BCT Market Outlook

June 2015

US Equities

The annualised GDP in 1Q contracted by 0.7% quarter-to-quarter, revised from previous 0.2% increment. Latest Fed minutes indicated that with the weak 1Q GDP figure, it is unlikely that rates will rise in June. However, the Fed's chairwoman Janet Yellen added that rate hike would be appropriate in this year if the economy improved continuously. Besides, the ISM Manufacturing in April maintained at 51.5, but was still in a downward trend. However, the housing starts in April rose from March's revised 944K to 1,135K while building permits jumped from 1,038K to 1,143K.

US economy is expected to speed up when transitory factors like adverse weather, weak oil prices, strong US dollar and regional labour conflict fade out, but the timing of rate hike is still a point of argument. In anticipating the picking up of US growth momentum, rate rise is likely to be taken place in the Fed's meeting in September after the annual economic policy symposium at Jackson Hole in August. On the other hand, in a 10-year horizon, the price-to-earnings ratio (both trailing and forward) of the S&P 500 Index have exceeded the 10-year average, implying overvaluation. We thus maintain our NEUTRAL stance.

European Equities

ECB officials addressed that the QE programme would last "as long as needed" and there was no intention to end the plan prematurely. And the debt negotiation of Greece was still under uncertainty, default remained possible. On the economic front, the advanced GDP of Eurozone in 1Q rose 1% from previous year, slightly speeded up from 4Q's 0.9%, but Germany's 1Q preliminary GDP was only up by 1%, slowed down from 4Q's 1.4%. Moreover, the April's CPI in Eurozone was unchanged while the core CPI rose 0.6% from previous year. Besides, the Conservative Party won the UK general election and market reacted positively.

Eurozone's GDP in 1Q gained momentum, unless Greece issue turns into crisis (in which the risk is still under control), further easing is unlikely, and credit improvement is another area needs to be monitored closely. On the other hand, the ECB's stance on keeping the QE fuels the market sentiment and liquidity expectation. However, the economy of Eurozone shows divergence, it should note that a unity of growth momentum is crucial to its stability and improvement in the unemployment and spending area. We hold NEUTRAL stance to the region in doubt of its fundamentals.

Japanese Equities

1Q preliminary annualised GDP rose 2.4% quarter-to-quarter from 4Q revised 1.1%, implying improvement in growth momentum. Meanwhile, the labour cash earnings in March rose by 0.1%, which was the same as February, but real cash earnings dropped by 2.6%, deepened from February's revised -2.3%. Also, the consumer confidence index in April was slightly down from March's 41.7 to 41.5. In addition, the upward adjustment of return on equity by corporates and the anticipation of a sustained pick up in recovery spurred the markets to 15-year high.

Growth in labour cash earnings and household spending are still waiting for improvement, there is doubt in the sustainability of recovery, and more evidence is needed for proof. Moreover, the anticipation of QE to stock and bond markets have been mostly reflected, it is believed that fundamentals will take an active role in market movement. Besides, the risk of disinflation and retreatment in household spending signaled the need for the government and BoJ to further enhance both monetary and fiscal policies. We maintain NEUTRAL as the recovery is still yet to be confirmed.

Asia ex-Japan ex-Hong Kong Equities

The estimated price-to-earnings ratio of MSCI Asia Pacific ex Japan Index was 13.9 times, while the US's S&P 500 Index recorded 17.8 times, valuation of the Asian regions was still attractive. Markets slipped from peak on the back of concerns on US rate hike, led to the outflow of capital and the rebound in oil prices from previous low also detracted the performances of oil-importing countries, like India. On the other hand, Indonesia rebounded from previous plunge as market sentiment was eased from the worries of foreign capital by the execution of foreign drug traffickers in April.

Market correction may occur as US rate hike is expected to come soon, capital may be driven out from the liquidity-sensitive regions. However, the fundamentals of most Asian countries are still solid, in addition to the policy anticipation. After the Fed has launched the rate rising cycle and with the market having fully digested, it may offer a new buying opportunity. Besides, the oil prices would impact the inflation outlook and easing stance of the countries. For rising oil prices, inflation may be stimulated but at the same time limit the room of rate cut. We downgrade the regions to NEUTRAL from SLIGHTLY POSITIVE to address the risk of possible market correction.

China & Hong Kong Equities

The PBoC cut interest rate for the 2nd time in 2015 since February by 0.25% to tackle sluggish credit. Also, a debt-for-bond swap programme was launched to refinance local government debt with municipal bonds, amounted to RMB 1 trillion, at the same time the Central Bank would accept municipal bonds as collaterals for lending facilities. Besides, the regulator allowed the mutual recognition between Hong Kong and Chinese funds, with RMB 300 billion for both inflows and outflows. On the other hand, the year-on-year growth of retail sales, industrial production and fixed asset investment all slowed down in April, while the aggregate financing and new Yuan loan both fell short of estimate and down from March.

With regard to the risk of disinflation, declining credit activeness and relatively high real interest rate, further RRR and rate cut is highly possible and the sufficient room for policy act is likely to fuel market sentiment. With regard to the debt-for-bond swap programme, it will affect the bank loans structure with higher-yielding local government debt replaced by lower-yielding municipals, hurting their revenues. The incentive of banks to join is in doubt. The amount is also distant from total local government debt of around RMB 16 trillion. Nevertheless, we are still SLIGHTLY POSITIVE to the markets due to the policy room of China.

Global Bonds

Speculation of early exit of ECB's QE programme spurred the rally of German bund yield (prices dropped). Moreover, the yield of US Treasury was up on worries on sooner-than-expected US rate rise and US dollar consolidated. However, the latest minutes of the Fed implied that rate hike might not be taken place in June's meeting. ECB also reiterated its continuity of the QE programme, favouring the expectation of abundant liquidity environment, Euro dropped after rebound. On the other hand, the Yen depreciated on Japan's encouraging 1Q GDP data.

Given the stance of ECB, the yield of European bonds is likely to have peaked. For the US Treasury, as the rate hike worries were only eased somewhat but they still existed, it is believed that the yield will trend upward in the medium term. Once the market has clear consensus on the timing of rate hike, rally in the US Treasury yield will be triggered off. Meanwhile, corporate bonds are still preferred over sovereignty bonds as the yield of the latter (mainly developed markets) has been highly compressed under the easing policies of major Central Banks and even negative yielded bonds exist. We are SLIGHTLY NEGATIVE in overall bonds with the expectation of recovery.

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