BCT Market Outlook

February 2016

US Equities

The Fed kept interest rates unchanged without giving clear guidance on the timing of the next rate hike. The Fed mentioned it would closely monitor global economic and financial development, as well as assess their implications for the labour market and inflation, and for the balance of risks to the outlook. Advance annualized GDP in 4Q moved up by 0.7% quarter-on-quarter, down from 3Q's 2%. December's ISM manufacturing further dropped from November's revised 48.4 to 48.2, indicating worsening manufacturing contraction. Non-farm payroll added 292K in December, with November's figures revised up from 211K to 280K. December's CPI rose 0.7% from the previous year while the figure ex food and energy rose 2.1%, both accelerated from November. Housing starts in December slightly dropped from November's revised figure of 1,179K to 1,149K.

Manufacturing continued to contract while servicing, employment and housing stayed robust. The continued decline of oil prices, the strong US dollar, as well as falling retail sales cast doubt on recovery in the US. Concerns over a global slowdown, a spike in market volatility and interest rate differentials may drive money flows into US dollar and fuel its strength, hurting exports and corporate earnings. The uncertainty of the rate hike in March affects the market. Though the Fed's policy has begun to normalize, its recovery is still hindered. Its credibility will be at stake if it reverses its monetary policy. Unless the economy slips into a severe recession, the US is unlikely to reverse its monetary policy. A delay in rate hike would also signal economic weakness. At this stage, the Fed may slow its rate hike schedule, and we expect 1 to 2 rate hikes this year. We remain NEUTRAL on US equities.

European Equities

ECB held interest rates and QE scale unchanged and reiterated its willingness, ability and determination for further moves to spur inflation if needed. ECB will review its policy in March. GDP in Germany, the largest economy in Eurozone, rose 1.7% in 2015 from previous year, slightly accelerating from 1.6% in 2014. On the other hand, Eurozone's ZEW Survey Expectation in January plunged from December's 33.9 to 22.7, reflecting a deteriorating outlook. Eurozone's CPI in December rose 0.2% year-on-year, and core CPI was up 0.9%. November's unemployment rate in the Eurozone dropped to 10.5% from October's revised 10.6%, down from the peak of 12.1% in March 2013, but still considered high. Moreover, credit remained weak.

With regard to disinflation, market may question ECB's commitment to "use all available tools" to boost inflation if there is no strong or new stimuli in the near future. Revising purchase restriction in the QE programme would cause conflict among member countries and intensify moral hazard. Further rate cuts will affect investment opportunities of pension funds and encourage more risk-taking behaviour, possibly increase return volatility and hurt consumption confidence. Apart from inflation, both employment and credit borrowing can indicate the condition of Eurozone's economy, thus one should keep an eye on any change in ECB's QE focus and reference indicators. We are SLIGHTLY POSITIVE on European equities.

Japanese Equities

BoJ shocked markets as it introduced an interest rate of -0.1% for excess reserves parked at the bank by financial institutions. BoJ also delayed the schedule to reach the 2% inflation target from fiscal year 2016 to first half of fiscal year 2017, mainly impacted by falling oil prices. November's real cash earnings recorded -0.4% year-on-year, reversing from October's 0.4%. CPI in December rose 0.2% from the previous year, slowed from November's 0.3%. The figure excluding food and energy rose 0.8%, which also decelerated from November's 0.9%. December's overall household spending worsened from November's -2.9% to -4.4% year-on-year, intensifying worries on consumption.

The negative rate policy is believed to have limited effect, given slowing demand in Asia and globally. In a volatile market, the yen acts as a safe haven. One should note its strength is unfavourable to exports and the outlook of the equity market. Total equity returns may not benefit from yen appreciation as it would be outweighed by concerns of corporate earnings. Slowdown in company profits and negative growth in household spending added to worries of disinflation and economic recovery. Besides, fiscal policies by the government require time to take effect, and uncertainty in US monetary policy also limit the room of BoJ for further act. We question the Japanese recovery and effectiveness of its policies, thus we remain NEUTRAL on Japanese equities.

Asia ex Japan ex Hong Kong Equities

Weak oil prices, continued decline in imports and exports, and market volatility drove money flows out of the region and set off further currency depreciation. In terms of individual countries, India launched a series of policies to support start-ups such as tax breaks. Year-on-year decline in December's exports and imports narrowed significantly. In Indonesia, the terror attacks hurt market sentiment. The government plans to relax rules for foreign investments. The Central Bank cut interest rates by 0.25%, while December's foreign trades remained sluggish. In Taiwan, the Democratic Progressive Party (DPP) won the presidential election. Korea kept rates on hold and December's year-on-year drop in foreign trades intensified from that of November. Thailand suffered from drought, which is expected to continue in the coming months.

Against the backdrop of an economic slowdown and export competition, RMB depreciation may trigger further depreciation of Asian currencies. The markets were also burdened by weak commodity prices. Concerns over economic growth may delay US rate hike, but does not necessarily signal money inflows to the Asian region. Geo-political instability may further spur market volatility and drag capital out of relatively risky Asian markets. In addition, sustained retreat in trades is another concern to growth and money flows. Numerous firms in the region rely on commodity-related revenue, weakening of commodity prices and demand may hurt earnings, increase borrowing costs and default risk, and at the same time deteriorate balance sheets. We are SLIGHTLY NEGATIVE on Asian ex-Japan ex-Hong Kong equities on concerns of capital outflows.

China & Hong Kong Equities

The authority abolished the Circuit Breaker after triggering trade suspension twice within 4 trading days. The authority also placed restrictions on major shareholders on shares redemption after locking period expiration to avoid large-scale sell-off. The PBoC provided liquidity support through instruments such as reverse repurchase and Medium Term Lending Facility (MLF) as Lunar New Year approached. GDP grew 6.8% in 4Q from the previous year, which slowed from 3Q's 6.9%. GDP grew 6.9% for the full year. December's CPI moved up by 1.6% year-on-year, slightly quickened from November's 1.5%, while PPI declined by the same pace as November by 5.9%. December's year-on-year growth of industrial production, retail sales and fixed asset investment slowed from that of November. Margin financing trended down with the markets.

For the upcoming NPC CPPCC sessions in March, any disappointment in policy may further drag on market sentiment. Recent PBoC moves in equity and foreign exchange markets may impact the pace of market liberation of Chinese capital markets. Compared with Asian currencies, the extent of RMB depreciation is relatively low. Whether exports could be spurred is still questionable. Moreover, foreign currency reserves can indicate money outflows, its further decrease signals more outflows and will limit monetary policy flexibility. More easing measures signal an economic slowdown and may put further downward pressure on RMB, causing more money outflows and in turn hinder easing pace. However, more fiscal means can be implemented to support growth, such as cutting taxes and encouraging private investments. We remain NEUTRAL on China & Hong Kong equities.

Global Bonds

US 10-year Treasury and German 10-year bunds were up on money inflows into less risky assets under the global market turmoil. China's foreign-exchange reserves in December amounted to USD 3,330.4 billion, down by a record USD 107.9 billion from November. Offshore RMB saw quick and significant depreciation in early January, but the trend was reversed and close to the on-shore RMB, rumored with the PBoC intervention in the market. The PBoC also charged reverse requirement ratio on RMB deposit of off-shore financial institutions in on-shore agent bank. Yen gained for most of the month in a volatile market but was reversed when BoJ introduced negative interest rates, and euro fluctuated. Hong Kong dollar depreciated against the US dollar.

Despite lackluster Japan economy and US rate hike, the yen and US dollar should act as safe havens and reverse the yen weakness given increased market volatility. With consideration to the huge liquidity inflows since US QE programme, de-pegging pressure of HK dollar with US dollar is rather small at this stage, but weakness may continue. Volatility of RMB should decrease after the PBoC intervenes, we remain NEUTRAL on RMB bonds. In addition, bonds should be favoured should the US rate hike schedule slow due to the volatile economy. We are NEUTRAL on overall bonds.

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