BCT Market Outlook

December 2015

US Equities

Fed's minutes in October's meeting indicated that a majority of FOMC members expect the inflation and labour markets would meet the condition for a December rate hike. In terms of data, the quarter-on-quarter growth of 3Q annualized GDP was revised upwards from 1.5% to 2.1%, while core personal consumption expenditure (PCE) stayed at 1.3% after revision. ISM manufacturing index dropped to 50.1 in October from 50.2 in September, further approaching the 50 expansion line. Non-farm payroll added 271K in October, a significant increase from September's revised 137K, while unemployment rate further decreased to 5%. October's CPI was up by 0.2% year-on-year and rose 1.9% on an ex food and energy basis.

The further improvement in labour markets, and anticipation of an inflation pickup on the rebound of commodity prices in the medium term support our view of a December rate hike. Rising interest rates reflect a solid recovery and Fed's confidence in the economy. The market's next focus should be on Fed's rate hike path, which is dependent on the global slowdown risk, financial market stability and strong US dollar. Differentiation of monetary policies between the Fed and the ECB/BoJ is expected to boost the US dollar, which will hurt US exports and corporate earnings, and manufacturing sector also shows signs of slowdown. On the other hand, the US presidential election in 2016 may influence Fed's rate hike decision, we expect a path of modest rate raises. Due to overvaluation and earnings growth concerns, we maintain NEUTRAL stance on the US equities.

European Equities

The terrorist attack in France did not cause substantial spike in market volatility. The ECB minutes in October showed worries in deflation risk, and the timing to achieve its 2% inflation target. The ECB also signaled for more accommodative moves in December's meeting, with rate cut, QE expansion in terms of bond types covered, and timeframe extension were put on the list. 3Q advanced GDP in Eurozone moved up 0.3% from the previous quarter, slightly down from 2Q's 0.4%. CPI rose marginally by 0.1% year-on-year in October while core CPI grew 1.1%, both slightly up from September's readings. Eurozone's ZEW Survey on expectations in November plunged for the third straight month to 28.3 from 30.1 in October.

Eurozone's structural problems still persist after the implementation of QE, including deflation risk, sluggish credit demand and high unemployment rate. The marginal effect of extending or expanding the bond purchasing programme, or cutting interest rates are decreasing, and whether or not it would stimulate the real economy has been in doubt. The main issue for a recovery is corporates' reluctance to lend for development. More easing may also signify unimproved economy and in turn dampen corporates' confidence. However, additional moves by the ECB should further enhance liquidity. The market's attractive valuation should support equities, and one should note that equity markets and fundamentals may show temporary disparity under ECB easing policy. We maintain SLIGHTLY POSITIVE stance on the region.

Japanese Equities

The government intends to increase the minimum hourly wage by 3% per annum until it reaches JPY 1000, and at the same time plans to launch measures to stimulate spending, including funding to low-income groups and disaster restoration to boost GDP and consumption spending. The preliminary annualized GDP in 3Q slipped 0.8% quarter-on-quarter, versus 2Q's revised 0.7% decline, demonstrating a technical recession with negative GDP growth for two consecutive quarters. September's labour cash earnings and real cash earnings increased by 0.6% and 0.5% respectively from the previous year, both accelerated from the revised figures in August. However, the overall household spending in October dropped 2.4% year-on-year, worsening from September's -0.4%.

Japan has again fell into recession. Sluggish consumer sentiment and weakening demand in Asia further raise concerns in the region. Compared to the Eurozone, the Japanese economy requires more stimuli. The depreciation pressure on yen may become enormous if the Fed raises its rates while the BoJ further eases its policy at the same time. High volatility in the currency market challenges corporates' adaptability in cost control and pricing, putting their earnings at risk, thus hindering the need for further QE. The policy should focus on boosting spending which helps drive inflation, wage growth and economic recovery. We remain NEUTRAL stance on Japanese equities as whether its policy can support a recovery is questionable.

Asia ex Japan ex Hong Kong Equities

Sluggish commodity prices, currency weakness and disappointing trades continued to shadow the markets and growth prospects. Several Central Banks held interest rate unchanged, which included Indonesia, Malaysia, Korea, Philippines and Thailand. For individual countries, India's year-on-year CPI growth in October quickened from September's 4.41% to 5%, while 3Q GDP jumped 7.4% from the previous year, accelerated from 2Q's 7%. Singapore's finalized 3Q GDP grew 1.9% year-on-year, improved from 2Q's 1.4%. Indonesia's GDP in 3Q grew 4.73% year-on-year versus 2Q's 4.67%, but the decline in exports and imports deepened in October. In Malaysia, growth of both exports and imports quickened in September on a year-on-year basis, however, the year-on-year GDP growth of 4.7% in 3Q slowed from 2Q's 4.9%.

Most Central Banks are waiting for the US Fed's decision on the rate hike and path, and hinted to formulate their own monetary policies on that basis. The path of the rate increase and market expectations on the issue will determine the money flows of Asian markets. US rate hike is not favourable to Asian markets, as it will trigger a strong US dollar which will depress commodity prices and induce money outflows on widened interest rate differentials. The Fed's move will also depreciate currencies and drag total equity returns. Currency depreciation may favour exports, but the consistently weak trade figures in recent months suggests demand is still the main driving forces to trade. The downturn in trades may continue, yet countries with more room to expand domestic investment, consumption or restructuring, such as India and Malaysia, are favoured. We hold NEUTRAL stance due to the concerns of US rate hike, which may affect money flows in the regions.

China & Hong Kong Equities

The regulator announced measures to curb leverage financing, including the prohibition of new funding provision by brokers for stock purchase through total return swaps, and filing investigations against brokers for illegal acts. The PBoC lowered the rate for SLF (Standing Lending Facility) to support banks' liquidity and to avoid spikes in short-term rates. In the quarter, the authority resumed IPO approval and listing. On the economic front, the year-on-year growth of October's CPI decelerated to 1.3% from September's 1.6%. The PPI slumped for the 44th straight month, at the same rate as in September by 5.9%. Moreover, October's credit greatly retreated, with new loans amounting to RMB 513.6 billion, down from RMB 1,050 billion in September. Aggregate financing dropped from September's revised RMB 1,329 billion to RMB 476.7 billion. Margin financing continued its upward trend in November.

The US's rate hike may set off money flows out of China, and the intensified disinflation may urge for more easing measures. The contraction in October's credit, the continued uptrend in margin financing and the year-end effect may trigger volatility in short-term rates in December. However, the PBoC has sufficient tools to adjust rate structure to avoid liquidity squeeze, such as MLF, PSL, SLO, while the overall policy should remain accommodative to support liquidity. In addition, the efforts made in curbing leverage financing should hurt market sentiment, and more similar measures may be introduced. However, the move should be beneficial to the development of the capital market in the long run. We are still SLIGHTLY POSITIVE to the regions as more favourable policies from the authority are expected.

Global Bonds

Diverging yields between US Treasury and German bunds continued, with the former trending up while the latter retreated. US dollar index tested March's high and the euro depreciated. The above phenomenon was driven by the heightened anticipation of the US rate hike and further easing by the ECB, despite the terrorist attack in France. In addition, yen depreciated in expectation of BoJ's QE enhancement. Asian currencies generally resumed a decline with more evidence of US's rate hike in December, fragile foreign trades and commodity prices. RMB was included into the SDR (Special Drawing Rights) basket of currencies. Offshore RMB depreciated against the US dollar's strength, despite the historical high October's trade surplus. Meanwhile, corporate bonds was down with the concern over the US rate hike.

With the US Fed very likely to raise rates in December, the US dollar may start a new round of appreciation but US Treasury returns may be limited by a jump in yields. Euro and yen will follow a downtrend, unless geopolitics worsen rapidly or sudden events arise such as epidemic outbreak, while the bond types under QE coverage of ECB and BoJ should be in favour. Further easing by the PBoC increases the depreciation risk of the RMB, but since the inclusion of RMB in the SDR, the relative solid growth and positive trade balances of China should act as positive catalysts for the currency's long-term prospects. We hold NEUTRAL stance on RMB bonds and remain SLIGHTLY NEGATIVE on overall bonds on the impending US rate hike.

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