BCT
銀聯集團

BCT Market Outlook

As of Jun 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

This year's rally in risk assets came to a screeching halt in May, derailed at first by the collapse of U.S.–China trade negotiations. From 10 May, the U.S. increased the tariff rate on USD 200 billion worth of Chinese imports from 10% to 25%, and announced that it may impose a 25% tariff on the remaining USD300 billion worth of Chinese imports. This led to China retaliating by increasing the tariff range from 5-10% to 5-25% on USD 60 billion worth of imports from the U.S. The end result in markets during May was a uniform risk-off move, and although not hugely severe, the -6.3% decline for the S&P 500 for example is still in the top 3 of the last 92 months. The Tech-heavy NASDAQ delivered a disastrous -7.8%. The Russell 2000, an index of mid- and small-caps, underperformed large-cap indices, with a monthly return of -7.8%. At sector-level[(1)], Energy, IT, and Materials underperformed (respectively -11.0%, -8.8% and -8.7%) while Real Estate and Utilities were the month's outperformers (respectively +1.1% and -1%). The VIX Index, a measure of aversion to risk, increased nearly 6 points from 13.1 at end-April to 18.7 at end-May, reflecting the end of the rally in risk assets for 2019.

The intensification of the trade disputes between the U.S. and China halted the equity bull run. However the correction was limited, and markets partly recovered from the post-tariffs lows, supported by financial conditions which continue to remain loose, dovish CBs, generally easier fiscal policies and relief from the low expectations on Q1 reporting season. Q1 earnings season has been positive, with revenue and earnings increasing. While the top line was sustained, the bottom line was less buoyant, and marked a clear deceleration vs 2018. Due to very accommodative monetary and financial conditions, we think that growth should be able to gradually decelerate to its potential in 2020, barring any major shock on financial conditions or major confidence corrections from businesses and consumers. Corporate profits will remain under pressure, especially if inflation re-accelerates, which is still possible, given that the economy is operating at close to full employment and tariffs may get at least partially passed through. **We remain cautiously neutral on U.S. Equities after the strong YTD rally, with sector/stock selection being the main strategy to approach the market, in which there are very expensive stocks (i.e., in bond proxies like consumer staples or utilities) as well as more appealing situations (e.g., in the services sector, where firms have faster sales and earnings growth, more stable gross margins, and stronger balance sheets.).**

European Equities

Eurozone data in May was somewhat mixed. The flash manufacturing PMI fell to 47.7, while the employment component also dipped below 50. There were some positive signs in the data, though. The new export orders component, while still below 50, did tick higher, and Eurozone consumer confidence picked up in May to its highest level this year. The Eurostoxx 600 delivered a disappointing -5.2% this month. At country level, the FTSE 100 lost only -2.9%, helped by a -3.4% depreciation for Sterling on the back of the probability of a hard or no deal Brexit rising post PM May's resignation, while the big winner was the Greek Athex (+7.4%), helped by hopes for business-friendly new government. The European Parliament elections, which took place from 22 to 26 May, yielded a generally positive result for the European project. Populist or Eurosceptic parties gained seats compared to the last election in 2014, but they underperformed expectations. The centrist parties of the EPP and S&D remain the largest two parties in parliament despite losing their combined majority. For now, the results are more likely to have bigger implications at the national level, particularly in Italy (prominent far-right, pressure to add fiscal stimulus), Greece (as a new business-friendly government takes over) and the UK (after Nigel Farage's pro-Brexit party's victory, although many options remain on the table). At sector level(1), Autos (-10.4%), Banks (-10%) and Basic Resources (-9.5%) underperformed, while Food & Beverages (+0.4%), Utilities (-0.2%) and Real Estate (-0.5%) outperformed.

European equities could offer interesting entry points after the EU elections, should the economic outlook improve in H2 and domestic demand remain resilient, as we expect. Q1 reporting season has been solid. Signs of improvement could come from easier fiscal policy and stabilization /improvement of growth in H2. Geopolitical factor could ease somewhat, with the EU election behind us. The current features of the market (increasing valuations dispersion, lower sector correlation) fit a stock picking approach. The Eurozone economy remains exposed to trade tensions. While there was a reprieve concerning the threat of higher U.S. tariffs on European autos, as Donald Trump postponed his decision to mid-August, European corporations can nonetheless be hit by U.S.-China tensions through global value chains. **We believe a cyclical rebound has to be confirmed to see a convincing repricing opportunity for some cyclical sectors, notably for financials. We therefore remain neutral on European equities. Possible upside on fundamentals remains clouded by political and trade frictions for the moment.**

Japanese Equities

The Japanese equity market fell sharply at the beginning of the month and ended May with a total return of -6.5%. Global macroeconomic and political factors were again dominant. In sector terms(1), Real Estate (+0.2%) was the only positive sector of the month, while all other ended in the red. The yen strengthened against other major currencies, reflecting its perceived safe haven status, which tended to add to downward pressure on equity prices. Economic data was mixed, with the largest positive surprise coming in real GDP growth for Q1 2019. This showed real GDP grew at an annualized rate of 2.1% during the quarter when consensus expectations were for a decline.

Japanese equities show compelling valuations but a possible strengthening of the yen backed by increased uncertainty represents a headwind for the equity market. The earnings per share momentum is weak, although valuations are attractive. Increased volatility due to geopolitical factors, could lead to a stronger yen, which could potentially be a drag for the market. Investment in infrastructure is buoyant on the back of urban development. In contrast, spending on machines remains weak, as an improvement in the Chinese economy has yet to stimulate manufacturers. Steady wage increases underscore consumption, whereas galloping prices of daily necessities are discouraging households. **We are neutral on Japan equities. Opportunities could be found at the stock picking level, but we are cautious on the overall market.**

Global economic stagnancy has crippled manufacturers, with exports marking a Year-over-Year fall for four months. The Bank of Japan corporate survey points to decent capital spending plans for 2019. In fact, sluggish shipments are undermining investment. Machinery orders showed only a meagre gain in February after three months of contraction. However, non-manufacturers held up well on urban redevelopment, job placement and the coming 5G Telecom standard. Despite the weak export snapshot, shipments are likely to gather strength as the Chinese economy rebounds solidly. On the consumer front, settled pay raises are slightly higher than last year. Nonetheless, a 2% increase in disposable income is being partly offset by a higher savings rate, reflecting households' apprehension over corporate earnings and the upcoming VAT tax hike. They are also being discouraged by higher consumer staple prices. The earnings per share momentum is weak, although valuations are attractive. **In the last few weeks we have become more cautious on Japanese equities, and try to find some bottom-up opportunities.**

Asia ex Japan Equities

The MSCI Asia ex-Japan Index saw brutal selling pressure (-8.5%) in May as re-escalation in U.S.-China trade negotiations weighted on investors' sentiment towards global growth and brought back a risk-off mode. Sector-wise, Consumer Discretionary was the worst performer (-13.2%), while Utilities outperformed (-2.1%). Taiwan (-7.8%) and Korea (-9.3%) were collateral damages given the high weight of the tech sector in their benchmark indices as well as their sensitivity to global trade. India (+0.2%) outperformed the rest of EM. The country saw the conclusion of its six-week long general election, with Narendra Modi's Bharatiya Janata Party (BJP) winning an absolute majority in the lower house. This provides some clarity on the policy outlook, and focus will now shift to unlocking the potential for long-term growth in India, which will be one of the key challenges and priorities for the BJP. In political developments, Philippine president Rodrigo Duterte's allies won a resounding victory in mid-term elections. Elsewhere, president Joko Widodo was re-elected as Indonesia's president.

In the Asia ex-Japan space, the Q1 reporting season showed marginal signals of bottoming out. Dividend is an attractive theme to play, as dividend per share growth increased strongly and is expected to further improve. The region's inflation figures have remained very benign. Oil and food prices reverted their contribution from negative to positive, pushing inflation levels up mildly. Central Banks targets are not at risk for the time being. The recent market correction relates to an increase of uncertainties surrounding the China-U.S. trade negotiations. After the decline of the past month, equity valuations are even more attractive but it comes with a higher risk than previously assumed. **We remain slightly positive on Asia ex-Japan equities. We favor defensive stories related to attractive domestic demand growth, more insulated in case of a trade escalation, as downside risks lurk in the background.**

China & Hong Kong Equities

China was the worst performer (MSCI China Index down -13.1%) among EM as the macro narrative quickly deteriorated following the U.S.'s decision to raise tariffs from 10% to 25% on USD 200bn of Chinese goods starting May 10, as well as the ban of selected tech firms. The failure to agree a trade deal with the U.S. increases the risks to the growth outlook. With the introduction of further tariffs, the renminbi fell against the U.S. dollar by 2.5% in May. This month saw reserve requirement ratio cuts, albeit on a smaller scale than those made earlier this year, amounting to roughly 20 basis points. The announced tax cuts on personal and corporate incomes also show the appetite from the authorities to help stabilize growth. Retail sales and industrial production (IP) data was particularly weak, with IP falling to 5.4% year on year in April, from 8.5% the month before. Exports dropped 2.7%, down from a 14.2% jump in March. Sector-wise, negative performance across the board, with Consumer Discretionary being hit the hardest (-17.7%) and Utilities outperforming (-1.7%).

The surprising turnaround in U.S./China negotiations and tariff increases on $200bn Chinese goods are adding new downward pressures to China's economy. Uncertainty increased in near term following U.S. announcement to restrict Huawei's purchases from U.S. suppliers. The current tariff increase still looks manageable for China, as policymakers are better prepared than last year, and policy supports since H2 last year are taking effects. Meanwhile, there are signs that policy supports since Q3 are starting to pass through into real economy and are becoming more visible, such as reductions in personal and value-added taxes put in place in January and April, respectively, or the cut of the Reserve Requirement Ratio that freed about 100 billion yuan in long term funds in its second phase according to the PBOC, the third phase being scheduled to take effect on July 15. RMB should be able to avoid large depreciation barring any further major escalations, helped by policy supports and capital control. **We are positive on China Equities. We think China's economy could hold up better than last year, as policymakers are better prepared, and local sentiment looks less fragile.**

Global Bonds

Bond markets were the main beneficiaries during May with U.S. Treasuries and German Bunds returning +2.4% and +1.5% respectively. German Bund yields actually started the month at 0% and finished at -0.202% and the lowest yield on record. U.S. Treasuries are also at 21-month lows while a number of yield curve measures have inverted further into negative territory, with a Fed rate cut now fully priced in. Meanwhile U.K. Gilts returned +2.9% and Spanish Bonds +2.0%. Emerging Markets bonds (+0.2%) were more or less unchanged however, while BTPs (-0.4%) were negative as concerns escalated about potential EU disciplinary action around Italy's growing debt pile. In terms of what that meant for credit, spreads were wider in USD and EUR credit however the move for U.S. Treasuries did at least help USD Investment Grade (+1.4%), Financial Senior (+1.2%) and Financial Subordinated (+1.2%) to deliver positive total returns. USD High Yield was however down -1.0% while EUR credit was negative across the board, with Investment Grade (-0.1%) outperforming High Yield (-1.5%).

We believe that the market has overestimated the probability of a rate cut by the Fed. The market could be vulnerable in case of readjustment of inflation expectations. A cautious duration position is warranted given current 10 Year U.S. Treasury yields. Regarding U.S. Credit, the current environment should be supportive for spread assets. We note, however, that recent market performance has reduced the prospects for returns relative to risk in many credit sensitive asset classes and reduced the scope for material near-term spread tightening. In the High-Yield space, we see valuable carry, but limited space for spread compression at the current level. The still sound economic picture is benign for the default outlook. Default rates are expected to remain very low in 2019. In Europe, at the current German Bund yield levels, we see little value in core Government Bonds. For fixed income investors, opportunities could be found playing yield curve flattening and Euro peripheral bonds. Investment Grade Corporate Valuations have become less compelling after the aggressive spread tightening but the asset class is still attractive for carry reasons and fundamentals remain solid. Central Banks actions could support financials. Subordinated debt is an area of interest too. **Our view is still constructive on Hard Currency Emerging Markets debt in the medium term, due to a benign economic outlook for Emerging Markets, dovish Central Banks and loose financial conditions. In the short terms, spreads are quite tight and some volatility could return in the market in light of the increased tensions between China and the U.S. We are Neutral on Government Bonds and Positive on Corporate Credit, i.e. Neutral on Global Bonds.**

(1) Sectors of the S&P 500 (U.S. Equities), Stoxx 600 (European Equities, Topix (Japanese Equities), MSCI China (Chinese Equities) indices.

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