US Equities

The Fed raised interest rates for the first time since 2006, by 0.25% to 0.25%-0.5%. The statement by Fed Chairwoman Yellen implied a gradual rate hike path and a steady Fed balance sheet. November's ISM manufacturing fell below 50 to 48.6 versus 50.1 in October, indicating manufacturing contraction. Non-farm payroll increased 197K in November, while October's figure was revised upward from 268K to 304K. The labour market remained robust with unemployment rate unchanged at 5%. November's core personal consumption expenditure (PCE) rose 1.3%, the same pace as October. November's average hourly earnings was up 0.2% month-on-month and 2.3% year-on-year, both slowed from October. Housing starts recorded 1,173K in November, up from October's revised 1,062K.

The rate hike signals policy normalization. Given the Fed has adopted a rather dovish monetary stance, subsequent rate hikes would depend on the sustainability of the US recovery. Since consumption makes up the majority of the US GDP, and US dollar appreciation should lower import prices and boost internal consumption, one should keep an eye on retail sales growth. However, a strong US dollar also impacts manufacturing and exports, while weak oil prices also weigh on inflation. The above factors, coupled with the continued uncertainties in global financial markets (especially the emerging markets), support our view of a modest rate hike path. In the past years, earnings-per-share (EPS) of some corporates were supported by share buybacks. Increasing cost of capital may further drag on earnings. We remain NEUTRAL on US equities on overvaluation and worries on peaked earnings.

European Equities

The ECB cut interest rates from -0.2% to -0.3%, expanded the bond purchase coverage to local government bonds and extended the QE programme to March 2017 or even further whenever necessary. However, it maintained the monthly bond purchase amount of EUR 60 billion. ECB also revised the 2016 and 2017 inflation forecast downward. Preliminary 3Q GDP of Eurozone rose 0.3% quarter-on-quarter and 1.6% year-on-year, both of which were the same as the advanced figures. November's CPI in Eurozone rose 0.2% year-on-year while core CPI rose 0.9%. December's Eurozone's ZEW Survey on Expectations rebounded from November's 28.3 to 33.9.

The lower-than-expected QE enhancement reflects ECB's limitation on easing, including money flows and currency impact by the US Fed's monetary policy, and restriction in bond purchase coverage. Moral hazards will increase if more bond types are covered. Unless Eurozone's economy deteriorates greatly, additional moves are unlikely. Boosting inflation and credit lending are ECB's ultimate goals in launching the QE programme, but substantial improvements have not surfaced. Despite Eurozone's sluggish fundamentals, sufficient market liquidity and favourable export prospects driven by weak euro under the easing programme all support equities. We are still SLIGHTLY POSITIVE on Europe's equities on favourable policy and liquidity environment.

Japanese Equities

BoJ kept the current scale of QE, but extended the duration of Japan government bonds (JGB) to 7-12 years, and increased the J-REIT purchase limit from 5% of total issuance to 10% and added annual purchase of 300 billion yen of ETF. Moreover, the government is considering to cut the fixed asset tax rate by 50% on new equipment for small and medium-sized firms. It also plans to trim Japan government bond (JGB) issuance in fiscal year 2015. Finalized and annualized GDP in 3Q were revised upward to a quarter-on-quarter growth of 1%, versus the decline of 0.8% in the previous revision, meaning it escaped from a technical recession. 3Q's company profits grew by 9% from previous year, slowed from 2Q's 23.8%. Overall household spending in November declined 2.9% year-on-year. The drop worsened from October's -2.4%.

The policy shift from monetary to fiscal means reflected the authority's target to drive consumption spending and corporate investment. Further QE is unlikely to avoid spurring deflationary expectations and further drag on corporates' confidence. Anticipated yen depreciation resulted from the US monetary policy tightening is another reason. We expect the fiscal measures to gradually take effect, but the aging population and working force remain a structural challenge. Slowdown in Asian markets and China would hinder the growth of Japan's exports-oriented economy. However, liquidity remains sufficient and the new round of fiscal stimuli should bolster market sentiment. We remain NEUTRAL on Japanese equities.

Asia ex Japan ex Hong Kong Equities

Concerns on US Fed rate hike, further plunge in oil prices and disappointing foreign trades dampened market sentiment in the region. Central Banks of India, Indonesia, the Philippines, Korea and Thailand held interest rates unchanged. In India, November's year-on-year decline in imports and exports worsened, dropping by 30.3% and 24.4% respectively, but yearly growth of CPI accelerated from that of October. Deflation in Thailand continued, with November's CPI dropping 0.97% from the previous year, compared against October's -0.77%. Taiwan's Central Bank cut interest rates by 0.125% to 1.625% and November's imports and exports continued to record double-digit drop year-on-year. Malaysia's exports in October surged by 16.7% from previous year versus 8.8% in September, but imports retreated.

Money flows, exchange rates and growth prospects of the region all depend on the US interest rate policy, and limit the room for Central Banks to boost growth through monetary means. A shift in focus towards fiscal means may become a trend, and balance sheet healthiness should mark countries' investment values. In comparison with countries driven by domestic consumption and are undergoing restructuring, such as India and Malaysia, weak demand may cause more damage to exports-oriented countries such as Taiwan and Indonesia. The rate hike in the US is likely to cause continued depreciation in Asian currencies and affect total equity returns. If the Fed increases rates faster-than-expected, it will further worsen the capital outflows. We downgrade Asia ex Japan ex Hong Kong equities to SLIGHTLY NEGATIVE from NEUTRAL.

China & Hong Kong Equities

The authority addressed the need of a more aggressive fiscal policy, gradual increase of the fiscal deficit and a more flexible monetary policy. The authority also cut tariffs for certain products including consumer goods, effective 2016. November's new yuan loan rebounded from October's RMB 513.6 billion to RMB 708.9 billion, aggregate financing also improved from October's RMB 476.7 billion to RMB 1,020 billion. Year-on-year growth of November's retail sales accelerated to 11.2% versus October's 11%, while industrial production was up 6.2%, from October's 5.6%. However, manufacturing continued to contract. Average prices of new homes in China's 70 cities were up 0.19% in November, advancing from October's 0.07%.

Investors should note that Lunar New Year is another high-risk period of short-term interest rate spikes due to settlement needs. One should make note of corporates' debt burden under divergence of US Fed and PBoC monetary policies, particularly of basic materials and energy which suffered from significant earnings decline. For local currency debts, the rate cut by PBoC should help reduce interest expense. However, it is expected the pace would be rather limited as PBoC needs to consider the consequences to RMB and money flows. For foreign currency debts, US rate rise will increase the interest burden, and the strengthening of the US dollar will worsen balance sheets. Moreover, reforms in currency, interest rate, SOEs ownership and involvement of private sector should continue, while monetary and fiscal means should support steady economic growth. However, due to concerns over economic growth, we downgrade China and Hong Kong equities from SLIGHTLY POSITIVE to NEUTRAL.

Global Bonds

In December, yields of 10-year US Treasury and German bunds swung up and down after the US Fed rate hike and ECB's QE enhancement. US dollar index retreated and euro appreciated on lower-than-expected QE enrichment by the ECB. Yen appreciated as the BoJ maintained its QE scale. Asian currencies showed divergence with Japanese yen and Indonesian Rupiah being the outperformers, while offshore RMB underperformed. China's foreign reserves in November dropped USD 87.2 billion, or 10.5% year-to-date, on-shore RMB depreciated to its lowest since August, when the PBoC triggered a one-time depreciation. Moreover, high-yield bonds tumbled, mainly hurt by energy-related bond types.

The yen is expected to depreciate on the back of Japan's lackluster economy and US rate hike. For euro bonds, the US rate hike cycle should also weaken euro. In the short term, RMB is believed to depreciate gradually on US rate hike and the slowdown in China, but relatively solid growth and sustained trade surplus of China should benefit RMB in the long run. PBoC's rate cut should also provide support to a certain extent, thus we are NEUTRAL on RMB bonds. On the other hand, the further drop in oil prices fueled global deflation expectations, which in turn should limit bonds' loss as a result of the US rate hike. High-yields may underperform, particularly for firms which are facing earnings pressure, such as those in the energy and materials sectors. We upgrade overall bonds from SLIGHTLY NEGATIVE to NEUTRAL as bonds serve as a safe haven amidst the expected volatility and uncertainties in the global markets.

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