022, when the drag from mobile phone charge cuts fades away. We expect the BoJ to stay put compared with its peers, in the absence of a full-fledged recovery and inflationary pressures. Suga's approval rate fell to 30% (based on the average of six surveys) in August, but the ruling party still enjoyed a wide margin in the support rate compared to the leading opposition party. Discussion of a supplementary budget is likely to start in September, ahead of autumn elections. Prime Minister Yoshihide Suga's surprise decision to resign has led to additional uncertainty in the next few months. However, no change in policy side could be predicted. We are neutral on Japanese equities. The cyclical nature of export-oriented Japanese markets linked to the global recovery should be positive, but we see some headwinds in the form of a stabilisation in economic momentum. There are domestic weakness - the August Economy Watchers Survey showed private sector sentiment deteriorated sharply. The spreading of Delta variant led to an expansion of State of Emergency, causing steep falls in household confidence. Global supply chain disruptions remain a main concern among manufacturers, which may well extend beyond the auto sector, weighing on the outlook. Japan is perceived as a traditional global cycle affected economy, particularly linked to China. A rapid deceleration could trigger a risk-off.

ASIA EX-JAPAN EQUITIES

Global economies continue to reopen although the process remains gradual in Asia. Top performer in the region was the Indian market with the Sensex appreciating by +9.4% and the Nifty 50 up by +8.7%. India is seeing the end of the COVID-19 impact on its economy thanks to natural immunity and improving vaccinations. The SET and the KLCI had a very good month with a growth respectively of +7.7% and +7.1%. Vaccination coverage continues to accelerate, with 11% and 42.4% of population fully vaccinated in Thailand and Malaysia. In the Philippines, the PSEi gained +9.3% month-on-month, the inoculation trend is encouraging, averaging 450,000/day (double month-on-month) with 60% receiving their first dose and 41% fully vaccinated. The JCI continued to show resilience in August with a +1.3% month-on-month gain. This reflects higher mobility in the domestic market together with higher vaccination rate. The

STI dipped -2% month-on-month in August. By the end of August, Singapore had 80% of its population fully vaccinated with the government lifting restrictions and allowing employees to return to work, enabling more businesses to reopen.

The Singaporean government announced pilot quarantine-free travel lanes for vaccinated passengers from Germany and Brunei in its border-lifting move. The rise in COVID-19 community infections remains merely noise in the near term. In the month, the Bank Indonesia kept the rate unchanged at 3.5%. In the near term, the lingering concerns on the spread of COVID-19 and interest rates uncertainty will dictate market direction. The Philippines government imposed a 2-week enhanced community quarantine (ECQ) ending on 20 August, with minimal relaxation to extend the modified ECQ until 7 September. Despite this, COVID-19 cases continue to surge, hitting a record high of around 22,000 per day. In Malaysia, as vaccinations continue to roll out, mobility restrictions eased for those fully vaccinated in all phases of the National Recovery Plan, with more sectors allowed to operate. Moving towards Q4, we expect the recovery theme to pick up. We are neutral on Asian equities. In our view, the situation is broadly improving and hospitalizations remain manageable but vaccination rates remain low in pockets of emerging markets Asia which may hinder re-opening progress. We also see growing risks related to concerns over Chinese growth, regulatory actions and lower earnings per share growth expectations; valuations in Asia ex-Japan are not particularly attractive. Hence, we prefer to stay neutral waiting for better entry points and focus on value/cyclical characteristics and businesses with strong cash flows. We believe continuing growth and vaccinations should support performances. However, there are headwinds such as rising U.S. rates and concerns over development in China, policy reformation, etc. The latter should pave the way for lower systemic risks over the long term in China.

CHINA & HONG KONG EQUITIES

In August, the Shanghai Composite rebounded with a return of +4.3% whilst the Hang Seng declined by -0.3%. July's monthly data pointed to a broad economic deceleration in China. Production, consumption and investment data were lower than expectation. In China, the broad policy tapering, together with the sector level tightening, were the major causes behind the deceleration. Housing indicators dropped in July, with property investment growth declining. Meanwhile, Delta variant risks will likely to become more visible in upcoming consumption data, given the expansion of social distancing rules since late July. The top-down credit rationing and sector tightening were the main issues. Money was directed into the manufacturing sector, but this sector's capex alone was not enough to offset the slowdown in infrastructure and housing sectors. Recent weakening of data will result in a more dovish stance from policymakers who support the long-term aim for a modern socialist society, where economic gains and wealth are more equally distributed. In Hong Kong, unemployment rate dropped another -0.5% in July, to 5.0%, on rising employment and a decline in total labor force.

In China, we expect a sequential slowdown in Q3, on renewed lockdowns and previous policy tightening, and then a moderate rebound in Q4. New social distancing rules since late July and Delta variant-related issues will become more visible in upcoming consumption data. In light of weakening growth momentum and inflation risks at bay, China's policy stance will turn more decisively to the dovish side. We expect policy loosening to come from the credit and fiscal sides, while the People's Bank of China (PBoC) sticks to an accommodative liquidity stance without rate cuts. We are neutral on Chinese equities. We expect policy loosening to come from the fiscal sides, while the PBoC should keep an accommodative liquidity stance without rate cuts (with mounting expectations of a required rate of return (RRR) cut in Q4 2021). The medium-term lending facility (MLF) and one-year loan prime rate (LPR) should remain on hold, with the MLF rollover staying generous, only slightly below the maturing amount and one additional RRR cut will be likely to be announced in late October or early November, given the MLF maturing schedule. We are neutral on Hong Kong equities. Hong Kong will start allowing visitors from China to skip the strict quarantine process required for most arrivals, though it has lagged other finance hubs in terms of mobility, this is a key first step towards reopening the border with the mainland.

GLOBAL BONDS

U.S. yields rose with relative larger moves seen on the belly of the yield curve: overall the U.S. 2-year yield rose from +0.19% to +0.21% and the 5-year yield rose from +0.69% to +0.78%. Further out the curve, the U.S. 10-year yield started the month at +1.22% and finished August at +1.31%. At the Fed meeting, Chair Powell reinforced the message that tapering could start before the end of this year if the economy evolves broadly as expected. He acknowledged strong employment gains in recent months. Any decisions to begin tapering asset purchases will be highly conditional on the data flow. The much-watched spread between the 2-year yield and the 10-year yield widened, moving from approximately +1.04% to +1.1%. The 10-year U.S. breakeven inflation rate, which started the quarter at 2.4%, finished the month at approximately 2.3%. The ECB governing council members reiterated the view that inflation should prove temporary and sent overall dovish messages. At its July meeting, following the outcome of the strategic review and through its new forward guidance, the ECB radically reinforced its commitment to keep rates very low. The J.P. Morgan Economic and Monetary Union Government short-dated bond indices had a negative return over the month, as yield generally rose. The J.P. Morgan Emerging Markets Bond Index Plus Composite had a positive month rising by +1.4%.

As the European economy is recovering from the largest economic shock of modern history, we believe the European Union (EU) will see two years of strong growth while inflation should revert below 2%. The ECB should implement a smooth transition from its emergency policies to QE and keep policy rates on hold. We reiterate our positive stance on European equities, which brings a cyclical and value tilt to the portfolio. We are cautious on government bonds. Even as inflation numbers are matching high expectations, U.S. Treasury yields remain at low levels, which are not consistent with the economic growth environment, high debt and deficits. We believe yields would depend on tapering progress. We are defensive on European bonds amid an improving economic environment, but we believe that the ECB will maintain its support. In that respect, we expect volatility to be low from these events. We remain positive on credit. Trends in credit remain benign, supported by a recovery in fundamentals. European investment grade bonds remains in a benign environment as rating upgrades are running ahead of downgrades.

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