BCT Market Outlook

As of Aug 2019

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

Scales of weighting: Underweight, Neutral & Overweight.

US Equities

During July, the U.S. shares gained and the S&P 500 rose by 1.44%. The U.S. Federal Reserve (Fed)'s forward guidance, a tool used to influence market expectations on the future levels of interest rates, was revised down, pointing to an easing cycle. The testimony of Fed's Chairman, Jerome Powell, strengthened the case for a cut soon despite a supportive payroll report and the G20 outcome. We revised down our targets on the U.S. bond yields: we expect the bull steepening of the U.S. bond yield curve to remain supported by the first rate cut. This month showed increases of market indices, up 2.16% on the NASDAQ Composite Index. The Russell 2000, an index of mid- and small-caps, increased with a shy monthly return of 0.57%. At sector level(1), Telecom, IT, and Consumer Staples performed well (respectively +3.37%, +3.33% and +2.50%) while Energy, Health Care and Materials were the month's underperformers (respectively -1.78%, -1.59% and -0.37%). The VIX index reflecting risk sentiment stabilized around level 16.

The G20 truce on tariffs was not a game changer. In the second half of 2019, we expect to see a very moderate recovery in global trade, which should continue to grow at a lower rate than GDP. In other words, global trade should continue to slow global growth. Corporate margins are peaking as a result of higher wages and higher costs from tariffs, and a weaker merger and acquisition trend is another sign of maturity of the cycle. It is obvious that value stocks are better than growth stocks based on relative valuations, but slowing economic growth and trade tensions are headwinds, which have led us to refrain from forming a positive view on this position. Our positive assessment on growth sectors is primarily for Consumer Retail and IT. Most retail stocks are expensive. In IT, we favour capital expenditures/cloud/software-as-a-service stocks, which are reasonably priced for long-term growth and have limited tariff exposure. Investors should reduce cyclical/value stocks positioning as the worst is yet priced in. **Recent rally has been mainly driven by expectations of the Fed's rate cut and G20 relief. Since economic fundamentals and the corporate earnings outlook still have not improved, earnings downward revisions are expected in the coming quarters. In the short term, the market may be vulnerable. We remain cautiously neutral on the U.S. equities after the strong rally since the beginning of the year, with sector/stock selection being the main strategy to approach the market.**

European Equities

European equity markets were almost flat during July (-0.07% for the Euro Stoxx 50). In the past, manufacturing recessions were mostly preludes to global recessions. We certainly saw a deterioration in the quality of growth (with lower capital expenditures). Despite the persistent poor indicators in the manufacturing sector (surveys, production), household spending showed little or no decline and the labor market continued to create jobs in Europe. In the Eurozone, consumption held up well and monetary policy represented an additional element of support. In the UK, the probability of rate hike of the Bank of England dropped significantly and the market is now discounting a rate cut. We are more inclined to adopt a wait-and-see approach. The risk of a no-deal Brexit slightly increased. The Euro Stoxx 600 delivered an increase of 0.34% this month. At country level, the UK's FTSE 100 was the best performer (+2.23%) whereas Spain was at the bottom of the ranking with the IBEX 35 losing 2.08%. At sector level(1), Food & Beverage (+4.57%), Travel & Leisure (+3.75%) and Financial Services (+2.82%) outperformed, while Basic Resources (-4.35%) underperformed.

In the Eurozone, the recently published German GDP data confirmed that manufacturing crisis led to economic weakness in Germany (GDP growth of second quarter in Germany came in line with expectations, contracting by 0.1), indicating possible downward revisions to growth expectations. Broadly speaking, it is also worth noting that the decline of manufacturing PMIs across major markets clearly depicted a much broader slowdown in the sector. The protracted uncertainty on the trade front and on the political side is going to affect investment decisions especially in Germany and Italy. We will watch the possible negative spill-overs into the job market and monitor the impact on the saving/consumption patterns. Regarding the European Central Bank (ECB), we expect a large-scale easing measure in September: a rate cut (0.10%), opening door for another rate cut, a tiered rate system and an Asset Purchase Program (30 billion per month with a more balanced spilt between Sovereign/Supra and Credit/Covered compared to the first round of quantitative easing). We expect the ECB to lift issuer limits to 50% from 33%. The ECB's president, Mario Draghi, mentioned at Sintra: "The limits we establish on our tools are specific to the contingencies we face". We remain neutral on European equities. The internal demand resilience is a supportive theme for the market, despite an overall weak economic environment. Eased political risks from multiple fronts, including successor appointments for EU institutions and Italy's financial issue, could support a mild repositioning towards European equities, with attractive valuations. Risks to monitor are Brexit and a further growth deceleration.

Japanese Equities

Japanese equity market slightly rose during July (+1.16% for the Nikkei 225) as the U.S. President, Donald Trump, and the Chinese President, Xi Jinping, met in Osaka at the end of June to resume trade talks. At sector level, Utilities and Telecom were the best performers (respectively +5.66% and +3.58%) while Energy lose 2.71%. Although expectation of a progress in the trade negotiation between the U.S. and China soon receded, speculation of an imminent rate cut by the U.S. Federal Reserve (Fed) bolstered the U.S. stocks and buoyancy spilt over Japanese market. Stock prices lost ground thereafter because a marked increase in the U.S. non-farm payrolls dashed hope of the Fed's rate cut, whereas weak machinery orders and consumer sentiment in Japan discouraged investors. Then, hints of rate cuts by the Federal Open Market Committee officials in the middle of the month triggered the appreciation of the Yen, exacerbating the outlook of electronics and device industry. However, share prices rebounded afterwards, in accordance with the decline of the Yen when market participants discarded a hefty 0.5% U.S. rate cut speculations. Yet, the ascent was hampered by worse-than-expected earnings by major electronics and machinery companies.

Domestic demand is expected to maintain momentum, partly supported by early purchases ahead of the value added tax (VAT) hike in October this year. Capital expenditure should hold up well, but foreign demand will continue to face difficulties. We remain cautious on Japanese equities due to trade war tensions and overall fragile risk sentiment. In such environment, the Yen should remain strong, preventing Japan from outperforming other markets. In fact, Japan is one of the most affected market by currency fluctuation and volatility. Japanese equities look cheap but global trade tensions pose some doubts on corporate profits in future. Given the global easing cycle started in recent weeks, the reaction of the Bank of Japan will be a crucial factor. We are neutral on Japanese equities but with less conviction. The G20 is behind us and the threat of a strong Yen (which benefits during the most acute phases of trade disputes) is fading, but the risk of a last minute decision to postpone the rise in VAT cannot be excluded.

Asia ex Japan Equities

After a strong performance in June, Asia ex-Japan equity market experienced a pull-back this month with the MSCI AC Asia ex-Japan registering a loss of 1.71% (in USD). Although the macro environment remained supportive with Asian central banks easing policy (Korea and Indonesia cut rates), downward revisions to corporate earnings growth resulted in broad-based equity market sell-offs. Korea (-4.98%) and India (-4.60%) suffered the biggest declines. Korean equity markets were hurt by an escalation of trade disputes with Japan with the latter tightening technology material exports to South Korea and removing South Korea from its preferential treatment list later in the month. India, on the other hand, was adversely impacted by poor auto sales data and delayed monsoon. Taiwan (+3.02%) and Indonesia (+0.63%) recorded the highest increase within the complex. A rate cut from the Bank of Indonesia provided some support to the domestic equity market while Taiwanese equity market benefited from strong gains in the technology and healthcare sectors.

We expect a further significant upside in the case of a deal between China and the U.S. before the U.S. presidential election, with existing tariffs remaining in place and no further escalation. On the contrary, if negotiations between the U.S. and China break down and the U.S. tariffs are extended to $300 billion of Chinese imports, it could lead to a material market correction. One of our main convictions in Asian equities is on India (political stability and reforms). In the last month, we have also become constructive on Indonesia equities because of lower rates and good economic fundamentals. Investors should look for relative value opportunities (i.e. Korea, although it has recently suffered from a spillover of the trade disputes over the technology sector, to which the country is highly relied on). A stabilization of the economic outlook (China's soft landing, easing trade tensions and supportive monetary policies) is a supportive element for Asia ex-Japan equities. The progress of trade negotiations has to be monitored as this is a major catalyst for the market. We remain slightly positive on Asia ex-Japan equities.

China & Hong Kong Equities

Chinese equity market ended lower (-0.65%) and was dragged down by cyclical sectors including Materials, Energy and Financials. The market remained fragile and was exposed to trade tensions with the US, leading to an uncertain future. The political situation in Hong Kong also created headwinds. The Hong Kong Hang Seng Index lost 2.3% during July. Macro data releases in July reflected headwinds from trade negotiations. China's exports contracted by 1.3% in June year-on-year, with exports to the U.S. and EU declining. The official manufacturing PMI dipped to the lowest level of the last decade at 49.4 in June, after three consecutive months of expansion. New orders and output indices dropped below the 50 mark, indicating weak domestic demand. It is worth noting that the political situation in Hong Kong appeared to worsen. Protesters and pro-government groups (including both the police and organized crime groups) continued to escalate their tactics. The Chinese government also became more vocal about the dangers of social instability, by implying that the current situation reached a critical point and they might consider sending the Chinese armed forces to intervene.

We believe that Chinese equity valuations (mainly A shares) remain attractive, but with a higher risk than previously assumed. We expect trade tension between the U.S. and China will continue to weigh on the market performance. Given the uncertainty of the timing of any trade deals between the U.S. and China, the Chinese government is ready to accelerate easing. Fiscal spending is set to accelerate and infrastructure investment will likely to rebound modestly. Monetary policy should also ease further to support lending growth to private businesses and the manufacturing sector. Tax cut, a large part of the fiscal expansion in 2019, may continue in 2020 to further reduce financial burden on corporates. There is a sizable degree of flexibility in most of these policies, which can provide a lot of cushion for growth in times of uncertainty. In this volatile environment, we continue to believe that stock picking using fundamental is a more reliable path to achieve attractive risk-adjusted performance. Hong Kong's GDP growth is likely to drop to 0% for 2019. The second quarter's GDP growth is expected at 0.6% because of slower external economic growth. In July, the protests started gaining traction and hence the performance of second half of 2019 will be negatively affected. The property prices has decreased since February and the recovery has been tepid. Falling retail sales and prolonged political uncertainties will dampen domestic consumption. So far, there is no evidence of any major fund outflows from Hong Kong. We are positive on Chinese equities and slightly negative on Hong Kong equities. We think that Chinese economy could hold up better than last year, as policymakers are better prepared, and local sentiment looks less fragile.

Global Bonds

Fixed income markets reflected a very aggressive dovish approach of the U.S. Federal Reserve (Fed) and a generally accommodative tone of the central banks in developed markets and emerging markets. Although the direction of Fed's rate seemed to set (downward), the "when" and "how much" questions related to the next easing cycle were still unknown, and the answer would broadly depend on the next set of economic data. The Fed lowered its benchmark interest rate by 0.25% on 31st of July to cushion the American economy from global financial slowdown and trade tensions.

Market expectations went a bit too far; we should see some volatility return to fixed income to re-adjust prices to expectations. In any event, it would not matter to the treasury market bulls in the medium term if the economic data begins to turn up.

Our duration view is overall neutral (slightly short in the Eurozone and slightly long in the U.S.). Playing yield curve movements according to central banks' expectations is a key strategy to add value in a low-yield world: we see a flatter curve in Europe and a steeper one in the U.S. For Euro-denominated assets, due to the extremely low yields of core bonds, investors should take a more cautious duration view to benefit from a possible market repricing. In the U.S., investors should favour lengthening duration in broadly diversified fixed income portfolios as a consequence of a more negative outlook for overall economic growth. In European credit markets, we prefer short-term bonds with higher spreads and subordinated financials, which are enjoying policy support from central banks. Overall, fundamentals are better for European investment grade bonds than that of U.S. investment grade bonds. In the U.S., we still think that the investment environment is attractive for carry and modest spread performance. We are neutral on government bonds and slightly positive on corporate credit.

[1] *Sectors of the S&P 500 (US Equities), Stoxx 600 (European Equities, Nikkei 225 (Japanese Equities), MSCI China (Chinese Equities) indices.*

"BCT" – BCT Financial Limited (Plan Sponsor)
– Bank Consortium Trust Company Limited (Trustee & Administrator)

Issued by BCT Financial Limited
The content of this Market Outlook is contributed by Amundi Hong Kong Limited.