BCT 銀聯集團

# BCT Market Outlook

## As of Sep 2019

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

*Scales of weighting: Underweight, Neutral & Overweight.*

**US Equities**

In the U.S., macroeconomic data was moderately positive for the job market and consumer sector. However, we continued to observe a decoupling between the services and manufacturing sectors. Pressure coming from trade and uncertainty will continue to prevail in the short term. The Q2 revenues and earnings of S&P 500 companies rose 4.7% at a better-than-expected pace. However, the guidance for Q2 earnings was conservative due to the lack of visibility in early July, resulting in a reduction of 2019 growth forecasts of earnings per share at that time. After achieving a new all-time-record high in late July, the U.S. equity market retreated in August as the U.S.-China trade war escalated. The S&P 500 dropped 1.58%. The narrower Dow Jones 30 lost 1.72%, whilst the Nasdaq went down 2.46%. The small-cap Russell 2000 depreciated by 4.94%. From a sector perspective, the best performers in the S&P 500 were Utilities and Consumer Staples (+5.16% and +1.80% respectively), whilst the worst-performing sectors were Energy (-8.07%) and Financials (-4.85%).

The global outlook is gloomier than it appeared at the start of the year. With accommodation at full speed by various central banks again, the prospect of a global recession is not in our base case scenario. However, further weaker trade dynamics will bring global economic growth for 2019 to 2020 lower in which the growth of most of the regions will fall below potential rate. The performance of earnings season was somewhat better than market expectations, but the trade war effects are starting to materialize, resulting in a more uncertain corporate earnings outlook, despite a still resilient economic backdrop. In terms of investment style, although we still prefer growth stocks, we now believe valuations are extremely stretched in med-tech, software and consumer stocks. Bond proxies and other low volume stocks still appear very expensive, with the exception of real estate stocks, which is the preferred bond proxy. **Overall in the U.S., we prefer sectors in Consumer Discretionary, Healthcare and Financials. We are negative towards Industrials, Utilities and Consumer Staples. We remain cautiously neutral on the U.S. equities.**

**European Equities**

Economic growth was disappointing in Q2 (+0.2%) and indicators for Q3 were weak. Activity remained strong in the services sector but the manufacturing sector was struggling, especially in Germany. News flow over the summer (the escalating trade war between the U.S. and China and the growing risk of a hard Brexit) dragged down investment confidence. Uncertainty about Brexit was extremely high. The Prime Minister of the United Kingdom (UK), Boris Johnson, was determined that Brexit would happen on 31 October, even without a withdrawal agreement. However, while the European Union (EU) seemed unwilling to make any additional concessions, the Parliament in the UK opposed to a no-deal Brexit. European equity markets posted negative results, with the Stoxx Europe 600 down 1.32%. The Euro Stoxx 50 lost 1.06%. Among the large economies, the Italian FTSE MIB dropped 0.35%, outperforming the majority of the European bourses. Italy benefitted from an improved political situation with the new government being more pro-EU and avoiding a snap election.

Manufacturing sector in the Eurozone continues to weaken due to trade tensions. In Germany, we now foresee a technical recession (with slightly negative GDP growth in Q2 and Q3 2019), however it should be mild and short-lived. On a positive note, domestic demand should remain well supported by the strong labour market and some wage pick-up that contribute to a positive trend in the real disposable income. The policy mix (monetary and fiscal policies) is turning more accommodative, this should help to cushion the “uncertainty shock”. There are a number of positive factors at play in favour of the European equity market: fundamentals appear solid (even if forward visibility has deteriorated); valuations are generally attractive or fair (cheaper than that of the U.S.); the dovish European Central Bank supports the market. The heightened volatility and market dislocations have created interesting relative value investment opportunities. Having said that, we do not encourage aggressive risk taking as different sources of uncertainty (Brexit, trade issues, Middle East tensions and rising oil prices) remain in place. We continue to find opportunities among cyclicals such as Industrials and Energy. **In particular, we prefer companies with high quality business models and strong balance sheets. The banking sector appears structurally challenged, given falling rates. While there are no clear triggers, we believe that the valuation of banking sector is cheap and a significant tactical opportunity to buy European bank stocks should arise. We are neutral on Financials and we prefer bank stocks over insurance stocks. Overall, we are slightly positive on European equities.**

**Japanese Equities**

The Nikkei 225 lost 3.72% in August. In sector terms[(1)], all sectors were negative, with the worst performance for Energy (-10.84%). Exports fell year-on-year, and it has been falling for eight straight months as of July, resulting in the longest stagnancy since 2015 to 2016. Exports of machine-tool plunged substantially due to reckless demand in China. Demand from Europe has also been faltering. Globally, companies suspended or downsized business investment as the U.S.-China trade dispute lingered. While technology industries eventually showed signs of improvement, automobile industry now becomes a drag for capital expenditure. Despite that survey results supported capital expenditure expansion, monthly machinery orders did not support this optimism. On the retail front, longer rainy season and subsequent hectic up-and-down in temperature averted consumers’ appetite. Consumer sentiment has fallen for 10 months in a row to the lowest in five years. With income growth decelerating, the growth of front-loaded purchase ahead of consumption tax hike in October this year was extremely slow. The only mainstay is public demand now. The first and the second supplementary budgets for the fiscal year 2018 boosted disaster relief while the plenary budget for the fiscal year 2019 proceeded reinforcement of infrastructure.

On the positive side, we note that valuation of Japanese stocks is cheap comparing to that of other developed markets (the U.S. and Europe). The relative performance of the Japanese market remains very much linked to the Japanese Yen. In August, the Japanese equities broke down because of global risk sell off, but the relief of the last 2 weeks doesn't look sustainable unless the trade dispute finds a happy end in October (low probability) and the purchasing managers' indexes (PMI) of global manufacturing bottom out soon (higher probability for next year than this year). The risk remains skewed on the downside and we maintain cautious on this area for the time being. **We remain neutral on Japanese equities. Valuation looks attractive and domestic recovery surprises to the upside, but this is only half of the story as the earnings momentum has been hammered by the appreciation of foreign exchange and the deceleration of global trade which justifies our cautious view.**

**Asia ex Japan Equities**

Emerging market equities underperformed developed markets with Asia ex-Japan experiencing a further pullback in August. The MSCI AC Asia ex Japan index registered a loss of 4.31%. Although none of the equity markets returned positively in August, the most resilient markets were India (-0.25%), the Philippines (-0.68%) and Indonesia (-0.97%). The rebound of trading activity since Q2 has helped Taiwanese stocks, particularly in the technology sector where the new product cycle could provide some cushion to the export outlook. In India, poor economic conditions were broadly based. As India is a relatively insulated economy, exports suffered, on average, less than other Asian economies but domestic structural issues (in the rural and banking sectors) weighed on investments and household consumption. The GDP growth forecast for the fiscal year 2020 (ending March 2020) was recently lowered to 5.7% from 6.1% year-over-year and increased slightly for the fiscal year 2021 to 6.7% from 6.5% year-over-year. Likewise, the policy mix has turned more supportive mainly on the monetary policy side.

The outlook for Asia ex-Japan remains dependent on the progress of trade discussions between the U.S. and China. Economic conditions in the region keep deteriorating, driven by a further decline in external demand and weak domestic demand. The outlook for Korean exports is dark, due to a re-escalation in trade tensions. India's growth outlook, broadly based, is weaker than expected. The region's inflation figures have remained very benign. Inflation in Indonesia is rising, mainly driven by food prices, while inflation in Thailand is experiencing new minimum level. In August, many central banks in the region moved towards a more accommodative monetary policy, including Indonesia, the Philippines and Thailand, which all cut their policy rates by 0.25%, while India cut its rate by 0.35%. Several countries are trying to stimulate their economies through fiscal leverage. The Philippines, Thailand and India recently announced different fiscal packages/measures. On the opposite side, in its 2020 budget announcement, Indonesia will continue to pursue virtuous fiscal consolidation. **We are neutral on Asia ex-Japan equities. Geopolitical risks and uncertainty remain elevated, leading to an increase in investor risk aversion and market volatility. We expect that this can only be offset partially by central banks' easing stance. In this environment, despite attractive valuations, we prefer to be more cautious in the short term.**

**China & Hong Kong Equities**

China's equity market ended lower (-4.09%) in August amid trade war escalation and deteriorating business confidence. Real Estate, Telecoms and Energy were the worst performing sectors, falling by 8.7%, 8.5% and 7.6% respectively while Healthcare rose by 5.8%. The first half corporate earnings came in broadly in line with expectations, with e-commerce and traditional retailers surprising on the upside. Meanwhile, macroeconomic data was disappointing and indicated a further contraction. Export orders fell due to ongoing trade tensions and global economic weakness. Hong Kong Hang Seng Index was the worst performing market in August losing 7.16% amid social turmoil and slowing trade and economic growth data resulting from the U.S.-China trade war. The political situation in Hong Kong took a turn for the worst in August raising concerns for an expected slowdown in residential demand, consumer spending and tourist arrival. Inflation data showed a significant increase in food and housing prices of 12.8% and 4% respectively.

In a re-escalation of trade tensions, China retaliated against the U.S. tariff increase, with 5% to 10% hike on some of the $75 billion of the U.S. targeted goods (a total of 1,717 items, but not clear at this point their value), starting on 1 September 2019. Chinese macroeconomic data showed a certain degree of deceleration that was quite broad-based, including in the manufacturing, consumer goods and property sectors. The latest export data showed some resilience, due to the front-loading of upcoming tariffs. The policy mix continued to support the economy in a limited way, both monetarily and fiscally. More stimulus is expected in the future (Reserve Requirement Ratio cuts and increases in the quota of local government bonds). In August, the People's Bank of China announced a move towards greater liberalization of interest rates, including the loan prime rate. The path to full liberalization is still far off, while China has gradually eased its monetary policy. The new mechanism of monetary policy aimed to make the borrowing costs more linked to the financial markets. The more dovish direction of the first fixing was widely expected. The MSCI China valuations are not so attractive but A shares are cheap. Cyclical adjusted valuations are moderately supportive. The growth expectations of earnings per share are too high and we expect they will go down in the next few months. The earnings season of Q2 2019 was positive, both in terms of results and surprises, but positioning on the MSCI China equity was still very light. **We are positive on China and Hong Kong equities. We maintain a preference for A shares as domestic stories are expected to benefit from fiscal and monetary stimulus. However, investors are advised to monitor headwinds including the depreciation of Renminbi, stance of Federal Reserve (Fed) versus market expectations and trade war escalation. On the positive side, A share inclusion ratio from 10% to 15% will support flows to China.**

**Global Bonds**

Several issues compound the situation for fixed income markets, the U.S.-China trade war, concerns over global economic growth, and expectations of aggressive rate cuts by various central banks. After the rate cut by the Fed in July, the market is now pricing in additional cuts in 2019 and some further cuts in 2020 (1% overall). In Europe, an accommodative monetary environment should remain for a prolonged period. However, there is a possibility that markets are expecting too much and we may see more volatility in case of disappointments. We are also increasingly selective in credit, where liquidity risk assessment is at the forefront. For emerging market bonds, we are navigating a complicated market environment amid a global economic growth slowdown, anchored inflation expectations and escalated trade tensions. In this environment, central bank easing, in an effort to mitigate trade war risks and stimulate growth and inflation, could be supportive of emerging market fixed income assets. We believe that emerging market bonds still offer notable potential return prospects and remain attractive for investors hunting for yield.

From a global fixed income perspective, we have an overall neutral duration stance. We believe that some tactical adjustments in European and the U.S. duration could benefit investors, given the recent dovish European Central Bank’s statement. With respect to European sovereigns, we keep a constructive view on the main peripheral countries but are now more cautious on Italy’s government bonds as the 10-year spread of Italy’s government bonds and that of German Bund has tightened significantly. We also continue to seek opportunities from yield curve movements both in the U.S. and Europe. From a U.S. investor perspective, we become more cautious on duration amid the strong yield drop. In the U.S., given narrower credit spreads and lingering macro uncertainties tied to global trade policy, business sentiment and the reactions to the Fed’s policy, we are moderately constructive.

Compared to investment grade credit (where we are cautious on the BBB space), we prefer securitized credit sectors such as asset-backed securities, commercial mortgage-backed securities and residential mortgage-backed securities that are expected to benefit from a still strong consumer sector. We also see selective opportunities in the U.S. high yield bonds on the BB and B space that provide better liquidity profiles. **In European credit, we are still constructive but selective, preferring short-term maturities with high spreads. Overall, we become more cautious on Financials, especially the banks in Italy and the UK. 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.*



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