BCT Market Outlook

As of Nov 2019

Can the dovish central bank reverse the global economic slowdown?

Investment Markets	BCT's Investment Views	Summary
Equities	**Neutral**	
US	Neutral	We remain cautiously neutral on the US equities. While there is support from improved geopolitical situation and central bank's liquidity, the market is close to the highs, rates are rising and earnings growth is fragile.
Europe	Overweight	We are slightly positive on European equities. Brexit uncertainty is clearing up and trade disputes with China are calming. ECB is injecting liquidity in the system through renewed quantitative easing while the PMIs of the region seem to hit bottom.
Japan	Neutral	We remain neutral on Japanese equities: valuations and improved corporate governance are supportive but fragile economic growth, weak earnings growth and the appreciation of the Yen pose risks and major headwinds.
Asia ex Japan	Overweight	We see reasons for a more constructive view on equity markets in the region: earnings have been better than expected; the central banks of various countries have been very accommodative by lowering the banks' required reserve ratio and the policy rates, as well as introducing target mechanisms to stimulate the economies. Selectivity is the key. We are slightly positive on Asia ex Japan equities.
China & HK	Overweight	We are positive on China equities; a partial trade deal between the US and China is always better than no deal. If there are more fruitful discussions ahead, it will bring more cheers to the markets. We are turning positive on value and cyclical stocks. We are slightly negative on Hong Kong equities due to the unsolved domestic social issues. As the economy is suffering and flows are not supportive, de-escalation of protests is needed for Hong Kong equities to become appealing.
Global Bonds	**Neutral**	
Government Bonds	Neutral	In global fixed income, investors should continue to seek opportunities at current levels, as well as at the country allocation level. We think investors should remain active in tactically adjusting the duration exposure when the market expectations get extreme. We are neutral on government bonds and positive on corporate credit.
Credit	Overweight	

Scales of weighting: Underweight, Neutral & Overweight.

US Equities

The drivers of domestic demand keep slowing and the growth deceleration is more pronounced in investment spending than private consumption. Business climate surveys showed a weak spot in manufacturing and services. Consumer confidence signals are mixed, but, on average, suggest that confidence is worsening. On the investment front, spending plans are shrinking. Inflation remains low (1.7% overall and 2.4% for core inflation), which is close to the Federal Reserve (Fed)'s target. The Fed delivered a cut in the October's Federal Open Market Committee meeting and announced that it will buy Treasury bills each month at least into Q2 2020, initially at $60 billion per month, to maintain an appropriate level of reserves, rapidly produce supportive effects on money markets, and create some leeway and flexibility for the future. A truce between the US and China was recently announced with China stepping up purchases of the US farm goods and the US delaying tariff increases. This is "phase one agreement" of a broader trade deal according to the US President, Donald Trump. New tariffs are not completely out of the radar but it is not in our base case for 2020 scenario. It is too early to anticipate rollbacks of current tariffs as the negotiation remains tough. We hope that phase one agreement and the postponement of tariff increase on 15 December can at least be done with no damage. Regarding the global trade dynamics, it has caused certain damage. There could be a rebound from the low base but we expect a very weak trend going forward.

US growth is expected to converge to potential, and set to decelerate as key drivers moderate. Consumption growth is expected to slow because labour income growth slightly decline and remains resilient. We forecast a stronger deceleration for investments. Inflation is set to pick up towards the Fed's target with some upside surprise risks in the near term but the overall outlook remains soft. As of now, no major fiscal easing is on sight in the US. When the presidential election gets near or if a very negative scenario materializes, there is a potential for more fiscal measures but they are likely to bring temporary effect. Given the soft inflation outlook, the Fed still keeps a dovish stance for the future. The Fed keeps its easing policies, but policy decisions are subject to economic data. In line with market expectations, our central scenario is another rate cut next year, in order to maintain accommodative financial conditions and keep the US growth on track. In our view, under the moderate growth outlook, resilient consumer sector (at least a partial easing of trade tensions), and easing financial conditions (in particular a stable/slightly weakening USD), we expect corporates to achieve single-digit earning growth for next year. Our expectation stays below the market consensus. Financial conditions are easing, but on the other side, top line components (sales growth, capital expenditures, Purchasing Managers' Indexes (PMIs) and trade weighted USD) highlight vulnerabilities. We remain cautiously neutral on the US equities. While there is support from improved geopolitical situation and central bank's liquidity, the market is close to the highs, rates are rising and earnings growth is fragile.

European Equities

Domestic drivers remain the core of growth, albeit not posting stellar performances, while external demand represents the swing factor, which can boost or drag economic growth in the more open economies. There is no major signs of reacceleration of growth from high frequency data, and we see mixed signals from PMIs. Service sector is resilient, but manufacturing is weak. As widely expected, following September's full package of new measures, the European Central Bank (ECB) meeting in October did not deliver any new monetary policy announcement or the details about previous decisions. The ECB confirmed "protracted weakness in the Eurozone dynamics" was the rationale supporting an easing stance. European equity markets mostly posted positive results, with the MSCI Europe up 0.44% during October in local currency total return terms, which grew 18.96% year-to-date. The MSCI European Economic and Monetary Union and the Euro Stoxx 50 did better, posting returns of 1.20% and 1.11% in October respectively. Only two markets in Europe posted negative returns during the month – the UK FTSE100 (-1.87%, mainly causeed by a rally in the U.K. currency as Brexit becomes clearer) and the Netherlands AEX index (-0.50%).

We expect the economic growth of the Eurozone to converge to potential level, which means slight acceleration for some countries (Germany, Italy) and slight deceleration or stabilization for others (Spain, France). Inflation is projected to remain subdued in the Eurozone over the next few years, while fiscal easing is set to come but is likely to be mild, uncoordinated or pre-designed. The second round of ECB's quantitative easing has just started and no major new measures are expected to be delivered in the short term. Christine Lagarde's first goal as the President of ECB is to regain unity within the Governing Council after open criticism of some of its members towards the new round of quantitative easing. We expect an additional 0.1% deposit rate cut in the next 12 months, but the fact is that it offers very limited room for further cut and will bring additional negative effects to the banking system. About the Brexit, the Brexit deadline will be extended until 31 January 2020 with an early general election on 12 December. Following these events, the risk of no-deal Brexit has declined sharply, and the most possible scenario would be the Parliament's ratification of the new withdrawal agreement reached on 17 October. In this case, the U.K. would enter a transition phase under which it will retain most of its access to the single European market, and it would have to negotiate a lasting framework for its relations with the European Union. Overall, we are slightly positive on European equities. Brexit uncertainty is clearing up and trade disputes with China are calming. ECB is injecting liquidity in the system through renewed quantitative easing while the PMIs of the region seem to hit bottom. A steeper Euro yield curve will help financial sector.

Japanese Equities

Weaker foreign demand has filtered through the domestic economy. According to the Bank of Japan's Tankan survey (Short-term Economic Survey of Enterprises in Japan), large manufacturers' business outlook slipped to a six-year low. However, exports finally started narrowing the scope of the year-over-year decline in Q3 2019, thanks to a stabilization in global manufacturing PMI. The Tankan survey also illustrated that the service sector successfully dodged a spill-over of the global economic slowdown. Despite the tax hike, Tokyo's Consumer Price Index did not accelerate in October (0.4% year-on-year growth as in September). At the October meeting, the Bank of Japan decided to keep its monetary policy unchanged in all areas, and kept the door open for lower rates in the future. The Governor of the Bank of Japan, Haruhiko Kuroda, said the Bank expected a delayed recovery in the global economy and lowered all its forecasts for economic growth and inflation in its quarterly outlook report. The relative earnings trend is not convincing. The earnings per share momentum has been disappointing so far. Japan market strongly performed, with the Topix up 4.99% and Nikkei up 5.39% in October. The Nikkei now ahead in year-to-date terms (+16.33%) compared to the Topix (+11.57%).

The economy will stall in Q4 2019, not because the consumption tax was raised but disastrous typhoons and subsequent floods disrupted business activity and consumer spending. Heavy price discounts by retailers are underpinning consumer demand. The government is considering a sizable supplementary budget. The government has accelerated the replacement of decrepit infrastructure since 2014 as 71% of bridges and 57% of tunnels will come to the end of their serviceable life (50 years) by 2028. So the size of public works spending would markedly increase, including reconstruction after the recent typhoon and infrastructure investments, to expand defence against floods and natural disasters. On the monetary policy side, the Bank of Japan still keeps the door open to more easing. The change in forward guidance wording at its last meeting showed that rates will likely remain at current level in 2020 with a possible further cut. We expect a rate cut by 0.1% in the next 12 months. The Bank of Japan will obviously keep the longer-end of the curve from decline in order to secure the slope of the curve. Price earnings ratios are consistent with a deflationary risk. Japanese equities still remains dependent on the Yen, which is very much linked to fluctuations in risk aversion. The tariff negotiations between the US and China ahead of the US presidential election will support Japanese equities, which is exposed to global trade and global growth. Overall, we remain neutral on Japanese equities: valuations and improved corporate governance are supportive but fragile economic growth, weak earnings growth and the appreciation of the Yen pose risks and major headwinds.

Asia ex Japan Equities

Economic conditions in the region remained quite weak in September but didn't worsen any further. External demand has been stabilizing at low growth levels. The region's inflation figures have remained very benign. Notably, India and China's September figures showed higher-than-expected food basket components (particularly pork prices in China), at 4.0% and 3.0% year-over-year, respectively. Global and domestic drivers have brought the central banks in emerging Asian markets to accelerate their monetary policy easing since July. As the Fed is so close to pause rate cut, more marginal easing by the emerging markets is expected. In October, the Bank of Indonesia continued its easing with a 0.25% rate cut, while the Bank of Philippines lowered its reserve requirement ratio by 4% to 14%. Although the signals of a more easing fiscal policy have increased in late 2019, the budget projections in 2020 remain on the prudent side with a few exceptions in some countries. The MSCI AC Asia ex-Japan registered a gain of 4.68% in USD terms. The majority of Asian markets returned positive, with Taiwan as the best contributor (+4.91%). Only Thailand and Australia were down at the end of the month (-2.00% and -0.35% respectively).

The outlook for the region remains dependent on the evolution of trade discussion between the US and China. Given the benign inflation of the region, we expect more easing going forward. Several countries are trying to stimulate their economies through fiscal leverage, but fiscal policy is not always supportive. For example, in Thailand, the proportion of current expenditure continues to account more than capital expenditure in public expenditure. Realized capital expenditure in the 2018-2019 fiscal year was again much lower than the target. We see reasons for a more constructive view on equity markets in the region: earnings have been better than expected; the central banks of various countries have been very accommodative by lowering the banks' required reserve ratio and the policy rates, as well as introducing target mechanisms to stimulate the economies. Selectivity is the key. We like Korea as a contrarian call which is geared to the cyclical recovery, and that valuation, positioning and negative sentiment on cycle/semiconductor stocks may have the opportunity to reverse. India is now appealing from quantitative metrics perspective, thanks to strong improvements in revisions, profitability and positioning, amid expensive valuation. We are slightly positive on Asia ex Japan equities.

China & Hong Kong Equities

As expected, China's GDP growth in Q3 2019 landed at 6% year-over-year, which was the target floor announced by the government. Looking at its components, final consumptions and net exports marginally deteriorated while fixed investments very marginally improved. Property sector proved resilient, with some signs of pickup in the saleable area. The policy mix continues to support the economy in a limited way, through both the monetary and fiscal levers. China's policy mix will continue its stimulating stance, but it has been very limited until now, and far from the massive economic stimulus implemented in recent years. The People's Bank of China left the loan prime rate on hold in September and cut the medium term lending facility rate by 0.05% on 4 November. Following the implementation of the easing monetary policies, credit growth has increased moderately as expected, driven by the impacts of core Renminbi loans and corporate bonds. Hong Kong fell into recession following 5 months of protests, which turned violent. Tourist arrivals declined; sales slowed and exports fell due to the US-China trade disputes. This month, the MSCI China returned positively (4.02%), so was the Hang Seng Index (3.29%).

For China, we reiterate that the economic growth will remain at the same level in the next quarter and it will move below 6% in 2020, which will correspond coherently with a target shift to be announced in the near future. That leaves US with the GDP growth forecasts for 2019 at 6.2% and for 2020 at 5.8% year-over-year respectively. In the 4th Plenum of the 19th Party Congress, focus was on the state's governance system rather than economic reforms. No big changes was announced, but using formal rules and regulations to strengthen party control. For the first time, some emphasis was put on trade diversification and pluralism (away from the US). A new attitude with regard to Hong Kong seemed to have emerged towards a full integration and establishment of a national security law. Finally, regarding policy mix, a more reactive than proactive stance was outlined, which seemed to stick to the past. We are positive on China equities; a partial trade deal between the US and China is always better than no deal. If there are more fruitful discussions ahead, it will bring more cheers to the markets. We are turning positive on value and cyclical stocks. We are slightly negative on Hong Kong equities due to the unsolved domestic social issues. As the economy is suffering and flows are not supportive, de-escalation of protests is needed for Hong Kong equities to become appealing.

Global Bonds

With some more positive signals coming from the US on the trade talks with China, and that the Fed might be about to signal a pause in rate cuts, fixed income markets traded weaker and yields rose modestly across most major markets. Whilst global PMIs are still struggling to form a base, some investors thought that the worst condition of economic slowdown may be behind US, economic activity could stabilize, especially if there are positive resolutions to some of the issues that have affected growth in recent quarters, such as Brexit and trade tensions between the US and China. With the Fed still supporting the front end of the yield curve via liquidity injections, the very short-dated part of the yield curve was the only part of global bond markets that saw falling yields, with the US 2-year yield falling from +1.62% to +1.53%. Further out the curve, the US 10-year yield started October at +1.67% and finished at +1.69% whilst 30-year yield moved up from +2.11% to +2.18%. The most watched spread between the 2-year yield and the 10-year yield widened over the month from +0.05% to +0.16%. In Europe, the big change for October in European bond markets was the retirement of the President of EC, Mario Draghi, and the appointment of the ex-Managing Director of the International Monetary Fund, Christine Lagarde. Having started October at -0.57%, the German 10-year yields rose to finish the month at -0.41%, which was -0.70% in the end of August. Over the month, the German 2-year yields rose 0.10% to -0.67%, and its 30-year yields went up 0.18% from -0.07% to +0.10%.

After the low at the beginning of September (when markets priced in 1.13% cut), market expectations of the Fed's easing have massively reduced. The global PMIs for October showed some tentative signs of stabilization, which supported a widespread rebound in breakeven inflation (the US 10-year breakeven inflation increased to 1.72% from the 1-year low of 1.47% in early October). In global fixed income, investors should continue to seek opportunities at current levels, as well as at the country allocation level. We think investors should remain active in tactically adjusting the duration exposure when the market expectations get extreme. In credit, we favour European credit because of strong fundamentals and relatively limited leverage. Participation is strong as investors hunt for yield and ECB provides support. There is still a quite benign environment for emerging market debt. Attractive carry, low US rates, subdued inflation, the dovish Fed and dovish central banks of emerging markets are supportive for emerging market duration investment. However, with uncertainty around trade negotiations, fragile growth dynamics and liquidity issues, investors are recommended to adopt a more cautious and selective approach. We are neutral on government bonds and positive on corporate credit.

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