BCT Market Outlook

September 2015

US Equities

Fed minutes of July revealed US was close to full employment and approaching the conditions for rate hike, but concerns on inflation and global economy remained. While the rate rise timing is still unclear, the Fed did address more evidence in growth and labour market was needed for it to be reasonably confident that inflation would move back to the 2% target in the medium term. According to the latest data, the annualized GDP in 2Q rose 3.7% from previous quarter, revised upward from 2.3%. Core personal consumption expenditure (PCE) price index rose 1.2% year-on-year in July, slower than 1.3% in June.

Economic data continued to improve in terms of employment, labour earnings and housing, but inflation had yet to pick up. However, the RMB devaluation may catalyze further strengthening of the US dollar and weigh on the outlook of US exports and corporate earnings. Moreover, weak oil prices reflect sluggish demand and poses threat to economic growth. This in turn lowered the US inflation expectation and increased the Fed's flexibility in the rate hike timing. The Fed's decision to increase interest rates rests on favourable economic data versus uncertainties over growth and inflation. In light of the recent global equity turmoil and the widespread expectation of a global slowdown, we believe a rate hike may not come until the end of 2015, and expect it to happen at a modest pace to avoid shocks to the economy. We remain NEUTRAL on US.

European Equities

ECB's latest minutes showed concerns on the slowdown of China and the impact of US rate hike. Meanwhile, Greece agreed to a EUR 86 billion bailout deal with its creditors. On the economic front, the quarter-on-quarter change of GDP growth in the eurozone eased to 0.3% in 2Q from 0.4% in 1Q. On the other hand, the eurozone CPI and core CPI in July stayed unchanged as in June, edging up year-on-year by 0.2% and 1.0%, respectively. In addition, August's ZEW survey expectation of eurozone jumped from 42.7 in July to 47.6, but that of Germany fell from 29.7 to 25.

After the latest bailout, the debt to be matured for Greece is relatively insignificant, and market volatility due to the issue is expected to dissipate. Moreover, the depreciation of RMB may suppress the eurozone's competitiveness in exports and increase ECB's need to enhance the QE programme to boost inflation and growth. At the same time, Chinese growth concerns is another potential catalyst for the ECB to act. It is worthy to note that recovery in eurozone's inflation, credit and unemployment rate lack visibility. However, its market valuation is attractive relative to the US and it is less sensitive to US rate hike and liquidity than emerging markets. In this regard, we upgrade the region to SLIGHTLY POSITIVE from NETURAL.

Japanese Equities

August's monthly economic report kept the view that Japanese economy continued to recover at a modest pace. However, the preliminary annualized GDP in 2Q contracted by 1.6% quarter-on-quarter, down significantly from the 4.5% in 1Q. Specifically, both GDP private consumption and business spending posted quarter-on-quarter drop of 0.8% and 0.1%, respectively, reversing the gain in 1Q. Also, the year-on-year labour cash earnings and real cash earnings fell in June by 2.4% and 2.9%, respectively. Moreover, consumer confidence index in July declined from June's 41.7 to 40.3, while household spending dropped 0.2% year-on-year, albeit narrowed from June's -2%.

The setback in 2Q GDP and latest data in labour earnings are indicative of an unstable recovery. Although the purchasing price index (PPI) is still in negative territory on a year-on-year basis which may reflect soft upcoming inflation, it may be appropriate for JCB to strengthen its monetary policy. The authorities aim to spur business spending, and in turn drive labour earnings, consumption, and inflation. However, whether or not this will go according to plan is still unknown. In addition, the yen may strengthen as investors turn to the currency as a safe haven against market volatility, which would in turn impact exports, corporate earnings and effectiveness of QE. We remain NEUTRAL on Japan.

Asia ex Japan ex Hong Kong Equities

The US rate hike expectation, sustained disappointing trade figures and RMB's sudden devaluation dragged on market performance. Most countries recorded notable decline in the month. In Indonesia, commodity prices slumped, and the RMB depreciation sparked concerns on exports and economic growth. Malaysia shared similarities with Indonesia, and suffered from the prime minister's corruption scandal. Meanwhile, Taiwan's outlook is dull as authorities of Taiwan slashed the 2015 GDP forecast for 2015 from 3.28% to 1.56%. India's Central Bank stated its accommodative stance, in addition to slowdown in inflation added anticipation of rate cut. Lastly, Thailand was hurt from the recent bomb attack and Korea from the intensified political tension with North Korea.

Aside from concerns on US rate hike, the persistent retreat in trade figures and sluggish commodity prices will continue to act as headwinds in the region. Weak commodity prices which point to uncertain demand is unfavourable to commodity-exporting countries such as Malaysia, while India may outperform as an oil-importing country. On the other hand, the depreciation of RMB mutes the competitiveness of exports of other Asian currencies, and places further pressure on the Asian currencies. Another concern is that the currencies of developing markets tend to move in line with equities, and increases the volatility of total equity returns. We maintain NEUTRAL on its liquidity-sensitive nature and possibly further stock market and currencies correction on the US rate hike.

China & Hong Kong Equities

The PBoC devalued RMB to improve the pricing mechanism of the currency against the US dollar and enhance flexibility of the exchange rate, as a way to push RMB internationalization and inclusion into IMF's Special Drawing Rights (SDR). According to economic data, the CPI in July rose 1.6% year-on-year, up from June's 1.4%, mainly driven by food prices. The year-on-year increment of industrial production in July slowed from 6.8% in June to 6%, while the growth of retail sales and fixed asset investment both worsened from June. On the other hand, the average prices of 70 cities newly built residential building rose 0.15% from July, versus 0.16% in June. Meanwhile, the manufacturing sector further deteriorated.

The RMB devaluation reflects a shift in the Chinese economy's growth model from being consumption-oriented to export-oriented. This is indicative of soft consumption momentum and sparked concerns on overall economic growth. Another concern is that the recovery in inflation was mainly attributable to an increase in food prices, while the downstream demand for non-food products remain worrisome, as shown by disappointing imports and the slowdown in industrial production. On the policy front in terms of direct market intervention, the authority needs to consider the effectiveness and impact to market liberation. Room to further act is relatively limited. In addition to housing stabilization, the accelerated inflation triggered by food prices may hinder the pace of introducing more monetary easing policies, though the direction should be unchanged. Considering the scope of policies, we are SLIGHTLY POSITIVE on China and Hong Kong equities, but investors should be cautious of a spike in volatility and risk of worsening fundamentals.

Global Bonds

Driven by US rate hike concerns, RMB depreciation and poor trade figures, a majority of Asian currencies continued to decline in August, with the Malaysia ringgit and offshore RMB recording two of the biggest slumps among major Asian currencies. Specifically, offshore RMB saw sharp depreciation on PBoC's move to adjust the rate of RMB against the US dollar. The PBoC stated the latest RMB devaluation is one-off and not a sustained trend of depreciation. On the other hand, yen and euro appreciated as safe haven currencies against market volatility.

Despite promoting RMB internationalization, the RMB re-pricing might reveal weaknesses in the Chinese economy, and concerns on growth may hinder RMB movement in the short-term. RMB is expected to enter a consolidation period, with increased volatility and gradual depreciation, which may persist until IMF's review of Special Drawing Rights (SDR) in November. For Asian currencies, the Fed's stance on US rate hike and Chinese growth prospects would be key. Although timing of US rate hike is still uncertain, it is only matter of time, and will hamper bond performances in the medium term. We hold the SLIGHTLY NEGATIVE view towards overall bonds but downgrade the outlook of RMB bond from SLIGHTLY POSITIVE to NEUTRAL for the short-term on risk aversion.

"BCT" – BCT Financial Limited (Plan Sponsor)
– Bank Consortium Trust Company Limited (Trustee & Administrator)
Issued by BCT Financial Limited