BCT 銀聯集團

BCT Market Outlook

As of Dec 2019

Double breakthroughs on Brexit and US-China trade war

Investment Markets	BCT's Investment Views	Summary
Equities	**Neutral**	
US	Neutral	We remain cautiously neutral on the US equities. There is no change in terms of strategic assessment. Economic data remains weak although some signs of bottoming-out are visible. Stock markets rally has been extreme, mainly driven by multiple expansion. Geopolitical situation, though improving, is still tense, generating asymmetric risks.
Europe	Overweight	We are slightly positive on European equities. Europe is well positioned to benefit from the positive tactical factors (light positioning, increasing inflows, close to agreement of the phase 1 trade deal between the US and China, as well as the ECB's stance).
Japan	Neutral	We are neutral on Japanese equities: economic growth is fragile, earning growth has been subdued and it is expected to remain low next year. However, Japan could benefit from investors' shift to value stocks and its appealing valuations.
Asia ex Japan	Overweight	We are slightly positive on Asia ex Japan equities. The phase 1 trade deal agreed between the US and China in December offered some relief to Asian markets, even though the most critical issues have been postponed to the next phases. The growth outlook of the emerging markets in 2020 is more constructive than that in 2019.
China & HK	Overweight	We continue to maintain a preference for A shares market. It represents the domestic sectors of the economy which should benefit the most from the economic policy stimulus. Also, flows will continue to be supported from the gradual lift of the A share inclusion factor following the plan set by MSCI. We are slightly negative on Hong Kong equities due to the ongoing domestic issues. Despite attractive valuation, there is little catalyst for price appreciation unless peace returns.
Global Bonds	**Neutral**	
Government Bonds	Neutral	We expect the 10-year Treasury to stay in trading range. We think German rates are expensive, while we are positive on Italian bonds. Search for yield is still fully in place and the Italian curve is one of the few places where attractive yield can be found. We are neutral on government bonds and positive on corporate credit.
Credit	Overweight	

Scales of weighting: Underweight, Neutral & Overweight.

US Equities

Growth is gradually decelerating in the US with the second estimate of Q3 growth at 2.1% quarter-over-quarter. Signals were diverging in manufacturing, with the Purchasing Managers Index (PMI) up from last month and above 50, while Institute for Supply Management's Manufacturing Index fell below 50. Divergent trends were visible in export orders, employment sub components and services. Closed businesses are expected to negatively affect payrolls on February 2020, and labour income growth will likely to slow because of relevant revisions. This deceleration was consistent with the moderate slowdown in domestic demand. Producer Price Index (PPI) was on a downward trend. Labour costs moved higher but it was still within the growth range since 2011 (unit labour costs increased 3.1% year-over-year in Q3). The growth of Consumer Price Index (CPI) remained within the target (headline at 1.8% year-over-year, core at 2.3%, core Personal Consumption Expenditures Price Index at 1.6%). Some upside risks in short term were confirmed by core CPI components. The Federal Open Market Committee, as widely expected, cut its policy rate by 0.25% for the third time in a row at the October meeting. The rewording of the statement pointed to a pause. The US equities continued to test new highs in November. The S&P 500 rallied 3.63% as value stocks (3.86%) sustained their strong run and outperformed growth stocks (3.43%). Notably, the NASDAQ Composite rose 4.65%.

Signals are starting to show that the labour market is decelerating, supporting the view that domestic demand will keep slowing into 2020. Risks remain tilted to the downside. Geopolitical tensions will persist and political uncertainty may be added to the framework as the presidential election approaches. Although we do not expect a recession to occur, doubts on the extension of the current cycle could intensify over the next few quarters. As of now, although no major fiscal easing on sight in the US will represent an upside risk, it is not likely that the US will introduce such measure in the short term. Under the current law, the US deficit will remain in the 4.5% to 5% range of the total GDP. The US corporate earnings are key variables to watch. The US earnings are exposed to global trade spillovers and are vulnerable to external risks. We expect a single-digit earnings growth for next year. High corporate leverage amid sluggish earnings generation is a key feature of this financial regime. The Federal Reserve (Fed) considered its policy stance appropriate and well calibrated to support moderate growth and resilience on the labour market, and that another cut would require a "material reassessment of the economic outlook". We remain cautiously neutral on the US equities. There is no change in terms of strategic assessment. Economic data remains weak although some signs of bottoming-out are visible. Stock markets rally has been extreme, mainly driven by multiple expansion. Geopolitical situation, though improving, is still tense, generating asymmetric risks.

European Equities

PMI data for the Eurozone were reassuring on the manufacturing side but it was mixed and somewhat more concerning on the services sector. Q3 GDP figures (+0.2% quarter-over-quarter) were slightly better than the forecast and Germany avoided recession. In aggregate, the relevant data confirmed resilience of domestic demand (+0.4% quarter-over- quarter) and private consumption (+0.5% quarter-over-quarter, +0.2% in Q2). Services and construction sectors continued to support growth. Pipeline inflationary pressures remained very weak, with negative PPI, while CPI was well below the European Central Bank (ECB)'s target (core inflation at 1.3%, headline at 1.0%). The unit labour costs in Q2 slightly rose by 2.7% year-over-year (high cycle) but they had little transmission into final prices. Some negative base effect will disappear in the next 2 months, which could support a temporary inflation pickup. The formation of the new European Commission was not without uneasy episodes. The Spanish's November election was inconclusive and, in Italy, cracks in the government majority remained which put the government stability at risk. Political risk partly improved after the UK elections. In Europe, equity markets generally posted positive results, with the MSCI Europe up 2.72% during November, and up 24.71% year-to-date. The MSCI EMU and the Euro Stoxx 50 did better, posting returns of +2.68% and +2.81% for the month respectively.

We expect the growth of the Eurozone to converge to potential (1.1% GDP growth is expected for 2020), with some countries slightly accelerating (Germany, Italy) and others slight decelerating or stabilizing (Spain, France). Inflation is projected to remain subdued over the forecast horizon on a modest recovery. Second quantitative easing has just started and no major new measure is expected to be delivered in the short term. Unless a material deterioration in the macro picture occurs, we expect the ECB to remain on hold on rates in the next 12 months. The bar looks quite high for another cut, because there is very limited room for the banking system to bear the risks of additional negative effects. Fiscal easing is set to come but it is not a coordinated and pre-designed; which is not deemed a “fiscal bazooka”. Yet, should the economy continue to underperform, more fiscal easing could come, and the current political situation is likely to favour this trend. In Germany, the SPD (Sozialdemokratische Partei Deutschlands, the Social Democratic Party) leadership contest resulted in the victory of the team running on a platform of fiscal change. On Brexit, given the striking victory of the Conservative forces, the ratification of the October’s Brexit agreement will very probably be fast-tracked so that the UK can leave the European Union (EU) smoothly at end-January 2020. However, please remember that this will not be the end of the Brexit process. A trade deal will then have to be negotiated with the EU. Overall, we are slightly positive on European equities. Europe is well positioned to benefit from the positive tactical factors (light positioning, increasing inflows, close to agreement of the phase 1 trade deal between the US and China, as well as the ECB’s stance).

Japanese Equities

Opposite dynamics are in place in the Japanese economy. Improvement in electronic and semiconductor industry is cancelled out by continuous stagnancy in automobile industry. Exports to the US started contracting while shipping to China has eventually stopped worsening. While companies have slashed payrolls and employment since the beginning of the fiscal year 2019 (from April), they continue to be positive on business investment. Companies have accelerated the replacement of the old equipments and tools to boost productivity and cope with labour shortage. As for investment in structure, the service industry has accentuated the refurbishment of hotels and shops for the Tokyo 2020 Olympic Games. While buoyant capital spending supports domestic demand, faltering consumer expenditure raises a renewed concern of an economic downturn. At the October meeting, the Bank of Japan decided to keep its monetary policy unchanged in all areas. The Bank of Japan removed the timeframe of "at least through around spring 2020" from its forward guidance, and instead included the possibility not only of maintaining short and long-term policy rates at the current low levels, but also of lowering them.

The economy is likely to contract in Q4 as the consumption tax increase and the attack of outsized typhoons spoil private consumption, which has already lost momentum on poor wage growth. The consumer inflation will remain benign for a while longer. The figure hardly accelerates even after the consumption tax hike, while the overall PPI has fallen, reflecting precarious domestic demand and anaemic international commodity market. Although the Bank of Japan maintained the rates, it still keeps the door open to more easing. We expect a 0.10% cut in the next 12 months under the following two conditions. First, a cut in the short-term interest rate target must be accompanied by realignment of the three-tiered structure in the Bank of Japan’s current account deposit to mitigate adverse effects on financial institutions. Second, the Bank of Japan will obviously keep the long-end of the curve from decline in order to secure the slope of the curve. The government considers to launch a 13 trillion yen economic package to help disaster relief in the flood-affected areas and reinforce the durability of social infrastructure against natural disaster. Also, these pump-priming measures aim to boost investment in new technology and protocols. If these measures are implemented, GDP will be boosted by 0.7% over the next two years. Overall, we are neutral on Japanese equities: economic growth is fragile, earning growth has been subdued and it is expected to remain low next year. However, Japan could benefit from investors' shift to value stocks and its appealing valuations.

Asia ex Japan Equities

Economic conditions in the region remained quite weak in November, with momentum slowing the most in Malaysia (besides China). The outlook for exports has marginally deteriorated. The region's inflation figures have remained very benign. Notably, October figures came out once again from India and China, with higher-than-expected food basket components (pork prices, in particular, in China), at 4.6% and 3.8% year-over-year, respectively. India announced an ambitious divestment plan and it was set to complete by the end of the current fiscal year to support poor revenues performance. Earnings for the Asia ex Japan region were revised upwards during the month, particularly for Taiwan, as a result of strong Q3 earnings and strong pick-up in iPhone and 5G demands. Meanwhile, Thailand, India and the Philippines have seen negative earnings revisions. In November, the MSCI Asia ex Japan rose 1.66%, led by Australia (+3.47%), followed by India (+1.66%), Taiwan (+1.16%) and South Korea (+0.22%) on the recovery of technology stocks. Southeast Asian equity market lagged with Indonesia, the Philippines and Malaysia falling by 3.45%, 2.84% and 2.09% respectively. As of end November, the MSCI Asia ex Japan has risen 11.52%, which was a stark difference from 14.18% decline in 2018.

The phase 1 trade deal agreed between the US and China in December offered some relief to Asian markets, even though the most critical issues have been postponed to the next phases. The growth outlook of the emerging markets in 2020 is more constructive than that in 2019: there will be some acceleration in the first half of the year followed by a stabilisation towards the end of 2020. The central banks of emerging markets kept easing of policy rates. Going forward, liquidity conditions remain conducive of growth. In Korea, exports are still suffering and it recorded a double-digit drop again in November in value terms. Macro momentum is negative but improving. The government announced fiscal support for 2020's budget. Korean equity is probably already discounting many negative news and could rebound a bit in the short term. Korea remains an attractive contrarian trade because of valuations on cycle/semiconductors, positioning and potential reversal of negative sentiment. India is now appealing from quant metrics perspective, thanks to the strong improvements in earnings revisions, profitability and positioning, amid expensive valuations. We are slightly positive on Asia ex Japan equities.

China & Hong Kong Equities

Both China's official PMI and Caixin/Markit manufacturing PMI have increased but they should not be read as a turning point from economic perspective. The latest soft and hard data confirmed that a weak economy (with pockets of resilience) is not in free fall and these data are still coherent with our scenario. Slowing industrial production and weaker fixed asset prompted an unexpected 0.05% cut in the medium-term lending facility rate to 3.25%, which was the first cut since 2016. Later in the month, the People's Bank of China lowered the loan prime rate by 0.05%. The region's inflation figures have remained very benign. Notably, October figures came out, once again, with higher-than-expected prices for the food basket components (pork prices). Protests in Hong Kong escalated with consequences on the real economy. Hotel occupancy dropped below 50% and the retail sales fell more than 40% in October. Trump signed “The Hong Kong Human Rights and Democracy Act of 2019” into law. It mandates annual reviews of the city’s political situation and imposes sanctions in case of violations of human rights. China condemned the US and warned of retaliation (so far very limited). After a peaceful district council election, protests in Hong Kong could possibly resume, which could lead to rising volatility. This month, the MSCI China returned positively (+1.69%), while the Hang Seng Index was negative (-1.98%).

Our 2020 GDP forecast for China is now below the 6% threshold at 5.8% year-over-year. We confirm our view of very gradual policy accommodation ahead. Focus of the authorities will be on the macro stability and growth sustainability, but not on short-term acceleration. The confrontational narrative between the US and China will remain in the background (tariffs and extra tariff measures). China trade surplus has marginally reduced on a continuous exports weakness. The trade surplus with the US keeps narrowing because of largely declining exports and mildly increasing imports (favourable base effect from November last year). With the signature of phase 1 trade deal, we should see some stabilization in the trade data, although more has to be done on the tariffs side. We are positive on China equities, but China needs to go through the phase 1 trade deal as soon as possible given the deteriorating economic conditions in order to lift sentiment and stabilize the market. We continue to maintain a preference for A shares market. It represents the domestic sectors of the economy which should benefit the most from the economic policy stimulus. Also, flows will continue to be supported from the gradual lift of the A share inclusion factor following the plan set by MSCI. We are slightly negative on Hong Kong equities due to the ongoing domestic issues. Despite attractive valuation, there is little catalyst for price appreciation unless peace returns.

Global Bonds

Economic data in November were mixed and did not provide a trigger for rates to break the current trading range. The US Treasury yields were once again driven by the news regarding the trade war evolution. There was a sharp selloff in bonds driven by the trade optimism at the beginning of the month, but this trend faded afterwards and the US rates ended the month only slightly higher compared to the beginning of the month. Inflation linked bonds performed relatively well in November as the market turned a bit more positive on growth and inflation dynamics. The US Treasury yields rose during November despite the Fed’s “liquidity injections”. The 2-year US Treasury yield rose 0.08% to 1.61% while the 10-year US Treasury yield finished 0.09% higher at 1.78%. Bond yields in the Eurozone took their cue from the US Treasuries. In core markets such as Germany, the 10-year bund yields rose by 0.05% to -0.36%, while in the periphery markets, Italian bond yields suffered a significant bout of profit taking as the 10-year bond yield rose 0.31% to 1.23%. Overall, the JP Morgan EMU Government Bond Indices suffered minor losses, with the 3-5 year index falling by 0.36% and the 5-7 year index down 0.69%. Emerging markets also ended in negative territory. The JP Morgan Government Bond Index Emerging Markets Global Core Index fell 1.9% in November. Despite higher underlying bond yields, credit markets benefited from spread compression given the positive environment and rising investment appetite for risk assets. In Europe, the investment grade iTraxx Main Index tightened 0.04% to 0.48%, while the High Yield Crossover Index tightened by 0.18% to 2.21% by end-November. However, the Bloomberg Barclays Euro Aggregate Corporate Index declined by 0.3% in November, underperforming the US Aggregate Corporate index, which rose 0.3%. It was a slightly different story in the high yield space, where the Credit Suisse European High Yield Index rose 1.0% while the wider Credit Suisse High Yield Index in USD terms increased 0.3%.

The market is pricing[1] cuts for roughly 0.16% from the Fed and 0.03% from the ECB's deposit rate over the next 12 months. The US10-year nominal bond yield does not look dislocated right now, which is in line with expectations on growth and inflation. The US-China deal continues to dominate the risk sentiment on rates. The phase 1 trade deal was confirmed by officials and is expected to be signed in January. However, the imposition of new tariffs on Argentina, Brazil and potentially France have been a reminder to investors of how unpredictable the matter can be, which could generate volatility in the rates market. In global fixed income, we expect the 10-year Treasury to stay in trading range. We think German rates are expensive, while we are positive on Italian bonds. Search for yield is still fully in place and the Italian curve is one of the few places where attractive yield can be found. We stay vigilant on the very recent resurgence of political risk, which could threaten the stability of the government. The late cycle environment is still favourable for credit market. Valuations are generally rich, but technical factors offer strong support especially in Europe. We prefer European market to the US because of the lower leverage profile in Europe. We are neutral on government bonds and positive on corporate credit.

[1] Market prices as of 19th December 2019

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