BCT Market Outlook

November 2015

US Equities

The Fed kept rate unchanged and signaled possible rate hike in December's meeting while taking inflation and unemployment into consideration. The Fed also removed the statement about the impact of global financial and economic risk on the timing of rate increase, preparing to focus on domestic economic situation for December's meeting. Further, on a quarterly basis, advanced annualized GDP in 3Q slowed to 1.5% from 3.9% in 2Q, core personal consumption expenditure (PCE) rose 1.3%, which stalled from 2Q's 1.9%. September's ISM manufacturing declined for the 3rd straight month to 50.2, versus August's 51.1, getting ever closer to the expansion line. Total non-farm payroll in September increased by 142K, lower than the monthly average of 198K in 2015, and the change in August was revised down from 173K to 153K.

Both manufacturing and employment retreated in recent months and triggered risk of a slowdown. In terms of employment, mining, energy and manufacturing sectors suffered, and whether this situation would spread to other sectors is key in assessing the US economy. However, we expect a rate hike in a modest pace in December, as US recovery is still on track, and inflation in medium term should pick up on the rebound in commodity prices. Besides, uncertainties in money flows is believed to persist before the rate increase, and the later the rate rise, the more detrimental it is to the Fed's credibility and normalization of investment markets. We are NEUTRAL on US markets on concerns of peaked earnings and overvaluation.

European Equities

ECB held interest rates unchanged, addressing worries on Eurozone's inflation and recovery against the backdrop of slowing growth in emerging markets. ECB would use all instruments available, possibly enhancing the QE programme and cutting interest rates. The authority would review the monetary policy in December's meeting. Moreover, Eurozone's CPI in September dropped 0.1% from the previous year, following a 0.1% gain in August, while core CPI rose 0.9%. October's ZEW survey expectations weakened from 33.3 in September to 30.1, indicating a deteriorating outlook. August's industrial production dropped by 0.5% from the previous month, reversing July's revised increment of 0.8%, while the year-on-year growth also slowed from July.

Deflation risk of Eurozone continued as inflation is far behind the 2% target, coupled with unimproved unemployment and deteriorating outlook, further monetary move is needed. The ECB reiterated the need for further action multiple times, but the effect on market sentiment will diminish unless solid steps are taken. However, in terms of further policy move, the ECB needs to consider the timing of the US rate increase, which affects the trend of the euro. Moral hazard may be associated with purchases if includes sovereign bonds, and the measures' marginal effects on the already-low yield of Eurobonds should be considered, especially as some of the short-term euro bonds are already delivering negative yields. We are still SLIGHTLY POSITIVE on Eurozone in expectation of additional policy act by the ECB to boost inflation and economy.

Japanese Equities

BoJ maintained target of 80 trillion yen annual rise of monetary base. BoJ also trimmed growth and inflation forecasts for the current and next fiscal years, and delayed the timeframe in reaching the 2% inflation target. September's CPI remained unchanged year-on-year, CPI ex food and energy rose 0.9%. September's overall household spending was down by 0.4% from previous year after August's 2.9% increment. In addition, September's consumer confidence index moved down from August's 41.7 to 40.6. Growth of September's retail trades and retail sales both fell short of estimates.

The delay in US rate hike should increase the possibility of further QQE by the BoJ, mainly because a weaker US dollar would strengthen the yen, while the ready-to-act stance by the ECB, weak wage growth, inflation and household spending are other catalysts. For further action, BoJ needs to consider the availability of Japanese government bonds for purchase, and the effect in further depressing bond yields. However, Asian trades disappointed which reflected worsening demand. With US growth also seeing instability, Japanese corporate earnings may suffer. We stay NEUTRAL on Japan in anticipation of more monetary and fiscal policies.

Asia ex Japan ex Hong Kong Equities

Markets rebounded in October, but foreign trade of several countries continued to decline to varying degrees, signifying worsening demand and economies. In terms of individual countries, India's year-on-year plunge in exports and imports intensified in September and yearly growth of CPI accelerated from August, which limited room for a rate cut. Indonesian Central Bank maintained interest rate unchanged, while foreign trades worsened. Singapore's advanced 3Q GDP grew by 0.1% quarter on quarter, following the revised 2.5% decline in 2Q. Korea kept interest rate unmoved at 1.5% and its preliminary 3Q GDP accelerated to 1.2% quarter on quarter, from 2Q's 0.3%. Malaysia's year-on-year exports speeded up in August, while industrial production slowed down.

Foreign trades of several countries stayed soft or even deteriorated, implying worsening demand and threatening growth. Currency is often one of the factors that enhances total equity returns in emerging markets. Extra attention should be paid to the development of the US rate increase and the countries' fundamentals, which affect liquidity flows and Asian currency prospects. On the other hand, correction risk remains until there is better visibility on the timing of US rate hike timing. Nevertheless, long-term investment in the regions is supported by attractive valuations and long-term growth prospects, once markets digest the news of US rate rise schedule and worries of Chinese growth subside. We are NEUTRAL to the region on possible correction led by uncertainty of the US rate hike.

China & Hong Kong Equities

The government abolished the one-child policy, allowing couples to have two children, while the PBoC cut interest rate and reserve requirement rate (RRR) simultaneously for the 3rd time this year, by 0.25% and 0.5% respectively and abolished the cap on deposit rate to further release liquidity. The PBoC also expanded its relending programme to more pilot cities, aimed to allow banks to use qualified loans as collaterals for refinancing. On the data side, GDP in 3Q rose by 6.9% from previous year, slightly down from 2Q's 7%. September's CPI was up by 1.6% year-on-year, slowing slightly from August's 2%, while PPI dropped by the same pace as August at 5.9%. New yuan loan and aggregate financing both exceeded expectations and August's figures, but the yuan position in financial institutions fell by a record-high of RMB 761.3billion. Margin financing showed signs of bottoming out.

CPI is likely to slow further as indicated by PPI, its leading indicator, triggering deflation risk. However, as liquidity outflows continue, further monetary act may weaken RMB and worsen the outflows, limiting the pace of easing. As an element of further easing, the expansion of collateral borrowing provides bank with self-driven borrowing based on its liquidity needs, while the authority can regulate loan structure through adjusting the collateral discount rate and types involved. Besides, real interest rate has turned negative, and the elimination of deposit cap may squeeze banks' net interest margin and room to lend. Ending one-child policy should have a long-term economic impact, while more fiscal measures and acceleration of projects such as the 13th 5-Year Plan, state-owned enterprises reform and 'One Belt, One Road' may help counteract an economic slowdown. We hold SLIGHTLY POSITIVE stance on the authority's ability to strengthen monetary and fiscal policies.

Global Bonds

Following significant depreciation, Asian currencies broadly bottomed out and rebounded in October, with Indonesian rupiah, South Korea won and Malaysian ringgit as the best performers. Offshore RMB swung up and down mainly due to the slowdown in Chinese 3Q GDP and PBoC's rate cut. On the other hand, Fed's possible rate hike in December resulted in depreciation of both euro and yen. At the same time, US Treasury yield was up and US dollar strengthened. Yield of German bonds dropped on possible further easing act by the ECB. Corporate bonds trended up with encouraging corporate earnings.

ECB, BoJ and other Central Banks are likely to put their monetary policies on hold until US Fed gives clear direction on rate hike, with consideration of the interest rate differentials and relative strength in currencies. Moreover, the Chinese GDP slowdown should drag on RMB in the short-term, and additional easing would depreciate the currency further. For Asian currencies, it is worthy to note US rate hike, continuous slump in external trades, weak commodity prices and growth may spark another round of significant currency depreciation. We remain SLIGHTLY NEGATIVE for overall bonds on the impending US rate rise, while we are NEUTRAL on RMB bonds.

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